AGENDA

ASSEMBLY BUDGET SUBCOMMITTEE NO. 2
ON EDUCATION FINANCE

Assemblymember Al Muratsuchi, Chair

TUESDAY, FEBRUARY 25, 2014

9:30 AM - STATE CAPITOL ROOM 444

OVERVIEW OF THE GOVERNOR'S 2014-15 PROPOSITION 98 FUNDING PROPOSAL

I. OPENING REMARKS

Assemblymember Al Muratsuchi, Chair

Committee Members

II. BUDGET PERSPECTIVES

Tom Torlakson, Superintendent of Public Instruction

III. GOVERNOR'S 2014-15 BUDGET PROPOSALS: PROPOSITION 98 FUNDING

Department of Finance

Legislative Analyst's Office

Department of Education

ITEMS TO BE HEARD

6110 DEPARTMENT OF EDUCATION

ISSUE 1: 2014-15 GOVERNOR'S BUDGET PROPOSAL: PROPOSITION 98 FUNDING

The issue for the Subcommittee to consider is the Proposition 98 funding level for the 2014-15 Fiscal Year.

PANELISTS

- Anthony Crawford, Department of Finance
- Edgar Cabral, Legislative Analyst's Office
- Monique Ramos, Department of Education

BACKGROUND

Proposition 98, approved by voters and enacted in 1988, amended California's Constitution and established an annual minimum funding level for K-14 education (K-12 schools and community colleges). The intent of Proposition 98 was to create a stable funding source for schools, which grows with the economy and student attendance. Two years later, Proposition 111 was also enacted, which made significant changes to Proposition 98 to allow for lower K-14 funding when General Fund revenues are weak and significant growth when revenues improve. Propositions 98 and 111 created three formulas, or "tests," to calculate the minimum funding level for schools, also called the "minimum guarantee."

- Test 1 – Share of General Fund. Provides the same percentage of General Fund revenues appropriated to schools and community colleges in 1986-87, or approximately 40 percent.
- Test 2 – Growth in Per Capita Personal Income. Provides the prior year funding level adjusted for growth in the economy (as measured by per capita personal income) and K-12 attendance. Applies in years when state General Fund growth is relatively healthy and the formula yields more than under Test 1.
- Test 3 – Growth in General Fund Revenues. Adjusts prior-year funding for changes in attendance and per capita General Fund revenues. Generally, this test is operative when General Fund revenues grow more slowly than per capita personal income.

The Constitution provides two comparisons for determining which test to use in calculating the minimum guarantee. First, compare Test 2 and Test 3 and select the test with the lower amount of funding. Compare that test to Test 1 and select the test with the higher amount of funding to determine your minimum guarantee. The State has the option of funding the designated minimum guarantee, funding above the minimum guarantee or "suspending" the guarantee to provide less funding than the formula requires. Suspending the Proposition 98 guarantee requires a two-thirds vote by the Legislature. The minimum guarantee for the 2013-14 fiscal year was determined by "Test 3." It is expected that "Test 1" will apply for the 2014-15 fiscal year.

Propositions 98 and 111 also created the “maintenance factor,” which is designed to help the State balance the budget in tough economic times. Maintenance factor is created in Test 3 years or if the minimum guarantee is suspended. Essentially, in times of slow economic growth, when the State cannot provide the Test 2 level of funding, the State keeps track of the funding commitment and eventually restores the Proposition 98 guarantee to what it would have been had education funding grown with the economy. Proposition 98 also uses a formula to dictate how much maintenance factor is paid back in strong fiscal years.

Because 2014-15 is expected to be in a "Test 1" year, meaning the state is experiencing strong economic growth, the state will also be required to make a higher maintenance factor payment. Therefore, if revenues come in higher than expected in 2014-15, it is likely that the majority will be required to be spent on education. The Governor's Budget provides a maintenance factor payment of $3.3 billion in 2014-15. This would result in a maintenance factor of $4.5 billion at the end of 2014-15.

Overall Proposition 98 Funding

Proposition 98 funding declined rapidly during the recession, slipping to a total of $47.2 billion in 2011-12. Since then, Proposition 98 funding has been on a positive trajectory. The Governor’s Budget estimates a Proposition 98 minimum guarantee of $61.6 billion for the 2014-15 Fiscal Year. This is $4.7 billion higher than the revised 2013-14 funding level, or 8 percent. As shown in the chart below, the increase in Proposition 98 funding is driven by growth in General fund revenue and increased property tax revenue.

Proposition 98 Funding
(Dollars in Millions)

	2012-13 Actual	2013-14 Revised	2014-15 Proposed	Change from 2013-14 Amount	Change from 2013-14 Percent
Preschool	$481	$507	$509	$2	–
K-12 Education					
General fund	37,740	36,361	40,079	3,718	10%
Local property tax revenue	13,895	13,633	14,171	537	4%
Subtotals	51,634	49,995	54,250	4,255	9%
California Community Colleges					
General fund	3,908	4,001	4,396	395	10%
Local property tax revenue	2,241	2,232	2,326	94	4%
Subtotals	6,149	6,233	6,723	489	8%
Other Agencies	78	78	77	-1	-1%
Totals	**$58,342**	**$56,813**	**$61,559**	**$4,746**	**8%**
General Fund	42,207	40,948	45,062	4,115	10%
Local property tax revenue	16,135	15,866	16,497	631	4%

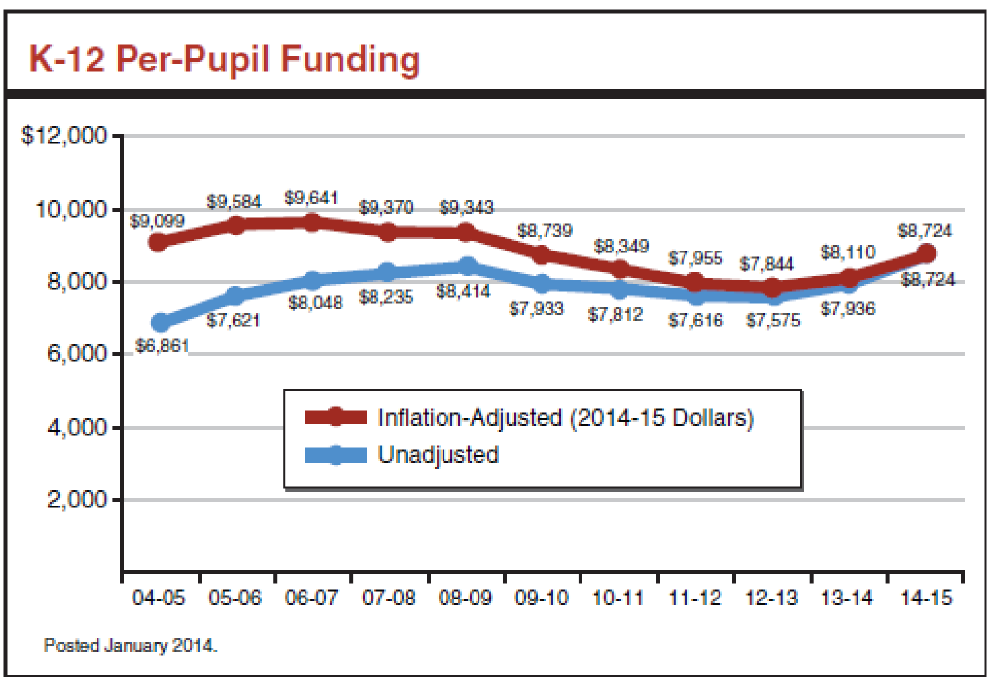
Source: Legislative Analyst's Office

The Governor's Budget also updates its estimates of the minimum guarantee in prior years. The 2012-13 minimum guarantee is $1.9 billion above the estimate made in the 2013-14 budget. This increase is due to higher than anticipated General Fund revenues and property tax revenues. Additionally, student attendance was lower than anticipated, resulting in $130 million less in proposition 98 spending in 2012-13. These Adjustments result in a "Settle-up" payment of 2 billion.

The Revised 2013-14 minimum guarantee is estimated to be $1.5 billion above the amount assumed in the 2013-14 budget. This increase is due to the higher 2012-13 minimum guarantee and higher growth in per capita General Fund revenues. Although the minimum guarantee is up $1.5 billion, the state's requirement is $1.9 billion because local property tax revenues are estimated to be down by $361 million, driven by lower redevelopment agency (RDA) revenues.

School Attendance
School attendance began to decline in 2012-13 and is expected to remain relatively flat in 2013-14. The Governor projects that average daily attendance (ADA) will decline by 0.12 percent in 2014-15. However, because 2014-15 is a Test 1 year, school attendance is not included in calculating the minimum guarantee.

Per Pupil Funding
Due to the passage of Proposition 30 and the improving economy, education funding is on the rise. As shown in the chart below, per pupil funding has improved considerably since the recession, but has not fully recovered to pre-recession levels when adjusted for inflation.



Source: Legislative Analyst's Office

Per pupil spending is still far below other U.S. states. In 2011-12, the most recent data comparison, California was ranked 49th in per pupil spending according to Education Week's annual Quality Counts report. However, per pupil funding has improved since 2011-12. The 2013-14 budget included a 5.5 percent increase in per pupil funding, or $415 per student.

Under the Governor's 2014-15 proposal, per pupil spending would increase from $7,936 in 2013-14 to $8,724 in 2014-15. This is an increase of $788 per student, or 10 percent, from 2013-14.

Major Proposition 98 Spending Proposals

The Governor's 2014-15 Budget includes a total of $11.8 billion in Proposition 98 spending increases. This includes $2 billion from 2012-13, $1.7 billion from 2013-14 and $7.6 billion in 2014-15. The Governor proposes to spend the increase in Proposition 98 funding on a combination of debt repayment ($6.7 billion) and programmatic spending ($5.1 billion). This includes eliminating all remaining K-14 deferrals and providing additional funding to schools to implement the Local Control Funding Formula. The Subcommittee will examine the Governor's spending proposals in more detail in subsequent hearings.

Major K-12 Proposals:

- Provides a total of $5.57 billion to retire all remaining K-12 deferrals. This includes $1.81 billion in 2012-13, $1.52 billion in 2013-14 and $2.24 billion in 2014-15.

- Provides $4.5 billion for school districts and charter schools to implement the Local Control Funding Formula.

- Provides $26 million for County Offices of Education to fully implement the Local Control Funding Formula.

- Includes $46 million for new computer based assessments aligned to the Common Core State Standards and $7.1 million to develop a new English proficiency assessment aligned to the English language development standards.

- Provides a 0.86 percent cost-of-living adjustment for those categorical programs outside of the Local Control Funding Formula.

Major CCC Proposals:

- Provides a total of $592 million to retire all remaining community college deferrals. This includes $194 million in 2012-13, $163 million in 2013-14 and $236 million in 2014-15.

- Provides $200 million to augment the Student Success and Support Program.

- Includes $175 million in one-time funding for maintenance and instructional equipment.

- Provides $155 million to grow enrollment by three percent.

- Provides a 0.86 percent cost-of-living adjustment to apportionments.

- Includes $2.5 million for technical assistance to community colleges under a new system of support.

The chart below outlines the specific changes to ongoing spending proposed by the Governor.

Proposition 98 Spending Changes
(In Millions)

2013-14 Revised Spending	**$56,813**
Crosscutting K-14 Adjustments	
Remove prior-year deferral payments	-$1,955
Remove prior-year one-time funds	-468
Fund QEIA program outside of Proposition 98	-361
Adjust energy efficiency funds	-101
Make other Adjustments	9
Subtotal	(–$2,876)
K–12 Education	
Fund increase in school district LCFF	$4,472
Pay down remaining deferrals	2,238
Increase funding for pupil testing	46
Provide 0.86 percent COLA to categorical programs	33
Fund increase in COE LCFF	26
Fund new English language proficiency test	8
Reduce categorical funding for lower ADA	–18
Subtotal	**($6,805)**
California Community Colleges	
Pay down remaining deferrals	$236
Augment Student Success and Support Program	200
Augment maintenance and instructional equipment	175
Fund 3 percent enrollment growth	155
Provide 0.86 percent COLA to apportionments	48
Create new community college technical assistance teams	3
Subtotal	($817)
Total Changes	**$4,746**
2014-15 Proposed Spending	**$61,559**

QEIA= Quality Education Investment Act; LCFF= Local Control Funding Formula; COLA= cost-of-living adjustment; COE= county office of education; and ADA= average daily attendance.

Source: LAO

Proposition 98 "Wall of Debt"

The Governor proposes to eliminate all school and community college outstanding obligations, or "wall of debt," by 2017-18.

The state has a total of $11.5 billion in outstanding K-14 obligations. These obligations include deferrals ($6.2 billion), unpaid mandate claims ($4.5 billion), the Emergency Repair Program (ERP) ($462 million) and the Quality Education Investment Act (QEIA) ($410 million).

In addition to these obligations, the state has $1.5 billion in outstanding one–time Proposition 98 obligations known as “settle–up” obligations. A settle–up obligation is created when the minimum guarantee increases midyear and the state does not make an additional payment within that fiscal year to meet the higher guarantee. The majority of the state’s existing settle–up obligation is from an increase in the 2009-10 Proposition 98 obligation. Settle–up funds can be used for any educational purpose, including paying off other state one–time obligations, such as deferrals and mandates.

The Governor's multi-year debt repayment plan eliminates all K-12 and community college deferrals by the end of 2014-15, a total of $6.2 billion over three fiscal years. The Governor's plan also makes the final QEIA payment in 2014-15, pays down the ERP obligation by 2015-16 and retires all unpaid mandates by 2017-18.

K-14 Deferrals

Since 2001, deferrals have become a common budgeting tactic in tough economic times. By delaying Proposition 98 payments owed to schools from one budget year to the next, the State is able to achieve one-time savings without cutting programmatic spending. Large Proposition 98 deferrals became a common mechanism for balancing the State budget, especially when the recession hit. By the end of 2011, a total of $10.4 billion in Proposition 98 payments were being paid late, approximately 21 percent of the total Proposition 98 support. Many school districts were no longer able to simply dip into their reserves to cover the late payment, resulting in districts turning to borrowing from private lenders, County Offices of Education (COE), or their County Treasurer. Districts are responsible for covering all interest or other transaction costs on such loans.

The 2012-13 budget began the process of retiring K-14 deferral payments by providing a total of $2.2 billion ($2.1 billion for K-12 schools and $160 million for community colleges) toward deferral buy down. The 2013-14 budget included an additional $2 billion in K-14 deferral payments (including spending adjustments for 2012-13).

The Governor's Budget proposes to fully pay all outstanding K-14 deferred payments by the end of 2014-15. The Governor proposes to use all of the increased Proposition 98 revenue in 2012-13 and 2013-14 to pay down deferrals. He also provides $2.4 billion ($2.2 billion for K-12 and $236 million for community colleges) for this purpose in 2014-15.

LAO Recommendations on Overall Proposition 98 Proposal.
Overall, the LAO believes the Governor's Budget is a reasonable mix of one-time and ongoing spending. They support the Governor's plan to pay off one-time obligations in order to minimize the potential disruption to ongoing school and community college programs, in the event that the state's fiscal situation were to deteriorate as a result of another economic downturn.

STAFF COMMENTS/QUESTIONS

Since the Proposition 98 funding level is determined largely by General Fund revenues, the Subcommittee should have the most up to date revenue estimates prior to constructing a specific Proposition 98 spending plan. Updated revenue estimates will be available in May when the Governor releases his revised budget. Staff recommends the Subcommittee hold all major Proposition 98 actions open until after the Governor's May Revision.

Suggested Questions:

1) Due to the passage of Proposition 30 and the improving economy, revenues have improved, which means more funding for education. How will the Governor's 2014-15 Budget impact programmatic spending for schools?

2) Tax collections in January finished slightly above the Administration's projections. Does the Administration anticipate this trend to hold? What will be the impact on Proposition 98 if revenues come in higher or lower than expected in 2014-15?

3) What is the Governor's rational for eliminating all payment deferrals to schools and community colleges instead of other outstanding obligations, such as mandates?

4) What would be the impact on schools if the State paid off the remaining deferrals over two years, instead of all at once.

Staff Recommendation: Hold Proposition 98 Funding Level Open Pending May Revision