



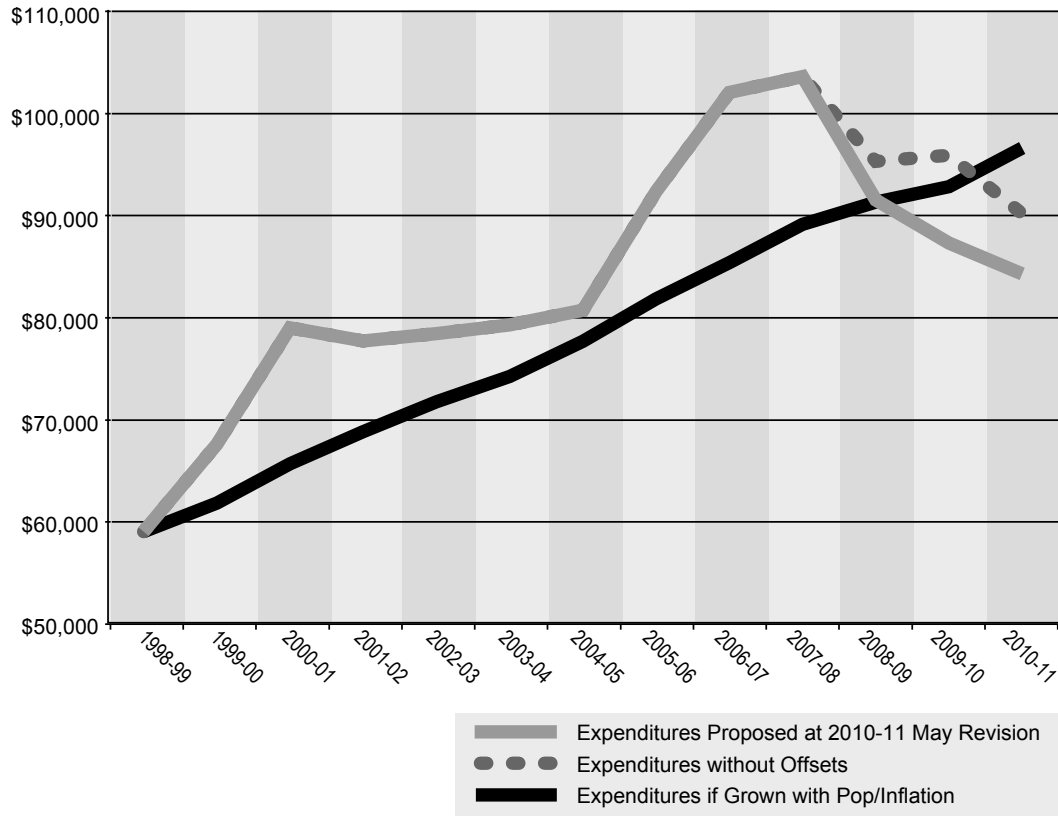
MAY REVISION 2010-11

INTRODUCTION

In January, California, like the rest of the nation, was slowly emerging from the most severe economic downturn since the Great Depression, and faced a significant budgetary imbalance. The Governor's Budget proposed spending reductions and alternative funding solutions to address a \$19.9 billion projected budget gap. As proposed, it would bring overall General Fund spending to a level well below what it was a decade ago, in 1998-99, adjusted for population and inflation growth. (See Figure INT-01.) The Governor's Budget closed the budget gap while maintaining State funding for schools at the current year level, fully funding the Proposition 98 guarantee, and increasing funding for higher education, without raising taxes.

While there continue to be signs the economy is slowly improving, California continues to confront serious budgetary problems. The May Revision continues to fully fund K-12 education, increases funding for the University of California, the California State University, and the California Community Colleges to avoid further tuition increases or deep cuts to the classroom. It fully funds the CalGrant program. It also avoids additional reductions in funding for Child Welfare Services, foster care, public safety, and the Judiciary. To balance the Budget in the face of significant revenue losses, legal constraints and federal funding restrictions, the May Revision proposes deep reductions and program eliminations.

Figure INT-01
Proposed General Fund Spending
Would Remain Below Population and Inflation Growth
 (Dollars in Millions)



RE-DEFINING THE BUDGET GAP

In January, California’s projected budget gap for the fiscal year 2010-11 was \$19.9 billion. The Governor declared a fiscal emergency and called upon the Legislature to adopt \$8.9 billion in solutions in the Special Session. Given the necessary time for budget solutions to achieve their full value and the scope of the problem, the Governor proposed adopting these budget solutions before March 1, as delays in the adoption of these proposals would result in the loss of more than \$2 billion in budgetary solutions and necessitate deeper cuts.

As Figure INT-02 shows, various factors have changed the 2010-11 deficit from the \$19.9 billion projected in January. The solutions adopted in the Special Session, combined with additional federal funds and administrative actions reduced the size of

Figure INT-02
Changes in the Budget Gap
 (Dollars in Billions)

| | |
|---|----------------|
| Budget Shortfall Projected in the 2010-11 Governor's Budget | -\$19.9 |
| Special Session Approved Solutions | 1.4 |
| Achieved Federal Funds | 0.7 |
| Revenue Decline | -0.6 |
| Cost Increases | -0.5 |
| Increase in Reserve | -0.2 |
| Total Budget Solutions Proposed | -\$19.1 |

the problem by \$2.1 billion. Revenue estimates are \$0.6 billion lower. Federal law, court decisions, population and caseload growth, as well as the need for a prudent reserve, increase the size of the problem by \$0.7 billion.

With all of these adjustments, the May Revision projects a budget gap of \$19.1 billion. This figure is comprised of a current year shortfall of \$7.7 billion, a budget year shortfall of \$10.2 billion and a modest reserve of \$1.2 billion.

In addition to the changes in the size of the problem, losses in available budgetary solutions have created a need for additional solutions and spending cuts. These losses include:

- Delays in the adoption of budgetary solutions that led to the loss—\$2.8 billion.
- Policy changes in the areas of higher education, public safety and funding for the state parks—\$0.5 billion.
- The update of federal funds to reflect Congressional Action, the President's proposed budget, and new information.

CLOSING THE BUDGET GAP

The May Revision proposes additional solutions to close the budget gap. Figure INT-03 shows the categories of solutions proposed. Various fund shifts, alternative funding, and other revenues, including a \$650 million loan of excise taxes on gasoline, account for \$3.4 billion.

Figure INT-03
Proposed Budget Solutions
 (Dollars in Millions)

| | Governor's Budget | May Revision | Total | |
|--------------------------------|------------------------------|---------------------|-------------------|--------|
| Expenditure Reductions | \$5,844.5 | \$6,523.4 | \$12,367.9 | 64.6% |
| Federal Funds | 1,967.9 | 1,414.1 | 3,382.0 | 17.7% |
| Alternative Funding | 1,025.9 | 252.4 | 1,278.3 | 6.7% |
| Fund Shifts and Other Revenues | 477.1 | 1,636.5 | 2,113.6 | 11.0% |
| | <u>\$9,315.4</u> | <u>\$9,826.4</u> | <u>\$19,141.8</u> | 100.0% |

Federal funds account for \$3.4 billion in solutions, a reduction from the Governor’s January Budget proposal. Proposed federal funds include \$1.7 billion from the extension of the temporary increase in the Federal Medical Assistance Percentage (FMAP), \$125 million from the extension of other enhanced federal funding provided under the American Recovery and Reinvestment Act, and \$1.6 billion in additional federal funds for health and human services and for the Department of Corrections and Rehabilitation. Congress and President Obama’s Administration have already acted on several funding requests and it is anticipated that Congress will act on a number of other funding requests, including the proposed extension of the temporary FMAP increase, later this year. The Administration will work with legislative leaders and continue to monitor progress on securing the proposed level of federal funds. The Governor will propose additional solutions to the Legislature for inclusion in the Budget in the event the federal government does not provide the additional funding in the timeline anticipated.

Spending reductions account for \$12.4 billion in solutions. The proposed spending reductions reflect the severe constraints the state faces when balancing the Budget. Federal court rulings have prevented the state from achieving \$2.4 billion in savings since 2008-09 and actions by the federal receiver over prison medical care have increased costs by \$1.1 billion. Federal and state maintenance-of-effort requirements and other legal constraints have also increased costs and substantially restricted the areas of the Budget that can be reduced. As a result, the state’s choices are more limited and more difficult. The May Revision’s proposals to eliminate child care programs, with the exception of pre-school and after school care, to eliminate the California Work Opportunity and Responsibility to Kids Program, (CalWORKs) program, and to reduce funding for local mental health services by approximately 60 percent are the result of these constraints.

As the Legislative Analyst has noted, balancing this year's Budget will be a daunting challenge that will require very difficult choices. The May Revision is a reflection of this challenge and of the difficult but necessary changes required to address this year's budget gap. Last year, California closed a \$60 billion budget gap and successfully managed its cash reserves to avert a fiscal crisis. This year will require the same difficult decisions. As he did last year, the Governor will propose permanent budget reform and creation of a strong "Rainy Day Fund", to prevent a future budget crisis of the magnitude California faces today.

PLAN TO ADDRESS ANTICIPATED CASH SHORTFALL

The May Revision continues to project that the state will have sufficient cash to repay the entire \$8.8 billion of RANs in May and June 2010 as scheduled. Legislation enacted in the Special Session provided the state additional tools to manage cash in July and during key months of the budget year. Proposals to close the budget shortfall will substantially reduce this cash gap. In addition to budget solutions, the state will need to obtain external financing early in the fiscal year. Additional cash solutions may be required to reduce the need for external borrowing. At the Governor's direction, the Department of Finance has begun working with the State Controller's Office and the State Treasurer's Office to develop additional cash solutions as needed to meet the state's financial obligations.

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SUMMARY CHARTS

This section provides various statewide budget charts and tables.

Figure SUM-01
2010-11 May Revision
General Fund Budget Summary
With All Proposed Budget Solutions
(Dollars in Millions)

| | <u>2009-10</u> | <u>2010-11</u> |
|---|-----------------|-----------------|
| Prior Year Balance | -\$5,361 | -\$5,305 |
| Revenues and Transfers | <u>\$86,521</u> | <u>\$91,451</u> |
| Total Resources Available | \$81,160 | \$86,146 |
| Non-Proposition 98 Expenditures | \$50,629 | \$48,397 |
| Proposition 98 Expenditures | <u>\$35,836</u> | <u>\$35,007</u> |
| Total Expenditures | \$86,465 | \$83,404 |
| Fund Balance | -\$5,305 | \$2,742 |
| Reserve for Liquidation of Encumbrances | \$1,537 | \$1,537 |
| Special Fund for Economic Uncertainties | -\$6,842 | \$1,205 |
| Budget Stabilization Account | - | - |
| Total Available Reserve | -\$6,842 | \$1,205 |

Figure SUM-02
2010-11 May Revision
General Fund Budget Summary
Budget Before Solutions
(Reflects Effect of Special Session and Achieved Federal Funds)
(Dollars in Millions)

| | <u>2009-10</u> | <u>2010-11</u> |
|---|-----------------|------------------|
| Prior Year Balance | -\$5,385 | -\$6,199 |
| Revenues and Transfers | <u>\$86,521</u> | <u>\$89,338</u> |
| Total Resources Available | \$81,136 | \$83,139 |
| Non-Proposition 98 Expenditures | \$50,658 | \$61,108 |
| Proposition 98 Expenditures | <u>\$36,677</u> | <u>\$38,431</u> |
| Total Expenditures | \$87,335 | \$99,539 |
| Fund Balance | -\$6,199 | -\$16,400 |
| Reserve for Liquidation of Encumbrances | \$1,537 | \$1,537 |
| Special Fund for Economic Uncertainties | -\$7,736 | -\$17,937 |
| Budget Stabilization Account | - | - |
| Total Available Reserve | -\$7,736 | -\$17,937 |

Figure SUM-03
General Fund Revenue Sources
(Dollars in Millions)

| | 2009-10 | 2010-11 | Change from 2009-10 | |
|---------------------|-----------------|-----------------|------------------------|-------------------|
| | | | Dollar Change | Percent Change |
| Personal Income Tax | \$44,021 | \$46,245 | \$2,224 | 5.1% |
| Sales Tax | 26,852 | 26,967 | 115 | 0.4% |
| Corporation Tax | 9,386 | 9,779 | 393 | 4.2% |
| Motor Vehicle Fees | 1,416 | 1,503 | 87 | 6.1% |
| Insurance Tax | 2,027 | 1,967 | -60 | -3.0% |
| Estate Taxes | - | 892 | 892 | 100.0% |
| Liquor Tax | 332 | 354 | 22 | 6.6% |
| Tobacco Taxes | 99 | 97 | -2 | -2.0% |
| Other | 2,388 | 3,647 | 1,259 | 52.7% |
| Total | \$86,521 | \$91,451 | \$4,930 | 5.7% |

Note: Numbers may not add due to rounding.

Figure SUM-04
2010-11 Revenue Sources
(Dollars in Millions)

| | General Fund | Special Funds | Total | Change From |
|---------------------|-----------------|------------------|------------------|----------------|
| | | | | 2009-10 |
| Personal Income Tax | \$46,245 | \$940 | \$47,185 | \$2,434 |
| Sales Tax | 26,967 | 4,057 | 31,024 | -242 |
| Corporation Tax | 9,779 | - | 9,779 | 393 |
| Highway Users Taxes | - | 5,534 | 5,534 | 2,419 |
| Motor Vehicle Fees | 1,503 | 5,368 | 6,871 | 139 |
| Insurance Tax | 1,967 | 163 | 2,130 | -136 |
| Estate Taxes | 892 | - | 892 | 892 |
| Liquor Tax | 354 | - | 354 | 22 |
| Tobacco Taxes | 97 | 796 | 893 | -19 |
| Other | 3,647 | 9,637 | 13,284 | 339 |
| Total | \$91,451 | \$26,495 | \$117,946 | \$6,241 |

Note: Numbers may not add due to rounding.

SUMMARY CHARTS

Figure SUM-05
2010-11 Total Expenditures by Agency
 (Dollars in Millions)

| | <u>General Fund</u> | <u>Special Fund</u> | <u>Bond Funds</u> | <u>Totals</u> |
|------------------------------------|---------------------|---------------------|-------------------|------------------|
| Legislative, Judicial, Executive | \$2,905 | \$2,844 | \$434 | \$6,183 |
| State and Consumer Services | 599 | 748 | 24 | 1,371 |
| Business, Transportation & Housing | 765 | 7,550 | 3,686 | 12,001 |
| Natural Resources | 2,037 | 2,503 | 1,438 | 5,978 |
| Environmental Protection | 65 | 1,114 | 714 | 1,893 |
| Health and Human Services | 22,859 | 11,148 | 278 | 34,285 |
| Corrections and Rehabilitation | 8,981 | 48 | - | 9,029 |
| K-12 Education | 35,133 | 81 | 684 | 35,898 |
| Higher Education | 11,794 | 36 | 1,098 | 12,928 |
| Labor and Workforce Development | 58 | 383 | - | 441 |
| General Government: | | | | |
| Non-Agency Departments | 588 | 1,612 | 2 | 2,202 |
| Tax Relief/Local Government | 534 | 3,646 | - | 4,180 |
| Statewide Expenditures | <u>-2,914</u> | <u>-856</u> | <u>-</u> | <u>-3,770</u> |
| Total | \$83,404 | \$30,857 | \$8,358 | \$122,619 |

Note: Numbers may not add due to rounding.

Figure SUM-06
General Fund Expenditures by Agency
(Dollars in Millions)

| | 2009-10 | 2010-11 | Change | % |
|------------------------------------|-----------------|-----------------|-----------------|--------------|
| Legislative, Judicial, Executive | \$1,828 | \$2,905 | \$1,077 | 58.9% |
| State and Consumer Services | 510 | 599 | 89 | 17.5% |
| Business, Transportation & Housing | 2,512 | 765 | -1,747 | -69.5% |
| Natural Resources | 1,873 | 2,037 | 164 | 8.8% |
| Environmental Protection | 71 | 65 | -6 | -8.5% |
| Health and Human Services | 24,408 | 22,859 | -1,549 | -6.3% |
| Corrections and Rehabilitation | 8,186 | 8,981 | 795 | 9.7% |
| K-12 Education | 35,869 | 35,133 | -736 | -2.1% |
| Higher Education | 10,570 | 11,794 | 1,224 | 11.6% |
| Labor and Workforce Development | 57 | 58 | 1 | 1.8% |
| General Government: | | | | |
| Non-Agency Departments | 497 | 588 | 91 | 18.3% |
| Tax Relief/Local Government | 470 | 534 | 64 | 13.6% |
| Statewide Expenditures | -386 | -2,914 | -2,528 | 654.9% |
| Total | \$86,465 | \$83,404 | -\$3,061 | -3.5% |

Note: Numbers may not add due to rounding.

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SUMMARY OF SIGNIFICANT CHANGES BY MAJOR PROGRAM AREAS

The May Revision to the 2010-11 Governor's Budget addresses a remaining General Fund budget gap of \$19.1 billion, \$7.7 billion for the 2009-10 fiscal year, \$10.2 billion for the 2010-11 fiscal year, and a modest reserve of \$1.2 billion. Figure MPA-01 illustrates the level of funding, by program area, proposed in the May Revision. Overall General Fund expenditures for 2010-11 are approximately \$0.5 billion above those proposed in the 2010-11 Governor's Budget.

The 2010-11 May Revision proposes General Fund revenues that are \$2.1 billion greater than projections in the 2010-11 Governor's Budget.

Figure MPA-01 compares General Fund revenues and expenditures proposed or estimated in the 2010-11 May Revision to those proposed in the 2010-11 Governor's Budget. The expenditures in each area reflect the true program General Fund costs and do not include significant one-time General Fund offsets from Proposition 1A, federal funds, and funds shifted from redevelopment agencies. Major expenditure changes since the Governor's Budget are highlighted below.

SUMMARY OF SIGNIFICANT CHANGES BY MAJOR PROGRAM AREAS

Figure MPA-01
General Fund Revenues and Expenditures
(Dollars in Millions)

| | As of 2010-11 Governor's Budget | | As of 2010-11 May Revision | | 2009-10 Change | | 2010-11 Change | |
|--|------------------------------------|---------------------|-------------------------------|---------------------|-------------------|-------------------|-------------------|-------------------|
| | Revised 2009-10 | Proposed 2010-11 | Revised 2009-10 | Proposed 2010-11 | Dollar Change | Percent Change | Dollar Change | Percent Change |
| Revenues and Transfers | \$88,083.5 | \$89,322.1 | \$86,521.2 | \$91,451.4 | -\$1,562.3 | -1.8% | \$2,129.3 | 2.4% |
| Expenditures | | | | | | | | |
| Non-Proposition 98 | | | | | | | | |
| Legislative, Judicial, and Executive | \$3,352.9 | \$3,160.4 | \$3,354.6 | \$3,239.6 | \$1.7 | 0.1% | \$79.2 | 2.5% |
| State and Consumer Services | 558.4 | 581.2 | 558.4 | 593.5 | 0.0 | 0.0% | 12.3 | 2.1% |
| Business, Transportation and Housing | 1,934.6 | 538.9 | 1,945.6 | 538.6 | 11.0 | 0.6% | -0.3 | -0.1% |
| Natural Resources | 1,131.8 | 794.4 | 1,146.8 | 1,052.9 | 15.0 | 1.3% | 258.5 | 32.5% |
| Environmental Protection | 68.6 | 60.6 | 70.4 | 57.2 | 1.8 | 2.6% | -3.4 | -5.6% |
| Health and Human Services | 29,897.5 | 27,494.4 | 30,711.6 | 26,698.3 | 814.1 | 2.7% | -796.1 | -2.9% |
| Corrections and Rehabilitation | 9,348.3 | 8,162.1 | 9,426.3 | 8,273.7 | 78.0 | 0.8% | 111.6 | 1.4% |
| K-12 Education | 1,294.3 | 1,292.3 | 1,294.3 | 1,292.1 | 0.0 | 0.0% | -0.2 | 0.0% |
| Higher Education | 6,468.6 | 6,693.1 | 6,478.8 | 6,657.5 | 10.2 | 0.2% | -35.6 | -0.5% |
| Labor & Workforce Development | 61.8 | 58.4 | 61.8 | 58.4 | 0.0 | 0.0% | 0.0 | 0.0% |
| General Government: | | | | | | | | |
| Non-Agency Department | 478.7 | 520.3 | 490.4 | 529.6 | 11.7 | 2.4% | 9.3 | 1.8% |
| Tax Relief/Local Government | 469.6 | 534.2 | 469.5 | 534.2 | -0.1 | 0.0% | 0.0 | 0.0% |
| Statewide Expenditures | -473.7 | 986.1 | -482.9 | 1,032.8 | -9.2 | -1.9% | 46.7 | 4.7% |
| Borrowing Costs | 5,858.6 | 6,279.7 | 5,490.7 | 5,860.3 | -367.9 | -6.3% | -419.4 | -6.7% |
| Infrastructure | 135.3 | 223.5 | 124.9 | 227.3 | -10.4 | -7.7% | 3.8 | 1.7% |
| Enhanced Federal Funds Offsets | -4,575.9 | -8,582.3 | -5,006.4 | -5,617.2 | -430.5 | -9.4% | 2,965.1 | -34.5% |
| Prop 1A and RDA Offsets | -2,821.3 | -350.0 | -3,711.5 | -350.0 | -890.2 | -31.6% | 0.0 | 0.0% |
| Higher Education--Federal Fund Offsets | -610.0 | 0.0 | -610.0 | 0.0 | 0.0 | 0.0% | 0.0 | NA |
| Employee Comp Changes ^{1/} | -1,146.0 | -1,635.9 | -1,184.5 | -2,281.6 | -38.5 | -3.4% | -645.7 | 39.5% |
| Total, Non Proposition 98 | \$51,432.1 | \$46,811.4 | \$50,628.8 | \$48,397.2 | -\$803.3 | -1.6% | \$1,585.8 | 3.4% |
| Proposition 98 | \$34,660.0 | \$36,089.9 | \$35,836.5 | \$35,006.6 | \$1,176.5 | 3.4% | -\$1,083.3 | -3.0% |
| Total, All Expenditures | \$86,092.1 | \$82,901.3 | \$86,465.3 | \$83,403.8 | \$373.2 | 0.4% | \$502.5 | 0.6% |

^{1/} Reflects three-day furlough in 2009-10 and various new proposals in 2010-11.

LEGISLATIVE, JUDICIAL, AND EXECUTIVE

General Fund expenditures are proposed to increase by \$79.2 million, or 2.5 percent.

The significant General Fund policy adjustments to the Governor's Budget are as follows:

- An increase of \$197,000 and 1.8 positions to create a collection cost recovery fee program at the Board of Equalization (BOE). This fee will be imposed upon delinquent accounts receivable to cover the actual costs incurred by BOE to collect the amounts owed. The fee is expected to generate \$4 million in General Fund revenues in 2010-11, increasing to \$13 million in subsequent years.

SUMMARY OF SIGNIFICANT CHANGES BY MAJOR PROGRAM AREAS

The significant adjustments to General Fund budget solutions since the Governor's Budget are as follows:

- An increase of \$91 million to backfill the revenue not achieved because the Automated Speed Enforcement proposal was not adopted in Special Session. These revenues were proposed to offset General Fund support for the trial courts. The May Revision assumes revised revenues of \$206.1 million resulting from this proposal.
- A decrease of \$13 million to reflect savings for the Judicial Branch resulting from the implementation of electronic court reporting.

The significant Non-General Fund workload adjustments to the Governor's Budget are as follows:

- An increase of \$3.3 million Technology Services Revolving Fund for the Office of the Chief Information Officer to purchase equipment for the Sacramento Public Safety Communications Decentralization project.

The significant Non-General Fund policy adjustments to the Governor's Budget are as follows:

- A net increase of \$19 million Trial Court Trust Fund for the Judicial Branch. These revenues will be generated for trial court security through the imposition of an additional \$15 court security fee.
- An increase of \$2.1 million reimbursements to provide start-up funding for the new Governor's Office of Economic Development. This amount will provide six months of funding and is being provided by existing state resources. This Office will be dedicated to helping businesses interact with the state.

BUSINESS, TRANSPORTATION, AND HOUSING

General Fund expenditures are increased in the current year by \$11 million, or 0.6 percent, reflecting an increase in gasoline fuel sales tax revenue.

SUMMARY OF SIGNIFICANT CHANGES BY MAJOR PROGRAM AREAS

The significant adjustments to General Fund budget solutions in 2010-11 are as follows:

- Extend the repayment date for \$230 million in loans from the State Highway Account and other transportation funds from June 2011 to June 2012. The projects planned for 2010 do not require this cash.
- Loan \$650 million from the Highway Users Tax Account to the General Fund, to be repaid by June 2013. This funding is available on a one-time-only basis, as specified in Chapter 12, Statutes of 2010, the recently enacted excise fuel tax legislation. Use of these funds is proposed in subsequent years to help fill the long-term funding gap for the State Highway Operations and Protection Program.
- Loan up to \$250 million from the Motor Vehicle Account to the General Fund. This funding depends in large part on the adoption of reductions in state staffing costs as proposed in the Governor's Budget.
- Transfer \$72.2 million from the Motor Vehicle Account to the General Fund. These are non-Article XIX revenues derived from the sale of documents and miscellaneous services to the public.

Non-General Fund expenditures are proposed to increase by \$104.4 million, or 8 percent in 2010-11 as compared to the Governor's Budget.

The significant Non-General Fund policy adjustments to the Governor's Budget are as follows:

- After adjusting for workload increases reflecting the need to deliver more projects with funds freed up from bid savings, a net decrease of \$42.3 million and 498 position-equivalents for engineering workload in the Department of Transportation Capital Outlay Support Program, including a reduction of 750 positions and 102 overtime position-equivalents, and an increase of 69 contract staff. These funding levels reflect greater efficiencies in project delivery that the Department has achieved over the past several years. The savings of State Highway Account funds have been redirected to fund highway maintenance activities.
- An increase of \$100.2 million for Caltrans to use American Recovery and Reinvestment Act (ARRA) funding it has received for high-speed intercity rail projects. Of this, \$349,000 will be for 4 positions to manage and oversee projects, administer the funding, and meet federal reporting requirements.
- A decrease of \$1.6 million State Highway Account consistent with Executive Order S-14-09 to reduce the number of fleet vehicles by 15 percent.

NATURAL RESOURCES

General Fund expenditures are proposed to increase by \$258.5 million, or 32.5 percent. This increase is primarily attributable to the withdrawal of the Governor's Budget proposal to fund the Department of Parks and Recreation from Tranquillon Ridge oil revenues and the erosion of savings associated with the Emergency Response Initiative.

The significant General Fund policy adjustments to the Governor's Budget are as follows:

- A decrease of \$5 million to multiple Department of Fish and Game habitat conservation and restoration programs, including the protection of marine ecosystems, review of timber harvest plans, and grants for fisheries' restoration projects.

The significant adjustments to General Fund budget solutions since Governor's Budget are as follows:

- An increase of \$140.1 million to reflect the withdrawal of the Governor's Budget proposal to fund state parks from Tranquillon Ridge oil revenues. The recent oil spill in the Gulf of Mexico has magnified the risk of offshore oil drilling. Consequently, the Administration no longer supports the Tranquillon Ridge proposal. The May Revision fully restores funding to state parks in 2010-11.
- An increase of \$124 million to reflect the loss of revenues to fund the Department of Forestry and Fire Protection due to the delay in the enactment of the Emergency Response Initiative. The Governor's Budget assumed enactment of a 4.8-percent statewide surcharge on all residential and commercial property insurance by March 1, 2010 to fund state and local fire protection and emergency response activities. The May Revision reflects \$76 million of General Fund savings associated with a July 1, 2010 enactment of the Emergency Response Initiative.

Non-General Fund expenditures are proposed to increase by \$401.6 million, or 3.7 percent.

The significant Non-General Fund policy adjustments to the Governor's Budget are as follows:

- An increase of \$602.7 million Safe, Clean, and Reliable Drinking Water Supply Fund to begin immediate implementation of the proposed 2010 Water Bond. The May Revision proposes a total of \$1.1 billion from the 2010 Water Bond, including \$602.7 million for the Department of Water Resources and the Department

SUMMARY OF SIGNIFICANT CHANGES BY MAJOR PROGRAM AREAS

of Fish and Game, to ensure that expenditures for high-priority water and ecosystem restoration projects begin immediately, upon approval by the voters in the November general election. Specific projects that will be funded include local and regional drought relief projects, groundwater and conveyance projects, desalination grants, urban and agricultural water management planning grants, Red Bluff Diversion Dam, and Delta sustainability projects consistent with the Bay Delta Conservation Plan. This proposal prioritizes expenditures for projects and grant programs that do not have existing Proposition 84 funds available. For additional information about 2010 Water Bond expenditures allocated to the State Water Resources Control Board and the Department of Public Health, see the Environmental Protection and Health and Human Services sections, respectively.

ENVIRONMENTAL PROTECTION

General Fund expenditures are proposed to decrease by \$3.4 million, or 5.6 percent.

The significant General Fund workload adjustments to the Governor's Budget are as follows:

- An increase of \$1.7 million in 2009-10 and \$2.7 million in 2010-11 to fund the state's defense in Pacific Lumber Company et al. v. State of California. In this litigation, Pacific Lumber is alleging that the state breached the Headwaters Agreement and is seeking damages in excess of \$500 million.

The significant adjustments to General Fund budget solutions since Governor's Budget are as follows:

- A decrease of \$6.1 million to reflect the shift of funding for basin planning from the General Fund to the Waste Discharge Permit Fund (WDPF). Basin plans provide the essential water quality information upon which discharge permits are based. For that reason, they are appropriately funded by the WDPF.

Non-General Fund expenditures are proposed to increase by \$428.7 million, or 26.8 percent.

SUMMARY OF SIGNIFICANT CHANGES BY MAJOR PROGRAM AREAS

The significant Non-General Fund policy adjustments to the Governor's Budget are as follows:

- An increase of \$418.9 million in bond funds to be provided by the proposed 2010 Water Bond. These funds will be allocated by the Water Resources Control Board to fund advanced treatment technology projects and water recycling projects as well as small community wastewater treatment plants.

The significant Non-General Fund workload adjustments to the Governor's Budget are as follows:

- An increase of \$1.3 million and 6.5 positions to fund the Office of Environmental Education. Combined with the resources provided in the 2010-11 Governor's Budget, these resources will provide the appropriate level to fund the ongoing workload of the Office.

HEALTH AND HUMAN SERVICES

General Fund expenditures are proposed to decrease by \$796.1 million, or 2.9 percent in 2010-11 as compared to the Governor's Budget.

The significant General Fund workload adjustments to the Governor's Budget are as follows:

Medi-Cal

- A decrease of \$200 million due to caseload and other base changes.
- An increase of \$1.3 million due to the restoration of optometry services for adults previously eliminated by Chapter 20, Statutes of 2009. The state policy must be rescinded to comply with federal law (42 U.S.C. §1396d(e)).
- An increase of \$108.6 million due to due to the following court rulings and injunctions:
 - Santa Rosa Memorial Hospital v. Maxwell-Jolly— 10-percent rate reduction (\$5 million).
 - CHA v. Maxwell-Jolly—Freeze reimbursement rate at the 2008-09 level for nursing facilities and pediatric subacute providers (\$28.2 million).

SUMMARY OF SIGNIFICANT CHANGES BY MAJOR PROGRAM AREAS

- Cota v. Maxwell-Jolly—Limiting adult day health care services (\$15.9 million).
- California Pharmacists Association v. Maxwell-Jolly—Reimbursement rate for pharmaceutical products (\$41.7 million).
- Independent Living Center v. Shewry—Restored 10-percent Medi-Cal rate reduction retroactive to July 1, 2008 (\$17.8 million).

Healthy Families

- A decrease of \$15.1 million in Healthy Families due to lower caseload for families with incomes up to 200 percent of poverty.

Mental Health

- An increase of \$30.7 million in the Early and Periodic Screening, Diagnosis and Treatment (EPSDT) Program due to a projected \$7.6 million increase in utilization and cost of services, and \$23.1 million in 2007-08 cost settlements and audit adjustments.
- An increase of \$5.7 million due to an adjustment in the State Hospital population.
- A decrease of \$7.2 million in the Sex Offender Commitment Program to reflect anticipated savings in the Sexually Violent Predator Program primarily due to a shift in the type of referrals from the California Department of Corrections and Rehabilitation.

Developmental Centers

- An increase of \$5.2 million to upgrade the existing fire alarm system at Sonoma Developmental Center. This upgrade is necessary to avoid potential licensing deficiencies and decertification.

Various Social Services

- A decrease of approximately \$45 million due to a decreased caseload projection in the In-Home Supportive Services (IHSS), Foster Care Child Welfare Services, Adoption Assistance Program (AAP), and Supplemental Security Income/State Supplementary Payment (SSI/SSP) programs, partially offset by an increased caseload projection in the Food Stamp program and an increased AAP average grant.
- An increase of \$79.1 million from the court decision requiring an increase in the rates paid to Foster Care Group Home providers, as well as the court decision preventing implementation of the 10-percent reduction to Group Home rates included in the 2009-10 Budget Act.

SUMMARY OF SIGNIFICANT CHANGES BY MAJOR PROGRAM AREAS

ADAP

- A decrease of \$32.7 million in the AIDS Drug Assistance Program (ADAP) due to: (1) a court ruling requiring a reduction in the average wholesale price of brand drugs; (2) the elimination of ADAP eligibility for county jail inmates; and, (3) an additional seven months of data used in the estimating process, which improved the precision of the estimate in comparison to the Governor's Budget.
- A decrease of \$10.5 million in ADAP Rebate Fund revenues due to lower projected program expenditures and elimination of ADAP eligibility for county jail inmates.

The significant General Fund policy adjustments to the Governor's Budget are as follows:

Medi-Cal

- An increase of \$400,000 in the Department of Health Care Services to perform rate studies on the maximum allowable ingredient cost on generic drugs (\$250,000), and the reimbursement rate for physician administered drugs (\$150,000).
- An increase of \$3.9 million total funds (\$1.8 million General Fund), fully offset by proposed penalties on noncompliant facilities, and 45.5 positions in the Department of Health Care Services and Department of Public Health to improve the quality of care and accountability of freestanding skilled nursing facilities. Specifically, the May Revision proposes increased oversight of staffing standards and changes to the payment methodology that will increase accountability and quality of care.
- An increase of \$4.1 million, including contract funds, and 53 limited-term positions in the Department of Health Care Services to implement the pending federal Section 1115 Hospital Finance Waiver proposed for reauthorization. This proposal includes funding to continue three existing limited-term positions. Goals are to enroll seniors and persons with disabilities into organized delivery systems of care, integrate care for dual eligible beneficiaries, pilot alternative health care delivery models in California Children's Services, integrate alternative behavioral health services methods into health care delivery, improve efficiencies and enhance and expand the current Health Care Coverage Initiative.
- An increase of \$174 million to provide an estimated 3.7-percent rate increase to managed care plans. The proposed rate increase would take into consideration a pharmacy pricing adjustment, and would be actuarially sound as required by federal law.

SUMMARY OF SIGNIFICANT CHANGES BY MAJOR PROGRAM AREAS

- An increase in the Department of Health Care Services of \$80 million, fully offset by an increase in quality assurance fee revenue, to provide a 3.9-percent rate increase to AB 1629 nursing facilities. Additional fees are generated by: (1) assessing fees on currently exempted multi-level retirement communities (this group currently benefits from related rate increases without contributing to the required state match); (2) decreasing Department of Public Health licensing and certification fees (which count against the overall federal nursing home fee cap); and, (3) using more recent data on which the fee is based (the current revenue base is derived from using two-year old data, and this proposal would instead use more current data). The May Revision also proposes increased oversight of nursing facility staffing standards and changes to the payment methodology to increase accountability and quality of care.

The significant adjustments to General Fund budget solutions since the Governor's Budget are as follows:

Medi-Cal

- The Governor's Budget included \$750 million in savings from a Medi-Cal Cost Containment proposal. The May Revision includes the following specific savings proposals to contain costs in the Medi-Cal program for \$523 million (proposed policies require a state plan amendment or federal waiver and include the federal stimulus impact):
 - (1) Limit services and establish utilization controls for \$90.2 million
 - Eliminate certain over-the-counter drugs (such as acetaminophen or cough and cold medicine) and nutritional supplements (\$13.0 million)
 - Establish a maximum annual benefit dollar cap on hearing aids at \$1,510, durable medical equipment at \$1,604, incontinence supplies at \$1,659, urological supplies at \$6,435, and wound care supplies at \$391 (\$3.8 million)
 - Limit prescriptions (except life-saving drugs) to six per month (\$4.2 million)
 - Limit the number of physician or clinic visits to 10 per year (\$69.2 million). The proposed limits are consistent with the aggregate utilization of these services at the 90th percentile of Medi-Cal enrollees.
 - (2) Increase cost sharing for \$218.8 million
 - \$5 copayments on physician/clinic/dental/and pharmacy (\$3 for the relatively lower cost preferred drugs and \$5 for others) visits (\$118.2 million)

SUMMARY OF SIGNIFICANT CHANGES BY MAJOR PROGRAM AREAS

- \$50 copayment on emergency room visits (\$41.5 million)
- \$100 per day copayment and \$200 maximum for hospital stays (\$59.1 million)
- (3) Other program changes for \$213.7 million
 - Enroll seniors and people with disabilities in managed care (\$137.3 million)
 - Reduce radiologist rates 80 percent of Medicare rates (\$10.5 million)
 - Freeze hospital rates at the current level (\$64.9 million)
 - No longer pay Medicare Part B premiums for beneficiaries whose income exceeds the Medi-Cal eligibility threshold by less than \$500 per month (\$1.0 million)
- An increase of \$1.8 billion to rescind the prior proposal to raise California's base Federal Medical Assistance Percentage from 50 to 57 percent.
- Savings of \$1.6 billion are assumed from additional federal flexibility or support in a number of targeted areas, including federal reimbursement for the cost of incarcerating undocumented immigrant felons, monies owed the state for incorrect Medicare disability determinations, and recalculation of state Medicare Part D clawback payments after taking into consideration aggressive state rebates (which would reduce clawback costs to California if these benefits were still provided through Medi-Cal), as well as possible General Fund relief through the new comprehensive Section 1115 Medi-Cal Financing Waiver.
- A decrease of \$447 million in 2009-10 and \$10 million in 2010-11 due to the recent federal decision to apply ARRA enhanced funding to clawback payments. This is in addition to \$225 million of 2010-11 savings originally included in the Governor's Budget for this issue.
- A decrease of \$300 million due to a revised estimate of the value of extending ARRA enhanced Medicaid funding (all departments). This is largely due to ARRA enhanced funding now applying to Clawback payments, a lower IHSS savings proposal, and other natural changes. This is in addition to the \$1.5 billion of savings originally included in the Governor's Budget.
- An increase of \$76 million in the Department of Health Care Services due to erosions of various Governor's Budget proposals not adopted in the Special Session.

SUMMARY OF SIGNIFICANT CHANGES BY MAJOR PROGRAM AREAS

- A decrease of \$160 million due to a proposed two-quarter extension of the AB 1383 (Chapter 627, Statutes of 2009) hospital fee through 2010-11 to conform to the expected extension of ARRA proposed in the President's Budget. This proposal would provide approximately \$700 million in fees and \$1.1 billion in federal matching funds, used to provide supplemental payments for hospital services and \$80 million per quarter for children's health coverage in Medi-Cal.
- A decrease of \$44 million due to a change in the methodology used to determine funding growth for County Administration. The historical methodology included duplicative adjustments for caseload growth's impact on administration (one for eligible growth based on caseload growth projections in the estimate, and a second one included by counties in their annual budget requests).
- A decrease of \$11.3 million by using Proposition 99 tobacco tax funds for Medi-Cal rather than a recently established asthma education program (\$1.3 million) and Expanded Access to Primary Care clinics (\$10 million), many of which receive extensive financial support from other state programs (such as Medi-Cal), federal funds, or private resources.

Healthy Families

- An increase of \$63.9 million due to the restoration of funding for children in families from 200 to 250 percent of poverty, since federal health care reform prohibits the previously proposed eligibility change. A conforming increase of \$3.9 million results in the California Children's Services Program since some Healthy Families beneficiaries are also eligible for these services.
- A decrease of \$13.3 million by increasing monthly premiums in families with incomes from 200 to 250 percent of poverty by \$18 per child (\$54 maximum per family with 3 or more children). This would increase the current premium of \$24 per child to \$42, and the family maximum from \$72 to \$126. This proposal would take effect September 1, 2010, after appropriate provider and beneficiary notification. Many other states do not cover this population in their SCHIP programs.
- A decrease of \$48.9 million due to a similar increase in the Children's Health and Human Services Special Fund resulting from increased carryover from prior year and higher-than-anticipated revenues from the enactment of Chapter 157, Statutes of 2009 (AB 1422).
- A decrease of \$3.2 million due to increasing copayments for emergency room visits from \$15 to \$50 (\$2.5 million) and adding copayments on hospital inpatient services of \$100 per day with a \$200 maximum (\$0.7 million) consistent with cost containment proposals in Medi-Cal.

SUMMARY OF SIGNIFICANT CHANGES BY MAJOR PROGRAM AREAS

CalWORKs

- A decrease of \$1.1 billion from eliminating the CalWORKs program effective October 1, 2010. This General Fund savings is in addition to the savings resulting from CalWORKs reduction proposals included in the Governor's Budget, and maintained in the May Revision. These reduction proposals include: (1) reducing monthly grant payments by 15.7 percent to reduce California's grant level to the average of the ten states with the highest cost of living, (2) reducing the level at which the state reimburses child care providers, and (3) eliminating the Recent Noncitizen Entrants program, which provides CalWORKs benefits to legal immigrants who have been in the United States for less than five years (see below for changes in savings from those proposals). Additionally, the \$1.1 billion is net of General Fund to be provided to the various departments and programs outside of CalWORKs that currently receive federal Temporary Assistance for Needy Families Block Grant funds.
- An increase of \$211.6 million for the Governor's Budget CalWORKs proposals to reduce grants by 15.7 percent, reduce the level at which the state reimburses CalWORKs child care providers, and eliminate the Recent Noncitizen Entrants program. The loss of savings is due to delayed implementation and a decreased caseload projection for CalWORKs in the May Revision as compared to the Governor's Budget. These proposals are now estimated to save \$488 million General Fund in 2010-11 (\$406.2 million for the grant reduction, \$41.1 million for the child care reimbursement reduction, and \$40.6 million for the elimination of the Recent Noncitizen Entrants program), assuming an October 1, 2010 implementation date for each proposal. Due to the shifting of federal funds, \$114.7 million of these savings would be achieved in the California Student Aid Commission budget and \$42.7 million would be achieved in the Department of Developmental Services budget.

IHSS

- A decrease of \$637.1 million from reducing General Fund expenditures in the IHSS program in lieu of the Governor's Budget reduction proposals to (1) limit the provision of services to consumers with the highest level of need and (2) reduce state participation in the wages of IHSS workers to the state minimum wage of \$8.00 per hour, plus \$0.60 per hour for health benefits. The 2010-11 savings amount is net of the enhanced federal match California is expected to receive under ARRA. Upon the expiration of ARRA, this reduction proposal is expected to yield General Fund savings of \$750 million annually beginning in 2011-12. In consultation with stakeholders,

SUMMARY OF SIGNIFICANT CHANGES BY MAJOR PROGRAM AREAS

the Administration will develop specific IHSS cost-containment measures in time for legislative enactment by July 1 to achieve the proposed General Fund saving amounts.

- An increase of \$779.9 million due to pursuing the IHSS reduction proposal above in lieu of the Governor's Budget proposals to limit the provision of IHSS services to consumers with the highest level of need and to reduce state participation in the wages/benefits of IHSS workers from \$10.10 per hour. The Administration is continuing to challenge litigation preventing the implementation of the reductions included in the 2009 Budget Act to (1) reduce state participation in the wages/benefits of IHSS workers from a combined \$12.10 per hour to \$10.10 per hour and (2) limit services to individuals with greater needs based on an assessment of their ability to function within 11 Activities of Daily Living.

Various Social Services

- A decrease of \$602 million to the Food Stamp and Child Welfare Services programs due to a shift of county mental health realignment funding to county social services programs. This adjustment eliminates the majority of funding for county mental health services and retains only the amount necessary to fund mandated mental health services.
- An increase of \$146 million for the Governor's Budget proposal to redirect county savings. The savings have eroded due to the delayed implementation of the CalWORKs reduction proposals and the reduced IHSS savings target described above. Redirecting a portion of the savings counties will achieve from reductions in IHSS and CalWORKs will result in annual General Fund savings of \$359.5 million beginning in 2010-11.
- An increase of \$550 million to reflect that the proposal to shift state and local California Children and Families Act of 1998 (Proposition 10) revenues for five years to offset General Fund costs in various health and human services programs was not adopted in time to be considered by the voters in the June election.
- An increase of \$86.9 million to reflect erosion of the Governor's Budget proposal to expand federal eligibility for Foster Care. While the Administration is continuing to pursue this proposal and it appears there will be a future opportunity for General Fund savings in this area, it is apparent no savings will occur in 2010-11.
- An increase of \$45 million for the Governor's Budget proposal to reduce SSI/SSP grants for individuals to the federal minimum. The loss of savings is due to delayed

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implementation and the decreased SSI/SSP caseload projection. This proposal is now projected to save \$132.8 million General Fund in 2010-11, assuming an October 1, 2010, implementation date.

- An increase of \$33.6 million for the Governor's Budget proposal to eliminate the Cash Assistance Program for Immigrants (CAPI). The loss of savings is due to delayed implementation and the decreased CAPI caseload projection. This proposal is now projected to save \$73.6 million General Fund in 2010-11, assuming an October 1, 2010, implementation date.
- An increase of \$13.3 million for the Governor's Budget proposal to eliminate the California Food Assistance Program (CFAP). The loss of savings is due to delayed implementation, partially offset by the increased CFAP caseload projection. This proposal is now projected to save \$42.8 million General Fund in 2010-11, assuming an October 1, 2010, implementation date.
- A decrease of \$53.4 million from eliminating all Drug Medi-Cal programs with the exception of the Perinatal and Minor Consent programs. This elimination is assumed to be effective October 1, 2010.

Mental Health

- The May Revision proposes to redirect \$602 million in Mental Health Realignment funds to achieve a commensurate General Fund savings. The remaining \$435 million in Mental Health Realignment funds would be left for counties to continue providing federally-required mental health services.
- An increase of \$452.3 million to restore General Fund in the EPSDT Program and the Mental Health Managed Care Program. Funding for these programs was proposed to be redirected from the Mental Health Services Fund, which would have required voter approval. The loss of savings stems from this proposal not being adopted in time for consideration by the voters in the June election.
- A decrease of \$52 million due to the suspension of the Chapter 1747, Statutes of 1984 (AB 3632) mandates, which provide, among other things, necessary mental health services so that children with disabilities will benefit from their education.

Regional Centers

- A decrease of \$39 million in 2009-10 and prior years, and \$14.5 million in 2010-11 associated with the increased federal reimbursement of services provided by Intermediate Care Facilities for individuals with developmental disabilities (ICF-DDs).

SUMMARY OF SIGNIFICANT CHANGES BY MAJOR PROGRAM AREAS

The significant Non-General Fund workload adjustments to the Governor's Budget are as follows:

- Local Revenue Fund—An increase of \$102.1 million attributable to revenue increases in the State-Local Realignment program.
- An increase of \$17.6 million Federal Trust Fund and 124.75 positions in the Licensing and Certification program to complete federally required certification activities of healthcare facilities. The Legislature has approved implementation of these activities in the current year.
- An increase of \$13.2 million for the reimbursement from DHCS to DDS of increased administration costs and quality assurance fees relating to active treatment and transportation services to regional center beneficiaries residing in ICF-DDs.

The significant Non-General Fund policy adjustments to the Governor's Budget are as follows:

- Proposition 10/Healthy Families/Department of Developmental Services —A one-time increase of \$25.8 million in funding provided by the state and local First 5 California Children and Families Commission to help fund the costs of children up to five years old enrolled in Healthy Families from households with incomes from 200 to 250 percent of poverty. The overall contributions requested from these commissions in 2010-11 are \$81.4 million for children receiving insurance through the Healthy Families Program and \$50 million for children receiving services through the Department of Developmental Services.
- Access to Infants and Mothers Program—The Managed Risk Medical Insurance Board will consider options to increase cost sharing from 1.5 to 2.0 percent (as authorized in law for the continuously appropriated Perinatal Insurance Fund) to meet anticipated caseload demand.

CORRECTIONS AND REHABILITATION

In 2010-11, General Fund expenditures are proposed to increase by \$111.6 million, or 1.4 percent. 2009-10 expenditures are proposed to increase by \$78.0 million, or 0.8 percent.

SUMMARY OF SIGNIFICANT CHANGES BY MAJOR PROGRAM AREAS

The significant General Fund workload adjustments to the Governor's Budget are as follows:

- A decrease of \$9.8 million General Fund and an increase of \$54,000 Inmate Welfare Fund in 2009-10 and a decrease of \$50.4 million General Fund and a decrease of \$930,000 Inmate Welfare Fund in 2010-11 related to changes in the adult inmate and parolee populations. The average daily inmate population is projected to decrease from 168,461 in 2009-10 to 163,681 in 2010-11, a decrease of 4,780 inmates, or 2.8 percent. The decrease in the adult inmate population is primarily due to the implementation of new legislation that provided enhanced credit earning for inmates and reformed the parole system. The average daily parolee population is projected to increase from 118,342 in 2009-10 to 119,200 in 2010-11, an increase of 858 parolees, or 0.7 percent. The increase in the adult parole population is primarily due to a decrease in the number of discharges from parole partially offset by a decrease in the number of discharges from prison onto parole. The population estimates include the extension of funding for out-of-state correctional facilities, which was originally due to expire on July 1, 2011. The Administration proposes to eliminate the current sunset on the authority to contract for out-of-state beds. To manage estimated population declines, the Department will be expected to explore the closure of entire housing units and yards, as well as evaluate the use of contract beds, to achieve maximum savings and efficiency.
- An increase of \$36.8 million in 2009-10 and \$100.9 million General Fund in 2010-11 to reflect revised savings estimates associated with prison reforms included in the 2009 Budget Act.
- A decrease of \$5.8 million General Fund and \$28,000 Reimbursements in 2009-10 and a decrease of \$22.1 million General Fund and \$194,000 Reimbursements in 2010-11 related to changes in the juvenile institution and parolee populations. The average daily ward population is projected to decrease by 107 in 2009-10 and 227 in 2010-11 and the average daily juvenile parole population is projected to increase by 52 in 2009-10 and 129 in 2010-11 primarily due to efforts made by the Division of Juvenile Justice to reduce the number of time adds given for behavioral violations and increase the number of time cuts given for positive behavior and program completions, which are both used to determine a ward's parole consideration date.

SUMMARY OF SIGNIFICANT CHANGES BY MAJOR PROGRAM AREAS

The significant General Fund policy adjustments to the Governor's Budget are as follows:

- To improve the success of felony probationers, and other offenders supervised or programmed at the local level, and reduce jail and prison incarceration, the Administration proposes a system of block grants to provide evidence-based programming and other probation and jail services at the local level. The block grants will be funded from a portion of state savings generated by having non-sex offender, non-serious, non-violent offenders convicted with sentences of three years or less to serve their felony sentence in local jails. The state will provide the counties with approximately \$11,500 per offender, to be allocated at the local level, for programs and services such as probation programming, drug courts, and alternative custody. A decrease of \$243.8 million in 2010-11 is associated with this proposal.
- A decrease of \$4.6 million in 2010-11 to reflect savings resulting from the transfer of the supervisory responsibilities for new Division of Juvenile Justice parolees to county probation. The state will allocate \$15,000 per parolee per year, based on the average length of stay on parole, to county probation departments to provide the necessary resources to supervise the parolees.
- Beginning in 2011-12, an increase of \$502.9 million annually, as a continuous appropriation to local jurisdictions for public safety programs currently funded using a portion of the revenue from vehicle license fees.

The significant adjustments to General Fund budget solutions since Governor's Budget are as follows:

- An increase of \$25.2 million in 2009-10 and \$291.6 million in 2010-11 to remove estimated savings related to the Felony Prison Term Reform proposal.
- An increase of \$35.7 million and \$6.3 million Proposition 98 General Fund in 2010-11 to reduce estimated savings for the Juvenile Offender Population Reform proposal that was included in the 2010-11 Governor's Budget. The portion of the proposal that would have reduced the Division of Juvenile Justice's age of jurisdiction to 21 is no longer being pursued.

Non-General Fund expenditures, including Capital Outlay, are proposed to increase by \$298.9 million, or 9.2 percent.

SUMMARY OF SIGNIFICANT CHANGES BY MAJOR PROGRAM AREAS

The significant Non-General Fund policy adjustments to the Governor's Budget are as follows:

- An increase of \$300 million lease revenue bond authority for local youthful offender rehabilitative facilities. This funding is necessary to provide facilities to enhance the capacity of local communities to implement an effective continuum of response to juvenile crime and delinquency.

HIGHER EDUCATION-NON PROPOSITION 98 PROGRAMS

General Fund expenditures are proposed to increase by \$10.2 million, or 0.2 percent, in 2009-10 and decrease by \$35.6 million, or 0.5 percent, in 2010-11 as compared to the Governor's Budget.

Higher Education includes the University of California (UC), the California State University (CSU), the Community Colleges (CCC), the Student Aid Commission (CSAC) and several other entities. Proposition 98-related expenditures for the CCC are reflected in the separate Proposition 98 section.

The significant General Fund workload adjustments to the Governor's Budget are as follows:

- An increase of \$10.6 million for CSAC to reflect updated estimates for CalGrants and loan assumption programs such as the Assumption Program of Loans for Education (APLE).
- An additional increase of \$11.1 million for CSAC is also recognized for 2009-10 CalGrant and loan assumption program costs. Coupled with the \$38.8 million shortfall recognized in the Governor's Budget, total recognized deficiency costs are approximately \$50 million.

The significant General Fund policy adjustments to the Governor's Budget are as follows:

- An increase of \$676,000 and 8.7 personnel years to CSAC to replace shared services currently performed by EdFund in anticipation of a sale of the state's assets associated with the Federal Family Education Loan program. Combined with current reappropriation authority for this purpose included in the Governor's Budget, a total of \$1.2 million is available, contingent upon a successful sale transaction, to re-establish mail room, printing, information technology, and other shared services.

SUMMARY OF SIGNIFICANT CHANGES BY MAJOR PROGRAM AREAS

- A decrease of \$7.2 million to reflect savings that will occur in CSAC's local assistance financial aid costs due to an increase from the Federal College Access Challenge Grant. The federal estimate of funds available has increased by over \$7.3 million since January and most of the increase is proposed to be utilized in ways that will offset General Fund costs.

The significant adjustments to General Fund budget solutions since Governor's Budget are as follows:

- In keeping with the Governor's commitment to protect higher education funding, an increase of \$45.5 million to CSAC to rescind the Governor's Budget solution proposal to suspend awards for the CalGrant Competitive program.
- Also consistent with the Governor's commitment to protect higher education funding, the contingent federal funds trigger related proposals discussed in the Governor's Budget that would have eliminated \$111.8 million for UC and CSU enrollment growth and reduced CalGrants by \$79 million by freezing income eligibility and award levels will no longer be considered as budget solution options under any circumstances.
- A decrease of \$75 million to CSAC associated with a May Revision proposal to shift a portion of CalGrant costs on a one-time basis to the Student Loan Operating Fund.
- A net decrease of \$10.3 million to CSAC associated with CalWORKs-related solutions in the Department of Social Services budget. In the Governor's Budget, \$18.3 million of excess Temporary Assistance for Needy Families (TANF) funds were proposed to offset the General Fund costs of CalGrants as a result of the Special Session proposal to reduce cash assistance grants by 15.7 percent for CalWORKs recipients. Since that time, \$4.6 million of the General Fund savings have eroded due to delays in adoption of the proposals. Workload adjustments in the CalWORKs budget have increased the amount available for offset in this solution by \$100.9 million. Finally, the May Revision proposal to eliminate the CalWORKs program, effective the second quarter of the 2010-11 year, will reduce the TANF offset by \$86 million. Thus, the total offsetting TANF reimbursements proposed in the CalGrant local assistance budget in 2010-11 will increase from \$18.3 million to \$28.6 million.

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The significant Non-General Fund workload adjustments to the Governor's Budget are as follows:

- An increase of \$727,000 in 2010-11 and \$249,000 in 2009-10 from Federal Funds for Community Colleges (CCC) associated with a new federal grant for the Solar Training Collaborative to develop standardized curriculum for industry certificated job-training programs in the photovoltaic and solar heating and cooling industry. Of the amounts, \$880,000 is for local assistance and the remainder will fund the Chancellor's administrative support costs.
- An increase of \$266,000 reimbursements to CCC for the Energy Sustainability program funded by a grant from the California Energy Commission that will be used to develop campus strategies for energy efficiency, renewable energy opportunities, waste reduction and recycling, transportation alternatives, and water pollution prevention.
- An increase of \$4.4 million reimbursements to CCC in 2009-10 from Workforce Investment Act (WIA) funding from the Employment Development Department to further incentives for sustaining recent enrollment increases in nursing courses and increasing enrollments in allied health-related training programs. Of this amount, \$3 million is the initial increment of a five-year funding commitment for the second phase of WIA funding for the Nursing Initiative. It is noted that the second phase of \$3 million for 2010-11 was proposed in an April Finance Letter.
- An increase of almost \$2.7 million reimbursements to UC from WIA funding to continue that segment's participation in the second phase of WIA funding for the Nursing Initiative. This is the second increment of the five-year commitment from this source designed to produce over 340 Baccalaureate, Masters, and Doctoral nursing graduates through 2013-14.
- An increase of \$4.4 million in Lottery funding is anticipated for higher education entities, including \$3 million for CCC, \$855,000 for CSU, and \$525,000 for UC. Additionally, increases of almost \$3.3 million are recognized in 2009-10 including \$2.2 million for CCC, \$639,000 for CSU and \$391,000 for UC.
- A decrease of \$431,000 to UC for the Tobacco Research program due to revised estimates of available funding.

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The significant Non-General Fund policy adjustments to the Governor's Budget are as follows:

- A decrease of \$6 million TANF reimbursements to CCC for the Special Services for CalWORKs local assistance program from the Department of Social Services associated with the new May Revision proposal to eliminate the CalWORKs program effective with the second quarter of the 2010-11 year. \$2 million remains budgeted.

K-12 EDUCATION-NON PROPOSITION 98 PROGRAMS

General Fund expenditures are proposed to decrease by \$120,000 in 2010-11 as compared to the Governor's Budget.

K-12 entities include the California Department of Education (CDE), the Commission on Teacher Credentialing (CTC), and several other smaller agencies.

The significant General Fund workload adjustments to the Governor's Budget are as follows:

- A decrease of \$120,000 to CDE to reflect the revised estimate of meals to be served by private entities to income-eligible children through the Child Nutrition Program.

The significant Non-General Fund workload adjustments to the Governor's Budget are as follows:

- A decrease of \$31.3 million Federal Funds to CDE to reflect the revised estimate of meals to be served through the Child Nutrition Program.

The significant Non-General Fund policy adjustments to the Governor's Budget are as follows:

- An increase of \$1.1 million Federal Funds to CDE for additional implementation costs associated with the California Longitudinal Pupil Achievement Data System (CALPADS). This brings total funding in the proposed 2010-11 budget to \$5.9 million. The increase will be used to support additional vendor contract costs, hardware and software acquisition, independent project oversight consultant costs, as well as independent verification and validation services.
- An increase of \$3.9 million Federal Funds and 2.8 personnel-years to CDE for the California Teacher Information Data System (CALTIDES) to continue development

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of the longitudinal teacher data base that is intended to be leveraged from the CALPADS. As such, performance difficulties with the CalPADS system must be resolved by the CDE before these funds will be available for expenditure.

- An increase of \$84,000 Teacher Credentialing Fund and 0.9 personnel-years to the CTC for CALTIDES to support their responsibilities in the development of the longitudinal teacher data base. Similarly, these funds are restricted until problems with CALPADS are resolved.
- Contingency Proposal for Longitudinal Data Systems—The Administration remains concerned with the progress of the CALPADS and CALTIDES. Both systems are critical to achieving federal compliance, to improve data driven accountability, and to implement necessary reforms for K-12 education. While the May Revision includes \$5 million to continue efforts on these systems for a total proposed 2010-11 budget of \$9.8 million, the state's existing investment in longitudinal data systems since 1997 totals about \$155 million from state and federal sources, including almost \$34 million specifically for CALPADS and \$7.1 million for CALTIDES. The CALPADS system was supposed to be operational in August 2009, yet due to poor vendor performance and inadequate monitoring by CDE, the system has not been implemented. It is therefore incumbent on the CDE to ensure at a minimum that by the end of this calendar year, CALPADS is able to receive and reliably transfer data. In the event this goal is not achieved, the Administration will seek to contract these projects out to a consortium of local school districts that, in collaboration with the segments of higher education, will leverage their statewide data systems to meet the requirements specified for federal Race to the Top (RTTT) funding.
- An increase of \$118,000 in reimbursements to CDE from the First 5 Commission for the new State Advisory Council on Early Childhood Education and Care (ELAC) pursuant to a Governor's Executive Order. Funding is sufficient for one additional position to augment the current resources available for the Early Learning Quality Improvement System Advisory Committee (ELQIS) created by SB 1629 (Chapter 207, Statutes of 2008). It is anticipated that these resources will enable the state to develop a successful proposal for \$10.6 million in federal funds authorized for the Council in the recent ARRA.
- A decrease of \$5.2 million in reimbursements from the Department of Social Services to CDE for Adult Education and ROCPs to train CalWORKs recipients associated with the new May Revision solution to eliminate the CalWORKs program effective with the second quarter of the 2010-11 year. \$2.5 million remains budgeted for this purpose.

PROPOSITION 98

The May Revision maintains the Governor's commitment to avoid additional cuts to K-14 education despite the need to close a deficit of \$ 19.1 billion. The Governor's January Budget proposed maintaining state funding for schools at approximately the same level for 2010-11 as schools received in 2009-10.

For 2010-11, the Proposition 98 funding level is \$48.4 billion, of which \$35 billion is General Fund. This level reflects elimination of state funding for child care only and does not reduce funding for K-14 education. As a result of the elimination of the child care program, the Proposition 98 guarantee is rebenchched downward by \$1.4 billion. Additionally, the Administration proposes a fund shift of \$386 million from on-going Proposition 98 funding to one-time reappropriations. Aside from rebenching the Proposition 98 guarantee to reflect the elimination of child care, K-14 funding in the May Revision remains largely unchanged from the Governor's January Budget level.

For 2009-10, the Proposition 98 funding level is \$49.9 billion, of which \$35.8 billion is General Fund. This Proposition 98 funding level is \$52.4 million higher than the level included in the Governor's January Budget. The significant decline in tax receipts in the second quarter of 2010 results in lowering the Proposition 98 guarantee in 2009-10. The Administration does not propose reductions in the Current Year to the minimum guarantee level, therefore the funding level proposed by the Governor in 2009-10 is \$502 million higher than the level required by Proposition 98. The Administration proposes to apply this overappropriation toward an early payment of the \$11.2 billion statutory obligation to schools agreed to in Chapter 3, Statutes of 2009, Fourth Extraordinary Session.

For 2008-09, the Proposition 98 funding level is \$49.1 billion, of which \$34 .1 billion is General Fund. This Proposition 98 funding level is \$76.4 million higher than the level included in the Governor's January Budget. Because this funding level is only \$6.4 million lower than the level certified in legislation for 2008-09, the Administration no longer proposes to amend the certification level. Thus, the Proposition 98 guarantee will remain overappropriated by \$2 billion in 2008-09. The May Revision continues to use a portion of this overappropriation toward satisfying the outstanding maintenance factor, which was \$1.3 billion as of 2007-08. The Administration maintains its support of Chapter 3, Statutes of 2009, Fourth Extraordinary Session, which required that the state makes \$11.2 billion in payments to K-14 education over time to restore the guarantee to its prior level. However, due to the continued strain on General Fund revenues as a result of the economic crisis,

SUMMARY OF SIGNIFICANT CHANGES BY MAJOR PROGRAM AREAS

the Administration continues to propose a temporary delay in the repayment schedule from 2010-11 to 2011-12. In 2008-09 the Proposition 98 calculation remains in a Test 1, thus the supplemental payments agreed to in statute as part of the 2009 Budget agreement are in lieu of a maintenance factor.

Flexibility

After discussions with district and county superintendents, the Administration withdraws its January proposal to specifically dictate the level of reductions from district and county office administration. Instead, the Administration proposes providing local district administrators and school boards maximum flexibility to manage the level of funding provided in the May Revision. The Governor continues to support providing more local autonomy in managing school funding and efforts to retain high-quality teachers and principals, especially during these difficult budget times.

While we have described our preferred approach in dealing with revisions to Proposition 98 spending, the Administration is open to working with the Legislature to consider other possible alternatives that achieve the same level of savings.

General Fund expenditures are proposed to increase by \$1.4 billion or 4.1 percent, in 2009-10 and decrease by \$829 million, or 2.3 percent in 2010-11 as compared to the Governor's Budget.

2009-10

The significant General Fund workload adjustments to the Governor's Budget for K-12 programs are as follows:

- Property Tax—An increase of \$1.133 billion for school district and county office of education revenue limits as a result of a decrease in offsetting property tax revenue and the shift of \$878 million in Redevelopment Agency property tax pass-throughs to other local governments.
- Unemployment Insurance and PERS Offsets—An increase of \$31.8 million for school district and county office of education revenue limits as a result of increased unemployment insurance and PERS costs.
- State-Operated Programs—A decrease of \$1.1 million to reflect lower education program costs for the Department of Corrections and Rehabilitation's Juvenile Justice Division.

SUMMARY OF SIGNIFICANT CHANGES BY MAJOR PROGRAM AREAS

The significant General Fund workload adjustments to the Governor's Budget for Child Care programs are as follows:

- CalWORKs Caseload—A decrease of \$3 million to recognize estimated savings based on revised caseload estimates for CalWORKs Stage 2 and 3, for a total of \$15.4 million that will be reappropriated for other K-12 purposes.

The significant General Fund workload adjustments to the Governor's Budget for Community Colleges are as follows:

- Property Tax—An increase of \$8.4 million in local revenue for apportionments that will help mitigate base reductions included in the 2009 Budget Act. Combined with the January estimate, property taxes are \$14 million higher compared to the Budget Act.
- Oil and Mineral Revenue—An increase of \$3.1 million in local revenue which will decrease apportionment resources by this amount.

The significant General Fund policy adjustments to the Governor's Budget for K-12 programs are as follows:

- Apportionments for Schools in Cashflow Deficit—A shift of \$15.7 million from General Fund to one-time reappropriations to fund the Economic Impact Aid Program. These General Fund savings will be redirected to allow CDE to make advance apportionments to schools that will be in a cashflow deficit in June as a result of the payment deferrals and are unable to make essential payments.
- New School Categorical Funding—A decrease of \$9 million to the \$20 million one-time reappropriation included in the Governor's Budget for newly established schools to align this funding with projected costs.

2010-11

The significant General Fund workload adjustments to the Governor's Budget for K-12 programs are as follows:

- Property Tax—An increase of \$447.5 million for school district and county office of education revenue limits to cover a reduction in the estimate of property tax revenue.

SUMMARY OF SIGNIFICANT CHANGES BY MAJOR PROGRAM AREAS

- Cost-of-Living Adjustment—A decrease of \$4.1 million for school district and county office of education revenue limits as a result of a decrease in cost-of-living adjustment index.
- Unemployment Insurance and CalPERS Offsets—An increase of \$71.7 million for school district and county office of education revenue limits as a result of increased unemployment insurance and CalPERS costs.
- Program Cost Adjustments—A decrease of \$78.5 million for special education, Economic Impact Aid, Child Nutrition and the Charter School Categorical Block Grant to reflect anticipated savings in these programs.
- State-Operated Programs—An increase of \$3.3 million to reflect educational program costs for the Department of Corrections and Rehabilitation’s Juvenile Justice Division.

The significant General Fund workload adjustments to the Governor’s Budget for Child Care programs are as follows:

- CalWORKs Caseload—A decrease of \$31.5 million based on revised caseload estimates for CalWORKs Stages 2 and 3.
- Federal Fund Change—A decrease of \$3.9 million General Fund to recognize an identical increase in ongoing and one-time federal Child Care and Development Fund (CCDF) resources.

The significant General Fund workload adjustments to the Governor’s Budget for Community Colleges are as follows:

- Property Tax—An increase of \$6.4 million General Fund for apportionments to offset an estimated reduction in local Property tax revenues for the budget year.
- Oil and Mineral Revenue—An increase of \$3.1 million General Fund in apportionments to offset an estimated reduction in local Oil and Mineral revenues.

The significant General Fund policy adjustments to the Governor’s Budget for K-12 programs are as follows:

- School District Administration and Contracting Out—As indicated above, the May Revision does not propose to specifically dictate the level of reductions from district administration. Likewise, the Administration no longer proposes to

SUMMARY OF SIGNIFICANT CHANGES BY MAJOR PROGRAM AREAS

require a specific level of savings to be achieved related to contracting out. Instead, the Administration proposes providing local district administrators and school boards maximum flexibility to manage the level of funding provided in the May Revision.

- County Offices of Education—An increase of \$16.8 million to restore a portion of the \$45 million reduction to county office of education revenue limits included in the Governor’s Budget. This makes the county office of education reduction proportional to the reduction proposed for school districts. Furthermore, the Administration proposes to provide county offices of education maximum flexibility to absorb this reduction and no longer proposes to require county offices consolidate services and functions.
- Fund Shift for Economic Impact Aid—A funding shift of \$321.7 million to one-time reappropriations for the Economic Impact Aid Program to achieve Proposition 98 General Fund savings.
- Testing and Accountability—The May Revision proposes to restore the writing component of the fourth grade English/language arts California Standards Test and California Modified Assessment and to commence the development of a longitudinal academic growth model without the need to increase the Standardized Testing and Reporting (STAR) program appropriation for these tasks. As a result of negotiations with the Administration, the STAR contractor has agreed to absorb all costs associated with the development of the growth measure as well as the costs for the administration of the fourth grade writing component for the 2010-11, 2011-12, and 2012-13 administrations. The writing component was eliminated in 2009-10 in an effort to save costs. The May Revision also proposes to set aside \$3.7 million for local educational agencies partnering with the state on reforms to improve student achievement to develop item banks for local student assessments such as summative and formative assessments to help California implement longitudinal academic growth models.
- Alternative Schools Accountability Model—A reduction of \$775,000 to eliminate the Alternative Schools Accountability Model (ASAM) program. This proposal was included in the Spring Finance Letter sent in April.

The significant General Fund policy adjustments to the Governor’s Budget for Child Care are as follows:

- Overpayment Collections—The May Revision proposes trailer bill language to implement more aggressive actions to minimize waste and seek collection of

SUMMARY OF SIGNIFICANT CHANGES BY MAJOR PROGRAM AREAS

overpayments in child care programs. Currently, the CDE does not require Alternative Payment (AP) agencies to seek repayment when overpayments are discovered, regardless of the reason, be it provider or recipient error, either intentional or inadvertent in nature. The proposed statutory changes will provide contractual expectations for APs to prevent and correct errors and collect overpayments from families that benefit from the errors. CDE would be authorized to impose appropriate consequences on APs that do not reduce the incidence of overpayments sufficiently and to providers and families involved in providing inaccurate information relative to eligibility, hours of care, or miscalculation of fees and reimbursement rates. All programs administered by CDE and the Department of Social Services, including state direct-funded centers and family care homes, are included in this proposal.

- Revised Cost Containment Proposal—The May Revision proposes a significant policy change to the \$200 million cost containment reductions proposed in the Governor’s Budget. The regional market rate limit (RMR) reductions, including deeper reductions for unlicensed care, are retained as proposed. However, the proposed \$123 million unallocated reduction to Stage 3 CalWORKs is partially mitigated by reducing the statutory income eligibility limit from 75 percent of the median family income to 60 percent for all subsidized child care programs except the State Preschool program.
- Elimination of CalWORKs—Consistent with the new May Revision solution proposal in the Department of Social Services budget to eliminate the CalWORKs program, remaining Stage 2 and 3 funding and caseload are shifted to the capped Alternative Payment Program based on income eligibility and to the extent of funds availability.
- Eliminate Funding for Child Care, Except Preschool—To close the budget gap, the May Revision also proposes to eliminate the remainder of state funding for need-based, subsidized child care totaling almost \$1.2 billion. State Preschool is exempted because it is a part-day education program that supports school readiness that is more consistent with preserving educational programs. This proposal would eliminate subsidized slots for approximately 142,000 children. However, approximately \$594 million in federal funds would remain available for approximately 78,000 slots for the neediest of families under a revised program that would be subject to the reimbursement rate and eligibility policy reforms described above. The Administration also proposes to work with CDE to obtain information from other state and local agencies in order to identify appropriate funding that may be utilized to meet the matching and MOE requirements of the CCDF.

SUMMARY OF SIGNIFICANT CHANGES BY MAJOR PROGRAM AREAS

The significant Proposition 98 Reversion Account expenditure adjustments are as follows:

- California School Information Services—A decrease of \$2 million for the California School Information Services program to maintain individual student identifiers. This funding is replaced with \$3.3 million in one-time reappropriations for the support of the program.

GENERAL GOVERNMENT: NON-AGENCY DEPARTMENTS

General Fund expenditures are proposed to increase by \$9.3 million, or 1.8 percent in 2010-11.

The significant General Fund policy adjustments to the Governor’s Budget are as follows:

- An increase of \$8.4 million to continue implementing the Governor’s Operation Welcome Home initiative. The initiative will connect returning California veterans with the multi-agency services necessary to assist veterans in making a successful transition to civilian life. The program is already underway as the Employment Development Department has hired and placed over 300 veterans for outreach efforts. This new funding will augment county veteran service office efforts to aid veterans in seeking services, receiving services and maximizing federal benefits available to them.
- The inclusion of budget authority to provide up to \$1.3 million General Fund to ensure continuance of the Pathway Home Program, which is a program at the Yountville Home to provide rehabilitative services to veterans returning from Iraq and Afghanistan.

Non-General Fund expenditures are proposed to increase by \$20.9 million, or 0.5 percent.

The significant Non-General Fund policy adjustments to the Governor’s Budget are as follows:

- A one-time increase of \$768,000 from the Veteran Service Officer Fund for a case management system that will help facilitate workload related to Operation Welcome Home. The new system will provide county veteran service offices with a modern and uniform tool for maximizing outreach efforts and monitoring outcomes.

BORROWING COSTS

General Fund expenditures for borrowing in 2010-11 will decrease by \$419.4 million, or 6.7 percent.

General Fund expenditures for debt service in 2010-11 will decrease by \$197.5 million, or 3.4 percent, to reflect lower-than-anticipated General Obligation (GO) debt service costs for bonds issued to pay for infrastructure projects and other bond-funded programs in the spring of 2010 and reduced interest rate assumptions for future GO bond sales.

In addition, General Fund expenditures for GO bond debt service in 2009-10 will decrease by a net of \$94.9 million, or 2.0 percent, to reflect increased transportation debt service offsets (\$163.9 million) included in the Special Session, the elimination of Proposition 1A of 2004 education debt service reimbursements (\$120.3 million), larger-than-anticipated premiums from the spring 2010 bond sale, and other minor savings.

For cash management, internal and external cash flow borrowing costs have decreased by \$135.0 million, or 39.7 percent, in 2009-10 and \$190 million, or 35.2 percent, in 2010-11 due to lower-than-projected interest costs.

For budgetary loans, the interest costs have decreased by \$5.0 million, or 38.5 percent, in 2009-10 and \$32.0 million, or 55.2 percent, in 2010-11 due to reduced budgetary loan repayments.

INFRASTRUCTURE

General Fund expenditures are proposed to increase by \$3.8 million, or 1.7 percent. This increase is mainly attributable to carryover funding from the current year to the budget year. Only \$26.9 million of the \$227.3 million budgeted in 2010-11 is new funding not carried over from earlier years.

ENHANCED FEDERAL FUNDS OFFSETS

Federal fund offsets through ARRA and the receipt of new federal funds are estimated to change as stated below. These offsets result in a commensurate reduction in General Fund spending. To demonstrate an analogous comparison between 2009-10 and 2010-11 for the affected agency spending, these significant offsets are removed from the agency spending amounts and displayed separately.

SUMMARY OF SIGNIFICANT CHANGES BY MAJOR PROGRAM AREAS

- A decrease of \$447 million in the current year and an increase of \$1.7 billion in the budget year due to revised projections of federal funds solutions in Health and Human Services programs and the State Criminal Alien Assistance Program.
- A decrease of \$1 billion in federal fund reimbursements to the General Fund for the unfunded federal share-of-cost for special education services. At this point in time, it appears unlikely that the federal government will reimburse the state for these costs in the near future.

The significant offset changes since the Governor's Budget for the Health and Human Services programs are further discussed in the Health and Human Services section.

EMPLOYEE COMPENSATION CHANGES

General Fund expenditures are proposed to decrease by \$645.7 million in 2010-11 as compared to the Governor's Budget.

The significant adjustments to General Fund budget solutions since Governor's Budget are as follows:

- A decrease of \$445.7 million associated with implementation of a one-day-per-month personal leave program for all state civil service employees from July 1, 2010 until June 30, 2011.
- A decrease of \$200 million associated with anticipated savings from partial reimbursement for reinsurance costs for early retirees included in the Federal Health Care Reform Act, passed in March of 2010.

Non-General Fund expenditures are proposed to decrease by \$149.8 million.

The significant Non-General Fund policy adjustments to the Governor's Budget are as follows:

- A decrease of \$349.8 million associated with implementation of a one-day-per-month personal leave program for all state civil service employees from July 1, 2010 until June 30, 2011.
- An increase of \$200 million reflecting the General Fund shift due to partial reimbursement for reinsurance costs for early retirees included in the Federal Health Care Reform Act, passed in March of 2010.

2010-11 STATE APPROPRIATIONS LIMIT CALCULATION

Pursuant to Article XIII B of the California Constitution, the 2010-11 State Appropriations Limit (SAL) is estimated to be \$79.118 billion. The revised limit is the result of applying the growth factor of -1.77 percent. The revised 2010-11 limit is \$68 million below the \$79.186 billion estimated in January. This decrease is due to changes in the following factors and shifts in financial responsibility.

- Per Capita Personal Income
 - January Percentage Growth: -2.77%
 - May Revision Percentage Growth: -2.54%
- State Civilian Population
 - January Percentage Growth: 0.94%
 - May Revision Percentage Growth: 1.03%
- K-14 Average Daily Attendance
 - January Percentage Growth: 0.70%
 - May Revision Percentage Growth: 0.45%

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 March, 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 2009-10 does not change since it was statutorily established by Control Section 12.00 of the Amended 2009 Budget Act.

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ECONOMIC OUTLOOK

The national and California economies improved between the Governor's Budget and the May Revision. Output of the national economy grew for the third consecutive quarter in the first quarter of 2010, and California payroll employment grew in four of the six months ending in March. These were perhaps the most encouraging signs coming from the two economies in recent months but there were others. In fact, the good signs are coming at an increasing rate, especially in the national economy.

Because the recession was so deep, the recent monthly gains in payroll employment pale in comparison to the loss of payroll jobs since the beginning of the recession. The same is true for national economic output. The gains in the last three quarters were small compared to the loss in economic output since the recession began. And that is the case for almost every economic indicator that is showing gains.

In addition, some sectors of both economies have yet to show any positive signs—construction being a prime example. Unless the pace of the recovery picks up substantially, the recovery will be long.

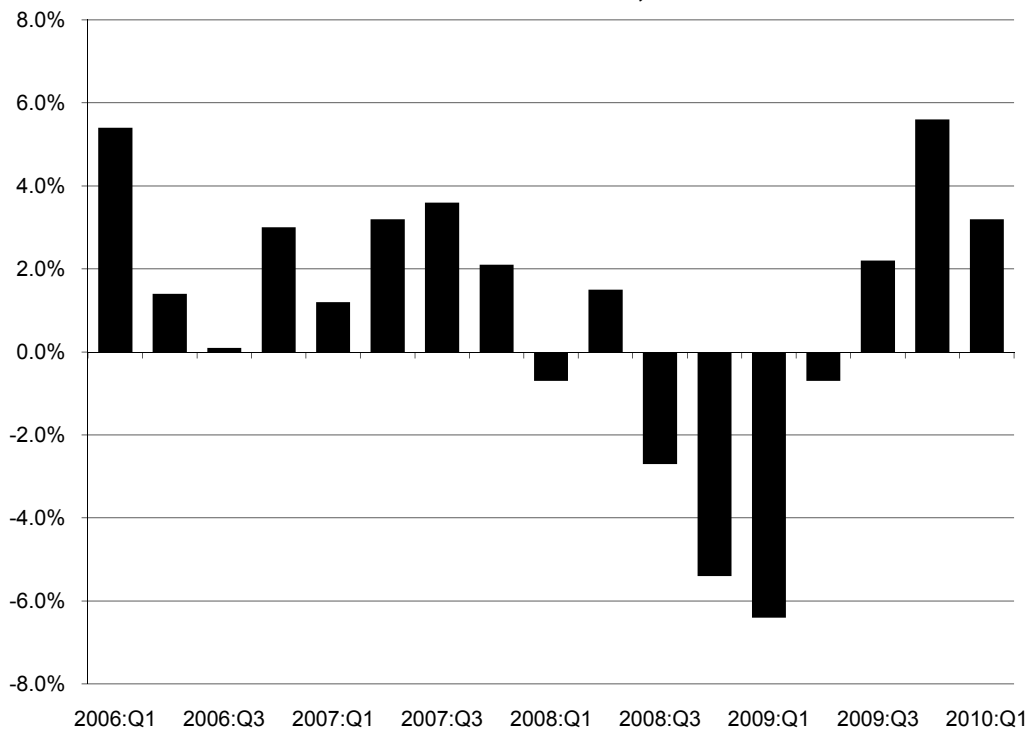
Based on better-than-expected indicators that have been released since the Governor's Budget forecast, most notably GDP growth in the final quarter of 2009 that was much stronger than anticipated, the outlook for the national and state economies is more positive, but remains cautious. Historically, recessions sparked by financial crises and significant declines in asset prices, such as this one, are followed by long, gradual recoveries. The impact of the Federal Reserve actions taken and the federal fiscal

stimulus package enacted in early 2009 that moderated the severity and length of the recession will be weakening. Consumer spending is likely to be hamstrung by modest income and job growth, a reduction in wealth, and limited credit availability.

THE NATION

The recession likely ended in the middle of 2009 after hitting its depths during the first half of the year. A wide range of stimulus measures turned the national economy around quickly. Real GDP fell by 6.4 percent on an annualized basis in the first quarter of 2009; in the fourth quarter of 2009, it grew by 5.6 percent. The advance estimate for the first quarter of 2010 was a more moderate and sustainable 3.2- percent annualized growth (Figure ECO-01).

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



Source: U.S. Bureau of Economic Analysis

The national economy has shown signs of improvement on many fronts. After plunging from July 2008 to March 2009, factory orders grew by 12 percent between March 2009 and February 2010.

Vehicle sales have stabilized and are beginning a modest but irregular rebound. During the six months ending with April 2010, motor vehicle sales averaged over 11 million units—somewhat better than their 2009 average, but still well below their 2008 level of 13 million units.

Exports and imports grew strongly in the second half of 2009 and the first quarter of 2010, indicating that the disruptions from the global economic recession and credit market turmoil have eased.

Retail sales surged in the first quarter of 2010, posting their strongest growth since the end of 2007. Consumers spent strongly at the beginning of the New Year despite high unemployment, sluggish income growth, and relatively tight credit.

Despite these positive developments, the recovery remains fragile. As would be expected, construction is the most significant drag on the recovery at this point. Residential construction dropped during the first quarter of 2010, which by itself subtracted 0.29 percentage point from the rate of GDP growth. Nonresidential construction remains on a declining trend because of rising vacancy rates, falling rents, and tight credit conditions, which reduced GDP growth by 0.44 percentage point in the fourth quarter of 2009.

On the bright side, there are signs that home prices have begun to stabilize and have improved in many regions. Existing home sales peaked during the summer of 2005 and fell steadily through November 2008. A robust recovery in sales took place between November 2008 and November 2009, as sales were boosted by the first-time homebuyers' tax credit. The credit's expiration, coupled with severe winter weather, caused home sales to fall again. Following the credit's extension, there was a moderate rebound in sales in March 2010. Nevertheless, home prices appear to have ended their 3-1/2 year slide, although any recovery in prices may be weak given the large number of distressed sales. The inventory of homes available for sale has fallen over the past year but there is likely a substantial "shadow" inventory that could come onto the market if home sales or prices were to rebound sharply.

Even though 2010 began with a return to sustained job growth, employment remains the biggest source of concern as it will take a long time to regain the nearly eight million

ECONOMIC OUTLOOK

jobs lost during the recession. After falling steadily between December 2007 and October 2009, industry employment increased in five of the six months ending in April 2010. Monthly job losses averaged 615,000 during the first six months of 2009 and only 175,000 during the last half of the year. Then, in concert with other improving indicators, over 570,000 jobs were gained during the first four months of 2010, or 143,000 per month on average. However, the unemployment rate is still elevated — 9.9 percent in April. Ongoing robust job growth will be needed to keep the recovery moving ahead.

The level of employment is still very low and it could take a long time to recover all of the lost jobs. Hiring usually lags behind output during the early stages of a recovery because firms tend to increase output first by boosting productivity and by raising the number of hours worked by existing employees. Hiring new employees tends to occur later. Moreover, the unemployment rate often remains high after employment begins to recover, because the perception of better labor market conditions encourages workers who had given up looking for work during the recession to reenter the labor force. According to the current outlook, the unemployment rate will improve gradually and may not reach “full employment” for several years.

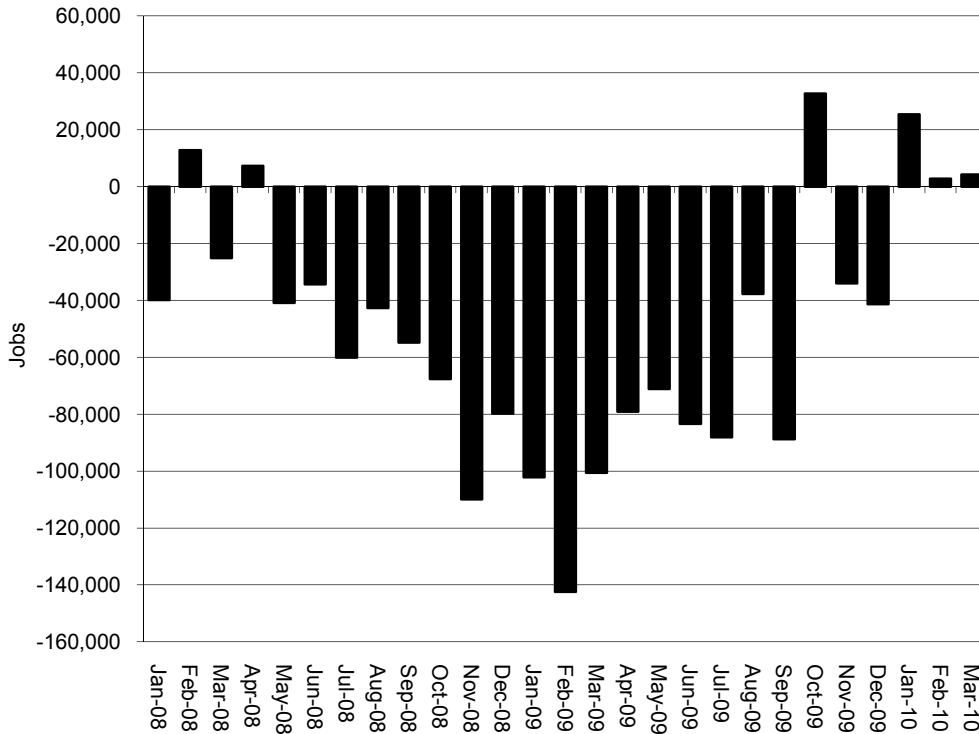
CALIFORNIA

The state followed the nation’s path through the recession. California labor markets deteriorated dramatically during the latter half of 2008 and the first six months of 2009, suffering their worst losses on record (Figure ECO-02). Between June 2008 and June 2009, the state dropped nearly a million nonfarm jobs. These losses moderated as the year progressed and switched to very modest gains during each of the first three months of 2010. A return to positive job growth is a good sign, but as with the nation, it will take considerable time to recoup the losses.

California’s unemployment rate partially bucked the national trend by climbing through the early months of 2010. The national rate leveled off at 10 percent in November and December 2009 and slipped slightly during the first quarter of 2010. The state’s rate, in contrast, was still trending up through March 2010, reaching 12.6 percent. Since the recession began in December 2007, the ranks of California’s unemployed had grown by 1.3 million.

Given the large toll of lost jobs, it’s not surprising that California personal income declined in 2009 on a year-over-year basis for the first time since 1938. The decline began at the

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



Source: Employment Development Department, Labor Market Information Division

end of 2008 and continued through the end of 2009. The rate of decline eased up during the last quarter of 2009 when personal income fell 1.6 percent from a year earlier.

As with other economic measures, taxable sales slid dramatically in 2008, bottomed out early in 2009 and made meager gains during the rest of the year. Taxable sales in 2009 were down 15 percent from 2008 and despite their upward trend, the level of sales during the last half of 2009 were still down 20 percent from the peak reached in the second half of 2006.

Car sales in California reflect this same pattern. Sales ratcheted down harshly in 2008 as the housing crisis unfolded. New fee-paid automobile registrations at the end of 2008 were down over 40 percent from a year earlier. They continued slowing until bottoming out in the middle of 2009. A tentative recovery followed, spurred initially by the federal "Cash for Clunkers" incentive program. Registrations in December 2009 and January 2010 were up 16.7 percent on average from a year earlier. However, the level of

ECONOMIC OUTLOOK

registrations during these two months was still off more than 38 percent from the same months of 2006/2007.

Made-in-California exports plummeted in the second half of 2008 before bottoming out in the first quarter of 2009. For the year as a whole, California exports fell 17 percent in 2009. High-tech exports fell by nearly 16 percent. With global economic conditions easing up, California exports increased 19.4 percent year-over-year in the first quarter of 2010.

The worst of the housing slump that is at the heart of California's current economic troubles may be over. Home building permitting—which suffered a long, steady three-year decline starting in 2006—bottomed out early in 2009 and was actually up on a year-over-year basis at the start of 2010. However, the number of permits issued was still off 78 percent from the peak output reached in mid-2005. Existing home markets are also faring better as home prices firmed up, inventories shrank, and the pace of sales stabilized at a sustainable rate. It remains to be seen however, how much of this recovery is owed to the federal tax credit and what impact the “shadow” inventory of existing homes will have on prices.

THE FORECAST

The longest and deepest recession in the post-Depression era is most likely over. Both the state and national economies appear poised to make modest comebacks. And many indicators released since the Governor's Budget forecast have been more encouraging than originally expected. The recovery, will probably be moderate and prolonged by historical standards. This means that the outlook for the near future is positive but sober. The national economy is forecast to return to modest growth rates in 2010 and beyond. The outlook for the California economy largely mirrors the national outlook, but with slightly less growth (Figure ECO-03 and Figure ECO-04).

Figure ECO-03
Selected U.S. Economic Indicators

| | 2009 (Est.) | 2010 (Projected) | 2011 (Projected) |
|---|----------------|---------------------|---------------------|
| Real gross domestic product, (2000 dollar) (Percent change) | -2.4 | 3.0 | 3.0 |
| Personal consumption expenditures | -0.6 | 2.4 | 2.7 |
| Gross private domestic investment | -23.2 | 11.4 | 13.2 |
| Government purchases of goods and services | 1.8 | 0.8 | -0.8 |
| GDP deflator (2000=100) (Percent change) | 1.2 | 1.0 | 1.9 |
| GDP, (Current dollar) (Percent change) | -1.3 | 4.0 | 5.0 |
| Federal funds rate (Percent) | 0.16 | 0.20 | 1.70 |
| Personal income (Percent change) | -1.7 | 3.3 | 4.9 |
| Corporate profits before taxes (Percent change) | -2.4 | 18.4 | 10.4 |
| Nonfarm wage and salary employment (Millions) | 130.9 | 130.2 | 132.6 |
| (Percent change) | -4.3 | -0.5 | 1.8 |
| Unemployment rate (Percent) | 9.3 | 9.6 | 9.0 |
| Housing starts (Millions) | 0.55 | 0.67 | 1.19 |
| (Percent change) | -38.6 | 21.8 | 75.9 |
| New car and light truck sales (Millions) | 10.3 | 11.8 | 13.8 |
| (Percent change) | -21.6 | 14.2 | 16.9 |
| Consumer price index (1982-84=100) | 214.5 | 219.3 | 224.6 |
| (Percent change) | -0.4 | 2.2 | 2.4 |

*Forecast based on data available as of April 2010.
Percent changes calculated from unrounded data.*

Figure ECO-04
Selected California Economic Indicators

| | 2009 | Percent change | Projected | | | |
|--------------------------------------|----------|----------------|-----------|----------------|----------|----------------|
| | | | 2010 | Percent change | 2011 | Percent change |
| Personal income (\$ billions) | 1,558.8 | -2.8% | 1,608.8 | 3.2% | 1,681.6 | 4.5% |
| Nonfarm W&S employment (thousands) | 14,089.0 | -6.0% | 13,984.5 | -0.7% | 14,228.8 | 1.7% |
| Natural resources and mining | 25.9 | -9.9% | 25.4 | -1.6% | 25.8 | 1.4% |
| Construction | 621.5 | -21.2% | 596.2 | -4.1% | 650.5 | 9.1% |
| Manufacturing | 1,281.8 | -10.1% | 1,244.1 | -2.9% | 1,263.2 | 1.5% |
| High technology | 350.7 | -6.2% | 346.9 | -1.1% | 355.1 | 2.4% |
| Trade, transportation, & utilities | 2,640.1 | -7.4% | 2,616.0 | -0.9% | 2,662.3 | 1.8% |
| Information | 444.4 | -6.5% | 446.9 | 0.6% | 460.0 | 2.9% |
| Financial activities | 797.0 | -6.3% | 780.6 | -2.1% | 784.2 | 0.5% |
| Professional and business services | 2,055.3 | -8.1% | 2,075.5 | 1.0% | 2,151.2 | 3.6% |
| High technology | 307.7 | -4.4% | 309.1 | 0.5% | 314.9 | 1.9% |
| Educational and health services | 1,740.7 | 0.9% | 1,775.6 | 2.0% | 1,817.4 | 2.4% |
| Leisure and hospitality | 1,498.5 | -4.7% | 1,471.8 | -1.8% | 1,487.7 | 1.1% |
| Other services | 486.6 | -4.8% | 485.8 | -0.2% | 499.6 | 2.8% |
| Government | 2,497.2 | -0.9% | 2,466.5 | -1.2% | 2,427.0 | -1.6% |
| Unemployment rate | 11.4% | | 11.9% | | 10.7% | |
| Housing permits (thousands of units) | 36 | -44.5% | 64 | 75.4% | 105 | 64.2% |
| Consumer price index (1982-84=100) | 224.1 | -0.3% | 229.4 | 2.4% | 235.5 | 2.7% |

*Forecast based on data available as of April 2010.
 Percent changes calculated from unrounded data.*

REVENUE ESTIMATES

General Fund revenues before solutions are expected to be \$86.521 billion in 2009-10 and \$89.814 billion in 2010-11. These current revenue estimates are below the Governor's Budget by \$1.562 billion in 2009-10 and above by \$492 million in 2010-11. The Governor's Budget revenue forecast had been based on data through November 2009. Since that time, actual cash receipts and the revised economic outlook have been incorporated in this forecast.

Additionally, the May Revision reflects \$1.637 billion in proposed loans and transfers from state special funds. With these additional resources, 2010-11 revenues total \$91.451 billion.

Figure REV-01 displays the forecast changes between the 2010 Governor's Budget and the May Revision.

PERSONAL INCOME TAX

The personal income tax forecast has been reduced by \$2.619 billion in 2009-10 and by \$617 million in 2010-11. Through March, Personal Income Tax receipts were up \$1.1 billion from the Governor's Budget forecast. However, April receipts fell short of forecast by \$3.1 billion due to the weakness of final payments tied to 2009 tax year liabilities.

Figure REV-01
2010-11 May Revision Estimate
General Fund Revenue Forecast
Summary Table
Reconciliation with 2010-11 Governor's Budget
(Dollars in Millions)

| Source | Governor's Budget | May Revision | Change Between Forecasts | |
|----------------------------|-------------------|-----------------|--------------------------|--------------|
| Fiscal 08-09 | | | | |
| Personal Income Tax | \$43,376 | \$43,376 | \$0 | 0.0% |
| Sales & Use Tax | 23,753 | 23,753 | 0 | 0.0% |
| Corporation Tax | 9,536 | 9,536 | 0 | 0.0% |
| Insurance Tax | 2,054 | 2,054 | 0 | 0.0% |
| Vehicle License Fees | 216 | 216 | 0 | 0.0% |
| Estate Tax | 0 | 0 | 0 | --- |
| Alcoholic Beverage | 324 | 324 | 0 | 0.0% |
| Cigarette | 107 | 107 | 0 | 0.0% |
| Other Revenues | 2,380 | 2,380 | 0 | 0.0% |
| Transfers | <u>1,026</u> | <u>1,026</u> | <u>0</u> | 0.0% |
| Total | \$82,772 | \$82,772 | \$0 | 0.0% |
| Fiscal 09-10 | | | | |
| Personal Income Tax | \$46,640 | \$44,021 | -\$2,619 | -5.6% |
| Sales & Use Tax | 26,036 | 26,852 | 816 | 3.1% |
| Corporation Tax | 9,407 | 9,386 | -21 | -0.2% |
| Insurance Tax | 1,952 | 2,027 | 75 | 3.8% |
| Vehicle License Fees | 1,386 | 1,386 | 0 | 0.0% |
| Estate Tax | 0 | 0 | 0 | --- |
| Alcoholic Beverage | 332 | 332 | 0 | 0.0% |
| Cigarette | 102 | 99 | -3 | -2.9% |
| Other Revenues | 1,800 | 1,971 | 171 | 9.5% |
| Transfers | <u>428</u> | <u>447</u> | <u>19</u> | 4.4% |
| Total | \$88,083 | \$86,521 | -\$1,562 | -1.8% |
| Change from Fiscal 08-09 | \$5,311 | \$3,749 | | |
| % Change from Fiscal 08-09 | 6.4% | 4.5% | | |
| Fiscal 10-11 | | | | |
| Personal Income Tax | \$46,862 | \$46,245 | -\$617 | -1.3% |
| Sales & Use Tax | 25,851 | 26,967 | 1,116 | 4.3% |
| Corporation Tax | 10,052 | 9,779 | -273 | -2.7% |
| Insurance Tax | 1,897 | 1,967 | 70 | 3.7% |
| Vehicle License Fees | 1,472 | 1,472 | 0 | 0.0% |
| Estate Tax (a) | 892 | 892 | 0 | --- |
| Alcoholic Beverage | 354 | 354 | 0 | 0.0% |
| Cigarette | 101 | 97 | -4 | -4.0% |
| Other Revenues | 2,367 | 2,562 | 195 | 8.2% |
| Transfers | <u>-526</u> | <u>1,116</u> | <u>1,642</u> | -312.2% |
| Total | \$89,322 | \$91,451 | \$2,129 | 2.4% |
| Change from Fiscal 09-10 | \$1,239 | \$4,930 | | |
| % Change from Fiscal 09-10 | 1.4% | 5.7% | | |
| Three-Year Total | | | \$567 | |

(a) The Federal estate tax, to which the state's pick-up tax is tied, is scheduled to be re-instated for deaths occurring on and after January 1, 2011. Federal estate tax law may be changed to modify or eliminate the state pick-up tax, modifying or eliminating estate tax revenues in the forecast.

There are several explanations for the April 2010 revenue shortfall. First, more people than predicted carried 2008 investment losses into the 2009 tax year. Preliminary 2008 tax return data, which were not available at the time the Governor's Budget forecast was prepared, revealed that taxpayers incurred an unprecedented stock of capital losses that were carried forward. Since capital losses can be carried forward to offset capital gains in subsequent years, it is assumed that these losses had a significant dampening impact on 2009 capital gains, which largely accrue to taxpayers subject to the top tax rate. Small-business owners also had less income in 2009 than had been realized at the time of the Governor's Budget. Lastly, analysts underestimated the timing impact of 2009 tax year payments related to the increase in marginal rates and reduction of the dependent credit. It appears that many quarterly filers paid more in their estimated payments prior to April 2010 than was predicted at the time of the Governor's Budget, thus reducing final payments in April.

The current estimate for 2010-11 is for a 5-percent increase over 2009-10 due to the moderate recovery as reflected in the May Revision economic outlook and an estimate of higher capital gains in 2010 due to higher stock prices and, in part, to a shifting in gains to 2010 from 2011 when the federal preferential rates are due to sunset.

SALES AND USE TAX

The sales and use tax forecast has been increased by \$816 million in the current year and \$1.116 billion in the budget year.

The higher forecast is primarily due to a moderately stronger economic outlook and the recent strength in sales and use tax cash receipts. The budget year forecast reflects the \$1.6 billion impact of the fuel tax swap, which eliminated the General Fund portion of the sales and use tax on motor vehicle gasoline sales.

CORPORATION TAX

The corporation tax forecast has been decreased by \$21 million in the current year and \$273 million in the budget year.

Corporation tax revenues in 2009-10 are tracking closely with the Governor's Budget forecast. The \$273 million decline in corporation tax revenues in 2010-11 reflects the weaker-than-expected first estimated payment for the 2010 tax year and a California economy that is improving at a slower pace than the rest of the nation.

INSURANCE TAX

The insurance tax forecast has been increased by \$75 million in the current year and by \$70 million in the budget year. The revenue increases are due primarily to slightly stronger cash receipts and to an expected delay in refunds associated with a previous Board of Equalization decision on the accounting method used by insurers.

OTHER REVENUES AND TRANSFERS

The forecast for all other revenues and transfers has been increased by \$187 million in 2009-10 and by \$1.833 billion in 2010-11. This includes \$1.637 billion of new loans, loan repayment extensions and transfers from special funds. More information on this is provided in the Significant Changes by Major Program Areas section. This forecast includes Vehicle License Fees, Alcoholic Beverage Taxes, Tobacco Taxes, the Estate Tax, which is scheduled to be re-instated in 2011 under current federal law, and all minor revenues and transfers.

PROPERTY TAX

Statewide property tax revenues are forecast to decline by 4.1 percent in 2009-10, and decline by 3.1 percent in 2010-11. The 2010-11 Governor's Budget forecast the respective growth rates at -2.9 percent and -2.2 percent.

Input from county assessors throughout the state was solicited when developing these revised estimates. Consideration also was given to the approximately 30 percent decline in median sales prices for residential properties in 2009 (property tax revenue in a given fiscal year is based on the January 1 lien date which, in turn, derives value from activity in the preceding calendar year). These declines in 2009 sales prices will drive reductions in the 2010-11 assessed values of neighboring properties. Moderating somewhat the decline in property tax revenues from 2009-10 to 2010-11 is the fact that existing home sales increased by 1.4 percent from 2008 to 2009.

The state budget reflects about 36 percent of property taxes as a funding source for K-14 education.

Property tax of \$2.0 billion from Proposition 1A borrowing and \$1.7 billion of redevelopment funds are continued to be reflected as offsets to various state programs.

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