2010-11 State Budget
Week of August 2, 2010

August 5, 2010

TO: CSAC Board of Directors
County Administrative Officers
CSAC Corporate Associates

FROM: Paul McIntosh, CSAC Executive Director
Jim Wiltshire, CSAC Deputy Executive Director
Jean Kinney Hurst, Legislative Representative

RE: **Budget Action Bulletin #5**

On Tuesday afternoon, Assembly Speaker John Pérez and Senate President pro Tempore Darrell Steinberg jointly announced the newly revised "California Jobs Budget," representing a joint budget package that reflects the Speaker's focus on saving jobs and the Pro Tem's interest in restructuring the provision and funding of state services. The package includes a mix of cuts, new revenues, restructuring, tax reductions, and reforms that was adopted by the Budget Conference Committee and could be taken up for a vote as early as next week.

Counties interested in the details of the proposal can visit Senator Steinberg's website for the press release and accompanying materials.

Response to the plan was, as expected, mixed, with the Governor's office calling it "dead on arrival" and legislative Republicans panning the package for its tax provisions. "This is not a productive proposal to get us closer to a budget resolution," Senate GOP Leader Dennis Hollingsworth told reporters.

As for the Multi-Year Government Restructuring Proposal offered by the Senate Democrats in mid-June, all programs proposed for realignment — except for the corrections components, described in more detail in the Administration of Justice section below — have been eliminated from the new budget construct unveiled by the Senate and Assembly Democrats yesterday. (Programs no longer proposed for realignment include: several alcohol and drug treatment programs, changes to cost-

sharing ratios for various CalWORKs program components, as well as Adult Protective Services and other aging programs.)

On Friday, State Controller John Chiang is expected to release updated cash flow information that will inform the timing of issuance of IOUs for state obligations. This announcement, coupled with the Governor's recent order directing furloughs for state employees, will place additional pressure on legislators to come to agreement on a budget resolution.

This *Budget Action Bulletin (BAB)* outlines the various components of the Democrats' budget proposal as well as various recent Budget Conference Committee actions. Still, many details have yet to be worked out. Of course, we will communicate additional information as the budget process evolves.

ADMINISTRATION OF JUSTICE

The Budget Conference Committee approved a conference compromise in the corrections area that contains all of the following elements:

- Rejects the Governor's May Revision proposal to require counties to house certain non-violent/non-sex/non-serious offenders in county jails for terms of up to 36 months;

- Extends the 0.5 percent Vehicle License Fee (VLF) rate and dedicates a portion to fund public safety and a corrections restructuring package; and,

- Adopts a corrections restructuring package (described below and effectively mirroring the Senate Democrats' revised corrections restructuring proposal released on July 14)

Corrections Restructuring Proposal. The conferees approved a corrections restructuring package on a partisan vote, with the following four components:

1. **Funded wobbler shift**: Would give counties an annual grant amount based on an as-yet-unknown formula for purposes of managing the wobbler population. If the court sentenced an offender convicted of a wobbler to state prison, the county would be required to send the state a fixed dollar amount ($23,000/offender). Otherwise, counties would be expected to manage the wobblers locally with the remaining resources (overall block grant less any funds returned to the state for wobblers committed to state prison). The notion is that, over time, local jurisdictions would be incentivized to develop a range of evidence-based programs to better address offenders' needs and the cycle of

reoffending. Detention in the county jail would, of course, remain a local option for this population to the extent that capacity permitted. The state estimates that there are approximately 40,000 wobblers in state prison who serve an average one-year sentence in state prison. This proposal assumes a January 1, 2011 implementation date.

2. **Sustained commitment of funding to local law enforcement**: Would reauthorize and make permanent the VLF rate increase (scheduled to expire on June 30, 2011), with 0.15 percent of the VLF dedicated to the Local Safety and Protection Account (LSPA). As counties are aware, the LSPA supports the Citizens' Option for Public Safety program, Juvenile Justice Crime Prevention Act, Juvenile Probation and Camps Funding, Rural and Small County Sheriffs Program, booking fee "replacement" revenue, and other local assistance programs.

3. **Funding of Youthful Offender Block Grant (YOBG) out of VLF**: Would convert the revenue source for funding the 2007 juvenile offender population shift (pursuant to the provisions of SB 81) from the state General Fund to a VLF funding base, giving the program a potential opportunity to grow along with VLF.

4. **Creation of Board of Community Corrections**: Rename the Corrections Standards Authority as the Board of Community Corrections, reestablish it as a stand-alone entity outside of the California Department of Corrections and Rehabilitation (CDCR) organizational structure, and expand its duties. The measure would be similar in content to Senator Denise Ducheny's SB 441 presently before the Legislature.

In advancing the package, the Conference Committee removed one element of the restructuring proposal: a proposed parole realignment pilot. This pilot program would test a parole realignment model in four counties starting in 2011-12; participating counties would self select. The plan also proposes that the jurisdiction for the revocation process for the offenders in the pilot would transfer from the Board of Parole Hearings to the local court. The parole realignment pilot remains an "open item" before the Budget Conference Committee.

AGRICULTURE AND NATURAL RESOURCES

Emergency Response Initiative (ERI). The Conference Committee approved the Assembly version of the ERI proposal, approving $124 million to backfill the General Fund for fire protection. The ERI would place a 4.8 percent surcharge on all residential and commercial property insurance statewide. The "fee" would fund a portion of the Department of Forestry and Fire Protection operations.

State Water Board Waste Discharge Requirement. In the proposed 2010-11 budget, the Governor proposed a new Waste Discharge Requirement fee by the State Water Resources Control Board (SWRCB) on operating solid waste landfills. Since 1994, with the enactment of AB 1220 (Eastin, Statutes of 1994), operating landfills have not been subject to such a fee and, instead, the regulatory activities of the SWRCB and the Regional Waste Quality Control Boards (RWQCB) related to such facilities has been covered by funding from the Integrated Waste Management Account (IWMA). CalRecycle claims that IWMA revenues are down 30 percent, much of it due to a reduction in disposal due to the downturn in the economy. The reduced funding from the IWMA to SWRCB and RWQCB programs is about $2.3 million per year or about 34 percent.

Yesterday, the Budget Conference Committee adopted the SWRCB Board provisions as follows:

- Requiring the SWRCB by March 1, 2011 to analyze and report on the costs of regulating active landfills, and,

- Requiring the SWRCB to begin billing the permittees in the second half of the 2010 -2011 fiscal year.

GOVERNMENT FINANCE AND OPERATIONS

The Democrats propose to raise personal income taxes on all but the highest bracket, raise VLF, and reduce the state's sales tax. Together, the changes would result in $1.8 billion in new revenue for the state in the budget year.

However, taxpayers cannot deduct what they pay in sales tax from federal income tax returns, but they can deduct what they pay in state income tax and vehicle license fees. Democrats claim that, due to this federal deductibility, the "average taxpayer in each tax bracket could see a tax cut." The size of the cut would depend on the taxpayer's bracket and the percent of their income they spend on goods subject to sales tax.

For personal income taxes, the Democrats propose to increase the rate for all brackets except the highest one by 1.00 percent. They would also make the current temporary surcharge of 0.25 percent permanent. These changes would raise $8.7 billion in the budget year. (*All revenue estimates have been made by the Democrats.*)

The VLF rate is currently 1.15 percent, but, absent legislative action to extend it, will drop to 0.65 percent on July 1, 2011. Instead, the Democrats propose to raise the rate to 1.65 percent permanently. They would dedicate about 0.5 percent of that to the

public safety restructuring proposal, described elsewhere in this BAB. These changes would raise $1.5 billion in the budget year.

The state's portion of the sales tax would decrease by 2.5 percent, implemented in two parts; they would cut 1.75 percent in the budget year and 0.75 percent in 2011-12. The change would not affect the transit funding guaranteed as part of the gas tax swap. It would also be completely separate from the "single flip," which continues to be part of the plan. The sales tax reduction would reduce state receipts by $8.4 billion.

Mark Hill, representing the Department of Finance at yesterday's Budget Conference Committee hearing, made the point that it is too late in the 2010 tax year for most individuals to adjust personal income withholdings sufficient to cover the proposed increase, and many taxpayers would therefore get a large tax bill in April. The Democrats tout their proposal as neutral both on the aggregate and for most taxpayers due to the federal deductibility, but Mr. Hill also pointed out that the gap between the new revenue and what is deductible widens over time, and that the proposal can only not be considered a tax increase from current, temporary tax rates, not from the levels to which they are scheduled to drop next year.

The Democrats' plan includes other tax provisions, including the oil severance tax and the single flip mentioned above. The oil severance tax would raise $600 million in the budget year, half the amount raised in the out-years because it would only be in effect for half of the budget year. Democrats believe they can raise the oil severance tax with a majority vote by using a mechanism known as the Single Flip, which would unravel the Triple Flip of 2004.

Under the Triple Flip, the state shifted a quarter-cent of the local sales tax to the state and reimbursed local agencies with schools' property taxes, which the state then backfilled pursuant to Proposition 98. The single flip is a mechanism by which the Legislature would reduce the state sales tax rate by that quarter-cent and allow the local sales tax to return to its previous level. Legislative Counsel has opined that, while bills that raise taxes generally require two-thirds approval, a bill that simultaneously raises and lowers taxes so that the net effect is revenue neutral only requires majority approval. So, pursuant to that opinion, the single flip would reduce the state sales tax and increase the oil severance tax by an amount to make the net effect revenue neutral. Meanwhile, the local tax would return to its historical rate by operation of law, making it outside of the neutrality calculation.

Securitization of Pre-2004 Mandate Reimbursements. The Jobs Budget includes authorization for school districts and local governments (cities, counties, and special districts) to securitize future state payments for mandate reimbursements. Counties will

recall that Proposition 1A requires that payments for mandate reimbursements owed prior to 2004 over a period of years; statute sets that time frame at 15 years, starting with the 2006-07 and ending in 2020-21. These amounts total about $1 billion, with counties owed about 80 percent of funds.

Using the Vehicle License Fee Gap Loan and Proposition 1A Securitization as a model, a joint powers authority would be authorized to pool local agency reimbursements and sell a bond with proceeds going to local agencies. CSAC has done some initial research into this option with positive results. We will be working with legislative staff, bond counsel, and others to flesh out the details, but are hopeful we can develop a construct that will assist counties in this difficult fiscal environment.

HEALTH AND HUMAN SERVICES

CalWORKS. There are no CalWORKs grant cuts or further cuts to the CalWORKs Single Allocation in the Democrats' budget plan beyond the existing $375 million cut. However, the proposed $300 million augmentation to the Single Allocation proposed by the Assembly Democrats in their previous budget proposal is not included in this latest plan and was actually rejected by the Budget Conference Committee today. The Democrats' plan does continue the existing $375 million cut to the Single Allocation that was enacted in the 2009-10 Budget Act for the 2009-10 and 2010-11 fiscal years. The Democrats' budget plan also restores all funding for child care programs that the Governor proposed to cut in the May Revision.

IHSS. Funding for the In-Home Supportive Services (IHSS) program would be reduced by $250 million general fund (GF). Based on the Democrats' budget plan's assumptions, $190 million of this reduction would be achieved by imposing a provider fee on the wages of IHSS providers. Revenues from the fee would be used to draw down addition federal funds in IHSS that would offset GF costs in the IHSS program. IHSS providers would also be reimbursed dollar for dollar for the fee. The remaining $60 million in IHSS reductions proposed in the Democrats' budget plan are unspecified and would be achieved through agreements with stakeholders. In addition, the IHSS budget action would include having stakeholders look at long-term reforms to IHSS, including looking at health care reform and opportunities for long-term care coordination and managed care. In the briefing today on the plan, legislative staff indicated that cuts enacted last year to the IHSS program that are currently on hold because of litigation (the functional index-based service cuts and the reduction in state participation in wages) would be repealed.

The $80 million GF to restore the Child Welfare Services programs veto **is** included in the Democrats budget plan.

The Senate Democrats' realignment proposal as it relates to CalWORKs, Adult Protective Services and aging programs, and drug and alcohol programs is ***not*** included in this budget plan.

AB 3632 Mandate – Special Education Mental Health Related Services. The Budget Conference Committee rejected the Governor's proposal to eliminate the reimbursable mandate on counties to provide mental health services to special education students. This is a federal requirement that in every other state is performed by schools, and under the Legislative Analyst's alternative budget proposal, would make schools responsible for it.

The Committee augmented the amount available to pay for prior year AB 3632 payments to counties by $133 million, but reduced the appropriation for current-year claims by $52 million. They also directed the Department of Education to help Special Education Local Planning Areas establish best practices so that schools could begin delivering this program in the future, and appropriated $3 million of federal Individuals with Disabilities Education Act funds for that purpose.

STAY TUNED FOR THE NEXT BUDGET ACTION BULLETIN!

If you would like to receive the Budget Action Bulletin electronically, please e-mail Amanda Yang, CSAC Legislative Assistant, at ayang@counties.org. We're happy to accommodate you!