Governor's Budget May Revision 2014-15

Edmund G. Brown Jr. Governor State of California

Introduction

The Governor's Budget—reflecting a modest surplus as a result of a temporary windfall in capital gains tax revenues—laid out a multiyear plan that was balanced, paid down budgetary debt from past years, saved for a rainy day, and increased spending for education, the environment, public safety, public works, affordable health care, and CalWORKs.

Under this May Revision, state revenues are forecast to increase by $2.4 billion. Nevertheless, the costs of health care, drought, and other programs have increased by essentially the same amount.

This May Revision maintains the Governor's Budget principle of paying down debt and reducing long-term liabilities. After years of discussion, the May Revision finally proposes a plan to shore up the teacher pension system.

Despite the state's achieving a solid balanced budget, there remain a number of major risks that threaten the state's fiscal stability, including the overhang of fiscal debts, growing long-term liabilities, and lingering uncertainties regarding the costs of the federal Affordable Care Act. The recent agreement between the Governor and legislative leaders to create a Rainy Day Fund will help the state minimize future boom-and-bust cycles.

Changes since the Governor's Budget

The May Revision reflects the net changes in the national and state economic outlook, the corresponding effects on revenues and the state's obligation to schools, increased costs for implementing federal health care reform and other spending adjustments.

The key developments and proposals reflected in the May Revision include:

- A net increase of $2.4 billion in expected revenues across 2012-13 through 2014-15. This increase is largely driven by higher than expected personal income tax withholding, partnership income, and dividend income. These revenues are associated with higher annual bonus payments and one-time shifts due to federal tax policy changes in 2012. Therefore, the higher revenues are largely a one-time bump in 2013-14.

- Due to the change in state revenues, lower property taxes, and higher enrollment in K-12 schools, state General Fund costs for the Proposition 98 minimum guarantee for education have increased by $659 million. The May Revision includes $10 billion in new Proposition 98 resources for schools this year, including $4.5 billion to continue the implementation of the Local Control Funding Formula.

- Last year, the state's adoption of the optional expansion of Medi-Cal under the Affordable Care Act represented a major new spending commitment in providing Californians with health care coverage. Compared to what was expected just a few months ago, implementation of federal health care reform will provide more than one million additional people with coverage through Covered California and Medi-Cal combined. Medi-Cal enrollment is now expected to rise from 7.9 million before implementation to 11.5 million in 2014-15.

  This is a 46 percent increase and Medi-Cal will now cover about 30 percent of the state's population. This surge in coverage will bring significantly higher state costs. Although the federal government will pay the costs for the optional expansion for the next few years, approximately 800,000 individuals will receive Medi-Cal benefits under the current 50-50 state-federal cost sharing arrangement. As a result, General Fund Medi-Cal costs will rise by $2.4 billion over two years. This represents an additional General Fund cost of $1.2 billion compared to what was expected in the Governor's January Budget.

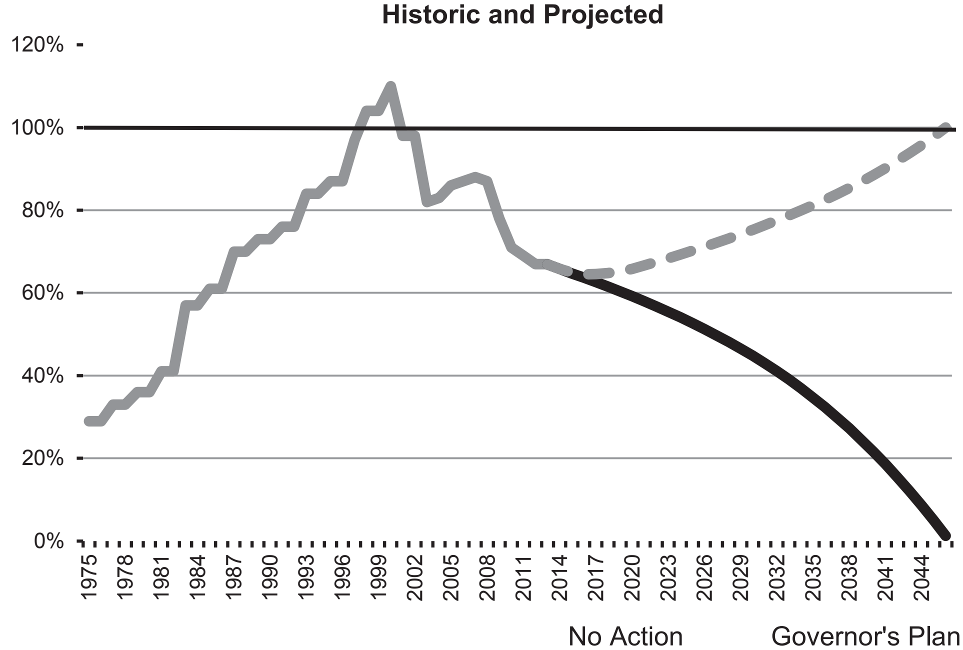
- On January 17, 2014, the Governor declared a state of emergency because of increasingly severe drought conditions. In February, the Governor signed Chapter 2, Statutes of 2014 (SB 103), appropriating $687 million in new expenditures. Additionally, the May Revision provides $142 million ($121 million General Fund) in drought-related expenditures to reflect higher costs in firefighting, emergency response, enforcement, monitoring, wildlife preservation, food assistance, and other critical activities.

- On February 20, 2014, the California Public Employees' Retirement System Board adopted new assumptions regarding the longer life expectancy of state retirees. The impact of these assumptions will be $1 billion phased in over three years. The costs in 2014-15 will be $430 million ($254 million General Fund).
- The Governor's January Budget included an increase of $100 million for trial court operations. The May Revision increases this amount to $160 million as part of a two-year strategy to stabilize trial court funding and allow time for the Judiciary to pursue cost reduction strategies.

Shoring Up Teacher Pensions

In its 101-year history, the California State Teachers' Retirement System (CalSTRS) has rarely been adequately funded—meaning that expected contributions and investment returns have not been equal to expected pension payouts. As shown in Figure INT-01, the system was only 29 percent funded as recently as 1975. The system did reach full

Figure INT 01
STRS Funded Ratio
Historic and Projected



funding (100 percent) for a few years around 2000 because of exceptional investment returns and higher contributions in the preceding years. Yet, reduced contributions, benefit enhancements, and stock market crashes have reduced the system's funding status to its current 67 percent and set it on a consistent downward trajectory.

Unlike other pension systems, contributions to CalSTRS are set in state law, and contributions from school districts and teachers do not automatically adjust to ensure the system's revenues meet its required expenditures. If no action is taken, it is projected that the system will run out of money in 33 years.

To counteract this dire prospect, the May Revision sets forth a plan of shared responsibility among the state, school districts and teachers to shore up the teacher pension system. The first year's increased contributions from all three entities are modest, totaling about $450 million. The contributions would increase in subsequent years, reaching more than $5 billion annually. Total contributions today equal 19.3 percent of teacher payroll and will rise to 35.7 percent. This would eliminate the unfunded liability in approximately 30 years.

Paying Down Debts and Liabilities

The state's budget challenges have been exacerbated by the Wall of Debt —an unprecedented level of debts, deferrals, and budgetary obligations accumulated over the prior decade. The Governor's January Budget proposed to reduce the Wall of Debt by over $11 billion this year and fully eliminate it by 2017-18 (as shown in Figure INT-02).

Figure INT 02

Budget Plan Would Eliminate the Wall of Debt

(Dollars in Billions)

	End of 2010-11 [1/]	End of 2013-14 [2/]	End of 2014-15 [3/]	End of 2017-18 [3/]
Deferred payments to schools and community colleges	$10.4	$6.1	$0.0	$0.0
Economic Recovery Bonds	7.1	3.9	0.0	0.0
Loans from Special Funds	5.1	3.9	2.9	0.0
Unpaid costs to local governments, schools and community colleges for state mandates	4.3	6.7	6.6	0.0
Underfunding of Proposition 98	3.0	2.4	1.8	0.0
Borrowing from local governments (Proposition 1A)	1.9	0.0	0.0	0.0
Deferred Medi Cal Costs	1.2	1.8	2.2	0.0
Deferral of state payroll costs from June to July	0.8	0.8	0.8	0.0
Deferred payments to CalPERS	0.5	0.4	0.4	0.0
Borrowing from transportation funds (Proposition 42)	0.4	0.2	0.1	0.0
Total	**$34.7**	**$26.2**	**$14.8**	**$0.0**

[1/] As of 2011-12 May Revision

[2/] Based on 2013 Budget Act policies

[3/] As of 2014-15 May Revision

Under the plan, all remaining deferrals to schools and the Economic Recovery Bonds would be completely paid off this year and early repayments to transportation and the Cap and Trade Program would allow accelerated investments in those areas.

The May Revision includes an additional $100 million to repay a portion of existing mandate reimbursement claims that have been owed to local governments since at least 2004. This payment will provide local governments with discretionary dollars that can be spent on their highest local priorities. The Administration expects that the majority of the dollars will be spent improving implementation of 2011 Realignment and public safety.

Keeping a Balanced Budget

When Governor Brown took office in 2011, the state faced a $26.6 billion immediate budget deficit and future annual deficits estimated to be roughly $20 billion. The state's annual deficits have been eliminated through voter-approved temporary taxes, spending cuts, and a recovering economy.

The state is now on its most stable fiscal footing in more than a decade. Maintaining this stability will require continued fiscal restraint. There are numerous risks — each of which could cost the state hundreds of millions, or even billions, of dollars. Since January, for example, the costs of implementing federal health care reform increased General Fund costs by $1.2 billion. The cost of our future health care commitments contains large unknowns.

On the other hand, some risks and pressures have been reduced (although not eliminated) since the release of the Governor's January Budget. In February, the federal court overseeing prison overcrowding granted the state a two-year extension to meet the previously ordered 137.5 percent of capacity population cap. Also in February, the federal government avoided causing economic turbulence by raising its debt ceiling without incident. In addition, the state has prevailed in several key court decisions regarding the dissolution of redevelopment agencies that threatened the loss of billions of dollars for core public services.

Other risks remain. The May Revision assumes the continued modest economic expansion of the past couple of years. This expansion has now reached the historical average length of five years. While there are few signs of immediate contraction, we know from history that another recession is inevitable, with the potential of huge revenue losses. The state has also accumulated more than $300 billion in retirement, deferred maintenance, and other long-term liabilities, as shown in Figure INT-03. These liabilities cannot be ignored and must be kept in mind as new spending needs and desires are identified and advanced.

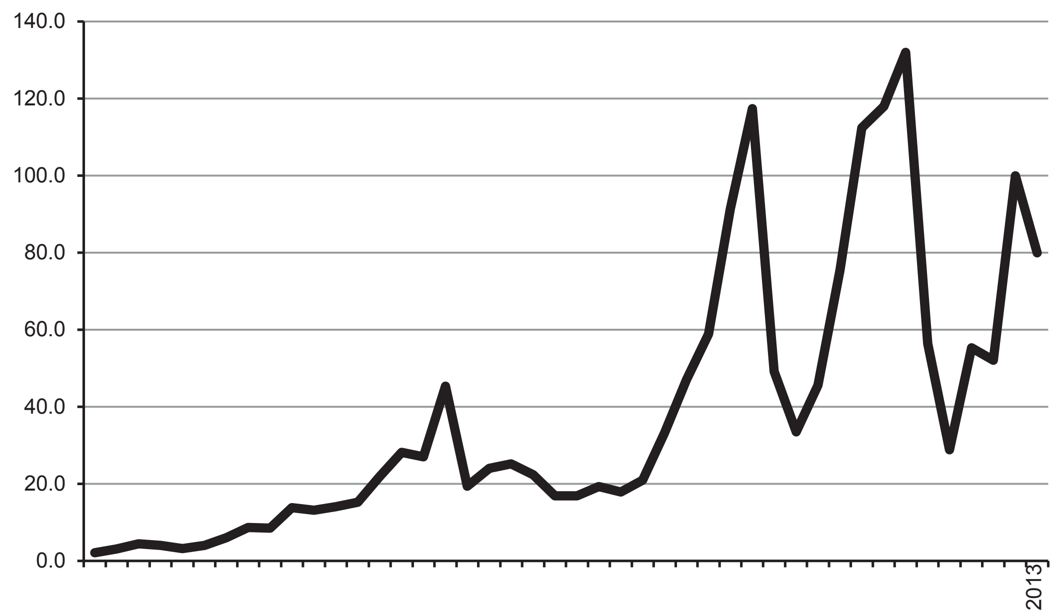
Figure INT-03
California's Long-Term Liabilities
As of 2014-15 May Revision

	($ in Billions)
Proposition 98 Maintenance Factor	$4.0
Unemployment Insurance Debt	6.8
Wall of Debt	14.8
Unfunded Retirement Liabilities	217.3
Deferred Maintenance	64.6
Unissued Bonds	30.0
Total	**$337.5**

Saving for a Rainy Day

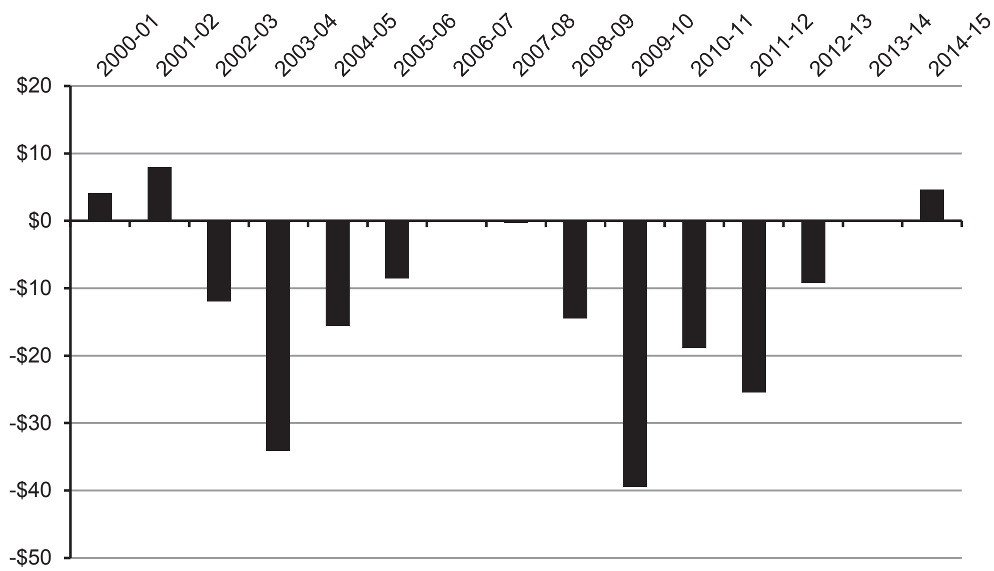
The state's current modest surplus is a welcome reprieve from recent budget crises. Nevertheless, the budget is heavily dependent on the performance of the stock market. Capital gains alone will provide 9.8 percent of General Fund tax revenues in 2014-15. Figure INT-04 illustrates the volatility of these revenues.

Figure INT-04
Unpredictable Capital Gains
(Dollars in Billions)



As shown in Figure INT-05, since 2000, the state has only had two short periods without budget deficits. During both periods, the state made big new ongoing commitments assuming that the economic growth would be permanent. Unfortunately, these periods of fiscal balance quickly turned into budget crises as the stock market plunged. Both times, the state encountered deficits of almost $40 billion, forcing the state to cut basic programs and raise taxes. The lesson is clear — during short spikes in revenues, the state should avoid new ongoing commitments.

Figure INT-05
Balanced Budgets Have Been Quickly Followed by Huge Deficits[1/]
(Dollars in Billions)



[1/] Budget shortfalls or surplus, measured by the annual Governor's Budget.

Learning from recent history and seeking to avoid the traps of the past, the Governor and legislative leaders recently announced a constitutional amendment for a strong Rainy Day Fund that requires both paying down liabilities and saving for a rainy day. Upon voter approval in November, this amendment would take effect for 2015-16, and its key components would be:

- Making deposits into the Rainy Day Fund whenever capital gains revenues rise to more than 8 percent of General Fund tax revenues. In addition, 1.5 percent of annual General Fund will be set aside each year.
- Setting the maximum size of the Rainy Day Fund at 10 percent of revenues.

- Requiring half of each year's deposits for the next 15 years to be used for supplemental payments to the Wall of Debt or other long-term liabilities. After that time, at least half of each year's deposit would be saved, with the remainder used for supplemental debt payments or savings.
- Withdrawing funds only for a disaster or if spending remains at or below the highest level of spending from the past three years. The maximum amount that could be withdrawn in the first year of a recession would be limited to half of the fund's balance.
- Requiring in the Constitution that the state provide a multiyear budget forecast to help better manage the state's longer term finances.
- Creating a Proposition 98 reserve, whereby spikes in funding would be saved for future years. This would smooth school spending and thereby minimize future cuts. This reserve would make no changes to the Proposition 98 calculations, and it would not begin to operate until the existing maintenance factor is fully paid off.

As shown in Figure INT-06, under current projections, the proposed Rainy Day Fund would result in over $3 billion in savings and $3 billion in additional debt payments in its

Figure INT-06

Calculation of Rainy Day Amounts at 2014-15 May Revision

(Dollars in Millions)

	Fiscal Year		
	2015-16	**2016-17**	**2017-18**
Annual 1.5% of General Fund Revenues	$1,698	$1,773	$1,854
Capital Gains Tax Revenues in Excess of 8% of General Fund Taxes [1/]	$174	$233	$341
Total Rainy Day Amount	**$1,872**	**$2,005**	**$2,195**
Debt Repayment (50%)	$936	$1,003	$1,097
Deposit to Rainy Day Fund (50%)	$936	$1,003	$1,097

[1/] Net of amount of revenues attributable to Proposition 98.

Note: Numbers may not add due to rounding.

first three years of operation. If capital gains surge above normal levels during that period, even more money would go into the Fund. This May Revision sets aside 3 percent of revenues in 2014-15 as required by Proposition 58. Half of this deposit will go to make a supplemental payment to pay off the Economic Recovery Bonds and the other half—$1.6 billion—will be saved.

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Summary Charts

This section provides various statewide budget charts and tables.

Figure SUM-01

2014-15 May Revision
General Fund Budget Summary

(Dollars in Millions)

	2013-14	2014-15
Prior Year Balance	$2,429	$3,903
Revenues and Transfers	$102,185	$105,346
Total Resources Available	**$104,614**	**$109,249**
Non-Proposition 98 Expenditures	$57,980	$63,304
Proposition 98 Expenditures	$42,731	$44,462
Total Expenditures	**$100,711**	**$107,766**
Fund Balance	**$3,903**	**$1,483**
Reserve for Liquidation of Encumbrances	$955	$955
Special Fund for Economic Uncertainties	$2,948	$528
Budget Stabilization Account/Rainy Day Fund	**-**	**$1,604**

Figure SUM-02

2014-15 Total State Expenditures by Agency

(Dollars in Millions)

	General Fund	Special Funds	Bond Funds	Totals
Legislative, Judicial, Executive	$2,919	$2,981	$226	$6,126
Business, Consumer Services & Housing	750	775	199	1,724
Transportation	216	8,354	1,902	10,472
Natural Resources	2,258	1,387	526	4,171
Environmental Protection	63	2,679	427	3,169
Health and Human Services	29,633	19,345	-	48,978
Corrections and Rehabilitation	9,600	2,404	-	12,004
K-12 Education	44,743	101	413	45,257
Higher Education	12,495	42	340	12,877
Labor and Workforce Development	303	612	-	915
Government Operations	692	237	8	937
General Government:				
Non-Agency Departments	701	1,511	1	2,213
Tax Relief/Local Government	442	1,762	-	2,204
Statewide Expenditures	1,347	2,153	-	3,500
Supplemental Payment to the Economic Recovery Bonds	1,604	-	-	1,604
Total	**$107,766**	**$44,343**	**$4,042**	**$156,151**

Note: Numbers may not add due to rounding.

Figure SUM-03

General Fund Expenditures by Agency

(Dollars in Millions)

			Change from 2013-14	
	2013-14	2014-15	Dollar Change	Percent Change
Legislative, Judicial, Executive	$2,696	$2,919	$223	8.3%
Business, Consumer Services & Housing	643	750	107	16.6%
Transportation	73	216	143	195.9%
Natural Resources	2,234	2,258	24	1.1%
Environmental Protection	51	63	12	23.5%
Health and Human Services	28,858	29,633	775	2.7%
Corrections and Rehabilitation	9,332	9,600	268	2.9%
K-12 Education	42,892	44,743	1,851	4.3%
Higher Education	11,373	12,495	1,122	9.9%
Labor and Workforce Development	300	303	3	1.0%
Government Operations	754	692	-62	-8.2%
General Government:				
Non-Agency Departments	504	701	197	39.1%
Tax Relief/Local Government	420	442	22	5.2%
Statewide Expenditures	581	1,347	766	131.8%
Supplemental Payment to the Economic Recovery Bonds	-	1,604	1,604	100.0%
Total	**$100,711**	**$107,766**	**$7,055**	**7.0%**

Note: Numbers may not add due to rounding.

Figure SUM-04

General Fund Revenue Sources

(Dollars in Millions)

	2013-14	2014-15	Change from 2013-14 Dollar Change	Change from 2013-14 Percent Change
Personal Income Tax	$66,522	$70,238	$3,716	5.6%
Sales and Use Tax	22,759	23,823	1,064	4.7%
Corporation Tax	8,107	8,910	803	9.9%
Insurance Tax	2,287	2,382	95	4.2%
Alcoholic Beverage Taxes and Fees	351	359	8	2.3%
Cigarette Tax	86	84	-2	-2.3%
Motor Vehicle Fees	19	20	1	5.3%
Other	2,054	1,134	-920	-44.8%
Subtotal	**$102,185**	**$106,950**	**$4,765**	**4.7%**
Transfer to the Budget Stabilization Account/Rainy Day Fund	-	-1,604	-1,604	-100.0%
Total	**$102,185**	**$105,346**	**$3,161**	**3.1%**

Note: Numbers may not add due to rounding.

Figure SUM-05

2014-15 Revenue Sources

(Dollars in Millions)

	General Fund	Special Funds	Total	Change From 2013-14
Personal Income Tax	$70,238	$1,737	$71,975	$3,999
Sales and Use Tax	23,823	12,936	36,759	1,866
Corporation Tax	8,910	-	8,910	803
Highway Users Taxes	-	5,544	5,544	-470
Insurance Tax	2,382	-	2,382	95
Alcoholic Beverage Taxes and Fees	359	-	359	8
Cigarette Tax	84	702	786	-26
Motor Vehicle Fees	20	6,211	6,231	179
Other	1,134	16,409	17,543	-2,072
Subtotal	**$106,950**	**$43,539**	**$150,489**	**$4,382**
Transfer to the Budget Stabilization Account/Rainy Day Fund	-1,604	1,604	0	0
Total	**$105,346**	**$45,143**	**$150,489**	**$4,382**

Note: Numbers may not add due to rounding.

K thru 12 Education

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

The May Revision includes total funding of $75.9 billion ($45.1 billion General Fund and $30.8 billion other funds) for all K-12 Education programs.

Proposition 98

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

Driven by changes to General Fund revenues over the three-year period of 2012-13 to 2014-15, Proposition 98 funding obligations increase by a total of $242 million over the Governor's Budget. Specifically, Proposition 98 funding in 2012-13 decreases by $547 million primarily due to a decrease in revenues. In 2013-14, Proposition 98 funding increases by approximately $1.5 billion due to higher revenues and enrollment growth. Proposition 98 funding in 2014-15 decreases by approximately $700 million primarily due to slower year-over-year General Fund revenue growth and a decrease in local revenues. As a result of these changes, the revised Proposition 98 Guarantee levels at the May Revision for the 2012-13 through 2014-15 fiscal years are $57.8 billion, $58.3 billion, and $60.9 billion respectively.

The May Revision focuses on maintaining the core priorities outlined in the Governor's Budget for K-12 schools-paying down the "Wall of Debt" and investing significantly in the new Local Control Funding Formula (LCFF). The May Revision prioritizes available funding to repay all of the inter-year budgetary deferrals through a mix of ongoing 2014-15 funds and one-time funds attributable to 2012-13 and 2013-14. This will provide local educational agencies with a significant infusion of additional cash, which in turn will substantially reduce borrowing costs for schools. The May Revision also continues the Administration's commitment to the LCFF, by maintaining the $4.5 billion second-year-implementation investment in the formula, enough to eliminate more than 28 percent of the remaining funding gap. Funding is provided for various workload adjustments under the new formula, as detailed in the K-12 Budget Adjustments section.

In addition to retiring K-12 deferrals and investing in the LCFF, the Administration is also focused on a successful implementation of the Common Core academic standards in California. An investment of $1.25 billion in one-time funds was provided in the 2013 Budget Act to assist schools with investments in the areas of professional development, instructional materials, and technology enhancements. Adequate technological capability is important to supporting basic access for all schools and students to the computer-based assessment environment envisioned under Common Core. This is reinforced by information from field testing of the Common Core English Language Arts and Mathematics assessments. As a result, the May Revision proposes an investment of $26.7 million for the K-12 High Speed Network to perform a comprehensive network connectivity assessment and allocate grant funding to those school districts with the greatest need in this area. Providing this funding will allow maximum participation in computer adaptive tests during 2014-15.

Finally, significant swings in state revenues and their related impact on Proposition 98 funding from year to year has created an ongoing challenge to maintain stable funding for education. The recently announced agreement between the Governor and legislative leaders to strengthen the state's Rainy Day Fund will establish a Proposition 98 reserve for the first time. This reserve will address some of this volatility and put schools on a smoother and more predictable revenue and expenditure path. The reserve would make no changes to the guaranteed level of funding dedicated to schools, and it would not begin to operate until school funding is fully restored following cuts made during the Great Recession.

K-12 Budget Adjustments

Significant Adjustments:

- Independent Study—The Governor's Budget proposed to streamline and expand the instructional opportunities available through independent study by authorizing local educational agencies to offer course-based independent study options for students in grades 9-12 and site-based blended learning programs for grades K-12. The May Revision proposes a series of changes to the Administration's January proposal, including:
  - Eliminating the requirement that certificated teachers and students meet weekly to assess if a student is making satisfactory academic progress in a school site-based blended learning independent study program. Teachers and students in these programs already interact frequently enough to monitor student progress.
  - Providing schools with the ability to offer site-based blended learning, utilizing a universal learning agreement for all students enrolled in the same course or courses.
  - Promoting equitable funding by funding students enrolled in course-based independent study programs on the basis of average daily attendance, and not enrollment, and applying the statewide excused absence rate to average daily attendance (ADA) claimed by local educational agencies.
- K-12 High Speed Internet Access—An increase of $26.7 million in one-time Proposition 98 General Fund for the K-12 High Speed Network to provide technical assistance and grants to local educational agencies to address the technology requirements necessary for successful Common Core implementation. Based on an assessment by the K-12 High Speed Network, these funds will be targeted to those local educational agencies most in need of help with securing required internet connectivity and infrastructure to implement the new computer adaptive tests under Common Core.

- K-12 Deferrals—A combined net increase of $742.2 million in one-time Proposition 98 General Fund attributable to the 2012-13 and 2013-14 fiscal years to accelerate the repayment of inter-year budgetary deferrals in those years, relative to the Governor's Budget. This acceleration will be offset by a reduction of $742.2 million in ongoing Proposition 98 General Fund for proposed deferral repayments in 2014-15. When combined, total funding over the three-year period will eliminate all K-12 inter-year deferrals.

- Local Control Funding Formula: Unduplicated Pupils—During the initial transition to the LCFF in 2013-14, local educational agencies participating in Provisions 2 and 3 of the National School Lunch Program encountered administrative challenges collecting income eligibility forms to determine if a student qualified for a free or reduced-price meal. To address those challenges, the May Revision proposes the following changes to the calculation of unduplicated pupils under the LCFF:

  - Authorize schools participating in Provision 2 or 3 of the National School Lunch Program to establish base-year student eligibility for free or reduced-price meals no less than once every four years; provided that the school annually updates its free and reduced-price meal eligible student counts for newly enrolled or disenrolled students during the intervening years.

  - Require the Superintendent of Public Instruction to revise a local educational agency's three-year rolling average unduplicated student enrollment percentage using 2014-15 student data in place of 2013-14 data, if doing so would increase the local educational agency's rolling average.

- Proposition 39—The California Clean Energy Jobs Act was approved by voters in 2012 and increases state corporate tax revenues. For 2013-14 through 2017-18, the measure requires half of the increased revenues, up to $550 million per year, to be used to support energy efficiency projects. The May Revision decreases the amount of energy efficiency funds available to K-12 schools in 2014-15 by $9 million to $307 million to reflect reduced revenue estimates.

- Local Property Tax Adjustments—An increase of $83.9 million Proposition 98 General Fund in 2014-15 for school districts, special education local plan areas, and county offices of education as a result of lower offsetting property tax revenues.

- Average Daily Attendance—An increase of $103.1 million in 2013-14 and an increase of $121.1 million in 2014-15 for school districts, charter schools and county offices of education as a result of an increase in projected ADA in both years.

- Categorical Program Growth — An increase of $15.3 million Proposition 98 General Fund for selected categorical programs based on updated estimates of projected ADA growth.

- Cost-of-Living Adjustments — A decrease of $258,000 Proposition 98 General Fund to selected categorical programs based on a revised cost-of-living factor of 0.85 percent for 2014-15.

- K-12 Mandates Block Grant — An increase of $1.6 million Proposition 98 General Fund to align mandate block funding with revised ADA estimates. This additional funding is required to maintain statutory block grant funding rates assuming 100 percent program participation.

- K-12 Mandates Claims Process — An increase of $5,000 Proposition 98 General Fund to reflect the addition of five mandates to the mandate claiming process. Specifically, $1,000 is provided for each of the following new mandates: Parental Involvement Programs; *Williams* Case Implementation I, II, and III; and Developer Fees. An additional $1,000 is provided for both the existing Student Records and Graduation Requirements mandates, which were inadvertently omitted from the claims process budget bill item last year.

Child Care and State Preschool

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

Significant Adjustments:

- Stage 2 — A decrease of $15.6 million non-Proposition 98 General Fund to reflect a decline in the number of new CalWORKs Stage 2 beneficiaries. Total base cost for Stage 2 is $348.5 million.

- Stage 3—An increase of $30.2 million non-Proposition 98 General Fund to reflect a slight increase in CalWORKs Stage 3 caseload and cost per case. Total base cost for Stage 3 is $216.1 million.
- Capped Non-CalWORKs Programs—A net decrease of $15.4 million non-Proposition 98 General Fund to reflect a decrease of $15.9 million of excess authority in these programs that had been included to backfill federal sequestration cuts, which did not occur, and an increase of $481,000 due to an increase in the population of 0-4 year old children.
- State Preschool—An increase of $356,000 Proposition 98 General Fund to reflect an increase in the population of 0-4 year old children.
- Child Care and Development Funds—A net increase of $24.4 million federal funds in 2014-15 reflecting an increase in ongoing base federal funds of $17.3 million and an additional $7.1 million in one-time funds from 2013-14.

Higher Education

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

The May Revision includes total funding of $26.4 billion ($14.7 billion General Fund and local property tax and $11.7 billion other funds) for all programs included in these entities.

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

As proposed in the Governor's Budget, the May Revision continues the commitment to a multi-year stable funding plan for higher education. The plan prioritizes higher education by providing new funds to continue reinvesting in the public universities, with the expectation that the universities will improve the quality, performance, and cost effectiveness of the educational systems. The plan is rooted in the belief that higher education should be affordable and student success can be improved without dramatic increases in costs to the state or to students.

- Funding Stability—The plan provides each segment up to a 20 percent increase in General Fund appropriations over a four-year period (2013-14 through 2016-17), representing about a 10 percent increase in total operating funds (including tuition and fee revenues).

- Affordability — The plan assumes a freeze on UC and CSU resident tuition from 2013-14 through 2016-17 to avoid contributing to higher student debt and tuition levels.
- Student Success — The plan expects UC and CSU to decrease the time it takes students to complete a degree, increase the number of students who complete programs, and improve the rate of transfer of community college students to four-year colleges and universities.
- Innovation — In addition to efforts by the UC, CSU, and CCC to meet student success goals, the Governor's Budget includes $50 million to promote innovative models of higher education at the campus level that result in more bachelor's degrees, improved four-year completion rates, and more effective transfers between the community colleges and the universities.

The multi-year plan directs the universities to prepare three-year sustainability plans that set targets for key measures adopted in statute in 2013.

California Community Colleges

The CCC are publicly supported local educational agencies that provide educational, vocational, and transfer programs to approximately 2.1 million students. The CCC is the largest system of higher education in the world, with 72 districts, 112 campuses, and 69 educational centers. By providing education, training, and services, the CCC contribute to continuous workforce improvement and also provide remedial instruction for hundreds of thousands of adults across the state through basic skills courses and adult non-credit instruction.

The May Revision maintains $200 million Proposition 98 General Fund to improve and expand student success programs and to strengthen efforts to assist underrepresented students.

Significant Adjustments:

- Apportionments — A decrease of $16 million Proposition 98 General Fund in 2014-15 to reflect a reduction of growth from 3 percent to 2.75 percent, and a reduction in the statutory cost-of- living adjustment from 0.86 percent to 0.85 percent. The May Revision provides $187.7 million Proposition 98 General Fund divided as follows:

- $140.4 million available for general apportionment growth;
- $47.3 million for a 0.85-percent cost-of-living adjustment.

- Career Technical Education—An increase of $50 million Proposition 98 General Fund to support one-time and ongoing costs to improve student success in career technical education:
  - A one-time increase of $50 million Proposition 98 General Fund to support the existing Economic and Workforce Development program at the CCC Chancellor's Office. These funds will provide resources for community colleges to develop, enhance, and expand career technical education programs that build upon existing regional capacity to better meet regional labor market demands.
  - Beginning in 2015-16, an increase in the funding rate for career development and college preparation noncredit courses (also known as CDCP or enhanced noncredit) to equal the rate provided for credit courses. Career development and college preparation noncredit courses offer flexibility for community colleges to design and deliver courses better suited for students pursuing career technical education. Currently, the lower funding rate, along with the higher cost of career technical education, serve as barriers to many community colleges offering career development and college preparation instruction in a manner that best supports student success. Community colleges will have a year to plan how best to take advantage of this new flexibility before the rates increase.
- Deferred Maintenance—An increase of $60.5 million Proposition 98 General Fund, for a total of $148 million, to reduce the backlog of deferred maintenance. Community colleges will not need to provide matching funds for deferred maintenance in 2014-15. The May Revision amends the Governor's Budget proposal so that all funds will go to deferred maintenance as opposed to a portion being reserved for instructional equipment.
- Technology Infrastructure—An increase of $6 million Proposition 98 General Fund, of which $1.4 million is one-time and $4.6 million is ongoing, to upgrade bandwidth and replace technology equipment at each community college. These investments will support student success technology initiatives started in 2013-14, including electronic transcripts, electronic planning, incoming student evaluation, and the online education initiative.

- Proposition 39—A decrease of $1.5 million Proposition 98 General Fund due to a lower revenue forecast for the California Clean Energy Jobs Act, which was approved by voters in 2012 and increases state corporate tax revenues to support energy efficiency.
- Local Property Tax Adjustment—An increase of $17.7 million Proposition 98 General Fund in 2014-15 as a result of decreased offsetting local property tax revenues.
- Student Enrollment Fee Adjustment—An increase of $24.7 million Proposition 98 General Fund as a result of decreased offsetting student enrollment fee revenues.
- CCC Mandates Block Grant—A decrease of $345,000 Proposition 98 General Fund to align mandate block grant funding with the revised full-time equivalent students estimate.

California Student Aid Commission

The California Student Aid Commission administers state financial aid to students attending all institutions of public and private postsecondary education through a variety of programs including the Cal Grant High School and Community College Transfer Entitlement programs, the Competitive Cal Grant program, and the Assumption Program of Loans for Education. More than 100,000 students received new Cal Grant awards, and more than 160,000 students received renewal awards in 2012-13. The Commission will also administer the Middle Class Scholarship program beginning in 2014-15.

Prior to 2001, the Cal Grant program offered a capped number of awards to students and award amounts were specified in the Budget—supporting 130,000 students at a cost of $462 million in 2000-01. The program is now an entitlement and has been one of the fastest growing programs in the state. Costs have increased due to an increased number of students participating in the program and UC and CSU tuition increases before 2012-13. The number of students in the program has increased to an estimated 314,000, and costs have increased to an estimated $1.8 billion in 2014-15.

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

Significant Adjustments:

- Cal Grant Program Growth—An increase of $13.9 million General Fund in 2013-14 and $25.1 million General Fund in 2014-15 to reflect revised participation estimates in the Cal Grant program.
- Offset Cal Grant Costs with Federal Temporary Assistance for Needy Families (TANF) Reimbursements—A decrease of $104.5 million TANF and a like increase of General Fund in 2014-15. Combined with the TANF funds included in the Governor's Budget, the May Revision offsets $440.5 million in Cal Grant General Fund costs.
- Offset Cal Grant Costs with Student Loan Operating Fund (SLOF)—A decrease of $60 million SLOF and a like increase of General Fund to reflect that SLOF funds will not be available in 2014-15 to offset Cal Grant program General Fund costs.
- Offset Loan Assumption Costs with Excess Cal Loan Funds—An increase of up to $6 million Student Loan Authority Fund and a like decrease of General Fund to reflect an offset of costs for the loan assumption program. These funds are available due to the sale of the Cal Loan Program portfolio, recently approved by the California Educational Facilities Authority.

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Health and Human Services

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

The May Revision includes total funding of $136.7 billion ($29.6 billion General Fund and $107.1 billion other funds) for all programs overseen by this Agency, an increase of $839.2 million General Fund over the Governor's Budget.

Department of Health Care Services

The Department of Health Care Services (DHCS) administers Medi-Cal, California's Medicaid program, which is a public health insurance program that provides comprehensive health care services at no or low cost for low-income individuals including families with children, seniors, persons with disabilities, children in foster care, and pregnant women. The federal government mandates basic services including physician services, family nurse practitioner services, nursing facility services, hospital inpatient and outpatient services, laboratory and radiology services, family planning, and early and periodic screening, diagnosis, and treatment services for children. In addition to these mandatory services, the state provides optional benefits such as outpatient drugs, home and community-based services, and medical equipment. DHCS also administers California Children's Services, Primary and Rural Health program, Family PACT, Every Woman Counts, and Drug Medi-Cal as well as county-operated community mental health programs.

Significant Adjustments:

- Pediatric Vision Services—The May Revision proposes $2 million ($1 million General Fund) for a pilot program to increase utilization of pediatric vision services. The pilot would use qualified mobile vision providers to expand vision screenings and services. Participating mobile vision service providers will contract with school districts to provide vision exams and eyeglasses to children enrolled in Medi-Cal managed care plans. The pilot may expand to other locations as discussions with providers continue.
- *Katie A.* Settlement/Administrative Costs—The May Revision includes $2 million ($600,000 General Fund in the DHCS budget and $400,000 General Fund in the Department of Social Services budget) as a placeholder for potential county administrative costs associated with semi-annual progress reports requirements under the *Katie A. v. Bonta* settlement agreement. The settlement concerns the improvement of mental health and supportive services for children and youth in, or at imminent risk of placement in, foster care in California. Proposition 30, passed in 2012, requires the state to provide annual funding for newly required activities that have an overall effect of increasing county costs in realigned programs. Although the settlement was reached prior to the passage of Proposition 30, there may be new administrative activities that increase the overall cost to counties. The use of this funding is subject to further discussion between the Administration and counties to determine if overall costs have increased.

Health Care Reform Implementation

In the past year, California has continued to implement the federal Affordable Care Act (ACA). Since January 1, more than 3 million Californians have been able to procure health insurance, either through the state's new insurance exchange (Covered California) or through Medi-Cal.

The state has been committed to early implementation of health care reform. California initiated a Medi-Cal expansion by enacting the Low Income Health Program (LIHP) under the "Bridge to Reform" federal waiver in 2010. The waiver permitted counties to provide a Medicaid-like expansion to individuals with incomes up to 138 percent of the federal poverty level through 2013. The purpose of the LIHP was to expand health care coverage to low-income adults prior to the effective date of the ACA. The LIHP was a voluntary, county-run program financed with 50 percent county and 50 percent federal funds. On January 1, 2014, 650,000 LIHP members were successfully enrolled into Medi-Cal.

On October 1, 2013, Covered California began offering affordable health insurance, including plans subsidized with federally funded tax subsidies and products for small businesses. In addition, the Medi-Cal program was expanded in two ways:

- The mandatory expansion simplified eligibility, enrollment, and retention rules making it easier to enroll and stay on the program.
- The optional expansion extended eligibility to adults without children and parent and caretaker relatives with incomes up to 138 percent of the federal poverty level, which includes the LIHP population.

Based on the large increases in Medi-Cal enrollment from the LIHP transition and the optional and mandatory expansions, total Medi-Cal enrollment is now projected to be 11.5 million in 2014-15, or almost 30 percent of the total state population.

The May Revision increases the caseload estimate for the ACA mandatory expansion by nearly 60 percent (to 815,000) for 2014-15 over what was assumed in the Governor's Budget. The May Revision assumes additional net General Fund costs of approximately $89.3 million in 2013-14 and $513 million in 2014-15 associated with this increase, bringing the total General Fund costs to $193 million in 2013-14 and $918 million in 2014-15.

The May Revision increases the estimate for the optional expansion caseload by nearly 100 percent to 1.6 million in 2014-15 and assumes additional federal fund costs of $6 billion in 2014-15 for the optional Medi-Cal expansion. The federal government has committed to pay 100 percent of the cost of the new adult group optional expansion for the first three years; by 2020-21, the federal share will decrease to 90 percent and the state will pay 10 percent.

California also increased the mental health and substance use disorder benefits available through Medi-Cal, at a General Fund cost of $191.2 million in 2014-15. The May Revision also includes $187.2 million General Fund for managed care rate increases in 2014-15.

The California Health Eligibility Enrollment and Retention System (CalHEERS) is the information technology system designed to determine Medi-Cal eligibility and process Covered California applications. Although the system was made operational in time to implement the ACA by January 1, 2014, numerous problems with the system persist. There is a backlog of approximately 900,000 Medi-Cal applications pending verification of residency and income. To reduce this backlog more quickly, the state has already suspended the requirement that paper verification of residency be submitted until the CalHEERS system can electronically verify residency beginning in July 2014. Due to the anticipated workload for new enrollees, the Governor's Budget assumed a delay of required Medi-Cal eligibility redeterminations through April 1, 2014. However, the necessary CalHEERS functionality to perform redeterminations will likely not be available until July. The May Revision assumes further delays in resuming redeterminations and additional General Fund costs of $68.6 million in 2013-14 and $25.8 million in 2014-15.

The ACA is a fundamental change to the way health care is delivered. All aspects of the health care industry are adjusting and changing to meet the new realities of the health care market. Despite the state's initial success, significant uncertainties and risks still exist with the ACA and with the Medi-Cal program. Uncertainty regarding eligibility, rates, and utilization continue to pose significant risks to the state budget.

Capturing County Indigent Care Savings

Under the ACA, county costs and responsibilities for indigent health care are expected to decrease as more individuals gain access to health care coverage. The state-based Medi-Cal expansion will result in indigent care costs previously paid by counties shifting to the state. Chapter 24, Statutes of 2013 (AB 85), modifies 1991 Realignment Local Revenue Fund distributions to capture and redirect county savings due to the implementation of federal health care reform. The savings will be redirected to counties for CalWORKs expenditures, providing a corresponding General Fund offset.

AB 85 included several methodologies for calculating savings. Based on updated county information, the May Revision continues to assume a redirection of $300 million in 2013-14, but decreases the 2014-15 redirection amount of $900 million to $724.9 million. Compared to the Governor's Budget, this revised redirection amount results in increased CalWORKs General Fund costs of $175.1 million. The 2013-14 and 2014-15 estimated redirections are interim calculations. A final reconciliation for 2013-14 will take place no later than January 2016.

Managed Risk Medical Insurance Board

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

The Governor's Budget proposes to eliminate MRMIB and transfer the remaining programs to DHCS on July 1, 2014.

Significant Adjustment:

- Major Risk Medical Insurance Program (MRMIP)—The May Revision eliminates this state-only program effective January 1, 2015. Because most individuals with pre-existing conditions can now seek coverage through Covered California or the individual market and get better coverage than through MRMIP, program participation has dropped by more than 50 percent. There is a small population of individuals with End Stage Renal Disease on Medicare who cannot obtain supplemental coverage in the individual market due to statutory prohibitions and therefore use MRMIP as their Medicare supplemental insurance. The proposal includes statutory changes to require health care plans to offer their Medicare supplemental insurance products to these individuals.

Department of Social Services

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

Significant Adjustments:

- In-Home Supportive Services Caseload—An increase of $107.9 million General Fund in 2013-14 and $134.4 million General Fund in 2014-15 primarily associated with increases in caseload, hours per case, and costs per hour.

- CalWORKs Caseload—Increased General Fund and federal Temporary Assistance for Needy Families block grant expenditures of $35 million in 2013-14 and $95.2 million in 2014-15 to reflect revised caseload projections since the Governor's Budget. Overall CalWORKs caseload continues to decline, but at a slower rate than previously assumed.

- March 2014 CalWORKs Grant Increase—Effective March 1, 2014, CalWORKs Maximum Aid Payment levels increased by 5 percent. Based on the revised caseload and updated projections of revenues to the Child Poverty and Family Supplemental Support Subaccount of the Local Revenue Fund, additional General Fund is needed to fund the grant increase in 2014-15. The May Revision includes $13 million

General Fund for this purpose, an increase of $6.8 million General Fund from the Governor's Budget.

- Drought Relief—The May Revision includes $5 million General Fund in 2014-15 for additional food assistance to severely drought-impacted communities with high levels of unemployment. This funding is in addition to $15 million in estimated unspent funds authorized for 2013-14, bringing the total amount available for drought response to $20 million in 2014-15.

- Title IV-E Waiver Extension—An increase of $3.1 million ($1.5 million General Fund) for additional positions to support the entrance of up to 18 additional counties into the federal child welfare waiver program. This waiver allows California to improve child welfare services program outcomes.

- State Utility Assistance Subsidy—An increase of $10.5 million General Fund in 2014-15 to provide a state-funded energy assistance subsidy for CalFresh recipients, to comply with recent federal changes regarding the minimum energy assistance benefit that must be received by a household in order to access the standard utility allowance. This program increases household monthly food budgets by an average of $62 for over 320,000 families.

- CalFresh Caseload—The May Revision includes $20.7 million General Fund for administration, associated with an additional 134,000 CalFresh households by June 2015 as a result of ACA implementation—bringing the total estimated 2014-15 CalFresh caseload increase due to ACA implementation to 279,000 households.

Department of Public Health

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

Significant Adjustments:

- AIDS Drug Assistance Program (ADAP)-New Hepatitis C Virus Medications—The May Revision includes $26.1 million (federal funds) to add two new Hepatitis C virus drugs to the ADAP drug formulary. The drugs were approved by the Food and Drug Administration in late 2013 and were recently recommended for addition to the ADAP drug formulary by the ADAP Medical Advisory Committee because they provide a significant improvement in treatment, have a better cure rate, and require a shorter treatment duration. The Department is working with the ADAP Medical Advisory Committee to develop usage and treatment authorization guidelines to ensure available resources are targeted for ADAP clients with the greatest needs.

- Office of AIDS-Health Insurance Premium Payment Program (OA-HIPP)-Medical Payment Cost Sharing Wrap—The Department will pursue mechanisms to pay out-of-pocket medical expenses for clients who choose to purchase private health insurance beginning January 1, 2016. Developing and implementing the administrative capacity to pay out-of-pocket medical expenses in addition to premiums for eligible OA-HIPP clients will remove the current financial disincentive for ADAP-only clients to obtain private health insurance. This shift will provide clients with comprehensive health insurance and access to the full continuum of care.

Department of Developmental Services

The Department of Developmental Services provides consumers with developmental disabilities a variety of services and supports that allow them to live and work independently, or in supported environments. The Department serves approximately 275,000 individuals with developmental disabilities in the community, and 1,112 individuals in state-operated developmental centers. The May Revision includes $5.2 billion ($2.9 billion General Fund) in 2014-15 for support of the Department and community services.

The Plan for the Future of Developmental Centers

The Plan for the Future of Developmental Centers in California, issued January 13, 2014, recommended that the future role of the state should be the operation of a limited number of smaller, safety-net crisis and residential services. The Plan also recommends continuing to serve individuals judicially committed to the state for competency training and to provide these individuals transition services as they move back to the community. Further, the Plan recommended developing new and additional service components, including development of an enhanced community behavioral home model and providing health resource centers and community housing through public/private partnerships.

Consistent with the Plan, the May Revision proposes developing resources in the community for individuals transitioning from developmental centers, as follows:

- Developing a pilot program for a new enhanced behavioral support home model in the community. The May Revision contains $13 million in reappropriated Community Placement Plan funds for this purpose.
- Improving crisis services at Fairview Developmental Center and establishing new crisis services at Sonoma Developmental Center. The May Revision proposes $3.2 million ($2 million General Fund) and 43.1 positions to serve individuals in the community with developmental disabilities who need short-term stabilization.
- Expanding the Community State Staff Program to support individuals moving from developmental centers and enhancing regional center staffing to support community transition, resource development, and quality assurance. The May Revision contains $458,000 ($321,000 General Fund) and four redirected positions for the Department to evaluate developmental services community placement funds.

Significant Adjustment:

- Federal Certification Status—The May Revision includes $1.5 million ($894,000 General Fund) for 2014-15 contract costs related to the Program Improvement Plan for Fairview, Porterville, and Lanterman Developmental Centers. The Plan was entered into on January 16, 2014, with the California Department of Public Health and the federal Centers for Medicare and Medicaid Services to bring the facilities back into compliance with federal requirements.

Department of State Hospitals

The Department of State Hospitals administers the state mental health hospital system, the Forensic Conditional Release Program, the Sex Offender Commitment Program, and the evaluation and treatment of judicially and civilly committed and voluntary patients. The May Revision includes $1.6 billion ($1.5 billion General Fund) in 2014-15 for support of the Department. The patient population is projected to reach a total of 7,109 in 2014-15.

Significant Adjustment:

- Restoration of Competency Expansion—The May Revision includes $3.9 million General Fund and 13.5 positions to expand the Restoration of Competency Program by up to 55 beds. The program provides for treatment of certain Incompetent to Stand Trial (IST) patients in county jails rather than inpatient treatment at a state hospital. Treating these patients at the county jail is more cost effective than inpatient treatment at a state hospital. This expansion should result in more patients receiving competency restoration faster, while helping to reduce the waitlist for IST defendants.

Health and Human Services Agency

Significant Adjustment:

- Office of Investigations and Law Enforcement Support—The May Revision proposes $1.2 million General Fund and nine positions to establish the Office of Investigations and Law Enforcement Support within the Health and Human Services Agency. The Department of Developmental Services has been the subject of federal interventions regarding the handling of investigations in a significant number of assault cases. The Department of State Hospitals also operates a law enforcement unit that would benefit from the oversight and support of the Office. The Office will work with the California Highway Patrol to develop policies and procedures and an organizational structure that will enable the Office to provide centralized oversight and accountability of these two law enforcement programs. The Office will also establish and implement standardized policies and procedures, provide and review administrative and criminal investigations, and improve recruitment and training.

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Public Safety

The May Revision includes the following proposals related to public safety.

Trial Court Security

2011 Public Safety Realignment includes the shifting of responsibility for trial court security costs to counties. The funding is allocated based on historical court security expenditures and is adjusted based on Sales and Use Tax revenue growth. The state initiated various efforts to build and replace court facilities in recent years, and the activation of those facilities may result in increased court security costs. Proposition 30, passed in 2012, requires the state to provide annual funding for new administratively required activities (after October 9, 2011) that have an overall effect of increasing county costs in this realigned program. New court facilities built by the state and opened after October 9, 2011, may necessitate a different level of court security than the facilities they replaced. The May Revision includes $1 million to address potential increased court security costs from such new court construction. Counties must demonstrate the need for increased trial court security staff as a result of these new courthouses.

City Law Enforcement Grants

The May Revision proposes to augment the existing city law enforcement grant by $12.5 million, providing a total of $40 million in 2014-15 for front line law enforcement activities. The Board of State and Community Corrections allocates funds to individual cities acting as the fiduciary agent within each county receiving the funds.

Update on Meeting the Court-Ordered Population Cap

For over two decades, California's prison system has faced many challenges with overcrowding, the need for General Fund resources, and lawsuits related to the provision of health and mental health services in prison. The population increased from approximately 60,000 inmates in 1986 to an all-time high of 173,479 in 2006. In 2011, notwithstanding the significant progress made in providing medical and mental health services and reducing the prison population, the United States Supreme Court upheld a lower court ruling requiring the Department to reduce population in its institutions to 137.5 percent of the system's design capacity by June 30, 2013. Subsequent orders extended the deadline, and on February 10, 2014, the lower court issued a final order, granting the state a two-year extension to meet the cap by February 28, 2016. In granting the two-year extension, the court also established benchmarks, requiring the state to meet 143 percent of design capacity by June 30, 2014 and 141.5 percent by February 28, 2015.

To comply with the federal court order and avoid the early release of offenders, Chapter 310, Statutes of 2013 (SB 105), provided the statutory changes and funding necessary for the Department to meet the population cap by December 2013. The bill appropriated $315 million that could be used in different ways, depending on whether or for how long the federal court extended the deadline for meeting the population cap. As a result of the two-year extension granted by the court, SB 105 expenditures are anticipated to be $208 million in 2013-14, for a savings of $107 million, which is an increase of $20 million in savings compared to the Governor's Budget. Savings are attributable to a lower-than-anticipated average daily population being housed in contract beds.

Recidivism Reduction Fund

SB 105 specified that if a sufficient time extension were granted and all funding was not used for capacity, the first $75 million of any savings would be transferred into the Recidivism Reduction Fund created by SB 105. Savings beyond the $75 million would be split, with half going to the Recidivism Reduction Fund and half going to the General Fund.

The May Revision augments the amount available in the Recidivism Reduction Fund by $9.9 million, increasing the total amount available in the fund to $91 million in 2014-15. The May Revision proposes to allocate $865,000 to fund a planning grant for the California Leadership Academy and an additional $9 million for reentry programs provided in the community.

Reentry

The May Revision includes total funding of $49 million for reentry programs provided in the community. The mental health population is typically excluded from alternative placements, but is likely the most in need of intensive reentry programming.

The Administration proposes to fund local reentry programs targeting the mental health population who are within six to twelve months of release to facilitate their reentry into the community. The facilities will offer a therapeutic environment and include services such as case management services, employment services, and assistance with securing identification cards, housing, and enrollment in programs such as Medi-Cal and CalWORKs. The facilities will house offenders who will be released to both parole and Post Release Community Supervision and would allow parole agents and probation officers access to this population for the purpose of developing reintegration plans and strategies for continuity of treatment upon release. Finally, it is anticipated that the facilities could also house probationers and parolees who could benefit from these services either through a referral from a probation officer or parole agent or upon order of a court as a remedial sanction.

Federal Court Order Impact on Post Release Community Supervision

The February 10, 2014 federal court order increased credit earnings for non-violent, non-sex second strikers, increasing credits from 20 percent to 33.3 percent. Under 2011 Realignment, inmates with non-violent and non-serious offenses are released onto Post Release Community Supervision under the jurisdiction of counties. While the initial intent was to retain these offenders on parole until they otherwise would have been released, law enforcement concurs that it is in the best interest of public safety for these offenders to be under the supervision of one jurisdiction for the length of their supervision term. The statewide Post Release Community Supervision average daily population impact is estimated to be 216 in 2013-14 and 819 in 2014-15. The May Revision includes $11.3 million to be allocated to county probation departments for the short-term increase of offenders on Post Release Community Supervision.

Additional Population Reduction Strategies

The May Revision includes General Fund expenditures of $3.1 million (a reduction of $2.9 million from the Governor's Budget) to comply with the additional population reduction strategies ordered by the court. The resources will allow the Department to begin expanding medical parole, implementing an elderly parole program, establishing a parole process for non-violent, non-sex second strikers that have served 50 percent of their sentence, and reducing the hearing preparation timeline.

Corrections and Rehabilitation

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

The May Revision includes $9.8 billion ($9.5 billion General Fund and $329.1 million other funds) for CDCR in 2014-15.

Significant Adjustments:

- Adult Population Adjustment—An increase of $5.3 million General Fund in 2013-14 and $4.2 million General Fund in 2014-15 for adult inmate and parole population changes. The revised average daily population projections for adult inmates are 134,215 in the current year and 136,530 in the budget year, a decrease from Governor's Budget estimates of 771 and 1,258 inmates, respectively. The revised average daily parolee population projections are 47,247 in the current year and 41,866 in the budget year, an increase from Governor's Budget estimates of 1,313 and 5,214 parolees, respectively.
- Juvenile Population Adjustment—A decrease of $271,000 General Fund in 2013-14 and an increase of $258,000 General Fund in 2014-15 for juvenile population adjustments. The revised average daily population projections for wards

are 707 in the current year and 656 in the budget year, which is a decrease of 4 wards in the current year and an increase of 11 wards in the budget year compared to January projections.

- California Health Care Facility—An increase of $12.5 million General Fund to address plant operations, food service, and custody staffing needs at the California Health Care Facility (CHCF). The Receiver suspended intake of inmates to the facility at the end of January 2014 due to unanticipated operational issues. The additional resources are intended to remedy these issues and meet licensing standards.

Transportation

The Transportation Agency is responsible for improving the mobility, safety, and sustainability of California's transportation system. The Agency includes the Department of Transportation, the California Transportation Commission, the High-Speed Rail Authority, the Department of Motor Vehicles, the California Highway Patrol, the Board of Pilot Commissioners, and the Office of Traffic Safety.

The May Revision includes total funding of $15.6 billion ($83 million General Fund and $15.5 billion other funds) for all programs administered within the Agency.

Department of Transportation

The Department of Transportation (Caltrans) has almost 20,000 employees and a budget of $11.1 billion. Caltrans designs and oversees the construction of state highways, operates and maintains the highway system, funds three intercity passenger rail routes, and provides funding for local transportation projects. The Department maintains 50,000 road and highway lane miles and nearly 13,000 state bridges, and inspects more than 400 public-use and special-use airports and heliports. The largest sources of funding for transportation projects are excise taxes paid on fuel consumption, federal funds also derived from fuel taxes, and weight fees on trucks.

Significant Adjustment:

- Capital Outlay Support Program — The Department traditionally updates the Capital Outlay Support program based on project allocations by the California Transportation Commission and adjusts support resources needed to proceed with those projects. The program provides the funding and resources necessary to plan, construct, and oversee state highway projects.
  - The May Revision reflects a net reduction of $21.8 million and 195 state positions for engineering, design, and construction oversight activities due to diminishing fund sources, such as Proposition 1B and the federal American Recovery and Reinvestment Act.
  - Contract resources are provided to advance 22 highway projects associated with the one-time funding available due to an early General Fund loan repayment of $340 million proposed in the Governor's Budget.

Emergency Drought Response

The State of California has experienced three consecutive years of below-average rainfall, and is currently facing severe drought conditions in all of the state's 58 counties. The most recent manual survey of the Sierra Nevada snowpack recorded water content at 18 percent of the normal average. Water levels at the state's largest reservoirs, as well as groundwater aquifers, are also dangerously below average. As a result, drinking water supplies are at risk in some communities, agricultural areas face increased unemployment, dry conditions create higher risks for wildfires, and important environmental habitats have been degraded.

On January 17, 2014, the Governor proclaimed a state of emergency and directed state agencies to take all necessary actions to respond to drought conditions. Since the emergency proclamation was issued in January, the state has initiated the following actions.

Task Force

The Governor has formed an interagency Drought Task Force, led by the Office of Emergency Services and comprised of representatives of the Governor's Cabinet and various department directors. The Task Force enables daily coordination on actions to help minimize harm from the drought. In support of this unified effort, all state agencies that participate in drought response and relief efforts are organized under the Incident Command System and will continue to provide emergency planning, response, and mitigation support. As part of this effort, immediate state support is being provided to communities running out of water, community outreach is being made to inquire about other upcoming shortages, and the University of California, Davis has been assisting the Task Force in analyzing the economic impacts of the drought.

Legislation

In February, the Legislature enacted urgency legislation to assist drought-impacted communities and improve the management of local water supplies. The legislation provided $687.4 million to support drought relief, including emergency financial assistance for housing and food for workers directly impacted by the drought, funding to secure emergency drinking water supplies for drought-impacted communities, and funds for projects to help local communities more efficiently capture and manage water.

Highlights of the legislation include:

- $549 million from the accelerated expenditure of voter-approved bonds, Proposition 84 and Proposition 1E, for the Department of Water Resources (DWR) to provide infrastructure grants for local and regional projects. These projects will increase local water supply reliability by recapturing storm water, expanding the use and distribution of recycled water, enhancing the management and recharge of groundwater storage, and strengthening water conservation efforts.
- $30 million Greenhouse Gas Reduction Fund for the DWR to support state and local water use efficiency projects that will save energy and reduce greenhouse gas emissions.
- $25 million General Fund for the Department of Social Services to provide food assistance to those impacted by the drought.
- $21 million special funds and federal funds for the Department of Housing and Community Development for housing-related assistance for individuals impacted by the drought.
- $15 million General Fund for the Department of Public Health to address drought-related drinking water emergencies.
- $13 million General Fund for the California Conservation Corps and local community conservation corps to expand water use efficiency and conservation activities and to reduce fuel loads to prevent catastrophic fires.

- $10 million Greenhouse Gas Reduction Fund for the California Department of Food and Agriculture to invest in irrigation and water pumping systems that reduce water use, energy use, and greenhouse gas emissions.

Expanded Fire Protection

The Governor's emergency proclamation directed the Department of Forestry and Fire Protection (CAL FIRE) to hire additional seasonal firefighters to suppress wildfires and take other needed actions to address elevated fire risk as a result of drought conditions. Between January 1 and May 1, CAL FIRE has responded to over 1,200 wildfires that have burned nearly 2,700 acres. In an average year over the same period, CAL FIRE would typically respond to fewer than 600 wildfires. CAL FIRE's quarterly seasonal outlook predicts above-normal large-fire potential through August. To combat severe fire conditions this spring and through the summer, CAL FIRE has increased its firefighter surge capacity pool to address high-risk areas. Enhancements to CAL FIRE's firefighting capacity are estimated to cost an additional $44 million General Fund (Emergency Fund), and total Emergency Fund expenditures including the drought related costs are expected to increase by $90 million in the current year.

Operations Plan

In April, the DWR, in conjunction with the U.S. Bureau of Reclamation, began implementation of a Drought Operations Plan. The Plan will be implemented in close coordination with the U.S. Fish and Wildlife Service, the National Marine Fisheries Service, the Department of Fish and Wildlife, and the State Water Resources Control Board.

The overall objectives of the Plan are to:

- Closely manage scarce water resources in the coming dry months and into next year.
- Augment water exports from the Delta for storage and use this spring when possible.
- Provide adequate water supplies for drinking water, sanitation, and firefighting.
- Prevent saltwater from intruding into California's water delivery system.
- Provide sufficient water for fish migration and spawning.

- Meet water quality needs for water users located in the Delta by keeping saltwater at bay.

The Drought Operations Plan provides a flexible framework for water management decisions through mid-November 2014 and will be modified as conditions change and new water supply information is available.

Executive Order

In late April, the Governor issued a continued proclamation of drought emergency to enable regulatory streamlining that will allow several urgent actions to be expedited, including voluntary water transfers, emergency drinking water projects, crucial habitat protection measures, and the purchase of essential equipment for fire suppression and drought response.

Additional Proposed Budget Actions

The May Revision includes additional one-time resources for 2014-15 to continue immediate drought-related efforts started in the current year.

Significant Adjustments:

- Department of Forestry and Fire Protection—An increase of $53.8 million General Fund and $12.2 million other funds to expand firefighter surge capacity, retain seasonal firefighters beyond the budgeted fire season, provide additional defensible space inspectors, and enhance air attack capabilities to suppress wildfires. Of these additional resources, $10 million is available to support local grants for fire prevention projects or public education efforts that benefit owners of habitable structures in state responsibility areas.
- Department of Fish and Wildlife—An increase of $30.3 million General Fund and $8.5 million other funds to implement enhanced salmon monitoring, restore sensitive habitat, improve water infrastructure for wildlife refuges, expand the fisheries restoration grant program, and remove barriers for fish passage.
- Department of Water Resources—An increase of $18.1 million General Fund to comprehensively assess current surface and groundwater conditions, expedite water transfers, provide technical guidance to local water agencies, and provide additional public outreach through the Save Our Water campaign.

- Department of Social Services—An increase of $5 million General Fund to provide food assistance for communities most impacted by the drought.
- Office of Emergency Services—An increase of $4.4 million General Fund for the State Operations Center to continue to provide local communities with technical guidance and disaster recovery support related to the drought.
- Department of General Services—An increase of $5.4 million special funds to implement water efficiency and conservation measures in state-owned facilities.
- State Water Resources Control Board—An increase of $4.3 million General Fund to continue enforcement of drought-related water rights and water curtailment actions.

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Natural Resources

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

The May Revision includes total funding of $7.9 billion ($2.2 billion General Fund and $5.7 billion other funds) for all programs included in the Agency.

Department of Water Resources

The Department of Water Resources protects, conserves, develops, and manages California's water. The May Revision includes total funding of $3.3 billion ($121.6 million General Fund and $3.2 billion other funds) to support the Department.

Groundwater Management

The May Revision builds upon the Water Action Plan and actions proposed in the Governor's Budget to better manage groundwater. The Governor's Budget proposed $2.9 million General Fund for the Department of Water Resources to collect and update groundwater data and information, as well as $1.9 million General Fund for the State Water Resources Control Board to act as a backstop when local or regional agencies are unable or unwilling to sustainably manage groundwater basins. Groundwater accounts for more than one-third of the water used by cities and farms and much more in dry years when other sources are reduced. Some of California's groundwater basins are sustainably managed, but many are not. Inconsistent and inadequate tools, resources, and authorities make managing groundwater difficult in California and impede the state's ability to address problems such as overdraft, seawater intrusion, land subsidence, and water quality degradation. Groundwater extraction, in excess of recharge, results in declining groundwater levels, increasing energy demand and pumping costs, and may contribute to stream flow depletion and declining ecosystem conditions. Excessive groundwater pumping can also mobilize toxins and cause irreversible land subsidence, which damages infrastructure and diminishes future aquifer storage capacity. The strategies identified in the Water Action Plan are intended to address these challenges and move California toward more sustainable management of the state's groundwater resources. When properly managed, groundwater resources can provide a reliable and valuable water supply to communities, farms, and the environment.

Significant Adjustments:

- Sustainable Groundwater Management Program—Groundwater resources are most effectively managed at the local and regional level, and the state's role should be to provide guidance, tools, and resources to local and regional entities to assist them in management of local groundwater basins. An increase of $2.5 million General Fund in 2014-15 and $5 million annually for four additional years to support local groundwater management efforts, including:
    - Planning and Oversight—Assess the status of groundwater basins; develop groundwater basin sustainability metrics; track development and implementation of groundwater monitoring programs by local agencies; and review and assess groundwater plans developed by local agencies.
    - Local and Regional Technical Assistance—Offer technical assistance, including guidance and tools for local and regional agencies related to: collecting and reporting local groundwater data, preparing and updating groundwater management plans, assessing the status of local groundwater basins, establishing appropriate and effective groundwater governance, preparing local groundwater basin water budgets to determine sustainable yield, and forming governance structures for managing groundwater basins.

Department of Parks and Recreation

The California Department of Parks and Recreation operates the state's park system to preserve and protect the state's most valued natural, cultural and historical resources.

The May Revision includes total funding of $553.3 million ($115.9 million General Fund and $437.4 million other funds) to support the Department.

Improving the State Park System

The Parks Forward Commission began an assessment in June 2013 of the financial, operational, and cultural challenges facing the state parks system. The Commission released a draft report with preliminary recommendations in April, and the final report will be released in the fall of 2014. The Administration is prepared to establish a team of experts to further develop and lead the Department in implementing organizational reforms. In the meantime, the Department has begun implementing many of the Commission's recommendations described in the recent draft report:

- Increase Number of Cabins in Park System — The Department is working with the Parks Forward Commission to locate new cabins within the state park system. This would increase the number of cabins available in some parks and make cabin camping available for the first time in other parks. Expanding the types of camping opportunities available in the park system should make camping more accessible and appealing to a broader range of people.
- Modernize Fee Collection and Technology in Park System — Currently, visitors must use cash to pay parking and entrance fees in most parks. The Department will modernize the current fee collection system, which would allow visitors to use debit and credit cards. The improved technology would also allow financial information to be communicated electronically from the parks to departmental fiscal systems and to the campground reservation system.
- Enhance Information on Park System — The Department will increase the amount of information available about the state park system. New technology will allow images of parks to be available on the internet. Providing such information would facilitate use of the parks by allowing visitors to view the trails and features in advance of their visit.

Judicial Branch

The Judicial Branch consists of the Supreme Court, courts of appeal, trial courts and the Judicial Council. The trial courts are funded with a combination of resources from the General Fund, county maintenance-of-effort requirements, fees, and other charges. All other portions of the Judicial Branch primarily receive funding from the General Fund.

The May Revision includes total funding of $3.6 billion ($1.3 billion General Fund) for the Judicial Branch.

Trial Courts

Under the Trial Court Funding Act of 1997, the state assumed the cost of funding the trial courts above a county maintenance-of-effort level. The Act acknowledges that trial courts are part of a statewide system that should operate as efficiently as possible, the Administrative Office of the Courts should provide administrative assistance to those courts that need such assistance, and the Judicial Council should act to more equitably distribute funding to further equal access to the judicial system.

A change in the allocation of resources to under-resourced courts has been slower than envisioned in 1997. However, in 2013-14, the Judicial Council took a major step forward in implementing a new workload-based funding model that will result in a more equitable distribution of funds to the trial courts as it is phased in.

All segments of the Judiciary, and particularly the trial courts, have seen significant General Fund decreases over the past few years as has every agency in state government. The Administration has been clear that state-funded entities should not expect restorations of reductions—moving forward, government has to be done differently.

A strong court system is a basic function and service of government. The trial courts have operationalized reductions through the closure of court facilities and courtrooms, furloughs, and layoffs. The Judicial Council has also implemented various outcome measures and efficiencies aimed at improving processes in the trial courts.

The Administration is confident the Chief Justice and Judicial Council will continue to manage the resources of the Judiciary in a manner that promotes efficiency, effectiveness, and access to justice.

Given the expectation of continued limited resources, it is appropriate for the Chief Justice and Judicial Council to make a thorough assessment of the trial courts in terms of additional efficiencies or changes in operations, including how efficiencies can be built into the trial court funding model more quickly, if there are functions that could be administered in a totally different way, or whether courtrooms and courthouses should be reopened with the goal of access to justice in mind.

Given the importance of such a review, the May Revision proposes a two-year strategy to stabilize trial court funding. This proposal increases the $100 million augmentation proposed in the Governor's Budget for trial courts for a total augmentation of $160 million based on a more specific funding methodology.

Significant Adjustments:

- Trial Court Employee Costs—At the time of the Governor's Budget, the Administrative Office of the Courts indicated that the trial courts estimated that $64.8 million would be needed for increased retirement ($39.8 million), retiree health care ($1.9 million), and health care ($23.1 million) costs. The trial courts generally have little control over these costs with one exception—the amount each employee pays toward retirement. The Department of Finance estimates that the trial courts currently spend approximately $22 million covering the current employee share of cost for retirement. The Public Employees' Pension Reform Act (PEPRA) sets a standard that requires equal sharing of normal pension costs for all employees. The May Revision proposes to reduce the trial court request for pension costs by the estimated amount spent by trial courts on employee contributions with the understanding that trial courts have three years to meet the PEPRA standard. Consequently, the May Revision proposes a total of $42.8 million for these trial court employee benefit costs. Assuming progress towards meeting the PEPRA standard, the Administration is committed to funding future increases related to existing health benefits and retirement costs for trial court employees and retirees one year in arrears.

- Trial Court Funding—To meet court workload obligations, the May Revision proposes $86.3 million—an amount equal to 5 percent of the trial court support appropriation (Program 45.10-Support for Operation of the Trial Courts). The Administration intends to propose an additional 5-percent increase in the 2015-16 Governor's Budget.
- Trial Court Trust Fund Revenues—As the General Fund contribution to the trial courts has decreased, fee revenue going to the trial courts have been increased. However, there is a projected shortfall in two types of fee revenue. The first is court-specific fees charged for a service, such as copying, which are allocated back to the court that collected them. These revenues are not a part of a court's allocation from the Trial Court Trust Fund, and these locally based charges should not be backfilled by the state. The second type is those fees which make up a significant amount of base trial court funding. The Department of Finance estimates this revenue shortfall could be up to $30.9 million. The May Revision proposes to provide this amount of General Fund revenues to backfill the potential fee revenue loss. These dollars will be allocated after the 2015 May Revision when there is an updated estimate of fee revenue.

This two-year funding approach will provide the trial courts with stable funding and sufficient time to carefully evaluate and pursue workload process changes and efficiencies that will modernize court operations and improve access to justice.

The May Revision also includes $2.1 million General Fund and $152,000 other funds to address increased rent costs for the Supreme Court, Courts of Appeal, and the Administrative Office of the Courts.

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Labor and Workforce Development

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

The May Revision includes total funding of $14.7 billion ($303.1 million General Fund and $14.4 billion other funds) for all programs administered within the Agency.

Employment Development Department

The Employment Development Department (EDD) administers the Unemployment Insurance (UI), Disability Insurance (DI), and Paid Family Leave programs and collects payroll taxes from employers, including the Personal Income Tax. EDD connects job seekers with employers through a variety of job services programs and America's Job Centers of California and provides employment training programs through the Employment Training Panel and the Workforce Investment Act programs.

The May Revision includes $14.1 billion ($287.5 million General Fund), which reflects an increase of $271.2 million compared to the Governor's Budget. This change is primarily due to a $215.1 million increase in UI benefit payments, a $13.1 million decrease in interest owed on the federal UI loan, and a $67.6 million increase in resources to administer the UI Program.

Significant Adjustments:

- Revised UI Benefit Payments—A decrease of $660.5 million in 2013-14 to reflect a projected decrease in UI benefit payments due to a lower-than-anticipated unemployment rate and the discontinuation of the federal benefits extension program in December 2013. While the May Revision continues to reflect a lower unemployment rate in 2014-15, the revised estimate of UI benefit payments is $215.1 million higher than the Governor's Budget forecast, due in part to a longer duration of claims.
- UI Program Administration Funding—An increase of $67.6 million, including $46.6 million General Fund, to provide additional resources for the administration of the UI Program. The Governor's Budget proposed a $64 million package of efficiencies and supplemental funding, but the UI Program continued to receive a greater demand for services than anticipated. In February 2014, the Secretary for Labor and Workforce Development outlined a plan for additional resources in the current year to take immediate action to improve customer service. While UI service levels have significantly improved as a result of those efforts, additional resources are needed in 2014-15 to sustain that level of service and provide timely unemployment benefits. The May Revision proposes additional staff and overtime funding to support the following service levels:
  - Process all claims for unemployment benefits within three days of receipt.
  - Respond to online inquiries within five days of receipt.
  - Schedule 95 percent of eligibility determinations in a timely manner.
  - Respond to 50,000 calls per week.

  These resources, along with program efficiencies and an improving economy, will eliminate the backlog of claims and are expected to address the operating concerns of the program.

Local Government

This part of the Budget includes information related to local governments.

Redevelopment Agencies

The winding down of the state's former redevelopment agencies (RDAs) continues to be a priority for the Administration. Chapter 5, Statutes of 2011 (ABx1 26), eliminated the state's approximately 400 RDAs and replaced them with locally organized successor agencies that are tasked with retiring the former RDAs' outstanding debts and other legal obligations. The elimination of RDAs allows local governments to protect core public services by returning property tax money to cities, counties, special districts, and K-14 schools.

In 2011-12 and 2012-13 combined, approximately $620 million was returned to cities, $875 million to counties, and $310 million to special districts. The May Revision estimates that cities will receive an additional $541 million in general purpose revenues in 2013-14 and 2014-15 combined, with counties receiving $662 million and special districts $209 million. It is estimated that additional ongoing property tax revenues of more than $700 million annually will be distributed to cities, counties, and special districts by 2016-17.

In 2011-12 and 2012-13 combined, approximately $2.2 billion was returned to K-14 schools. The May Revision estimates that Proposition 98 General Fund savings resulting from the dissolution of RDAs will be $1.1 billion in 2013-14. For 2014-15, Proposition 98 General Fund savings are estimated to be $811 million. On an ongoing basis, Proposition 98 General Fund savings are estimated to be $1 billion by 2016-17. When Test 1 of the Proposition 98 calculation is operative, funds above this amount will increase available resources for K-14 schools.

Tools For Local Economic Development

The elimination of RDAs returns over $1 billion annually to core public services. Since compliance levels with the RDA dissolution statutes are improving, the Governor's Budget proposed expanding the tax increment financing tool utilized by Infrastructure Financing Districts (IFDs) for a broader array of uses than are authorized under current law.

Specifically, the Governor's Budget included legislation that would provide greater flexibility to IFDs for cities and counties that have: (1) received a Finding of Completion, demonstrating they have remitted all unencumbered cash assets of their former RDAs to the affected taxing entities; (2) complied with all State Controller's Office RDA-related audit findings; and (3) concluded all outstanding legal issues concerning their former RDA with the state. These changes include:

- Expanding the types of projects that IFDs can fund to include military base reuse, urban infill, transit priority projects, affordable housing, and associated necessary consumer services. The goal is to maintain the IFD focus on projects which have tangible quality-of-life benefits for the residents of the IFD project area.
- Allowing cities or counties that meet specified benchmarks to create these new IFDs, and to issue related debt, subject to receiving 55-percent voter approval.
- Allowing new IFD project areas to overlap with the project areas of the former RDAs, while strictly limiting the available funding in those areas to dollars available after payment on all of the former RDA's approved obligations.
- Maintaining the current IFD prohibition on the diversion of property tax revenues from K-14 schools, which will ensure any usage will have no state General Fund impact, and require entities that seek to establish an IFD to gain the approval of the county, cities, and special districts that would contribute their revenue, including residual revenue, to the IFD.

Based on feedback received since the Governor's Budget, the May Revision proposes the following changes to the Administration's IFD proposal:

- Establishes Enhanced IFDs as a stand-alone provision in statute. This will allow cities and counties that have not resolved their outstanding RDA-related issues to participate in the current IFD program, which will continue in existence without modification.
- Clarifies that monies received by cities and counties pursuant to the Vehicle License Fee Swap may be securitized to fund Enhanced IFD projects.
- Clarifies that entities participating in an Enhanced IFD may seek voter approval, pursuant to existing statutory and constitutional requirements, to levy new fees or assessments to support projects identified in an Enhanced IFD project plan.
- Establishes affordable housing projects as projects of community-wide significance that an Enhanced IFD may fund.
- Clarifies that Enhanced IFDs must replace any low- or moderate-income housing that is removed as part of a project plan, as is required under current IFD law.
- Specifies that any affordable housing created or replaced as part of an Enhanced IFD project plan must include long-term affordability covenants of 55 years for rental units and 45 years for owner-occupied units.

State-County Assessors' Partnership Agreement Program

County assessors are responsible for assessing real and qualifying personal property for property tax purposes, and for maintaining and updating property tax rolls. An effective assessment system benefits the public, local governments, and the state.

The Governor's Budget proposed a State-County Assessors' Partnership Agreement Program to enhance local property assessment efforts. The Program would replace a similar statewide program that was eliminated in 2005-06 as a budget savings measure. The new program would begin on a three-year pilot basis, to be funded at $7.5 million per year and administered by the Department of Finance. The program will be limited to nine county assessors' offices that will be competitively selected from a mix of urban, suburban, and rural counties.

The May Revision proposes the following changes to the State-County Assessors' Partnership Agreement Program:

- Clarifies program funds may be used to assess and reassess business personal property as well as real property.
- Provides more flexibility in the distribution of grant funds to enable, for example, funds that are not claimed by assessors' offices in larger counties to be used to fund the participation of additional assessors' offices in smaller counties.
- Allows program funds to be used for information technology systems that can assist assessors' offices in reassessing property to its appropriate value.

State Mandate Reimbursements

The Commission on State Mandates is a quasi-judicial body that hears test claims to determine whether local agencies and school districts are entitled to reimbursement for costs related to new or higher levels of service mandated by the state. The Constitution was amended in 2004 to require the Legislature to either fund or suspend specified mandates in the annual Budget Act. The state owes counties, cities, and special districts $900 million in mandate reimbursements for costs incurred prior to 2004 that must be repaid under current law by 2020-21. Annual payments on this debt have been postponed in recent years.

To accelerate the repayment of this liability, the May Revision proposes a $100 million payment to local governments for the pre-2004 mandate debt. Approximately 73 percent of the payment will go to counties, 25 percent to cities, and 2 percent to special districts. A local agency will receive a portion of this payment based on the proportion of total pre-2004 mandate debt owed to that local agency. The monies paid would be general purpose and available to fund the highest priority core local government services. The Administration expects that most of the spending will be focused on improving implementation of 2011 Realignment and public safety.

Statewide Issues and Various Departments

This Chapter describes items in the Budget related to statewide issues and various departments.

Employee Compensation

The Governor's Budget assumed salary increases for 13 of the state's collective bargaining units based on agreements reached in the summer of 2013. These salary increases were tied to the concept of a revenue-based "trigger," provided the Director of Finance makes the determination that revenues at the 2014-15 May Revision are sufficient to fully fund existing statutory and constitutional obligations, existing fiscal policy, and the cost of the trigger-based salary increases. The Governor's Budget included $173.1 million ($82.4 million General Fund) to fund these increases.

The Director of Finance has determined that revenues will meet the criteria listed above. Therefore, the May Revision proposes an additional $9 million ($6.8 million General Fund) for updated salary information for these bargaining units and an additional $1.6 million ($1.1 million General Fund) to include a "trigger" increase recently negotiated with the International Union of Operating Engineers (Bargaining Unit 13). This brings the total funding to $183.7 million ($90.3 million General Fund).

State Employees' Retirement

The May Revision reflects an increase to state retirement contributions of $576.7 million ($342.7 million General Fund) for 2014-15. Of this incremental increase, $65.1 million General Fund is projected for California State University. The projected increase in state retirement contributions are due to the following:

- On February 20, 2014, the CalPERS Board of Administration adopted new assumptions as part of a regular review of demographic trends. Key assumption changes included longer post-retirement life expectancy, earlier retirement ages, and higher-than-expected wage growth for State Peace Officers/Firefighters and California Highway Patrol. The impact of the assumption changes will be phased in over three years, with a 20-year amortization, beginning in 2014-15. This action accounts for $430.1 million ($254.2 million General Fund) of the total increase.
- Retirement rates are higher than originally projected in the Governor's Budget because of normal changes due to differences in actual versus projected employer contributions, payroll growth, retirement dates, and benefit payments. Of the total increases indicated above, these factors account for $146.6 million ($88.5 million General Fund) additional costs.

Figure VAR-01 provides a historical overview of the contributions to CalPERS, the California State Teachers' Retirement System (CalSTRS), the Judges' Retirement System (JRS), the Judges' Retirement System II (JRS II), and the Legislators' Retirement System (LRS) for pension and retiree health care benefits.

Teachers' Retirement System

In its 101-year history, contributions to CalSTRS have rarely aligned with investment income to meet the promises owed to retired teachers, community college instructors, and school administrators. The 2012 pension reform law lowered long-term costs at CalSTRS by reducing benefit levels and extending retirement ages for new teachers. Even with those changes, and despite recent investment success, the viability of CalSTRS ultimately requires significant new money on an annual basis. If the shortfall worsens, the long-term threat to school finances, other budget priorities, and teacher retirement security will continue to multiply.

The Governor's Budget called for the Administration to begin working with stakeholders on a new funding strategy for CalSTRS. In recognition of the critical need to address this

Figure VAR-01

State Retirement Contributions*

(Dollars in Millions)

	CalPERS[1]	CSU CalPERS	Retiree Health & Dental	CSU Retiree Health	CalSTRS	JRS	JRS II	LRS
2005-06	$2,403		$887		$1,081	$121	$24	$0
2006-07	2,765		1,006		959	129	27	0
2007-08	2,999		1,114		1,623 [2]	162	37	0
2008-09	3,063		1,183		1,133	189	40	0
2009-10	2,861		1,182		1,191	184	32	0
2010-11	3,230		1,387		1,200	166	54	0
2011-12	3,174		1,505		1,259	195	58	0
2012-13	2,948 [3]	449 [3]	1,365 [3]	222 [3]	1,303	160	51	0
2013-14[4]	3,219	474	1,420	246	1,360	188	52	1
2014-15[4]	4,042	543	1,559	270	1,500	179	56	1

1/ In addition to the Executive Branch, this includes Judicial and Legislative Branch employees. Contributions for judges and elected officials are included in Judges' Retirement System (JRS), Judges' Retirement System II (JRS II), and Legislators' Retirement System (LRS).

2/ Includes repayment of $500 million from 2003-04 Supplemental Benefit Maintenance Account withholding/lawsuit loss (interest payments not included).

3/ Beginning in 2012-13, CSU pension and health care costs are displayed separately.

4/ Estimated as of the 2014-15 May Revision. 2014-15 General Fund costs are $2,120 million for CalPERS, $543 million for CSU CalPERS, $1,553 million for Retiree Health & Dental, and $177 million for JRS. The remaining totals are all General Fund.

* The chart does not include contributions for University of California pension, retiree health, and retiree dental costs or CSU retiree dental costs.

issue, the May Revision includes a comprehensive funding solution to close the CalSTRS shortfall—now estimated at $74.4 billion.

The Administration's proposal—built on shared responsibility among the state, school districts, and teachers—will put CalSTRS on a sustainable path and eliminate the unfunded liability by 2045-46. The funding plan will start modestly in 2014-15, to provide teachers, school employers, and the state sufficient time to prepare for significant, future budget costs. After the state's contribution is fully phased in over three years, the plan will eliminate the unfunded liability in 30 years. The May Revision includes about $450 million ($73.2 million General Fund) in additional funding in 2014-15 for the funding plan.

Under the funding plan, teacher contributions will increase from 8 percent to a total of 10.25 percent of pay, phased in over the next three years. School contributions will increase from 8.25 percent to a total of 19.1 percent of payroll, phased in over the next seven years. These school contributions will be paid from existing revenue sources.

The state's total contribution to the Defined Benefit plan will increase from approximately 3 percent in 2013-14 to 6.3 percent of payroll in 2016-17 and ongoing. In addition, the state will continue to pay 2.5 percent of payroll annually for a supplemental inflation protection program—for a total of 8.8 percent. The state's share reflects the shortfall that would exist had benefits or contributions not changed after 1990. The Administration proposes increasing the state's contribution to meet its commitment to liabilities based on the 1990 benefit level. The 1990 funding plan was the first time CalSTRS had a long-term sustainable funding plan in place. In 1998, as the pension fund approached a surplus, the Legislature increased retirement benefits and restructured the state's contribution. Additional benefit and contribution changes were later made. Pursuant to Education Code 22955, the state is not responsible for unfunded liabilities based on those changes. However, state funding to support the pre-1990 benefit structure remains insufficient.

Department of Human Resources

The Department of Human Resources (CalHR) is responsible for managing the state's personnel functions and represents the Governor as the "employer" in all matters concerning state employer-employee relations. CalHR is responsible for issues related to recruitment, selection, salaries, benefits, and position classification, and provides a variety of training and consultation services to state departments and local agencies.

Significant Adjustment:

- In-Home Supportive Services (IHSS) Employer-Employee Relations Act—The May Revision includes five positions and $848,000 ($424,000 General Fund) in 2014-15 to provide additional resources for labor relations. Pursuant to Chapter 45, Statutes of 2012 (SB 1036), CalHR will represent the statewide authority on all aspects of labor relations for the IHSS Employer-Employee Relations Act. Positions will become effective over time to align bargaining obligations to when counties are expected to fully implement the Coordinated Care Initiative. This will result in nine ongoing positions starting in 2015-16.

State Controller

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

Significant Adjustment:

- 21^{st} Century Project: Independent Assessment — The May Revision provides $2.5 million General Fund and one position on a one-year basis for the State Controller's Office to contract with Department of Technology to oversee an independent assessment of the 21^{st} Century Project.

Debt Service

Current Year Debt Service — General Fund debt service expenditures will decrease by a net of $112.7 million as compared to the Governor's Budget, for a total of $5.4 billion. This reflects reduced General Obligation debt service costs ($4.8 billion total) and no change for lease revenue bond debt service costs ($575.8 million total). The net decrease in General Obligation debt service is primarily related to: (1) increased savings in the form of investor premiums received from the spring 2014 bond sales, (2) savings related to bond refinancings, and (3) reduced variable interest rates and fees.

Budget Year Debt Service — General Fund debt service expenditures will decrease by $81.6 million as compared to the Governor's Budget, to a total of $5.8 billion. This adjustment reflects reduced General Obligation debt service costs ($5.2 billion total) and no change for lease revenue bond debt service costs ($609.9 million total). The net decrease in General Obligation debt service is primarily attributable to: (1) a smaller spring 2014 bond sale than projected, (2) lower variable interest rates and fees, and (3) savings related to bond refinancings this spring. The decrease in the size of the spring 2014 bond sale was accomplished by using existing bond cash and the commercial paper program more efficiently. The Department of Finance continues to work with departments to manage bond cash and ensure bonds are issued only when necessary.

Department of Technology

The Department of Technology is the central information technology (IT) organization for California. It is responsible for the approval and oversight of all statewide IT projects; provides centralized IT services and training to government entities;

promulgates statewide IT security policies and procedures; and has responsibility over telecommunication and IT procurements.

Significant adjustments are as follows:

- Statewide Project Management Office—The May Revision includes two positions and $208,000 General Fund in 2014-15, and $304,000 General Fund in 2015-16 to establish the Statewide Project Management Office (PMO). These positions will establish the PMO management team that will be responsible for developing the framework for the office which will ultimately consist of experienced project managers who will manage information technology projects across the state.

State Appropriations Limit Calculation

2014-15 State Appropriations Limit (SAL) Calculation—Pursuant to Article XIIIB of the California Constitution, the 2014-15 SAL is estimated to be $89.902 billion. This amount is used for various calculations related to state budgeting. The revised limit is the result of applying the growth factor of 0.48 percent. The revised 2014-15 limit is $564 million below the $90.5 billion estimated in January. This decrease is due to changes in the following factors:

- Per Capita Personal Income
  - January Percentage Growth: 0.26%
  - May Revision Percentage Growth: -0.23%
- State Civilian Population
  - January Percentage Growth: 0.89%
  - May Revision Percentage Growth: 0.95%
- K-14 Average Daily Attendance
  - January Percentage Growth: 0.38%
  - May Revision Percentage Growth: 0.40%

Economic Outlook

Jobs are being added and the unemployment rate is falling gradually for the nation and California. However, the economy continues to grow at a slow pace. The outlook assumes that global growth remains slow despite a few near-term risks.

The Nation – Steady Growth

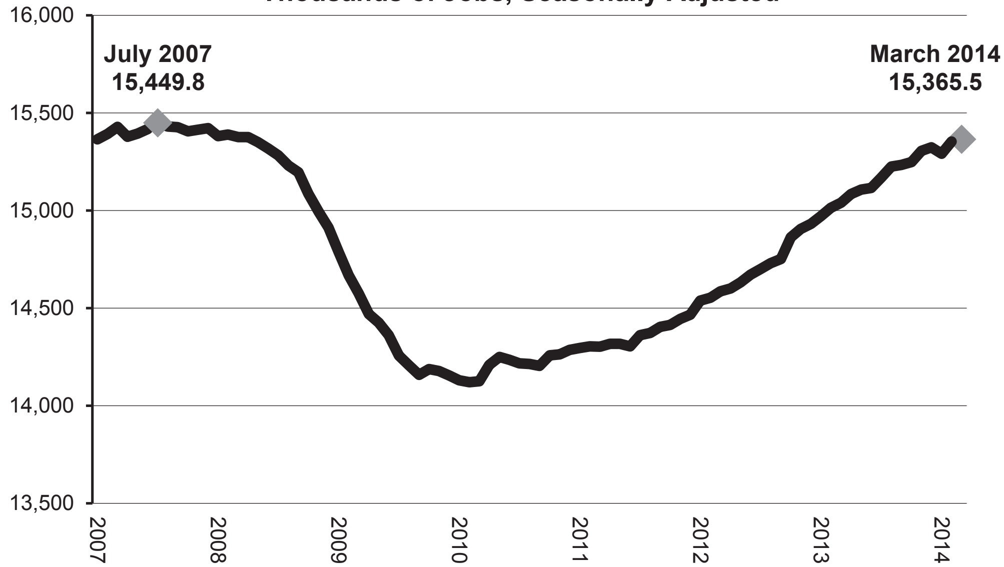
Consumer confidence is leading to improving growth, with unemployment falling, jobs being added, and personal income growth in 2013 closing out the year slightly stronger than expected. Overall, real gross domestic product (GDP) growth in 2014 is expected to be 2.4 percent, and is expected to increase further to 3 percent in 2015.

Real GDP growth is being supported by increasing consumption as people return to work. The national unemployment rate fell to 6.3 percent in April 2014—the lowest level since September 2008. Jobs are being added, although there continue to be low rates of participation in the labor force and high numbers of people in part-time work.

California – Continuing Slow Recovery

California's unemployment rate remained at 8.1 percent for the first three months of 2014, and is expected to fall gradually over the forecast period, reaching 7.2 percent by the end of 2014 and 6.7 percent by the end of 2015. Job growth has been relatively robust with higher growth in lower-wage occupations. A technical revision to the job series, making it more consistent with national statistics, provides a more complete picture of the job recovery. California has now recovered nearly all of the jobs lost during the recession, as shown in Figure ECO-01.

Figure ECO-01
California Nonfarm Payroll Employment
Thousands of Jobs, Seasonally Adjusted



Source: CA Employment Development Department
Labor Market Information Division

The supply of homes for sale remains low, and home prices continue to increase. Housing permits are growing slowly. During the recovery, permits have been mostly for multi-family structures, which are generally apartments and condominiums sold at a lower cost than single-family homes.

The California drought will likely affect the agricultural sector, with the impact on the wider California economy offset by growth in other sectors. Those areas where agriculture is a larger share of the local economy are likely to see more pronounced effects.

Risks to the Forecast

There are few near-term risks to the outlook. However, if tensions between Russia and Ukraine disrupt markets, energy prices could rise faster than forecast. Another risk is that the very slow pace of the recovery and growing income inequality could slow consumption growth. This could mute overall growth and make it harder for people to save and invest. As noted in the Governor's Budget forecast, economic expansions do not last indefinitely. In the post-war period, the average expansion length is almost five years. Although there are few signs of inflation or tight supply conditions that would trigger a contraction, the U.S. is already five years into its current expansion.

See Figure ECO-02 for highlights of the national and California forecasts.

Figure ECO-02

Selected Economic Indicators

United States	2009	2010	2011	2012	2013	2014 Projected	2015 Projected
Nominal gross domestic product, $ billions	$ 14,418	$ 14,958	$ 15,534	$ 16,245	$ 16,800	$ 17,511	$ 18,352
Real gross domestic product, percent change	-2.8%	2.5%	1.8%	2.8%	1.9%	2.4%	3.0%
Contributions to real GDP growth							
Personal consumption expenditures	-1.1%	1.3%	1.7%	1.5%	1.4%	1.7%	2.0%
Gross private domestic investment	-3.5%	1.7%	0.7%	1.4%	0.8%	0.8%	1.4%
Net exports	1.1%	-0.5%	0.1%	0.1%	0.1%	0.0%	-0.5%
Government purchases of goods and services	0.6%	0.0%	-0.7%	-0.2%	-0.4%	-0.1%	0.1%
Personal income, $ billions	$ 12,082	$ 12,435	$ 13,191	$ 13,744	$ 14,135	$ 14,650	$ 15,403
Corporate profits, percent change	8.4%	25.0%	7.9%	7.0%	4.6%	8.9%	4.4%
Housing permits, thousands	583	605	624	830	976	--	--
Housing starts, thousands	554	586	612	783	929	1,045	1,389
Median sales price of existing homes	$ 172,100	$ 173,100	$ 166,200	$ 177,200	$ 197,400	--	--
Federal funds rate, percent	0.2%	0.2%	0.1%	0.1%	0.1%	0.1%	0.4%
Consumer price index, percent change	-0.4%	1.6%	3.2%	2.1%	1.5%	1.7%	2.1%
Unemployment rate, percent	9.3%	9.6%	8.9%	8.1%	7.4%	6.5%	6.1%
Civilian labor force, millions	154.2	153.9	153.6	155.0	155.4	155.9	158.5
Nonfarm employment, millions	131.2	130.3	131.8	134.1	136.4	138.5	141.1
California							
Personal income, $ billions	$ 1,536	$ 1,579	$ 1,683	$ 1,768	$ 1,817	$ 1,901	$ 1,997
Made-in-California exports, percent change	-17.1%	19.3%	11.1%	1.7%	3.9%	--	--
Housing permits, thousands	36	44	47	58	84	106	123
Housing unit change, thousands	70	36	36	45	59	--	--
Median sales price of existing homes	$ 274,960	$ 305,010	$ 286,040	$ 319,310	$ 407,180	--	--
Consumer price index, percent change	-0.3%	1.3%	2.6%	2.2%	1.5%	1.9%	2.1%
Unemployment rate, percent	11.4%	12.3%	11.8%	10.4%	8.9%	7.6%	6.9%
Civilian labor force, millions	18.2	18.3	18.4	18.5	18.6	18.7	18.9
Nonfarm employment, millions	14.4	14.2	14.4	14.7	15.1	15.5	15.9
Percent of total nonfarm employment							
Mining and logging	0.2%	0.2%	0.2%	0.2%	0.2%	0.2%	0.2%
Construction	4.3%	3.9%	3.9%	4.0%	4.2%	4.3%	4.3%
Manufacturing	8.9%	8.7%	8.7%	8.5%	8.3%	8.1%	8.1%
High technology	2.4%	2.4%	2.4%	2.3%	2.2%	2.2%	2.2%
Trade, transportation, and utilities	18.4%	18.5%	18.7%	18.6%	18.5%	18.4%	18.3%
Information	3.1%	3.0%	3.0%	3.0%	2.9%	2.9%	2.8%
Financial activities	5.4%	5.3%	5.3%	5.3%	5.2%	5.1%	5.1%
Professional and business services	14.3%	14.6%	14.8%	15.2%	15.4%	15.6%	15.8%
High technology	2.2%	2.2%	2.3%	2.4%	2.4%	2.5%	2.6%
Educational and health services	14.2%	14.5%	14.5%	14.8%	15.2%	15.3%	15.4%
Leisure and hospitality	10.5%	10.6%	10.7%	10.9%	11.0%	11.2%	11.4%
Other services	3.4%	3.4%	3.4%	3.4%	3.4%	3.4%	3.4%
Government	17.2%	17.2%	16.7%	16.2%	15.7%	15.4%	15.2%

Forecast based on data available as of April 2014.
Percent changes calculated from unrounded data.

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Revenue Estimates

General Fund revenues under the May Revision forecast will be higher than at the Governor's Budget by $2 billion in 2013-14 and $856 million in 2014-15. These gains are partially offset by a $513 million downward adjustment to 2012-13 revenues. Figure REV-01 compares the revenue forecasts, by source, in the Governor's Budget and the May Revision. Total May Revision revenue is projected to be $102.2 billion in 2013-14 and $107 billion in 2014-15.

The economic forecast has not changed significantly since the Governor's Budget. As such, the majority of the changes to the forecast reflect current data on cash receipts as well as new tax return data. Cash trends since January have been generally positive. On net, cash tax receipts are up about $1.9 billion over forecast through the end of April. Although still preliminary, cash data through April suggest that personal income tax (PIT) receipts are up about $1.4 billion, corporation tax receipts are up almost $600 million, and sales and use tax (sales tax) receipts are down $190 million.

A cash surplus or shortfall can have different effects on the revenue forecast for all three open revenue years, depending on the source of the cash and other factors such as accruals.

- Personal Income Tax—The cash surplus in PIT is mostly due to withholding in early 2014, and has been realized in months that are usually associated with high levels of withholding for annual bonus payments. Given the timing of the increased withholding and minimal changes forecast for wage growth—up 0.1 percent for

Figure REV-01

2014-15 May Revision
General Fund Revenue Forecast
Baseline

(Dollars in Millions)

Source	Governor's Budget	May Revision	Change	
Fiscal 12-13				
Personal Income Tax	$65,332	$64,484	-$849	-1.3%
Sales & Use Tax	20,482	20,482	$0	0.0%
Corporation Tax	7,462	7,783	$321	4.3%
Insurance Tax	2,221	2,221	$0	0.0%
Vehicle License Fees	7	7	$0	0.0%
Alcoholic Beverage	357	357	$0	0.0%
Cigarette	90	90	$0	0.0%
Other Revenues	2,150	2,165	$14	0.7%
Transfers	1,813	1,813	$0	0.0%
Total	**$99,915**	**$99,402**	**-$513**	-0.5%
Fiscal 13-14				
Personal Income Tax	$64,287	$66,522	$2,235	3.5%
Sales & Use Tax	22,920	22,759	-$161	-0.7%
Corporation Tax	7,971	8,107	$136	1.7%
Insurance Tax	2,143	2,287	$144	6.7%
Alcoholic Beverage	350	351	$1	0.3%
Cigarette	89	86	-$3	-3.4%
Other Revenues	2,041	1,726	-$315	-15.4%
Transfers	346	347	$0	0.1%
Total	**$100,147**	**$102,185**	**$2,038**	2.0%
Change from Fiscal 12-13	$233	$2,784		
% Change from Fiscal 12-13	0.2%	2.8%		
Fiscal 14-15				
Personal Income Tax	$69,764	$70,238	$474	0.7%
Sales & Use Tax	24,071	23,823	-$248	-1.0%
Corporation Tax	8,682	8,910	$228	2.6%
Insurance Tax	2,297	2,382	$85	3.7%
Alcoholic Beverage	357	359	$2	0.6%
Cigarette	86	84	-$2	-2.9%
Other Revenues	1,602	1,957	$355	22.2%
Transfers	-765	-803	-$38	5.0%
Subtotal	**$106,095**	**$106,951**	**$856**	0.8%
Change from Fiscal 13-14	$5,947	$4,765		
% Change from Fiscal 13-14	5.9%	4.7%		
BSA Transfer	-$1,591	-$1,604		
Total	**$104,504**	**$105,346**	**$843**	
Three-Year Total (including BSA transfer)			**$2,368**	

Note: Numbers may not add due to rounding.

2014 and down 0.7 percent for 2015—the higher PIT receipts so far this year are not expected to translate into significant increases in PIT revenue for the remainder of 2013-14 or 2014-15.

- Corporation Tax—Although corporation tax cash is up almost $600 million through April, the 2013-14 revenue forecast increases only $136 million. Much of the strength in corporation tax cash is related to the timing of refunds. Refunds are down by almost $400 million through April and the Franchise Tax Board expects a large amount of refunds to be paid out through the end of June.
- Sales Tax—Cash from the sales tax is lower than the January projection and this reduces revenues through 2014-15.

Long-Term Forecast

The May Revision economic forecast reflects slow growth over the next five years. The projected average growth rate in U.S. real gross domestic product over the next five years is 2.9 percent.

Figure REV-02 shows the forecast for the largest three General Fund revenues from 2012-13 through 2017-18. Total General Fund revenue from these sources is expected to grow from $92.7 billion in 2012-13 to $119.1 billion in 2017-18. The average year-over-year growth rate over this period is 5.1 percent.

Figure REV-02

Long-Term Revenue Forecast - Three Largest Sources

(General Fund Revenue - Dollars in Billions)

	2012-13	2013-14	2014-15	2015-16	2016-17	2017-18	Average Year-Over-Year Growth
Personal Income Tax	$64.5	$66.5	$70.2	$74.4	$78.1	$82.0	4.9%
Sales and Use Tax	$20.5	$22.8	$23.8	$25.7	$26.3	$26.8	5.6%
Corporation Tax	$7.8	$8.1	$8.9	$9.6	$10.0	$10.3	5.8%
Total	**$92.7**	**$97.4**	**$103.0**	**$109.8**	**$114.4**	**$119.1**	5.1%
Growth	15.7%	5.0%	5.7%	6.6%	4.2%	4.1%	

Note: Numbers may not add due to rounding.

Personal Income Tax

Compared to the Governor's Budget, the PIT forecast is lower by $849 million in 2012-13 and higher by $2.2 billion in 2013-14 and $474 million in 2014-15. Over the three-year period, the PIT forecast reflects a total increase of $1.9 billion.

The PIT forecast reflects an increase in withholding receipts, which has largely been realized in higher monthly cash through April. Tax agency data from Franchise Tax Board shows that 2012 wage income was about 1 percent above the Governor's Budget, which increases the forecast for withholding in subsequent years. However, the higher withholding seen early this year tied to bonuses is not expected to continue at the same rate for the remainder of the year.

Based on 2012 tax return data, net partnership income was up by 28 percent and dividend income was up by 39 percent. The forecast assumes that these unusually high growth rates were in part due to shifting income from 2013 to 2012 due to federal tax law changes. As a result, only a portion of the increase in partnership and dividend income is carried forward to subsequent years.

Capital gains realizations were reduced slightly in 2013 and 2014 primarily due to new data showing lower capital gains realizations in 2012. Specifically, capital gains income was revised down from $87 billion to $80 billion in 2013 and from $108 billion to $105 billion in 2014. Actual capital gains income in 2012 was $100 billion compared to the $104 billion forecast in January.

The PIT forecast includes Proposition 30 revenues, which are estimated at $5.4 billion in 2012-13, $5.7 billion in 2013-14, and $6 billion in 2014-15.

Sales and Use Tax

The sales tax forecast reflects a decrease of $161 million in 2013-14 and $248 million in 2014-15. This includes Proposition 30 revenues totaling $1.4 billion in 2013-14 and $1.4 billion in 2014-15.

The decline in the sales tax forecast is attributed to lower-than-estimated cash receipts through March.

Corporation Tax

The corporation tax forecast reflects an increase of $321 million in 2012-13, $136 million in 2013-14, and $228 million in 2014-15. This includes Proposition 39 revenues totaling $293 million in 2012-13, $613 million in 2013-14, and $705 million in 2014-15.

Compared to the Governor's Budget, the revenue increase in 2012-13 and 2013-14 can mainly be attributed to lower refunds and higher cash receipts through April 2014.

Insurance Tax

The insurance tax forecast reflects an increase of $144 million in 2013-14 and $85 million in 2014-15. The revenue changes are primarily due to the updated refunds estimate pursuant to a Board of Equalization decision in the *California Automobile Insurance Company* case.

Property Tax

The property tax forecast is essentially flat compared to the Governor's Budget. The May Revision estimates that the revenue growth is projected to decrease slightly in 2013-14 to 4.05 percent from 4.2 percent and to increase to 7.02 percent from 6.32 percent in 2014-15. The base 1-percent rate is expected to generate approximately $55.5 billion in 2014-15, of which roughly half ($30 billion) will go to K-14 schools. The $30 billion figure does not include additional property tax revenue that schools are expected to receive in 2014-15 from the dissolution of redevelopment agencies.

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