

January 24, 2008

Special Session Guide to Building the Current-Year Proposition 98 Budget

L E G I S L A T I V E A N A L Y S T ' S O F F I C E

Presented to:

Senate Budget and Fiscal Review Committee

Hon. Denise Moreno Ducheny, Chair



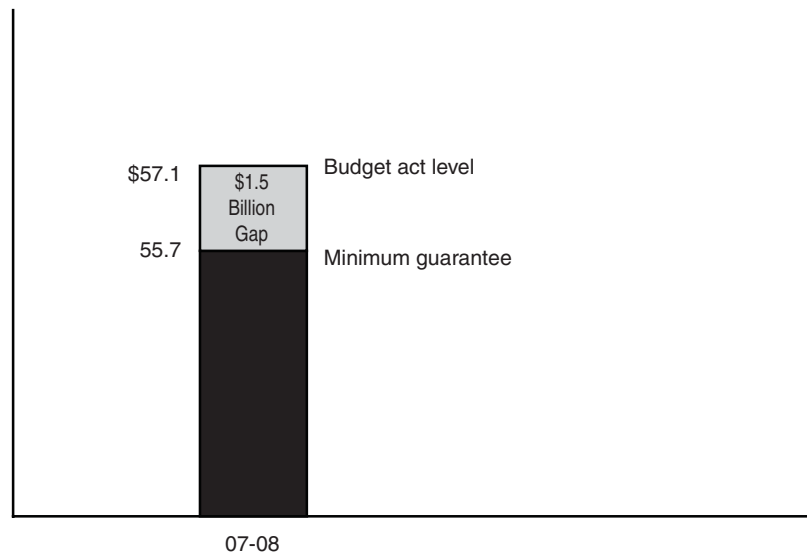


Current-Year Proposition 98 Situation

Figure 1

Proposition 98 Guarantee Below Budget Act Funding Level

(In Billions)



- ☒ The administration estimates that current-year General Fund tax revenues have declined roughly \$4 billion from the *2007-08 Budget Act* level.
- ☒ The drop in revenues results in a drop in the Proposition 98 minimum guarantee.
- ☒ The administration estimates the Proposition 98 minimum guarantee is almost \$1.5 billion below the Proposition 98 budget act funding level.

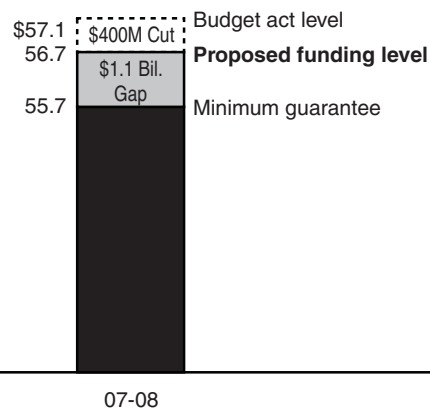


Governor's Current-Year Proposition 98 Proposal

Figure 2

Governor Proposes Reducing Spending by \$400 Million

(In Billions)



Of the proposed \$400 million reduction:

- K-12 revenue limits would be reduced by \$360 million (or 1 percent).
- Community college apportionments reduced by \$40 million (or 0.7 percent).



For K-12 revenue limits, the administration proposes to create a “deficit factor” of 1 percent. It does not propose creating a deficit factor for community college apportionments.

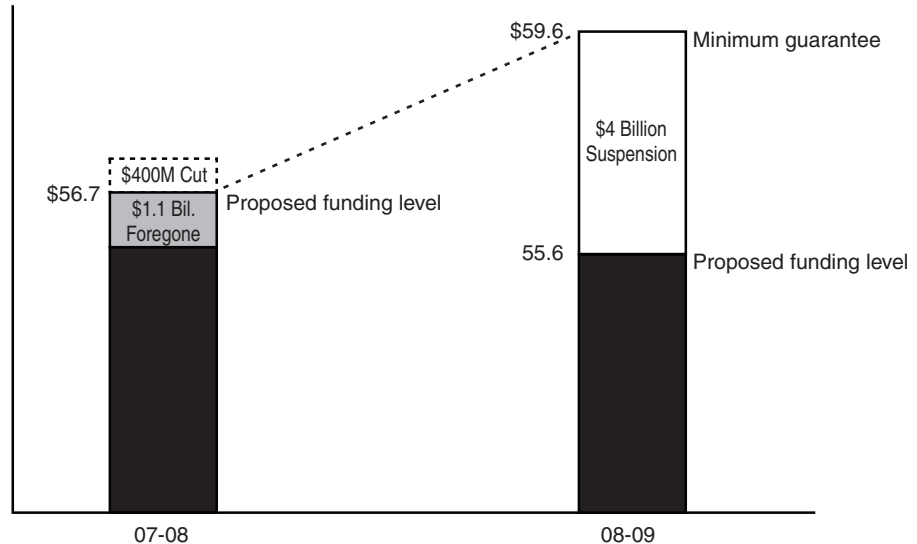


Concerns With Governor's Current-Year Plan

Figure 3

Governor's Current-Year Plan Affects Budget Year Guarantee^a

(In Billions)



^a Based on Governor's revenue projection and accrual proposal.

Governor's current-year proposal would:

- ☒ Result in actual midyear cuts to schools and colleges.
- ☒ Establish a new out-year obligation for K-12 education.
- ☒ Lose an opportunity in current year to achieve additional savings that could help in budget year.
- ☒ Increases the minimum guarantee for 2008-09 beyond what otherwise would be required.

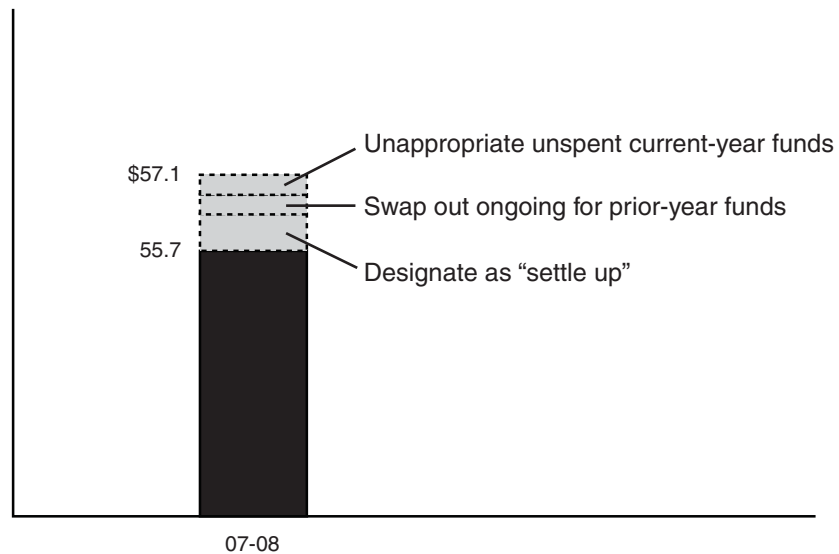


LAO Current-Year Alternative

Figure 4

LAO Alternative Closes Entire \$1.5 Billion Gap

(In Billions)



- ☑ We recommend the Legislature adjust Proposition 98 spending all the way down to the minimum guarantee.
- ☑ To close the \$1.5 billion gap, we recommend using a combination of three strategies.
- ☑ The major advantage of these strategies is that they offer a budget solution without affecting current school operations.



LAO Alternative Uses Three Strategies

Strategies:

- ☒ **Unappropriate.** Unappropriate any current-year funds that would not be spent by end of fiscal year (approximately \$300 million).
- ☒ **Swap.** Sweep up unspent Proposition 98 funds from 2006-07 and earlier years, swap out ongoing for prior-year funds (approximately \$500 million).
- ☒ **Settle Up.** Designate remainder as payment toward existing Proposition 98 obligation (approximately \$700 million).

Impact:

- ☒ No 2007-08 budget impact on schools.
- ☒ Immediate budget savings of at least \$800 million (compared to \$400 million proposed by Governor).
- ☒ Making settle-up payment now reduces future budget obligations (\$700 million).



Unappropriate Unspent Current-Year Funds

Figure 5
Unspent Current-Year Funds

(In Millions)

Program	Amount
Child development	\$80.5
Physical Education Teacher Incentive	41.8
Class Size Reduction (K-3)	32.0
Child care facilities	30.0
Economic Impact Aid	25.0
Class Size Reduction (9th Grade)	20.0
High Priority Schools Grant program	18.2 ^a
School Safety Competitive Grant program	18.1
Year Round Operations	15.0
Home-to-School Transportation	11.0
Math and Reading Professional Development	6.3
Teacher training programs ^b	4.0
High Priority Schools Corrective Action	3.8
Cal-SAFE	2.0
National Board Certification	2.0
Pupil Retention Block Grant	1.0
CCC Career Technical Education	32.0
CCC (various)	2.7
Total	\$345.3

^a This amount of federal funding will revert if districts do not spend by September 2008.

^b Includes intern and paraprofessional teacher training programs.



Swap Out Ongoing Funds for Unspent Prior-Year Funds

Figure 6

Unspent Prior-Year Funds

(In Millions)

Year	Program	Amount
Various	Existing Reversion Account Balance	\$41.8
2003-04	Child development	12.0
2004-05	Child development	3.8
	County Offices	1.7
2005-06	9 th Grade Class Size Reduction	25.0
	Targeted Instructional Improvement	22.8
	Cal-SAFE	7.2
	Partnership Academies	2.1
	Child Nutrition	1.2
	Specialized Secondary	0.3
	California Community Colleges (various)	2.7
2006-07	Before and After School	200.0 ^a
	Child development	159.1
	Year Round Schools	13.7
	English Learner Assistance	5.1
	Cal-SAFE	3.5
	National Board Certification	2.5
	Mentoring program	0.5
	Administrator Training	0.4
	California Community Colleges (various)	7.8
Total		\$513.3

^a Requires legislation clarifying the meaning of "continuous appropriation," as used in Proposition 49. The clarification would indicate that the generally required \$550 million appropriation would be made annually and available for one year, after which time unspent funds would revert to the Proposition 98 Reversion Account. The estimate of savings is based on a four-to-five month start-up period, resulting in less than a full year of initial program cost.



Settle Up Could Be Remainder of Solution

Figure 7
Existing "Settle-Up" Obligations

(In Millions)

Year	Amount
2002-03	\$483
2003-04	618
Total	\$1,101

- ☒ A settle-up obligation is created when the minimum guarantee goes up after the budget has been enacted. The difference between the budget act funding level and the minimum guarantee is deemed settle up.
- ☒ The state currently owes \$1.1 billion in outstanding settle-up obligations.
- ☒ The state is now planning on paying that \$1.1 billion in \$150 million annual installments until the entire obligation is retired.
- ☒ If sufficient prior- and current-year funds cannot be found to close the entire \$1.5 billion gap, the remainder could be designated as settle up.

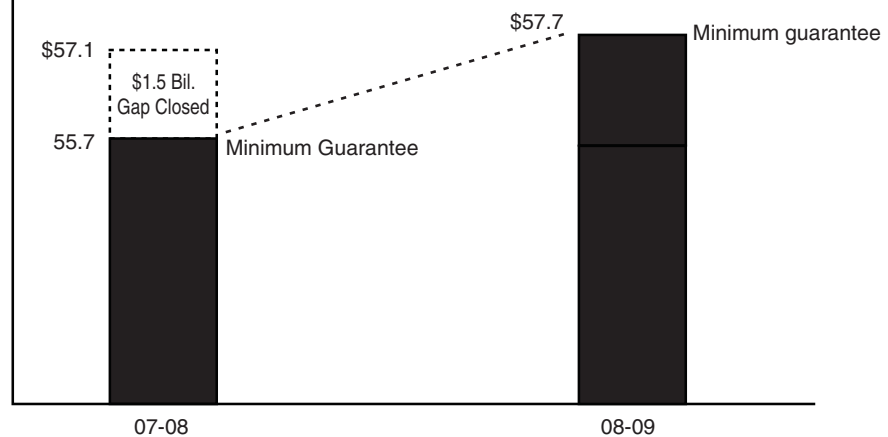


Advantages of LAO Alternative

Figure 8

LAO Alternative Maximizes Budget-Year Options^a

(In Billions)



^a Based on administration's revenue projection and no accrual proposal. If accrual proposal were adopted, the minimum guarantee would increase to \$58.6 billion.

Compared to administration's plan, LAO alternative:

- ☒ Obtains more budget solution in current year.
- ☒ Does not result in real midyear cuts to schools and colleges.
- ☒ Does not create any new out-year obligations.
- ☒ Retires portion of existing out-year obligation.
- ☒ Maximizes Legislature's budget-year options.