January 2013

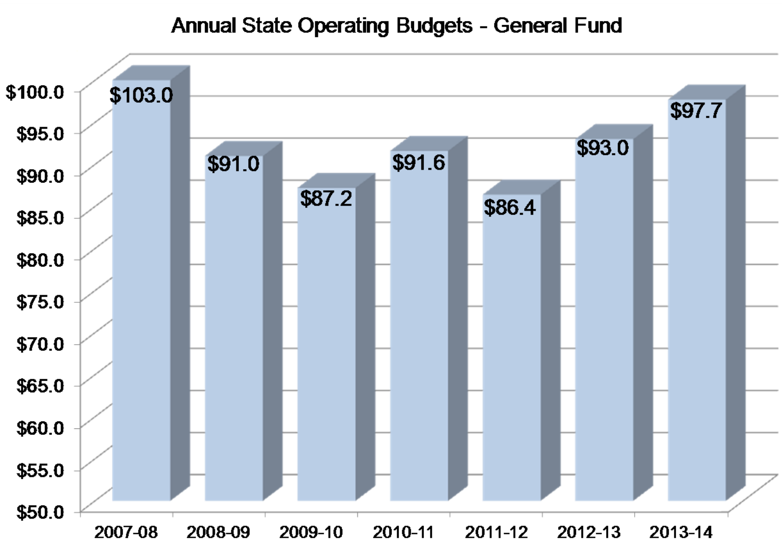
Analysis of the Governor's 2013-14 Proposed Budget

The Governor released his proposed 2013-14 budget on January 10, 2013. The budget proposal reflects significant improvement in the state's finances. Prior budgets projected annual deficits exceeding $20 billion, and included billions of dollars in program reductions, revenue increases, and borrowing to close the gap. In contrast, the new budget proposal presents a balanced spending plan with 5.0% growth in expenditures and a $1.0 billion reserve. Much of this improvement can be attributed to the economic recovery, which continues at a moderate pace, and voter approval of Proposition 30, which raises tax rates on higher-income Californians and temporarily increases the state sales tax by a quarter of a cent to fund K-12 schools, community colleges and state universities.

Monterey County Board of Supervisors 2012

The 2012 Monterey County Board of Supervisors: Fernando Armenta (District 1), Louis R. Calcagno (District 2), Simon Salinas (District 3), Jane Parker (District 4), and Dave Potter (District 5).

In the last few years, the Governor proposed major program reductions and realignment of health, social services, and corrections responsibilities to counties. This year's budget proposal offers more of a *baseline* funding approach, with most departments receiving "as is" allotments similar to current year funding levels. Exceptions include additional funding for schools, including a new funding formula that provides more local flexibility, and more resources for universities. The proposed budget also lays out policy considerations for expanding Medi-Cal under federal health care reform, although the budget lacks specifics.



State General Fund Expenditures

The Governor's 2013-14 Proposed Budget provides for $97.7 billion in general fund expenditures. This level of planned expenditures is $4.7 billion higher than the current year estimate and $11.3 billion (13.1%) higher than the 2011-12 amount. As shown in the chart below, the budget is the highest it has been in the last five years, but still below the 2007-08 (pre-recession) budget of $103.0 billion.

The chart below summarizes proposed general fund expenditures by agency. Over half the proposed budget goes to education, including both K-12 schools and higher education, and most ($4.2 billion) of the year-over-year growth in expenditures goes to education. This was expected given the intent of Proposition 30 sponsors to secure funding for schools. In addition, the University of California and California State University systems would each receive a 5.0% base increase in 2013-14, in addition to the $125 million each system received in the current year in exchange for not increasing tuition levels in 2012-13. The other significant area of growth is in health and human services to expand enrollment among the currently eligible Medi-Cal population, and for support of CalWORKS employment services.

State General Fund Expenditures (In Billions)

	2012-13	2013-14	Change
K-12 Education	$38.3	$41.1	$2.8
Health & Human Services	27.1	28.4	1.3
Higher Education	9.8	11.1	1.3
Corrections & Rehabilitation	8.8	8.8	-
Natural Resources	2.0	2.1	0.1
Legislative, Judicial, Executive	2.0	2.5	0.5
Other	5.0	3.7	(1.3)
Totals	$93.0	$97.7	$4.7

Economic Outlook and Revenues

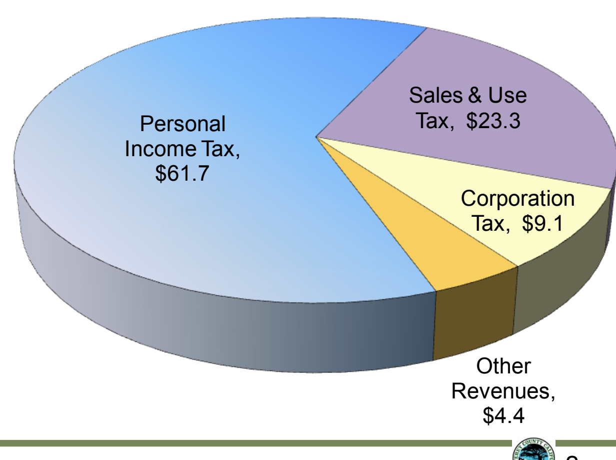
The economic assumptions used to build the Governor's Budget mirror those of other recent forecasts by the Legislative Analyst's Office and UCLA Anderson. All three forecasts assume continuation of the modest economic recovery, with growth in Gross Domestic Product (GDP) ranging between 1.7% to 1.8% in 2013 and 2.8% to 3.0% in 2014. Personal income, housing, and employment are also expected to continue to improve at a moderate pace. One notable risk of these forecasts, however, is that they assumed continuation of the payroll tax holiday in effect the last two years. This "tax holiday" has since ended, reducing disposable income. This will mean slightly weaker prospects for economic growth.

Other economic uncertainties include oil price spikes from instability centered around the conflict in Syria and increased tensions between Iran and Israel, as well as decisions at the federal level concerning the statutory cap on U.S. public debt (debt ceiling) and the 8% to 10% across-the-board cuts, known as sequestration, set to begin on March 1, 2013. Without a debt ceiling increase, the federal government will have no choice but to delay payment on some of its obligations beginning in late February or early March. Even if action is taken on the debt ceiling, a prolonged debate and the associated uncertainties could weaken investor and consumer confidence and impede the recovery as it did in the 2011 debt ceiling debate.

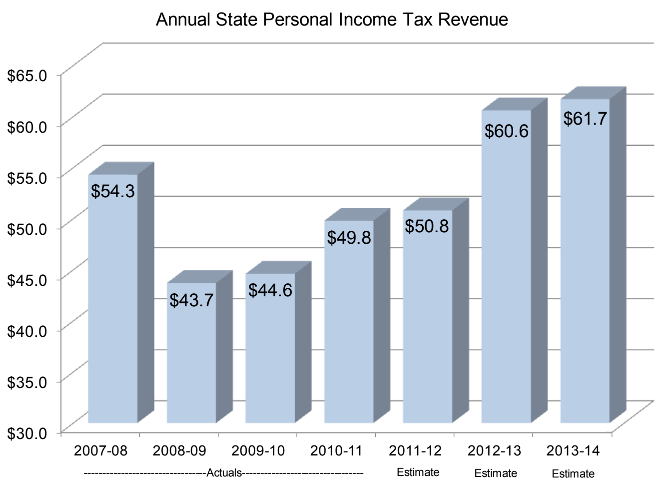
If the U.S. can navigate through these risks successfully, the State can expect to see improvement in its revenues. State general fund financing from revenues and transfers is expected to improve to $98.5 billion in 2013-14, up from an estimated $95.4 billion in the current year and $87.1 billion in the prior year. This is the highest level of revenues since the beginning of the recession, but still below the 2007-08 amount of $103 billion.

Most of the State's general fund revenues come from three sources: personal income taxes, sales and use taxes, and corporation taxes. As shown below, personal income taxes comprise nearly two-thirds of the state's general fund revenues and are estimated at $61.7 billion for 2013-14. Sales and use taxes provide roughly a quarter of general fund financing, with the remaining financing coming from corporation taxes and other revenue sources.

2013-14 Proposed Governor's Budget: Sources of Revenue



Much of the improvement in state revenues can be attributed to growth in personal income tax collections. These revenues are expected to climb to $61.7 billion in 2013-14, up $18.0 billion (41%) since 2008-09 when the nation slipped into deep recession. The improvement reflects growth in the underlying economy, including higher capital gains, and the increase in personal income tax rates for wealthier Californians under Proposition 30. In addition to the improvement in personal income taxes, state sales and use tax collections and corporation tax revenues are also estimated to grow a healthy $2.7 billion and $0.6 billion, respectively, over prior year levels.



The State's "Wall of Debt"

The Governor has often discussed the state's "wall of debt" which refers to "budgetary borrowing" over the years to balance annual budgets through loans and deferrals. Examples include deferring payments to schools, economic recovery bonds used to balance prior budgets, and loans from special funds. As shown below, the state is expected to end the current year with $27.8 billion in this type of debt, down from $34.7 billion at the end of 2010-11. Under the Governor's projections, this debt will decline to $4.3 billion by the end of 2016-17.

Reducing reliance on budgetary borrowing is a positive feature of the proposed budget, but as he points out, the state still has much work to do to address other "looming liabilities". The Governor's administration estimates $181.2 billion in unfunded retirement liabilities for state workers, teachers, university employees, and judges. Also, the unemployment insurance fund has been insolvent since 2009, with an outstanding loan due to the federal government of $10.2 billion. The Governor's Office does not expect to pay down the loan until sometime after 2020.

The State's "Wall of Debt" (In Billions)

	End of 2010-11	End of 2012-13	End of 2016-17
Deferred Payments to Schools	10.4	8.2	-
Economic Recovery Bonds	7.1	5.2	-
Loans from Special Funds	5.1	4.1	-
Unpaid Costs to Local Gov't	4.3	4.9	2.5
Underfunding of Proposition 98	3.0	2.4	-
Other Debt	4.8	3.0	1.8
Totals	$34.7	$27.8	$4.3

Health Care Reform

The Affordable Care Act enacted on March 23, 2010 increases access to private and public health care coverage through various mechanisms. To expand coverage, the ACA provides for (1) the health insurance exchange, a new marketplace for those individuals currently uninsured and employers to be able to purchase insurance and access federal tax credits, and (2) two expansions of Medicaid.

The mandatory expansion of Medicaid requires simplification of eligibility, enrollment, and retention processes. The Governor's budget includes $350 million general fund as a placeholder for the costs of the mandatory expansion.

The optional expansion builds upon California's "Bridge to Reform" or Low Income Health Program (LIHP) enacted in 2010 under a federal waiver. The waiver allows counties to implement a Medi-Cal-like expansion to individuals with incomes up to 138% of the federal poverty level (FPL) through 2013. The budget outlines two alternatives for the optional expansion: a state-based approach or a county-based approach. Conversations are still needed to address "risks and responsibilities" of counties and the state to determine which approach to take. The budget claims that statewide counties currently spend between $3 and $4 billion annually on indigent health care.

The *state-based approach* would build upon the existing state-administered Medicaid program and managed care delivery system. Covered benefits for the expansion population would be similar to benefits available to the currently eligible population. The budget proposal asserts that county savings associated with medically indigent adults becoming eligible for Medi-Cal under the expansion, "should be redirected to pay for the shift in health care costs to the state". In addition, it suggests an increase in county programmatic and financial responsibility for child care and other social services approaches.

Under the *county-based approach*, the counties would have operational and fiscal responsibility for the expansion and would maintain current responsibilities for indigent health care services. Counties will be responsible for developing provider networks, setting rates, and processing claims. Counties would need to meet statewide eligibility standards and cover at a minimum a benefits package similar to coverage requirements for health exchange. This approach would likely require federal approval.

The County of Monterey utilizes a combination of health realignment (sales tax revenue and vehicle license fee) funds and County general funds up to the statutorily required County Maintenance of Effort amount of $3.3 million to fund indigent health care services and public health services in the areas of tuberculosis control, communicable disease management, case management, laboratory services, health officer services, etc. At this point, it is uncertain how much of this funding the state will want to be categorized as "realized savings" and redirected to pay for the shift in health care costs to the state. Currently the County only allocates $6.2 million from this pool for indigent health care costs. After the implementation of the expansion, the County will continue to be responsible for indigent health care costs.

Social Services

The 2013-14 Governor's Budget spares the Department of Social Services from any further deep cuts that have been experienced over the last six years. In fact there is a glimmer that there will be some restoration funding for child welfare services through realignment growth funds and other augmentations described below.

CalWORKs

The governor proposes an increase of approximately $140 million for the CalWORKs Single Allocation that provides funding for employment services, eligibility determinations, child care and supportive services and a reinstatement of the Cal Learn Program for pregnant and parenting teens on assistance. This will provide roughly an additional $1 million to Monterey County that will be used for increasing work participation rates, reengagement activities and case management for recipients that have been exempted from participating due to having young children and subsidized employment for those placed jobs in collaboration with business partners.

In-Home Support Services (IHSS)

The Governor proposes to restore a 3.6% service level reduction to IHSS recipients but also assumes that the state will prevail in implementing a 20% reduction in service hours effective November. This reduction was proposed by the Schwarzenegger administration and has been in court since December 2011. There would be no fiscal impact to Monterey County as part of the 2012-13 Budget deal set into law a Maintenance of Effort (MOE) for each county based on expenditures for 2011-12. Any increases in the future will be absorbed by the state except for a small California Necessities Index (CNI) increase.

Child Welfare Services (CWS), Adoptions, Foster Care

CWS was included as part of the 2011 safety realignment restructuring that provides state sales tax funding and allows counties more flexibility to meet program outcomes. Growth in sales tax is estimated to provide an increase for these programs. As stipulated in statute, the CWS program will receive a substantial amount of the growth in the first three years to mitigate an $80 million cut to the program two years ago. In total counties are estimated to receive approximately $222.3 million as a result of this growth in 2013-14. Monterey County expects to receive approximately $1.5 million.

Medi- Cal and Healthy Families

Additional funding will be received by counties to accept the transfer of the Healthy Families Children into the Medi-Cal Program in both the current year and budget year. These additional funds will be used to increase staffing needed to address an additional 18,000 cases as well as plan for Health Care Reform.

Child Support Services

Governor Brown made good on the commitment of last year's budget agreement by proposing the restoration of $14.7 million (statewide) to the local child support administrative funding base. The previous reduction resulted in a $202,460 cut to the County. Additionally, the Administration also recognizes the hard work of local child support professionals and proposes the reinstatement of the county share of assistance collections, resulting in nearly $30 million in additional statewide funding for counties. The proposed action will increase Monterey County's public assistance recoupments by $200,000 - $300,000 in 2013-14. The budget proposal also continues to give counties the option to use non-program funds to draw additional federal dollars into the program, with a 66% federal financial participation (FFP) rate for qualified matching dollars.

Suspension of Election Mandates

The Governor's proposed budget for 2013-14 continues the 2011-12 suspension of major election program mandates, including Absentee (Vote by Mail) Ballots, Permanent Absent (Vote by Mail) Voters I, Absentee (Vote by Mail) Ballots: Tabulation by Precinct, Voter Registration Procedures, Fifteen-Day Close of Voter Registration, and the Brendon Maquire Act (special election due to the death of a candidate). There are three additional election-specific mandates proposed for suspension in 2013-14: Modified Primary Election, Permanent Absentee Voter II, and Voter ID Procedures (relating to provisional voting). The largest impact to voters continues to be the suspension of all vote by mail programs. Eliminating the automatic delivery of mail ballots to over 110,000 voters will significantly increase voter confusion and lead to possible disenfranchisement. Continued implementation of the above nine suspended mandates through 2013-14 and into the future may equate to an estimated annual loss of approximately $350,000 in offsetting revenue under SB 90.

Emergency Services/Disaster Assistance

The proposed budget includes a $10 million statewide reduction to the California Disaster Assistance Act Program which provides state financial assistance to counties, cities and special districts for recovery efforts related to a disaster. This $10 million reduction will reduce the amount of disaster assistance available to cities and counties as part of a cost share for a state/federal declared disaster. Lack of available emergency funds could result in counties/cities having to fund a larger portion of repairs, replacement of public infrastructure such as public buildings, roads, public utilities that are the lifelines for community recovery. This in turn could impact community resiliency and economic recovery.

Public Safety Realignment

The proposed budget continues its implementation of public safety realignment authorized under AB 109 (Chapter 15, Statues of 2011). AB 109 transferred responsibility for managing lower level offenders and parole violators from the state to counties. The 2011 Realignment is funded through two sources: a dedicated portion (1.0625%) of state sales tax and $453.4 million in Vehicle License Fees (VLF). Last year's budget proposal included an ongoing funding structure for 2012-13 and beyond, for both base and potential growth revenues. The 2013-14 budget proposal continues this base formula and Proposition 30, approved by voters in November 2012, put into place protections to safeguard revenues dedicated to the realigned programs.

State funding to the County for AB 109 realignment grew from $4.4 in 2011-12, the first partial year (nine months) of implementation, to $7.9 million in 2012-13. Preliminary indications are that this funding will continue growing in 2013-14. Growth dollars for 2012-13 will be distributed in September of the 2013-14 budget year.

California Community Corrections Performance Incentive Act of 2009 SB 678 Funding

SB 678 established a system of performance-based funding that shares state general fund savings with County probation departments when they demonstrate success in reducing the number of adult felony probationers re-committed to state prison because of new crimes or violating the terms of probation.

The Governor's proposed 2013-14 budget of $35 million (statewide) reflects a 74% reduction from the 2012-13 budget of $138 million. The County Probation Department is scheduled to receive $227,711 in SB 678 funding for 2012-13. The proposed 2013-14 budget would reduce the SB 678 budget to an estimated $59,205. In turn, staffing for this program would need to be reduced.

The County Probation department continues its ongoing discussions with state administration and the Legislature about the ability to support the original intent of SB 678 under the current funding formula. The Governor's administration has expressed its willing to discuss ideas related to achieving the positive outcomes supported by SB 678 programs.

Transportation Infrastructure Assessment

The California Transportation Commission recently published the "2011 Statewide Transportation System Needs Assessment" to identify all transportation funding needs over the next decade. The report identified $538.1 billion in total infrastructure needs, including $172.3 billion in highway and intercity rail needs.

This needs assessment identified approximately $24 billion of annual revenues dedicated to transportation infrastructure statewide. Over $10 billion in state and federal funds flow through the annual state budget. Of this budgeted amount, approximately 37 percent supports local transportation needs, including local streets and roads.

In addition to the amounts provided in the state budget, local agencies receive a $1.4 billion share of state sales tax revenue for transportation purposes, another $1.4 billion in federal support for local transit systems, and 19 counties have exercised the option of passing local sales tax measures which generate another $3.6 billion in revenue for transportation purposes. The remaining revenues are from local transit fares and other local sources, such as property taxes, developer fees and local bond proceeds.

Beginning in the spring of 2013, the Transportation Agency will convene a workgroup consisting of state and local transportation stakeholders to refine the transportation infrastructure needs assessment, explore long-term, pay-as-you-go funding options, and evaluate the most appropriate level of government to deliver high priority investments to meet the state's infrastructure needs.

Next Steps

Although the Governor's Budget does not include much growth to restore funding lost over the last five years, the absence of significant program cuts is welcome news. As the next step, the proposed budget will be introduced in each house of the Legislature as the "budget bill", with "budget hearings" typically beginning in late February soon after the Legislative Analyst issues the "Analysis of the Budget Bill". The traditional "May Revision" adjustments are due by May 14. The Legislature typically waits for the May Revision update before final budget decisions are made. Constitutionally, the Legislature must pass the budget bill by June 15, although the deadline is rarely met. In recent years, many of the critical decisions necessary to generate the required two-thirds vote have taken place at the leadership level between the governor and the majority and minority leaders in each house – the so-called "Big Five." The budget is "enacted" upon signature of the Governor, which typically accompanies line item vetoes.

Almost half of the County's general fund revenue comes from the state, either as direct state subventions and grants, or as "pass-through" of federal monies. Given the County's vested interest in State budget outcomes, the County Administrative Office and departmental leadership will continue to monitor state budget deliberations closely, advocate for the interests of Monterey County and its residents, and apprise the Board of Supervisors of major developments.