State Budget Impacts

The County's Recommended Budget incorporates the impacts of the State Budget adjustments approved in March 2010. It does not take into account any proposals included in the FY2010/11 May Revision, which are substantial. These changes will be incorporated into the Supplemental Budget document to the extent information is available in early June 2010.

May Revision

The State Budget Outlook as reflected in the May Revision has not improved. In fact, the Governor indicates the State budget problem to be $19.1 billion, which includes $7.7 billion for the 2009/10 fiscal year, $10.2 billion for the 2010/11 fiscal year and a modest reserve of $1.2 billion. The Governor has also backed away from his estimate of $7 billion in Federal dollars as part of the budget. His revised proposal only includes drawing down $3.4 billion in Federal funds. Overall, the Governor's Budget solutions include $12.4 billion in spending reductions and about $3.4 billion in various fund shifts, alternative funding, and other revenues, including a $650 million loan of excise taxes on gasoline.

As proposed, the Governor's May Revision would bring overall General Fund spending to a level well below what it was a decade ago, adjusted for population and inflation growth. The Governor's Budget purports to close the budget gap without raising taxes, while maintaining State funding for schools at the current year level, fully funding the Proposition 98 guarantee, and increasing funding for higher education.

Governor's Proposals

The Governor is proposing major spending reductions across State government to address the budget shortfall. These cuts will impact social services programs, Medi-Cal and the public safety system. Some of the Governor's most significant program reductions impacting counties are described below:

Education

- "Re-benching" Proposition 98. To achieve additional budget-year savings without suspending the Proposition 98 minimum guarantee, the May Revision "re-benches" the guarantee to reflect the elimination of child care services. The re-benching essentially reduces the FY2010/11 minimum guarantee by an amount equal to Proposition 98 child care spending in FY2009/10. By re-benching the guarantee, the Governor essentially redefines expenditures counted toward Proposition 98 and the minimum percentage of General Fund revenues that the State must provide for Proposition 98 spending.

Health and Social Services Reductions

The May Revision includes total General Fund expenditures of $22.9 billion for all Health and Human Services Agency budgets, which represents a decrease of ($1.5 billion), or (6.4 %), from the revised 2009 Budget Act. **General Fund costs would have increased by $2.9 billion** above FY2009/10 if it were not for $4.4 billion in total health and human services budget solutions (includes proposals from January 2010 and May Revision), which include the following major reduction proposals since January 2010:

- Eliminating the CalWORKs program ($1.5 billion).
- Restructuring the In-Home Supportive Services program ($637.1 million).
- Establishing limits and cost-sharing for Medi-Cal benefits ($309 million).
- Restructuring county mental health realignment programs to offset expenditures in child welfare services and adult protective services ($602 million).
- Suspension of AB 3632 mandate for the Individuals with Disabilities Education Act (IDEA) Services.

Public Safety Proposals

- $243.8 million projected General Fund savings in FY2010/11 from an Administration proposal to send non-sex offender, non-serious, non-violent offenders convicted with sentences of three years or less to serve their felony sentence in local jails. The State will provide the counties with approximately $11,500 per offender, to be allocated at the local level, for programs and services, such as probation programming, drug courts and alternative custody.

- $4.6 million decrease in FY2010/11 to reflect savings resulting from the transfer of the supervisorial responsibilities for new Division of Juvenile Justice parolees to county probation. The State will allocate $15,000 per parolee per year, based on the average length of stay on parole, to provide county probation departments some resources to supervise the parolees.

- $300 million increase in lease revenue bond authority for local juvenile detention facilities to enhance the capacity of local communities to implement an effective continuum of response to juvenile crime and delinquency.

- Proposes design build legislation to assist AB 900 and SB 81 new jail construction projects.

- $502.9 million annual General Fund commitment, beginning in FY2011/12, as a continuous appropriation to local jurisdictions for public safety programs that are currently funded using a portion of the revenue from vehicle license fees.

- The Administration supports the intent of AB 1697 (Hall) to ensure a more stable and ongoing funding source for court security and to create a specific fund inside the judicial budget for court security. Proposed to increase the court security fee to $45 and remove the sunset date. Department of Finance estimates this $15 increase will generate $45 to $60 million for court security.

Transportation

- Loan $650 million from the Highway Users Tax Account to the General Fund, to be by repaid by June 2013. This was new revenue created by “gas tax swap” as adopted in March and not previously dedicated to any programs.

In March, the Governor signed several measures called the “gas tax swap” which changed the funding mechanisms for transportation within the State of California. None of these proposals were affected by the May Revision. The “gas tax swap” proposal:

- Eliminated the sales tax on gasoline and increases the excise tax on gasoline by 17.3 cents.

- Beginning in FY2011/12, increases the sales tax on diesel fuel by 1.75 percent (5% to 6.75%) and decreases the excise tax on diesel by 4.4 cents in 2011-12 (from 18 to 13.6 cents). The Board of Equalization will adjust this tax annually thereafter to maintain revenue neutrality (and keep pace with what Proposition 42 would have generated in a given year).

- Authorized the deferral of $50 million each month from July 2010 through March 2011. Any deferrals must be paid within two business days of April 28, 2011. Cities and Counties with a population of less than 50,000 are exempt from the HUTA deferral.

- Provided that deferrals from July 2010 to March 2011 are to be made on a pro rata basis, as determined by the Controller, from all allocations to cities, counties, and cities and counties from the Highway Users Tax Account.

- Allows local jurisdictions to borrow against Prop 1B funding but requires any accrued interest to be repaid to be used for purposes consistent with Prop 1B.

Williamson Act

The May Revision did not include any changes to the Governor's January proposal to eliminate state funding for the Williamson Act. There are ongoing negotiations to secure "bridge financing" for the Act while long-term reforms are developed that will make the Act more self-financing.

Legislative Analyst Proposals

The Legislative Analyst in his overview of the 2010/11 May Revision states that "the administration's estimate is reasonable. While our tax revenue estimates are slightly higher than the Governor's: $400 million in FY2009/10 and $1 billion in FY2010/11 – overall, the view of the budget problem is similar."

Revenues

- In the January trigger proposals (withdrawn as part of the May Revision), the Administration suggested delaying the implementation of recent tax changes (such as the optional single sales factor) by one year. The LAO recommends the Legislature consider delaying these provisions for two years in recognition of the FY2010/11 budget challenges, as well as the loss of nearly $10 billion in other temporary taxes in FY2011/12.

- **Fee Increases.** According to the LAO, some fee increases benefit the General Fund and make sense from a policy perspective.

- **Targeted Tax Rate Increases.** Given the fragile state of the economy and the level of these taxes relative to other states, the LAO discourages increasing the state's broad-based big three taxes (personal income, sales and use, and corporation taxes) above their current levels. According to the LAO, since alcohol tax rates have not been updated for inflation since 1991, such an adjustment could produce over $200 million of General Fund benefit. In addition, the LAO suggests permanently aligning the VLF—currently increased temporarily under provisions of the February 2009 budget package—with local property tax rates, as it represents a tax on property.

Most Likely State Budget Scenario This Summer

It is unclear how the Legislature will address the May Revision/Budget process given the continued nature of the problem. All legislative budget committees have begun budget deliberations and are holding hearings on the Governor's proposals. The budget subcommittees have already rejected the Governor's proposals regarding CalWORKs and IHSS.

Very recently, Senate Democrats proposed $4.9 billion in tax increases to help bridge the budget gap. Their proposal includes:

- Suspending corporate tax breaks scheduled to begin January 1, including a suspension of net operating losses for two years and eliminating the ability to carry back losses for two years ($2.05 billion);

- Raising the vehicle license fee from 1.15 percent to 1.5 percent of estimated value starting July 1 ($1.2 billion);

- Extending a 0.25 percent income tax surcharge that is scheduled to end December 31 ($1 billion);

- Extending a $217 per dependent income tax credit, also scheduled to end December 31 ($430 million); and,

- Increasing the state's alcohol tax by adding inflation factor from current level set in 1991 to the present ($210 million).

The Governor has suggested that government should be more efficient. The Senate Republicans have indicated that they would like to see performance-based budgeting introduced into the State's budget system. Additionally, some Republicans have tied passage of the Budget to longer-term reforms such as public pension, a State spending cap, streamlining energy functions, eliminating and/or merging a number of boards and committees, consolidating commissions, and transferring functions. Republicans have also indicated the budget needs to be balanced without another tax hike and without gimmicks as in the last few budgets. It is therefore likely that the budget will be comprised largely of program reductions.

Conventional wisdom suggests that an on-time budget is highly unlikely, given the difficult decisions regarding program reductions and the reluctance of Republicans to provide the requisite votes for a budget that contains any type of tax increase. Rumors persist that the budget may not be passed until the very end of the legislative session in August or that the Legislature may have to remain in session in September to get the job done.

As former Director of Finance Mike Genest recently said, "The unavoidable reality of the cash flow situation is going to dictate how much pressure the Legislature is going to feel to solve the budget."

The State's Cash Position

Year-to-date revenues are now behind estimates by approximately $1.3 billion. Personal income taxes accounted for most of the drop in April, coming in $3.1 billion below projections for the month and $2.2 billion short for the year-to-date. State expenditures, however, were running $102 million behind estimates through April 30.

The State started the fiscal year with an $11.9 billion cash deficit in the General Fund, which grew to $20.2 billion by April 30. Those deficits are being covered with a combination of $11.4 billion of internal borrowing from special funds and $8.8 billion in short-term Tax Revenue Anticipation Notes.

The State Controller believes that the State currently has enough cash to pay all of the debts through the end of the fiscal year. However, without changes it is expected that the State of California will have trouble paying bills as early as July and this issue will persist throughout the summer and – absent significant additional budgetary measures – possibly well into FY2010/11.

Future Budget Years

Various factors will affect future budget years at the State level: Federal assistance, pension reform, the continuation of certain taxes currently due to expire, new taxes, the overall performance of the economy, realignment of services to other levels of government, and litigation, most especially new suits brought by the education community wherein they contend that the schools are owed as much as $11 billion for past years under Proposition 98.

Lastly, significant revamping of the political system in California may also greatly affect future budget years for counties. Proposition 11, the redistricting initiative, has already passed, and presumably – barring successful legal challenge – legislative districts will be redrawn by a Citizens Commission rather than the Legislature for the 2012 elections. Proposition 14, the latest "open primary" initiative, will be on the June ballot this year. If the open primary initiative passes, it could, especially in concert with the already passed redistricting initiative, have wide ranging effects on the California political landscape, affecting state and county budgets for years to come.