

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

Assembly Member Susan Bonilla, Chair
TUESDAY, JANUARY 25, 2011
STATE CAPITOL, ROOM 444
9:00 AM

ITEMS TO BE HEARD

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ITEMS TO BE HEARD

6110 DEPARTMENT OF EDUCATION

ISSUE 1: 2011-12 GOVERNOR'S BUDGET PROPOSAL: PROPOSITION 98 FUNDING

The issue for the Subcommittee to consider is the Proposition 98 funding level for the 2011-12 Fiscal Year.

PANELISTS

- Department of Finance
- Legislative Analyst's Office
- California Department of Education

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. The Legislature can also choose to "overappropriate" (provide more than the minimum guarantee), or provide less through a two-third's vote to suspend the provisions of the law.

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. This minimum requirement must be met each year.

Test 2—Growth in Per Capita Personal. The Proposition 98 requirement is determined by growth in the economy (as measured by per capita personal income) and K-12 attendance. Applies in years when state General Fund growth is relatively healthy and formula yields more than under Test 1.

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.

The 2010-11 Budget Act invoked suspension of Proposition 98 and provided a statutory funding level of \$49.7 billion (\$4.1 billion less than the minimum guarantee for that year).

The basic underlying premise of Proposition 98 is to guarantee that per pupil funding keep pace with the cost of living (Test 2). In times of slow economic growth, when the state cannot 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 2010-11, the state had a maintenance factor obligation of \$9.6 billion.

GOVERNOR'S 2011-12 PROPOSAL: PROPOSITION 98

The Governor's budget proposes to provide \$49.3 billion in Proposition 98 funding for 2011-12, reducing overall Proposition 98 spending by less than 1 percent from the current year to the budget year. This is the minimum guarantee for 2011-12, assuming the adoption of the Governor's tax plan to raise \$4.8 billion in additional state General Fund revenues, primarily from the extension of higher personal income tax rates. Absent these additional revenues, the minimum guarantee would have fallen by \$2 billion year over year.

The Administration will provide testimony on the details of their plan and the Legislative Analyst's Office will provide the committee with a handout and comments on the Governor's proposal.

SUGGESTED QUESTIONS

- 1) What is the impact on Proposition 98 if the Governor's tax proposals are not passed by the voters? Does the Governor have specific proposals for K-12 education absent voter approval of the tax proposals?
- 2) What is the total maintenance factor obligation for 2011-12? Do the Administration and the LAO agree on this amount?
- 3) How does Proposition 98 funding compare with actual "programmatic funding" for schools in 2011-12?

ISSUE 2: 2011-12 GOVERNOR'S BUDGET PROPOSAL: K-12 GROWTH AND COST OF LIVING (COLA) ADJUSTMENTS

The issues for the Subcommittee to consider are the Governor's K-12 growth and COLA adjustments for 2010-11 and 2011-12.

PANELISTS

- Department of Finance
- Legislative Analyst's Office
- California Department of Education

BACKGROUND ON GROWTH

Revenue limits provide the primary source of funding assistance to K-12 public schools. These funds are discretionary and primarily cover the cost of personnel salaries. Funding is distributed to schools based on average daily attendance (ADA). Revenue limits were initially developed 30 years ago as a means of constraining growth in high revenue districts. After Proposition 13, the state used the revenue limit system to establish state funding levels.

Schools also receive funding through categorical programs. These programs provide a dedicated funding source for specific student populations or specific purposes such as special education or transportation.

Most K-12 education programs – revenue limits and categorical programs -- receive year-to-year statutory growth adjustments. These enrollment growth rates reflect the estimated changes in student attendance. Categorical programs typically receive enrollment growth at budgeted rates; revenue limits, which are continuously appropriated, receive growth at adjusted rates.

After declining for four out of five years (between 2005-06 to 2009-10), the number of students in K-12 schools is estimated to increase for both the 2010-11 and 2011-12 fiscal years. For 2010-11, the overall number of students in K-12 schools is estimated to increase by 18,065 bringing total K-12 ADA to 5,951,826. For 2011-12, DOF estimates K-12 ADA will increase by an additional 12,974 to 5,964,800 in 2011-12.

2010-11 Growth Adjustments:

- **Revenue limit adjustments.** The Governor's budget proposes a net increase of \$357.5 million to fund enrollment growth in 2010-11 for school district and county office of education (COE) revenue limits as a result of an increase in projected ADA. Specifically, school district revenue limits would receive an increase of \$389.2 million however COE revenue limits would receive a reduction of \$31.7 million.
- **Categorical program adjustments.** The Governor proposes no growth adjustments to the 2010-11 fiscal year for categorical programs.

2011-12 Growth Adjustments:

- **Revenue limit adjustments.** The Governor's Budget proposes a net increase of \$81.4 million to fund enrollment growth in 2011-12 for school district and COE revenue limits as a result of an increase in projected ADA. Specifically, school district revenue limits would receive an increase of \$88.9 million, however COE revenue limits would receive a reduction of \$7.5 million.
- **Categorical program adjustments.** The Governor's budget provides growth adjustments for two categorical programs. The Governor provides \$7.3 million for special education and \$16.1 million for charter school categorical programs.

GOVERNOR'S 2011-12 COLA PROPOSAL

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 of 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.

2011-12 COLA Proposal. The Governor's Proposition 98 plan includes no cost-of-living-adjustments for any K-14 program in 2011-12. The projected COLA for 2011-12 is 1.67 percent, which would have provided an increase of \$964.5 million overall.

Although no COLA is provided, the Administration proposes to establish a deficit factor in 2011-12 for school district and county office of education revenue limit apportionments to reflect the lack of a COLA, ensuring that funding in future years is used to restore this adjustment. The deficit factor for school districts under the Governor's proposal is 19.608% and for County Offices of Education the deficit factor is 19.892%.

SUGGESTED QUESTIONS

- 1) What are the projected growth trends in the out-years? Is growth expected to continue? What are the regional trends?
- 2) Why did the Administration choose to provide growth only to special education and charter school categorical programs when other programs grew in 2011-12 (for example, child nutrition, which grew by \$7.2 million)?

ISSUE 3: 2011-12 GOVERNOR'S BUDGET PROPOSAL: K-12 INTER-YEAR DEFERRAL

The issue for the Subcommittee to consider is the Governor's proposal to defer \$2.1 billion in K-12 Proposition 98 funds from 2011-12 to 2012-13.

PANELISTS

- Department of Finance
- Legislative Analyst's Office
- California Department of Education

BACKGROUND

Over the last few years, in an attempt to avoid further difficult reductions in education, the state has deferred school funding from one year to the next. The chart on the next page lists the various inter-year deferrals imposed on schools.

Inter-Year Deferrals of Proposition 98 Payments (In Millions)	<i>Source: LAO</i>
Deferrals	Amount
Established Prior to 2008-09	
Shift some K-12 revenue limit and categorical payments from June to July	1,103
Shift some CCC apportionment payments from May-June to July	200
Subtotal	1,303
Enacted in February 2009 Budget (to begin in 2008-09)	
Retire Home-to-School Transportation deferral	-53
Shift some K-12 revenue limit and categorical payments from February to July	2,000
Shift K-3 Class Size Reduction payment from February to July	570
Increase size of existing K-12 June-to-July deferral	334
Shift portions of CCC apportionments from January-April to July	340
Subtotal	3,191
Enacted in July 2009 Budget (to begin in 2009-10)	
Shift portion of K-12 revenue limit payments from May to August	1,000
Shift portion of K-12 revenue limit payments from April to August	679
Increase size of existing CCC apportionment deferral from Jan-May to July	115
Make CCC QEIA payment in following year	48
Subtotal	1,842
Enacted in October 2010 Budget Package (to begin in 2010-11)	
Increase size of existing K-12 June-to-July deferral	500
Increase size of existing K-12 May-to-August deferral	800
Increase size of existing K-12 April-to-August deferral	420
Increase size of existing CCC apportionment deferral from January-May to July	129
Subtotal	1,849
Proposed in Governor's January Budget (to begin in 2011-12)	
Increase size of existing K-12 revenue limit deferrals (likely to October)	2,064
Increase size of existing CCC apportionment deferrals from January-May (likely to October)	129
Subtotal	2,193
Total Inter-Year Deferrals	10,378
K-12 Education	9,417
CCC	961
Share of Proposition 98 Program Paid Late	
K-12 Education (excluding child care)	21%
CCC	17%

With the enactment of the 2010-11 Budget Act, a total of \$7.3 billion (17%) of Proposition 98 funding for K-12 schools was deferred from one fiscal year to the next.

GOVERNOR'S PROPOSAL

The Governor's budget includes an additional \$2.1 billion inter-year deferral of K-12 revenue limits. As the chart shows, if the Legislature were to adopt the Governor's proposal, a total of \$9.4 billion (21%) of K-12 Proposition 98 funds would be deferred from one year to the next. Although the administration has not yet determined from which months K-12 revenue limit payments would be deferred, they have indicated that deferrals likely would not be repaid until September or October of 2012.

It is also worth noting that, in addition to the *inter-year* deferrals proposed by the Governor, the budget also proposes to continue *intra-year* deferrals to help with the state's cash flow problems. The Governor's intra-year deferral plan would delay \$2.5 billion in K-12 payments and \$200 million in CCC apportionments beginning in July 2011, reflecting the same magnitude as the 2010-11 intra-year deferrals.

LAO COMMENTS

The state's reliance on deferrals over the past several years has placed a large cash flow burden on school districts and community colleges. Nonetheless, adopting deferrals would help mitigate the reductions that districts and community colleges otherwise would need to make in 2011-12.

The LAO has expressed concern that additional deferrals would continue the deterioration of school district and community college fiscal health and could result in the need for state emergency loans to avoid insolvency. These deferrals would be especially problematic if, as indicated by the administration, they are not paid until the fall of 2012 (all existing deferrals are paid by August). Further, the LAO notes that intra-year deferrals further exacerbate the situation—in essence deferring already-deferred payments until even later in the next fiscal year. Combined, the inter-year and intra-year deferrals could result in school districts and community colleges facing significant cash flow difficulties in the summer and fall of 2012.

SUGGESTED QUESTIONS

- 1) What options do school districts have for borrowing funds to carry them through to the next fiscal year?
- 2) Does the Administration and the Department of Education share the LAO's concerns about the potential for state emergency loans and district insolvency? Is data available on how many districts might be at risk?
- 3) We understand the Administration plans to provide a process for districts to seek a waiver from this deferral should they face financial hardship. What will the requirements be for seeking a waiver?

ISSUE 4: 2011-12 GOVERNOR'S BUDGET: REDEVELOPMENT AND REALIGNMENT PROPOSALS: PROPOSITION 98 IMPACTS (INFORMATION ONLY)

This informational item is intended to provide a brief overview of the Governor's realignment and redevelopment proposals as they pertain to education and Proposition 98 funding. The main proposals will be heard in other subcommittees.

With regard to the Governor's realignment proposals, this Subcommittee will participate in a joint hearing on January 26 to discuss the mental health realignment and the impacts on the AB 3632 program. As such, this agenda will focus on the Department of Juvenile Justice realignment impacts on Proposition 98.

In addition to the information provided in this agenda, the Legislative Analyst's Office will include a brief overview of these proposals in their handout.

PANELISTS

- Department of Finance
- Legislative Analyst's Office
- California Department of Education

GOVERNOR'S REDEVELOPMENT PROPOSAL

Redevelopment agencies receive approximately \$5 billion of property tax revenue that would otherwise fund school districts, cities, counties, and special districts. The redevelopment agencies "pass through" about \$1.1 billion to local agencies based upon negotiated agreements and state statute. Of this amount, approximately \$300 million is passed through to schools with only \$40 million offsetting state education costs. The state General Fund must backfill the remaining property tax revenues diverted from K-14 schools, at a cost of over \$2 billion annually.

Governor's Proposal. The Governor's budget proposes to dissolve existing redevelopment agencies by July 1, 2011. Local successor agencies would receive the property tax increment that currently goes to redevelopment agencies.

In 2011-12, the successor agencies would use the redevelopment revenues to pay redevelopment debts and obligations, offset state funding for Medi-Cal and trial courts, distribute funds to cities, counties and special districts in proportion to their share of property taxes. With regard to schools, successor agencies would allocate \$1.1 billion to schools and local agencies.

Beginning in 2012-13, any property tax revenues remaining after the successor agencies pay redevelopment debt would be distributed to other local governments in the county following provisions in existing law. One exception is that the additional K-14 property taxes would augment their existing state funding (not offset state education

spending under Proposition 98) and would be distributed to districts throughout the county based on enrollment. The Administration estimates approximately \$1 billion would go to schools for this purpose.

LAO Comments. The rationale for providing school districts with property tax revenues *in addition* to their existing property taxes is not clear. Such supplemental funding would create distributional issues among school districts in the state, further complicate an already complicated school finance system, and eliminate an opportunity to achieve ongoing General Fund savings.

GOVERNOR'S REALIGNMENT PROPOSALS

The Governor's budget proposes a major realignment of various program duties. The Governor's plan proposes to ask voters to decide whether to extend by five years two tax increases due to expire on June 30, 2011: a one cent sales tax and the 0.5 percent VLF General Fund rate. If the voters approve these tax extensions, the revenues would be dedicated to implementing the realignment plan. The Administration estimates the extension of these taxes would yield \$5.9 billion for 2011-12. These funds would bypass the General Fund and instead be shifted directly to counties, thereby avoiding Proposition 98 impacts.

Division of Juvenile Justice. According to the Administration, the vast majority of youthful offenders are now directed to county programs, enabling direct access and closer proximity to their homes, families, social programs and services, and other support systems. Offenders directed to the Division of Juvenile Justice have been convicted of the most serious and violent crimes and are most in need of specialized treatment services. These offenders represent less than one percent of the 195,000 youth arrests made each year. Over the past decade, the number of wards in state juvenile facilities has decreased from approximately 10,000 to fewer than 1,300. The state now has a very small and expensive system of providing services to the most violent juvenile wards at a cost exceeding \$200,000 per ward per year.

The Governor's Budget proposes the elimination of the Division of Juvenile Justice by June 30, 2014, and the transfer of jurisdiction for these offenders to local governments. The Governor's budget also proposes to provide additional revenue to support local governments in making this mission change.

With regard to Proposition 98, the Governor reduces funding for the Division of Juvenile Facilities by \$8.7 million to reflect a three-year phase-out linked with this realignment proposal.

SUGGESTED QUESTIONS**Redevelopment:**

- 1) What are the potential distributional effects of this funding shift on schools?
- 2) Can the Administration explain the rationale for augmenting schools by \$1 billion in 2012-13 under this proposal? How would these funds be distributed?

Realignment:

- 3) What are the educational impacts of moving wards from the Division of Juvenile Justice to counties?
- 4) What is the amount of funding per ward that the Governor proposes to shift to the counties? Who will be the recipient of these funds and how will they be distributed? Do you anticipate any cost pressures on county court schools?