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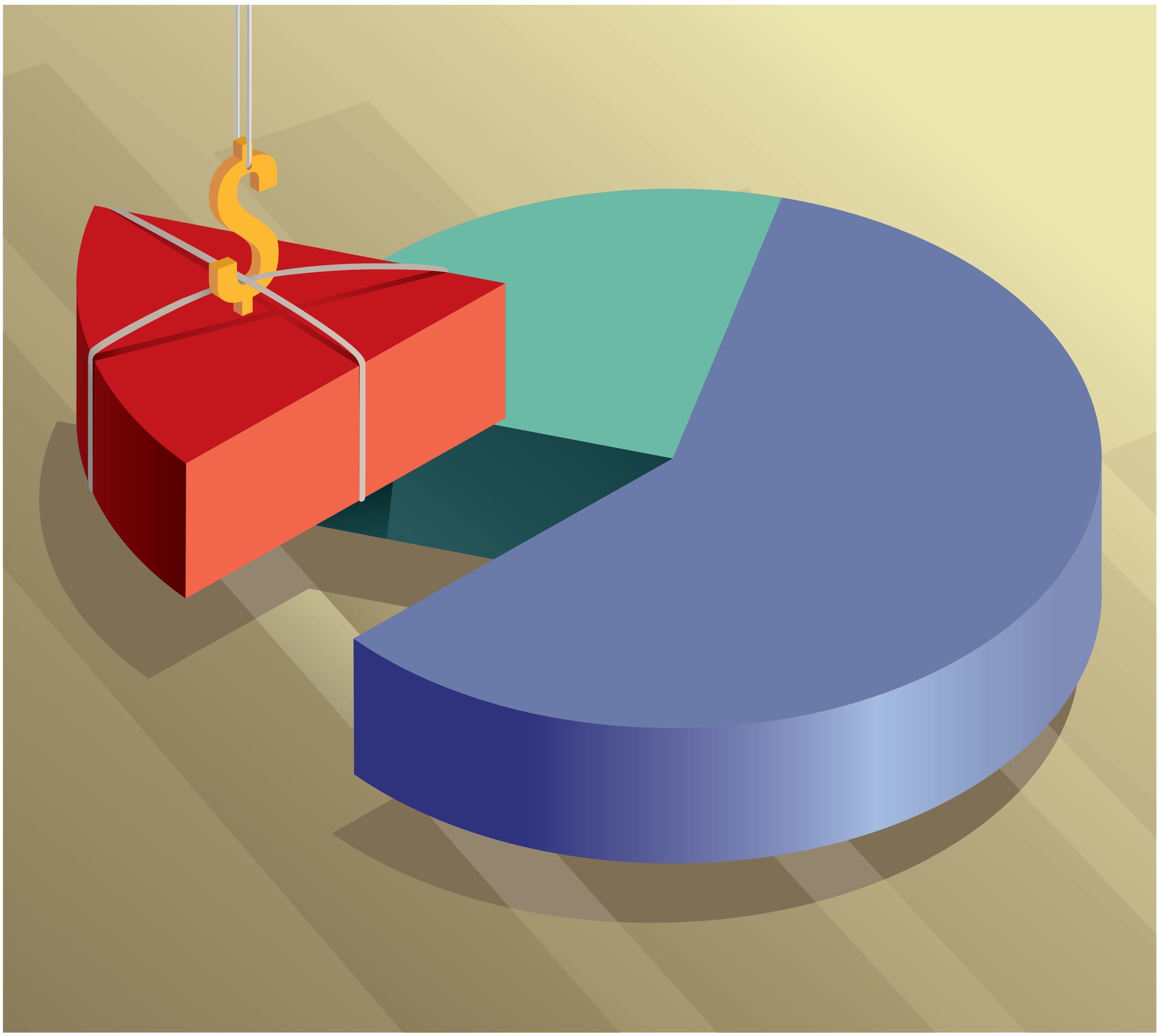
The Budget Package

2011-12 California Spending Plan



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Chapter 1

Key Features of the 2011-12 Budget Package

Budget Overview

Total State and Federal Funds Spending

The 2011-12 state spending plan includes total budget expenditures of $120.1 billion from the General Fund and special funds, as shown in Figure 1. This consists of $85.9 billion from the General Fund and $34.1 billion from special funds. While General Fund spending has dropped by around 6 percent from 2010-11, this has, in part been offset by increases in special fund spending as the state shifts some programs—from state to local responsibility under what has been called "realignment"—from General Fund support to special fund support. Federal funds spending continues to decline with the expiration of much of the funding made available through the American Recovery and Reinvestment Act.

The Condition of the General Fund

Figure 2 (see next page) summarizes the estimated General Fund condition for 2010-11 and 2011-12.

2010-11: Third Consecutive Year to End With a Deficit. Under the spending plan, the General Fund ends 2010-11 with a year-end deficit of $1.2 billion. This is the third year in a row in which the state has ended the year with a General Fund deficit (albeit a smaller deficit than was seen at the end of 2009-10, when the deficit was $6.3 billion).

Figure 1

Total State and Federal Fund Expenditures

(Dollars in Millions)

Fund Type	Actual 2009-10	Estimated 2010-11	Enacted 2011-12	Change From 2010-11 Amount	Change From 2010-11 Percent
General Fund	$87,014	$91,480	$85,937	-$5,543	-6.1%
Special funds	23,514	31,219	34,180	2,961	9.5
Budget Totals	**$110,528**	**$122,699**	**$120,117**	**-$2,582**	**-2.1%**
Selected bond funds	$6,250	$13,195	$9,360	-$3,836	-29.1%
Federal funds	89,088	91,459	79,182	-12,276	-13.4

Figure 2

General Fund Condition

(Dollars in Millions)

	2010-11	2011-12	Percent Change
Prior-year balance	-$4,507	-$1,206	
Revenues and transfers	94,781	88,456	-6.7%
Total resources available	$90,274	$87,250	
Total expenditures	$91,480	$85,937	-6.1%
Fund balance	-$1,206	$1,313	
Encumbrances	$770	$770	
Reserve	**-$1,976**	**$543**	

Note: Department of Finance estimates.

2011-12: Small Reserve Expected. The budget projects General Fund revenues and transfers of $88.5 billion and expenditures of $85.9 billion in 2011-12. The resulting $2.6 billion operating surplus is necessary for the state to address the carry-in deficit and rebuild a reserve balance of $0.5 billion by June 30, 2012. This reserve is based, in large part, on assumed revenue growth between 2010-11 and 2011-12.

Solutions Adopted During the Budget Process

Figure 3 shows the solutions adopted to close the budget gap. The budget plan (including gubernatorial vetoes) includes the following actions (based upon our office's categorization):

- $13.2 billion of revenue actions, of which $11.8 billion is assumed growth in the state's baseline revenues in 2010-11 and 2011-12. The final budget did not renew any of the temporary tax increases adopted in 2009, all of which expired by the end of 2010-11. These budget actions are discussed in more detail in "Chapter 2."
- $11.1 billion of expenditure-related solutions (including ongoing and temporary reductions). These actions are discussed in more detail in "Chapter 3."
- $2.9 billion of largely one-time loans and transfers.

Additional Cuts of Up to $2.5 Billion if General Fund Revenues Fall Short. In addition to the expenditure reductions shown in Figure 3, the budget package also contains a mechanism for further reducing expenditures in 2011-12 if General Fund revenues are estimated to fall short of the amount contained in the *2011-12 Budget Act*. As shown in Figure 4 (see page 4), the cuts are in two tiers: first, if revenues are forecast to be $1 billion below the budget level, and second, if the revenue is forecast to be $2 billion below.

Figure 3

Actions to Close 2011-12 Budget Gap

Two-Year General Fund Benefit (In Billions)

Expenditure-Related Actions	
Reduce Medi-Cal spending	$2.0
Reduce UC and CSU budgets	1.4
Fund transportation debt costs and loans primarily using weight fees	1.1
Reduce Proposition 98 funding[a]	0.9
Shift Proposition 63 funds to support community mental health services	0.9
Reduce CalWORKs spending	0.8
Reduce court budget and suspend court construction projects	0.7
Implement cost-containment measures and increase federal funding for developmental services	0.6
Score savings from efficiencies in state operations and reduced employee compensation costs	0.5
Reduce In-Home Supportive Services spending	0.4
Suspend, defer, or repeal state mandates	0.3
Reduce Receiver's inmate medical care budget and other CDCR spending	0.4
Reduce SSI/SSP grants to individuals to the federal minimum	0.2
Redirect funding from the Gas Consumption Surcharge	0.2
Reduce Cal Grant program	0.2
Other expenditure reductions (net)	0.5
Total	**$11.1**
Revenue Actions	
General Fund Revenue Actions	
Score additional baseline revenues	$11.8
Adopt tax shelter amnesty	0.2
Enforce sales and use tax collection on out-of-state retailers	0.2
Extend the existing Medi-Cal hospital fee	0.2
Maintain existing revenue accrual policy	0.2
Adopt other revenue measures	0.2
Subtotal	($12.7)
Local Realignment Revenue Actions[b]	
Increase Vehicle Registration Fee by $12 to fund Department of Motor Vehicles	$0.3
Redirect Vehicle License Fee funds previously dedicated to Orange County and to cities	0.2
Subtotal	($0.5)
Total	**$13.2**
Borrowing and Transfers	
Enact new loans, loan extensions, and transfers from special funds	$2.5
Borrow from Disability Insurance Fund for Unemployment Insurance interest payments	0.3
Transfer tribal gaming transportation payments to the General Fund	0.1
Total	**$2.9**
Grand Total, All Budget Actions	**$27.2**

[a] Net effect of all budget actions on the General Fund share of the minimum guarantee—including increases in baseline revenues, redirection of a portion of the state sales tax for realignment, and the shift of certain local property tax revenues from redevelopment agencies to schools.

[b] The budget package also dedicates 1.0625 percentage points of the existing state sales tax rate to pay for realignment. This revenue will be placed into a dedicated fund for local entities to use to fund services that are transferred from state to local responsibility.

Chapter 41, Statutes of 2011 (AB 121, Committee on Budget), Chapter 43, Statutes of 2011 (AB 114, Committee on Budget), and Chapter 34, Statutes of 2011 (SB 73, Committee on Budget) provide the mechanisms and the upper limits for the additional cuts (also referred to as "trigger cuts").

Department of Finance (DOF) Will Select Revenue Level in December 2011. The provisions of Chapter 41 require that DOF compare its updated revenue estimate for 2011-12 with our office's estimate (presented in November). The higher of these two estimates will be compared with the forecast contained in the *2011-12 Budget Act*. The DOF has the authority to reduce expenditures as laid out in Chapter 41.

Restructuring of Some Aspects of the State-Local Relationship. The budget package shifts $5.6 billion in state program costs to counties and provides a comparable amount of funds to support these new county commitments. The programs shifted include some health and human services programs (such

Figure 4

Trigger Reductions if Revenues Fall Short of Forecasts[a]

General Fund Benefit (In Millions)

Tier 1 Trigger—Revenues Are Forecast to Be $1 Billion Below Budget Act	
Reduce University of California budget	$100
Reduce California State University budget	100
Reduce funding for developmental services	100
Reduce service hours for In-Home Supportive Services (IHSS) recipients by 20 percent	100
Increase charges to counties for youthful offenders sent to CDCR facilities	72
Reduce community college funding (offset with a $10 per unit fee increase)	30
Reduce child care funding by 4 percent	23
Reduce CDCR budget	20
Eliminate state grants for local libraries	16
Eliminate vertical prosecution grants	15
Extend Medi-Cal provider cuts and copayments to all managed care plans	15
Eliminate funding for local antifraud efforts in IHSS	10
Subtotal	($601)
Tier 2 Trigger—Revenues Are Forecast to Be $2 Billion Below Budget Act	
Reduce school year by seven days	$1,540
Eliminate Home-to-School Transportation	248
Reduce community colleges budget	72
Subtotal	($1,860)
Total	**$2,461**

[a] The Department of Finance could reduce spending by less than the amount shown in each category. Legislation includes a specific formula directing the amount of reductions to K-12 schools based on the amount by which revenues fall short of *Budget Act* estimates.

CDCR = California Department of Corrections and Rehabilitation.

as child welfare services and mental health programs) and some criminal justice programs. We discuss the details of these shifts including the funding mechanism in more detail in "Chapter 3."

Additional Cash Deferrals Part of the Budget. In common with recent years, the budget package contains provisions that give the executive branch more flexibility in the management of the state's cash in 2011-12. These provisions are, for the most part, similar to those from the prior fiscal year, with payment delays of up to around $6 billion to schools, universities, and local governments. The budget package also created a new account into which the University of California (UC) and California State University can deposit funds normally outside of the state's control that will be available for cash borrowing purposes.

Evolution of the Budget

The Governor signed the *2011-12 Budget Act* on June 30, 2011. The Legislature passed three iterations of the budget bill—one in March and two in June—all using the new majority-vote provision contained in Proposition 25 (an initiative adopted by voters in November 2010). The March version was not sent to the Governor, the first June version was vetoed, and the third budget bill was eventually signed. The Legislature also sent a number of budget-related trailer bills to the Governor in both March and June. (The budget and related bills are listed in Figure 5, see next page.)

Governor's January Budget and Special Session

$25.4 Billion Budget Problem Estimated in January. On January 10, 2011, the Governor released the *2011-12 Governor's Budget* shortly after assuming office. At that time, the administration put the size of the budget problem facing the Legislature at $25.4 billion—consisting of an expected General Fund deficit of $8.2 billion at the end of 2010-11 (assuming no corrective actions by the state) and a $17.2 billion operating deficit in 2011-12. The Governor's January budget contained $26.4 billion of actions, according to administration estimates, which would have solved the $25.4 billion problem and left the state with around $1 billion reserve at the end of 2011-12.

Governor's Budget Plan Included a Mix of Expenditure Reductions and Tax Increases. Of the $26.4 billion in proposed budget actions, the Governor's January plan included some $12.5 billion in reductions to General Fund state expenditures (including both reductions in services and benefits and use of other funding sources in lieu of the General Fund). The Governor also proposed $14 billion in new revenues primarily from renewing four temporary taxes that were all to expire in 2011. (These additional revenues would have been offset, in part, by a $2 billion increase in the Proposition 98 minimum funding guarantee for schools and community colleges.) The remaining $1.9 billion in actions in the Governor's budget were from borrowing from special funds and other sources.

Governor Proposed Accelerated Budget Process. Under the Governor's January plan, there would have been a special statewide election in June 2011 where voters would have been asked to extend the temporary taxes for an additional five years as well as make some constitutional changes to facilitate the Governor's realignment proposal to shift funding and responsibility to local governments for various services. To achieve this, the Governor targeted early March for the completion of the budget process.

Governor Drops Sale/Leaseback Plans. In February 2011, the Governor decided to reverse a 2009-10 budget action and not pursue the sale of certain state-owned buildings that would then be leased back to the state. The loss of these revenues increased the size of the forecast deficit by $1.2 billion. The Governor proposed new budget actions—primarily borrowing from special funds—to replace this lost revenue.

Legislature Passed Majority Vote Budget in Mid March. Using the provisions of Proposition 25, the Legislature passed a number of budget-related

Figure 5

2011-12 Budget and Budget-Related Legislation

Bill Number	Chapter	Author	Subject
2011-12 Regular Session			
SB 87	33	Leno	*2011-12 Budget Act*
SB 70	7	Budget Committee	Education
SB 72	8	Budget Committee	Human services
SB 73	34	Budget Committee	Health and human services "trigger cuts"
SB 74	9	Budget Committee	Developmental services
SB 78	10	Budget Committee	Judiciary
SB 79	142	Budget Committee	Cash management (create investment account for state agencies)
SB 80	11	Budget Committee	General government
SB 82	12	Budget Committee	Cash management
SB 84	13	Budget Committee	Special fund loans and transfers
SB 86	14	Budget Committee	Tax enforcement
SB 89	35	Budget Committee	Vehicle license fees (VLFs) and vehicle registration fees
SB 90	19	Steinberg	Medi-Cal hospital quality assurance fees
SB 91	119	Budget Committee	Adult day health care centers
SB 92	36	Budget Committee	Public safety
SB 93	143	Budget Committee	IHSS changes
SB 94	21	Budget Committee	VLFs and vehicle registration fees
AB 94	23	Budget Committee	Criminal justice realignment
AB 95	2	Budget Committee	Resources
AB 97	3	Budget Committee	Health
AB 99	4	Budget Committee	Shift of Proposition 10 funds to fund health services for children
AB 100	5	Budget Committee	Shift of Proposition 63 funds to fund mental health services

Continued

bills as well as the budget bill in mid-March 2011 with a majority vote. However, as the Legislature was unable to achieve a two-thirds vote for the budget package, the required constitutional amendment for the June special election was not passed, and the June special election was not called. In total, the Legislature passed, and the Governor signed, budget-related legislation containing about $11 billion in expenditure-related actions. (Some of these bills were passed during the First Extraordinary Session that was called in response to the fiscal emergency declared by the former Governor in December 2010.)

May Revision Proposals Included Higher Revenue Forecasts. The updated forecast released by the administration as part of the May Revision forecast included an additional $6.6 billion in baseline revenues over 2010-11 and 2011-12. While the May Revision contained many of the proposals from the Governor's January budget, including the plan to seek voter approval of revenue extensions, the additional baseline revenues allowed the Governor to (1) scale back some of the revenue proposals, (2) increase the proposed level of

Bill Number	Chapter	Author	Subject
AB 102	29	Budget Committee	Health
AB 104	37	Budget Committee	Developmental services
AB 105	6	Budget Committee	Transportation
AB 106	32	Budget Committee	Human services
AB 107	134	Budget Committee	Resources
AB 108	135	Budget Committee	Education
AB 109	15	Budget Committee	Criminal justice realignment
AB 110	193	Blumenfield	Implementation of budget reductions to the courts
AB 111	16	Budget Committee	Criminal justice realignment
AB 112	30	Budget Committee	Amendments to the *2010-11 Budget Act*
AB 114	43	Budget Committee	Education funding
AB 115	38	Budget Committee	Transportation
AB 116	136	Budget Committee	Criminal justice realignment
AB 117	39	Budget Committee	Public safety realignment
AB 118	40	Budget Committee	Sales tax shift for realignment
AB 119	31	Budget Committee	State government
AB 120	133	Budget Committee	Resources
AB 121	41	Budget Committee	Overall trigger cuts
2011-12 First Extraordinary Session			
ABX1 19	4	Blumenfield	Long-term care
ABX1 26	5	Blumenfield	Elimination of redevelopment agencies
ABX1 27	6	Blumenfield	Creation of new, voluntary redevelopment agency program
ABX1 28	7	Blumenfield	Enforcement of sales and use tax collection on out-of-state retailers
ABX1 29	8	Blumenfield	State Responsibility Area fire fee on landowners

education funding, and (3) reduce the level of proposed budgetary borrowing. Due to the timing of a potential special election, the administration sought a six-month extension of taxes prior to voter approval.

First Budget Passed by Legislature Vetoed by the Governor. The Legislature was unable to pass the Governor's proposals that required a two-thirds vote in both houses of the Legislature (that is, the proposals to extend temporary taxes and hold a special election). The Legislature passed a second budget bill on June 15, 2011, that did not contain any additional tax revenues. This budget included an almost $3 billion reduction to education funding, a change in how the state sales tax was shared with locals, and a deferral of payments to UC to the next fiscal year. The Governor vetoed this budget bill the following day. Following the Governor's veto, the State Controller stated that the budget passed by the Legislature did not meet the requirements of Proposition 25 as it was "not balanced" and announced that legislators would forfeit their pay for the days between June 15 and the date when a new, balanced budget was passed.

Budget Package Passed on June 28, 2011. The final budget package was passed on June 28, 2011 and was signed by the Governor on June 30, 2011. The measures acted upon at this point in the process contained no proposals that would have required a two-thirds vote in both houses.

Governor's Vetoes. When signing the budget, the Governor vetoed $24 million in General Fund spending and $244 million in special funds spending that had been approved by the Legislature. The vetoes included:

- A $235 million reduction in funds for mass transportation.
- A $23 million reduction to reflect a delay in shifting certain responsibilities associated with realignment of criminal justice programs to the trial courts.

Chapter 2

Revenue Provisions

Figure 1 displays the key revenue assumptions underlying the *2011-12 Budget Act*. General Fund revenues in 2011-12 are assumed to be $88.5 billion, down $6.3 billion (6.7 percent) from the 2010-11 level. As described below, this decrease is attributable to (1) the expiration of temporary personal income tax (PIT), sales and use tax (SUT), and vehicle license fee (VLF) increases that were adopted in 2009; (2) prior actions to accelerate certain corporation tax (CT) revenues to years prior to 2011-12; and (3) actions to redirect over $5 billion of SUT revenues from the General Fund to a state special fund dedicated to local expenses under the budget's realignment plan.

Figure 2 (see next page) displays the estimated revenue effects of the revenue-related budget solutions in the budget package. By far, the most significant solutions were those that scored additional baseline revenues—that is, additional revenues above what was assumed in January due to economic performance and *not* any increase in tax rates or tax bases. Over one-half of the additional revenues were assumed consistent with the administration's

Figure 1

2011-12 Budget Act
General Fund Revenues

(Dollars in Millions)

	2009-10 Actual	2010-11 Estimated	*2011-12 Budget Act*	Change From 2010-11[a] Amount	Change From 2010-11[a] Percent
Personal income tax (PIT)	$44,852	$50,027	$50,408	$381	0.8%
Sales and use tax (SUT)	26,741	27,140	19,009	-8,131	-30.0
Corporation tax (CT)	9,115	9,963	9,012	-951	-9.5
Insurance tax	2,002	2,016	1,893	-123	-6.1
Vehicle license fee (VLF)	1,380	1,360	150	-1,210	-89.0
Other revenues	2,481	2,378	2,518	140	5.9
Unallocated baseline revenue increase assumed in *2011-12 Budget Act*	—	—	4,000	4,000	—
Transfers and loans	476	1,897	1,465	-432	-22.8
Totals	**$87,046**	**$94,781**	**$88,456**	**-$6,325**	**-6.7%**

[a] Reflects, among other things, expiration of temporary PIT, SUT, and VLF increases that increased revenues to the General Fund in fiscal years 2009-10 and 2010-11, but generally not in 2011-12. Prior CT actions also accelerated certain revenues to years before 2011-12. In addition, the *2011-12 Budget Act* and related legislation redirect revenue attributable to 1.0625 percentage points of the SUT (over $5 billion) from the General Fund to the Local Revenue Fund 2011 for realignment purposes.

May Revision economic forecast, and the remainder was built into the budget package during the final days of legislative action on the budget plan in June 2011. The budget package also authorized $2.9 billion of additional loans and transfers to the General Fund from state special funds. This included a $320 million loan from the Disability Insurance Fund. Many, but not all, of these loans and transfers are reflected in the loans and transfers item of Figure 1.

Expiration of Previous Tax Measures

Legislature Did Not Adopt Governor's Proposal to Renew Several Temporary Taxes. In February 2009, the Legislature enacted a measure that increased the SUT, PIT, and VLF temporarily. These increases—described in our October 2009 publication, *2009-10 California Spending Plan*—all expired on or before June 30, 2011. Throughout the 2011-12 budget process, the Governor proposed renewing these temporary tax increases to help balance the 2011-12 budget (including his proposals for a special election to ask the voters to approve such renewals). In the May Revision, the administration estimated that having the temporary tax increases in effect during 2011-12 would result in $9.4 billion of additional state revenues to help balance the 2011-12

Figure 2

Revenue-Related Budget Balancing Actions
***2011-12 Budget Act* and Related Legislation**

General Fund Net Benefit (+) or Cost (-) (In Millions)

	2010-11 and Prior Years	2011-12	Total
General Fund Actions			
Score additional baseline revenues (relative to January budget)	$3,070	$8,777	$11,847
Adopt tax shelter amnesty	270	-50	220
Enforce sales and use tax (SUT) collection on out-of-state retailers	—	200	200
Extend existing Medi-Cal hospital fee[a]	210	-12	198
Maintain existing revenue accrual policy	1,560	-1,400	160
Repeal refundability of state child and dependent care expenses credit	—	75	75
Institute fire prevention fee for structures in state responsibility areas[a]	—	50	50
Implement Financial Institution Records Match tax compliance data system	—	40	40
Implement use tax look-up table in personal income tax forms	—	7	7
Local Realignment Fund Actions[b]			
Increase vehicle registration fee by $12 to fund Department of Motor Vehicles	—	300	300
Redirect vehicle license fee funds previously dedicated to Orange County and cities	—	153	153

[a] Some or all of the revenues generated flow to special or federal funds and reduce the need for General Fund expenditures. In other words, General Fund benefit results from a decrease of General Fund expenditures—not an increase of General Fund revenues.

[b] The budget package also dedicates 1.0625 percentage points of the existing state SUT rate to pay for realignment. This revenue—about $5.1 billion in 2011-12—will be placed into the Local Realignment Fund 2011 for local entities to use to fund services that are transferred from state to local responsibility.

budget. A two-thirds vote of each house of the Legislature was required either to renew the taxes or to adopt the Governor's proposed constitutional amendment submitting these taxes to voters for approval. Neither of these occurred. Accordingly, the temporary SUT, PIT, and VLF tax increases adopted in 2009 all expired on or before June 30, 2011. This is a major factor (along with realignment changes, summarized below) that results in the decrease of General Fund revenues between 2010-11 and 2011-12.

CT Revenues Also Decline Due in Part to Prior Tax Measures. In recent years, the state has taken a number of actions that tended to accelerate CT revenue to years prior to 2011-12. These actions and others will result in lower CT revenues beginning in 2011-12. For example, the state suspended, for 2008 through 2011, larger businesses' ability to use net operating loss deductions, and revenues will fall as businesses resume using these deductions. The state also passed measures in prior years that allow multistate and multinational businesses to choose whether to apportion their income to California based on a three-factor method or the newly adopted "single sales factor" method, resulting in General Fund revenue losses of about $1 billion per year beginning in tax year 2011. The Governor proposed requiring these companies to use the single sales factor—thereby reversing these revenue losses—but the Legislature did not approve this proposal.

General Fund Revenue Actions

Additional Baseline Revenues Scored. As noted in "Chapter 1," the Legislature and the Governor eventually adopted over $27 billion of budget solutions to address the budget problem. By far the largest solution included in the budget was an assumption of higher baseline revenues than indicated in the Governor's original January budget estimates. As shown in Figure 2, the budget package assumes $11.8 billion of increased baseline revenues, compared to the original January budget estimates. This total consists of three major components:

- ***May Revision Forecast ($6.6 Billion).*** The Governor's May Revision included an updated economic and revenue forecast indicating that General Fund revenues would be $6.6 billion higher than the January forecast. These increases were the result of improved economic and revenue performance—not increases in tax rates or changes in tax bases. The $6.6 billion included a $1.9 billion net increase in revenues for 2010-11 and prior years and a $4.8 billion increase in 2011-12 revenues. By the time the May Revision was finalized, the state's "Big Three" General Fund taxes (PIT, SUT, and CT) were running $2.5 billion above forecast in 2010-11 due primarily to strong performance in PIT withholding and estimated tax payments.
- ***Higher 2010-11 Assumptions Adopted in June ($1.2 Billion).*** As legislative deliberations on the budget entered their final weeks in June 2011,

General Fund revenues continued to perform strongly—hundreds of millions of dollars above the May Revision forecast for May and June combined. In response to this trend, the Legislature and the Governor agreed to increase the 2010-11 revenue forecast in the final budget package—by a total of $1.2 billion above the levels included in the May Revision for the state's major taxes.

- ***Higher 2011-12 Assumptions Adopted in June ($4 Billion).*** In the final days of legislative deliberations, the Legislature and the Governor decided to incorporate an assumption of $4 billion of higher 2011-12 revenues into the budget plan. (As shown in Figure 1, this $4 billion is not allocated to any specific tax in the budget plan.)

Tax Shelter Amnesty. The budget plan assumes net revenues of $220 million attributable to 2010-11 and 2011-12 from a limited tax amnesty program known as the Voluntary Compliance Initiative 2 (VCI 2). The program targets specific categories of abusive tax shelters—generally, transactions that give rise to tax benefits but which lack significant economic substance independent of income tax considerations. These shelters generally are invalid under tax law. In VCI 2, taxpayers who previously have underreported California income tax liabilities through the use of offshore financial arrangements or abusive tax avoidance transactions can amend their returns for 2010 and prior tax years and receive a waiver of most penalties. The filing period for VCI 2 is between August 1, 2011 and October 31, 2011.

Enforcement of SUT on Out-of-State Retailers. Past decisions of the U.S. Supreme Court have determined that states generally cannot require retailers to collect and remit SUTs on purchases to tax agencies unless the retailers have a physical presence in the state in question. In past decades, this rule meant that states had a difficult time collecting SUT on mail and phone order purchases from out-of-state companies. Recently, a new tax gap has emerged due to the inability to require out-of-state Internet retailers to collect and remit use taxes to state authorities. One part of the 2011-12 budget package—Chapter 7, Statutes of 2011 First Extraordinary Session (ABX1 28, Blumenfield)—attempts to address this tax gap by instituting three separate requirements on out-of-state retailers, such as Amazon.com, to collect and remit SUT on purchases by Californians. The budget plan assumes this generates $200 million of additional SUT revenue in 2011-12. (A petition was filed on July 8, 2011, that seeks to overturn the key provisions of Chapter 7 through the referendum process.)

Extend Existing Medi-Cal Hospital Fee. The budget package scores a net General Fund benefit of $198 million in 2010-11 and 2011-12 combined from extending an existing Medi-Cal hospital fee. Chapter 19, Statutes of 2011 (SB 90, Steinberg), extended and modified an existing Medi-Cal quality assurance fee on hospitals from December 31, 2010, through June 30, 2011. This results in reduced net General Fund costs in the Medi-Cal Program.

Maintain Existing Accrual Policy. As we described in our January 31, 2011 report, *The Administration's Revenue Accrual Approach*, the administration proposed a change in the state's method for accruing (attributing) revenues by fiscal year in the Governor's January budget submission. In the May Revision, the Governor proposed extending the proposed new accrual approach to the entirety of General Fund baseline revenues. In January and May, the administration interpreted the accrual changes as implementations of existing law and, therefore, included their effects in their baseline revenue estimates—thereby affecting the calculation of the overall budget problem to be solved in the 2011-12 budget package. In June, however, the Legislature and the Governor determined not to change the state's method for accruing revenues. By sticking to the existing accrual policy, the state reduced the size of the previously calculated 2011-12 budget problem by a net amount of $160 million (due to there being $1.6 billion more revenue attributed to 2010-11 and prior years and $1.4 billion less revenue to 2011-12). Accrual changes do not affect the amount of cash paid by taxpayers or received by the state in the long run—only to which fiscal years that cash is attributed.

Changes to Child and Dependent Care Expenses Credit. Federal and state income tax laws allow credits for certain expenses that taxpayers incur for qualified child or dependent care. Previously, the state credit was refundable, meaning that taxpayers receive the full benefit of the credit regardless of their other tax liabilities. The 2011-12 budget package changes the state tax credit from being refundable to being nonrefundable beginning in tax year 2011. This change is estimated to increase state income tax revenues by $75 million per year.

Fire Prevention Fee. Chapter 8, Statutes of 2011 First Extraordinary Session (ABX1 29, Blumenfield), establishes a fire prevention fee not to exceed $150 on each structure in a parcel within a state responsibility area (SRA). (Under state law, SRAs generally are areas where the state has the primary financial responsibility for preventing and suppressing wildland fires.) This is estimated to generate $50 million of revenue to offset General Fund expenses in the Department of Forestry and Fire Protection in 2011-12, with savings growing to $200 million in 2012-13. (A petition was filed on July 20, 2011 that seeks to overturn Chapter 8 through the referendum process.)

Financial Institution Records Match (FIRM). Federal law establishes the Financial Institution Data Match program—which matches financial institutions' customer records with those of child support debtors—in order to increase compliance with child support collection requirements. The budget package authorizes a similar program, FIRM, in which the Franchise Tax Board (FTB) will coordinate with financial institutions in California to match lists of their accountholders to identify delinquent tax debtors' accounts. Increased tax compliance through the FIRM program is estimated to generate $40 million of additional General Fund revenue in 2011-12.

Use Tax Look-Up Table. The use tax—a companion to the state's sales tax for over 70 years—is required to be paid by individual Californians when they purchase tangible goods from out-of-state retailers and then have them shipped into the state for use here. As part of the 2011-12 budget package, the state requires the Board of Equalization to develop a "look-up" table for insertion into FTB income tax form instructions, through which taxpayers will be informed how much use tax a typical taxpayer owes due to such purchases from out-of-state retailers. Beginning with the 2011 income tax year, the legislation allows taxpayers to use the look-up table to determine their use tax obligations on non-business purchases of tangible goods, each with a sales price of less than $1,000. The budget package assumes the look-up table will result in $6.5 million of increased collections in 2011-12.

Local Realignment Fund Actions

The realignment plan included in the 2011-12 budget package is discussed in more detail in "Chapter 3." This section briefly discusses revenue actions in the budget that are related to the realignment plan.

Sales Tax Revenue Redirected to Realignment Fund. The budget package redirects 1.0625 percentage points of SUT from the General Fund to the Local Realignment Fund 2011 to provide funding to local governments for functions reassigned to them under the realignment plan. This is estimated to reduce General Fund revenues by about $5.1 billion in 2011-12 and increase Local Realignment Fund revenues by the same amount. This change does not affect the amount of SUT revenues paid by Californians.

Vehicle Registration Fee Increased. The Department of Motor Vehicles (DMV) is funded from different taxes and fees collected on vehicles, including the VLF and the vehicle registration fee. (Both of these revenue sources are deposited to special funds and not the General Fund.) Chapter 35, Statutes of 2011 (SB 89, Committee on Budget and Fiscal Review), increases the vehicle registration fee from $31 to $43 beginning July 1, 2011, which will generate new annual fee revenue of about $300 million. This new fee revenue will cover DMV administration costs, thereby freeing up a like amount of existing VLF revenue. The budget plan then directs the $300 million of VLF revenue to realignment accounts, thereby reducing General Fund expenditure requirements on realigned programs.

Redirecting VLF Funds Previously Dedicated to Orange County and Cities. Under previous law, cities and Orange County received allotments of VLF funds. The budget package shifts these funds—totaling an estimated $153 million in 2011-12—to local realignment accounts, thereby reducing General Fund expenditure requirements on realigned programs.

Chapter 3

Expenditure Highlights

Proposition 98

Proposition 98 funding constitutes about 70 percent of total funding for K-12 education and the California Community Colleges (CCC). Proposition 98 funding also supports the state's subsidized preschool program and, historically, has supported certain child care programs. In this section, we review the changes in 2010-11 Proposition 98 spending and describe the major Proposition 98 components of the 2011-12 budget package. In the following three sections, we discuss in more detail the budgets for K-12 education, child care, and community colleges, respectively.

2010-11 Proposition 98 Spending Up Slightly

Since the adoption of the *2010-11 Budget Act*, Proposition 98 spending for 2010-11 increased by a net of $129 million. The state experienced higher costs primarily for K-12 revenue limits, CCC apportionments, and K-3 Class Size Reduction ($443 million). These increases, however, were offset by $314 million in savings, primarily from the veto of Stage 3 child care funding and a reduction in categorical funding for basic aid school districts. The cut to basic aid school districts, adopted in March 2011, reduced categorical funding for basic aid districts by an amount equivalent to an 8.9 percent revenue limit reduction. This reduction is equivalent to the base revenue limit reductions that apply to nonbasic aid school districts. The reduction (for both basic aid and nonbasic aid districts) is maintained in 2011-12. (As discussed further in the child care section, partial funding for Stage 3 child care in 2010-11 was restored with one-time Proposition 98 funds.)

2011-12 Proposition 98 Minimum Guarantee Affected by Several Factors

Figure 1 (see next page) shows all the changes in the 2011-12 Proposition 98 minimum guarantee relative to the January current-law estimate. These changes are discussed in more detail below.

Baseline Revenue Increases Raise Minimum Guarantee. Relative to the January estimate, the minimum guarantee is up by $3.9 billion due to improvements in baseline General Fund revenues ($3.1 billion) and local property tax revenues (almost $800 million). The improvement in local

Figure 1

Summary of Changes in 2011-12 Proposition 98 Minimum Guarantee

January Estimate to Final Budget (In Millions)

Adjustments	Amount
Baseline Changes	
General Fund revenue increases	$3,083
Property tax increases	792
Subtotal	($3,876)
Policy Changes	
Gas tax swap	$578
AB 3632 student mental health services shift	222
Tax enforcement relating to out-of-state retailers	83
Remittance payments from redevelopment agencies	—
Certain sales tax revenues excluded from guarantee	-2,105
Child care excluded from guarantee	-1,134
Other	-179
Subtotal	(-$2,535)
Net Effect of All Changes	**$1,341**

property tax revenues increases the guarantee because "Test 1" is operative in 2011-12—meaning roughly 40 percent of state General Fund revenues must be provided to K-14 education and any increases in local property tax revenues do not offset General Fund spending but rather result in additional funding for schools and community colleges.

Six Policy Decisions Also Affect Minimum Guarantee. In addition to these baseline changes, the 2011-12 minimum guarantee is affected by the following policy decisions.

- ***"Gas Tax Swap."*** The minimum guarantee is held harmless for the gas tax swap adopted by the Legislature in March 2011. The gas tax swap eliminated the sales tax on gasoline (previously included in the Proposition 98 calculation) and replaced it with an increase in the excise tax on gasoline (excluded from the Proposition 98 calculation). Absent a hold harmless provision, the minimum guarantee would have decreased by $578 million due to the swap.
- ***Student Mental Health Services Shift.*** The minimum guarantee is adjusted to account for the shift of responsibility for special education-related student mental health services from county mental health agencies to school districts. The state increased the minimum guarantee by $222 million to account for this shift in responsibility to school districts.

- ***Tax Enforcement Relating to Certain Online Retailers.*** The minimum guarantee is affected by a new tax enforcement policy intended to require out-of-state retailers to collect sales and use tax (SUT) from California consumers making online purchases. This policy change is estimated to increase the minimum guarantee by $83 million.
- ***Remittance Payments From Redevelopment Agencies.*** The minimum guarantee is held harmless for the shift of $1.7 billion in property tax revenues from redevelopment agencies to schools and community colleges—meaning the shifted funds offset General Fund spending and generate state savings rather than augment overall school funding. (Under the redevelopment package, these remittance payments would augment school funding beginning in 2012-13.)
- ***Certain Sales Tax Excluded.*** As part of the realignment package, the budget diverts 1.0625 cents of the state's SUT (approximately $5.1 billion) to counties and excludes these revenues from the Proposition 98 calculation. This reduces the minimum guarantee by $2.1 billion. This change, however, requires that voters approve one or more ballot measures before November 2012 that (1) expressly authorize excluding these sales tax revenues from the Proposition 98 calculation and (2) provide alternative funding of the same amount for K-12 schools and community colleges. If no ballot measure is adopted satisfying these requirements, the applicable sales tax revenue would not be excluded from the guarantee moving forward and a $2.1 billion "settle-up" obligation will be created for 2011-12 (increasing the state's total outstanding settle-up obligation up to $3.6 billion). If created, this new settle-up obligation would be paid over a five-year period.
- ***Child Care Excluded.*** The minimum guarantee is reduced by $1.1 billon to account for the exclusion of all child care programs but preschool. Beginning in 2011-12, child care programs are to be supported using non-Proposition 98 General Fund monies.

Proposition 98 Funding for K-12 Education Flat, Down for Community Colleges and Child Care Programs

Figure 2 (see next page) shows funding levels for K-12 education, CCC, child care, and other Proposition 98-supported agencies (including the state special schools and juvenile justice). As the figure shows, total K-12 education funding remains relatively flat from 2010-11 to 2011-12. The share covered by local property taxes, however, is significantly higher (largely due to estimated redevelopment agency remittance payments) whereas the share covered by the General Fund is lower. Proposition 98 funding for community colleges is down $419 million year over year. Child care funding is removed from the Proposition 98 guarantee beginning in 2011-12. Although not evident from the figure (which shows only ongoing Proposition 98 funding), overall child care funding (including one-time funding) is reduced by roughly $400 million year over year.

Figure 2

Ongoing Funding for K-14 Education and Child Care

(In Millions)

	2009-10 Final	2010-11 Revised	2011-12 Budgeted	Change From 2010-11
K-12 Education[a]				
General Fund	$30,279	$30,806	$29,328	-$1,478
Local property tax revenue	12,328	12,147	13,823	1,676
Subtotals	($42,606)	($42,953)	($43,151)	($198)
California Community Colleges				
General Fund	$3,721	$3,885	$3,466	-$419
Local property tax revenue	2,000	1,949	1,949	-1
Subtotals	($5,721)	($5,834)	($5,415)	(-$419)
Child Care	$1,454	$915	—	-$915
Other Agencies	93	85	$85	—
Totals, Proposition 98	**$49,874**	**$49,787**	**$48,651**	**-$1,137**
Non-Proposition 98 General Fund for child care	—	—	$1,054	$1,054
Totals, K-14 Education and Child Care	**$49,874**	**$49,787**	**$49,705**	**-$83**

[a] Includes funding for state preschool program.

Specific Proposition 98 Reductions Triggered If Revenues Fall Short of Projections

As discussed earlier, the 2011-12 budget package includes various "trigger" reductions that would be implemented if estimates of state revenues as of December 2011 are more than $1 billion lower than budget assumptions, with additional reductions triggered if revenues fall more than $2 billion below budget assumptions.

If Revenues Fall Somewhat Short of Projections, Certain Community College and Child Care Cuts Triggered. If revenue estimates are $1 billion to $2 billion below budget assumptions, the state would reduce community college apportionments by $30 million and implement a 4 percent across-the-board reduction to child care programs, for savings of $23 million. If the reductions were triggered, the state also would implement a $10 per-unit increase on community college fees. The additional revenues from the fee increase would offset the effects of the apportionment reduction on community colleges.

If Revenues Fall Further Below Projections, Certain K-12 Cuts and Additional CCC Cuts Also Triggered. If revised revenue estimates are more than $2 billion below budget assumptions, up to $1.9 billion in additional K-12 and community college reductions would be triggered. The K-12 revenue limits would be reduced based on a sliding scale, in proportion to the size of the General Fund shortfall. The revenue limit reductions would be capped at $1.5 billion—associated with revenue estimates falling $4 billion or more below budget assumptions. Funding for the Home-to-School Transportation program also would be eliminated effective January 2012 (for half-year savings of $248 million), and community college apportionments would be further reduced by $72 million.

K-12 Trigger Also Includes Shorter School Year Provisions. If revised revenue estimates fall $2 billion below budget estimates, the state also would allow K-12 schools to reduce the school year by an additional seven days in 2011-12. Any reductions in instructional time and accompanying reductions in salaries or benefits, however, would need to be achieved by school districts through the collective bargaining process.

Out-Year Proposition 98 Spending Obligations Still Growing

The state currently faces a number of Proposition 98-related funding obligations associated with payment deferrals, K-12 revenue limits, mandates, the Quality Education Investment Act (QEIA), and the Emergency Repair Program (ERP).

State Adopts New, Large K-14 Payment Deferrals. The budget package continues the state's reliance on payment deferrals to achieve budget solution, deferring an additional $2.1 billion in K-12 payments and $129 million in CCC payments from 2011-12 to 2012-13. Proposition 98 payment deferrals now total $10.4 billion. As a result of these deferrals, 20 percent of funding for Proposition 98-supported programs in 2011-12 will not be paid until 2012-13. In essence, the first $10 billion in Proposition 98 funding for 2012-13 will pay for services that schools and community colleges will have already provided in 2011-12.

Revenue Limit "Deficit Factor" Still Growing. The state's existing obligation for K-12 revenue limits is also growing. When the state has made a base reduction to K-12 revenue limits and/or has not provided an annual cost-of-living adjustment (COLA), it has chosen to create a deficit factor. In essence, the deficit factor reflects a statutory commitment to use Proposition 98 funds at some point in the future to raise revenue limits to the level they would have been absent the base reductions and foregone COLAs that have occurred over the last four years. Cumulative base revenue limit reductions and foregone revenue limit COLAs total $8 billion in 2011-12—$7.9 billion for school districts (resulting in a deficit factor of 19.8 percent) and $144 million for county offices of education (resulting in a deficit factor of 20 percent).

Mandate Backlog Still Growing. The state's existing backlog of K-14 mandate claims also continues to increase. Although the budget provides $90 million for the ongoing cost of K-14 mandates, 2011-12 costs are projected to be $180 million. This underfunding, when coupled with an already large backlog, leaves the state at the end of 2011-12 with $3.8 billion in unpaid claims.

Four More Years of Scheduled QEIA Payments to Make. The budget includes $450 million non-Proposition 98 funding to support the QEIA program. Of this amount, $402 million is provided to schools and $48 million is provided to community colleges. As set forth in Chapter 751, Statutes of 2006 (SB 1133, Torlakson), the state has scheduled $450 million annual payments until a total of $2.8 billion has been provided. In addition to the 2011-12 appropriation, the state would need to make three additional payments to pay off the obligation (estimated to occur in 2014-15).

Roughly Half of ERP Obligation Still to Be Paid. In 2004, the state settled the *Williams v. California* case, a class-action lawsuit filed on behalf of public school students. In response to the settlement, the Legislature created the ERP, which provides grants for critical health and safety repairs in certain low-performing schools. The state is required to provide $800 million to the ERP to meet the requirements of the settlement. The budget package suspends funding for the ERP in 2011-12. The state has provided $343 million for the program to date.

K-12 Education

Figure 3 shows K-12 per-pupil programmatic funding from 2007-08 through 2011-12. Per-pupil programmatic funding decreased by $117 from 2010-11 to 2011-12, reflecting a 1.5 percent year-over-year reduction. School districts will receive $522 less per pupil in 2011-12 than in 2007-08.

Figure 3

K-12 "Programmatic" Funding[a]

(Dollars in Millions Unless Otherwise Specified)

Programmatic Funding	2007-08 Final	2008-09 Final	2009-10 Final	2010-11 Final	*2011-12 Budget Act*
K-12 ongoing funding[b]	$48,883	$43,215	$40,717	$43,017	$43,179
Payment deferrals	—	2,904	1,679	1,719	2,064
Settle-up payments	—	1,101	—	267	—
Public Transportation Account	99	619	—	—	—
Freed-up restricted reserves[c]	—	1,100	1,100	—	—
American Recovery and Reinvestment Act funding[c]	—	1,192	3,575	1,192	—
Federal education jobs funding[c]	—	—	—	421	781
Totals	**$48,982**	**$50,130**	**$47,070**	**$46,616**	**$46,024**
Per-Pupil Programmatic Funding					
K-12 attendance	5,947,758	5,957,111	5,933,761	5,953,259	5,966,942
K-12 Per-Pupil Funding (In Dollars)	**$8,235**	**$8,415**	**$7,933**	**$7,830**	**$7,713**

[a] Excludes federal funds not associated with stimulus packages, lottery, and various other local funding sources.

[b] Includes ongoing Proposition 98 funding, Proposition 98 accounting adjustments, and funding for the Quality Education Investment Act.

[c] Reflects LAO estimates of funds spent in each year.

Districts Affected by Loss of Federal Funds. The year-to-year reduction in K-12 programmatic funding is primarily due to the loss of one-time federal funds. Schools in California received $6 billion in American Recovery and Reinvestment Act (ARRA) funding that could be spent in 2008-09, 2009-10, and 2010-11. School districts will have exhausted these revenues, however, by 2011-12. Many school districts will still have funding available from the federal Education Jobs and Medicaid Assistance Act of 2010, which provided California schools with $1.2 billion in one-time federal funding to retain school staff and reduce teacher layoffs. These funds, however, are not sufficient to entirely offset the loss of ARRA funding.

K-12 Spending Changes

In addition to K-12 revenue limit deferrals, discussed earlier, and a major change in funding for certain student mental health services, discussed below, the budget package includes the following K-12 spending changes.

- ***Provides Ongoing Funding for K-12 Mandates.*** The package includes $80 million General Fund monies to pay for the ongoing costs of education mandates, though actual K-12 mandate claims will likely total roughly $150 million in 2011-12. Actual costs will depend on the outcome of a few unresolved mandate issues. Any claims not paid in 2011-12 will be rolled into the education mandate backlog, which the state eventually will be required to pay.
- ***Provides Certain Flexed Categorical Funding for New Charter Schools.*** In lieu of flexible categorical funding received by existing schools, the budget provides new start-up charter schools with $11 million (or $127 per pupil) that may be used for any educational purpose. (Conversion charter schools are prohibited from receiving this new funding given they previously had access to these funds from their school district and the school district is required to continue passing through at least $127 per pupil to the school.)
- ***Funds "Clean Technology" Partnership Academies.*** The package provides $3.2 million to support the creation of schools that blend core academic and career-technical education (partnership academies) with particular emphasis on renewable resources technology.

Mental Health Services for Students

The budget package includes a notable shift of program and funding responsibility related in student mental health services.

California Had Tasked Counties With Carrying Out Federal Education Requirement. Federal law requires that school districts provide students with disabilities the accommodations necessary for them to benefit from their education. This entitlement covers a range of services, including—if determined educationally necessary by an official assessment—mental health care. Since 1984, California has required that, county mental health (CMH) agencies provide mental health services to special education students. These responsibilities, referred to as AB 3632 services after the authorizing legislation, were determined to be a state reimbursable mandate for counties. As part of the *2010-11 Budget Act*, then-Governor Schwarzenegger vetoed funding for the AB 3632 program and declared the state mandate suspended, leading to uncertainty as to which entity—schools or counties—was responsible for ensuring that students receive services in 2010-11.

Budget Shifts Responsibility, Increases Funding to Schools. To help address uncertainty from the veto and ensure students continued to receive services in 2010-11, the March 2011 education trailer bill provided $81 million in one-time Proposition 98 funds to school districts. Beginning in 2011-12, the budget package repeals the AB 3632 mandate and permanently shifts responsibility for special education-related mental health services from CMH agencies back to schools. The budget package provides up to $421 million for school districts to assume these responsibilities, including the previously mentioned $222 million permanent increase to the Proposition 98 minimum guarantee. Specifically, the budget dedicates funding for educationally necessary mental health services—including costs for students placed in residential facilities—from the following sources:

- ***Proposition 98 ($253 Million).*** Of this amount, $250 million is to be allocated to Special Education Local Planning Areas (SELPAs) on an equal per-pupil basis (consisting of $219 million in new funding and $31 million redirected from a previous special education program), and $3 million is to be reserved for small SELPAs that face extraordinary costs.
- ***Proposition 63 ($99 Million).*** These funds are allocated to CMH agencies and are available on a one-time basis for SELPAs and districts that choose to contract with CMH agencies for services in 2011-12.
- ***Federal Special Education Funds ($69 Million).*** For 2011-12, this funding is allocated to SELPAs based on existing counts of students that receive special education-related mental health services. Budget legislation expresses intent that beginning in 2012-13 funding is to be allocated on an equal per-pupil basis.

Additional Funding Provided to Implement Transition. In addition to funds for schools to provide services, the budget package provides $2.8 million in one-time federal special education carryover funds for state-level activities associated with the programmatic shift. This includes $2 million for the Office of Administrative Hearings to cover an anticipated increase in mental health dispute resolution cases and $800,000 for the California Department of Education (CDE) to undertake certain transition activities. Specifically, CDE is to provide oversight and technical assistance to SELPAs and school districts as well as identify options for improving accountability for effective services under the realigned system.

Notable K-12 Budget Provisions

The budget package also includes several budget provisions that affect school district financial management and administration.

State Prohibits Districts From Using Summer Layoff Window. The budget package suspends existing law that allows school districts to lay off teachers during the period between five days after the budget is enacted and August 15 if school district revenue limits in the enacted budget do not increase by at least 2 percent. Given that the budget package includes no increases to K-12 revenue limits, the law would have been operative in 2011.

State Requires Districts to Build Budgets Assuming Flat Year-Over-Year Revenues. The budget package also requires school districts to project the same level of per-pupil funding in 2011-12 as they received in 2010-11 and to maintain staffing and program levels commensurate with those funding levels. The Governor's signing message for the education trailer bill, however, emphasizes that school districts might still need to make reductions due to cost increases, the loss of federal funds, declining enrollment, or other factors. The signing message also states that the law was not intended to interfere with these local school board decisions.

State Suspends Requirement for Districts to Demonstrate Multiyear Solvency. The budget package also temporarily modifies the approval process for school district budgets. Under current law, the county superintendent is required to review and approve a school district's budget to ensure the district can meet its financial obligations in that fiscal year and has a financial plan to satisfy its obligations for the two subsequent years. In 2011-12, a county superintendent would be unable to disapprove a school district's budget based on the district's inability to meet its financial obligations in 2012-13 and 2013-14.

Governor Vetoes Funding for Longitudinal Teacher Data System. The Governor vetoed $2.1 million in federal funds and $84,000 in special funds for the California Longitudinal Teacher Integrated Education Data System. Authorized by 2006 legislation, this information system was intended to help the state identify teacher workforce trends; assess future teacher workforce needs; analyze the effectiveness of teacher recruitment, retention, and support programs; and develop related state policies. The Governor's veto leaves no funding for the project in 2011-12 and ends further development of the system.

State Grants Flexibility for Two Additional Years. The March 2011 education trailer bill extends by two additional years most of the flexibility options that the state originally granted to school districts in the February

2009 budget package (including options related to K-3 Class Size Reduction, other categorical programs, and shortened school year).

Child Care and Development

As shown in Figure 4, the *2011-12 Budget Act* includes a total of $2.4 billion for child care and development (CCD) in 2011-12. This is a decrease of $412 million, or 15 percent, compared to the prior year. The figure also highlights the shift of funding for most CCD programs from Proposition 98 to non-Proposition 98 General Fund monies, as discussed earlier in this chapter. In addition, the figure reflects the expiration of federal stimulus

Figure 4

Child Care and Development Budget Summary

(Dollars in Millions)

	2009-10 Final	2010-11 Revised	2011-12 Budgeted	Change From 2010-11	
				Amount	Percent
Expenditures					
CalWORKs Child Care					
Stage 1	$547	$486	$428	-$58	-12%
Stage 2	476	458	442	-16	-3
Stage 3	412	288	146[a]	-142	-49
Subtotals	($1,436)	($1,232)	($1,016)	(-$215)	(-17%)
Non-CalWORKs Child Care					
General Child Care	$797	$785	$686	-$99	-13%
Other child care	321	298	247	-51	-17
Subtotals	($1,118)	($1,083)	($933)	(-$150)	(-14%)
State Preschool	$439	$397	$374	-$23	-6%
Support programs	109	100	76	-24	-24
Totals	**$3,101**	**$2,812**	**$2,399**	**-$412**	**-15%**
Funding					
State General Fund					
Proposition 98	$1,827	$1,253	$374	-$879	-70%
Non-Proposition 98	29	29	1,084	1,054	3,626
Other state funds[b]	66	350	—	-350	100
Federal funds					
CCDF	541	602	533	-69	-11
TANF	528	467	408	-59	-13
ARRA	110	110	—	-110	100

[a] Includes funds that were redirected from other programs. The amounts reflected for the other programs have been adjusted downward accordingly.

[b] Includes prior-year Proposition 98 carryover. For 2010-11, also includes $83 million from local reserves and $6 million redirected from the Assembly's budget.

CCDF = Child Care and Development Fund; TANF = Temporary Assistance for Needy Families; and ARRA = American Recovery and Reinvestment Act.

funding (which provided $110 million annually in 2009-10 and 2010-11). The year-to-year decreases in "other state funds" and federal child care block grant monies reflect a markedly lower reliance on one-time carryover funds to support ongoing child care programs in 2011-12.

Legislature Restores Funding for CalWORKs Stage 3 Child Care in 2010-11. As part of the *2010-11 Budget Act*, then-Governor Schwarzenegger vetoed $256 million for the California Work Opportunity and Responsibility to Kids (CalWORKs) Stage 3 child care program with the intent that services be eliminated as of November 1, 2010. In response to a court ruling requiring the state to extend services through December 2010 and a legislative decision to continue operating the program, the Legislature ultimately restored $186 million to retain Stage 3 child care services in 2010-11. These funds came from a combination of three sources:

- $118 million in prior-year federal carryover (including $58 million authorized through a Section 28 letter in December 2010 and $60 million appropriated in the March 2011 education trailer bill).
- $62 million in 2010-11 Proposition 98 funds redirected from other CCD programs (authorized through a Section 26 letter in March 2011).
- $6 million redirected from the Assembly's operating budget.

Although former Stage 3 families maintained eligibility for services, uncertainty regarding the program's funding and status in the months following the veto resulted in decreased caseload numbers once program services resumed. (Some Stage 3 families re-enrolled in CalWORKs Stage 2 child care through the county-level Diversion program, resulting in a $27 million increase in 2010-11 Stage 2 costs compared to *2010-11 Budget Act* assumptions.) As shown in Figure 4, budget estimates reflect diminished Stage 3 caseload levels continuing through 2011-12.

Budget Package Makes Several Programmatic Reductions in 2011-12. Figure 5 (see next page) provides a summary of the major changes in CCD spending for 2011-12. Caseload and technical adjustments account for $122 million less spending, with the remaining $290 million in savings coming from reducing child care contracts across the board, reducing reimbursement rates for license-exempt providers, lowering income eligibility thresholds, and reducing spending on quality improvement activities. The administration estimates that the contract reduction and lower eligibility threshold will eliminate funding for about 35,500 child care slots. The budget package also redirects $7.9 million previously used for maintaining countywide centralized eligibility lists to general child care services.

Figure 5

Major Child Care and Development Spending Changes

(In Millions)

Change	Amount
Reduce child care contracts by 11 percent[a]	-$177
Make technical and caseload adjustments	-122
Reduce maximum reimbursement rate for license-exempt providers from 80 percent to 60 percent of licensed rate	-68[b]
Lower maximum income eligibility from 75 percent to 70 percent of the state median income	-28
Reduce or eliminate quality improvement activities	-16
Eliminate $7.9 million for Centralized Eligibility Lists, redirect funds to child care program	—
Total	**-$412**

[a] Does not apply to CalWORKs Stages 1 and 2 child care. Contract reduction taken after making other policy reductions. Contractors will realize savings by eliminating slots and prioritizing remaining services for families with the lowest income.

[b] Includes $31 million non-Proposition 98 savings related to CalWORKs Stage 1 child care.

Higher Education

The enacted budget provides a total of $10.1 billion in General Fund support for higher education in 2011-12 (see Figure 6). This reflects a decrease of $1.4 billion, or 12 percent, from the 2010-11 amount. Thus, the 2011-12 budget more than eliminates the $911 million General Fund increase higher education received the previous year. As a result, higher education's share of state General Fund spending declines from 12.6 percent to 11.8 percent.

Tuition Partly Backfills Cuts. All three public higher education segments will receive additional tuition and fee revenue as a result of approved increases. After diverting a portion of this new revenue to institutional financial aid programs, the segments will receive from these increases about $675 million, which effectively backfills an equal amount of their General Fund reductions. As explained below, this continues a recent trend whereby students pay an increasing share of the cost of their education.

When all core sources of revenue (including General Fund, local property taxes, federal stimulus funds, and net fees/tuition) are considered, higher education's programmatic support is now about 7 percent lower than it was in 2010-11 (see Figure 7, page 28). Compared to 2007-08—generally considered to be the last "normal" funding year before the current recession necessitated spending reductions—higher education's programmatic support has declined about 2 percent.

UC and CSU

Overall Funding. As shown in Figure 6, the 2011-12 budget provides $2.4 billion in General Fund support to the University of California (UC), and $2.1 billion to the California State University (CSU). For both university systems, these amounts reflect net reductions of 18 percent. Specifically, each segment received a General Fund reduction of $650 million, a General Fund *augmentation* of $106 million to replace one-time federal stimulus funds in the 2010-11 budget, and a variety of other technical adjustments. Approved tuition increases (net of amounts set aside for student financial aid) will backfill about $266 million and $300 million, respectively, of UC and CSU's General Fund reductions. As a result, the decline in total programmatic funding for each system is about 11 percent.

Potential for Further General Fund Reductions. The UC and CSU budgets each reflect a $500 million reduction originally proposed in the Governor's January budget, as well as an additional $150 million reduction included in the final budget agreement. As described in "Chapter 1", the enacted budget makes provision for an additional $100 million General Fund reduction to each university system in the event that anticipated state revenues are not realized. If the Director of Finance determines that revenues are projected to fall more than $1 billion short, the Director must reduce UC and CSU's General Fund appropriations by up to $100 million each.

Enrollment Targets. The 2011-12 budget sets state-supported enrollment targets of 209,977 full-time equivalent (FTE) students at UC and 331,716 FTE students at CSU. The target for UC is the same as the 2010-11 target, while

Figure 6

Higher Education Funding

General Fund (Dollars in Millions)

			Change From 2010-11	
	2010-11	**2011-12**	**Change**	**Percent**
University of California	$2,911.6	$2,374.1	$537.6	-18%
California State University	2,607.7	2,141.3	466.4	-18
California Community College	3,913.5	3,477.3	436.2	-11
Hastings University	8.4	6.9	1.4	-17
California Student Aid Commission	1,257.3	1,402.9	145.6	12
California Postsecondary Education Commission	1.9	—	1.9	-100
General obligation bond debt service	809.9	743.2	66.8	-8
Lease-revenue bond debt service[a]	(265.8)	(267.7)	(1.9)	(1)
Totals	**$11,510.3**	**$10,145.6**	**$1,364.7**	**-12%**

[a] Amounts in parentheses are shown here for reference only, as they are already reflected in the individual segments' General Fund appropriations.

the CSU target is about 8,000 FTE students lower than in 2010-11. The CSU's enrollment fell short of its target in 2010-11, and a provision in that year's budget caused $75 million in General Fund support associated with that enrollment shortfall to be reverted from CSU's budget. In a departure from past practice, the 2011-12 budget provides for no reversion of funding if either university system falls short of its enrollment target.

Student Tuition. Both UC and CSU have approved the following tuition increases for the 2011-12 academic year:

- The UC Regents initially adopted an 8 percent increase at their November 2010 meeting. In July 2011, following adoption of the *2011-12 Budget Act*, they approved an additional 9.6 percent increase. Together, those actions bring 2011-12 mandatory systemwide charges to $12,192—an overall increase of 18.3 percent. Including mandatory campus fees, undergraduate students will pay an average of about $13,218 at UC campuses.
- The CSU Trustees initially adopted a 10 percent tuition increase for 2011-12 in November 2010, and approved an additional 12 percent increase in July, for an overall increase of 23.2 percent. Mandatory systemwide charges for CSU undergraduates will be $5,472, with campus fees (some of which may increase) adding another $1,000 on average.

The 2011-12 tuition increases are expected to generate about $415 million at UC and $450 million at CSU in additional revenues. Both segments plan to

Figure 7

Higher Education Programmatic Support[a]

Selected Core Funds (Dollars in Millions)

						Change From 2010-11	
	2007-08	**2008-09**	**2009-10**	**2010-11**	**2011-12**	**Amount**	**Percent**
University of California	$4,399.7	$4,326.4	$4,067.0	$4,841.9	$4,313.6	-$528.22	-11%
California State University	3,945.0	4,018.4	3,599.0	4,015.1	3,587.8	-427.30	-11
California Community Colleges	6,702.9	6,796.0	6,442.6	6,595.4	6,228.6	-366.80	-6
Hastings College of the Law	32.3	36.8	39.1	42.7	42.4	-0.30	-1
California Postsecondary Education Commission	2.1	2.0	1.8	1.9	—	-1.85	—
California Student Aid Commission	866.7	912.3	1,075.5	1,357.5	1,465.1	107.63	8
Totals	**$15,948.7**	**$16,091.9**	**$15,225.0**	**$16,854.4**	**$15,637.6**	**-$1,216.85**	**-7%**

a Includes General Fund, state lottery funds, federal stimulus funding, student fee and tuition revenues (net of funds diverted to institutional aid), and Student Loan Operating Fund. The CCC funding "deferred" to subsequent years is reflected in the year spending commitments were made. Figures for CCC also reflect local property taxes counted toward Proposition 98.

increase financial aid expenditures by about one-third of this amount. In addition, Cal Grant recipients will receive larger grants to cover the tuition increases.

Other Provisions. The budget includes several new requirements for the universities. One provision requires UC to allocate $3 million of its General Fund appropriation for scheduled salary increases for its service employees. Other provisions provide guidance as to how the universities allocate their budget reductions, prohibiting disproportionate cuts in academic preparation and outreach programs at both segments, and in certain math, science, and nursing education programs at UC. The *Budget Act* makes explicit a longstanding prohibition on the use of General Fund appropriations to support auxiliary enterprises or intercollegiate athletic programs at UC. Trailer bill language strengthens requirements for CSU's annual systemwide audit and removes a requirement for individual campus audits.

Capital Outlay. The budget includes appropriations for six UC projects—$45.3 million in lease-revenue bond funding for two new projects, and $9.3 million in general obligation bond funding for the equipment phase of four projects. It also includes appropriations for seven CSU projects—$201 million in lease-revenue bond funding for five new projects, and $2.8 million in general obligation bond funding for the equipment phase of two projects.

California Community Colleges

Like K-12 education, community colleges' local property tax revenue and most of their General Fund support is included within Proposition 98's funding formulas. Figure 2 (in the "Proposition 98" section of this chapter) shows that the 2011-12 budget package provides the CCC system with $5.4 billion in Proposition 98 funding, which is 11.1 percent of total state Proposition 98 spending. This reflects a reduction of $419 million (7 percent) from the revised 2010-11 spending level.

Budget Defers More Funding to Later Years. As noted earlier in the "Proposition 98" section, the 2011-12 budget defers an additional $129 million to 2012-13, thereby creating a total ongoing deferral of $961 million. This represents about 17 percent of Proposition 98 funding for CCC.

Base Apportionment Cuts Coupled With Workload-Reduction Provision. The budget includes a $400 million base reduction in Proposition 98 General Fund support for CCC apportionments (general-purpose monies), offset by an increase of $110 million in fee revenue. The budget includes a provision that permits community colleges to reduce the number of students they serve in 2011-12 in proportion to the net reduction in base apportionment funding ($290 million). The provision expresses the Legislature's intent that any resulting workload reductions be limited as much as possible to "courses and programs outside of those needed by students to achieve their basic skills, workforce training, or transfer goals."

Higher Student Fees to Mitigate Budget Cuts. The budget package increases enrollment fees from $26 per unit to $36 per unit beginning in the fall 2011 term. The budget assumes that these higher fees will generate $110 million in additional revenue for CCC, thereby mitigating the impact of reduced Proposition 98 General Fund support for apportionments.

Categorical-Program Flexibility Extended. As discussed in our *2009-10 California Spending Plan* (page 34), the 2009-10 budget created a "flex item" so that, between 2009-10 and 2012-13, community colleges could transfer funds from about a dozen categorical programs to any other categorical spending purpose. The 2011-12 budget package extends this flexibility until the end of 2014-15.

Mandates. The budget provides $9.5 million in Proposition 98 monies for CCC mandates, and suspends 7 of CCC's 21 mandates. Two of these seven mandates were added in the 2011-12 budget (Student Records and Sexual Assault Response Procedures).

Trigger Cuts. As noted in the "Proposition 98" section, if projected 2011-12 state revenues fall short by at least $1 billion, CCC's apportionment funding would be reduced by an additional $30 million. In addition, enrollment fees would be increased from $36 per unit to $46 per unit beginning in January 2012, which would likely generate enough revenues to backfill the $30 million cut. If projected 2011-12 state revenues fall short by more than $2 billion, CCC apportionments would be further reduced by $72 million.

Capital Outlay. The 2011-12 budget package appropriates $48.6 million in general obligation bond funding for three continuing projects (at City College of San Francisco, College of the Canyons, and Orange Coast College).

California Postsecondary Education Commission (CPEC)

The Governor's May Revision proposed to reduce CPEC's General Fund support roughly by half, and eliminate the commission as of January 1, 2012. Most of CPEC's functions would disappear, with the exception of a federal teacher grant program that would be transferred from CPEC to CDE. The Legislature rejected the Governor's proposal, and restored full funding for CPEC. The Legislature also adopted supplemental report language directing LAO to recommend structures and duties for a statewide higher education coordinating body. The report is to be submitted to the Legislature by January 1, 2012.

The Governor vetoed all funding for CPEC, and in his veto message requested that the three segments and other higher education stakeholders explore alternatives for coordinating higher education.

California Student Aid Commission (CSAC)

The budget provides $1.5 billion for CSAC, including $1.4 billion in General Fund support, $62.3 million in one-time funds from the Student Loan Operating Fund (SLOF), and $15 million in federal funds for Cal Grants and other financial aid programs. This reflects an increase of about $145 million from the 2010-11 level, primarily to offset tuition increases at UC and CSU. However, given that UC and CSU raised tuition further after passage of the budget act, actual Cal Grant costs are likely to be at least $100 million higher than the amount appropriated for this purpose.

The budget act and related legislation make two significant changes to the operation of Cal Grants programs:

- ***Tighter Eligibility Criteria for Renewals.*** Previously, Cal Grant recipients only had to meet certain eligibility criteria when they first applied for a Cal Grant (and not when they renewed the grant in subsequent years). Changes enacted with the budget package now require Cal Grant recipients applying for renewals to meet several of those requirements. For example, a renewal applicant's family income and assets must fall below specified levels (see Figure 8). Applying these requirements to renewals will disqualify an estimated 12,920 recipients who would otherwise be eligible for awards, reducing Cal Grant expenditures by about $100 million. To mitigate the impact on students, CSAC will use the higher of the limits in place at the time of a student's initial award and those in place at the time of renewal.
- ***New Restrictions on Student Loan Default Rates.*** A second change enacted by the budget package removes some higher education institutions from eligibility to participate in Cal Grant programs. Specifically, institutions may not participate if a high proportion of

Figure 8

2011-12 California Grant Program Income and Asset Ceilings for Dependent Students

Family Size	Cal Grant A and C	Cal Grant B
Income Ceilings		
Six or more	$90,300	$49,600
Five	83,800	46,000
Four	78,100	41,100
Three	71,900	36,900
Two	70,200	32,800
Asset Ceiling		
All family sizes	60,500	60,500

Source: California Student Aid Commission.

their former students default on federal student loans. For 2011-12, the threshold is set at 24.6 percent of an institution's students defaulting within three years of loan repayment, as defined and calculated by the federal government. For subsequent years, the ceiling is 30 percent. These ceilings apply only to institutions with 40 percent or more of undergraduates borrowing federal student loans. For 2011-12, about 76 institutions are affected, and most of these are career and technical colleges. There is a limited exception for continuing students at institutions that become ineligible. These students may qualify for renewal awards reduced by 20 percent.

Federal Loan Program. In November 2010, the U.S. Department of Education transferred federal student loans guaranteed by CSAC (and serviced by its auxiliary, EdFund) to Education Credit Management Corporation (ECMC), ending California's role in administering federally guaranteed loans. As part of the transition, ECMC has entered into a two-year agreement to provide CSAC with technical and operational support previously offered by EdFund. In addition to providing some services, ECMC has also agreed to continue sharing proceeds from SLOF to offset Cal Grant costs. The Governor's budget assumed a $30 million General Fund offset from this source, and subsequent actions by the ECMC Board raised the available amount to $62.25 million. The SLOF contributions are expected to continue beyond the two-year service agreement, with available amounts to be determined annually by the ECMC Board.

Realignment

As part of the 2011-12 budget package, the Legislature made a number of changes to realign certain state program responsibilities and revenues to local governments (primarily counties). Figure 3 in "Chapter 1" identifies the budget-related bills including those related to the realignment package. In total, the realignment plan provides $6.3 billion in 2011-12 to local governments to fund various criminal justice, mental health, and social service programs. The plan adopted by the Legislature is largely similar to the one proposed by the Governor, as modified in the May Revision, with respect to the programs realigned and the amount of revenue provided to local governments. However, the adopted realignment package differs in two important respects from the administration's proposal. First, the Legislature's plan relies on a shift of existing state and local tax revenues rather than the extension of expiring tax rates as proposed by the Governor. Second, the adopted budget legislation does not include the Governor's proposal for a constitutional amendment to, among other things, make the funding allocations to local governments permanent and protect the state from potential mandate claims. We discuss the details of the adopted realignment package in more detail below.

Architecture of 2011 Realignment

2011-12 Expenditures

The realignment package includes $6.3 billion in 2011-12 for court security, corrections and public safety, mental health services, substance abuse treatment, child welfare programs, adult protective services, and CalWORKs. Figure 9 displays the amounts dedicated to each of the realigned programs in 2011-12.

Shift of Existing State and Local Revenues

Unlike the Governor's realignment proposal, the realignment package adopted by the Legislature does not extend the sales and vehicle license fee (VLF) tax rate increases that expired at the end of 2010-11. Instead, the budget reallocates $5.6 billion of state sales tax and state and local VLF revenues for purposes of realignment in 2011-12. Specifically, the Legislature approved the diversion of 1.0625 cents of the state's sales and use tax rate to counties. This is projected to generate $5.1 billion in 2011-12, growing to $6.4 billion in 2014-15 (see Figure 10, next page). In addition, the realignment plan redirects an estimated $453 million from the base 0.65 percent VLF rate for local law enforcement grant programs. Under prior law, these VLF revenues were allocated to the Department of Motor Vehicles (DMV) ($300 million) for administrative purposes and to cities and Orange County ($153 million) for general purposes. The budget increases the motor vehicle registration fee by $12 per automobile to offset the lost revenue to DMV. The budget also shifts $763 million on a one-time basis in 2011-12 from the Mental Health Services Fund (established with voter approval of Proposition 63 in November 2004) for support of the Early and Periodic Screening, Diagnosis, and Treatment (EPSDT) and Mental Health Managed Care programs.

Figure 9

Expenditures for 2011 Realignment

(In Millions)

Adult offenders and parolees	$1,587
Local public safety grant programs	490
Court security	496
Existing juvenile justice realignment	97
Early and Periodic Screening, Diagnosis, and Treatment	579
Mental health managed care	184
Drug and alcohol programs—substance abuse treatment	184
Foster care and child welfare services	1,567
Adult protective services	55
CalWORKs/mental health transfer	1,084
• CalWORKs	(1,066)
• Mental health	(18)
Total	**$6,322**

Figure 10

Revenues for Realignment

(In Millions)

	2011-12	2012-13	2013-14	2014-15
Sales and use tax	$5,106	$5,571	$6,015	$6,388
Vehicle license fee	453	453	453	453
Proposition 63	763	—	—	—
Totals	**$6,322**	**$6,025**	**$6,468**	**$6,841**

Realignment Account Structure

The revenues provided for realignment are deposited into a new fund, the Local Revenue Fund 2011. The budget package creates 8 separate accounts and 12 subaccounts within this fund to pay for the realigned programs. One of the accounts, the Mental Health Account, is somewhat different than the other accounts because its funds support the CalWORKs program and interact with accounts created in 1991 under the state-local realignment plan adopted at that time. Another account created in the Local Revenue Fund 2011 is the Reserve Account, where revenues in excess of the amount projected for each account are deposited. The budget legislation requires revenue deposited into the Reserve Account to be used to reimburse counties for programs paid from the Foster Care, Drug Medi-Cal, and Adoption Assistance Program Subaccounts. In addition, for 2011-12, the budget assumes that about $1.2 billion of the funds deposited into the Local Revenue Fund 2011 will be used to reimburse the state for costs associated with incarcerating and supervising inmates and parolees who were convicted prior to the implementation of realignment.

The budget legislation establishes various formulas to determine how much revenue is deposited into each account and subaccount. Several of these accounts and subaccounts have annual caps on how much funding each can receive. The budget package limits the use of funds deposited into each account and subaccount to the specific programmatic purpose of the account or subaccount. The budget does not contain any provisions allowing cities or counties flexibility to shift funds among these programs. The budget legislation also contains some formulas and general direction to determine how the funding would be allocated among counties. The budget legislation does not specify program allocations among the various accounts and subaccounts, or among counties, for 2012-13 and beyond (except for the CalWORKs/mental health transfer which appears to be ongoing). Despite uncertainty surrounding these ongoing allocations, the revenues being deposited into the Local Revenue Fund 2011 for purposes of realignment are expected to be ongoing.

Legislative Intent for Future Actions. The budget package also includes legislative intent language that (1) new allocation formulas be developed for 2012-13 and subsequent fiscal years, and (2) sufficient protections be in place to provide ongoing funding and mandate protection for the state and local governments.

Most of State Fiscal Benefit From Proposition 98 Savings

The budget assumes that, by depositing the sales tax revenue into a special fund for use by local governments for realignment, these funds are not available for the Legislature to spend for education purposes and thus are not counted as state revenue for purposes of calculating the Proposition 98 minimum funding guarantee. As discussed more fully in our education section of this report, this action reduced the Proposition 98 minimum funding guarantee by $2.1 billion. The exclusion of these revenues, however, is contingent upon the approval of a ballot measure providing additional funding for K-12 school districts and community colleges. If no ballot measure is adopted satisfying these requirements, the funds would not be excluded from the guarantee moving forward and the state would need to repay K-14 education for the loss of $2.1 billion for the 2011-12 year.

In addition to the Proposition 98 savings, the realignment plan achieves state General Fund savings in two other ways. First, using VLF revenue to fund local law enforcement grant programs reduces the state's costs for these programs by $453 million. Second, the budget assumes about $86 million in savings to the state associated with corrections realignment. Offsetting these savings, however, is $34 million provided in the budget to support local government hiring, training, and other transition costs associated with implementing the corrections realignment in 2011-12.

Description of Realignment Changes

We describe each of the major programs included in the realignment package below.

Adult Offenders and Parolees

As part of the 2011-12 budget package, the Legislature shifted the responsibility for certain lower-level offenders, parole violators, and parolees from the state to the counties on a prospective basis effective October 1, 2011. Under the realignment plan, the shifted offenders who previously would have been sentenced to state prison will now serve their sentence in a county jail and/or under local community supervision. In addition, certain offenders released from prison will now be supervised in the community by county agencies (such as county probation) instead of by state parole agents. When locally supervised offenders violate the terms and conditions of their supervision, the courts, rather than the Board of Parole Hearings, will preside over revocation hearings to determine if they should be revoked to county jail. According to the administration, the above changes are projected to reduce the state inmate population by about 14,000 inmates in 2011-12 and nearly 40,000 inmates (roughly one-fourth of the total inmate population) upon full implementation in 2014-15. The state parolee population is projected to decline by about 25,000 parolees in 2011-12 and by 77,000 parolees (roughly three-fourths of the total parole population) in 2014-15. The budget assumes that the reduction in the inmate and parolee populations will result in state savings of about $453 million in 2011-12, growing to $1.5 billion upon full implementation.

The realignment plan assumes a total of $1.6 billion from the Local Revenue Fund 2011 to support the realignment of adult offenders and parolees in 2011. Of this total, $354 million will be transferred to the newly established Local Community Corrections Account to support the local incarceration and supervision of the realigned offenders. In addition, the plan estimates that about $13 million will be transferred into the District Attorney and Public Defender Account to support the involvement of district attorneys and public defenders in parole revocation proceedings. The funds in these two accounts will be distributed in 2011-12 to counties based on a formula that takes into account various factors, such as the proportion of the state prison population that is from a particular county. The realignment plan also assumes that the Local Revenue Fund 2011 will reimburse the state about $1.2 billion for costs that the state incurs in 2011-12 for lower-level offenders in state prison who were sentenced prior to October 1, 2011 (when the realignment is implemented).

Local Public Safety Grant Programs

Under the realignment plan, funding for various local public safety grant programs (such as the Citizens' Option for Public Safety Program, juvenile justice grant programs, and booking fees) will be shifted directly to local governments for the same purposes as specified in existing statutes.

Under the plan, a total of about $490 million will be transferred to the newly established Local Law Enforcement Services Account—an estimated $453 million from the redirection of existing VLF revenue and $37 million from the Local Revenue Fund 2011—to support the realigned public safety grant programs. For 2011-12, the funds in this account will be allocated to local governments by the State Controller's Office generally based on the level of funding received for each grant program in recent years. The realignment plan requires that, if there are insufficient revenues to fully fund this account, the Director of Finance shall allocate the funds necessary from the Local Revenue Fund 2011 to provide the full allocation.

Court Security

Current law generally requires trial courts to contract with their local sheriff's offices for court security. Under the realignment plan, the sheriffs would continue to be responsible for providing court security. However, funding to pay for the security will now be provided directly to the sheriffs rather than being appropriated in the annual state budget to the trial courts. Existing statutes related to court security (such as the requirement that each trial court negotiate a memorandum of understanding with the sheriff specifying the level of security to be provided) are unchanged.

The realignment plan estimates that $496 million from the Local Revenue Fund 2011 will be transferred to the newly established Trial Court Security Account for allocation to county sheriffs for the provision of court security. Under the terms of the realignment legislation, the Department of Finance (DOF) will determine how much money is allocated to each county sheriff for these purposes in 2011-12. According to DOF, the allocation of funds in 2011-12 will generally be determined based on the amount of state funding a given sheriff's office received in 2010-11 for court security.

Existing Juvenile Justice Realignment

Under recent statutory changes, only certain juvenile offenders who are violent, serious, or sex offenders may be committed to youth correctional facilities operated by the state. Counties are responsible for the housing and supervision of all other juvenile offenders, as well as for the community supervision of all offenders upon their release from state youth correctional facilities, including some who previously were state responsibility. Counties receive state funding from two grants to support these responsibilities—the Youthful Offender Block Grant Program and the Juvenile Reentry Grant. Under the realignment plan, funding for these grants will be shifted directly to counties for the same purposes as specified in existing statutes.

The realignment plan estimates that $97 million from the Local Revenue Fund 2011 will be transferred to the Juvenile Justice Account in support of the above grants—$93.4 million for the Youthful Offender Block Grant Program and $3.7 million for the Juvenile Reentry Grant. The allocation of these grants among the 58 counties is unchanged in 2011-12.

Mental Health Managed Care (MHMC)

County Mental Health Plans administer MHMC and are responsible for ensuring that Medi-Cal beneficiaries receive specialty mental health services. Under a federal waiver, specialty mental health services are "carved out" of the Medi-Cal program administered by the Department of Health Care Services (DHCS), which provides physical health care. County mental health plans generally have responsibility for authorization and payment of Medi-Cal covered psychiatric inpatient hospital services and outpatient specialty mental health services. In November 2004, the state's voters approved Proposition 63, an initiative that allocated additional state revenues generated through a surcharge on income taxpayers earning more than $1 million annually for various specified community mental health programs.

Under realignment, in 2011-12 about $184 million of Proposition 63 (Mental Health Services Act) funds will be redirected and used in lieu of General Fund on a one-time basis to support MHMC. Proposition 63 revenues are not deposited into the Local Revenue Fund 2011. Although the final budget package did not specify ongoing realignment allocations, the administration's plan was for realignment revenues to substitute for the Proposition 63 funds on an ongoing basis beginning in 2012-13.

Early and Periodic Screening, Diagnosis, and Treatment

The EPSDT is a federally mandated program that requires the state to provide Medi-Cal beneficiaries under age 21 with any physical and mental health services that are deemed medically necessary to correct or ameliorate a defect, physical or mental illness, including services not otherwise included in the state's Medicaid plan. Periodic health screening, vision, dental, and hearing services are provided under EPSDT. So are some mental health services, including crisis intervention and medication monitoring. County mental health plans generally have responsibility for authorization and payment of mental health services provided through EPSDT.

Under realignment, in 2011-12, about $580 million of Proposition 63 funds will be redirected and used in lieu of General Fund on a one-time basis to support EPSDT. Proposition 63 funds are not deposited into the Local Revenue Fund 2011. Although the final budget package did not specify ongoing realignment allocations, the administration's plan was for realignment revenues to substitute for the Proposition 63 funds on an ongoing basis beginning in 2012-13.

Drug and Alcohol Programs—Substance Abuse Treatment

The budget plan realigns several substance abuse treatment programs that were previously funded through the Department of Alcohol and Drug Programs (DADP). While DADP in the past provided funding and state oversight of these programs, the provision of services has long been administered primarily at the county level. The major substance abuse treatment programs that have been realigned are:

- ***Regular and Perinatal Drug Medi-Cal.*** The Drug Medi-Cal program provides drug and alcohol-related treatment services to Medi-Cal beneficiaries. These include outpatient drug free services, narcotic replacement therapy, day care rehabilitative services, and residential services for pregnant and parenting women.
- ***Regular and Perinatal Non Drug Medi-Cal.*** The Non Drug Medi-Cal program provides treatment services generally to individuals who do not qualify for Medi-Cal. This includes the Women and Children's Residential Treatment Services Program.

- ***Drug Courts.*** Drug courts link supervision and treatment of drug users with ongoing judicial monitoring and oversight.

The budget plan realigns a total of about $184 million of DADP programs (Regular and Perinatal Drug Medi-Cal, $131 million; Regular and Perinatal Non Drug-Medi-Cal, $26 million; and Drug Courts, $27 million) to the counties. Under the realignment plan, funding for these programs are deposited into three separate subaccounts within the newly created Health and Human Services Account of the Local Revenue Fund 2011. Under realignment, some programs would be supported with a combination of realignment funds and federal matching funds, while other programs would be supported mainly by realignment funds.

Foster Care and Child Welfare Services (CWS)

California's child welfare system was created to prevent, identify, and respond to allegations of child abuse and neglect. Under prior law, the state and counties shared the nonfederal costs of the child welfare system. Pursuant to the realignment legislation of 2011, counties will now bear 100 percent of the costs for nearly the entire child welfare system, including CWS, Foster Care, Adoptions, Adoptions Assistance, and Child Abuse Prevention. (The state will continue to oversee the CWS Case Management System, social worker training, state-tribal agreements, and some adoptions services.) The realignment legislation does not change the major programmatic functions of the child welfare system. Counties, which were already responsible for ensuring the safety of children within their communities, will continue to make the decision of whether or not to remove a child from a home due to allegations of abuse or neglect. Meanwhile, the state will continue to oversee the child welfare system.

The budget legislation creates five child welfare system program subaccounts within the Health and Human Services Account of the Local Revenue Fund 2011. Under this arrangement, total funding for the child welfare system is estimated to be about $1.6 billion in 2011-12. The allocations for each subaccount are designed to be equal to what the programs would have received in General Fund support absent realignment. Funding in the CWS subaccount will be distributed among counties based on the 2010-11 allocation structure. Funding in the other subaccounts will be distributed to counties based on an allocation provided by DOF.

Adult Protective Services (APS)

County APS agencies investigate reports of abuse and neglect of elders and dependent adults who live in private settings. Upon investigating these reports, APS social workers may arrange for services such as counseling, money management, or out-of-home placement for the abused or neglected adult. Although there is no federal requirement to operate an APS program, state law currently requires that APS be available in all 58 counties.

The 2011-12 realignment legislation establishes the APS Subaccount within the Health and Human Services Account for the support of the APS program. The APS Subaccount will be allocated 3 percent of the funds available in the Health and Human Services Account, which is estimated to be $55 million in 2011-12. The funds from the APS Subaccount will be allocated to the local APS programs, to the extent possible, in the same way they were in 2010-11.

CalWORKs/Mental Health Transfer

The CalWORKs program provides cash grants and welfare-to-work services (such as child care, training, or job readiness) to families whose incomes are insufficient to meet their basic needs. The program is administered by the counties, but the state and federal governments provide the vast majority of funding. Although each county must provide grants and services consistent with state law, counties have significant control over how services are provided and when to sanction clients for noncompliance. With respect to funding, counties have a fixed maintenance-of-effort level for administration and welfare-to-work services, and a 2.5 percent share of grant costs. The 2011 realignment legislation provides counties with revenue from the Local Revenue Fund 2011 for mental health programs, which then frees up existing county mental health funding to pay for a higher share of CalWORKs grant costs. This process is described in more detail below.

In 1991, the Legislature adopted realignment legislation that, among other changes, established several local funding streams for various mental health and other programs. This included creation of a mental health subaccount and a social services subaccount. The 1991 social services subaccount is available to fund several programs including CalWORKs. The 2011 realignment legislation provides $1,084 million in funding for a new Mental Health Account in the Local Revenue Fund 2011. From this account, the 2011 legislation allocates to each county new mental health funding equal to what it would have received in its mental health subaccount under the 1991 realignment formula. Because the new funding is now available to pay mental health obligations, the 2011 legislation shifts the preexisting 1991 mental health funding to the social services subaccount with no detrimental effect on support for county mental health programs. The 2011 realignment legislation also increases each county's individual share of CalWORKs grant costs so that it exactly equals the amount of its new mental health realignment funds. Essentially, the additional mental health funding for 2011 pays for an increased county share of CalWORKs grants. On average this new county share for CalWORKs grants will be about 34 percent, but the exact amount will vary by county and be directly tied to what the county would have received under the 1991 formula for distribution of funding for mental health services. The amounts provided to counties will be recalculated each year to equal whatever they would otherwise have been under the 1991 formula.

Health

The 2011-12 spending plan provides $19.7 billion from the General Fund for health programs. This is an increase of $2.2 billion, or 12.5 percent, compared to the revised prior-year spending level, as shown in Figure 11. The net increase largely reflects the following: (1) increases in caseload and utilization of services, (2) the expiration of federal economic stimulus funds used to temporarily offset state General Fund costs, (3) the adoption of significant health program reductions and cost-containment measures, and (4) shifts in the funding sources used to support various health programs. The major program-specific changes and cost-containment measures are summarized in Figure 12 (see next page) and discussed in more detail below.

Expiration of Enhanced Federal Funding. The ARRA, the 2009 federal economic stimulus law, and subsequent federal legislation extended fiscal relief to the states. California benefited from an enhanced federal medical assistance percentage (FMAP), which is the federal share of Medicaid costs, from October 2008 through June 2011. Normally the state pays 50 percent of costs for most Medi-Cal services and the federal government pays the balance. The ARRA temporarily increased the federal matching share to 61.59 percent. Subsequent federal legislation extended the enhanced FMAP for an additional six months, but reduced the level of federal funding

Figure 11

Major Health Programs and Departments—Spending Trend

General Fund (Dollars in Millions)

				Change 2010-11 to 2011-12	
	2009-10	2010-11	2011-12	Amount	Percent
Medi-Cal—Local Assistance	$10,136	$12,437	$14,701	$2,264	18.2%
Department of Developmental Services	2,419	2,451	2,622	171	7.0
Department of Mental Health	1,711	1,852	1,314[a]	-538	-29.0
Healthy Families Program—Local Assistance	217	126	286	160	127.0
Department of Public Health	184	186	226	40	21.5
Department of Alcohol and Drug Programs	189	189	222	33	17.5
Other Department of Health Care Services programs	106	32	96	64	200.0
Emergency Medical Services Authority	8	8	7	-1	-12.5
All other health programs (including state support)	212	221	219	-2	-0.9
Totals	**$15,182**	**$17,502**	**$19,693**	**$2,191**	**12.5%**
Costs paid from temporary federal funds	$3,995	$3,777	$31		
Estimated realignment savings[b]	—	—	-$184		

[a] The budget uses $862 million in Proposition 63 funds in lieu of General Fund in 2011-12 to support three mental health services programs.
[b] Savings not reflected in numbers above.

available during this phase-out period in comparison to ARRA. The budget adjusts for the loss of about $3.8 billion in federal funding due to the expiration of the enhanced FMAP that the state received in 2010-11, thereby increasing state General Fund costs in the budget year. While the expiration of enhanced federal funding mainly affects General Fund expenditure levels for Medi-Cal benefits provided by DHCS, it also affects components of the Medi-Cal Program administered by other state departments that administer health programs.

Figure 12

Major Changes—State Health Programs 2011-12 General Fund Effect

(In Millions)

Program	Amount
Medi-Cal—Department of Health Care Services	
Impose provider payment reduction of up to 10 percent	-$623
Impose mandatory copayments on Medi-Cal beneficiaries	-511
Implement unallocated reduction	-345
Eliminate Adult Day Health Care (ADHC) benefit	-170
Provide funds to transition ADHC beneficiaries to other services	85
Adopt fund shifts and one-time funding sources	-128
Collect additional drug rebates	-64
Impose "soft cap" on physician and clinic visits	-41
Collect state share of intergovernmental transfers	-34
Impose utilization limits and eliminate certain benefits	-16
Department of Mental Health	
Shift support for mental health programs from General Fund to Proposition 63 funds	-763
Provide resources to improve safety and security in state hospitals	10
Expand psychiatric program at California Medical Facility—Vacaville	6
Provide funds to activate Stockton health care facility	1
Department of Developmental Services	
Implement various cost-containment measures for community programs	-284
Extend provider payment reduction of 4.25 percent	-92
Assume additional federal funds from various initiatives	-78
Reduce funding for Developmental Centers	-28
Department of Public Health	
Impose several measures to achieve public health savings	-8
Healthy Families Program	
Implement unallocated reduction	-103
Increase premiums paid by families for children's health insurance	-22
Increase copayments for emergency department visits and inpatient hospital stays	-6
Reduce the scope of the vision benefit	-3

Federal Waiver Helps State Achieve Savings. The budget assumes $400 million in General Fund savings related to Medi-Cal's 1115 demonstration waiver renewal. Under the waiver, the state may claim up to $400 million in federal funds to offset costs in designated state health programs that are generally supported only with state funds. The waiver savings are reflected in the budget as follows: (1) $219 million in Medi-Cal local assistance, (2) $74 million in AIDS Drug Assistance Program (ADAP) savings, and (3) $106 million in savings for DHCS Family Health Programs.

Administration States Intent to Eliminate Departments. As part of its 2011-12 budget proposal, the administration stated its intent to eventually eliminate the Department of Mental Health (DMH) and DADP. Responsibility for the programs administered by DMH and DADP would be transferred to other departments, agencies, and government entities. The administration indicates that as part of its 2012-13 budget proposal, it will submit a detailed plan to eliminate these two departments.

Department of Health Care Services (Medi-Cal)

The spending plan provides $14.7 billion from the General Fund for Medi-Cal local assistance expenditures administered by DHCS. This is an increase of almost $2.3 billion, or 18 percent, in General Fund support for Medi-Cal local assistance compared to the revised prior-year spending level. In addition to growth in caseload and utilization, several major factors contributed to this net increase:

- ***Expiration of FMAP.*** General Fund support was needed to offset the loss of $3.2 billion due to the expiration of the enhanced FMAP.
- ***Acceleration of Provider Payments.*** The administration took advantage of the enhanced FMAP before it expired by making payments to Medi-Cal providers and some managed care plans earlier than previously scheduled to achieve General Fund savings of $144 million. The accelerated payments resulted in a prior year cost of $691 million and reduced costs of $835 million in 2011-12.
- ***Hospital Quality Assurance Fee.*** The revised prior-year spending level reflected an estimated $770 million in hospital fee revenue from the imposition of a quality insurance fee used to offset General Fund costs. As we discuss below, pending legislation would again impose a quality assurance fee on hospitals that could generate an estimated $320 million in General Fund relief in 2011-12.
- ***Other Changes.*** The spending plan includes program reductions, fund shifts, and cost-containment measures that reduce program costs as shown in Figure 12.

We discuss the most significant spending changes that were adopted in the Medi-Cal Program budget in more detail below.

Provider Payment Reductions of Up to 10 Percent. The budget assumes $623 million in General Fund savings from reducing Medi-Cal provider payments by up to 10 percent for physicians, pharmacies, clinics, medical transportation, home health, family health programs, and other providers. The budget authorizes the director of DHCS to adjust these payment reductions based on studies of whether such reductions meet certain federal requirements. Implementation of this action requires federal approval.

Mandatory Copayments. The budget assumes $511 million in General Fund savings by imposing mandatory copayments on physician and clinic visits ($5), dental visits ($5), prescriptions ($3 for preferred drugs, $5 for non-preferred drugs), emergency and nonemergency use of emergency rooms ($50), and hospital inpatient visits ($100 per day, $200 maximum per admission). The copayments apply to all Medi-Cal enrollees and providers may deny the service if the enrollee does not make the copayment. Implementation of this action requires federal approval.

Unallocated Reduction. The spending plan includes a $345 million unallocated reduction to the Medi-Cal Program. A large portion of the unallocated savings may be achieved through the passage of pending legislation discussed above which would impose a quality assurance fee on hospitals potentially generating $320 million in General Fund relief.

Elimination of Adult Day Health Care Benefit. The spending plan assumes elimination of Adult Day Health Care (ADHC) as an optional Medi-Cal benefit for savings of about $170 million to the General Fund. The spending plan also provides up to $85 million from the General Fund to assist ADHC beneficiaries in transitioning to other services in order to minimize the risk of institutionalization. However, the Governor vetoed legislation that would have created a new type of ADHC program, to be called the Keeping Adults Free from Institutions Program, to provide services to eligible Medi-Cal beneficiaries who are at high risk of institutionalization. The Governor instead proposed to continue efforts to transition beneficiaries who previously received ADHC into other existing home and community-based services.

Fund Shifts and One-Time Funding Sources. The budget assumes one-time fund shifts and other one-time funding sources totaling $128 million to offset General Fund spending in the Medi-Cal Program. These funds include: (1) a $45.2 million shift from the Inpatient Payment Adjustment Fund, (2) a $32.7 million shift from Private Hospital Supplemental Fund, and (3) $50.1 million from a court settlement with Quest Diagnostics Inc. to reflect the repayment of alleged overcharges for testing services. The budget does not assume that a shift of $1 billion in Proposition 10 funds approved in a March 2011 budget action will be used to support Medi-Cal as had initially been proposed.

Managed Care Drug Rebates. The budget assumes savings of a benefit of $64 million to the General Fund from new authority to collect rebates from drug manufacturers for medications provided through Medi-Cal managed care plans.

"Soft Cap" on Physician and Clinic Visits. The budget assumes $41 million in General Fund savings through a soft cap on physician and clinic visits for adults. This utilization limit of seven annual visits can be waived through a physician certification that additional visits are medically necessary.

Other Utilization Limits and Benefit Eliminations. The budget assumes about $16 million in General Fund savings by limiting or eliminating some other Medi-Cal benefits. These changes include: (1) limiting enteral nutrition to tube feeding only for savings of almost $14 million, (2) eliminating Medi-Cal coverage for over-the-counter cold and cough products for savings of about $2 million, and (3) limiting annual hearing aid expenditures to $1,510 per person for savings of $229,000.

State Share of Intergovernmental Transfers. Counties and district hospitals may voluntarily transfer funds to DHCS under what are known as Intergovernmental Transfers (IGTs) for the purpose of providing increases in the rates paid to Medi-Cal managed care plans. The monies that counties and district hospitals transfer to the state draw down matching federal Medicaid monies, thus generating additional funding for managed care plans that ultimately is used to increase compensation for certain county- and district hospital-operated providers. Under the budget plan, entities that choose to submit these IGTs will pay a processing fee to the state equal to 20 percent of the IGTs. The estimated $34 million in fee revenues generated from this proposal will be used to offset General Fund costs in Medi-Cal.

Department of Mental Health

The budget plan provides about $4.6 billion from all fund sources for DMH programs. This is a decrease of about $310 million, or 6.3 percent, compared to the revised prior-year spending level. Between 2010-11 and 2011-12, General Fund spending will decrease from about $1.8 billion to $1.3 billion, or about 29 percent.

This year-over-year decrease in General Fund support is mainly due to the one-time use of $862 million in Proposition 63 (Mental Health Services Act) funds in lieu of General Fund monies to support three community mental health programs—EPSDT, MHMC, and so-called "AB 3632" mental health care for special education students. Another major factor affecting net General Fund expenditures for DMH programs was the expiration of the enhanced FMAP provided under ARRA and subsequent federal legislation which provided about $167 million in General Fund relief to mental health programs in 2010-11. We discuss below the most significant spending changes included in the DMH budget.

Administration States Intent to Eliminate DMH and Create State Hospitals Department. In presenting its budget plan, the administration stated its intent to eventually eliminate DMH based on its rationale that this would achieve administrative efficiencies and provide more focused leadership for behavioral health services. Part of the administration's plan is to create a new Department of State Hospitals, again based on its rationale that this would improve fiscal accountability, create safer hospitals, and achieve other benefits. The administration indicated it will provide its plan to accomplish these objectives along with its 2012-13 budget proposal.

Shift of Some Mental Health Programs to DHCS. Consistent with the administration's plan to eventually eliminate DMH, the budget plan transfers administrative responsibility for EPSDT and MHMC to DHCS by June 30, 2012. The DOF must notify the Legislature regarding various aspects of the shifts, including the number and classification of the positions to be transferred and any potential fiscal effects on the programs from which resources are being transferred. Furthermore, the administration is required to provide a transition plan to the Legislature by October 1, 2011. We note that EPSDT and MHMC are included in realignment. We discuss the details of realignment elsewhere in this report.

Proposition 63 Funds Used to Support Services for Special Education Students. The budget plan uses $99 million of Proposition 63 funds on a one-time basis to pay for mental health services for special education students. In the past, these services were supported in part with a General Fund appropriation in the DMH budget. Responsibility for providing these services is being shifted from the counties to the school districts as part of realignment. We discuss this shift in more detail earlier in this chapter.

Department of Developmental Services (DDS)

The 2011-12 budget provides $4.6 billion in total funds for DDS programs. This is a decrease of $113 million, or 2.3 percent, compared to the revised prior-year spending level. Between 2010-11 and 2011-12, General Fund spending will increase from about $2.5 billion to $2.6 billion, or about 7 percent. This net year-over-year increase in General Fund support is partly due to increases in caseload and utilization of services. Another major factor affecting net General Fund expenditures for DDS programs was the expiration of the enhanced FMAP provided under ARRA and subsequent legislation, which had provided about $386 million in fiscal relief in 2010-11. Below, we discuss the most significant spending changes that were adopted in the DDS budget.

Measures to Contain Costs and Improve Transparency and Accountability. The budget plan achieves $284 million in savings through a combination of measures to contain costs and improve transparency and accountability. For example, costs will be contained by implementing an annual family program fee for families with incomes above 400 percent of the federal poverty level (about $89,000 for a family of four in 2011). The budget plan also reflects about $110 million in savings from various measures to improve the transparency and accountability of the community services program.

Extension of Regional Center Provider Payment Reduction. The budget plan extends a 4.25 percent provider payment reduction that has been imposed in recent years in order to achieve $92 million in savings in 2011-12.

Assumption of Additional Federal Funds. The budget plan assumes $78 million in additional federal funds resulting from the following initiatives: (1) modifications to the state's Home and Community-Based Services program of community services for persons with disabilities ($60 million); (2) certification of Porterville Developmental Center to obtain federal Medicaid reimbursement for care provided to certain patients ($13 million), and (3) an increase in Money Follows the Person grants intended to help promote the shift of disabled persons from institutions to the community ($5 million).

Reduction in Funding for Developmental Centers (DCs). The budget plan includes several reductions to the DCs for a total of $28 million in savings. These reductions reflect the consolidation of residences and programs, reductions in funding for operations, and the elimination of funding for some DC staff.

Trigger Reductions. As noted earlier, the final 2011-12 budget included several reductions that would only be triggered if state General Fund revenue estimates are later determined to be too high. Effective January 2012, these trigger reductions include up to $100 million in unspecified savings in services for persons with developmental disabilities.

Department of Public Health (DPH)

The budget provides $3.5 billion from all fund sources for DPH programs. This is an increase of $188 million or about 5.6 percent compared to the revised prior-year spending level. Of this total, the spending plan provides $226 million from the General Fund for DPH, an increase of $40 million or 22 percent. This year-over-year increase is largely the result of increased General Fund support for ADAP.

Various Savings Measures. The budget plan includes several reductions to achieve a total of $8.3 million in General Fund savings in various public health programs. Funding reductions to Licensing and Certification, the Laboratory Field Division, the County Health Services Section, and operating expenses and equipment achieve combined savings of $4.5 million. Federal funds held in reserve for maternal and child health programs were redirected to offset $1.7 million in General Fund costs, and $1 million of General Fund support for a contract to support Valley Fever research was eliminated. The budget plan also reduces funding for the California Health Information Survey by $572,000 and for health care surge standby costs by $506,000.

Healthy Families Program (HFP)

The budget plan provides $286 million from the General Fund for HFP, which is administered by MRMIB. This is a General Fund increase of $160 million, or 127 percent, compared to the revised prior-year spending level. The major factors contributing to the year-over-year increase in General Fund support are: (1) an $81 million reduction in contributions from the First 5 California Children and Families Commission used to offset General Fund costs, (2) a $64 million reduction in the availability of revenues from a tax imposed on managed care organizations (MCOs) used to offset General Fund costs in 2010-11, and (3) increased costs of $34 million associated with implementing a new type of payment system for Federally Qualified Health Centers and Rural Health Centers that serve program beneficiaries. The spending plan also reflects several measures to reduce General Fund costs in HFP below:

- ***Increase in Monthly Premiums Paid by Families ($22 Million Savings).*** The amount of the monthly premium increases vary depending on family income levels.
- ***Increase in Copayments ($6 Million).*** The annual copayments for each family would be limited, as under prior program rules, to $250. The copayments established for HFP generally parallel those adopted in the budget plan for the Medi-Cal Program for emergency department visits and inpatient hospital stays.
- ***Reduction in the Scope of Vision Benefit ($3 Million).*** The budget plan eliminates support for the vision benefit provided to children enrolled in HFP, in lieu of an administration proposal to entirely eliminate the vision benefit.

Unallocated Reduction. The spending plan includes a $103 million unallocated reduction to HFP. A proposed extension of the MCO tax described above, still under consideration by the Legislature, would provide an equivalent amount of money for the support of HFP in 2011-12.

Shift of Programs From MRMIB to DHCS. The budget plan authorizes DOF to transfer expenditure authority from MRMIB to DHCS to consolidate administrative functions for the operation of HFP and Access for Infants and Mothers Program. The DOF must notify the Legislature regarding various aspects of the shift, including the number and classification of the positions to be transferred and any potential fiscal effects on the programs from which resources are being transferred. The administration is required to provide a plan for the transfer of state administrative functions no later than December 1, 2011.

Department of Alcohol and Drug Programs

The budget provides $631 million from all fund sources for DADP programs. This is an increase of $25 million, or about 4 percent, compared to the revised prior-year spending level. Of this total, the budget package provides $222 million from the General Fund for DADP, an increase of $33 million, or 18 percent. The General Fund increase is due, in part, to the expiration of the enhanced FMAP provided under ARRA, which provided about $17 million in fiscal relief in 2010-11. The General Fund spending level for DADP identified above for 2011-12 does not take into account the realignment of most state-supported substance abuse treatment programs to the counties. Doing so would have the effect of reducing the 2011-12 General Fund spending level by $184 million. (The realignment package is discussed in more detail earlier in this chapter.) As part of the budget plan, the administration stated its intent to eventually eliminate DADP, citing what it views as a potential for greater administrative efficiencies and more focused leadership for behavioral health services.

Drug Medi-Cal Program Will Shift to DHCS. Consistent with the administration's plan to eventually eliminate DADP, administrative responsibility for the Drug Medi-Cal Program will be shifted to DHCS in 2011-12. The DOF must notify the Legislature regarding various aspects of the shift. Furthermore, the administration is required to provide a transition plan to the Legislature by October 1, 2011. We note that Drug Medi-Cal and some other programs administered by DADP are included in the realignment.

California Medical Assistance Commission (CMAC)

The budget plan requires CMAC to be dissolved after June 30, 2012. All of CMAC's powers, duties, and responsibilities would be transferred to the Director of DHCS along with CMAC executive and staff positions.

Social Services

Overview of Total Spending Excluding Realignment. General Fund support for social services programs in 2011-12 totals $9.1 billion, an increase of about $80 million, or 0.9 percent, compared to the revised prior-year level. This modest increase is due to higher costs in county administration and automation and the child welfare system, partially offset by reductions in Supplemental Security Income/State Supplementary Program (SSI/SSP) grants. Figure 13 (see next page) shows the change in General Fund spending in each major social services program and department, excluding the impact of realignment.

The Impact of Social Services Realignment on General Fund Spending. Budget legislation realigns 100 percent of most child welfare system costs, 100 percent of APS costs and about 34 percent of CalWORKs costs to counties. Under this realignment, General Fund support for these programs will be replaced by 2011 realignment special fund spending. After accounting for realignment, General Fund spending for social services programs in 2011-12 is reduced by about $2.7 billion, almost 30 percent below the revised spending level for 2010-11. The 2011 realignment plan is discussed in more detail earlier in this chapter.

Summary of Major Changes. Figure 14 shows the major General Fund changes adopted by the Legislature for social services programs. Most of the budget reductions were in the CalWORKs, In-Home Supportive Services (IHSS), and SSI/SSP programs. Absent the changes shown in the figure, total General Fund spending for social services programs in 2011-12 would have been almost $1.5 billion higher. Below, we discuss the major changes in each program area.

CalWORKs

The budget provides $2.1 billion for the CalWORKs program in 2011-12, which is unchanged from the revised level of spending in the prior year. This amount does not include the impact of the 2011 realignment legislation, which shifts about $1.1 billion in CalWORKs grant costs to the counties. Absent the major policy changes described below, CalWORKs spending would have increased by over $800 million.

Extension of County Block Grant Reduction and Exemptions for One Year. For 2009-10 and 2010-11, the Legislature reduced the county block grants for welfare-to-work services and child care by approximately $375 million each year. These reductions were accompanied by additional exemptions of

Figure 13

Major Social Services Programs and Departments

General Fund (Dollars in Millions)

			Change	
	2010-11	**2011-12**	**Amount**	**Percent**
Supplemental Security Income/State Supplementary Program	$2,860.8	$2,752.2	-$108.7	-3.8%
California Work Opportunity and Responsibility to Kids	2,079.2	2,072.3	-6.9	-0.3
In-Home Supportive Services[a]	1,343.2	1,380.3	37.1	2.8
Child welfare system[b]	1,510.3	1,590.8	80.6	5.3
County Administration/Automation	607.5	671.8	64.3	10.6
Department of Child Support Services	335.2	321.6	-13.6	-4.1
Department of Rehabilitation	54.1	55.1	1.0	1.9
Department of Aging	32.8	32.5	-0.3	-0.8
All other social services (including state support)	215.7	240.5	24.9	11.5
Totals[a]	**$9,038.7**	**$9,117.2**	**$78.4**	**0.9%**
Estimated realignment savings[c]	—	-$2,687.8	—	—

[a] Does not reflect $140 million in savings from medication compliance pilot. Such savings would most likely occur in Medi-Cal.
[b] Includes Child Welfare Services, Foster Care, Adoption Assistance, Adoptions, and Child Abuse Prevention.
[c] Savings not reflected in numbers above.

CalWORKs recipients from work participation requirements which allowed counties to manage the reduction by not providing services to the exempted families. The budget extends the block grant reduction and the exemptions for one additional year. After accounting for certain grant costs associated with the exemptions, this extension results in one-time savings of almost $370 million.

Figure 14

Major Changes—Social Services Programs 2011-12 General Fund Effect

(In Millions)

Program	Amount
CalWORKs	
Extend two-year county block grant reduction for an additional year	-$369.4
Reduce grants by 8 percent	-314.3
Establish 48-month time limit for adults	-102.9
Reduce earned income disregard	-83.3
Suspend Cal-Learn services for teen parents	-43.6
Limit license-exempt child care reimbursements to 60 percent	-30.6
Eliminate community challenge grants	-20.0
Reduce allocations for substance abuse/mental health and automation	-10.0
Repeal sanctions and time limits originally scheduled for July 2011	135.0
In-Home Supportive Services	
Achieve long-term care savings through medication dispensing devices	-$140.0
Obtain additional federal funding through Community First Choice option	-128.0
Make health certification a condition of eligibility	-67.4
Reflect savings from lower than anticipated caseload	-53.7
End mandate for advisory committees	-1.5
Hold public authorities and counties harmless from caseload decline	7.1
Supplemental Security Income/State Supplementary Program	
Reduce grants to federal minimum for individuals	-$183.4
Foster Care	
Shift responsibility for seriously emotionally disturbed children to schools	-$68.0
Reflect additional cost of court-imposed rate increase	17.4
County Administration and Automation	
Delay Los Angeles county welfare system procurement	-$13.0
Suspend child welfare system procurement	-3.0
Department of Child Support Services	
Suspend county share of collections (revenue)	-$24.0
Department of Aging	
Reduce Multipurpose Senior Services Program	-$2.5
Total	**-$1,499.1**

Eight Percent Grant Reduction. Effective July 1, 2011, budget legislation reduces maximum monthly grants by 8 percent, resulting in ongoing annual General Fund savings of about $314 million. Figure 15 shows the maximum monthly grant and CalFresh (formerly known as Food Stamps) benefits for a family of three in both high- and low-cost counties. As the figure shows, the net decrease in total monthly benefits is about $40. Recipients in high-cost counties will receive total benefits equal to 72 percent of the federal poverty guideline. For low-cost counties, the total benefits are at 71 percent of the guideline.

Reduced Time Limit for Aided Adults. Budget legislation reduces from 60 to 48 the number of months that an adult may receive cash benefits. Although adults will be removed from the calculation of the family's grant, children will continue to receive aid in a program informally known as the "safety net." The shorter time limit results in combined grant and county block grant savings of $103 million each year. Budget legislation also repealed prior laws which would have instituted shorter time limits and deeper sanctions in July 2011. This repeal results in foregone savings of about $135 million.

Reduction in Earned Income Disregard. Under prior law, California "disregarded" (did not count) the first $225 of monthly income and 50 percent of each dollar earned beyond $225 when calculating a family's monthly grant. This policy provides a work incentive for families. Budget legislation modifies the grant calculation so that only the first $112 of earned income and 50 percent of each dollar earned above that amount will be disregarded. This change in the disregard policy results in ongoing savings of about $83 million annually.

Figure 15

CalWORKs Maximum Monthly Grant and CalFresh Benefits Family of Three

	January 2011	July 2011	Change	
			Amount	Percent
High-Cost Counties				
Grant	$694	$638	-$56	-8%
CalFresh benefits[a]	460	476	16	3
Totals	**$1,154**	**$1,114**	**-$40**	**-3%**
Percent of Poverty	**75%**	**72%**		
Low-Cost Counties				
Grant	$661	$608	-$53	-8%
CalFresh benefits[a]	470	484	14	3
Totals	**$1,131**	**$1,092**	**-$39**	**-3%**
Percent of Poverty	**73%**	**71%**		

[a] Formerly known as Food Stamps.

One-Year Suspension of Cal-Learn Program. The Cal-Learn program provides intensive case management to about 12,000 teen parents who remain in school. Depending on school performance, the teens may earn bonuses and sanctions. Budget legislation suspends the case management component of the program for one year, resulting in General Fund savings of $44 million.

Reduction in Child Care Reimbursements. Under prior law, the state would reimburse license-exempt child care providers up to 80 percent of the regional market rate (RMR) ceiling. Effective July 1, 2011, the maximum reimbursement rate is reduced to 60 percent of the RMR. This results in CalWORKs child care savings of $31 million and additional savings within CDE's child care budget.

Other Reductions. The budget eliminated $20 million provided to DPH for the Community Challenge Grant project. This program aimed to reduce adolescent and unwed pregnancies while encouraging father-child involvement. The budget also reduced funding for substance abuse/mental health treatment and welfare automation by a total of $10 million.

In-Home Supportive Services

The 2011-12 budget provides about $1.4 billion from the General Fund for support of the IHSS program. This represents an increase of 2.8 percent for the program in 2011-12 over the revised prior-year level of spending. Funding for IHSS has experienced relatively slower growth than in the past due to reductions in the program. Below, we describe the major changes included in the 2011-12 budget for IHSS.

Community First Choice Option. The 2011-12 budget assumes that the state will qualify for additional federal funding available to states under the federal Affordable Care Act, also known as the federal health care reform legislation. This additional federal funding would be used to offset the General Fund costs for IHSS. Specifically, if California meets federal regulations still under development, the Community First Choice option could increase the federal share of costs of the IHSS program by 6 percentage points. (Until now, the federal government has generally paid 50 percent of program costs.) It is estimated that implementing this option would save $128 million in the budget year. Future savings would depend on the overall spending in the program and the extent to which California can draw down these new federal funds.

Elimination of IHSS for Recipients Without a Health Certificate. Effective August 2011, the budget eliminates IHSS services for recipients lacking certification that indicates that, without IHSS, they would be at risk of out-of-home placement. The certificate must be signed by a licensed health care professional such as a physician, physician assistant, or public health nurse. The budget assumes that 10 percent of current and future recipients will not obtain the health certificate, and will therefore lose IHSS eligibility. After accounting for administrative implementation costs, this eligibility change is estimated to save $67 million in the budget year and over $120 million when fully implemented.

Medication Compliance and Budget Cut Trigger. As part of the 2011-12 budget, the Legislature implemented a medication dispensing pilot program. By providing automated medication dispensing machines, the program is intended to improve medication compliance for Medicaid recipients who are at high risk of nursing home placement, hospital admission, and emergency room usage. Based on anticipated improvement in medication compliance, the budget plan assumes that the state will avoid $140 million in health care costs at skilled nursing facilities, hospitals, and emergency rooms in 2011-12. Since the savings are expected to reduce health care costs, they would occur in the Medi-Cal budget rather than the Department of Social Services (DSS) budget.

Beginning October 1, 2011, budget legislation requires DHCS to provide quarterly reports to DOF on the implementation of these activities. If the DOF determines that the medication pilot project will not achieve $140 million in annual savings, it must notify the Legislature of its conclusion by April 10, 2012. The Legislature then has until July 1, 2012 to enact legislation to modify the pilot project or to implement other options to achieve the ongoing savings beginning in 2012-13. If, after July 1, 2012, the DOF determines that the Legislature's additional actions will still not achieve $140 million in savings, budget legislation authorizes an across-the-board reduction in IHSS hours for 2012-13 sufficient to ensure that the savings, coupled with any savings from the pilot project, reach $140 million. We note that the across-the-board reduction has certain exemptions and processes in place for hour restorations for recipients who find that the reduction will put them at risk of out-of-home placement.

Slower-Than-Anticipated Caseload Growth. The budget reflects estimated savings of $54 million in 2011-12 based on more recent data which show lower than estimated caseload growth.

Funding for Public Authorities and County Administration. The 2011-12 budget includes $7.1 million in funding to hold county and public authority administrative allocations to the levels provided as of March 2011. Absent this legislative action, funding for counties and public authorities would have declined by an equivalent amount. Additionally, the Legislature adopted uncodified budget legislation requiring the department to work with the public authorities to develop a new rate-setting methodology for public authorities.

Trigger Reductions. As noted earlier, the final 2011-12 budget included several reductions that would only be triggered if certain revenue estimates are later determined to be incorrect. Effective January 2012, these trigger reductions include (1) up to $100 million in savings from a 20 percent across-the-board reduction to IHSS hours and (2) the elimination of up to $10 million in funding for local antifraud activities. Similar to the medication compliance across-the-board reduction, budget legislation allows for certain exemptions and processes for hour restorations if recipients find that the across-the-board reduction puts them at risk of out-of-home placement.

Supplemental Security Income/State Supplementary Program

The budget provides $2.8 billion from the General Fund for SSI/SSP. This is an overall decrease of $109 million, or 4 percent, in funding compared to the revised 2010-11 spending level. This decrease is primarily due to grant reductions for individuals receiving SSI/SSP. These savings are partially offset by an increase in the program caseload.

Grant Reduction. Effective July 2011, the budget reduces SSI/SSP grants for *individuals* to the minimum amount allowable under federal law. The SSI/SSP grants for *couples* were reduced to the federal minimum as part of the *2009-10 Budget Act*. The savings from this new reduction are estimated to be $183.4 million in 2011-12. As seen in Figure 16, this action reduces maximum monthly grants for individuals by $15 (1.7 percent).

Foster Care and Child Welfare Services

The budget includes about $1.6 billion from the General Fund for children's programs, an increase of 5.3 percent from revised 2010-11 spending levels. This increase is primarily due to backfilling for the phase-out of federal ARRA funds, a technical shift of certain costs from CalWORKs to Foster Care, and a rate increase (described below). These budget totals do not reflect the impact of realigning 100 percent of most child welfare costs to the counties. The realignment proposal is discussed in more detail earlier in this chapter.

Court-Ordered Foster Family Home (FFH) Rate Increase. In May 2011, the U.S. District Court ordered DSS to immediately increase FFH rates based on a new rate methodology

Figure 16

SSI/SSP Maximum Monthly Grants

	Prior Levels	July 2011
Individuals		
SSI	$674	$674
SSP	171	156
Totals	**$845**	**$830**
Percent of Poverty[a]	**93%**	**91%**
Couples		
SSI	$1,011	$1,011
SSP	396	396
Totals	**$1,407**	**$1,407**
Percent of Poverty[a]	**115%**	**115%**

[a] Compares grant level to federal poverty guideline. Poverty guideline is from 2011 U.S. Department of Health and Human Services guidelines.

developed by DSS at the direction of the court. The new methodology results in an average rate increase of 31 percent for current FFH cases and for future cases in the Adoption Assistance Program (AAP), Kinship Guardianship Assistance Payment (Kin-GAP), federal Kin-GAP, and Non-Related Legal Guardian programs. The court also ordered that rates be increased each year in accordance with the California Necessities Index (CNI). The 2011-12 budget reflects all of the above changes, including a 1.92 percent CNI COLA for all current and future cases effective July 1, 2011. The General Fund cost of these changes is $17 million. Figure 17 displays the new FFH rates implemented in May and the 2011-12 rates, including the CNI COLA.

Figure 17

Revised Monthly Foster Family Home Rates

Child's Age	Prior Law	May 2011	July 2011[a]
0 - 4	$446	$609	$621
5 - 8	485	660	673
9 - 11	519	695	708
12 - 14	573	727	741
15 - 19	627	761	776

[a] Rates shown for July reflect a court-ordered inflation adjustment.

Repeal of AB 3632 Mandate for Seriously Emotionally Disturbed (SED) Children. Budget legislation repeals the mandate requiring DSS and county welfare departments to provide board and care for so-called AB 3632 SED children. Local school districts are instead responsible for their out-of-home placement. This change results in a decrease of $68 million in DSS board and care and administration costs, with a comparable cost increase in Proposition 98 funding. The education section of this report provides a further discussion of these actions.

County Welfare Automation Projects

Suspension of Child Welfare Services Project. The Child Welfare Services/Case Management System Web (CWS/Web) project would build a modern, web-based system to replace the current system, which is based on outdated technology and does not fully comply with federal system requirements. Project staff planned to select a vendor and begin development work by late 2012-13 at a cost of about $70 million (all funds) annually for several years. Because the federal government is revising its requirements for such systems and escalating project costs, the Legislature suspended development of the CWS/Web project and canceled the current procurement. General Fund support for the project in the 2011-12 was reduced by $3 million, leaving $1 million for shutdown activities. In addition, trailer bill language directs DSSand the Office of Systems Integration, after consulting with stakeholders, to report by January 10, 2012 to the Legislature on (1) the current system's ability to support CWS practice, (2) the best approach to address missing functionality in the system, and (3) any next steps for implementing this approach, among other issues.

Los Angeles Project Delay. The Los Angeles Eligibility, Automated Determination, Evaluation and Reporting (LEADER) replacement system is one of three county-led consortia that make up the statewide automated welfare system. The LEADER system is nearing the end of its useful life and procurement of a replacement system has been under way for several years. The consortium recently selected a vendor to build the new system at an estimated total cost of $485 million over the next four years. The administration proposed to indefinitely suspend the replacement project due to its high cost and indications that the federal government would not participate in funding its development until a long-term strategic plan for its three automated welfare systems was submitted and approved. Rather than indefinitely suspend development, the Legislature delayed the replacement project and reduced General Fund support by $14 million in 2010-11 and $13 million in 2011-12.

Department of Child Support Services

Suspension of County Share of Collections. Typically, when Local Child Support Agencies collect child support on behalf of families receiving CalWORKs, the county retains a portion (2.5 percent) of the collections. Most counties use these funds for the support of their CalWORKs programs. The 2011-12 budget package suspends the county share of collections for one year, which results in an increase in General Fund revenue of about $24 million in the budget year.

Department of Aging

The budget provides $33 million from the General Fund for the Department of Aging, a 1 percent decrease in funding compared to the revised 2010-11 funding level. Savings from a reduction in the Multipurpose Senior Services Program are largely offset by expiration of federal ARRA funding, which had previously been used to offset General Fund costs.

Reduction for Multipurpose Senior Services Program. In January, the Governor proposed the elimination of the Multipurpose Senior Services Program (MSSP). The Legislature instead reduced General Fund support for MSSP by $2.5 million (about 13 percent) in 2011-12. Additionally, the Legislature adopted budget bill language requiring the Department of Aging to work with the federal government to reduce MSSP administration costs to help limit reductions in the number of recipients served by the program.

California Children and Families Commission

Fund Sweep Not Reflected in Budget. Chapter 4, Statutes of 2011 (AB 99, Committee on Budget), redirected $1 billion in funding from the California Children and Families Commission—also known as the First 5 Commission, originally established by Proposition 10 in 1998—to offset General

Fund-supported Medi-Cal costs for children up to age five. Chapter 4 requires local county commissions to transfer $950 million and the state commission to contribute the remaining $50 million. Several local First 5 commissions have challenged the legality of the fund sweep in court. The 2011-12 Medi-Cal budget does not assume any offset of costs with First 5 funding. However, the administration has indicated that it will defend the legal challenge in court.

Judiciary and Criminal Justice

The 2011-12 budget provides $12.3 billion from the General Fund for judicial and criminal justice programs, including support for ongoing programs and capital outlay projects (see Figure 18). This is an increase of $286 million, or 2.4 percent, above the revised 2010-11 General Fund spending level. As discussed in the "Realignment" section of this chapter, the realignment of various criminal justice responsibilities from the state to local governments is estimated to reduce General Fund costs for criminal justice programs by almost $1.5 billion, thereby bringing the adjusted total for General Fund expenditures for these purposes in 2011-12 to about $10.8 billion. Figure 19 summarizes the major General Fund changes adopted by the Legislature in the criminal justice area, which we discuss in more detail below.

Judicial Branch

The budget provides about $4 billion for support of the judicial branch—a decrease of $59 million, or 1.5 percent, from the revised 2010-11 level. This amount includes $1.7 billion from the General Fund and $499 million from the counties, with most of the remaining balance of about $1.8 billion derived

Figure 18

Judicial and Criminal Justice Budget Summary

General Fund (Dollars in Millions)

				Change From 2010-11	
Program/Department	**2009-10**	**2010-11**	**2011-12**	**Amount**	**Percent**
Department of Corrections and Rehabilitation	$7,952	$9,491	$9,833	$342	3.6%
Judicial Branch	614	1,662	1,715	53	3.2
Department of Justice	317	292	233	-59	-20.2
Other criminal justice programs[a]	495	534	484	-50	-9.4
Totals	**$9,378**	**$11,979**	**$12,266**	**$286**	**2.4%**
Program funding temporarily paid from federal funds and local government finance shift	$2,457	$350	—	—	—
Estimated realignment savings	—	—	-$1,496[b]	—	—

[a] Includes debt service on general obligation bonds, Office of Inspector General, State Public Defender, and various public safety grant programs (excluding those administered by the California Emergency Management Agency).

[b] Savings not reflected in numbers above.

from fine, penalty, and court fee revenues. The General Fund amount is a net increase of about $53 million, or 3.2 percent, from the revised 2010-11 amount. (The $1.2 billion figure does not reflect the estimated General Fund savings from the realignment of court security to county sheriffs.) Funding for trial court operations is the single largest component of the judicial branch budget, accounting for over 80 percent of total spending.

Court Operations. The budget package includes a $403 million General Fund augmentation to the budget of the judicial branch. This is primarily to replace redevelopment funds that were used on a one-time basis in 2010-11 to offset General Fund costs for trial courts, as well as to support increased employee compensation costs. However, a significant portion of this increase is offset by a largely unallocated reduction of $350 million to the judicial branch. Under the budget plan, part of the reduction will be accommodated in 2011-12 through the one-time redirection of $170 million from various special funds (such as court construction funds).

Figure 19

Major General Fund Changes—
Judicial and Criminal Justice Programs[a]

2011-12 (In Millions)

Program	Amount
Judicial Branch	
Backfill redevelopment funds used to support trial courts in 2010-11	$350
Increase funding for various workload adjustments	53
Reduce budget for judicial branch	-350
California Department of Corrections and Rehabilitation (CDCR)	
Increase funding to address CDCR budget shortfalls	$380
Fund community corrections performance incentive grants	89
Increase funding support for additional nurses and new health care facilities	28
Reflect "workforce cap" savings	-195
Reduce funding for rehabilitation programs on one-time basis	-101
Reduce Receiver's budget by about 5 percent	-81
Reduce funding to reflect decline in pharmaceutical expenditures	-46
Department of Justice	
Increase funding for state forensic laboratories	$14
Increase funding for employee compensation costs	13
Implement "billable-services" model for legal services	-50
Reduce funding for Division of Law Enforcement	-37
Office of the Inspector General	
Reflect savings from reduced duties and responsibilities	-$4

[a] Although not reflected in this figure, the realignment of various criminal justice responsibilities to local governments is estimated to reduce General Fund costs by $1.5 billion.

Courts Capital Outlay. The budget also reflects a one-time transfer of $310 million from the Immediate and Critical Needs Account (ICNA) to the General Fund. (In accordance to Chapter 311, Statutes of 2008 [SB 1407, Perata], the ICNA receives revenue from certain court fee and fine increases to support 40 court construction projects.) As a result of this transfer to the General Fund, most of the planned court construction projects that would be supported by ICNA will be delayed by about a year.

Corrections and Rehabilitation

The budget contains $9.8 billion from the General Fund for support of the California Department of Corrections and Rehabilitation (CDCR). This is a net increase of $342 million, or 3.6 percent, above the revised 2010-11 level of spending. (This figure does not reflect the estimated General Fund savings from the realignment of certain lower-level offenders, parole violators, and parolees to local governments.) As discussed earlier in this report, if state General Fund revenues are forecast to fall $1 billion below the level assumed in the *2011-12 Budget Act*, various General Fund expenditure reductions would be triggered, including a $20 million unallocated reduction to CDCR's budget. Under these circumstances, counties would also be required to pay $125,000 per year to the state for each juvenile offender committed to the Division of Juvenile Facilities (DJF), resulting in an assumed savings of $72 million in the General Fund cost of operating state youth correctional facilities.

Adult Correctional Population. Figure 20 shows the recent changes and projected declines in the inmate and parolee populations. As shown in the figure, these populations are expected to decline significantly starting in 2011-12 due largely to the effect of the realignment plan, such as the shift of responsibility for certain adult offenders to counties. For example, the realignment plan is expected to reduce the inmate population by about 14,000 inmates in 2011-12. (Please see the "Realignment" section of this report for a more detailed discussion of that plan.)

Additional Funding to Address CDCR Budget Shortfalls. The budget includes an additional $380 million in General Fund support for CDCR for ongoing annual operating costs that the department indicates have exceeded its budget authority in previous years. For example, correctional officer, sergeant, and lieutenant positions have traditionally been budgeted based on the middle step of each position's salary range. However, CDCR reports that the average officer in these positions actually earns closer to the top step of the salary range. Of the $380 million total augmentation, $267 million was provided to make such adjustments related to the costs for the department's security staff. The remainder of the augmentation is in response to increased costs for medical guarding and transportation, correctional officer overtime, legal expenses, and inmate housing.

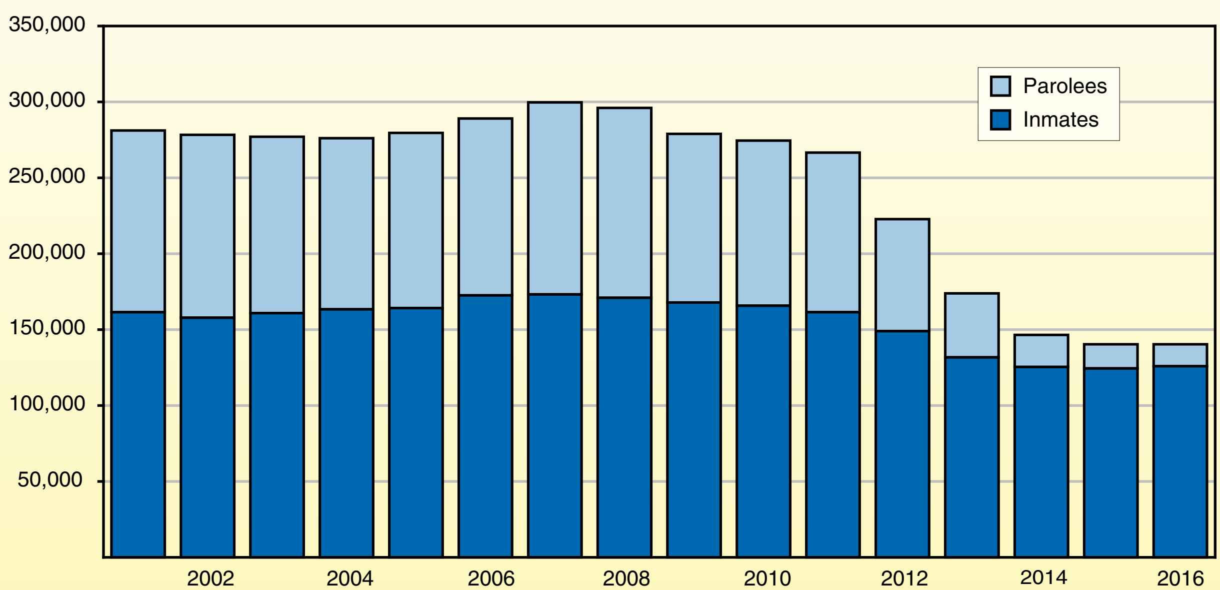
Inmate Health Care Services. The budget includes a total General Fund augmentation of $28 million for compliance with federal court orders and settlements, such as medical services under the *Plata* case and mental health services under the *Coleman* case. This amount includes $12 million for about 211 additional nursing positions to distribute medication to inmates, and $15 million for the planning and activation of various new health care facilities. However, the budget also reflects $81 million in General Fund savings from an unallocated reduction of about 5 percent in the federal Receiver's inmate medical services program. The Receiver intends to achieve these savings by seeking federal reimbursement for inpatient health care delivered to inmates in community hospitals who are eligible for Medi-Cal and carrying out other unspecified operational and policy changes. In addition, the budget includes a $46 million decrease to reflect a reduction in projected pharmaceutical expenditures.

CDCR "Workforce Cap" Savings. The budget plan assumes $195 million in savings as a result of an unallocated reduction to CDCR's personnel budget. The department plans to achieve these savings through various measures, such as reducing headquarters positions, closing one DJF facility, reducing security staffing at the prisons, and increasing the number of parolees each parole agent supervises.

Figure 20

Inmate and Parolee Populations Projected to Decline Significantly Starting in 2011-12

As of June 30 of Each Year



Adult Correctional Rehabilitation and Other Programs. The budget includes a one-time reduction of $101 million to inmate and parolee rehabilitation programs. The department plans to achieve these savings primarily by delaying implementation of new contracts for sex offender treatment programs and female offender programs, reducing operating expenses and equipment for education programs, and reducing substance abuse treatment capacity for inmates and parolees. In addition, the budget includes $89 million to provide community corrections performance incentive grants to county probation departments that successfully send fewer probationers to state prison. In accordance with Chapter 608, Statutes of 2010 (SB 678, Leno), this funding reflects a portion of the state savings from having a reduced prison population.

Corrections Standards Authority (CSA). The budget package eliminates the CSA and assigns its former duties to a new 12-member Board of State and Community Corrections. Unlike CSA, this new board will be independent of CDCR. The primary goals of the new board will be to assist other state and local government agencies in implementing the criminal justice realignment plan discussed above, provide leadership in the area of criminal justice policy, and to develop data and information related to the implementation of outcome-based measures and evidence-based practices in community corrections efforts.

Department of Justice (DOJ)

The budget includes $233 million from the General Fund for support of DOJ, a net reduction of about $59 million, or 20 percent, from the revised 2010-11 level. The budget shifts $50 million from DOJ to various state agencies in order to implement a "billable-services" model for the legal services that these agencies receive from DOJ. Under this new model, state agencies will reimburse DOJ for its services. The budget also reflects $37 million in savings from a reduction in state support for DOJ's Division of Law Enforcement. These reductions are partially offset by increased funding for state forensic laboratories ($14 million) and employee compensation costs ($13 million).

Office of the Inspector General (OIG)

The budget includes about $21 million from the General Fund to support OIG, a reduction of $3.8 million, or 15.5 percent, from the revised 2010-11 level. This reflects savings expected from policy changes specified in budget trailer legislation that reduce the duties and responsibilities of the OIG.

Resources and Environmental Protection

The 2011-12 budget provides about $7.3 billion from various fund sources for programs administered by the Natural Resources and Environmental Protection Agencies. This is a decrease of $3.8 billion, or 34 percent, when compared to revised 2010-11 expenditures. Most of this decrease reflects lower bond expenditures in 2011-12, although the budget still includes a major infusion (around $1.4 billion) of available bond funds from various resources-related measures. The budgets also include a combined $2 billion from the General Fund.

Figures 21 and 22 (see next page) compare expenditure totals for resources and environmental protection programs in 2009-10, 2010-11, and 2011-12. As the figures show, General Fund expenditures are somewhat lower in 2011-12. This reduction reflects (1) a partial shift in funding from the General Fund to fees for wildland fire prevention ($50 million) and for water quality and water rights activities ($24 million), (2) a $44 million reduction in CalFire's fire protection program, (3) a partial shift in funding of $16 million from the General Fund to bond funds for flood management, and (4) an $11 million reduction in state park operations. Debt service on general obligation bonds continues to be the largest single General Fund expenditure in the resources and environmental protection areas—totaling $942 million in 2011-12. The significant decrease in local assistance and capital outlay for resources and environmental protection programs is largely due to reduced bond expenditures.

Resources and Environmental Protection Expenditures

Bond Expenditure Summary. The budget includes about $1.4 billion from a number of bond funds (mainly Propositions 50, 84, 1B, and 1E) for various resources and environmental protection programs. The largest set of bond expenditures in 2011-12 are for state and local parks (primarily local parks).

Figure 21

Resources Programs: Expenditures and Funding

(Dollars in Millions)

				Change From 2010-11 to 2011-12	
	2009-10	**2010-11**	**2011-12**	**Amount**	**Percent**
Expenditures					
State operations	$4,449.6	$5,329.4	$4,638.6	-$690.8	-13.0%
Local assistance	426.9	2,060.2	701.0	-1,359.2	-66.0
Capital outlay	340.2	1,944.2	264.6	-1,679.6	-86.4
Totals	**$5,216.7**	**$9,333.8**	**$5,604.2**	**-$3,729.6**	**-40.0%**
Funding					
General Fund	$1,800.2	$1,989.9	$1,946.4	-$43.5	-2.2%
Special funds	2,122.1	2,525.6	2,377.3	-148.3	-5.9
Bond funds	867.0	4,479.7	1,000.2	-3,479.5	-77.7
Federal funds	427.4	338.6	280.3	-58.3	-17.2
Totals	**$5,216.7**	**$9,333.8**	**$5,604.2**	**-$3,729.6**	**-40.0%**

Figure 22

Environmental Protection Programs: Expenditures and Funding

(Dollars in Millions)

				Change From 2010-11 to 2011-12	
	2009-10	**2010-11**	**2011-12**	**Amount**	**Percent**
Expenditures					
State operations	$1,131.6	$1,449.1	$1,453.9	$4.8	0.3%
Local assistance	202.7	318.0	214.7	-103.3	-32.5
Capital outlay	—	0.2	1.6	1.4	700.0
Totals	**$1,334.3**	**$1,767.3**	**$1,670.2**	**-$97.1**	**-5.4%**
Funding					
General Fund	$61.0	$75.2	$50.9	-$24.3	-32.3%
Special funds	828.4	1,072.5	1,049.9	-22.6	-2.1
Bond funds	215.3	421.5	369.0	-52.5	-12.5
Federal funds	229.6	198.1	200.4	2.3	1.2
Totals	**$1,334.3**	**$1,767.3**	**$1,670.2**	**-$97.1**	**-5.4%**

Delta-Related Expenditures. The budget provides a total of $272 million in state funds (mainly bond funds) across nine state agencies to address a number of interrelated water problems in the Sacramento-San Joaquin Delta region. These expenditures are coordinated and overseen by the relatively new Delta Stewardship Council, which was established pursuant to Chapter 5, Statutes of 2009 (SBX7 1, Simitian), to manage the state's interests in the Delta. The largest program expenditures are for improvements to the existing conveyance system ($98 million) and ecosystem restoration ($80 million).

Climate Change. The budget includes $37 million from special funds across eight state agencies for implementation of the California Global Warming Solutions Act of 2006 (Chapter 488, Statutes of 2006 [AB 32, Núñez]), to reduce the state's emission of greenhouse gases (GHGs) to 1990 levels by 2020. Figure 23 lists the expenditures, number of positions, funding sources, and activities funded on an agency-by-agency basis for the implementation of AB 32 in 2011-12. These expenditures include about $9 million for the Air Resources Board (ARB) to finish developing and begin implementation of its cap-and-trade regulation. The balance of the expenditures is to be used mainly to develop and implement other measures to reduce GHG emissions, as well as for programmatic oversight and interdepartmental coordination. As shown in the figure, the primary funding source for AB 32 implementation is the "AB 32 fee" that the ARB began assessing in 2010-11 on major GHG emitters subject to state regulation. Over the next several years, revenues from this new fee will also be used to repay loans made from various special funds that were the major means of support for AB 32 implementation from 2007-08 through 2009-10. Although not reflected in the figure, there are also expenditures in other departments that, while not funded by the AB 32 fee, nonetheless serve to help meet the state's AB 32 goals. These include expenditures of the California Public Utilities Commission and the California Energy Commission to implement the state's Renewables Portfolio Standard and various energy efficiency programs.

Assembly Bill 118-Funded Programs. The budget includes (1) $106 million for financial incentives administered by the Energy Commission to advance alternative and renewable fuel vehicle technologies and (2) $44 million for the ARB to provide grants and loans to owners of heavy-duty diesel vehicles to retrofit vehicles to achieve early compliance with regulations requiring reductions in emissions of air pollutants and GHGs. These expenditures are funded from various charges (smog abatement, vehicle registration, and vessel registration) raised pursuant to Chapter 750, Statutes of 2007 (AB 118, Núñez).

CalFire. The budget includes $121 million in a General Fund budget item that is designated specifically for emergency fire protection. The Director of Finance can augment this amount to pay for additional fire protection

Figure 23

AB 32 Implementation in 2011-12

(Dollars in Thousands)

Agency	Positions	Expenditures	Fund Source	Activity
Air Resources Board	155	$32,932	AB 32 fee revenue in Air Pollution Control Fund (APCF)	Develop and implement GHG emission reduction measures such as cap-and-trade program.
Secretary for Environmental Protection	6	1,807	AB 32 fee revenue in APCF, Motor Vehicle Account, General Fund	Climate Action Team activities, including program oversight and coordination.
Department of Water Resources	3	551	AB 32 fee revenue in APCF, State Water Project (SWP) funds	Evaluate impact of climate change on state's water supply and flood control systems; SWP climate change/energy program activities.
State Water Resources Control Board	2	535	AB 32 fee revenue in APCF	Develop GHG emission reduction measures.
Department of Resources Recycling and Recovery	6	501	AB 32 fee revenue in APCF	Develop and implement GHG emission reduction measures.
Department of General Services	5	416	Service Revolving Fund	Implement Green Building Initiative and Sustainability Program.
Department of Public Health	—	323	AB 32 fee revenue in APCF	Develop GHG emission reduction measures.
Department of Housing and Community Development	1	98	AB 32 fee revenue in APCF	Develop GHG emission reduction measures.
Totals	**178**	**$37,163**		

expenses, as needed. The budget also includes $524 million for separate budget items to support CalFire operations. This total reflects $44 million in General Fund savings from program reductions, of which $31 million results from changing staffing levels back to the pre-2003 level of three firefighters per engine instead of four. The budget also establishes a wildland firefighting working group to discuss future funding, realignment, and possible changes to the state's management of wildland firefighting.

The General Fund total also reflects the revenues raised from a new fire prevention fee to be assessed on property owners residing in State Responsibility Areas (SRAs)—mostly privately owned rangelands, timberlands, and watershed areas for which the state is responsible for providing wildland fire protection. The fee—to be assessed at up to $150 per inhabitable structure within an SRA—is projected to realize $50 million in General Fund savings in 2011-12 and $200 million in ongoing General Fund savings beginning in 2012-13.

State Parks General Fund Support. The budget provides $119 million from the General Fund for state park operations—reflecting an $11 million reduction in the Department of Parks and Recreation's (DPR's) base level of General Fund support. (The budget plan reflects an additional $11 million ongoing reduction beginning in 2012-13.) This programmatic reduction will be met through immediate service reductions and, beginning July 2012, the closure of up to 70 state parks. The Legislature directed DPR to select parks for closure based on several factors, including: rate of visitation, net savings from closure, existence of (or potential for) partnerships for the support of a park unit, relative statewide significance of a unit identified in department documents, significant and costly infrastructure deficiencies, and feasibility of physical closure of a park unit.

Williamson Act Subventions. The budget does not provide financial relief to counties for implementing Williamson Act contracts in 2011-12. This state subvention program allows counties to partially defray the loss of property tax revenues they incur by entering into open space contracts with landowners. The Legislature also approved the Governor's proposal to reverse a $10 million appropriation provided for 2010-11 for the Williamson Act subvention program.

Energy Expenditures

Use of Gas Consumption Surcharge Monies. The budget provides $453 million for various natural gas-related energy programs, funded from the Gas Consumption Surcharge, which is assessed on natural gas ratepayers. While the budget reflects $612 million in available resources from the Gas Consumption Surcharge in 2011-12, the Legislature made a programmatic cut of $155 million to the non-low income energy efficiency activities funded by the surcharge (leaving $20 million for this purpose), facilitating a one-time transfer of $155 million to the General Fund. Funding for discounts for low-income natural gas customers, low-income energy efficiency programs, and natural gas energy research was maintained at budgeted levels.

Energy Research and Renewable Energy Incentives. The budget includes $67 million for energy-related research and development (electricity and natural gas) that was funded through the Energy Commission's Public Interest Energy Research (PIER) Program. This expenditure amount reflects partial-year funding for this program, as the authority to collect the "public goods charge" (a surcharge on utility ratepayer bills) which funds the electricity portion of the program will sunset in January 2012 unless extended through legislative action.

The spending plan also provides about $71 million for incentives for energy producers and rebates to purchasers of renewable energy systems (like solar panels) under the Energy Commission's Renewable Energy Program. As with the PIER Program, this expenditure amount also reflects partial-year funding, as this program receives its funding support from the public goods charge that is scheduled to sunset in January 2012.

Transportation

The 2011-12 spending plan provides $17.2 billion from various fund sources for transportation programs. This is an increase of $2.2 billion, or 15 percent, when compared to the revised level of spending in the prior year, as shown in Figure 24.

Department of Transportation

The 2011-12 budget plan includes total expenditures of $13.3 billion from various fund sources for the Department of Transportation (Caltrans). This level of expenditures is greater than in 2010-11 by about $1.5 billion (or 13 percent) mainly due to the timing of the expenditure of certain one-time funds. Specifically, Proposition 1B bond funds and federal stimulus funds were not spent at the rate assumed in the *2010-11 Budget Act*, with the result that 2010-11 expenses were lower and 2011-12 spending was higher. The

Figure 24

Transportation Program Expenditures

Various Fund Sources (In Millions)

Program/Department	2009-10	2010-11	2011-12	Change From 2010-11 to 2011-12: Amount	Percent
Department of Transportation	$11,552	$11,801	$13,341	$1,540	13.0%
California Highway Patrol	1,835	1,863	1,876	13	0.7
Department of Motor Vehicles	843	908	928	20	2.2
Transit Capital	64	100	500	400	400.0
State Transit Assistance	400	—	330	330	—
High-Speed Rail Authority	140	221	155	-66	-29.9
California Transportation Commission	5	28	28	—	—
Totals	**$14,839**	**$14,921**	**$17,158**	**$2,237**	**15.0%**

2011-12 budget provides approximately $5.9 billion for transportation capital outlay, $2.2 billion for local assistance, $1.9 billion for capital outlay support, and $1.8 billion for highway maintenance and operations. The budget also provides $1.2 billion for Caltrans' mass transportation and rail programs and $184 million for transportation planning. The balance of funding goes for program development, legal services, and other purposes.

Fuel Tax Swap. In March 2010, the Legislature and Governor enacted what became known as the "fuel tax swap" legislation as part of the 2010-11 budget plan. The tax swap eliminated the state's sales tax on gasoline and replaced the lost revenue with an additional excise tax on gasoline, among other changes, to increase the Legislature's flexibility over the use of transportation funds. At the time, these actions were estimated to result in about $2.3 billion in benefit to the General Fund over 2010-11 and 2011-12, with an ongoing benefit of about $1 billion per year thereafter.

New legislative action was required for the 2011-12 budget, however, to reenact portions of the fuel tax swap package because of conflicts with two initiative measures approved by voters in November 2010, Proposition 22 and Proposition 26. Proposition 22, among other provisions, restricted the state's ability to pay for transportation debt service using fuel excise tax revenues and prohibited the borrowing of fuel excise tax revenues as well as certain other transportation funds. Proposition 26 potentially repealed certain tax and fee increase measures, including the additional excise tax on gasoline, unless they were reenacted by a two-thirds vote of the Legislature.

The new version of the fuel tax swap, which was reenacted by a two-thirds vote of the Legislature in March 2011, relies on vehicle weight fees, rather than fuel excise tax revenues, to benefit the General Fund, thus addressing potential conflicts with both of the propositions. For a detailed description of the 2011 fuel tax swap and the use of weight fees to benefit the General Fund, please see our January 2011 publication, *The 2011-12 Budget: Achieving General Fund Relief From Transportation Funds*.

The original and reenacted fuel tax swap, along with provisions in the 2011-12 budget package, provide a total of $2.7 billion in relief to the General Fund.

- ***Debt Service.*** Before conflicts arose with the 2010 ballot measures, $362 million in transportation funds were used under the prior tax swap legislation to offset General Fund debt-service costs in 2010-11. The reenactment of the fuel tax swap allows the resumption of the use of transportation funds to pay these debt-service costs to achieve additional General Fund savings of $353 million in 2010-11 and $778 million in 2011-12.
- ***Loans to the General Fund.*** Before conflicts arose with the 2010 ballot measures, $437 million in transportation funds were loaned to the

General Fund under the prior tax swap legislation. The reenactment of the fuel tax swap made possible $551 million in additional loans to the General Fund during 2010-11 and $210 million in 2011-12.

Continued Appropriations of Proposition 1B Funds. Proposition 1B, a ballot measure approved by voters in November 2006, authorized the issuance of $20 billion in general obligation bonds for state and local transportation improvements. All Proposition 1B funds are subject to appropriation by the Legislature. The 2011-12 budget appropriates a total of $3.5 billion for various programs, mainly for capital outlay and local assistance purposes.

Special Transportation Programs

Significant Funds Available to Local Operators for Public Transportation. The 2011-12 budget package provides an estimated $330 million for the State Transit Assistance program to support transit operations. In contrast to past years, the 2011-12 budget package provides no Proposition 1B funding to local transit operators for capital projects. However, the administration estimates $500 million will be available to local operators for these purposes from unspent allocations that were made in previous years.

High-Speed Rail Authority

Federal Funds Supplement State Bond Funding. The 2011-12 budget plan appropriates $155 million to the California High-Speed Rail Authority (HSRA), including $89 million in state bond funds from Proposition 1A of 2008 and $66 million in federal funds, for the following uses:

- ***Preparation for Right-of-Way Acquisition.*** About $71 million will be spent for contract services to prepare to purchase rights-of-way or the land upon which the train will eventually operate. This includes $38 million in state bond funds and $33 million in federal funding. In order to provide for additional legislative review of the high-speed rail project, statutory language in the *2011-12 Budget Act* generally forbids the purchase of rights-of-way prior to January 1, 2012. However, HSRA may proceed with a right-of-way purchase if it provides at least 60 days before the date of purchase an explanation of the critical need to purchase the land.

- ***Project-Level Planning and Design.*** About $9 million will be spent for contract services to perform preliminary design and environmental review for the nine segments of the rail system. This includes $5 million in state bond funds and $4 million in federal funding.

- ***Contract Services and State Administrative Costs.*** About $52 million will be spent for contract services for overall program management, as well as roughly $14 million for various other contracts, including communications and financial consulting services. An additional $9 million is authorized for state administrative costs and support of the authority.

The budget plan makes one-half of the funds appropriated to HSRA available only after it has met certain reporting requirements, such as providing an analysis of the revenue that would be contributed to the project from a private operator and an update of the financial plan for the project that includes alternative funding scenarios.

Proposition 1A Funds for Some Connector Rail Projects Vetoed. The Governor vetoed $235 million in Proposition 1A bond funds that the Legislature had budgeted for intercity rail and local rail projects that would provide connectivity to the high-speed rail system. This action leaves about $28 billion in Proposition 1A funds for safety projects on various local rail and intercity rail corridors in the 2011-12 budget plan.

California Highway Patrol and Department of Motor Vehicles

The 2011-12 budget provides $1.9 billion to fund California Highway Patrol operations, or roughly the same amount as was provided in 2010-11. The funding includes support for the department's ongoing programs ($1.8 billion), the cost of various capital outlay projects ($72 million), the full-year cost of the 180 patrol officers that were added in 2010-11 ($16 million), and the cost of a new computer-aided dispatch system ($7 million). For DMV, the budget provides $928 million for departmental operations, about $20 million (2 percent) more than in 2010-11, mostly due to increased costs resulting from the expiration of furloughs and the personal leave program.

Increased Vehicle Registration Fee and Funding Shifts. The DMV receives funding to support its operations from a variety of sources, including registration fees and VLF. State law requires DMV to charge a registration fee on vehicles and trailers registered in the state (with certain exceptions). The VLF, which is also paid to the DMV at the time of vehicle registration, is an annual fee on the ownership of a registered vehicle in California. It is levied in place of taxing vehicles as personal property. The bulk of VLF revenue is distributed to cities and counties, but the DMV retains a portion to pay for its collection costs. The 2011-12 budget plan contains changes that affect both sources of revenues for the DMV.

First, the 2011-12 budget plan increases the vehicle registration fee from $31 to $43. This change is assumed to generate $300 million in additional revenues that will be used to offset DMV costs. Second, the budget shifts $300 million in VLF revenues that previously were used for the support of DMV instead to local law enforcement programs. This funding shift is one component of a realignment of public safety programs discussed in more detail earlier in this chapter.

Motor Vehicle Account (MVA). To help address the General Fund condition, the 2011-12 budget provides a one-time transfer of $72 million from the MVA to the General Fund. Unlike other MVA revenues, these funds are not restricted by Article XIX of the State Constitution and thus are available for general state purposes. The *2010-11 Budget Act* provided a loan of up to $180 million to the General Fund, which must be repaid to the MVA within three years. The 2011-12 budget plan provides a partial repayment of the loan in the amount of $19.5 million, leaving $160.5 million to be repaid over the next two years.

Other Major Provisions

Redevelopment Agencies

The budget package includes two bills related to redevelopment agencies designed to generate $1.7 billion in 2011-12 and about $400 million annually in out-years. The first bill eliminates the statutory authority for redevelopment agencies to exist. Under this bill, successor agencies are established for the purpose of paying off any existing redevelopment debt with revenues that otherwise would have gone to the redevelopment agencies. Any revenue in excess of what is required to pay off these debts is distributed to schools and other local governments (cities, counties, and special districts) pursuant to existing property tax allocation laws.

The second bill permits a city or county that has a redevelopment agency to prevent that agency's elimination by making a remittance payment to the K-12 schools, fire protection districts, and transit districts that overlap with the redevelopment agency's project areas. Each city or county's remittance payment is calculated as its proportionate share of $1.7 billion in 2011-12 and $400 million in out-years. This calculation takes into account each redevelopment agency's 2008-09 tax increment revenues, debt payments, and pass-through payments. On a one-time basis in 2011-12, the bill exempts redevelopment agencies from the requirement to set aside funds (usually 20 percent of their tax increment revenues) for low- and moderate-income housing projects.

The second bill also has provisions that adjust cities' and counties' out-year annual remittance payments primarily based on growth in tax increment revenues and new debt issued by redevelopment agencies (excluding debt issued for affordable housing programs). The bill also states the intent of the Legislature to enact legislation to establish a reduced schedule of payments for new redevelopment debt related to projects designed to achieve statewide environmental, transportation, or community development goals.

Effect on State Education Spending. These bills provide additional funds to K-12 schools—either increased property revenues (in cases where the redevelopment agency is eliminated) or remittance payments (in cases where a city or county elects to make these payments). In both cases, the additional funds offset state-required education spending for one year: 2011-12. Specifically, the additional funds are counted as local property tax revenues in 2011-12 and included in the calculation of the Proposition 98 minimum guarantee. Beginning in 2012-13, however, the property tax revenues and remittance payments are excluded from the Proposition 98 calculation and do not offset state-required education spending.

State-Mandated Local Programs (Non-Education)

The 2011-12 budget approved by the Legislature provides $47.8 million (General Fund) for 13 mandates. The budget bill suspended 60 non-education mandates, including a series of mandates requiring counties to provide absentee ballots. When the Legislature suspends a mandate, for one year (1) local governments are not required to implement its requirements and (2) the state may postpone its obligations to pay the accumulated mandates bills. The budget took no action regarding the Open Meeting Act mandate. Because the budget did not suspend, repeal, or fund this mandate, it is not clear whether local governments are required to implement its requirements during the budget year.

The budget package deferred payment for two labor relations mandates (Peace Officer Procedural Bill of Rights and Local Government Employment Relations), as well as a scheduled payment (about $100 million) towards retiring the state's accumulated non-education mandate debt. Finally, as we discuss more fully in our "K-12 Education" section of this report, the budget transferred responsibility to provide mental health services to special education students (the AB 3632 mandate) from counties to schools.

Employee Compensation

Savings From Collective Bargaining. The state's rank-and-file employees are organized into 21 collective bargaining units. During the course of 2010-11, the Legislature ratified contracts with each of these units. While managers and supervisors are not included in the collective bargaining process, the state extended some of the provisions from the new contracts to them. In total, the budget assumes $135 million in net savings (General Fund) from these new employee compensation policies:

- ***Unpaid Leave.*** Nearly all state employees will experience reduced wages during the first 12 months of their contract as a result of the Personal Leave Program (PLP). The PLP—typically eight hours of unpaid leave every month—does not affect employees' benefits or pension calculations.
- ***Employee Contributions for Pensions.*** Most state employees will make larger contributions to their retirement, generally about 2 percent to 5 percent of pay more than they previously contributed. The increased employee contributions offset the state's contribution to employee retirement.
- ***New Pension Formula.*** Future state employees will be enrolled in a new pension formula that generally reduces pension benefits to pre-1999 levels.
- ***Health Care.*** The state's employee health care costs will increase for all bargaining units.

- ***Pay Increase.*** The top step of state employee salary ranges will increase by 2 percent to 5 percent. The pay increases will occur in either 2012 or 2013 and generally be equal to the employees' increased pension contribution.

Health Benefits Program. The budget assumes that the California Public Employees' Retirement System (CalPERS) will achieve one-time savings of $80 million (General Fund) in its Health Benefits Program in 2011-12. In future years, the budget specifies that CalPERS will achieve an equivalent level of ongoing savings from the adoption of a core health care plan (a new health plan that provides somewhat less coverage at a lower premium cost) or other measures.

Labor Programs

Disability Insurance Fund Loan. California's Unemployment Insurance (UI) fund has been insolvent since 2009 due to an imbalance between revenues collected from employers and benefits paid to claimants. To continue payment of UI benefits, the state obtained a loan from the federal government, with a current outstanding balance of over $10 billion. As of January 2011, the state began to accrue interest on this federal loan and will be required to make an interest payment of approximately $320 million in September 2011. The 2011-12 budget authorizes this interest payment from the General Fund. To offset this cost, the budget plan provides a loan equal to the amount of the interest payment from the Disability Insurance Fund to the General Fund. The loan is to be repaid over the next four years at an annual cost of about $80 million.

Additional Federal Funds Used to Support Ongoing Implementation of an Alternate Base Period. In 2009, the Legislature authorized the Employment Development Department (EDD) to make automation and programmatic changes in order to incorporate an Alternate Base Period (ABP) into the UI program. An ABP allows some unemployed workers to qualify for UI benefits sooner than would have been the case under prior law. In May 2011, EDD made sufficient progress on ABP development to certify to the U.S. Department of Labor that it would fully implement an ABP in September 2012, allowing the state to receive $839 million in additional federal funds. The 2011-12 budget appropriates $48 million of these federal funds to cover the cost of implementing ABP through 2014-15 and the remaining $791 million to repay the state's outstanding UI loan balance.

Reduction in Federal Workforce Investment Act (WIA) Funds. A 2011 federal law reduced the federal funding provided to California in 2011-12 for WIA programs by roughly $50 million or 10 percent. In addition, the act altered the allocation of WIA job training funds within California by reducing the portion available for statewide discretionary projects, probably by $16 million to $41 million. This reduction in state discretionary funding could significantly limit or eliminate several statewide workforce development programs in

2011-12. Budget bill language requires DOF and EDD to present the Legislature with a detailed expenditure plan reflecting these federal actions prior to the expenditure of any WIA state discretionary funds.

Department of Food and Agriculture

The 2011-12 budget plan provides $336 million to fund the Department of Food and Agriculture (CDFA), which is a reduction of $31 million (8 percent) compared to its 2010-11 funding level. The reduction in spending is mainly due to the elimination of $32 million in General Fund support for local fairs and expositions.

The 2011-12 budget plan also includes a $19 million reduction in General Fund support for various CDFA agricultural programs. For some programs, General Fund monies will be replaced with revenues from new assessments on the agriculture industry and other fees will be increased for five years. For example, the industry will be charged on a fee-for-service basis to use the department's Animal Health and Food Safety Laboratory and to participate in the meat and poultry inspection program. In addition, the licensing fee for a new or previously unlicensed meat processing or poultry plant will increase from $50 to $500.

General Government Automation

Financial Information System for California (FI$Cal) Project. The Governor's January budget proposal included $71 million to continue the FI$Cal project to build an integrated financial system for the state. Due to cost reductions and schedule shifts, the approved budget provides $38 million for the project for 2011-12.

State Operations

Savings and Consolidations. The budget assumes that the state will save $250 million (General Fund) through various unallocated efficiencies and cost-reduction measures. The budget also assumes that the state will save $19 million General Fund through consolidations, eliminations, and improved operational efficiencies in 17 state boards, commissions, and departments.

Debt Service on Bonds

The budget assumes $5.5 billion (General Fund) in debt-service payments on general obligation bonds and lease-revenue bonds, an increase of $66 million, or 1.2 percent, from the 2010-11 spending level. This is a modest increase compared with the growth of debt-service obligations in previous years. The slowing growth in debt service is partly due to the administration's decision not to issue bonds in spring 2011 and the budget plan's assumption of a small bond sale ($1.2 billion) in fall 2011. (In recent years, the state sold between $5 billion and $20 billion of bonds annually, usually in the spring and fall.) Additionally, the budget plan offsets some General Fund debt-service costs in transportation by using weight fees (see "Transportation" section for more information).