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Early Release of Governor's Proposed 2009-10 State Budget

In an unprecedented move, on December 31, 2008, the Governor released his State Budget Proposal for 2009-10 more than a week earlier than the Constitutional requirement. At the press conference, the Director of the Department of Finance, Mike Genest, presented the Budget, stressing that the state faces a "major crisis."

The Constitutional deadline is January 10th, 2009, but the Governor's Administration has been working hard to get the budget out early because of the collapse of state revenues. The deficit at the end of 2009-10 is estimated now to be \$41.6 billion unless corrective action is taken. The Administration's position is that, even if all of the special session proposals are enacted by February 1, 2009, the state will still run out of cash by March

State Revenues/Overall Budget

The Governor's Budget identifies a \$41.6 billion gap, including a \$2 billion reserve, between expected revenues and workload expenditure requirements by the end of the 2009-10 fiscal year. About three-fourths of the budget gap is a result of the collapse in state revenues (\$14.5 billion in the current year and \$16.3 billion projected for 2009-10), with the balance attributed to higher caseload costs and General Fund costs to backfill for property tax shortfalls. The revenue collapse is rooted in the broader national recession which began in December 2007, but is compounded by California's precipitous drop in home prices and high unemployment rate.

Genest acknowledged that the Budget released today was incomplete and that all of the programmatic details would be issued on January 9, 2009. However, the broad dimensions of the Budget problem as outlined in the press conference would not change. Genest indicated that the Governor chose to release his Budget proposal early in order to secure early action by the Legislature. Delayed action would force more drastic measures in order to capture foregone savings or revenues, according to Genest.

Genest continued to stress the State's impending cash crisis, noting that even if all of the Governor's proposed current year solutions are adopted, there will be insufficient cash to pay all of the State's bills in March. The Governor's Budget warns that the State may have to defer some payments and make other payments with registered warrants. The payment of debt service and repayment of \$5 billion in Revenue Anticipation Notes (RANs) sold in October 2008, however, are expected to be made as scheduled.

The Budget describes the \$41.6 billion in proposed solutions as falling into three broad categories - expenditure reductions which account for 42% of the solutions, higher revenues which account for 35% of the total, and borrowing (Lottery, internal borrowing, and RAWs) which account for 24% of the total.

The Director of Finance also said that the Governor's plan calls for the issuance of a Reimbursement Warrant (RAW) in July 2009, which would allow a portion of the 2008-09 shortfall to be repaid in 2010-11. Genest acknowledged that the condition of the current credit markets make it impossible to issue a RAW today.

Moreover, the State would have to have in place a balanced budget and a plausible plan for the repayment of the RAW for it to receive market acceptance, again pressing the Legislature for quick action.

Education Budget

The Governor's Budget for education includes midyear reductions, as expected, for 2008-09 as well as cuts for 2009-10. And, as expected, there is no cost-of-living adjustment proposed to be provided to K-14 education in either year. Further, since an important aspect of the Governor's revenue solution continues to be securitization of Lottery funding, the education budget reflects some changes as a result of that.

2008-09 Budget

The Governor's January proposals include almost all of what has been proposed by the Administration in calling the recent special sessions of the Legislature. The major proposals for 2008-09 in the Governor's 2009-10 Budget are as follows:

- Elimination of the .68% cost of living adjustment (COLA) for K-14 education
- Further reduction of K-12 revenue limits of \$1.6 billion, estimated to be 4.5%
- Higher General Fund expenditures of \$430 million to backfill K-12 property tax shortfalls
- Acknowledgement of \$4 million shortfall in community college property taxes, expected to be backfilled by additional fee revenues and oil and mineral revenues
- Reduction of \$42 million and \$108 million prior year savings in CalWORKs Stage 2 and Stage 3 funding due to reduced caseload
- Workload savings of \$55 million in General Child Care and Preschool programs
- Allocation of \$619 million directly to local education agencies in Public Transportation Account and Mass Transportation Fund revenues for K-12 home-to-school transportation programs
- Savings of \$55.5 million from unappropriated funds from various programs

In recognition of the state's continuing cash management issues, the Governor's Budget proposes additional deferrals of cash payments to education as follows:

- \$2.6 billion in K-12 apportionment and K-3 Class Size Reduction (CSR) payments from April 2009 to July 2009 (already deferred from February as part of the enacted 2008-09 State Budget)
- \$230 million in community college apportionments from January and February 2009 to July 2009

2008-09 Flexibility

In order to assist local education agencies mitigate the effects of the 2008-09 reductions, the Governor continues to propose flexibility in the local use of state funds. The current proposals are as follows:

- Utilize categorical funds for any purpose after local public hearings (for community colleges, the priorities are for transfer, basic skills, and career preparation course offerings)
- Reducing the K-12 local Routine Restricted Maintenance Account (RRMA) set-aside requirement from 3% of General Fund expenditures to 1%

- Elimination of the K-12 Deferred Maintenance match
- Reducing the state-required level of K-12 unrestricted General Fund reserves to ½ (which means, for most districts, a reduction from 3% to 1.5%)

Most school agencies will not be able to reduce their RRMA set-aside without eliminating classified positions. And, as we have stated before, we have significant concerns with reducing the required reserve level of school agencies at a time when the surrounding economy is more uncertain than ever - when we believe that higher reserve levels are necessary.

2009-10 Budget

Not surprisingly, the Governor's proposal for 2008-09 does not include funding for the statutory COLA, and continues many of the proposals made for 2008-09. The major provisions for the 2009-10 Budget are as follows:

- \$152.7 million reduction in funding due to the projected decrease in K-12 enrollment
- \$185.4 million in growth (3%, or 36,000 full time equivalent students) for community colleges
- No COLA (estimated to be 5.02%) for K-14 education, including Child Care programs
- Reduction in revenue limit funding for K-12 education (\$1.1 billion) to allow school agencies to eliminate 5 days of instruction
- \$268.2 million in property tax backfill funding for K-12 revenue limits, along with proposed legislation to provide a similar backfill for community college apportionments
- \$83.2 million in growth for K-12 Adult Education, Child Nutrition, Charter School Categorical Block Grants, K-3 CSR, and the Teacher Credentialing Block Grant
- \$35.5 million increase for K-12 Deferred Maintenance
- \$398.5 million shifted from Public Transportation Account and Mass Transportation Fund resources to K-12 home-to-school transportation, maintaining \$618.7 million in funding for this program
- \$287.5 million increase in CalWORKs child care funding, plus \$18.9 million (1.23%) increase due to age 4 and under statutory growth
- Further deferral of the \$150 million in mandate settle-up funds scheduled for 2009-10
- \$114.2 million to eliminate the High Priority School Grant Program
- Shift \$1.06 billion from the General Fund to K-14 education to replace Lottery revenues due to the securitization proposal, bringing this funding under the Proposition 98 umbrella
- \$65 million increase to pay for the special education behavioral intervention lawsuit settlement
- \$13.4 million for state mandated programs, thereby suspending all programs except for two K-12 mandates: interdistrict and intradistrict transfers and the California High School Exit Exam. This is apparent recognition of the recent judgment that the state must either fund or suspend mandates.

The proposals for reducing the school year and eliminating mandates are particularly questionable, as the

applicability of local collective bargaining agreements and historical practices will need to be addressed in light of these broad statewide strategies for reducing expenditures.

The Administration's cash management proposals continue the proposals enacted in the 2008-09 State Budget and outlined in the proposed 2008-09 midyear cuts delineated above.

2009-10 Flexibility

The Governor proposes flexibility for local agencies to be the same as he has proposed for 2008-09, as specified above.

Summary and Conclusions

The early release of the Governor's Budget, preceded by the two special sessions called by the Governor to deal with the Budget crisis, indicates that this will be no ordinary year. The effects of this Budget in combination with the performance of the broader economy will affect all Californians for many years to come. Unfortunately, California's public education system has never recovered from the funding setbacks it suffered in the aftermath of Proposition 13 and the implications of this Budget bode very poorly for education's near term future. While the Legislature must still react to this proposal, it is difficult to see how the outlook for education will be significantly improved from this dismal starting point. Nevertheless, the enactment of a State Budget is a dynamic process and we must remember that there is a long road yet to travel.

-Sheila Vickers and Robert Miyashiro

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