

Governor Proposes Increased Funding for Prop 98 & Continues To Push for an Extension of Taxes in May Revision

On May 16, 2011, Governor Brown unveiled his May Revision to the State Budget. In his presentation of the May Revision, the Governor focused on three key issues: 1) he continued to make the case that even with an increase in new revenue, California still has a significant budgetary shortfall and an extension of the current taxes set to expire is still needed; 2) he committed \$3 billion of the new revenues to Proposition 98 and directed them to reduce a small portion of the deferrals; and 3) he intends to stay the course he began in January of ensuring passage of a balanced approach to solving the state's budget problems.

Overall Perspective

The May Revision to the 2011-12 Budget reflects the following major changes to budget assumptions that were used to build his January budget proposal:

- \$6.6 billion in additional state revenue over the current and budget years,
- \$1.2 billion in higher local property tax revenues (which decrease the amount of state General Fund revenue needed to fund K-12 revenue limit apportionments)
- \$3.5 billion in reductions to tax extensions and borrowing proposed in January—made possible by higher state revenues.
- \$3 billion in additional Proposition 98 spending to “buyout” inter-year deferrals and fund the shift of responsibility for providing mental health (AB 3632) services from county mental health agencies and county welfare agencies to school districts.
- \$1 billion in lost Proposition 10 savings to fund child health services due to ongoing litigation.
- \$500 million in new funding for the Department of Corrections and the Department of Mental Health to cover prior year unfunded expenditure obligations.

Despite the enactment \$13.4 billion in adopted spending cuts since January, the Governor's May Revision calls for an additional \$10.8 billion in budget solutions, including \$9.321 billion in tax extensions scheduled to expire on June 30. While the Governor continues to demand that these taxes be placed before voters, “as soon as possible” is how he characterized it, his revised budget calls for Republican votes in the Legislature to actually extend the taxes until the statewide election. It is unclear from the budget documents how long the taxes should be extended pending a public vote. Finally, the Governor is using part of the increase in state revenues to offset a loss of the temporary 0.25% increase in personal income taxes for 2011-12, which he now plans to forego until 2012-13, in an attempt to make the tax extension package more acceptable.

K-12 Overview

Highlights of the K-12 education budget adjustments in May Revision includes:

Proposition 98 - If the tax extensions fail, the Prop 98 minimum guarantee would automatically drop about \$2 billion, from the \$52.4 billion level proposed in the May budget revision, to \$50.4 billion. In addition, DOF staff offered that if the taxes failed, K-12 education would be at risk for another \$5 billion in cuts, given that, without the tax extension, the state would be unable to fund even that lowered guarantee of \$50.4 billion.

DOF staff was queried about whether they had a “Plan B” scenario for education that detailed the deeper cut level. Staff responded that they had discussions regarding how this level of additional cuts to education would be levied, but stopped short of putting together a formal “Plan B” that reflects details of cuts of this magnitude.

COLA/Deficit factors - The (unfunded) K-12 statutory COLA for 2011-12 is **2.24%**. The resultant deficit factors for 2011-12 are **19.754%** for school districts, and **20.041%** for county offices of education.

Categorical/Other flexibility - No new changes proposed, beyond the additional two-year extension proposed in January.

Buyout of \$2.53 billion in K-12 Inter-year Deferrals - The May Revision restores K-12 revenue limit apportionment funding that had been deferred in the March Budget legislation. This augmentation eliminates the most recent enacted deferral of \$2.1 billion, and provides an additional \$434 million to reduce approximately 25% of the existing February to July deferral.

Shifts costs for all AB 3632 Mental Health Services from Counties to Schools - The May Revision proposes to shift the responsibility for providing mental health services and out-of-home residential services required under federal law from county mental health agencies and county welfare agencies to school districts. This proposal would re-bench the Proposition 98 guarantee and provide an increase of \$221.8 million to Proposition 98 to cover program cost. The May Revision also reflects the permanent repeal of the AB 3632 mandate and removes mental health services from the realignment proposal for counties.

In his May Revision briefing material, the Governor acknowledged that the existing approach to delivering mental health services which reimburses county mental health agencies for claims has lacked accountability for program and funding and service delivery. *“Shifting the responsibility for mental health services back to schools would lead to greater cost containment and also create a stronger connection between the services provided and student educational outcomes.”*

In addition to the proposed \$221.8 million of Prop 98 funding designated for AB 3632 students, the May Revision continues to make available \$98.6 million in Proposition 63 funds to county mental health agencies on a one-time basis in 2011-12.

School districts can contract with counties to provide services using Proposition 63 funds but schools would be responsible for any costs exceeding this amount. In total, the May Revision proposes \$389.4 million from all fund sources, including \$69 million in federal funds currently budgeted, for mental health services.

\$221.8	million Proposition 98
\$ 98.6	million Proposition 63
<u>\$ 69</u>	<u>million federal funds</u>
\$389.4	million total funding for 2011-12

According to the Department of Finance staff, in 2012-13, the administration will phase out the \$98.6 million Proposition 63 funds (since they were only intended to be one-time in nature) and will back fill this dollar amount with Proposition 98 funds. This procedure will require the DOF to re-bench the Proposition 98 guarantee a second time in 2012-2013.

County Offices of Education Funding - The administration proposes increases of \$14.6 million in 2010-11 and \$13.9 million in 2011-12 for updates to unemployment insurance, PERS, average daily attendance growth, and deficit factor adjustments.

Child Care and Development Workload Savings - The administration proposes a net \$97.12 million in child care and development program workload savings based upon the following changes:

- savings of \$123.5 million due to revised estimates for CalWORKs Stage 2 and Stage 3 child care caseload, primarily due to the implementation of the Stage 3 reduction included in the 2010 Budget Act;
- savings of \$6.9 million from a revised estimate of growth;
- \$40.6 million of higher costs from higher caseloads, and
- an increase of \$7.4 million in federal funds which will offset General Fund costs

Elimination of Selected K-14 Mandates - The Governor is proposing a \$38.2 million reduction *“to reflect the adoption of specific recommendations of the K-14 workgroup on mandate reform.”* His budget does not specify which reforms, although the mandate work group has called for the elimination of some mandates, and the savings appear to be tied to those recommendations. The May Revision states that the administration *“intend[s] to pursue additional long-term reform options in collaboration with the [Legislative Analyst’s Office] to streamline future funding of K-14 mandates through a block grant approach.”*

Charter School Augmentations - The May Revision requests an increase of:

- \$19.5 million for Charter School Categorical Block Grant and Economic Impact Aid caseload growth.
- \$8 million to provide charter schools that commenced operations between 2008-09 and 2011-12 with supplemental categorical funding, in lieu of categorical funding they are no longer able to apply for under current categorical flexibility provisions. The administration stipulates that *“new conversion charter schools would be excluded from this funding and would instead receive a pass through payment from the school district.”*

Clean Technology and Renewable Energy Training - \$3.2 million is provided in the May Revision to support the Clean Technology and Renewable Energy Job Training, Career Technical Education, and Dropout Prevention Program, which creates school-business partnerships that provide occupational training for at-risk high school students in areas such as conservation, renewable energy, and pollution reduction.

Special Education Adjustment - The May Revision proposes an increase of \$399,000 for Special Education caseload growth.

Local Property Tax Adjustments - As noted above, the May Revision proposes to decrease General Fund costs for school district and county office of education revenue limit apportionments as a result of increases in estimated local property tax revenues.

Highlights of the K-12 non-Proposition 98 state General Fund spending adjustments:

- **Child Nutrition Program Administration.** The administration proposes an augmentation of \$2.5 million in Federal Trust Fund spending for child nutrition programs, including \$500,000 on an ongoing basis for workload associated with an increase in the frequency of required compliance reviews of federal child nutrition programs and \$2 million on a one-time basis for projects that will support the efficiency and quality of child nutrition program administration.
- **Child Nutrition Summer Food Service Program.** The May Revision proposes an increase of \$2 million Federal Trust Fund due to an anticipated increase in meals served through the Summer Food Service Program.

Review of Assessment, Accountability and Data Collection

In what may turn out to be the most important policy issue outlined in the budget, the Governor stated his intention of undertaking a complete review of the state's policies on accountability, assessment and data collection. The Governor will propose careful reforms of the testing and accountability systems to achieve genuine accountability and maximum local autonomy. The goal is to develop proposals to: 1) reduce the amount of time devoted to state testing, 2) eliminate data collections that do not provide useful information to administrators, teachers and parents, and 3) restore power to school administrators, teachers and parents. The end result is to improve the learning environment in every classroom. Toward this goal, the Governor has decided to suspend funding for CalPADS in 2011-12 pending a continued review of data collection. Specifically, the May Revises proposes the following:

- **Suspension of CALPADS.** The Governor proposes savings of \$2.9 million in federal Title VI funds and 5.3 positions to Department of Education state operations to reflect the suspension of all CALPADS development and implementation activities pending continued review of the system. In lieu of continuing CALPADS, the May Revision proposes that *“any federally required data can be collected and reported through CBEDS, and any other systems utilized by the Department of Education outside of the CALPADS system.”*
- **Elimination of CALTIDES.** The May Revision proposes savings of \$560,000 in the Federal Trust Fund and 3 positions to the Department of Education state operations and \$84,000 in the Test Development and Administration Account, Teacher Credentials Fund and 1 position to the Commission on Teacher Credentialing state operations to reflect the State Department of Education's termination of CALTIDES and to conform to the suspension of CALPADS.

Community Colleges

As a result of the March budget solutions approved by the legislature, the community colleges have a net expenditure reduction of \$290 million distributed as follows:

- The community colleges budget was decreased by \$400 million in apportionment funding as a result of implementing a base reduction.
- However, the base reduction was offset by \$110 million in additional student fee revenue as a result of increasing student fees from \$26 per unit to \$36 per unit.

In the May Revision, the following workload adjustments have been proposed. These adjustments will not increase the overall funding for the system.

- Eliminate Deferral. The May Revision proposes an increase of \$350 million to restore community college apportionment funding that had been deferred by Chapter 7, Statutes of 2011. This augmentation reduces the amount of apportionment funding deferred from \$961 million to \$611 million. Although this will not result in increased funding to the community colleges, it will improve their cash flow of apportionment funds.
- Property Tax Adjustments. An increase of \$57.8 million in 2010-11 and \$75.1 million in 2011-12 due to an increase in estimated local property tax and other local revenues. Because increases in property taxes offset state apportionment funds, this workload adjustment will not result in increased total funding to the community college system.

Is There a “Plan B” for the 2011-12 State Budget

In their press conferences, both Governor Brown and Finance Director Ana Matasantos were questioned about whether there was a “Plan B” if the taxes are not extended. More specifically, there were asked about schools’ planning problems as a result of the Budget’s uncertainty. The Governor was very direct in saying that he was aware of the issue stating “we understand the problems of schools,” at one point and adding “and there would have to be some phase-out if the taxes are defeated and I don’t think they will be.” Ana Matasantos was asked specifically to provide guidance for school leaders facing calendar and staffing decisions, in light of the uncertainty over revenues. On each occasion Matasantos provided the same advice: *“We’re advising districts to plan their budgets for \$52.4 billion.”*, and *“Schools should work towards the \$52.4 billion; schools traditionally budget to the May Revise and that is what they should do.”*

The Administration acknowledged in its written summary, however, that in the absence of tax extensions a suspension of Proposition 98 would be necessary in 2011-12. The official May Revision document states: “Because Proposition 98 represents more than 40 percent of General Fund spending, K-12 schools and community colleges would need to bear a heavy share of any “all cuts” budget. An “all cuts” budget would require a suspension of the Proposition 98 minimum guarantee and deep reductions. To remain in balance in future years, the minimum guarantee would likely need to be suspended in subsequent years.”

Finance Director Ana Matasantos reported (and Department of Finance staff confirmed in a briefing for the education community) that an “all-cuts budget” would result in a \$45.4 billion spending level for K-14 schools and require a suspension of the Proposition 98 guarantee. Department of Finance staff did indicate this afternoon that the Governor’s proposal to “buyout” over \$2.8 billion in deferrals would have to be re-examined in an “all cuts” budget.

Funding Scenario for an All Cuts Budget

In an all cuts budget the Proposition 98 guarantee would drop \$52.5 billion (new May Revise figure) to \$50.4 billion which assumes the tax extensions do not make it to the ballot or are not approved by the voters. This drop would not require a suspension of Prop 98. If there were to be a suspension of Prop 98, the administration would likely urge a \$5 billion cut to schools off of the \$50.4 minimum guarantee and not a higher revenue figure. This action would take Prop 98 to a \$45.4 level. It is highly likely that this action would be accompanied by a restoration of the \$2.5 billion in deferrals. This would bring the actual funding level for K-12 up to \$47.9 billion. What does this mean? Districts planned for a reduction of \$349 per student based on the January

Budget which was predicated on a drop in the Prop 98 guarantee to \$47.5 billion. The worst case scenario in order to reach cuts for a \$5 billion cut would be a cut of approximately another \$2 billion in order to get to a figure of \$45.4 billion. This would require districts to almost double their proposed cuts by adding another \$330 per ADA.

Is There a Plan C?

Additionally, while both the May Revise plan and the mysterious “Plan B” have been outlined above, there is a very likely third option should taxes not be extended. This “Plan C” would result in taxes not being extended by the end of June and the legislature passing a budget that does not suspend Proposition 98, makes some additional non-Prop 98 programmatic cuts, assumes additional revenue, and relies on additional borrowing. This scenario is very possible given the statements by all four legislative caucuses that they will not vote to suspend Prop 98. In this scenario, the Governor could blue-pencil non-Prop 98 revenue but would be limited in cuts he could make in Prop 98. The down side of this option is that it is very likely that the state would run out of cash by January 2012. If this occurred, there would be huge pressure on the legislature to suspend Prop 98 mid-year – thus resulting in mid year cuts to schools.

Summary

Our budget situation has never been more volatile than it is right now. As a result, it is important for districts to maintain all of their options and keep a close eye on actions taken in the legislature in the next month. We will keep you posted.