LAO

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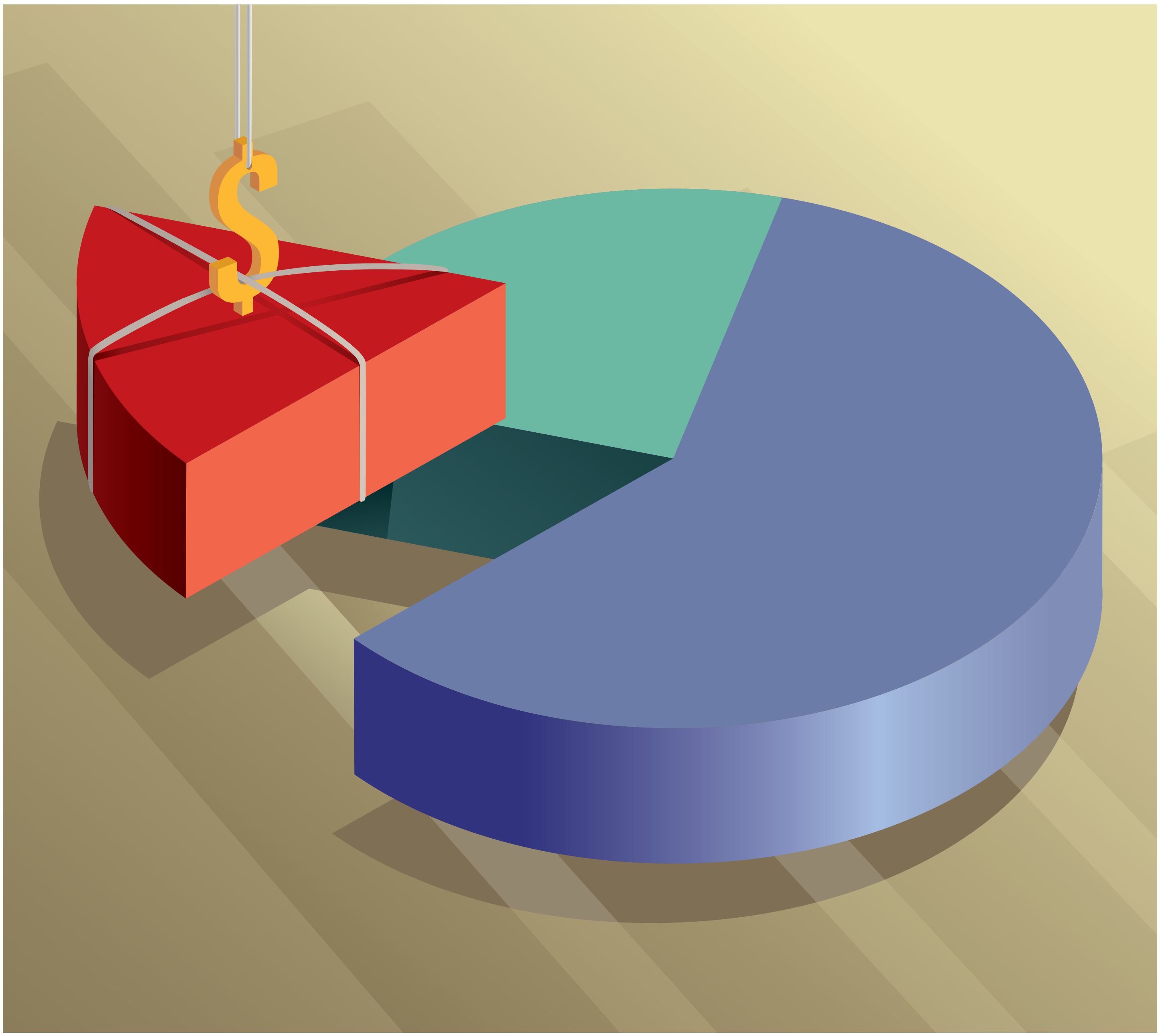
October 2012

The 2012-13 Budget:

California Spending Plan



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Chapter 1

Key Features of the 2012-13 Budget Package

This publication summarizes the elements of California's 2012-13 state spending plan, including legislative and gubernatorial actions through September 2012. (A preliminary electronic version was released prior to gubernatorial actions on bills passed by the Legislature in August 2012. This final published version reflects the Governor's vetos of SB 1030 [Budget and Fiscal Review Committee] and various minor changes.)

Budget Overview

Total State and Federal Funds Spending

The 2012-13 state spending plan assumes total budget expenditures of $130.7 billion from the General Fund and special funds, as shown in Figure 1. This consists of $91.3 billion from the General Fund and the Education Protection Account (which would be created by Proposition 30), as well as $39.4 billion from other special funds. Together, spending from these funds is assumed to increase by around 7 percent over 2011-12. Federal funds spending is projected to be about $83 billion for 2012-13, an increase of 6 percent over 2011-12. (Unless otherwise specified, figures in this publication generally reflect the administration's official scoring as of late June 2012.)

Figure 1

Total State and Federal Fund Expenditures

(Dollars in Millions)

Fund Type	Actual 2010-11	Estimated 2011-12	Enacted 2012-13	Change From 2011-12	
				Amount	Percent
General Fund[a]	$91,549	$87,027	$91,338	$4,311	5.0%
Special funds	33,432	35,010	39,409	4,399	12.6
Budget Totals	**$124,981**	**$122,037**	**$130,746**	**$8,709**	**7.1%**
Selected bond funds	$6,000	$13,072	$11,674	-$1,398	-10.7%
Federal funds	84,764	78,235	82,956	4,721	6.0

[a] Includes Education Protection Account spending attributed to 2011-12 and 2012-13, assuming passage of Propsition 30 in November 2012.

General Fund Revenues

Figure 2 displays the key revenue assumptions underlying the *2012-13 Budget Act*.

Key Budget Estimates Assume Voters Approve Proposition 30. In 2012-13, General Fund and Education Protection Account revenues are estimated at $95.9 billion, an increase of $9 billion, or about 10 percent, over the estimated 2011-12 level. The state's largest General Fund revenue sources are the personal income tax (PIT) and the sales and use tax (SUT). As discussed in the nearby box, PIT and SUT estimates for 2011-12 and 2012-13 assume $8.5 billion in additional revenues across the two fiscal years resulting from passage of the Governor's proposed tax initiative (Proposition 30) in November.

The Condition of the General Fund

Figure 3 summarizes the budget plan's estimated General Fund condition for 2011-12 and 2012-13.

2011-12: Fourth Consecutive Year to End With a Deficit. Under the 2012-13 spending plan, the General Fund and the Education Protection Account would have a combined 2011-12 year-end deficit of about $3.6 billion. This deficit was created, in large part, by General Fund revenues being lower than were projected in the 2011-12 spending plan. This is the fourth year in a row in which the state has ended the year with a General Fund deficit.

Figure 2

2012-13 Budget Act

General Fund and Education Protection Account Revenues[a]

(Dollars in Millions)

	2010-11 Actual	2011-12 Estimated	2012-13 Enacted	Change From 2011-12	
				Amount	Percent
Personal income tax (PIT)	$49,445	$52,958	$60,268	$7,310	13.8%
Sales and use tax (SUT)	26,983	18,921	20,605	1,684	8.9
Corporation tax (CT)	9,614	8,208	8,488	280	3.4
Insurance tax	2,077	2,148	2,089	-59	-2.7
Vehicle license fee (VLF)	1,330	70	3	-67	-95.7
Other revenues	2,506	2,740	2,846	105	3.8
Transfers and loans	1,488	1,784	1,588	-196	-11.0
Totals	**$93,443**	**$86,830**	**$95,887**	**$9,057**	**10.4%**

Note: Department of Finance estimates.

[a] Assumes passage of Proposition 30 and receipt of about $8.5 billion in resulting revenues for the Education Protection Account in 2011-12 and 2012-13 combined. Reflects, among other things, expiration of temporary PIT, SUT, and VLF increases that increased revenues to the General Fund in fiscal year 2010-11, but generally not in 2011-12 and 2012-13. Prior CT action also accelerated certain revenues to years before 2011-12. In addition, the *2011-12 Budget Act* and related legislation redirected a portion of the SUT (over $5 billion) from the General Fund to the Local Revenue Fund 2011 for realignment purposes.

Figure 3

General Fund Condition

General Fund and Education Protection Account Combined (Dollars in Millions)

	2011-12	2012-13	Percent Change
Prior-year balance	-$2,685	-$2,882	
Revenues and transfers	86,830	95,887	10.4%
Total resources available	$84,145	$93,005	
Total expenditures	$87,027	$91,338	5.0%
Fund balance	-$2,882	$1,667	
Encumbrances	$719	$719	
Reserve	**-$3,601**	**$948**	

Note: Department of Finance estimates, assuming passage of Proposition 30.

Spending Plan Assumes Voters Approve Proposition 30

The Governor's proposed tax initiative (Proposition 30) would temporarily increase the state sales and use tax (SUT) rate for all taxpayers and the personal income tax (PIT) rates for upper-income taxpayers.

Increases SUT Rate for Four Years. The SUT rate varies by locality, with an average rate statewide of 8.1 percent. Proposition 30 would temporarily increase the SUT rate by one-quarter cent for every dollar of goods purchased. This higher rate would be in effect for four years—from 2013 through the end of 2016.

Increases PIT Rate From 2012 Through 2018. Under current law, the maximum PIT rate is 9.3 percent (excluding the additional 1 percent tax on income in excess of $1 million for mental health services). This rate applies to taxable income in excess of $48,209 for individuals; $65,376 for heads of households; and $96,058 for joint filers. Proposition 30 would increase PIT rates on higher incomes. Specifically, the measure would impose:

- A 10.3 percent tax rate on income between $250,000 and $300,000 for individuals; $340,000 and $408,000 for heads of household; and $500,000 and $600,000 for joint filers.
- An 11.3 percent tax rate on income between $300,000 and $500,000 for individuals; $408,000 and $680,000 for heads of household; and $600,000 and $1 million for joint filers.
- A 12.3 percent tax rate on income in excess of $500,000 for individuals; $680,000 for heads of household; and $1 million for joint filers.

Additional Revenues of $8.5 Billion in 2011-12 and 2012-13 Combined. Funds from Proposition 30 taxes would be placed into a newly created state account—the Education Protection Account—and would be included in calculations of the Proposition 98 minimum education funding guarantee. The budget assumes Proposition 30 would increase state revenues by $8.5 billion in 2011-12 and 2012-13 combined. Because calculation of the Proposition 98 minimum guarantee is driven by year-to-year changes in revenues, the $8.5 billion in additional revenues would be offset by a $2.9 billion increase in the Proposition 98 minimum guarantee. After accounting for that increase, the measure would result in about $5.6 billion of net General Fund benefit.

2012-13: $948 Million Reserve Projected in Budget Plan. Under the spending plan, the state would record General Fund and Education Protection Account revenues and transfers of $95.9 billion and expenditures of $91.3 billion in 2012-13. The $4.5 billion operating surplus is necessary for the state to close the 2011-12 deficit discussed above and end 2012-13 with a $948 million reserve balance.

Actions Adopted During the Budget Process

As of May 2012, the administration estimated that the state needed to take about $15.7 billion of actions in order for the state to end 2012-13 with a balanced budget. Figure 4 shows actions adopted to address this budget problem. The budget plan (including gubernatorial vetoes) includes the following actions to balance the budget (based on our office's categorization):

- About $9 billion in revenue actions, $8.5 billion of which reflect the assumed passage of Proposition 30. These actions would be offset by a $2.9 billion increase in the Proposition 98 minimum education funding guarantee due to higher revenues from the Governor's tax initiative.
- $4.6 billion in expenditure actions. These budget actions are discussed in more detail in "Chapter 2."
- $5.8 billion in other actions, including loans, transfers, and funding shifts. This amount includes a transfer of liquid assets (cash) from the former redevelopment agencies to local governments, including school and community college districts. The administration estimates that this transfer of liquid assets will generate $1.5 billion of General Fund benefit in 2012-13 by reducing the level of General Fund spending required to meet the Proposition 98 minimum guarantee. This proposal is discussed in more detail in "Chapter 2."

Additional Cuts of $6 Billion if Voters Reject Proposition 30. In addition to the expenditure reductions detailed in Figure 4, the budget contains a mechanism for further reducing expenditures in 2012-13 if voters reject the Governor's tax initiative. Figure 5 (see page 6) details about $6 billion in additional expenditure reductions—also referred to as "trigger cuts"—that would take effect if voters reject the tax measure. Almost all of the reductions would affect education programs—$5.4 billion for K-14 education and $500 million for public universities.

Evolution of the Budget

The Governor signed the *2012-13 Budget Act* on June 27, 2012. Between that date and the end of August 2012, the Legislature also sent over 40 budget-related trailer bills to the Governor. (The budget and related bills enacted during this period are listed in the Appendix.)

Figure 4

Actions to Close 2012-13 Budget Gap[a]

2011-12 and 2012-13 General Fund Benefit (In Millions)

Revenue Actions	
Increase personal income and sales and use taxes (assumes passage of Proposition 30)	$8,479
Realize savings from pending settlements	121
Implement changes to unclaimed property program	78
Implement other revenue actions (net)	95
Subtotal	($8,772)
Increased Proposition 98 costs due to proposed tax increases	-$2,908
Expenditure Actions	
Make various Proposition 98 adjustments	$1,885
Restructure and reduce CalWORKs and subsidized child care program costs	763
Expand Medi-Cal demonstration project to coordinate care and defer provider payments	608
Reduce Medi-Cal costs through program efficiencies and other changes	586
Reduce state employee compensation through negotiations and furloughs	402
Reduce Healthy Families Program costs (unallocated reduction)	183
Reduce various other program costs (net)	153
Change Cal Grant award amounts and institutional eligibility requirements	109
Reduce In-Home Supportive Services costs and services	52
Subtotal	($4,741)
Other Actions	
Use cash assets of former redevelopment agencies to offset Proposition 98 General Fund obligation	$1,479
Delay loan payments to special funds	1,158
Delay court construction, use local trial court reserves for operations, and other actions	544
Use part of cap-and-trade program auction revenues to offset General Fund costs[b]	500
Use proceeds from mortgage settlement to fund housing debt service and other activities	392
Use weight fee revenues to offset General Fund costs	385
Borrow from disability insurance fund to pay costs of federal unemployment insurance loans	313
Transfer funds from the Motor Vehicle Fuel Account	312
Borrow from the Motor Vehicle Account	300
Incorporate lower-than-projected increases in retiree health care costs	148
Defer payment on pre-2004 local mandate obligations[c]	100
Use First 5 (Proposition 10) funds in lieu of General Fund	80
Implement other fund shifts and transfers (net)	91
Subtotal	($5,803)
Total[d]	**$16,408**

[a] Generally reflects administration's scoring of listed actions as of the June 2012 passage of the *2012-13 Budget Act*. Excludes some proposed program augmentations.

[b] Although the administration's workload budget includes these funds, we characterize this as a budget-balancing policy change.

[c] Contrary to the administration's official scoring, does not list a $729 million action related to past-year costs of suspended mandates.

[d] The administration characterized the 2012-13 spending plan's budget-balancing actions as totaling $16.6 billion. Our estimate is $229 million lower due to the differences described in footnotes b and c above.

$9.2 Billion Budget Problem Estimated in January. On January 5, 2012, the Governor proposed the *2012-13 Governor's Budget*. At that time, the administration estimated the size of the budget problem to be $9.2 billion. That problem consisted of a projected $4.1 billion deficit at the end of 2011-12 and an operating deficit of $5.1 billion in 2012-13. The Governor's proposal for 2012-13 included $10.3 billion of budget actions, according to administration estimates, leaving the state with a $1.1 billion reserve at the end of 2012-13.

Figure 5

2012-13 Spending Reductions if Voters Reject Proposition 30

(In Millions)

Schools and community colleges	$5,354
University of California	250
California State University	250
Department of Developmental Services	50
City police department grants	20
CalFire	10
DWR flood control programs	7
Local water safety patrol grants	5
Department of Fish and Game	4
Department of Parks and Recreation	2
DOJ law enforcement programs	1
Total	**$5,951**

DWR = Department of Water Resources; and DOJ = Department of Justice.

Proposed Tax Initiative Was a Key Part of Governor's January Budget Proposal. The Governor's budget proposal included a major restructuring of the California Work Opportunity and Responsibility to Kids program and subsidized child care, the state's primary sources of cash assistance and work support for low-income families, for a total General Fund benefit of about $1.4 billion. The centerpiece of the proposal, however, was its assumption that voters would approve the Governor's tax initiative to temporarily increase the state SUT rate for all taxpayers and PIT rates for upper-income taxpayers. Specifically, the proposal would have increased the SUT rate by one-half cent for every dollar of goods purchased from 2013 through 2016. In addition, the measure would have increased PIT rates as follows:

- A 10.3 percent tax rate on income between $250,000 and $300,000 for individuals; $340,000 and $408,000 for heads of household; and $500,000 and $600,000 for joint filers.
- A 10.8 percent tax rate on income between $300,000 and $500,000 for individuals; $408,000 and $680,000 for heads of household; and $600,000 and $1 million for joint filers.
- An 11.3 percent tax rate on income in excess of $500,000 for individuals; $680,000 for heads of household; and $1 million for joint filers.

In January, the administration estimated that the plan would generate $6.9 billion in revenues over 2011-12 and 2012-13. The administration projected that those revenues would be offset by a $2.5 billion increase in the Proposition 98 minimum guarantee, resulting in a net General Fund benefit of $4.4 billion.

Governor Released Revised Tax Proposal. In March, the Governor introduced a revised tax initiative with lower SUT rates for all taxpayers and higher PIT rates on upper-income taxpayers (see earlier box for details of the proposal, which subsequently qualified for the November ballot as Proposition 30). At that time, the administration projected the measure would increase state revenues by $9 billion in 2011-12 and 2012-13 combined. In May, revised administration projections indicated the proposal would increase state revenues by $8.5 billion in 2011-12 and 2012-13 combined. This May total was $1.6 billion more than the estimated revenue for the original tax initiative proposed in the January budget.

Budget Problem Grew to $15.7 Billion. In May, the administration revised its overall revenue estimates downward, increasing the size of the budget problem by $4.3 billion. At the same time, the May Revision projected higher school funding requirements in 2012-13 than the administration estimated in January. The $2.4 billion increase in Proposition 98 funding, combined with the $4.3 billion lower revenue assumptions, and lower anticipated net costs in other areas (-$0.2 billion), resulted in the May problem definition growing to $15.7 billion. The May Revision modified many of the January proposals, including the CalWORKs and child care proposals mentioned above. It also included major new proposals to reduce the compensation of state employees ($402 million) and change Medi-Cal payments to hospitals ($387 million, in addition to other Medi-Cal savings proposals).

Legislature Passed Budget Package. On June 15, 2012, the Legislature sent the budget bill to the Governor. Combined with the trailer bills, this budget package incorporated many of the Governor's May Revision proposals, but with scaled-back cuts to the CalWORKs and Cal Grant programs. The budget package also transfers all children enrolled in the Healthy Families Program to Medi-Cal on a phased-in basis beginning in January 2013 and increases the amount of proceeds from the national mortgage settlement used to offset General Fund costs. These issues are discussed in more detail in "Chapter 2."

Budget Package Signed by Governor. The final budget package was signed by the Governor on June 27, 2012. At that time, the Governor vetoed $129 million in General Fund spending and $67 million in special fund spending that had been approved by the Legislature.

Additional Actions at End of Legislative Session. In the days prior to the August 31 conclusion of the 2011-12 regular legislative session, the Legislature adopted about a dozen additional budget-related bills that are listed in the Appendix. These bills included various amendments to the 2012-13 budget and a measure implementing a lumber tax that changes statutory provisions related to timber harvest plans.

Following passage of the 2012-13 budget in June, the administration reported the discovery of tens of millions of dollars of additional moneys in special fund accounts related to the Department of Parks and Recreation. In addition, the administration reported that there were differences between the balances of dozens of other special funds that had been reported previously in Governor's Budget documents and State Controller's Office financial reports. In response to these developments, the Legislature passed AB 1478 (Blumenfield), which provides additional appropriations for state parks (described later in this report), and AB 1487 (Committee on Budget), which changes accounting and reporting requirements related to the state's over 500 special funds. The Governor signed these two measures.

In addition to the budget-related bills passed in late August, the Legislature considered other measures with potential budgetary effects, including pension legislation (discussed later in this report) and AB 1500 (J. Pérez). This bill would have required multistate corporations to allocate taxable income to California based on a mandatory "single sales factor" apportionment methodology, thereby changing the 2009 law that includes an elective single sales factor formula. The bill would have used the increased tax revenues related to the tax change to lower the cost of higher education for specified students. Other possible fiscal effects related to forest fire prevention and Proposition 98 also were discussed during legislative deliberations on AB 1500. This legislation—requiring a two-thirds vote in each house—passed the Assembly on a 54-25 vote on August 13, but failed in the Senate on a 22-15 vote during the early hours of September 1.

Chapter 2

Major Expenditure and Other Budget Actions

The previous chapter described the state's overall budget situation under the 2012-13 budget plan, as well as the tax provisions of Proposition 30. This chapter provides more detail on the expenditure and other budget actions included in the spending plan.

Proposition 98

Proposition 98 funding is the main funding source for K-12 education and the California Community Colleges (CCC). Proposition 98 funding also fully supports the state's subsidized preschool program. In this section, we (1) review the changes in the 2011-12 Proposition 98 budget, (2) describe the major factors that affect the minimum guarantee in 2012-13, (3) summarize the major Proposition 98 components of the 2012-13 budget package if Proposition 30 goes into effect, and (4) discuss the Proposition 98 reductions that would be triggered if the tax increases included in Proposition 30 do not go into effect. In the subsequent three sections, we discuss in more detail the budgets for K-12 education, child care and preschool, and higher education, respectively. (In addition, the online version of this report contains a link to a packet of detailed tables relating to various aspects of the education budget.)

2011-12 Spending Essentially Unchanged From *2011-12 Budget Act*

Drop in 2011-12 Minimum Guarantee Primarily Due to Lower Revenues. As shown in Figure 1 (see next page), the 2011-12 minimum guarantee decreased by roughly $2.2 billion due to General Fund revenues being lower than estimated in the *2011-12 Budget Act*. The guarantee decreased by an additional $609 million due to eliminating the rebenching for the "gas tax swap" adopted by the Legislature in 2011. These reductions in the guarantee were partly offset by an increase associated with attributing (or, accruing) some of the new revenues from Proposition 30 to the 2011-12 fiscal year. After adjusting for all of these changes, 2011-12 Proposition 98 spending was $893 million above the revised estimate of the minimum guarantee.

Plan Redesignates Funds Provided Above Minimum Guarantee. Total spending for schools and community colleges in 2011-12 is essentially unchanged from the level in the *2011-12 Budget Act*. To bring ongoing Proposition 98 spending down to the lower minimum guarantee, however,

Figure 1

Major Adjustments to Proposition 98 Minimum Guarantee

(In Millions)

2011-12 Budget Act	**$48,651**
Update for changes in baseline revenues	-$2,220
Update for changes in other Proposition 98 factors[a]	-339
Eliminate gas tax rebenching	-609
Use consistent rebenching approach	103
Add Governor's new revenues accrued to 2011-12	1,330
2011-12 Revised	**$46,916**
Baseline growth	$3,702
Add Governor's new revenues attributed to 2012-13	2,878
Additional student mental health services rebenching	99
2012-13 Budget Act	**$53,595**

[a] Includes updated estimates of revenues from local property taxes and redevelopment agencies, which affect the guarantee when Test 1 is operative. Also includes updated estimate of the amount of sales tax revenue that would have been raised from gasoline.

the budget package reclassifies $893 million of 2011-12 appropriations above the guarantee. Of the amount reclassified, $672 million is counted toward meeting a statutory obligation associated with 2004-05 and 2005-06 and the remaining $221 million replaces ongoing Proposition 98 funds with one-time Proposition 98 funds unspent from prior years. These accounting adjustments do not affect the amount of funding school districts and community colleges receive.

Higher General Fund Spending Due to Lower Redevelopment Property Taxes. The *2011-12 Budget Act* assumed $1.7 billion in redevelopment-related property tax revenues would flow back to school districts and community colleges. The updated budget package assumes only $133 million in associated revenues will flow back in 2011-12. If these revenues do not materialize, the budget plan would backfill school districts and community colleges with additional General Fund monies.

2012-13 Minimum Guarantee Substantially Higher Than 2011-12

Minimum Guarantee Higher Primarily Due to Revenues From Tax Measure. As shown in Figure 2, the 2012-13 minimum guarantee increases from $46.9 billion to $53.6 billion, an increase of $6.7 billion. Of this amount, $3.7 billion is due to growth in baseline revenues and $2.9 billion is due to the new revenues assumed from Proposition 30. The budget plan also increases the minimum guarantee by $99 million to account for additional Proposition 98 funding being provided for student mental health services.

The significant year-to-year increase in the minimum guarantee is partly driven by the manner in which the budget plan makes maintenance factor payments, which results in a larger share of new revenues being dedicated to Proposition 98.

Programmatic Spending Roughly Flat

As Figure 2 shows, Proposition 98 funding grows to $53.5 billion in 2012-13, a $6.6 billion increase from 2011-12. (Proposition 98 spending under the budget plan is $46 million below the minimum guarantee as a result of vetoes by the Governor.) Of this increase in spending, $3.7 billion is supported by the General Fund and $2.9 billion is supported by local property tax revenues. Although local property tax revenues not related to redevelopment decrease somewhat in 2012-13, the budget plan assumes large increases in redevelopment-related property tax revenues. Specifically, the budget plan assumes $1.7 billion in ongoing redevelopment property tax revenues and $1.5 billion in one-time property tax revenues from the transfer of liquid assets from the former redevelopment agencies (RDAs) to school districts and community colleges. (For more information, see the "Redevelopment Agencies" section later in this report.)

Figure 2

Proposition 98 Funding

(Dollars in Millions)

				Change From 2011-12	
	2010-11	2011-12	2012-13	Amount	Percent
K-12 Education					
General Fund	$29,995	$29,361	$32,828[a]	$3,468	12%
Local property tax revenue	12,191	11,856	14,342	2,487	21
Subtotals	($42,186)	($41,216)	($47,170)	($5,954)	(14%)
California Community Colleges					
General Fund	$3,885	$3,279	$3,415[a]	$136	4%
Local property tax revenue	1,965	1,971	2,403	432	22
Subtotals	($5,850)	($5,251)	($5,818)	($568)	(11%)
Preschool	$380	$368	$481	$113	31%
Other Agencies	87	82	79	-3	-3
Totals, Proposition 98	**$48,503[b]**	**$46,916**	**$53,549[c]**	**$6,633**	**14%**
General Fund	$34,346	$33,089	$36,804[a]	$3,714	11%
Local property tax revenue	14,157	13,827	16,745	2,918	21

[a] Includes revenues from the Education Protection Account.
[b] In 2010-11, the state also provided $872 million in Proposition 98 funding for child care programs.
[c] Due to Governor's vetoes ($46 million), funding level is slightly below minimum guarantee.

Virtually All Additional Spending Used for Existing Obligations. Although Proposition 98 spending increases substantially from 2011-12 to 2012-13, most of the additional funding is used to pay for existing Proposition 98 obligations. As Figure 3 shows, $3.3 billion is needed to backfill one-time actions made in 2011-12 and $2.2 billion is used to pay down existing K-14 deferrals (reducing total outstanding deferrals from $10.4 billion to $8.2 billion). Several other Proposition 98 spending increases also have no programmatic effect. The package, for example, uses: $110 million to more closely align K-14 mandate funding with anticipated costs, $99 million to complete the shift of student mental health services to schools, and $60 million for anticipated student growth in a few existing programs. The package also funds the existing Quality Education Investment Act and State Preschool Program from within Proposition 98 rather than from other fund sources. (We discuss the major changes to the preschool program in the "Child Care and Preschool" section of this report.)

Figure 3

Major 2012-13 Proposition 98 Spending Changes

(In Millions)

Technical Changes:	
Backfill one-time actions	$3,334
Make revenue limit adjustments	238
Backfill Proposition 63 mental health funding	99
Fund growth in certain categorical programs[a]	60
Other adjustments	-25
Subtotal	($3,705)
Policy Changes:	
Pay down K-14 deferrals	$2,225
Fund QEIA program within Proposition 98	361
Fund all preschool slots within Proposition 98	164
Create K-14 mandate block grant	110[b]
Backfill for lower CCC fee revenues	82
Fund CCC enrollment growth (0.9 percent)	50
Reduce preschool slots and collect family fees	-50
Eliminate Early Mental Health Initiative	-15
Subtotal	($2,928)
Total Changes	**$6,633**

[a] Applies to Charter School Categorical Block Grant, supplemental categorical grant for new charter schools, Child Nutrition, and preschool.

[b] An additional $90 million in base funding is provided—for total block grant funding of $200 million.

QEIA = Quality Education Investment Act.

Trigger Reductions if Proposition 30 Does Not Take Effect

As discussed earlier in this report, the *2012-13 Budget Act* includes a backup plan that makes $6 billion in trigger cuts if Proposition 30's tax increases do not go into effect. The vast majority of those reductions are made to K-14 education. We discuss the Proposition 98 backup plan in more detail below.

If Proposition 30 Does Not Take Effect, Debt Service and Early Start Program Shifted Into Proposition 98. As shown in Figure 4, if the tax increases in Proposition 30 do not go into effect, the backup plan pays for K-14 facility debt service ($2.5 billion) and the Early Start program ($197 million) using Proposition 98 funds. These shifts increase Proposition 98 costs by $2.7 billion. (As part of the debt service shift, the budget package adjusts the 2012-13 minimum guarantee upward by $190 million. It makes no adjustment in the minimum guarantee to reflect the shift of the Early Start program.)

Total Reductions of $5.4 Billion to Schools and Community Colleges. The backup plan includes $5.4 billion in trigger cuts to Proposition 98 funding in 2012-13 to address the drop in General Fund revenues and the shift of additional programs into Proposition 98 if the Governor's tax measure is not implemented. Figure 4 itemizes these reductions. The backup plan rescinds the proposal to pay down outstanding K-14 payment deferrals, resulting in $2.2 billion in General Fund savings. The rescinding of these payments would have little programmatic effect, but it may require some school districts and community colleges to increase their short-term borrowing. The backup plan also includes $3.1 billion in programmatic reductions—$2.7 billion to K-12 revenue limits and $389 million to community college apportionments.

Figure 4

Proposition 98 Trigger Reductions

(In Millions)

New Proposition 98 Spending:	
Fund K-14 debt service payments within Proposition 98	$2,518
Fund Early Start program within Proposition 98	197
Subtotal	($2,715)
Proposition 98 Reductions:	
Rescind K-12 deferral pay downs	-$2,065
Rescind CCC deferral pay downs	-160
Reduce K-12 revenue limits	-2,740
Reduce CCC apportionments	-339
Rescind apportionment funds for CCC enrollment growth	-50
Subtotal	(-$5,354)
Total Changes	**-$2,639**

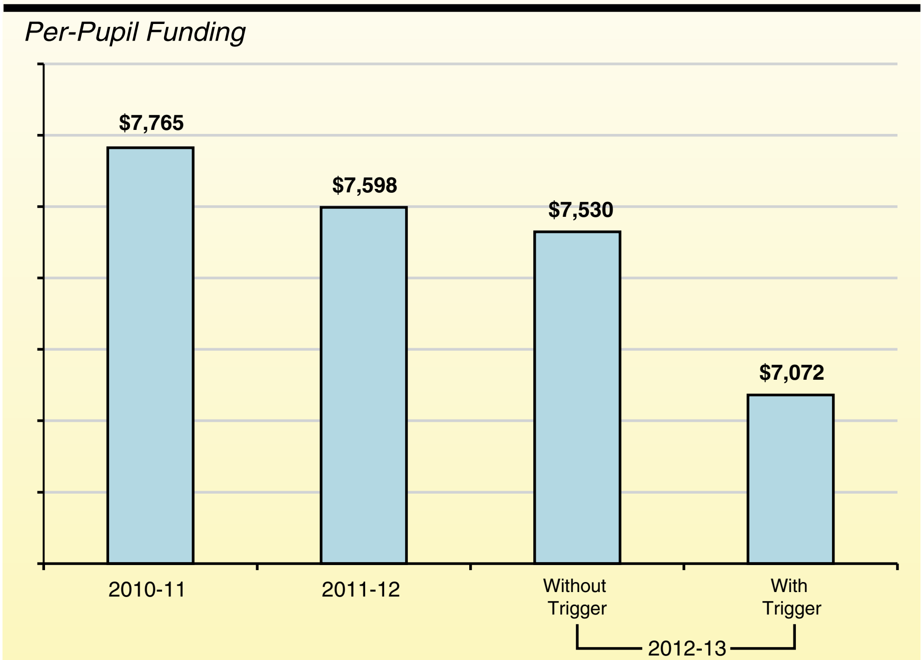
Of the community college reduction, $50 million would eliminate funding provided to serve additional students in 2012-13. To accommodate the programmatic reductions, the budget plan allows school districts to reduce the school year by an additional 15 days in both 2012-13 and 2013-14. Any reductions in instructional time and accompanying reductions in teacher costs, however, would need to be achieved by school districts through the collective bargaining process.

K-12 Education

Spending Roughly Flat, Though Down 6 Percent Under Trigger Plan. Figure 5 displays K-12 per-pupil programmatic spending from 2010-11 through 2012-13. As the figure shows, if the Governor's tax measure is implemented, per-pupil funding in 2012-13 will decrease slightly from $7,598 to $7,530, a drop of less than 1 percent from the prior year. This slight decrease is primarily due to the loss of federal "Education Jobs" funds that were available for school districts to spend in 2010-11 and 2011-12. This 2012-13 per-pupil spending level is about 9 percent less than the prerecession 2007-08 level. By comparison, if the trigger reductions are implemented, per-pupil funding will decrease to $7,072, a 6 percent decrease from the prior year and a 14 percent decrease from the prerecession 2007-08 level.

Figure 5

K-12 Programmatic Funding



Mandate Block Grant Adopted. The 2012-13 budget includes $167 million for a new discretionary block grant for K-12 mandates. School districts, charter schools, and county offices of education (COEs) may apply for mandate block grant funding. School districts and COEs that choose to participate in the block grant are to receive $28 per average daily attendance (ADA), whereas charter schools are to receive $14 per ADA. In addition, COEs are to receive $1 per ADA for all ADA served within the county. In lieu of participating in the block grant, local educational agencies could continue to seek reimbursement for mandated activities through the existing mandates claiming process. (The enacted budget appropriates a total of $41,000 for agencies that opt to submit claims for reimbursement.) The budget continues to suspend the same mandates in 2012-13 that were suspended in 2011-12 and does not eliminate any K-12 mandates.

Final Shift of Student Mental Health Service Funding. The budget plan provides an additional $99 million to complete the shift in responsibility of student mental health services from county mental health agencies to school districts. The additional funding backfills for the loss of $99 million in one-time Proposition 63 funds that were provided in 2011-12.

Various Changes to Increase Charter School Access to Facilities and Short-Term Cash. The budget package includes several changes to existing law that provide charter schools with additional access to facility space and short-term cash. The plan includes provisions that give charter schools priority to lease or purchase properties that have been deemed "surplus property" by a school district. In addition, the budget package authorizes COEs and county treasurers to provide short-term loans to charter schools. The plan also allows charter schools to issue their own tax revenue anticipation notes (TRANs) or have a COE issue a TRAN on their behalf.

Governor Vetoes Funding for Certain K-12 Programs. In June, the Governor vetoed all funding for the Early Mental Health Initiative, for Proposition 98 savings of $15 million. In addition, the Governor vetoed $10 million in non-Proposition 98 funds that would have provided child nutrition funding for private schools and child care centers not eligible for the state's existing child nutrition program. The Governor also vetoed $8.1 million in one-time Proposition 98 funding for support of regional activities and statewide administration of the Advancement Via Individual Determination program.

Child Care and Preschool

As shown in Figure 6 (see next page), the *2012-13 Budget Act* authorizes total spending of $2.2 billion for subsidized child care and preschool programs. This is a decrease of $185 million, or 8 percent, from the prior year. As shown in the bottom part of the figure, this decline is due to reduced state funding, as federal funding remains relatively flat. The drop in state funding consists of a $306 million reduction in non-Proposition 98 General Fund support, partially offset by a $113 million increase in Proposition 98 General Fund spending.

Aligns All Funding for State Preschool Program Within Proposition 98. The budget package includes a change in the way the state accounts for subsidized preschool services. In 2011-12, the state supported approximately 100,000 part-day/part-year preschool slots using Proposition 98 funds and an additional roughly 45,000 full-day/full-year preschool slots using non-Proposition 98 funds. The *2012-13 Budget Act* consolidates the state's subsidized preschool program by funding the preschool-associated portion of full-day/full-year slots within Proposition 98. From an accounting perspective, this increases Proposition 98 funding for the State Preschool Program by $164 million and decreases funding for the General Child Care program by a commensurate amount (resulting in state General Fund savings). The accounting change has no programmatic effect. Eligible working families whose preschoolers need full-day/full-year child care can continue to receive supplementary "wraparound" services funded through the General Child Care program.

Funds Fewer Subsidized Child Care and Preschool Slots. The budget package adopted by the Legislature reduced General Fund support for child care programs by $80 million, or 8.7 percent, eliminating funding for about

Figure 6

Child Care and Preschool Budget Summary

(Dollars in Millions)

				Change From 2011-12	
	2010-11	**2011-12[a]**	**2012-13**	**Amount**	**Percent**
Expenditures					
CalWORKs Child Care	$1,232	$1,023	$976	-$46	-5%
Non-CalWORKs Child Care	1,083	918	666	-252	-27
Preschool	397	368	481	113	31
Support programs	100	76	76	—	—
Totals	**$2,812**	**$2,385**	**$2,199**	**-$185**	**-8%**
Funding					
Proposition 98 General Fund	$1,597[b]	$368	$481	$113	31%
Non-Proposition 98 General Fund	35	1,077	771	-306	-28
Federal funds	1,179	939	947	8	1

[a] Includes midyear trigger reductions totaling $23 million across all programs. Also includes $8 million midyear augmentation to Stage 3 CalWORKs child care.

[b] Includes prior-year Proposition 98 carryover and funds from local reserves.

10,500 slots. Child care contractors would achieve these savings through attrition and, to the degree necessary, by disenrolling currently served children from higher-income families. The Legislature applied these across-the-board reductions to the California Work Opportunity and Responsibility to Kids (CalWORKs) Stage 3, Alternative Payment, General Child Care, and migrant child care programs (exempting the CalWORKs Stage 1 and Stage 2 programs and the State Preschool Program). The Governor vetoed $50 million of associated spending in the legislative budget package. Specifically, he vetoed: (1) $20 million in non-Proposition 98 General Fund spending by deepening the AP program cut to about 18 percent (eliminating an additional 3,400 slots) and (2) $30 million in Proposition 98 spending by also applying the 8.7 percent reduction to the State Preschool Program (eliminating 12,500 slots).

Extends Family Fees to Preschool Program. As their family earnings increase, the state requires parents to pay an increasing share of their subsidized child care costs. (The maximum family contribution is capped at 10 percent of the family's total income.) For example, based on 2012-13 rates, a family of three earning $2,500 per month pays about $45 per month towards the cost of part-day care. The budget package extends this fee policy to families participating in the part-day/part-year State Preschool Program, which previously had been available free of charge. Revenue from charging these fees—estimated at $3.4 million—will support approximately 900 additional preschool slots. (The legislative budget package had assumed $20 million in additional family fee revenue, but the Governor's veto reduces the number of preschool slots. Given enrollment priorities, the reduction in slots will affect the relatively higher-income families who pay fees, which in turn results in less fee revenue assumed in the final enacted budget.)

Higher Education

The enacted budget provides a total of $9.5 billion in General Fund support for higher education in 2012-13 (see Figure 7 on next page). The net General Fund reduction of $554 million from the prior year results largely from (1) using federal funds to replace about $800 million in General Fund support for Cal Grants, and (2) modest General Fund augmentations for the three public higher education segments. On a programmatic basis, support for public colleges and universities is relatively flat, while Cal Grant awards are reduced primarily at private institutions. Total General Fund support for higher education has declined since its peak in 2007-08, though much of that General Fund reduction has been backfilled with substantial tuition and fee increases at the public colleges and universities as well as with federal and other funds in the state Cal Grant programs. Below, we discuss the major components of the 2012-13 budget package for the University of California (UC), California State University (CSU), CCC, and California Student Aid Commission (CSAC). (In the nearby box, we discuss the Governor's proposed "long-term funding plan" for higher education which the Legislature ultimately rejected.)

UC and CSU

Overall UC Funding. The 2012-13 budget provides UC with $2.4 billion in General Fund support—an increase of $105 million (5 percent) from the prior year. Of this increase, $89 million is for UC's pension costs (as discussed below). The remainder is for increased lease-revenue bond payments for projects approved by the Legislature in prior budgets ($10 million) and increased health care costs for UC retirees ($5.2 million). In addition, the university currently expects to receive roughly $2.4 billion in 2012-13 from student tuition payments. Given that UC has not approved any tuition increase for 2012-13, this amount is roughly the same as the university collected in the prior year.

Overall CSU Funding. For CSU, the budget provides $2 billion in General Fund support—virtually the same as the prior year. (The CSU budget also includes $240 million for health care costs for retired annuitants. These costs previously were funded in a statewide item outside of CSU's budget.) In addition to its General Fund support, CSU currently expects to receive roughly $1.7 billion in 2012-13 from student tuition payments. This includes $132 million from a 9.1 percent tuition increase that the Trustees approved for 2012-13. As described below, the budget includes financial incentives for the university to rescind that tuition increase.

Figure 7

Higher Education Funding

General Fund (Dollars in Millions)

				Change From 2011-12	
	2010-11	**2011-12**	**2012-13**	**Amount**	**Percent**
University of California	$2,910.7	$2,273.6	$2,378.1	$104.5	5%
California State University	2,577.6	2,002.7	2,010.7[a]	8.0	0
California Community Colleges	4,060.8	3,366.9	3,531.6[b]	164.7	5
Hastings College of the Law	8.4	6.9	7.8	0.9	13
California Postsecondary Education Commission	1.9	0.9	—	-0.9	—
California Student Aid Commission	1,251.0	1,486.2	678.5	-807.6[c]	-54
General obligation bond debt service	809.9	724.3	700.5	-23.8	-3
Lease-revenue bond debt service[d]	(335.0)	(330.9)	(346.7)	(15.7)	(5)
Totals	**$11,620.3**	**$9,861.5**	**$9,307.3**	**-$554.2**	**-6%**

[a] In addition to this amount, the budget includes $240 million in General Fund support in a new item for CSU retired annuitant health care costs. These costs were previously funded through a statewide appropriation and not displayed separately for CSU.

[b] Includes revenues from Education Protection Account.

[c] Includes $804 million General Fund reduction that is backfilled with federal Temporary Assistance for Needy Families funding.

[d] Amounts in parentheses are shown for reference only, as they already are included in the segments' General Fund appropriations.

Provides Augmentation for UC Pension Costs. The $89 million augmentation for UC's pension costs represents the first time in more than two decades that the state has provided funding for this purpose. (For most of that time, neither UC nor its employees were contributing to UC's pension plan because investment returns more than covered those costs. The university and its employees resumed contributions in 2010, which was a few years after the plan ceased to be fully funded.) Provisional language in the budget restricts the funding to increased pension costs for university employees whose salaries are supported by General Fund or student tuition. In addition, this language states that the amount of future augmentations for this purpose, if any, shall be determined by the Legislature. (In addition, the budget provides about $1 million to Hastings College of the Law for retirement costs.)

Eliminates Most UC and CSU Earmarks. Typically, the annual budget act includes a number of restrictions on UC's and CSU's General Fund appropriations that reflect legislative priorities. For example, the 2011-12 budget earmarked $9.2 million for AIDS research at UC. The Legislature rejected the Governor's January proposal to eliminate these earmarks—restoring them in provisional language. The Governor, however, vetoed the earmarks, with three exceptions—the $89 million for UC's pension costs, $52 million for UC student financial aid, and $34 million for CSU financial aid. Because the earmarks were all in provisional language (rather than in itemized budget schedules), the Governor's vetoes did not reduce the total amount of funding available to the universities. Rather, his vetoes allow the universities to use this once restricted funding for any purpose that they wish.

Sets UC and CSU Enrollment Expectations. The budget act typically specifies the number of full-time equivalent (FTE) state-supported resident students that the state expects the universities to enroll. As passed by the Legislature, the 2012-13 budget specifies corresponding enrollment targets of 209,977 state-supported students at UC and 331,716 students at CSU.

No Higher Education "Compact"

The Governor's January budget proposed a new "long-term funding plan" for higher education. In general, the plan was similar to multiyear funding "compacts" developed under prior administrations. Those earlier compacts were uncodified agreements whereby the Governor promised to propose specified funding increases for the universities in exchange for the universities' commitments to specified enrollment and tuition levels, as well as other targets. Unlike the prior compacts, however, the Governor's plan would have (1) significantly reduced budgetary controls for all the segments and (2) eliminated the budgetary distinction between support and facility funding for the universities. The Legislature rejected the Governor's proposed plan.

Capital Outlay. The budget includes new appropriations from general bond funding for two UC projects—$7.7 million for the construction phase of an infrastructure improvement project at the Santa Cruz campus and $4.8 million for preliminary plans and working drawings for a new classroom and academic office building at the Merced campus. It also includes a total $16.5 million in general obligation bond funding for three renovation projects and five seismic upgrade projects at CSU.

Provides Fiscal Incentive to Freeze Tuition Levels. For UC and CSU, the budget package appropriates $125 million each in General Fund support *for the 2013-14 fiscal year* under specified conditions. Specifically, the universities would receive these augmentations only if (1) they maintain student tuition for the 2012-13 academic year at the same level as the 2011-12 academic year and (2) the Proposition 30 tax increases take effect. At the time this report was prepared, the UC Regents had not taken any action to increase student tuition for 2012-13. However, the CSU Trustees had already approved a 9.1 percent tuition increase for fall 2012. At the time this report was prepared, the Trustees had not made any change to that action.

Potential Trigger Reductions. As discussed elsewhere in this report, the enacted budget includes various midyear cuts that would be triggered in the event that the Proposition 30 tax increase measures do not take effect. Among those trigger cuts, UC and CSU each would receive an unallocated $250 million reduction.

CCC

Total Proposition 98 Funding. As with K-12 education, community colleges' local property tax revenue and most of their General Fund support counts toward the Proposition 98 minimum guarantee. Figure 2 (in the "Proposition 98" section of this chapter) shows that the 2012-13 budget provides CCC with $5.8 billion in Proposition 98 support. This reflects an increase of $568 million (11 percent) over the revised 2011-12 level. The 2012-13 budget assumes that CCC's Proposition 98 funding will include $451 million in revenues (local property taxes as well as cash assets) resulting from the dissolution of RDAs. The budget package includes language that provides a General Fund backfill for community colleges to the extent that these revenues do not materialize in 2012-13.

Slight Programmatic Increase. Much of CCC's increased funding pays for costs incurred in the prior year or reflects funding swaps and technical adjustments that do not have a programmatic effect on community colleges. Most notably, the 2012-13 budget package provides a $129 million increase to restore base funding following a prior-year deferral and $160 million to retire other existing CCC deferrals (reducing the state's late payments to community colleges to $801 million). From a programmatic perspective, CCC funding increases by $88 million. Of this amount, $50 million is for

0.9 percent enrollment growth, $24 million is an increase associated with creating a CCC mandate block grant (bringing total block grant funding to $33 million), and $14 million is a workload adjustment for CCC financial aid administration.

Mandate Block Grant Adopted. As discussed in the "Proposition 98" chapter of this report, the budget package includes a new mandate block grant for K-12 education and CCC. The 2012-13 budget provides community colleges with $33 million for the block grant. Community college districts that choose to participate in the block grant will receive $28 per FTE student in 2012-13. Alternatively, districts can seek reimbursement for mandated activities through the regular claiming process. (The enacted budget appropriates a total of $17,000 for community college districts that opt to submit claims for reimbursement.)

Community College Fees. Effective July 2012, enrollment fees for in-state residents increased to $46 per unit (from $36 per unit) as part of the 2011-12 budget package's trigger cuts. The 2012-13 budget package does not include any additional changes to this fee level for resident students. It does, however, increase fees for nonresident students from neighboring states that have a reciprocity agreement with California (currently, Arizona and Oregon). Specifically, in 2012-13, fees for these nonresident students will increase from $42 per unit to two times the amount of in-state enrollment fees (that is, $92 per unit). Beginning in 2013-14, these fees will be pegged to three times the prevailing in-state fee. (Nonresident students from other states will continue to pay higher fees that reflect the full cost of instruction.)

Potential Trigger Reductions. If Proposition 30's tax increases do not go into effect, two of CCC's budget act augmentations would be rescinded: (1) $160 million to buy down deferrals and (2) $50 million for enrollment growth. In addition, community colleges would experience a base programmatic cut of $339 million. Under such a scenario, the budget includes a provision that makes a proportionate reduction (about 6 percent) to the number of FTE students community colleges would be required to serve in 2012-13. Statutory language 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."

Cal Grants

The 2012-13 budget provides $1.5 billion for Cal Grants, including $645 million in General Fund support, $804 million in federal Temporary Assistance for Needy Families (TANF) funds, and $85 million from the Student Loan Operating Fund (SLOF). Spending is virtually flat from the prior year. Spending changes include a combination of cost increases offset by programmatic reductions. The *2012-13 Budget Act* and related legislation make several programmatic changes to Cal Grants. The budget package also relies heavily on fund swaps and phases out loan assumption programs. Each of these changes is discussed in more detail below.

Tightens Eligibility Requirements for Schools. The 2011-12 budget package established a new rule that affected which postsecondary institutions may participate in the Cal Grant program. The new rule specified that institutions with student default rates on federal loans of greater than 24.6 percent no longer would be able to participate. The 2012-13 budget package tightens this default rate limit and adds a graduation rate requirement. Specifically, a school must have a three-year cohort default rate below 15.5 percent and a graduation rate above 30 percent to remain eligible for Cal Grants. (The budget package also clarifies that an institution that becomes ineligible due to its default or graduation rates may regain eligibility for an academic year for which it satisfies the requirements.)

The package contains two exceptions to these requirements. First, the restrictions do not apply to institutions with fewer than 40 percent of undergraduates borrowing federal student loans. Second, institutions with a default rate below 10 percent and a graduation rate above 20 percent are exempt from the graduation requirement until 2016-17. Students already attending an institution that becomes ineligible as a result of the new rules would be allowed to receive renewal awards (in 2012-13 only), but the amount of those awards is reduced by 20 percent. The budget assumes these actions will result in $55 million in Cal Grant savings.

Veto Results in Reduced Award Amounts in 2012-13. Using his veto authority, the Governor reduced new and renewal Cal Grant awards by 5 percent from their 2011-12 levels—achieving $23 million in associated savings. The reduction applies to the maximum Cal Grant A and B tuition and fee award for students at nonpublic institutions, the Cal Grant B access award (a stipend for books and supplies), the Cal Grant C tuition and fee award, and the Cal Grant C book and supply award (see Figure 8).

Trailer Bill Reduces Some Award Amounts in 2013-14 and 2014-15. The education trailer bill reduces award amounts for some students in 2013-14 and 2014-15 (as shown in Figure 8). Specifically, in 2013-14, tuition and fee awards are reduced by an additional 2 percent for new recipients at nonprofit colleges and universities as well as for-profit institutions accredited by the Western Association of Schools and Colleges (WASC). Awards are reduced by an additional 57 percent for new recipients at all other for-profit colleges. In 2014-15, new awards at nonprofit and WASC-accredited for-profit institutions are reduced an additional 11 percent. Renewal awards in future years will be based on the award amount in place when the recipient first received a Cal Grant.

Corrects Unintended Consequence of Previous Legislation. Last year the Legislature adopted several changes to Cal Grant eligibility, including a requirement that students meet income, asset, and financial need thresholds to renew awards. Previously, students had to meet these financial criteria only for initial awards. Under the new policy, about 5,000 students who were initially eligible for both Cal Grant A and Cal Grant B awards received a Cal Grant B award and then became ineligible for renewal under Cal Grant B eligibility thresholds, which are tighter than those for Cal Grant A. These recipients were unable to renew their awards, even though they continued to meet the eligibility criteria for Cal Grant A. The budget clarifies that students in this situation may receive Cal Grant A renewal awards. This action increased Cal Grant expenditures by $28 million in 2011-12 and $27 million in 2012-13.

Codifies Transfer Entitlement Requirement. Under current practice, a student must attend a baccalaureate institution in the year immediately after attending a community college to qualify for a transfer entitlement award. A recent CSAC decision would have removed this restriction, potentially adding 9,000 students and $70 million in new Cal Grant awards. The budget package codifies the attendance requirement in legislation but provides an additional year of eligibility for students who attended community college in 2011-12.

New and Expanded Fund Shifts Offset General Fund Costs. The budget includes two fund shifts. The SLOF, which receives proceeds of the federal guaranteed student loan program, will provide $85 million toward Cal Grant costs, an increase of $22 million in SLOF support over 2011-12. The TANF funds redirected from the state's CalWORKs program will provide

Figure 8

Lower Maximum Amounts for Many New Cal Grant Awards[a]

	2011-12	2012-13	2013-14	2014-15
Maximum New Cal Grant A and B Tuition Awards[b]				
Nonprofit and WASC-accredited for-profit institutions	$9,708	$9,223	$9,084	$8,056
All other for-profit institutions	9,708	9,223	4,000	4,000
Other Maximum Awards				
Cal Grant B access awards	1,551	1,473	Amounts to be specified in annual budget act	
Cal Grant C tuition and fee awards	2,592	2,462		
Cal Grant C book and supply awards	576	547		

[a] Represents new award amounts. Current law allows renewal awards up to the maximum amount in effect when the student first receives a Cal Grant award.

[b] Maximum award amounts at public universities continue to cover full systemwide tuition and fees as established by the universities' respective governing boards. As of July 2012, these amounts are $5,970 for the California State University and $12,192 for the University of California.

WASC = Western Association of Schools and Colleges.

$804 million for Cal Grants. Although previous budgets have proposed similar actions, this is the first time the Legislature has adopted a redirection of TANF funds to Cal Grants. Each fund shift offsets an equal amount of General Fund support, with no programmatic impact on financial aid programs.

Hiatus in Loan Assumption Programs. The Governor's January budget proposed phasing out loan assumption programs. Under these programs, the state agrees to make loan payments on behalf of eligible students who borrow federal loans and work in specified occupations and settings—such as teachers in low-performing schools and nurses in state prisons—after graduation. The proposed phase-out involved issuing no new agreements and continuing payments for students who have already received at least one payment and who complete additional years of qualifying employment. (Students can receive payments for a total of three to four years as they complete years of qualifying employment.) Students with existing agreements who had not yet received initial payments would have received no benefits under the Governor's proposal, even if they had completed a portion of their qualifying employment. The Legislature rejected this proposal and restored budget language authorizing 7,500 new agreements in 2012-13. The Governor deleted authority for new warrants using his veto power. While this action has no 2012-13 impact, it will reduce expenditures in later years. Under the terms of the final budget, students with existing agreements who continue to meet their employment obligations will receive loan assumption payments in accordance with their agreements.

Realignment

In 2011, the Legislature made a number of changes to realign certain state program responsibilities and revenues to local governments (primarily counties). In total, the 2011 realignment shifted about $6 billion in state sales tax revenues, vehicle license fee revenues, and (on a one-time basis) Mental Health Services Fund revenues to local governments to fund various criminal justice, mental health, and social service programs. (For more detail on the 2011 realignment, see our August 2011 publication, *2011 Realignment: Addressing Issues to Promote Its Long-Term Success*.) As part of the 2012-13 budget package, the Legislature approved a number of changes to the funding structure and programs in the 2011 realignment. The most significant of these changes are described below.

Ongoing Funding Structure

As part of the 2012-13 budget process, the Legislature approved an ongoing funding structure for the programs realigned in 2011. The structure establishes several state accounts and subaccounts within the Local Revenue Fund 2011 into which the realignment funding is deposited for the various realigned programs. The realignment legislation provides formulas for how the funding is to be allocated among these accounts and subaccounts. The legislation specifies, for example, that the first allocation of sales tax revenue each month goes to fund 1991 mental health realignment responsibilities that were incorporated in the 2011 realignment. The legislation also specifies how much of any future increases in realignment revenues are distributed among growth accounts associated with each account and subaccount. The funding structure also provides some formulas and general direction for how the funding in each of the accounts and subaccounts is to be allocated among local governments.

The realignment structure also establishes some limits on how local governments can use their realignment funding. For example, the legislation creates a strict "firewall" between the criminal justice programs and the health and human services programs in realignment so that funding provided for criminal justice programs cannot be used for health and human services programs and vice versa. In addition, the structure provides counties with some flexibility to shift funding among the health and human services programs. It does so primarily in two ways. First, the new account structure groups all realigned health and human services programs into one account—the Support Services Account—which contains two subaccounts, the Protective Services Subaccount (includes funding for various child welfare and adult protective services programs) and the Behavioral Health Subaccount (includes funding for several mental health and substance abuse treatment programs). In so doing, the account structure allows counties flexibility to shift funding among different programs *within* the same subaccount to meet their local needs and priorities. Second, the new realignment legislation allows each county to transfer a limited amount of funding—up to 10 percent of the smaller subaccount—between these two subaccounts. The legislation does not provide any similar flexibility for the law enforcement services subaccounts (including community corrections, trial court security, and various grant programs). Figure 9 (see next page) shows the estimated realignment revenues in 2012-13 and how they would be allocated among the realigned programs.

Child Welfare and Adult Protective Services Programs

The 2012-13 budget continues implementation of the 2011 realignment for the Child Welfare Services, Foster Care, Adoptions, Adoption Assistance, Child Abuse Prevention, and Adult Protective Services programs (for additional detail on these programs, see our August 2011 publication on realignment). Legislation enacted as part of the 2012-13 budget package makes several policy and technical changes to the child welfare realignment programs, provides additional county flexibility, and establishes oversight and accountability provisions specific to realignment. Some of the major changes for child welfare realignment include:

- ***County Flexibility.*** The 2012-13 budget gives counties a single funding allocation for all child welfare and Adult Protective Services realignment programs, thus allowing counties to establish local funding priorities for these programs and providing counties greater funding flexibility to respond to caseload trends in these programs. As mentioned previously, budget legislation also allows counties to transfer funds between protective services and behavioral health programs, on a limited basis, to more flexibly respond to caseload growth and funding needs across health and human services realignment programs. Budget legislation also makes some child welfare program components optional to counties, subject to public notice requirements.

Figure 9

Local Revenue Fund 2011: Realignment Revenues and Allocations

2012-13 (In Millions)

Revenues	
Sales Tax	$5,435
Vehicle License Fee	455
Total Revenues	**$5,890**
Allocations	
Law Enforcement Services	
Community corrections	$901
Trial court security	504
Various law enforcement grants	490
Juvenile justice	107
District attorneys and public defenders	19
Law Enforcement Total	($2,020)
Support Services	
Protective services[a]	$1,759
Behavioral health[b]	983
Support Services Total	($2,742)
1991 Mental Health and CalWORKs	$1,128
Total Allocations	**$5,890**

[a] Includes child welfare and adult protective services programs.
[b] Includes mental health and alcohol and drug programs.
CalWORKs = California Work Opportunity and Responsibility to Kids.

- ***Outcomes and Accountability.*** Budget legislation clarifies the Department of Social Services' (DSS) oversight role in the state's child welfare programs and clarifies continued county accountability to state and federal outcome measures under realignment. Budget legislation also clarifies the state's authority to conduct audits of county child welfare programs, and requires DSS and the counties to develop mutually agreed-upon program performance goals when counties do not meet child welfare outcome measures. Budget legislation also requires DSS to prepare an annual report on county expenditures of child welfare realignment funds.

- ***Extended Foster Care.*** Chapter 559, Statutes of 2010 (AB 12, Bass and Beall), commonly referred to as "AB 12," authorized extended foster care for foster youth up to age 21 on a phased-in basis. Assembly Bill 12 required a legislative appropriation to fully implement extended foster care from age 20 to 21. The 2012-13 budget continues AB 12 implementation and provides realignment funding for extended foster care. Beginning in January 2014, extended foster care will be available for foster youth up to age 21.

Mental Health Programs

Two major mental health programs previously funded, in part, through the Department of Mental Health (DMH) were realigned as part of the 2011-12 budget package. The major realigned mental health programs are Mental Health Managed Care (MHMC) and Early and Periodic Screening, Diagnosis, and Treatment (EPSDT).

Under realignment, in 2011-12 $763 million of Proposition 63 funds was redirected in lieu of General Fund on a one-time basis to support MHMC ($184 million) and EPSDT ($579 million). (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.) Beginning in 2012-13, MHMC and EPSDT will mainly be funded with a combination of funds from the 2011 realignment revenues and federal matching funds.

Alcohol and Drug Programs

Several programs previously funded through the Department of Alcohol and Drug Programs (DADP) were realigned as part of the 2011-12 budget package. The major realigned programs are Regular and Perinatal Drug Medi-Cal, Regular and Perinatal Non-Drug Medi-Cal, and drug courts.

In 2011-12, about $184 million in funding for these programs was deposited into three separate subaccounts within the newly created Health and Human Services Account of the Local Revenue Fund 2011. In 2012-13, some of these programs will be funded mainly with a combination of realignment funds and federal matching funds, while other programs will be funded mainly by realignment funds. Under realignment, counties have some discretion to significantly increase or decrease their spending levels for some drug and alcohol programs to reflect local priorities.

Community Corrections Programs

The 2011 realignment included several changes to the state's correctional system, most notably requiring counties to house and supervise all newly convicted felons with no current or prior convictions for serious, violent, or sex offenses. As part of the 2012-13 budget package, the Legislature approved trailer legislation related to the ongoing implementation of the realignment of adult offenders. For example, trailer legislation was enacted to make technical corrections to previously enacted realignment-related statutes. The Legislature realigned to local responsibility certain crimes—such as various weapon possession offenses—that were inadvertently *excluded* from realignment under prior legislation. This legislation also undid the realignment of other crimes—such as certain sex offenses—that were inadvertently *included* in the set of realigned crimes. In addition, previously enacted realignment legislation shifted responsibility for parole revocation hearings from the state Board of Parole Hearings to local trial courts effective July 1, 2013. To facilitate this transition, the budget package included trailer legislation intended to make future parole revocation hearing procedures in trial courts similar to the procedures already used by these courts for county probation revocation hearings. The trailer legislation also attempts to address local concerns about potential jail overcrowding that could occur under realignment by (1) expanding the ability of counties to transfer—on a contract basis—more inmates to other county jails regardless of how close the counties are to each other and (2) allowing sheriffs operating overcrowded jails to release sentenced inmates up to 30 days before the end of their jail sentence—up from five days under prior law—as long as each affected inmate already had served at least 90 percent of their sentence.

Health

The 2012-13 spending plan provides $19.3 billion from the General Fund for health programs. This is a decrease of $767 million, or almost 4 percent, compared to the revised 2011-12 spending level, as shown in Figure 10. The net decrease reflects both increases in caseload and utilization of services and the adoption of significant health program reductions and cost-containment measures. The major program-specific changes and cost-containment measures are summarized in Figure 11 (see page 30) and discussed in more detail below. Absent the changes shown in the figure, total General Fund spending for health programs in 2012-13 would have been $1.6 billion higher.

Realignment of Mental Health Programs. 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). The 2012-13 budget package continues the process of realigning mental health programs and alcohol and drug programs to local governments and dedicating revenue streams to support them. For more information, see the "Realignment" section earlier in this report.

Department Eliminations, Program Shifts, and Other Transfers

As part of its 2011-12 budget proposal, the administration stated its intent to eventually eliminate DMH and DADP. Pursuant to the adopted budget plan, DMH was eliminated effective July 1, 2012, and DADP is slated for elimination at the end of the 2012-13 fiscal year. The budget plan also shifts several programs, offices, and task forces from one department to another and transfers state-level administration of some functions between departments. We discuss these major organizational changes below.

DMH Eliminated: New Department of State Hospitals (DSH) Will Administer State Hospitals. The budget plan approves the administration's proposal to eliminate DMH and shift state-level administration of community mental health programs and other DMH functions to other departments. It also creates the DSH to administer the state hospitals, in-prison programs, and the Conditional Release Program (CONREP). The administration states that its goals for the creation of DSH are to (1) allow DSH to focus on effective patient treatment and increased worker and patient safety; (2) integrate services to provide an effective continuum of care, consistent with federal health care reform; and (3) better align program missions and functions to improve efficiency and program delivery.

Shifts State-Level Oversight for Bulk of Mental Health Programs to Department of Health Care Services (DHCS). State level oversight for the EPSDT program, MHMC, and Proposition 63 activities was largely shifted from DMH to DHCS during 2011-12. The Mental Health Oversight and

Figure 10

Major Health Programs and Departments—Spending Trends

General Fund (Dollars in Millions)

				Change From 2011-12 to 2012-13	
	2010-11	2011-12	2012-13	Amount	Percent
Medi-Cal—Local Assistance	$12,366	$15,461	$14,442	-$1,019	-6.6%
Department of Developmental Services	2,451	2,551	2,647	96	3.8
Department of State Hospitals	—	—	1,368	—	—
Department of Mental Health	1,852	1,351[a]	—	—	—
Healthy Families Program—Local Assistance	119	286	163	-123	-42.9
Department of Public Health	186	133	132	-1	-0.8
Department of Alcohol and Drug Programs	189	38	34	-4	-10.5
Other Department of Health Care Services programs	32	76	176	100	131.6
Emergency Medical Services Authority	8	7	7	—	—
All other health programs (including state support)	222	121	288	167	137.5
Totals	**$17,425**	**$20,024**	**$19,257**	**-$767[b]**	**-3.8%**

[a] The 2011-12 budget used $862 million in Proposition 63 funds in lieu of General Fund to support three mental health services programs.
[b] Includes $17 million difference between 2011-12 spending for Department of Mental Health and 2012-13 spending for Department of State Hospitals.

Accountability Commission will also provide oversight for Proposition 63. As shown in Figure 12, the remaining DMH programs and functions were shifted to various departments including DSS, the Department of Public Health (DPH), and the Office of Statewide Health Planning and Development.

DADP Slated for Elimination July 1, 2013. State-level oversight of the Drug Medi-Cal program was shifted from DADP to DHCS effective July 1, 2012. Budget legislation transfers other administrative and programmatic functions of DADP to unspecified departments within the California Health and Human Services Agency (HHSA), effective July 1, 2013. The legislation

Figure 11

Major Changes—State Health Programs
2012-13 General Fund Effect

(In Millions)

Program	Amount
Medi-Cal—Department of Health Care Services	
Expand demonstration project to coordinate care for seniors and persons with disabilities	
Transition long-term supports and services from fee-for-service to managed care	$115
Defer payments to providers and managed care plans	-711
Shared savings from Medicare	-12
Hospital payment changes	-387
Nursing home payment changes	-88
Change payment structure for retroactive services in certain counties	-48
Use First 5 (Proposition 10) monies to fund Medi-Cal	-40
Temporarily increase rates for primary care services	39
Eliminate payments for certain potentially preventable hospital admissions	-30
Implement copays for certain prescription drugs and emergency room services	-20
Identify and achieve operational efficiencies	-10
Reduce rates for laboratory services	-8
Expand managed care to rural counties	-3
Department of Developmental Services (DDS)	
Implement various cost-containment measures for DDS programs	-200
Use First 5 (Proposition 10) monies to fund services for developmentally disabled children	-40
Healthy Families Program (HFP)	
Implement unallocated reduction	-183
Transition of HFP children to Medi-Cal (only part of the transition occurs in 2012-13)	-13
Department of State Hospitals	
Governor's veto of funding for the Adult Education program	-4
Department of Public Health	
Eliminate the Public Health Laboratory Training Program	-2
Total	**-$1,645**

requires that HHSA, in consultation with stakeholders and affected departments, submit a detailed plan for the reorganization of DADP's functions to the Legislature as part of the 2013-14 Governor's Budget. The ultimate placement of these functions will have to be determined in the 2013-14 budget package.

Children Enrolled in the Healthy Families Program (HFP) Shift to Medi-Cal. The budget plan transfers all children enrolled in HFP to Medi-Cal on a phased-in basis, beginning in January 2013. This transition is projected to occur over a 12-month period and create General Fund savings of $13.1 million in 2012-13, $58.4 million in 2013-14, and $72.9 million in 2014-15 (when the transfer of all HFP children to Medi-Cal is expected to be complete). The children enrolled in HFP will be transitioned to Medi-Cal in four phases:

- The first phase will begin January 1, 2013 and include approximately 415,000 children enrolled in HFP managed care plans that also contract with Medi-Cal.
- The second phase will begin April 1, 2013 and include approximately 249,000 children enrolled in HFP managed care plans that subcontract with a Medi-Cal managed care plan.
- The third phase will begin August 1, 2013 and include approximately 173,000 children enrolled in HFP healthcare plans that do not contract

Figure 12

Elimination of Department of Mental Health: Shift of Programs to Other Entities

(Dollars in Millions)

From Department of Mental Health (DMH)	2011-12 Personnel Years	2011-12 Total Funds[a]	2012-13 Personnel Years	2012-13 Total Funds[a]	To
Mental health, Medi-Cal, and Propositon 63 oversight	74.7	$4.2	146.6	$82.5	Department of Health Care Services
Licensing functions	—	—	10.8	1.1	Department of Social Services
Proposition 63—mental health workforce development programs	—	—	0.9	12.3	Office of Statewide Health Planning and Development
Early Mental Health Initiative	—	—	—	—	California Department of Education
Proposition 63—Mental Health Services Act technical assistance and training	—	—	—	1.7	Mental Health Oversight Accountability Committee
Office of multicultural services	—	—	2.8	2.2	Department of Public Health

[a] Includes state operations and local assistance.

Note: Personnel years and total funds are displayed as shown in the budget for the department receiving the program or function from DMH.

with Medi-Cal or subcontract with a Medi-Cal plan. These children will be transitioned into a Medi-Cal managed care plan.

- The fourth phase will begin no earlier than September 1, 2013 and affect approximately 43,000 children enrolled in HFP healthcare plans who live in a county where Medi-Cal managed care is not available. They will be transitioned into Medi-Cal fee-for-service, unless a Medi-Cal managed care plan becomes available.

The budget plan requires HHSA to work with the Managed Risk Medical Insurance Board (MRMIB), the Department of Managed Health Care, DHCS, and stakeholders to develop a strategic plan for the transition of HFP. This plan will address several components of the transition, including ensuring stakeholder engagement in the transition, state monitoring of managed care health plans' performance, and network adequacy standards.

Office of Health Equity (OHE) Created Within DPH. The budget plan creates OHE within DPH to consolidate several offices and other entities that focus on health disparities. The OHE will consolidate the functions and responsibilities of: (1) the Office of Women's Health—formerly within DHCS, (2) the Office of Multicultural Services—formerly within DMH, (3) the Office of Multicultural Health—formerly within both DPH and DHCS, (4) the Health in All Policies Task Force—within DPH, and (5) the Healthy Places Team—within DPH.

Several Direct Healthcare Service Programs Will Be Transferred From DPH to DHCS. The budget plan transfers the following programs from DPH to DHCS: (1) Every Woman Counts, (2) Family Planning Access Care and Treatment, and (3) the Prostate Cancer Treatment Program. All of these programs deliver individual health care services. In part, the administration's rationale for transferring these programs from DPH to DHCS is that they align well with DHCS' mission to preserve and improve the health status of all Californians.

DHCS—Medi-Cal

The spending plan provides $14.4 billion from the General Fund for Medi-Cal local assistance expenditures administered by DHCS. This is a decrease of $1 billion, or 6.6 percent, in General Fund support for Medi-Cal local assistance compared to the revised prior-year spending level. Spending in 2011-12 was about $760 million greater than the amount appropriated in the 2011-12 budget. Some of the major factors that contributed to the higher-than-expected 2011-12 spending levels in the Medi-Cal Program were:

- ***Federal Government Denies Mandatory Copayment Proposal.*** The 2011-12 spending plan assumed over $500 million in savings by imposing mandatory copayments for Medi-Cal beneficiaries on physician visits ($5), dental visits ($5), prescription drugs ($3 or

$5), emergency room visits ($50), and hospital inpatient visits ($100 per day). The state was unable to obtain approval from the federal Centers for Medicare and Medicaid Services (CMS) to implement the mandatory copayments at the levels authorized in the 2011-12 budget. As discussed below, the 2012-13 spending plan assumes a lower level of savings from a revised copayment proposal pending CMS approval.

- ***Legal Challenges Prevent Provider Payment Reductions.*** The 2011-12 spending plan assumed over $600 million in savings by reducing certain Medi-Cal provider payments by up to 10 percent. Preliminary federal court injunctions prevented the state from implementing many of these reductions. The 2012-13 Medi-Cal budget assumes the state will prevail in its appeal of the court ruling and the payment reductions will be implemented beginning in October 2012.
- ***Adult Day Health Care (ADHC) Transition.*** The 2011-12 spending plan assumed General Fund savings of $170 million from eliminating ADHC as a Medi-Cal benefit. The 2011-12 spending plan also provided $85 million from the General Fund to help transition existing ADHC enrollees to other services. A lawsuit resulted in a nine-month delay in the elimination of ADHC and the creation of a new program called Community-Based Adult Services. These developments have caused the administration to revise the General Fund impact in 2011-12 from eliminating ADHC to a net cost of $2.4 million.

Differences in Medi-Cal spending between 2011-12 and 2012-13 are, in part, the result of underlying cost drivers in the program, such as changes to caseload and utilization of services. We discuss the major policy-driven spending changes that were adopted as part of the 2012-13 Medi-Cal Program budget below.

Expand Demonstration Project to Coordinate Care for Seniors and Persons With Disabilities. The budget assumes net savings of $608 million from a payment deferral to Medi-Cal providers combined with expanding from four to eight counties a previously authorized—but not yet implemented—demonstration project aimed at coordinating care for individuals who are eligible for both Medi-Cal and Medicare ("dual eligibles"). (As discussed below, it is the payment deferral that generates most of the savings in 2012-13. The demonstration project will actually result in a *cost* in 2012-13, although the savings in future years are expected to be significant.) Generally, the demonstration project will test the use of managed care to integrate the provision and financing of Medi-Cal and Medicare services. The eight counties selected by DHCS to participate in the demonstration project are: Los Angeles, Orange, San Mateo, San Diego, Riverside, San Bernardino, Alameda, and Santa Clara. The major components of the expanded demonstration project, also known as the "Coordinated Care Initiative," include:

- ***Medi-Cal Long-Term Supports and Services (LTSS) Become Managed Care Benefits.*** In the demonstration counties, LTSS—including nursing home care, In-Home Supportive Services (IHSS), and the Multipurpose Senior Services Program (MSSP)—will be managed care benefits for nearly all Medi-Cal beneficiaries. Prior to this change, LTSS were provided mainly by Medi-Cal on a fee-for-service basis.
- ***Dual Eligibles Are Enrolled in Managed Care for Medi-Cal and Medicare Benefits.*** Most dual eligibles will be enrolled in managed care plans that are responsible for providing both Medi-Cal and Medicare benefits beginning no earlier than March 2013. Dual eligibles will be mandatorily enrolled into managed care for their Medi-Cal benefits, but will have the option to opt out of the managed care plan for their Medicare benefits before the demonstration project begins. In addition, the budget assumes that dual eligibles who do not initially opt out of the managed care plan must remain in the plan for six months before having the option to disenroll.
- ***Budget Legislation Provides Implementation Detail.*** Budget-related legislation imposes a variety of requirements related to the implementation of the demonstration project, such as: (1) the details of how LTSS will operate as managed care benefits, (2) beneficiary notifications and protections, (3) the process used to determine managed care plan readiness, and (4) additional monitoring and oversight of managed care plans.
- ***Major Changes to IHSS Collective Bargaining.*** The budget package includes legislation to transition collective bargaining for IHSS provider wages and benefits from the local level to the state in the eight demonstration counties. Prior law required counties to pay about 17.5 percent of IHSS program costs. Budget-related legislation eliminates the county share of cost and creates a county maintenance of effort (MOE). This MOE is based upon county expenditures in IHSS in 2011-12 and will be adjusted annually for inflation.

Once fully implemented in 2014-15, the demonstration project is estimated to save hundreds of millions of General Fund dollars annually. Generally, the estimated ongoing savings assumes that managed care plans will coordinate the delivery of services in a way that helps beneficiaries avoid costly hospital and nursing home admissions. These savings are expected to accrue to both Medi-Cal and Medicare.

For 2012-13, the budget assumes General Fund savings of $12 million from a partial-year of shared savings from the Medicare Program—mainly by reducing hospital utilization. Estimates of shared savings from the Medicare Program are based on an assumption that the federal government will share 50 percent of any savings from implementing the proposal that would otherwise accrue to Medicare. The transition of services and beneficiaries from Medi-Cal fee-for-service to Medi-Cal managed care will require the state to initially incur an estimated $115 million in General Fund costs in 2012-13. To offset these up-front costs—and generate savings in 2012-13—the state will defer payments to providers and managed care plans. The budget assumes the payment deferral will generate $711 million in General Fund savings.

The demonstration is a joint project with the federal government and is subject to federal approval. In addition, continued state authorization for the demonstration project depends on federal approval of certain aspects of the demonstration, including the six-month stable enrollment period for Medicare benefits.

Hospital Payment Changes. The spending plan assumes combined General Fund savings of $387 million from implementing changes to Medi-Cal payments for three categories of hospitals: private hospitals, designated public hospitals, and non-designated public hospitals (NDPHs).

- ***Change Payment Methodology for NDPHs.*** The spending plan assumes $94 million in General Fund savings by requiring NDPHs to use "certified public expenditures" to draw down federal matching payments. The NDPHs will no longer receive reimbursement from the General Fund.
- ***Reduce Private Hospital Payments.*** Under the spending plan, $150 million in hospital fee revenues that currently fund managed care payments to private hospitals will be redirected for General Fund savings.
- ***Split Unspent Federal Funding With Designated Public Hospitals.*** The spending plan assumes $100 million, or 50 percent, of funds reallocated to an uncompensated care pool for designated public hospitals will be retained for one-time General Fund savings.
- ***Redirect Unpaid Hospital Stabilization Funding.*** Under the spending plan, $43 million previously set aside as stabilization funding for NDPHs and certain private hospitals will be redirected to the General Fund for one-time savings.

Nursing Home Payment Changes. The spending plan assumes $88 million in General Fund savings from making adjustments to Medi-Cal nursing home payments, including: (1) rescinding an increase in rates to nursing homes, (2) redirecting funds associated with limiting nursing homes' costs for professional liability insurance, and (3) deferring one payment to nursing homes until 2013-14.

Change Payment Structure for Retroactive Services in County Organized Health Systems (COHS). The budget assumes $48 million in one-time General Fund savings by changing the payment structure for retroactive services provided to beneficiaries in COHS managed care plans. Previously, COHS were required to pay for the medical services provided to beneficiaries up to 90 days prior to enrollment, also known as a retroactive coverage period. The costs for these services were included in COHS capitation payments. The new payment structure requires COHS to pay for services that a beneficiary receives only while enrolled in the plan; the services received during the retroactive coverage period will be paid by Medi-Cal fee-for-service. This makes the treatment of retroactive coverage in COHS consistent with the payment structure used in other managed care models. The change will lower costs in the budget year by shifting payments for retroactive services received in 2012-13 from an up-front capitation payment to a series of fee-for-service payments—some of which will not be made until 2013-14.

Use First 5 Monies to Fund Medi-Cal. The budget assumes $40 million in Proposition 10 funds from the California First 5 Commission will be used in lieu of General Fund to fund Medi-Cal services for children.

Temporarily Increase Payments for Primary Care Services. The budget assumes $39 million in General Fund costs from increasing payments for primary care services as required by the federal Affordable Care Act (ACA). Under the ACA, Medicaid is required to increase rates for primary care services to an amount equivalent to Medicare for calendar years 2013 and 2014. During this period, the federal government will pay 100 percent of the cost of the rate increase above the rates in effect on July 1, 2009. Since the state enacted a 9 percent payment reduction for primary care services in 2011, it must pay for the state share of the incremental difference between existing Medi-Cal rates and the rates that were in effect on July 1, 2009. The increased rates for primary care services are scheduled to sunset at the end of 2014.

Eliminate Payments for Certain Potentially Preventable Hospital Admissions. The budget assumes $30 million in General Fund savings from eliminating payments to managed care plans for certain potentially preventable hospital admissions. Capitation rates paid to managed care plans will be adjusted downward based on the number of potentially preventable admissions.

Implement Copays for Certain Prescription Drugs and Emergency Room Services. The budget assumes $20 million in General Fund savings from imposing mandatory copayments for certain prescription drugs and nonemergency use of emergency rooms. Only beneficiaries in managed care would be subject to the copayments. Additional details about how the copayments will be implemented are still being developed, but generally enrollees would be required to pay $15 if they receive nonemergency services from an emergency room and $3.10 for non-preferred drugs. As mentioned above, implementation of these copayments requires federal approval.

Identify and Achieve Operational Efficiencies. The budget assumes $10 million in General Fund savings from DHCS achieving "operational efficiencies." At the time of this report, the source of these operational efficiencies has not been determined.

Reduce Rates for Laboratory Services. The budget assumes $8 million in General Fund savings from reducing rates for laboratory services. Upon federal approval, the department will implement a new payment methodology that is expected to reduce payments for laboratory services. The state will reduce laboratory payments by 10 percent until federal approval for the new rate methodology is obtained.

Expand Managed Care to Rural Counties. The budget assumes $3 million in net General Fund savings associated with authorizing the expansion of Medi-Cal managed care into the 28 counties where managed care does not currently exist—generally rural counties. Mandatory enrollment into managed care plans is expected to begin in June 2013. Certain beneficiaries, such as dual eligibles, will be exempt from the mandatory enrollment. This proposal is estimated to generate savings in future years, but the transition from fee-for-service to managed care will require the state to initially incur some costs. The budget plan offsets these initial costs and generates General Fund savings by deferring payments to managed care plans.

Department of Developmental Services (DDS)

Under the budget plan, General Fund spending for DDS will increase from about $2.5 billion in 2011-12 to $2.6 billion in 2012-13, or about 4 percent. The net year-over-year increase in General Fund support is partly due to increases in caseload and utilization of services and a $29 million increase in capital outlay expenditures for the developmental centers (DCs). Below, we discuss the most significant policy-driven spending changes that were adopted in the DDS budget.

Use First 5 Monies to Fund Services for Developmentally Disabled Children. The budget assumes $40 million in Proposition 10 funds from the California First 5 Commission will be used to fund services for children with developmental disabilities.

Legislature Adopts $200 Million in Savings. Under the 2011-12 budget, DDS budget reductions totaling $100 million from the General Fund for 2011-12 were triggered when state General Fund revenue came in below projected levels. For 2012-13, the budget reflects measures to achieve a total of $200 million in General Fund savings. The major savings proposals are as follows:

- ***Use of Federal Funds.*** The budget plan maximizes the use of federal funding under the Home and Community Based Waiver and the Community First Choice Option for estimated General Fund savings of $61 million.

- ***Implementation of SB 946.*** The budget plan recognizes savings from the implementation of Chapter 650, Statutes of 2011 (SB 946, Steinberg), which requires private insurance companies to provide autism treatment services. The shift from regional centers to private insurance companies paying for these services results in approximately $70 million in estimated General Fund savings.

- ***Policy Changes With DCs.*** The DDS plans to limit admissions to DCs to those who are either committed by the criminal or juvenile justice system or in acute crisis needing short-term stabilization. By restricting admissions, the administration hopes to simultaneously expand community services able to serve those who would not be eligible for DC admission. The estimated General Fund savings are $20 million.

- ***Regional Center and Provider Payment Reduction.*** The budget plan implements a 1.25 percent reduction in provider payments to achieve $31 million of General Fund savings in 2012-13. (A 4.25 percent provider payment reduction expired at the end of 2011-12.)

- ***Additional Cost Savings and Efficiencies.*** The budget plan assumes the implementation of efficiencies to reduce administrative and operational costs for the department for General Fund savings of $4 million, as well as other cost savings measures.

Budget Subject to Trigger Reduction. The budget plan includes several reductions that would be triggered if the voters do not approve Proposition 30. These trigger reductions include $50 million in unspecified reductions in services for persons with developmental disabilities.

Healthy Families Program

The budget plan provides $163 million from the General Fund for HFP, which is administered by MRMIB. This is a net decrease of $123 million, or 43 percent, compared to the revised prior-year spending level. The spending plan reflects (1) General Fund savings resulting from the transition of HFP children to Medi-Cal (discussed above), (2) increased General Fund costs resulting from erosions to previously projected savings, and (3) an unallocated General Fund reduction discussed below.

Implement Unallocated Reduction. The spending plan includes a $183 million unallocated General Fund reduction to HFP. A proposed extension of a tax imposed on managed care organizations used to offset General Fund costs would have provided an equivalent amount of money for the support of HFP in 2012-13, but it was not enacted into law.

Department of Public Health

The 2012-13 budget provides $132 million in General Fund support for DPH programs, a decrease of $1.1 million, or 1 percent, from 2011-12 spending levels. The budget plan implements the creation of OHE and the transfer of several DPH programs to DHCS, as discussed in more detail earlier in this report.

Eliminate the Public Health Laboratory Training Program. The budget includes $2.2 million in General Fund savings resulting from the elimination of the Public Health Laboratory Training Program. The program addressed a shortage of public health laboratory directors through contracts with academic centers and postdoctoral training. (The Governor's veto accounts for $500,000 of the total of $2.2 million in savings from this proposal.)

Department of Alcohol and Drug Programs

The budget provides $34 million from the General Fund for DADP, a decrease of $4 million, or 11 percent, from 2011-12 spending levels. In part, this year-over-year decrease is due to the transition of administration of the Drug Medi-Cal program from DADP to DHCS, effective July 1, 2012. The General Fund spending level for DADP identified above for 2012-13 takes into account the realignment of most state-supported programs for substance use treatment to the counties in 2011-12. (Without realignment, General Fund spending would likely be around $184 million higher in 2012-13.) Under realignment, counties have some discretion to adjust their spending levels for drug and alcohol programs to reflect local priorities.

Effective July 1, 2013, the budget transfers administrative and programmatic functions of DADP to other departments within HHSA, based on a detailed reorganization plan to be submitted to the Legislature, as discussed above.

Department of State Hospitals

The budget provides $1.4 billion from the General Fund for DSH in 2012-13. As noted earlier in this report, the new DSH is comprised of the state hospitals, in-prison mental health programs, and CONREP. Between 2011-12 and 2012-13, General Fund spending for these programs will remain relatively flat. General Fund support for capital outlay projects at state hospitals increases from about $4 million in 2011-12 to almost $30 million in 2012-13.

In 2011-12, an internal audit of DMH (the predecessor to DSH) recommended the department improve fiscal transparency and accountability, increase worker and patient safety, and improve its budgeting process. In response to the audit, the administration implemented a number of measures that not only respond to the auditors' concerns but also are intended to control costs. For example, to reduce costs, the administration proposes to eliminate over 600 positions (most of which are vacant), revise a number of external contracts, negotiate a higher payment from counties for hospital beds, and use county jails in order to treat certain populations.

Governor's Veto of Funding for the Adult Education Program. As part of his January budget plan, the Governor proposed to eliminate the positions and funding for the Adult Education Program in state hospitals. The Legislature restored the positions and funding during its budget deliberations. The Governor vetoed $3.6 million of General Fund support and 37.6 positions for the program.

Social Services

Overview of Total Spending. The 2012-13 spending plan provides $7.4 billion from the General Fund for social services programs. This is an increase of $688 million, or about 10 percent, compared to the revised prior-year spending level, as shown in Figure 13. This net increase largely reflects an $804 million funding swap between CalWORKs and CSAC that serves to increase General Fund expenditures in CalWORKs by $804 million without increasing total expenditures in CalWORKs or overall General Fund spending across the budget. If not for the funding swap, there would be a net decrease in General Fund expenditures for social services programs in 2012-13, reflecting a number of policy changes creating General Fund savings, mainly in the CalWORKs program.

Summary of Major Changes. Figure 14 shows the major General Fund changes adopted by the Legislature for social services programs. Most of the

Figure 13

Major Social Services Programs and Departments—Spending Trends

General Fund (Dollars in Millions)

				Change From 2011-12 to 2012-13	
	2010-11	2011-12	2012-13	Amount	Percent
SSI/SSP	$2,852.3	$2,719.7	$2,770.1	$50.4	1.9%
CalWORKs[a]	2,079.2	992.0	1,564.6[b]	572.6	57.7
In-Home Supportive Services	1,541.0	1,711.3	1,668.4	-42.9	-2.5
County Administration/Automation	610.6	634.5	717.3	82.8	13.0
Department of Child Support Services	308.3	314.9	307.6	-7.3	-2.3
Department of Rehabilitation	54.2	54.6	55.8	1.3	2.3
Department of Aging	32.2	32.4	32.1	-0.3	-0.9
All other social services (including state support)[c]	1,838.4	224.1	255.1	31.0	13.8
Totals	**$9,316.2**	**$6,683.5**	**$7,371.0**	**$687.6**	**10.3%**

[a] Spending amounts for 2011-12 and 2012-13 reflect the impact of 2011 realignment legislation, which shifted about $1.1 billion in CalWORKs General Fund costs to counties.

[b] Reflects the impact of a funding swap between CalWORKs and the California Student Aid Commission, which increased General Fund expenditures in CalWORKs by $804 million.

[c] Spending amounts for 2011-12 and 2012-13 reflect the impact of 2011 realignment legislation, which shifted about $1.6 billion in child welfare and adult protective services General Fund costs to counties.

budget reductions were in CalWORKs, IHSS program, and the Department of Child Support Services. Absent the changes shown in the figure, total General Fund spending for social services programs in 2012-13 would have been almost $550 million higher. Below, we discuss the major changes in each program area.

Realignment of Child Welfare Programs. 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). The 2012-13 budget package continues the process of realigning child welfare programs to local governments and dedicates revenue streams to support them. For more information, see the "Realignment" section earlier in this report.

CalWORKs

The budget provides $1.6 billion from the General Fund ($5.2 billion total funds) in support of the CalWORKs program in 2012-13. This is about $470 million less than would have otherwise been spent absent the policy changes discussed below. The General Fund spending amount for CalWORKs reflects a funding swap between CalWORKs and CSAC which decreased federal funding for CalWORKs by $804 million and increased the amount of General Fund provided to CalWORKs by a like amount, with no net effect overall on total CalWORKs expenditures or General Fund spending.

Figure 14

Major Changes—Social Services Programs 2012-13 General Fund Effect

(In Millions)

Program	Amount
CalWORKs	
Continuation of work exemptions and associated reductions in funding for counties	-$443.8
Reduced reporting requirements for child-only cases	-26.5
Phase-in of Cal-Learn	-9.8
Automation costs associated with policy changes	11.0
In-Home Supportive Services	
3.6 percent across-the-board reduction in service hours	-52.2
County Administration and Automation	
Begin development of Los Angeles County welfare eligibility replacement system	10.0
Department of Child Support Services	
Suspension of county share of child support collections (revenue)	-32.0
Unallocated reduction to local child support agencies	-5.0
Total	**-$548.3**

This funding swap increases the amount of state expenditures which count toward the state's MOE requirement under federal welfare-to-work laws, which may serve to increase state flexibility to pursue additional CalWORKs policy changes in future years.

Changes to Work Exemption Policies. In each of the last three years, as a means of achieving budgetary savings, the Legislature broadened the circumstances under which counties may exempt CalWORKs recipients from participating in welfare-to-work activities. Budgetary savings were achieved by not providing employment services and child care to the exempted cases. Budget legislation extends these temporary work exemptions for six months (until January 1, 2013), after which counties are required to reengage all previously exempted cases in welfare-to-work activities over a period of two years. In addition, budget legislation creates a new, one-time work exemption for recipients who are primary caregivers for a child 24 months of age or younger. Altogether, these policy changes result in General Fund savings of $444 million in 2012-13 and significantly less ongoing savings in future years.

Tighter Work Requirements for Adult Eligibility. Beginning January 1, 2013, budget legislation shortens (from 48 months to 24 months) the duration an adult may remain eligible for assistance (cash aid and employment services) by meeting *state*-defined work requirements. After 24 months, adult recipients will be required to meet more stringent *federal* work requirements to remain eligible for an additional 24 months of assistance. Counties have the option of extending adult eligibility based on state work requirements beyond 24 months—but not beyond 48 months—if a case meets specific criteria that suggest additional months of assistance will provide significant progress toward self-sufficiency or if the case is facing uniquely adverse labor market conditions. Such extensions may be granted to no more than 20 percent of a county's work-eligible cases that would otherwise have reached the new 24-month limit. These work requirement changes would be applied prospectively, such that any months of assistance prior to January 1, 2013 do not count towards a recipient's 24-month limit. For this reason, no savings will be realized in 2012-13 from these policy changes. Rather, savings will begin to be realized in 2014-15. However, General Fund costs of $8.5 million will be incurred in 2012-13 for automation changes necessitated by these policy changes.

Reduced Reporting Requirements for Child-Only Cases. Under prior law, in order to receive assistance, all cases were required to comply with quarterly income reporting requirements. Budget legislation decreases the cost of administering "child-only" cases without an eligible adult—such as cases headed by an adult who is undocumented, receiving Supplemental Security Income, or timed off of aid—by reducing the frequency of reporting from quarterly to annually for these cases, effective October 1, 2012. This change results in General Fund savings of $26 million in 2012-13 and about $40 million in future years.

Phased-In Restoration of Cal-Learn. The Cal-Learn program, which provides intensive case management to about 10,000 teen parents who remain in school, was suspended for one year as part of the 2011-12 budget package. This year's budget plan restores funding for Cal-Learn, but realizes General Fund savings of $10 million in 2012-13 in recognition that some counties are not prepared to fully restore Cal-Learn at the beginning of the fiscal year due to the suspension in 2011-12.

Increase in the Earned Income Disregard. Currently, the first $112 plus 50 percent of additional earned income is not counted ("disregarded") when determining a family's cash grant. Budget legislation changes this policy to disregard the first $225 and 50 percent of additional earned income, effective October 1, 2013. This change has no fiscal impact in 2012-13 but will result in projected increased costs of about $64 million in 2013-14 and about $85 million ongoing.

Decreased Monthly Benefit for Work Incentive Nutritional Supplement (WINS) Program. Under prior law, the WINS program, which was set to be implemented October 1, 2013, was to provide a $40 monthly food benefit to CalFresh (California's primary food assistance program for low-income families) families who are meeting federal welfare-to-work requirements but are not in the CalWORKs program. Budget legislation reduces the monthly benefit provided to WINS recipients to $10 and delays program implementation to January 1, 2014. No General Fund savings are generated from these changes in 2012-13. Total General Fund expenditures in 2012-13 for WINS, which are related to automation, are $2.5 million. These policy changes will result in projected General Fund savings of about $50 million in 2013-14 and about $60 million ongoing.

In-Home Supportive Services

The budget decreases General Fund support for IHSS by about $43 million (2.5 percent) in 2012-13 compared to the revised 2011-12 level. Below, we describe the major changes to the IHSS program.

A 3.6 Percent Across-the-Board Reduction in Authorized Hours. As part of the 2010-11 budget, IHSS recipients received a 3.6 percent across-the-board reduction in service hours. Recipients were allowed to decide how to apply the 3.6 percent reduction to their services. This reduction was set to expire in July 2012. However, as part of the 2012-13 budget, the Legislature extended the reduction on a one-time basis effective August 2012, meaning that the hours lost from the 3.6 percent reduction were restored for recipients for the month of July. This gives time to notify recipients of the change in the law. This 3.6 percent across-the-board reduction is estimated to result in net savings of $52.2 million in 2012-13 and is scheduled to expire in July 2013.

County Funding for IHSS. The Legislature provided an increase of $4.7 million General Fund above the Governor's May Revision budget proposal for county administration of the IHSS program. This funding was ultimately vetoed by the Governor. As a result, counties will receive $134.2 million General Fund to administer the IHSS program.

The IHSS Program as a Managed Care Benefit. As more fully described earlier, the 2012-13 budget makes IHSS a managed care benefit in eight demonstration counties. Budget legislation provides specific guidance on how IHSS will function as a managed care benefit. Some particular implementation details that are addressed in the legislation include a transition from local collective bargaining for wages and benefits to state level bargaining for counties participating in the demonstration, the establishment of a county MOE (maintenance of effort), and the creation of an optional training curriculum for IHSS providers.

Repeal of Medication Dispensing Pilot Project and Associated Across-the-Board Reduction in Hours. As part of the 2011-12 budget, the Legislature enacted legislation adopting a Medication Dispensing Pilot project that was estimated to save the General Fund $140 million. The legislation also allowed for an across-the-board reduction in IHSS service hours if a determination was made that the project would not save $140 million (please see our *2011-12 Spending Plan* for more detail). As part of the 2012-13 spending plan, the Legislature repealed the Medication Compliance Pilot project legislation and the associated across-the-board reduction, resulting in a General Fund savings erosion of $140 million in 2012-13. The decision to repeal the project's implementing legislation was based on the results of a study that indicated that the project would not be cost-effective.

Budget No Longer Assumes Savings From the Extension of the Sales Tax to IHSS Providers. The 2010-11 budget assumed savings from the extension of the sales tax to IHSS services. Essentially, this sales tax extension would have allowed the state to draw down federal funding to offset General Fund costs in IHSS (please see the *2010-11 Spending Plan* for more detail). Because the state has yet to receive federal approval for this tax, the budget does not assume any savings from the policy in the budget year.

Other Changes From 2011-12 Were Delayed or Have Not Yet Been Implemented. Other savings proposals that were included in the 2011-12 budget were delayed in their implementation or have not yet been implemented as of the date this publication was prepared. As part of the 2011-12 budget, it was assumed that the state would qualify for additional federal funds made available under ACA. This additional federal funding, known as the Community First Choice Option, was expected to offset $128 million in General Fund expenditures in 2011-12. (The state was only recently notified that it did qualify.) The 2012-13 budget assumes $199 million in savings from implementing the Community First Choice Option.

Additionally, the 2011-12 budget package contained a mechanism, or trigger, for further reducing General Fund program expenditures if General Fund revenues were re-estimated to fall short of the amount assumed in the *2011-12 Budget Act*. One of these budget trigger cuts was a 20 percent across-the-board reduction in IHSS service hours estimated to save $100 million General Fund in 2011-12. Ultimately, the trigger was pulled. However, a federal judge issued a preliminary injunction preventing the state from implementing the IHSS-related reduction. The state has appealed this injunction. The 2012-13 budget assumes the state will ultimately prevail in the litigation and begin implementing the reduction in April 2013.

Department of Aging

The budget provides $32 million from the General Fund for the Department of Aging, a 1 percent decrease in funding compared to the revised 2011-12 spending level.

MSSP Becomes a Managed Care Benefit. As more fully described earlier in this report, the 2012-13 budget makes MSSP a managed care benefit in eight demonstration counties. Budget legislation provides specific guidance on how MSSP will function as a managed care benefit.

County Welfare Automation Projects

Statewide Automated Welfare Systems (SAWS). The budget includes $62.9 million ($23.5 million General Fund) to begin the first year of development for the Los Angeles Eligibility, Automated Determination, Evaluation and Reporting (LEADER) replacement system. The current LEADER system is one of three county-led consortia that make up SAWS. The administration and Los Angeles County have been engaged in a lengthy procurement for a replacement system for several years and in 2009 selected a vendor to build the system at a cost of about $475 million (all funds). To date, the state and Los Angeles County have not entered into a contract with the vendor but plan to do so in 2012-13.

Child Welfare Services Automation Project. The *2011-12 Budget Act* indefinitely suspended the Child Welfare Services Web (CWS/Web) project proposed to replace the current system, which is based on outdated technology and not fully compliant with federal system requirements, with a modern web-based system. The suspension was a result of escalating project costs (early estimates were that the new system would cost about $70 million [all funds] annually for several years) and potential federal changes to system requirements. However, the Legislature made clear its continued interest in addressing the deficiencies in the existing system through 2011-12 budget legislation directing DSS and the Office of Systems Integration (OSI), in consultation with stakeholders, to report by January 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 including, but not limited to, upgrading the current system, restarting CWS/Web project, or developing a new procurement for another replacement system; and (3) the next steps to implement the recommended approach.

In their 2012 report to the Legislature, DSS and OSI stated that it was neither technically feasible nor cost-effective to maintain and upgrade the existing system. Instead, they recommended its replacement using a "buy/build approach," which would involve purchasing an application or suite of applications that are already available in the marketplace. Once purchased, the applications would be used as-is with additional business functions identified and built over time. The cost estimates for implementing this replacement system are about $560 million (all funds) over five years, with costs in the initial years of about $100 million annually.

The 2012-13 spending plan includes $2.5 million ($1.1 million General Fund) to continue with the CWS replacement system. In budget legislation, the Legislature directed DSS to utilize this funding for the procurement of a new system pursuant to its buy/build recommendation. Additionally, DSS and OSI are to report to the Legislature by March 2013 on their activities toward this goal along with key milestones for system development.

Department of Child Support Services

Continued Suspension of County Share of Collections. When local child support agencies collect child support on behalf of families receiving CalWORKs, counties receive a portion (2.5 percent) of the collections. The 2012-13 budget continues the suspension of the county share of collections, as originally adopted in the 2011-12 budget on a one-time basis, and deposits the funds withheld from counties (about $32 million) into the General Fund instead.

Unallocated Reduction to Local Child Support Agencies. The budget includes a $14.7 million (approximately 2 percent) unallocated reduction to local child support agencies. This reduction results in one-time General Fund savings of $5 million.

Judiciary and Criminal Justice

The 2012-13 budget provides $9.8 billion from the General Fund for judicial and criminal justice programs, including support for ongoing programs and capital outlay projects (see Figure 15). This is a decrease of $895 million, or 8.3 percent, below the revised 2011-12 General Fund spending level. Figure 16 summarizes the major General Fund changes adopted by the Legislature in the criminal justice area, which we discuss in more detail below.

Figure 15

Judicial and Criminal Justice Budget Summary[a]

General Fund (Dollars in Millions)

Program/Department	2010-11	2011-12	2012-13	Change From 2011-12 Amount	Change From 2011-12 Percent
Department of Corrections and Rehabilitation	$9,491	$9,272	$8,860	-$413	-4.4%
Judicial Branch	1,662	1,231	730	-501	-40.7
Department of Justice	292	169	187	19	11.1
Other criminal justice programs[b]	534	57	57	—	-0.5
Totals	**$11,979**	**$10,730**	**$9,834**	**-$895**	**-8.3%**

[a] Amounts do not reflect various fund shifts, which make year-to-year comparisons difficult.

[b] Includes debt service on general obligation bonds, Board of State and Community Corrections, Office of Inspector General, State Public Defender, and various public safety grant programs.

Figure 16

Major General Fund Changes— Judicial and Criminal Justice Programs

2012-13 (In Millions)

Program	Amount
Judicial Branch	
Various workload adjustments	$43
Reduce budget for judicial branch	-544
California Department of Corrections and Rehabilitation	
Increase funding for inmate medical services	128
Increase funding for inmate pharmaceuticals	60
Begin activation of the Correctional Health Care Facility	11
Additional savings from 2011 realignment of adult offenders	-647
Cancel activation of Estrella Correctional Facility	-45
Increase county fees to send juvenile offenders to state institutions (revenue)	-20
Reflect declining juvenile facility population	-9
Board of State and Community Corrections	
Establish new grant program for police departments	20
Department of Justice	
Increase penalty assessment to offset General Fund support for forensic laboratories	-10
Increase False Claims Act Fund transfer to General Fund	-8

Judicial Branch

The budget provides nearly $3 billion for support of the judicial branch—a decrease of $140 million, or 4.5 percent, from the revised 2011-12 level. This amount includes $730 million from the General Fund and $499 million from the counties, with most of the remaining balance of about $1.8 billion derived from fine, penalty, and court fee revenues. The General Fund amount is a net reduction of $501 million, or 40.7 percent, from the revised 2011-12 amount. (This General Fund reduction is offset by local trial court reserves and court construction funds, as described below.) Funding for trial court operations is the single largest component of the judicial branch budget, accounting for four-fifths of total spending.

Court Operations. The budget package includes a $544 million General Fund reduction to the judicial branch in 2012-13, including a $525 million reduction to the trial courts and a $19 million reduction to the Administrative Office of the Courts. However, under the budget plan, the reduction to the trial courts would be offset through the one-time use of $285 million of local trial court reserves—unspent funds from prior years—and the redirection of $240 million of court construction funds. Of the $544 million reduction to the judicial branch, $111 million is intended to be ongoing and partially offset by the future redirection of $50 million from court construction funds on an ongoing basis. In addition, the budget maintains the $350 million General Fund reduction initially enacted in 2011-12. Of this amount, $302 million was offset in 2011-12 through one-time actions. The budget plan addresses this $302 million shortfall in 2012-13 by (1) redirecting $152 million from various special funds to offset trial court costs, (2) using $100 million in local trial court reserves on a one-time basis, and (3) generating additional revenues of $50 million from increased civil filing fees.

The final budget package also includes a number of policy changes related to court operations, specifically:

- ***Trial Court Reserves***. The budget package requires the creation of a statewide reserve consisting of 2 percent of the total funds appropriated each year for the support of trial court operations. The purpose of this reserve is to address unforeseen emergencies, unanticipated expenses for existing programs, or unavoidable funding shortfalls. In addition, as of June 30, 2014, each trial court will only be allowed to retain reserves of up to 1 percent of its prior-year operating budget.

- ***Statewide Court Projects***. Beginning in 2012-13, trial court operation funds may no longer be redirected to statewide court projects, including the California Case Management System, unless approved by the Legislature and specifically appropriated in statute.

- ***Other Provisions***. The final budget package also includes changes to: (1) increase appellate filing fees to offset prior reductions to state courts, (2) create a $30 fee for court reporter services in civil proceedings lasting less than an hour, and (3) prohibit trial courts from changing their policies on how they calculate transcription fees.

Courts Capital Outlay. The budget provides roughly $983 million for various court construction projects. This amount includes: (1) $839 million in lease-revenue bond authority for the construction or renovation of seven previously approved projects and (2) $144 million from the Immediate and Critical Needs Account (ICNA) to acquire sites for 19 projects. (In accordance to Chapter 311, Statutes of 2008 [SB 1407, Perata], ICNA receives revenue from certain court fee and fine increases.) In addition, the design activities for up to 38 projects will be delayed for up to one year—generating the $240 million redirected to trial court operations—as the branch reevaluates the scope and budget of all planned projects.

Corrections and Rehabilitation

The budget contains $8.9 billion from the General Fund for support of the California Department of Corrections and Rehabilitation (CDCR). This is a net reduction of $413 million, or 4.4 percent, below the revised 2011-12 level of spending. This decrease primarily reflects additional savings in 2012-13 from the decline of the state inmate and parolee populations due to the 2011 realignment of adult offenders. (The 2011 realignment is discussed in more detail in our publication, *The 2012-13 Budget: Refocusing CDCR After the 2011 Realignment.)*

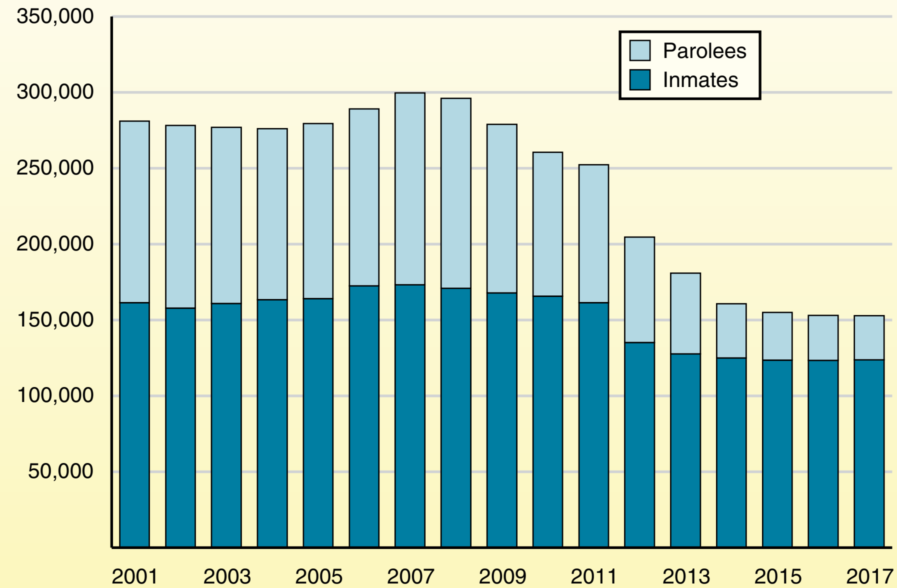
Adult Correctional Population. Figure 17 (see next page) shows the recent changes and projected declines in the inmate and parolee populations. As shown in the figure, these populations are projected to continue to decline significantly in the coming years. The reductions are due largely to the effect of the 2011 realignment, which shifted responsibility for managing many lower-level adult offenders to counties. The prison population is projected to decline to about 128,000 inmates by the end of 2012-13, and the parole population is projected to decline to about 53,000 parolees.

Reorganization of CDCR. In April 2012, CDCR released a report (referred to as the "blueprint") on the administration's plan to reorganize various aspects of CDCR operations, facilities, and budgets in response to the 2011 realignment of adult offenders, as well as to meet various federal court requirements (such as reducing the inmate population to meet population cap targets set by a federal three-judge panel). The plan includes a multitude of changes—including several that would either increase or decrease the state's prison system capacity, as well as other operational changes. The aspects of the blueprint requiring budget or budget trailer legislation were approved by the Legislature as part of the 2012-13 budget package. In total, the administration's plan would reduce state spending on adult prison and parole operations by $1 billion in 2012-13, growing to $1.5 billion by 2015-16,

Figure 17

Inmate and Parolee Populations Projected to Decline Further

As of June 30 Each Year



relative to what the administration estimates CDCR's budget would have been in the absence of realignment. For more detail on the blueprint, please see the nearby box.

Inmate Medical Care Services. The budget reflects a net General Fund reduction of $146 million in the federal court-appointed Receiver's program for inmate medical services from the revised 2011-12 level. (In 2011-12, there was a one-time supplemental appropriation of $249 million for the program.) The Receiver intends to achieve the assumed savings by (1) implementing a new medical staffing plan that is expected to reduce costs, (2) pursuing federal reimbursement for medical services for eligible inmates, and (3) reducing the number of inmate referrals to specialty medical care by more consistently applying the utilization management system used to determine when such referrals are appropriate. The budget also includes a $128 million General Fund augmentation in 2012-13 to restore an unallocated budget reduction that the federal Receiver was unable to achieve in 2011-12, as well as $60 million for increased inmate pharmaceutical costs. In addition, the budget provides $11 million to CDCR for pre-activation activities for the California Health Care Facility in Stockton, which is scheduled to open in July 2013.

Division of Juvenile Justice (DJJ). In January 2012, the Governor's budget included a proposal to complete the realignment of juvenile justice programs

Major Features of the CDCR Blueprint

The CDCR blueprint includes proposals to:

- ***Request Increased Prison Capacity of 145 Percent.*** Last year, the U.S. Supreme Court upheld a federal three-judge panel's ruling limiting the state's prison population to no more than 137.5 percent of prison design capacity. The blueprint reflects the administration's request that this limit be increased to 145 percent of design capacity. (The court has yet to rule on the request.)
- ***Construct Three Infill Projects.*** The plan includes $810 million in new lease-revenue bond authority to construct additional low-security prison housing at three existing prisons.
- ***Renovate DeWitt Juvenile Facility for Adult Inmates.*** The plan includes $167 million in lease-revenue bond authority from Chapter 7, Statutes of 2007 (AB 900, Solorio), for the renovation and conversion of the DeWitt Nelson Youth Correctional Facility to an adult prison. Most of these beds would be used to house inmates who have regular medical and mental health treatment needs.
- ***Make Prison Health Care Facility Improvements.*** The plan includes the use of $700 million in existing lease-revenue bond authority from AB 900 for health care improvements at all existing prisons except the California Rehabilitation Center (CRC).
- ***Reduce AB 900 Appropriation.*** Assembly Bill 900 originally authorized a total of $6.5 billion for prison construction projects. The blueprint calls for the elimination of $4.1 billion of the remaining $5 billion in lease-revenue bond authority provided in AB 900.
- ***Close CRC.*** The blueprint assumes that CRC will be closed in 2016.
- ***End Use of Out-of-State Contract Beds.*** Over the next four years, the administration plans to eliminate the practice of housing inmates in out-of-state contracted facilities.
- ***Modify Inmate Classification System.*** The administration plans to implement new security classification regulations that will allow about 17,000 inmates to be housed in lower-security facilities than under current classification rules.
- ***Establish Standardized Staffing for Prisons.*** The administration plans to begin using standardized staffing packages for each prison based on factors such as the prison's population, physical design, and missions.
- ***Modify Delivery of Rehabilitation Programming.*** The plan also calls for the expansion of certain types of inmate and parolee rehabilitation programs, including some that the department has not historically provided on a large scale (such as cognitive behavioral treatment).

The blueprint also included various other proposals, such as an expansion of the alternative custody program for women. (For more detailed information on the blueprint, please see our recent publication, *The 2012-13 Budget: State Should Consider Less Costly Alternatives to CDCR Blueprint*.)

to counties and end new admissions to DJJ. The administration withdrew this proposal as part of its May Revision and instead proposed several policy changes that were adopted by the Legislature, including (1) increasing to $24,000 the annual fee charged to counties for each ward committed to DJJ by juvenile courts, (2) reducing DJJ administrative staff, (3) completing the realignment of juvenile parole on January 1, 2013, instead of July 1, 2014, and (4) reducing DJJ's age jurisdiction from 25 to 23 for wards committed by the juvenile courts. The budget assumes an additional $19.9 million in General Fund revenues from the fee increase, as well as $4.8 million in General Fund savings to DJJ from the other policy changes. The budget also reflects a savings of $8.8 million in General Fund ($1.6 million in Proposition 98 funds) from a projected decrease in DJJ's facilities population in 2012-13. In addition, the Legislature adopted budget trailer legislation to remove the ability of DJJ staff to delay a ward's parole consideration date for disciplinary or other reasons. The 2012-13 budget, however, does not reflect any savings from this policy change.

Board of State and Community Corrections (BSCC)

The budget includes about $130 million ($37.6 million from the General Fund and $92.4 million in special funds) for support of BSCC, which was established as a new department following the elimination of the Corrections Standards Authority (CSA). The BSCC will continue most of CSA's duties, such as administering various public safety grants, overseeing local correctional standards, and administering jail construction funds. The BSCC also assumes responsibility for providing technical assistance and collecting data related to counties' implementation of 2011 adult offender realignment.

Grants to City Police Departments. As part of its budget package, the Legislature approved $20 million in General Fund for each of the next three years to provide grants to city police departments. The purpose of these grants is to help offset the effects of local budget reductions caused by the recent economic decline. The BSCC will be responsible for administering these grants.

Jail Construction Funds. The budget package provides an additional $500 million in lease-revenue bond authority for jail construction and modification. These funds are intended to help counties add additional bed space in their jails, as well as provide appropriate treatment and programming space for jail inmates. A 10 percent funding match from county governments is required.

Department of Justice (DOJ)

The budget includes $187 million in General Fund support for DOJ, an increase of $18 million, or 10.7 percent, from the revised 2011-12 level. The budget provides an additional $2.9 million in General Fund, as well as $8.9 million in special funds, to partially restore prior-year reductions to the

Division of Law Enforcement within DOJ. As part of the budget package, the Legislature also approved statutory changes to increase the penalty assessment used to fund DOJ's forensic laboratories (from $3 for every $10 in fines, to $4). The budget reflects the use of this additional penalty revenue to offset $10 million in General Fund support for DOJ's laboratories.

Resources and Environmental Protection

The 2012-13 budget provides a total of roughly $7 billion from various funds for programs administered by the Natural Resources and Environmental Protection Agencies. This is a decrease of about $3.7 billion, or 35 percent, when compared to revised 2011-12 expenditures. Most of this decrease reflects lower bond expenditures in 2012-13.

Resources Programs

As shown in Figure 18, the budget includes $5.5 billion (including about $1.9 billion from the General Fund) for the support of various resources programs in 2012-13. This is a decrease of about $3.6 billion, or 40 percent,

Figure 18

Resources Budget Summary

(Dollars in Millions)

				Change From 2011-12	
	2010-11	2011-12	2012-13	Amount	Percent
Expenditures					
Department of Resources, Recycling, and Recovery	$1,527	$1,439	$1,436	-$3	—
General obligation bond debt service	902	897	904	6	1%
Department of Water Resources	508	2,255	792	-1,463	-65
Department of Forestry and Fire Protection	702	795	756	-39	-5
Department of Parks and Recreation	534	1,190	530	-660	-55
Energy Resources Conservation	403	549	378	-170	-31
Department of Fish and Game	292	446	335	-110	-25
California Conservation Corps	66	89	68	-21	-24
Wildlife Conservation Board	158	755	62	-693	-92
Department of Conservation	60	142	64	-78	-55
Other resources programs	269	607	196	-411	-68
Totals	**$5,423**	**$9,163**	**$5,520**	**-$3,642**	**-40%**
Funding					
General Fund	$1,990	$1,948	$1,900	-$49	-2%
Special funds	2,526	2,616	2,459	-157	-6
Bond funds	4,480	4,278	876	-3,402	-80
Federal funds	339	321	286	-35	-11

from the revised 2011-12 spending level. Although the Department of Resources, Recycling, and Recovery (DRRR) is the single largest resources department in terms of total funds, debt service on general obligation bonds continues to be the largest single General Fund expenditure in the resources area—totaling $904 million in 2012-13.

Department of Water Resources (DWR)

The budget includes $792 million from various fund sources to support DWR, a net reduction of $1.5 billion, or 65 percent, from the revised 2011-12 level. This is primarily due to a reduction in planned bond expenditures. The budget does, however, include funding and staffing increases for several DWR-related programs. For example, the budget provides an increase of 75 positions—37 permanent positions and 38 two-year limited-term positions—to support the preliminary engineering and final design of conveyance associated with the Bay-Delta Conservation Plan (BDCP). The BDCP is a planning process conducted by DWR to provide the basis for the issuance of endangered species permits necessary for the operation of state and federal water projects in the Delta for the next 50 years. The additional 75 positions are supported by $12.1 million in off-budget State Water Project (SWP) funds. As part of the budget package, the Legislature also approved a continuous appropriation of $7.5 million from the Harbors and Watercraft Revolving Fund (HWRF) to pay for SWP operations and routine capital improvements attributed to recreation (so-called "Davis-Dolwig costs"). The budget also provides $2.5 million from the HWRF to pay for costs associated with recreation that were not paid in past years.

Delta-Related Expenditures

The budget provides a total of $249 million in state funds—mainly SWP funds and various bond funds—across nine state entities (such as DWR, the Department of Fish and Game, and the Delta Stewardship Council) to address a number of interrelated water problems in the Sacramento-San Joaquin Delta region. The largest program expenditures are for improvements to the existing conveyance system ($106 million) as part of BDCP and ecosystem restoration ($62 million).

California Department of Forestry and Fire Protection (CalFire)

The budget includes total expenditures of $756 million for CalFire from various funding sources, a decrease of $39 million, or 5 percent, from the revised 2011-12 level. Of this total, nearly $712 million is for fire protection activities. (This does not include reimbursements from local governments for cooperative fire protection, which is expected to be $293 million in 2012-13.) Of this amount, $543 million is from the General Fund for CalFire operations, which is an increase of $18 million over the prior year. The increase results from various budgetary changes, including annual employee compensation adjustments and additional funding related to legal services and court settlements. As has been the case in previous years, the budget includes $131 million from the General Fund for emergency fire protection activities and allows the Director of Finance to augment this amount to pay for additional fire protection expenses, as needed.

State Responsibility Area (SRA) Fee. The budget also includes funding for staff and other resources to implement a new fee that will be assessed on property owners residing in an SRA. Specifically, the budget provides $9 million to CalFire and $6 million to the state Board of Equalization (BOE) for this purpose. The implementation of this fee was delayed in 2011-12 and full-year implementation is now anticipated in 2012-13. General Fund savings from this fee are expected to be $70 million annually beginning in 2012-13.

Lumber Tax. The budget provides funding to implement a 1 percent sales tax on lumber products. Specifically, the budget provides $2 million for BOE to implement the tax and for reimbursing retail stores for some associated costs. The tax is expected to raise $15 million in 2012-13 and $30 million annually beginning in 2013-14. Revenues will fund regulatory activities related to timber harvesting and result in nearly $8 million in General Fund savings in 2012-13, with an estimated $16 million of General Fund savings in future years. In addition, the Legislature approved provisions that make timber harvest plans effective for five years (with two-year extensions) rather than three years. The legislation also requires the Natural Resources Agency to report annually on all state activities related to forest and timberland regulation and limits the amount public agencies seek when there is a fire on timber or forest land to the actual cost of damages.

Department of Parks and Recreation (DPR)

The budget provides a total of $530 million for the support of DPR. This is a decrease of $660 million, or 55 percent, from the revised 2011-12 level, mainly due to a reduction in bond fund expenditures for local assistance grants and capital outlay projects. The budget includes $112 million from the General Fund, about $100 million from fees paid by park visitors, and $318 million in special funds and bond funds.

Reduced General Fund Support. The budget includes an $11 million General Fund reduction to the park system. (This is in addition to an $11 million ongoing reduction in General Fund support that was adopted as part of the 2011-12 budget.) In order to achieve the assumed savings, the administration proposed to close up to 70 state parks by July 2012. To date, DPR has secured operating agreements with various entities (such as local governments and nonprofit organizations), as well as monetary donations, to keep 40 parks open in 2012-13. The department is in the process of negotiating agreements to maintain the operation of up to an additional 25 state parks. Moreover, in adopting the 2012-13 budget, the Legislature took several actions to better enable the department to operate state parks with reduced General Fund support. Specifically, the budget package (1) includes a continuous appropriation of $15 million per year for two years of park fee revenues to encourage park staff to implement new programs to increase the number of paying park visitors, (2) reduces the need to have sworn peace officers perform certain park ranger tasks, and (3) shifts $10 million in bond funds to pay for the capital costs of projects intended to more effectively collect revenue for parks, such as computerized parking meters and kiosks to collect entrance fees.

After passage of the 2012-13 budget, the administration reported the discovery of about $20 million in additional unspent funds in the State Parks and Recreation Fund (SPRF). Given the discovery of funds in the SPRF, the Legislature provided $10 million in matching funds for grants to parks on the closure list and $10 million for park maintenance projects. The Legislature also approved a two-year moratorium on park closures, authorized the State Parks Commission to take on a stronger oversight role, and provided an additional $10 million in bond funds for capital improvements at parks. In addition to the discovery of the SPRF funds, the administration reported a $34 million discrepancy between balances in the Off-Highway Vehicle (OHV) Trust Fund previously reported by the administration and the State Controller's Office. The administration indicated that it was unclear if the additional balances in the OHV Trust Fund were available for expenditure; therefore, these additional funds were not addressed in the 2012-13 budget plan.

Energy Resources Conservation and Development Commission

The budget provides a total of $378 million for the support of the Energy Resources Conservation and Development Commission (commonly referred to as the California Energy Commission, or CEC). This is a decrease of $170 million, or 31 percent, from the revised 2011-12 budget. The decrease is mainly due to the exhaustion of one-time federal stimulus funds and the sunset of the "public goods charge" (a surcharge on utility ratepayer bills) in January 2012 that previously funded certain CEC programs (such as the Public Interest Energy Research Program). The budget does, however, include $1 million for CEC to develop a plan to administer $127 million in funds collected from an "electricity procurement investment charge" that was recently established by the California Public Utilities Commission (CPUC). The funds are intended to support the continuation of programs previously funded by the public goods charge.

Environmental Protection Programs

As shown in Figure 19, the budget includes $1.5 billion (mostly from special funds) for various environmental protection programs. This is a slight decrease of $90 million, or 6 percent, from the revised 2011-12 spending level.

Air Resources Board (ARB)

The budget provides a total of $539 million, an increase of $79 million, or 17 percent, from the revised 2011-12 level, mainly due to an increase in

Proposition 1B bond funds for certain infrastructure improvements, emission reductions from activities related to freight movement, and ferry terminal security improvements.

Climate Change. The budget includes $38 million from special funds across nine 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 20 (see next page) lists the expenditures, number of positions, funding sources, and activities funded on an agency-by-agency basis for the implementation of AB 32 in 2012-13. These expenditures include about $33 million for ARB to begin implementation of various measures, such as the cap-and-trade regulation discussed in more detail below. The balance of the expenditures is to be used mainly to 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 cost of implementation fee" that the ARB began assessing in 2010-11 on major GHG emitters subject to state regulation. Over the next few years, revenues from this 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

Figure 19

Environmental Protection Budget Summary

(Dollars in Millions)

	2010-11	2011-12	2012-13	Change From 2011-12 Amount	Change From 2011-12 Percent
Expenditures					
State Water Resources Control Board	$749	$816	$662	-$154	-18.9%
Air Resources Board	320	460	539	79	17.0
Department of Toxic Substances Control	158	200	178	-22	-11.0
Department of Pesticide Regulation	74	80	83	2	3.0
Other environmental programs	31	36	41	5	15.0
Totals	**$1,333**	**$1,593**	**$1,503**	**-$90**	**-6.0%**
Funding					
General Fund	$75	$51	$46	-$5	-10.0%
Special funds	1,073	1,069	1,043	-26	-2.0
Bond funds	422	274	213	-61	-22.0
Federal funds	198	199	200	2	1.0

goals. These include expenditures of CPUC, CEC, and the Department of General Services to implement the state's Renewables Portfolio Standard and various energy efficiency programs.

Cap-and-Trade. In order to achieve the state's emission reduction goal (as specified in AB 32), ARB recently adopted a regulation to establish a new "cap-and-trade" program that places a "cap" on aggregate GHG emissions from entities responsible for roughly 80 percent of the state's emissions. The ARB will issue carbon allowances both freely and through an auction that these entities will, in turn, be able to "trade" (buy and sell) on the open market. The ARB will hold three auctions in 2012-13, the first of which is scheduled for November 2012. The budget package assumes that $500 million of the revenues generated from these auctions will offset costs of GHG mitigation activities traditionally supported by the General Fund. The budget requires the administration to submit a spending plan to the Legislature prior to the allocation of these funds. The budget package also requires the administration to submit each year an expenditure plan of cap-and-trade revenues as part of

Figure 20

AB 32 Implementation in 2012-13

(Dollars in Thousands)

Agency	Positions	Expenditures	Fund Source	Activity
Air Resources Board	158	$33,291	AB 32 Cost of Implementation Fund	Implement GHG emission reduction measures such as cap-and-trade program.
Secretary for Environmental Protection	7	1,827	AB 32 Cost of Implementation Fund, Motor Vehicle Account, General Fund	Climate Action Team activities, including program oversight and coordination.
State Water Resources Control Board	2	555	AB 32 Cost of Implementation Fund	Develop GHG emission reduction measures.
Department of Water Resources	4	552	AB 32 Cost of Implementation Fund, 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.
Department of Resources, Recycling, and Recovery	6	496	AB 32 Cost of Implementation Fund	Develop and implement GHG emission reduction measures.
Department of Public Health	—	348	AB 32 Cost of Implementation Fund	Evaluate public health impacts of GHG emission reduction measures.
Department of Forestry and Fire Protection	1	290	AB 32 Cost of Implementation Fund	Conduct carbon sequestration analysis.
Department of Housing and Community Development	1	115	AB 32 Cost of Implementation Fund	Implement sustainable community planning process.
Totals	**179**	**$37,474**		

GHG = Greenhouse gas.

the Governor's January budget proposal. The Legislature also adopted budget trailer legislation to provide greater oversight of ARB's programmatic activities with other jurisdictions and the Western Climate Initiative, Inc. (a nonprofit corporation that will provide ARB with administrative and technical services regarding its GHG emissions trading program).

Department of Toxic Substances Control (DTSC)

The budget includes $178.4 million for DTSC, a net reduction of $22 million, or 11 percent, from the revised 2011-12 level. The total includes $21 million from the General Fund, $49 million from the Hazardous Waste Account, and $47 million from the Toxic Substances Control Account.

Implementation of the Green Chemistry Program. The budget redirects 39 positions, eliminates about 5 positions, and redirects total funding of $6.2 million from various programs within DTSC to implement Chapters 559 and 560, Statutes of 2008 (AB 1879 Feuer and SB 509 Simitian, respectively), known as the "green chemistry program." This program will identify the presence of hazardous chemicals in consumer products and require producers of these products to consider safer alternatives.

Other Environmental Protection Programs

Beverage Container Recycling Program. The DRRR operates the Beverage Container Recycling Program, which is funded by the collection of beverage container redemption payments that are deposited into the Beverage Container Recycling Fund (BCRF). About $1.4 billion is annually deposited in this fund. In order to help maintain the solvency of the BCRF, the Legislature adopted budget trailer legislation requiring beverage container distributors to submit redemption payments the last day of the first month following the sale, rather than the last day of the second month. This change would more closely align the department's revenue and expenditure cash flows.

Increased Collaboration in the Lake Tahoe Basin. The budget includes language intended to increase collaboration among various state agencies regarding issues in the Tahoe Basin by (1) establishing an agreement between DPR and the California Tahoe Conservancy for the management and operation of several Tahoe-area properties (such as the Kings Beach State Park); (2) requiring the California Natural Resources Agency, the Tahoe Regional Planning Agency, and the Nevada Department of Conservation and Natural Resources to create four-year measureable performance benchmarks for implementation of the 2012 Regional Plan Update; (3) requiring various state agencies to collaboratively develop a comprehensive monitoring, evaluation, and reporting plan for environmental thresholds and Regional Plan performance benchmarks; and (4) requiring the California Tahoe Conservancy to report to the Legislature on Tahoe-basin annual expenditures and accomplishments related to the Environmental Improvement Plan.

Transportation

The 2012-13 spending plan provides $23.9 billion from various fund sources for transportation programs. This is an increase of $4.6 billion, or about 24 percent, when compared to the revised level of spending in the prior year, as shown in Figure 21.

Department of Transportation (Caltrans)

The 2012-13 budget plan includes total expenditures of $12.6 billion from various fund sources for Caltrans. This level of expenditures is less than in 2011-12 by roughly $3 billion (or 19 percent) mainly due to the timing of the expenditure of certain one-time funds. For instance, about $2.9 billion in Proposition 1B bond funds were not spent at the rate assumed in the *2011-12 Budget Act*, with the result that 2011-12 expenses were lower and the assumed level of spending in 2012-13 is higher. The 2012-13 budget provides approximately $4.9 billion for transportation capital outlay, $2.1 billion for local assistance, $1.8 billion for capital outlay support, and $1.7 billion for highway maintenance and operations. The budget also provides $1.8 billion for Caltrans' mass transportation and rail programs and $194 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 enacted a "fuel tax swap" to increase its flexibility over the use of transportation funds while maintaining fuel tax revenues at approximately the same level. Under the swap, the state no longer charges a sales tax on gasoline and instead imposes an additional excise tax (18 cents per gallon) on gasoline, with the new revenue deposited into the Motor Vehicle Fuel Account. Due to the passage of Proposition 22 in November 2010, which (among other provisions) restricted the state's ability to

Figure 21

Transportation Program Expenditures

Various Fund Sources (Dollars in Millions)

Program/Department	2010-11	2011-12	2012-13	Change From 2011-12 Amount	Change From 2011-12 Percent
Department of Transportation	$8,823	$15,611	$12,642	-$2,969	-19.0%
High-Speed Rail Authority	216	164	7,227	7,063	4,309.9
California Highway Patrol	1,773	1,806	1,850	44	2.4
Department of Motor Vehicles	888	929	950	21	2.3
Transit Capital	78	420	830	410	97.6
State Transit Assistance	—	399	420	22	5.4
California Transportation Commission	29	28	29	—	0.2
Totals	**$11,807**	**$19,357**	**$23,948**	**$4,591**	**23.7%**

pay for transportation debt service using excise tax revenues and prohibited the borrowing of fuel excise tax revenues, the Legislature revised the above fuel swap in March 2011 to rely on vehicle weight fees to benefit the General Fund. The current fuel tax swap, along with provisions in the 2012-13 budget package, provide a total of $1.3 billion in relief to the General Fund.

- ***Debt Service.*** The fuel tax swap allows the use of weight fees to offset General Fund debt-service costs of $606 million in 2012-13.
- ***Loans to the General Fund.*** Because the amount of weight fees paid exceeds the state's debt-service costs, the budget package loans $11 million in weight fee revenues to the General Fund in 2011-12 and $374 million in 2012-13.
- ***Transfer to the General Fund.*** An unintended effect of the fuel tax swap has been a substantial increase in the amount of revenues transferred to several special funds that receive a specified percentage of the fuel excise tax attributable to fuel purchased for OHVs, including the OHV Trust Fund, (the HWRF), and the Department of Agriculture Account. As part of the 2012-13 budget package, the Legislature enacted budget trailer legislation to amend the fuel tax swap and transfer this increased revenue from the Motor Vehicle Fuel Account to the General Fund—$184 million in 2011-12 and $128.2 million annually beginning in 2012-13.

Additional 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 2012-13 budget appropriates $1.3 billion for various programs, mainly for capital outlay and local assistance purposes.

High-Speed Rail Authority (HSRA)

Construction to Begin on High-Speed Rail Line. The 2012-13 budget plan appropriates a total of $7.2 billion—$3.9 billion in state bond funds from Proposition 1A of 2008 and $3.3 billion in federal funds—to the HSRA to begin the construction of the high-speed rail line. This is about $7.1 billion more than the revised level of spending in 2011-12. Specifically, the $7.2 billion is for the following uses.

- ***Final Design and Construction of Central Valley Segment.*** The budget includes about $4.9 billion for contract services to complete the final engineering design work and to construct up to 130 miles of high-speed railroad track in the Central Valley. Up to five separate design/build contracts are expected to be awarded and the funds will be available for spending until June 30, 2018.

- ***Right-of-Way Acquisition.*** About $900 million is provided to acquire approximately 1,100 parcels of land from Madera to just north of Bakersfield for the 130-mile Central Valley segment.
- ***Project-Level Planning and Design.*** The budget provides about $253 million for contract services to complete preliminary engineering design and environmental review for the entire rail system. This amount includes $204 million in state bond funds and $48 million in federal funding, which will be available for spending until June 30, 2018.
- ***Contract Services and State Administrative Costs.*** About $25 million is available for state operations and contract services for overall program management, oversight, external communications, and financial consulting services. In addition, the budget provides up to $4 million for Caltrans to review and approve engineering and environmental documents related to the high-speed rail project.

Proposition 1A Funds Appropriated for Local Projects. The 2012-13 budget includes $1.1 billion of Proposition 1A bond funds for capital improvements on existing local rail systems that would also advance high-speed rail.

- ***Caltrain Electrification.*** About $600 million in state bond funds is for improvements to the Caltrain commuter rail line, which provides commuter rail service between San Francisco and San Jose. This system is part of the current high-speed rail implementation plan, which will share existing passenger rail infrastructure where feasible.
- ***Southern California Local Rail Projects.*** About $500 million in state bond funds is for capital improvements to existing passenger rail systems or facilities in the Palmdale to Los Angeles and Los Angeles to Anaheim project segments of the high-speed rail system.

Under Proposition 1A, the above funds must be matched with at least equal contributions of funds or in-kind resources.

Special Transportation Programs

The budget provides $819 million in Proposition 1A bond funds to Caltrans for capital improvement projects to intercity and commuter rail lines and urban rail systems that provide direct connectivity to the high-speed train system and its facilities. In addition, the budget package provides an estimated $420 million for the State Transit Assistance program to support transit operations.

California Highway Patrol (CHP) and Department of Motor Vehicles (DMV)

The 2012-13 budget provides $1.9 billion to fund CHP operations, about $44 million (2 percent) more than in 2011-12. The funding includes support for the department's ongoing programs ($1.8 billion) and the cost of various capital outlay projects ($36 million), many of which were approved in prior years. For the DMV, the budget provides $950 million for departmental operations, about $21 million (2 percent) more than the 2011-12 revised funding level. This amount includes support for DMV's operations ($947 million) and for DMV to consolidate, relocate, and replace several of its facilities ($3 million).

Increasing DMV's Efficiency. The DMV's budget includes $250,000 to support the development of an Internet-based system to manage customers and reduce the amount of time they have to wait at DMV field offices. The project is estimated to be completed in 2015-16 at a total cost of $16 million. The budget also includes $4.1 million in federal funds to expand the use of automated driver licensing exams at a limited number of DMV field offices, mainly through the installation of additional testing terminals. The total project is estimated to cost about $10 million and is expected to reduce staffing costs beginning in 2014-15.

Motor Vehicle Account (MVA). To help address the state's General Fund condition, the 2012-13 budget provides a loan of $300 million from the MVA to the General Fund, which must be repaid by June 30, 2016.

Other Major Provisions

RDA's

As Figure 22 indicates, the budget package assumes that K-14 agencies will receive $3.2 billion in 2012-13 from the dissolution of RDAs, offsetting a comparable amount of state General Fund education spending. This amount includes:

- ***Residual Property Tax Revenue ($1.7 Billion).*** Under last year's redevelopment dissolution legislation (Chapter 5, Statutes of 2011-12, First Extraordinary Session [ABX1 26, Blumenfield]), "residual property

Figure 22

2012-13 Projected Funds From Redevelopment Dissolution

General Fund Benefit (In Millions)

	Residual Property Taxes	Liquid Assets	Total
K-12	$1,349	$1,190	$2,539
County Offices of Education	87	77	165
California Community Colleges	240	211	451
Totals	**$1,676**	**$1,479**	**$3,155**

tax revenues" are any property tax revenues of a former RDA that exceed the amounts needed to pay the agency's debts. County auditors distribute these residual revenues to local agencies (cities, counties, special districts, schools, and community colleges) every January and June in a manner similar to how they distribute other property tax revenues. The budget package assumes that K-14 agencies will receive one additional distribution of residual property tax revenues in 2012-13. Specifically, in July 2012, the budget package requires county auditors to recalculate each former RDA's 2011-12 residual property tax revenues using a methodology defined by the Department of Finance (DOF). If the resulting sum is larger than the amount the auditor calculated in 2011-12, the former RDA's successor agency must return any excess property tax revenues allocated to it. The county auditor, in turn, distributes these returned funds to other local agencies.

- ***Liquid Assets ($1.5 Billion).*** The budget package assumes that local agencies will receive distributions of cash and other liquid assets of the former RDAs as shown in Figure 22. These funds are distributed to local agencies in a manner similar to existing property tax allocation laws.

Sanctions and Incentives. The budget package establishes a series of sanctions and incentives to encourage successor agency cooperation with redevelopment dissolution laws. For example, successor agencies that do not transfer funds to their county auditors as required in July 2012 may be subject to (1) penalties of 10 percent of the amounts owed and (2) having their sales or property tax revenues reduced until the amounts owed are repaid. Conversely, successor agencies that comply with the state's redevelopment dissolution requirements may earn a "finding of completion." Successor agencies with these findings have greater authority to retain real property assets, spend unspent bond proceeds, and pay loans made between the former RDA and the city.

Backfill if Redevelopment Revenues Come Up Short. While the state automatically backfills K-12 districts if local property taxes fall short of budget assumptions, there is no similar requirement for community college districts or K-12 special education. The budget package specifies that, in 2011-12 and 2012-13, the state will use General Fund resources to backfill community colleges and K-12 special education programs if the sums anticipated from redevelopment do not meet expectations.

Senate Bill 1030 Vetoed. Senate Bill 1030 (Committee on Budget)—passed by the Legislature in late August 2012—sought to eliminate a provision in the June budget package that would have prevented some erosion of General Fund savings related to the dissolution of RDAs. Specifically, under the June budget package, some property taxes—that otherwise would have been allocated to non-education local governments in a manner that would not result in state

General Fund savings—are used to reimburse cities and counties for their vehicle license fee swap and triple flip revenue losses. (Such losses result from these prior state actions that reduced certain local revenues.) The elimination of this provision in SB 1030 would have had the indirect effect of shifting some K-14 district property taxes to cities and counties and requiring the state to backfill these K-14 district revenue losses with increased state aid. Citing "unclear" potential costs of the bill, the Governor vetoed SB 1030 on September 29, 2012.

Employee Compensation

Reduction in Employee Compensation. The budget assumes that the state will reduce its General Fund employee compensation costs by $401.7 million. The Legislature authorized the administration to achieve these savings through (1) collective bargaining with the 21 bargaining units that represent the state's rank-and-file employees, (2) furloughs, and (3) existing administrative authority over the compensation of state employees who are excluded from the collective bargaining process (managers and supervisors). As described below, the administration used this authority to establish a Personal Leave Program (PLP) for most employees and impose a furlough on employees represented by two bargaining units. Beginning July 2012, the PLP and furloughs will reduce affected employees' pay by about 5 percent and give them eight hours of leave each month for 12 months.

- ***PLP.*** The administration negotiated addenda to existing memoranda of understanding (MOUs) for 19 bargaining units to establish a PLP. Many of the MOU addenda also require the state to (1) eliminate "non-mission critical" retired annuitants who are performing work that could be performed by union members, (2) suspend hiring retired annuitants during the 12 months of PLP, and (3) establish labor-management committees to study personal services contracts and current state employee compensation levels. Using its existing authority, the administration extended the PLP to all excluded employees.
- ***Furloughs.*** The administration was not able to negotiate pay reductions for two bargaining units (Bargaining Units 9 [Professional Engineers] and 13 [Stationary Engineers]). The administration is imposing a one-day-per-month furlough on employees represented by these two bargaining units.

Most MOUs Will Expire July 2013. All 21 bargaining units have active contracts for the 2012-13 fiscal year. The MOU addenda establishing PLP for Bargaining Units 5 (Highway Patrol) and 8 (Firefighters) extended the expiration dates of these bargaining units' MOUs to July 2018 and July 2017, respectively. The MOUs for the remaining 19 bargaining units will expire in July 2013.

Rising Health Care Costs. The California Public Employees' Retirement System (CalPERS) manages the health care benefits that the state offers to state employees and retirees. The CalPERS board approves the premiums for these benefits each year. Based on current law and existing MOUs, the state pays a portion of these monthly premium costs for employees and retirees. These costs are a significant and growing component of employee compensation. The state's average cost for health care premiums for employees and retirees increased by 4.1 percent in 2012 and will increase by 9.6 percent in 2013.

Pension Legislation

Likely Future Savings Due to 2012 Pension Legislation. On August 31, 2012, the Legislature passed AB 340 (Furutani), the California Public Employees' Pension Reform Act of 2013 (PEPRA). (In addition, amendments to PEPRA were approved in AB 197 [Buchanan].) The Governor signed AB 340 and AB 197 (Chapters 296 and 297, Statutes of 2012) on September 12, 2012. This legislation reduces pension benefit formulas for most future public employees in the state and encourages later retirements for these employees, effective for most such individuals hired after January 1, 2013. The PEPRA also caps compensation considered in calculating pension benefits for most future higher-income public employees. The legislation describes a new statewide standard for a "50/50" split of employee and employer normal cost contributions to pension benefits. (Most state employees already pay over 50 percent of normal costs, under legislation passed in 2010 and 2011.) Some state and local employees will experience increases in their pension contributions—generally accompanied by matching decreases in employer contributions—over the next several years under PEPRA.

The legislation would have little or no effect on state finances in 2012-13. State savings are believed likely to begin in 2013-14. According to a preliminary actuarial analysis by CalPERS, for example, state savings of over $70 million are possible in 2013-14, due largely to required increases in certain state employees' pension contributions. These savings would be spread across the General Fund, special funds, and other state accounts. Pension cost savings related to CalPERS would increase in future years as more and more state employees are affected by PEPRA's reduced benefit levels. By 2020, for example, CalPERS estimated that state savings would grow to over $200 million per year. Representatives of both CalPERS and CalSTRS have indicated that additional, clarifying legislation will be required in 2013.

Substantial Future Costs to Fund Teachers' Retirement Benefits. Resolution Chapter 123, Statutes of 2012 (SCR 105, Negrete McLeod)—approved by both houses in late August 2012—declares legislative intent to adopt measures during the 2013-14 regular session to address the long-term funding needs of the California State Teachers' Retirement System (CalSTRS). In this resolution, the Legislature asks CalSTRS to submit at least three alternative proposals to address the system's funding shortfall by February 15, 2013. Prior actuarial valuations of CalSTRS have indicated that additional contributions—from some source or sources—of over $3 billion per year could be required to retire the system's unfunded liabilities over the next 30 years. Pension system officials have stated that they intend to submit proposed plans to the Legislature that include "gradual, incremental" increases in contributions.

FI$Cal

The Financial Information System for California (FI$Cal). Combined, the *2012-13 Governor's Budget* released in January and a March Finance Letter included a total of $89 million ($53.5 million General Fund) for the first year of development of the state's integrated financial information system known as FI$Cal. In a May Revision letter submitted to the Legislature, the Governor eliminated all General Fund in the budget year, deciding instead to accelerate special fund contributions and defer General Fund expenditures to future project years. The *2012-13 Budget Act* reflects these changes and includes $89 million in special funds to continue with FI$Cal development. If there are insufficient special funds for the project in the budget year, the budget allows DOF, upon Joint Legislative Budget Committee notification, to seek a General Fund augmentation.

The FI$Cal project concluded its procurement for a vendor to build the system and awarded the selected vendor a contract in June 2012. The total estimated cost for system development and deployment is $617 million all funds ($332 million General Fund). The estimated date of system implementation across all state departments is 2016-17.

National Mortgage Settlement Proceeds

As part of a nationwide settlement obtained against five major mortgage lenders, the state will receive $411 million in 2012-13. The budget specifies that $393 million is to be used to offset General Fund costs in 2011-12 and 2012-13. The remaining $18 million is budgeted for DOJ to provide homeownership counseling and monitor the mortgage lenders' compliance with the settlement agreement.

State-Mandated Local Programs (Non-Education)

The 2012-13 budget plan, after accounting for a $1.8 million veto, provides $48.8 million (General Fund) for mandates. The budget bill suspended 56 non-education mandates, including mandates related to absentee ballots, open meeting procedures, and animal shelters. The Governor's veto eliminated funding for two components of a multi-part mandate requiring local governments to provide crime statistics to DOJ. (The Legislature suspended all other components of this mandate in the budget bill.) When the Legislature suspends a mandate or the Governor vetoes its appropriation, (1) local governments are not required to implement its requirements and

(2) the state may postpone paying its accumulated bills. Budget trailer legislation (Chapter 32) specifies that, for all mandates suspended in the *2012-13 Budget Act*, the period of suspension will continue through 2014-15.

Similar to state budget actions in the recent years, the budget deferred payment for two labor relations mandates (the Peace Officer Procedural Bill of Rights and Local Government Employment Relations). The budget also deferred making payments towards retiring the state's accumulated non-education mandate debt (owed primarily to counties). This debt consists of approximately:

- $1 billion for claims submitted by local governments in or after 2004. Almost all of these claims are for mandates that the state has subsequently suspended, repealed, or substantially revised. State law does not specify a payment plan for retiring these mandate obligations.
- $700 million for claims submitted before 2004. State law specifies a 15-year payment plan for these mandates, but the state has not made a payment on this plan since 2006-07. The budget package (Chapter 32) specifies that the state will continue deferring these payments through 2014-15.

Debt Service on Bonds

The budget assumes $5.2 billion in General Fund debt-service payments on general obligation bonds and lease-revenue bonds, an increase of $35 million (less than 1 percent) from the 2011-12 spending level. General Fund spending on infrastructure bond debt service remained relatively flat partly because the Treasurer's Office structured the payment schedules for recently sold bonds to avoid large payments in 2012-13 in order to accommodate the Proposition 1A (2004) payment ($1.9 billion) due in June 2013. Additionally, the budget plan offsets some General Fund debt-service costs for housing bonds ($106 million in 2011-12 and $92 million in 2012-13) by using proceeds from the state's settlement with five major banks related to their foreclosure practices. As in previous years, the budget plan also uses weight fees to offset most of the General Fund debt-service costs for transportation bonds. The budget plan assumes $5.9 billion of general obligation bond sales in 2012-13.

Labor Programs

Disability Insurance Fund Loan. California's Unemployment Insurance (UI) fund has been insolvent since 2009, requiring the state to borrow from the federal government to continue payment of UI benefits. California's outstanding federal loan is about $9 billion. The state is required to make annual interest payments on this federal loan. These interest costs total $313 million in 2012-13. The budget authorizes this interest payment from the General Fund. To offset this cost, the budget provides a loan of a like amount from the Disability Insurance Fund to the General Fund.

Appendix

2012-13 Budget and Budget-Related Legislation

Bill Number	Chapter[a]	Subject
AB 1464[a]	21	*2012-13 Budget Act*
AB 1465	22	Transportation
AB 1467	23	Health
AB 1470	24	Transition to Department of State Hospitals
AB 1472	25	Developmental services
AB 1484	26	Implementation of redevelopment agency dissolution
AB 1485	27	Augmentations to the *2011-12 Budget Act*
AB 1494	28	Transition from Healthy Families Program to Medi-Cal
AB 1497	29	Amendments to the *2012-13 Budget Act*
AB 1499	30	Order of measures appearing on statewide ballots
AB 1502	31	Higher education
SB 81	2	*2011-12 Budget Act*: Home-to-School Transportation
SB 95	1	Cash management
SB 1006	32	State government
SB 1008	33	Medi-Cal Coordinated Care Initiative
SB 1009	34	Mental health realignment
SB 1013	35	Child welfare services realignment
SB 1014	36	Alcohol and drug programs realignment
SB 1015	37	Tax enforcement
SB 1016	38	Education
SB 1018	39	Resources and environmental protection
SB 1020	40	Public safety realignment—account structure
SB 1021	41	Public safety
SB 1022	42	Correctional facilities
SB 1023	43	Public safety realignment
SB 1029	152	High-speed rail
SB 1033	44	Cash management (create investment account for local agencies)
SB 1036	45	In-Home Supportive Services changes
SB 1038	46	State government
SB 1041	47	Human services
August Budget-Related Legislation		
AB 1468	438	Health—amendments
AB 1471	439	Human services—amendments
AB 1477	630	Amendments to the *2012-13 Budget Act*
AB 1478[a]	530	State parks
AB 1481	342	Public safety—amendments
AB 1487	343	Special funds reporting and accounting
AB 1488	440	State hospitals—amendments
AB 1489	631	Nursing home quality assurance fee
AB 1492	289	Timber harvest plans and lumber tax
AB 1496	717	2011 Realignment—amendments
SB 71[a]	728	Boards, commisions, and reports
SB 1028	575	Education—amendments

[a] AB 1464 and AB 1478 authored by Assembly Member Blumenfield. SB 71 authored by Senator Leno. All other budget-related legislation was introduced by the Budget Committee in either the Assembly or the Senate.

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