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January 10, 2005

To: Chairs of the Board
CSAC Board of Directors
County Administrative Officers

From: Supervisor Greg Cox, CSAC President
Jim Keene, CSAC Executive Director
Steve Keil, CSAC Legislative Coordinator
Jean Kinney Hurst, CSAC Legislative Representative

Re: Highlights of the 2005-06 State Budget

This afternoon, Governor Arnold Schwarzenegger released his 2005-06 Proposed Budget with a major focus on reforming the state's budget process. These major reforms, summarized below, will be submitted to the Legislature for consideration in a special session.

To review the Governor's plan, please visit the Department of Finance website: <http://govbud.dof.ca.gov/>. Please note that printed, bound copies of the Budget Summary and Governor's Budget are no longer available.

Budget Aggregates

The Governor's 2005-06 proposed budget provides a General Fund spending plan of \$85.738 billion, representing an increase of \$3.443 billion, or a 4.2 percent increase over the prior fiscal year. Nearly 93 percent of the proposed budget is confined to only three program areas: K-12 and higher education (53.6 percent); health and human services (31.1 percent); and youth and adult corrections (8.2 percent). State General Fund expenditures have grown by a total of \$27.9 billion, or a cumulative 48.3 percent since 1998-99.

The proposed budget anticipates \$85.454 billion in General Fund revenues, representing an increase of \$3.746 billion, or a 4.6 percent increase over last year. Three primary revenue sources constitute more than 92 percent of General Fund revenues: personal income tax (50.2 percent); sales tax (31.5 percent); and bank and corporation tax (10.6 percent). State General Fund revenues have grown by a total of \$26.9 billion, or a cumulative 45.9 percent since fiscal year 1998-99. Please note that these figures do not include revenues from the Economic Recovery Bonds.

When taking the Economic Recovery Bonds into consideration, the General Fund revenue level is \$1.141 billion above the General Fund expenditure amount (including a prior year balance of \$1.425 billion). The reserve amount is \$1.141 to guard against unforeseen expenditure increases and revenue shortfalls, representing 1.31 percent of estimated 2005-06 revenues.

ATTACHMENT VII

Recent General Fund Revenues and Expenditures (\$ in billions)

	1998-99	1999-00	2000-01	2001-02	2002-03	2003-04	2004-05*	2005-06*
Revenues	58.6	65.2	76.9	77.1	79.3	77.6	81.7	85.5
Expenditures	57.8	65.8	79.7	78.4	78.8	78.0	82.3	85.7

Figures do not include one-time carry-over balances in the revenue data or reserves in the expenditure data.

**These figures do not include revenues from the Economic Recovery Bonds.*

2005-06 General Fund Expenditure Estimates by Category (\$ in millions)

Expenditure Category	\$	%
K-12 & Higher Education	\$45,926	53.6
Health & Human Services	26,708	31.1
Youth & Adult Corrections	7,014	8.2
Other	6,090	7.1
TOTAL	\$85,738	100.0

2005-06 General Fund Revenues Estimates by Category (\$ in millions)

Revenue Category	\$	%
Personal Income Tax	\$42,895	50.2
Sales Tax	26,947	31.5
Bank and Corporation Tax	9,015	10.6
Other	6,597	7.7
TOTAL	\$85,454	100.0

2005-06 General Fund Budget Summary (\$ in millions)

Carry-Over Fund Balance	\$1,425
Revenues and Transfers	83,771
Economic Recovery Bonds	1,683
TOTAL REVENUES	\$86,879
TOTAL EXPENDITURES	\$85,738
Fund Balance	\$1,141
Liquidation of Encumbrances	\$641
Special Fund for Economic Uncertainties	\$500

The 2005-06 budget proposes to eliminate an \$8.1 billion structural deficit in the following ways:

ATTACHMENT VII

Closing the Gap
(\$ in millions)

	2005-06
Workload Budget Resources	\$84,198
Workload Budget Expenditures	92,620
Funding Gap at Workload Budget	-\$8,422
Adjustments Due to Policy Decisions	-170
Funding Gap with Policy Decisions	-\$8,592
Total Policy Decisions to Close the Budget Gap:	
Proposition 98	\$2,284
Non-Proposition 98:	
Business, Transportation and Housing	1,311
Health and Human Services	1,167
General Government	928
Education	543
Resources	475
Youth and Adult Correctional	272
Others	20
New Economic Recovery Bonds	1,683
Revenue Issues	409
Total	\$9,092
General Fund Reserve	\$500

General Fund Revenues and Expenditures
2004-05 Revised vs. 2005-06 Proposed
(\$ in millions)

	Revised 2004-05	2005-06	Dollar Change	Percent Change
REVENUES				
Revenues	\$77,903.9	\$83,227.5	\$5,323.6	6.8
Transfers	315.2	544.0	228.8	72.6
Totals, Revenues and Transfers	78,219.1	83,771.5	5,552.4	7.1
New Economic Recovery Bonds	2,012.0	1,682.8	-329.2	-16.4
EXPENDITURES				
NON-PROPOSITION 98:				
Governor's Office	\$18.4	\$18.3	-\$0.1	-0.5
Remaining Executive	793.2	759.8	-33.4	-4.2
Legislative	297.7	309.9	12.2	4.1
Judicial	1,763.7	1,928.2	164.5	9.3
State and Consumer Services	534.9	563.4	28.5	5.3
Business, Transportation and Housing	376.6	380.3	3.7	1.0
Resources/Environmental Protection	1,140.8	1,338.7	197.9	17.3
Health and Human Services	25,518.6	26,689.2	1,170.6	4.6
Youth and Adult Correctional	6,896.9	6,979.7	82.8	1.2
Non-Proposition 98 Education	7,911.8	8,589.3	677.5	8.6
STRS Contribution	1,148.8	581.4	-567.4	-49.4
Labor and Workforce Development	87.2	87.2	0.0	0.0
General Government	1682.5	980.1	-702.4	-41.7
Total – Non-Proposition 98	\$48,171.1	\$49,205.5	\$1,034.4	2.1
PROPOSITION 98:	\$34,123.8	\$36,532.3	\$2,408.5	7.1
TOTAL – ALL EXPENDITURES	\$82,294.9	\$85,737.8	\$3,442.9	4.2

Budget Reform Proposals

The Governor's Budget Summary includes a detailed explanation of his reform proposals. We've summarized these proposals below.

Budget Control Proposal. The Governor's plan to change the budget process builds upon Proposition 58 (March 2004), with an overarching principle of increasing the state's ability to enact and implement balanced budgets.

- Proposition 58 indicates that whenever the Director of Finance advises the Governor that state spending is at a level that is likely to exceed available revenue, the Governor may call a special session of the Legislature to address the imbalance. The Governor's reform proposal will require the Governor to call a special session.
- The Legislature regularly fails to submit a budget by June 15. The proposed reform will provide that whenever the state does not have a budget in effect at the beginning of the fiscal year (July 1), the appropriation levels in the previous year's budget will remain in effect until such time as the Legislature and the Governor enact a new budget.
- Under Proposition 58, when the Governor calls a special session to address a budgetary imbalance, the Legislature has 45 days to act. If it fails to do so, it is prohibited from passing any other laws until it has acted to address the budgetary imbalance. The Governor's reform proposal will require the State Controller to implement an across-the-board reduction in all state payments (except for debt services and other instances where doing so would violate the federal constitution). These reductions would be implemented only if the Legislature and the Governor have failed to agree on a plan to address the budget imbalance within the 45-day deadline.

Furthermore, when a new budget year begins without a budget having been enacted, the analysis to see whether resources cover expenditures will be made immediately, and the across-the-board cuts, if necessary, will be implemented within 30 days, not 45 days of the day the Budget was due.

- *Proposition 98 Reform:* The Governor's reform proposal would eliminate the ability to suspend Proposition 98. It will also provide any settle-up funds to be provided through a continuous appropriation, to ensure that the state will not be able to under-fund the schools. Thus, the Governor proposes to change Proposition 98 to eliminate the use of the maintenance factor. The guarantee will be set at the 2004-05 appropriated level, with increases guaranteed each year as specified in Proposition 98.
- *Proposition 42 Reform:* Proposition 42 has been suspended once and partially suspended a second time. The Governor's approach would mirror the agreement with local governments and would allow the state to suspend Proposition 42 for two more years, but removed from the Constitution the ability to suspend after that. All Proposition 42 transfers that are suspended will be treated as loans to the General Fund.
- *Special Funds Reform:* The Governor's proposal would prohibit borrowing from special funds.
- *Debt Consolidation:* Selected amounts owed by the state to the following accounts will be proposed for repayment over a period of up to 15 years. These include Proposition 42 loans, maintenance factor and accumulated settle-up under Proposition 98, deferred mandates for local governments, and deferred mandated for schools (under Proposition 98).

Pension Reform. The Governor is proposing a constitutional amendment that prohibits the state or any local government from offering defined benefit retirement plans to employees hired after July 1, 2007.

Defined benefit (DB) retirement plans are those plans typically provided employees by counties including PERS local agency plans, 1937 Act County Retirement system plans, and pension system plans. DB plans provide the employee certainty of benefits based upon a formula consisting of: highest final compensation, times years of service, times a fraction relating to age at time of retirement; typically DB plans also fix the employee costs and leave the employer at risk for annual increases or decreases in cost due to actuarial changes. In recent years, due to losses in investments, changes in employee demographics, and increased benefits, many DB plans have dramatically increased in cost.

The Governor's proposed constitutional amendment would, instead, limit newly hired state and local government employees to Defined Contribution (DC) plans in which both the employer and employee could make contributions, probably in a IRS Code 401 A qualified plan; unlike DB plans, DC plans provide the employer certainty regarding annual costs, but provide no certainty to the employee regarding the value of contributions at time of retirement due to unknown future changes in interest earnings. One related constitutional amendment proposal has been introduced in ACA 5 by Assembly Member Keith Richman that would, in addition to proposals by the Governor, place limits on annual contributions made by public employers to the DC plan.

Statutory State Employee Pension Reform. The Governor is proposing \$296 million in annual savings from two additional pension reforms impacting state employees. All state employees, as their contracts expire, would be required to fund one-half of the cost (both normal cost and unfunded liability) of retirement rather than the approximately one-fourth paid by the employee under current actuarial costs (typically, state miscellaneous employees pay 5% and safety employees 8% of salary, after the first approximate \$500 of monthly wages, and the employer pays the remainder of actuarial funding obligations) saving \$206 million. State employees would also be allowed to opt out of the PERS system; the state would augment the salaries of employees who opt-out from PERS by one-half the actuarial normal cost, netting a savings of \$90 million.

Public School Teacher Retirement Programs. Teachers participate in the State Teachers Retirement System (STRS). Currently, the school districts pay an amount equal to 8.25% of current payroll, and teachers pay an amount equal to 6% of pay. Since 2001, teachers have contributed an additional 2% of pay to a new annuity program; however, prior to this annuity program benefit, teachers paid 8% of pay to STRS (consequently, the annuity program was provided at no net cost to the teachers). In the early 1970's, the state began payments to STRS to improve the systems' actuarial status with the intent of full funding within thirty years. Over the years, the state payment has become permanent and increased to 4.3% of teacher payroll. The state ended its payments to STRS in 2000, but resumed its payments in 2001 when the teacher annuity plan was initiated, and current annual state payments are \$469 million. The Governor's budget proposes elimination of this state payment to STRS and transfer of the liability to the school districts with an additional 2% of payroll payment and teachers for the remainder of the cost (costs could be further shifted between districts and teachers by collective bargaining agreements). Teachers would also be permitted to drop out of the supplemental annuity program to receive the equivalent of a 2% increase in take-home pay.

Other State Employee Compensation Savings. Savings of \$112 million are proposed resulting from several reforms included in new state employee contracts including: five-day furlough for state employees, elimination of two holidays, a change in how overtime is calculated, and cost-savings in employee health plans. It should be noted that changes to state employee holiday schedules may impact trial-court court employee holiday schedules and holiday schedules for county employees that are tied to state holiday schedules by local ordinance or contract provisions.

Administration of Justice

Citizens' Option for Public Safety (COPS) and Juvenile Justice Funding. The Governor's 2005-06 budget contains \$100 million to maintain the current-year level of support for the COPS program, which supports local law enforcement front-line services. However, the budget proposes to reduce support for intervention and prevention programs funded through the Juvenile Justice Crime Prevention Act by \$75 million. The budget indicates that the Board of Corrections will be responsible for distributing the remaining \$25 million (less \$250,000 in administrative costs) for juvenile justice programs to counties. Budget documents indicate that the ultimate disposition of the \$75 million in cost savings to the state will be deferred in anticipation of juvenile justice reforms expected later this year.

Federal TANF Funding for Juvenile Probation. The Governor's Budget proposes to provide \$201.4 million in funding for core juvenile probation services through the federal Temporary Assistance for Needy Families (TANF) program, returning the funding mechanism to that which was in place prior to the current budget year. Counties will recall that in the 2004-05 budget, these core juvenile probation services — which initially were proposed to be fully eliminated in the Governor's budget one year ago — were funded through a general fund appropriation in the current year.

Juvenile Justice Reform. As indicated above, the Governor's Budget assumes that over the next several months a juvenile justice reform proposal will emerge as a result of the Governor's working group on juvenile justice; the reform working group, counties will recall, began its effort in Spring 2004. Budget materials indicate that a comprehensive plan to restructure California's juvenile justice system and the role of the California Youth Authority (CYA) should be completed in time for incorporation into the May Revision. Among the substantive policy changes under consideration include (1) a realignment of responsibility for the supervision of CYA parolees to the counties and (2) additional incentives for county governments to limit the types of offenders referred to the CYA for placement. The budget indicates that these policy changes will permit the CYA to direct its efforts to providing services to juvenile offenders most in need of mental health and sex offender treatment.

Rural and Small Counties Local Assistance Program. The Governor's Proposed Budget eliminates the Rural and Small County Law Enforcement Assistance Program, which in recent years (except for a one-year suspension in 2003-04) has provided a \$500,000 assistance grant to 37 specified local sheriffs' departments for purposes of enhancing local law enforcement efforts. The state savings associated with this cut is \$18.5 million.

Transfer of Undesignated Fees. Although this action is not revealed by any budget documents currently available, CSAC understands that the Governor's Budget assumes continuation of \$31 million transfer of revenues from various undesignated fees from the counties to the courts. This revenue shift is inconsistent with the provisions of AB 1769 (2003), which limited the undesignated fee shift to two years (ending in 2005-06). Additional information will be provided to counties as soon as those details are made available.

Other Criminal Justice Local Assistance Programs. The Governor's 2005-06 Budget proposes to reduce a number of local assistance programs currently administered through the Office of Emergency Services, most of which were formerly administered by the Office of Criminal Justice Planning. Reductions totaling \$4 million would be achieved by the following program cuts or eliminations:

- Elimination of the Community Crime Resistance Program (state savings of \$231,000), the Career Criminal Apprehension Program (state savings of \$866,000), the Serious Habitual Offender Program (state savings of \$137,000), the Vertical Defense of Indigents Program (state savings of \$172,000), and the Drug Abuse Suppression in Schools Program (state savings of \$690,000); and

- Reduction in the Rural Crime Prevention Program (state savings of \$1.9 million).

Judiciary and Trial Court Funding. The total judicial branch budget — which funds the Supreme Court, Courts of Appeal, the Administrative Office of the Courts, Commission on Judicial Performance, Judges Retirement and the trial courts — is \$3.4 billion. This total represents a \$176.9 million (\$164.5 million State General Fund) increase over last year. The increase is primarily due to a growth factor adjustment (\$97.4 million), restoration of one-time reductions (\$60.5 million), and an augmentation of the State Trial Court Trust Fund for increased employee compensation and benefits (\$4.1 million). Trial Court funding constitutes 80.2 percent (or about \$2.7 billion) of the total judicial branch budget.

Proposition 69. The budget proposes funding in at least two categories to carry out the provisions of Proposition 69, the DNA Fingerprint, Unsolved Crime, and Innocence Protection Act passed by voters in November 2004. Under the Department of Corrections budget, \$4 million in additional funds in 2004-05 and a \$3.6 million augmentation for 2005-06 are proposed to assist the department in obtaining necessary forensic samples from inmates and parolees. It is believed that approximately 150,000 inmates and parolees currently have no DNA profile in the state's DNA data bank. Additionally, the Department of Justice is expected to receive additional funding and positions to manage the new workload associated with expanded collections of DNA, palm prints, and thumbprints.

Agriculture and Natural Resources

Williamson Act. The Governor's 2005-06 Budget would fund the Williamson Act at \$39.6 million for subventions to counties for property tax losses incurred by enrolling agricultural land in Williamson Act contracts.

Department of Forestry and Fire Protection. Consistent with the Blue Ribbon Fire Commission's recommendations, the Governor's Budget provides a total of \$22.7 million General Fund for fire engine and helicopter replacement (\$10.8 million), year-round staffing in Southern California (\$9.0 million and 48.8 positions), and conversion and replacement of radio equipment (\$2.9 million). The Budget also includes \$3.8 million in federal funds and 19 positions to address the severe fire conditions in Southern California.

Department of Water Resources. Under a recent court decision, *Paterno v. State of California*, the state was found to be liable for damages caused by a levee failure along the Yuba River during the 1986 floods. As a result of this decision, the state is now facing increased liability for the structural integrity of the aging levees in the Sacramento and San Joaquin Valley flood control system. To address this issue, the Governor's Budget provides \$9.7 million General Fund to implement a more comprehensive flood protection plan in the Sacramento and San Joaquin Valley. This funding will be spent on levee maintenance activities, engineering evaluations of the structural integrity and capacity of levees, improved emergency response capabilities, and floodplain mapping activities to identify areas vulnerable to floods. According to the Budget Summary, the Administration is also exploring statutory reforms to place liability for damages caused by flooding where it appropriately should reside.

The Budget Summary also states that the Administration plans to evaluate alternatives to provide sustainable funding for the State's flood protection role, including the potential formation of a Central Valley Flood Control Assessment District with the authority to assess fees to provide adequate flood control protection in the region. The potential for mandatory insurance requirements for all people who reside behind flood control levees will also be evaluated.

The Governor's Budget also includes \$202.5 million from Proposition 50 bond funds for various water projects, including grants for integrated regional water management projects (\$47.9

million), CALFED water use efficiency projects (\$34.0 million), and desalination projects (\$21.3 million).

The budget fails to include any funding for the State Flood Control Subvention Program.

Sierra Nevada Conservancy. The Governor's Budget includes \$3.6 million and 13.5 positions to provide services in a 22-county area within the Sierra Nevada Mountains.

Underground Storage Tank Programs. The Budget includes \$834,000 and 9.0 positions to support the growth of the Underground Storage Tank Cleanup Program. Additionally, the Budget includes a one-time appropriation of \$15 million to accelerate reimbursement of private parties for their underground storage tank cleanup costs, and includes an ongoing augmentation of \$32.5 million for the same purpose. The Budget also includes \$560,000 and 3.8 positions to continue support for the Replacement of Underground Storage Tank program, which provides low interest loans and grants to small businesses to comply with new safety codes for underground storage tanks. In addition, \$11.5 million is included for local assistance to fund new grants to test the underground storage tanks during and after installation, and loans to purchase equipment needed for long-term leak detection monitoring.

Government Finance and Operations

\$1.3 Billion Reduction to Local Governments. While not highlighted in the Governor's budget package, it is important to note that the second year of local government reductions totaling \$1.3 billion is included in this budget package. Reduction amounts for counties, cities, special districts, and redevelopment agencies have been calculated and submitted to county auditor-controllers. For additional information on this item, please contact Jean Hurst at jhurst@counties.org or 916/327-7500 ext. 515.

Property Tax Administration Grants. Grants to counties for property tax administration are funded at \$54.3 million, reflecting a reduction of \$5.7 million from the 2004-05 level.

Mandates. The Budget outlines which state-local mandated programs would be funded this year; for a complete list, please visit the Department of Finance website at: [ftp://ftpgovbud.dof.ca.gov/pub/GovernorsBudget/8000/8885_fig1f.pdf](http://ftpgovbud.dof.ca.gov/pub/GovernorsBudget/8000/8885_fig1f.pdf). You will note that a number of programs have been suspended, as Proposition 1A requires.

Additionally, the Budget outlines a plan to consolidate debts from deferred state-local mandates, along with other deferrals, and proposes a repayment plan over a period of up to 15 years. Recall that Proposition 1A requires the state, beginning in 2005-06, to either fund or suspend state-local mandates and authorizes the state to repay previously deferred mandates over a period of time.

Senior Citizens' Property Tax Assistance Program. The Budget proposes to replace the existing Senior Citizens' Property Tax Assistance Program with expansion of the Senior Citizens' Property Tax Deferral Program. Currently, the Senior Citizens' Property Tax Assistance program allows a once a year payment from the state to qualified individuals based on a portion of the property taxes paid on their homes. Instead of this grant, eligible individuals will be able to defer their property tax payment under the Senior Citizens' Property Tax Deferral Program. The budget proposes an increase in the income limit in that program, so that all individuals who were previously eligible for the grant program would now be eligible for deferral. Further, the Senior Citizen Renters' Tax Assistance Program benefits will also be scaled back to about 1998 levels to reduce program costs.

Elections. The Governor's Proposed Budget notes that in 2004, California received \$264.4 million from the Help America Vote Act (HAVA). The Governor's proposed budget notes that the

Legislature restricted the release of a portion of the HAVA funds until the receipt of a plan for the use of the HAVA funds was approved by the Department of Finance and the Legislature. The plan is currently under administrative review.

In addition, the Governor's Budget notes that in past years the state has depended on the deficiency process to pay actual costs of election by including a base amount in the Secretary of State budget and adding election costs in excess of this base amount through the deficiency process. As a result of eliminating Control Section 27.00, related to deficiencies, the state can no longer depend on receiving election funds through a deficiency bill. Therefore, the Governor's Budget includes an increase of \$3 million for election costs to fund the full costs of statewide elections.

Health and Human Services

A significant portion of the spending reductions proposed in the Governor's 2005-06 state budget are in health and human services programs. Based on a preliminary review, the budget contains \$8.1 billion in state general fund spending reductions; the proposed health and human services reductions total almost \$1.2 billion. Following is a description of the spending reductions and other fund shifts proposed for health and human services.

SOCIAL SERVICES

The Administration is proposing major program reforms to a number of social services programs including CalWORKs, In-Home Supportive Services, Foster Care, and programs for immigrants. Increased costs due to caseload increases are generally funded. There appears to be no cost-of-doing-business increases for county-administered human services programs.

CalWORKs. CalWORKs expenditures are proposed to be \$6.7 billion in 2005-06. Of this amount, \$4.7 billion is budgeted for CalWORKs program expenditures within the state Department of Social Services budget, \$1.9 billion is budgeted in other programs, and \$196.4 million for a CalWORKs reserve.

CalWORKs Reforms. The Administration is proposing to make changes to the CalWORKs program to because "...enhanced efforts are need to improve participation in work..." The Governor's Budget includes the following reforms/changes:

- 1) *Full implementation of the Enhanced Work Participation Requirement.* Require recipients to be enrolled in welfare-to-work activities sooner after aid is approved and require that more hours of work be dedicated to direct work activities.
- 2) *Pay for Performance.* Bases a portion of the counties single allocation for administration and employment services on specific outcomes of CalWORKs clients in each county. However, the budget eliminates the \$50 million augmentation provided in 2004-05 for employment services. The state estimates a \$22.2 million savings as a result of this proposal.
- 3) *Align California CalWORKs with other states' programs.*
 - Reduce CalWORKs grants by 6.5%;
 - Eliminate statutory COLA
 - Reduce the Income disregard from \$225 and 50% of earned income to \$200 and 40% of earned income.

CalWORKs Administration.

Current-Year Single Allocation Adjustment. There is a **current-year** increase in the Single Allocation of \$22.4 million, due primarily to caseload adjustments. Note that the department has changed its methodology for calculating current-year adjustments for the CalWORKs Single Allocation and Food Stamps Administration. Instead of reflecting only premise items that result in

an increased allocation, these premises now are being offset by negative premises. The \$22.4 million increase is the net number.

CalWORKs Administration. Eligibility funding drops from \$304.1 million in the current year to \$254.4 million in the budget year, a \$49.7 million reduction. This is primarily due to a \$48.1 million increase in the administrative savings attributed to Prospective Budgeting/Quarterly Reporting.

Employment Services. Employment services funding drops from \$923.3 million in the current year to \$861.2 million in the budget year, a \$62.1 million reduction. The budget eliminates the \$50 million CalWORKs Employment Services augmentation counties received in the current year, but moves the \$40 million provided to counties from unspent prior-year funds into the base as continued funding in the budget year. The large reduction in funding is primarily due to the savings associated with recipients reaching their 60-month time limits.

Pay for Performance. Starting in 2006-07, the budget proposes to base five percent of the counties' Single Allocation funding on specific outcomes for CalWORKs clients. The outcomes on which counties would be measured are improved rates of employment and higher federal work participation rates. The Department of Social Services would set a standard for each measure, and would retain five percent of each county's Single Allocation, excluding child care funding, until it determined whether the county met the performance standards. Funds would then be distributed as follows:

- Counties that meet both standards will receive the remaining 5 percent of their funds.
- A county that meets one of the two standards will receive 2.5 percent of its funds.
- Counties that do not meet either of the standards will not receive any of their 5 percent holdback.
- Counties that meet the standard for one or both of the measures and commit to improving their performance above the standard for the next year would be able to receive additional pay-for-performance funds from the unallocated funds of the counties that did not meet the standards.

The pay-for-performance system is proposed as a three-year pilot, running from 2006-07 through 2008-09. Note that while the proposal would not go into effect until 2006-07, the budget assumes \$22.1 million in grant savings in 2005-06, assuming that counties will make program changes in anticipation of the new system.

Quarterly Reporting/Prospective Budgeting. The budget assumes \$122 million in total administrative savings associated with the implementation of Quarterly Reporting/Prospective Budgeting, offset by \$184.3 million in grant costs. As noted above, this is an increase of \$48.1 million in administrative savings over the current year. The grant savings reflect a \$1.5 million decrease from the current year.

SB 1104 Implementation. The budget assumes the following costs and savings associated with the implementation of universal engagement and the core work requirement, for net savings of \$8.5 million in the budget year.

- \$148 million in grant savings associated with increased work participation.
- \$11.1 million in services and administrative costs.
- \$128.4 million in Stage One Child Care costs.

60-Month Time Limits. The budget reflects savings of \$238 million to grant expenditures due to cases reaching their 60-month time limits. Services are projected to decrease by \$121.9 million

due to the time limits, child care is reduced by \$50.9 million, and administration is decreased by \$3.8 million.

Sanction Savings. The budget assumes \$12 million in savings based on anticipated changes to the sanction process. The legislatively mandated study on the sanction process, which is being conducted by RAND, is due to be released prior to the May Revision.

TANF Transfers. The budget proposes \$316.5 million in transfers from TANF to other program areas. This includes \$55.1 million to foster care, \$60 million to the Department of Developmental Services, and \$201.4 million to county probation departments for juvenile justice activities. The county probation activities had been removed from the TANF block grant and funded with state General Fund dollars in the current year.

Substance Abuse and Mental Health. Total funding for substance abuse and mental health services is \$105.7 million, including \$60.7 million for mental health (a \$2.7 million increase) and \$45 million for substance abuse (a \$3 million decrease). The funding changes are due to changing caseload and cost-per-case estimates.

Tribal TANF. The budget provides \$60.6 million for Tribal TANF grants, \$4.8 million for welfare-to-work services, and \$3.9 million for county administration.

In-Home Supportive Services (IHSS). The Schwarzenegger Administration proposes a number of changes to the IHSS program in order to reduce the cost of providing services.

- *Eliminate state participation in IHSS wages above minimum wage.* The Administration is proposing reduce the state's share of costs for IHSS wages and benefits to the state minimum wage (\$6.75). This proposal affects public authority and contract provider wage rates. This reduction would be phased in by October 1, 2005 for all existing or future contracts. This proposal would result in General Fund savings of \$194.8 million in 2005-06 and \$216.8 million annually thereafter. The Administration notes that counties have the option of reinvesting the local savings (\$112 million from the 2004-05 and \$93 million from 2005-06) resulting from the IHSS federal waiver.
- *IHSS quality assurance.* The budget continues funding for enhanced quality assurance (QA) activities, providing a total of \$32 million (\$11.7 million General Fund) to reflect full-year funding for the 110 county QA staff and 110 county IHSS workers provided in the current year, as well as funding to train 1,345 county IHSS staff during the budget year. The budget assumes \$70.9 million General Fund savings associated with the implementation of uniform assessment guidelines, earlier reassessments for some clients, and other new QA activities.

Programs for Immigrants. The Administration is proposing to eliminate the \$1.5 million Naturalization Assistance Program under the Department of Community Services and Development.

OTHER SOCIAL SERVICES PROGRAMS

SSI/SSP. The budget proposes \$3.5 billion General Fund for SSI/SSP in 2005-06, a 1.1 percent increase from the 2004-05 Budget Act. Caseloads are projected to increase 2.3 percent. The Administration proposes that the January 2005 state COLA be eliminated and the pass-through of the January 2006 federal COLA be suspended. This will result in \$258.9 million in General Fund savings in 2005-06 and \$517.85 million annually thereafter.

Adult Protective Services. APS is funded at the current-year level.

Child Care. The Governor's Budget proposes a number of changes to the state's child care system.

CalWORKs Funding. The budget contains \$464.1 million for Stage One child care for CalWORKs recipients, and \$558.3 million for Stage Two Child Care administered by the California Department of Education. A five percent holdback totaling \$60.4 million will be kept in reserve for Stages One and Two.

Child Care Reform Proposal. The 2005-06 Budget includes \$62.6 million in savings due to a tiered reimbursement proposal and a separate proposal to reduce rates for providers who serve only subsidized children. The tiered structure is similar to last year's proposal, and contains a two-tiered reimbursement rate for license-exempt providers and a three-tiered reimbursement rate for licensed providers. Providers move through the tiers based on training, accreditation, teacher permits, and/or achieving specified scores on environmental rating scales. It appears that reimbursement rates for license-exempt care would be significantly reduced under the proposal.

Stage Three. The budget proposes a two-year time limit on Stage Three after leaving cash aid, but recipients will be allowed to put their names on waiting lists for general child care much sooner, and can move into those slots as they become available.

Food Stamps. Administration for the Food Stamp program is budgeted at \$207.2 million, a \$5 million decrease from the current year. The budget assumes \$61.6 million in savings associated with the implementation of Quarterly Reporting/Prospective Budgeting, an increase of \$27.4 million over the current year.

Child Welfare Services. The Governor's Budget includes \$2 billion (\$645.1 million General Fund) for county social workers to provide case management, coordinate treatment services for children and their families, and monitor progress. The Administration also proposes to expand the implementation of a Standardized Safety Assessment System, a differential response system for responding to child welfare referrals, and enhanced permanency and youth transition standards to additional counties.

The Administration also indicates that it will continue to work with counties and other stakeholders in assessing proposals for performance improvement and how to best invest available resources and will work with counties to develop an approach that balances the state's fiscal challenges with the need to improve outcomes for children.

The Governor's Budget also proposes legislation to allow the state to pass on to counties a portion of future federal penalties associated with California being out of compliance with CWS. The Budget Summary indicates that, as counties implement this program, the proposed legislation will help ensure that counties are making progress towards federal compliance.

HEALTH

Medi-Cal Redesign. The 2005-06 budget proposes various reform measures to control costs and program growth, and expand Medi-Cal fraud and audit efforts. However, no savings are yet associated with most of the proposals. Reforms include:

- *Streamlining.* The Administration proposes streamlining the Medi-Cal eligibility determination process for children whose applications are submitted to the Health Families vendor. Initial applications that are received by the vendor will be processed by the vendor rather than be sent to the county for processing.
- *Modifying the Medi-Cal dental package.* The state will establish a yearly limit of \$1000 for dental services for adults, excluding federally mandated emergency services.
- *Monthly premiums.* Monthly premiums will be required from Medi-Cal beneficiaries: \$4 per month per child and \$10 per adult, with a monthly cap of \$27 per month per family. Individuals participating in the current share-of-cost programs would be exempt.

- *County performance standards monitoring.* The state will secure vendor services to monitor county compliance with performance standards.
- *Stabilizing the financing of California's safety net hospitals.* Although this is listed as a significant part of the redesign, no details were provided in association with the budget.
- *Geographic expansion of managed care into 13 new counties, under two models.* GMC and COHS. Fresno would be converted to Geographic Managed Care (GMC), and would be expanded to include Madera, Merced, and Kings counties. Sacramento GMC would be expanded to include El Dorado and Placer, and San Diego GMC would expand into Imperial. Under County Organized Health Systems (COHS), San Luis Obispo would join the Santa Barbara Health Authority, San Benito would join Central Coast Alliance for Health, and the Partnership Health Plan would expand into Marin, Mendocino, Sonoma, and Lake. Ventura would form a new COHS (which will require federal approval). If this proposed expansion is fully implemented 262,000 parents and children would be moved into managed care.
- *Mandatory enrollment of seniors and persons with disabilities* (a total of 554,000 Medi-Cal beneficiaries) into any county in which Medi-Cal managed care is available. This proposal is likely to meet with significant opposition in the Legislature.
- *Implementation of Long Term Care Integration Pilot projects in Contra Costa, Orange, and San Diego counties.*

California Rx (Cal Rx). Cal Rx will utilize a "single point of entry" approach, where uninsured families and individuals under 300 percent of the annualized federal poverty level (\$27,936 for an individual and \$56,568 for a family of four) will have access to a web-based clearinghouse that will allow the uninsured to access the free and reduced price drug assistance programs currently offered by pharmaceutical companies.

California Obesity Initiative. \$6 million state general fund to support a new, comprehensive obesity prevention program. This program will allow DHS to "provide leadership in preventing obesity by promoting healthy eating, regular physical activity, and responsible choices by individuals."

Healthy Families Program.

- *Improve Outreach and Enrollment by Restoring Healthy Families Program/Medi-Cal Application Assistance.* \$5.9 million general fund and \$8.6 million in federal matching funds to re-establish application assistance fees to support individuals and organizations to increase enrollment of children in the Healthy Families program.
- *Improve Retention of Children Transitioning from Medi-Cal to Health Families program Through County Performance Standards.* \$5.6 million (\$2.1 million general fund) ensure that counties comply with the "bridge" requirements. This would allow children transitioning off Medi-Cal one additional month of coverage (bridge). Counties would be required to forward applications to Healthy Families when children are eligible for the bridge.
- *Facilitate enrollment by revising the Joint Healthy Families program/Medi-Cal application.*

Public Health and Other Health Programs.

- \$15 million and 2.8 positions to expand the Newborn Screening program.
- Continuation of funding for bioterrorism prevention and preparedness (\$108.6 million federal funds).

Elimination of \$694,000 for the Office of Binational Border Health. The budget states that \$500,000 in federal bioterrorism funds are still available. This could be construed as supplantation, which is prohibited in the federal grant.

Proposition 99 Changes. Although the budget assumes two-year savings of \$152 million in Prop 99 savings by pulling down federal SCHIP funding for AIM mothers, these savings are not being restored to county programs. Instead the following program enhancements are proposed (funding is combined for 2004-05 and 2005-06):

- \$87.2 million to the Medi-Cal Recent Immigrants Program
- \$23.4 million for State Mental Health hospitals
- \$21.8 million for breast and cervical cancer screening services
- \$10 million augmentation for EAPC clinics

MENTAL HEALTH

The Governor's budget includes \$2.7 billion (\$1 billion General fund) and 9,356.5 positions for mental health services, a net increase of \$171.8 million (\$7.8 million general fund) and 601 positions above the revised 2004-05 budget. This net increase primarily reflects population growth in the state hospitals, activation of Coalinga State Hospital and employee compensation adjustments.

Proposition 63. The Department of Mental Health will present a detailed resource needs assessment for implementation of the Mental Health Services Act as part of the Spring Budget process.

Other mental health budget issues include the following:

- *Activation of Coalinga State Hospital.* The hospital will open in September 2005 and will contain 1,500 beds intended to accommodate the growing number of forensic patients.
- *Restructure Treatment of Sexually Violent Predators.* The administration proposes to require that all precommitted SVPs remain in local custody until the courts commit them as SVPs. In addition precommitted SVPs currently residing at Atascadero State Hospital awaiting trial who have not yet been committed as SVPs will be returned to local custody under this proposal. \$9.2 million state savings.

AB 3632, Severely Emotionally Disturbed Pupils. The Governor proposes to suspend the AB 3632 mandate that requires counties to provide services to SED students in 2005-06. There remains a federal entitlement to these services; it appears, however, that the Administration is proposing that schools meet this federal mandate.

REALIGNMENT

For 2005-06, Realignment revenues are estimated to total \$4.3 billion, which represents an increase of \$227.3 million above 2004-05. The \$4.3 billion total includes \$2.7 billion in sales tax revenues and \$1.6 billion in Vehicle License Fee revenues. The projected \$173.9 million in sales tax growth will be distributed to the Caseload Subaccount to pay the balance of unfunded 2002-03 caseload growth (\$45.7 million) and the remainder (\$128.2 million) will be applied toward a portion of the unfunded 2003-04 caseload growth. The \$53.4 million in projected VLF growth will be distributed pursuant to current statute.

CHILD SUPPORT SERVICES

The Governor's Budget proposes \$194.1 million General Fund to fund local agency administrative costs, which is approximately the same level of funding for local program expenditures that was provided in 2004-05.

As a result of California's delay in implementing a single, statewide-automated child support system, the federal government has levied annual federal penalties against the state. The Governor's Budget includes \$218 million General Fund for payment of the federal fiscal year

(FFY) 2005 penalty. The Governor's Budget also assumes that the federal government will allow the state to defer payment of the FFY 2006 penalty, if any, to September 30, 2006.

Transportation

Transportation Funding Reductions. The state's long-term structural deficit has led to another year of proposed borrowing from Proposition 42 funds for state General Fund purposes. The value of Proposition 42 revenues is estimated at \$1.310 billion for fiscal year 2005-06. Should this budget proposal become a reality, it will represent the third year Proposition 42 funds will be diverted from transportation since the voters passed Proposition 42 in 2002.

Although the Budget is silent regarding the fate of Proposition 42 in 2006-07, it is apparent that the state budget woes are expected to worsen next fiscal year. Further, the Governor's Budget proposes to place on the ballot a constitutional amendment to eliminate the ability to suspend or borrow Proposition 42 funds due to a fiscal crisis, with the exception of a natural disaster or terrorist attack. If passed by the voters, this protection is slated to begin in fiscal year 2007-08, thus lending to the fact that Proposition 42 funds will again be vulnerable in 2006-07.

Another aspect of the Proposition 42 proposal includes payback of the total \$3.4 billion borrowed in even increments over a 15-year period beginning in fiscal year 2006-07.

Although tribal gaming funds were expected to generate a partial early payback of Proposition 42 funds and other transportation loans to the tune of \$1.2 billion, a lawsuit filed to challenge aspects of the tribal/state compacts has thrown into jeopardy the issuance of those bonds. The Governor's Budget does not anticipate resolving that litigation in this fiscal year, thus the \$1.2 billion in bond revenues have been moved into the 2006-07 fiscal year. In addition, questions have arisen as to whether the total \$1.2 billion will actually be realized due to securitization problems associated with the nature of the stability of the revenue stream, according to State Treasurer Phil Angelides. Unfortunately, the city and county local streets and roads funds and transit funds are the lowest in priority for the bond revenues, thus will be affected should the amount realized be less than the \$1.2 billion expected.

Lastly, the Governor has unveiled a comprehensive 10-year strategy referred to as "Go California" that plans to focus on transportation and housing linkages, project delivery issues, performance based management, design-build, design-sequencing and public-private partnerships. The specifics will be contained within legislative proposals introduced by the Administration in the 2005-06 legislative session.

What this means for cities and counties and local streets and roads funding is that the \$192 million expected from the tribal gaming funds will not materialize this fiscal year and neither will the \$253 million in Proposition 42 funds expected in fiscal year 2005-06.

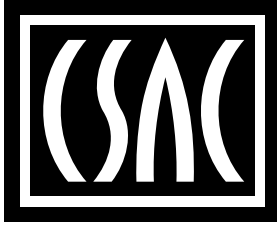
Housing. The Governor's Budget does not contain any specific housing proposals, but makes several statements regarding the importance of local government to plan for and accommodate their own natural population increase and workforce, and to do so by the most efficient land use pattern possible, minimizing impacts on valuable habitat and productive farmland. The Budget goes on to mention another goal of the Administration, which is to seek to "reform onerous regulatory and planning laws to promote home building and accountability for housing production while requiring less paperwork between local governments and the state."

It was made clear by Administration officials that the Governor intends to introduce legislation, which focuses on the linkages between housing, land use and transportation, and the housing related goals mentioned above. There was no timeline available, but the Administration stressed that key stakeholders would be included in future discussions.

Indian Gaming. The Governor's Budget notes that the 2004-05 Budget Act assumed repayment of \$1.4 billion in transportation loans that were due to be repaid no later than June 30, 2005. This repayment was to be done by dedicating \$1.214 billion in bond proceeds from Indian gaming revenues. Due to litigation filed against the state, the timing of the bond sale is unknown. The Budget proposes a trailer bill to make repayment of the above loans explicitly contingent upon receipt of the tribal gaming moneys dedicated to transportation purposes.

In addition, the Governor's Budget proposes an augmentation to the California Gambling Control Commission (CGCC) of \$2.2 million resulting from Tribal-State Gaming Compacts in 2004, and a budget year augmentation of \$4.8 million. This augmentation will provide the CGCC funding to do the following:

- Develop and implement a state testing laboratory and field testing program
- Audit Indian gaming to ensure compliance with Compacts
- Provide legal support for Compact interpretation
- Account for and project Indian gaming revenues to the State
- Coordinate with local and tribal law enforcement and other states concerning licensing status, gambling related issues, and tribal gaming areas identified as needing compliance reviews.



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FOR IMMEDIATE RELEASE

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County Officials React to New Budget Local Government Leaders Pledge to Work with Governor, Legislators to Reach Equitable Solution

SACRAMENTO – County officials, who appreciate Governor Arnold Schwarzenegger’s ongoing commitment to local government, are concerned about significant proposed costs shifts to counties contained within his 2005-06 budget proposal.

Counties, cities and special districts agreed last year to participate in the Governor’s ongoing budget solution by contributing \$1.3 billion for this current budget year and in 2005-06, for a total of \$2.6 billion from local government coffers. Last years’ agreement with the Governor provided the State with two years of additional local agency property tax dollars. It also resulted in significant constitutional protection for local governments in the form of Proposition 1A.

While the Governor’s proposed 2005-06 budget adheres to that negotiated deal, several additional issues contained within the fiscal proposal will result in significant impacts for counties.

Areas of concern for counties include the Governor’s proposal to withdraw state participation in funding wages for In Home Supportive Services workers, which would require counties to shoulder more than \$194 million in additional costs for these programs this year. Counties are also concerned about the proposed suspension of Proposition 42 transportation funds, which will shift \$192 million away from local streets and transit projects in the coming year, with additional losses anticipated the following year.

Additionally, counties are concerned over proposals to shift future foster care penalties to counties, restructure hospital funding and reductions in funding for Cal-WORKS programs while at the same time implementing state performance measures for such programs.

Counties understand the tough decisions facing the Governor as he works to ensure the Golden State’s fiscal future. We are eager to work with him and the Legislature to create equitable and fair solutions for all Californians who depend on critical county services.

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