AGENDA

ASSEMBLY BUDGET SUBCOMMITTEE NO. 2
ON EDUCATION FINANCE

ASSEMBLYMEMBER KEVIN MCCARTY, CHAIR

TUESDAY, FEBRUARY 28, 2023

9:00 A.M. – STATE CAPITOL, ROOM 447

This hearing can be viewed via live stream on the Assembly's website at https://assembly.ca.gov/todayevents.

We encourage the public to provide written testimony before the hearing. Please send your written testimony to: BudgetSub2@asm.ca.gov. Please note that any written testimony submitted to the committee is considered public comment and may be read into the record or reprinted.

*To provide public comment, please call toll-free number: **877-692-8957 / Access Code: 131 54 47***

OVERVIEW OF THE GOVERNOR'S 2023-24 BUDGET: PROPOSITION 98 AND TK-12 EDUCATION

I. Opening Remarks

II. Governor's 2023-24 Budget: Proposition 98

III. Public Comment

ITEMS TO BE HEARD

6100 CALIFORNIA DEPARTMENT OF EDUCATION

OVERVIEW

In the Governor's 2023-24 January Budget, the state's priority for public education funding and system transformation is evident. This Budget proposes maintaining major Proposition 98, general fund, and federal fund increases in TK-12 public education, despite a projected slow-down in the economy. This hearing will provide an overview of the revenue dynamics effecting the Proposition 98 guarantee and the Local Control Funding Formula, and the state's Fiscal Crisis Management Action Team.

ISSUE 1: PROPOSITION 98 OVERVIEW

This issue will cover the Proposition 98 guarantee and Public School System Stabilization Account contributions, as projected in the Governor's Budget, for the 2021-22, 2022-23, and 2023-34 Budget years.

PANEL

- State Superintendent of Public Instruction Tony Thurmond
- Amanpreet Singh, Department of Finance
- Kenneth Kapphahn, Legislative Analyst's Office

BACKGROUND

2022-23 Budget Act Oversight

Since 2011-12, total Proposition 98 Funding has increased from $47.3 billion to $110.3 billion annually, an increase of $63.1 billion (134 percent), 72 percent when adjusted for inflation. This translates into an increase of $9,980 per K-12 student in 2011, to a current rate of $17,011 per student, TK-12 in the current year.

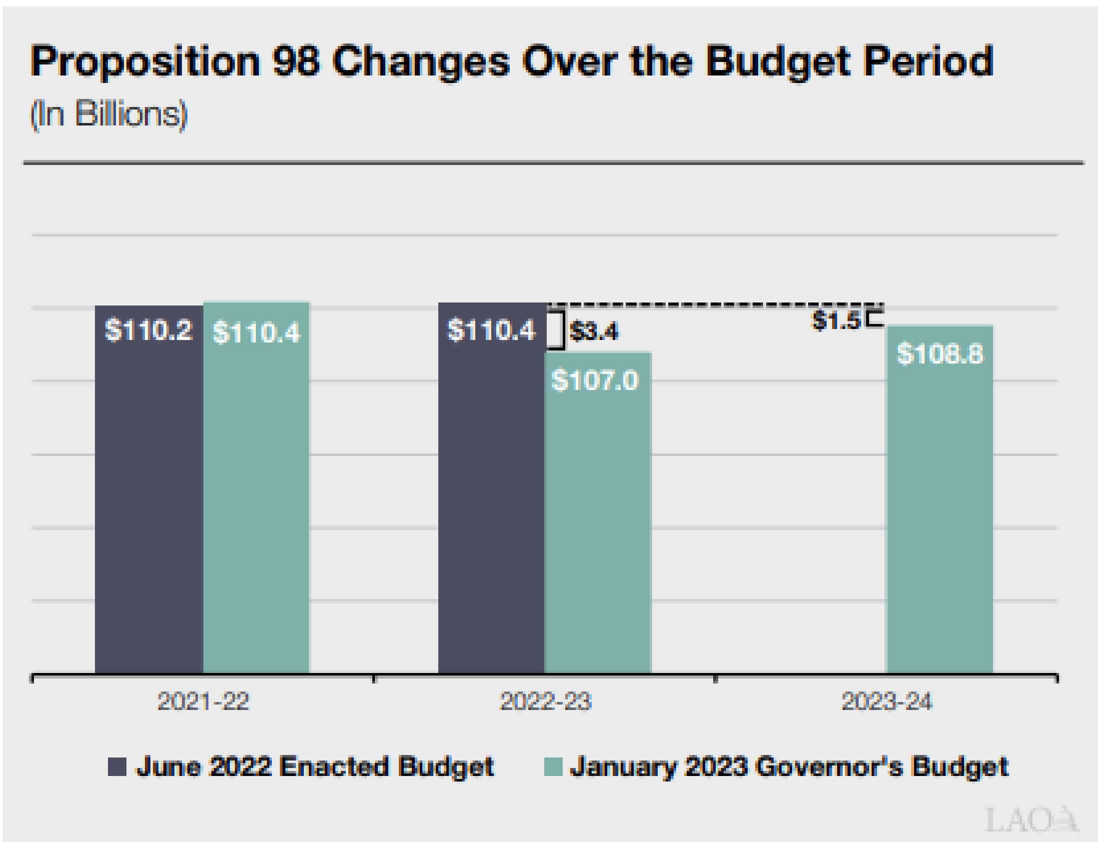
The 2022-23 Budget Act and corresponding trailer bills appropriated Proposition 98 funding at $96.1 billion in the 2020- 21 Budget Year, $110.2 billion in the 2021-22 Budget Year, and $110.3 billion in the 2022-23 Budget Year, for preschool, TK-12, and community college programs. Each of the three years is a Test One calculation for the guarantee.

The $110.3 billion appropriation for Proposition 98 funding for 2022-23, included $614 million above the Test One guarantee level, for state preschool, TK-12 public education, and community colleges, per the 2021-22 Budget Act agreement to rebench the guarantee for Transitional Kindergarten eligibility expansion.

The Budget Act also projected a total of $9.5 billion in mandatory contributions to the Public School System Stabilization Account (Prop 98 Rainy Day Fund).

Governor's 2023-24 Budget

The Governor's Budget revises the state's projected Proposition 98 guarantee of $110.2 billion in 2021-22, up to $110.4 billion, an increase of $178 million in available one-time funding. The Governor's Budget revises the state's projected Proposition 98 guarantee of $110.3 billion in the current year, down to $106.9 billion, a decrease of $3.4 billion in one-time funding from the enacted 2022-23 Budget. Both the 2021-22 and 2022-23 Budget years remain in a Test One calculation.



Source: LAO

For 2023-24, the Governor's January Budget provides a total of $108.8 billion for Proposition 98 funding, $690 million above the Test One guarantee level, for state preschool, TK-12 public education, and community colleges. The $690 million reflects the Administration's TK enrollment projections in 2023-24, which will be covered in a later panel.

Proposition 98 Funding by Segment and Source
(Dollars In Millions, Except Funding Per Student)

	2021-22 Revised	2022-23 Revised	2023-24 Proposed	Change From 2022-23	
				Amount	Percent
K-12 Education					
General Fund[a]	$71,130	$69,294	$70,489[b]	$1,195	1.7%
Local property tax	23,273	24,241	25,393	1,151	4.7
Subtotals	($94,403)	($93,535)	($95,881)	($2,346)	(2.5%)
California Community Colleges					
General Fund	$8,790	$8,713	$8,758	$45	0.5%
Local property tax	3,512	3,648	3,811	164	4.5
Subtotals	($12,301)	($12,360)	($12,569)	($209)	(1.7%)
Reserve Deposit/Withdrawal (+/-)[c]	$3,710	$1,096	$365	-$730	-66.7%
Totals	**$110,415**	**$106,991**	**$108,816**	**$1,825**	**1.7%**
Enrollment					
K-12 attendance	5,348,132	5,512,717	5,468,175	-44,542	-0.8%
Community college FTE students	1,107,128	1,106,951	1,106,451	-500	—
Funding Per Student					
K-12 Education	$17,652	$16,967	$17,534	$567	3.3%
California Community Colleges	11,111	11,166	11,360	194	1.7

[a] Includes funding for instruction provided directly by state agencies and the portion of State Preschool funded through Proposition 98.
[b] Excludes $941 million supplemental payment associated with Proposition 28 (2022).
[c] Proposition 98 Reserve established by Proposition 2 (2014). Amounts consist entirely of General Fund.

FTE = full-time equivalent.

Source: Legislative Analyst's Office

The January Budget continues to project historic levels of TK-12 ongoing per-pupil spending, at $128.5 Billion in 2023-24 from all funding sources, at a funding rate of $23,723 per student.

The January Budget also assumes the rebenching of Proposition 98 in 2024-25 for the inclusion of almost one billion in annual arts education funding, as authorized by the voters in 2022 through Proposition 28. This spending proposal will be covered the March 29, 2023 hearing.

Despite reductions to the multi-year surplus projections, the Governor proposes a total of $6.4 billion in new Proposition 98 spending. $376 million are one-time proposals, and $6 billion are ongoing proposals.

Governor's Budget Contains $5.2 Billion in K-12 Proposition 98 Spending Proposals

(In Millions)

Ongoing Local Control Funding Formula (LCFF)	
Statutory COLA (8.13 percent)	$5,691
Baseline attendance changes	-1,575
Transitional kindergarten expansion	690
Transitional kindergarten staffing ratios	165
Equity multiplier	300
Subtotal LCFF	($5,272)
Other Ongoing Spending	
COLA for select categorical programs (8.13 percent)[a]	$669
State Preschool for students with disabilities	64
Access to opioid overdose reversal medication	4
K-12 High Speed Network	4
California College Guidance Initiative	4
Preschool assessment tool	1
Fiscal Crisis and Management Assistance Team	1
Subtotal Other Ongoing	($746)
New One-Time Spending	
Literacy coaches and reading specialists	$250
Arts and cultural enrichment	100
Charter School Facility Grant Program	30
CCEE adjustment for unspent prior year funds	-4
Testing consortium membership fee	1
Update to digital learning and standards integration guidance	0.1
Subtotal One-Time	($376)
Reductions to Existing Spending	
Arts, Music, and Instructional Materials Discretionary Block Grant	-$1,174
Total K-12 Spending Changes	**$5,221**

[a] Applies to Special Education, State Preschool, Child Nutrition, K-12 mandates block grant, Charter School Facility Grant Program, Foster Youth Program, American Indian education programs, and Adults in Correctional Facilities.

COLA = cost-of-living adjustment and CCEE = California Collaborative for Educational Excellence.

LEGISLATIVE ANALYST'S OFFICE

Public School System Stabilization Account (PSSSA)

Proposition 2 (2014) established the PSSSA or "Prop 98 Rainy Day fund", a constitutional reserve account within Proposition 98. The purpose of this reserve is to set aside some Proposition 98 funding in relatively strong fiscal times to mitigate funding reductions during economic downturns. The PSSSA can grow to a maximum of 10% of the Proposition 98 guarantee in the Budget Year. A deposit to the PSSSA was first triggered by these requirements in the 2019-20 budget when $376 million was deposited, which was then drawn out of the reserve by new estimates in the 2020-21 Budget Act.

The 2021-22 budget plan deposited $4.5 billion into this account - $1.9 billion related to 2020-21 and $2.6 billion related to 2021-22. The deposits also triggered a statutory cap on school district reserves in 2022-23. The local cap applies the year after the balance in the PSSSA reserve exceeds 3 percent of the Proposition 98 funding allocated to K-12 schools. The cap prohibits medium and large districts—those with more than 2,500 students—from holding general purpose reserves that exceed 10 percent of their annual expenditures. Districts can respond to the cap by designating their reserves for specific purposes, seeking exemptions from their county offices of education (COEs), or spending down their reserves.

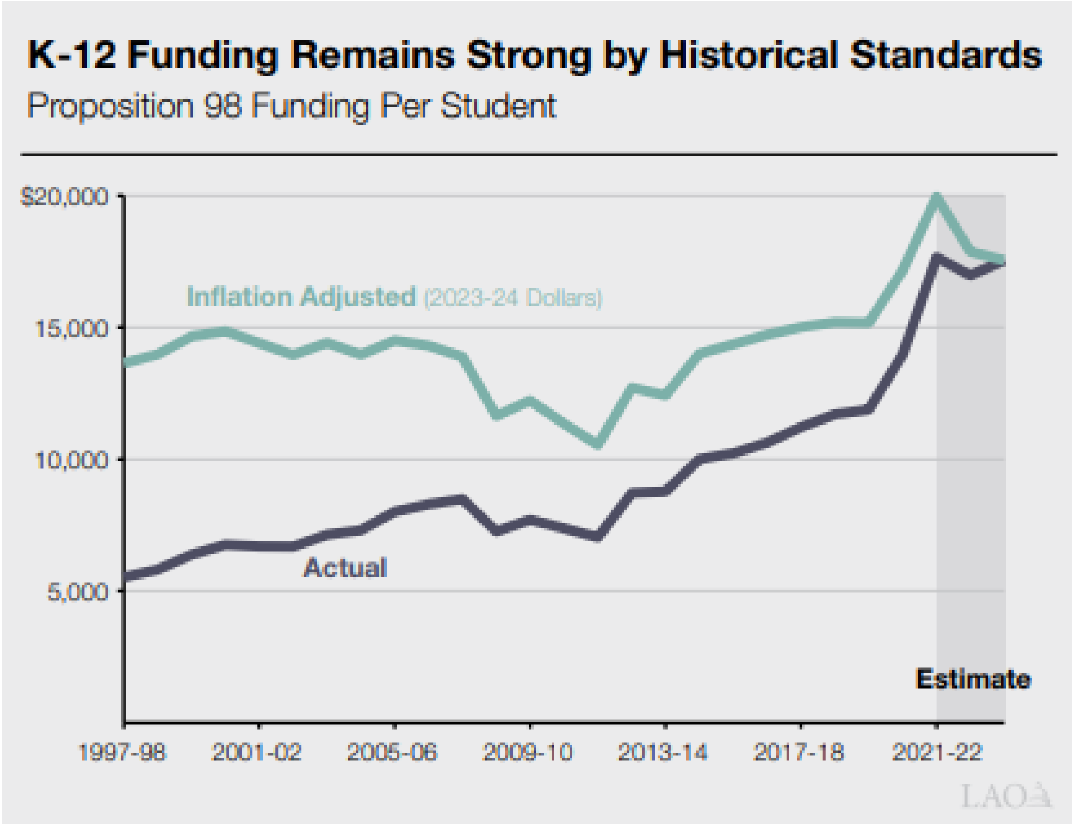
The Administration now estimates the state is required to make a reduced contribution of $8.4 billion through the Budget year. The January Budget increases the 2021-22 allocation to the Public School System Stabilization Account to $3.7 billion, reduces the 2022-23 allocation to $1.1 billion, and assumes a $365 million 2023-24 allocation.

The current Rainy Day fund balance estimate continues to trigger the statutory 10% cap on local school district reserves. When the local reserve cap went into effect in 2022-23, the LAO estimated that approximately 265 LEAs statewide would be impacted, based on a state review in 2019-20 of LEA reserve levels: at the end of the 2019-20 fiscal year, districts held a total of $13.6 billion in unrestricted reserves.

Two Reserve Withdrawal Options. The Constitution requires the state to withdraw funds from the reserve if the guarantee is below the prior-year funding level, as adjusted for student attendance and inflation. The amount withdrawn equals the difference between the prior-year adjusted level and the actual guarantee, up to the full balance in the reserve. If the Governor declares a budget emergency, the Legislature may withdraw any amount from the reserve or suspend required deposits. Unlike other state reserve accounts, the Proposition 98 Reserve is available only to supplement the funding schools and community colleges receive under Proposition 98.

LAO Comments

School Funding Remains Relatively Strong Despite Tighter Budget Picture. Although the Governor's budget reflects a decrease in the guarantee relative to the previously enacted budget, Proposition 98 funding remains strong by historical standards. Between 2019-20 and 2021-22, the minimum guarantee grew by $31.1 billion (39.2 percent)—the fastest increase over any two-year period since the passage of Proposition 98 in 1988. Overall funding for schools remains relatively high even though the drop in 2022-23 erodes some of this gain. The graph below illustrates this point by showing how funding per student under the Governor's budget compares with funding over the previous 25 years.



Modest Growth in the Guarantee After the Budget Year. Under the Administration's estimates, the Proposition 98 guarantee would increase by an average of 3.9 percent per year from 2023-24 through 2026-27. By 2026-27, the guarantee would grow to $122.2 billion, an increase of $13.4 billion over the 2023-24 level. Of this increase, $9.9 billion (74 percent) is attributable to growth in the General Fund portion of the guarantee and $3.5 billion (26 percent) is attributable to growth in local property tax revenue. Test 1 would remain operative each year of the period. The 3.9 percent annual increase in the guarantee is somewhat below the historical average—growth in the guarantee since the adoption of Proposition 98 in 1988 has averaged 5.5 percent per year. This lower growth rate primarily reflects the administration's estimate that economic growth will be moderate after multiple years of rapid growth.

General Fund Revenue in 2022-23 and 2023-24 Likely Lower Than Administration's Estimates. Although the Governor's budget contains lower revenue estimates than the budget the state adopted in June, we think revenues are likely to drop even further. For 2022-23, we estimate the probability that General Fund revenues fall below the level in the Governor's budget is nearly 80 percent. Our best estimate is that revenues would be about $5 billion lower, though the decrease easily could be several billion dollars more or less than this estimate. For 2023-24, we think revenues are likely to remain roughly flat relative to our lower 2022-23 estimate. Compared with the Governor's budget estimate for 2023-24, this level of revenues would represent a reduction of approximately $5 billion.

Reductions in General Fund Revenues Would Reduce the Guarantee. Our analysis indicates Test 1 is likely to remain operative for all three years of the budget period, even if General Fund revenue varies significantly from the levels in the Governor's budget. In Test 1 years, the guarantee increases or decreases about 40 cents for each $1 of higher or lower revenue.

Proposition 98 Reserve Provides Some Cushion Against Revenue Declines. Changes in revenue estimates and the minimum guarantee likely would affect the amount of funding the state is required to deposit in the Proposition 98 Reserve. A relatively modest revenue reduction occurring in 2022-23 or 2023-24 likely would reduce or eliminate the required deposit in the year the reduction occurs. If the revenue reduction were significant— especially in 2023-24—the state might be required to make an automatic withdrawal. These changes in the Proposition 98 Reserve would help mitigate the effects of a drop in the guarantee on school and community college programs.

Growth in Guarantee Might Not Be Enough to Support Full COLA in 2024-25. Although the administration anticipates the Proposition 98 guarantee will grow 3.9 percent annually over the next four years, some of that increase is reserved for specific program expansions—most notably, the expansion of transitional kindergarten and new funding for arts instruction under Proposition 28. After accounting for these costs and various other adjustments, we estimate the annual growth in the guarantee available to fund COLA or other new commitments would be about 3.2 percent. Using the administration's assumptions about the guarantee and future COLA rates, we estimate the guarantee would be about $500 million short of the amount required to cover the COLA in 2024-25. In that scenario, the administration would have the authority under existing law to reduce the COLA to rate to fit within the available funding. For 2025-26 and 2026-27, we estimate the guarantee would be just above the level necessary to fund the COLA under the administration's assumptions. All of these calculations are sensitive to small changes in assumptions about the economy

STAFF COMMENTS

The Proposition 98 guarantee estimate for the 2023-24 Budget Year is $1.6 billion lower than the enacted 2022-23 Budget Act. However, the current year budget includes $2.8 billion in one-time TK-12 expenditures and PSSSA deposit assumptions that provide room for on-going growth between the two fiscal years.

Based on updated revenue forecasts, the multi-year surplus inside the Proposition 98 guarantee has decreased by $4.7 billion. January Budget solutions only address a portion of this reduction in revenue projections.

Protect Priorities. The final Budget deal created a one-time spending buffer inside the 2022-23 Proposition 98 guarantee of over $3 billion, and a multi-year one-time spending package of over $15 billion. While the January Budget does not propose eliminating or delaying most of these one-time expenditures, the estimated $3.4 billion one-time shortfall will require a re-prioritization of investments over the multi-year budget forecast. The Assembly's commitment to protect ongoing classroom funding may require a reexamination of all one-time appropriations.

Define a Rainy Day. The Subcommittee may want to consider what fiscal threshold warrants reserve withdrawals. Are there any one-time programs that need to be protected with reserves, or should only ongoing cuts be prevented? Is full COLA in the Budget Year and out years worthy of reserve funding, if the Guarantee is insufficient?

Suggested Questions:

- In light of the 13.7% LCFF increase in the 2022-23 Budget Act, and overall funding increase of 15%, how is that increase translating in local budgets?

- How are LEAs responding to the local reserves cap, triggered for the 2022-23 fiscal year?

- Does the Administration have threshold criteria for utilizing the Prop 98 Rainy Day fund, PSSSA?

Staff Recommendation: HOLD OPEN.

The current year and Budget Year Proposition 98 funding levels and relevant proposals will be considered as part of the Final Budget guarantee estimate.

ISSUE 2: UNIVERSAL TRANSITIONAL KINDERGARTEN ENROLLMENT & "REBENCH"

This issue will cover the Governor's Budget proposals on Universal Transitional Kindergarten (UTK) enrollment, as it impacts the Proposition 98 guarantee.

PANEL

- Amanpreet Singh, Department of Finance
- Kenneth Kapphahn, Legislative Analyst's Office
- Sarah Neville Morgan, California Department of Education

BACKGROUND

The Governor's Budget maintains the state's 2025-26 goal for full UTK implementation, and provides $1.2 billion in new, ongoing funding to expand Universal Transitional Kindergarten (UTK) access in the Budget Year. $690 million General Fund is proposed to "rebench" the Proposition 98 guarantee for an estimated 46,000 new universal TK enrollments in 2023-24.

$165 million Proposition 98 is also proposed to maintain decreased UTK ratios at 1:12, adults to children. This ratio funding and policy will be covered in the March 21, 2023 early childhood education hearing.

Rebenching the Proposition 98 Guarantee

The 2021-22 Budget agreement included shared Administrative and Legislative intent to "rebench" the Proposition 98 guarantee to accommodate the growth of ADA for Universal Transitional Kindergarten (UTK). This agreement and statutory timeline would add new UTK enrollment in Budget years 2022-23, 2023-24, 2024-25, and 2025-26. The intent is that the Proposition 98 guarantee would be rebenched in each year of statutory UTK enrollment growth, to reflect the actual costs of the new grade's ADA.

The intent of the rebenching agreement is to create adequate room inside the guarantee in each year TK enrollment is required to expand in statute, and then adjust for actual enrollment changes.

Modifications to the Proposition 98 guarantee calculations under either of the three "tests" are commonly known as rebenchings. The state constitution is silent on whether the Proposition 98 minimum guarantee can be adjusted to account for policy changes, but a rebench has been adopted in prior years to prevent certain state actions from having unintended consequences on the Proposition 98 minimum guarantee.

In recent rebenching budget actions, the state rebenched the total Guarantee for the current value of the shift, thereby ensuring that it achieved an associated dollar–for–dollar impact. For example, the removal of child care programs from the Proposition 98 calculation resulted in a $1.1 billion reduction in the guarantee, and the shift of responsibility for student mental health services from counties to school districts resulted in a $222 million increase in the guarantee.

In the final 2022-23 Budget Act the rebench for TK was $614 million above the budget year's Test One guarantee calculation, to reflect an estimated 56,000 increase in TK average daily attendance (ADA) for the Budget Year. The Governor's Budget adjusts the 2022-23 guarantee rebench and funding to $604 million, compared to $614 million in the enacted Budget. This proposal is in alignment with updated TK enrollment data, and may be further adjusted in the May Revision.

STAFF COMMENTS

Estimating TK Growth. Prior to the COVID pandemic, enrollment trends were relatively stable and predictable. However, in addition to pre-COVID declining enrollment, California experienced a significant drop in school-age population and enrollment since 2020; the long term implications of this school enrollment drop is yet unknown.

According to DOF, out-migration and COVID deaths account for most of California's population "loss." Of the approximately 600K Californians lost from our state population count since 2020, DOF has detail on approximately 280K: Of those 280K individuals, approximately 80K are school-aged; 130k are of childbearing age (between 18 and 40 years); and about 70K are over 40 years of age. Over 100K Californians were lost to COVID deaths. DOF has updated and adjusted their demographic projections for these new trends.

In addition to population shifts, California experienced a school enrollment drop, disproportionate to out-migration. This school enrollment drop is reported nationwide, across all school types – private and public.

In addition to predicting enrollment patterns, UTK is struggling with "take-up" rate predictions. States with universal Preschool program offerings see a wide range of enrollment rates, based on a multitude of factors that impact parent choice. Prior to COVID, TK "take-up" rates had risen to over 70% of eligible children.

Rebenching in a Recession. The final UTK rebench in any budget year is intended to reflect actual enrollment growth. The Administration estimates that the full price tag for new enrollment will be approximately $3 billion through 2025-26. Recent budgets have enjoyed both General Fund and Proposition 98 growth and surplus: as economic growth slows, the availability of General Fund for the rebench may come at a steep cost to programs funded outside the Proposition 98 guarantee.

According to DOF, the annual variance in rebenching could range from $50 million to $200 million a year, based on the factors above.

The Rebench Split. According to DOF, the Governor's Budget proposes to maintain the Proposition 98 split between TK-12 schools and community colleges at 89.07% for TK-12 and 10.93% for community colleges across the budget window. Funding for other education agencies, adult education, adults in correctional facilities, and the K-12 adults in correctional facilities is taken off the top before computing this split.

Because the cost of expanded TK is unique to TK-12 schools, the reason for making this rebench subject to a split with community colleges is unclear.

Early & Accelerated UTK Plans. According to the Learning Policy Institute, many large LEAs report plans to accelerate their new TK enrollment, including Long Beach, Los Angeles, San Diego, and Fresno USDs. These LEAs are offering TK enrollment to children younger than the statutory expansion timelines. While these younger students do not earn ADA in the Budget Year, they may impact near-term enrollment counts dramatically.

The current year and Budget Year Proposition 98 funding levels and relevant proposals will be considered as part of the Final Budget guarantee estimate.

Suggested Questions:

- If the TK rebench is intended to accommodate TK enrollment growth, why is the funding subject to a split with Community Colleges?

- What is the estimated enrollment growth from LEAs enrollment students outside the statutory window? Should the TK growth methodology take into consideration the large LEAs on accelerated implementation timelines?

- What is the first year UTK cohort's "take-up" rate? How does this compare to other states' universal preschool rates?

- What are LEAs doing to promote UTK enrollment?

- With economic softening, what is risk of under-estimating the rebench and ratio needs in the Budget Year?

Staff Recommendation: HOLD OPEN.

ISSUE 3: COLA & LOCAL CONTROL FUNDING FORMULA

This panel will provide an overview of the Local Control Funding Formula (LCFF) for public schools, and Governor's Budget proposals for cost of living adjustments to the Formula and categorical programs. The proposed LCFF accountability system changes and equity multiplier will be covered in the April 11, 2023 hearing.

PANEL

- Michael Alferes, Legislative Analyst's Office
- Katie Lagomarsino, Department of Finance
- Mary Nicely, California Department of Education

BACKGROUND

The bulk of funding for school districts and county offices of education for general operations is provided through the Local Control Funding Formula (LCFF) and is distributed based on the numbers of students served and certain student characteristics, including grade, income, and home language. The state first fully funded the LCFF in 2018-19 and has annually adjusted the LCFF base grant amounts by a cost-of-living adjustment (COLA).

The LCFF is based on student average daily attendance (ADA). The state allocates LCFF funding to school districts and charter schools based on their ADA—the average number of students in class each day throughout the school year. The 2022-23 Budget Act adjusted this historical calculation for non-charter LEAs: the state credits school districts with their ADA in the current year, prior year, or the average of three prior years, whichever is higher.

Please see Attachment A for a comprehensive LAO overview of the Local Control Funding Formula.

Overview of the Local Control Funding Formula
(In Billions)

Components	Description	2022-23 Funding (LAO Estimates)
Base grant	Provides a uniform level of funding per student in different grade spans. Includes two grade span adjustments—one for smaller class sizes in grades K-3 and one to acknowledge costs of providing career technical education in high schools. Beginning in 2022-23, also includes additional funding for students in transitional kindergarten.	$60.8
Supplemental grant	Provides an additional 20 percent of the adjusted base grant rate for each student that is an English learner, low income, or foster youth.	7.5
Concentration grant	Each English learner, low-income student, and foster youth above 55 percent of enrollment generates an additional 65 percent of the adjusted base rate.	5.5
	Total, Main Components	**$73.8**
Add-ons	Includes Targeted Instructional Improvement Block Grant, Home-to-School Transportation, Economic Recovery Target, Education Protection Account, and Minimum State Aid.	$1.7
	Total	**$75.5**

2 LEGISLATIVE ANALYST'S OFFICE

Statute requires a Cost-of-Living Adjustment (COLA) for LCFF. The COLA rate is based on a price index published by the federal government. This index reflects changes in the cost of goods and services purchased by state and local governments across the country. State law provides an automatic COLA for LCFF unless the constitutionally required Proposition 98 funding level is insufficient to cover the associated costs. In these cases, the law reduces the COLA rate to fit within the available funding. The state applies the COLA to LCFF by increasing the grade span base rates, necessary small schools rates, and the transitional kindergarten staffing adjustment. These rate increases also result in proportional increases to the grade span adjustments and supplemental and concentration grants, since the value of these components are funded as a percentage of the base grant.

Recent Budget Acts have made two notable changes related to how supplemental and concentration grant funding must be spent:

1) Statute now includes a new requirement that districts track their unspent supplemental and concentration grant funding and use the funding to increase or improve services for English Learning/Low Income (EL/LI) students in future years.

2) The concentration grant rate was increased from 55 percent to 65 percent of the base grant, with a requirement that the associated increase in funding must be used by school districts to increase the number of staff that provide direct services to students in schools where more than 55 percent of students are EL/LI.

2022-23 Budget Act

The 2022-23 Budget Act increased ongoing LCFF funding by $9.8 billion, including an 13.7 percent LCFF base increase, compared to the 6.56% statutory COLA. Categorical programs received the statutory COLA.

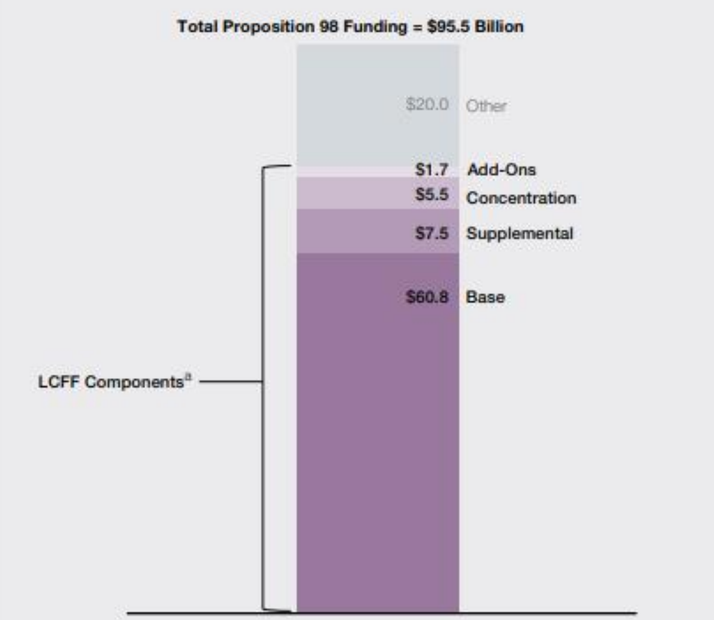
In addition to the new three year rolling ADA average, the Budget also created a one time "boost" payment for school districts and County Offices of Education that implemented independent study offerings consistent with state law, but still experienced steep ADA declines in the 2021-22 school year. This one-time payment adjusted the LEA's 2021-22 ADA to their pre-pandemic, 2019-20 level. According to CDE, approximately 800 LEAs certified their eligibility for, and received the "boost" calculation for their 2021-22 ADA. Charter schools received a one-time hold harmless for ADA.

The 2022-23 budget package included two major changes to how the state funds school transportation. Beginning in 2023-24, the existing Home to School Transportation (HTS) add-on will receive the same COLA as the rest of LCFF. The budget also established a new funding stream, beginning in 2022-23, for school districts and county offices of education (COEs) to be reimbursed for 60 percent of eligible transportation expenditures they reported in the previous year. For 2022-23, the cost of the new transportation increases is estimated to be $637 million.

Figure 6

LCFF Represents Majority of Proposition 98 Funding for K-12 Education

2022-23 (In Billions)



[a] Reflects LCFF funding for school districts and charter schools.
LCFF = Local Control Funding Formula.

Source: LAO

Governor's 2023-24 Budget Proposals

The January Budget provides an increase of $4.972 billion in Proposition 98 funding for the Local Control Funding Formula (LCFF), reflecting new UTK enrollment and an 8.13% percent cost-of-living adjustment (COLA) in 2023-24. Total Budget Year LCFF is estimated at $80.035 billion.

The January Budget proposes an "equity multiplier" and corresponding changes to the LCFF accountability system that will be covered in the April 11, 2023 hearing.

The Governor's Budget also provides $669 million for an 8.13% COLA to statutorily-required TK-12 programs, including Special Education, Child Nutrition, State Preschool, Youth in Foster Care, Mandates Block Grant, Adults in Correctional Facilities Program, American Indian Education Centers, and the American Indian Early Childhood Education Program. The new state Expanded Learning Opportunities Program does not receive a COLA under the proposal.

LAO Comments

Lower Local Control Funding Formula (LCFF) Costs Over the Period Due to Attendance-Related Adjustments. For 2021-22, data published by the California Department of Education last year show that costs for LCFF were $471 million lower than the state's previous estimate. For 2022-23, the administration estimates LCFF costs are $1.3 billion below the level it estimated last June. This lower estimate primarily reflects (1) the lower costs in the prior year carrying forward, and (2) an increase in the estimate of the savings from the phaseout of districts' pre-pandemic attendance levels within the three-year rolling average calculation the state adopted last year. This phaseout will continue in 2023-24 and 2024-25. For 2023-24, the administration estimates that baseline costs for LCFF will decrease by an additional $1.6 billion relative to the lower 2022-23 level.

Dedicates Most Ongoing Funds to Covering Statutory Cost-of-Living Adjustment (COLA). The state calculates the statutory COLA each year using a price index published by the federal government. This index reflects changes in the cost of goods and services purchased by state and local governments across the country during the preceding year. For 2023-24, the administration estimates the COLA rate is 8.13 percent. The Governor's budget includes $5.7 billion to cover the associated increase for LCFF. It also funds the same COLA for various categorical programs. The COLA rate for 2023-24 would build upon the 13.26 percent increase the state provided in 2022-23, which was approximately twice the statutory rate that year.

Statutory COLA Rate for 2023-24 Likely to Be Slightly Higher by May. On January 26, the federal government published a new quarter of data affecting the calculation of the COLA rate. Based on the new data and our latest projections, we estimate the statutory COLA rate in 2023-24 is 8.4 percent. Covering this higher rate would increase ongoing costs for LCFF and other K-12 programs by approximately $220 million (relative to the Governor's budget).

Administration Anticipates Much Lower COLAs After 2023-24. The administration's economic forecast anticipates inflation will moderate significantly later this year. Consistent with this assumption, the administration estimates the statutory COLA rate for 2024-25 is 3.54 percent. For 2025-26 and 2026-27, the administration anticipates COLA rates of about 3.3 percent and 3.2 percent, respectively. These COLA rates are slightly above the historical average over the past 20 years (2.8 percent).

STAFF COMMENTS

Steep Enrollment Loss Impacts. The ADA hold harmless and rolling average policies in the 2020-21 and 2022-23 Budget Acts appear crucial for the stabilization of the public education system during this pandemic and post-pandemic period. While it is still unknown at this time how the pandemic student enrollment decline will manifest in future years, the lack of enrollment recovery and continued steep declines in the current year raise significant concerns for LEA budgets in 2023-24.

Regardless of the near-term package of state and regional supports necessary to support student re-engagement and recovery from the academic and social emotional impacts of the COVID-19 pandemic, the state must also explore how to ensure enrollment rebounds due to Universal Transitional Kindergarten do not mask student withdrawal patterns at the local and state level. Data trends, by grade and student group will require multi-year analyses for state and school-based decision making.

Ongoing ADA crisis. While the impacts on students from chronic absenteeism will be covered in a future hearing, the fiscal impacts of ongoing absenteeism are also enormous. Statewide absence rates are hovering over 30%, compared to the 5% average pre-pandemic.

The Budget Year LCFF and COLA funding levels and relevant proposals will be considered as part of the Final Budget guarantee estimate.

Suggested Questions:

- What are LEAs doing to address chronic absenteeism and prevent impacts to their ADA?
- Are students returning to formal school, post-pandemic? Or are we still missing large groups of students? Where did they go?
- Are there remaining barriers to alternative education options, like Independent Study?

Staff Recommendation: HOLD OPEN.

ISSUE 4: FISCAL CRISIS MANAGEMENT ASSISTANCE TEAM

This panel will provide an overview of the January Budget proposal relative to the state's Fiscal Crisis Management Assistance Team.

PANEL

- Katie Lagomarsino, Department of Finance
- Kenneth Kapphahn, LAO
- Mary Nicely, CDE

BACKGROUND

AB 1200 (Chapter 1213, Statutes of 1991) created an early warning system to help local educational agencies (LEAs) avoid fiscal crisis, such as bankruptcy or the need for an emergency loan from the state. AB 1200 expanded the role of county offices of education (COEs) in monitoring school districts and requires that they intervene, under certain circumstances, to ensure districts can meet their financial obligations. AB 1200 also created the Fiscal Crisis and Management Assistance Team (FCMAT), recognizing the need for a statewide resource to help monitoring agencies in providing fiscal and management guidance.

FCMAT's work is divided into six categories:

Management Assistance (EC 42127.8(d)(1)) for K12 and community colleges. The work is focused on preventive measures and solving LEA-specific issues at the lowest level before they grow. A significant portion of management assistance is requested by the LEA and supported on a fee for service model. A smaller portion of management assistance is performed under the automatic triggers and is limited to Fiscal Health Risk Analysis studies supported by state appropriations. Management assistance can include interventions driven by fiscal distress. All management assistance work culminates in a written report posted on the FCMAT website.

Professional Learning (includes Product Development) (EC 42127.8(d)(2) – (4)) for K12 and community colleges. Training is provided directly by FCMAT and in collaboration with private partners. Training provided directly by FCMAT is provided free of charge to LEA personnel. Professional learning includes traditional training sessions (i.e., fiscal oversight training), year-long programs (i.e., CBO Mentor Program), the provision of application-based tools (i.e., LCFF calculators and Projection-Pro), and manuals and guides. Professional Learning is a key element of FCMAT's focus on preventive measures; ensuring the most qualified personnel with the right training and tools are in positions such as CBO.

AB 139 Reviews (EC 1241.5) for fraud, misappropriation of funds and other illegal fiscal practices in school districts and charter schools. While statute does not designate FCMAT as the provider of AB 139 reviews, the budget does make an annual appropriation to FCMAT to reimburse county superintendents for the work. FCMAT provides nearly one-hundred percent of the AB 139 reviews.

Fiscal Crisis (EC 41320 – 41329) includes numerous aspects of assisting and evaluating school districts in fiscal crisis. This work can best be summarized as work in various stages of fiscal crisis leading to receivership including pre-receivership activities, receivership activities, comprehensive reports, identifying and vetting trustee/administrator candidates and providing general counsel.

California School Information Services (CSIS) (EC 49080) is a service of FCMAT. CSIS work includes an annual scope of work in partnership with CDE for the California Longitudinal Pupil Achievement Data System (CALPADS) and product development, maintenance and operations for the Standardized Account Code Structure (SACS) System Replacement Project. CSIS plays an integral role in the new Cradle-to-Career Data System (C2C) Governing Board, with the CSIS's chief operating officer serving as the C2C board chair. CSIS developed and maintains the Ed-Data.org website, and provides technical support for the internal operations of both FCMAT and, under contract to, the California Collaborative for Educational Excellence (CCEE).

Other includes the overall governance and leadership of the organization (EC 42127.8), interface with state and private partners, internal accounting and planning. This includes the annual J90 reporting (Salary and Benefit Schedule for the Certificated Bargaining Unit) capturing information from 80% of school districts and county offices of education covering 95.6% of non-charter ADA. Further, the "other" category includes FCMAT's role with the Education Audit Appeals Panel (EAAP) (EC 14502.1, 41344 and 41344.1).

Total FCMAT and CSIS full-time staff capacity stands at 86.5, all funded through the Proposition 98 guarantee to the Kern County Office of Education.

FCMAT publishes an annual report each fall summarizing the activities of the prior fiscal year and providing other relevant information about the organization:
https://www.fcmat.org/PublicationsReports/FCMAT_Annual_Report_2021-22.pdf

Governor's 2022-2023 Budget

The Governor's Budget proposes an ongoing augmentation of $750,000 Proposition 98 funding to the FCMAT to expand one Professional Learning program and create two new programs:

Coaching and Induction Program (CIP): The FCMAT CBO Coaching and Induction Program has been created to support California's school districts in addressing the need for well-trained, professional CBOs. This yearlong program provides new LEA Chief Business Officials (CBOs) a combination of a monthly two-day instructional component with an on-the-job professional coach. The curriculum is matched to the day-to-day challenges a CBO may face in the annual "cycle" in the role. The FCMAT Fiscal Health Risk Analysis (FHRA) is also a featured component of the curriculum; each participant will complete the entire FHRA for their LEA by the conclusion of the course, guided by the content experts, their peers and their coach. According to FCMAT, it is commonplace in LEAs for superintendents, principals and other executive leaders to have professional coaches. However, generally speaking, CBOs have been left out of that opportunity. FCMAT pays the coaches a stipend of $7,500 for each participant they are coaching. Each coach has from one to five participants. FCMAT intends to support 25 individual CBOs annually. For more information on the CIP visit the FCMAT website at:https://www.fcmat.org/cbo-coaching.

Small School District CBO Mentor Program: FCMAT is recommending that an additional CBO Mentor Program be developed and offered to build and improve school business leadership capacity and fiscal accountability in small school districts. FCMAT envisions a program structured identically to the existing CBO Mentor Program but with adjustments to the curriculum and the experience of the mentors to be small district specific. The plan is to offer the program on an annual basis (January to December) serving approximately 25 participants. More than half of all California LEAs are small – 2,500 ADA or less.

Community College CBO Mentor Program: Funds are requested for planning this new program in 2023-24. This new program would be identical in all ways to the long-standing CBO Mentor Program except the curriculum would be adjusted to be specific to community colleges. There is already a training program provided by the Association of Chief Business Officials (ACBO). This program would supplement the ACBO program with California specific, leadership training. The program would be developed in collaboration with ACBO and the chancellor's office.

The existing FCMAT CBO Mentor and CIP programs are application based. The application requires a nomination from a knowledgeable peer with district superintendent concurrence. While not frequent, some cohorts may include participants given a priority because of their role in a district in fiscal distress, experiencing low staff capacity or other indicators of risk where the program becomes a part of the district's efforts to create stability in leadership, capacity and fiscal status. FCMAT normally receives approximately 80 applications per year for the long-standing CBO Mentor Program.

STAFF COMMENTS & QUESTIONS

Basic State Role? LEAs spend millions annually to unpack the intent and implementation requirements of Budget Act funding and policy changes. Both the Department of Education and FCMAT provide intensive professional support during this annual cycle, as well as competency-building for new CBOs. The capacity of both agencies should be examined more comprehensively, to achieve this basic state role.

In light on the unknown revenue and Proposition 98 guarantee volatility, all new Proposition 98 spending proposals will be considered in the context of May Revision.

Suggested Questions:

- Is this FCMAT capacity expansion adequate to address CBO demand for state support?
- Is existing statute adequate to encompass this expansion of Professional Learning/Development responsibilities?

Staff Recommendation: HOLD OPEN.

Issue 5: STATE OF SCHOOL FISCAL HEALTH (INFORMATION ITEM ONLY)

The Fiscal Crisis and Management Assistance Team (FCMAT) is California's public resource to monitor and guide Local Education Agency fiscal health. This hearing will provide FCMAT's annual address to update the Assembly on the state of school fiscal health.

PANEL

- Michael Fine, Fiscal Crisis and Management Assistance Team

BACKGROUND

AB 1200 (Chapter 1213, Statutes of 1991) created an early warning system to help local educational agencies (LEAs) avoid fiscal crisis, such as bankruptcy or the need for an emergency loan from the state. AB 1200 expanded the role of county offices of education (COEs) in monitoring school districts and requires that they intervene, under certain circumstances, to ensure districts can meet their financial obligations. AB 1200 also created the Fiscal Crisis and Management Assistance Team (FCMAT), recognizing the need for a statewide resource to help monitoring agencies in providing fiscal and management guidance.

There are several defined "fiscal crises" that can interventions in a district: a disapproved budget, a qualified or negative interim report or recent actions by a district that could lead to not meeting its financial obligations. The interim reports must include a certification of whether or not the LEA is able to meet its financial obligations. The certifications are classified as positive, qualified, or negative.

- A positive certification is assigned when the district will meet its financial obligations for the current and two subsequent fiscal years.

- A qualified certification is assigned when the district may not meet its financial obligations for the current or two subsequent fiscal years.

- A negative certification is assigned when a district will be unable to meet its financial obligations for the remainder of the current year or for the subsequent fiscal year.

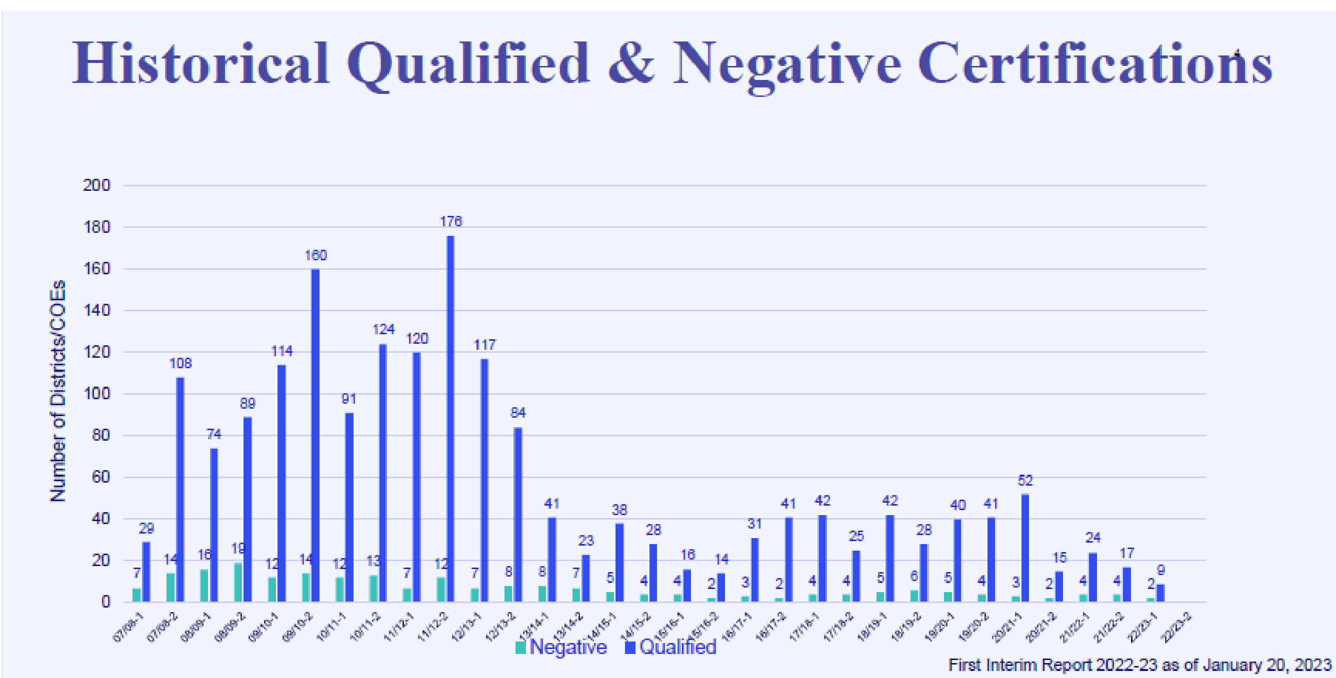
State of School Fiscal Health

FCMAT will provide more details in this hearing, however they have already provided preliminary information, as of the first interim report:

- 9 school districts received a qualified certification:
  - Byron Union ESD
  - Cabrillo USD
  - Del Norte County Office of Education
  - East San Gabriel ROP
  - Happy Camp Union ESD
  - Oakland USD
  - Pine Ridge
  - Santa Rosa ESD
  - Santa Rosa HSD

- Two school districts have been assigned a negative certification:
  - Junction Unified School District
  - Ojai Unified School District

- And additional seven LEAs are anticipated to have a “lack of going concern” designation, and no LEAs have a disapproved budget.



Source: FCMAT

Emergency Loans

In most cases, the assistance provided by county offices of education and FCMAT is sufficient to pull LEAs out of immediate financial trouble. The option of last resort for LEAs that have insufficient funds is to request an emergency loan from the state. This is often the result of years of deficit spending and budgetary issues.

An emergency loan can be provided by the state through a legislative appropriation. Accepting a state loan is not without consequence, however. The county superintendent assumes all legal rights, duties, and powers of the district governing board and an administrator is appointed to the district. Several conditions must be met before control is returned to the district. State loans are typically set up for repayment over 20 years and county control remains over the school district until the loan is fully repaid. The state loan is sized to accommodate the anticipated shortfall in cash that the district will need during the life of the loan in order to meet its obligations. In addition, all of the costs of ensuring a fiscal recovery are the responsibility of the district and are added to the amount of the state loan. Therefore, a state loan will be much larger than what the district would otherwise need to borrow locally if it had been able to solve its own fiscal crisis.

Since 1991, the state has provided nine districts with emergency loans. Inglewood Unified School District is the most recent LEA to receive emergency apportionments in 2012. Since 2019 Inglewood Unified School District and Oakland Unified School District have received additional state apportionments through AB1840 (2018). Oakland USD required a $10 million AB1840 additional apportionment in the 2021-22 Budget, and is continuing to struggle with forecasted deficits, despite robust one-time funds.

No new LEAs are recommended for state assistance at this time.

FCMAT will present on current solvency trends, including:

- Local LEA reserves generally higher than in Great Recession (22% vs 8% for USDs).
- Employer contribution rates to CalSTRS and CalPERS increasing.
- Inflationary pressures on cost side.
- Declining enrollment and continued low average daily attendance yields.
- Spend down of one-time pandemic-related funds.
- Slowing state revenues in near term years.
- Significant increase in liability claims against LEAs as AB 218 deadline approached; this has not been quantified as to impacts on LEA fiscal stability, but risk pools are being impacted.
- Most frequent condition among qualified certifications is declining enrollment, ADA yields not rebounding as expected; some outyear distress due to expiring one-time funds and exposure to deficits currently masked

TK-12 Pension Contributions

The 2020-21 Budget Act appropriated $1.15 billion to offset 2021-22 LEA employer pension contributions. For 2021-22, CalSTRS applied $820 million to reduce the employer rate from 18.1 percent to approximately 15.92 percent, and CalPERS applied $330 million to reduce the Schools Pool employer contribution rate from 24.9 percent to 23 percent. The expiration of this state contribution results in an increase to LEA employer contributions:

System	School Employer Contribution Rates		
	2021-22*	2022-23	2023-24**
CalPERS	22.91%	25.37%	27.00%
CalSTRS	16.92%	19.10%	19.10%

**Rate reflects supplanting payments.*
***Current projected rates.*

While this pension contribution offset was not extended in the final 2022-23 Budget Act, the discretionary Arts, Music, et al Block Grant does allow LEA employer pension costs as an expenditure.

The January Budget does not include a new proposal that offsets the LEA employer contribution rate, but does propose a $1.17 billion reduction to the Arts and Music Block Grant.

STAFF COMMENTS

It is unknown at this time whether LEAs have adequately updated their enrollment projections in the current year, Budget Year, and the out-years, for both steep enrollment declines and new UTK enrollment. It is also unclear whether LEAs have recalibrated their Budget-year and out-year planning for the billions in one-time, multi-year funding packages adopted in the 2021-22 and 2022-23 Budget Acts.

According to FCMAT, many LEAs are struggling with how to transition from one-time federal and state funds to ongoing plans, including use of Expanded Learning, UTK, and other new 21-22 and 22-23 Budget Act programs. FCMAT has also expressed concerns that one-time federal and state funds from prior Budget years are masking systemic LEA problems, including declining enrollments and attendance.

Staff Recommendation: Information Only.