
The FISCAL REPORT *32* *informational update*

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No. 1

Governor's Proposals for the 2012-13 State Budget and Education

Preface

The economic recovery, weak at best, has created the need for yet another crisis spending plan for the state of California. The Governor's Budget Proposal for 2012-13 represents a heroic effort to balance the increasingly heavy demands of an under-employed population with the stark reality that, on the natural, there will be little new revenue available to the state over the next few years.

As a result, this will be the fifth straight year that education cuts will be maintained. Five years ago, California's education spending on a per-student basis was among the lowest in the nation, even before a cut of roughly 15% was imposed. That cut remains the baseline as we enter yet another difficult year.

Even under the most optimistic assumptions, education recovers only a small portion of the ongoing cuts imposed beginning in 2008-09. But at this point, any gain for education would be more than welcome and will be difficult for the state to afford.

Notwithstanding the difficult economic climate, we think the Governor, while facing hard choices, is indeed attempting to avoid further cuts to public education. But the assumption that he will have to rely completely on solutions that can be accomplished with a 50% vote of the Legislature severely limits the options available. Though the Budget can be passed by the existing Democratic majority in each house, tax measures still require a two-thirds vote, which has not been available to this Governor. Recognizing this, the Governor will instead seek a ballot proposal that bypasses the Legislature, allowing state voters to weigh in on his tax proposal directly.

Potential Gains or Midyear Cuts?

While the Governor has proposed increases to education funding, they are contingent on the passage of a major tax initiative in November. This means it will be difficult to plan and budget again this year. The state has not solved its budget problems on a permanent basis. We will, therefore, continue to recommend that districts plan conservatively and maintain prudent reserves.

What constitutes a prudent reserve? While it is difficult to give a specific number that would apply to all districts, the average district finished 2010-11 with a reserve of about 14%. We see no reason to reduce that amount in 2012-13. Districts will need to assess the risk of a midyear cut, make an informed estimate of the potential exposure, and plan accordingly. We, at SSC, are analyzing the exposure now and will offer our specific recommendations in the revised SSC Education Dashboard that will accompany our Governor's Budget Workshop materials.

Revolutionary Changes

Beyond the very significant financial portrayal offered by the Budget, there are also revolutionary proposals that fundamentally alter the manner in which public education is funded and delivered in California.

- **Weighted Student Funding**—Categorical programs that are not mandated by the federal government (e.g., special education) would be combined with revenue limits and allocated "on a single formula," based on the number of students in a school and the concentration of English learners and pupils eligible for free and reduced-price lunches.
- **Cost of Living (COLA)**—No COLA adjustment is proposed for 2012-13.
- **Elimination of Home-to-School Transportation**—The Budget reaffirms the current-year trigger reduction of \$248 million for transportation and proposes a complete elimination of funding (\$619 million) for the program in 2012-13. No further details are available at this time.
- **Mandates**—The Budget provides \$200 million for a new K-12 and community college mandate incentive block grant and also proposes to eliminate more than half of the existing mandates.
- **Transitional Kindergarten**—No funding is provided for Transitional Kindergarten, but the change of kindergarten eligibility for children turning five in November is retained, resulting in a state savings of \$224 million.
- **Deferrals**—The Governor's Budget proposes to direct \$2.3 billion in Proposition 98 funding to reduce interyear apportionment deferrals for K-12 education and community colleges.
- **Child Care**—Funding for child care is proposed to be reduced by \$447 million in non-Proposition 98 funds and \$70 million in Proposition 98 funds, reflecting reduced reimbursement rates and the alignment of eligibility for state child care services with federal welfare-to-work participation requirements.

Conclusion

We are not going to get a stable and reliable budget until we have a stable and reliable economy. That is not going to happen this year. We have therefore added materials to our Governor's Budget Workshop to help deal with what has become a new reality in California. We depend heavily on our highest earners to fund government operations in California and the nation; a "tax the rich" strategy only works when the rich are doing well. Until the economy recovers, neither the rich nor the poor will do all that well, but you can be assured that the demand for government services, including education, will increase.

We applaud the Governor's tenacious approach in trying to put California's finances on a stable footing. But this year, he is unlikely to get much help; not from the Republicans, the economy, or the Feds. His one, last best hope is some temporary help from the voters. That help will be very difficult to secure.

So, despite the Governor's best hopes and intentions, we believe public education is in for another rough year. Now is the time to keep options open and to plan conservatively. As in past years, public school agencies will need to do it better, do it cheaper, and do it locally. The long-term effects on our society and our economy of doing less are unthinkable. We look forward to seeing you at our workshops.

In order to provide our analysis of the Governor's Budget Proposal in the shortest possible time, we have relied on information provided by the Administration and the Department of Finance on Thursday, January 5, 2012. Unfortunately, a copy of the proposed Budget Bill was not yet available, nor were there draft bills for some of the Administration's proposals. In other words, there may be some surprises and later information might be different.

As we gather further information about the Governor's proposal in the coming days, we will provide updates and any necessary corrections on our website. Simply go to www.sscal.com.

Overview of the Governor's Budget Proposals

The Economy and Revenues

The Economy

The U.S. economy has finally begun to show signs of a sustained recovery, and concerns about a double-dip recession seem to be fading. It is important to remember that the Great Recession began in December 2007, more than four years ago. And while it was "officially" declared over in June 2009, the path of this recovery has left most wondering whether the official economists in Washington are seeing the same economy as the rest of us.

For the national economy, the Governor's Budget describes a "slow, steady economic expansion" with more encouraging signs emerging in recent months. For example, the Index of Leading Indicators for October 2011 posted the largest monthly increase since November 2010, and the U.S. unemployment rate has dropped from 9.2% in June to 8.6% in November. Similarly, the Consumer Confidence Index posted its largest monthly gain in November in more than eight years, and in the same month, auto sales reached their highest level since June 2008.

With these signs of improvement, the Governor's Department of Finance is forecasting that U.S. Gross Domestic Product will increase 1.7% in 2012 and 2.5% in 2013, still modest by historical standards. The greatest risk to the U.S. recovery continues to be the European debt crisis, with a number of nations still striving to reduce their level of deficit spending. This crisis is expected to slow economic growth in Europe, which will, in turn, hold back the U.S. expansion.

For California, the Governor's Budget acknowledges that the fate of California is largely tied to the national economy. California will experience strong growth in some sectors, like technology and professional services, but also will be held back by the continuing drag of the housing market. The export sector, which rose 19% from 2009 to 2010, is expected to continue to expand, but an economic slowdown in Europe or China could significantly curtail California's growth.

The Governor's Budget forecasts personal income in California to increase 3.8% in 2012 and 4.1% in 2013, again low by historical standards for this phase of an economic recovery. Fortunately, however, the Administration does not foresee a near-term economic downturn. The state's employment outlook will improve in the coming years, but the unemployment rate will remain one of the highest in the nation, at 11.7% in 2013.

State Revenues

The key component of the Governor's Budget is a proposal to increase the state income tax rate by up to 2% on high income earners and to raise the state sales tax by ½ cent, effective upon the approval by state voters in the November 2012 General Election. This temporary tax increase would generate \$6.9 billion in new revenues annually from 2013 through 2016. The Governor's Budget, however, counts about \$2.3 billion of this gain in 2011-12.

In addition to the gain from the temporary taxes, the Governor's Budget counts on about \$1.5 billion from other revenue sources, including payment delays, fee increases, and loans.

In total, General Fund revenues are expected to increase 7.7% in 2012-13 under the Governor's plan, reaching \$95.4 billion, an increase of \$6.8 billion from the current year estimated total. Absent the temporary tax proposal, baseline revenue growth is projected at 3.5% or a \$3 billion increase.

For the current year, the Governor's Budget shows that revenues are expected to fall short \$2.1 billion when compared to the 2011-12 Budget Act. This shortfall triggered the midyear cuts to the state's higher education segments and the loss of \$248 million in K-12 transportation funding. In addition, the revenue shortfall results in a revenue limit cut of about 0.25% of districts' deficated revenue limit, or about \$13 per average daily attendance (ADA) on average.

Proposition 98

Proposition 98 sets, in the State Constitution, a series of complex formulas that establish the minimum funding level for K-12 education and the community colleges from one year to the next. This target level is determined by prior-year appropriations that count toward the guarantee, plus (1) workload changes as measured by the change in ADA and (2) inflation adjustments as measured by the change in either per-capita personal income or per-capita state General Fund revenues, whichever is less. Under certain circumstances the minimum level is set by a fixed percentage of General Fund revenues, called "Test 1," and it is this percentage that determines the Proposition 98 funding level for both 2011-12 and 2012-13.

The Governor's Budget estimates that the Proposition 98 guarantee will be \$48.3 billion in 2011-12, or \$661 million above the \$47.6 billion level forecast in the 2011-12 Adopted Budget. While acknowledging that this increase must be paid in support of K-14 education, the Budget assumes that it will be appropriated for schools at some time in the future as "settle-up" funding after 2012-13. For 2012-13, the Budget projects that the Proposition 98 guarantee will grow to \$52.5 billion, a \$4.9 billion increase that comes from a combination of anticipated growth in base state revenues and a Proposition 98 share of new temporary taxes proposed for the November 2012 ballot.

The Governor's Budget Proposal is dependent on voters taking action to adopt a new round of temporary taxes—a ½ percentage point increase in the sales tax and higher tax rates for the state's wealthiest taxpayers—which is expected to garner \$6.9 billion in additional revenues. All of the additional tax revenue is allocated to an Education Protection Account created by the ballot measure, and used to fund Proposition 98, but only \$2.5 billion actually increases funding for education programs. The remaining \$4.4 billion will benefit other state programs because it reduces Proposition 98 spending from the state General Fund.

If the proposed temporary taxes aren't approved by voters, the Proposition 98 guarantee will drop by about \$2.5 billion. The Budget proposes a second round of "trigger" reductions, with a loss of \$4.8 billion falling on K-14 education. To achieve this level of reduction, the Budget proposes two changes: first, the proposed \$2.2 billion repayment of deferred apportionments would be rescinded. Relative to current practice, this will have no net impact on education funding.

Secondly, the Governor's Budget proposes to recast debt service costs for school construction bonds—historically funded with non-Proposition 98 dollars—as Proposition 98 expenditures. Doing so without also rebenching the guarantee means that funds for education program spending will be reduced by the amount of debt service, set at \$2.4 billion. Other programmatic spending cuts of \$200 million will result in a real loss of \$2.6 billion in funds for education, or about 15 instructional days. The Budget proposal indicates that the Administration will, ". . . work with school officials and

stakeholders to develop legislation that protects education programs, but allows schools to develop and implement necessary contingency plans."

Revenue Limits and Categorical Programs

Revenue limits provide about two-thirds of school districts' revenues and the vast majority of general purpose funding.

In recent years, the multitude of non-federally required categorical programs in the state have been provided significant flexibility when compared to historical trends, and just last year were extended two additional years of temporary flexibility.

For the current year, the Governor's Budget contains a proposal that would completely change the way revenue limit and categorical program funding (excluding federally required programs) is distributed to schools, whereby these important funding categories would be consolidated into one revenue stream on a permanent basis. Funding from this new consolidated source would reportedly be distributed based upon a single weighted allocation formula that takes into account the school's number of disadvantaged pupils, and that is reportedly intended to increase local involvement in decision making. The weighted formula, which takes into consideration a variety of factors proposed by the Administration, would be phased in over a five-year period. This dramatic revision could alter the funding landscape for California schools quite demonstrably.

Transitional Kindergarten

Senate Bill (SB) 1381 (Chapter 705/2010) amended Education Code Sections (E.C.) 46300, 48000, and 48010, to change the required birthday for admission to kindergarten and first grade and established an ongoing Transitional Kindergarten program beginning in the 2012-13 school year. Transitional Kindergarten programs were to be the first year of a two-year kindergarten program using a modified kindergarten curriculum that is age and developmentally appropriate.

The 2012-13 Governor's Budget Proposal does not fund the Transitional Kindergarten program for the 2012-13 school year, and eliminates the requirement that schools provide Transitional Kindergarten instruction beginning in 2012-13. The Proposal redirects the cost savings of \$223.7 million to support existing education programs.

Many districts are already working to determine staffing needs for the first year of implementation of the program this fall, and may have hoped to avoid some certificated layoffs by assigning appropriately credentialed teachers to the Transitional Kindergarten program. At this time, it is not likely that the Transitional Kindergarten program will be funded for 2012-13. Districts should plan their staffing needs for the 2012-13 school year based upon updated enrollment projections and the elimination of the Transitional Kindergarten program, and notice any affected certificated staff by March 15, 2012.

Special Education

The Governor's proposed 2012-13 Budget contains some positive news for special education. The Budget includes \$98.6 million in Proposition 98 funding to replace the one-time \$98.6 million in Proposition 63 (mental health services act) funds used in 2011-12 to pay schools for the cost of providing educationally necessary mental health services to students with disabilities. The Budget proposes to rebench the Proposition 98 guarantee to reflect this increase. Additionally, the Governor proposes to provide \$12.3 million to fund special education ADA growth. As part of his mandate proposal, Governor Brown proposes to eliminate the Behavioral Intervention Plan (BIP) mandate,

noting "local districts may choose to continue these activities at local discretion." Similar to other programs, special education programs will not receive a COLA.

Transportation

The Governor's Budget proposal officially takes the state out of the business of providing funding for school transportation (home-to-school and special education). Funding also is eliminated for Small School District Bus Replacement.

In our article, "Glass Half Empty or Glass Half Full?" in the December 22, 2011, *Fiscal Report*, we reported the impact of the 2011-12 trigger cuts to transportation and shared Director of Finance Ana Matosantos' statement that while the midyear cuts are one time in nature, they will be carried forward into next year as adjustments to baseline funding for affected programs. This, in effect, makes all of the midyear cuts ongoing, contrary to the language in AB 114 (Chapter 43/2011) specifying they are one time.

Mandate Reimbursements

Under current statutory and constitutional law, the state may direct local agencies to provide new services to the public, but must also reimburse those agencies for costs incurred in providing those services.

In 2012-13, the Governor's Budget proposes sweeping reform to K-14 mandates. The Budget Proposal will eliminate nearly half of all existing mandates, including Graduation Requirements (Second Science Course) and Behavioral Intervention Plans. Local educational agencies (LEAs) may choose to continue the eliminated mandates at their discretion.

Mandates that are not eliminated will be made optional; however, the Proposal creates a block grant in order to encourage LEAs to continue meeting these requirements. Receipt of block grant funding will be contingent on schools performing the activities. Some of the continuing mandates include sensitive notification and school safety functions like pupil health screenings, immunization records, AIDS prevention, School Accountability Report Cards, and criminal background checks. The Governor's Budget provides a total of \$200 million to fund the mandates block grant incentive program for K-12 schools and community colleges.

Deferrals

There is a \$2.2 billion increase in funding to reduce interyear budgetary deferrals as part of the \$52.5 billion in Proposition 98 funding contained in the Governor's Budget. The details regarding the timing of receipt of cash from the additional deferral has yet to be determined. Dollars used to "buy back" deferrals count toward Proposition 98, but do not provide more spending authority to schools.

Child Care

Total funding proposed for California Department of Education child care programs in 2012-13 is \$1.5 billion, consisting of \$585.3 million in non-Proposition 98 General Fund, \$310.2 million in Proposition 98 General Fund, and \$557.9 million in federal funds. The \$1.5 billion in total funding reflects a \$516.8 million reduction in child care, nearly \$69.9 million of which is Proposition 98 funding, and \$446.9 million of which is non-Proposition 98 funding. Primary reductions to child care are the result of the following reductions:

- A decrease of \$293.6 million in non-Proposition 98 General Fund by requiring families to meet welfare-to-work participation requirements. **This reduction will eliminate about 46,300 child care slots.**
- A decrease of \$43.9 million in non-Proposition 98 General Fund and \$24.1 million in Proposition 98 General Fund by reducing the income eligibility ceilings from 70% of the state median income to 200% of the federal poverty level. **This reduction will eliminate about 15,700 child care slots.**
- A decrease of \$29.9 million in non-Proposition 98 General Fund and \$11.7 million in Proposition 98 General Fund by eliminating the statutory COLA for capped non-CalWORKs child care programs.
- A decrease of \$11.8 million in non-Proposition 98 General Fund by reducing the reimbursement rate ceiling for voucher-based programs.
- A decrease of \$67.8 million in non-Proposition 98 General Fund and \$34.1 million in Proposition 98 General Fund by reducing the standard reimbursement rate for direct-contracted Title 5 centers by 10%.

Child Nutrition

The Governor's Budget includes increases in federal funding for child nutrition to support program growth and additional funding for the Fresh Fruits and Vegetable Program. A total of \$37.2 million in federal funding is proposed for Child Nutrition Program growth, along with \$2 million for the Fresh Fruit and Vegetable Program to provide an additional fruit or vegetable snack to students during the school day.

Charter Schools

The Governor's Proposal includes an increase of \$50.3 million for charter school funding—General Purpose Block Grant and Categorical Block Grant—due to growth in ADA.

In addition, the Governor's Proposal includes changes to "improve in general the operational and financial playing field for charter schools." The Budget Proposal identifies several areas of financial support in which charter schools lag behind traditional schools. The Proposal states, "charter schools receive less per ADA funding than traditional public schools and are not eligible for mandate reimbursements. They have limited options for borrowing funds at affordable interest rates and may not issue bonds."

To address these issues, the Governor's Proposal includes the following:

- **Enhance Charter School Funding**—The Governor's Proposal eliminates the requirement of the authorizing agency's review of charter school deferral exemption and allows for the authorizing agency's inclusion of charter schools in their issues of County Treasury Revenue Anticipation Notes (TRANS).
- **Invest in Charter School Facilities**—The Governor's Proposal opens the participation of the Charter School Facility Program to the non-classroom based charter schools as well as eliminates some of the red tape to expedite the program's funding to the charter schools.
- **Improve Charter School Working Capital**—The Governor's Proposal authorizes the California School Finance Authority to refinance existing working capital revenue bonds and expand financings to include charter management organizations.

Redevelopment

Recently, the state Supreme Court issued its decision regarding a contested budget action in which two bills enacted as part of the 2011-12 State Budget were challenged by redevelopment agencies (RDAs). The Court ruled that Assembly Bill 26 of the First Extraordinary Session (ABX1 26), which dissolved RDAs, was constitutional. Its companion bill, ABX1 27 was ruled unconstitutional. ABX1 27 would have allowed an RDA to remain in existence if it provided a payment to the county treasury to support local schools and other agencies, which the state would have used to offset its General Fund spending. The decision effectively dismantles the 400-plus RDAs throughout California.

As a result of the decision, the state will not recapture the RDA revenues, estimated to be about \$1.7 billion in the first year of implementation and \$400 million each year thereafter, that were anticipated when the bills were adopted last year. However, with the termination of the RDAs, local property tax dollars will go back to local government and to local schools. This will effectively allow the state to recapture a smaller portion, roughly \$1 billion each year, through school district revenue limits and community college apportionments. This adjustment is reflected in the 2012-13 Governor's Budget.

The RDA legislation, if they had both been upheld, would have provided additional local revenues to school districts in future years outside of the revenue limit, resulting in real increases in discretionary local funds available for education programs. This proposed funding was not included in the Governor's Budget for next year.

School Facilities

The Governor's Budget Proposal includes the proposition to shift existing School Facilities Program bond authority from the Overcrowding Relief Grant Program to the New Construction Program and to regulate the allocation of new construction and modernization funds to ensure continued construction of new classrooms and modernization of existing classrooms. The Budget Proposal states "this action will delay local authority to impose a third level of construction fee while continuing construction of new classrooms using bond proceeds, fee revenues, and local funds."

While the proposed Budget focuses primarily on the operating budget for 2012-13, capital budgets are also affected. While the district operating budget benefits from continuation of flexibility in deferred maintenance and routine restricted maintenance, the capital budget suffers to an equal degree. Flexibility, once envisioned as temporary, continues through 2014-15. Facility planners know that even though the dollars may be desperately needed on the operating budget side, seven years of minimal maintenance expenditures will most certainly lead to big repair bills later. Coupled with the absence of a new statewide school facilities bond, facilities funding is minimal indeed. Thus, in the context of protecting programs for students now, we support continuation of this flexibility. However, this is not a cost-free option; there will be a piper to be paid.

Deferred Maintenance

The Governor's Budget proposal includes a line item for Deferred Maintenance with the state funding its contribution with \$250.8 million in the 2012-13 State Budget. LEAs are not required to make the match to receive the funds through 2014-15.

Routine Restricted Maintenance Account

LEAs continue to have the ability to reduce the amount they must deposit into a routine restricted maintenance account through 2014-15. The flexibility was allowed beginning with the 2008-09 fiscal year through 2014-15.

The exemption allows a district to reduce its contribution from 3% of General Fund expenditures to 1%; however, if the school district maintains its facilities in good repair, as defined in E.C. 17002, it shall be exempt from this 1% requirement.

As with all flexibility, agencies must review their options locally and utilize the flexibility provisions as reasonable and applicable.

Emergency Repair Program

The Governor's Budget Proposal includes an increase of \$12.3 million, in one-time funding in 2012-13 for the Emergency Repair Program (*Williams Settlement*).

Federal Programs

In late December, the 2012 Consolidated Appropriations Act (H.R. 2055) was passed by Congress and signed into law by the President, which set the funding levels for various federal programs, including education. While there has been much speculation that school funding would be drastically reduced, the focus on other key issues, such as extension of the Social Security payroll tax cut, dominated the debate. The U.S. Department of Education has released budget tables, which can be found at <http://www2.ed.gov/about/overview/budget/budget12/12action.pdf>.

The charts reflect the impact of a 0.189% across-the-board cut that will be applied to all education programs. One sliver of good news is that both Special Education Basic Grants and Title I Basic Grants received small increases, and Pell Grants received enough funding to maintain the maximum grant at \$5,500, albeit with several modifications on student eligibility and the elimination of some existing benefits. Nationally, Title I funding increased by \$60 million and Individuals With Disabilities Education Act funding by \$100 million, less the across-the-board cut. Additionally, Head Start Programs will receive a \$424 million increase and a new literacy program is established and funded at \$160 million. While many of the current federal education programs will receive flat funding in 2012, Race to the Top Grants were reduced from \$700 million to \$550 million, and Teacher Incentive Funds were reduced from \$400 million to \$300 million nationally. On average, California receives about 10% of the funds.

There is recent word from Congress that draft bills addressing several No Child Left Behind reauthorization issues—such as teacher quality, accountability, and Adequate Yearly Progress—are being debated, but it remains unclear if bipartisan support can be reached on an overhaul this year. Driving the renewed interest was the President's decision in August to authorize U.S. Education Secretary Arne Duncan to issue conditional waivers to states, something our California political leaders have yet to embrace.

November Ballot

The Governor's Budget Proposal relies significantly on new tax revenues generated from passage of the Governor's proposed tax initiative at the November 2012 General Election. The proposed initiative, introduced in December 2011, would temporarily increase the state sales tax by ½% and raise the personal income tax for the state's top earners by up to 2%. The tax increases would expire at the end of 2016. Together, these two tax increases would raise an estimated \$6.9 million in the 2012-13 Budget year with those funds directed to LEAs.

However, it may not be the only tax proposal on the November ballot. Several other tax proposals are being drafted and prepared for circulation, including a \$10 billion increase in personal income taxes for all taxpayers but the state's poorest. Proposed by attorney Molly Munger (sister of Charlie

Munger Jr., the proponent of 2010's successful redistricting initiative Proposition 20), the proposal would dedicate the first \$3 billion to retiring state bond debt, with the remaining \$7 billion going to public schools.

Another tax proposal comes by way of the Think Long Committee, a bipartisan group of former elected officials and policy makers led by billionaire Nicolas Berggruen. The proposal would reduce the state sales tax while extending the state sales tax to services to generate about \$10 billion. Revenues would be used to pay down debt first, then \$5 billion would go to public schools and community colleges.

A third proposal from the California Federation of Teachers would increase the marginal income tax for those earning more than \$1 million annually by up to 5%. Sixty percent of the revenues from the increased taxes would go to K-12 schools and higher education, with the remaining 40% going to local government. Finally, an oil extraction tax estimated to bring in roughly \$3.5 billion earmarked for education could also appear on the ballot.

Recognizing that more than \$36 billion in tax proposals might potentially be on the November 2012 ballot would prove problematic to passage of his proposal, Governor Brown is trying to convince the proponents of the initiatives to back off or modify their proposals so that they don't run afoul of each other, making it harder for him to promote the need for *his* tax proposal to voters.

Pension Reform

The Budget document refers to the Governor's Twelve-Point Pension Reform plan, unveiled in October 2011, and which we detail in our previous article, "Governor Brown Releases Pension Reform Plan" in our October 28, 2011, *Fiscal Report*. The Budget document cites that, when fully implemented, the reforms should cut the cost to taxpayers of providing pension benefits to state employees roughly in half. There are no other proposals with regard to pension reform in the Governor's 2012-13 Proposed Budget.

Collective Bargaining

The Governor's Proposal suggests, but does not explicitly state, that should his temporary tax initiative fail, the school year would need to be reduced by more than three weeks. Specifically, the proposal states that "a reduction of this magnitude would result in a funding decrease equivalent to more than the cost of three weeks of instruction." Budget documents go on to say that the "Administration will work with school officials and stakeholders to develop legislation that protects education programs, but allows schools to develop and implement necessary contingency plans."

The Administration's strategy for protecting education programs from trigger cuts in the 2011-12 enacted Budget was to require that LEAs maintain student programs and staffing at a prescribed level. The ability to reduce the school year by seven additional days was offered as the contingency plan.

Current law allows districts to provide as little as 175 days of instruction, and many districts have successfully negotiated agreements with certificated employees to reduce their work year to this level. Remember that 175 days is needed for teachers to receive a full year of service credit per E.C. 22138.5. The Administration has opposed fixing E.C. 22138.5 in anticipation of a service credit problem for teachers. Likewise, it is unreasonable to assume that certificated employees will agree to reduce their work year below 175 days if the contingency plan does not include a service credit fix.

—SSC Staff

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No. 1

By the Way . . . Legislative Analyst's Office Projects a Revenue Amount Lower than the Governor if His Tax Plan is Approved by the Voters in November

Pursuant to Elections Code Section 9005, the Legislative Analyst's Office (LAO) and the Department of Finance (DOF) have reviewed the proposed constitutional amendment related to the funding of local governments and schools and temporary taxes. The LAO currently forecasts the tax measure would generate an average annual increase in state revenues of \$5.5 billion compared to the DOF forecast of an average annual increase in state revenues of \$6.9 billion for years 2013-14 through 2015-16. Specifically, for the 2012-13 Budget, the LAO forecasts that the measure would generate \$4.8 billion of additional revenues compared to the DOF forecast of \$6.9 billion of additional revenues. Using the LAO forecast, the tax hike would raise \$2.1 billion less than the Governor is banking on to balance the 2012-13 Budget.

For a copy of the analysis, go to <http://www.lao.ca.gov/ballot/2011/110784.pdf>.

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Legislative Analyst Acknowledges Trigger Cuts Pose Problems for District Budgeting

The Legislative Analyst's Office (LAO) cautions that the uncertainty surrounding the Governor's proposal to raise taxes through a voter initiative will force school districts to develop their 2012-13 budgets conservatively, assuming that trigger cuts will be implemented. The Governor's Budget proposes to place a \$6.9 billion tax initiative before voters in November 2012, five months after the start of the new fiscal year. (The LAO's analysis of the initiative disputes the revenue estimates—see the recent *Fiscal Report* article.)

Should the voters approve the tax initiative, K-12 education would be flat funded, except for the elimination of the transportation program. However, if the initiative fails, K-12 school districts would face a \$2.2 billion midyear cut, beginning in January 2013.

Legislative Analyst Mac Taylor and his staff issued their *Overview of the Governor's Budget* on January 11, 2012, noting that the Legislature and the Governor have made significant progress in closing the State Budget gap, but cautioning that the Governor's tax proposal and the associated trigger cuts make budgeting very difficult, especially for school districts. The LAO points out that the Governor's trigger reductions are concentrated on K-14 education, with schools accounting for 90% of the cuts if the tax initiative fails.

On a positive note for the Governor, the LAO concludes that several of his education reform proposals have merit and that the Legislature should adopt the Governor's basic restructuring approaches regardless of the state's revenue situation. The LAO agrees with the Administration's approach to providing greater local budget flexibility through the weighted student funding formula. According to the LAO, especially beneficial would be provisions that allow for immediate increases in categorical flexibility, a five-year phase-in period, and additional funding for disadvantaged students.

The LAO also recommends that the Legislature adopt the Governor's reform proposal to reimburse state mandates. The Governor proposes to eliminate 31 of 57 existing mandates and to amend the remaining mandates to make them permissive. School districts that elect to implement the permissive mandates would receive incentive funding from a mandates block grant funded at \$178 million for 2012-13.

The revenue forecasts of the Administration's Department of Finance (DOF) and the LAO differ, with the LAO's revenue projections falling below the Administration's by \$4.7 billion for the current year and 2012-13 combined. The majority of this difference is attributable to their differing views about the rebound in capital gains income of high bracket taxpayers. The report indicates that the top 1% of the income earners account for 40% of income tax receipts and whose income is largely driven by capital gains. The LAO is forecasting lower capital gains than the DOF. Moreover, the Governor's tax initiative depends heavily upon revenues generated from high income earners, thus making the overall Budget plan all the more risky.

Finally, the LAO warns that school districts will likely assume that the Governor's tax proposal will not be enacted and thus build their budgets conservatively, anticipating a significant cut in state support. The LAO estimates that programmatic funding would be cut about 6% from 2011-12 levels if the trigger cuts are imposed. The LAO points out that districts that do not budget conservatively could face severe budget problems in 2012-13, including an inability to make payroll, fiscal insolvency, and ultimately a state takeover of district operations.

—Robert Miyashiro

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The 2012-13 Midyear Trigger Reduction and District Budgeting

The Governor's Budget is based on the assumption that Governor Jerry Brown's tax proposal will be approved by state voters in November 2012 and will generate \$6.9 billion in additional revenues. If approved, K-12 education will not see a restoration of prior cuts or the establishment of new programs. Instead, the Governor proposes that \$2.5 billion in prior-year deferrals be bought back.

If, on the other hand, voters reject the tax proposal (or if it never even reaches the ballot), the Governor proposes to implement midyear trigger cuts totaling \$5.4 billion. Proposition 98 is targeted to be slashed \$4.8 billion, accounting for almost 90% of the total trigger cuts. Of this amount, about half would be covered by reversing his deferral buyback plan, and the balance would be achieved through a cut to K-14 education.

Planning for the Midyear Cut—The Department of Finance (DOF) indicates that this cut is about \$370 per ADA. Because of the timing of the vote, the uncertainty of its fate and the difficulty that districts would face attempting to make significant expenditure cuts after the school year has begun, we recommend that districts build their budgets assuming that the \$370 per-ADA cut is imposed. This reduction should be taken against the 2011-12 revenue limit before implementation of the \$13 per-ADA trigger reduction.

Should a COLA be Budgeted?—The Governor has indicated that schools will be flat funded in 2012-13, and we assume that is in reference to general purpose revenue limits, since his Budget fully eliminates all transportation funding in 2012-13. The DOF has estimated the statutory revenue limit cost-of-living adjustment (COLA) at 3.17% for 2012-13 and a deficit factor of 21.666% to eliminate the impact of the COLA. However, after reviewing these figures, we conclude that the DOF's deficit factor yields a \$37 per-ADA COLA increase (about 0.7%) for the average unified district, rather than a zero COLA. (Recall that last year the DOF's initial deficit factor resulted in a cut in funding of \$19 per ADA, rather than flat funding.)

We recommend, however, that districts disregard this slight increase since the Governor has indicated that no COLA will be provided. Like last year, we expect that both the COLA and the deficit factor will change at the May Revision and that these adjustments will indeed yield flat funding, rather than the \$37 per-ADA gain that appears in the January Governor's Budget.

—*Ron Bennett and Robert Miyashiro*

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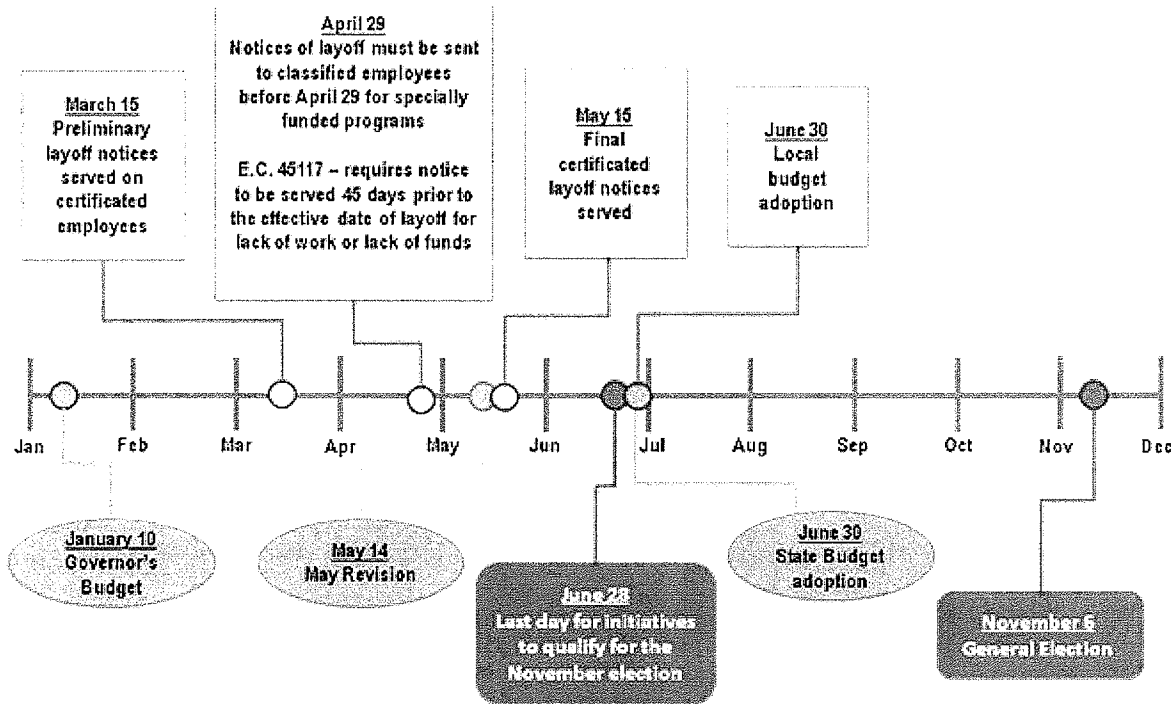
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Layoffs a Continuing Reality in 2012-13

The economic realities of the last four years have taken a toll on the labor-management relationship. Year-after-year of funding uncertainty forces local educational agencies (LEAs) to plan conservatively. Planning conservatively means proposing cuts and issuing layoff notices long before funding is certain. The statutory timeline for certificated and classified layoffs prevents LEAs from adopting a wait-and-see approach, and budgets built upon the hope of new taxes and the threat of midyear cuts only make matters worse.

The Governor's proposed 2012-13 Budget hinges on passage of his tax initiative. Should the initiative fail, we are projecting a midyear cut of \$370 per average daily attendance (ADA) for the average unified school district. Given that approximately 90% of a district's unrestricted resources are dedicated to employee compensation, LEAs will find it necessary to issue another round of layoff notices this year. Hoping that the tax initiative passes sure would simplify your planning, help you avoid layoffs, and minimize labor strife that is sure to follow another round of proposed concessions—but hope is not a sound financial strategy!

Our new funding reality of legislatively induced uncertainty is further complicated by proposed revolutionary changes that fundamentally alter the manner in which public education is funded and delivered in California. In particular, the Governor's proposals to eliminate home-to-school transportation and create a weighted student funding formula by consolidating categorical programs and shifting dollars into the revenue limit will impact certificated and classified personnel. Regardless of the merits or faults that might be argued relative to each proposal, LEAs will be forced to eliminate or reduce categorically funded positions as a precautionary measure and potentially layoff large numbers of bus drivers this spring. The timeline below demonstrates the need for action.



Unfortunately, LEAs will have to issue certificated and classified notices in advance of the State Budget being adopted and long before the outcome of the November general election will be known. That means planning now to issue preliminary certificated layoff notices no later than March 15 and classified notices by April 29. Remember that hope is not a sound financial strategy and a "wait-and-see" plan is no plan at all.

—*Suzanne Speck*

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