

SUBCOMMITTEE NO. 1 on Education



Subcommittee No. 1

Chair, Carol Liu

Member, Robert Huff

Member, Roderick Wright

**Monday, January 24, 2011
2:30 p.m. or Upon Adjournment of Session
Room 3191, State Capitol**

**Overview of the Governor’s P-98 and K-12 Education Budget –
Department of Finance**

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

**Comments on the Governor’s K-12 Education Budget,
Erin Gabel, Department of Education**

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ISSUE 1: Governor’s Budget Proposal - Student Attendance Adjustments

DESCRIPTION: The Governor’s Budget provides a funding increase of **\$81.4 million** in 2011-12 to reflect K-12 student attendance growth for revenue limit programs and two categorical programs subject to statutory growth adjustments. This action reflects Department of Finance (DOF) estimates that predict the number of students attending K-12 schools in 2011-12 will increase by 0.22 percent above 2010-11 revised levels.

The Governor also provides an increase of **\$357.5 million** to reflect K-12 student attendance growth for revenue limit programs in 2010-11, thereby revising funding above the level provided in the 2010-11 budget act.

BACKGROUND:

Attendance Estimates. The number of students attending K-12 schools, which is measured by average daily attendance (ADA), is estimated by DOF to increase by 12,974 in 2011-12, an increase of 0.22 percent above the revised 2010-11 level. This attendance increase will bring total K-12 (ADA) from 5,951,826 in 2010-11 to 5,964,800 in 2011-12. While enrollment rates were declining in many years since 2005-06, this increase reflects the second year of positive attendance growth for K-12 schools.

K-12 attendance growth declined for four out of five years between 2005-06 and 2009-10. These declines reflected the loss of children born to “baby-boomers” who are aging out of the K-12 schools – particularly high schools -- and a decline in birth rates beginning in the 1990s. However, K-12 attendance is projected to increase in 2010-11 and 2011-12, and will likely continue in coming years, due to increasing population for elementary grade students.

Student Numbers	2005/6	2006/7	2007/8	2008/9	2009/10	2010/11	2011/12
Student ADA*	5,965,701	5,953,147	5,947,758	5,957,790	5,933,761	5,951,826	5,964,800

**Average Daily Attendance.*

Student enrollment changes play out quite differently for elementary schools and high schools than reflected by statewide trends overall. Enrollment trends also differ greatly among school districts. The latest data available (2009-10) indicates that 550 districts statewide are currently experiencing declining enrollment; another 416 districts are not in decline.

Attendance Growth Rates. Most K-12 education programs – revenue limits and categorical – are subject to annual statutory growth adjustments. Per statute, revenue limit and several categorical programs require adjustments based upon the ADA growth rates; other categorical programs have more specialized growth rates. Categorical programs typically receive enrollment growth at budgeted rates; revenue limits, which are continuously appropriated, receive growth at adjusted rates.

GOVERNOR'S BUDGET PROPOSALS

2010-11 Attendance Adjustments. (Total \$357.5 million)

- **Revenue Limits.** The Governor provides a net increase of **\$357.5 million**, above the 2010-11 budget act, to reflect estimated ADA growth for revenue limit programs, which are subject to continuous appropriations. This total includes an increase of \$389.2 million for school districts and a decrease of \$31.7 million for county offices of education.
- **Categorical Programs.** The Governor does not propose any funding changes for categorical programs subject to statutory attendance adjustments. As indicated previously, statutory categorical adjustments follow budgeted rates, and are not subject to adjusted rates, as is the case for revenue limit programs, which are continuously appropriated.

2011-12 Attendance Adjustments. (Total \$104.9 million)

- **Revenue Limits.** The Governor provides a net increase of **\$81.4 million** for revenue limit programs above the 2010-11 revised level. This amount includes a \$88.9 million increase for school districts and \$7.5 million decrease for county offices of education.
- **Categorical Programs.** The Governor provides **\$23.5 million** to provide positive growth adjustments for two categorical programs subject to statutory adjustments. This amount includes a \$16.1 million increase for the Charter School Categorical Block Grant program to reflect increased ADA for new charter schools and \$7.4 million for the Special Education program to reflect estimated ADA growth.

STAFF COMMENTS:

- **May Revise Updates.** DOF will update 2011-12 estimates of student ADA as part of the Governor's May Revise to reflect more current K-12 enrollment data.
- **Governor's Proposal Provides Positive Growth to Selective Categorical Programs in 2011-12.** DOF estimates positive growth for approximately 12 categorical programs, but provides growth funding for only two programs – the Charter School Categorical Block Grant (\$16.1 million) and Special Education (\$7.4 million) programs. Other programs with similar amounts of estimated growth—but not funded by the Governor -- include Adult Education (\$19.8 million) and Child Nutrition (\$7.3 million).
- **Governor Protects Two Categorical Programs from Negative Growth Adjustments – Lost Savings in 2011-12.** The Governor's proposal does not apply negative growth adjustments to two categorical programs (excluding child care) estimated to decline in 2011-12. Elimination of these protections could create **\$30.1 million** in savings that could be used for other purposes in 2011-12. For example, these savings could be directed to providing positive COLA for other statutory programs that are growing, most notably Child Nutrition.

- **Declining Enrollment.** The Governor’s Budget estimates **\$334 million** for revenue limit enrollment adjustments for school districts experiencing declining enrollment in 2011-12. Revenue limit funding is calculated by multiplying revenue limit rates for school districts times student enrollment, which is calculated by average daily attendance (ADA). State statute allows school districts that are experiencing declining student enrollment to delay revenue limit reductions associated with enrollment declines for one year. Declining enrollment districts can choose to use prior year enrollment as the basis of their revenue limit funding to soften the impact of enrollment based funding losses. This is significantly lower than expenditures in previous years.

The \$334 million budgeted for declining enrollment in 2011-12 is significantly lower than amounts provided in previous years at the height of enrollment declines. As K-12 attendance continues to increase statewide, the number of districts in decline and state spending for declining enrollment will also decrease.

QUESTIONS:

1. How does the Governor’s Budget fund the \$357.5 million in statutory revenue limit ADA adjustments in 2010-11, given the Proposition 98 funding level was set by Chapter 715, Statutes of 2010?
2. Why doesn’t the Governor apply negative growth adjustments for categorical programs subject to statutory adjustments? For example, the Department of Finance estimates negative growth of \$28.4 million for the Teacher Credentialing Block Grant in 2011-12?
3. Why were the Charter School Categorical Block Grant (\$16.1 million) and Special Education program (\$7.4 million) selected for growth funding, above other categorical programs that are also subject to statutory growth adjustments? For example, the Department of Finance estimates positive growth of \$7.3 million for the Child Nutrition program in 2011-12, but does not propose to fund that growth.
4. How has growth funding been handled in recent years for nearly 40 programs included in the Categorical Flexibility Program established in 2008-09?

6110 CALIFORNIA DEPARTMENT OF EDUCATION

ISSUE 2: Governor's Budget Proposal - Cost-of-Living Adjustments

DESCRIPTION: The Governor proposes not to fund cost-of-living adjustments (COLAs) for K-12 education programs in 2011-12. The Department of Finance (DOF) estimates a COLA of 1.67 percent for K-12 education programs in 2011-12. The Governor's proposal equates to a savings of **\$860.5 million** for K-12 revenue limit and categorical programs in 2011-12.

BACKGROUND:

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

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

Due to recent budget shortfalls, COLAs have not been included in recent budget acts -- foregoing K-12 COLAs of 5.66 percent in 2008-09 and 4.25 percent in 2009-10.

In 2010-11, the K-12 COLA was estimated to be negative (-0.39 percent) due to recessionary factors that led to a decrease in government costs. According to the LAO, 2010-11 was the first time in over 60 years, the index used to calculate the K-12 COLA was negative. However, because positive COLAs had not been funded in previous years, the negative COLA was not applied in 2010-11. Instead COLA was funded at zero percent in 2010-11.

Deficit Factors. Deficit factors have been established in recent years to keep track of the foregone COLA for revenue limit programs -- adjusted by negative COLA in 2010-11 -- so revenue limit funding could eventually be restored to previous base levels. The Legislature is not required to create a deficit factor for revenue limits when no COLA is provided; however, the Legislature has adopted the practice of establishing deficit factors for revenue limit programs -- based upon statutory COLA rates -- when COLA has not been provided.

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

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

GOVERNOR'S BUDGET PROPOSAL:

The Governor proposes not to provide COLA, estimated by DOF at 1.67 percent for K-12 programs in 2011-12. This proposal will result in program savings of **\$860.5 million** in 2011-12 for revenue limit and categorical programs that traditionally receive COLA, as follows:

- **\$662.7 million** for revenue limit programs (statutory).
- **\$25.5 million** for child care categorical programs (statutory).
- **\$56.6 million** for special education program (statutory)
- **\$87.6 million** for other categorical programs (statutory)
- **\$28.1 million** for other categorical programs (discretionary)

The Governor proposes to establish deficit factors to track the foregone COLA for revenue limit programs in 2011-12, consistent with recent and traditional practice. Without funded COLA, revenue limit deficit factors will increase to **19.608 percent** for school districts and **19.892 percent** for county offices of education in 2011-12. (Note: Deficit factors reflect both foregone COLA and base reductions from past years for revenue limit programs.)

STAFF COMMENTS:

- **Governor's Proposal Reasonable; Reflects Budget Realities.** Given ongoing base reductions for revenue limit and categorical programs, and in light of substantial reductions for child care proposed by the Governor, it does not seem reasonable to provide COLA increases for K-12 programs in 2011-12.
- **Improving Efficiency of COLA Calculations.** Beginning in 2008-09, the prior Administration proposed to switch the current COLA index to a modified version of the California Consumer Price Index for Wage Earners and Clerical Workers. The LAO agreed with the need for an alternative, but recommended modifying the current K-14 COLA index (GDPSL) to focus more heavily on projected compensation cost increases that the Administration considered. At that time, both the prior Administration and the LAO had concerns with the existing K-12 COLA Calculation (GDPSL) because it is heavily weighted by costs that do not affect schools and community colleges. For example, the LAO then noted that schools typically spend about 85 percent of their annual budget on employee salaries and benefits, however employee compensation comprises only about 56 percent of the current COLA index. In addition, both the Administration and the LAO recommended that their alternative to the current COLA index take effect in a year when no COLA was being provided.

SUGGESTED QUESTIONS:

1. What factors within the State and Local Government Price Deflator (GDPSL) explain the COLA estimate of 1.67 percent in 2011-12? This positive rate contrasts with the negative COLA rate in 2010-11 – the first negative rate in 60 years. Have increasing fuel costs affected the 2011-12 COLA estimate?
2. Would the new Administration be open to considering changes to the basis of K-12 COLA calculations to better reflect school district costs? For example, the State and Local Government Price Deflator (GDPSL) gives heavy weight to fuel prices, even though about 85 percent of school district expenses are tied to employee salaries and benefits.

6110 CALIFORNIA DEPARTMENT OF EDUCATION

ISSUE 3: Governor’s Budget Proposal – Payment Deferrals

DESCRIPTION: The Governor proposes **\$2.1 billion** in additional, inter-year payment deferrals for K-12 education from 2011-12 to 2012-13. Per the LAO, the Governor’s proposal would bring annual K-12 inter-year payment deferrals to **\$9.4 billion**, which equates to **21 percent** of annual K-12 Proposition 98 payments. This proposal is central to the Governor’s K-12 Proposition 98 plan that maintains current year funding levels without making further programmatic cuts to K-12 education in 2011-12.

The Governor has also signaled that K-12 intra-year payment deferrals in effect in 2010-11 are likely to be continued in 2011-12 in order to meet the state’s cash needs.

BACKGROUND:

Inter-Year Deferrals Used for Ten Years as Alternative to K-12 Program Cuts. The state has been utilizing inter-year payment deferrals for ten years – since 2001-02. Deferrals have allowed K-12 local education agencies (LEAs) to essentially borrow from the next fiscal year to cover current programmatic costs.

The Legislative Analyst’s Office (LAO) points out, that initially, inter-year payment deferrals were a means of making mid-year budget reductions that would not cut programs well after the school year had commenced. Since the initial years, deferrals have become more a part of primary budget packages, as is the case with the Governor’s current proposal.

In addition, the size of deferrals has grown significantly in recent years. While remaining at about \$1.1 billion for most of the first seven years, inter-year deferrals have grown by \$6.280 billion in the last three years (2008-09 through 2010-11), as indicated by the LAO’s figures below. In 2010-11, year-to-year payment deferrals for K-12 LEAs total **\$7.383 billion**, which accounts for **17 percent** of annual Proposition 98 payments.

K-12 Inter-Year Deferrals	Amount
Prior Year Base (Beginning in 2001-02)	\$1.103 billion
2008-09 New	\$2.851 billion
2009-10 New	\$1.679 billion
2010-11 New	\$1.750 billion
SUBTOTAL, Current Inter-Year Deferrals	\$7.383 billion
Share of Proposition 98 Program	(17 percent)
2011-12 (New Proposed)	\$2.064 billion
TOTAL, Current & Proposed Inter-Year Deferrals	\$9.417 billion
Share of Proposition 98 Program	(21 percent)

As a result of larger inter-year payments, the LAO reports that more substantial portions of February to June payments for K-12 LEAs are currently made in the next fiscal year.

While a portion of the 2002-03 inter-year payment deferral was repaid in 2003-04, no other inter-year payment deferral has been repaid since then.

Intra-Year Deferrals Utilized to Meet State Cash Needs. In addition to inter-year payment deferrals to achieve budgetary savings, intra-year deferrals have been utilized for the last two years to help the state meet its cash needs. These intra-year deferrals proposals have differed in amount, length and frequency of deferrals, based on the state's cash flow situation at the time. In 2010-11, the state is authorized to defer \$2.5 billion in K-12 payments to LEAs in July and October 2011 and March 2012. These payment deferrals were authorized by two bills enacted in the 2010 Special Session -- ABX8 5 (Committee on Budget) and ABX8 14 (Committee on Budget).

GOVERNOR'S BUDGET PROPOSAL:

The Governor proposes to defer an additional **\$2.1 billion** in state payments for K-12 LEAs from 2011-12 to 2012-13. The Administration has not identified specific details for this new inter-year deferral yet. Specifically, the Administration has not indicated when (months) payment deferrals would occur and when they would be paid back. Per the LAO, the Administration has generally indicated deferrals would involve 2011-12 revenue limit payments that would not be repaid until September or October of 2012.

In addition, the Governor has signaled that intra-year payment deferrals for K-12 LEAs in effect in 2010-11 are likely to be continued in 2011-12. Under this scenario, \$2.5 million in K-12 payments to LEAs could be deferred for various periods in July and October 2011 and March 2012. However, specific details for these inter-year details have not yet been released by the Administration.

The Governor proposes to continue hardship waivers for both inter-year and intra-year deferrals to provide relief to LEAs that may not be able to maintain fiscal solvency with additional payment deferrals.

LAO COMMENTS:

Reliance on Deferrals Has Placed Significant Burdens on School Districts. Under the Governor's proposal, annual K-12 inter-year payment deferrals would increase by **\$2.1 billion** to a total of **\$9.4 billion**, so that **21 percent** of the 2011-12 Proposition 98 program would be paid in 2012-13. While the LAO recognizes that adopting deferrals will mitigate reductions that K-12 districts will have to make, the LAO believes that large deferrals have placed a large cash flow burden on LEAs. The LAO is concerned that additional deferrals would continue the deterioration of LEA fiscal health and could result in the need for state emergency loans to avoid insolvency.

Combination of New Inter-Year Deferrals and Continuation of Existing Intra-Year Deferrals Could Create Significant Cash Shortages for LEAs. The LAO indicates that inter-year deferrals would be especially problematic if they are not paid back until fall of 2012. (While not official, the Administration has indicated possible repayment in September or October 2012.) Per the LAO, the Governor's proposed intra-year deferrals would further exacerbate the problem – by deferring already-deferred payments until even later in the fiscal year. In combination, inter-year and intra-year deferrals could

result in K-12 LEAs facing significant cash flow difficulties in the summer and fall of 2012.

STAFF COMMENTS:

- **\$2.1 Billion Deferral Central to Governor's K-12 Proposition 98 Plan.** The \$2.1 billion K-12 payment deferral proposal is the most substantial piece of the Governor's plan to continue Proposition 98 funding in 2011-12 at essentially the same level as 2010-11, while maintaining programmatic spending. Without the deferral, K-12 schools would have to make \$2.1 billion in cuts in order to live within the Governor's budget in 2011-12.
- **More Details Needed to Assess Impact, Provide Advance Notice to LEAs.** While on a short budget time-frame, it will be important to have specific details as soon as possible on the amount and timing of payment deferrals and repayment schedules to assess impact and give LEAs advance notice so they can make plans to cover payments.
- **More Districts Might Seek Relief Through Hardship Waivers, Which Could Reduce Deferral Savings.** Given the LAO's concerns, it is likely that additional LEAs -- possibly small school districts -- will not be able to maintain fiscal solvency and will apply for deferral hardship waivers. These LEAs may find they cannot borrow internally and externally at a sufficient level to address the combined effects of continuing intra-year deferrals and new inter-year deferrals with longer repayment periods.

Suggested Questions:

1. Can the Department of Finance provide any additional details on the specifics of the inter-year deferrals for K-12 schools proposed by the Governor in 2011-12? For example, in what months will deferrals occur and when will deferrals be paid back?
2. Is it possible to defer an additional \$2.1 billion in K-12 payments from May or June of 2011-12 or will it require April, March, or February payments as well?
3. Is it likely that the Governor's new inter-year deferrals will not be repaid until September or October of 2012?
4. Can the Department of Education or LAO comment on how far is too far on state payment deferrals to LEAs? Where is the fiscal or legal limit for LEAs? For the state?
5. The LAO has raised serious concerns about the negative fiscal impact of the Governor's additional intra-year and inter-year deferrals -- especially in combination -- on LEAs. Is the Administration confident that the Governor's additional deferrals won't result in additional district insolvencies and emergency loans from the state?

6. Can the Department of Education provide any information on the number of hardship waiver requests received by districts for the 2010-11 payment deferrals? Did the number or types of LEAs change from 2009-10?
7. Does the existing hardship waiver process – in place for both inter-year and intra-year deferrals -- appear to provide effective relief to the LEAs that need it most?
8. While the Department of Education has not yet certified First Interim Fiscal Reports – submitted by LEAs in October 2010 - can the Department provide any information on the relative fiscal status of local educational agencies and their ability to absorb \$2.1 billion in new inter-year payment deferrals in 2011-12?
9. Is the Governor committed to reversing payment deferrals in future years? What is the likelihood that regular monthly payments will ever be restored to LEAs?
10. Since payment deferrals rely on paying current year bills with funding from next year, are deferrals good public policy in years when sufficient budget year growth cannot be assured?