An Overview of the 2015-16 Governor’s May Revision

Preface

The May Revision marks a very significant point in the state’s Budget development process. It is the last statutory opportunity for Governor Jerry Brown to update his economic projections for the current year and the Budget year. And this year, in the May Revision presented by the Governor on May 14, 2015, both years are coming up aces.

As far back as the enactment of the 2014-15 State Budget, School Services of California, Inc., (SSC) has opined that economic conditions were improving and that the state’s revenue projections would likely prove to be low for 2014-15. Recently we created analytical tools which projected that revenues for 2014-15 would be up by more than $3 billion. In the May Revision, the Governor confirmed that growth in state revenues and transfers for 2014-15 will be $3.3 billion with education spending to be increased by $3.1 billion; these are treated as one-time dollars. Additionally, the Governor has revised his projected education spending for 2015-16 upward by $2.7 billion over his January proposal; these dollars are primarily ongoing. In the sections below, we detail the additional funding by program. But suffice it to say that 2014-15 already provided the highest increase in education funding in history, and now it will be even higher with much of the increase carried forward into 2015-16 as an ongoing increase.

Remember that because of the maintenance factor, Proposition 98 is getting roughly 90% of all new state tax revenues. As recently as a month ago, the Legislative Analyst’s Office identified ways to reduce General Fund support for Proposition 98 and thereby increase resources to the non-Proposition 98 side of the Budget. We commend the Governor and the Department of Finance (DOF) staff for choosing to provide a full measure of restoration for Proposition 98 and to resist the urge to manipulate the guarantee. The Governor’s proposals for 2015-16 would greatly reduce, but not quite eliminate, the maintenance factor. But the reality is that even one more good year and the maintenance factor will be fully repaid, and we will be back in a world where education gets only about 40% of new revenues; that will be a hard adjustment.

Finally, the Governor continues to keep his commitment to local control, the Local Control Funding Formula (LCFF), and the Local Control and Accountability Plan (LCAP). As preferred by nearly every education organization, the lion’s share of the increased funding goes straight to the LCFF as detailed below. We sincerely commend the Governor, and his education advisors, and DOF staff for protecting the Governor’s long-term commitment to the children of California.

Overview of the Governor’s May Revision

The Governor’s May Revision acknowledges the continuing expansion of the state economy and a surge in state revenues in the current year well in excess of the level projected just five months ago when the January Governor’s Budget was released. State revenues are up $3.3 billion in 2014-15 and $1.7 billion in 2015-16, according to the revised Budget forecast.
The Governor, consistent with the requirements of Proposition 98, allocates the majority of these new revenues to K-12 education and the community colleges. Over the three-year period 2014-15, 2015-16, and 2016-17, the minimum funding guarantee increases $6.1 billion.

In his press conference, the Governor stressed the importance of living within our means and avoiding the boom-bust budgeting of the past. To explain why his May Revision does not expand spending for many state programs, the Governor said that the view that “now that we’re getting a little money, we’re in fiscal utopia” is “demonstrably false.” He stressed the notion that while some may want a bigger role for the public sector, everything must be balanced and that tradeoffs or cuts would have to be made in some programs if expansions were sought for others.

The Governor warned that despite stronger state revenue collections this year, the Budget remains precariously balanced and faces the prospect of deficits in future years. One of the highlights of the May Revision for the Governor is a $1.9 billion contribution to the state’s Rainy Day Fund and $1.9 billion to pay down existing liabilities and retire long-term debt.

The Economy and State Revenues

Economic Outlook

The May Revision notes that economic growth in 2014 was strong, with job growth better than anticipated and the unemployment rate falling both at the national and state level. Since the start of the year, the drop in the price of oil has kept inflation low and allowed consumers to boost spending.

At the national level, the Administration’s revised forecast assumes global growth will remain slow, but steady. National Gross Domestic Product in 2014 was 2.4%, and the May Revision forecasts a continuation of that momentum in 2015 at 2.8% and in 2016 at 2.7%. The forecast concludes that the slow growth in the first quarter of 2015 is due to severe weather conditions in the eastern U.S. and other temporary factors.

In California, the unemployment rate dropped to 6.5% in March 2015 and is projected to fall further to 6.0% by the end of 2016.

Even though the drought has hurt the agricultural sector, the state’s diversified economy is expected to remain on a steady growth path, thereby mitigating the overall impacts of the water shortage. It is important to note that the forecast assumes that the drought does not continue into 2016.

The May Revision identifies several risks to the forecast. Of chief concern is the performance of the stock market. DOF economists point out that 2014 marked the sixth straight year of positive growth in the stock market, with annual average growth exceeding 12%. A downward correction could significantly impair personal income tax collections, especially since California’s tax structure is heavily dependent upon the top income earners who receive a disproportionate share of their income from capital gains.

The forecast notes that there has been an economic slowdown in China and European Union countries, which has implications for U.S. and California exports. A broad based and sustained slowdown will hurt exports and in turn reduce corporate profits, employment, and personal income in California.

State Revenues

The May Revision details higher state revenues of $5.7 billion compared to the January Budget proposal ($700 million in 2014-15, $3.3 billion in 2014-15, and $1.7 billion in 2015-16). This total reflects the impact
of transfers to the Rainy Day Fund and the loss of revenues associated with the proposed Earned Income Tax Credit, which reduces tax collections. Compared to the January Budget, personal income tax revenues for 2014-15 are up 5.1%, or $3.7 billion, but other revenue sources fell short by a combined $400 million, resulting in a net increase for all taxes of $3.3 billion, or 3%. For the Budget year, the revised forecast boost revenues in 2015-16 by 1.5%, or $1.7 billion.

The Administration’s long-term forecast presents a warning for lawmakers and others dependent upon the state General Fund for support. The DOF forecast shows revenue growth for the three major taxes—the personal income tax, the sales and use tax, and the corporation tax—increasing at a 4.6% rate in 2016-17 but slowing to only 1% in 2018-19. Revenue growth for the three major taxes, which account for more than 95% of General Fund revenues, is forecast to be only $1.3 billion in that year. We note that tax revenues associated with Proposition 30, the Governor’s temporary tax proposal approved by voters in November 2012, will begin to expire commencing in 2016.

**Proposition 98**

The Governor’s May Revision acknowledges a major surge in current-year General Fund revenues and a corresponding increase in the outlook for revenues in 2015-16. These increases in turn boost funding for K-12 education and the community colleges under Proposition 98, the state’s minimum funding guarantee for K-14 education.

Specifically, the May Revision shows Proposition 98 funding increasing $6.1 billion over a three-year period ($241 million in 2013-14, $3.1 billion in 2014-15 and $2.7 billion in 2015-16). In the current year, the minimum guarantee will reach $66.3 billion and increase to $68.4 billion in 2015-16.

The May Revision also acknowledges that the Proposition 98 maintenance factor—the amount owed to K-14 education to restore the cuts imposed during the recession—will almost be fully repaid in 2015-16. Only $772 million will remain at the end of the Budget year. As recently as June 2014, the Administration estimated that the maintenance factor totaled $6.6 billion.

**Local Control Funding Formula**

In January Governor Brown continued his emphasis on implementation of the LCFF with an infusion of $4.048 billion of Proposition 98 revenues, and reinforced in May with the addition of another $2.1 billion of new Proposition 98 funding. The total of $6.1 billion in new LCFF revenues provides for an estimated gap closure percentage of 53% applied to the difference between each school district’s and charter school’s floor funding level and their LCFF target entitlement. The new formula provides funding to move all school districts and charter schools toward allocations of similar amounts per average daily attendance (ADA) as base grants within four grade spans, and provides additional percentage increases, or “weights,” for class-size reduction (CSR) in grades Transitional Kindergarten (TK)-3, career technical education (CTE) for grades 9-12, and supplemental/concentration grants on behalf of students who English learners, who are from low-income families, or who are in foster care.

The 2015-16 targets for base grants are increased from 2014-15 levels by the statutory cost-of-living adjustment (COLA). In January the COLA percentage was estimated at 1.58%, but the actual statutory COLA is 1.02%. The following table shows the May Revision COLA amounts per ADA and the corresponding revised 2015-16 targets by grade span:
In addition to the base grants, the 2015-16 May Revision estimated grant increase for CSR for grades TK-3 is $737 per ADA, and the grade 9-12 grants are increased by $223 to provide resources for CTE. Supplemental and concentration grants continue with percentage weighting factors unchanged from current law.

Pupil transportation and Targeted Instructional Improvement Grants will continue as separate add-ons to the LCFF allocations, which do not receive a COLA; and categorical programs, such as Child Nutrition and Special Education, remain outside of the new formula.

School districts with property tax revenues that exceed the formula funding levels will continue to retain their local tax growth, and will receive a minimum state aid allocation that is reduced by the cuts incurred during the recession which, under the LCFF, are carried forward into future years for these districts.

County offices of education (COEs) receive funding under a formula similar to the school district LCFF, but in two parts: one in recognition of direct instructional services for pupils in juvenile court schools and community schools, and a second allocation for countywide services based on the number of school districts and the total ADA within the county. The LCFF for COEs is fully implemented in the current year, and LCFF increases for COEs in 2015-16 are provided through the statutory COLA only, with COEs that are at their LCFF target receiving a 1.02% increase (those COEs that are more than 1.02% above their LCFF target will receive no additional funding through the formula in the budget year).

Funding for most categorical programs was consolidated into the LCFF in 2013-14. Those categorical programs still funded outside the LCFF, including Special Education, Child Nutrition, Foster Youth, Preschool, American Indian Centers, and the American Indian Early Education Program, are provided with a 1.02% COLA in the Governor’s May Revision.

### Cash Deferrals

The May Revision maintains the repayment of all the interyear budgetary deferrals.

### Special Education

The Governor’s May Revision proposes $60.1 million to address a few of the recommendations outlined in the March 2015 Statewide Special Education Task Force report. The Governor proposes $30 million in

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<th>Grade Span</th>
<th>2014-15 Target Base Grant per ADA</th>
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ongoing funds to augment existing Early Education Program for Infants and Toddlers with Exceptional Needs programs, designed to identify and provide early interventions for infants from birth to age two with disabilities; and, $12.1 million “to provide access to an additional 2,500 children in part day state preschool programs, with enrollment priority given to children with disabilities.” An additional $6 million is proposed within the state preschool program to provide parents information on accessing local resources for the screening and treatment of developmental disabilities and to provide teachers with training on behavioral strategies and targeted interventions to improve kindergarten readiness, consistent with existing professional development statutes.

The May Revision proposes some one-time funding for Special Education. Ten million dollars in one-time funding is proposed to provide state technical assistance and to develop statewide resources to assist local educational agencies interested in implementing “school-wide, data-driven systems of support and intervention.” And an additional $1.7 million in one-time federal funds to expand existing Alternative Dispute Resolution Grant Programs to all Special Education Local Plan Areas. The May Revision proposal adjusts the Special Education COLA downward to the statutory 1.02%.

**Child Care and State Preschool Programs**

As with previous years, the May Revision proposes administrative adjustments from the Governor’s Budget to the California Work Opportunity and Responsibility to Kids (CalWORKs) child care system. These adjustments reflect an increase in the number of newly eligible beneficiaries for Stage 2 ($46.8 million non-Proposition 98 General Fund increase) and a small increase for Stage 3 of $2 million (non-Proposition 98 General Fund) to reflect minor adjustments in caseload and the cost of providing care.

Capped child care programs (non-CalWORKs) are proposed to see a net decrease of $7.2 million reflecting the change in the COLA proposed in January of 1.58% to the 1.02% COLA at May Revision. A small net decrease of $2.5 million is also applied to reflect a reduction in the population of 0-4 year-old children.

Child care and development funds see a net increase in the May Revision of $17.7 million in federal funds.

To support increased services for Special Education students, 2,500 part-day state preschool slots will be added at a cost of $13.5 million Proposition 98 General Fund dollars. Priority for these slots will be given to children with exceptional needs.

Other requirements for children with exceptional needs who participate in state preschool are proposed in the May Revision, as is an increase of 1% to state preschool reimbursement rates to reflect the new requirements.

**Discretionary Funds**

In January, the Governor’s Budget proposal included more than $1.1 billion in discretionary one-time Proposition 98 funding for school districts, charter schools, and COEs. The May Revision adds $2.4 billion to total more than $3.5 billion in total discretionary funding. The discretionary funds may be used for any educational purpose. The narrative in the May Revision provides examples of discretionary expenditures to be professional development, teacher induction support to beginning teachers, instructional materials, and technology. COEs will receive $40 million of the $3.5 billion to assist schools in meeting new responsibilities required under the accountability structure of the LCFF. These funds will offset any applicable mandate reimbursement claims.

**Proposition 39 Funding—The California Clean Energy Jobs Act**
In 2014-15, $354 million in funding was allocated as a result of the passage of Proposition 39—The California Clean Energy Jobs Act. In his January 2015 Budget proposal, Governor Brown allocated an additional $368 million, including $320.1 million to K-12 agencies and $39.6 million to community colleges for energy efficiency project grants, $5.3 million to the California Conservation Corps for continued technical assistance to K-12 schools, and $3 million to the Workforce Investment Board for continued implementation of the job-training program.

Due to reduced Proposition 39 revenue estimates, the May Revision proposes a decrease of $7.5 million, from $368 million to $360.5 million—with K-12 agencies reduced to $313.4 million and community colleges reduced to $38.7 million.

Adult Education

In January 2015, Governor Brown indicated his commitment to Adult Education by proposing a $500 million Adult Education Block Grant. The Governor’s May Revision strengthens the proposal by making adjustments based on stakeholder feedback such as eliminating the allocation boards, requiring more robust, but less frequent, planning, and providing for a more stable funding stream.

Career Technical Education

In January 2015, the Governor proposed $250 million over three years for a transitional Career Technical Education Incentive Grant Program. The May Revision proposes an additional $150 million for 2015-16, $50 million for 2016-17, and then a reduction of $50 million in 2017-18. The May Revision proposes a phased plan for the matching requirement to better allow schools to transition entirely to using their own discretionary funding by 2018-19.

K-3 Grade Span Adjustment

The K-3 grade span adjustment requirement to reduce class sizes in grades TK-3 at the same rate of the LCFF gap funding each year to a 24 school site average is most impacted by the increase in the 2015-16 gap funding percentage. Most districts have finalized staffing plans and facilities needs based upon the most recent data available before the May Revision, the Governor’s Budget proposal gap funding estimate of 32.19%. Now, for 2015-16, with the May Revision projections, districts will need to prepare to further reduce class sizes in these grade levels by an additional 20% to 53% of the difference between the current-year class size and the school site average of 24 students per class target, unless the collective bargaining exception applies to your district.

QEIA Transition Funding

Selected Quality Education Investment Act (QEIA) school districts that do not qualify for concentration grant funds will receive an additional $4.6 million in one-time funds to help ease the transition off of QEIA. These districts have been identified as having isolated concentrations of English learners and students who qualify for free or reduced-price meals.

Public Schools on Military Installations

A program was established by the U.S. Secretary of Defense to construct, renovate, repair, or expand elementary and secondary public schools on military installations to address capacity or facility condition deficiencies. The program is 80% funded by the federal government and has a 20% local match requirement in order for school districts to receive funds.
In 2010, the Department of Defense assessed the condition of 160 public schools on military installations in the United States. A priority list of schools with the most serious conditions and/or capacity deficiencies was created. California has 11 schools located in six school districts that are within the top 33 of the priority list. Districts with schools on this list have expressed concerns about making the 20% local match requirement. The Governor’s Administration is exploring ways to assist participating districts with funding options to help the eligible schools establish their local match. Funding options include the provision of low-interest state loans through existing programs.

**K-12 Mandate Block Grant**

There is an increase of $1.2 million to reflect greater school district participation in the mandate block grant. The increase is necessary to maintain statutory block grant funding rates based on the assumption that there will be 100% program participation.

**Commission on Teacher Credentialing**

The Governor’s May Revision includes $4.5 million in additional funding to assist the Commission on Teacher Credentialing (CTC) in addressing a growing structural deficit. The structural deficit is the result of reduced revenues from the state and declining teacher credential fees at a time when nondiscretionary operating costs are rising. The additional funding is intended to streamline functions and create workload efficiencies in a number of areas but with a focus on the CTC’s responsibility for monitoring teacher misconduct. Additionally, the May Revision proposes to increase the teacher credential fee for initial and renewal credentials from $70 to $100.

**Home-to-School Transportation**

Beginning in 2015-16, the Governor proposes to shift transportation funding that previously went directly to a joint powers agency (JPA) to the JPA’s member districts. The proposal allows each agency to determine the amount of funding each member district will receive. Member districts will be required to use the funds received on transportation expenditures in the district or through support of the JPA.

**School Facilities and Facilities Investments**

In contrast to his January Budget, the Governor’s May Revision was conspicuously silent on school facilities. Recall that the Governor outlined several recommended principles to guide discussions and development of a new school facility program in January. These principles included (1) enhancing local authority to raise and use facilities revenue, and (2) target state resources to the “neediest” districts. The January Budget proffered ideas about reforming developer fee laws, expanding the use of routine restricted maintenance account funds, increasing the Proposition 39 local general obligation bond tax caps, and reducing eligibility criteria for charter schools.

In the absence of any additional recommendations on school facilities in the May Revision, the Governor maintains his January Budget proposal to provide $273.4 million in Proposition 98 one-time funds for the Emergency Repair Program, a budget-year investment that extinguishes the list of approved but unfunded projects.

Additionally, the May Revision reduces the Proposition 39 appropriation for energy efficiency projects by $6.7 million (to $313.4 million) to reflect reduced revenue estimates from the single sales factor.

**Proposition 2 and Proposition 98 Reserves**
According to the Administration’s revised estimates, California’s General Fund revenues increased by a total of $6.7 billion above January projections. The May Revision appropriates the lion’s share of the additional revenue pursuant to constitutional requirements to fund education, pay down state debts, and make deposits into the state’s Rainy Day Fund. Specifically, of the increased $6.7 billion revenues, the May Revision spends $5.5 billion on education and makes an additional $633 million into the Rainy Day Fund (for a total deposit of $1.9 billion).

With regard to the Proposition 98 reserve, the criteria for requiring a deposit into the fund have not been met; however, the May Revision proposes to pay off the Proposition 98 maintenance factor (one of the criteria) by $5.4 billion, leaving a maintenance factor balance of $772 million.

Summary

While we are certainly appreciative of the overall positive implications of the May Revision, we do need to highlight some problems that remain unresolved.

The first issue of importance that was not addressed is the projected increase in employer costs for the California Public Employees’ Retirement System and the California State Teachers’ Retirement System. Even with the higher funding, the increased cost of retirement contributions will take nearly 2% off the bargaining table for employees. This issue will continue to be a high priority for schools and ultimately consumes about 25% of the planned growth in LCFF funding at full implementation. A coalition comprised of a large number of school districts will continue to pursue a better solution, but the May Revision is silent on the issue.

One of the consequences of last year’s Budget Act and the passage of Proposition 2 was a limitation on the amount of reserves a district could maintain. All of the conditions for implementation of those limitations have not yet been met. But ultimately they will be met. This limitation flies in the face of local control and though it deserves a watery grave, the May Revision does not address the issue.

In the area of facilities, there is still no concrete plan for state participation in the funding of school construction and modernization. This will be brought into sharp focus as school districts adjust their staffing plans for 2015-16 to reflect that 53% of the remaining difference between TK-3 class sizes and a ratio of 24:1 must be closed. For many districts, there simply will not be enough classrooms to do that. With no expectation of state facility funding assistance and the long lead time necessary for school construction, or even the installation of portables, we expect facilities to again be a limiting factor in improvement of educational opportunities.

A longer range factor for schools will be the return to 40% of new revenues once the maintenance factor has been repaid. Remember that the LCFF is a commitment to make up the cuts and lost COLA for schools by 2021. Those same losses create the obligation for the state to make them up. So we will predictably go from receiving about 90% of new state revenues to about 40%. We think full implementation could come earlier than 2020-21.

Finally, the LCFF/LCAP model is maturing rapidly, and we see some evolutionary changes in operation of the program even though the basic law has not been changed. Two years ago, in the infancy of the LCFF, all of the emphasis was on the permissible uses of the new dollars. Many people asked us to help define strict rules where there really had been a purposeful effort by the state to not create hard and fast rules.

All of the attention was on the inputs to the process: the dollars. Today, we see a shift away from strict
accountability for the dollar inputs and greater emphasis on the actual services provided to students plus accountability for the results achieved through increased and improved services. Those who would like the state to draw hard lines are likely to be disappointed as the state moves even further from that interpretation.

Our guidance will always be to follow both the letter and the spirit of the law; however, we truly believe in local control, and we will not suggest limitations that go beyond those enforced by the state. As we see the state emphasizing student outcomes more and dollar inputs less, you can expect that our guidance will evolve as well.

We will cover all of these topics in much greater detail at our May Revision Workshops next week. We look forward to seeing you there.

—SSC Staff

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