An Overview of the 2016-17 Governor’s May Revision

Preface

The buzz preceding the release of Governor Jerry Brown’s May Revision mainly focused on the fact that revenue collections in April were well below the level projected in January. In fact, April revenues were down so much that the overall gain from prior months was completely wiped out, leaving the state well below its January projections for 2015-16 revenues. We have enjoyed the past three years of revenue increases in May that were above the January forecasts, but we have also warned that someday the Governor’s projections would miss the other way—this is that year.

Because the Rainy Day Fund deposit required by Proposition 2 is sensitive to revenue levels, the majority of the shortfall detailed below will be covered by reducing the state’s contribution to the reserve. Thus, there are no budget cuts for education included in the Governor’s May Revision. In fact, both ongoing and one-time dollars for education increase slightly from the planned January expenditure levels.

In January, the Governor proposed a $1.6 billion Early Education Block Grant; despite widespread opposition, the proposal remains in the Budget with some modifications. The Governor also proposes use of $100 million of Proposition 98 funding for an emergency repair loan program for school facilities. And the recently passed minimum wage legislation is fully funded.

Looking to the future, the Governor is careful to point out that the state’s projections do not assume a recession, but do assume that Proposition 30 temporary taxes expire. Under these assumptions, the state forecasts large deficits, which grow even higher if a recession should develop.

The May Revision is silent on topics of local school district reserve levels and the effect of the California State Teachers’ Retirement System and the California Public Employees’ Retirement System increases. Ironically, the Governor emphasized the need for adequate reserves for the state; we think districts need an adequate reserve as well. No district is required to reduce reserves under a prospective state law that has not yet taken effect. We advise districts not to reduce reserves as we see the storm clouds forming on the horizon. We continue to seek relief in the area of increased costs of employer retirement contributions, but we advise all local educational agencies (LEAs) to budget for the increases.

Overview of the Governor’s Budget Proposals

Governor Jerry Brown released the May Revision to his 2016-17 proposed State Budget on Friday, May 13, 2016. The Governor’s press packet included an Aesop fable—the Grasshopper and the Ant. The lesson learned in the fable is that the ant is wise to stock up during the summer and plan for the winter, compared to the grasshopper who has played through the summer and is not prepared when winter comes. The fable concludes, “It is best to prepare for the days of necessity.”
The fable reinforced the Governor’s January message to plan for the effects of the next recession, whenever it may be. In his press conference, Governor Brown highlighted last month’s lackluster personal income tax revenue and year-to-date weak sales tax receipts, which he estimates at $1.9 billion below January projections, noting “the surging tide of revenue is beginning to turn.”

In addition to the drop in anticipated state revenues, the Governor acknowledged significant developments since he released his State Budget proposal in January, including:

- Passage of legislation to gradually increase the minimum wage to $15 an hour, which will “eventually raise General Fund costs by an estimated $3.4 billion”
- Additional funding provided during a legislative special session for developmental disability services
- Passage of the managed care organization financing package solidifying funding for Medi-Cal

On the specifics of the Budget, General Fund revenues and transfers are proposed at $120 billion compared to expenditures of $122.1 billion; both of these figures were reduced by approximately $500 million compared to the January proposal. The state would end the 2016-17 fiscal year with a fund balance of $2.7 billion, plus $6.7 billion in the Rainy Day Fund, a decrease of nearly $1.3 billion since January. Proposition 2’s required contribution to the Rainy Day Fund was automatically reduced based on declining revenues and reduced capital gains expectations.

Outside of the Proposition 98 budget, the May Revision reflects $3.2 billion in state and federal funding and award authority for various affordable housing and homelessness programs. The May Revision also continues the Governor’s transportation package to provide $36 billion over the next decade to improve the maintenance of highways and roads, expand public transit, and improve critical trade routes.

Although during the press conference and in his May Revision summary document, the Governor officially remains neutral on the extension of Proposition 30 (“I’m leaving that to the people of California,” he said), much attention is given to the effects of the impending expiration of those taxes. The May Revision Budget summary notes, “Even if the voters pass this extension of taxes, the longer-term budget outlook would be barely balanced . . . if instead the voters do not pass the extension of taxes, the state will need to cut spending.” Furthermore, “Given that the state has added considerable ongoing commitments since [Proposition 30’s] passage, the budget is currently projected to return to deficit spending when Proposition 30 revenues expire.” Expect to hear these talking points repeated until the November 2016 election.

The Economy and Revenues

Economic Outlook

The Governor’s May Revision includes many of the recurring themes that were present in the January Budget proposal, but with extra emphasis on the looming risks. The Governor was quick to point out that most Governors don’t point out the problem areas and choose to focus on the good things. However, his favorable public perception, coupled with the fact that he is serving his final term in the state’s top spot, allows the Governor to be more candid and “counterfactual”—his word—in his outlook. We concur with the Governor’s position that numerous risks are present, but there is plenty to be optimistic about as well.

The value of the dollar continues to be strong when compared with our trading partners. This is beneficial for importing goods, but hurts the United States’ ability to export its goods. The depression of currencies in global economies also creates an incentive to outsource labor as the dollar becomes much more valuable when the cost of living is factored into the equation.
Oil prices have begun to rise from the six-year low of approximately $30 per barrel. These historically low oil prices have translated into savings at the pump, and theoretically, should create additional discretionary dollars for families to spend. However, some economists note that Americans have transitioned into a pattern of saving the excess dollars, rather than spending and generating sales tax revenues. However, the low oil prices cannot be sustained on a global level without ultimately impacting the generation of goods and ultimately job creation.

The average home price in California continues to steadily rise. The trough occurred in February 2009 when home prices averaged $246,000, but as of March 2016, the average home price has increased nearly 100% to $483,280. The increased valuations have been a boon for the state’s General Fund, specifically with respect to funding for K-12 education. Property taxes, not the state General Fund, have paid for the entire increase in education funding.

Unemployment rates as of February 2016 are at pre-recession levels of 5.0% and 5.5% for the United States and California, respectively. As a country, we are nearing the mark of full employment, which is a sign that the recovery period is squarely entrenched in the maturation stage. If nothing else, history has proven two things: (1) A recession will occur again; (2) The recession occurs after an economic recovery has passed its maturation stage. The Governor has enjoyed the good times by rewarding education with a new funding model, which has achieved historic levels of funding, but he is quick to remind everyone of the message that history is bound to repeat itself. The message is: be cautious.

**State Revenues**

It appears that the Governor’s conservative nature has finally come to pass. We had grown accustomed to the Governor’s revenue projections, which were very conservative. Actual revenues would surpass those projections, and LEAs would receive significant increases to the Local Control Funding Formula (LCFF) funding, as well as one-time funds. Based on the recent collection of personal income taxes in the month of April, the state’s estimate fell $1.2 billion short. We see this shortfall factored into both the 2015-16 and 2016-17 Budgets when compared with the January Budget proposal. Total General Fund revenues have been revised downward $1.49 billion for 2015-16 and $918 million in 2016-17. However, revenues are still projected to grow year over year by $4.5 million, or 3.7%

The Governor’s Budget has factored in the expiration of Proposition 30 temporary taxes in the upcoming years, along with a less vigorous stock market. Once the dust settles in November, we could experience significant upward revisions in revenue projections that are dependent upon the ballot measures.

**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 and (1) workload changes as measured by the change in K-12 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. Over the last three years, Proposition 98 has provided significant funding increases for schools, which have been used to restore cuts that were imposed during the Great Recession.

While Proposition 98 funding increases slightly over the January proposal, this May Revision reveals that the major gains of the recent past have come to an end. The May Revision proposes that Proposition 98 adjustments for 2014-15, 2015-16, and 2016-17 combined total $626 million.
**2014-15 Adjustment**

The May Revision shows that the Proposition 98 guarantee had been underestimated for 2014-15 and that a $463 million increase is due. This result is a revised guarantee for the prior year of $67.2 million compared to $66.7 million estimated in January.

**Current-Year Minimum Guarantee**

For the current year, the May Revision reflects a decrease in Proposition 98 of $125 million to $69.1 billion, from $69.2 billion in January. For the current year, Proposition 98 funding is based on Test 2—the change in per capita personal income—which is down slightly from the estimate in January.

Recall, however, that the January Budget estimated that Proposition 98 for the current year would be $766 million above the 2015-16 Budget Act level; therefore, funding under the constitutional measure is still above the enacted State Budget by $641 million.

Proposition 98 also requires the state to account for state funding that falls below the long-term target established by Test 2 (i.e., adjustments required by annual changes in per capita personal income). This cumulative shortfall is termed the Maintenance Factor. As of June 30, 2014, the state owed K-14 education approximately $6.4 billion in Maintenance Factor payments. While the Governor’s January Budget anticipated that the $6.4 billion Maintenance Factor would be fully repaid by the end of the current fiscal year, the May Revision now projects that $155 million will remain unpaid on June 30, 2016.

**2016-17 Minimum Guarantee**

For 2016-17, the May Revision proposes an increase of $288 million in Proposition 98 funding from the level proposed in January, bringing the minimum funding level to $71.9 billion. For the budget year, the guarantee is based on Test 3, the change in per capita General Fund revenues, plus 0.5%. In January, per capita General Fund revenues were estimated to increase 2.88%; the May Revision budgets the Test 3 increase at 3.56%.

Because Proposition 98 would be funded based on Test 3 in 2016-17, the January Governor’s Budget projected that a new Maintenance Factor would be created totaling $548 million in 2016-17. The May Revision revises that amount to $908 million.

The May Revision maintains the split of Proposition 98 funding between K-12 education and community colleges of 89.07% for K-12 education and 10.93% for community colleges for 2014-15, 2015-16, and 2016-17.

**Proposition 2 and Proposition 98 Reserves**

With the state’s revised tax revenues down by nearly $2 billion, the state’s Proposition 2 debt payment and deposit obligations are reduced by $1.6 billion compared to the January Governor’s Budget. However, Governor Brown maintains his proposal to overappropriate the state’s Rainy Day Fund with a $2 billion supplemental deposit, maintaining his commitment to fiscal prudence.

In January, the proposed state budget anticipated full repayment of the Proposition 98 Maintenance Factor by the end of 2015-16. Full repayment would meet one of four criteria needed to trigger a contribution to the Proposition 98 reserve. The May Revision, however, shows a Maintenance Factor balance of $155 million for 2015-16. Therefore, this criterion would not be met as had been anticipated in January.
Local Control Funding Formula

The Governor’s 2016-17 May Revision continues implementation of the LCFF with an infusion of nearly $3 billion in additional Proposition 98 revenues, up $154 million from the January State Budget proposal. The LCFF provides funding to transition all school districts toward target funding levels, and provides supplemental revenues through percentage weighting factors to increase or improve services for students who are not English language proficient, who are from low-income families, or who are in foster care.

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

The target base grants by grade span for 2016-17 are unchanged from 2015-16 because the statutory cost-of-living adjustment (COLA) is zero:

<table>
<thead>
<tr>
<th>Grade Span</th>
<th>2015-16 Target Base Grant per ADA</th>
<th>0% COLA</th>
<th>2016-17 Target Base Grant per ADA</th>
</tr>
</thead>
<tbody>
<tr>
<td>TK-3</td>
<td>$7,083</td>
<td>-</td>
<td>$7,083</td>
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<tr>
<td>4-6</td>
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<tr>
<td>7-8</td>
<td>$7,403</td>
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<td>$7,403</td>
</tr>
<tr>
<td>9-12</td>
<td>$8,578</td>
<td>-</td>
<td>$8,578</td>
</tr>
</tbody>
</table>

The 2016-17 transitional kindergarten-3 grade span adjustment (GSA) for class-size reduction (CSR) is also unchanged from 2015-16 at $737 per ADA, as well as the grade 9-12 GSA, which stays at an augmentation of $223 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 increases equal to 20% of the adjusted base grant (which 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 (the unduplicated pupil percentage). An additional 50% per-pupil increase is provided as a concentration grant for the percentage of eligible students enrolled beyond 55% of total enrollment.

Bear in mind that the LCFF target entitlement is the full funding level for each LEA, in today’s dollars, that the state intends to provide at some point in the future under the formula. It is not the amount an LEA will receive in 2016-17, which is based on the difference, or “gap,” between the current-year LCFF funding level, the LEA’s target entitlement, and the proportion of the gap that can be funded with the LCFF increase.

**LCFF Transition Entitlements and Gap Funding**

The difference between a district’s or charter school’s current funding and its target entitlement is called the LCFF gap, and it is this gap that is funded with the additional dollars dedicated each year to implementation of the LCFF. For 2016-17, the May Revision proposal calls for $2.979 billion to close more than half
(54.84%) of the gap remaining to full implementation of the LCFF.

Pupil transportation and Targeted Instructional Improvement Grants continue as separate add-ons to the LCFF allocations and do not receive a COLA.

**Community-Funded School Districts**

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

**County Offices of Education**

County offices of education (COEs) receive funding under a formula that is similar to, but not identical with, the LCFF for school districts and charter schools. COE funding is provided in recognition of direct instructional services for pupils in juvenile court schools and community schools, and an additional allocation is made for countywide services based on the number of school districts and total ADA within the county. As of 2014-15, the LCFF for COEs was fully implemented and, therefore, with no statutory COLA, the basic funding amounts that drive COE LCFF entitlements in 2016-17 will remain unchanged from 2015-16 levels. State funding for COEs in 2016-17 is adjusted at the May Revision to account for changes in ADA.

The May Revision includes a newly proposed 2016-17 allocation of $20 million for COEs to work with school districts and other early education providers in their regions to prepare for implementation of a revised early education program in 2017-18 (See the Preschool/Early Education section for more information).

**K-3 Grade-Span Adjustment**

The K-3 GSA program requirements are unchanged in the May Revision. The revised proposal to fund the LCFF gap at 54.84% for 2016-17 continues the significant reduction in class size for those school districts still making progress to the average school site enrollment target of 24. School districts (excluding charter schools) will need to prepare to further reduce class sizes in these grade levels by 54.84% 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. School districts may use the May Revision gap closure percentage of 54.84% on the gap closure percentage or the 2016-17 Adopted State Budget to determine class size reduction progress for 2016-17.

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

The May Revision includes no COLA for K-12 education programs. The statutory COLA for K-12 education is based on the annual average percentage change in value of the federally maintained Implicit Price Deflator for state and local governments, and is applied to the LCFF base grant targets, as well as other education programs that are funded outside of the LCFF. The estimated statutory COLA for K-12 education programs in the Governor’s January Budget proposal for 2016-17 was 0.47%, but based on final data for the Implicit Price Deflator, the actual COLA percentage is 0.0029%, which rounds to zero.

During implementation of the LCFF, the COLA is a less significant factor for most K-12 LEAs in estimating revenue changes for the upcoming year than it was under revenue limits. The lack of a COLA will affect the
per-pupil grants used to calculate the LCFF target, but does not directly impact the level of the appropriation for LCFF gap closure. Rather than the COLA, it is the appropriation, and its corresponding gap closure percentage, which determines revenue growth for most school districts and charter schools.

The lack of a COLA will, however, affect the LCFF funding for LEAs that are at their LCFF target, as well as funding for categorical programs. Those programs include Special Education, Child Nutrition, Foster Youth, Preschool, American Indian Education Centers, and American Indian Early Childhood Education, all of which were proposed to receive the statutory COLA of 0.47% in January.

Statewide estimated ADA for school districts and charter schools in 2016-17 is 5,966,068 at the May Revision, 5,244 ADA lower than the January Budget estimate of 5,971,292. Compared with 2015-16, the year-over-year decline in ADA is 11,155 ADA—about 0.2%—due to both an increased May Revision estimate of 2015-16 ADA and the decline in estimated ADA for 2016-17. Revised ADA forecasts for the May Revision resulted in marginal changes to funding for school districts, COEs, and charter schools under the LCFF, with an ADA-driven increase of $11.2 million in 2015-16 and a decrease of $2 million in 2016-17.

**Special Education**

Special education is one of the casualties of the zero COLA. There is no proposed increase in funding in the Governor’s May Revision for special education base programs or special education preschool. The Governor has called for another study regarding special education financing. The Public Policy Institute of California will release its findings in the fall 2016.

**Technology**

The Governor’s January Budget includes no additional funds for technology infrastructure purposes. The K-12 High Speed Network continues to implement Round 2 of the Broadband Infrastructure Improvement Grants approved in the 2015-16 State Budget and is finalizing a three-year plan to provide LEAs with resources to assist in network management to support teaching and learning activities funded from the $10 million provided in the 2015-16 State Budget.

**Child Care**

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 include (1) a decrease to reflect a lower estimated increase in the cost per case for Stage 2 of $884,000, and (2) a decrease for Stage 3 of $42.3 million to reflect adjustments in the cost per case and reduced caseload.

Capped child care programs (non-CalWORKs) are proposed to see a net decrease of $3.5 million reflecting the reductions in the COLA of 0.47% proposed in January to the zero COLA at May Revision.

Child care and development funds are proposed to receive a net increase in the May Revision of $55.6 million in federal funds, of which $9.2 million will be allocated to child care activities in compliance with the federal Child Care and Development Block Grant Act of 2014. Total one-time federal funding is $648.9 million.

**Preschool/Early Education**

The Administration updated its Early Education Block Grant proposal, which faced stiff opposition over the
spring and was rejected outright by the Assembly Budget Subcommittee on Education. As revised, the proposal would include a “funding model that maintains current levels of funding for school districts and regions for a period of time as the transition to the new Block Grant model occurs. Future state spending investments will be targeted to those areas of the state that have traditionally lacked an equitable share of total funding.”

The May Revision includes $20 million ($10 million ongoing and $10 million one-time) for COEs to begin work in the budget year to ensure a successful transition to the new early education program beginning in 2017-18.

**Adult Education**

The Governor’s May Revision maintains $500 million in ongoing funding for the Adult Education Block Grant. To date, 71 regional adult education consortia have been established under the new program. The Governor is proposing 2016-17 budget trailer bill language to require regional consortia to consider input from “students, teachers, community college faculty, principals, administrators, classified staff, and the local bargaining units of both school districts and community college districts before making final decisions.”

In the community college budget, an additional $5 million in one-time funds is proposed to provide consortia with technical assistance, coordination, and capacity building assistance through 2018-19.

**Charter Schools**

The Governor’s January Budget included an increase of $61 million in Proposition 98 funding to support projected charter school ADA growth and an additional $20 million in one-time funds for charter school start-up grants. The May Revision makes no changes to these proposals.

**Discretionary Funds**

The Governor’s May Revision includes more than $1.4 billion in one-time Proposition 98 funding for school districts, charter schools, and COEs. The funds are unrestricted and the use of the dollars are discretionary. Funding is estimated at $237 per ADA. Consistent with prior-year proposals, the funds provided will offset outstanding mandate reimbursement claims.

**New “Emergency Repair Revolving Loan Program” and Proposition 39**

**Emergency Repair Revolving Loan Program:** The May Revision includes no statement on the statewide school bond that qualified for the November 2016 ballot. However, with increased Proposition 98 one-time revenue, Governor Brown proposes to create a $100 million revolving loan program to expedite funds to districts with emergency facilities needs when conditions that pose health and safety risks exist that could cause the displacement of students from educational settings. The new bridge loan program is intended to assist districts with insufficient resources to address their health and safety issues.

Under the Emergency Repair Revolving Loan Program, participating districts would have to provide independent verification that the site is unsuitable for occupation and certify that no alternative facilities are available to house displaced students. Unlike the Facility Hardship Program, which is administered by the Office of Public School Construction and requires verification by the Division of the State Architect, the new loan program will be administered by the California Department of Education under an expedited review and approval process so that funds can be provided to districts “in a matter of days.”
Districts receiving loans would have the option of repaying the loan in full within one year without interest or by structuring long-term, low-interest repayment plans over a 20-year period.

**Proposition 39—The California Clean Energy Jobs Act:** The May Revision includes an increase of $33.3 million for K-12 education and $4.1 million for community colleges for Proposition 39 energy efficiency projects from the January Budget. Total funding for K-12 education would be $398.8 million and for community colleges $49.3 million for 2016-17.

**Teacher Workforce Actions**

In response to statewide teacher shortages, the May Revision proposes one-time investments to accelerate candidates securing a teaching credential and improve statewide recruitment of qualified individuals into the teaching profession.

The Governor proposes $10 million in one-time funds for investment grants to be awarded to private and public postsecondary institutions to improve upon or develop four-year integrated teacher credential programs, reducing the time to a preliminary teaching credential by up to three years. Competitive grants of up to $250,000 would be administered by the Commission on Teacher Credentialing (CTC) and will be awarded with preference to proposals that include partnerships with local community colleges and K-12 LEAs.

Additional one-time funds of $2.5 million will be provided to support the creation of the California Center on Teaching Careers (Center). A competitive multiyear grant will be administered by the CTC to select an LEA to administer the Center and provide outreach and support to recruit teachers statewide.

**Other Categorical Programs**

To reflect both updated estimates of projected ADA in 2016-17 and the change in COLA from 0.47% to zero, proposed appropriations for selected categorical programs will be decreased compared to the January proposal by $24.3 million.

**Federal Programs**

There was a small uptick in funding for some of the major federal education programs. Title I, which supports services to assist low-achieving students enrolled in the highest poverty schools, will receive a $138 million increase, of which $29.1 million is one-time. Special education base grants will increase by only $41.3 million, of which $5 million is one-time. Migrant education programs, which support services to meet the needs of highly mobile children, receive a $14 million increase, of which half is one-time funding.

The other news at the federal level is the release of the U.S. Department of Education updated Every Student Succeeds Act Frequently Asked Questions (FAQs) on Transitioning document. The updated FAQs document provides additional clarity regarding transition for supplemental education services funds and specific formula grant programs, as well as paraprofessional qualification requirements for the upcoming school year. Here are the updated FAQs on Transitioning to the Every Student Succeeds Act.

**In Closing**

We remain convinced that, during some of the most difficult economic circumstances in the state’s history, the Governor has provided vision, balance, and fiscal discipline. All of those things are easier to do when there is a boost from temporary taxes and a rebounding economy. We are very concerned that over the next
couple of years the state will not be able to meet its growing obligations and fixed costs. As a result, we advise careful planning and fiscal restraint. As a result of the 95.7% LCFF implementation rate forecast for 2016-17, we think the time for creating new programs and services has passed. We now believe the emphasis should be on stabilizing expenditures, maintaining adequate reserves, and planning to sustain current programs.

The May Revision almost always has some surprises. We will detail all aspects of the May Revision to help you prepare your 2016-17 LEA's budget, close the books for 2015-16, and maintain sound operations throughout the upcoming year. Our SSC May Revision Workshops beginning on May 18 and you can register here. We will provide additional information and insights at that time.

—SSC Staff

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