

May 18, 2012

Proposition 98: May Revision Overview

LEGISLATIVE ANALYST'S OFFICE

Presented to:
Assembly Budget Subcommittee No. 2 on Education Finance
Hon. Susan Bonilla, Chair





Governor's Proposed Changes to Proposition 98 Funding Levels

Changes in Proposition 98 Minimum Guarantee			
<i>(In Millions)</i>			
	January	May	Change
2011-12 minimum guarantee	\$48,288	\$47,024	-\$1,264
2012-13 minimum guarantee	52,527	53,735	1,208

- In 2011-12, minimum guarantee decreases by \$1.3 billion, primarily due to drop in baseline revenues.
- In 2012-13, minimum guarantee *increases* by \$1.2 billion.
- Despite estimated *drop* in revenues in both current and budget years, the year-to-year growth in General Fund revenues increases—resulting in a *higher* Proposition 98 minimum guarantee.
- Higher minimum guarantee driven by maintenance factor provisions.
- Problem magnified by Governor's interpretation of maintenance factor payments (increases minimum guarantee by \$1.7 billion in 2012-13).



Governor Uses Questionable Maintenance Factor Assumption

- Governor's application fundamentally delinks maintenance factor creation from maintenance factor payment.

- Governor's application produces irrational outcomes.
 - Does not always create maintenance factor in years when funding grows slower than the economy (such as 2011-12).
 - Virtually all revenue growth can go to schools with the rest of the budget not benefitting at all from economic recoveries or tax increases.
 - Proposition 98 funding restored to a long-term spending level higher than if no maintenance factor had been created.

- Legislature could apply reasonable maintenance factor approach.
 - Retains the link between the creation and payment of maintenance factor.
 - Creates maintenance factor whenever state revenues grow slower than the economy.
 - Makes maintenance factor payment to increase funding corresponding with earlier shortfalls.



Concerns With Governor’s Rebenchings

	Rebenching Method Used:		
	2011-12 Budget Act	January	May
Shift:			
ERAF and triple flip	1986-87	1986-87	1986-87
Ongoing redevelopment-related revenues	Current-year	1986-87	1986-87
One-time redevelopment-related revenues	Not applicable	Not applicable	Current-year
Gas tax swap	Current-year	None	None
Child care	Current-year	1986-87	Current-year
Student mental health services	Current-year	1986-87	Current-year
Debt-service payments ^a	Not applicable	1986-87	1986-87
Early Start ^a	Not applicable	Not applicable	None

^a Applicable only under Governor’s trigger plan.
ERAF = Educational Revenue Augmentation Fund.

- Using different rebenching methods across years and among program calls into question the meaningfulness of the Proposition 98 minimum guarantee.
- Recommend using “current-year” approach for all adjustments.
- Current-year approach ensures that shifts result in dollar-for-dollar effect.



2011-12 Major Spending Changes

2011-12 Proposition 98 Spending Changes	
<i>(In Millions)</i>	
Baseline Adjustments:	
Restore HTST reduction	\$248
Make revenue limit technical adjustments	188
Make other technical adjustments	22
Reduce revenue limits to conform to HTST restoration	-275
Subtotal	(\$183)
Accounting Changes:^a	
Designate as Quality Education Investment Act payment	-450
Designate as settle-up payment	-335
Subtotal	(-\$785)
Total May Revision Adjustments	-\$603

^a Rather than counting as Proposition 98 spending, designates spending toward related prior-year obligations. Does not reflect programmatic reductions.
HTST = Home-to-School Transportation.

- Increased spending of \$183 million, primarily due to revenue limit cost increases.
- Makes \$785 million in accounting adjustments to reduce spending that counts toward Proposition 98 minimum guarantee.
 - Designates \$450 million in spending as a payment relating to Quality Education Investment Act (QEIA). This generates comparable budget-year savings.
 - Designates \$335 million in spending as a “settle-up” payment (associated with unmet prior-year Proposition 98 obligations).



2012-13 Major Spending Changes

Changes in 2012-13 Proposition 98 Spending			
<i>(In Millions)</i>			
	January	May	Change
Baseline adjustments	\$2,775	\$2,333	-\$442
Pay down K-14 deferrals	2,369	2,815	446
Create K-14 mandate block grants ^a	110	110	—
Do not initiate Transitional Kindergarten	-224	-92	132
Modify preschool funding	-58	33	92
Swap with one-time funds	-57	-112	-55
Eliminate Early Mental Health Initiative	-15	-15	—
Restore Home-to-School Transportation ^b	—	496	496
Fund QEIA program	—	450	450
Hold harmless for weighted student formula ^b	—	90	90
Total Changes	\$4,900	\$6,108	\$1,208

^a Proposes no change in overall spending but shifts \$11 million from schools to community colleges.
^b Reflects proposals the administration made shortly after releasing the January budget.
 QEIA = Quality Education Investment Act.

- Increases K-14 deferral pay-downs by \$446 million.
- Reduces estimated savings from not initiating Transitional Kindergarten program.
- Increases preschool funding for an additional 7,900 slots (and rescinds earlier proposed reductions).
- Recognizes restoration of Home-to-School Transportation funding and provides \$90 million to hold districts harmless from proposed shift to weighted student formula.
- Funds QEIA program within Proposition 98.



K-14 District Redevelopment Funds

Administration Estimates: K-14 District Redevelopment Funds			
<i>(In Millions)</i>			
	2011-12	2012-13	Totals
Property Tax	\$818	\$991	\$1,809
Proposition 98 offset	(818)	(981)	(1,799)
Not an offset		(10)	(10)
Assets	—	\$1,478	\$1,478
Proposition 98 offset	—	(1,405)	(1,405)
Not an offset	—	(74)	(74)
Totals	\$818	\$2,469	\$3,287
Proposition 98 offset	(818)	(2,386)	(3,204)
Not an offset	—	(84)	(84)

Detail does not add due to rounding.

- Governor assumes \$1.8 billion ongoing and \$1.5 billion in one-time redevelopment-related property tax revenues are available for school districts and community colleges across the two-year period.

- Redevelopment revenues overstated.
 - We estimate only \$200 million in ongoing redevelopment-related property tax revenues will materialize in 2011-12 and \$700 million will materialize in 2012-13—\$900 million lower than Governor’s estimate over the two-year period.
 - Significant risk to cash asset revenue assumption. Revenues may materialize but may take several years to be available for distribution to local agencies.



Notable Changes to Governor's Weighted Student Formula (WSF) Proposal

Overview of Revisions to Governor's Weighted Student Formula (WSF) Proposal		
Formula Component	January	May
Amount of base grant	<ul style="list-style-type: none"> • \$4,920 	<ul style="list-style-type: none"> • \$5,421 (average across grades)
Grade span adjustments	<ul style="list-style-type: none"> • None. 	<ul style="list-style-type: none"> • K-3: \$5,466 • 4-6: \$4,934 • 7-8: \$5,081 • 9-12: \$5,887
Supplemental funding for disadvantaged students	<ul style="list-style-type: none"> • 37 percent of base grant. • No spending requirements. • Provides additional funding for districts with large concentrations of targeted students. 	<ul style="list-style-type: none"> • 20 percent of base grant. • Requirement that districts spend supplemental funding to provide services for disadvantaged students. • Maintains concentration grant proposal.
Treatment of existing categorical programs	<ul style="list-style-type: none"> • Excludes Home-to-School Transportation (HTS) from WSF, provides funding only in 2012-13. • Eliminates existing spending requirements from seven additional programs. • Incorporates all currently flexed programs plus seven additional programs into new formula. 	<ul style="list-style-type: none"> • Also excludes Targeted Instructional Improvement Grant (TIIG) from WSF. • Locks in existing HTS and TIIG district-level allocations, provides as permanent "add-ons" separate from WSF with no spending requirements. • Maintains January approach for other programs.
Phase-in period	<ul style="list-style-type: none"> • Six years (5 percent via new formula in 2012-13, full implementation in 2017-18). 	<ul style="list-style-type: none"> • Seven years (5 percent via new formula in 2012-13, full implementation in 2018-19).
Implementation of new formula contingent upon:	<ul style="list-style-type: none"> • No contingencies. 	<ul style="list-style-type: none"> • Passage of Governor's tax initiative in November 2012. • Adoption of legislation in 2013-14 to revise the state's K-12 accountability system. • Annual increases in Proposition 98 funding above predetermined growth levels. • Full restoration of existing revenue limit deficit factor (by 2017-18).
Priorities for future growth in Proposition 98 funds	<ul style="list-style-type: none"> • First priority: Retiring deferrals. • Second priority: Increasing the WSF base grant. 	<ul style="list-style-type: none"> • Half for retiring deferrals. • Half for making comparable increases to both base revenue limits and the WSF base grant.



Recommend Legislature Adopt Some Version of Governor's Proposal



Most of Governor's Proposed Modifications Reasonable

- Persuasive rationale for making revisions to base grant amount and supplemental weight, as well as adding grade span adjustments.
- Spending requirements for supplemental grants would help ensure disadvantaged students receive needed services.
- Extending phase-in period and adopting contingencies is reasonable given districts' budgetary uncertainty.



Recommend Against Excluding Two Large Programs From WSF

- Excluding Home-To-School Transportation and Targeted Instructional Improvement Grant counteracts the goals of moving towards a more equitable, rational system. Existing funding formulas are antiquated, and locking in allocations further delinks funding from future needs.



Block Grants Remain an Alternative Option

- In lieu of a WSF—under which funds typically are general purpose in nature—the state could restructure K-12 funding into a few thematic block grants with broad programmatic objectives and spending requirements.



Continue to Recommend Initiating Reform Now

- Long criticized for being overly complex and inefficient, recent changes have rendered the existing system even more irrational and inequitable. Now is the time to begin laying the groundwork for a new K-12 funding system.



Comparing May Revision to Governor’s Earlier Mandate Proposals

Three Versions of Education Mandates Proposal

	Version 1 (January)	Version 2 (February)	Version 3 (May)
Number of K-14 mandates targeted for elimination	31	31	32 ^a
Number of K-14 mandates included in block grant	23	26 ^b	28 ^c
Block grant activities still mandated?	No	Yes	Yes
Claims process still allowed?	No	Yes	No
Block grant (in millions)			
K-12 block grant amount:	\$178	\$178	\$167
CCC block grant amount:	22	22	33
Totals	\$200	\$200	\$200
Per-student block grant rate (in dollars)			
K-12 districts:	\$30	\$30	\$28
Charter Schools:	30	26	28
County Offices of Education:	30	89	28
CCCs:	20	20	28
Compliance audits for block grant activities?	Yes	Yes	Yes

^a Includes one newly identified CCC mandate.
^b Includes three CCC mandates that the earlier version (January) would have retained as mandates.
^c Includes two newly identified CCC mandates.

May Revision Changes

- Unlike earlier proposals, the May Revision (1) retains some activities as formal mandates but eliminates the formal mandate reimbursement process and (2) provides a uniform per-student block grant rate for all local educational agencies (LEAs).
- The May Revision also (1) immediately eliminates six of the costliest K-12 mandates and (2) addresses three newly identified mandates for community colleges.



Recommend Legislature Create Mandate Block Grant



Adopt List of Mandates Proposed for Elimination

- For community colleges, consider also eliminating:
(1) Enrollment Fee Collection and Waivers,
(2) Community College Construction, and
(3) Minimum Conditions for State Aid.
- Further review needed for California Community Colleges' Discrimination Complaint Procedures mandate.



Make Participation in Block Grant Discretionary

- Suspend all mandates included in the block grant but require activities be conducted as a condition of receiving block-grant funding.



Modify Per-Student Funding Rate to Encourage Greater Block Grant Participation

- Setting a minimum grant amount could encourage very small LEAs to participate.
- Consider different rates for county offices of education and community colleges. Claims data indicate these agencies face different costs.



Governor’s Trigger Plan

Changes to Governor’s Proposition 98 Trigger Plan		
<i>(In Millions)</i>		
	January	May
Changes in 2012-13 Minimum Guarantee		
Revenue drop due to measure failing	-\$2,444	-\$2,907
Rebench for debt-service payments	200	194
Eliminate rebenching for student mental health services	—	-103
Total Changes	-\$2,244	-\$2,815^a
Changes in 2012-13 Proposition 98 Spending		
Accommodate debt-service payments	\$2,593	\$2,551 ^b
Accommodate Early Start program	—	238
Rescind deferral pay downs	-2,369	-2,815
Reduce general purpose funding	-2,468	-2,789 ^c
Total Changes	-\$2,244	-\$2,815

^a As estimated in the May Revision, the Proposition 98 minimum guarantee would drop from \$53.7 billion to \$50.9 billion.

^b Reflects updated amounts. The May Revision had relied on earlier point-in-time estimates.

^c Reflects updated general purpose reduction assuming administration wants to fund at minimum guarantee.

- Minimum guarantee decreases by \$2.8 billion.
 - If ballot measure fails, minimum guarantee drops by \$2.9 billion. Governor also proposes to rebench for K-14 debt service (\$194 million) but not rebench for additional mental health services shift (-\$103 million).

- Spending decreases by \$2.8 billion.
 - Would no longer pay down outstanding deferrals and would make programmatic reduction.
 - Would pay for K-14 debt service and Early Start within guarantee.



Alternative Proposition 98 Package

- Package contains alternatives to Governor's basic plan and trigger plan. Both assume reasonable maintenance factor approach and current-year rebenchmarking methodology.

- Alternative to Governor's basic plan:
 - Has little to no programmatic effect on schools (has a smaller deferral pay-down).
 - Funds the guarantee.
 - Frees up \$1.9 billion for rest of budget.

- Alternative trigger plan:
 - Contains smaller programmatic reduction than Governor.
 - Funds the guarantee without any new rebenchings.
 - Spreads pain of trigger cuts (\$1.3 billion more in nonschool cuts).



Side-by-Side: Governor and Alternative Packages

Comparing Governor and Alternative Proposition 98 Spending Plans

(In Millions)

	Governor	Alternative	Difference
Basic Plans			
Baseline adjustments	\$2,333	\$2,333	—
Pay down K-14 deferrals	2,815	1,525	-\$1,290
Restore Home-to-School Transportation funding	496	496	—
Fund Quality Education Investment Act program	450	328	-122
Create K-14 mandate block grants	110	110	—
Hold harmless for weighted student formula	90	90	—
Modify preschool funding	33	—	-33
Use unspent prior-year Economic Impact Aid monies	—	-350	-350
Swap one-time funds	-112	-186	-73
Do not initiate Transitional Kindergarten program	-92	-75	17
Eliminate Early Mental Health Initiative	-15	-15	—
Total Augmentation	\$6,108	\$4,257	-\$1,851
Proposition 98 Spending	\$53,736	\$51,885	-\$1,851
K-14 debt service ^a	\$2,551	\$2,551	—
Early Start Program ^a	238	238	—
Total Related Spending	\$56,525	\$54,674	-\$1,851
Trigger Plans^a			
Rescind deferral pay downs	-\$2,815	-\$1,525	\$1,290
Reduce general purpose programmatic funding	-2,789	-975	1,814
Total Reductions	-\$5,604	-\$2,500	\$3,104
Total Related Spending	\$50,921	\$52,174	\$1,253

^a Both the Governor and the alternative fund both of these activities under both the basic and trigger plans. Under the Governor's trigger plan, activities are funding within the Proposition 98 guarantee.