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# *The* FISCAL REPORT an informational update

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## **Governor's Proposals for the 2009-10 State Budget and K-12 Education - Special Fiscal Report**

All of us at SSC are optimists; we believe that, despite short-term setbacks and challenges, the path of our state and our nation is inevitably destined to be upward and forward. Having said that, the confluence of the current economy, the state's financial system, and the impact of past spending patterns has certainly created a huge challenge for all of us. If we had to choose one line to characterize this situation, it would be from an old Marty Robbins song, "This time Lord you gave me a mountain."

As California faces the deepest economic downturn since at least the early 1990s and perhaps since the Great Depression of the 1930s, education will certainly feel the pain. On the one hand, we believe strongly that the ability of the state to manage its financial affairs well over the long term is a key to the future; but, on the other, we know that California's children deserve better than the meager amount this Budget will afford them.

The dilemma of how to balance the State Budget in the face of growing needs is at the core of the inability of the Legislature and the Administration to agree on a spending plan. How much to cut? How much to tax? Which sectors take the cuts? These questions are central to the discussion-and there are no right or wrong answers or "silver bullets." Reasonable people can, will, and have disagreed on the answers to these questions.

The fundamental economic principles are clear. Tax revenues of all kinds are coming in well below projections, some below even last year's anemic levels. Job growth has all but evaporated to the point where California's 8%+ unemployment rate leads the nation. The housing slump continues to drag down economic activity. The credit crunch has shocked the nation and the world and fueled volatility in the financial markets. This is a crummy time to be responsible for managing an enterprise that relies on the economy in general and the state government in particular for its vitality and its money.

One thing has been proven beyond a doubt-all of the economic forecasts were wrong and were overly optimistic. California has again way overforecasted its revenues. As a result, the 2008-09 Budget, the latest in history and only a few months old, is already in deep trouble. Revenues keep falling, expenditures march on, and proposed Budget changes are inextricably mired in the legislative process.

Special sessions called under the emergency authority granted the Governor under Proposition 58 provide a vehicle for dealing with current-year fiscal problems. But neither the special session called in November 2008 nor the one called on December 1, the day legislators were sworn in, have produced any positive results. The Legislature rejected the Governor's plan and in turn, the Governor vetoed the Legislature's plan. At this moment, only the Governor's Budget is on the table and the Legislature has already rejected much of it.

Meanwhile, time marches on. And as time passes, the abyss grows deeper and wider. Delayed implementation of actions to close the gap leads to lowered savings and deeper cuts. But the paralysis that

has surrounded the Capitol for most of the past year shows no signs of abatement.

We know the choices are hard and the impact of those choices will affect millions of Californians for decades to come. But, at the same time, we recognize that California's flawed finance and budgeting system is likely to cause a repeat of this situation in the future. We have faced difficult economic times before and, while the state has survived and made it through, our handling of economic crises could never be described as our finest hour.

We think at a bare minimum the Legislature and the Administration should be looking at two things: First, California Forward offers a truly innovative way of addressing our budget process. It carries the weight of many credible participants and should be given full consideration.

A more immediate and pragmatic action is passage of SCA 6 (Simitian, D-Palo Alto). SCA 6 would lower the vote requirement for the passage of parcel taxes from two-thirds to 55%. We think that, at a time when the state's finance system is clearly failing our children, the Legislature at least owes communities the chance to decide to tax themselves to protect their schools.

Finally, under current law, when there is rain, there will eventually be sunshine. The huge deficits applied to public education this year will at some future time be restored to the base. As we fight to survive the short term, we should not forget that there is also a long term with brighter prospects. We wish you well in all of your endeavors-personal and professional. Remember, we are honored to serve you in any way we can; please call upon us.

RON BENNETT

President and CEO

### **Economy and Revenues**

The story of the 2009-10 Governor's Budget is dominated by the condition of the state and national economies. One year ago, the Governor's advisors at the Department of Finance foresaw a weakening California economy driven down by the housing crisis; however, no recession was forecast for 2008 or 2009. In January 2009, the Governor's Budget now acknowledges that the state and the nation are in a severe recession that could be the worst since the Great Depression.

#### **Economic Outlook**

As the events of 2008 unfolded, a housing crisis brought about by the collapse of the subprime lending market led to a broader crisis in the credit markets. Major national financial institutions either collapsed or teetered on the brink of insolvency as the extent of their holdings of "toxic mortgages" were revealed. The collapse of the credit markets in turn drove down stock prices, with the Dow Jones averages falling 40% from their high. Signaling a broader collapse in international markets and economic activity, oil prices fell from a high of almost \$150 per barrel in the summer of 2008 to less than \$40 per barrel by year's end.

All of these forces, along with California's greater exposure to the housing crisis and high unemployment rate, have resulted in a precipitous drop in economic activity. State personal income, one of the broadest measures of the economy, is expected to increase only 2.0% in 2009. However, after adjusting for inflation, this increase is essentially wiped out, leaving real economic growth flat. For 2010, the Administration's forecast for personal income growth is a meager 2.1%, which again is all but eliminated after adjusting for inflation.

This falloff in economic activity is also reflected in the employment market, which is expected to fall three straight years through 2010. Currently, California suffers from one of the highest unemployment rates in the nation at 8.4%; one year ago, the state's unemployment rate stood at 5.9%. Between 2007 and 2010, the Administration is projecting that the state will lose almost 380,000 jobs, a decline of 2.5%. Keep in mind that the state's population is expected to continue to grow even during the recession, which makes the competition for jobs even more fierce.

### Revenue Forecast

This bleak economic picture yields an equally dismal outlook for state revenues. The Governor's Budget forecasts a shortfall in current-year revenues of \$14.5 billion when measured against the revenue projections for the 2008-09 Budget Act, a drop of 14.2%. For the budget year, the Governor's Budget sees no significant improvement, with baseline revenues falling short of projections by \$16.3 billion, or 15.9%. (Note: The baseline revenue projections exclude the effects of the Governor's new revenue proposals, such as the increase in the sales tax, the broadening of the sales tax to services, and the reduction of the dependent credit, among others.)

As in prior economic downturns, one of the chief reasons for the shortfall in 2008-09 General Fund revenues is the state's heavy reliance on the personal income tax and the steeply progressive nature of this tax.

Personal income tax revenues are expected to fall short by

\$8.9 billion in the current year. In California, because of the steeply progressive design of the income tax rates, the highest one percent of income earners contributes almost one-half of the personal income tax. These taxpayers also derive a disproportionate share of their income from capital gains, and these gains are expected to plummet from \$127 billion statewide in 2007 to \$57 billion in 2008, resulting in a drop in capital gains tax revenues of \$6.3 billion.

The Governor's Budget indicates that, of the \$41 billion budget gap for 2008-09 and 2009-10 combined, roughly three quarters of the problem is related to revenues falling short of projections. As a result, the Governor is proposing a number of measures to raise additional revenues. Some of these proposals are temporary, but others would continue as permanent revisions to the State's tax laws. The table below summarizes the major revenue proposals.

<b>Proposal</b>	<b>2008-09 (in millions)</b>	<b>2009-10 (in millions)</b>
Temporary 1.5¢ sales and use tax	\$2,350	\$7,114
Broaden sales tax base	\$272	\$1,154
"Nickel-per-drink" alcoholic beverage tax	\$244	\$585
9.9% oil severance tax	\$358	\$855

Reduce dependent exemption credit	-	\$1,440
Increase vehicle registration fees	\$92	\$359
Special fund transfers and loans	\$298	\$94

### Proposition 98

Proposition 98 sets in the State Constitution a series of complex formulas that establish the minimum funding level for K-12 education and the community colleges from one year to the next. This target level is determined by prior-year appropriations that count toward the guarantee and (1) workload changes as measured by the change in ADA, and (2) inflation adjustments as measured by the change in either per capita personal income or per capita state General Fund revenues, whichever is less. For California public education in 2008-09 and 2009-10, these factors have collapsed all at the same time.

The Governor's Budget projects that the Proposition 98 guarantee for 2008-09 will drop from the budgeted level of \$58.1 billion assumed in the 2008-09 Budget Act to \$50.2 billion as a result of the collapse in state revenues and then will increase to \$51.5 billion after including \$1.3 billion in new revenues included in this proposal. While the Governor's Budget proposes to reduce current-year appropriations down to the level of the newly forecast minimum, actual spending by local educational agencies (LEAs) would not fall by a commensurate amount. According to the Governor's proposals, this would be accomplished by enacting a number of accounting adjustments, deferrals, and real spending cuts. In the end, LEAs would experience spending cuts, but not on the order of magnitude suggested by the drop in the Proposition 98 minimum guarantee, and the state's obligation in 2009-10 would in turn be reduced as a result of these midyear adjustments.

#### 2008-09 Proposition 98 Reductions

For the current year, the Governor's Budget proposes to reduce appropriations subject to the Proposition 98 guarantee by (1) deferring \$2.8 billion for the April 2009 revenue limit and K-3 class-size reduction apportionment to July 2009 (i.e., the subsequent fiscal year), (2) reducing General Fund support for Home-to-School Transportation by \$619 million and replacing this reduction with special fund revenues from the Public Transportation Account (PTA) and the Mass Transit Fund, (3) designating \$1.1 billion in current-year appropriations as counting toward prior-year Proposition 98 "settle up" funds, and (4) imposing actual expenditure reductions in revenue limits of \$1.89 billion.

According to the Budget, the first three proposals will not require an actual reduction in school agency spending. Instead, these changes allow a reduction to the current-year Proposition 98 base, which in turn reduces the constitutional minimum funding guarantee for 2009-10. The actual current-year expenditure reductions are estimated to result in a loss of approximately \$319 per ADA, or about 5.2%.

#### 2009-10 Proposition 98 Minimum Guarantee

For the budget year, the Governor's Budget assumes adoption of the current-year proposals and thus the guarantee is built off of a considerably lower base. Under this assumption, the 2009-10 Proposition 98 guarantee would be \$55.9 billion, an increase of \$4.4 billion, or 8.6%, above the revised current-year

guarantee.

This increase in the Proposition 98 guarantee, however, does not provide education additional resources to expand services in 2009-10. Instead, these funds are completely used to backfill one-time adjustments made in 2008-09, with further cuts proposed in the Budget year fully meet current-year and Budget-year obligations.

When Proposition 98 funding is determined by Test 3-ADA changes and the change in per capita General Fund Revenues-a Maintenance Factor is created to track the long-term funding obligation to schools. When the 2008-09 Budget was enacted in September 2008, the Maintenance Factor was estimated at \$1.9 billion. Despite the major reduction in the minimum guarantee since September, there is no Maintenance Factor, according to the Department of Finance (DOF). The DOF projects that funding is now determined by Test 1-a fixed share of General Fund Revenues-and as a result, no Maintenance Factor obligation is created. While this situation seems counter to the intent of the drafters of Proposition 98 to protect K-14 education, this interpretation may be correct. Further review is in process.

### **Midyear Proposals for 2008-09**

In addition to the adjustments to Proposition 98 discussed in the previous section, the Governor's Budget proposes other current-year reductions as follows:

- Eliminating the 0.68% cost-of-living adjustment (COLA) for K-14 education (\$284 million)
- A further reduction to K-12 revenue limits of approximately 4.5% (\$1.6 billion)
- Reducing the Budget by \$55.5 million to capture anticipated savings in various K-12 education programs
- Reducing Child Care program funding on an ongoing basis by \$55 million to capture savings
- Reducing CalWORKs Stage 2 and Stage 3 programs by \$42 million to capture expected savings, and reappropriating \$108 million in savings from prior-year programs to cover shortfalls in one-time sources funding current-year programs

The major provisions of the Governor's midyear proposal with direct impact to K-12 local agency budgets and cash flow are:

- The elimination of the 0.68% COLA
- The 4.5% reduction in revenue limit funding
- The further deferral of apportionment funds to July 2009

According to the Governor, in order to "help schools minimize impacts [of the above cuts] to essential classroom instruction," the proposal includes the following flexibility options for the current year:

- Transfer of any categorical funding received to be used for any purpose after the local agency conducts a public hearing on the matter
- Transfer of prior-year categorical balances (with limitations) to be used for any purpose in the current year
- Eliminate the Deferred Maintenance match requirement (while retaining the state funding as set forth in the 2008 Budget Act)
- Reduce the required contribution to the Routine Restricted Maintenance Account from 3% to 1%
- Reduce the state-required reserve level by half for the current year and the budget year

Note that, in the Governor's initial proposal issued during the first special session for midyear cuts, categorical funding shifts were limited to the amount of the revenue limit reduction. This latest proposal

imposes no dollar limitation. Our advice continues to be to set aside as much of your current-year categorical allocations as you can, including the 6.5% restoration from the Governor's initial proposal made last year for this year, and to preserve carryover balances from last year in order to position your agency to take advantage of this flexibility if it is in the final deal.

With regard to the state-required reserve level flexibility, we, along with county offices and the state's Fiscal Crisis and Management Assistance Team (FCMAT), have concerns about local agencies reducing their reserve levels below what is normally required at a time when there is significant uncertainty and reserve levels should actually be higher. If your agency may need to use this provision, you should be prepared to demonstrate a plan to restore the reserves in 2010-11.

The Governor's proposal to further defer apportionments into July 2009 will cause local agencies to operate with lower levels of cash and may cause additional borrowing. Be prepared to enact this additional borrowing to carry your local agency through the spring and into the summer if needed.

Finally, remember that all of the Governor's proposals have yet to be enacted by legislation, but it is the only formal proposal on the table right now. The Legislative Analyst's Office (LAO), in its review of the Governor's Budget Proposal, has recommended that the cuts be made from categorical programs and not revenue limits (like the legislative Democrat proposal that was just vetoed) and that the further deferral of cash going to local agencies should only be done as a last resort. The LAO also acknowledges that, since we are more than halfway through the school year, much of the Governor's proposed cuts will impact local agency revenues and will "likely leave many districts in financial hardship . . . "

### **2009-10 Proposition 98 Reductions**

The 2009-10 proposed Budget cuts \$2.5 billion from K-12 education by eliminating funding for cost-of-living adjustments (COLAs) to revenue limits and categorical programs. It also includes an additional \$1.1 billion reduction to revenue limits and makes an additional decrease of approximately \$300 million, which includes \$114.2 million to eliminate the High Priority Schools Grant program, \$111 million attributed to a 0.3% declining ADA, and smaller reductions.

The Governor's Budget also proposes major funding shifts that do not result in direct reductions or increases to schools.

- Home-to-school transportation loses \$398.5 million in General Fund support; however, funds from the Public Transportation Account and the Mass Transportation Fund replace the reduction so that funding remains stable at the local level
- In addition, \$891.6 million from the General Fund is added to Proposition 98 to replace State Lottery revenues, provided voters approve the proposal to borrow against future Lottery earnings. This funding shift increases the Proposition 98 base without actually providing additional funds to schools since the increase simply backfills revenue from the State Lottery that schools would have received anyway

The Governor's Budget also proposes increases for 2009-10:

- \$65 million to fund the AB 602 Special Education Local Plan Area (SELPA) Special Education Behavior Intervention Plans (BIP) as part of the multiyear settlement agreement reached late last year
- \$13.4 million for two K-12 mandates-\$6.3 million for interdistrict and intradistrict transfers and \$7.1 million for costs related to the California High School Exit Exam (CAHSEE). All other K-12 mandates are suspended for the budget year with no funding provided as a result of a lawsuit that requires mandates to be either paid or suspended
- \$35.5 million increase in funds for Deferred Maintenance

- \$83.2 million for growth in various programs

## Revenue Limits

### K-12 Revenue Limits

For both 2008-09 and 2009-10 the Governor proposes to eliminate funding for the statutory COLA and to also make further reductions to revenue limits. For 2008-09 the Governor proposes to eliminate the 0.68% partial funding of the statutory COLA plus make additional reductions of approximately \$1.6 billion. For 2009-10 the proposal would eliminate the 5.02% statutory COLA and impose further cuts amounting to approximately \$1 billion to the revenue limit, which is also accompanied by a proposal to allow local education agencies to reduce the length of their school year as one means to offset the impact (see below for further details).

In order to account for these adjustments in the revenue limit calculation, districts first must apply the estimated COLA and then the deficit factor. The statutory COLA provides a uniform dollar increase for all districts of the same type, but the deficit results in a larger cut to a district with a high revenue limit than to a district with a low revenue limit. That is, while the average unified district will experience a net cumulative reduction of 16.16% for both years, the actual dollar amount and percentage cut will vary by district. The table below provides the factors based on the Governor's Proposal by type of district:

	2008-09	2009-10
Statutory COLA	5.66%	5.02%
COLA Rates by District Type		
Elementary	\$315	\$295
High School	\$379	\$355
Unified	\$329	\$309
Deficit Due to COLA	5.36%	9.88%
Deficit Due to COLA and Revenue Limit Cuts	9.68%	16.16%

Clearly, the Governor has proposed no new revenue limit funding for equalization aid or for districts experiencing declining enrollment. The existing state law allowing districts with declining ADA to use prior-year ADA continues to apply in 2009-10.

### Reducing School Year Length and Collective Bargaining Contracts

The Governor's Budget proposes to authorize school districts to reduce the statutorily required school year from 180 days to 175 days. It is important to note that, while the Governor proposes changing the law to allow for a shorter school year, the fact remains that, for LEAs to alter the length of their school year calendars, collective bargaining units must agree to a shorter calendar and a commensurate reduction in

compensation. As proposed, a reduction to revenue limits of an estimated \$153 per ADA would be implemented whether an LEA reduces the school year calendar or not. Those that are unable to reduce the school year calendar would be forced to make other cuts to accommodate the loss of revenues.

The estimated impact of the proposal would be a budget reduction of \$1.1 billion in addition to the proposed midyear cut of \$1.6 billion. After taking into account all proposed adjustments to revenue limits in 2008-09 and 2009-10, the Governor's proposals would reduce revenue limit funding by approximately \$472 per ADA (\$319 per ADA in 2008-09 plus an additional \$153 per ADA in 2009-10).

### **County Office of Education Revenue Limit**

County offices of education (COEs) receive the 5.02% (est.) COLA for their Form "O" revenue limit calculations with a 4.78% revenue limit deficit, which offsets the COLA but doesn't make any further cut.

Like school district revenue limits, COE revenue limits are funded based on ADA. And with statewide ADA declining, most COEs have funding reductions in proportion to the decline in ADA served. Also, COEs are funded only on current-year ADA when they are declining. They do not receive the same protection as school districts, which are funded based on the greater of current- or prior-year ADA.

### **Special Education**

The Governor's Budget Proposal treats special education as it does all other categorically funded programs-there's no COLA and no growth. And, while special education funding is presumably included within the funding flexibility proposals, for practical purposes this would be limited to transfers of funds to special education rather than the other way around because of the maintenance-of-effort requirements, not to mention the increasing cost of providing support that occurs on the natural.

There is, however, a small amount of new funding proposed as a result of the Governor and the education community finally, after 14 years, reaching a settlement agreement on the Positive Behavioral Intervention Plan (BIP) disputed mandate claim. The negotiated agreement between the Department of Finance and school agencies includes \$510 million in one-time funds and \$65 million in ongoing funds in lieu of filing ongoing BIP mandate claims.

Under the settlement and contingent upon the passage of legislation, school districts would receive \$85 million annually, from 2011-12 through 2016-17. Additionally, effective 2009-10, SELPAs would receive \$65 million in ongoing funding that would be added to the AB 602 base in lieu of filing ongoing claims. The Governor has presumed the settlement will be ratified and included the \$65 million as part of the Proposed Budget. (For more details regarding the full settlement, see "[Special Education Mandate Settlement Reached](#)" in the December 5, 2008, *Fiscal Report*, page 666.)

SELPAs entitled to increased funding under the Out-of-Home-Care Funding Model should not budget for any increase. But SELPAs entitled to less in 2008-09 should expect that they will lose 50% of the difference between their 2009-10 entitlement and the amount they received in 2008-09, as required by current law. The Governor's Budget assumes that the Special Disability Adjustment continues to be calculated in 2009-10 as it has been in the past.

### **Charter Schools**

Our table below reflects estimated 2009-10 charter school funding rates under the Governor's Budget Proposal.

The general purpose rates are based on statewide average revenue limits-and thus reflects the 5.02% COLA

that is then reduced by the deficit factor. The rates also reflect minor changes in the statewide cost of the revenue limit adjustments for unemployment insurance and the Public Employees' Retirement System (PERS) Reduction. These rates will be recalculated by the California Department of Education at each apportionment during 2009-10 and can fluctuate up or down by more than \$20 per ADA.

### 2009-10 ESTIMATED CHARTER SCHOOL RATES

**Caution: The General Purpose rates are rough estimates; actual rates may change considerably**

	K-3	4-6	7-8	9-12
General Purpose Block Grant	\$5,360	\$5,440	\$5,596	\$6,493
Categorical Block Grant	\$500	\$500	\$500	\$500
Total	\$5,860	\$5,940	\$6,096	\$6,993

Source: Department of Finance

The charter school categorical block grant is maintained at the 2008-09 level.

The Governor's Budget includes \$56.7 million in one-time funds for the charter school facilities grant program, often called the SB 740 program after the initial implementing legislation. Under this program, charter schools that serve primarily low-income students are eligible to receive reimbursement for their rent, up to \$750 per ADA.

### Categorical Programs

In addition to deferring \$2.6 billion in payments for revenue limits and categorical programs, such as K-3 Class-Size Reduction, the Governor also proposes funding adjustments and flexibility options that would impact LEA categorical program budgets.

The Governor's Proposed Budget includes \$83.2 million for growth in several categorical programs: Adult Education, Child Nutrition, Charter School Categorical Block Grant, K-3 Class-Size Reduction, and Teacher Credentialing Block Grant, but it does not provide for any COLA increase. Other major Budget adjustments announced by the Governor for 2009-10 include:

- \$65 million for Special Education Behavioral Intervention Plans (see the Special Education section for additional details)
- Eliminating \$114.2 million for the final year of the High Priority Schools Grant Program
- Reducing by \$1 million National Board Certification Incentive funding
- Various adjustments to child development programs, including the redirection of all state funding from Proposition 10 and half of local grants to other health and human services uses (\$275 million)

### Funding Flexibility

While the reductions to categorical programs are not significant in number, a key aspect of the Governor's proposal is to provide flexibility options for LEAs to offset the dramatic reductions proposed to revenue limit funding. As proposed, these options would be available beginning in 2008-09 and continue at least through 2009-10. Following is an overview of his proposal:

- Ability to transfer state categorical funding, including special funds (e.g., Adult Education and Child Nutrition), to the unrestricted General Fund
- Lifting of statutory requirements for many categorical programs
- Ø Example: Eliminating 20:1 K-3 Class-Size Reduction caps
- Allow for prior-year restricted balances to be transferred to the unrestricted General Fund
- Cut budget reserve requirements in half
- Eliminate the Deferred Maintenance match requirement, but provide the state share
- Reduce the required routine restricted maintenance set-aside from 3% to 1%

In addition, for 2009-10 the Governor proposes to allow local education agencies to reduce their school year calendar by up to five days as a means to offset the proposed revenue limit reductions. Plus the Governor's proposal includes permanent categorical flexibility. The specific proposal calls for providing LEAs virtually all state categorical funding as a single block grant, comparable to charter school funding. The funding level would be determined based a selected base year with subsequent adjustments for growth and COLA should funding be available.

### **Mandate Reimbursements**

Under current statutory and constitutional law, the state may direct local agencies to provide new services to the public, but must also reimburse those agencies for costs incurred in providing those services. Over the years, the state generally honored this compact until it faced a Budget gap commencing in 2001-02. In that year-and in every year since, with the exception of 2006-07-the state has elected to sidestep its obligation to reimburse local agencies for mandated costs and instead has deferred payments to some unspecified future fiscal year. During this period, school districts were not freed of the obligation to provide the mandated service, but instead were required to maintain services and fund them from existing resources.

### **Court Ruling Invalidates State's Mandate Deferrals**

In response to the ongoing practice of deferring mandate reimbursements, a coalition of school districts and the California School Boards Association filed suit against the state, arguing that the state's policy violated the California Constitution by denying school districts funding for costs imposed by state law and regulation. In December 2008, the Superior Court in San Diego County agreed with the petitioners and invalidated the state's practice of deferring mandate reimbursements. The court ruled that the Legislature must "comply with the Constitutional requirements of Article XIII B, Section 6, by fully funding state mandated programs and thereby foregoing the practice of deferring payment to school districts and county offices of education."

### **Governor's Budget Proposal**

In prior years, the Governor's Budget proposed and the Legislature enacted a Budget that provided a token \$1,000 for each of 38 education mandates. This policy triggered the requirement to provide the mandated services, but provided essentially no funding for cost reimbursements. Acknowledging the San Diego Superior Court ruling, the Governor's Budget for 2009-10 proposes to fund only two education mandates: \$6.3 million for mandated costs related to interdistrict and intradistrict attendance and \$7.1 million for costs related to the California High School Exit Exam.

Under the Governor's proposal, the remaining mandates would be suspended for 2009-10. These mandates

include, among others, collective bargaining, criminal background checks, removal of chemicals, and county office of education fiscal accountability reporting. The following is a list of all education mandates as reported by the State Controller's Office:

### **School District and County Office of Education Mandates**

#### **Proposed for Funding in 2009-10**

Chapter 1/1999-High School Exit Exam

Chapter 161/1993-Interdistrict and Intradistrict Attendance

#### **Proposed for Suspension in 2009-10**

Chapter 77/1978-Absentee Ballots

Chapter 893/2000-Agency Fee Arrangements

Chapter 818/1991-AIDS Prevention Instruction II

Chapter 98/1994-Caregiver Affidavits

Chapter 34/1998-Charter Schools

Chapter 34/1998-Charter Schools III

Chapter 917/1987-COE Fiscal Accountability Reporting

Chapter 961/1975-Collective Bargaining

Chapter 736/1997-Comprehensive School Safety Plans

Chapter 448/1975-Consolidation of Annual Parent Notification

Chapter 594/1998-Criminal Background Checks II

Chapter 30/1998-Differential Pay and Reemployment

Chapter 650/1994-Employee Benefits Disclosure

Chapter 1253/1975-Expulsion Transcripts

Chapter 36/1977-Financial and Compliance Audits

Chapter 498/1983-Graduation Requirements

Chapter 1184/1975-Habitual Truant

Chapter 1120/1996-Health Benefits for Survivors of Peace Officers & Firefighters

Chapter 1176/1977-Immunization Records

Chapter 325/1998-Immunization Records: Hepatitis B

- Chapter 1011/1984-Juvenile Court Notices II
- Chapter 1117/1989-Law Enforcement Agency Notification
- Chapter 249/1986-Missing Children Reports
- Chapter 828/1997-National Norm-Referenced Achievement Test
- Chapter 498/1983-Notification of Truancy
- Chapter 1306/1989-Notification to Teachers: Pupils Subject to Suspension or Expulsion
- Chapter 1284/1988-Parent Classroom Visits
- Chapter 465/1976-Peace Officers Procedural Bill of Rights
- Chapter 875/1985-Photographic Record of Evidence
- Chapter 640/1997-Physical Education Reports
- Chapter 975/1995-Physical Performance Tests
- Chapter 965/1977-Pupil Classroom Suspension: Counseling
- Chapter 668/1978-Pupil Exclusions
- Chapter 965/1977-Pupil Health Screenings
- Chapter 100/1981-Pupil Promotion and Retention
- Chapter 309/1995-Pupil Residency Verification and Appeals
- Chapter 1253/1975-Pupil Suspensions, Expulsions, and Expulsion Appeals
- Chapter 1107/1984-Removal of Chemicals
- Chapter 1463/1989-School Accountability Report Cards
- Chapter 100/1981-School District Fiscal Accountability Reporting
- Chapter 1192/1980-School District Reorganization
- Chapter 1347/1980-Scoliosis Screening
- Chapter 828/1997-Standardized Testing and Reporting
- Chapter 331/1998-Teacher Incentive Program
- Chapter 1249/1992-Threats Against Peace Officers

If the Legislature adopts the Governor's mandate proposal, LEAs would not be required to implement the suspended mandates nor would state reimbursement be provided for costs incurred during the year of suspension. From a practical standpoint, however, districts will likely continue to implement many of these activities, although not necessarily in conformity with the level specified in statute.

### State School Facilities Program

There continues to be a need for more funding for modernization and new construction of school facilities.

The Office of Public School Construction (OPSC) reports that, as of December 10, 2008, the following amounts have been apportioned and remain to be apportioned from the following state facilities bonds:

**(\$ in millions)**

<b>Proposition 1D-2006</b>	
Total Proposition 1D Apportionments	\$3,486.4
Remaining Proposition 1D Funds	\$3,871.1
<b>Proposition 55-2004</b>	
Total Proposition 55 Apportionments	\$9,480.2
Remaining Proposition 55 Funds	\$535.3
<b>Proposition 47-2002</b>	
Total Proposition 47 Apportionments	\$10,469.1
Remaining Proposition 47 Funds	\$930.9

On December 17, 2008, the state's Pooled Money Investment Board (PMIB) took action to halt disbursing cash from the state's Pooled Money Investment Account (PMIA) for capital projects, including public school construction, given the current Budget and cash flow issues at the state level.

The Office of Public School Construction (OPSC) uses cash from the PMIA to release funds for projects that have been approved by the State Allocation Board (SAB). Until further notice, the OPSC will be unable to release funds for approved school construction projects, and the SAB will be unable to approve apportionments for new projects.

Disbursements of funds from the PMIA for state and local infrastructure projects could start flowing relatively quickly if agreement on the current-year Budget is reached between the Legislature and the Governor; however, due to the enormity of the problem and the uncertainty of an agreement, LEAs must make contingency plans. Contingency plans should include a review of cash required for works in progress,

project bids not yet awarded, and internal and external borrowing options. Districts and county offices should consult with legal counsel to review contract language and protections they may use as a strategic plan is developed to address the problem.

The SAB will meet on Wednesday, January 14, 2009, at a special public meeting to receive proposed emergency regulatory amendments in response to the state's financial crisis. There are two additional agenda items at the special meeting: (1) consideration of making unfunded project approvals and (2) a report from staff on administrative and regulatory actions taken by state agencies to assist school districts during the financial crisis.

The Pooled Money Investment Board (PMIB) will meet Friday, January 16, to further discuss the impact of cash management requirements. The discussion will include possible reductions or freezing of disbursements under outstanding SAB loans.

### **Future State Bond Proposals**

In the new legislative session, there are no bills for state General Obligation bonds to provide aid to school districts, county superintendents of schools, county boards of education, the California Community Colleges, the University of California (UC), the Hastings College of the Law, and the California State University (CSU) to construct and modernize education facilities.

The Budget proposal makes adjustments to the K-12 Facilities Aid Program with a \$3.9 billion current-year increase in estimated expenditures of bond funds. This adjustment virtually exhausts balances in the 2002 and 2004 K-12 facilities bond funds.

California has passed some of the largest state bonds in the nation's history and yet there still is a need for additional funding for capital facilities projects to construct and renovate our schools. Based on testimony from the California Department of Education (CDE) just one year ago, we have an estimated \$6.9 billion in unmet school facilities needs. Legislation for a facilities bond act failed in the legislative process in 2008 due in part to the state's fiscal crisis. It will be critical for a school facilities legislative bill and subsequent proposition to make its way to the voters in 2010.

### **Deferred Maintenance**

The SAB has yet to apportion Deferred Maintenance funding from the 2008 State Budget and other funding sources. In the past, SAB action was taken each December to provide funding to county offices and districts. Due to shifts in responsibility for performing the allocation calculation from the CDE to the OPSC, the SAB item and action has been delayed until the January SAB meeting. The lack of allocation and apportionment further stresses county offices' and districts' cash flow needs as they relate to paying for works in progress and the ability to utilize cash borrowing in the short term from this fund.

The Governor is proposing to again fully fund the state's contribution, with \$312.89 million in the 2009-10 State Budget. The Governor proposes eliminating for both 2008-09 and 2009-10 the Deferred Maintenance Program matching requirements of one-half of one percent of revenue limit funding. We recommend that districts plan their Second Interim reports and 2009-10 budget with the flexibility provision option, as appropriate.

### **Routine Restricted Maintenance Account**

The calculation of the Routine Restricted Maintenance Account is codified in Education Code Section 17070.75, and the 3% minimum contribution is based on a district's 2009-10 total general fund expenditures and other financing uses as reflected in the district's adopted budget. Based on the flexibility

provision in the Budget proposal, districts may reduce required contributions into RRMA's from 3% of general fund expenditures to 1% in 2008-09 and 2009-10. As with all flexibility, we recommend that districts review their options and utilize the flexibility provisions as reasonable and applicable.

### **Lottery Funding**

After two years of a decline in Lottery funds, the Lottery continues to be a volatile funding source for 2008-09, not protected from our current recession. California's Tribal Gaming revenue is estimated to be down 15% to 18% and casinos in Nevada are reporting a drop of 15% to 20% in revenues. Recently it has been reported that Lottery sales have decreased from the prior-year by approximately 10% in California. This equates to a drop of \$113.4 million in revenues in the 2008-09 fiscal year.

In the first quarter of 2008-09, the per-ADA amount distributed by the State Controller's Office was lower than the first quarter apportionment of 2007-08. The 2008-09 first quarter Lottery payment was \$30.52 per ADA (unrestricted). This is approximately \$5.92 less than the first quarter of 2007-08. School agencies should utilize the same measures to reduce ongoing expenditures as with any other funds that are decreasing. It is also important to account for decreases in Lottery revenues in districts that are declining in enrollment.

Although the Lottery Commission has not officially reduced the 2008-09 projections at this time, we are updating the original projections with a 10% reduction based on the information known at this time. The reduction to school agencies will equate to a total amount of \$121 per 2008-09 Annual ADA. This updated projection is adjusted down from the 2008-09 Adopted Budget Dartboard projection. Under this projection, the allocation is \$109.50 per Annual ADA unrestricted and \$11.50 per Annual ADA for Proposition 20 restricted funding. The 2008-09 projected amounts will be revised as the year progresses and updates will be made based on changes in revenues and/or annual ADA.

For the 2009-10 fiscal year, the Governor's proposal includes a securitization of Lottery funding by leveraging the funds to borrow against future sales. The proposal would hold local educational agencies (LEAs) harmless in 2009-10, using funding rates at the 2008-09 level. The current proposal would backfill LEAs with General Fund dollars that are not part of the revenue limit funding. However, the funding would be subject to changes in the COLA and deficits. This proposal would require voter approval prior to any implementation.

### **Federal Programs**

At the federal level, all eyes are on the new Administration and the pledge that President-Elect Obama has made to act quickly on a national economic stimulus package aimed at jump-starting job creation and long-term growth. The scope of the American Recovery and Reinvestment Act is expected to include a multibillion dollar infrastructure package that includes funding for school modernization, renovation, and repair. Additionally, an influx of new funding for special education (IDEA), Pell grants, and Head Start programs are also a possibility.

The incoming President also has several Fiscal Year 2009 pending appropriation bills, including education, that have been languishing since last December. Before last year's adjournment, Congress passed a continuing resolution for most of the FY 2009 appropriation bills, including education, that is set to expire in March. Congress can either extend the continuing resolution to the end of 2009, which would mean schools would receive the same level of funding in 2009-10 as they received in 2008-09. Alternatively, Congress can resolve the differences that exist between the House and Senate versions of the education appropriations bill and send a single version to the President for his action.

Additionally, the President is expected to unveil his proposed FY 2010 federal budget sometime in

February. And waiting in the wings is the reauthorization of the federal No Child Left Behind Act and a long-term resolution to reimburse schools for administrative and transportation-related services for Medicaid- and IDEA-eligible students.

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