

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

ASSEMBLYMEMBER JOE SIMITIAN, CHAIR

**TUESDAY, MARCH 12, 2002
STATE CAPITOL, ROOM 444
10:00 A.M.**

ITEMS TO BE HEARD

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OVERVIEW OF THE GOVERNOR'S K-12 EDUCATION BUDGET

Opening Remarks

Assemblymember S. Joseph Simitian, Chair

Committee Members

Office of the Secretary for Education

Kerry Mazzoni
Secretary for Education

Superintendent of Public Instruction

Delaine Eastin
Superintendent of Public Instruction

Legislative Analyst's Office

Robert Turnage, K-12 Coordinator
Legislative Analyst's Office

Public Comment/Additional Member Questions

Comments by Committee Members

ITEM 1 REVENUE LIMITS

ISSUE 1: REVENUE LIMITS

The issue for the subcommittee to consider is the Governor's budget-year proposal regarding the PERS offset freeze and equalization adjustments to school district revenue limits.

BACKGROUND:

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

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

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

Governor's proposed budget. The Governor's proposed budget does not contain funds to pay for the PERS offset reduction and equalization adjustments in the budget year. This proposal is consistent with the Governor's proposed November cuts, in which he proposed to delete funding for the PERS offset freeze and equalization in the current year. Adoption of the Governor's proposed budget for these two areas would mean a reduction in districts' revenue limits in the budget year, relative to the current year level, with revenue limits climbing back up to the current year level the following year (2003-04).

COMMENTS:

The Legislative Analyst's Office recommends that the subcommittee restore the PERS offset freeze and equalization in the budget year, to the extent funding is available. It argues that the proportion of state funding that is discretionary has consistently decreased for the past 12 years, and that this impedes districts' fiscal flexibility, as well as being inconsistent with the recent accountability reforms that reward outcomes and not processes. Consequently, it argues that the Legislature should increase discretionary funding in the form of the PERS offset freeze and equalization. However, the subcommittee would need to identify other reductions if it were to pay for these restorations, due to the existing budget crisis.

The LAO also estimates that a COLA adjustment will add approximately \$3 million to the cost of these two items for a total of \$42 million for equalization and \$36 million for the PERS offset freeze.

**ISSUE 2: EFFECT OF PERS DEFERRAL ON REVENUE LIMITS
(INFORMATION ONLY)**

The issue to consider is the effect that a deferral of state retirement contributions (to PERS) would have on revenue limits.

BACKGROUND:

Governor's proposed budget. As proposed in January, the Governor's budget proposed to defer \$1 billion of the state's General Fund retirement contributions to PERS and STRS in 2002-03 in exchange for additional retirement benefits.

Governor's withdrawal of PERS/STRS deferral. After releasing his proposed budget in January, the Governor formally withdrew his proposal to defer state retirement contributions in favor of a debt restructuring proposal that also saves General Fund money.

LAO's estimate of the effect of the PERS deferral. The LAO estimates that if the Legislature chooses NOT to adopt the PERS and STRS contribution deferrals, this will result in an increase in revenue limits worth approximately \$113 million. This increase is not included in the Governor's budget, given that his January budget assumed the PERS and STRS contribution deferrals -- a proposal which the Governor has now formally withdrawn. It is unclear whether the administration now plans to assume the \$113 million expenditure increase, given its withdrawal of the PERS and STRS contribution deferral plan.

The LAO's estimate of a \$113 million increase in revenue limit apportionments as a result of a rejection of the deferral proposal results from the way that the state currently deducts districts' PERS contributions from districts' revenue limits. Under current law, the state reduces revenue limits by the extent to which districts' PERS contribution rates are less than they were in 1982-83. In 1982-83 the rate was approximately 13% of districts' covered payroll, but in recent years the rate has dropped to 0%. This difference has been subtracted from districts' revenue limits, allowing the state to capture savings that would have otherwise accrued to school districts. In the budget year, the PERS contribution rate is expected to increase to 1.7%, thereby reducing the amount the state subtracts from revenue limits and effectively increasing the amount the state pays in revenue limit apportionments (equal to \$113 million). However, if the Legislature adopts the PERS and STRS contribution deferrals, this will postpone the anticipated increase in the PERS contribution rate and keep the contribution rate at the current level of 0%, thereby increasing the amount the state deducts from revenue limits and reducing revenue limit apportionments.

COMMENTS:

The issue of whether to defer state retirement contributions will not be considered by this subcommittee, but will be considered and acted upon by Subcommittee #4 on State Administration. However, whatever action that subcommittee takes on this issue will have a direct effect on required K-12 expenditures, according to the LAO, as outlined above.