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February 13, 2009

To: Supervisor Don Knabe, Chairman
Supervisor Gloria Molina
Supervisor Mark Ridley-Thomas
Supervisor Zev Yaroslavsky
Supervisor Michael D. Antonovich

From: William T Fujioka
Chief Executive Officer

STATUS OF STATE BUDGET DISCUSSIONS, PROPOSALS TO DEFER OR DELAY PAYMENTS TO THE COUNTY, COUNTY CASH POSITION AND MITIGATIONS TO REDUCE EXPENDITURES (AGENDA ITEM S-1, MEETING OF FEBRUARY 17, 2009)

This report provides an update of State Budget discussions, the status of proposals for program payment deferrals and delays, the County's cash position and County mitigation efforts.

State Budget Discussions

According to various news accounts, Governor Schwarzenegger and the Legislative Leadership have reached a tentative State Budget agreement to address the current shortfall through June 30, 2010. The Assembly and the Senate are both scheduled to meet in the morning of Saturday, February 14, 2008.

While details of the agreement are not yet available, the proposed budget plan reportedly will include $14.3 billion in new revenues; $15.8 billion in reductions; and $10.9 billion in borrowing. One report indicates that if the State receives $10.0 billion in Federal economic stimulus funding, proposed reductions would decline by $1.2 billion, borrowing by $5.5 billion, and tax increases by $1.8 billion.

However, it is not clear which categories of economic stimulus funding would be used to offset the reductions, borrowing and tax increases. If the State should choose to maintain its current level of overall Medicaid spending, it could take advantage of the increase in the Federal share by backing out its current State matching share and dedicating those funds to the reduction of the State's deficit. If, instead, the State opts to take full advantage of the temporary increase in the Federal Medical Assistance Percentage (FMAP) from 50 percent to 61.59 percent, it would increase the investment value of each State dollar from the current rate of return of one State dollar for each Federal dollar to $1.6159 for the same State dollar. This approach would increase the amount of Federal Medicaid funds flowing to the State.

Revenues

The revenue proposals under consideration include:

- Increasing the State sales tax by 1 cent;
- Increasing gasoline taxes from the current 18 cents per gallon to 30 cents per gallon;
- Raising the Vehicle License Fee from its current rate of 0.65 percent of a vehicle's market value to 1.15 percent with a portion of the fee dedicated to law enforcement programs;
- Increasing the Personal Income Tax rate across-the-board for calendar year 2009, or assessing a surtax on personal income taxes; and
- Reducing the tax credit for dependents from $309 to $99.

Other sources of revenue include: 1) a proposal to temporarily shift $227 million from the Mental Health Services Act of 2004 (Proposition 63) to help fund the Early Periodic Screening, Diagnosis and Treatment Program. Proposition 63 is a tax surcharge levied on individuals with personal income over $1.0 million; and 2) a proposal to redirect $608.0 million from First 5 Child Development Programs (Proposition 10) to fund other children's programs. Proposition 10 is supported by tobacco taxes.

Ballot Measure Proposals

It appears that the proposed tax increases would be in effect for two years unless voters pass a ballot measure that would impose an annual State expenditure limit determined by the growth in State revenues over a 10-year period. If the initiative is successful, the taxes would be extended for an additional three years. At this time, it is unclear whether the proposed gasoline tax also would be tied to the ballot measure or how long it would remain in effect.

The same ballot measure also would contain initiatives asking voters to approve: borrowing from the securitization of the lottery; a change to Proposition 98 to protect education funding when State revenues rebound after lean budget years; and the use of funding from Proposition 10, which created the California Children and Families Commission, and Proposition 63, the Mental Health Services Act.

Reductions

Detailed information about the proposed $15.8 billion in budget cuts has not been released. It has been reported that education spending would be reduced by $8.6 billion over the two year period with $5.6 billion occurring in the current year. The State's annual cost-of-living adjustments (COLA) for CalWORKs recipients would be eliminated as would the State and Federal COLAs for those receiving Supplemental Security Income/State Supplemental Payments. These reductions are estimated to save $79.0 million and $594.1 million, respectively.

Also, it has been reported that depending on the size of the Federal stimulus package, there may be additional reductions to the courts, Medi-Cal, CalWORKs, In-Home Support Services and other health and social service programs in a total amount approaching $1.0 billion. Other reductions include continuation of the State's two-day-a month furlough and the elimination of two holidays for State employees for an estimated savings of $1.4 billion.

Administration Proposal to Defer State Payments to Counties

As reported last week, based on the Administration's proposed trailer bill language to defer payments to counties for up to seven months, the California State Association of Counties (CSAC) estimated that the potential exposure to counties would be $3.5 billion. Of this amount we estimated the impact on the County to be $1.423 billion. However, CSAC staff met yesterday with Mr. Mike Genest, Director of the California Department of Finance, and asked specifically about the deferral proposal, and he indicated that deferrals were not part of the deal at this time. However, he indicated that this could change due to the State's cash flow problem and the uncertainty of the revenue and cut proposals. Based on Mr. Genest's comments, CSAC staff cautions that the payment deferrals may "still be very much in play."

State Controller's February Payment Delays

As anticipated, today the State Controller began delaying payments to counties since an agreement on the State Budget has not been approved, and the necessary solutions to address the cash flow crisis are not yet in place. **This morning the Treasurer Tax Collector confirmed that the County received only funding for Trial Court operations and Federal reimbursement for the**

CalWORKs Program. **The County did not receive the State's portion of the CalWORKs Program payment in the amount of $9,432,500.** As previously reported, we estimate the impact to the County of the February payment delays to be $105.6 million. The second round of payment delays for this month is scheduled to take place on February 28, 2009.

Based on information received from the State Controller's Office, CSAC and the California Welfare Director's Association, we anticipate that this month's payment delays could affect the following programs:

- CalWORKs Single Allocation and Assistance Payments
- Foster Care Administration and Assistance Payments
- Food Stamps
- Child Welfare Services
- Children's Services
- Adoptions Eligibility and Adoptions Payments
- Adult Protective Services
- Community Services Block Grant
- Early and Periodic Screening, Diagnosis and Treatment Program
- Certain Alcohol and Drug Abuse Programs

In addition, Sacramento and San Diego counties plan to file a lawsuit today against the State Controller contending that the Legislature appropriated funding for various health and social services programs, and the State Controller cannot unilaterally withhold payments if he has funds available. According to CSAC, an estimated 26 other counties, including Los Angeles intend to join in the lawsuit against the State Controller.

County Cash Position

Prior to the threat of State cash deferrals, the County General Fund's cash position had already been negatively impacted by the economic downturn. We have previously advised that we can only backfill delayed State payments with County reserves for approximately one month. Then we will need to consider other options, including, but not limited to, curtailments or limited borrowing. Although the County's General Fund maintains budgeted reserves, the General Fund's cash balance requires ongoing attention and monitoring to ensure that revenues are received in a timely manner and at the levels assumed in the budget. We are meeting regularly with the Auditor-Controller and the Treasurer to complete an analysis for your review of our cash position (actual vs. planned).

We are taking follow-up action to draw cash due in from all possible sources such as asking departments to review their current and prior years' revenue accruals and actively seeking more timely reimbursement. In addition, we have alerted departments that there should be no new programs initiated outside of the budget process and/or without Board approval.

Mitigation to Reduce Expenditures

On February 10, 2009, your Board approved a hard-hiring freeze and directed our office to work with the Auditor-Controller to freeze non-essential purchases of services and supplies and fixed assets. Appropriations in the amount of $196.0 million across departments for services and supplies and fixed assets are now frozen. In addition, we are considering options for cutbacks of the County's capital program, and will report back with specific recommendations as appropriate.

All position hiring is frozen temporarily while we formulate a blanket exemption list for critical health and safety positions. We are also preparing the procedure and justification criteria for handling other critical hiring requests as needed, recognizing the need to hold a maximum reasonable number of vacancies until we can secure a stable cash flow.

We are working with County departments that will be affected by State payment deferrals by requesting that they identify the impact on services or programs should they have to live within limited State reimbursement. We are also compiling a list by department or programs that are discretionary in nature. Once this information is available and, if State deferrals and delays remain a threat to the County, we will present your Board with options to address the State's funding delays and deferrals.

We will continue to keep you informed.

WTF:GK:ML
SK:EC:MR:MG:yjf

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County.cash.flow.bm