AGENDA

ASSEMBLY BUDGET SUBCOMMITTEE NO. 2
ON EDUCATION FINANCE
Assembly Member Mervyn Dymally, Chair

TUESDAY, MARCH 15, 2005
STATE CAPITOL, ROOM 444
10:00 AM-12 NOON

ITEMS TO BE HEARD

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6110 DEPARTMENT OF EDUCATION

ISSUE 1: GOVERNOR'S PROPOSED PROPOSITION 98 FUNDING LEVEL FOR K-12 SCHOOLS AND COMMUNITY COLLEGES

The issue for the subcommittee to consider is the total Proposition 98 funding level proposed by the Governor for K-12 schools and community colleges.

BACKGROUND:

Governor's proposal: total proposed Proposition 98 funding level. The Governor proposes a total funding level for K-12 schools and community colleges of almost $50 billion ($49.97 billion). This amount meets the minimum Proposition 98 guarantee for 2005-06, as calculated by the administration[1]. This proposed funding level represents an increase in Proposition 98 funding of $2.9 billion total for K-14. For K-12, the proposed increase is $2.5 billion, and for community colleges, it is $360 million. These figures are summarized in Figure 1.

Figure 1: Proposed Proposition 98 Appropriations (dollars in millions) (a)

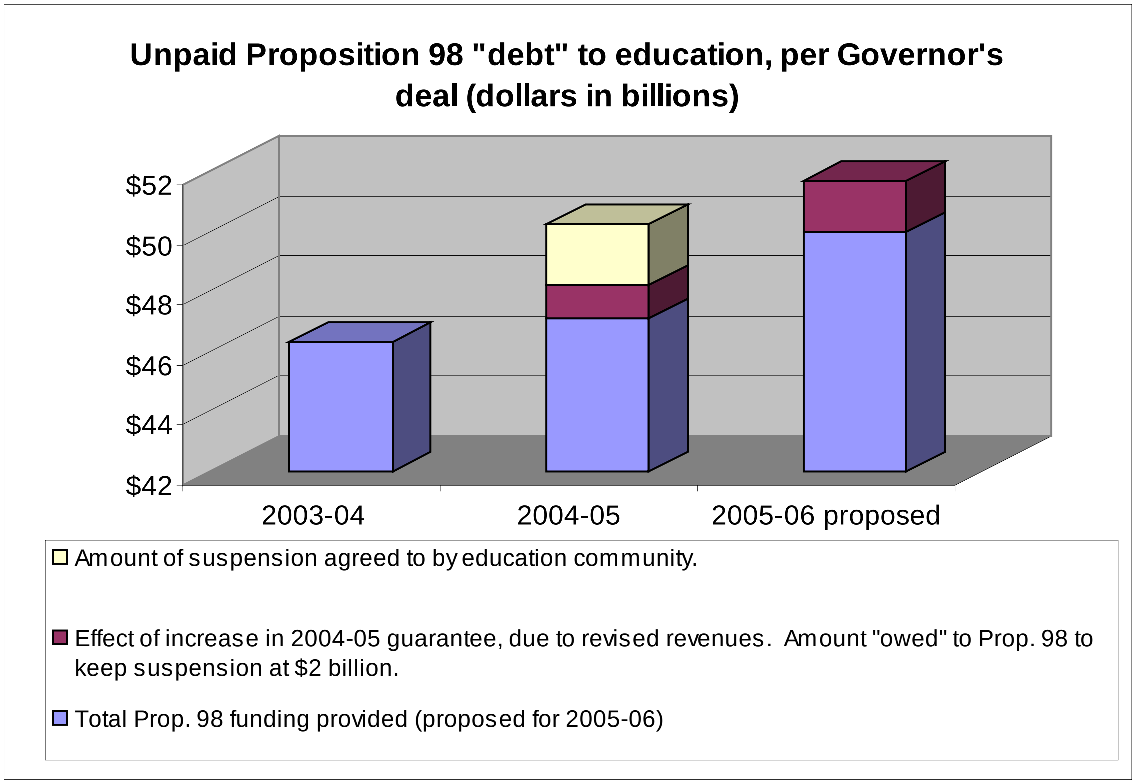
			Change from 2004-05	
	2004-05 (b)	**2005-06**	**Amount**	**Percent**
K-12 Proposition 98 (Department of Education) (c)	$42,178	$44,705	$2,527	5.99%
Community colleges	$ 4,804	$ 5,163	$359	7.47%
Other agencies	$101	$100	- $1	-1.24% (a)
Total Proposition 98	**$47,083**	**$49,968**	**$2,884**	**6.13%**
General Fund	$34,124	$36,532	$2,409	7.06%
Property tax revenues	$12,959	$13,435	$ 476	3.67%

(a) Figures may not compute due to rounding.
(b) These figures are slightly different from those enacted in the 2004 Budget Act. Changes are mostly due to updated information on population, which differed from the estimates used in the 2004 Budget Act. The main adjustment was a $100 million increase for K-12 discretionary funds (which are continuously appropriated), due to population adjustments. Total Proposition 98 appropriations in the 2004 Budget Act were $46.989 billion, whereas the Governor's proposed budget shows total Proposition 98 appropriations for the 2004-05 fiscal year at $47.083 billion.
(c) K-12 Proposition 98 funding includes funding for childcare and development and the state preschool program.

[1] The administration's estimate of the 2005-06 Proposition 98 minimum guarantee assumes that education funding is not increased for the 2004-05 fiscal year.

Governor’s proposal: Increase for K-12? The extent of the proposed increase in K-12 Proposition 98 funding over the 2004-05 funding level is a matter of dispute. While the administration cites a 7% increase for K-12, this is only the percentage increase in the General Fund portion of Proposition 98. The Governor's proposed funding level would actually provide a 6% increase in total Proposition 98 funding for K-12 schools. However, the Governor also proposes a number of reductions and shifts that would offset the proposed growth funding. For example, the Governor's proposes to shift more than $400 million in retirement costs to school districts, and proposes to require school districts to provide mental health services to special education students. Currently, counties provide this service. These and other proposed reductions would reduce the real rate of growth below the gross 6% total Proposition 98 increase proposed by the Governor for K-12 schools. The LAO estimates that the growth rate for K-12 schools, adjusted for inflation and the negative effect of the proposed retirement shift, would be 1.25%. The Governor's proposed retirement shift would also similarly reduce the real growth rate in Proposition 98 funding proposed for the community colleges.

Difference from last year's target for Proposition 98 funding. Last year, the Education Coalition and the Governor agreed to a deal in which the state would suspend the 2004-05 minimum Proposition 98 guarantee, but the amount of the suspension would not exceed $2 billion. That is, the amount of 2004-05 funding would not be "under" the Proposition 98 minimum by more than $2 billion. Since the approval of last year's budget, however, the Proposition 98 minimum for 2004-05 has been driven up by improvements in the economy, and the Governor's budget estimates the gap between the 2004-05 minimum and the 2004-05 funding level at $3.1 billion. If the Governor were to propose increasing funding for the 2004-05 fiscal year by $1.1 billion to maintain the gap at $2 billion, this would drive up the Proposition 98 minimum required spending level for 2005-06 by $1.2 billion. Thus, the two-year cost of keeping the 2004-05 suspension amount at $2 billion is $2.3 billion. This is illustrated in the figure below.



LAO's estimates of difference from last year's target. The LAO estimates that revenues for 2004-05 increase more than the Governor's estimates. This would have the effect of increasing the estimated Proposition 98 minimum by $1.9 billion, for a total between the 2004-05 funding level and the 2004-05 minimum guarantee of $3.9 billion. The LAO estimates that if the state were to increase funding for the 2004-05 fiscal year by $1.9 billion to maintain the gap at $2 billion, this would drive up the Proposition 98 minimum required spending level for 2005-06 by $2.1 billion. Thus, the LAO's estimate of the two-year cost of keeping the 2004-05 suspension amount at $2 billion is $4 billion, significantly higher than the Governor's estimate of $2.3 billion.

LAO's estimate of 2005-06 guarantee lower. The LAO's estimate of the Proposition 98 minimum for 2005-06 is lower than the Governor's estimate by approximately $420 million. If the Legislature were to assume the LAO's revenues at this point, but decide to provide the amount of education funding proposed by the Governor in his January budget, it would be over-appropriating the minimum guarantee by $420 million. However, the LAO recommends providing education funding based on needs, and not the minimum guarantee. It therefore recommends providing more funding than required by the 2005-06 minimum guarantee, based on workload needs.

Major piece of the 2005-06 proposed budget. To provide the subcommittee with information on how the Governor proposes to spend the proposed increase in Proposition 98 funding, the LAO will present an overview of the major pieces of the 2005-06 proposed budget, as presented on p. E-42 of their analysis.

COMMENTS:

2005-05 over-appropriation early packback of debt. If the Legislature uses the LAO's revenue estimates, but funds education at the Governor's proposed funding level, it will technically be over-appropriating the guarantee by $420 million. However, the state owes approximately $3.9 billion in maintenance factor to schools. An over-appropriation of the minimum Proposition 98 guarantee in 2005-06 would only be an early pay-back of part of that maintenance factor. When the state does not owe any maintenance factor and the Proposition 98 minimum is a Test 2, an over-appropriation permanently increases the long-term trajectory upward by the amount of the over-appropriation. (This has occurred in the past, during better fiscal times.) An over-appropriation in 2005-06 would only quicken the pace at which the state would move back up to the long-term funding trajectory in which education funding keeps pace with the economy, and ***not*** permanently increase that long-term funding trajectory.

ISSUE 2: GOVERNOR'S PROPOSED CHANGES TO PROPOSITION 98 (INFORMATION ONLY)

The issue for the subcommittee to consider is the Governor's proposed changes to Proposition 98, as contained in ACA 4x1 (Keene), which is the Governor's proposed budget reform initiative.

BACKGROUND:

Governor's proposed changes to Proposition 98

As part of his budget reform proposal, the Governor proposes some major changes in Proposition 98, which is a provision of the constitution that requires the state to pay a certain amount of state funds for K-14 education. Proposition 98 was approved in 1988 by California voters, and later amended in 1990. It was intended to protect education from the cuts that often accompany down-cycles in state budget revenues. In general, Proposition 98 ensures that, over time, education funding for K-12 schools and community colleges grows in proportion to the California economy (as measured by per-capita personal income growth) and student enrollment.

The proposed changes to Proposition 98 are listed below. All of these changes could affect total education funding for decades to come.

- **Eliminates the budget protection provisions of Proposition 98**, which allow for slower growth in education spending when the growth in budget revenues is not keeping up with the growth in the economy (also known as "Test 3" provisions). The Governor also proposes to eliminate the ability of the state to suspend the minimum funding requirements of Proposition 98, as the state did last year. The effect of these provisions may be higher funding levels for education in certain years, but potentially at the expense of the rest of the budget. These provisions would also put incredible pressure on the non-Proposition 98 side of the budget.

- **Education funding in included autopilot across-the-board cuts that become automatic** under the Governor's other budget reform provisions. Under those provisions, the Governor may call a special session if expenditures exceed revenues by $250 million. If the Legislature does not act to address the fiscal emergency within 30-45 days of the beginning of the special session, indiscriminate across-the-board cuts immediately take effect, based on the gap between expenditures and revenues. It is possible that the Governor's proposal to eliminate the budget protection provisions of Proposition 98 could exacerbate or even precipitate budget crises, which could then end in across-the-board cuts, including cuts to education. Therefore, even though the Governor is proposing to eliminate the ability for the state to suspend Proposition 98, the across-the-board cuts provisions could end up having the same effect or worse as the suspension or Test 3 provisions of Proposition 98, which the Governor proposes to eliminate.

- **Changes definition of "base funding" for future Proposition 98 calculations.** Under current provisions of Proposition 98, if the Legislature decides to appropriate more than the minimum Proposition 98 guarantee in any one year, that expenditure level becomes the base for future Proposition 98 calculations. The Governor proposes to end that practice, such that there would no longer be any requirement to continue any state funding that was provided in excess of the minimum guarantee in a prior year. However, if the automatic across-the-board cuts reduce education funding, the reduced funding level becomes the base for future funding calculations. In addition, under that situation there would be no mechanism to make up for the reduction in better fiscal years (no "maintenance factor"-type mechanism). Therefore, the Governor proposes to prohibit upward adjustments in the long-term funding trend of Proposition 98, but allow downward adjustments due to the across-the-board cuts provision. The combination of these two provisions could lead to a ratcheting down effect on education funding over the long-term.

- **Re-benches the base funding level, long-term $4 billion cut to schools.** Under the Governor's revenue estimates, after 2005-06, the state will owe education funding approximately $3.7 billion in maintenance factor funds, which roughly represent the amount we need to provide in order to ensure that education funding keeps up with the growth in the economy. The Governor proposes to pay back the $3.7 billion over a 15-year period, but only on a one-time basis. Essentially, the $3.7 billion would not become part of base education funding, which is a major departure from the current maintenance factor pay-back provisions of Proposition 98. The effect of this provision is a downward shift of at least $3.7 billion plus growth in the long-term funding trend of Proposition 98 in which education funding tracks the growth in the economy.

Other changes of note include: 1) The proposed 15-year pay-back of outstanding mandate claims and prior-year settle-up funds (which the state owes because of unintentional underfunding of the Proposition 98 minimum in prior years). 2) The requirement that future education mandate costs be absorbed within existing funding allocations. 3) The inclusion of current statute regarding "Proposition 98 settle-up funds" in the constitution. Under current law, if the Proposition 98 minimum required spending level is re-adjusted upwards after a budget is passed, the state must pay the difference – these are commonly referred to as "Proposition 98 settle-up funds." The Governor's proposal would make these payments a continuous appropriation. The proposal would then place these and other changes in the state constitution, which would make the provisions difficult to amend if there are implementation problems.

COMMENTS:

ACA 4 x1 (Keene), which contains the proposed revisions to Proposition 98, is under the jurisdiction of the Budget Process Committee of the extraordinary session. That committee has held two hearings on the bill, the first of which focused on the Proposition 98 provisions of the proposal.

ISSUE 3: GROWTH AND COLA FOR K-12 EDUCATION

The issue for the subcommittee to consider is the Governor's proposal to fully fund growth and cost-of-living adjustment (COLA) for K-12 education.

BACKGROUND:

Governor's proposal. The Governor proposes fully funding growth and COLA in K-12 programs at a cost of a little more than $2 billion. This would cover both growth and COLA for revenue limits (discretionary funds) and categorical programs. Growth and COLA accounts for most of the Governor's proposed $2.5 billion gross Proposition 98 increase for K-12 schools.

The proposed growth for revenue limits reflects an estimated enrollment growth rate of less than one percent, or 0.8%. The Governor's proposed COLA funding reflects an estimated COLA rate of 3.93%. The Governor's proposal is detailed in Figure 2 below.

Figure 2: K-12 Growth and COLA proposed in Governor's budget ($ in millions)

	Growth	**COLA (3.93%)**	**Total growth and COLA**
Revenue limits	$ 234.7 (0.8%)	$1,222.1	$1,456.8
Categorical programs	$ 160	$ 427.6	$ 587.6
Total	$ 394.7	$1,649.7	$2,044.4

As is customary, the administration is expected to update its estimated of the COLA percentage as part of the May Revise. California uses a COLA index based on statistics that will be available in late April. Therefore, the Legislature will most likely know what that final percentage is at that time.

COMMENTS:

LAO estimates. In its Analysis of the Budget, the LAO estimates the COLA at 4.1%, slightly higher than the Governor's figures. The higher COLA would cost an additional $80 million to fund for K-14.

ISSUE 4: GOVERNOR'S PROPOSED INCREASE IN DISCRETIONARY FUNDING

The issue for the subcommittee to consider is whether to approve the Governor's proposal to provide an increase of $329 million in discretionary funds to school districts and county offices (in the form of revenue limit deficit reduction).

BACKGROUND:

Governor's proposal. The Governor proposes a total increase of $329 million in discretionary funds, in the form of a revenue limit deficit reduction. This proposed increase would amount to approximately $54 per K-12 pupil.

"Deficit reduction" refers to the elimination of a "debt" that the state formalized two years ago when the state reduced revenue limits to address a severe budget crisis. At that time (during the fiscal year 2003-04), the state did not provide a 1.8% COLA to revenue limits and further reduced revenue limits by 1.2%. At the same time it created a "deficit factor" to revenue limits, to keep track of the amount that revenue limits would be had the state not made those cuts.

The LAO estimates that the Governor's proposed increase of $329 million would reduce the deficit factor from around 2.1% to 1.1%. The value of the remaining "deficit factor" is approximately $360 million.

Last year's budget provided a $270 million increase to revenue limits to reduce the revenue limit deficit. It also included increases to various categorical programs, to make up for cuts to those categorical programs during the 2003-04 fiscal year. Last year's deficit reduction and restorations to previous categorical cuts were part of a deal between the Governor and the education community. That deal specified priorities for new Proposition 98 funds in the 2004-05 fiscal year and beyond. That deal also included a historic suspension of the Proposition 98 guarantee (see above).

COMMENTS:

LAO recommendation: The LAO recommends that the Legislature redirect the $329 million that the Governor proposes for deficit reduction and instead spend it on the ongoing costs of mandate reimbursements for school districts. (It has a similar recommendation to fund mandate reimbursements for community colleges.) The LAO argues that the proposed deficit reduction exceeds a current service level of funding, and therefore is not as high a priority as providing funding to pay the 2005-06 costs of mandate claims.

ISSUE 5: MANDATES

The issues for the subcommittee to consider are 1) the Governor's proposal to not provide any funding for the ongoing cost of mandates, 2) issues raised by the LAO to reduce the state's obligations related to mandated reimbursements, and 3) the LAO's statutorily required analysis of several new mandates.

BACKGROUND:

Governor's proposal. The Governor's budget does not include any ongoing funding for the cost of mandate reimbursements for K-12, other than nominal appropriations of $1000 per mandate. This is consistent with the state's practice of the past few years (since 2002-03), in which it deferred any payment of the ongoing costs until future years.

There are two types of mandated costs that the state can and normally does fund through the budget: 1) the ongoing cost of mandated claims the state is expected to incur in the coming fiscal year, and 2) the cost of prior-year claims that have not been funded (either because the state deferred the cost or because the amount it provided was too little). The LAO's estimate of the ongoing cost of mandated claims is approximately $315 million for 2005-06 for K-12. It also estimates that the state will owe approximately $1.7 billion in unpaid (prior-year) K-12 mandate claims by the end of the budget year, if we provided no funding for 2005-06 mandated costs. Unpaid mandate claims accrue interest, which the state must pay along with the mandate reimbursements.

Efforts at reform. The state's non-payment of ongoing and prior-year claims has coincided with: 1) the state's fiscal crisis and 2) calls for mandate reform, raised by both the administration and the Legislature over a number of issues. One of the issues leading to calls for reform was raised by the LAO over the School Bus Safety II mandate. In its analysis, the LAO found that the Commission on State Mandates issued claiming guidelines that were broad enough to allow locals to claim for expenses they already incurred absent the mandate. Last year, Assemblymember Laird authored a series of bills to eliminate or revise a number of state mandates, with the intent that these changes streamline the claims process as well as save money to the state in the form of reduced claims. The bills also contained a number of reforms. (Appendix A contains a list of the bills that were successful last year.) Assemblymember Laird has introduced a bill this year on mandates, AB 1467 (Laird), sponsored by the Commission on State Mandates. He has indicated that the bill may serve as a means of continuing mandate reform.

In addition, last year the subcommittee approved an action requiring the Commission on State Mandates to re-evaluate their earlier decision to approve mandates related to the STAR statewide test. This was based on an LAO finding that the Commission did not consider the fact that several of the reimbursable mandates identified by the

Commission were required by the federal law. Under current law, locals cannot claim mandates for state requirements mandated by federal law.

LAO recommendations regarding mandates. The LAO will present their recommendations at the hearing. Their recommendations are summarized below:

- **Fund 2005-06 costs.** Redirect Governor's proposed deficit reduction funding to fund the 2005-06 costs of mandated claims, to reduce the amount that the state has to pay at a future date.

- **Recognize 8 new mandates**. The Governor's budget recognizes only 1 of the eight new education mandates approved by the Commission on State Mandates in the budget bill. The LAO recommends recognizing all eight in the budget bill, since there is no longer any process for recognizing and reviewing new mandates. The LAO reviewed these mandates and did not identify any issues with the Commission's determination of mandate costs. These mandates are summarized in LAO's table below:

- **Ask agencies to share information related to offsetting revenues.** Current law requires local agencies to consider certain state funds (e.g., categorical funding) as "offsetting revenues" used to fulfill certain mandates, thereby reducing the amount claimed. The LAO recommends that the California Department of Education work with the State Controller to better share information on the amount of funding that school districts receive, so that the Controller can do a better job of checking school districts' claims to ensure that they have properly included offsetting revenues.

- **Strengthen language on offsetting revenues.** The Governor's proposed budget includes language-requiring districts to use funds from the School Safety Consolidated Competitive Grant Program, to first offset the costs of complying with the new Comprehensive School Safety Plan mandate. The LAO recommends technical changes to strengthen this language, and also recommends placing similar language under the budget item for the School Improvement Program (now part of the School and Library Improvement Block Grant), to identify a funding source for elementary schools to comply with the new mandate.

Figure 1

New Mandates Approved by The Commission on State Mandates in 2004

(In Millions)

Mandate	Requirement	Accrued Costs Through 2004-05	Estimated Cost In 2005-06
Comprehensive School Safety Plan	Develop and annually update a comprehensive school safety plan.	$37.1	$5.5
Immunization Records: Hepatitis B	Ensure students have needed immunizations before entering school.	29.6	4.3
Pupil Promotion and Retention	Provide supplemental instruction to students at risk of academic failure.	9.0	1.4
Standards-Based Accountability	Provide specific accountability information (one-time).	0.6	—
Charter Schools II	Requires districts and counties to review charter petitions.	0.3	0.1
Criminal Background Check II	Requires background checks on employees and contractors.	0.3	0.1
School District Reorganization	Provide specific information on school district reorganization petitions.	—a	—
Attendance Accounting	Provide information for state change in attendance accounting (one-time).	—a	—
Totals		**$76.9**	**$11.3**

A Less than $50,000.

COMMENTS:

LAO's "credit card." In addition to mandates, the LAO has identified a number of "debts" that the state owes, including prior-year mandate claims. The LAO will present this information at the hearing.

Distributional effects of LAO alternative? As noted above, the LAO recommends redirecting the proposed deficit reduction funding to fund the ongoing cost of mandates. Whereas school districts and county offices would roughly receive the proportion of funding per-pupil under deficit reduction, they may receive different amounts under the LAO's recommendation, depending on how it is structured.

Appendix A: List of the five successful mandate reform bills sponsored by the Special Commission on State Mandates, last year.

AB 2851 – Local Government State Mandates
Signed into law August 25, 2004 by Governor Schwarzenegger – Chapter 316
This bill is the first of six bills introduced by the State Legislature's Special Committee on State Mandates (SCSM), chaired by Assemblymember Laird, to help streamline government and save taxpayer money by eliminating or revising state mandates. This bill makes certain mandates upon school districts contingent upon funding, repeals obsolete mandates, and directs the Commission on State Mandates to review specified federal mandates in light of more recent federal statutes enacted by Congress or through federal or state court decisions.

AB 2853 – Local Government State Mandates
Signed into law September 29, 2004 by Governor Schwarzenegger – Chapter 889
As approved by the SCSM, this bill revises specified mandates implemented by local counties and cities by changing them from required mandates to optional. Over recent years through the budget, the state legislature has chosen to suspend these specified mandates. However, removing their suspension status and allowing them to become optional provides local agencies the flexibility to better administer financial and statutory reporting requirements.

AB 2854 – Elections State Mandates
Signed into law July 27, 2004 by Governor Schwarzenegger – Chapter 206
As the fourth measure to be produced by the SCSM, it repealed the current mandate that requires a local agency to do a cost-effectiveness study when a request is made to consolidate a local election with a statewide primary or general election. Under current law, there are already guidelines that stipulate why a local agency may deny such a request. However, when reviewing such a request, local agencies cannot deny a voting enhancement request simply because it is not cost-effective. Since local governments cannot deny a non-cost-effective request, there is no need for such a requirement.

AB 2855 – Public School Mandates
Signed into law September 29, 2004 by Governor Schwarzenegger – Chapter 895
This measure is the fifth of six bills that originated from California's SCSM, which was established to review and evaluate the fiscal and administrative value of reimbursable state mandates included in the Governor's Budget. This measure would amend specific public school mandates to make them permissive rather than required, which then makes it no longer reimbursable by the State. It would also consolidate several safety provisions. According to the Assembly Appropriations Committee, this bill is estimated to save over $6 million in Proposition 98 money.

AB 2856 – The State Legislature's Mandates Process
Signed into law September 29, 2004 by Governor Schwarzenegger – Chapter 890

The last of six bills to come out of the SCSM, it would help the commission identify mandate funding to ensure that local governments are receiving the appropriate financing to implement state mandates. Should the SCSM determine that a local agency is implementing an un-funded state mandate, based upon a claim by that local agency; it must establish guidelines for how the state will fund the mandate. However, when reviewing claims current law does not provide the SCSM the authority to identify mandates that receive funding provided by an executive order or statute that did not originally create the mandate. A common unidentifiable mandate is one that receives funding through an allocation in the state budget rather than the mandate being coupled with an automatic funding mechanism. This bill would allow the SCSM to identify a mandate that receives funding in this manner.