

State budget comes together

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Here are the details of the education portion of the state budget plan.

Current year cuts (2008-09)

Total cuts to K-12 in the current year would be about \$2.3 billion, with the .68 percent COLA being repealed and a further cut to revenue limits of \$944 million (about \$160 per ADA). In addition, there would be a separate \$944 million cut to certain categorical programs. Categoricals are treated differently by being considered three separate ways:

- ***Those programs that will receive no cuts and are not subject to program flexibility:*** this includes Economic Impact Aid, Child Development, QEIA, K-3 Class Size Reduction, Special Education, Home-to-School Transportation, Proposition 49 After School Programs, and Child Nutrition.
- ***Those programs that will be subject to a 15 percent cut, but are not subject to program flexibility:*** this includes Adults in Correctional Facilities, Apprenticeship Programs, English Language Acquisition Program, Foster Youth, K-12 High Speed Network, Partnership Academies, State Testing, Ag Vocational Education, Charter School Facility Grants, and Multi-track Year Round Education.
- ***Those programs that are subject to a 15 percent cut and are subject to the program flexibility provisions:*** this includes everything not listed above. This list of programs includes, but is not limited to, Adult Education, ROC/Ps, Instructional Materials, Professional Development, Deferred Maintenance, GATE, etc. If the program is not listed in the first two bullets, it is included in this provision

Program Flexibility

Programs not explicitly excluded from the flexibility provisions (i.e. those listed in the first two bullets above) are subject to the governor's flexibility proposal. This means that Local Educational Agencies (LEAs) will be able to use funds from these programs in any way. Program flexibility will begin immediately in the current year and continue through the 2012-13 fiscal year.

Also included in the flexibility provisions is the ability to tap into 2007-08 ending balances for use in the current year and 2009-10 (this does not include tapping into 2008-09 ending balances). LEAs would also be able to reduce their contribution to routine restricted maintenance to one percent, and there would be no deferred maintenance match. Statutes governing Reserves for Economic Uncertainties are not included in the flexibility provisions and will not change from current law.

K-3 CSR Penalties

While K-3 CSR is not included in the program flexibility provisions, the penalties under the program are being modified significantly as follows:

- 5 percent penalty up to 21:1
- 10 percent penalty up to 22:1
- 15 percent penalty up to 23:1
- 20 percent penalty between 23:1 and 25:1
- 30 percent penalty above 25:1

Budget year cuts (2009-10)

There will be no COLA provided in 2009-10 to revenue limits and categorical programs. Additionally, will be \$265 million in cuts to the revenue limit (about \$45 per ADA) and another across-the-board cut to categorical programs of \$265 million. The cuts to categorical programs will be allocated in 2009-10 the same way as in the current year (see current year reference above) and will amount to an additional cut of about five percent. Additionally, the budget eliminates the High Priority Schools Grant Program of \$114 million.

Deferrals

The deal creates new deferrals as follows:

- Defers \$2 billion in revenue limit apportionments (approximately \$339 per ADA) and \$570 million in K-3 CSR apportionments (about half) from February of this year to July 2009.
- Defers \$1.2 billion in K-14 apportionments from July 2009 to October 2009.
- Defers \$1.5 billion in K-12 apportionments from August 2009 to October 2009.
- Increases the June to July deferral by \$340 million.

Revenue limit deficits

With the actions described above, the school district revenue limit deficit factor would be 7.844 percent in 2008-09 and 13.094 percent in 2009-10. For county office revenue limits, the deficit factor would be 7.839 percent in the current year and 13.360 percent in 2009-10.

Mandates

There is no provision proposed to change, repeal, or suspend any K-12 education mandates.

May Revision and Budget Subcommittees

With the adoption of a 17-month budget, legislative leaders still see the need for a May revision and meetings of the budget subcommittees. With a special election being called for May 19, the May revision will be postponed until about May 25. Additionally, budget subcommittees will probably be meeting during the spring to consider any changes or corrections to the 2009-10 budget.

May 19 special election

As part of the budget plan, a special election will be called for May 19. On the ballot will be five specific proposals needed to implement the plan. Included in those ballot measures are three proposals that impact schools: State Lottery, Proposition 98 maintenance factor, and a modified budget stabilization mandate.

Here is how the May 19 ballot will shape up:

- Proposition 1A: State Lottery
- Proposition 1B: Budget Stabilization (ACA 1 3x)
- Proposition 1C: Education Funding – Proposition 98 Maintenance Factor (ACA 2 3x)
- Proposition 1D: Allows the state to divert the use of Proposition 63 monies
- Proposition 1E: Allows the state to divert the use of Proposition 10 monies

State Lottery – Proposition 1A

Voter approval is needed on a plan to securitize the state lottery, taking schools out of the lottery and allowing the state to sell bonds to help balance the budget in the 2009-10 fiscal year and possibly later. Schools will see an increase in Proposition 98 funding to accommodate the loss of lottery revenue. This will appear as Proposition 1A. It is the same proposal that was part of the current year budget adopted in Sept. 2008.

Budget stabilization – Proposition 1B

ACA 3X 1 (Niello), which will appear on the May 19 ballot as Proposition 1B, establishes a state rainy day fund. Beginning with the 2011-12 fiscal year, ACA 3X 1 would require the state to calculate “unanticipated revenues.” Unanticipated revenues would be actual revenues (plus transfers and prior year reserves) that exceed forecasted revenues for that year. The calculation of forecasted revenues would be based on actual revenues received for the prior 10 years, using a linear regression analysis.

The first use of unanticipated revenues would be to satisfy any outstanding Proposition 98 obligations for that year. Any remaining funds would be transferred to the Budget Stabilization Fund until the amount in the fund reaches 12.5 percent of General Fund revenues. However, the transfer to the rainy day fund could be less than the difference between actual and forecasted revenues if a portion of the excess revenues are needed to

maintain a “workload” budget. The workload budget would be defined as the General Fund expenditures for the prior year as increased for the so-called “Gann factors” (California CPI and population growth).

After the Budget Stabilization Fund reaches its cap, any unanticipated revenues would be spent in the following order of priority:

1. Outstanding Proposition 98 obligations
2. Debt service
3. One-time infrastructure or other capital outlay purposes
4. Additional debt retirement
5. Unfunded liabilities for vested non pension benefits for state annuitants
6. Transfer by statute to the Budget Stabilization Fund

Proposition 98 Maintenance Factor – Proposition 1C

In January, an issue arose regarding the long term funding levels under Proposition 98. During downturns in state revenues, Proposition 98 allows for a lower level of funding for schools known as Test 3. However the Constitution also provides that the loss of funding be restored over time, through a “maintenance factor.” The Department of Finance, in calculating the revised funding levels for 2008-09 and 2009-10, determined that both years would be Test 1 years and in this determination they also asserted that no maintenance factor was created. This opinion would have resulted in a loss of \$9 billion in future maintenance factor payments to schools.

This issue was part of the negotiations on the budget deal and an agreement was reached that calls for a constitutional amendment that would provide \$9.3 billion in payments to schools and community colleges. Specifically the proposal, contained in ACA3X 2 (Bass), would establish annual supplemental payments beginning in 2011-12 that would be in lieu of a maintenance factor for 2007-08 and 2008-09. The supplemental funding would be adjustments to school district revenue limits and in addition to the Proposition 98 guarantee. The supplemental payments would subsequently be built into the base for each year. Up to \$200 million would be set aside in the first payment to fully fund any remaining equalization.

Establishing these supplemental payments is linked to the establishment of a rainy day fund as the funding source for these payments would be half of the annual set-aside for the fund. ACA3X 1 (Niello) creates the Supplemental Education Payment Account for the purpose of making the payments to schools and requires that 1.5 percent of general fund revenues be transferred to that account annually. The entire \$9.3 billion would likely be paid out over five years.

The maintenance factor issue will appear before voters as Proposition 1C on the May 19 ballot.

Budget overview

The overall budget solution includes \$15 billion in cuts, \$14.4 billion in temporary revenues, and \$11 billion of borrowing (\$6 billion from RAWs and \$5 billion from lottery securitization). Revenues include five major elements:

- 1 cent increase in the sales tax
- Increase in the VLF to 1 percent of the car's value
- Increase in the gas excise tax
- Reduction of the dependent care tax credit
- Income tax surcharge of 2.5 percent

Revenues are tied directly to the passage or failure of the budget stabilization proposal which will appear on the ballot on May 19 of this year. If the spending cap is approved by voters, then the revenues will stay in effect through the 2012-13 fiscal year. If the spending cap is not approved by voters, then the revenue will stay in effect for only 24 months after their enactment.

Impact of Federal Stimulus Package

The federal stimulus package will likely be signed into law by President Obama this week. This funding will provide \$789 billion to boost the national economy. While there will be billions of dollars provided for education, these resources will have a minimal impact on reducing the size and magnitude of the state reductions in education funding. The current stimulus package contains funding dedicated to a provision called the "State Stabilization Fund." This funding will be allocated to local school districts and/or higher education using existing funding formulas, which can be used to backfill cuts, prevent layoffs and modernize schools as well as other purposes. However, these funds will be provided to the governor to determine how they will be spent. We believe that the Legislature will also want a say in how to use those resources not specifically targeted to schools. For example, a portion of the non-school allocation could be used to pay for the state's Revenue Anticipation Warrants and to build the state General Fund reserves. Right now, there is clear intent that the federal money for schools be used to supplement existing resources and language in the bill clearly requires allocation to schools based on current allocation methods.

We certainly will keep you posted on any further developments.