

**AGENDA
ASSEMBLY BUDGET SUBCOMMITTEE NO. 2
ON EDUCATION FINANCE**

Assemblymember Joe Simitian, Chair

**WEDNESDAY, MARCH 26, 2003
STATE CAPITOL, ROOM 126
9:30 AM**

ITEMS TO BE HEARD

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ITEM # 6110 DEPARTMENT OF EDUCATION**K-12 PROPOSITION 98 OVERVIEW (INFORMATION ONLY)**

The issue to consider is the requirements of Proposition 98 for the 2003-04 fiscal year.

BACKGROUND:

Proposition 98, known as "The Classroom Instructional Improvement and Accountability Act," was passed by the voters in November 1988 and amended by Proposition 111. 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 1) changes in statewide average daily attendance, 2) changes in per capita General Fund revenues, and 3) changes in per capita income from one year to the next.

Furthermore, Proposition 98 is generally calculated based on three "tests" (i.e., Test 1, Test 2, and Test 3). The following is a brief description of these tests:

- Test 1 – Percent of General Fund (GF) revenues: Requires that K-12 schools and community colleges receive at least the same share of state GF tax revenues as in 1986-87. The current rate is approximately 34.5 percent.
- Test 2 – Adjustments based on statewide income: Requires that K-12 schools and community colleges receive at least the same amount of combined state funds and local tax dollars as was received in the prior year, adjusted for statewide growth in average daily attendance and inflation (i.e., annual change in per capita personal income).
- Test 3 – Adjustment based on available resources: This "test" is calculated the same as "Test 2," except that the inflation factor is equal to the annual change in per capita state GF revenues plus 0.5 percent. Test 3 is used only when it calculates a guarantee that is less than that determined by "Test 2."

As passed in 1998, Proposition 98 contains a provision for "suspension." Under this provision, the state is allowed to suspend the minimum funding level for one year through urgency, legislation other than the budget bill.

2002-03. The 2002-03 Budget Act contains a total of \$46.4 billion in funding for K-12 schools and community colleges, of this amount \$41.6 billion, or 89 percent, is funding for K-12 schools. This equates to funding for K-12 education at a "Test 2" level.

The budget provides \$817 million to school districts for a 2 percent Cost-of-Living Adjustment (COLA) for revenue limits and categorical programs. Also, it fully funds enrollment growth for the revenue limit and categorical programs at \$727 million.

2002-03 Mid-Year Adjustments. In November 2002 and January 2003, the Governor proposed a total of \$2.6 billion in Proposition 98 mid-year reductions for K-14 education, \$2.24 billion represents the K-12 portion. These cutbacks reduce K-12 education funding from Proposition 98 to \$39.4 billion, which equals a 5.4 percent reduction from the budget act. The majority of these reductions were proposed through across-the-board reductions to the revenue limit and categorical programs, which total \$1.5 billion.

The Legislature rejected the Governor's across-the-board reductions and instead, chose to make more targeted cuts, including deferring \$1.1 billion from the last special apportionment payment to school districts from June 2003 until July 2003, \$103 million in one-time instructional materials funding, and deferring \$122 million in the remaining K-12 mandate claims. The 2002-03 mid-year adjustments (as reflected in SB 18 X1, Chapter 4, Statutes of 2003) for K-12 total \$2.2 billion, \$17 million less than the Governor's proposal. This results in a total of \$39.4 billion in Proposition 98 funding for K-12 education in the 2002-03 Budget Act, as revised. This represents a 5.3 percent change from the 2002-03 Budget Act. These reductions bring the Proposition 98 guarantee virtually down to the minimum guarantee (i.e., "Test 3").

Governor's Proposed 2003-04 Budget. The Governor's proposal assumes that the total \$2.24 billion in K-12, current year adjustments are made to the 2002-03 Budget Act, which lowers the guarantee to its minimum funding level (i.e., "Test 3"), or \$39.4 billion.

For the 2003-04 fiscal year, the Administration continues to calculate the K-12, Proposition 98 guarantee at a "Test 3" level of \$40.0 billion. This represents an increase of \$104 million. Also, the Governor's proposes to "realign" child care from the state to the counties causes Proposition 98 to lose approximately \$878.8 million in funding for child care, which directly affects K-12 education funding.

Enrollment in California schools is estimated to increase by 1 percent statewide, or 58,879 students. The state is estimated to spend \$6,708 per student in Proposition 98 funding, an increase of \$172 from the 2002-03 funding level of \$6,536.

Below is a table that summarizes the Proposition 98 allocations for the 2002-03 Budget Act, 2002-03 Mid-Year Reductions, and the Governor's Proposed 2003-04 Budget.

2002-03 and 2003-04 Proposition 98 Allocations
(in millions)

	2002-03		2003-04 Governor Proposed	Change From Budget Act	
	Budget Act	SB 18 X1		Amount Change	Percent Change
Allocations ^a					
K-12	\$41,647.3	\$39,422.5	\$40,029.7	-\$1,617.7	-3.9%
California Community Colleges	4,832.3	4,639.7	4,063.5	-768.8	-15.9
Proposition 98 Totals	\$46,479.6	\$44,062.1	\$44,093.1	-\$2,386.5	-5.1%

Source: Legislative Analyst Office

^aGeneral Fund and local property tax revenue.

COMMENTS:

The Legislative Analyst Office (LAO) estimates that the Proposition 98 guarantee (K-12 and community colleges) is \$624 million higher in 2003-04. This estimate is based on the following current year and budget year factors:

Current Year:

- The LAO estimate of the minimum guarantee in the current year is \$93 million less than the Governor
- SB 18 X1, Chapter 4, Statutes of 2003 provides \$151 million more than the Governor.

For the current year, these two factors result in the Proposition 98 minimum overappropriated by \$244 million.

Budget Year:

- The LAO estimate of the minimum guarantee in the budget year is \$373 million higher than the Governor's level (assuming the LAO's forecasts for the guarantee in the current year).
- SB 18 X1, Chapter 4, Statutes of 2003 increases the Proposition 98 base, which results in a minimum guarantee that is \$251 million higher than the LAO in the budget year.

The current year and budget year factors result in the Proposition 98 minimum guarantee \$624 million higher than the Governor's estimate (i.e., \$373 in current year and \$251 million in budget year).

Furthermore, the LAO recommends that the Legislature make additional current year reductions in order to reduce the Proposition 98 guarantee down to its revised minimum level. This will enable the guarantee to be at its absolute minimum for the budget year.

ITEM 6110 DEPARTMENT OF EDUCATION

ISSUE 1: REVENUE LIMITS

The issues for the subcommittee to consider is the Governor's budget-year proposal regarding growth and Cost-of-Living (COLA) adjustments, the Public Employees Retirement System (PERS) offset freeze, and equalization adjustments to school district revenue limits.

BACKGROUND:

Revenue Limit reduction. Revenue limit funding represents "general purpose" money for school districts and county offices of education. Revenue limits are funded through local property taxes and state General Fund money. As part of its 2002-03 mid-year reductions, the Administration proposed to cut the revenue limit by 2.15 percent, for a total of \$612 million in savings. The Legislature rejected the revenue limit reduction and instead, decided to make more targeted reductions, fund shifts, etc. Likewise, the Administration proposes to carry this cut forward into the budget year.

Growth and COLA. The budget proposes to fully fund revenue limit growth for school districts (\$299.2 million), county offices of education (\$22.3 million), and special education (\$37.2 million), based on the projected statewide attendance growth of 1 percent, which totals \$359 million.

However, the Administration does not propose to fund enrollment growth for categorical programs (excluding special education), for a total savings of \$106 million. Nor does it propose to fund the 1.55 % cost-of-living-adjustment (COLA) for either the revenue limit (\$431 million) or categorical programs (\$204 million), which realizes a total savings of \$635 million.

Likewise, there is not a proposal to create a "deficit factor," which would allow funds to be claimed and restored when economic conditions improved. During the difficult budget years of the early 1990's, the Legislature did not fully fund the statutory COLA for revenue limits. As a result of this, it created "deficit revenue limits," which were revenue limits that reflected the amount of funding school districts and county offices of education would have received if the state fully funded the statutory COLA. The state kept track of the difference between the base revenue limits and the "deficit revenue limits" through the establishment of a "deficit factor" in statute. Therefore, when the state found itself "flushed" with excess revenues, the Legislature paid off the "deficit

factor," which allowed school districts and county offices of education to receive the entire statutory amount of revenue limit funding for those years.

2001 Budget. As part of this budget year's proceedings, the Legislature approved two augmentations to school districts' revenue limits, which are discretionary funds and form the largest proportion of funding that school districts receive from the state. These augmentations were:

- \$35 million to freeze the PERS offset to revenue limits. The existing PERS offset results in a reduction to school districts' revenue limits, and was initiated in 1981 by the state to capture any savings that would accrue to school districts from reduced employer contribution rates for PERS. The freeze results in a reduction in the offset, and thereby increases revenue limits by \$35 million.
- \$40 million for revenue limit equalization, as defined in AB 441 (Simitian), Chapter 155, Statutes of 2001. This amount reflects 10% of the full cost of the equalization formula laid out in the bill, which aims to ensure that at least 90% of the average daily attendance (ADA) in the state, by size and type of district, would receive the same revenue limit by the 2006-07 fiscal year.

2001 Current Year Adjustments. Due to an unexpected reduction in state revenues, the Governor proposed a total of over \$2.2 billion in reductions to the 2001 budget. Of these proposed cuts, \$851 million were in K-12 education and included postponement of the implementation of the two revenue limit increases outlined above. In response to the Governor's proposals, the subcommittee took action to adopt cuts totaling the same amount as proposed by the Governor, but in different areas. It choose to restore the cuts to the PERS offset freeze and equalization, and enacted these restorations for the 2001-02 and 2003-04 fiscal years, leaving open the possibility of a similar restoration in 2002-03, depending on available revenues.

2002-03 Budget Act. The Governor vetoed the \$36 million augmentation that the Legislature provided for the PERS offset and the \$42 million it provided to restore the cut to revenue limit equalization.

AB 2781 (Oropeza), Chapter 1171, Statutes of 2002. This bill contains \$203 million for revenue limit equalization for the 2003-04 budget. The formula for the equalization provides funding based on excused absence adjustments (post-SB 727). The Legislature originally appropriated \$406 million for equalization, and provided half of the funding based on excused absence adjustments (post- SB 727), and half of the funding excluding excused absence adjustments (pre-SB 727). However, the Governor vetoed the half of the funding that was scheduled to be distributed based on the pre-SB 727 formula, leaving only the \$203 million to be distributed based on the post-SB 727 formula.

2003-04 Proposed Budget. The Administration proposes the following regarding PERS offset and revenue limit equalization:

- There is not any funding provided in the proposed budget to fund the buyout the PERS offset; therefore, eliminating the \$35 million appropriated pursuant to the 2001 current year adjustments.
- \$250 million in revenue limit equalization funding. Of this amount, \$203 million represents the funding that was allocated for this purpose under AB 2781 (Oropeza), Chapter 1171, Statutes of 2002, which is based on excused absence adjustments (post-SB 727). The remaining \$47 million is additional funding that is proposed to be allocated based on this same formula. As a result, the entire \$250 million is allocated based on the post-SB 727 formula.

COMMENTS:

The Legislative Analyst Office (LAO) recommends that the Legislature not establish a "deficit factor" for revenue limit funding. Specifically, they argue that by not creating a "deficit factor," the Legislature has greater flexibility in spending future funds. The LAO also states that the Legislature is not precluded from paying back the lost revenue in the future, if it chooses to do so.

On the issue of revenue limit equalization, the LAO recommends that the Legislature delay the \$250 million for this proposal. It argues that the Governor's proposal is contradictory because his budget proposes to reduce the revenue limit by 2.15 percent (i.e., \$612 million) at the same time as it provides \$250 million for equalization. Furthermore, it urges the Legislature to use this funding to pay off Proposition 98 deferrals.

ITEM # 6110 DEPARTMENT OF EDUCATION**ISSUE 2: BASIC AID SCHOOL DISTRICTS**

The issue for the subcommittee to consider is the Governor's budget-year proposals regarding basic aid school districts.

BACKGROUND:

What is a basic aid school district? According to the California Constitution, the state must provide every school district with \$120 per student. For the majority of districts, the state's portion of its general purpose funding (i.e., revenue limit) generally far exceeds the Constitutional minimum of \$120 per student. However, for a small number of school districts, the revenue limit, funding requirement is met entirely with local property tax revenues. Even though this occurs, the state still provides funds above the level of the district revenue limit in order to meet the \$120 per student minimum required by the Constitution. These school districts are known as "basic aid." In 2001-02, there were 82 school districts that received "basic aid." According to the LAO, there are two types of basic aid school districts:

- "Excess" Tax Districts. These districts receive more local property taxes than is needed to fully fund district revenue limits. In 2001-02, there were 60 excess tax districts. In 2001-02, there were 82 school districts that received "basic aid."
- "Not Quite" Excess Tax Districts. These districts receive slightly less in property tax revenues than is needed to fully fund district revenue limits. In 2001-02, districts received state general purpose funding of \$120 per student – a portion of which came in the form of revenue limit payments and the remainder as basic aid.

2003-04 Budget. The Administration has the following two basic aid proposals in its budget:

- **Elimination of \$120 per student payment to basic aid school districts.** The Administration proposes to eliminate the \$120 per average daily attendance (ADA) funding that basic aid school districts receive from the state, which totals \$17.8 million in savings. As outlined above, school districts are required to receive at least \$120 per ADA for their general purpose grant (i.e., revenue limit). This proposal would assume that any type of state funding, including categorical program funding, meets the constitutional requirement for the \$120 per ADA that the state must provide.

According to the Department of Finance, the majority of basic aid school districts receive enough categorical funding to cover the \$120 per ADA. However, if a school

district does not receive enough funding, it would still receive the difference from the state in order to reach the \$120 requirement.

- **Capturing of "Excess" Property Tax.** The Governor's budget proposes to capture \$126.2 million in excess property taxes from basic aid school districts. The Administration projects that basic aid school district excess property tax totals \$160 million statewide. However, this proposal attempts to capture approximately 78 percent of it. The Administration further proposes to use the excess property tax captured to fund revenue limit growth within the same county as the school district the excess tax was taken from. It costs \$321.5 million statewide to fully fund revenue limit growth for school districts and county offices of education.

Currently, if local property taxes exceed the amount of money it takes to fund the revenue limit, school districts keep this excess funding and can spend it on programs, priorities that it deems appropriate within K-12 education. Likewise, because this funding originates from local property taxes, it is "general purpose" and discretionary in nature. Therefore, school districts can use it to fund everything from core academic programs to enrichment ones. Also, because these districts have utilized this excess general purpose funding for a number of years, it has been built into their budgets and an abrupt cut of this magnitude would cause severe fiscal hardship. For example, the LAO estimates that, for some school districts, this proposed reduction would create a disproportionate cut in comparison to the across-the-board reductions proposed by the Governor. Specifically, the LAO estimates that the average excess tax district receives \$1,200 per student in additional general purpose funding. If 78 percent of this funding were recaptured (as proposed by the Governor), it would represent a \$936 reduction in general purpose funding for these districts.

Also, it must be noted that not all basic aid school districts have large amounts of excess property taxes (i.e., "Not Quite" Excess Tax Districts). For example, a number of these districts have low revenue limits, which means that the excess property tax simply allows them to reach the statewide revenue limit and nothing more.

Of the 82 basic aid school districts in the state, the Administration estimates that 60 have a significant amount of excess property tax. The following is a summary chart of the characteristics of Basic Aid "Excess Tax" Districts:

A Profile of 60 Basic Aid "Excess Tax" Districts

(2001-02 Data)

	Minimum	Maximum	Median	State Median
District Enrollment	17	21,919	668	1,497
Percent English Language Learner	----	59.0%	5.7%	10.2%
Percent Free / Reduced Price Lunch	----	100.0	10.3	40.7
District Revenue Limit (per student)	\$4,362	\$8,181	\$4,880	\$4,525
District General Purpose Funding (per student)	4,539	19,763	6,526	4,525
"Excess Property Taxes" (per student)	61	13,720	1,727	----

Source: Legislative Analyst Office

The LAO further estimates that the amount of excess property tax collected across the state is increasing rapidly. For example, the total amount of excess property taxes increased by 56 percent in 2001-02, totaling \$148 million. The Governor's budget projects approximately a 4 percent growth of excess tax revenues for 2002-03 and 2003-04.

COMMENTS:

According to 2001-02 data, the LAO estimates that \$1,200 per student is the average "excess tax" amount for the 60 school districts characterized as "excess tax" districts. (The amount ranged from \$1.60 per student to about \$13,000 per student). When added to the district revenue limit, general purpose funding for the highest funded district was almost \$20,000 per student compared to the statewide average revenue limit of about \$4,650 per student. Due to this fact, the LAO argues that excess taxes exacerbate the problem of unequal general purpose funding levels among districts. While relatively few in number, districts receiving large amounts of excess taxes are able to afford programs and services for their students that are out of reach of other districts. From our perspective, there are few policy reasons that justify allowing such large amount of revenues to benefit these districts."

At the same time, the LAO acknowledges that the Governor's proposal to recapture 78 percent of the excess tax all once is too large of a reduction for school districts to absorb. Therefore, it recommends that the Legislature place a cap on the amount of excess tax districts can keep as general purpose funds in 2003-04 rather than except the Governor's proposal. The LAO suggests that the cap be established at the amount of excess taxes distributed to districts in 2000-01, which would result in \$65 million in savings for the budget year.