

Proposition 98 May Revision Proposal

LEGISLATIVE ANALYST'S OFFICE

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May Revision Changes to Proposition 98

(In Millions)

| | 2002-03 | 2003-04 | 2004-05 |
|---------------------|-----------------|-----------------|-----------------|
| January | | | |
| K-12 | \$38,906 | \$41,491 | \$41,942 |
| Community Colleges | 4,623 | 4,359 | 4,679 |
| Other | 95 | 95 | 93 |
| Totals | \$43,624 | \$45,945 | \$46,714 |
| May Revision | | | |
| K-12 | \$38,968 | \$41,721 | \$42,087 |
| Community Colleges | 4,633 | 4,395 | 4,807 |
| Other | 95 | 95 | 95 |
| Totals | \$43,695 | \$46,212 | \$46,989 |
| Difference | | | |
| K-12 | \$62 | \$230 | \$145 |
| Community Colleges | 9 | 36 | 128 |
| Other | — | — | 2 |
| Totals | \$71 | \$267 | \$275 |

- The May Revision increases Proposition 98 funding by \$267 million in the current year and \$275 million in the budget year.
- If this level of funding was provided, the state would still have settle-up obligations of \$935 million for 2002-03 and 2003-04 combined.
- Proposition 98 funding would increase by \$777 million over the revised current-year amount. In addition, the state would take advantage of around \$1 billion in freed-up funds used for one-time deferral costs in 2003-04.



K-12 Proposition 98 May Revision Changes From January Budget

(In Millions)

| | |
|---|-----------------|
| 2004-05 January Budget | \$41,942 |
| April Revisions | |
| Deficit factor reduction | \$270 |
| Discretionary growth and COLA ^a | 53 |
| Deferred maintenance | -173 |
| Instructional materials | -188 |
| K-12 equalization | -28 |
| Total April Revisions | -\$66 |
| May Revisions | |
| Revenue limit | |
| COLA ^a | \$169 |
| Growth | -118 |
| K-12 equalization | 28 |
| Deferred maintenance | \$107 |
| Instructional materials | 100 |
| Categorical growth and COLA ^a | 39 |
| Special education—Licensed Children's Institution | 38 |
| Child care reform adjustments | 14 |
| Child care Stage 2 and 3 caseload | -45 |
| Special education federal fund offset | -35 |
| Child care shift to one-time funds | -25 |
| Other | -57 |
| Total Adjustments | \$145 |
| 2004-05 Proposed | \$42,087 |
| ^a Cost-of-living adjustments. | |



Major Adjustments to K-12 Proposition 98 Funding

Changes From 2003-04 Budget Act (In Millions)

| Program | 2004-05 | | |
|--|----------------|--------------|--------------|
| | January Budget | April Letter | May Revision |
| Revenue Limits | | | |
| Cost-of-living adjustment | \$555 | \$555 | \$724 |
| Growth | 280 | 280 | 162 |
| K-12 equalization | 110 | 82 | 110 |
| Deficit factor reduction | — | 270 | 270 |
| Instructional materials | \$188 | — | \$100 |
| Deferred maintenance | \$173 | — | \$107 |
| Net reduction of deferral costs ^a | -\$1,036 | -\$1,036 | -\$1,029 |
| Other changes | \$163 | \$216 | \$136 |
| Total Changes | \$433 | \$367 | \$580 |

^a In 2003-04, the state used over \$1 billion to pay off categorical and revenue limit deferrals. These costs were one-time in nature, and the funds can be used for ongoing purposes beginning in 2004-05. The budget takes advantage of these freed-up one-time funds to support other K-14 priorities.

- The April finance letter reduced funding for instructional materials (\$188 million), deferred maintenance (\$173 million), and K-12 equalization (\$28 million). These funds were used to provide \$270 million in deficit factor reduction, and provide for discretionary cost-of-living adjustments (COLAs) for K-12 and community colleges.
- The May Revision partially restores funding for instructional materials (\$100 million) and deferred maintenance (\$107 million), and fully restores funding for equalization. It also fully funds a 2.41 percent statutory and discretionary COLAs for K-12.



LAO Proposition 98 Current-Year and Reversion Account Recommendations

Current-Year Proposition 98

- We recommend the Legislature suspend the Proposition 98 minimum guarantee for 2002-03 and 2003-04. This would free-up \$298 million in General Fund revenues, and would eliminate \$935 million in settle-up obligations the Governor defers to 2006-07. These savings could be realized without impacting the K-14 programs for 2003-04 or 2004-05.
- If the Legislature chooses not to suspend the minimum guarantee, then the Governor's proposal to pay off the principle apportionment deferral is fiscally responsible.

Proposition 98 Reversion Account

- The Governor provides \$95 million in Proposition 98 Reversion Account funds for school libraries. We recommend eliminating the augmentation. Instead, we recommend providing \$74 million to reduce funding deferrals, and have identified \$21 million in proposed reversions for which we believe the funds have already been obligated, and cannot be reverted.



LAO Budget-Year Proposition 98 K-12 Savings Proposal

(In Millions)

| Program | Amount |
|--|--------------|
| Public Employees' Retirement System offset | \$141 |
| K-12 equalization | 110 |
| Instructional materials | 100 |
| Internet access | 21 |
| Basic aid | 1 |
| Total | \$373 |

- We recommend \$361 million in reductions. The Public Employees' Retirement System (PERS) recently released new actuarial assumptions that suggest that PERS rates for 2004-05 will be 9.952 percent instead of the 12.2 percent budgeted. This saves the state around \$130 million for other K-14 priorities. We also recommend not funding K-12 equalization, the instructional materials augmentation, and internet access. We recommend suspending Proposition 98 by an additional \$361 million, and using these funds to address the state's fiscal problem.



LAO Options—Using Identified Funding To Solve K-12 Problems



If the Legislature wants to provide Proposition 98 funding at the Governor's proposed level, we would make the following suggestions:

- ***AB 3632 Mental Health (\$100 Million).*** The Governor has provided \$100 million in federal special education funding for these mental health services. We suggest redirecting \$100 million in General Fund from Proposition 98 to county mental health. (This would require increasing the suspension level by \$100 million to \$2.1 billion.) The \$100 million would be used for "medically required" mental health services. School districts would receive the \$100 million in federal special education funding distributed on a per pupil basis, which would offset the General Fund transfer to the counties.
- ***Reduce Costs on the Education Credit Card.*** We suggest reducing the \$3.8 billion outstanding obligations on the K-14 education credit card. This would include providing funding for state-reimbursable mandates or deficit factor reduction. Both of these options would provide additional general purpose funds to school districts to help them balance their budgets in this difficult fiscal year. At the same time, this proposal would reduce the state's outstanding obligations to K-14 education.
- ***Fund Categorical Shortfalls.*** We have identified funding deficiencies in the current year for supplemental instruction and charter schools. We believe that these deficiencies will continue into the budget year. We would suggest providing an additional \$20 million for supplemental instruction, and \$10 million for the charter school block grant programs.



LAO Options—Using Identified Funding To Solve K-12 Problems *(Continued)*

- ***K-12 Equalization.*** Above, we recommended reducing funding for equalization to improve the overall General Fund situation through additional Proposition 98 suspension. If the Legislature is funding at the Governor's proposed Proposition 98 level, then we would suggest providing some funding for equalization. We make two recommendations to adjust the method of providing equalization funding. First, we recommend folding six revenue limit add-ons into base revenue limits prior to equalization. We recommend this so that equalization is on a broader measure of general purpose funds not just base revenue limits. We also recommend a mechanism to maintain the current relative relationship between the six school district size and type categories. The Governor's proposed method would unintentionally distort these relationships.



Summary of LAO Analysis Recommendations

- Certify Proposition 98.*** We recommend the Legislature (1) “close the books” (certify) the Proposition 98 funding level for fiscal years 1995-96 through 2001-02 and (2) certify the 1995-96 and 1996-97 funding level at the existing appropriation level—eliminating a potential obligation of \$251 million.

- Implement Categorical Reform.*** The Governor’s budget proposes to increase district fiscal and program flexibility by consolidating \$2 billion in existing categorical program funds for 22 programs into revenue limits. While parts of the proposal are still in development, we recommend the Legislature approve the proposal with several modifications that we believe will further the goals of the reform.

- Professional Development Block Grant.*** We recommend the Legislature consolidate the ten remaining teacher-related programs into a teacher quality block grant. This would allow the state to retain its focus on teacher quality while simultaneously allowing school districts to pool their existing resources and use them more strategically.

- School Safety Block Grant.*** The Governor’s budget proposes to consolidate five of seven existing school safety programs into a School Safety Competitive Grant, leaving two programs outside of the block grant. We recommend the Legislature expand on the Governor’s proposal by creating a formula-driven School Safety Block Grant combining all seven school safety programs and 12 school safety-related state-reimbursable mandates. We also recommend reversion of \$1.6 million in current-year funds for competitive grant programs that the State Department of Education does not plan to administer.



Summary of LAO Analysis Recommendations (Continued)

- Update Economic Impact Aid Formula.** We find that the Economic Impact Aid (EIA) funding formula is outdated and results in district allocations that appear arbitrary and unpredictable. We recommend the Legislature simplify the EIA formula so that district allocations are predictable and meet local needs for serving both poor and English learner students.

- Mandate Reform.** We recommend the Legislature (1) add budget bill language to several K-12 budget items in order to guarantee that districts use funds the state appropriates to satisfy local mandated costs, and (2) adopt trailer bill language requesting the Commission on State Mandates to reconsider its decision on the Standardized Testing and Reporting program mandate to clarify whether federal testing requirements would reduce the scope of the state-mandated costs and to address the issue of offsetting state revenues.