

FEBRUARY 27, 2024

The 2024-25 Budget: Proposition 98 Overview and K-12 Education

PRESENTED TO:

Assembly Budget Subcommittee No. 3 on
Education Finance
Hon. David A. Alvarez, Chair



LEGISLATIVE ANALYST'S OFFICE

Update on the Guarantee in 2022-23 and 2023-24

(In Millions)

	2022-23			2023-24		
	June 2023 Estimate	January 2024 Estimate	Change	June 2023 Estimate	January 2024 Estimate	Change
General Fund	\$78,117	\$68,563	-\$9,554	\$77,457	\$74,633	-\$2,824
Local property tax	29,241	29,742	501	30,854	30,953	99
Totals	\$107,359	\$98,306	-\$9,053	\$108,312	\$105,586	-\$2,725
General Fund tax revenue	\$204,533	\$178,952	-\$25,581	\$201,213	\$193,185	-\$8,028

Unprecedented Reduction in 2022-23 Guarantee

- Delays in tax payment deadlines obscured underlying weakness in state revenues.
- Revenues for 2022-23 came in nearly \$26 billion below June 2023 estimates.
- The lower revenues reduced the guarantee by nearly \$9.1 billion (8.4 percent).
- Previous drops to the guarantee in a prior year have been only a couple hundred million dollars.

Moderate Reduction in 2023-24 Guarantee

- The Governor's budget anticipates a relatively rapid rebound in state revenues. Specifically, it assumes revenues overall grow 8 percent from the lower 2022-23 level to 2023-24, ending up moderately below the 2023-24 enacted budget level.
- The Proposition 98 guarantee is \$2.7 billion (2.5 percent) below the enacted budget level under these revenue assumptions.



Governor’s Estimate of the Guarantee in 2024-25

(Dollars in Millions)

	2022-23	2023-24	2024-25
Minimum Guarantee			
General Fund	\$68,563	\$74,633	\$76,894
Local property tax	29,742	30,953	32,185
Totals	\$98,306	\$105,586	\$109,080
Change From Prior Year			
General Fund	-\$15,190	\$6,070	\$2,261
Percent change	-18.1%	8.9%	3.0%
Local property tax	\$2,942	\$1,211	\$1,232
Percent change	11.0%	4.1%	4.0%
Total guarantee	-\$12,248	\$7,281	\$3,493
Percent change	-11.1%	7.4%	3.3%
General Fund Tax Revenue	\$178,952	\$193,185	\$194,941

Moderate Growth in the 2024-25 Guarantee

- The guarantee would grow to \$109.1 billion in 2024-25, an increase of \$3.5 billion (3.3 percent) over the revised 2023-24 level and \$768 million (0.7 percent) over the 2023-24 enacted level.
- Increases in General Fund and local property tax revenue both contribute to growth in the guarantee.

Two Special Adjustments Affect the Guarantee

- Proposition 28 (2022) requires the state to increase the guarantee for the cost of providing arts education funding, beginning in 2024-25 (\$930 million).
- The state previously established a plan to make transitional kindergarten available to all four-year olds by 2025-26. It also decided to “rebench” (adjust) the guarantee upward to account for the cost of the expansion each year (\$630 million in 2024-25).



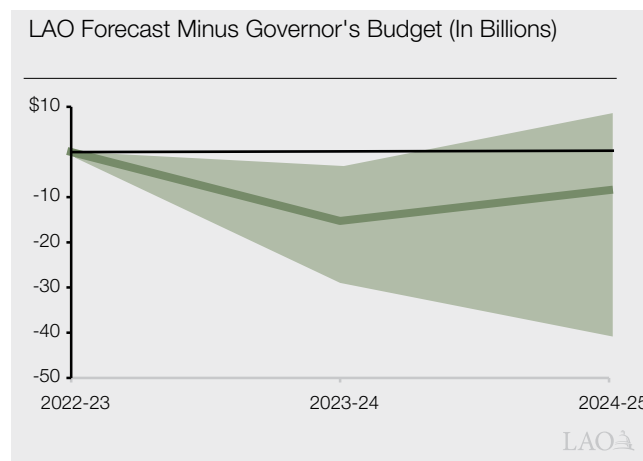
LAO Estimates of General Fund Revenue

State Tax Collections Are Tracking Well Below the Governor's Budget Level

- January personal income tax collections came in \$5 billion (24.5 percent) below the Governor's budget estimate. Most of this weakness is attributable to estimated payments (which generally consist of taxes owed on capital gains and other nonwage income).
- Indicators that are important for state revenues have remained weak. For example, investment in California startups and technology companies remains depressed, and relatively few California companies are going public.

LAO Revenue Estimates Are Nearly \$24 Billion Below the Governor's Budget Level

- Our best estimate of revenue is \$15.3 billion lower in 2023-24 and \$8.4 billion lower in 2024-25.
- Though uncertainty remains for both years, the state has a low probability of receiving revenues that approach the levels in the Governor's budget.



LAO Estimates of the Guarantee

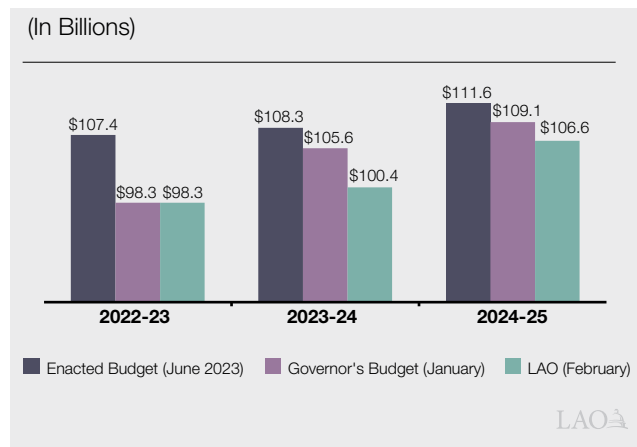
Our Estimates Are \$7.7 Billion Below Governor’s Budget Level

- \$9 billion in lower required General Fund spending across 2023-24 and 2024-25.
- Our local property tax estimates are \$1.3 billion above the Governor’s budget level over the two years, which offsets a portion of the drop.

(In Millions)

	2022-23	2023-24	2024-25	Three-Year Totals
Governor’s January Budget				
General Fund	\$68,563	\$74,633	\$76,894	\$220,091
Local property tax	29,742	30,953	32,185	92,881
Totals	\$98,306	\$105,586	\$109,080	\$312,972
LAO February Estimates				
General Fund	\$68,563	\$68,815	\$73,702	\$211,081
Local property tax	29,742	31,543	32,867	94,153
Totals	\$98,306	\$100,358	\$106,570	\$305,234
Change From Governor’s Budget				
General Fund	—	-\$5,818	-\$3,192	-\$9,010
Local property tax	—	590	682	1,272
Totals	—	-\$5,228	-\$2,510	-\$7,738

Our Estimates Represent Further Drop Relative to June 2023



Governor’s Plan for Addressing the Drop in Proposition 98 Guarantee

Budget Obtains \$13.7 Billion in Savings From Four Main Solutions Affecting K-12 Schools

\$7.1 Billion Funding Maneuver That “Accrues” Costs to Future Years

- The state would remove the budgetary cost of \$7.1 billion in previous payments to schools from its books in 2022-23. (The Governor also has a similar proposal affecting \$910 million in community college payments.)
- The state would not reduce any previous payments to schools or attempt to recoup this funding in subsequent years. Instead, it would attribute the costs to the non-Proposition 98 side of the budget over several subsequent years.
- In effect, the state would (1) use its cash resources to finance payments to schools that exceed the Proposition 98 guarantee in the prior year and (2) create an internal obligation to recognize the underlying budgetary cost in the future.

\$4.9 Billion Discretionary Withdrawal From the Proposition 98 Reserve for K-12 Schools

- The budget also withdraws \$722 million for community college programs.
- The withdrawals would leave nearly \$3.9 billion in the reserve for future use.

\$1.2 Billion Baseline Savings From Lower Student Attendance

\$446 Million One-Time Reduction to Preschool Funding That Would Otherwise Go Unused



Governor's K-12 Spending Proposals

The Budget Proposes \$1.4 Billion in New Spending for K-12 Schools

- \$784 million for ongoing increases.
- \$599 million in one-time spending.

New Spending Directed Toward Four Main Areas

- \$628 million for 0.76 percent cost-of-living adjustment (COLA) (ongoing).
- \$500 million for second round of zero-emission school bus grants (one time).
- \$187 million for universal school meals (mix of ongoing and one time).
- \$68 million for other augmentations, mainly related to teacher training and education technology (mix of ongoing and one time).



Governor's K-12 Solutions and Spending Proposals

(In Millions)

Solutions and Reductions	
Shift prior-year costs to future budgets	-\$7,097
Discretionary reserve withdrawal	-4,946
LCFF attendance changes ^a	-1,217
State Preschool savings	-446
Total	-\$13,705
Ongoing Increases	
LCFF COLA (0.76 percent)	\$564
Universal school meals	122
COLA for select categorical programs (0.76 percent) ^b	64
Training for literacy screenings	25
CA College Guidance Initiative	5
Inclusive College Technical Assistance Center	2
Homeless Education Technical Assistance Centers	2
Total	\$784^c
One-Time Increases	
Green school bus grants (second round)	\$500
2023-24 universal school meals increase	65
Training for new mathematics framework	20
Item bank for science performance tasks	7
Instructional continuity	6
FCMAT long term planning	1
Science safety handbook	— ^d
Total	\$599

^a Consists of a \$2.6 billion reduction from the continuing phaseout of pre-pandemic attendance funding, partially offset by a \$796 million increase related to transitional kindergarten.

^b Applies to Adults in Correctional Facilities, American Indian programs, Charter School Facility Grant Program, Child and Adult Care Food Program, Child Nutrition program, Equity Multiplier, Foster Youth Program, K-12 mandates block grant, and Special Education.

^c The budget also proposes \$2 million ongoing for a program supporting state parks access for fourth graders. This program is an existing pilot the state funded previously with non-Proposition 98 funds.

^d Reflects \$150,000.

LCFF = Local Control Funding Formula; COLA = cost-of-living adjustment; and FCMAT = Fiscal Crisis and Management Assistance Team.



Positive Elements of Governor's Plan

Aligns General Fund Spending With Lower Estimates of the Proposition 98 Guarantee

- The state is facing a \$58 billion overall budget shortfall under the revenue estimates in the Governor's budget.
- Under our latest revenue estimates, the shortfall is \$73 billion.
- The state likely cannot balance its budget without adjustments to school spending.

Introduces a Few Reasonable Ideas

- The Governor signals he is open to a discretionary withdrawal from the Proposition 98 Reserve. (Discretionary withdrawals are contingent upon the declaration of a budget emergency and the Legislature approving the withdrawal.)
- The Governor indicates he is willing to explore savings in State Preschool.



Concerns With Governor's Plan

Estimate of the Proposition 98 Guarantee Seems Too Optimistic

- Our estimate of the Proposition 98 guarantee is \$7.7 billion lower than the Governor's budget level across 2023-24 and 2024-25.
- Assuming the state attributes 89 percent of this reduction to schools and aligns spending with the guarantee, it would need \$6.9 billion in school solutions.

Major Concerns With Funding Maneuver

- **Worsens Future Deficits.** The state is facing deficits of more than \$30 billion per year over the next several years, and the maneuver accounts for \$1.6 billion of that amount each year for the next five years. By worsening future deficits, the proposal sets up even more difficult decisions in subsequent years.
- **Represents Bad Fiscal Policy.** The state in effect is borrowing from future revenues by creating a binding obligation on itself. The proposal does not address the underlying misalignment between expenditures and available revenues.
- **Sets a Problematic Precedent.** Adopting this proposal could set an expectation the state would adopt similar maneuvers to address future shortfalls affecting schools or other programs in the state budget.
- **Reduces Budget Transparency.** The proposal decouples payments to schools and state recognition of the underlying cost of those payments for an extended period.



Concerns With Governor's Plan

(Continued)

Proposes New Spending When State Cannot Afford Existing Programs

- The state historically has tried to contain spending during tight times. During the Great Recession, for example, the state (1) avoided new commitments, (2) suspended the annual COLA, and (3) reduced funding for categorical programs.
- Instead of containing spending, the Governor's budget adds to the problem by increasing the ongoing spending level (through the COLA) and proposing additional one-time spending.
- Since the Proposition 98 guarantee cannot even support existing spending levels, these increases require the state to draw down the Proposition 98 Reserve. The additional withdrawals leave less funding available to support existing programs.

Creates Larger Shortfall in Ongoing Programs

- The 2023-24 budget relied upon nearly \$1.6 billion in one-time funds to cover ongoing program costs. Under the Governor's budget, this shortfall would grow to \$2.2 billion in 2024-25.
- The shortfall positions the state poorly—it sets up a spending level the state would have difficulty maintaining and makes future priorities more difficult to address.

Needs Significantly More Reductions and Solutions

- Avoiding the funding maneuver and addressing the drop in the guarantee could require the state to identify solutions of up to \$14 billion.
- The next few months provide an opportune time to establish priorities, consider options, and assess trade-offs.



Recommendations

Build Alternative Budget Plan That Prioritizes Core Programs and Budget Stability

- Reject the proposed funding maneuver.
- Use the Proposition 98 Reserve to address the shortfall in 2022-23.
- Reject all spending increases, including the COLA.
- Begin identifying additional reductions and solutions now.

Advantages of the Alternative Approach

- Helps preserve core programs at their existing levels.
- Reduces future state deficits.
- Results in smaller ongoing shortfall in school programs.
- Sets up better choices next year.



Identifying Additional Solutions

Review Unallocated Grants and Rescind Any Amounts That Are Not Highest Priority

LAO Estimates (In Millions)	
Program	Amount available
Community schools	\$2,594
Green school bus grants (first round)	500
Golden State Pathways Program	475
Teacher and counselor residency grants	330
National board certification grants	205
Inclusive Early Education Expansion Program	163
Dual enrollment access	122
Other	108
Totals	\$4,495

Explore Temporary Reductions to Ongoing Programs

- The state could reduce certain programs temporarily and expect districts to operate the underlying activities with unspent carryover funds. The most notable examples are the Expanded Learning Opportunities Program (ELOP) and the Special Education Early Intervention Grant.
- The state also could pause new grants under existing programs, such as the Career Technical Education Incentive Grant Program (\$300 million annually).



Identifying Additional Solutions

(Continued)

Explore Changes to Ongoing Programs That Could Generate Additional Savings

- **ELOP.** The state could likely save at least several hundred million dollars annually by assuming 90 percent participation (instead of assuming 100 percent participation) and/or exploring other changes.
- **State Preschool.** The state could likely save at least a few hundred million dollars annually in the future by sweeping funds not needed to cover existing rates and slots and by allowing an existing “hold harmless” provision to expire (we describe this issue in a forthcoming report).
- **School Nutrition.** The state could likely save at least a few hundred million dollars annually by reducing rates, revisiting its approach to COLA, suspending administrative augmentation authority, and removing participation requirements related to the Community Eligibility Provision.
- **School Transportation.** The state could save about \$200 million annually by reducing the reimbursement rate from 60 percent to 50 percent.
- **Transitional Kindergarten Staffing.** The state could save about \$100 million annually by aligning the funding amount with existing staffing requirements.

Consider Reducing “Add-Ons” That Are Based on Antiquated Factors

- Three add-ons provide funding for districts based on the programs they operated decades ago—Targeted Instructional Improvement Block Grants (\$855 million), minimum state aid (\$356 million), and Economic Recovery Targets (\$61 million).
- Eliminating or scaling back these add-ons would simplify school funding, reduce disparities among districts, and provide ongoing savings.



Identifying Additional Solutions

(Continued)

Plan for Larger Required Reserve Withdrawal

- Under our Proposition 98 estimates—and assuming the Legislature uses the Governor’s proposed reserve withdrawal to address the shortfall in 2022-23—the State Constitution would require withdrawing the \$3.9 billion remaining in the reserve.
- The additional withdrawal could help address the shortfall in 2023-24.

