AGENDA

ASSEMBLY BUDGET SUBCOMMITTEE NO. 2

ON EDUCATION FINANCE

ASSEMBLYMEMBER KEVIN MCCARTY, CHAIR

TUESDAY, FEBRUARY 1, 2022

9:00 A.M. – STATE CAPITOL, ROOM 444

We encourage the public to provide written testimony before the hearing. Please send your written testimony to: BudgetSub2@asm.ca.gov. Please note that any written testimony submitted to the committee is considered public comment and may be read into the record or reprinted. All are encouraged to watch the hearing from its live stream on the Assembly's website at https://assembly.ca.gov/todayevents.

The Capitol will be open for attendance of this hearing. Any member of the public attending a hearing in the Capitol will need to wear a mask at all times while in the building.

A moderated telephone line will be available to assist with public participation. The public may provide comment by calling the following toll-free number: ***877-692-8957, access code: 131 54 44.***

OVERVIEW OF THE GOVERNOR'S 2022-23 BUDGET: PROPOSITION 98 & TK-12 EDUCATION

ITEMS TO BE HEARD

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I. OPENING REMARKS

- ASSEMBLYMEMBER MCCARTY, CHAIR
- COMMITTEE MEMBERS

II. BUDGET PERSPECTIVE

- THE HONORABLE TONY THURMOND, STATE SUPERINTENDENT OF PUBLIC INSTRUCTION

III. GOVERNOR'S 2022-23 BUDGET: PROPOSITION 98

- **ISSUE ONE: PROPOSITION 98 OVERVIEW**
- **ISSUE TWO: JANUARY BUDGET SCHOOL FINANCE PROPOSALS**
- **ISSUE THREE: JANUARY BUDGET SCHOOL FACILITIES PROPOSAL**
- **ISSUE FOUR: JANUARY BUDGET TK-12 SPECIAL EDUCATION PROPOSALS**

VI. STATE OF SCHOOL FISCAL HEALTH

- MICHAEL FINE, FISCAL CRISIS MANAGEMENT ASSISTANCE TEAM (FCMAT)

V. PUBLIC COMMENT

ITEMS TO BE HEARD

6100 CALIFORNIA DEPARTMENT OF EDUCATION
6350 OFFICE OF PUBLIC SCHOOL CONSTRUCTION

OVERVIEW

In the Governor's 2022-23 January Budget, the state's priority for public education funding is evident. This Budget proposes significant one-time and on-going Proposition 98, general fund, and federal fund increases in TK-12 public education. This hearing will provide an overview of the dynamics and largest one-time and on-going fiscal proposals effecting the Proposition 98 guarantee, Local Control Funding Formula, Special Education finance, and the School Facilities Program.

ISSUE 1: PROPOSITION 98 OVERVIEW & RELEVANT PROPOSALS

The January Budget proposes significant one-time and on-going Proposition 98 and general fund increases in TK-12 public education. This issue will cover the Proposition 98 guarantee and relevant proposals impacting the total amount of Proposition 98 funding LEAs receive in the Budget Year, and oversight concerns for the TK-12 budget in the current year.

PANEL

The following individuals will participate virtually in the discussion of this issue:

- Aaron Heredia, Department of Finance
- Kenneth Kapphahn, Legislative Analyst's Office
- Mary Nicely, California Department of Education

BACKGROUND

2021-22 Budget Act Oversight

The Final Budget for 2021-22 and the two education trailer bills, AB 130 and AB 167, appropriated approximately $121.7 billion for public school funding, at a historic high of $21,152 per student average, from all funding sources.

Major 2021-22 items relevant to the larger Proposition 98 discussion in the Budget Year included:

- Appropriated Proposition 98 funding at $79.329 Billion, for the 2019-20 Budget Year, $93.429 Billion for the 2020-21 Budget Year, and $93.728 Billion in ongoing Proposition 98 funding for the 2021-22 Budget Year.

- Paid back $11 Billion in deferred Proposition 98 funding to local education agencies from the 2020-21 Budget Act.
- Repealed the statutory "Supplemental Payment" schedule for the difference between total Prop 98 funding level and Test Two in the Guarantee for 2020-21, beginning in 2021-22.
- Assumed an out-year rebench of the Proposition 98 Guarantee to accommodate growth in Transitional Kindergarten enrollment in Budget Years 2022-23 through 2025-26.
- Made deposits in the State School Reserve of $1.889 Billion for 2020-21, and $2.617 Billion for 2021-22 Budget Years.
- Provided $2.331 Billion in new one-time federal relief funding.

Federal Relief Funding Oversight

The 2021-22 Budget package included $22.3 billion in one-time federal TK-12 education funding from the Coronavirus Response and Relief Supplemental Appropriations Act (CRRSAA) and the American Rescue Plan Act (ARPA). The majority of funding ($20 billion) is provided as grants to schools to cover a broad range of activities. The remaining funds are used to cover costs associated with in-person instruction and expanded learning grants, provide temporary rate and slot increases for after-school and summer learning programs, and support the allocation and monitoring of COVID-19 relief funds.

COVID -19 Federal Response Funding

(In Millions)

Program	Description	Amount
Grants to schools[a]	Provides $19.6 billion directly to schools for broad array of activities, including those related to COVID-19. Also includes $302 million to support students with disabilities and $99 million for homeless students.	$20,002
Instruction and expanded learning grants	Covers a portion of costs associated with In-Person Instruction and Expanded Learning Opportunities Grants, adopted in Chapter 10 of 2021 (AB 86, Committee on Budget).	2,015
Expanded learning	Provides temporary rate and slot increases for the After School Education and Safety Program and 21st Century Community Learning Centers.	301
State operations	Funds California Department of Education to allocate and monitor federal COVID-19 relief funding.	15
Total		**$22,334**

[a] Includes funding provided directly to public K-12 schools from CRRSAA and ARPA. Excludes federal funds from the CARES Act, which were allocated in the 2020-21 budget.

Note: Reflects federal funding included in the 2021-22 budget package and mid-year appropriations made during 2020-21.

COVID-19 = coronavirus disease 2019; CRRSAA = Coronavirus Response and Relief Supplemental Appropriations Act; ARPA = American Rescue Plan Act; and CARES = Coronavirus Aid, Relief, and Economic Security.

Source: Legislative Analyst's Office

A recent State Audit had flagged early concerns about LEAs carrying large balances from CARES Act federal funds appropriated in the revised 2020-21 Budget Act, and a concern that federal funds may revert if not spent prior to federal deadlines. According to the most updated CDE reports, LEAs are spending down federal relief funds quickly, with over 99% of funds

expiring in 2021 expended, and 79% and 89% of the Governor's Emergency Education Relief (GEER) Funds and the Elementary and Secondary School Emergency Relief (ESSER 1) Funds

expended respectively, prior to the upcoming September 30, 2022 expiration date. These funds had very broad allowable uses to prevent, prepare for, or respond to the COVID-19 pandemic, in both academic and health uses.

In addition to the 2021-22 Budget, early Budget action augmented the 2020-21 Budget Act to provide $6.6 billion in resources for safe in-person instruction in the Spring of 2021, including $2 billion in state funding for In-Person Instruction (IPI) Grants and $4.6 billion in a combination of state and federal funding for Expanded Learning Opportunities (ELO) Grants.

In-Person Instruction Grants. To be eligible for these grants, LEAs must have offered in-person instruction, including hybrid models, by April 1, 2021 for specified student groups. IPI Grants are reduced by one percent for each calendared instructional day that an LEA did not offer in-person instruction for all required groups. IPI Grants are forfeited if an LEA did not offer in-person instruction for all required groups by May 15, 2021; if in-person instruction was not offered continuously through the end of the scheduled 2020–21 school year, unless otherwise ordered by a state or local health officer; or if an LEA did not complete the IPI Grant LEA Certification Form required. IPI Grants may be used for any purpose consistent with providing in-person instruction for any pupil participating in in-person instruction, including, but not limited to, COVID-19 testing, cleaning and disinfection, personal protective equipment, ventilation and other school site upgrades necessary for health and safety, salaries for certificated or classified employees providing in-person instruction or services, and social and mental health support services provided in conjunction with in-person instruction.

Expanded Learning Opportunities Grants (ELO). To be eligible for funding, LEAs must implement a learning recovery program, that at a minimum, provides supplemental instruction, support for social and emotional well-being, and, to the maximum extent permissible under the guidelines of the United States Department of Agriculture, meals and snacks to specified student groups who have faced adverse learning and social-emotional circumstances. ELO Grants shall be expended only for any of the following purposes: extending instructional learning time, accelerating progress to close learning gaps, integrated pupil supports, community learning hubs, supports for credit deficient pupils, additional academic services, and training for school staff. LEAs are encouraged to engage, plan, and collaborate on program operation with community partners and expanded learning programs, and leverage existing behavioral health partnerships and Medi-Cal billing options, in the design and implementation of services. The ELO Grant will follow the same reporting process as the federal stimulus funding.

Most LEAs Opened for In-Person Instruction. According to CDE, 1,731 out of 1,983 eligible LEAs certified that their schools offered in person instruction by May 15, 2021, as part of the IPI Grant. Notable large LEAs that forfeited all funds include Pittsburg USD, Fremont USD, Montebello USD, Anaheim USD, Santa Ana USD, and San Bernardino City USD. The first round of ELO Grant reporting is not yet available.

Governor's 2022-23 Budget

The Governor's Budget provides a total Proposition 98 General Fund funding level of $95.9 billion in 2020-21, $ 99.1 billion in 2021-22, and estimates $102 billion for the guarantee in 2022-23, all at Test 1:

- Provides a total of $102 billion for Proposition 98 funding for 2022-23, $639.2 million above the Test 1 guarantee level.
- Projects ongoing state per-pupil spending to be $15,278 in 2022-23, an increase of $1,286 (9.2 percent) over the enacted 2021-22 Budget.
- Provides $7.2 billion in new on-going and $10.5 billion in one-time Proposition 98 funding.

Proposition 98 Funding by Segment and Source
(Dollars in Millions Except Funding Per Student)

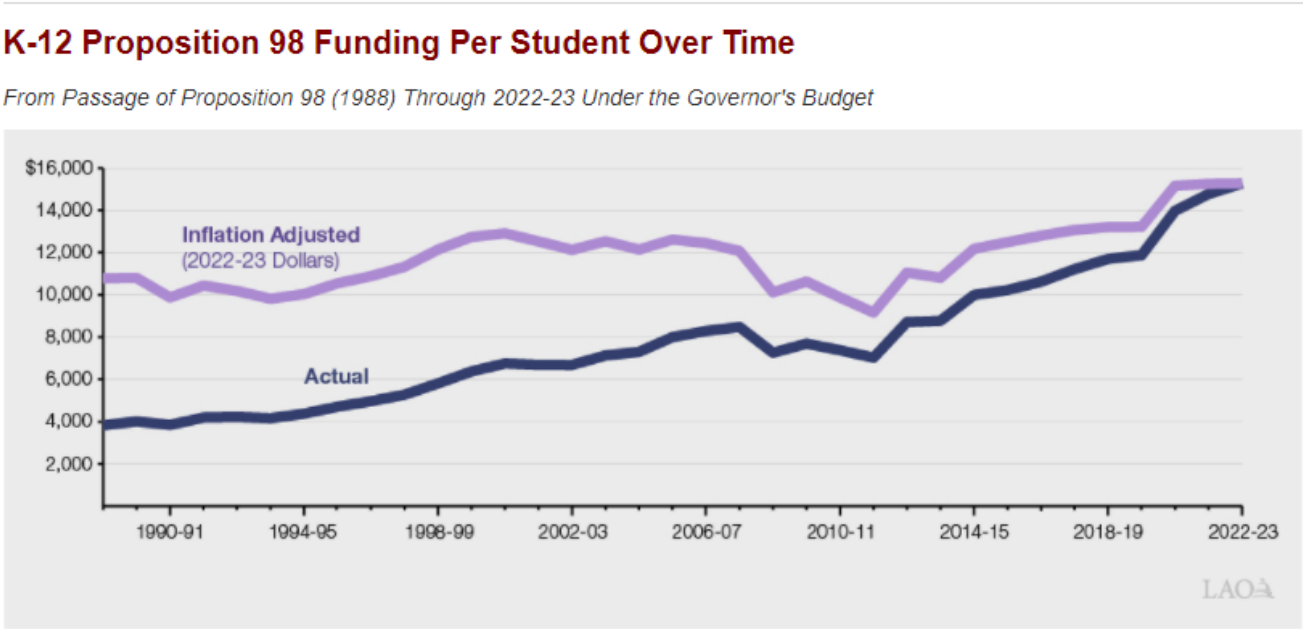
	2020-21 Revised	2021-22 Revised	2022-23 Proposed	Change From 2021-22 Amount	Change From 2021-22 Percent
K-12 Education					
General Fund[a]	$59,562	$60,735	$62,246	$1,512	2.5%
Local property tax	22,527	23,672	25,080	1,408	5.9
Subtotals	($82,089)	($84,407)	($87,326)	($2,919)	(3.5%)
California Community Colleges					
General Fund	$7,392	$7,528	$7,827	$299	4.0%
Local property tax	3,374	3,546	3,766	220	6.2
Subtotals	($10,766)	($11,075)	($11,593)	($518)	(4.7%)
Reserve Deposit/Withdrawal (+/-)[b]	$3,081	$3,582	$3,061	-$521	-14.5%
Totals	**$95,936**	**$99,064**	**$101,980**	**$2,916**	**2.9%**
Enrollment					
K-12 attendance	5,871,581	5,711,791	5,715,844	4,053	0.1%
Community college FTE students	1,097,850	1,107,543	1,101,510	-6,033	-0.5
Funding Per Student					
K-12 Education	$13,981	$14,778	$15,278	$500	3.4%
California Community Colleges	9,807	9,999	10,524	525	5.3

[a] Includes funding for instruction provided directly by state agencies and the portion of state preschool funded through Proposition 98.
[b] Proposition 98 Reserve established by Proposition 2 (2014). Amounts consist entirely of General Fund.

FTE = full-time equivalent.

Source: Legislative Analyst's Office

The January Budget continues to project historic levels of TK-12 ongoing per-pupil spending, growing to $119 Billion in 2022-23 from all funding sources, at a funding rate of $20,855 per student. State TK-12 funding per student grows to $15,278 in 2022-23, an increase $1,286 (9.2 percent) over the 2021-22 enacted budget level. Adjusted for inflation, per student spending will be at a new high in the Budget year:



Source: Legislative Analyst's Office

In addition to the Proposition 98 Guarantee projections, there are additional major TK-12 education proposals relevant to overall public education fiscal health:

Public School System Stabilization Account (PSSSA)

Proposition 2 (2014) established the PSSSA, a constitutional reserve account within Proposition 98. The purpose of this reserve is to set aside some Proposition 98 funding in relatively strong fiscal times to mitigate funding reductions during economic downturns. The PSSSA can grow to a maximum of 10% of the Proposition 98 guarantee in the Budget Year. A deposit to the PSSSA was first triggered by these requirements in the 2019-20 budget when $376 million was deposited, which was then drawn out of the reserve by new estimates in the 2020-21 Budget Act.

The 2021-22 budget plan deposited $4.5 billion into this account—$1.9 billion related to 2020-21 and $2.6 billion related to 2021-22. The deposits also triggered a statutory cap on school district reserves in 2022-23. The local cap applies the year after the balance in the PSSSA reserve exceeds 3 percent of the Proposition 98 funding allocated to K-12 schools. The cap prohibits medium and large districts—those with more than 2,500 students—from holding general purpose reserves that exceed 10 percent of their annual expenditures. Districts can respond to the cap by designating their reserves for specific purposes, seeking exemptions from their county offices of education (COEs), or spending down their reserves.

The Administration now estimates the state is required to make a $3.1 billion deposit in 2020-21, a $3.6 billion deposit in 2021-22, and a $3.1 billion deposit in 2022-23. The total balance of the reserve would grow to $9.7 billion, which equates to almost 10 percent of all funding that would be allocated to schools and community colleges in 2022-23, and thus the 10 percent PSSSA contribution maximum.

Additionally, this level of reserves triggers again a statutory requirement that LEAs may not have local reserves in excess of 10% of their total annual expenditures, in the year after the state reserve balance is equal to or greater than 3% of the total TK-12 share of the annual Proposition 98 guarantee level.

When the local reserve cap goes into effect in 2022-23, the LAO estimates that approximately 265 LEAs statewide would be impacted, based on a state review in 2019-20 of LEA reserve levels: at the end of the 2019-20 fiscal year, districts held a total of $13.6 billion in unrestricted reserves. The data indicate that $6.7 billion of this amount was earmarked for specific uses and $6.9 billion was not earmarked.

TK-12 Pension Contributions

The 2020-21 Budget Act appropriated $1.15 billion to offset 2021-22 LEA employer pension contributions. For 2021-22, CalSTRS will apply $820 million to reduce the employer rate from 18.1 percent to approximately 15.92 percent, and CalPERS will apply $330 million to reduce the Schools Pool employer contribution rate from 24.9 percent to 23 percent.

According to the LAO, while 2020-21's historically high 27.2 percent CalSTRS investment returns are projected to eliminate the state's share of the unfunded actuarial obligation (UAO,) employers' share of UAO is projected to increase by billions of dollars. Accordingly, LEA employers' required contributions will reflect this increase—meaning the employer rate will need to remain higher for future years relative to what CalSTRS previously had projected. LEA employers' share increased by around $1.6 billion, based on CalSTRS' annual calculations. This change is dictated in statute by the funding plan. 2021-22 marks the first year that the CalSTRS board can exercise its authority to set the employer rate—within the rate-setting limitations of the funding plan.

The January Budget does not include a proposal to continue a state offset to the LEA employer contribution rate.

Rebenching the Proposition 98 Guarantee

The 2021-22 Budget agreement included shared Administrative and Legislative intent to "rebench" the Proposition 98 guarantee to accommodate the growth of ADA for Universal Transitional Kindergarten (UTK). This agreement and statutory timeline would add new UTK enrollment in Budget years 2022-23, 2023-24, 2024-25, and 2025-26. The intent is that the Proposition 98 guarantee would be rebenched in each year of statutory UTK enrollment growth, to reflect the costs of the new grade's ADA.

Modifications to the Proposition 98 guarantee calculations under either of the three "tests" are commonly known as rebenchings. The state constitution is silent on whether the Proposition 98 minimum guarantee can be adjusted to account for policy changes, but a rebench has been adopted in prior years to prevent certain state actions from having unintended consequences on the Proposition 98 minimum guarantee.

In recent rebenching budget actions, the state rebenched the total Guarantee for the current value of the shift, thereby ensuring that it achieved an associated dollar–for–dollar impact. For example, the removal of child care programs from the Proposition 98 calculation resulted in a $1.1 billion reduction in the guarantee, and the shift of responsibility for student mental health services from counties to school districts resulted in a $222 million increase in the guarantee.

At the time of this agenda's publication, trailer bill language was not yet available for the January Budget rebench methodology. According to the Department of Finance, the rebench for the 2022-23 Budget Act would be $639.2 million above the budget year's Test One guarantee calculation, to reflect an estimated 56,000 increase in TK average daily attendance (ADA) for the Budget Year. While the LCFF ADA estimates are included in the DOF methodology, it appears that the $393 million cost of the January Budget's new 1:12 TK teacher to student ratio funding is not included in the rebench.

LAO Comment

Comparison to LAO November Outlook. In our Fiscal Outlook released in November 2021, our office anticipated the state would have a surplus of $31 billion, slightly higher than the surplus allocated in the Governor's budget. This relatively small difference reflects many moving—and offsetting— factors across the budget. Specifically, relative to our outlook, the administration's estimates include:

- $10.5 Billion in Lower Revenues: Setting aside policy changes, federal funding scored as revenues, and reserve deposits, the administration's baseline revenue are $10.5 billion lower than our November estimates across 2020-21, 2021-22, and 2022-23. This primarily is due to our differing estimates of corporation tax revenues, particularly in the current year.

- $6.5 Billion in Lower School and Community College Spending: Reflecting these lower revenue estimates—and including policy changes in the Governor's budget—the administration's estimates of constitutionally required General Fund spending on K-14 education is about $6.5 billion lower than our November estimates. This largely offsets the revenue reduction described above.

Fund Fewer of the One-Time Proposals. School and community college districts are currently navigating several issues that will affect their ability to implement new programs next year. Specifically, districts face (1) ongoing cost pressures related to higher inflation and pension rate increases, (2) challenges maintaining continuity of operations due to the effects of the pandemic on students and staff, and (3) elevated uncertainty over future enrollment trends and program participation levels. In addition, districts are in the midst of implementing many new programs and requirements included in the June 2021 budget plan. Due to these issues, we think districts have relatively limited capacity to implement additional programs in 2022-23. We are concerned that the Governor's budget contains so many proposals that districts will be unable to implement them all effectively. Accordingly, we recommend the Legislature fund fewer new activities than the Governor proposes. In some cases, the Legislature could consider providing a smaller

amount or delaying implementation. The Legislature could use the funding it frees up from funding fewer proposals to address district cost pressures (such as rising pension costs), or it could set this funding aside in the Proposition 98 Reserve for future allocation.

School and Community College Budget Likely Prepared for a Mild Recession. Under the Governor's budget, the balance in the Proposition 98 Reserve would reach $9.7 billion by the end of 2022-23. If the Proposition 98 guarantee were to drop, the Legislature would be able to withdraw this amount to maintain funding for programs. (In some cases, the constitutional formulas would require withdrawals.) In addition, the budget contains a one-time cushion of more than $4 billion in 2022-23. This cushion consists of the one-time spending and reserve deposit specifically attributable to 2022-23. The expiration of these allocations the following year creates a buffer that helps insulate ongoing programs from future drops in the guarantee. Based on the reserve balance and one-time cushion, we think the state likely could weather a relatively mild recession without resorting to significant cuts or payment deferrals for school and community college programs.

Eliminate the Complex Theoretical Calculations in Favor of a Proportional Split of UAO. The exceedingly complex theoretical calculations employed by CalSTRS result in an ever-changing proportional division of UAO between the state and employers, extra sensitivity to investment returns in terms of the state's contribution rate, and counterintuitive (but less significant) impacts on the employers' contribution rate. CalSTRS' 27.2 percent investment returns in 2020-21 provide an extreme example of the complex and counterintuitive effects of these calculations. Specifically, as a result of the 27.2 percent investment returns, CalSTRS projects the state's share of UAO will be eliminated in a few years. At the same time, employers' share of UAO is projected to increase by billions of dollars.

We recommend the Legislature amend the funding plan to specify a fixed proportional division of UAO between the state and employers. By eschewing the current complex UAO calculations and adopting a fixed proportional division of UAO between the state and employers, the Legislature would be able to lessen the volatile effects of investment returns on the state's actuarially required contribution rate, and align impacts of investment returns across the state's and employers' actuarially required contribution rates—meaning the state and employers would benefit equitably as a result of years like 2020-21 when CalSTRS enjoys significant gains in assets. In addition, a fixed proportional split would result in more predictable changes to both the state's and employers' contribution rates in response to future actuarial gains and losses.

State Appropriations Limit Is a Key Budget Issue. The state is $2.6 billion above its limit across 2020-21 and 2021-22— even after accounting for proposed spending on infrastructure (which is exempt from the limit). The Legislature can respond to excess revenues by (1) lowering tax revenues, (2) spending more on exempt purposes (such as infrastructure or state emergencies), or (3) splitting the excess revenues between taxpayer refunds and one-time payments to schools and community colleges.

If the Legislature were to shift funding from the Governor's infrastructure proposals to nonexempt priorities, the state would exceed the limit by a larger amount.

STAFF COMMENTS & QUESTIONS

What base increases to the LCFF formula are necessary to consider, beyond a statutory COLA, to address universal LEA funding pressures, including rising pension contributions, health care and insurance costs, and inflation?

How should the UTK rebench of the Proposition 98 guarantee be calculated, to reflect the cost of adding a new, yet non-compulsory, grade to the public education system? Does the rebench need to be rigid and predictable, or responsive to actual ADA growth?

Is it allowable for LEAs to use federal funds to backfill lost ADA in the 21-22 school year due to COVID absences? Do we know how many LEAs are planning for this use of funds, and at what magnitude?

Staff Recommendation: The current year and Budget Year Proposition 98 funding levels and relevant proposals will be considered as part of the Final Budget comprehensive package, including the interactions between General Fund growth and increasing cost pressures for public schools.

ISSUE 2 JANUARY BUDGET SPENDING PROPOSALS

The January Budget proposes $9.73 billion in new on-going Proposition 98 spending for the 2022-23 Budget Year. This hearing will review the major on-going fiscal proposals for TK-12 schools.

PANEL

The following individuals will participate virtually in the discussion of this issue:

- Aaron Heredia, Department of Finance
- Michael Alferes, Legislative Analyst's Office
- Mary Nicely, California Department of Education

BACKGROUND

2021-22 Budget Act Oversight

Major 2021-22 items relevant to the larger Proposition 98 discussion in the Budget Year included:

- Increased the Local Control Funding Formula (LCFF) Base Grant by a 5.07 percent "super-COLA" to reflect two years of COLA.

- Increased the LCFF concentration grant formula to 65 percent with $1.1 Billion ongoing funds, for purposes of reducing student to adult ratios for direct services, including custodial services.

- Created an Expanded Learning LCFF add-on, and provided $1 Billion ongoing Proposition 98, and $753 million one-time Proposition 98, in 2021-22 for all classroom-based LEAs, based on their counts of unduplicated student enrollment in grades TK-6, with higher per pupil amounts for LEAs with concentrated poverty above 80%.

- Created Universal Transitional Kindergarten (UTK) by the 2025-26 school year, with required age cohorts increased in increments of two months of age per year from 2022-23 through 2025-26, when all four-year-olds would be eligible. Required quality standards for TK including 1:12 staff to student ratio by 22-23, and 1:10 staff to student ratio by 23-23, subject to future Budget appropriations.

- Increased Special Education funding by $396.8 million ongoing Proposition 98 funds, with a COLA of 4.05 percent to all SELPAs, even those above the statewide rate, then calculate the new statewide rate with the additional funding, including an Out-of-Home formula adjustment.

- Reinstated requirements for in-person classroom instruction and resumed attendance-based funding, with an LCFF ADA hold harmless in place from the 2020-21 Budget Act.
- Required districts to offer students an Independent Study option for the 2021-22 school year, as an alternative to in-person instruction.
- Made permanent changes to Independent Study standards and requirements.
- Modified requirements for schools receiving emergency attendance funding.
- Provided more flexibility for using substitute teachers.

Governor's 2022-23 Budget

The January Budget proposes $9.73 billion in new on-going Proposition 98 spending for the 2022-23 Budget Year, including $3.306 billion in adjustments to the Local Control Funding Formula for attendance, COLA, and adjustments to ADA calculations for both in-person and Independent Study instruction.

TK-12 Local Control Funding Formula & Cost of Living Adjustments

The bulk of funding for school districts and county offices of education for general operations is provided through the Local Control Funding Formula (LCFF) and is distributed based on the numbers of students served and certain student characteristics, including grade, income, and home language. The state first fully funded the LCFF in 2018-19 and has annually adjusted the LCFF base grant amounts by a cost-of-living adjustment (COLA). The proposed budget provides a COLA of 5.33 percent, at a cost of approximately $2.106 billion when adjusted for declining ADA estimates under current law, for the 2022-23 fiscal year. All January Budget proposals combined would bring total LCFF funding to $70.522 billion in on-going funds.

The January Budget also proposes a 5.33 percent COLA, at an on-going increase of $352 million, to all statutorily-required early education and TK-12 programs, including Special Education, Child Nutrition, State Preschool, Youth in Foster Care, Mandates Block Grant, Adults in Correctional Facilities Program, American Indian Education Centers, and the American Indian Early Childhood Education Program. The state Afterschool Education and Safety program does not receive a COLA under the proposal.

County Offices of Education would receive an increase of $11.5 million ongoing Proposition 98 General Fund to reflect the 5.33 percent COLA and ADA changes applicable to the LCFF.

The budget allocates more than $5 billion to fund multiyear program expansions established by the 2021-22 Budget agreements for the Expanded Learning Opportunities Program (E-LOP), universal school meals, universal Transitional Kindergarten, and preschool rate increases. These proposals will be heard in future hearings.

ADA Hold Harmless & Declining School Enrollment

Average Daily Attendance. California funds schools on a simple metric of "average daily attendance", based on three census dates each school year.

LEAs track the average daily attendance (ADA) of their students, which is an average of the daily attendance of the total enrolled student population in that LEA.

The CDE uses attendance data to allocate state funding for various programs, including the Local Control Funding Formula (LCFF) and state special education categorical program. State law ordinarily requires districts to provide classroom-based or work-value-based (Independent Study) instruction as a condition of receiving state funding. Districts must ensure this instruction meets certain daily and annual requirements for the amount of time students spend under the direct supervision of a credentialed teacher. Under this system, the state allocates LCFF funding to districts based on the average daily attendance of their students in the current or previous year, whichever is higher.

One of the factors used to calculate the Proposition 98 minimum guarantee level in Test 2 and Test 3 years, is growth in ADA. In the case of negative ADA growth, the guarantee is only impacted if the preceding two years also show declines. Under current projections, which reflect birth rates, migration, and pandemic-related disenrollments, TK-12 ADA is expected to decline annually in coming years. However, DOF and LAO do project Test 1 calculations for the guarantee for the foreseeable future, which means the overall guarantee would not be impacted by ADA declines.

In response to the pandemic, the 2020-21 Budget suspended the annual time requirement and allowed districts to meet the daily time requirement through classroom instruction, distance learning, or a combination of classroom instruction and distance learning. The Budget Act also suspended the state collection of attendance data for ADA purposes, and funded districts according to their 2019-20 attendance levels. Districts could receive growth funding under certain conditions if they demonstrated increases in enrollment.

The 2021-22 Budget Act allowed these pandemic-related changes to expire, meaning districts would need to resume classroom-based instruction in 2021-22, and offer Independent Study for students seeking a distance learning-like option. For funding purposes, the Budget Act credits districts with their average daily attendance in 2021-22 or 2019-20, whichever is higher.

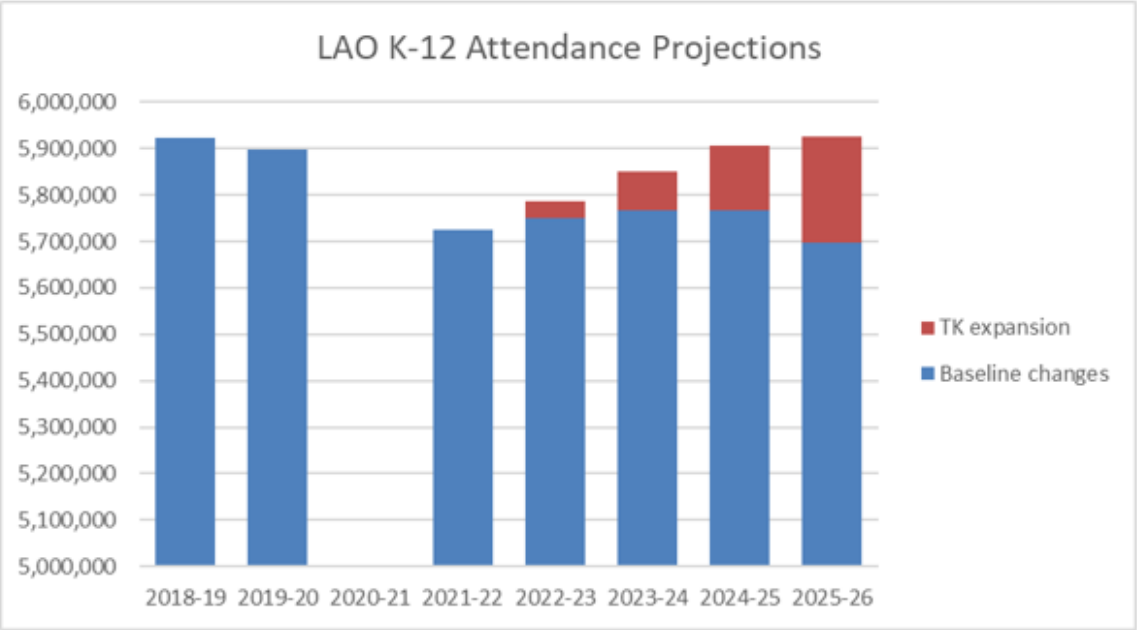
The hold harmless policy enacted in the 2020-21 Budget Act protected traditional LEAs from enrollment drops in both 2020-21 and 2021-22 due to the pre-existing hold harmless policy for LCFF. This protection for charter-based LEAs was limited to attendance and enrollment drops in 2020-21.

Declining Enrollment. According to CDE's preliminary January 2021 enrollment census data and final 2020-21 enrollment data, student enrollment dropped dramatically by over 150,000 students (2.6%) statewide for the 2020-21 school year, compared to 2019's pre-pandemic enrollment, and then dropped again in the 2021-22 school year by approximately 100,000 more students (1.9%). This is a huge change from pre-pandemic forecasts with a more gradual and consistent decline of approximately 20,000 enrollments per year due to birth rate declines. Final

CDE data reports on state-wide enrollment and grade and demographic-specific implications should be available no later than March 2022.

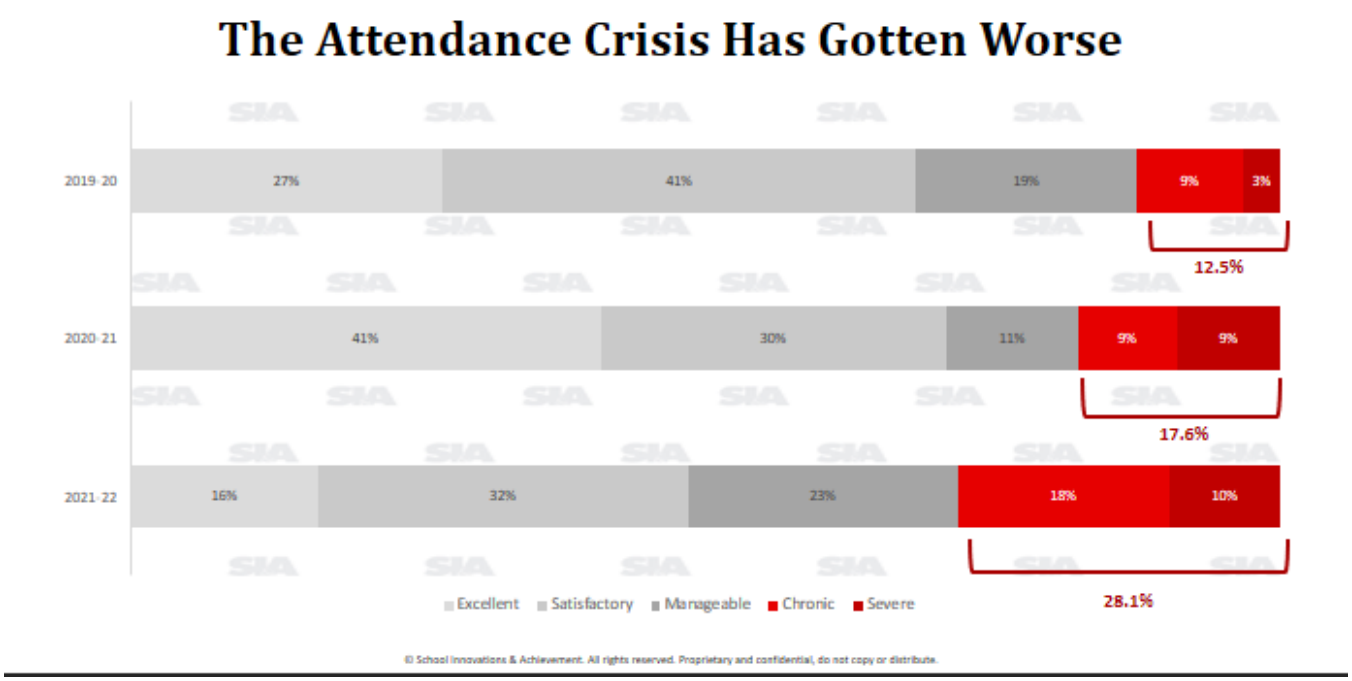
According to the recent LAO Fiscal Forecast, there is a continuing decline in enrollment and attendance, beyond pre-pandemic projections. For 2021-22, the LAO outlook assumes ADA will be down about 170,000 students (3%) relative to the pre-pandemic level of 5,897,000. Over the following four years, the outlook accounts for three trends affecting attendance. First, the LAO expects an additional reduction of about 170,000 students by 2025-26 due to declines in the school age population. This drop primarily reflects declining births in California—a trend that began more than a decade ago and has continued through the pandemic.

Unlike DOF forecasts, the LAO assumes districts' attendance eventually recovers by the equivalent of about 140,000 students relative to the drop in 2021-22. The LAO assumptions include state investments in student re-engagement over a multi-year period, and the high number of students not enrolled in the early grades, including Transitional Kindergarten (TK) and kindergarten. Significantly, the LAO also expects the expansion of TK to add nearly 230,000 students by full implementation in 2025-26. Accounting for all these estimates and assumptions, statewide attendance would be approximately 5,925,000 students in 2025-26—slightly above the pre-pandemic level.



Source: LAO

Pandemic Impacts to Attendance. While the state did not collect attendance in the 2020-21 school year, and preliminary 2021-22 data is not yet available statewide, individual LEAs are reporting alarming spikes in increased chronic and severe absenteeism, both during Distance Learning last year, and now:



Source: School Innovations & Achievement

According to a survey by the California Collaborative for Education Excellence (CCEE), 90% of LEAs are experiencing declines in attendance. Attendance Works, CCEE, and local education leaders will present their preliminary data on attendance drops, and chronic absenteeism patterns at this point in the Fall, post-reopening our public schools.

January Budget Proposal. For 2022-23, the Governor's budget assumes that funded attendance for the purpose of LCFF drops 2.19 percent in 2022-23, reflecting the expiration of the temporary attendance provisions included in the June 2020 budget plan. However, the Governor also proposes to expand the LCFF declining enrollment adjustment.

Under current law, the state funds school districts' LCFF ADA according to their attendance in the current or prior year, whichever is higher. Under this proposal, districts would be credited with their average daily attendance over the three prior years if it exceeds their current- and prior-year attendance. (For 2022-23, attendance would be based on the average of 2019-20, 2020-21, and 2021-22.) The budget does not propose any specific changes to attendance for charter schools. According to the DOF, this proposal would cost $1.2 billion in the Budget Year. Both the policy and funding are proposed as an ongoing to soften the impact of ADA declines in a single year, though the LAO estimates the ongoing cost at $650 million annually. At the time of this agenda publication, trailer bill language was not yet available.

Independent Study

Independent study is an alternative to classroom-based instruction that allows students to generate funding based on their participation in programs not conducted at a traditional school site. Independent study programs range from fully online virtual academies to hybrid programs that combine on-site and off-site (as well as synchronous and asynchronous) instruction. Whereas state law ordinarily allows districts to decide whether to provide these programs, the

2021-22 Budget Act requires districts to provide an independent study option in the 2021-22 school year, as an alternative to distance learning.

The 2021-22 Budget Act also made permanent changes to the independent study program. LEAs must offer synchronous instruction to independent study students throughout the school year, with frequency varying by grade level. These requirements range from daily instruction for TK through grade 3 to weekly instruction for high school students. In addition, LEAs must establish procedures for reengaging with independent study students who are failing to participate, such as students who have completed less than 60 percent of their assigned work in one week, participated in less than 60 percent of scheduled synchronous instruction in one month, or violated their independent study agreement. This agreement is a document which specifies the student's coursework and assignments and typically must be signed, in writing or electronically, by the parent or guardian prior to the commencement of instruction for a student enrolled in independent study. The law allows for up to 30 days to obtain agreement signatures. These procedures are to include several elements, such as notification to parents or guardians regarding lack of participation, a plan for outreach from the school to determine a student's needs, and a standard for when the student and parent should meet with the teacher to reevaluate whether the student should be enrolled in independent study. LEAs also must have a plan for transitioning independent study students back to in-person instruction within five days, if requested by the family.

These new Independent Study requirements do not apply to students who are enrolled in independent study for less than 15 school days during the academic year, and the new law allows LEAs to earn apportionment funding for independent study that occurs due to COVID-19 quarantine, beginning with the first day of a student's quarantine.

January Budget Proposals. The Administration is recommending two adjustments to Independent Study policy beginning in the 2022-23 school year. These proposals would clarify how synchronous instruction is tracked for independent study and extend the time for obtaining Independent Study agreement signatures. At the time of this agenda publication, trailer bill language was not yet available.

LAO Comments

Some Major Ongoing Augmentations for Schools Seem Reasonable. All of the major ongoing increases for K-12 schools relate to previous commitments or involve additional funding for longstanding programs. Although we are still reviewing the details, these proposals generally appear reasonable and align with previous cost estimates.

ADA Proposal Addresses Short-Term Funding Drops Attributable to the Pandemic. Our discussions with district budget experts suggest that the ongoing effects of the pandemic— such as school closures, student and staff quarantines, and challenges implementing remote learning—are continuing to affect school attendance levels. (Preliminary attendance for 2021-22 is not yet available.) Although districts are insulated from these declines in 2021-22, they would experience notable declines in funding to the extent attendance remains at lower levels in 2022-23. Adding a three-year average to the declining attendance adjustment for school

districts would soften the declines in LCFF funding attributable to the pandemic. Districts with declining attendance over a sustained period typically manage the reductions to their funding with a range of actions that can include reducing staff, consolidating programs, closing schools, and reorganizing administrative functions. Some of these actions can take a few years to plan and implement. The Governor's proposal would slow future funding reductions, allowing districts more time to adjust their educational programs. The proposal could promote fiscal stability for these districts and allow them to prioritize programs that best serve the needs of their remaining students. In addition, the three-year average would help reduce future fluctuations in funding from temporary changes in average daily attendance levels.

Proposal Would Require Tracking More Data. Under the Governor's proposal, districts would need to track some additional attendance data. For example, a district would need to identify the students currently attending charter schools and determine how much attendance those students had generated for the district in each of the three prior years.

Consider Temporary Adjustment for Charter Schools. We think the Governor's plan to study potential attendance adjustments for charter schools is reasonable. The proposed discussions could help identify various options for the Legislature to consider. Unlike school districts, however, charter schools face the prospect of immediate funding reductions based on attendance declines they experience in 2021-22. The Legislature could consider providing some type of temporary adjustment—one option would be to allow charter schools to receive funding based on their pre-pandemic attendance for another year. This would provide the Legislature and the administration more time to examine longer-term alternatives.

Estimated COLA Likely to be Higher in May. The federal government released additional data used to calculate the COLA on January 27. Using this data and our updated projections, we estimate the COLA for 2022-23 will be closer to 6.17 percent. Covering this higher COLA rate for LCFF would cost approximately $2.6 billion, an increase of $500 million compared with the estimate in the Governor's budget. The federal government will release the final data for the 2022-23 COLA on April 28, 2022.

STAFF COMMENTS

Local Control Funding Formula. In light of growing inflationary pressures, the January Budget COLA is even higher than the "super-COLA" provided in the 2021-22 Budget Act. However, this one-time increase to the base of our education funding system may not be sufficient to 1) address ongoing and growing base cost pressures for all schools, and 2) set ambitious targets for an adequate school funding base and sufficient funding to address the growing achievement and opportunity gaps.

Steep Enrollment Loss Impacts. The ADA hold harmless and growth policies in the 2020-21 Budget Act appear crucial for the stabilization of the public education system during this pandemic period. While it is still unknown at this time how the pandemic student enrollment decline will manifest in future years, the lack of enrollment recovery and continued steep declines in the current year raise significant concerns for LEA budgets in 2022-23.

Additionally, CDE's data shows that Unduplicated Pupils, who generate LCFF additional funding, are declining in enrollment at a higher rate than their peers, statewide. The impact of this demographic shift on individual LEAs and their LCFF targets remains unknown at this time.

The data on enrollment and attendance trends across California are only a snapshot at this time, as the State does not regularly monitor and collect this information for more than an annual examination. In a data-free environment, the State is hampered in contemplating data-driven, near-term solutions to support school leaders in this latest phase of the pandemic crisis.

Regardless of the near-term package of state and regional supports necessary to support student re-engagement and recovery from the academic and social emotional impacts of the COVID-19 pandemic, the state must also explore how to ensure enrollment rebounds due to Universal Transitional Kindergarten do not mask student withdrawal patterns at the local and state level. Data trends, by grade and student group will require multi-year analyses for state and school-based decision making.

Student Re-Engagement. In addition to stabilizing LEA finances during the volatility of pandemic enrollment and attendance drops, there is urgency in addressing the chronic absenteeism rates across the state.

Emerging recommendations from school leaders vary across fiscal and student engagement strategies including:

- Create immediate state and local infrastructure for restorative practices.
- Expedite implementation of Budget Act investments and infrastructure for student engagement.
- Dedicate on-going new funds to student engagement and campus climate programs, like Community Schools and Expanded Learning, to promote sustainable planning and hiring.
- Support LEAs in leveraging local data for student re-engagement and individualized recovery.
- Stabilize Public Health LEA quarantine procedures to minimize absences or need for Independent Study.
- Require LEA exit codes in CalPADs for dis-enrolled students for regional state-level aggregation and response.
- Increase attendance reporting frequency at the state level.

Independent Study. The January Budget contains two proposals to streamline Independent Study in the Budget Year. The end of pandemic-impacted instruction appears distant, and will continue to drive a need for virtual instruction options through Independent Study. Due to the heavy reliance on Independent Study in the current year during pandemic surges, the state may consider if the clarifications in the January Budget would be beneficial retroactively. Many LEAs have struggled with synchronous instruction tracking and Independent Study paperwork in the current year.

Any changes to accountability in Independent Study will require a broad lens for the program's multiple applications, including non-classroom based charter schools.

Questions:

- Will families return to public education after the pandemic? If so, how do we prepare?
- How are LEAs disaggregating their attendance reporting data to track the underlying reasons for absences? How are they using this data?
- How much of a contributing factor is student quarantines beyond public health requirements?
- How can data systems better capture the reasons behind enrollment and absence for interventions?

Staff Recommendation: This issue will need to be revisited as part of the overall Assembly priorities for the Budget Year and out-years, in context with one-time pandemic-related relief, ongoing growing base cost pressures, and ongoing student opportunity gaps.

ISSUE 3: SCHOOL FACILITY PROGRAM PROPOSAL & OVERSIGHT

The January Budget authorizes $1.4 billion in the remaining Proposition 51 K-12 school bond fund allocations, and an additional $ 2.175 billion in one-time General Fund for school facilities after the exhaustion of bond funds for new construction and modernization. This hearing will review these proposals. The January Budget's infrastructure proposals for charter schools, school kitchens and green school buses will be heard in a later hearing.

PANEL

The following individuals will participate virtually in the discussion of this issue:

- Jennifer Kaku, Department of Finance
- Amy Li, Legislative Analyst's Office
- Lisa Silverman, Office of Public School Construction

BACKGROUND

School Facilities Program

The School Facility Program (SFP) was created in 1998. The SFP funding is provided in the form of per-pupil grants, with supplemental grants for site development, site acquisition, and other specific project costs when an application is eligible for them.

The SFP provides funding grants for school districts to acquire school sites, construct new school facilities, and modernize existing school facilities. The two major funding types available are "new construction" and "modernization." The new construction grant provides funding on a 50/50 state and local match basis. The modernization grant provides funding on a 60/40 state and local match basis. School districts that are unable to provide some or all of the local match requirement, and meet financial hardship criteria, may qualify for additional State funding

Since 1998, California voters have approved over $42 billion in statewide general obligation bonds to construct or renovate public school classrooms through the SFP. These funds primarily support the construction and modernization of school facilities, however, voters have supported funding other programs through the SFP including, but not limited to: (1) charter school facility grants, (2) career technical education grants, (3) overcrowding relief projects, (4) high performance incentive grants, (5) joint-use projects, (6) critically overcrowded schools grants, and (7) seismic mitigation grants.

Proposition 51, approved by voters in November 2016, authorized a total of $7 billion in state general obligation bonds for school construction projects. These funds will be allocated amongst various existing programs including $3 billion for new construction, $3 billion for modernization, $500 million for charter schools, and $500 million for career technical education projects.

Approximately $1.4 Billion in Proposition 51-approved bond authority remains for new construction and modernization projects.

The 2021-22 Budget Act included $250 million in non-Proposition 98 general fund, the first general fund contribution since 1998, for the School Facility Program. According to the Office of Public School Construction, these funds are estimated to support 103 new projects across the state.

According to the Office of Public School Construction's December 2021 reports, school construction and modernization projects totaling $4.030 Billion are on a waiting list beyond existing bond authority. A recent report from the State Auditor projects at least $5.6 billion in additional school modernization needs over the next five years, beyond current waiting lists.

Governor's 2022-23 Budget

The January Budget authorizes $1.4 billion in the remaining Proposition 51 K-12 school bond fund allocations, which would exhaust the remaining bond authority for New Construction and Modernization. No new bond for school facilities has been approved or is scheduled for a future ballot at this time.

Following up on the 2021-22 Budget Act's general fund contribution to the School Facility Program, the January Budget proposes an additional $ 2.175 billion in one-time General Fund for school facilities after the exhaustion of bond funds for new construction and modernization, specifically $1.25 billion one-time General Fund for 2022-23 and $925 million one-time General Fund for 2023-24. According to DOF, the Office of Public School Construction (OPSC) expects to process an average of $125 million in new construction and modernization projects each month, and all funds would be would be exhausted by April 2024.

OPSC anticipates needing to propose regulatory changes to the State Allocation Board to process the applications for general fund-funded projects using a direct funding model, which differs from how funds are currently apportioned for bond-funded projects.

As of the publication of this agenda, trailer bill language on the proposal was not available. The Department of Finance describes the School Facilities Program as in alignment with the 2021-22 Budget Act authority.

According to the LAO, this facility proposal is excluded from the State Appropriation Limit or "SAL" calculations in the January Budget.

LAO Comment

State Appropriations Limit Is a Key Budget Issue. The state is $2.6 billion above its limit across 2020-21 and 2021-22— even after accounting for proposed spending on infrastructure (which is exempt from the limit). The Legislature can respond to excess revenues by (1) lowering tax revenues, (2) spending more on exempt purposes (such as infrastructure or state

emergencies), or (3) splitting the excess revenues between taxpayer refunds and one-time payments to schools and community colleges. If the Legislature were to shift funding from the Governor's infrastructure proposals to nonexempt priorities, the state would exceed the limit by a larger amount.

STAFF COMMENTS

The Assembly Budget Blueprint calls for $10 Billion in one-time General fund surplus to support school facilities. New construction, modernization, and deferred maintenance demand statewide far exceeds even this Budget year Assembly target, over the next 5-10 years. Additionally, the Universal TK, Expanded Learning, and Community Schools program investments in the 2021-22 Budget Act may require facilities not clearly authorized under the existing School Facilities Program, or not envisioned at the time LEAs submitted their existing applications.

Staff Recommendation: This issue will need to be revisited after the May Revision as part of the overall General Fund infrastructure priorities for the Budget Year and out-years, in context with additional one-time infrastructure investments to be covered in future hearings.

ISSUE 4: SPECIAL EDUCATION FINANCE

The January Budget contains multiple proposals impacting Special Education finance and policy. This hearing will address the TK-12 related Special Education proposals. Early Education and Preschool related proposals will be covered in a future hearing.

PANEL

The following individuals will participate virtually in the discussion of this issue:

- Liz Mai, Department of Finance
- Amy Li, Legislative Analyst's Office
- Mary Nicely, California Department of Education

BACKGROUND

Special Education

Schools receive general purpose education funds each year to educate all students, including students with disabilities. These funds can be used for any educational purpose but primarily cover general education costs. Beyond these general education costs, schools incur additional costs to serve students with disabilities (for example, to provide specialized instructional support and adaptive equipment). To help cover these additional costs, in 2021-22, schools received about $6 billion combined from state and federal categorical funding specifically for special education. These fund sources together cover roughly one-third of the additional cost of special education services provided in local schools. Schools cover remaining special education costs with their local general purpose funding, including their Local Control Funding Formula budgets.

The state allocates most special education funding through a base rate formula commonly called AB 602 (after its enacting legislation). The formula distributes funding to regional agencies called Special Education Local Plan Areas (SELPAs) based on total student attendance in Transitional Kindergarten through grade 12— regardless of the number of students receiving special education, the specific disabilities of those students, or the types of services those students receive. Roughly 16 percent of state special education funding is currently provided through other programs based on alternative formulas and/or for specific types of special education services, including those for students with higher-cost disabilities. The largest of these programs allocates $396 million in Proposition 98 funding to SELPAs for mental health services. In another Budget-Year relevant example, the state runs an extraordinary cost pool which provides reimbursement for very expensive student placements in nonpublic schools exclusively serving students with disabilities.

Since 2019-20, the state has increased on-going special education base funding by almost $1 billion (30 percent) beyond annual cost-of-living and attendance adjustments. The corresponding statewide special education base rate grew from $557 per student in 2019-20 to $715 per student in 2021-22. In addition to increased base funding, the state also recently funded several work groups and studies aimed at reforming different aspects of the special education system—

including improving the state's special education governance and accountability system, expanding access to a regular high school diploma for students with disabilities, and studying placements in nonpublic schools.

2021-22 Budget actions greatly increased the on-going Special Education funding base:

- $397 million ongoing to increase the special education base rate from $625 per student to a new rate of $715 per student.
- $260 million ongoing for a new early intervention preschool grant. The funding can be used to support early intervention services for preschool children at risk of being identified for special education, resources for preschool children with disabilities not required under special education, and other activities that improve school readiness and long-term outcomes for children under the age of five. Funding must supplement existing special education spending and, to the extent possible, promote inclusive practices. Funding is to be distributed to school districts based on the number of first graders with disabilities.

Extraordinary Cost Pools. The state provides a total of $6 million ongoing Proposition 98 to run two extraordinary cost pools ($3 million each) to reimburse SELPAs for high-cost student services and placements. The Special Education Necessary Small SELPAs Extraordinary Cost Pool (ECP) for Mental Health Services reimburses small SELPAs (those with fewer than 15,000 students) for high-cost mental health services. Typically, funding requests from the extraordinary cost pool for small SELPAs do not fully exhaust available funding. Provisional language in the annual budget typically authorizes any remaining funding to be made available to the Extraordinary Cost Pool for Nonpublic School/Licensed Children's Institutions (NPS/LCI), which provides reimbursement for high-cost student placements in nonpublic schools exclusively serving students with disabilities. Requests for this latter pool consistently exceed available funding, in which case SELPAs receive a prorated portion of their request. According to CDE, 2019-20 total claims for the NPS/LCI pool were $19.4 million and the available funds were $4.2 million, resulting in a reimbursement rate of approx. 0.21 cents on the $1.00.

Special Education Mental Health Services. $396 million is apportioned to SELPAs based on average daily attendance. The purpose of these funds is to provide educationally mental-health related services for students with or without an individualized education program, including out-of-home residential services for emotionally disturbed pupils, pursuant to the federal Individuals with Disabilities Education Act.

Special Education Studies to Inform Future Reforms. The 2020-21 budget provided a total of $600,000 one-time federal funds to convene two work groups. One work group was required to develop a statewide individualized education program (IEP) template that LEAs could use to focus on capturing student strengths and improving student outcomes. The second work group was required to provide recommendations to expand access to a regular high school diploma for students with disabilities, including recommendations related to developing an alternate pathway for students with significant cognitive disabilities. Both work groups submitted their final reports to the Legislature on October 1, 2021.

Governor's 2022-2023 Budget

Provides $500 Million to Increase Base Rates Under Modified Formula. In addition to a $105 million statutory COLA and attendance adjustment, the Governor proposes to increase the base rate for most SELPAs from $715 per student to around $820 per student—an increase of nearly 15 percent.

In addition to the base augmentation, the Governor's budget modifies the existing base formula to calculate total student attendance at the LEA level, rather than the SELPA level. Specifically, rather than funding the highest year of SELPA-level attendance across four years, the Governor proposes to fund the highest year of attendance for each respective member LEA across four years. Funds would continue to be allocated to SELPAs.

Includes $400,000 One-Time to Further Develop Studies. Of the total amount, $200,000 is provided to continue work on the statewide IEP template by convening stakeholders to provide feedback and further refine the template. The remaining $200,000 would be for developing alternative coursework and activities for teachers to use with students with disabilities pursuing a high school diploma under the state minimum graduation requirements as an alternate diploma pathway.

Allocates Mental Health Funding to LEAs. Rather than allocating special education mental health funding to SELPAs, the Governor's budget allocates this funding directly to LEAs.

Consolidates Extraordinary Cost Pools. The Governor proposes to consolidate the two existing special education extraordinary cost pools into one single cost pool, at the combined existing appropriation of $6 million.

Requires Development of Special Education Addendum to the LCAP. The Governor proposes to direct the California Department of Education to develop a new addendum to the LCAP focused on special education.

Requires Resource Lead on IEP Best Practices. The Governor's proposal requires that one of the existing special education resource lead contracts be redirected to focus on IEP best practices beginning in 2022-23, when the current contracts will be up for renewal.

At the time of this agenda's publication, trailer bill language on these proposals was not yet available.

LAO Comments

Recommend Adopting Proposed Base Rate Increase. Given historical statewide increases in special education costs, we think using growth in Proposition 98 funding to provide special education base rate increases is a prudent way to address local cost pressures. This approach would reduce the need for LEAs to rely on local general purpose funding to cover growing costs.

Furthermore, the base rate augmentation helps to offset reductions in special education funding that are driven by decreases in overall attendance. (The base rate formula is tied to overall student attendance, which has been declining for several years.)

Formula Modification Provides Additional Funding Buffer for Some SELPAs. The proposed formula modification would benefit SELPAs that include a mix of growing and declining member LEAs. (The proposed change would have no effect on SELPAs where all members are declining or growing, or on single LEA SELPAs.) Under current law—where attendance is calculated at the SELPA level—a member district with growing attendance could have their gains offset by another member district with declining attendance. By contrast, the Governor's proposed approach would provide additional funding to reflect growth within a specific district, even if overall attendance in a SELPA is declining. We think this is a reasonable approach, as it provides additional cushion for SELPAs with some member LEAs experiencing declining enrollment. Depending on how funds are allocated within the SELPA, this cushion could allow growing districts to receive more special education funding without requiring reductions to districts experiencing attendance declines.

Recommend Setting Clear Expectations and Time Lines for Activities Related to Previous Work Groups. The proposed activities to continue work from previous work groups lack specific time lines. For instance, the Governor's proposal does not specify a date by which the alternative coursework and activities for an alternate pathway to a diploma must be finalized or made available to teachers. In the report submitted this past October, the alternate pathway work group suggested that districts be allowed to pilot the new alternate pathways as soon as possible, with statewide implementation by 2023-24. It is unclear how the proposed activities would affect this time line. Similarly, the administration has no deadline for when stakeholders must convene and refine the statewide IEP template and no expectations for next steps after the template has been refined. Should the Legislature be interested in funding additional activities to implement the recommendations of these work groups, we recommend it specify clear deadlines and reporting requirements to monitor the outcomes of these activities. To ensure these activities result in statewide policy changes, the Legislature may also want to consider setting explicit deadlines for the state to adopt these items. For example, by setting a date by which the State Board of Education must adopt alternate pathways to a diploma.

Consider the Effects of Mental Health Proposal on Regional Programs and Partnerships. Before adopting the Governor's proposal, the Legislature may want to better understand how the mental health proposal might impact regionally coordinated programs and partnerships. Although many SELPAs allocate mental health funding directly to their member LEAs, some SELPAs—especially those with smaller member LEAs—retain this funding and operate regional mental health programs on behalf of their members. In some cases, the member LEAs would not receive sufficient funding from the program under the Governor's proposal to hire mental health staff and, hence, likely would still need to combine funds across the SELPA to ensure access to mental health services when required by a student's IEP. Allocating funding directly to LEAs could also affect partnerships with county mental health programs. The state has provided $235 million one-time and $10 million ongoing funding for school-county mental health partnerships since 2019-20. Under such a partnership, a SELPA

could direct mental health funds to its county mental health department, which then provides widespread student services in schools throughout the county. Allocating funds directly to LEAs could pose challenges for maintaining the existing levels of funding for regional mental health services, or could make managing these programs more administratively burdensome (by requiring counties to develop agreements with each LEA). The Legislature may want to further explore the potential benefits of this proposal and determine whether these benefits outweigh the impact on regional programs or partnerships.

Impact of Consolidating Extraordinary Cost Pools Unclear. We are uncertain whether the proposal to consolidate the two existing extraordinary costs pools would have any practical impact. Our understanding is that the administration intends to fund mental health services requests from small SELPAs first, and then make any remaining funding available for high-cost nonpublic school placements. In practice, this is consistent with how the extraordinary cost pools currently operate, because the mental health services funding is rarely exhausted.

No Concerns With Developing Special Education Addendum or Establishing an IEP Best Practices Resource Lead. A special education addendum to the LCAP could increase transparency regarding how LEAs spend special education funding and facilitate more local input on actions to support special education students. Designating a resource lead for IEP best practices within the system of support could assist with the implementation a statewide IEP template. The Legislature may want to require the new resource lead be involved in the development of the IEP template, to ensure that statewide technical assistance on IEPs is consistent with the final statewide IEP template.

STAFF COMMENTS & QUESTIONS

While the base calculation shift proposed in the January Budget may appear to only be a formula shift in favor of funding stabilization, are there governance implications of changing the base calculation to the LEA-level, rather than SELPA level?

Prior budget actions have broadened the uses for special education mental health funds to support all students with mental health needs, regardless of IEP. However, what are the implications of shifting the Mental Health services funds directly to LEAs and away from existing local regional practices, particularly in a cost-neutral proposal?

The current AB 602 formula is based on the higher ADA of the current year, or one of three prior years. How will the ADA cliff impact AB 602 funding and local maintenance of effort requirements, and when?

Is the extraordinary cost pool consolidation an opportunity to more adequately fund LEA partnerships with Non-Public Schools to meet ongoing pressures?

Staff Recommendation: This issue will need to be revisited after the May Revision as part of the overall Proposition 98 guarantee and investment priorities in base funding as well as special education goals.

5. STATE OF SCHOOL FISCAL HEALTH (INFORMATION ITEM ONLY)

The Fiscal Crisis and Management Assistance Team (FCMAT) is California's public resource to monitor and guide Local Education Agency fiscal health. This hearing will provide FCMAT's annual address to update the Assembly on the state of school fiscal health.

PANEL

The following individuals will participate virtually in the discussion of this issue:

- Michael Fine, Fiscal Crisis and Management Assistance Team

BACKGROUND

AB 1200 (Chapter 1213, Statutes of 1991) created an early warning system to help local educational agencies (LEAs) avoid fiscal crisis, such as bankruptcy or the need for an emergency loan from the state. AB 1200 expanded the role of county offices of education (COEs) in monitoring school districts and requires that they intervene, under certain circumstances, to ensure districts can meet their financial obligations. The bill was largely in response to the bankruptcy of Richmond School District (now West Contra Costa USD), and the fiscal troubles of a few other districts that were seeking emergency loans from the state.

The formal review and oversight process, often referred to as the "AB 1200 process" requires the county superintendent to approve the budget and monitor the financial status of each school district and JPA in its jurisdiction. COEs (or district authorizers) perform a similar function for charter schools and the CDE oversees the finances of COEs.

AB 1200 created the Fiscal Crisis and Management Assistance Team (FCMAT), recognizing the need for a statewide resource to help monitoring agencies in providing fiscal and management guidance. The purpose of the FCMAT is to help LEAs fulfill their financial and management responsibilities by providing fiscal advice, management assistance, training and other related services.

There are several defined "fiscal crises" that can interventions in a district: a disapproved budget, a qualified or negative interim report or recent actions by a district that could lead to not meeting its financial obligations. The interim reports must include a certification of whether or not the LEA is able to meet its financial obligations. The certifications are classified as positive, qualified, or negative.

- A positive certification is assigned when the district will meet its financial obligations for the current and two subsequent fiscal years.

- A qualified certification is assigned when the district may not meet its financial obligations for the current or two subsequent fiscal years.

- A negative certification is assigned when a district will be unable to meet its financial obligations for the remainder of the current year or for the subsequent fiscal year.

State of School Fiscal Health

FCMAT will provide more details in this hearing, however they have already provided preliminary information, as of the first interim report:

- 23 school districts "qualified:" two of which have three or more consecutive qualified certifications Oakland USD (9 consecutive) and Oceanside USD (4 consecutive).
- Three new school districts are negative: Elverta JESD, Loleta UESD, and West Contra Costa USD.
- 11 LEAs have "lack of going concern" designation.

According to FCMAT, the January Budget Proposal revenue changes should be reflected at Second Interim and will positively influence at least 12 qualified certifications and 1 negative certification. The second interim reports are due March 15th.

Emergency Loans

In most cases, the assistance provided by county offices of education and FCMAT under the AB 1200 process is sufficient to pull LEAs out of immediate financial trouble. The option of last resort for LEAs that have insufficient funds is to request an emergency loan from the state. This is often the result of years of deficit spending and budgetary issues.

An emergency loan can be provided by the state through a legislative appropriation. Accepting a state loan is not without consequence, however. The county superintendent assumes all legal rights, duties, and powers of the district governing board and an administrator is appointed to the district. Several conditions must be met before control is returned to the district. State loans are typically set up for repayment over 20 years and county control remains over the school district until the loan is fully repaid. The state loan is sized to accommodate the anticipated shortfall in cash that the district will need during the life of the loan in order to meet its obligations. In addition, all of the costs of ensuring a fiscal recovery are the responsibility of the district and are added to the amount of the state loan. Therefore, a state loan will be much larger than what the district would otherwise need to borrow locally if it had been able to solve its own fiscal crisis.

Since 1991, the state has provided nine districts with emergency loans. Inglewood Unified School District is the most recent LEA to receive emergency apportionments in 2012. Since 2019 Inglewood Unified School District and Oakland Unified School District have received additional state apportionments through AB1840 (2018). Inglewood Unified School District did not require an AB1840 additional apportionment in the 2021-22 Budget, and has a positive certification as of the first interim report. Oakland USD required a $10 million AB1840 additional apportionment in the 2021-22 Budget, and is continuing to struggle with forecasted deficits.

No new LEAs are recommended for state assistance at this time, however one LEA, Loleta USD is in a fast-evolving financial situation that may require legislative action in the 2022-23 Budget Year. Loleta USD received an emergency loan from Humboldt County Office of Education earlier this fall, to exit negative cash-balance position.

FCMAT will present on current solvency trends, including:

- Local LEA reserves generally higher than in Great Recession.
- Multiyear projections show deficit trends, but Governor's Budget will change trending for at least 50 percent of qualified districts and one negative district.
- Most frequent condition among qualified certifications is declining enrollment, decrease in ADA rates; some outyear distress due to expiring one-time funds.
- Employer contribution rates to CalSTRS and CalPERS increasing in 2022-23.
- Inflationary pressures on cost side.
- Additional outyear concern: instability in the UPP rates for LCFF, with implementation of free meals, and declining enrollment trends.

STAFF COMMENTS

According to FCMAT, the January Budget COLA is about double local LEA projections, and COLA, Special Education base increases, and the ADA policy should significantly impact LEA projections.

It is unknown at this time whether LEAs have adequately updated their enrollment projections in current year, Budget Year, and the out-years, for both steep enrollment declines and new UTK enrollment. It is also unclear whether LEAs have recalibrated their Budget-year and out-year planning for the billions in Expanding Learning, Community School, universal meal, and student mental health funding packages adopted in the 2021-22 Budget Act.

According to FCMAT, many LEAs are struggling with how to transition from one-time federal funds to ongoing plans, including use of Expanded Learning, UTK, and other new 21-22 and proposed 22-23 programs.

Staff Recommendation: Information Only.