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2009-10 Budget Analysis Series

Proposition 98 Education Programs



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EXECUTIVE SUMMARY

The Governor's 2009-10 budget includes almost \$55 billion in Proposition 98 funding for K-12 education and the California Community Colleges (CCC). The budget reflects major reductions to school spending in 2008-09 and 2009-10. In this report, we outline ways for the Legislature to achieve budgetary savings while minimizing the adverse effects on core educational programs. In addition, we recommend that the Legislature use the state's fiscal crisis as an opportunity to rethink the state's K-14 educational framework and undertake substantive reform in some key areas—categorical program funding, state mandates, and cash disbursements.

Governor's Plan Balances K-14 Budget by Cutting K-12 General Purpose Funding. To achieve state savings, the Governor's budget takes a deep cut to K-12 revenue limits. ("Revenue limits" reflect general purpose funding that supports schools' base academic program.) After proposing to cut K-12 revenue limits roughly \$2 billion in 2008-09, the Governor's budget for 2009-10 makes an additional cut of roughly \$1 billion. Combined, these cuts represent roughly \$3 billion in budget-year solutions to help address the state's huge shortfall.

Recommend Making More Targeted Reductions. Rather than cutting districts' most flexible source of funding, we recommend that the Legislature make targeted spending reductions. Because the level of education savings that the state will need to achieve in 2009-10 is unknown at this time, we develop a three-tiered approach to achieving Proposition 98 savings. Under each tier, we make targeted reductions to specific K-14 categorical programs or block grants. Tier 1 reductions would provide this first step of savings with little, if any, programmatic effect. In contrast, tier 3 reductions would have relatively significant programmatic effects on schools. Taken together, the tiers are intended to give the Legislature many options for achieving budget-year solutions.

Opportunity for Categorical Program Reform

Governor's Plan Suspends Most Categorical Program Requirements. To help school districts and community colleges respond to a tight budget, the administration proposes to permanently suspend most categorical program requirements. This means districts would no longer need to adhere to virtually any of the state's existing program or reporting requirements. In addition, districts would be able to transfer funds among categorical programs as well as from categorical programs to general purpose accounts. Although additional flexibility would benefit districts, we have concerns with the Governor's approach of merely disregarding—rather than reforming—the state's categorical system.

Recommend Undertaking Substantive Categorical Reform. We recommend that the Legislature adopt a more strategic approach that provides districts with additional flexibility but also simplifies, streamlines, and improves the existing system. Specifically, we recommend consolidating 42 existing K-12 categorical programs into three large block grants focused on instructional support, at-risk students, and special education students. The three block grants would consolidate more than \$10 billion, or roughly two-thirds, of all state categorical funding for K-12 education. For CCC, we recommend consolidating eight programs into two block

grants focused on student success and faculty support. These block grants would consolidate \$257 million, or roughly one-third, of all state categorical funding for community colleges. Under a block grant approach, districts would have much more flexibility to determine how best to meet local needs, but the state still would preserve important education priorities.

Opportunity for Mandate Reform

Governor's Plan Suspends Most Education Mandates. To help districts respond to a tight budget, the administration also proposes to permanently suspend all but three K-14 mandates. The proposed suspensions of more than 40 education mandates would reduce associated 2009-10 mandate claims by roughly \$200 million. While suspending most education mandates would reduce state obligations, such an approach does nothing to improve the existing mandate process, address currently flawed mandates, or preserve important state policies that underlie some education mandates.

Recommend Undertaking Substantive Mandate Reform. Rather than suspend virtually all K-14 mandates in one fell swoop, we recommend undertaking substantive mandate reform. We review the nine costliest K-14 mandates and make specific recommendations for addressing each one. In some cases, we eliminate the mandate as we conclude it serves no compelling statewide objective. In other cases, we eliminate the mandate but find an alternative way to fulfill its underlying policy objective. Such an approach reduces some district requirements and some state obligations, while still preserving important education priorities.

Opportunity for Cash Disbursement Reform

Governor's Plan Includes Several Large Deferrals of K-14 Payments. To help the state achieve cash relief in critical cash-poor months, the Governor's budget includes several deferrals of K-14 payments. Specifically, it defers \$1.2 billion in July payments and \$1.5 billion in August payments until October. It also would defer \$115 million in January payments and \$2.7 billion in February payments until July. These deferrals are in addition to \$2 billion in other deferrals begun in earlier years. These various deferrals are layered on top of an existing K-14 payment structure that is not well aligned with district expenditures. The K-12 payment structure, in particular, does a poor job of linking state payments with district costs. Even without the various deferrals in the Governor's plan, the underlying K-12 payment structure lacks transparency, predictability, and coherence.

Recommend More Rational K-14 Payment System. As with any rational payment system, we recommend the state's K-14 payment schedule be aligned with district expenditures. Specifically, we recommend disbursing state payments at the same rate district expenses are incurred. We call the approach "5-5-9" because it would disburse 5 percent of total state payments in July and August, when district costs are lowest, and 9 percent of total state payments in every other month, when district costs are evenly spread out. The 5-5-9 approach would put the state in a comparable cash position relative to the administration's plan while minimizing the need for deferrals.

BACKGROUND

In this report, we analyze major budget issues affecting K-12 education, child care, and CCC, with a focus on Proposition 98 issues. Voters enacted Proposition 98 in 1988 as an amendment to the California Constitution. The measure, which was later modified by Proposition 111, establishes a minimum annual funding level to support K-14 education. Proposition 98 funding constitutes around three-fourths of total K-14 funding, with the remainder of support coming from federal funds, special funds (such as lottery revenues), fee revenue (such as CCC enrollment fees), and non-Proposition 98 state General Fund dollars (which are largely dedicated to debt service on school facilities and costs for teacher retirement).

Below, we provide some basic information about how Proposition 98 works and describe the Governor's 2009-10 Proposition 98 proposals (starting with an overview and then highlighting proposals unique to K-12 education, child care, and CCC). In the next section of the report, we provide alternatives for balancing the K-14 budget. In the final section of the report, we lay out detailed recommendations relating to categorical reform, mandate reform, and cash management.

Proposition 98 Minimum Guarantee Driven by Formulas. The minimum Proposition 98 funding requirement—commonly called the minimum guarantee—is

determined by one of three formulas. Figure 1 briefly explains these formulas (or “tests”). The five major factors underlying the Proposition 98 tests are (1) General Fund revenues, (2) state population, (3) personal income, (4) local property taxes, and (5) K-12 average daily attendance (ADA). In most years, the key determinants of the Proposition 98 minimum guarantee are changes in ADA, per capita personal income, and per capita General Fund revenues.

State Can Provide More or Less Than Minimum Guarantee. The Legislature can provide more or less funding is than required by the Proposition 98 formulas. For example, in 1999-00, when state revenues were booming, the Legislature decided to spend \$1.8 billion more than the minimum guarantee. Alternatively, in 2004-05 the Legislature suspended the minimum guarantee and provided less than would have been required. To suspend the minimum guarantee requires a two-thirds vote of the Legislature and creates out-year obligations due to the constitutional requirement to accelerate growth

Figure 1

Proposition 98 Basics



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

- **Test 1—Share of General Fund.** Provides roughly 40 percent of General Fund revenues to K-14 education. From 1988-89 through 2007-08, this test has been applied only once (1988-89).
- **Test 2—Growth in Per Capita Personal Income.** Adjusts prior-year funding for changes in attendance and per capita personal income. This test has been operative 13 of the last 20 years.
- **Test 3—Growth in General Fund Revenues.** Adjusts prior-year funding for changes in attendance and per capita General Fund revenues. Generally, this test is operative when General Fund revenues grow more slowly than per capita personal income. This test has been operative 6 of the last 20 years.

in future years until overall K-14 funding is back to where it otherwise would have been absent the suspension.

Governor's Proposition 98 Budget Proposal

As shown in Figure 2, the Governor's 2009-10 budget includes \$54.9 billion in Proposition 98 funding for K-14 education, a 7 percent increase from the proposed 2008-09 spending level (but a 6 percent decrease from the enacted 2008-09 budget). The various components of the Governor's budget-year Proposition 98 plan are discussed below.

Governor Assumes Approval of Lottery Ballot Measure. The Governor's 2009-10 budget assumes voters will approve a ballot measure to securitize profits of the state lottery. As part of the securitization, the measure would eliminate direct payments from the lottery to K-14 entities. In order to hold schools and colleges harmless for this change, the ballot measure requires an increase in the Proposition 98 minimum guarantee comparable to the amount of lottery funds K-14

entities received in 2008-09. In the near term, the enactment of the measure would not affect the amount of total funding that K-14 entities receive. Funding, however, that was previously outside the Proposition 98 funding calculations would now be included within the 2009-10 Proposition 98 funding level. To provide a clearer picture of the year-to-year changes in Proposition 98 funding, we have excluded Proposition 98 funds provided to backfill for lottery funds from budget-year numbers throughout this report.

Budget-Year Proposal Assumes Adoption of Current-Year Proposals. Proposition 98 funding considerations rely heavily on state revenues. Due to the dramatic deterioration of revenues in the current year, the Governor has proposed significant current-year Proposition 98 spending reductions and revenue increases. The Governor has assumed adoption of his current-year proposals when building his 2009-10 proposal. If any of the revenue or spending assumptions underlying the Governor's 2008-09 proposals are modified by the Legislature in taking midyear action, the Proposition 98 requirements for both years will change.

Figure 2

Summary of Governor's Proposition 98 Budget

(In Millions)

| | 2008-09 | | | 2009-10 | |
|-------------------------------|-----------------|-----------------|-----------------|-----------------------|------------------------------|
| | Budget Act | Proposed | Change | Proposed ^a | Change From 2008-09 Proposed |
| K-12 education | \$51,620 | \$45,294 | -\$6,327 | \$48,279 | \$2,985 |
| California Community Colleges | 6,359 | 6,085 | -274 | 6,482 | 396 |
| Other agencies ^b | 106 | 106 | — | 107 | 1 |
| Totals | \$58,086 | \$51,485 | -\$6,600 | \$54,868 | \$3,382 |
| General Fund | \$41,943 | \$35,783 | -\$6,160 | \$39,425 | \$3,643 |
| Local property tax revenue | 16,143 | 15,703 | -440 | 15,442 | -260 |

^a Excludes \$1.1 billion proposed backfill of lottery funds. Including lottery funds, Proposition 98 funding totals \$55.9 billion.

^b Proposition 98 funding supports direct educational services provided by various other agencies, including the state special schools and the Division of Juvenile Facilities.

Revised Current-Year Proposal Reduces Proposition 98 Spending by \$6.6 Billion, Cuts Programmatic Spending by \$2.1 Billion. As shown in the upper part of Figure 3, the Governor proposes funding at his revised estimate of the 2008-09 Proposition 98 minimum guarantee (\$51.5 billion). This is \$6.6 billion (or 11 percent) below the spending level provided in the *2008-09 Budget Act*. Of this amount, \$2.1 billion reflects programmatic cuts, with the largest portion associated with a base reduction to K-12 revenue limits. As a result, the proposed programmatic spending level in 2008-09 would be \$56 billion (a reduction of 3.6 percent from the enacted budget level). The remainder of the downward adjustment in Proposition 98 spending does not reflect a programmatic cut. Specifically, the Governor's proposes to defer \$2.8 billion in Proposition 98 payments to July 2009, provide \$619 million from transportation-related special funds to directly

**Figure 3
Detail on Governor's Proposition 98 Proposal**

(In Millions)

| | |
|--|-------------------|
| 2008-09 Budget Act Funding | \$58,086 |
| Cuts | |
| Reduce base K-12 revenue limits | -\$1,639 |
| Rescind K-12 cost-of-living adjustment (COLA) | -247 |
| Rescind California Community Colleges (CCC) COLA | -40 |
| Unappropriate current-year funds expected to go unused | -153 |
| Subtotal | <u>(-\$2,078)</u> |
| 2008-09 Programmatic Spending Level | \$56,008 |
| Other Adjustments in Proposition 98 Spending | |
| Defer certain K-12 payments | -\$2,570 |
| Defer certain CCC payments | -230 |
| Retire settle-up obligation | -1,101 |
| Use special funds for Home-to-School Transportation | -619 |
| Other | -3 |
| Subtotal | <u>(-\$4,522)</u> |
| 2008-09 Proposed Proposition 98 Spending Level | \$51,485 |
| Baseline adjustments | \$197 |
| Backfill Prior-Year One-Time Solutions | |
| K-14 Deferrals | \$2,800 |
| Settle-up | 1,101 |
| Home-to-School Transportation | 220 |
| Special education | 5 |
| Subtotal | <u>(\$4,126)</u> |
| Growth Adjustments | |
| K-12 average daily attendance (decline of 0.30 percent) | -\$111 |
| California Work Opportunity and Responsibility to Kids (CalWORKs) caseload | -37 |
| Non-CalWORKS child care slots (1.23 percent) | 19 |
| Community college enrollment growth for apportionments (3 percent) | 175 |
| CCC enrollment growth for select categorical programs (3 percent) | 10 |
| Subtotal | <u>(\$56)</u> |
| Other Budget Proposals | |
| Reduce base revenue limits | -\$904 |
| Eliminate High Priority Schools program | -114 |
| Reduce child care regional market reimbursement rates | -39 |
| Restructure child care family fee schedule | -14 |
| Suspend all CCC mandates | -4 |
| Pay behavioral intervention plans settlement | 65 |
| Pay three K-12 mandates | 13 |
| Subtotal | <u>(-\$997)</u> |
| 2009-10 Proposed Proposition 98 Spending Level | \$54,868 |
| Special funds for Home-to-School Transportation | \$402 |
| 2009-10 Proposed Programmatic Spending Level | \$55,270 |

support the K-12 Home-to-School Transportation program, and use \$1.1 billion in General Fund dollars for retiring the state's prior-year Proposition 98 settle-up obligations. In these cases, existing school operations are intended to be sustained, while spending that counts toward the Proposition 98 minimum guarantee is reduced.

Programmatic Spending Would Be Reduced Further in 2009-10. As the bottom of Figure 3 shows, the Governor proposes to fund at the minimum guarantee of \$54.9 billion in the budget year. In addition, the administration proposes to use \$400 million in special fund monies for the K-12 Home-to-School Transportation program, for total programmatic spending of \$55.3 billion. This results in a programmatic cut of \$700 million, or 1 percent, from the proposed current-year programmatic spending level of \$56 billion. Under the Governor's proposal, K-12 education spending would decrease by \$900 million, but CCC spending would increase by approximately \$200 million.

Governor Proposes Virtually Unlimited Flexibility in Responding to Cuts. In tandem with his proposed cuts, the Governor proposes to allow school districts and community colleges to transfer funding among categorical programs, as well as from categorical programs to their general fund. The Governor also proposes to allow K-12 school districts to use categorical balances from prior years for any purpose. Locally elected boards would be required to discuss and approve these transfers during public meetings, as well as provide an annual report on actions taken. (See the categorical reform write-up in the "Other Issues" section of this report for additional detail on the Governor's K-14 flexibility proposals.)

Governor Suspends Most Mandates. The Governor also proposes to suspend virtually all

K-14 mandates. Currently, the state is obligated to reimburse districts for more than 60 mandated education activities. The Governor proposes to suspend virtually all these activities, thereby reducing annual state mandate obligations by roughly \$200 million. The Governor's budget does, however, include \$13 million to cover the costs of three existing K-12 mandates and \$65 million for a pending settlement related to special education behavioral intervention plans. (See the mandate reform write-up in the "Other Issues" section of this report for additional detail on these mandate proposals.)

Governor Adds New Deferrals, Maintains Old Ones. To help with the state's cash flow, the Governor also proposes to delay \$2.7 billion in payments *within* 2009-10. Specifically, the Governor would delay \$1.2 billion in July payments until October (\$1 billion from K-12 schools and \$200 million from community colleges) and \$1.5 billion in August payments until October (all from K-12 schools). The Governor's budget also expands existing deferrals that delay payments *across* fiscal years. Specifically, he maintains the existing \$1.3 billion June to July deferral (\$1.1 billion for K-12 education and \$200 million for community colleges) and adds a proposed \$2.8 billion February to July deferral (\$2.6 billion for K-12 education and \$230 million for community colleges). In total, the Governor's proposal would defer \$4.1 billion in Proposition 98 payments from 2009-10 to 2010-11. (See the cash management write-up in the "Other Issues" section of this report for additional detail on these deferrals.)

Quality Education Investment Act (QEIA) Faces No Reduction. Despite the proposed cuts, suspensions, and deferrals in the Governor's budget, the administration provides \$450 million (\$402 million for K-12 education and \$48 million

for community colleges) to fund the third year of QEIA. This program was created in response to a settlement the administration reached with the California Teacher’s Association regarding the Proposition 98 suspension that occurred in 2004-05. Chapter 751, Statutes of 2006 (SB 1133, Torlakson), appropriates \$2.8 billion for K-14 education—paid out over a seven-year period beginning in 2007-08 and extending through 2013-14. This funding comes from the state General Fund and is in addition to the ongoing Proposition 98 funding provided to K-14 education.

Governor Achieves Some Budget-Year Savings by Retiring Settle-Up Obligation in Current Year. By using \$1.1 billion General Fund in 2008-09 to retire the state’s prior-year Proposition 98 settle-up obligations, the state achieves

\$150 million General Fund savings in 2009-10. This is because the state, pursuant to Chapter 216, Statutes of 2004 (SB 1108, Committee on Budget and Fiscal Review), had scheduled to make annual settle-up payments of this amount until the entire \$1.1 billion obligation was retired. (A settle-up obligation is generated when K-12 attendance or General Fund revenues increase after the budget is enacted—resulting in a Proposition 98 minimum guarantee that is higher than the funding level included in the budget act. The state currently owes schools \$1.1 billion to meet the minimum guarantee for 2002-03 and 2003-04.)

K-12 Education

As shown in Figure 4, the Governor’s 2009-10 budget provides \$69.5 billion in total

Figure 4
K-12 Education Budget Summary

(Dollars in Millions)

| | 2007-08 Actual | 2008-09 Proposed | 2009-10 Proposed | Changes From 2008-09 | |
|---|-------------------|---------------------|-------------------------|----------------------|-------------|
| | | | | Amount | Percent |
| K-12 Proposition 98 | | | | | |
| State General Fund | \$37,687 | \$31,644 | \$34,900 | \$3,256 | 10.3% |
| Local property tax revenue | 12,578 | 13,649 | 13,379 | -271 | -2.0 |
| Subtotals, Proposition 98 | (\$50,266) | (\$45,294) | (\$48,279) ^a | (\$2,985) | (6.6%) |
| General Fund | | | | | |
| Teacher retirement | \$1,535 | \$1,044 | \$1,153 | \$109 | 10.4% |
| Bond payments | 1,993 | 2,209 | 2,588 | 380 | 17.2 |
| Other programs | 1,522 | 2,104 | 590 | -1,514 | -71.9 |
| State lottery funds | 859 | 890 | 893 | 3 | 0.3 |
| Federal funds | 6,482 | 6,794 | 6,655 | -139 | -2.0 |
| Other | 8,426 | 8,732 | 8,466 | -266 | -3.0 |
| Subtotals | (\$20,817) | (\$21,773) | (\$20,346) | (\$1,428) | (-6.6%) |
| Totals | \$71,083 | \$67,067 | \$69,516 | \$2,449 | 3.7% |
| Proposition 98 funding per ADA ^c | \$8,453 | \$7,650 | \$8,179 ^b | \$529 | 6.9% |
| Total K-12 funding per ADA ^c | \$11,953 | \$11,328 | \$11,777 | \$449 | 4.0% |

^a Excludes \$893 million proposed backfill of lottery funds. Including lottery funds, Proposition 98 support totals \$49.2 billion.

^b Total excludes lottery backfill. Including lottery backfill, Proposition 98 per ADA spending would total \$8,330.

^c Average Daily Attendance (ADA) continues to decline slightly—going from 6 million in 2007-08 to an estimated 5.9 million in 2009-10.

funding for K-12 education (including child care), a 3.7 percent increase over his proposed current-year spending level. This equates to \$11,777 per pupil, an increase of \$449 (or 4 percent) over the proposed 2008-09 per pupil funding level. Proposition 98 funds are the primary funding source for schools, providing about 70 percent of total K-12 funding.

Governor's Approach Creates Hefty Out-Year Revenue Limit Obligation. The Governor's budget proposals for the current year and budget year include no cost-of-living adjustment (COLA) for K-12 revenue limits (or any K-12 categorical program). When a COLA is not provided to K-12 revenue limits, the state, though not required, traditionally has established a "deficit factor." It also has created deficit factors when revenue limits have received base reductions. The deficit factor keeps track of what revenue limits would have been if the COLA had been provided and/or the base cut not made. Given the high statutory COLA rates in 2008-09 and 2009-10 (5.66 percent and 5.02 percent, respectively) and the proposed base reductions, the Governor's budget recognizes a total deficit factor of 16.5 percent for school districts and 14 percent for county offices of education (COEs). Creating deficit factors of this magnitude would equate to a \$6.5 billion state obligation, which would be paid from within Proposition 98 resources at some point in the future as they become available. (Even during a healthy economic environment, deficit factors this large would take years to retire.)

Child Care and Development

The state currently supports a variety of child care and development (CCD) programs using Proposition 98 and federal funding. As shown in Figure 5, the Governor's 2009-10 budget

includes \$3.2 billion to provide CCD services to more than 440,000 children from birth through age 12 (or longer for children with special needs). The Governor's budget for CCD programs includes \$70 million in augmentations and \$88 million in reductions—resulting in a nearly flat year-to-year budget.

Reimbursement Rate Proposal Would Lower Provider Rates. California Work Opportunity and Responsibility to Kids (CalWORKs) providers currently are reimbursed for services up to a maximum rate equivalent to the 85th percentile of the rates charged by private providers in the same region (determined by a "regional market rate (RMR) survey" conducted every two years). The Governor proposes lowering that maximum reimbursement rate to the 75th percentile of the RMR. This proposal is estimated to generate Proposition 98 savings of \$39 million for CalWORKs stage 2 and stage 3 and \$31 million non-Proposition 98 savings for CalWORKs stage 3. (Though some savings also would be generated in non-CalWORKs child care, the administration assumes the savings would be redirected to funding additional child care slots.)

Also Proposes to Increase Family Fees. Currently, most subsidized child care programs use a family fee schedule to determine what amount of the cost, if any, a family needs to pay. Family fees begin as low as \$2 per day (for a family earning 40 percent of state median income) and are capped at 10 percent of family income (for a family earning 75 percent of state median income). The Governor proposes to revise the family fee schedule and increase fees for nearly all families currently paying fees. The administration estimates the new schedule would result in additional fee revenue of \$14 million for CalWORKs Stage 2 and 3 combined. (The administration

makes no estimate of additional fee revenue for non-CalWORKs child care—instead assuming that any new fee revenue would be redirected to funding additional child care slots.)

Non-CalWORKs Reduction Would Result in Loss of Roughly 10,000 Slots. The Governor’s current-year child care proposal reduces non-CalWORKs programs by \$55 million. This funding was not used in the current year due largely to contracting issues that routinely result in some

budgeted child care funding going unused. For the budget year, the Governor proposes to make the \$55 million reduction ongoing. The reduction would result in roughly 10,000 fewer child care slots being funded.

California Community Colleges

As shown in Figure 6 (see next page), the Governor proposes a total of \$9.6 billion for community colleges in 2009-10, a 4.9 percent increase over his proposed

current-year funding level. As shown in the figure, funding comes from a variety of sources, including the General Fund, local property taxes, student fee revenues, and federal funds. Over two-thirds of CCC’s budget is supported by Proposition 98 funding. (Below we highlight major Proposition 98 CCC issues. See the *2009-10 Budget Analysis Series Higher Education* report for more information on other CCC issues.)

CCC’s Share of Proposition 98 Funding Highest Ever. As proposed by the Governor, CCC would receive 11.9 percent of total Proposition 98 funding in 2009-10—the highest percentage to date. Since 2000, the CCC share

Figure 5
California Child Care and Development Programs
Budget Summary

(Dollars in Millions)

| Program ^a | 2008-09 Budget Act | 2008-09 Proposed | 2009-10 Proposed | Change From 2008-09 | |
|--|-----------------------|---------------------|------------------------|------------------------|--------------|
| | | | | Amount | Percent |
| CalWORKs^b Child Care | | | | | |
| Stage 1 ^c | \$617 | \$617 | \$674 ^e | \$57 | 9.2% |
| Stage 2 ^d | 532 | 505 | 443 ^e | -62 | -11.6 |
| Stage 3 | 433 | 418 | 389 ^e | -28 | -6.6 |
| Subtotals | (\$1,582) | (\$1,539) | (\$1,506) ^e | (\$33) | (-2.1%) |
| Non-CalWORKs Child Care^f | | | | | |
| General child care | \$810 | \$780 | \$789 | \$10 | 1.2% |
| Other child care programs | 338 | 329 | 333 | 4 | 1.2 |
| Subtotals | (\$1,148) | (\$1,109) | (\$1,122) | (\$14) | (1.2%) |
| State Preschool^f | \$445 | \$429 | \$435 | \$5 | 1.2% |
| Support Programs | \$106 | \$106 | \$102 | -\$4 | -4.0% |
| Totals—All Programs | \$3,281 | \$3,183 | \$3,165 | -\$19 | -0.6% |
| Funding Sources | | | | | |
| Proposition 98 General Fund | \$1,801 | \$1,718 | \$1,973 | \$255 | 14.2% |
| Federal funds | 1,140 | 1,126 | 1,191 | 65 | 5.7 |
| Other ^g | 340 | 339 | 1 | -338 | -99.6 |

^a Except where noted otherwise, all programs are administered by the California Department of Education.
^b California Work Opportunity and Responsibility to Kids.
^c Administered by California Department of Social Services.
^d Includes funding for centers run by California Community Colleges.
^e Includes policy proposals (to increase family fees and lower provider reimbursement rates).
^f Growth funds have been distributed.
^g Includes prior-year carryover, federal reimbursements, and Child Care Facilities Revolving Fund monies.

of Proposition 98 has ranged from 9.4 percent (2003-04) to 10.9 percent (2008-09 Budget Act).

Budget-Year Augmentations for Backfill and Enrollment Growth. The Governor's budget-year proposal would increase total Proposition 98 support for CCC by \$396 million, or 6.5 percent, over the proposed current-year funding. Of this amount, \$230 million is to backfill a proposed current-year deferral. The Governor's budget also provides \$185 million for 3 percent enrollment growth. In addition, the Governor's budget achieves \$4 million in savings by suspending all CCC mandates. Consistent with K-12 education, the administration's proposal does not provide an

estimated 5 percent COLA for CCC in 2009-10 (for savings of \$323 million).

Proposition 98 Spending by Major Program.

The Governor's 2009-10 budget for CCC includes \$5.7 billion in apportionment (or general purpose) funding, accounting for 86 percent of CCC's total Proposition 98 expenditures. Apportionment funding would increase 7 percent over proposed current-year expenditures. By comparison, most categorical programs would receive the same level of funding in the budget year as in the current year. Funding for the three largest categorical programs, however, would increase by 3 percent for enrollment growth.

Figure 6

California Community Colleges Budget Summary

(Dollars in Millions)

| | 2007-08 Actual | 2008-09 Proposed | 2009-10 Proposed | Change from 2008-09 | |
|---|-------------------|---------------------|--------------------------|---------------------|-------------|
| | | | | Amount | Percent |
| Community College Proposition 98 | | | | | |
| General Fund | \$4,142.1 | \$4,031.9 | \$4,418.0 | \$386.1 | 9.6% |
| Local property tax | 1,970.7 | 2,053.5 | 2,063.6 | 10.1 | 0.5 |
| Subtotals, Proposition 98 | (\$6,112.8) | (\$6,085.4) | (\$6,481.7) ^a | (\$396.3) | (6.5%) |
| Other Funds | | | | | |
| General Fund | (\$312.7) | (\$386.7) | (\$424.3) | (\$37.6) | (9.7%) |
| Proposition 98 Reversion Account | 19.1 | 21.6 | — | -21.6 | -100.0 |
| Quality Education Investment Act | 32.0 | 48.0 | 48.0 | — | — |
| Chancellor's Office | 10.0 | 9.8 | 10.2 | 0.4 | 3.8 |
| Teachers' retirement | 87.8 | 89.2 | 95.5 | 6.4 | 7.1 |
| Bond payments | 164.1 | 219.0 | 271.6 | 52.6 | 24.0 |
| Compton CCD ^b Loan Payback | -0.3 | -0.9 | -0.9 | — | — |
| State lottery funds | 168.7 | 164.2 | 169.8 | 5.6 | 3.4 |
| Other state funds | 19.7 | 28.6 | 28.3 | -0.3 | -1.0 |
| Student fees | 291.3 | 299.4 | 308.4 | 9.0 | 3.0 |
| Federal funds | 257.9 | 256.1 | 255.8 | -0.3 | -0.1 |
| Other local funds | 1,918.4 | 1,916.9 | 1,916.9 | — | — |
| Subtotals, Other Funds | (\$2,968.7) | (\$3,051.9) | (\$3,103.5) | (\$51.6) | (1.7%) |
| Grand Totals | \$9,081.6 | \$9,137.3 | \$9,585.2 | \$447.9 | 4.9% |

^a Excludes \$169.8 million backfill of lottery funds.

^b Community college district.

Detail may not total due to rounding.

Protection From Future Local Property Tax Shortfalls. Community colleges rely on local property taxes as an important funding source for their general operations. Each year, the budget assumes a certain level of property tax revenues (as well as fees) in calculating the General Fund contribution toward those CCC costs. Unlike K-12 education, however, there is no automatic backfill of General Fund monies when local property tax receipts fall short of budget

assumptions. This was a major issue for the CCC system in 2007-08, when community colleges faced an \$85 million property tax shortfall. (The state ended up redirecting other Proposition 98 funds to backfill all but \$10 million of the shortfall.) The Governor proposes to minimize the chances of this reoccurring in the future and shift the risk of lower-than-expected property taxes to the state General Fund.

BALANCING THE 2009-10 BUDGET

To help address the state's \$40 billion budget shortfall, the Governor's plan provides \$8 billion (roughly \$5 billion in 2008-09 and \$3 billion in 2009-10) in solutions from K-14 education. (In addition, the Governor makes \$1.7 billion in other Proposition 98 adjustments for 2008-09.) As we discussed in our January report, *Overview of the Governor's Budget*, we encourage the Legislature to reduce Proposition 98 spending as much as possible in the current year. This report focuses on building the budget-year Proposition 98 plan. For the budget year, we identify almost \$6 billion in potential K-14 reductions—roughly double that identified by the Governor for 2009-10. We identify more budget-year savings given (1) a current-year package adopted by the Legislature could achieve less savings than the Governor assumes and (2) the size of the total budget problem could grow. Below, we lay out a three-tiered approach toward identifying K-14 cuts.

PROPOSITION 98 REQUIREMENT FOR BUDGET YEAR UNCERTAIN

The Proposition 98 minimum guarantee for 2009-10 is difficult to estimate at this time be-

cause it is heavily dependent upon inputs that remain very uncertain. The budget-year minimum guarantee depends upon General Fund revenues, local property taxes, and K-12 attendance—estimates of which will fluctuate over the course of the next 18 months. Although some of these inputs (such as K-12 attendance) likely will fluctuate only modestly, others (such as General Fund revenues) likely will fluctuate to a much greater degree. General Fund revenues remain particularly uncertain both because of broader economic trends and potential legislative actions to increase tax revenues. Furthermore, the 2009-10 minimum guarantee depends upon final current-year Proposition 98 spending, which, at the time of this analysis, also remained uncertain.

Technical Debate Over Proposition 98 Mechanics Also Could Affect 2009-10 Requirement. In addition to the uncertainty regarding revenues and current-year spending levels, differing interpretations of Proposition 98 could lead to different estimates of the funding requirement for 2009-10. As of this analysis, the administration is forecasting the Proposition 98 minimum guarantee will be calculated using the "Test 1" formula in 2008-09 and 2009-10. Under Test 1,

the state spends roughly 40 percent of General Fund revenues on K-14 education. Other than the first year under Proposition 98 in 1988-89, the state has always provided more for K-14 education than Test 1 required and has calculated the minimum guarantee using either the “Test 2” or “Test 3” formula. Now in uncharted territory, debate has arisen over how the mechanics of Proposition 98 are supposed to work under Test 1. The debate tends to hinge on whether the constitutional provisions are read literally (sometimes leading to odd outcomes) or in a way that avoids strange outcomes (but conflicts with the literal language).

Different Views of What Happens Under Test 1. Specifically, different views have emerged regarding the treatment of the “maintenance factor” under Test 1. The first issue (potentially relevant in 2008-09) relates to whether the state needs to establish a maintenance factor in a year when Test 1 is applicable. Historically, a maintenance factor has been established only in Test 3 years to record the difference between the Test 3 level and the higher Test 2 level. Whereas some believe a maintenance factor continues to be established in Test 1 years that are lower than the Test 2 level, others believe no maintenance factor is generated. The second issue relates to how the maintenance factor is paid (potentially relevant in 2009-10). Whereas some believe maintenance factor payments are to be made on top of the Test 2 level, others believe it is to be made on top of the

Test 1 level. While the outcome of this debate is not likely to affect the minimum guarantee in 2008-09, it could have a multibillion effect on the 2009-10 funding requirement.

ESTABLISHING PROPOSITION 98 PRIORITIES

Given all these factors, we do not know what level of K-14 reductions the Legislature will feel compelled to make in the budget year. We therefore use a tiered approach to identify potential reductions. Under such an approach, the Legislature could begin by making tier 1 budget reductions and then work its way through the tiers until it achieved the desired amount of K-14 budget solution. If the Legislature were to adopt every option in each of the three tiers, it could achieve slightly more than \$5 billion in Proposition 98 savings (reflecting a 10 percent programmatic reduction) and slightly more than \$600 million in non-Proposition 98 General Fund savings.

Budget Crisis Leaves Few Easy Choices.

Figure 7 summarizes the value of the Proposition 98 reductions included in each tier for K-12 education and the community colleges. While the state’s fiscal crisis leaves few easy choices,

**Figure 7
A Tiered Approach to Making Proposition 98 Reductions^a**

(Dollars in Millions)

| | Tier 1 Reductions | Additional Tier 2 Reductions | Additional Tier 3 Reductions | Cumulative by Segment | |
|-------------------------------|----------------------|------------------------------------|------------------------------------|-----------------------|---------|
| | | | | Amount | Percent |
| K-12 Education ^b | \$874 | \$1,499 | \$2,111 | \$4,484 | 88% |
| California Community Colleges | 254 | 270 | 114 | 638 | 12 |
| Totals | \$1,127 | \$1,769 | \$2,225 | \$5,122 | — |
| Cumulative by Tier | \$1,127 | \$2,897 | \$5,122 | — | — |

^a We also identify \$652 million in non-Proposition 98 K-14 reductions (\$152 million in tier 1 reductions and \$450 million in tier 2 reductions).

^b Includes reductions to child care and development programs.

we believe some program reductions would be less harmful than others. In all of our tiers, we avoid reducing funding for districts' base academic program—making this our top priority. As described in more detail below, tier 1 consists primarily of program eliminations and technical adjustments we recommend that the Legislature make in any fiscal environment. In tier 2, we offer additional options that would result in some reduced K-14 services, whereas tier 3 options would have relatively significant programmatic effects. Under tier 3, virtually all categorical programs would experience some level of reduction, though we suggest smaller reductions to programs serving at-risk students, with larger reductions to instructional support programs. While the proportions vary slightly by tier, cumulatively, K-12 education would absorb 88 percent of the reductions under our approach, with community colleges absorbing the remainder.

Block Grants Can Help Legislature Prioritize. In the categorical reform write-up of the "Other Issues" section of this report, we recommend the Legislature consolidate 42 K-12 programs and 8 CCC programs into 5 block grants. One benefit of a block grant approach is that it can help decision makers more easily prioritize among education programs and services. That is, by pulling together like programs, block grants allow decision makers to judge among broad categories of services rather than having to evaluate the merits of dozens of individual programs that serve similar purposes. Under our tiered approach, we apply smaller reductions to programs serving at-risk students, including those who are economically disadvantaged, English learners, in special education services, or in need of remediation. As a result of this prioritization, we take increasingly deep cuts to our K-12 "Instructional

Support" and CCC "Faculty Support" block grants. We take no cuts, however, to funding for districts' base academic program (K-12 revenue limits and CCC apportionments).

Tier 1: Recommended Reductions

In tier 1, we identify \$1.1 billion in Proposition 98 reductions and \$152 million in non-Proposition 98 reductions—for total K-14 General Fund savings of \$1.3 billion. Figure 8 (see next page) lists the Proposition 98 reductions. We have recommended many of these reductions in the past, as they would eliminate activities that are duplicative, funded in excess of estimated need, or capable of being run more efficiently. Even if taken in total, these tier 1 reductions would have minimal effect on K-14 education. Below, we briefly describe each of the recommended Proposition 98 reductions in order of magnitude, beginning with K-12 education and continuing with CCC. We then discuss the non-Proposition 98 reductions. (Included in the tier 1 list are savings from eliminating two mandates—one related to K-12 behavioral intervention plans and one related to CCC health services. These are not discussed below, as we cover them in the "Other Issues" section of this report.)

Capture Savings From Block Grant Efficiencies. Our categorical reform proposal consolidates 33 K-12 programs and 8 CCC programs into 4 large block grants—Instructional Support, "Opportunity to Learn" (OTL), "Student Success," and Faculty Support. (A fifth block grant concerns special education programs, which are tied to a federal maintenance-of-effort [MOE] requirement.) Because our approach would eliminate most of the underlying requirements and reporting currently associated with these programs, less funding would be needed for completing

paperwork and general compliance and administrative activities. As such, we believe districts and colleges could offer the same level of services at a lower cost. We recommend the Legislature reduce each of these block grants by 5 percent to account for these efficiencies. This would have virtually no effect on student and faculty services.

Eliminate the High Priority Schools Grant Program (HPSGP). This is one of several school improvement programs. Not only is the program duplicative, it has proved ineffective in improving student achievement. We recommend the Legislature eliminate the program for state savings of \$114 million. The vast majority of HPSGP schools would continue to receive support through a federal school improvement program.

Align After School Funding With Estimated Expenditures. Currently, California spends \$550 million in state funds on the After School Education and Safety (ASES) program. Nearly every year, it has received more funding than needed to cover all ongoing program costs. We estimate the Legislature could reduce ASES funding by \$100 million, with no reduction in the number of students currently served. (A similar federal after school program provides more than \$100 million annually and also routinely carries forward unspent funds.) Because ASES funding was established by a voter initiative, voter approval would be required before this option could be implemented. (As a part of this approval, we recommend that voters allow the Legisla-

Figure 8

Tier 1: Recommended Proposition 98 Reductions^a

(In Millions)

| Program | Action | 2009-10 Savings |
|---|---|------------------|
| K-12 Education | | |
| New Instructional Support and Opportunity to Learn block grants | Capture 5 percent savings from new efficiencies | \$369.8 |
| High Priority Schools grant program | Eliminate program | 114.2 |
| After School Education and Safety | Align funding with estimated expenditures | 100.0 |
| Year Round Schools grant program | Eliminate program | 58.1 |
| Behavioral intervention plans | Eliminate mandate | 65.0 |
| Adult education | Reduce base program to account for "excess" growth from 2004-05 through 2009-10 | 57.0 |
| Regional Occupational Centers and Programs | Use excess local property tax revenue to offset state costs | 40.0 |
| CalWORKs Stage 2 and 3 | Align funding with updated caseload estimates | 37.1 |
| Charter school facility grants | Align funding with estimated expenditures | 29.4 |
| National Board Certification Incentive program | Phase out program | 3.0 |
| California Community Colleges | | |
| Student fees | Increase from \$20 to \$30 per unit | \$120.0 |
| Enrollment growth | Reduce from 3 percent to 1 percent | 117.0 |
| New Student Success and Faculty Support block grants | Capture 5 percent savings from new efficiencies | 12.9 |
| Health mandate | Eliminate mandate | 4.0 |
| Total | | \$1,127.4 |

^a We also recommend prepaying the 2009-10 settle-up obligation in 2008-09 (for non-Proposition 98 savings of \$150 million) and eliminating the Office of the Secretary for Education (for non-Proposition 98 savings of \$2 million).

CalWORKs = California Work Opportunity and Responsibility to Kids.

ture to make ASES funding decisions as part of the regular budget process without a guaranteed set-aside.)

Eliminate Year Round Schools Program.

Currently, the Year Round Schools program provides incentive funding for school districts that operate on a multitrack, year round calendar and enroll more students than the state's facility capacity standards. Over the last few years, the program has experienced a significant decline in participation, with only four school districts currently receiving funding. In addition, a number of participating schools are planning to move off multitrack calendars in the near future. Thus, we recommend eliminating the program, for savings of \$58 million.

Align Adult Education Funding With Growth in Adult Population. State law authorizes 2.5 percent enrollment growth in adult education each year. Since the 1990s, however, the adult population has grown at a rate well below 2.5 percent. Over the last two decades, the adult education program and associated funding has grown about 25 percent larger than justified based on growth in California's adult population. As a result, many adult education providers cannot serve enough students to earn their full state entitlements, and those who can, often do so in large part by offering enrichment classes. We recommend reducing the program by \$57 million to adjust for excess growth that has occurred since 2004-05. We further recommend tying future growth in adult education spending to the adult population. (This reduction would have virtually no impact on core adult education classes such as English as a second language and adult basic education.)

Use More Accurate Method to Build Budget for Regional Occupation Centers and Programs

(ROC/Ps). Currently, state law requires certain "excess" local revenues to be used for ROC/Ps. Specifically, if local revenues alone prove sufficient to fund all of a county office of education's revenue limit, then state law directs the county to apply any remaining local revenues to its ROC/P. Though these excess local revenues have materialized over the last several years, the state has not been accounting for them when building the ROC/P budget. Rather than achieving offsetting state savings, the "left over" state funding has been redistributed to all ROC/Ps, essentially providing each program with a small, unanticipated additional payment. We see no policy rationale for such a practice. Instead, we recommend the state use a more accurate method of budgeting for ROC/Ps—one that would use prior-year excess local revenues to offset program costs in the next year. For 2009-10, we recommend reducing state support by \$40 million to account for this excess local revenue.

Reduce CalWORKs Child Care Due to Declining Caseload. Demand for Stage 2 and 3 CalWORKs child care is projected to decline in 2009-10. We recommend the Legislature reduce funding by \$37 million to account for the anticipated decline in caseload.

Align Charter School Facility Funding With Estimated Expenditures. Currently, the Charter School Facility Grant program provides per-pupil funding to assist some charter schools with rent and lease costs. To be eligible for the program, schools cannot use facilities from their chartering authority and must be located in an attendance area or have a student population with more than 70 percent of students eligible for free and reduced-price meals. Last year, legislation was passed that augmented funding for the program. Because the significant funding increase was not

accompanied by a corresponding expansion of eligibility, we estimate funding will exceed program costs over the next few years. For 2009-10, we recommend the Legislature reduce funding by \$29 million to align the appropriation with anticipated program costs. Such action would have no effect on the ability of charter schools to access state funds for facilities.

Phase Out National Board Certification

Program. This program, currently budgeted at \$6 million, provides a \$5,000 annual stipend for four years to any teacher who both becomes certified by the National Board for Professional Teaching Standards and agrees to work in a low-performing school. While attracting and retaining high-quality teachers in low-performing schools is certainly a worthwhile endeavor, we question whether this program is effective statewide policy. Currently, the program benefits only about 700 teachers a year (less than 1 percent of the state's teaching force). Moreover, virtually all teacher compensation decisions are made at the district level, and districts have full discretion to offer financial or other types of incentives to help recruit and retain quality teachers at hard-to-staff schools. Districts may decide that national board certification is worthy of financial reward or select another method of identifying, attracting, and recognizing good teachers in their community. For these reasons, we recommend the state phase out this program but honor existing commitments to teachers who have already become certified and begun working in low-performing schools. This would result in about \$3 million in savings in 2009-10, with \$1 million in additional savings each year for the next three years until the final cohort has exited the program.

Increase CCC Fees to \$30 Per Unit. The CCC's enrollment fees, which are currently

\$20 per unit, are the lowest in the country. We recommend the Legislature raise fees to \$30 per unit. This action would generate about \$120 million in new fee revenue—replacing a like amount of General Fund support. Financially needy students would not be affected by this increase given they qualify for a full fee waiver. In addition, middle-income students would continue to qualify for a full or partial federal tax offset to their fees. Even with our recommended increase, CCC fees would remain the lowest in the country. (See our *2009-10 Budget Analysis Series: Higher Education*, page HED-24 for more detail on this proposal.)

Reduce Governor's Proposed Enrollment Augmentation to Reflect Fee Increases. The Governor's budget includes \$175 million to provide a 3 percent increase in CCC enrollment in 2009-10. Additional enrollment funding for CCC is appropriate given recent growth trends. The size of CCC's growth is likely to be tempered, however, to the extent that fees are raised. We therefore recommend a smaller amount of enrollment funding if the Legislature approves a fee increase. Enrollment growth of 1 percent would cost about \$58 million, resulting in savings of \$117 million relative to the Governor's proposal. (See our Higher Education publication, page HED-20) for more detail on this proposal.)

Achieve Savings by Prepaying "Settle-Up" Obligation. In addition to our recommended Proposition 98 reductions, we recommend the Legislature achieve \$150 million in non-Proposition 98 savings by prepaying the 2009-10 settle-up obligation in 2008-09, as proposed by the Governor.

Eliminate the Office of the Secretary of Education (OSE). We also recommend the state eliminate the OSE, for non-Proposition 98 sav-

ings of \$2 million. The office, led by the Secretary of Education (Secretary), has 18 positions and is responsible for advising the Governor on education policy. Additionally, the state funds the California Department of Education (CDE), led by the publicly elected Superintendent of Public Instruction (SPI). The department administers programs, reports to the federal government, and provides technical assistance to local educational agencies (LEAs). It also supports the State Board of Education (SBE) in setting long-term education policy, granting waivers, and hearing appeals. Together, the CDE and SBE annual budget is more than \$225 million. The Legislature could eliminate the OSE and reassign the Secretary to work with CDE and SBE. This would not only generate savings and eliminate redundant positions but also would pave the way for future education governance reforms consistent with the *California Master Plan for Education* (2002) and the Governor's Committee on Educational Excellence's technical report (2007). (Under these governance reforms, the Secretary would head CDE, and the SPI would become responsible for oversight and accountability.)

Tier 2: Reductions With Some Programmatic Effects

In tier 2, we identify \$1.8 billion in Proposition 98 reductions and \$450 million in non-Proposition 98 reductions—for total K-14 General Fund savings of \$2.3 billion. Similar to tier 1, we continue to preserve funding for certain programs—including those that serve disadvantaged student populations, provide fiscal oversight services, and/or leverage substantial federal funding. In contrast to tier 1 recommendations, however, these tier 2 options would result in some reduced services for K-14 students. Nonetheless, we believe these options—if needed—would

be less severe than other types of cuts. Figure 9 (see next page) lists the reductions, which we describe below.

Reduce K-12 Instructional Support Block Grant by 25 percent. Our proposed K-12 Instructional Support block grant includes funding for a variety of services and activities, including reducing class sizes, providing professional development for teachers, and enrichment in subjects such as art and music. While these activities can be valuable, we believe they are of lower priority compared to the core instructional program and supplemental services for at-risk students. The Legislature could reduce this block grant by 25 percent, for savings of almost \$1 billion. School districts presumably would respond by narrowing their focus to those instructional support activities deemed most important to their local communities.

Eliminate Deferred Maintenance Program. Currently, the Deferred Maintenance program provides one-to-one matching funds to help school districts make major facility repairs or replace existing school building components. We recommend eliminating the program in 2009-10 for savings of \$313 million. Although delaying major repairs can lead to greater future facility costs, we do not think funding for this program should take priority over core educational activities. Additionally, school districts that have critical repair needs could do the repairs using general purpose funding. In the future, rather than resurrecting this program, we recommend the Legislature increase the amount districts must deposit in their routine maintenance accounts. To the degree the state has funding available, it could provide additional revenue limit funding to support this higher requirement. This would provide similar funding to districts but would do

so in streamlined fashion—without separate programs for “routine” and “deferred” maintenance.

Speed Up Timeline for Reducing Adult Enrollment in ROC/Ps. In 2006, legislation shifted the educational mission of ROC/Ps to focus more on serving high school students and less on serving adults. Specifically, the 2006 law imposed a timeline for ROC/Ps to reduce adult enrollment to 10 percent or less by July 1, 2010. The Legislature could move up the final deadline to the beginning of the 2009-10 fiscal year. Changing the timeframe for phasing out adult services could save the state roughly \$100 million (though savings could be lower depending on how far ahead of schedule some ROC/Ps are in reducing adult enrollment). This would result in fewer adults being offered no-fee career technical education in 2009-10.

Lower Child Care Reimbursement Rates.

Currently, CalWORKs providers are reimbursed for services up to a maximum rate equivalent to the 85th percentile of the rates charged by private-market providers in the same region (determined by a “regional market rate survey” conducted every two years). The Governor is proposing to lower that maximum reimbursement rate to the 75th percentile of the regional market rates. In tier 2, we suggest the Legislature implement the Governor’s proposal and save at least \$38 million in 2009-10. There is a risk, however, that some providers will forego subsidized clients in favor of higher paying private clients, thereby increasing the difficulty some low-income families could have in finding available child care.

Figure 9

Tier 2: Proposition 98 Reductions With Some Programmatic Effects^a

(In Millions)

| Program | Action | 2009-10 Savings |
|--|--|----------------------|
| K-12 Education | | |
| Instructional Support block grant | Reduce by 25 percent | \$996.0 ^b |
| Deferred maintenance | Eliminate program | 312.9 |
| Regional Occupational Centers and Programs | Eliminate funding for adult services | 100.0 |
| Child care provider reimbursement rates | Set at 75 th percentile of regional market rate | 38.7 |
| Early Mental Health Initiative | Suspend due to anticipated decline in participation | 15.0 |
| Child care family fee schedule | Adopt Governor’s proposal (or some variant) | 14.4 |
| Home economics courses | Eliminate funding for these courses at adult schools | 12.3 |
| Special education | Reduce funding down to minimum federal requirement | 10.0 |
| California Community Colleges | | |
| Credit recreational courses | Reduce funding to regular non-credit rate | \$120.0 |
| Student fees | Increase from \$30 to \$40 per unit | 105.0 ^b |
| Various categorical programs | Reduce by 25 percent | 30.6 |
| Faculty Support block grant | Reduce by 25 percent | 14.4 ^b |
| Total | | \$1,769.3 |
| Cumulative—Tiers 1 and 2 | | \$2,896.7 |

^a The Legislature also could suspend the Quality Education Investment Act (for non-Proposition 98 savings of \$450 million).

^b Reductions taken *after* accounting for tier 1 savings.

Suspend Early Mental Health Initiative (EMHI). Currently, EMHI provides short-term matching grants to help LEAs provide mental health services to students with mild to moderate school adjustment difficulties. Given the severe budget reductions LEAs could face in 2009-10, local matching funds may not be available and demand for the program could be low. On this assumption, the Legislature could suspend funding. This may result in students with mild to moderate school adjustment difficulties receiving less additional support.

Increase Family Fees for Child Care. The Governor has proposed a revised family fee schedule that increases fees for nearly all families currently paying fees. The Legislature could adopt the Governor's proposal, with offsetting state savings of at least \$14 million. (Family fee schedules can be modified in several ways to achieve a desired amount of savings. For example, the schedule could be adjusted based on changes to the starting income level, rate at which fees increase, or maximum percentage of income paid.)

Eliminate Funding for Adult Home Economics Classes. Adult education programs receive state funding to offer home economics classes at no cost to students. These classes cover topics such as knitting, quilting, food preparation, and interior design. While home economics classes can be of value to students, they fall outside the core mission of adult education. Thus, we recommend eliminating state funding for these courses. (Schools still could offer the courses on a fee basis, if so desired.)

Reduce Special Education to Federally Required Minimum. Under the Governor's 2009-10 budget proposal, special education funding is above the minimum level required by the federal

government. The Legislature could reduce special education spending to the federally required minimum without losing federal dollars. This would result in state savings of \$10 million (compared to total spending of \$3.1 billion) with virtually no effect on the level of service provided to special education students.

Reduce Funding Rate for CCC Recreational Courses. The CCC system provides a variety of recreational courses (such as archery, badminton, and art appreciation) on a credit basis. Districts that offer these courses receive the same per-student funding rate as credit-bearing academic and vocational courses (such as mathematics and automotive repair). All CCC courses can be of value to students. Recognizing resource limitations, however, the Legislature has established statutory priorities for the CCC system that emphasize developing basic skills (such as communicating in English) and preparing students for careers. Given the state's fiscal condition, it is more important than ever to ensure that available resources are put to their highest use. Thus, we recommend the Legislature reduce funding for physical education and other enrichment courses to the rate that districts receive for regular non-credit courses. This action would result in state savings of up to \$120 million in 2009-10. (See our Higher Education publication, page HED-33 for more detail on this proposal.)

Increase CCC Fees to \$40 Per Unit. Whereas we recommend increasing CCC per unit credit fees from \$20 to \$30 under tier 1, the Legislature could increase fees to \$40 per unit if it determines additional state savings are needed. Even at \$40 per unit, financially needy students would not be affected (because of the state's fee waiver program) and middle-income students would qualify for a full or partial fee refund from federal

tax credits and deductions. Fees of \$40 per unit would generate a total of roughly \$225 million (twice as much as under tier 1) in additional revenue for CCC, with virtually no programmatic effect.

Reduce Funding for Various Other CCC Categorical Programs. Currently, the state provides funding for six CCC categorical programs that are nonworkload-based programs (such as physical plant and technology services). In tier 2, the Legislature could reduce funding for these programs by 25 percent. These programs do not provide direct student support or classroom instruction.

Reduce Funding for Faculty Support Block Grant. Our proposed CCC Faculty Support block grant would provide additional funds—on top of general-purpose apportionment monies—for professional development and other full- and part-time faculty programs. While these activities can be valuable, we believe they are of lower priority compared to core instruction and direct student support services. The Legislature could reduce this block grant by 25 percent, for savings of \$14 million. Community colleges presumably would respond by narrowing their focus to those instructional support activities deemed most important to their local communities.

Suspend Quality Education Investment Act (QEIA). In addition to these tier 2 Proposition 98 reductions, the Legislature could achieve \$450 million in non-Proposition 98 General Fund savings by suspending QEIA. This program provides K-12 funding (\$402 million) to a small set of low-performing schools for implementing a uniform set of requirements, including class size reduction. Community colleges also receive QEIA funding (\$48 million), primarily for supplemental support related to career and vocational education. If the Legislature were to

suspend QEIA funding, the vast majority of K-12 QEIA schools would continue to receive support through a federal school improvement program. Community colleges likely would reduce certain career and vocational education support, such as curriculum planning and outreach.

Tier 3: Reductions With More Significant Programmatic Effects

In tier 3, we identify \$2.2 billion in additional K-14 reductions (all Proposition 98 savings). When combined with the other tiers, cumulative General Fund savings would be \$5.7 billion (\$5.1 billion Proposition 98 and \$652 million non-Proposition 98). Figure 10 summarizes this final grouping of reductions. Relative to tier 1 and tier 2 reductions, these cuts represent more drastic options. Nonetheless, we include them to aid the Legislature if additional budget solutions are needed beyond the level proposed by the Governor.

Virtually All Programs Would Experience Reduction. As shown in the figure, virtually every sector of K-14 education and child care is affected under tier 3. Virtually the only funding left untouched would be for the base academic program (K-12 revenue limits and CCC apportionments). The list includes options for reducing instructional support, student support, special education, after school programs, charter schools, subsidized child care slots, outreach, and CCC faculty support. In several of these cases, funding would be dramatically reduced. For example, funding for K-12 instructional support, K-12 after school programs, and CCC faculty support would be cut in half. Charter schools would be reduced comparable to public non-charter schools. Tier 3 also includes eliminating funding for K-12 regional technology support (with hopes

that the K-12 High Speed Network program might be able to assume some of these responsibilities) and reducing the amount districts are required to deposit in their routine maintenance funds from 3 percent to 1 percent.

Some Programs Experience Smaller Cuts Than Others. Though virtually every K-14 service is affected under tier 3, some programs would be less affected than others—reflecting our judgment of educational priorities. In particular, we apply smaller reductions to programs serving at-risk students and special education students. Specifically, the K-12 OTL block grant, special

education, and CCC Extended Opportunity Programs and Services (EOPS) would be reduced by 10 percent. In addition, subsidized child care would be reduced about 3 percent (as the program serves low-income families and currently has a long wait list).

Unappealing Trade-Offs Associated With Tier 3 Options... Realizing savings from these tier 3 options is not without trade-offs. To accommodate 50 percent reductions to some programs would mean dramatic reductions in service levels. The 10 percent special education reduction, though modest compared to other cuts, would

Figure 10
Tier 3: Proposition 98 Reductions With More Significant Programmatic Effects

(In Millions)

| Program | Action | 2009-10 Savings |
|--|--|----------------------|
| K-12 Education | | |
| Instructional Support block grant | Reduce by 50 percent | \$996.0 ^a |
| Opportunity to Learn block grant | Reduce by 10 percent | 320.2 |
| Special Education | Reduce by 10 percent | 303.2 ^b |
| After School Education and Safety | Reduce by 50 percent | 225.0 ^b |
| Adult education | Reduce by 25 percent | 129.0 ^a |
| Reduce non-CalWORKs child care | Reduce by about 18,000 slots | 100.0 |
| Charter school block grant | Reduce funding to \$438 per charter pupil (comparable to the non-charter pupil rate) | 20.2 |
| California Technology Assistance Project | Eliminate program and shift responsibilities to High Speed Network | 17.6 |
| Routine maintenance requirement | Reduce from 3 percent to 1 percent | — ^c |
| California Community Colleges | | |
| Various categorical programs | Reduce by 50 percent | \$30.6 ^a |
| Student Success block grant | Reduce by 25 percent | 46.6 |
| Faculty Support block grant | Reduce by 50 percent | 14.4 ^a |
| EOPS | Reduce by 10 percent | 12.6 |
| High school exit exam remediation | Eliminate program | 10.0 |
| Total | | \$2,225.2 |
| Cumulative—All Tiers | | \$5,121.9 |

^a Amounts reflect incremental savings beyond those already counted through tier 2 reductions.

^b Percentage reductions taken after accounting for tier 1 and 2 reductions.

^c Does not achieve savings at state level but offers school districts additional flexibility in how to spend discretionary funds.

EOPS = Extended Opportunity Programs and Services; CalWORKs = California Work Opportunity and Responsibility to Kids.

put California out of compliance with the federal government's "MOE" requirement and could result in a loss of federal funds, meaning a double hit to districts. Reducing OTL funds might mean a widening achievement gap between economically disadvantaged students and English learners as compared to their higher achieving peers. A \$100 million reduction in CCD funding would result in a loss of approximately 18,000 child care or preschool slots. Cutting CCC programs would reduce students' access to support services such as counseling.

OTHER ISSUES

FLEXIBILITY AND CATEGORICAL REFORM

To give school districts and community colleges options for responding to the sizeable cuts included in his budget plan, the Governor has proposed to permanently suspend most requirements related to how schools and colleges use state funding. Although we believe additional flexibility would help districts and community colleges in accommodating cuts, we have concerns with the Governor's approach of disregarding—rather than reforming—the state's categorical system. Specifically, we think his proposal leaves many components of a complicated and irrational system in place, while removing incentives designed to ensure schools and colleges provide effective instructional programs for all students.

We recommend the Legislature adopt a more strategic approach that simplifies the existing system and provides schools and colleges with additional flexibility over how they use their funding, while still emphasizing important education priorities. Below, we assess the Governor's

...But Other Options May be Worse. Although tier 3 reductions have downsides, we believe other options for realizing these savings could be worse. Large reductions to revenue limits and CCC apportionments likely would have a greater effect on students, including significantly larger K-12 class sizes and fewer CCC course sections. Additionally, larger cuts to the OTL block grant, special education, and CCC EOPS would further disadvantage already needy students. In short, we see no way to cut billions of dollars from K-14 education without confronting difficult trade-offs.

flexibility proposals and then lay out our recommended alternatives, beginning with K-12 education and finishing with community colleges.

Governor's Flexibility Proposals Miss Opportunity for Substantive Reform

Figure 11 describes each of the Governor's flexibility proposals. As noted, all of the proposals apply to K-12 school districts, with two applying to CCCs. Four of the proposals—allowing smaller reserves for economic uncertainties, allowing access to categorical fund balances, reducing required routine maintenance deposits, and waiving the local deferred maintenance match—are changes the state has allowed on a short-term basis in prior years when fiscal times were tight. The Governor adds a new short-term option that would allow districts to reduce the minimum school year from 180 to 175 days. The Governor's proposal would remove these five restrictions for the near term, with existing requirements resuming in 2010-11. In addition, the Governor proposes to permanently

remove restrictions on districts contracting out for noninstructional services. The most significant proposed change—suspending most K-14 cat-

egorical program requirements—also would be on an ongoing basis. Although we recommend adopting several of the Governor’s short-term

Figure 11
Governor’s Flexibility Proposals

| Proposal | Description | Recommendation |
|--|---|---|
| Short-Term (Through End of 2009-10)^a | | |
| Allow Smaller Emergency Reserves, Reduce Associated Oversight | Districts currently are required to set aside between 1 percent and 5 percent of their General Fund expenditures into a reserve, depending on the size of the district. They can access these reserve funds at any time, but if they dip below their requirement, additional monitoring by county offices of education is triggered. This proposal would lower the percentage that districts must set aside and could reduce associated fiscal oversight. | Reject—Retain oversight of school district fiscal health. |
| Allow for Shorter School Year | Under current law, districts receive incentive funding for offering 5 additional days of instruction beyond the minimum requirement of 175 days. This proposal would allow districts to provide only 175 days of instruction without losing incentive funding. | Adopt. |
| Allow Access to Categorical Fund Balances | Under current law, districts receive categorical funds for specified program activities. If they do not use all the funding provided in a given year, they typically can carryover the funds to the next year, but funds must still be used for the original intended activity. This proposal would allow districts to use carryover funding from prior years for any use, not just the original activity. | Adopt. |
| Reduce Routine Maintenance Requirement | Under current law, districts that receive state bond funds are required to deposit an amount equal to at least 3 percent of annual General Fund expenditures into a fund for ongoing and major maintenance of school buildings. This proposal would lower the percentage districts must deposit to 1 percent. | Adopt—Contingent on level of cuts. |
| Eliminate Local Deferred Maintenance Match | The state currently maintains a state categorical program intended to match school district contributions to deferred maintenance projects. This proposal would eliminate the requirement that districts spend their own funds on deferred maintenance in order to qualify for state dollars. | Adopt. |
| Ongoing | | |
| Waive Virtually All Categorical Program Requirements | The state has created numerous categorical programs for which funding is contingent on conducting certain activities and meeting specific requirements. This proposal would allow districts to use these funds for purposes other than the program activities for which they were originally intended. | Reject—Implement substantive categorical reform. |
| Remove Restrictions on Contracting Out | Under current law, districts can contract out for many noninstructional services, such as food service, maintenance, and clerical functions such as payroll only if certain conditions are met. (For example, contracting out for services cannot result in the layoff or demotion of existing district employees.) This proposal would remove these restrictions and allow districts to contract externally for these functions at any time. | Adopt. |

^a Applies only to K-12 school districts, not California Community Colleges.

flexibility proposals as well as his contracting out proposal (which could help districts lower some of their costs), we have serious concerns with his one-time suspension of emergency reserve requirements and his ongoing categorical flexibility proposal.

Several of Governor’s Short-Term Flexibility Proposals Make Sense in Current Budget Climate. We believe three of the Governor’s proposals—accessing categorical balances, shortening the school year, and eliminating the local deferred maintenance match—would offer additional flexibility in 2009-10 without undermining important education priorities over the long run. Depending on the magnitude of cuts included in the final budget package, we also believe lowering routine maintenance requirements in 2009-10 could be warranted, as discussed in the “Balancing the 2009-10 Budget” section of this report. In a climate of multibillion dollar cuts, we believe these flexibility options would free up certain resources to help districts preserve those services they consider most effective in producing positive student outcomes. We believe this flexibility should be granted only through the budget year to avoid negative outcomes. For example, the state’s maintenance requirements stem from long experience with school districts that failed to regularly maintain their own facilities. Thus, while maintenance might be deemed a lower priority during a tight fiscal year, we believe the state should re-instate a maintenance requirement next year.

Lowering Emergency Reserve Requirement Does Not Provide Any Additional Flexibility, Weakens State Oversight. We recommend the Legislature reject the Governor’s proposal to lower the amount school districts must set aside in their reserves for economic uncertainty.

Districts already are able to access these reserves whenever needed, so reducing the requirement does not actually provide them any additional flexibility or discretionary funding compared to current law. We also believe it is important to maintain the current “warning system” that alerts the state and local community when districts may be entering fiscal distress. Given the significant midyear cuts under consideration for 2008-09, many districts likely will be accessing these reserves in the near term. All the Governor’s proposed change would do is delay the point at which the state and local communities are alerted that a district is getting closer to fiscal insolvency. Because the courts have ruled that the state has ultimate fiscal responsibility for educating a district’s students, the state needs an early warning system to know when and how aggressively to intervene in struggling districts.

Categorical Proposal Leaves Complicated and Irrational System in Place, Layers on Additional Complications. Although the Governor’s proposal to suspend virtually all categorical requirements would obviously offer districts and colleges greater flexibility, we believe it has several major problems. Most importantly, it does not formally consolidate or eliminate any program. Leaving program requirements “on the books” sends a confusing message about the state’s intentions. Is the state telling districts and colleges these program activities are still important priorities? If that is the case, why allow them to ignore the program requirements? Alternatively, if the programs are not important, why not eliminate them? Appropriating and tracking funding levels for individual programs that have no requirements also renders the annual state budget act unnecessarily complicated and misleading. In addition, the Governor’s proposal

raises funding distribution questions. Given the proposal would not change the existing funding distributions, some districts and colleges would continue to get additional streams of funding for activities they no longer are required to conduct. In contrast, others who were not participating in certain categorical programs would miss out on what has essentially become a new source of general purpose funding.

Administration Overestimates Power of Existing Accountability System. Presumably, the Legislature established existing categorical programs because it felt particular activities were important enough that school districts and community colleges should be financially encouraged to undertake them. The Governor asserts that because schools and colleges are now outcome-oriented, these categorical programs are no longer necessary. That is, he believes sufficient accountability now exists for districts and colleges to conduct all of the activities needed to produce positive student outcomes. According to this argument, all spending decisions can therefore be made at local level. While we agree that stronger accountability systems could allow for increased local fiscal flexibility, we are concerned the Governor is overestimating the power of the existing accountability system. The existing K-12 accountability framework is neither nuanced enough to help districts clearly determine how they need to improve nor to help the state clearly identify which school districts need intervention. Furthermore, we are not convinced the sanctions included in the current K-12 intervention system are strong enough to force struggling districts to significantly change their practices. Similarly, while the state requires community colleges to report on student outcomes (such as through the annual Accountability Reporting

for the Community Colleges), no consequences are in place for underachieving college districts. Until such time that state and local systems are strong enough to fully hold college districts and community colleges accountable for improving outcomes for all students, we believe the state needs to continue having some explicit requirements to be sure they address certain important education priorities.

Undertake Substantive K-12 Categorical Reform

While we have serious concerns with the Governor's categorical approach, we do believe major changes should be made to the state's K-12 categorical system. Our office, as well as numerous education policy researchers (including the recent collection of *Getting Down to Facts* authors and the Governor's Commission on Education Excellence), have long argued the state's existing system of categorical programs is convoluted, irrational, and overly prescriptive. While the rationale for reform exists in any fiscal environment, the current fiscal climate lends a greater sense of urgency to revisiting the state's education funding system by offering the possibility of stretching limited dollars further. As in prior years, we continue to recommend the Legislature consolidate most of the state's existing K-12 categorical programs into large block grants.

Consolidate Most K-12 Categorical Programs Into Thematic Block Grants. Specifically, we recommend the state consolidate 42 existing K-12 categorical programs into three large block grants focused on instructional support, at-risk students, and special education students. The programs we target for consolidation represent roughly two-thirds of all state categorical funding for K-12 education. Coupled with the consoli-

dation, we recommend removing the majority of the associated programmatic restrictions but establishing a broad requirement that districts spend a dedicated stream of funding on high priority students and activities. (The programs excluded from our block grants typically have a specific policy rationale for continuing to exist as stand-alone programs. For example, they fund a regional rather than local activity, such as the K-12 High Speed Network and California School Information Services, or they serve special populations, such as adult education, child development, and foster youth programs.) We describe the three block grants in more detail below.

Create Instructional Support Block Grant.

As shown in Figure 12, we recommend consolidating 22 programs and \$4.2 billion into a new Instructional Support block grant. Under current law, these programs provide funding for a collection of narrowly defined student services or activities. These include reducing class size; transporting students; training teachers; and supporting enrichment activities like libraries, art, music, and physical education. In contrast, the new block grant would allow districts to choose from a broad menu of these support activities and prioritize among them to construct the instructional program that best meets student needs in their community.

Create Opportunity to Learn Block Grant.

As shown in Figure 13, we recommend consolidating 12 programs and \$3.2 billion into a new OTL block grant. Most of the programs we include in this block grant are targeted for economically disadvantaged students, English learners, and students in need of academic remediation. Under the block grant, districts would be required to spend funds on *supplemental* services to improve the academic achievement of these three groups of students. Furthermore, “first call” on the OTL funds would be to meet require-

Figure 12
LAO Instructional Support Block Grant
Would Consolidate 22 Programs

(In Millions)

| Program | 2009-10 Proposed |
|--|------------------|
| K-3 Class Size Reduction | \$1,824.6 |
| Home-to-School Transportation | 618.7 |
| School and Library Improvement Block Grant | 461.6 |
| Instructional materials | 416.3 |
| Professional Development Block Grant | 272.5 |
| Teacher Credentialing Block Grant | 129.1 |
| Arts and Music Block Grant | 109.8 |
| 9th Grade Class Size Reduction | 98.5 |
| Math and Reading Professional Development | 56.7 |
| Gifted and Talented Education | 55.2 |
| Physical Education Teacher Incentive Grants | 41.8 |
| Commission on Teacher Credentialing programs | 32.7 |
| Peer Assistance Review | 29.8 |
| Apprenticeship | 19.6 |
| Specialized Secondary Program Grant | 6.1 |
| Agricultural Vocational Education | 5.2 |
| Principal Training | 4.9 |
| Partnership Academies | 4.5 |
| Oral health assessments | 4.4 |
| International Baccalaureate | 1.3 |
| Reader Services for Blind Teachers | 0.4 |
| Teacher Dismissal Apportionment | 0.1 |
| Total | \$4,193.7 |

ments related to the *Valenzuela v. O'Connell et al* settlement (to provide counseling and remedial instruction to students who fail or are likely to fail the high school exit exam) and for addressing state mandates related to providing supplemental instruction and maintaining school safety plans. Beyond these broad requirements, districts would have flexibility in determining the mix and characteristics of additional classroom services, remedial services, and support activities they wish to provide for the targeted groups of students.

Create Special Education Block Grant. As shown in Figure 14, we recommend merging base special education apportionment funding (commonly called AB 602 funding) with three apportionment “add-ons” and four stand-alone special education programs. (The add ons—distributed as part of a district’s base apportionment—are intended to account for certain higher costs students.) These eight programs, associated with \$3.1 billion in total funding, currently distribute funds to most Special Education Local Plan Areas (SELPA) and/or support core special education activities. Under the block grant approach, districts and SELPA still would be required to meet federal mandates, but they would have more flexibility in how they went about fulfilling these requirements. In addition, by consolidating funding sources, the

Legislature could clarify actual funding levels and set the stage for future equalization efforts.

Figure 13

LAO Opportunity to Learn Block Grant Would Consolidate 12 Programs

(In Millions)

| Program | 2009-10 Proposed |
|--|------------------|
| Targeted Instructional Improvement Grant | \$1,167.0 |
| Economic Impact Aid | 994.3 |
| Supplemental Instruction | 419.5 |
| Supplemental School Counseling Program | 208.4 |
| School safety programs | 99.7 |
| Pupil Retention Block Grant | 95.7 |
| CAHSEE ^a Supplemental Instruction | 72.8 |
| English Language Acquisition | 63.1 |
| Community-Based English Tutoring | 50.0 |
| School Safety Competitive Grant | 17.9 |
| Certificated Staff Mentoring | 11.7 |
| Advanced Placement | 1.8 |
| Total | \$3,201.9 |

^a California High School Exit Exam.

Figure 14

LAO Special Education Block Grant Would Consolidate Eight Programs

(In Millions)

| Program | 2009-10 Proposed |
|--|------------------------|
| Attendance-based apportionment | \$2,915.3 ^a |
| SELPA ^b base funding | 87.6 |
| Special Disabilities Adjustment ^c | 80.6 ^a |
| Project Workability | 39.5 |
| Vocational education | 5.2 |
| Personnel development | 2.5 |
| Low incidence services ^c | 1.7 |
| Necessary small SELPA ^c | 0.2 |
| Total | \$3,132.6 |

^a Reflects estimated funding level.

^b Special Education Local Plan Area (SELPA).

^c Reflects apportionment “add on.”

Hold Districts Harmless During Transition, Then Distribute Funding on Per Pupil Basis.

For 2009-10, our proposal would not alter the distribution of funding currently provided by the individual programs being merged. Thus, districts would continue to receive the same amount as if the programs had not been consolidated. Moving forward, we recommend allocating the block grants on a per pupil basis, using 2009-10 as the “base year” for determining each district’s per pupil funding rate. (As discussed below, we recommend using slightly different student counts for calculating each grant’s per pupil rate.) In 2010-11, all districts would be held harmless at their 2009-10 *per pupil* levels, but a district’s overall grant would increase or decrease depending on whether its student population grows or declines.

Use Most Relevant Student Counts to Determine Each Grant’s Per Pupil Rate. Because each of our block grants is targeted at a different student population, we recommend the Legislature use different “student counts” when determining per pupil rates and future funding distributions. For example, because the Instructional Support block grant is designed to support all students, we recommend basing funding on the district’s total enrollment. For the OTL block grant, we recommend basing funding on a district’s English learner and economically disadvantaged student population (as measured by Title I), with additional funding for districts with especially high concentrations of these students. (This is how funding allocations for the Economic Impact Aid program currently are determined.) For the special education block grant, we recommend distributing funding using the existing base program’s per pupil formula.

Equalize Per Pupil Amounts in the Future.

Because the distribution of existing categorical programs is not uniform across every district, dividing current funding levels by a district’s student count likely will result in large discrepancies in per pupil rates across districts. We therefore recommend that the Legislature use future increases in Proposition 98 funding to help equalize the per pupil rates for each grant. Once per student rates are more comparable across districts, the Legislature could use future funding increases to adjust per pupil rates for changes in the cost of living.

Maintain Some State Regulations. Even as the Legislature eliminates most specific programmatic funding streams and spending requirements, we recommend it maintain, monitor, and enforce some key compliance regulations. For example, the state should continue to require that districts provide every student with standards-aligned instructional materials (although, as discussed in our May 2007 report, *Reforming California’s Instructional Material Adoption Process*, we believe the state should extend the length of time districts can use an existing set of materials). Similarly, the state likely would want to continue requiring that districts offer a support program for new teachers, though a block grant approach would allow districts a greater degree of discretion as to how to structure these programs. The state must also continue to ensure districts meet certain legal requirements, including federal mandates and obligations resulting from the *Williams v. California* and *Valenzuela v. O’Connell et al* court settlements. While certain requirements will continue, block grants provide districts broader discretion as to how to best meet these regulations.

Categorical Reform Would Change the Role of CDE, Open Door for Broad Governance Reforms. While we recommend maintaining some essential state requirements, our proposed reforms would dramatically reduce—compared to the current system—administrative and compliance-related activities. Currently, CDE must implement complicated funding distribution formulas and enforce countless program requirements. Greatly reducing the number of formulas and program requirements would free up significant CDE resources. A slimmed down CDE administering the remaining programs and providing technical assistance to local agencies is consistent with governance reform proposals made by the LAO *K-12 Master Plan: Starting the Process* (1999), the Legislature’s *California Master Plan for Education* (2002), and the Governor’s Committee on Education Excellence’s technical report (2007). Even though complete implementation of the governance reform proposals laid out in these documents is not achievable by July 1, 2009, the state

could take significant steps this year to streamline CDE operations with the goal of aligning categorical workload with administrative support.

Undertake Substantive Community College Categorical Reform

Consistent with his proposal for K-12 education, the Governor proposes to give CCC the authority to use categorical funding for general purposes. (The Governor’s proposals to ease certain state requirements for K-12 education—such as reducing districts’ minimum reserve levels—do not apply to the CCC system, as statute does not currently prescribe such limits for community colleges.) Similar to our K-12 recommendations, we recommend an alternative approach for community colleges that creates block grants around thematic areas. While there are considerably fewer CCC categorical programs than K-12 programs (with less overlap in targeting certain groups of students), opportunities still exist to consolidate related programs in ways that maximize flexibility for community college districts.

community college districts.

Consolidate CCC Categorical Programs.

Specifically, we recommend two CCC block grants—one centered around student success and one around faculty support. Figure 15 summarizes the programs included in each recommended block grant. As the figure shows, our block grants would consolidate eight programs and \$257 million

Figure 15
Two New Community College Block Grants Recommended

(In Millions)

| | 2009-10 Proposed |
|--|---------------------|
| Student Success Block Grant | |
| Matriculation | \$104.9 |
| Financial aid/outreach | 52.2 |
| Basic skills initiative | 33.1 |
| Fund for Student Success | 6.2 |
| Total | \$196.3 |
| Faculty Support Block Grant | |
| Part-Time Faculty Compensation | \$50.8 |
| Part-Time Faculty Office Hours | 7.2 |
| Faculty and staff diversity/Equal Employment Opportunity | 1.7 |
| Part-Time Faculty Health Insurance | 1.0 |
| Total | \$60.7 |

in associated funding. These block grants would include more than one-third of all CCC categorical programs and funding. To ensure continued investment by districts in two groups of students, we exclude from block grants the CCC system's lone program for economically disadvantaged students (EOPS), as well as its program for disabled students. Because the remaining 11 existing categorical programs serve various unrelated and specialized purposes (such as foster-parent training, scheduled maintenance, and economic development), we recommend that they, too, remain separate.

Create Student Success Grant. As shown in Figure 15, we recommend consolidating four programs and \$196 million into a new Student Success block grant. By combining funding for these programs into one block grant, community college districts would be able to allocate student service funding in a way that best meets the needs of their students. With this funding, community college districts, for example, could provide services such as assessment, orientation, counseling (academic and financial aid), tutoring, and other activities designed to improve student completion. As with our K-12 proposal, we recommend that districts retain the same amount of categorical funding in 2009-10 that they would have received absent a consolidation. After this transition period, we recommend the funds provided under this block grant be allocated to districts primarily on a per-student basis (with some allowance made for districts with high percentages of financial aid recipients).

Create Faculty Support Grant. Also shown in Figure 15, we recommend consolidating four programs and \$61 million into a new Faculty Support block grant. This block grant is designed to improve faculty performance as well as recruit

and retain part-time faculty. With this funding, community college districts, for example, could undertake professional development activities for instructors or offer faculty-leave time to develop new curricula. Under the block grant approach, community college districts would have flexibility to allocate faculty resources to meet local campus needs. Similar to our recommendation for the Student Success block grant, we recommend that the funds provided under this block grant be allocated to all districts on a per-student basis following a one-year hold harmless transition period.

Block Grants Can Help Legislature And Districts Address Budget Cuts

One of the additional benefits of creating block grants is that budget and policy makers can more easily prioritize among thematic areas. This can be useful if additional budget cuts must be made in 2009-10. At the state level, prioritizing among a few thematic areas is a much more straightforward endeavor than having to compare the merits of dozens of individual categorical programs. As discussed in the "Balancing the 2009-10 Budget" section, our recommended approach would place a higher priority on maintaining K-12 revenue limits, CCC apportionments, special education, and funding for disadvantaged students as compared to instructional and faculty support. Similarly, at the local level, having flexibility to operate within the parameters of large thematic block grants can help districts and colleges retain those specific activities they deem highest priority.

EDUCATION MANDATES

The state currently requires LEAs to perform 45 mandated activities, including 4 newly mandated activities approved by the Commis-

sion on State Mandates (CSM) in 2008-09. In recent years, the state has not funded the annual costs associated with these mandates, instead deferring payment to future years. Nonetheless, unlike most mandates for other local agencies, LEAs must perform the mandated activities even in the absence of funding. This year, rather than continuing the practice of deferring payment, the administration proposes suspending most K-14 mandates. That is, the state would not require LEAs to perform the mandated activities so the state would not incur any fiscal liability—now or in the future.

The administration’s proposal is at least partly a response to a recent court ruling and partly a reaction to an existing mandate process laden with problems. Below, we summarize these problems, describe the administration’s mandate proposals in more detail, highlight concerns we have with those proposals, and then recommend the Legislature instead undertake substantive mandate reform.

Existing Mandate System Has Well-Recognized, Longstanding Problems

The existing mandate system has four major problems.

Costs Can Exceed Expectations. Frequently, when an activity required by law is deemed a reimbursable mandate, the price of funding the activity exceeds anticipated costs. This mismatch can occur for several reasons. In some cases, the state can end up being required to reimburse LEAs for activities that were not intended to increase total education costs. In other cases, lawmakers do not anticipate the range of activities that eventually will be deemed reimbursable. In addition, costs can vary dramatically depending on the number of districts that file claims,

the reimbursement period, the activities deemed allowable, and subsequent statutory decisions and legal rulings. Consequently, legislators cannot always predict the fiscal ramifications of their policy decisions.

LEAs Claim Vastly Different Reimbursement Amounts. The mandate process also allows districts to claim widely different amounts and receive widely different reimbursement levels for performing the same activities. The variation often reflects local record keeping and claim-filing practices more than substantive cost differences in implementing policy objectives. For example, some larger districts have staffing units dedicated to processing mandate claims whereas many smaller districts have one administrator presumably expected to file mandate claims while juggling many other responsibilities. Figure 16 provides an example of the notable variation in reimbursements for performing collective bargaining requirements range from \$4 to \$43 per

Figure 16
Mandate Reimbursement Claims Vary Widely

2002-03 Through 2006-07

| School District | Average Yearly Claim Per Pupil |
|-------------------------------|--------------------------------|
| Collective Bargaining | |
| Colusa | \$43 |
| Sacramento | 13 |
| Los Angeles Unified | 7 |
| Grossmont | 6 |
| Clovis | 4 |
| Graduation Requirement | |
| Clovis | \$163 |
| Grossmont | 144 |
| Los Angeles Unified | 72 |
| Riverside | 71 |
| Sacramento | 13 |
| Chico | 10 |

pupil—a greater than tenfold difference. Regarding the graduation requirement mandate, claims range from \$10 to \$163 per pupil.

Reimbursement Process Can Reward Inefficiency. Districts also receive more in mandate funding by claiming more activity, not by performing an activity efficiently. Many mandates are reimbursed based on the amount of time devoted to a required activity and the salary of the staff member performing it. In other words, the more time devoted to an activity and the higher the staff member's rank, the greater the reimbursement.

No Accountability for Results. The state also has little power to hold LEAs accountable for performing mandated activities effectively. The LEAs can claim expenses for performing an activity regardless of whether they achieve its underlying policy objectives. The state cannot avoid mandate liabilities for ineffective implementation of a mandated activity.

Governor Proposes Suspending Most K-14 Mandates

The Governor's 2009-10 budget includes funding for the annual cost of three K-12 mandates but suspends all remaining K-14 mandates. (The Governor's budget does not recognize four new mandates approved by CSM in 2008.) Unlike the practice of deferring mandate costs, suspending mandates would relieve the state from the obligation to pay for required activities as well as relieve local schools from performing them. The Governor's proposed suspensions would reduce associated 2009-10 claims by roughly \$200 million.

Three Remaining Mandates Linked With Federal Requirements. According to the administration, the three mandates proposed to be

paid in 2009-10 constitute educational activities related to complying with federal law. The first mandate covers activities associated with administering the California High School Exit Exam, a test used for federal accountability. The other two mandates also relate to federal accountability laws, which require that students attending failing schools be allowed to transfer to other schools. State law mandates that districts ensure inter- and intra-district transfers do not adversely affect racial and ethnic balances at a given school. The administration estimates that funding these three mandates in 2009-10 will cost approximately \$13 million.

Court Case Provides Extra Motivation for Governor's Proposal. In December 2008, an appellate court found the state's practice of deferring education mandates unconstitutional and ordered the state to fully fund mandated programs "in the future." (The opinion responds to a lawsuit filed in 2007 by five school districts and the California School Boards Association against the Department of Finance [DOF] and State Controller seeking payment of past mandate claims and an end to deferrals.) While constitutional separation of powers lead to the court not forcing the Legislature to make budgetary appropriations, its decision increases pressure on the state to pay the annual ongoing cost of education mandates. By suspending most mandate requirements (and paying for the few remaining mandates), the Governor's proposal therefore relieves cost pressures and responds to a legal risk.

Cost of Compliance Significant

As Figure 17 shows, we estimate the total cost of unpaid mandates recognized by the administration will exceed \$1 billion in 2008-09 (with annual ongoing costs of roughly \$190 million).

Many Potential Activities Now in Mandate Review Pipeline. In 2008, four new K-14 mandates were recognized by CSM and more than a dozen additional mandate claims remain on file with the commission awaiting a decision. Figure 18 displays the four new mandates and their relatively minor associated costs through 2007-08 (\$344,000). The pending mandate with the potentially greatest cost involves state high school graduation requirements. This mandate could dramatically increase annual state costs as well as the mandate backlog, as discussed later in this write-up.

New Settlement Agreement Also Would Increase Costs Notably. The administration is finalizing a settlement agreement with districts concerning a disputed mandate related to behavioral interventions for students with special needs. The settlement would provide \$65 mil-

lion in annual ongoing payments, as well as an additional \$500 million for back payments (paid over the course of six years). The \$500 million is intended to cover roughly one-half of districts' estimated retroactive claims.

Governor Misses Reform Opportunity, Pushes Off Important Decisions

While the Governor's plan reduces state mandate payments in the short-term, we believe his plan misses an opportunity to substantively address flawed mandates in the long-term. Specifically, we think the Governor's plan has two major shortcomings.

Only a Short-Term Solution. Suspending mandates only provides savings in the budget year but does not provide permanent solutions. Given the recent court's ruling, pressure to fund the annual ongoing cost of mandates will per-

sist. Moreover, the cost of many mandates can be reduced on a long-term basis with simple amendments to state law. Especially given the relative ease of creating more lasting solutions, the Governor's budget misses an opportunity to eliminate the costs of ineffective mandates altogether.

Treats All Currently Mandated Activities Alike Regardless of Policy Merits. The Governor's proposal does nothing to preserve the state policies that underlie some education mandates. For instance, while the graduation requirement mandate in our view would not justify its price tag reimbursed using the existing method, we

Figure 17
Total Outstanding Mandate Obligations^a

(In Millions)

| Year | 2006-07 | 2007-08 | 2008-09 |
|---------------------------------------|--------------|--------------|----------------|
| K-12 mandates ^b | \$424 | \$583 | \$746 |
| California Community College mandates | 90 | 115 | 300 |
| Totals | \$514 | \$698 | \$1,046 |

^a As of June 30th of each fiscal year.

^b Costs for the Stull Act, high school science graduation, and California High School Exit Exam mandates could be substantially higher once various outstanding issues have been resolved.

Figure 18
New Mandates Approved in 2008-09

| Mandate | Total Claims |
|----------------------|------------------|
| Pupil Safety Notices | \$46,000 |
| Charter Schools | 102,000 |
| Missing Children | 34,000 |
| Enrollment Fees | 162,000 |
| Total | \$344,000 |

believe that the state should not weaken its high school science requirements. In the past, lawmakers have found strategies to limit the high cost of some mandates while creating strong incentives for schools to perform valuable educational activities. By suspending mandates, the administration fails to create such incentives.

Create Lasting Solutions on Case-by-Case Basis

Rather than suspend virtually all K-14 mandates in one fell swoop, we recommend re-viewing each mandate on a case-by-case basis. Below, we review the costliest K-14 mandates. Figure 19 summarizes our recommendations on these requirements.

Tying Activities to Optional Funding Has Several Benefits. As shown in Figure 19, we do identify some mandated activities that the state might want to continue supporting. In these cases, we search for optional funding sources (such as a voluntary categorical program) that

could be leveraged to support such activities. In addition to reducing associated state costs, we believe this approach can be a better method of implementing many policy objectives. In particular, we think three major benefits result from using optional funding sources.

- **Fewer Administrative Hassles.** As noted above, the existing mandate process creates significant administrative hassles for districts. In contrast, funding activities using voluntary funding streams eliminates the need for a separate reimbursement process. Under such a system, districts not only spend less time on paperwork but also have more freedom in determining how best to undertake an activity.
- **Connects With Broader Objectives.** Tying activities to an optional funding source also ties them to a broader policy objective. For example, situating teacher reviews in the context of school

Figure 19
Summary of LAO Mandate Recommendations

(In Millions)

| Mandate | Recommended Action | Reduction in State Obligations 2009-10 |
|---------------------------------------|--|--|
| K-12 Mandates | | |
| Habitual Truant | Eliminate mandate but meet objective in different way | \$8 |
| Notification of Truancy | Eliminate mandate but meet objective in different way | 17 |
| Stull Act | Eliminate mandate but meet objective using different funding source | 24 |
| Collective Bargaining | Request reconsideration given activity no longer meets mandate criteria | 30 |
| Pending K-12 Mandates | | |
| Graduation Requirement | Eliminate mandate by clarifying statutory language | \$196 |
| Behavioral Intervention Plans | Eliminate mandate by aligning state and federal requirements | 65 |
| Community College Mandates | | |
| Integrated Waste Management | Eliminate mandate or meet objective using different funding source | Uncertain |
| Enrollment Fee Collection And Waivers | Eliminate mandate because adequate incentives already exist to fulfill objective | \$21 |
| Health Fees/Services | Eliminate mandate but meet objective using different funding source | 11 |
| Total | | \$372 |

reform gives those reviews purpose they otherwise lack. Reorganizing mandated activities in this manner could improve coordination among education policies.

- **Majority of Districts Still Perform Actively.** Voluntary funding sources often are large enough that the majority of districts apply for them and comply with related requirements. Since many of these funding streams target at-risk students, they would help guarantee that California's policies benefit students most in need of academic and social support.

Notification of Truancy and Habitual Truant

Both truancy mandates have a simple premise: parents should be alerted when their children do not show up for school. Such notification generally is supported by research suggesting that increased parental involvement tends to reduce truancy. Whereas the notification of truancy mandate requires LEAs to notify parents when students miss a certain number of school days, the habitual truant mandate requires notification before the student is classified as "habitually" absent.

Policy Objectives Appear to Have Gotten Lost in Paperwork. Despite the laudable objective, these mandates in practice do not necessarily increase parental involvement. When a student shows up late to class or misses school a certain number of times, for example, districts typically comply with the notification of truancy mandate by sending a letter to the student's home. Reports from several districts suggest that these letters are formalities and do not increase

substantive interaction among educators, parents, and students.

Reimbursement Rules Create Waste. Each time a district sends a letter to a parent, the state reimburses that action at a rate of roughly \$17 per letter. This rate was set before the state established mandate review procedures that included a more rigorous process of cost determination. Given the text of the letter changes little if at all from year to year or student to student, the real cost of sending letters is likely far below the \$17 rate.

Eliminate Mandates but Meet Overall Objective in Different Way. We recommend that the Legislature eliminate the two truancy mandates but meet their overall policy objective in a different way. The state already has various categorical programs that can be used to support parental involvement of at-risk students. For example, the state currently funds Economic Impact Aid (EIA), a program designed to provide comprehensive support services for at-risk students. In the "Categorical Reform" piece of this section, we recommend consolidating this program, along with several other similar programs, into a large block grant for at-risk students. As a condition of receiving either EIA or block grant funding, the Legislature could require districts to engage parents of at-risk students—with the intent to improve at-risk students' academic performance and reduce their dropout rates. Compared to mandating specific parental notification requirements, this approach still would ensure districts make good-faith efforts to engage parents while giving districts much more flexibility over implementation.

Stull Act

Passed in 1971, the Stull Act requires school districts to evaluate their teachers on a regular

basis. Changes to the law in 1983 and 1999 were eventually deemed reimbursable mandates. The 1983 change requires districts to evaluate teachers receiving an unsatisfactory performance review on an annual basis. The 1999 law requires districts to include a review of student test scores in the evaluation process.

Mandate Does Little to Promote Effective Teacher Evaluations. The Stull Act requirements raise a major policy consideration: What does mandating specific teacher evaluation practices accomplish for the state? In many organizations outside of K-12 education, employee evaluations represent an important management activity that can help improve employee performance. These evaluations typically are part of a broader set of processes and incentives for employees. Many employers link staff salary increases to evaluations. Similarly, in cases where employees fail to meet performance expectations over an extended time period, they may be terminated. In K-12 education, however, evaluations are rarely linked to teacher raises and dismissals. Given evaluations are not linked to these decisions, justifying the cost of mandating them is difficult.

Eliminate Newer Provisions of Stull Act. We recommend eliminating the Stull Act mandate (meaning the relevant 1983 and 1999 amendments). This would not mean eliminating the requirement that schools evaluate teachers. Rather, eliminating only the newer provisions would alleviate reimbursable costs. As mentioned earlier, these provisions relate primarily to the yearly reviews of teachers with poor performance records and using student test scores in the evaluation process. Thus, removing the mandate does not remove basic evaluation requirements like annual reviews for untenured instructors (as these were established by the original 1971 Stull Act, which

predates the state's existing mandate process). It also in no way prohibits districts—at their discretion—from following good management practices and evaluating teachers for the purposes of better supporting and rewarding them.

Increase Value of Specific Evaluation Practices by Tying to School Improvement. The state also could meet the general objectives of the 1983 and 1999 laws by linking yearly evaluations of struggling teachers to federal school improvement funding. Currently, schools that fail to meet certain student benchmarks can receive federal school improvement funding. As a condition of receiving these funds, schools must submit an improvement plan to the state. California could require that these plans include both annual performance reviews of teachers whose students miss benchmarks (the general intent of the 1983 law) and the analysis of student test scores to support instructional improvements (the general intent of the 1999 law). Beyond eliminating related state costs, embedding specific evaluation practices in school improvement plans would give them a clearer objective and tie them to the broader consequences of the accountability system.

Collective Bargaining

California's K-14 employees gained the right to bargain collectively by passage of the Rodda Act in 1975. In 1978, the Board of Control (the predecessor to CSM) found that the act imposed a state-reimbursable mandate on K-14 districts. Specifically, the board determined that the provisions of the law requiring districts to meet and negotiate constituted a higher level of service and were therefore reimbursable.

Subsequent Court Rulings Suggest Collective Bargaining No Longer Qualifies as a Mandate.

Since the passage of the Rodda Act, California appellate courts have decided several relevant cases that affect mandate determinations. Specifically, cases in 1987 and 1990 ruled that a state mandate is only reimbursable if it imposes a unique requirement on local governments that does not apply generally to residents and entities in the state. In other words, since public and private employees both have collective bargaining rights, the Rodda Act has not shifted responsibilities to local governments so much as extended rights available to many employees. While K-14 collective bargaining does have unique requirements, most activities associated with the K-14 collective bargaining process are, in all likelihood, no longer reimbursable under law based on these recent court decisions.

Request CSM to Reconsider Mandate; Would Not Impact Collective Bargaining. We recommend the Legislature request CSM to reconsider the K-14 collective bargaining mandate. Even if CSM determines the Rodda Act is no longer reimbursable, the law still would preserve all rights of K-14 employees to bargain collectively. In contrast, the Governor's proposal would suspend all activities associated with the Rodda Act that are reimbursable.

High School Science Graduation Requirement

As part of major education reform legislation in the early 1980s, the Legislature increased the state's high school graduation requirements. Among other changes, the law required that all students complete two high school science classes prior to receiving a diploma (the previous requirement was one science class). This change raised the total number of state-required courses from 12 to 13. The costs associated with provid-

ing an additional science class were the basis of an eventual mandate claim. In 1987, CSM determined that providing an additional science class imposes a higher level of service on districts and, therefore, constituted a reimbursable mandate.

Court Interpretation Has Led to Great Increase in Estimated Mandate Costs. The primary factor contributing to high mandate costs relates to a statutory provision that provides school districts with discretion in implementing the high school science graduation requirement. This provision was interpreted differently by various parties, until a 2004 court ruling indicated that school districts had full discretion to increase their total graduation requirements and total instructional costs. Based on this ruling, CSM decided the state could not increase the number of courses it requires for graduation above 12 courses without providing reimbursement. As a result, the state could need to pay the full cost of every additional science course for most districts as far back as 1995-96.

Absent Action, State Will Face High Price Tag. We estimate the state would face annual ongoing mandate costs of roughly \$200 million if it were to pay the full cost of an additional science course for every applicable LEA. In addition, we estimate retroactive costs would total approximately \$2 billion (resulting in part from the formula chosen by CSM to be the basis for reimbursement).

Amend Statute to Avoid Prospective Costs. We recommend the Legislature avoid prospective science graduation requirement costs by clarifying how districts are to implement the graduation requirement. Specifically, we recommend language clarifying that school districts shall ensure that any modification of coursework relating to the second science course require-

ment results neither in students needing to take a greater total number of courses for graduation nor higher district costs. Such an approach has been used in previous test claims and affirmed by a California appellate court.

Statutory Change Would Have Minimal Programmatic Impact on Districts, Provide Flexibility in Containing Costs. In practical terms, this change would have minimal programmatic impact on districts. This is because districts typically require at least a dozen additional year-long courses on top of the state's requirements for 13 year-long courses. Thus, even with our recommended statutory change, school districts still would have substantial discretion both to increase academic requirements beyond the state requirements and require electives. For example, a district could require four year-long courses each in math, science, English, social science, and foreign language (for a total of 20 courses) and still have room within its existing base program to require several additional year-long elective courses. The statutory change also would provide districts with substantial discretion in determining how best to offset any potentially higher costs associated with a science course within their existing base program (consistent with the intent of the original legislation).

Addressing Retroactive Costs Is More Complicated. While eliminating costs prospectively is relatively straightforward, addressing retroactive costs is somewhat more complicated. This is because the Legislature generally cannot apply clarifying statutory language retroactively, even when associated mandate costs have grown far beyond legislative intent. As a result, options available for addressing the \$2 billion backlog of graduation requirement claims are limited.

Given these constraints, we suggest the Legislature consider three possibilities: (1) support the administration's efforts to appeal CSM's decision, (2) request CSM to base claims on documented costs rather than a formula, or (3) pay all claims within available Proposition 98 resources.

Behavioral Intervention Plans

Federal law entitles children with disabilities to a "free and appropriate education" (FAPE) tailored to their unique needs. Toward this end, districts are responsible for providing special education and related services pursuant to an Individualized Education Program (IEP), which is developed by a team with special education expertise and knowledge of a child's particular needs. As part of the IEP process, Chapter 959, Statutes of 1990 (AB 2586, Hughes), sought to regulate the use of behavioral interventions and encourage the use of positive behavioral strategies with special education students. To this end, the law required SBE to adopt regulations that (1) specified the types of behavioral interventions districts could and could not use; (2) required IEPs to include, if appropriate, a description of positive interventions; and (3) established guidelines for emergency interventions.

Regulations Exceed Legislative Intent. Regulations adopted by SBE go beyond what the Legislature intended—being both more extensive and more prescriptive. Specifically, SBE regulations require districts to conduct one particular type of behavioral assessment—a "functional" assessment—followed by a particular type of behavioral intervention plan (BIP)—a systematic positive BIP—for any special education student exhibiting serious behavior problems that interfered with the implementation of his or her IEP. In addition,

the regulations require districts to train staff on these strategies. In 1994, three school districts filed a claim arguing that BIP-related requirements constituted a reimbursable mandate. In reviewing the claim, CSM staff found that state statute, “on its face, does not impose any reimbursable state mandated activities,” however, regulations adopted pursuant to state law do.

Tentative Settlement in the Works. In 2000, CSM heard the BIP test claim and ruled in favor of the districts. The administration, however, appealed the decision. Rather than proceeding with the appeal, the administration has reached a settlement with districts outside of the legal process. Under the terms of the settlement, districts would receive \$65 million annually to defray the ongoing cost of BIPs, in addition to a lump sum payment of roughly \$510 million to settle the outstanding claims. (The settlement amounts are based on results from district and SELPA surveys conducted by DOF.)

Federal Law Now Largely Achieves Original Legislative Goals. At the time BIP-related regulations were implemented, federal law was silent on the use of behavioral interventions. In 1997, however, federal law was amended to include behavioral interventions in the IEP process. Specifically, federal law now requires IEP teams to *consider* behavioral interventions, including positive behavioral interventions, when a student’s behavior impedes his or her learning or that of others. Additionally, if an IEP team determines that a behavioral intervention is needed to ensure a child receives a FAPE, the IEP team *must* include an intervention in that child’s IEP. Federal law, however, does not prescribe the type of behavioral intervention that IEP teams may include.

Eliminate Mandate by Better Aligning Regulations to Federal Law. Given that activities

mandated by federal law are not reimbursable mandates for the state, the state could eliminate future BIP-related costs by more closely aligning state regulations with federal law. Under this approach, IEP teams would have to *consider* positive intervention strategies and would be obligated to include them in an IEP when teams deem them necessary for a child to meet his or her IEP goals. The state also could continue to limit the types of interventions that districts may use in an IEP and in case of emergencies. It would not, however, require a specific course of action be taken in all instances. Districts therefore would have more discretion in addressing individual behavior problems. They also would achieve savings by the repeal of current assessment, training, and procedural requirements. Any remaining costs could be covered by existing federal and state special education funding. This approach would save the state the \$65 million in estimated annual ongoing costs.

State Likely Liable for Retroactive Claims. While the state can eliminate future BIP-related costs by amending regulations, it is likely still liable for past claims. Even if the Legislature takes action to amend existing regulations, districts have the right to pursue reimbursement for BIP-related costs incurred between 1993, the year regulations were implemented, and the date regulations are repealed. Since these activities occurred in the past, the state would likely be liable for the claim costs. The administration estimates retroactive claims could reach \$1 billion. They have, as mentioned above, tentatively negotiated the amount down to \$510 million, which would be paid to districts in \$85 million increments over the course of six years, beginning in the 2011-12 fiscal year.

Integrated Waste Management Mandate

Chapter 764, Statutes of 1999 (AB 75, Strom-Martin), requires state agencies (including locally governed CCC districts) to divert from landfills a specified percentage of their solid waste through reduction, recycling, and composting activities. State agencies must develop an integrated waste management plan and report annually to the California Integrate Waste Management Board (CIWMB) on their ability to meet solid-waste diversion goals.

Districts Now Required to Offset Claims. In March 2004, CSM determined that these activities constitute a state-reimbursable mandate for community college districts. In March 2005, CSM adopted “parameters and guidelines,” which determine the methodology for reimbursing the mandate. As we discuss in the *2007-08 Analysis of the Budget Bill* (E-281), CSM found that savings (avoided landfill disposal fees) and revenues (from the sale of recyclable materials) could *not* be used to offset districts’ cost claims. In March 2007, CIWMB and DOF sued CSM over its decision. In June 2008, the court ruled against CSM, and ordered it to amend the parameters and guidelines to require districts that are claiming reimbursable costs to identify and offset from their claims any savings and revenues realized from the mandate. The CSM revised the parameters and guidelines in September 2008. Districts have until March 2009 to submit amended claims for reimbursement by the state.

Recommend Legislative Action Depending on Statewide Cost Estimate. Because districts have until March 2009 to submit their claims, a statewide cost estimate for this mandate will not be known until this spring. According to CIWMB, it is possible that savings and revenues could fully offset any costs that districts incur. If so, we recom-

mend the Legislature retain this mandate. If the statewide cost estimate shows a significant net cost to the state, however, an alternative would be for the Legislature to treat community colleges the same as K-12 school districts, which are encouraged—but not required—to comply with diversion goals. We believe most colleges, like K-12 schools, would participate in waste-diversion programs.

Enrollment Fee Collection and Waivers Mandate

Existing law requires CCC districts to collect enrollment fees, as well as waive fees for certain students (usually based on financial need). In April 2003, CSM determined that these requirements constitute a state-reimbursable mandate for districts. Last year, CSM concluded that total costs for the mandate (which include costs for staff to collect fees and prepare a receipt for students) reached approximately \$162 million between 1998-99 and 2007-08. This amount takes into account \$31 million in revenues over the decade that the state provided to districts for purposes of offsetting fee/financial aid administrative costs. Annual costs total about \$18 million, which includes about \$4 million in offsets. (As part of the 2008-09 budget package, the Legislature amended statute to clarify an additional state-provided revenue source is a partial offset to district costs.)

Recommend Elimination of Mandate. We recommend the Legislature eliminate this mandate and instead rely on fiscal incentives for districts to perform these activities on their own. Under current law, the state budget specifies a total amount of apportionment funding (general-purpose monies) that is provided to community college districts. Apportionment funding comes from three main sources: the state General Fund,

local property taxes, and student fee revenue. Local property taxes and student fee revenue are retained by community college districts and counted toward their apportionment entitlement. The General Fund provides the additional funding needed to meet each district's apportionment amount. To the extent that districts decline to collect fees, we recommend that the Legislature reduce districts' General Fund support by an equal amount. This would create a strong incentive for districts to perform these administrative functions.

Health Fees/Services Mandate

Community colleges provide varying levels of on-campus health care to students. Generally, CCC health centers are funded by health fees. State statute restricts the amount of the fee that colleges may charge. Currently, the highest allowable charge is \$16 per semester, which a district may increase to keep pace with inflation.

Current law also contains a MOE provision for community college districts related to health centers. Specifically, each district is required to provide students at least the level of health services it provided in 1986-87. Thirty-five of the system's 72 districts provided health care to students in 1986-87 and therefore must continue to offer these services. Districts subject to this requirement are eligible to claim reimbursement for these costs. The remaining 37 districts are not subject to this mandate, although many choose to provide health services even without state reimbursement. The *2008-09 Budget Act* provides \$4 million for this mandate, which partially offsets claimants' total costs (roughly \$10 million annually after accounting for offsetting revenues from the collection of student health fees).

Recommend Elimination of Mandate. We recommend that the Legislature eliminate this

mandate by no longer requiring districts to provide a particular level of care to students. Student characteristics and access to health care off-campus (such as through one's parents) vary within the CCC system. As such, student demand for on-campus services can vary by college. We therefore believe that locally elected boards should be charged with making decisions about the type and scope of services offered to students. By eliminating the health mandate, districts that are subject to the MOE would be able to make these decisions just as non-MOE districts currently do. Alternatively, the Legislature could increase the cap on health fees so that districts can fund the full cost associated with the MOE. This, too, would eliminate the mandate costs.

Other Existing Mandates

While the costliest K-14 mandates have been reviewed in this section, the review is far from exhaustive. During the spring budget process, we recommend the Legislature continue to review remaining mandates on a case-by-case basis to determine if each fulfills a compelling state purpose at a reasonable cost. If a currently mandated activity is determined to be of notable statewide benefit, then we recommend the Legislature explore ways to both contain associated costs and improve incentives. In many cases, we believe the Legislature has opportunities to link requirements with optional funding streams, thereby providing cost containment as well as a voluntary fiscal incentive to undertake critical activities.

CASH MANAGEMENT

Largely as a result of the state's recent difficulties balancing the budget, it has also experienced difficulties managing its cash flow situa-

tion. To address these cash problems, the state deferred several large payments in 2008-09, with the largest deferrals coming from Proposition 98 payments. Given the state's reliance on Proposition 98 deferrals and concern about their impact on districts, the Legislature directed our office to convene a work group to examine K-14 cash management more closely. Below, we describe the distribution of existing Proposition 98 payments and discuss the strategies local agencies use to ensure they have sufficient cash available to make major payments. We then identify areas of misalignment between cash payments and programmatic needs under the current system and develop two new better aligned payment systems. Although we believe the state should begin implementing a more rational payment system as soon as possible, we recognize a new system might take more than one year to implement fully. At the same time, the state might continue to need extraordinary short-term cash solutions. Thus, we also provide the Legislature with a few guidelines for making deferrals under the existing system that would help the state while minimizing the negative impact on K-14 entities.

State Payments

The distribution of existing Proposition 98 payments is notably different for K-12 education compared to the CCC and CCD. Whereas payments for CCC and CCD are rather evenly distributed throughout the fiscal year, K-12 payments are more erratic. (The nearby box briefly describes the distribution of federal funds. We do not cover these payments in detail because the federal government currently has separate efforts underway to better align federal disbursements with districts' programmatic needs.)

Three K-12 Payment Systems. K-12 school districts receive Proposition 98 funding from a combination of state General Fund dollars and local property tax revenues (\$46 billion proposed for 2009-10). Statewide, approximately three-quarters of Proposition 98 payments to school districts are made from the state General Fund. State payments to school districts are distributed by the CDE using one of three payment systems.

- **Principal Apportionment.** Approximately 80 percent of state payments to school districts are distributed through the principal apportionment system. Under this system, school districts receive payments for 21 programs, with funding distributed according to monthly payment schedules set by law. As shown in Figure 20 (see page 46), the apportionment schedule for most school districts is generally uniform throughout the year, but has smaller payments in July and larger payments in August and February. (Current law also authorizes two alternative payment schedules that provide larger payments in the beginning of the fiscal year. These schedules are used for small school districts that receive a large percentage of their funding from property taxes and, therefore, are more cash poor at the beginning of the fiscal year.) State revenue limit payments, which provide general purpose funding for districts, represent about 80 percent of the principal apportionment payment. In addition, current law requires that 15 specified categorical programs be paid using the principal apportionment system. At its discretion, CDE makes payments for five other cat-

egorical programs through the principal apportionment.

- ***Special Purpose Apportionments.*** The state distributes approximately 5 percent of state funds to school districts through the special purpose apportionment system, which provides ten equal monthly payments from September to June. The special purpose apportionment currently provides payments for two categorical

programs—EIA and Home-to-School Transportation.

- ***Other Categorical Payments.*** School districts also receive payments for more than 20 other K-12 categorical programs throughout the year at the discretion of CDE. Approximately 15 percent of state payments to school districts are made in this manner. Based on our discussions with the department, payments are

FEDERAL PAYMENTS

In addition to state payments and local property taxes, K-14 entities also receive a significant amount of federal funding to operate their programs. In total, K-14 entities are estimated to receive almost \$7 billion in federal funding in 2009-10—\$5.5 billion for school districts, approximately \$250 million for community colleges, and \$1.2 billion for child care.

Federal K-12 Payments Similar to “Other” Categorical Payment. Federal K-12 payments are made to the California Department of Education (CDE), which then transfers the appropriate amounts to each school district. Most of these payments are made in the same manner as “other categorical” payments—each program is paid out in two or three installments throughout the year. Payments per month vary, but large payments typically are made in August, November, April, and June. The department indicates that it is in the process of better aligning its disbursements of federal funds with districts’ programmatic needs. The federal government has directed states to move toward a virtually instantaneous “pull down” system, whereby districts would receive federal funds within days of incurring expenses. Though this is the federal government’s objective, CDE indicates that it is trying to move to a system of quarterly allocations as a first step. Given these separate efforts, we do not integrate federal payments into the new payment systems we describe later in this section.

Federal California Community Colleges (CCC) and Child Care and Development (CCD) Payments Already Aligned With State Payment System. Community colleges receive most of their federal funding for services to individuals participating in the California Work Opportunity and Responsibility to Kids (CalWORKs) program and from Carl Perkins vocational grants. Most federal funds for CCC’s CalWORKs program are allocated on the CCC monthly apportionment schedule. The Carl Perkins vocational grants are distributed on a quarterly basis. Federal child care payments are made in the same manner as state payments, with one-quarter of funds paid in July, and the remainder evenly distributed between October and June.

made with the goal of providing as much money as possible early in the fiscal year. The department, however, takes into consideration its own staff availability and data constraints. To limit the amount of workload, only two or three payments are made annually for each applicable program. The CDE is also restricted by the specific data required to calculate districts' allotments (such as current-year student enrollment or first-year teacher counts). Payments are made later in the year for programs that rely on data not readily available at the beginning of the fiscal year. The exact payment schedule for each applicable program varies from year to year, but generally provides large payments to districts in September, October, January, and February. (A tentative cash flow schedule is available on the department's Web site so districts know when funding for certain programs is expected to be paid.) Among the large categorical programs distributed in this way are K-3 Class Size Reduction (CSR), the Targeted Instructional Improvement Block Grant, and the School and Library Improvement Block Grant.

One Primary CCC Payment System. As with K-12 education, community colleges also receive Proposition 98 funding from a combination of state General Fund dollars and local property tax revenues (\$6.5 billion proposed for 2009-10). Statewide, approximately two-thirds of Proposition 98 community college payments are from the General Fund. These payments are made to community college districts by the CCC Chancellor's Office.

➤ **Apportionments and Most CCC Categorical Payments Are Distributed Using Set Schedule.** Community college regulations establish the percentage of apportionment funds that are allocated to districts every month. As shown in Figure 20, districts receive about 8 percent of the total each month, with the highest percentage (12 percent) coming in September and the lowest (5 percent) in December (when districts receive their property tax revenues). Payments for the latter half of the fiscal year are generally evenly distributed. Of CCC's 22 categorical programs, 17 are distributed on this monthly apportionment schedule. Payments for the remaining five programs are disbursed fully or partially through an invoice or direct billing process (based on specific contractual terms or as costs are actually incurred).

One Primary CCD Payment System. Child care providers also receive Proposition 98 funding from the state. (They do not receive any local property tax revenues.) Aside from the beginning of the year, CCD payments are spread evenly throughout the year. In July (or whenever a budget is enacted), CDE provides a 25 percent payment to providers intended as an advance for expenses incurred in the first three months of the fiscal year. Thereafter, nine equal payments are made from October through June. All 11 child care programs receive state payments using this disbursement system.

Adjustments Throughout Year as Better Data Become Available. State funding for most K-14 programs are based on current-year estimates of numerous factors, including K-12

attendance and community college enrollment. Because estimates of these numbers are constantly changing, CDE and the CCC Chancellor's Office must make corrections throughout the year to ensure districts are receiving the appropriate amount of funding.

Principal Apportionment Adjustments.

School districts and community colleges rely on a specific process for adjusting principal apportionment payments. In July (or whenever a budget is enacted), CDE and the Chancellor's Office determine monthly allocations to districts from July through January based on the "advance." The advance is based on prior-year funding levels adjusted by the estimated statewide change in K-12 average daily attendance (ADA)/CCC enrollment growth, any applicable COLA, local property tax estimates, and CCC fee revenue estimates. In February, CDE and the Chancellor's

Office use actual ADA and enrollment information from the fall, as well as revised property tax estimates, to recalculate monthly payments for each district. These revised estimates, known as the "first principal apportionment" (or P-1), are used to make payments from February through May. The "second principal apportionment" (or P-2) uses revised attendance/enrollment information up to April 15 and is used for the June payment for each district. The largest K-12 programs generally receive funding based on attendance estimates up to April 15, so after receiving the June payment their total allocations are not typically further adjusted. Some K-12 programs and all community college programs, however, receive funding based on annual data up to June 30. A final set of adjustments are made for these programs after the close of the fiscal year when actual enrollment and revenue numbers are known.

Similar But Less Complicated CCD Adjustment Process. Child care programs have a similar, but less complex, process for making adjustments to initial payments. The CDE adjusts total payments to each provider after reviewing quarterly attendance information. Depending on the accuracy of the initial estimates, payments are increased or decreased to ensure providers receive the appropriate reimbursement.

Figure 20
Payment Schedules for Major K-14 Programs

General Fund

| | K-12 Principal Apportionment | CCC ^a Apportionment | Child Care |
|---------------|------------------------------|--------------------------------|---------------|
| July | 6.0% | 8.0% | 25.0% |
| August | 12.0 | 8.0 | — |
| September | 8.0 | 12.0 | — |
| October | 8.0 | 10.0 | 8.3 |
| November | 8.0 | 9.0 | 8.3 |
| December | 8.0 | 5.0 | 8.3 |
| January | 8.0 | 8.0 | 8.3 |
| February | 14.0 | 8.0 | 8.3 |
| March | 7.0 | 8.0 | 8.3 |
| April | 7.0 | 8.0 | 8.3 |
| May | 7.0 | 8.0 ^c | 8.3 |
| June | 7.0 ^b | 8.0 ^c | 8.3 |
| Totals | 100.0% | 100.0% | 100.0% |

^a California Community Colleges.
^b Under current law, the entire K-12 principal apportionment payment for June is made in the first week of July.
^c Under current law, a portion of the May and June CCC apportionments are paid in July.

Property Tax Payments

Statewide, property tax revenues account for approximately one-fourth of Proposition 98 funding for K-12 school districts and community college districts (\$15.4 billion estimated in 2009-10). Each school and community college district uses property tax revenues to fund a portion of revenue limits/apportionments (the remainder of support comes from the state General Fund). The share of funding that a district receives from property taxes varies widely throughout the state, depending on the value of assessed property in the district and the portion of property tax revenues that are provided to school districts (counties, cities, and other local agencies also receive a share of property tax revenues). According to state law, property owners must pay their property taxes to the county in two installments, due on December 10 and April 10. Payments are collected by counties and transferred to school districts shortly thereafter. As a result of the property tax due dates, districts receive virtually no property tax revenues until the middle of the fiscal year.

Dealing With District Cash Shortages

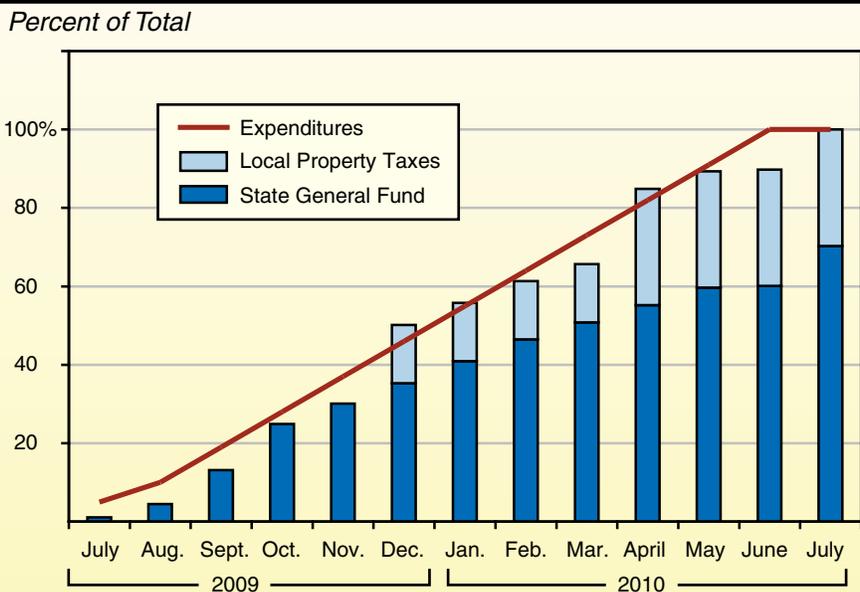
School and community college districts generally face cash flow shortages at certain times in the fiscal year, primarily as a result of the property tax payment schedule. Cash shortages can be par-

ticularly severe for districts that receive a large share of their revenues from property taxes. As Figure 21 shows, before December and April, even the average school district has spent more than it has received in state and local revenues. These cash flow problems can be further exacerbated by deferrals of state payments. Below, we discuss the various ways districts go about meeting their short-term cash needs.

Internal Borrowing. If a district does not have sufficient cash available to meet its obligations, the simplest and least costly option for districts is to borrow internally from other district accounts or funds. Districts, for example, can use categorical funding for a different purpose on a temporary basis if it is experiencing a cash shortage in another program. In addition, districts can use funds from other restricted funds, such as those for facilities projects. Current law requires that

Figure 21

The Average School District Experiences Cash Flow Difficulties Prior to Property Tax Payments^a



^aReflects Legislative Analyst's Office estimates of expenditures and percentage of revenues from local property taxes for the average school district.

no more than 75 percent of any restricted fund be loaned at any one time, and the loan must be repaid by June 30 if it was taken more than four months prior to the end of the fiscal year. If the loan is made within four months of the end of the fiscal year, then the money does not have to be repaid until the end of the subsequent fiscal year. This is the most common option used by districts to address cash flow shortages.

Borrowing From COEs. If a school or college district has insufficient cash available in other district funds to meet its expenses, state law allows them to borrow from their COE. The ability of a COE to lend money to a district depends on the COE's cash situation. Given COEs have the same cash issues related to late-arriving property tax payments, districts very rarely request loans from COEs.

Borrowing From County Treasurer. Both school and community college districts can obtain a loan from the county treasurer. The California Constitution *requires* the county treasurer to loan to a district, as long as the loan is no more than 85 percent of the direct taxes levied by the county on behalf of the district (such as property taxes). The district must pay the loan back with the first new revenues received by the district, before any other payments are made. Due to these restrictions, districts rarely use this option as a cash management tool.

Issuing Tax and Revenue Anticipation Notes (TRANs). School and community college districts also have the option of borrowing from the private sector by issuing TRANs to access cash on a short-term basis. The TRANs are purchased by investors and must be paid back by districts (with interest) within a short period of time, typically by the end of the fiscal year. In determining how

much cash to access through TRANs, school districts typically determine their most "cash-poor" month and borrow enough money to ensure the district can pay all its obligations in that month. In addition to paying interest for the borrowed cash, districts also incur some upfront costs for the cost of issuing the notes. The number of districts that issue TRANs varies from year to year, but districts use this option more frequently than borrowing from COEs or the county treasurer.

Pooling to Issue TRANs. To reduce the cost of issuing TRANs, most districts pool their efforts to access funds from the private market. The California School Boards Association (CSBA) and the Community College League of California (which represents the system's trustees and chief executive officers) both sponsor pools for districts that are interested in issuing TRANs. These organizations gather the interested parties and issue one set of TRANs on behalf of all districts. The CSBA's pool currently includes 164 districts. The League's pool currently includes 11 community colleges. In addition, several COEs, including Los Angeles, have created pools for districts in their region. In total, approximately one-fifth of districts participated in a TRANs pool in 2008-09.

Dealing With State Cash Shortages

Much like school and community college districts, the state also faces cash flow shortages during certain times of the year. The state generally is most cash poor in the months of October and March, prior to the issuance of private cash-flow borrowing in November and the receipt of large income tax payments in April. Unlike districts, the state has the option of deferring certain local assistance payments to help manage its cash flow.

Governor’s Budget Includes Several K-14 Deferrals. For 2009-10, the Governor’s budget includes several proposals to defer K-14 payments, thereby achieving state cash relief in critical cash-poor months. Less than 10 percent of the deferrals would affect community colleges, with the remainder affecting K-12 schools. As shown in Figure 22, the Governor would defer \$1.2 billion in July payments and \$1.5 billion in August payments until October. He also would defer \$115 million in January payments and \$2.7 billion in February payments until July. These deferrals are in addition to already existing \$2 billion deferrals from May and June to July that were created in earlier years.

Problems With the Current State Payment System

We have no significant issues with the method in which child care and community college payments are made. Both receive funding through a simple process that consolidates several programs into one payment system. As

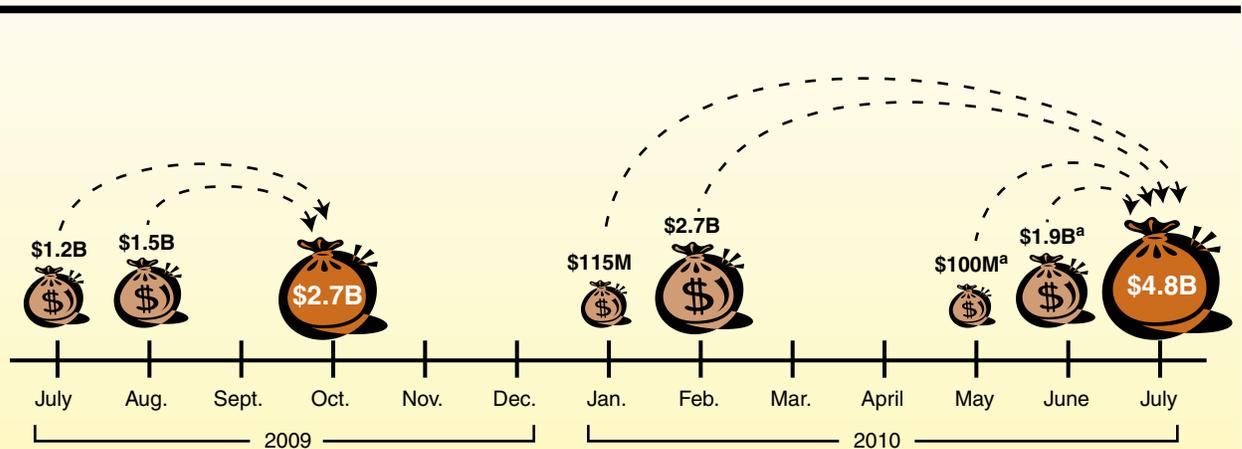
discussed below, we do, however, have concerns with the payment structure used for K-12 schools. In addition, we see no clear rationale for distributing K-12 and community college payments differently.

Lacks Transparency and Predictability. The multiple existing K-12 payment systems make determining how much funding a school district will receive each month difficult. As noted, the state operates both a “principal” and “special purpose” apportionment system as well as an ever-changing payment system for many categorical programs. This complexity can make it difficult for school districts to plan their cash flows.

No Clear Rationale or Coherence in Current Structure. None of the finance experts in the K-14 cash management work group that we convened could explain the rationale for having three separate K-12 payment systems or the rationale for why each system currently worked as it did. For example, the state typically pays 14 percent of principal apportionment and a large portion of funding for the K-3 CSR program

Figure 22

Governor’s Budget Defers Substantial K-14 Payments in 2009-10



^aFor purposes of counting Proposition 98 expenditures, \$1.3 billion of these funds are scored as July payments, while the remainder are scored as paid in June.

in February. There is, however, no clear justification for why February payments are so much larger than payments in other months. Similarly, there is no clear policy rationale for the manner in which categorical payments are made. Most categorical programs are paid in two or three large sums, even though most of these programs require districts to incur costs evenly throughout the year. The specific idiosyncrasies of each payment system result in a disconnected system that is not designed to provide a rational, well-planned method of distributing payments.

No Rationale for Treating School and Community College Districts Differently. School and community college districts experience the same types of problems in dealing with cash shortages. Although the magnitude of the problem varies in each district, both school and college districts must manage their cash situation to ensure sufficient funds are available in the months prior to receiving property tax payments. Because the issue is not fundamentally different for school and college districts, we see no analytical reason why payment schedules should be different for the two segments.

Build a More Streamlined System That Aligns Payments With Costs

Because of its lack of transparency, predictability, and coherence, we recommend making major changes to the current K-12 payment structure to provide a simpler, more rational system for providing school districts with funding in line with expenses.

Create One Payment Schedule. Rather than have several different schedules for distributing state payments, we recommend that all payments go out under the principal apportionment system. This would provide a more predictable

payment schedule and allow the state to distribute funding uniformly throughout the year.

Align Payment Schedule With Expenditures. As with any rational payment system, we recommend that the K-12 payment schedule be aligned with district expenditures. Based on reviews of district-level expenditure data collected as part of the cash management work group, school district expenditures tend to be evenly spread throughout the year, with the exception July and August. (The summer months have lower teacher payroll costs.) Below, we provide two possible payment schedules that would provide funding in line with expenditures. The first would disburse *state payments* at the same rate school expenses are incurred. The second would disburse state payments earlier in the year so that *total* (state and local) revenues are aligned with expenditures.

“5-5-9” Approach. Under this approach, the state would provide 5 percent of state payments in July and August, with 9 percent payments for the remainder of the year. This schedule would provide somewhat less cash in the first two months of the year, when districts incur lower costs, and provide even payments thereafter (consistent with school district expenditure patterns). Although this payment schedule would distribute state payments in a manner consistent with district expenditures, it would not provide additional resources for school districts to manage cash flow prior to property tax payments. Finding short-term cash solutions prior to the receipt of property tax payments would remain the responsibility of the school district.

“10-10” Approach. This option would provide 10 percent payments in every month except for December and April, the months when districts receive property tax payments. There would be no state payments in these

two months. Because of the larger payments in the beginning of the year, this schedule would provide districts with additional resources to deal with their cash-poor months. As a result of the larger payments in early months, the state would need to have additional cash available to make these payments early in the year.

Different Effects on State Cash Flow. These two options would have significantly different effects on the state’s cash flow. As shown in Figure 23, compared to the Governor’s proposed payment distribution (including all his proposed deferrals), the 5-5-9 approach would result in cash loss to the state in the first two and last few months of the fiscal year, but would provide a cash gain from September to February. Despite these differences, the 5-5-9 approach would generally put the state in a comparable cash position as the administration’s plan. The 10-10 approach, however, would provide a cash loss to the state every month except for December and April. As a result, the 10-10 approach would generally put the state in a less favorable cash position relative to the administration’s plan.

Apply 5-5-9 Approach to K-12 and CCC Payments. The 5-5-9 approach aligns state payments with district costs, at least partly eliminates the need for deferrals, and treats all districts consistently. For these reasons, we recommend

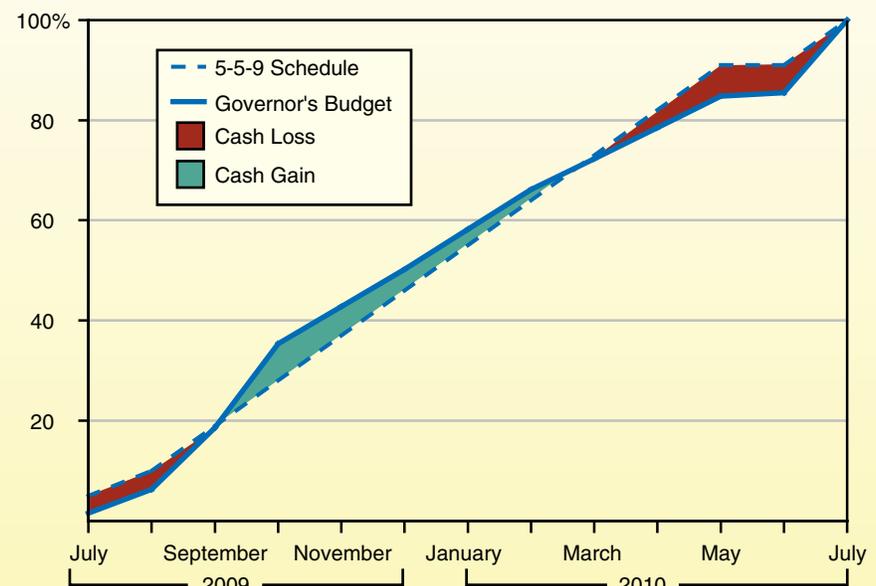
the state convert to a 5-5-9 system over the next few years. Because we see no strong rationale for using different payment systems for school districts and community colleges, we recommend applying the 5-5-9 system to both segments. This would only require modest changes to CCC payments.

Given Great Variation Across Districts, 5-5-9 Approach Is Reasonable Statewide Policy. Under a 5-5-9 system, we recognize many school and college districts would lose the benefit they now receive from somewhat frontloaded state payments as they await property tax allocations. Nonetheless, we believe it is a reasonable statewide policy given districts across the state vary greatly in terms of their reliance on property tax revenues. That is, unless the state provides unique payment schedules for each school district, it cannot fully address the property tax situation for all school districts. Furthermore,

Figure 23

5-5-9 Approach Would Provide Comparable State Cash Savings Over the Year

Percent of Total



many districts have well-established tools for addressing cash flow issues related to property tax payments, and districts that currently do not use such tools could access them if needed.

2009-10 May Be a Transition Year. Transitioning from the current system to a one-payment-schedule system would entail near-term implementation challenges. First, the new system would require administrative changes at CDE. In particular, the transition to a new system would require changes in organization, staffing, and information technology systems. The Legislature likely also would need to change some of the data requirements underlying certain categorical payments. As a result, CDE may not be able to fully implement the new system for the start of the 2009-10 fiscal year. Second, the state's cash situation could be so severe in 2009-10 and 2010-11 that additional one-time deferrals could be needed to help the state meet all of its cash obligations.

Provide Early Notice. With sufficient time, school districts are capable of adapting to most situations and securing sufficient cash to meet their obligations. Adapting to a changing cash situation, however, can be difficult without sufficient notice—particularly if a deferral would affect districts in cash-poor months. Many of the actions school districts must take to secure cash require planning and cannot occur immediately. For example, districts would need to provide advance notice to counties if they were to request a loan. Due to the cost of issuance and time required to sell notes, issuing TRANs also can require several months of planning. We recommend, therefore, that any deferrals be declared as soon as possible to ensure districts can properly plan for their cash needs in the upcoming fiscal year.

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