Special Fiscal Report: Governor’s Proposals for the 2019-20 State Budget and K-12 Education

Preface

Governor Gavin Newsom enjoys a much more positive financial and economic environment at the release of his first State Budget than his predecessor did. Governor Newsom inherits a state that is enjoying a strong economy and a historic budget surplus due primarily to the prudent policies of Governor Jerry Brown. During Brown’s tenure as Governor, public education experienced a massive philosophical and practical shift that has involved significant infusions of revenue over a relatively short period of time, but with equally significant cost pressures. The question in everyone’s mind has been: what will our new Governor do with his good fortune?

Subsidiarity

We all learned a new word during Governor Brown’s tenure: subsidiarity. Subsidiarity is defined as the idea that a central authority should have a subsidiary function, performing only those tasks that cannot be performed effectively at a more immediate or local level. Throughout his term, Governor Brown preached the idea of subsidiarity and followed through in every way. Through the Local Control and Accountability Plan, we have a system that allows us to define what is important locally. We also decide the strategies to attain our goals locally. Each year he focused the lion’s share of ongoing Proposition 98 funding into the Local Control Funding Formula (LCFF), and any additional one-time dollars into discretionary grants whose use was to be determined locally. In fact, for several years, local educational agencies (LEAs) were routinely provided significant one-time dollars to address local needs.

In Governor Newsom’s first State Budget proposal we see a continued commitment to the LCFF by providing the statutory cost-of-living adjustment (COLA), but nothing more like we saw during the gap closure years and this year’s augmented COLA. The additional ongoing Proposition 98 dollars above that required amount are proposed to address specified purposes, and not at the complete discretion of the LEAs.

Fiscal Stability for Schools

During Governor Brown’s tenure we celebrated his commitment to public education that allowed for a restoration of debilitating cuts during the Great Recession. We also, however, noted that during that same time, LEAs were saddled with increased cost pressures outside of their control including dramatic rate increases in the California State Teachers’ Retirement System (CalSTRS) and the California Public Employees’ Retirement System (CalPERS).

We are pleased that Governor Newsom has devoted a section to his State Budget’s “A” pages to acknowledge the stress that these significant cost pressures have placed on local budgets. More importantly, we are pleased that he has proposed a major infusion of funds (non-Proposition 98) to mitigate some of those pressures.

Proposition 98 Slows

During the past several years we have experienced robust growth in Proposition 98 due to multiple factors:
robust economic growth in the earlier stages of the current economic recovery and significant Proposition 98 maintenance factor created in the recession that must be paid off. With the maintenance factor being fully repaid and slowing economic growth in the later stages of the recovery, both the Legislative Analyst Office and the Administration project slower growth in Proposition 98 than in prior years.

Three decades ago with voter approval of Proposition 98, expectations were high that funding for California’s K-14 schools would eventually return to the levels of the top ranked states in the nation. Unfortunately, 30 years of experience has shown that California has made little, if any, progress toward this goal. If funding under Proposition 98 continues to slow and generally just keeps pace with workload and inflation how will the Administration and Legislature respond? Every year there is debate about which education programs should be increased or new programs added. In the past, all of these debates have taken place within the boundaries established by Proposition 98. We are encouraged that much of the Governor’s investments in his proposed State Budget that benefit public education are coming from non-Proposition 98 dollars.

Building Reserves

At this time last year, Governor Brown led off his 2018-19 State Budget press conference with a statement that he was preparing California for the future. He warned of the dire consequences of a recession, especially given the state’s volatile tax system. He noted that there were 10 recessions since World War II and that we must prepare for the 11th. As a result, he once again highlighted the need to build up the state’s Rainy Day Fund. Governor Brown took his fiduciary responsibility to the people of California seriously.

Governor Newsom appears to be keeping with that tradition in his first State Budget by adding money to the state’s Rainy Day Fund for 2019-20 and beyond. Many of us who lived through the last “Great Recession” and the horrendous cuts sustained in public education during that time know that we are all better served with a State Budget that is balanced and has appropriate reserves for economic uncertainties.

Overview of the Governor’s Budget Proposals

On Thursday, January 10, 2019, just after 11:00 a.m., Governor Newsom released his first proposed “California for All” State Budget for the upcoming 2019-20 fiscal year. Before beginning his remarks, he warned the press corps that he would be going into great detail and likely talk longer than many might expect. “This is something I really enjoy,” Newsom declared. In contrast to Governor Brown who last year completed his prepared remarks in about five minutes, Newsom’s presentation lasted almost an hour, plus an additional 45 minutes of Q&A.

The Governor led by explaining that he is proposing a $144 billion General Fund Budget for the upcoming fiscal year, a 3.6% increase over the current year. He emphasized that he is being fiscally prudent, noting that 86.4% of the new spending is for one-time investments compared to 71% last year.

Economic Outlook

The Governor’s Budget recognizes a revised revenue forecast that is $5.2 billion higher from 2017-18 through 2019-20 compared to the 2018-19 State Budget Act projection. Over the three fiscal years, personal income tax is up $7.5 billion, sales tax is down $1.4 billion, and corporation tax is up $1.3 billion.

Governor Newsom continues to build additional reserves beyond the $13.5 billion currently set aside in the Rainy Day Fund. An additional $1.8 billion transfer is proposed in the budget year and an additional $4.1 billion over time, bringing the Rainy Day Fund to $19.4 billion by 2022-23.

Proposition 98

The proposed 2019-20 State Budget includes Proposition 98 funding of $80.7 billion for 2019-20, which Governor Newsom notes as an “all-time high.” While there are many representations of the actual per-
student funding provided, the Governor’s Budget asserts that total per-pupil expenditures from all sources are projected to be $16,857 in 2018-19 and $17,160 in 2019-20. From Proposition 98 alone, per-pupil expenditures are $12,003 in 2019-20, an increase of $435 per pupil over the level provided in 2018-19.

Other Major Initiatives

Paid Family Leave. The Governor is proposing to expand the Paid Family Leave program, with the goal of ensuring that all babies can be cared for by a parent or a close family member for the first six months. During the year, the Administration will convene a task force to evaluate options to increase participation in the program and to phase in program expansion.

Housing. To address California’s housing crisis, the Budget includes $1.3 billion in one-time funds to spur housing development to address the state’s affordability crisis and promote economic growth. The Budget also expands state tax credits to further develop both low- and moderate-income housing, and proposes new innovative housing on excess state property.

Expanded Tax Credit Program. The Governor’s Budget proposes to more than doubling the state’s Earned Income Tax Credit to $1 billion, which would provide low-income families with young children under the age of six a $500 credit. The credit will also be expanded to reach full-time workers earning $15 per hour—reaching 400,000 additional families.

Higher Education. The Governor’s Budget includes $1.4 billion ($942 million ongoing) for higher education to support increased enrollment, improved time to degree, and a tuition freeze. The Budget also proposes funding for two free years of community college tuition for first-time, full-time students.

- University of California—$240 million ongoing General Fund for operational costs; student success, student hunger and housing initiatives; ongoing support for graduate medical education; and mental health resources. The Budget also includes $138 million one-time for deferred maintenance.
- California State University—$300 million ongoing General Fund for operational costs, increased enrollment, and for continued progress toward the equity goals of the Graduation Initiative 2025. The Budget also includes $247 million in one-time for on-campus child care facilities and deferred maintenance.
- Community Colleges—$402 million ongoing, including a 3.46% COLA, enrollment growth, legal services for undocumented students and families, and providing a second year of free tuition.

Emergency Services. Governor Newsom also proposes $200 million to augment CAL FIRE’s firefighting capabilities, adding 13 additional year-round engines, replacing Vietnam War-era helicopters, deploying new large air tankers, and investing in technology and data analytics that will support CAL FIRE’s incident command in developing more effective initial fire suppression strategies.

In the end, Governor Newsom displayed a detailed command of his proposed budget, fielding questions on every aspect of his new Administration’s priorities. Unlike prior governors who rely on their directors of the Department of Finance, Newsom did not give up the podium to his newly appointed director, Keely Bosler, to fill in the details. He did this himself.

The Economy and Revenues

Economic Outlook

Following the footsteps of his predecessor, Governor Newsom cautions that the opportunities for continued economic expansion are narrowing as both the nation and the state have reached full employment, likely have capitalized on last year’s federal tax policy changes, and face the growing risks of trade tensions between the U.S. and China and a federal government shutdown that appear to be impacting Wall Street performance. In particular, California faces unique structural risks in its aging population and housing shortage.

The State Budget assumes steady job growth alongside a strong increase in personal income. Governor
Newsom notes the shift in the distribution of wages that stand to benefit the average worker, but as a result of the state’s highly progressive tax structure will translate to slower growth in General Fund revenue. Specifically, the budget assumes that personal income growth will be 5.5% in 2018, 5.0% in 2019, and then averaging 4.3% through 2022. Growth in real wages and personal income are necessary to sustain healthy consumption and overall economic activity.

While the State Budget identifies rising economic risks related to the state’s aging population and housing shortage, the UCLA Forecast from December 2018 maintains that the continued trade tensions with China and an unratified tri-nation agreement among the U.S., Mexico, and Canada as significant risks to the world’s fifth largest economy so reliant on the import-export business.

Revenues

The 2019-20 State Budget assumes higher overall revenues for fiscal years 2017-18 through 2019-20, exceeding the 2018-19 State Budget projections by more than $5.2 billion. Over the three-year period, both the personal income tax and the corporation tax are expected to beat earlier estimates; however, the budget anticipates that the sales and use tax will fall shy of projections.

Over the long term, the forecast calls for continued increases in the state’s “Big Three” taxes.

<table>
<thead>
<tr>
<th>“Big Three” Revenue Forecast</th>
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<tbody>
<tr>
<td>(General Fund Revenue—in billions)</td>
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</tbody>
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<table>
<thead>
<tr>
<th></th>
<th>FY 2017-18</th>
<th>FY 2018-19</th>
<th>FY 2019-20</th>
<th>FY 2020-21</th>
<th>FY 2021-22</th>
<th>FY 2022-23</th>
<th>Average Year Over Year Growth</th>
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<tbody>
<tr>
<td>Personal Income Tax</td>
<td>$94.3</td>
<td>$97.7</td>
<td>$100.5</td>
<td>$103.1</td>
<td>$106.0</td>
<td>$109.4</td>
<td>3.0%</td>
</tr>
<tr>
<td>Sales and Use Tax</td>
<td>$25.0</td>
<td>$26.2</td>
<td>$27.4</td>
<td>$28.2</td>
<td>$29.0</td>
<td>$29.8</td>
<td>3.5%</td>
</tr>
<tr>
<td>Corporation Tax</td>
<td>$12.2</td>
<td>$12.3</td>
<td>$13.1</td>
<td>$13.6</td>
<td>$14.0</td>
<td>$14.5</td>
<td>3.5%</td>
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</tbody>
</table>

Proposition 98

Adopted by state voters in 1988, Proposition 98 sets in the State Constitution a series of complex formulas that establish the minimum funding level for K-12 education and community colleges from one year to the next. This target level is determined by prior-year appropriations that count toward the guarantee and (1) workload changes as measured by the change in average daily attendance (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. The gains experienced over the last several years continue with the 2019-20 State Budget proposal.

Current- and Prior-Year Minimum Guarantee

Proposition 98 minimum guarantee has declined from the 2018 Budget Act for both 2017-18 and 2018-19 due to lower-than-anticipated ADA and a year-over-year decline in General Fund revenue growth from 2017-18 to 2018-19.
For the current year, the Governor’s Budget acknowledges a decline of $525.7 million from the 2018-19 Budget Act. Therefore, the Proposition 98 guarantee is now estimated at $77.9 billion, down from $78.4 billion in the enacted Budget. The 2017-18 year reflects a more modest decline of $120.1 million, lowering the minimum guarantee from $75.6 billion to $75.5 billion.

However, despite the declines of the minimum guarantee, the Governor’s Budget maintains level funding by continuing a $44 million “over-appropriation” in 2017-18 and using settle-up payments to offset otherwise unfunded 2018-19 obligations.

**2019-20 Minimum Guarantee**

For 2019-20, the Governor’s Budget proposes a Proposition 98 guarantee of $80.7 billion, an increase of $2.8 billion year over year. The guarantee is projected to be based on Test 1—funding based on education’s proportion of the General Fund in 1986-87.

**Cost-of-Living Adjustment and Average Daily Attendance**

The estimated statutory COLA for K-12 education programs in 2019-20 is 3.46%, and is applied to the LCFF base grant targets, as well as other education programs that are funded outside of the LCFF. Those programs include Special Education, Child Nutrition, Preschool, Foster Youth, American Indian Education Centers, the American Indian Early Childhood Education program, and the Mandate Block Grant, all of which are proposed to receive the statutory COLA.

Statewide, ADA is expected to continue declining—from 5.935 million in 2018-19 to 5.928 million in 2019-20.

**Local Control Funding Formula**

The Governor’s 2019-20 State Budget proposal includes an increase of $2 billion in Proposition 98 for the LCFF reflecting the 3.46% COLA. This brings LCFF funding to $63 billion.

**LCFF Target Entitlements for School Districts and Charter Schools**

The target base grants by grade span for 2019-20 are increased over 2018-19 by 3.46% to reflect the estimated statutory COLA:

<table>
<thead>
<tr>
<th>Grade Span</th>
<th>2018-19 Target Base Grant Per ADA</th>
<th>3.46% COLA</th>
<th>2019-20 Target Base Grant Per ADA</th>
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<tbody>
<tr>
<td>TK-3</td>
<td>$7,459</td>
<td>$258</td>
<td>$7,717</td>
</tr>
<tr>
<td>4-6</td>
<td>$7,571</td>
<td>$262</td>
<td>$7,833</td>
</tr>
<tr>
<td>7-8</td>
<td>$7,796</td>
<td>$270</td>
<td>$8,066</td>
</tr>
<tr>
<td>9-12</td>
<td>$9,034</td>
<td>$313</td>
<td>$9,347</td>
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</table>

The Transitional Kindergarten (TK)-3 grant increase for the class-size reduction (CSR) grade span adjustment is $803 per ADA in 2019-20, and the grade 9-12 base grant per ADA is increased by $243 in recognition of the need for Career Technical Education (CTE) courses provided to students in the secondary grades.
School districts and charter schools are entitled to supplemental grant increases equal to 20% of the adjusted base grant (includes CSR and CTE funding) for the percentage of enrolled students who are English learners, eligible for the free and reduced-price meals program, or in foster care. An additional 50% per-pupil increase is provided as a concentration grant for each eligible student enrolled beyond 55% of total enrollment.

**Special Education**

Acknowledging the rising cost of Special Education services, Governor Newsom proposes $576 million (of which $186 million is one-time) to support expanded Special Education services and school readiness supports at LEAs with high percentages of both students with disabilities and unduplicated students. Eligible LEAs may use these grants to fund supplemental services not currently included in an individualized education program for a student with disabilities and for preventative services that may reduce the need for additional services in future years.

Noting that school districts were most likely to be identified as needing support because of poor performance on student outcome indicators for students with disabilities, this funding can also be used to adopt strategies to improve Special Education student outcomes identified through the statewide system of support and/or other activities to build upon or expand local multi-tiered systems of support efforts.

Finally, the Administration intends to pursue policy changes to improve coordination regarding Medi-Cal billing to better leverage available federal funding for medically related Special Education costs.

**CalSTRS and CalPERS Payments**

Governor Newsom’s proposed State Budget recognizes the growing burden of pension rate increases that LEAs face. A total of $3 billion in one-time non-Proposition 98 funds will be used to buy down CalSTRS employer contribution rates in 2019-20 and beyond and to reduce employers’ long-term unfunded liability. Based on current assumptions, a $700 million investment would be used to decrease the statutory CalSTRS employer contributions in 2019-20 of 18.13% to 17.1% and in 2020-21 from 19.1% to 18.1%. (The current CalSTRS employer contribution rate is 16.28% for 2018-19.) The remaining $2.3 billion would be applied toward employers’ long-term unfunded liability, which is expected to translate to an estimated reduction in the employer contributions beyond 2020-21 of approximately half a percentage point.

The proposed State Budget also includes additional payments to address the state’s share of the CalSTRS liability. In addition to the statutorily required $3.3 billion state CalSTRS contribution, $1.1 billion will go toward the state’s share of the CalSTRS Defined Benefit Program. This is expected to be the first installment of an estimated $2.9 billion to be paid to CalSTRS through 2022-23.

Finally, Governor Newsom proposes an infusion of $3 billion into CalPERS as a supplemental pension payment in 2018-19, which follows on a $6 billion supplemental payment made to the system in 2017-18.

**Early Childhood Education: Child Care, State Preschool, and Kindergarten**

Governor Newsom’s first State Budget includes significant new investments in children and young learners as a critical part of his “California for All” vision. Many of his proposals leverage one-time funding as a way to ensure that the state does not overcommit itself while building the essential components of the early care and education (ECE) infrastructure. Governor Newsom’s ECE budget includes the following key investments:

- **Universal Preschool**: The Budget proposes instituting universal preschool for all low-income four-year-olds in California over a three-year period, and includes a first-year investment of $124.9 million in non-Proposition 98 funding for new full-day preschool slots for community-based providers. The Budget also proposes to shift $297.1 million in non-LEAs part-day slots from Proposition 98 to the non-Proposition 98 portion of the Budget to enable community-based providers greater flexibility to draw down full-day, full-year funding for state preschool slots. Finally, the Budget proposes to remove a barrier for families to access full-day wraparound services under the State Preschool...
Program by eliminating the requirement to demonstrate that the need for care stems from employment or postsecondary enrollment.

- **Full-Day Kindergarten**: To incentivize the provision of full-day kindergarten throughout the state for which facilities constraints are viewed as a barrier, the Governor's Budget invests $750 million in one-time (non-Proposition 98) funding to build new kindergarten facilities, which LEAs have identified as the biggest barrier to providing full-day programs. This investment builds upon the 2018 Budget Act's $100 million investment for the same purpose and administered by the Office of Public School Construction (OPSC).

- **Birth to Three**: The Governor proposes to spend over $200 million in state and federal funds on home visiting programs and child developmental and health screenings as a way to bridge the child readiness gap and ensure positive health and life outcomes for all children.

- **Child Care**: The Budget proposes $490 million in one-time funding (non-Proposition 98) for child care facilities ($245 million) and the professional development of child care workers ($245 million—non-Proposition 98) to improve the overall quality of child care.

As part of long-term visioning, the Governor proposes to invest $10 million to develop a child care and universal preschool roadmap for California. The roadmap will address systems capacity issues, workforce development needs, and identify funding options. Additionally, the roadmap may contemplate changes to TK due to its intersection with universal preschool. This work will augment California's federal preschool development grant for which the California Department of Education is conducting state needs analysis.

**School Facilities**

The State Budget includes some bright spots for school facilities. Since the passage of Proposition 51 in 2016, approximately $1.2 billion in bond funds have been sold. The Budget proposal includes the sale of an additional $1.5 billion in 2019-20 alone to support the State Facility Program, including New Construction, Modernization, Career Technical Education, and the Charter School Facilities programs.

In addition, the Budget includes $1.2 million in ongoing Proposition 51 bond funds and State School Site Utilization Funds, and 10 positions in the OPSC to process the more than $4.5 billion in school facility applications currently pending.

**Discretionary Funds**

Breaking with his predecessor, Governor Newsom’s 2019-20 State Budget does not propose any one-time Proposition 98 discretionary funding for school districts, charter schools, or county offices of education (COEs).

**Longitudinal Data System**

Governor Newsom is proposing $10 million one-time non-Proposition 98 to plan for and develop a longitudinal data system that would connect student data from early education providers, K-12 schools, higher education institutions, employers, other workforce entities, and health and human services agencies. The funding would be used for initial planning purposes and the initial stages of implementation, once an implementation plan is adopted by the Administration and the Legislature. Governor Newsom has continuously expressed his support for this type of data system and the proposal is consistent with his “cradle-to-career” education strategy that looks to connect all education segments.

**Systems of Support**

The new Administration is committed to continuing the evolving accountability system that has been implemented as part of the LCFF. With the latest release of the California School Dashboard in December 2018, 374 school districts have been identified for differentiated assistance. The proposed 2019-20 State Budget provides $20.2 million in additional funding for COEs to work with these identified districts as required by statute. These funds will be distributed consistent with the formula adopted in the 2018-19 State Budget.
Federal Programs

Fortunately, the partial government shutdown has not affected the federal Department of Education; unfortunately, the federal 2019 budget includes minimal increases for federally funded programs. In October 2018, President Donald Trump signed the fiscal year 2019 spending bill that increased education funding nationally by $581 million to an all-time high of $71.5 billion. Title I and Special Education each received a $100 million increase while Head Start was increased by $240 million. Generally, California receives one-tenth of these national figures making the increases insignificant for a state with six million students.

In Closing

In closing, Governor Newsom is making his mark and distinguishing himself in his proposed 2019-20 State Budget. While respecting the education reform of Brown’s LCFF, he is striking out on his own path in addressing the whole child through early childhood education, parental leave, health care, and housing. He has gone out on a limb to dedicate significant non-Proposition 98 funds to help education through increased contributions to the pension systems, K-12 facilities funding, and investments to make children better prepared to learn when they reach our schools.

Remember that the Governor’s Budget proposal marks the beginning of the process, not the end. We expect the Legislature to push back on the Governor’s priorities and propose their own. As the various proposals are considered by legislative committees, we can expect both confrontation and compromise. The key difference this year will be the unknown dynamic between a new Governor and a well-established legislative leadership with a strong Democratic majority.

We look forward to continuing to see the new vision Governor Newsom has for the state of California and wish him well as we all take this journey together.

—SSC Staff

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