Senate Budget and Fiscal Review—Scott D. Wiener, Chair

SUBCOMMITTEE NO. 1 Agenda

Senator John Laird, Chair
Senator Dave Min
Senator Scott Wilk

Thursday, February 29, 2024
9:30 a.m. or Upon Adjournment of Session
1021 O Street, Room 2100

Consultant: Yong Salas

Public Comment

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6100 DEPARTMENT OF EDUCATION

Issue 1: State of Education

Panel.

- Mary Nicely, Chief Deputy Superintendent, Department of Education

Background.

A representative of the Superintendent of Public Instruction will provide an update on the state of K-12 education in California. This item is informational only.

Issue 2: Fiscal Health of School Districts

Description.

The Fiscal Crisis and Management Assistance Team (FCMAT) provides a statewide resource to help monitoring agencies in providing fiscal and management guidance and helps local education agencies (LEAs) - school districts, county offices of education (COEs), and charter schools, as well as community college districts - fulfill their financial and management responsibilities. Lead FCMAT staff will provide a general overview of the fiscal health of school districts.

Panel.

- Mike Fine, Chief Executive Officer, FCMAT

Background:

Assembly Bill 1200 (Eastin), Chapter 1213, Statutes of 1991, created an early warning system to help LEAs avoid fiscal crisis, such as bankruptcy or the need for an emergency loan from the state. The measure expanded the role of COEs in monitoring school districts and required that they intervene, under certain circumstances, to ensure districts can meet their financial obligations. The bill was largely in response to the bankruptcy of the Richmond School District, and the fiscal troubles of a few other districts that were seeking emergency loans from the state. The formal review and oversight process requires that the county superintendent approve the budget and monitor the financial status of each school district in its jurisdiction. COEs perform a similar function for charter schools, and the California Department of Education (CDE) oversees the finances of COEs. There are several defined "fiscal crises" that can prompt a COE to intervene in a district: a disapproved budget, a qualified or negative interim report, or recent actions by a district that could lead to not meeting its financial obligations.

Beginning in 2013-14, funding for COE fiscal oversight was consolidated into the Local Control Funding Formula (LCFF) for COEs. COEs are still required to review, examine, and audit district budgets, as well as annually notify districts of qualified or negative budget certifications, however, the state no longer provides a categorical funding source for this purpose.

AB 1200 also created FCMAT, recognizing the need for a statewide resource to help monitoring agencies in providing fiscal and management guidance. FCMAT also helps LEAs fulfill their financial and management responsibilities by providing fiscal advice, management assistance, training, and other related services. FCMAT also includes the California School Information Services (CSIS). LEAs and community colleges can proactively ask for assistance from FCMAT, or the Superintendent of Public Instruction (SPI), the county superintendent of schools, the FCMAT Governing Board, the California Community Colleges Board of Governors or the state Legislature can assign FCMAT to intervene or provide assistance. Ninety percent of FCMAT's work is a result of an LEA inviting FCMAT to perform proactive, preventive services, or professional development. Ten percent of FCMAT's work is a result of assignments by the state

Legislature and oversight agencies to conduct fiscal crisis intervention. The office of the Kern County Superintendent of Schools was selected to administer FCMAT in June 1992.

Interim Financial Status Reports. Current law requires LEAs to file two interim reports annually on their financial status with the CDE. First interim reports are due to the state by December 15 of each fiscal year; second interim reports are due by March 17 each year. Additional time is needed by the CDE to certify these reports.

As a part of these reports, LEAs must certify whether they are able to meet their financial obligations. The certifications are classified as positive, qualified, or negative.

- A positive certification is assigned when an LEA will meet its financial obligations for the current and two subsequent fiscal years.
- A qualified certification is assigned when an LEA may not meet its financial obligations for the current and two subsequent fiscal years.
- A negative certification is assigned when an LEA will be unable to meet their financial obligations in the current year or in the subsequent fiscal year.

AB 1200 states the intent that the legislative budget subcommittees annually conduct a review of each qualifying school district (those that are rated as unlikely to meet their fiscal operations for the current and two subsequent years), as follows: “It is the intent of the Legislature that the legislative budget subcommittees annually conduct a review of each qualifying school district that includes an evaluation of the financial condition of the district, the impact of the recovery plans upon the district’s educational program, and the efforts made by the state-appointed administrator to obtain input from the community and the governing board of the district.”

First Interim Report. The first interim report has not yet been published by CDE. However, according to FCMAT, six LEAs have negative certifications for the first interim report, as of January 23, 2024. For comparison, two LEAs were identified with negative certifications at this same time last year. These LEAs that have negative certifications will not be able to meet their financial obligations for 2023-24 or 2024-25, based on data generated by LEAs in Fall 2023, prior to release of the Governor’s January 2024-25 budget. The first interim report also identified 31 LEAs with qualified interim report certifications. These LEAs with qualified certifications may not be able to meet their financial obligations for 2023-24, 2024-25, or 2025-26. For comparison, the first interim report in fiscal year 2022-23 identified 9 LEAs with qualified certifications, and in fiscal year 2021-22 24 LEAs were identified with qualified certifications.

Second Interim Report. The second interim report, which covers the period ending January 31, 2023, is due March 17th.

State Emergency Loans. A school district governing board may request an emergency apportionment loan from the state if the board has determined the district has insufficient funds to meet its current fiscal obligations. Existing law states the intent that emergency apportionment loans be appropriated through legislation, not through the budget. The conditions for accepting loans are specified in statute, depending on the size of the loan. For loans that exceed 200 percent of the district’s recommended reserve, the following conditions apply:

- The county superintendent shall assume all the legal rights, duties, and powers of the governing board of the district.
- The county superintendent, with concurrence from both the SPI and the president of the state board of their designee, shall appoint an administrator to act on behalf of the SPI.
- The school district governing board shall be advisory only and report to the state administrator.
- The authority of the county superintendent and state administrator shall continue until certain conditions are met. At that time, the county superintendent, with concurrence from both the SPI and the president of the state board of their designee, shall appoint a trustee to replace the administrator.

For loans equal to or less than 200 percent of the district's recommended reserve, the following conditions apply:

- The county superintendent, with concurrence from the SPI and the president of the state board or their designee, shall appoint a trustee to monitor and review the operation of the district.
- The school district governing board shall retain governing authority, but the trustee shall have the authority to stay and rescind any action of the local district governing board that, in the judgment of the trustee, may affect the financial condition of the district.
- The authority of the county superintendent and the state-appointed trustee shall continue until the loan has been repaid, the district has adequate fiscal systems and controls in place,
- and the SPI has determined that the district's future compliance with the fiscal plan approved for the district is probable.

State Emergency Loan Recipients. Nine school districts have sought emergency loans from the state since 1991. The table below summarizes the amounts of these emergency loans, interest rates on loans, and the status of repayments. Five of these districts: Coachella Valley Unified, Compton Unified, Emery Unified, West Fresno Elementary, and Richmond/West Contra Costa Unified have paid off their loans. Four districts have continuing state emergency loans: Oakland Unified, South Monterey County Joint Union High (formerly King City Joint Union High), Vallejo City Unified, and Inglewood Unified School District. The most recently authorized loan was to Inglewood Unified School District in 2012 in the amount of $55 million from the General Fund and the California Infrastructure and Economic Development Bank (I-Bank). Of the four districts with continuing emergency loans from the state, Inglewood Unified School District is the only district operating under an administrator and has a positive certification list at first interim in 2023-24. Oakland Unified School District and Vallejo City Unified School District continues to be on the qualified certification list in the first interim report in 2023-24.

Emergency Loans to School Districts
1990 through 2023

District	Tenure of Administrators and Trustees	Amount of State Loan	Interest Rate	Outstanding Balance of I-Bank and General Fund Loans	Amount Paid By District Including Principal & Interest	Pay Off Date
Inglewood Unified	Administrator 10/03/12–Present	$7,000,000 $12,000,000 $10,000,000 **= $29,000,000** ($55 million authorized)	2.307%	$19,627,190 as of 07/01/23	$14,655,872	11/01/34 GF
South Monterey County Joint Union High (formerly King City Joint Union High)	Administrator 07/23/09–06/30/16 Trustee 07/01/16–Present	$2,000,000 $3,000,000 $8,000,000 **= $13,000,000**	2.307%	$5,467,204 as of 07/01/23	$13,625,410	October 2028 I-bank
Vallejo City Unified	Administrator 06/22/04–03/31/13; Trustee 07/13/07–Present	$50,000,000 $10,000,000 **= $60,000,000**	1.5%	$3,948,587 as of 07/01/23	$65,395,408	January 2024 I-bank 08/13/24 GF
Oakland Unified	Administrator 06/16/03–06/28/09; Trustee 07/01/08–Present	$65,000,000 $35,000,000 **= $100,000,000**	1.778%	$6,067,672 as of 07/01/23	$113,424,029	January 2023 I-bank 6/29/26 GF
West Fresno Elementary	Administrator 03/19/03–06/30/11; Trustee 08/26/08–12/04/09	$1,300,000 ($2,000,000 authorized)	1.93%	-0-	$1,425,773	12/31/10 GF

Emery Unified	Administrator 08/07/01–06/30/04; Trustee 07/1/04–07/29/11	$1,300,000 ($2,300,000 authorized)	4.19%	-0-	$1,742,501	06/20/11 GF
Compton Unified	Administrators 07/93–12/10/01; Trustee 12/11/01–06/02/03	$3,500,000 $7,000,000 $9,451,259 **= $19,951,259**	4.40% 4.313% 4.387%	-0-	$24,358,061	06/30/01 GF
Coachella Valley Unified	Administrators 05/26/92–09/30/96; Trustee 10/01/96–12/20/01	$5,130,708 $2,169,292 **= $7,300,000**	5.338% 4.493%	-0-	$9,271,830	12/20/01 GF
West Contra Costa Unified (formerly Richmond Unified)	Pre-AB 1200 Trustee 07/01/90–05/01/91; Administrator 05/02/91–05/03/92; Trustee 05/04/92–05/31/12	$2,000,000 $7,525,000 $19,000,000 **= $28,525,000**	1.532% 2004 refi rate	-0-	$47,688,620	05/30/12 I-bank

Source: California Department of Education

<u>Staff Recommendation.</u> This item is informational.

Issue 3: Proposition 98 Overview and Structure

Panel.

- Alex Shoap, Department of Finance
- Ken Kapphahn, Legislative Analyst's Office

Proposition 98.

California provides academic instruction and support services to nearly six million public school students in kindergarten through twelfth grades (K-12) and 1.8 million students in community colleges. There are 58 county offices of education, approximately 1,000 local K-12 school districts, more than 10,000 K-12 schools, and nearly 1,300 charter schools throughout the state. Of the K-12 students, approximately 3.8 million are low-income, English learners, or foster youth students or some combination of those categories. Approximately 1.12 million of the K-12 students served in public schools are English learners. There are also 73 community college districts, 116 community college campuses, and 72 educational centers. Proposition 98, which was passed by voters as an amendment to the state Constitution in 1988, and revised in 1990 by Proposition 111, was designed to guarantee a minimum level of funding for public schools and community colleges.

For 2024-25, the proposed budget includes $109 billion in Proposition 98 funding. The Governor's budget also proposes to provide total Proposition 98 funding for 2022-23 of $98.3 billion, a decrease of $9.1 billion over the 2023 final budget act level. For 2023-24, the Governor estimates a decrease in the total Proposition 98 minimum guarantee of $2.7 billion for a total of $105.6 billion. These adjustments are primarily the result of lower than anticipated General Fund revenues than projected at the 2023 final budget act.

Proposition 98 Funding. State funding for K-14 education—primarily K-12 local educational agencies and community colleges—is governed largely by Proposition 98. The measure, as modified by Proposition 111, establishes minimum funding requirements (referred to as the "minimum guarantee") for K-14 education. General Fund resources, consisting largely of personal income taxes, sales and use taxes, and corporation taxes, are combined with the schools' share of local property tax revenues to fund the Proposition 98 minimum guarantee. These funds typically represent about 80 percent of statewide funds that K-12 schools receive. Non-Proposition 98 education funds largely consist of revenues from local parcel taxes, other local taxes and fees, federal funds and proceeds from the state lottery. In past years, there have been two statewide initiatives that increased General Fund revenues and therefore, the Proposition 98 minimum guarantee. Proposition 30, passed by the voters in 2012, raised sales and income taxes, but was designed to phase out over seven years. Anticipating the expiration of the Proposition 30 taxes, Proposition 55 was passed by voters in 2016, extending the income tax portion of Proposition 30 for another 12 years.

The Great Recession that began in 2008 impacted both General Fund resources and property taxes. The amount of property taxes has also been impacted by a large policy change since then—the elimination of redevelopment agencies (RDAs) and the shift of property taxes formerly captured by the RDAs back to school districts. The guarantee was adjusted to account for these additional property taxes, so although Local Educational Agencies (LEAs) received significantly increased property taxes starting in 2012-13, they received a roughly corresponding reduction in General Fund.

The table below summarizes overall Proposition 98 funding for K-12 schools and community colleges in 2007-08, or just prior to the Great Recess, and 2018-19, prior to the COVID-19 pandemic.

The Governor's 2024-25 proposed budget includes significant decreases in comparison to the 2023 Budget Act, as revenues have come in lower than anticipated in light of the delayed deadline for tax returns in 2023.

Proposition 98 Funding
Sources and Distributions
(Dollars in Millions)

	Pre-Recession **2007-08**	Pre-Pandemic **2018-19**	Revised **2022-23**	Revised **2023-24**	Proposed **2024-25**
Sources					
General Fund	42,015	54,505	68,563	74,633	76,894
Property taxes	14,563	23,942	29,742	30,953	32,185
Total	**56,577**	**78,448**	**98,306**	**105,586**	**109,080**
Distribution					
K-12	50,344	69,253	86,473	95,877	98,068
CCC	6,112	9,195	11,494	12,460	12,890
PSSSA	N/A	N/A	339	-2,751	-1,878

Source: Legislative Analyst's Office

Calculating the Minimum Guarantee. The Proposition 98 minimum guarantee is determined by comparing the results of three "tests," or formulas, which are based on specific economic and fiscal data. The factors considered in these tests include growth in personal income of state residents, growth in General Fund revenues, changes in student average daily attendance (ADA), and a calculated share of the General Fund. When Proposition 98 was first enacted by the voters in 1988, there were two "tests", or formulas, to determine the required funding level. Test 1 calculates a percentage of General Fund revenues based on the pre-Proposition 98 level of General Fund that was provided to education, plus local property taxes. The Test 2 calculation is the prior year funding level adjusted for growth in student ADA and per capita personal income. K-14 education was initially guaranteed funding at the higher of these two tests. In 1990, Proposition 111 added a third test, Test 3, which takes the prior year funding level and adjusts it for growth in student ADA and per capita General Fund revenues. The Proposition 98 formula was adjusted to compare Test 2 and Test 3, the lower of which is applicable. This applicable test is then compared to Test 1; and the higher of the tests determines the Proposition 98 minimum guarantee. Generally, Test 2 is operative during years when the General Fund is growing quickly and Test 3 is operative when General Fund revenues fall or grow slowly.

Proposition 98 Tests
Calculating the Level of Education Funding
(Including the 2024-25 Governor's Budget Estimate)

Test	Calculated Level	Operative Year	Times Used
Test 1	Based on a calculated percent of General Fund revenues (currently around 38 percent).	If it would provide more funding than Test 2 or 3 (whichever is applicable).	11
Test 2	Based on prior year funding, adjusted for changes in per capita personal income and attendance.	If growth in personal income is ≤ growth in General Fund revenues plus 0.5 percent.	16
Test 3	Based on prior year funding, adjusted for changes in General Fund revenues plus 0.5 percent and attendance.	If statewide personal income growth > growth in General Fund revenues plus 0.5 percent.	8

Source: Legislative Analyst's Office

The Governor's proposal assumes that in 2022-23, 2023-24 and 2024-25 the Proposition 98 minimum guarantee is calculated under Test 1.

Generally, the Proposition 98 minimum guarantee calculation was designed in order to provide growth in education funding equivalent to growth in the overall economy, as reflected by changes in personal income (incorporated in Test 2). In a Test 3 year, the Proposition 98 minimum guarantee does not grow as fast as in a Test 2 year, recognizing the fact that the state's General Fund is not reflecting the same strong growth as personal income and the state may not have the resources to fund at a Test 2 level; however, a maintenance factor is created, as discussed in more detail later.

The Test 1 percentage is historically-based, but is adjusted, or "rebenched," to account for large policy changes that impact local property taxes for education or changes to the mix of programs funded within Proposition 98. In the past few years, rebenching was done to account for property tax changes, such as the dissolution of the redevelopment agencies (RDAs), and program changes, such as removing childcare from the Proposition 98 minimum guarantee and adding mental health services. For 2024-25, the Governor's Budget adjusts the Test 1 percentage for the expansion of transitional kindergarten from 38.6 percent in 2023-24 to 39.5 percent in 2024-25.

Suspension of Minimum Guarantee. Proposition 98 includes a provision that allows the Legislature and Governor to suspend the minimum funding requirements and instead provide an alternative level of funding. Such a suspension requires a two-thirds vote of the Legislature and the concurrence of the Governor. To date, the Legislature and Governor have suspended the Proposition 98 minimum guarantee twice; in 2004-05 and 2010-11. While the suspension of Proposition 98 can create General Fund savings during the year in which it is invoked, it also creates obligations in the out-years, as explained below.

Maintenance Factor. When the state suspends the Proposition 98 minimum guarantee or when Test 3 is operative (that is, when the Proposition 98 minimum guarantee grows more slowly due to declining or low General Fund growth), the state creates an out-year obligation referred to as the "maintenance factor." When growth in per capita General Fund revenues is higher than growth in per capita personal income (as determined by a specific formula also set forth in the state Constitution), the state is required to make maintenance factor payments, which accelerate growth in K-14 funding, until the determined maintenance factor obligation is fully restored. Outstanding maintenance factor balances are adjusted each year by growth in student ADA and per capita personal income.

The maintenance factor payment is added on to the minimum guarantee calculation using either Test 1 or Test 2.

- In a Test 2 year, the rule of thumb is that roughly 55 percent of additional revenues would be devoted to Proposition 98 to pay off the maintenance factor.

- In a Test 1 year, the amount of additional revenues going to Proposition 98 could approach 100 percent or more. This can occur because the required payment would be a combination of the 55 percent (or more) of new revenues, plus the established percentage of the General Fund— roughly 38 percent—that is used to determine the minimum guarantee.

Prior to 2012-13, the payment of maintenance factor was made only on top of Test 2; however, in 2012-13, the Proposition 98 guarantee was in an unusual situation as the state recovered from the recession. It was a Test 1 year and per capita General Fund revenues were growing significantly faster than per capita personal income. Based on a strict reading of the Constitution, the payment of maintenance factor is not linked to a specific test, but instead is required whenever growth in per capita General Fund revenues is higher than growth in per capita personal income. As a result, the state funded a maintenance factor payment on top of Test 1 and this interpretation can result in the potential for up to 100 percent or more of new revenues going to Proposition 98 in a Test 1 year with high per capita General Fund growth. This was the case in 2014-15, when the maintenance factor payment was more than $5.6 billion. However, since the last recession the state has significantly increased funding for K-14 education due in part to payments made towards reducing the maintenance factor balance. As a result, the maintenance factor obligation was paid off in 2017-18.

Average Daily Attendance. One of the factors used to calculate the Proposition 98 minimum guarantee level is growth in ADA. In a Test 2 or Test 3 year, the guarantee is adjusted for changes in ADA. However, there is a hold harmless provision for reductions in ADA. Under that provision, negative growth is only reflected if the preceding two years also show declines. Under current projections, which reflect birth rates and migration, K-12 ADA is expected to increase slightly and then decline slightly in coming years and the hold harmless will continue to apply for the guarantee calculation.

Proposition 98 Certification. The 2018 budget package included a new process for certifying the Proposition 98 guarantee and the 2019 budget package made additional changes to this process. Under current statute, certification of the guarantee is a process by which the Department of Finance (DOF), in consultation with the Department of Education and the Chancellor's Office of the Community Colleges, verifies the factors for the calculation of the Proposition 98 guarantee and the appropriations and expenditures that count towards the guarantee level. Certifying the guarantee results in a finalized guarantee level for the year, as well as finalizing any settle-up owed as a result of changes in the guarantee level. Adjustments will be made to increase the guarantee after the fiscal year is over if the calculation results in an increase in a prior year, but makes no changes in the event of a decrease in a prior year. Prior to this new process, the guarantee was last certified for 2008-09. In August 2018, DOF released the proposed certification for the 2009-10 through 2016-17 fiscal years. The most recently certified year is 2021-22.

Public School System Stabilization Account (PSSSA). The state's Proposition 98 Rainy Day Fund was established with the passage of Proposition 2 in 2014. Proposition 2 also requires a deposit in a Proposition 98 Rainy Day Fund under certain circumstances. These required conditions are that maintenance factor accumulated prior to 2014-15 is paid off, Test 1 is in effect, the Proposition 98 guarantee is not suspended, and no maintenance factor is created. The 2024-25 proposed budget requires deposits for 2022-23, 2023-24, and 2024-25 payments of $339 million, $288 million, and $2.7 billion, respectively, and withdrawals of approximately $3 billion in 2023-24 and $2.7 billion in 2024-25, for a total balance of approximately $3.8 billion at the end of 2024-25. The withdrawals in 2023-24 and 2024-25 will be contingent upon a budget emergency being declared at some point.

Additionally, this level of PSSSA reserves triggers a statutory requirement that LEAs may not have local reserves in excess of 10 percent of their total annual expenditures, in the year after the state reserve balance is equal to or greater than 3 percent of the total TK-12 share of the annual Proposition 98 guarantee level. The balance of $5.7 billion in 2023-24 continues to trigger school district reserve caps in 2024-25.

<u>Proposition 98 K-12 Proposals:</u>

The proposed budget includes a Proposition 98 funding level of $105.6 billion for K-12 programs. This includes a year-to-year decrease of $3.5 billion in Proposition 98 funding for K-12 education, as compared to the revised Proposition 98 K-12 funding level for 2023-24. Under the Governor's proposal, ongoing K-12 Proposition 98 per pupil expenditures increase from $17,749 provided in 2023-24 (revised) to $18,160 in 2024-25, an increase of 2.3 percent.

Proposition 98 Accrual Proposal. Due to the delay in the tax filing deadlines in 2023 to November 16, actual tax revenues fell significantly short of the revenue projections for prior year 2022-23 at the time of the budget's enactment in June 2023. As a result, the calculated Proposition 98 minimum guarantee decreased by $9.1 billion. This decline is offset by several baseline spending changes, which reduces the 2022-23 shortfall to approximately $8 billion. Under the Governor's proposal, the proposed budget would adjust the 2022-23 Proposition 98 funding level down to its minimum calculated level, but allow local educational agencies to retain the $8 billion that was previously appropriated for Proposition 98 purposes. Beginning in 2025-26 through 2029-30, an annual amount of $1.6 billion (for both K-12 and community colleges) would be recorded for the state's budgetary and financial reporting purposes outside of Proposition 98, which means that this proposal would obligate funding that could be used by programs from the non-Proposition 98 side of the budget in those future years.

K-12 Local Control Funding Formula. The bulk of funding for school districts and county offices of education for general operations is provided through the Local Control Funding Formula (LCFF) and is distributed based on the number of students served and certain student characteristics. The state fully funded the LCFF in 2018-19 and has annually adjusted the grant amounts by a cost-of-living adjustment (COLA). The budget proposes an LCFF COLA of 0.76 percent, and when combined with growth adjustments, results in $1.4 billion in decreased discretionary funds for local educational agencies. The budget proposes withdrawing $2.8 billion from the PSSSA to support ongoing LCFF costs in 2023-24, withdrawing approximately $2.2 billion from the PSSSA to support ongoing LCFF costs in 2024-25, and using available re-appropriation and reversion funding totaling $38.6 million to support ongoing LCFF costs in 2024-25.

Educational Revenue Augmentation Fund. The budget proposes statutory changes to clarify that charter schools are eligible to receive local educational revenue augmentation funds.

Attendance Recovery. The budget proposes statutory changes that would allow local educational agencies to add attendance recovery time to the attendance data submitted to the Department of Education for funding purposes and chronic absenteeism data. These statutory changes would also include requiring local educational agencies to provide students with access to remote instruction or support to enroll at a neighboring local educational agency for emergencies lasting five or more days. The budget also includes $6 million one-time Proposition 98 General Fund to support models of hybrid and remote learning, and research and make recommendations to allow local educational agencies to discern local and statewide data related to student absences.

Child Nutrition. The budget continues to fund universal access to school meals with an increase of $122.2 million ongoing Proposition 98 General Fund, so that students who want a meal will have access to two free meals each day.

Arts and Music in Schools-Funding Guarantee and Accountability Act (Proposition 28). The budget includes $931 million to fund Proposition 28. The budget also proposes that the Commission on Teacher Credentialing create a new Elementary Arts and Music Education authorization for career technical educational teachers for experienced artists to provide arts instruction in elementary school classrooms.

Literacy Screener Professional Development. The budget proposes $25 million ongoing Proposition 98 General Fund through the K-12 Mandate Block Grant to support training for educators to administer literacy screenings.

Math Curriculum Professional Development. The budget proposes $20 million one-time Proposition 98 General Fund for a county office of education to work with the University of California Subject Matter Projects to develop training for mathematics coaches and leaders who can in turn provide training to support math teachers. The budget also proposes statutory changes to allow the use of the Learning Recovery Emergency Block Grant funds for professional development related to the new mathematics framework.

Cost-of-Living Adjustments. The proposed budget provides $65 million ongoing Proposition 98 General Fund to support a 0.76 percent COLA for categorical programs that are not included in LCFF and the LCFF equity multiplier. These programs include special education and child nutrition, State Preschool, Youth in Foster Care, Mandates Block Grant, Adults in Correctional Facilities Program, Charter School Facility Grant Program, American Indian Education Centers, and the American Indian Early Childhood Education Program.

County Offices of Education. The proposed budget includes a decrease of $5 million ongoing Proposition 98 General Fund to reflect the average daily attendance (ADA) changes applicable to the county office of education LCFF and a 0.76 percent COLA.

Local Property Tax Adjustments. The proposed budget includes a decrease of $113 million in ongoing Proposition 98 General Fund in 2023-24, and a decrease of $996 billion in Proposition 98 General Fund in 2024-25 for school districts and county offices of education related to changes to the offsetting local property taxes.

Curriculum-Embedded Performance Tasks for Science. The budget proposes $7 million one-time Proposition 98 General Fund to develop a bank of performance tasks to measure a student's science subject matter knowledge.

California College Guidance Initiative. The budget proposes an increase of $5 million ongoing Proposition 98 General Fund to support the California College Guidance Initiative.

K-12 High Speed Network. The budget proposes an increase of $3.2 million ongoing Proposition 98 General Fund to support the K-12 High Speed Network program.

Broadband Infrastructure Grant. The budget proposes a one-time increase of $5 million Proposition 98 General Fund to extend the program through 2029. In addition to providing fiber broadband connectivity, this funding would also be available for joint projects connecting schools, local libraries, and telehealth providers to high-speed fiber broadband.

Parks Access. The budget proposes an increase of $2.1 million ongoing Proposition 98 General Fund for county offices of education to enable fourth graders attending public schools to access California state parks.

Inclusive College Technical Assistance Center. The budget proposes an increase of $2 million ongoing Proposition 98 General Fund to establish a technical assistance center to: (1) assist local educational agencies with students applying for the Free Application for Federal Student Aid; (2) assist local educational agencies in identifying potential funding sources and student financial assistance opportunities; and, (3) assisting students, including those with intellectual disabilities, and their families to plan for postsecondary transition through facilitation between local educational agencies and institutions of higher education.

Homeless Education Technical Assistance Centers. The budget proposes an increase of $1.5 million ongoing Proposition 98 General Fund to maintain support for Homeless Education

Technical Assistance Centers that were first established through federal funding. This funding would continue to support the identification of homeless youth.

Early Education

Transitional Kindergarten. The 2023 Budget Act provided $357 million to support the first year of expanded eligibility for transitional kindergarten in 2022-23, in addition to $283 million to add one additional certificated or classified staff person to transitional kindergarten classrooms to meet ratio requirements. The 2023 Budget also provided $597 ongoing Proposition 98 General Fund to support the second year (2023-24) of expanded eligibility, and $165 million to support the addition of certificated or classified staff. The budget proposes to include $635 million to implement the third year of transitional kindergarten, and $161 million to support the addition of certificated or classified staff in transitional kindergarten classrooms. These funds will increase the Proposition 98 Guarantee through the process of rebenching.

Legislative Analyst's Office.

The LAO's recent publication, *The 2024-25 Budget: Proposition 98 and K-12 Spending Plan*, included an analysis of the Governor's Proposition 98 Proposals. Below are comments provided by the LAO.

One-Time Solutions

Discretionary Reserve Withdrawal Is Warranted—if Used as a Solution for 2022-23. Discretionary withdrawals from the Proposition 98 Reserve are contingent upon the Governor declaring a budget emergency and the Legislature enacting a law authorizing the withdrawal. Although the Governor has not yet declared a budget emergency, the proposal for a withdrawal signals the Governor is open to using reserves as a solution. We share the Governor's view that a reserve withdrawal is warranted, but have concerns about the way the budget would use these funds. Reserves generally provide the greatest benefit for the state budget—and for schools—when the state is facing a large, unexpected shortfall and would need to adopt disruptive alternatives if it did not withdraw reserves. The significant drop in the guarantee in 2022-23 meets all of these conditions. The Governor's budget, however, would use reserves to cover costs in 2023-24 and 2024-25, including to free-up funding for spending increases. Using reserve withdrawals to support new spending seems contrary to the core purpose of the reserve—protecting existing programs—and diminishes an important tool that could mitigate the prior-year shortfall. In addition, the estimate of the Proposition 98 guarantee is higher in 2024-25, making the case for reserve withdrawals that year less compelling.

Formulas Could Require Withdrawal of Remaining Reserve Balance. The constitutional formulas governing the Proposition 98 Reserve generally require withdrawals when the Proposition 98 guarantee is growing slowly relative to changes in inflation and student attendance. Whereas the Governor's budget anticipates relatively strong growth in the guarantee from 2022-23 to 2023-24, our estimate of the guarantee in 2023-24 reflects notably weaker growth. Assuming the state uses a discretionary withdrawal to cover at least a portion of the drop in 2022-23, the constitutional formulas likely would require the state to withdraw the remaining balance in

2023-24. Whereas the Governor's budget has $3.9 billion remaining in the reserve, the state under our estimates would have to allocate this amount for programs.

State Preschool Reduction Is Reasonable, but Needs Additional Monitoring. The proposed reduction for State Preschool is intended to align the budgeted amount with anticipated costs of the program. While a reduction is reasonable, the Legislature will want to wait for additional program data before determining the amount necessary to continue covering program costs. One uncertainty is program enrollment. If program enrollment increases, the costs associated with providing certain payments in 2024-25 will increase. Alternatively, the state could identify other unspent funds the administration has not yet included, such as funds set aside for unallocated slots in the current year.

State Could Achieve Additional One-Time Savings by Reducing Unallocated Grants. Over the past three years, the state has approved more than $18 billion for one-time grants supporting various school activities. As of January 2024, we estimate that about $4.5 billion of this amount remains unallocated (Figure 8). The unallocated funds generally consist of competitive grants for which the state has either not finished reviewing applications or not yet disbursed funding. The grant with the largest amount of unallocated funds is the Community Schools Partnership Program ($2.6 billion). Many of the other grants with unallocated funds involve teacher training and professional development initiatives. In contrast to the approach for most other areas of the budget, the Governor does not propose revisiting any of these one-time allocations or reverting unspent funds. If the Legislature were to reduce any of these unallocated grants, it could use the savings as a one-time budget solution.

Figure 8

Estimate of Unallocated One-Time Grants

LAO Estimates (In Millions)

Program	Amount available
Community schools	$2,594
Green school bus grants (first round)	500
Golden State Pathways Program	475
Teacher and counselor residency grants	330
National board certification grants	205
Inclusive Early Education Expansion Program	163
Dual enrollment access	122
Other	108
Totals	**$4,495**

<u>Ongoing Spending</u>

Growing Shortfall in Ongoing Programs Sets Up Difficult Decisions Next Year. Turning to ongoing programs, the Governor's budget would expand the state's reliance on one-time Proposition 98 funding to cover ongoing program costs. Under the June 2023 budget plan, the state used nearly $1.6 billion in one-time funds to cover ongoing costs in 2023-24. This shortfall increases under the Governor's budget, growing to nearly $2.2 billion in 2024-25. (This shortfall reflects the $2.1 billion reserve withdrawal and an additional $37 million from other one-time funds.) Entering 2025-26, the state would need to make up this shortfall before it could fund other priorities. Accounting for a similar use of one-time funds for community college apportionments, the total shortfall across all K-14 programs is $2.7 billion—equivalent to nearly all of the growth in the Proposition 98 guarantee the budget anticipates in 2025-26. Having an ongoing shortfall places the state and schools in a relatively risky financial position and increases the likelihood the state is unable to maintain its commitments to existing programs next year.

Funding Statutory COLA Contributes to Ongoing Shortfall. State law automatically increases most ongoing programs by the statutory COLA rate unless the Proposition 98 guarantee is insufficient to cover the associated costs. In these cases, the law authorizes the Department of Finance (DOF) to reduce the COLA rate to fit within the K-12 portion of the guarantee. Instead of invoking this exception, the Governor's budget funds the full COLA in 2024-25 even though the guarantee cannot even support existing program costs. This budgeting approach accounts for $628 million of the $2.2 billion shortfall in 2024-25 and requires the state to rely even more heavily on one-time solutions like reserve withdrawals. Moreover, it represents the second consecutive year in which the Governor has not aligned the COLA rate with the guarantee. Whereas the estimates of the Proposition 98 guarantee from May 2023 showed the state could cover a 5.1 percent COLA in 2023-24, the Governor instead proposed funding an 8.22 percent statutory COLA. If the state had reduced the COLA rate for 2023-24, it would face little or no ongoing shortfall in 2024-25.

LCFF Cost Estimates Likely Too High. Separate from our assessment of the COLA, we think the baseline estimates of LCFF costs in the Governor's budget are likely too high. Our latest estimates are about $1.8 billion lower—$690 million lower in 2023-24 and $1.1 billion lower in 2024-25. The largest contributing factor is our treatment of TK. Although our underlying attendance estimates are similar, the Governor's budget scores the LCFF costs for these newly eligible students immediately. If a district receives funding based on its average attendance over the past three years, however, the full effect of this additional attendance will not materialize for several years. Given that most districts are funded this way, we anticipate that TK expansion will have only modest effects on LCFF costs in 2023-24 and 2024-25.

State Likely Could Achieve Additional Savings by Revisiting Recent Program Expansions. Over the past three years, the state has established or significantly expanded several large ongoing programs. Most notably, the state established the Expanded Learning Opportunities Program (ELOP), made all students eligible for free school meals, significantly increased funding for State Preschool, provided much larger reimbursements for school transportation, and funded lower staffing ratios for TK students. In 2023-24, the state will spend more than $9 billion on all of these programs combined. The Governor's budget does not propose any changes to these programs except for the one-time reduction to State Preschool. If the Legislature were to revisit any of these programs, it could likely find ways of achieving its core goals at somewhat lower cost. Reductions to any of these programs would help the state help the state address the current budget problem and align its ongoing spending level with the funding available under Proposition 98.

Recommendations

Below, we provide our recommendations for addressing the budget shortfall. We begin by outlining an overall approach, then recommend specific one-time solutions and ongoing actions consist with this approach.

Overall Approach

Build Alternative Budget Package That Prioritizes Core Programs and Budget Stability. The Governor's budget would avoid immediate reductions to school programs, but it relies heavily on solutions that shift expenditures into the future. The Governor's proposals would worsen future state budget deficits (through the funding maneuver) and increase the ongoing shortfall in LCFF (through reliance on one-time funds). This budgeting approach positions the state poorly—making spending commitments the state would have difficulty sustaining and setting up more difficult choices for next year. We recommend the Legislature take a different approach—one that prioritizes core school programs but also promotes stability for the budget moving forward. Taking this approach would require the Legislature to make some difficult choices this year, but offers substantial advantages. Specifically, it would (1) reduce the overall state deficit and the shortfall in ongoing programs, (2) position the state to provide funding increases for schools in the future as state revenues improve, and (3) allow the Legislature to preserve its highest priorities. Figure 9 summarizes our recommendations.

Figure 9

LAO Recommendations for Addressing the K-12 Budget Shortfall

Overall Approach

- ✓ Build Alternative Budget Package That Prioritizes Core Programs and Budget Stability
- ✓ Reject Proposed Funding Maneuver
- ✓ Begin Identifying Additional Reductions and Solutions Now

One-Time Solutions

- ✓ Use Reserve Withdrawal to Address 2022-23 Shortfall
- ✓ Reject All One-Time Spending Increases
- ✓ Review Unallocated Funds and Reduce Lower Priority Grants
- ✓ Explore One-Time Reductions to Certain Ongoing Programs

Ongoing Spending

- ✓ Reject Statutory Cost-of-Living Adjustment Increase
- ✓ Reject Most Other Ongoing Proposals
- ✓ Plan for Lower Attendance-Related Costs
- ✓ Explore Changes to Ongoing Programs That Could Generate Additional Savings
- ✓ Consider Reducing Funding Streams That Are Based on Antiquated Factors

Reject Funding Maneuver. The Governor's proposed funding maneuver is bad fiscal policy, sets a problematic precedent, and creates a binding obligation on the state that will worsen future deficits and require more difficult decisions. We strongly recommend the Legislature reject it. The state has other options to achieve budgetary savings in 2022-23 without the problematic downsides of this specific proposal.

Begin Identifying Additional Reductions and Solutions Now. We recommend the Legislature use its upcoming budget hearings to begin identifying the alternative reductions and solutions it would need to balance the budget. The next few months provide an opportune time to establish priorities, consider options, and assess trade-offs. Waiting to begin this work in May, by contrast, would place the Legislature in a difficult position and provide little time for careful deliberation. Moreover, replacing the funding maneuver and addressing the drop in the guarantee would involve identifying up to $14 billion in alternatives—likely requiring the Legislature to sift through a large number of options. The rest of this report begins this process. Specifically, it critiques the Governor's proposals with a view to reducing costs and introduces additional options that would provide a mix of one-time and ongoing savings. Adopting more of these options reduces the likelihood that the Legislature would need to make reductions to core programs like LCFF to address the shortfall.

One-Time Solutions

Use Reserve Withdrawal to Address 2022-23 Shortfall. We recommend building a budget that (1) contains a discretionary reserve withdrawal and (2) directs the entire withdrawal toward addressing the shortfall in 2022-23. Using reserves in this way would help the state accommodate the drop in the prior-year guarantee without resorting to reductions in school programs. In contrast to the Governor's funding maneuver, this alternative works within an existing legal framework, avoids setting a troubling fiscal precedent, and does not worsen future budget deficits. To the extent the state is required to withdraw any funds that remain in the reserve after covering the shortfall in 2022-23, we recommend directing those funds toward existing program costs that would otherwise exceed the guarantee in 2023-24. Using the reserve withdrawals in this way would help the state balance its budget with fewer disruptive changes for schools.

Reject All One-Time Spending Increases. We recommend the Legislature reject all of the one-time increases proposed in the Governor's budget to achieve savings of $599 million. The largest proposal affected by this recommendation is the $500 million allocation for green school bus grants. Although the Legislature previously expressed its intent to provide additional funding for this program, the state has not yet awarded any grants from the initial $500 million it provided in previous budgets. In addition, federal grants (administered by the Environmental Protection Agency) and local funding (administered by air quality districts) are available to support the purchase of low- and zero-emission school buses. Regarding the other one-time increases, we do not think any of the proposals are urgent enough to justify the additional spending reductions or reserve withdrawals that would be needed to fund them in 2024-25. We provide additional analysis and considerations for a few of these proposals later in this report.

Review Unallocated Funds and Reduce Lower-Priority Grants. We recommend the Legislature review existing grants with unallocated funding and reduce or eliminate any grants that do not represent its highest priorities. One reasonable starting point would be to rescind some of the funding for community schools. For example, the Legislature could rescind $1 billion out of $2.4 billion currently set aside for future rounds of implementation grants and extension grants for current grantees. This would leave about $1.1 billion for providing implementation grants to roughly 400 grantees that are currently in the planning process and eligible for implementation grants this year and next year, as well as maintain $280 million for providing two-year extension grants to current grantees. This reduction also accounts for the likelihood that in tighter fiscal times, districts are likely to have less interest in implementing the community schools model this grant is intended to support. Any savings the Legislature identifies from unallocated grants would help address the budget shortfall and reduce the likelihood of other reductions that districts might find more disruptive.

Explore One-Time Reductions to Certain Ongoing Programs. For a few ongoing programs, the state likely could make one-time reductions that districts could accommodate by drawing upon unspent carryover funding. Two of the programs for which we anticipate districts have unspent funds available are ELOP and the Special Education Early Intervention Grant. If the state were to reduce funding temporarily, most districts likely could continue to support the underlying activities by drawing upon their unspent funds from previous years. Temporary reductions to programs like these likely would be less disruptive than reductions to programs for which districts currently have little or no carryover funding. In March, the state will receive updated information about the amount of unspent funding districts had for each program at the end of 2022-23. A related solution would be to pause new grants under existing programs. For example, the state could temporarily stop making new awards under the Career Technical Education Incentive Grant Program (the state currently provides $300 million per year for these grants).

Ongoing Spending

Reject Statutory COLA Increase. We recommend zeroing out the COLA for the upcoming year. Rejecting the COLA would reduce the ongoing shortfall by $628 million and help the state avoid committing to an ongoing spending level it would have difficulty maintaining in the future. An additional consideration is that a zero COLA for 2024-25 would follow several years of very large funding increases for LCFF. Between 2019-20 and 2023-24, the state increased LCFF funding rates per student by nearly 30 percent.

Reject Most Other Ongoing Proposals. In addition to the COLA, we recommend rejecting most other ongoing increases in the budget, including the increases for school meals and the funding for literacy screeners. (We do not recommend delaying expansion of TK.) This recommendation would reduce ongoing costs by $156 million. Regarding the additional funding for school meals, the state could address the shortfall by prorating the reimbursement rate. Regarding literacy screening, we think the proposed increase is premature given that the state has not yet adopted the literacy screening tool.

Plan for Lower Attendance-Related Costs. We recommend the Legislature (1) plan to adopt lower LCFF cost estimates than Governor's budget anticipates for 2023-24 and 2024-25 and (2) use updated data that will be released within the next few weeks to calibrate its estimates. Related to these recommendations, we recommend ensuring these estimates account for the interaction between the expansion of TK and the three-year rolling average attendance calculation. Under our latest estimates, the overall cost of LCFF would be $1.8 billion lower across 2023-24 and 2024-25. The updated data, however, easily could change these estimates by several hundred million dollars in each year. Adopting lower LCFF cost estimates would reduce the size of the budget problem the Legislature needs to address.

Explore Changes to Ongoing Programs That Could Generate Additional Savings. If the Legislature were to revisit some recent program expansions, it could likely find ways of achieving its core objectives in less costly ways. The ongoing savings the state identifies through this process would help the state address the current shortfall and ease future budget pressure. Below, we outline options for reducing costs in five large programs (the amounts in parentheses indicate total spending in 2023-24):

- ***ELOP ($4 Billion).*** The state created this program in the 2021-22 budget to further fund educational and enrichment activities for K-12 students outside of normal school hours. ELOP allocations are based on attendance in elementary grades and calculated using two different per-student rates. We understand that some districts are not on track to spend all of their ELOP funds in part due to challenges in hiring staff and given that, similar to other after school programs, not all students are participating. The state has an opportunity to reevaluate whether the ELOP funding model can be simplified and/or restructured to further incentivize student participation. One option is to strengthen the fiscal incentive for districts to serve more students by distributing funds based on actual student participation rather than assume 100 percent participation. Even a relatively modest change to assume 90 percent participation would reduce costs by several hundred million dollars. (Regardless of how the Legislature proceeds, we recommend the state require districts to report data on program participation to help the state gauge student interest and ensure alignment with overall program goals.)

- ***State Preschool ($1.8 Billion).*** The state made programmatic changes to State Preschool in 2021-22 and 2022-23. The actual costs associated with implementing these changes were less than budgeted, resulting in funds that were anticipated to go unused. The 2023-24 budget package redirected these funds to cover costs associated with a new two-year collectively bargained early education and parity agreement. Beginning 2025-26, the state will again have anticipated unspent funds that could be used to ease future budget pressure. In a forthcoming brief, our office will discuss this issue in more detail.

- ***School Nutrition ($1.7 Billion).*** The implementation of universal school meals in 2022-23 and an increase in the reimbursement rate have resulted in an 827 percent increase in state funds provided to the program compared to 2018-19 funding levels. Program costs are higher than anticipated and recent projections from the California Department of Education (CDE) indicate an additional state fund shortfall. In the "School Nutrition" section of this report, we discuss options to contain future cost growth in the program while maintaining the requirement for public schools to continue offering free meals to all their students. These options include setting rates at a lower level and revisiting the approach to COLA.

- ***School Transportation ($1.2 Billion).*** School districts historically received a fixed amount of funding for transportation based on the size of the programs they operated during the 1970s. The June 2022 budget plan significantly increased funding so that every district would receive an allowance equal to 60 percent of its transportation expenditures during the previous year. If the Legislature reduced the rate to 50 percent, the state could save approximately $200 million per year while still minimizing historical funding disparities among districts.

- ***TK Staffing Add-On ($505 Million).*** In 2022-23, the state began providing additional funding based on TK attendance. (This is in addition to funding the state already provided for these students through LCFF.) To receive this funding, districts must maintain an average of 1 adult for every 12 students in TK classrooms at each school site. Beginning in 2025-26, districts must maintain an average of 1 adult for every 10 students. Our understanding is that the existing rates were calculated based on an assumption that TK classrooms would have 20 students, aligning with the policy to have 1 adult for every 10 students. The Legislature could modify the rates to align with the current ratio. If the Legislature were to fund based on the assumption that TK classrooms have 24 students (consistent with a 1-to-12 ratio), it would result in savings of about $100 million. Next year, the Legislature could assess its fiscal situation and determine whether higher staffing ratios and associated rates could be covered within its ongoing Proposition 98 funding levels.

Consider Reducing Funding Streams That Are Based on Antiquated Factors. Another way the Legislature could obtain ongoing savings is by revisiting three LCFF add-ons that provide additional funding for certain districts based on historical factors. Unlike the core components of the formula, these add-ons are not based on the number of students districts currently enroll or the needs and characteristics of those students. Instead, they provide additional funding based primarily on the size of certain programs districts operated decades ago. Eliminating or scaling back these add-ons would reduce historical funding inequities among districts, simplify the LCFF, and provide ongoing savings. If the Legislature were concerned that eliminating these add-ons immediately would be disruptive for district budgets, it could provide for a gradual phaseout. Below, we profile these three add-ons (the parenthetical amounts indicate expenditures in 2023-24):

- ***Targeted Instructional Improvement Block Grants ($855 Million).*** This add-on provides additional funding for school districts that (1) operated desegregation programs during the 1980s, and/or (2) benefited from general-purpose grants intended to equalize district funding levels during the 1990s. The add-on is a fixed amount and unrelated to whether a district currently operates a desegregation program or the level of funding the district receives relative to other districts.

- ***Minimum State Aid ($356 Million).*** This add-on provides additional funding for school districts and COEs with high levels of local property tax revenue per student. The add-on amount is based on the level of state funding the district or COE received prior to the LCFF and is unrelated to the programs it currently operates or the characteristics of its students.

- ***Economic Recovery Targets ($61 Million).*** The state created this add-on to ensure all districts would receive at least as much funding under the LCFF as they would have received if the state had retained its former funding system and increased it for the statutory COLA. Over the past decade, the state has provided multiple LCFF increases beyond the statutory COLA. Based on these increases, all districts are likely receiving more funding than they would have received under the former system, adjusted for COLA.

<u>**Suggested Questions.**</u>

- DOF: According to the LAO, both the LAO and DOF anticipates deficits of roughly $30 billion beginning in 2025-26 and onward. How does the Proposition 98 accrual proposal fit into this deficit, and what is the Administration's plan to address these deficits in the future?

- LAO: The Legislative Analyst recommends that we withdraw from the Proposition 98 reserve to address the shortfall in 2022-23, in addition to identifying reductions and other solutions as an alternative budget framework. Are there trade-offs the Legislature should consider with regard to withdrawing from the Proposition 98 reserve in 2022-23 versus in 2023-24 and 2024-25 as the Administration proposes? Given the budget deficits projected in the future, would withdrawing from the Proposition 98 reserve to address 2022-23 shortfalls as the LAO recommends create either an immediate or exacerbate out-year deficits?

Staff Recommendation. Hold open.

Issue 4: Local Control Funding Formula (LCFF)

Panel.

- Michael Alferes, Legislative Analyst's Office
- Katie Lagomarsino, Department of Finance
- Aaron Heredia, Department of Education

Background.

K-12 School Finance Reform. Commencing in the 2013-14 fiscal year, the state significantly reformed the system for allocating funding to LEAs - school districts, charter schools, and county offices of education (COEs). The LCFF replaced the state's prior system of distributing funds to LEAs through revenue limit apportionments (based on per student average daily attendance) and approximately 50 state categorical education programs.

Under the previous system, revenue limits provided LEAs with discretionary (unrestricted) funding for general education purposes, and categorical program (restricted) funding was provided for specialized purposes, with each program having a unique allocation methodology, spending restrictions, and reporting requirements. Revenue limits made up about two-thirds of state funding for schools, while categorical program funding made up the remaining one-third portion. That system became increasingly cumbersome to LEAs as they tried to meet student needs through various fund sources that were layered with individual requirements.

Local Control Funding Formula. The LCFF combines the prior funding from revenue limits and more than 30 categorical programs that were eliminated, and uses new methods to allocate these resources, additional amounts of new Proposition 98 funding since 2013-14, and future allocations to LEAs. The LCFF allows LEAs much greater flexibility in how they spend the funds. There is a single funding formula for school districts and charter schools, and a separate funding formula for COEs that has some similarities to the district formula, but also some key differences.

School Districts and Charter Schools Formula. The LCFF is designed to provide districts and charter schools with the bulk of their resources in unrestricted funding to support the basic educational program for all students. It also includes additional funding based on the enrollment of low-income students, English learners, and foster youth for increasing or improving services to these high-needs students. Low-income students, English learners, and foster youth students are referred to as “unduplicated” students in reference to the LCFF because, for the purpose of providing supplemental and concentration grant funding, these students are counted once, regardless of if they fit into more than one of the three identified high-need categories. Major components of the formula are briefly described below.

- **Base Grants** are calculated on a per-student basis (measured by student ADA) according to grade span (K-3, 4-6, 7-8, and 9-12) with adjustments that increase the base rates for grades K3 (10.4 percent of base rate) and grades 9-12 (2.6 percent of base rate). The adjustment for grades K-3 is associated with a requirement to reduce class sizes in those grades to no more than 24 students by 2020-21, unless other agreements are collectively bargained at the local level. The adjustment for grades 9-12 recognizes the additional cost of providing career technical education in high schools. For school districts, funded ADA is equal to the greater of current, prior, or the average of the three most recent prior years' ADA.

- **Supplemental Grants** provide an additional 20 percent in base grant funding for the percentage of enrollment that is made up of unduplicated students.

- **Concentration Grants** provide an additional 65 percent above base grant funding for the percentage of unduplicated students that exceed 55 percent of total enrollment.

- **Categorical Program** add-ons for Targeted Instructional Improvement Block Grant and Home-to-School Transportation provide districts the same amount of funding they received for these two programs in 2012-13. The transportation funds must be used for transportation purposes. Charter schools are not eligible for these add-ons.

- **LCFF Economic Recovery Target** add-on ensured that districts receive, by 2020-21, at least the amount of funding they would have received under the old finance system to restore funding to their 2007-08 level adjusted for inflation. Districts are not eligible for this add-on if their LCFF funding exceeds the 90th percentile of per-pupil funding rates estimated under the old system.

- **Hold Harmless Provision** ensures that no school district or charter school will receive less funding under the LCFF than its 2012-13 funding level under the old system.

Budget Appropriations. The LCFF established new “target” LCFF funding amounts for each LEA, and these amounts are adjusted annually for COLA and pupil counts. When the formula was initially introduced, funding all school districts and charter schools at their target levels was expected to take eight years and cost an additional $18 billion, with completion by 2020-21. However, Proposition 98 growth exceeded expectations and LCFF was fully funded in the 2018-19 fiscal year for school districts and charter schools. COEs reached their target funding levels in

2014-15, which adjusts each year for COLAs and ADA growth. The 2018-19 budget also provided an additional amount above the required COLA to provide a $670 million increase to LCFF grants. With full-funding of the formula, LEAs and stakeholders can see how much funding is received through base, supplemental, and concentration grants on the CDE website and reported through each LEA's local control and accountability plan (LCAP). Most recently, the 2022-23 budget included a 6.28 increase to the LCFF base grant, in addition to a 6.56 percent COLA, and smoothed out the year-to-year funded average daily attendance by allowing LEAs to be funded by either their current year, past year, or average of the three prior years' average daily attendance. The 2022-23 budget also provided a "boost" for the funded 2021-22 average daily attendance for LEAs that provided independent study offerings to students. In the 2023-24 budget, the COLA was 8.22 percent.

Restrictions on Supplemental Funding. Statute requires LEAs to increase or improve services for unduplicated students in proportion to the supplemental funding LEAs receive for the enrollment of these students. The law also allows this funding to be used for school-wide and district-wide purposes. The State Board of Education (SBE) adopted regulations governing LEAs expenditures of this supplemental funding that require an LEA to increase or improve services for unduplicated students, compared to the services provided for all students, in proportion to the supplemental funding LEAs receive for the enrollment of these students. LEAs determine the proportion by which an LEA must increase or improve services by dividing the amount of the LCFF funding attributed to the supplemental and concentration grant by the remainder of the LEA's LCFF funding. Whereas, this percentage (known as the minimum proportionality percentage (MPP)), relied on an LEA's estimates during the transition period, under a fully funded system is based on the actual allocation to each LEA as determined by the CDE. The regulations allow an LEA to meet this requirement to increase or improve services in a qualitative or quantitative manner and detail these expenditures in their LCAP.

County Offices of Education Formula. The COE formula is very similar to the school district formula, in terms of providing base grants, plus supplemental and concentration grants for the students that COEs serve directly, typically in an alternative school setting. However, COEs also receive an operational grant that is calculated based on the number of districts within the COE and the number of students county-wide. This operational grant reflects the additional responsibilities COEs have for support and oversight of the districts and students in their county.

Similar to the LCFF formula for school districts and charter schools, COEs were also guaranteed that they would not get less funding than was received in 2012-13. In addition, COEs were held harmless for the amount of state aid (essentially the value of the categorical funding) received in 2012-13. Unlike school districts, for COEs this minimum state aid amount floats above their target, meaning that as local property tax revenue grows in a county over time and funds their LCFF allocation, the minimum state aid allotment for that COE becomes a new bonus in base funding on top of the their LCFF level.

<u>Governor's Budget Proposal.</u>

The proposed budget includes a COLA of 0.76 percent, which, costs approximately $564 million for the LCFF, and combined with growth adjustments, results in a decrease of approximately $1.4 billion. The Governor's proposal to shift approximately $8 billion General Fund of expenditures beginning in 2025-26, of which $7 billion is attributable to K-12 LCFF in 2022-23.

Additionally, the Governor's Budget proposes to withdraw $2.8 billion and $2.2 billion in 2023-24 and 2024-25, respectively, from the Public School System Stabilization Account (the Proposition 98 reserve) for purposes of the LCFF in those years.

Legislative Analyst's Office.

The LAO's recommendations on LCFF are included as part of its overall Proposition 98 comments, which is provided in Issue 3 of this agenda.

Suggested Questions.

- DOF: The LAO estimates that the Administration overestimates its costs for LCFF approximately by $1.8 billion, as a result of scoring newly eligible TK students immediately rather than taking into consideration whether a district is funded based on the average of its prior three years of attendance. With regard to the estimating costs for LCFF, are there challenges to incorporating the prior three years' average, or other challenges or trade-offs?

Staff Recommendation. Hold open.

Issue 5: Excess Educational Revenue Augmentation Fund Calculations

Panel.

- Alex Shoap, Department of Finance
- Ken Kapphahn, Legislative Analyst's Office

Background.

The State Constitution requires that the proceeds of property taxes be allocated among the local government agencies in the county where the revenue is collected. Recipients of property tax revenue include cities, counties, special districts, K–12 school districts, and community college districts. Proposition 98 established a minimum funding requirement for school and community college districts, commonly known as the "minimum guarantee." The guaranteed funding level is met through a combination of revenues from the state General Fund and local property taxes. A set of formulas in the State Constitution determines the "minimum guarantee" calculation each year.

In 1992, the Legislature redirected a portion of property tax revenue from cities, counties, and special districts into a county-held account known as the Educational Revenue Augmentation Fund (ERAF). Revenue from ERAF is allocated to school and community college districts to offset the funding that these entities would otherwise receive from the state General Fund.

In certain years where the Proposition 98 minimum guarantee is determined as a percentage of overall General Fund revenues (otherwise known as “Test 1” years), any changes to the amount of property tax revenue received by schools and community colleges have a dollar-for-dollar effect on the size of the guarantee. The minimum guarantee has been calculated under Test 1 factors since 2018-19, and under the Governor’s Budget, will continue to be calculated under Test 1 factors in 2022-23, 2023-24 and 2024-25. In contrast, during years where the guarantee is not calculated under Test 1 factors, property tax changes affect the amount of state General Fund the state must allocate to meet the guarantee but does not necessarily impact the overall calculation of the guarantee.

In the mid-1990s, the Legislature enacted a law returning the portion of ERAF not needed for school and community colleges districts to cities, counties, and special districts in proportion to the amount of property taxes that the non-educational local government agencies contributed to ERAF. The returned ERAF funds are known as Excess ERAF. A portion of the excess ERAF revenue are used for special education programs, and the remainder are allocated to other local agencies. According to the Legislative Analyst’s Office, as of 2018-19, there are five counties that have excess ERAF – Marin, Napa, San Francisco, San Mateo, and Santa Clara.

Most charter schools are approved and monitored by the school districts in which they are located. The first charter schools opened in 1992-93. Since that time, the Legislature has taken steps to integrate charter schools into the K-12 funding system. For example, state law deems charter schools to be school districts for the purposes of allocating LCFF funding and meeting the Proposition 98 guarantee. Unlike school districts, however, charter schools do not receive an automatic allocation of property tax revenue. Instead, the law requires school districts to share their property tax revenue—including ERAF—by making payments in-lieu of taxes to their charter schools. Generally, each charter school receives a share of the property tax revenue that is proportional to its share of students in the school district. The state then backfills the school district for the reductions to its property tax revenue. (Somewhat different rules apply for charter schools in basic aid school districts.)

Legislative Analyst’s Office 2020 Report – Excess ERAF: A Review of the Calculations Affecting School Funding.

The Legislative Analyst wrote a report in 2020 that made several findings and concerns in their review of the calculation of excess ERAF. Below are their comments from this report.

We Recently Reviewed Excess ERAF Calculations in the Five Counties. For our review, we examined county calculations, spoke with local officials, and reviewed relevant state law. We identified three specific concerns regarding the calculation of excess ERAF, which are summarized in Figure 7. The first relates to the treatment of charter schools, the second to the dissolution of redevelopment, and the third to the calculation of minimum state aid. In each case, our concern is that certain counties are calculating excess ERAF in ways that shift too much property tax revenue from schools to other local agencies. Apart from the three specific issues, we have two broader concerns that we describe at the end of this section.

Figure 7

Three Specific Concerns About Excess ERAF Calculations

Issue	Concern	Revenue Shifted From Schools to Other Agencies[a]	Amount Shifted Over Three-Year Budget Period[a]
Treatment of charter schools	Counties excluding charter schools from calculation of excess ERAF.	$180 million	$540 million
Implementation of redevelopment dissolution	Counties allowing redevelopment revenue to increase excess ERAF.	$170 million	$510 million
Calculation of minimum state aid	At least one county overcounting minimum state aid, which increases excess ERAF.	$2 million	$6 million

[a]Reflects estimates based on available data and our understanding of counties' current practices.

ERAF = Educational Revenue Augmentation Fund.

Concerns Affect Funding for the School System Overall. One potential misconception about our findings is that they affect the budgets of individual schools within the five counties. In fact, each issue affects the state's entire school system. To the extent a county allocates too little ERAF to schools, the state provides more General Fund. Depending upon which test is operative for calculating the Proposition 98 guarantee, the cost of this backfill results in (1) less overall funding for school and community college programs (when Test 1 applies), or (2) higher General Fund costs for the state (when another tests applies).

Three Specific Concerns

Counties Are Increasing Excess ERAF by Excluding Charter Schools... The amount of excess ERAF in a county depends upon the difference between the amount of (1) ERAF revenue available and (2) General Fund revenue that schools within the county are eligible to receive. We recently learned that two counties have been excluding charter schools from this second amount for the past few years. That is, these counties are treating charter schools as though they receive no General Fund revenue that could be replaced with ERAF. By reducing the ERAF allocated for schools, this practice increases excess ERAF. We also learned that other excess ERAF counties—which previously included charter schools—began excluding them in their most recent calculations. Across all five counties, we estimate the exclusion of charter schools would shift roughly $180 million per year in property tax revenue from schools to other local agencies.

…Even Though State Law Includes Charter Schools. State law specifically allocates ERAF and other property tax revenue to charter schools through their school districts. This property tax revenue offsets the General Fund revenue charter schools otherwise would receive from the state. The counties' approach, however, would involve calculating excess ERAF as though these parts of the allocation process did not exist. The overall effect would be to reduce the amount of ERAF revenue available for allocation to the school districts in the county. (Charter schools would experience the reduction indirectly, in the form of smaller payments in-lieu of taxes.) This approach also runs counter to various state laws declaring charter schools to be school districts for funding purposes such as LCFF.

Redevelopment Revenues Are Increasing Excess ERAF. Though state law provides that redevelopment revenue allocated to schools should not increase excess ERAF, we found that the five counties are not implementing this provision. Instead, redevelopment revenues are displacing property tax revenue that schools otherwise would receive from ERAF. This means that revenues intended to benefit schools are instead benefitting cities, counties, and special districts through additional excess ERAF. We estimate this practice is shifting roughly $170 million per year from schools to other local agencies.

At Least One County Is Increasing Excess ERAF by Over Counting Minimum State Aid. A third, much smaller concern relates to the calculation of minimum state aid. We found that at least one county is assuming its school districts receive more minimum state aid than the law actually provides. This assumption reduces the amount of ERAF that can be allocated to schools. Excess ERAF, in turn, increases by a corresponding amount. We estimate this practice is shifting at least $2 million per year from schools to other local agencies. (Technically, this issue stems from the assumption that school districts receive both $120 per student in state funding and the amount received in 2012-13, whereas the law specifies that the minimum level be based on one of these amounts.)

Two Broader Concerns

State and Schools' Interests Not Sufficiently Represented. Although each of our specific concerns is rooted in a different part of law, taken together we think they illustrate a broader concern. Each year, the property tax produces a finite amount of revenue for the agencies within each county. The state and schools share an interest in maximizing the revenue allocated for schools, as this revenue results in either more overall school funding or lower state General Fund costs. Conversely, other local agencies share an interest in maximizing their share of the property tax revenue. This trade-off provides an incentive for counties to implement the law in ways that increase their share of the property tax revenue, particularly when so many different steps are involved in the calculation. We think the lack of state involvement in the ERAF allocation process is one reason the law is being implemented in ways the Legislature did not intend.

State Has Difficulty Monitoring the Calculation of Excess ERAF. Two main issues limit the state's ability to monitor the calculation of excess ERAF. First, the implementation of the law varies from county to county. Each county uses its own procedures to calculate excess ERAF. The five counties, for example, implemented the decision to exclude charter schools differently. Second, the state has not assigned responsibility for collecting ERAF data to any single agency. Instead, this responsibility is spread across multiple agencies including the State Controller's Office (SCO), California Department of Education (CDE), and the Department of Finance (DOF). For example, the SCO collects information on the total amount of property tax revenue shifted into ERAF, but CDE collects information on excess ERAF. Due to these two issues, the state has difficulty monitoring the calculations, identifying errors or inconsistencies, and projecting how the amount of excess ERAF might change in the future.

<u>State Controller's 2021 Guidance.</u>

On February 16, 2021, then State Controller Betty Yee issued guidance to counties to continue to exclude charter schools from its ERAF calculations. The California School Board Association challenged this guidance in the courts, and in June 2022, the court found in favor of the State Controller's interpretation of local ERAF calculations.

Governor's Budget.

The Governor's Budget proposes statutory changes to clarify that charter schools are eligible to receive ERAF. As of the writing of this agenda, the proposed statutory changes have not been made available to the Legislature.

Suggested Questions.

- DOF/LAO: Is there information available on estimated fiscal impact of this proposal to Proposition 98 funding levels?

Staff Recommendation. Hold open.