AGENDA
ASSEMBLY BUDGET SUBCOMMITTEE NO. 2
ON EDUCATION FINANCE

ASSEMBLYMEMBER SARAH REYES, CHAIR

TUESDAY, MARCH 2, 1999
STATE CAPITOL, ROOM 447
4:00 P.M.

6110 DEPARTMENT OF EDUCATION (K-12)

ISSUE 1: PROPOSITION 98

The issue for the subcommittee to consider is whether to increase overall funding for Proposition 98 education expenditures above the level proposed in the Governor's budget and if so by how much.

BACKGROUND:

Proposition 98: Proposition 98, known as "The Classroom Instructional Improvement and Accountability Act," was passed by the voters in November, 1998. The initiative amended the State Constitution to provide for an annual minimum guaranteed level of funding for school and community college districts. This minimum annual funding guarantee is based on changes in statewide average daily attendance, General Fund revenues, statewide population and per capita personal income.

DOF BY estimate**:** The Department of Finance's (DOF) January estimate of the total Proposition 98 guarantee for 1999-2000 is $36.7 billion. The amount of this year's increase in proposed Proposition 98 spending is modest at $1.7 billion, which amounts to a 4.8 percent increase over Proposition 98 expenditures in the current year. The Governor's proposed budget does not propose to spend more than the minimum Proposition 98 guarantee on K-14 expenditures in the budget year.

Current year estimate**:** The Budget Act of 1998 appropriated approximately $35 billion for K-14 expenditures. The Governor's proposed budget includes an increase of $41.9 million in K-14 expenditures for the current year. (The LAO concurs with DOF's new current year spending level estimate.)

No one-time settle up funds this year**.** This year's budget contains no one-time Prop. 98 settle up funds, because 1998-99 Budget Act appropriated hundreds of millions of dollars over the required Proposition 98 spending level for K-14 expenditures. The requirements of Proposition 98 usually create the need for one-time "settle up" funds every year that must be used toward K-14 education but are not ongoing. Settle up funds are funds that the Legislature is required to spend in the current year to meet the minimum funding obligations for K-14 in that year. Because the factors that are part of the Proposition 98 formula are revised after the Legislature passes a Budget Act, the Proposition 98 minimum funding obligation is revised as well during the year. Consequently, the Legislature is required to spend money during that year to meet the minimum funding level. Even though DOF and LAO have revised their estimates of the Proposition 98 minimum funding obligation for the current year the amount that the Legislature appropriated in the current year for K-14 expenditures still far exceeds this minimum funding obligation. Therefore there is no need for settle up funds.

However, the Governor's proposed budget does contain $108 million in one-time current year funds that result from savings in the current year. The state has the option of using these savings for expenses other than K-14 expenditures, since current year appropriations far exceed the minimum level required by Proposition 98. Nevertheless, the Governor proposes to maintain these funds for K-14 uses in his proposed budget.

COMMENTS:

***LAO's BY Prop. 98 estimate*:** The LAO estimates that the Proposition 98 minimum guarantee for the budget year is $111 million higher than the guarantee assumed by the Governor's budget. This difference is due to the fact that the LAO is able to use more recent data in calculating its estimate, since its report is published after the Governor's budget. Specifically, the LAO used a more recent estimate of the inflation factor used for the Test 2 Proposition 98 calculation: per capita personal income growth. The LAO revised its estimate of this factor from 3.4 percent to 3.7 percent and this difference accounts for the $111 million difference in the LAO's estimate.

The LAO recommends that the Legislature combine the additional $111 million in Proposition 98 funds with other savings that result from their recommendations on other portions of the budget, for a total of $218.2 million in additional ongoing Proposition 98 funds. The LAO recommends that the Legislature utilize this additional money to restore deferred maintenance funding to the current year level, to provide per-ADA block grants to districts and to provide staff development block grants to school districts.

ISSUE 2: REVENUE LIMITS (Information only)

Pursuant to recent legislation, school district revenue limits have been adjusted to reflect a change in the way student attendance is counted.

BACKGROUND:

School district revenue limits serve as the largest source of unrestricted funds that school districts receive. Approximately two-thirds of school support is provided through revenue limits. Roughly one third of school support is provided through categorical funds.

In 1997 the Legislature approved SB 727 (Rosenthal) Chapter 855, Statutes of 1997, which changed the way that the state calculates apportionments. The formula for calculating district apportionments roughly multiplies a district's average daily attendance (ADA) by its revenue limit. Prior to the passage of SB 727, districts included excused absences in their total ADA count for calculating apportionments. SB 727 eliminated excused absences from districts' ADA total for calculating apportionments for two reasons: 1) to bring California in line with the way other states calculate attendance and 2) to create an incentive for districts to address chronic absenteeism among certain students. SB 727 attempted to compensate for the loss of revenue that districts would normally receive due to this revision by increasing their revenue limits by their excused absence rate for the year before the bill was passed: 1996-97. For 1996-97 the statewide excused absence rate (excused absences as a percentage of actual attendance) was around four percent, meaning that on average, a school district received a four percent increase in its revenue limit as a result of SB 727.

COMMENTS:

The revisions to districts' revenue limits that resulted from SB 727 mean that revenue limits now have a different "distribution" than prior to SB 727. Prior to SB 727, revenue limits were very close to each other, by size and type of district, with the exception of a few "outlier" districts that were far above the mean. Now, after revenue limits have been adjusted under SB 727, revenue limits by size and type of district are a little further apart.

ISSUE 3: DEFICIT FACTOR, DEFICIT REDUCTION

Related issues for the subcommittee to consider are: A) whether to adjust the deficit factor to take into account real inflation and prior-year equalization, B) whether to adopt a deficit factor for multiple years and C) whether to approve a $200 million appropriation for deficit reduction.

ISSUE 3A: DEFICIT FACTOR RE-CALCULATION

The issue for the subcommittee to consider is whether to adjust the deficit factor to take into account real inflation and prior-year equalization.

BACKGROUND:

The proposed trailer bill establishes a school district revenue limit deficit factor of 8.001 percent, which presumes approval of $200 million in deficit reduction funding proposed in the budget. The state uses the deficit factor to track the difference between the actual revenue limits that districts currently receive and the revenue limits they should be receiving but do not because the state did not fund cost-of-living adjustments during the early 1990's when the state faced budget shortfalls. Currently, the deficit factor is calculated based on prior year COLA's that are derived from a formula in statute. The current deficit factor is calculated to be 8.8 percent. In the past, the Legislature has reduced the deficit factor by appropriating money for deficit reduction.

COMMENTS:

The LAO believes that the deficit factor should be adjusted to account for two things: 1) the real inflation rate and not the statutory COLA because the statutory COLA overstates actual inflation and 2) all prior additions to districts' revenue limits, including equalization.

The LAO estimates that if the real inflation rate for prior years is considered in calculating the deficit factor, the deficit factor amounts to 5.2 percent instead of the current calculation of 8.8 percent. If the real inflation rate and all equalization money the Legislature has provided in prior years is considered the deficit factor drops to 1.7 percent. The LAO calculates that this readjustment of the deficit factor can reduce the amount needed to eliminate the deficit, from $2.2 billion (under the current deficit factor calculation) to $1.3 billion (if the deficit factor is adjusted for real inflation rates) or $435 million (if the deficit factor is adjusted for the real inflation rates and prior year equalization). The LAO notes that their use of the real inflation rate instead of the statutory COLA is consistent with the Governor's proposal to change the statutory COLA formula – see Issue 4 below.

Staff notes that equalization funds are distributed to districts differently than deficit reduction money and the COLA. Typically, districts with revenue limits below the average for their size and type benefit from equalization, whereas all districts benefit similarly from deficit reduction and COLA money. There may be a need for clarification regarding the LAO's proposal. Would the proposed adjustment consider the amount of funding that each district has received in equalization (in which case it might create a distinct deficit factor for each district), or would it consider the amount of funding that districts have received statewide?

ISSUE 3B: MULTIPLE-YEAR DEFICIT FACTOR

The issue for the subcommittee to consider is whether to adopt a deficit factor for multiple years.

BACKGROUND:

The Governor's proposed trailer bill language (section 6 of RN9902192 and section 1 for county offices) proposes a deficit factor of 8.001 percent for the fiscal year 1999-2000 and each fiscal year thereafter. (This factor reflects the Governor's proposal to spend $200 million to reduce the deficit.)

COMMENTS:

In prior years, the Legislature established a deficit factor for one or two years at a time. The proposed trailer bill language represents a change in the way the Legislature normally handles the deficit factor, because it specifies a factor for years beyond the budget year.

There are questions about the need to establish a deficit factor that is in effect for years beyond the budget year. Specifically, the subcommittee may wish to ask the following questions regarding the proposed change:

- Is the intent of the proposed language to finalize the issue of reducing the deficit? Is the intent to establish a "permanent" deficit factor?

- If the Legislature approves the proposed trailer bill language will it be stating its intent to not reduce the deficit factor in future years?

- What advantages does the proposed language have over establishing a deficit factor that is in effect for only 1999-2000?

ISSUE 3C: DEFICIT REDUCTION FUNDING

The issue for the subcommittee to consider is whether to approve $200 million in deficit reduction funds proposed by the Governor's budget.

BACKGROUND:

The Governor's budget proposes $200 million to reduce the revenue limit deficit for school districts and county offices. This money serves as unrestricted funds for districts to use as their local priorities dictate. The $200 million proposed in the budget would reduce the deficit factor from the existing level of 8.8 percent to 8.001 percent.

COMMENTS:

The LAO recommends approving this amount because it would provide general purpose funding for school districts and county offices of education.

ISSUE 4: COLA FORMULA

The issue for the subcommittee to consider is whether to adopt proposed trailer bill language that would change the formula for calculating cost-of-living adjustments.

BACKGROUND:

The Governor's budget proposes a change in the statutory formula that determines the inflation index to be used for the COLA for K-12 expenditures. Current law requires DOF to calculate the COLA by dividing the prior-year revised inflation index by the unrevised index of a year earlier. The Governor's proposed trailer bill changes this formula so that the COLA is calculated by dividing the prior-year revised index by the revised index of a year earlier (section 5 of RN9902192). The COLA calculated under the revised formula proposed in the trailer bill is 1.83 percent.

The revised COLA of 1.83 percent is higher than the COLA that would be calculated under current law, of 0.3 percent. (The Governor's budget summary documents cite the statutory COLA under current law to be 2.42 percent. However, DOF may revise this figure in the future due to more recent data.)

Last year the Governor proposed an identical statutory change to the COLA formula. However, the change would have meant a lower COLA than under current statute. The Legislature rejected the revision in the COLA formula because it would have meant a lower COLA and because the proposed budget did not contain any funding for deficit reduction.

COMMENTS:

The LAO recommends approving the proposed change to the COLA formula. It argues that the proposed formula produces a more consistent and accurate reflection of inflation. In its Analysis of the Budget, the LAO provides data that shows that the formula in current law leads to erratic calculations, due to the fact that the U.S. Department of Commerce revises the inflation index periodically. When this happens, the formula produces bizarre results because it calculates the change in inflation by comparing new data on inflation in the prior year with old data on inflation for a year earlier. As an example of the results the existing formula creates, the LAO cites the COLA that the current formula calculates for the budget year: 0.3 percent. This does not appear to reflect inflation. The LAO cites even worse cases in the COLA calculations for the 1992-93 and 1996-97 fiscal years, which yielded negative figures of –19.32 percent and –15.31 percent, respectively.

On p. E-28 of its Analysis of the Budget Bill for 1999-2000, the LAO provides data that demonstrates that the proposed change to the COLA formula provides results that are much closer to actual inflation.

ISSUE 5: GOVERNOR'S INITIATIVES (INFORMATION ONLY)

The Governor's budget proposes to spend $444 million on a three-part reform package labeled "Raising Expectations, Achievements and Development (READ) in Schools" to improve reading skills, improve teacher quality and preparation and hold schools and students accountable for their success. (Note: the $444 million package includes state and federal K-12 expenditures as well as community college, UC and CSU expenditures.)

In its Analysis of the Budget Bill for 1999-2000, the LAO makes the following recommendations to the Legislature regarding the Governor's proposals. The majority of the proposals are contained in four bills currently being considered in the First Extraordinary Session: AB 1x (Villaraigosa), AB 2x (Mazzoni), SB 1x (Alpert) and SB 2x (O'Connell). The Sub-committee will not hear these bills, as they are being considered by the Appropriations Committees of both houses. The Sub-committee will consider the Governor's reform proposals that are contained in the budget bill at a later hearing. For proposals that are contained in special session bills, only fiscal recommendations are listed.

Proposal	Amount (millions)	Bill	LAO recommendation [fiscal]
IMPROVING READING RESULTS			
K-4 Intensive Reading Academies	$75	AB 2x	Consolidate this program with others as part of an "Improving Academic Skills" mega-item
K-4 classroom libraries	$25		Allow districts to utilize funds interchangeably with those from new program for school libraries.
Public involvement reading campaign	$4	AB 2x	No recommendation
Governor's Reading Awards	$2	AB 2x	No recommendation
Instructional methods for secondary students	$5	Budget bill	No recommendation
Supplemental instruction for English learners	$50	Budget bill	Consolidate this program with others as part of an "Improving Academic Skills" mega-item
Staff development for teaching English learners	$10	Budget bill	Combine this program with Goals 2000 funding to create a staff development block grant.
Administration of English Language Development test	$14	Budget bill	Withhold recommendation pending full report on the progress of test development.
Pre-kindergarten reading	$1	Budget bill	No recommendation

guidelines			
ENHANCING PROFESSIONAL QUALITY			
Peer Review and Assistance	$100	AB 1x	Don't redirect Mentor Teacher money. Combine with BTSA and $16.8 million and allow districts to use combined money to participate in new program.
California Reading Development Institutes	$12	AB 2x	Shift funds to school districts for staff development priorities.
Teachers Scholars Program	$0.5	AB 2x	Use funds to provide additional Cal Grant T awards.
Principal leadership institute	$0.5	AB 2x	Use funds to provide additional Cal Grant T awards.
Teacher and reading development partnerships	$10	Budget bill	Do not approve.
Paraprofessional teacher training program	$10	Budget bill	Approve $6.6 million of augmentation.
Teacher credential fee waiver	$1.5	Budget bill	Use funds for additional Cal Grant T awards.
INCREASING SCHOOL ACCOUNTABILITY			
Planning/Implementation grants	$96	SB 1x	Increase implementation grants to $175/student for two-year period.
Performance awards	$96	SB 1x	Appropriate in 2000-01
High school report cards	$10.6	Budget bill	Do not approve.
Middle colleges	$1.8	Budget bill	Do not approve augmentation.
High school exit exam	$2	SB 2x	Authorize SDE to contract with any vendor instead of LEA.