

MARCH 14, 2019

Overview of Proposition 98 Budget Proposals

PRESENTED TO: Senate Budget Subcommittee No. 1 on Education
Hon. Richard D. Roth, Chair



LEGISLATIVE ANALYST'S OFFICE

Update on the 2018-19 Minimum Guarantee

<i>(In Millions)</i>			
	June 2018 Estimate	January 2019 Estimate	Change
Minimum guarantee	\$78,393	\$77,867	-\$526
Funding above guarantee reclassified as settle-up	—	475	475
Total K-14 Funding	\$78,393	\$78,342	-\$50

- ▶ **The 2018-19 Budget Act Set Funding Equal to the Estimate of the Minimum Guarantee**
- ▶ **Two Notable Developments Have Occurred Since June 2018:**
 - Administration estimates the minimum guarantee is down \$526 million, mainly due to decline in student attendance.
 - Administration estimates Local Control Funding Formula costs are about \$50 million below previous projections (also primarily due to lower-than-anticipated student attendance).
- ▶ **School Funding Is Now \$475 Million Above the Minimum Guarantee**
- ▶ **Governor Proposes Reclassifying Funding Above Guarantee as Settle-Up Payment**
 - Schools would continue to receive all of the funding they are expecting in 2018-19 (no midyear cuts or payment deferrals).
 - State would count funding toward meeting the Proposition 98 guarantee in some prior years for which it has not already met the guarantee.



Governor's Estimate of the 2019-20 Minimum Guarantee

(Dollars in Millions)

	2017-18 Revised	2018-19 Revised	2019-20 Proposed	Change From 2018-19	
				Amount	Percent
Minimum Guarantee	\$75,498	\$77,867	\$80,680	\$2,813	3.6%
By Segment					
K-12 education	\$66,778	\$68,693	\$71,242	\$2,549	3.7%
California Community Colleges	8,720	9,174	9,438	264	2.9%
By Source					
General Fund	\$52,887	\$54,028	\$55,295	\$1,268	2.3%
Local property tax	22,610	23,839	25,384	1,545	6.5%

► **Minimum Guarantee Is Up \$2.8 Billion Over Revised 2018-19 Level**

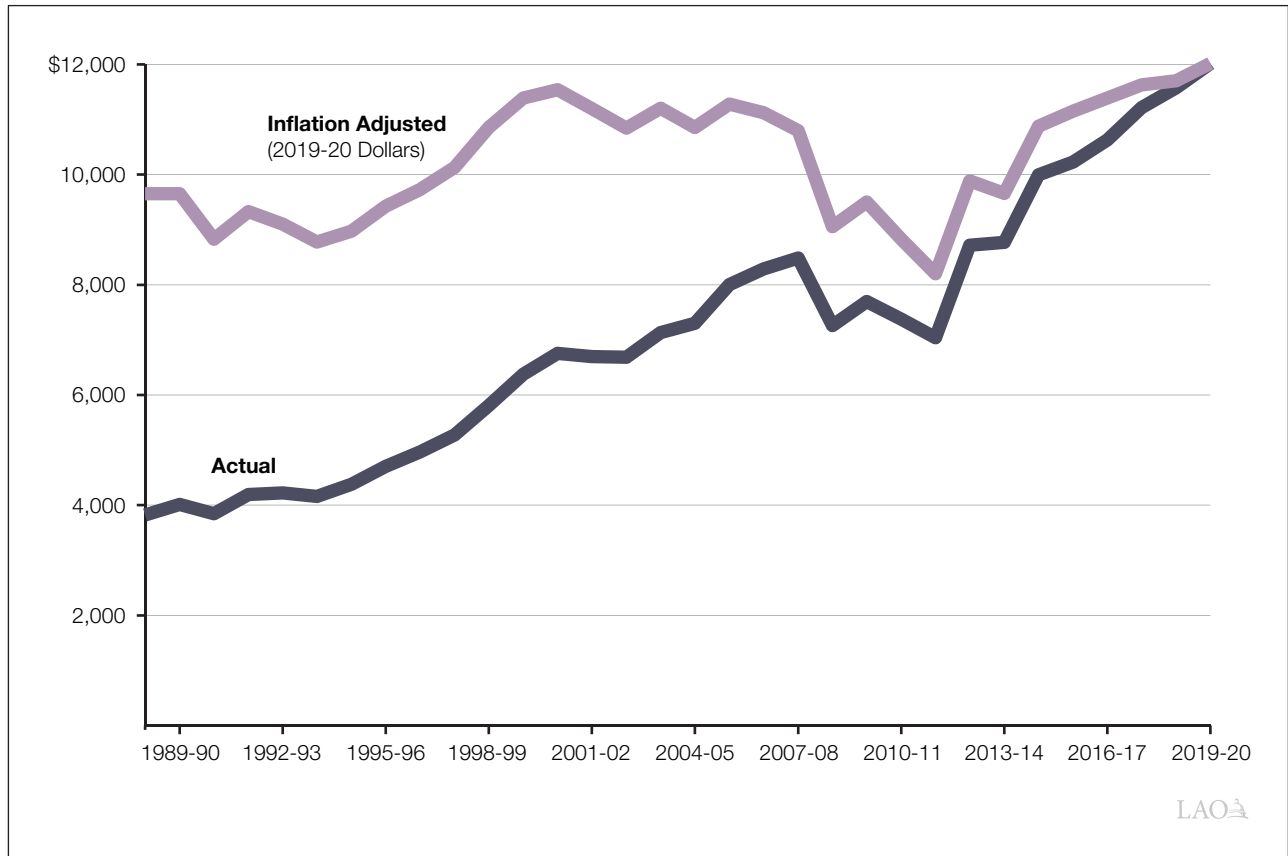
- Due primarily to increase in General Fund revenue.
- Under the Proposition 98 formulas, the state is required to provide schools with a fixed share (about 40 percent) of state General Fund revenue in 2019-20.

► **Local Property Tax Revenue Is Up \$1.5 Billion**

- Due primarily to administration's estimated growth in assessed property values.
- Covers more than half of the increase in the minimum guarantee.
- The administration's property tax estimates seem reasonable. Over the three-year budget period, the administration's estimates are only \$136 million (0.2 percent) below our November 2018 estimates.



Funding Per Student Over Time



► **Under Governor’s Budget, Funding Per Student Grows**

- K-12 funding would be \$12,018 per student in 2019-20, an increase of \$444 (3.8 percent) over the revised 2018-19 level.

► **Adjusted for Inflation, Funding Per Student Is at All-Time High**

- \$500 per student above the previous peak (2000-01).
- \$1,200 per student above the prerecession level (2007-08).



Proposition 98 Outlook Beyond the Budget Year

- ▶ **Under the Economic Growth Scenario We Examined in November 2018, the Guarantee Grows Steadily Over the Outlook Period**
 - Average annual increases of 3.4 percent over the four-year outlook period.
 - Growth is at a slower pace compared with recent years because the state has no outstanding maintenance factor.

- ▶ **Under Our Recession Scenario, the Guarantee Drops in 2020-21 and 2021-22**
 - Under a moderate recession scenario, the minimum guarantee would drop to a level where it would be unable to support the state's existing school programs.
 - If the Legislature wanted to avoid reductions by funding above the guarantee, higher reserves would be needed. (The state school reserve currently has no balance.)

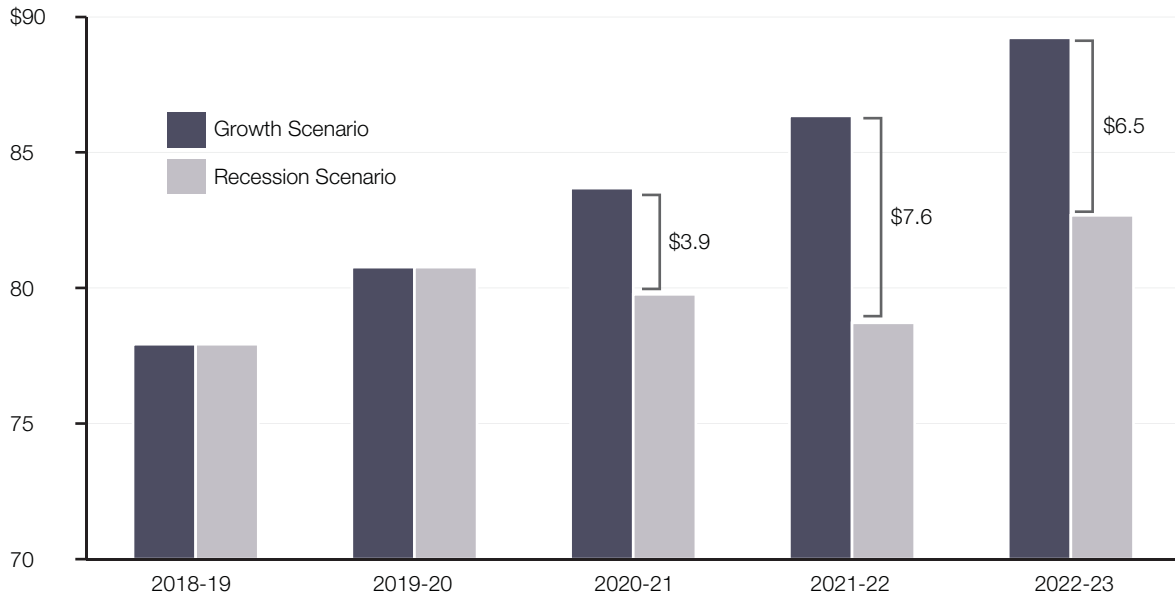


Proposition 98 Outlook Beyond the Budget Year

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Minimum Guarantee Differs by Billions of Dollars Under Different Scenarios

(In Billions)



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Governor's Proposition 98 Spending Proposals

<i>Reflects Ongoing Commitments Unless Otherwise Noted (In Millions)</i>	
K-12 Education	
COLA and attendance adjustments for LCFF	\$2,027
Special education grants (\$187 million one time)	577
COLA for select categorical programs	187
Full-year cost of previously approved preschool slots	27
COLA and attendance adjustments for COEs	9
School district accounting system replacement project (one time)	3
Subtotal	(\$2,830)
California Community Colleges	
COLA for apportionments	\$248
College Promise fee waivers for second-year students	40
COLA for select student support programs	32
Enrollment growth for apportionments	26
Student Success Completion Grants caseload adjustment	11
Legal services for undocumented students	10
Subtotal	(\$367)
Accounting Shifts	
Three K-12 initiatives shifted to Proposition 98 budget (one time)	\$8
Preschool costs shifted to non-Proposition 98 budget	-297
Subtotal	(\$289)
Total Spending Proposals^a	\$2,908
^a Reflects all proposals scored to 2017-18, 2018-19, 2019-20, or prior years. COLA = cost-of-living adjustment (3.46 percent); LCFF = Local Control Funding Formula; and COEs = county offices of education.	

- ▶ **Across All Years of the Period, Governor Proposes \$2.9 Billion in Net New Spending**
- ▶ **Cost-of-Living Adjustments (COLA) Account for \$2.5 Billion of New Spending**
 - Administration projects the statutory COLA rate is 3.46 percent.
 - Largest associated cost is \$2 billion for the Local Control Funding Formula.



Governor's Budget Allocates Essentially All 2019-20 Funding for Ongoing Programs

- ▶ **State Historically Has Set Aside Some Funding for One-Time Purposes**
 - Over the past six years, the amount of funding dedicated for one-time funding has averaged about \$700 million per year. (This amount excludes one-time funds associated with prior-year true-ups and settle-up payments.)

- ▶ **One-Time Funding Has Some Notable Advantages**
 - Provides a measure of protection against future volatility in the minimum guarantee.
 - Allows the Legislature to address drops in the minimum guarantee without making reductions to ongoing school programs.

- ▶ **Governor's Budget Has Very Little Funding for One-Time Activities**
 - Of the \$2.8 billion in funding specifically attributable to the 2019-20 fiscal year, just \$3 million is for one-time activities.
 - The Governor's budget also proposes using \$77 million in one-time funds to pay for ongoing program costs.
 - Using one-time funds for ongoing costs builds a shortfall into the Proposition 98 budget the following year, effectively reducing the augmentations schools could expect in 2020-21.

- ▶ **Governor's Budget Reflects a Riskier Approach Compared With Previous Years**



Proposition 98 Budget Planning

- ▶ **State Revenue Estimates Could Be Somewhat Lower by May**
 - Drop in financial markets at the end of 2018 could reduce revenue somewhat, particularly in 2018-19.
 - Some other economic indicators—like home sales and unemployment claims—suggest economic growth could be slowing.

- ▶ **Proposition 98 Guarantee Is Sensitive to Lower Revenue Estimates**
 - Guarantee would drop about 55 cents for each dollar of lower revenue in 2018-19.
 - Guarantee would drop about 40 cents for each dollar of lower revenue in 2019-20.

- ▶ **Governor’s Budget Excludes Some Costs Likely to Materialize Over Coming Months**
 - One-time General Fund backfill related to overallocation of property tax revenue in San Francisco.
 - Higher attendance-related costs for the Local Control Funding Formula based on recent data from the California Department of Education.
 - Increases in formula-driven costs for county offices of education and community college apportionments.
 - Operating grants for Oakland Unified and Inglewood Unified.



Proposition 98 Budget Planning

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- ▶ **Lower Guarantee and Higher Costs Could Mean a Tighter School Budget by May**
 - Even a relatively small reduction of a few hundred million dollars could limit state's ability to fund initiatives beyond COLA.

- ▶ **Legislature Could Begin Preparing for Potentially Tighter School Budget**
 - Use coming months to identify proposals that could be rejected or reduced.
 - Build a budget cushion by replacing some of the proposed ongoing spending with one-time initiatives. Use the cushion to mitigate reductions in ongoing spending if the guarantee drops.



Background on Proposition 98 True-Up Process

► **Proposition 98 Guarantee Often Changes After Fiscal Year Is Over**

- Estimates of General Fund revenue and other inputs affecting the guarantee are not final until at least nine months after the close of the fiscal year.
- When the state updates the relevant inputs, the minimum guarantee often changes from the initial estimate. Changes occurring after the year is over typically are in the range of tens of millions to low hundreds of millions.

► **State Typically Addresses Changes in Guarantee in the Following Budget Cycle**

- When the minimum guarantee is higher than previously estimated, the state makes a one-time payment to “settle up” to the higher level.
- When the minimum guarantee is lower, the state generally reduces school funding to the lower level. The state usually makes this reduction by reclassifying funding above the guarantee as being a payment toward a different fiscal year (one where it has not already met the guarantee). This approach allows schools to keep the funding they already received but recognizes a lower base for calculating the guarantee moving forward.

► **2018-19 Budget Package Created a New True-Up Process**

- The new process effectively automated the state’s previous practice for adjusting school funding up or down in response to changes in the minimum guarantee.
- The new process was designed to make changes in the guarantee and associated funding adjustments less disruptive and more predictable for schools and the state.



Proposed Changes to the True-Up Process

▶ **Governor Has Two Proposals Relating to True-Ups**

- Proposes eliminating the automatic true-up process created last year.
- Proposes prohibiting the state from making any downward adjustments to school funding in the prior year, while still requiring upward adjustments.

▶ **Recommend Rejecting Governor's Two True-Up Proposals**

- The proposals could result in school funding being above the guarantee even if the Legislature did not intend that result.
- Without adjusting school funding, the state budget would be more difficult to balance that year. This is because the rest of the state budget would bear the full effect of the drop in state revenue.
- The state budget likely would be more difficult to balance in future years too. This is because base school funding would be higher (even though the revenue to support the higher level did not materialize).

