

# SUBCOMMITTEE NO. 1 on Education



**Subcommittee No. 1**  
**Senator Marty Block, Chair**  
**Member, Benjamin Allen**  
**Member, Mike Morrell**

**Thursday, March 5, 2015**  
**9:30 a.m. or Upon Adjournment of Session**  
**Room 3191, State Capitol**

**Governor's 2015-16 Budget:**  
**Proposition 98 and K-12 Education Budget Overview**

- I. Overview of Proposition 98 and Governor's 2015-16 Budget Proposals
  - Highlights of the Governor's Proposition 98 & K-12 Education Budget  
Lisa Mierczynski, Department of Finance
  - Proposition 98 and K-12 Education Funding Overview  
Kenneth Kappahn, Legislative Analyst's Office
  - Perspective on Governor's K-12 Education Budget  
Monique Ramos, California Department of Education
  
- II. Public Comment

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# Overview of Proposition 98 and Governor's 2015-16 Budget Proposals

## BACKGROUND

California provides academic instruction and support services to over six million public school students in kindergarten through twelfth grade (K-12) and 2.3 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 roughly 1,100 charter schools throughout the state, as well as 72 community college districts, 112 community college campuses, and 70 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.

The Governor's proposed 2015-16 budget includes funding at the Proposition 98 minimum guarantee level of \$65.7 billion. The budget proposal also revises the 2014-15 Proposition 98 minimum guarantee to \$63.2 billion, an increase of \$2.3 billion from the 2014 Budget Act, and revises the 2013-14 Proposition 98 minimum guarantee to \$58.7 billion, an increase of \$371 million from the 2014 budget act. The Governor also proposes to pay \$256 million in Proposition 98 settle-up towards meeting the 2006-07 and 2009-10 Proposition 98 minimum guarantees. Together, the increased guarantee levels and settle-up payments reflect a total of \$7.8 billion in increased funding for education over the three years, as compared to the 2014 Budget Act.

The Governor proposes to use one-time Proposition 98 funds to pay off the remaining K-14 education deferrals and reduce the mandate backlog. Most of the ongoing Proposition 98 increase is proposed to be used towards implementing the Local Control Funding Formula (LCFF). The Governor's proposal also includes several other initiatives in the areas of adult education, career technical education, and facilities, among others. These proposals are more fully described below.

**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. The largest contributors to non-Proposition 98 education funds consist of federal funds, proceeds from the state lottery, revenues from local parcel taxes, and other local taxes and fees.

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 steep recent recession. 2012-13 marked a turning point for education funding, and resources have grown each year since then. The economic recession impacted both General Fund resources and property taxes. The amount of property taxes has 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 LEAs received significantly increased property taxes starting in 2012-13, they received a roughly corresponding reduction General Fund.

**Proposition 98 Funding  
Sources and Distributions  
(Dollars in Millions)**

	2007-08	2008-09	2009-10	2010-11	2011-12	2012-13	2013-14	2014-15	2015-16
<b>Sources</b>									
General Fund	42,015	34,212	37,044	35,508	33,136	41,682	42,824	46,648	47,019
Property Taxes	14,563	15,001	14,624	14,139	14,132	16,224	15,849	16,505	18,697
<b>Total</b>	<b>56,577</b>	<b>49,213</b>	<b>51,667</b>	<b>49,647</b>	<b>47,268</b>	<b>57,907</b>	<b>58,673</b>	<b>63,153</b>	<b>65,716</b>
<b>Distribution</b>									
K-12	50,344	43,162	45,695	43,710	41,901	51,719	52,182	56,171	58,005
CCC	6,112	5,947	5,879	5,850	5,285	6,110	6,413	6,902	7,630
Other	121	105	93	87	83	78	78	80	80

Source: Legislative Analysts' Office

**Calculating the Minimum Guarantee.** The Proposition 98 minimum guarantee is determined by comparing the results of three “tests”, or formulas, that 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, 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 guaranteed 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. Test 2 guaranteed the prior year funding level adjusted for growth in student average daily attendance and per capita personal income. K-14 education was 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 average daily attendance 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 guarantee level.

**Proposition 98 Tests**  
**Calculating the Level of Education Funding**

Test	Calculated Level	Operative Year	Times Used
Test 1	Based on a calculated percent of General Fund revenues (currently around 38.4%).	If it would provide more funding than Test 2 or 3 (whichever is applicable).	4
Test 2	Based on prior year funding, adjusted for changes in per capita personal income and attendance.	If growth in personal income is $\leq$ growth in General Fund revenues plus 0.5%.	14
Test 3	Based on prior year funding, adjusted for changes in General Fund revenues plus 0.5% and attendance.	If statewide personal income growth $>$ growth in General Fund revenues plus 0.5%.	8

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. 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 RDAs, and program changes, such as removing childcare from the Proposition 98 minimum guarantee and adding mental health services. In the budget year, the Test 1 calculation is adjusted to reflect the end of the “triple flip” and the retirement of the Economic Recovery Bonds and for certain RDA changes. Proposition 98 tests are based on estimated factors during budget planning, however the factors are updated over time and can change past guarantee amounts and even which test is applicable in a previous year.

The Governor’s proposal assumes that in 2015-16, the Proposition 98 guarantee is calculated under Test 2, the current year is a Test 1 year, and prior year is a Test 3. Test 2 is reflective of the increased General Fund revenues the state is receiving during this economic recovery period. 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). As noted in the table above, in most years the Proposition 98 minimum guarantee has been determined by the application of Test 2.

**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.** In years following suspension of the Proposition 98 minimum guarantee or the operation of Test 3 (that is, when the Proposition 98 guarantee grows more slowly due to declining or low General Fund growth), the state creates an out-year obligation referred to as 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 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 average daily attendance 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 38.4 percent—that is used to determine the minimum guarantee.

Prior to 2012-13, the payment of maintenance factor was made on top of Test 2, even if Test 1 was greater than Test 2. In 2012-13, however, the Proposition 98 guarantee was in 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 was made on top of Test 1. As a result, the state was required to provide roughly 55 percent of new revenue to make the required maintenance factor payment on top of the roughly 40 percent of new revenue already provided under Test 1. This interpretation continues today and results 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, as is the case in 2014-15.

The Governor's proposal includes maintenance factor payments of \$3.8 billion in the 2014-15 year and \$725 million in the 2015-16 year, leaving a balance of approximately \$1.9 billion going into the 2016-17 year.

**Settle-Up.** Every year, the Legislature and Governor estimate the Proposition 98 minimum guarantee before the final economic, fiscal, and attendance factors for the budget year are known. If the estimate included in the budget for a given year is ultimately lower than the final calculation of the minimum guarantee once those factors are known, Proposition 98 requires the state to make a "settle-up" payment, or series of payments, in order to meet the final guarantee for that year. The Governor's budget assumes General Fund settle-up payments of \$371 million in 2013-14 and \$2.3 billion in 2014-15 (due to increases in the guarantees for those years.) The Governor's budget proposal also includes a settle-up payment of \$256 million, with \$212 million going toward the 2006-07 minimum guarantee and the remaining \$44 million counting towards the 2009-10 minimum guarantee.

**Spike Protection.** Proposition 98 also has a built-in formula to prevent large increases in the guarantee, referred to as "spike protection". This constitutional formula specifies that in years when a Test 1 is operative and is greater than the Test 2 amount by 1.5 percent of General Fund Revenues, then when calculating the guarantee level in the subsequent year, the excess amount over the 1.5 percent of General Fund revenues is not included in the calculation. This part of the formula has only been in play in 2012-13, impacting the 2013-14 minimum guarantee.

**Outstanding Obligations.** The state currently has outstanding obligations to school districts and community colleges. As of the 2014-15 budget act, outstanding obligations included close to \$6 billion in mandate payments, \$992 million in deferrals, and \$273 million in Emergency Repair Program payments. (The estimate of the mandate backlog does not yet reflect a \$450 million payment provided in the 2014-15 budget act or state actions to offset mandate claims with other funds.) The Governor's proposal for 2015-16 would retire the remaining deferrals, the remaining Emergency Repair Program payments, and approximately \$1.5 billion in mandate obligations. The state also has a \$1.3 billion outstanding Proposition 98 settle-up obligation, which can be used to pay off these aforementioned obligations.

## GOVERNOR'S PROPOSAL

**K-14 Proposition 98 Education Overall.** The Governor's budget estimates that the total Proposition 98 guarantee (K-14) for 2013-14 increased by \$371 million, compared to the level estimated in the 2014 Budget Act. Similarly, for 2014-15, the Governor estimates an increase in the total guarantee of \$2.3 billion. Both of these adjustments lead to Proposition 98 "settle-up" obligations, which result in additional one-time resources. The Governor proposes to use these additional one-time resources primarily to pay off deferrals and reduce the backlog of mandate payments. The Governor's budget estimates a total Proposition 98 funding level of \$65.7 billion (K-14). This is a \$4.9 billion increase over the 2014-15 Proposition 98 level provided in the 2014 Budget Act.

**K-12 Education Proposition 98 Major Spending Proposals.** The Governor's budget includes a proposed Proposition 98 funding level of \$57.3 billion for K-12 programs. This includes a year-to-year increase of more than \$1.8 billion in Proposition 98 funding for K-12 education, as compared to the revised Proposition 98 K-12 funding level for 2014-15. Under the Governor's proposal, ongoing K-12 Proposition 98 per pupil expenditures increase from \$9,361 provided in 2014-15 to \$9,667 in 2015-16. This 2015-16 proposed funding level in Proposition 98 funds for K-12 reflects a per-pupil increase of three percent, as compared to the revised per-pupil funding level provided for 2014-15. The Governor's major K-12 spending proposals are identified below.

- **Local Control Funding Formula.** The 2013 Budget Act adopted the LCFF, a new way for the state to provide funding to school districts and county offices of education. The Governor's budget proposes an increase of approximately \$4 billion to implement the LCFF. This investment would eliminate about 32 percent of the remaining funding gap between the formula's current year funding level and full implementation for school districts and charter schools. County offices of education reached full implementation with the LCFF allocation in the 2014 Budget Act. Accountability for LCFF is also not yet fully implemented.
- **Paying off Deferrals.** The Governor's budget proposes to pay off outstanding payment deferrals – a practice used in previous budgets whereby the state would delay the issuance of money to school districts for months after school districts had planned to spend it. The Governor's budget proposes to end this practice by paying off all payment deferrals, estimated at a cost of \$992 million for K-12 programs and community colleges. For K-12 programs, the Legislative Analyst's Office (LAO) estimates the total amount of payment deferrals at \$897 million, all of which would be paid off in the Governor's proposed budget.

- **Adult Education.** The Governor’s budget proposes to provide \$500 million in Proposition 98 funding for a new adult education block grant. In 2013-14 and 2014-15, K-12 districts had a maintenance-of-effort (MOE) requirement to continue to spend the same amount of funding on adult education as in 2012-13. In addition the 2013 Budget Act provided \$25 million in two-year planning grants to community college and K-12 consortia for adult education. This Governor’s budget proposal is intended to build off of the last two years and fund adult education programs through regional consortia. The Chancellor of the Community Colleges and the Superintendent of Public Instruction would jointly approve the allocation of funds. In 2015-16, the funds would first be allocated to K-12 school districts in the amount of their MOE requirements in previous years and remaining funds would be allocated to regional consortia. In future years, all block grant funding would be allocated to regional consortia. Adult education consortia plans resulting from the 2-year planning grants included in the 2013 Budget Act will be provided by March 1, 2015. This proposal is part of the Administration’s overall workforce development plan and regional adult education efforts are intended to support occupations with high employment potential.
- **Enrollment and Cost-of-Living Adjustments.** The Governor’s proposed budget reflects changes in K-12 enrollment and associated LCFF costs. Specifically, it reflects an increase of \$197.6 million in 2014-15, as a result of an increase in the projected average daily attendance (ADA), as compared to the 2014 Budget Act. For 2015-16, the Governor’s proposed budget reflects a decrease of \$6.9 million to reflect a projected decline in ADA for the budget year. (For charter schools, the Governor’s proposed budget funds an estimated increase in charter school ADA—see “Other adjustments” below.) The proposed budget also provides \$71.1 million to support a 1.58 percent cost-of-living adjustment for categorical programs that are not included in the new LCFF. These programs include special education and child nutrition, among others. The proposed funding level for the LCFF includes cost-of-living adjustments for school districts and county offices of education.
- **K-12 School Facilities.** The Governor’s budget proposes several changes to increase local and state capacity to fund facilities projects in the neediest schools and districts, without providing additional funding resources.
  - Increase school districts’ ability to fund projects locally by raising the caps on assessed valuation and local bonded indebtedness, establishing consistency in developer fee levels, and expanding the use of restricted routine maintenance funds to include modernization and new construction.
  - Target state funding to the neediest school districts by limiting eligibility to schools districts that are unable to issue local bonds in amounts that meet student needs, providing priority for health, safety, and severe overcrowding projects, and establishing a sliding scale for determining the state share of funding based on local funding capacity.
  - Increase charter school access to the Charter School Facility Grant Program by reducing the eligibility threshold from 70 to 55 percent of enrollment of students eligible for free or reduced-price meals.

In addition, the Administration proposes to continue the dialogue with the Legislature and stakeholders that began in the current year about the best way to fund school facilities going

forward, specifically focused on funding for the highest need schools and districts and increased local flexibility. Finally, the Governor's budget proposes \$273 million in one-time Proposition 98 funds for the Emergency Repair Program.

- **Proposition 98 Rainy Day Fund.** The Governor's budget notes that with the passage of Proposition 2 in the November 4, 2014 general election, a deposit in a Proposition 98 Rainy Day Fund is required under certain circumstances. Related statute requires that in the year following a deposit into this fund, a cap on local school district reserves would be implemented. Although the Administration notes that it is unlikely that fiscal conditions triggering these actions would occur in the near future, they also note a willingness to engage with stakeholder groups who are concerned about the potential caps on school district reserves over the next few months.

### **Other K-12 Education Budget Proposals**

Additional proposals contained within the Governor's budget related to K-12 education include the following:

- **Career Technical Education.** The Governor's budget proposes to provide \$250 million in one-time Proposition 98 funding for each of the next three years for a Career Technical Education Incentive Grant Program. This program would provide funding for school districts, charter schools, and county offices of education to develop and expand career technical education programs. Grantees would be required to provide matching funds and demonstrate positive results on career technical education-related outcomes over time. Priority for funding would be given to regional partnerships. This marks a change from efforts to fund career technical education programs in prior years. Specifically, in 2013-14 and 2014-15, K-12 districts had a maintenance-of-effort (MOE) requirement to continue to spend the same amount of funding on career technical education as in 2012-13. The 2013 and 2014 budget acts also provided \$250 million each year in one-time Proposition 98 funding for the Career Pathways Trust Program to provide one-time competitive grants for career technical education programs.
- **Mandate Backlog Reduction.** The Governor's budget proposes \$1.5 billion in discretionary one-time Proposition 98 funding be provided to school districts, charter schools, and county offices of education to offset outstanding mandate debt. The Administration indicates that this investment is intended to allow school districts, charter schools, and county offices of education to continue to invest in implementing state-adopted academic standards—Common Core state standards, English Language Development standards and the Next Generation Science standards, upgrade technology, and support new responsibilities under the LCFF.
- **Technology Infrastructure.** The Governor's budget proposes \$100 million in one-time Proposition 98 funding to support increase broadband infrastructure for schools that have limited internet capacity or are unable to administer the new state assessments online.
- **Proposition 39 Energy Efficiency Investments.** The Governor's budget proposes to allocate \$368 million in Proposition 39 energy funds available in 2015-16, as follows:
  - \$320.1 million to K-12 school districts, for energy efficiency project grants.
  - \$39.6 million to community college districts, for energy efficiency project grants.

- \$5.3 million to the California Conservation Corps, to provide technical assistance to school districts.
- \$3 million to the Workforce Investment Board, for continued implementation of job-training programs.
- **Charter Schools.** The Governor's budget proposes an increase of \$59.5 million in Proposition 98 funds to reflect an increase in charter school ADA.
- **Child Care and Development.** The Governor's budget provides \$2.5 billion total funds (\$899 million federal funds; \$657 million Proposition 98 GF; and \$941 million non-Proposition 98 GF) for child care and early education programs. Within the \$657 million allocation of Proposition 98 General Fund, the Governor includes \$15 million to cover the full annual cost of 4,000 new preschool slots approved by the Legislature last June.

**California Community Colleges Education Proposition 98 Major Spending Proposals.** The Governor's budget includes a proposed Proposition 98 funding level of \$7.6 billion for California Community College (CCC) programs. This includes a year-to-year increase of approximately \$728 million in Proposition 98 funding for CCC education, as compared to the revised Proposition 98 CCC funding level for 2014-15. This 2015-16 proposed funding level in Proposition 98 funds for CCC reflects a year-over-year increase of eleven percent, as compared to the revised CCC funding level provided for 2014-15. The Governor's major CCC spending proposals are identified below.

- **Student Success Programs.** The Governor's budget increases support for student success programs by \$200 million Proposition 98 General Fund, including \$100 million to increase orientation, assessment, placement, counseling and other planning services, and \$100 million to close achievement gaps and access between underrepresented groups and their peers as identified in local student equity plans.
- **Workload Adjustments.** The Governor's budget provides \$125 million Proposition 98 General Fund to increase base allocation funding in recognition of increased operating expenses, retirement benefit costs, professional development costs, efforts to convert part time to full-time faculty, and other general expenses.
- **Enrollment Growth.** The Governor's budget calls for two percent enrollment growth and provides \$106.9 million Proposition 98 General Fund to support growth, and notes that this growth funding shall be distributed based on a new growth formula described in 2014 budget legislation.
- **Cost of Living Adjustment.** The Governor's budget provides \$92.4 million Proposition 98 General fund to support a 1.58 percent Cost of Living Adjustment for CCC.
- **Apprenticeship Programs.** The Governor's budget expands apprenticeship programs and provides \$29.1 million in Proposition 98 funding for the programs, including \$15 million to create new apprenticeship projects that address emerging industries and unmet labor market demand.

- **Career Technical Education Pathways Program.** The Governor’s budget supports the Career Technical Education Pathways Program by providing \$48 million in one-time Proposition 98 General Fund.
- **Non-Credit Course Rates.** The Governor’s budget provides \$49 million Proposition 98 General fund to reflect increased rates for enhanced non-credit courses, as outlined in 2014 budget legislation.
- **Mandate Backlog Reduction.** The Governor’s budget provides \$353.3 million Proposition 98 General Fund to continue paying down outstanding mandate claims. The funding is intended to help colleges reduce debt, address deferred maintenance and other instructional equipment needs, and other one-time costs.

### Suggested Questions

1. What factors/indicators did the LAO use to inform their prediction that at the May Revision revenue estimates could be higher?
2. Does the Administration agree with the LAO’s assessment of potential new revenues?
3. What does the Administration, LAO, or CDE think spending priorities for any new one-time or ongoing Proposition 98 funds should be?
4. Does LAO agree with the Administration’s calculation of the Proposition 98 Guarantee, in particular the rebenching for the dissolution of RDAs and inclusion of the end of the “Triple Flip”?
5. Based on multi-year projections, how will changes in revenues impact 2016-17 and future years? What choices made today for expenditure of Proposition 98 funds are important to ensure stability in funding for the education community and services provided to students?
6. The facilities proposals from the Administration and the LAO are silent on whether Proposition 98 funds should be used to cover some, or all, of the state’s share of local school facility needs. What should the Legislature consider when evaluating funding for these proposals?

### Staff Recommendations

Staff recommends holding all major Proposition 98 items open pending May revision.