Overview of Proposition 98 Budget

LEGISLATIVE ANALYST’S OFFICE

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Overview of State Budget Problem and Governor’s Proposed Solutions

Governor identifies budget problem of $18.9 billion (consisting of projected $6.6 billion year-end deficit in 2009-10 and $12.3 billion shortfall in 2010-11).

- Most of problem attributable to: (1) inability of state to achieve previous budget solutions, (2) effects of several adverse court rulings, and (3) expiration of various solutions that provided one-time benefit in 2009-10 but no ongoing benefit in 2010-11.

Governor’s plan contains $1 billion reserve in 2010-11.

Governor’s plan contains $19.9 billion in proposed solutions.

- Roughly 40 percent relies on funding or flexibility to be provided by the federal government.
- Roughly 40 percent consists of reductions to state spending.
- Remainder consists of various fund shifts, including a major transportation tax proposal as well as proposals to put measures relating to early childhood development funds and mental health funds on June ballot.

If federal relief does not materialize, Governor’s plan proposes to trigger certain revenue increases and expenditure reductions.
Governor’s Federal Fund Package Contains Proposal Relating to Special Education

- Governor requests $6.9 billion of federal funding.
- Of this amount, $1 billion related to special education.
  - Governor seeks one-time federal appropriation to reimburse California for prior-year special education costs.
  - Though federal government has committed to covering 40 percent of special education costs, it has been covering less than 20 percent of total costs.
  - If one-time federal funds were received, the budget assumes they would provide general relief in 2010-11 but would not change proposed level of K-12 education spending.
LAO Assessment of Governor’s Overall Budget Plan

- Reasonable estimate of problem but some downside risk.
- Not realistic to expect $7 billion in new federal funding.
- Significant legal risks associated with some proposals.
- Some proposals might not generate level of savings assumed in Governor’s plan.
- Time is of the essence for many proposals given they require time to implement changes.
- No way to avoid reprioritizing state finances.
- Revenue actions should be part of budget solution.
- Multiyear approach is needed.
Overview of Governor’s Proposition 98 Plan

| Proposition 98 Spending Stays Virtually Flat Under Governor’s Plan |
|-----------------------|------------------------------------------------------------------|
| **(Dollars in Millions)** | 2007-08 Final | 2008-09 Final | 2009-10 Revised | 2010-11 Proposed | Change From 2009-10 |
| **K-12 Education** | | | | | |
| General Fund | $37,752 | $30,260 | $30,844 | $32,023 | $1,179 | 3.8% |
| Local property tax revenue | 12,592 | 12,726 | 13,237\(^a\) | 11,950 | -1,287 | -9.7% |
| Subtotals | ($50,344) | ($42,986) | ($44,082) | ($43,974) | ($108) | (-0.2%) |
| **California Community Colleges** | | | | | |
| General Fund | $4,142 | $3,918 | $3,722 | $3,981 | $259 | 7.0% |
| Local property tax revenue | 1,971 | 2,011 | 1,953 | 1,913 | -40 | -2.0% |
| Subtotals | ($6,112) | ($5,929) | ($5,675) | ($5,895) | ($219) | (3.9%) |
| **Other Agencies** | | | | | |
| General Fund | $121 | $105 | $94 | $85 | -$9 | -9.1% |
| Local property tax revenue | $14,563 | $14,737 | $15,191\(^a\) | $13,864 | -$1,327 | -8.7% |
| **Totals, Proposition 98** | $56,577 | $49,019 | $49,851 | $49,954 | $103 | 0.2% |

\(^a\) Includes $850 million in one-time shift of local government revenues.

- **Plan provides:**
  - $49.0 billion for Proposition 98 in 2008-09, a reduction of $83 million compared to the July 2009 budget agreement.
  - $49.9 billion for Proposition 98 in 2009-10, a reduction of $568 million compared to the July 2009 budget.
  - $50.0 billion in 2010-11 Proposition 98 funding, an increase of $103 million from 2009-10.

- **Plan:**
  - Departs from ABX4 3 provisions.
  - Seeks waiver from federal maintenance-of-effort (MOE) requirement.
Governor’s Plan Compared to ABX4 3 Agreement

The July budget agreement (per ABX4 3):

- Statutorily set the 2008-09 Proposition 98 minimum guarantee at $49.1 billion.
- Established a maintenance factor obligation of $11.2 billion.
- Designated that maintenance factor payments be made as specified in the Constitution.

The Governor’s plan:

- Recognizes a drop in the 2008-09 Proposition 98 minimum guarantee to $46.8 billion.
- Achieves $83 million in revenue limit savings from lower-than-expected K-12 attendance.
- Assumes that Test 1 is operative in 2008-09 (and 2009-10 and 2010-11).
- Retires $1.3 billion in maintenance factor in 2008-09 (created in 2006-07 and 2007-08).
- Delays beginning payments on remainder of statutorily required maintenance factor payments until 2012-13.

Departure from ABX4 3 agreement results in significantly lower Proposition 98 funding requirements for current and budget years. Specifically, achieves savings of:

- $893 million in 2009-10.
- $979 million in 2010-11.
Governor’s Plan Compared to Federal MOE Levels

Comparing Funding to Federally Required Maintenance-of-Effort (MOE) Level

(Dollars in Millions)

<table>
<thead>
<tr>
<th></th>
<th>MOE Level:</th>
<th>2008-09</th>
<th>2009-10</th>
<th>2010-11</th>
</tr>
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<tbody>
<tr>
<td><strong>K-12 Education</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
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<tr>
<td>Proposition 98 Fund</td>
<td>$32,961</td>
<td>$30,260</td>
<td>$30,844</td>
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<tr>
<td>Settle-up</td>
<td>7</td>
<td>1,101</td>
<td>—</td>
<td>—</td>
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<tr>
<td>QEIA</td>
<td>—</td>
<td>402</td>
<td>250</td>
<td>152</td>
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<tr>
<td>Deferrals</td>
<td>—</td>
<td>2,904</td>
<td>1,679</td>
<td>—</td>
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<tr>
<td><strong>K-12 Totals</strong></td>
<td>$32,968</td>
<td>$34,667</td>
<td>$32,773</td>
<td>$32,175</td>
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<tr>
<td>Average Daily Attendance (ADA)</td>
<td>5,965,268</td>
<td>5,957,111</td>
<td>5,921,510</td>
<td>5,927,728</td>
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<tr>
<td>Total Per ADA (In Dollars)</td>
<td>$5,527</td>
<td>$5,819</td>
<td>$5,535</td>
<td>$5,428</td>
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<tr>
<td><strong>Amount Above/Below MOE</strong></td>
<td></td>
<td>$1,744</td>
<td>$47</td>
<td>-$585</td>
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<tr>
<td><strong>Institutions of Higher Education (IHEs)</strong></td>
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<td></td>
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<tr>
<td>UC General Fund</td>
<td>$2,839</td>
<td>$2,451</td>
<td>$2,596</td>
<td>$3,019</td>
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<td>CSU General Fund</td>
<td>2,596</td>
<td>2,186</td>
<td>2,350</td>
<td>2,723</td>
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<td>Subtotals—UC/CSU</td>
<td>($5,435)</td>
<td>($4,636)</td>
<td>($4,946)</td>
<td>($5,742)</td>
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<td>CCC</td>
<td>$3,422</td>
<td>$4,306</td>
<td>$3,915</td>
<td>$3,999</td>
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<tr>
<td>Proposition 98 Fund</td>
<td>3,422</td>
<td>3,918</td>
<td>3,721</td>
<td>3,981</td>
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<td>QEIA</td>
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<td>48</td>
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<td>Deferrals</td>
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<td>—</td>
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<tr>
<td>Subtotals—CCC</td>
<td>($3,422)</td>
<td>($4,306)</td>
<td>($3,915)</td>
<td>($3,999)</td>
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<td><strong>IHE Totals</strong></td>
<td>$8,857</td>
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<td>$8,861</td>
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<td><strong>Amount Above MOE</strong></td>
<td></td>
<td>$85</td>
<td>$4</td>
<td>$885</td>
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</tbody>
</table>

☑️ Governor’s plan:

- Meets K-12 MOE requirement in 2009-10.
  - To avoid violating MOE requirement in 2009-10, pays $250 million of 2010-11 Quality Education Investment Act obligations in June 2010.

- Falls below K-12 MOE level in 2010-11 by almost $600 million.

- Meets higher education MOE requirement in both 2009-10 and 2010-11.
Governor has indicated to United State Department of Education (USDE) that California might need a waiver from the MOE requirement.

- To qualify for a waiver under the American Recovery and Reinvestment Act (ARRA), state support for education as a share of total state support must be kept the same or higher than the prior year.

Whether California ultimately qualifies for waiver depends on various factors that will be in flux until new budget package adopted.

The USDE does not provide final approval of waiver request until all input factors has been finalized.

<table>
<thead>
<tr>
<th>Calculation of Waiver From Federal Maintenance-of-Effort Requirements</th>
</tr>
</thead>
<tbody>
<tr>
<td>(Dollars in Millions)</td>
</tr>
<tr>
<td>2009-10</td>
</tr>
<tr>
<td>-----------------</td>
</tr>
<tr>
<td>State support for education</td>
</tr>
<tr>
<td>Total General Fund expenditures</td>
</tr>
<tr>
<td>Education as Share of Total Expenditures</td>
</tr>
</tbody>
</table>
Governor’s Major Midyear and Budget-Year Proposals

### Proposition 98: Governor’s Major Spending Proposals

**Midyear 2009-10 Proposals**
- Recognize K-3 Class Size Reduction (CSR) savings: -$340
- Make various other baseline adjustments: -228
- **Total Changes:** -$568

**2010-11 Proposals**
- Backfill prior-year one-time solutions: $1,908
- Make various other adjustments: 238
- Reduce K-12 revenue limits:
  - Spend less on school district administration: -1,184
  - Remove restrictions on contracting out: -300
  - Consolidate County Office of Education functions: -45
  - Make K-14 cost-of-living adjustments (-0.38 percent): -230
  - Recognize additional K-3 CSR savings: -210
  - Reduce CalWORKs Stage 3 child care funding: -123
  - Reduce child care reimbursement rates: -77
  - Fund CCC apportionment growth (2.21 percent): 126
- **Total Changes:** $103

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*a* Includes growth for revenue limits, special education, and child nutrition. Also includes funding for three K-12 mandates.
Governor’s Major Midyear and Budget-Year Proposals

(Continued)

☑ Major midyear proposals:
  ■ Capture $340 million in savings from unspent funds anticipated in the K-3 Class Size Reduction (CSR) program.
  ■ Recognize additional savings of $228 million (consisting of $236 million in revenue limit savings due to lower-than-expected K-12 attendance and an $8 million increase due to various technical adjustments).

☑ Major budget-year proposals:
  ■ Includes $1.9 billion increase to restore 2009-10 one-time solutions.
  ■ Reduces K-12 education funding (primarily revenue limits) by $1.9 billion.
  ■ Applies -0.38 percent cost-of-living adjustment to most K-14 programs, for savings of $230 million.
  ■ Provides $35 million in growth funding for K-12 revenue limits, special education, and child nutrition, as well as $126 million for California Community College (CCC) apportionments.
  ■ Includes several new flexibility proposals.
Despite providing a slight increase in overall Proposition 98 funding, Governor’s plan includes sizeable reductions.

Reductions necessitated because of heavy reliance on one-time solutions in 2009-10 that do not provide ongoing savings in 2010-11.

Major one-time 2009-10 solutions:

- $1.8 billion in payments deferrals ($1.7 billion from K-12 revenue limits, $163 million from CCC). Without year-to-year increase in overall funding, higher program level supported last year can no longer be sustained.

- $100 million in one-time reductions to various K-12 education programs (charter school facility grants, Division of Juvenile Facilities, and state preschool) that are restored in 2010-11.
K-12 Revenue Limit Reductions
Linked to Policy Changes

☑ Reduces school district revenue limit funding by $1.5 billion:
  ■ $1.2 billion reduction to school district central administration.
  ■ $300 million reduction linked to anticipated savings resulting from removing restrictions on school districts’ ability to contract for noninstructional services.

☑ Reduces county office of education revenue limits by $45 million and requires consolidation of some services.
Makes Other Adjustments to K-12 Education Programs

- Further reduces the K-3 CSR program by $210 million, for a total reduction of $550 million compared to July 2009 budget.
- Achieves $64 million in one-time savings by using prior-year unspent funds.
- Provides $29 million in categorical funding for new schools.
Proposes Several New Flexibility Options

☑️ Eases restrictions regarding teacher employment.
  ■ Removes requirement that school districts must layoff, rehire, assign, reassign, and transfer teachers based on seniority. Use of seniority would be determined at the local level.
  ■ Eliminates requirement that laid-off teachers must be placed first on substitute teaching list and does not require districts to pay teachers pre-layoff rate if they have worked 20 days in a 60-day period.
  ■ Changes teacher layoff notification window to 60 days after enactment of the state budget.

☑️ Removes restrictions on contracting out noninstructional services.
Funds Three K-12 Mandates

- Governor suspends most education mandates.
- Provides funding for the following three mandates:
  - $65 million for behavioral intervention plan settlement.
  - $7.7 million for inter/intra-district transfer costs.
  - $6.8 million for costs of administering California High School Exit Exam.
- Seeks court action to overrule new reimbursement rate methodology adopted for High School Science Graduation Requirement mandate.
Under the Governor’s proposal, K-12 per-pupil programmatic funding in 2010-11 would be more than 10 percent lower than the 2007-08 level.

The large drop in 2010-11 is mostly due to the heavy reliance on one-time solutions in 2008-09 and 2009-10.

The 2008-09 and 2009-10 per-pupil funding rates reflected in the table vary notably depending on assumptions relating to the use of freed-up restricted reserves and federal stimulus funding (particularly with regard to the year in which the funds are attributed). Rates intended only to reflect general statewide trends.
Overview of Governor’s Child Care Budget

Under Governor’s 2010-11 proposal, total funding for child care and development programs would decrease by $316 million, or about 10 percent, compared to 2009-10.

Most of the decrease would be in the California Work Opportunity and Responsibility to Kids (CalWORKs) programs.

Funding for CalWORKs Stage 3 programs would be cut by more than one-third.
Largest reduction ($132 million) is due to proposed change in the amount state would pay voucher-based child care providers.

- Lowers reimbursement for licensed child care providers from 85 percentile of regional market rate (RMR) to 75 percentile.
- Lowers reimbursement for license-exempt providers from 90 percent of licensed rate to 70 percent.
- Governor’s proposal is based on 2005 RMR survey, even though 2007 survey data are available.

Additional $123 million cut to CalWORKs Stage 3.
LAO Initial Assessment of Governor’s Proposition 98 Plan

Plan contains several major risks:

- Unclear if constitutional obligations would be met.

- Minimum guarantee could go up if: (1) finalized inputs for 2008-09 change slightly, (2) the Governor’s Proposition 42 proposal is rejected (or substantially modified), (3) certain revenue increases are triggered, (4) the Legislature adopts other revenue increases, and/or (5) a different constitutional interpretation prevails.

- Uncertain if: (1) state will qualify for a waiver and/or (2) federal government will approve waiver request.

Governor’s flat year-to-year funding proposal might be all state can afford.

Flexibility proposals have merit, though some require significant refinement.

Recommend against taking major actions that would restrict local discretion, thereby working at cross-purposes with new flexibility options.

- For example, we recommend rejecting the Governor’s district administration proposal, which provides no new flexibility but instead restricts how school districts can use existing general purpose funding.

Suspending education mandates misses opportunity to fix broken system. Recommend assessing mandates on case-by-case basis and adopting comprehensive reform package.