

SUBCOMMITTEE NO. 1 on Education



Subcommittee No. 1
Chair, Carol Liu
Member, Ted Gaines
Member, Roderick Wright

Thursday, March 8, 2012
10:30 a.m. or Upon Adjournment of Senate
Room 3191, State Capitol

Proposition 98 & K-12 Education Budget Overview Hearing

- I. Highlights of the Governor's Proposition 98 & K-12 Education Budget –**
Thomas Todd, Department of Finance
- II. Proposition 98 and K-12 Education Funding Overview –** Edgar Cabral,
Office of the Legislative Analyst
- III. Comments on the Governor's K-12 Education Budget --** Superintendent of
Public Instruction Tom Torlakson
- IV. Public Comment**

Attachment:

Proposition 98 & K-12 Funding, Senate Budget and Fiscal Review Committee.

Proposition 98 & K-12 Funding

BACKGROUND:

This paper presents the major components of the Governor's 2012-13 Proposition 98 budget package. The following sections provide background on Proposition 98, summarize the Governor's proposed Proposition 98 funding levels and expenditure plans for K-12 schools and community colleges, and identify issues for the Legislature to consider in evaluating the Governor's proposals.

Proposition 98 Initiative and Funding History. State funding for K–14 education – primarily K-12 local educational agencies and community colleges – is governed largely by Proposition 98, passed by voters in 1988. The measure, modified by Proposition 111 in 1990, establishes minimum funding requirements – referred to as the “minimum guarantee” – for K-14 education. Until recently, Proposition 98 supported most state funding for child care programs. In 2011-12, child care funding was shifted out of Proposition 98; however, Proposition 98 funding was continued for the state's subsidized part-day preschool program.

The table below summarizes overall Proposition 98 funding for K-12 schools and community colleges since 2007-08, before the state economy and state General Fund revenues began to fall resulting in significant budget reductions for K-14 education, as well as other state funded programs.

Proposition 98 Funding (Dollars in Millions)	2007-08	2008-09	2009-10	2010-11	2011-12 Budget Act	2011-12 Revised	2012-13 Proposed
K-12 Education							
General Fund	\$37,752	\$30,075	\$31,472	\$31,291	\$29,328	\$29,329	\$33,755
Local property tax revenue	12,592	12,969	12,631	12,084	13,823	12,891	12,908
K-12 Subtotal	\$50,344	\$43,044	\$44,103	\$43,376	\$43,151	\$42,220	\$46,663
California Community Colleges							
General Fund	\$4,142	\$3,918	\$3,721	\$3,885	\$3,466	\$3,217	\$3,683
Local property tax revenue	1,971	2,029	1,993	1,959	1,949	2,107	2,101
CCC Subtotal	\$6,112	\$5,947	\$5,714	\$5,844	\$5,415	\$5,324	\$5,784
Other Agencies	\$121	\$105	\$93	\$87	\$85	\$83	\$80
Total Proposition 98	\$56,577	\$49,096	\$49,910	\$49,306	\$48,651	\$47,627	\$52,527
General Fund	\$42,015	\$34,098	\$35,286	\$35,263	\$32,879	\$32,629	\$37,518
Local property tax revenue	\$14,563	\$14,997	\$14,624	\$14,044	\$15,772	\$14,998	\$15,009

Source: Legislative Analyst's Office

Calculating the Minimum Guarantee. The Proposition 98 minimum guarantee is determined by one of three formulas (tests) set forth in the State Constitution. The operative test for each fiscal year is determined according to various economic and fiscal factors. These factors include measures of state personal income, General Fund revenues, and student enrollment, as follows:

- **Test 1 – Percent of General Fund Revenues.** Test 1 is based on a percentage or share of General Fund tax revenues. The base year for the Test 1 percentage is 1986–87 – a year in

which K-14 education received approximately 40 percent of General Fund tax revenues. As a result of the recent shifts in property taxes from education to cities, counties, and special districts, the current rate is approximately 39 percent.

- **Test 2 – Adjustments Based on Statewide Personal Income.** Test 2 is operative in years with normal to strong General Fund revenue growth. This calculation requires that school districts and community colleges receive at least the same amount of combined state aid and local property tax dollars as they received in the prior year, adjusted for enrollment growth and growth in per capita personal income.
- **Test 3 – Adjustment Based on Available Revenues.** Test 3 is used in low revenue years when General Fund revenues decline or grow slowly. During such years, the funding guarantee is adjusted according to available resources. A “low revenue year” is defined as one in which General Fund revenue growth per capita lags behind per capita personal income growth more than one-half percentage point.

Suspension of Minimum Guarantee. Proposition 98 includes a provision allowing the Legislature to suspend the minimum funding requirements. In so doing, the Legislature can provide an alternative level of funding to that required by the Proposition 98 formulas. In order to suspend, the Legislature must pass an urgency bill – other than the budget bill – requiring a two-thirds vote for passage. To date, the Legislature has voted to suspend the Proposition 98 minimum guarantee twice – in 2004-05 and 2010-11.

Maintenance Factor. In years following a suspension of the minimum guarantee or a Test 3 year, (when the Proposition 98 guarantee grows more slowly due to declining or low General Fund growth), the state creates an out-year obligation referred to as a "maintenance factor." When growth in state General Fund revenues is healthier (as determined by a specific formula also set forth in the Constitution), the state is required to make maintenance factor payments, thereby accelerating growth in K-14 funding, until the maintenance factor obligation is fully restored.

Settle-Up. Another type of Proposition 98 obligation is created when the finalized calculation of the minimum guarantee for a particular year ends up being higher than the Proposition 98 appropriation for that year. When this happens, the state needs to make a "settle-up payment" (or series of payments) to ensure the minimum guarantee is met.

GOVERNOR’S PROPOSAL:

Proposition 98 – Overall Funding Levels for K-14 Education

2011-12 Revisions. The Governor’s proposed revisions provide **\$47.6 billion** in Proposition 98 funding in 2011-12. This is roughly \$1.0 billion below the level of funding authorized in the 2011 Budget Act, reflecting reductions of \$436 million in December trigger cuts and more than \$588 million in savings from lower than estimated student growth funding. Since the estimated minimum guarantee drops by \$360 million below 2011-12 budget levels, the Governor proposes **\$661 million** in future settle-up payments to meet the revised minimum guarantee in 2011-12. This level of funding reflects new revenues for K-14 education from the Governor’s proposed

November 2012 tax initiative. The Administration assumes that 2011-12 will continue to be a Proposition 98 Test 1 year.

Proposition 98 Funding (Dollars in Millions)	2011-12 Revised	2012-13 Proposed	Change from 2011-12	
			Amount	Percent
K-12 education				
General Fund	\$29,329	\$33,755	\$4,426	15%
Local property tax revenue	12,891	12,908	17	0%
Subtotals	\$42,220	\$46,663	4,443	11%
Community Colleges				
General Fund	\$3,217	\$3,683	465	14%
Local property tax revenue	2,107	2,101	-6	0%
Subtotals	5,324	5,784	459	9%
Other Agencies				
General Fund	83	80	-2	-3%
Totals	\$47,627	\$52,527	\$4,900	10%
General Fund	\$32,629	\$37,518	\$4,889	15%
Local property tax revenue	\$14,998	\$15,009	\$11	0%

2012-13 Proposals. The Governor’s Budget provides Proposition 98 funding of **\$52.5 billion** for K-12 education in 2012-13, an increase of \$4.9 billion compared to 2011-12, as revised. This level of funding assumes passage of the Governor’s 2012 tax initiative, which per the Administration would produce an additional \$2.5 billion in new funds for education in 2012-13. The Administration estimates that Proposition 98 will be a Test 1 year in 2012-13.

The Governor proposes to expend the additional \$4.9 billion in funds principally to reverse \$2.2 billion in costs for the new K-14 inter-year payment deferrals in 2011-12; reduce ongoing K-14 payment deferrals in 2012-13 by \$1.8 billion; continue \$496 million in funding for school transportation programs in 2012-13; and provide \$90 million to hold districts harmless from any loss of per-pupil funding from the proposed Weighted Pupil Formula in 2012-13.

Proposition 98 Trigger Cuts

2012-13 Trigger Cuts. In the event his 2012 tax initiative does not pass, the Governor has an alternative Proposition 98 budget plan for 2012-13. Under the Governor’s alternative plan, Proposition 98 guarantee would fall to approximately **\$50.3 billion** in 2012-13 and approximately \$4.8 billion in Proposition 98 funding reductions would be “triggered” mid-year for K-14 education. These reductions reflect a \$2.4 billion drop in the minimum guarantee from lower revenues. In addition, the Governor proposes to shift K-14 general obligation bond debt service payments into the lower minimum guarantee, accompanied by \$2.4 billion in Proposition 98 program reductions to accommodate this shift.

In order to achieve the \$4.8 billion in Proposition 98 reductions in 2012-13, the Governor proposes to: (1) eliminate the restoration of \$1.8 billion in inter-year payment deferrals currently proposed by the Governor; and (2) implement an additional \$3.1 billion in unspecified, proportional programmatic reductions for K-14 education. The table below displays the specific reductions for K-12 and community colleges included in the Governor’s mid-year trigger cuts.

Governor’s 2012-12 Trigger Cuts (Dollars In Billions)	K-12 Schools	Community Colleges	Total
Eliminating Buy Down of Payment Deferrals	\$1.6	\$.2	\$1.8
Unspecified Programmatic Cuts	2.8	.3	3.1
Total	\$4.4	\$.5	\$4.8*

*Numbers do not add due to rounding.

The Administration plans to work with K-12 schools and community college officials and stakeholders to develop legislation regarding the unspecified programmatic reductions with intent to protect education programs and allow the education systems to develop and implement necessary contingency plans.

Governor’s Major Budget Adjustments. The Governor’s Proposition 98 budget proposal reflects a variety of factors – new revenues and various rebenching adjustments – that change the minimum guarantee in 2011-12 and 2012-13. Altogether, these adjustments have the effect of increasing the Proposition 98 minimum guarantee by **\$2.3 billion** in 2012-13. These adjustments are listed and described below.

- **Revenue Adjustments.** The Governor assumes the following changes in revenues that affect calculation of the Proposition 98 minimum guarantee.
 - **New Revenues from the Governor’s Tax Initiative.** As proposed, the Governor’s November 2012 tax initiative would raise \$6.9 billion in new revenues that would be directed to the Education Protection Account. The Governor budgets these revenues on an accrual basis, which attributes \$2.2 billion to 2011-12 and \$4.7 billion to 2012-13. While these revenues are partially offsetting to Proposition 98, the Governor estimates that the Proposition 98 minimum funding guarantee will grow by **\$879 million** in 2011-12 and **\$2.4 billion** in 2012-13 as a result of these new revenues.
- **Rebenching Adjustments.** In addition to assuming new revenues, the Governor’s Budget includes a series of adjustments to rebench the Proposition 98 guarantee to reflect tax shifts and programmatic shifts. Several of the Governor’s proposed changes involve application of a 1986-87 level cost methodology – used to rebench in the past – in order to provide a single, consistent methodology for all rebenching adjustments. Individual adjustments are summarized below:
 - **Fuel Tax Swap.** The 2011-12 budget act increased the minimum funding guarantee by **\$578 million** to reflect current laws that hold Proposition 98 harmless from the loss of revenues from the fuel tax swap that began in 2010-11. Trailer bills in 2011-12 extended previous laws that assured no negative effect from the amounts that would otherwise be calculated for the tax change under Test 1 of the Proposition 98 minimum funding guarantee. The Governor’s 2012-13 budget proposes to eliminate these policies enacted to hold Proposition 98 harmless from the elimination of the state’s share of sales tax on

gasoline. This adjustment would reduce the minimum guarantee by **\$596 million** beginning in 2011-12.

- **RDA Related Property Taxes.** The 2011-12 budget required redevelopment agencies (RDAs) to make **\$1.7 billion** in remittance payments to K-12 local education agencies pursuant to 2011-12 budget trailer bills. As enacted, these budget measures required that new local funds be used to offset state General Fund support of Proposition 98 through a rebenching of the Test 1 factor. A recent California Supreme Court decision on last year's legislation resulted in the elimination of RDAs and a different allocation of related property tax revenue to schools and community colleges. Due to the court decision, estimated revenues for schools and community colleges have dropped from \$1.7 billion to \$1.1 billion in 2011-12. The Governor's Budget proposes to continue **\$1.1 billion** in offsetting local property taxes in 2012-13 due to the elimination of RDAs. In so doing, the Governor proposes to rebench this adjustment based upon 1986-87 property taxes. This adjustment increases the minimum guarantee by **\$267 million**.
- **Child Care Funding Shift.** The 2011-12 budget provided a decrease in the minimum guarantee of **\$1.134 billion** to reflect the shift of funding for most child care programs from Proposition 98 General Fund to non-98 General Fund. The budget continued Proposition 98 funding for part-day preschool programs in 2011-12. The Governor proposes to rebench the 2011-12 funding shift based upon the 1986-87 costs for child care programs. This adjustment increases the minimum guarantee by an additional **\$298 million** in 2012-13, compared to the 2011-12 budget act.
- **Mental Health Shift.** The 2011-12 budget act provided an increase of **\$221.8 million** in Proposition 98 funding to reflect a shift in responsibility for the provision of educationally related mental health services for students with disabilities from counties to K-12 schools. The minimum guarantee was increased by \$221.8 million to cover these services in 2011-12. The Governor proposes to rebench this 2011-12 funding shift based upon the 1986-87 costs for these mental health programs. This change reduces the minimum guarantee by **\$197 million** in 2011-12. In addition, the Governor proposes an additional adjustment of **\$98.6 million** for special education mental health services in 2012-13 to cover costs funded in 2011-12 out of Proposition 63 funds, ensuring the guarantee is fully adjusted for the program. This change increases the minimum guarantee by **\$5 million** in 2012-13.

Major Adjustments -- Governor's Alternative Budget. The Governor proposes the following revenue and rebenching adjustments, if the tax initiative is not passed by voters:

- **Revenue Adjustments.**

- **Realignment-Related Sales Taxes.** The 2011-12 budget package removed \$5.1 billion in sales tax revenues from the Proposition 98 calculation to reflect the redirection of specific state sales tax revenues to local realignment. As a result, these sales tax funds were excluded from the Proposition 98 calculation in 2011-12 and reduced the minimum funding guarantee by **\$2.1 billion**. Pursuant to budget trailer bill language contained in AB 114 (Ch. 43; Statutes of 2011), these sales tax exclusion provisions are operative beginning in 2011-12, only if: (1) these changes are authorized via ballot measures prior to November 17, 2012; and (2) new funding is provided for K-12 schools and community colleges equal to the amount that would have otherwise been provided if specified sales

tax revenues were General Fund. If these conditions are not met, sales tax funds that would have been provided to Proposition 98 in 2011-12 prior to this shift would have to be calculated and repaid to K-12 schools and community colleges -- over a five year period beginning in 2012-13. In subsequent fiscal years, these sales tax revenues would be included in the calculation of the minimum guarantee. The Governor’s alternative budget includes \$450 million in General Fund in 2012-13 to begin repayments to backfill for the \$2.1 billion loss of realignment-related sales taxes from Proposition 98 in 2011-12. However, under his alternative budget, the Governor proposes to exclude realignment-related sales taxes from the Proposition 98 minimum guarantee in 2012-13.

- **General Obligation Bond Debt Payments.** The Governor proposes to include K-14 general obligation bond debt-service payments within the Proposition 98 minimum guarantee in 2012-13. The Governor proposes to rebench the guarantee to reflect this shift based upon the 1986-87 costs for these bond payments. This adjustment increases the minimum guarantee by **\$200 million** in 2012-13. The cost of debt service payments is \$2.6 billion. To accommodate the remaining program within the minimum guarantee, the Governor proposes \$2.4 billion in unspecified Proposition 98 programmatic reductions.

Governor’s Major Proposition 98 Expenditure Proposals. As summarized by the table below, the **\$4.9 billion** in additional Proposition 98 funding provided by the Governor’s budget plan in 2012-13 would be expended primarily to backfill one-time solutions in 2011-12 – most notably to cover the costs of the \$2.2 billion K-14 payment deferral added in 2011-12 – and to buy-down ongoing K-14 payment deferrals by \$1.8 billion in 2012-13.

2012-13 Proposition 98 Spending Changes - Ongoing	
(Dollars In Millions)	
Technical	
Backfill one-time actions	\$ 2,688
Make revenue limit technical adjustments	162
Fund revenue limit growth	158
Backfill Proposition 63 mental health funding	99
Backfill CCC fee revenue decline	97
Make other technical adjustments	66
Subtotal	\$ 3,271
Policy	
Pay down K-12 deferrals	\$ 1,565
Pay down CCC deferrals	218
Create K-12 mandate block grant	98
Per Pupil “hold harmless” for Weighted Pupil Formula	90
Create CCC mandate block grant	12
Do not initiate Transitional Kindergarten program	-224
Reduce preschool funding	-58
Swap one-time funds	-57
Eliminate Early Mental Health Initiative	-15
Subtotal	\$ 1,629
Total	\$ 4,900

The Governor’s January 10 budget proposed to eliminate all funding for school transportation programs in 2012-13, for a savings of **\$496 million** in 2012-13. The Governor’s latest budget proposes to restore this funding for one year only in 2012-13. On a related front, SB 81 (Chapter 2; Statutes of 2012) – as signed into law on February 12, 2012 – restores \$248 million in trigger cuts for school transportation programs pursuant to the original 2011-12 budget package, and instead implements a \$248 million reduction in revenue limit apportionments in 2011-12.

The Governor provides **\$158 million** in growth funding for K-12 revenue limit apportionments based upon enrollment growth – as measured by student average daily attendance (ADA) – which is estimated by the Administration to grow by .35 percent in 2012-13. The Governor also provides growth funding for two categorical programs – **\$56.6 million** for Charter Schools and **\$12.3 million** for Special Education. The Governor does not provide growth funding for the community colleges in 2012-13. In addition, the Governor does not propose to fund cost-of-living adjustments (COLAs) for K-14 education programs. The COLA rate is estimated at 3.19 percent in 2012-13.

The Governor’s proposal adds **\$110 million** to expand funding for new block grants for K-12 schools and community colleges to replace the current education mandates program in 2012-13.

The Governor also proposes to reduce several programs, including savings of **\$224 million** to halt the creation of a new, two-year state “Transitional” Kindergarten (TK) program beginning in 2012-13, pursuant to Chapter 75, Statutes of 2010. (The Administration indicates that the Governor’s latest TK proposal could reduce savings by up to \$100 million in 2012-13 due principally to declining enrollment adjustments.) In addition, the Governor proposes to cut the state preschool program by **\$57 million** by lowering income eligibility and reducing reimbursement rates in 2012-13.

Reducing the State’s Wall of Debt

The Governor’s Budget proposes to pay down the “Wall of Debt” as a means of addressing unprecedented levels of state debts, deferrals, and budgetary obligations. The Governor’s Wall of Debt identifies **\$33 billion** in outstanding budgetary borrowing statewide. According to the Department of Finance, this includes **\$17.4 billion (52.7 percent)** in Proposition 98 related funding obligations for K-12 schools and community colleges.

Governor’s Budget -- Outstanding Budgetary Borrowing (Dollars in Billions)	
Deferred payments to K-12 schools and community colleges	\$10.4
Unpaid state mandate costs to K-12 schools and community colleges	3.6
Underfunding of Proposition 98:	3.4
-Proposition 98 Settle-Up	(1.9)
-Quality Education Investment Act	(1.1)
-Emergency Repair Program	(0.5)
Total, K-14 Education	\$17.4
Total, All State Programs	\$33.0

Similar to the Governor's Wall of Debt, the Legislative Analyst's Office (LAO) has tracked outstanding Proposition 98 obligations in recent years through updates of the "Education Credit Card". Beyond the Governor's list, the LAO also includes obligations to restore revenue limit deficit factors for K-12 schools on the Education Credit Card list. Here's a summary of the Proposition 98 spending obligations identified by the Governor and the LAO to date.

- **K-14 Inter-Year Payment Deferrals.** The 2011-12 budget act continued the state's reliance on ongoing, inter-year payment deferrals to achieve budget solution, deferring an additional \$2.1 billion in K-12 payments and \$129 million in CCC payments from 2011-12 to 2012-13. As a result, ongoing Proposition 98 payment deferrals total **\$10.4 billion** for K-12 schools and community colleges in 2011-12. At this level, 20 percent of the funding for Proposition 98 programs in 2011-12 will not be paid until 2012-13. The Governor proposes to reduce K-14 deferrals by \$1.8 billion in 2012-13, which would reduce ongoing, inter-year deferrals to approximately \$8.6 billion in 2012-13.
- **K-14 Education Mandate Backlog.** The Department of Finance estimates that the state's backlog of unpaid, K-14 mandate claims totaled **\$3.6 billion** at the end of 2011-12. These large unfunded balances resulted in part from the practice of "deferring" annual mandate payments as a means of achieving budget savings. The courts have clarified that K-12 schools and community colleges must fully fund, suspend, or eliminate mandates, so the state can no longer defer mandate payments. The Governor proposes a number of reforms to the K-14 education mandate system beginning in 2012-13.
- **Quality Education Investment Act (QEIA) Payments Remain.** The Governor's budget includes **\$450 million** in General Funds to support the QEIA program in 2012-13, which originated with a \$2.8 billion Proposition 98 "settlement" agreement in 2006-07. Of this amount, \$402 million is provided to schools and \$48 million is provided to community colleges. Per statute, the state will be required to make payments through 2014-15 in order to pay off **\$1.1 billion** in remaining funds owed per the settlement agreement.
- **Facility Repair Funding Owed.** In 2004, the state settled the *Williams v. California* case, a class-action lawsuit filed on behalf of public school students. In response to the settlement, the Legislature created the Emergency Repair Program (ERP), which provides grants for critical health and safety repairs in certain low-performing schools. Per statute, the state is required to provide a total of \$800 million over the life of ERP to meet the requirements of the settlement. The state has appropriated \$343 million for the program to date, leaving **\$457 million** in remaining funds owed for ERP. In recent years, full funding for the program has been suspended due to budget shortfalls. The Governor proposes **\$12.3 million** in one-time Proposition 98 reversion funds for ERP in 2012-13.
- **Revenue Limit Deficit Factor Obligations.** Revenue limits provide the primary form of general purpose (discretionary) funding for K-12 local agencies – school districts and county offices of education. Revenue limits are funded through both property taxes and state General Fund and allocated on the basis of student enrollment, as measured by average daily attendance (ADA). Funds are continuously appropriated by statutes that continue base funding, adjusted by cost-of-living adjustments (COLAs). In recent years, state funding has been insufficient to fully fund base revenue limits or COLAs. Budget trailer bills have defined statutory deficit factors to reflect base revenue limit reductions and foregone COLAs,

and to apply cuts equally to school districts and county offices of education. These deficit factors have been used traditionally to track base revenue limit reductions and foregone COLAs, so that revenue limit levels could eventually be restored. The Governor’s Budget reflects deficit factors of 21.666 percent for school districts and 22.497 percent for county offices in 2012-13. It would cost the state approximately **\$9.8 billion** to eliminate these deficit factors and fully restore revenue limit base funding and statutory COLAs to K-12 local agencies.

Maintenance Factor Obligations Under Governor’s Proposals. The Department of Finance has provided the following information reflecting the level of the Proposition 98 minimum guarantee and maintenance factor under the Governor’s budget proposals, including his alternative budget plan.

Proposition 98 Funding (Dollars in Millions)	2011-12 Revised	2012-13 Proposed	Alternative Budget	
			2011-12 Revised	2012-13 Proposed
State Appropriations Limit (SAL)				
General Fund Revenues	\$85,140	\$92,457	\$82,891	\$87,756
Proposition 98 Minimum Guarantee (State and Local)	48,288	52,527	47,409	50,283
Proposition 98 Guarantee (GF)	32,629	30,881	32,629	35,274
Education Protection Account		6,637		
Local Revenues	14,998	15,009	14,998	15,009
Total Proposition 98 Funded	\$47,627	\$52,527	\$47,627	\$50,283
Proposition 98 Test	1	1	1	2
Settle Up Created	661			
Settle Up Outstanding	2,569	2,569	1,908	1,908
Maintenance Factor Obligation	10,577	9,739	10,359	10,764
Maintenance Factor Created/Paid (+/-)	--	(1,359)	(218)	(105)

The Governor’s budget proposal, which provides **\$52.527 billion** Proposition 98 funding in 2012-13 to meet the minimum guarantee, reflects a **\$9.739 billion** maintenance factor obligation. Due to the new revenues created by the Governor’s tax initiative, Proposition 98 formulas require a maintenance factor payment in 2012-13. The Governor proposes to make a **\$1.359 billion** maintenance factor payment in 2012-13, which reduces the amount of outstanding maintenance factor owed in 2011-12. The Governor’s budget assumes that Test 1 will continue to be the operative test in 2012-13. In calculating the minimum guarantee, the Governor proposes to pay maintenance factor on top of the Proposition 98 Test 1 amount in 2012-13.

Under the Governor’s alternative budget, the Proposition 98 funding drops from \$52.527 billion to **\$50.283 billion** in 2012-13 – a drop of **\$2.244 billion**. The Governor’s alternative budget assumes that the operative Proposition 98 test will change from Test 1 in 2011-12 to Test 2 in 2012-13. The Governor’s alternative budget would provide relatively small maintenance factor payments – \$218 million in 2011-12 and \$105 million in 2012-13 – due to the drop in revenues assuming the tax initiative does not pass. These payments result in a small reduction in maintenance factor in 2011-12. However, ongoing maintenance factor would grow to **\$10.764**

billion in 2012-13 – even with the small 2012-13 payment – due to changes that result from shifting from a Test 1 to Test 2 calculation.

Programmatic Spending for K-12 Education. The LAO has prepared the table below summarizing total “programmatic funding” for K-12 schools from 2007-08 through 2012-13, including Proposition 98 funds, non-98 General Funds, special funds and federal funds.

Programmatic Funding (Dollars in Millions)	2007-08 Final	2008-09 Final	2009-10 Final	2010-11 Final	2011-12 Revised	2012-13 Proposed	2012-13 Proposed Alternative
K-12 ongoing funding	\$48,883	\$43,215	\$40,717	\$43,017	\$42,254	\$47,341	\$42,243
Payment deferrals		2,904	1,679	1,719	2,064	-1,565	
Settle-up payments		1,101		267			
Public Transportation Account	99	619					
Freed-up restricted reserves		1,100	1,100				
ARRA funding		1,192	3,575	1,192			
Federal education jobs funding				421	781		
Totals	\$48,982	\$50,130	\$47,070	\$46,616	\$45,099	\$45,776	\$42,243
Per-Pupil Programmatic Funding							
K-12 attendance	5,947,812	5,957,790	5,933,768	5,947,368	5,950,041	5,970,775	5,970,775
K-12 per pupil funding (Actual Dollars)	\$8,235	\$8,414	\$7,933	\$7,838	\$7,580	\$7,667	\$7,075

In calculating programmatic funding, the LAO offers a method of reflecting the true level of funding available to K-12 schools for program in a given fiscal year. The utilization of large inter-year payment deferrals to address budget shortfalls and the influx of significant one-time federal education funds to our state has made this less than straightforward, especially for purposes of making year-to-year funding comparisons.

Assuming the Governor’s tax initiative is passed by voters, the LAO estimates per pupil programmatic funding would total **\$7,667** in 2012-13, a year-over-year increase of **\$87** compared to 2011-12. K-12 schools would receive **\$568** less per pupil in programmatic funding in 2012-13 compared to 2007–08.

Under the Governor’s alternative budget plan – assuming the tax initiative fails passage – per pupil programmatic funding would total **\$7,075** in 2012-13. This level of funding would reflect a per pupil decrease of **\$505** from 2011-12. Compared to 2007-08, K-12 schools would receive **\$1,160** less in per pupil programmatic funding in 2012-13 under the Governor’s alternative plan.

ISSUES TO CONSIDER:

There are several major issues for the Legislature as it considers the Governor's Proposition 98 budget proposals for 2012-13.

Governor Budget Proposals:

How will revenue changes influence the Governor's Proposition 98 proposals? The LAO estimates lower baseline revenues and lower revenues from the Governor's tax initiative in 2012-13. Under the Governor's plan, new revenues from the tax initiative are budgeted on an accrual basis. How will all of these revenue factors affect the level of Proposition 98 funding under the Governor's plan in 2012-13? How will these revenue factors affect the level of funding for the Governor's alternative budget if the tax initiative does not pass?

What level of funding would the Governor's proposal provide for Proposition 98 funding beyond the budget year? According to the LAO, while the Governor's plan is difficult in 2012-13, his plan would improve notably the outlook for K-14 education over the next four years.

How do programmatic rebenching adjustments affect the minimum guarantee? The Governor proposes a series of rebenching adjustments to the minimum guarantee that are tied to both revenue changes and program shifts in and out of Proposition 98. Several of these adjustments reflect updates based upon the 1986-87 costs of the program. According to the Administration, "the 1986-87 level cost methodology was used for previous rebenchings and, therefore, the change provides a single and consistent methodology for all rebenching adjustments." What is the net effect of all these rebenchings on the Proposition 98 guarantee?

Governor's Alternative Budget:

Why are realignment-related sales taxes excluded from Proposition 98? The Governor's alternative budget assumes payments to make up approximately \$2.1 billion in excluded sales taxes in 2011-12, pursuant to AB 114. These payments will be made over a five year period beginning in 2012-13. However, the Governor excludes sales taxes from calculation of the Proposition 98 minimum guarantee in 2012-13. While AB 114 seems to require that the state add sales taxes to the Proposition 98 calculations in 2011-12, and beyond, this is not the Administration's interpretation. If the tax initiative fails passage, the Administration does not believe that current statutes require realignment-related sales taxes to be added back to the Proposition 98 calculation in the future. Additionally, the Administration does not believe that the \$2.1 billion in payment owed for 2011-12 would become a part of the Proposition 98 base moving forward.

What is the appropriate K-14 share of trigger cuts? Proposition 98 funding reductions for K-14 education would total \$4.8 billion in 2012-13 per the Governor's alternative plan, which equates to about 90 percent of the 2012-13 trigger cuts. On face, K-14 education is taking a large share of the trigger cuts.

What is behind the Governor’s proposal to shift general obligation payments for K-14 education within the Proposition 98 budget? The Governor’s proposal would shift K-14 education general obligation bond debt service payments into Proposition 98, thereby displacing existing education program spending. It appears that this shift would allow the state to make programmatic reductions and still fund the Proposition 98 minimum guarantee, thus avoiding a suspension. The Governor also proposes to include state general obligation bond debt payments for the University of California and California State University within the respective budgets for these two higher education segments.

What is the impact of \$3.1 billion in K-14 programmatic trigger cuts? The Governor proposes to work with K-12 schools and community colleges to develop the details for proposed trigger cuts, including **\$2.8 billion** for K-12 education and **\$300 million** for community colleges in 2012-13. According to the Administration, a reduction of this magnitude equates to a reduction of more than three weeks of instruction for K-12 schools. These additional trigger cuts would be layered on substantial, ongoing revenue limit base and categorical programs reductions in the billions, as well as \$436 million in 2011-12 trigger cuts for K-12 school programs.

What’s the best way to structure trigger cuts in 2012-13? The LAO has raised concerns that the Governor’s alternative budget plan is based upon revenues that will not materialize until mid-year and then has a relatively severe back-up plan in case the revenues do not materialize. The LAO is concerned that such an approach generates significant uncertainty for K-12 school districts in particular. The LAO suggests that the Legislature be very deliberate in developing a trigger package, “its size and essence will determine the size and quality of California’s 2012-13 K-14 education program.”

What is the impact of elimination of \$1.8 billion deferral buy-down for K-14 education? In making the trigger cuts, the Governor turns first to eliminating the K-14 deferral buy-down to avoid programmatic reductions. Elimination of the buy-down would eliminate any prospects of cash relief for school districts and community colleges in 2012-13. However, there are certainly local borrowing costs associated with deferring **\$10.4 billion** (about 20 percent) in annual payments to the next fiscal year. Are ongoing deferrals of this level sustainable for K-12 schools and community colleges for continued borrowing, especially as they deplete budget reserves and one-time federal funds?

What are the long-term effects of the Administration’s approach for paying maintenance factor in 2012-13? In recent years there has been disagreement about *when* maintenance factor is created and paid. Some of the new and ever-changing Proposition 98 scenarios may not have been contemplated by the constitutional provisions of Proposition 98. In addition to disagreement about when maintenance factor is paid, there has been disagreement about *how* maintenance factor is paid. Confusion about when maintenance factor is paid continues in 2012-13. The Administration estimates that Test 1 will be the Proposition 98 test in 2012-13. While Test 1 has been operative in several recent years, it has been lower than Test 2, so when maintenance factor payments were paid on top of Test 1, they were lower than Test 2. In 2012-13, Test 1 will be higher than Test 2. This situation has never occurred before in Proposition 98 history. It rekindles recent debates about when and how maintenance factor should be paid. Paying maintenance factor on top of Test 1 – when it is higher than Test 2 – could significantly increase the minimum guarantee in years with strong growth in General Fund revenues.