ASSEMBLY BUDGET SUBCOMMITTEE NO. 2 ON EDUCATION FINANCE

Assembly Member Wilmer Amina Carter, Chair

TUESDAY, MARCH 16, 2010
STATE CAPITOL, ROOM 444
9:00 AM

OVERVIEW

2010-11 K-12 EDUCATION BUDGET PERSPECTIVES

- Jack O'Connell, Superintendent of Public Instruction
- Kathryn Radtkey-Gaither, Undersecretary of Education, Office of the Secretary for Education
- Committee Questions

2010-11 PROPOSITION 98 FUNDING OVERVIEW

- Edgar Cabral, Legislative Analyst's Office (LAO)
- Nicolas Schweizer, Department of Finance (DOF)
- Committee Questions

ITEMS TO BE HEARD

6110 DEPARTMENT OF EDUCATION

ISSUE 1: BACKGROUND ON PROPOSITION 98 (INFORMATION ONLY)

The Legislative Analyst's Office (LAO) will provide a comprehensive handout describing the Governor's proposals relative to Proposition 98. This agenda item provides background information and context for the LAO overview as well as the remaining items on the Subcommittee agenda today.

Proposition 98 Background. Proposition 98 is a 1988 ballot initiative that amended the California constitution to establish a minimum annual funding level for K-14. Roughly 80 percent of total funding for K-12 education is provided under Proposition 98. This funding formula provides K-12 and community colleges with a guaranteed funding source that grows each year with the economy and the number of students attending. The guaranteed funding is provided through a combination of state General Fund and local property tax revenues and is more commonly referred to as the "minimum guarantee."

There are three formulas or "Tests" that, based on various inputs, determine the minimum level of funding required under Proposition 98.

Three Formulas ("Tests") Used to Determine K-14 Funding:

Test 1—Share of General Fund. Provides roughly 40 percent of General Fund revenues to K-14 education. From 1988-89 through 2007-08, this test was applied only once (1988-89).

Test 2—Growth in Per Capita Personal Income. Adjusts prior-year funding for changes in attendance and per capita personal income. This test was operative 13 of the last 20 years.

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. This test was operative 6 of the last 20 years.

Source: LAO

The basic underlying premise of Proposition 98 is to guarentee that per pupil funding keep pace with the cost of living (Test 2). In times of slow economic growth, however, when the state can not provide the Test 2 level of funding, the state keeps track of this long term funding commitment and eventually restores Proposition 98 to what it otherwise would have been had education funding grown with the economy. This outstanding obligation is called "maintenance factor." Formulas under Proposition 98 dictate when and how much maintenance factor is restored in a given year. At the end of 2007-08, the state had a maintenance factor obligation of $1.3 billion.

Governor's proposed 2010-11 Proposition 98 funding level is linked to assumptions in 2008-09 and 2009-10. As this Subcommittee heard in February, the Governor's special session budget proposes to recertify the 2008-09 Proposition 98 funding level to align the guarantee with more current estimates of expenditures. This reduction would provide $49 billion for 2008-09 (a reduction of $82.9 million).

In accordance with the Governor's various assumptions about Proposition 98 funding in 2008-09, the Governor proposes to reduce Proposition 98 to $49.9 billion in 2009-10. This equates to a reduction of $568 million compared to the 2009-10 Budget Act.

For 2010-11, the Governor continues to make certain assumptions that result in a minimum guarantee of $50 billion in Proposition 98 funding. This equates to an increase of $103 million above the Governor's proposed 2009-10 funding level. While this looks like a small year-to-year change, 2009-10 relied heavily on one-time funds. As a result, the Governor must propose programmatic cuts of $1.9 billion for K-12 education in 2010-11 (excluding child care).

Unclear if Constitutional Obligations Would Be Met; Obligations Could Increase Significantly. Trailer bill language adopted as part of the 2009-10 July Budget Act (Chapter 3, 4th Extraordinary Session, Statutes of 2009) certified the 2008-09 funding level for schools and recognized $11.2 billion in new constitutional maintenance factor obligations. Under July budget act funding levels, the Proposition 98 minimum guarantee would be $2.2 billion higher in 2009-10 and $3.2 billion higher in 2010-11 than the Governor's proposal.

The Governor's proposal is based on a different interpretation of the constitutional provisions of Proposition 98 than was used in the July budget agreement. This new interpretation allows the Governor to retire all outstanding maintenance factor in 2008-09 and create no new maintenance factor going forward, resulting in significantly lower Proposition 98 guarantee funding levels.

According to the LAO, the Governor's Proposition 98 assumptions for the 2008-09, 2009-10, and 2010-11 fiscal years may not meet constitutional obligations and has some legal risks. It should be noted that although the Governor does not recognize a constitutional maintenance factor obligation in 2009-10, he does propose to make $11.2 billion of "in-lieu" payments starting in 2011-12.

Minimum Guarantee Could Increase Due to Changes in Revenues. According to the LAO, in addition to constitutional issues mentioned above, the LAO points out that the minimum guarantee for 2009-10 and 2010-11 could also increase due to changes in the Governor's revenue estimates for 2008-09. There are five factors that affect the underlying tests and minimum guarantee calculations – General Fund revenues, local property taxes, personal income, state population, and K-12 population. Changes in these factors – most likely changes in revenues – could change the underlying factors and operative tests for Proposition 98 in 2008-09, which would in turn change the operative tests for 2010-11 and 2011-12. In addition, the Governor's minimum guarantee could increase even further due to interaction with some of the Governor's revenue proposals, such as the revenue increases that are "triggered" if federal funding solutions are not successful.

Alternatives to the Governor's Proposal. Several factors will determine the level of funding the state provides for K-12 eduction. Under current law, the state owes more to education than the Governor's budget provides. According to the LAO, if the Legislature does not take the Governor's approach, other options include:

- **Raise Additional Revenues or Cut Other Spending to Meet Higher Current-Law Funding Levels**. The Legislature could either raise enough additional revenues or make further spending reductions elsewhere in the budget to meet the higher current law K-14 funding level for 2010-11 ($3.2 billion). According to the LAO, to the extent the Legislature used new tax revenues to provide this supplemental funding, the initial $3.2 billion gap would grow. This is because without suspending Proposition 98, every new dollar of General Fund revenue increases the Proposition 98 minimum guarantee by 40 cents to 50 cents. For example, if the Legislature were to take this approach relying entirely on tax revenues, it would need to raise roughly $6 billion in new revenues, with essentially all of the new funding used for K-14 education. (The LAO assumes the state would be able to meet a higher funding obligation in 2009-10 through "settle-up" payments in future years.)

- **Suspend Proposition 98.** Suspending Proposition 98 in 2009-10 and 2010-11 would allow the state to decide the level of funding it could afford for K-14 education, regardless of the Proposition 98 formulas, constitutional interpretations of maintenance factor, and otherwise interacting revenue proposals. Suspension requires a two-thirds vote of each house of the Legislature. (Under suspension, the state creates a new maintenance factor obligation, which would require additional payments in future years.)

ISSUE 2: GOVERNOR'S BUDGET – 2010-11 CLASS SIZE REDUCTION PROGRAM SAVINGS

The issue for the Subcommittee to consider is the Governor's proposal to reduce 2010-11 funding for the K-3 Class Size Reduction (CSR) program based on estimates of declining program participation.

PANELISTS

- Department of Finance
- Legislative Analyst's Office

BACKGROUND

The K-3 CSR program was established in 1996 as a voluntary program. Participating school districts received per pupil incentive funding to maintain K-3 classes at an average of 20 students. Districts received graduated funding losses for a class sized above this level. If an average class size exceeded 20.4 students the district received no CSR funding for that class.

In 2004, the K-3 CSR funding program was amended to allow a class to increase up to 21.9 students and still receive 20 percent of their funding rate. If an average class size exceeded 21.9 students the district received no CSR funding for that class.

As a part of the across-the-board categorical reductions and categorical funding flexibility options approved in February 2009, additional funding flexibility was provided for the K-3 CSR Program. School districts may now increase K-3 class sizes to 25 students or more and retain up to 70 percent of their program funds. The new flexibility laws, which are summarized below, are in effect from 2008-09 through 2011-12.

- 5 percent reduced funding if average class size greater or equal to 20.5 but less than 21.5;
- 10 percent reduced funding if average class size greater or equal to 21.5 but less than 22.5;
- 15 percent reduced funding if average class size greater or equal to 22.5 but less than 23.0;
- 20 percent reduced funding if average class size greater or equal to 23.0 but less than 25.0;
- 30 percent reduced funding if average class size greater than 25.0.

Governor's 2010-11 Proposal. In February, this Subcommittee heard but did not take action on the Governor's 2009-10 K-3 CSR savings proposal given that the savings appeared to be overstated and the California Department of Education (CDE) did not have data available to determine the true savings available. The LAO recommended the Subcommittee hold off action until after the May Revision.

The Governor proposes to reduce 2010-11 K-3 CSR funding by $550 million (30 percent) based on the administration's estimates that participation in the K-3 CSR program will decline. This level of savings would add $210 million to the Governor's savings proposal of $340 million in 2009-10.

The same issues raised around the Governor's 2009-10 savings proposal apply to the Governor's 2010-11 proposal. Accurate savings projections are not yet available from CDE.

LAO Alternative Proposal. Rather than provide estimates of program savings, the LAO recommends an alternative approach. The LAO recommends that the K-3 CSR program be added to the K-12 cut/flex program, which currently covers approximately 40 categorical programs. In so doing, the LAO recommends that districts receive funding equal to their 2007‑ 08 allocation less 20 percent—which would equate to funding levels for other programs in the categorical cut/flex program. Districts would continue to receive funding regardless of class size increases. This would result in K-3 CSR savings of $382 million in 2010-11.

SUGGESTED QUESTIONS

1. What are the benefits or tradeoffs associated with rolling the CSR program into the flexibility program?

ISSUE 3: GOVERNOR'S BUDGET – 2010-11 SCHOOL DISTRICT REVENUE LIMIT REDUCTION: NON-INSTRUCTIONAL EXPENDITURES

The issue before the Subcommittee is the Governor's proposal to reduce school district revenue limit funding by $1.2 billion in 2010-11 and require the reduction be made to noninstructional expenditures. This is the first and largest of three proposals that allow the Governor to achieve a total of $1.5 billion in savings through reductions to school district and county office of education revenue limits.

PANELISTS

- Department of Finance
- Legislative Analyst's Office

BACKGROUND

Revenue limit apportionments provide general purpose funding for school districts and county offices of education. Revenue limits comprise roughly two-thirds of all Proposition 98 funding. The 2009-10 budget act provides a total of approximately $30.6 billion in revenue limit funding to school districts and county offices of education. Ongoing K-12 base revenue limit apportionments were reduced significantly in 2008-09 and 2009-10 as a result of the state's budget shortfall -- $925 million in 2008-09 and an additional $2.4 billion in 2009-10. In addition, K-12 base revenue limits were reduced by $1.5 billion on a one-time basis in 2009-10. Deficit factors have been established for the ongoing base reductions – as well as foregone cost-of-living increases – as a symbol of intent to restore these levels when the state budget allows.

GOVERNOR'S PROPOSAL

The Governor's proposal reduces revenue limits in 2010-11 for districts (and charter schools) by $1.184 billion and requires districts to reduce noninstructional expenditures by a minimum of 12 percent compared to 2008-09 spending levels. The Governor specifies five categories of non-instructional expenditure for reduction, which are defined in the California School Accounting Manual. These categories include instructional supervision and administration, general administration, plant maintenance and operations, board and superintendent costs, and centralized data processing.

Per the Governor's proposal, revenue limit reductions for school districts will be allocated per average daily attendance (ADA). For excess tax districts – commonly known as basic aid districts – reductions would be applied to the district's state categorical programs, with the following exclusions: Special Education, Child Care and Development, After School Education and Safety, and Quality Education Investment Act. The Governor's proposed reduction of $1.2 billion would amount to roughly a 4 percent reduction to school district revenue limits.

The Governor's proposal allows school district governing boards to apply for a hardship exemption from the reductions for noninstructional services if the reduction would result in a serious financial hardship to the district or if the district has already reduced noninstructional expenses to less than 15 percent of the district's current expense of education.

The Governor does not establish a deficit factor for this revenue limit reduction. This suggests that the Governor sees these reductions as ongoing base reductions.

LAO RECOMMENDATIONS

The LAO recommends rejecting the Governor's proposal to require reductions in school district non-instructional services because this would remove local flexibility and limit local decision-making power.

According to the LAO, the Governor's proposal raises serious implementation issues. Every district would be required to make the same proportional reduction to the targeted expenditure categories regardless of its current mix of spending on administration and instruction. Furthermore, it is unclear who would review expenditure data to ensure districts made reductions in the required places, how this policy would be enforced, and what the penalties would be for noncompliance.

The LAO also believes that the Governor's proposal would work at cross-purposes with the flexibility options the state has recently granted to school districts. For this reason, and the reasons previously stated, the LAO recommends the Legislature reject the Governor's proposal to place new limits on how much districts spend on noninstructional activities. Districts confronting budget reductions need new options for how to respond, not new constraints.

STAFF COMMENTS

Staff supports the LAO recommendation to delink the Governor's revenue limit reductions from the Governor's policy proposals.

With regard to the proposed reduction to school district revenue limits, staff recommends decisions around major program reductions be postponed until after the May Revision when the Legislature will have updated information about the State's fiscal situation to determine the appropriate level of Proposition 98 funding in 2010-11.

SUGGESTED QUESTIONS

1. The Administration does not propose deficit factors for the 2010-11 revenue limit cuts. Since the Administration has supported deficit factors for all other revenue limit cuts for the last two years – what's the reason for the change in 2010-11?

2. How will non-instructional reductions be implemented, monitored and enforced?

3. What if school districts and county offices have already made significant administrative cuts to their budgets? Will they be protected by the hardship provisions proposed by the Administration?

ISSUE 4: GOVERNOR'S BUDGET – 2010-11 SCHOOL DISTRICT REVENUE LIMIT REDUCTIONS: CONTRACTING OUT

The issue before the Subcommittee is the Governor's proposal to reduce school district revenue limits by $300 million. This reduction is linked to changes in existing contracting out policy. This is the second of three proposals that allow the Governor to achieve a total of $1.5 billion in savings through reductions to school district and county office of education revenue limits.

PANELISTS

- Department of Finance
- Legislative Analyst's Office

BACKGROUND

Under current law (SB 1419, Chapter 894, Statutes of 2002), school districts can contract out for many non-instructional services -- such as food service, maintenance, clerical functions, and payroll -- only if certain conditions are met. For example, a district can contract out for services to achieve cost savings, however, there must be a clear demonstration that the contract will result in actual overall cost savings to the district.

Current law specifically prohibits the approval of contracts solely on the basis that savings will result from lower contractor pay rates or benefits, and requires that contractor's wages be at the industry's level and not undercut district pay rates. Current law also does not allow for the displacement of district employees (defined as layoff, demotion, involuntary transfer to a new classification, involuntary transfer to a new location requiring a change of residence, and time base reductions).

GOVERNOR'S PROPOSAL

The Governor's proposal amends existing law governing contracting out for personal services to remove provisions that currently: (1) disallow approval of contracts solely on the basis of cost savings; and, (2) disallow contracts if it causes displacement of school employees who previously provided the services. This new authority would become effective for personal services contracts entered into after January 1, 2011.

The Governor proposes to reduce school district revenue limits by $300 million, to be allocated per average daily attendance (ADA). For excess tax districts – commonly known as basic aid districts – reductions would be applied to the district's state categorical programs, with the following exclusions – Special Education, Child Care and Development, After School Education and Safety, and Quality Education Investment Act. School districts receive approximately $31.5 billion in base revenue limit funding. A reduction of $300 million would amount to roughly a 1 percent reduction.

The Governor does not establish a deficit factor for this revenue limit reduction. This suggests that the Governor sees this reduction as an ongoing base reduction.

LAO RECOMMENDATIONS

The LAO recommends approval of the Governor's language to remove restrictions on contracting out, but they recommend removing the link between the policy proposal and the revenue limit funding reduction.

According to the LAO, the Governor's proposal allows a district to layoff or demote a district employee who formerly performed the service to be contracted out. Easing these restrictions would allow districts to more frequently bid on the open market for non-instructional services. The LAO thinks district's identifying the most cost–effective options for meeting their needs makes sense. Therefore, the LAO recommends that the Legislature approve the Governor's proposal to waive the restrictions on contracting out for non-instructional services.

The LAO agrees with the Governor's assessment that districts would realize some cost savings at the local level, however, the LAO would argue that assuming $300 million in savings is overly optimistic. Depending on the percent of non-instructional services contracted out and the incremental reduction in cost, the LAO estimates total savings statewide could be as high as $250 million or as low as $50 million. Further, the LAO thinks it is highly unlikely that the savings a particular district generates will be well aligned with that district's per ADA revenue limit reduction. Therefore, the LAO recommends the Legislature make the statutory change on contracting without establishing any link to district revenue limit funding levels.

STAFF COMMENTS

There are no state savings associated with this proposal. Per LAO testimony during 2009 budget conference committee discussions, lack of data makes it difficult to determine the amount of savings school districts would achieve if the contracting restrictions were removed. It is also unclear whether the state's current fiscal condition has already resulted in the elimination or reduction of services generally performed by classified employees and whether there is room to realize any additional savings as the result of repealing existing personal services contracting provisions at this time.

Staff supports the LAO recommendation to delink the Governor's revenue limit reductions from the Governor's policy proposals.

With regard to the proposed reduction to school district revenue limits, staff recommends decisions around major program reductions be postponed until after the May Revision when the Legislature will have updated information about the State's fiscal situation to determine the appropriate level of Proposition 98 funding in 2010-11.

Related Legislation:

SBX8 61 (Huff) changes existing law governing non-instructional services contracting for school districts, by repealing existing law restricting the conditions under which a school district or community college is authorized to contract for personal services or food service management consulting services. In addition, the bill authorizes these entities to contract for these services if the governing board determines that the contract provides a benefit to the district and the contract is awarded in accordance with "applicable" Public Contract Code provisions. Status: Failed Passage in Senate Education on February 25, 2010.

AB 2621 (Norby) would repeal existing law that permits school districts to use personal services contracting, in order to achieve cost savings, for all services that are currently or customarily performed by classified school employees if specified conditions are satisfied. Status: Pending committee referral.

SUGGESTED QUESTION

1. The Administration is proposing amendments to provisions of SB 1419 as a part of its contracting out proposal, instead of full repeal per the Administration's proposal last year. Can the Administration discuss the intent of their proposal?

ISSUE 5: GOVERNOR'S BUDGET – 2010-11 REVENUE LIMIT REDUCTIONS: COUNTY OFFICE OF EDUCATION CONSOLIDATION

The issue before the Subcommittee is the Governor's proposal to reduce county office of education (COE) revenue limit funding by $45 million and to link the reduction to a plan that would require COEs to form regional consortia to consolidate functions, provide services at the regional level, achieve economies of scale, and reduce administrative costs. This is the last of three proposals that allow the Governor to achieve a total of $1.5 billion in savings through reductions to school district and county office of education revenue limits.

PANELISTS

- Department of Finance
- Legislative Analyst's Office

BACKGROUND

COE revenue limit funding consists of two categories of funding – funding for direct instruction to students and general purpose funding for school district services. Each COE uses their general purpose funding differently but activities generally include business support services, professional development, technology services, and credential monitoring for certificated staff.

GOVERNOR'S PROPOSAL

The Governor's proposal requires the Legislative Analyst's Office and Department of Finance – jointly with the California County Superintendents Educational Services Association – to develop a plan that results in a reduction of $45 million in costs for county offices of education statewide. Per the plan, county offices of education would be required to form regional consortia in order to consolidate functions, provide services on the regional level, achieve economies of scale, and reduce administrative costs.

Beginning in 2010-11, funding to county offices of education would be reduced by $45 million on a per ADA basis. For excess tax county offices, reductions would be applied to the county's state categorical programs, with the following exclusions: Special Education, Child Care and Development, After School Education and Safety, and Quality Education Investment Act. County office base revenue limit general purpose funding is approximately $330 million. The Governor's reduction would amount to roughly a 14 percent reduction.

The Governor does not establish a deficit factor for this revenue limit reduction. This suggests that the Governor sees this reduction as an ongoing base reduction.

LAO RECOMMENDATION

The LAO offers an alternative to the Governor's proposal. Specifically, the LAO recommends: (1) reducing general purpose funding for each county office of education by 10 percent ($33 million), and, (2) redirecting an additional 10 percent ($33 million) into new county office of education regional revenue limits.

The LAO recommends creating a new "regional" revenue limit to establish a formal structure for sharing funding and services at the regional level. Specifically, in addition to the 10 percent reduction to general purpose funding, the LAO recommends redirecting an additional 10 percent of each county office's unrestricted revenue limit funding into a regional COE revenue limit to be shared by all of the county offices in that region. The LAO's proposed framework would require county offices of education to communicate and collaborate over how to best use limited resources to meet the needs of the school districts in their region. Under the LAO's approach, each of the state's existing 11 education regions would select one county office to be the fiscal agent over their share of this new $33 million grant. Spending decisions, however, would be shared among all the county offices in the region. The resulting arrangements likely would differ based on the individual characteristics of the regions and the strengths and needs of each county.

STAFF COMMENTS

Consistent with the two prior proposals, staff suggests the Governor's policy proposals be delinked from proposed revenue limit reductions. Staff recommends decisions around major program reductions be postponed until after the May Revision when the Legislature will have updated information about the State's fiscal situation to determine the appropriate level of Proposition 98 funding in 2010-11.

While consolidation of general purpose activities of county offices of education may have merit, such major policy changes should be fully vetted through a working group or the legislative bill process before any action is considered.

SUGGESTED QUESTIONS

1. Is the Governor's plan for county offices tied to any larger, long-term policy goal for county offices of education?

2. Counties offices of education statewide have already organized themselves into eleven contiguous regions reflective of size and proximity. What is the purpose of these existing regions and how would they interact with the Governor's proposal?

ISSUE 6: GOVERNOR'S BUDGET – 2010-11 COST-OF-LIVING ADJUSTMENTS

The issue before the Subcommittee is the Governor's proposal to apply a negative cost-of-living adjustment (COLA) of -0.38 percent to K-12 education programs in 2010-11.

PANELISTS

- Department of Finance
- Legislative Analyst's Office

BACKGROUND

Current law requires that a COLA be applied annually to revenue limits and most K-12 categorical programs in order to reflect the higher costs that schools face due to inflation.

The statutory K-12 COLA is based on an index that measures changes in costs experienced by state and local governments. School districts generally use COLAs to provide annual increases to employee salaries and address cost increases for local operating expenses, including employee benefits, utilities, materials, and supplies.

Due to the state budget crisis, the state has not provided COLAs in recent years—foregoing K-12 COLAs of 5.66 percent in 2008-09 and 4.25 percent in 2009-10. Deficit factors were established in both these years to keep track of the foregone COLA for revenue limit programs, so revenue limit funding could eventually be restored to previous base levels. The Legislature is not required to create a deficit factor for revenue limits when no COLA is provided; however, the Legislature has adopted the practice of establishing deficit factors for revenue limit programs -- based upon statutory COLA rates -- when COLA has not been provided.

GOVERNOR'S PROPOSAL

The Governor proposes to reduce the K-12 revenue limit and most categorical programs by a total of $201 million to implement a negative statutory COLA rate of -0.38 percent for these programs in 2010-11. According to the LAO, for the first time in over 60 years, the index used to calculate the K-12 COLA is negative (-0.38 percent). Per the LAO, this suggests the recession has led to a decrease in government costs; implying school districts might be able to purchase the same goods and services for less money.

The $201 million in savings created by the Governor's proposal includes $150 million which results from school district and county office revenue limits, $45 million from various categorical programs, and $6 million for child care. In addition to the $201 million in savings for K-12 programs, the Governor proposes savings of $23 million from applying a -0.38 percent COLA to community college programs.

LAO RECOMMENDATION

The LAO recommends rejecting the Governor's proposal. According to the LAO, applying a negative COLA after years of not providing a positive COLA is unreasonable. The LAO does however, recommend waiving statutory COLA requirements and would apply a downward adjustment to revenue limit deficit factors to reflect the negative COLA.

STAFF COMMENTS

Consistent with recommendations on prior issues, staff recommends decisions around reductions be postponed until after the May Revision when the Legislature will have updated information about the State's fiscal situation to determine the appropriate level of Proposition 98 funding in 2010-11.