

# SUBCOMMITTEE NO. 1 on Education



## Subcommittee No. 1

Chair, Carol Liu

Member, Robert Huff

Member, Roderick Wright

**Thursday, March 11, 2010**

**9:30 a.m. or Upon Adjournment of Senate  
Room 3191, State Capitol**

**Proposition 98 and K-12 Education Funding Overview –  
Office of the Legislative Analyst, Edgar Cabral**

**Highlights of the Governor’s K-12 Education Budget –  
Department of Finance, Jeannie Oropeza**

**Comments on the Governor’s K-12 Education Budget --  
Lupita Cortez Alcalá, California Department of Education,  
on behalf of State Superintendent Jack O’Connell**

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**ITEM 1: Governor’s January 2010 Proposition 98 Proposals**

**DESCRIPTION:** The Governor’s January 2010 budget proposes to reduce 2008-09 Proposition 98 spending by **\$82.9 million** to align the guarantee with more current estimates of expenditures. The Governor proposes to reduce the level of funding certified by Chapter 3 (4<sup>th</sup> Extraordinary Session of 2009) to accomplish this change. In accordance with the Governor’s various assumptions about Proposition 98 funding in 2008-09, he proposes to reduce Proposition 98 to \$49.9 billion in Proposition 98 funding in 2009-10. This equates to a reduction of **\$568 million** compared to the 2009-10 Budget Act. In addition, the Governor proposes \$50 billion in Proposition 98 funding, which equates to an increase of **\$103 million** above his proposed 2009-10 funding level. This level of funding requires programmatic reductions of approximately **\$1.9 billion** for K-12 education – excluding child care.

The issues discussed in this agenda item will be covered by the K-12 and Proposition 98 Funding Overview presented by the Legislative Analyst’s Office to the Subcommittee today. This agenda item is meant to provide background information about the Governor’s overall Proposition 98 funding proposals in preparation for hearing the remaining items on the Subcommittee agenda today.

**BACKGROUND:** The Proposition 98 minimum funding guarantee is determined by one of three “tests”, which are formulas established in the State Constitution. These three tests are outlined by the LAO chart below.

### Proposition 98 Basics

#### Three Formulas (“Tests”) Used to Determine K–14 Funding:

Test 1—Share of General Fund. Provides roughly 40 percent of General Fund revenues to K–14 education. From 1988–89 through 2007–08, this test was applied only once (1988–89).

Test 2—Growth in Per Capita Personal Income. Adjusts prior–year funding for changes in attendance and per capita personal income. This test was operative 13 of the last 20 years.

Test 3—Growth in General Fund Revenues. Adjusts prior–year funding for changes in attendance and per capita General Fund revenues. Generally, this test is operative when General Fund revenues grow more slowly than per capita personal income. This test was operative 6 of the last 20 years.

The Governor's January 2010 budget proposals assume that Test 1 continues to be operative in 2008-09, 2010-11, and 2011-12.

## **GOVERNOR'S BUDGET PROPOSALS:**

**1. Proposition 98 – Recertification of the 2008-09 Guarantee.** The Governor proposes to reduce Proposition 98 minimum funding – as statutorily certified – by \$82.9 million in 2008-09, in order to align the guarantee with more current estimates of expenditures.

Chapter 3 (4<sup>th</sup> Extraordinary Session of 2009) certified the Proposition 98 minimum guarantee at \$49.1 billion in 2009-10. The Governor proposes to reduce this amount to \$49 billion, a reduction of \$82.9 million.

The Governor proposes this change to align the Proposition 98 guarantee with expenditures, which have declined as a result of revenue limit savings in 2008-09.

The Administration proposes to amend provisions of Chapter 3, to recertify Proposition 98 funding in 2008-09, in order to reflect this change.

**2. Overall Proposition 98 Funding Levels for 2009-10 and 2010-011.** The Governor proposes \$49.9 billion in Proposition 98 funding in 2009-10. This equates to a reduction of **\$568 million** compared to the 2009-10 Budget Act, and provides funding at the minimum guarantee level, as calculated by the Governor.

In 2010-11, the Governor proposes \$50.0 billion in Proposition 98 funding, which equates to an increase of **\$103 million** above the Governor's proposed 2009-10 funding level. This level of funding also provides funding at the minimum guarantee, as calculated by the Governor.

The Governor's estimates of the minimum guarantee in 2009-10 and 2010-11 are based upon his interpretation of the constitutional provisions of Proposition 98. These interpretations are at odds with the July budget agreements -- pursuant to Chapter 3 (4<sup>th</sup> Extraordinary Session of 2009) – and have the effect of lowering the guarantee in both years.

In addition to recertifying the 2008-09 minimum guarantee discussed above, Chapter 3 certifies \$11.2 billion in maintenance factor obligations owed in 2008-09. (This amount includes \$1.3 billion in obligations owed at the end of 2007-08.) Payment for these maintenance factor obligations would commence in 2010-11, per Chapter 3; although, per the LAO, other provisions of Chapter 3 could be interpreted to suggest that payment begins in 2009-10.

In calculating the minimum guarantee for 2009-10 and 2010-11, the Governor now assumes that \$1.3 billion in maintenance factor obligation --owed through 2007-08--is paid off in 2008-09. The Governor also proposes postponing the commencement of the payments required by Chapter 3 by one year -- from 2010-11 to 2011-12. (The LAO believes that Chapter 3 requires payments commencing in 2009-10, so from their perspective this is a two year delay.)

**TRAILER BILL:** The Governor proposes statutory changes to Chapter 3 in order to lower the level of Proposition 98 funding certified in 2008-09 by \$82.9 million. The Governor also proposes to change provisions of Chapter 3 to delay the repayment of “in lieu” maintenance factor from 2010-11 to 2011-12.

### **LAO COMMENTS:**

**Unclear if Constitutional Obligations Would Be Met; Obligations Could Increase Significantly.** Per the LAO, the Governor’s Proposition 98 assumptions for the 2008-09, 2009-10, and 2010-11 fiscal years may not meet constitutional obligations, and therefore has some legal risks. Under the provisions of Chapter 3, the state enters the 2009-10 year owing \$11.2 billion in maintenance factor. Under this current-law scenario, the Proposition 98 minimum guarantee would be **\$2.2 billion** higher in 2009-10 and **\$3.2 billion** higher in 2010-11, than proposed by the Governor.

**Minimum Guarantee Could Increase Due to Changes in Revenues.** In addition to constitutional issues, the LAO points out that the minimum guarantee for 2009-10 and 2010-11 could also increase due to changes in the Governor’s revenue estimates for 2008-09. There are five factors that affect the underlying tests and minimum guarantee calculations – General Fund revenues, local property taxes, personal income, state population, and K-12 population. Changes in these factors – most likely changes in revenues – could change operative tests for Proposition 98 in 2008-09, which would in turn change the operative tests for 2010-11 and 2011-12. In addition, the Governor’s minimum guarantee could increase even further due to interaction with some his revenue proposals, such as the revenue increases that are “triggered” if federal funding solutions are not successful.

### **LAO RECOMMENDATIONS:**

The LAO offers two courses of action for approaching Proposition 98 funding as alternatives to the Governor’s proposals. The LAO will present their alternative to the Subcommittee today as a part of their K-12 and Proposition 98 Funding Overview.

In summary, the LAO believes that the Legislature has two basic alternatives—both of which involve their own difficult choices. The first option is to suspend the Proposition 98 minimum guarantee. Per the LAO, this option is the safest legal course of action and offers the Legislature the most flexibility in building both the education and the overall state budget. The second option would be to increase education spending above the Governor’s funding level to meet the higher current-law funding requirements—either by reducing spending more in other areas or by raising additional revenues.

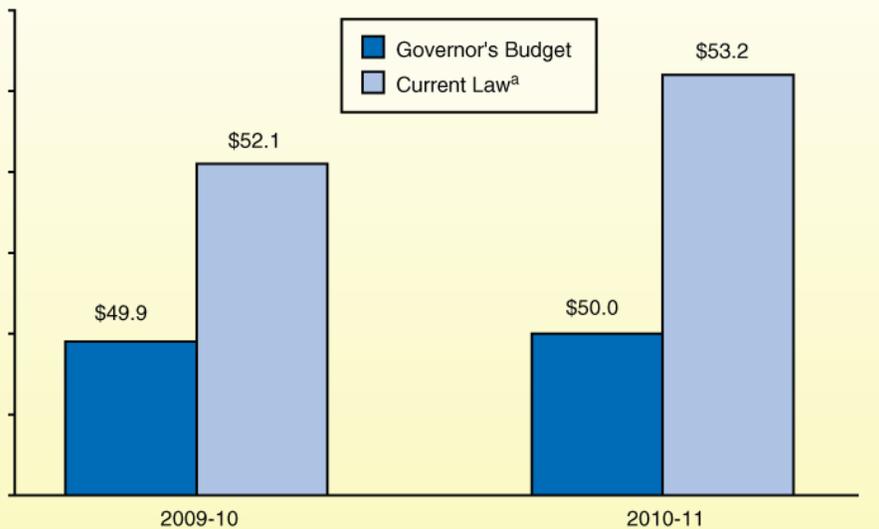
The following excerpts from the LAO's recent publication - *The 2010-11 Budget: Proposition 98 and K-12 Education* -- offer additional detail about the LAO's alternatives, which will be presented at the Subcommittee hearing today.

- Suspend Proposition 98.** Suspending Proposition 98 in 2009-10 and 2010-11 would allow the state to decide the level of funding it could afford for K-14 education, regardless of the Proposition 98 formulas, constitutional interpretations of maintenance factor, and otherwise interacting revenue proposals. Suspension requires a two-thirds vote of each house of the Legislature. (Under suspension, the state creates a new maintenance factor obligation, which would require additional payments in future years.)
- Raise Additional Revenues or Cut Other Spending to Meet Higher Current-Law Funding Levels.** The Legislature could take another course of action and either raise enough additional revenues or make further spending reductions elsewhere in the budget to meet the higher current-law K-14 funding level for 2010-11 (\$3.2 billion). (See LAO chart below.) To the extent the Legislature used new tax revenues to provide this supplemental funding, the initial \$3.2 billion gap would grow. This is because without suspending Proposition 98, every new dollar of General Fund revenue increases the Proposition 98 minimum guarantee by 40 cents to 50 cents. For example, **if the Legislature were to take this approach relying entirely on tax revenues, it would need to raise roughly \$6 billion in new revenues, with essentially all of the new funding used for K-14 education.** (We assume the state would be able to meet a higher funding obligation in 2009-10 through “settle-up” payments in future years.)

Figure 6

**Comparing Proposition 98 Funding Levels**

(Dollars in Billions)



<sup>a</sup>Current law assumes the state entered 2009-10 with an \$11.2 billion maintenance factor. It also assumes the Governor's baseline revenue forecast, excluding his policy proposals.

**STAFF COMMENTS:** The remaining issues in this agenda reflect the Governor’s spending proposals (savings and expenditures) that conform to his proposed Proposition 98 funding levels in both 2009-10 and 2010-11. The LAO chart below summarizes the Governor’s major spending proposals – many of which will be covered today.

**Proposition 98: Governor’s Major Spending Proposals**  
(In Millions)

<b>Midyear 2009–10 Proposals</b>	
Recognize K–3 Class Size Reduction (CSR) savings	–\$340
Make various other baseline adjustments	–228
	–
<b>Total Changes</b>	<b>\$568</b>
<b>2010–11 Proposals</b>	
Backfill prior–year one–time solutions	\$1,908
Make various other adjustments	238 <sup>a</sup>
Reduce K–12 revenue limits:	
Spend less on non-instructional activities	–1,184
Remove restrictions on contracting out	–300
Consolidate County Office of Education functions	–45
Make K–14 cost–of–living adjustments (–0.38 percent)	–230
Recognize additional K–3 CSR savings	–210
Reduce CalWORKs Stage 3 child care funding	–123
Reduce child care reimbursement rates	–77
Fund CCC apportionment growth (2.21 percent)	126
<b>Total Changes</b>	<b>\$103</b>

<sup>a</sup> Includes growth for revenue limits, special education, and child nutrition. Also includes funding for three K–12 mandates.

In summary, the Governor proposes to reduce Proposition 98 funding by **\$568 million** in 2009-10 through program savings for K-12 programs, as described later in the agenda.

While the Governor’s proposal results in a net increase of **\$103 million** in Proposition 98 funding from 2009-10 to 2010-11, this masks a reduction of approximately **\$1.9 billion** in support for K-12 education programs (excluding \$200 million in child care reductions). Reductions of this size were required to backfill one-time savings solutions utilized in 2009-10. All of the Governor’s major proposals tied to the 2010-11 reductions are also covered later in this agenda.

Decisions about the level of Proposition 98 will not likely be made until after May Revise, when factors affecting the Proposition 98 requirements are updated.

**ITEM 2: Governor's Budget –2009-10 Expenditure Proposals**

**DESCRIPTION:** The Governor proposes to reappropriate **\$38.4 million** in Proposition 98 funds in 2009-10 to provide increased funding for two programs.

**GOVERNOR'S BUDGET PROPOSALS:** As a part of the Governor 2009-10 budget proposal, the Governor proposes to appropriate **\$38.4 million** in one-time Proposition 98 savings in 2009-10, for the following programs:

- 1. Charter School Facility Grant Program (6110-220-0001):** The Governor proposes an increase of **\$18.4 million** to convert the Charter Schools Facilities Grant Program from a reimbursement-based to a grant program, consistent with statute enacted as a part of the 2009 budget package. This program offsets 75 percent of the facility rental or lease costs of charter schools operating in low-income areas. Funding is restricted to charter schools that are unable to secure public or other facilities.
  
- 2. Categorical Flexibility Funding – New Schools:** The Governor proposes a **\$20 million** increase to provide categorical funding to newly-established schools in 2008-09 and 2009-10. These funds are intended to allow new schools – including charter schools - - to receive categorical funds from more than 40 programs that were subject to the five year categorical flexibility beginning in 2008-09. Under the original categorical flexibility statutes enacted as a part of the February 2009 budget package, statewide programs are adjusted annually for growth, but local growth allocations are locked into proportions established for the base year of the program. The July budget package added language to allow schools established after the base year to receive categorical allocations if they are administering programs as they existed before they were flexible.

**TRAILER BILL LANGUAGE:** The Governor proposes to amend the 2009-10 budget act to reappropriate Proposition 98 savings for the Charter School Facility Grant program and to provide funding to allow new schools to receive categorical funding subject to flexibility.

**LAO COMMENTS/LAO RECOMMENDATIONS:**

**Charter School Facility Grant Program.** The LAO recommends that funding for the Charter School Facility Grant program be continued on a reimbursement basis in 2009-10 and 2010-11, which result in savings of **\$34 million** over the two year period, compared to the Governor's Budget. This includes \$15 million in one-time savings in 2009-10 and \$19 million in 2010-11.

- **Categorical Funding for New Schools.** The LAO has concerns and about how the Governor's proposal for providing categorical funds within the new categorical cut/flex program would work and how much it would cost. The LAO recommends clarifying the eligibility requirements and usage parameters before allocating categorical funds for new schools.

- Preliminary data and information gathered by the LAO from the Department of Education indicates that approximately 180 schools applied for categorical funding in 2008-09 and 2009-10. Of this total, 123 were charter schools, 46 were community day schools and 11 were new district schools other than community day schools. It is unclear whether the enrollment for these new schools is redirected enrollment, which is not funded under current law. It is also unclear if new schools would have to meet the program requirements for some period of time under the Governor’s proposal, or whether their funding would be flexible right away.

**STAFF COMMENTS:**

**Charter School Facility Grant Program.** The Governor proposes **\$45.5 million** for the Charter School Facility Grant program in 2009-10 and **\$61.0 million** in 2010-11. The Department of Education estimates that eligible grants total **\$34.0 million** in 2009-10 and **\$37.0 million** in 2010-11.

Staff notes that funding for the Charter School Facility Grant program has grown significantly in recent years, as indicated by the table below. In a period of declining school enrollments, this program has experienced enrollment growth from new schools and expanded enrollments at existing schools. Even with the across-the-board categorical reductions beginning in 2008-09, the Charter School Facility Grant program has sufficient funding, as proposed, to provide full funding for its enrollment growth in 2008-09 and 2009-10.

<b>Charter School Facility Grant Program</b> <i>(Dollars In Millions)</i>	<b>2002-03</b>	<b>2003-04</b>	<b>2004-05</b>	<b>2005-06</b>	<b>2006-07</b>	<b>2007-08</b>	<b>2008-09</b>	<b>2009-10 Proposed</b>	<b>2010-11 Proposed</b>
<b>Budget Appropriation</b>	<b>10.0</b>	<b>7.7</b>	<b>7.7</b>	<b>9.0</b>	<b>9.0</b>	<b>18.0</b>	<b>31.6</b>	<b>45.5</b>	<b>61.0</b>
<b>Grants Funded</b>	<b>5.3</b>	<b>7.7</b>	<b>7.7</b>	<b>9.0</b>	<b>9.0</b>	<b>18.0</b>	<b>31.6</b>	<b>34.0</b>	<b>NA</b>
<b>Eligible Grants (Demand)</b>						<b>23.6</b>	<b>32.3</b>	<b>34.0</b>	<b>37.0</b>

**Categorical Funding for New Schools.** Staff notes that that the Governor’s proposal implements statute to address an existing problem with the five year categorical cut/flexibility program enacted in 2009. However, as noted by the LAO, there are several questions about the Governor’s proposal that need to be resolved in order to develop an appropriate implementation plan.

**STAFF RECOMMENDATIONS:**

**Charter School Facility Grant Program.** Staff recommends that following May Revise, the Subcommittee adopt the LAO recommendation to delay conversion of the Charter School Facility Grant program from a reimbursement program to a grant program. This action will provide an additional **\$34 million** to the state that can be used

to mitigate other K-12 reductions. At the same time, the program will continue to receive annual funding that fully funds enrollment growth.

**Categorical Funding for New Schools.** The Governor's proposal implements trailer bill language added as a part of the 2009-10 budget to address an oversight in the original categorical cut/flex program. However, the Governor's current proposal may have unintended consequences from both a policy and fiscal standpoint. For these reasons, staff recommends that the Subcommittee request the Legislative Analyst to work with the Department of Finance and Department to refine the Governor's proposal to better define eligibility and usage parameters - as recommended by the LAO - while better reflecting true enrollment growth and avoiding double counting.

### **SUGGESTED QUESTIONS:**

1. The Charter School Facility Grant program provides funds for lease and rental costs. What other costs are allowed under the program?
2. The Charter School Facility Grant program is intended to provide funding charter schools that are unable to secure public or other facilities. However, the CDE website indicates that the program can be used by charter schools to reimburse school districts for the rental or lease costs of their facilities. How often does this occur?
3. Can you provide more background on the rapid enrollment growth in the Charter School Facility Grant program?
4. Are Charter School Facility Grants distributed fairly evenly throughout the state or does the program serve a more limited number of counties or districts in the state?

**ITEM 3: Governor Budget -- 2009-10 Savings Proposals**

**DESCRIPTION:** The Governor proposes to reduce Proposition 98 spending in 2009-10 by capturing an estimated **\$568 million** in K-12 program savings. This amount includes a **\$340 million** (19 percent) reduction for the K-3 Class Size Reduction program that results from lower program participation, as estimated by the Administration. In addition, the Governor proposes **\$228 million** in other savings, largely from revenue limits, that results from lower K-12 enrollments.

**BACKGROUND:**

For revenue limit apportionments and other K-12 categorical programs, funding *earned* by local educational agencies may be more or less than funding *appropriated* in the annual budget act. These differences are most often affected by K-12 attendance factors or other workload adjustments. When actual K-12 enrollments drop below budgeted levels, Proposition 98 savings are created for many programs at the state level.

As a part of the across-the-board categorical reductions and categorical funding flexibility options approved in February 2009, additional funding flexibility was provided for the K-3 Class Size Reduction Program. More specifically, school districts may now increase K-3 sizes to 25 students or more and retain up to 70 percent of their program funds. Under the previous rules, districts lost all program funding (100 percent) if class sizes exceeded 21.9 students. The new flexibility laws are in effect for a four year period beginning in 2008-09. As districts increase class sizes, they will lose funding, which translates into Proposition 98 savings at the state level.

**GOVERNOR'S BUDGET PROPOSAL:**

1. **Revenue Limit and Other Workload Adjustments:** The Governor's Budget reflects a net reduction of **\$228 million** in 2009-10 resulting primarily from revenue limit savings for school districts and county offices of education, offset by small adjustments for a few other programs. Revenue limit savings of **\$236 million** result from a decrease in average daily attendance as well as unemployment insurance and retirement costs. These reductions are offset by additional costs of **\$8 million** resulting from property tax adjustments and other workload adjustments for various Proposition 98 programs.

2. **K-3 Class Size Reduction Program Savings:** The Governor's Budget proposes to reduce funding for the CSR program by **\$340 million** in 2009-10 to reflect anticipated "natural" savings for the program. Penalties for increasing class size were reduced beginning in 2008-09 in order to give school districts greater flexibility in meeting budget shortfalls. However, due to increasing class sizes, school districts are losing some funding from remaining penalties, which results in program savings for the state.

#### **LAO COMMENTS/RECOMMENDATIONS:**

- **Governor's CSR Savings Estimates Too Optimistic.** The LAO believes that the Governor's assumptions regarding the likely increases in K-3 class sizes are overstated. The LAO states that "while data show that some districts did increase K-3 class sizes in 2009-10, the increase in class size appears to be more modest than the administration assumes, with few districts likely to experience large reductions in their class allocations."
- The LAO states that better estimates cannot be calculated without actual program participation data, which will not be available from the Department of Education until June 2010. Until that time, the LAO recommends that the Legislature assume **\$200 million** in 2009-10 savings, instead of the \$340 million (19 percent) currently estimated by the Governor.

#### **STAFF COMMENTS/RECOMMENDATIONS:**

The Legislature will not have data to better estimate the savings from the Class Size Reduction program until late May or June 2010.

Following Proposition 98 updates at May Revise, if the Legislature decides to reduce the 2009-10 Proposition 98 budget, "natural" program savings provide the most reasonable way to reduce funding for K-12 education within the school year.

However, if there is no need to reduce Proposition 98 funding in 2009-10, the savings identified by the Governor can be used to offset existing 2009-10 reductions or additional reductions proposed for 2010-11.

#### **SUGGESTED QUESTIONS:**

1. How did the Administration develop their savings estimates for the Class Size Reduction program in 2009-10?
2. What data are available about school district participation in the K-3 Class Size Reduction program in 2009-10?

**ITEM 4: Governor's Budget – 2010-11 Class Size Reduction Program Savings**

**DESCRIPTION:** The Governor proposes to capture **\$550 million** in savings from the K-3 Class Size Reduction (CSR) program in 2010-11. This equates to program savings of nearly 30 percent. This level of savings assumes an additional \$210 million in savings in 2010-11, on top of the \$340 million in CSR savings anticipated by the Governor in 2009-10.

**BACKGROUND:**

The K-3 CSR program was established in 1996 as a voluntary program. Participating school districts received per pupil incentive funding for their classes that maintained average K-3 class sizes below 20.4 students. Districts received graduated funding penalties – losses – for a classes sized above this level. If an average class size exceeded 20.4 students, districts received a penalty of 100 percent -- no CSR funding for that class.

In 2004, the K-3 CSR funding program was amended to allow a class to increase up to 21.9 students and still receive 20 percent of their funding rate. The 100 percent penalty was applied to classes with average class size of more than 21.9 students.

As a part of the across-the-board categorical reductions and categorical funding flexibility options approved in February 2009, additional funding flexibility was provided for the K-3 Class Size Reduction Program. More specifically, school districts may now increase K-3 sizes to 25 students or more and retain up to 70 percent of their program funds. Under the previous rules, districts lost all program funding (100 percent) if class sizes exceeded 21.9 students. The new flexibility laws, which are summarized below, are in effect for a four year period beginning in 2008-09 through 2011-12.

- 5 percent penalty if average class size greater or equal to 20.5 but less than 21.5;
- 10 percent penalty if average class size greater or equal to 21.5 but less than 22.5;
- 15 percent penalty if average class size greater or equal to 22.5 but less than 23.0;
- 20 percent penalty if average class size greater or equal to 23.0 but less than 25.0;
- 30 percent penalty if average class size greater than 25.0.

**GOVERNOR'S BUDGET PROPOSAL:**

The Governor estimates that participation in the K-3 CSR program will decline even further in 2010-11. As a result, the Governor anticipates **\$550 million** (30 percent) in K-3 CSR savings in 2010-11. This level of savings adds another **\$210 million** to the Governor's savings estimate of **\$340 million** in 2009-10.

**LAO COMMENTS/RECOMMENDATIONS:**

As was the case with the Governor's 2009-10 proposal, the LAO believes the Governor's K-3 CSR savings estimate for 2010-11 is also overstated. However, rather than providing an alternative savings estimate, the LAO recommends a different approach, as follows:

- **Recommend Placing K-3 CSR Program in K-12 Flex Item.** The LAO recommends that the K-3 CSR program be added to the K-12 cut/flex program, which currently covers approximately 40 categorical programs. In so doing, the LAO recommends that districts receive funding equal to their 2007-08 allocation less 20 percent—which would equate to funding levels for other programs in the categorical cut/flex program. This would result in K-3 CSR savings of \$382 million in 2010-11. Districts would continue to receive funding regardless of class size increases.
- **Parallels LAO Recommendations to Provide More Flexibility, Budget More Transparently.** Per the LAO, their approach offers districts greater flexibility by allowing them to determine class sizes within the context of their overall fiscal situation and education priorities. While their approach means the state might forego additional CSR savings if districts were to increase class sizes even further in the future, the LAO questions the benefit of continuing the program under the existing program rules. In the LAO's view, many schools now receiving K-3 CSR funding are not really running a K-3 CSR program anymore. According to the LAO, schools that chose to increase K-3 class sizes above 20 students prior to January 2009 are essentially locked out of the program whereas other schools that waited until after January 2009 to increase class sizes continue to receive funds.

#### **STAFF COMMENTS/RECOMMENDATIONS:**

Staff supports the LAO's alternative proposal for including the CSR program in the categorical cut/flex program. Staff recommends that the Subcommittee adopt the LAO's proposal after May Revise.

#### **SUGGESTED QUESTIONS:**

1. What is the Administration's view of the LAO proposal to place the K-3 CSR program in the categorical cut/flex program?

**ITEM 5: Governor’s Budget – 2010-11 Revenue Limit Reductions – School District Non-Instructional Expenditures**

**DESCRIPTION:** The Governor proposes to reduce school district revenue limits by **\$1.2 billion** in 2010-11 and to impose limits on non-instructional spending for districts. This reduction is the largest piece of the Governor’s **\$1.5 billion** proposal to reduce revenue limit reductions for school districts and county offices of education in 2010-11.

**BACKGROUND:**

Revenue limit apportionments provide general purpose funding for school districts and county offices of education. Revenue limits comprise roughly two-thirds of all Proposition 98 funding. The 2009-10 budget act provides a total of approximately \$30.6 billion in revenue limit funding to school districts and county offices of education. Ongoing K-12 base revenue limit apportionments were reduced significantly in 2008-09 and 2009-10 as a result of the state’s budget shortfall -- \$925 million in 2008-09 and an additional \$2.4 billion in 2009-10. In addition, K-12 base revenue limits were reduced by \$1.5 billion on a one-time basis in 2009-10. Deficit factors have been established for the ongoing base reductions – as well as foregone cost-of-living increases – as a symbol of intent to restore these levels when the state budget allows.

**SUMMARY OF GOVERNOR’S OVERALL REVENUE LIMIT PROPOSALS.**

The Governor’s proposes a total of **\$1.5 billion** in revenue limit reductions – the largest reduction for K-12 education in 2010-11. There are three separate reduction proposals, as summarized below, that are each linked to policy proposals intended to create local savings.

<i>Proposal</i>	<i>Base Funding</i>	<i>Reduction</i>	<i>%</i>	<i>Per ADA* Equivalent</i>
<b>School Districts – Reductions Tied to Limitations on Non-Instructional Service Expenditures</b>	<b>\$31,475 m</b>	<b>\$1,184 m</b>	<b>4%</b>	<b>\$200/ADA</b>
<b>School Districts – Reductions Tied to New Contracting Out Authority</b>	<b>\$31,475 m</b>	<b>\$300 m</b>	<b>1%</b>	<b>\$50/ADA</b>
<b>County Offices of Education – Savings Tied to County Office of Education Consolidation *</b>	<b>\$595 m</b>	<b>\$45 m</b>	<b>7%</b>	<b>Between \$2.40 - \$30/ADA based on CDE estimates. **</b>
<b>TOTAL</b>		<b>\$1,529 m</b>		

*\*Average Daily Attendance.*

The Governor does not propose establishing deficit factors for any of these revenue limit reductions. Instead, the deficit factors would remain unchanged from their 2009-10 levels.

## **GOVERNOR'S BUDGET PROPOSALS: SCHOOL DISTRICT REDUCTIONS FOR NON-INSTRUCTIONAL ACTIVITIES**

The Governor's proposal reduces revenue limits for districts (and charter schools) by **\$1,184,449,000**, and commencing in 2010-11, requires districts to reduce noninstructional expenditures by a minimum of 12 percent compared to 2008-09 spending levels. The Governor specifies five categories of non-instructional expenditure for reduction, which are defined in the California School Accounting Manual. These categories include instructional supervision and administration, general administration, plant maintenance and operations, board and superintendent costs, and centralized data processing.

Per the Governor's proposal, revenue limit reductions for school districts will be allocated per average daily attendance (ADA). For excess tax districts – commonly known as basic aid districts – reductions would be applied to the district's state categorical programs, with the following exclusions: Special Education, Child Care and Development, After School Education and Safety, and Quality Education Investment Act.

The Governor's proposal allows school district governing boards to apply for a hardship exemption from the reductions for noninstructional services if the reduction would result in a serious financial hardship to the district or if the district has already reduced noninstructional expenses to less than 15 percent of the district's current expense of education.

**TRAILER BILL:** The Governor proposes to add new statutes to implement the Governor's proposed revenue limit reductions and to add provisions that would require districts to reduce non-instructional services. The Governor also includes statutory provisions to continue revenue limit deficit factors at 2009-10 levels in 2010-11.

**LAO COMMENTS/LAO RECOMMENDATIONS:** The LAO recommends rejecting the Governor's proposal to require reductions in school district non-instructional services because this would remove local flexibility and limit local decision-making power. The LAO provides the following details for their recommendations:

- **Proposal Has Serious Implementation Problems.** The LAO has serious concerns with how this proposal would be implemented. First, every district would be required to make the same proportional reduction to the targeted expenditure categories regardless of its current mix of spending on administration and instruction. Furthermore, it is unclear who would review expenditure data to ensure districts made reductions in the required places, how this policy would be enforced, and what the penalties would be for noncompliance.
- **Proposal Would Counteract Recent Flexibility Provisions.** The LAO believes that the Governor's proposal also would work at cross-purposes with the flexibility options the state has recently granted to school districts.
- **Recommend Legislature Reject Governor's Proposal, Preserve Local Decision-Making Power.** The LAO recommends that the Legislature reject the Governor's

proposal to place new limits on how much districts spend on noninstructional activities. Districts confronting budget reductions need new options for how to respond, not new constraints.

#### **STAFF COMMENTS/STAFF RECOMMENDATIONS:**

**Overall Revenue Limit Proposals.** Staff supports the LAO's general recommendations that all three of the Governor's revenue limit reductions be delinked from the Governor's policy proposals.

With regard to the level of the Governor's revenue limit reductions for school districts and county offices of education, decisions about major program reduction programs will not likely occur until after May Revise, when the Legislature has determined the appropriate level of Proposition 98 funding in 2010-11.

**School District Non-Instructional Services Proposals.** Staff supports the LAO's position to reject the Governor's proposal to limit non-instructional services in school districts. Staff agrees that this policy conflicts with recently enacted policies that provide local educational agencies with greater flexibility in the use of state funds. For this reason, staff recommends that the Subcommittee reject this policy proposal after May Revise.

#### **SUGGESTED QUESTIONS**

1. Are the Administration's proposals meant to be temporary or permanent?
2. The Administration does not propose deficit factors for the 2010-11 revenue limit cuts. Since the Administration has supported deficit factors for all other revenue limit cuts for the last two years – what's the reason for the change in 2010-11?
3. How will non-instructional reductions be implemented?
4. How will non-instructional reductions be monitored and enforced?
5. What if school districts and county offices have already made significant administrative cuts to their budgets? Will they be protected by the hardship provisions proposed by the Administration?

**ITEM 6: Governor’s Budget – 2010-11 Revenue Limit Reductions – School District Contracting Out**

**DESCRIPTION:** The Governor proposes to reduce revenue limits by **\$300 million** for school districts and to remove existing restrictions affecting the ability of districts to contract out for non-instructional services. This reduction is part of the Governor’s **\$1.5 billion** proposal to reduce revenue limit reductions for school districts and county offices of education in 2010-11.

**BACKGROUND:**

Revenue limit apportionments provide general purpose funding for school districts and county offices of education. Revenue limits comprise roughly two-thirds of all Proposition 98 funding. The 2009-10 budget act provides a total of approximately \$30.6 billion in revenue limit funding to school districts and county offices of education. Ongoing K-12 base revenue limit apportionments were reduced significantly in 2008-09 and 2009-10 as a result of the state’s budget shortfall -- \$925 million in 2008-09 and an additional \$2.4 billion in 2009-10. In addition, K-12 base revenue limits were reduced by \$1.5 billion on a one-time basis in 2009-10. Deficit factors have been established for the ongoing base reductions – as well as foregone cost-of-living increases – as a symbol of intent to restore these levels when the state budget allows.

Under current law, school districts can contract out for many non-instructional services -- such as food service, maintenance, clerical functions, and payroll -- only if certain conditions are met. For example, contracting out for services cannot result in the layoff or demotion of existing district employees.

**SUMMARY OF GOVERNOR’S REVENUE LIMIT PROPOSALS.**

The Governor proposes a total of **\$1.5 billion** in revenue limit reductions – the largest reduction for K-12 education in 2010-11. There are three separate reduction proposals, as summarized below, that are each linked to policy proposals intended to create local savings.

<i>Proposal</i>	<i>Base Funding</i>	<i>Reduction</i>	<i>%</i>	<i>Per ADA* Equivalent</i>
<b>School Districts – Reductions Tied to Limitations on Non-Instructional Service Expenditures</b>	<b>\$31,475 m</b>	<b>\$1,184 m</b>	<b>4%</b>	<b>\$200/ADA</b>
<b>School Districts – Reductions Tied to New Contracting Out Authority</b>	<b>\$31,475 m</b>	<b>\$300 m</b>	<b>1%</b>	<b>\$50/ADA</b>
<b>County Offices of Education – Savings Tied to County Office of Education Consolidation *</b>	<b>\$595 m</b>	<b>\$45 m</b>	<b>7%</b>	<b>Between \$2.40 - \$30/ADA based on CDE estimates. **</b>
<b>TOTAL</b>		<b>\$1,529 m</b>		

\*Average Daily Attendance.

The Governor does not propose establishing deficit factors for any of these revenue limit reductions. Instead, the deficit factors would remain unchanged from their 2009-10 levels.

### **GOVERNOR'S BUDGET PROPOSAL -- SCHOOL DISTRICT REDUCTIONS FOR ADDITIONAL CONTRACTING-OUT AUTHORITY**

The Governor's proposal reduces revenue limits for school district (and charter schools) by **\$300 million**, beginning in 2010-11. In accordance with these reductions, districts are required to use contracting out authority – including new authority proposed by the Governor – to the maximum extent possible.

The Governor's proposal amends existing law governing contracting out for personal services to remove provisions that currently: (1) disallow approval of contracts solely on the basis of cost savings; and (2) disallow contracts if it causes displacement of school employees who previously provided the services.

This new authority would become effective for personal services contracts entered into after January 1, 2011.

Per the Governor's proposal, revenue limit reductions for school districts will be allocated per average daily attendance (ADA). For excess tax districts – commonly known as basic aid districts – reductions would be applied to the district's state categorical programs, with the following exclusions – Special Education, Child Care and Development, After School Education and Safety, and Quality Education Investment Act.

**TRAILER BILL:** The Governor proposes to add new statutes to implement revenue limit reductions and to link reductions to contracting out provisions. In addition, the Governor proposes to amend Education Code Section 45103.1, to remove contracting out restrictions for school districts. These provisions were added by Chapter 894; Statutes of 2002 (SB 1419). The Governor also includes statutory provisions to continue revenue limit deficit factors at 2009-10 levels in 2010-11.

### **RELATED LEGISLATION:**

**SBX8 61 (Huff)** This bill changes existing law governing non-instructional services contracting for school districts, by repealing existing law restricting the conditions under which a school district or community college is authorized to contract for personal services or food service management consulting services. In addition, the bill authorizes these entities to contract for these services if the governing board determines that the contract provides a benefit to the district and the contract is awarded in accordance with "applicable" Public Contract Code provisions. **Status:** Failed Passage in Senate Education on February 25, 2010.

**LAO COMMENTS/LAO RECOMMENDATIONS:** The LAO recommends approval of the Governor's language to remove restrictions on contracting out, but the LAO recommends removing the link between the policy proposal and the revenue limit funding reduction. The LAO provides the following details for their recommendations.

- **Governor Proposes to Modify State Restrictions on Contracting Out.** The Governor proposes to cut an additional \$300 million from school district revenue limits (roughly \$50 per ADA) and to modify restrictions that prohibit districts from contracting externally for non-instructional services. For example, districts would no longer be prohibited from contracting out based solely on savings they would get from lower contractor pay rates or benefits. They also would be able to layoff or demote a district employee who used to perform the service to be contracted out. Easing these restrictions would allow districts to more frequently bid on the open market for non-instructional services.
- **Proposal Could Result in Some Local Savings but \$300 Million Overly Optimistic.** To the extent local districts took greater advantage of contracting out, they likely would realize some cost savings at the local level. However, contractor availability, collective bargaining agreements, and existing service arrangements differ across the state, such that it is uncertain how much savings could be realized or how many districts would take advantage of the new flexibility. The LAO thinks assuming \$300 million in associated savings is overly optimistic. Depending on the percent of non-instructional services contracted out and the incremental reduction in cost, the LAO estimates total savings statewide could be as high as \$250 million or as low as \$50 million.
- **Savings Generated and Cut Applied Unlikely to Match.** Given the proposed cuts are to be spread across all districts regardless of the amount of contract savings they are able to achieve, the LAO thinks it is highly unlikely that the savings a particular district generates will be well aligned with that district's \$50 per ADA revenue limit reduction.
- **Recommend Approving Contracting Out Proposal but Without Link to Revenue Limit Reduction.** The LAO thinks district's identifying the most cost-effective options for meeting their needs makes sense. Therefore, the LAO recommends that the Legislature approve the Governor's proposal to waive the restrictions on contracting out for non-instructional services. Nonetheless, the LAO believes it is inappropriate to equate this proposal with an across-the-board revenue limit savings estimate, as individual districts could save more or less than their share of the \$300 million cut. Thus, the LAO recommends the Legislature make the statutory change on contracting without establishing any link to district revenue limit funding levels.

#### **STAFF COMMENTS/STAFF RECOMMENDATIONS:**

**Revenue Limit Proposals Overall.** Staff supports the LAO's general recommendations that all three of the Governor's revenue limit reductions be delinked from the Governor's policy proposals. With regard to the level of the Governor's revenue limit reductions for school districts and county offices of education, staff notes that decisions about major program reduction programs will not likely occur until after May Revise, when the Legislature has determined the appropriate level of Proposition 98 funding in 2010-11.

**School District Contracting Out.** Staff recommends that when votes on the revenue limit proposals are taken following May Revise the Subcommittee reject the Governor's revenue limit policy proposal that would remove restrictions in current law governing

school contracting out. The Conference Committee rejected a similar proposal in 2009. More recently, SB 61 (Huff) – 8<sup>th</sup> Extraordinary Session – failed passage in the Senate Education Committee

### **SUGGESTED QUESTION**

1. The Administration is proposing amendments to provisions of SB 1419 as a part of its contracting out proposal, instead of full repeal per the Administration's proposal last year. Can the Administration discuss the intent of their proposal?

**ITEM 7: Governor’s Budget – 2010-11 Revenue Limit Reductions –  
County Office of Education Consolidation**

**DESCRIPTION:** The Governor proposes to reduce revenue limit funding by **\$45 million** and to link the reduction to a plan that would require county offices of education to form regional consortia in order to consolidate functions, provide services at the regional level, achieve economies of scale, and reduce administrative costs. This reduction is part of the Governor’s **\$1.5 billion** proposal to reduce revenue limit reductions for school districts and county offices of education 2010-11.

**BACKGROUND:**

Revenue limit apportionments provide general purpose funding for school districts and county offices of education. Revenue limits comprise roughly two-thirds of all Proposition 98 funding. The 2009-10 budget act provides a total of approximately \$30.6 billion in revenue limit funding to school districts and county offices of education. Ongoing K-12 base revenue limit apportionments were reduced significantly in 2008-09 and 2009-10 as a result of the state’s budget shortfall -- \$925 million in 2008-09 and an additional \$2.4 billion in 2009-10. In addition, K-12 base revenue limits were reduced by \$1.5 billion on a one-time basis in 2009-10. In addition, K-12 base revenue limits were reduced by \$1.5 billion on a one-time basis in 2009-10. Deficit factors have been established for the ongoing base reductions – as well as foregone cost-of-living increases – as a symbol of intent to restore these levels when the state budget allows.

There are two basic categories of county revenue limit funding – funding for direct instruction to students and general purpose funding for school district services. While each county office uses this unrestricted portion of its revenue limit differently, activities generally include business support services, professional development, technology services, and credential monitoring for certificated staff.

**SUMMARY OF GOVERNOR’S OVERALL REVENUE LIMIT PROPOSALS.**

The Governor proposes a total of **\$1.5 billion** in revenue limit reductions – the largest reduction for K-12 education in 2010-11. There are three reduction proposals, each linked to policy proposals intended to create local savings, as summarized below.

<i>Proposal</i>	<i>Base Funding</i>	<i>Reduction</i>	<i>%</i>	<i>Per ADA* Equivalent</i>
<b>School Districts – Reductions Tied to Limitations on Non-Instructional Service Expenditures</b>	<b>\$31,475 m</b>	<b>\$1,184 m</b>	<b>4%</b>	<b>\$200/ADA</b>
<b>School Districts – Reductions Tied to New Contracting Out Authority</b>	<b>\$31,475 m</b>	<b>\$300 m</b>	<b>1%</b>	<b>\$50/ADA</b>
<b>County Offices of Education – Savings Tied to County Office of Education Consolidation *</b>	<b>\$595 m</b>	<b>\$45 m</b>	<b>7%</b>	<b>Between \$2.40 - \$30/ADA based on CDE estimates. **</b>
<b>TOTAL</b>		<b>\$1,529 m</b>		

\*Average Daily Attendance.

The Governor does not propose establishing deficit factors for any of these revenue limit reductions. Instead, the deficit factors would remain unchanged from their 2009-10 levels.

### **GOVERNOR’S BUDGET PROPOSALS – CONSOLIDATION OF COUNTY OFFICES OF EDUCATION:**

The Governor’s proposal requires the Legislative Analyst’s Office and Department of Finance – jointly with the California County Superintendents Educational Services Association – to develop a plan that results in a reduction of **\$45 million** in costs for county offices of education statewide. Per the plan, county offices of education would be required to form regional consortia in order to consolidate functions, provide services on the regional level, achieve economies of scale, and reduce administrative costs.

Beginning in 2010-11, funding to county offices of education would be reduced by \$45 million on a per ADA basis. For excess tax county offices, reductions would be applied to the county’s state categorical programs, with the following exclusions: Special Education, Child Care and Development, After School Education and Safety, and Quality Education Investment Act.

**TRAILER BILL:** The Governor proposes to add new statutes to implement this proposal. The Governor also includes statutory provisions to continue revenue limit deficit factors at 2009-10 levels in 2010-11.

**LAO COMMENTS/LAO RECOMMENDATIONS:** The LAO believes the Governor’s proposal has some merit, but recommends implementing a more structured regionalization plan. Specifically, the LAO recommends: (1) reducing general purpose funding for each county office of education by 10 percent (\$33 million), and (2) redirecting an additional 10 percent (\$33 million) into new county office of education regional revenue limits. The LAO provides the following details for their recommendations:

- **Concept Has Merit, Lacks Detail.** While some room for further consolidation of services across county offices likely exists, county offices currently face no explicit prohibitions on working more collaboratively on a regional basis. Because the administration’s plan is not yet fully developed, it remains unclear how the Governor envisions county offices might seek further regionalization of services. The LAO thinks that the Legislature should do more to encourage cooperation than simply cut county office funding and hope they choose to work together.
- **Recommend More Structured County Office Regionalization Plan.** To help address the state’s budget shortfall, the LAO recommends reducing county office revenue limits by 10 percent, or about \$33 million—somewhat less than the Governor’s proposed 15 percent cut. The LAO also recommends creating a new “regional” revenue limit to establish a formal structure for sharing funding and services at the regional level. Specifically, the LAO recommends redirecting an

additional 10 percent of each county office's unrestricted revenue limit funding into a regional COE revenue limit to be shared by all of the county offices in that region.

- **Within New Structure, Regions Have Flexibility.** The LAO's proposed framework would require county offices of education to communicate and collaborate over how to best use limited resources to meet the needs of the school districts in their region. Under the LAO's approach, each of the state's existing 11 education regions would select one county office to be the fiscal agent over their share of this new \$33 million grant. Spending decisions, however, would be shared among all the county offices in the region. The resulting arrangements likely would differ based on the individual characteristics of the regions and the strengths and needs of each county.

#### **STAFF COMMENTS/RECOMMENDATION:**

**Revenue Limit Proposals Overall.** Staff supports the LAO's general recommendations that all three of the Governor's revenue limit reductions be delinked from the Governor's policy proposals. With regard to the level of the Governor's revenue limit reductions for school districts and county offices of education, staff notes that decisions about major program reduction programs will not likely occur until after May Revise, when the Legislature has determined the appropriate level of Proposition 98 funding in 2010-11.

**County Office Consolidation Proposal.** Staff also supports the LAO's view that the Governor's policy proposal to pursue consolidation of the general purpose activities of county offices of education has merit. For this reason, staff recommends that the Subcommittee direct the LAO to work with Department of Finance and the California County Superintendents Educational Services Association to develop a consolidation plan. This approach is in keeping with the Governor's proposal. The plan could be presented to the Subcommittee at or closely following May Revise.

#### ***SUGGESTED QUESTIONS***

1. Is the Governor's plan for county offices tied to any larger, long-term policy goal for county offices of education?
2. Counties offices of education statewide have already organized themselves into eleven contiguous regions reflective of size and proximity. What is the purpose of these regions?

**ITEM 8: Governor's Budget – 2010-11 Cost-of-Living Adjustments**

**DESCRIPTION:** The Governor proposes to apply a negative cost-of-living adjustment (COLA) of **-0.38 percent** for K-12 education programs in 2010-11. This equates to a savings of **\$201 million** for K-12 revenue limit apportionments and categorical funds.

**BACKGROUND:**

Current law requires that a COLA be applied annually to revenue limits and most K-12 categorical programs in order to reflect the higher costs that schools face due to inflation. According to the LAO, COLAs are not statutorily provided for community colleges, but are typically provided for apportionments (general purpose funds) and some categorical programs based upon the K-12 COLA rate.

The statutory K-12 COLA is based on an index that measures changes in costs experienced by state and local governments. School districts generally use COLAs to provide annual increases to employee salaries and address cost increases for local operating expenses, including employee benefits, utilities, materials, and supplies.

Due to the state budget crisis, the state has not provided COLAs in recent years—foregoing K-12 COLAs of 5.66 percent in 2008-09 and 4.25 percent in 2009-10. Deficit factors were established in both these years to keep track of the foregone COLA for revenue limit programs, so revenue limit funding could eventually be restored to previous base levels. The Legislature is not required to create a deficit factor for revenue limits when no COLA is provided; however, the Legislature has adopted the practice of establishing deficit factors for revenue limit programs -- based upon statutory COLA rates -- when COLA has not been provided.

**Current COLA Index.** The current index used to calculate COLA for K-12 education and community colleges is the state and local government price deflator (GDPSL). This index is calculated by the federal government to reflect changes in costs experienced by state and local governments. The GDPSL includes the following components, summarized by the LAO:

- **Employee Compensation** - salaries and benefits for government employees.
- **Services** - utilities and contracted services, such as financial, professional, and business services.
- **Structures/Gross Investments** - capital outlay, construction and deferred maintenance.
- **Durable Goods** - books, tools, and equipment.
- **Nondurable Goods** - gasoline, office supplies, and food.

**GOVERNOR'S BUDGET PROPOSAL:**

The Governor proposes to reduce the K-12 revenue limit and most categorical programs by a total of \$201 million to implement a negative statutory COLA rate of -0.38 percent for these programs in 2010-11. According to the LAO, for the first time in over 60 years,

the index used to calculate the K-12 COLA is negative (-0.38 percent). Per the LAO, this suggests the recession has led to a decrease in government costs; implying school districts might be able to purchase the same goods and services for less money.

The \$201 million in savings created by the Governor’s proposal includes \$150 million which results from school district and county office revenue limits, \$45 million from various categorical programs, and \$6 million for child care, as summarized below.

**Governor’s K-12 COLA Proposal**

<i>Dollars in Millions</i>	<b>Estimated COLA Rate</b>	<b>Revenue Limit Reduction</b>	<b>Categorical Program Reduction</b>	<b>Child Care Reduction</b>	<b>Total</b>
<b>School Districts</b>	<b>-0.38</b>	<b>-\$147 million</b>	<b>-\$45million</b>	<b>-\$6 million</b>	<b>-\$198 million</b>
<b>County Offices of Education</b>	<b>-0.38</b>	<b>-\$3 million</b>			<b>-\$3 million</b>
<b>Total</b>	<b>-0.38</b>	<b>-\$150 million</b>	<b>-\$45 million</b>	<b>-\$6 million</b>	<b>-\$201 million</b>

In addition to the \$201 million in savings for K-12 programs, the Governor proposes savings of \$23 million from applying a -0.38 percent COLA to community college programs.

**LAO COMMENTS/RECOMMENDATION:** The LAO recommends rejecting the Governor’s proposal and, instead, notwithstanding statutory COLA provisions. In the LAO’s view, applying a negative COLA after years of not providing a positive COLA is unreasonable. The LAO does recommend applying the negative COLA to revenue limit deficit factors. More specific detail on the LAO’s recommendations is provided below.

- **Unreasonable to Apply Negative COLA After Not Applying Positive COLAs.** While the recession could be resulting in some lower costs for schools, the LAO believes applying a negative COLA is unreasonable. Given the state did not provide positive COLAs in recent years (and has made program reductions), school funding has not kept pace with inflation over the last few years.
- **Recommend Not Providing COLA.** As it has in the past two years, the LAO recommends the Legislature waive the statutory COLA provisions and avoid making inflationary adjustments to K-12 programs in 2010-11. As the state has continued to adjust the revenue limit “deficit factor” for changes in the cost of living, the LAO would further recommend making the comparable downward adjustment to this future obligation.

**STAFF COMMENTS/RECOMMENDATIONS:**

Staff recommends that at May Revise the Subcommittee approve the LAO recommendation to provide zero COLA for K-12 programs if COLA is still estimated to

be negative at that time. Staff concurs with the LAO that it seems unreasonable to apply a negative COLA since positive COLAs have not been provided for K-12 education programs in either 2008-09 or 2009-10. As a result, assuming the Governor's current levels of Proposition 98 spending in 2010-11, reductions of \$201 million will be required for other education programs, most likely revenue limits.

Staff further recommends that the Subcommittee adopt the LAO's recommendation to adjust the revenue limit deficit factors downward in 2010-11 to reflect the negative COLA. Since deficit factors by their nature track foregone COLA adjustments, it is reasonable to count both positive as well as negative adjustments.

Beginning in 2008-09, the Governor proposed to switch the current COLA index to a modified version of the California Consumer Price Index for Wage Earners and Clerical Workers. The LAO agreed with the need for an alternative, but recommended modifying the current K-14 COLA index to focus more heavily on projected compensation cost increases that the Administration considered. At that time, both the Administration and the LAO had concerns with the existing K-12 COLA Calculation (GDPSL) because it is heavily weighted by costs that do not affect schools and community colleges. For example, the LAO then noted that schools typically spend about 85 percent of their annual budget on employee salaries and benefits, however employee compensation comprises only about 5-6 percent of the current COLA index. In addition, both the Administration and the LAO recommended that their alternative to the current COLA index take effect in a year when no COLA was being provided. Per the LAO, 2008-09 was an ideal time for the change for this reason.

Prior to May, Staff also suggests that the Subcommittee reconsider proposals developed by the Administration and LAO to change the basis for calculating COLA to better reflect the costs for K-12 education. These alternative calculations could be presented and discussed at a future Subcommittee hearing. If there is consensus that these alternatives more closely track school expenditures, there may be an opportunity for changing the calculation beginning in 2010-11 when negative COLA factor is being recommended by the Administration.

#### **SUGGESTED QUESTIONS:**

1. Have the Administration or LAO reconsidered their 2008-09 proposals to change the COLA calculations to better reflect school district costs? With a current negative statutory rate, would this be a good time to make the change?