

This Preliminary Offering Memorandum and the information contained herein are subject to completion or amendment without notice. Under no circumstances shall this Preliminary Offering Memorandum constitute an offer to sell or the solicitation of an offer to buy, nor shall there be any sale of these securities in any jurisdiction in which such offer, solicitation or sale would be unlawful prior to the registration or qualification or filing under the securities law of any such jurisdiction.

PRELIMINARY OFFERING MEMORANDUM DATED NOVEMBER 8, 2010

NEW ISSUE — BOOK-ENTRY ONLY

RATINGS: Moody's: —
S&P: —
Fitch: —
(See "Ratings" herein)



STATE OF CALIFORNIA
\$2,000,000,000*
VARIOUS PURPOSE GENERAL OBLIGATION BONDS
(FEDERALLY TAXABLE)

Dated: Date of Delivery

Due: November 1, as shown on inside cover

The Bonds will be issued in fully registered form in denominations of \$5,000 and any integral multiple thereof and when issued, will be registered in the name of Cede & Co., as nominee of The Depository Trust Company, New York, New York ("DTC"). DTC will act as securities depository for the Bonds. Beneficial interests in the Bonds may be purchased in book-entry form only, in denominations of \$5,000 and any integral multiple thereof. Purchasers of the Bonds will not receive physical certificates representing their ownership interests in the Bonds purchased. *For information regarding minimum unit sales for purchasers outside the United States, see "INFORMATION CONCERNING OFFERING RESTRICTIONS IN CERTAIN JURISDICTIONS OUTSIDE THE UNITED STATES" herein.*

The State of California (the "State") intends to sell revenue anticipation notes on or about November 17, 2010, and tax-exempt general obligation bonds on or about November 23, 2010, pursuant to separate official statements.

Interest on the Bonds will be payable on May 1 and November 1 of each year, commencing on May 1, 2011. So long as the Bonds are held by DTC, the principal and redemption price of, and interest on, the Bonds will be payable by wire transfer to DTC, which in turn is required to remit such principal or redemption price and interest to the DTC Participants for subsequent disbursement to the Beneficial Owners of the Bonds, as more fully described in APPENDIX B—"THE BOOK-ENTRY ONLY SYSTEM AND GLOBAL CLEARANCE PROCEDURES."

The Bonds are subject to redemption prior to their respective stated maturity dates, as described herein. See "THE BONDS—Redemption." A portion of the Bonds may be issued as "Build America Bonds" (the "BABs").

The Bonds are general obligations of the State to which the full faith and credit of the State are pledged. The principal of and interest on all State general obligation bonds, including the Bonds, are payable from any moneys in the General Fund of the State, subject only to the prior application of such moneys to the support of the public school system and public institutions of higher education. See "AUTHORIZATION OF AND SECURITY FOR THE BONDS." The State will use the proceeds of the Bonds to pay or reimburse expenditures made for various State and local infrastructure and other public projects, as approved by the voters of the State.

The distribution of this Offering Memorandum and the offering, sale and delivery of the Bonds in certain jurisdictions outside the United States is restricted by law. Persons into whose possession this Offering Memorandum comes are required by the State to inform themselves about and to observe any such restrictions. For a description of certain restrictions on offers, sales and deliveries of the Bonds and on distribution of this Offering Memorandum and other offering material relating to the Bonds, see "INFORMATION CONCERNING OFFERING RESTRICTIONS IN CERTAIN JURISDICTIONS OUTSIDE THE UNITED STATES" and "UNDERWRITING."

In the opinion of Bond Counsel to the State, interest on the Bonds is not excluded from gross income for federal income tax purposes under Section 103 of the Internal Revenue Code of 1986, as amended, but is exempt from State of California personal income taxes. See "TAX MATTERS."

This cover page contains certain information for general reference only. It is not a summary of the security or terms of this issue. Investors are advised to read the entire Offering Memorandum to obtain information essential to the making of an informed investment decision.

The Bonds are offered when, as and if issued and received by the Underwriters, subject to the approval of validity by the Honorable Edmund G. Brown Jr., Attorney General of the State of California and by Orrick, Herrington & Sutcliffe LLP, Bond Counsel to the State. Orrick, Herrington & Sutcliffe LLP and Alexis S. M. Chiu, Esq., are serving as Co-Disclosure Counsel to the State with respect to the Bonds. Orrick, Herrington & Sutcliffe LLP and Stradling Yocca Carlson & Rauth, a Professional Corporation, are serving as Co-Disclosure Counsel to the State regarding Appendix A. Certain matters will be passed upon for the Underwriters by their counsel, Sidley Austin LLP. Public Resources Advisory Group is serving as the Financial Advisor to the State with respect to the Bonds. The Bonds are expected to be available for delivery through the facilities of The Depository Trust Company in the United States and through Euroclear and Clearstream Luxembourg in Europe, on or about November 30, 2010.

HONORABLE BILL LOCKYER
Treasurer of the State of California

Citi
(Joint Book Runner)

Backstrom McCarley Berry & Co., LLC
BNY Mellon Capital Markets, LLC
Cabrera Capital Markets, LLC
Estrada Hinojosa & Company, Inc.
Great Pacific Securities
J.P. Morgan
Prager, Sealy & Co., LLC
Southwest Securities, Inc.
The Williams Capital Group, L.P.
Wells Fargo Securities

RBC Capital Markets
(Joint Book Runner)

Barclays Capital
BofA Merrill Lynch
City National Securities, Inc
Fidelity Capital Markets
Greencoast Capital Partners LLC
MFR Securities, Inc.
RH Investment Corporation
Stinson Securities, LLC
Touissant Capital Partners, LLC
Westhoff, Cone & Holmstedt

Siebert Brandford Shank & Co., L.L.C.
(Joint Book Runner)

BMO Capital Markets GKST Inc.
Brandis Tallman LLC
De La Rosa & Co.
Goldman, Sachs & Co.
Jefferies & Company
Morgan Stanley
Seattle-Northwest Securities Corporation
Stone & Youngberg
Wedbush Securities
Wulff, Hansen & Co.

Offering Memorandum Dated: November __, 2010.

* Preliminary, subject to change.

**MATURITIES, PRINCIPAL AMOUNTS, INTEREST RATES,
ISSUE PRICES, CUSIPS, ISINS AND COMMON CODES
\$2,000,000,000* VARIOUS PURPOSE GENERAL OBLIGATION BONDS
(FEDERALLY TAXABLE)**

Base CUSIP[†]: _____

Base ISIN[†]: _____

<u>Maturity Date</u> (November 1)	<u>Principal</u> <u>Amount</u>	<u>Interest</u> <u>Rate</u>	<u>Issue</u> <u>Price</u>	<u>CUSIP[†]</u> <u>Suffix</u>	<u>ISIN[†]</u> <u>Suffix</u>	<u>Common</u> <u>Codes [±]</u>
	\$	%				

* Preliminary, subject to change.

† Copyright 2010, American Bankers Association. CUSIP® is a registered trademark of the American Bankers Association. CUSIP and ISIN data herein is provided by the CUSIP Service Bureau, operated by Standard & Poor's, a division of The McGraw-Hill Companies, Inc. This data is not intended to create a database and does not serve in any way as a substitute for the CUSIP Services Bureau. CUSIP and ISIN numbers have been assigned by an independent company not affiliated with the State and are included solely for the convenience of the registered owners of the applicable Bonds. Neither the State nor the Underwriters are responsible for the selection or uses of these CUSIP or ISIN numbers, and no representation is made as to their correctness on the applicable Bonds or as included herein. The CUSIP or ISIN number for a specific maturity is subject to being changed after the issuance of the Bonds as a result of various subsequent actions including, but not limited to, a refunding in whole or in part or as a result of the procurement of secondary market portfolio insurance or other similar enhancement by investors that is applicable to all or a portion of certain maturities of the Bonds.

± The Common Codes are provided herein by Euroclear Bank S.A./N.V. Common Codes are provided for convenience of reference only. Neither the State nor the Underwriters take any responsibility for the accuracy of such numbers.

No dealer, broker, salesperson or other person has been authorized by the State or the Underwriters to give any information or to make any representations with respect to the State or its Bonds other than those contained in this Offering Memorandum and, if given or made, such other information or representations must not be relied upon as having been authorized by any of the foregoing. The information set forth herein has been obtained from sources that are believed to be reliable. Estimates and opinions are included and should not be interpreted as statements of fact. Summaries of documents do not purport to be complete statements of their provisions and such summaries are qualified by references to the entire contents of the summarized documents. The information and expressions of opinion herein are subject to change without notice, and neither the delivery of this Offering Memorandum nor any sale made by use of this Offering Memorandum shall, under any circumstances, create any implication that there has been no change in the affairs of the State since the date hereof.

This Offering Memorandum is not to be construed as a contract with the purchasers of the Bonds.

The Underwriters have provided the following sentence for inclusion in this Offering Memorandum. The Underwriters have reviewed the information in this Offering Memorandum in accordance with, and as a part of, their responsibilities to investors under the federal securities laws as applied to the facts and circumstances of this transaction, but the Underwriters do not guarantee the accuracy or completeness of such information.

IN CONNECTION WITH THIS OFFERING, THE UNDERWRITERS MAY OVERALLOT OR EFFECT TRANSACTIONS WHICH STABILIZE OR MAINTAIN THE MARKET PRICES OF THE BONDS AT LEVELS ABOVE THAT WHICH MIGHT OTHERWISE PREVAIL IN THE OPEN MARKET. SUCH STABILIZING, IF COMMENCED, MAY BE DISCONTINUED AT ANY TIME. THE UNDERWRITERS MAY OFFER AND SELL THE BONDS TO CERTAIN DEALERS, INSTITUTIONAL INVESTORS AND OTHERS AT PRICES LOWER THAN THE PUBLIC OFFERING PRICES STATED ON THE INSIDE FRONT COVER HEREOF, AND SAID PUBLIC OFFERING PRICES MAY BE CHANGED FROM TIME TO TIME BY THE UNDERWRITERS.

THE BONDS WILL NOT BE REGISTERED UNDER THE SECURITIES ACT OF 1933, AS AMENDED, OR ANY STATE SECURITIES LAWS IN RELIANCE UPON EXEMPTIONS CONTAINED IN SUCH LAWS. THE BONDS WILL NOT HAVE BEEN RECOMMENDED BY THE SECURITIES AND EXCHANGE COMMISSION ("SEC") OR ANY OTHER FEDERAL, STATE OR FOREIGN SECURITIES COMMISSION OR REGULATORY AUTHORITY, AND NO SUCH COMMISSION OR REGULATORY AUTHORITY WILL HAVE REVIEWED OR PASSED UPON THE ACCURACY OR ADEQUACY OF THIS OFFERING MEMORANDUM. ANY REPRESENTATION TO THE CONTRARY MAY BE A CRIMINAL OFFENSE.

NO ACTION HAS BEEN TAKEN BY THE STATE THAT WOULD PERMIT A PUBLIC OFFERING OF THE BONDS OR POSSESSION OR DISTRIBUTION OF THE OFFERING MEMORANDUM OR ANY OTHER OFFERING MATERIAL IN ANY FOREIGN JURISDICTION WHERE ACTION FOR THAT PURPOSE IS REQUIRED. ACCORDINGLY, EACH OF THE UNDERWRITERS HAS AGREED THAT IT WILL COMPLY WITH ALL APPLICABLE LAWS AND REGULATIONS IN FORCE IN ANY FOREIGN JURISDICTION IN WHICH IT PURCHASES, OFFERS OR SELLS THE BONDS OR POSSESSES OR DISTRIBUTES THIS OFFERING MEMORANDUM OR ANY OTHER OFFERING MATERIAL AND WILL OBTAIN ANY CONSENT, APPROVAL OR PERMISSION REQUIRED BY IT FOR THE PURCHASE, OFFER OR SALE BY IT OF THE BONDS UNDER THE LAWS AND REGULATIONS IN FORCE IN ANY FOREIGN JURISDICTION TO WHICH IT IS SUBJECT OR IN WHICH IT MAKES SUCH PURCHASES, OFFERS OR SALES AND THE STATE SHALL HAVE NO RESPONSIBILITY THEREFOR.

Copies of this Offering Memorandum may be obtained from:

HONORABLE BILL LOCKYER
Treasurer of the State of California
P.O. Box 942809
Sacramento, California 94209-0001
1-800-900-3873

This Preliminary Offering Memorandum is available as public information on the State Treasurer's Internet site.

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INFORMATION CONCERNING OFFERING RESTRICTIONS

IN CERTAIN JURISDICTIONS OUTSIDE THE UNITED STATES

MINIMUM UNIT SALES

The Bonds will trade and settle on a unit basis (one unit equalling one Bond of \$5,000 principal amount). For any sales made outside the United States, the minimum purchase and trading amount is 20 units (being 20 Bonds in an aggregate principal amount of \$100,000).

NOTICE TO PROSPECTIVE INVESTORS LOCATED IN AUSTRALIA

Any offer of securities in connection with this notice will not be made by way of a disclosure document under Part 6D of the Corporations Act (Cth) (the “Act”).

Neither the State nor any underwriter is required to provide to you with a prospectus or other disclosure document for the issue of securities because of the application of specific exemptions from the requirements for disclosure set out in section 708 of the Act. In particular, this notice is being provided to you on the basis that:

1. any offer in connection with this notice is a personal offer within the meaning of section 708(2) of the Act, and that offer will not result in any breach referred to in that section;
2. section 708(8) of the Act applies and you are a sophisticated investor in accordance with the terms of that section;
3. you are an experienced investor within the meaning of s 708(10) of the Act; or
4. you are a professional investor in accordance with section 708(11) of the Act).

Any documents provided in connection with this notice are furnished solely for information purposes only and may not be reproduced or redistributed to any other persons except with the prior written consent of the State and each underwriter. The documents are strictly confidential.

This notice does not constitute an offer or invitation to subscribe for or to purchase any securities and neither this notice nor anything contained in it will form the basis of any contract or commitment on the part of the State or any underwriter to issue or transfer securities to any person.

NOTICE TO RESIDENTS OF BRAZIL

THE SECURITIES HAVE NOT BEEN AND WILL NOT BE REGISTERED WITH THE BRAZILIAN SECURITIES COMMISSION (COMISSÃO DE VALORES MOBILIÁRIOS – “CVM”). ANY PUBLIC OFFERING, AS DEFINED UNDER BRAZILIAN LAWS AND REGULATIONS OF THE SECURITIES IN BRAZIL IS NOT LEGAL WITHOUT SUCH PRIOR REGISTRATION UNDER LAW NO. 6.385/76.

NOTICE TO PROSPECTIVE INVESTORS LOCATED IN CANADA

No securities commission or similar authority in Canada has reviewed or in any way passed upon this offering memorandum or the merits of the securities described herein, and any representation to the contrary is an offence.

NOTICE TO PROSPECTIVE INVESTORS IN THE PEOPLE'S REPUBLIC OF CHINA (PRC)

This offering memorandum has not been and will not be circulated or distributed in the PRC, and the securities may not be offered or sold, and will not be offered or sold to any person for re-offering or

resale, directly or indirectly, to any residents of the PRC except pursuant to applicable laws and regulations of the PRC. For the purposes of this paragraph, the PRC does not include Taiwan, Hong Kong or Macau.

NOTICE TO PROSPECTIVE INVESTORS IN DENMARK

This offering memorandum does not constitute a prospectus under any Danish law and has not been filed with or approved by the Danish Financial Supervisory Authority as this offering memorandum has not been prepared in the context of a public offering of securities in Denmark within the meaning of the Danish Securities Trading Act or any Executive Orders issued pursuant thereto. Pursuant to Section 11 (1) of the Danish Prospectus Order No. 223 of 10 March 2010 and Section 2 of the Danish Executive Order No. 222 of March 10, 2010, this offering memorandum will only be directed to:

- (i) qualified investors as defined in Section 2 of the Danish Prospectus Order No. 223 of 10 March 2010 and/or
- (ii) fewer than 100 natural or legal person in Denmark, and/or
- (iii) investors who acquire securities for a total consideration of at least EUR 50,000 per investor for each single offer of securities, and/or
- (iv) securities which are subject to a minimum denomination equivalent to at least EUR 50,000 per security.

Accordingly, this offering memorandum may not be made available nor may the securities otherwise be marketed and offered for sale in Denmark other than in circumstances which are deemed not to be considered as marketing or an offer to the public in Denmark.

NOTICE TO PROSPECTIVE INVESTORS IN THE DUBAI FINANCIAL SERVICES AUTHORITY

This statement relates to an Exempt Offer in accordance with the Offered Securities Rules of the Dubai Financial Services Authority.

This statement is intended for distribution only to persons of a type specified in those rules. It must not be delivered to, or relied on by, any other person.

The Dubai Financial Services Authority has no responsibility for reviewing or verifying any documents in connection with Exempt Offers. The Dubai Financial Services Authority has not approved this document nor taken steps to verify the information set out in it, and has no responsibility for it.

The securities to which this offering memorandum relates may be illiquid and/or subject to restrictions on their resale. Prospective purchasers of the securities offered should conduct their own due diligence on the securities.

If you do not understand the contents of this document you should consult an authorised financial adviser.

NOTICE TO PROSPECTIVE INVESTORS IN THE EUROPEAN ECONOMIC AREA

No action has been or will be taken in any jurisdiction that would permit a public offering of any of the bonds, or possession or distribution of this offering memorandum or any other offering material, in any country or jurisdiction where action for that purpose is required. Each underwriter shall comply with all relevant laws, regulations and directives in each jurisdiction in which it purchases, offers, sells or delivers bonds or has in its possession or distributes this offering memorandum or any other offering material, in all cases at its own expense.

In relation to each member state of the European Economic Area which has implemented the prospectus directive (each, a “relevant member state”), each underwriter has severally represented and agreed that with effect from and including the date on which the prospectus directive is implemented in that relevant member state (the “relevant implementation date”) it has not made and will not make an offer of the bonds which are the subject of the offering contemplated by this offering memorandum to the public in that relevant member state except that it may, with effect from and including the relevant implementation date, make an offer of such bonds to the public in that relevant member state:

- (A) to legal entities which are authorized or regulated to operate in the financial markets or, if not so authorized or regulated, whose corporate purpose is solely to invest in securities;
- (B) to any legal entity which has two or more of (1) an average of at least 250 employees during the last financial year; (2) a total balance sheet of more than €43,000,000; and (3) an annual net turnover of more than €50,000,000, as shown in its last annual or consolidated accounts;
- (C) to fewer than 100 natural or legal persons (other than qualified investors as defined in the prospectus directive) subject to obtaining the prior consent of the relevant underwriter or underwriters nominated by the State for any such offer; or
- (D) in any other circumstances falling within article 3(2) of the prospectus directive,

Provided that no such offer of the bonds referred to above shall require the State or any underwriter to publish a prospectus pursuant to article 3 of the prospectus directive or supplement a prospectus pursuant to article 16 of the prospectus directive.

For purposes of this provision, the expression an “offer of the bonds to the public” in relation to any bonds in any relevant member state means the communication in any form and by any means of sufficient information on the terms of the offer and the bonds to be offered so as to enable an investor to decide to purchase or subscribe for the bonds, as the same may be varied in that member state by any measure implementing the prospectus directive in that member state, and the expression “prospectus directive” means directive 2003/71/ec and includes any relevant implementing measure in each relevant member state.

NOTICE TO RESIDENTS OF FRANCE

The securities have not been offered or sold and will not be offered or sold, directly or indirectly, by way of a public offer in France (Offre au Public, as defined in articles l. 411-1, of the Code Monétaire et Financier). The securities may only be subscribed for or held by qualified investors (Investisseurs Qualifiés) solely for their own account, as provided by articles l. 411-2, d. 411-1, d. 411-2, d. 734-1, d. 744-1, d. 754-1 and d. 764-1 of the Code Monétaire et Financier. Thus, the securities acquired shall not be distributed directly or indirectly to the public otherwise than in accordance with articles l. 411-1, l. 411-2, l. 412-1 and l. 621-8 to l. 621-8-3 of the Code Monétaire et Financier.

This offering memorandum is furnished to potential qualified investors solely for their information and may not be reproduced or redistributed to any other person. It is strictly confidential and is solely destined for qualified investors to which it was initially supplied. This offering memorandum does not constitute an offer or invitation to subscribe for or to purchase any securities and neither this offering memorandum nor anything herein shall form the basis of any contract or commitment whatsoever.

This offering memorandum or any other material relating to the securities may not be distributed to the public in France or used in connection with any offer for subscription or sale of securities in France other than in accordance with articles l. 411-2, d. 411-1 and d. 411-2 of the code Monétaire et Financier. This offering memorandum has not been submitted and no prospectus will be submitted to the “Autorité des Marchés Financiers” for approval. Any contact with potential qualified investors in France does not

and will not constitute financial and banking solicitation (Démarchage Bancaire et Financier) as defined in articles L. 341-1 et seq. Of the code Monétaire et Financier.

NOTICE TO PROSPECTIVE INVESTORS IN GERMANY

The securities have not been, will not be and may not be offered, promoted or sold, either directly or indirectly, in Germany by way of an offer to the public within the meaning of section 2 No. 4 of the Securities Prospectus Act (Wertpapierprospektgesetz). The securities may only be offered to, sold to, subscribed for or held by qualified investors within the meaning of section 2 No. 6 of the Securities Prospectus Act or, if applicable, any person in Germany whose professional or commercial activities involve them in the acquiring or disposing of investments within the meaning of section 8f subsection 2 No. 4 of the Sales Prospectus Act (Verkaufprospektgesetz) either as principal or agent.

This offering memorandum does not constitute an offer to subscribe for or buy any of the securities offered hereby to any person to whom it is unlawful to make such offer or solicitation in Germany. This document is given to potential investors solely for their information and may not be distributed to any other person. It is confidential and solely targeted at the recipients, i.e. qualified investors within the meaning of section 2 No. 6 of the Securities Prospectus Act, to which it has been initially supplied.

NOTICE TO RESIDENTS OF HONG KONG

The securities have not been authorised by the securities and futures commission in Hong Kong for public offering in Hong Kong, nor has a copy of this offering memorandum been registered with the registrar of companies in Hong Kong.

The securities may not be offered or sold by means of any document other than (i) in circumstances which do not constitute, or form part of, an offer to the public within the meaning of the companies ordinance (Cap.32 of the laws of Hong Kong), or (ii) to “professional investors” within the meaning of the securities and futures ordinance (Cap.571 of the laws of Hong Kong) and any rules made thereunder, or (iii) in other circumstances which do not result in the document being a “prospectus” within the meaning of the companies ordinance (Cap.32 of the laws of Hong Kong), and that no advertisement, invitation or document relating to the securities may be issued or may be in the possession of any person for the purpose of issue (in each case whether in Hong Kong or elsewhere), which is directed at, or the contents of which are likely to be accessed or read by, the public in Hong Kong (except if permitted to do so under the laws of Hong Kong) other than with respect to the securities which are or are intended to be sold or otherwise disposed of only to persons outside Hong Kong or only to “professional investors” within the meaning of the securities and futures ordinance (cap. 571 of the laws of Hong Kong) and any rules made thereunder.

NOTICE TO RESIDENTS OF JAPAN

The securities have not been and will not be registered under the financial instruments and exchange law of Japan (law no. 25 of 1948, as amended, the “FIEL”). The securities may not be offered or sold, directly or indirectly, in Japan or to, or for the benefit of, any resident of Japan (which term as used herein means any person resident in Japan, including any corporation or other entity organized under the laws of Japan), or to others for re-offering or resale, directly or indirectly, in Japan or to, or for the benefit of, any resident of Japan, except pursuant to an exemption from the registration requirements of, and otherwise in compliance with, the FIEL and any other applicable laws, regulations and ministerial guidelines of Japan.

NOTICE TO PROSPECTIVE INVESTORS IN KOREA

The securities have not been and will not be registered under the Financial Investments Services and Capital Markets Act of Korea and the decrees and regulations thereunder (the “FSCMA”) and the

securities have been and will be offered in Korea as a private placement under the FSCMA. None of the securities may be offered, sold and delivered directly or indirectly, or offered or sold to any person for re-offering or resale, directly or indirectly, in Korea or to any resident of Korea except pursuant to the applicable laws and regulations of Korea, including the FSCMA and the Foreign Exchange Transaction Law of Korea and the decrees and regulations thereunder (the “FETL”). For a period of one year from the issue date of the securities, the denomination of the securities may not be sub-divided. Furthermore, the purchaser of the securities shall comply with all applicable regulatory requirements (including but not limited to requirements under the FETL) in connection with the purchase of the securities.

Each underwriter will represent and agree that it has not offered, sold or delivered the securities directly or indirectly to any person for re-offering or resale, directly or indirectly, in Korea or to any resident of Korea and will not offer, sell or deliver the securities directly or indirectly to any person for re-offering or resale, directly or indirectly, in Korea or to any resident of Korea, except pursuant to an exemption from the registration requirements of, and otherwise in compliance with, the FSCMA, the FETL and other relevant laws and regulations of Korea.

NOTICE TO PROSPECTIVE INVESTORS IN THE NETHERLANDS

1. In accordance with the Dutch Financial Supervision Act (“Wet op het Financieel Toezicht” or “Wft”) and the Wft Exemptions Regulation (in Dutch: “Vrijstellingsregeling Wft”) a straight forward offering of the securities to the public in the Netherlands requires publication of a prospectus that is duly approved by the competent Dutch authority (i.e. Netherlands Authority for the Financial Markets, in Dutch: “Autoriteit Financiële Markten” or “AFM”) or by a competent authority of another European Member State, unless:
 - (a) the securities are offered exclusively to qualified investors as defined in the Wft; and/or
 - (b) the securities are offered to less than 100 people, not being qualified investors as defined in the Wft; and/or
 - (c) the securities are offered in minimum lots of EUR 50,000 in terms of nominal value or subscription price; and/or
 - (d) the total consideration value of the offering of securities involves a total amount of less than EUR 100,000 calculated over a 12-month-period; and/or
 - (e) the offering of securities forms part of an offer under which the total consideration value of the offer, calculated over a period of twelve months, does not exceed EUR 2.5 million, provided that in all relevant documentation and advertisements the offeror mentions that the offer in question is exempted from the statutory requirement to publish a prospectus; and/or
 - (f) the securities are offered to investors, not being qualified investors, who have concluded a written mandate agreement (“schriftelijke overeenkomst van lastgeving”) with an asset manager entitled to provide investment services under the law of the Netherlands and who is entitled in terms of that agreement to undertake or realise transactions at his own discretion without taking orders from or consulting with the investors who granted the mandate.
2. In light of the above, the securities that are offered to you without publication of a prospectus that is duly approved by the AFM or by a competent authority of another European Member State shall not be deemed to be in violation of the Wft and the Wft Exemption Regulation, if and insofar as:
 - (a) you are a qualified investor as defined in the Wft; and /or

- (b) you are not a qualified investor as defined in the Wft, but you have concluded a written mandate agreement (“schriftelijke overeenkomst van lastgeving”) with an asset manager entitled to provide investment services under the law of the Netherlands and who is entitled in terms of that agreement to undertake or realise transactions in the securities at his own discretion without being required to take orders from or consult with you; and/or
 - (c) you invest at least EUR 50,000 in the acquisition of the securities.
3. The offering of securities is only aimed at, directed and made to prospective investors in The Netherlands who fall within the scope of par. 2 above and, therefore, any response to an offer of securities made by an investor that does not fall within the scope of par. 2 above shall not be deemed to constitute nor imply acceptance of the offer and the offeror shall in that case not be held to sell the securities to that investor.
4. This notice is furnished to prospective investors in The Netherlands only in connection with this prospectus and is solely for their information. This opinion is not to be used, circulated, quoted or otherwise relied upon by any other person or entity or, for any purpose.

NOTICE TO PROSPECTIVE INVESTORS IN NEW ZEALAND

No action has been taken to authorize the offer of any of the securities to the public in New Zealand. Accordingly, the securities may not be offered or sold, or re-offered or resold, and this offering memorandum or any other material in connection with the securities may not be issued, circulated, delivered or distributed, in New Zealand, either directly or indirectly, other than to:

- (a) persons whose principal business is the investment of money or who, in the course of and for the purposes of their business, habitually invest money;
- (b) persons who are each required to pay a minimum subscription price of at least \$500,000 for the securities before the allotment of those securities;
- (c) persons who have each, in a single transaction, previously paid the State a minimum subscription price of at least \$500,000 for other securities issued by the same entity before the allotment of such other securities and provided that the offer of the current securities is made within 18 months of the date of the first allotment of the previous securities; or
- (d) persons who are “eligible persons” (as defined in Section 5(2CC) of the Securities Act 1978 (NZ)),

in each case as interpreted in accordance with the Securities Act 1978 (NZ) and the laws of New Zealand.

All persons into whose possession this material may come must inform themselves about and strictly observe the restrictions detailed in the preceding sentence.

This offering memorandum is not a New Zealand registered prospectus or investment statement, the content of which is prescribed by the Securities Act 1978 (NZ) and other laws, and does not contain the information that such documents would be required to contain.

NOTICE TO PROSPECTIVE INVESTORS IN NORWAY

The securities have not and will not be offered or sold, directly or indirectly, to any person in Norway, other than to legal and physical persons deemed to be professional investors as further defined in Section 7-1 of the Norwegian Regulation of Securities Trading (“the Regulation”).

Professional investors are categorized as:

- (i) Legal entities that are deemed to be professional investors without further requirements, cf. Section 7-1 (1) of the Regulation, and
- (ii) Legal and physical persons that must be registered with the competent authority responsible for inspecting prospectuses in order to be deemed professional investors, cf. Section 7-1 (2) and (3) of the Regulation.

This offering memorandum is furnished to potential investors solely for their information and may not be reproduced or redistributed to any other person. It is strictly confidential and is solely destined for persons or institutions to which it was initially supplied. This offering memorandum does not constitute an offer or invitation to subscribe for or to purchase any securities. Neither this offering memorandum nor anything herein shall form the basis of any contract or commitment whatsoever.

This offering memorandum has not been submitted to the Oslo Stock Exchange / the Norwegian Financial supervisory authority for approval.

Investment services, including offering and subscription of securities, can only be made through investment firms authorized by the Financial Supervisory Authority of Norway, cf. the Norwegian Securities Trading Act chapter 9. The State reserves its rights, at its sole discretion, to reject any subscription made through non-authorized investment firms.

SELLING RESTRICTIONS FOR OFFER OF SECURITIES IN SINGAPORE TO ACCREDITED INVESTORS AND INSTITUTIONAL INVESTORS

Neither this offering memorandum nor any other document or material in connection with any offer of the securities has been or will be lodged or registered as a prospectus with the Monetary Authority of Singapore (MAS) under the Securities and Futures Act (Cap.289) of Singapore (SFA). Accordingly, MAS assumes no responsibility for the contents of this document. This offering memorandum is not a prospectus as defined in the SFA and statutory liability under the SFA in relation to the contents of prospectuses would not apply.

This offering memorandum and any other documents or materials in connection with this offer and the securities may not be directly or indirectly issued, circulated or distributed, nor may the securities be offered or sold, or be made the subject of an invitation for subscription or purchase, whether directly or indirectly, to persons in Singapore other than (i) to an institutional investor under section 274 of the SFA; (ii) to a relevant person (as defined in section 275(2) of the SFA) pursuant to section 275(1) of the SFA; (iii) to any person pursuant to the conditions of section 275(1A) of the SFA; or (iv) otherwise pursuant to, and in accordance with, the conditions of any other applicable provisions of the SFA.

Any subsequent offers in Singapore of securities acquired pursuant to an initial offer made in reliance on an exemption under section 274 of the SFA or section 275 of the SFA may only be made, pursuant to the requirements of section 276 of the SFA, for the initial six month period after such acquisition to persons who are institutional investors (as defined in section 4A of the SFA) or to accredited investors and certain other persons (as set out in section 275 of the SFA). Any transfer after such initial six month period in Singapore shall be made, pursuant to the requirements of section 257 of the SFA, in reliance on any applicable exemption under Subdivision (4) of Division 1 of Part XIII of the SFA.

In addition to the above, pursuant to the requirements of section 276(3) of the SFA, where the securities are acquired pursuant to an offer made in reliance on the exemption under section 275 of the SFA by a corporation (other than a corporation that is an accredited investor (as defined in section 4A of the SFA)) whose sole business is to hold investments and the entire share capital of which is owned by one or more individuals each of whom is an accredited investor (as defined in section 4A of the SFA),

securities of such corporation shall not be transferred within 6 months after the corporation has acquired the securities pursuant to an offer made in reliance on the exemption under section 275 of the SFA unless that transfer is made only to institutional investors (as defined section 4A of the SFA) or relevant persons (as defined in section 275(2) of the SFA); or arises from an offer referred to in section 275(1A) of the SFA; or no consideration is or will be given for the transfer; or the transfer is by operation of law. This restriction does not apply to Securities previously made in or accompanied by a prospectus and which are of the same class as other securities of a corporation listed on the Singapore Exchange Securities Trading Limited.

Pursuant to the requirements of section 276(4) of the SFA, where the securities are acquired pursuant to an offer made in reliance on the exemption under section 275 of the SFA for a trust (other than a trust the trustee of which is an accredited investor (as defined in section 4A of the SFA)) whose sole purpose is to hold investments and each beneficiary of the trust is an individual who is an accredited investor (as defined in section 4A of the SFA), the beneficiaries' rights and interest (howsoever described) in the trust shall not be transferred within 6 months after the securities are acquired for the trust pursuant to an offer made in reliance on the exemption under section 275 of the SFA unless that transfer is made only to institutional investors (as defined in section 4A of the SFA) or relevant persons (as defined in section 275(2) of the SFA); or arises from an offer that is made on terms that such rights or interest are acquired at a consideration of not less than S\$200,000 (or its equivalent in a foreign currency) for each transaction, whether such amount is to be paid for in cash or by exchange of securities or other assets; or no consideration is or will be given for the transfer; or the transfer is by operation of law. This restriction does not apply to securities previously made in or accompanied by a prospectus and which are of the same class as other securities of a corporation listed on the Singapore Exchange Securities Trading Limited.

NOTICE TO SWEDISH INVESTORS

This offering memorandum has not been, and will not be, registered with or approved by the Swedish Financial Supervisory Authority (*Sw. Finansinspektionen*). Accordingly, this offering memorandum is not intended for and may not be made available to the public in Sweden. Nor may the securities otherwise be marketed and offered for sale, other than under circumstances that are deemed not to be an offer to the public in Sweden under the Swedish Financial Instruments Trading Act (1991:980). Notwithstanding the above, if the offer is deemed as an offer to the public in Sweden, please note that the offer is directed solely to qualified investors.

NOTICE TO PROSPECTIVE INVESTORS IN SWITZERLAND

This offering memorandum together with the any accompanying documents does not constitute an issue prospectus to Art. 1156 and Art. 652a of the Swiss Federal Code of Obligations. The securities may not be offered to the public in or from Switzerland, but only to a selected and limited circle of investors. This offering memorandum together with any accompanying documents and any other supplement hereto are personal to each offeree and do not constitute an offer to any other person. This offering memorandum together with any accompanying documents may only be used by those persons to whom they have been distributed in connection with the offering of the securities and may neither be copied nor directly or indirectly be distributed nor be made available to other persons without the express prior written consent of the State.

NOTICE TO PROSPECTIVE INVESTORS IN TAIWAN

The offer of the securities has not been and will not be registered with the Financial Supervisory Commission of Taiwan pursuant to relevant securities laws and regulations of Taiwan and the securities, including any copy of this document or any other documents relating to the securities, may not be offered, sold, delivered or distributed within Taiwan through a public offering or in circumstances which constitute an offer within the meaning of the Securities and Exchange Act of Taiwan that requires the prior registration with or approval of the Financial Supervisory Commission of Taiwan. Taiwan investors

who subscribe and purchase the securities shall comply with all relevant securities, tax and foreign exchange laws and regulations in effect in Taiwan.

NOTICE TO PROSPECTIVE INVESTORS IN THE KINGDOM OF THAILAND

Warnings:

Prior to making an investment decision, investors should exercise their own judgment when considering information relating to a party issuing securities or bonds as well as the terms and conditions of the securities or bonds, including the suitability of such securities or bonds for investment and their relevant risk exposure. Nothing in the prospectus should be read to represent or even suggest that the Securities and Exchange Commission or the Office of the Securities and Exchange Commission have recommended investment in the offered securities or bonds; nor does the prospectus contain any assurance in relation to the value or returns on the offered securities or bonds; nor has the Securities and Exchange Commission or the Office of the Securities and Exchange Commission certified the accuracy and completeness of information contained in the prospectus. The liability for certification of the accuracy and completeness of information contained in the prospectus is vested in the offeror of the securities or bonds.

If the prospectus contains any false statements or omits to state any material information which should have been disclosed, the securities or bond holders shall be entitled to claim damages from the securities or bond offeror or the securities or bond owners pursuant to section 82 of the Securities and Exchange Act B.E. 2535 (1992) within one year from the date on which the fact that this prospectus contained false information becomes known or should have been known, but not exceeding two years from the date the prospectus was delivered to the bond or securities holders.

Risks and restrictions:

In respect of investing in securities or bonds offered in Thailand by a foreign offeror, investors shall be entitled to rights and protections similar in nature to those provided by any foreign jurisdiction to investors making direct investments in the securities or bonds offered. Accordingly, investors are strongly encouraged to review and update themselves on the pertinent laws and regulations of the foreign offeror's home jurisdiction and of any jurisdiction where the securities or bonds of the foreign offeror are traded on an exchange.

NOTICE TO PROSPECTIVE INVESTORS IN THE UNITED ARAB EMIRATES

This offering memorandum has not been reviewed, approved or licensed by the UAE Central Bank or any other relevant licensing authorities or governmental agencies in the United Arab Emirates. This offering memorandum is strictly private and confidential and has not been reviewed, deposited or registered with any licensing authority or governmental agency in the United Arab Emirates, and securities offered hereby are being issued to a limited number of institutional or private investors and must not be provided to any person other than the original recipient and may not be reproduced or used for any other purpose. The securities may not be offered or sold directly or indirectly to the public in the United Arab Emirates.

NOTICE TO PROSPECTIVE INVESTORS IN THE UNITED KINGDOM

This offering memorandum is for distribution only to, and is directed solely at, persons who (i) are outside the United Kingdom, or (ii) if not outside of the United Kingdom (1) are investment professionals, as such term is defined in Article 19(5) of the Financial Services and Markets Act 2000 (Financial Promotion) Order 2005, as amended (the "Financial Promotion Order"), (2) are persons falling within Article 49(2)(a) to (d) of the Financial Promotion Order, or (3) are persons to whom an invitation or inducement to engage in investment banking activity (within the meaning of Section 21 of the Financial Services and Markets Act 2000) in connection with the issue or sale of any securities may

otherwise be lawfully communicated or caused to be communicated (all such persons together being referred to as “relevant persons”). This offering memorandum is directed only at relevant persons and must not be acted on or relied on by persons who are not relevant persons. Any investment or investment activity to which this offering memorandum relates is available only to relevant persons and will be engaged in only with relevant persons. Any person who is not a relevant person should not act or rely on this offering memorandum or any of its contents.

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OFFERING MEMORANDUM

STATE OF CALIFORNIA

\$2,000,000,000*

VARIOUS PURPOSE GENERAL OBLIGATION BONDS (FEDERALLY TAXABLE)

INTRODUCTION

This Introduction contains only a brief summary of the terms of the captioned Bonds and a brief description of this Offering Memorandum; a full review should be made of the entire Offering Memorandum, including the Appendices. Summaries of provisions of the Constitution and laws of the State of California (the "State") or any other documents referred to in this Offering Memorandum do not purport to be complete and such summaries are qualified in their entirety by references to the complete provisions.

Description of the Bonds

This Offering Memorandum describes \$2,000,000,000* aggregate principal amount of State various purpose general obligation bonds comprised of ___ series of bonds (the "Bonds"). The Bonds are described further below under "THE BONDS—Identification, Authorization and Purposes of the Bonds."

The State intends to sell revenue anticipation notes on or about November 17, 2010, and tax-exempt general obligation bonds on or about November 23, 2010, pursuant to separate official statements. Sale and delivery of the Bonds is not contingent upon the sale and delivery of the revenue anticipation notes or the tax-exempt bonds.

The Bonds will be registered in the name of a nominee of The Depository Trust Company, New York, New York ("DTC"), which will act as securities depository for the Bonds. Beneficial interests in the Bonds may be purchased in book-entry form only, in denominations of \$5,000 or any integral multiple thereof. See "THE BONDS—General" and APPENDIX B – "THE BOOK-ENTRY ONLY SYSTEM AND GLOBAL CLEARANCE PROCEDURES."

The issuance of each series of Bonds is authorized by the related general obligation bond act identified under "THE BONDS—Identification, Authorization and Purposes of the Bonds" (collectively, the "Bond Acts") approved by the voters of the State and by resolutions of the applicable finance committees designated under such Bond Acts. Each series of Bonds is equally secured. The Bonds are being issued to repay State general obligation commercial paper notes, to fund various projects under certain of the Bond Acts and to pay certain costs of issuance of the Bonds. See "THE BONDS – Identification; Authorization and Purposes of the Bonds."

A portion of the Bonds may be issued as "Build America Bonds" (the "BABs"). See "THE BONDS—Designation of Certain Bonds as 'Build America Bonds.'"

Security and Source of Payment for the Bonds

The Bonds are general obligations of the State to which the full faith and credit of the State are pledged. See "AUTHORIZATION OF AND SECURITY FOR THE BONDS—Security." The principal of and interest on all State general obligation bonds, including the Bonds, are payable from moneys in the General Fund of the State Treasury (the "General Fund"), subject only to the prior application of moneys in the General Fund to the support of the public school system and public institutions of higher education. See "AUTHORIZATION OF AND SECURITY FOR THE BONDS—Security." See also APPENDIX A

* Preliminary, subject to change.

– “THE STATE OF CALIFORNIA—STATE FINANCES—The General Fund” and “—STATE INDEBTEDNESS AND OTHER OBLIGATIONS—Capital Facilities Financing—General Obligation Bonds.”

Redemption*

The Bonds are subject to redemption, as described herein, prior to their respective stated maturity dates. See “THE BONDS—Redemption.”

Information Related to this Offering Memorandum

The information set forth herein has been obtained from official sources that are believed to be reliable, but is not guaranteed as to accuracy or completeness. The information and expressions of opinion herein are subject to change without notice and neither delivery of this Offering Memorandum nor any sale made hereunder or any future use of this Offering Memorandum shall, under any circumstances, create any implication that there has been no change in the affairs of the State since the date hereof.

All financial and other information presented or incorporated by reference in this Offering Memorandum has been provided by the State from its records, except for information expressly attributed to other sources. The presentation of certain information, including tables of receipts from taxes and other revenues, is intended to show recent historic information and is not intended to indicate future or continuing trends in the financial position or other affairs of the State. No representation is made that past experience, as it might be shown by such financial and other information, will necessarily continue or be repeated in the future. However, certain statements included or incorporated by reference in this Offering Memorandum do constitute “forward-looking statements.” Such statements are generally identifiable by the terminology used such as “plan,” “expect,” “estimate,” “budget” or other similar words. The achievement of certain results or other expectations contained in such forward-looking statements involve known and unknown risks, uncertainties and other factors that may cause actual results, performance or achievements described to be materially different from any future results, performance or achievements expressed or implied by such forward-looking statements. Any statements made in this Offering Memorandum involving matters of opinion, whether expressly stated or not, are set forth as such and not as representations of fact.

A wide variety of other information concerning the State, including financial information, is available from State agencies, State agency publications and State agency websites. Such information includes websites operated by the State Department of Finance, the State Controller’s Office and the State Treasurer’s Office. Any such information that is inconsistent with the information set forth in this Offering Memorandum should be disregarded. No such information is a part of or incorporated into this Offering Memorandum, except as expressly noted in APPENDIX A – “THE STATE OF CALIFORNIA—FINANCIAL STATEMENTS.”

The information in APPENDIX B – “THE BOOK-ENTRY ONLY SYSTEM AND GLOBAL CLEARANCE PROCEDURES” regarding DTC and its book-entry system has been furnished by DTC and no representation is made by the State, the Underwriters or the Financial Advisor as to the accuracy or completeness of such information. The information in APPENDIX B – “THE BOOK-ENTRY ONLY SYSTEM AND GLOBAL CLEARANCE PROCEDURES” regarding Euroclear Bank S.A./N.V., as operator of the Euroclear System (“Euroclear”) and Clearstream Banking, société anonyme, Luxembourg (“Clearstream, Luxembourg”) has been obtained by sources believed to be reliable and no representation is made by the State, the Underwriters or the Financial Advisor as to the accuracy or completeness of such information.

* Preliminary, subject to change

This Offering Memorandum does not constitute an offer to sell the Bonds or the solicitation of an offer to buy, nor shall there be any sale of, the Bonds by any person in any state or other jurisdiction to any person to whom it is unlawful to make such offer, solicitation or sale in such state or jurisdiction.

Continuing Disclosure

The State Treasurer will agree on behalf of the State to provide annually certain financial information and operating data relating to the State by not later than April 1 of each year in which any Bonds are outstanding (the "Annual Report"), commencing with the report to be filed on or before April 1, 2011, containing 2009-10 Fiscal Year financial information, and to provide notice of the occurrence of certain enumerated events. The specific nature of the information to be contained in the Annual Report and the notices of events and certain other terms of the continuing disclosure obligation are set forth in APPENDIX C—"FORM OF CONTINUING DISCLOSURE CERTIFICATE."

Within the past five years, the State has not failed to comply, in all material respects, with any "previous undertakings," as that term is used in Rule 15c2-12 (the "Rule") promulgated under the Securities and Exchange Act of 1934, as amended.

The State's Annual Reports are available from the Electronic Municipal Market Access ("EMMA") website (www.emma.msrb.org) operated by the Municipal Securities Rulemaking Board ("MSRB") or on such other website as may be designated by MSRB or the Securities and Exchange Commission.

STATE FINANCIAL PRESSURE

The state experienced a severe economic recession which began at the end of 2007, from which the state is still slowly recovering. Personal income fell in the first three quarters of 2009 before increasing moderately in the fourth quarter of 2009. Taxable sales fell sharply in the first half of 2009 before increasing in the third and fourth quarters of 2009 and in the first quarter of 2010. Taxable sales during the first two quarters of 2010 were up 3.6 percent from the first half of 2009. The state's unemployment rate increased from 5.9 percent in January 2008 to 12.6 percent in March 2010. The rate improved slightly thereafter, falling to 12.4 percent in August 2010 and holding steady in September 2010. In response to the most severe economic downturn in the United States since the Great Depression, in the Amended 2009 Budget Act, the state implemented substantial spending reductions, program eliminations, revenue increases, and other solutions in order to close an estimated \$60 billion budget gap over the combined 2008-09 and 2009-10 fiscal years. The state adopted reforms in nearly every area of government to better contain costs in the future. The 2010 Budget Act, adopted on October 8, 2010, made further reductions to many programs. Overall General Fund spending has been reduced to a level well below what it was over a decade ago in fiscal year 1998-99, adjusted for population and inflation growth. See APPENDIX A – "THE STATE OF CALIFORNIA --CURRENT STATE BUDGET."

The severe economic downturn resulted in General Fund revenues in fiscal year 2009-10 (\$86.9 billion) falling by approximately 16 percent from their peak in fiscal year 2007-08 (\$102.6 billion). The state is currently emerging from the recession, and although the level of unemployment is still very high, economic growth is rebounding. As a result, General Fund revenues in fiscal year 2010-11 (\$94.2 billion) are expected to rebound by approximately 8.4 percent above the depressed fiscal year 2009-10 levels. Future revenues will be affected by the expiration after fiscal year 2010-11 of temporary tax increases enacted in fiscal year 2009-10, which represent about \$7 billion in receipts in the current year, as well as the expiration of certain one-time revenues which were obtained in fiscal years 2009-10 and 2010-11.

The 2010 Budget Act was passed by the Legislature and signed by the Governor on October 8, 2010, the latest budget enactment in state history. The 2010 Budget Act projects revenues and transfers to the General Fund of \$94.2 billion, with expenditures of \$86.6 billion, leaving a balance on June 30, 2011 (after taking into account the negative beginning fund balance from June 30, 2010 of \$6.3 billion) of \$1.3 billion. An estimated \$19.3 billion budget gap was resolved with a combination of expenditure

reductions (44 percent of solutions), federal funds (28 percent of solutions) and various other one-time receipts, loans and other solutions (28 percent of solutions). Whether the state will be able to receive all the projected receipts or achieve all the planned expenditure reductions will depend on future actions at the state and federal level, and there is no assurance that all of the assumptions will be met. Furthermore, Proposition 22, an initiative measure approved by the voters on November 2, 2010, will prohibit the operation of certain parts of the 2010 Budget Act, with a negative effect of an estimated \$850 million on the current fiscal year and increased effects on future years. The Administration projects that there will be multi-billion dollar budget gaps in future years, as temporary fiscal measures adopted in recent years have to be repaid or temporary tax increases expire at the end of the 2010-11 fiscal year. More information is contained in the caption APPENDIX A – “THE STATE OF CALIFORNIA -- CURRENT STATE BUDGET.”

The fact that revenue for the last two years has been significantly lower than in the peak revenue year of 2007-08 resulted in a significant depletion of cash resources to pay the state’s obligations. By July 2009, the state’s cash resources dwindled so far that, commencing July 2, 2009, the State Controller began to issue registered warrants (or “IOUs”) for certain lower priority obligations in lieu of warrants (checks), which could not be immediately cashed. The registered warrants were all called for redemption on September 4, 2009, once the state was able to access the public credit markets for cash management purposes following enactment of the Amended 2009 Budget Act. No registered warrants were used to pay debt service on bonds, payments to schools, or employee payrolls. By employing a combination of external borrowing with Revenue Anticipation Notes and other cash management techniques after the registered warrants were redeemed, the state was able to meet all its cash obligations for the balance of the 2009-10 fiscal year and through the date of adoption of the 2010 Budget Act on October 8, 2010. Legislation enacted in early March 2010 and in October 2010 provided the state with additional tools to manage cash during the 2010-11 fiscal year by authorizing short-term deferral of certain state payments, primarily to schools and local governments.

The long delay in enacting the 2010 Budget Act caused a build-up of about \$6.7 billion of bills payable from the General Fund which could not be paid after July 1 in the absence of budget authority. In order to manage cash flow once all these bills became due for payment, in addition to using authority for payment deferrals either within the month of October or from the month of October to November 2010, the state replenished its cash position by issuing \$6.7 billion of interim revenue anticipation notes to six financial institutions. See APPENDIX A – “THE STATE OF CALIFORNIA -- CASH MANAGEMENT – Cash Management in Fiscal Year 2010-11”

The national and California economies improved following the 2010-11 Governor’s Budget. Output of the national economy grew for the fifth consecutive quarter in the third quarter of 2010, and California payroll employment grew by 7,800 jobs each month on average during the first eight months of 2010. However, while many sectors of both economies have bottomed out or made modest improvements, the level of economic activity is still far below normal—construction being a prime example.

There are signs that home prices have begun to stabilize and have improved in many regions of the state. Existing home sales peaked during the summer of 2005 and fell steadily through November 2008. A robust recovery in sales took place between November 2008 and November 2009, as sales were boosted by the first-time homebuyers’ tax credit. The tax credit was initially set to expire at the end of November 2009, but prior to its expiration, it was extended through April 30, 2010. Following the tax credit’s extension, there was a moderate rebound in sales in March 2010. The tax credit’s expiration on April 30, 2010, coupled with severe winter weather, caused home sales to fall again.

Both the state and national economies appear poised to make modest comebacks. Still, the recovery will probably be moderate and prolonged by historical standards.

The pension funds managed by the state's principal retirement systems, the California Public Employees' Retirement System and the California State Teachers' Retirement System, have sustained significant investment losses during the economic downturn and currently have substantial unfunded liabilities which will require increased contributions from the General Fund in future years. The state also has an unfunded liability relating to retirees' post-employment healthcare benefits which was estimated to be \$51.8 billion as of June 30, 2009. See APPENDIX A – "THE STATE OF CALIFORNIA -- STATE FINANCES – Pension Trusts."

These and other matters relating to the State's finances are set forth in greater detail in Appendix A which should be read in its entirety by purchasers of the Bonds.

AUTHORIZATION OF AND SECURITY FOR THE BONDS

Authorization

The issuance of each series of Bonds is authorized by the related general obligation bond act identified under "THE BONDS—Identification, Authorization and Purposes of the Bonds" (collectively, the "Bond Acts") approved by the voters of the State and by resolutions of the applicable finance committees designated under such Bond Acts. Each Bond Act and the State General Obligation Bond Law (the "Law") in Chapter 4 (commencing with Section 16720) of Part 3 of Division 4 of Title 2 of the California Government Code, as incorporated by reference into each Bond Act, provides for the authorization, sale, issuance, use of proceeds, repayment and refunding of State general obligation bonds. Each series of the Bonds is authorized under the related Bond Act by one or more resolutions adopted by a finance committee designated in such Bond Act (collectively, the "Resolutions").

Security

The Bonds are general obligations of the State, payable in accordance with the Bond Acts out of the General Fund. The Bond Acts provide that the State will collect annually in the same manner and at the same time as it collects other State revenue an amount sufficient to pay principal of and interest on the Bonds. The Bond Acts also contain a continuing appropriation from the General Fund of the sum annually necessary to pay the principal of and interest on the Bonds as they become due and payable. No further appropriation by the Legislature is required to pay the principal of and interest on the Bonds. Under the State Constitution, the appropriation to pay the principal of and interest on the Bonds as set forth in the Bond Acts cannot be repealed until the principal of and interest on the Bonds is paid and discharged.

The Bond Acts each provide that the Bonds issued thereunder "shall be and constitute a valid and binding obligation of the State of California, and the full faith and credit of the State is hereby pledged for the punctual payment of the principal of, and interest on, the bonds as the principal and interest become due and payable." The pledge of the full faith and credit of the State alone does not create a lien on any particular moneys in the General Fund or any other assets of the State, but is an undertaking by the State to be irrevocably obligated in good faith to use its taxing powers as may be required for the full and prompt payment of the principal of and interest on all general obligation bonds as they become due. The only provision of the State Constitution that creates a higher priority for any State fiscal obligation is a provision directing that from all State revenues there will first be set apart the moneys to be applied by the State for support of the public school system and public institutions of higher education. In the past when cash resources in the General Fund have been constrained, State officials have worked within their powers granted by State law to manage cash resources to ensure that payments to schools and universities and for general obligation debt service would be made. On any debt service payment date, all general obligation bonds have an equal claim on moneys in the General Fund on that date for payment of debt service. See APPENDIX A—"THE STATE OF CALIFORNIA—STATE INDEBTEDNESS AND OTHER OBLIGATIONS—Capital Facilities Financing—General Obligation Bonds," "—CASH MANAGEMENT" and "—STATE FINANCES – State Warrants."

Remedies

Under the Resolutions, it is an event of default of the State to fail to pay or to fail to cause to be paid, when due, or to declare a moratorium on the payment of, or to repudiate, any Bond.

Each Resolution states that in the case that one or more events of default occurs, then and in every such case the registered Bondholder is entitled to proceed to protect and enforce such registered Bondholder's rights by such appropriate judicial proceeding as such registered Bondholder deems most effectual to protect and enforce any such right, whether by mandamus or other suit or proceeding at law or in equity, for the specific performance of any covenant or agreement contained in the one or more Resolutions authorizing the affected Bonds, as more specifically set forth in each Resolution authorizing the Bonds pursuant to the respective Bond Acts. Beneficial owners of the Bonds (the "Beneficial Owners") cannot protect and enforce such rights except through the registered Bondholder. See "THE BONDS—General" and APPENDIX B—"THE BOOK-ENTRY ONLY SYSTEM AND GLOBAL CLEARANCE PROCEDURES."

Since the State has never failed to make a debt service payment on any general obligation bond when due, the exact steps which would be taken, or the remedies available to Bondholders, have never been tested. There are no cross-default provisions among general obligation bonds, so any default with respect to any particular issue of bonds would not provide any remedy to holders of other bonds which are not affected. The State is not eligible to file for protection under the federal bankruptcy laws of the United States.

THE BONDS

General

The Bonds will be registered in the name of a nominee of DTC, which will act as securities depository for the Bonds. Beneficial interests in the Bonds may be purchased in book-entry form only in denominations of \$5,000 or any integral multiple thereof and Bonds sold outside of the United States will be sold in minimum purchase and trading amounts of \$100,000. See APPENDIX B - "THE BOOK-ENTRY ONLY SYSTEM AND GLOBAL CLEARANCE PROCEDURES."

The Bonds will be dated and accrue interest from the date of their delivery, and will mature on November 1 of the years and in the amounts set forth on the inside cover page hereof. Interest on the Bonds is payable on May 1 and November 1 in each year (each, an "Interest Payment Date"), commencing on May 1, 2011, at the rates shown on the inside cover page of this Offering Memorandum. Interest on the Bonds will be calculated on the basis of a 360-day year comprising twelve 30-day months.

Principal, premium, if any, and interest, including the redemption price, are payable directly to DTC by the State Treasurer. Upon receipt of payments of principal, premium, if any, and interest, DTC is to in turn remit such principal, premium, if any, and interest to the Direct Participants in DTC for disbursement to the Beneficial Owners of the Bonds. The record date for the payment of interest on the Bonds is the close of business on the 15th day of the month immediately preceding an Interest Payment Date, whether or not the record date falls on a business day.

Neither the State Treasurer nor the Underwriters can give any assurance that DTC will distribute to Participants, or that Participants or others will distribute to the Beneficial Owners, payment of principal of and premium, if any, and interest on the Bonds paid or any redemption or other notices or that they will do so on a timely basis or will serve and act in the manner described in this Offering Memorandum. Neither the State Treasurer nor the Underwriters are responsible or liable for the failure of DTC or any Direct Participant or Indirect Participant to make any payments or give any notice to a Beneficial Owner with respect to the Bonds or any error or delay relating thereto.

The terms of each series of Bonds are substantially identical, except that the State may assign each maturity of the Bonds to one or more particular Bond Acts, rather than having all of the Bonds mature proportionally by Bond Act across the entire maturity schedule.

Identification, Authorization and Purposes of the Bonds

The Bonds are issued as ___ separate series under ___ Bond Acts, each authorized by the voters pursuant to the Bond Acts as set forth below, to repay certain outstanding State general obligation commercial paper notes, to fund various projects under certain of the Bond Acts and to pay certain costs of issuance of the Bonds.

<u>BOND ACT</u>	<u>BOND NAME</u>	<u>FINANCE COMMITTEE</u>	<u>SERIES</u>	<u>AMOUNT</u>
Water Conservation and Water Quality Bond Law of 1986	Water Conservation and Water Quality Bonds	Water Conservation and Water Quality Finance Committee		
Water Conservation Bond Law of 1988	Water Conservation Bonds	Water Conservation Finance Committee		
1988 School Facilities Bond Act	School Facilities Bonds	State School Building Finance Committee		
New Prison Construction Bond Act of 1988	New Prison Construction Bonds	1988 Prison Construction Committee		
California Safe Drinking Water Bond Law of 1988	Safe Drinking Water Bonds	California Safe Drinking Water Finance Committee		
New Prison Construction Bond Act of 1990	New Prison Construction Bonds	1990 Prison Construction Committee		
1990 School Facilities Bond Act	School Facilities Bonds	State School Building Finance Committee		
Higher Education Facilities Bond Act of June 1990	Higher Education Facilities Bonds	Higher Education Facilities Finance Committee		
Earthquake Safety and Public Buildings Rehabilitation Bond Act of 1990	Earthquake Safety and Public Buildings Rehabilitation Bonds	Earthquake Safety and Public Buildings Rehabilitation Finance Committee		
Clean Air and Transportation Improvement Bond Act of 1990	Clean Air and Transportation Improvement Bonds	Transportation Improvement Finance Committee		
School Facilities Bond Act of 1992	School Facilities Bonds	State School Building Finance Committee		
Higher Education Facilities Bond Act of June 1992	Higher Education Facilities Bonds	Higher Education Facilities Finance Committee		
1992 School Facilities Bond Act	School Facilities Bonds	State School Building Finance Committee		

<u>BOND ACT</u>	<u>BOND NAME</u>	<u>FINANCE COMMITTEE</u>	<u>SERIES</u>	<u>AMOUNT</u>
Public Education Facilities Bond Act of 1996	Public Education Facilities Bonds	State School Building Finance Committee		
Safe, Clean, Reliable Water Supply Act	Safe, Clean, Reliable Water Supply Bonds	Safe, Clean, Reliable Water Supply Finance Committee		
Class Size Reduction Kindergarten-University Public Education Facilities Bond Act of 1998	Class Size Reduction Kindergarten-University Public Education Facilities Bonds	State School Building Finance Committee		
Safe Neighborhood Parks, Clean Water, Clean Air, and Coastal Protection Bond Act of 2000 (the Villaraigosa-Keeley Act)	Safe Neighborhood Parks, Clean Water, Clean Air, and Coastal Protection Bonds	Safe Neighborhood Parks, Clean Water, Clean Air, and Coastal Protection (Villaraigosa-Keeley Act) Finance Committee		
Safe Drinking Water, Clean Water, Watershed Protection, and Flood Protection Act	Safe Drinking Water, Clean Water, Watershed Protection, and Flood Protection Bonds	Safe Drinking Water, Clean Water, Watershed Protection, and Flood Protection Finance Committee		
California Reading and Literacy Improvement and Public Library Construction and Renovation Bond Act of 2000	Library Construction and Renovation Bonds	California Library Construction and Renovation Finance Committee		
California Clean Water, Clean Air, Safe Neighborhood Parks, and Coastal Protection Act of 2002	California Clean Water, Clean Air, Safe Neighborhood Parks, and Coastal Protection Bonds	California Clean Water, Clean Air, Safe Neighborhood Parks, and Coastal Protection Act Finance Committee		
Veterans' Homes Bond Act of 2000	Veterans' Homes Bonds	Veterans' Home Finance Committee		
Voting Modernization Bond Act of 2002 (Shelley-Hertzberg Act)	Voting Modernization Bonds	Voting Modernization Finance Committee		
Kindergarten-University Public Education Facilities Bond Act of 2002	Kindergarten-University Public Education Facilities Bonds	Higher Education Facilities Finance Committee		
Kindergarten-University Public Education Facilities Bond Act of 2002	Kindergarten-University Public Education Facilities Bonds	State School Building Finance Committee		

<u>BOND ACT</u>	<u>BOND NAME</u>	<u>FINANCE COMMITTEE</u>	<u>SERIES</u>	<u>AMOUNT</u>
Housing and Emergency Shelter Trust Fund Act of 2002	Housing and Emergency Shelter Bonds	Housing Finance Committee		
Water Security, Clean Drinking Water, Coastal and Beach Protection Act of 2002	Water Security, Clean Drinking Water, Coastal and Beach Protection Bonds	Water Security, Clean Drinking Water, Coastal and Beach Protection Act of 2002 Finance Committee		
Kindergarten-University Public Education Facilities Bond Act of 2004	Kindergarten-University Public Education Facilities Bonds	State School Building Finance Committee		
Kindergarten-University Public Education Facilities Bond Act of 2004	Kindergarten-University Public Education Facilities Bonds	Higher Education Facilities Finance Committee		
California Stem Cell Research and Cures Bond Act of 2004	California Stem Cell Research and Cures Bonds	California Stem Cell Research and Cures Finance Committee		
Children's Hospital Bond Act of 2004	Children's Hospital Bonds	Children's Hospital Bond Act Finance Committee		
Kindergarten-University Public Education Facilities Bond Act of 2006	Kindergarten-University Public Education Facilities Bonds	State School Building Finance Committee		
Kindergarten-University Public Education Facilities Bond Act of 2006	Kindergarten-University Public Education Facilities Bonds	Higher Education Facilities Finance Committee		
Highway Safety, Traffic Reduction, Air Quality, and Port Security Bond Act of 2006	Highway Safety, Traffic Reduction, Air Quality, and Port Security Bonds	Highway Safety, Traffic Reduction, Air Quality, and Port Security Committee		
Housing and Emergency Shelter Trust Fund Act of 2006	Housing and Emergency Shelter Bonds	Housing Finance Committee		
Disaster Preparedness and Flood Prevention Bond Act of 2006	Disaster Preparedness and Flood Prevention Bonds	Disaster Preparedness and Flood Prevention Bond Finance Committee		
Safe Drinking Water, Water Quality and Supply, Flood Control, River and Coastal Protection Bond Act of 2006	Safe Drinking Water, Water Quality and Supply, Flood Control, River and Coastal Protection Bonds	Safe Drinking Water, Water Quality and Supply, Flood Control, River and Coastal Protection Finance Committee		

<u>BOND ACT</u>	<u>BOND NAME</u>	<u>FINANCE COMMITTEE</u>	<u>SERIES</u>	<u>AMOUNT</u>
Safe, Reliable High-Speed Passenger Train Bond Act for the 21st Century	High-Speed Passenger Train Bonds	High-Speed Passenger Train Finance Committee		
Children's Hospital Bond Act of 2008	Children's Hospital Bonds	Children's Hospital Bond Act Finance Committee		

The proceeds of the Bonds, after payment of certain costs of issuance, will be used to finance or refinance capital facilities or other voter-approved costs for public purposes, including correctional facilities; neighborhood parks, clean water, clean air and coastal protection; safe drinking water; children's hospitals; earthquake safety, seismic retrofit and public building rehabilitation; public primary, secondary, community college and university education facilities; highway safety, traffic reduction, air quality and port security; transportation; housing and emergency shelters; clean water, watershed protection and flood protection; water quality, water supply and river and coastal protection; water conservation; literacy improvement and public library construction and renovation; medical research; veterans' homes; high speed rail facilities and disaster preparedness and flood prevention; and voting modernization.*

Designation of Certain Bonds as “Build America Bonds”

The Bonds maturing in _____ (the “BABs”) are expected to be issued as “Build America Bonds” for purposes of the American Recovery and Reinvestment Act of 2009 (the “Recovery Act”). Pursuant to the Recovery Act, the State expects to receive a cash subsidy payment from the United States Treasury equal to 35% of the interest payable on the BABs on or about each interest payment date. The cash payment does not constitute a full faith and credit guarantee of the United States Government, but is required to be paid by the United States Treasury under the Recovery Act. Any cash subsidy payments received by the State will be deposited into the State Treasury. Such payments are not pledged to secure repayment of the Bonds.

Redemption*

Make-Whole Optional Redemption. The Bonds are subject to redemption prior to their stated maturity dates at the option of the State, in whole or in part on any date, at a redemption price (the “Make-Whole Redemption Price”) equal to the greater of:

- (1) the issue price set forth on the cover page hereof (but not less than 100%) of the principal amount of the Bonds to be redeemed; or
 - (2) the sum of the present value of the remaining scheduled payments of principal and interest to the maturity date of the Bonds to be redeemed, not including any portion of those payments of interest accrued and unpaid as of the date on which the Bonds are to be redeemed, discounted to the date on which the Bonds are to be redeemed on a semi-annual basis, assuming a 360-day year consisting of twelve 30-day months, at the Treasury Rate, plus __ basis points;
- plus, in each case, accrued interest on the Bonds to be redeemed to the redemption date.

* Preliminary, subject to change.

“Treasury Rate” means, with respect to any redemption date for a particular Bond, the yield to maturity as of such redemption date of United States Treasury securities with a constant maturity (as compiled and published in the most recent Federal Reserve Statistical Release H.15 (519) that has become publicly available at least two Business Days, but not more than forty-five (45) calendar days, prior to the redemption date (excluding inflation indexed securities) (or, if such Statistical Release is no longer published, any publicly available source of similar market data)) most nearly equal to the period from the redemption date to the maturity date of the Bond to be redeemed; provided, however, that if the period from the redemption date to such maturity date is less than one year, the weekly average yield on actually traded United States Treasury securities adjusted to a constant maturity of one year will be used.

On and after _____ 1, 20___, the Bonds maturing on November 1, 20___ will be subject to redemption as described under “Optional Redemption” below and will no longer be called at the Make-Whole Redemption Price.

Extraordinary Optional Redemption. The BABs are subject to redemption prior to their stated maturity dates at the option of the State, in whole or in part upon the occurrence of an Extraordinary Event, at a redemption price (the “Extraordinary Redemption Price”) equal to the greater of:

- (1) the issue price set forth on the inside cover page hereof (but not less than 100%) of the principal amount of such Bonds to be redeemed; or
- (2) the sum of the present value of the remaining scheduled payments of principal and interest to the maturity date of such Bonds to be redeemed, not including any portion of those payments of interest accrued and unpaid as of the date on which such Bonds are to be redeemed, discounted to the date on which such Bonds are to be redeemed on a semi-annual basis, assuming a 360-day year consisting of twelve 30-day months, at the Treasury Rate (described above) plus 100 basis points;

plus, in each case, accrued interest on such Bonds to be redeemed to the redemption date.

An “Extraordinary Event” will have occurred if a material adverse change has occurred to Section 54AA or 6431 of the Internal Revenue Code of 1986, as amended (the “Code”) (as such Sections were added by Section 1531 of the Recovery Act, pertaining to “Build America Bonds”), pursuant to which the State’s 35% cash subsidy payment from the United States Treasury is reduced or eliminated.

On and after _____ 1, 20___, the Bonds maturing on November 1, 20___ will be subject to redemption as described under “Optional Redemption” below and will no longer be called at the Extraordinary Optional Redemption Price.

Optional Redemption. The Bonds maturing on November 1, 20___ are subject to optional redemption prior to their stated maturity date, in whole or in part, on any date on or after _____, at a redemption price equal to 100% of the principal amount thereof to be redeemed (the “Redemption Price”), plus accrued interest to the date fixed for redemption.

Sinking Fund Redemption. The Bonds maturing on November 1, 20___ (the “20___ Term Bonds”) are subject to redemption prior to their stated maturity date, in part, pro rata, from sinking fund payments made by the State, at a redemption price of 100% of the principal amount thereof plus accrued interest to the sinking fund payment date fixed for redemption, on November 1 of the years, and in the amounts, designated below:

Sinking Fund Payment Date (November 1)	Principal Amount Redeemed
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¹Maturity

If the 20__ Term Bonds are called for optional redemption in part (see “Redemption—*Make-Whole Optional Redemption*,” “—*Extraordinary Optional Redemption*,” and “—*Optional Redemption*,” above), the remaining sinking fund installments for the 20__ Term Bonds shall be adjusted pro rata.

The Bonds maturing on November 1, 20__ (the “20__ Term Bonds”) are subject to redemption prior to their stated maturity date, in part, pro rata, from sinking fund payments made by the State, at a redemption price of 100% of the principal amount thereof plus accrued interest to the sinking fund payment date fixed for redemption, on November 1 of the years, and in the amounts designated below:

Sinking Fund Payment Date <u>(November 1)</u>	Principal Amount <u>Redeemed</u>
--	-------------------------------------

[†]Maturity

If the 20__ Term Bonds are called for optional redemption in part (see “Redemption— *Make-Whole Optional Redemption*,” “—*Extraordinary Optional Redemption*,” and “—*Optional Redemption*,” above), the remaining sinking fund installments for the 20__ Term Bonds shall be adjusted pro rata.

Calculation of Redemption Price. At the request of the State Treasurer, as Paying Agent, the redemption price of the Bonds to be redeemed at the option of the State as described under “Make Whole Optional Redemption” and “Extraordinary Optional Redemption” shall be determined by an independent accounting firm, investment banking firm or financial advisor retained by the State at the State’s expense to calculate such redemption price. The State may conclusively rely on the determination of such redemption price by such independent accounting firm, investment banking firm or financial advisor and shall not be liable for such reliance.

Selection of Bonds for Redemption. If less than all of the Bonds of a maturity shall be called for redemption, the State Treasurer shall select the specific Bonds for redemption pro rata; provided that, so long as the Bonds are held in book-entry-only form and so long as DTC, or a successor securities depository, is the sole registered owner of the Bonds, the selection for redemption of such Bonds of a maturity shall be made so that the particular Bonds or portions thereof to be redeemed shall be selected on a “Pro Rata Pass-Through Distribution of Principal” basis, subject to the operational arrangements of DTC then in effect. If the DTC operational arrangements do not allow for redemption on a pro rata basis, the Bonds will be selected for redemption in accordance with DTC procedures, by lot or in such other manner as is in accordance with applicable DTC operational arrangements. None of the State, the State Treasurer or the Underwriters can provide any assurance that DTC, DTC’s direct and indirect participants, or any other intermediary will allocate partial redemptions among beneficial owners of the Bonds of a maturity on a pro rata basis. See APPENDIX B – “THE BOOK-ENTRY ONLY SYSTEM AND GLOBAL CLEARANCE PROCEDURES—THE DTC’S BOOK ENTRY SYSTEM” for a description of DTC and the book-entry only system.

The portion of any Bond of a denomination of more than \$5,000 to be redeemed will be in the principal amount of \$5,000 or any integral multiple thereof. The State Treasurer will select such portions of Bonds to be redeemed in such manner as the State Treasurer in his or her discretion may deem to be fair and appropriate.

Notice of Redemption. When Bonds are redeemed, the State Treasurer is to give notice of redemption by mail and/or mutually acceptable electronic means only to DTC (not to the Beneficial Owners of the Bonds) not less than 30 or more than 60 days prior to the date fixed for redemption. DTC, in turn, is to send the notice of redemption to its participants for distribution to the Beneficial Owners of the Bonds. See APPENDIX B—“THE BOOK-ENTRY ONLY SYSTEM AND GLOBAL

CLEARANCE PROCEDURES.” The notice from the State Treasurer will state, among other things, that the Bonds or a designated portion thereof (in the case of partial redemption of a Bond) are to be redeemed, the dated date of the Bonds, the date fixed for redemption, the maturities of the Bonds to be redeemed and the redemption price or method of calculation of redemption price, as applicable. The notice will also state that after the date fixed for redemption no further interest will accrue on the principal of any Bonds called for redemption. The notice of redemption may also state that such redemption may be cancelled in whole or in part by the State Treasurer upon written notice to DTC no later than five business days prior to the date fixed for redemption. Notice of redemption will also be provided by mail or electronic means to the MSRB’s EMMA portal.

Annual Debt Service Requirements

The following table sets forth the amounts required to be made available for the payment of principal, interest and the total payments due on the Bonds.

<u>Fiscal Year Ended June 30*</u>	<u>Principal</u>	<u>Interest</u>	<u>Fiscal Year Total Debt Service</u>
2011	\$	\$	\$
2012			
2013			
2014			
2015			
2016			
2017			
2018			
2019			
2020			
2021			
2022			
2023			
2024			
2025			
2026			
2027			
2028			
2029			
2030			
2031			
2032			
2033			
2034			
2035			
2036			
2037			
2038			
2039			
2040			
Total	\$_____	\$_____	\$_____

* Certain maturities may be issued as BABs. The State expects to receive payments from the United States Government equal to 35% of the interest on the BABs as reimbursement for a portion of the interest payments made by the State.

For additional information regarding debt service payment obligations of the State, see APPENDIX A – “THE STATE OF CALIFORNIA – STATE DEBT TABLES.”

Supplemental Resolutions

The State may modify or amend the Resolutions with respect to any outstanding Bonds and the rights and obligations of the Bondholders of such outstanding Bonds and the State at any time by a Supplemental Resolution, without notice to or the consent of any Bondholder, but only to make such provisions for the purpose of (i) curing any ambiguity or curing, correcting or supplementing any defective provision contained in the Resolutions, or (ii) complying with requirements of the Code in order to satisfy the covenants of the Resolutions relating to the tax status of interest on the affected bonds; in each case as the applicable finance committee may deem necessary or desirable and not inconsistent with the Resolutions, and which shall not adversely affect the interests of the Bondholder of the affected bonds.

Defeasance

Pursuant to the Bond Acts and the provisions of California Government Code Section 16780 *et seq.* (the “Refunding Law”), refunding bonds may be issued to refund outstanding Bonds at or prior to their stated maturity. Pursuant to Section 16784 of the Refunding Law, the proceeds of such refunding bonds and other funds as described herein shall be deposited into the Refunding Escrow Fund of the State Treasury, which fund is irrevocably dedicated to pay the principal of, premium, if any, and interest on the refunded Bonds as it comes due. A separate account or accounts will be created within the Refunding Escrow Fund for each issue of refunding bonds. If Defeasance Obligations together with cash, if any, sufficient to pay all of the principal of, premium, if any, and interest on the refunded Bonds to their maturity or the date fixed for redemption are so deposited in the Refunding Escrow Fund, the refunded Bonds will no longer be deemed outstanding for purposes of the Resolutions. Except in the case of the defeasance of Bonds by the deposit of Defeasance Obligations (without accounting for investment earnings, if any, thereon) or cash or both in the full amount of the principal, premium, if any, and interest due until the date fixed for redemption or maturity, the sufficiency of the deposit in the Refunding Escrow Fund will be verified by a firm of independent public accountants. Defeasance of any Bond may result in a reissuance thereof, in which event a holder will recognize taxable gain or loss equal to the difference between the amount realized from the sale, exchange or retirement (less any accrued qualified stated interest which will be taxable as such) and the holder’s adjusted tax basis in the Bond.

“Defeasance Obligations” for these purposes are defined as follows: (i) bonds or interest-bearing notes or obligations of the United States, or those for which the faith and credit of the United States are pledged for the payment of principal and interest, including receipts, certificates or any other evidences of an ownership interest therein, or in specified portions thereof, which are rated in the highest rating category by each rating agency rating such obligations; (ii) bonds or interest-bearing notes or obligations that are guaranteed as to principal and interest by a federal agency of the United States; (iii) pre-refunded municipal bonds which are rated in the highest rating category by each rating agency rating such bonds; (iv) bonds, consolidated bonds, collateral trust debentures, consolidated debentures or other obligations issued by federal land banks or federal intermediate credit banks established under the Federal Farm Loan Act, as amended; debentures and consolidated debentures issued by the Central Bank for Cooperatives and banks for cooperatives established under the Farm Credit Act of 1933, as amended; bonds or debentures of the Federal Home Loan Bank Board established under the Federal Home Loan Bank Act; bonds, debentures and other obligations of the Federal National Mortgage Association established under the National Housing Act as amended and bonds of any federal home loan bank established under that act; obligations of the Federal Home Loan Mortgage Corporation; bonds, notes and other obligations issued by the Tennessee Valley Authority under the Tennessee Valley Authority Act as amended; and bonds, notes and other obligations guaranteed by the Commodity Credit Corporation for the export of California agricultural products under the Commodity Credit Corporation Charter Act as amended,

provided, however that the Defeasance Obligations specified in this paragraph (iv) shall be rated by at least two of any three rating agencies rating such obligations not lower than the higher of (1) the rating on the Bonds to be defeased at the time of the original issuance thereof and (2) the rating on the Bonds to be defeased at the time of defeasance; (v) deposit in the State Surplus Money Investment Fund; or (vi) any other investment designated in a Supplemental Certificate as a Defeasance Obligation for purposes of defeasing the Bonds authorized by such Supplemental Certificate, provided that each rating agency has confirmed in writing to the Treasurer that the use of such other investment will not, by itself, result in the withdrawal, suspension or downgrade of any rating issued by such rating agency with respect to any such Bonds defeased.

LEGAL MATTERS

The opinion of the Honorable Edmund G. Brown Jr., Attorney General of the State (the “Attorney General”), approving the validity of the Bonds will accompany the Bonds deposited with DTC. The opinion of Orrick, Herrington & Sutcliffe LLP, Bond Counsel to the State (“Bond Counsel”), approving the validity of the Bonds and addressing certain tax matters will also accompany the Bonds deposited with DTC. The proposed forms of legal opinions for the Bonds are set forth in Appendix D. See “TAX MATTERS” and APPENDIX D—“PROPOSED FORMS OF LEGAL OPINIONS.” Orrick, Herrington & Sutcliffe LLP and Alexis S. M. Chiu, Esq., are serving as Co-Disclosure Counsel to the State with respect to the Bonds (“Bond Co-Disclosure Counsel”). Orrick, Herrington & Sutcliffe LLP and Stradling Yocca Carlson and Rauth, a Professional Corporation, are serving as Co-Disclosure Counsel to the State regarding Appendix A (“Appendix A Co-Disclosure Counsel”). Certain legal matters will be passed upon for the Underwriters by their counsel, Sidley Austin LLP (“Underwriters’ Counsel”).

The Attorney General, Bond Counsel, Bond Co-Disclosure Counsel, Appendix A Co-Disclosure Counsel and Underwriters’ Counsel, respectively, undertake no responsibility for the accuracy, completeness or fairness of this Offering Memorandum.

TAX MATTERS

In the opinion of Bond Counsel, based upon an analysis of existing laws, regulations, rulings and court decisions, and assuming, among other matters, the accuracy of certain representations and compliance with certain covenants, interest on the Bonds is not excluded from gross income for federal income tax purposes under Section 103 of the Internal Revenue Code of 1986, as amended. Bond Counsel is of the opinion that interest on the Bonds is exempt from State of California personal income taxes. Bond Counsel expresses no opinion regarding any other tax consequences relating to the ownership or disposition of, or the accrual or receipt of interest on, the Bonds.

The following discussion summarizes certain U.S. federal tax considerations generally applicable to holders of the Bonds that acquire their Bonds in the initial offering. The discussion below is based upon laws, regulations, rulings, and decisions in effect and available on the date hereof, all of which are subject to change, possibly with retroactive effect. Prospective investors should note that no rulings have been or are expected to be sought from the U.S. Internal Revenue Service (the “IRS”) with respect to any of the U.S. federal income tax consequences discussed below, and no assurance can be given that the IRS will not take contrary positions. Further, the following discussion does not deal with all U.S. federal income tax consequences applicable to any given investor, nor does it address the U.S. federal income tax considerations applicable to categories of investors some of which may be subject to special taxing rules (regardless of whether or not such persons constitute U.S. Holders), such as certain U.S. expatriates, banks, REITs, RICs, insurance companies, tax-exempt organizations, dealers or traders in securities or currencies, partnerships, S corporations, estates and trusts, investors that hold their Bonds as part of a hedge, straddle or an integrated or conversion transaction, or investors whose “functional currency” is not the U.S. dollar. Furthermore, it does not address (i) alternative minimum tax consequences or (ii) the indirect effects on persons who hold equity interests in a holder. In addition, this summary generally is limited to investors that acquire their Bonds pursuant to this offering for the issue price that is applicable

to such Bonds (i.e., the price at which a substantial amount of the Bonds are sold to the public) and who will hold their Bonds as “capital assets” within the meaning of Section 1221 of the U.S. Internal Revenue Code of 1986, as amended (the “Code”).

As used herein, “U.S. Holder” means a beneficial owner of a Bond that for U.S. federal income tax purposes is an individual citizen or resident of the United States, a corporation or other entity taxable as a corporation created or organized in or under the laws of the United States or any state thereof (including the District of Columbia), an estate the income of which is subject to U.S. federal income taxation regardless of its source or a trust where a court within the United States is able to exercise primary supervision over the administration of the trust and one or more United States persons (as defined in the Code) have the authority to control all substantial decisions of the trust (or a trust that has made a valid election under U.S. Treasury Regulations to be treated as a domestic trust). As used herein, “Non-U.S. Holder” generally means a beneficial owner of a Bond (other than a partnership) that is not a U.S. Holder. If a partnership holds Bonds, the tax treatment of such partnership or a partner in such partnership generally will depend upon the status of the partner and upon the activities of the partnership. Partnerships holding Bonds, and partners in such partnerships, should consult their own tax advisors regarding the tax consequences of an investment in the Bonds (including their status as U.S. Holders or Non-U.S. Holders).

For U.S. Holders

The Bonds may be issued with original issue discount (“OID”). In general, the excess of the stated redemption price at maturity of a Bond over its issue price will constitute OID for U.S. federal income tax purposes. The stated redemption price at maturity of a Bond is the sum of all scheduled amounts payable on the Bond (other than qualified stated interest). U.S. Holders of the Bonds will be required to include OID in income for U.S. federal income tax purposes as it accrues, in accordance with a constant yield method based on a compounding of interest (which may be before the receipt of cash payments attributable to such income). Under this method, U.S. Holders generally will be required to include in income increasingly greater amounts of OID in successive accrual periods.

Prospective investors that are not individuals or regular C corporations who are U.S. persons purchasing the Bonds for investment should consult their own tax advisors as to any tax consequences to them from the purchase, ownership and disposition of the Bonds.

Disposition of the Bonds. Unless a nonrecognition provision of the Code applies, the sale, exchange, redemption, retirement (including pursuant to an offer by the State) or other disposition of a Bond, will be a taxable event for U.S. federal income tax purposes. In such event, in general, a U.S. Holder of a Bond will recognize gain or loss equal to the difference between (i) the amount of cash plus the fair market value of property received (except to the extent attributable to accrued but unpaid interest on the Bond which will be taxed in the manner described above) and (ii) the U.S. Holder’s adjusted tax basis in the Bond (generally, the purchase price paid by the U.S. Holder for the Bond, increased by the amount of any OID previously included in income by such U.S. Holder with respect to such Bond and decreased by any payments previously made on such Bond (other than payments of qualified stated interest) or, decreased by any amortized premium). Any such gain or loss generally will be capital gain or loss. In the case of a noncorporate U.S. Holder of the Bonds, the maximum marginal U.S. federal income tax rate applicable to any such gain will be lower than the maximum marginal U.S. federal income tax rate applicable to ordinary income if such U.S. holder’s holding period for the Bonds exceeds one year. The deductibility of capital losses is subject to limitations.

For Non-U.S. Holders

Interest. Subject to the discussion below under the heading “Information Reporting and Backup Withholding,” payments of principal of, and interest on, any Bond to a Non-U.S. Holder, other than a

bank which acquires such Bond in consideration of an extension of credit made pursuant to a loan agreement entered into in the ordinary course of business, will not be subject to any U.S. withholding tax provided that the beneficial owner of the Bond provides a certification completed in compliance with applicable statutory and regulatory requirements, which requirements are discussed below under the heading “Information Reporting and Backup Withholding,” or an exemption is otherwise established.

Disposition of the Bonds. Subject to the discussion below under the heading “Information Reporting and Backup Withholding,” any gain realized by a Non-U.S. Holder upon the sale, exchange, redemption, retirement (including pursuant to an offer by the State) or other disposition of a Bond generally will not be subject to U.S. federal income tax, unless (i) such gain is effectively connected with the conduct by such Non-U.S. Holder of a trade or business within the United States; or (ii) in the case of any gain realized by an individual Non-U.S. Holder, such holder is present in the United States for 183 days or more in the taxable year of such sale, exchange, redemption, retirement (including pursuant to an offer by the State) or other disposition and certain other conditions are met.

U.S. Federal Estate Tax. A Bond that is held by an individual who at the time of death is not a citizen or resident of the United States will not be subject to U.S. federal estate tax as a result of such individual’s death, provided that at the time of such individual’s death, payments of interest with respect to such Bond would not have been effectively connected with the conduct by such individual of a trade or business within the United States.

Information Reporting and Backup Withholding. U.S. information reporting and “backup withholding” requirements apply to certain payments of principal of, and interest on the Bonds, and to proceeds of the sale, exchange, redemption, retirement (including pursuant to an offer by the State) or other disposition of a Bond, to certain noncorporate holders of Bonds that are United States persons. Under current U.S. Treasury Regulations, payments of principal and interest on any Bonds to a holder that is not a United States person will not be subject to any backup withholding tax requirements if the beneficial owner of the Bond or a financial institution holding the Bond on behalf of the beneficial owner in the ordinary course of its trade or business provides an appropriate certification to the payor and the payor does not have actual knowledge that the certification is false. If a beneficial owner provides the certification, the certification must give the name and address of such owner, state that such owner is not a United States person, or, in the case of an individual, that such owner is neither a citizen nor a resident of the United States, and the owner must sign the certificate under penalties of perjury. If a financial institution, other than a financial institution that is a qualified intermediary, provides the certification, the certification must state that the financial institution has received from the beneficial owner the certification set forth in the preceding sentence, set forth the information contained in such certification, and include a copy of such certification, and an authorized representative of the financial institution must sign the certificate under penalties of perjury. A financial institution generally will not be required to furnish to the IRS the names of the beneficial owners of the Bonds that are not United States persons and copies of such owners’ certifications where the financial institution is a qualified intermediary that has entered into a withholding agreement with the IRS pursuant to applicable U.S. Treasury Regulations.

In the case of payments to a foreign partnership, foreign simple trust or foreign grantor trust, other than payments to a foreign partnership, foreign simple trust or foreign grantor trust that qualifies as a withholding foreign partnership or a withholding foreign trust within the meaning of applicable U.S. Treasury Regulations and payments to a foreign partnership, foreign simple trust or foreign grantor trust that are effectively connected with the conduct of a trade or business within the United States, the partners of the foreign partnership, the beneficiaries of the foreign simple trust or the persons treated as the owners of the foreign grantor trust, as the case may be, will be required to provide the certification discussed above in order to establish an exemption from withholding and backup withholding tax requirements. The current backup withholding tax rate is 28% (subject to future adjustment).

In addition, if the foreign office of a foreign “broker,” as defined in applicable U.S. Treasury Regulations pays the proceeds of the sale of a Bond to the seller of the Bond, backup withholding and information reporting requirements will not apply to such payment provided that such broker derives less than 50% of its gross income for certain specified periods from the conduct of a trade or business within the United States, is not a controlled foreign corporation, as such term is defined in the Code, and is not a foreign partnership (1) one or more of the partners of which, at any time during its tax year, are U.S. persons (as defined in U.S. Treasury Regulations Section 1.1441-1(c)(2)) who, in the aggregate hold more than 50% of the income or capital interest in the partnership or (2) which, at any time during its tax year, is engaged in the conduct of a trade or business within the United States. Moreover, the payment by a foreign office of other brokers of the proceeds of the sale of a Bond, will not be subject to backup withholding unless the payer has actual knowledge that the payee is a U.S. person. Principal and interest so paid by the U.S. office of a custodian, nominee or agent, or the payment by the U.S. office of a broker of the proceeds of a sale of a Bond, is subject to backup withholding requirements unless the beneficial owner provides the nominee, custodian, agent or broker with an appropriate certification as to its non-U.S. status under penalties of perjury or otherwise establishes an exemption.

Circular 230

Investors are urged to obtain independent tax advice based upon their particular circumstances. The tax discussion above was not intended or written to be used, and cannot be used, for the purposes of avoiding taxpayer penalties. The discussion was written to support the promotion or marketing of the Bonds.

LITIGATION

There is not now pending (with service of process on the State having been accomplished) or threatened any litigation seeking to restrain or enjoin the sale, issuance, execution or delivery of the Bonds or challenging the validity of the Bonds or any proceedings of the State taken with respect to the foregoing.

At any given time, including the present, there are numerous civil actions pending against the State, which could, if determined adversely to the State, affect the State’s expenditures and, in some cases, its revenues and cash flow. While there can be no assurances as to the ultimate outcome and fiscal impact of such litigation, the State believes that it is unlikely that the outcome of any such litigation could adversely affect the ability of the State to pay the principal of and interest on the Bonds when due. See APPENDIX A—“THE STATE OF CALIFORNIA—LITIGATION.”

UNDERWRITING

The Bonds are being purchased by an underwriting group comprised of the underwriters listed on the cover page hereof (the “Underwriters”). Citigroup Global Markets Inc., RBC Capital Markets, LLC, and Siebert Brandford Shank & Co., L.L.C., are acting as representatives of the Underwriters. The Underwriters have agreed to purchase the Bonds for an aggregate purchase price of \$_____ (representing the principal amount of the Bonds of \$_____, plus net original issue premium of \$_____, less an Underwriters’ discount of \$_____) pursuant to a Bond Purchase Contract dated the date of this Offering Memorandum (the “Bond Purchase Contract”). The initial public offering prices of the Bonds may be changed from time to time by the Underwriters.

The Bond Purchase Contract provides that (i) the Underwriters will purchase all of the Bonds if any of the Bonds are purchased and (ii) the obligation to make such purchase is subject to certain terms and conditions set forth in such purchase contract including, among others, the approval of certain legal matters by counsel.

Several of the Underwriters have provided letters to the State Treasurer set forth herein as Appendix E relating to their distribution practices, for inclusion in this Offering Memorandum. The State

does not guarantee the accuracy or completeness of the information contained in such letters and the information therein is not to be construed as a representation of the State or any Underwriter other than the Underwriter providing such representation.

FINANCIAL STATEMENTS

Audited Basic Financial Statements of the State of California (the “Financial Statements”) are available for the Fiscal Year ended June 30, 2009. These statements have been examined by the State Auditor to the extent indicated in her report. Such Financial Statements have been filed with the MSRB’s EMMA website, as part of an Official Statement for certain State General Obligation Bonds sold in 2010, and are incorporated by reference into this Offering Memorandum. The Financial Statements are also available through other electronic means. No such information is a part of or incorporated into this Offering Memorandum, except as expressly noted. See APPENDIX A—“THE STATE OF CALIFORNIA – FINANCIAL STATEMENTS” for further information on how to obtain or view the Financial Statements.

Certain unaudited financial information for the twelve months ended June 30, 2010 and the three months ended September 30, 2010 are included as Exhibits to Appendix A. Unaudited financial information, including results for the month of October 2010, will be made public on or about November 10, 2010, and will be included in the final Offering Memorandum. See APPENDIX A—“THE STATE OF CALIFORNIA—FINANCIAL STATEMENTS.”

RATINGS

All of the Bonds have received ratings of “___” by Moody’s Investors Service (“Moody’s”), “___” by Standard & Poor’s, a Division of The McGraw-Hill Companies, Inc. (“S&P”), and “___” by Fitch Ratings (“Fitch”). An explanation of the significance and status of such credit ratings may be obtained from the rating agencies furnishing the same. There is no assurance that such ratings will continue for any given period of time or that they will not be revised or withdrawn entirely by any such rating agencies if, in their respective judgments, circumstances so warrant. Any revision or withdrawal of a credit rating could have an effect on the market prices and marketability of the Bonds. The State cannot predict the timing or impact of future actions by the rating agencies.

FINANCIAL ADVISOR

Public Resources Advisory Group is serving as the Financial Advisor to the State in connection with the issuance of the Bonds. The Financial Advisor has not been engaged, nor has it undertaken, to make an independent verification or assume responsibility for the accuracy, completeness or fairness of the information contained in this Offering Memorandum.

ADDITIONAL INFORMATION

The purpose of this Offering Memorandum is to supply information to prospective buyers of the Bonds. Quotations from and summaries and explanations of the Bonds and of statutes or documents are brief summaries thereof which do not purport to be complete or definitive, and reference is made to such statutes or documents for full and complete statements of the contents thereof.

Any statements in this Offering Memorandum involving estimates, forecasts or matters of opinion, whether or not expressly so stated, are intended as such and not as representations of fact. This Offering Memorandum is not to be construed as a contract or agreement between the State and the purchasers or holders of any of the Bonds.

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Questions regarding this Offering Memorandum and the issuance of these securities may be addressed to the Office of the Honorable Bill Lockyer, Treasurer of the State of California, 915 Capitol Mall, Room 110, Sacramento, California 95814, telephone (800-900-3873).

STATE OF CALIFORNIA
BILL LOCKYER
Treasurer of the State of California

APPENDIX A

THE STATE OF CALIFORNIA



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INTRODUCTION TO THE STATE OF CALIFORNIA AND APPENDIX A

APPENDIX A is the part of the Official Statement that provides investors with information concerning the State of California. This Introduction is intended to give readers a very brief overview of the main topics covered in APPENDIX A. Investors are advised to read the entire Official Statement, including APPENDIX A, to obtain information essential to making an informed investment decision. See “ – Certain Defined Terms” at the end of this section for certain defined terms used in this APPENDIX A.

Current Financial Stress

California’s chronic budget crises have been driven by growing state spending commitments funded by temporary spikes in revenues. Once revenues return to their normal trend – or drop precipitously, as has been the case in the recent recession – these commitments cannot be sustained, and dramatic cuts to programs and/or tax increases sometimes have been required. Budgets also have repeatedly been balanced using, at least in part, unrealized assumptions and one-time or temporary measures. As a result, budget deficits have recurred from year to year, and budget gaps are expected to continue to challenge state fiscal leaders in future years.

In 2008 and most of 2009, the state experienced what was the most significant economic downturn since the Great Depression of the 1930s. Since then, the state’s economy has grown slowly. As a result of continuing weakness in the state economy, state tax revenues declined precipitously, resulting in large budget gaps and occasional cash shortfalls. Further information is set forth under “STATE FINANCIAL PRESSURE” and “CURRENT STATE BUDGET.”

There can be no assurances that the fiscal stress and cash pressures currently facing the state will not continue or become more difficult, or that continuing declines in state tax receipts or other impacts of the current economic situation will not further materially adversely affect the financial condition of the state.

State Revenues and Expenditures

The state receives revenues from taxes, fees and other sources, the most significant of which are the personal income tax, sales and use tax and corporation tax (which collectively constitute more than 90 percent of total revenues and transfers). The state expends money on a variety of programs and services. Significant elements of state expenditures include education (both kindergarten through twelfth grade (“K-12”) and higher education), health and human services, correctional programs, transportation and debt service. For a discussion of the sources and uses of state funds, see “STATE FINANCES.”

The final enacted state budget for fiscal year 2009-10 was accomplished in two steps, in February and July 2009, and required actions to close an estimated budget gap of almost \$60 billion over the two fiscal years 2008-09 and 2009-10. See “AMENDED 2009 BUDGET ACT.” The budget gap was proposed to be closed with a combination of expenditure reductions, temporary tax increases and a variety of loans and other one-time actions. Some of the assumptions for the Amended 2009 Budget Act were not achieved, so that the Administration estimates the General Fund ended fiscal year 2009-10 with a negative balance of \$6.3 billion, compared to an anticipated positive balance of \$500 million when the final portion of the Amended 2009 Budget Act was enacted.

The 2010 Budget Act (for fiscal year 2010-11) was passed by the Legislature and signed by the Governor on October 8, 2010, the latest budget enactment in state history. The 2010 Budget Act projects revenues and transfers to the General Fund of \$94.2 billion, with expenditures of \$86.6 billion, leaving a

balance on June 30, 2011 (after also taking into account a negative beginning fund balance from June 30, 2010 of \$6.3 billion) of \$1.3 billion. An estimated \$19.3 billion budget gap was resolved with a combination of expenditure reductions (44 percent of solutions), additional federal funds (28 percent of solutions) and various other one-time receipts, loans and other solutions (28 percent of solutions). Whether the state will be able to receive all the projected receipts or achieve all the planned expenditure reductions will depend on future actions at the state and federal level, and there is no assurance that all of the assumptions will be met. One initiative measure adopted by the voters on November 2, 2010 will have a negative impact estimated at \$850 million on the fiscal year 2010-11 budget. Legislation accompanying the adoption of the 2010 Budget Act included (1) a measure to reduce pension benefits primarily for newly hired state employees, and (2) a proposed constitutional amendment to be on the next general election ballot which would strengthen existing provisions for a budget reserve fund, and limit state spending in years when revenues exceed a specified cap. More information is contained in the caption "CURRENT STATE BUDGET."

The state manages its cash flow requirements during the fiscal year primarily with a combination of external borrowing and internal borrowing by the General Fund from over 700 Special Funds. The General Fund has typically ended each fiscal year with a net borrowing from Special Funds, which has been increased because of the recurring budget deficits which have occurred in recent years. As of June 30, 2010, the General Fund owed \$9.992 billion to Special Funds from internal borrowings for cash management purposes. See "STATE FINANCES-Inter-Fund Borrowings."

The Legislative Analyst's Office is scheduled to release a report concerning the state's current budget and the outlook for the state's future financial condition on November 10, 2010.

General Fund

The moneys of the state are segregated into the General Fund and over 1,000 other funds, including special, bond and trust funds. The General Fund consists of revenues received by the State Treasury and not required by law to be credited to any other fund, as well as earnings from the investment of state moneys not allocable to another fund. The General Fund is the principal operating fund for the majority of governmental activities and is the depository of most of the major tax revenue sources of the state. For additional financial data relating to the General Fund, see the financial statements incorporated in or attached to this APPENDIX A. See "STATE FINANCES" and "FINANCIAL STATEMENTS."

State Budget

The State Constitution specifies that an annual budget shall be proposed by the Governor by January 10 of each year for the next fiscal year (the "Governor's Budget"). Under state law, the annual proposed Governor's Budget cannot provide for projected expenditures in excess of projected revenues for the ensuing fiscal year. State law also requires the Governor to update the Governor's Budget projections and budgetary proposals by May 14 of each year (the "May Revision"). The May Revision is normally the basis for final negotiations between the Governor and Legislature to reach agreement on appropriations and other legislation to fund state government for the ensuing fiscal year (the "Budget Act"). On November 2, 2010, the voters of the state approved Proposition 25, an initiative measure amending the state's Constitution to provide that the Budget Act, which is required by the Constitution to be in balance, must now be approved by a majority (as opposed to two-thirds) vote of each House of the Legislature. (Two other initiatives, Propositions 22 and 26, were also approved, which together limit the state's fiscal flexibility. See "RECENT DEVELOPMENTS"). Legislation accompanying the 2010 Budget Act provides for submission to the voters at the next statewide election of an amendment to the state Constitution which would strengthen existing provisions for a budget reserve fund and place limits

on state spending in years in which state revenues exceed a specified cap. See “STATE FINANCES – Budget Reserves – Proposed Strengthening of Reserve Funds.”

Over the years, a number of laws and constitutional amendments have been enacted, often through voter initiatives, which have made it more difficult for the state to raise taxes, restricted the use of the General Fund or special fund revenues, or otherwise limited the Legislature and the Governor’s discretion in enacting budgets. See “THE BUDGET PROCESS – Constraints on the Budget Process.”

State General Obligation Debt and Other Obligations

As of October 1, 2010, the state had outstanding obligations payable principally from the state’s General Fund or from lease payments paid from the operating budget of the respective lessees, which operating budgets are primarily, but not exclusively, derived from the General Fund, consisting of \$68.1 billion principal amount of general obligation bonds, \$9.8 billion of lease-revenue bonds and \$1.9 billion for repayment of budgetary borrowing from local governments pursuant to Proposition 1A of 2004. As of November 1, 2010, there were approximately \$41.6 billion of authorized and unissued voter-approved general obligation debt payable from the General Fund. See “STATE INDEBTEDNESS AND OTHER OBLIGATIONS - Future Issuance Plans; General Fund Debt Ratio.” As of October 1, 2010, there were approximately \$12.3 billion of authorized and unissued lease revenue bonds. In addition, certain state agencies and authorities issue revenue obligations for which the General Fund has no liability. Revenue bonds represent obligations payable from state revenue-producing enterprises and projects, which are not payable from the General Fund, and conduit obligations payable only from revenues paid by local governments or private users of facilities financed by the revenue bonds.

California has always paid the principal of and interest on its general obligation bonds, general obligation commercial paper notes, lease-revenue obligations and short-term obligations, including revenue anticipation notes (“RANs”) and revenue anticipation warrants (“RAWs”), when due. Detailed information regarding the state’s long-term debt appears in the sections “STATE INDEBTEDNESS AND OTHER OBLIGATIONS” and “STATE DEBT TABLES.”

Deferred Obligations

In addition to the bonds described in the previous paragraphs, the General Fund is obligated to make a variety of payments in future years. In some cases, the Legislature has the ability to modify, further extend the timing or even cancel the obligation to make these payments. Substantial deferred General Fund obligations include, among other things, deferrals of guaranteed payments to school districts pursuant to Proposition 98, repayment of certain legislatively-approved interfund borrowings, reimbursement of borrowings from state and local governments, reimbursements to local governments and school districts for the costs of state mandates placed on those entities under state laws, obligations to employees for compensated absences, costs for self-insurance, and possibly future payment of interest owed on borrowings from the federal government for unemployment insurance payments. The Department of Finance estimates that deferred Proposition 98 payments will total \$9.5 billion as of the end of the 2010-11 fiscal year and that legislatively-approved interfund borrowings will total \$2.6 billion as of the same date. The deferred Proposition 98 payments will be repaid pursuant to the constitutional repayment formula in years when state revenue increases. See “STATE FINANCES - Proposition 98 and K-12 Funding.” The interfund borrowings are scheduled to be repaid over a number of years. These figures do not include short-term deferrals within or across fiscal years, such as when the Legislature has recently deferred certain education payments from one fiscal year into the next fiscal year, nor do they include short-term interfund borrowings (also called “special fund borrowings”) for cash management purposes. See “CASH MANAGEMENT” for more information on cash deferrals and special fund

borrowings. See also “STATE INDEBTEDNESS AND OTHER OBLIGATIONS – Indirect, Nonpublic and Contingent Obligations.”

State Pension Funds

The two main state pension funds have sustained substantial investment losses in recent years and face large unfunded future liabilities. The most recent actuarial valuation of California Public Employees’ Retirement System (“CalPERS”), based on data through June 30, 2009, showed an accrued unfunded liability allocable to state employees of \$23.450 billion on an actuarial value of assets basis (“AVA”) and \$48.648 billion on a market value of assets basis (“MVA”). The California State Teachers’ Retirement System (“CalSTRS”) reported the unfunded accrued liability of its Defined Benefit Plan at June 30, 2009 at \$40.541 billion on an AVA basis; it did not report a comparable MVA. The state may be obligated to make increasingly large payments in the future to bring CalPERS closer to a fully funded condition; the state’s contributions to CalSTRS are set by a statutory formula. For instance, state contributions to CalPERS have increased by 63 percent in the past five years, and in fiscal year 2010-11 is estimated to be about \$3.8 billion, of which the General Fund pays about 57 percent. Contributions to CalSTRS have grown about 11 percent in the past five years to an estimated \$1.2 billion in fiscal year 2010-11. The combined contributions represent about 4 percent of all General Fund expenditures in fiscal year 2010-11. See “STATE FINANCES – Pension Trusts.”

Financial Statements

APPENDIX A incorporates by reference the Audited Basic Financial Statements of the state for the fiscal year ended June 30, 2009, together with certain information required by governmental accounting and financial reporting standards to be included in the Financial Statements, including a “Management’s Discussion and Analysis” that describes and analyzes the financial position of the state and provides an overview of the state’s activities for the fiscal year ended June 30, 2009. In addition, EXHIBITS 1 and 2 to APPENDIX A contain the State Controller’s unaudited reports of General Fund cash receipts and disbursements for the periods July 1, 2009 through June 30, 2010 and July 1, 2010 through September 30, 2010. See “FINANCIAL STATEMENTS.” The Controller’s cash report for the month of October 2010 will be released on or about November 10, 2010, and will be included in the final Official Statement.

Population and Economy of the State

The State of California is by far the most populous state in the nation, over 60 percent larger than the second-ranked state according to the 2000 U.S. Census. The state’s July 1, 2009 population of about 38.5 million represented over 12 percent of the total United States population.

California’s economy, the largest among the 50 states and one of the largest and most diverse in the world, has major components in high technology, trade, entertainment, agriculture, manufacturing, government, tourism, construction and services. The relative proportion of the various components of the California economy closely resembles the make-up of the national economy.

In its most recent report from May 2010, the Department of Finance projected that the California economy started to recover from the recession in the latter part of 2009, but growth in calendar year 2010 and beyond would be slow and would continue to lag slightly behind the national economic recovery as a whole. As of September 2010, unemployment in the state was 12.4 percent, compared to 12.5 percent in January 2010 and 9.7 percent in January 2009. The U.S. unemployment rate for September 2010 was 9.6 percent.

Demographic and economic statistical information and a discussion of economic assumptions are included in this APPENDIX A under “CURRENT STATE BUDGET – Current Economic Conditions” and “– Economic Assumptions Underlying the 2010 Budget Act” and “ECONOMY AND POPULATION.”

Certain Defined Terms.

The following terms and abbreviations are used in this APPENDIX A:

“2008-09 Governor’s Budget” means the Governor’s Proposed Budget for the 2008-09 fiscal year released on January 10, 2008.

“2008-09 May Revision” means the May Revision of the 2008-09 Governor’s Budget released on May 14, 2008.

“2008 Budget Act” means the Budget Act for the 2008-09 fiscal year adopted on September 16, 2008, together with other related budget legislation.

“2009-10 Governor’s Budget” means the Governor’s Proposed Budget for the 2009-10 fiscal year released on December 31, 2008.

“Initial 2009 Budget Act” means the Budget Act for the 2009-10 fiscal year adopted on February 19, 2009, together with other related budget legislation.

“February 2009 Budget Package” collectively refers to the amendments to the 2008 Budget Act, the Initial 2009 Budget Act, and related budget legislation, all as adopted by the Legislature and signed by the Governor in February 2009.

“Amended 2009 Budget Act” means the budget plan for fiscal year 2009-10 adopted on February 20, 2009 as amended by the revisions enacted on July 28, 2009 together with other related budget legislation.

“2009-10 May Revision” means, collectively, the May Revision of the Initial 2009 Budget Act first released May 14, 2009 as subsequently updated.

“2010-11 Governor’s Budget” means the Governor’s Proposed Budget for the 2010-11 fiscal year released on January 8, 2010.

“2010-11 May Revision” means the May Revision of the 2010-11 Governor’s Budget released May 14, 2010.

“2010 Budget Act” means the Budget Act for the 2010-11 fiscal year adopted on October 8, 2010, together with related budget legislation.

“ARRA” means the American Recovery and Reinvestment Act, also known as the federal stimulus bill, enacted on February 17, 2009.

“BSA” means the Budget Stabilization Account created under Proposition 58. See “STATE FINANCES – Budget Reserves.”

“COLA” means a cost of living adjustment.

“ERBs” means Economic Recovery Bonds of the state issued pursuant to Proposition 57. See “STATE INDEBTEDNESS AND OTHER OBLIGATIONS – Economic Recovery Bonds.”

“EXHIBIT 1” means the most recent State Controller’s Unaudited Statement of General Fund Cash Receipts and Disbursements for the period from July 1, 2009 through June 30, 2010 as attached to this APPENDIX A as EXHIBIT 1.

“EXHIBIT 2” means the most recent State Controller’s Unaudited Statement of General Fund Cash Receipts and Disbursements for the period from July 1, 2010 through September 30, 2010 as attached to this APPENDIX A as EXHIBIT 2.

“Fiscal emergency special session” means a special session of the Legislature called by the Governor to respond to a fiscal emergency as authorized by Proposition 58.

“LAO” means the Legislative Analyst’s Office, an entity of the State Legislature.

“SFEU” means the Special Fund for Economic Uncertainties, created pursuant to Government Code Section 16418.

Reference to the “state” as a noun or adjective means the State of California, following the practice of the Department of Finance.

RECENT DEVELOPMENTS

The following significant developments have occurred since the date of the Official Statement for State of California Veterans General Obligation Bonds dated June 23, 2010.

The Legislature enacted and the Governor signed the 2010 Budget Act on October 8, 2010. Legislation accompanying the 2010 Budget Act provided for certain payment deferrals to improve the state’s cash position in fiscal year 2010-11; made significant changes in the law providing pensions for primarily future state government employees; approved several new employee bargaining agreements which generally included cost reductions and increased employee contributions to pension funds; and provided for submission to the voters at the next statewide general election of an amendment to the state Constitution which would strengthen existing provisions for a budget reserve fund and place limits on state spending in certain years in which state revenues exceed a specified cap. See “CURRENT STATE BUDGET” and “STATE FINANCES – Budget Reserves – Proposed Strengthening of Reserve Funds” in particular.

On November 2, 2010, the voters elected Edmund G. Brown Jr. as Governor, to start a new term on January 3, 2011. In addition, Bill Lockyer was re-elected as Treasurer and John Chiang was re-elected as Controller.

Also on November 2, 2010, voters approved the following initiative measures, which have an impact on the state budget or finances; all three of these measures are effective immediately:

- Proposition 22 restricts the ability of the state to use or borrow money from local governments, and moneys dedicated to transportation financing. It also prohibits actions taken in current and prior budgets to use excise taxes on motor vehicle fuels to offset General Fund costs of debt service on certain transportation bonds, and to borrow money from certain transportation funds.

- Proposition 25 reduces the required vote in each house of the Legislature to adopt the annual budget act, “trailer bills” which accompany the budget act, and other appropriations measures to a majority from two-thirds.
- Proposition 26 expands the definition of “taxes” under existing Constitutional provisions which require a two-thirds vote of the Legislature to approve.

See “THE BUDGET PROCESS – Constraints on the Budget Process – November 2010 Initiatives.”

On October 4, 2010, the California Supreme Court issued its rulings in two cases challenging actions taken as part of the Amended 2009 Budget Act. In *Professional Engineers in California Government v. Schwarzenegger*, the Court upheld the Governor’s orders requiring state employees to take two furlough days per month on the ground that the Legislature had ratified this action in enacting revisions to the 2008 Budget Act. In *St. John’s Well Child and Family Center v. Schwarzenegger*, the Court upheld the Governor’s power to use his line-item veto authority in connection with legislation which reduced appropriations as part of the revisions to the Amended 2009 Budget Act. See “LITIGATION – Budget-Related Litigation.”

After lengthy periods of negotiations during which most state employees worked without a contract in place, over the last few months the Administration has reached agreement with a number of state employee bargaining units on new contracts, which have been approved by the Legislature. These new contracts include cost reductions and pension reforms. See “OVERVIEW OF STATE GOVERNMENT – Employee Relations.”

STATE FINANCIAL PRESSURE

The state experienced a severe economic recession which began at the end of 2007, from which the state is still slowly recovering. Personal income fell in the first three quarters of 2009 before increasing moderately in the fourth quarter of 2009. Taxable sales fell sharply in the first half of 2009 before increasing in the third and fourth quarters of 2009 and in the first quarter of 2010. Taxable sales during the first two quarters of 2010 were up 3.6 percent from the first half of 2009. The state’s unemployment rate increased from 5.9 percent in January 2008 to 12.6 percent in March 2010. The rate improved slightly thereafter, falling to 12.4 percent in August 2010 and holding steady in September 2010. In response to the most severe economic downturn in the United States since the Great Depression, in the Amended 2009 Budget Act, the state implemented substantial spending reductions, program eliminations, revenue increases, and other solutions in order to close an estimated \$60 billion budget gap over the combined 2008-09 and 2009-10 fiscal years. The state adopted reforms in nearly every area of government to better contain costs in the future. The 2010 Budget Act, adopted on October 8, 2010, made further reductions to many programs. Overall General Fund spending has been reduced to a level well below what it was over a decade ago in fiscal year 1998-99, adjusted for population and inflation growth. See “CURRENT STATE BUDGET.”

The severe economic downturn resulted in General Fund revenues in fiscal year 2009-10 (\$86.9 billion) falling by approximately 16 percent from their peak in fiscal year 2007-08 (\$102.6 billion). The state is currently emerging from the recession, and although the level of unemployment is still very high, economic growth is rebounding. As a result, General Fund revenues in fiscal year 2010-11 (\$94.2 billion) are expected to rebound by approximately 8.4 percent above the depressed fiscal year 2009-10 levels. Future revenues will be affected by the expiration after fiscal year 2010-11 of temporary tax increases enacted in fiscal year 2009-10, which represent about \$7 billion in receipts in the current year, as well as the expiration of certain one-time revenues which were obtained in fiscal years 2009-10 and 2010-11.

The 2010 Budget Act was passed by the Legislature and signed by the Governor on October 8, 2010, the latest budget enactment in state history. The 2010 Budget Act projects revenues and transfers to the General Fund of \$94.2 billion, with expenditures of \$86.6 billion, leaving a balance on June 30, 2011 (after taking into account the negative beginning fund balance from June 30, 2010 of \$6.3 billion) of \$1.3 billion. An estimated \$19.3 billion budget gap was resolved with a combination of expenditure reductions (44 percent of solutions), federal funds (28 percent of solutions) and various other one-time receipts, loans and other solutions (28 percent of solutions). Whether the state will be able to receive all the projected receipts or achieve all the planned expenditure reductions will depend on future actions at the state and federal level, and there is no assurance that all of the assumptions will be met. Furthermore, Proposition 22, an initiative measure approved by the voters on November 2, 2010, will prohibit the operation of certain parts of the 2010 Budget Act, with a negative effect of an estimated \$850 million on the current fiscal year and increased effects on future years. The Administration projects that there will be multi-billion dollar budget gaps in future years, as temporary fiscal measures adopted in recent years have to be repaid or temporary tax increases expire at the end of the 2010-11 fiscal year. More information is contained in the caption "CURRENT STATE BUDGET."

The fact that revenue for the last two years has been significantly lower than in the peak revenue year of 2007-08 resulted in a significant depletion of cash resources to pay the state's obligations. By July 2009, the state's cash resources dwindled so far that, commencing July 2, 2009, the State Controller began to issue registered warrants (or "IOUs") for certain lower priority obligations in lieu of warrants (checks), which could not be immediately cashed. The registered warrants were all called for redemption on September 4, 2009, once the state was able to access the public credit markets for cash management purposes following enactment of the Amended 2009 Budget Act. No registered warrants were used to pay debt service on bonds, payments to schools, or employee payrolls. By employing a combination of external borrowing with Revenue Anticipation Notes and other cash management techniques after the registered warrants were redeemed, the state was able to meet all its cash obligations for the balance of the 2009-10 fiscal year and through the date of adoption of the 2010 Budget Act on October 8, 2010. Legislation enacted in early March 2010 and in October 2010 provided the state with additional tools to manage cash during the 2010-11 fiscal year by authorizing short-term deferral of certain state payments, primarily to schools and local governments.

The long delay in enacting the 2010 Budget Act caused a build-up of about \$6.7 billion of bills payable from the General Fund which could not be paid after July 1 in the absence of budget authority. In order to manage cash flow once all these bills became due for payment, in addition to using authority for payment deferrals either within the month of October or from the month of October to November 2010, the state replenished its cash position by issuing \$6.7 billion of interim revenue anticipation notes to six financial institutions. See "CASH MANAGEMENT – Cash Management in Fiscal Year 2010-11"

The national and California economies improved following the 2010-11 Governor's Budget. Output of the national economy grew for the fifth consecutive quarter in the third quarter of 2010, and California payroll employment grew by 7,800 jobs each month on average during the first eight months of 2010. However, while many sectors of both economies have bottomed out or made modest improvements, the level of economic activity is still far below normal—construction being a prime example.

There are signs that home prices have begun to stabilize and have improved in many regions of the state. Existing home sales peaked during the summer of 2005 and fell steadily through November 2008. A robust recovery in sales took place between November 2008 and November 2009, as sales were boosted by the first-time homebuyers' tax credit. The tax credit was initially set to expire at the end of November 2009, but prior to its expiration, it was extended through April 30, 2010. Following the tax

credit's extension, there was a moderate rebound in sales in March 2010. The tax credit's expiration on April 30, 2010, coupled with severe winter weather, caused home sales to fall again.

Both the state and national economies appear poised to make modest comebacks. Still, the recovery will probably be moderate and prolonged by historical standards.

The pension funds managed by the state's principal retirement systems, the California Public Employees' Retirement System and the California State Teachers' Retirement System, have sustained significant investment losses during the economic downturn and currently have substantial unfunded liabilities which will require increased contributions from the General Fund in future years. The state also has an unfunded liability relating to retirees' post-employment healthcare benefits which was estimated to be \$51.8 billion as of June 30, 2009. See "STATE FINANCES – Pension Trusts."

CURRENT STATE BUDGET

General

The 2010 Budget Act enacted on October 8, 2010, projects to end fiscal year 2010-11 with a \$1.3 billion reserve. General Fund revenues and transfers for fiscal year 2010-11 are projected at \$94.2 billion, an increase of \$7.3 billion compared with fiscal year 2009-10. General Fund expenditures for fiscal year 2010-11 are projected at \$86.6 billion—essentially flat compared to the prior year. These amounts compare to the following which were proposed in the 2010-11 Governor's Budget: revenues and transfers of \$89.3 billion, expenditures of \$82.9 billion, and an ending reserve of \$1.0 billion. In approving the 2010 Budget Act, the Governor exercised his line-item veto power to reduce General Fund expenditures by about \$960 million, mostly in the areas of health care and social services. The 2010 Budget Act also included Special Fund expenditures of \$30.9 billion and Bond Fund expenditures of \$7.9 billion.

Proposition 22, approved by the voters on November 2, 2010, will have a negative impact estimated at \$850 million on several portions of the enacted 2010 Budget Act. See "Impact of Proposition 22" below.

The LAO is scheduled to release a report on the 2010 Budget Act and the state's outlook for the state's future financial condition on or about November 10, 2010. This report will be available on the website of the LAO. The state may include pertinent information from this LAO report in the final Official Statement.

Prior to enactment of the 2010 Budget Act, the Administration had reported a budget gap of \$19.3 billion, including a \$1.3 billion reserve based on projected General Fund revenues and transfers in fiscal year 2010-11 compared against projected expenditures (assuming the workload budget from fiscal year 2009-10, adjusted for increases in costs and certain other developments but no changes in law). The 2010 Budget Act planned to close the estimated budget gap by a combination of expenditure reductions, federal funds, and other solutions. The majority of these solutions are one-time or temporary in nature, which will cause budget gaps to recur in fiscal year 2011-12 and beyond. The 2010 Budget Act solutions consist of the following major components, which are described in more detail below:

- \$8.4 billion in expenditure reductions (43.6 percent of total solutions).
- \$5.4 billion in additional federal funds above ongoing federal support of state programs and commitments of funds from ARRA (28.0 percent of total solutions). About \$1.83 billion of these funds have been approved; the balance is being sought by the state.

- \$5.5 billion in other one-time solutions (28.4 percent of total solutions). This includes adoption of the LAO's revenue forecast, a two-year suspension of the net operating loss carry forward provision on business income taxes, the sale and leaseback of 11 state office buildings, and borrowing from special funds and delaying repayment of earlier special fund loans.

The 2010 Budget Act contains the following major General Fund expenditure reductions and other significant solutions.

Expenditure Reductions

1. Health and Human Services

Some of the larger expenditure reductions include:

- Department of Health Care Services—a decrease of \$187.1 million by enrolling seniors and people with disabilities in managed care plans and deferring some payments.
- Department of Social Services—a reduction of \$365.9 million from an advance of Temporary Assistance for Needy Families Block Grant funds.
- Department of Social Services—a decrease of \$300 million in funding for the In-Home Supportive Services program due to assumed additional federal funds, a 3.6 percent across-the-board program reduction in assessed hours, and a reduced estimate of caseload volume.

2. Corrections and Rehabilitation

- A decrease of \$820 million to the budget for the Medical Services Program implemented by the court-appointed Receiver for the state's prison system to reduce per-inmate medical costs to a level comparable to other states' correctional health-care programs. The Receiver is cooperating in trying to achieve these savings but has not yet presented a specific plan; the state cannot guarantee the final result.
- Decrease of \$200 million from projected reduction of inmate population.

3. Proposition 98

- A decrease of \$4.1 billion due to suspension of the Proposition 98 Guarantee for education funding. Even with the suspension, the guaranteed funding level for K-14 education remains the same as in the prior year, and is higher with federal funding increases.

4. General Government

- Employee Compensation—a reduction of \$1.6 billion in the General Fund and special funds through collective bargaining agreements and other administrative actions.

- Workforce Cap—a reduction of \$449.6 million through a five-percent workforce reduction. The 2010 Budget Act also includes \$130 million in associated operating expense and equipment savings.
- Commission on State Mandates—a one-time reduction of \$365 million by suspending most mandates not related to elections, law enforcement, and property taxes.

Additional Federal Funds

The 2010 Budget Act assumes the state will benefit from \$5.4 billion in additional federal funds or flexibility to reduce expenses by waiver of federal requirements. This \$5.4 billion of federal aid is above amounts in ongoing federal programs or stimulus moneys previously approved. As of November 1, 2010 about \$1.83 billion of these funds have been approved, consisting of:

- A decrease in state expenditures of \$1.33 billion resulting from extension by prior act of Congress of the enhanced Medicaid funding.
- A decrease in state expenditures of approximately \$500 million from federal approval of a Medi-Cal Financing Waiver.

The state is continuing to seek the remaining funding, which includes:

- A decrease of \$395.4 million resulting from continuation by prior act of Congress of the Temporary Assistance for Needy Families funding. The state will during the third quarter of the current fiscal year request federal administrative approval to advance the first quarter of the fiscal year 2011-12 payment into the fourth quarter of fiscal year 2010-11, an action permitted by federal law.
- A prospective decrease of \$3.1 billion in state expenditures in anticipation of increased federal funding for a number of areas, including incarceration of undocumented immigrant felons, special education, Medicare and Medicaid programs. Congress has not taken action on these items, which are still the subject of discussions between the state and the federal government. A small portion (\$200-300 million) of this funding may become available through federal administrative action.

Other Solutions

- A revenue increase of \$399 million in fiscal year 2009-10 and \$961 million in fiscal year 2010-11, based on the LAO revenue forecast rather than the Department of Finance projection in the 2010-11 May Revision.

**Differences Between Department of Finance and LAO Revenue Estimates
(Dollars In Millions)**

	2009-10	2010-11
Sales and Use Tax	-\$234	\$58
Corporation Tax	-111	270
Personal Income Tax	799	678
Other Taxes	-55	-45
Total	\$399	\$961

- A revenue increase of \$1.2 billion from extension of the suspension of tax deductibility of net operating losses for taxpayers with incomes in excess of \$300,000.
- A one-time revenue increase of \$1.2 billion to reflect the sale of 11 state office buildings (net proceeds after repayment of about \$1.1 billion of debt secured by leases on some of the buildings). The state would lease back these properties for a period of 20 years with first right of refusal if the properties are put up for sale. This amount, which resulted from a competitive bid process, is about \$600 million higher than was assumed in the 2010-11 Governor's Budget. The transaction is planned to close by December 31, 2010, but the contract places a deadline of January 31, 2011 for completion.
- A revenue increase of \$1.9 billion due to new loans and transfers or extension of repayment date of existing loans from various special funds. This includes \$762 million from the excise tax revenues approved in the Amended 2009 Budget Act, but an estimated \$434 million of this loan will not be made because of the enactment of Proposition 22.

Impact of Proposition 22

There are two major budget impacts from adoption of this measure:

- Use of moneys from excise taxes on gasoline to offset General Fund costs of debt service on general obligation bonds for transportation will no longer be possible. This is expected to increase General Fund expenditures in fiscal year 2010-11 by an estimated \$416 million, increasing to over \$1 billion in future years.
- A portion of the budgetary loan from excise taxes in the estimated amount of \$434 million (identified in "Other Solutions" above) will be prohibited. (A portion of the loan has already been made, and is not affected by Proposition 22.)

Pension and Budget Reforms

As part of the enactment of the 2010 Budget Act, the Legislature adopted bills addressing reform of the state pension system and proposed reform of the state's budget reserve.

Pension Reform. Legislation was adopted (SB 22, Chapter 3, Sixth Extraordinary Session of 2010) (SB6X 22) which will reduce pension benefits primarily for newly-hired state employees. Some of these same reductions are also included in labor agreements signed in recent months with some state bargaining units. In general, this law sets benefit levels for future employees at levels which were in effect in 1999, prior to a law which at that time increased the percentage of salary which could be received by state employees, and reduced the number of years of service required to achieve maximum benefits. In addition, future employees will have their benefits based on the highest three-year average annual pay, rather than being based on the highest single year, as is provided under current law (except for those employees already using the three-year formula under a contract). SB6X 22 does not change the pension benefits for current state employees and retirees, so the financial benefits will accrue over a number of years. However, pursuant to labor agreements signed with several bargaining units, both current and future employees will be required to contribute a larger portion of their salary toward future pension benefits. See "STATE FINANCES – Pension Trusts – New Formula for Retirement Benefits."

Budget Reform. The Legislature adopted Senate Constitutional Amendment 10, which will be placed before the voters at the next statewide primary, general or special election (currently June 2012). If approved by the voters, this measure would place a limit on state spending if revenues in any fiscal year exceed a specified cap, by requiring such unanticipated revenues (after required payment of Proposition 98 obligations to schools) to be spent only on designated purposes such as deposit to the budget reserve fund, repayment of existing debts or capital investment in infrastructure. The measure would also strengthen existing law providing for annual deposits to the budget reserve fund, would increase the maximum size of the reserve fund from \$8 billion to an amount equal to 10 percent of General Fund revenues, and would tighten the rules by which moneys can be transferred from the budget reserve fund. See “STATE FINANCES – Budget Reserves – Proposed Strengthening of Reserve Funds.”

Budget Risks and Erosions

The 2010 Budget Act and related legislation addressing the state’s financial situation, and the state’s cash management plan, were based on a variety of assumptions that could be adversely impacted if they do not materialize. Some events have occurred since enactment of the 2010 Budget Act which already erode those assumptions. There can be no assurances that the financial condition of the state will not be further materially and adversely affected by actual conditions or circumstances, including but not limited to those described below. See “STATE FINANCIAL PRESSURE.”

Budget erosions already identified, and risks for the remainder of fiscal year 2010-11 include, but may not be limited to, the following:

- The federal government may reject most or some of the federal fund assumptions included in the 2010 Budget Act. This item represents about \$3.6 billion in additional federal funds or administrative relief which would reduce state expenditures. To date, the federal government has appropriated or approved approximately \$1.8 billion of the \$5.4 billion federal fund assumed in the 2010 Budget Act. The remainder will require congressional action, or, in the case of \$200-300 million of actions, administrative approval. The state remains optimistic that more aid will ultimately be acquired from the federal government during fiscal year 2010-11.
- Budget erosions estimated to be at least \$850 million will occur from enactment of Proposition 22, as described above.
- Actual revenues through the end of the fiscal year may be below projected amounts. Although cash receipts from major tax sources through September 2010 have exceeded the 2010-11 May Revision projections, the Department of Finance does not know if this trend reflects underlying strength or is a timing effect, as it appears some taxpayers made estimated tax payments in September despite a change in law which eliminated a September 2010 payment obligation.
- The 2010 Budget Act assumes \$800 million in estate tax revenues based on the scheduled reinstatement of the federal estate tax after January 1, 2011; this assumption could be affected by congressional action on the federal estate tax.
- The Administration may not be able to achieve the full amount of projected savings in various programs. Some of these are listed below.

- Estimated savings of \$820 million related to the Department of Correction and Rehabilitation's medical care budget and \$200 million for reduced inmate population may not be achieved.
- The state may be required, under orders of a federal court, to fund prison health care improvements in excess of amounts set forth in the 2010 Budget Act.
- \$130 million in General Fund operating expenses and equipment savings associated with the workforce cap reductions may not be fully achievable.
- \$140 million estimated for information technology unallocated savings may not be fully achieved.
- The planned sale of 11 state office buildings may not be completed, although the state is moving forward with the sale at this time and a nonrefundable deposit of \$50 million is due from the buyers on November 17, 2010.
- Planned solutions in the 2010 Budget Act may be prevented by litigation. Some litigation remains in progress from the Amended 2009 Budget Act, including lawsuits dealing with reductions in healthcare costs and a lawsuit challenging the state's ability to use redevelopment agency funds (the latter suit affects \$350 million in fiscal year 2010-11). On November 5, 2010, the Superior Court issued a temporary stay preventing the state from making \$256 million of cuts to certain childcare programs which had been vetoed by the Governor. A further hearing is scheduled for November 23, 2010. See "LITIGATION – Budget-Related Litigation." Furthermore, the state does not budget for or set aside revenues to pay adverse litigation judgments.
- The 2010 Budget Act assumes \$190 million General Fund savings within the In-Home Supportive Services (IHSS) program from imposing a fee, in the form of the state sales tax, on all providers of specified home health services. Because funding for the IHSS program includes federal Medicaid reimbursements, implementation of a fee on IHSS providers is subject to federal approval. In the event this approval is not granted, the General Fund savings associated with this proposal would not materialize.

Development of Revenue Estimates

The development of the forecast for the major General Fund revenues begins with a forecast of national economic activity prepared by an independent economic forecasting firm. The Department of Finance's Economic Research Unit, under the direction of the Chief Economist, adjusts the national forecast based on the Department's economic outlook. The national economic forecast is used to develop a forecast of similar indicators for California activity.

After finalizing the forecasts of major national and California economic indicators, revenue estimates are generated using revenue forecasting models developed and maintained by the Department of Finance. With each forecast, adjustments are made for any legislative, judicial, or administrative changes, as well as for recent cash flow results. The forecast is updated twice a year and released with the Governor's Budget by January 10 and the May Revision by May 14.

Current Economic Conditions

National Economy. Output of the national economy (real GDP) grew at a rate of 3.7 percent in the first quarter of 2010, 1.7 percent in the second quarter, and 2.0 percent in the third quarter—the fifth consecutive quarter of growth. Consumers were largely responsible for the gain by increasing their spending by the largest amount in four years. Retail sales rose in the first quarter of 2010, posting their strongest growth since the end of 2007. This rebound sputtered at midyear, however, before settling in to a modest growth trend. Vehicle sales have begun a modest recovery.

Unemployment eased slightly while nonfarm payroll expanded modestly during the first nine months of 2010.

Residential construction fell by almost 11 percent in the first quarter of 2009. Home building increased in the last two quarters of 2009, largely because of the first-time home buyer federal tax credit program. The credit was first applicable to homes purchased between April 2008 and July 2009. The program was extended to April 30, 2010 and expanded. Home building increased modestly during the first half of 2010.

Investment by businesses in equipment and software expanded in the first two quarters of 2010. Manufacturing activity increased for the fourteenth consecutive month in September 2010, according to the Institute for Supply Management (ISM) index.

U.S. exports and imports grew in the first nine months of 2010, reflecting growing economies abroad and increased demand for imports at home. On net, however, international trade subtracted from domestic economic growth in the first three quarters of 2010.

California Economy. California does not have a quarterly measure of economic output that could be used to compare its economic growth to that of the nation. However, other economic indicators show that California's economy was hit harder by the recession than the economies of most other states. Still there are clear signs that economic growth in California improved during the second half of 2009 and the first nine months of 2010.

For example, personal income fell in the first three quarters of 2009 before increasing moderately in the fourth quarter of 2009 and the first quarter of 2010. After falling for six consecutive quarters, taxable sales grew in the third and fourth quarters of 2009 and the first quarter of 2010. Taxable sales during the first half of 2010 were up 3.6 percent from the first half of 2009. The state unemployment rate reached a high of 12.6 percent in March 2010. The rate improved slightly thereafter, falling to 12.4 percent in August and September 2010. In comparison, the national unemployment rate was 9.6 percent.

The state's housing sector is showing some signs of recovery. Existing home sales have stabilized around the half-million unit rate (seasonally-adjusted and annualized) and the median sales price rose by nearly 5 percent from September 2009 to September 2010, bringing the median price of these homes to approximately \$310,000. Unsold inventory trended downward in 2009, as did the number of days needed to sell a home. While both measures appeared to bottom out early in 2010, they worsened during the summer and fall. Additional foreclosures may result from the resetting of rates on adjustable rate mortgages between 2010 and 2012, the commencement of amortization during the same period on mortgages that were previously in an interest-only mode, and the expiration of the mortgage foreclosure relief program. The impact of the resetting may be mitigated by the resets being spread out over multiple years, and may be further mitigated if mortgage interest rates remain low.

The worst of the housing slump, though, may be over. Home building permitting—which suffered a long, steady three-year decline starting in 2005—bottomed out early in 2009 and increased on a year-over-year basis at the start of 2010. Permitting during the first nine months of 2010 was up 22 percent year-over-year, but remained at a very low level—only about 35 percent of the pre-recession levels. New residential construction measured by permits issued had fallen almost 90 percent in 2009 from its peak in 2004, and nonresidential construction in 2009 was valued at about one quarter of the peak valuation in 2008.

Made-in-California exports were down 17 percent in 2009. The decline was widely spread across countries, reflecting the global nature of the economic downturn. Large declines in technology, transportation, and machinery exports were instrumental in the decline. However, with global economic conditions improving, California exports increased 21.5 percent year-over-year in the first two quarters of 2010.

Economic Assumptions Underlying the 2010 Budget Act

The revenue and expenditure assumptions utilized in connection with the 2010 Budget Act were based upon certain estimates of the performance of the California, national, and global economies in calendar years 2010 and 2011.

As part of the 2010-11 May Revision, the Department of Finance published estimates, shown below, for the state’s economic performance for calendar years 2010 and 2011. Also shown below are the Department of Finance’s previous forecasts, contained in the 2010-11 Governor’s Budget, for the same calendar years. The 2010 Budget Act, however, is based upon more optimistic revenue forecasts developed by the Legislative Analyst’s Office and not those prepared by the Department of Finance. The LAO stated in its May 2010 report that its underlying economic assumptions were similar to the Administration’s, but the LAO projects greater revenue estimates, principally from capital gains (part of personal income taxes). See “– General – Other Solutions” above for more information on the differences between the LAO’s revenue forecast and the 2010-11 May Revision. Taxpayer behavior may be affected by future congressional action on federal tax rates.

TABLE 1
Estimates Of State’s Economic Performance

(Dollars In Billions)

	For Calendar Year 2010		For Calendar Year 2011	
	2010-11 Governor’s Budget (January 8, 2010)	2010-11 May Revision (May 14, 2010)	2010-11 Governor’s Budget (January 8, 2010)	2010-11 May Revision (May 14, 2010)
Non-Farm Wage and Salary Employment (Thousands)	14,063	13,985	14,239	14,229
Percent Change from prior year	(0.7)%	(0.7)%	1.3%	1.7%
Personal Income	\$1,597	\$1,609	\$1,655	\$1,682
Percent Change from prior year	2.4%	3.2%	3.6%	4.5%
Housing Permits (Thousands)	61	64	101	105
Consumer Price Index	2.5%	2.4%	2.6%	2.7%

Source: State of California, Department of Finance.

Summary of State Revenues and Expenditures

The table below presents the actual revenues, expenditures and changes in fund balance for the General Fund for fiscal years 2006-07, 2007-08, and 2008-09, the estimated results for fiscal year 2009-10 and the enacted budgeted amounts for fiscal year 2010-11.

TABLE 2
Statement Of Estimated Revenues, Expenditures,
And Changes In Fund Balance – General Fund
(Budgetary Basis) ^(a)
Fiscal Years 2006-07 Through 2010-11

(Dollars In Millions)

	<u>2006-07</u>	<u>2007-08</u>	<u>2008-09</u>	<u>Estimated^{(b)(c)}</u> <u>2009-10</u>	<u>Estimated^{(b)(c)}</u> <u>2010-11</u>
Fund Balance–Beginning of Period	\$ 11,255.5	\$ 5,972.4	\$ 5,684.8	\$ (4,743.8)	\$ (4,803.8)
Restatements					
Prior Year Revenue, Transfer Accrual Adjustments	(20.0)	(270.7)	181.8	(426.1)	–
Prior Year Expenditure, Accrual Adjustments	206.5	(288.3)	(51.4)	(205.3)	–
Fund Balance–Beginning of Period, as Restated	\$ 11,442.0	\$ 5,413.4	\$ 5,815.2	\$ (5,375.2)	\$ (4,803.8)
Revenues	\$ 95,906.5	\$ 98,515.2	\$ 81,960.8	\$ 86,472.8	\$ 92,830.1
Other Financing Sources					
Economic Recovery Bonds ^(d)	–	3,313.0	–	–	–
Transfers from Other Funds	994.0	2,565.2 ^(e)	1,054.9	447.4	1,399.4
Other Additions	84.4	99.8	40.3	–	–
Total Revenues and Other Sources	\$ 96,984.9	\$104,493.2	\$ 83,056.0	\$ 86,920.2	\$ 94,229.5
Expenditures					
State Operations ^(f)	\$ 24,682.8	\$ 26,318.5	\$ 24,111.3	\$ 23,136.2	\$ 24,901.2
Local Assistance	73,899.7	74,825.3	67,800.8	61,593.2	61,343.0
Capital Outlay	2,903.1	1,601.6	1,137.4	102.7	223.9
Unclassified	–	–	–	1,516.7	83.4
Other Uses					
Transfer to Other Funds ^g	968.9	1,476.4	565.5	– ^(g)	– ^(g)
Total Expenditures and Other Uses	\$102,454.4	\$104,221.8	\$ 93,615.0	\$ 86,348.8	\$ 86,551.5
Revenues and Other Sources Over or (Under)					
Expenditures and Other Uses	\$ (5,469.6)	\$ 271.4	\$ (10,559.0)	\$ 571.4	\$ 7,678.0
Fund Balance					
Reserved for Encumbrances	\$ 842.1	\$ 1,061.6	\$ 1,536.7	\$ 1,536.7	\$ 1,536.7
Reserved for Unencumbered Balances of Continuing Appropriations ^(h)	1,721.3	1,196.2	1,232.9	–	–
Unreserved–Undesignated ⁽ⁱ⁾	3,409.0	3,427.0	(7,513.4)	(6,240.5)	1,337.5
Fund Balance–End of Period	\$ 5,972.4	\$ 5,684.8	\$ (4,743.8)	\$ (4,803.8)	\$ 2,874.2

(a) These statements have been prepared on a budgetary basis in accordance with state law and some modifications would be necessary in order to comply with generally accepted accounting principles (“GAAP”). The Supplementary Information contained in the state’s Audited Basic Financial Statements for the year ended June 30, 2009, incorporated by reference into this APPENDIX A, contains a description of the differences between the budgetary basis and the GAAP basis of accounting and a reconciliation of the June 30, 2009 fund balance between the two methods. See “FINANCIAL STATEMENTS.”

(b) Department of Finance estimates shown net of reimbursements and abatements.

(c) Department of Finance estimates as of the 2010 Budget Act, October 8, 2010.

(d) Reflects the issuance of Economic Recovery Bonds sufficient to provide net proceeds to the General Fund in fiscal year 2007-08.

(Remainder of footnotes on following page.)

- (e) This amount includes the transfer of \$1.5 billion from the BSA to the General Fund as stated in the 2007 Budget Act.
- (f) Includes debt service on general obligation bonds. The estimated amount of debt service is \$4.739 billion for fiscal year 2009-10 and \$4.813 billion for fiscal year 2010-11, net of federal Build America Bond subsidy. For fiscal years 2009-10 and 2010-11, the amounts include reimbursement to the General Fund from special funds of approximately \$243 million in fiscal year 2009-10 and \$808 million in fiscal year 2010-11 to offset debt service costs of certain bonds. Debt service amounts for earlier years are set forth in the table titled "Outstanding State Debt Fiscal Years 2004-05 through 2008-09" under "STATE DEBT TABLES."
- (g) "Transfer to Other Funds" is included either in the expenditure totals detailed above or as "Transfers from Other Funds."
- (h) For purposes of determining whether the General Fund budget, in any given fiscal year, is in a surplus or deficit condition, see Chapter 1238, Statutes of 1990, amending Government Code Section 13307. As part of the amendment, the unencumbered balances of continuing appropriations which exist when no commitment for expenditure is made should be an item of disclosure, but the amount shall not be deducted from the fund balance. Accordingly, the General Fund condition included in the 2010 Budget Act includes the unencumbered balances of continuing appropriations of \$387.9 million in fiscal year 2009-10 and \$.5 million in fiscal year 2010-11. However, in accordance with Government Code Section 12460, the State's Budgetary/Legal Basis Annual Report reflects a specific reserve for the encumbered balance for continuing appropriations.
- (i) Includes SFEU. The Department of Finance generally includes in its estimates of the SFEU and set aside reserves, if any, the items reported in the table under "Reserved for Unencumbered Balances of Continuing Appropriations," and "Unreserved – Undesignated." The Department of Finance estimates a \$6.34 billion SFEU deficit and total reserve on June 30, 2010, and projects a \$1.34 billion SFEU balance and total reserve on June 30, 2011, based upon the 2010 Budget Act. These amounts include the suspension of Proposition 58 transfers to the BSA in fiscal years 2009-10 and 2010-11 as estimated at 2010 Budget Act. The BSA was created pursuant to the California Balanced Budget Act (Proposition 58), enacted in 2004.

Source: Fiscal years 2006-07 to 2008-09: State of California, Office of the State Controller.
Fiscal years 2009-10 and 2010-11: State of California, Department of Finance.

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Revenue and Expenditure Assumptions

The table below presents the Department of Finance’s budget basis statements of major General Fund revenue sources and expenditures for fiscal years 2009-10 and 2010-11, as set forth in the 2010 Budget Act.

TABLE 3
General Fund Revenue Sources And Expenditures
Fiscal Years 2009-10 Through 2010-11
(Dollars In Millions)

Source	Revenues		
	2009-10 Enacted (as of July 2009)	2009-10 Revised (as of 2010 Budget Act)	2010-11 Enacted (as of 2010 Budget Act)
Personal Income Tax	\$48,868	\$44,820	\$47,127
Sales and Use Tax	27,609	26,618	27,044
Corporation Tax	8,799	9,275	10,897
Insurance Tax	1,913	2,029	2,072
All Other	2,352	4,178	7,090 ^(b)
Transfer to/from BSA Reserve ^(a)	--	--	--
Total Revenues and Transfers	\$89,541	\$86,920	\$94,230

Function	Expenditures		
	2009-10 Enacted	2009-10 Revised	2010-11 Enacted
K-12 Education	\$35,042	\$35,732	\$36,179
Health and Human Services	24,953	24,394	26,346
Higher Education	10,547	10,602	11,490
Corrections and Rehabilitation	8,210	8,164	8,931
Legislative, Judicial and Executive	1,884	1,828	3,149
Tax Relief ^(c)	445	438	442
Natural Resources	1,842	1,873	2,108
State and Consumer Services	569	510	598
Business, Transportation and Housing	2,585 ^(d)	2,512 ^(e)	905 ^(f)
All Other	-1,494 ^(g)	296	-3,496 ^(h)
Total Expenditures	\$84,583	\$86,349	\$86,552

- (a) In fiscal years 2009-10, and 2010-11, Proposition 58 transfers to the BSA were suspended.
- (b) Consists of \$1.5 billion in transfers and loans, \$1.5 billion of motor vehicle license fees, \$1.2 billion from sale of assets, \$0.8 billion from restoration of the estate “pick up” tax under current federal law, and various smaller amounts for miscellaneous fees, taxes, royalties, tribal gaming revenues, unclaimed property and other sources.
- (c) Reflects funding for only the Homeowners’ Property Tax Relief Program and \$1,000 for the Williamson Act, essentially suspending the program in fiscal year 2009-10. A \$10 million appropriation for Williamson Act in fiscal year 2010-11 is contained in separate legislation (Senate Bill 863, Committee on Budget and Fiscal Review).
- (d) Includes \$1.441 billion in Proposition 42 transfers from the General Fund to the Transportation Investment Fund, \$82.7 million partial repayment of prior year Proposition 42 loans, \$551.7 million debt service, and \$497 million vehicle license fee and General Fund revenues transferred to the Local Protection and Safety Account.
- (e) Includes \$1.433 billion in Proposition 42 transfers from the General Fund to the Transportation Investment Fund, \$83.4 million partial repayment of prior year Proposition 42 loans, \$565.9 million debt service, and \$415.8 million vehicle license fee and General Fund revenues transferred to the Local Protection and Safety Account.
- (f) Includes \$83.4 million partial repayment of prior year Proposition 42 loans, \$366.7 million debt service, and \$441.5 million vehicle license fee and General Fund revenues transferred to the Local Protection and Safety Account.
- (g) Nearly \$5.0 billion of offset from federal stimulus moneys is no longer included in the “All Other” category but is distributed in each program category above (i.e., K-12 Education, Health and Human Services, Higher Education etc.).
- (h) Includes \$3.6 billion for additional federal funds that are not allocated to specific dollars or programs at this time.

Source: State of California, Department of Finance. Figures in this table may differ from the figures in Table 7; see “Note” to Table 7.

Future Deficits

California's chronic budget crises have been driven by growing state spending commitments funded by temporary spikes in revenues. Once revenues return to their normal trend – or drop precipitously, as had been the case in the recent recession – the higher spending base cannot be sustained, and dramatic cuts to programs and/or tax increases have sometimes been required. Since many of the budget balancing actions in the Amended 2009 Budget Act and 2010 Budget Act are either one-time actions, or involve loans which have to be repaid, or are based on temporary revenue increases which will expire after fiscal year 2010-11 or the non-recurring receipt of federal stimulus funds, significant budget gaps are expected to recur in fiscal year 2011-12 and subsequent years. The Department of Finance will not prepare an estimate of the budget gap for fiscal year 2011-12 until the Governor's Budget is released in January 2011.

To help avoid these types of boom-and-bust budget cycles in the future, a constitutional amendment will be placed before voters at the next statewide general election presently scheduled in June 2012 to substantially strengthen the state's Rainy Day Fund, with more stringent deposit requirements in good budget years that will provide a greater cushion for bad budget years.

The state's ability to balance its budget in the future will also be affected by other budget pressures, including particularly potential significant increases in required state contributions to the California Public Employees' Retirement System, increased financial obligations related to other post-employment benefits, potential adverse decisions in litigation, deferred obligations to schools and local governments and increased debt service.

Another factor creating pressure on future budgets is that the General Fund is obligated to make a variety of payments in future years. In some cases, the Legislature has the ability to modify, further extend the timing or even cancel the obligation to make these payments. Substantial deferred General Fund obligations include, among other things, deferrals of guaranteed payments to school districts pursuant to Proposition 98, repayment of certain legislatively-approved interfund borrowings, reimbursement of borrowings from state and local governments, reimbursements to local governments and school districts for the costs of state mandates placed on those entities under state laws, obligations to employees for compensated absences, costs for self-insurance, and possibly future payment of interest owed on borrowings from the federal government for unemployment insurance payments. The Department of Finance estimates that deferred Proposition 98 payments will total \$9.5 billion as of the end of the 2010-11 fiscal year and that legislatively-approved interfund borrowings will total \$2.6 billion as of the same date. These figures do not include short-term deferrals within or across fiscal years, such as when the Legislature recently deferred certain education payments from one fiscal year into the next fiscal year, nor do they include short-term interfund borrowings (also called "special fund borrowings") for cash management purposes. See "CASH MANAGEMENT" for more information on cash deferrals and special fund borrowings. See also "STATE INDEBTEDNESS AND OTHER OBLIGATIONS – Indirect, Nonpublic and Contingent Obligations."

AMENDED 2009 BUDGET ACT

Background

The state's budget for fiscal year 2009-10 was enacted in an unusual sequence. The 2008 Budget Act was one of the latest ever enacted up to that time, having been delayed until mid-September 2008 as a result of the difficulty of balancing the budget with reduced revenues, as declining economic conditions were already evident. The 2008 Budget Act, however, was based on revenue assumptions made in the spring of 2008, which proved to be greatly overstated by the time actual revenue results for September

and October 2008 were received. With the financial market meltdown starting in September 2008, which resulted in massive federal assistance and caused large drops in stock market and other asset values and reductions in consumer spending, projections of tax revenues, which are heavily dependent on capital gains taxes and sales taxes, had to be dramatically reduced. In November 2008, the Governor announced that the 2008 Budget Act would be billions of dollars out of balance, and called several special sessions of the Legislature to enact corrective actions.

Because of strong disagreement in the Legislature as to the amount of corrective actions which would be taken by tax increases versus expenditure reductions, a compromise was not reached until February 2009. At that time, the February 2009 Budget Package was enacted which included modifications to the 2008 Budget Act and the enactment, more than four months early, of a full budget act for fiscal year 2009-10. For more details on the 2008 Budget Act, see “PRIOR FISCAL YEARS’ BUDGETS – 2008 Budget Act.”

Initial 2009 Budget Act

The Initial 2009 Budget Act was adopted by the Legislature on February 19, 2009, along with a number of implementing measures, and signed by the Governor on February 20, 2009. In February, the state enacted \$36 billion in solutions to what was then estimated to be a \$42 billion General Fund budget gap for the combined 2008-09 and 2009-10 fiscal years. It also provided for five budget-related measures that would have provided an estimated \$6 billion in additional budget solutions, to be placed before the voters on May 19, 2009. These measures were all rejected by the voters.

Under the Initial 2009 Budget Act, based on then-current assumptions about the state’s financial circumstances, and assuming receipt of approximately \$8.0 billion of federal stimulus funds to offset General Fund costs (\$4.9 billion of which was assumed to be received in fiscal year 2009-10) and voter approval of various ballot measures, General Fund revenues and transfers were projected to increase 9.3 percent, from \$89.4 billion in fiscal year 2008-09 to \$97.7 billion in fiscal year 2009-10. The Initial 2009 Budget Act contained General Fund appropriations of \$92.2 billion, compared to \$94.1 billion in fiscal year 2008-09, a 2.0 percent decrease. The June 30, 2010 total reserve was projected to be \$2.1 billion, an increase of \$5.5 billion compared to the estimated June 30, 2009 reserve deficit of negative \$3.4 billion. The Amended 2009 Budget Act reflected vetoes by the Governor of \$1.305 billion in appropriations from the General Fund, special funds, and bond funds (including \$957.2 million in General Fund appropriations). See “STATE FINANCES – Budget Reserves – Budget Stabilization Account” for an explanation of the budgetary reporting method for revenues.

After adoption of the Initial 2009 Budget Act, the state continued to experience significant declines in revenues and other financial pressures. On May 14, 2009, the Governor released the 2009-10 May Revision. Together with subsequent revisions, the 2009-10 May Revision identified a further budget shortfall through the 2009-10 fiscal year of approximately \$24 billion.

Amended 2009 Budget Act

On July 24, 2009, the Legislature approved the amendments to the Initial 2009 Budget Act and the Governor signed the Amended 2009 Budget Act on July 28, 2009. The Amended 2009 Budget Act included another \$24 billion in solutions to address the further deterioration of the state’s fiscal situation identified in the 2009-10 May Revision.

Under the Amended 2009 Budget Act, General Fund revenues and transfers were projected to increase 6.4 percent, from a revised \$84.1 billion in fiscal year 2008-09 to \$89.5 billion in fiscal year 2009-10. A significant element of this increase was projected to come from certain new revenues enacted

in February 2009. See “STATE FINANCES – Services of Tax Revenue – Temporary Revenue Enhancements in 2009 and 2010 Budget Acts” below. The Amended 2009 Budget Act contained General Fund appropriations of \$84.6 billion in fiscal year 2009-10, compared to \$91.5 billion in fiscal year 2008-09, a 7.5 percent decrease. The June 30, 2010 total reserve was projected to be \$500 million as compared to the revised June 30, 2009 General Fund balance of negative \$4.5 billion.

Events after adoption of the Amended 2009 Budget Act resulted in the state ending the 2009-10 fiscal year with \$86.9 billion in General Fund revenues and transfers (compared to \$89.5 billion projected in the Amended 2009 Budget Act) and expenditures of \$86.3 billion (compared to \$84.6 billion projected). As a result, the state exhausted the projected General Fund reserve and ended the 2009-10 fiscal year with a negative General Fund balance of \$6.3 billion. See “TABLE 3 – GENERAL FUND REVENUE SOURCES AND EXPENDITURES FISCAL YEARS 2009-10 THROUGH 2010-11.”

The discussion below describes some of the elements of the Amended 2009 Budget Act, some of which could not be implemented as originally expected. See also “Fiscal Year 2009-10 Revised Estimates in the 2010-11 Governor’s Budget” for a discussion of new revenue and expenditure estimates.

The Amended 2009 Budget Act contained the following major General Fund components:

1. Addressing the Deficit – The \$60 billion in budget solutions adopted for the combined fiscal years 2008-09 and 2009-10 (\$36 billion in solutions were adopted in February 2009 and \$24 billion in July 2009) were wide-ranging and touched all three of the state’s major revenue sources (personal income taxes, corporation taxes and sales and use taxes). Spending cuts were implemented in virtually every state program that receives General Fund support. The budget solutions included spending reductions of \$31.0 billion (52 percent of total solutions). The spending reductions consisted primarily of reductions in education spending under Proposition 98 (\$14.9 billion reduction), higher education (\$3.3 billion reduction), employee compensation (\$2.0 billion reduction), and reductions in other spending due to the use of redevelopment agency revenues and fund balances to pay costs that would otherwise be payable from the General Fund (\$1.7 billion reduction). The budget solutions also included an estimated receipt of \$8.0 billion (13 percent of total solutions) of federal stimulus funds to be used to offset General Fund expenditures. Additional solutions included \$12.5 billion of tax increases (21 percent of total solutions), and \$8.4 billion of other solutions (14 percent of total solutions). Significant elements of the budget solutions include:

- *Proposition 1A of 2004 Borrowing from Local Governments* – The Amended 2009 Budget Act authorized the state to exercise its borrowing authority under Proposition 1A of 2004 to borrow from local agencies up to 8 percent of their fiscal year 2008-09 property tax revenues. The state utilized this authority and the borrowing generated \$1.998 billion that was used to offset state General Fund costs for a variety of court, health, corrections and K-12 programs. The borrowed sums must be repaid by the state, with interest, by June 15, 2013. See “STATE INDEBTEDNESS AND OTHER OBLIGATIONS – Obligations in Connection with Proposition 1A of 2004” and “STATE FINANCES – Local Governments.”

- *Use of Redevelopment Agency Funds* – The Amended 2009 Budget Act also contained a shift of \$1.7 billion in local redevelopment agency funds to the state from current revenues and reserves in fiscal year 2009-10 and \$350 million in fiscal year 2010-11. Under the Amended 2009 Budget Act these revenues are ultimately shifted to schools that serve the redevelopment areas. An association of redevelopment agencies and a group of counties have filed separate suits to block this transfer which if successful could adversely affect the state’s financial condition. However, substantially all of the required transfers have been made. In May 2010, a trial court ruled in favor of the state in this challenge; the decision was appealed to the Third District Court of Appeals in September 2010. Subsequent to enactment of the Amended 2009 Budget Act the Legislature also passed clean-up legislation authorizing redevelopment agencies to borrow from prior-year balances in the Low and Moderate Income Housing Funds to make the fiscal years 2009-10 and 2010-11 payments. As of the 2010 Budget Act, the appeal is still pending. See “AMENDED 2009 BUDGET ACT – Budget Risks” and “STATE FINANCES – Local Governments.”
- *Payroll Shift* – One-time savings of \$1.618 billion (\$937.6 million General Fund) from shifting the payments for employee payroll covering the pay period ending June 30, 2010 to July for all entities that are paid through the Uniform State Payroll System. This shift will be repeated on an annual basis. This payment shift excludes the University of California, Community Colleges, staff of the Legislature, the California Exposition and State Fair, and local trial courts.
- *State Compensation Insurance Fund Sale* – One-time revenues of \$1 billion from the sale of certain assets of the State Compensation Insurance Fund (“SCIF”). Because of pending litigation, the state no longer expects the sale of SCIF assets to occur in fiscal years 2009-10 or 2010-11. See “LITIGATION - Budget-Related Litigation - Action Challenging Proposed Sale of State Compensation Insurance Fund Assets.”

2. Federal Stimulus – The Amended 2009 Budget Act assumed the receipt of at least \$8 billion from the American Recovery and Reinvestment Act of 2009 (“ARRA”) to offset General Fund expenditures in fiscal years 2008-09 and 2009-10. As of the 2010 Budget Act, the 2008-09 and 2009-10 estimates have been adjusted to \$9.2 billion. See “STATE FINANCES – American Recovery and Reinvestment Act.”

3. Proposition 98 – As of the Amended 2009 Budget Act, the Proposition 98 Guarantee for fiscal year 2009-10 was projected to be \$50.4 billion, of which \$35.0 billion was the General Fund portion. See “STATE FINANCES – Proposition 98 and K-14 Funding.” As of the 2010-11 May Revision, the Proposition 98 Guarantee for fiscal year 2009-10 is projected to be \$49.9 billion, of which \$34.7 billion is the General Fund portion. The 2010 Budget Act included \$49.5 billion in 2009-10 funding for Proposition 98, of which \$35.5 billion is the General Fund portion.

4. K-12 Education – The Amended 2009 Budget Act included \$66.7 billion for K-12 education programs for fiscal year 2009-10 of which \$35.0 billion was funded from the General Fund. As of the Amended 2009 Budget Act, total per-pupil expenditures were projected to be \$11,259 in fiscal year 2009-10. Revised estimates in the 2010-11 May Revision reflect \$65.9 billion for K-12 education programs for fiscal 2009-10 of which \$35.9 billion is funded from the General Fund. Revised estimates in the 2010-11 May Revision reflect that total per-pupil expenditures are projected to be \$11,121 in fiscal year 2009-10. As of the 2010 Budget Act, total K-12 funding remains at the May Revision level of \$65.9 billion for 2009-10, of which \$36.0 billion is provided from the General Fund. The 2009-10 per-pupil expenditures are \$11,135.

5. Higher Education – The Amended 2009 Budget Act reflected total funding of \$20.9 billion, including \$12.5 billion General Fund and Proposition 98 sources, for all major segments of Higher Education (excluding infrastructure and stem cell research), including approximately \$2 billion from local property taxes that are included in the Proposition 98 Guarantee and expended on California Community Colleges. The 2010 Budget Act includes total funding of \$20.6 billion for fiscal year 2009-10, including \$12.6 billion General Fund and Proposition 98 sources for all major segments of Higher Education (excluding infrastructure and stem cell research).

6. Health and Human Services – The Amended 2009 Budget Act included \$24.8 billion in non-Proposition 98 General Fund expenditures for Health and Human Service Programs for fiscal year 2009-10. Due to the state's severe fiscal shortfall, the Amended 2009 Budget Act included \$5.8 billion in proposed General Fund expenditure reductions in Health and Human Services programs in fiscal year 2009-10. Apart from the reduction in General Fund funding for these programs, the Amended 2009 Budget Act reflected significant General Fund relief for Health and Human Services programs resulting from the ARRA. As of the 2010 Budget Act, non-Proposition 98 General Fund expenditures for Health and Human Service Programs for fiscal year 2009-10 are projected to be \$24.3 billion.

7. Transportation Funding – The Amended 2009 Budget Act included \$1.441 billion of General Fund expenditures to fully fund local transportation programs under Proposition 42 in fiscal year 2009-10. Additionally, the Amended 2009 Budget Act directed \$1.015 billion of funds from sales tax on fuels to offset costs of programs otherwise likely to be funded from the General Fund such as debt service on transit bonds and other transportation programs. Of this amount approximately \$878 million was for uses substantially similar to those that were the subject of litigation related to the 2008 Budget Act. On September 30, 2009 the State Supreme Court denied review of an adverse Court of Appeal decision in *Shaw v. Chiang*, which invalidated the use of these funds as appropriated. Consequently, these fuels sales taxes were retained in the Public Transportation Account for appropriation. These funds are "borrowable" for short-term General Fund cash needs. Chapters 11 and 12, Statutes of 2010, were passed in the special session providing General Fund relief by eliminating the state sales tax on gas and increasing the state gas excise tax by a like amount. This effectively eliminates funding subject to the provisions of Proposition 42 and significantly reduces the funding going into the Public Transportation Account, eliminating the so-called spillover allocation. Fuel excise tax revenues will be used to offset highway bond debt service thus providing increasing General Fund relief beginning in fiscal year 2009-10 and growing in future years. (Approximately \$603 million of relief is projected for fiscal year 2010-11.) Remaining Public Transportation Account funds and new diesel sales tax revenues are used to offset transit bond debt service allowable under the court ruling in fiscal years 2009-10 and 2010-11. After these two fiscal years, the statute provides for no further use of Public Transportation Account for debt service offset.

Additionally, \$650 million of excise tax proceeds available from this legislation in fiscal year 2010-11 was proposed to be loaned to the General Fund and repaid in three years. The 2010 Budget Act assumed fuel excise tax revenues will be used to offset highway bond debt service, providing \$491 million of General Fund relief in fiscal year 2010-11. Additionally, \$225 million of Public Transportation Account funds and diesel sales tax revenues will be used to offset transit bond debt service allowable under the court ruling. All of these actions are apparently prohibited by enactment of Proposition 22, although fund transfers which took place prior to November 3, 2010 are not affected. Of the amounts of General Fund solutions above, at least \$850 million are not expected to be realized in 2010-11.

The special session transportation legislation provides for ongoing highway and local road funding similar in distribution to the former provisions that governed Proposition 42 funds (sales tax on gasoline). Increased funding is provided for the State Highway Operations and Protection Program (highway safety and rehabilitation projects, primarily) as well as local streets and roads and the State

Transportation Improvement Program (capacity projects, primarily). The legislation provides approximately \$350 million in ongoing annual transit operations grants with a one-time appropriation of \$400 million for the remainder of fiscal years 2009-10 and 2010-11. Subject to interpretation by the courts, Proposition 22 provides for a different distribution of transit funding. Similarly, to the extent the debt service allocation of this revenue is prohibited by Proposition 22, those revenues could be distributed as provided in current law to the State Transportation Improvement Program, local roads, and the State Highway Operations and Protection Program. It is not certain how the courts will interpret the repealer provisions of Proposition 22, nor how any litigation may be framed, so other outcomes are possible. Proposition 26 may also be interpreted by the courts as applying to the revenues that provide for these transportation allocations. If the Legislature does not reenact the statute providing these revenues with a two-thirds vote by November 3, 2011, some or all of the revenue provisions may no longer be operative after that date. Revenue sources formerly operative may or may not be restored. It is not certain how the courts would rule on a suit, if one is filed.

8. Budget Stabilization Account – Pursuant to Proposition 58, the state normally would be required to set aside a specified portion of estimated annual General Fund revenues for fiscal year 2009-10 in the BSA for reserves that may be used to offset future shortfalls in the General Fund. Given the magnitude and urgency of the state’s ongoing financial stress, in accordance with Proposition 58, the Amended 2009 Budget Act suspended the transfer to the BSA for fiscal year 2009-10.

9. Prison Funding – The Amended 2009 Budget Act included \$7.9 billion in General Fund expenditures for the California Department of Corrections and Rehabilitation (“CDCR”). In arriving at this figure, a total of \$1.2 billion of savings for CDCR operations was assumed. Due to the delay in passage of legislation, and the failure of the Legislature to adopt certain prison and parole reforms requested by the Governor, actual savings were approximately \$587 million, with the result that CDCR costs were approximately \$613 million higher than assumed in the Amended 2009 Budget Act, not including any changes as of the 2010-11 May Revision. As of the 2010-11 May Revision, CDCR costs in fiscal year 2009-10, excluding debt service and savings from employee compensation, are projected to exceed the level included in the Amended 2009 Budget Act by \$906.6 million. As of the 2010 Budget Act, CDCR General Fund expenditures in fiscal year 2009-10, excluding debt service and savings from employee compensation, are \$8.6 billion. A total of \$578 million of savings was assumed, of which \$250 million is related to a reduction in programs, \$100 million is an unallocated reduction, \$53 million relates to population decreases, \$48 million is for the elimination of that year’s special repair budget, and \$42 million pertains to a reduction in Female Community Correctional Center beds.

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Set forth below is a table showing the estimated General Fund Budget Summary for fiscal year 2009-10 as of the Amended 2009 Budget Act, as originally projected by the 2010-11 Governor’s Budget, and as subsequently revised by the 2010 Budget Act.

TABLE 4
2009-10 Estimated General Fund Budget Summary
(Dollars In Millions)

	As of Amended 2009 Budget Act (July 28, 2009)	As of 2010 Budget Act (October 8, 2010)
Prior Year Resources Available	\$(3,379) ^(a)	\$(5,375) ^(a)
Revenues and Transfers	89,541	86,920
Expenditures	84,583	86,349
Fund Balance	<u>\$1,579</u>	<u>\$(4,804)</u>
Reserve for Liquidation of Encumbrances	\$1,079	\$1,537
Special Fund for Economic Uncertainties	\$500	\$(6,341)
Budget Stabilization Account	--	--
Total Available Reserve	\$500	\$(6,341)

^(a) Includes a carry-over adjustment of \$1.09 billion from amnesty-related payments, of which \$710 million will have to be refunded or will reduce revenues in future years, including a \$200 million adjustment in fiscal year 2009-10 and a \$510 million adjustment in fiscal years 2010-11 and 2011-12.

Source: State of California, Department of Finance.

CASH MANAGEMENT

Cash Management Tools

General. The majority of the state’s General Fund revenues are received in the latter part of the fiscal year. Expenditures from the General Fund occur more evenly throughout the fiscal year. The state’s cash flow management program customarily addresses this timing difference by making use of internal borrowing (see “ – Internal Borrowing”) and by issuing short-term notes in the capital markets (see “ – External Borrowing”). External borrowing is typically done with RANs that are payable not later than the last day of the fiscal year in which they are issued. RANs have been issued in 22 of the last 23 fiscal years and have always been paid at maturity. The state also is authorized under certain circumstances to issue RAWs that are payable in the succeeding fiscal year. The state issued RAWs to bridge short-term cash flow shortages in 1992, 1993, 1994, 2002 and 2003. See “STATE FINANCES – State Warrants – Reimbursement Warrants” for more information on RAWs.

RANs and RAWs are both payable from any “Unapplied Money” in the General Fund of the state on their maturity date, subject to the prior application of such money in the General Fund to pay Priority Payments. “Priority Payments” are payments as and when due to: (i) support the public school system and public institutions of higher education (as provided in Section 8 of Article XVI of the State Constitution); (ii) pay principal of and interest on general obligation bonds and general obligation commercial paper notes of the state; (iii) reimburse local governments for certain reductions in ad valorem property taxes (as required by Section 25.5 of Article XIII of the State Constitution), or make required payments for borrowings secured by such repayment obligation (see “STATE INDEBTEDNESS AND OTHER OBLIGATIONS – Obligations in Connection with Proposition 1A of 2004”); (iv) provide

reimbursement from the General Fund to any special fund or account to the extent such reimbursement is legally required to be made to repay borrowings therefrom pursuant to California Government Code Sections 16310 or 16418; and (v) pay state employees' wages and benefits, state payments to pension and other state employee benefit trust funds, state Medi-Cal claims, lease payments to support lease-revenue bonds, and any amounts determined by a court of competent jurisdiction to be required by federal law or the State Constitution to be paid with state warrants that can be cashed immediately. See "STATE FINANCES - State Warrants."

The state has employed additional cash management measures during some fiscal years; all of the following techniques were used at one time or another during fiscal years 2008-09 and 2009-10 and so far in fiscal year 2010-11:

- The State Controller has delayed certain types of disbursements from the General Fund.
- Legislation was enacted during the 2009-10 fiscal year increasing the state's internal borrowing capability, and the state has increased the General Fund's internal borrowings.
- Legislation has been enacted deferring some of the state's disbursements until later in the fiscal year, when more cash receipts are expected, or into the succeeding fiscal year.
- In addition, as noted below, the state issued registered warrants in July and August 2009 because of insufficient cash resources. See "– Cash Management in Fiscal Year 2009-10."

Internal Borrowing. The General Fund is currently authorized by law to borrow from more than 700 of the state's approximately 1,300 other funds in the State Treasury (the "Special Funds"). Total borrowing from Special Funds must be approved by the PMIB. The Controller submits an authorization request to the PMIB quarterly, based on forecasted available funds and borrowing needs. The Legislature may from time to time adopt legislation establishing additional authority to borrow from Special Funds. The state has historically made extensive use of its internal borrowing capability to provide cash resources to the General Fund. On September 15, 2010, the PMIB authorized the internal borrowing of up to \$20.995 billion for the period of October 1 through December 31, 2010. Enactment of Proposition 22 could prohibit the General Fund from making temporary borrowings for cash management from certain transportation funds. The Department of Finance has estimated the effect of reducing internal borrowable resources by up to \$2 billion (the amounts borrowable vary from time to time during the year), and is projected to be about \$1.1 billion in June 2011. The State Controller's Office is continuing to review Proposition 22 to make a final determination of which funds, and in what amounts, are affected by the measure.

One fund from which moneys may be borrowed to provide additional cash resources to the General Fund is the BSA, a reserve fund established in 2004 by Proposition 58. However, during fiscal year 2009-10, there are no funds available in the BSA. The state also may transfer funds into the General Fund from the state's SFEU, which is not a Special Fund. See "STATE FINANCES – Inter-Fund Borrowings" for a further description of this process.

External Borrowing. As noted above, issuance of RANs is a normal part of the state's annual cash flow management program. On September 29, 2009, the state issued \$8.8 billion of RANs which matured in May and June 2010. The state expects to issue approximately \$10 billion of RANs to assist its cash flow management in fiscal year 2010-11 ("2010 RANs"). The 2010 RANs result in sufficient unapplied cash resources in the General Fund which can be used to repay Interim RANs in the amount of \$6.7 billion which were sold privately to financial institutions on October 28, 2010. The Interim RANs provided short-term cash flow resources pending issuance of the 2010 RANs. See "STATE INDEBTEDNESS AND OTHER OBLIGATIONS – Cash Flow Borrowings."

Payment Deferrals. From time to time, the Legislature changes by statute the due date for various payments, including those owed to public schools, universities and local governments, until a later date in the fiscal year, or even into the following fiscal year, in order to more closely align the state's revenues with its expenditures. This technique has been used several times through the enactment of budget bills in fiscal years 2008-09 and 2009-10. Some of these statutory deferrals were made permanent, and others were implemented only for one fiscal year. One effect of these deferrals has been to reduce the state's need for external borrowing to bridge its cash flow deficit during the fiscal year.

In addition, state law gives the State Controller some flexibility as to how quickly the state must pay its bills. For instance, income tax refunds for personal income taxes are not legally due until 45 days after the return filing deadline, which is normally April 15. Accordingly, while the state has typically paid tax refunds as returns are filed, it can conserve cash by withholding refund payments until after the April 15 due date. Payments to vendors generally must be made within 45 days of receipt of an invoice. The state may delay payment until the end of this period, or it may even choose to make these payments later and pay interest. These delays are only used if the State Controller foresees a relatively short-term cash flow shortage. Such an instance occurred in February 2009, when the State Controller delayed making about \$2.9 billion of tax refunds, and another \$1.3 billion of vendor and other payments. Enactment of budget solutions in February 2009 allowed all the delayed payments to be made up in March 2009.

On March 1, 2010 the Governor signed a bill to provide additional cash management flexibility to state fiscal officials (Chapter 1, Statutes of 2009-10 Eighth Extraordinary Session, the "first cash management bill"). The effect of the first cash management bill is further described below. As part of the 2010 Budget Act, a second cash management bill was enacted to provide short-term deferral of certain state obligations, totaling about \$4.5 billion, mostly from October to November, 2010.

Cash Management in Fiscal Year 2009-10

The state entered fiscal year 2009-10 on July 1, 2009 with severely depleted cash resources as a result of having to pay significant obligations before June 30, 2009, including repayment of \$5.5 billion of RANs issued in fiscal year 2008-09. In addition, significant payments to public schools had been deferred from the end of fiscal year 2008-09 into the first few weeks of July 2009. The state had projected in May 2009 that revenues would be lower than expected and that it faced a \$22 billion budget gap. However, by July 1, 2009, additional budget solutions for fiscal year 2009-10 had not been adopted.

Faced with reduced cash resources, as described above, the State Controller started to issue registered warrants (or IOUs) on July 2, 2009, for certain obligations of the state not having payment priority under law. The State Controller was able to manage cash resources, as described above, to ensure that higher priority payments, such as for schools and debt service, were made on time in July and August 2009. On July 28, 2009, the Governor signed the Amended 2009 Budget Act, which included a number of provisions for cash management purposes.

With the adoption of the Amended 2009 Budget Act, the state was able to undertake its normal external borrowing program for fiscal year 2009-10. In order to provide an immediate increase in cash resources, the state issued \$1.5 billion of 2009 Interim RANs (the "Interim Notes") on August 27, 2009, which were scheduled to mature on October 5, 2009. This permitted early redemption of the outstanding registered warrants (\$2.6 billion) as of September 4, 2009. (The Interim Notes were subsequently repaid in full on September 29, 2009 using unapplied cash resources which were available in the General Fund following issuance of the 2009-10 Series A Notes.)

The state was able to manage its cash flows for the balance of fiscal year 2009-10 although it was assisted by legislatively authorized deferral of certain payments in March-April 2010 under the first cash management bill described above. The state paid all its obligations due through the end of the fiscal year using revenues and internal borrowable resources. The General Fund ended the fiscal year owing \$9.992 billion to special funds for such short-term cash flow borrowings.

Cash Management in Fiscal Year 2010-11

The first cash management bill (described above) authorized deferral of certain payments during fiscal year 2010-11 including payments to K-12 schools (not to exceed \$2.5 billion in the aggregate at any one time), SSI/SSP reimbursements to the federal government, certain local government social services, transportation payments and Proposition 63 mental health payments (not to exceed \$1 billion in the aggregate at one time), higher education, STRS payment modifications and trial operations (not including payroll). Many of these deferrals were made or can be made in July 2010, October 2010 and March 2011 and did not and will not exceed 60, 90 and 60 days, respectively. However, depending on actual cash flow conditions at the time, the Controller, Treasurer and Director of Finance may either accelerate or delay the deferrals up to 30 days, or reduce the amounts deferred. In total, as of the 2010 Budget Act, the Department of Finance estimates these deferrals will improve the state's cash position by up to \$4.8 billion in certain months, thereby reducing the need for external cash management borrowing or other measures. Certain small cities and counties, community college districts and school districts that can demonstrate hardship, will not be subject to these deferrals. The cash management bill expressly provides that no deferrals may affect state payroll or payments of debt service on state bonds, lease rental payments which support revenue bonds, or certain other payments which are used to support debt service. The July 2010 deferrals were made as authorized, and the October 2010 deferral was accelerated into September 2010 because of the delay in enactment of a budget.

The state entered fiscal year 2010-11 on July 1, 2010 with general fund cash and unused borrowable resources of approximately \$8.8 billion, but without an enacted budget, which prevented the state from making payment for many programs which did not have continuing appropriations or constitutionally mandated payment obligations, and payments to a variety of suppliers of goods and services to the state. This allowed the state to conserve its cash resources, and, unlike the previous year, no registered warrants had to be issued.

Once the 2010 Budget Act was enacted, however, the state had to meet all its obligations which had remained unpaid in the absence of valid appropriations during the three months that the state had no approved budget, totaling approximately \$6.7 billion payable from the General Fund. The requirement that the state make up these payments created cash challenges for October and November 2010. The state responded to these challenges by (1) enactment of a cash management bill accompanying the 2010 Budget Act that allows for short term deferrals (mostly within October 2010 or from October 2010 to November 2010) of approximately \$4.5 billion to help manage the cash flow during that period and (2) by issuing \$6.7 billion of 2010 Interim Revenue Anticipation Notes (the "Interim Notes") on October 28, 2010 in a private placement with multiple financial institutions. The state is planning to issue \$10 billion

of RANs to public investors on or about November 23, 2010 which will allow repayment of the Interim Notes (see “External Borrowing” above).

While the Administration’s estimates of cash flow in fiscal year 2010-11 indicate a positive projected cash position in each month of fiscal year 2010-11 (even after reduction of borrowable resources due to Proposition 22), this is not indicative of a return to fiscal health. Rather, the state’s cash position has improved as a result of (1) the cash deferral legislation passed in March 2010 and October 2010, described above and (2) continued heavy reliance on internal borrowing by the General Fund from various Special Funds. The state’s fiscal officers are continuing to closely monitor developments which may impact the state’s cash management requirements, including monthly cash receipts and disbursements. There can be no assurance that deterioration in revenue and/or increases in expenditures in the current fiscal year or early in fiscal year 2011-12 will not require state officers to implement additional cash management measures before the end of the fiscal year, including but not limited to additional payment deferrals, issuance of additional revenue anticipation notes, or issuance of registered warrants or registered reimbursement warrants, to supplement its cash management program for fiscal years 2010-11 or 2011-12.

STATE INDEBTEDNESS AND OTHER OBLIGATIONS

General

The State Treasurer is responsible for the sale of most debt obligations of the state and its various authorities and agencies. The state has always paid when due the principal of and interest on its general obligation bonds, general obligation commercial paper notes, lease-revenue obligations and short-term obligations, including RANs and RAWs. Additional information regarding the state’s long-term debt appears in the section “STATE DEBT TABLES.”

Capital Facilities Financing

General Obligation Bonds

The State Constitution prohibits the creation of general obligation indebtedness of the state unless a bond measure is approved by a majority of the electorate voting at a general election or a direct primary. General obligation bond acts provide a continuing appropriation from the General Fund of all debt service payments on general obligation bonds, subject only to the prior application of moneys in the General Fund to the support of the public school system and public institutions of higher education. Under the State Constitution, the appropriation to pay debt service on the general obligation bonds cannot be repealed until the principal and interest on the bonds have been paid. See “STATE FINANCES - State Expenditures.” Certain general obligation bond programs, called “self-liquidating bonds,” receive revenues from specified sources so that moneys from the General Fund are not expected to be needed to pay debt service, but the General Fund is liable as a back-up if the specified revenue source is not sufficient. The principal self-liquidating bond programs are the ERBs, supported by a special sales tax, and veterans general obligation bonds, supported by mortgage repayments from housing loans made to military veterans. See “ – Economic Recovery Bonds.”

General obligation bonds are typically authorized for infrastructure and other capital improvements at the state and local level. Pursuant to the state Constitution, general obligation bonds cannot be used to finance state budget deficits (except as already authorized by ERBs, as described below).

As of October 1, 2010, the state had outstanding \$76,810,154,000 aggregate principal amount of long-term general obligation bonds, of which \$68,098,479,000 were payable primarily from the state's General Fund, and \$8,711,675,000 were "self-liquidating" bonds payable first from other special revenue funds. As of October 1, 2010, there were unused voter authorizations for the future issuance of \$42,884,259,000 of long-term general obligation bonds, some of which may first be issued as commercial paper notes (see "General Obligation Commercial Paper Program" below). Of this unissued amount, \$1,306,210,000 is for general obligation bonds payable first from other revenue sources. See the table "Authorized and Outstanding General Obligation Bonds" following the caption "STATE DEBT TABLES."

A ballot measure will be submitted to the voters at the statewide election on November 6, 2012 to approve the issuance of \$11.14 billion in general obligation bonds for a wide variety of purposes relating to improvement of California's water supply systems, drought relief, and groundwater protection. This legislation specifies that not more than one-half of the bonds may be sold before July 1, 2015. Additional bond measures may be included on future election ballots, but any proposed bond measure must first be approved by the Legislature or placed on the ballot through the initiative process.

Variable Rate General Obligation Bonds

The general obligation bond law permits the state to issue as variable rate indebtedness up to 20 percent of the aggregate amount of long-term general obligation bonds outstanding. As of October 1, 2010, the state had outstanding \$4,844,275,000 principal amount of variable rate general obligation bonds (which includes a portion of the ERBs described below), representing about 6.3 percent of the state's total outstanding general obligation bonds as of that date. These bonds are described generally in the following table:

Name of Bond	Outstanding Principal Amt (\$000) as of October 1, 2010	Variable Type	Liquidity Support ^(a)	Other Information
General Obligation	\$2,671,790	Daily/Weekly Floating Rate	Letters of Credit	
General Obligation	\$1,047,880	Fixed Rate to Mandatory Tender Dates	None	Mandatory Tenders in April 2012, November 2012 and April 2013
ERB	\$624,605	Daily/Weekly Floating Rate	Letters of Credit	
ERB	\$500,000	Fixed Rate to Mandatory Tender Dates	None	Mandatory Tender on July 1, 2014

^(a) See "Bank Arrangements."

Source: State of California, Office of the State Treasurer.

Under state law, except for the ERBs, the state must pay the principal of any general obligation bonds which are subject to optional or mandatory tender, and which are not remarketed or, if applicable, purchased by financial institutions which provide liquidity support to the state. The state has not entered into any interest rate hedging contracts in relation to any of its variable rate general obligation bonds, and it no longer has any auction rate bonds outstanding.

General Obligation Commercial Paper Program

Pursuant to legislation enacted in 1995, voter-approved general obligation indebtedness may be issued either as long-term bonds or, for some but not all bond issues, as commercial paper notes. Commercial paper notes may be renewed or may be refunded by the issuance of long-term bonds. It is

currently the state's policy to use commercial paper notes to provide flexibility for bond programs, such as to provide interim funding of voter-approved projects and to facilitate refunding of variable rate bonds into fixed rate bonds. Pursuant to the terms of the bank credit agreement presently in effect, the general obligation commercial paper program may have up to \$2 billion in aggregate principal amount at any time. This maximum amount may be increased or decreased in the future. As of November 1, 2010, \$1,292,170,000 aggregate principal amount of general obligation commercial paper notes were outstanding. Commercial paper notes are not included in the calculation of permitted variable rate indebtedness described under "Variable Rate General Obligation Bonds" and are not included in the figures provided above in the section "General Obligation Bonds."

Bank Arrangements

In connection with the letters of credit or other credit facilities obtained by the state in connection with variable rate obligations and the commercial paper program, the state has entered into a number of reimbursement agreements or other credit agreements with a variety of financial institutions as set forth in the table titled "BANK ARRANGEMENTS" which immediately follows the end of the text of this APPENDIX A, prior to "STATE DEBT TABLES." These agreements include various representations and covenants of the state, and the terms (including interest rates and repayment schedules) by which the state would be required to repay any drawings (including drawings resulting from any failed remarketings) on the respective letters of credit or other credit enhancement to which such credit agreements relate. To the extent that variable rate obligations cannot be remarketed over an extended period (whether due to reductions in the credit ratings of the institution providing credit enhancement or other factors), interest payable by the state pursuant to the reimbursement agreement or credit agreement would generally increase over current market levels relating to the variable rate obligations, and the principal repayment period would generally be shorter (typically less than five years) than the repayment period otherwise applicable to the variable rate obligation. On occasion the state's variable rate obligations have not been remarketed resulting in draws on the applicable credit facilities.

Since the start of 2009, the state has taken a number of actions regarding its bank credit arrangements, including extending existing letter of credit facilities and converting standby purchase agreements to letters of credit for some of its floating rate ERBs and for its Commercial Paper program. The makeup of some of the state's credit facilities was also revised with the deletion or substitution of banks. About \$1.37 billion of letters of credit for several series of variable rate general obligation bonds expire in November and December 2010. The state has received commitments from banks to renew or replace these expiring facilities, and is in the process of finalizing the documentation for those actions. These transactions are scheduled to be completed on November 12 and November 23, 2010. See the "BANK ARRANGEMENTS" table at the end of APPENDIX A, preceding the "STATE DEBT TABLES."

Lease-Revenue Obligations

In addition to general obligation bonds, the state has acquired and constructed capital facilities through the use of lease-revenue borrowing (also referred to as lease-purchase borrowing). Under these arrangements, the State Public Works Board, another state or local agency or a joint powers authority issued bonds to pay for the construction of facilities such as office buildings, university buildings, courthouses or correctional institutions. These facilities are leased to a state agency, the California State University, the University of California or the Judicial Council under a long-term lease that provides the source of payment of the debt service on the lease-revenue bonds. In some cases, there was not a separate bond issue, but a trustee directly created certificates of participation in the state's lease obligation, which were then marketed to investors. Under applicable court decisions, such lease arrangements do not constitute the creation of "indebtedness" within the meaning of the State Constitutional provisions that

require voter approval. For purposes of this APPENDIX A and the tables under “STATE DEBT TABLES,” the terms “lease-revenue obligation,” “lease-revenue financing,” “lease-purchase obligation” or “lease-purchase” means principally bonds or certificates of participation for capital facilities where the lease payments providing the security are payable from the operating budget of the respective lessees, which are primarily, but not exclusively, derived from the General Fund, and also includes revenue bonds for a state energy efficiency program secured by payments made by various state agencies under energy service contracts. The state had \$9,761,885,000 in lease-revenue obligations outstanding as of October 1, 2010. The tables under “STATE DEBT TABLES” do not include equipment leases or leases which were not sold, directly or indirectly, to the public capital markets. The State Public Works Board, which is authorized to sell lease-revenue bonds, had \$12,272,464,280 authorized and unissued as of November 1, 2010. In addition, SB 1407 (Chapter 311, statutes of 2008) included intent language authorizing up to \$5 billion in lease revenue financing for court construction. Of this amount, \$868,020,000 was authorized in the 2010 Budget Act and is included in the November 1, 2010 figure. The debt service for all court projects financed under SB 1407 will be paid from a special fund with revenues dedicated for debt service payments. See “STATE FINANCES – Department of Corrections and Rehabilitation – Prison Construction Program.”

Non-Recourse Debt

Certain state agencies and authorities issue revenue obligations for which the General Fund has no liability. Revenue bonds represent obligations payable from state revenue-producing enterprises and projects, which are not payable from the General Fund, and conduit obligations payable only from revenues paid by private users of facilities financed by the revenue bonds. The enterprises and projects include transportation projects, various public works projects, public and private educational facilities (including the California State University and University of California systems), housing, health facilities and pollution control facilities. State agencies and authorities had approximately \$57 billion aggregate principal amount of revenue bonds and notes which are non-recourse to the General Fund outstanding as of June 30, 2010, as further described in the table “State Agency Revenue Bonds and Conduit Financing” under “STATE DEBT TABLES.”

Build America Bonds

In February 2009, the Congress enacted certain new municipal bond provisions as part of the ARRA (stimulus bill). One provision allows municipal issuers such as the state to issue “Build America Bonds” (“BABs”) for new infrastructure investments. BABs are bonds whose interest is subject to federal income tax, but the U.S. Treasury will repay to the state an amount equal to 35 percent of the interest cost on any BABs issued during 2009 and 2010. This results in a net interest expense lower than what the state would have had to pay for tax-exempt bonds of similar maturity. The subsidy payments from general obligation bonds are General Fund revenues to the state, while subsidy payments for lease-revenue bonds are deposited into a fund which is made available to the State Public Works Board for any lawful purpose. In neither instance are the subsidy payments specifically pledged to repayment of the BABs to which they relate. The cash subsidy payment with respect to the BABs, to which the state is entitled, is treated by the Internal Revenue Service as a refund of a tax credit and such refund may be offset by the Department of the Treasury by any liability of the state payable to the federal government, including in respect of any internal revenue tax (including any interest and penalties), past due child support, past due and legally enforceable debt due federal agencies, unemployment compensation debts, and past due legally enforceable state income tax debts. As of November 1, 2010 the state has received all BABs cash subsidy payments to which it has been entitled, without offset.

Starting in April 2009 and through September 2010, the state has issued a significant amount of BABs, including \$10.39 billion of general obligation bonds and \$551 million of lease-revenue bonds.

The aggregate amount of the subsidy payments to be received from fiscal year 2010-11 through the maturity of these bonds (mostly 20 to 30 years) is approximately \$7.3 billion for the general obligation BABs and \$327 million for the lease-revenue BABs. The Obama Administration has proposed making the BABs program permanent, although at a lower subsidy rate for future issuances. The House of Representatives passed a bill which extends the BAB program for two years, at successively lower subsidy rates, but higher than what was proposed by the Obama Administration; this proposal has not yet been acted on by the Senate.

Future Issuance Plans; General Fund Debt Ratio

Between November 2006 and August 2009, voters and the Legislature authorized more than \$60 billion of new general obligation bonds and lease-revenue bonds. This new authorization substantially increased the current amount of such General Fund-supported debt outstanding to more than \$78 billion, while still leaving current authorized and unissued bonds of about \$54 billion.

The State Treasurer has estimated that the aggregate amount of outstanding debt supported by the General Fund, including general obligation, lease revenue, and Proposition 1A bonds, based on current voter and legislative authorizations, and bond cash flow needs as reported by the Department of Finance, is estimated to peak at approximately \$114.6 billion by fiscal year 2015-16, compared to the current outstanding amount of about \$79.8 billion. The annual debt service costs on this amount of debt is estimated by the State Treasurer to increase to approximately \$9.49 billion in fiscal year 2012-13 compared to about \$6.84 billion estimated in fiscal year 2010-11. The projected amounts for fiscal year 2010-11 through 2011-12 include the interest, and for fiscal year 2012-13, the interest and principal payable on the \$1.90 billion of bonds issued in connection with Proposition 1A of 2004. (See “Obligations in Connection with Proposition 1A of 2004.”) After fiscal year 2012-13, projected peak debt service is \$10.39 billion in fiscal year 2017-18. (These estimates do not include ERBs, described below, or veterans general obligation bonds supported by mortgage repayments from housing loans made to military veterans, nor do they take into account potential benefits from future refunding opportunities.)

In light of the substantial drop in General Fund revenues since fiscal year 2007-08, described elsewhere in this APPENDIX A, and the projections of substantial new bond sales in the future, the ratio of debt service on general obligation, lease-revenue, and the Proposition 1A bonds supported by the General Fund, to annual General Fund revenues and transfers (the “General Fund Debt Ratio”), can be expected to increase significantly in future years. As assumptions for future debt issuance and revenue projections are updated from time to time, any changes to these amounts may impact the projected General Fund Debt Ratio. Based on the revenue estimates used for the 2010 Budget Act, in fiscal year 2010-11, the General Fund Debt Ratio is estimated to equal approximately 7.26 percent. Based on Department of Finance estimates for future debt issuance, and the assumed growth in General Fund revenues and transfers contained in the 2010-11 May Revision, from fiscal year 2011-12 through fiscal year 2013-14, the state’s General Fund Debt Ratio is projected to peak at 10.12 percent in fiscal year 2012-13, the year in which the Proposition 1A bonds mature. In the fiscal year following the maturity of the Proposition 1A bonds, fiscal year 2013-14, the state’s General Fund Debt Ratio is projected to decline to 8.93 percent. The state’s General Fund Debt Ratio after fiscal year 2013-14 will depend on the state’s future General Fund revenues which will in turn depend on a variety of factors including but not limited to economic, population and inflation growth. Based on the state’s current debt issuance projections and an assumed combined average annual General Fund revenue growth rate of between 2 percent to 5 percent, the state’s General Fund Debt Ratio in fiscal year 2019-20 is projected to range from 7.60 percent to 9.06 percent. The General Fund Debt Ratio is calculated based on actual gross debt service, without adjusting for receipts from the U.S. Treasury for the state’s current outstanding general obligation and lease-revenue BABs or the availability of any special funds that may be used to pay a portion of the debt service to help reduce General Fund costs, and an assumed interest rate of approximately 6.00

percent and 6.60 percent for future issuances of general obligation and lease-revenue bonds, respectively. See the table “OUTSTANDING STATE DEBT, FISCAL YEARS, 2004-05 THROUGH 2008-09” under “STATE DEBT TABLES” for certain historical ratios of debt service to General Fund receipts. The actual General Fund Debt Ratio in future fiscal years will depend on a variety of factors, including actual debt issuance (which may include additional issuance approved in the future by the Legislature and, for general obligation bonds, the voters), actual interest rates, debt service structure, and actual General Fund revenues and transfers.

Economic Recovery Bonds

The California Economic Recovery Bond Act (“Proposition 57”) was approved by the voters on March 2, 2004. Proposition 57 authorized the issuance of up to \$15 billion in ERBs to finance the negative General Fund reserve balance as of June 30, 2004, and other General Fund obligations undertaken prior to June 30, 2004. Repayment of the ERBs is secured by a pledge of revenues from a one-quarter cent increase in the state’s sales and use tax that became effective July 1, 2004. In addition, as voter-approved general obligation bonds, the ERBs are secured by the state’s full faith and credit and payable from the General Fund in the event the dedicated sales and use tax revenue is insufficient to repay the bonds.

The entire authorized amount of ERBs was issued in three sales, in May and June 2004, and in February 2008. No further ERBs can be issued under Proposition 57, except for refunding bonds.

Because of the sharp reduction in taxable sales as a result of the recent economic recession, the Special Sales Tax Revenues (“SSTRs”) collected from the one-quarter cent tax dedicated to repayment of the ERB debt decreased to a level which did not provide adequate coverage above the required debt service amounts for the 2004 and 2008 ERBs. In order to restore adequate coverage, the state restructured the ERB debt through the issuance of approximately \$3.435 billion ERB refunding bonds on November 5, 2009. The restructuring reduced annual debt service costs to come into alignment with reduced tax revenues, with a coverage target of at least 1.3 times. The ratings for all ERBs have since been raised to levels above the state’s general obligation bond ratings.

Three different sources of funds are required to be applied to the early retirement (generally by purchase or redemption) of ERBs: (i) all proceeds from the dedicated quarter cent sales tax in excess of the amounts needed, on a semi-annual basis, to pay debt service and other required costs of the bonds, (ii) all proceeds from the sale of specified surplus state property, and (iii) fifty percent of each annual deposit, up to \$5 billion in the aggregate, of deposits in the BSA (see “THE BUDGET PROCESS – Constraints on the Budget Process – Balanced Budget Amendment (Proposition 58)”). As of October 2010, funds from these sources have been used for early retirement of approximately \$3.98 billion of bonds during fiscal years 2005-06 through 2010-11, including \$472 million which was transferred from the BSA in fiscal year 2006-07 and \$1.023 billion transferred from the BSA in fiscal year 2007-08. As of September 1, 2010 a total of \$7.28 billion of ERBs has been retired, leaving a principal balance of \$7.39 billion.

Legislation enacted as part of the 2010 Budget Act put a Constitutional amendment on the next statewide general election ballot that, if approved, would strengthen the “rainy day” fund created by Proposition 58. See “STATE FINANCES – Budget Reserves – Proposed Strengthening of Reserve Funds.” Although this proposed amendment would not change the \$5 billion limit for ERB payments from the BSA, it is expected to make it more difficult to suspend future BSA payments and, therefore, would likely result in additional BSA related ERB redemptions.

The Governor suspended each of the fiscal years 2008-09, 2009-10 and 2010-11 BSA transfers due to the condition of the General Fund.

Tobacco Settlement Revenue Bonds

In 1998 the state signed a settlement agreement (the “Master Settlement Agreement” or “MSA”) with the four major cigarette manufacturers (the “participating manufacturers” or “PMs”). Under the MSA, the PMs agreed to make payments to the state in perpetuity, which payments, at the time were predicted to total approximately \$25 billion (subject to adjustments) over the first 25 years. Under a separate Memorandum of Understanding, half of the payments made by the cigarette manufacturers are paid to the state and half to local governments. The specific amount to be received by the state and local governments is subject to adjustment. Details in the MSA require reduction of the PMs’ payments for decreases in cigarette shipment volumes by the PMs, payments owed to certain “Previously Settled States” and certain other types of offsets. However, settlement payments are adjusted upward each year by at least 3 percent for inflation, compounded annually.

State law enacted in 2002 (the “Tobacco Securitization Law”) authorized the establishment of a special purpose trust to purchase the tobacco assets and to issue revenue bonds secured by the tobacco settlement revenues received beginning in the 2003-04 fiscal year. Legislation in 2003 amended the Tobacco Securitization Law to authorize a “back-up state guaranty” that requires the Governor to request an appropriation from the General Fund in the annual Budget Act to pay debt service and other related costs of the tobacco settlement revenue bonds secured by the second 2003 sale of tobacco settlement revenues when such tobacco settlement revenues are insufficient. The Legislature is not obligated to make any General Fund appropriation.

In 2003, two separate sales of these assets financed with revenue bonds (the “2003 Bonds”) produced about \$4.75 billion in proceeds which were transferred to the General Fund. In 2005 and 2007, the state refunded all of the original 2003 Bonds, generating additional proceeds of approximately \$1.783 billion, which were also transferred to the General Fund. The back-up state guarantee was applied to only the second 2003 sale of bonds and was continued when those bonds were refunded in 2005. The back-up state guaranty now applies to the \$3.14 billion of 2005 Refunding Bonds.

The MSA provides for a potential reduction to the PMs’ payments under specified conditions relating to the loss of market share to non-participating manufacturers (“NPMs”). This potential reduction is called an “NPM adjustment.” The state disputes the PMs’ right to an NPM adjustment for any year. The MSA also allows the PMs to withhold any portion of their annual payments that is disputed, until such time as the dispute is resolved. Since 2006, the annual amount of revenues received by the state has incurred some level of withholding based on the PMs’ assertion of their right to receive an NPM adjustment as is reflected in the table below. Nevertheless, the annual amount of tobacco settlement revenues received to date has been in excess of the required debt service payments.

Year of Scheduled Payment	Approximate NPM Adjustment withheld
2006	\$50.9 million
2007	\$44.0 million
2008	\$33.9 million*
2009	\$32.8 million
2010	\$35.3 million

*In February 2009, these funds were released and remitted to the state as part of the NPM arbitration negotiations.

Source: State of California, Department of Finance.

The State Attorney General is pursuing, in a multi-state arbitration proceeding, a determination compelling the PMs to pay the full amount scheduled, given that the state asserts that it has been diligently enforcing the statute governing the NPMs, as required in the MSA.

Tobacco settlement revenue bonds are neither general nor legal obligations of the state or any of its political subdivisions and neither the faith and credit nor the taxing power nor any other assets or revenues of the state or of any political subdivision is or shall be pledged to the payment of any such bonds; provided that, in connection with the issuance of the 2005 Refunding Bonds, the state covenanted to request the legislature for a General Fund appropriation in the event tobacco settlement revenues fall short. Tobacco settlement revenues have been sufficient to pay debt service with respect to the tobacco settlement revenue bonds, and therefore the state's covenant to request an appropriation has never been invoked.

Obligations in Connection with Proposition 1A of 2004

The Amended 2009 Budget Act provided for state borrowing, pursuant to Proposition 1A of 2004, of approximately \$1.998 billion of local property tax revenues. In accordance with Proposition 1A of 2004, the state is required to repay such revenues no later than June 2013. See "THE BUDGET PROCESS – Constraints on the Budget Process- Local Government Finance (Proposition 1A of 2004)."

Legislation implementing the borrowing in the Amended 2009 Budget Act provided authority to local governments to sell their right to receive the state repayment to a joint powers authority (JPA) and for the JPA to issue bonds backed by the state's repayment obligation. The repayment obligation includes interest and issuance costs for the JPA bonds. See "STATE FINANCES – Local Governments."

On November 19, 2009, the California Statewide Communities Development Authority, a JPA, issued \$1,895,000,000 of bonds which are secured by the state's obligation to make these payments to about 1,300 local governments, representing about 95 percent of the state's total borrowing from local governments. The 2010 Budget Act includes \$90.8 million General Fund for the interest payments that will be incurred in that fiscal year. In accordance with the authorizing legislation, these bonds will be repaid by June 15, 2013. In addition, for the obligations to entities not participating in the JPA bond program (which are \$103 million in principal amount); the Director of Finance has set an interest rate of two percent per annum. See "STATE DEBT TABLES" for a schedule of payments.

Cash Flow Borrowings

As part of its cash management program, the state has regularly issued short-term obligations to meet cash flow needs. See "CASH MANAGEMENT."

The following table shows the amount of RANs issued in the past six fiscal years and to date in the current fiscal year.

TABLE 5
State of California Revenue Anticipation Notes Issued
Fiscal Years 2004-05 to 2010-11

(Dollars In Billions)

Fiscal Year	Type	Principal Amount	Date of Issue	Maturity Date
2004-05	Notes Series A – D	\$6.0	October 6, 2004	June 30, 2005
2005-06	Notes	3.0	November 10, 2005	June 30, 2006
2006-07	Notes	1.5	October 3, 2006	June 29, 2007
2007-08	Notes	7.0	November 1, 2007	June 30, 2008
2008-09	Notes Series A-1	1.2	October 23, 2008	May 20, 2009
	Notes Series A-2	3.8	October 23, 2008	June 22, 2009
	Notes Series B-1	0.5	March 23, 2009	June 23, 2009
2009-10	Interim Notes	1.5	August 27, 2009	October 5, 2009*
	Notes Series A-1	2.825	September 29, 2009	May 25, 2010
	Note Series A-2	5.975	September 29, 2009	June 23, 2010
2010-11	Interim Notes	6.7	October 28, 2010	January 21, 2011
2010-11	Notes Series A	10.0**	November 23, 2010**	_____, 2011**

* Repaid on September 29, 2009 with a portion of the 2009-10 Notes Series A.

** Expected.

Source: State of California, Office of the State Treasurer.

Indirect, Nonpublic or Contingent Obligations

Flood Litigation Judgment. In 2005, the state settled a lawsuit arising from liability for past flood damages through a stipulated judgment in the amount of \$428 million, which provided for the state to make annual payments of \$42.8 million, plus interest, for 10 years; the payments are subject to annual appropriation by the Legislature. The Legislature has included the required annual installment in each budget act since the settlement was approved. This matter is not treated as a “debt” of the state for any legal or constitutional purposes. The state understands that its annual installment payments have been pledged to secure certain debt instruments.

Unemployment Insurance Fund Borrowing. As described in “STATE FINANCES – Unemployment Insurance,” commencing in fiscal year 2011-12, the state will be required to pay interest payments on loans made by the federal government to the state Unemployment Insurance (UI) Fund.

Office of Statewide Health Planning and Development Guarantees. Pursuant to a law created in 1969, the Office of Statewide Health Planning and Development (“OSHPD”) insures loans and bond issues for construction and renovation projects for nonprofit and publicly-owned healthcare facilities. The Program (commonly called “Cal-Mortgage Loan Insurance”) is currently authorized in statute to insure up to \$3 billion for health facility projects.

State law established the Health Facility Construction Loan Insurance Fund (“Fund”) as a trust fund which is continuously appropriated and may only be used for Program purposes. The Fund is used as a depository of fees and insurance premiums and is the initial source of funds used to pay administrative costs of the Program and shortfalls resulting from defaults by insured borrowers. If the Fund were unable to make payment on an insured loan or bond, state law provides for the State Treasurer to issue debentures to the holders of the defaulted loan or bond which are payable on a parity with state general obligation bonds. All claims on insured loans to date have been paid from the Fund.

As of July 31, 2010, OSHPD insured approximately 139 loans to nonprofit or publicly owned health facilities throughout California for approximately \$1.730 billion. As of October 31, 2010, the cash balance of the Fund was approximately \$188.1 million. The Office engaged Oliver Wyman Actuarial

Consulting, Inc. to perform an actuarial study of the Fund, last completed in 2008 (the “2008 actuarial study”). Based upon a number of assumptions, the 2008 actuarial study concluded, among other things, that the Fund appeared to be sufficient, assuming “normal and expected” conditions, to maintain a positive balance over 30 years. Even assuming abnormal and unexpected events, the 2008 actuarial study found that the Fund’s reserves would protect against General Fund losses for 14 years. More information on the Program can be obtained from OSHPD’s website.

Equipment Lease/Purchase Program. The state Department of General Services operates a centralized program which allows state departments to acquire equipment, software or services under financing programs with approved vendors. The state departments make annual payments for the equipment from their support budgets, which are subject to annual appropriation by the Legislature. If for any reason the annual payments are not appropriated, the state department is obligated to return the equipment to the vendor. These contracts are represented as capital leases in the state’s financial statements. As of November 1, 2010, the aggregate total of contracts under this program was approximately \$154 million.

STATE FINANCES

The General Fund

The moneys of the state are segregated into the General Fund and over 1,000 other funds, including special, bond and trust funds. The General Fund consists of revenues received by the State Treasury and not required by law to be credited to any other fund, as well as earnings from the investment of state moneys not allocable to another fund. The General Fund is the principal operating fund for the majority of governmental activities and is the depository of most of the major revenue sources of the state. For additional financial data relating to the General Fund, see the financial statements incorporated in or attached to this APPENDIX A. See “FINANCIAL STATEMENTS.” The General Fund may be expended as a consequence of appropriation measures enacted by the Legislature and approved by the Governor (including the annual Budget Act), as well as appropriations pursuant to various constitutional authorizations and initiative statutes.

Budget Reserves

Special Fund for Economic Uncertainties

The SFEU is funded with General Fund revenues and was established to protect the state from unforeseen revenue reductions and/or unanticipated expenditure increases. The State Controller may transfer amounts in the SFEU to the General Fund as necessary to meet cash needs of the General Fund and such transfers are characterized as “loans.” The State Controller is required to return moneys so transferred without payment of interest as soon as there are sufficient moneys in the General Fund. At the end of each fiscal year, the State Controller is required to transfer from the SFEU to the General Fund any amount necessary to eliminate any deficit in the General Fund.

The legislation creating the SFEU (Government Code Section 16418) also contains a continuous appropriation authorizing the State Controller to transfer the unencumbered balance in the General Fund to the SFEU, as of the end of each fiscal year. However, if, at the end of any fiscal year in which it has been determined that there are revenues in excess of the amount that may be appropriated, as defined in subdivision (a) of Section 2 of Article XIII B of the California Constitution, this transfer shall be reduced by the amount of the excess revenues. The estimates of the transfer shall be made jointly by the LAO and the Department of Finance. For a further description of Article XIII B, see “– State Appropriations Limit.” In certain circumstances, moneys in the SFEU may be used in connection with disaster relief.

For budgeting and accounting purposes, any appropriation made from the SFEU, other than appropriations contained in Government Code Section 16418, is deemed an appropriation from the General Fund. For year-end reporting purposes, the State Controller is required to add the balance in the SFEU to the balance in the General Fund so as to show the total moneys then available for General Fund purposes.

See Table 1 and footnote (i) in Table 3 for information concerning the recent balances in the SFEU and projections of the balances for the previous and current fiscal years. As in any year, the Budget Act and related trailer bills are not the only pieces of legislation which appropriate funds. Other factors, including re-estimates of revenues and expenditures, existing statutory requirements and additional legislation introduced and passed by the Legislature may impact the fiscal year-end balance in the SFEU.

Budget Stabilization Account

Proposition 58, approved in March 2004, created the BSA as a second budgetary reserve. Beginning with fiscal year 2006-07, a specified portion of estimated annual General Fund revenues (reaching a ceiling of 3 percent by fiscal year 2008-09) will be transferred by the State Controller into the BSA no later than September 30 of each fiscal year unless the transfer is suspended or reduced as described below. These transfers will continue until the balance in the BSA reaches \$8 billion or 5 percent of the estimated General Fund revenues for that fiscal year, whichever is greater. The annual transfer requirement will go back into effect whenever the balance falls below the \$8 billion or the 5 percent target. The annual transfers can be suspended or reduced for a fiscal year by an executive order issued by the Governor no later than June 1 of the preceding fiscal year. Proposition 58 also provides that one-half of the annual transfers shall be used to retire ERBs, until a total of \$5 billion has been used for that purpose. A total of \$1.495 billion of the \$5 billion amount has been applied to the retirement of ERBs. (See “STATE INDEBTEDNESS AND OTHER OBLIGATIONS – Economic Recovery Bonds.”)

Since 2007, the Budget Act has provided the Director of Finance the authority to transfer moneys from the BSA back into the General Fund in an amount determined by the Director of Finance to be sufficient to ensure there is a prudent General Fund balance. Using this authority, the Director of Finance ordered the transfer of the entire balance of \$1.495 billion from the BSA to the General Fund to address a fiscal emergency proclaimed by the Governor on January 10, 2008. Once moneys are transferred out of the BSA, pursuant to the authority, they will not be replenished by a future fiscal year’s annual transfer unless the Legislature, by statute, directs additional funds to be transferred from the General Fund into the BSA. Separate from the foregoing process for a budgetary transfer, the BSA may be used to make temporary loans to the General Fund, which must be repaid when the General Fund has available cash, as described under “– Inter-Fund Borrowings.”

In light of the condition of the General Fund, the Governor issued an Executive Order on May 24, 2010, to suspend the September 30, 2010 transfer from the General Fund to the BSA estimated at \$2.8 billion based on the 2010 Budget Act. The Governor had also suspended the General Fund transfer to the BSA for fiscal year 2009-10 (approximately \$2.8 billion) and fiscal year 2008-09 (approximately \$3.0 billion). There are currently no moneys in the BSA.

Proposed Strengthening of Reserve Funds

California’s chronic budget crises have been driven by growing state spending commitments funded by temporary spikes in revenues. When revenues return to their normal trend – or drop precipitously, as had been the case in the recent recession – the higher spending base cannot be sustained, and dramatic cuts to programs and/or tax increases have sometimes been required.

To help avoid these types of boom-and-bust budget cycles in the future, as part of the legislative package accompanying the 2010 Budget Act, a constitutional amendment will be placed before voters at the next statewide election (presently June 2012). If approved by the voters, this measure would place a limit on state spending if revenues in any fiscal year exceed a specified cap, by requiring such unanticipated revenues (after required payment of Proposition 98 obligations to schools) to be spent only on designated purposes such as deposits to the budget reserve fund, repayment of existing debts or capital investment in infrastructure. The measure would also strengthen existing law providing for annual deposits to the budget reserve fund, would increase the maximum size of the reserve fund from \$8 billion to an amount equal to 10 percent of General Fund revenues, and would tighten the rules by which moneys can be transferred from the budget reserve fund. A description of the current provisions for the Budget Stabilization Account (the “Rainy Day Fund”) is found at “THE BUDGET PROCESS – Constraints on the Budget Process – Balanced Budget Amendment (Proposition 58).” The Administration has provided the following outline of the amendment’s key changes to the Rainy Day Fund:

Rainy Day Fund Deposits

- 3 percent of current year revenues are required to be deposited in the Rainy Day Fund every September.
- The requirement to deposit funds cannot be waived after fiscal year 2012-13, except: (i) when a withdrawal would be allowed, or (ii) to the extent the deposit would bring the balance to over 10 percent of General Fund revenues in the year of the transfer.
- Half of the deposited funds stay in the Rainy Day Fund and half goes into a subaccount to pay down ERB Debt until a total of \$5 billion has been deposited or the ERBs are retired.

Unanticipated Revenues

- Unanticipated Revenues are defined as the amounts above a trend line derived from a regression analysis of revenues over the past 20 years, accounting for temporary tax changes.
- Unanticipated Revenues will:
 - Fund Proposition 98 obligations created by the revenue over the trend line, and
 - Fund the current services budget (previous budget adjusted for population and inflation).
- Unanticipated Revenues will then be deposited into the Rainy Day Fund until the balance in the Fund equals 10 percent of General Fund revenues.
- When the Rainy Day Fund reaches its maximum required level, then Unanticipated Revenues may be used for one time purposes, as follows:
 - Paying off budget debts shall have priority over other one-time purposes. This would include repaying Proposition 1A loans, Proposition 42 suspensions, Economic Recovery Bonds, and unfunded prior year Proposition 98 obligations.
 - After all budget debts are paid, other payments for other one-time purposes such as: additional transfers to the Rainy Day Fund, infrastructure, other debt reduction, tax rebates or one-time reductions, and funding liabilities for non-pension benefits for annuitants.

Rainy Day Fund Withdrawals

- Withdrawals from the Rainy Day Fund are permitted only when revenues are not sufficient to fund the current services budget. Withdrawal amounts are limited to the lesser of: (i) the amount that when added to available revenues would fund the current services budget, or (ii) half of the balance when a withdrawal has not occurred in the previous year.

- If withdrawals were made from the Rainy Day Fund in both of the previous two years, then the withdrawal amount is limited to the amount that when added to available revenues would fund the current services budget.
- Withdrawals are permitted to fund the costs of responding to a declared emergency (e.g., natural disaster, civil disturbance, or war).
- Except in years when a transfer from the Rainy Day Fund to the General Fund is made, 1.5 percent of revenues are transferred from the Rainy Day Fund to an account, which must be used for reduction of debt and infrastructure spending.

The Governor has stated that had these provisions been in place over the past decade, the state would have entered the recession with a \$10 billion Rainy Day Fund. Expenditures would have grown at a much steadier pace, without the unsustainable highs that were fueled by the dot-com and housing bubble revenue. Thus, the cuts necessary to adjust to the recession would have been mitigated by: (a) the larger Rainy Day Fund and (b) starting from a significantly lower fiscal year 2008-09 budget level.

Inter-Fund Borrowings

Inter-fund borrowing is used to meet temporary imbalances of receipts and disbursements in the General Fund. In the event the General Fund is or will be exhausted, the State Controller is required to notify the Governor and the PMIB (comprised of the State Director of Finance, the State Treasurer and the State Controller). The Governor may then order the State Controller to direct the transfer of all or any part of the moneys not needed in Special Funds to the General Fund, as determined by the PMIB. All money so transferred must be returned to the special fund from which it was transferred as soon as there is sufficient money in the General Fund to do so. Transfers cannot be made which will interfere with the objective for which such special fund was created, or from certain specific funds. In general, when moneys transferred to the General Fund in any fiscal year from any special fund pursuant to the inter-fund borrowing mechanism exceed 10 percent of the total additions to such special fund as shown in the statement of operations of the preceding fiscal year as set forth in the Budgetary/Legal Basis Annual Report of the State Controller, interest must be paid on such excess at a rate determined by the PMIB to be the current earning rate of the PMIA. This provision does not apply to temporary borrowings from the BSA or other accounts within the General Fund.

The amount of loans from the SFEU, the BSA and other internal sources to the General Fund, as of the end of any month is displayed in the most recent State Controller's Statement of General Fund Cash Receipts and Disbursements, on the first page under "Borrowable Resources – Outstanding Loans." See EXHIBIT 1 – "State Controller's Statement of General Fund Cash Receipts and Disbursements, July 1, 2009 – June 30, 2010 (Unaudited)" and EXHIBIT 2 – "State Controller's Statement of General Fund Cash Receipts and Disbursements, July 1, 2010 – September 30, 2010 (Unaudited)."

Any determination of whether a proposed borrowing from one of the Special Funds is permissible must be made with regard to the facts and circumstances existing at the time of the proposed borrowing. The State Attorney General has identified certain criteria relevant to such a determination. For instance, amounts in the Special Funds eligible for inter-fund borrowings are legally available to be transferred to the General Fund if a reasonable estimate of expected General Fund revenues, based upon legislation already enacted, indicates that such transfers can be paid from the General Fund promptly if needed by the Special Funds or within a short period of time if not needed. In determining whether this requirement has been met, the Attorney General has stated that consideration may be given to the fact that General Fund revenues are projected to exceed expenditures entitled to a higher priority than payment of internal transfers, i.e., expenditures for the support of the public school system and public institutions of higher education.

At the November 1998 election, voters approved Proposition 2. This proposition requires the General Fund to repay loans made from certain transportation special accounts (such as the State Highway Account) at least once per fiscal year, or up to 30 days after adoption of the annual Budget Act. Since the General Fund may reborrow from the transportation accounts any time after the annual repayment is made, the proposition does not have any adverse impact on the state's cash flow.

Enactment of Proposition 22 on November 2, 2010 could prohibit interfund borrowing from certain transportation funds. The Controller's Office is studying the measure to determine exactly which funds are affected and to what extent.

In addition to temporary inter-fund cash flow borrowings described in this section, budgets enacted in the current and past fiscal years have included other budgetary transfers and long-term loans from Special Funds to the General Fund. In some cases, such budgetary loans and transfers have the effect of reducing internal borrowable resources. See "CURRENT STATE BUDGET – Future Deficits."

The following table shows internal borrowable resources available for temporary cash flow loans to the General Fund on June 30 of each of the fiscal years 2006-07 through 2010-11 and estimates the amount currently available based on the 2010 Budget Act. See also EXHIBIT 1 – "State Controller's Statement of General Fund Cash Receipts and Disbursements, July 1, 2009 – June 30, 2010 (Unaudited)" and EXHIBIT 2 – "State Controller's Statement of General Fund Cash Receipts and Disbursements, July 1, 2010 – September 30, 2010 (Unaudited)." The amount of internal borrowable resources fluctuates throughout the year.

TABLE 6
Internal Borrowable Resources

(Cash Basis)
(Dollars In Millions)

	June 30,				
	2007	2008	2009	2010	2011 ^(a)
Available Internal Borrowable Resources	\$14,888.6	\$14,209.4	\$19,037.7	\$18,680.5	\$18,991.5
Outstanding Loans					
From Special Fund for Economic Uncertainties and Budget Stabilization Account	--	1,451.8	1,539.6	435.9	1,337.5
From Special Funds and Accounts	--	--	10,368.5	9,486.2	4,694.5
Total Outstanding Internal Loans	--	(1,451.8)	(11,908.1)	(9,922.1)	(8,946)
Unused Internal Borrowable Resources	\$14,888.6	\$12,757.6	\$7,129.6	\$8,758.4	\$11,076

^(a)Estimates based on the 2010 Budget Act.

Source: Years ended June 30, 2007 through June 30, 2010: State of California, Office of the State Controller.
Year ended June 30, 2011: State of California, Department of Finance.

State Warrants

No money may be drawn from the State Treasury except upon a warrant duly issued by the State Controller. The State Controller is obligated to draw every warrant on the fund out of which it is payable

for the payment of money directed by state law to be paid out of the State Treasury; however, a warrant may not be drawn unless authorized by law and unless unexhausted specific appropriations provided by law are available to meet it. As described below, state law provides two methods for the State Controller to respond if the General Fund has insufficient “Unapplied Money” available to pay a warrant when it is drawn, referred to generally as “registered warrants” and “reimbursement warrants.” “Unapplied Money” consists of money in the General Fund for which outstanding warrants have not already been drawn and which would remain in the General Fund if all outstanding warrants previously drawn and then due were paid subject to the prior application of such money to obligations of the state with a higher priority. See “STATE INDEBTEDNESS AND OTHER OBLIGATIONS - Cash Flow Borrowings.” Unapplied Money may include moneys transferred to the General Fund from the SFEU and the BSA and internal borrowings from state Special Funds (to the extent permitted by law); however the state is not obligated to utilize interfund borrowings for the payment of state obligations if insufficient “Unapplied Money” is available for such payment. See “STATE FINANCES - Budget Reserves - Special Fund for Economic Uncertainties” and “-Inter-Fund Borrowings.”

Registered Warrants

If a warrant is drawn on the General Fund for an amount in excess of the amount of Unapplied Money in the General Fund, after deducting from such Unapplied Money the amount, as estimated by the State Controller, required by law to be earmarked, reserved or set apart from the Unapplied Money for the payment of obligations having priority over obligations to which such warrant is applicable, the warrant must be registered on the reverse side as not paid because of the shortage of funds in the General Fund. The State Controller may issue registered warrants before exhausting all cash management techniques that could provide Unapplied Money to the General Fund. See “CASH MANAGEMENT.”

Registered warrants are interest bearing obligations that may be issued either with or without a maturity date. Most registered warrants bear interest at a rate designated by the PMIB up to a maximum of five percent per annum except, if the PMIB determines that it is in the best interests of the state to do so, the PMIB may fix the rate of interest paid on registered warrants at no more than 12 percent per annum. If issued with a maturity date, the principal and interest on such warrant will not be due until that date (although it may be optionally redeemed early if the state has sufficient unapplied money to do so) and the state may make other payments prior to that maturity date. If a registered warrant is issued without a maturity date, or its maturity date has occurred, it becomes redeemable by the holders on the date determined by the State Controller, with the approval of the PMIB.

State law generally requires that registered warrants be redeemable in the order they are issued but not prior to their maturity date, if any. The state issued approximately \$2.6 billion of registered warrants to pay certain obligations of the state not having payment priority under law commencing on July 2, 2009, all of which were called for early redemption on September 4, 2009. (The State Controller was able to manage cash resources to ensure that higher priority payments, such as for schools and debt service, were made on time in July and August 2009.) As of October 14, 2010, approximately \$11 million of registered warrants have yet to be presented for redemption and currently remain outstanding. The issuance of the registered warrants permitted the state to pay Priority Payments with regular warrants which could be cashed.

Reimbursement Warrants

In lieu of issuing individual registered warrants to numerous creditors, state law provides an alternative procedure whereby the Governor, upon request of the State Controller, may authorize utilizing the General Cash Revolving Fund in the State Treasury to borrow from other state Special Funds to meet payments authorized by law. The State Controller may then issue “reimbursement warrants” (sometimes

called “revenue anticipation warrants” or “RAWs”) for sale to investors to reimburse the General Cash Revolving Fund, thereby increasing cash resources for the General Fund to cover required payments. The General Cash Revolving Fund exists solely to facilitate the issuance of reimbursement warrants. Reimbursement warrants have a fixed maturity date which may not be later than the end of the fiscal year following the year in which they were issued.

The principal of and interest on reimbursement warrants must be paid by the State Treasurer on their respective maturity dates from any Unapplied Money in the General Fund and available for such payment. In the event that Unapplied Money is not available for payment on the respective maturity dates of reimbursement warrants, and refunding warrants (see “– Refunding Warrants”) have not been sold at such times as necessary to pay such reimbursement warrants, such reimbursement warrants will be paid, together with all interest due thereon (including interest accrued at the original interest rate after the maturity date), at such times as the State Controller, with the approval of the PMIB, may determine.

The state has issued reimbursement warrants on several occasions in order to meet its cash needs when state revenues were reduced because of an economic recession, and the state incurred budget deficits. The state most recently issued reimbursement warrants in June 2002 and in June 2003.

Refunding Warrants

If it appears to the State Controller that, on the maturity date of any reimbursement warrant there will not be sufficient Unapplied Money in the General Fund to pay maturing reimbursement warrants, the State Controller is authorized under state law, with the written approval of the State Treasurer, to issue and sell refunding warrants to refund the prior, maturing reimbursement warrants. Proceeds of such refunding warrants must be used exclusively to repay the maturing warrants. In all other respects, refunding warrants are treated like reimbursement warrants, as described above.

Sources of Tax Revenue

The following is a summary of the state’s major tax revenues and tax laws. Further information on state revenues is contained under “CURRENT STATE BUDGET,” and “STATE FINANCES – Recent Tax Receipts.” In fiscal year 2009-10, approximately 93 percent of the state’s General Fund revenues and transfers were derived from personal income taxes, corporation taxes, and sales and use taxes. See Table 8 titled “Comparative Yield of State Taxes – All Funds, 2005-06 Through 2010-11” for a summary of the actual and projected sources of the state’s tax revenue for those fiscal years.

Enactment of Proposition 26 on November 2, 2010 will make it more difficult in the future for the state to raise taxes. See “THE BUDGET PROCESS – Constraints on The Budget Process – November 2010 Initiatives – Proposition 26 – Increases in Taxes or Fees.”

Temporary Revenue Enhancements in 2009 and 2010 Budget Acts

The Amended 2009 Budget Act included several major changes in General Fund revenues described below. The Amended 2009 Budget Act did not include any additional tax increases over those provided for pursuant to the Initial 2009 Budget Act, though it did include certain tax law changes intended to increase tax compliance and accelerate some revenues that were not in the Initial 2009 Budget Act.

As part of the Initial 2009 Budget Act passed in February 2009, the following tax and fee increases were adopted:

- Temporary Sales Tax Increase: Effective April 1, 2009, the General Fund sales and use tax rate was temporarily increased by 1 cent, from 5 percent to 6 percent. This tax increase will be in effect through June 30, 2011. As of the 2010 Budget Act, this tax law change is expected to generate additional sales tax revenues of \$4.299 billion in fiscal year 2009-10 and \$4.223 billion in fiscal year 2010-11 for the General Fund.
- Vehicle License Fees: Effective May 19, 2009, vehicle license fees were temporarily increased from 0.65 percent to 1.15 percent with 0.35 percent going to the General Fund and 0.15 percent going to the Local Safety and Protection Account for local law enforcement grant programs previously funded from the General Fund. Vehicle license fees apply to the value of the vehicle (initially its market value and then subject to a standard depreciation schedule). This increase will remain in effect through June 30, 2011. As of the 2010 Budget Act, this law change is expected to generate additional revenues of approximately \$1.386 billion in fiscal year 2009-10 and \$1.472 billion in fiscal year 2010-11.
- Personal Income Tax Surcharge: The Initial 2009 Budget Act provided for a temporary addition of 0.25 percent to each personal income tax rate for tax years 2009 and 2010. As of the 2010 Budget Act, this change is expected to generate approximately \$2.707 billion of additional General Fund revenues in fiscal year 2009-10 and \$1.073 billion in fiscal year 2010-11.
- Dependent Exemption Credit Reduction: The Initial 2009 Budget Act included a temporary reduction in the Personal Income Tax-exemption credit for dependents to the amount provided for the personal credit for tax years 2009 and 2010 from \$309 to \$99 (tax year 2008 values). As of the 2010 Budget Act, this change is expected to generate approximately \$1.429 billion of additional General Fund revenues in fiscal year 2009-10 and \$700 million in fiscal year 2010-11.

The Amended 2009 Budget Act, passed in July 2009, included tax law changes affecting the General Fund as described below:

- Non-Retailer Registration for Use Tax: Under current law, non-retailers – those who do not sell tangible personal property – are not required to register with the Board of Equalization (“BOE”). This law change will require non-retailers that hold a business license and have at least \$100,000 in gross receipts to register with the BOE and submit a return that details purchases made during the year that were subject to the use tax yet for which no use tax was paid. This law change was expected to increase General Fund sales and use tax revenue by \$26 million in fiscal year 2009-10 and \$123 million in fiscal year 2010-11, with increasing amounts thereafter. As of the 2010 Budget Act, the expected increase in General Fund sales and use tax revenue in fiscal year 2009-10 from this law change is estimated at \$15 million, and the fiscal year 2010-11 forecast is unchanged.
- Accelerate Estimated Tax Payments: Under current law in 2009, individuals and corporations are required to pay 30 percent each with the first two estimated payments, and 20 percent each for the last two estimated payments. Under this law change, beginning with the 2010 tax year, the first quarter estimated payment percentage will remain at 30 percent payable on April 15, the second quarter will increase to 40 percent payable on June 15, the third estimated payment will be eliminated, and the fourth quarter estimated payment will increase from 20 percent to 30 percent payable on December 15 for corporations and January 15 for individuals. As of the 2010 Budget Act, this law change is expected to accelerate \$1.295 billion into fiscal year 2009-10 (\$672 million in personal income tax

receipts and \$623 million in corporate tax receipts) and \$98 million in fiscal year 2010-11 (\$60 million in personal income tax receipts and \$38 million in corporate tax receipts).

- Accelerate Wage Withholding: This tax law change increased current wage withholding rates by 10 percent and, as of the 2010 Budget Act, is expected to accelerate \$1.6 billion of personal income tax receipts into fiscal year 2009-10.
- Require Backup Withholding: Under current federal law, gambling winnings reported on Internal Revenue Service (“IRS”) Form W2G and payments made by banks and businesses reported on various IRS 1099 forms may be subject to backup withholding on those payments. Payments reported on IRS 1099 forms include payments to independent contractors, rents, commissions, and royalty payments. This law change will conform state law to federal law by requiring a withholding rate of 7 percent for state purposes whenever it is required for federal purposes. As of the 2010 Budget Act, this law change is expected to increase personal income tax revenues by \$32 million in fiscal year 2009-10 followed by an additional \$31 million in fiscal year 2010-11.

The 2010 Budget Act includes General Fund revenue changes of \$2.034 billion for fiscal year 2010-11. Listed below are the significant solutions:

- LAO Revenue Forecast: The 2010 Budget Act assumes the LAO’s revenue forecast, which increases revenues by \$399 million in fiscal year 2009-10 and \$961 million in fiscal year 2010-11 above amounts estimated in the 2010-11 May Revision. See “CURRENT STATE BUDGET – General – Other Solutions.”
- Extension of Net Operating Loss (NOL) Suspension and Delay of Carrybacks: Except for taxpayers with income that is less than or equal to \$300,000, NOL deductions are suspended for tax years 2010 and 2011. The suspension exempts an estimated 91 percent of taxpayers. In addition, the ability to carry back losses for two years will be delayed until 2013. Carrybacks will be limited to 50 percent of losses for tax years beginning in 2013, 75 percent of losses for tax years beginning in 2014 and 100 percent of NOLs will be allowed to be carried back for tax years beginning tax year 2015 and later. This tax law change is expected to increase revenues by \$1.2 billion in fiscal year 2010-11.

The sections below captioned “Sales and Use Tax” and “Corporation Tax” include descriptions of pending lawsuits relating to various taxes.

Personal Income Tax

The California personal income tax, which accounted for 51.6 percent of General Fund revenues and transfers in fiscal year 2009-10, is closely modeled after the federal income tax law. It is imposed on net taxable income (gross income less exclusions and deductions), with rates ranging from 1 percent to 9.3 percent. For tax years 2009 and 2010, the rates will range from 1.25 percent to 9.55 percent. The personal income tax is adjusted annually by the change in the consumer price index to prevent taxpayers from being pushed into higher tax brackets without a real increase in income. Personal, dependent, and other credits are allowed against the gross tax liability. In addition, taxpayers may be subject to an alternative minimum tax (“AMT”), which is much like the federal AMT. The personal income tax structure is considered to be highly progressive. For example, the Franchise Tax Board (FTB) indicates that the top 1 percent of taxpayers paid 42.8 percent of the total personal income tax in tax year 2008.

Proposition 63, approved by the voters in the November 2004 election, imposes a 1 percent surcharge on taxable income over \$1 million in addition to the 9.3 percent rate (9.55 percent for tax years 2009 and 2010). The surcharge became effective January 1, 2005. The proceeds of the tax surcharge are required to be used to expand mental health programs.

Taxes on capital gains realizations, which are largely linked to stock market performance, can add a significant dimension of volatility to personal income tax receipts. Capital gains tax receipts accounted for 14.8 percent of General Fund revenues and transfers in fiscal year 2000-01. The 2010 Budget Act projects that capital gains will account for 3.6 percent of General Fund revenues and transfers in fiscal year 2009-10 and 5.6 percent in fiscal year 2010-11.

Sales and Use Tax

The sales and use tax (referred to herein as the “sales tax”), which accounted for 30.6 percent of General Fund revenues and transfers in fiscal year 2009-10, is imposed upon retailers for the privilege of selling tangible personal property in California. Most retail sales and leases are subject to the tax. However, exemptions have been provided for certain essentials such as food for home consumption, prescription drugs, gas delivered through mains, and electricity. Other exemptions provide relief for a variety of sales ranging from custom computer software to aircraft.

The California use tax is imposed at the same rates as the regular sales tax on consumers of tangible personal property that is used, consumed, or stored in this state. Use tax applies to purchases from out-of-state vendors that are not required to collect tax on their sales. Use tax also applies to most leases of tangible personal property.

As of October 1, 2010, the breakdown for state and local sales tax rate of 8.25 percent was as follows (many local jurisdictions have voted additional sales taxes for local purposes):

- 6 percent imposed as a state General Fund tax (this tax rate is scheduled to return to 5 percent on July 1, 2011);
- 0.5 percent dedicated to local governments for health and welfare program realignment (Local Revenue Fund);
- 0.5 percent dedicated to local governments for public safety services (Local Public Safety Fund);
- 1 percent local tax imposed under the Uniform Local Sales and Use Tax Law, with 0.25 percent dedicated to county transportation purposes and 0.75 percent for city and county general-purpose use; and
- 0.25 percent deposited into the Fiscal Recovery Fund to repay the state’s ERBs (the “special sales tax”).

Existing law provides that 0.25 percent of the base state and local sales tax rate may be suspended in any calendar year upon certification by the Director of Finance, by November 1 in the prior year, that both of the following have occurred: (1) the General Fund reserve (excluding the revenues derived from the 0.25 percent special sales tax) is expected to exceed 3 percent of revenues in that fiscal year (excluding the revenues derived from the 0.25 percent special sales tax) and (2) actual revenues for the period May 1 through September 30 equal or exceed the previous May Revision forecast. The 0.25 percent rate will be reinstated the following year if the Director of Finance subsequently determines

conditions (1) or (2) above are not met for that fiscal year. The Department of Finance estimates that the reserve level will be insufficient to trigger a reduction for calendar year 2010. See “CURRENT STATE BUDGET – Summary of State Revenues and Expenditures” for a projection of the fiscal years 2009-10 and 2010-11 General Fund Reserve.

Existing law provides that the special sales tax will be collected until the first day of the calendar quarter at least 90 days after the Director of Finance certifies that all ERBs and related obligations have been paid or retired or provision for their repayment has been made or enough sales taxes have been collected to pay all ERBs and related obligations to final maturity. At such time the special sales tax will terminate and the city and county portion of taxes under the uniform local sales and use tax will be automatically increased by 0.25 percent. See “STATE INDEBTEDNESS AND OTHER OBLIGATIONS – Economic Recovery Bonds.”

Proposition 1A of 2004, approved by the voters in the November 2004 election, amended the state Constitution to, among other things, reduce the Legislature’s authority over local government revenue sources by restricting the state from lowering the local sales tax rate or changing the allocation of local sales tax revenues without meeting certain conditions. Proposition 22, adopted on November 2, 2010, supersedes Proposition 1A of 2004 and completely prohibits any future borrowing by the state from local government funds, and generally prohibits the Legislature from making changes in local government funding sources. Allocation of local transportation funds cannot be changed without an extensive process.

An appellate court decision from 2008 held that two Dell entities and two providers of maintenance and warranty services had improperly collected from customers and remitted to the BOE use tax on optional service contracts that were sold with computers. The state anticipates that a pending action will result in a judgment or settlement requiring the BOE to refund the tax with interest. Plaintiffs estimate that the refund amounts could be as much as \$250 million. Identification and notification of consumers affected by the decision and thus due a refund is unresolved, and determination of the total refund amount depends upon such identification and notification. The 2010 Budget Act projects that the refunds will not occur prior to fiscal year 2011-12. See “LITIGATION – Tax Cases.”

Corporation Tax

The corporation tax accounted for 10.6 percent of General Fund revenues and transfers in fiscal year 2009-10.

Corporation tax revenues are derived from the following taxes:

1. The franchise tax and the corporate income tax are levied at an 8.84 percent rate on profits. The former is imposed on corporations for the privilege of doing business in California, while the latter is imposed on corporations that derive income from California sources but are not sufficiently present to be classified as doing business in the state.

2. Banks and other financial corporations are subject to the franchise tax plus an additional tax at the rate of 2 percent on their net income. This additional tax is in lieu of personal property taxes and business license taxes.

3. The AMT is similar to that in federal law. In general, the AMT is based on a higher level of net income computed by adding back certain tax preferences. This tax is imposed at a rate of 6.65 percent.

4. A minimum franchise tax of up to \$800 is imposed on corporations subject to the franchise tax but not on those subject to the corporate income tax. New corporations are exempted from the minimum franchise tax for the first year of incorporation.

5. Sub-Chapter S corporations are taxed at 1.5 percent of profits.

6. Fees paid by limited liability companies (“LLCs”), which account for 2.8 percent of corporation tax revenue, are considered “corporation taxes.” Three separate cases have been filed challenging the constitutionality of the LLC fee. Two have been resolved and one is pending. See “LITIGATION - Tax Cases.”

In *California Taxpayers Association v. Franchise Tax Board*, California Taxpayers Association (“Cal-Tax”) challenged the constitutionality of the corporate understatement penalty that was enacted in Chapter 1, Statutes of 2007-08 First Extraordinary Session (SB X1 28, 2008 Budget Act Trailer Bill) and sought an injunction precluding the Franchise Tax Board from enforcing the statute. The trial court ruled for the state and Cal-Tax appealed. A decision may be issued during fiscal year 2010-11. An adverse ruling would result in a potential loss of revenue in fiscal year 2010-11 of between \$500 million and \$800 million, and an ongoing loss of about \$500 million thereafter. See “LITIGATION – Tax Cases.”

As part of the 2009 Budget Act, the Legislature adopted certain additional tax benefits for corporations, affecting carryover of losses, sharing tax credits among affiliates, and changes to the unitary tax calculations for multinational corporations, all of which are to become effective in 2011 or later.

Insurance Tax

The majority of insurance written in California is subject to a 2.35 percent gross premium tax. For insurers, this premium tax takes the place of all other state and local taxes except those on real property and motor vehicles. Exceptions to the 2.35 percent rate are certain pension and profit-sharing plans which are taxed at the lesser rate of 0.5 percent, surplus lines and non-admitted insurance at 3 percent and ocean marine insurers at 5 percent of underwriting profits. To provide interim funding for the Healthy Families and Medi-Cal programs, Chapter 157, Statutes of 2009 extends the 2.35-percent gross premiums tax to the Medi-Cal managed care plans in 2009 and 2010.

The BOE ruled in December 2006 that the premium tax insurers pay should be calculated on a cash basis rather than the accrual method required by the Department of Insurance. This ruling is expected to result in a total loss of \$406 million spread over several years; the impact was \$15 million in fiscal year 2008-09 and is estimated to be \$11 million in fiscal year 2009-10, \$230 million in fiscal year 2010-11, and \$149 million in fiscal year 2011-12.

Vehicle License Fee

The Amended 2009 Budget Act temporarily increased the vehicle license fee from 0.65 percent to 1.15 percent, effective May 19, 2009, through June 30, 2011. Of this 0.5 percent increase, 0.35 percent goes to the General Fund with the remaining 0.15 percent going to local law enforcement.

Estate Tax; Other Taxes

The state estate tax is based on the state death tax credit allowed against the federal estate tax. The California estate tax is designed to pick up the maximum credit allowed against the federal estate tax return. The federal Economic Growth and Tax Relief Reconciliation Act of 2001 (the “Economic Growth and Tax Relief Reconciliation Act”) phases out the federal estate tax by 2010. As a consequence, the

Economic Growth and Tax Relief Reconciliation Act resulted in the reduction of the state estate tax revenues by 25 percent in calendar year 2002, 50 percent in calendar year 2003, and 75 percent in calendar year 2004, and the elimination of the state estate tax beginning in calendar year 2005. The provisions of this federal act sunset after 2010. At that time, the federal estate tax is scheduled to be reinstated along with the state's estate tax. The 2010 Budget Act assumes receipts of \$800 million based on reinstatement of the federal estate tax after January 1, 2011. Federal estate tax law may be changed to modify or eliminate the state pick-up tax. See Table 8 titled "Comparative Yield of State Taxes – All Funds."

Other General Fund major taxes and licenses include: Inheritance and Gift Taxes; Cigarette Taxes; Alcoholic Beverage Taxes; Horse Racing License Fees and Trailer Coach License Fees.

Special Fund Revenues

The California Constitution and statutes specify the uses of certain revenues. Such receipts are accounted for in various Special Funds. In general, special fund revenues comprise three categories of income:

- Receipts from tax levies which are allocated to specified functions, such as motor vehicle taxes and fees and certain taxes on tobacco products.
- Charges for special services to specific functions, including such items as business and professional license fees.
- Rental royalties and other receipts designated for particular purposes (e.g., oil and gas royalties).

Motor vehicle related taxes and fees are projected to account for 39 percent of all special fund revenues in fiscal year 2010-11. Principal sources of this income are motor vehicle fuel taxes, registration and weight fees and vehicle license fees. In fiscal year 2010-11, \$10.9 billion is projected to come from the ownership or operation of motor vehicles. About \$2.9 billion of this revenue is projected to be returned to local governments. The remainder will be available for various state programs related to transportation and services to vehicle owners. For a discussion of Proposition 1A, approved by the voters in November 2004, which replaced a portion of vehicle license fees with increased property tax revenues, see "STATE FINANCES – Local Governments." Vehicle license fees were increased temporarily as part of the Initial 2009 Budget Act. See "AMENDED 2009 BUDGET ACT."

Taxes on Tobacco Products

As a result of Proposition 99, approved by the voters in 1988, and Proposition 10, approved by the voters in 1998, the state imposes an excise tax on cigarettes of 87 cents per pack and the equivalent rates on other tobacco products. Tobacco product excise tax revenues are earmarked as follows:

1. Fifty cents of the per-pack tax on cigarettes and the equivalent rate levied on non-cigarette tobacco products are deposited in the California Children and Families First Trust Fund and are allocated primarily for early childhood development programs.
2. Twenty-five cents of the per-pack tax on cigarettes and the equivalent rates levied on non-cigarette tobacco products are allocated to the Cigarette and Tobacco Products Surtax Fund. These funds are appropriated for anti-tobacco education and research, indigent health services, and environmental and recreation programs.

3. Ten cents of the per-pack tax is allocated to the state's General Fund.
4. The remaining two cents of the per-pack tax is deposited into the Breast Cancer Fund.

Recent Tax Receipts

The following table shows the trend of major General Fund and total taxes per capita and per \$100 of personal income for the past five fiscal years and the current year.

**TABLE 7
Recent Tax Receipts**

Fiscal Year	State Taxes Per Capita^(a)		Taxes per \$100 of Personal Income	
	General Fund	Total	General Fund	Total
2005–06	2,451.75	2,867.55	6.52	7.63
2006–07	2,501.35	2,934.28	6.23	7.31
2007–08	2,530.79	2,967.26	6.06	7.11
2008–09	2,084.46	2,494.59	4.95	5.92
2009–10 ^(b)	2,200.23	2,581.38	5.42	6.36
2010–11 ^(b)	2,318.16	2,753.61	5.58	6.63

^(a) Data reflects population figures based on the 2000 Census.

^(b) Estimated.

Source: State of California, Department of Finance.

The following table displays the actual and estimated revenues by major source for the past five years and the current year. This table shows taxes that provide revenue both to the General Fund and state Special Funds.

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TABLE 8
Comparative Yield Of State Taxes – All Funds
2005-06 Through 2010-11

(Modified Accrual Basis)
(Dollars In Thousands)

Year Ending June 30	Sales and Use ^(h)	Personal Income ^(b)	Corporation	Tobacco	Inheritance, Estate and Gift ^(e)	Insurance	Alcoholic Beverage	Horse Racing	Motor Vehicle Fuel ^{(d)(j)}	Motor Vehicle Fees ^(e)
2006	34,954,632 ^(a)	51,224,276	10,316,466	1,088,214	3,786	2,202,328	318,276	38,018	3,393,381	5,082,899
2007	35,502,500 ^(a)	53,352,906	11,157,897	1,078,553	6,347	2,178,336	333,789	37,528	3,399,694	5,176,621
2008	34,782,591 ^(a)	55,750,128	11,849,096	1,037,279	6,303	2,172,935	327,260	34,950	3,351,268	5,218,206
2009	31,390,845 ^(a)	44,360,228	9,535,679	1,000,434	245	2,053,850	323,934	30,737	3,162,299	5,636,427 ^(m)
2010 ^(f)	31,031,727 ^{(g)(i)}	45,550,000 ^(k)	9,275,000	910,649	--	2,268,209 ^(l)	324,000	19,958	3,115,020	6,683,749 ⁽ⁿ⁾
2011 ^(f)	31,100,411 ^{(g)(i)(j)}	48,067,000 ^(k)	10,897,400	889,649	782,000	2,234,613 ^(l)	331,400	21,783	5,533,928	6,857,881 ⁽ⁿ⁾

- (a) These figures include the General Fund allocation and the 0.5 percent Local Public Safety Fund. The figures do not include the voter approved local revenue, local city and county operations revenue (Bradley-Burns) which also includes the 0.25 percent county transportation funds revenue.
- (b) Includes the revenue estimate for a 1-percent surcharge on taxpayers with taxable income over \$1 million, with the proceeds funding mental health programs pursuant to Proposition 63.
- (c) The state estate tax is based on the state death tax credit allowed against the federal estate tax. As a result, the federal Economic Growth and Tax Relief Reconciliation Act progressively reduced the state estate tax in calendar years 2002 through 2004 and eliminated it beginning in calendar year 2005. Under current federal law, the estate tax will be reinstated after 2010.
- (d) Motor vehicle fuel tax (gasoline), use fuel tax (diesel and other fuels), and jet fuel. The 2011 figure includes the effect of an increase in the excise tax from 18 cents to 35.3 cents on motor vehicle gasoline and a decrease from 18 cents to 13.6 cents on motor vehicle diesel fuel.
- (e) Registration and weight fees, motor vehicle license fees and other fees. See "STATE FINANCES – Local Governments."
- (f) Estimated.
- (g) These estimated figures do not include the 0.5 percent Local Public Safety Fund revenue. These estimated figures also do not include voter approved local revenue, local city and county operations revenue (Bradley-Burns), or the 0.25 percent county transportation funds revenue. Estimate for fiscal year 2009-10 includes \$1.12 billion and for fiscal year 2010-11 includes \$1.20 billion for the temporary one-quarter cent tax described in footnote (h).
- (h) These figures include the temporary one-quarter cent tax increase which started to be collected in July 2004, and which is deposited in the Fiscal Recovery Fund and used for repayment of the Economic Recovery Bonds. See "STATE FINANCES–Sources of Tax Revenue – Sales and Use Tax."
- (i) Includes the impact of a temporary increase in the General Fund sales and use tax rate from 5 percent to 6 percent, effective April 1, 2009 through June 30, 2011.
- (j) Includes the impact of the fuel tax swap that eliminated the General Fund portion of sales and use tax on motor vehicle gasoline fuel sales.
- (k) Includes the revenue estimates for a temporary 0.25-percent surcharge applied to each marginal tax rate and the reduced dependent exemption credit for the 2009 and 2010 tax years.
- (l) Includes insurance tax on Medi-Cal managed care plans in 2009 and 2010 to provide interim funding for the Healthy Families and Medi-Cal programs.
- (m) Effective May 19, 2009, registration fees on Motor Vehicle Licenses Fee increased to 1.15 percent from 0.65 percent (excluding heavy vehicles). This rate increase will expire June 30, 2011.
- (n) Includes the impact of a temporary increase in the vehicle license fee from 0.65 percent to 1.15 percent, effective May 19, 2009 through June 30, 2011.

Note: This table shows taxes that provide revenue both to the General Fund and state Special Funds. Also, some revenue sources are dedicated to local governments.

Source: Fiscal Years 2005-06 through 2008-09: State of California, Office of the State Controller; Fiscal Years 2009-10 through 2010-11, State of California Department of Finance.

American Recovery and Reinvestment Act

Congress enacted the ARRA, which provides approximately \$787 billion of economic stimulus actions in the form of direct payments from the federal government and tax relief to individuals and businesses nationwide. The stimulus bill provides about \$330 billion in aid to states, about \$170 billion for federal projects and non-state aid, and about \$287 billion of tax relief.

The California Recovery Task Force estimates ARRA will have an \$85.4 billion effect in California, which will include \$28.8 billion in projects, \$26.4 billion in entitlement programs such as Medi-Cal, Food Stamps and Unemployment Insurance, and an additional \$30.2 billion in tax relief. Of the \$28.8 billion in project investments and as of June 30, 2010, Californians have been awarded \$907 million for labor and workforce development, \$7.6 billion for education, \$3.8 billion investment for transportation infrastructure, \$2.9 billion for energy, \$1.9 billion for science and technology, \$1.5 billion for water and environment, \$1.2 billion for housing, \$676 million for public safety, \$464 million investment for health and human services and \$1.2 billion for other projects.

The 2010 Budget Act includes an estimated \$5.4 billion in fiscal year 2009-10 and a minimum of \$4.2 billion in fiscal year 2010-11 ARRA funds to offset General Fund expenditures. Of the estimated \$3.6 billion of additional federal funds still subject to action and approval by the federal government which are included in the 2010 Budget Act, up to another \$500 million may come from ARRA. Of the \$1.8 billion of additional federal funds which have been approved, \$1.3 billion is from ARRA. See “CURRENT STATE BUDGET.”

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State Expenditures

The following table summarizes the major categories of state expenditures, including both General Fund and special fund programs for fiscal years 2004-05 through 2008-09.

TABLE 9
Governmental Cost Funds (Budgetary Basis)
Schedule Of Expenditures By Function And Character
Fiscal Years 2004-05 To 2008-09

(Dollars In Thousands)

Function	2004-05	2005-06	2006-07	2007-08	2008-09
Legislative, Judicial, Executive					
Legislative	\$ 408,427	\$ 314,263	\$ 326,163	\$ 338,482	\$ 330,594
Judicial	2,881,680	3,164,602	3,515,815	3,902,038	3,962,289
Executive	1,361,910	1,504,886	1,634,180	1,761,510	1,669,476
State and Consumer Services	1,025,817	1,174,171	1,280,450	1,272,910	1,248,522
Business, Transportation and Housing					
Business and Housing	196,209	199,665	227,794	245,062	228,408
Transportation ^(a)	6,819,308	8,103,385	9,647,351	10,058,388	7,331,284
Resources	2,247,498	2,595,652	3,176,459	3,657,430	3,225,625
Environmental Protection	788,805	975,995	1,093,916	1,124,326	1,032,212
Health and Human Services	30,223,891	32,243,938	35,333,446	37,232,168	35,041,981
Correctional Programs	6,769,319	7,661,983	9,012,954	9,978,422	9,566,474
Education					
Education-K through 12	32,118,886	36,163,319	38,453,336	39,229,865	34,354,841
Higher Education	9,985,180	11,114,993	10,801,631	11,303,864	9,486,317
Labor and Workforce Development	319,984	353,970	406,464	421,116	414,307
General Government					
General Administration	(207,319)	1,842,451	2,240,543	1,796,460	1,728,781
Debt Service ^(b)	3,390,651	4,017,468	4,812,893	4,988,637	5,693,895
Tax Relief	665,597	666,691	666,504	669,140	480,312
Shared Revenues	1,691,964	3,003,378	2,117,815	1,649,546	1,976,050
Other Statewide Expenditures ^(c)	823,848	889,971	1,532,718	1,454,338	1,168,937
Expenditure Adjustment for Encumbrances ^(d)	(1,038,274)	(520,272)	(1,177,635)	(1,244,356)	551,826
Credits for Overhead Services by General Fund	(329,797)	(371,965)	(470,455)	(549,309)	(507,543)
Statewide Indirect Cost Recoveries	(74,581)	(83,338)	(86,071)	(88,045)	(94,458)
Total	<u>\$100,069,003</u>	<u>\$115,015,206</u>	<u>\$124,546,271</u>	<u>\$129,201,992</u>	<u>\$118,890,130</u>
Character					
State Operations	\$28,798,080	\$34,037,821	\$36,867,742	\$41,027,869	\$38,101,282
Local Assistance	70,216,800	78,626,805	84,578,753	85,603,560	78,795,864
Capital Outlay	1,054,123	2,350,580	3,099,776	2,570,563	1,992,984
Total	<u>\$100,069,003</u>	<u>\$115,015,206</u>	<u>\$124,546,271</u>	<u>\$129,201,992</u>	<u>\$118,890,130</u>

- (a) For fiscal years 2006-07 and 2007-08, the Transportation Investment Fund (Fund 3008) and the Transportation Deferred Investment Fund (Fund 3093) contracted for additional street and road repairs with monies provided by the General Fund per Revenue and Taxation Code Sections 7104 and 7107.
- (b) The Constitution makes payment of Debt Service on General Obligation Bonds one of the state's two highest fiscal priorities. Bond interest and redemption increased by \$697 million in fiscal year 2008-09 per the Governor's Budget Summary.
- (c) Assembly Bill 1634, (Chapter 723 Statutes of 2005) appropriated General Fund monies to reimburse the counties for the state's share of costs for the November 2005 special statewide election. County budgets statewide contain funding authority to support only one statewide election per year.
- (d) For fiscal year 2008-09 Expenditure Adjustments for Encumbrances has an abnormal balance due to prior year reversal of over encumbered expenditures. Subsequent Budget adjustments per Executive Order S-09-08 issued July 31st did not allow for full expenditure of anticipated encumbered expenses. Health and Human Services, Corrections and Rehabilitation, and Higher Education had the most significant reductions.

Source: State of California, Office of the State Controller.

State Appropriations Limit

The state is subject to an annual appropriations limit imposed by Article XIII B of the State Constitution (the “Appropriations Limit”). The Appropriations Limit does not restrict appropriations to pay debt service on voter-authorized bonds.

Article XIII B prohibits the state from spending “appropriations subject to limitation” in excess of the Appropriations Limit. “Appropriations subject to limitation,” with respect to the state, are authorizations to spend “proceeds of taxes,” which consist of tax revenues, and certain other funds, including proceeds from regulatory licenses, user charges or other fees to the extent that such proceeds exceed “the cost reasonably borne by that entity in providing the regulation, product or service,” but “proceeds of taxes” exclude most state subventions to local governments, tax refunds and some benefit payments such as unemployment insurance. No limit is imposed on appropriations of funds which are not “proceeds of taxes,” such as reasonable user charges or fees and certain other non-tax funds.

There are various types of appropriations excluded from the Appropriations Limit. For example, debt service costs of bonds existing or authorized by January 1, 1979, or subsequently authorized by the voters, appropriations required to comply with mandates of courts or the federal government, appropriations for qualified capital outlay projects, appropriations for tax refunds, appropriations of revenues derived from any increase in gasoline taxes and motor vehicle weight fees above January 1, 1990 levels, and appropriation of certain special taxes imposed by initiative (e.g., cigarette and tobacco taxes) are all excluded. The Appropriations Limit may also be exceeded in cases of emergency.

The Appropriations Limit in each year is based on the Appropriations Limit for the prior year, adjusted annually for changes in state per capita personal income and changes in population, and adjusted, when applicable, for any transfer of financial responsibility of providing services to or from another unit of government or any transfer of the financial source for the provisions of services from tax proceeds to non-tax proceeds. The measurement of change in population is a blended average of statewide overall population growth, and change in attendance at local school and community college (“K-14”) districts. The Appropriations Limit is tested over consecutive two-year periods. Any excess of the aggregate “proceeds of taxes” received over such two-year period above the combined Appropriations Limits for those two years, is divided equally between transfers to K-14 districts and refunds to taxpayers.

The Legislature has enacted legislation to implement Article XIII B which defines certain terms used in Article XIII B and sets forth the methods for determining the Appropriations Limit. California Government Code Section 7912 requires an estimate of the Appropriations Limit to be included in the Governor’s Budget, and thereafter to be subject to the budget process and established in the Budget Act.

The following table shows the Appropriations Limit for fiscal years 2006-07 through 2010-11.

TABLE 10
State Appropriations Limit

(Dollars In Millions)

	Fiscal Years				
	2006-07	2007-08	2008-09	2009-10	2010-11
State Appropriations Limit	\$72,304	\$76,093	\$79,858	\$80,984	\$79,390
Appropriations Subject to Limit	(58,663)	(59,201)	(48,148)	(55,237) ^(a)	(61,800) ^(a)
Amount (Over)/Under Limit	\$13,641	\$16,892	\$31,170	\$25,747 ^(a)	\$17,590 ^(a)

^(a) Estimated/projected.

Source: State of California, Department of Finance.

Proposition 98 and K-14 Funding

On November 8, 1988, the voters of the state approved Proposition 98, a combined initiative constitutional amendment and statute called the “Classroom Instructional Improvement and Accountability Act.” Proposition 98 changed state funding of public education below the university level and the operation of the Appropriations Limit, primarily by guaranteeing K-14 education a minimum level of funding (the “Proposition 98 Guarantee”). Proposition 98 (as modified by Proposition 111, enacted on June 5, 1990) guarantees K-14 education the greater of: (a) in general, a fixed percentage of General Fund revenues (“Test 1”), (b) the amount appropriated to K-14 education in the prior year, adjusted for changes in state per capita personal income and enrollment (“Test 2”), or (c) a third test, which replaces Test 2 in any year that the percentage growth in per capita General Fund revenues from the prior year plus one half of one percent is less than the percentage growth in state per capita personal income (“Test 3”).

Legislation adopted prior to the end of the 1988-89 fiscal year implementing Proposition 98 determined the K-14 education’s funding guarantee under Test 1 to be 40.7 percent of General Fund tax revenues based on 1986-87 appropriations. This percentage has since been adjusted to approximately 41.5 percent of 1986-87 appropriations to account for subsequent changes in the allocation of local property taxes since these changes altered the share of General Fund revenues received by schools. The Proposition 98 Guarantee has typically been calculated under Test 2. Under Test 3, however, schools receive the amount appropriated in the prior year adjusted for changes in enrollment and per capita General Fund revenues, plus 0.5 percent. If Test 3 is used in any year, the difference between Test 3 and Test 2 becomes a “credit” (called the “maintenance factor”) to schools and is paid to them in future years when per capita General Fund revenue growth exceeds per capita personal income growth.

The Proposition 98 Guarantee is funded from two sources: local property taxes and the General Fund. Any amount not funded by local property taxes is funded by the General Fund. Thus, local property tax collections represent an offset to General Fund costs in a Test 2 or Test 3 year.

Proposition 98 permits the Legislature, by a two-thirds vote of both Houses (on a bill separate from the Budget Act) and with the Governor’s concurrence, to suspend the K-14 education’s minimum funding guarantee for a one-year period. The amount of the suspension is added to the maintenance factor, the repayment of which occurs according to a specified State Constitutional formula, and eventually restores Proposition 98 funding to the level that would have been required in the absence of such a suspension. Therefore, suspending the minimum funding guarantee provides ongoing General Fund savings over multiple fiscal years until the maintenance factor is fully repaid.

Proposition 98 also contains provisions for the transfer of certain state tax revenues in excess of the Appropriations Limit to K-14 education in Test 1 years when additional moneys are available. No such transfers are anticipated during fiscal years 2009-10 and 2010-11. See “STATE FINANCES – State Appropriations Limit.”

The Amended 2009 Budget Act reduced fiscal year 2008-09 Proposition 98 appropriations by \$7.3 billion from the \$58.1 billion assumed in the 2008 Budget Act through a combination of payment deferrals (\$3.2 billion), fund re-designations (\$1.7 billion), and program reductions (\$2.4 billion). In comparison to the fiscal year 2008-09 revised Proposition 98 spending level, the Initial 2009 Budget Act included an additional \$4.6 billion to backfill prior-year one-time solutions and \$252 million to fund growth adjustments. The fiscal year 2009-10 Proposition 98 appropriation level reflected an additional \$702 million in program reductions.

In July 2009, the Legislature adopted and the Governor signed legislation to further reduce Proposition 98 funding levels for both the 2008-09 and 2009-10 fiscal years. The fiscal year 2008-09 Proposition 98 funding level was established in statute at \$49.1 billion. This reflects another \$1.6 billion reduction beyond the Initial 2009 Budget Act. Furthermore, the Amended 2009 Budget Act reduced fiscal year 2009-10 appropriations by \$5.6 billion through a combination of payment deferrals (\$1.8 billion), program reductions (\$2.8 billion), and a technical adjustment related to the failure of Proposition 1C (The Lottery Modernization Act) (\$1.1 billion).

In order to balance the 2010 Budget Act, it was necessary to suspend the Proposition 98 Guarantee by \$4.1 billion in the 2010-11 fiscal year. The Proposition 98 Guarantee is reduced from the estimated minimum funding level of \$53.8 billion down to a level of \$49.4 billion, reflecting an additional veto reduction of \$256 million. Per the Proposition 98 constitutional formula, the \$4.1 billion owed is added to the outstanding maintenance factor balance and will be repaid over multiple years. The total program spending for 2009-10 is calculated at \$49.5 billion. The 2010 Budget Act also includes \$300 million in settle-up payments that do not count towards the fiscal year 2010-11 Guarantee but reduces the settle-up owed at the end of the 2009-10 fiscal year by a like amount.

The Proposition 98 Guarantee for fiscal year 2010-11 increased by \$1 billion from the 2010-11 May Revision estimate of \$48.4 billion and the General Fund share is \$36.0 billion of total Proposition 98 funding.

The 2010 Budget Act reflects General Fund Proposition 98 expenditures in fiscal years 2008-09 through 2010-11, as outlined in the table below.

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TABLE 11
Proposition 98 Funding

(Dollars In Millions)

	<u>2008-09</u>		<u>2009-10</u>		<u>2010-11</u>	<u>Change From Revised 2009-10 to Enacted 2010-11</u>	
	<u>Enacted^(a)</u>	<u>Revised^(b)</u>	<u>Enacted^(c)</u>	<u>Revised^(b)</u>	<u>Enacted^(b)</u>	<u>Amount</u>	<u>Percent</u>
K-12							
Proposition 98							
State General Fund	\$37,641	\$30,181	\$35,936	\$31,755	\$32,082	\$327	(1.0)%
Local property tax revenue	14,024	12,969	13,379	12,105	11,529	(576)	(4.8)
Subtotals ^(d)	\$51,665	\$43,150	\$49,315	\$43,859	\$43,611	\$(249)	(0.6)%
Other							
Proposition 98							
State General Fund	\$4,302	\$3,918	\$4,588	\$3,722	\$3,885	\$163	4.4%
Local property tax revenue	2,119	2,029	2,064	1,962	1,907	(55)	(2.8)
Subtotals ^(d)	\$6,421	\$5,947	\$6,652	\$5,684	\$5,792	\$108	1.9%
Total							
Proposition 98							
State General Fund	\$41,943	\$34,098	\$40,524	\$35,477	\$35,967	\$490	(1.4) %
State General Fund Settle-up Funds ^(e)				\$300			
Local property tax revenue	16,143	14,997	15,442	14,066	13,435	(631)	(4.5)
Totals ^(d)	\$58,086	\$49,096	\$55,966	\$49,843	\$49,402	(\$441)	(0.9)%

^(a) As of the 2008 Budget Act, September 23, 2008.

^(b) As of the 2010 Budget Act, October 8, 2010.

^(c) As of the Initial 2009 Budget Act, February 20, 2009.

^(d) Totals may not add due to rounding.

^(e) An additional \$300 million in General Fund settle-up payments were provided in fiscal year 2010-11, but counted towards the Proposition 98 Guarantee in the 2009-10 fiscal year.

Source: State of California, Department of Finance.

A maintenance factor is created in years when the Proposition 98 Guarantee is suspended or calculated under Test 3 pursuant to the constitution. The maintenance factor equals the difference between the funded Guarantee level and the amount that would have been calculated under Test 2. Repayment of the maintenance factor occurs in years when per capita General Fund revenue growth exceeds per capita personal income growth and is calculated as half the difference between the percentage increase in per capita General Fund revenue growth and per capita personal income growth multiplied by the General Fund subject to the State Appropriations Limit. The required repayment is part of the Proposition 98 Guarantee level for that year. Legislation adopted with the Amended 2009 Budget Act created an outstanding obligation for the fiscal year 2008-09 of \$11.2 billion to be repaid commencing in fiscal year 2010-11. In light of the state's current fiscal condition, the Governor's Budget proposed to delay commencing repayment of the remaining \$10.7 billion obligation from fiscal year 2010-11 until fiscal year 2011-12. The 2010 Budget Act instead commences with the repayment of the \$11.2 billion maintenance factor in fiscal year 2009-10, resulting in higher total Proposition 98 Guarantee levels in fiscal years 2009-10 and 2010-11 than assumed under the 2010-11 Governor's Budget and May Revision. As of the 2010 Budget Act, the outstanding maintenance factor balance at the end of the 2010-11 fiscal

year is \$9.5 billion. This amount will be repaid pursuant to the constitutional repayment formula in years when state revenues increase. The amount owed and repaid each year cannot be finalized until certain Proposition 98 factors (e.g., per capita personal income and per capita General Fund revenue growth factors) are available.

Legislation related to the 2004 Budget Act suspended the Proposition 98 minimum guarantee. At the time the 2004 Budget Act was enacted, this suspension was estimated to be \$2.004 billion. This suspended amount was added to the existing maintenance factor, which was fully paid in fiscal year 2005-06. However, subsequent growth in General Fund revenue increased the estimated fiscal year 2004-05 Proposition 98 Guarantee calculation by an additional \$1.6 billion. This additional funding, along with approximately \$1.1 billion in fiscal year 2005-06, was the subject of a lawsuit brought by the California Teachers Association (“CTA”), which has been settled. The terms agreed upon consist of retiring this approximately \$2.7 billion obligation beginning in fiscal year 2007-08 with a \$300 million payment and then in annual payments of \$450 million beginning in fiscal year 2008-09 until the full amount is paid. Due to the state’s severe revenue decline, the Amended 2009 Budget Act suspended this payment for fiscal year 2009-10. The 2010 Budget Act restarts the annual settlement payments by providing \$30 million for fiscal year 2009-10 and \$420 million for fiscal year 2010-11, a total of \$450 million.

The CTA lawsuit settlement was ratified by legislation enacted in September of 2006 (Chapter 751, Statutes of 2006). In addition, legislation was approved to refinance the Golden State Tobacco Securitization Corporation’s Series 2003A Bonds, which became effective on January 1, 2007. Of the \$1.258 billion in additional funds raised from the refinancing, which was completed on March 14, 2007, the first \$900 million offset initial costs of the settlement.

Settle-up funding results from changes in assumptions and recalculations of previous years’ Proposition 98 Guarantees based upon revised estimates of state and local property taxes, ADA and civilian population. After the end of the fiscal year, and as numbers are finalized, if the appropriations for any year are less than the Guarantee level, the remainder counts as “settle-up” and must be paid back at a future date. Proposition 98 appropriations for fiscal years 1995-96, 1996-97, 2002-03, and 2003-04 are cumulatively estimated to be \$1.4 billion below the amounts required by the Proposition 98 minimum guarantee for those years due to changes in various Proposition 98 factors applicable to those years. Chapter 216, Statutes of 2004, annually appropriates \$150 million per year beginning in fiscal year 2006-07, to repay these prior year Proposition 98 obligations. However, Chapter 491, Statutes of 2005, appropriated \$16.8 million toward these settle-up obligations during the fiscal year 2005-06, and explicitly reduced the first Chapter 216 settle-up appropriation from \$150 million to \$133.2 million for fiscal year 2006-07. Chapter 79, Statutes of 2006, appropriated \$133.2 million for the remaining balance of the fiscal year 2006-07 allocation and \$150 million for the fiscal year 2007-08 allocation. However, legislation related to the 2008 Budget Act suspended the fiscal year 2008-09 allocation. As a result, the outstanding settle-up balance as of the 2008 Budget Act was \$1.1 billion. The Initial 2009 Budget Act used the \$1.1 billion in settle-up moneys to pay for school district revenue limit costs in the 2008-09 fiscal year. The Amended 2009 Budget Act has further clarified that Proposition 98 appropriations for the 2006-07 fiscal year are \$212 million below the amounts required by the Proposition 98 minimum guarantee. This amount should be appropriated by the Legislature beginning in the 2014-15 fiscal year. Assumptions made in the 2010 Budget Act result in the fiscal year 2009-10 Proposition 98 Guarantee being underfunded by an estimated \$1.8 billion, however, in the 2010-11 fiscal year \$300 million in settle-up funding is appropriated towards fiscal year 2009-10, resulting in a remaining balance of \$1.5 billion to be paid in future years. Finally, the 2010 Budget Act created \$256 million in additional settle-up obligations for fiscal year 2010-11. However, the final amount of settle-up owed for fiscal years 2009-10 and 2010-11 is unknown until the Proposition 98 Guarantee factors for that year are certified, usually a few years after the close of the fiscal year.

While Proposition 98 mandates have been regularly deferred in recent years, the Legislature chose to fund the majority of these programs as part of the 2010 Budget Act, while suspending the remainder of mandates. Specifically, the Legislature provided more than \$80 million to fund the ongoing cost associated with 28 K-12 local mandated programs, while suspending 17 others. The Legislature also provided almost \$10 million to fund the ongoing cost of 15 community college local mandated programs, while suspending 6 others. This decision is due in part to recent court ruling that found the act of deferring mandate costs to be unconstitutional. In addition, the 2010 Budget Act provides one-time funding of \$210 million to reimburse schools and community colleges for prior year mandate costs, which exceed \$1 billion.

Local Governments

The primary units of local government in California are the 58 counties, which range in population from approximately 1,100 in Alpine County to approximately 10.4 million in Los Angeles County.

Counties are responsible for the provision of many basic services, including indigent health care, welfare, jails, and public safety in unincorporated areas. There are also 480 incorporated cities in California and thousands of special districts formed for education, utilities, and other services. The fiscal condition of local governments was changed when Proposition 13, which added Article XIII A to the State Constitution, was approved by California voters in 1978. Proposition 13 reduced and limited the future growth of property taxes and limited the ability of local governments to impose “special taxes” (those devoted to a specific purpose) without two-thirds voter approval. Although Proposition 13 limited property tax growth rates, it also has had a smoothing effect on property tax revenues, ensuring greater stability in annual revenues than existed before Proposition 13 passed.

Proposition 218, another constitutional amendment enacted by initiative in 1996, further limited the ability of local governments to raise taxes, fees, and other exactions. (The limitations include requiring a majority vote approval for general local tax increases, prohibiting fees for services in excess of the cost of providing such service, and providing that no fee may be charged for fire, police, or any other service widely available to the public.)

In the aftermath of Proposition 13, the state provided aid to local governments from the General Fund to make up some of the loss of property tax moneys, including assuming principal responsibility for funding K-12 schools and community colleges. During the recession of the early 1990s, the Legislature reduced the post-Proposition 13 aid to local government entities other than K-12 schools and community colleges by requiring cities and counties to transfer some of their property tax revenues to school districts. However, the Legislature also provided additional funding sources, such as sales taxes, and reduced certain mandates for local services funded by cities and counties. See “STATE FINANCES – Sources of Tax Revenue – Sales and Use Tax” for a discussion of the impact of the Economic Recovery Bond issuances on local sales taxes.

The 2004 Budget Act, related legislation and the enactment of Proposition 1A in 2004 and Proposition 22 in 2010 (described below) dramatically changed the state-local fiscal relationship. These constitutional and statutory changes implemented an agreement negotiated between the Governor and local government officials (the “state–local agreement”) in connection with the 2004 Budget Act. One change relates to the reduction of the vehicle license fee (“VLF”) rate from 2 percent to 0.65 percent of the market value of the vehicle. In order to protect local governments, which had previously received all VLF revenues, the 1.35 percent reduction in VLF revenue to cities and counties from this rate change was backfilled (or offset) by an increase in the amount of property tax revenues they receive. This worked to the benefit of local governments because the backfill amount annually increases in proportion to the

growth in property tax revenues, which has historically grown at a higher rate than VLF revenues, although property tax revenues have declined over the past two years. This arrangement continues without change in the 2010 Budget Act.

Pursuant to statutory changes made in conjunction with the Initial 2009 Budget Act, the VLF rate increased from 0.65 percent to 1.15 percent effective May 19, 2009. Of this 0.50 percent increase, 0.35 percent flows to the General Fund, and 0.15 percent supports various law enforcement programs previously funded by the state General Fund. This increased VLF rate will be effective through the 2010-11 fiscal year.

As part of the state-local agreement, voters at the November 2004 election approved Proposition 1A (“Proposition 1A of 2004”). Proposition 1A of 2004 amended the State Constitution to, among other things, reduce the Legislature’s authority over local government revenue sources by placing restrictions on the state’s access to local governments’ property, sales, and VLF revenues as of November 3, 2004. A detailed description of the provisions of this constitutional amendment is set forth below under the caption “THE BUDGET PROCESS – Constraints on the Budget Process – Local Government Finance (Proposition 1A of 2004).”

The Amended 2009 Budget Act authorized the state to exercise its authority under Proposition 1A of 2004 to borrow an amount equal to about 8 percent of local property tax revenues, or \$1.9 billion, which must be repaid within three years. State law was also enacted to create a securitization mechanism for local governments to sell their right to receive the state’s payment obligations to a local government-operated joint powers agency (JPA). This JPA sold bonds in a principal amount of \$1.895 billion in November 2009 to pay the participating local governments their full property tax allocations when they normally would receive such allocations. Pursuant to Proposition 1A of 2004, the state is required to repay the local government borrowing (which in turn will be used to repay the bonds of the JPA) no later than June 30, 2013. The 2010 Budget Act includes \$90.8 million for the interest payments that will be incurred in that fiscal year to be paid from the General Fund.

Proposition 22, adopted on November 2, 2010, supersedes Proposition 1A of 2004 and completely prohibits any future borrowing by the state from local government funds, and generally prohibits the Legislature from making changes in local government funding sources. Allocation of local transportation funds cannot be changed without an extensive process. The Proposition 1A borrowing done as part of the Amended 2009 Budget Act is not affected by Proposition 22.

The Amended 2009 Budget Act also contains a shift of \$1.7 billion in redevelopment agency tax increment funds from current revenue and reserves in fiscal year 2009-10 and \$350 million in fiscal year 2010-11. These funds are shifted to schools that serve the redevelopment areas. This frees an equal amount of base property tax for the impacted schools that is shifted to the Supplemental Revenue Augmentation Funds in each county that were established by Proposition 1A of 2004. The funds in the Supplemental Revenue Augmentation Fund are then used to offset various state General Fund costs incurred in the counties. In fiscal year 2010-11 the \$350 million will be used to offset trial court costs. The enabling legislation allows redevelopment agencies to borrow from parent agencies, and from any available reserves in their Low and Moderate Income Housing Funds.

The California Redevelopment Association (“CRA”), whose membership includes a large number of redevelopment agencies, has filed a lawsuit challenging the \$1.7 billion shift described above. The 2008 Budget Act included a shift of \$350 million of redevelopment agency moneys. The CRA had also challenged that shift, and a trial court held that the legislation providing for the shift was invalid, which prevented the state from shifting the funds for the 2008-09 fiscal year. The state withdrew its appeal of the decision and subsequently enacted legislation that addresses the concerns noted by the trial

court. However, the subsequently enacted legislation is being challenged in the current CRA lawsuit. A group of counties has filed a separate lawsuit challenging the shift. See “LITIGATION – Budget-Related Litigation – Actions Challenging Required Contribution by Redevelopment Agencies.” The Sacramento County Superior Court issued a ruling on May 4, 2010 upholding the state’s ability to shift \$1.7 billion and \$350 million from redevelopment agencies in fiscal years 2009-10 and 2010-11, respectively. The plaintiffs have appealed the ruling to the Third District Court of Appeals.

Trial Courts

Prior to legislation enacted in 1997, local governments provided the majority of funding for the state’s trial court system. The legislation consolidated the trial court funding at the state level in order to streamline the operation of the courts, provide a dedicated revenue source, and relieve fiscal pressure on the counties. The state’s trial court system will receive approximately \$2.6 billion in state resources in fiscal year 2009-10 and \$2.8 billion in fiscal year 2010-11, as well as \$499 million in resources from the counties in each fiscal year. The 2010 Budget Act reflects \$55 million in General Fund reductions for the trial court system, plus an additional one-time reduction of \$17.4 million. The Budget also reflects an increase in fee revenues (\$103.6 million) and the transfer of special fund balances (\$130 million) to support trial court operations. As discussed in the Local Governments section above, the fiscal year 2010-11 budget for the Trial Courts includes \$350 million in redevelopment agency tax increment funds to offset General Fund costs. In addition, legislation enacted in 2008 provides California’s court system with increased fees and fines to expand and repair its infrastructure to address significant caseload increases and reduce delays. The fees raised by this legislation are intended to support up to \$5 billion in lease-revenue bonds. Additional legislative authorization is required prior to the issuance of such lease-revenue bonds.

Welfare System

The entire statewide welfare system was changed in response to the change in federal welfare law enacted in 1996 (see “Welfare System”). Under the CalWORKs program, counties are given flexibility to develop their own plans, consistent with state law, to implement the program and to administer many of its elements. Counties are still required to provide “general assistance” aid to certain persons who cannot obtain welfare from other programs.

Welfare System

The Personal Responsibility and Work Opportunity Reconciliation Act of 1996 (P.L. 104–193, the “Law”) fundamentally reformed the nation’s welfare system. The Law included provisions to: (i) convert Aid to Families with Dependent Children (“AFDC”), an entitlement program, to Temporary Assistance for Needy Families (“TANF”), a block grant program with lifetime time limits on TANF recipients, work requirements and other changes; (ii) deny certain federal welfare and public benefits to legal noncitizens (subsequent federal law has amended this provision), allow states to elect to deny additional benefits (including TANF) to legal noncitizens, and generally deny almost all benefits to illegal immigrants; and (iii) make changes in the Food Stamp program, including reducing maximum benefits and imposing work requirements. The TANF block grant formula under the Law is operative through December 3, 2010, as further described below.

Chapter 270, Statutes of 1997, embodies California’s response to the federal welfare systems. Effective January 1, 1998, CalWORKs replaced the former AFDC program and California’s previous welfare program, Greater Avenues to Independence programs. Consistent with the federal law, CalWORKs contains time limits on the receipt of welfare aid, both lifetime as well as current period. The centerpiece of CalWORKs is the linkage of eligibility to work participation requirements.

Caseload under CalWORKs is projected to increase in fiscal year 2010-11. CalWORKs caseload projections are 552,000 cases in fiscal year 2009-10 and 578,000 cases in fiscal year 2010-11. Even with the increase in caseload, this still represents a major decline in caseload from the early 1990s, when caseload peaked at 921,000 cases in fiscal year 1994-95. Since CalWORKs' inception in January 1998 through fiscal year 2010-11, caseload is projected to decline by approximately 10 percent.

The federal Deficit Reduction Act of 2005 ("DRA") included legislation that reauthorized and extended the TANF program until September 30, 2010. On September 30, 2010, the President signed into law a Continuing Resolution (HR 3081) to allow continued government operations through December 3, 2010. Under the resolution, funding will continue at federal fiscal year ("FFY") 2010 enacted levels for most programs, including the TANF block grant.

The reauthorization legislation modifies countable work activities under TANF and applies new federal work participation rates to separate state programs. In addition, because reauthorization legislation effectively eliminates the state's caseload reduction credit, the bulk of the CalWORKs caseload is subject to 50 percent work participation level requirement beginning in FFY 2007.

Current policies are not expected to increase work participation rates enough to meet the federal requirement for at least 50 percent work participation among all families. In August 2009, the state received official notice from the federal government that California failed to meet the work participation rate for FFY 2007, the first year for which the DRA's changes were effective. However, California's penalty of approximately \$230 million was waived primarily due to the impact of program changes made in the DRA and California's ability to engage nearly 30,000 families in work activities between FFY 2006 and FFY 2007. As a result of not meeting the work participation rate requirements, California's required Maintenance of Effort ("MOE") has increased to 80 percent of FFY 1994 historic expenditures rather than the 75 percent MOE level California is required to meet when work participation rates are achieved. The 2010 Budget Act continues to reflect an increase of MOE spending by \$179.5 million in fiscal year 2010-11, to \$2.9 billion, to reflect this penalty. The federal government recently notified California that it has not met the FFY 2008 work participation rate requirements and assessed a penalty of \$47.7 million. Under current state law, 50 percent of the penalty amount is the state's responsibility and the remaining 50 percent would be shared among those counties not meeting work participation rate requirements. The state intends to seek relief from the FFY 2008 penalty based on current economic conditions and/or a corrective action plan. To the extent full or partial relief is not obtained, any FFY 2008 penalty likely would not be assessed prior to fiscal year 2011-12.

Considerable improvement in work participation rates must be achieved to avoid additional federal penalties, which could cost the state and counties more than \$2 billion over a five-year period, beginning in fiscal year 2011-12. Efforts to address improving work participation began during fiscal year 2006-07, and the state is continuing to identify and evaluate additional options that place greater emphasis on work participation and reduce reliance upon public assistance to significantly improve the ability of the state and counties to meet federal work requirements in the TANF program. In addition, beginning in fiscal year 2011-12, the following long-term reforms will become effective:

- Restructuring time limits by requiring the adults in families that have received aid for a cumulative 48 months within a 60-month period to "sit out" and not receive aid for 12 months.
- Requiring all non-exempt recipients who are not meeting work requirements to meet face-to-face twice a year for a review with county employees.

- Strengthening the sanction process for adults who do not comply with program requirements by removing the adult portion of the grant if the adult refuses to comply within a cumulative total of three months.
- Reducing by 25 percent the child-only grant for non-work-eligible adults unless they meet work participation requirements. Counties may, at their own expense, provide services to enable these adults to meet program participation requirements. If they are successful in meeting program requirements, the child-only grant will continue to be provided at its full value.
- Eliminating the statutory COLA for CalWORKs. This statutory COLA was placed in law in the early 1970s. The COLA has been suspended during many of the years in which the state faced large budget deficits, including the current fiscal year.

Nationwide, the ARRA appropriated a combined total of \$5 billion for a new TANF Emergency Contingency Fund (“ECF”) for FFYs 2009 and 2010. A state can receive an ECF allocation for (i) caseload increases, (ii) increased expenditures for non-recurrent short-term benefits, and/or (iii) increased expenditures for subsidized employment. Through the ECF, a state can be reimbursed for 80 percent of expenditures in FFY 2009 and FFY 2010 that exceed the level of state expenditures in each of these areas in FFY 2007 or FFY 2008, whichever is lower (California uses FFY 2007). For the two-year period ending September 30, 2010, total General Fund savings resulting from TANF ECF are estimated to be over \$708 million.

The 2010 Budget Act includes \$407.8 million in General Fund savings. The bulk of these savings is derived from the extension of TANF Emergency Contingency Funding from October 1, 2010 through June 30, 2011, for General Fund savings of \$395.4 million.

Health Programs

Medi-Cal – Medi-Cal, California’s Medicaid program, is a health care entitlement program for low-income individuals and families who receive public assistance or otherwise lack health care coverage. Medi-Cal serves over one in six Californians. Federal law requires Medi-Cal to provide basic services such as doctor visits, laboratory tests, x-rays, hospital inpatient and outpatient care, hospice, skilled nursing care, and early periodic screening, diagnosis and treatment. Also, federal matching funds are available if states choose to provide any of numerous optional benefits. The federal government pays for half of the cost of providing most Medi-Cal services in California, including optional benefits. A wide range of public and private providers and facilities delivers these services. Providers are reimbursed by the traditional fee-for-service method or by capitated payments from managed care plans. Approximately 4.0 million Medi-Cal beneficiaries (more than half of the people receiving Medi-Cal benefits and services) are currently enrolled in managed care plans.

For the 2010 Budget Act, Medi-Cal expenditures are estimated to be \$41.2 billion (\$11.2 billion General Fund) in fiscal year 2009-10 and \$ 50.2 billion (\$12.2 billion General Fund) in fiscal year 2010-11. There is a net increase of \$1 billion in Medi-Cal General Fund expenditures in fiscal year 2010-11, when compared to revised fiscal year 2009-10. This is the net result of:

- (a) An increase in the base cost of about \$4.2 billion due to the currently scheduled end of ARRA enhanced funding (\$1.7 billion), removal of the Proposition 1A transfer (\$1.6 billion), base caseload and cost increases (\$0.9 billion), and other baseline issues.

(b) A savings of \$3.2 billion related to six month extension of ARRA funding, mandatory enrollment into managed care for seniors and persons with disability, an adjustment to the county administration estimate process, a hospital rate freeze, and other savings proposals.

The 2010 Budget Act includes a decrease of \$3.6 billion in General Fund expenditures (statewide) by obtaining additional federal funds in a number of targeted areas. The proposals include an increase in the state's Federal Medical Assistance Percentage, monies owed to the state for incorrect Medicare disability determinations, and recalculation of state Medicare Part D clawback payments after taking into consideration aggressive state rebates (which would reduce clawback costs to California if these benefits were still provided through Medi-Cal), as well as possible General Fund relief through the new comprehensive Section 1115 Medi-Cal Financing Waiver. Additional options include seeking federal support on court cases currently preventing the state from implementing previously enacted program changes to Health and Human Services programs or increasing the income standard to receive federal funds in the Foster Care program.

The 2010 Budget Act included \$560 million of General Fund savings from funds (to cover children's health care costs in Medi-Cal) made available through the enacted AB 1383 hospital fee. The federal government has now authorized the state fee. State legislation may also be explored in the next session to potentially extend the hospital fee from January 1 to July 1, 2011 to benefit from extended ARRA funds. Overall, the program uses fees on the industry to match federal funds, most of which are returned to Medi-Cal providers through supplemental payments, and \$80 million per quarter is designated for providing children's health care in Medi-Cal. The 2010 Budget Act also includes a technical fund shift authorized by AB 1653, which enables the state to achieve savings previously budgeted, and without any adverse impact on hospitals.

Litigation is pending with respect to certain cost reductions implemented by the state. See "LITIGATION – Actions Regarding Medi-Cal Reimbursements and Fees."

Average monthly caseload in Medi-Cal was 7.28 million in fiscal year 2009-10. Caseload is expected to increase in fiscal year 2010-11 by approximately 262,300, or 3.6 percent, to 7.54 million eligible people.

Federal health care reform now allows states to offer family planning services through a state plan amendment. Accordingly, the Family Planning, Access, Care and Treatment ("Family PACT") Waiver program has been converted to a state plan amendment, which removes prior treatment of the services and federal funds as one-time in nature. In other words, the services and federal funds are now ongoing.

The 2008 Budget Act required the DHCS to achieve estimated savings of \$323.3 million through unallocated reductions as a result of historical expenditure trends in the program. The savings did not materialize for fiscal year 2008-09. In November 2007, the department noted similar concerns while initially reporting achieved savings of \$195.2 million of \$331 million expected for fiscal year 2007-08. At year end, the DHCS did achieve the full \$331 million General Fund savings plus an additional \$265 million General Fund savings. The Amended 2009 Budget Act assumes that DHCS achieves \$323.3 million in savings in fiscal year 2009-10. DHCS ultimately saved \$646 million in fiscal year 2009-10 due to the receipt of budgeted federal funds to offset General Fund costs. After accounting for the federal fund adjustments, the additional \$323.3 million budgeted for savings in fiscal year 2009-10 did not materialize. The 2010 Budget Act assumes a savings of \$323 million General Fund in fiscal year 2010-11.

On February 17, 2009, President Obama signed ARRA, which enhances California's FMAP for the Medi-Cal program through December 31, 2010. The measure provides an across-the-board increase in FMAP to all states. Furthermore, states with significant changes in unemployment are eligible for an additional FMAP increase determined through a formula. California qualified for additional FMAP increase due to its high unemployment rate. California's current FMAP is 61.59 percent. The federal government subsequently passed a six month increased FMAP extension of 8.8 percent during the first quarter and 6.9 percent in the second quarter of 2011.

In February 2010, the federal government announced it would apply the federal ARRA FMAP to the clawback for October 2008 through December 31, 2010. The "clawback" is a payment made to the federal government to compensate for state Medicaid savings that would otherwise result from the Medicare Part D prescription drug benefit. This action resulted in \$682.2 million one-time federal funds to offset the state's General Fund. DHCS used \$447.3 million in fiscal year 2009-10 to credit against the monthly Part D clawback payments, beginning with the January 2010 invoice that was paid in March 2010. The remaining amount would be used in fiscal year 2010-11.

SSI/SSP – The federal Supplemental Security Income ("SSI") program provides a monthly cash benefit to eligible seniors and persons with disabilities who meet the program's income and resource requirements. In California, the SSI payment is augmented with a State Supplementary Payment ("SSP") grant. The 2010 Budget Act includes approximately \$3.0 billion in General Fund expenditures for fiscal year 2010-11, which remains relatively unchanged from the revised fiscal year 2009-10 funding level. The average monthly caseload in this program is estimated to be 1.3 million recipients in fiscal year 2010-11, a 1.4 percent increase over the revised fiscal year 2009-10 projected level.

Health Care Reform – The state is continuing to study the recently enacted federal health care reform and its implications. Among other things, the law: (1) expands Medi-Cal coverage beginning January 1, 2014; (2) requires specified rate increases for primary care and outpatient services beginning in 2013; and (3) prohibits California from restricting eligibility primarily for the Medi-Cal and Healthy Families programs (other health programs may also be affected, pending further review) before the new coverage requirements go into effect in 2014. Health care reform may result in a significant net increase of General Fund program costs in fiscal year 2013-14 and beyond. The net impact of health care reform on the General Fund will depend on a variety of factors, including levels of participation and potential savings resulting from the reform. The state has preliminarily estimated annual costs of \$1.4 billion General Fund in fiscal year 2013-14 and growing to about \$3.5 billion annually by 2020-21. Actual costs could vary significantly based on economic factors or subsequently enacted program changes.

Two bills, Chapter 655, Statutes of 2010 (AB 1602, Perez) and Chapter 659, Statutes of 2010 (SB 900, Alquist and Steinberg) establish the Health Care Reform Exchange ("Exchange") as an independent entity in state government and outline the authorities and responsibilities of the Exchange and its governing board. The Exchange will provide a marketplace for individuals and small businesses to purchase health insurance by January 1, 2014. The Exchange will establish requirements for health plans to participate in the Exchange, standards and criteria for selecting health plans to be offered in the Exchange, and require the Exchange to provide an adequate selection of qualified health plans in each region of the state. It could cost in the hundreds of millions or even billions of dollars potentially--depending on federal particulars when they are known, how much the federal government pays for implementation, and policy decisions made by the yet to be appointed board. The federal law authorizes the Secretary of the federal Health and Human Services Department to provide grants necessary to fund start-up costs. AB 1602 authorizes the Exchange to assess charges as a part of premiums on participating health plans and at rates reasonable to support the ongoing operations of the Exchange and maintain a prudent reserve.

Department of Corrections and Rehabilitation

General – CDCR was established in July 2005 by combining the former Department of Corrections, Youth Authority, Board of Prison Terms, Narcotic Addict Evaluation Authority, Board of Corrections, Commission on Correctional Peace Officer Standards and Training, and Prison Industry Authority. CDCR is responsible for incarcerating the state’s most serious adult and juvenile offenders and for supervising offenders released on parole to the community. Today, CDCR, as one of the largest departments in state government, operates 39 youth and adult correctional facilities, 46 camps, 3 Family Foundation facilities and 3 adult prisoner/mother facilities. In addition, the CDCR contracts for 14 adult parolee service centers and 9 adult community correctional facilities, and leases beds at 2 county jails. The CDCR also operates 234 youth and adult parole units and sub-units, 4 parole outpatient clinics, 4 regional headquarters, 1 correctional training center, 3 licensed general acute care hospitals, 1 licensed skilled nursing facility, 1 hospice program for the terminally ill, 18 licensed correctional treatment centers, 5 hemodialysis clinics, and 17 outpatient housing units. In addition, the CDCR has 6 regional accounting offices and leases almost two million square feet of office space. The CDCR’s infrastructure includes more than 42 million square feet of building space on more than 27,000 acres of land (42 square miles) statewide.

CDCR Budget – The 2010 Budget Act includes total operating expenditures of \$8.8 billion for CDCR from all funding sources. Of this amount, \$8.5 billion comes from the General Fund. The CDCR budget includes funding for over 66,550 personnel years at a total cost for salaries and benefits of approximately \$6.6 billion. Lease payments and bond insurance costs total \$268.7 million, and the remaining funds are budgeted for operating expenses and equipment.

The 2010 Budget Act includes reductions for CDCR totaling \$1.1 billion. Of these savings \$820 million is to reduce the Receiver’s Medical Program budget to decrease the per-inmate medical cost to a level comparable to other states correctional health care programs, and a savings of \$200 million related to a reduction in the inmate population.

CDCR Population – Under existing law, the average daily adult inmate population is projected to decrease by 3,377 inmates from 167,058 in fiscal year 2009-10 to 163,681 in fiscal year 2010-11. Under existing law the average daily parole population is projected to decrease by 713 parolees from 119,913 in fiscal year 2009-10 to 119,200 in fiscal year 2010-11.

The Division of Juvenile Justice (“DJJ”) average daily institution population is projected to decrease by 200 wards from 1,517 in fiscal year 2009-10 to 1,317 in fiscal year 2010-11. The juvenile parole average daily population is expected to decrease by 452 parolees from 1,722 in fiscal year 2009-10 to 1,270 in fiscal year 2010-11. The institution population decrease is primarily due to efforts made by DJJ to reduce the number of time adds given for behavioral violations and increase the number of time cuts given for positive behavior and program completions, which are both used to determine a ward’s parole consideration date. The parole population decrease is primarily a result of transferring the supervisory responsibilities for new DJJ parolees to county probation.

Litigation Concerning Prison Medical Care Services – In April 2001, a class-action lawsuit, now known as *Plata v. Schwarzenegger*, was filed in federal court contending that the state was in violation of the Eighth and Fourteenth Amendments to the U.S. Constitution by providing inadequate medical care to prison inmates. Three other cases are pending in federal court challenging the adequacy of services to prisoners for mental health care, dental health care, and disability rights. The four cases are coordinated among the courts, but the lead action has been delegated to the *Plata* court. On June 30, 2005, the *Plata* court ordered the establishment of a receivership to take control of the CDCR’s medical care system due to the state’s delay in successfully implementing the changes required by the Stipulated Agreement for

Injunctive Relief, entered into as the settlement of the *Plata v. Schwarzenegger* case. A medical care receiver (“Receiver”) was appointed by the *Plata* court in February 2006, and given broad authority over CDCR’s medical care program. The *Plata* court approved the Turnaround Plan of Action on June 16, 2008.

Since the Receiver was appointed, he proposed and subsequently revised plans for, among other things, design and construction of health-related facilities and housing for inmates with medical or mental health care needs, and supporting infrastructure and ancillary facilities, at existing state correctional facilities statewide or at other appropriate state owned real property, as well as improvements to health care facilities at existing prison facilities statewide. The CDCR currently plans to meet the Receiver’s needs through its implementation of the AB 900 Prison Construction Program. See “Prison Construction Program” below.

On October 27, 2008, the district court ordered the state to transfer \$250 million to the Receiver. The court indicated it would proceed later with additional amounts requested by the Receiver. The state appealed that order and the Ninth Circuit Court of Appeals dismissed the state’s appeal for lack of jurisdiction, stating that the order to pay \$250 million was an interim order. The state’s motion asking the *Plata* court to terminate the Receiver was denied. The state appealed this denial and a hearing on the appeal was heard in the Ninth Circuit Court of Appeals in September 2009. As of the 2010 Budget Act, the state’s appeal was denied. The Receiver has subsequently withdrawn this motion. See “LITIGATION – Prison Healthcare Reform and Reduction of Prison Population.”

The 2010 Budget Act includes \$968 million for the Receiver’s Medical Services Program, which is a decrease of \$773 million compared to the Amended 2009 Budget Act and a subsequent supplemental appropriations bill. Failure to achieve these full reductions would place increased pressure on General Fund resources.

Ruling Concerning Prison Overcrowding – On August 4, 2009, a panel of three federal judges issued a ruling related to the class action lawsuits over medical care (*Plata*) and mental health care (*Coleman v. Schwarzenegger*). The ruling found that overcrowding is the primary cause of unconstitutional medical and mental health conditions in California’s state prisons. The ruling required the state, within 45 days, to submit a plan to reduce the state prison population to 137.5 percent of the system’s design capacity within two years, a reduction of approximately 46,000 inmates. The state filed a prisoner-release plan with the three-judge panel. On January 12, 2010, the three-judge panel issued its final order, containing the same rulings. The state has appealed the order to the U.S. Supreme Court. On June 14, 2010, the U.S. Supreme Court granted the state’s request for review of the prisoner release order. Oral argument has been scheduled for November 30, 2010, and a decision is expected before the end of the Court’s current 2010-11 term.

The three-judge panel’s ruling, if sustained by the Supreme Court, will not result in the immediate release of any prisoners, only the preparation of a population reduction plan. The fiscal and policy impact of the three-judge panel ruling is therefore unknown at this point, being dependent on the outcome of proposed budget solutions, the pace of currently authorized prison construction, the timing of any future order to implement a population reduction plan, and the outcome of potential legal appeals to such an order.

Prison Construction Program

On May 3, 2007, the Governor signed AB 900 (Chapter 7, Statutes of 2007) (“AB 900”), which provides for a critical expansion of capacity in the state prison system and additional funds for county jails. In addition to construction funding, AB 900 emphasized expanding rehabilitative programs and

measuring outcomes through performance goals to reduce the high rate of recidivism among adult offenders.

The central feature of AB 900 is authorization for issuance of a total of up to \$7.4 billion of lease-revenue bonds by the State Public Works Board in two phases. Prison Phase I, which may be implemented immediately, authorizes approximately \$3.6 billion to finance (i) up to 12,000 new state prison beds to replace temporary housing for inmates in public spaces not designed for such uses, (ii) up to 6,000 re-entry beds for the incarceration of inmates who have served the majority of their terms near the communities into which they will eventually be released, and (iii) facilities to provide medical, dental and mental health treatment or housing for up to 6,000 inmates. Prison Phase II may be implemented after a designated three-member panel certifies that about one-third of the spaces specified in Prison Phase I are under construction and other specified rehabilitative program requirements have been met. Prison Phase II, which must be commenced by January 1, 2014, authorizes up to approximately \$2.5 billion for (i) up to an additional 4,000 beds at existing state prisons, (ii) facilities to provide medical, dental and mental health treatment or housing for up to an additional 2,000 inmates, and (iii) up to an additional 10,000 spaces in re-entry housing.

Litigation challenging the constitutionality of the lease-revenue bond financing method included in AB 900 was dismissed by the trial court judge and the dismissal was upheld on appeal.

AB 900 also authorizes funding for acquisition, design and construction of county jail facilities, subject to a 25 percent local match and certain designated priorities and standards. Prison Phase I authorizes up to \$750 million of lease-revenue bonds for county jail facilities, which must be issued by June 30, 2017. Upon certification that certain benchmarks are met for commencement of construction under Prison Phase I and county jails, up to \$470 million in additional funds for county jails will be available under Prison Phase II.

Implementation of AB 900 was delayed for several reasons, including the need to obtain necessary technical corrections to clarify the scope of the legislation. The Legislature passed the necessary technical corrections in February 2009 and the Administration is implementing the construction programs within the constraints of cash available for interim financing. Several projects to provide mental health capacity have been initiated and the first projects have begun construction during calendar year 2010. Additionally, one reentry and three infill projects have begun design during calendar year 2010.

In addition to authorization for new bonds, AB 900 appropriated \$50 million from the General Fund for the CDCR to expand rehabilitative programs and \$300 million from the General Fund to complete various infrastructure and capacity improvements.

Unemployment Insurance

The Unemployment Insurance (UI) program is a federal-state program that provides weekly UI payments to eligible workers who lose their jobs through no fault of their own. To be eligible for benefits, a claimant must be able and available to work, seeking work, and be willing to accept a suitable job. The regular unemployment program is funded by unemployment tax contributions paid by employers for each covered worker.

Due to the high rate of unemployment, the employer contributions are not sufficient to cover the cost of the benefits to claimants. In a report titled "October 2010 Unemployment Insurance (UI) Fund Forecast" (the "October 2010 UI Forecast"), the state Employment Development Department stated that the UI Fund had a deficit of \$6.2 billion at the end of 2009, and \$8.3 billion at the end of September 2010,

and projected that, absent changes to the UI Fund financing structure, the UI Fund will have deficits of \$10.3 billion at the end of 2010; a deficit of \$13.4 billion at the end of 2011, and a deficit of \$16.0 billion at the end of 2012. The projections in the October 2010 UI Forecast were based on an economic outlook and labor projections prepared in June 2010.

Commencing in January 2009, in accordance with federal law, the state began to fund deficits in the UI Fund through a federal loan to support benefit payments. If the loan is repaid within the federal fiscal year in which it is taken, the state does not have to pay interest on the loan. If the state is unable to repay the loan within the same year it is taken, then the state must pay interest on the borrowed funds with state funds. However, the American Recovery and Reinvestment Act (ARRA) provides that interest will not begin to accrue until January 1, 2011, and repayment to the U.S. Department of Labor would need to occur no later than September 30, 2011, or interest payments would begin as described below.

Assuming the state does not begin repayment of the loan prior to September 2011, as described above, in fiscal year 2011-12 the General Fund would be required to make an interest only payment of approximately \$362.3 million for the period from January 1 through September 30, 2011 (based on an assumed then outstanding federal loan of \$13.4 billion). The amount payable in fiscal years after fiscal year 2011-12 (assuming no federal waiver of the interest payment) will depend on a variety of factors, including the actual amount of the federal loan then outstanding (which in turn will depend on the rate of unemployment, employer contributions to the UI Fund, and any state or federal law changes relating to the funding of the program) and the interest rate imposed by the federal government. Congress is currently considering an extension of the interest waiver beyond December 31, 2010.

On October 20, 2010, the Legislative Analyst's Office issued a report titled "California's Other Budget Deficit: The Unemployment Insurance Fund Insolvency" (the "LAO UI Report"). The LAO UI Report was based on projections prepared by the Employment Development Department in May 2010. The LAO UI Report stated that the UI Fund is currently insolvent. The LAO UI Report also stated:

"The Legislature essentially has three main choices for returning the UI fund to solvency: (1) reducing benefit payments, (2) increasing employer tax contributions, or (3) adopting some combination of the previous two options. To assist the Legislature we examined multiple scenarios for achieving solvency and found that:

- Decreasing UI benefits alone cannot address the fund insolvency in the near future.
- Options involving UI tax increases could quickly improve the fund condition.
- Employer tax increases could hurt California's competitiveness.
- The UI financing structure is not sufficiently robust."

"In developing a strategy to bring solvency to the UI fund, we recommend that the Legislature:

- Attempt to minimize adverse impacts on the economy.
- Make both tax and benefit changes.
- Consider different approaches for the short term (calendar years 2011 and 2012) than for the long term.
- At a minimum, take prompt action to bring UI benefits and tax revenues into line so that the accumulated deficit and associated interest obligation stops growing."

Pension Trusts

The principal retirement systems in which the state participates are the California Public Employees' Retirement System (CalPERS) and the California State Teachers' Retirement System

(CalSTRS). The assets and liabilities of the funds administered by CalPERS and CalSTRS, as well as certain other retirement funds administered by the state, are included in the financial statements of the state as fiduciary funds. They are also described in Note 23 to the Audited Basic Financial Statements of the State of California for the Year Ended June 30, 2009. See "FINANCIAL STATEMENTS." The University of California maintains a separate retirement system. (The state's General Fund does not directly contribute to the University of California's system, however the system has been advocating that the state begin to do so.) Information about this system may be obtained directly from the University of California.

As described below, the obligation of the state to fund retirement benefits constitutes a significant financial obligation. Retirement related costs payable from the General Fund have increased significantly over the last several years, for a variety of reasons, including enhancement to retirement benefits enacted prior to 2003, and significant investment losses in 2008 and early 2009. CalPERS and CalSTRS each currently have unfunded liabilities in the tens of billions of dollars. Retirement related costs payable from the General Fund could increase significantly in the foreseeable future. The actual amount of such increases will depend on a variety of factors, including but not limited to investment returns, actuarial assumptions, retirement benefit adjustments and, in the case of CalSTRS, statutory changes in contributions.

New Formula for Retirement Benefits

Legislation enacted in October 2010 as part of the 2010 Budget Act package (SB 22, Chapter 3, Sixth Extraordinary Session of 2010) (SB6X 22) makes changes to the retirement formula for state employees hired after January 15, 2011. Generally, the formula for receiving full retirement benefits will be restored to the provisions in effect prior to 1999, when a law increased the percentage formula and reduced the age at which employees could obtain maximum benefits; these formulas vary depending on the category of employment. SB6X 22 also recognized that these reforms of the pension formula for future employees had been agreed to by some state employee bargaining units prior to enactment of the law. SB6X 22 also addressed the problem of pension "spiking" by generally requiring the retirement formula for future employees to be based on an average of pay in three consecutive years, rather than being based on the single highest year's pay (for those not currently in the three year formula). While these reforms will only start to impact state retirement costs many years in the future, there will be current savings by requiring existing and future employees to contribute a greater percentage, ranging from 2 to 5 percent, of their salaries toward future pension benefits.

Finally, separate legislation, SB 867 (Chapter 733, Statutes of 2010) will require CalPERS to submit to the Legislature, Governor and Treasurer certain reports when it adopts the contribution rate for state payments to the System. The Treasurer will be required to evaluate and report to the Legislature his or her opinion regarding these report.

CalPERS

CalPERS administers the Public Employees' Retirement Fund (PERF), which is a multiple employer defined benefit plan. In addition to the state, employer participants, as of June 30, 2009, included 1,458 school districts and 1,568 public agencies. As of June 30, 2009, PERF had 1,134,397 active and inactive program members and 492,513 benefit recipients. The projected payroll for state employees covered by PERF for fiscal year 2009-10 was approximately \$17.4 billion.

The actuarial assumptions used in determining actuarial liabilities and required employer contributions include both economic and non-economic assumptions. These assumptions represent the actuary's best estimate of anticipated future experience and are reviewed in depth periodically. The

current economic assumptions include assumed inflation of 3.0 percent compounded annually, investment return (net of administrative and investment expenses) of 7.75 percent per year, compounded annually, and annual payroll increases of 3.25 percent. CalPERS has indicated it will reconsider the discount rate it uses in February 2011. Reductions in the discount rate assumption could result in significant increases to required contributions.

Required contributions to PERF are determined annually on an actuarial basis and solely by CalPERS. Payments into PERF are made from employer contributions (including the state) and employee contributions. State contributions are made from the General Fund, Special Funds, and non-governmental cost funds. Table 12 shows the state's actual contributions to PERF for fiscal years 2005-06 through 2009-10 and estimated contributions for fiscal year 2010-11. Approximately 57 percent of the state contributions to PERF are made from the General Fund.

TABLE 12
State Contribution To
Public Employees' Retirement Fund
Fiscal Years 2005-06 To 2010-11

(Dollars In Thousands)

Fiscal Year	Amount
2005-06	\$2,402,846
2006-07	2,765,107
2007-08	2,999,455
2008-09	3,063,009
2009-10	2,860,787
2010-11 ^(a)	3,769,000

^(a) Estimated contributions.

Source: State of California, Department of Finance, June 21, 2010 (Past Year Schedule 10s).

Employees, except those participating in the non-contributory, second tier plan contribute to PERF based upon required contribution rates. Approximately 6 percent of the employees participate in the second tier plan, and these employees generally receive lower pension benefits.

The following table is a summary of additions and deductions from PERF for the five fiscal years shown. These figures reflect activity for all employers, including the state.

TABLE 13
Public Employees' Retirement Fund
Schedule Of Additions And Deductions

(Dollars In Millions)^(a)

	Fiscal Year Ended June 30,				
	2005	2006	2007	2008	2009
Contributions: Employer	\$5,774	\$6,095	\$6,442	\$7,243	\$6,912
Contributions: Employee	3,177	3,081	3,263	3,512	3,882
Total Contributions	\$8,951	\$9,176	\$9,705	\$10,755	\$10,795
Net Investment Income/(Losses) (including Appreciation)	21,894	22,041	40,748	(12,499)	(57,367)
Total Additions	30,845	31,217	50,462	(1,738)	(46,569)
Total Deduction (Benefits Paid and Administrative Expenses)	(8,798)	(9,657)	(10,530)	(11,469)	(12,446)
Net Assets as of the Beginning of the Fiscal Year	167,584	189,631	211,191	251,123	237,915
Net Assets as of the End of the Fiscal Year	189,631	211,191	251,123	237,915	178,900
Change in Net Assets	\$22,047	\$21,560	\$39,932	\$ (13,207)	\$ (59,016)

^(a) Totals may not add up due to adjustments.

Source: CalPERS Comprehensive Annual Financial Reports, Fiscal Years Ended June 30, 2005, 2006, 2007, 2008 and 2009.

The State and Schools Actuarial Valuation for the year ended June 30, 2009 uses the Market Value of Assets (“MVA”) basis to report the funded status of the system rather than the Actuarial Value of Assets (“AVA”) basis. CalPERS is monitoring the funded status of the plan using the MVA to ensure that the new rate stabilization methods do not impair the security of benefits. The MVA funded ratios are more volatile than the actuarial funded ratios due to the smoothing effects of the actuarial value. Using the MVA basis in times when returns are profitable gives the perception of a larger funded status. However, a much lower funded status will be shown if the market slows down and returns decline. The AVA is used for rate setting purposes because it maintains some consistency over fluctuating markets through rate smoothing.

The state contributes an amount equal to the sum of the normal cost and amortization of the unfunded actuarial accrued liability, if any. Actuarial valuations of the PERF are released in the summer of each calendar year and based on data through June 30 of the preceding fiscal year. The most recent actuarial valuation of CalPERS, based on data through June 30, 2009, showed an accrued unfunded liability allocable to state employees of \$23.450 billion on an actuarial value of assets basis (“AVA”) and \$48.648 billion on a market value of assets basis (“MVA”). The actuarial valuation for PERF was based upon an assumed 7.75 percent investment return. According to CalPERS, the weighted rates of return experienced by PERF over the past 20 years, 10 years, 5 years, and 3 years (in each case through fiscal year 2008-09) has been 7.4 percent, 2.3 percent, 1.6 percent, and -4.9 percent, respectively.

The following table is a schedule of funding projections of the PERF with respect to the state’s covered payroll. Actuarial information is provided on an MVA and AVA basis for each year and is based upon an actuarial valuation performed as of the end of such fiscal year.

For the six month period ended December 31, 2009, CalPERS experienced a net investment gain of 12.57 percent.

TABLE 14
Public Employees' Retirement Fund
Schedule Of Funding Projections (State Only)

(Dollars In Millions)

	Fiscal Year Ended June 30,				
	2005	2006	2007	2008	2009
Market Value of Assets (MVA)	\$74,050	\$81,968	\$96,988	\$91,349	\$68,179
Actuarial Value of Assets (AVA)	\$71,830	\$77,143	\$83,439	\$89,304	\$93,377
Actuarial Accrued Liabilities					
(AAL)-entry age	86,595	92,557	100,352	107,642	116,827
Excess of Market Value of Assets over AAL					
or Surplus (Unfunded) Actuarial Accrued					
Liabilities (UAAL) MVA Basis	(12,545)	(10,589)	(3,364)	(16,293)	(48,648)
Excess of Actuarial Value of Assets over AAL					
or Surplus (Unfunded) Actuarial Accrued					
Liabilities (UAAL) AVA Basis	(14,765)	(15,414)	(16,913)	(18,338)	(23,450)
Covered Payroll	12,935	13,299	14,571	15,890	16,333
Funded Ratio (MVA)	85.5 %	88.6%	96.6%	84.9%	58.4%
Funded Ratio (AVA)	82.9%	83.4%	83.1%	83.0%	79.9%

Source: CalPERS State and Schools Actuarial Valuation, Fiscal Year Ended June 30, 2005, 2006, 2007, 2008 and 2009.

Because of the rate stabilization methods adopted by the Board in April 2005 and in December 2009, the impact of current market returns, and in particular, the fiscal year 2008-09 investment loss, on employer rates for the future will be mitigated. Except as described below, when CalPERS sets rates, the actuarial value of assets cannot be more than 120 percent of the market value or less than 80 percent of the market value. Any asset value changes outside these ranges will result in a greater impact on future employer contribution rates.

As of June 30, 2007, CalPERS had set aside approximately 14 percent of the market value of the fund as a reserve. The negative 5.1 percent return for fiscal year 2007-08 used up all but 1 percent of the 14 percent set aside for the "rainy day" fund. The remaining 1 percent was used in developing employer contribution rates for the 2009-10 fiscal year. Therefore, the reserve is no longer available. It is important to note that, as described in CalPERS Comprehensive Annual Financial Report for the Fiscal Year Ended June 30, 2009, in recent years, the demographic experience of most plans translated to increases in employer rates.

CalPERS' rate stabilization methods help to mitigate short term increases in the state's required annual contribution. While this will limit extreme increases in the state's required annual contribution to CalPERS in the near term, absent extraordinary investment returns (over and above the 7.75 percent assumed by CalPERS), it is expected to result in significantly higher required contributions in future fiscal years. Depending on actual investment returns and other factors, the state's required annual contribution (which is estimated to be \$3.8 billion for fiscal year 2010-11) could increase by 50 percent or more.

Although the investment horizon for pension plans is long term, CalPERS recognizes that investment returns over the short term fluctuate and can lead to volatile employer contribution rates, despite the current smoothing policy in place. Announced in December 2009, CalPERS has implemented an enhancement to their current rate stabilization method, which will utilize a 3-year phase-in of the negative 24 percent fiscal year 2008-09 investment loss.

According to CalPERS, the 3-year phase-in of the fiscal year 2008-09 investment loss is achieved by temporarily relaxing the constraints on the smoothed value of assets. Previously, the actuarial value of assets could not be more than 120 percent of the market value or less than 80 percent of the market value. Under the 3-year phase in, assets are treated as follows:

1. For fiscal year 2011-12, the actuarial value of assets cannot be more than 140 percent of the market value or less than 60 percent of the market value on June 30, 2009.
2. For fiscal year 2012-13, the actuarial value of assets cannot be more than 130 percent of the market value or less than 70 percent of the market value on June 30, 2010.
3. For fiscal year 2013-14, the actuarial value of assets cannot be more than 120 percent of the market value or less than 80 percent of the market value on June 30, 2011, a return to the previous values.

Lastly, the asset loss outside of the 80 percent – 120 percent will be isolated, and paid down with a fixed and certain 30 year amortization schedule. By utilizing a fixed and certain 30 year payment schedule, these losses will be paid in full at the end of 30 years, and will be independent of any investment gain/loss experienced by the remaining portfolio as a whole.

The level of future required contributions depends on a variety of other factors, including future investment portfolio performance, actuarial assumptions and additional potential changes in retirement benefits. There can be no assurances that the required annual contribution to CalPERS will not continue to significantly increase, despite the recent enhancement to rate stabilization methods, and that such increases will not materially adversely affect the financial condition of the state.

CalSTRS

CalSTRS administers the Teachers' Retirement Fund, which is an employee benefit trust fund created to administer the State Teachers' Retirement Plan ("STRP"). STRP is a cost-sharing, multi-employer, defined benefit pension plan that provides retirement, disability, and survivor benefits for teachers and certain other employees of the California public school system. STRP is comprised of three programs: the Defined Benefit Program ("DB Program"), the Defined Benefit Supplement Program ("DBS Program"), and the Cash Balance Benefit Program. Within the DB Program there is also a Supplemental Benefits Maintenance Account ("SBMA") which provides purchasing power protection for retired members. Actuarial valuations of the DB program are released each year based on data through June 30 of the preceding fiscal year. As of June 30, 2009, the DB Program had approximately 1,745 contributing employers. According to CalSTRS, as of June 30, 2009, the DB Program had 615,216 active and inactive program members and 232,617 benefit recipients.

The state's General Fund contributions to the DB Program and the SBMA are established by statute, and are not adjusted to reflect actual investment returns or other factors which affect the funded status of the DB Program and SBMA. The contribution rate to the DB Program is currently 2.017 percent of teacher payroll for the fiscal year ending in the immediately preceding calendar year. The contribution rate to the SBMA is 2.5 percent of teacher payroll for the fiscal year ending in the immediately preceding calendar year less \$66.4 million in fiscal year 2008-09, \$70 million in fiscal year 2009-10, \$71 million in fiscal year 2010-11, and \$72 million thereafter.

The following table shows the state's contributions to CalSTRS for fiscal years 2005-06 through 2009-10 and its estimated contributions for fiscal year 2010-11.

TABLE 15
State Contribution To CalSTRS
Fiscal Years 2005-06 To 2010-11

(Dollars In Thousands)

Fiscal Year	DB Program	SBMA
2005-06	\$499,697	\$581,367
2006-07	360,182	598,391
2007-08	501,416	621,501
2008-09	535,614	597,474
2009-10	563,110	627,955
2010-11 ^(a)	567,707	632,653

^(a) Estimated.

Source: State of California, Department of Finance. (Past Year Schedule 10s) for 2005-06 to 2007-08. CalSTRS transfer letter to State Controller's Office for 2008-09 and 2009-10.

The following table is a summary of additions and deductions from the DB Program for the five fiscal years shown. These figures reflect activity for all employers, as well as the state's contribution.

TABLE 16
California State Teachers' Retirement System Defined Benefit Program
Schedule Of Additions And Deductions

(Dollars In Millions)^(a)

	Fiscal Year Ended June 30,				
	2005	2006	2007	2008	2009
Contributions: Employer	\$ 2,105	\$ 2,204	\$2,286	\$2,453	\$2,464
Contributions: Employee	2,327	2,231	2,335	2,512	2,501
Contributions: State ^(b)	1,219	1,019	1,084	1,630	1,140
Total Contributions	\$ 5,650	\$ 5,454	\$5,705	\$6,595	\$6,105
Net Investment Income/(Losses) (including Appreciation)	14,138	16,078	29,840	(9,655)	(40,358)
Total Additions	\$19,779	\$21,531	\$35,546	\$(2,847)	\$(34,245)
Total Deduction (Benefits Paid and Administrative Expenses)	(6,317)	(6,842)	(7,380)	(8,033)	(8,823)
Net Assets as of the Beginning of the Fiscal Year	116,061	129,524	144,212	172,378	161,498
Net Assets as of the End of the Fiscal Year	129,524	144,212	172,378	161,498	118,430
Change in Net Assets	\$13,462	\$14,689	\$28,166	\$(10,880)	\$(43,068)

^(a) Totals may not add up due to adjustments.

^(b) Includes federal funds.

Source: CalSTRS, Comprehensive Annual Financial Reports, Fiscal Year Ended June 30, 2005, 2006, 2007, 2008 and 2009.

Each employer contributes 8.25 percent of payroll, while employees generally contribute 6 percent of pay to the DB Program (and an additional 2 percent of pay to the DBS Program). The most recent actuarial valuation of the DB Program, based on data through June 30, 2009, showed an actuarial accrued unfunded liability of \$40.5 billion. Actuarial valuations as of June 30, 2010 are expected to be available by April 2011. The actuarial valuation of the DB Program is based upon an assumed 8 percent investment return. The average net rate of return experienced by the DB Program over the past 10 years and 5 years (in each case through fiscal year 2009-10) was 2.5 percent and 2.1 percent, respectively.

The actuarial assumptions used in determining actuarial liabilities and required employer contributions include both economic and non-economic assumptions. These assumptions represent the actuary's best estimate of anticipated future experience and are reviewed in depth periodically. The current economic assumptions for the DB Program include assumed inflation of 3.25 percent compounded annually, investment return (net of administrative and investment expenses) of 8.00 percent per year, compounded annually, and annual payroll increases of 4.25 percent. The current economic assumptions for the SBMA Program include assumed inflation of 3.25 percent compounded annually, investment return (net of administrative and investment expenses) of 8.00 percent per year, compounded annually, and annual payroll increases of 4.25 percent. At its December meeting, the CalSTRS board will be evaluating whether to reduce its assumptions on investment return, wage and price inflation. The net effect of reduced investment return and inflation assumptions will generally result in increased required contributions.

The following table is a schedule for funding projections for the DB Program for the five fiscal years shown. Actuarial information is based upon actuarial valuations performed as of the end of such fiscal year. Actuarial valuations as of June 30, 2010, are expected to be available by April 2011.

TABLE 17
California State Teachers' Retirement System Defined Benefit Program
Schedule Of Funding Projections

(Dollars In Millions)

	Fiscal Year Ended June 30,				
	2005	2006	2007	2008	2009
Actuarial Value of Assets	\$121,882	\$131,237	\$146,419	\$155,215	\$145,142
Actuarial Obligation	142,193	150,872	167,129	177,734	185,683
Unfunded Actuarial Obligation	\$(20,311)	\$(19,635)	\$(20,710)	\$(22,519)	\$(40,541)
Covered Payroll	23,293	24,263	26,202	27,384	27,550
Funded Ratio	86%	87%	88%	87%	78%

Source: CalSTRS Defined Benefit Program Actuarial Valuation as of June 30, 2005, 2006, 2007, 2008 and 2009.

On September 28, 2010, the Chief Executive Officer of CalSTRS sent a letter to Governor Schwarzenegger pursuant to which he transmitted the June 30, 2009 actuarial valuation for the benefit programs that comprise the state teachers' retirement plan (the "CalSTRS Letter"). The CalSTRS letter noted that the unfunded liability for the DB Program (described above) was approximately \$40.5 billion. The CalSTRS Letter also stated that:

"To amortize this unfunded liability over 30 years will require an increase in contributions equal to 14 percent of the total compensation paid to CalSTRS members each year; an increase initially equal to \$3.8 billion annually and increasing thereafter. This projection was based on an assumption that CalSTRS would earn eight percent in its investments each year, and that inflation would equal 3.25 percent annually...."

"Unlike other California retirement systems, the Teachers' Retirement Board has no authority to set the rates of contribution that fund the program; those contribution rates are set by statute enacted by the Legislature and approved by the Governor. Although the contributions paid have generally complied with the requirements of those statutes, the amount contributed has been less than the amount needed to fully fund the retirement program in accordance with Government Accounting Standards Boards standards since 2002.

The projected 14 percent contribution rate increase would amortize the fund over 30 years only if it was enacted immediately by the entire amount. The board recognizes that immediately increasing contributions by that amount would put a severe strain on already stressed state and local budgets and that required increases in contributions might be deferred for a period of time, and implemented gradually. Nonetheless, it is important that the state, as the sponsor of the State Teachers' Retirement Plan, recognize its obligation to provide an actuarially sound retirement system to those Californians who have so admirably served our state. If the state fails to address this funding shortfall, the assets of the DB Program will be depleted by 2044. At that time the state would be required to pay, each year, the difference between the amount contributed and the amount paid in benefits. While that might suggest that the state has many years to implement a solution, the longer the state delays implementing a solution, the more expensive it will be to fully fund the program. It may reach the point that the cost of a funding solution could become unaffordable to the state."

As previously noted, the state's contribution to CalSTRS is established in statute, and is not adjusted to reflect actual investment returns or other factors which affect the funded status of the DB Program and SBMA . The Administration does not concur with CalSTRS' assertion that the state is ultimately responsible to address any funding shortfall. Further, there are a number of ways to address the unfunded liability including increased employer and employee contributions.

Academic Studies of Pension Obligations

There have been a number of published studies concerning public pension obligations of states and local governments. One recent study from Stanford University's Institute for Economic Policy Research (which was prepared at the request of Governor Schwarzenegger), analyzed the potential for significant financial risk to the state due to the funding status of the systems, using different investment and other assumptions. The Stanford study states that as of July 1, 2008, CalPERS had unfunded liabilities of \$239.7 billion and a funding ratio 49.9 percent when using a risk-free discount rate of 4.14 percent. The study also states as of July 1, 2008, CalSTRS had unfunded liabilities of \$156.7 billion and a funding ratio of 50.8 percent when using the same risk-free discount rate. In addition, a study from Northwestern University's Kellogg School of Management looks at pension benefit payments relative to asset levels and contributions. Using a different approach to project benefit payments relative to assets, this study concludes that California's three pension systems (presumably including the University of California), in the aggregate, will be depleted in the year 2030.

CalPERS and CalSTRS both disagreed with the findings in the Stanford study and the Northwestern study, generally stating that the studies utilized inappropriate assumptions (including, in particular, unrealistically low long term investment return assumptions) and methodologies, in light of the long term nature of the respective system's obligations. In addition, the basis upon which CalSTRS and CalPERS currently disclose their assets and liabilities are in compliance with accounting standards adopted by the Government Accounting Standards Board.

Other Post-Employment Benefits (OPEB)

The state also provides post-employment health care and dental benefits to its employees and their spouses and dependents, when applicable, and recognizes these costs on a "pay-as-you-go" basis. The following table illustrates the state's budget for post-employment benefits from fiscal years 2005-06 to 2010-11 and does not reflect any future liability for current employees or annuitants. It is anticipated that these costs will continue to grow in the future.

As of June 30, 2009, approximately 141,900 retirees were enrolled to receive health benefits and 116,400 to receive dental benefits. The employer contribution for health premiums maintains the average 100/90 percent contribution formula established in the Government Code. Under this formula, the state averages the premiums of the four largest health benefit plans in order to calculate the maximum amount the state will contribute toward the retiree’s health benefits. The state also contributes 90 percent of this average for the health benefits of each of the retiree’s dependents. Employees vest for this benefit after serving 10 years with the state. With 10 years of service credit, employees are entitled to 50 percent of the state’s full contribution. This rate increases by 5 percent per year and with 20 years of service, the employee is entitled to the full 100/90 formula.

TABLE 18
Budget For Other Post-Employment Benefits
Fiscal Years 2005-06 Through 2010-11

(Dollars In Thousands)

Fiscal Year	Amount
2005-06	\$ 895,197
2006-07	1,019,368
2007-08	1,139,495
2008-09	1,200,955
2009-10	1,187,213
2010-11	1,393,549

Source: Budget Acts of 2005, 2006, 2007 and 2008. Figures shown for fiscal years 2009-10 and 2010-11 are estimates and included in the 2010 Budget Act.

Table 18 displays the “pay-as-you-go” contributions from all funding sources for health and dental benefits through fiscal year 2010-11.

Pursuant to the Governmental Accounting Standard Board Statement No. 45, Accounting and Financial Reporting by Employers for Postemployment Benefits Other Than Pensions (“Statement No. 45”), the state now reports on its liability for post-employment healthcare as well as other forms of post-employment benefits, such as life insurance, in its annual financial reports. The long-term costs for other post-employment benefits may negatively affect the state’s financial reports and impact its credit rating if the state does not adequately manage such costs.

On February 9, 2010, the State Controller’s Office released the state’s latest OPEB actuarial valuation report by the private actuarial firm, Gabriel, Roeder, Smith & Company, tasked with calculating the state’s liability for these benefits. The report was based on a variety of data and economic, demographic and healthcare trend assumptions described in the report. The actuarial valuation contained in the report covers the cost estimates for existing employees and retirees. The main objective of the report was to estimate the Actuarial Accrued Liability (“AAL”), which is the present value of future retiree healthcare costs attributable to employee service earned in prior fiscal years.

The report looked at three different scenarios: (i) continuation of the “pay-as-you-go” policy; (ii) a “full funding” policy under which assets would be set aside to prepay the future obligations, similar to the way in which pension obligations are funded, and (iii) a “partial funding” policy, a hybrid of the two scenarios. According to the actuarial valuation as of June 30, 2009, the current pay-as-you-go funding policy results in an AAL of \$51.82 billion, an annual OPEB cost of \$3.93 billion, estimated employer contributions of \$1.44 billion and an expected net OPEB obligation of \$7.18 billion for fiscal year 2009-10.

The key factors contributing to the \$864 million change in actuarial liabilities from the previous valuation report include:

- Healthcare claims grew at a rate lower than the assumed trend rate, resulting in a decrease in actuarial liabilities of approximately \$1.03 billion.
- Demographic experience (more members retiring earlier and living longer than assumed) caused actuarial liabilities to increase by \$601 million.
- Changes in assumptions and methods (updating the aging factors and healthcare trend rates used to project the member's average healthcare claim costs after retirement) increased actuarial liabilities by \$1.29 billion.

The valuation depended primarily on the interest discount rate assumption used to develop the present value of future benefits and on the assets available to pay benefits. The discount rate represents the long-term expectation of the earnings on the state's General Fund, which is invested in short-term securities in the Pooled Money Investment Account. The State Controller's Office plans to issue an actuarial valuation report annually.

On October 1, 2009, the Governor signed legislation that provides for prefunding OPEB for California Highway Patrol (CHP) officers, including cadets, and supervisors, and managers. The contributions for prefunding OPEB were effective July 1, 2009 (at 1 percent of pay increasing to 2 percent on July 1, 2010), and are deposited in an account in the California Employers' Retiree Benefits Trust. This contribution will be temporarily redirected to pensions until July 1, 2013 due to contract agreements reached in fiscal year 2010-11 (this redirection does not currently apply to CHP supervisors and managers). Contract agreements reached in 2010-11 with the International Union of Operating Engineers (Bargaining Unit 12) and the Union of American Physicians and Dentists (Bargaining Unit 16) included employee contributions of 0.5 percent of pay to prefund OPEB starting July 1, 2012. Additionally, Bargaining Unit 12 agreed to a revised vesting schedule for retiree health benefits for new employees hired after January 1, 2011. Under the revised schedule those employees will have to work for 25 years to qualify for 100 percent of state coverage of premium and 15 years to qualify for 50 percent coverage (the current schedule is 20 years and 10 years, respectively).

THE BUDGET PROCESS

General

The state's fiscal year begins on July 1 and ends on June 30 of the following year. The state's General Fund Budget operates on a legal basis, generally using a modified accrual system of accounting for its General Fund, with revenues credited in the period in which they are measurable and available and expenditures debited in the period in which the corresponding liabilities are incurred.

The annual budget is proposed by the Governor by January 10 of each year for the next fiscal year (the "Governor's Budget"). Under state law and constitution, the annual proposed Governor's Budget cannot provide for projected expenditures in excess of projected revenues for the ensuing fiscal year. Following the submission of the Governor's Budget, the Legislature takes up the proposal. As required by the Balanced Budget Amendment ("Proposition 58") and as described below, beginning with fiscal year 2004-05, the Legislature may not pass a budget bill in which General Fund expenditures exceed estimated General Fund revenues and beginning fund balances at the time of the passage and as set forth in the budget bill.

Under the State Constitution, money may be drawn from the State Treasury only through an appropriation made by law. The primary source of annual expenditure appropriations is the annual Budget Act as approved by the Legislature and signed by the Governor. Pursuant to Proposition 25, enacted on November 2, 2010, and effective immediately, the Budget Act (or other appropriation bills and “trailer bills” which are part of a budget package) must be approved by a majority vote of each House of the Legislature. (This was a reduction from a requirement for a two-thirds vote.) The Governor may reduce or eliminate specific line items in the Budget Act or any other appropriations bill without vetoing the entire bill. Such individual line-item vetoes are subject to override by a two-thirds majority vote of each House of the Legislature.

Appropriations also may be included in legislation other than the Budget Act. Continuing appropriations, available without regard to fiscal year, may also be provided by statute or the State Constitution.

Funds necessary to meet an appropriation are not required to be in the State Treasury at the time an appropriation is enacted; revenues may be appropriated in anticipation of their receipt.

Constraints on the Budget Process

Over the years, a number of laws and constitutional amendments have been enacted, often through voter initiatives, which have increased the difficulty of raising state taxes, restricted the use of the state’s General Fund or special fund revenues, or otherwise limited the Legislature and the Governor’s discretion in enacting budgets. Historic examples of provisions that make it more difficult to raise taxes include Proposition 13, passed in 1978, which, among other things, required that any change in state taxes enacted for the purpose of increasing revenues collected pursuant thereto, whether by increased rates or changes in computation, be approved by a two-thirds vote in each house of the Legislature. Examples of provisions restricting the use of General Fund revenues are Proposition 98, passed in 1988, which mandates that a minimum amount of General Fund revenues be spent on local education, and Proposition 10, passed in 1998, which raised taxes on tobacco products and mandated how the additional revenues would be expended. See “STATE FINANCES – Proposition 98 and K-14 Funding” and “ – Sources of Tax Revenue – Taxes on Tobacco Products.”

Constitutional amendments approved by the voters have also affected the budget process. These include Proposition 58, approved in 2004, which requires the adoption of a balanced budget and restricts future borrowing to cover budget deficits; Proposition 49, approved in 2002, which requires the expansion of funding for before and after school programs; Proposition 63, approved in 2004, which imposes a surcharge on taxable income of more than \$1 million and earmarks this funding for expanded mental health services; Proposition 1A, approved in 2004, which limits the Legislature’s power over local revenue sources, and Proposition 1A approved in 2006, which limits the Legislature’s ability to use sales taxes on motor vehicle fuels for any purpose other than transportation. Most recently, Propositions 22 and 26, approved on November 2, 2010, will further limit the state’s fiscal flexibility.

These approved constitutional amendments are described below.

Balanced Budget Amendment (Proposition 58)

Proposition 58, approved by the voters in 2004, requires the state to enact a balanced budget, and establish a special reserve and restricts certain future borrowing to cover fiscal year end deficits. As a result of the provisions requiring the enactment of a balanced budget and restricting borrowing, the state would in some cases have to take more immediate actions to correct budgetary shortfalls. Beginning with the budget for fiscal year 2004-05, Proposition 58 requires the Legislature to pass a balanced budget and

provides for mid-year adjustments in the event that the budget falls out of balance and the Governor calls a special legislative session to address the shortfall. The balanced budget determination is made by subtracting estimated expenditures from all resources expected to be available, including prior-year balances.

If the Governor determines that the state is facing substantial revenue shortfalls or spending increases, the Governor is authorized to declare a fiscal emergency. He or she would then be required to propose legislation to address the emergency, and call the Legislature into special session for that purpose. If the Legislature fails to pass and send to the Governor legislation to address the fiscal emergency within 45 days, the Legislature would be prohibited from: (i) acting on any other bills or (ii) adjourning in joint recess until such legislation is passed.

Proposition 58 also requires that a special reserve BSA be established. The BSA is funded by annual transfers of specified amounts from the General Fund, unless suspended or reduced by the Governor or until a specified maximum amount has been deposited. A constitutional amendment which would strengthen the BSA is going to be submitted to voters on the June 2012 election ballot. See “STATE FINANCES – Budget Reserves – Proposed Strengthening of Reserve Funds.”

Proposition 58 also prohibits the use of general obligation bonds, revenue bonds, and certain other forms of borrowing to cover fiscal year end budget deficits. The restriction does not apply to certain other types of borrowing, such as: (i) short-term borrowing to cover cash shortfalls in the General Fund (including revenue anticipation notes or revenue anticipation warrants currently used by the state), or (ii) inter-fund borrowings.

Local Government Finance (Proposition 1A of 2004)

As described under “STATE FINANCES – Local Governments,” Senate Constitutional Amendment No. 4 (also known as “Proposition 1A of 2004”), approved by the voters in the November 2004 election, amended the State Constitution to, among other things, reduce the Legislature’s authority over local government revenue sources by placing restrictions on the state’s access to local governments’ property, sales, and vehicle license fee revenues as of November 3, 2004. Beginning with fiscal year 2008-09, the state is able to borrow up to 8 percent of local property tax revenues, but only if the Governor proclaims such action is necessary due to a severe state fiscal hardship and two-thirds of both houses of the Legislature approve the borrowing. The amount borrowed is required to be paid back within three years. The state also will not be able to borrow from local property tax revenues for more than two fiscal years within a period of 10 fiscal years. In addition, the state cannot reduce the local sales tax rate or restrict the authority of local governments to impose or change the distribution of the statewide local sales tax.

The provisions of Proposition 1A allowing the state to borrow money from local governments from time to time have been suspended by Proposition 22 of 2010, which permanently prohibits any future such borrowing.

Proposition 1A also prohibits the state from mandating activities on cities, counties or special districts without providing for the funding needed to comply with the mandates. Beginning in fiscal year 2005-06, if the state does not provide funding for the mandated activity, the requirement on cities, counties or special districts to abide by the mandate is suspended. In addition, Proposition 1A expands the definition of what constitutes a mandate on local governments to encompass state action that transfers to cities, counties and special districts financial responsibility for a required program for which the state previously had partial or complete financial responsibility. The state mandate provisions of Proposition 1A do not apply to schools or community colleges or to mandates relating to employee rights.

Proposition 1A further requires the state to reimburse cities, counties, and special districts for mandated costs incurred prior to fiscal year 2004-05 over a term of years. Chapter 72, Statutes of 2005 (AB 138) requires the payment of mandated costs incurred prior to fiscal year 2004-05 to begin in fiscal year 2006-07 and to be paid over a term of 15 years. The 2010 Budget Act defers payment of these claims and refinances the balance owed over the remaining payment period. The remaining estimated cost of claims for mandated costs incurred prior to fiscal year 2004-05 is approximately \$950 million.

The Amended 2009 Budget Act authorized the state to exercise its Proposition 1A borrowing authority. This borrowing generated \$1.998 billion that was used to offset state General Fund costs for a variety of court, health, corrections, and K-12 programs. The enabling legislation also created a securitization mechanism for local governments to sell their right to receive the state's payment obligations to a local government-operated joint powers agency (JPA). This JPA sold bonds in an aggregate amount of \$1.895 billion in November 2009 to pay the local agencies their property tax allocations when they otherwise would receive them. Pursuant to Proposition 1A of 2004, the state is required to repay the local government borrowing (which in turn will be used to repay the bonds of the JPA) no later than June 15, 2013. The 2010 Budget Act includes \$90.8 million for the interest payments that will be incurred in fiscal year 2010-11 to be paid from the General Fund.

After School Education Funding (Proposition 49)

An initiative statute, Proposition 49, called the "After School Education and Safety Program Act of 2002," was approved by the voters on November 5, 2002, and required the state to expand funding for before and after school programs in the state's public elementary, middle and junior high schools. The increase was first triggered in fiscal year 2006-07, which increased funding for these programs to \$550 million. These funds are part of the Proposition 98 minimum funding guarantee for K-14 education and, in accordance with the initiative, expenditures can only be reduced in certain low revenue years. See "STATE FINANCES – Proposition 98 and K-14 Funding."

Mental Health Services (Proposition 63)

On November 2, 2004, the voters approved Proposition 63, the Mental Health Services Act, which imposes a 1 percent tax surcharge on taxpayers with annual taxable income of more than \$1 million for purposes of funding and expanding mental health services. Proposition 63 prohibits the Legislature or the Governor from redirecting funds now used for mental health services to other purposes or from reducing General Fund support for mental health services below the levels provided in fiscal year 2003-04. Additionally, Chapter 20, Statutes of 2009 makes allowable administrative changes to Proposition 63 to streamline and make more efficient administrative processes and clarifies the role of the Mental Health Services Oversight and Accountability Commission.

Transportation Financing (Proposition 1A of 2006)

On November 7, 2006, voters approved Proposition 1A of 2006, which had been placed on the ballot by the Legislature as Senate Constitutional Amendment No. 7, to protect Proposition 42 transportation funds from any further suspensions. Provisions of the State Constitution enacted as Proposition 42 in 2002, permitted the suspension of the annual transfer of motor vehicle fuel sales tax revenues from the General Fund to the Transportation Investment Fund if the Governor declared that the transfer would result in a "significant negative fiscal impact" on the General Fund and the Legislature agreed with a two-thirds vote of each house. The new measure modified the constitutional provisions of Proposition 42 in a manner similar to Proposition 1A of 2004, so that if such a suspension were to have occurred, the amount owed by the General Fund would have had to be repaid to the Transportation Investment Fund within three years, and only two such suspensions could have been made within any

10-year period. In fiscal year 2003-04, \$868 million of the scheduled Proposition 42 transfer was suspended, and in fiscal year 2004-05 the full transfer of \$1.258 billion was suspended. Budget Acts for fiscal years 2006-07, 2007-08, 2008-09 and 2009-10 all fully funded the Proposition 42 transfer and partially repaid the earlier suspensions. Chapter 11, Statutes of 2010, in the Eighth Extraordinary Session eliminated the General Fund sales tax on gasoline that funded the Proposition 42 Transfer, and replaced it with increased fuel excise tax revenues that go directly to local governments for road maintenance and to the State Highway Account for highway maintenance and rehabilitation projects. However, the 2010 Budget Act still includes \$83 million to repay a portion of past suspensions. See “AMENDED 2009 BUDGET ACT.” Proposition 22, described below, overturns the tax “swap” made in Chapter 11.

November 2010 Initiatives

Two initiative measures approved by the voters on the November 2, 2010 ballot affect the budget process described previously in Appendix A.

Proposition 22 – Local Government Funds

This measure, called the “Local Taxpayer, Public Safety and Transportation Protection Act of 2010,” supersedes some parts of Proposition 1A of 2004, prohibits any future action by the Legislature to take, reallocate or borrow money raised by local governments for local purposes, and prohibits changes in the allocation of property taxes among local governments designed to aid state finances. The Proposition 1A borrowing done in 2009 is grandfathered. In addition, superseding Proposition 1A of 2006, the state is prohibited from borrowing sales taxes or excise taxes on motor vehicle fuels or changing the allocations of those taxes among local governments except pursuant to specified procedures involving public notices and hearings. Any law enacted after October 29, 2009 inconsistent with Proposition 22 is repealed. Passage of this measure eliminates an estimated \$850 million in General Fund relief in fiscal year 2010-11, an amount which would have grown to over \$1 billion by fiscal year 2013-14. The inability of the state to borrow or redirect property tax or redevelopment funds will reduce the state’s flexibility in reaching budget solutions in the future. The state has used these actions for several billion dollars of solutions in some recent years.

Proposition 26 – Increases in Taxes or Fees

This ballot measure revises provisions in Articles XIII A and XIII C of the Constitution dealing with tax increases. The measure specifies that a two-thirds vote of both houses of the Legislature is required for any increase in any tax on any taxpayer, eliminating the current practice where a tax increase coupled with a tax reduction is treated as being able to be adopted by majority vote. Furthermore, any increase in a fee beyond the amount needed to provide the specific service or benefit is deemed a tax requiring two-thirds vote. Finally, any tax or fee adopted after January 1, 2010 with a majority vote which would have required a two-thirds vote if Proposition 26 were in place would be repealed after one year from the election date unless readopted by the necessary two-thirds vote. Passage of this measure is expected to have the same impact on transportation related taxes as Proposition 22.

PRIOR FISCAL YEARS’ BUDGETS

Fiscal Years Prior to 2007-08

Following a half decade of strong economic and revenue growth in the late 1990s and into 2000, during fiscal year 2001–02, as the state and national economies fell into a recession and the stock markets dropped significantly, the state experienced an unprecedented drop in revenues compared to the prior year largely due to reduced personal income taxes from stock option and capital gains activity. During the

three fiscal years between 2001-02 and 2003-04, the state encountered severe budgetary difficulties because of reduced revenues and failure to make equivalent reductions in expenditures, resulting in successive budget deficits. The budgets for these years included substantial reliance on one-time measures, internal borrowing, and external borrowing. The state also faced a cash flow crisis during this period which was relieved by the issuance of RAWs in June 2002 and June 2003 and ERBs in the spring of 2004. See “STATE INDEBTEDNESS AND OTHER OBLIGATIONS.”

The state’s economy rebounded strongly during the 2004-05, 2005-06 and 2006-07 fiscal years, with the result that General Fund revenues were substantially higher in each year than had been projected at the start of the year. This allowed the budgets in these years to end with substantial positive balances (although the positive balance declined from approximately \$9.9 billion at the end of fiscal year 2005-06 to approximately \$3.5 billion at the end of fiscal year 2006-07). The state continued to utilize a combination of expenditure cuts, cost avoidance, internal and external borrowing, fund shifts, and one-time measures such as securitization of tobacco settlement revenues and sale of ERBs, to produce balanced budgets. The 2005 Budget Act had much less reliance on one-time measures than the budgets of the immediately preceding years, but did include receipt of \$525 million from refinancing of tobacco securitization bonds.

Final estimates relating to the 2006-07 fiscal year, as released in the 2007-08 Governor’s Budget in January 2008, showed that the state experienced more favorable results than were projected at the time the 2006 Budget Act was signed. As a result of revised estimates for years prior to fiscal year 2005-06 and improved economic results which generated increases in tax revenues, the Administration estimated that the fund balance at June 30, 2006 was about \$3.487 billion, of which \$3.0 billion was in the SFEU, compared to the original 2006 Budget Act estimate of \$1.6 billion in the SFEU.

Additional information about prior fiscal years’ budgets for this period can be obtained from prior official statements of state bonds.

2007 Budget Act

The 2007 Budget Act was adopted by the Legislature on August 21, 2007, along with a number of implementing measures, and signed by the Governor on August 24, 2007. In approving the budget the Governor vetoed \$943 million in appropriations from the General Fund, Special Funds, and bond funds (including \$703 million in General Fund appropriations).

The 2007 Budget Act included the largest reserve of any budget act in the state’s history, a total of \$4.1 billion. The reserve was made so large because the 2007 Budget Act contained a number of risks. By the time of the 2008-09 Governor’s Budget, released on January 10, 2008, it had become clear that many of these risks had in fact occurred, and that even the planned reserve would not be enough to keep the budget in balance through June 30, 2008. Accordingly, the Governor called a special session of the Legislature which took a series of actions to close the budget gap, and the Governor took certain additional actions not requiring legislative action.

Under the 2007 Budget Act as originally enacted, General Fund revenues and transfers were projected to increase 6.0 percent, from \$95.5 billion in fiscal year 2006-07 to \$101.2 billion in fiscal year 2007-08. The 2007 Budget Act contained General Fund appropriations of \$102.3 billion, compared to \$101.7 billion in fiscal year 2006-07. The June 30, 2008 total reserve was projected to be \$4.1 billion. See “STATE FINANCES – Budget Reserves – Budget Stabilization Account” for an explanation of the budgetary reporting method for revenues.

2008 Budget Act

After an extended delay, the 2008 Budget Act was adopted by the Legislature on September 16, 2008, along with a number of implementing measures, and signed by the Governor on September 23, 2008. In approving the budget, the Governor vetoed \$714 million in appropriations from the General Fund, Special Funds, and bond funds (including \$510 million in General Fund appropriations).

The 2008 Budget Act as originally enacted, resolved the \$17.3 billion budget deficit (after implementation of the \$7.0 billion in actions taken during the February 2008 fiscal emergency special session of the Legislature) identified in the 2008-09 May Revision. It provided a modest reserve of \$1.7 billion for fiscal year 2008-09, but projected a deficit of \$1.0 billion in fiscal year 2009-10.

Under the 2008 Budget Act as originally enacted, General Fund revenues and transfers were projected to decrease 1.0 percent, from \$103.0 billion in fiscal year 2007-08 to \$102.0 billion in fiscal year 2008-09. The 2008 Budget Act contained General Fund appropriations of \$103.4 billion, compared to \$103.3 billion in fiscal year 2007-08. The June 30, 2009 total reserve was projected to be \$1.7 billion, a decrease of \$1.4 billion or 45 percent compared to the June 30, 2008 reserve. See “STATE FINANCES – Budget Reserves – Budget Stabilization Account” for an explanation of the budgetary reporting method for revenues. The February 2009 Budget Package made major changes to the 2008 Budget Act. See Table 19 for the fiscal year 2008-09 estimated General Fund budget summary.

The 2008 Budget Act as originally enacted, contained the following major General Fund components:

1. Addressing the Deficit – The 2008 Budget Act resolved the \$17.3 billion budget deficit for the combined 2007-08 and 2008-09 fiscal years identified in the 2008-09 May Revision (after implementation of the \$7.0 billion in actions taken during the February 2008 fiscal emergency special session of the Legislature described below) and provided a modest reserve of \$1.7 billion for fiscal year 2008-09 in part via \$8.0 billion in expenditure reductions which account for 46 percent of all solutions. As a result of these reductions, this budget intended to hold General Fund spending to virtually no growth in fiscal year 2008-09, \$103.4 billion in fiscal year 2008-09 compared to \$103.3 billion in fiscal year 2007-08. Additional solutions included \$8.4 billion in revenue increases, \$700 million in borrowing, and a reduction in the reserve of \$306 million. The following were the major elements of the \$8.4 billion revenue increase: Corporate Penalty for Understatement of Tax (\$1.510 billion), Net Operating Loss Suspension and Carryback (\$1.265 billion), Tax Credit Limitation and Usage Modification (\$615 million), Limited Liability Corporations Payment Date Change (\$360 million), Accelerated Estimated Payments (\$1.270 billion), Remove Estimated Payment Option for High Income Taxpayers (\$1.035 billion), and Accrual Change (\$1.856 billion). See “STATE FINANCES – Sources of Tax Revenue.” The 2008 Budget Act also contained transfers and loans of \$855 million to the General Fund from various Special Funds; savings of \$340 million from the delay in enactment of the 2008 Budget Act and an Executive Order by the Governor reducing the use of certain part-time state employees; use of \$500 million of sales taxes on gasoline to offset certain General Fund costs associated with transportation activities; and \$200 million of certain other one-time budgetary actions. Of the \$24.3 billion budget deficit identified in the 2008-09 May Revision, \$7.0 billion (including the \$3.313 billion issuance of Economic Recovery Bonds) of the deficit was addressed in February 2008 during a Fiscal emergency special session.

2. Cash Flow Management – Under the 2008 Budget Act, the Legislature approved a plan to improve cash management to smooth cash flow imbalances and to reduce the amount of external borrowing the state needed to meet its cash needs in fiscal year 2008-09. To smooth out the cash flow imbalances, certain payments for the following programs were shifted during the year: Education (K-12,

excluding Child Development), the University of California, Community Colleges, the Williamson Act, and Citizens' Option for Public Safety/Juvenile Justice Crime Prevention Act. The plan was intended to reduce the amount of external borrowing by \$3 billion to \$4 billion in fiscal year 2008-09, and was expected to result in savings of tens of millions of dollars, depending on interest rates and external borrowing issuance timing.

3. Proposition 98 – The Proposition 98 Guarantee for fiscal year 2008-09 was projected to grow to \$58.1 billion, which is \$1.3 billion above the 2008-09 May Revision. The 2008 Budget Act appropriates \$58.1 billion, of which \$41.9 billion is from the General Fund and \$16.1 billion is from local revenue. See “STATE FINANCES – Proposition 98 and K-14 Funding.”

4. K-12 Education – Total expenditures from all sources for K-12 education programs in fiscal year 2008-09 were projected to be \$71.9 billion (\$42 billion General Fund). This reflected an increase of \$3.4 billion over the 2008-09 Governor's Budget. Total per-pupil expenditures were projected to increase by \$110 to \$12,152 in fiscal year 2008-09 compared with the fiscal year 2007-08 level, which includes funds provided for prior year settle-up obligations.

5. Higher Education – The 2008 Budget Act reflected a total funding level of \$20.7 billion, including \$14.2 billion from General Fund and Proposition 98 sources for all major segments of Higher Education (excluding infrastructure and stem cell research) after budget-balancing reductions and other policy reductions. This reflected an increase of \$751.3 million (including \$386 million from General Fund and Proposition 98 sources) above the revised 2007-08 level.

6. Health and Human Services – The 2008 Budget Act included \$31 billion from General Fund for Health and Human Services programs, which is an increase of \$1.6 billion from the revised fiscal year 2007-08 estimate. Total funding from all state funds for Health and Human Services programs was \$39.4 billion. The major General Fund workload adjustments included the following: (a) an increase of \$556.7 million in the CalWORKs program, primarily due to depletion of federal funding that has historically been carried over from year to year; (b) an increase of \$187.7 million for health programs and an increase of \$52.5 million for human services programs attributable to enrollment, caseload, and population driven changes; (c) an increase of \$169.8 million for required managed care rate adjustments; and (d) an increase of \$22.4 million for statutorily required COLAs for Skilled Nursing Facilities. The 2008 Budget Act reflected expenditure reductions due to policy adjustments, including (a) \$985.8 million from reducing provider payment rates in the Medi-Cal program; (b) \$313.3 million for fully suspending the June 2008 and June 2009 state COLAs from the Supplemental SSI/SSP program; (c) \$171.9 million from fully suspending the July 2008 COLA for the CalWORKs program; and (d) \$22.5 million from placing limitations on the rates managed care plans pay to non-contract hospitals for emergency care services in the Medi-Cal program.

7. Transportation Funding – The 2008 Budget Act included \$1.42 billion to fully fund Proposition 42 in fiscal year 2008-09. Proposition 1A was passed in November 2006 and provides for the repayment of any remaining Proposition 42 debt by the fiscal year 2015-16. Pursuant to Proposition 1A, the 2008 Budget Act repays \$83 million from the fiscal years 2003-04 and 2004-05 Proposition 42 suspensions. Because the issuance of tribal gaming bonds continues to be delayed, the Governor's Budget proposed to use the \$100 million in tribal gaming compact revenues received in fiscal year 2008-09 until the bonds are sold, to repay past loans made from the State Highway Account and the Traffic Congestion Relief Fund. Proposition 1B was also passed in November 2006, providing \$19.9 billion in bonding authority for a total of 16 programs intended to address a broad range of transportation priorities including rehabilitation and expansion of highways, transit and transit security, port security, and air quality. The authority for the use of any bond funds must be provided for in the Budget Act. The 2008 Budget Act appropriated \$4.7 billion in Proposition 1B funding. The 2008 Budget

Act also appropriated \$1.5 billion in General Fund relief from sales tax revenues, including revenues from the “spillover” (the amount that gasoline sales tax revenues at the 4.75 percent rate exceed the amount generated from sales tax on all other goods at the 0.25 percent rate). Of this amount, \$593 million was redirected from local transit grants through the State Transit Assistance program to reimburse the General Fund for its Home-to-School Transportation and state special schools costs out of the Public Transportation Account. Additionally, the remaining \$939 million was redirected from both local transit grants and state capital projects to reimburse the General Fund for debt service payments made on transportation bonds in past years.

8. Budget Stabilization Account – Under normal circumstances, the state would set aside \$1.509 billion for fiscal year 2008-09 in the BSA for rainy day purposes. Given the \$24.3 billion budget deficit, the 2008 Budget Act suspended this transfer to the BSA for the 2008-09 fiscal year.

Subsequent Developments. Since the enactment of the 2008 Budget Act, economic conditions in the state worsened considerably from projections, as described under “STATE FINANCIAL PRESSURE.” The 2009-10 Governor’s Budget projected that the state would end fiscal year 2008-09 with no reserve, compared to the original estimate of \$1.7 billion at the time of the 2008 Budget Act. Subsequent projections prepared in connection with the Initial 2009 Budget Act estimated a total reserve deficit on June 30, 2009 of \$3.4 billion, down \$5.1 billion from the 2008 Budget Act estimate.

Given the dramatic decline in General Fund revenues and the emergence of a \$41.6 billion combined current and budget year General Fund gap, the Governor called three special sessions of the Legislature on November 6, December 1, and December 19, 2008 to take actions on various budget items in order to reduce expenditures in fiscal year 2008-09 and address the state’s cash shortage. The Legislature passed on February 19, 2009 and the Governor signed on February 20, 2009, the Initial 2009 Budget Act that addressed the combined deficit of \$41.6 billion in fiscal years 2008-09 and 2009-10. See “STATE FINANCIAL PRESSURE” and “AMENDED 2009 BUDGET ACT.”

As the recession deepened throughout the spring, revenues continued to erode and the budget had again fallen out of balance. On July 1, 2009 the Governor declared a fiscal emergency and called a special session of the Legislature to solve the new \$24.3 billion deficit. The Legislature passed on July 24, 2009 and the Governor signed on July 28, 2009 the Amended 2009 Budget Act.

Under the Amended 2009 Budget Act, General Fund expenditures for fiscal year 2008-09 were projected at \$91.5 billion, a decrease of \$11.9 billion compared with 2008 Budget Act estimates. This primarily included a decrease of \$10.4 billion in expenditure reductions offset by, among other things, \$2.8 billion of federal stimulus funds and \$1.5 billion in increased taxes.

The following table shows the estimated General Fund Budget Summary for fiscal year 2008-09 as originally projected by the 2008 Budget Act, as subsequently revised by the 2009-10 Governor's Budget, and as further revised by the Amended 2009 Budget Act.

Budget Summary for Fiscal Year 2008-09

TABLE 19
2008-09 Estimated General Fund Budget Summary

(Dollars In Millions)

	As of 2008 Budget Act (September 16, 2008)	As of 2009-10 Governor's Budget (December 31, 2008)	As of Amended 2009 Budget Act (July 28, 2009)
Prior Year Resources Available	\$3,999 ^(a)	\$2,375 ^(a)	\$4,071 ^(a)
Revenues and Transfers	101,991	91,117	84,097
Expenditures	103,401	92,413	91,547
Fund Balance	\$2,589	\$1,079	\$(3,379)
Reserve for Liquidation of Encumbrances	\$885	\$1,079	\$1,079
Special Fund for Economic Uncertainties	\$1,703	--	\$(4,458)
Budget Stabilization Account	--	--	--
Total Available Reserve	\$1,703	--	\$(4,458)

^(a) Includes a carry-over adjustment of \$1.34 billion from amnesty-related payments, of which \$960 million will have to be refunded or will reduce revenues in future years, including a \$250 million adjustment in fiscal year 2008-09 and \$710 million in fiscal year 2009-10 or later.

Source: State of California, Department of Finance.

FINANCIAL STATEMENTS

The Audited Basic Financial Statements of the State of California for the Year Ended June 30, 2009 (the "Financial Statements") are available and incorporated by reference in this APPENDIX A. The Financial Statements consist of an Independent Auditor's Report, a Management Discussion and Analysis, Basic Financial Statements of the state for the Year Ended June 30, 2009 ("Basic Financial Statements"), and Required Supplementary Information. Only the Basic Financial Statements have been audited, as described in the Independent Auditor's Report. A description of the accounting and financial reporting standards set by the Governmental Accounting Standards Board and used in the Basic Financial Statements is contained in Note 1 of the Basic Financial Statements.

A copy of the Financial Statements may also be obtained or reviewed from the following sources:

1. By obtaining, from Municipal Securities Rulemaking Board's Electronic Municipal Market Access website or from any other source, a copy of the State of California's Official Statement dated March 11, 2010 for \$2,500,000,000 Various Purpose General Obligation Bonds. The Financial Statements are printed in full in such Official Statement. No other part of the March 11, 2010 Official Statement is incorporated into this document except the Financial Statements.

2. By accessing the internet website of the State Controller (www.sco.ca.gov), selecting “Publications,” “State Government Reports” and then selecting “State Government Annual Financial Reports,” or by contacting the Office of the State Controller at (916) 445-2636.

3. By accessing the internet website of the State Treasurer (www.treasurer.ca.gov) and under the heading “Bond Finance,” select “Public Finance Division” and then select “Recent Financial Information” or by contacting the Office of the State Treasurer at (800) 900-3873.

The State Controller issues a monthly report on General Fund cash receipts and disbursements. These reports are available on the State Controller’s website, and are normally released on the 10th day of every calendar month for the period ended on the last day of the prior month. The State Controller’s unaudited reports of General Fund cash receipts and disbursements for the period after June 30, 2009 are included as EXHIBIT 1 and EXHIBIT 2 to this APPENDIX A. The Controller’s cash report for October 2010 will be released on or about November 10, 2010, and will be included in the final Official Statement.

Periodic reports on revenues and/or expenditures during the fiscal year are issued by the Administration, the State Controller’s Office and the LAO. The Department of Finance issues a monthly bulletin, available by accessing the internet website of the Department of Finance (www.dof.ca.gov), which reports the most recent revenue receipts as reported by state departments, comparing those receipts to budget projections. The Administration also formally updates its budget projections three times during each fiscal year, in January, May, and at the time of budget enactment. These bulletins and reports are available on the internet at websites maintained by the agencies and by contacting the agencies at their offices in Sacramento, California. Such bulletins and reports are not part of or incorporated into this APPENDIX A. Investors are cautioned that interim financial information is not necessarily indicative of results for a fiscal year. Information which may appear in this APPENDIX A from the Department of Finance concerning monthly receipts of “agency cash” may differ from the State Controller’s reports of cash receipts for the same periods because of timing differences in the recording of in-transit items.

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INVESTMENT OF STATE FUNDS

Moneys on deposit in the State Centralized Treasury System are invested by the State Treasurer in the PMIA. As of September 30, 2010, the PMIA held approximately \$45.7 billion of state moneys, and \$21.7 billion invested for about 2,778 local governmental entities through the Local Agency Investment Fund (“LAIF”). The assets of the PMIA as of September 30, 2010 are shown in the following table.

TABLE 20
Analysis Of Pooled Money Investment Account Portfolio^(a)

(Dollars In Thousands)

<u>Type of Security</u>	<u>Amount</u>	<u>Percent of Total</u>
U.S. Treasuries	\$31,467,668	46.57%
Federal Agency Debentures	1,086,062	1.61
Certificates of Deposit	7,190,000	10.64
Bank Notes	200,000	0.30
Federal Agency Discount Notes	5,731,359	8.48
Time Deposits	4,226,650	6.26
GNMAs	65	0.00
Commercial Paper	6,571,530	9.73
FHLMC/REMICs	600,821	0.89
AB 55 Loans	301,517	0.45
General Fund Loans	9,881,700	14.63
Other	<u>300,000</u>	<u>0.44</u>
Total	\$67,557,372	100.00%

^(a) Totals may not add due to rounding.

Source: State of California, Office of the State Treasurer.

The State’s Treasury operations are managed in compliance with the California Government Code and according to a statement of investment policy which sets forth permitted investment vehicles, liquidity parameters and maximum maturity of investments. The PMIA operates with the oversight of the PMIB. The LAIF portion of the PMIA operates with the oversight of the Local Agency Investment Advisory Board (consisting of the State Treasurer and four other appointed members).

The PMIA does not now invest, nor has it ever invested, in Structured Investment Vehicles (“SIVs”) or Collateralized Debt Obligations (“CDOs”). In keeping with full transparency of the PMIA portfolio performance, the PMIA’s holdings are displayed quarterly on the State Treasurer’s website and may be accessed under PMIB Quarterly Reports. The PMIA does not currently invest in auction rate securities.

The State Treasurer does not invest in leveraged products or inverse floating rate securities. The investment policy permits the use of reverse repurchase agreements subject to limits of no more than 10 percent of the PMIA. All reverse repurchase agreements are cash matched either to the maturity of the reinvestment or an adequately positive cash flow date which is approximate to the maturity of the reinvestment.

The average life of the investment portfolio of the PMIA as of September 30, 2010 was 185 days.

OVERVIEW OF STATE GOVERNMENT

Organization of State Government

The State Constitution provides for three separate branches of government: the legislative, the judicial and the executive. The Constitution guarantees the electorate the right to make basic decisions, including amending the Constitution and local government charters. In addition, the state voters may directly influence state government through the initiative, referendum and recall processes. The Constitution provides for mechanisms through which it may be amended or revised.

California's Legislature consists of a forty-member Senate and an eighty-member Assembly. Assembly members are elected for two-year terms, and Senators are elected for four-year terms. Assembly members are limited to three terms in office and Senators to two terms. The Legislature meets almost year round for a two-year session. The Legislature employs the Legislative Analyst, who provides reports on state finances, among other subjects. The Bureau of State Audits, headed by the State Auditor, an independent office since 1993, annually issues an auditor's report based on an examination of the General Purpose Financial Statements of the State Controller, in accordance with generally accepted accounting principles. See "FINANCIAL STATEMENTS."

The Governor is the chief executive officer of the state. The Governor presents the annual budget and traditionally presents an annual package of bills constituting a legislative program. In addition to the Governor, state law provides for seven other statewide elected officials in the executive branch. The Governor and the other statewide officials may be elected for up to two four-year terms. The current elected statewide officials, their party affiliation and the dates on which they were first elected are as follows:

<u>Office</u>	<u>Name</u>	<u>Party Affiliation</u>	<u>First Elected</u>
Governor	Arnold Schwarzenegger	Republican	2003
Lieutenant Governor	Abel Maldonado*	Republican	2010
Controller	John Chiang	Democrat	2006
Treasurer	Bill Lockyer	Democrat	2006
Attorney General	Edmund G. Brown Jr.	Democrat	2006
Secretary of State	Deborah Bowen	Democrat	2006
Superintendent of Public Instruction	Jack O'Connell	Democrat	2002
Insurance Commissioner	Steve Poizner	Republican	2006

* Appointed to fill the remaining term of the previous Lieutenant Governor, who resigned to take a seat in Congress.

Based on preliminary results from the general election on November 2, 2010, the statewide officers will be as follows starting on January 3, 2011:

Office	Name	Party Affiliation	First Elected
Governor	Edmund G. Brown Jr.	Democrat	2010*
Lieutenant Governor	Gavin Newsom	Democrat	2010
Controller	John Chiang	Democrat	2006
Treasurer	Bill Lockyer	Democrat	2006
Attorney General	[undecided]**		2010
Secretary of State	Deborah Bowen	Democrat	2006
Superintendent of Public Instruction	Tom Torlakson	Democrat	2010
Insurance Commissioner	Dave Jones	Democrat	2010

* Previously served two terms as Governor 1975-83, prior to term limit law.

**Ballots are still being counted between Kamala D. Harris (D) and Steve Cooley (R).

The executive branch is principally administered through eighteen major agencies and departments: Business, Transportation and Housing Agency, Department of Corrections and Rehabilitation, Office of the Secretary of Education, Environmental Protection Agency, Department of Finance, Department of Food and Agriculture, Health and Human Services Agency, Labor and Workforce Development Agency, Natural Resources Agency, Office of the State Chief Information Officer, Secretary of Service and Volunteering, State and Consumer Services Agency, Department of Veterans Affairs, Emergency Management Agency, Arts Council, Office of the Inspector General, Military Department, and State Public Defender. In addition, some state programs are administered by boards and commissions, such as The Regents of the University of California, Public Utilities Commission, Franchise Tax Board and California Transportation Commission, which have authority over certain functions of state government with the power to establish policy and promulgate regulations. The appointment of members of boards and commissions is usually shared by the Legislature and the Governor, and often includes ex officio members.

Higher Education

California has a comprehensive system of public higher education comprised of three segments: the University of California, the California State University System and California Community Colleges. The University of California provides undergraduate, graduate and professional degrees to students. Approximately 61,434 degrees were awarded in the 2009-10 school year. Approximately 233,930 full-time students were enrolled at the ten University of California campuses and the Hastings College of Law in the 2009-10 school year. (The newest campus, at Merced, opened to graduate students in 2004 and to undergraduates in the fall of 2005.) The California State University System (CSU) provides undergraduate and graduate degrees to students. Approximately 95,070 degrees were awarded in the 2009-10 school year. The CSU estimates that about 354,811 full-time students were enrolled at the 23 campuses in the 2009-10 school year. The third sector consists of 110 campuses operated by 72 community college districts, which provide associate degrees and certificates to students. Additionally, students may attend community colleges to meet basic skills and other general education requirements prior to transferring to a four-year undergraduate institution. About 134,331 associate degrees and certificates were awarded in the 2009-10 school year. More than 1.7 million students were enrolled in California Community Colleges in the spring of 2010.

Employee Relations

According to the Department of Personnel Administration, as of November 30, 2009, the state work force was comprised of approximately 359,000 personnel years (“PYs”), of which approximately 122,000 PYs represented state employees of the legislative and judicial branches of government, and institutions of higher education. Of the remaining 237,000 PYs, approximately 193,000 were subject to collective bargaining and approximately 44,000 were excluded from collective bargaining. State law provides that state employees, defined as any civil service employee of the state and teachers under the jurisdiction of the Department of Education or the Superintendent of Public Instruction, and excluding certain other categories, have a right to form, join, and participate in the activities of employee organizations for the purpose of representation on all matters of employer-employee relations. Once a bargaining unit selects an employee organization, only that organization can represent those employees.

The scope of representation is limited to wages, hours, and other terms and conditions of employment. Representatives of the Governor are required to meet and confer in good faith and endeavor to reach agreement with the employee organization and, if an agreement is reached, to prepare a memorandum of understanding and present it to the Legislature for ratification. The Governor and the recognized employee organization are authorized to agree mutually on the appointment of a mediator for the purpose of settling any disputes between the parties, or either party could request the Public Employment Relations Board to appoint a mediator.

There are 21 collective bargaining units that represent state employees. The Service Employees International Union (“SEIU”) is the exclusive representative for 9 of the 21 collective bargaining units, or approximately 50 percent of those represented employees subject to collective bargaining. The International Union of Operating Engineers is the exclusive representative for 2 of the 21 collective bargaining units. The remaining bargaining units each have their own exclusive representative.

Of the 21 bargaining units, 15 have contracts recently approved by the Legislature; however, 10 of the 15 have yet to be ratified by their membership. Bargaining Unit 9, engineers represented by the Professional Engineers in California Government, has been without a contract since July 2008. Bargaining Units 7, (safety employees represented by the California Statewide Law Enforcement Association), 10 (scientists represented by the California Association of Professional Scientists), and 13 (stationary engineers represented by the International Union of Operating Engineers) have been without a contract since June 2008. Bargaining Unit 2, represented by the California Attorneys, Administrative Law Judges, and Hearing Officers in State Employment, has been without a contract since June 30, 2007. Bargaining Unit 6, correctional officers represented by the California Correctional Peace Officers Association, has been without a contract since July 2, 2006.

As part of the Amended 2009 Budget Act and pursuant to Executive Orders S-16-08 and S-13-09, the state implemented three furlough days per month from July 1, 2009 through June 30, 2010 for all state civil service employees with the exception of those in Bargaining Unit 5 (patrol officers represented by the California Association of Highway Patrolmen), Highway Patrol Dispatchers, the Bureau of State Audits, the Legislative Counsel Bureau, and the Department of Forestry and Fire Protection. Furloughs resulted in savings of \$2.2 billion (\$1.2 billion General Fund) in fiscal year 2009-10. The elimination of two holidays (Lincoln’s Birthday and Columbus Day) and premium pay for hours worked on all remaining holidays as of February 2009 resulted in savings of \$76.6 million (\$74.5 million General Fund) in fiscal year 2009-10. The revised methodology of calculating overtime based on actual time worked (excludes leave from overtime calculations), also implemented in February 2009, resulted in savings of \$56.5 million (\$48 million General Fund) in fiscal year 2009-10. In addition, as a part of the 2010 Budget Act the following savings are estimated to be achieved:

- \$932.4 million (\$579.6 million General Fund) through a 5 percent reduction in personal services costs.
- \$521.1 million (\$239.6 million General Fund) from collectively bargained contracts agreed to by unions representing 15 of the 21 state bargaining units.
- \$256.3 million (\$125.8 million General Fund) for administratively established compensation adjustments for excluded employees.
- \$645.2 million (\$382.5 million General Fund) for three furlough days per month for rank and file employees in the 6 bargaining units that have not reached a contract agreement with the Administration.

Major provisions of the contracts, recently passed pension reform legislation, and administratively established compensation adjustments for excluded employees include:

- A rollback of the expansion of pension benefits adopted in SB 400 (1999) for new hires.
- Increased employee pension contributions ranging from 2 to 5 percent for all current and future employees with the exception of rank and file employees in bargaining units without a contract.
- A one day per month unpaid personal leave program for 12 months, which equates to a 4.62 percent reduction in salaries, for Bargaining Units 12, 16, 18, 19, the 9 SEIU bargaining units, and excluded employees.
- Restructured pay scales that add a top step of 2 to 5 percent for Bargaining Units 5, 8, 18 (psychiatric technicians represented by the California Association of Psychiatric Technicians), and 19 (health and social services employees represented by the American Federation of State, County, and Municipal Employees) in 2012 and an increase of 3 percent for the 9 SEIU bargaining units and excluded employees in 2013.
- Continuous appropriation of any funds necessary to pay for the economic terms of the MOUs.
- Revision of the salary calculation for pension benefits to be based on the average salary of the three highest concurrent years instead of the current single-highest-year for all future employees not already under this formula.
- Protection from furloughs for Bargaining Units 5, 8, 18, and 19 for the duration of their MOUs.
- Protection from furloughs during the 12 months the Personal Leave Program for the 9 SEIU bargaining units and excluded employees.
- Revised premium pay policies so that employees earn time-and-a-half instead of straight time when working on 6 of 11 state holidays for Bargaining Units 12, 16, 18, 19, and the 9 SEIU bargaining units.
- Two professional development days per year for the 9 SEIU bargaining units and excluded employees.

- Employee contributions of 0.5 percent of base salary towards prefunding other post employment retirement benefits for Bargaining Units 12 and 16 beginning July 1, 2012.

Subsequent to the 2010-11 May Revision, the Administration has entered into tentative contract agreements with representatives of Bargaining Units 5 (CAHP representing 6,660 employees), 8 (California Department of Forestry Firefighters representing 4,280 employees), 18 (California Association of Psychiatric Technicians representing 6,543 employees), and 19 (American Federation of State, County and Municipal Employees representing 5,407 employees). These tentative agreements still require ratification by union members and the Legislature. Provisions of the contracts include:

- Reduced pension benefits for new hires (Bargaining Units 5, 8, 18, and 19);
- Increased pension contributions for existing employees of 2 percent, 4 percent, 5 percent, and 5 percent for Bargaining Units 5, 8, 18, and 19, respectively;
- Restructured pay scales that add a top step of 2 percent, 4 percent, 5 percent, and 5 percent for Bargaining Units 5, 8, 18, and 19, respectively in 2012;
- Revision of the salary calculation for pension benefits to be based on the average salary of the three-highest-years for new employees instead of the current single-highest-year (Bargaining Units 5 and 8);
- Protection from furloughs and from minimum wage when a budget is not signed by July 1 (Bargaining Units 5, 8, 18, and 19);
- A one-day-per-month unpaid personal leave program during the 2010-11 fiscal year (Bargaining Units 18 and 19);
- Revised employer health care premium payment (Bargaining Unit 18);
- Use of leave time in calculating overtime (Bargaining Units 8 and 18);
- Revised premium pay policies so that employees earn time-and-a-half instead of straight time when working on 6 of 11 state holidays (Bargaining Units 18 and 19).

It is estimated that these contracts would save the state \$72 million (\$43 million General Fund) in fiscal year 2010-11. This generally represents a portion of the proposed savings put forth in the 2010-11 May Revision associated with increased pension contributions and the unpaid personal leave program.

ECONOMY AND POPULATION

Introduction

California's economy, the largest among the 50 states and one of the largest in the world, has major components in high technology, trade, entertainment, agriculture, manufacturing, tourism, construction and services. California followed the nation's path through the recession and into the recovery.. California labor markets deteriorated dramatically during the latter half of 2008 and the first six months of 2009, suffering their worst losses on record. Between June 2008 and June 2009, the state dropped nearly a million nonfarm jobs. These losses moderated as the year progressed and switched to very modest gains during each of the first five months of 2010. In subsequent months, the state lost jobs

due to the drawdown of temporary U.S. Census workers. See “CURRENT STATE BUDGET – Current Economic Conditions.”

Population and Labor Force

The state’s July 1, 2009 population of about 38.5 million represented over 12 percent of the total United States population. California is by far the most populous state in the nation, more than sixty percent larger than the second-ranked state according to the 2000 U.S. Census. California has grown about twice as rapidly as the national population during the last half of the 20th century, averaging about 27 percent growth for each decade between 1950 and 2000. Although California’s growth has slowed since the 1980s, it is still expected to be in the range of 1 to 1.3 percent annually through the next ten years. Population growth is expected to be about seventy percent due to natural increase (excess of births over deaths) and thirty percent due to net migration into the state.

Population growth in the next five years is expected to be largest in the 65-84 years of age category. The segment of the population under age 24 will have lower than statewide average growth, reflecting lower births in the state during the 1990s. The working age population will grow at about the same rate as the overall population.

California’s population is perhaps the most diverse in the nation. At the time of the 2000 Census, no single ethnic group constituted a majority of the population. It is estimated that within 10 years, Latinos will become the largest ethnic group in the state.

California’s population is concentrated in metropolitan areas. According to the findings of the 2000 census, 97 percent of the population of California resided in the 25 Metropolitan Statistical Areas in the state. As of July 1, 2009, the five-county Los Angeles area accounted for 41 percent of the state’s population, with over 18.5 million residents, and the nine-county San Francisco Bay Area represented nearly 20 percent, with a population of over 7.0 million.

The following table shows California’s population data for 2000 through 2009.

TABLE 21
Population 2000-2009

Year	California Population(a)	Increase Over Preceding Year (%)	United States Population(a)	Increase Over Preceding Year (%)	California as (%) of United States
2000	34,095,000	2.0%	282,171,957	1.1%	12.1%
2001	34,767,000	2.0	285,081,556	1.0	12.2
2002	35,361,000	1.7	287,803,914	1.0	12.3
2003	35,944,000	1.6	290,326,418	0.9	12.4
2004	36,454,000	1.4	293,045,739	0.9	12.4
2005	36,899,000	1.2	295,753,151	0.9	12.5
2006	37,275,000	1.0	298,593,212	1.0	12.5
2007	37,674,000	1.1	301,579,895	1.0	12.5
2008	38,134,000	1.2	304,374,846	0.9	12.5
2009	38,488,000	0.9	307,006,550	0.9	12.5

^(a) Population as of July 1.

Source: U. S. figures from U.S. Department of Commerce, Bureau of the Census; California figures from State of California, Department of Finance.

The following table presents civilian labor force data for the resident population, age 16 and over, for the years 2000 to 2009.

TABLE 22
Labor Force 2000-2009
(Thousands)

Year	Labor Force	Employment	Unemployment Rate (%)	
			California	United States
2000	16,858	16,024	4.9%	4.0%
2001	17,152	16,220	5.4	4.7
2002	17,344	16,181	6.7	5.8
2003	17,391	16,200	6.8	6.0
2004	17,444	16,355	6.2	5.5
2005	17,629	16,672	5.4	5.1
2006	17,821	16,948	4.9	4.6
2007	18,078	17,109	5.4	4.6
2008	18,392	17,060	7.2	5.8
2009	18,250	16,164	11.4	9.3

Source: State of California, Employment Development Department.

Employment, Income, Construction and Export Growth

The following table shows California's non-agricultural employment distribution and growth for 1999 and 2009.

TABLE 23
Payroll Employment By Major Sector
1999 And 2009
(Thousands)

Industry Sector	Employment		Distribution of Employment %	
	1999	2009	1999	2009
Trade, Transportation and Utilities	2,650.6	2,636.5	18.9%	18.7%
Government				
Federal Government	270.1	251.4	1.9	1.8
State and Local Government	1,969.3	2,246.0	14.1	16.0
Professional and Business Services	2,096.8	2,051.6	15.0	14.6
Educational and Health Services	1,370.9	1,740.2	9.8	12.4
Manufacturing				
Nondurable goods	647.0	482.7	4.6	3.4
High Technology	506.5	349.3	3.6	2.5
Other Durable Goods	673.2	448.9	4.8	3.2
Leisure and Hospitality	1,299.4	1,499.0	9.3	10.6
Financial Activities	804.6	797.1	5.8	5.7
Construction	684.9	620.1	4.9	4.4
Other Services	474.0	484.3	3.4	3.4
Information	518.3	446.8	3.7	3.2
Mining and Logging	26.3	25.7	0.2	0.2
TOTAL	13,991.8	14,079.3	100%	100%

Source: State of California, Employment Development Department.

The following tables show California's total and per capita income patterns for selected years.

TABLE 24
Total Personal Income In California 2000-2009^(a)
(Dollars In Millions)

Year	Total Personal Income	% Change ^(b)	California % of U.S.
2000	\$1,135,342	10.5%	13.3%
2001	1,168,723	2.9	13.2
2002	1,187,348	1.6	13.1
2003	1,232,981	3.8	13.2
2004	1,312,227	6.4	13.2
2005	1,387,661	5.7	13.2
2006	1,495,533	7.8	13.3
2007	1,568,257	4.9	13.2
2008	1,610,932	2.7	13.0
2009	1,572,650	-2.4	12.9

^(a) Revised estimates as of September 20, 2010.

^(b) Change from Prior Year.

Note: Omits income for government employees overseas.

Source: U.S. Department of Commerce, Bureau of Economic Analysis.

TABLE 25
Per Capita Personal Income
2000-2009^(a)

Year	California	% Change ^(b)	United States	% Change ^(b)	California % of U.S.
2000	\$33,398	8.9%	\$30,318	7.0%	110.2%
2001	33,890	1.5	31,145	2.7	108.8
2002	34,045	0.5	31,461	1.0	108.2
2003	34,977	2.7	32,271	2.6	108.4
2004	36,903	5.5	33,881	5.0	108.9
2005	38,767	5.1	35,424	4.6	109.4
2006	41,567	7.2	37,698	6.4	110.3
2007	43,291	4.1	39,458	4.7	109.7
2008	44,038	1.7	40,673	3.1	108.3
2009	42,548	-3.4	39,626	-2.6	107.4

^(a) Revised estimates as of September 20, 2010.

^(b) Change from prior year.

Note: Omits income for government employees overseas.

Source: U.S. Department of Commerce, Bureau of Economic Analysis.

The following tables show California's residential and non-residential construction.

TABLE 26
Residential Construction Authorized By Permits
2000-2009

(Dollars In Millions)

Year	Units			Valuation ^(a)
	Total	Single	Multiple	
2000	148,540	105,595	42,945	\$28,142
2001	148,757	106,902	41,855	28,804
2002	167,761	123,865	43,896	33,305
2003	195,682	138,762	56,920	38,968
2004	212,960	151,417	61,543	44,777
2005	208,972	155,322	53,650	47,138
2006	164,280	108,021	56,259	38,108
2007	113,034	68,409	44,625	28,621
2008	64,962	33,050	31,912	18,072
2009	36,421	25,454	10,967	12,037

^(a) In millions of dollars. Valuation includes additions and alterations.

Source: Construction Industry Research Board.

TABLE 27
Nonresidential Construction 2000-2009

(Dollars In Thousands)

Year	Commercial	Industrial	Other	Additions and Alterations	Total
2000	6,962,031	2,206,169	2,204,754	7,252,004	18,624,958
2001	6,195,368	1,552,047	2,584,321	6,421,551	16,753,287
2002	5,195,348	1,227,754	2,712,681	5,393,329	14,529,112
2003	4,039,561	1,320,222	2,954,039	5,601,117	13,914,939
2004	5,105,541	1,456,283	3,100,982	6,026,567	15,689,373
2005	5,853,351	1,693,373	3,818,100	6,900,709	18,265,533
2006	7,733,068	1,760,888	3,873,055	7,741,610	21,108,621
2007	8,812,083	1,450,875	3,496,471	8,782,424	22,541,853
2008	6,513,610	938,081	2,983,640	8,776,285	19,211,616
2009	1,919,763	359,868	1,984,534	6,602,103	10,866,268

Source: Construction Industry Research Board.

The following table shows changes in California’s exports for the period from 2000 through 2009.

TABLE 28
Exports Through California Ports 2000-2009

(Dollars In Millions)

Year	Exports(a)	% Change ^(b)
2000	148,554.6	21.7
2001	127,255.3	(14.3)
2002	111,340.1	(12.5)
2003	113,550.7	2.0
2004	123,039.2	8.4
2005	129,988.9	5.6
2006	147,823.8	13.7
2007	159,549.5	7.9
2008	170,594.2	6.9
2009	137,215.5	(19.6)

^(a) “Free along ship” value basis.

^(b) Change from prior year.

Source: U.S. Department of Commerce, Bureau of the Census.

LITIGATION

The state is a party to numerous legal proceedings. The following describes litigation matters that are pending with service of process on the state accomplished and have been identified by the state as having a potentially significant fiscal impact upon the state’s revenues or expenditures. See “LITIGATION” in the main body of the Official Statement. The state makes no representation regarding the likely outcome of these litigation matters.

The following description was developed by the state with the participation of the Office of the Attorney General and other state entities. The Office of Attorney General does not represent the state, its subdivisions, departments, agencies and other units in all litigation matters, and accordingly there may be litigation matters of which the Office of the Attorney General is not aware. The state does not conduct a docket search of federal or state court litigation filings to identify pending litigation and no inquiry has been made into pending administrative proceedings. There may be litigation and administrative proceedings with potentially significant fiscal impacts that have not been described below.

Budget-Related Litigation

Actions Challenging School Financing

In *Robles-Wong, et al. v. State of California* (Alameda County Superior Court, Case No. RG-10-515768) and *California Teachers Association (“CTA”) “Complaint in Intervention*, plaintiffs challenge the state’s “education finance system” as unconstitutional. Plaintiffs, consisting of 62 minor school children, various school districts, the California Association of School Administrators, the California School Boards Association and CTA, allege the state has not adequately fulfilled its constitutional obligation to support its public schools, and seek an order enjoining the state from continuing to operate and rely on the current financing system and to develop a new education system that meets constitutional standards as declared by the court. It is currently unknown what the fiscal impact of

this matter might be upon the General Fund. In a related matter, *Campaign for Quality Education et al. ("CQE") v. State of California* (Alameda County Superior Court, Case No. RG-10-524770), plaintiffs also challenge the constitutionality of the state's education finance system. An initial hearing on these matters is set for December 10, 2010.

Actions Challenging Governor's Line-Item Vetoes

One of two cases challenging the \$489 million in line-item vetoes the Governor made to the Amended 2009 Budget Act was resolved by the California Supreme Court, which upheld the vetoes, while the second case remains pending. In *St. John's Well Child and Family Center, et al. v. Schwarzenegger, et al.*, the Supreme Court issued a decision affirming the appellate court ruling that the vetoes were lawful (California Supreme Court, Case No.S181760). The second case, *Steinberg v. Schwarzenegger, et al.* (San Francisco County Superior Court, Case No. CPF-09-509721) was stayed pending resolution of the *St. John's* matter, with the stay to remain in effect until 30 days after the *St. John's* matter is final. Both actions maintained that because the Legislature only reduced existing appropriations in the budget revision bill without making any new appropriations, the Governor was not entitled to use his line-item veto power.

Action Challenging Reductions to Child Care Services

In *Parent Voices Oakland, et al. v. Jack O'Connell, et al.* (Alameda County Superior Court, Case No. RG-10-544021), an advocacy group and parents challenge the implementation of the Governor's veto of \$256 million from a program that provides subsidized child care services to low-income families who participated in the CalWORKS program, alleging the termination of services fails to comply with due process and applicable administrative procedures. Plaintiffs request that the court order the state to continue providing services pending compliance with appropriate procedures. On November 5, 2010, the trial court ordered a temporary stay of the terminations and required the state to provide new notices to recipients who are subject to termination that they may be screened for eligibility for other child care services. A further hearing is scheduled for November 23, 2010.

Action Challenging Proposed Sale of State Compensation Insurance Fund Assets

In *Poizner v. Genest, et al.* (Sacramento County Superior Court, Case No. 34-2009-80000310-CU-WM-GDS), the State Insurance Commissioner challenges the proposed sale of a portion of SCIF, a public enterprise providing workers' compensation insurance to California employers, asserting that the proposed sale would violate the California Constitution.

Action Challenging Budget Bill

In *Lord, et al. v. Schwarzenegger, et al.* (San Francisco County Superior Court, Case No. CPF-09-509770), petitioners are a correctional officer and the employee organization designated as the exclusive bargaining representative of the officer and other correctional law employees. Petitioners allege that a state budget implementation bill enacted in July 2009, A.B.X4 12, violated the provision of the California Constitution which requires that a statute embrace one subject expressed in its title. The bill included budget-related changes to statutes intended to reduce state expenses and increase state revenues, including deferral of payment of state employee compensation for the month of June 2010 from June 30 to July 1, authorization to sell a portion of SCIF's assets and liabilities, and elimination of a rural health care subsidy paid to the petitioner and other state employees. Petitioners sought a declaration that the bill was unconstitutional and void, and a ruling in this matter could have invalidated the entire bill. The trial court ruled the bill violated the Constitution, and it struck from the bill the provision eliminating the rural

health care subsidy program, leaving the remainder of the bill intact. Judgment has not yet been entered in the trial court.

Actions Challenging Required Contribution by Redevelopment Agencies

Petitioners in *California Redevelopment Association, et al. v. Genest, et al.* (Sacramento County Superior Court, Case No. 34-2009-80000359), challenge the constitutionality of legislation that required that local redevelopment agencies remit a total of \$1.7 billion in fiscal year 2009-10 and \$350 million in fiscal year 2010-11 to county education funds. Petitioners asked the trial court to enjoin implementation of the legislation. A second case challenging the constitutionality of this legislation and seeking to enjoin its implementation was filed by seven counties. *County of Los Angeles, et al. v. Genest, et al.* (Sacramento County Superior Court, Case No. 34-2009-80000362). The trial court denied the petitions in both matters, and petitioners in both matters appealed (Court of Appeal, Third Appellate District, Case Nos. C064907 and C065390). The appellate court denied petitioners' request in the *California Redevelopment Association* matter for a stay pending resolution of the appeal.

Actions Regarding Furlough of State Employees

In several cases, petitioners challenge the Governor's executive orders directing the furlough without pay of state employees. The first order, issued on December 19, 2008, directed furloughs for two days per month, effective February 1, 2009 through June 30, 2010. The second, issued on July 1, 2009, required a third furlough day per month, effective through June 30, 2010. On July 28, 2010, the Governor issued a new executive order requiring furloughs for three days per month beginning August 1, 2010, until a new 2010-11 fiscal year budget was adopted and the Director of the Department of Finance determined that the state had sufficient cash flow to pay for essential services.

On October 4, 2010, the California Supreme Court, ruling in three consolidated cases, upheld the validity of the two day per month furloughs implemented by the Governor's December 2008 order on the ground that the Legislature had ratified these furloughs in enacting the 2008 budget revision. *Professional Engineers in California Government ("PECG"), et al. v. Schwarzenegger, et al.* (California Supreme Court, Case No. S183411). The ruling affirmed a judgment rendered by the trial court in these three cases, which had challenged the furloughs. *PECG v. Schwarzenegger* (Sacramento County Superior Court, Case No. 34-2008-80000126-CU-WM-GDS); *California Attorneys, Administrative Law Judges and Hearing Officers in State Employment ("CASE") v. Schwarzenegger, et al.* (Sacramento County Superior Court, Case No. 34-2009-80000134-CU-WM-GDS); *Service Employees International Union, Local 1000 ("SEIU") v. Schwarzenegger, et al.* (Sacramento County Superior Court, Case No. 34-2009-80000135-CU-WM-GDS).

Three pending cases involve the application of the furlough order to employees of SCIF. In *CASE v. Schwarzenegger, et al.* (San Francisco County Superior Court, Case No. CPF-09-509205), the trial court ruled that the furlough order did not apply to attorneys employed by SCIF. The appellate court ruled against the state and upheld the trial court ruling (Court of Appeal, First Appellate District, Case No. A125292). This case is now before the California Supreme Court, which has set an expedited briefing schedule (California Supreme Court, Case No. S182581). In *SEIU v. Schwarzenegger, et al.* (San Francisco County Superior Court, Case No. CPF-09-509580), plaintiff challenged the order as applied to other SCIF employees based on SCIF's governing statutes which prohibit the state from "adjusting" its staffing levels. The trial court ruled that the furlough order did not apply to the SCIF employees, and on June 11, 2010, the Court of Appeal affirmed the trial court ruling (Court of Appeal, First Appellate District, Case No. A126525). The California Supreme Court granted review (California Supreme Court, Case No. S184629). In *International Union of Operating Engineers, Locals 3, 12, 39 and 501 v. Schwarzenegger, et al.* (San Francisco County Superior Court, Case No. CGC-09-492675),

plaintiffs are challenging the order as applied to other SCIF employees in different unions based on the SCIF governing statute.

In *California Association of Psychiatric Technicians (“CAPT”) v. Schwarzenegger, et al.* (Sacramento County Superior Court, Case No. 34-2009-80000148-CU-WM-GDS); and *CDF Firefighters v. Schwarzenegger, et al.* (Sacramento County Superior Court, Case No. 34-2009-00032732-CU-WM-GDS), petitioners challenge the furlough order as applied to their respective members. The trial court has dismissed the CAPT matter for failure to exhaust administrative remedies. *CASE v. Schwarzenegger, et al.* (San Francisco County Superior Court, Case No. CPF-09-509629) challenges the July 1, 2009 executive order implementing the third furlough day.

In *CCPOA v. Schwarzenegger, et al.* (Alameda County Superior Court, Case No. RG-09-441544), petitioner alleges that the furloughs violate Government Code 19826 because its members (correctional officers) cannot take their furlough days off during the same pay period in which their salaries are reduced because of operational needs. The trial court found in favor of CCPOA and directed the state to pay CCPOA members for all hours worked. The state filed a notice of appeal and the trial court’s order is stayed pending further briefing in the appellate court (Court of Appeal, First Appellate District, Case No. A127292).

In *Newton v. Schwarzenegger, et al.* (U.S. District Court, Northern District, Case No. 09-CV-05887 JCS), correctional officers allege that the self-directed furloughs violate the federal Fair Labor Standards Act.

In *California Professional Public Employees Association, et al. v. Schwarzenegger, et al.* (Sacramento County Superior Court, Case No. 34-2009-80000308), petitioners allege the state is violating Labor Code Section 212 by permitting some employees to “accrue furlough days.” The trial court ruled for the state. In *California Correctional Supervisor’s Organization (“CCSO”) v. California Department of Corrections and Rehabilitation, et al.* (Sacramento County Superior Court, Case No. 34-2009-00063209-CU-OE-GDS), plaintiff alleges that the furloughs violate the state Labor Code when correctional supervisors work furlough days but are not paid wages for those days during the same pay period. CCSO has dismissed this action.

Walker, et al. v. Schwarzenegger, et al. (Sacramento County Superior Court, Case No. 34-2009-80000150-CU-WM-GDS) alleges that the furlough order is invalid because it does not comply with state law requirements for promulgating regulations.

In *SEIU v. Schwarzenegger, et al.* (San Francisco County Superior Court, Case No. CPF-09-509782), petitioners allege the furloughs violate the state Emergency Services Act and undermine the Legislature’s budgetary authority.

In *CASE v. Schwarzenegger, et al.* (Alameda County Superior Court, Case No. RG-09-453982); *Union of American Physicians and Dentists (“UAPD”) v. Schwarzenegger, et al.* (Alameda County Superior Court, Case No. RG-09-456684); *SEIU v. Schwarzenegger, et al.* (Alameda County Superior Court, Case No. RG-09-456750); *California Association of Professional Scientists (“CAPS”), et al. v. Schwarzenegger, et al.* (San Francisco County Superior Court, Case No. CPF-09-509695); and *International Union of Operating Engineers (“IUOE”) v. Schwarzenegger, et al.* (Los Angeles County Superior Court, Case No. BC423409), the employee organizations allege that the Governor illegally furloughed employees who are paid from Special Funds because the deficit stems from General Fund deficiencies and therefore furloughing employees who are paid with Special Funds will not result in any benefit or cost savings. In the case brought by CAPS, the trial court ruled in favor the state, and CAPS appealed but has now voluntarily dismissed its appeal (Court of Appeal, First Appellate District, Case No.

A128427). In the matters brought by *CASE*, *UAPD* and *SEIU*, the trial court ruled in favor of the plaintiffs, finding the furloughs were improper, and final judgment was entered on February 25, 2010. The judgment applies to all employees of agencies sued in the three lawsuits, and includes an award of back pay. An appeal in these cases was filed by the state (Court of Appeal, First Appellate District, Case Nos. A127775, A127776, A127777), and the judgment was stayed due to the appeal. On March 24, 2010, the trial court judge lifted the stay with respect to the furloughs and ordered that furloughs cease with respect to the specially funded departments and agencies named in these cases. The portion of the judgment with respect to back pay remains stayed pending appeal. On March 29, 2010, the state requested the appellate court stay the trial court order with respect to ending the furloughs, and the appellate court has issued a stay pending the outcome of the appeals. The lawsuit brought by IUOE has been stayed by the trial court pending decisions in other matters.

There are currently nine cases pending in Alameda County Superior Court which challenge the Governor's July 28, 2010 furlough order. These nine cases are consolidated under the lead case *PECG v. Schwarzenegger, et al.* (Alameda County Superior Court, Case No. RG-10-494800). In *SEIU v. Schwarzenegger* (Alameda County Superior Court, Case No. RG-10-516259), *Association of California State Supervisors (ACSS) v. Schwarzenegger, et al.* (Alameda County Superior Court, Case No. RG-10-501997), *International Union of Operating Engineers (IUOE) v. Schwarzenegger* (Alameda County Superior Court, Case No. RG-10-503805), *SEIU v. Schwarzenegger, et al.* (Alameda County Superior Court, Case No. RG-09-546750), *CCPOA v. Schwarzenegger* (Alameda County Superior Court, Case No. RG-10-530312), *CASE v. Schwarzenegger* (Alameda County Superior Court, Case No. RG-10-528855), and *California Correctional Supervisors Organization (CCSO) v. California Department of Corrections and Rehabilitation, et al.* (Alameda County Superior Court, Case No. RG-10-507081), plaintiffs challenge the furloughs as allegedly violating provisions of state law. *California Statewide Law Enforcement Association (CSLEA), et al. v. Schwarzenegger, et al.* (Alameda County Superior Court, Case No. RG-10-507081), filed as a class action on behalf of all current and former members of the employee organization, challenges the furlough orders as violating numerous provisions of state law. All nine cases are currently on review and stayed by order of the California Supreme Court (California Supreme Court, Case No. S185404), but the plaintiffs are seeking to have the cases remanded to the trial court.

In *Board of Administration of the California Public Employees' Retirement System v. Schwarzenegger* (San Francisco County Superior Court, Case No. CPF-09-509754), plaintiff alleges that the furloughs unlawfully interfere with its ability to carry out its constitutional obligation to its participants and beneficiaries. The trial court ruled in favor of the state.

In *Acosta v. Henning, et al.* (San Francisco County Superior Court, Case No. CPF-08-508192), plaintiffs assert that the furloughs interfere with the ability of the California Employment Development Department and the California Unemployment Insurance Appeals Board to timely perform their functions.

In a separate action, *Schwarzenegger, et al. v. Chiang, et al.* (Sacramento County Superior Court, Case No. 34-2009-80000158-CU-WM-GDS), the Governor is seeking an order to compel the State Controller to implement the reduction in wages as a result of the reduced work time (furlough) with respect to employees of other statewide elected executive branch officers, including the Lieutenant Governor, State Controller, Secretary of State, State Treasurer, Superintendent of Public Instruction, Insurance Commissioner, and Attorney General. The trial court ruled in favor of the Governor, and the State Controller, Lieutenant Governor, Secretary of State, Attorney General, State Treasurer, Superintendent of Public Instruction and State Board of Equalization appealed (Court of Appeal, Third Appellate District, Case No. C061648). The Lieutenant Governor has been voluntarily dismissed from the appeal.

Actions Challenging Transfers from Special Fund to General Fund

In *TOMRA Pacific, Inc. et al. v. Chiang, et al.* (Alameda County Superior Court, Case No. RG-09-483580), plaintiffs challenge three transfers totaling \$415.7 million from a special fund, the California Beverage Container Recycling Fund, to the General Fund, asserting that the transfers have interfered with the operation of the recycling program for which the special fund was created, in violation of state law. In *California Chamber of Commerce et al. v. Chiang et al.* (Alameda County Superior Court, Case No. RG 09-490447), which has been consolidated with the *TOMRA* case, plaintiffs challenge these same transfers on the grounds that their inclusion in the Budget Act violates the provision of the California Constitution which requires that a statute embrace one subject. The trial court issued a ruling denying the plaintiffs' requests for a writ of mandate in both cases, and plaintiffs appealed (Court of Appeal, First Appellate District, Case No. A129401).

Tax Cases

Six actions have been filed contending that the Legislature's modification of Revenue and Taxation Code Section 25128, which implemented the double-weighting of the sales factor in California's apportionment of income formula for the taxation of multistate business entities, is invalid and/or unconstitutional. *Kimberly-Clark Worldwide, Inc., et al. v. Franchise Tax Board* (San Francisco County Superior Court, Case No. CGC-10-495916); *Gillette Company and Subsidiaries v. Franchise Tax Board* (San Francisco County Superior Court, Case No. CGC-10-495911); *Proctor & Gamble Manufacturing Company & Affiliates v. Franchise Tax Board* (San Francisco County Superior Court, Case No. CGC-10-495912); *Sigma-Aldrich, Inc. and Affiliates v. Franchise Tax Board* (San Francisco County Superior Court, Case No. CGC-10-496437); *RB Holdings (USA), Inc. v. Franchise Tax Board* (San Francisco County Superior Court, Case No. CGC-10-496438); and *Jones Apparel Group v. Franchise Tax Board* (San Francisco County Superior Court, Case No. CGC-10-499083), now consolidated in one matter, collectively referred to as *Gillette Company v. Franchise Tax Board*. Plaintiffs contend that the single-weighted sales factor specified in Section 25128 prior to amendment was contained within the Multistate Tax Compact and therefore cannot be modified without repealing the legislation that enacted the Compact. An adverse ruling in these cases would affect multiple taxpayers and create potential exposure to refund claims in excess of \$750 million. The trial court has ruled for the state in each of these matters.

A pending case challenges the fee imposed by the state tax code upon LLCs registered in California, alleging that it discriminates against interstate commerce and violates the U.S. and California Constitutions, it is an improper exercise of the state's police powers, and it has been misapplied by the Franchise Tax Board. *Bakersfield Mall LLC v. Franchise Tax Board* (San Francisco County Superior Court, Case No. CGC-07-462728). *Bakersfield Mall* was filed as a purported class action on behalf of all LLCs operating solely in California. Plaintiff filed an amended complaint to allege that not all of its income is derived solely from sources in California, which would call into question the class plaintiff purports to represent. A second lawsuit that is virtually identical to *Bakersfield Mall* has been filed, and also seeks to proceed as a class action. *CA-Centerside II, LLC v. Franchise Tax Board* (Fresno County Superior Court, Case No. 10 CECG00434). If either case proceeds as a class action, the claimed refunds could be significant. See "STATE FINANCES – Sources of Tax Revenue - Corporation Tax."

Plaintiff in *River Garden Retirement Home v. California Franchise Tax Board* (San Francisco County Superior Court, Case No. CGC-07-467783) challenges the constitutionality of the penalty assessed under the state's tax amnesty program. Under the amnesty program, for taxable years beginning before January 1, 2003, taxpayers that had not paid or had underpaid an eligible tax could agree to pay the tax and waive their rights to claim refunds thereof. In exchange, certain penalties and fees associated with the unpaid taxes would be waived and no criminal actions would be brought for the tax years for which amnesty was allowed. The program also imposed a new penalty equal to 50 percent of accrued

interest as of March 31, 2005, on any unpaid tax liabilities ultimately determined to be due for tax years 2002 and earlier for which amnesty could have been requested. The trial court granted summary judgment for the state, and the ruling was affirmed on appeal (Court of Appeal, First Appellate District, Case No. A123316). Plaintiff is seeking review by the California Supreme Court. The potential fiscal impact of the case is dependent on further court rulings, but is estimated to be in excess of \$300 million.

Nortel Networks Inc. v. State Board of Equalization (Los Angeles County Superior Court, Case No. BC 341568) and *Lucent Technologies, Inc. v. State Board of Equalization* (Los Angeles County Superior Court, Case No. BC 402036), tax refund cases, involve the interpretation of certain statutory sales and use tax-exemptions for “custom-written” computer software and licenses to use computer software. In *Nortel*, the trial court ruled in favor of plaintiff and the State Board of Equalization appealed (Court of Appeal, Second Appellate District, Case No. B213415). The appeal was heard on October 21, 2010. The trial court ruling, if applied to other similarly situated taxpayers, could have a significant negative impact, in the range of approximately \$500 million annually, on tax revenues.

In *River Garden Retirement Home v. California Franchise Tax Board* (San Francisco County Superior Court, Case No. CGC-07-467783), plaintiff is challenging the denial of a deduction for dividends under Revenue and Taxation Code Section 24402. After Section 24402 was held to be unconstitutional because it allowed a dividend deduction only to the extent the dividends were paid from income previously taxed by California, the Franchise Tax Board allowed a deduction for all dividends for years in which the normal 4-year statute of limitations prevented additional assessments and denied the deduction for all dividends in years in which the 4-year statute was still open. The trial court sustained the demurrer of the Franchise Tax Board on this issue and the plaintiff unsuccessfully appealed; plaintiff also challenges the tax amnesty penalty, as described above. An adverse ruling in this matter, applied in the context of other statutes, could have a significant revenue impact.

In *Computer Service Tax Cases (Dell, Inc. v. State Board of Equalization)*, the Court of Appeal ruled that the State Board of Equalization improperly collected sales and use tax on optional service contracts that Dell sold with computers (Judicial Council Coordination Proceeding No. 4442, San Francisco County Superior Court, Case No. CGC-03-419192 and Court of Appeal, First Appellate District, Case No. A118657). The decision will lead to a judgment requiring the Board to refund the tax with interest. The amount of the refund has not been determined but, with interest, may exceed \$250 million.

Petitioners in *California Taxpayers Association v. Franchise Tax Board* (Sacramento County Superior Court, Case No. 34-2009-800000168-CU-WM-GDS) challenge Revenue and Taxation Code Section 19138, which imposes a penalty for large understatement of corporate tax, alleging it violates the state and federal constitutions, and was not properly enacted. The trial court ruled in favor of the Franchise Tax Board. Petitioner appealed (Court of Appeal, Third Appellate District, Case No. C062791). An adverse ruling enjoining collection of the tax could have a significant impact on tax revenue. See “STATE FINANCES – Sources of Tax Revenue – Corporation Tax.”

Environmental Matters

In a federal Environmental Protection Agency (“U.S. EPA”) administrative abatement action titled *In the Matter of: Leviathan Mine, Alpine County, California, Regional Water Quality Control Board, Lahontan Region, State of California* (U.S. EPA Region IX CERCLA Docket No. 00-16(a)), the state, as owner of the Leviathan Mine, is a party through the Lahontan Regional Water Quality Control Board. The Atlantic Richfield Company (“ARCO”) is a party as the successor in interest to the mining company that caused certain pollution of the mine site. The Leviathan Mine site is listed on the U.S. EPA “Superfund” List, and both remediation costs and costs for Natural Resource Damages may be imposed

on the state. The alleged bases for the state's liability are the state's ownership of the mine site and the terms of a 1983 settlement agreement between the state and ARCO. The Lahontan Regional Water Quality Control Board has undertaken certain remedial action at the mine site, but the U.S. EPA's decision on the interim and final remedies is pending. ARCO has sued the state, the State Water Resources Control Board, and the Lahontan Regional Water Quality Control Board, seeking to recover past and future costs, based on the settlement agreement, the state's ownership of the property, and the state's allegedly negligent past clean up efforts. *Atlantic Richfield Co. v. State of California* (Los Angeles County Superior Court, Case No. BC 380474). It is possible these matters if determined adversely to the state could result in potential liability in the hundreds of millions of dollars.

In *Pacific Lumber Company, et al. v. State of California, et al.* (Sacramento County Superior Court, Case No. 34-2009-00042016), plaintiffs are seeking injunctive relief and damages against the state for an alleged breach of the Headwaters Agreement. The Headwaters Agreement was reached in 1996, and involved the sale of certain timberlands by plaintiffs to federal and state agencies. Plaintiffs allege that the state's environmental regulation of plaintiffs' remaining timberlands since the Headwaters Agreement constitutes a breach of the Agreement. The state denies plaintiffs' allegations. The current plaintiffs are successors in interest to original plaintiffs, who are debtors in a bankruptcy proceeding. In that proceeding, the debtors have claimed that the value of the litigation ranges from \$626 million to \$639 million in the event they could establish liability. It is currently unknown what the fiscal impact of this matter might be upon the General Fund.

In *City of Colton v. American Professional Events, Inc. et al.* (Los Angeles County Superior Court, Case No. BC 376008), two defendants in an action involving liability for contaminated groundwater have filed cross complaints seeking indemnification from the state and the Regional Water Quality Control Board in an amount of up to \$300 million.

Escheated Property Claims

In two cases, plaintiffs claim that the state has an obligation to pay interest on private property that has escheated to the state, and that failure to do so constitutes an unconstitutional taking of private property: *Suever v. Connell* (U.S. District Court, Northern District, Case No. C03-00156 RS); and *Taylor v. Chiang* (U.S. District Court, Eastern District, Case No. S-01-2407 WBS GGH). Both *Suever* and *Taylor* are styled as class actions but to date no class has been certified. The *Suever* and *Taylor* plaintiffs argue that the state's failure to pay interest on claims paid violated their constitutional rights. In *Suever*, the district court concluded that the state is obligated to pay interest to persons who reclaim property that has escheated to the state, but its ruling did not specify the rate at which interest must be paid. The district court certified this issue for appeal. Plaintiffs in *Suever* and *Taylor* also assert that for the escheated property that has been disposed of by the state, plaintiffs are entitled to recover, in addition to the proceeds of such sale, any difference between the sale price and the property's highest market value during the time the state held it; the state asserts that such claims for damages are barred by the Eleventh Amendment. The district court granted the state's motion for summary judgment on this claim in *Suever*, and plaintiffs appealed. The Ninth Circuit ruled against plaintiffs on the two consolidated *Suever* appeals, holding that the state is not required to pay interest and that the Eleventh Amendment bars plaintiffs from suing in federal court for anything other than the return of their property or the proceeds of its sale. (U.S. Court of Appeals, Ninth Circuit, Case No. 08-015884). The Ninth Circuit denied plaintiffs' request for rehearing and plaintiffs declined to seek review in the U.S. Supreme Court. The district court granted the state's motion for summary judgment on all remaining claims in *Suever*, and plaintiffs have appealed.

Actions Seeking Damages for Alleged Violations of Privacy Rights

In *Gail Marie Harrington-Wisely, et al. v. State of California, et al.* (Los Angeles County Superior Court, Case No. BC 227373), plaintiffs seek damages, asserting that the use by CDCR of a body-imaging machine to search visitors entering state prisons for contraband violated the rights of the visitors. This matter was certified as a class action. The trial court granted judgment in favor of the state. Plaintiffs' appeal has been dismissed (Court of Appeal, Second Appellate District, Case No. B190431) and the trial court denied plaintiffs' motion for attorneys' fees. The parties agreed to a stipulated judgment and dismissed the case subject to further review if the Department decides to use similar technology in the future. Plaintiffs may not seek further review of the trial court's rulings until 2013. If plaintiffs were successful in obtaining an award of damages for every use of the body-imaging machine, damages could be as high as \$3 billion.

Plaintiff in *Gilbert P. Hyatt v. Franchise Tax Board* (State of Nevada, Clark County District Court, Case No. A382999) was subject to an audit by the Franchise Tax Board involving a claimed change of residence from California to Nevada. Plaintiff alleges a number of separate torts involving privacy rights and interference with his business relationships arising from the audit. The trial court ruled that plaintiff had not established a causal relation between the audit and the loss of his licensing business with Japanese companies; the Nevada Supreme Court denied review of this ruling. The economic damages claim exceeded \$500 million. On the remaining claims, the jury awarded damages of approximately \$387 million, including punitive damages, and over \$1 million in attorneys' fees. The total judgment with interest is approximately \$490 million. The state appealed and the Nevada Supreme Court has granted a stay of execution on the judgment pending appeal. The state will vigorously pursue its appeal of this unprecedented award.

Actions Regarding Medi-Cal Reimbursements and Fees

In *Orinda Convalescent Hospital Inc., et al. v. Department of Health Services et al.* (Sacramento County Superior Court, Case No. 06CS01592), plaintiffs challenge a quality assurance fee charged to skilled nursing facilities and a Medi-Cal reimbursement methodology applicable to such facilities that was enacted in 2004, alleging violations of the federal and state constitutions and state law. Plaintiffs seek a refund of fees paid and to enjoin future collection of the fee. If an injunction against collection of the fee is issued, it could negatively affect the state's receipt of federal funds. At this time it is unknown what fiscal impact this matter would have upon the state's General Fund.

Other pending cases challenge state legislation requiring reductions in Medi-Cal reimbursements to providers. In *Independent Living Center of Southern California, et al. v. Shewry, et al.* (U.S. District Court, Central District, Case No. CV 08-3315 CAS (MANx)), health care advocates, Medi-Cal providers and Medi-Cal recipients challenge various 10 percent rate reductions, the 10 percent "actuarial equivalent" managed care rate reductions, the hold on payments to providers for one month prior to January 2009, and delays in the annual cost of living adjustments in the state-funded SSI/SSP. Plaintiffs seek injunctive relief to prevent implementation of these measures. The district court granted in part a preliminary injunction, requiring the state, as of August 18, 2008, to pay the rates in effect prior to the 10 percent reduction. The district court thereafter issued a second preliminary injunction, restoring the rates in effect prior to the reduction, as of November 2008, for two additional categories of services. The state and plaintiffs appealed and the Ninth Circuit affirmed the preliminary injunctions. (U.S. Court of Appeals, Ninth Circuit, Case No. 08-56422.) The Ninth Circuit also found that the district court erred in making the injunction effective as of August 18, 2008, and that the injunction should apply to services rendered on or after July 1, 2008. The Ninth Circuit denied both petitions for rehearing filed by the state. The state filed a petition for certiorari in the U.S. Supreme Court (U.S. Supreme Court, Case No. 09-958), and the Court invited the Solicitor General to file a brief expressing its views on the petition. The district

court amended the injunction to apply retroactively. On June 17, 2010, the district court stayed further proceedings pending resolution of the petition for certiorari. A final decision adverse to the state in this matter could result in additional costs to the General Fund of \$70 million.

In *California Medical Association, et al. v. Shewry, et al.* (Los Angeles County Superior Court, Case No. BC 390126), professional associations representing Medi-Cal providers seek to enjoin implementation of the 10 percent Medi-Cal rate reductions planned to go into effect on July 1, 2008, alleging that the legislation violates federal Medicaid requirements, state laws and regulations, and the California Constitution. The trial court denied plaintiffs' motion for a preliminary injunction. Plaintiffs filed an appeal, which was dismissed at their request. (Court of Appeal, Second Appellate District, Case No. B210440.) Plaintiffs have indicated that they will file an amended petition seeking the retrospective relief the Ninth Circuit awarded in the *Independent Living* case, above, after final disposition of that case. A final decision adverse to the state in this matter could result in costs to the General Fund of \$508.2 million.

In *California Pharmacists Association, et al. v. David Maxwell-Jolly, et al.*, (U.S. District Court, Central District, Case No. CV09-08200), Medi-Cal pharmacy providers filed a suit challenging reimbursement rates, including the Department of Health Care Services' use of reduced published average wholesale price data to establish reimbursement rates, and challenging the Legislature's amendment of Welfare and Institutions Code section 14105.45 and enactment of Welfare and Institutions Code section 14105.455. Plaintiffs seek injunctive relief based on alleged violations of federal law. The district court granted a request for preliminary judgment in part, with respect to sections 14104.45 and 14105.455, and denied it in part, with respect to the Department of Health Care Services' use of reduced published average wholesale price data to establish reimbursement rates. Plaintiffs filed a motion seeking to modify the district court ruling, and both parties filed notices of appeal to the Ninth Circuit Court of Appeals. The Ninth Circuit stayed the appeals and the district court also stayed further proceedings in light of the pending petitions for certiorari in *Independent Living Center of Southern California, et al. v. Shewry, et al.* (discussed above) and *Maxwell-Jolly v. California Pharmacists Association* (U.S. Supreme Court, Case No. 09-1158). At this time it is unknown what fiscal impact this case would have on the state's General Fund.

In *Centinela Freeman Emergency Medical Associates, et al. v. David Maxwell-Jolly, et al.* (Los Angeles County Superior Court, Case No. BC 406372), filed as a class action on behalf of emergency room physicians and emergency department groups, plaintiffs claim that Medi-Cal rates for emergency room physicians are below the cost of providing care. Plaintiffs seek damages, injunctive relief, and a writ of mandate based on alleged violations of state law and the federal and state Constitutions. The trial court granted the petition of the plaintiffs and ordered the Department of Health Care Services to conduct an annual review of reimbursement rates for physicians and dentists pursuant to Welfare and Institutions Code section 14079. A final decision in this matter adverse to the state could result in costs to the General Fund of \$250 million.

In *Sierra Medical Services Alliance, et al. v. David Maxwell-Jolly, et al.* (U.S. District Court, Central District, Case No. CV10-04182), emergency medical transportation companies challenge California Code of Regulations, title 22, section 51527, which sets Medi-Cal reimbursement rates paid for medical transportation services. Plaintiffs seek damages and injunctive relief under the Supremacy Clause, the Takings Clause, the Due Process Clause, and 42 U.S.C. §1983. The case is stayed pending the petitions for certiorari in *Maxwell-Jolly v. Independent Living Center of Southern California, Inc., et al.* (U.S. Supreme Court, Case No. 09-958) and in *Maxwell-Jolly v. California Pharmacists Association*, (U.S. Supreme Court, Case No. 09-115). At this time it is unknown what fiscal impact this case would have on the state's General Fund.

In *California Association of Health Facilities v. David Maxwell-Jolly* (U.S. District Court, Central District, Case No. CV10-03284 CAS (MANx), consolidated with *Developmental Services Network, et al., v. David Maxwell-Jolly*, plaintiffs (professional associations representing Medi-Cal providers) challenge AB 5, which amended Welfare and Institutions Code §14105.191(f)(2)(A), to maintain Medi-Cal reimbursement rates for intermediate care facilities and freestanding pediatric sub-acute facilities as the rates for fiscal year 2009-10, and each year thereafter, to not exceed the rates applicable in fiscal year 2008-09. Plaintiffs seek declaratory and injunctive relief under the Supremacy Clause and 42 U.S.C. §1983. Plaintiffs allege that the rate freeze violates 42 U.S.C. § 1396a(a)(30)(A) because the Legislature did not study the impact of the freeze on efficiency, economy, quality of care, and access to care. Plaintiffs also allege that the rate freeze violates the notice and public process provisions of 42 U.S.C. § 1396a(a)(13)(A) and 42 C.F.R. § 447.205. At this time, it is unknown what fiscal impact these matters will have upon the state's General Fund.

In *California Hospital Association v. Maxwell-Jolly, et al.* (Sacramento County Superior Court, Case No. 34-20010-80000673), plaintiff challenges limits on Medi-Cal reimbursement rates for hospital services enacted in 2008, and which were to take effect October 1, 2008 or March 1, 2009, as allegedly violating federal law. Plaintiff seeks to enjoin the implementation of the limits. At this time it is unknown what fiscal impact this matter may have on the state's General Fund.

Action to Increase Amount of State Aid for Dependent Children

In a statewide class action, *Katie A., et al. v. Bonta, et al.* (U.S. District Court, Central District, Case No. CV 02-05662 AHM (SHx)), plaintiffs seek to expand Medicaid-covered services for mentally disordered children in foster care. The district court issued a preliminary injunction ordering the state defendants to provide additional services to class members. Further, the court ordered the state defendants and plaintiffs to meet and confer both to develop a plan to implement the preliminary injunction and to come to consensus on whether the court should appoint a special master. On appeal (U.S. Court of Appeals, Ninth Circuit, Case No. 06-55559), the Ninth Circuit reversed the decision of the district court and remanded the matter for further proceedings. Plaintiffs filed another motion for preliminary injunction in the district court. The district court vacated the motion without prejudice and appointed a special master to assist the parties in resolving differences. At this time, it is unknown what financial impact this unprecedented litigation would have on the state's General Fund.

Local Government Mandate Claims and Actions

In litigation filed in November 2007, *California School Boards Association, et al. v. State of California, et al.* (San Diego County Superior Court, Case No. 37-2007-00082249-CU-WM-CTL), plaintiffs, including the San Diego County Office of Education and four school districts, allege the state has failed to appropriate approximately \$900 million for new state-required programs or services in violation of the California Constitution. Plaintiffs sought declaratory and injunctive relief, including an order compelling reimbursement. The trial court ruled that the legislature had improperly failed to fund state education mandates, but refused to grant writ relief for the \$900 million sought by the plaintiffs. The state has appealed the ruling regarding the failure to fund mandates and plaintiffs filed a cross-appeal regarding the denial of an order to pay \$900 million allegedly owed (Court of Appeal, Fourth Appellate District, Case No. D055659). The trial court judgment has been stayed pending resolution of the appeal. At this time it is unknown what fiscal impact this matter would have upon the state's General Fund.

In *Department of Finance v. Commission on State Mandates, et al.* (Sacramento County Superior Court, Case No. 03CS01432), the Department of Finance is seeking to overturn a determination of the Commission on State Mandates that a state law requiring the development of a behavioral intervention plan for certain children receiving special education services exceeds the federal requirements for

individualized education plans and therefore is an unfunded state mandate. The parties reached a settlement in 2008 under which the state would pay school districts \$510 million in retroactive reimbursements over six years starting in fiscal year 2011-12, and permanently increase the special education funding formula by \$65 million annually, beginning in fiscal year 2009-10. The settlement was dependent upon funding by the Legislature, which failed to provide funding for the settlement agreement. Rather than proceed to trial, the Department of Finance filed a request for dismissal that is pending in the trial court. The school districts and county offices of education have indicated they will seek reimbursement on their claims through the normal procedure.

In *Department of Finance v. Commission on State Mandates* (Sacramento County Superior Court, Case No. 34-2010-80000529), the state is appealing a determination by the Commission on State Mandates relating to whether the requirement for completion of a second science course for graduation from high school constitutes a reimbursable state-mandated program. Following court action on consolidated cases involving challenges to the State Controller's Office reduction of claims (*San Diego Unified School District, et al. v. Commission on State Mandates, et al.* (Sacramento County Superior Court, Case No. 03CS01401) and *Woodland Joint Unified School District v. Commission on State Mandates, et al.* (Sacramento County Superior Court, Case No. 05CS01401)), the Commission adopted revised parameters and guidelines which included a reasonable reimbursement methodology for claiming increased teacher costs. (CSM 41 81A, 04-PGA-30, 05-PGA-05, and 06-PGA-05). Historically, education-related state mandate claims are funded from moneys provided to meet the Proposition 98 Guarantee. The Commission's adoption of the revised parameters and guidelines could result in a reimbursement requirement that exceeds the funding available through the Proposition 98 Guarantee in any one fiscal year.

Actions Relating to Certain Tribal Gaming Compacts

In June 2004, the state entered into amendments to tribal gaming compacts (the "Amended Compacts") between the state and five Indian Tribes (the "Five Tribes"). Those Amended Compacts are being challenged in two pending cases, as described below. A decision unfavorable to the state in the cases described below (or in any future litigation relating to the Amended Compacts) could eliminate future receipts of gaming revenues anticipated to result from the Amended Compacts, and could impair the state's ability to sell a portion of the revenue stream anticipated to be generated by these Amended Compacts.

In *Rincon Band of Luiseno Mission Indians of the Rincon Reservation v. Schwarzenegger, et al.* (U.S. District Court, Southern District, Case No. 04 CV 1151 W (WMc)) plaintiff (the "Rincon Band" or "Rincon") sought an injunction against implementation of the Amended Compacts on grounds that their execution and ratification by the state constituted an unconstitutional impairment of the state's compact with the Rincon Band. The Rincon Band asserts that its compact contains an implied promise that the state would not execute compacts or compact amendments with other tribes that would have an adverse impact on the Rincon Band's market share by allowing a major expansion in the number of permissible gaming devices in California. The complaint also asserts that the state breached Rincon's compact, principally by incorrectly calculating the total number of gaming device licenses the state is authorized to issue tribes with compacts identical to Rincon's compact and by failing to negotiate a compact amendment with the Rincon Band in good faith. The district court dismissed the impairment of contract claims, the claim regarding the total number of gaming device licenses, and a claim for damages sought for a separate alleged breach of compact but did not dismiss Rincon's other breach of compact claims, including a claim that the state failed to negotiate a compact amendment with the Rincon Band in good faith. The district court entered a separate judgment with respect to the dismissed claims, and Rincon appealed (U.S. Court of Appeals, Ninth Circuit, Case No. 06-055259). On appeal, the Rincon Band did not challenge the validity of the Amended Compacts. The Ninth Circuit reversed the dismissal of the

claim involving the authorized number of gaming device licenses and affirmed the dismissal of the Rincon's claim for damages. The U.S. Supreme Court denied the state's petition, seeking review of the Ninth Circuit's decision to allow the challenge to the number of authorized gaming device licenses to proceed in the absence of other tribal parties. The district court granted summary judgment for Rincon on its claim that the state failed to negotiate a compact amendment in good faith, finding that the state's request for revenue sharing to be deposited in the General Fund was a request for an unlawful tax. The state filed a petition for certiorari to the U.S. Supreme Court (U.S. Supreme Court, Case No. 10-330). The district court granted Rincon's partial motion for summary judgment on its remaining claim regarding the authorized number of gaming device licenses, and the state appealed (U.S. Court of Appeals, Ninth Circuit, Case No. 10-56461).

In *San Pasqual Band of Mission Indians v. State of California, et al.* (U.S. District Court, Southern District, Case No. 06 CV 0988 LAB AJB), plaintiff seeks a declaration that more aggregate slot machine licenses are available for issuance to all tribes that signed compacts with the state (the 1999 Compact) than the number of such licenses determined by the state in 2002. Should relief be granted and more licenses become available, the Five Tribes' obligations to continue to fund state transportation bonds under the Amended Compacts would be rendered uncertain because the Amended Compacts contemplated that the license pool created by the 1999 Compact would remain fixed at the number determined by the state. An expanded license pool would thus present questions about the Five Tribes' monetary obligations that would presumably be required to be addressed by amendment of the Amended Compacts. The district court dismissed the complaint, and plaintiff appealed (U.S. Court of Appeals, Ninth Circuit, Case No. 07-55536). The Ninth Circuit reversed the district court order and remanded the matter to the district court. The district court granted plaintiff's motion for summary judgment regarding the number of licenses, and the state appealed (U.S. Court of Appeals, Ninth Circuit, Case No. 10-55858).

In a separate action, *Twenty-Nine Palms Band of Mission Indians v. Stanislaus, et al.* (U.S. District Court, Central District, Case No. EDCV 08-1753 VAP), plaintiff tribe seeks an injunction and a declaration that federal law exempts from state taxation (1) monetary distributions made to tribe members and derived from its casino gambling operation profits, and (2) income earned by tribe members by means of employment at the tribe casino. The district court dismissed the complaint without leave to amend and plaintiff appealed (U.S. Court of Appeals, Ninth Circuit, Case No. 10-55965). It is currently unknown what the fiscal impact of this matter might be upon the General Fund, should the plaintiff obtain a favorable ruling that may be applicable to other similarly situated taxpayers.

Prison Healthcare Reform and Reduction of Prison Population

The adult prison health care delivery system includes medical health care, mental health care and dental health care. The annual budget for this system, which is operated by the CDCR and affects approximately 33 prisons throughout the state, exceeds \$1.8 billion. There are three significant cases pending in federal district courts challenging the constitutionality of prison health care. *Plata v. Schwarzenegger* (U.S. District Court, Northern District, Case No. C 01-1351 TEH) is a class action regarding the adequacy of medical health care; *Coleman v. Schwarzenegger* (U.S. District Court, Eastern District, Case No. CIV S-90-0520 LKK JFM P) is a class action regarding mental health care; and *Perez v. Tilton* (U.S. District Court, Northern District, Case No. C 05-05241 JSW) is a class action regarding dental health care. A fourth case, *Armstrong v. Schwarzenegger* (U.S. District Court, Northern District, Case No. C 94-02307 CW) is a class action on behalf of inmates with disabilities alleging violations of the Americans with Disabilities Act and Section 504 of the Rehabilitation Act. In *Plata* the district court appointed a Receiver, who took office in April 2006, to run and operate the medical health care portion of the health care delivery system. The *Plata* Receiver and the Special Master appointed by the *Coleman* court, joined by the court representatives appointed by the *Perez* and *Armstrong* courts, meet routinely to coordinate efforts in these cases. To date, ongoing costs of remedial activities have been incorporated

into the state's budget process. However, at this time, it is unknown what financial impact this litigation would have on the state's General Fund, particularly in light of the unprecedented step of appointing a Receiver of medical health care. The Receiver filed a motion in the *Plata* case, asking the court to hold the Governor and State Controller in contempt of court for failing to fund prison healthcare capital projects the Receiver wishes to construct and to order the state to pay \$8 billion to fund such projects. On October 27, 2008, the district court ordered the state to transfer \$250 million to the Receiver. The court indicated it would proceed later with the additional amounts requested by the Receiver. The state appealed that order and the Ninth Circuit Court of Appeals dismissed the state's appeal for lack of jurisdiction, stating that the order to pay \$250 million was an interim order in the contempt proceedings. The Receiver later abandoned the \$8 billion plan and has withdrawn the motion for contempt. The Receiver and state agreed to a smaller construction plan using funding provided by AB 900. The district court also denied the state's motion to terminate the Receiver, and the state appealed that order. The Ninth Circuit affirmed the district court order. See "STATE FINANCES – Department of Corrections and Rehabilitation – Prison Construction Program."

In *Plata* and *Coleman*, discussed above, a three-judge panel was convened to consider plaintiffs' motion for a prisoner-release order. The motions alleged that prison overcrowding was the primary cause of unconstitutional medical and mental health care. After a trial, the panel ordered the state to prepare a plan for the release of approximately 46,000 prisoners over two years. The state filed a prisoner-release plan with the three-judge panel and filed an appeal in the U.S. Supreme Court. On June 14, 2010, the U.S. Supreme Court granted the state's request for review of the prisoner release order. The matter will be heard by the Court on November 30, 2010.

Construction-Related Actions Against the Department of Transportation

Willemsen, et al. v. State of California, et al. (San Bernardino County Superior Court, Case No. RCV 071843) is an inverse condemnation action, nuisance and negligence action arising out of construction, maintenance and operation of a state highway. It was originally filed by the owners of 595 homes who sought damages in the amount of \$600 million, alleging excessive dust and noise as well as structural damage to some of the homes. Approximately half of the plaintiffs are no longer pursuing these claims.

A pending litigation matter, *Otay River Constructors v. South Bay Expressway, et al.* (San Diego County Superior Court Consolidated Action, Case No. GIC 869386), relates to an agreement between Caltrans and South Bay Expressway ("SBX") for the design, construction and operation of a private-public partnership project in San Diego County. SBX contracted with Otay River Constructors ("ORC") for the design and construction of the project, consisting of: 1) the privately-funded toll road initially contemplated by the parties; and 2) the publicly and privately funded gap and connector project to connect the toll road to existing state highways. ORC sued SBX, alleging cost overruns on the gap/connector project were caused by SBX, and SBX cross-complained against Caltrans for breach of contract and indemnification, seeking \$295 million in damages. In separate pending arbitration relating to the toll road, SBX is seeking approximately \$278 million in damages based on the same theories as in the gap/connector litigation. ORC has filed a motion to join this arbitration with the litigation. Both matters are currently stayed after SBX filed for bankruptcy.

BANK ARRANGEMENTS

The table immediately following the text of Appendix A, prior to the State Debt Tables, includes certain information relating to bank arrangements the state has entered into. See also "STATE INDEBTEDNESS AND OTHER OBLIGATIONS – Capital Facilities Financing – Bank Arrangements."

STATE DEBT TABLES

The tables which follow provide information on outstanding state debt, authorized but unissued general obligation bonds and commercial paper notes, debt service requirements for state general obligation and lease-revenue bonds, and authorized and outstanding state revenue bonds. The table titled "Bank Arrangements" contains certain information relating to letters of credit, liquidity facilities and other bank arrangements in connection with variable rate obligations. Also, see "STATE INDEBTEDNESS AND OTHER OBLIGATIONS." For purposes of these tables, "General Fund bonds," also known as "non-self liquidating bonds," are general obligation bonds expected to be paid from the General Fund without reimbursement from any other fund. Although the principal of general obligation commercial paper notes in the "non-self liquidating" category is legally payable from the General Fund, the state expects that principal of such commercial paper notes will be paid only from the issuance of new commercial paper notes or the issuance of long-term general obligation bonds to retire the commercial paper notes. Interest on "non-self liquidating" general obligation commercial paper notes is payable from the General Fund.

"Enterprise Fund bonds," also known as "self liquidating bonds," are general obligation bonds for which program revenues are expected to be sufficient to reimburse in full the General Fund for debt service payments, but any failure to make such a reimbursement does not affect the obligation of the state to pay principal and interest on the bonds from the General Fund.

"Special Revenue Fund bonds" also known as Economic Recovery Bonds or ERBs, are "self liquidating" general obligation bonds which are primarily secured by a pledge of a one-quarter cent statewide sales and use tax deposited in the Fiscal Recovery Fund. Debt service payments are made directly from the Fiscal Recovery Fund and not the General Fund. The Special Revenue Fund bonds are also general obligations of the state to which the full faith and credit of the state are pledged to the punctual payment of the principal of and interest thereon, if the sales tax revenues are insufficient.

BANK ARRANGEMENTS

(See “STATE INDEBTEDNESS AND OTHER OBLIGATIONS – Capital Facilities Financing – Bank Arrangements.”)

<u>Program</u>	<u>Series</u>	<u>Outstanding Par Amount</u>	<u>Credit Provider</u>	<u>Expiration</u>	<u>Type of Credit</u>	<u>Reset Mode</u>
GO VRDOs	2003A 1	\$50,000,000	JP Morgan Chase	12/1/2011	LOC	Daily
	2003A 2-3	\$200,000,000	Bank of Montreal	12/1/2012	LOC	Daily
GO VRDOs	2003B 1-4	\$250,000,000	BNP Paribas (60.0%)	12/1/2010	LOC	Weekly
			CA Public Employees’ Retirement System (20.0%)	12/1/2010		Weekly
			CA State Teachers Retirement Syst. (20.0%)	12/1/2010		Weekly
GO VRDOs	2003C 1	\$100,000,000	Bank of America, N.A.	12/1/2011	LOC	Weekly
	2003C 2	\$100,000,000	Bank of Nova Scotia	12/1/2011	LOC	Weekly
	2003C 3-4	\$100,000,000	Citibank, N.A.	12/1/2012	LOC	Weekly
GO VRDOs	2004A 1, 4 & 5	\$200,000,000	Citibank, N.A. (75%)	10/15/2012	LOC	Daily
			CA State Teachers Retirement Syst. (25%)	10/15/2012		
GO VRDOs	2004A 2 & 3	\$150,000,000	State Street Bank & Trust Company (75%)	10/15/2012	LOC	Daily
			CA State Teachers Retirement Syst. (25%)	10/15/1012		
GO VRDOs	2004A 6, 7, 8 & 10	\$200,000,000	Citibank, N.A. (75.0%)	10/15/2012	LOC	Weekly
			CA State Teachers Retirement Syst. (25%)	10/15/2012		
GO VRDOs	2004 A 9	\$50,000,000	State Street Bank & Trust Company (75%)	10/15/2012	LOC	Weekly
			CA State Teachers Retirement Syst. (25%)	10/15/2012		
GO VRDOs	2004B 1-3	\$165,000,000	Citibank, N.A.	10/15/2012	LOC	Daily
GO VRDOs	2004B 4-6	\$135,000,000	Citibank, N.A.	10/15/2012	LOC	Weekly
GO VRDOs	2005A-1	\$171,600,000	Fortis Bank	11/17/2010	LOC	Weekly
GO VRDOs	2005A-2	\$171,600,000	Credit Agricole Corporate & Investment Bank (formerly Calyon)	11/17/2010	LOC	Weekly
GO VRDOs	2005A-3	\$49,100,000	Bank of America	11/17/2010	LOC	Weekly
GO VRDOs	2005B-1	\$147,100,000	Bank of America	11/17/2010	LOC	Weekly
GO VRDOs	2005B-2	\$98,100,000	Societe General	11/17/2010	LOC	Weekly
GO VRDOs	2005B-3	\$49,100,000	JP Morgan Chase	11/17/2010	LOC	Weekly
GO VRDOs	2005B-4	\$49,100,000	JP Morgan Chase	11/17/2010	LOC	Weekly
GO VRDOs	2005B-5	\$88,890,000	Depfa Bank	11/17/2010	LOC	Weekly
GO VRDOs	2005B-6	\$98,100,000	KBC Bank	11/17/2010	LOC	Daily
GO VRDOs	2005B-7	\$49,100,000	Landesbank Hessen-Thuringen Girozentrale (Helaba)	11/17/2010	LOC	Daily
ERB VRDOs	2004C-1	\$100,000,000	Bank of America	6/15/2012	LOC	Daily
ERB VRDOs	2004C-2	\$50,000,000	Bank of America	6/15/2012	LOC	Daily
ERB VRDOs	2004C-3	\$100,000,000	Bank of America	6/15/2012	LOC	Daily
ERB VRDOs	2004C-4	\$150,000,000	JP Morgan Chase	6/15/2012	LOC	Daily

<u>Program</u>	<u>Series</u>	<u>Outstanding Par Amount</u>	<u>Credit Provider</u>	<u>Expiration</u>	<u>Type of Credit</u>	<u>Reset Mode</u>
ERB VRDOs	2004C-5	\$100,000,000	Bank of America	6/15/2012	LOC	Daily
ERB VRDOs	2004C-11	\$152,395,000	BNP Paribas	6/15/2012	LOC	Weekly
ERB VRDOs	2004C-15	\$237,285,000	Dexia Local/FSA Insurance	6/15/2011	SBPA	Weekly
ERB VRDOs	2004C-16	\$185,090,000	Dexia Local/ FSA Insurance	6/15/2011	SBPA	Weekly
GO CP	N/A	\$2,000,000,000 ^(a)	Royal Bank of Canada (21.735%) Dexia Credit Local (21.735%) Wells Fargo Bank, N.A. (18.48%) CA Public Employees Retirement Sys. (10.87%) Credit Agricole Corporate & Investment Bank (formerly Calyon) (10.87%) CA State Teachers Retirement Sys (8.70%) Landesbank Hessen-Thuringen Girozentrale (Helaba) (7.61%)	10/30/2012	LOC	Up to 90 days
Total Par		\$5,746,560,000				

^(a) For commercial paper (CP), the total par outstanding represents the maximum commitment. The bank group is responsible for the total CP outstanding.

OUTSTANDING STATE DEBT
FISCAL YEARS 2005-06 THROUGH 2009-10
(Dollars in Thousands Except for Per Capita Information)

	<u>2005-06</u>	<u>2006-07</u>	<u>2007-08</u>	<u>2008-09</u>	<u>2009-10</u>
Outstanding Debt (a)					
General Obligation Bonds					
General Fund (Non-Self Liquidating).....	\$ 37,066,227	\$ 41,275,412	\$ 45,465,459	\$ 59,037,759	\$ 68,766,304
Enterprise Fund (Self Liquidating).....	\$ 1,960,105	\$ 1,950,920	\$ 1,905,490	\$ 1,655,265	\$ 1,475,440
Special Revenue Fund (Self Liquidating).....	\$ 9,759,490	\$ 8,291,010	\$ 9,120,285	\$ 8,223,450	\$ 7,720,220
Total General Obligation Bonds.....	<u>\$ 48,785,822</u>	<u>\$ 51,517,342</u>	<u>\$ 56,491,234</u>	<u>\$ 68,916,474</u>	<u>\$ 77,961,964</u>
Revenue Bonds					
Lease-Purchase Debt.....	\$ 7,785,005	\$ 7,738,011	\$ 7,833,069	\$ 8,051,007	\$ 9,887,600
Proposition 1A Receivables Program.....	N/A	N/A	N/A	N/A	\$ 1,895,000
Total Revenue Bonds.....	<u>\$ 7,785,005</u>	<u>\$ 7,738,011</u>	<u>\$ 7,833,069</u>	<u>\$ 8,051,007</u>	<u>\$ 11,782,600</u>
Total Outstanding General Obligation and Revenue Bonds.....	<u>\$ 56,570,827</u>	<u>\$ 59,255,353</u>	<u>\$ 64,324,303</u>	<u>\$ 76,967,481</u>	<u>\$ 89,744,564</u>
Bond Sales During Fiscal Year (b)					
Non-Self Liquidating General Obligation Bonds....	\$ 5,516,560	\$ 10,226,550	\$ 8,748,685	\$ 13,934,985	\$ 12,446,005
Self Liquidating General Obligation Bonds.....	\$ 0	\$ 359,160	\$ 91,200	\$ 0	\$ 118,710
Proposition 1A Receivables Revenue Bonds.....	N/A	N/A	N/A	N/A	\$ 1,895,000
Self Liquidating Special Fund Revenue Bonds.....	\$ 0	\$ 0	\$ 3,179,260	\$ 0	\$ 3,435,615
Lease-Purchase Debt.....	\$ 1,112,595	\$ 995,920	\$ 489,700	\$ 641,975	\$ 2,269,235
Debt Service (c)					
Non-Self Liquidating General Obligation Bonds....	\$ 3,121,563	\$ 3,259,041	\$ 4,032,601	\$ 4,081,518	\$ 5,075,976
Lease-Purchase Debt.....	\$ 804,311	\$ 774,947	\$ 791,371	\$ 825,788	\$ 881,994
General Fund Receipts (d).....	\$ 94,302,567	\$ 97,357,252	\$ 103,416,171	\$ 87,774,952	\$ 88,654,941
Non-Self Liquidating General Obligation Bonds					
Debt Service as a Percentage of General					
Fund Receipts.....	3.31%	3.35%	3.90%	4.65%	5.73%
Lease-Purchase Debt Service as a					
Percentage of General Fund Receipts.....	0.85%	0.80%	0.77%	0.94%	0.99%
Population (e).....	36,899,000	37,275,000	37,674,000	38,134,000	38,488,000
Non-Self Liquidating General Obligation Bonds					
Outstanding per Capita.....	\$ 1,004.53	\$ 1,107.32	\$ 1,206.81	\$ 1,548.17	\$ 1,786.69
Lease-Purchase Debt Outstanding per Capita.....	\$ 210.98	\$ 207.59	\$ 207.92	\$ 211.12	\$ 256.90
Personal Income (f).....	\$ 1,387,661,000	\$ 1,495,533,000	\$ 1,568,257,000	\$ 1,610,932,000	\$ 1,572,650,000
Non-Self Liquidating General Obligation Bonds					
Outstanding as Percentage of Personal Income....	2.67%	2.76%	2.90%	3.66%	4.37%
Lease-Purchase Debt Outstanding as					
Percentage of Personal Income.....	0.56%	0.52%	0.50%	0.50%	0.63%

- (a) Principal outstanding as of July 1 of the next fiscal year. Includes the initial value of capital appreciation bonds rather than the accreted value.
- (b) Includes refunding bonds.
- (c) Calculated on a cash basis. Debt service costs of bonds issued in any fiscal year largely appear in subsequent fiscal year.
- (d) Calculated on a cash basis. General Fund Receipts includes both revenues and nonrevenues, such as borrowings the proceeds of which are deposited in the General Fund (e.g. tobacco securitization bonds and economic recovery bonds).
- (e) As of July 1, the beginning of the fiscal year.
- (f) Revised estimates as of September 20, 2010.

SOURCES: Population: State of California, Department of Finance.

Personal Income: United States, Department of Commerce, Bureau of Economic Analysis

Outstanding Debt, Bonds Sales During Fiscal Year and Debt Service: State of California, Office of the Treasurer.

General Fund Receipts: State of California, Office of the State Controller.

AUTHORIZED AND OUTSTANDING GENERAL OBLIGATION BONDS
As of October 1, 2010
(Thousands)

	Voter Authorization Date	Voter Authorization Amount \$	Long Term Bonds Outstanding (a) \$	Long Term Bonds Unissued (b) \$
GENERAL FUND BONDS (Non-Self Liquidating)				
1988 School Facilities Bond Act	11/08/88	800,000	106,115	2,255
1990 School Facilities Bond Act	06/05/90	800,000	177,890	2,125
1992 School Facilities Bond Act	11/03/92	900,000	394,989	1,789
California Clean Water, Clean Air, Safe Neighborhood Parks, and Coastal Protection Act of 2002	03/05/02	2,600,000	2,163,530	389,060
California Library Construction and Renovation Bond Act of 1988	11/08/88	75,000	24,795	2,595
* California Park and Recreational Facilities Act of 1984	06/05/84	370,000	24,005	1,100
* California Parklands Act of 1980	11/04/80	285,000	4,775	0
California Reading and Literacy Improvement and Public Library Construction and Renovation Bond Act of 2000	03/07/00	350,000	265,565	40,785
* California Safe Drinking Water Bond Law of 1976	06/08/76	175,000	8,505	2,500
* California Safe Drinking Water Bond Law of 1984	11/06/84	75,000	4,135	0
* California Safe Drinking Water Bond Law of 1986	11/04/86	100,000	32,830	0
California Safe Drinking Water Bond Law of 1988	11/08/88	75,000	38,350	580
* California Wildlife, Coastal, and Park Land Conservation Act	06/07/88	776,000	179,180	7,330
Children's Hospital Bond Act of 2004	11/02/04	750,000	653,605	85,715
Children's Hospital Bond Act of 2008	11/04/08	980,000	525,320	454,680
Class Size Reduction Kindergarten-University Public Education Facilities Bond Act of 1998 (Higher Education)	11/03/98	2,500,000	2,115,435	0
Class Size Reduction Kindergarten-University Public Education Facilities Bond Act of 1998 (K-12)	11/03/98	6,700,000	5,048,355	11,860
Clean Air and Transportation Improvement Bond Act of 1990	06/05/90	1,990,000	1,029,250	99,580
* Clean Water Bond Law of 1970	11/03/70	250,000	500	0
* Clean Water Bond Law of 1974	06/04/74	250,000	955	0
* Clean Water Bond Law of 1984	11/06/84	325,000	18,765	0
* Clean Water and Water Conservation Bond Law of 1978	06/06/78	375,000	6,940	0
Clean Water and Water Reclamation Bond Law of 1988	11/08/88	65,000	31,125	0
* Community Parklands Act of 1986	06/03/86	100,000	7,290	0
* County Correctional Facility Capital Expenditure Bond Act of 1986	06/03/86	495,000	46,050	0
County Correctional Facility Capital Expenditure and Youth Facility Bond Act of 1988	11/08/88	500,000	144,225	0

AUTHORIZED AND OUTSTANDING GENERAL OBLIGATION BONDS
As of October 1, 2010
(Thousands)

	Voter Authorization Date	Voter Authorization Amount \$	Long Term Bonds Outstanding (a) \$	Long Term Bonds Unissued (b) \$
GENERAL FUND BONDS (Non-Self Liquidating)				
* County Jail Capital Expenditure Bond Act of 1981	11/02/82	280,000	800	0
Disaster Preparedness and Flood Prevention Bond Act of 2006	11/07/06	4,090,000	1,566,635	2,512,060
Earthquake Safety and Public Buildings Rehabilitation Bond Act of 1990	06/05/90	300,000	175,545	12,410
* Fish and Wildlife Habitat Enhancement Act of 1984	06/05/84	85,000	7,475	0
* Higher Education Facilities Bond Act of 1986	11/04/86	400,000	2,550	0
Higher Education Facilities Bond Act of 1988	11/08/88	600,000	80,705	0
Higher Education Facilities Bond Act of June 1990	06/05/90	450,000	105,480	550
Higher Education Facilities Bond Act of June 1992	06/02/92	900,000	458,680	1,305
Highway Safety, Traffic Reduction, Air Quality, and Port Security Bond Act of 2006	11/07/06	19,925,000	6,952,215	12,952,510
Housing and Emergency Shelter Trust Fund Act of 2002	11/05/02	2,100,000	1,670,270	191,270
Housing and Emergency Shelter Trust Fund Act of 2006	11/07/06	2,850,000	1,472,595	1,377,405
Housing and Homeless Bond Act of 1990	06/05/90	150,000	3,415	0
Kindergarten-University Public Education Facilities Bond Act of 2002 (Hi-Ed)	11/05/02	1,650,000	1,552,535	8,820
Kindergarten-University Public Education Facilities Bond Act of 2002 (K-12)	11/05/02	11,400,000	9,897,730	645,150
Kindergarten-University Public Education Facilities Bond Act of 2004 (Hi-Ed)	03/02/04	2,300,000	2,085,960	167,505
Kindergarten-University Public Education Facilities Bond Act of 2004 (K-12)	03/02/04	10,000,000	7,993,520	1,738,630
Kindergarten-University Public Education Facilities Bond Act of 2006 (Hi-Ed)	11/07/06	3,087,000	2,492,255	593,305
Kindergarten-University Public Education Facilities Bond Act of 2006 (K-12)	11/07/06	7,329,000	3,604,520	3,717,595
* Lake Tahoe Acquisitions Bond Act	08/02/82	85,000	2,605	0
* New Prison Construction Bond Act of 1986	11/04/86	500,000	20,915	0
New Prison Construction Bond Act of 1988	11/08/88	817,000	101,700	3,170
New Prison Construction Bond Act of 1990	06/05/90	450,000	86,225	605
Passenger Rail and Clean Air Bond Act of 1990	06/05/90	1,000,000	246,785	0
Public Education Facilities Bond Act of 1996 (Higher Education)	03/26/96	975,000	660,160	37,465
Public Education Facilities Bond Act of 1996 (K-12)	03/26/96	2,025,000	1,241,175	12,965
Safe Drinking Water, Clean Water, Watershed Protection, and Flood Protection Act	03/07/00	1,970,000	1,495,815	277,190
Safe Drinking Water, Water Quality and Supply, Flood Control, River and Coastal Protection Bond Act of 2006	11/07/06	5,388,000	2,034,190	3,348,140
Safe Neighborhood Parks, Clean Water, Clean Air, and Coastal Protection Bond Act of 2000	03/07/00	2,100,000	1,673,800	172,900

AUTHORIZED AND OUTSTANDING GENERAL OBLIGATION BONDS
As of October 1, 2010
(Thousands)

	Voter Authorization Date	Voter Authorization Amount \$	Long Term Bonds Outstanding (a) \$	Long Term Bonds Unissued (b) \$
GENERAL FUND BONDS (Non-Self Liquidating)				
Safe, Clean, Reliable Water Supply Act	11/05/96	995,000	727,295	101,820
Safe, Reliable High-Speed Passenger Train Bond Act for the 21st Century	11/04/08	9,950,000	258,395	9,691,605
* School Building and Earthquake Bond Act of 1974	11/05/74	40,000	21,310	0
School Facilities Bond Act of 1988	06/07/88	800,000	31,690	0
School Facilities Bond Act of 1990	11/06/90	800,000	255,040	0
School Facilities Bond Act of 1992	06/02/92	1,900,000	814,240	10,280
Seismic Retrofit Bond Act of 1996	03/26/96	2,000,000	1,504,365	0
* State School Building Lease-Purchase Bond Law of 1984	11/06/84	450,000	1,850	0
* State School Building Lease-Purchase Bond Law of 1986	11/04/86	800,000	6,900	0
* State, Urban, and Coastal Park Bond Act of 1976	11/02/76	280,000	5,780	0
Stem Cell Research and Cures Bond Act of 2004	11/02/04	3,000,000	1,028,545	1,971,455
Veterans Homes Bond Act of 2000	03/07/00	50,000	40,345	975
Voting Modernization Bond Act of 2002	03/05/02	200,000	72,705	64,495
Water Conservation Bond Law of 1988	11/08/88	60,000	30,680	5,235
* Water Conservation and Water Quality Bond Law of 1986	06/03/86	150,000	48,800	15,535
Water Security, Clean Drinking Water, Coastal and Beach Protection Act of 2002	11/05/02	3,440,000	2,511,805	843,745
Total General Fund Bonds		<u>130,782,000</u>	<u>68,098,479</u>	<u>41,578,049</u>
ENTERPRISE FUND BONDS (Self Liquidating)				
* California Water Resources Development Bond Act	11/08/60	1,750,000	458,115	167,600
Veterans Bond Act of 1986	06/03/86	850,000	136,545	0
Veterans Bond Act of 1988	06/07/88	510,000	119,685	0
Veterans Bond Act of 1990	11/06/90	400,000	111,555	0
Veterans Bond Act of 1996	11/05/96	400,000	242,665	0
Veterans Bond Act of 2000	11/07/00	500,000	250,890	238,610
Veterans Bond Act of 2008	11/04/08	900,000	0	900,000
Total Enterprise Fund Bonds		<u>5,310,000</u>	<u>1,319,455</u>	<u>1,306,210</u>

AUTHORIZED AND OUTSTANDING GENERAL OBLIGATION BONDS
As of October 1, 2010
(Thousands)

	Voter Authorization Date	Voter Authorization Amount \$	Long Term Bonds Outstanding (a) \$	Long Term Bonds Unissued (b) \$
SPECIAL REVENUE FUND BONDS (Self Liquidating)				
* Economic Recovery Bond Act	04/10/04	15,000,000	7,392,220	0
Total Special Revenue Fund Bonds		<u>15,000,000</u>	<u>7,392,220</u>	<u>0</u>
TOTAL GENERAL OBLIGATION BONDS		<u>151,092,000</u>	<u>76,810,154</u>	<u>42,884,259</u>

(a) Includes the initial value of capital appreciation bonds rather than the accreted value.

(b) A portion of unissued bonds may be issued initially in the form of commercial paper notes, as authorized from time to time by the respective Finance Committees. A total of not more than \$2 billion of commercial paper principal plus accrued interest may be owing at one time. See "STATE INDEBTEDNESS AND OTHER OBLIGATIONS - Capital Facilities Financing -- Commercial Paper Program" above. Bond acts marked with an asterisk (*) are not legally permitted to utilize commercial paper.

SOURCE: State of California, Office of the Treasurer.

**GENERAL OBLIGATION AND REVENUE BONDS
SUMMARY OF DEBT SERVICE REQUIREMENTS
As of October 1, 2010**

GENERAL OBLIGATION BONDS	Total Debt		
	<u>Interest</u>	<u>Principal (a)</u>	<u>Total</u>
<u>GENERAL FUND NON-SELF LIQUIDATING (b)</u>			
Fixed Rate	\$ 59,384,385,737.98	\$ 64,378,809,045.16	\$ 123,763,194,783.14
Variable Rate (c)	1,308,662,273.74	3,719,670,000.00	5,028,332,273.74
<u>ENTERPRISE FUND SELF LIQUIDATING</u>			
Fixed Rate	717,685,140.95	1,319,455,000.00	2,037,140,140.95
<u>SPECIAL REVENUE FUND SELF LIQUIDATING (d)</u>			
Fixed Rate	2,034,892,207.50	6,267,615,000.00	8,302,507,207.50
Variable Rate (e)	206,060,510.07	1,124,605,000.00	1,330,665,510.07
REVENUE BONDS			
<u>GENERAL FUND LEASE-REVENUE</u>			
Lease-Revenue	5,861,280,031.48	9,761,885,000.00	15,623,165,031.48
<u>PROPOSITION 1A RECEIVABLES PROGRAM</u>			
Revenue	<u>272,400,000.00</u>	<u>1,895,000,000.00</u>	<u>2,167,400,000.00</u>
General Fund and Lease-Revenue Total (f)	<u><u>\$ 69,785,365,901.72</u></u>	<u><u>\$ 88,467,039,045.16</u></u>	<u><u>\$ 158,252,404,946.88</u></u>

(a) Includes scheduled mandatory sinking fund payments.

(b) Does not include outstanding commercial paper.

(c) The estimate of future interest payments is based on rates in effect as of October 1, 2010. The interest rates for the daily and weekly rate bonds range from 0.16 - 1.00%. The 2009 Stem Cell Bonds, 2009B and 2009C Highway Safety, Traffic Reduction, Air Quality and Port Security Private Placement Bonds, the 2009A Solano County Private Placement Bonds and the 2009A UC Private Placement Bonds currently bear interest at fixed rates of 5.65%, 3.77%, 3.30%, 3.18%, and 3.183% respectively, until reset date, and are assumed to bear those rates from reset until maturity.

(d) Economic Recovery Bonds.

(e) The estimate of future interest payments is based on rates in effect as of October 1, 2010. The interest rates for the daily and weekly rate bonds range from 0.17 - 0.26%. \$500,000,000 of the series 2009B Economic Recovery Bonds bear interest at fixed rates ranging from 3.50 - 5.00% until reset date, and are assumed to bear interest at the rate of 4.00% from each reset date to maturity.

(f) Estimated interest included.

SOURCE: State of California, Office of the Treasurer.

**SCHEDULE OF DEBT SERVICE REQUIREMENTS
FOR GENERAL FUND NON-SELF LIQUIDATING BONDS
Fixed Rate
As of October 1, 2010**

Fiscal Year Ending June 30	Current Debt		
	Interest (a)	Principal (b)	Total
2011	\$ 2,131,406,234.71	\$ 1,339,774,045.16	\$ 3,471,180,279.87 (c)
2012	3,434,790,228.69	1,931,030,000.00	5,365,820,228.69
2013	3,343,472,625.95	1,599,315,000.00	4,942,787,625.95
2014	3,264,690,148.39	2,226,410,000.00	5,491,100,148.39
2015	3,157,030,742.50	2,336,360,000.00	5,493,390,742.50
2016	3,046,112,415.00	2,003,435,000.00	5,049,547,415.00
2017	2,945,494,427.79	1,802,860,000.00	4,748,354,427.79
2018	2,856,095,592.12	1,760,125,000.00	4,616,220,592.12
2019	2,766,722,649.27	1,883,495,000.00	4,650,217,649.27
2020	2,647,866,726.65	2,220,430,000.00	4,868,296,726.65
2021	2,548,866,108.96	1,827,315,000.00	4,376,181,108.96
2022	2,455,406,595.94	1,915,400,000.00	4,370,806,595.94
2023	2,357,206,436.98	1,872,920,000.00	4,230,126,436.98
2024	2,265,774,719.29	1,686,855,000.00	3,952,629,719.29
2025	2,179,565,744.34	1,893,325,000.00	4,072,890,744.34
2026	2,080,869,571.70	2,006,075,000.00	4,086,944,571.70
2027	1,972,714,853.64	2,028,635,000.00	4,001,349,853.64
2028	1,871,431,603.12	2,219,300,000.00	4,090,731,603.12
2029	1,762,653,756.25	2,190,385,000.00	3,953,038,756.25
2030	1,652,320,807.96	2,448,440,000.00	4,100,760,807.96
2031	1,531,658,126.56	2,070,470,000.00	3,602,128,126.56
2032	1,427,436,305.00	2,305,075,000.00	3,732,511,305.00
2033	1,305,230,145.00	2,259,295,000.00	3,564,525,145.00
2034	1,183,189,298.80	3,387,935,000.00	4,571,124,298.80
2035	948,977,041.25	2,830,030,000.00	3,779,007,041.25
2036	777,804,138.26	2,679,740,000.00	3,457,544,138.26
2037	610,615,071.97	2,625,870,000.00	3,236,485,071.97
2038	452,133,153.14	2,410,635,000.00	2,862,768,153.14
2039	333,518,600.00	3,093,990,000.00	3,427,508,600.00
2040	73,331,868.75	1,523,885,000.00	1,597,216,868.75
Total	\$ 59,384,385,737.98	\$ 64,378,809,045.16	\$ 123,763,194,783.14

(a) The amounts do not reflect any interest subsidy under the Build America Bonds program. Subsidy not pledged to the repayment of debt service.

(b) Includes scheduled mandatory sinking fund payments.

(c) Total represents the remaining estimated debt service requirements from November 1, 2010 through June 30, 2011.

SOURCE: State of California, Office of the Treasurer.

**SCHEDULE OF DEBT SERVICE REQUIREMENTS
FOR GENERAL FUND NON-SELF LIQUIDATING BONDS
Variable Rate
As of October 1, 2010**

Fiscal Year Ending June 30	Current Debt		
	Interest (a)(b)	Principal (c)	Total
2011	\$ 26,742,059.15	\$ -	\$ 26,742,059.15 (d)
2012	51,832,842.48	-	51,832,842.48
2013	51,844,235.41	-	51,844,235.41
2014	51,811,105.96	-	51,811,105.96
2015	51,811,105.96	-	51,811,105.96
2016	51,829,269.85	32,000,000.00	83,829,269.85
2017	51,703,572.26	326,945,000.00	378,648,572.26
2018	50,848,348.14	431,245,000.00	482,093,348.14
2019	49,775,174.23	197,450,000.00	247,225,174.23
2020	49,257,674.52	184,250,000.00	233,507,674.52
2021	48,842,968.00	108,600,000.00	157,442,968.00
2022	48,715,978.89	58,000,000.00	106,715,978.89
2023	48,633,309.03	88,200,000.00	136,833,309.03
2024	48,510,482.44	270,600,000.00	319,110,482.44
2025	48,201,901.06	174,200,000.00	222,401,901.06
2026	47,988,369.93	318,000,000.00	365,988,369.93
2027	47,665,591.49	46,100,000.00	93,765,591.49
2028	47,585,339.97	49,700,000.00	97,285,339.97
2029	47,491,704.07	87,500,000.00	134,991,704.07
2030	46,841,193.52	106,440,000.00	153,281,193.52
2031	45,248,286.36	129,335,000.00	174,583,286.36
2032	43,337,108.06	132,435,000.00	175,772,108.06
2033	41,419,315.04	135,335,000.00	176,754,315.04
2034	39,509,081.00	54,235,000.00	93,744,081.00
2035	37,731,263.62	52,635,000.00	90,366,263.62
2036	35,955,251.56	52,635,000.00	88,590,251.56
2037	34,179,204.13	52,635,000.00	86,814,204.13
2038	32,403,192.07	52,635,000.00	85,038,192.07
2039	30,627,168.22	557,600,000.00	588,227,168.22
2040	320,177.33	20,960,000.00	21,280,177.33
Total	\$ 1,308,662,273.74	\$ 3,719,670,000.00	\$ 5,028,332,273.74

(a) The estimate of future interest payments is based on rates in effect as of October 1, 2010. The interest rates for the daily and weekly rate bonds range from 0.16 - 1.00%. The 2009 Stem Cell Bonds, 2009B and 2009C Highway Safety, Traffic Reduction, Air Quality and Port Security Private Placement Bonds, the 2009A Solano County Private Placement Bonds and the 2009A UC Private Placement Bonds currently bear interest at fixed rates of 5.65%, 3.77%, 3.30%, 3.18%, and 3.183% respectively, until reset date, and are assumed to bear those rates from reset until maturity.

(b) The amounts do not reflect any interest subsidy under the Build America Bonds program. Subsidy not pledged to the repayment of debt service.

(c) Includes scheduled mandatory sinking fund payments for the 2009 Stem Cell Bonds, the Series 2009B and 2009C of the Highway Safety, Traffic Reduction, Air Quality and Port Security Private Placement Bonds, the 2009A Solano County Private Placement Bonds and the 2009A UC Private Placement Bonds.

(d) Total represents the remaining estimated debt service requirements from November 1, 2010 through June 30, 2011.

**SCHEDULE OF DEBT SERVICE REQUIREMENTS
FOR STATE OF CALIFORNIA PROPOSITION 1A RECEIVABLES PROGRAM^(a)
REVENUE BONDS
Fixed Rate
As of October 1, 2010**

Fiscal Year Ending June 30	Current Debt		
	Interest	Principal	Total
2011	\$ 90,800,000.00	\$ -	\$ 90,800,000.00 (b)
2012	90,800,000.00	-	90,800,000.00
2013	90,800,000.00	1,895,000,000.00	1,985,800,000.00
Total	\$ 272,400,000.00	\$ 1,895,000,000.00	\$ 2,167,400,000.00

(a) Bonds were issued by the California Statewide Communities Development Authority pursuant to Article 4 (commencing with Section 6584) of Chapter 5 of Division 7 of Title 1 of the Government Code of the State of California.

(b) Total represents the remaining estimated debt service requirements from November 1, 2010 through June 30, 2011.

SOURCE: State of California, Office of the Treasurer.

**SCHEDULE OF DEBT SERVICE REQUIREMENTS FOR
SPECIAL REVENUE FUND SELF LIQUIDATING BONDS**

Fixed Rate

As of October 1, 2010

Fiscal Year Ending June 30	Current Debt		
	Interest	Principal (a)	Total
2011	155,327,316.25	221,170,000.00	376,497,316.25 (b)
2012	294,816,967.50	240,330,000.00	535,146,967.50
2013	278,116,960.00	476,470,000.00	754,586,960.00
2014	253,545,855.00	500,470,000.00	754,015,855.00
2015	227,360,123.75	525,615,000.00	752,975,123.75
2016	199,987,330.00	556,690,000.00	756,677,330.00
2017	172,061,875.00	584,210,000.00	756,271,875.00
2018	142,939,488.75	612,540,000.00	755,479,488.75
2019	113,287,497.50	592,955,000.00	706,242,497.50
2020	86,381,762.50	496,145,000.00	582,526,762.50
2021	61,485,062.50	507,445,000.00	568,930,062.50
2022	36,945,093.75	451,575,000.00	488,520,093.75
2023	12,591,250.00	500,000,000.00	512,591,250.00
2024	45,625.00	2,000,000.00	2,045,625.00
Total	\$ 2,034,892,207.50	\$ 6,267,615,000.00	\$ 8,302,507,207.50

(a) Includes scheduled mandatory sinking fund payments.

(b) Total represents the remaining estimated debt service requirements from November 1, 2010 through June 30, 2011.

SOURCE: State of California, Office of the Treasurer.

**SCHEDULE OF DEBT SERVICE REQUIREMENTS FOR
SPECIAL REVENUE FUND SELF LIQUIDATING BONDS
Variable Rate
As of October 1, 2010**

Fiscal Year Ending June 30	Current Debt		
	Interest (a)	Principal (b)	Total
2011	12,123,519.89	-	12,123,519.89 (c)
2012	24,148,381.06	-	24,148,381.06
2013	24,149,061.58	-	24,149,061.58
2014	24,147,082.68	-	24,147,082.68
2015	22,222,657.68	-	22,222,657.68
2016	20,299,531.06	-	20,299,531.06
2017	20,298,572.94	-	20,298,572.94
2018	20,299,052.00	25,000,000.00	45,299,052.00
2019	18,800,690.64	115,000,000.00	133,800,690.64
2020	12,907,892.42	189,500,000.00	202,407,892.42
2021	5,118,572.94	240,155,000.00	245,273,572.94
2022	1,227,752.00	219,190,000.00	220,417,752.00
2023	293,194.79	210,820,000.00	211,113,194.79
2024	24,548.38	124,940,000.00	124,964,548.38
Total	\$ 206,060,510.07	\$ 1,124,605,000.00	\$ 1,330,665,510.07

(a) The estimate of future interest payments is based on rates in effect as of October 1, 2010. The interest rates for the daily and weekly rate bonds range from 0.17 - 0.26%. \$500,000,000 of the series 2009B Economic Recovery Bonds bear interest at fixed rates ranging from 3.50 - 5.00% until reset date, and are assumed to bear interest at the rate of 4.00% from each reset date to maturity.

(b) Includes scheduled mandatory sinking fund payments.

(c) Total represents the remaining estimated debt service requirements from November 1, 2010 through June 30, 2011.

SOURCE: State of California, Office of the Treasurer.

**SCHEDULE OF DEBT SERVICE REQUIREMENTS
FOR ENTERPRISE FUND SELF LIQUIDATING BONDS
Fixed Rate
As of October 1, 2010**

Fiscal Year Ending June 30	Current Debt		
	Interest	Principal (a)	Total
2011	\$ 51,409,173.46	\$ 44,860,000.00	\$ 96,269,173.46 (b)
2012	54,291,331.00	100,080,000.00	154,371,331.00
2013	50,614,403.50	85,060,000.00	135,674,403.50
2014	47,060,902.50	107,040,000.00	154,100,902.50
2015	43,709,424.33	77,565,000.00	121,274,424.33
2016	40,695,867.88	75,620,000.00	116,315,867.88
2017	37,995,183.75	61,895,000.00	99,890,183.75
2018	35,308,185.90	60,655,000.00	95,963,185.90
2019	32,432,145.17	65,065,000.00	97,497,145.17
2020	30,176,406.11	31,225,000.00	61,401,406.11
2021	28,633,175.00	24,830,000.00	53,463,175.00
2022	27,227,176.28	27,005,000.00	54,232,176.28
2023	26,174,826.25	14,945,000.00	41,119,826.25
2024	25,386,566.25	19,015,000.00	44,401,566.25
2025	24,368,813.55	24,240,000.00	48,608,813.55
2026	23,176,171.05	26,085,000.00	49,261,171.05
2027	21,887,431.15	28,155,000.00	50,042,431.15
2028	20,514,605.30	29,490,000.00	50,004,605.30
2029	18,695,830.30	46,130,000.00	64,825,830.30
2030	16,324,896.19	52,400,000.00	68,724,896.19
2031	13,861,787.28	50,490,000.00	64,351,787.28
2032	11,371,757.50	53,235,000.00	64,606,757.50
2033	8,761,341.25	55,095,000.00	63,856,341.25
2034	6,889,425.00	22,940,000.00	29,829,425.00
2035	5,786,720.00	23,560,000.00	29,346,720.00
2036	4,731,100.00	21,210,000.00	25,941,100.00
2037	3,670,842.50	23,885,000.00	27,555,842.50
2038	2,756,210.00	15,590,000.00	18,346,210.00
2039	2,028,212.50	16,330,000.00	18,358,212.50
2040	1,257,530.00	17,110,000.00	18,367,530.00
2041	450,087.50	17,925,000.00	18,375,087.50
2042	28,050.00	350,000.00	378,050.00
2043	9,562.50	375,000.00	384,562.50
Total	\$ 717,685,140.95	\$ 1,319,455,000.00	\$ 2,037,140,140.95

(a) Includes scheduled mandatory sinking fund payments.

(b) Total represents the remaining estimated debt service requirements from November 1, 2010 through June 30, 2011.

SOURCE: State of California, Office of the Treasurer.

**STATE PUBLIC WORKS BOARD AND
OTHER LEASE-REVENUE FINANCING
OUTSTANDING ISSUES
As of October 1, 2010**

<u>Name of Issue</u>	<u>Outstanding</u>
<u>GENERAL FUND SUPPORTED ISSUES:</u>	
State Public Works Board	
California Community Colleges	\$ 477,310,000
California Department of Corrections and Rehabilitations	2,257,430,000
Office of Energy Assessments (a)	3,905,000
The Regents of the University of California (b)	2,308,180,000
Trustees of the California State University	811,325,000
Various State Facilities (c)	3,381,765,000
	\$ 9,239,915,000
Total State Public Works Board Issues	\$ 9,239,915,000
Total Other State Facilities Lease-Revenue Issues (d)	\$ 521,970,000
Total General Fund Supported Issues	\$ 9,761,885,000
 <u>SPECIAL FUND SUPPORTED ISSUES:</u>	
East Bay State Building Authority*	\$ 42,777,519
San Bernardino Joint Powers Financing Authority	39,770,000
San Francisco State Building Authority (e)	13,705,000
	\$ 96,252,519
Total Special Fund Supported Issues	\$ 96,252,519
 TOTAL	 \$ 9,858,137,519

* Includes the initial value of capital appreciation bonds rather than the accreted value.

(a) This program is self liquidating based on energy cost savings.

(b) The Regents' obligations to the State Public Works Board are payable from lawfully available funds of The Regents which are held in The Regents' treasury funds **and** are separate from the State General Fund. A portion of The Regents' annual budget is derived from General Fund appropriations.

(c) This includes projects that are supported by multiple funding sources in addition to the General Fund.

(d) Includes \$134,670,000 Sacramento City Financing Authority Lease-Revenue Bonds State of California - Cal/EPA Building, 1998 Series A, which are supported by lease rentals from the California Environmental Protection Agency; these rental payments are subject to annual appropriation by the State Legislature.

(e) The sole tenant is the California Public Utilities Commission.

SOURCE: State of California, Office of the Treasurer.

**SCHEDULE OF DEBT SERVICE REQUIREMENTS
FOR LEASE-REVENUE DEBT
Fixed Rate
As of October 1, 2010**

Fiscal Year Ending June 30	Current Debt		
	Interest (a)	Principal (b)	Total
2011	\$ 387,200,449.78	\$ 334,755,000.00	\$ 721,955,449.78 (c)
2012	495,875,683.49	456,785,000.00	952,660,683.49
2013	473,550,326.05	483,720,000.00	957,270,326.05
2014	449,223,020.20	510,475,000.00	959,698,020.20
2015	423,393,890.32	535,190,000.00	958,583,890.32
2016	396,623,581.88	525,545,000.00	922,168,581.88
2017	369,804,676.59	538,170,000.00	907,974,676.59
2018	342,611,419.67	559,140,000.00	901,751,419.67
2019	314,649,639.45	528,080,000.00	842,729,639.45
2020	287,918,642.71	508,940,000.00	796,858,642.71
2021	263,296,001.20	457,430,000.00	720,726,001.20
2022	239,730,203.33	440,100,000.00	679,830,203.33
2023	218,309,540.75	400,850,000.00	619,159,540.75
2024	198,317,716.13	327,230,000.00	525,547,716.13
2025	181,094,870.06	344,460,000.00	525,554,870.06
2026	163,234,543.32	344,535,000.00	507,769,543.32
2027	144,390,317.60	363,370,000.00	507,760,317.60
2028	124,442,938.38	367,595,000.00	492,037,938.38
2029	104,835,813.79	319,840,000.00	424,675,813.79
2030	86,992,738.82	300,625,000.00	387,617,738.82
2031	70,057,388.41	255,565,000.00	325,622,388.41
2032	54,587,907.75	239,695,000.00	294,282,907.75
2033	39,039,859.95	229,840,000.00	268,879,859.95
2034	23,594,827.23	211,880,000.00	235,474,827.23
2035	8,504,034.62	178,070,000.00	186,574,034.62
Total	\$ 5,861,280,031.48	\$ 9,761,885,000.00	\$ 15,623,165,031.48

(a) The amounts do not reflect any interest subsidy under the Build America Bonds program. Subsidy not pledged to the repayment of debt service.

(b) Includes scheduled mandatory sinking fund payments.

(c) Total represents the remaining estimated debt service requirements from November 1, 2010 through June 30, 2011.

SOURCE: State of California, Office of the Treasurer.

**STATE AGENCY REVENUE BONDS
AND CONDUIT FINANCING
As of June 30, 2010**

<u>Issuing Agency</u>	<u>Outstanding</u> ^{(a)(b)}
<u>State Programs Financing:</u>	
California Alternative Energy and Advanced Transportation Financing Authority.....	\$ 18,666,667
California Department of Transportation - GARVEE.....	405,310,000
California Infrastructure and Economic Development Bank.....	1,116,530,000
California State University.....	3,436,168,000
Department of Water Resources - Central Valley Project.....	2,421,185,000
Department of Water Resources - Power Supply Program.....	8,394,625,000
The Regents of the University of California.....	9,013,985,000
<u>Housing Financing:</u>	
California Housing Finance Agency.....	8,894,635,945
Veterans Revenue Debenture.....	677,430,000
<u>Conduit Financing:</u>	
California Alternative Energy and Advanced Transportation Financing Authority.....	55,110,000
California Earthquake Authority.....	220,500,000
California Educational Facilities Authority.....	4,736,523,782
California Health Facilities Financing Authority.....	9,498,852,948
California Infrastructure and Economic Development Bank	4,227,477,301
California Pollution Control Financing Authority.....	3,895,169,843
California Student Loan Authority.....	17,035,000
TOTAL.....	<u>\$ 57,029,204,486</u>

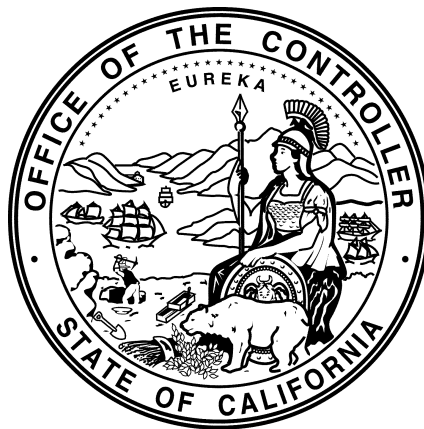
(a) Totals for California Department of Transportation, California State University, Department of Water Resources and Veterans Revenue Debenture were provided by the State of California, Office of the Treasurer. All other totals were provided by the listed issuing agency.

(b) Does not include the Tobacco Settlement Revenue Bonds issued by Golden State Tobacco Securitization Corporation.

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STATEMENT of GENERAL FUND CASH RECEIPTS and DISBURSEMENTS

June 2010



JOHN CHIANG
California State Controller



JOHN CHIANG
California State Controller

July 9, 2010

Users of the Statement of General Fund Cash Receipts and Disbursements:

Enclosed is the Statement of General Fund Cash Receipts and Disbursements for the period July 1, 2009 through June 30, 2010. This statement reflects the State of California's General Fund cash position and compares actual receipts and disbursements for the 2009-10 fiscal year to cash flow estimates prepared by the Department of Finance for the Amended 2009-10 Budget Act. The statement is prepared in compliance with Provision 8 of Budget Act item 0840-001-0001, using records compiled by the State Controller. Prior year actual amounts are also displayed for comparative purposes.

Attachment A compares actual receipts and disbursements to date for the 2009-10 fiscal year to cash flow estimates published in the 2010-11 May Revision. These cash flow estimates are predicated on projections and assumptions made by the Department of Finance in preparation of the May Revision.

Attachment B compares actual receipts and disbursements to date for the 2009-10 fiscal year to cash flow estimates prepared by the Department of Finance based upon the Amended 2009 Budget Act.

These statements are also available on the Internet at the State Controller's website at www.sco.ca.gov under the category Monthly Financial Reports.

Any questions concerning this report may be directed to Michael Havey, Division Chief of Accounting and Reporting, at (916) 327-4144.

Sincerely,

Original signed by

JOHN CHIANG
California State Controller

STATEMENT OF GENERAL FUND CASH RECEIPTS AND DISBURSEMENTS
A Comparison of Actual to 2010-11 May Revision Estimates
(Amounts in thousands)

	July 1 through June 30				2009 Actual
	2010		Actual Over or (Under) Estimate		
	Actual	Estimate (a)	Amount	%	
GENERAL FUND BEGINNING CASH BALANCE	\$ -	\$ -	\$ -	-	\$ -
Add Receipts:					
Revenues	86,589,547	86,051,959	537,588	0.6	85,179,154
Nonrevenues	2,065,394	2,185,678	(120,284) (e)(f)	(5.5)	2,595,798
Total Receipts	88,654,941	88,237,637	417,304	0.5	87,774,952
Less Disbursements:					
State Operations	23,541,235	23,348,729	192,506 (e)(f)	0.8	26,668,214
Local Assistance	60,583,449	61,897,828	(1,314,379) (e)(f)	(2.1)	69,825,334
Capital Outlay	1,860,643	1,692,316	168,327	9.9	1,202,612
Nongovernmental	683,664	1,090,534	(406,870)	(37.3)	535,119
Total Disbursements	86,668,991	88,029,407	(1,360,416)	(1.5)	98,231,279
Receipts Over / (Under) Disbursements	1,985,950	208,230	1,777,720	853.7	(10,456,327)
Net Increase / (Decrease) in Temporary Loans	(1,985,950)	(208,230)	(1,777,720)	-	10,456,327
GENERAL FUND ENDING CASH BALANCE	-	-	-	-	-
Special Fund for Economic Uncertainties	-	-	-	-	-
TOTAL CASH	\$ -	\$ -	\$ -	-	\$ -
BORROWABLE RESOURCES					
Available Borrowable Resources	\$ 18,680,554	\$ 17,944,737	\$ 735,817 (d)	4.1	\$ 19,037,711
Outstanding Loans (b)	9,922,135	11,699,858	(1,777,723)	(15.2)	11,908,085
Unused Borrowable Resources	\$ 8,758,419	\$ 6,244,879	\$ 2,513,540	40.2	\$ 7,129,626

General Note:

This report is based upon funded cash. Funded cash is cash reported to and recorded in the records of the State Controller's Office. Amounts reported as funded cash may differ from amounts in other reports to the extent there are timing differences in the recording of in-transit items.

Footnotes:

- (a) A Statement of Estimated Cash Flow for the 2009-10 fiscal year was prepared by the Department of Finance for the 2010-11 May Revision. Any projections or estimates are set forth as such and not as representation of facts.
- (b) Outstanding loan balance is comprised of \$9.9 billion of internal borrowing. Current balance is comprised of \$11.9 billion carried forward from June 30, 2009 plus current year Net Increase/Decrease in Temporary Loans of \$2 billion.
- (c) Negative variances are the result of repayments received that are greater than disbursements made.
- (d) On September 29, 2009, \$8.8 billion of Revenue Anticipation Notes proceeds were received, \$2.8 billion and \$5.97 billion were repaid on May 25, 2010 and June 23, 2010. The \$1.5 billion interim RAN issued August 27, 2009 was repaid on September 29, 2009.
- (e) These amounts reflect the receipt of funds from the County Office of Education pursuant to Revenue and Tax Code Section 100.06, as added by Chapter 14, Statutes of 2009 (AB x4 15, Gaines) as offsets to General Fund expenditures in accordance with Control Section 15.45 of the Budget Act of 2009. The total non-revenue receipts of \$2,105 million were applied to the following expenditures: \$895 million to Administrative Office of the Courts, \$385 million to California Department of Corrections and Rehabilitation, \$816 million to Health Care Services Medi-Cal Assistance, \$190 thousand to Department of Child Support Services and \$9 million to Department of Developmental Services.

SCHEDULE OF CASH RECEIPTS

(Amounts in thousands)

	Month of June		July 1 through June 30				
	2010	2009	2010		2009		
			Actual	Estimate (a)	Actual Over or (Under) Estimate		Actual
				Amount	%		
REVENUES							
Alcoholic Beverage Excise Tax	\$ 26,858	\$ 25,699	\$ 323,583	\$ 329,175	\$ (5,592)	(1.7)	\$ 333,435
Corporation Tax	1,943,530	4,489,284	9,446,013	9,518,200	(72,187)	(0.8)	12,260,536
Cigarette Tax	1,262	1,274	96,213	96,629	(416)	(0.4)	107,415
Estate, Inheritance, and Gift Tax	2,119	1,211	7,008	4,752	2,256	47.5	18,275
Insurance Companies Tax	368,149	406,789	2,015,489	2,000,306	15,183	0.8	2,059,909
Personal Income Tax	5,805,579	4,505,900	44,629,412	43,904,371	725,041	1.7	43,701,844
Retail Sales and Use Taxes	2,515,865	2,486,729	26,659,015	26,739,586	(80,571)	(0.3)	23,702,413
Vehicle Licence Fees	110,701	-	1,370,059	1,387,979	(17,920)	(1.3)	-
Pooled Money Investment Interest	10,163	31,444	26,025	21,378	4,647	21.7	226,399
Not Otherwise Classified	556,193	605,298	2,016,730	2,049,583	(32,853)	-	2,768,928
Total Revenues	11,340,419	12,553,628	86,589,547	86,051,959	537,588	0.6	85,179,154
NONREVENUES							
Transfers from Special Fund for Economic Uncertainties	42,841	-	1,103,675	1,060,834	42,841	4.0	837,902
Transfers from Other Funds	38,566	6,109	301,034	527,355	(226,321)	(42.9)	1,081,352
Miscellaneous	77,205	33,684	660,685	597,489	63,196	10.6	676,544
Total Nonrevenues	158,612	39,793	2,065,394	2,185,678	(120,284)	(5.5)	2,595,798
Total Receipts	\$ 11,499,031	\$ 12,593,421	\$ 88,654,941	\$ 88,237,637	\$ 417,304	0.5	\$ 87,774,952

See notes on page 1.

Footnotes:

- (f) These amounts reflect the shift of Redevelopment Agency monies pursuant to Revenue and Tax Code Section 100.06, as added by Chapter 14, Statutes of 2009 (AB x4 15, Gaines) as offsets to General Fund expenditures in accordance with Control Section 15.45 of the Budget Act of 2009. The total non-revenue receipts of \$1,409 million were applied to the following expenditures: \$428 million to Administrative Office of the Courts, \$203 million to California Department of Corrections and Rehabilitation, \$766 million to Health Care Services Medi-Cal Assistance, \$240 thousand to Department of Child Support Services and \$12 million to Department of Developmental Services.

SCHEDULE OF CASH DISBURSEMENTS

(Amounts in thousands)

	Month of June		July 1 through June 30				2009 Actual
	2010	2009	Actual	Estimate (a)	Actual Over or (Under) Estimate		
					Amount	%	
STATE OPERATIONS (c)							
Legislative/Judicial/Executive	\$ 142,213	\$ 109,625	\$ 1,467,820	\$ 1,480,118	\$ (12,298)	(0.8)	\$ 1,471,734
State and Consumer Services	39,872	51,313	489,950	508,346	(18,396)	(3.6)	537,149
Business, Transportation and Housing	414,794	169	417,389	(216,105)	633,494	-	4,695
Resources	73,766	90,605	1,115,364	1,123,469	(8,105)	(0.7)	1,567,600
Environmental Protection Agency	8,397	533	52,162	63,350	(11,188)	(17.7)	61,400
Health and Human Services:							
Health Services	3,311	(7,003)	209,271	215,311	(6,040)	(2.8)	210,754
Mental Health	83,572	93,206	1,082,781	1,075,506	7,275	0.7	1,204,252
Other Health and Human Services	8,032	40,482	511,050	471,345	39,705	8.4	626,695
Education:							
University of California	139,648	358,473	1,801,720	1,835,875	(34,155)	(1.9)	3,206,579
State Universities and Colleges	59	159	1,630,282	1,635,611	(5,329)	(0.3)	2,875,470
Other Education	11,604	15,088	160,544	163,866	(3,322)	(2.0)	167,672
Dept. of Corrections and Rehabilitation	326,706	514,202	8,111,662	8,468,351	(356,689)	(e)(f) (4.2)	9,016,603
General Government	64,254	78,320	1,516,442	1,349,052	167,390	12.4	1,496,416
Public Employees Retirement							
System	(133,488)	(139,055)	15,886	22,098	(6,212)	(28.1)	19,807
Debt Service	180,501	371,461	4,703,924	4,959,814	(255,890)	(5.2)	3,995,754
Interest on Loans	137,003	141,345	254,988	192,722	62,266	32.3	205,634
Total State Operations	1,500,244	1,718,923	23,541,235	23,348,729	192,506	0.8	26,668,214
LOCAL ASSISTANCE (c)							
Public Schools - K-12	1,410,621	258,670	29,151,614	29,965,039	(813,425)	(2.7)	31,186,076
Community Colleges	139,056	287,500	3,757,261	3,740,350	16,911	0.5	4,068,798
Debt Service-School Building Bonds	-	-	-	(1,263)	1,263	-	-
Contributions to State Teachers'							
Retirement System	-	-	1,248,045	1,248,045	-	-	1,133,088
Other Education	1,340	80,679	3,351,573	3,625,622	(274,049)	(7.6)	3,623,193
Dept. of Corrections and Rehabilitation	1,797	7,080	203,469	205,267	(1,798)	(0.9)	276,343
Dept. of Alcohol and Drug Program	948	(21,688)	203,151	179,001	24,150	13.5	254,842
Dept. of Health Services:							
Medical Assistance Program	(334,126)	927,885	10,236,433	10,269,334	(32,901)	(e)(f) (0.3)	12,645,121
Other Health Services	7,932	17,629	279,796	361,778	(81,982)	(22.7)	384,433
Dept. of Developmental Services	(41,951)	54,862	1,895,351	2,091,219	(195,868)	(e)(f) (9.4)	2,338,766
Dept. of Mental Health	3,469	(16,521)	677,190	676,009	1,181	0.2	840,415
Dept. of Social Services:							
SSI/SSP/IHSS	(80,469)	324,300	4,248,830	4,299,725	(50,895)	(1.2)	5,025,255
CalWORKs	63,257	95,077	2,367,641	2,335,434	32,207	1.4	2,849,760
Other Social Services	35,455	170,813	1,420,981	1,435,381	(14,400)	(1.0)	1,503,172
Tax Relief	-	1,177	439,725	437,764	1,961	0.4	482,071
Other Local Assistance	(523,456)	244,581	1,102,389	1,029,123	73,266	(e)(f) 7.1	3,214,001
Total Local Assistance	683,873	2,432,044	60,583,449	61,897,828	(1,314,379)	(2.1)	69,825,334

See notes on page 1.

(Continued)

SCHEDULE OF CASH DISBURSEMENTS (Continued)

(Amounts in thousands)

	Month of June		July 1 through June 30				
	2010	2009	2010		2009		
			Actual	Estimate (a)	Actual Over or (Under) Estimate Amount	%	Actual
CAPITAL OUTLAY	406,110	(42,747)	1,860,643	1,692,316	168,327	9.9	1,202,612
NONGOVERNMENTAL (c)							
Transfer to Special Fund for Economic Uncertainties	-	-	-	-	-	-	-
Transfer to Budget Stabilization Account	-	-	-	-	-	-	-
Transfer to Other Funds	(293,556)	56,672	733,986	1,133,744	(399,758)	(35.3)	567,538
Transfer to Revolving Fund	(69,964)	(17,855)	(55,061)	-	(55,061)	-	12,778
Advance:							
MediCal Provider Interim Payment	-	-	-	-	-	-	-
State-County Property Tax Administration Program	43,676	17,409	18,430	-	18,430	-	(44,356)
Social Welfare Federal Fund	26,686	4,700	(33)	-	(33)	-	2,681
Tax Relief and Refund Account	-	-	-	-	-	-	-
Counties for Social Welfare	532,613	546,271	(13,658)	(43,210)	29,552	-	(3,522)
Total Nongovernmental	239,455	607,197	683,664	1,090,534	(406,870)	(37.3)	535,119
Total Disbursements	\$ 2,829,682	\$ 4,715,417	\$ 86,668,991	\$ 88,029,407	\$ (1,360,416)	(1.5)	\$ 98,231,279
TEMPORARY LOANS							
Special Fund for Economic Uncertainties	\$ (42,841)	\$ -	\$ (1,103,676)	\$ (1,060,835)	\$ (42,841)	-	\$ 87,814
Budget Stabilization Account	-	-	-	-	-	-	-
Outstanding Registered Warrants Account	-	-	-	-	-	-	-
Other Internal Sources	(2,651,508)	(3,578,004)	(882,274)	852,605	(1,734,879)	(203.5)	10,368,513
Revenue Anticipation Notes	(5,975,000)	(4,300,000)	-	-	-	(d)	-
Net Increase / (Decrease) Loans	\$ (8,669,349)	\$ (7,878,004)	\$ (1,985,950)	\$ (208,230)	\$ (1,777,720)	-	\$ 10,456,327

See notes on page 1.

(Concluded)

COMPARATIVE STATEMENT OF REVENUES RECEIVED
All Governmental Cost Funds
(Amounts in thousands)

	July 1 through June 30			
	General Fund		Special Funds	
	2010	2009	2010	2009
MAJOR TAXES, LICENSES, AND INVESTMENT INCOME:				
Alcoholic Beverage Excise Taxes	\$ 323,583	\$ 333,435	\$ -	\$ -
Corporation Tax	9,446,013	12,260,536	-	-
Cigarette Tax	96,213	107,415	824,376	918,551
Estate, Inheritance, and Gift Tax	7,008	18,275	-	-
Insurance Companies Tax	2,015,489	2,059,909	233,966	-
Motor Vehicle Fuel Tax:				
Gasoline Tax	-	-	2,664,166	2,654,779
Diesel & Liquid Petroleum Gas	-	-	494,728	513,536
Jet Fuel Tax	-	-	2,283	2,785
Vehicle License Fees	1,370,059	187,405	1,956,797	2,116,192
Motor Vehicle Registration and Other Fees	-	-	3,454,433	3,301,626
Personal Income Tax	44,629,412	43,701,844	792,093	794,958
Retail Sales and Use Taxes	26,659,015	23,702,413	6,774,168	8,097,424
Pooled Money Investment Interest	26,025	226,399	766	1,845
Total Major Taxes, Licenses, and Investment Income	84,572,817	82,597,631	17,197,776	18,401,696
NOT OTHERWISE CLASSIFIED:				
Alcoholic Beverage License Fee	2,777	3,771	44,592	48,583
Electrical Energy Tax	-	-	694,143	684,872
Private Rail Car Tax	5,814	6,045	-	-
Penalties on Traffic Violations	-	-	92,230	96,356
Health Care Receipts	11,805	13,616	-	-
Revenues from State Lands	270,882	374,167	-	-
Abandoned Property	120,785	558,208	-	-
Trial Court Revenues	63,670	67,260	1,699,627	1,439,088
Horse Racing Fees	1,381	2,534	12,679	27,570
Miscellaneous	1,539,616	1,555,922	6,145,011	6,334,780
Not Otherwise Classified	2,016,730	2,581,523	8,688,282	8,631,249
Total Revenues, All Governmental Cost Funds	\$ 86,589,547	\$ 85,179,154	\$ 25,886,058	\$ 27,032,945

See notes on page 1.

STATEMENT OF GENERAL FUND CASH RECEIPTS AND DISBURSEMENTS
A Comparison of Actual to Amended 2009 Budget Act Estimates
(Amounts in thousands)

	July 1 through June 30				2009
	2010		Actual Over or (Under) Estimate		
	Actual	Estimate (a)	Amount	%	
GENERAL FUND BEGINNING CASH BALANCE	\$ -	\$ -	\$ -	-	\$ -
Add Receipts:					
Revenues	86,589,547	88,705,882	(2,116,335)	(2.4)	85,179,154
Nonrevenues	2,065,394	2,070,749	(5,355)	(h)(i) (0.3)	2,595,798
Total Receipts	88,654,941	90,776,631	(2,121,690)	(2.3)	87,774,952
Less Disbursements:					
State Operations	23,541,235	21,346,245	2,194,990	(h)(i) 10.3	26,668,214
Local Assistance	60,583,449	61,737,409	(1,153,960)	(h)(i) (1.9)	69,825,334
Capital Outlay	1,860,643	1,861,118	(475)	(0.0)	1,202,612
Nongovernmental	683,664	859,768	(176,104)	(20.5)	535,119
Total Disbursements	86,668,991	85,804,540	864,451	1.0	98,231,279
Receipts Over / (Under) Disbursements	1,985,950	4,972,091	(2,986,141)	(60.1)	(10,456,327)
Net Increase / (Decrease) in Temporary Loans	(1,985,950)	(4,972,091)	2,986,141	-	10,456,327
GENERAL FUND ENDING CASH BALANCE	-	-	-	-	-
Special Fund for Economic Uncertainties	-	-	-	-	-
TOTAL CASH	\$ -	\$ -	\$ -	-	\$ -
BORROWABLE RESOURCES					
Available Borrowable Resources	\$ 18,680,554	\$ 17,342,333	\$ 1,338,221	(d) 7.7	\$ 19,037,711
Outstanding Loans (b)	9,922,135	6,936,017	2,986,118	43.1	11,908,085
Unused Borrowable Resources	\$ 8,758,419	\$ 10,406,316	\$ (1,647,897)	(15.8)	\$ 7,129,626

General Note:

This report is based upon funded cash. Funded cash is cash reported to and recorded in the records of the State Controller's Office. Amounts reported as funded cash may differ from amounts in other reports to the extent there are timing differences in the recording of in-transit items.

Footnotes:

- (a) A Statement of Estimated Cash Flow for the 2009-10 fiscal year was prepared by the Department of Finance for the Amended 2009 Budget Act. Any projections or estimates are set forth as such and not as representation of facts.
- (b) Outstanding loan balance is comprised of \$9.9 billion of internal borrowing. Current balance is comprised of \$11.9 billion carried forward from June 30, 2009 plus current year Net Increase/Decrease in Temporary Loans of \$2 billion.
- (c) Negative variances are the result of repayments received that are greater than disbursements made.
- (d) On September 29, 2009, \$8.8 billion of Revenue Anticipation Notes proceeds were received, \$2.8 billion and \$5.97 billion were repaid on May 25, 2010 and June 23, 2010. The \$1.5 billion interim RAN issued August 27, 2009 was repaid on September 29, 2009.
- (e) The University of California received \$198 million in ARRA funds in October not included in the Amended 2009 Budget Act cash flow estimates.
- (f) The State Universities and Colleges received \$270 million in ARRA funds in October not included in the Amended 2009 Budget Act cash flow estimates.
- (g) Subsequent to the release of the Amended 2009 Budget Act cash flow estimates, the Department of Social Services indicated that the CalWORKS program is projected to spend less than the published estimate for 2009-10 fiscal year.
- (h) These amounts reflect the receipt of funds from the County Office of Education pursuant to Revenue and Tax Code Section 100.06, as added by Chapter 14, Statutes of 2009 (AB x4 15, Gaines) as offsets to General Fund expenditures in accordance with control Section 15.45 of the Budget Act of 2009. The total non-revenue receipts of \$2,105 million were applied to the following expenditures: \$895 million to Administrative Office of the Courts, \$385 million to California Department of Corrections and Rehabilitation, \$816 million to Health Care Services Medi-Cal Assistance, \$190 thousand to Department of Child Support Services and \$9 million to Department of Developmental Services.

SCHEDULE OF CASH RECEIPTS

(Amounts in thousands)

	Month of June		July 1 through June 30				
	2010	2009	2010		2009		
			Actual	Estimate (a)	Actual Over or (Under) Estimate Amount	%	Actual
REVENUES							
Alcoholic Beverage Excise Tax	\$ 26,858	\$ 25,699	\$ 323,583	\$ 333,000	\$ (9,417)	(2.8)	\$ 333,435
Corporation Tax	1,943,530	4,489,284	9,446,013	8,524,044	921,969	10.8	12,260,536
Cigarette Tax	1,262	1,274	96,213	111,014	(14,801)	(13.3)	107,415
Estate, Inheritance, and Gift Tax	2,119	1,211	7,008	488	6,520	1,336.1	18,275
Insurance Companies Tax	368,149	406,789	2,015,489	1,913,000	102,489	5.4	2,059,909
Personal Income Tax	5,805,579	4,505,900	44,629,412	48,884,004	(4,254,592)	(8.7)	43,701,844
Retail Sales and Use Taxes	2,515,865	2,486,729	26,659,015	27,398,300	(739,285)	(2.7)	23,702,413
Vehicle Licence Fees	110,701	-	1,370,059	1,657,000	(286,941)	(17.3)	-
Pooled Money Investment Interest	10,163	31,444	26,025	81,000	(54,975)	(67.9)	226,399
Not Otherwise Classified	556,193	605,298	2,016,730	(195,968)	2,212,698	-	2,768,928
Total Revenues	11,340,419	12,553,628	86,589,547	88,705,882	(2,116,335)	(2.4)	85,179,154
NONREVENUES							
Transfers from Special Fund for Economic Uncertainties	42,841	-	1,103,675	1,039,571	64,104	6.2	837,902
Transfers from Other Funds	38,566	6,109	301,034	559,000	(257,966)	(46.1)	1,081,352
Miscellaneous	77,205	33,684	660,685	472,178	188,507	39.9	676,544
Total Nonrevenues	158,612	39,793	2,065,394	2,070,749	(5,355)	(0.3)	2,595,798
Total Receipts	\$ 11,499,031	\$ 12,593,421	\$ 88,654,941	\$ 90,776,631	\$ (2,121,690)	(2.3)	\$ 87,774,952

See notes on page 1.

Footnotes:

- (i) These amounts reflect the shift of Redevelopment Agency monies pursuant to Revenue and Tax Code Section 100.06, as added by Chapter 14, Statutes of 2009 (AB x4 15, Gaines) as offsets to General Fund expenditures in accordance with Control Section 15.45 of the Budget Act of 2009. The total non-revenue receipts of \$1,409 million were applied to the following expenditures: \$428 million to Administrative Office of the Courts, \$203 million to California Department of Corrections and Rehabilitation, \$766 million to Health Care Services Medi-Cal Assistance, \$240 thousand to Department of Child Support Services and \$12 million to Department of Developmental Services.

SCHEDULE OF CASH DISBURSEMENTS

(Amounts in thousands)

	Month of June		July 1 through June 30				2009 Actual
	2010	2009	Actual	Estimate (a)	Actual Over or (Under) Estimate		
					Amount	%	
STATE OPERATIONS (c)							
Legislative/Judicial/Executive	\$ 142,213	\$ 109,625	\$ 1,467,820	\$ 1,363,331	\$ 104,489	7.7	\$ 1,471,734
State and Consumer Services	39,872	51,313	489,950	577,665	(87,715)	(15.2)	537,149
Business, Transportation and Housing	414,794	169	417,389	500,373	(82,984)	(16.6)	4,695
Resources	73,766	90,605	1,115,364	986,977	128,387	13.0	1,567,600
Environmental Protection Agency	8,397	533	52,162	79,710	(27,548)	(34.6)	61,400
Health and Human Services:							
Health Services	3,311	(7,003)	209,271	242,232	(32,961)	(13.6)	210,754
Mental Health	83,572	93,206	1,082,781	1,342,668	(259,887)	(19.4)	1,204,252
Other Health and Human Services	8,032	40,482	511,050	667,098	(156,048)	(23.4)	626,695
Education:							
University of California	139,648	358,473	1,801,720	1,955,100	(153,380)	(e) (7.8)	3,206,579
State Universities and Colleges	59	159	1,630,282	1,622,400	7,882	(f) 0.5	2,875,470
Other Education	11,604	15,088	160,544	191,903	(31,359)	(16.3)	167,672
Dept. of Corrections and Rehabilitation	326,706	514,202	8,111,662	7,759,011	352,651	(h)(i) 4.5	9,016,603
General Government	64,254	78,320	1,516,442	(1,349,185)	2,865,627	-	1,496,416
Public Employees Retirement							
System	(133,488)	(139,055)	15,886	985	14,901	1,512.8	19,807
Debt Service	180,501	371,461	4,703,924	4,895,977	(192,053)	(3.9)	3,995,754
Interest on Loans	137,003	141,345	254,988	510,000	(255,012)	(50.0)	205,634
Total State Operations	1,500,244	1,718,923	23,541,235	21,346,245	2,194,990	10.3	26,668,214
LOCAL ASSISTANCE (c)							
Public Schools - K-12	1,410,621	258,670	29,151,614	29,044,961	106,653	0.4	31,186,076
Community Colleges	139,056	287,500	3,757,261	3,737,400	19,861	0.5	4,068,798
Debt Service-School Building Bonds	-	-	-	(1,900)	1,900	-	-
Contributions to State Teachers'							
Retirement System	-	-	1,248,045	1,248,055	(10)	(0.0)	1,133,088
Other Education	1,340	80,679	3,351,573	3,027,294	324,279	10.7	3,623,193
Dept. of Corrections and Rehabilitation	1,797	7,080	203,469	193,850	9,619	5.0	276,343
Dept. of Alcohol and Drug Program	948	(21,688)	203,151	210,839	(7,688)	(3.6)	254,842
Dept. of Health Services:							
Medical Assistance Program	(334,126)	927,885	10,236,433	10,556,530	(320,097)	(h)(i) (3.0)	12,645,121
Other Health Services	7,932	17,629	279,796	173,620	106,176	61.2	384,433
Dept. of Developmental Services	(41,951)	54,862	1,895,351	2,063,282	(167,931)	(h)(i) (8.1)	2,338,766
Dept. of Mental Health	3,469	(16,521)	677,190	583,554	93,636	16.0	840,415
Dept. of Social Services:							
SSI/SSP/IHSS	(80,469)	324,300	4,248,830	4,058,777	190,053	4.7	5,025,255
CalWORKs	63,257	95,077	2,367,641	2,633,242	(265,601)	(g) (10.1)	2,849,760
Other Social Services	35,455	170,813	1,420,981	1,438,402	(17,421)	(1.2)	1,503,172
Tax Relief	-	1,177	439,725	455,622	(15,897)	(3.5)	482,071
Other Local Assistance	(523,456)	244,581	1,102,389	2,313,881	(1,211,492)	(h)(i) (52.4)	3,214,001
Total Local Assistance	683,873	2,432,044	60,583,449	61,737,409	(1,153,960)	(1.9)	69,825,334

See notes on page 1.

(Continued)

SCHEDULE OF CASH DISBURSEMENTS (Continued)

(Amounts in thousands)

	Month of June		July 1 through June 30				
	2010	2009	2010		2009		
			Actual	Estimate (a)	Actual Over or (Under) Estimate	Actual	
				Amount	%		
CAPITAL OUTLAY	406,110	(42,747)	1,860,643	1,861,118	(475)	(0.0)	1,202,612
NONGOVERNMENTAL (c)							
Transfer to Special Fund for Economic Uncertainties	-	-	-	-	-	-	-
Transfer to Budget Stabilization Account	-	-	-	-	-	-	-
Transfer to Other Funds	(293,556)	56,672	733,986	643,078	90,908	14.1	567,538
Transfer to Revolving Fund	(69,964)	(17,855)	(55,061)	(35,979)	(19,082)	-	12,778
Advance:							
MediCal Provider Interim Payment	-	-	-	-	-	-	-
State-County Property Tax Administration Program	43,676	17,409	18,430	30,118	(11,688)	(38.8)	(44,356)
Social Welfare Federal Fund	26,686	4,700	(33)	(9,939)	9,906	-	2,681
Tax Relief and Refund Account	-	-	-	-	-	-	-
Counties for Social Welfare	532,613	546,271	(13,658)	232,490	(246,148)	(105.9)	(3,522)
Total Nongovernmental	239,455	607,197	683,664	859,768	(176,104)	(20.5)	535,119
Total Disbursements	\$ 2,829,682	\$ 4,715,417	\$ 86,668,991	\$ 85,804,540	\$ 864,451	1.0	\$ 98,231,279
TEMPORARY LOANS							
Special Fund for Economic Uncertainties	\$ (42,841)	\$ -	\$ (1,103,676)	\$ (1,039,571)	\$ (64,105)	-	\$ 87,814
Budget Stabilization Account	-	-	-	-	-	-	-
Outstanding Registered Warrants Account	-	-	-	-	-	-	-
Other Internal Sources	(2,651,508)	(3,578,004)	(882,274)	(3,932,520)	3,050,246	-	10,368,513
Revenue Anticipation Notes	(5,975,000)	(4,300,000)	-	-	-	(d)	-
Net Increase / (Decrease) Loans	\$ (8,669,349)	\$ (7,878,004)	\$ (1,985,950)	\$ (4,972,091)	\$ 2,986,141	-	\$ 10,456,327

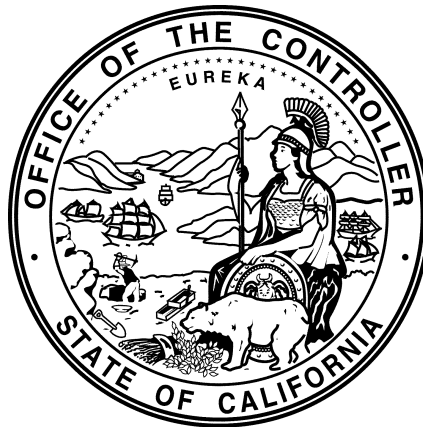
See notes on page 1.

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STATEMENT of GENERAL FUND CASH RECEIPTS and DISBURSEMENTS

September 2010



JOHN CHIANG
California State Controller



JOHN CHIANG
California State Controller

October 10, 2010

Users of the Statement of General Fund Cash Receipts and Disbursements:

Enclosed is the Statement of General Fund Cash Receipts and Disbursements for the period July 1, 2010 through September 30, 2010. This statement reflects the State of California's General Fund cash position and compares actual receipts and disbursements for the 2010-11 fiscal year to cash flow estimates prepared by the Department of Finance for the 2010-11 May Revision. The statement is prepared in compliance with Provision 8 of Budget Act item 0840-001-0001, using records compiled by the State Controller. Prior year actual amounts are also displayed for comparative purposes.

Attachment A compares actual receipts and disbursements for the 2010-11 fiscal year to cash flow estimates prepared by the Department of Finance based upon the 2010-11 May Revision.

These statements are also available on the Internet at the State Controller's website at www.sco.ca.gov under the category Monthly Financial Reports.

Any questions concerning this report may be directed to Michael Havey, Division Chief of Accounting and Reporting, at (916) 327-4144.

Sincerely,

Original signed by:

JOHN CHIANG
California State Controller

STATEMENT OF GENERAL FUND CASH RECEIPTS AND DISBURSEMENTS
A Comparison of Actual to 2010-11 May Revision Estimates
(Amounts in thousands)

	July 1 through September 30				2009
	2010		Actual Over or (Under) Estimate		
	Actual	Estimate (a)	Amount	%	
GENERAL FUND BEGINNING CASH BALANCE	\$ -	\$ -	\$ -	-	\$ -
Add Receipts:					
Revenues	19,662,468	18,430,000	1,232,468	6.7	19,399,161
Nonrevenues	281,969	600,097	(318,128) (d)(e)	(53.0)	323,413
Total Receipts	19,944,437	19,030,097	914,340	4.8	19,722,574
Less Disbursements:					
State Operations	5,848,466	4,895,385	953,081 (d)(e)	19.5	4,444,316
Local Assistance	15,501,744	22,304,112	(6,802,368) (d)(e)	(30.5)	18,452,829
Capital Outlay	7,751	115,894	(108,143) (g)	(93.3)	290,174
Nongovernmental	1,261,583	(204,944)	1,466,527 (g)	-	799,244
Total Disbursements	22,619,544	27,110,447	(4,490,903)	(16.6)	23,986,563
Receipts Over / (Under) Disbursements	(2,675,107)	(8,080,350)	5,405,243	-	(4,263,989)
Net Increase / (Decrease) in Temporary Loans	2,675,107	8,080,350	(5,405,243)	(66.9)	4,263,989
GENERAL FUND ENDING CASH BALANCE	-	-	-	-	-
Special Fund for Economic Uncertainties	-	-	-	-	-
TOTAL CASH	\$ -	\$ -	\$ -	-	\$ -
BORROWABLE RESOURCES					
Available Borrowable Resources	\$ 20,365,261	\$ 28,790,737	\$ (8,425,476) (f)	(29.3)	\$ 28,339,171
Outstanding Loans (b)	12,597,242	19,780,208	(7,182,966)	(36.3)	16,172,074
Unused Borrowable Resources	\$ 7,768,019	\$ 9,010,529	\$ (1,242,510)	(13.8)	\$ 12,167,097

General Note:

This report is based upon funded cash. Funded cash is cash reported to and recorded in the records of the State Controller's Office. Amounts reported as funded cash may differ from amounts in other reports to the extent there are timing differences in the recording of in-transit items.

Footnotes:

- (a) A Statement of Estimated Cash Flow for the 2010-11 fiscal year was prepared by the Department of Finance for the 2010-11 May Revision. Any projections or estimates are set forth as such and not as representation of facts. May Revision estimates include proposed Budget solutions, which are not enacted at the time of this publication.
- (b) Outstanding loan balance is comprised of \$12.6 billion of internal borrowing. Current balance is comprised of \$9.9 billion carried forward from June 30, 2010 plus current year Net Increase/Decrease in Temporary Loans of \$2.7 billion.
- (c) Negative amounts are the result of repayments received that are greater than disbursements made.
- (d) These amounts reflect the receipt of funds from the County Office of Education pursuant to Revenue and Tax Code Section 100.06, as added by Chapter 14, Statutes of 2009 (AB x4 15, Gaines, Prop 1A) as offsets to General Fund expenditures in accordance with Control Section 15.45 of the Budget Act of 2009. The total non-revenue receipts of \$22.6 million were applied to the following expenditures: \$9.9 million to Administrative Office of the Courts, \$4.2 million to California Department of Corrections and Rehabilitation, \$8.4 million to Health Care Services Medi-Cal Assistance, \$2 thousand to Department of Child Support Services and \$90 thousand to Department of Developmental Services.

Notes continued on page 2

SCHEDULE OF CASH RECEIPTS

(Amounts in thousands)

	Month of September		July 1 through September 30				
	2010	2009	2010		2009		
			Actual	Estimate (a)	Actual Over or (Under) Estimate	Actual	
				Amount	%		
REVENUES							
Alcoholic Beverage Excise Tax	\$ 26,971	\$ 28,039	\$ 86,066	\$ 93,000	\$ (6,934)	(7.5)	\$ 84,830
Corporation Tax	1,200,683	1,384,909	1,493,531	1,180,000	313,531	26.6	1,941,167
Cigarette Tax	3,187	1,064	25,957	27,000	(1,043)	(3.9)	24,430
Estate, Inheritance, and Gift Tax	394	207	1,244	-	1,244	-	1,352
Insurance Companies Tax	368,776	398,408	510,842	507,000	3,842	0.8	521,429
Personal Income Tax	4,056,860	3,998,662	10,089,066	9,447,000	642,066	6.8	9,572,533
Retail Sales and Use Taxes	2,136,017	2,130,177	6,628,052	6,374,000	254,052	4.0	6,395,170
Vehicle License Fees	120,535	126,289	385,381	381,000	4,381	1.1	356,369
Pooled Money Investment Interest	3,964	-	6,193	12,000	(5,807)	(48.4)	-
Not Otherwise Classified	60,659	143,596	436,136	409,000	27,136	-	501,881
Total Revenues	7,978,046	8,211,351	19,662,468	18,430,000	1,232,468	6.7	19,399,161
NONREVENUES							
Transfers from Special Fund for Economic Uncertainties	-	3,906	-	-	-	-	53,703
Transfers from Other Funds	91,733	46,137	244,457	497,075	(252,618)	(50.8)	181,607
Miscellaneous	3,170	10,101	37,512	103,022	(65,510)	(63.6)	88,103
Total Nonrevenues	94,903	60,144	281,969	600,097	(318,128)	(53.0)	323,413
Total Receipts	\$ 8,072,949	\$ 8,271,495	\$ 19,944,437	\$ 19,030,097	\$ 914,340	4.8	\$ 19,722,574

See notes on page 1.

Footnotes:

- (e) These amounts reflect the shift of Redevelopment Agency monies pursuant to Revenue and Tax Code Section 100.06, as added by Chapter 14, Statutes of 2009 (AB x4 15, Gaines) as offsets to General Fund expenditures in accordance with Control Section 15.45 of the Budget Act of 2009. The total non-revenue receipts of \$100.2 million were applied to the following expenditures: \$30.5 million to Administrative Office of the Courts, \$14.4 million to California Department of Corrections and Rehabilitation, \$54.5 million to Health Care Services Medi-Cal Assistance, \$17 thousand to Department of Child Support Services and \$834.8 thousand to Department of Developmental Services.
- (f) California State Universities were subject to cash deferral of \$221 million pursuant to ABx8_5. In-lieu of the deferral, CSU is holding the transfer of funds in reserve in a borrowable fund. Estimates include \$10 billion RAN which has not materialized due to Budget impasse.
- (g) There is no federal mandate, court order or appropriation authority (due to the budget impasse) to make a portion of these payments. Pursuant to Government Code 16531.1, a \$1 billion advance from the General Fund is authorized to the Medi-Cal Providers Interim Payment Fund. In 2010, the American Recovery and Reinvestment Act of 2009 (ARRA) requires timely payment to certain Medi-Cal providers, hospitals and nursing homes, that would normally be subject to the \$1 billion limitation.
- (h) May Revision estimates were reduced by a \$493 million deferral of Supplement Security Income/State Supplementary Payment Program (SSI/SSP) pursuant to ABx8_5. Subsequently, this deferral was not implemented with the concurrence of DOF, STO, and SCO.
- (i) May Revision estimates reflect payment of K-12 apportionment in September 2010. However, ABx8_5 provided for a 30-day acceleration of the \$2.5 billion October deferral to September, which was implemented with the concurrence of DOF, STO, and SCO.

SCHEDULE OF CASH DISBURSEMENTS

(Amounts in thousands)

	Month of September		July 1 through September 30				2009	
	2010	2009	Actual	Estimate (a)	Actual Over or (Under) Estimate			Actual
					Amount	%		
STATE OPERATIONS (c)								
Legislative/Judicial/Executive	\$ 86,630	\$ 324,507	\$ 328,924	\$ 455,766	\$ (126,842)	(27.8)	\$ 528,097	
State and Consumer Services	42,436	54,333	124,384	188,867	(64,483)	(34.1)	132,852	
Business, Transportation and Housing Resources	35,864	1,082	100,868	686	100,182	-	1,252	
Environmental Protection Agency	100,463	173,215	305,134	404,169	(99,035)	(24.5)	356,715	
Health and Human Services:	1,406	9,615	10,440	18,549	(8,109)	(43.7)	12,816	
Health Services	47,194	77,340	123,174	142,552	(19,378)	(13.6)	148,823	
Mental Health	83,910	143,559	258,224	279,190	(20,966)	(7.5)	282,064	
Other Health and Human Services	80,229	82,658	299,230	191,097	108,133	56.6	200,609	
Education:								
University of California	23,482	(160,161)	103,332	281,919	(178,587)	(63.3)	(507,443)	
State Universities and Colleges	257,299	323,307	701,355	466,112	235,243 (f)	50.5	(129,788)	
Other Education	21,279	11,697	61,715	80,407	(18,692)	(23.2)	49,205	
Dept. of Corrections and Rehabilitation	611,011	1,226,416	1,886,834	1,691,312	195,522 (d)(e)	11.6	2,086,885	
General Government	171,492	124,938	545,719	(279,737)	825,456	-	400,144	
Public Employees Retirement System	(133,265)	(134,673)	(16,306)	(32,391)	16,085	-	8,159	
Debt Service	611,553	416,450	1,015,439	931,887	83,552	9.0	941,294	
Interest on Loans	-	(67,368)	-	75,000	(75,000)	(100.0)	(67,368)	
Total State Operations	2,040,983	2,606,915	5,848,466	4,895,385	953,081	19.5	4,444,316	
LOCAL ASSISTANCE (c)								
Public Schools - K-12	2,664,436	2,364,745	8,778,119	12,039,342	(3,261,223) (i)	(27.1)	8,013,100	
Community Colleges	11,551	476,871	730,823	1,468,220	(737,397)	(50.2)	1,433,604	
Debt Service-School Building Bonds	-	-	-	-	-	-	-	
Contributions to State Teachers' Retirement System	(1)	(1)	198,906	198,230	676	0.3	197,757	
Other Education	24,893	696,473	423,452	654,015	(230,563)	(35.3)	1,116,258	
Dept. of Corrections and Rehabilitation	1,947	141,836	2,760	8,198	(5,438)	(66.3)	144,622	
Dept. of Alcohol and Drug Program	9,172	58,743	37,467	98,808	(61,341)	(62.1)	49,971	
Dept. of Health Services:								
Medical Assistance Program	741,489	1,012,292	2,083,509	2,939,802	(856,293) (d)(e)(g)	(29.1)	3,093,072	
Other Health Services	9,285	184,947	2,807	90,669	(87,862)	(96.9)	165,532	
Dept. of Developmental Services	(502)	915,852	31,404	1,058,627	(1,027,223) (d)(e)(g)	(97.0)	809,848	
Dept. of Mental Health	(11,364)	57,046	101,020	237,164	(136,144)	(57.4)	146,778	
Dept. of Social Services:								
SSI/SSP/IHSS	514,007	846,318	1,505,323	1,468,397	36,926 (h)	2.5	1,274,151	
CalWORKs	389,455	932,900	748,547	1,040,242	(291,695)	(28.0)	896,283	
Other Social Services	133,792	337,370	269,961	303,833	(33,872)	(11.1)	327,544	
Tax Relief	-	964	2	1,698	(1,696)	(99.9)	963	
Other Local Assistance	220,829	371,732	587,644	696,867	(109,223) (d)(e)	(15.7)	783,346	
Total Local Assistance	4,708,989	8,398,088	15,501,744	22,304,112	(6,802,368)	(30.5)	18,452,829	

See notes on page 1.

(Continued)

SCHEDULE OF CASH DISBURSEMENTS (Continued)

(Amounts in thousands)

	Month of September		July 1 through September 30				
	2010	2009	2010		2009		
			Actual	Estimate (a)	Actual Over or (Under) Estimate	Actual	
				Amount	%		
CAPITAL OUTLAY	995	12,828	7,751	115,894	(108,143)	(93.3)	290,174
NONGOVERNMENTAL (c)							
Transfer to Special Fund for Economic Uncertainties	-	-	-	-	-	-	-
Transfer to Budget Stabilization Account	-	-	-	-	-	-	-
Transfer to Other Funds	-	683,714	257,572	339,067	(81,495)	(24.0)	715,792
Transfer to Revolving Fund	(4,055)	68,656	(54,445)	-	(54,445)	-	71,073
Advance:							
MediCal Provider Interim Payment	-	-	1,000,000	-	1,000,000 (g)	-	-
State-County Property Tax Administration Program	46,364	10,810	65,389	-	65,389	-	30,627
Social Welfare Federal Fund	29,040	27,830	(6,933)	-	(6,933)	-	(8,929)
Tax Relief and Refund Account	-	-	-	-	-	-	-
Counties for Social Welfare	-	1	-	(544,011)	544,011	-	(9,319)
Total Nongovernmental	71,349	791,011	1,261,583	(204,944)	1,466,527	-	799,244
Total Disbursements	\$ 6,822,316	\$ 11,808,842	\$ 22,619,544	\$ 27,110,447	\$ (4,490,903)	(16.6)	\$ 23,986,563
TEMPORARY LOANS							
Special Fund for Economic Uncertainties	\$ -	\$ (3,906)	\$ -	\$ -	\$ -	-	\$ (53,703)
Budget Stabilization Account	-	-	-	-	-	-	-
Outstanding Registered Warrants Account	-	-	-	-	-	-	-
Other Internal Sources	(1,250,633)	(3,758,747)	2,675,107	(1,919,650)	4,594,757 (f)	-	(4,482,308)
Revenue Anticipation Notes	-	7,300,000	-	10,000,000	(10,000,000) (f)	(100.0)	8,800,000
Net Increase / (Decrease) Loans	\$ (1,250,633)	\$ 3,537,347	\$ 2,675,107	\$ 8,080,350	\$ (5,405,243)	(66.9)	\$ 4,263,989

See notes on page 1.

(Concluded)

COMPARATIVE STATEMENT OF REVENUES RECEIVED
All Governmental Cost Funds
(Amounts in thousands)

	July 1 through September 30			
	General Fund		Special Funds	
	2010	2009	2010	2009
MAJOR TAXES, LICENSES, AND INVESTMENT INCOME:				
Alcoholic Beverage Excise Taxes	\$ 86,066	\$ 84,830	\$ -	\$ -
Corporation Tax	1,493,531	1,941,167	-	-
Cigarette Tax	25,957	24,430	219,530	208,904
Estate, Inheritance, and Gift Tax	1,244	1,352	-	-
Insurance Companies Tax	510,842	521,429	40,376	-
Motor Vehicle Fuel Tax:				
Gasoline Tax	-	-	1,124,808	687,262
Diesel & Liquid Petroleum Gas	-	-	128,069	126,706
Jet Fuel Tax	-	-	599	402
Vehicle License Fees	385,381	356,369	532,239	536,357
Motor Vehicle Registration and Other Fees	-	-	945,018	897,824
Personal Income Tax	10,089,066	9,572,533	182,102	169,088
Retail Sales and Use Taxes	6,628,052	6,395,170	1,387,452	1,337,493
Pooled Money Investment Interest	6,193	-	(16)	(109)
Total Major Taxes, Licenses, and Investment Income	19,226,332	18,897,280	4,560,177	3,963,927
NOT OTHERWISE CLASSIFIED:				
Alcoholic Beverage License Fee	612	865	18,193	13,014
Electrical Energy Tax	-	-	212,633	124,569
Private Rail Car Tax	2	-	-	-
Penalties on Traffic Violations	-	-	15,480	16,301
Health Care Receipts	45	651	-	-
Revenues from State Lands	87	42,647	-	-
Abandoned Property	(21,853)	23,386	-	-
Trial Court Revenues	15,888	16,536	363,249	314,633
Horse Racing Fees	365	554	4,184	3,492
Miscellaneous	440,990	417,242	1,477,905	1,512,637
Not Otherwise Classified	436,136	501,881	2,091,644	1,984,646
Total Revenues, All Governmental Cost Funds	\$ 19,662,468	\$ 19,399,161	\$ 6,651,821	\$ 5,948,573

See notes on page 1.

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APPENDIX B

THE BOOK-ENTRY ONLY SYSTEM AND GLOBAL CLEARANCE PROCEDURES

DTC'S BOOK ENTRY SYSTEM

The information in the following section entitled "DTC's Book-Entry System" has been provided by DTC for use in securities offering documents, and the State takes no responsibility for the accuracy or completeness thereof. The State cannot and does not give any assurances that DTC, DTC Participants or Indirect Participants will distribute to the Beneficial Owners either (a) payments of interest, principal or premium, if any, with respect to the Bonds or (b) certificates representing ownership interest in or other confirmation of ownership interest in the Bonds, or that they will so do on a timely basis or that DTC, DTC Participants or DTC Indirect Participants will act in the manner described in this Offering Memorandum. The current "Rules" applicable to DTC are on file with the Securities and Exchange Commission and the current "Procedures" of DTC to be followed in dealing with DTC Participants are on file with DTC.

1. The Depository Trust Company ("DTC"), New York, New York, will act as securities depository for the bonds (the "Bonds"). The Bonds will be issued as fully-registered securities registered in the name of Cede & Co. (DTC's partnership nominee) or such other name as may be requested by an authorized representative of DTC. One fully-registered Bond certificate will be issued for each issue of the Bonds, each in the aggregate principal amount of such issue, and will be deposited with DTC. If, however, the aggregate principal amount of any issue exceeds \$500 million, one certificate will be issued with respect to each \$500 million of principal amount and an additional certificate will be issued with respect to any remaining principal amount of such issue.

2. DTC, the world's largest securities depository, is a limited-purpose trust company organized under the New York Banking Law, a "banking organization" within the meaning of the New York Banking Law, a member of the Federal Reserve System, a "clearing corporation" within the meaning of the New York Uniform Commercial Code, and a "clearing agency" registered pursuant to the provisions of Section 17A of the Securities Exchange Act of 1934. DTC holds and provides asset servicing for over 3.5 million issues of U.S. and non-U.S. equity issues, corporate and municipal debt issues, and money market instruments (from over 100 countries) that DTC's participants ("Direct Participants") deposit with DTC. DTC also facilitates the post-trade settlement among Direct Participants of sales and other securities transactions in deposited securities, through electronic computerized book-entry transfers and pledges between Direct Participants' accounts. This eliminates the need for physical movement of securities certificates. Direct Participants include both U.S. and non-U.S. securities brokers and dealers, banks, trust companies, clearing corporations, and certain other organizations. DTC is a wholly-owned subsidiary of The Depository Trust & Clearing Corporation ("DTCC"). DTCC is the holding company for DTC, National Securities Clearing Corporation and Fixed Income Clearing Corporation, all of which are registered clearing agencies. DTCC is owned by the users of its regulated subsidiaries. Access to the DTC system is also available to others such as both U.S. and non-U.S. securities brokers and dealers, banks, trust companies, and clearing corporations that clear through or maintain a custodial relationship with a Direct Participant, either directly or indirectly ("Indirect Participants"). DTC has Standard & Poor's highest rating: AAA. The DTC Rules applicable to its Participants are on file with the Securities and Exchange Commission. More information about DTC can be found at www.dtcc.com and www.dtc.org.

3. Purchases of Bonds under the DTC system must be made by or through Direct Participants, which will receive a credit for the Bonds on DTC's records. The ownership interest of each actual purchaser of each Bond ("Beneficial Owner") is in turn to be recorded on the Direct and Indirect Participants' records. Beneficial Owners will not receive written confirmation from DTC of their purchase. Beneficial Owners are, however, expected to receive written confirmations providing details of

the transaction, as well as periodic statements of their holdings, from the Direct or Indirect Participant through which the Beneficial Owner entered into the transaction. Transfers of ownership interests in the Bonds are to be accomplished by entries made on the books of Direct and Indirect Participants acting on behalf of Beneficial Owners. Beneficial Owners will not receive certificates representing their ownership interests in the Bonds, except in the event that use of the book-entry system for the Bonds is discontinued.

4. To facilitate subsequent transfers, all Bonds deposited by Direct Participants with DTC are registered in the name of DTC's partnership nominee, Cede & Co., or such other name as may be requested by an authorized representative of DTC. The deposit of Bonds with DTC and their registration in the name of Cede & Co. or such other nominee do not effect any change in beneficial ownership. DTC has no knowledge of the actual Beneficial Owners of the Bonds. DTC's records reflect only the identity of the Direct Participants to whose accounts such Bonds are credited, which may or may not be the Beneficial Owners. The Direct and Indirect Participants will remain responsible for keeping account of their holdings on behalf of their customers.

5. Conveyance of notices and other communications by DTC to Direct Participants, by Direct Participants to Indirect Participants, and by Direct Participants and Indirect Participants to Beneficial Owners will be governed by arrangements among them, subject to any statutory or regulatory requirements as may be in effect from time to time. The State Treasurer will not have any responsibility or obligation to such Direct Participants and Indirect Participants or the persons for whom they act as nominees with respect to the Bonds. Beneficial Owners of Bonds may wish to take certain steps to augment the transmission to them of notices of significant events with respect to the Bonds, such as redemptions, tenders, defaults, and proposed amendments to the Bond documents. For example, Beneficial Owners of Bonds may wish to ascertain that the nominee holding the Bonds for their benefit has agreed to obtain and transmit notices to Beneficial Owners. In the alternative, Beneficial Owners may wish to provide their names and addresses to the registrar and request that copies of notices be provided directly to them.

6. Redemption notices shall be sent to DTC. If less than all of the Bonds within a maturity are being redeemed, DTC's practice is to determine by lot the amount of the interest of each Direct Participant in such maturity to be redeemed.

7. Neither DTC nor Cede & Co. (nor such other DTC nominee) will consent or vote with respect to the Bonds unless authorized by a Direct Participant in accordance with DTC's Procedures. Under its usual procedures, DTC mails an Omnibus Proxy to the State Treasurer as soon as possible after the record date. The Omnibus Proxy assigns Cede & Co.'s consenting or voting rights to those Direct Participants to whose accounts the Bonds are credited on the record date (identified in a listing attached to the Omnibus Proxy).

8. Principal and interest payments on the Bonds will be made to Cede & Co., or such other nominee as may be requested by an authorized representative of DTC. DTC's practice is to credit Direct Participants' accounts upon DTC's receipt of funds and corresponding detail information from the State Treasurer, on payable dates in accordance with their respective holdings shown on DTC's records. Payments by Participants to Beneficial Owners will be governed by standing instructions and customary practices, as is the case with securities held for the accounts of customers in bearer form or registered in "street name," and will be the responsibility of such Participant and not of DTC or its nominee, Agent, or the State Treasurer, subject to any statutory, or regulatory requirements as may be in effect from time to time. Payment of principal and interest to Cede & Co. (or such other nominee as may be requested by an authorized representative of DTC) is the responsibility of the State Treasurer, disbursement of such payments to Direct Participants will be the responsibility of DTC, and disbursement of such payments to the Beneficial Owners will be the responsibility of Direct and Indirect Participants.

9. DTC may discontinue providing its services as depository with respect to the Bonds at any time by giving reasonable notice to the State Treasurer. Under such circumstances, in the event that a successor depository is not obtained, Bond certificates are required to be printed and delivered.

10. The State Treasurer may decide to discontinue use of the system of book-entry-only transfers through DTC (or a successor securities depository). If the State Treasurer determines not to continue the DTC book-entry only system, or DTC discontinues providing its services with respect to the Bonds and the State Treasurer does not select another qualified securities depository, the State will deliver physical Bond certificates to the Beneficial Owners. The Bonds may thereafter be transferred upon the books of the State Treasurer by the registered owners, in person or by authorized attorney, upon surrender of Bonds at the Office of the State Treasurer in Sacramento, California, accompanied by delivery of an executed instrument of transfer in a form approved by the State Treasurer and upon payment of any charges provided for in the Resolutions. Certificated bonds may be exchanged for Bonds of other authorized denominations of the same aggregate principal amount and maturity at the Office of the State Treasurer in Sacramento, California, upon payment of any charges provided for in the Resolutions. No transfer or exchange of Bonds will be made by the State Treasurer during the period between the record date and the next Interest Payment Date.

THE STATE TREASURER, AS LONG AS A BOOK-ENTRY ONLY SYSTEM IS USED FOR THE BONDS, WILL SEND ANY NOTICE OF REDEMPTION OR OTHER NOTICES TO OWNERS TO ONLY DTC. ANY FAILURE OF DTC TO ADVISE ANY DTC PARTICIPANT, OR OF ANY DTC PARTICIPANT TO NOTIFY ANY BENEFICIAL OWNER, OF ANY NOTICE AND ITS CONTENT OR EFFECT WILL NOT AFFECT THE VALIDITY OR SUFFICIENCY OF THE PROCEEDINGS RELATING TO THE REDEMPTION OF THE BONDS CALLED FOR REDEMPTION OR OF ANY OTHER ACTION PREMISED ON SUCH NOTICE.

11. The foregoing description of the procedures and record keeping with respect to beneficial ownership interests in the Bonds, payment of principal of and interest and other payments with respect to the Bonds to Direct Participants, Indirect Participants or Beneficial Owners, confirmation and transfer of beneficial ownership interest in such Bonds and other related transactions by and between DTC, the Direct Participants, the Indirect Participants and the Beneficial Owners is based solely on information provided by DTC. Accordingly, no representations can be made concerning these matters and neither the Direct Participants, the Indirect Participants nor the Beneficial Owners should rely on the foregoing information with respect to such matters but should instead confirm the same with DTC or the Participants, as the case may be.

SO LONG AS CEDE & CO. IS THE REGISTERED OWNER OF THE BONDS, AS NOMINEE OF DTC, REFERENCES HEREIN TO THE HOLDERS OF THE BONDS (OTHER THAN UNDER THE CAPTION "TAX MATTERS" HEREIN) SHALL MEAN CEDE & CO., AS AFORESAID, AND SHALL NOT MEAN THE BENEFICIAL OWNERS OF THE BONDS.

GLOBAL CLEARANCE PROCEDURES

The information set out below has been obtained from sources that the State believes to be reliable, but prospective investors are advised to make their own inquiries as to such procedures. In particular, such information is subject to any change in or interpretation of the rules, regulations and procedures of Euroclear or Clearstream, Luxembourg (together, the "Clearing Systems") currently in effect and investors wishing to use the facilities of any of the Clearing Systems are therefore advised to confirm the continued applicability of the rules, regulations and procedures of the relevant Clearing System. Neither the State nor the Underwriters will have any responsibility for the performance by the Clearing Systems, the Clearstream Participants or customers or the Euroclear Operator or their respective direct or indirect participants or accountholders of their respective obligations under the rules and procedures governing their operations or for the sufficiency for any purpose of the arrangements described below. No representation is made as to the completeness or the accuracy of such information or as to the absence of material adverse changes in such information subsequent to the date hereof.

CLEARSTREAM

Clearstream Banking, société anonyme, 42 Avenue J.F. Kennedy, L-1855 Luxembourg ("Clearstream, Luxembourg"), was incorporated in 1970 as "Cedel S.A.," a company with limited liability under Luxembourg law (a société anonyme). Cedel S.A. subsequently changed its name to Cedelbank. On January 10, 2000, Cedelbank's parent company, Cedel International, société anonyme ("CI") merged its clearing, settlement and custody business with that of Deutsche Börse AG ("DBAG"). The merger involved the transfer by CI of substantially all of its assets and liabilities (including its shares in Cedelbank), and the transfer by DBAG of its shares in Deutsche Börse Clearing ("DBC"), to a new Luxembourg company, which with effect January 14, 2000 was renamed Clearstream International, société anonyme, and was then 50% owned by CI and 50% owned by DBAG. Following this merger, the subsidiaries of Clearstream International were also renamed to give them a cohesive brand name. On January 18, 2000, Cedelbank was renamed "Clearstream Banking, société anonyme," and Cedel Global Services was renamed "Clearstream Services, société anonyme." On January 17, 2000, Deutsche Börse Clearing AG was renamed "Clearstream Banking AG." Today Clearstream International is 100% owned by DBAG. The shareholders of DBAG are comprised of mainly banks, securities dealers and financial institutions.

Clearstream, Luxembourg holds securities for its customers and facilitates the clearance and settlement of securities transactions between Clearstream, Luxembourg customers through electronic book-entry changes in accounts of Clearstream, Luxembourg customers, thereby eliminating the need for physical movement of certificates. Transactions may be settled by Clearstream, Luxembourg in any of 36 currencies, including United States Dollars. Clearstream, Luxembourg provides to its customers, among other things, services for safekeeping, administration, clearance and settlement of internationally traded securities and securities lending and borrowing. Clearstream, Luxembourg also deals with domestic securities markets in many countries through established depository and custodial relationships. Clearstream, Luxembourg is registered as a bank in Luxembourg, and as such is subject to regulation by the Commission de Surveillance du Secteur Financier, "CSSF," and the Banque Centrale du Luxembourg ("BCL") which supervise and oversee the activities of Luxembourg banks. Clearstream, Luxembourg's customers are world-wide financial institutions including underwriters, securities brokers and dealers, banks, trust companies and clearing corporations.

Clearstream, Luxembourg's U.S. customers are limited to securities brokers and dealers and banks. Currently, Clearstream, Luxembourg has approximately 2,500 customers located in over 110 countries, including all major European countries, Canada, and the United States. Indirect access to Clearstream, Luxembourg is available to other institutions that clear through or maintain a custodial relationship with an account holder of Clearstream, Luxembourg. Clearstream, Luxembourg has established an electronic bridge with Euroclear Bank S.A./N.V. as the Operator of the Euroclear System

(the “Euroclear Operator”) in Brussels to facilitate settlement of trades between Clearstream, Luxembourg and the Euroclear Operator.

EUROCLEAR BANK

Euroclear Bank S.A./N.V. (“Euroclear Bank”) holds securities and book-entry interests in securities for participating organizations and facilitates the clearance and settlement of securities transactions between Euroclear Participants, and between Euroclear Participants and Participants of certain other securities intermediaries through electronic book-entry changes in accounts of such Participants or other securities intermediaries.

Euroclear Bank provides Euroclear Participants, among other things, with safekeeping, administration, clearance and settlement, securities lending and borrowing, and related services. Euroclear Participants are investment banks, securities brokers and dealers, banks, central banks, supnationals, custodians, investment managers, corporations, trust companies and certain other organizations. Certain of the managers or underwriters for this offering, or other financial entities involved in this offering, may be Euroclear Participants. Non-Participants in the Euroclear System may hold and transfer book-entry interests in the Securities through accounts with a Participant in the Euroclear System or any other securities intermediary that holds a book-entry interest in the securities through one or more securities intermediaries standing between such other securities intermediary and Euroclear Bank.

Clearance and Settlement. Although Euroclear Bank has agreed to the procedures provided below in order to facilitate transfers of securities among Participants in the Euroclear System, and between Euroclear Participants and Participants of other intermediaries, it is under no obligation to perform or continue to perform such procedures and such procedures may be modified or discontinued at any time.

Initial Distribution. Investors electing to acquire securities through an account with Euroclear Bank or some other securities intermediary must follow the settlement procedures of such an intermediary with respect to the settlement of new issues of securities. Securities to be acquired against payment through an account with Euroclear Bank will be credited to the securities clearance accounts of the respective Euroclear Participants in the securities processing cycle for the business day following the settlement date for value as of the settlement date, if against payment.

Secondary Market. Investors electing to acquire, hold or transfer securities through an account with Euroclear Bank or some other securities intermediary must follow the settlement procedures of such an intermediary with respect to the settlement of secondary market transactions in securities. Please be aware that Euroclear Bank will not monitor or enforce any transfer restrictions with respect to the securities offered herein.

Custody. Investors who are Participants in the Euroclear System may acquire, hold or transfer interests in the securities by book-entry to accounts with Euroclear Bank. Investors who are not Participants in the Euroclear System may acquire, hold or transfer interests in the securities by book-entry to accounts with a securities intermediary who holds a book-entry interest in the securities through accounts with Euroclear Bank.

Custody Risk. Investors that acquire, hold and transfer interests in the securities by book-entry through accounts with Euroclear Bank or any other securities intermediary are subject to the laws and contractual provisions governing their relationship with their intermediary, as well as the laws and contractual provisions governing the relationship between such an intermediary and each other intermediary, if any, standing between themselves and the individual securities.

Euroclear Bank has advised as follows:

Under Belgian law, investors that are credited with securities on the records of Euroclear Bank have a co-property right in the fungible pool of interests in securities on deposit with Euroclear Bank in an amount equal to the amount of interests in securities credited to their accounts. In the event of the insolvency of Euroclear Bank, Euroclear Participants would have a right under Belgian law to the return of the amount and type of interests in securities credited to their accounts with Euroclear Bank. If Euroclear Bank did not have a sufficient amount of interests in securities on deposit of a particular type to cover the claims of all Participants credited with such interests in securities on Euroclear Bank's records, all Participants having an amount of interests in securities of such type credited to their accounts with Euroclear Bank would have the right under Belgian law to the return of their pro-rata share of the amount of interests in securities actually on deposit.

Under Belgian law, Euroclear Bank is required to pass on the benefits of ownership in any interests in securities on deposit with it (such as dividends, voting rights and other entitlements) to any person credited with such interests in securities on its records.

Initial Settlement; Distributions; Actions Upon Behalf of Owners

All of the Bonds will initially be registered in the name of Cede & Co., the nominee of DTC. Clearstream and Euroclear may hold omnibus positions on behalf of their participants through customers' securities accounts in Clearstream's and/or Euroclear's names on the books of their respective U.S. Depository, which, in turn, holds such positions in customers' securities accounts in its U.S. Depository's name on the books of DTC. Citibank, N.A. acts as depository for Clearstream and JPMorgan Chase Bank acts as depository for Euroclear (the "U.S. Depositories"). Holders of the Bonds may hold their Bonds through DTC (in the United States) or Clearstream or Euroclear (in Europe) if they are participants of such systems, or directly through organizations that are participants in such systems. Investors electing to hold their Bonds through Euroclear or Clearstream accounts will follow the settlement procedures applicable to conventional EuroBonds in registered form. Securities will be credited to the securities custody accounts of Euroclear and Clearstream holders on the business day following the settlement date against payment for value on the settlement date.

Distributions with respect to the Bonds held beneficially through Clearstream will be credited to the cash accounts of Clearstream customers in accordance with its rules and procedures, to the extent received by its U.S. Depository. Distributions with respect to the Bonds held beneficially through Euroclear will be credited to the cash accounts of Euroclear Participants in accordance with the Terms and Conditions, to the extent received by its U.S. Depository. Such distributions will be subject to tax reporting in accordance with relevant United States tax laws and regulations. Clearstream or the Euroclear Operator, as the case may be, will take any other action permitted to be taken by an owner of the Bonds on behalf of a Clearstream customer or Euroclear Participant only in accordance with the relevant rules and procedures and subject to the U.S. Depository's ability to effect such actions on its behalf through DTC.

Secondary Market Trading

Secondary market trading between Participants (other than U.S. Depositories) will be settled using the procedures applicable to U.S. corporate debt obligations in same-day funds. Secondary market trading between Euroclear Participants and/or Clearstream customers will be settled using the procedures applicable to conventional EuroBonds in same-day funds. When securities are to be transferred from the account of a Participant (other than U.S. Depositories) to the account of a Euroclear Participant or a Clearstream customer, the purchaser must send instructions to the applicable U.S. Depository one business day before the settlement date. Euroclear or Clearstream, as the case may be, will instruct its U.S. Depository to receive the securities against payment. Its U.S. Depository will then make payment to the Participant's account against delivery of the securities. After settlement has been completed, the

securities will be credited to the respective clearing system and by the clearing system, in accordance with its usual procedures, to the Euroclear participant's or Clearstream customers' accounts. Credit for the securities will appear on the next day (European time) and cash debit will be back-valued to, and the interest on the Bonds will accrue from the value date (which would be the preceding day when settlement occurs in New York). If settlement is not completed on the intended value date (i.e., the trade fails), the Euroclear or Clearstream cash debit will be valued instead as of the actual settlement date.

Euroclear Participants and Clearstream customers will need to make available to the respective clearing systems the funds necessary to process same-day funds settlement. The most direct means of doing so is to pre-position funds for settlement, either from cash on hand or existing lines of credit, as they would for any settlement occurring within Euroclear or Clearstream. Under this approach, they may take on credit exposure to Euroclear or Clearstream until the securities are credited to their accounts one day later. As an alternative, if Euroclear or Clearstream has extended a line of credit to them, participants/customers can elect not to pre-position funds and allow that credit line to be drawn upon to finance settlement. Under this procedure, Euroclear Participants or Clearstream customers purchasing securities would incur overdraft charges for one day, assuming they cleared the overdraft when the securities were credited to their accounts. However, interest on the securities would accrue from the value date. Therefore, in many cases, the investment income on securities earned during that one day period may substantially reduce or offset the amount of such overdraft charges, although this result will depend on each participant's/customer's particular cost of funds. Because the settlement is taking place during New York business hours, Participants can employ their usual procedures for sending securities to the applicable U.S. Depository for the benefit of Euroclear Participants or Clearstream customers. The sale proceeds will be available to the DTC seller on the settlement date. Thus, to the Participant, a cross-market transaction will settle no differently from a trade between two Participants.

Due to time zone differences in their favor, Euroclear Participants and Clearstream customers may employ their customary procedure for transactions in which securities are to be transferred by the respective clearing system, through the applicable U.S. Depository to another Participant's. In these cases, Euroclear will instruct its U.S. Depository to credit the securities to the Participant's account against payment. The payment will then be reflected in the account of the Euroclear Participant or Clearstream customer the following business day, and receipt of the cash proceeds in the Euroclear Participants' or Clearstream customers' accounts will be backvalued to the value date (which would be the preceding day, when settlement occurs in New York). If the Euroclear Participant or Clearstream customer has a line of credit with its respective clearing system and elects to draw on such line of credit in anticipation of receipt of the sale proceeds in its account, the back-valuation may substantially reduce or offset any overdraft charges incurred over that one-day period. If settlement is not completed on the intended value date (i.e., the trade fails), receipt of the cash proceeds in the Euroclear Participant's or Clearstream customer's accounts would instead be valued as of the actual settlement date.

Procedures May Change

Although DTC, Clearstream and Euroclear have agreed to these procedures in order to facilitate transfers of securities among DTC and its Participants, Clearstream and Euroclear, they are under no obligation to perform or continue to perform these procedures and these procedures may be discontinued and may be changed at any time by any of them.

General Statement

THE STATE CANNOT AND DOES NOT GIVE ANY ASSURANCES THAT DTC, DIRECT PARTICIPANTS OR INDIRECT PARTICIPANTS OF DTC, CLEARSTREAM, CLEARSTREAM PARTICIPANTS OR CUSTOMERS, EUROCLEAR OR EUROCLEAR PARTICIPANTS WILL DISTRIBUTE TO THE BENEFICIAL OWNERS OF THE BONDS (1) PAYMENTS OF PRINCIPAL OF OR INTEREST OR REDEMPTION PREMIUM ON THE BONDS (2) CONFIRMATIONS OF THEIR OWNERSHIP INTERESTS IN THE BONDS OR (3) OTHER NOTICES SENT TO DTC OR

CEDE & CO., ITS PARTNERSHIP NOMINEE, AS THE REGISTERED OWNER OF THE BONDS, OR THAT THEY WILL DO SO ON A TIMELY BASIS, OR THAT DTC, DIRECT PARTICIPANTS OR INDIRECT PARTICIPANTS, CLEARSTREAM, CLEARSTREAM PARTICIPANTS OR CUSTOMERS, EUROCLEAR OR EUROCLEAR PARTICIPANTS WILL SERVE AND ACT IN THE MANNER DESCRIBED IN THIS OFFERING MEMORANDUM.

THE STATE WILL NOT HAVE ANY RESPONSIBILITY OR OBLIGATIONS TO DTC, THE DIRECT PARTICIPANTS, THE INDIRECT PARTICIPANTS OF DTC, CLEARSTREAM, CLEARSTREAM PARTICIPANTS OR CUSTOMERS, EUROCLEAR, EUROCLEAR PARTICIPANTS OR THE BENEFICIAL OWNERS WITH RESPECT TO (1) THE ACCURACY OF ANY RECORDS MAINTAINED BY DTC OR ANY DIRECT PARTICIPANTS OR INDIRECT PARTICIPANTS OF DTC, CLEARSTREAM, CLEARSTREAM PARTICIPANTS OR CUSTOMERS, EUROCLEAR OR EUROCLEAR PARTICIPANTS; (2) THE PAYMENT BY DTC OR ANY DIRECT PARTICIPANTS OR INDIRECT PARTICIPANTS OF DTC, CLEARSTREAM, CLEARSTREAM PARTICIPANTS OR CUSTOMERS, EUROCLEAR OR EUROCLEAR PARTICIPANTS OF ANY AMOUNT DUE TO ANY BENEFICIAL OWNER IN RESPECT OF THE PRINCIPAL AMOUNT OF OR INTEREST OR REDEMPTION PREMIUM ON THE BONDS; (3) THE DELIVERY BY DTC OR ANY DIRECT PARTICIPANTS OR INDIRECT PARTICIPANTS OF DTC, CLEARSTREAM, CLEARSTREAM PARTICIPANTS OR CUSTOMERS, EUROCLEAR OR EUROCLEAR PARTICIPANTS OF ANY NOTICE TO ANY BENEFICIAL OWNER THAT IS REQUIRED OR PERMITTED TO BE GIVEN TO OWNERS UNDER THE TERMS OF THE INDENTURE; OR (4) ANY CONSENT GIVEN OR OTHER ACTION TAKEN BY DTC AS OWNER OF THE BONDS.

APPENDIX C

FORM OF CONTINUING DISCLOSURE CERTIFICATE

This Continuing Disclosure Certificate (this “Disclosure Certificate”) is executed and delivered as of _____, 2010, by the Treasurer of the State of California (the “State Treasurer”) in connection with the issuance of \$_____ aggregate principal amount of the State of California Various Purpose General Obligation Bonds (Federally Taxable) (collectively, the “Bonds”) as authorized by various acts of the State of California legislature (the “Acts”). The Bonds are being issued pursuant to resolutions of finance committees (the “Resolutions”), designated under the Acts. Pursuant to the Resolutions, the State Treasurer, on behalf of the State of California (the “State”), covenants and agrees as follows:

Section 1. Nature of the Disclosure Certificate. This Disclosure Certificate is executed and delivered for the benefit of the Holders and Beneficial Owners (as defined below) of the Bonds from time to time, and in order to assist the Participating Underwriters (as defined below) in complying with the Rule (as defined below), but shall not be deemed to create any monetary liability on the part of the State or the State Treasurer to any other persons, including Holders or Beneficial Owners of the Bonds based on the Rule. The sole remedy in the event of any failure of the State Treasurer to comply with this Disclosure Certificate shall be an action to compel performance of any act required hereunder.

Section 2. Definitions. In addition to the definitions set forth in the Resolutions, which apply to any capitalized term used in this Disclosure Certificate unless otherwise defined in this Section, the following capitalized terms shall have the following meanings:

“Annual Report” shall mean any Annual Report provided by the State Treasurer pursuant to, and as described in, Sections 3 and 4 of this Disclosure Certificate.

“Beneficial Owner” shall mean any person who has or shares the power, directly or indirectly, to make investment decisions concerning ownership of any Bonds (including persons holding Bonds through nominees, depositories or other intermediaries).

“Dissemination Agent” shall mean the State Treasurer, acting in its capacity as Dissemination Agent hereunder, or any successor Dissemination Agent designated in writing by the State Treasurer and which has filed with the State Treasurer a written acceptance of such designation.

“Holder” shall mean any person listed on the registration books of the State Treasurer as the registered owner of any Bonds.

“Listed Event” shall mean any of the events listed in Section 5(a) or (b) of this Disclosure Certificate.

“MSRB” shall mean the Municipal Securities Rulemaking Board or any other entity designated or authorized by the SEC to receive reports or notices pursuant to the Rule. Until otherwise designated by the MSRB or the SEC, filings with the MSRB are to be made through the Electronic Municipal Market Access (EMMA) website of the MSRB, currently located at <http://emma.msrb.org>.

“Offering Memorandum” shall mean the Offering Memorandum relating to the Bonds, dated _____, 2010.

“Participating Underwriter” shall mean any of the original underwriters of the Bonds required to comply with the Rule in connection with the offering of the Bonds.

“Rule” shall mean Rule 15c2-12(b)(5) adopted by the SEC under the Securities Exchange Act of 1934, as the same may be amended from time to time.

“SEC” shall mean the Securities and Exchange Commission.

“State” shall mean the State of California.

Section 3. Provision of Annual Reports.

(a) The State Treasurer on behalf of the State shall, or shall cause the Dissemination Agent to, not later than April 1 of each year in which the Bonds are outstanding, commencing with the report for the 2009-10 fiscal year (which is due not later than April 1, 2011), provide to the MSRB an Annual Report which is consistent with the requirements of Section 4 of this Disclosure Certificate. The Annual Report must be submitted in electronic format, accompanied by such identifying information as is prescribed by the MSRB, and may cross-reference other information as provided in Section 4 of this Disclosure Certificate; provided, that the audited financial statements of the State may be submitted separately from the balance of the Annual Report and later than the date required above for the filing of the Annual Report if they are not available by that date. If the State’s fiscal year changes, it shall give notice of such change in the same manner as for a Listed Event under Section 5(f). The Annual Report shall be submitted on a standard form in use by industry participants or other appropriate form and shall identify the Bonds by name and CUSIP number.

(b) Not later than 15 business days prior to said date, the State Treasurer shall provide the Annual Report to the Dissemination Agent (if other than the State Treasurer). If the State Treasurer is unable to provide to the MSRB an Annual Report by the date required in subsection (a), the State Treasurer shall send a notice to the MSRB in substantially the form attached as Exhibit A.

(c) The Dissemination Agent shall (if the Dissemination Agent is other than the State Treasurer) file a report with the State Treasurer certifying that the Annual Report has been provided pursuant to this Disclosure Certificate, stating the date it was provided to the MSRB.

Section 4. Content of Annual Reports. The Annual Report shall contain or include by reference the following:

(a) The audited Basic Financial Statements of the State for the fiscal year ended on the previous June 30, prepared in accordance with generally accepted accounting principles promulgated to apply to government entities from time to time by the Governmental Accounting Standards Board. If the State’s audited financial statements are not available by the time the Annual Report is required to be provided to the MSRB pursuant to Section 3(a), the Annual Report shall contain unaudited financial statements in a format similar to the financial statements contained in the final Offering Memorandum, and the audited financial statements shall be provided to the MSRB in the same manner as the Annual Report when they become available.

(b) Financial information relating to the State’s General Fund budget for the fiscal year ended on the previous June 30 and information concerning the State budget for the fiscal year in which the Annual Report is issued. Such information shall describe the sources of revenues, the principal categories of expenditures, and changes in fund balances, a summary of expected State revenues and budgeted expenditures, and significant assumptions relating to revenue and expenditure expectations; including updating the following tables which appear under the caption APPENDIX A—“THE STATE OF CALIFORNIA—CURRENT STATE BUDGET” in the Offering Memorandum:

Table Entitled

Statement of Estimated Revenues, Expenditures, and Changes in Fund Balance—General Fund

General Fund Revenue Sources and Expenditures

(c) Information concerning the total amount of the State’s authorized and outstanding debt, long-term lease obligations and other long-term liabilities as of the end of the most recent June 30, which debt is supported by payments from the State’s General Fund and which includes short-term debt. Such information shall include schedules of debt service for outstanding general obligation bonds and lease-purchase debt. This shall be accomplished by updating the following tables which appear under the caption APPENDIX A—“THE STATE OF CALIFORNIA—STATE DEBT TABLES” in the Offering Memorandum.

Table Entitled

Outstanding State Debt

Authorized and Outstanding General Obligation Bonds

General Obligation and Revenue Bonds—Summary of Debt Service Requirements

Schedule of Debt Service Requirements for General Fund—Non-Self Liquidating Bonds—Fixed Rate

Schedule of Debt Service Requirements for General Fund—Non-Self Liquidating Bonds—Variable Rate

Schedule of Debt Service Requirements for State of California Proposition 1A Receivables Program—Revenue Bonds—Fixed Rate

Schedule of Debt Service Requirements for Special Revenue Fund—Self Liquidating Bonds—Fixed Rate

Schedule of Debt Service Requirements for Special Revenue Fund—Self Liquidating Bonds—Variable Rate

Schedule of Debt Service Requirements for Enterprise Fund—Self Liquidating Bonds—Fixed Rate

Schedule of Debt Service Requirements for Lease-Revenue Debt—Fixed Rate

State Public Works Board and Other Lease-Revenue Financing Outstanding Issues

State Agency Revenue Bonds and Conduit Financing

The Annual Report may consist of one or more documents. Any or all of the items listed above may be included in the Annual Report by reference to other documents that have been filed by the State with the MSRB, including any final official statement or offering memorandum (in which case such final official statement or offering memorandum must also be available from the MSRB). The State Treasurer shall clearly identify in the Annual Report each such document so included by reference.

Section 5. Reporting of Significant Events.

(a) The State Treasurer shall give, or cause to be given, notice of the occurrence of any of the following events with respect to the Bonds in a timely manner not later than ten business days after the occurrence of the event:

1. Principal and interest payment delinquencies;
2. Unscheduled draws on debt service reserves reflecting financial difficulties;
3. Unscheduled draws on credit enhancements reflecting financial difficulties;
4. Substitution of credit or liquidity providers, or their failure to perform;
5. Issuance by the Internal Revenue Service of proposed or final determination of taxability or of a Notice of Proposed Issue (IRS Form 5701 TEB);
6. Tender offers;
7. Defeasances;
8. Rating changes; or
9. Bankruptcy, insolvency, receivership or similar event of the obligated person.

Note: for the purposes of the event identified in subparagraph (9), the event is considered to occur when any of the following occur: the appointment of a receiver, fiscal agent or similar officer for an obligated person in a proceeding under the U.S. Bankruptcy Code or in any other proceeding under state or federal law in which a court or governmental authority has assumed jurisdiction over substantially all of the assets or business of the obligated person, or if such jurisdiction has been assumed by leaving the existing governmental body and officials or officers in possession but subject to the supervision and orders of a court or governmental authority, or the entry of an order confirming a plan of reorganization, arrangement or liquidation by a court or governmental authority having supervision or jurisdiction over substantially all of the assets or business of the obligated person.

(b) The State Treasurer shall give, or cause to be given, notice of the occurrence of any of the following events with respect to the Bonds, if material, in a timely manner not later than ten business days after the occurrence of the event:

1. Unless described in paragraph 5(a)(5), adverse tax opinions or other material notices or determinations by the Internal Revenue Service with respect to the tax status of the Bonds or other material events affecting the tax status of the Bonds;
2. Modifications to rights of Bond holders;
3. Optional, unscheduled or contingent Bond calls;
4. Release, substitution, or sale of property securing repayment of the Bonds;
5. Non-payment related defaults;

6. The consummation of a merger, consolidation, or acquisition involving an obligated person or the sale of all or substantially all of the assets of the obligated person, other than in the ordinary course of business, the entry into a definitive agreement to undertake such an action or the termination of a definitive agreement relating to any such actions, other than pursuant to its terms; or
7. Appointment of a successor or additional trustee or the change of name of a trustee.

(c) The State Treasurer notes that Sections 5(a)(2), (3) and (4) are not applicable to the Bonds.

(d) The State Treasurer shall give, or cause to be given, in a timely manner, notice of a failure to provide the annual financial information on or before the date specified in Section 3(a), as provided in Section 3(b).

(e) Whenever the State Treasurer obtains knowledge of the occurrence of a Listed Event described in Section 5(b), the State Treasurer shall determine if such event would be material under applicable federal securities laws.

(f) If the State Treasurer learns of the occurrence of a Listed Event described in Section 5(a), or determines that knowledge of a Listed Event described in Section 5(b) would be material under applicable federal securities laws, the State Treasurer shall within ten business days of occurrence file a notice of such occurrence with the MSRB in electronic format, accompanied by such identifying information as is prescribed by the MSRB. Notwithstanding the foregoing, notice of the Listed Event described in subsections (a)(7) or (b)(3) need not be given under this subsection any earlier than the notice (if any) of the underlying event is given to Holders of affected Bonds pursuant to the Resolutions.

Section 6. Termination of Reporting Obligation. The State's obligations under Sections 3, 4 and 5 of this Disclosure Certificate shall terminate upon the maturity, legal defeasance, prior redemption or acceleration of all of the outstanding Bonds or if less than all the Bonds are defeased, with respect to those Bonds. If such termination occurs prior to the final maturity of the Bonds, the State Treasurer shall give notice of such termination in the same manner as for a Listed Event under Section 5(f).

Section 7. Dissemination Agent. The State Treasurer may, from time to time, appoint or engage a Dissemination Agent to assist it in carrying out the obligations under this Disclosure Certificate, and may discharge any such Dissemination Agent, with or without appointing a successor Dissemination Agent. The Dissemination Agent shall not be responsible in any manner for the content of any notice or report prepared by the State Treasurer pursuant to this Disclosure Certificate. If at any time there is not any other designated Dissemination Agent, the State Treasurer shall be the Dissemination Agent. The initial Dissemination Agent shall be the State Treasurer.

Section 8. Amendment; Waiver. Notwithstanding any other provision of this Disclosure Certificate, the State Treasurer may amend any provision of this Disclosure Certificate, and any provision of this Disclosure Certificate may be waived, provided that the following conditions are satisfied:

(a) If the amendment or waiver relates to the provisions of Section 3(a), 4, 5(a), (b), (d) or (f), or 8(a), it may only be made in connection with a change in circumstances that arises from a change in legal requirements, change in law, or change in the identity, nature or status of an obligated person with respect to the Bonds, or the type of business conducted;

(b) The undertaking, as amended or taking into account such waiver, would, in the opinion of nationally recognized bond counsel, have complied with the requirements of the Rule at the time of the original issuance of the Bonds, after taking into account any amendments or interpretations of the Rule, as well as any change in circumstances; and

(c) The amendment or waiver either (i) is approved by the Holders of 60% of the Bonds outstanding or (ii) does not, in the opinion of nationally recognized bond counsel, materially impair the interests of the Holders or Beneficial Owners of the Bonds. The State also may amend this Disclosure Certificate without approval by the Holders to the extent permitted by rule, order or other official pronouncement of the SEC.

In the event of any amendment or waiver of a provision of this Disclosure Certificate, the State Treasurer shall describe such amendment in the next Annual Report, and shall include, as applicable, a narrative explanation of the reason for the amendment or waiver and its impact on the type (or, in the case of a change of accounting principles, on the presentation) of financial information or operating data being presented by the State. In addition, if the amendment relates to the accounting principles to be followed in preparing financial statements, (i) notice of such change shall be given in the same manner as for a Listed Event under Section 5(f), and (ii) the Annual Report for the year in which the change is made should present a comparison (in narrative form and also, if feasible, in quantitative form) between the financial statements as prepared on the basis of the new accounting principles and those prepared on the basis of the former accounting principles.

Section 9. Additional Information. Nothing in this Disclosure Certificate shall be deemed to prevent the State Treasurer from disseminating any other information, using the means of dissemination set forth in this Disclosure Certificate or any other means of communication, or including any other information in any Annual Report or notice of occurrence of a Listed Event, in addition to that which is required by this Disclosure Certificate. If the State Treasurer chooses to include any information in any Annual Report or notice of occurrence of a Listed Event in addition to that which is specifically required by this Disclosure Certificate, the State Treasurer shall not have any obligation under this Disclosure Certificate to update such information or include it in any Annual Report or future notice of occurrence of a Listed Event.

Section 10. Default. In the event of a failure of the State or State Treasurer to comply with any provision of this Disclosure Certificate, any Holder or Beneficial Owner of the Bonds may take such actions as may be necessary and appropriate, including seeking mandate or specific performance by court order, to cause the State or State Treasurer to comply with its obligations under this Disclosure Certificate. The sole remedy under this Disclosure Certificate in the event of any failure of the State or State Treasurer to comply with this Disclosure Certificate shall be an action to compel performance.

Section 11. Beneficiaries. This Disclosure Certificate shall inure solely to the benefit of the Holders and Beneficial Owners from time to time of the Bonds, and shall create no rights in any other person or entity (except the right of the Dissemination Agent or any Holder or Beneficial Owner to enforce the provisions of this Disclosure Certificate on behalf of the Holders). This Disclosure Certificate is not intended to create any monetary rights on behalf of any person based upon the Rule.

Section 12. Partial Invalidity. If any one or more of the agreements or covenants or portions thereof required hereby to be performed by or on the part of the State Treasurer shall be contrary to law, then such agreement or agreements, such covenant or covenants or such portions thereof shall be null and void and shall be deemed separable from the remaining agreements and covenants or portions thereof and shall in no way affect the validity hereof, and the Holders of the Bonds shall retain all the benefits afforded to them hereunder. The State Treasurer hereby declares that he would have executed and

delivered this Disclosure Certificate and each and every other article, section, paragraph, subdivision, sentence, clause and phrase hereof irrespective of the fact that any one or more articles, sections, paragraphs, subdivisions, sentences, clauses or phrases hereof or the application thereof to any person or circumstance may be held to be unconstitutional, unenforceable or invalid.

Section 13. Governing Law. The laws of the State shall govern this Disclosure Certificate, the interpretation thereof and any right or liability arising hereunder. Any action or proceeding to enforce or interpret any provision of this Disclosure Certificate shall be brought, commenced or prosecuted in any courts of the State located in Sacramento County, California.

IN WITNESS WHEREOF, the State Treasurer has executed this Disclosure Certificate as of the date first above written.

By: _____
Deputy Treasurer
For California State Treasurer Bill Lockyer

CONTINUING DISCLOSURE EXHIBIT A

**FORM OF NOTICE TO THE MUNICIPAL SECURITIES RULEMAKING BOARD
OF FAILURE TO FILE ANNUAL REPORT**

Name of Issuer: STATE OF CALIFORNIA
Name of Bond Issue: STATE OF CALIFORNIA
Various Purpose General Obligation Bonds
(Federally Taxable)

Date of Issuance: _____, 2010

NOTICE IS HEREBY GIVEN that the Issuer has not provided an Annual Report with respect to the above-named Bonds as required by Section 4 of the Continuing Disclosure Certificate of the Issuer, dated the Date of Issuance. [The Issuer anticipates that the Annual Report will be filed by _____.]

Dated: _____

STATE OF CALIFORNIA

By _____ [to be signed only if filed]

APPENDIX D
PROPOSED FORMS OF LEGAL OPINIONS
FORM OF FINAL OPINION OF BOND COUNSEL

[Closing Date]

STATE OF CALIFORNIA

\$ _____
VARIOUS PURPOSE
GENERAL OBLIGATION BONDS
(FEDERALLY TAXABLE)

(Final Opinion)

We have acted as Bond Counsel in connection with the issuance by the State of California (the “State”) of \$ _____ aggregate principal amount of State of California Various Purpose General Obligation Bonds (Federally Taxable) (the “Bonds”), all dated _____, 2010, and issued as _____ separate series under _____ bond acts, all identified in Schedule A hereto, which is incorporated by reference (collectively, the “Bonds”). The Bonds are authorized pursuant to the respective bond acts identified in Schedule A (collectively, the “Laws”) and are issued pursuant to Part 3 of Division 4 of Title 2 of the California Government Code and to resolutions (the “Resolutions”) adopted by the respective finance committees designated under the Laws.

In such connection, we have examined the Resolutions, other certifications of officials of the State, and such other documents and matters deemed necessary by us to render the opinions set forth herein, although in doing so, we have not undertaken to verify independently the accuracy of the factual matters represented, warranted or certified therein, and we have assumed the genuineness of all documents and the signatures thereto.

The opinions expressed herein are based upon an analysis of existing laws, regulations, rulings and court decisions and cover certain matters not directly addressed by such authorities. Such opinions may be affected by actions taken or omitted or events occurring after the date hereof. We have neither undertaken to determine, nor to inform any person, whether any such actions are taken or omitted or events do occur or whether any other matters come to our attention after the date hereof. Accordingly, this opinion speaks only as of its date and is not intended to, and may not, be relied upon in connection with any such actions, events or matters. We disclaim any obligation to update this letter. Furthermore, we have assumed compliance with the agreements and covenants contained in the Resolutions.

We call attention to the fact that the rights and obligations under the Bonds and the Resolutions and their enforceability may be subject to bankruptcy, insolvency, reorganization, arrangement, fraudulent conveyance, moratorium and other laws relating to or affecting creditors’ rights, to the application of equitable principles, to the exercise of judicial discretion in appropriate cases, and to the limitations on legal remedies against the State. We express no opinion with respect to any indemnification, contribution, penalty, choice of law, choice of forum, choice of venue, waiver or severability provisions contained in foregoing documents. Finally, we undertake no responsibility for the accuracy, completeness or fairness of the Offering Memorandum or other offering material relating to the Bonds and express no opinion with respect thereto.

Based on and subject to the foregoing, and in reliance thereon, as of the date hereof, we are of the following opinions:

1. The State has lawful authority for the issuance of the Bonds, and the Bonds constitute valid and binding general obligations of the State payable in accordance with the Laws from the General Fund of the State. The full faith and credit of the State are pledged to the punctual payment of the principal of and interest on the Bonds as the principal and interest become due and payable.

2. Interest on the Bonds is not excluded from gross income for federal income tax purposes under Section 103 of the Internal Revenue Code of 1986, as amended. Interest on the Bonds is exempt from State personal income taxes. We express no opinion regarding any other tax consequences related to the ownership or disposition of, or the accrual or receipt of interest on, the Bonds.

Circular 230 Disclaimer: Investors are urged to obtain independent tax advice regarding the Bonds based upon their particular circumstances. The tax discussion above regarding the Bonds was not intended or written to be used, and cannot be used, for the purposes of avoiding taxpayer penalties. The advice was written to support the promotion or marketing of the Bonds.

Very truly yours,

Orrick, Herrington & Sutcliffe LLP

Per

Schedule A

FORM OF OPINION OF THE ATTORNEY GENERAL

[Closing Date]

The Honorable Bill Lockyer
State Treasurer
Sacramento, California

STATE OF CALIFORNIA
\$ _____
VARIOUS PURPOSE
GENERAL OBLIGATION BONDS
(FEDERALLY TAXABLE)

Honorable Bill Lockyer:

We have acted as counsel to the State of California (the "State") in connection with the issuance by the State of \$ _____ aggregate principal amount of State of California Various Purpose General Obligation Bonds (Federally Taxable) (the "Bonds"), dated _____, 2010, and issued as _____ separate series under _____ bond acts, all identified in Schedule A hereto, which is incorporated by reference. The Bonds are authorized pursuant to the respective bond acts identified in Schedule A (collectively, the "Laws") and are issued pursuant to Chapter 4 of Part 3 of Division 4 of Title 2 of the California Government Code and to resolutions (the "Resolutions") adopted by the respective finance committees designated under the Laws.

In such connection, we have examined the record of proceedings submitted to us relative to the issuance of the Bonds, including the Resolutions, certifications of officials of the State, and such other documents and matters deemed necessary by us to render the opinions set forth herein, although in doing so, we have not undertaken to verify independently, and have assumed the accuracy of the factual matters represented, warranted or certified therein.

The opinions expressed herein are based upon an analysis of existing laws, regulations, rulings and court decisions and cover certain matters not directly addressed by such authorities. Such opinions may be affected by actions taken or omitted or events occurring after the date hereof and we disclaim any obligation to update this letter. We have neither undertaken to determine, nor to inform any person, whether any such actions are taken or omitted or events do occur or whether any other matters come to our attention after the date hereof. We have assumed the genuineness of all documents and signatures presented to us, the conformity to original documents and certificates of all documents and certificates submitted to us as certified or photostatic copies, and the authenticity of the originals of such latter documents and certificates. Furthermore, we have assumed compliance with the agreements and covenants contained in the Resolutions.

We call attention to the fact that the rights and obligations under the Bonds and the Resolutions and their enforceability may be subject to bankruptcy, insolvency, reorganization, arrangement, fraudulent conveyance, moratorium and other laws relating to or affecting creditors' rights, to the application of equitable principles, to the exercise of judicial discretion in appropriate cases, and to the limitations contained in State law regarding legal remedies against the State. We express no opinion with respect to any indemnification, contribution, penalty, choice of law, choice of forum, choice of venue, severability or waiver provisions contained in the foregoing documents. We express no opinion as to whether interest on the Bonds is excluded from gross income for federal income tax purposes or exempt from State personal income taxes or as to any other tax consequences related to the ownership or disposition of, or the accrual or receipt of interest on, the Bonds. Finally, we undertake no responsibility

for the accuracy, completeness or fairness of the Offering Memorandum dated _____, 2010, or other offering material relating to the Bonds and express no opinion with respect thereto.

Based on and subject to the foregoing, and in reliance thereon, as of the date hereof, we are of the opinion that the State has lawful authority for the issuance of the Bonds, and the Bonds constitute the valid and binding general obligations of the State payable in accordance with the Laws from the General Fund of the State. The full faith and credit of the State are pledged to the punctual payment of the principal of and interest on the Bonds, as the principal and interest become due and payable.

Sincerely,

Deputy Attorney General
For EDMUND G. BROWN JR.
Attorney General of the State of California

Schedule A

APPENDIX E
LETTERS FROM UNDERWRITERS



November 1, 2010

Ms. Katie Carroll
Deputy Treasurer
Office of the Treasurer of the State of California
915 Capitol Mall, Room 110
Sacramento, CA 95814

RE: State of California Various Purpose General Obligation Bonds (Federally Taxable)
State of California Various Purpose General Obligation Bonds (Tax-Exempt)

Dear Ms. Carroll:

Citigroup Global Markets Inc. and Morgan Stanley & Co. Incorporated are providing the following language for inclusion in the Offering Statement.

Citigroup Inc. and Morgan Stanley, the respective parent companies of Citigroup Global Markets Inc. and Morgan Stanley & Co. Incorporated, each an underwriter of the Bonds, have entered into a retail brokerage joint venture. As part of the joint venture each of Citigroup Global Markets Inc. and Morgan Stanley & Co. Incorporated will distribute municipal securities to retail investors through the financial advisor network of a new broker-dealer, Morgan Stanley Smith Barney LLC. This distribution arrangement became effective on June 1, 2009. As part of this arrangement, each of Citigroup Global Markets Inc. and Morgan Stanley & Co. Incorporated will compensate Morgan Stanley Smith Barney LLC. for its selling efforts in connection with their respective allocations of Bonds.

Citigroup Global Markets Inc.
Morgan Stanley & Co. Incorporated



November 3, 2010

State Treasurer's Office
Public Finance Division
915 Capitol Mall, Room 110
Sacramento, CA 95814

To Whom It May Concern:

Pershing LLC, a subsidiary of The Bank of New York Mellon Corporation, and Barclays Capital Inc. established a strategic alliance in May of 2009, which enables Pershing LLC to participate as a selling group member and a retail distributor for all new issue municipal bond offerings underwritten by Barclays Capital Inc., including the State of California General Obligation Bonds offered hereby. Pershing LLC will receive a selling concession from Barclays Capital Inc. in connection with its distribution activities relating to the State of California General Obligation Bonds.

Sincerely,

BARCLAYS CAPITAL INC.



November 1, 2010

Ms. Katie Carroll
Deputy Treasurer
Office of the Treasurer of the State of California
915 Capitol Mall, Room 110
Sacramento, CA 95814

Re: State of California, General Obligation Bonds, Fall 2010 ('the Bonds')

Dear Ms. Carroll:

De La Rosa & Co., Underwriter on the Bonds, has entered into separate agreements with UnionBanc Investment Services LLC and Credit Suisse Securities USA LLC for retail distribution of certain municipal securities offerings, at the original issue prices. Pursuant to said agreement, if applicable to the Bonds, De La Rosa & Co. will share a portion of its underwriting compensation with respect to the Bonds with UnionBanc Investment Services LLC or Credit Suisse Securities USA LLC.

De La Rosa & Co.

October 28, 2010

Ms. Katie Carroll
Deputy Treasurer
Office of the Treasurer of the State of California
915 Capitol Mall, Room 110
Sacramento, CA 95814

RE: November, 2010 State of California General Obligation Bonds (the “Bonds”)

Dear Ms Carroll:

Fidelity Capital Markets (“FCM”), one of the underwriters of the Bonds, is a division of National Financial Services LLC (“NFS”), which provides fully-disclosed clearing and other services to correspondent broker-dealers (the “correspondent broker-dealers”). NFS has entered into Master Reallowance Agreements with several of the correspondent broker-dealers to allow them to redistribute municipal securities underwritten by NFS to their retail investors at the original offering price. Pursuant to these Master Reallowance Agreements, NFS may share a portion of the underwriting compensation with respect to this bond offering with its correspondent broker-dealers.

Fidelity Capital Markets



November 3, 2010

Ms. Katie Carroll
Deputy Treasurer
Office of the Treasurer of the State of California
915 Capitol Mall, Room 110
Sacramento, CA 95814

Dear Ms. Carroll:

Goldman, Sachs & Co. ("Goldman Sachs"), one of the Underwriters of the State of California, Various Purpose General Obligation Bonds (the "Bonds"), has entered into a master dealer agreement (the "Master Dealer Agreement") with Incapital LLC ("Incapital") for the distribution of certain municipal securities offerings, including the Bonds, to Incapital's retail distribution network at the initial public offering prices. Pursuant to the Master Dealer Agreement, Incapital will purchase the Bonds from Goldman Sachs at the initial public offering price less a negotiated portion of the selling concession applicable to the Bonds that Incapital sells.

Sincerely,

GOLDMAN, SACHS & CO.



November 3, 2010

Mr. Blake Fowler
Director
Office of the Treasurer of the State of California
915 Capitol Mall, Room 261
Sacramento, CA 95814

RE: State of California General Obligation Bonds (the "Bonds")

Dear Mr. Fowler:

Greencoast Capital Partners LLC is providing the following language for inclusion in the Official Statement:

Greencoast Capital Partners LLC ("Greencoast") has entered into a distribution agreement (the "Distribution Agreement") with Cantor Fitzgerald & Co. ("Cantor") for the distribution of certain municipal securities offerings, including the Bonds, underwritten by Greencoast at the original offering prices. Under the Distribution Agreement, Greencoast will share with Cantor a portion of the fee or commission paid to Greencoast.

Sincerely,

Greencoast Capital Partners LLC

J.P.Morgan

November 2, 2010

Mr. Blake Fowler
Director, Public Finance Division
Office of the Treasurer of the State of California
915 Capitol Mall, Room 261
Sacramento, CA 95814

RE: State of California General Obligation Bonds (the "Bonds")

Dear Mr. Fowler:

J.P. Morgan Securities LLC ("JPMS"), one of the Underwriters of the Bonds, has entered into negotiated dealer agreements (each, a "Dealer Agreement") with each of UBS Financial Services Inc. ("UBSFS") and Charles Schwab & Co., Inc. ("CS&Co.") for the retail distribution of certain securities offerings, including the Bonds, at the original issue prices. Pursuant to each Dealer Agreement, each of UBSFS and CS&Co. will purchase Bonds from JPMS at the original issue price less a negotiated portion of the selling concession applicable to any Bonds that such firm sells.

J.P. MORGAN SECURITIES LLC



PRAGER, SEALY & CO., LLC

INVESTMENT BANKERS

October 29, 2010

Ms. Katie Carroll
Deputy Treasurer
Office of the Treasurer of the State of California
915 Capitol Mall, Room 110
Sacramento, CA 95814

Re: State of California General Obligation Bonds (Taxable and Tax Exempt) November 2010 Sales

Dear Ms. Carroll:

Prager, Sealy & Co., LLC, Co-Managing Underwriter of the above-referenced Series 2010 Bonds, has entered into an agreement (the "Distribution Agreement") with HSBC Securities for the retail distribution of certain municipal securities offerings, at the original issue prices. Pursuant to the Distribution Agreement (if applicable for this transaction), Prager, Sealy & Co., LLC will share a portion of its underwriting compensation with respect to the Series 2010 Bonds with HSBC Securities.

Prager, Sealy & Co., LLC



November 5, 2010

Ms. Katie Carroll
Deputy Treasurer
Office of the Treasurer of the State of California
915 Capitol Mall, Room 110
Sacramento, CA 95814

RE: State of California Various Purpose General Obligation Bonds (Federally Taxable) (the "Bonds")

Dear Ms. Carroll:

Wells Fargo Bank, National Association ("WFBNA"), one of the underwriters of the Bonds, has entered into an agreement (the "Distribution Agreement") with Wells Fargo Advisors, LLC ("WFA") for the retail distribution of certain municipal securities offerings, including the Bonds. Pursuant to the Distribution Agreement, WFBNA will share a portion of its underwriting compensation with respect to the Bonds. WFBNA and WFA are both subsidiaries of Wells Fargo & Company.

Wells Fargo Securities is the trade name for certain capital markets and investment banking services of Wells Fargo & Company and its subsidiaries, including Wells Fargo Bank, National Association.

Wells Fargo Bank, National Association



WESTHOFF, CONE
& HOLMSTEDT

October 29, 2010

Ms. Katie Carroll
Deputy Treasurer
State of California
State Treasurer's Office
915 Capitol Mall, Room 110
Sacramento, California 95814

**RE: State of California
General Obligation Bonds (the "Bonds")**

Dear Ms. Carroll:

Westhoff, Cone & Holmstedt, Co-Managing Underwriter on the Bonds, has entered into an agreement with Alamo Capital for retail distribution of certain municipal securities offerings, at the original issue prices. Pursuant to said agreement, if applicable to the Bonds, Westhoff, Cone & Holmstedt will share a portion of its underwriting compensation with respect to the Bonds with Alamo Capital.

Sincerely,

WESTHOFF, CONE & HOLMSTEDT

500 Ygnacio Valley Road, Suite 380
Walnut Creek, California 94596
Telephone: 925 472 8740
Fax: 925 939 5099

