OVERVIEW OF THE 2013-14 BUDGET BILL
Subcommittee No. 1

Senate Bill 65

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Senate Committee on Budget and Fiscal Review

Senator Mark Leno, Chair

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SUBCOMMITTEE NO. 1

EDUCATION

K-12

Higher Education

K-12 Finance – Local Control Funding Formula

BACKGROUND:

Current K-12 School Finance System. The state currently appropriates more than **$47 billion** annually to public schools. Of this amount, **$33 billion** (about 70 percent) is distributed to schools through revenue limit apportionments and most of the remaining **$14 billion** (about 30 percent) is distributed through different categorical program allocations.

Revenue limits provide basic apportionments to schools on a per pupil basis. Revenue limits provide discretionary (unrestricted) funding to schools that can be used for general education purposes.

Categorical programs provide individualized funding streams for specialized (restricted) purposes. There are currently about 60 different state categorical programs, each with its own funding allocation and program requirements.

Recent Categorical Funding and Flexibility. As a means of meeting education budget shortfalls, state budgets have granted K-12 schools substantial funding flexibility since 2008-09. Currently, the state allows K-12 schools to use about **$4.4 billion** in categorical funds "for any educational purpose". This flexibility has been granted to **38 categorical programs** for a seven year period ending in 2014-15. Funding for these individual programs continues – reflecting overall reductions of nearly 20 percent – that will also continue through the end of 2014-15.

District allocations for categorical programs in the flexibility program are based generally upon the proportion of state funding the district received for each program in 2008-09. Under current law, these district proportions will continue through 2014-15, with no adjustments for enrollment (growth or decline). Under this scenario, declining enrollment districts benefit financially from higher funding proportions for up to seven years and growing districts lose since they retain lower funding proportions for up to seven years.

Governor Proposed Weighted Pupil Formula in 2012-13 Reflecting Warren Institute Brief. Last year, the Governor proposed a new K-12 finance formula – known as the Weighted Pupil Formula. The new formula was based upon a modified version of the formula recommended by an issue brief published by the Warren Institute in 2008.[1] The Weighted Pupil Formula included two key features recommended by the Warren Institute brief: (1) base funding and (2) supplemental funding for low-income students and English learners. The Legislature did not adopt the Governor's new formula last year.

[1] Alan Bersin, Michael W. Kirst, and Goodwin Liu. *Getting Beyond the Facts: Reforming California School Finance*, The Chief Justice Earl Warren Institute on Race, Ethnicity & Diversity, University of California, Berkeley Law School, April 2008.

GOVERNOR'S PROPOSAL:

Problems with Existing School Finance System. According to the Governor's State of the State message, California's public school finance system is **"overly complex, bureaucratically driven, and deeply inequitable."**

The Governor's Budget Summary makes strong statements about the current K-12 finance system. Per the Governor, the current funding system is a "relic of the past, where program allocations have been frozen and no longer reflect changing student needs." There are many different funding streams, each with their own allocation formula and spending restrictions. The system is also state-driven in that it requires local districts to perform certain activities that interfere with ability of local officials to best meet the needs of students.

The Governor also states that scholarly research and practical experience indicate that low-income students and English language learners come to school with unique challenges and often require supplemental instruction and support services to be successful in school.

Lastly, the Governor believes that the current school finance system provides few incentives for school districts to offer innovative educational programs that increase student success.

In proposing a new finance system for K-12 schools, the Governor has developed specific goals to:

- Increase local controls and reduce state bureaucracy.
- Ensure that student needs drive the allocation of resources.
- Increase transparency in school funding, empowering parents and local communities to access information in a more user-friendly manner and enhance their ability to engage in local school matters.
- Ensure sufficient flexibility and accountability at the local level so those closest to the students can make the decisions.

Governor's Overall Funding Flexibility and Accountability Plan. To remedy problems with the existing school finance system, the Governor proposes a new K-12 school finance system – the Local Control Funding Formula – beginning in 2013-14. The new funding formula provides significant and permanent additional flexibility to local districts by consolidating the vast majority of state categorical programs and revenue limit apportionments into a single source of funding. Notably, the Governor proposes an additional **$1.6 billion** in Proposition 98 funding to begin implementation of the new formula in 2013-14.

The formula will distribute these combined resources to schools using base grants and funding supplements that account for the variability in costs of educating specific student populations, thereby ensuring that funds will continue to be targeted to districts with large populations of educationally disadvantaged pupils.

The funding formula will be phased in over a period of seven years, estimated to be completed by 2019-20, and will provide an additional **$15 billion, plus COLA,** to K-12 schools districts, county offices of education, and charter schools statewide over the 2012-13 funding levels.

This new funding formula is coupled with a newly-proposed system of accountability that will accompany implementation of the new funding formula in 2013-14. While details are not fully known, the Governor proposes a new accountability system "to focus on core requirements and outcomes expected of schools to better integrate accountability with the local school district budget process." The new system also maintains academic performance and federal accountability requirements, as well as fiscal and budgetary controls.

Specific Features of the Governor's Local Control Funding Formula & Appropriations.

The Governor proposes an increase of **$1.6 billion** to implement a new **Local Control Funding Formula** for school districts, county offices of education, and charter schools beginning in 2013-14. The formula would be phased in over a seven year period, estimated to be completed by 2019-20, with an estimated **$15 billion, plus COLA,** in new Proposition 98 funding for K-12 schools.

The proposed Local Control Funding Formula collapses K-12 revenue limit apportionments and most of the nearly 60 state categorical programs into one formula accompanied by new accountability requirements. Major features of the new formula are summarized below:

- **Base Grants.** The new formula establishes a base funding grant "target" for each school district, county office of education, and charter school based upon grade span funding levels multiplied by the number of students – measured by student average daily attendance (ADA), as follows:

  $**6,342** for grades K-3
  $6,437 for grades 4-6
  $6,628 for grades 7-8
  $7,680 for grades 9-12

  The Governor also proposes two special grade span adjustments -- an additional 11.2 percent class size reduction adjustment for grades K-3, and an additional 2.8 percent career technical education adjustment for grades 9-12.[2]

- **Supplemental Grants**. The formula also provides additional funding for educationally disadvantaged pupils based upon a percentage of base grant funding. Specifically, school districts, county offices of education, and charter schools receive an additional **35 percent** in base grant funding for low-income students, English learner students, and students residing in

[2] Qualifications for additional class size reduction and career technical education adjustments are not fully known at this time. To date, the Administration has indicated that in future years, districts would have to maintain class sizes of 24 or fewer students in order to qualify for K-3 grade span adjustment, unless other agreements were collectively bargained at the local level.

foster care. (These are unduplicated pupil counts so students are not counted more than once.)

School districts and county offices of education with larger proportions of disadvantaged pupils receive supplemental "concentration" grants. More precisely, per pupil amounts would increase another **35 percent** above base grant funding for unduplicated counts of educationally disadvantaged students that exceed 50 percent of the total district enrollment. Charter schools are also eligible for concentration grants but must not exceed proportions of disadvantaged students for the districts where they reside.

Supplemental and concentration grant calculations are applied to base grants by grade span, but do not include special grade span adjustments for class size reduction and career technical education.

- **New Target Funding Levels & Growth.** Under the Governor's plan, a new unique "target" funding grant would be established for districts, county offices, and charter schools reflecting base grants (including basic and special grade spans adjustment) and supplemental grants (including concentration grants). In allocating an estimated $15 billion in new funding over the next seven years; districts further from the target level would receive a larger share of new funds and districts with funding above the targeted level would receive no additional funds. Each district below the target would receive same proportional amount.

- **Cost-of-Living Adjustments (COLAs).** The Governor's proposes $15 billion to implement the new formula over seven years. This figure would increase based upon annual COLA adjustments, which will be provided to target grant for each district, county office, and charter school target grant during (and after) this timespan. COLAs would not be provided for the Targeted Instructional Improvement Grants (TIIG) and Home-to-School (HTS) programs, but would be provided to other separate categorical programs currently subject to annual statutory COLAs.

- **Hold Harmless Provisions.** The Governor proposes to hold districts harmless from any loss of per pupil funding beginning in 2013-14. So no district will experience a loss in funding below their 2012-13 level as a result of the new formula.

- **Restoration of Revenue Limit Losses.** The Governor proposes to begin restoration of recent revenue limit reductions and foregone COLAs by eliminating current "deficit factors" and providing $15 billion, plus COLAs, to phase in the new formula by 2019-20. This is accomplished by building the new targets based on the average "undeficited" revenue limit rates ($6,816 per student).

  Since deficit factors are restored on the statewide average through the base grant structure, there will be some variability in what increases each district, county office or charter school receives through the new formula compared to repayments under the current revenue limit system.

- **Flexibility Provisions.** Funding for all of the programs that will be replaced by the Governor's new formula will immediately be made completely flexible for use in supporting any locally determined educational purpose. As such, the Governor proposes to eliminate most of the programmatic and compliance requirements for programs under the existing finance system. (Many of these current statutory requirements are already on hold as a result of categorical flexibility granted to about 40 state categorical programs from 2008-09 through 2014-15.)

- **Categorical Program "Add-Ons".** The Governor proposes to exclude two categorical programs – TIIG and HTS Transportation – from the new formula. Districts that currently receive funding for these programs would continue to receive funding as a permanent "add-on" to the new formula. The Governor's plan "locks" funding in at existing allocations, but makes funds flexible so districts can use funds for any educational purpose.

- **Excluded Programs.** The Governor proposes to exclude a number of programs from the new formula and continues these programs as separate categorical programs, such as Special Education, After School Education and Safety, Child Nutrition, Preschool and various programs that are not distributed to all districts (High-Speed Internet Access, Fiscal Crisis Management and Assistance Team, etc.).

- **County Funding.** The Governor's plan includes a new two-part funding formula for county offices of education. The first part would provide a per-student allocation for students educated in county-operated alternative schools, including court schools. The second part would provide funding for general operations and support for school districts and would be allocated based upon the number of students and number of districts in the county.

- **Accountability System.** The Governor proposes a new accountability system to accompany the new funding formula in 2013-14. The new plan requires that all school districts produce and adopt a Local Control and Accountability Plan concurrent and aligned with each district's annual budget and spending plan. Plans are required to address how districts will use state funding received through the new funding formula toward improvement in the following categories:

    - Basic conditions for student achievement, including qualified teachers, sufficient instructional material, and school facilities in good repair.
    - Programs or instruction that benefit low-income students and English language learners.
    - Implementation of Common Core content standards and progress toward college and career readiness, as measured by the Academic Performance Index, graduation, completion of college preparatory classes, and career technical education.

  While the Governor's proposal would eliminate the programmatic and compliance requirements associated with current funding streams rolled into the new formula, the proposal would retain federal accountability requirements, academic performance requirements, as well as fiscal and budgetary controls.

Education Programs Included in New Formula. The Governor's Local Control Funding Formula proposal consolidates revenue limit apportionments and more than 40 of the state's categorical programs in 2013-14, as reflected in the table below.

In summary, the new formula would encompass a total of about **$40.4 billion** in existing K-12 funding in 2012-13, including **$32.9 billion** in revenue limit entitlements and **$7.5 billion** in categorical funding.

The additional **$1.6 billion** proposed by the Governor for growth, brings total funding for the new formula to **$42.0 billion** in 2013-14.

K-12 Programs Included in the Local Control Funding Formula
(Dollars in Thousands)

Item	Program	2012-13		Item	Program	2012-13
				208	Civic Education	200
104	Summer School Programs	336,246		209	Teacher Dismissal Apportionments	38
105	ROC/Ps	384,708		211	Charter Schools Block Grant	211,583
107	County Office Oversight	4,370		211	Charter EIA	123,956
108	Grade 7-12 Counseling	167,056		212	Charter Start Up	20,015
119	Foster Youth Programs	15,096		227	Community Based English Tutoring	40,082
122	Specialized Secondary Program Grants	4,892		228	School Safety Block Grant	79,932
124	Gifted and Talented	44,225		232	High School Class Size Reduction	78,950
128	Economic Impact Aid	944,447		682	Statutory K-3 CSR	1,270,000
137	Professional Development Institutes for Math and English	45,476		240	Advanced Placement Grant Programs	2,443
144	Principal Training	3,928		242	Student Leadership/CA Association of Student Councils	26
156	Adult Education	634,805		243	Pupil Retention Block Grant	76,675
158	Adults in Correctional Facilities	14,967		244	Teacher Credentialing Block Grant	90,404
166	Partnership Academies	21,428		245	Professional Development Block Grant	218,380
167	Agricultural Vocational Education	4,134		266	County Office (Williams)	8,016
181	Educational Technology	14,073		247	School and Library Improvement Block Grant	370,000
188	Deferred Maintenance	250,826		248	School Safety Competitive Grant	14,349
189	Instructional Materials Block Grant	333,689		260	Physical Education Block Grant	33,519
190	Community Day Schools	41,685				
193	Staff Development	25,957		265	Arts and Music Block Grant	87,987
195	National Board Certification	2,405		267	Certificated Staff Mentoring	8,583
198	California School Age Families Education Program	46,419		268	Oral Health Assessments	3,527
204	California High School Exit Exam	58,322		6360-101	Alternative Credentialing	26,191
					Subtotal, Categorical Programs	$6,164,010
				111	Home to School –Add On	495,991
				246	TIIG—Add On	855,131
					Subtotal, Categorical Add-Ons	$1,346,243
					Subtotal, Categorical Programs	**$7,515,132**
					Subtotal, Revenue Limit Apportionments	**$32,929,583**
					TOTAL	**$40,444,715**

Programs Excluded from the New Formula.

The Governor proposes to exclude a total of **12 categorical programs** – accounting for about **$4.9 billion** in state funding -- from the Local Control Funding Formula. These programs, which would be retained as separate categorical programs subject to program requirements and funding allocations, are listed in the table below.

K-12 Categorical Programs Excluded from the Local Control Funding Formula		
Budget Item	**Program**	**2012-13**
107	County Office of Education Oversight	4,799
113	Student Assessments Programs	$72,688
150	American Indian Early Education Programs	540
151	Indian Education Centers	4,006
161	Special Education	3,314,927
182	K12 Internet Access	8,340
196	State Preschool Program (Part Day/Part Year Preschool)	480,761
201	Child Nutrition	1,017
203	Child Nutrition	156,673
220	Charter School Facility Grants	92,031
295	Mandates Block Grant	166,609
649	After-School Education and Safety Services (Proposition 49)	546,965
	Subtotal	**$4,849,356**

The Governor would exclude some categorical programs from the new funding formula for some specific purposes, such as meeting federal maintenance of effort (MOE) requirements. Two large programs – special education (the largest by far) and child nutrition – are excluded for this purpose.

Another large program, the After School Education Safety program, is excluded because it was authorized by a state ballot measure – Proposition 49.

The state preschool program, which provides education programs for low-income three and four-year olds, is excluded by the Governor because it is not a K-12 program.

Most – but not all – other programs appear excluded because they are considered state-level programs or projects, such as student assessments, fiscal and program oversight, and shared technology.

Another large categorical program excluded from the Governor's weighted pupil formula is the Quality Education Investment Act (QEIA). This program is not reflected on the Governor's list of excluded programs, probably because it is a limited-term program.

The Governor's proposal involves state funded programs only, and therefore does not include $**6.9 billion** in funding for more than 20 federal programs for K-12 schools in 2012-13.

Impact of New Funding Formula on Local Educational Agencies (LEAs).

The Administration has indicated it will release data in the next few weeks that will identify funding levels for school districts, county offices, and charter schools under the Governor's proposed Local Control Funding Formula.

While the specific impact of the new formula is not yet known, there will likely be some districts who earn more and some districts that earn less than they would have under existing formulas, although all districts are held harmless from any loss of funding below 2012-13 per pupil funding rates. In general, districts with larger numbers and concentrations of educationally disadvantaged pupils will receive more supplemental funds, while those districts with fewer disadvantaged pupils will not receive comparable supplements.

Governor's Related K-12 Budget Proposals.

Adult Education and Apprenticeship Realignment. The Budget proposes to consolidate administration of Adult Education and Apprenticeship programs within the California Community Colleges. Currently Adult Education programs are funded and administered by both K-12 school districts and community colleges. The Governor proposes to eliminate this bifurcated system and create a more accountable and centralized adult education learning system within the community colleges.

The Budget proposes **$315.7 million** in Proposition 98 funding for community colleges for this purpose in 2013-14. Of this amount, **$300 million** is new Proposition 98 funding and **$15.7 million** is shifted from the K-12 Apprenticeship Program. The Budget proposes to allocate funding for the consolidated program through a new Adult Education Block Grant based upon the number of adults served.

(The Governor's Adult Education proposal is included as a separate topic in this report.)

Charter Schools. The Budget proposes the following changes, intended to address financial and operational challenges for charter schools identified by the Governor:

- Shifting the Charter School Facility Grant Program and the Charter School Revolving Loan Program from the Department of Education to the California School Finance Authority to improve the efficiency of charter school program administration and disbursement of funds to local charter schools. The Authority already administers similar programs.

- Modifying the funding determination process for non-classroom based charter schools by limiting it to the first and third years of operation, in most instances. Charter schools that are found to be out of compliance with minimum standards and applicable laws will be required to comply with annual funding determinations.

- Expanding the Charter Schools Facility Grant Program to include eligibility for non-classroom based charter schools, as these schools still have facility needs for instructional support.

- Extending for five additional years, the 2012-13 requirements that school districts with identified surplus property and facilities first offer to sell those resources to charter schools before selling them to other entities or disposing of those assets.

Special Education. The Governor proposes to retain the Special Education programs outside of the new Local Control Funding Formula. However, the Budget includes the following proposals intended to simplify and consolidate special education funding in order to address funding inequities and inefficiencies in these programs. As such, the Budget includes the following:

- Eliminating the integration of federal funds in the state's AB 602 calculation and treating both funding streams separately to remove unnecessary complications in the formula and help equalize funding among special education local plan areas.
- Consolidating funding for several special education program add-ons into the base AB 602 formula calculation, while collapsing another 15 special education add-on programs into 12 based on similar activities.

The Governor's proposal does not affect funding for realignment of mental health services for special education. These funds will continue to be set aside for this purpose.

School Facility Funding Flexibility. The Governor proposes to make permanent provisions of current law that provide temporary funding flexibility to K-12 schools. Without extension, these statutory provisions are set to expire over the next two years. The Governor proposes the following changes:

- **Routine Maintenance Contributions**. Eliminate the minimum contribution requirement for routine maintenance.

- **Deferred Maintenance Program Matching Requirement.** Eliminate the required local district set-aside for deferred maintenance contributions.

- **Surplus Property.** Allow districts to use the proceeds from the sale of any real and personal surplus property for any one-time general fund purposes.

ISSUES TO CONSIDER:

Governor's Plan to Streamline School Finance System is Very Positive Overall. The Governor's plan clearly simplifies an overly complicated and confusing K-12 finance system. Additionally, the Governor's plan substantially reinvests state categorical funding based upon student needs. In so doing, the plan eliminates illogical and inequitable funding allocations which characterize the state's current funding system for K-12 schools.

According to the LAO, the Governor's proposal to restructure the way the state allocates K–12 funding has many strong components. Most importantly, it would replace a complicated, top–down system with one that is more transparent, better linked with student costs, and locally driven. It also would transition gradually to the new system, ensuring that the vast majority of districts receive funding increases in 2013–14 and the coming years, while simultaneously making progress towards a more rational distribution of funds.

Though the Governor's overall school finance plan has considerable merit, the LAO believes the Legislature could strengthen it by making a few modifications. A couple of these recommendations are highlighted in the following sections.

Governor's Plan Builds Upon Research and Input from Stakeholders. There is broad based consensus among the research community that the K-12 system is deeply flawed. Most notably, the "Getting Down to Facts" studies and reports from the Governor's Committee on Education Excellence, both published in 2007, identify major problems with the existing system.

The proposed Local Control Funding Formula replaces the Weighted Pupil Formula proposed by the Governor last year, but includes some similar and some new features based upon input from education stakeholders.

As originally proposed last year, the Weighted Pupil Formula was based upon a modified version of the formula recommended by an issue brief published by the Warren Institute in 2008.[3] The Governor's new Local Control Funding Formula includes two components recommended by the Warren Institute brief: (1) base funding and (2) supplemental funding for low-income students and English learners. While not specifically recommended, the Warren Institute brief contemplated grade span adjustments for base grants, which are also reflected in the Governor's Local Control Funding Formula.

Administration Views Accountability as Critical Companion to Local Funding Flexibility, But Current Concept Needs Strengthening. The Governor's new funding formula is coupled with a newly-proposed system of accountability that will accompany implementation of the new funding formula in 2013-14. While details are not fully known, the Governor appears focused more on a locally-based system that tracks core requirements (access to qualified teachers, adequate textbooks, facilities in good repair, specialized instruction/programs for low-income students and English language learners, access to Common Core standards), as well as student and school outcomes. The Governor also proposes to maintain academic performance and federal accountability requirements, as well as fiscal and budgetary controls currently in place. However, under the Governor's plan, it is not clear what role the state or counties, if any, would play in monitoring, supporting, and assuring the basic conditions of education and strong academic outcomes for students statewide. This will be an important issue for the Legislature to consider.

[3] Alan Bersin, Michael W. Kirst, and Goodwin Liu. *Getting Beyond the Facts: Reforming California School Finance,* The Chief Justice Earl Warren Institute on Race, Ethnicity & Diversity, University of California, Berkeley Law School, April 2008.

Governor Estimates $15 Billion in Additional Proposition 98 Funding over the Next Seven Years to Grow the New Formula. The LAO's November forecast projected a more robust economy beginning in 2013-14 and beyond, that would provide notable growth for the Proposition 98 guarantee. More recently, the LAO has indicated that the Governor's plan would notably improve the outlook for schools for four years following 2013-14. The Governor's plan for rolling out the new formula depends upon healthy Proposition 98 revenues.

Governor's Holds Schools Harmless from Per Pupil Funding Losses and Eventually Restores Revenue Limit Funding Lost Since 2007-08. The Governor proposes to hold districts harmless from the loss of per pupil funding beginning in 2013-14, so no district will experience a loss in total per pupil funding as the new formula is implemented. In addition, the Governor proposes to begin restoration of revenue limit cuts and foregone COLA since 2007-08. This is accomplished by building restoration of "undeficited" revenue limits into the new statewide average base grant of $6,816 per student. However, since deficit factors are restored on the statewide average through the base grant structure, there will be some variability in what increases each district, county office or charter school receives through the new formula compared to repayments under the current revenue limit system. Are there still districts that will lose funding over the next seven years?

Cost-of-Living Adjustments (COLAs) Resumed and Applied to All Funding within the New Formula Beginning in 2013-14. COLAs have not been provided in recent years for revenue limits and categorical programs as required by statute. The Governor proposes funding to provide a 1.65 percent COLA in 2013-14 – as a part of the $1.6 billion in new funding -- for all funding in the new formula. While COLAs have not been funded in recent years, under current law they are required for revenue limits and <u>some</u> categorical programs. The Governor proposes to apply to all funding in the new formula – except the TIIG and HTS categorical program "add-ons" -- which may reflect a larger base and additional COLA for schools.

Administration Says Poverty Measures Not Perfect, But May Be Best Available. The Governor's proposal would use the number of pupils reported by schools as eligible for free- or reduced-price meals (FRPM) as the measure of economic disadvantage. Given the importance of the poverty factor, is this an accurate measure? Have other options been explored, such as Title I census data? What are the limitations of census data, for example does it prevent calculation of unduplicated counts of educationally disadvantaged students? What about other census data in California – is it available by district? Does the addition of students residing in foster care in any way strengthen free- and reduced-price meal counts? How many districts utilize direct certification of free- and reduced-price lunches?

Governor's Plan Limits Timeframe for English Learner-Only Counts in Determining Supplemental Funding. The Governor's proposal adds a new element with regard to English learner student counts under the new formula for purposes of supplemental and concentration grant funding. The Governor's plan continues to use the number of pupils identified by schools as "English learners" as the measure for English learner pupils. However, the Governor now proposes to authorize supplemental and concentration grant funding for an English learner for up to five years. The Administration estimates that approximately 75 percent of English learner pupils statewide are low-income under the Governor's proposal. Since English learner pupils who remain low-income or reside in foster care will continue to be counted, this time limit appears to limit counts for English learner-only students. That said, what is the Governor's rationale for the new time limits for English learners? Additionally, what is known about the percentage of English learner students who are not low-income?

Substantial Overlap of Educationally Disadvantaged Students Counts Used for Supplemental Funding. The Governor's proposal utilizes unduplicated student counts – including low-income students, English learner students and students in foster care – as the basis of supplemental and concentration funding under the new formula. The Governor has added students residing in foster care to supplemental counts to the new formula proposal this year. However, because all students residing in foster care also qualify for free- and reduced-price lunch, by definition, there should be no increase in unduplicated student counts. As mentioned above there is significant overlap between low-income and English learner student counts, with only 25 percent of English learners who do not also qualify as low-income. Last year the Administration estimated that 60 percent of students statewide would be included in the unduplicated, counts of disadvantaged students. Is this figure still accurate?

Not Clear Yet How Governor's Plan Assures Supplemental Funding is Used for Benefit of Students that Generate Funding. Per the Administration, the Governor's school finance proposals are intended to empower local school officials to determine the best use of scarce resources. In so doing, the Governor proposes to eliminate most of the program and funding requirements for most categorical funds, including statute for many needs-based programs. Given the historic under-performance of low-income students, English learner students, and students in foster care, are there funding requirements under current law that should be retained for these students, at least until the new formula is fully funded? What more can be done to achieve the Governor's stated goals to increasing transparency in school funding, empowering parents and local communities to access information in a more user-friendly manner and enhance their ability to engage in local school matters.

<u>As mentioned previously, the LAO recommends that the Legislature work with the Administration to explore ways to ensure that districts are using supplemental funds to benefit disadvantaged students.</u>

Governor's Plan Permanently Increases Proportion of "Unrestricted" Funding for Districts and Converts Most Existing Categorical Funding to a Continuous Appropriation. The LAO estimates that the Governor's plan would make about 91 percent of state funding available to schools as discretionary funding. Currently, the LAO estimates that about 85 percent of state funding is available to schools as discretionary (unrestricted) funding, available for general purposes. (This estimate reflects the current categorical flex program in place from 2008-09 through 2014-15. Prior to categorical flexibility, the LAO estimates that about 75 percent of state funding was available as discretionary funding.)

Per the Governor's proposal, more than 40 separate budget items for existing state categorical programs have been removed from the annual budget bill. While trailer bill language has not yet been released, the Governor proposes to appropriate all funding rolled into the new funding formula through continuous appropriation in statute.

Grade Spans Added by Governor's Latest Proposal Better Reflect Cost Variances for Elementary, Middle, and High Schools. The Warren Institute brief did not specifically recommend a base formula for each grade-span. However, the brief did raise grade-span base funding levels as a question for policymakers to consider in moving forward with a weighted pupil formula. What was the rationale for these funding levels? What is known about the true education cost differences for different elementary, middle, and high school pupils? The Governor also proposes a different funding level for lower elementary (grades K-3) and upper elementary (grades 4-6). In addition, the Governor proposes special grade span adjustments for class size reduction in grades K-3 and career technical education in grades 9-12. What is the rationale for these adjustments?

Categorical "Add Ons" Proposed by Governor Undermine Equity Goals. As a part of his new K-12 funding formula, the Governor proposes to exclude two large categorical programs from the new funding formula, and to provide separate funding for these programs beginning in 2013-14. Funding for the TIIG and HTS programs – would be permanently "added on" to amounts districts receive under the Governor's new formula. Funding would be limited to districts that currently receive funding. These districts would be locked into their existing allocations; however, districts could use all of the "add-on" funding for any education purpose.

The TIIG and HTS programs are two large and very inequitable state categorical programs. In fact, TIIG and HTS may be two of the most inequitable state funding programs. While originally intended as needs-based programs, current funding allocations are highly inequitable reflecting historical funding levels and uses that are no longer clearly tied to need. Funding is limited to districts that currently receive funding. The Governor's plan would lock in these in amounts for districts and lock out funding for other districts based upon any reasonable measure of need.

<u>The LAO has concerns about the "particularly antiquated" funding formulas for the TIIG and HTS programs, and therefore does not support the Governor's proposal to exclude these two programs from the new formula.</u>

Governor Excludes Special Education from New Formula, But Recommends Other Reforms to Consolidate Funding and Improve Transparency. The special education formulas were updated in the late 1990s, and as such, might not fit into the targeted pupil formula. However, given the size and complexity of this categorical program – the largest state categorical program – is there room for some reform to make allocations more equitable, streamlined, and transparent?

Governor's Plan Provides More Equitable Funding for Charter Schools. The Governor's new formula provides funding for school districts, county offices, and charter schools. This appears to make charter school funding the same as funding for districts and county offices. The Governor also proposes to increase access to all charter school funding for non-classroom based charter schools.

K-14 Adult Education

BACKGROUND:

Adult Education's Primary Purpose. The primary purpose of adult education to provide persons 18 years and older with the precollegiate-level knowledge and skills they need to participate in society and the workforce.

The typical types of students served by adult education programs include: (1) immigrants who want to learn English, obtain citizenship, and receive job training; (2) native English speakers who are illiterate or only can read and write simple sentences; (3) high school dropouts who want to earn a diploma for General Educational Development (GED) high school equivalency certificate to increase their employability or attend college; (4) high school graduates who seek to earn a college degree but have not yet fully mastered reading, writing, or math at precollegiate levels; and (5) unemployed persons or unskilled workers earning low wages who seek short-term vocational training to improve their economic conditions. Adult education also serves older adults who want stay active physically and mentally, as well as parents seeking to learn effective techniques for raising their children.

Providers and Students. According to the LAO, more than 400 state-funded entities provide adult education, including 112 community colleges and about 300 K-12 adult schools. Data is incomplete, but it is estimated that 1.5 million students (headcount) were served in 2009-10 (latest estimate available). This estimate translates to about 550,000 full-time equivalent (FTE) students. (Data is incomplete because state funding for K-12 adult education programs was made flexible in 2008-09 and school districts are no longer required to report data on students served.)

System Governance and Coordination. As noted, both K-12 school districts and community college districts currently provide adult education. Adult education is not a "core" mission for either system.

For K-12 school districts, the core statutory and constitutional responsibility is for elementary and secondary education.

For community college districts, the primary mission is to offer academic and vocational education at the lower division level for both recent high school graduates and those returning to school. Another primary mission is to advance the state's economic growth and global competitiveness through education, training, and services that contribute to continuous workforce improvement. In addition, current law provides that essential and important functions include: basic skills instruction, providing English as a second language, adult noncredit instruction, and support services that help students to succeed at the postsecondary level. Finally, community colleges are also authorized to provide community service courses and programs, so long as their provision is compatible with an institution's ability to meet its obligations in its primary missions.

Throughout the adult education program's history, several legislative clarifications have been attempted and lawsuits have been filed, yet today adult education remains a bifurcated responsibility of both K-12 school and community college districts. Therefore, there is a lack of clarity about governance and coordination of adult education. As a result, instructional areas overlap in the two segments.

There are ten state-supported and state-authorized instructional areas, which K-12 and community college districts can both provide: (1) adults with disabilities; (2) apprenticeship; (3) vocational/career technical education; (4) immigrant education in citizenship and workforce preparation; (5) elementary and secondary education; (6) English as a second language; (7) health and safety, including exercise and fitness classes; (8) home economics; (9) older adults; and (10) parenting. Of these ten areas, community colleges provide instruction on both a credit and non-credit basis for the following: (1) adults with disabilities; (2) apprenticeship; (3) vocational education; (4) elementary and secondary education; (5) English as a second language; and (6) health and safety.

Figure 2

Adult Education Includes a Wide Array of Instructional Areas

Instructional Area	Adult Schools	CCC Noncredit	CCC Credit
Adults with disabilities	X	X	X
Apprenticeship	X	X	X
Vocational education[a]	X	X	X
Immigrant education (citizenship and workforce preparation)	X	X	
Elementary and secondary education	X	X	X
English as a second language	X	X	X
Health and safety[b]	X	X	X
Home economics	X	X	
Older adults	X	X	
Parenting	X	X	

[a] Also referred to in statute as career technical education.
[b] Includes exercise and fitness classes.

Funding Amount and Source. The LAO estimates that more than $2 billion in total funding was spent in 2011-12 for adult education programs, of which about $1.7 billion supported community colleges and about $400 million supported K-12 adult schools. The largest funding sources are state General Fund and local property tax revenues, which together comprise Proposition 98 funding. In addition, this total also includes student fees and federal funds.

The primary source of federal funds is Workforce Investment Act (WIA) Title II funds, of which the state received $91 million in 2011-12. Per the LAO, these funds are utilized to support instruction in adult elementary education, adult secondary education, and English as a second language. A total of 169 K-12 adult schools ($59 million), 17 community colleges with non-credit programs ($13 million), and 38 other providers such as libraries and community-based organizations ($7 million) received WIA funding. The remaining $12 million in funding is retained by the California Department of Education (CDE) to administer the program, as well as to support statewide activities such as professional development. Per the Budget Act of 2012, and beginning with the 2013-14 grant cycle, CDE is required to reopen the WIA Title II grants to new applicants as well as introduce performance measures that track student transitions from adult education to postsecondary studies and the workforce.

In addition to WIA funds, federal Perkins funding also supports vocational programs offered by K-12 adult schools and community colleges. In 2011-12, K-12 adult schools and community colleges received $8 million and $55 million in Perkins funds, respectively.

Funding Methodology. Historically, K-12 adult schools were funded based on reimbursements of average daily attendance for adult education students in districts participating as of a specific date. Beginning in 2008-09, state funding levels were reduced and a 15 percent across-the-board cut was implemented. This cut deepened to 20 percent in 2009-10 and has remained at that reduced level since then. Also in 2008-09, the state allowed K-12 school districts to “flex” their adult education funding and use it for any purpose. As a result, districts were no longer required to report data on the whether funds were expended for adult education, and, if so, how many adults were served. While actual data is not available, the LAO surveyed K-12 districts and estimated that only between 40 to 50 percent of the $635 million provided in Proposition 98 adult education funding in 2011-12 was spent for that purpose. Per the LAO, this equated to about $400 million in 2011-12.

Within the community colleges, enrollment funding can be used for both credit and non-credit instruction. The funding is allocated on a per-student (FTES) basis. In 2012-13, course rates are as follows: (1) credit rate, regardless if coursework is degree applicable or non-degree applicable, of $4,565; (2) regular non-credit rate, such as for home economics and programs designed for older adults, of $2,745; and (3) enhanced non-credit rate, for coursework in career development and college preparation, of $3,232.

Similar to K-12 school districts, community college funding has decreased in recent years. This has resulted in smaller adult education programs as many districts have targeted non-credit instruction for a disproportionate share of cuts. Statewide, the number of non-credit FTES served in 2011-12 was about 30 percent lower compared to 2008-09 levels.

Recent LAO Report Identifies Key Strengths but Many Weaknesses. In its December 5, 2012, report entitled, *“Restructuring California’s Adult Education System,”* the LAO found that the state’s adult education system possesses some key strengths, including having two large systems with extensive experience working with adult learners throughout the state, a data system that can measure learning gains for at least some students, and an innovative policy that allocates federal funds to providers based on performance. However, the LAO review also identified a number of major problems, including: (1) an overly broad mission; (2) lack of clear delineations between precollegiate (adult education) and collegiate coursework at the CCC; (3) inconsistent state-level policies; (4) widespread lack of coordination among providers; and (5) limited student data, which impairs the public’s ability to hold the system accountable for performance.

The LAO also found that, over the past few years, the role of adult education in California has become even more clouded, as the Legislature has allowed K-12 school districts to use, for any education purpose, GF monies that previously have been dedicated to adult education.

In conclusion, the LAO found that adult education in California is a complex, confusing, and incoherent system in need of a comprehensive restructuring. The LAO's proposal to restructure the adult education system is discussed further in the "*Issues to Consider*" section below.

GOVERNOR'S PROPOSAL:

- ✓ Provides an increase of $315.7 million Proposition 98 GF to realign adult education from K-12 education and within the community college system, in order to eliminate the current bifurcated system and create a more accountable and centralized adult education learning system within the community colleges.

- ✓ Of the total funding, $300 million is new Proposition 98 GF funding to community colleges to reconstitute the adult education program within that system, and $15.7 million is a fund shift of the Apprenticeship Program from the K-12 system to the community college system.

- ✓ The $300 million in adult education funding will be allocated from a new categorical block grant based on the number of students served and only for the following six core instructional areas: (1) vocational education; (2) English as a second language; (3) elementary and secondary education; (4) citizenship; (5) apprenticeship; and (6) adults with disabilities. With this restriction, funding will be refocused away from non-mission areas and savings reinvested for additional courses in mission areas such as basic skills and workforce training. If community colleges offer non-mission courses, students will be required to pay the full cost of instruction.

- ✓ The budget bill contains placeholder language directing the California Community Colleges Chancellor's Office to develop an adult education expenditure plan for submittal to the Department of Finance by July 1, 2013. Budget trailer bill language to implement the reconstitution of the adult education program within the community colleges will also be proposed.

- ✓ The Administration indicates that the adult education funding level will be reassessed in the future based on program participation and effectiveness. Community colleges will also be encouraged to leverage the capacity and expertise currently available at the K-12 adult schools.

- ✓ The $15.7 million in apprenticeship program funding shifted to the community colleges is restricted for that programmatic purpose. Its expenditure is controlled by budget bill provisional language in the community college budget that mirrors 2012-13 budget bill provisional language contained in the CDE's budget item, including retention of an annual reporting requirement.

ISSUES TO CONSIDER:

LAO Proposal to Restructure the Adult Education System. In its December 5, 2012, report entitled, *"Restructuring California's Adult Education System,"* the LAO recommended a comprehensive restructuring that retained the comparative advantages that K-12 adult schools and community colleges currently have in delivering adult education. Though comparative data on student outcomes are limited, the LAO reported that research suggests that K-12 adult schools and community colleges perform equally well at educating adult learners. Therefore, in proposing a restructuring, the LAO built upon each segment's strengths while also addressing current problems, as summarized on the next page.

Current System	New System Under LAO Proposal
Authorizes ten state-supported instructional programs that serve various purposes.	Focuses on the six instructional programs most closely aligned with adult education's core mission.
Lacks a clear and consistent distinction between adult education and collegiate instruction.	Clearly distinguishes between adult education and collegiate education.
Applies inconsistent and conflicting policies regarding faculty qualifications, fees, and student assessments at adult schools and community colleges.	Applies a consistent set of policies for faculty and students at adult schools and community colleges.
Misses opportunities to create strong collaborations between adult schools and community colleges.	Creates a funding mechanism for adult education that promotes a coordinated system centered on student access and success.
Fails to collect key data needed to fully evaluate the effectiveness of the adult education system.	Collects some data on student enrollment and outcomes for both adult schools and community colleges. Links the respective data systems.

Adult Education a Priority in 2013-14 Budget. As emphasized by the recent LAO report, the state's existing adult education system has a number of problems, not the least of which is its bifurcated governance structure between K-12 school districts and community college districts, which results in an inefficient system that is not always structured in the best interests of adult learners. The Governor's budget would coordinate the efforts of the two segments with the stated intent to, *"eliminate the current bifurcated system and place community colleges in a position to improve coordination at the regional and statewide levels."*

The Governor should be commended for identifying adult education reform as a high state priority. At this juncture, many aspects of the Administration's proposal remain undefined or under-defined, in large part due to the fact that budget trailer bill language has not yet been transmitted to the Legislature. However, the overall approach presents a number of questions for the Legislature to consider as outline below.

Two Different Proposals to Restructure Adult Education. Given the LAO proposal described above, the Legislature effectively has before it two different proposals to restructure the state's adult education program. While the proposals share some similarities, such as the definition of "core" instructional areas (discussed further below), the plans differ significantly. The Governor's proposal would reconstitute the adult program within the community college system while the LAO's proposal would maintain the program at both K-12 and community college districts, building on each segment's strengths yet with significant policy reforms. The Governor's proposal would allocate funding to community colleges based on existing service levels, while the LAO's proposal includes a dedicated revenue stream that would provide the same funding rate for the same instruction, reward providers for student success, and align future allocations with program need. Both proposals warrant further consideration by the Legislature.

Both LAO and Governor Refocus Adult Education on Programs within Core Instructional Areas. Both the LAO and Governor's proposals continue funding authority for adult education programs within "core instructional areas" defined to include: vocational education, English as a second language, elementary and secondary education, citizenship, apprenticeship, and adults with disabilities. As a result, the proposals would continue funding for six programs currently authorized for both K-12 schools and community colleges. Four adult education programs that do not clearly fit within these core areas are not continued for funding under either proposal. Programs excluded by the plans include: health and safety (including exercise and fitness classes), home economics, older adults, and parenting classes. The plans' focus on elementary and secondary education and English as a second language reflects programs also authorized under federal adult education programs (Title II Workforce Investment Act.)

Governor's Proposed Funding Allocations within the Community Colleges in Need of Improvement. Community colleges vary significantly in terms of the extent to which they consider adult education to be part of their educational mission. This results in wide variation across the state in terms of the availability of adult education instruction at community colleges. As such, some districts might not be prepared to assume responsibility for adult education programs. Yet the Governor's plan would allocate funds to community colleges based solely on existing service levels. Going forward, this could build a significant inequity into the adult education system. It is also worth noting that, absent specific requirements about the expenditure of the $300 million, the funding could simply support existing service levels at the community colleges as opposed to expanding adult education offerings in the six core instructional areas. These policy considerations will likely become more well-defined once the Administration releases budget trailer bill language.

Different Treatment of Apprenticeship Funds under Governor's Plan. Similar to K-12 education, the 2009 budget also provided categorical flexibility for the community colleges. Included in the "flexed" programs is a community college-based apprenticeship program and $7.2 million in funding. Since 2009, roughly $69,000 per year has been transferred out of the apprenticeship program and into other categorical programs. Overall, less than $2 million per year each year has been transferred, out of total funding of roughly $440 million. This outcome could be construed several ways, including: (1) the community college apprenticeship program is critical, so districts have not used the enhanced flexibility; or (2) because the flexibility is temporary, districts have chosen not to exercise the option due to concerns that when the flexibility expires the programs will be reinstituted. It would be difficult to draw the conclusion that flexibility within the community colleges signaled lower priority programs, as so little funding has been transferred with programs. While the Governor's plan continues to flex the $7.2 million for community college apprenticeship programs, the Governor takes a different approach for K-12 apprenticeship funds. Specifically, the Governor proposes to shift $15.7 million in funding from the K-12 Apprenticeship program to community colleges; however, the Governor does not "flex" the program funding. Therefore, when community college flexibility expires in 2014-15, these issues will warrant further consideration by the Legislature.

Administration of Adult Education Programs Continues at Department of Education Under Governor's Plan. The Governor's proposal does not address adult education state operations program administration costs. Even though the budget reconstitutes the adult education program within the community colleges, CDE would retain the roughly 38 positions that currently provide oversight of state K-12 adult education programs, as well as administration of the federal WIA Title II and Perkins adult education. The budget also does not contain any state operations augmentation for the Chancellor's Office to administer the program. These choices warrant further consideration by the Legislature as it considers the budget proposal.

K-12 Adult Education Funding Already Reduced and Redirected to Other Programs Reflecting Lower Priority for Many School Districts. Statutes enacted in 2008-09, granted K-12 school districts the authority to use adult education – and nearly 40 other state categorical funds – for "any education purposes." In other words, districts are not required to use these funds for adult education. Under current law, this funding flexibility will continue through 2014-15. According to surveys conducted by the LAO, most school districts appear to be utilizing this flexibility for adult education funds. More specifically, 80 percent of school districts last surveyed by the LAO are redirecting funds away from adult education. The LAO estimates that of the $635 million appropriated for adult education in 2012-13, about $400 million (roughly 40 to 50 percent) is being spent for that purpose. The Administration estimates that school districts are currently expending less than half of the $635 million – about $300 million – for adult education programs in 2012-13.

Despite Consolidation of Administration at Community Colleges, Governor's Proposal Continues Current K-12 Funding Levels for K-12 Adult Education Making Continued Access to K-12 Adult Education Programs Possible. The Governor's proposal does not shift funding the $635 million in existing K-12 adult education funds to community colleges. Instead, the Governor retains these funds in the K-12 system and – along with nearly 50 other state categorical programs – rolls them into a new Local Control Funding Formula (discussed in detail in a separate section of this report). It would be up to K-12 districts to continue programs reflecting local needs and priorities. Understanding current adult education funding is flexed, the Governor's proposal does not represent a big change to current law, which continues through 2014-15. While the Governor plans to eliminate the statutory requirements for adult education, K-12 schools could decide to continue these programs under their own local authority.

Governor Adds New Funding to Reinvest in Adult Education System That Could Support Continuation of Adult Education Now Provided by K-12 Schools. The Governor adds $300 million in new Proposition 98 funding to the community colleges budget for adult education, to reinvest in adult education statewide. The $300 million reflects the Administration's best estimate of current adult education expenditure levels in the K-12 system. The LAO estimates expenditures of $400 million for K-12 adult education. While the Governor's plan consolidates state administration and funding of adult education programs within the community colleges, the plan clearly contemplates community college contracts with some existing K-12 adult education programs statewide.

Governor's Proposal Could Improve Access to Adult Learning Opportunities – Both Career and Higher Education. Adult education programs, as they currently exist, do not fit clearly within the mission of either K-12 schools or community colleges. That said, programs for adult learners appear a much closer fit for the community colleges, since – as stated by the Administration – serving adult learners is the system's core function. In addition, community colleges can offer opportunities for connecting adult learners to a full continuum of adult vocational and higher education opportunities.

Loss of physical access (proximity) to K-12 adult education programs in neighborhoods has been raised as a concern with the Governor's proposal. While there are about 300 K-12 adult school sites and 112 community colleges statewide, community college also operate 70 official centers and other satellite locations. In addition, both K-12 adult education and community colleges offer classes in a variety of settings – such as school sites, community centers, libraries, churches, storefronts, and job sites – in order to locate programs to best reach adult learners. Additionally, as mentioned earlier, the Governor's proposal contemplates that community colleges could contract with existing K-12 adult education programs.

Governor's Proposal Provides an Opportunity to Adopt Improvements in Adult Education Funding and Accountability -- As Recommended by the LAO. The basic intent of the Governor's proposal is "*to create a more accountable and centralized adult education learning structure.*" The Governor will provide more details for his proposal soon, however the need for consistent data and stronger accountability systems for adult education are much needed. In addition, the existing adult education funding allocations for both the K-12 education and community colleges are seriously flawed – resulting in funding distributions that are neither needs based or equitable. In the K-12 system, existing funding allocations are also outdated reflecting historical funding levels limited to districts that participated at a particular point in time.

According to the LAO, the performance-based funding and accountability system utilized by the federal WIA programs in California is commendable. Among several recommendations related to improving adult education funding allocations and accountability, the LAO recommends that adult education funds be based ultimately upon adult need and performance. Under the LAO's long term plan, adult education needs would be determined regionally, utilizing census data such as adults with less than a high school diploma and adults who do not speak English at home, as well as, regional unemployment rates, and poverty rates. At this time, the Governor's proposes to allocate funding based upon existing delivery patterns at the community colleges.

Governor's Proposal Also Provides an Opportunity to Adopt Consistent Policies on State Faculty Qualifications, Fees, and Assessment – As Also Recommended by the LAO. The Governor proposal states intent to create a more centralized and coordinated adult education system. While full details of the Governor's proposal are not yet available, the Governor's plan to consolidate administration and funding could also include changes to make differing and confusing state adult education policies more consistent. For example, the LAO recommends eliminating the credential requirement for K-12 adult education instructors but not required for community college instructors. The LAO also recommends changing state law to allow for a modest fee (such as $25 per course) for all adult education courses, to reconcile differing fee structures in place across the state. In addition, the LAO recommends that adult schools and community colleges align their different assessment and placement standards and practices to better serve students.

K-14 Education: Proposition 39

BACKGROUND:

The budget includes a proposal for expenditure of funds derived from the recently passed Proposition 39 ballot initiative. This initiative adjusts the way corporate taxes are calculated and provides for expenditures for energy efficiency and school funding for a period of five years.

State Corporate Income Taxes. The amount of money a business owes the state in corporate income taxes each year is based on the business' taxable income. For a business that operates both in California and in other states or countries (a multistate business), the state taxes only the part of its income that was associated with California. While only a small portion of corporations are multistate in nature, multistate corporations pay the vast majority of the state's corporate income taxes. This tax is the state's third largest General Fund revenue source, raising $9.6 billion in 2010-11.

Multistate Businesses Choose How Their Taxable Income Is Determined. Prior to the passage of Proposition 39, state law allowed most multistate businesses to pick one of two methods to determine the amount of their income associated with California and taxable by the state, with multistate businesses generally allowed to choose the method that is most advantageous to them for tax purposes:

> <u>"Three-Factor Method" of Determining Taxable Income</u>. One method uses the location of the company's sales, property, and employees. When using this method, the more sales, property, or employees the multistate business has in California, the more of the business' income is subject to state tax.
>
> <u>"Single Sales Factor Method" of Determining Taxable Income</u>. The other method uses only the location of the company's sales. When using this method, the more sales the multistate business has in California, the more of the business' income is taxed. For example, if one-fourth of a company's product was sold in California and the remainder in other states, one-fourth of the company's total profits would be subject to California taxation.

Energy Efficiency Programs. There are currently numerous state programs established to reduce energy consumption. These efforts are intended to reduce the need to build new energy infrastructure, such as power plants and transmission lines, and help meet environmental quality standards. For example, the California Public Utilities Commission (CPUC) oversees various types of energy efficiency upgrade and appliance rebate programs that are funded by monies collected from utility ratepayers. In addition, the California Energy Commission (CEC) develops building and appliance standards that are intended to reduce energy consumption in the state.

School Funding Formula. Proposition 98, passed by voters in 1988 and modified in 1990, requires a minimum level of state and local funding each year for public K-12 schools and community colleges. This funding level is commonly known as the Proposition 98 minimum guarantee. Though the Legislature can suspend the guarantee and fund at a lower level, it typically decides to provide funding equal to or greater than the guarantee.

The Proposition 98 guarantee can grow with increases in state General Fund revenues (including those collected from state corporate income taxes). Accordingly, a measure such as Proposition 39 that results in higher revenues results in a higher school funding guarantee.

Proposition 98 expenditures are the largest category of spending in the state's budget, totaling roughly 40 percent of state General Fund expenditures.

Proposition 39 Ballot Initiative Eliminates Ability of Multistate Businesses to Choose How Taxable Income Is Determined. Under this measure, starting in 2013, multistate businesses are no longer allowed to choose the method for determining their state taxable income that is most advantageous for them. Instead, most multistate businesses would have to determine their California taxable income using the single sales factor method. Businesses that operate only in California would be unaffected by this measure.

Proposition 39 also includes rules regarding how all multistate businesses calculate the portion of some sales that are allocated to California for state tax purposes. These include a set of specific rules for certain large cable companies.

Proposition 39 Provides Funding for Energy Efficiency and Alternative Energy Projects. This measure establishes a new state fund, the Clean Energy Job Creation Fund, to support projects intended to improve energy efficiency and expand the use of alternative energy. The measure states that the fund could be used to support:

1. Energy efficiency retrofits and alternative energy projects in public schools, colleges, universities, and other public facilities;
2. Financial and technical assistance for energy retrofits; and
3. Job training and workforce development programs related to energy efficiency and alternative energy.

The Legislature would determine spending from the Clean Energy Job Creation Fund and be required to use the monies for cost-effective projects run by agencies with expertise in managing energy projects. The measure also: (1) specifies that all funded projects must be coordinated with CEC and CPUC and (2) creates a new nine-member oversight board to annually review and evaluate spending from the fund.

The Clean Energy Job Creation Fund would be supported by some of the new revenue raised by moving to a mandatory single sales factor. Specifically, half of the revenues so raised—up to a maximum of $550 million, would be transferred annually to the Clean Energy Job Creation Fund. These transfers would occur for only five fiscal years, from 2013-14 through 2017-18.

GOVERNOR'S PROPOSAL:

2012-13 Proposition 39 Funding Proposal. The budget includes a $426 million increase in the Proposition 98 minimum guarantee for K-12 schools and community colleges as a result of new revenues generated by Proposition 39 in 2012-13. The budget does not direct these funds for any specific purpose.

The budget does not propose any funding for an energy efficiency program in 2012-13 since Proposition 39 does not require establishment of such a program until 2013-14.

The budget assumes $440 million in total Proposition 39 revenues in 2012-13, of which $426 million is appropriated for Proposition 98 pursuant to Test 1 calculations utilized by the Administration. The remaining $14 million in Proposition 39 revenues provides General Fund savings in 2012-13.

2013-14 Proposition 39 Funding Proposal. The budget provides a $520 million increase in the Proposition 98 minimum guarantee for K-12 schools and community colleges as a result of new revenue generated by Proposition 39 in 2013-014.

The budget proposes to allocate all energy efficiency funding required by Proposition 39 <u>within</u> the $520 million in Proposition 98 funding provided under his plan. Specifically, the budget proposes to expend $450 million of the $520 million in Proposition 98 funds to establish a new Energy Efficiency Program for K-12 schools and community colleges in 2013-14.

Of the $450 million proposed for the Energy Efficiency Program in 2013-14, $400.5 million (89 percent) is appropriated to K-12 schools and $49.5 million (11 percent) is appropriated to community colleges. The Department of Education and the Community College Chancellor's Office would be responsible for allocating funding on a per student basis within their respective systems.

The budget estimates $900 million in total Proposition 39 revenues in 2013-14. Under the Governor's calculations, which assume Test 3 factors applied to total estimated Proposition 39 revenues, the Proposition 98 minimum guarantee increases by $520 million in 2013-14. The budget proposes $380 million in remaining revenues as General Fund savings in 2013-14.

2014-15 through 2017-18 Proposition 39 Funding Proposals. The Governor proposes to continue energy efficiency funding for K-12 schools and community colleges at $500 million for four additional years, from 2014-15 through 2017-18. This assumes $1.0 billion in total Proposition 39 revenues, with half provided for energy efficiency per the proposition during this timeframe. (The Governor's proposal is limited to these four years, since Proposition 39 does not require energy efficiency funding beyond 2017-18.)

Proposition 39 Energy Efficiency Investment Program Parameters. The budget approach for each year the Proposition 39 revenues are available is intended to make a substantial energy efficiency imprint throughout the state with the reduction in utility costs and in turn assisting schools and community colleges in recovering from budgetary reductions implemented over the past five years.

The Department of Education and the Chancellor's Office will be responsible for distributing funding, and may consult with both the CEC and the CPUC to develop guidelines for prioritizing the use of the funds. The *Budget Summary* indicates the guidelines will reflect the state's energy "loading order," which guides the state's energy policies and decisions according to the following order of priority: (1) decreasing electricity demand by increasing energy efficiency; (2) responding to energy demand by reducing energy usage during peak hours; (3) meeting new energy generation needs with renewable resources; and (4) meeting new energy generation needs with clean fossil-fueled generation. Schools and community colleges will be able to use Proposition 39 funding consistent with the state's loading order policies and guidance to undertake energy efficiency measures including, but not limited to, the construction or modernization of buildings in a manner that uses less energy, purchasing energy efficient equipment, as well as undertaking renewable energy projects like installation of solar panels and geothermal heat pumps.

Local schools and community colleges may use Proposition 39 funds for technical assistance to help identify, evaluate, and implement appropriate projects. Schools and community colleges will also be encouraged to partner on their energy efficiency projects with the California Conservation Corps' Energy Corps program and participating community conservation corps programs, which provide career technical education and on-the-job work experience in the energy efficiency and renewable energy industry sectors. Upon project completion, schools and community colleges will report their project expenditure information to the Department of Education and the Chancellor's Office, respectively. The Administration will work with the Department of Education, the Chancellor's Office, and the Citizens Oversight Board to ensure these funds are used by schools and community colleges in a manner that is consistent with Proposition 39.

This proposal includes budget trailer bill language.

ISSUES TO CONSIDER – PROPOSITION 98 FUNDING:

Differing Views on Calculation of Minimum Guarantee for Proposition 39 Revenues. The Governor applies Proposition 98 calculations to the total amount of Proposition 39 revenues for purposes of calculating the minimum guarantee. According to the LAO, state revenues are excluded from the Proposition 98 minimum guarantee calculations if the Legislature cannot use them for general purposes, typically due to restrictions created by a voter-approved initiative or constitutional amendment. Per the LAO, the Proposition 39 voter guide reflected this interpretation by indicating that funds required to be used for energy-related projects would be excluded from the Proposition 98 calculation. As a result, the LAO recommends that the Legislature exclude from the Proposition 98 calculation all Proposition 39 revenues required to be used on energy-related projects. The LAO recommendation would reduce the minimum guarantee to roughly $260 million, half of the $520 million proposed by the Governor.

Differing Views on Providing Energy Efficiency within Proposition 98. The Governor counts all revenue raised by Proposition 39 toward the Proposition 98 calculation and then funds energy efficiency projects within this amount. The Governor does not provide non-Proposition 98 funding for energy efficiency. According to the LAO, the Governor's approach is a serious departure from how revenues are to be treated for the purposes of Proposition 98. The LAO also believes this approach is contrary to how the official voter guide described the treatment of revenues to statewide voters. In response, the LAO recommends the Legislature count the $450 million in allocations for energy efficiency projects as non-Proposition 98 expenditures. The Legislature could choose to spend a portion on schools and community colleges per the LAO, although this is not the LAO's specific recommendation.

Total Funding for Schools and Community Colleges Using LAO Approach. A plan to provide $450 million in energy efficiency funding to schools and community colleges coupled with the two LAO recommendations above would result in roughly $190 million in additional operational Proposition 98 support for schools and community colleges in 2013-14. As indicated below, total state savings would decline by the same amount.

Bottom-line General Fund Savings. The Governor's Proposition 39 proposal results in General Fund savings of about $380 million in 2013-14. The LAO recommendations above would provide total savings of roughly $190 million, half the $380 million proposed by the Governor.

ISSUES TO CONSIDER – ENERGY EFFICIENCY:

Per Pupil Allocation of Energy Funding to Schools and Community Colleges Not Needs Based. The Governor proposes to provide school districts $400.5 million and community college districts $49.5 million for energy efficiency projects. The Administration proposes to allocate this funding to districts on a per-student basis, with school districts and community college districts receiving $67 and $45 per student, respectively. Per the LAO, the Governor's approach providing every school district and community college district with the same per-pupil funding does not tie the funding with potential benefits. Instead, according to the LAO, the Governor's plan presumes the potential for energy savings is equal among all districts and does not focus on those school and community college energy projects likely to provide the greatest energy and job benefits. Most notably, the LAO asserts that the Governor's approach does not take into account that the need for energy efficiency projects varies by district, with the need depending on the size, age, and climate zone of the facilities in each district.

Lack of Program Structure and Guidelines Could Challenge Districts to Achieve Energy Efficiencies. The *Budget Summary* describes a process whereby the Department of Education and the Chancellor's Office, who are responsible for distributing funds, may consult with the CEC and CPUC to develop guidelines for prioritizing the use of the funds. Why this is permissive, as opposed to required, is unclear. Proposition 39 specifies that all funded projects must be coordinated with CEC and CPUC. Even if this were not the case, it is illogical to distribute these funds without clear structure and guidelines. Absent this specificity, each district individually would be left to decipher what is prioritized under Proposition 39 and it is questionable if a substantial energy imprint could actually be achieved.

Why Only K-12 Schools and Community Colleges? The *Budget Summary* identifies K-12 school facilities as the single largest capital outlay investment made by the state since the mid-1990s. From 1998 to present, the state has invested more than $30 billion in school bond funding to modernize and construct school facilities. Therefore, the Administration asserts that schools and community colleges are well positioned to undertake projects that reduce their current utility requirements and expand the use of renewable energy sources.

The state has made a similar investment in higher education facilities. In the last ten years, the LAO reports that the state spent an estimated $10.1 billion on higher education infrastructure; 80 percent of that support came from general obligation bonds and an additional 19 percent from lease-revenue bonds. UC and CSU have similarly seen their budgets significantly reduced in recent years. UC and CSU are also just as well positioned as school and community college districts "*to undertake projects that would reduce their current utility requirements and expand the use of renewable energy sources*," yet UC and CSU are excluded from receiving any Proposition 39 funds under the Governor's plan. This choice warrants further consideration by the Legislature as it begins its review of the budget proposal for expenditure of Proposition 39 revenues.

Are There Other Ways to Maximize Energy Efficiency and Job Benefits? Proposition 39 requires that the Clean Energy Job Creation Fund maximize energy and job benefits by, among other things, supporting energy efficiency retrofits and alternative energy projects in public schools, colleges, universities, and other public facilities. Proposition 39 specifically states that projects must be selected based on the number of in-state jobs they would create and their energy benefits. According to the LAO, by dedicating all the energy-related funding over the five-year period only to schools and community colleges and excluding other eligible projects that potentially could achieve a greater level of benefits, the Governor's proposal very likely would not maximize state energy and job benefits. The LAO believes that a more effective approach would be to first evaluate the relative energy savings and job benefits among all potential projects.

The state currently has programs that both benefit energy efficiency and jobs through the California Conservation Corps (Corps), a department designed to provide job training to at-risk young adults. As an example, one Corps program provides energy efficiency audits of businesses, enabling the businesses to reduce energy usage while teaching Corps program participants about energy efficiency in the workplace—a dual benefit. The Governor's proposal states that schools may permissively consult or contract with the Corps; however, this scenario is highly unlikely given that the Corps program does not fall directly under the K-14 education umbrella.

Can Funding Be Appropriated Directly to Education? Proposition 39 requires that monies from the Clean Energy Job Creation Fund be appropriated only to agencies with established expertise in managing energy projects and programs. Proposition 39 also requires that funding be coordinated with the CEC and CPUC to avoid duplication and maximize leverage of existing energy efficiency and clean energy efforts. As the LAO states, the Governor's proposal does not appear to adhere to these provisions. Specifically, because the funding is to be appropriated to CDE and the Chancellor's Office, the Governor's proposal might not meet the Proposition 39 provision requiring funds be provided only to agencies with established energy-project expertise. Additionally, the Governor indicates that CDE and the Chancellor's Office have the option to consult with CEC and CPUC, despite Proposition 39 requiring more formal CEC and CPUC involvement.

Higher Education – Multi-Year Plan

BACKGROUND:

California's public higher education system involves three "segments": the University of California, the California State University, and the California Community Colleges. It also includes the Hastings College of the Law. The state's Master Plan for Higher Education, originally adopted in 1960, ascribes distinct missions to each of the segments and expresses a set of general policies for higher education in the state, including the state's intent that higher education remain accessible, affordable, high-quality, and accountable.

University of California (UC). Drawing from the top 12.5 percent of the state's high school graduates, the UC educates approximately 239,500 undergraduate and graduate students at its ten campuses and is the primary institution authorized to independently award doctoral degrees and professional degrees in law, medicine, business, dentistry, veterinary medicine, and other programs. UC manages one U.S. Department of Energy national laboratory, partners with private industry to manage two others, and operates five medical centers that support the clinical teaching programs of the UC's medical and health sciences schools and handle more than 3.9 million patient visits each year.

The UC was written into the State Constitution of 1879 as a public trust, to be administered by an independent governing board, the Regents of the University of California, which includes 28 members: seven ex officio; 20 appointed by the Governor subject to Senate confirmation; and one student appointed by the Board. The UC is headed by a President who is responsible for overall policy development, planning, and resource allocations. Chancellors are responsible for the management of individual campuses. The Regents have delegated authority to the Academic Senate to determine conditions for admission, degree requirements, and approval of courses and curricula.

California State University (CSU). Drawing students from the top one-third of the state's high school graduates, as well as transfer students who have successfully completed specified college work, the CSU provides undergraduate and graduate instruction through master's degrees and independently awards doctoral degrees in education, nursing practice, and physical therapy, or jointly with UC or private institutions in other fields of study. With 23 campuses and approximately 410,300 students, the CSU is the largest and most diverse university system in the country.

The CSU is administered by an independent governing Board of Trustees that includes 25 members: five ex-officio; 16 appointed by the Governor to four-year terms (subject to Senate confirmation); and four members appointed to two-year terms (two student representatives, one voting and one non-voting, and one representative each from faculty and alumni). The Trustees appoint the Chancellor, who is the chief executive officer of the system, and the Presidents, who are the chief executive officers of the respective campuses. The Trustees, the Chancellor, and the Presidents develop systemwide policy, with actual implementation at the campus level taking place through a broadly based consultative process. The Academic Senate, made up of elected faculty representatives from each campus, recommends academic policy to the Board of Trustees through the Chancellor.

California Community Colleges (CCC). The CCC are publicly supported local educational agencies that provide educational, vocational, and transfer programs to approximately 2.4 million students. The CCC system is the largest system of higher education in the world, with 72 districts, 112 campuses, and 70 educational centers. In addition to providing education, training, and services, the CCC contributes to continuous workforce improvement. The CCC also provides remedial instruction for adults across the state through basic skills courses and adult non-credit instruction.

The Board of Governors of the CCC was established in 1967 to provide statewide leadership and technical assistance and allocate funding to the 72 districts and 112 colleges that constitute the system. The Board has 17 members appointed by the Governor subject to Senate confirmation. Twelve members are appointed to six-year terms, and two student members, two faculty members, and one classified member are appointed to two-year terms. Locally elected Boards of Trustees work on the district level with Presidents who collectively are responsible for the operation of individual college districts and campuses.

Hastings College of the Law (Hastings). Hastings was founded in 1878 and on March 26, 1878, the Legislature provided for affiliation with the UC. Hastings is the oldest law school and one of the largest public law schools in the West. Its mission is to provide an academic program of the highest quality, based upon scholarship, teaching, and research, to a diverse student body of approximately 1,100 students.

The Hastings Board of Directors establishes policy that is carried out by the Chancellor, Dean, and other officers. The Board has 11 directors serving 12-year terms: one is an heir or representative of S.C. Hastings and the other ten are appointed by the Governor subject to Senate confirmation.

Higher Education Funding from 2008-09 thru 2011-12. From 2008-09 through 2011-12, the state reduced funding for UC, CSU, CCC, and Hastings by $2.65 billion General Fund. The most notable consequences of these reductions were significant student tuition increases (as illustrated in the chart on the next page), effectively increasing the share of total education costs being shifted to students, and declining course offerings, which made it difficult for students to complete their certifications and degrees in a timely manner. In 2012-13, and with the passage of Proposition 30, higher education budgets were held flat and mandatory systemwide tuition fees remained at the 2011-12 level.

Higher Education Annual Tuition/Fees: 2008-09 through 2012-13

Full-Time Resident Students							Change from 2007-08	
	2007-08	2008-09	2009-10	2010-11	2011-12	2012-13	Amount	Percent
University of California								
Undergraduate	$ 6,636	$ 7,126	$ 8,373	$ 10,302	$ 12,192	$ 12,192	$ 5,556	84%
Graduate	7,440	7,986	8,847	10,302	12,192	12,192	$ 4,752	64%
California State University								
Undergraduate	2,772	3,048	4,026	4,440	5,472	5,472	$ 2,700	97%
Teacher credential	3,216	3,540	4,674	5,154	6,348	6,348	$ 3,132	97%
Graduate	3,414	3,756	4,962	5,472	6,738	6,738	$ 3,324	97%
Doctoral	7,380	7,926	8,676	9,546	10,500	10,500	$ 3,120	42%
California Community Colleges	600	600	780	780	1,080	1,380	$ 780	130%
Hastings College of the Law	21,303	26,003	29,383	36,000	37,747	43,486	$ 22,183	104%

Source: LAO

GOVERNOR'S PROPOSAL:

Higher Education Funding. The budget provides $11.9 billion in General Fund support for higher education in 2013–14 (*including funding for financial aid programs administered by the California Student Aid Commission described in a separate chapter of this report*). This is $1.4 billion (13 percent) more than the revised 2012-13 level. The bulk of the new funding is for base increases at the universities, a general purpose increase for the community colleges, adult education restructuring, and increased participation in the Cal Grant program. A portion of the total ongoing General Fund increase is due to Budget Act of 2012 appropriations of $125 million each to UC and CSU if student tuition fee levels were held flat in 2012–13.

Higher Education General Fund Support
(Dollars in millions)

	2011–12 Actual	2012–13 Revised	2013–14 Proposed	Change From 2012–13	
				Amount	Percent
UC	$2,504	$2,567	$2,846	$279	11%
CSU	2,228	2,492	2,809	317	13
CCC	3,612	3,802	4,503	701	18
Hastings	8	9	10	—	3
CSAC	1,533	1,624	1,722	98	6
Totals	**$9,885**	**$10,494**	**$11,890**	**$1,396**	**13%**

For UC, CSU, and Hastings, amounts include general obligation bond debt service in each year. For CCC, amounts include general obligation bond debt service and funding for the CCC Chancellor's Office. For the California Student Aid Commission, amounts include federal Temporary Assistance for Needy Families and the Student Loan Operating Fund support that directly offset General Fund costs.

Source: LAO

Multi-Year Funding Plan and Increased State Support for Base Budgets. The budget proposes a multi-year funding plan across all segments of higher education, including increased state support. UC, CSU, and Hastings budgets will increase by roughly five percent per year in 2013-14 and 2014-15, and by four percent in each of the subsequent two years. CCC funding will also increase by roughly five percent in 2013-14, and then grow significantly over the subsequent years of the multi-year plan. These increases translate to an additional $125.1 million each for UC and CSU, $392,000 for Hastings, and $197 million for the community colleges (an additional $179 million for the community colleges is directed to the buydown of inter-year deferrals and is discussed further in the "*Issues to Consider*" section below).

Assumes No Tuition Fee Increases Over Extended Period. The budget expects the segments to maintain current tuition fee levels for the life of the plan. No increases are necessary because any need is negated by the year-over-year General Fund increases coupled with savings from expected reforms from the improved deployment of teaching resources and from current segmental efforts to increase efficiencies. The reforms related to improved deployment of teaching resources include: (1) making available the courses students need and help them progress through college efficiently; (2) using technology to deliver quality education to greater numbers of students in high demand courses (with $37 million in designated funding for UC, CSU, and CCC as described further below); (3) improving course management and planning; (4) using faculty more effectively; and (5) increasing the use of summer sessions.

Expects Performance on Certain Priorities. The budget directs each segment to use the increased funding to achieve the following priorities: (1) provide high quality instruction at lower cost; (2) decrease the time it takes to earn a degree; (3) increase graduation rates; (4) increase the CCC transfer rate; and (5) improve credit and basic skills course completion.

Variety of Segment-Specific Proposals. The budget proposes various segment-specific "tools" to assist the segments in achieving the priorities of the multi-year plan. In addition, and in order to require the segments to factor these costs into their fiscal forecasting and decision-making, the budget proposes to shift certain costs onto the segments' budgets, such as for debt service and retiree benefits, that have been historically borne by the state's budget.

- <u>*UC, CSU, and CCC – Funding for On-Line Education*</u>. To expand the number of courses available to matriculated undergraduate students through the use of technology, the budget provides $10 million each to UC and CSU as part of their $125.1 million General Fund increases and a separate augmentation of $16.9 million Proposition 98 General Fund to the CCC. For all segments, the focus is on courses that have the highest demand, fill quickly, and are prerequisites for many different degrees. For UC and CSU, the budget bill earmarks the funding and requires that the courses be available to all undergraduates systemwide, regardless of the campus where they are enrolled, and that student tuition is the same as for regular academic year state-subsidized courses. For the CCC, the budget bill earmarks the funding and requires the Chancellor's Office to submit an expenditure plan to the Administration by July 1, 2013. The *Budget Summary* indicates the CCC initiative will include three key elements: (1) creation of a "virtual campus" to increase state student access to 250 new courses delivered through technology; (2) creation of a single, common, and centralized delivery and support infrastructure for all courses delivered through technology and for all colleges; and (3) expansion of options for students to access instruction in other environments and earn college credit for demonstrated knowledge and skills through credit by exam. Budget trailer bill language will also be submitted to implement this proposal.

- <u>*UC, CSU, and CCC – Unit Caps*</u>. To shorten students' time-to-degree, reduce costs for students and the state, and increase access to more courses for other students, the budget proposes trailer bill language to cap the number of General Fund subsidized-units students can take during the life of the plan. For UC and CSU in the first two years, the limit would be 150 percent of degree requirements (for example, 180 units for a standard bachelor's degree and 90 units for an associate's degree). The limit would be reduced in year three to the equivalent of about one extra year of full-time attendance (for example, 150 units for a bachelor's and 90 for an associate's). For CCC, starting in 2013-14, students will be allowed to take no more than 90 semester credit units (150 percent of the standard required to earn an associate's degree or credits for transfer).

- *UC, CSU, and Hastings – Bond Debt Service Costs and Capital Outlay*. The budget shifts roughly $400 million in debt service costs for general obligation bond financed capital improvements at UC, CSU, and Hastings into each segment's budget. The budget also makes one last adjustment to UC and CSU budgets for lease-revenue bond debt service costs. No further augmentations will be provided for either form of debt service payment. The budget further proposes that any new capital expenditures will be subject to approval by the Administration and there will be limits on the amount of the budget that can be spent on capital expenditures. Budget trailer bill language will be submitted to implement this proposal as well as to authorize UC and CSU to restructure their respective lease-revenue debt obligations to create budgetary savings.

- *CSU Employer Contribution to CalPERS*. The budget provides a $51.4 million General Fund increase to fund the annual increase in costs for CSU's required employer pension contribution to CalPERS. In future years, CSU will continue to receive annual General Fund adjustments based on current payroll; however, if CSU chooses to increase expenditures beyond the 2012-13 payroll level, CSU would be responsible for the associated pension costs.

- *CSU Employer-Employee Share of Cost for Health Premiums*. The budget proposes budget trailer bill language to provide CSU with the same statutory authority to negotiate or set employee health care benefit rates that is provided to the California Department of Human Resources for other state employees. Currently, CSU pays 100 percent of the health care premiums for its employees and 90 percent for employees' family members. However, for most other state employees, the state pays either 80 or 85 percent of employees' health care premiums and 80 percent for family members.

- *CCC Board of Governor's Fee Waiver Program Reform*. The budget proposes trailer bill language to require all students seeking financial aid, including Board of Governor's (BOG) Fee Waivers, to fill out a Free Application for Federal Student Aid (FAFSA) form. This change is proposed to ensure that only financially needy students are determined eligible for the BOG fee waiver program and to ensure program integrity. Any savings will be reinvested to further increase course offerings and student services.

- *CCC Funding Incentive Initiative*. The budget proposes trailer bill language to change community college census accounting practices by adding a second census date at the end of each academic term. Over a five-year-period, the earlier census date (which is currently in the third or fourth week of the each semester) would gradually be phased-out.

Any enrollment monies that districts "lose" due to this policy change would be transferred to district categorical programs that fund student support services (such as counseling). This proposal is intended to apportion funding by focusing on completion at the end of the term, thereby incentivizing districts to focus on outcomes.

T*he Governor's proposals related to K-14 Adult Education and expenditure of Proposition 39 Energy Efficiency funds are discussed in other sections of this report.*

ISSUES TO CONSIDER:

Overall Theme to the Higher Education Budget. The Governor has identified several important areas of focus for the state's higher education system, including the need for increased productivity, a lower cost per degree for students and the state, and improved student success and outcomes. The Governor has also highlighted that continued increases in costs are not necessarily adding value or productivity. Rather, to achieve long-term financial sustainability and to fund future initiatives, higher education segments will have to lower their cost structures. The Governor also acknowledges the significant budget reductions that have been made in recent years and proposes to begin reinvesting in the higher education system.

While there will be questions raised about some of the specific reforms and tools the Governor proposes as part of his multi-year plan, the areas of focus identified therein are generally shared by the Legislature. At this juncture, many aspects of the Administration's multi-year plan remain undefined or under-defined. This will remain the case until budget trailer bill language is transmitted and subcommittee hearings begin in early March. However, the overall approach contained in the multi-year plan presents a broad threshold question about the role of the Legislature, as well as a number of other questions on specific components of the plan, as delineated below.

What is the Legislature's Role in the Multi-Year Plan? Last year, the Governor proposed a similar long-term funding plan for UC, Hastings, CSU, and the CCC that promised stable and increasing state funding and fiscal incentives to allow the segments to better manage their resources. The plan was dependent upon the passage of Proposition 30 and on the segments achieving certain performance metrics as specified by the Administration. While the Legislature expected to be provided with further details of the plan, no specific or complete plan ever materialized.

In the interim, Proposition 30 passed. In the 2013-14 budget, the Governor again proposes a multi-year funding plan for higher education but with increased funding. Similar to last year, the multi-year plan proposes a new approach to capital outlay (discussed below) and the elimination of earmarks and enrollment targets (also discussed below), all of which effectively decrease legislative oversight and remove key budget tools that the Legislature uses to guide higher education agencies. Finally, the multi-year plan identifies several performance expectations.

In short, the multi-year plan significantly increases the segments level of autonomy but does not link to any specific outcome targets or means to hold the segments accountable for meeting those expectations. This approach raises important questions for the Legislature to consider: What role should the Legislature play in making key high level decisions about the $4.5 billion spent each year on higher education, including regarding capital outlay and determining the outcomes and the metrics used to measure performance of the segments? Is the Legislature's role simply to appropriate state funding absent any earmarks and/or enrollment targets and leave it to the Administration and the segments to determine priorities and progress? If this is the funding level that the state is going to provide for higher education, what does the Legislature expect the segments to achieve? Does the Legislature want to provide even greater autonomy to the segments?

Legislature's Consistent Message on Higher Education Accountability. On a bipartisan basis, the Legislature has been developing, supporting, and refining proposals to create greater accountability for higher education since 2002. These provisions are consistent with recent LAO recommendations on the need for a public agenda and improved oversight of the higher education segments, and reflect the findings of the most recent review of the state's Master Plan for Higher Education – that there is a need for clearly articulated goals in order to enable increased accountability across the entire higher education system. This is especially true in the current fiscal climate; the state needs to be clear about priorities for the use of the public funding provided to the segments. Being clearer about the goals and the measures will highlight and drive the budget and policy decisions necessary to support the state's higher education system in meeting the state's goals.

The most recent iteration of this effort was Senate Bill 721 (Lowenthal). Passed by wide margins in both houses, this bill established goals for higher education and laid out a process for establishing metrics and targets and for assessing progress in meeting California's educational and workforce needs. The Governor vetoed SB 721, stating, "*This bill sets three goals for our colleges and postsecondary institutions and orders the Legislative Analyst to create a committee to establish metrics that measure progress towards these goals. The bill also requires annual reports. Questions about who should measure, what to measure, and how to measure what is learned in college are way too important to be delegated to the Legislative Analyst*."

The Governor's stated reason for the veto is process-orientated. Therefore, it would appear that the broad objectives of the Administration and the Legislature about goal setting and establishing metrics to measure progress are consistent. Further, SB 721 and preceding bills were approved by the Legislature in the leanest of fiscal times. This raises a key question for the Legislature to consider: now that the state is reinvesting in higher education, to be consistent with prior legislative intent and action shouldn't that reinvestment and overall higher education budget be linked directly to an accountability framework?

The State Lacks a Higher Education Oversight Structure. In 2011, the Governor vetoed funding for the California Postsecondary Education Commission (CPEC), citing the agency's ineffectiveness in higher education oversight. In light of this action, the future of higher education oversight remains unclear. While the public segments have stepped in to assume some roles previously performed by CPEC, there are concerns about how institutional and public interests will be balanced. In its January 6, 2012, report entitled, "*Improving Higher Education Oversight*," the LAO focused on the need for oversight that enables policymakers and others to monitor how efficiently and effectively the postsecondary system is serving the state's needs, and make changes to improve its performance. The specific recommendations of that report include that the Legislature: (1) define the state's postsecondary education needs, such as setting specific goals; (2) use performance results to inform policy decisions; and (3) establish an independent oversight body with limited and clear responsibilities.

Noting the difficulty of creating a new public organization in the current fiscal environment, the LAO offered a number of short-term measures to strengthen oversight in the interim: (1) amending statute to ensure pertinent data remain available to policymakers and researchers; (2) increasing direct legislative oversight and limiting new long-term funding commitments until an effective oversight structure is in place to support the legislature's decision-making; and (3) monitoring segments' allocation decisions, including investment in new programs and other major program changes, until mechanisms are in place for outcome review. The LAO's short-term measures warrant further consideration by the Legislature as it begins its review of the Governor's multi-year plan.

Online Education at the Higher Education Segments. A key component of the multi-year plan's focus on improved deployment of teaching resources is the proposal to use technology to deliver quality education to greater numbers of students in high demand courses; e.g., bottleneck courses that slow time to degree while students await a "seat" in the required course. If the reform bears fruit, the net result will be increased productivity and lower cost per degree for students and the state, as well as increased access for other students. While budget trailer bill language has not been transmitted, the *Budget Summary* and budget bill language provide insight into the Governor's vision: the focus is matriculated undergraduate students and for high demand courses. For UC and CSU, the courses will be available systemwide regardless of a student's "home" campus and tuition will be the same as for regular courses. For the CCC, a "virtual campus" will be created and credit by exam options will be expanded.

While the state's colleges and universities have been providing distance education for decades through university extension programs, online instruction for credit towards undergraduate and graduate degrees has become a much more prominent part of postsecondary education in recent years. At the same time, debates have been sparked about quality assurances. Recent media reports have been focused on the rapid rise of MOOCs (massive open online courses), which are online courses aimed at large-scale participation and open access via the web. Though the design of and participation in a MOOC may be similar to college or university courses, MOOCs typically do not offer credits awarded to paying students at schools. However, that aspect is changing as universities here, and nationally, are now examining opportunities to use the MOOC platform for credit instruction, including the recently announced pilot at San Jose State using a MOOC platform for introductory and remedial classes.

In its October 2010 report entitled, "*The Master Plan at 50: Using Distance Education to Increase College Access and Efficiency*," the LAO found that while distance education is not, and is not intended to be, suitable for everyone (students as well as faculty), it offers an important alternative means of providing instruction that can complement existing formats and expand options for the state's students and segments. In order to take fuller advantage of this potential, the LAO recommended that the Legislature guide a clearer statewide vision that specifies data which the segments should collect and report on distance-education students and clarifies expectations concerning intercampus collaborations and other partnerships. Specific LAO recommendations included: (1) streamlining educational pathways for online students; (2) promoting the sharing of curriculum across campuses; and (3) encouraging collaborative academic programs.

There are several other key questions for the Legislature to consider: (1) What is online credit instruction? Should it be more than simply taking the traditional classroom model and moving it online without any change in approach? (2) How much are the segments currently spending for online credit instruction and can supplanting be prevented? (3) What will move the needle? Should the focus be systemwide, for projects that can ease taking courses across campuses and/or support the development of courses to be used across campuses? (4) What is the appropriate balance between investing funds in proven methods versus new and emerging methods? (5) How can the quality of instruction be ensured?

Unit Caps on State-Subsidized Courses at UC, CSU, and CCC. The budget proposes caps on the number of units the state will subsidize at UC, CSU, and CCC. While budget trailer bill language has not been transmitted, the Administration has indicated that the cap would apply to both new and continuing students beginning in the 2013-14 academic year and be in place over the life of the multi-year plan. The budget would allow the universities and colleges to grant waivers and allow students to take additional units above the cap; however, the state would provide no subsidy so either the student pays full freight or the institution bears the entire cost of providing the instruction. This approach raises important considerations for the Legislature.

The initial limit for UC and CSU (150 percent of standard requirements) likely would not have a significant impact, but the eventual limit to be imposed at the universities after two years (125 percent of standard requirements) would impact more students primarily at CSU. For the community colleges, however, the impact is much more immediate and significant. For instance, in 2009-10, nearly 120,000 students had earned 90 units or more.

The cap is intended to create an incentive for students to shorten their time-to-degree, reduce costs for the state, and increase access to more courses for other students. This is a legitimate goal, but ignores some of the realities of the current situation. Students should be able to take appropriate courses and earn degrees in a timely fashion, but there needs to be shared responsibility for doing so. However, this proposal penalizes only students and ignores the reasons why students may accrue excess units, including the unavailability of courses, inconsistent transfer requirements, and requirements of particular majors, and to what degree those reasons are within the control of students.

A one-size-fits-all approach is potentially punitive to those who have a double major and those who may be returning to college to train for a new job. For the community colleges specifically, the cap would also apply to so-called freeway fliers, who are students that, largely out of necessity, enroll and take classes at multiple colleges and/or districts. It is not clear that the community colleges have the data capabilities to track those students and the number of accumulated units. This raises a legitimate question about enforcement of the cap within the community college system.

A New Approach to UC and CSU Capital Outlay. The *Budget Summary* indicates the Administration is considering some changes to the state's infrastructure spending practices, including identifying alternatives to limit future bond authorizations backed by the General Fund, currently the state's main source of infrastructure funding. Some alternatives mentioned include identifying new funding sources and creating new mechanisms to prioritize and limit capital spending.

For higher education, and consistent with the above direction, the budget proposes a new approach to UC and CSU capital outlay, including how debt service costs are budgeted and structured as well as how future projects are approved and funded. While many details remain outstanding, including what, if any, role the Administration envisions for the Legislature in approval of new higher education capital outlay expenditures and the impacts of the proposal to authorize UC and CSU to restructure their respective lease-revenue bond debt to create budgetary savings, the approach raises important considerations for the Legislature.

The approach is a departure from how UC and CSU capital outlay has been historically addressed. Under prior practice, and in the last ten years, the LAO reports that the state spent an estimated $10.1 billion on higher education infrastructure; 80 percent of that support came from general obligation (GO) bonds and an additional 19 percent from lease-revenue bonds. Associated higher education debt-service costs more than doubled during this same time period, from about $516 million in 2000-01 to an estimated $1.1 billion in 2010-11. Most of the GO bond spending was from bonds approved by the voters in 1998, 2002, 2004, and 2006. In general, the state provides less funding for higher education projects when the balance of GO bonds is exhausted. In the case of UC and CSU, the state has typically offset some of this reduction by funding some projects with lease-revenue bonds. All of these projects were presented as part of the annual budget process, thereby ensuring the segments requested approval from the Administration and Legislature for any projects funded with either GO bonds or state-issued lease-revenue bonds.

At this point, the remaining higher education GO bond authority has all but been exhausted. This Administration has not advanced any new lease-revenue bond financed projects. To wit, the Budget Act of 2012 included very limited new funding for capital outlay. For UC, $4.75 million (2006 GO bond funds) was appropriated for preliminary plans and working drawings for a new building at UC Merced. For CSU, $10.995 million (GO bonds) and $11.155 million (federal funds) to fund all phases of five seismic upgrade projects at the Los Angeles, San Luis Obispo, Bakersfield, and Humboldt campuses.

Looking ahead to 2013-14, both the UC and CSU governing boards adopted extensive state-funded capital outlay programs, with 39 projects totaling $788.5 million and 38 projects totaling $520 million, respectively. The request submitted to the Administration was much smaller: UC advanced three projects totaling $73 million and CSU advanced 21 projects totaling $390.3 million. The budget includes no capital outlay projects for UC; for CSU, the budget includes $3.637 million (GO bonds), for equipment phases of already constructed projects at the San Jose, Maritime Academy, Bakersfield, and Fresno campuses.

By shifting the debt service payments into the segments' base budgets, the Administration asserts that this would limit the segments' capital spending by highlighting the trade-offs between spending on infrastructure versus operations. As it stands now, these debt service costs are borne by the state's budget providing no incentive for the segments to limit the number and scope of capital projects they submit to the Administration and Legislature. Yet, this change in approach raises several questions for the Legislature to consider, including: (1) Is the 2013-14 funding provided adequate to annually service the segments' existing bond debt in the coming years? (2) Is the proposed total base funding (which could grow by up to five percent annually over the life of the multi-year plan) reasonable to cover the UC's and CSU's various operational and bond-related costs? (3) To what extent, and in what ways, will the Legislature have a role in approval of higher education capital outlay projects?

Elimination of UC and CSU Budgetary Earmarks. Typically, the annual budget act includes a number of conditions on UC's and CSU's General Fund appropriations. These earmarks for UC and CSU funding have varied over the years in keeping with the Legislature's and Governor's particular concerns at the time and have covered such programs as nursing and medicine, student financial aid, and science and math teaching initiatives. Due to Governor's vetoes, the Budget Act of 2012, for the first time, included minimal earmarks in UC's and CSU's budgets. The budget contains no earmarks except for a new one to address the Governor's priority, namely the $10 million provided to each segment to increase the number of courses available through the use of technology.

The UC and CSU are governed by independent boards that make various decisions about how the universities will spend their resources, including the number of faculty, executives, and other employees on the payroll and those employees' salary and benefits; student tuition levels; and the amount of tuition revenue redirected to financial aid, among other fiscal decisions. Further, UC has constitutional autonomy afforded by the California Constitution, under which the Regents have "*full powers of organization and governance*" subject only to very specific areas of legislative control, such as budget act appropriations.

Given this dynamic, where significant budget authority has already been delegated to UC and CSU, the Legislature has relied on earmarks to ensure key concerns are addressed within the funding appropriated to the universities. The inclusion of earmarks in the budget bill provides a clear public record of budgetary allocations and expectations. The Governor's approach effectively eliminates this budgetary tool for Legislative priorities, but creates a new earmark for his priority.

The LAO has recommended that rather than simply abandoning all earmarks in the universities' budgets, the Legislature should reevaluate budgetary earmarks on a case-by-case basis. In some cases, the Legislature may decide that a particular earmark is no longer a priority. In others, the Legislature may wish to keep or change or add an earmark. To help in evaluating potential earmarks, the Legislature may wish to develop guidelines such as approving only those earmarks that serve a broader state purpose.

Elimination of UC and CSU Enrollment Targets. The *Budget Summary* states that "*enrollment based funding does not promote innovation and efficiency or improve graduation rates. It does not focus on critical outcomes, affordability, timely completion rates, and quality* *programs. Instead, it builds on the existing institutional infrastructure, allowing public universities and colleges to continue to deliver education in the high-cost, traditional model.*" Therefore, the budget does not include enrollment targets for either UC or CSU, effectively allowing UC and CSU to make their own decisions about how many students to enroll with the funding available to them.

Historically, UC's and CSU's budget have been tied to a specified enrollment target. To the extent that the segments failed to meet those targets, the state funding associated with the missing enrollment reverted to the General Fund. Beginning with the Budget Act of 2011, enrollment targets were included but without any penalty should a segment fail to meet its target in recognition of the overall reductions to higher education budgets.

Enrollment levels are irrefutably a fundamental building block of higher education budgets. The number of students enrolled is a direct measurement of the "access" provided to higher education. Further, enrollment levels are a central cost driver for the segments and drive other costs, such as state financial aid. For these reasons, enrollment targets have been a major legislative concern in recent years. With no target, as proposed by the Governor, the segments would have wide discretion as to their enrollment levels. For example, they could significantly reduce the number of students served, thus raising the amount of funding available per student. Or UC and CSU could reduce the number of undergraduates served, and use the funding to add a smaller number of higher-cost graduate students. Certainly choices here link back to the multi-year plan and its expectations for segmental performance on certain priorities. For instance, it is unlikely the segments would decrease the acceptance of community college transfer students, as that is an identified priority of the multi-year plan. Nevertheless, enrollment decisions have implications not just for educating students, but they also have a profound effect on the level of access provided at each segment.

In the past, the LAO has recommended the rejection of any proposal to eliminate enrollment targets. Further, to the extent that the Legislature chooses to significantly increase a segment's budget, it may wish to modify the enrollment targets. Alternatively, the Legislature may wish to require the segments to achieve greater efficiencies without reducing enrollment. In addition, this proposal raises other key questions for the Legislature's consideration: With no enrollment target, what assurances does the Legislature have that UC and CSU will continue to serve all students eligible for their institutions under the Master Plan? What recourse would be available if the segments fail to do so?

CSU Employer Costs for Retirement. CSU's required employer contribution to CalPERS has been historically borne by the state's budget. Each year, the annual budget act provided an adjustment for either the increase or decrease in the required contribution level as determined by the CalPERS Board of Administration. CSU's base budget of $1.9 billion contains $460 million for this purpose. The budget proposes an annual adjustment of $51.4 million General Fund and a substantive change in approach going forward. In future years, CSU will continue to receive annual General Fund adjustments for CalPERS costs based on 2012-13 payroll; however, if CSU chooses to increase payroll expenditures above the 2012-13 level, CSU would be responsible for the associated pension costs. CSU could be concerned that under the budget proposal, it and its employees will have little flexibility and few tools beyond salary/benefit setting authority to manage unfunded liabilities and higher costs that could result in the future. For instance, the CalPERS Board sets the employer contribution rate. However, this is not unique to CSU as an employer; this also applies to the state as well as every other public employer who contracts with CalPERS. Absent the Governor's proposal, the alternative is that the state's budget will continue to bear these costs yet have no control over the salary/benefits and resulting pension costs (above the 2012-13 expenditure level) that CSU negotiates with its employees.

CSU Employee Health Care Benefit Rates. The budget proposes trailer bill language to provide CSU with the same statutory authority to negotiate or set employee health care benefit rates that is provided to the California Department of Human Resources (CalHR) for other state employees. A similar proposal was included as part of the 2012 May Revision but was not part of the final budget. Last year concerns were raised about timeliness given that CSU was actively bargaining with the majority of its represented employees. At present, all of CSU's bargaining units are under contract. While the actual trailer bill language has not been transmitted, the Governor is raising a legitimate point about providing CSU with the same tools as CalHR to better manage and negotiate the entirety of its personnel costs, including employee health care benefit rates.

Community College Base Budget Increase. The budget provides $197 million in Proposition 98 General Fund support for the community colleges. Unlike other state funds in the community college budget, the budget would allow the Chancellor's Office to make its own decisions about how the funds would be distributed and for what purpose. This is a broad departure from past practice, whereby any increase in base budget funding was provided for a specific purpose, such as for growth (unfunded FTES) or a cost-of-living-adjustment (increase in the per FTES amount). The LAO has raised concerns about whether the Governor's approach would ensure that the state's highest community college priorities would be addressed. For instance, the Legislature has enacted several pieces of legislation specifying a number of priorities to fund once new resources become available, such as a common assessment instrument to place incoming students into appropriate coursework, additional academic counselors to help students identify and make progress toward their educational goals, and a system for electronic student transcripts to improve campus record-keeping and efficiencies. In addition, the state has a number of outstanding community college-related liabilities, including over $300 million that is owed for past mandate claims.

Buydown of Community College Inter-Year Deferrals. The Governor's budget proposes an increase of approximately $1.9 billion in Proposition 98 General Fund to reduce inter-year budgetary payment deferrals for K-14 education in 2013-14. Of that total, $179 million is for community colleges reducing the deferral debt owed to the community colleges to $622 million (the Budget Act of 2012 reduced the debt to $801 million from a total of $961 million). The level of deferral "buy down" is consistent with, and proportional to, the payment of deferred funding in K-12 education; e.g., basically a 50-50 split of new funding versus deferral buydown. The Governor further plans to eliminate all inter-year payment deferrals to schools and community colleges over the next few years. From a fiscal and policy standpoint, it is prudent to reduce these inter-year deferrals, as they remain outstanding obligations on the state's books. The deferrals also were an agreed-upon solution to avoid more draconian cuts to K-14 budgets. They also come with borrowing costs for districts, in order to address cash flow concerns caused by the delayed state payments. It remains unclear if there are any advantages to delaying repayment of inter-year deferrals for K-12 schools and community colleges to future years.

Board of Governor's Fee Waiver Program Reform. The budget proposes to require all community college students seeking financial aid, including Board of Governor's (BOG) Fee Waivers, to fill out a Free Application for Federal Student Aid (FAFSA) form.

The BOG Fee Waiver program waives enrollment fees for CCC students who demonstrate financial need. The cost of the program, which is covered by Proposition 98 General Fund monies, has grown rapidly in recent years with waiver costs projected to total $855 million in 2012-13. Under current law and regulation, there are three means of eligibility: (1) Part A, if students or their parents receive cash assistance from other need-based programs (such as CalWORKs); (2) Part B, if a student's or his/her family adjusted gross income is at or below 150 percent of the federal poverty level; and (3) Part C, if students have any financial need (cost of attendance exceeds their federally determined family contribution by $1,104 or more; $1,104 is the amount of annual fees charged to a full-time student taking 24 units). Students can apply for a fee waiver by completing: (1) the FAFSA or (2) for Part A and B waivers, the BOG Fee Waiver application. Verification policies differ by which type of fee waiver is sought. For instance, under Part A, appropriate documentation includes copies of a student's benefits check. Under Part B, Chancellor's Office guidelines give districts flexibility to determine what "documentation" means; acceptable methods include verifying tax records or "self-certification," whereby students are taken at their word about their or their family's income level. All students signing the BOG Fee Waiver application form do so under penalty of perjury. The Chancellor's Office indicates that 80 percent of students currently receiving aid filled out a FAFSA.

The LAO has previously recommended that the Legislature enact the statutory changes necessary to add satisfactory academic progress requirements to the BOG Fee Waiver program (Chapter 624, Statutes of 2012). The LAO also recommended that the Legislature enact the statutory changes necessary to require students to apply for a waiver using the FAFSA to ensure that they are considered for the full spectrum of federal and state aid. In considering this proposal, an important consideration is to avoid creating a new reimbursable state mandate.

Community College Funding Incentives Initiative. The budget proposes to change the basis on which districts are funded for credit instruction by phasing in a second census date at the end of each academic term to focus on completion at the end of the term. While the Governor raises a fair point about the benefit about moving to a funding model that is more outcome-oriented, legitimate concerns can be raised about unintended consequences in the classroom, such as grade inflation or reductions in course rigor. The LAO has also noted that by redirecting any "lost" funds to a district's categorical program, the budget presupposes that students do not complete their coursework because of inadequate support services. This may be a contributing factor, but it ignores the many other factors that could be at play such as a poorly designed or taught course. The LAO has suggested the Legislature consider changes to the funding model that would place greater emphasis on more meaningful outcomes, such as rewarding colleges for student learning gains and program completions (such as obtaining a degree or skills certificate) rather than course completion. Given that the Student Success Task Force (SSTF), which is discussed below, considered and rejected a similar proposal, the Legislature should consider the interaction of this proposal with the work of the SSTF, such as establishing enrollment priorities, which is already underway and could accomplish the same goal.

Interaction with the Priorities of the Student Success Task Force. Pursuant to Chapter 409, Statutes of 2010, the Board of Governors (BOG) created the Student Success Task Force (SSTF) to research, study and debate the best methods to improve student outcomes. The SSTF final report was unanimously adopted by the BOG in January 2012. The SSTF efforts resulted in 22 specific recommendations, to be accomplished through regulatory changes, system-wide administrative policies, local best practices, and legislation. Major recommendations address linkages with K-12 schools, student intake and support, instructional programs, and accountability. Seven of the 22 recommendations are in the implementation phase, as follows: (1) Common Core State Standards; (2) Common Assessment; (3) Statewide Enrollment Priorities; (4) BOG Fee Waiver Requirements, contained in Chapter 624, Statutes of 2012; (5) Student Success Score Card; (6) Longitudinal Student Record System; and (7) Student Support Initiative, also contained in Chapter 624. With all of this work related to the SSTF recommendations underway, the conversation has effectively moved from "what" recommendations to "how" the recommendations are implemented. The Legislature has been a full partner in this process as evidenced by Chapter 624.

There is, however, an interesting juxtaposition between the SSTF recommendations and the budget reforms. The SSTF is an example of local control that the Governor supports, yet some of the budget reforms would supersede the SSTF work done to date and planned for the future. For instance, there is overlap between the SSTF recommendations and the budget reforms (such as differing policy changes regarding BOG waiver requirements and unit caps), other SSTF recommendations address issues not identified in the budget reforms (such as establishing registration priorities, including allowing students who participate in orientation and academic assessment programs and have 100 units or less to enroll in classes first), and some of the budget reforms go well beyond the SSTF recommendations (such as the proposed funding incentives initiative). Given these intersections, and prior legislative support for the SSTF process and recommendations, careful legislative consideration is warranted of all related budget proposals.

Student Financial Aid – Cal Grant Program

BACKGROUND:

The Cal Grant program is the primary financial aid program run directly by the state. Modified in 2000 to become an entitlement award, Cal Grants are guaranteed to students who graduated from high school in 2000-01, or beyond, and meet financial, academic, and general program eligibility requirements. Administered by the California Student Aid Commission (CSAC), Cal Grant programs include:

- *Cal Grant A** high school entitlement award provides tuition fee funding for the equivalent of four full-time years at qualifying postsecondary institutions to eligible lower and middle income high school graduates who have at least a 3.0 grade point average (GPA) on a four-point scale and apply within one year of graduation.

- *Cal Grant B** high school entitlement award provides funds to eligible low-income high school graduates who have at least a 2.0 GPA on a four-point scale and apply within one year of graduation. The award provides up to $1,473 for book and living expenses for the first year and each year following for up to four years (or equivalent of four full-time years). After the first year, the award also provides tuition fee funding at qualifying postsecondary institutions.

- *Community College Transfer Award* provides a Cal Grant A or B to eligible high school graduates who have a community college GPA of at least 2.4 on a four-point scale and transfer to a qualifying baccalaureate degree granting college or university.

- *Cal Grant Competitive Award Program* provides 22,500 Cal Grant A and B awards available to applicants who meet financial, academic, and general program eligibility requirements. Half of these awards are reserved for students enrolled at a community college and who met the September 2 application deadline.

- *Cal Grant C Program* provides funding for financially eligible lower income students preparing for occupational or technical training. The authorized number of new awards is 7,761. For new and renewal recipients, the current tuition and fee award is up to $2,462 and the allowance for training-related costs is $547.

*In 2013-14, the maximum award for Cal Grants A and B are equal to the mandatory systemwide tuition fees at the UC ($12,192) and CSU ($5,472), $9,084 at independent non-profit institutions and WASC-accredited private for-profit institutions, and $4,000 at all other private for-profit institutions.

Cal Grant Program Awards/Funding (dollars in thousands)

	2011-12	2012-13	2013-14
Entitlement Awards			
Number	204,182	222,433	241,538
Amount	$1,366,180	$1,461,798	$1,569,028
Competitive Awards			
Number	37,868	38,510	39,183
Amount	$128,236	$124,255	$117,405
Cal Grant C			
Number	7,910	7,936	7,899
Amount	$8,964	$8,212	$7,947
Total			
Amount	**$1,503,380**	**$1,594,265**	**$1,694,380**

GOVERNOR'S PROPOSAL:

- ✓ Proposes no programmatic changes to the Cal Grant program.

- ✓ Accounts for an additional $61 million in 2012-13 and $161.1 million in 2013-14 to fully fund Cal Grant programmatic costs. Of the 2013-14 amount, $19.5 million is attributable to implementation of Chapter 604, Statutes of 2011 (The California Dream Act).

- ✓ Proposes to offset $942.9 million GF in Cal Grant program costs by utilizing federal Temporary Assistance for Needy Families (TANF) program funds. The Administration indicates that this shift is an allowable use of TANF funds because support for low-income, unmarried students age 25 or younger could prevent and reduce out-of-wedlock pregnancies, which is one purpose of TANF. This level of offset is an increase of $139.2 million over the level included in the Budget Act of 2012, which was the first time this offset was adopted.

- ✓ Proposes to offset $60 million GF in Cal Grant program costs due to the availability of surplus funds from the Student Loan Operating Fund (SLOF), which receives proceeds from the federal guaranteed student loan program. The Budget Act of 2012 included an offset of $84.7 million GF from this same fund source.

ISSUES TO CONSIDER:

Recent Changes to the Cal Grant Program to Reduce Program Costs. In the 2011 and 2012 Budget Acts, significant changes were made to the Cal Grant program, particularly with regard to eligibility criteria for participating institutions with a substantial proportion of their students borrowing federal student loans, to address concerns about participating institution quality and in order to reduce overall program costs. However, none of these changes, which are summarized below, impacted the entitlement aspect of the Cal Grant program.

Program Change	2013-14 Law	*Prior Law*
Tighter Eligibility Criteria for Participating Institutions	Participating institutions must maintain a maximum cohort default rate (CDR, proportion of former students defaulting on federal student loans) of 15.5 percent and a minimum graduation rate of 30 percent.	*No policy prior to 2011-12, when a CDR of 24.6 percent was instituted.*
Reduction in Award Levels for Non-Public Institutions	Cal Grant A and B new maximum awards will be $9,084 at independent non-profit institutions and WASC-accredited private for-profit institutions, and $4,000 at all other private for-profit institutions.	*Prior to 2012-13, the maximum award levels had been $9,708 for all non-public institutions since 2000 (except for 2004-2006, in which it was reduced to $8,322). In 2012-13, Governor's veto reduced award levels by five percent, to $9,223.*
Renewal Awards at Ineligible Institutions	Cal Grant eligible students attending an ineligible institution will not be able to renew their Cal Grant for the 2013-14 academic year if they choose to remain at that ineligible institution.	*No policy prior to 2011-12, when renewal awards were reduced by 20 percent if a student chose to remain at an ineligible institution.*
Tighter Eligibility Criteria for Renewal Recipients	Cal Grant recipients applying for renewal awards must meet certain financial eligibility criteria.	*Prior to 2011-12, Cal Grant recipients had to demonstrate financial need but not meet these "certain" criteria upon renewal.*
Awards Levels Reduced Through Governor's Veto Action	Through a veto action, the Governor reduced certain Cal Grant awards by five percent ongoing: (1) Cal Grant B access award – $1,473; (2) Cal Grant C tuition and fee award – $2,462; and (3) Cal Grant C book and supply award – $547.	*Prior to 2012-13, Cal Grant B access award had been $1,551; the Cal Grant C tuition award had been $2,592; and the Cal Grant C book and supply award had been $576.*
Community College Transfer	Codified CSAC practice limiting community college transfer entitlement awards to students who attended a CCC in the academic year before transferring to a four-year institution.	*N/A*

Budget Act Reforms Reduce Student Choices but in Long-Term Improve Outcomes. Under the new institutional eligibility standards, 154 schools, comprising 35 percent of all institutions and more than 80 percent of private for-profit schools participating in the Cal Grant program in recent years, have been deemed Cal Grant-ineligible. This shift in eligibility is evident in where the Cal Grant funds flow. Of the $1.6 billion in Cal Grant program costs in 2012-13, five percent of those costs are within the private for-profit sector, 15 percent are within the private non-profit sector, and 80 percent are within the public sector. Of the $1.3 billion within the public sector, 45 percent of those costs are at UC, 29 percent at CSU, and six percent at CCC. As a result, the new rules have reduced Cal Grant recipients' college choices and, at least in the short term, their access to postsecondary education. However, it is important to note that the ineligible schools are those where less than 30 percent of students are graduating and where more than 15.5 percent of students are defaulting on their federal student loans. Both of these "tests" are indicators of outcomes and student success. Therefore, in the longer term, the eligibility changes could improve outcomes for Cal Grant recipients as students shift to eligible schools and institutions make investments to improve their outcomes (and regain eligibility for the Cal Grant program).

Even With Recent Reforms Cal Grant Program Costs Continue to Increase. The Governor's Budget proposes a funding level of $1.7 billion ($720 million state GF, $942.9 million TANF, and $60 million SLOF), an increase of roughly six percent over 2012-13. Cal Grant program costs are affected by award amounts, program eligibility policies, and the number of students participating in the program. Cal Grant participation has grown between four percent and eight percent in recent years, despite constraints on campus enrollments, as more students have applied and qualified for need-based aid. Another contributing factor is Chapter 604, Statutes of 2011, which allows certain previously ineligible students to receive state financial aid beginning in 2013.

Interaction with Tuition Fees at UC and CSU. Under current state policy, Cal Grant award amounts keep pace with tuition fees at UC and CSU. This link has been a primary driver of dramatically increased program costs through the 2011-12 year (UC and CSU fees have since been held at the 2011-12 level). The Governor's Budget assumes no tuition fee increases at UC and CSU in 2013-14 (*See the Higher Education chapter in this report*). However, the 2013-14 budget bill retains controlling language that states UC and CSU maximum Cal Grant awards shall be $12,292 and $5,472, respectively, or <u>whatever lesser or greater amount</u> is approved for mandatory systemwide tuition by the respective governing boards. The Legislature may wish to consider amending this language to delete the linkage to Cal Grant award amounts should either or both of the governing boards act to increase tuition fees in 2013-14. The LAO has also suggested that in future years, if annual tuition fee increases are implemented, the Legislature might want to explore ways to constrain the anticipated growth in associated Cal Grant program costs. For example, the LAO has suggested that the Legislature could limit award amounts for CSU and UC students to either a fixed amount or a share of tuition that varies according to student need.

LAO's Analysis of the New Eligibility Rules. The recent budget act changes included a requirement that the LAO monitor initial implementation of the changes and analyze the state's other options for measuring institutional quality. In its report issued January 7, 2013, the LAO found that the changes, which primarily affect students at for-profit schools, are generally working as intended but have three notable drawbacks: (1) schools can manipulate the CDR; (2) the rules exempt some institutions without strong justification for doing so; and (3) the standards penalize institutions serving more disadvantaged students. The LAO recommended exploring alternative student debt measures when the information needed to calculate these measures becomes more readily available and applying the graduation rate requirement to all schools but modifying the measure to track the graduation rate only of Cal Grant recipients. In addition, the LAO recommended taking into consideration a school's student characteristics to avoid creating a disincentive to serve disadvantaged students.

The LAO also raised concerns about the actual implementation of the new standards and made recommendations to address those concerns. More specifically, although CSAC is required by statute to certify institutional eligibility by October 1 each year, the U.S. Department of Education plans to release new graduation rate data later in October. For this reason, the LAO recommended changing the certification deadline to November 1 if the Legislature maintains the current graduation rate measure. The LAO also noted that the recent policy changes, implemented in the middle of Cal Grant award cycles, have left many students with insufficient time to make alternative plans for the coming academic year. Moving forward, the LAO recommended the Legislature avoid making changes to eligibility rules during award cycles already underway, instead making them effective for the next award cycle. Some eligibility changes, such as those requiring consultation on specific metrics to be used, may require even longer implementation lags.