Governor's Budget

May Revision 2008-09

Introduction

California's structural budget deficit persists. Slower rates of economic growth, softening state revenues and increased costs have widened California's budget gap. In January, the projected deficit for 2008-09 was $14.5 billion. Left unaddressed, the projected gap would grow to $24.3 billion based on updated revenue projections, revised caseload estimates and higher costs. The single largest factor contributing to the increase in the projected budget gap is a $6.0 billion decrease in estimated General Fund revenues. Other factors include increased program costs, higher estimates of growth and costs of living adjustments, and erosion of savings due to delays in the adoption of reduction proposals. (See Figure INT-01).

Figure INT-01

Defining the Budget Gap

(Dollars in Millions)

Governor's Budget	-$14,479
Reserve	-2,009
Adjustments Since Governor's Budget	-7,789
Total Size of Problem	-$24,277

A productive Special Session of the Legislature made a down payment to address the budget deficit; now, the remaining budget gap is $17.2 billion.

The Governor's January Budget proposed difficult but necessary changes to address the state's structural budget deficit. Specifically, it proposed spending restraint, including an average 10-percent reduction in the budget of almost every program, while protecting essential state services and the sale of authorized Economic Recovery Bonds to provide additional revenues. It also proposed budget reform to provide necessary tools to bring spending and revenues into alignment and to ensure the state does not spend beyond its means in future years. See Figure INT-02 below.

Figure INT-02

How to Close the Budget Gap

(Dollars in Millions)

Projected Shortfall			**-$24,277**
Solutions:	**Revenue**	**Expenditures**	**Total**
Special Session	$3,559	$3,484	$7,043
Proposed Solutions	$8,130	$9,104	$17,234
Total	**$11,689**	**$12,588**	**$24,277**

The May Revision proposes a combination of spending reductions and revenue solutions to address the budget gap and to provide for a responsible reserve of $2 billion, and it does so without raising taxes. It proposes $12.6 billion in expenditure reductions across state government. While it retains the vast majority of 10-percent across-the-board reductions proposed in January, the May Revision makes some important adjustments to address the larger deficit while protecting education and public safety. The May Revision fully funds the Proposition 98 guarantee and provides a modest increase in total funding for education in the budget year. It reflects approximately $300 million in savings in the California Department of Corrections and Rehabilitation's budget without the early release of inmates. It also includes funds to keep all of the state's parks open, increasing fees where feasible to offset General Fund costs. The May Revision also makes additional difficult choices to reduce spending, including proposing $627 million in additional

reductions to health and human services programs. Without comprehensive health care reform that infuses the health care system with additional, stable sources of funding, these services will unfortunately continue to be significantly impacted by California's broken and volatile budget system.

Budget Reform

California's fiscal strength and security hinges on fixing our broken budget system.

In his State of the State speech, Governor Schwarzenegger proposed a constitutional amendment, the Budget Stabilization Act (BSA), to address two shortcomings in the state budget process: volatile revenues and over-spending. The BSA would prevent spending temporary increases in revenues on ongoing programs and give the state mechanisms to avoid future budget crises. It calls for the creation of the Revenue Stabilization Fund (RSF) where revenues above a reasonable, long-term average rate of growth will be deposited. Moneys in the RSF will only be available for transfers to the General Fund to bring revenues up to the long-term average in years with below-average revenue growth, such as 2008-09. The May Revision proposes to capitalize the RSF in 2008-09 and thus provide $5.1 billion to the General Fund.

In addition to the proposed Budget Stabilization Act, Governor Schwarzenegger will issue an Executive Order to establish a bipartisan commission of legislative and gubernatorial appointees to modernize the state's tax laws and better reflect the current economy. The Tax Modernization Commission will be charged with recommending ways to stabilize California's revenues, to bring our tax system into better alignment with our modern economy and to improve the state's economic competitiveness.

Improved Performance of the Lottery

The California Lottery is an underperformer when compared to the other 40 states with lotteries. Per capita average sales in 2006 of all other states was $189, and the average of the ten most populous states was $225. In contrast, California's only had $88 in average per capita sales. Clearly, there is room for a greater return on this public asset. The underperformance of the California Lottery stems from numerous restraints on its operation. The May Revision proposes to improve the performance of the state's lottery by providing operational flexibility similar to lotteries in most other states. The May Revision proposes to securitize future revenues resulting from the improved performance of the lottery to fund the RSF. This would be done in a manner similar to the Tobacco Securitization Act, which authorized the issuance of bonds against future tobacco settlement revenues. It is anticipated that the proposed bonds will

yield $5.1 billion in revenue for the state budget in 2008-09 and a total of $15 billion by 2010-11, after providing education the $1.2 billion in annual funding from the lottery that it currently receives.

Fail-Safe Mechanism for RSF Capitalization

To ensure that the RSF has a sufficient balance to transfer $5.1 billion to the General Fund in 2008-09, the May Revision includes a fail-safe mechanism that is similar to the mechanism established by Chapter 10, Statutes of 1983, which was signed into law by Governor Deukmejian. Under this mechanism, next year, the Director of the Department of Finance will determine whether the RSF has a sufficient balance for transfer to bring General Fund revenues up to the long-term average of General Fund revenue growth. If the RSF balance is insufficient, temporary a one-cent ($.01) sales tax increase will be triggered. The triggered increase would remain in effect until the RSF has reached the targeted fund balance (15 percent of General Fund tax revenues) or until June 30, 2011, whichever occurs first. After this temporary mechanism is no longer in effect, Californians will receive tax rebates that in the aggregate will be equal to the amount of revenues collected under the temporary mechanism.

Conclusion

In summary, the Governor's May Revision responsibly addresses the state's structural budget deficit through a combination of necessary spending reductions and new revenue through better utilization of state assets. The proposed May Revision, coupled with the Budget Stabilization Act and the Tax Modernization Commission, will ensure that California not only closes its immediate budget gap without a tax increase, but it has the necessary mechanisms to prevent future budget crises.

Summary Charts

This section provides various statewide budget charts and tables.

Figure SUM-01
2008-09 May Revision
General Fund Budget Summary
(Dollars in Millions)

	2007-08	2008-09
Prior Year Balance	$4,096	$1,743
Revenues and Transfers	$101,190	$102,987
Total Resources Available	**$105,286**	**$104,730**
Non-Proposition 98 Expenditures	$61,716	$60,436
Proposition 98 Expenditures	$41,827	$41,400
Total Expenditures	**$103,543**	**$101,836**
Fund Balance	**$1,743**	**$2,894**
Reserve for Liquidation of Encumbrances	$885	$885
Special Fund for Economic Uncertainties	$858	$2,009
Budget Stabilization Account [1/]	**-**	**-**
Total Available Reserve	**$858**	**$2,009**

[1/] In 2007-08, includes the transfer of $1,494 million from Budget Stabilization Account back to the General Fund under Control Section 35.60.

In 2008-09, reflects the suspension of Proposition 58 transfer to the Budget Stabilization Account.

Figure SUM-02
2008-09 Revenue Sources
(Dollars in Millions)

	General Fund	Special Funds	Total	Change From 2007-08
Personal Income Tax	$53,733	$1,449	$55,182	-$389
Sales Tax	27,361	6,214	33,575	1,099
Corporation Tax	11,039	-	11,039	904
Highway Users Taxes	-	3,383	3,383	-18
Motor Vehicle Fees	28	5,938	5,966	637
Insurance Tax	2,029	-	2,029	-142
Liquor Tax	341	-	341	7
Tobacco Taxes	114	934	1,048	3
Other	8,342	8,136	16,478	1,163
Total	**$102,987**	**$26,054**	**$129,041**	**$3,264**

Note: Numbers may not add due to rounding.

Figure Sum-03

2008-09 Total Expenditures by Agency

(Dollars in Millions)

	General Fund	Special Fund	Bond Funds	Totals
Legislative, Judicial, Executive	$3,792	$2,127	$473	$6,392
State and Consumer Services	566	865	86	1,517
Business, Transportation & Housing	1,635	6,988	4,214	12,837
Resources	1,624	2,331	2,234	6,189
Environmental Protection	88	1,154	397	1,639
Health and Human Services	29,800	8,112	150	38,062
Corrections and Rehabilitation	10,139	22	-	10,161
K-12 Education	41,145	155	4,427	45,727
Higher Education	11,758	46	2,436	14,240
Labor and Workforce Development	97	334	-	431
General Government	1,192	5,933	31	7,156
Total	**$101,836**	**$28,067**	**$14,448**	**$144,351**

Note: Numbers may not add due to rounding.

Figure Sum-04

General Fund Expenditures by Agency

(Dollars in Millions)

	2007-08	2008-09	Change	%
Legislative, Judicial, Executive	$3,920	$3,792	-$128	-3.3%
State and Consumer Services	598	566	-32	-5.4%
Business, Transportation & Housing	1,502	1,635	133	8.9%
Resources	1,877	1,624	-253	-13.5%
Environmental Protection	89	88	-1	-1.1%
Health and Human Services	29,726	29,800	74	0.2%
Corrections and Rehabilitation	10,173	10,139	-34	-0.3%
K-12 Education	42,507	41,145	-1,362	-3.2%
Higher Education	11,819	11,758	-61	-0.5%
Labor and Workforce Development	105	97	-8	-7.6%
General Government	1,227	1,192	-35	-2.9%
Total	**$103,543**	**$101,836**	**-$1,707**	**-1.6%**

Note: Numbers may not add due to rounding.

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Economic Outlook

Two years into the housing slump, the national and California economies began to face additional headwinds—falling home prices, tight credit conditions, dysfunctional financial markets, and soaring food and energy prices. These headwinds took a toll: The housing downturn worsened. Labor markets weakened. And, at the end of 2007, consumers began to lose confidence in the economy.

In the mid-2000s, low interest rates, easy credit, and questionable lending practices sharply increased the demand for housing, leading to accelerating home prices, increased home building, and strong consumer spending. But this sizable economic stimulus depended on rising home prices, and when declining home affordability put a cap on home prices, the stimulus evaporated. Uncertainty about how far home values would decline depressed home sales and building. Consumers were pinched as their home equity fell.

Declining home prices and jumps in subprime mortgage rates have led to record mortgage delinquencies and home foreclosures in California. Home values may decrease further before real estate markets and home building return to normal. Until then, the housing sector will be a significant drag on economic growth in the state.

The most significant differences between the May Revision forecast and the Governor's Budget forecast are lower real GDP growth, weaker California job growth, and smaller gains in California personal income in 2008 and 2009.

The outlook for the national economy is for slow growth in 2008, moderate growth in 2009, and near-trend growth in 2010:

- Real GDP is projected to grow 1.2 percent in 2008, 1.7 percent in 2009, and 3 percent in 2010, as compared to 2.2 percent in 2007.
- Nonfarm payroll employment is forecast to increase 0.2 percent in 2008, 0.4 percent in 2009, and 1.2 percent in 2010, as compared to 1.1 percent in 2007.

The outlook for the California economy is for little growth in 2008 followed by slow growth in 2009 and moderate growth in 2010:

- Personal income is projected to grow 4.5 percent in 2008, 4.1 percent in 2009, and 5.1 percent in 2010, as compared to 5.9 percent in 2007.
- Nonfarm payroll employment is forecast to fall 0.2 percent in 2008, and then grow by 0.6 percent in 2009 and 1.4 percent in 2010, as compared to 0.7 percent in 2007.

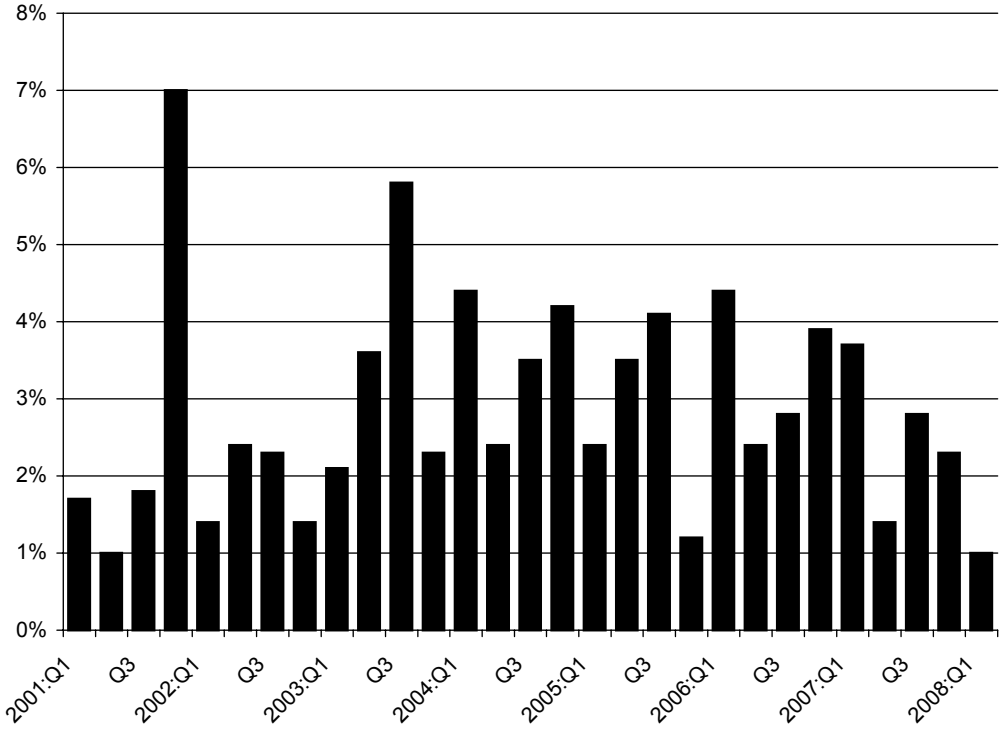
The Nation

Real GDP grew only 0.6 percent in the first quarter of 2008. The weakness was concentrated in residential construction, which fell 27 percent at an annualized rate. Residential construction has been a significant drag on the national economy for eight consecutive quarters, and there is little indication that the end to the decline is near. New and existing home sales continue to fall. Inventories of homes available for sale remain large. The number of new homes being built is still declining. The subprime mortgage debacle and subsequent financial market turmoil, waves of home foreclosures, and credit tightening appear to have reinforced the housing slump.

More troubling, consumer spending increased by just 1 percent in the first quarter —its slowest quarterly rate in nearly seven years (Figure ECO-01). Granted, it is only one quarter, and consumers have bounced back from a quarter of weak spending a number of times in the past seven years. However, the retrenchment by consumers is consistent with sharp declines in consumer confidence surveys in the last three months to levels that historically have been associated with recessions. Consumer spending is being squeezed by slower job growth, falling home prices, higher energy and food prices, high consumer debt levels, and the falling dollar.

Elsewhere in the GDP report, business investment in structures and equipment and software fell in the first quarter. Government spending increased modestly. But what

Figure ECO-01
U.S. Real Consumer Spending
Year-over-Year Growth



Source: U.S. Bureau of Economic Analysis

kept real GDP from falling in the first quarter was an increase in inventory investment of $20 billion by businesses, which most likely was not intended.

National labor markets weakened in the first four months of 2008. Nonfarm payroll employment fell each month, with the losses averaging 65,000 per month. In comparison, nonfarm payroll employment rose with an average monthly gain of 94,000 in the first four months of 2007. The national unemployment rate averaged about 5 percent in the first four months of 2008. A year ago, it averaged 4.5 percent in the first four months.

Energy and food prices shot up in the first three months of 2008, with the average price for regular-grade gasoline reaching $3.60 per gallon and the crude oil spot price $116 per barrel by the end of April. A year earlier, regular gasoline sold for $2.97 and the crude oil spot price was $59 per barrel. The average cost of food at home in the first quarter of 2008 was 5.2 percent higher than a year earlier. A year earlier, this measure of inflation was 2.7 percent. The increase in food and energy prices, coming at a time when the

economy has decelerated appreciably, puts the Federal Reserve in a difficult position. In an effort to give the economy a boost, the central bank has eased monetary policy on seven occasions in the last eight months, lowering their target for federal funds from 5.25 percent to 2 percent. Believing that the committee was risking higher inflation, some members of the Federal Reserve monetary policy committee have dissented on the last three votes to ease policy.

California

Growth in nonfarm payroll employment slowed in California in 2007, with employment peaking in the third quarter and then slipping in the fourth quarter. The state lost jobs again in the first quarter of 2008, although to a lesser extent than the nation.

The annual average of nonfarm payroll employment increased by 102,900, or 0.7 percent in 2007, down from 259,000, or 1.7 percent, in 2006. Eight of the 11 major industry sectors saw employment grow in 2007. Educational and health services, government, leisure and hospitality, and trade, transportation, and utilities posted the biggest gains in jobs. Together, construction, financial activities, and manufacturing lost nearly 95,000 jobs. The San Francisco Bay Area economy had the strongest job growth of the major regional economies. The state's unemployment rate averaged 5.4 percent in 2007 and was 5.9 percent in the first three months of 2008.

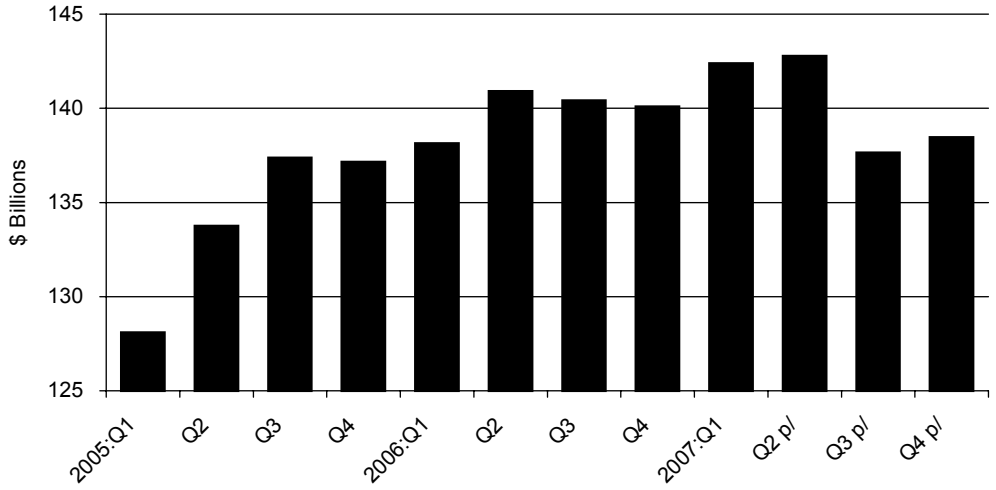
California personal income grew by an estimated 5.9 percent in 2007, slightly lower than the 6.5-percent gain in 2006. Taxable sales, however, peaked in the second quarter of 2007 and were down 3 percent from the peak in the fourth quarter of 2007 (Figure ECO-02). New vehicle registrations fell again in 2007, likely playing a role in the slowdown of taxable sales.

Made-in-California exports grew by 5 percent to a new record level of $134.2 billion in 2007; however, high-tech exports fell 1.9 percent. In 2006, total exports increased by 9.4 percent. Leading export destinations (in order) were Mexico, Canada, Japan, mainland China, South Korea, Taiwan, Germany, the United Kingdom, Hong Kong, and Singapore. Exports to these markets expanded, except for Mexico, Singapore, and Japan.

California home building and residential real estate markets slowed considerably in 2007. The number of single-family residential units permitted fell 37 percent in 2007, after falling by 30 percent in 2006. In the first quarter of 2008, they were down 61 percent from a year ago. Existing single-family detached home sales fell 26 percent in 2007. The median price fell 16 percent from December 2006 to December 2007.

Figure ECO-02

California Taxable Sales
Seasonally Adjusted



Source: California State Board of Equalization; p/ preliminary estimate

Figure ECO-03

Selected U.S. Economic Indicators

	2007 (Est.)	2008 (Projected)	2009 (Projected)
Real gross domestic product, (2000 dollar) (Percent change)	2.2	1.2	1.7
Personal consumption expenditures	2.9	1.4	1.4
Gross private domestic investment	-4.9	-8.4	1.0
Government purchases of goods and services	2.0	1.8	0.2
GDP deflator (2000=100) (Percent change)	2.7	2.0	2.0
GDP, (Current dollar) (Percent change)	4.9	3.2	3.8
Federal funds rate (Percent)	5.02	2.02	2.09
Personal income (Percent change)	6.2	4.2	3.6
Corporate profits before taxes (Percent change)	3.9	-14.7	18.0
Nonfarm wage and salary employment (Millions)	137.6	137.9	138.4
(Percent change)	1.1	0.2	0.4
Unemployment rate (Percent)	4.6	5.3	5.8
Housing starts (Millions)	1.34	0.91	1.13
(Percent change)	-25.8	-32.2	24.1
New car and light truck sales (Millions)	16.1	14.9	15.2
(Percent change)	-2.4	-7.5	1.9
Consumer price index (1982-84=100)	207.3	213.5	218.2
(Percent change)	2.9	3.0	2.2

Forecast based on data available as of April 2008.
Percent changes calculated from unrounded data.

The Forecast

The struggling housing sector will continue to weigh on the state and national economies in the next two years, but economic growth should begin to improve late this year or in the first half of 2009 (Figure ECO-03 and Figure ECO-04).

Figure ECO-04

Selected California Economic Indicators

			Projected			
	2007	Percent change	2008	Percent change	2009	Percent change
Personal income ($ billions)	1,521.3	5.9%	1,589.0	4.5%	1,654.8	4.1%
Nonfarm W&S employment (thousands)	15,170.0	0.7%	15,140.4	-0.2%	15,225.9	0.6%
Natural resources and mining	25.8	3.0%	26.4	2.3%	27.4	3.9%
Construction	891.6	-4.5%	812.7	-8.9%	819.1	0.8%
Manufacturing	1,460.2	-1.9%	1,424.5	-2.4%	1,385.5	-2.7%
High technology	377.8	-0.9%	368.1	-2.6%	354.5	-3.7%
Trade, transportation, & utilities	2,911.0	1.1%	2,928.2	0.6%	2,948.4	0.7%
Information	471.6	1.2%	454.5	-3.6%	454.2	-0.1%
Financial activities	906.2	-3.1%	868.1	-4.2%	849.6	-2.1%
Professional and business services	2,265.4	1.1%	2,293.8	1.3%	2,337.5	1.9%
High technology	304.5	3.8%	316.9	4.1%	329.4	3.9%
Educational and health services	1,668.6	3.4%	1,702.6	2.0%	1,727.7	1.5%
Leisure and hospitality	1,559.8	2.7%	1,594.0	2.2%	1,634.3	2.5%
Other services	512.4	1.1%	516.4	0.8%	520.7	0.8%
Government	2,497.4	1.8%	2,519.2	0.9%	2,521.5	0.1%
Unemployment rate	5.4%		6.4%		6.6%	
Housing permits (thousands of units)	112	-31.5%	70	-37.5%	96	37.6%
Consumer price index (1982-84=100)	217.4	3.3%	224.7	3.4%	231.3	2.9%

Forecast based on data available as of April 2008.
Percent changes calculated from unrounded data.

Revenue Estimates

General Fund revenues are expected to be $101.190 billion in 2007-08 and $102.987 billion in 2008-09. This represents a decrease of $40 million in 2007-08 and an increase of $83 million in 2008-09 compared to the Governor's January Budget. These revenues include $11.7 billion in revenue solutions proposed to close the budget gap – $3.3 billion in 2007-08 from the sale of authorized Economic Recovery Bonds, $1.9 billion from a change in accrual accounting, $5.1 billion of lottery proceeds in 2008-09 from the proposed fund transfer from the Revenue Stabilization Fund to the General Fund, and $1.4 billion in other initiatives. In the absence of these revenue solutions, 2007-08 revenues would be $97.7 billion and 2008-09 revenues would be $94.8 billion. Thus, revenues would grow by 2.4 percent in 2007-08 and decline by 3.0 percent in 2008-09.

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 $1.407 billion in 2007-08 and decreased by $2.725 billion in 2008-09. The 2007-08 increase is due to strong payments, primarily tied to 2007 tax year liabilities. The reduction in 2008-09 is due to a lowered forecast of personal income and capital gains. This forecast estimates that capital gains income will decline by 18 percent in 2008 and grow by 3 percent in 2009. Capital growth rates reflect weakness in 2008 real estate prices and sales, and a lower forecast for stock market gains. Personal income reductions reflect softness in U.S. and California economic growth.

Figure REV-01

General Fund Revenue Forecast

Reconciliation with the 2008-09 Governor's Budget

(Dollars in Millions)

Source	Governor's Budget	May Revision	Change Between Forecasts	
Fiscal 06-07				
Personal Income Tax	$51,943	$51,941	-$2	0.0%
Sales & Use Tax	27,445	27,445	$0	0.0%
Corporation Tax	11,158	11,158	$0	0.0%
Insurance Tax	2,178	2,178	$0	0.0%
Alcoholic Beverage	334	334	$0	0.0%
Cigarette	115	115	$0	0.0%
Other Revenues	2,261	2,261	$0	0.0%
Transfers	-19	-19	$0	0.0%
Total	**$95,415**	**$95,413**	**-$2**	**0.0%**
Fiscal 07-08				
Personal Income Tax	$52,681	$54,088	$1,407	2.7%
Sales & Use Tax	27,689	27,100	-$589	-2.1%
Corporation Tax	10,675	10,135	-$540	-5.1%
Insurance Tax	2,075	2,171	$96	4.6%
Alcoholic Beverage	334	334	$0	0.0%
Cigarette	116	114	-$2	-1.7%
Other Revenues	6,440	6,036	-$404	-6.3%
Transfers	1,220	1,212	-$8	-0.7%
Total	**$101,230**	**$101,190**	**-$40**	**0.0%**
Change from Fiscal 06-07	$5,815	$5,777		
% Change from Fiscal 06-07	6.1%	6.1%		
Fiscal 08-09				
Personal Income Tax	$56,458	$53,733	-$2,725	-4.8%
Sales & Use Tax	29,215	27,361	-$1,854	-6.3%
Corporation Tax	11,937	11,039	-$898	-7.5%
Insurance Tax	2,276	2,029	-$247	-10.9%
Alcoholic Beverage	341	341	$0	0.0%
Cigarette	119	114	-$5	-4.2%
Other Revenues	2,501	2,534	$33	1.3%
Transfers	57	5,836	$5,779	10138.6%
Total	**$102,904**	**$102,987**	**$83**	**0.1%**
Change from Fiscal 07-08	$1,674	$1,797		
% Change from Fiscal 07-08	1.7%	1.8%		
Three-Year Total			**$41**	

Sales and Use Tax

The sales and use tax forecast has been reduced by $589 million in the current year and $1.854 billion in the budget year. Through April, sales tax receipts are $646 million below the Governor's Budget estimate.

The current year reduction is due primarily to the effects of a soft housing market on taxable sales. The budget year reduction is due to a reduced forecast for disposable income and housing permits, and increased "spillover" from the General Fund.

"Spillover" is the transfer of gasoline and diesel fuel sales tax revenues from the General Fund to the Public Transportation Account (PTA) and the Mass Transportation Fund (MTF). The May Revision increases the forecast for 2008-09 spillover transfers from $909 million to $1.177 billion due to significantly higher gas prices in 2008.

Corporation Tax

The Corporation tax forecast has been decreased by $540 million for the current year and $898 million for the budget year. The current year has been reduced by $715 million for weakness in cash receipts, and increased by $175 million for a change in accrual accounting. For the budget year, the Corporation tax forecast has been reduced by $1.083 billion for weaker corporate profits, reduced by $175 million for a change in accrual accounting, and increased by $360 million for a change in the due date for Limited Liability Companies (LLC) fee payments.

Insurance Tax

The Insurance tax forecast has been increased by $96 million in the current year and decreased by $247 million in the budget year. The current year increase and budget year decrease are in part due to a delay in refunds from a Board of Equalization ruling (BOE). BOE ruled that the gross premiums tax be calculated on a cash basis, rather than the accrual method used by the Department of Insurance.

Other Revenues and Transfers

With the recent withdrawal of the state's sale advisor for the EdFund transaction, tightening of the Wall Street credit market, as well as potential changes in the student lending industry, the sale of the EdFund is being postponed. It is anticipated that a

sale will be pursued and completed in 2009-10. This reduces 2007-08 revenues by $500 million.

The state's lottery is an underperforming asset because of numerous restraints on its operation. The May Revision proposes to place a measure on the November 2008 ballot to modernize the state's lottery, providing operational flexibility similar to lotteries in most other states. With this modernization in place, it is anticipated that bonds can be issued against increased lottery revenues to capitalize the Revenue Stabilization Fund (RSF) proposed to be created as a part of the Governor's Budget Reform proposal. When capitalized, the RSF would be available to provide $5.122 billion in revenue for the state budget in 2008-09.

To provide for a prudent reserve, the May Revision proposes a total of $75 million of transfers and $574 million of loans from various special funds.

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 $1.7 million General Fund, to be transferred to the Court Facilities Trust Fund, to fund the operations and maintenance costs of 11 trial court facilities expected to transfer to state responsibility following the enactment of Chapter 9, Statutes of 2008. This funding is needed to provide for facility operational costs for additional court facilities that will transfer to the state.

Office of Emergency Services

The May Revision proposes to utilize $3.5 million federal funds for critical Office of Emergency Services (OES) communications proposals previously proposed to be funded with General Fund. This proposal reflects the Office of Homeland Security's

determination that activities in the Operational Area Satellite Information System (OASIS) and Critical Communications budget change proposals can be funded with federal funds.

Emergency Response Initiative

The Governor remains committed to rapidly responding to emergencies and disasters that will occur in California. For this reason, the May Revision continues to propose the Emergency Response Initiative, formerly known as the Wildland Firefighting Initiative, to enhance the emergency response capabilities of the California Department of Forestry and Fire Protection (CAL FIRE), the Office of Emergency Services (OES), and the Military Department.

The significant changes since the Governor's Budget are the following:

- The surcharge, paid by those who hold insurance on all residential and commercial property statewide, will be set at two levels based on differing risk: 1.40 percent on those structures in areas designated as high-hazard zones in terms of earthquake, fire, or flood, as determined by OES and CAL FIRE risk maps, and 0.75 percent on those structures in low-hazard zones. These zones will be designated by zip code. Since homeowners, on average, pay $900 per year to insure their home, a 1.40-percent surcharge would result in an average cost of $12.60 per household in a high-risk zip code, and a .75-percent surcharge would result in an average cost of $6.75 per household in a low-risk zip code to fund this initiative.
- The OES, rather than the California Department of Insurance, will be the entity responsible for administering the Emergency Response Account.
- Due to delayed implementation, this surcharge is expected to generate approximately $69.3 million in the Emergency Response Account in 2008-09 as compared to the $104.9 million proposed in the Governor's Budget. In order to immediately enhance the state's firefighting capabilities, the May Revision proposes a $30 million loan to the Emergency Response Account from the Restitution Fund, to be repaid in equal annual installments, by no later than June 30, 2012.

Additional enhancements proposed in the Governor's Budget will be phased in and fully funded in 2009-10. These investments will be phased-in due to the lower projected revenues in the budget year. The revenue generated, plus the borrowed resources from the Restitution Fund, will fund the following critical needs for CAL FIRE and the OES in 2008-09:

CAL FIRE

- $28.9 million for 1,100 seasonal firefighters to staff all 336 state fire engines with full four-member crews during peak and transition fire seasons.
- $49.1 million to backfill CAL FIRE's General Fund budget-balancing reduction to its firefighting protection budget.

Office of Emergency Services

- $1.9 million to backfill the OES' General Fund budget-balancing reduction to its Fire and Rescue Mutual Aid Response section and its Warning Center/Information Technology/Telecommunications section. Restoring these budget-balancing reductions will ensure the OES can respond to fires and use its Warning Center to notify emergency first responders.
- $1.3 million to fund the OES' administrative costs to collect the Emergency Response Initiative surcharge from insurance companies statewide.
- $480,000 to fund the increased maintenance and fuel costs of the OES' existing fleet of fire engines and vehicles.

Tribal Gaming Revenues

The May Revision includes a revised General Fund revenue projection of $446.7 million in 2008-09 from tribal gaming compacts, which is $16.3 million more than the estimate included in the Governor's Budget. This change is comprised of two components:

- An increase of $40 million to the General Fund as a result of addressing the shortfall in the Revenue Sharing Trust Fund with the Indian Gaming Special Distribution Fund, instead of using General Fund gaming compact revenue. This one-time transfer will not create a negative impact on the fund balance given that the fund can support the transfer in addition to planned expenditures.
- A reduction of $23.7 million in anticipated General Fund revenues due to delay of the effective date of the compact between the State of California and the Sycuan Band of Kumeyaay Indians because of pending ratification by their General Council, which is expected to occur by January 2009.

Loans and Transfers from Special Funds

The May Revision proposes loans and transfers from various special funds to provide one-time funding to the General Fund to help close the budget gap. For funds within this agency, the total loans and transfers are $43 million and $2 million, respectively. A loan or transfer was only proposed when there would not be an impact to the programs supported by the fund, no fee increases would be required, and no repayment would be needed prior to 2010-11.

Loans from Various Special Funds

The May Revision proposes loans totaling $43 million, including:

- Antiterrorism Fund—$2 million
- Department of Justice Sexual Habitual Offender Fund—$1 million
- False Claims Act Fund—$6 million
- Gambling Control Fund—$10 million
- California Debt and Investment Advisory Commission Fund—$2 million
- California Debt Limit Allocation Committee Fund—$2 million
- Occupancy Compliance Monitoring Account, Tax Credit Allocation Fee Account —$10 million
- Tax Credit Allocation Fee Account—$10 million

Transfer from the Victim-Witness Assistance Fund

The May Revision also proposes a transfer of $2 million from the Victim-Witness Assistance Fund. With this transfer, there will be a fund balance of $2.4 million at the end of 2008-09.

State and Consumer Services

The State and Consumer Services Agency's (SCSA) mission is to help educate consumers and make government more efficient, effective, and accountable for all California taxpayers. SCSA entities are responsible for civil rights enforcement, consumer protection, and the licensing of 2.4 million Californians in more than 255 different professions. SCSA entities provide oversight and guidance for the procurement of more than $9 billion worth of goods and services; management and development of state real estate; operation and oversight of two state employee pension funds; collection of state taxes; hiring of state employees; provision of information technology services; adoption of state building standards; and administration of two state museums.

Loans and Transfers from Special Funds

The May Revision proposes loans and transfers from various special funds to provide one-time funding to the General Fund to help close the budget gap. For funds within this agency, the total loans and transfers are $186.5 million and $50 million, respectively. The majority of the funds considered for a transfer or loan had projected reserves of at least $5 million in 2008-09. In addition, a loan or transfer was only proposed when there would be no impact to the programs supported by the fund, when a fee increase would not be required, and when no repayment would be needed prior to 2010-11.

Loans from the Department of Consumer Affairs Boards and Bureaus – $126.5 million

The following 13 Board and Bureau funds within the Department of Consumer Affairs include a proposed loan to the General Fund to be repaid in 2011-12 or later:

- State Board of Barbering and Cosmetology Fund – $10 million
- Psychology Fund – $2.5 million
- Accountancy Fund – $16 million
- Contractors' License Fund – $13 million
- Contingent Fund of the Medical Board of California – $6 million
- Board of Registered Nursing Fund – $2 million
- Pharmacy Board Contingent Fund – $1 million
- Professional Engineers' and Land Surveyors' Fund – $4 million
- Behavioral Science Examiners Fund – $3 million
- Vocational Nursing and Psychiatric Technicians Fund – $1 million
- Occupational Therapy Fund – $3 million
- Vehicle Inspection and Repair Fund – $25 million
- High Polluter Repair or Removal Account – $40 million

Loan from the Department of General Services

The May Revision proposes a $60 million loan from the Public School Planning, Design, and Construction Review Revolving Fund to the General Fund to be repaid after 2011-12.

Transfer from the Restitution Fund

The May Revision proposes a one-time transfer of $50 million from the Restitution Fund to the General Fund. This transfer along with a $30 million loan to the Emergency Response Account will result in a revised fund balance of more than $44 million at the end of 2008-09.

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's 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 Programs

- 2007-08 No Change
- 2008-09 $126.1 million Other Funds

Capital Outlay Support Staffing

The Department of Transportation traditionally submits a zero-based request for Capital Outlay workload as part of the May Revision. This request is based on anticipated project allocations by the California Transportation Commission for the upcoming year and associated workload. The May Revision reflects a decrease of $26.1 million in state special funds and bond funds, reflecting a decrease in workload due to declining gas tax revenues, and being close to peak workload for bond-funded projects. Approximately 89 percent of the decrease will come from a reduction of 247 positions and 11 percent will come from a reduction of 22 contract positions.

Gas Excise Tax Revenue – Effect on State Highway Operation and Protection Program

Funding for the State Highway Operation and Protection Program (SHOPP) is $100 million less than proposed in the Governor's Budget due to further declines in projections for gasoline excise tax (per gallon) revenues (gasoline usage year over year also is down). Total excise tax revenues are projected to be $225 million lower in 2008-09, but $125 million in carryover funds from 2007-08 will be available to offset part of the shortfall. Total funding for the SHOPP will be approximately $2.5 billion in 2008-09.

Public Transportation Account, Mass Transportation Fund

- 2007-08 No Change
- 2008-09 -$828 million General Fund

  -$437 million Other Funds

A portion of the revenue in the Public Transportation Account (PTA) is derived from "spillover" sales tax on gasoline. "Spillover" revenues occur when revenue derived from gasoline sales taxes is proportionately higher to revenue derived from all taxable sales pursuant to a statutory formula. These revenues generally reflect higher gas prices. The Governor's Budget projected $909 million in spillover revenues for 2008-09. The May Revision reflects an increase of $268 million, for a total of $1.177 billion. Additionally, revenues from sales taxes on diesel fuel and Proposition 111 sales tax on gasoline are projected to increase from $434 million to $558 million. Revenues under Proposition 42 are projected to decrease from $1.49 billion to $1.43 billion.

Current law requires specified sales tax revenues on fuel go to the PTA, including half of the spillover sales tax revenues. The remaining half of spillover revenues goes to the Mass Transportation Fund to reimburse the General Fund for transportation-related debt service and loan repayments. The Governor's Budget did not propose any changes to these formulas.

The May Revision proposes to amend current law by funding the State Transit Assistance Program at $306 million, the same level as the current year. Increased revenue projections for diesel fuel taxes and spillover totaling $828 million are proposed to offset General Fund expenditures for K-12 home-to-school transportation ($593 million reflected

in the Education portion of the Budget) and debt service on current and prior year transportation-related General Obligation bonds ($235 million).

Secretary for Business, Housing and Transportation

- 2007-08 No Change
- 2008-09 $2.0 million General Fund

California Partnership for the San Joaquin Valley

The May Revision proposes $2 million General Fund to be transferred to the California Economic Development Fund, created by Chapter 631, Statutes of 2007, to continue the implementation of the 10-Year San Joaquin Valley Strategic Action Proposal. Funding will sustain a public-private partnership to promote economic development, workforce development, education, transportation, land use and environmental issues. The California Economic Development Fund will allow state funding to complement potential federal, local, and private funds

High-Speed Rail Authority

- 2007-08 No Change
- 2008-09 $41.2 million Other Funds

In November, voters will have the opportunity to approve a $9.9 billion bond for high-speed rail. While the Authority's current long-term plans could cost $40 billion, it is expected that local and federal sources, as well as private investment, will provide the rest of the funding for construction of high speed rail. The High-Speed Rail Authority projects that once train service is operational, it will be self-supporting from fares.

- The May Revision includes $10 million from the Public Transportation Account to sustain current engineering and project management work and mobilize contract resources for all corridors, prior to the election. The May Revision also proposes to appropriate $8.2 million from Proposition 116 for additional environmental studies and engineering work on the Fresno-to-Sacramento segment. An additional $23 million is proposed to be appropriated from the bond fund to continue work after the election.

The Administration will be proposing amendments to the Safe, Reliable High-Speed Passenger Train Bond Act for the 21st Century to ensure an appropriate balance between

assuring that expenditures of the bond funds will result in operational high-speed rail services and providing the flexibility needed to attract federal and local government, as well as private sector, participation in funding, constructing, and operating the system. The following changes to the bond legislation are being proposed.

- Limit the amount of bond funding that may be used for engineering work, environmental studies needed to obtain permits, and preservation of right-of-way to enable project costs to be more accurately determined and project risk to be reduced before other parties' funds are fully committed. This will help pave the way for public and private partners to participate in the project, while limiting the amount of bond funds at risk.
- Before any construction or equipment purchase contracts can be signed for a portion of the system, there must be a complete funding plan that provides assurance that all funding needed to provide service on that portion of the system is secured.

Loans from Special Funds

- 2007-08 No Change
- 2008-09 -$288.7 million General Fund

  $288.7 million Other Funds

The May Revision proposes loans from various special funds to provide one-time funding to the General Fund to help close the budget gap. Loans from funds in the BTH Agency total $288.7 million as noted below. The loans are proposed only from those funds in which the loss of revenue will not result in any impact to the programs supported by the fund, will not require fee increases, and will not need to be repaid prior to 2010-11. Budget Trailer legislation is proposed to provide the State Highway Account authority to borrow from the Pooled Money Investment Account to reduce the need to carry a large cash balance.

Transportation Loans — $238.1

- State Highway Account, State Transportation Fund—$200 million
- Local Airport Loan Account—$14.9 million
- Motor Vehicle Fuel Account—$8 million

- Bicycle Transportation Account, State Transportation Fund—$6 million
- Environmental Enhancement and Mitigation Program Fund—$4.4 million
- Historic Property Maintenance Fund—$3 million
- Pedestrian Safety Account, State Transportation Fund—$1.8 million

Other Special Fund Loans — $50.6

- Financial Institutions Fund – $1.5 million
- State Corporations Fund – $1.5 million
- Mobilehome Park Revolving Fund – $2.5 million
- Mobilehome-Manufactured Home Revolving Fund – $1 million
- Joe Serna, Jr. Farmworker Housing Grant Fund—$1.2 million
- Housing Rehabilitation Loan Fund—$12.9 million
- Real Estate Appraisers Regulation Fund—$16.6 million
- Real Estate Fund—$12.2 million
- New Motor Vehicle Board Account—$1.2 million

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Resources

The May Revision proposes an additional $72.5 million in General Fund savings in the Resources area. These savings will be achieved by shifting funding for Colorado River water management projects and Habitiat Conservation Fund projects to bond funds, as well as providing loans and transfers from various special funds to the General Fund. In addition, the May Revision proposes to provide funding for the Department of Parks and Recreation to ensure that all state parks remain open to the public and state beaches are staffed with seasonal lifeguards.

Additional General Fund Savings

The May Revision proposes to shift $13.5 million from the General Fund to Proposition 84 bond funds for Colorado River water management projects. Existing law committed $235 million General Fund for various water management projects, including the lining of the All American Canal, to reduce California's annual use of Colorado River water. The Governor's Budget proposed $13.5 million General Fund for this purpose. This amount represents the remaining balance of the state's commitment toward completion of the projects. Proposition 84 provides $1 billion for integrated regional water management projects. The Colorado River water management projects are eligible for these funds.

The May Revision also proposes to shift $20.4 million of the required annual transfer to the Habitat Conservation Fund from the General Fund to Proposition 1E bond funds. Proposition 117, approved by the voters in 1990, requires an annual transfer of $30 million

to the Habitat Conservation Fund for the acquisition and restoration of habitat. The Governor's Budget proposed $20.4 million General Fund toward this purpose, with the remaining amount funded from various other funds. Proposition 1E provides $290 million for the enhancement of flood protection corridors, including projects that preserve the wildlife value of the properties. These funds are eligible to meet the Habitat Conservation Fund transfer requirement.

Provide Funding for State Parks

The May Revision proposes $13.3 million in funding for the Department of Parks and Recreation. The Governor's Budget proposed a $13.3 million General Fund reduction, which would have resulted in closing 48 state parks and reducing seasonal lifeguards at state beaches by a minimum of 50 percent. This proposal will provide $11.8 million General Fund and $1.5 million from increased state park fees to keep parks open. The fee increases will range from $1 to $2 at selected state parks where the effect on attendance would be minimal.

Loans and Transfers from Special Funds

The May Revision proposes loans and transfers from various special funds to provide one-time funding to the General Fund to help close the budget gap. For funds within the Resources Agency, the total loans and transfers are $30.4 million and $8.2 million respectively.

Loans from Special Funds — $30.4 million

- Renewable Resources Trust Fund—$10.9 million
- Oil Spill Prevention and Administration Fund—$13.0 million
- Hatchery and Inland Fisheries Fund—$4.0 million
- California Waterfowl Habitat Preservation Account—$2.5 million

Transfers from Special Funds — $8.2 million

- Coastal Wetlands Account—$4.7 million
- Environmental Water Fund—$2.4 million
- California Water Fund—$1.1 million

Environmental Protection

The May Revision proposes an additional $49.7 million Special Funds to achieve surplus emission reductions from on- and off-road heavy-duty vehicle and equipment projects, as well as funding to support cost recovery litigation and enforcement cases related to hazardous waste sites and illegal disposal.

- 2007-08 No Change
- 2008-09 $49.7 million

Financial Incentive Program for Surplus Emission Reductions

The Air Resources Board (Air Board) proposes to spend $48.7 million from the Air Quality Improvement Fund on a one-time basis to fund financing programs, including loans and loan guarantees to assist heavy-duty mobile pollution source fleets affected by the Air Board's new emission control rules. The financing program is intended to leverage state funding at a ratio of seven to one. The program will facilitate early action on regulatory compliance, ensuring critical emission reductions are achieved in an expedited manner.

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Health and Human Services

The May Revision continues to provide a safety net of essential services and supports for California's most vulnerable residents and targets investments in specific areas to improve the health and safety of Californians. Due to the state's deepening fiscal difficulties, the May Revision includes additional reductions aimed at restoring the state's fiscal balance while maintaining essential services.

Department of Health Care Services

- 2007-08 $31.1 million
- 2008-09 $342.6 million

Medi-Cal

Current Year

The May Revision reflects total Medi-Cal expenditures of $36.6 billion ($14.1 billion General Fund), a decrease of $353.2 million (an increase of $12.7 million General Fund) from the Governor's Budget. General Fund expenditures for Medi-Cal have increased by $427.7 million, or 3.1 percent over the 2006-07 level.

The average monthly Medi-Cal caseload is expected to decrease by 1,200 beneficiaries to 6,636,500 eligibles, which is a decrease of 0.02 percent from the level projected

in the Governor's Budget. This revised caseload is 0.6 percent higher than the 2006-07 caseload.

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

- $16.0 million will be transferred from Medi-Cal to the Genetically Handicapped Persons Program (GHPP) and $3.4 million to the California Children's Services (CCS) Program to cover current-year cost increases. Treatment costs, especially those for hemophilia, have greatly increased in the GHPP, and CCS continues to experience growth in its treatment and therapy costs (see issue below in the Family Health section for greater detail).
- $102.7 million decrease due to changes in the timing of the receipt of federal financial participation (FFP) for interim payments to Designated Public Hospitals (DPHs). These payments are initially paid with 50 percent General Fund and 50 percent federal funds. On a quarterly basis, these payments are adjusted to 100 percent federal funding. The Department of Health Care Services (DHCS) will implement system changes in the current year that will allow the adjustment to occur on a weekly basis instead of quarterly.
- $47.6 million increase to reflect a loss of savings from various proposed current year Budget Balancing Reductions (BBRs) that have not been adopted. These include the elimination of certain optional Medi-Cal benefits, stopping the payment of Medicare Part B premiums for beneficiaries who do not meet their share of cost, and a delay in the implementation of the 10-percent provider rate reduction to July 1, 2008.

Budget Year

The May Revision includes total Medi-Cal expenditures of $37.2 billion ($13.9 billion General Fund), a net total funds increase of $1,172.5 million ($315.7 million General Fund) from the Governor's Budget. General Fund expenditures are expected to decrease by $169.1 million, or 1.2 percent, over the revised 2007-08 level.

The average monthly Medi-Cal caseload is expected to increase from the Governor's Budget by 22,900 beneficiaries, or 0.3 percent, to 6,586,700 eligibles.

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

- $13.0 million decrease due to the delayed implementation of Chapter 328, Statutes of 2006 which authorized simultaneous pre-enrollment and application process for uninsured women in the Women, Infants, and Children program into Medi-Cal, allowed presumptive eligibility, and a two-county pilot that would allow Medi-Cal beneficiaries to self-certify their income.
- $42.0 million decrease by implementing a monthly eligibility requirement for emergency services for undocumented immigrants.
- $86.7 million decrease by limiting benefits for newly qualified immigrants and immigrants who permanently reside under the color of law (PRUCOL) to the same level as currently provided for undocumented immigrants. Benefits retained include emergency services, pregnancy-related services, long-term care in a nursing facility, and breast and cervical cancer treatment.
- $31.2 million decrease from the rollback of the allowable income level for persons applying for Section 1931(b), which provides Medi-Cal eligibility to families with low-incomes who meet eligibility requirements. The qualifying level would be lowered to 61 percent of the federal poverty level (FPL) and employment would be defined as the principal wage earner working less than 100 hours a month. Parents with higher incomes who meet the resource and status requirements would be eligible for the medically needy program under Medi-Cal. Savings from this proposal will be phased in and will increase to $342.5 million in 2011-12.
- $173.1 million increase due to an erosion of savings from various proposed budget balancing reductions. Adjustments to the savings amount also reflect updated caseload estimates and expenditure data, technical corrections, and a delay in enactment until July 1, 2008.
- $22.4 million increase to reflect the revised estimate of the August 2008 cost-of-living adjustment to 4.9 percent for Skilled Nursing Facilities (SNFs). More recent data reflect higher-than-anticipated growth in labor costs.
- $169.8 million increase to fund rate adjustments for Medi-Cal managed health care plans. The amounts of the rate adjustments were derived by utilizing an experience-based, plan-specific methodology that was implemented in 2007-08 and is the minimum amount needed to ensure matching federal funds for the Medi-Cal managed care program.

- $800,000 increase to fund Screening and Brief Intervention, which will allow medical providers to screen Medi-Cal patients in an emergency department setting for non-dependent substance abuse, provide a brief intervention and, as necessary, refer patients for appropriate services. It is estimated that this change will result in General Fund cost avoidance of $1.2 million in 2009-10, increasing to $2.5 million annually thereafter by reducing the number of beneficiaries who progress to the utilization of more expensive drug and alcohol addiction programs. Evaluations of other states, including Washington State, have shown screening and brief intervention to be cost effective.

- $1.5 million increase to establish the Beneficiary Utilization Review (BUR) Unit. The purpose of the BUR will be to review overuse and abuse of prescription drugs by Medi-Cal beneficiaries. These identified beneficiaries will be assigned to a single primary care physician to ensure that they only get the medical care and services they need. If DHCS determines providers or beneficiaries have been acting in a fraudulent manner, those cases will be referred to the Attorney General or District Attorney offices, respectively. It is anticipated that these efforts will result in substantial savings in unnecessary prescription drug costs.

- $11.3 million decrease by reducing non-contracted hospital rates. Rates paid to general acute care hospitals for inpatient services will be reduced to the lower of the average regional rate or tertiary rate established by the California Medical Assistance Commission (CMAC) minus five percent or to the non-contracted hospital's interim rate minus 10 percent as enacted by Chapter 3, Statutes of 2008. Hospitals participating in the Selective Provider Contracting Program will be exempt and rural hospitals will remain at their interim rate minus 10 percent consistent with Chapter 3, Statutes of 2008. Similar trailer bill language is proposed for Medi-Cal managed care to reduce the rate of growth in Medi-Cal managed care rates in 2009-10 and thereafter. This proposal is intended to remove the disincentive that exists for contracting with Medi-Cal and to provide cost avoidance related to hospital rates.

- A net increase of $324,000 for Medi-Cal's fiscal intermediary to hire additional pharmacy consultants to process treatment authorization requests (TARs). These positions will address the backlog in TARs and reduce the need for auto-adjudication, which will result in General Fund savings of $272,000 in 2008-09, increasing to an annual savings of $2.3 million.

- $102.7 million increase attributable to the new interim rate payment process for Designated Public Hospitals (See issue in Current Year section for more detail).

Other Items of Interest:

- Fee for Service Improvements in Medi-Cal—Slowing the rate of growth in health care expenditures is an essential component of efforts to restore the state's fiscal balance and to achieve the coverage for all Californians. The Medi-Cal program is the largest purchaser of health care in California. Medi-Cal spending is concentrated among a small segment of enrollees, the majority of whom have complex chronic medical conditions, coupled with additional conditions, including behavioral health conditions. Five percent of Medi-Cal enrollees incur sixty percent of all fee-for-service (FFS) Medi-Cal expenditures. Two percent of the most expensive enrollees incur more than forty percent of all FFS Medi-Cal benefit expenditures. These statistics underscore the need to look carefully at the health care needs of persons with serious health conditions to assure that the right care is delivered at the right time in the right setting to maximize health outcomes and contain overall costs. Nationally, state Medicaid programs are using a variety of approaches to improve care delivery in their FFS programs. Emphasizing prevention and increased use of primary care services offers the promise of better health outcomes and slower rates of growth in costs. The Administration is committed to working with the Legislature and stakeholders to identify enhancements to the Medi-Cal FFS system that improve health outcomes and slow the overall rate of cost growth.
- DHCS will enter into a competitive bid procurement process to contract with an organization on a pay-for-performance basis in an effort to reduce durable medical equipment (DME) costs. The vendor will be paid only if cost savings are achieved. The maximum payment would be $1 million, paid on a dollar-for-dollar basis from actual savings. Savings achieved beyond the $1 million threshold will go to the state.
- Budget trailer bill language is proposed to implement the Public Assistance Reporting Information System (PARIS) pilot project. The purpose of the project is to improve the identification of the subset of Medi-Cal beneficiaries who are also veterans and who may be eligible for duplicative services. The DHCS will implement this project with existing resources beginning in 2008-09.

Family Health Estimates

Current Year

The Family Health Program is comprised of the California Children's Services (CCS), the Child Health and Disability Prevention (CHDP) program, and the Genetically Handicapped Persons Program (GHPP). The May Revision includes $301.9 million

($156.3 million General Fund), a net increase of $20.4 million ($18.4 million General Fund) from $281.5 million provided in the Governor's Budget. The change primarily is due to increased costs of treatment for beneficiaries with hemophilia. The General Fund increase from the Governor's Budget level includes the following significant adjustments:

- $16.0 million will be transferred from Medi-Cal to GHPP to cover a projected funding shortfall from the 2007 Budget Act due to increased treatment costs of hemophilia, which makes up to 90 percent of the costs of the GHPP. The GHPP served approximately 477 beneficiaries with hemophilia in 2007-08. Treatment for hemophilia is expensive and episodes of bleeding for a few beneficiaries can significantly increase health care costs for the program. This funding shortfall will be addressed by transferring funds from Medi-Cal to the GHPP program.
- $3.4 million will be transferred from Medi-Cal to CCS, which has a projected $3.7 million General Fund funding shortfall from the 2007 Budget Act ($2.1 million above the Governor's Budget) in the California Children's Services (CCS) program for caseload growth and increased costs for treatment and therapy services. This funding shortfall will be resolved by transferring funds from Medi-Cal to the CCS program. The remaining $0.3 million of the shortfall will be funded through savings in the CHDP program.

Budget Year

The May Revision includes $313.5 million ($134.8 million General Fund), a net increase of $26.1 million ($25.2 million General Fund) from the $287.5 million provided in the Governor's Budget. The net General Fund increase from the Governor's Budget level includes the following significant adjustments:

- $19.5 million increase to cover caseload growth and increased costs of service in GHPP. The May Revision also includes proposals to contain costs in the GHPP, including:
  - Negotiate supplemental rebates from blood factor manufacturers, for increased General Fund revenue of $250,000 in 2008-09;
  - Statutory change to allow the DHCS to contract directly with pharmacies; and
  - System changes that will allow for improved tracking of blood factor utilization to ensure proper billing for manufacturers' rebates.

- $6.0 million increase in the CCS program for caseload growth and increased costs for treatment and therapy services.

Department of Public Health

- 2007-08 No Change
- 2008-09 $0.1 million

AIDS Drug Assistance Program

The May Revision includes $325.3 million to fund the AIDS Drug Assistance Program (ADAP), which is 16.2 percent above the $280.0 million identified in the Governor's Budget. The ADAP will serve nearly 34,256 clients in 2008-09, approximately 1,400 clients above revised current year caseload estimates.

Cigarette and Tobacco Products Surtax Fund-Proposition 99

The May Revision projects decreased Proposition 99 revenue of $7.0 million in 2007-08, and $15.0 million in 2008-09, for revised total revenues of $320.0 million in the current and budget years. The projected decrease in Proposition 99 revenue is primarily attributable to larger annual declines in cigarette consumption than had been assumed in the Governor's Budget, based on an analysis of historical consumption data. In addition, the forecast reflects a modest downward adjustment in the 18-to-64 population. The revised 2007-08 projection also incorporates updated data on cash collections.

Due to the decrease in revenues, the May Revision reflects decreases in funding for the California Healthcare for Indigents Program and the Rural Health Services program totaling $3.0 million in 2007-08 and $9.8 million in 2008-09. The reductions will not affect funding for the Managed Risk Medical Insurance Program and the Access for Infants and Mothers program. These programs are being adjusted for caseload changes only.

Managed Risk Medical Insurance Board

- 2007-08 $2.3 million
- 2008-09 $2.1 million

Healthy Families Program

Current Year

The May Revision projects an overall expenditure increase of $5.6 million ($2.3 million General Fund and $3.3 million other funds), to $1.1 billion ($395.8 million General Fund), from the level anticipated in the Governor's Budget. The Healthy Families Program (HFP) is expected to serve a total of 880,999 children by June 30, 2008, a decrease of 27,913, or 3.1 percent, from June 30, 2007. Funding increases are primarily due to an increase in the average statewide capitation rate paid per enrollee. The average statewide rate may vary as enrollees shift among the 21 health plans available to subscribers, as some plans have higher capitation rates than others.

Budget Year

Between June 2008 and June 2009, enrollment in the HFP is projected to grow from 880,999 children to 935,482 children, a 6.2-percent increase. This is a decrease of 18,770 children compared to the projection at Governor's Budget. The May Revision projects an overall expenditure increase of $5.8 million ($2.1 million General Fund), to $1.1 billion ($389.9 million General Fund), from the level anticipated in the Governor's Budget. The General Fund increase from the Governor's Budget level includes the following significant adjustments:

- $4.8 million increase due to the loss of savings associated with the delay of the enactment of the HFP Budget Balancing Reductions.
- $1.9 million decrease related to delaying implementation of Chapter 328, Statutes 2006. Upon implementation, HFP beneficiaries will be able to self-certify their income at annual eligibility redetermination.

Access for Infants and Mothers Program

Current Year

The May Revision projects an overall expenditure decrease of $4.4 million ($2.5 million federal funds and $1.9 million Perinatal Insurance Fund) from the level anticipated in the Governor's Budget, to $130.2 million. This 3.3-percent decrease in total funds is primarily due to a decrease in expected enrollment, offset by an increase in capitation rates. Average monthly enrollment in the Access for Infants and Mothers (AIM) program is expected to be 1,054 women, 8.7 percent lower than the 1,155 originally estimated in the Governor's Budget.

Budget Year

The May Revision projects an overall expenditure decrease of $7.2 million ($3.9 million federal funds and $3.3 million Perinatal Insurance Fund) from the level anticipated in the Governor's Budget. This decrease of 4.7 percent in total funds is largely due to a decrease in expected enrollment. Average monthly enrollment in the AIM program is expected to be 1,159 women, a decrease of 12.2 percent from the 1,320 originally estimated in the Governor's Budget.

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 $90,000 ($31,000 county funds and $59,000 federal funds) in 2007-08 and by $90,000 ($32,000 county funds and $58,000 federal funds) in 2008-09 due to updated county caseload and expenditure information.

Department of Developmental Services

- 2007-08 -$110.8 million
- 2008-09 $67.9 million

Developmental Centers

Current Year

At 2,620 residents, the average Developmental Center (DC) population remains unchanged from the Governor's Budget projection.

Agnews Developmental Center Closure – The May Revision includes Budget Bill Language to reappropriate 2007-08 General Fund savings in the Regional Center and Developmental Center budgets to 2008-09 to fund the cost of consumers who will remain at Agnews Developmental Center past the June 30, 2008 closure date. The actual amount required for reappropriation will be based on the number of consumers residing at Agnews Developmental Center after June 30, 2008 and their individual service needs and costs; however, the May Revision includes a $22 million reappropriation to reflect the

best estimate at this time. The number of consumers residing at Agnews Developmental Center on May 1, 2008 was 157.

It is anticipated that funds appropriated in 2007-08 to provide services in the community for consumers who have not yet moved and funds available for employee costs associated with the closure are available for reappropriation. These funds are being reappropriated to 2008-09 to cover the costs of developmental center services, employee costs associated with closure and regional center placement costs in 2008-09.

Budget Year

The average DC population is projected to decrease by 45 residents over the Governor's Budget projection, to 2,404 residents to reflect the Budget Balancing Reduction (BBR) which caps the resident population at the Porterville Developmental Center's (DC) Secured Treatment Program (STP). The May Revision includes the following changes:

- Staffing—The May Revision includes a decrease of 70.6 positions attributable to the Governor's Budget BBRs, which reflected a reduction in positions. The May Revision reconciles the position authority, primarily at the Porterville DC, to reflect a decrease of 57 positions due to a capped resident population at the Porterville DC's STP, a decrease of 13 positions at the Porterville DC Office of Protective Services, and a decrease of 0.6 positions in Regional Resource Development Projects.
- Foster Grandparent Program – The May Revision includes a decrease of $21,000 in federal funds for the Foster Grandparent Program, which receives funds from Senior Corps. For federal fiscal year 2008, the funding allocated by the federal government included a 1.747-percent across-the-board rescission to this grant. California's share of this reduction is $21,000.
- Other Fund Technical Adjustments – The May Revision includes an increase of $42,000 in Reimbursements to reflect an adjustment to Other Funds amounts since the Governor's Budget.

Regional Centers

Current Year

Compared to the Governor's Budget, Regional Center community caseload is projected to decrease by 586 consumers, to 221,069 consumers. The May Revision includes a net decrease of $53.3 million ($88.8 million General Fund) for Regional Centers to reflect updated caseload and expenditure data. The May Revision reflects increased federal

funds, reimbursements, and Public Transportation Account (PTA) funds of $35.5 million, which offset the General Fund and thus reduces the General Fund increase from the 2008-09 Governor's Budget. The May Revision reflects the following:

- Early Start/Part C Grant – The May Revision reflects an increase of $19.8 million federal funds in 2007-08 and a corresponding decrease in General Fund by accelerating the drawdown of Early Start federal grant funds.
- Transportation – The May Revision reflects an increase of $6.2 million from the PTA funds to reflect updated transportation expenditures.
- Reversion of Current Year Savings – The May Revision reflects General Fund savings of $88.8 million in 2007-08, in part due to the increased federal funds, reimbursements, and PTA funds totaling $35.5 million. The savings will be reverted to the General Fund effective June 30, 2008.

Budget Year

Compared to the Governor's Budget, Regional Center community caseload is projected to decrease by 2,450 consumers, to 229,675 consumers. The May Revision includes a net increase of $150.4 million ($45.9 million General Fund), reflecting the following changes:

- Purchase of Services – The May Revision provides a net increase of $124.5 million (increase of $8.2 million General Fund) to fund projected Regional Center expenditures for residential and other services. These services include Community Care Facilities, Health Care, Health Facilities, In-Home Respite, and Day Programs. Utilization and costs for services are estimated to increase by 3.8 percent over the Governor's Budget. This is due to funding adjustments and factors such as an increase in the number of consumers dually diagnosed with mental health conditions, an increase in persons diagnosed with autism spectrum disorders, and increased need for support services.
- Operations—The May Revision reflects an increase of $4.8 million ($22.8 million General Fund) due to funding adjustments and increased Early Start staffing resulting from projected increased eligibility assessments of approximately 823 cases since the Governor's Budget.
- Early Start/Part C Grant – The May Revision reflects an increase of $13.9 million federal funds in 2008-09 and a corresponding decrease in General Fund by accelerating the draw down of Early Start federal grant funds.

- Impacts of Reductions in Other Departments – The May Revision includes $21.1 million ($14.9 million General Fund) to reflect the impacts of reductions in the Department of Social Services and the Department of Health Care Services.
- Transportation—The May Revision includes a reduction of $2.6 million in PTA funds based on updated Transportation expenditures.

Department of Mental Health

- 2007-08 -$0.1 million
- 2008-09 -$34.7 million

Long-Term Care / State Hospitals

Current Year

The May Revision reflects no change from the 2008-09 Governor's Budget. However, during the 2007-08 Third Extraordinary Special Session, $12.6 million General Fund was reduced from the Department of Mental Health's (DMH's) budget in March 2008 to account for the fact that caseload for the Sexually Violent Predator (SVP) population was not materializing as projected.

Budget Year

Funding for long-term care and state hospitals is anticipated to decrease by $31.1 million General Fund compared to the Governor's Budget. The change is comprised of the following adjustments:

- State Hospital Population:
  - The May Revision reflects a decrease of $13.3 million General Fund to reflect a lower projected caseload for the SVP population.
  - A decrease of $24.7 million General Fund to reflect full-year impact of the current year reduction in the state hospital population by 225 patients.
  - A decrease of $328,000 General Fund associated with Phase IX of the Coalinga State Hospital (CSH) Activation, which was requested in the fall State Hospital Population Estimate. The DMH revised the estimated population at CSH for 2008-09 to 825 patients and subsequently reduced the number of non-level-of-care staff to reflect this change.

- An increase of $6.7 million General Fund to support a 64-bed expansion at the Salinas Valley Psychiatric Program (SVPP). The expansion includes both the level-of-care and non-level-of-care positions necessary to meet the *Coleman* court's expectation that the facility be fully staffed within four months of the first admission, which will take place on November 30, 2008.

- Forensic Conditional Release Program (CONREP): The May Revision includes an increase of $0.6 million General Fund to support alternative placements for SVPs. There are currently 11 SVPs who are either scheduled to be released into CONREP and are awaiting placement in the community, or who have filed petitions with the Court for conditional release. The DMH anticipates that alternative placement will be required for a total of 4 SVPs in the budget year.

Community Mental Health Services

Current Year

The May Revision reflects a net increase of $110.5 million ($54,000 General Fund decrease and $110.6 million increase in reimbursements) for community mental health services relative to the Governor's Budget. The adjustments include the following:

- Early and Periodic Screening, Diagnosis and Treatment (EPSDT) Program – The May Revision includes an increase of $113.1 million in reimbursements due to a change from cash-based accounting to accrual-based accounting.

- Healthy Families Program – The May Revision includes a decrease of $2.6 million ($54,000 General Fund and $2.5 million in reimbursements) due to a decrease in forecasted claims for the current year.

Budget Year

The May Revision includes a net increase of $24.7 million ($3.6 million General Fund decrease and $28.3 million increase in reimbursements) 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 $31.1 million ($3.5 million General Fund decrease and $34.6 million reimbursements increase). This includes the following adjustments:

- A decrease of $57.2 million ($27.8 million General Fund and $29.4 in reimbursements) due to lower-than-projected EPSDT claims.
- An increase of $13.4 million in reimbursements due to the change from cash-based accounting to accrual-based accounting.
- An increase of $17.2 million ($8.6 million General Fund and $8.6 million in reimbursements) due to delays in implementing proposed budget balancing reductions (BBR) and adjustments to the BBRs based on the new EPSDT claims information.
- An increase of $57.7 million ($15.7 million General Fund and $42 million in reimbursements) due to the 2005-06 cost settlement. This is an estimated amount because final settlement amounts have not been received for all counties, including Los Angeles.

- Healthy Families Program (HFP)—The May Revision includes a decrease of $6.4 million ($171,000 General Fund and $6.3 million in reimbursements), primarily due to lower than projected HFP claims

Department of Social Services

- 2007-08 $42.6 million
- 2008-09 $118.0 million

CalWORKs

The 2007-08 average monthly CalWORKs caseload of 460,119 represents an increase of 0.1 percent from 2006-07, and an increase of 1.9 percent from the Governor's Budget estimate. Absent the program changes described below, the average monthly caseload in this program is estimated to be 459,744 in 2008-09, a 0.1 percent decrease over the 2007-08 projection. The proposed changes to CalWORKs are estimated to reduce the 2008-09 caseload projection to 386,871 families, a 16.0 percent decrease from the 2007-08 estimate. Combined federal Temporary Assistance for Needy Families (TANF) Block Grant and state and county maintenance-of-effort expenditures in 2007-08 and 2008-09 are anticipated to be $6.7 billion.

The May Revision continues to reflect the Administration's January proposals for major CalWORKs reform measures that emphasize work participation and personal responsibility and improve the state's ability to meet federal requirements.

The May Revision also incorporates additional program reductions and transfers necessary to maintain the CalWORKs program within the limits of federal TANF funding and General Fund Maintenance-of-Effort (MOE) requirements. The final federal TANF regulations issued in February 2008 disallowed many of the expenditures that California had been counting towards its MOE requirement. In order to offset this disallowance, the May Revision reflects the exchange of TANF funds for General Fund that is currently expended in other TANF-qualifying programs. This proposal allows California to continue to meet federal MOE requirements without increasing overall state General Fund expenditures. The following programs participate in the TANF-General Fund exchanges:

- CalGrants ($223 million)
- Probation ($151.8 million)
- Emergency Assistance Foster Care ($50.4 million)
- Increased Title XX transfer to Department of Developmental Services ($22.2 million).

Higher caseloads and costs per case, and an erosion of the savings assumed in the Governor's Budget for certain proposals, will create a TANF shortfall in the CalWORKs program of $376 million. The following changes are proposed to maintain program expenditures at the level of available TANF and MOE funding:

- Eliminate 2008-09 Cost of Living Adjustment ($131 million—$20 million taken in special session, $111 million additional proposed in May Revision)
- Five percent grant reduction ($108.2 million).
- Self-Sufficiency Reviews ($59.7 million; see below for details)
- Eliminate County Pay-for-Performance Incentive ($40 million)
- Use Unspent Performance and Fraud Incentives funding to offset General Fund ($20.6 million)
- Implement the Regional Market Rate for Child Care in January 2009 and limit reimbursement rates to the 75th Percentile ($19.4 million)

- Eliminate the TANF Reserve ($13.0 million)

In order to move the state closer to meeting federal work participation requirements, the May Revision includes three proposals to benefit the work participation rate calculation:

- Pre-Assistance Employment Readiness System (PAERS) is proposed as a four-month, pre-CalWORKs program for all new or returning CalWORKs participants. The program will be designed to accelerate efforts in assisting applicants to secure employment and avoid entry into CalWORKs and develop a work plan as a condition of eligibility for CalWORKs for those applicants who are unable to secure employment during the PAERS program.
- Institute a face-to-face self-sufficiency review every six months with a county worker for CalWORKs families who are not meeting work requirements. The review will assess what services or resources may be necessary to address barriers that are preventing participation and help remove a family's dependence upon public assistance.
- Transfer $5 million in TANF to the Boys and Girls Club in order to count an estimated $88 million in additional expenditures as excess MOE.

Supplemental Security Income/State Supplementary Payment Program

Total General Fund expenditures for the Supplemental Security Income/State Supplementary Payment (SSI/SSP) program are $3.6 billion in 2007-08, representing an increase of $4.6 million compared to the Governor's Budget. SSI/SSP General Fund expenditures for 2008-09 are $3.5 billion, a decrease of $213.4 million from the Governor's Budget. Caseload for the SSI/SSP program is projected at 1,247,575 recipients in 2007-08 and 1,274,000 recipients in 2008-09, a year-to-year caseload growth of 2.1 percent.

The May Revision includes a proposal to retain the January 2009 federal SSI COLA, rather than pass it through to recipients, as part of a package of additional reductions made necessary by the state's current fiscal condition. This will provide additional savings of $108.8 million General Fund in 2008-09. 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, 2008

	Aged and Disabled	
State	**Individuals**	**Couples**
Alaska	$965	$1,432
California	870	1,524
Connecticut	771	1,144
Massachusetts	766	1,158
New York	724	1,060

In addition, the May Revision proposes to eliminate the Cash Assistance Program for Immigrants. This program, which provides benefits to aged, blind, and disabled legal immigrants, was projected to have an average monthly caseload of 10,300 individuals in 2008-09. Elimination of the program will result in savings of $111.2 million General Fund in 2008-09.

In-Home Supportive Services

Total General Fund expenditures for the In-Home Supportive Services (IHSS) program are $1.7 billion in 2007-08 and $1.5 billion in 2008-09, including an increase of $36.5 million in 2007-08 and a decrease of $110.7 million in 2008-09 compared to the Governor's Budget. Caseload is projected to be 396,612 recipients in 2007-08 and 415,589 in 2008-09. Caseload estimates in 2007-08 and 2008-09 are slightly higher than projected in the Governor's Budget.

The May Revision includes alternative reduction proposals to replace the 18-percent reduction in domestic and related service hours proposed in the Governor's Budget:

- Focus the state buyout program for IHSS recipients whose Medi-Cal share of cost is higher than their IHSS share of cost on persons with the most severe needs. Under this proposal, the state will no longer pay the difference in the share of cost for those IHSS recipients with average functional index scores below 4. This proposal will result in 2008-09 savings of $27.7 million General Fund.
- Provide IHSS domestic and related services to individuals with the highest levels of need, as measured by a functional index score of 4 or higher. The provision of other

IHSS services to all eligible consumers regardless of their functional index score will not be impacted. This proposal will save $52.0 million General Fund in 2008-09.

The May Revision also limits state participation in the wages of IHSS workers to the state minimum wage plus $0.60 per hour for benefits. This would result in savings of $186.6 million General Fund in 2008-09. The principal reason that the average cost of care for an IHSS recipient has nearly doubled over the past 10 years is wage growth.

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/or neglect. The May Revision includes $4.0 billion ($1.5 billion General Fund) to provide assistance payments and services to children and families under these programs. This is a $60.1 million increase ($16.5 million General Fund decrease) from the Governor's Budget. The net General Fund decrease is the result of using TANF funds in lieu of General Fund for the Emergency Assistance Foster Care program ($50 million), offset by the erosion of savings associated with not enacting the Budget Balancing Reduction proposal to reduce rates in the Foster Care, Adoption Assistance, and Kin-Gap programs ($22.5 million) by 10 percent by March 1, 2008.

In addition, the May Revision includes a $9.4 million augmentation to pay a federal penalty for failure to meet a performance measure related to the stability of foster care placements noted in the federal Child and Family Services Review. The Department of Social Services is appealing the penalty, but will make the payment to stop the accrual of interest charges pending the appeal.

Loans and Transfers from Special Funds

The May Revision proposes loans and transfers from various special funds to provide one-time funding to the General Fund to help close the budget gap. For funds within this agency, total loans and transfers are $25.7 million and $14.6 million respectively. A loan or transfer was only proposed where the loss of the revenue would not result in any impact to the programs supported by the fund and would not require any fee increases. Loans will be repaid by June 30, 2011.

Office of Statewide Health Planning and Development

- $10.0 million loan from the Hospital Building Fund.
- $12.0 million loan from the California Health Data and Planning Fund.
- $1.0 million loan from the Registered Nurse Education Fund.

Department of Health Care Services

- $3.0 million transfer from the Emergency Services and Supplemental Payment Fund.
- $1.0 million transfer from the Private Hospital Supplemental Fund.

Department of Public Health

- $1.1 million loan from the Occupational Lead Poisoning Prevention Account.
- $1.6 million loan from the Drinking Water Operator Certification Special Account.
- $2.1 million transfer from the Cancer Research Fund.
- $8.5 million transfer from the Drinking Water Treatment and Research Fund.

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Corrections and Rehabilitation

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

- 2007-08 -$46.8 million
- 2008-09 -$115.2 million

The May Revision proposes a decrease of $115.2 million General Fund for the CDCR, including the following:

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.

Northern California Re-entry Facility

Consistent with the Administration's commitment and current efforts to implement the requirements of Chapter 7, Statutes of 2007, and to comply with the requirements of Chapter 228, Statutes of 2007, the May Revision includes $11.7 million to activate the state's first secure re-entry facility beginning July 1, 2009.

Chapter 228, Statutes of 2007 authorized the conversion of the former Northern California Women's Facility (NCWF) to a secure reentry facility that will house male offenders for up to 12 months prior to parole. Construction to convert the NCWF is projected to begin in September 2008 and is estimated to be completed in June 2009.

Once construction is completed, the Northern California Re-entry Facility (NCRF) will be a 500-bed secured re-entry facility that will provide programs and services to offenders returning to San Joaquin, Calaveras, and Amador counties. These programs and services will include intensive substance abuse treatment, vocational training and job placement, academic education, housing placement, anger management classes, family counseling, and other targeted services to ease the transition from prison to the community. In addition, the CDCR is engaging in ongoing communication with local stakeholders to ensure that continuity of service will exist once an offender is paroled.

Adult Inmate/Parolee Population/Caseload Changes

Current Year

As a result of successful implementation of parole reforms, increased access to rehabilitation services, implementation of SB 1453, and a decline in new admissions, the institutional Average Daily Population (ADP) is projected to decrease by 2,107 in 2007-08 compared to the Governor's Budget. The May Revision reflects an estimated institutional ADP of 171,886 inmates for the current year.

The projected parolee ADP is 126,456 for the current year. Parole reforms have contributed to a decrease of 2,887 in the parolee population from the level projected in the Governor's Budget.

The net effect of these population changes is a decrease to the General Fund of $27.9 million and a decrease of $340,000 to the Inmate Welfare Fund.

Budget Year

The May Revision also reflects an estimated institutional ADP of 170,641 inmates for the budget year, a decrease of 6,380 from the level projected in the Governor's Budget.

The projected parolee ADP is 122,872 for the budget year. This is a decrease of 10,189 from the level projected in the Governor's Budget. The parole population is expected to continue to decrease due to the effectiveness of parole reforms.

The population changes will reduce costs to the General Fund by $78.2 million and reduce costs to the Inmate Welfare Fund by $1.5 million.

Ward/Parolee Population/Caseload Changes

Current Year

For 2007-08, the May Revision estimates an average daily population of 2,277, a decrease of 17 wards from the projection in the Governor's Budget. In addition, the average daily juvenile parole population is projected to be 2,426, an increase of 11 parolees from the Governor's Budget projection. The change in population is due to more wards being released to parole than previously anticipated. Given the minimal change in population, there is no funding adjustment proposed.

The Safety and Welfare Remedial Plan in the *Farrell* lawsuit requires females under the jurisdiction of the Division of Juvenile Justice (DJJ) to receive services under a gender-specific rehabilitative model. Because there are few females housed by the DJJ, the Remedial Plan required DJJ to consult with experts in adolescent and young adult female offender treatment to develop and issue a Request for Proposals (RFP) to provide services to females in secure placements outside of DJJ facilities. The DJJ has issued a RFP, but has been unable to secure a viable service provider. The 2007 Budget Act includes $8.6 million in contract funding for this purpose. Since the DJJ has been unable to secure a viable service provider in the current year and continues to house female offenders, the May Revision reflects a reduction of $8.6 million General Fund in 2007-08. The DJJ is continuing to search for a service provider but does not anticipate entering into a contract until 2008-09.

General Fund expenditures for juvenile institutions are partially offset by General Fund revenues from the sliding scale fees paid by counties. In 2007-08, these revenues are estimated to be $12.7 million, an increase of $346,000 from the revenue expected at the time of the Governor's Budget.

Budget Year

For 2008-09, the average daily population is projected to be 1,847, an increase of 61 wards from the projection included in the Governor's Budget. This increase in population is due primarily to more "M" and "E" cases, which are juvenile offenders whose offense would have placed them in an adult institution but because of their age are housed in DJJ. Additionally, the average daily parole population is estimated to be 1,971, an increase of eight parolees from the Governor's Budget projections. This increase is due to more

wards being released to parole than previously anticipated. Given the minimal change in population, there is no funding adjustment proposed.

As discussed above, since the DJJ has been unable to secure a viable provider to serve female offenders, the May Revision proposes to reduce funding for the female contract by $4.3 million General Fund in 2008-09. This is based on the assumption that the DJJ will enter into a contract by January 2009.

In 2008-09, the sliding scale fees paid by counties are estimated to be $7.5 million, a decrease of $618,000 compared to the revenue expected at the time of the Governor's Budget.

Prison Medical Care Receiver

The May Revision proposes an augmentation of $8.6 million General Fund in 2008-09 to ensure that the Receiver appointed by the court in the *Plata* lawsuit is able to improve the delivery of medical care to inmates. Specifically, the May Revision includes the following adjustments:

- An augmentation of $12.5 million to establish additional Supervising Registered Nurse II positions to improve nursing care.
- A reduction of $3.9 million to correct a technical error in the Receiver's Health Care Guarding and Transportation proposal. These resources will provide inmates access to higher levels of care and specialty care outside the institution.

In addition, the Receiver has completed his draft Strategic Plan for the delivery of medical care to inmates. The Receiver has determined that new facilities for medical and mental health care to serve up to 10,000 inmates statewide are required. The Receiver anticipates supervising construction of facilities for his health care expansion program at up to seven sites serving up to 1,500 inmates at each site. Furthermore, the Receiver has determined that it is necessary to upgrade administrative and clinical facilities to provide inmates with appropriate access to health care at each of the CDCR's institutions.

To provide the full authority and funding for these projects, the Administration has withdrawn the trailer bill language included in the Governor's Budget and supports the Reciever's urgency legislation. Because not all of the planned renovations will be able to be financed with lease revenue bonds, $100 million General Fund is necessary to ensure all facilities can be completed as the Receiver plans.

In summary, this proposed legislation would do the following:

- Appropriate $6 billion in lease revenue bond authority for projects proposed by the Receiver, for and on behalf of CDCR, including the design and construction of health related facilities and housing for up to 10,000 inmates with medical or mental health care needs, and supporting infrastructure and ancillary facilities, at existing state correctional facilities statewide or at other appropriate state-owned real property. Of this $6 billion (Public Buildings Construction Fund), it is estimated $2.5 billion would be expended in fiscal year 2008-09.
- Appropriate $100 million General Fund and $900 million lease revenue bond authority to be used by the Receiver, for and on behalf of CDCR, to design and construct health care facility improvements at existing prison facilities statewide. Of the $100 million General Fund and $900 million Public Buildings Construction Fund, it is estimated that $50 million and $450 million, respectively, would be expended in fiscal year 2008-09.

Juvenile Probation Funding

In February 2008, the federal Health and Human Services Agency released updated federal regulations for the Temporary Assistance for Needy Families (TANF) Block Grant. As a result of these new provisions, the requirements to meet the TANF Maintenance of Effort (MOE) requirement are more restrictive. To address the loss of available MOE, the May Revision proposes to replace $151.8 million General Fund that currently supports the Juvenile Probation Program with TANF Block Grant Funds, and transfer the General Fund to the Department of Social Services.

Update to Budget-Balancing Reductions

The Governor's Budget reflected savings of $17.9 million General Fund in 2007-08 and $354.3 million in 2008-09 related to Budget-Balancing Reductions for the CDCR. Savings estimates in the Governor's Budget assumed that the proposals would be adopted in the special session and would be implemented by March 1, 2008.

Summary Parole

The May Revision includes total savings of $173.6 million for the Summary Parole proposal, which is an increase $75.7 million compared to the Governor's Budget.

The net increase in savings is due to $110 million in corresponding operational and programmatic savings which were not previously identified, offset by a $34 million erosion related to the change in implementation dates, the revised population impact associated with the spring projections, and the shift of implementation costs from 2007-08 to 2008-09.

The majority of the corresponding savings results from the need for the Department to reconfigure many of the programs that serve its parolee population, the reduced need to provide funding to reimburse local governments for the cost of housing detained and revoked parolees, and projected reductions in Board of Parole Hearings workload.

The decrease in institutional ADP associated with Summary Parole in 2008-09 decreases from 6,249 to 4,774, a reduction of 1,475. This ADP grows to 7,800 in 2009-10.
The decrease in parolee ADP associated with Summary Parole in 2008-09 decreases from 18,522 to 13,517, a reduction of 5,005. This ADP grows to 22,448 in 2009-10.

Early Release

Given the effectiveness of parole reforms and rehabilitative efforts to date and the associated savings resulting from the decrease in the inmate population compared to the fall projection, as well as other proposed savings in the CDCR budget, the May Revision Budget achieves approximately $300 million in CDCR savings without releasing any inmates prior to their anticipated release date.

K thru 12 Education

California's school districts, charter schools and county offices of education provide instruction and a variety of programs and support services for pre-Kindergarten through grade twelve (K-12) students. These programs are designed to prepare students with the skills necessary to pursue higher education, obtain fulfilling employment, achieve career goals, and develop as productive citizens. Programs and services provided to more than six million students annually include standards-based instruction, special education, English learner support, career preparatory programs, child care and development, remedial instruction, and adult education.

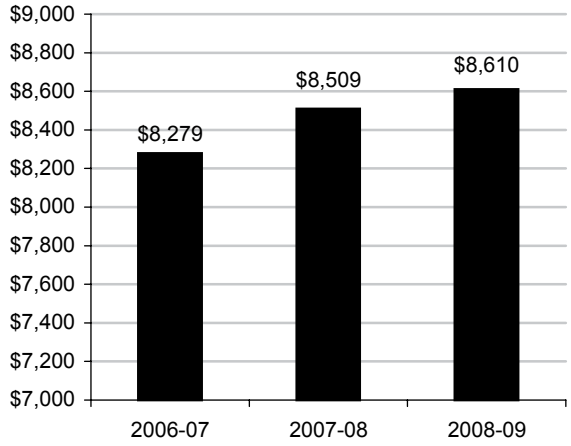
Due to the state's budget shortfall, the Governor's Budget proposed suspension of the minimum Proposition 98 Guarantee and no cost-of-living increases for schools.

The Governor's May Revision proposes $1.8 billion General Fund in additional funding for K-12 education and community colleges to fully fund the minimum Proposition 98 Guarantee in 2008-09. Total Proposition 98 funding for K-14 education programs will increase year over year by $193 million. With this additional investment, K-12 Proposition 98 per-pupil funding in the May Revision are $8,610 in 2008-09, up from $8,509 in 2007-08 (see Figure K12-01).

Change in Total K-12 Funding

- 2007-08 $12 million
- 2008-09 $1,470 million

Figure K12-01
K-12 Proposition 98 Funding Per Pupil

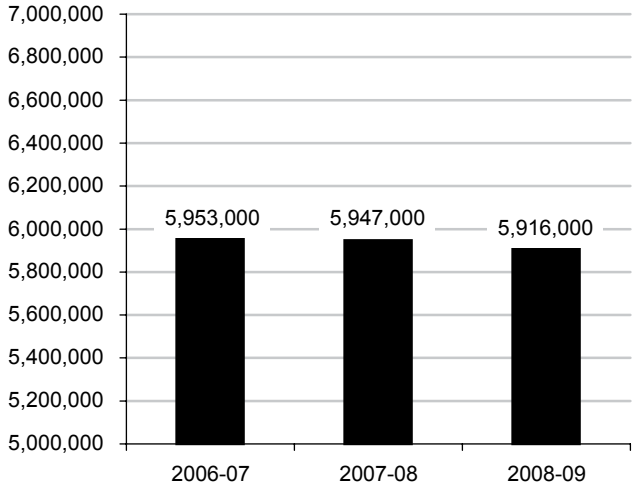


The May Revision to the Governor's Budget projects total revenue for K-12 education programs in 2008-09 to be $71 billion ($41.7 billion General Fund). Of this amount, $67 billion is state, federal and local property tax funding accounted for in the State Budget. This reflects an increase of $1.5 billion ($1.7 billion General Fund) over the Governor's Budget. More notable funding changes are described below.

Attendance

As a result of a steady decline in birth rates throughout the 1990s, attendance growth in public schools is declining (see Figure K12-02). For the 2007-08, K-12 average daily attendance (ADA) is estimated to be 5,947,000, a decrease of 6,400 from the 2006-07 fiscal year. For 2008-09, the Administration estimates K-12 ADA will decrease by an additional 31,000 to

Figure K12-02
K-12 Average Daily Attendance



5,916,000. However, both of these projections are higher than the Governor's Budget ADA estimates of 5,923,000 for 2007-08 and 5,892,000 for 2008-09, reflecting increases of 24,000 and 23,000, respectively.

Per-Pupil Spending

Total per-pupil expenditures from all sources are projected to be $11,997 in 2007-08 and $12,000 in 2008-09, including funds provided for prior year settle-up obligations. 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.

Major Workload Adjustments

Major workload adjustments include the following:

- ADA—The May Revision proposes an $85.3 million net increase in 2008-09 to reflect the increase in ADA from the Governor's Budget projection. The majority of this amount consists of a $92.6 million increase in school district and county office of education revenue limit apportionments (general purpose funding for schools) partially offset by $7.3 million in reductions to categorical programs. Due to an increase in the attendance estimate for 2007-08, there also is a $50.5 million increase in revenue limit apportionments included in the May Revision for that year.

- Local Property Tax Adjustments—The May Revision reflects General Fund increases of $179.1 million in school district and county office of education revenue limit and special education apportionments in 2007-08 and $521.3 million in 2008-09, related to school district and county office of education property tax revenues. In general, decreases in local property tax revenues increase the amount of state General Fund costs for revenue limit apportionments.

- School District Revenue Limits —$780 million in workload adjustments for 2008-09 school district revenue limits are included in the figures above related to ADA and Property Tax Adjustments. These adjustments include a $142 million increase related to higher ADA, a $519.4 million increase related to lower estimates of property taxes, a $93.4 million increase to reflect a six-fold increase in unemployment insurance rates, and a $25.3 million increase for adjustments in PERS contribution rates. The May Revision also reflects workload increases for 2007-08 totaling $218.3 million including a $34.6 million net increase related higher ADA, which is significantly offset by lower projections of declining enrollment cost, as well as an increase of $183.7 million for lower than expected local property tax revenues.

Proposition 98 Guarantee

The 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 (SCA1) was adopted to allow for a third funding test in low revenue 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 2006-07, the Proposition 98 Guarantee was $55.2 billion, of which the General Fund share was $41.4 billion. Local property taxes covered the balance.

Figure K12-03

Proposition 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 to K-14 schools from cities, counties, and special districts, the current rate is approximately 40.96 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.

At the time of the Governor's Budget, 2007-08 Proposition 98 appropriations exceeded the minimum guarantee. During the Special Session called by the Governor to address the budget shortfall, the Administration and the Legislature reduced 2007 Budget Act appropriations by $506.8 million by reducing programs that were not projected to fully expend their appropriations and by replacing ongoing funding with one-time savings from prior year appropriations. As a result of these actions, Proposition 98 General Fund appropriations for 2007-08 are now $41.8 billion, which is $802.1 million higher than

the minimum Proposition 98 Guarantee. Total Proposition 98 funding for 2007-08 is $56.6 billion.

The Proposition 98 Guarantee for 2008-09 is projected to grow to $56.8 billion of which $41.4 billion would be from the General Fund. As part of the budget-balancing reductions, the Governor's Budget proposed to suspend Proposition 98 and reduce Proposition 98 General Fund to $39.6 billion. However, consistent with the priority the Administration has placed on education funding and its continuing efforts to improve the state's education system, the May Revision proposes to restore $1.8 billion General Fund thereby increasing Proposition 98 General Fund in 2008-09 to the minimum Proposition 98 Guarantee level, with no suspension.

Adjustments to the Budget Balancing Reductions

Public Transportation Account Funding for Home to School Transportation

In the Legislative Special Session called to address the budget shortfall, legislation was adopted which authorized up to $409 million in Proposition 98 General Fund expenditures for the Home-to-School Transportation Program for the 2007-08 fiscal year to be reimbursed from the Public Transportation Account (PTA). Similarly, the May Revision proposes to achieve additional General Fund savings for the 2008-09 fiscal year by adding language to the budget to authorize up to $592.9 million from the PTA to be used to reimburse the General Fund for the budgeted cost of the Home to School Transportation Program, including Special Education transportation.

Surplus Relocatable Classroom Program Funds

In prior years, the state has transferred rental income received from the State Relocatable Classroom Program that was not needed for the program to the General Fund. Subsequently, the State Allocation Board approved a plan to phase out the program since it was no longer meeting its original intent to temporarily assist districts with excessive enrollment growth and unforeseen classroom emergencies, and due to the general condition of the aging fleet of relocatable classrooms. The Office of Public School Construction has now indicated there is $14 million in excess revenue from the program that is available. As a result, consistent with prior practice, the May Revision proposes to transfer this funding to the General Fund.

Additional Savings Proposals Coupled with Flexibility

Deferred Maintenance

The May Revision proposes to shift $222.6 million Proposition 98 General Fund from deferred maintenance as part of fully restoring the reduction proposed to Special Education. This leaves $39.6 million for the deferred maintenance program which is proposed to be reserved for hardship projects. In addition, the May Revision provides $100 million for the Emergency Repair Program established under the Williams settlement.

Coupled with the redirection, the Administration proposes to eliminate the local matching requirement for the deferred maintenance program for the 2008-09 fiscal year.

Additional Flexibility Options

The May Revision proposes to reauthorize the flexibility provisions that were adopted in 2003-04 to provide greater flexibility for school districts to cope with a constrained budget environment and to help mitigate the need for reductions in workforce. Specifically, the proposals would:

- Reduce reserve requirements for purposes of determining "Negative" and "Qualified" budget status.
- Authorize districts to increase apportionments sufficient to ensure a 2 percent increase from restricted categorical sources.
- Reduce the required 3 percent annual contribution to the districts' restricted reserve for routine maintenance to 2 percent.
- Increase current percentage caps on district transfer authority for AB 825 categorical block grants from 15/20 percent to 20/25 percent.
- Eliminate the local match requirement under the Deferred Maintenance Program.
- Allow districts to move state categorical program carryover or reserve funds from any prior year and from any program to the district's unrestricted general fund, excluding those funds prohibited under federal or state law.

Restoration of Critical Programs

Revenue Limits

The May Revision provides significant additional resources in general purpose funding by restoring $841.1 million for school district revenue limits. Specifically, this funding represents the portion of the deficit factor proposed in the Governor's Budget that was in excess of the 2008-09 COLA, as adjusted for revised ADA. This funding is in addition to the $780 million of workload adjustments detailed previously in the Major Workload Adjustments section, resulting in a total increase of $1.6 billion in new general purpose funding.

Therefore, the remaining deficit results only from suspending the budget year COLA. Based on the Governor's Budget proposed statutory change to the K-12 COLA factor to the CPI-W index (4.40 percent), the school district revenue limit deficit is estimated to be 4.214 percent.

Special Education

The May Revision provides a Proposition 98 General Fund increase of $234.1 million over the amount previously proposed in the Governor's Budget. These changes include adjustments for reinstating $189.2 million previously proposed for reduction as a part of budget balancing solutions, and revised figures for local property tax and ADA growth. The proposal also meets the federal maintenance-of-effort requirement for special education programs.

State Special Schools

The May Revision includes an increase of $5.1 million Proposition 98 General Fund to help the State Special Schools continue to provide high quality diagnostic services and instruction for students with special needs. The proposal also includes a $1.2 million augmentation for Home-to-School Transportation costs, in addition to General Fund savings of $4.1 million overall as a result of shifting these mass transit costs to the Public Transportation Account.

Other Budget Adjustments

Child Care

Subsidized child care services help low-income working families become self-sufficient, contribute to school readiness of younger children, and are essential to support work

participation of CalWORKs families. Services are provided through voucher programs, in which parents select the provider of choice, and through center-based programs that contract directly with the state.

The Governor's Budget provided $2.48 billion for State Department of Education (SDE) administered child care programs, after necessary budget balancing reductions totaling $198.9 million were identified. Total funding included $252.1 million in one-time Proposition 98 sources and $56.3 million in one-time federal sources to meet Stage 2 and Stage 3 caseload estimates at that time. This is consistent with past practices. Since the Governor's Budget, the following factors have affected child care funding needs, and result in a net increase in funding of $45.4 million, for a total of $2.5 billion, including an increase in ongoing Proposition 98 resources of $41.9 million, for 2008-09:

- The Legislature acted in the Special Session to use a large share of the carryover sources anticipated to meet budget year costs of Stage 2 and 3 child care to help reduce the current year Proposition 98 Guarantee as part of larger budget solutions. Accounting for these actions and revised estimates, carryover sources were reduced by $193 million. In addition, one-time and ongoing federal funds diminished by $63.6 million. This resulted in a need for additional resources of $256.6 million to backfill these losses.
- Caseload costs for Stage 2 and 3 have increased, requiring $20 million in additional funding.
- A policy change is proposed to fully fund Stage 2 costs without a traditional federal Temporary Assistance for Needy Families (TANF) holdback from the full estimate in the Department of Social Services CalWORKs budget. This requires additional Proposition 98 resources of $25.5 million and completes the policy change implemented last year to fund Stage 2 from Proposition 98. This also frees up TANF to fund CalWORKs, helps meet the TANF maintenance-of-effort requirement shortfall, and reduces pressure on the General Fund.
- Policy changes are also proposed to help reduce rapidly rising reimbursement rate cost pressure caused by the revised methodology for computing regional market rate limits that was implemented several years ago. This change will help preserve slots in the capped voucher-based Alternative Payment Program, as well as contain costs in voucher-based Stage 2 and Stage 3 programs, while enabling full funding of all caseload in this very constrained budget environment. Specifically, trailer bill revisions are proposed to bench market limits to the 75th percentile based on the new 2007 market survey beginning January 1, 2009, and to conduct the market

survey every two years instead of annually. These actions are fully consistent with federal requirements and provide an average rate limit increase effective January 2009. California's reimbursement rate structure would remain among the most generous in the nation. Conducting the market survey every two years will save several hundred thousand dollars annually, as well.

Student and Teacher Longitudinal Data Systems

The May Revision continues to fully fund development of the California Longitudinal Pupil Achievement Data System (CalPADS) and California Longitudinal Teacher Integrated Data Education System (CalTIDES) systems. CalPADS will enable tracking of individual student enrollment history and academic performance data over time. CalTIDES will serve as the central state repository for information regarding the teacher workforce for the purpose of developing and reviewing state policy, identifying workforce trends, and providing high-quality program evaluations of the effectiveness of teacher preparation and induction programs. Total funding for these projects is $10.3 million ($2.2 million General Fund) in 2008-09.

The May Revision also includes language to authorize the California Technology Assistance Project to provide training for implementing CalPADS. The California Technology Assistance Project promotes the effective use of technology in teaching, learning and school administration. The project currently provides technical assistance to schools and districts based upon local needs in each of 11 regions in California. This proposal would provide necessary training to local education agencies for CalPADS implementation.

The Administration believes that the primary goal of any education data system should be to help improve academic achievement. The focus should be on enabling local education agencies to use the data directly to improve instruction expeditiously. The implementation of CalPADS and CalTIDES, along with assignment of individual student identifiers through the California School Information Services program, is an important first step in making data available for local education agencies. There also is an abundance of education data available in many other forms at all levels of government and in the private sector. Examples range from automated reporting systems, program evaluations, studies, articles, and more. The Administration believes it is necessary to fully implement CalPADS and CalTIDES and analyze the information that is currently available to schools from various sources to improve outcomes before efforts are made to expand these systems or plan new systems.

California State Teachers' Retirement System

The California State Teachers' Retirement System (CalSTRS) administers the Teachers' Retirement Fund, which is an employee benefit trust fund created to administer the State Teachers' Retirement Plan. The State Teachers' Retirement Plan is a defined benefit pension plan that provides retirement, disability, and survivor benefits for teachers and certain other employees of the California public school system. The Plan is comprised of three programs: the Defined Benefit Program, the Defined Benefit Supplement Program, and the Cash Balance Benefit Program. Within the Defined Benefit Program there is also a Supplemental Benefit Maintenance Account (SBMA), which provides annual supplemental payments in quarterly installments to retired teachers whose purchasing power has fallen below 80 percent of the purchasing power of an initial allowance.

Currently, the state makes annual General Fund contributions to the SBMA of 2.5 percent of teacher payroll for purchasing power protection. The 80 percent level of purchasing power is currently not a vested benefit. This means that if the amount in the SBMA is not sufficient to maintain payments keeping retired teachers benefits at the 80 percent level, the benefit may be reduced or employer contributions may be increased.

The Governor's Budget proposed to make the following changes to SBMA:

- Fully vest the SBMA benefit at 80 percent purchasing power protection.
- Reduce the state's contributions to the SBMA from 2.5 percent to 2.2 percent of salary.
- Delay the State's contribution from July 1 and split the contribution into two payments of 1.1 percent, made on November 1 and April 1 each year.
- Pay the $210 million interest from the $500 million STRS lawsuit in three installments beginning in 2008-09.

The May Revision will modify the Governor's Budget proposal as follows:

- Increase the benefit from 80 percent to 85 percent while retaining the existing policy where this benefit is not vested.
- Reduce the state's contribution from 2.5 percent to 2.25 percent of salary.
- General Fund savings of $66 million in 2008-09 and $16 million in 2009-10 from Governor's Budget.

- Contribute two payments of 1.125 percent each on November 1 and April 1 each year.
- Pay the interest from the STRS lawsuit in four equal payments of $52.6 million beginning in 2009-10.

Provider Accounting and Reporting Information System

The May Revision includes $285,000 in one-time federal funds in 2008-09 to rewrite the Provider Accounting and Reporting Information System (PARI$). The PARI$ is designed to manage SDE's child care agency contracts and payment processing functions. The rewrite is necessary because the current system is outdated, difficult to maintain, and does not have the capability to share data with other SDE systems.

Personnel Management Assistance Teams

The May Revision proposes that $3 million in Proposition 98 General Fund be reappropriated to continue funding for the Personnel Management Assistance Teams authorized by Chapter 517, Statutes of 2006. These teams assist school districts establish and maintain effective personnel management, recruitment and hiring processes.

Emergency Repair Program

The May Revision proposes another $100 million transfer from the Proposition 98 Reversion Account to the Emergency Repair Account in satisfaction of the Williams settlement agreement. This increment of funding for the program will bring total transfers to $392 million for the purpose of funding school facility emergency repair projects.

Local Educational Agency Corrective Action Assistance

Consistent with actions taken by the State Board of Education to further the intentions of the federal No Child Left Behind Act, the May Revision proposes separate legislation that will appropriate $45 million federal Title I Set Aside funds to assist local educational agencies in their efforts to improve the academic performance of their students and to meet their federal accountability measures.

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Higher Education

Due to the State's significant budget shortfall, the Governor's Budget proposed to suspend the provisions of the Higher Education Compact (Compact) to help achieve fiscal balance. The May Revision protects education funding and makes additional resources available to the University of California (UC), the California State University (CSU) and the California Community Colleges (CCC) to ensure affordability, preserve quality and maintain essential levels of access. As discussed in the K-12 section, the Proposition 98 guarantee will be met which will provide additional resources for CCC to meet instructional demand and ensure local property tax declines do not impose hardships on the colleges. While the greater budget gap prevents fulfillment of the Compact, additional General Fund resources are provided to UC and CSU to ensure that fees will not increase beyond the levels agreed to in the Compact, to preserve enrollments in high-state-need instructional programs, and to address cost pressures from required implementation of new Teaching Performance Assessment standards pursuant to Chapter 517, Statutes of 2006. Thus, mandatory undergraduate fees will rise by no more than 7.4 percent for UC students and 10 percent for CSU students. CSU fees will remain the lowest in the nation for comparable public four-year comprehensive colleges and UC fees will remain very competitive with other comparable public research universities.

For the Student Aid Commission (CSAC), the Governor's Budget assumed a current year, one-time revenue adjustment of $500 million related to the sale or other authorized transaction (Transaction) to maximize the value of CSAC's auxiliary organization, EdFund, pursuant to Chapter 182, Statutes of 2007. The state's selected sale advisor has decided

to withdraw its commitment to help prepare the EdFund Transaction. In addition, there have been numerous changes in the student lending industry and credit pressure on Wall Street. Given these conditions, it is necessary to postpone this transaction to maximize the value of this asset. As the student loan guaranty function is not a core function for state government, a sale will continue to be pursued and completed in 2009-10. Therefore, the May Revision reflects a shift of $500 million in anticipated revenue from the end of the current year to the 2009-10 fiscal year. Additionally, the May Revision reflects conforming state operations adjustments since decoupling of CSAC and EdFund operations will not occur in the budget year.

For CSAC local assistance programs, the $80 million Cal Grant workload cost placeholder that was included in the Governor's Budget as a contingency in the event UC and CSU raised fees further is no longer necessary and has been deleted from the budget. The May Revision also proposes that approximately 30-percent of projected Cal Grant costs be shifted from General Fund to Temporary Assistance for Needy Families (TANF) reimbursements from the Department of Social Services to help address the state's TANF Maintenance of Effort (MOE) shortfall. Please refer to the Health and Human services section for more details.

Changes to the Community Colleges budget reflect workload adjustments for revised estimates of local property tax revenues, including relief in the current year, increased funding for enrollment growth, and a policy change to provide more flexibility in categorical spending similar to K-12 categorical programs.

Total Funding by Segment

Total funding at the May Revision for Higher Education reflects a year-over-year increase of $565.6 million (2.8 percent) which is $155 million greater than comparable figures in January. General Fund and related Proposition 98 expenditures reflect a year-over-year increase of $14.2 million which is a reduction of $76 million from comparable figures in January. This is primarily due to the large shift of GF costs to TANF for a portion of Cal Grants. Absent that, this figure would have increased $146 million or 1.1 percent. Segment-by-segment figures follow:

- Total funding in 2008-09 for UC increases from year to year by $179.8 million (3.3 percent), with total General Fund essentially flat compared to 2007-08.

- Total funding in 2008-09 for CSU increases from year to year by $132.8 million (3 percent), with total General Fund essentially flat compared to 2007-08.
- Total funding in 2008-09 for CCC increases from year to year by $191.8 million (2.2 percent), with total General Fund and Proposition 98 related sources increasing by $187.9 million (2.9 percent) excluding carryovers, compared to revised 2007-08.
- Total funding in 2008-09 for CSAC (excludes Ed Fund) decreases from year to year by $30.4 million (-3.5 percent), with total General Fund decreasing by $261 million (-31 percent) compared to 2007-08.

University of California

- 2007-08 No Change
- 2008-09 $98.5 million General Fund

Budget Year

- The May Revision proposes a General Fund increase of $98.5 million to maintain funding for UC level from year to year and to limit fee increases to the levels agreed to in the Compact. This funding is also intended to preserve enrollment levels in high-state-need instructional programs and provide resources for implementation of the Teaching Performance Assessment standards for teacher preparation programs required to be implemented in 2008-09 pursuant to Chapter 517, Statutes of 2006 that would otherwise have to be absorbed. Thus, the unallocated portion of the reduction to the workload budget level for UC is reduced to $201.1 million for a revised total reduction of $233.4 million.

California State University

- 2007-08 No Change
- 2008-09 $97.6 million General Fund

Budget Year

- The May Revision proposes a General Fund increase of $97.6 million to maintain funding for CSU level from year to year and to limit fee increases to the levels agreed to in the Compact. This funding is also intended to preserve enrollment levels in high-state-need instructional programs and provide resources for implementation of

the Teaching Performance Assessment standards for teacher preparation programs required to be implemented in 2008-09 pursuant to Chapter 517, Statutes of 2006 that would otherwise have to be absorbed. Thus, the unallocated portion of the reduction to the workload budget level for CSU is reduced to $172.1 million for a revised total reduction of $215.3 million.

California Student Aid Commission

- 2007-08 No Change
- 2008-09 -$303 million General Fund

Budget Year

The May Revision proposes a net General Fund decrease of $303 million over the level proposed in the Governor's Budget, as noted below:

- $223 million of Cal Grant costs are proposed to be shifted from General Fund to reimbursements from TANF federal funds available to the Department of Social Services through an interagency agreement. This proposal is necessary to address a significant shortfall in TANF MOE expenditures. Please refer to the Health and Human Services section for more detail on the overall approach to resolving the TANF MOE shortfall.
- $80 million savings associated with the elimination of the $80 million Cal Grant workload cost placeholder from the Governor's Budget that was included in the event UC and CSU increased fees beyond the level anticipated for the workload budget. As discussed, further increases by the UC and CSU governing boards are not anticipated.
- A redirection of the $1.8 million one-time augmentation proposed in January for restoring shared services from the EdFund is proposed. Although the Transaction is delayed, CSAC will have to relocate to a new building due to termination of their current leased space. Funding is needed to address necessary costs including ongoing additional leased space and telephone system costs, and one-time cost for moving and office furnishings. These costs total approximately $1.8 million and thus offset the costs anticipated for adding 11 new staff, equipment, software and other technology related costs that would have been necessary to replace shared services from EdFund.

- Reappropriation of state operations savings is proposed to be reserved for unanticipated costs related to CSAC's relocation or other unforeseen costs in 2008-09.

The May Revision also proposes the following Student Loan Operating Fund increases to conform to the delay in the EdFund Transaction:

- $1 million from the Student Loan Operating Fund (SLOF) is proposed for restoration of the six CSAC positions reduced in January that are dedicated to the oversight of EdFund operations. These positions are proposed on a limited-term basis.
- Additionally, the May Revision restores position authority for the remaining 24 EdFund civil service employees on a limited-term basis and restores over $779 million to reflect continuously appropriated SLOF expenditures ($96.4 million) and Federal Student Loan Reserve Fund expenditures ($682.8 million) for EdFund operations in 2008-09.
- Trailer bill legislation is proposed to remove a potential statutory conflict that may impact the Commission's ability to act as a Lender of Last Resort for the Federal Family Education Loan program to address a potential crisis in the student lending markets resulting from changes in federal law and the concurrent general difficulties in the credit market.

California Community Colleges

- 2007-08 -$69 million General Fund and Proposition 98 Related Sources
- 2008-09 $236.2 million net General Fund and Proposition 98 Related Sources (with carryovers)

Current Year

The May Revision proposes the following Proposition 98-related adjustments:

- The May Revision reflects reductions in estimated property tax revenue of $74.9 million that are offset by increases of $5.9 million in fee revenue compared to the 2007 Budget Act estimates. Reappropriations totaling $69 million, including estimated savings of $47.3 million from 2006-07 community college apportionments, are provided to backfill the resulting deficit to ensure colleges are not adversely affected by the current year shortfall. This amount will become available in the budget year.

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 $236.2 million compared to the Governor's Budget, including an increase of $167.2 in ongoing Proposition 98 General Fund and $69 million in one time sources.

The following ongoing Proposition 98 workload adjustments are proposed to conform to revised estimates of local revenues and other workload changes:

- An increase of $35.5 million for growth in apportionments, bringing the total growth funding in the budget year to $95.5 million (1.67 percent), sufficient to serve approximately 20,000 additional students.
- An increase of $572,000 to restore the reduction proposed in the Governor's Budget to the Foster Care Training program which will preserve approximately $700,000 of federal matching funds for training foster parents in meeting the needs of this vulnerable population.
- An increase of $138.7 million to offset the reduction in estimated property tax revenues for 2008-09.
- A decrease of $6.4 million to reflect an increase in estimated offsetting student fee revenues based on more recent current year data.
- A decrease of $1.8 million to reflect an increase in offsetting oil and mineral revenues of an identical amount.
- An increase of $717,000 for the Board of Governor's Fee Waiver program administrative costs to reflect updated estimates of student fee waivers.

Policy-related adjustments for the CCC include the following:

- As mentioned, $69 million is proposed to be reappropriated to backfill the current year deficit caused by the anticipated property tax shortfall. $47.3 million is carryover savings from 2006-07 and $21.7 is appropriated from the reversion account.
- Provisional language is proposed to provide colleges flexibility to transfer funds between categorical programs in two programmatic areas. Specifically, this would allow up to 20 percent of funds to be transferred out of a particular program in order to increase other programs by up to 25 percent within each program area. This flexibility would encompass three part-time faculty staff incentive programs

in one and five student services programs in another. Given the necessity to reduce programs costs, this additional flexibility will allow local priority needs to be better addressed.

- $2.7 million in reimbursements is proposed to reflect an interagency agreement that is being developed between the California Department of Corrections and Rehabilitation and the Chancellor's Office that would provide training for prison staff that play key roles in the rehabilitation process, consistent with strategies authorized by Chapter 7, Statutes of 2007 and the Expert Panel on Adult Offender Reentry and Recidivism Reductions' report to the Legislature in June, 2007. Of this amount, it is anticipated that $140,000 would be available to support one position for state operations workload and up to $2.6 million would support local assistance allocations for colleges to provide the training and development services.

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Statewide Issues

This section includes issue(s) that affect multiple departments in various major program areas.

2008-09 State Appropriations Limit Calculation

Pursuant to Article XIIIB of the California Constitution, the 2008-09 State Appropriations Limit (SAL) is estimated to be $79.808 billion. The revised limit is the result of applying the growth factor of 4.95 percent. The revised 2008-09 limit is $70 million above the $79.738 billion estimated in January. This increase is due to changes in the following factors and shifts in financial responsibility:

- Per Capita Personal Income
  - January Percentage Growth: 4.16
  - May Revision Percentage Growth: 4.29
- State Civilian Population
  - January Percentage Growth: 1.16
  - May Revision Percentage Growth: 1.31
- K-14 Average Daily Attendance
  - January Percentage Growth: -0.21

- May Revision Percentage Growth: -0.37

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

The SAL for 2007-08 does not change since it was statutorily established by Control Section 12.00 of the 2007 Budget Act.

State Cash Management Improvement

The proposal will smooth out General Fund disbursements throughout the fiscal year to better align receipts and disbursements. It will reduce the state's reliance on external borrowing. Effective cash management is one major factor considered by rating agencies in evaluating the state's credit-worthiness. Improving cash management could improve accessibility to the credit markets and reduce borrowing costs on long-term bonds. Under current projections, the state will need at least $9 billion of external cash flow borrowing in 2008-09. This improved cash management program would result in a reduction in external cash flow borrowing by several billion dollars.

Item 9800 – Augmentation for Employee Compensation

The 2008-09 Governor's Budget proposed $260.4 million General Fund for 2007-08 and $230.2 million General Fund for 2008-09 for the Administration's Last, Best, and Final Offer (LBFO) to Bargaining Unit 6, California Correctional Peace Officers Association.

Section 3517.8 (b) of the Government Code (Dills Act) states: "If the Governor and the recognized employee organization reach an impasse in negotiation for a new memorandum of understanding, the state employer may implement any or all of its LBFO. Any proposal in the state employer's LBFO that, if implemented, would conflict with existing statutes or require the expenditure of funds shall be presented to the Legislature for approval and, if approved, shall be controlling without further legislative action, notwithstanding Sections 3517.5, 3517.6, and 3517.7."

Consistent with statutory requirements, the Administration has submitted to the Legislature for its consideration those items of the LBFO which require legislative approval. To date, the Legislature has not approved those items or appropriated funding for the 2007-08 portion of the LBFO. Therefore, the Administration is proposing that funds proposed in the budget to implement the salary increase and other financial provisions of the LBFO be shifted from the specific budget item and placed in the reserve. Funding for the proposed health benefits increase will remain in the budget.

The Administration continues to pursue legislation to implement the LBFO. When the Legislature approves the requested changes, the Administration will implement those provisions of the LBFO.

Reimbursable State Mandates Program

The May Revision proposes a decrease of $75 million General Fund to reflect a delay of the third payment of the 15-year payment plan for mandate costs incurred prior to July 1, 2004. Statute requires these costs be fully paid by the 2020-21 fiscal year.

Tax Modernization Commission

California's tax system was designed decades ago and has not been adjusted to reflect a shift from a manufacturing and agriculture-based economy to an information, service, and technology-based economy. The state's tax system contributes to revenue volatility and to the substantial swings in available resources that the state has experienced during the past decade. California would benefit from an improved and more modern tax system that supports a strong economy, job creation, and provides a more predictable revenue source for essential government services.

As part of budget reform, Governor Schwarzenegger will issue an executive order to establish a bipartisan commission of legislative and gubernatorial appointees to modernize the state's tax laws and better reflect the current economy. The Tax Modernization Commission will make recommendations to assist the state in becoming less susceptible to revenue swings in the future.

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