Senate Budget and Fiscal Review—Nancy Skinner, Chair

SUBCOMMITTEE NO. 1 Agenda

Senator John Laird, Chair
Senator Dave Min
Senator Rosilicie Ochoa Bogh
Senator Lola Smallwood-Cuevas

Thursday, March 2, 2023
9:30 a.m. or Upon Adjournment of Session
State Capitol - Room 2100

Consultant: Yong Salas

Public Comment

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6100 Department of Education

Issue 1: State of Education

Panel.

- Superintendent of Public Instruction, Tony Thurmond

Background.

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: Proposition 98 Overview and Structure

Panel.

- Amanpreet Singh, 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 3.3 million are low-income, English learners, or foster youth students or some combination of those categories. Approximately 1.13 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 2023-24, the proposed budget includes $108.8 billion in Proposition 98 funding. The Governor's budget also proposes to provide total Proposition 98 funding for 2021-22 of $110.4 billion, an increase of $178 million over the 2022 final budget act level. For 2022-23, the Governor estimates a decrease in the total Proposition 98 minimum guarantee of $3.4 billion for a total of $107 billion. These adjustments are primarily also the result of lower than anticipated General Fund revenues than projected at the 2022 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 table below summarizes overall Proposition 98 funding for K-12 schools and community colleges since 2007-08, or just prior to the beginning of the Great Recession. 2011-12 marks the low point for the guarantee, with steady increases since then. The Great Recession impacted both

General Fund resources and property taxes. The amount of property taxes has also been impacted by a large policy change in the past few years—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 Governor's 2023-24 proposed budget includes significant increases in comparison to the 2022 Budget Act, as revenues during the pandemic have come in lower than anticipated.

Proposition 98 Funding
Sources and Distributions
(Dollars in Millions)

	Pre-Recession **2007-08**	Low Point **2011-12**	Revised **2021-22**	Revised **2022-23**	Proposed **2023-24**
Sources					
General Fund	42,015	33,136	83,630	79,103	79,613
Property taxes	14,563	14,132	26,785	27,889	29,204
Total	**56,577**	**47,268**	**110, 415**	**106,991**	**108,816**
Distribution					
K-12	50,344	41,901	94,403	93,535	95,881
CCC	6,112	5,285	12,301	12,360	12,569
PSSSA	N/A	N/A	3,710	1,096	365

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 2022-23 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).	10
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 2021-22, 2022-23, and 2023-24 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 2023-24, the Governor's Budget adjusts the Test 1 percentage for the expansion of transitional kindergarten from 38.3 percent in 2022-23 to 38.6 percent in 2023-24. The 2023-24 Proposition 98 guarantee is likely to remain a Test 1 even with some changes in factors at the May Revision.

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 decline slightly in coming years and the hold harmless will no longer apply for the guarantee calculation, contributing to a dampening effect on Proposition 98 guarantee growth in future years.

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 2020-21.

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 2023-24 proposed budget requires deposits for 2021-22, 2022-23, and 2023-24 payments of $3.7 billion, $1.1 billion, and $365 million, respectively, for a total balance of approximately $8.5 billion.

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 $8.1 billion in 2022-23 continues to trigger school district reserve caps in 2023-24.

Proposition 98 K-12 Proposals:

The proposed budget includes a Proposition 98 funding level of $95.9 billion for K-12 programs. This includes a year-to-year increase of $2.3 billion in Proposition 98 funding for K-12 education, as compared to the revised Proposition 98 K-12 funding level for 2022-23. Under the Governor's proposal, ongoing K-12 Proposition 98 per pupil expenditures increase from $16,967 provided in 2022-23 (revised) to $17,534 in 2023-24, an increase of 3.3 percent.

Governor's Budget Contains $6 Billion in Proposition 98 Spending Proposals
(In Millions)

K-12 Education	
Ongoing	
LCFF Growth and COLA (8.13 percent)	$4,117
Transitional kindergarten expansion[a]	856
COLA for select categorical programs (8.13 percent)[b]	669
LCFF equity multiplier add-on	300
State Preschool for students with disabilities	64
Access to opioid overdose reversal medication	4
K-12 High Speed Network	4
California College Guidance Initiative	4
Preschool assessment tool	1
Fiscal Crisis and Management Assistance Team	1
Subtotal	$6,018
One Time	
Arts, Music, and Instructional Materials Discretionary Block Grant	-$1,174
Literacy coaches and reading specialists	250
Arts and cultural enrichment	100
Charter School Facility Grant Program	30
CCEE adjustment for unspent prior year funds	-4
Testing consortium membership fee	1
Update to digital learning and standards integration guidance	0.1
Subtotal	-$798
Total K-12 Education	$5,221
California Community Colleges	
Ongoing	
COLA for apportionments (8.13 percent)	$653
COLA for select categorical programs (8.13 percent)[c]	92
Enrollment growth (0.5 percent)	29
Fiscal Crisis and Management Assistance Team	0.2
Subtotal	$774
One Time	
Student enrollment and retention strategies	$200
Forestry/fire protection workforce training	14
Fiscal Crisis and Management Assistance Team	—[d]
Facilities maintenance and instructional equipment	-213
Subtotal	$1
Total California Community Colleges	$775
Total Spending Proposals	**$5,996**

[a] Reflects additional LCFF costs associated with serving more students in transitional kindergarten, including costs of lower transitional kindergarten staffing ratios.

[b] Applies to the Foster Youth Program, American Indian Early Childhood Education, Special Education, Preschool, Child Nutrition, K-12 Mandates Block Grant, and Charter School Facility Grant Program.

[c] Applies to the Adult Education Program, apprenticeship programs, CalWORKs student services, campus child care support, Disabled Students Programs and Services, Extended Opportunity Programs and Services, and mandates block grant.

[d] Reflects $75,000.

Source: Legislative Analyst's Office

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 8.13 percent, and when combined with growth adjustments, results in $4.2 billion in additional discretionary funds for local educational agencies. The budget proposes $613 million in one-time resources to support the ongoing cost of LCFF in 2022-23 and $1.4 billion in one-time resources to support the ongoing cost of LCFF in 2023-24.

The budget also proposes an "equity multiplier" outside of LCFF, and will be allocated based on school-site eligibility.

K-12 Special Education. The proposed budget includes statutory changes to special education, including:

- Limiting the amount of additional funding that Special Education Local Plan Areas (SELPAs) are allowed to retain for non-direct student services before allocating special education base funding to their member local educational agencies.

- Stabilizing current SELPA membership by extending the moratorium on the creation of new single-district SELPAs by two years from June 30, 2024 to June 30, 2026.

- Increasing fiscal transparency by requiring the California Department of Education to post each SELPA's annual local plan, including their governance, budget and service plans, on its website.

Literacy. The budget proposes $250 million one-time Proposition 98 General Fund to build upon the existing Literacy Coaches and Reading Specialists Grant Program. The budget also proposes $1 million one-time General Fund to create a Literacy Roadmap to help educators navigate various literacy-related resources.

School Facility Program. The budget proposes a decrease of $100 million General Fund in planned support for the School Facility Program, taking the planned allocation in 2023-24 from approximately $2.1 billion to $2 billion.

Preschool, Transitional Kindergarten and Full-Day Kindergarten Facilities Grant Program (FDK Program). The 2022 Budget Act reflected $550 million in 2023-24 to support the FDK Program. The proposed budget delays this investment to the 2024-25 fiscal year.

Child Nutrition. The budget continues to fund universal access to school meals and the additional enhanced meal rate, so that students who want a meal will have access to two free meals each day.

Kitchen Infrastructure and Training Funds. The 2022 Budget Act included $600 million in one-time Proposition 98 General Fund to assist local educational agencies for infrastructure and training to provide universal school meals. The budget proposes to use $15 million of the $600 million for commercial dishwasher grants.

Reversing Opioid Overdoses. The budget proposes an increase of $3.5 million ongoing Proposition 98 General Fund for all middle and high school sites to maintain at least two doses of naloxone hydrochloride or another medication to reverse an opioid overdose on campus for emergency aid.

Arts and Music in Schools-Funding Guarantee and Accountability Act (Proposition 28). The budget includes $941 million to fund Proposition 28 outside of Proposition 98 funding levels. To accommodate this cost pressure as well as one-time costs related to LCFF, the budget proposes to reduce the Arts, Music, and Instructional Materials Discretionary Bock Grant, for which the 2022 Budget Act included $3.5 billion Proposition 98 General Fund, by $1.2 billion, for a revised level of $2.3 billion Proposition 98 General Fund.

Further Access to Art Enrichment Activities. The budget proposes $100 million one-time Proposition 98 General Fund ($200 per every 12th grade student enrolled in California public schools) to provide high school seniors with access to cultural enrichment experiences across the state.

Cost-of-Living Adjustments. The proposed budget provides $669 million Proposition 98 General Fund to support an 8.13 percent COLA for categorical programs that are not included in LCFF. 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. The proposed funding level for the LCFF includes COLAs for school districts and county offices of education.

County Offices of Education. The proposed budget includes $51.7 million ongoing Proposition 98 General Fund to reflect the 8.13 percent COLA and ADA changes applicable to the LCFF.

Local Property Tax Adjustments. The proposed budget includes a decrease of $153 million in ongoing Proposition 98 General Fund in 2022-23, and a decrease of $1.3 billion in Proposition 98 General Fund in 2023-24 for school districts and county offices of education related changes to offsetting local property taxes.

California College Guidance Initiative. The budget proposes an increase of $3.9 million ongoing Proposition 98 General Fund to support the California College Guidance Initiative.

K-12 High Speed Network. The budget proposes an increase of $3.8 million ongoing Proposition 98 General Fund to support the K-12 High Speed Network program.

Data Support (State Operations). The budget proposes an increase of $2.5 million General Fund and 15 positions for the California Department of Education to meet state and federal data and accountability reporting requirements, support data exchanges with other agencies, and to quickly respond to data requests.

Fiscal Crisis and Management Assistance Team. The budget proposes an increase of $750,000 ongoing Proposition 98 General Fund to support the professional development of local educational agencies' Chief Budget Offers through mentorship programming by the Fiscal Crisis and Management Assistance Team.

Child Care and Early Education

Transitional Kindergarten. The 2022 Budget Act provided $614 million to support the first year of expanded eligibility for transitional kindergarten, in addition to $383 million to add one additional certificated or classified staff person to transitional kindergarten classrooms to meet ratio requirements. The budget revises these estimates from $614 million to $604 million for expanded access, and $383 million to $337 million for the additional certificated or classified staff. The budget also proposes to include $690 million to implement the second year of transitional kindergarten, and $165 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.

State Preschool Program. Consistent with the 2022 Budget Act, the budget proposes $64.5 million Proposition 98 General Fund and $51.8 million General Fund to continue a multi-year plan to ramp up the inclusivity adjustments for the State Preschool Program. The 2023-24 year will be the second year of the three-year ramp up process, and students with disabilities will be required to make up at least 7.5 percent of State Preschool Program providers' enrollment.

Preschool Classroom Assessment Scoring System. The budget proposes $763,000 Proposition 98 General Fund to support the preschool Classroom Assessment Scoring System.

Legislative Analyst's Office.

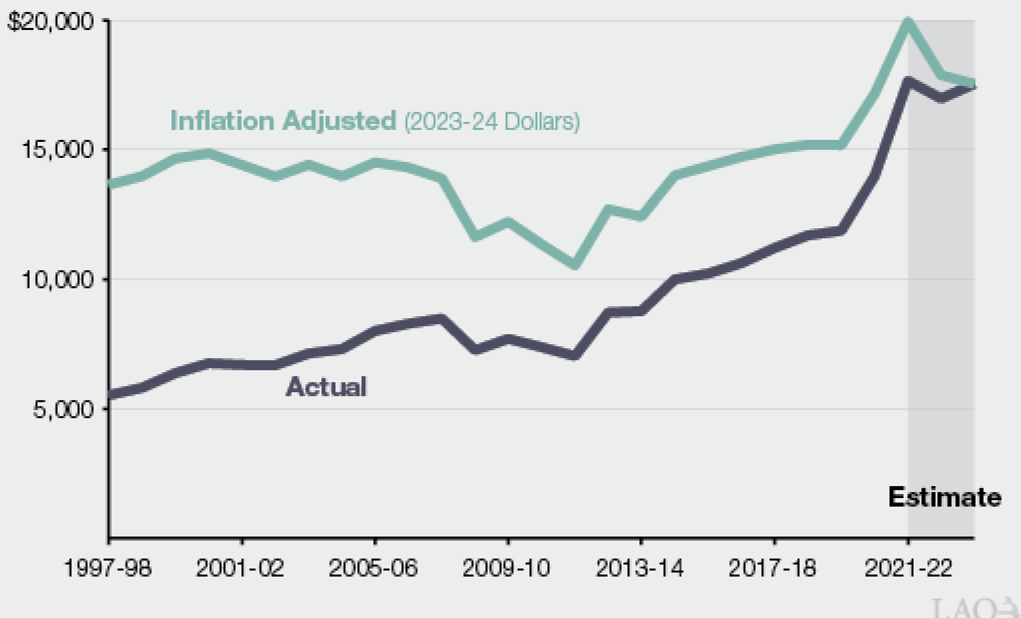
The LAO's recent publication, *The 2023-24 Budget: Proposition 98 Overview and K-12 Spending Plan*, included an analysis of the Governor's Proposition 98 Proposals. While the Governor's Budget estimates the Proposition 98 Guarantee is decreasing by $3.4 billion in 2022-23 and $1.5 billion in 2023-24, the LAO estimates that the guarantee is likely to decline further so that the guarantee is roughly $2 billion below the Governor's Budget level in each year, and potentially offset by higher local property tax revenue. Below are comments provided by the LAO.

School Funding Remains Relatively Strong Despite Tighter Budget Picture. Although the Governor's budget reflects a decrease in the guarantee relative to the previously enacted budget, Proposition 98 funding remains strong by historical standards. Between 2019-20 and 2021-22, the minimum guarantee grew by $31.1 billion (39.2 percent)—the fastest increase over any two-year period since the passage of Proposition 98 in 1988. Overall funding for schools remains relatively high even though the drop in 2022-23 erodes some of this gain. Figure 6 illustrates this point by showing how funding per student under the Governor's budget compares with funding over the previous 25 years.

Figure 6

K-12 Funding Remains Strong by Historical Standards

Proposition 98 Funding Per Student



School Funding Also Fares Relatively Well Compared With the Rest of State Budget. In contrast to the relatively modest changes affecting K-12 schools, the Governor's budget proposes notable reductions affecting many other state programs. The Governor's budget addresses a shortfall of approximately $18 billion across all programs in the state budget. The Governor's proposed changes to programs outside of Proposition 98 include (1) delaying more than $7 billion in spending to future years, (2) eliminating more than $6 billion in previously approved augmentations (some of these reductions would be restored if revenue improves), and (3) shifting more than $4 billion in General Fund costs to various special funds. In addition, the budget provides limited or no COLA for most state programs funded outside of Proposition 98.

Statutory COLA Rate for 2023-24 Likely to Be Slightly Higher by May. On January 26, the federal government published a new quarter of data affecting the calculation of the COLA rate. Based on the new data and our latest projections, we estimate the statutory COLA rate in 2023-24 is 8.4 percent. Covering this higher rate would increase ongoing costs for LCFF and other K-12 programs by approximately $220 million (relative to the Governor's budget). The state will be able to finalize its calculation of the statutory rate on April 27 when the federal government releases the final quarter of data used to calculate the 2023-24 COLA.

Governor's Plan to Avoid Discretionary Reserve Withdrawal Is a Prudent Starting Point. Although the state likely meets the conditions to declare a budget emergency, the Governor does not propose any discretionary withdrawals from the Proposition 98 Reserve. We think this approach is a fiscally prudent starting point because (1) funding for school programs remains relatively strong under the Governor's budget, and (2) saving reserves now gives the state a way to address further reductions in the guarantee that would occur if revenue deteriorates. This budgeting approach seems especially important this year given our outlook for lower General Fund revenues and the heightened risk of a recession. Saving reserves preserves a key tool the state could decide to use later to avoid program reductions or deferrals in a recession scenario. The Governor's approach to the Proposition 98 Reserve also mirrors the approach to the Budget Stabilization Account (BSA)—the state's main rainy day fund. One difference between these accounts is that the state might be required to make withdrawals from the Proposition 98 Reserve if revenues were to decline significantly, whereas the rules governing the BSA do not require automatic withdrawals.

Proposed Proposition 98 Budget Would Create a Deficit for Next Year. Using one-time funds to cover ongoing costs creates a deficit in the Proposition 98 budget the following year. Under the Governor's budget, the Proposition 98 guarantee would need to grow at least $1.4 billion in 2024-25 to cover the portion of LCFF paid with one-time funds in 2023-24. If the state were in recession, this deficit would compound an already difficult budget situation and make program reductions or deferrals more likely or more severe. Even if the guarantee were growing more quickly, the deficit would reduce the funding available to cover COLA and other priorities. Recognizing these risks, the Legislature generally has avoided adopting Proposition 98 budgets that contain these deficits except during severe downturns.

Growth in Guarantee Might Not Be Enough to Support Full COLA in 2024-25. Although the administration anticipates the Proposition 98 guarantee will grow 3.9 percent annually over the next four years, some of that increase is reserved for specific program expansions—most notably, the expansion of transitional kindergarten and new funding for arts instruction under Proposition 28. After accounting for these costs and various other adjustments, we estimate the annual growth in the guarantee available to fund COLA or other new commitments would be about 3.2 percent. Using the administration's assumptions about the guarantee and future COLA rates, we estimate the guarantee would be about $500 million short of the amount required to cover the COLA in 2024-25. In that scenario, the administration would have the authority under existing law to reduce the COLA to rate to fit within the available funding. For 2025-26 and 2026-27, we estimate the guarantee would be just above the level necessary to fund the COLA under the administration's assumptions. All of these calculations are sensitive to small changes in assumptions about the economy.

LAO Recommendations. The LAO recommends that the Legislature (1) build a budget without creating future deficits, (2) consider funding a lower COLA rate, (3) consider changes to the LCFF equity multiplier proposal that would ease budget pressure, (4) consider certain reductions for expanded learning opportunities program, and (5) consider reductions for state preschool.

<u>Suggested Questions.</u>

- DOF: What were the factors that went into the decision to reduce the Arts, Music, and Instructional Materials Block Grant, instead of other one-time investments, and at the same time propose significant new, one-time investments?

- LAO: In light of a 6.56 percent COLA and a 6.28 percent LCFF base increase funded in the 2022-23 Budget, would there be any negative impacts for LEAs if the Legislature and the Administration funded a lower COLA rate in the 2023-24 budget?

- DOF/LAO: Outside of the statutorily required conditions to withdraw from the Public School System Stabilization Account (PSSSA), what kind of considerations should be made before withdrawing from the PSSSA?

Staff Recommendation. Hold open.

Issue 3: Local Control Funding Formula (LCFF)

Panel.

- Michael Alferes, Legislative Analyst's Office
- Katie Lagomarsino, Department of Finance
- Mary Nicely, 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 or prior year 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.

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.

Governor's Budget Proposal.

The proposed budget includes a COLA of 8.13 percent, which, coupled with growth adjustments, costs approximately $4.1 billion for the LCFF. The budget also uses one-time funding of $613 million in 2022-23 and $1.4 billion in 2023-24 to cover costs for LCFF.

Legislative Analyst's Office.

The Legislative Analyst's Office recommends reducing the ongoing spending in 2023-24 to avoid passing a budget that creates a deficit in 2024-25. The Legislative Analyst's Office suggests options for making ongoing reductions, including (1) funding a lower COLA; (2) rejecting or delaying implementation of new ongoing funding for high-poverty schools, or (3) making certain reductions to existing programs, such as the Expanded Learning Opportunities Program or State Preschool. Taking one or a combination of these actions would free up room to fund 2023-24 LCFF costs with ongoing funds, which would then free up 2021-22 funds that can be used to minimize or eliminate the need for reducing the discretionary block grant.

Suggested Questions.

- DOF: How does the Administration plan to address the ongoing costs in the outyears if we are using one-time funds to help cover LCFF in 2022-23 and 2023-24?
- LAO: What are some of the ways that LCFF can be improved to help provide more equitable outcomes for students?

Staff Recommendation. Hold open.

Issue 4: 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, two LEAs have negative certifications for the first interim report, as of January 20, 2023. These LEAs that have negative certifications will not be able to meet their financial obligations for 2022-23 or 2023-24, based on data generated by LEAs in Fall 2022, prior to release of the Governor's January 2023-24 budget. The first interim report also identified 9

LEAs with qualified certifications. LEAs with qualified certifications may not be able to meet their financial obligations for 2022-23, 2023-24, or 2024-25. For comparison, the first interim report in fiscal year 2021-22 identified 24 LEAs with qualified certifications, and in fiscal year 2020-21 52 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 2022-23. Oakland Unified School District continues to be on the qualified certification list in the first interim report in 2022-23.

Emergency Loans to School Districts
1990 through 2022

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%	$20,975,274 as of 07/01/22	$12,823,888	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%	$6,307,855 as of 07/01/22	$12,639,237	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%	$7,420,366 as of 07/01/22	$61,812,324	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%	$11,842,547 as of 07/01/22	$107,438,594	January 2023 I-bank 6/29/26 GF
West Fresno Elementary	Administrator 03/19/03–06/30/11;	$1,300,000 ($2,000,000 authorized)	1.93%	-0-	$1,425,773	12/31/10 GF

	Trustee 08/26/08–12/04/09					
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>Suggested Questions:</u>

- It is notable that the number of LEAs with qualified certifications have gone down in the past few years when there have been an abundance of resources available. Is this a result of improved fiscal governance, or do we expect to see the number of LEAs with qualified certifications to increase when the economy begins to show signs of weakness?

<u>Staff Recommendation.</u> Hold open.