Governor's Budget **May Revision** 2013-14

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Introduction

The Governor's Budget reflected California's most stable fiscal footing in well over a decade. With the tough spending cuts enacted over the past two years and new temporary revenues provided by the passage of Proposition 30, the state's budget is projected to remain balanced for the foreseeable future. However, substantial risks, uncertainties, and liabilities remain.

The May Revision maintains the fundamentals of the Governor's Budget. It reflects that the state's economic and budget recovery is continuing. However, the national economic outlook has dimmed since the Governor's Budget and recent federal actions have slowed the pace of the state's economic growth.

In the past four months, the state has experienced a multibillion dollar increase in current-year cash receipts. Yet, the influx is expected to be short-lived. Schools will benefit from this one-time increase, as well as from the implementation of the Local Control Funding Formula. The May Revision also proposes an affordable and sustainable path for a state-based expansion of health care coverage and a commensurate shift in some responsibilities to counties. It preserves the state's safety net, encourages job growth, and pays down debt.

Changes since the Governor's Budget

The May Revision reflects the net changes in the national and state economic outlook, the corresponding effects on revenues and the state's obligation to schools, as well as other spending adjustments.

Among the key developments are:

- A downward revision in the short-term economic outlook due to recent federal actions. Specifically, the federal government did not extend the 2-percent payroll tax reduction that had been in place in 2011 and 2012. This action was not assumed in the Governor's Budget economic forecast. As a result, forecasted personal income growth in 2013 has been cut almost in half — from 4.3 percent to 2.2 percent. In addition, the federal government allowed the sequester of tens of billions of dollars in spending.

- The May Revision reflects, as required by Proposition 98, $2.9 billion in additional funds in the current year for K-12 schools and community colleges. The May Revision proposes that these one-time funds be used to reduce the deferral of payments to schools and community colleges, and to support the implementation of new academic standards.

- Medi-Cal experiencing higher costs of $467 million, principally as a result of the federal government and courts either rejecting or delaying approval of previously adopted legislative actions.

- The costs of borrowing for both short-term cash and long-term infrastructure investments have been reduced by $484 million. This was made possible by the state's improved fiscal condition.

The May Revision includes several key investments that will help successfully implement recent programmatic changes. It proposes an additional $48 million in CalWORKs for job training and subsidized employment opportunities to assist Californians in getting back to work under program reforms adopted last year. The May Revision also includes an additional $72 million (for a total of $107 million) for county probation departments because of responsibilities they have incurred in assisting the state in reducing its prison population.

Proposed legislation aims to strengthen the state's economic development programs to bolster the business environment and reintegrate people into the workforce.

By revamping the existing enterprise zone and hiring credit programs in a revenue neutral manner, the state can encourage manufacturing investment and increase employment in high poverty areas across the state.

Reinvesting in Education

With the passage of Proposition 30, the 2012-13 and 2013-14 budgets will reinvest in, rather than cut, education funding. From 2011-12 through 2016-17, the Proposition 98 minimum funding guarantee will increase from $47.3 billion to $66.5 billion, an increase of more than $19 billion.

For K-12 schools, funding levels will increase by $2,754 per student through 2016-17. As shown in Figure INT-01, the May Revision increases funding for higher education by between $1,503 and $2,491 per student through 2016-17.

Figure INT-01
Budget Increases Funding Per Student

	2011-12	2016-17	Funding Increase
K-12 Education	$7,175	$9,929	$2,754
Community Colleges	$4,893	$6,396	$1,503
California State University	$5,868	$7,803	$1,935
University of California	$10,630	$13,121	$2,491

The May Revision provides $1,046 more per K-12 student in 2013-14 than was provided in 2011-12, with an additional $170 dollars per student to support the implementation of the Common Core—new standards for evaluating student achievement in English-language arts and math. The upcoming Budget also provides the opportunity to correct historical inequities in school district funding. In January, the Governor's Budget proposed an overhaul of school funding to create a more just allocation of resources and increase local flexibility. The May Revision makes modest modifications to this Local Control Funding Formula to address issues raised over the past few months—the basic approach remains the same. All California school districts can improve under this formula with new ongoing funding based on the number of students served. By committing the most new funding to districts serving English language learners, students from low-income families, and foster youth, the formula ensures that the students most in need of help have an equal opportunity for a quality education.

When fully implemented, it is projected that the formula will spend 80 cents of every dollar on base grants for every student in a district, 16 cents for every English learner, low-income student, or foster child in a district, and 4 cents for those districts who have a particularly high concentration of English learners, students from low-income families, and foster youth. While the concentration funds represent only a small portion of the total dollars, they are critically important to those districts with the greatest challenges. Academic research confirms that a large concentration of English learners, students from low-income families, and foster youth presents the greatest and costliest challenge to effective teaching. Investing in these students now will better prepare the entire state for the future.

This new funding will be coupled with strong accountability. These measures will allow communities to govern their schools locally—but provide authority to county offices of education and the state to step in if districts fail to improve. Districts will be required to spend the entire amount allocated for English learners, students from low-income families, and foster youth for the benefit of these students. Independent audits and county and state oversight will make sure this occurs.

Expanding Health Care

Medi-Cal currently serves more than one out of every five Californians. Federal health care reform will significantly expand that coverage. The May Revision proposes a state-based approach to the optional expansion of care allowed under federal law. This expansion will significantly increase health care coverage and access new federal dollars. The law, however, also comes with costs, risks, and uncertainties.

The state currently dedicates about $1.5 billion annually to counties for health care, primarily for services for indigent adults—many of the same people who will move to Medi-Cal under the new law. While the need for county indigent services will continue and preserving a safety net is a priority, the state cannot—and should not—pay for the same services twice. Consequently, the May Revision proposes that over time, as the state takes on more responsibility for health care, counties take on more financial responsibility for certain human services programs. To ensure adequate funding remains at the county level for safety net services, dollars would only be redirected based on actual county-by-county experience. The goal is to allocate risk fairly, strengthen local flexibility, and clearly delineate the respective responsibilities of the state and the counties.

A Balanced Budget Plan, But Risks Remain

The May Revision proposes a multiyear plan that is balanced, maintains a $1.1 billion reserve, and pays down budgetary debt. Yet, the budget remains balanced only by a narrow margin. Further, the state must begin to plan now to ensure that the budget will remain balanced after the temporary Proposition 30 tax revenues expire.

Risks

A number of risks could quickly return the state to fiscal deficits:

- The pace of the economic and revenue recovery is still uncertain. Limited international growth may dampen the pace of domestic expansion. The forecast for revenues attributable to capital gains remains subject to considerable volatility.
- In recent years, under court orders, the state has significantly reduced prison crowding and improved the quality of the health care provided in prisons. If the state is unsuccessful in convincing the federal courts that it is now meeting the constitutionally required level of care, significant costs totaling hundreds of millions of dollars annually may be imposed.
- Rising health care costs could strain the state budget. Medi-Cal is the budget's second largest program. Additionally, the state provides health benefits to its own employees and retirees. As the state implements federal health care reform, budgetary spending will become even more dependent on the rate of health care inflation. If this inflation rises faster than expected, annual General Fund spending could quickly rise by hundreds of millions of dollars.
- The federal government and the courts have hindered the state's past efforts to reduce spending and could again interfere with the successful implementation of approved budget actions. For example, the Budget relies on the orderly dissolution of redevelopment agencies to defray state education costs of $1.5 billion in 2013-14. Yet, there are more than 70 active lawsuits from former redevelopment agencies. The Budget also relies on about $450 million in lower spending from a Medi-Cal provider rate reduction originally adopted in 2011, but that remains tied up in federal court.
- Actions taken by the federal government to address its own fiscal challenges could further strain the state budget. Such a strain could take many forms—such as

shifting of program costs from the federal government to states or reducing overall federal spending in California.

Debts

The state's budget challenges have been exacerbated by the Wall of Debt — an unprecedented level of debts, deferrals, and budgetary obligations accumulated over the prior decade. The May Revision dedicates billions to repay this budgetary borrowing. Moving forward, continuing to pay down the Wall of Debt is key to increasing the state's fiscal capacity. In 2011, the level of outstanding budgetary borrowing totaled $35 billion. As shown in Figure INT-02, the debt will be reduced to less than $27 billion this year. Under current projections, it will be reduced to below $5 billion by the end of 2016-17.

Figure INT-02

Budget Plan Would Reduce Wall of Debt to Less than $5 Billion

(Dollars in Billions)

	End of 2010-11 [1/]	End of 2012-13 [2/]	End of 2016-17 [2/]
Deferred payments to schools and community colleges	$10.4	$6.4	$0.0
Economic Recovery Bonds	7.1	5.2	0.0
Loans from Special Funds	5.1	4.6	0.5
Unpaid costs to local governments, schools and community colleges for state mandates	4.3	4.9	3.1
Underfunding of Proposition 98	3.0	2.4	0.0
Borrowing from local government (Proposition 1A)	1.9	0.0	0.0
Deferred Medi-Cal Costs	1.2	2.0	1.1
Deferral of state payroll costs from June to July	0.8	0.7	0.0
Deferred payments to CalPERS	0.5	0.4	0.0
Borrowing from transportation funds (Proposition 42)	0.4	0.3	0.0
Total	**$34.7**	**$26.9**	**$4.7**

[1/] As of 2011-12 May Revision

[2/] As of 2013-14 May Revision

Future Liabilities

Balancing the budget was a critical step in returning the state to fiscal stability. Maintaining that stability will require more work. California still needs to address other liabilities that have been created over many decades. For example, beginning in 2015-16, the state will begin to pay hundreds of millions of dollars more to the California Public Employees'

Retirement System to help pay down the $38.5 billion unfunded liability for state employees' pensions. Those higher payments will need to continue for decades.

Between now and 2016-17, the costs for retired state employees' health care is projected to rise by 59 percent. Yet, the state has not set aside significant money to address the $63.8 billion in unfunded liabilities for future obligations. That liability increases by billions of dollars each year.

The state also has tens of billions of dollars in deferred maintenance on the critical infrastructure that allows for the delivery of key public services and the movement of goods across the state.

These liabilities and others were built up over many decades. Eliminating the liabilities will also take many years, but doing so will constrain the state's capacity to make other investments.

The May Revision outlines a budget that lives within our means, now and for many years to come. But risks and uncertainties remain. Only by continuing to exercise fiscal discipline can the state avoid repeating the boom and bust cycles of the last decade.

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Summary Charts

This section provides various statewide budget charts and tables.

Figure SUM-01

2013-14 May Revision
General Fund Budget Summary
(Dollars in Millions)

	2012-13	2013-14
Prior Year Balance	-$1,658	$850
Revenues and Transfers	$98,195	$97,235
Total Resources Available	**$96,537**	**$98,085**
Non-Proposition 98 Expenditures	$55,233	$57,004
Proposition 98 Expenditures	$40,454	$39,349
Total Expenditures	**$95,687**	**$96,353**
Fund Balance	**$850**	**$1,732**
Reserve for Liquidation of Encumbrances	$618	$618
Special Fund for Economic Uncertainties	$232	$1,114

Figure SUM-02

2013-14 Total Expenditures by Agency

(Dollars in Millions)

	General Fund	Special Funds	Bond Funds	Totals
Legislative, Judicial, Executive	$2,559	$2,720	$275	$5,554
Business, Consumer Services & Housing	646	743	92	1,481
Transportation	206	8,179	5,107	13,492
Natural Resources	2,118	1,228	1,284	4,630
Environmental Protection	46	2,452	127	2,625
Health and Human Services	28,473	17,714	76	46,263
Corrections and Rehabilitation	8,929	2,272	3	11,204
K-12 Education	39,863	119	5	39,987
Higher Education	10,564	45	422	11,031
Labor and Workforce Development	299	564	-	863
Government Operations	743	223	14	980
General Government:				
Non-Agency Departments	516	1,584	3	2,103
Tax Relief/Local Government	421	3,439	-	3,860
Statewide Expenditures	971	664	-	1,635
Total	**$96,353**	**$41,946**	**$7,408**	**$145,707**

Note: Numbers may not add due to rounding.

Figure SUM-03

General Fund Expenditures by Agency

(Dollars in Millions)

	2012-13	2013-14	Change	%
Legislative, Judicial, Executive	$2,002	$2,559	$557	27.8%
Business, Consumer Services & Housing	217	646	429	197.7%
Transportation	-54	206	260	481.5%
Natural Resources	2,030	2,118	88	4.3%
Environmental Protection	47	46	-1	-2.1%
Health and Human Services	27,001	28,473	1,472	5.5%
Corrections and Rehabilitation	8,763	8,929	166	1.9%
K-12 Education	41,085	39,863	-1,222	-3.0%
Higher Education	9,909	10,564	655	6.6%
Labor and Workforce Development	345	299	-46	-13.3%
Government Operations	661	743	82	12.4%
General Government:				
Non-Agency Departments	469	516	47	10.0%
Tax Relief/Local Government	2,507	421	-2,086	-83.2%
Statewide Expenditures	705	971	266	37.7%
Total	**$95,687**	**$96,353**	**$666**	**0.7%**

Note: Numbers may not add due to rounding.

Figure SUM-04

General Fund Revenue Sources

(Dollars in Millions)

	2012-13	2013-14	Change from 2012-13 Dollar Change	Change from 2012-13 Percent Change
Personal Income Tax	$63,901	$60,827	-$3,074	-4.8%
Sales and Use Tax	20,240	22,983	2,743	13.6%
Corporation Tax	7,509	8,508	999	13.3%
Insurance Tax	2,156	2,200	44	2.0%
Liquor Tax	325	332	7	2.2%
Tobacco Taxes	91	89	-2	-2.2%
Motor Vehicle Fees	29	23	-6	-20.7%
Other	3,944	2,273	-1,671	-42.4%
Total	**$98,195**	**$97,235**	**-$960**	**-1.0%**

Note: Numbers may not add due to rounding.

Figure SUM-05

2013-14 Revenue Sources

(Dollars in Millions)

	General Fund	Special Funds	Total	Change From 2012-13
Personal Income Tax	$60,827	$1,131	$61,958	-$3,370
Sales and Use Tax	22,983	10,961	33,944	3,438
Corporation Tax	8,508	-	8,508	999
Highway Users Taxes	-	6,157	6,157	564
Insurance Tax	2,200	832	3,032	534
Liquor Tax	332	-	332	7
Tobacco Taxes	89	749	838	-25
Motor Vehicle Fees	23	5,887	5,910	115
Other	2,273	14,009	16,282	-2,288
Total	**$97,235**	**$39,726**	**$136,961**	**-$26**

Note: Numbers may not add due to rounding.

K thru 12 Education

California provides compulsory instruction and support services to roughly six million students in grades kindergarten through twelve in more than 10,000 schools throughout the state. Through a system of 58 county offices of education and more than 1,000 local school districts and charter schools, students are provided with instruction in English, mathematics, history, science, and other core competencies to provide them with the skills they will need upon graduation for either entry into the workforce or higher education.

The May Revision includes total funding of $70 billion ($39.9 billion General Fund and $30.1 billion other funds) for all K-12 Education programs.

Proposition 98

A voter-approved constitutional amendment, Proposition 98, guarantees minimum funding levels for K-12 schools and community colleges. The guarantee, which went into effect in the 1988-89 fiscal year, determines funding levels according to multiple factors including the level of funding in 1986-87, General Fund revenues, per capita personal income and school attendance growth or decline.

Overall, General Fund revenues that drive the Proposition 98 calculation are projected to grow by over $1 billion for the two-year period of 2012-13 to 2013-14, including a projected increase of $2.8 billion for 2012-13 and a projected decrease of $1.8 billion for 2013-14. Driven in large part from these changes in revenues, Proposition 98 funding increases by $2.9 billion to a total of $56.5 billion in 2012-13, and decreases by $941.4 million to a total of $55.3 billion in 2013-14, relative to the Governor's Budget. Proposition 98 funding for K-12 education is projected to grow by over $17.4 billion from the 2011-12 fiscal year to the 2016-17 fiscal year, representing an increase of more than $2,700 per student.

The May Revision continues to reinvest in K-12 schools and pay down the "Wall of Debt." The increase in revenues makes it possible to accelerate the repayment of inter-year budgetary deferrals by $1.6 billion in 2012-13. This will provide local education agencies with a significant infusion of additional cash for 2012-13, which in turn will substantially reduce borrowing costs for schools. Moving forward, these funds will further shore up base funding for all schools, providing them with additional ongoing resources in future years for critical programs and services. The May Revision further improves base resources for local education agencies by increasing first-year funding for the Local Control Funding Formula by $240 million, for a total of $1.9 billion. It will also help schools prepare for significant changes in curriculum and instruction by providing a $1 billion augmentation in 2012-13 to assist schools in implementing the new Common Core academic standards. This investment will allow school districts, county offices, and charter schools to make significant one-time investments in the required areas of focus for Common Core implementation—professional development, instructional materials, and enhancements to technology. This investment will provide a substantial increase to all schools outside of the Local Control Funding Formula, providing on average almost $170 per student.

As detailed further in the Higher Education section, the May Revision also proposes to restructure and delay the Adult Education proposal included in the Governor's Budget. This pause will reduce the level of uncertainly for existing K-12 adult education providers, while providing additional time to phase in governance and program delivery changes.

Additional discussion of the Local Control Funding Formula and other K-12 budget adjustments appear in the pages that follow, while the Higher Education section contains the Proposition 98 adjustments for the Community Colleges.

Local Control Funding Formula

The Governor's Budget proposed a new Local Control Funding Formula predicated on an assessment that the current system of school finance is overly complex, administratively costly, and inequitably distributed. The new formula also recognized that the current system is largely state-driven, limiting the ability of local school officials to decide how best to meet the needs of their students. The formula was also grounded in empirical research and practical experience indicating that students from low-income families and English language learners come to school with unique challenges that often require supplemental instruction and other support services to be successful in school.

The Local Control Funding Formula proposed in the Governor's Budget included the following components: (1) a base grant for each local education agency equal to the 2007-08 statewide average undeficited revenue limit upon full implementation, (2) an adjustment of 11.23 percent to the base grant to support lowering class sizes in grades K-3, (3) an adjustment of 2.8 percent to reflect the cost of operating career technical education programs in high schools, (4) a 35-percent supplemental grant for English learners, students from low-income families or foster youth to reflect increased costs associated with educating those student groups, and (5) an additional concentration grant up to 17.5 percent of a local education agency's base grant, based on the number of English learners, students from low-income families, or foster youth served by the local agency that comprise more than 50 percent of enrollment.

The Local Control Funding Formula will bring greater equity in base funding between all schools by setting a statewide base funding target. It also avoids taking resources away from any school by ensuring that no school receives less funding than it did during the 2012-13 year. The vast majority of schools will benefit from additional resources. This is directly attributable to the emphasis that the formula places on base grants. Of the more than $22 billion in new funding to be invested in this formula over the next seven years, the vast majority of new funding will be provided for base grants. Specifically, of every dollar invested in this formula, 80 cents will go to base grants, 16 cents will go to supplemental grants, and 4 cents will go to concentration grants.

Under the proposal, the base grant is $6,816, $1,548 more than today's average revenue limit. Increasing this substantial base grant would only delay implementation of the formula, direct new money away from those schools that need it most, and perpetuate existing inequities. Similarly, an elimination or significant reduction of the concentration grant would direct new money away from the schools that need it most and perpetuate existing inequalities. Further, any money redirected from the concentration grant will not produce as significant a benefit when spread out across all schools, as it would if it remained concentrated with those districts that need it most.

There is broad consensus that the current system of school finance is inequitable. Even before the substantial reductions to revenue limits and categorical programs that began in 2008-09, the distribution of resources between schools differed substantially. Generally, schools with relatively higher proportions of English learners and students from low-income families had lower revenue limits and relied more heavily on state aid, including targeted categorical funds. Reductions since the economic downturn of 2008 have disproportionally affected these districts given their heavy reliance on state aid. The May Revision reflects the Administration's commitment to establishing a just funding system for school districts by maintaining the same targeted funding levels for base grants, supplemental funding, and concentration grants as proposed in the Governor's Budget.

The Administration would also like to clarify some common misperceptions surrounding the calculation of the concentration grant factor. This grant is intended to provide, on a sliding scale, additional per-student funding of anywhere between 0 and 17.5 percent of a district's base grant funding level. The level of additional funding provided by this grant is directly scaled to the district's enrollment of English learners students from low-income families, and foster youth that exceed more than 50 percent of a district's total enrollment. Figure K12-01 below provides four examples that illustrate the respective range of concentration grant adjustments.

Figure K12-01
Funding Under the Formula: Four Examples

	District A	District B
Base Grant per ADA	$7,895	$7,895
Unduplicated % of Eligible Students	41.9%	52.4%
Supplemental Grant	$7,895 * 35% * 41.9% = $1,158	$7,895 * 35% * 52.4% = $1,448
Concentration Grant	N/A	$7,895 * 35% * (52.4% - 50%) = $66
Total	$7,895 + $1,158 = $9,053	$7,895 + $1,448 + $66 = $9,409

	District C	District D
Base Grant per ADA	$7,895	$7,895
Unduplicated % of Eligible Students	80.7%	100%
Supplemental Grant	$7,895 * 35% * 80.7% = $2,230	$7,895 * 35% * 100% = $2,763
Concentration Grant	$7,895 * 35% * (80.7% - 50%) = $848	$7,895 * 35% * (100% - 50%) = $1,382
Total	$7,895 + $2,230 + $848 = $10,973	$7,895 + $2,763 + $1,382 = $12,040

The Concentration Grant is calculated as follows: Base Grant * 35% * (a district's percentage of English learners, free and reduced price meal eligible, and foster youth students above 50%)

The May Revision proposes the following adjustments in response to concerns raised with the formula:

- Use a three-year rolling average percentage of English learners, students from low-income families, and foster children for purposes of calculating the supplemental and concentration grants.
- Require county offices of education to review school district English learner, low-income, and foster child data and require that data to be subject to audit as part of each local education agency's annual financial and compliance audit.
- Allow local educational agencies to receive supplemental and concentration grant funding for each English learner for up to seven years.
- Provide Regional Occupation Centers and Programs and Home-to-School Transportation joint powers authorities with continued direct funding for two additional years.

Accountability

The Local Control Funding Formula fundamentally shifts accountability from a system focused on state control of local spending to a system of local planning and goal setting to improve outcomes for students. While providing additional authority to locals, this new system retains the state role in determining the composition of the statewide testing system, the Academic Performance Index, and school accountability report cards, as well as establishing policies to administer the federal accountability system. It also recognizes the value in creating a more defined process to monitor and assist school districts that are unable to meet state performance expectations.

The proposed system will focus accountability on the core requirements and outcomes expected of schools and better integrate accountability within the local school district budget process. The new system moves away from expenditure requirements and other input-based measures. It requires that all school districts produce and adopt a Local Control and Accountability Plan concurrent and aligned with each district's annual spending plan. While school districts have some discretion regarding the content of the plan, all plans are required to address how districts will use state funding received through the new funding formula toward improvement in the following categories:

- Basic conditions for student achievement (having qualified teachers at each school site, sufficient instructional materials available for students, and school facilities in good repair).

- Programs or instruction that primarily benefit English language learners, foster youth, and students from low-income families—students who applied for and were deemed eligible to receive a free or reduced-price meal.
- Implementation of Common Core content standards and progress toward college and career readiness (as measured by the Academic Performance Index, graduation rates, completion of college-preparatory and career technical education courses).

The accountability structure for the Local Control Funding Formula will also require local education agencies to spend supplemental and concentration grant funding in a manner that benefits the students generating those additional funds. Districts will have flexibility over specific investments to benefit these students. To ensure that the needs of these students are addressed, the accountability system will require the following:

- Local education agencies will be required to spend for the primary benefit of English learners and students designated fluent-English proficient, students from low-income families, and foster children no less than the amount they spent for these students during the 2012-13 fiscal year. However, local agencies would be encouraged to invest additional resources in these students.
- Upon full implementation of the Local Control Funding Formula, local agencies will be required to spend for the primary benefit of English learners, students from low-income families, and foster children at least as much as they receive from the base, supplemental and concentration grants generated by these students.
- Local agencies will be required to demonstrate how they will comply with these requirements and how they will increase expenditures over time, in proportion to the additional funding they receive each year for Local Control Funding Formula implementation.

To further ensure that local agencies spend the amounts they receive for students from low-income families, English learners, and foster students to support these students, expenditures of the supplemental and concentration funds must be proportional to the number of these students at each school site. Required annual independent audits will be used to verify these proportionality requirements, along with all other expenditure requirements. In cases where the annual audit determines a specific level of misused supplemental and/or concentration grant funds, local districts will be required the following year to use an identical amount of base grant funds to address specific investments for those students.

To hold schools accountable for the achievement among all student groups, the new system proposes that county superintendents and the Superintendent of Public Instruction, based on direction of the State Board of Education, provide support to school districts and intervene when districts are unable to support their students in meeting minimum state achievement expectations. Under this structure:

- County superintendents may provide technical assistance to any school district at any time.
- For school districts that fail to meet academic achievement targets set by the State Board of Education, including achievement goals for each sub group of students, for two out of three years, the county superintendent may disapprove local plans that are not likely to improve student achievement. In more limited cases where a Fiscal Crisis and Management Assistance Team review deems necessary, a county superintendent may make changes to a district's plan or overturn decisions made by the district governing board.
- The Superintendent of Public Instruction may intervene in place of the county superintendent in a district which is failing to meet academic achievement targets.

Finally, the Local Control Funding Formula provides significantly more instructional resources for foster youth than the existing categorical program. However, there is a need for defined and coordinated services between local education agencies and county social service agencies to ensure foster youth receive necessary services and support to be successful in school. The May Revision proposes to require the Department of Education to report on the educational progress of foster youth as part of the state's accountability system. In addition, county superintendents will be required to develop plans to coordinate services for foster youth provided by various local agencies, such as county child welfare agencies. This coordination will assist in the maintenance of health and student records and assist in appropriate educational placements.

K-12 Budget Adjustments

Significant Adjustments:

- *Common Core Implementation*—An increase of $1 billion in one-time Proposition 98 General Fund in 2012-13 to support the implementation of the Common Core. Funding will be distributed to local education agencies on the basis of average daily attendance (ADA) to support necessary investments in professional development, instructional materials, and technology. Because every school throughout the state is in varying stages of implementing the Common Core, local education agencies will have discretion to determine the best use of this money for their schools. However, they will be required to develop a plan to spend this money over the next two years and hold a public hearing on the plan.

- *K-12 Deferrals*—An increase of $1.6 billion in one-time Proposition 98 General Fund for 2012-13 to accelerate the repayment of inter-year budgetary deferrals. This acceleration will be offset by a reduction of $909.1 million Proposition 98 General Fund for proposed deferral repayments in 2013-14. When combined, total funding over the two-year period will reduce K-12 inter-year deferrals to $4.9 billion by the end of the 2013-14 fiscal year, representing an almost $600 million net reduction to outstanding deferrals over the two-year period from the Governor's Budget proposal. This will reduce total outstanding deferrals to almost half of their peak value, when more than $9.5 billion was deferred.

- *Local Control Funding Formula*—An increase of $236 million Proposition 98 General Fund for school districts and charter schools, and $4 million Proposition 98 General Fund for County Offices of Education, to support an ongoing increase in first-year funding provided through the Local Control Funding Formula. The total funding increase is $1.9 billion.

- *Proposition 39 Implementation*—The Governor's Budget proposed to allocate $400.5 million Proposition 98 General Fund to K-12 local education agencies on a per-ADA basis to support energy efficiency projects consistent with Proposition 39. State-level entities were charged with providing guidance to local education agencies to ensure appropriate use of these funds, and local entities would be required to report expenditure information. After the release of this proposal, concerns were raised about the capacity of local education agencies to initiate and complete these types of projects, and about the lack of a minimum grant award level. To address these concerns, the May Revision proposes a minimum grant level of $15,000 for exceptionally small local education agencies. The proposal will provide other local education agencies the greater of $50,000 or their per-ADA distribution, ensuring that relatively small entities receive sufficient resources to complete these projects. Additionally, the May Revision proposes $4 million Energy Resources Programs Account and 8 positions to enable the California Energy Commission to provide technical assistance to small local education agencies. The Energy Commission will help identify cost-effective energy savings opportunities for K-12 school facilities, and provide guidance on establishing baselines and tracking performance.

The May Revision proposes an increase of $12.5 million for K-12 energy efficiency projects, based on higher Proposition 39 revenues.

- *Special Education Funding Reform*—The Governor's Budget proposed several program consolidations for various special education programs to provide Special Education Local Plan Area's (SELPA's) with additional funding flexibility. The May Revision proposes several additional program consolidations to further simplify special education funding and provide even greater flexibility for SELPA's.

- *Special Education Backfill*—An increase of $60.7 million Proposition 98 General Fund for special education programs to backfill a federal sequestration cut of an identical amount.

- *Local Property Tax Adjustments*—A decrease of $509.8 million Proposition 98 General Fund in 2013-14 for school districts, special education and county offices of education as a result of higher offsetting property tax revenues.

- *Average Daily Attendance*—An increase of $35.5 million in 2012-13 and an increase of $87.6 million in 2013-14 for school districts, charter schools and county offices of education as a result of an increase projected ADA in both years.

- *Categorical Program Growth*—An increase of $14.3 million Proposition 98 General Fund for selected categorical programs based on updated estimates of projected ADA growth.

- *Cost-of-Living Adjustments*—A decrease of $2.9 million Proposition 98 General Fund to selected categorical programs based on a revised Cost-of-Living factor of 1.565 percent for 2013-14.

- *CTA v Schwarzenegger Settlement*—At Governor's Budget, the 2012-13 Proposition 98 guarantee was over-appropriated by $162.8 million. This over-appropriation was used to pre-pay a portion of the settlement obligation incurred by the *CTA v Schwarzenegger* lawsuit. As a result of the changes in the guarantee at the May Revision, the settlement payment will be made on its regular schedule.

- *Technology-Based Instruction*—After releasing this proposal in January, a number of concerns were raised by the Department of Education and the Legislative Analyst's Office related to the calculation of ADA, accountability for student outcomes under this mode of instruction, and whether 2013-14 was a reasonable timeframe for implementation. The Administration remains committed to expanding the use of technology-based instruction but believes these concerns have merit. As a result, the May Revision proposes to delay consideration of reforms to the 2014-15 Budget.

Child Care and State Preschool

Subsidized Child Care includes a variety of programs designed to support low-income families so they may remain gainfully employed. These programs are primarily administered by the State Department of Education (SDE). Additionally, the State Preschool program is designed as an educational program to help ensure children develop the skills needed for success in school. SDE and the Department of Social Services jointly administer the three-stage CalWORKs child care system to meet the needs for child care of recipients of aid while they participate in work activities and as they transition off of cash aid. Families can access services through centers that contract directly with SDE, or by receiving vouchers from county welfare departments or alternative payment program providers.

Significant Adjustments:

- *Stage 2*—A decrease of $511,000 non-Proposition 98 General Fund in 2013-14 to reflect a slight decline in the number of eligible CalWORKs Stage 2 beneficiaries. In 2010-11, approximately 6,000 children were determined eligible for diversion services in Stage 2. These children and their eligible families are re-entering Stage 3 in 2012-13, and this population trend will continue into 2013-14. Total base cost for Stage 2 is $397.8 million.
- *Stage 3*—A decrease of $15.1 million non-Proposition 98 General Fund in 2013-14 to primarily reflect updated caseload data. At the Governor's Budget, it was assumed that approximately 6,000 children that were diverted to Stage 2 would transfer back to Stage 3. At the May Revision, actual caseload information indicates that the Stage 3 population fell short of these estimates. The May Revision grows the Stage 3 base by $9.1 million in 2013-14 over the 2012 Budget Act level, for a total base cost for Stage 3 of $157.5 million.
- *Capped Non-CalWORKs Programs*—An increase of $1.7 million General Fund for capped child care programs and an increase of $1.2 million Proposition 98 General Fund for state preschool due to an increase in the population of 0-4 year old children.
- *Child Care and Development Funds*—A net increase of $8.5 million federal funds in 2013-14.

Higher Education

Higher Education includes the University of California (UC), the California State University (CSU), the California Community Colleges, the California Student Aid Commission and several other entities.

The May Revision includes total funding of $25.4 billion ($12.7 billion General Fund and $12.7 billion other funds) for all programs included in these agencies.

Multi-Year Stable Funding Plan — University of California and California State University

The May Revision builds upon the multi-year stable funding plan for higher education proposed in the Governor's Budget. It prioritizes higher education by providing new funds to begin reinvesting in the public universities, with the expectation that the universities will improve the quality, performance, and cost effectiveness of the educational systems. The plan is rooted in the belief that higher education should be affordable and student success can be improved.

- *Funding Stability*—The Governor's Budget increased the General Fund contribution to each institution's prior-year funding base. Each segment will receive up to a 20-percent increase in General Fund appropriations (about $511 million each) over a four-year period (2013-14 through 2016-17), representing about a 10-percent increase in total operating funds including tuition and fee revenues.

- *Affordability*—The plan includes a freeze on UC and CSU resident tuition from 2013-14 to 2016-17 to ensure that the universities stay affordable for students and their families, and to avoid high student debt and tuition levels.
- *Student Success*—The plan expects UC and CSU to achieve the following priorities: improve graduation rates; increase the number of transfer students from community colleges; increase the number of degrees completed, particularly by low-income students; and reduce the cost per degree.

The multi-year funding plan increases funding and strengthens accountability to encourage UC and CSU to become more affordable and to maintain quality and access over the long term. The Administration will continue working with the Legislature, the segments, and other stakeholders to strengthen the accountability plan.

To improve student success, the Governor's Budget proposed capping the number of units students can take while receiving a state General Fund subsidy at UC, CSU, and the community colleges. Given concerns that were raised, the Administration is withdrawing the proposal for this year and focusing on alternative incentives to increase cost-effectiveness.

California Community Colleges

The California Community Colleges are publicly supported local educational agencies that provide educational, vocational, and transfer programs to approximately 2.6 million students. The Community College system is the largest system of higher education in the world, with 72 districts, 112 campuses, and 71 educational centers. By providing education, training, and services, the Community Colleges contribute to continuous workforce improvement. The Community Colleges also provide remedial instruction for hundreds of thousands of adults across the state through basic skills courses and adult non-credit instruction.

Improving Adult Education

The Governor's Budget proposed to increase funding for and restructure the adult education system. The proposal provided a $300 million Proposition 98 General Fund augmentation in 2013-14 for adult education. Given concerns raised with the timing and structure of the proposal, the May Revision proposes the following:

- Maintains status quo for existing K-12 and Community College Adult Education programs for two years.

- Maintains the existing apportionment structure and funding remains in place for existing community college programs.
- School districts retain their authority to independently continue their existing adult education programs. Over time, it is expected they will join a regional adult education consortium, described below, to gain access to additional dedicated adult education funding and to ensure coordination with other local adult education providers.

- Transitions to a new adult education partnership program comprised of regional adult education providers, who jointly determine what programs to offer to their communities and how best to allocate additional state resources for this purpose.
  - Includes $30 million Proposition 98 General Fund in 2013-14 for two-year planning and implementation grants and $500 million Proposition 98 General Fund in 2015-16 to fund adult education schools jointly operated by regional consortia of community colleges districts and school districts.
  - Regional consortia may also include other local providers such as workforce investment boards, local correctional facilities, other local public entities and community-based organizations.
  - The planning grants will be awarded jointly to the consortia by the State Department of Education and the Chancellor's Office. The consortia will use this money to create plans to serve adult students in their region. These plans must identify how the consortia will integrate existing programs with the new partnership program, including how to best serve adults in local correctional facilities.
  - The State Department of Education and the Chancellor's Office are also charged with jointly reviewing the plans and allocating the $500 million in available apportionment funding beginning in 2015-16. At least $350 million must be apportioned to existing adult education providers.
  - Available funding will be prioritized to critical areas of instruction. As a result, only instruction in English as a second language, citizenship, high school diploma and general education development (GED), and workplace education will be eligible for funding through the new program. Instruction in parenting, home economics, and programs for older adults will not be eligible for funding. Furthermore, consortia will be required to develop course sequencing pathways to allow adult learners to move seamlessly from completing their adult education

programs into their next endeavor—such as improving personal goals, learning a skill or trade for immediate employment, or attaining abilities for college-level career technical and academic programs.

- The districts making up each consortium must maintain their current level of spending for adult education in 2013-14 and 2014-15 and into the future to receive the new funding.

Other Significant Adjustments

- *Apportionments*—An increase of $30 million Proposition 98 General Fund in 2013-14. Combined, the Governor's Budget and the May Revision provide $226.9 million Proposition 98 General Fund divided as follows:
  - $87.5 million for a cost of living adjustment representing 1.57 percent of base apportionments.
  - $89.4 million available for general apportionment growth.
  - $50 million for additional student support services including orientation, assessments, counseling, advising, and education planning, as developed by the Student Success Task Force recommendations and the Student Success Act of 2012. The May Revision withdraws a proposal to change census accounting practices. Instead, it proposes to develop, for consideration as part of the 2014-15 Budget, a broad-based framework to improve student success and establish appropriate incentives to encourage course and degree completions, as well as cost effectiveness.
- *Board of Governors Fee Waiver Program Reform*—The Governor's Budget proposed that students seeking financial aid be required to fill out a Free Application for Federal Student Aid (FAFSA) and include both parent and student income when determining fee waiver eligibility. Concerns were raised that financial aid processing time is longer using the FAFSA and that the proposal would reduce participation for some emancipated students whose parents are unwilling to provide their income for FAFSA purposes. The May Revision proposes the following adjustments to preserve the state's resources for students in need:
  - Provides students one academic term to collect all documentation necessary to validate financial need.

- Requires the Board of Governors to establish criteria that provide emancipated students the opportunity to demonstrate that they are living independently of their parents and are financially in need.
- The new policies would commence with the 2014-15 academic year.

- *Apprenticeship Programs*—The May Revision continues to consolidate apprenticeship programs at the Chancellor's Office, generally maintaining the current structure of the Chancellor's Office and the State Department of Education programs. The May Revision also removes the Chancellor's Office program from categorical flexibility and allows community colleges the geographic freedom to administer programs covering areas outside their district boundaries, similar to what is already allowed for the State Department of Education programs.
- *Property Tax Adjustment*—A decrease of $70.8 million Proposition 98 General Fund in 2013-14 to reflect increased property tax estimates. Current law intends that property taxes offset Proposition 98 General Fund costs for community college apportionments. Because property taxes are estimated to increase, General Fund costs are decreased by a like amount.
- *Student Fee Adjustment*—A decrease of $38.9 million Proposition 98 General Fund to reflect revised estimates of student fee revenue, primarily resulting from lower-than-anticipated Board of Governors' fee waivers. Similar to property taxes, student fees are intended to offset the costs of apportionments.
- *Deferrals*—At the beginning of 2011-12, the state had accumulated $961 million of deferral debt owed to community colleges. The May Revision reduces that balance to $621.2 million in 2012-13 and $557.5 million in 2013-14. The payment of deferrals is consistent with, and proportional to, the payments in K-12 education. This debt reduction will reduce the substantial borrowing costs borne by the community colleges. Every dollar that colleges must now spend on borrowing is a dollar taken out of the classroom.

California Student Aid Commission

The California Student Aid Commission administers state financial aid to students attending all institutions of public and private postsecondary education through a variety of programs including the Cal Grant High School and Community College Transfer Entitlement programs, the Competitive Cal Grant program, and the Assumption Program of Loans for Education. Over 99,000 students received new Cal Grant awards, and over 150,000 students received renewal awards in 2011-12.

Prior to 2001, the program offered a capped number of awards to students and award amounts were specified in the Budget. Under that construct, the program supported 130,000 students at a cost of $462 million in 2000-01. The program is now an entitlement and has been one of the fastest growing programs in the state. Costs have increased due to an increased number of students participating in the program and UC and CSU tuition increases before 2012-13. The number of students in the program has increased to an estimated 283,000 and costs have increased to an estimated $1.65 billion in 2013-14.

The May Revision continues the Governor's Budget prioritization of financial aid for students attending the state's public higher education institutions and other institutions that are able to minimize student debt loads and produce successful graduates, students demonstrating a high likelihood of completing their degrees or programs, and students demonstrating the greatest financial need.

Significant Adjustments:

- *Cal Grant Program Growth*—A decrease of $23.6 million General Fund in 2012-13 and $42 million General Fund in 2013-14 to reflect revised participation estimates in the Cal Grant program.
- *Offset Cal Grant Costs with Federal Temporary Assistance for Needy Families (TANF) Reimbursements*—A decrease of $18.7 million TANF and a like increase of General Fund in 2013-14 to reflect revised Cal Grant program participation estimates. TANF funds are available through an interagency agreement with the Department of Social Services. Combined with the TANF funds included in the Governor's Budget, the May Revision offsets $924.2 million in Cal Grant General Fund costs.
- *Offset Cal Grant Costs with Student Loan Operating Fund (SLOF)*—An increase of $38.1 million SLOF and a like decrease of General Fund in 2013-14 to reflect the availability of SLOF funds to offset Cal Grant program General Fund costs. Combined with the SLOF funds included in the Governor's Budget, the May Revision offsets $98.1 million in Cal Grant General Fund costs.

Health Care Reform

Federal health care reform (Affordable Care Act, ACA) increases access to both private and public health care coverage. The Governor's Budget continued implementation of federal health care reform in California, building on the early establishment of the California Health Benefit Exchange (Covered California) and the early coverage expansion through the "Bridge to Reform" waiver. It outlined the following principles for health care reform implementation: (1) it must be sustainable and affordable, (2) it must fairly allocate risk and clearly delineate responsibilities between the state and counties, (3) it must maintain a strong public safety net, and (4) it must support local flexibility. It outlined two approaches—county-based and state-based—to provide coverage to low-income adults without eligible children (optional expansion).

The May Revision proposes the state-based approach for expansion. Newly eligible individuals will receive the comprehensive benefits currently provided by Medi-Cal, including county-administered comprehensive specialty mental health services and county-supported substance use disorder services. Long-term care services will be covered, provided the federal government approves the retention of an asset test for these services. At a county option, beneficiaries, both existing enrollees and new eligibles, may receive an enhanced benefit package for substance use disorders.

Today, as the provider of last resort, counties are responsible for indigent health care. Under the 1991 realignment, the state provides roughly $1.5 billion to counties to assist them in meeting their obligations. To receive these funds, counties must spend a required maintenance of effort of $343 million. Many counties spend additional funds on indigent care.

Under health care reform, county costs and responsibilities for indigent health care are expected to decrease. Under the state-based expansion and the eligibility simplification required by federal law, the state will bear the financial cost and risk of expanding coverage to currently uninsured adults. The state will be responsible for the bulk of indigent health care, providing coverage for nearly all low-income, uninsured individuals seeking health services. Given that health care costs have risen rapidly over the last few decades, generally outpacing revenue growth, and given that Medi-Cal is the second largest General Fund expense, the state cannot afford to both assume the cost of coverage, and continue its level of funding for county health care programs. Preserving a strong public safety net remains a priority.

While coverage will increase, thereby lessening county costs, uncertainty remains regarding how many people will enroll in coverage, where they will receive care, and what costs associated with services provided to uninsured individuals will remain. Counties play a key role in providing access to and delivery of health care services to both Medi-Cal beneficiaries and the uninsured. Given these factors, the May Revision proposes to determine county health care savings based on actual experience.

Mechanism to Preserve Access to the Safety Net

The state has an interest in maintaining a strong public safety net to ensure access to health care services as the safety net is the primary source of care for Medi-Cal beneficiaries and the uninsured. As part of the optional Medi-Cal expansion, the state will work with counties to support a viable patient base for county safety net providers, as well as adequate rates for services provided to the new population.

Given the increased coverage that will occur under the ACA, county responsibilities are expected to decrease, generating savings to counties. In recognition of the ongoing role of counties in delivering services to Medi-Cal and the uninsured, and the difficulty in projecting the specific impacts, a mechanism will be established to determine the level of county savings based on actual experience. Under this mechanism, each county's savings will be determined by measuring actual county costs for providing services to Medi-Cal and uninsured patients and the revenues received for such services. Revenues will include patient care revenues, federal funds, health realignment dollars, and net county contributions to health care services, which will be adjusted to reflect historic growth rates. The difference between total revenues and total costs will determine the savings. These savings will be redirected to support human services programs at the local level. The May Revision estimates that $300 million in 2013-14, $900 million in 2014-15, $1.3 billion in 2015-16 and in 2016-17 will shift from local health programs to local human services programs. However, the actual amount of savings shifted will be based on the mechanism.

Because this mechanism is cost-based, it must include incentives for cost containment and maximizing enrollment in coverage, and it must also account for the remaining uninsured being served by the county, consistent with today's level of service. The Administration proposes a cap on the cost growth of county expenditures based on historic trends for purposes of determining savings. The mechanism will be in place until health care reform is fully implemented. This allows the state to determine savings that occur as a result of health care expansion and counties to retain funding for the costs—mostly related to outpatient services—that will remain for caring for uninsured individuals.

Given today's reimbursement structure and how it may change under the ACA, there is a risk of losing substantial federal funding and destabilizing local health care safety net systems—in particular, county-run public hospital and clinic systems. The state will seek to maximize federal funding through the development and procurement of a future Medicaid Waiver to replace the existing "Bridge to Reform" Medicaid Waiver that expires in 2015.

Delineation of Responsibilities for Health and Human Services Programs

Under the May Revision, the state will assume greater financial responsibility for health care programs. This builds on the Coordinated Care Initiative, which limited county contributions for In-Home Supportive Services program costs, transitioned collective bargaining for participating counties to the state, and expanded the state's financial responsibility in that program. Consistent with this expanded state responsibility for health care and long-term care services, the Administration proposes to, over time, shift responsibility to the state for California Children's Services—which provides specialized services for children with severe chronic health conditions, such as cystic fibrosis, hemophilia and cancer. Consideration will also be given to the appropriate role of counties in the Medical Therapy Program. Counties would retain responsibility for providing and funding public health programs—such as immunizations and communicable disease control activities.

The May Revision proposes to expand the counties' role in human services programs. Specifically, it proposes that, over time, counties assume greater financial responsibility for CalWORKs, CalWORKs-related child care programs and CalFresh (formerly Food Stamps) administration costs. Counties would be responsible for the coordination of all client services and would have opportunities to reinvest caseload savings and revenue growth in CalWORKs and related child care programs based on their local needs and priorities. Eligibility, grant levels and rates would continue to be set at the state level. The state would continue to provide funding for above-average costs that result from economic downturns or policy changes outside counties' control. Consideration would be given to balancing county flexibility and appropriate beneficiary protections.

Medi-Cal Optional Expansion—May Revision Adjustments

The May Revision includes $1.5 billion ($21 million General Fund, $1.5 billion federal funds) to implement the optional expansion in 2013-14. These figures assume that the state will receive 100 percent federal funding for the expansion population in the budget year, and reflect the following General Fund adjustments.

Significant Adjustments:

- *Services for Pregnant Women*—A decrease of $26.4 million in 2013-14 to reflect that pregnant women with income between 100 percent and 200 percent of the Federal Poverty Level who today are eligible for Medi-Cal will instead receive comprehensive coverage through Covered California beginning in 2014. To ensure health care coverage is affordable for this population, the May Revision proposes to cover all cost sharing not covered by the federal advance premium tax credits.

- *Services for Newly Qualified Immigrants Present Fewer than Five Years*—A decrease of $5.4 million in 2013-14 to reflect that individuals who would otherwise have been eligible under Medi-Cal as newly qualified immigrants will instead receive coverage through Covered California. To ensure health care coverage is affordable for this population, the May Revision proposes to cover all cost sharing not covered by the federal advance premium tax credits.

- *County Administration Costs*—An increase of $71.9 million in 2013-14 for increased county administration costs related to implementing the ACA. Additional resources are needed to process new applications and redeterminations, develop training and curriculum materials, train county eligibility workers, and support planning and implementation activities. The Administration proposes to base future appropriations on a time study of resource needs, beginning in 2015-16.

Health and Human Services

The Health and Human Services Agency oversees departments and other state entities such as boards, commissions, councils, and offices that provide health and social services to California's vulnerable and at-risk residents.

The May Revision includes total funding of $113.3 billion ($28.5 billion General Fund and $84.8 billion other funds) for all programs overseen by this Agency.

Department of Health Care Services

The Department of Health Care Services (DHCS) preserves and improves the health status of Californians. To fulfill its mission, DHCS finances and administers a number of individual health care service delivery programs, including Medi-Cal, the California Children's Services, the Primary and Rural Health, Family PACT, Every Woman Counts, and Drug Medi-Cal programs. DHCS also oversees county-operated community mental health programs.

Medi-Cal, California's Medicaid program, is a public health insurance program that provides comprehensive health care services at no or low cost for low-income individuals including families with children, seniors, persons with disabilities, children in foster care, and pregnant women. The federal government mandates basic services including physician services, family nurse practitioner services, nursing facility services, hospital inpatient and outpatient services, laboratory and radiology services, family planning, and early and periodic screening, diagnosis, and treatment services for children.

In addition to these mandatory services, the state provides optional benefits such as outpatient drugs, home and community-based services, and medical equipment.

Significant Adjustments:

- *Managed Care Organization Tax*—The May Revision proposes a tax on Medi-Cal managed care plans for 2012-13, 2013-14, and beyond. Medi-Cal managed care plans are assessed the tax and proceeds are matched with federal funds to provide supplemental payments to plans. Remaining proceeds are used for the provision of health services to children and seniors and persons with disabilities in the Medi-Cal program. In 2012-13, the tax rate will be equal to the gross premiums tax. In 2013-14 and beyond, the tax rate will equal the state sales tax rate. This proposal generates General Fund savings of $128.1 million in 2012-13 in the Managed Risk Medical Insurance Board budget and $342.9 million in DHCS's budget in 2013-14.
- *Coordinated Care Initiative (CCI)*—Persons eligible for both Medicare and Medi-Cal (dual eligibles) will receive medical, behavioral health, long-term support and services, and home and community-based services through a single health plan. The CCI will also enroll all dual eligibles in managed care plans for their Medi-Cal benefits. Dual eligibles will enroll in the CCI in specified counties participating in the demonstration. The May Revision reflects the following changes:
    - The size and scope of the demonstration has been revised as agreed to in a Memorandum of Understanding with the federal government. The May Revision reflects the population participating in the demonstration and accounts for a cap on the number of beneficiaries from Los Angeles County.
    - The May Revision changes the scheduled phasing for beneficiaries enrolling in the CCI. Beneficiaries in the eight participating counties will enroll in the demonstration no sooner than January 2014. Los Angeles County will phase-in beneficiaries over 12 months, subject to further discussions with the federal government. San Mateo County will enroll all beneficiaries over 3 months. Orange, San Diego, San Bernardino, Riverside, Alameda, and Santa Clara counties will phase-in over 12 months.
    - The May Revision projects revised General Fund savings for CCI of $119.6 million in 2013-14. This amount includes the net benefit of moving to a higher tax rate on Medi-Cal managed care plans. The proposal also requires statutory changes to reflect the changes in the implementation schedule.

- The May Revision includes $518,000 ($259,000 General Fund) and 4 positions in the Department of Social Services to staff the Statewide Authority, which is responsible for collective bargaining with unions representing individual providers in counties that have transitioned to the CCI. The Administration expects to convene the Statewide Authority before the first county completes its transition into managed care.

Managed Risk Medical Insurance Board

The Managed Risk Medical Insurance Board (MRMIB) currently administers programs that provide health coverage through commercial health plans, local initiatives, and county organized health systems to eligible individuals who do not have health insurance.

Significant Adjustments:

- *Managed Risk Medical Insurance Program (MRMIP)*—The Governor's Budget assumed MRMIP would phase-out with the implementation of the federal Affordable Care Act. The May Revision defers the elimination of this and other state-only programs affected by the Act.
- *Transfer Infants to the Department of Health Care Services*—The Access for Infants and Mothers (AIM) Program provides comprehensive health care to pregnant women and infants. The May Revision proposes to transition to DHCS infants born to mothers enrolled in the AIM Program whose income is between 250 and 300 percent of the federal poverty level.

Department of Social Services

The Department of Social Services (DSS) administers programs that provide services and assistance payments to needy and vulnerable children and adults in ways that strengthen and preserve families, encourage personal responsibility, and foster independence.

Significant Adjustments:

- *CalWORKs Early Engagement*—The recent CalWORKs reform established a prospective 24-month time limit on cash assistance and employment services for adults. DSS held stakeholder workgroup sessions to identify best practices and strategies to ensure program participants are receiving appropriate services during their limited time on aid. The May Revision includes $48.3 million

General Fund to implement additional proven appraisal protocols, promote family stabilization, and provide enhanced subsidized employment opportunities. The proposal establishes a standardized assessment tool and process for new welfare-to-work participants. Barriers to employment such as mental health, substance abuse, domestic violence, and housing issues will be identified early on and addressed so clients can successfully pursue employment. Counties with mature subsidized employment programs can expand those efforts as resources become available. Counties new to such programs will receive technical assistance. The appropriate level of ongoing resources will be determined in the 2014-15 Governor's Budget.

- *IHSS caseload*—An increase of $80.3 million General Fund in 2012-13 and $120 million General Fund in 2013-14 as a result of increased caseload projections resulting primarily from increased costs per case and from an erosion of savings associated with the health care certification requirement. Additional months of data indicate more recipients are securing the required certification than was assumed in the Governor's Budget.

- *IHSS Settlement*—In March 2013, the Administration reached an agreement with plaintiffs with respect to the *Oster* and *Dominguez* class-action lawsuits. For the settlement terms to be implemented, legislation is necessary to repeal IHSS provider wage and service reductions enacted in prior years, including the 20-percent across-the-board reduction, for which General Fund savings was included in the 2013-14 Governor's Budget. The settlement requires an 8-percent across-the-board reduction effective July 1, 2013, and 7-percent savings annually thereafter. The May Revision reflects savings of $176.4 million General Fund in the budget year.

- *Federal Sequester Backfill*—The Social Services Block Grant is subject to sequestration reductions. DSS will use carryover funds to backfill the current year reduction and half of the budget year reduction to its Community Care Licensing program. The May Revision proposes Budget Bill language to authorize up to $2.1 million from the Child Health and Safety Fund to backfill the loss of federal Title XX funds for the Community Care Licensing program in 2013-14. The Child Health and Safety Fund has sufficient reserves to absorb this increase on a one-time basis.

- *Other Caseload Adjustments*—A decrease of $94.5 million General Fund in 2012-13 and $126.5 million General Fund in 2013-14 as a result of decreased caseload projections in the CalWORKs and Supplemental Security Income/State Supplementary Payment programs as compared to the Governor's Budget.

Department of Public Health

The Department of Public Health is charged with protecting and promoting the health status of Californians through programs and policies that use population-wide interventions.

Significant Adjustment:

- *AIDS Drug Assistance Program*—A decrease of $12.5 million (other funds) in 2012-13 and a decrease of $46.4 million (other funds) in 2013-14 as a result of updated caseload and cost projections since the Governor's Budget.

Department of Developmental Services

The Department of Developmental Services serves approximately 256,000 individuals with developmental disabilities in the community and 1,569 individuals in state-operated facilities. The May Revision includes $5 billion ($2.8 billion General Fund) for support of the Department and community services.

Significant Adjustments:

- *Sonoma Program Improvement Plan*—The May Revision includes an increase of $344,000 ($241,000 General Fund) in 2012-13 and $2.5 million ($1.7 million General Fund) in 2013-14 to reflect anticipated costs related to the Sonoma Developmental Center Program Improvement Plan requirement to contract with Independent Consultative Review Experts to develop an action plan to bring the facility into compliance with federal requirements. Provisional language would authorize up to $10 million in additional funding to address costs necessary to implement the action plan. The May Revision also assumes increases of $7.4 million in 2012-13 and $15.7 million in 2013-14 to backfill the loss of federal funding resulting from the withdrawal of four residential units at Sonoma from the Medicaid Provider Agreement. Withdrawing these units ensures continued federal funding for Sonoma's remaining six Intermediate Care units.
- *Federal Sequester Backfills*—The May Revision includes an increase of $5.7 million General Fund in 2012-13 and $11.9 million General Fund in 2013-14 to backfill the sequester reduction to the Social Services Block Grant (Title XX), which is used to partially fund regional center purchase of services. The May Revision also proposes

an increase of $613,000 General Fund in 2013-14 to backfill the sequester reduction to the Early Start IDEA Part C grant for regional center purchase of services.

- *California Children and Families Commission (First 5) Backfill*—An increase of $25 million in 2012-13 to backfill lower-than-anticipated funding from the First 5 Commission.

- *Caseload Adjustments*—The growth in Regional Center caseload is down slightly from the Governor's Budget, but per-case costs have increased due to higher utilization and cost per service, increasing purchase of services by $42.1 million ($14.7 million General Fund) in 2012-13 and $36.3 million ($9.4 million General Fund) in 2013-14. The May Revision contains an increase of $1.5 million ($0.9 million General Fund) in 2012-13 and $1.5 million ($0.9 million General Fund) in 2013-14 due to slightly higher caseload in the Developmental Centers and increased per-case costs. Caseload is slightly higher because fewer individuals than projected have transitioned to community living settings. However, the Developmental Center population continues to decline year-over-year consistent with the ongoing transition of Developmental Center residents into community living; a moratorium on admissions to state-operated facilities; and the continuation of Lanterman Developmental Center closure activities.

Department of State Hospitals

The Department of State Hospitals (DSH) administers the state mental health hospital system, the Forensic Conditional Release Program, the Sex Offender Commitment Program, and the evaluation and treatment of judicially and civilly committed and voluntary patients. The May Revision includes $1.6 billion ($1.5 billion General Fund) in 2013-14 for support of the Department. The patient population is projected to reach a total of 6,730 in 2013-14.

Significant Adjustments:

- *Establish Additional Intermediate Care and Acute Units*—The May Revision contains $22.1 million ($16 million General Fund) and 173 positions (primarily Level-of-Care staff) to establish four new units and convert one existing unit at three state hospitals. This funding would increase the number of beds by 155 and better accommodate patient population for Lanterman-Petris-Short, Incompetent to Stand Trial, Mentally Disordered Offender, and Sexually Violent Predator commitments.

- *Patient Management and Bed Utilization Unit*—The May Revision proposes $1.8 million General Fund and 18 positions in 2013-14 to establish a Patient Management Unit dedicated to managing patient bed needs to maximize utilization within state hospitals. The Unit would provide more appropriate patient-security level placement, reduce wait lists by identifying available alternative placements, and provide a centralized patient population data repository to track patient referrals, transfers, wait lists, rejections, and demographics.

- *Psychiatric Inpatient Hospital Programs co-located with the California Department of Corrections and Rehabilitation (CDCR)*—A net decrease of $10 million General Fund and 3.1 positions resulting from the transition of beds from DSH-Salinas and DSH-Vacaville to the California Health Care Facility in Stockton (DSH-Stockton) and an adjustment to staffing standards and relief factors. This proposal is consistent with the approved Mental Health Bed Plan and would provide necessary inpatient treatment staff for the Psychiatric Programs co-located with CDCR facilities. Activation of DSH-Stockton results in the transition of 450 inpatient beds from DSH-Salinas and DSH-Vacaville.

Mental Health Services Oversight and Accountability Commission

The Mental Health Services Oversight and Accountability Commission provides oversight, review, accountability and evaluation of projects and programs supported with Mental Health Services Act funds.

Significant Adjustment:

- *Evaluation Master Plan*—The May Revision includes $947,000 Mental Health Service Fund and 6 positions to begin implementation of the Mental Health Services Act Evaluation Master Plan approved by the Commission on March 28, 2013. These resources fund the initial costs of the 5-year Evaluation Master Plan beginning in 2013-14, which includes steps to maintain and upgrade the performance monitoring system, and evaluation studies.

Office of Statewide Health Planning and Development

The Office of Statewide Health Planning and Development (OSHPD) develops policies, plans and programs to meet current and future health needs of the people of California. Its programs provide transparent health care quality and cost information, ensure safe health care facility construction, improve financing opportunities for health care facilities, and promote access to a culturally competent health care workforce.

Significant Adjustment:

- *Healthcare Workforce Development Grant Funds*—The May Revision includes $21 million Reimbursements for OSHPD to deliver healthcare workforce development incentive programs funded through a grant from the California Endowment. OSHPD received a total grant of $52 million that will be spent over four years. Of the budget year amount, $14 million is for health profession scholarships and loan repayments, while the remainder is to provide financial support to family practice residency, family nurse practitioner, physician assistant, and registered nurse education programs throughout California.

Corrections and Rehabilitation

The California Department of Corrections and Rehabilitation (CDCR) incarcerates the most serious and violent felons, supervises them when they are released on parole, and provides rehabilitation programs to help them reintegrate into the community. CDCR provides safe and secure detention facilities and necessary support services to inmates, including food, clothing, academic and vocational training, as well as health care services.

The May Revision includes $9.1 billion ($8.8 billion General Fund and $252 million other funds) for CDCR in 2013-14.

Significant Adjustments:

- *Long-Term Offenders*—The May Revision proposes additional tools to assist counties in managing long-term offenders. The proposal authorizes CDCR to house long-term offenders, provided the county agrees to accept an equivalent average daily population of short-term offenders. The proposal relies on County Parole Boards to make the determination to send long-term inmates to state prison after inmates have served three years of their sentence in a county jail. Lastly, the proposal establishes a presumption of a minimum level of split sentencing, but authorizes a judge to make an exception if the judge determines that a split sentence is not appropriate.
- *California Community Corrections Performance Incentive Act (SB 678)*—An increase of $72.1 million General Fund for the allocation of SB 678 funds to county probation

departments that demonstrate success in reducing the number of adult felony probationers going to prison or jail for committing new crimes or violating the terms of probation. This augmentation continues to support probation efforts targeted at reducing recidivism and encouraging alternatives to incarceration.

- *Expand Fire Camp Capacity*—An increase of $15.4 million to reflect 3,800 state prison inmates participating in fire camps. The 2012 Budget Act assumed that the number of inmates in fire camps would decrease to 2,500 in 2013-14. As a result, the Governor's Budget included a $15.4 million General Fund reduction for lower levels of custody staffing. Based on more recent projections, there are sufficient eligible inmates to maintain all current fire camps and crews. Housing these additional inmates in fire camps provides overcrowding relief, expands credit earning opportunities, and supports fire suppression.

- *Drug Interdiction Program*—An increase of $6.6 million General Fund to reduce the prevalence of drugs in prisons by implementing various initiatives that have proven successful in other states. This proposal is intended to increase correctional staff and inmate safety, reduce inmate violence and the use of solitary confinement, and increase participation in rehabilitative programs.

- *Health Care Reorganization*—To support the transition of inmate health care back to the state, the Administration is proposing the establishment of a third Undersecretary and related executive positions to oversee CDCR's adult inmate health care services programs. These positions will not be filled until a transition plan and timeline have been finalized.

- *Adult Population Adjustment*—An increase of $11.5 million General Fund in 2012-13 and $6.7 million General Fund in 2013-14 for adult inmate and parole population changes. The revised average daily population projections for adult inmates are 132,621 in the current year and 128,885 in the budget year, an increase of 398 and 280, respectively. The mental health population projection is 31,889 in the current year and 31,753 in the budget year, an increase of 1,966 and 2,321, respectively. The revised average daily population projections for parolees are 62,498 in the current year and 46,358 in the budget year, an increase of 60 parolees and a decrease of 1,262 parolees, respectively.

- *Juvenile Population and Workload Adjustment*—A decrease of $353,000 Proposition 98 in 2012-13 and $2.4 million ($1.4 million General Fund and $1 million Proposition 98) in 2013-14 for juvenile population adjustments and cost changes. The revised average daily population projections for wards are 821 in the current year and 679 in the budget year, a decrease of 50 wards in the current year and 234 wards in the budget year. The May Revision reflects budget changes necessary to continue serving a reduced juvenile population, including establishment of a ward-driven Operating Expenses and Equipment funding mechanism, funding the cost of mental health treatment provided by the Department of State Hospitals, and funding the actual salaries for filled custody positions.

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Natural Resources

The Natural Resources Agency consists of 27 departments, boards, commissions, and conservancies responsible for administering programs to conserve, protect, restore, and enhance the natural, historical, and cultural resources of California.

The May Revision includes total funding of $7.9 billion ($2.1 billion General Fund and $5.8 billion other funds) for all programs included in the Agency.

Emergency Fund

The May Revision proposes an increase of $51 million General Fund to reflect historical expenditures for emergency wildfire suppression costs. The Emergency Fund (E Fund) provides necessary resources to the Department of Forestry and Fire Protection's emergency fire suppression efforts. Over the last five years, average emergency firefighting costs have been higher than the E Fund budgeted amount. This proposal increases the E Fund to $172 million based on a five-year average of costs.

By using historical expenditures to estimate E Fund costs, the May Revision reflects a more realistic estimate. The Department will continue to receive the financial resources necessary to protect the public from catastrophic wildfires. The number and severity of fires caused by extremely dry winter and spring conditions in the state this year demonstrate the unpredictability of fire suppression costs. Maintaining a prudent General Fund reserve is necessary to ensure financial resources are available for emergency response capabilities.

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Transportation

The programs within the Transportation Agency promote the state's transportation infrastructure. The Agency includes the Department of Transportation, the Department of Motor Vehicles, the California Highway Patrol, the Board of Pilot Commissioners, the Office of Traffic Safety, the High Speed Rail Authority, and the California Transportation Commission.

Department of Transportation

The Department of Transportation (Caltrans) has almost 20,000 employees and a budget of $12.8 billion. Caltrans designs and oversees the construction of state highways, operates and maintains the highway system, funds three intercity passenger rail routes, and oversees funding for local mass transit projects. Approximately 50,000 road and highway lane miles and 12,910 state bridges are maintained. Over 800 public-use and special-use airports and heliports are inspected. The largest sources of funding for transportation projects are excise taxes paid on fuel consumption, federal funds also derived from fuel taxes, and weight fees on trucks. Bond funds currently provide approximately 30 percent of the total funding available. As a result, approximately 13 percent of annual state transportation revenue will continue to be dedicated to offsetting debt service costs, which are expected to grow to over $1 billion in 2013-14.

Significant Adjustments:

- *Capital Outlay Program*—A reduction of $36.3 million and 184 state positions for engineering, design, and construction oversight activities in the Program. While some Proposition 1B work continues, overall Caltrans' workload is anticipated to decrease significantly as a result of the expiration of this and other temporary sources of funding such as the federal American Recovery and Reinvestment Act funds. The proposed level of staffing will establish a 90/10 percent split of state staff to architectural and engineering consultant contracts.

- *Zero-Base Budget Review*—Executive Order B-13-11 directs the Department of Finance to modify the state budget process to increase efficiency and focus on accomplishing program goals. Pursuant to this Executive Order, Finance and Caltrans developed a four-year plan to conduct a zero-base analysis of all Caltrans' programs. The Equipment and Stormwater Programs were reviewed in the spring of 2013. The Budget includes the following proposals that reflect the outcome of the zero-base review:

    - *Equipment Program*—A reduction of $12.8 million and 41 state positions to reflect savings associated with the Governor's Executive Order B-2-11 (State Fleet Reduction) and a one-time augmentation of $10.3 million in operating expenses to replace equipment. The Budget proposes to establish staffing levels that are consistent with the current equipment inventory.

    - *Stormwater Program*—A redirection of $2.1 million from contract services to fund 25 new positions in 2013-14 to implement Caltrans' new National Pollution Discharge Elimination System stormwater permit. The proposed staffing will assess total maximum daily load requirements, address areas of special biological significance, and perform additional maintenance and reporting activities.

- *Increased Operating Expenses for AMTRAK*—An increase of $18.6 million to comply with federal operating requirements for intercity passenger rail service operated by AMTRAK. The federal Passenger Rail Investment and Improvement Act of 2008 required all short distance AMTRAK corridor services to be 100 percent state-supported. The state currently pays only 70 percent of operating expenses for the Pacific Surfliner.

California Highway Patrol

The California Highway Patrol (CHP) has a budget of approximately $1.9 billion, all from non-General Fund sources, and more than 11,000 positions to ensure the safe, convenient, and efficient transportation of people and goods across the state highway system.

Significant Adjustment:

- *Air Fleet Replacement*—An increase of $17 million from the Motor Vehicle Account to replace three helicopters and one airplane. CHP has a current air fleet of 15 helicopters and 15 airplanes, which are used for speed enforcement, patrolling rural roadways, emergency response, and homeland security. This request will provide one-time funding to replace the four aircraft with the highest flight hours, each over 14,000 hours. The CHP will also conduct a base workload analysis of its air operations program over the next year to determine the number of aircraft needed for core operations and outline a schedule to modernize its aging fleet.

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Labor and Workforce Development

The Labor and Workforce Development Agency addresses issues relating to California workers and their employers. The Agency is responsible for: labor law enforcement, workforce development, and benefit payment and adjudication. The Agency works to combat the underground economy and to help legitimate businesses and workers in California.

The May Revision includes total funding of $17.6 billion ($299.5 million General Fund and $17.3 billion other funds) for all programs included in this Agency.

Employment Development Department

The Employment Development Department (EDD) administers the Unemployment Insurance (UI), Disability Insurance (DI), and Paid Family Leave programs and collects payroll taxes from employers, including the Personal Income Tax. EDD connects job seekers with employers through a variety of job services programs and one-stop service centers. The Department also supports workforce training programs.

The May Revision includes $17 billion ($283.6 million General Fund), which reflects an increase of $73 million compared to the Governor's Budget. This change is primarily due to a $153 million increase in DI benefit payments and a $72 million decrease in UI benefit payments.

Significant Adjustments:

- *Revised UI Benefit Payments*—A decrease of $351 million in 2012-13 and a decrease of $72 million in 2013-14 to reflect a projected decrease in UI benefit payments due to a lower unemployment rate and the discontinuation of the federal benefits extension program in December 2013.
- *Effects of Federal Sequestration*—The Emergency Unemployment Compensation Program provides payments to unemployed individuals who have exhausted their regular unemployment benefits (lasting 26 weeks). While regular unemployment benefits were unaffected by sequestration, extension benefits were reduced by approximately $468 million for federal fiscal years 2013 and 2014. These reductions result in a 17.7-percent reduction in payouts to approximately 350,000 to 400,000 unemployed individuals who normally receive a full benefit check.
- *UI Program Administration Funding* —An increase of $29.7 million from the Contingent Fund for the administration of the UI Program. The May Revision reflects a decrease of 870 positions to administer the UI Program in 2013-14 as compared to the 2012 Budget. This decrease is a result of two main factors —an improving economy and an inherent funding shortfall in the program. As the unemployment rate drops, fewer resources are needed to process claims and pay UI benefits. Additionally, because the federal cost recovery model does not provide sufficient funds to support the administrative costs of the UI Program, a number of positions go unfunded. Federal extensions, other state funds, and federal carryover from prior years have helped bridge this gap in recent years, but the Department still faces a significant funding gap in 2013-14. The funding gap will continue to grow as most of these one-time sources are no longer available. Sequestration exacerbated the problem by reducing available UI administration funding by an additional $31.2 million in 2013-14. The proposed funding will allow EDD to retain approximately 300 positions to pay UI benefits, process UI claims, answer telephone calls, and collect payroll taxes.

Various Departments and Issues

This section provides budget information for various departments and statewide expenditures.

Redevelopment Agencies

ABx1 26 (Chapter 5, Statutes of 2011) eliminated the state's redevelopment agencies (RDAs) and replaced them with locally organized successor agencies that are tasked with retiring the former RDAs' outstanding debts and other legal obligations. The elimination of RDAs allows local governments to protect core public services by returning property tax revenue to cities, counties, special districts, and K-14 schools.

In general, successor agencies are tasked with using the property tax revenue that the former RDAs would have received to retire the debts and other contractual obligations of the RDAs, which are collectively known as "enforceable obligations." Enforceable obligations include bonded debt issued by the RDAs, loans of money to third parties that the RDAs are legally required to repay, court judgments or settlements, and legally binding contracts or agreements between the RDAs and public agencies or private entities.

Every six months, successor agencies provide Recognized Obligation Payment Schedules (ROPS) to the Department of Finance which list all enforceable obligations of the former RDAs that are proposed to be paid with property taxes, bond revenues, and any other funding available to the former RDAs. Finance reviews these ROPS to determine whether the listed obligations are enforceable under the law, and has the authority to prohibit payments that are not enforceable. This process is required to continue until all enforceable obligations of the former RDA have been retired.

Any property tax revenue remaining after payment of enforceable obligations is distributed to cities, counties, special districts, and K-14 schools located within the boundaries of the former RDAs pursuant to existing formulas. These payments are referred to as "residual pass-through payments." Every dollar of residual pass-through payments that goes to counties, cities, and special districts is unrestricted general purpose revenue that can be used to protect core public services. Every dollar of residual pass-through payments that goes to K-14 schools results in an offset of state Proposition 98 General Fund expenditures.

As a result of the RDA dissolution process, the May Revision estimates that counties are receiving $1.4 billion in new general purpose revenues in 2012-13 and 2013-14 combined, while cities are receiving $1.1 billion and special districts $500 million. It is estimated that $675 million annually will be distributed to counties, cities, and special districts. This is a significant amount of unrestricted funding that can be used by local governments to fund police, fire, or other critical public services.

The May Revision estimates Proposition 98 General Fund savings resulting from the dissolution of RDAs to be $2.1 billion in 2012-13—the same amount that was estimated at the Governor's Budget. For 2013-14, Proposition 98 General Fund savings are estimated to be $1.5 billion—$400 million above the amount estimated at the Governor's Budget. Ongoing Proposition 98 General Fund savings are estimated to be $825 million—$265 million higher than at the Governor's Budget. The increase in savings in the budget year and ongoing is due to an increase in the Due Diligence Review remittances received by K-14 schools, an increase in the K-14 savings associated with the third and fourth ROPS cycle reviews, and an increase in property tax revenues.

State Controller

The State Controller, among other responsibilities, administers the statewide payroll system that issues pay to approximately 294,000 state employees.

Significant Adjustment:

- *21st Century Project: Legal, Suspension, and Reconciliation Costs*—Prior to the suspension of the project, the State Controller's Office estimated costs of

$38 million to finish implementation in 2013-14. The May Revision provides a total of $14.5 million ($11.9 million General Fund, $2.6 million other funds, and 40 positions) on a one-year basis to address workload associated with completing specific tasks for the 21st Century Project, including legal costs, payroll migration, payroll stabilization, and payroll reconciliation. A comprehensive assessment and evaluation of the strategy going forward will be addressed in future years.

Secretary of State

The Secretary of State is the chief elections officer of the state and is responsible for the administration and enforcement of election laws. The Office is also responsible for administering and enforcing laws pertaining to filing documents associated with business and non-profit entities. To support the Secretary of State, the May Revision includes $112 million ($26.6 million General Fund) and 559 positions.

Significant Adjustment:

- *Business Programs Division Backlog*—The Governor recently signed AB 113, which provides $1.6 million in the current year to eliminate backlogs and maintain an average five business day processing time for business filings until the implementation of an automated business filing system. The Budget includes an increase of $5.7 million Business Fees Fund and 56 positions to continue these activities into the budget year. The budget also includes language requiring the Secretary of State to report on its progress in achieving and maintaining the five business day processing time for these filings.

Department of Food and Agriculture

The Department of Food and Agriculture protects and promotes California's agricultural industry and food quality and safety. The May Revision includes $28.5 million for the citrus pest and disease prevention program.

Significant Adjustment:

- *Citrus Pest and Disease Prevention Program*—An increase of $2.5 million in 2013-14 and 2014-15 to help prevent the spread of the Asian Citrus Psyllid and Huanglongbing disease.

California Department of Veterans Affairs

The California Department of Veterans Affairs promotes and delivers services for California veterans and their families. Specifically, the Department provides aid and assistance to veterans and their families for presenting claims for federal veterans' benefits, provides California veterans with direct low-cost loans to acquire farms and homes, and provides the state's aged and disabled veterans with rehabilitative, residential, and medical care services in the California Veterans Homes. California owns and operates eight veterans homes located in Yountville, Chula Vista, Barstow, Lancaster, Ventura, West Los Angeles, Redding, and Fresno. These homes provide residential and medical care services to honorably discharged California veterans who served on active duty and are over the age of 55 or disabled. The recently completed homes in Redding and Fresno will begin admitting residents in the fall of 2013. The May Revision includes $305.2 million General Fund to support the activities of the Department.

Significant Adjustment:

- *Conversion of Skilled Nursing Facility Units to Domiciliary Units at the West Los Angeles Veterans Home*—A decrease of $3.2 million General Fund and 35.6 positions in 2013-14 and a decrease of $5.1 million General Fund and 67 positions in 2014-15 and ongoing to reflect the conversion of 84 skilled nursing facility beds to less costly domiciliary beds. This conversion will allow the Department to better meet the needs of veterans in the greater Los Angeles region by providing domiciliary beds, which are currently not available in that area.

Implementing Federal Sequestration

The federal sequester is a package of spending cuts that was part of the Federal Budget Control Act of 2011. While the sequester has started for federal fiscal year 2013, the exact funding implications on most individual programs at the state level are still unclear. Federal agencies have not issued all necessary guidelines and affected state departments are in the process of putting measures in place to minimize impacts.

Furthermore, the federal budget for federal fiscal year 2014 is in its early stage of negotiation. Given the uncertainty of the exact program reductions and the interaction between federal fiscal years and state fiscal years, a budget control section is being proposed to provide flexibility to decrease spending authority resulting from the sequester once final details are determined. Before any reductions go into effect, they will be subject to legislative review.

The Administration has evaluated the impact on specific programs related to federal sequestration and proposes a modest amount of backfill for these critical areas: Special Education Program, Title XX Program, and Early Start Part C Grant Reallocation Program. For further details on these proposals, please refer to the program chapters.

The sequester has also resulted in decreases in General Fund offsets related to Build America Bonds subsidy payments and State Criminal Alien Assistance Program.

The overall impact on the General Fund is less than $65 million in 2012-13 and 2013-14 combined.

Debt Service

Budget Year Debt Service—General Fund debt service expenditures will decrease by a net of $141.9 million as compared to the Governor's Budget, to a total of $5.7 billion. This adjustment reflects reduced General Obligation debt service costs ($4.9 billion total) and no change for lease revenue bonds ($766.1 million total). The net decrease in General Obligation debt service is primarily attributable to: (1) projected premium generated from future bond sales in the budget year, (2) a smaller spring 2013 bond sale than projected, (3) savings related to bond refinancings this spring, and (4) an increase of $30.7 million from reduced Build America Bonds subsidy payments because of the federal sequester. The decrease in the size of the spring 2013 bond sale was accomplished by using existing bond cash more efficiently. The Department of Finance continues to work with departments to manage bond cash and ensure bonds are issued only when necessary. The balance of unspent bond proceeds from previous sales has been reduced to approximately $4.4 billion, as of March 30, 2013, compared to $7.3 billion, as of April 30, 2012.

Current Year Debt Service—General Fund debt service expenditures will decrease by a net of $292.1 million as compared to the Governor's Budget, for a total of $4.7 billion. This reflects reduced General Obligation debt service costs ($4 billion total) and no change for lease revenue bonds ($673.4 million total). The net decrease in General Obligation debt service is primarily related to: (1) increased premium generated from the spring 2013 bond sales, (2) savings related to bond refinancings, and (3) an increase of $12.4 million from reduced Build America Bonds subsidy payments because of the federal sequester.

State Appropriations Limit Calculation

2013-14 State Appropriations Limit (SAL) Calculation—Pursuant to Article XIIIB of the California Constitution, the 2013-14 SAL is estimated to be $89.716 billion. The revised limit is the result of applying the growth factor of 5.8 percent. The revised 2013-14 limit is $16 million above the $89.7 billion estimated in January. This increase is due to changes in the following factors and shifts in financial responsibility.

- Per Capita Personal Income
  - January Percentage Growth: 5.66%
  - May Revision Percentage Growth: 5.12%
- State Civilian Population
  - January Percentage Growth: 0.73%
  - May Revision Percentage Growth: 0.80%
- K-14 Average Daily Attendance
  - January Percentage Growth: 0.08%
  - May Revision Percentage Growth: 0.43%

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

Economic Outlook

The national and California economies continue to recover at a modest pace. There are some signs the economy gained strength in the first quarter of 2013. Consumer spending boosted growth more than expected, while housing permits, home values, and construction jobs all grew. Industry sectors across the board added jobs, and unemployment fell.

Weaker global growth and reduced federal government spending will likely prevent acceleration to a more robust pace. At the time of the Governor's Budget, the forecast assumed across-the-board federal tax increases and major spending cuts would be avoided in 2013. With federal spending cuts now in place and the sunset of the payroll tax holiday, the outlook is weaker than the prior forecast. The recovery is expected to be slower than the Budget forecast.

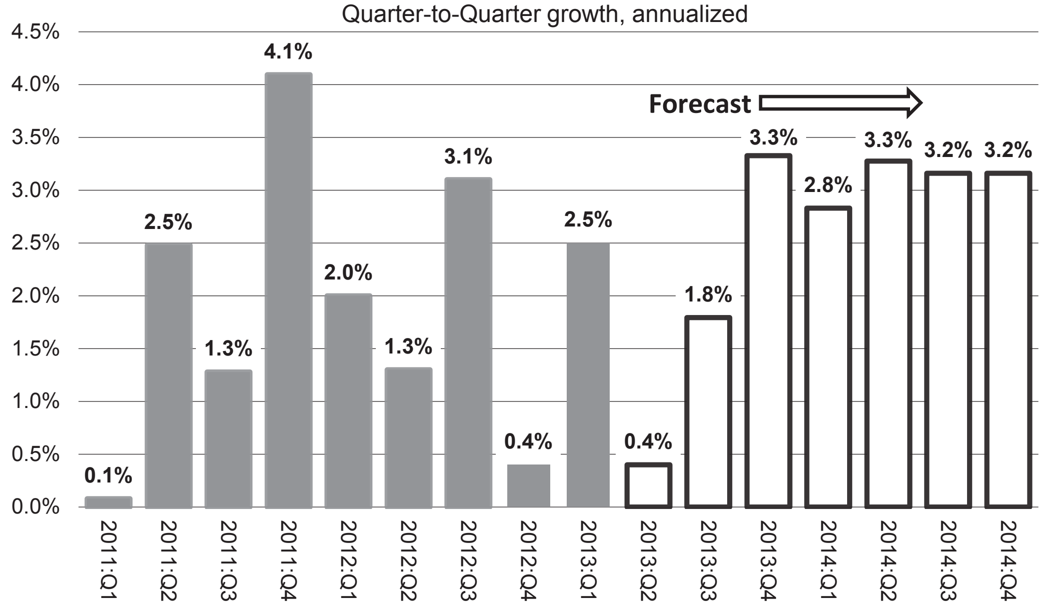
The Nation – Slow Recovery

The national economy has continued to grow at a slow pace. While the risks of another recession have receded, the determination of the federal government to cut spending in the near term has lowered overall demand and uncertainty has likely dampened consumer confidence.

The Governor's Budget forecast assumed that federal income taxes for households earning more than $250,000 would return to pre-tax cut levels, payroll taxes would not be raised, and automatic spending cuts would be averted by a more permanent agreement on deficit reduction.

The current forecast includes the higher federal income taxes on households earning more than $450,000 a year, expiration of the payroll tax holiday, and automatic spending cuts. The 2-percent increase in payroll taxes shows up directly in a lower rate of personal income growth. Automatic spending cuts and the higher federal income taxes for upper-income households are reflected in slower national economic growth during 2013 (Figure ECO-01).

Figure ECO-01
U.S. Real Gross Domestic Product
Quarter-to-Quarter growth, annualized



Source: U.S. Bureau of Economic Analysis; CA Department of Finance May Revision Forecast

Nonfarm employment continues to rise, with an average of 205,000 jobs added per month in the first quarter of 2013. The unemployment rate continued to fall, sliding to 7.6 percent at the end of the first quarter, but this was due partially to declining labor force participation. Hourly wages have been stagnant, and in April, weekly earnings for private sector workers fell by 0.4 percent due to fewer hours worked. Therefore, the reduction in the unemployment rate does not directly translate to higher personal income growth.

The inventory of existing homes for sale was 4.7 months in March 2013. This is well below the levels of the last six years, when inventories rarely dropped below 7 months. This indicates that demand is now outstripping supply. With the Case-Shiller index of home prices increasing for thirteen straight months (through February 2013), more owners may be encouraged to put their homes on the market.

Inflation has remained at low levels, and the Federal Reserve is expected to continue to keep interest rates low. With global demand slowing, commodities prices, including food and fuel, are not expected to rise quickly.

California – Recovery is Proceeding Slowly

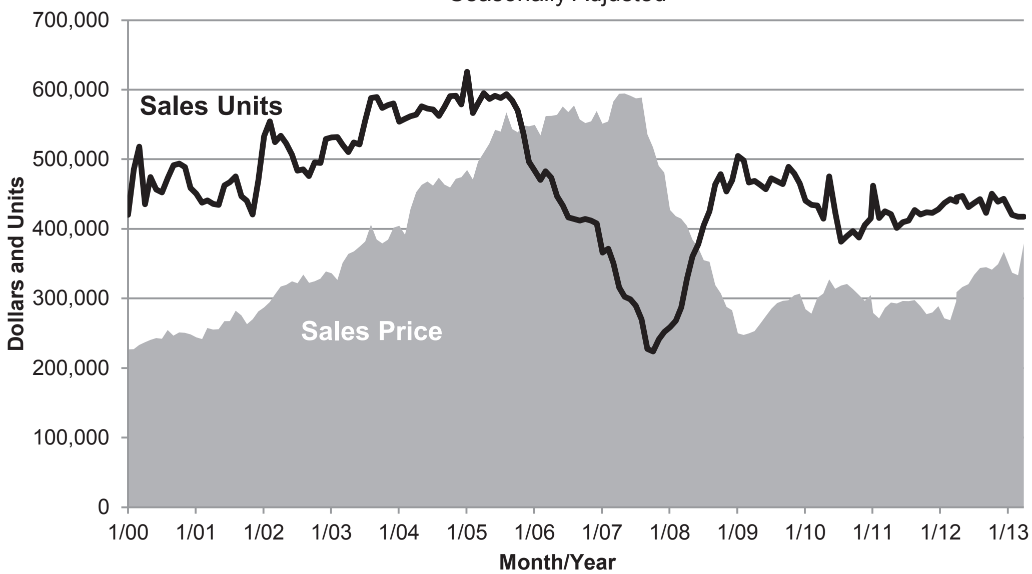
In conjunction with the national economy, California is growing at a slow but steady pace, albeit slower than at the Governor's Budget forecast. After a steeper fall than the nation, the State's recovery is proceeding somewhat faster, and is spreading to more sectors and areas. The largest change to the California forecast comes as a result of federal changes. These changes will slow growth through lower federal spending in California, including unemployment insurance for the long-term unemployed who have exhausted regular unemployment benefits (lasting 26 weeks). In addition, the sunset of the payroll tax holiday directly lowered personal income growth by 2 percent in 2013, lowering consumer demand. The housing market is recovering, with median prices rebounding and new permits increasing. Jobs are being added at a fast enough pace that the unemployment rate is steadily falling and is now below 10 percent.

The housing market is showing signs of a more sustainable recovery. After hitting a low of close to 200,000 units in the middle of 2007, sales of existing single-family homes have rebounded to above 400,000 units (Figure ECO-02). Inventories of homes for sale are low, indicating demand is outstripping supply. More permits for new housing units are being issued. These trends are not confined to the coastal areas, where the housing recovery started last year, but have spread to inland markets.

There are also indications that sales are being supported by investment firms buying up homes to refurbish and convert to rentals. This is likely a reflection of high rental prices and low interest rates. Conversions of homes for sale into rental properties should help limit rental price increases and help support the housing sector. Median prices of single-family homes have risen to above $350,000 after consistently being below $300,000 as recently as the beginning of 2012. Rebounding prices should bring down the stock of underwater mortgages and bring more houses onto the market.

This shift has raised some concern about whether investment firms can effectively manage rentals. There is also concern that first-time homebuyers are being squeezed out of the market by investors who have the ability to pay cash, given current cash reserves

Figure ECO-02
California Median Home Price and Sales
Existing Single-Family Homes
Seasonally Adjusted



Source: California Association of Realtors

and a lack of other investment opportunities with higher yields. On the other hand, it is expected that the investor demand will be a temporary phenomenon as they draw down their cash to buy up the stock of foreclosed homes. Once house prices rise and individuals begin to sell and buy in larger numbers, large-scale investors are expected to concentrate on managing their housing portfolios. With mortgage rates expected to remain low for the next few years, the demand from investors should benefit California homeowners by helping transition the housing market back to a higher rate of buying and selling.

Jobs are being added at a steady pace, and the unemployment rate is falling despite an expanding workforce. More sectors are adding jobs, both in higher-wage sectors such as professional services, and in sectors such as construction and leisure and hospitality. Educational and health services have been growing, and this trend is expected to continue as the Affordable Care Act is implemented over the next few years. The number of jobs is expected to reach 2008 levels by the end of 2014. However, the unemployment rate will fall slowly as the California civilian labor force continues to expand from 18.21 million in 2008 to 18.77 million in 2014.

Manufacturing jobs continue to decline, although the share of high-technology manufacturing jobs is holding steady. After strong export growth of 19 percent in 2010 and 11 percent in 2011 to compensate for the large fall in 2009, the pace slowed in 2012 to 1.6 percent for made-in-California exports. Overall, corporate profits remain high at the national level compared to gross domestic product. Continued investment by businesses, particularly in computers, should benefit California industries in these sectors.

Risks to the Forecast

The California and national economies are expected to continue their modest pace of growth, albeit with a weaker outlook than the Governor's Budget forecast. With unemployment falling, the housing sector slowly recovering, and monetary conditions offsetting fiscal tightening at the federal level, growth is becoming more sustainable. However, the expiration of the payroll tax holiday at the beginning of 2013 has notably reduced disposable income, and with consumers now preferring a higher saving rate, it will be some time before the economy is completely recovered.

Risks to the outlook include international, national, and local factors:

- Very slow growth in Europe will weaken global growth. This will also likely keep the US dollar strong in comparison, limiting export growth.
- Asian growth could slow. A sharper downturn in the State's major trading partners such as China, Japan, or South Korea would reduce exports and make California more reliant on domestic sources of growth.
- National fiscal policy could further reduce growth. Congress remains sharply divided about the appropriate pace for deficit reduction. While a recession is unlikely, another few years of slow growth would be costly to the still large numbers of unemployed workers.
- California's recovery could fail to take hold. Even with steady job growth and an improving housing market, uncertainty about future growth could cause individuals and businesses to delay spending, creating a self-reinforcing lower rate of expansion.

See Figure ECO-03 for highlights of the national and California forecasts.

Figure ECO-03

Selected Economic Indicators

United States	2008	2009	2010	2011	2012	2013 Projected	2014 Projected
Nominal gross domestic product, $ billions	$ 14,292	$ 13,974	$ 14,499	$ 15,076	$ 15,685	$ 16,211	$ 16,947
Real gross domestic product, percent change	-0.3%	-3.1%	2.4%	1.8%	2.2%	2.0%	2.8%
Contributions to real GDP growth							
Personal consumption expenditures	-0.4%	-1.4%	1.3%	1.8%	1.3%	1.5%	1.8%
Gross private domestic investment	-1.7%	-3.6%	1.5%	0.6%	1.2%	1.0%	1.2%
Net exports	1.2%	1.1%	-0.5%	0.1%	0.0%	0.0%	-0.2%
Government purchases of goods and services	0.5%	0.7%	0.1%	-0.7%	-0.3%	-0.5%	0.0%
Personal income, $ billions	$ 12,460	$ 11,867	$ 12,322	$ 12,947	$ 13,407	$ 13,787	$ 14,485
Corporate profits, percent change	-17.4%	7.5%	26.8%	7.3%	6.8%	1.0%	2.8%
Housing permits, thousands	905	583	605	624	816	--	--
Housing starts, thousands	900	554	586	612	782	970	1,265
Median sales price of existing homes	$ 196,600	$ 172,100	$ 173,100	$ 166,200	$ 177,200	--	--
Federal funds rate, percent	1.9%	0.2%	0.2%	0.1%	0.1%	0.2%	0.2%
Consumer price index, percent change	3.8%	-0.4%	1.6%	3.2%	2.1%	1.8%	1.9%
Unemployment rate, percent	5.8%	9.3%	9.6%	8.9%	8.1%	7.7%	7.3%
Civilian labor force, millions	154.3	154.2	153.9	153.6	155.0	156.1	157.5
Nonfarm employment, millions	136.8	130.9	129.9	131.5	133.7	135.7	137.9
California							
Personal income, $ billions	$ 1,611	$ 1,517	$ 1,564	$ 1,645	$ 1,730	$ 1,767	$ 1,868
Made-in-California exports, percent change	7.8%	-17.1%	19.2%	11.1%	1.6%	--	--
Housing permits, thousands	65	37	45	47	58	82	121
Housing unit change, thousands	95	70	36	36	45	--	--
Median sales price of existing homes	$ 348,490	$ 274,960	$ 305,010	$ 286,040	$ 319,340	--	--
Consumer price index, percent change	3.4%	-0.3%	1.3%	2.6%	2.2%	1.9%	2.0%
Unemployment rate, percent	7.3%	11.4%	12.3%	11.8%	10.5%	9.4%	8.6%
Civilian labor force, millions	18.2	18.2	18.3	18.4	18.5	18.6	18.8
Nonfarm employment, millions	15.0	14.1	13.9	14.1	14.4	14.7	15.0
Percent of total nonfarm employment							
Mining and logging	0.2%	0.2%	0.2%	0.2%	0.2%	0.2%	0.2%
Construction	5.3%	4.4%	4.0%	4.0%	4.1%	4.2%	4.4%
Manufacturing	9.5%	9.1%	8.9%	8.9%	8.7%	8.6%	8.6%
High technology	2.5%	2.5%	2.5%	2.5%	2.4%	2.3%	2.3%
Trade, transportation, and utilities	19.0%	18.8%	18.8%	18.9%	18.9%	18.9%	18.7%
Information	3.2%	3.1%	3.1%	3.0%	3.0%	2.9%	2.9%
Financial activities	5.6%	5.6%	5.5%	5.4%	5.4%	5.4%	5.4%
Professional and business services	14.9%	14.6%	14.9%	15.1%	15.5%	15.8%	15.9%
High technology	2.1%	2.2%	2.3%	2.4%	2.5%	2.5%	2.6%
Educational and health services	11.6%	12.5%	12.8%	13.0%	13.1%	13.2%	13.2%
Leisure and hospitality	10.5%	10.7%	10.8%	10.9%	11.1%	11.3%	11.3%
Other services	3.4%	3.5%	3.5%	3.5%	3.5%	3.5%	3.5%
Government	16.8%	17.6%	17.6%	17.1%	16.5%	16.1%	15.9%

Forecast based on data available as of April 2013.
Percent changes calculated from unrounded data.

Revenue Estimates

General Fund revenues under the May Revision forecast will be higher than at the Governor's Budget by $2.8 billion in 2012-13 and lower by $1.3 billion in 2013-14. Figure REV-01 shows the revenue forecasts, by source, in the Governor's Budget and the May Revision. Total May Revision revenue is projected to be $98.2 billion in 2012-13 and $97.2 billion in 2013-14.

Accurately forecasting tax revenue for a large and diverse economy like California's is always a challenging task. That task has become even more challenging in recent years because of several factors. First, the economy is still recovering from the most severe recession since the Great Depression. The recovery pattern does not conform to the patterns of other recent economic recoveries. Second, the increasing concentration of income has made tax revenues dependent to a greater degree on the income and decisions of a relatively small population of taxpayers. Third, the use of tax credits and deductions has increased in unpredictable ways. Finally, recent changes to state and federal tax laws affect how much tax is owed and when taxes are paid making it increasingly difficult to make accurate predictions based on cash receipts.

Personal Income Tax (PIT) receipts for January were $4.9 billion higher than expected. At the time, it was expected that much of the additional January payments were related either to taxpayers making their 2012 tax payments related to Proposition 30 earlier than required, or to taxpayers shifting more income into 2012 due to federal tax law changes. While the issue of whether Proposition 30 revenue was shifted from April to January is no longer relevant based on cash receipts through the end of April, there is still uncertainty

Figure REV-01
2013-14 May Revision
General Fund Revenue Forecast
Baseline
(Dollars in Millions)

Source	Governor's Budget	May Revision	Change	
Fiscal 11-12:				
Personal Income Tax	$53,836	$54,261	$425	0.8%
Sales & Use Tax	18,652	18,658	$6	0.0%
Corporation Tax	7,949	7,233	-$716	-9.0%
Insurance Tax	2,165	2,165	$0	0.0%
Vehicle License Fees	70	70	$0	0.0%
Estate Tax	0	0	$0	---
Alcoholic Beverage	346	346	$0	0.0%
Cigarette	95	95	$0	0.0%
Other revenues	2,449	2,449	$0	0.0%
Transfers	1,509	1,509	$0	0.0%
Total	**$87,071**	**$86,786**	**-285**	-0.3%
Fiscal 12-13				
Personal Income Tax	$60,647	$63,901	$3,254	5.4%
Sales & Use Tax	20,714	20,240	-$474	-2.3%
Corporation Tax	7,580	7,509	-$71	-0.9%
Insurance Tax	2,022	2,156	$134	6.6%
Vehicle License Fees	4	7	$3	75.0%
Estate Tax	0	0	$0	---
Alcoholic Beverage	320	325	$5	1.6%
Cigarette	91	91	$0	0.0%
Other revenues	2,216	2,218	$1	0.1%
Transfers	1,800	1,748	-$52	-2.9%
Total	**$95,394**	**$98,195**	**2,801**	2.9%
Change from Fiscal 11-12	$8,323	$11,409		
% Change from Fiscal 11-12	9.6%	13.1%		
Fiscal 13-14				
Personal Income Tax	$61,747	$60,827	-$920	-1.5%
Sales & Use Tax	23,264	22,983	-$281	-1.2%
Corporation Tax	9,130	8,508	-$622	-6.8%
Insurance Tax	2,198	2,200	$2	0.1%
Vehicle License Fees	0	0	$0	---
Estate Tax	0	0	$0	---
Alcoholic Beverage	326	332	$6	1.8%
Cigarette	89	89	$0	0.0%
Other revenues	1,770	1,828	$58	3.3%
Transfers	-23	468	$491	2126.9%
Total	**$98,501**	**$97,235**	**-1,266**	-1.3%
Change from Fiscal 12-13	$3,106	-$960		
% Change from Fiscal 12-13	3.3%	-1.0%		
Three-Year Total			**$1,250**	

about whether the additional cash is tied to more income shifting from 2013 to 2012 or to underlying economic strength. The May Revision assumes that the cash is attributable to both additional income shifting and modest economic growth in 2012. For 2013, however, the economic forecast has weakened.

The Governor's Budget assumed that the federal government would extend the 2-percent payroll tax holiday and that sharp across-the-board spending cuts would be avoided. The payroll tax holiday was not extended, and across-the-board spending cuts did go into effect. These developments have reduced the May Revision forecast for economic growth for 2013 and later years. For the forecast of 2013, personal income dropped over 2 percent. The wage growth forecast, a significant driver for revenue, has declined from 4.6 percent at the Governor's Budget to 4 percent at the May Revision.

The May Revision estimates that capital gains in 2012 were over $100 billion, the highest level since 2007. This is partially due to taxpayers shifting the realization of capital gains from 2013 to 2012 to minimize federal taxes. The May Revision assumes that 25 percent of capital gain realizations that would have occurred in 2013 instead occurred in 2012. The forecast assumes that capital gains will fall to $58 billion in 2013, after accounting for the shift of gains from 2013 to 2012. While this level is substantially lower than the 2012 level of capital gains, it is higher than the capital gains observed in any of the other four post-recession years. The May Revision assumes somewhat slower wage growth, due to the expiration of the 2-percent payroll tax holiday and implementation of federal spending cuts. The combination of slower economic growth and the shift of capital gains (and other income items) from 2013 into 2012 leads to a reduction in PIT liability from 2012 to 2013. Consequently, 2012-13 PIT revenue is up for the May Revision by $3.3 billion, while 2013-14 PIT revenue is down by $900 million.

While cash for PIT was up by $4.5 billion through the end of April, the May Revision forecast is $3.3 billion higher in the 2012-13 fiscal year than at the Governor's Budget. There are several reasons for this difference. Some of the additional cash, about $400 million, received for the 2012 tax year is attributable to 2011-12 and 2013-14. A lower wage forecast and higher refund forecast reduces May and June cash by $200 million. To reflect recent cash patterns, additional cash adjustments for the final two months of the fiscal year have been made, moving revenues to 2013-14.

The forecasts for both Sales and Use Tax (SUT) and Corporation Tax (CT) are reduced for the May Revision. The SUT reduction reflects weaker SUT tax receipts in recent months versus the Governor's Budget forecast. The reduction also reflects the expiration of the

2-percent payroll tax holiday and a lower forecast for wage growth. Sales tax revenue is often a leading indicator of economic conditions and has been underperforming relative to the Governor's Budget forecast. The May Revision reflects this early indicator of changing conditions. The decrease in CT revenue reflects reduced CT cash receipts for the 2012-13 fiscal year compared to the prior year. The CT forecast has also been negatively affected by an increase in refunds for prior years. The CT revenue forecast is reduced by $71 million in 2012-13 and by $622 million in 2013-14.

Job Creation and Economic Development Proposal

The May Revision proposes to modernize the state's job creation and economic development incentives. Created over 25 years ago, the Enterprise Zone program should be reshaped to meet the needs of the current economy. In its current form, it fails to encourage the creation of new jobs and instead rewards moving jobs from one place to another within the state. Additionally, the New Jobs Hiring Credit created in 2009 has not been effective at stimulating job growth. The May Revision aims to strengthen both of these programs to bolster California's business environment and reintegrate people into the workforce.

The hiring credit will be refocused to specific areas with high unemployment and poverty rates. This credit will be available for the hiring of long-term unemployed workers, unemployed veterans, and people receiving public assistance. The Enterprise Zone sales tax program will be expanded to a statewide, upfront sales tax exemption for manufacturing or biotech research and development equipment purchases. Finally, the California Competes Recruitment and Retention Fund will be created, to be administered by the Governor's Office of Business and Economic Development (GO-Biz). GO-Biz will negotiate agreements to provide businesses tax credits in exchange for investments and employment expansion in California.

The proposal is revenue neutral and focuses on improving the performance of those dollars already spent. It will allow California to be more effective at stimulating economic growth and creating new jobs. The program will be designed to ensure that small businesses are able to easily obtain the manufacturing sales tax exemption, and will dedicate a portion of the hiring credit and the incentive fund solely to small businesses.

Long-Term Forecast

Figure REV-02 shows the forecast for the largest three General Fund revenues from 2011-12 through 2016-17. Total General Fund revenue from these sources is expected to grow from $80.2 billion in 2011-12 to $112 billion in 2016-17. The average year-over-year growth rate over this period is 7 percent.

Figure REV-02
Long-Term Revenue Forecast - Three Largest Sources
(General Fund Revenue - Dollars in Billions)

	2011-12	2012-13	2013-14	2014-15	2015-16	2016-17	average year over year growth
Personal Income Tax	$54.3	$63.9	$60.8	$67.1	$71.8	$75.0	6.9%
Sales and Use Tax	$18.7	$20.2	$23.0	$24.7	$26.3	$27.0	7.7%
Corporation Tax	$7.2	$7.5	$8.5	$9.1	$9.6	$10.1	6.9%
Total	**$80.2**	**$91.7**	**$92.3**	**$100.9**	**$107.7**	**$112.0**	7.0%
Growth	--	14.3%	0.7%	9.3%	6.7%	4.0%	

Note: Numbers may not add due to rounding

The May Revision economic forecast reflects modest but steady growth over the next five years. The projected average growth rate in GDP over the next five years is 2.7 percent, a slightly slower rate than normal for an economic expansion.

The total revenue generated by these three sources has grown at an average annual rate of 5 percent since 1987. The relatively high average growth rate in revenue expected in the next few years reflects the passage of Proposition 30 and Proposition 39, which affect the near-term growth rates. When fully phased-in, these two provisions increase revenue by $7 billion to $8 billion per year. Also adding to the volatile year-to-year growth is the shifting of income (capital gains realizations, dividend payouts, and wages) from 2013 into 2012 due to the federal tax increases in 2013.

Personal Income Tax

Compared to the Governor's Budget, the PIT forecast is higher by $425 million in 2011-12 and $3.3 billion in 2012-13 and lower by $920 million in 2013-14. Over the entire three-year period, the PIT forecast increased by $2.8 billion. Through April, current-year

PIT receipts are up $4.5 billion from the Governor's Budget forecast. However, the revenue forecast for 2013-14 has been reduced and reflects a modestly lower forecast for wages and salaries in 2013.

April's cash receipts provide a clearer picture of 2012 tax year liability, but add a layer of difficulty in estimating 2013 tax liability. Based on these receipts and the most recent economic data, it now appears that the Governor's Budget forecast underestimated the strength of capital gains income for the 2012 tax year. Because of this, the forecast of capital gains income for 2012 has been increased from $87 billion to $104 billion. This represents a 100-percent increase over the prior year. However, capital gains income is forecast to decrease by 44 percent in 2013, due primarily to the shifting of capital gains realizations from 2013 into 2012 as a result of higher federal tax rates on capital gains income beginning in 2013. The May Revision forecast assumes that 25 percent of 2013 capital gains shifted into 2012, whereas the Governor's Budget assumed a 20-percent shift. In addition, the forecast for capital gains in 2013 and forward reflects capital gains income as a percent of personal income that is in line with historical averages.

This forecast also reflects the passage of Proposition 30 in November 2012. Proposition 30 PIT revenues are estimated at $3.2 billion in 2011-12, $4.7 billion in 2012-13, and $4.8 billion in 2013-14.

Sales and Use Tax

The Sales and Use Tax (SUT) forecast reflects a decrease of $474 million in 2012-13 and $281 million in 2013-14. This includes Proposition 30 revenues totaling $598 million in 2012-13 and $1.3 billion in 2013-14.

For the current year, the decline in the SUT forecast is attributed to lower than estimated cash receipts through March, the expiration of the payroll tax holiday, and the expected slower growth in wages. Overall weakness in the forecast continues through 2013-14.

Corporation Tax

The Corporation Tax (CT) forecast reflects a decrease of $71 million in 2012-13 and $622 million in 2013-14.

The May Revision economic forecast for national corporate profits projects growth of 6.8 percent in 2012, and 1 percent in 2013. The year-over-year increases in California taxable profits are estimated at 0.8 percent in 2012-13, and 1.2 percent in 2013-14. However, the modest growth in estimated taxable profits for California corporations does not translate to increased CT revenues. This is due largely to outflows in the current and budget years from the resolution of disputes between taxpayers and the state. Recent tax changes allowing increased usage of credits, as well as recently enacted legislation allowing the sharing of credits among members of the same unitary group, and allowing the elective use of single sales factor apportionment also contributed to this divergence between corporate profits and tax receipts. Additionally, temporary limitations on the use of tax credits and net operating losses that were enacted in 2008 and 2010 have ended as of the 2010 and 2012 tax years respectively, further reducing taxes from corporations.

This forecast also reflects the passage of Proposition 39 in November 2012. Proposition 39 revenues are estimated at $453 million in 2012-13 and $928 million in 2013-14.

Insurance Tax

The Insurance Tax forecast reflects an increase of $134 million in 2012-13 and $2 million in 2013-14. The revenue changes are due in large part to a delay in refunds paid pursuant to a Board of Equalization decision in the *California Automobile Insurance Company* case.

Estate Tax

The federal Estate Tax, to which the state's pick-up tax is tied, was reinstated in January 2013 for deaths on or after January 1, 2013. The new federal Estate Tax operates in such a way as to effectively eliminate the state pick-up estate tax.

Property Tax

The property tax forecast reflects an increase of $2.7 billion compared to the Governor's Budget. Revenues are projected to increase 1.3 percent in 2012-13 and 2.8 percent in 2013-14. The base 1-percent rate is expected to generate roughly $50.9 billion in revenue in 2013-14, of which roughly half ($27.2 billion) will go to K-14 schools. The $27.2 billion figure does not include additional property tax revenue that schools are expected to receive in 2013-14 from the former redevelopment agencies.

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