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GOVERNOR'S MAY REVISION MAINTAINS CALWORKS CUTS, WOULD PRIVATIZE THE LOTTERY AND EDFUND

Governor Arnold Schwarzenegger released his May Revision to the 2007-08 Budget on May 14. The May Revision updates policy proposals, revenue projections, and estimated expenditures for both the current and upcoming budget years. Relative to the Governor's January Proposed Budget, the May Revision:

- Assumes that combined 2005-06, 2006-07, and 2007-08 revenues from the state's major General Fund taxes will be \$219 million below the Governor's January budget estimates. Current year revenues would be \$563 million higher than previous estimates, while 2007-08 revenues would be \$806 million lower.
- Maintains the reductions to the CalWORKs Program proposed by the Governor in January and would suspend the state's share of the January 2008 cost of living adjustment (COLA) for SSI/SSP grants, a \$184.7 million reduction.
- Would privatize the California State Lottery through a long-term lease and would sell EdFund, a state controlled entity that guarantees student loans made by private lenders, to a private bidder. The May Revision assumes a \$980 million increase in 2007-08 revenues from the proceeds of the sale of EdFund. The proceeds would be used to support general state operations. The May Revision states that "one potential use" of the proceeds of leasing the lottery would be to pay off outstanding Economic Recovery Bonds (ERBs).
- Uses an additional \$200 million in Public Transportation Account (PTA) funds to pay for home-to-school transportation in 2006-07 and maintains the \$627 million shift proposed for 2007-08 in the Governor's January budget.
- Would eliminate \$39.1 million in state payments to local governments for revenues lost because of Williamson Act contracts. The Williamson Act lowers the property taxes paid by agricultural landowners that agree to not develop their land.
- Would shift \$600 million in 2006-07 and \$657 million in 2007-08 to the General Fund from the proceeds of the sale of bonds backed by payments the state receives from tobacco companies as a result of the settlement between states and the tobacco industry. A total of \$900 million was originally scheduled to be transferred in three installments (2007-08, 2008-09, and 2009-10). However, the state was able to refinance the bonds on better terms than was previously anticipated and received a total of \$1.257 billion. The transfer of funds was initially timed to match payments for low-performing schools mandated by the Quality Education Investment Act. Accelerating the transfer would increase the state's 2008-09 and 2009-10 operating deficits.

The May Revision reflects a \$2.3 billion erosion in the state's fiscal condition. The Legislative Analyst's Office (LAO) notes that:

- State expenditures for K-14 education programs covered by the Proposition 98 guarantee would rise by a total of \$809 million in 2006-07 and 2007-08. The changes stem from increases in the Proposition 98 guarantee level in both years, lower than previously anticipated local property tax collections, and other changes.
- The May Revision assumes a delay in issuance of a pension obligation bond beyond the end of 2007-08. This would result in a \$525 million in increased costs and/or reduced 2007-08 revenues.
- Lower than previously forecast revenues from taxes, tideland oil revenues, and tribal gaming would reduce available resources by a total of \$521 million.
- Higher than previously anticipated costs, primarily in the area of corrections, would increase demands on the budget by \$438 million.

The LAO argues that the May Revision overstates the estimated 2007-08 budget reserve by \$1.7 billion due to the vulnerability of a number of key budget assumptions. The LAO also estimates that the state will face a shortfall of more than \$5 billion in 2008-09 due to the expiration of a number of one-time solutions proposed for the 2007-08 budget. The May Revision continues the Governor's proposal to make \$1.6 billion in supplemental payments toward repayment of the outstanding ERBs. The LAO states that, in light of their assessment of the state's fiscal condition in 2007-08 and beyond, "we believe these funds could be better used in addressing near-term budget problems."

The May Revision Reflects Slower Than Previously Anticipated Economic Growth

The May Revision's revenue forecast reflects slower than anticipated economic growth in 2007-08. The May Revision assumes that major tax revenues would increase 4.7 percent between 2006-07 and 2007-08. In contrast, the January budget assumed 6.2 percent growth over the same period. The continued weakness in the housing sector is the major factor underlying the weaker than anticipated forecast.

The May Revision forecast for 2006-07 and 2007-08 reflects higher than previously forecast corporate tax collections in both years; higher than previously assumed personal income and sales tax proceeds in 2006-07 and lower than anticipated collections in 2007-08; and lower than anticipated insurance tax collections in both years.

The May Revision assumes that tribal gaming compacts pending ratification by the Legislature will generate \$313.5 million in state revenues, a decrease of \$192.4 million from the amount assumed in the Governor's January budget. The Director of Finance noted in the Governor's May Revision press conference that this estimate assumes that the compacts will be ratified on May 15 and that any delay in ratification would further reduce the amount the state receives.

Privatizing Public Assets

The May Revision:

- Assumes the state will receive \$980 million from the sale of EdFund. EdFund was created in 1997 as a nonprofit student loan guarantee organization. EdFund guarantees student loans made by private lenders both inside and outside California. Recent news reports have raised a number of concerns regarding the role of private entities in student loan activities around the country.
- Proposes to lease the California Lottery to a private corporation with the goal of increasing lottery sales. The May Revision states that education would receive, at a minimum, "the same dollar level of funding that it received in the highest year of lottery funding." While the May Revision does not indicate how much the state

would receive for leasing the lottery, it does suggest that proceeds should go toward paying off \$8 billion in outstanding ERBs.

K-12 Education

The May Revision:

- Reflects an increase in 2007-08 spending covered by the Proposition 98 guarantee relative to the Governor's January budget, from \$56.8 billion to \$57.6 billion. This results in a \$112 increase in 2007-08 Proposition 98 K-12 per pupil spending, from \$8,569 to \$8,681. The May Revision also reflects an increase in 2006-07 Proposition 98 spending, from \$55.0 billion to \$55.4 billion.
- Revises the Governor's January proposal to shift \$627 million in home-to-school transportation costs from the General Fund to the PTA and adjust the Proposition 98 guarantee downward by an equal amount. The new proposal would use PTA dollars to reimburse the General Fund for a total of \$630 million in home-to-school transportation costs for 2007-08. The May Revision also proposes to reimburse the General Fund for an additional \$200 million in home-to-school transportation costs from the PTA for 2006-07. The revised proposal would not affect the Proposition 98 school funding guarantee, but it would still result in a loss of operating funds for public transit.
- Reflects a reduction of \$285.6 million in revenue limit funding for 2007-08 due to a projected enrollment drop of 0.48 percent. The Governor's January budget assumed an enrollment decline of only 0.39 percent. The May Revision also increases 2006-07 revenue limit funding by \$41.2 million due to an increase in estimated enrollment relative to the Governor's January budget. Revenue limits provide general purpose funds for schools.
- Includes a \$226.8 million increase to fund a 4.53 percent COLA for 2007-08. The Governor's January budget assumed that the COLA would be 4.04 percent. The additional funds would provide \$160.8 million for revenue limits, \$31.7 million for various categorical programs, and \$17.8 million for special education.
- Provides a total increase of \$35.9 million for special education, which reflects changes in enrollment and local property tax collections.
- Fails to account for the 2007-08 cost of revenue limit equalization, which is intended to reduce funding disparities between school districts. This results in an understatement of education costs by \$366 million for 2007-08, according to the LAO.
- Includes an additional \$96 million in one-time funds for emergency repairs, according to the LAO.
- Allocates \$50 million for the second phase of the PreKindergarten Family Literacy program, a three-year preschool initiative. The program targets four-year-olds living in the attendance areas of schools with Academic Performance Index scores in the lowest three deciles.
- Provides \$50 million to support hiring additional Career Technical Education (CTE) teachers and \$50 million to support hiring additional teachers of college preparatory courses.
- Allocates \$25 million to support hiring additional high school counselors specializing in CTE.
- Includes \$24.9 million for the School Nutrition Program – which helps schools serve nutritious meals to students – to support a 4.7 cent increase in the per meal reimbursement rate.
- Allocates \$11.1 million to the California Fresh Start Program, which provides funds for schools to provide fruits and vegetables to students.
- Includes \$341.7 million in one-time funding for a variety of purposes, including \$100 million for the purchase of CTE equipment to be split equally between K-12 schools and community colleges; \$100 million for a three-year school safety pilot program; \$65 million to help school districts implement the California Achievement Longitudinal Pupil Data System; \$48.1 million to fund Supplemental Instruction Program costs for afterschool and summer school programs; \$20 million for the purchase of instructional materials for English learners; and \$8.6 million for school breakfast and nutrition programs.

Higher Education

The May Revision:

- Allocates \$2 million for the University of California (UC) in 2007-08 to provide additional support for tobacco-related research.
- Increases funding for the California State University by \$3.6 million in 2007-08 to support an additional 340 full-time equivalent undergraduate nursing students.
- States the Administration's intent to seek legislation that would reinstate the employer's contribution to the UC employees' retirement plan. According to the May Revision, this contribution is needed to avert a shortfall in the fund.

Community Colleges

The May Revision:

- Increases 2006-07 Proposition 98 funding by \$100 million, including \$50 million for career technical education equipment and related facilities and \$50 million for nursing programs' equipment and other one-time uses.
- Would make a number of adjustments that, in total, would increase 2007-08 funding for the California Community Colleges by \$9 million compared to the Governor's January budget. The adjustments include an \$80 million reduction in apportionment funding to reflect lower than projected enrollment growth in the current and prior years; an increase of \$23.6 million for apportionments and \$1.6 million for selected categorical programs to reflect an increase in the COLA from 4.04 percent to 4.53 percent; and an additional \$10 million for assessment, advising, and counseling services.
- Would allocate \$52.7 million for deferred maintenance, instructional equipment, hazardous substance abatement, one-time technology costs, and textbook assistance.

California Student Aid Commission

The May Revision:

- Projects savings of \$23 million in the Cal Grant Program awards in 2006-07, reflecting a lower than anticipated number of entitlement awards and a shift of students to lower cost postsecondary institutions.
- Projects savings of \$1.3 million in 2006-07 payments for the Assumption Program of Loans for Education (APLE).
- Would reduce funding for the California Student Aid Commission by \$20 million compared to the Governor's January budget, including savings of \$42.8 million based on a lower estimate of the number of Cal Grant awards in 2007-08, an increase of \$2.5 million to fund revised estimates of payments for the APLE program, and an increase of \$20.3 million to shift costs of the Commission's state operations and costs of the financial aid awareness program (CalSOAP) to the state's General Fund in anticipation of the sale of EdFund to a private bidder.

California Work Opportunity and Responsibility to Kids (CalWORKs) Program

The May Revision maintains the Governor's January budget proposals to:

- Eliminate cash assistance for nearly 200,000 children in the CalWORKs Program for savings of approximately \$315 million in 2007-08.
- Freeze CalWORKs grants for a third consecutive year for savings of \$123.6 million in 2007-08.

- Withhold the October 2003 CalWORKs COLA for savings of approximately \$550 million in 2007-08. In 2004, a superior court judge ruled that the COLA denial violated state law and that the Administration must provide the COLA retroactively to October 1, 2003. An appellate court overturned this decision in February 2007, and the plaintiffs have appealed to the state Supreme Court. The Administration assumes it will win the case, thereby avoiding additional grant payments to CalWORKs families.
- Increase, by \$268.9 million, the amount of CalWORKs Stage 2 child care costs counted toward the Proposition 98 guarantee.
- Use \$56.4 million in federal Temporary Assistance for Needy Families (TANF) block grant funds to replace an equivalent amount of state support for the Child Welfare Services (CWS) Program, for state savings of the same amount in 2007-08.

Supplemental Security Income/State Supplementary Payment (SSI/SSP) Program

The May Revision suspends the state's January 2008 COLA for SSI/SSP grants for savings of \$184.7 million in 2007-08 and approximately \$370 million annually in future years. The Governor proposes to "pass through" the federal January 2008 COLA, which would increase grants for individuals from \$856 to \$863 and for couples from \$1,502 to \$1,514. SSI/SSP grants help 1.2 million low-income seniors and people with disabilities meet basic living expenses.

In-Home Supportive Services (IHSS)

The May Revision:

- Maintains the Governor's proposal to freeze the state's share of IHSS workers' wages and benefits. Counties would not receive additional state funding for wage and/or benefit increases provided after the date the proposal is enacted, except for wage increases due to a rise in the state's minimum wage. Currently, the state contributes toward IHSS workers' wages and benefits that do not exceed \$11.10 per hour. In January, the Administration estimated that freezing the state's share of IHSS wages and benefits would reduce state spending by \$14.1 million in 2007-08 and "lead to significant future cost savings."
- Increases state funding by \$33.2 million in 2006-07 and \$48.5 million in 2007-08 to reflect lower savings from the IHSS Quality Assurance Program, which aims to standardize services provided to IHSS recipients with the goal of controlling costs.
- Increases state funding by \$8.2 million in 2006-07 and \$35.7 million in 2007-08 to fund IHSS provider wage and/or benefit increases approved in 19 counties since January.

Other Human Services

The May Revision:

- Proposes to freeze the income eligibility limit for child care assistance at the 2006-07 level and to re-evaluate this limit based on the most recent state median income (SMI) data in 2009-10 and every three years thereafter. The Governor's January Budget proposed to freeze the income eligibility limit at the 2006-07 level in 2007-08 only. Current state law requires California to adjust the income eligibility limit annually to reflect changes in the SMI.
- Proposes to link annual funding increases for counties to cover basic operating costs for human services programs to salary and benefit increases provided to state employees, as well as to performance measures in several programs. In contrast, current state law requires the Department of Social Services to estimate operating costs using county-specific factors, starting with the 2007-08 May Revision. Neither the Governor's

January budget nor the May Revision includes funding increases for county operating costs for human services programs in 2006-07 or 2007-08.

- Provides an additional \$4.45 million in state funds for emergency food organizations – including local food banks – to assist individuals affected by last winter’s freeze. The state already has allocated \$4.7 million for this purpose.

Medi-Cal

The May Revision:

- Includes \$37.7 billion (\$14.7 billion General Fund) for the Medi-Cal Program, an increase of \$330.3 million (\$39.4 million General Fund) from the Governor’s January budget. The Administration projects 6.6 million Medi-Cal enrollees in 2007-08.
- Increases payments to managed care plans that enroll Medi-Cal recipients at a cost to the state of \$107.1 million. The May Revision states that the new rates are based on an independent consultant’s recommendations to improve the state’s process for setting payment rates for these plans.
- Provides \$25.2 million in additional state funds to implement the federal Deficit Reduction Act (DRA) requirement that states verify the identity and citizenship status of Medi-Cal recipients who are citizens.
- Provides an increase of \$20 million in state funds for pregnancy services for minors. The increase reflects a decision to forgo federal funding because California will not enforce the DRA citizenship and identity requirements for minors seeking these services.

Other Health Related Programs

The May Revision:

- Makes no changes to the Governor’s January proposal to extend health coverage to the uninsured. However, like the Governor’s January budget, the May Revision does not reflect funding for, or the cost of, his proposal.
- Includes \$7.5 million (\$7.4 million in state funds) for the Department of Mental Health and \$1.6 million (\$914,000 in state funds) for the Department of Developmental Services to increase salaries for health care staff. These increases are intended to bring the state into compliance with the Coleman and Perez court cases related to inmate health care.
- Allocates \$1 million for the state to contract with a “headhunter” agency to help hire health care staff. The Administration cites new positions and higher pay within the corrections system as reasons why it has had difficulty hiring sufficient staff at non-corrections facilities. According to the Administration, “the state’s usual recruiting and hiring practices have proven ineffective in locating and hiring health care staff” at various state institutions.
- Continues the Governor’s January proposal to reduce funding by \$60 million for Proposition 36, which funds substance abuse treatment for nonviolent offenders. The May Revision also retains the Governor’s January proposal to increase funding for the Substance Abuse Offender Treatment Program (OTP) by \$35 million. The OTP provides services for the same population as Proposition 36.

Transportation

The May Revision:

- States that due to savings identified by the Department of Transportation, more than \$331 million in funding for 2006-07 projects under the State Transportation Improvement Program (STIP) and State Highway Operations and Protection Program has been accelerated, making more funds available for other projects in 2007-08. Proposition 1B, approved by voters in November 2006, authorized nearly \$20 billion in general obligation bonds for transportation and air quality improvement projects.
- Proposes to increase the amount of Proposition 1B bond funds that would be allocated in the budget year by \$1.3 billion over the Governor's January budget, for a total of \$4.1 billion in 2007-08. The increase would primarily go to the Corridor Mobility Program (\$293 million) and the STIP (\$399 million). The May Revision also proposes new allocations for air quality improvement (\$111 million), port and harbor security (\$178 million), and intercity rail (\$190 million). All Proposition 1B allocations require legislative approval.
- Notes that the balance of the Motor Vehicle Account (MVA) is declining and states that a working group of state agencies will be convened to provide recommendations for consideration in next year's budget. The MVA is funded primarily from vehicle registration and driver's license fees and supports the California Highway Patrol, the Department of Motor Vehicles, and the Air Resources Board. The Legislative Analyst's Office has pointed out that due to employee compensation increases, major multi-year projects being launched, and various information technology and facility improvements, the MVA could face significant shortfalls beginning in 2009-10.

State Employees and State Operations

The May Revision:

- Includes an increase of \$18.9 million above the amount provided in the Governor's January budget for employee compensation for the California Highway Patrol and Unit 9 Engineers, based on revised estimates from annual salary surveys.
- Does not include additional funds for salary increases for correctional peace officers, the only employees represented by a bargaining unit with an expired collective bargaining agreement. According to the LAO, the Administration's most recent contract offer to the correctional peace officers would result in \$330 million in increased General Fund costs. The LAO pointed out earlier this year that even if a new contract is not ratified, the correctional peace officers may receive a raise on July 1 as scheduled in the prior agreement, which remains in effect until a new agreement is ratified.
- Anticipates that the CalPERS board will increase state employee and retired annuitant co-payments for office visits, emergency room visits, and prescription drugs in order to limit state health premium increases to no more than 10 percent at its May 16 meeting. The Governor's January budget assumed a 12 percent premium increase; a 10 percent increase would create General Fund savings of \$14.3 million.
- Proposes an increase of \$654,000 to support the Public Employee Post-Employment Benefits Commission, created in December 2006 by executive order. The commission is charged with identifying the cost of retiree health care and proposing a plan to address these costs by January 1, 2008. The State Controller recently reported that the state faces \$47.9 billion in future retiree health costs under the current practice of funding these costs as they become due each year.

Legislative, Judiciary, and Executive

The May Revision:

- Allocates \$36.6 million in state funds for trial court security based on the recommendations of a working group composed of sheriffs and court officials. The increase would provide funding for courtroom guards, to monitor screening stations, and to transport prisoners within courts.
- Allocates \$177.6 million in Proposition 1B funds to two homeland security grant programs for the purchase of security equipment in order to prevent and respond to acts of terrorism at ports and in mass transit systems.
- Allocates \$11.7 million to the Secretary of State for costs related to the February 2008 primary. County costs related to the election would be paid on a reimbursement basis and the May Revision states that these costs will be addressed in the 2008-09 Budget.

Environmental Protection

The May Revision proposes to spend \$111 million in Proposition 1B funds for air quality improvement projects along the state's main highway and trade corridors. Funding would be used to upgrade high pollution-emitting trucks that serve ports and rail yards; decrease and avoid the use of onboard diesel generators by electrifying piers; replace older locomotives with ultra-low emission models; and replace diesel engines on harbor craft with cleaner models.

May Revision Reflects Recent Prison Legislation

On May 3, the Governor signed into law AB 900 (Solorio, Chapter 7 of 2007), which authorized the state to issue \$7.4 billion in lease-revenue bonds to provide funding for 53,000 additional prison and jail beds. This measure also allocated \$350 million to increase support for rehabilitation programs and infrastructure improvements. The May Revision includes \$26.8 million to implement AB 900, including \$2.6 million to address immediate staffing needs and administer jail bed construction grants, as well as \$9.6 million in 2007-08 and \$14.6 million in 2008-09 to transfer 5,060 inmates to prisons in other states to ease prison overcrowding.

Adult Corrections

The May Revision increases total funding for the California Department of Corrections and Rehabilitation (CDCR) by \$4.6 million in 2006-07 and \$113 million in 2007-08 over the Governor's January budget. The Governor's proposal assumes savings of \$46.0 million in 2007-08 due to projected decreases in the inmate population and savings of \$31.2 million in 2007-08 and \$58.3 million in 2008-09 resulting from the discharge of parolees after 12 months of clean time. In addition, the May Revision:

- Allocates \$11.7 million in 2007-08 and \$27.8 million in 2008-09 to provide educational and vocational services to an additional 6,372 inmates.
- Deletes \$457,000 in funding for the California Sentencing Commission. The Governor proposed the creation of the commission in January to make recommendations on sentencing guidelines.
- Includes additional funds to pay for costs associated with various court cases, including \$25 million to coordinate activities mandated by the Plata, Perez, and Coleman lawsuits; \$2.7 million for dental care improvements ordered by Perez v. Hickman; \$4.6 million to modify certain high-risk cells to prevent suicides; \$1.6 million to hire staff to monitor parole revocation processes; \$1.3 million in contract funding for the Board of Parole Hearings to transcribe lifer hearings and publish the transcriptions online; and \$2.8 million in 2006-07 and \$7.4 million in

2007-08 in response to a federal injunction requiring compliance with the Americans with Disabilities Act within correctional facilities.

- Includes \$16.9 million to reimburse local governments for costs incurred in the prosecution of inmate crimes and other costs related to state inmates.
- Allocates \$18.7 million in 2007-08 for the CDCR's peace officer recruitment efforts.

Juvenile Corrections

The May Revision:

- Allocates \$7.1 million for anti-gang efforts, including \$3 million in 2007-08 to implement the Criminal Intelligence Analysis Unit, a statewide gang intelligence-gathering and analysis organization; \$3.3 million to create three pilot task forces to disrupt gang activity in Los Angeles, the Bay Area, and the Inland Empire; and \$820,000 for Project IMPACT, a program that aims to rehabilitate incarcerated and newly-released young gang members.
- Includes an additional \$1.2 million in 2006-07 to address cadet training costs at the R. A. McGee Correctional Training Center and to meet juvenile center staffing ratios ordered in the Farrell v. Allen lawsuit.
- Reduces funding from \$50 million to \$25 million for the California Adult Probation Accountability and Rehabilitation Act (CAPARA) to increase the effectiveness of adult probation services. The CAPARA aims to reduce crime by improving rehabilitative services and supervision of adult probationers age 18 to 25.