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Chapter 1

Key Features of the 2009-10 Budget Package

Budget Overview

Total State and Federal Funds Spending

The 2009-10 state spending plan was enacted into law on February 20, 2009, and substantial amendments to that plan were enacted on July 28, 2009. Both of these packages included various amendments to the 2008-09 spending plan (originally enacted in September 2008) in order to benefit the state's overall financial condition.

General and Special Fund Spending Down 15 Percent From Two-Years Ago. After considering both the February and July budget packages (including the Governor's line-item vetoes), the 2009-10 state spending plan includes total state budget expenditures of $110 billion from the General Fund and special funds, as shown in Figure 1. This consists of $85 billion from the General Fund and $25 billion from special funds. Spending from these funds in 2009-10 will be $20 billion—15 percent—less than it was in 2007-08. In addition, the budget assumes spending from bond funds of nearly $10 billion as the state continues to allocate moneys from the $43 billion bond package approved at the November 2006 election. Figure 2 (see next page) shows General Fund spending in 2007-08, 2008-09, and 2009-10 by policy area.

Figure 1

Total State and Federal Funds Expenditures

(Dollars in Millions)

Fund Type	Actual 2007-08	Estimated 2008-09	Enacted 2009-10	Change From 2008-09	
				Amount	Percent
General Fund	$103,000	$91,547	$84,583	-$6,964	-7.6%
Special funds	26,674	26,530	25,123	-1,407	-5.3
Budget Totals	**$129,659**	**$118,077**	**$109,706**	**-$8,371**	**-7.1%**
Selected bond funds	$8,405	$14,158	$9,539	-$4,619	-32.6%
Federal funds	$56,211	$76,629	$93,636	$17,007	22.2%

Big Increase in Stimulus Funds From Federal Government. While state expenditures decline in 2009-10, federal funds spending will increase dramatically, as shown in Figure 1. Federal stimulus funding provided by the American Recovery and Reinvestment Act (ARRA) is largely responsible for the increase in spending from federal funds—from $56 billion in 2007-08 to $77 billion in 2008-09 and an estimated $94 billion in 2009-10. (The President signed ARRA into law on February 17, 2009, as the Legislature and the Governor concluded consideration of the February state budget package.)

Figure 2

General Fund Spending by Major Program Area

(In Millions)

	Actual 2007-08	Estimated 2008-09	Enacted 2009-10
K-12 Education	$39,825	$32,356	$33,745
Higher Education	11,823	10,138	10,495
Health	19,906	18,794	16,077
Social Services	9,432	10,009	8,876
Criminal Justice	13,059	12,778	9,032
All other	8,954	7,472	6,358
Totals	**$103,000**	**$91,547**	**$84,583**

The Condition of the General Fund

Figure 3 summarizes the estimated General Fund condition for 2007-08 through 2009-10.

2008-09: Large Revenue Drops and a Year-End Deficit. At the time the Governor signed the original *2008-09 Budget Act* on September 23, 2008, General Fund revenues and transfers in 2008-09 were expected to total $102 billion—just slightly less than the total recorded in 2007-08. Despite over $1 billion of 2008-09 tax increases enacted as part of the February 2009 budget package, the recession took a massive toll on state revenues. As shown in Figure 3, only $84 billion of General Fund revenues and transfers were recorded during 2008-09—18 percent less than estimated in September 2008. In the February and July budget packages, the Legislature and the Governor took action to reduce spending in response to the revenue trend. Because of these actions, 2008-09 General Fund spending will be over 11 percent less than the total estimated when the 2008-09 budget was first passed in September 2008.

Because the Legislature did not reduce 2008-09 spending as much as the decline in revenues that materialized during the fiscal year, the state ended 2008-09 with a significant deficit—the largest year-end shortfall in the state's reserve ever recorded. As shown in Figure 3, the state's General Fund reserve had a negative balance of about $4.5 billion as of June 30, 2009. Despite spending more than it took in, the state continued operations through a variety of cash management measures, as discussed in the box on page 5.

2009-10: Large Operating Surplus Projected in Order to Rebuild a Reserve. The budget plan projects revenues and transfers of about $90 billion and expenditures of $85 billion in 2009-10. The resulting $5 billion operating surplus is necessary for the state to address the $4.5 billion carry-in deficit discussed above and rebuild a small $500 million reserve by June 30, 2010. Due in large part to the tax increases enacted as part of the February budget package, revenues and transfers are expected to grow from $84 billion in 2008-09 to $90 billion in 2009-10—an increase of 6.5 percent. Budgeted expenditures decline from $92 billion to $85 billion—a drop of 7.6 percent. As described later in this report, budgeted revenues and expenditures in 2008-09 and 2009-10 include a variety of one-time and temporary measures—such as federal ARRA funds which reduce General Fund expenditures—that make multiyear budget comparisons unusually difficult.

Figure 3

General Fund Condition
As of the July 2009 Budget Revisions

(Dollars in Millions)

			2009-10	
	2007-08	2008-09	Amount	Percent Change
Prior-year fund balance	$4,549	$4,071	-$3,379	
Revenues and transfers	102,522	84,097	89,541	6.5%
Total resources available	$107,071	$88,168	$86,162	
Expenditures	$103,000	$91,547	$84,583	-7.6%
Ending fund balance	$4,071	-$3,379	$1,579	
Encumbrances	1,079	1,079	1,079	
Reserve	**$2,992**	**-$4,458**	**$500**	
Budget Stabilization Account	—	—	—	
Special Fund for Economic Uncertainties	$2,992	-$4,458	$500	

Solutions Adopted During the Budget Process

Figure 4 (see next page) shows the budget solutions adopted during the 2009-10 budget process. As described above, these solutions affected both the 2008-09 and 2009-10 state budgets. Of the roughly $60 billion of General Fund budget solutions adopted by the Legislature, about $15 billion (including $10 billion of spending measures and over $1 billion of new tax revenues) affected the 2008-09 budget, and $45 billion (including $22 billion

Figure 4

General Fund Solutions Enacted During 2009-10 Budget Process

(In Billions, 2008-09 and 2009-10 Combined)

	February Budget Package[a]	July Budget Package	Totals
Spending-Related Solutions			
Reduce Proposition 98 spending to the minimum guaranteed funding level	$8.4	$6.1	$14.5
Reduce health and social services spending	1.7	3.4	5.0
Furlough state workers, delay June 2010 payroll by one day, and reduce other employee costs	1.2	1.8	3.0
Reduce higher education spending[b]	0.9	2.0	2.9
Redirect local redevelopment funds to offset state spending	—	1.7	1.7
Redirect transportation funds	0.7	0.9	1.6
Reduce corrections and rehabilitation spending	0.6	0.8	1.4
Reduce other spending and other spending-related measures	1.1	1.4	2.6
Subtotals	($14.5)	($18.0)	($32.5)
Temporary Tax Increases			
Increase sales tax by 1 cent through end of 2010-11	$5.8	—	$5.8
Increase personal income tax (PIT) rates by 0.25 percentage point through tax year 2010	3.7	—	3.7
Increase vehicle license fee by 0.5 percent through end of 2010-11	2.0	—	2.0
Reduce PIT dependent credit through tax year 2010	1.4	—	1.4
Create new tax credits	-0.4	—	-0.4
Subtotals	($12.5)	(—)	($12.5)
One-Time Revenue Measures and Transfers to the General Fund			
Increase schedules for payroll withholding by 10 percent	—	$1.7	$1.7
Assume that parts of State Compensation Insurance Fund can be sold	—	1.0	1.0
Accelerate receipts of PIT and corporation tax estimated payments	—	0.6	0.6
Increase other revenue receipts or transfers in 2009-10	—	0.2	0.2
Subtotals	(—)	($3.5)	($3.5)
Federal Stimulus Funds	$8.5	—[d]	$8.5
Borrowing			
Suspend Proposition 1A to borrow local government property taxes	—	$1.9	$1.9
Borrow from various special fund accounts	$0.3	0.2	0.5
Subtotals	($0.3)	($2.2)	($2.5)
Total Solutions	**$35.9**	**$23.7[c]**	**$59.5**

[a] Amounts listed as scored at the time of enactment of the February package. Actual solution totals may have changed subsequently. These changes, including lower revenue estimates, generally were incorporated into estimates related to the July package.

[b] Not including Proposition 98 spending solutions related to community colleges.

[c] In addition to the $23.7 billion of solutions listed, the administration's scoring of the July package reflected as solutions (1) a reduction in the targeted reserve by $418 million compared to the legislative leaders' prior budget agreement and (2) $118 million of reduced 2008-09 spending unrelated to the budget package.

[d] A portion of the Proposition 98 and higher education solutions above will be offset by the availability of federal stimulus funds.

Cash Management

Cash Management Measures Included in Both Budget Packages. Throughout the 2009-10 budget process, the state's budget problems and disruptions in the worldwide credit markets contributed to serious problems with California's state government cash flows—that is, the state's ability to make payments on time. In response, the Legislature included cash flow management measures in both the February and July budget packages. The Legislature chose to delay billions of dollars in payments (largely for K-14 education) to later within the 2009-10 fiscal year. In addition, the February budget package added about $3 billion in borrowable special funds—internal state resources available to bridge seasonal lows in the General Fund's cash flow. Moreover, the budgetary changes in the two packages also benefitted the state's ability to make its scheduled payments on time.

Controller Delayed Payments in February 2009 and Issued IOUs in July and August 2009. The February and July budget packages were not enacted early enough to prevent the Controller from: (1) delaying over $3 billion of scheduled payments (mainly tax refunds) in February 2009 and (2) issuing 449,000 registered warrants (also known as IOUs) for a total of $2.6 billion of payments in July and August 2009. The February 2009 delayed payments generally were paid in March 2009, and the IOUs were able to be redeemed by recipients beginning on September 4, 2009. This was only the second time since the Depression that the state issued IOUs for some of its budgeted payments. In effect, the IOUs forced recipients (such as state vendors and local governments) to provide the state with a loan involuntarily. The IOUs were redeemable with interest, paid at a 3.75 percent annual rate. "Priority payments"—including school, payroll, and debt service payments—were not subject to IOUs.

About $9 Billion of Cash-Flow Borrowing Projected in 2009-10. As the Legislature began consideration of the Governor's May budget proposals, officials warned lawmakers that, absent corrective action by the Legislature, the state might need to seek a 2009-10 cash-flow borrowing in the unprecedented (and unlikely) amount of over $23 billion in order to pay all of its bills on time throughout the fiscal year. As a result of the July budget package, that amount was whittled down to about $10 billion, according to estimates prepared by the administration in August 2009. The administration also sought and received legislative approval for an additional $1.7 billion of delays in payments now scheduled in early 2010 (principally for higher education and in September budget legislation). The administration estimates these September actions will reduce the state's 2009-10 revenue anticipation note borrowing requirements to about $9 billion.

of spending measures and about $11 billion from increased taxes) affected the 2009-10 budget.

Spending-Related Solutions. About $32.5 billion of the solutions affected state spending. These measures will result in service reductions across state government and many parts of local government as well. The solutions include:

- ***Reduced Proposition 98 Spending for K-14 Education.*** By far, the largest single group of solutions adopted during the budget process—totaling $14.5 billion—brought Proposition 98 spending for K-14 education down to its minimum guaranteed funding level under the State Constitution in both 2008-09 and 2009-10. The reductions are offset by school districts' receipt of $6 billion in federal ARRA funds in 2008-09 and 2009-10. In addition, requirements attached to many categorical funding programs were relaxed to give districts increased program and financial flexibility.
- ***Other Budgeted Solutions.*** In addition to budget solutions affecting Proposition 98 expenditures, the 2009-10 spending plan includes solutions affecting health and social services spending ($5 billion), state employee compensation ($3 billion), appropriations to the university systems ($2.9 billion), and virtually every other category of General Fund spending. (More details of these actions are provided in Chapter 3.)

Temporary Tax Increases. In the February budget package, the Legislature enacted several temporary tax increases, as well as some new tax credits. In 2008-09 and 2009-10 combined, these tax changes were estimated in February to increase General Fund revenues by a net amount of $12.5 billion. (These are also described in more detail in Chapter 2.)

One-Time Revenue Measures and Transfers to the General Fund. In addition to the tax increases in the February budget package, the Legislature and the Governor agreed to various additional revenue measures—mainly one-time in their benefit to the General Fund—in the July budget package. These measures total about $3.5 billion in 2009-10. (These are described in more detail in Chapter 2.)

Federal Stimulus Funds. The February budget package took account of expected funds resulting from ARRA that could offset General Fund expenditures in 2008-09 and 2009-10. These federal stimulus funds—described in more detail in Chapter 3—were budgeted at the time of the February budget package to total about $8.5 billion. Most of these funds will not be available to help balance the state budget after 2009-10 as the ARRA funds are one-time in nature.

Borrowing. The budget package includes about $2.5 billion of borrowing to help return the 2008-09 and 2009-10 state budgets to balance. The largest single provision consists of $1.9 billion to be borrowed from city, county, and special district property taxes, which will be used to offset state General Fund spending for education and other programs. The $1.9 billion loan is authorized through the Legislature's suspension of Proposition 1A (2004).

Evolution of the Budget

The 2009-10 budget process was highly unusual. Because 2008-09 revenues were severely affected by the recession, lawmakers and the Governor worked to address both 2008-09 and 2009-10 annual budget deficits simultaneously from November 2008 through July 2009.

November 2008 Special Session

On November 6, 2008, just two days after the general election, the Governor called a special session of the Legislature to deal with major economic and budget developments that had occurred in the six weeks since he and the Legislature agreed to terms of the 2008-09 budget.

A Huge Deterioration in Revenue and Economic Forecasts. In September 2008, when the Governor signed the *2008-09 Budget Act*, the state had a projected reserve of $1.7 billion at the end of 2008-09. By the time of the Governor's November 2008 special session proclamation, the administration reported that it expected revenues for 2008-09 to fall short of original projections by $11 billion. In total, it estimated the state would end 2008-09 with a $9.5 billion shortfall if no corrective actions were taken. In addition, the administration adjusted its previous projection of 2009-10 state revenues downward by $13 billion and said the state needed to adopt about $22.5 billion in budget solutions for the two fiscal years combined in order to keep the General Fund in the black.

Governor's November 2008 Proposals. Total budget solutions proposed in the Governor's November 2008 package equaled $24.9 billion over 2008-09 and 2009-10 combined. The majority of the solutions over the two-year period—totaling an estimated $14 billion—consisted of tax increases. Major components of the package included:

- A 1.5 cent increase in the sales and use tax for three years.
- Expansions of the sales and use tax (SUT) to various services.
- Imposition of an oil severance tax.
- A $2.5 billion midyear reduction in 2008-09 Proposition 98 spending related to the large drop in projected General Fund revenues.
- Reductions in Supplemental Security Income/State Supplementary Payment grants.

Legislative Session Ended Without a Budget Agreement. The 2007-08 biennial legislative session (including the November special session) came to an end on November 30. No revised budget agreement was reached by that date.

December 2008 Special Sessions

New Special Session Called as 2009-10 Legislature Begins Its Work. On December 1, 2008, the first day of the 2009-10 Legislature, the Governor declared a fiscal emergency pursuant to his powers under Proposition 58 (2004) and called a special legislative session. The Governor reiterated his estimate of a 2008-09 revenue shortfall of about $11 billion and noted our office's estimate during November 2008 that the budget problem over the two-year period of 2008-09 and 2009-10 could total $28 billion. The Governor continued to advance the major elements of his November 2008 special session proposals.

Cash Situation Becomes Major Concern During December 2008. During December 2008, state finances continued their steep decline. Due largely to the mounting declines in revenues, the Pooled Money Investment Board voted on December 17, 2008, to cease advancing money to about 2,000 bond-funded projects. In the subsequent weeks, this would cause many such projects to grind to a halt. (That funding halt would continue for many projects until the state resumed general obligation bond sales and secured over $13 billion in financing from investors in March and April 2009.) On December 30, 2008, the State Controller announced that he would begin delaying many categories of state payments or issuing IOUs as early as February 1, 2009, due to the lack of sufficient state cash resources if the Legislature and the Governor did not reach agreement on returning the budget to balance. The Controller eventually took action to delay over $3 billion in scheduled state payments in February 2009, but the state did not issue IOUs at that time.

December Legislative Package Was Vetoed by the Governor. On December 18, 2008, the Legislature passed a budget package addressing a portion of the state's then-identified budget shortfall—similar in scope to the Governor's special session proposals. Many spending reductions in the vetoed legislative package were similar to proposals made by the Governor, although in some cases—particularly in the health and social services areas—the administration's reductions at the time went further than the Legislature's. The Legislature also passed a personal income tax (PIT) surcharge, a change in income tax withholding, a 0.75 cent increase in the sales tax, and a conversion of the gas tax to a fee. The Legislature's December 2008 package was passed on a majority vote (as opposed to a two-thirds vote) on the premise that the package was not a net tax increase. The Governor immediately announced his intention to veto the December 2008 legislative package, and he did so formally on January 6, 2009.

Another Special Session Called. Following the Legislature's actions described above, the Governor used his Proposition 58 authority to declare another fiscal emergency on December 19, 2008, and he called another special session. The Governor also directed his administration to develop a plan to go into effect in February 2009 to furlough state employees by two days per month in order to generate budgetary savings. (The furlough plan went into effect on February 1, 2009, following a Superior Court judge's rejection of a lawsuit challenging it.)

January 2009 Governor's Budget Proposals

Governor Released Outline of 2009-10 Budget Proposal Nearly Two Weeks Early. On December 31, 2008, the Governor released the outline of the administration's 2009-10 budget proposals nearly two weeks before the typical January 10 deadline. (Because the administration released the details of the proposal in the ensuing days, we refer to these as the Governor's January 2009 budget proposals.)

Huge Additional Budget Problems Forecast by the Administration. Updating fully its revenue and expenditure estimates, the administration estimated in its January 2009 package that the state would face a deficit of $39.6 billion at the end of 2009-10. Compared to its November 2008 estimate, the administration announced that it expected $7 billion less in revenue over 2008-09 and 2009-10 combined. In addition, the magnitude of the revenue drop, as well as the year-to-year change in revenues, affected the administration's calculation of the 2009-10 Proposition 98 minimum guarantee, making it about $3.5 billion higher than our office's November 2008 estimate.

Governor's Package of Proposed Budget Solutions Grows to $41.7 Billion. Generally, the Governor included his November 2008 special session proposals in his January 2009 budget proposals, but the value of several of these options was reduced to reflect the delay in enacting them. In total, his proposed $41.7 billion of budget solutions in 2008-09 and 2009-10 consisted of $17.5 billion of spending-related actions, $14.2 billion of revenue increases (primarily tax increases), and $10 billion of borrowing. The major new proposals included:

- A proposal to borrow $4.7 billion through issuance of revenue anticipation warrants (RAWs) that would be applied to eliminate the year-end 2008-09 General Fund deficit.
- A reduction in the value of the PIT dependent credit beginning in 2009.
- Deferring Proposition 98 costs in 2008-09 to 2009-10.
- Recognizing $5 billion of lottery securitization proceeds originally proposed for voter approval along with passage of the 2008-09 budget, as well as other budget solutions requiring voter approval.

February 2009 Budget Package

Earliest Budget Act Passage in Modern California History. On February 19, 2009, the Legislature approved the *2009-10 Budget Act*, amendments to the *2008-09 Budget Act*, and related legislation. The Governor signed the measures on February 20. The list of bills included in the February budget package can be found at the end of this chapter. As we discussed in our publication, *The Fiscal Outlook Under the February Budget Package*, the early passage of the 2009-10 budget was unprecedented.

Package Includes $41.7 Billion of Solutions. The February budget package included $41.7 billion of budget solutions to close an approximately $40 billion shortfall and build up a reserve that was then projected to be $2.1 billion by the end of 2009-10. (The $41.7 billion figure included about $6 billion of measures—principally included proceeds from the proposed lottery securitization—which were later rejected by voters and, therefore, are not listed in Figure 4.) The four main components of the package were:

- ***Spending Reductions.*** The package included about $15 billion of spending-related budget solutions, the largest of which involved K-12 education funding.
- ***Temporary Tax Increases.*** The package included about $12.5 billion of temporary tax increases, principally the result of increased rates for the SUT, the vehicle license fee, and the PIT. The tax increases were scheduled to remain in effect for about two years under the package. The budget package, however, specified that if voters approved Proposition 1A (a measure to make changes to state budget practices) at the May 19, 2009 special election, the tax increases would be extended for either one or two years.
- ***Borrowing.*** As described above, the February budget package assumed that voters would approve $5 billion of borrowing from future lottery profits, which required passage of Proposition 1C at the May 19, 2009, special election.
- ***Federal Stimulus Funds and the Federal Funds Trigger.*** The February budget package assumed receipt of $8.5 billion in federal funds from ARRA to help balance the budget. In addition, because the exact amount of funds the state would receive to offset General Fund expenditures was unknown at the time the February budget package was passed, legislation provided that if the Treasurer and the Director of Finance determined that more than $10 billion of ARRA funds would be available to offset General Fund spending through June 30, 2010, then $2.8 billion of spending reductions and tax increases in the budget package would not go into effect. This was known as the federal funds "trigger." (On March 27, 2009, the Treasurer and the Director of Finance determined that the state would receive less than $10 billion of ARRA funds to offset General Fund spending during the specified time period.)

Governor's May 14 Budget Proposals

Large New Budget Problem Identified. The Governor released his May Revision on May 14, identifying a new $15.5 billion budget problem. Over $12.5 billion of this problem related to projected drops in revenues related to the recession in 2008-09 and 2009-10. These declines affected all major taxes. In addition, various other changes contributed to an additional $3 billion of budgetary problems, including a $1.3 billion lower property tax forecast that affected state Proposition 98 obligations and a $1.1 billion increase in health and social services costs related to program caseloads.

Proposals Included $14.5 Billion of Solutions. The Governor's May 14 package included about $14.5 billion of budget solutions, assuming that voters approved Propositions 1A through 1E on May 19. The largest proposal was to issue $6 billion of RAWs and apply them to reducing the 2008-09 year-end budget deficit. The Governor also proposed to reduce Proposition 98 funding by $1 billion in 2008-09 and $2 billion in 2009-10 and to reduce University of California (UC) and California State University (CSU) funding by a combined $1 billion in 2008-09. The proposals included an array of cuts in health and social services and the proposed $1 billion sale of State Compensation Insurance Fund. The Governor's package included a proposed $1.1 billion General Fund reserve at the end of 2009-10—down from the $2.1 billion assumed in the February budget package.

Contingency Proposals Included to Address Possible Failure of Special Election Measures. On May 14, the Governor also announced an additional $6.8 billion of contingency measures to address the possible failure of Propositions 1A through 1E on the May 19 ballot. The additional measures included $2.3 billion more of Proposition 98 funding reductions over 2008-09 and 2009-10, the suspension of a different ballot measure also designated as Proposition 1A (2004) to borrow about $2 billion of local government property taxes, additional cuts in the corrections budget, and various health and social services cuts, such as $302 million of savings from limiting In-Home Supportive Services program benefits. The Governor proposed increasing PIT withholding schedules by 10 percent to produce an estimated 2009-10 budgetary benefit of $1.7 billion.

May 19 Special Election and Its Aftermath

Voters Reject Propositions 1A Through 1E. Voters rejected Propositions 1A through 1E at the May 19, 2009 special election. In addition to the loss of $5 billion in lottery securitization funds, the defeat of the special election measures resulted in the loss of over $800 million of assumed 2009-10 budget solutions related to early childhood development and mental health funds.

Governor's May 26 Budget Proposal

Governor Changes Position on Budgetary Borrowing. On May 21, the Governor issued a statement indicating he had directed his administration to develop "additional options to cut state spending so that we can eliminate the need to seek borrowing in the form of a RAW." In making this decision, the Governor cited discussions with legislative leaders and federal officials (who announced on May 21 that additional extraordinary assistance to the state was unlikely), as well as the results of the May 19 special election.

Administration Proposes $5.5 Billion of Additional Budget Solutions. To make up for the loss of the $5.5 billion RAW from its budget proposal, the administration proposed an additional $5.5 billion of General Fund solutions on May 26, 2009. The May 26 proposals included the elimination of the California Work Opportunity and Responsibility to Kids (CalWORKs) and Healthy Families Programs (HFP); redirection of local gas tax funds; additional university budget cuts; elimination of new Cal Grant awards; deletion of General Fund support for state parks; and an array of health, corrections, employee compensation, and other spending actions.

Governor's May 29 Budget Proposal

Administration Shifts Position to Address Possible $3 Billion Revenue Overestimate. In our May 21 review of the Governor's original May Revision proposals, we described the administration's May revenue estimates as "reasonable" but noted that our revenue estimates for 2009-10 were about $3 billion less than the administration's. In response to our lower revenue estimates, on May 29 the administration released another round of budget solutions totaling $2.8 billion to address this possible additional revenue problem.

Proposed $2.8 Billion of Additional Actions Affects Various Areas. The Governor's May 29 proposals included a $680 million reduction in Proposition 98 funding to reflect the lower revenue estimates, $550 million from realigning state and county costs, and $470 million from a permanent 5 percent base salary reduction for all state employees.

Governor's May Proposals Included Cumulative Total of $24 Billion of Solutions. Essentially, the Governor's final set of May proposals included each of the proposals made on May 14, May 26, and May 29. Cumulatively, these proposals produced $3.1 billion of budgetary relief for 2008-09 and $20.8 billion of relief for 2009-10, for a total of $24 billion over the two fiscal years combined. On June 5, 2009, the administration estimated that its proposals would leave the state with a General Fund reserve of $4.5 billion at the end of 2009-10 excluding its acknowledged $3 billion potential overestimate of General Fund revenues. (In other words, if the administration had reduced its revenue estimate by $3 billion at that time, the estimated reserve under its package would have been $1.5 billion at the end of 2009-10.)

Conference Committee Package

Conference Committee Meets in May and June. A conference committee consisting of five Senators and five Assembly Members began public meetings on May 21, 2009, to consider the Governor's May Revision proposals. The conferees adopted a set of proposed budget revisions on June 16, 2009.

Conference Package Rejects Several Key Administration Proposals. The conference committee package rejected several administration proposals, including proposed eliminations of CalWORKs, HFP, and new Cal Grant awards. Borrowing from local governments through suspension of Proposition 1A (2004) was rejected. A 5 percent base salary cut for state employees was rejected, although the conference committee continued to score savings from a two-day monthly furlough of essentially all state employees and added a measure to delay the June 30, 2010 state payroll one day so about $1 billion in costs could be attributed to the 2010-11 fiscal year.

More Revenues, Less Expenditure Solutions Than Governor's May Proposals. The conference package included a larger revenue package—totaling $7.7 billion—than that in the Governor's May proposals, including $2 billion from requiring income tax withholding for payments to independent contractors, $1 billion from increasing cigarette taxes by $1.50 per pack, $800 million from instituting a 9.9 percent tax on each barrel of extracted oil, and $200 million from establishing a park access tax on California vehicles to preserve park funding. Included in the $15.5 billion of spending-related solutions proposed by the conference committee were cuts in virtually every area of state government, although—in many cases, such as in health and social services—these cuts were much less than proposed by the Governor. The conference committee package included $5.5 billion of reductions in Proposition 98 funding, as well as $2 billion in university cuts—generally mitigated by receipt of federal ARRA funds by the educational institutions. The conference committee package failed to pass either house of the Legislature.

Governor's July 1 Budget Proposal

Another Special Session Called, and Another Furlough Day Ordered. On July 1, 2009, the Governor declared another fiscal emergency pursuant to Proposition 58 and initiated another special session of the Legislature. In conjunction with the declaration, the Governor ordered state employees to take another furlough day—bringing the total number of furlough days to three per month for essentially all executive branch employees—and reduced their pay by an additional amount of approximately 5 percent. Effective July 1, most state offices were ordered closed on the first three Fridays of most months, known as "furlough Fridays." (Previously, state workers generally chose their own furlough days with managerial approval and state offices did not close.)

Another $4.9 Billion of Solutions Proposed. On July 1, the administration updated its revenue estimates to acknowledge officially that revenues would be $3 billion less than it projected on May 14. In addition, the administration stated that the Legislature's failure to enact several proposed solutions by the end of the 2008-09 fiscal year—principally related to K-12 and higher education—had eroded $5.3 billion of possible savings in the 2008-09 and 2009-10 budget. To offset this loss, the administration proposed the following new solutions:

- ***Suspending the Proposition 98 Minimum Funding Guarantee.*** The Governor proposed suspending the Proposition 98 minimum funding guarantee in 2009-10 to achieve $3 billion of savings.
- ***Retroactive Cuts to UC and CSU.*** The Governor proposed implementing his proposed 2008-09 cuts to UC and CSU on a retroactive basis totaling $1.4 billion.
- ***Scoring Savings From Third Furlough Day.*** The Governor implemented the third monthly furlough day under his executive power, as described by the Superior Court decision upholding his initial furlough order in February. In his July 1 budget proposal, he proposed scoring $425 million of savings in 2009-10 from this action.

Governor Lowers Reserve Target to $1.1 Billion. Under his July 1 budget proposals and revenue revisions, the Governor lowered his reserve target to $1.1 billion at the end of 2009-10.

July 2009 Budget Package

Legislature Passes Package, but Rejects Solutions Totaling Over $1 Billion. Following several days of debate, the Legislature adopted further revisions to both the 2008-09 and 2009-10 budgets, as well as accompanying legislation (listed in Figure 5), on July 24. Measures negotiated by the legislative leaders and the Governor included about $24 billion of solutions and an estimated $900 million reserve at the end of 2009-10. Two key measures that emerged from these negotiations did not receive the required number of votes to pass the Assembly. These measures were (1) a proposed loan of $1 billion of gasoline excise tax revenue from cities and counties to the General Fund in 2009-10 and 2010-11 for reimbursement of transportation-related bond payments and (2) authorization for a lease worth about $100 million in 2009-10 for oil drilling in federal waters near Santa Barbara. By approving the remaining measures, the Legislature adopted budget revisions that left the state with a slight projected deficit in the General Fund reserve at the end of 2009-10.

Governor's Line-Item Vetoes and Subsequent Constitutional Challenges. On July 28, 2009, the Governor signed the July budget package and announced line-item vetoes to reduce budgeted General Fund spending by $489 million, principally in health and human services. In addition to the vetoes, the administration announced $118 million of reduced 2008-09 spending items, such as lower-than-expected interest payments from the General Fund. After considering these adjustments, the administration estimated the General Fund reserve at the end of 2009-10 would total $500 million, as shown in Figure 3. The Legislative Counsel subsequently opined that because the Legislature had structured most of these budget revisions as reductions to existing appropriations approved in February, they did not comprise an "item of appropriation" subject to the Governor's line-item veto power under the

State Constitution. Subsequently, the President pro Tempore of the Senate and others filed suit against the Governor challenging the constitutionality of the line-item vetoes. Our report lists as savings the Governor's line-item vetoes (since this annual report usually is based on estimates of the Department of Finance). We note, however, that spending would return to its higher levels if the vetoes are overturned by the courts.

Figure 5

2009-10 Budget and Budget-Related Legislation

Bill Number	Chapter	Author	Subject
February Budget Package			
SBX3 1	1	Ducheny	*2009-10 Budget Act*
SBX3 2	2	Ducheny	Changes to *2008-09 Budget Act*
SBX3 4	12	Ducheny	Education
SBX3 6	13	Ducheny	Human services
SBX3 7	14	Ducheny	Transportation
SBX3 8	4	Ducheny	General government
SBX3 10	15	Ducheny	Proposition 1E
SBX3 14	16	Ducheny	Prison facilities
SBX3 15	17	Calderon	Tax credits and sales factor
SBX3 19	7	Ducheny	Elections
SBX3 20	3	Maldonado	State Controller
SBX2 3	1	Florez	Farm equipment and air quality
SBX2 4	2	Cogdill	Design-build and public private partnerships
SBX2 7	4	Corbett	Residential foreclosures
SBX2 9	7	Padilla	Prevailing wage
SBX2 10	8	Oropeza	Vehicle license fee (VLF) and rental cars
SBX2 11	9	Steinberg	Judicial employment benefits
SBX2 12	10	Steinberg	Court facilities financing
SBX2 15	11	Ashburn	New home purchase credit
SBX2 16	12	Ashburn	Horse racing
SB 6	1	Maldonado	Open primaries statutory changes
SCA 4	2	Maldonado	Open primaries proposition
SCA 8	3	Maldonado	Proposition 1F
ABX3 3	18	Evans	VLF, income tax, and sales tax increases
ABX3 5	20	Evans	Health
ABX3 11	6	Evans	Special election
ABX3 12	8	Evans	State lottery
ABX3 13	9	Evans	Cash management
ABX3 15	10	Krekorian	Tax credits and sales factor
ABX3 16	5	Evans	Federal fund trigger
ABX3 17	11	Evans	Proposition 1D
ACAX3 1	1	Niello	Proposition 1A
ACAX3 2	2	Bass	Proposition 1B
ABX2 5	3	Gaines	Alternative work week
ABX2 7	5	Lieu	Residential foreclosures
ABX2 8	6	Nestande	California Environmental Quality Act

Continued

September Budget-Related Legislation

Additional Measures Passed During Session's Final Days. During the closing days of its 2009 regular session, the Legislature passed several additional budget-related measures listed in Figure 5. These include several "cleanup" bills, as well as legislation affecting prisons, HFP, and schools.

Figure 5 *(continued)*

Bill Number	Chapter	Author	Subject
July Budget Package			
ABX4 1	1	Evans	Changes to *2009-10 Budget Act*
ABX4 2	2	Evans	Education
ABX4 3	3	Evans	Education finance
ABX4 4	4	Evans	Human services
ABX4 5	5	Evans	Health
ABX4 6	6	Evans	Medi-Cal
ABX4 7	7	Evans	Public social services: statewide enrollment process
ABX4 8	8	Evans	CalWORKs policy; IHSS fraud; COLA changes
ABX4 9	9	Evans	Developmental services
ABX4 10	10	Evans	Transportation
ABX4 11	11	Evans	Public resources
ABX4 12	12	Evans	State government
ABX4 14	13	Budget Committee	Property tax revenue allocations
ABX4 15	14	Gaines	Property tax revenue allocations; Proposition 1A payback
ABX4 17	15	Budget Committee	Revenue acceleration
ABX4 18	16	Budget Committee	Tax compliance
ABX4 19	17	Evans	In-home supportive services
ABX4 20	18	Strickland	Reorganizations and consolidations
ABX4 21	19	Evans	State contracts
ABX4 22	20	Evans	Asset management
ABX4 25	24	Evans	Surplus state funds
ABX4 26	21	Budget Committee	Community redevelopment fund shift
SBX4 13	22	Ducheny	Courts/public safety
SBX4 16	23	Ducheny	Cash deferrals
SB 63	21	Strickland	Integrated Waste Management Board
SB 90	22	Ducheny	Supplemental appropriations
September Budget-Related Legislation[a]			
SBX3 18	—	Ducheny	Corrections
ABX3 37	—	Evans	Cash deferrals
SB 72	—	Budget Committee	Payroll deferral and CalPERS health plans
SB 73	—	Budget Committee	Various fee provisions
SB 75	—	Budget Committee	Court fees and pensions/furloughs
SB 84	—	Steinberg	Quality Education Investment Act provisions
AB 1383	—	Jones	Medi-Cal: hospital payments and quality assurance fees
AB 1422	157	Bass	Healthy Families; Medi-Cal managed care plan tax

[a] These bills passed the Legislature but have not been acted upon by the Governor as of the date this report was prepared.

Chapter 2

Revenue Provisions

The 2009-10 budget package contains several major revenue-related changes, including more than $10 billion in temporary tax increases and $1 billion from the sale of state workers' compensation insurance business. Figure 1 displays the revenue assumptions underlying the *2009-10 Budget Act*, by source. General Fund revenues are estimated at $89.5 billion, an increase of $5.4 billion, or 6.5 percent, from the revised 2008-09 level. Increases in personal income tax (PIT), sales and use tax (SUT), and vehicle license fee (VLF) revenues in 2009-10 are the result of tax increases, as described below.

2009-10 Revenues. The 2009-10 estimates for the different revenue sources are based on the Department of Finance (DOF) economic forecast and its estimate of the impact of policy changes that were made as part of the budget package—with one exception. Figure 1 shows a "revenue forecast adjustment" downward of $3 billion in 2009-10. This adjustment reflects the assumption adopted in the budget that final General Fund revenues for the fiscal year will be $3 billion *lower* than estimated in the May Revision (based on the Legislative Analyst's Office's May forecast). Rather than alter its baseline

Figure 1

2009-10 Budget Act
General Fund Revenues

(Dollars in Millions)

	2007-08 Actual	2008-09 Revised	*2009-10 Budget Act*	Change From 2008-09	
				Amount	Percent
Personal income tax	$54,182	$43,824	$48,868	$5,044	11.5%
Sales and use tax	26,613	24,288	27,609	3,321	13.7
Corporation tax	11,849	9,682	8,799	-883	-9.1
Insurance tax	2,173	2,041	1,913	-128	-6.3
Vehicle license fee	—	360	1,657	1,297	360.3
Other tax	463	456	461	5	1.1
Other revenues	6,005	2,398	2,705	307	12.8
Transfers	1,237	1,048	529	-519	-49.5
Revenue forecast adjustment	—	—	-3,000	-3,000	—
Totals	**$102,522**	**$84,097**	**$89,541**	**$5,444**	**6.5%**

revenue forecast for individual tax sources, however, DOF includes the reduction as a net adjustment to revenues. If the $3 billion does not materialize (as assumed in the budget), total collections from PIT, SUT, and the other major revenue sources would be lower than shown in the figure.

2008-09 Revenues. The 2008-09 revenues in Figure 1 also differ from the department's May Revision estimates. Because budget discussions continued well into July, actual collections data from May and June affected the revenue picture. Receipts in 2008-09 were lower than estimated by DOF in the May Revision by about $1.9 billion, partially offset by $1.3 billion in increases to prior-year revenue amounts. Figure 1 reflects downward adjustments to DOF's 2008-09 revenue totals for PIT (about $1.5 billion), SUT ($324 million), and corporation taxes ($101 million) to account for the lower receipts in May and June 2009.

Tax Rate Increases

As noted above, the *2009-10 Budget Act* reflects more than $10 billion in estimated revenues resulting from four temporary tax increases. These changes were adopted as part of the February package, and two of the increases also affected 2008-09 revenues. The estimated revenue gains from these hikes are shown in Figure 2. As the figure illustrates, the temporary increases are expected to generate $10.3 billion in additional revenues in 2009-10. As a result of the continuing struggles of the state's economy, this estimate is about $1 billion lower than when the taxes were adopted in February. In 2010-11, the total revenue expected falls to $8.1 billion, as some of the tax increases expire halfway through the year. Below, we briefly describe the four increases.

One-Cent SUT Increase. The increase in the state's SUT became effective April 1, 2009—raising the state's General Fund rate to 6 percent and the average state and local rate to almost 9 percent. The higher rate will end on June 30, 2011. The budget assumes additional revenues of $4.4 billion in 2009–10 from this change.

Figure 2

Temporary Tax Increases Included in the 2009-10 Budget Package

(In Millions)

	2008-09	2009-10	2010-11
Sales and use tax: 1 cent increase	$1,126	$4,411	$4,637
Vehicle license fee: 0.5 percent increase	360	1,657	1,690
Personal income tax (PIT):			
• 0.25 percentage point increase in marginal rates	—	$2,833	$1,101
• Reduction of the PIT dependent credit	—	1,439	702
Totals	**$1,486**	**$10,340**	**$8,130**

The PIT Rate Increase. This change increases each of the seven PIT tax rates by one–quarter of 1 percent. For example, the top PIT rate in 2008 for most taxpayers was 9.3 percent. With this increase, the top rate will now be 9.55 percent. Similarly, the lowest rate will increase from 1 percent to 1.25 percent. The change in the rates is assumed to bring in $2.8 billion in additional revenues in 2009-10. This rate increase is effective for the 2009 and 2010 tax years.

The VLF Increase. The Legislature increased the VLF from 0.65 percent to 1.15 percent as part of the budget package. Of this increase, 0.15 percent is dedicated to local public safety programs, with the remainder deposited into the state's General Fund. The VLF is essentially a personal property tax on cars and trucks. This change became effective in May 2009, thereby generating a small amount of revenues in 2008-09. For 2009-10, the budget assumes this provision will raise revenues by $1.7 billion. The VLF rate increase ends on June 30, 2011.

Reduction in the Dependent Credit. This change reduces the dependent credit ($309 in 2008) to the same level as the personal credit ($99 in 2008). The budget assumes the reduction in the dependent credit will increase revenues by $1.4 billion in 2009–10. This reduction is in effect for the 2009 and 2010 tax years.

Other Revenue Changes

The 2009-10 budget package contains a number of other changes to the state's revenue base. Figure 3 (see next page) summarizes these revisions. In 2009-10, the net increase from the revisions is $3.1 billion. As the figure shows, most of the increases are one-time revenue accelerations or sales of assets that boost 2009-10 receipts, but provide no or relatively small long-term increases. In addition, the budget package includes several new credits that reduce revenues in 2009-10 and 2010-11. These revisions are discussed briefly below.

Personal Income Tax. The budget package includes two PIT revenue accelerations that generate almost $2 billion in 2009-10. These changes do not increase the amount of taxes owed. Instead, they seek to collect the existing tax liabilities earlier in the year. For instance, the budget increases suggested income tax withholding rates for individuals by 10 percent (effective November 2009). The budget assumes an additional $1.7 billion in 2009-10 from this change. As a result, unless individual taxpayers make manual adjustments to their withholding, they will see larger income tax deductions from their monthly paychecks. By paying more during the year, however, individuals will pay less in April 2010 to settle their 2009 taxes or they will receive larger refunds.

The package also assumes an additional $250 million in PIT revenues from a permanent revision in how individuals are required to calculate estimated payments. Prior to the 2010 income years, payments were required quarterly, generally in equal amounts. (The *2008-09 Budget Act* "front-loaded" the payments in 2009.) The budget package makes additional changes beginning with the 2010 income year, adopting a system of three payments each year, coming in April, June, and December. The April payment equals 40 percent of the expected tax liability, and the June and December payment equal 30 percent each.

Corporate Income Tax. Corporate tax payments also are affected by the change in estimated payments, resulting in an expected increase of $360 million in revenues in 2009-10. The budget package also includes several tax *reductions* for corporations. Three new credits were authorized:

- ***Employment Credit.*** The employment credit has the largest fiscal impact in 2009-10, reducing General Fund revenues by an estimated $264 million. The employment credit provides $3,000 for each net new hire in 2009 or 2010. The credit is designed to provide firms that are expanding an incentive to hire more workers. This credit (which also is available to small business through a PIT credit) is capped at $400 million over its life.
- ***Film and New Home Credits.*** The budget package also establishes two other temporary credits: a film credit that provides $500 million

Figure 3

Other Tax Changes, *2009-10 Budget Act*

(In Millions)

	2008-09	2009-10	2010-11
Personal Income Tax			
Increased withholding	—	$1,700	$98
Revised estimated payment schedule	—	250	25
Increased enforcement	—	29	29
Employment tax credit	—	-66	-10
Subtotals	—	($1,913)	($142)
Corporate Income Tax			
Revised estimated payment schedule	—	$360	$70
Employment tax credit	-$15	-264	-40
Optional single sales factor	—	—	-260
Other new credits	—	-11	-56
Subtotals	(-$15)	($85)	(-$286)
Sales tax—increased enforcement	—	$138	$243
Sale of state workers' compensation insurance business	—	$1,000	—
Totals	**-$15**	**$3,136**	**$99**

in personal or corporate tax credits for qualified activities beginning in 2011-12, and $100 million in credits of up to $10,000 for individuals who buy newly built homes by March 2010. These two credits are expected to reduce General Fund revenues by $11 million in 2009-10.

The Legislature also enacted legislation as part of the February package that permanently gives multistate or multinational corporations another option for determining the proportion of profits that is subject to California's corporate tax. Currently, companies must use a three–part formula that includes the proportion of total company sales, workforce, and property that is attributable to its California operations. The new legislation allows companies the option to use only sales to determine income attributable to California. This "single factor" option becomes effective for the 2011 tax year and, therefore, has no impact on revenues in 2008–09 or 2009–10. This change, however, is expected to reduce state revenues by $260 million in 2011–12, reaching about $1 billion annually over the long run.

Sale of State Compensation Insurance Fund (SCIF) Activities. The budget assumes $1 billion in one-time revenues in 2009-10 from the sale of a part of the state's SCIF business. The SCIF is a publicly run workers' compensation insurer that was created as the "insurer of last resort" for businesses in California. The state also contracts with SCIF to administer workers' compensation benefits for injured state employees. Legislation enacted with the budget authorizes the administration to sell certain areas of SCIF's business . The budget assumes such a sale would occur by the end of the 2009-10 fiscal year. (The Insurance Commissioner filed suit in August to block the sale. Among other things, he has claimed the sale of parts of SCIF could threaten its solvency.)

Chapter 3

Expenditure Highlights

Proposition 98

Proposition 98 funding constitutes about three-fourths of total funding for child care, preschool, K-12 education, and the California Community Colleges (CCC). In this section, we review major Proposition 98 decisions for 2008-09 and 2009-10, identify outstanding Proposition 98 funding obligations, and discuss the K-12 and child care budgets in more detail. In the "Higher Education" section, we discuss the community college budget in more detail.

Major Proposition 98 Budget Decisions

Below, we explain the effect of revenue changes on the Proposition 98 funding requirement for 2008-09 and 2009-10 and describe the February and July Proposition 98 packages. Figure 1 shows the various budget reductions made for 2008-09 and 2009-10.

February Proposition 98 Package Reflects Initial Drop in Revenues. Due to the ongoing deterioration of the state's economic situation, General Fund revenues for 2008-09 were significantly lower than estimated in the September *2008-09 Budget Act*. This revenue decline resulted in a decrease in the Proposition 98 funding requirement (commonly known as the "minimum guarantee"). In response to the drop in the guarantee, the state, as part of the February special session, reduced 2008-09 Proposition 98 spending to $50.7 billion, a decrease of $7.3 billion. The February reductions included a $2.4 billion cut to base programs, primarily from K-12 revenue limits and categorical programs. The remaining $5 billion in Proposition 98 reductions reflected funding swaps and deferrals, which were not intended to affect base programs in 2008-09. The February package also approved an additional $700 million reduction to 2009-10 spending. This reduction also was primarily from K-12 revenue limits and categorical programs.

July Package Reflects Continued Deterioration of Revenue Situation. The July package made additional Proposition 98 reductions to both 2008-09 and 2009-10. Due to a further decline in General Fund revenues, the Proposition 98 funding requirement further decreased for both years. As a result, the spending levels approved in February were $1.6 billion higher than the estimated minimum guarantee in 2008-09 and $4.5 billion higher than the 2009-10 estimate. The July package reduces Proposition 98 spending to the revised estimates of the minimum guarantee for both years. For 2008-09, the package made a downward accounting adjustment to recognize $1.6 billion in K-12 cash disbursements that had not yet been provided to districts at the time of enactment. The bulk of these funds (with the exception of $90 million) are paid to school districts in 2009-10 instead. The new 2009-10 reductions include $2.7 billion in base reductions and $1.8 billion in payment deferrals.

Various Factors Mitigate Significant Drop in Proposition 98. Figure 2 (see next page) shows the effect of all the reductions made to Proposition 98 spending in 2008-09 and 2009-10. As shown in the figure, the July package provides $49.1 billion in 2008-09 and $50.4 billion in 2009-10. By comparison, Proposition 98 spending in 2007-08 totaled $56.6 billion. Various factors help mitigate this significant drop in Proposition 98 spending. Most notably,

Figure 1

Proposition 98 Package

(In Millions)

2008-09	
September Spending Level	**$58,086**
February Package	
Reduce base K-12 revenue limits	-$944
Reduce most categorical programs across the board	-944
Rescind K-14 cost-of-living adjustment	-287
Other	-210
Defer certain K-14 payments	-3,244
Retire settle-up obligation	-1,101
Use special funds for Home-to-School Transportation	-619
February Spending Level	**$50,738**
July Package	
Revert unallocated categorical funds	-$1,606
Baseline adjustments	-30
Final Spending Level	**$49,102**
2009-10	
February Package	
Backfill February 2008-09 one-time solutions	$4,614
February baseline adjustments	253
February reductions	-702
July Package	
Backfill additional 2008-09 one-time solutions	$1,888
Reduce K-12 revenue limits	-3,953
Defer K-12 revenue limit payments	-1,679
Provide 2008-09 unallocated categorical funds	1,516
Other K-12 adjustments	290
Make various child care reductions	-102
Make various community college reductions	-813
July Spending Level	**$50,415**

California is to receive more than $6 billion in federal stimulus funds from the American Recovery and Reinvestment Act (ARRA) for K-14 education (discussed in more detail in the "K-12 Education" and "Higher Education" sections). In addition, the state allowed school districts access to more than $3 billion in previously restricted reserves—resulting in a like increase in some districts' general purpose funding. Lastly, the state also provided school districts and community colleges with substantially more discretion over previously restricted categorical funding, as well as loosened certain state program requirements. For example, the state allowed school districts to reduce the academic year up to five days. (These flexibility provisions are discussed in more detail below.)

Maintenance Factor

During 2008-09, a disagreement arose regarding the implementation of the "maintenance factor" provisions in Proposition 98. In years when state General Fund revenues grow relatively slowly, Proposition 98 typically allows the state to provide a lower level of funding than otherwise required. Though the state can spend at the lower funding level, it must keep track of the difference between the amount that otherwise would have been required and the actual funding provided. This difference is known as the maintenance factor. In future years, the state makes payments based upon a formula that is intended to accelerate funding until it reaches the level it otherwise would have been absent the earlier reduction. At the close of 2007-08, the state had an outstanding maintenance factor obligation of $1.4 billion.

2008-09 Scenario Leads to Uncertainty. When budget and economic data was updated as part of the February package, an unprecedented Proposi-

Figure 2

Proposition 98 Funding

(In Millions)

	2007-08 Final	2008-09 Revised	2009-10 Revised
K-12 Education			
General Fund	$37,752	$30,028	$31,194
Local property tax revenue	12,592	13,033	13,439
Subtotals	($50,344)	($43,062)	($44,634)
California Community Colleges			
General Fund	$4,142	$3,918	$3,722
Local property tax revenue	1,971	2,016	1,947
Subtotals	($6,112)	($5,934)	($5,669)
Other Agencies	$121	$106	$112
Totals, Proposition 98	**$56,577**	**$49,102**	**$50,415**

tion 98 scenario arose. Although the Proposition 98 minimum guarantee was clear, the maintenance factor obligation created in 2008-09 was unclear. Differing interpretations of the Constitution led to a disagreement whether maintenance factor was created in certain low-growth General Fund situations. Under one interpretation, a $9.3 billion maintenance factor obligation was believed owed (a $7.9 billion obligation created in 2008-09, plus the existing $1.4 billion obligation). Under a second interpretation, only the prior-year $1.4 billion obligation was owed, with no new obligation created in 2008-09.

July Package Resolves the Issue on a One-Time Basis. As part of the February budget, the Legislature and Governor agreed to resolve the issue on a one-time basis by placing Proposition 1B on the May 2009 ballot. Voters, however, rejected the measure. Similarly, the July budget package includes a statutory change that addresses the issue on a one-time basis. The July package establishes an $11.2 billion maintenance factor obligation as of the close of 2008-09 (the obligation increased as a result of additional Proposition 98 reductions in July). As with Proposition 1B, the July package does not address similar situations in the future.

"Other" Outstanding Funding Obligations

The state currently has several other outstanding Proposition 98-related funding obligations. Several of these obligations, highlighted in Figure 3, can be funded from within the annual Proposition 98 appropriation. These include "deferrals," unpaid mandate claims, and the revenue limit "deficit factor." At times, the state also can have K-14 obligations that are paid on top

Figure 3

Proposition 98-Funded Obligations Grow to $15 Billion[a]

(In Millions)

	2007-08	2008-09	2009-10
Deferrals			
K-12 education	$1,103	$4,007	$5,685
Community colleges	200	540	703
Subtotals	($1,303)	($4,547)	($6,388)
Mandates[b]			
K-12 education	$621	$808	$1,003
Community colleges	300	355	405
Subtotals	($921)	($1,163)	($1,408)
K-12 Revenue Limits	—	$2,978	$7,270
Totals	**$2,224**	**$8,687**	**$15,066**

[a] Reflects cumulative obligations at year end. These obligations are paid from within the Proposition 98 appropriation.

[b] Estimates based on existing mandate claims as well as actions taken by the Commission on State Mandates.

of the Proposition 98 appropriation using other state General Fund monies. Currently, the state has one such obligation relating to a K-14 program it created in 2006-07. These specific obligations are discussed in more detail below.

Deferrals to a Subsequent Fiscal Year. In 2001-02, the state achieved a budget solution by deferring $1.3 billion in K-14 education costs to the subsequent fiscal year. These deferrals resulted in districts receiving some state funds a few weeks later than normal (in early July rather than late June). To achieve additional budget solutions as part of this year's budget process, the state approved $3.2 billion in new deferrals of school district and community college payments for 2008-09 and $1.8 billion for 2009-10. As a result of all these actions, a total of $6.4 billion in Proposition 98 funds, 12 percent of funding for 2009-10, will not be provided until 2010-11.

Mandates. Since 2001-02, the state has not funded the annual ongoing costs of school and community college mandate claims. Essentially, the state requires schools and colleges to undertake certain activities each year without providing them immediate reimbursement. Despite a 2008 Superior Court decision questioning the constitutionality of delaying mandate reimbursements, the *2009-10 Budget Act* continues this practice. We estimate 2009-10 costs for K-14 mandates are about $245 million. (This figure, however, could easily double once several costly mandate claims finish the mandate determination process.) Coupled with the backlog of mandate claims from previous years, we estimate the state will end 2009-10 with outstanding K-14 mandate claims totaling $1.4 billion.

Revenue Limits. State law requires school districts to receive annual cost-of-living adjustments (COLA) to their revenue limits as well as certain categorical programs. Though the state suspended this statutory requirement, it created a deficit factor for K-12 revenue limits. The deficit factor is intended to track both the foregone COLA as well as base revenue limit reductions. In essence, the deficit factor creates a statutory commitment to use Proposition 98 funds at some point in the future to raise revenue limits to the level they would have been absent the 2008-09 and 2009-10 reductions. As shown in the figure, the base reductions and foregone revenue limit COLA total almost $7.3 billion in 2009-10—$7.1 billion for school districts (resulting in a deficit factor of 18.4 percent) and $140 million for county offices of education (resulting in a deficit factor of 18.6 percent).

Quality Education Investment Act (QEIA). The QEIA, established by Chapter 751, Statutes of 2006 (SB 1133, Torlakson), appropriated a total of roughly $2.8 billion over a seven-year period. The state provided $300 million in 2007-08 and was scheduled to provide $450 million ($402 million for K-12 education and $48 million for CCC) every year thereafter until the obligation was paid in full (through 2013-14). These payments were to be made outside of annual Proposition 98 spending. The July package required the 2009-10 QEIA payment to be made from within Proposition 98 spending. This resulted in districts with QEIA schools essentially shifting some revenue limit funding to the affected school sites to cover program costs. The July package also extended the QEIA payment schedule for an additional year (until 2014-15), thereby lengthening the life of the program. Senate Bill 84, (Steinberg) (Governor's action pending at time of publication) makes a further modification—essentially requiring districts to shift revenue limit funding to the affected school sites only upon determination by the Superintendent of Public Instruction and the Director of Finance that an equivalent amount of additional federal or state general purpose funds had been identified to backfill the loss. Regardless of whether these general purpose funds materialize, districts with QEIA schools will receive Proposition 98 funding to cover program costs, while also being encouraged to access federal school improvement funding.

"Settle-Up" Obligation Retired. In 2002-03 and 2003-04, the Proposition 98 constitutional funding requirement ended up being higher than the amount of Proposition 98 funding appropriated. As a result, the state incurred a settle-up obligation totaling $1.1 billion across the two years. As part of the February package, however, the state provided $1.1 billion to school districts in 2008-09 to retire the entire settle-up obligation.

K-12 Education

Major Budget Decisions

Figure 4 (see next page) displays all significant funding sources for K-12 education for 2007-08, 2008-09, and 2009-10. The figure shows that total K-12 funding in 2009-10 is $66.7 billion. This is a 2.6 percent decline from 2008-09 and a 6.2 percent decline from 2007-08. The decline in ongoing Proposition 98 funding is larger—11 percent from 2007-08. The significant reductions to state funding, however, are mitigated by various factors—including federal stimulus funding, funding swaps, deferred rather than eliminated payments, access to restricted reserves, categorical flexibility, and loosened state requirements, as discussed in more detail below.

July Package Includes Further 2008-09 K-12 Reductions. To further reduce spending to the 2008-09 minimum guarantee, the July package makes a $1.6 billion downward accounting adjustment to reflect K-12 cash disbursements not yet made to districts. (In turn, these reductions lower the 2009-10 guarantee.) Of these funds, $1.5 billion is subsequently paid to school districts in 2009-10.

Makes 2009-10 Reductions Mostly From K-12 Revenue Limits. In the February budget package, K-12 programmatic reductions for 2008-09 were split between revenue limits and categorical programs. As part of the July package, however, 2009-10 reductions were made primarily from revenue limits. Specifically, the July package reduces revenue limits across-the-board by $4 billion. Of this amount, $1.5 billion is reduced on a one-time basis to backfill the categorical reductions from 2008-09.

Significant Increase in K-12 Payment Deferrals. The state relied significantly on payment deferrals to achieve budget and cash solutions in 2008-09 and 2009-10. As shown in Figure 5, the 2009-10 budget includes $5.7 billion in *inter*-year deferrals for K-12 education. These are payment deferrals that are not paid until the next fiscal year, thereby achieving one-time Proposition 98 savings. The state also adopted $6 billion in *intra*-year deferrals—payment deferrals that are paid off within the fiscal year. These deferrals shift various payments to improve the state's cash situation in its cash-poor months, but they do not produce annual budget savings.

Federal Stimulus Funds for Education

Federal stimulus funding will help school districts mitigate the reductions and deferrals adopted in the February and July packages. In April 2009, the state received its first installment of federal stimulus funding as part of ARRA, which included over $2.6 billion in "stabilization" funding to support K-12 education (as well as $537 million for higher education). The stabilization funds are intended to help mitigate cuts in state funding. Sometime during 2009-10, the state is likely to receive the remainder of its ARRA stabilization funding (totaling $1.8 billion for all of education). In anticipation of this ad-

Figure 4

K-12 Education Funding[a]

(In Millions)

	2007-08 Final	2008-09 Revised	2009-10 Revised
Proposition 98			
State General Fund	$37,752	$30,028	$31,198
Local property tax revenue	12,592	13,033	13,439[b]
Subtotals, Proposition 98	($50,344)	($43,062)	($44,637)
Other General Fund			
Teacher retirement	$1,535	$1,044	$1,153
Bond payments	1,993	2,211	2,416
Other programs	1,522[c]	2,109[d]	280
State lottery funds	859	806	806
Federal funds (ongoing)	6,484	6,786	7,077
ARRA funds	—	3,788	2,280
Other[d]	8,432	8,694	8,074
Subtotals	($20,824)	($25,438)	($22,086)
Totals	**$71,168**	**$68,500**	**$66,723**

a Includes funding for child care and development programs as well as adult education.
b Includes $850 million in funds redirected from redevelopment agencies on a one-time basis.
c Includes spending for Quality Education Investment Act.
d Includes special funds, local debt service, and other local revenues.

ditional federal support, the *2009-10 Budget Act* provides ARRA stabilization spending authority of $600 million for K-12 education, and $130 million for CCC. (The division of funds among educational segments could change slightly as the state finalizes its second-round application. To allow the state to more easily make adjustments, the federal funds spending authority in the budget is greater than the amount of funding actually available. More detail on higher education funding is included in the "Higher Education" section.)

Additional Stimulus Funds for Low-Income Students and Students With Disabilities. The ARRA also provides additional stimulus funding for states to support educational programs serving low-income students and students with disabilities. In April 2009, California received authority for the first half of this funding—$540 million for low-income students and $613 million for students with disabilities. The *2009-10 Budget Act* includes additional spending authority for the other half of available funding. California likely will receive authority from the federal government for the remainder of this funding in the summer of 2009.

Figure 5

Deferrals of K-12 Education Payments

(In Millions)

Inter-Year Deferrals	
Deferrals Established Prior to 2008-09	$1,103
New Deferrals Enacted in February Budget Package (to begin in 2008-09)	
Increase size of existing K-12 June-to-July deferral	$334
Shift K-3 class size reduction payment from February to July	570
Shift some K-12 revenue limit and categorical payments from February to July	2,000
Subtotal	($2,904)
New Deferrals Enacted in July Budget Package (to begin in 2009-10)	$1,679
Total Inter-Year Deferrals	**$5,686**
Intra-Year Deferrals	
Deferrals Enacted in February Budget Package	
Shift some K-12 payments from July to October	$1,000
Shift some K-12 payments from August to October	1,500
Subtotal	($2,500)
New Deferrals Enacted in July Budget Package (to begin in 2009-10)[a]	
Shift some school district revenue limit payments from July to December	$1,000
Shift some school district revenue limit payments from August to October	1,500
Shift some school district revenue limit payments from November to January	1,000
Subtotal	($3,500)
Total Intra-Year Deferrals	**$6,000**

[a] The state also adopted a 5-5-9 payment distribution method, which aligns state payments more closely with local costs.

Greater Flexibility for the Next Several Years

In addition to the changes in spending, the February and July packages also made several significant policy changes to loosen restrictions and give school districts more discretion in making spending decisions. Among the larger changes, the state eliminated spending restrictions for a number of categorical programs, postponed the requirements that school districts purchase new textbooks, and allowed school districts to reduce the length of the school year. Figure 6 provides a comprehensive list of these changes.

Programmatic Per Pupil Funding Changes Moderately

"Programmatic" funding reflects the amount of resources school districts have available to spend each year after accounting for funding swaps, payment deferrals, and other funding sources (such as ARRA funds). When these adjustments are taken into account, the change in per-pupil funding from 2007-08 levels could range from an increase of roughly 3 percent to a decrease of roughly 3 percent.

Figure 6

K-12 Flexibility Provisions Included in 2008-09 and 2009-10 Budgets

2008-09 to 2012-13 (Unless Otherwise Noted)

Provision	Description
Flexibility in Use of Categorical Program Funding	Creates categorical "flex item" whereby districts can use funds from roughly 40 programs for any purpose.
Lesser Penalties for Exceeding K-3 Class Size Reduction Program Guidelines	Allows districts to exceed 20 students per K-3 classroom without losing as much funding as under previous penalties.
Reduced Requirement for Routine Maintenance Deposit	Lowers the percentage districts must set aside for maintenance of school buildings from 3 percent to 1 percent of expenditures. Districts with facilities in good repair are exempt from any set-aside requirement.
Elimination of Local Spending Requirement to Qualify for State Deferred Maintenance Match	Eliminates requirement that districts spend their own funds on deferred maintenance in order to qualify for state dollars.
Access to Categorical Fund Balances	Allows districts to spend leftover categorical funding from 2007-08 or prior years for any purpose (except in seven programs). (2008-09 and 2009-10 only.)
Postponement of Instructional Material Purchase Timeline	Postpones requirement that districts purchase new instructional material packages.
Reduced Instructional Time Requirements	Provides school districts option to reduce length of school year by as many as five days.
Sale of Surplus Property	Allows districts to use the proceeds of surplus property sales for any purpose if property was purchased entirely with local funds.

Child Care and Development

The July budget package includes nearly $3.1 billion for child care and development (CCD) in 2009-10. Of that total, nearly $2.6 billion is for CCD programs administered by the California Department of Education (CDE). Total CCD funding decreased by just over 3 percent compared to the revised 2008-09 level of spending.

Programmatic Reductions. Most of the year-to-year reduction can be attributed to policy changes in the California Work Opportunity and Responsibility to Kids (CalWORKs) program that are expected to reduce demand for Stage 1 child care in 2009-10. The July package also eliminates the Extended Day program (which serves school-age children from low-income families before and after school), effective August 31, 2009, to achieve $27 million in savings. The apportionments and number of children expected to be served in the remaining CCD programs were held virtually flat from 2008-09 levels.

Higher Education

The budget provides a total of $10.5 billion in General Fund support for higher education in 2009-10 (see Figure 7, next page). While this reflects an increase over the revised 2008-09 level of funding, it is about $1.3 billion (11 percent) *less* than the amount provided in 2007-08. Much of the decline in General Fund support is offset with one-time federal funding provided through ARRA. In addition, all three public segments will receive additional new funding as a result of student fee increases. When all major funding sources are considered, higher education funding for 2009-10 exceeds 2007-08 funding by $555 million, or 3.3 percent. (See Figure 8, next page.)

UC and CSU

Overall Funding. As shown in Figure 7, the 2009-10 budget provides University of California (UC) with $2.6 billion, and California State University (CSU)) with $2.3 billion, in General Fund support. These amounts reflect reductions of about 20 percent from 2007-08 levels. However, as shown in Figure 8, the two segments will receive increases of 5.8 percent and 7.4 percent, respectively, on a programmatic basis when other major funding such as ARRA funding and student fee revenue are considered. (The exact amount of federal ARRA funds had not been determined at the time the report was prepared.)

The figures reflect *2009-10 Budget Act* provisions reverting $1.5 billion in 2008-09 General Fund support from UC and CSU. About $64 million of this unallocated reduction originally took the form of cuts the Governor imposed through an executive order in fall 2008.

Student Fees. For 2009-10, UC and CSU have enacted fee increases of 9.3 percent and 32 percent, respectively. The enacted budget assumes these fee increases will provide additional revenue of $166 million for UC and $366 million for CSU (At the time this publication was prepared, the UC Regents were considering a further fee increase for 2009-10.) Because fee revenue is unrestricted, the fee increases effectively offset General Fund reductions.

Both segments plan to direct about a third of this new revenue to augment campus-based financial aid for their students.

Enrollment. The budget does not specify an expected level of student enrollment for UC and CSU, nor does it specify a "marginal cost" associated with enrolling additional students at the universities. In budget hearings, UC indicated that it expects to enroll about 2,300 fewer new freshmen, and about 500 more transfer students, in 2009-10 compared to 2008-09. The CSU indicated it intends to admit no students in spring 2010, thus trying

Figure 7

Higher Education Funding

(General Fund Dollars in Millions)

				Change From 2007-08	
	2007-08	2008-09	2009-10	Amount	Percent
University of California (UC)	$3,257	$2,420[a]	$2,636	-$621	-19.1%
California State University (CSU)	2,971	2,156[a]	2,338	-633	-21.3
California Community Colleges	4,170	3,948	3,736	-434	-10.4
Hastings College of the Law	11	10	8	-2	-22.2
Student Aid Commission	867	897	967[b]	101	11.6
California Postsecondary Education Commission	2	2	2	—	-4.1
State Library	49	47	44	-5	-10.6
Bond debt service	496	594	759	263	52.9
Totals	**$11,823**	**$10,074**	**$10,491**	**-$1,332**	**-11.3%**

[a] Reflects reductions made through Governor's executive order of $33.1 million for UC and $31.3 million for CSU.

[b] Reflects Governor's veto of $6.3 million from state operations.

Figure 8

Higher Education Programmatic Support[a]

(Dollars in Millions)

				Change From 2007-08	
	2007-08	2008-09	2009-10	Amount	Percent
University of California	$4,876	$4,449	$5,161	$285	5.8%
California State University	4,205	3,721	4,518	313	7.4
California Community Colleges (CCC)	6,693	6,791	6,504	-189	-2.8
Hastings College of the Law	37	43	45	8	21.4
Student Aid Commission	962	1,031	1,105	144	15.0
California Postsecondary Education Commission	2	2	2	—	-4.1
State Library	49	47	44	-5	-10.6
Totals	**$16,824**	**$16,083**	**$17,379**	**$555**	**3.3%**

[a] Includes General Fund, state lottery funds, federal stimulus funding, student fee revenues, and Student Loan Operating Fund. Does not reflect funding deferrals. Figures for CCC also reflect local property taxes counted toward Proposition 98.

to reduce overall enrollment by about 40,000 students. The budget directs the segments to report by March 15, 2010 on whether they met their 2009-10 enrollment goals.

Academic Preparation Programs. The Legislature rejected the Governor's proposal to eliminate funding for academic preparation (outreach) programs. Instead, the enacted budget contains language requiring the segments to limit any redirection of funding from these programs to an amount proportionate to their overall reduction in General Fund support.

California Community Colleges

The July 2009-10 budget package provides $3.7 billion in General Fund support for CCC. This is $434 million (10.4 percent) less than the 2007-08 level. However, some of this funding pays for costs incurred in different fiscal years. Also, CCC receives substantial funding from other sources, primarily local property taxes. When all funding sources are considered and counted toward the year in which costs are incurred, CCC's 2009-10 programmatic funding totals $6.5 billion, which is $189 million (2.8 percent) less than 2007-08, or $287 million (4.2 percent) less than 2008-09.

Proposition 98. Like K-12 education (but unlike the universities), CCC's General Fund support and local property tax revenue are subject to Proposition 98. For 2009-10, CCC receives $5.7 billion in Proposition 98 support, which is 11.2 percent of total state Proposition 98 spending. This reflects a reduction of $265 million (4.5 percent) from the revised 2008-09 level. In addition, the budget package establishes a maintenance factor obligation for CCC (as well as K-12) for payments in future years. Proposition 98 spending is discussed in more detail in the "Proposition 98" section of this chapter.

Deferrals. As shown in Figure 3, in 2008-09, the Legislature added $340 million to the existing $200 million in CCC funding deferrals. Thus, while community colleges incurred costs for certain programs in 2008-09, they did not actually receive these deferred state payments until early 2009-10. The budget package defers an additional $163 million from 2009-10 to 2010-11, thereby creating an ongoing deferral of $703 million annually.

No New Funding for Enrollment or Cost-of-Living Increases. The budget provides neither enrollment growth nor a COLA for CCC in 2009-10. This is the second consecutive year that community colleges have not received a COLA.

Base Apportionment Reductions. The budget reflects cuts totaling $140 million (about 2 percent) to Proposition 98 General Fund support for CCC apportionments (general-purpose monies). This includes an unallocated reduction of $130 million as well as $10 million in savings from the elimination of the California High School Exit Exam remediation program.

Local Property Tax Backfill. The budget includes a total of $63.3 million in General Fund support to partially compensate for an estimated $116.7 million drop in CCC's local property tax revenues in 2009-10 from earlier estimates.

This backfill is derived from two sources: (1) a redirection of $58.3 million in funds previously intended for enrollment growth, and (2) a $5 million reappropriation of unspent funds from prior years.

Student Fees. The budget package increased enrollment fees from $20 per unit to $26 per unit, which returned student fees back to their 2006 level. These higher fees are expected to generate $80 million in additional revenue for CCC, thereby mitigating the impact of reduced Proposition 98 support for apportionments. Lower- and middle-income students are largely shielded from the fee increase by CCC's fee waiver program and recently expanded federal tax credits.

Workload-Reduction Provision. The budget package includes a provision that permits community colleges to reduce the number of students they serve in 2009-10 in proportion to the net reduction in base apportionment funding. Another provision expresses the Legislature's intent that any resulting workload reductions be limited as much as possible to areas other than basic skills, workforce training, and transfer-level coursework.

Categorical Cuts and Flexibility. The budget package reduces Proposition 98 support for categorical programs by a total of $263 million compared with revised 2008-09 levels. The budget assumes that $130 million of this reduction will be backfilled by federal stimulus funding, for a net reduction of $133 million. In order to better accommodate these cuts, 12 of CCC's 21 categorical programs were moved to a "flex item" (see Figure 9). From 2009-10 though 2012-13, districts are permitted to transfer funds from categorical programs in the flex item to any other categorical spending purpose.

Figure 9

Budget Package Creates "Flex Item" for Many California Community College Categorical Programs

Programs Included In Flex Item	Programs Excluded From Flex Item
Academic Senate	Basic Skills Initiative
Apprenticeship	CalWORKs[a] Student Services
Campus Child Care Tax Bailout	Disabled Students Program
Career Technical Education Initiative	Extended Opportunity Programs and Services
Economic Development	Financial Aid Administration
Equal Employment Opportunity	Foster Care Education Program
Matriculation	Fund for Student Success
Part-Time Faculty Compensation	Nursing Grants
Part-Time Faculty Health Insurance	Telecommunications and Technology Services
Part-Time Faculty Office Hours	
Physical Plant and Instructional Support	
Transfer Education and Articulation	

[a] CalWorks = California Work Opportunity and Responsibility to Kids.

California Student Aid Commission

The budget package provides $967 million in General Fund support for the California Student Aid Commission (CSAC), which reflects a $70 million increase from 2008-09 and a $101 million increase (11.6 percent) from 2007-08. In addition, the budget provides CSAC with $32 million from the Student Loan Operating Fund to help cover Cal Grant costs.

Rejection of Governor's Proposals. The Legislature rejected the Governor's proposals to phase out the Cal Grant programs. Instead, the enacted budget fully funds projected Cal Grant awards in both the competitive and entitlement programs. The budget package also does not include the Governor's proposals to (1) decentralize the administration of Cal Grants to the campuses and (2) eliminate CSAC and the California Postsecondary Education Commission and transfer some of their functions to an executive agency. The Governor in turn vetoed $6.3 million from CSAC's support budget, and signaled a willingness to restore $4.3 million of this amount if the Legislature enacts a decentralization plan. The veto eliminates about half of CSAC's support budget, which could affect its ability to administer state financial aid programs.

Capital Outlay

The 2009-10 spending plan authorizes the segments to spend $263 million in general obligation bond funding for a variety of capital outlay projects. As the only segment with a substantial remaining balance of authorized general obligation bonds, the community colleges received the majority of the capital outlay appropriations—$216 million for 17 new projects and 8 continuing projects. The Legislature rejected the Governor's proposal to use lease-revenue bonds to fund new capital outlay projects at UC and CSU and provided funding for only those projects that could be completed using remaining, authorized general obligation bonds. The spending plan also contained reappropriations for many projects approved in previous years including:

- Numerous projects that experienced delays due to the Pooled Money Investment Board's freeze on loan disbursements during 2008-09.
- $10 million for the new Life Sciences Research and Nursing Education facility at Charles Drew University.
- The Helios Energy Research Facility at UC Berkeley that was delayed due to changes in the project's scope.

Health

The 2009-10 spending plan provides $16.1 billion from the General Fund for health programs. This is a decrease of $2.7 billion (14.5 percent) compared to the revised prior-year spending level and a decrease of $3.8 billion from the 2007-08 level, as shown in Figure 10 (see next page). These spending reductions result in large part from federal economic stimulus legislation that increased the federal medical assistance percentage (FMAP) in 2008-09 and 2009-10. The FMAP is the federal formula used to determine the amount of federal matching funds the state receives for Medi-Cal and certain social services programs. Part of the reduction in health spending relates to local government financing shifts discussed later in this chapter. Significant program reductions were also made by the Legislature and the Governor to various health programs. The amounts shown in Figures 10 and 11 also reflect about $270 million in gubernatorial vetoes that are the subject of pending litigation. The key aspects of the budget package are discussed below and summarized in Figure 11.

Medi-Cal

The spending plan provides about $10.9 billion from the General Fund ($38.7 billion all funds) for Medi-Cal local assistance expenditures. This is a decrease of almost $2 billion, or 15.3 percent, in General Fund support for Medi-Cal local assistance compared to the revised prior-year spending level. We discuss the most significant spending changes below.

Additional Federal Funds. The spending plan assumes a significant increase in the receipt of federal funds, which reduces the overall level of General Fund spending. Under ARRA, California benefits from an enhanced FMAP, which adjusts the federal share from 50 percent minimum FMAP for most services to 61.59 percent. The enhanced FMAP began in October 2008 and will continue through December 2010. It mainly affects General Fund expenditure levels for Medi-Cal benefits provided by the Department of Health

Figure 10

Major Health Programs and Departments—Spending Trend

(General Fund, Dollars in Millions)

				Change From 2008-09 to 2009-10	
	2007-08	2008-09	2009-10	Amount	Percent
Medi-Cal—local assistance	$14,036	$12,888	$10,910	-$1,977	-15.3%
Department of Developmental Services	2,548	2,561	2,391	-170	-6.6
Department of Mental Health	1,931	1,961	1,857	-104	-5.3
Healthy Families Program—local assistance	387	391	225	-166	-42.5
Department of Public Health	362	353	199	-154	-43.6
Other Department of Health Care Services programs—local assistance	181	184	122	-62	-33.7
Department of Alcohol and Drug Programs	285	283	189	-94	-33.2
Emergency Medical Services Authority	13	12	9	-3	-25.0
All other health programs (including state support)	163	161	175	14	8.7
Totals	**$19,906**	**$18,794**	**$16,077**	**-$2,717**	**-14.5%**
Health Program Spending Temporarily Paid From:					
General Fund offset due to FMAP changes	—	$2,380	$3,747	$1,368	57.5%
Local government finance shift	—	—	565	565	—

Figure 11

Major Changes—State Health Programs
2009-10 General Fund Effect

July Budget Actions, Unless Otherwise Noted (In Millions)

Program	Total
Medi-Cal	
Assume federal actions to reduce program funding requirements	-$1,000.0
Continue unspecified reduction to reflect past program spending trends	-323.0
Eliminate certain optional benefits for adults (February)	-122.2
Reduce payments to hospitals ($54.2 million in February)	-109.0
Freeze long-term care rates	-90.0
Implement changes to reduce prescription drug costs	-66.1
Governor's veto of county administration funding	-60.4
Redirect Proposition 99 funds to Medi-Cal from various health programs	-50.0
Expand anti-fraud efforts	-46.8
Impose limits on Adult Day Health Care	-28.1
Suspend cost-of-living adjustment for county administration (February)	-24.7
Other Department of Health Care Services Programs	
Reduce funding for community clinics ($25 million from Governor's vetoes)	-$35.1
Public Health	
Reduce HIV/AIDS programs ($52.2 million from Governor's vetoes)	-$85.7
Reduce Maternal, Child, and Adolescent Health programs and domestic violence shelters ($28.2 million from Governor's vetoes)	-40.9
Suspend immunization local assistance on one-time basis	-18.0
Reduce other public health programs	-9.6
Healthy Families Program[a]	
Various reductions (unallocated $124 million, application assistance $4.6 million, Governor's veto—$50 million)	-$178.6
Department of Mental Health	
Eliminate funding for services that are not federally required	-$64.0
Defer AB 3632 mandate payments	-52.0
Eliminate state funding for new programs in Early and Periodic Screening, Diagnosis, and Treatment (EPSDT)	-28.0
Defer EPSDT state funding for 2006-07 county cost settlements until 2010-11	-15.8
Reduce state funding for Caregiver Resource Centers ($4.1million from Governor's vetoes)	-7.6
Coleman bed expansion at Salinas and Vacaville psychiatric programs	25.3
Implement *Emily Q. v. Bonta* ruling in EPSDT	19.0
Department of Developmental Services	
Savings proposals developed through a workgroup process ($100 million in February)	-$334.0
Governor's veto of community program services for children up to age five	-50.0
Department of Alcohol and Drug Programs	
Eliminate some Proposition 36 funding	-$90.0
Reduce Drug Medi-Cal provider reimbursement rates by 10 percent	-8.8
Emergency Medical Services Authority	
Reduce state funding for California Poison Control System	-$3.0

[a] Figures do not include augmentations or reductions approved in post-budget actions.

Care Services (DHCS), but also affects components of the Medi-Cal Program administered by other health departments as shown in Figure 12. The budget assumes that the enhanced FMAP will provide $2.4 billion in 2008-09 and $3.7 billion in 2009-10 in federal relief for the Medi-Cal Program.

Savings From Increased Federal Flexibility. The budget plan assumes $1 billion in General Fund savings from the receipt of additional federal funds and obtaining additional flexibility to reduce program costs. This includes the possibility that the federal government will reimburse the state for costs of care for disabled beneficiaries who should instead have received their care under the federal Medicare program. Savings may also be achieved through other changes being sought by the state in the way federal authorities administer the program.

Funding Shifts. The spending plan includes $565.2 million in funding from a local government finance shift to support Medi-Cal. We discuss the shift of these funds in more detail in the "Local Government" section of this chapter. In addition, $50 million in tobacco tax revenues from the Proposition 99 ballot measure approved by voters in November 1988 were redirected from various health programs to support Medi-Cal.

Unspecified Reduction. The budget plan includes an unspecified reduction in Medi-Cal local assistance of $323 million from the General Fund. Comparable amounts of savings for this purpose were initially assumed in the 2007-08 and 2008-09 budget plans, although the savings were not achieved in 2008-09.

Elimination of Optional Benefits. The February 2009 budget package eliminated certain optional benefits for adults effective July 2009 for General Fund savings of $122.2 million. The bulk of the savings come from the elimination of adult dental services, but savings also come from the elimination of optician services, incontinence creams and washes, audiology, acupuncture, and other services.

Reductions in Hospital Payments. The February budget plan includes a 10 percent reduction to designated public hospital rates to achieve savings of $54.2 million for the General Fund. An additional $54.8 million in General Fund savings were achieved in July through (1) a 10 percent reduction in

Figure 12

FMAP Savings in Health-Related Departments

(In Millions)

Department/Program	2008-09	2009-10
Medi-Cal	$2,137.1	$3,159.5
Developmental Services	188.9	304.8
Mental Health	42.9	259.4
Alcohol and Drug Programs	10.6	23.4
Totals	**$2,379.5**	**$3,747.1**

FMAP = federal medical assistance percentage.

payments to private hospitals ($23.9 million), (2) redirecting the Distressed Hospital Fund and hospital stabilization funds ($23.9 million), and (3) reducing rates for small and rural hospitals by 10 percent ($7 million).

Freeze on Long-Term Care Facility Rates and Expanded Fees. The spending plan freezes rate adjustments that would otherwise occur for certain long-term care facilities for General Fund savings of $90 million. In addition, the budget plan expands quality assurance fee assessments on certain long-term care facilities to include Medicare revenues, resulting in increased state revenue of $17 million in 2009-10.

Changes to Reduce the Cost of Prescription Drugs. The spending plan includes several changes in pharmacy practices to reduce the cost of prescription drugs and achieve total General Fund savings of about $66 million. These changes include: (1) paying lower drug reimbursements ($37 million), (2) requiring pharmacy providers to bill at lower rates ($22.5 million), (3) requiring eligible entities to use "340B" program drug pricing ($3.8 million), and (4) performing a "therapeutic category review" of antipsychotic drugs to see which are most cost-effective ($1.5 million) and requiring drug manufacturers to pay certain rebates for HIV/AIDS and cancer drugs ($1.3 million).

Reduction in Funding for County Administration. The budget plan includes savings of $24.7 million General Fund from the suspension of a cost-of-living adjustment for county administration. The Governor vetoed an additional $60.6 million from the General Fund for county administration of Medi-Cal.

Expansion of Anti-Fraud Efforts. The budget plan assumes that efforts to reduce fraud, waste, and abuse in the areas of adult day health care (ADHC), physician services, and pharmacy will achieve General Fund savings of $46.8 million.

Limits on ADHC. The spending plan adopts several modifications to the ADHC benefit to achieve $28.1 million in General Fund savings. The changes include: (1) a three day per week cap on services, (2) standards on medical necessity that will be developed through a workgroup process, (3) on-site processing of treatment authorization requests, and (4) a freeze on provider rates as of August 2009. Some of these savings may not be realized due to a preliminary court injunction on the three day per week cap.

Development of Plan for Changes to Eligibility Processing. The budget authorizes the development of a plan to create a centralized eligibility and enrollment process for Medi-Cal, CalWORKs, and the Supplemental Nutrition Assistance Program (formerly the Food Stamp Program). The development of the plan includes stakeholder involvement, and implementation of the plan requires legislative approval.

Improvement of Care Coordination and Long-Term Cost Containment. The budget plan gives DHCS broad authority to implement a demonstration project intended to accomplish a series of goals, including:

- Strengthening the "safety net" of health care for the poor.
- Improving health care quality and outcomes.
- Restructuring the delivery of services to be more responsive to the most vulnerable Medi-Cal beneficiaries, such as the aged, blind, and disabled.

The administration estimates that savings of $400 million annually to the General Fund could be achieved by 2012-13 through this effort to provide earlier and more appropriate health care to patients.

Other DHCS Programs

Elimination of Community Clinic Programs. State funding for various community clinic programs was eliminated for General Fund savings of $35.1 million. This amount reflects the Governor's veto of $25 million. The affected programs included Indian Health, Seasonal, Agricultural, and Migratory Workers; Rural Health Services Development; and Expanded Access to Primary Care.

Department of Public Health

In total, the spending plan provides about $199 million from the General Fund ($2.9 billion all funds) for the Department of Public Health. This reflects a decrease of about $153 million or 44 percent from the General Fund ($49 million from all fund sources), compared to the revised prior-year spending level. The budget reflects a number of reductions in public health spending.

HIV/AIDS Programs. The budget reduces General Fund spending on HIV/AIDS programs by a total of $85.7 million. Of this total, $33.5 million was approved by the Legislature as a package of cuts to HIV/AIDS programs. These included cuts to: (1) therapeutic monitoring, education and prevention, home and community-based care, surveillance and epidemiology, and housing ($4.6 million); (2) state operations in the Office of AIDS ($3.4 million); and (3) the AIDS Drug Assistance Program (ADAP) ($25.5 million). The Legislature backfilled almost all of the reduction to ADAP with ADAP Rebate Fund monies.

In addition to these cuts, the governor vetoed $52.2 million from HIV/AIDS local assistance programs. This eliminated the remaining General Fund support for a variety of programs, including therapeutic monitoring, education and prevention, home and community-based care, and housing, as well as the Early Intervention Program and HIV counseling and testing. As a result, all remaining state funding is now devoted to support HIV/AIDS surveillance and epidemiology, and ADAP.

Maternal, Child, and Adolescent Health (MCAH) and Domestic Violence Shelters. In total, the budget plan reduces spending for MCAH programs by $20.5 million from the General Fund, and for domestic violence shelters by $20.4 million from the General Fund. The Legislature reduced spending for MCAH programs by $8.6 million and for domestic violence shelters by

$4.1 million. The Governor then vetoed an additional $11.9 million from MCAH local assistance programs and $16.3 million from domestic violence shelters. These vetoes eliminated all remaining General Fund support for the MCAH program and domestic violence shelters.

Proposition 99 Programs. The spending plan reduces Proposition 99 spending by eliminating funding for uncompensated emergency care and reducing funding for asthma, breast cancer screening, and other programs as part of the $50 million shift of funds to support the Medi-Cal Program discussed above.

Immunization and Other Reductions. The budget plan suspends local assistance funding for immunization programs in 2009-10 for savings of $18 million to the General Fund. In addition, the plan makes General Fund reductions to other public health programs for savings of $9.1 million. These include: (1) denial of a capital outlay budget request for state laboratory improvements ($3.1 million), (2) a reduction in grants to Alzheimer's Disease Research Centers ($3.1 million), and (3) suspension of preventative dental services to low-income children ($2.9 million).

Healthy Families Program

In total, the July budget package provided about $225 million from the General Fund for the Healthy Families Program (HFP), which is administered by the Managed Risk Medical Insurance Board (MRMIB). This reflected a net General Fund decrease of about $166 million, or 42 percent, compared to the revised prior-year spending level. The February budget initially increased funding to HFP for caseload adjustments by about $13 million, but this augmentation was more than offset by a reduction in General Fund support for the HFP of almost $179 million. These figures do not reflect the significant post-budget changes to the HFP discussed below.

In May, the Governor proposed elimination of General Fund support for HFP. The Legislature rejected the Governor's proposal and instead adopted a reduction of $124 million from the General Fund, along with budget bill language directing MRMIB to seek assistance from philanthropic and other organizations to maintain funding for the program. Support for certified application assistance was also eliminated by the Legislature for General Fund savings of $4.6 million. Subsequently, the Governor vetoed an additional $50 million of General Fund from HFP.

Several actions subsequent to adoption of the budget package are expected to largely restore funding for the program in 2009-10. These actions include: (1) a contribution of $81.4 million from the California Children and Families Commission (also known as First 5 California) for coverage of children up to age five, (2) estimated program savings of $17.5 million from premium and co-payment increases for families enrolled in the program, and (3) estimated funding of $97 million from a temporary gross premiums tax on Medi-Cal managed care plans that would be in place until 2011. Changes to co-payments would be made through regulation, while the gross premiums tax and changes to HFP premiums would be implemented through post-budget legislation—Chapter 157, Statutes of 2009 (AB 1422, Bass). This tax measure is expected to raise about $157 million for the General Fund in 2009-10. It specifies that 38 percent of these revenues (about $60 million) are to be continuously appropriated to augment the Medi-Cal Program, while the remaining 62 percent of revenues ($97 million) are continuously appropriated to support HFP.

MRMIB—Other Programs

The Legislature reduced Proposition 99 funding for two programs by cutting (1) $6.6 million from the Major Risk Medical Insurance Program, the state's high-risk health insurance pool program, and (2) $4.9 million from the Access for Infants and Mothers (AIM) health insurance program for pregnant women. These reductions were part of a larger redirection of Proposition 99 funds to support the Medi-Cal Program. Also, Proposition 99 funding for AIM was reduced by $28.5 million to reflect one-time savings in 2009-10 from implementation of a new methodology for payments to health plans.

Department of Mental Health

The spending plan provides about $1.9 billion from the General Fund ($3.5 billion from all fund sources) for the Department of Mental Health (DMH). This is a net decrease of about $104 million from the General Fund, or 5.3 percent, compared to the revised prior-year level of spending. The reductions to DMH community programs are partly offset by spending increases that are provided mainly for state hospital operations.

Reduction to Mental Health Managed Care. The spending plan provides $113.3 million General Fund for support of the Mental Health Managed Care program, a decrease from the revised prior-year spending level of $72.3 million General Fund, or 39 percent. This decrease reflects a $64 million reduction in state funding for certain services as well as adjustments due to increased FMAP under ARRA.

Reduction to Early and Periodic Screening, Diagnosis, and Treatment (EPSDT). The spending plan provides about $349 million General Fund for support of EPSDT, a net decrease from the revised prior-year adjusted spending level of about $30 million, or 8 percent. This decrease includes an assumption that $28 million in EPSDT support will come from county Proposition 63 funds rather than the state General Fund, the deferral until 2010-11 of $15.8 million for prior-year county cost settlements, and FMAP adjustments. These reductions are offset by other General Fund spending increases, including $19 million for compliance with the *Emily Q. v. Bonta* ruling, which requires DMH to implement a nine-point plan to increase county use of therapeutic behavioral services.

Assembly Bill 3632 Mandate Funding Deferred. The spending plan includes $52 million General Fund in the DMH budget to pay for mental health services provided to children enrolled in special education as directed under so-called AB 3632 programs. This represents a decrease of $52 million General Fund or 50 percent compared to revised prior-year spending levels.

Caregiver Resource Centers Reduced. The spending plan reduces funding for CRCs by $7.6 million, or about 72 percent, as compared to revised prior-year spending levels. The CRCs provide services to caregivers of a family member with a cognitive impairment such as respite and counseling. The budget reflects the Governor's veto of $4.1 million in addition to a $3.5 million legislative reduction to the CRCs.

State Hospitals/Long-Term Care Services. The spending plan provides about $1.2 billion from the General Fund for state hospital operations and long-term care services for the mentally ill, a $66.2 million increase in General Fund resources over revised prior-year spending levels. This includes $25.3 million for the expansion of mental health beds for prison inmates in the Salinas and Vacaville psychiatric programs, $24.4 million in increased lease-revenue debt service payments for DMH facilities, and costs due to projected caseload growth and other program changes. The spending plan also achieves $8.3 million General Fund savings in the Sex Offender Commitment Program due to reduced costs for evaluations and court testimony.

Department of Developmental Services

The budget provides $2.4 billion from the General Fund ($4.7 billion from all fund sources) for services for individuals with developmental disabilities who are clients of developmental centers (DCs) and regional centers (RCs). This amounts to a net decrease of about $170 million, or 6.6 percent, in General Fund support compared to the revised prior-year spending level. The decrease in General Fund spending for the Department of Developmental Services (DDS) is largely due to increased federal funds provided under ARRA and the adoption of several proposals to achieve a department savings target of $334 million. These spending reductions are partly offset by increases for caseload, costs, and utilization of services. We describe these proposals in more detail below.

Savings in Community Programs. The spending plan includes a total of $2.1 billion from the General Fund for community services for the developmentally disabled. This reflects a decrease in General Fund support of about $126 million, or 5.8 percent, over the revised prior-year spending level. Working with various stakeholder groups, DDS developed a variety of proposals to generate $334 million in General Fund savings in 2009-10. For example, $60 million in savings would come from obtaining additional federal Medicaid funds for certain services. In addition, the Governor vetoed $50 million from the community programs budget for services provided to children up to age five and directed DDS to request replacement funds from the First 5 Commission. The spending plan includes savings of $26.6 million to the General Fund due to the availability of additional federal funds for

California's Early Start program under ARRA. The DDS was also required to develop a new service model that provides consumers with an "individual choice budget" that allows RC clients to choose the services they want within a fixed budget.

Net Reduction in DCs. The spending plan includes about $301 million from the General Fund for the DCs, a decrease in General Fund of about $27 million, or 8.3 percent, compared to the revised prior-year spending level. This decrease in General Fund spending is mainly due to the delay of several capital outlay projects, and from the closure of the Sierra Vista Community Facility.

Department of Alcohol and Drug Programs

The budget provides about $189.5 million from the General Fund ($478.9 million all funds) for the Department of Alcohol and Drug Programs. This is a decrease of $93.8 million from the General Fund, or 33.1 percent, compared to the revised prior-year spending level, that is due mainly to reductions in funding for the Proposition 36 and Drug Medi-Cal programs.

Proposition 36 Programs Reduction. The spending plan includes the elimination of $90 million in General Fund support from the Substance Abuse and Crime Prevention Act (also known as Proposition 36), while maintaining $18 million in General Fund support for the Offender Treatment Program, which also serves Proposition 36 offenders. These spending reductions are, in effect, partly offset with $45 million in one-time federal Byrne Memorial Justice Assistance Grant funds for the Offender Treatment Program.

Drug Medi-Cal Reduced. The spending plan includes an across-the-board 10 percent reduction in the rates paid to Drug Medi-Cal providers that is estimated to achieve $8.8 million in General Fund savings. The spending plan also includes adjustments due to increased FMAP under ARRA.

Emergency Medical Services Authority (EMSA)

The spending plan eliminates $3 million, or one-half of the current General Fund support, for the California Poison Control System (CPCS). The EMSA is currently attempting to secure alternative sources of funding in order to continue CPCS operations through 2009-10.

Social Services and Labor

General Fund support for social services programs in the 2009-10 budget totals $8.9 billion, a reduction of $1.1 billion (11 percent) compared to the revised prior-year level. Most of this decrease is from grant reductions for recipients in the Supplemental Security Income/State Supplementary Program (SSI/SSP), eligibility and service restrictions for recipients of In-Home Supportive Services (IHSS), reduced funding for child welfare services and foster care, and additional available funds from ARRA. Figure 13 shows the change in General Fund spending in each major social services program or department. The budget plan also achieved some significant General Fund savings on labor programs, which we discuss later in this section.

Savings From ARRA. For 2008-09, ARRA provided about $800 million in federal funds which were used to offset General Fund costs for social services programs. In 2009-10, ARRA funding is projected to increase to about $1 billion. Figure 14 (see next page) shows ARRA funding used to offset General Fund spending by program area.

Summary of Other Major 2009-10 Budget Changes. Figure 15 (see next page) summarizes the major programmatic changes to social services programs which were included in the February budget and the July revised package compared to prior law. The budget totals reflect the Governor's vetoes of approximately $125 million in funding for child welfare services, Department of Aging programs, and IHSS, some of which are now the subject of pending litigation.

The amounts shown in Figure 15 generally reflect the ongoing annual savings from the policy changes. For some of the changes in CalWORKs and IHSS, however, the amounts shown overstate the impact in 2009-10. This is because the federal government—under ARRA—is temporarily picking up a greater share of program costs, thereby reducing the value of General Fund savings in 2009-10 from service reductions. (The footnotes to the figure provide additional information regarding this interaction with ARRA.) Although Figure 15 shows a total General Fund solution of $2.1 billion, the

Figure 13

Major Social Services Programs and Departments—Spending Trend

(General Fund, Dollars in Millions)

				Change From 2008-09 to 2009-10	
	2007-08	2008-09	2009-10	Amount	Percent
SSI/SSP	$3,623.5	$3,637.2	$2,968.4	-$668.8	-18.4%
CalWORKs	1,481.7	1,981.6	2,015.3	33.7	1.7
In-Home Supportive Services	1,686.5	1,588.0	1,255.2	-332.8	-21.0
Child Welfare Services/Foster Care/Adoptions Programs	—[a]	1,639.6	1,485.4	-154.2	-9.4
County administration and automation	451.0	509.4	571.1	61.7	12.1
Department of Child Support Services	326.3	353.0	279.8	-73.2	-20.7
Department of Rehabilitation	55.3	56.4	58.1	1.6	2.9
Department of Aging	62.2	45.1	33.4	-11.7	-25.9
All other social services programs	—[a]	198.5	209.6	11.2	5.6
Totals	**$9,432.4**	**$10,008.8**	**$8,876.3**	**-$1,132.5**	**-11.3%**

[a] Data not available.

net General Fund savings in 2009-10 would be about $1.8 billion after accounting for the interaction with ARRA.

Elimination of Automatic COLAs and Other Long-Term CalWORKs Changes. Prior law required that the maximum monthly grants for SSI/SSP and CalWORKs be adjusted each year to reflect the change in the California Necessities Index. Beginning with 2010-11, budget legislation eliminates this automatic adjustment. Effective in July 2011, the budget plan substantially modifies the CalWORKs program by increasing the magnitude of sanctions imposed for noncompliance and reducing the number of consecutive months an adult may receive cash assistance. These longer-term changes are discussed in the box on page 49.

SSI/SSP

The budget provides $3 billion from the General Fund for SSI/SSP. This is an overall decrease of $669 million (18 percent) in funding compared to the revised 2008-09 spending level. This decrease is primarily the result of reducing COLAs related to grants for individuals and couples.

Changes to COLAs. In January 2009, recipients of SSI/SSP received a federal COLA which increased the federally funded SSI portion of the monthly grant by $37 for individuals and $55 for couples. Pursuant to the February budget package, the state-funded SSP portion of the grant was reduced in May 2009 by these same amounts. This is referred to as "not passing-through" the federal COLA. As shown in Figure 16 (see page 48), this action reduced maximum monthly grants for individuals from $907 to $870 and grants for couples from $1,579 to $1,524. This action is expected to result in General

Figure 14

ARRA-Related Savings for Major Social Services Programs

(In Millions)

Program Area	2008-09	2009-10
FMAP Relief		
In-Home Supportive Services	-$296.3	-$366.8
Adoptions Assistance Program	-22.4	-32.0
Foster Care	-9.7	-11.2
Foster Care Waiver	-6.2	-8.7
Multipurpose Senior Services Program	-4.0	-5.3
Other Relief		
Temporary Assistance for Needy Families Emergency Contingency Fund	-$474.9	-$578.3
Child Support	-20.4	-27.7
Total ARRA General Fund Benefit	**-$833.9**	**-$1,030.0**

ARRA = American Recovery and Reinvestment Act; FMAP = federal medical assistance percentage.

Figure 15

Major Changes—State Social Services Programs 2009-10 General Fund Effect

(In Millions)

Program	February Budget Package	July Budget Package	Totals
SSI/SSP			
Withhold pass-through of federal January 2009 COLA	-$362.9	—	-$362.9
Reduce grants by 2.3 percent	-233.8	—	-233.8
Make additional grant reductions for individuals (5.5%) and couples (0.6%)	—	-$109.3	-109.3
Suspend June 2010 state COLA	-27.0	—	-27.0
Recognize CAPI savings from federal SSI/SSP eligibility change	-24.6	—	-24.6
CalWORKs			
Reduce county block grant funds for child care and employment services	—	-$419.4	-$419.4
Reduce grants by 4 percent	-$160.3	—	-160.3[a]
Suspend July 2009 COLA	-79.1	—	-79.1[a]
Achieve grant savings from earnings related to expanded subsidized employment	—	-64.0	-64.0[a]
Suspend pay-for-performance county incentive program	-40.0	—	-40.0
Replace Employment Training Funds with General Fund	—	15.0	15.0
In-Home Supportive Services (IHSS)			
Net savings from anti-fraud initiatives	—	-$162.0	-$162.0[b]
Target services to most vulnerable recipients	—	-102.3	-102.3[b]
Reduce state participation in wages and benefits to $10.10 per hour	-$98.1	—	-98.1[b]
Eliminate share-of-cost buyout program	-1.7	-41.1	-42.8
Reduce administrative funding for public authorities	—	-13.3	-13.3
Child Welfare Services			
Governor's veto to reduce funding to counties	—	-$80.0	-$80.0
Implementation costs for federal requirements	—	17.7	17.7
Reduce Transitional Housing Plus Program	—	-5.0	-5.0
Foster Care			
Reduce foster care group home and agency rates by 10 percent	—	-$26.6	-$26.6[b]
County Welfare Automation			
Delay Los Angeles automation system reprocurement	-$14.6	—	-$14.6
Reduce M&O funding for county automation systems	—	-$8.5	-8.5
Community Care Licensing			
One-time federal funds to license and inspect child care homes	—	-$5.3	-$5.3
Ten percent fee increase	—	-2.1	-2.1
Department of Child Support Services			
Reduce child support automation system upgrades	-$36.1	-$0.5	-$36.6
Eliminate General Fund backfill of previous federal fund reduction	—	-27.7	-27.7
Department of Aging			
Eliminate Linkages and community-based programs	—	-$10.4	-$10.4
Totals	**-$1,078.2**	**-$1,044.7**	**-$2,122.9**

[a] Because of interaction with federal relief funds, savings for 2009-10 overstated by a factor of four.

[b] Because of interaction with federal relief funds, savings for 2009-10 overstated by roughly 20 percent.

COLA = cost-of-living adjustment; CAPI = Cash Assistance Program for Immigrants; M&O = maintenance and operation.

Fund savings of $61 million in 2008-09 and $363 million in 2009-10. In addition, the February budget deleted the June 2009 *state* COLA that would otherwise have been provided for SSI/SSP recipients. This is anticipated to result in savings of $27 million in 2009-10 and $312 million in 2010-11.

Grant Reductions. The budget includes two other grant reductions for SSI/SSP recipients. The first is a 2.3 percent reduction to individuals and couples effective July 2009. The second is a 0.6 percent reduction to individual grants and a 5.5 percent reduction to couples grants effective October 2009. We note that the grant reduction for couples brings their grants to the minimum amount allowable under federal law. The combined savings from these two reductions is $340 million in 2009-10.

Combined Impact on Grants. In total, these changes reduce maximum grants for individuals by $62 per month (about 6.8 percent) and couples by $172 per month (about 11 percent) between January 2009 and October 2009. The state-funded SSP portion of the grant decreased by 27 percent for individuals and 30 percent for couples over this time period.

Effect of Federal Law Changes on Cash Assistance Program for Immigrants. The state-only funded Cash Assistance Program for Immigrants (CAPI) provides a monthly cash grant to legal immigrants who meet SSI/SSP eligibility requirements but are not otherwise eligible to receive SSI/SSP due to their immigration status. Recent federal law increases, by two years, the amount of time certain CAPI recipients are eligible to receive SSI/SSP. Accordingly, the budget assumes temporary state savings of about $25 million in 2009-10.

Figure 16

SSI/SSP Maximum Monthly Grants in 2009

	January	May	July	October
Individuals				
SSI	$674	$674	$674	$674
SSP	233	196	176	171
Totals	**$907**	**$870**	**$850**	**$845**
Percent of Poverty[a]	100%	96%	94%	94%
Couples				
SSI	$1,011	$1,011	$1,011	$1,011
SSP	568	513	478	396
Totals	**$1,579**	**$1,524**	**$1,489**	**$1,407**
Percent of Poverty[a]	130%	126%	123%	116%

[a] Compares grant level to federal poverty guideline. Poverty guideline is from 2009 U.S. Department of Health and Human Services guidelines.

Longer-Term CalWORKs Policy Changes

Effective July 2011, budget legislation makes significant changes to CalWORKs sanction policies, time limits, and eligibility rules. When implemented, these changes are likely to result in ongoing General Fund savings potentially in the low hundreds of millions.

Limit to 48 Consecutive Months of Aid. Currently, able-bodied adults are generally limited to 60 months of aid. Once an adult reaches 60 months, the family's grant is reduced by the amount attributable to the adult, and the children continue to receive aid in a program informally known as the safety net. Budget legislation limits adult receipt of aid to 48 consecutive months. After 48 months, the adult is removed from the case and the children continue to be aided in the safety net. After "sitting out" for one year, the adult can rejoin the case for up to one year and the family's grant is restored, assuming the adult avoids program sanctions.

Self-Sufficiency Reviews. Currently, aided adults must be recertified for eligibility with an in-person interview each year. Budget legislation requires adults in CalWORKs cases who are not meeting participation requirements to instead meet with a county social or employment worker every six months. The purpose of the review is to determine barriers to participation and help connect the recipient to appropriate services and resources. If the adult does not attend the review, the family's grant is reduced by 50 percent.

Increase in Sanctions for Noncompliance. Currently when an adult does not meet work participation requirements, the family's grant is reduced by the amount attributable to the adult (leaving the family with a grant equal the "child-only" portion of the original grant). Budget legislation requires imposition of additional financial sanctions if the adult does not comply with work participation requirements. Specifically, if the noncompliance persists for an additional 90 days, the family's grant is reduced to 75 percent of the child-only grant. If the noncompliance persists for another 90 days, then the grant is reduced to 50 percent of the child-only grant. Before imposing these additional financial sanctions, counties must review and assess each case to identify barriers to participation and make good faith efforts to remediate any barriers identified.

Time in Sanction Counts Toward Time Limit. Currently, during those periods for which an adult is being sanctioned, their time on aid does not count toward the 60-month time limit. Pursuant to budget legislation, any months a CalWORKs recipient spends in sanction status will count toward the 48- and 60-month time limits on their aid.

CalWORKs

Despite a caseload increase of about 15 percent, General Fund support for CalWORKs in the 2009-10 budget plan remained essentially flat at about $2 billion. This is because the budget plan included about $700 million in budget reductions and because of an increase in federal Temporary Assistance to Needy Families (TANF) Emergency Contingency Funds (ECF) provided pursuant to the ARRA. The budget plan rejected the Governor's May proposal to eliminate the CalWORKs program.

Grant Reduction. The budget package deleted the July 2009 COLA and reduced grants by 4 percent. These actions are expected to result in total program savings of about $240 million. Figure 17 shows the combined maximum monthly grants and food stamps for a family of three in low- and high-cost counties. As the figure shows, despite the grant reduction, a recipient's combined grant and food stamps is higher as of July 2009 than it was in January, due to the increase in food stamps allotments pursuant to ARRA. The figure also shows how the combined maximum grant and food stamps compare to the federal poverty guideline for a family of three.

Reduction and Prioritization of County Block Grant Funds. The budget achieves about $420 million in savings by reducing county block grant funds for welfare-to-work services ($162 million) and child care ($215 million), and reverting county block grant funding from 2008-09 to the General Fund ($43 million). Budget legislation states the Legislature's intent that $375 million in block grant reductions continue through the end of 2010-11.

Because of these reductions, there will not be sufficient funding for counties to provide services to all eligible CalWORKs recipients. (There are sufficient funds to pay grants.) To help counties prioritize resources given this reduc-

Figure 17

CalWORKs Maximum Monthly Grant and Food Stamps Family of Three, 2009

	January	April	July
High-Cost Counties			
Grant	$723	$723	$694
Food Stamps	423	486	495
Totals	**$1,146**	**$1,209**	**$1,189**
Percent of Poverty[a]	75%	79%	78%
Low-Cost Counties			
Grant	$689	$689	$661
Food Stamps	433	496	505
Totals	**$1,122**	**$1,185**	**$1,166**
Percent of Poverty[a]	74%	78%	76%

[a] Compares grant level to federal poverty guideline. Poverty guideline is from 2009 U.S. Department of Health and Human Services guidelines.

tion in funding, budget legislation exempts families with a child under age two, or with two or more children under the age of six, from work participation requirements. Budget legislation also provides that, for any month for which a recipient has been excused from work participation requirements due to lack of support services, the case does not count toward the state's 60-month time limit for their receipt of cash aid. Finally, the budget includes intent language indicating that counties should be relieved from paying any federal penalties resulting from the state's failure to meet statewide work participation requirements due to these funding reductions.

Subsidized Employment Initiative Utilizes New Federal Funds. The ARRA created the TANF ECF. This new funding stream provides 80 percent federal financial participation in costs for ongoing basic assistance (cash grants), and certain other purposes, which exceed the corresponding costs during FFY 2006-07. Budget legislation authorizes counties to use these federal funds in combination with county and other local funds to create subsidized employment positions for CalWORKs recipients. The budget includes $275 million in ECF for this initiative and reflects grant savings of about $64 million due to the higher earnings of recipients who are employed in these new positions.

Other 2009-10 Budget Changes. The budget plan suspends pay-for-performance incentive payments to counties to avoid $40 million in costs. Finally, the budget reduces Employment Training Fund support for CalWORKs by $15 million, resulting in an identical General Fund cost.

IHSS

The budget decreases General Fund support for IHSS by $333 million (21 percent) in 2009-10 compared to the revised 2008-09 spending level. These savings are mostly due to reductions in state participation in wages, service reductions and eliminations, a planned expansion of IHSS anti-fraud activities, and the receipt of additional ARRA funds. These savings are partially offset by a caseload increase.

Reduction in State Participation in Wages. In January, the Governor's budget proposed to decrease state participation in provider wages and benefits from $12.10 per hour to the minimum wage ($8.00) plus $0.60 for benefits. In February, the Legislature reduced state participation in IHSS provider wages and benefits to $10.10 per hour effective July 1, 2009. This reduction is estimated to save the General Fund about $98 million in 2009-10. However, in late June, a federal judge issued an injunction to stop the proposed decrease in state participation in wages for providers until the state performs an analysis of the potential impacts of such a wage reduction. (This injunction was still in effect at the time this analysis was prepared.) As a result, despite current law, the state is still participating in combined wages and benefits of up to $12.10 per hour. For each month the state continues to participate at this level, the estimated savings from the reduction in state participation in wages is eroded by about $8.2 million.

Service Reductions and Eliminations. The Governor proposed to eliminate IHSS services for all but the most impaired recipients (resulting in a reduction of nearly 90 percent of the IHSS caseload), for total General Fund savings of roughly $700 million. Instead, the Legislature adopted, effective September 2009, several changes to services and eligibility that were initially estimated to result in General Fund savings of about $73 million in 2009-10. The first reduction targets domestic and related care services to the most impaired IHSS recipients. The second eliminates *all* IHSS services for the least impaired IHSS recipients. For both of these reductions, the Legislature adopted exceptions for certain recipients who meet specified criteria, but authorized the Governor to waive these exemptions under specified conditions if they put federal IHSS funding at risk. Ultimately, the Governor cited these conditions in vetoing an additional $28.9 million from the final budget package. In total, the savings from these proposals are estimated to be about $102 million in 2009-10. However, the Department of Social Services (DSS) recently announced that implementation will be delayed. For each month of delay, the savings are eroded by about $8.5 million.

IHSS Anti-Fraud Initiatives. The 2009-10 budget includes several anti-fraud activities that are estimated to save about $162 million for the General Fund. These activities include (1) fingerprinting of recipients and providers, (2) authorization of unannounced home visits to verify delivery of services, and (3) the imposition of civil penalties for fraudulent timecards.

Elimination of Share of Cost (SOC) Buyout Program. The budget eliminates the SOC buyout program in IHSS effective October 2009. About 9,300 recipients are expected to lose the state buyout as a result of this reduction, which is estimated to save $42.8 million in 2009-10.

Public Authority Administration Reduction. The IHSS public authorities essentially represent the county in provider wage negotiations. Besides collective bargaining, the primary responsibilities of public authorities include (1) establishing a registry of IHSS providers who have met various qualification requirements, (2) investigating the background of potential providers, (3) establishing a system to refer IHSS providers to recipients, and (4) providing training for providers and recipients. In 2009-10, the Governor proposed $23.3 million General Fund for support of the public authorities. The Legislature reduced General Fund support for public authority administration by $4.7 million. The Governor subsequently vetoed an additional $8.6 million, for a total reduction of about $13.3 million.

Children's Programs

The budget provides a combined total of $1.5 billion from the General Fund for Foster Care, Child Welfare Services (CWS), adoptions, and adoption assistance. This is an overall decrease of $154 million (9.4 percent) in funding compared to the revised 2008-09 spending level. This decrease is primarily the result of a reduction to certain Foster Care rates, a veto of funding for

CWS, and a temporary increase in federal funds (through ARRA) to offset General Fund costs in Foster Care and adoption assistance.

CWS Reductions. The Governor's veto reduced CWS funding to counties by $80 million (10 percent) from the General Fund. The budget also reduces General Fund support by $5 million for the Transitional Housing Plus Program, which provides housing services to emancipated foster youth.

Implementation Costs for Federal Requirements. The budget provides $13 million from the General Fund to support the Program Improvement Plan (PIP), which is required because the state did not meet CWS performance standards in a federal review. The budget also provides $4.7 million from the General Fund to cover implementation costs for the federal Fostering Connections to Success and Improving Adoptions Act.

Foster Care. The budget includes a 10 percent reduction to Foster Care group home and foster family agency rates, effective October 2009, for General Fund savings of $26.6 million.

County Welfare Automation

Delay in Los Angeles Eligibility and Determination, Evaluation, and Reporting System (LEADER) Replacement. By delaying for six months the development of the LEADER replacement system, one of the four welfare automation consortia, the budget achieves General Fund savings of about $15 million.

Ten Percent Reduction to County Welfare Automation Systems. The budget reduces funding by 10 percent for the operation and maintenance of the four welfare consortia systems ($4.5 million General Fund) and the Child Welfare Services/Case Management System ($4 million General Fund).

Development of Centralized Eligibility. Budget legislation authorizes the State Department of Health Care Services and the State Department of Social Services to implement a centralized eligibility and enrollment process for CalWORKs, the Medi-Cal, and the Food Stamp programs. This proposal is discussed earlier in the Health section of this chapter.

Community Care Licensing

The budget provides $31.1 million from the General Fund for the Community Care Licensing program. This is an overall decrease in funding of about $6 million (16 percent) compared to the revised 2008-09 funding level. This decrease is primarily the result of (1) a 10 percent fee increase for facilities, which results in General Fund savings of $2.1 million and (2) a one-time $5.3 million increase in federal funds to offset General Fund costs for licensing and inspecting family child care homes.

Department of Child Support Services

The budget provides $280 million from the General Fund for the Department of Child Support Services (DCSS). This is an overall decrease in funding of about $73 million (21 percent) compared to the revised 2008-09 funding level. This decrease is primarily the result of General Fund relief from ARRA and reductions in the cost of automation projects.

Augmentation for Child Support Enforcement Staff. The budget includes a proposal estimated to result in a net General Fund benefit of about $500,000 in 2009-10 by maintaining county child support enforcement staffing. Specifically, the budget includes an $18.7 million ($6.4 million General Fund) augmentation for DCSS for this purpose, which is assumed to increase child support collections and therefore increase General Fund revenues by more than the augmentation.

New Fee on Certain Families. Beginning in January 2008, in accordance with the Federal Deficit Reduction Act of 2005, the federal government began assessing an annual fee on the state of $25 for certain child support cases. The fee applies whenever $500 or more is collected on behalf of a child support family who had never received public assistance (referred to as "never-assisted" cases). State funds have been used to cover this fee in recent years, and $3.7 million is provided for this purpose in the 2009-10 budget plan. New budget legislation authorizes DCSS to begin collecting the annual $25 service fee from the custodial parent in never-assisted child support families effective October 2010, in effect reimbursing the state for these costs.

General Fund Savings From Suspending Backfill. The federal Deficit Reduction Act of 2005 eliminated the states' ability to use federal incentive funds to draw down a federal match. In order to maintain the level of child support enforcement, the Legislature has been backfilling the lost federal funds with General Fund monies. The ARRA temporarily (from October 2008 to September 2010) restores states' ability to use federal incentive funds to draw down other federal matching funds. In response to this change, the budget act removes the General Fund backfill, which saves about $28 million in 2009-10.

Reductions to the Child Support Automation System Budget. In February, the Legislature rejected $36 million in General Fund support proposed for various system upgrades. Additionally, in July, the Legislature further reduced by 10 percent the maintenance and operations budget for the system for an additional savings of $500,000.

Department of Aging

The budget provides $33.4 million from the General Fund for the Department of Aging. This is an overall decrease of about $11.7 million (26 percent) in funding compared to the revised 2008-09 funding level. This decrease is primarily the result of (1) the elimination of the Linkages program and (2) the elimination of state support for community-based services.

Elimination of Linkages. The Linkages program provides case management services that link elderly and impaired clients to services to assist them in remaining in their own communities. Instead of adopting an administration

May Revision proposal to eliminate state funding for the Linkages program, the Legislature reduced its General Fund support by $2.5 million and adopted legislation to prioritize Linkage services for individuals living in poverty. The Governor subsequently vetoed additional funding from Linkages to achieve a total of $6.1 million in General Fund savings—effectively eliminating state support as of October 2009.

Elimination of Community-Based Services Programs (CBSP). The Governor's May Revision proposed to eliminate state funding for CBSP as of October 2009. These programs include the Senior Companion, Brown Bag, Alzheimer's Day Care Resource Center, and Respite programs. The Legislature approved a reduction of about $1.7 million from the General Fund in these programs. The Governor subsequently vetoed additional funding from CBSP to achieve total savings of about $4 million—effectively eliminating state support as of October 2009.

Multipurpose Senior Services Program (MSSP). The Legislature rejected the Governor's May Revision proposal to eliminate MSSP, which provides case management services for elderly clients to prevent or delay institutional placement. However, due to the receipt of FMAP relief under ARRA, General Fund savings of $5.3 million were achieved in MSSP in 2009-10.

Labor Programs

Department of Industrial Relations

The budget provides $27.6 million from the General Fund for the Department of Industrial Relations (DIR). This is an overall decrease of about $41.3 million (60 percent) in funding compared to the revised 2008-09 spending level. This decrease is primarily the result of the implementation of new assessments on employers that make the majority of DIR's activities employer fee-funded, rather than supported by the General Fund.

Department Becomes Mostly Fee-Supported. Currently, California employers must pay five separate assessments (annual surcharges) that are added to their workers' compensation premiums to support various activities within DIR, including components of the workers' compensation program and some workplace safety and health activities.

In May, the Governor proposed to: increase the assessment fees for the Division of Occupational Safety and Health (DOSH) programs, create a sixth assessment to support the activities of the Division of Labor Standards Enforcement (DLSE), and increase staffing in DIR by 183 positions to increase enforcement activities. Essentially, these increased assessments would make DOSH and DLSE completely fee funded, rather than funded by the General Fund. The Legislature adopted the proposed changes to the assessments, but rejected the Governor's proposal to increase staffing. The budget plan increases assessments on employers by about $70 million. The budget establishes a sunset date for the increased assessments of July 2013.

Employment Development Department

Redirect Workforce Investment Act (WIA) Funds to Offset General Fund. The budget redirects a total of $15 million of WIA job-training program funds to offset General Fund costs for parolee employment services provided by California Department of Corrections and Rehabilitation (CDCR). This increases General Fund savings by $5.5 million compared to 2008-09.

Judiciary and Criminal Justice

The 2009-10 budget provides $11.1 billion from the General Fund for judicial and criminal justice programs, including support of ongoing programs and capital outlay projects (see Figure 18). This is a decrease of about $1.6 billion, or about 12.9 percent, below the revised 2008-09 General Fund spending level. As discussed in the "Local Government" section of this chapter, the funding from a local government finance shift would offset about $2.1 billion in General Fund costs for state prisons and courts, thereby bringing total General Fund expenditures for these purposes to about $9 billion in 2009-10. Although not reflected in the figure, General Fund costs for state prisons would also be offset with federal ARRA funds—$727 million in 2008-09 and $358 million in 2009-10. Below, we highlight the other major changes in these budgets.

Judicial Branch

The budget provides about $3.7 billion for support of the judicial branch. This amount includes $1.9 billion from the General Fund and $499 million transferred from the counties to the state, with most of the remaining balance of about $1.3 billion derived from fine, penalty, and court fee revenues. The General Fund amount is $272 million, or 12.3 percent, less than the revised

Figure 18

Judiciary and Criminal Justice Budget Summary

(General Fund, Dollars in Millions)

Program/Department	2007-08	2008-09	2009-10	Change From 2008-09	
				Amount	Percent
Department of Corrections and Rehabilitation	$10,011	$9,932	$8,708	-$1,224	-12.3%
Judicial Branch	2,211	2,212	1,940	-272	-12.3
Department of Justice	400	331	350	19	5.7
Other criminal justice programs[a]	437	303	134[b]	-169	-55.8
Totals	**$13,059**	**$12,778**	**$11,131**	**-$1,646**	**-12.9%**
Estimated General Fund Offset[c]	**—**	**—**	**-$2,099**	**—**	**—**

[a] Includes debt service on general obligation bonds, Office of Inspector General, Juvenile Justice Crime Prevention Act Grants, Small and Rural Sheriffs Grants, and other programs.

[b] Does not reflect the transfer of vehicle license fee revenue from the General Fund to the Local Public Safety and Protection Account.

[c] The budget package includes budget legislation authorizing the Director of Finance to use resources from a local government finance shift to offset General Fund spending for certain state programs. The director plans to use some of these resources for prisons ($588 million) and courts ($1.5 billion).

2008-09 amount. (This figure does not include additional General Fund savings from offsetting judicial branch costs with a local government finance shift.) Funding for trial court operations is the single largest component of the judicial branch budget, accounting for about 84 percent of total spending.

Court Operations. As noted above, the support budget for court operations includes a largely unallocated General Fund reduction of $272 million relative to the revised 2008-09 budget. In addition, the budget provides $124 million less than the estimated workload budget for the courts for 2009-10, primarily by (1) continuing permanently various reductions initially enacted on a one-time basis for 2008-09 (for $92 million in savings) and (2) eliminating the state appropriations limit (SAL) inflation adjustment otherwise required under state law for trial courts ($32 million). The Legislature also approved budget legislation to permanently eliminate the annually required SAL adjustment. The budget assumes that the total of $396 million in savings identified above would be accommodated primarily through the closure of courthouses for one day per month and related furloughs of court staff, increased court fees, and the redirection of various special funds. The budget also reflects the elimination of 100 new superior court judgeships.

Courts Capital Outlay. The budget provides $177 million for various new and ongoing court projects. This amount includes (1) $43 million from the State Court Facilities Construction Fund to continue five previously approved courthouse projects and (2) $100 million from the Immediate and Critical Needs Account (ICNA) to acquire sites for 13 new courthouse projects. (In accordance to Chapter 311, Statutes of 2008 [SB 1407, Perata], ICNA receives revenue from certain court fee and fine increases.) The remaining amount reflects $34 million in lease-revenue bond authority to construct the new Susanville courthouse.

Corrections and Rehabilitation

The budget contains $8.7 billion from the General Fund for support of CDCR. This is a net decrease of $1.2 billion, or 12.3 percent, below the revised 2008-09 level. (This figure does not include additional savings, discussed above, from offsetting CDCR expenditures with a local government finance shift.) Major changes to the CDCR budget are discussed below.

Adult Corrections. The 2009-10 budget reflects a total of $1.2 billion in savings in CDCR's budget from these policy actions as well as from other administrative and programmatic changes in adult corrections. First, the budget assumes that about $278 million in savings would be achieved in 2009-10 from the specific policies approved in budget legislation (SBX3 18, Ducheny) to reduce the inmate and parole populations. The five major actions are:

- ***Parole System Changes ($179 Million).*** The legislation makes certain parolees who have no current or prior violent, serious, or sex offenses ineligible for revocation to state prison by CDCR for parole violations.

(Also, in a related change, the budget plan provides $65 million for increased parole supervision for the most serious and violent offenders.)

- ***Additional Credits for Inmates ($42 Million).*** The legislation increases the credits that inmates can earn to reduce their stay in prison, such as for completing an educational or vocational program.
- ***Changes in Property Crime Statutes ($17 Million).*** Previously, a person could be convicted of certain property crimes, and be eligible to be sent to state prison, if the crime involved certain types of property worth more than a specified amount of money. For example, theft of certain farm crops exceeding $100 could previously have resulted in a state prison term. This measure adjusts these dollar amounts (to $250, in this example) for past inflation, which will mean that fewer offenders will be eligible for state prison.
- ***Probation Incentive Program ($30 Million).*** The budget package provides fiscal incentives to counties to reduce the number of revocations of persons on probation to state prison. The resulting prison savings are expected to exceed the costs of the payments to counties.
- ***Parolee Reentry Accountability Program ($10 Million).*** Under this provision, certain parolees with a history of substance abuse or mental illness who violate their conditions of their parole will be referred by the department to a reentry court program designed to reduce recidivism.

The Legislature rejected two other administration proposals which would have (1) changed sentencing laws so that certain lower-level crimes could only be prosecuted as misdemeanors, making these offenders ineligible for a prison sentence, and (2) transferred certain inmates from prison and placed them in the community on house arrest. The budget plan also assumes that about $618 million in savings will be achieved from other types of administrative and programmatic changes. These include (1) the commutation by the Governor of the sentences of undocumented immigrants currently incarcerated in state prison ($182 million), (2) reductions to inmate and parolee rehabilitation programs ($175 million), and (3) other changes to CDCR operations, such as the elimination of certain headquarters positions and funding for special building repairs ($261 million).

Taken altogether, the policy actions approved in SBX3 18 and the various other administrative and programmatic changes are assumed to achieve about $900 million in savings. At this time, it is unclear how the remaining $300 million in savings assumed in the budget will be achieved in 2009-10.

Impact on the Inmate Population. Figure 19 shows the recent changes and projected decline in the inmate population. Absent the adoption of policy changes discussed below, the state's inmate population would otherwise have been projected to increase by a few thousand inmates in 2009-10, due largely to increased admissions from criminal courts. However, the budget plan also reflects various actions discussed earlier to reduce the inmate population by roughly 16,000 inmates in 2009-10. As a result, the net impact on the inmate population in 2009-10 is projected to be a decline by about 14,000 inmates or 9 percent. When these policy changes have been fully implemented in 2010-11, they are expected to reduce the inmate population by a total of 22,000 inmates. The budget plan assumes a net reduction in 2009-10 of about 28,000 or 25 percent in the number of adult parolees under supervision due to related policy changes.

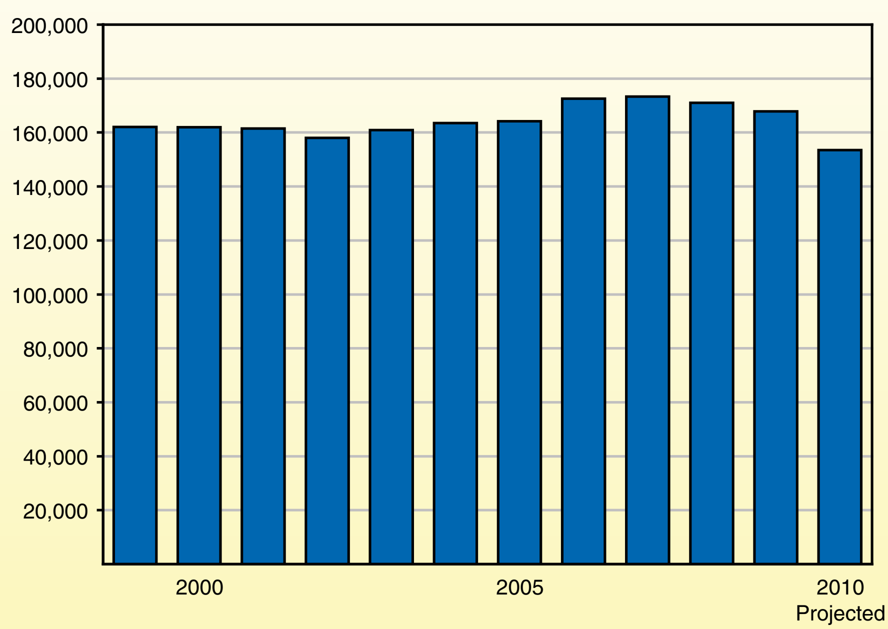
Adult Correctional Health Services. The budget includes a General Fund augmentation of about $30 million for compliance with federal court orders and settlements, such as mental health services under the *Coleman* case. However, the budget reflects $180.8 million in General Fund savings from an unallocated reduction of 10 percent in the federal Receiver's medical services operations. In addition, the budget assumes $50 million in savings in 2009-10 from limiting the reimbursement rates paid to private contractors that provide medical care to inmates outside of prison.

Corrections Capital Outlay. The budget includes $20 million from the General Fund and $16 million in lease-revenue bond authority for various CDCR capital outlay projects. The budget also reverts $20 million of the $300 million General Fund appropriation initially provided in Chapter 7,

Figure 19

Inmate Population Projected to Decline in 2009-10

(As of June 30 of Each Year)



Statutes of 2007 (AB 900, Solorio), a measure authorizing additional prison construction, to the General Fund. The Legislature also approved budget legislation to make various technical changes to the enacted language of AB 900 intended to help the projects move forward. In signing the budget, the Governor vetoed statutory language adopted by the Legislature to prohibit CDCR from encumbering funds for the previously approved condemned inmate housing complex at San Quentin until specified conditions were met. This veto is part of a pending legal challenge to various vetoes to the 2009-10 budget legislation made by the Governor in July.

Local Assistance Programs

As discussed in Chapter 2, the Legislature temporarily increased the vehicle license fee from 0.65 percent to 1.15 percent and dedicated about one-third of the revenues (0.15 percent, or $497 million in 2009-10) to various public safety local assistance programs. These monies will in effect replace General Fund spending for the Juvenile Probation and Camps Funding Program, the Citizens' Option for Public Safety program, the Juvenile Justice Crime Prevention Act program, and local detention facility subventions (booking fees).

Resources and Environmental Protection

The 2009-10 budget provides about $7.8 billion from various fund sources for natural resources and environmental programs administered by either the Natural Resources Agency or the California Environmental Protection Agency. This is a decrease of $2.1 billion, or 21 percent, when compared to revised 2008-09 expenditures. Most of this decrease reflects lower bond expenditures for the budget year, although the budget still includes a major infusion (around $2.1 billion) of available bond funds from various resources-related measures. The budgets also include a combined $1.9 billion from the General Fund.

Figures 20 and 21 compare expenditure totals for resources and environmental protection programs in 2007-08, 2008-09, and 2009-10. As the figures show, General Fund expenditures are lower in 2009-10, largely reflecting much higher-than-average one-time expenditures for emergency wildland firefighting in 2008-09, due to particularly severe fire conditions in that year. (This also accounts for much of the decrease in state operations for resources programs.) The significant decrease in local assistance and capital outlay for resources programs is largely due to reduced bond expenditures. For environmental protection programs, the spending increase for state operations and bond funds mainly reflects increased spending from Proposition 1B bond funds for air quality improvements in trade corridors.

Resources and Environmental Protection Expenditures

Bond Expenditure Summary. The budget includes about $2.1 billion from a number of bond funds (mainly Propositions 50, 84, 1B, and 1E) for various resources and environmental protection programs. Selected highlights of these bond expenditures are shown in Figure 22 (see next page).

Figure 20

Resources Programs: Expenditures and Funding

(Dollars in Millions)

	2007-08	2008-09	2009-10	Change From 2008-09 to 2009-10 Amount	Percent
Expenditures					
State operations	$4,303.2	$4,926.1	$4,446.1	-$480.0	-9.7%
Local assistance	697.2	1,402.1	744.5	-657.6	-46.9
Capital outlay	363.0	1,918.9	628.0	-1,290.9	-67.3
Totals	**$5,363.4**	**$8,247.1**	**$5,818.6**	**-$2,428.5**	**-29.5%**
Funding					
General Fund	$1,869.4	$2,021.0	$1,841.7	-$179.3	-8.9%
Special funds	2,251.1	2,239.0	2,060.6	-178.4	-8.0
Bond funds	1,145.5	3,748.9	1,584.3	-2,164.6	-57.7
Federal funds	97.4	238.2	332.0	93.8	39.4
Totals	**$5,363.4**	**$8,247.1**	**$5,818.6**	**-$2,428.5**	**-29.5%**

Figure 21

Environmental Protection Programs: Expenditures and Funding

(Dollars in Millions)

	2007-08	2008-09	2009-10	Change From 2008-09 to 2009-10 Amount	Percent
Expenditures					
State operations	$1,584.7	$1,260.5	$1,799.5	$539.0	42.8%
Local assistance	480.3	363.1	184.6	-178.5	-49.2
Capital outlay	1.4	4.2	—	-4.2	-100.0
Totals	**$2,066.4**	**$1,627.8**	**$1,984.1**	**$356.3**	**21.9%**
Funding					
General Fund	$90.9	$83.2	$73.5	-$9.7	-11.7%
Special funds	1,053.2	1,143.6	1,197.3	53.7	4.7
Bond funds	739.3	224.5	514.1	289.6	129.0
Federal funds	183.0	176.5	199.2	22.7	12.9
Totals	**$2,066.4**	**$1,627.8**	**$1,984.1**	**$356.3**	**21.9%**

Figure 22

Resources and Environmental Protection Bond Expenditures

(In Millions)

Program Area	Budgeted Expenditures
Water management and quality (including flood control projects and CALFED Bay-Delta Program)	$766
Air quality improvements in trade corridors	504
State and local parks	454
Conservation, restoration, and land acquisition	345

CALFED Bay-Delta Program. The CALFED Bay-Delta Program is a consortium of 24 state and federal agencies created to address a number of interrelated water problems in the state's Bay-Delta region. The budget provides a total of $297 million in state funds for the CALFED Bay-Delta Program in 2009-10, including about $16 million of reappropriations. Of this total amount, the largest program expenditures are for the existing water conveyance system ($89 million) and levee system integrity ($56 million). Funding comes mostly from various bond funds ($168 million) and State Water Project (SWP) funds ($115 million).

Alternative Delta Conveyance. The Department of Water Resources (DWR) is provided 15 limited-term positions for the Delta Habitat Conservation and Conveyance Program, with an estimated cost of $2.6 million (off-budget SWP funds). The budget act restricts the use of these funds to planning workload related to the program and prohibits their use for the physical construction of an "alternative conveyance facility." This term refers to infrastructure for the transport of water (perhaps through a new canal *around* the Delta) as an alternative to the current system of transporting water *through* the Delta.

SWP Positions and Recreation Funding. Of the 111 positions proposed to be added to SWP in 2009-10, the budget act includes authority for 49 SWP positions for state operations and Delta-related projects. The Legislature also rejected the administration's proposal to use state funds (fee revenues and bond funds) to pay for the portion of the SWP's overall operations as well as for capital outlay costs that DWR has allocated to recreation. However, as in past years, the budget includes funding (primarily from special funds) for operations and maintenance of specific SWP recreation facilities under the budgets of the Department of Parks and Recreation (DPR) and the Department of Boating and Waterways.

Federal Economic Stimulus Funding for Water Quality Projects. The revised state spending plan includes $283 million in federal economic stimulus monies in 2008-09 and 2009-10 for water quality improvements. These monies are largely for grants and loans to local water agencies for wastewater infrastructure, and are administered through the existing Clean Water State Revolving Fund. The usual state requirement for local matching funds was waived in order to meet federal requirements for the use of these funds.

Climate Change. The budget includes about $48 million (mostly special funds) across ten state agencies for implementation of the Global Warming Solutions Act of 2006 (Chapter 488, Statutes of 2006 [AB 32, Núñez]), to reduce the state's emission of greenhouse gases (GHGs) to 1990 levels by 2020. Figure 23 lists the expenditures, number of positions, funding sources, and

Figure 23

AB 32 Implementation

2009-10 (Dollars in Thousands)

Agency	Positions	Expenditures	Fund Source	Activity
Air Resources Board	153	$32,414	Air Pollution Control Fund (APCF)[a]	Develop market-based compliance measures (including cap-and-trade), Low Carbon Fuel Standard regulations, and vehicular/industrial measures to create greenhouse gas (GHG) emission reductions.
Forestry and Fire Protection	8	6,876	Proposition 84 bond funds	Award urban forestry management grants; staff support.
General Services	5	2,936	Service Revolving Fund	Implement Green Building Initiative and Sustainability Program.
Secretary for Environmental Protection	6	1,764	General Fund, APCF, Motor Vehicle Account	Climate Action Team activities, including program oversight and coordination.
Department of Water Resources	9	1,636	Proposition 84 bond funds, 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.
Integrated Waste Management[b]	6	1,312	Integrated Waste Management Account	Develop GHG emission reduction measures for landfills.
Energy Commission	5	610	Energy Resources Programs Account	Develop GHG emission reduction measures.
Secretary for Natural Resources	2	425	General Fund	Adopt GHG emissions mitigation guidelines.
Food and Agriculture	2	343	Food and Agriculture Fund	Develop GHG emission reduction measures.
Public Utilities Commission (PUC)	1	94	PUC Ratepayer Advocate Account	Monitor PUC implementation of AB 32.
Totals	**205**	**$48,410**		

[a] Supported by a loan from the Beverage Container Recycling Fund, to be re-paid within three years.

[b] Funding will be administered by new Department of Resources Recycling and Recovery following elimination of the board effective January 2010.

activities funded on an agency-by-agency basis for the implementation of AB 32 in 2009-10. These activities include the development of the regulations to implement various source-specific measures to reduce GHGs, and the award of urban forestry management grants.

Assembly Bill 118-Funded Programs. The budget includes (1) $102 million for financial incentives administered by the Energy Commission to advance alternative and renewable fuel vehicle technologies and (2) $44 million for the Air Resources Board (ARB) to provide grants and loans to owners of heavy-duty diesel vehicles to retrofit vehicles to achieve early compliance with regulations requiring reductions in emissions of air pollutants and GHGs from these vehicles. These expenditures are funded from fee revenues (smog abatement, vehicle registration, and vessel registration fees) raised pursuant to Chapter 750, Statutes of 2007 (AB 118, Núñez). The budget also includes a total of $5 million of AB 118 funds for Department of Forestry and Fire Protection (CalFire), DPR, and the Department of Fish and Game to retrofit their on-road diesel vehicles in compliance with ARB regulations.

Hydrogen Highway. The Energy Commission has allocated $40 million of its appropriation of AB 118 monies discussed above to the development of hydrogen refueling stations. The Governor vetoed budget act language passed by the Legislature that would have prohibited any expenditure from this appropriation for hydrogen refueling stations in 2009-10. This veto is being contested in pending litigation.

Wildland Fire Protection Capital Outlay. The budget includes $290 million of new lease-revenue bond funding for fire protection capital outlay projects—primarily to restore or replace existing facilities.

Emergency Wildland Fire Suppression. The budget act includes $182 million from the General Fund that is designated specifically for emergency fire protection. As has been the case in previous years, the budget act allows the Director of Finance to augment this amount to pay for additional fire protection expenses, as needed.

No New Funding Sources for CalFire. The budget does not include any new sources of funding for CalFire. Both the administration's proposal for a 4.8 percent statewide surcharge on property insurance premiums and the legislative proposal for a fee on structure owners in State Responsibility Areas were rejected.

General Fund Reduction for State Parks. The budget includes a $14 million unallocated reduction in General Fund support for DPR—a decrease of 11 percent from the level of support contained in the February enacted budget. This includes a veto by the Governor of $6.2 million that is the subject of pending litigation. Based on statements by the administration, the reductions will not lead to the complete closure of any state park in the budget year. A legislative proposal to replace all General Fund support for DPR with revenues from a new $15 annual vehicle registration surcharge (entitling vehicle registrants to free daily access to state parks) was considered but not adopted.

California Conservation Corps. The Legislature rejected the Governor's January budget proposal to eliminate the California Conservation Corps (CCC) and shift its functions to local conservation corps (LCCs) over a two-year period. Instead, the enacted budget includes legislative augmentations totaling about $15 million for the LCCs—$8.3 million from the Beverage Container Recycling Fund (BCRF) and $6.7 million from bond funds—for beverage container litter reduction, workforce training, and other activities.

Beverage Container Recycling Program. Due to a projected $157 million deficit in the BCRF, the budget reflects generally proportional reductions to the various programs that are funded by the BCRF through continuous appropriations (that is, ongoing appropriations made outside of the budget act). These include reduced payments to LCCs (see discussion above), to cities and counties for recycling programs, and to recyclers. The BCRF has now provided a total of $518 million in outstanding loans to the General Fund and to the Air Pollution Control Account, including $134 million in additional loans that are included in the 2009-10 budget.

Rejection of Oil Drilling Proposal. The Legislature rejected the administration's proposal to raise revenues by enacting legislation approving the Tranquillon Ridge offshore oil-drilling project. The administration estimated that this project, if approved, could result in state revenues of $100 million in 2009-10 and a total of $1.8 billion over the 14-year lease term of the project.

Energy Expenditures

Federal Economic Stimulus Funding. The budget package includes $182 million in federal funds—an increase of about $160 million from 2008-09—for energy-related programs. This includes state-administered energy efficiency and conservation block grants (for state and local purposes) and the State Energy Program (which funds state energy efficiency and renewable energy programs).

Energy Research and Renewable Energy Incentives. The budget includes $74 million for energy-related research and development funded through the Energy Commission's Public Interest Energy Research Program. It also provides about $69 million for production-based incentives and purchaser rebates to promote renewable energy under the Energy Commission's Renewable Energy Program. This program is funded from the Renewable Resource Trust Fund, which is supported from utility ratepayers.

Transportation

The 2009-10 spending plan provides about $17 billion from various fund sources for transportation programs. This is roughly the same as the overall level of spending in the prior year, as shown in Figure 24.

Department of Transportation

The 2009-10 budget plan includes total expenditures of $13.6 billion from various fund sources for the Department of Transportation (Caltrans), according to departmental estimates. This level of expenditures is higher than in 2008-09—by about $1.6 billion (or 13 percent). The higher spending level reflects the planned expenditure of federal stimulus funds on local roads, and highway repair and maintenance projects. The 2009-10 budget provides approximately $5.7 billion for transportation capital outlay, $3.6 billion for local assistance, $1.5 billion for capital outlay support, and about $1.4 billion for highway operations and maintenance. The budget also provides $512 million for department administration, $418 million for Caltrans' mass transportation and rail program, and $145 million for transportation planning. The balance of funding goes for program development, legal services, and other purposes.

Full Funding of Proposition 42. Consistent with the requirements of Proposition 42, a March 2002 ballot measure, the 2009-10 budget provides for the transfer of gasoline sales tax revenue from the General Fund for various transportation purposes. The total transfer is projected at about $1.4 billion. This amount is to be allocated as follows:

- $576 million for the State Transportation Improvement Program to fund state and local transportation projects.
- $576 million to cities and counties for local streets and roads projects.
- $288 million to the Public Transportation Account (PTA) for mass transportation purposes.

Figure 24

Transportation Program Expenditures

(Various Fund Sources, in Millions)

Program/Department	2007-08	2008-09	2009-10
Department of Transportation	$9,633	$12,011	$13,592
California Highway Patrol	1,729	1,834	1,881
Department of Motor Vehicles	895	1,027	941
High-Speed Rail Authority	17	43	139
State Transit Assistance	306	153	—
Other expenditures	537	448	378
Totals	**$13,117**	**$15,516**	**$16,931**

Repayment of Past Proposition 42 Suspensions. Proposition 1A (the ballot measure with that designation passed by voters in November 2006), requires that Proposition 42 suspensions that occurred in 2003-04 and 2004-05 be repaid with interest no later than June 2016. The budget includes $83 million from the General Fund to partially repay the outstanding amount. Following this year's payment, a balance of about $500 million in Proposition 42 loans (not including interest) remains outstanding.

Continued Appropriations of Proposition 1B Bond 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. As shown in Figure 25, the 2009-10 budget appropriates a total of about $4.2 billion for various programs. The funding will mainly be used for capital outlay and local assistance purposes.

Figure 25

2009-10 Appropriation of Proposition 1B Funds

(In Millions)

Program	Total
Corridor Mobility Improvement	$1,351
Local Streets and Roads	713
Trade Corridor Improvement	490
Public Transportation Modernization	477
Highway 99 Improvement	431
Air Quality	250
State Local Partnership	201
Transit Security	102
State Highway Operations and Protection	78
State Transportation Improvement	57
Local Bridge Seismic	31
School Bus Retrofit	3
Railroad Crossing Safety	1
Port Security	—
Total	**$4,185**

Note: Appropriations are through budget act and do not include statutory appropriations.

Loan From State Highway Account Would Help General Fund. The budget loans $135 million from the State Highway Account (SHA) to the General Fund to help the state's fiscal condition. This loan would be repaid no later than June 30, 2012. (The impact to transportation programs of this loan and the use of transportation funds to help the General Fund will be reviewed in our 2010-11 budget analysis.)

Special Transportation Programs

Substantial Public Transportation Funds Used to Help General Fund. The PTA derives its revenues from diesel sales tax and portions of the gasoline sales tax, including "spillover." (Spillover is the amount that gasoline sales tax revenue at the 4.75 percent rate exceeds the sales tax revenue amount generated from all other goods at the 0.25 percent rate.) The account also receives a portion of the Proposition 42 gasoline sales tax revenue.

Funds in the PTA are required statutorily to be used for mass transportation and planning purposes. Since 2003-04, a portion of the PTA funds have been used each year to benefit the General Fund. In 2007-08, the Mass Transportation Fund (MTF) was created to receive a portion of spillover revenues to benefit the General Fund on an ongoing basis. The budget package directs all spillover revenues to the MTF to be used for General Fund relief. The 2009-10 budget uses about $1 billion in mass transportation revenues to benefit the General Fund. This amount includes $652 million from spillover gasoline sales tax revenues to MTF and $363 million from PTA. Specifically, the budget plan assumes that the General Fund would be helped in the following ways:

- ***Transportation Bond Debt Service.*** The budget uses $652 million in spillover revenues from the MTF to reimburse the General Fund for debt service on transportation bonds, including $623 million incurred in prior years and $29 million in current-year debt service. In addition, the budget provides $225 million in PTA funds to pay for debt service on transportation bonds incurred in 2009-10.
- ***Regional Center Transportation.*** The budget provides $138 million in PTA funds to pay for the cost of regional center transportation.
- ***State Transit Assistance.*** The State Transit Assistance (STA) program provides operating assistance that is distributed to local rail and bus transit operators on a formula basis. Funding for the program comes from the PTA and spillover. In February, the Legislature reduced the 2008-09 funding level for the program by $153 million in order to help achieve General Fund relief. In addition, Chapter 14 suspended funding for STA for four fiscal years from 2009-10 through 2012-13.

High-Speed Rail Authority

Funding Levels Increase Due to Passage of Bond Measure. In November 2008, voters approved a statewide bond measure—Proposition 1A. This measure authorizes the state to sell $9 billion in general obligation bonds to partially fund the development and construction of a high-speed train system. The 2009-10 budget provides $139 million in Proposition 1A bond funds for the California High-Speed Rail Authority to plan and develop the rail system, with one-half of the funding available only upon the submittal of a revised business plan by December 2009. Specifically, the bond funds are budgeted for the following uses:

- ***Project-Level Planning and Management.*** About $105 million would be spent for contract services to perform preliminary design and environmental review for the eight segments of the rail system.
- ***Program Management and Other Services.*** About $27 million would be spent for contract services for overall program management, as well as roughly $5 million on various other contracts including ridership/revenue forecasts and financial consulting services.

- ***Administrative Costs.*** About $2 million would be for administrative costs and support of the authority.

California Highway Patrol and Department of Motor Vehicles

The 2009-10 budget provides $1.9 billion to fund California Highway Patrol (CHP) operations, about $47 million (or 3 percent) more than in 2008-09. The funding includes support for 240 new highway patrol officers ($25 million), and funds for a new computer-aided officer dispatch system ($12 million). For Department of Motor Vehicles, the budget provides $959 million for departmental operations, a reduction of $67 million (or 6.6 percent) compared to the 2008-09 level due to the expiration of one-time funding for capital outlay provided in the prior budget. The budget includes $6.6 million to support a new multiyear contract for the production of security-enhanced driver license and identification cards. To cover the cost of the new contract, driver license fees will increase by $2, beginning 2010. The budget includes provisional language prohibiting the department's use of facial-recognition biometric software as part of the driver license issuance process. In light of the state's fiscal condition, the Legislature rejected approximately $33 million requested by the two departments for various capital outlay projects.

Motor Vehicle Account (MVA). To help address the General Fund condition, the 2009-10 budget provides a one-time transfer of $70 million from the MVA to the General Fund. Unlike other MVA revenues, these funds are not restricted by Article XIX of the State Constitution and thus are available for general state purposes.

Local Government

Overview of Local Government Revenue Shifts

The budget package provides major General Fund relief by redirecting the use of two sources of local government funds: (1) property taxes by borrowing funds under the provisions of Proposition 1A (2004) and (2) redevelopment dollars. The package establishes a new fund in each county—the Supplemental Revenue Augmentation Fund (SRAF)—to receive $3.6 billion of resources related to these sources. Figure 26 (see next page) summarizes SRAF revenue sources and initial program allocations, as shown in the budget schedules prepared by the Department of Finance (DOF).

Under the spending plan, county offices of education serve as state fiscal agents for a wide range of programs. Specifically, under the direction of DOF, county offices use SRAF resources to reimburse the state for trial court, correctional, and other state-funded services and costs in their county. Any resources remaining in SRAF, after these state reimbursements are made (an estimated $850 million), are transferred to the county's Educational Revenue Augmentation Fund (ERAF) for apportionment to K-12 districts. The ERAF resources offset state-required spending for education under Proposition 98.

Proposition 1A Property Tax Suspension

The budget plan suspends Proposition 1A (2004) and borrows $1.9 billion of property taxes from cities, counties, and special districts. Under the Constitution, the funds must be repaid by June 30, 2013. Under the plan, revenues equal to 8 percent of each local agency's 2008-09 property tax apportionment (excluding debt levies) are redirected from the agency to SRAF.

Joint Securitization Option. The budget plan includes a way to offset losses by local governments due to the state borrowing. Specifically, the budget plan authorizes a joint powers authority to issue "Proposition 1A receivable notes" (backed by the state's repayment obligation) and use the proceeds to replace the revenues diverted from each agency that participates in the securitization. Under the plan, the state pays the full cost of the securitization, including interest and debt issuance costs. Local agencies that do not choose to participate in the securitization would be reimbursed by the state for their property tax diversion by June 30, 2013, including interest at a rate set by DOF.

Hardship Provisions. Local agencies facing severe economic difficulties may apply to DOF for a reduction or elimination of their property tax suspension. If DOF approves an agency's hardship petition, any reduced property

Figure 26

SRAF Revenues and Initial Allocations[a]

(In Millions)

Sources	
Proposition 1A property tax suspension	$1,935
Redevelopment/schools fund shift	1,700
	$3,635
Allocations	
County Offices of Education	
Trial courts	$1,511
Corrections	588
Medi-Cal	565
State general obligation bond debt service (school construction)	120
	$2,785
Educational Revenue Augmentation Fund	
K-12 apportionments	$850
Total Allocations	**$3,635**

[a] The spending plan gives DOF flexibility to revise SRAF allocations.

SRAF = Supplemental Revenue Augmentation Fund; DOF = Department of Finance.

tax amount would be reallocated to other agencies in the county so that the total suspension amount in the county remained unchanged. The department may not approve suspensions totaling more than 10 percent of the total suspension amount in a county.

Redevelopment/Schools Fund Shift

The budget package requires redevelopment agencies to make payments totaling $1.7 billion (2009-10) and $350 million (2010-11) to K-12 school districts serving students living in or near their redevelopment areas. Redevelopment agencies deposit these payments into a new county Supplemental Educational Revenue Augmentation Fund (SERAF) for allocation to the designated school districts.

These redevelopment deposits into SERAF, in turn, trigger a shift in school funds in a manner such that schools would experience no net change in their financial situation while the state benefits from the redevelopment deposits. Specifically, county auditors reduce each school district's base ("AB 8") property tax allocations by the amount the district receives from SERAF. The county auditor deposits these base school property tax revenues into the county's SRAF. As described above, county offices use SRAF resources to reimburse the state for a variety of programs. All remaining SRAF revenues are shifted to the county's ERAF for apportionment to schools.

Other Provisions. To help redevelopment agencies finance these payments, the budget plan allows agencies to suspend their contributions to their Low and Moderate Income Housing Funds or borrow these funds from their parent city or county. Redevelopment agencies that fail to restore any funds to their Low and Moderate Income Housing Funds by June 30, 2015, however, are subject to a 5 percent increase in their required annual housing set-aside (generally increasing the set-aside from 20 to 25 percent). Agencies that meet their payment obligation under the budget plan for 2009-10 may extend their time limits for plan effectiveness and receipt of tax increment revenues by one year.

State-Mandated Local Programs

The spending plan suspends most non-education mandates, with the exception of certain mandates relating to law enforcement, election procedures, open meeting requirements, and tax collection. When the state suspends a mandate, for one year (1) local governments are not required to implement its requirements and (2) the state may postpone its obligations to pay the accumulated mandate bills. The spending plan also defers a scheduled payment ($88 million) towards retiring the state's pre-2004 non-education mandate debt (approximately $1 billion).

Williamson Act Subventions

The spending plan reduced funding for Williamson Act subventions by 20 percent, or $8 million. The Governor vetoed the remaining $28 million of Williamson Act funds. (This veto is subject to the litigation described in Chapter 1.) Under this program, local governments enter into contracts with landowners to restrict certain property to open space and agricultural uses. In return for these restrictions, property owners pay reduced property taxes. State Williamson Act subventions offset part of these local government property tax losses.

Other Major Provisions

Employee Compensation

Budget Assumes Savings From Governor's Three-Day Furlough Order. Beginning in February, the Governor ordered the furlough of about 200,000 executive agency employees for two days per month, reducing pay by 9.2 percent. The Governor added an additional furlough day in July, bringing the total to three days per month and a 13.9 percent reduction in pay. Currently, nearly all state employees—with limited exceptions, such as CHP officers and certain CalFire staff—are prohibited from working on three Fridays per month, resulting in most state offices being closed. The *2009-10 Budget Act* assumes over $2.4 billion ($1.4 billion General Fund) in savings from the Governor's furlough orders and related employee compensation savings measures. The Governor's furlough orders are under review by the courts in various suits initiated by state employee unions, the California Public Employees' Retirement System (CalPERS), constitutional officers, and others. Court actions and other matters could affect the actual expenditure savings generated by furloughs.

Limited Amounts for Increases in Employee Compensation. While overall employee compensation costs should decline in 2009-10, prior state employee labor agreements provide for increases in state health premium contributions for some workers. In particular, state health contributions for some workers will rise due to an average increase in CalPERS plan premiums of 2.9 percent in 2010. The budget bill passed by the Legislature in July included a limited amount—$118 million ($41 million from the General Fund)—for these cost increases and other costs associated with previous agreements. The Governor reduced the appropriation as part of his July vetoes to $63 million ($16 million from the General Fund)—with the balance to be funded out of departmental budgets. As of the date of this publication, 20 of 21 state employee labor agreements have expired. (The exception is the agreement with the bargaining unit covering CHP officers, which expires in July 2010.)

Health Plan Funding Holiday Provides Some Relief. The budget reflects $132 million in savings from an employee and retiree health plan "premium holiday." Authorized by the CalPERS board for its preferred provider organization (PPO) health plans, CalPERS will waive healthcare contributions from employees, retirees, and public employers for two months in the fall of 2009 because of excess reserves in PPO plan accounts.

Rural Health Care Subsidies Eliminated. The budget package eliminates the Rural Health Care Equity Program, which subsidized PPO costs for state workers without access to less expensive health maintenance organization plans, for workers in 20 of the state's 21 bargaining units. (An exception continues the program one more year—to July 2010—for CHP officers.)

Payroll Deferral Shifts One Payday to 2010-11. The budget package reflects budget savings from moving the final paycheck of the fiscal year (June 30) to the first day of the following fiscal year. This facilitates $938 million in one-time General Fund savings in 2009-10.

Reorganizations and Consolidations

Assumes $50 Million in Savings. The budget package assumes $50 million in General Fund savings from the reorganization, consolidation, and elimination of several departments, boards, and committees. Figure 27 (see next page) shows actions included in the package.

Information Technology

Information Technology (IT) Savings. The Legislature adopted control language requiring the Office of the State Chief Information Officer to save $100 million General Fund from statewide reductions to IT budgets. Savings may come from renegotiating IT contracts and consolidation of IT purchases and services, among other actions.

Funding for 21st Century Project Reprocurement. After experiencing numerous difficulties with its prime vendor, the State Controller's Office (SCO) project staff terminated the vendor contract in January 2009 and began working on a re-procurement strategy. The SCO staff are currently involved in a two-stage procurement to secure a new prime vendor. The budget includes about $25 million to fund further project activities.

Financial Information System of California (FI$Cal). The budget plan includes spending authority of $80 million from the General Fund to continue project activities to build FI$Cal. Project staff indicate only about $35 million of that funding will be spent in 2009-10—about $2 million from a General Fund appropriation with the remainder coming from a General Fund loan. Additionally, a budget act provision requires the project to report to the Legislature on the outcome of its competitive multiple stage procurement to secure a prime vendor.

Procurement Process Changes. A measure in the July budget package loosens prior contracting restrictions that prevented a firm from bidding on an IT project for which it had previously held a consulting contract pertaining to the development of that project's scale and scope. The legislation also allows departments to withhold from vendors less than the previously required amount of 10 percent of the contract prices for certain goods and services until their final delivery and acceptance.

Cost-of-Living Increases

The budget package includes statutory language that eliminates automatic COLAs for CalWORKs and SSI/SSP grants and automatic increases for state operations (such as the state courts). Instead, decisions on COLAs would be made on an annual basis (generally as part of the budget process).

State Buildings and Surplus Property

The budget package makes a number of changes to the way in which the state manages its office buildings and surplus property. The budget authorizes the administration to enter into additional leases of state property and "lease-back" contracts for state buildings. Under these lease-back contracts, the state would sell or offer a long-term lease on a state building to a private entity. Generally, these types of contracts would involve the state paying higher costs over several decades (for rent) in exchange for an up-front cash payment from the private entity. In addition, the package authorizes the administration to sell the Orange County fairgrounds.

Figure 27

Reorganizations and Consolidations

Entity	Action	Result
Integrated Waste Management Board	Elimination	Moves board functions and recycling functions of the Department of Conservation to new Department of Resources Recycling and Recovery
Bureau of Naturopathic Medicine	Elimination	Creates committee in Osteopathic Medical Board to provide oversight of natural medicine industry
Board of Geologists and Geophysicists	Elimination	Moves function to Board for Professional Engineers and Land Surveyors
Structural Pest Control Board	Reorganization	Moves board from DCA to the Department of Pesticide Regulation
Bureau of Home Furnishings and Thermal Insulation and Bureau of Electronic and Appliance Repair	Consolidation	Consolidates both boards under DCA
Inspection and Maintenance Review Committee	Establishment of Sunset Date	Forces review of committee and sets up possible elimination by 2012
Various IT programs in DTS, Telecommunications Division in DGS, and OIS	Consolidation	Moves programs and some IT oversight authority to the Office of the Chief Information Officer

DCA = Department of Consumer Affairs; IT = information technology; DTS = Department of Technology Services; DGS = Department of General Services; OIS = Office of Information Security.