



March 29, 2007

Honorable Denise Moreno Ducheny, Chair
Senate Budget and Fiscal Review Committee

Attention: Mr. Danny Alvarez, Staff Director (2)

Honorable John Laird, Chair
Assembly Budget Committee

Attention: Mr. Christopher W. Woods, Chief Consultant (2)

Updated Total Reserve and Net Operating Surplus including April 1 Finance Letters

In light of the ongoing state budget structural shortfall, the Administration has been careful to approve only General Fund requests that are absolutely unavoidable (e.g., court orders and emergency fire suppression). We have also not approved any spending proposals that significantly reduce our slender net operating surplus unless those increases were offset by ongoing reductions.

We have successfully maintained both the total reserve and a structurally balanced proposed budget. Here is a summary of the major General Fund changes since the Governor's Budget.

Note: (Dollars in Millions)	Total Reserve	2007-08 Net Operating Surplus
2007-08 Governor's Budget, January 10	\$2,085	\$20
Major Changes since Governor's Budget:		
CCPOA Arbitration Settlement Deficiency	-154	--
E-Fund Deficiency—Emergency Fire Suppression	-115	--
Switch Funding of Various Capital Outlay Projects to Tobacco Funds	357	--
Coleman-Related Salary Increases	-34	-34
Net of All Other Changes	10	38
April 1 Revised Totals	\$2,149	\$24

The February Legislative Analyst Office's (LAO) revenue estimate had the advantage of data on cash receipts for the last quarter of 2006, data not available at the time Finance prepared the projections for the Governor's Budget. Given the most recent cash data, it now appears that cash receipts are more than \$800 million below forecast for this year. While cash is an important variable in revenue projections, it is not clear how much, if any, impact the current cash shortfall will have on our next revenue projection, which we will produce for the May Revision.

- Through February, General Fund revenues are \$847 million, or 1.4 percent, below the Governor's Budget forecast of \$861.457 billion for that period. The personal income tax is \$1.239 billion below forecast to date. This shortfall is partially offset by sales tax receipts, which are \$116 million above forecast, and by corporation tax receipts, which are \$279 million above estimates.
- March and April are critical revenue months for the state. Final payments from calendar-year corporations were due March 15. In April, final and extension payments for 2006 tax liability are due on the 17th, as are estimated payments for 2007 income tax and calendar-year corporation tax liability. Based on recent trends, we expect that 60 percent of the month's revenue will not be received until the last five days of the month.
- \$21.15 billion is forecast for all General Fund revenues during March and April, nearly 22 percent of all revenues for the fiscal year. We will reassess the revenue picture for May Revision based on receipts through April.

The LAO has raised concerns about some of the key assumptions in the January 10 Budget. We believe that all these assumptions remain achievable. In the three months since the January 10 Budget was released, we have seen progress on most of the assumptions. Specifically,

- A California Court of Appeal has ruled in favor of the state in the *Guillen* case. This lawsuit seeks to require the state to provide a cost-of-living adjustment (COLA) to CalWORKs recipients retroactive to October 2003. However, it is likely this decision will be appealed to the California Supreme Court. If that appeal results in a ruling against the state, the retroactive COLA would cost an estimated \$548 million in 2007-08 and \$114 million annually thereafter. Implementation of this COLA also would have a compounding fiscal effect on any subsequent COLAs provided because subsequent COLAs would be applied to a higher base. In addition, there would be significant administrative and automation costs associated with identifying affected recipients and providing retroactive grant increases.
- We are proposing to change our proposal regarding the Public Transportation Account funding of \$627 million for home-to-school transportation, consistent with our agreement with the education community not to pursue "re-basing" Proposition 98. Under the new proposal, there will be no re-basing but the General Fund will be reimbursed for the full amount. With this change, we do not anticipate significant opposition from the education community.
- We continue to work with the tribes to find ways to ensure receipt of the entire \$506 million in proposed revenues from the compacts. It is important for the Legislature to recognize that ratifying the compacts is essential and the alternative would be substantial, ongoing cuts to state programs.
- We continue to work on our appeal on the Pension Obligation Bonds case. If this is not successful in time for inclusion in the final 2007-08 budget, the result will have no impact on the net operating deficit, but it will reduce the budgeted reserve from \$2.1 billion to \$1.6 billion.

The Governor remains committed to a budget with no net operating deficit. The state can no longer spend more than it takes in on an ongoing basis and the goal of no net operating deficit ensures it will only spend what it takes, other than spending to make debt prepayments and repayments and one-time investments that would not add to the long-term structural deficit.

The Governor remains committed to pre-paying the Economic Recovery Bonds (ERBs). The affordability of the Strategic Growth Plan (SGP) is contingent on paying these bonds off early to make room for the costs of the SGP bonds. If we cannot pay off the ERBs in the next two to three years, the debt service on the SGP bonds will have to be covered by reductions in other state programs.

Just as the Governor's Budget established a benchmark of a structurally balanced budget, pre-paying the ERBs and maintaining a sizeable reserve, the April 1 Finance letters represent a realistic opportunity to be fiscally responsible while addressing the most urgent and pressing needs of the state.

If you have any questions or need additional information regarding this matter, please contact me.

Sincerely,

/s/ Michael C. Genest

MICHAEL C. GENEST
Director

cc: Honorable Tom Torlakson, Chair, Senate Appropriations Committee
Attention: Mr. Bob Franzonia, Staff Director
Honorable Dennis Hollingsworth, Vice Chair, Senate Budget and Fiscal Review Committee
Attention: Mr. Seren Taylor, Staff Director
Honorable Mark Leno, Chair, Assembly Appropriations Committee
Attention: Mr. Geoff Long, Chief Consultant
Honorable Roger Niello, Vice Chair, Assembly Budget Committee
Attention: Mr. Peter Schaafsma, Staff Director
Ms. Elizabeth Hill, Legislative Analyst (4)
Ms. Diane Cummins, Senate President pro Tempore's Office
Mr. Craig Cornett, Assembly Speaker's Office (2)
Mr. Ivan Altamura, Chief of Staff, Assembly Republican Leader's Office