SUBCOMMITTEE NO. 1

EDUCATION

Proposition 98 & K-12 Funding

BACKGROUND:

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

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

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

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

Source: Legislative Analyst's Office

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

- **Test 1 -- Percent of General Fund Revenues.** Test 1 is based on a percentage or share of General Fund tax revenues. The base year for the Test 1 percentage is 1986−87 -- a year in which K-14 education received approximately 40 percent of General Fund tax revenues. As a result of the recent shifts in property taxes from education to cities, counties, and special districts, the current rate is approximately 39 percent.

- **Test 2 -- Adjustments Based on Statewide Personal Income.** Test 2 is operative in years with normal to strong General Fund revenue growth. This calculation requires that school districts and community colleges receive at least the same amount of combined state aid and local property tax dollars as they received in the prior year, adjusted for enrollment growth and growth in per capita personal income.

- **Test 3 -- Adjustment Based on Available Revenues.** Test 3 is used in low revenue years when General Fund revenues decline or grow slowly. During such years, the funding guarantee is adjusted according to available resources. A "low revenue year" is defined as one in which General Fund revenue growth per capita lags behind per capita personal income growth more than one−half percentage point.

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

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

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

GOVERNOR'S PROPOSAL:

Proposition 98 – Overall Funding Levels for K-14 Education

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

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

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

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

The Governor proposes to expend the additional $4.9 billion in funds principally to reverse $2.2 billion in costs for the new inter-year payment deferrals in 2011-12 and to reduce ongoing payments deferrals in 2012-13 for K-12 schools and community colleges by $2.4 billion.

Proposition 98 Trigger Cuts

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

In order to achieve the $4.8 billion in Proposition 98 reductions in 2012-13, the Governor proposes to: (1) eliminate the restoration of $2.4 billion in inter-year payment deferrals currently proposed by the Governor; and (2) implement an additional $2.4 billion in unspecified, proportional programmatic reductions for K-14 education. The table displays the specific reductions for K-12 and community colleges included in the Governor's mid-year trigger cuts.

Governor's 2012-12 Trigger Cuts (Dollars In Billions)	**K-12 Schools**	**Community Colleges**	**Total**
Eliminating Buy Down of Payment Deferrals	$2.2	$.2	$2.4
Unspecified Programmatic Cuts	2.2	.2	2.4
Total	**$4.4**	**$.4**	**$4.8**

The Administration plans to work with K-12 schools and community college officials and stakeholders to develop legislation regarding the unspecified programmatic reductions with intent to protect education programs and allow the education systems to develop and implement necessary contingency plans. According to the Department of Finance, a $2.2 billion reduction equates to roughly $370 per student, or approximately three weeks of school.

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

- **Revenue Adjustments.** The Governor assumes the following changes in revenues that affect calculation of the Proposition 98 minimum guarantee.

  - **New Revenues from the Governor's Tax Initiative.** As proposed, the Governor's November 2012 tax initiative would raise $6.9 billion in new revenues that would be directed to the Education Protection Account. The Governor budgets these revenues on an accrual basis, which attributes $2.2 billion to 2011-12 and $4.7 billion to 2012-13. While these revenues are partially offsetting to Proposition 98, the Governor estimates that the Proposition 98 minimum funding guarantee will grow by **$879 million** in 2011-12 and **$2.4 billion** in 2012-13 as a result of these new revenues.

- **Rebenching Adjustments.** In addition to assuming new revenues, the Governor's Budget includes a series of adjustments to rebench the Proposition 98 guarantee to reflect tax shifts and programmatic shifts. Several of the Governor's proposed changes involve application of a 1986-87 level cost methodology – used to rebench in the past -- in order to provide a single, consistent methodology for all rebenching adjustments. Individual adjustments are summarized below:

  - **Fuel Tax Swap. The 2011-12 budget act increased the minimum funding guarantee by $578 million** to reflect current laws that hold Proposition 98 harmless from the loss of revenues from the fuel tax swap that began in 2010-11**.** Trailer bills in 2011-12 extended previous laws that assured no negative effect from the amounts that would otherwise be calculated for the tax change under Test 1 of the Proposition 98 minimum funding guarantee. The Governor's 2012-13 budget proposes to eliminate these policies enacted to hold Proposition 98 harmless from the elimination of the state's share of sales tax on gasoline. This adjustment would reduce the minimum guarantee by **$596 million** beginning in 2011-12.

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

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

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

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

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

Governor's Major Proposition 98 Expenditure Proposals. As summarized by the table below, the **$4.9 billion** in additional Proposition 98 funding provided by the Governor's budget plan in 2012-13 would be expended primarily to backfill one-time solutions in 2011-12 -- most notably to cover the costs of the $2.2 billion K-14 payment deferral added in 2011-12 – and to buy-down ongoing K-14 payment deferrals by $2.4 billion in 2012-13.

2012-13 Proposition 98 Spending Changes - Ongoing (Dollars In Millions)	
Technical	
Backfill one-time actions	$ 2,440
Make revenue limit technical adjustments	162
Fund revenue limit growth	158
Backfill Proposition 63 mental health funding	99
Backfill CCC fee revenue decline	97
Make other technical adjustments	-182
Subtotal	**$ 2,775**
Policy	
Pay down K-12 deferrals	$ 2,151
Pay down CCC deferrals	218
Create K-12 mandate block grant	98
Create CCC mandate block grant	12
Do not initiate Transitional Kindergarten program	-224
Reduce preschool funding	-58
Swap one-time funds	-57
Eliminate Early Mental Health Initiative	-15
Subtotal	**$ 2,125**
Total	**$ 4,900**

The Governor's budget does not build back any funding for the school transportation program in 2012-13, which provides savings of **$496 million** in 2012-13. Per the Governor, the 2011-12 trigger cut eliminated remaining funding for the program, and the Governor proposes to continue elimination of the program in 2012-13. (Note: The Legislature passed SB 81 on February 2, 2012, to restore $248 million in trigger cuts for school transportation programs, and instead implement a $248 million reduction in revenue limit apportionments in 2011-12.)

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

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

The Governor also proposes to reduce several programs, including savings of **$224 million** to halt the creation of a new, two-year state "Transitional" Kindergarten program beginning in 2012-13, pursuant to Chapter 75, Statutes of 2010. In addition, the Governor proposes to cut the state preschool program by $57 million by lowering income eligibility and reducing reimbursement rates in 2012-13. The Governor also proposes to eliminate the Early Mental Health Initiative program, currently administered by the State Department of Mental Health, for a savings of **$15 million** in 2012-13.

Reducing the State's Wall of Debt

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

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

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

- **K–14 Inter-Year Payment Deferrals**. The 2011-12 budget act continued the state's reliance on ongoing, inter-year payment deferrals to achieve budget solution, deferring an additional $2.1 billion in K–12 payments and $129 million in CCC payments from 2011–12 to 2012–13. As a result, ongoing Proposition 98 payment deferrals total **$10.4 billion** for K-12 schools and community colleges in 2011-12. At this level, 20 percent of the funding for Proposition 98 programs in 2011–12 will not be paid until 2012–13. The Governor proposes to reduce K-14 deferrals by $2.4 billion in 2012-13, which would reduce ongoing, inter-year deferrals to a total of $8.1 billion in 2012-13.

- **K-14 Education Mandate Backlog.** The Department of Finance estimates that the state's backlog of unpaid, K–14 mandate claims totaled **$3.6 billion** at the end of 2011–12. These large unfunded balances resulted in part from the practice of "deferring" annual mandate payments as a means of achieving budget savings. The courts have clarified that K-12 schools and community colleges must fully fund, suspend, or eliminate mandates, so the state can no longer defer mandate payments. The Governor proposes a number of reforms to the K-14 education mandate system beginning in 2012-13.

- **Quality Education Investment Act (QEIA) Payments Remain.** The Governor's budget includes **$450 million** in General Funds to support the QEIA program in 2012-13, which originated with a $2.8 billion Proposition 98 "settlement" agreement in 2006-07. Of this amount, $402 million is provided to schools and $48 million is provided to community colleges. Per statute, the state will be required to make payments through 2014-15 in order to pay off **$1.1 billion** in remaining funds owed per the settlement agreement.

- **Facility Repair Funding Owed.** In 2004, the state settled the *Williams v. California* case, a class–action lawsuit filed on behalf of public school students. In response to the settlement, the Legislature created the Emergency Repair Program (ERP), which provides grants for critical health and safety repairs in certain low–performing schools. Per statute, the state is required to provide a total of $800 million over the life of ERP to meet the requirements of the settlement. The state has appropriated $343 million for the program to date, leaving **$457 million** in remaining funds owed for ERP. In recent years, full funding for the program has been suspended due to budget shortfalls. The Governor proposes **$12.3 million** in one-time Proposition 98 reversion funds for ERP in 2012-13.

- **Revenue Limit Deficit Factor Obligations.** Revenue limits provide the primary form of general purpose (discretionary) funding for K-12 local agencies -- school districts and county offices of education. Revenue limits are funded through both property taxes and state General Fund and allocated on the basis of student enrollment, as measured by average daily attendance (ADA). Funds are continuously appropriated by statutes that continue base funding, adjusted by cost-of-living adjustments (COLAs). In recent years, state funding has been insufficient to fully fund base revenue limits or COLAs. Budget trailer bills have defined statutory deficit factors to reflect base revenue limit reductions and foregone COLAs, and to apply cuts equally to school districts and county offices of education. These deficit factors have been used traditionally to track base revenue limit reductions and foregone COLAs, so that revenue limit levels could eventually be restored. The Governor's Budget reflects deficit factors of 21.666 percent for school districts and 22.497 percent for county offices in 2012-13. It would cost the state approximately **$9.8 billion** to eliminate these deficit factors and fully restore revenue limit base funding and statutory COLAs to K-12 local agencies.

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

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

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

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

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

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

Programmatic Funding (Dollars in Millions)	**2007-08 Final**	**2008-09 Final**	**2009-10 Final**	**2010-11 Final**	**2011-12 Revised**	**2012-13 Proposed**	**2012-13 Proposed Alternative**
K-12 ongoing funding[1]	$48,883	$43,215	$40,717	$43,017	$42,254	$46,755	$42,390
Payment deferrals		2,904	1,679	1,719	2,064	-2,151	
Settle-up payments		1,101		267			
Public Transportation Account	99	619					
Freed-up restricted reserves[2]		1,100	1,100				
ARRA funding		1,192	3,575	1,192			
Federal education jobs funding				421	781		
Totals	**$48,982**	**$50,130**	**$47,070**	**$46,616**	**$45,099**	**$44,604**	**$42,390**
Per-Pupil Programmatic Funding							
K-12 attendance	5,947,758	5,957,111	5,933,761	5,953,259	5,947,368	5,950,041	5,950,041
K-12 per pupil funding (Actual Dollars)	**$8,235**	**$8,415**	**$7,933**	**$7,830**	**$7,583**	**$7,496**	**$7,124**

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

Assuming the Governor's tax initiative is passed by voters, the LAO estimates per pupil programmatic funding would total **$7,496** in 2012-13, a year–over–year reduction of **$87** compared to 2011-12. K-12 schools will receive **$739** less per pupil in programmatic funding in 2012-13 compared to 2007–08.

Under the Governor's alternative plan – assuming the tax initiative fails passage -- per pupil programmatic funding would total **$7,124** in 2012-1. This level of funding would reflect a per pupil decrease of **$459** from 2011-12. Compared to 2007-08, K-12 schools would receive **$1,111** less in per pupil programmatic funding in 2012-13 under the Governor's alternative plan.

[1] Includes ongoing Proposition 98 funding, Proposition 98 accounting adjustments, and funding for the Quality Education Investment Act.
[2] Reflects LAO estimates of federal funds spent in each year.

ISSUES TO CONSIDER:

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

Governor Budget Proposals:

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

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

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

Governor's Alternative Budget:

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

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

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

What is the impact of $2.4 billion in programmatic trigger cuts? The Governor proposes to work with K-12 schools and community colleges to develop the details for proposed trigger cuts. According to the Administration, a reduction of this magnitude equates to a reduction of more than three weeks of instruction for K-12 schools. The LAO estimates this cut would reduce K-12 per pupil spending by six percent. These additional trigger cuts would be layered on substantial, ongoing revenue limit base and categorical programs reductions in the billions, as well as **$436 million** in 2011-12 trigger cuts for K-12 school programs.

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

What is the impact of elimination of $2.4 billion deferral buy down for K-14 education? In making the trigger cuts, the Governor turns first to eliminating the K-14 deferral buy-down to avoid programmatic reductions. Elimination of the buy down would eliminate any prospects of cash relief for school districts and community colleges in 2012-13. However, there are certainly local borrowing costs associated with deferring **$10.4 billion** (about 20 percent) in annual payments to the next fiscal year. Are ongoing deferrals of this level sustainable for K-12 schools and community colleges for continued borrowing, especially as they deplete budget reserves and one-time federal funds?

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

K-12 Finance - Weighted Pupil Formula

BACKGROUND:

As a means of meeting education cutbacks, state budget packages have granted K-12 schools substantial funding flexibility since 2008-09. Currently, the state allows K-12 schools to use more than **$4.4 billion** in categorical funds “for any educational purpose”. This flexibility has been granted to **38 categorical programs** for a seven year period ending in 2014-15. Funding for these individual programs continues – reflecting overall reductions of nearly 20 percent -- that will also continue through the end of 2014-15. District allocations for categorical programs in the flexibility program are based generally upon the proportion of state funding the district received for each categorical in 2008-09. These district proportions will continue through 2014-5, with no adjustments for enrollment (growth or decline).

GOVERNOR’S PROPOSAL:

Problems with Existing School Finance System.

According to the Governor, California’s school finance system has become too complex, administratively costly and inequitable. There are many different funding streams, each with its own allocation formula and spending restrictions. Many program allocations have been frozen and no longer reflect demographic and other changes. Furthermore, the fiscal flexibility that has recently been provided to schools is time−limited and excludes some significant programs.

Governor’s Funding Flexibility and Accountability Plan.

To remedy problems with the existing school finance system, the Governor proposes a “weighted pupil formula” that will provide significant and permanent additional flexibility to local districts by consolidating the vast majority of categorical programs and revenue limit funding into a single source of funding.

The formula will distribute these combined resources to schools based on weighted factors that account for the variability in costs of educating specific student populations, thereby ensuring that funds will continue to be targeted to schools with large populations of disadvantaged pupils. The funding formula will be phased in over a period of five years.

All of the programs that will be replaced by the formula will immediately be made completely flexible for use in supporting any locally determined educational purpose.

This proposal will be coupled with a system of accountability measures that will be the basis for evaluating and rewarding school performance under this finance model. These measures will include the current quantitative, test−based accountability measures, along with locally developed assessments and qualitative measures of schools.

Major Features of the Governor's Weighted Pupil Formula.

Consolidation of Most Education Programs into Single Funding Stream Beginning in 2012-13. The Governor's proposal consolidates revenue limit apportionments and 42 state categorical programs into a weighted pupil formula - beginning in 2012-13. The newly proposed formula would provide a basic per pupil allocation with additional "weights" for economically disadvantaged pupils and English learner pupils. The new formula would apply to school districts, county office of education, and charter schools.

The weighted pupil formula would be phased in over a five year period, beginning in 2012-13. Through consolidation of **$34.4 billion** in revenue limit apportionments and **$6.9 billion** in categorical funding, the weighted student formula would ultimately reflect **$41.4 billion** in K-12 education funding. The 42 categorical programs included in the weighted student formula proposal are listed below.

K-12 Programs Included in the Weighted Pupil Formula
(Dollars in Thousands)

Item	Program	2012-13		Item	Program	2012-13
103	Apprentice Programs	$ 15,694		208	Civic Education	200
104	Summer School Programs	336,246		209	Teacher Dismissal Apportionments	38
105	ROC/Ps	384,708		211	Charter Schools Block Grant	180,006
108	Grade 7-12 Counseling	167,056		211	Charter EIA	102,242
119	Foster Youth Programs	15,096		227	Community Based English Tutoring	40,082
122	Specialized Secondary Program Grants	4,892		228	School Safety Block Grant	79,932
124	Gifted and Talented	44,225		232	High School Class Size Reduction	78,950
128	Economic Impact Aid	944,447			Statutory K-3 CSR	1,326,200
137	Professional Development Institutes for Math and English	45,476		240	Advanced Placement Grant Programs	2,443
144	Principal Training	3,928		242	Student Leadership/CA Association of Student Councils	26
156	Adult Education	634,805		243	Pupil Retention Block Grant	76,675
158	Adults in Correctional Facilities	14,967		244	Teacher Credentialing Block Grant	90,404
166	Partnership Academies	21,428		245	Professional Development Block Grant	218,380
167	Agricultural Vocational Education	4,134		246	Targeted Instructional Improvement Block Grant	855,131
181	Educational Technology	14,073		247	School and Library Improvement Block Grant	370,000
188	Deferred Maintenance	250,826		248	School Safety Competitive Grant	14,349
189	Instructional Materials Block Grant	333,689		260	Physical Education Block Grant	33,519
193	Staff Development	25,957		265	Arts and Music Block Grant	87,987
195	National Board Certification	2,405		267	Certificated Staff Mentoring	8,583
198	California School Age Families Education Program	46,419		268	Oral Health Assessments	3,527
204	California High School Exit Exam	58,322		6360-101	Alternative Credentialing	26,191
					Subtotal, Categorical Programs	**$6,963,658**
					Subtotal, Revenue Limit Apportionments	**34,406,159**

In order to phase in the new formula, the Administration proposes to provide 80 percent funding according to current funding formulas and 20 percent funding according to the new weighted pupil formula in 2012-13. The percent of new formula implemented would increase by twenty percent each year, over the next five fiscal years, until the new formula was fully implemented in 2016-17.

The Governor does not propose to hold K-12 local educational agencies (LEAs) harmless from any loss of funding resulting from phase- in of the weighted student formula. Without additional funding, existing funds would have to be reallocated among districts to phase-in the new formula.

While the specific impact of reallocation is not known, there will likely be some LEAS who gain and some LEAs who lose funding, as well as, some LEAs that remain about the same level of funding. In general, LEAs with larger numbers and concentrations of economically disadvantaged pupils and English learner pupils will probably gain funding, while districts with lower numbers and concentrations of these pupils will lose relative to current funding levels.

The Administration has indicated it will release data in the next few weeks that will identify funding levels for LEAs under the weighted pupil formula.

Elements of the Weighted Student Formula. While the Administration will be releasing more details soon, the Administration has indicated that the Governor's weighted pupil formula is based upon a modified version of the formula recommended by an issue brief published by the Warren Institute in 2008.[1] The Governor's new formula includes two recommended components of the Warren Institute brief: (1) base funding and (2) targeted funding for low-income students and English learners. In lieu of revenue limit apportionments and funding for most existing categorical programs, the new formula would provide:

- **Base funding** allocated on an unspecified, but equal amount per-pupil for all school districts, county offices of education, and charter schools; and

- **Targeted funding** for educationally disadvantaged pupils based upon pupil weights. Specifically, school districts, county offices of education, and charter schools would receive an additional 37 percent in base funding for low-income pupils and/or English learner pupils. (These would be unduplicated pupil counts so that pupils who are low-income and English learners are not double counted.) School districts, county offices, and charter schools with larger proportions of disadvantaged pupils would receive supplemental "concentration" funding. More precisely, when targeted pupil concentrations reach more than 50 percent of enrollment, the targeted per pupil amount would increase. Graduated increases would be provided, as pupil concentrations grow, and would reach up to double the targeted per pupil amount, if pupil concentrations reach 100 percent.

[1] Alan Bersin, Michael W. Kirst, and Goodwin Liu. *Getting Beyond the Facts: Reforming California School Finance*, The Chief Justice Earl Warren Institute on Race, Ethnicity & Diversity, University of California, Berkeley Law School, April 2008.

Programs Excluded from the Weighted Pupil Formula. The Governor proposes to exclude a total of **12 categorical programs** – accounting for **$4.5 billion** in state funding - from the weighted pupil formula. These programs are listed in the table below.

K-12 Categorical Programs Excluded from the Weighted Pupil Formula		
Budget Item	**Program**	**2012-13**
107	County Office Oversight (FCMAT)	$ 9,169
113	Student Assessments Programs	80,901
150	American Indian Early Education Programs	531
151	Indian Education Centers	3,639
161	Special Education	3,220,931
182	K12 Internet Access	8,340
190	Community Day School	41,685
196	State Preschool Program (Half Day Preschool)	310,188
203	Child Nutrition	155,232
220	Charter School Facility Grants	92,031
266	County Offices of Education Oversight	8,016
649	After-School Education and Safety Services (Proposition 49)	547,025
	Subtotal	**$4,477,688**

The Governor would exclude some categorical programs from the new weighted pupil formula for some specific purposes, such as meeting federal maintenance of effort (MOE) requirements. Two large programs – special education (the largest by far) and child nutrition – are excluded for this purpose.

Another large program, the After School Education Safety program, is excluded because it was authorized by a state ballot measure -- Proposition 49. The state preschool program, which provides education programs for low-income three and four year olds, is excluded by the Governor because it is not a K-12 program.

Most – but not all -- other programs appear excluded because they are considered state-level programs or projects, such as student assessments, fiscal and program oversight, and shared technology.

Another large categorical program excluded from the Governor's weighted pupil formula is the Quality Education Investment Act (QEIA). This program is not reflected on the Governor's list of excluded programs probably because it is funded with non-98 General Fund and perhaps because it is a limited–term program, which ends in 2014-15. The Governor proposes **$450 million** for the program in 2012-13.

The Governor's proposal involves state funded programs only, and therefore does not involve $**6.9 billion** in funding for more than 20 federal programs for K-12 schools in 2012-13.

Full Flexibility for Programs in the Weighted Pupil Formula in 2012-13. Per the Administration, all 42 categorical programs included in the new funding formula would be subject to full and permanent flexibility beginning in 2012-13.

The Governor would add eight existing categorical programs to the current categorical flexibility program list including, three large programs -- K-3 Class Size Reduction, Economic Impact Aid, and Charter School Economic Aid – and six other programs -- Foster Youth Programs, Adults in Correctional Facilities, Partnership Academies, Agricultural Vocational Education, Apprenticeship, and Student Leadership.

The Governor proposes to remove four programs from the existing flexibility program in 2012-13 and beyond – American Indian Education Centers, Indian Education Centers, Community Day Schools, and County Office of Education program oversight.

The Administration has not provided specific language about how this expanded program flexibility would be implemented for programs in the long-term. Under the existing program, which extends through 2014-15, K-12 schools can use funding from 38 programs for any educational purpose, notwithstanding authorizing statutes for each of these programs which remain on the books.

New Accountability Requirements Delayed Until 2013-14. The Governor's new funding stream would be accompanied by new accountability requirements for schools and would provide fiscal rewards for school performance, but not until 2013-14.

While both phase-in of the new weighted pupil formula and the expanded flexibility provisions for additional categorical programs would commence in 2012-13, the new accountability requirements would not be added until 2013-14 – one year after commencement of the Governor's major reforms. While there are few details yet, the Administration has indicated that a working group will be convened in 2012-13 to assess existing statewide accountability requirements and determine what requirements might need to be strengthened in 2013-14.

Governor's Related Proposals.

Eliminate Requirement for New Transitional Kindergarten Program. The Governor believes this is a time for reinvestment and reform of core programs, not for program expansions. As such, the Governor does not fund the new Transitional Kindergarten program created pursuant to Chapter 705, Statutes of 2010. Specifically, the Governor's proposal would:

- Eliminate the requirement for a Transitional Kindergarten, which would require a new two – year, kindergarten program for all pupils who are no longer eligible for Kindergarten beginning in 2012-13;
- Change existing statute to allow pupils who receive a district "waiver" to attend Kindergarten before they are five years old to receive funding from the beginning of the school year, instead of when they turn five. The Governor would allow up to two years of Kindergarten for pupils with such waivers. In addition, the Governor would also strengthen existing law to

clarify that pupils granted Kindergarten waivers must be developmentally ready for traditional Kindergarten; and

- Increase the preschool eligibility age to include low-income pupils who are no longer eligible for Kindergarten beginning in 2012-13.

The Governor estimates cost avoidance of up to $223.7 million from eliminating the requirement for the new Transitional Kindergarten program.

Streamline and Expand Financial Support for Charter Schools. The Governor's weighted pupil formula would be provided to charter schools, as well as school districts and county offices of education. As proposed, existing charter school funding streams – primarily revenue limits, charter categorical block grants, and categorical funds charters apply directly for – would be replaced by the weighted pupil formula beginning in 2012-13. On a related front, the Governor proposes the following changes to expand access and improve equity in 2012-13, as follows:

- **Enhance Charter School Funding**. Improve access to existing funding streams for all charter schools, including non-classroom based charter schools.
- **Invest in Charter School Facilities.** Provide greater charter school access to Charter Schools Facilities Grant program funds and ensuring the timely release of funds. (This program is excluded from the Governor's weighted pupil formula.)
- **Improve Charter School Working Capital.** Provide additional authority to the California School Finance Authority to expand working capital to charter schools.
- **Provide Access to State Mandates Funding**. The Governor also includes charter schools in his proposed mandate block grant, which replaces the existing education mandates program. Currently charter schools cannot access state education mandate funding.

Eliminate Funding for School Transportation Program. The Governor proposes to eliminate the school transportation categorical program in 2012-13, resulting in $486 million in Proposition 98 savings. For this reason, the Governor does not include school transportation programs in his weighted pupil formula or full flexibility program.

The June 2011-12 budget package included $248 million in trigger cuts that eliminated the second half of the school transportation program in 2011-12. The Governor's 2012-13 proposal is intended to continue elimination of school transportation in 2012-13. SB 81, recently passed by the Legislature, would restore $248 million in school transportation trigger cuts and replace them with $248 million in additional revenue limit cuts in 2011-12.

ISSUES TO CONSIDER:

Does the Governor believe that school finance reforms depend upon additional funding? Without new funding, how would the Governor's weighted pupil formula affect funding levels for LEAs beginning in 2012-13? The Governor does not propose to hold LEAs harmless from any loss of current funding. Instead, the Governor is proposing to begin phase-in of the new formula through reallocation of existing funding. What would it cost to hold LEAs harmless from any funding loss under the Governor's proposal? How would phase-in of the new formula work for LEAs – especially since LEAs are living with significant ongoing revenue limit and categorical funding reductions?

What options might exist for providing some new funding for implementation of the Governor's weighted pupil formula? The LAO November forecast projected a more robust economy beginning in 2013-14 and beyond, that would provide notable growth for the Proposition 98 guarantee. More recently, the LAO has indicated that the Governor's plan would improve "notably" the outlook for schools for four years following 2013-14.

Does the Governor's formula provide the best definition of poverty? The Governor's proposal would use the number of pupils reported by schools as eligible for free- or reduced-price meals (FRPM) as the as the measure of economic disadvantage. Given the importance of the poverty factor, is this an accurate poverty measure? Are there other better alternatives? How would different poverty measures affect for the weighted pupil formula?

How do English learner and poverty counts interact? The Governor's proposal would use the number of pupils identified by schools as "English learners" as the measure for English learner pupils. Per the Warren Institute brief, approximately 85 percent of English Learner pupils are low–income. Since the Governor's proposal would utilize unduplicated counts for targeted pupils, the English learner counts would reflect the 15 percent of pupils who are not low-income. In total, about 60 percent of students statewide would be included in the unduplicated targeted pupil counts, including both low-income and English learner pupils.

Does the Governor's proposal provide sufficient assurances that funds will ultimately benefit targeted students – low-income pupils and English learner pupils? Per the Administration, the Governor's school finance proposals are intended to empower local school officials to determine the best use of scarce resources. What assurances does the state have that funds allocated for targeted pupils are expended for targeted pupils? The accountability provisions, that are largely unknown, will be an important part of the State's oversight.

Does the Governor see any risks from adding Economic Impact Aid (EIA) to the flexibility program in 2012-13? The Governor's proposal adds several categorical programs to the current flexibility program beginning in 2012-13, including EIA. Per the Governor's proposal, the funding requirements for a total of 42 categorical programs would be permanently flexed – so that funds could be expended for any educational purpose. Funding allocations for these 42 programs would be phased into the weighted pupil formula over the next five years. Given historic under-performance of low-income and English learner pupils, are there some funding requirements that should be retained for this program in the short- or long-term, especially since the accountability improvements are not scheduled until 2013-14, a year after full funding flexibility occurs.

Did the Governor consider grade-span factors as a part of the base formula to better reflect the cost variances for elementary, middle and high school? The Warren Institute brief did not recommend a base formula for each grade-span. However, the brief did raise grade-span base funding levels as a question for policymakers to consider in moving forward with a weighted pupil formula. What is known about the true education cost differences for different elementary, middle, and high school pupils?

The Governor does not include the Special Education program as a part of his finance reforms at this time. Are some reforms still possible? The special education formulas were updated in the late 1990's, and as such, might not fit into the targeted pupil formula. However, given the size and complexity of this categorical program – the largest state categorical program – is there room for some reform to make allocations more equitable, streamlined, and transparent?

How would the Governor's proposal affect the level of funding for Charter Schools? The Governor's weighted pupil formula would provide funding for school districts, county offices, and charter schools. This would appear to make charter school funding the same as funding for districts and county offices. The Governor also proposes to increase access to all charter school funding for non-classroom based charter schools.

K-12 Education Mandate Reforms

BACKGROUND:

Underlying Problems. According to the Governor, the significant shortcomings of existing K-14 education mandates and the process for administering them compel reform of education mandates. According to the Governor:

- Many existing mandates fail to serve a compelling purpose;
- The mandates determination process takes years;
- The reimbursement costs for mandates are very often higher than anticipated and can vary greatly district by district; and
- The reimbursement process rewards inefficiency.

Annual Budget Appropriations for Mandates. Once approved by the Commission on State Mandates, the Legislature currently has three basic options for handling state education mandates:

- ***Fund.*** The Legislature may appropriate funding for each mandate based upon the State Controller's Office Statewide Cost Estimate Report.
- ***Suspend***. Alternatively, the Legislature may choose to "suspend" a mandate by eliminating funding in the budget and adding provisional language stating the mandate is suspended. When a mandate is suspended, local responsibilities for providing the mandate and state obligations for funding the mandate are also suspended. In recent years, five mandates applying to school districts (three of which also apply to community colleges) are suspended.
- ***Repeal***. The Legislature may also choose to repeal a mandate by eliminating funding in the budget and repealing the underlying statute.

In 2002-03, the Legislature adopted the practice of deferring payments for K-14 education mandates as a means of achieving state budget savings. With this practice, annual appropriations were virtually eliminated (limited to $1,000 per mandate) and full payments were deferred to future years, although local agency obligations to provide the mandated services continued. However, the courts have recently clarified that K-12 schools and community colleges must fully fund, suspend, or eliminate mandates, so the state can no longer defer mandate payments.

Annual Mandate Costs Growing. The 2011-12 budget provides **$90 million** to cover the costs of annual mandate claims. However, according to the LAO the annual cost of K-14 mandates is projected to be **$180 million** at the end of 2011-12.

Prior Year Mandate Claims Significant and Growing. The Department of Finance estimates that the state's backlog of unpaid, K–14 mandate claims totaled **$3.6 billion** at the end of 2011–12. These large unfunded balances resulted in part from the practice of deferring annual mandate payments as a means of achieving budget savings. These unpaid claims constitute a growing state obligation that must be paid eventually, once claims are audited and approved. The state must also pay interest on overdue claims, based upon the rate established for the Pooled Money Investment Account. According the State Controller's Office, as of June 30, 2011, the state owed **$69.7 million** in accrued interest on school mandates.

GOVERNOR'S PROPOSAL:

K−14 Education Mandate Reform Plan. The Budget provides a total of **$200 million** to fund a mandates block grant incentive program for K−12 schools and community colleges. Legislation will eliminate almost half of all current K−14 mandates and will create incentives for schools and community colleges to continue to comply with remaining previously mandated activities. More specifically, the Governor's proposal would:

- **Repeal Mandates.** The proposal will eliminate nearly half of all existing mandates, including Graduation Requirements (Second Science Course) and Behavioral Intervention Plans. While the mandate to perform these activities will be eliminated, local districts may choose to continue these activities at local discretion.
- **Preserve Core Programs and Functions.** Mandates that are not eliminated will be made optional. However, the proposal creates a block grant to encourage schools to continue meeting these requirements. Receipt of funding from this block grant will be conditioned on schools complying with these provisions. The proposal will sustain core programs, including school and county office fiscal accountability reporting. It will also continue to support sensitive notification and school safety functions like pupil health screenings, immunization records, AIDS prevention, School Accountability Report Cards, and criminal background checks

Major Features of Governor's Proposal.

The Governor proposes major changes to existing K-14 education mandates programs and funding in 2012-13. Major features are outlined below:

- **Eliminates More Than Half of Mandates.** The Governor proposes to eliminate 29 K-14 education mandates in 2012-13. This total includes 16 K-12-only mandates, five community colleges-only mandates, and eight mandates that apply to both schools and colleges. Mandates proposed for elimination include:
  - **K-12 Education (16):** Behavioral Intervention Plans (BIP), Caregiver Affidavits, Consolidation of Law Enforcement Agency Notifications (LEAN) and Missing Children Reports, Consolidation of Notification to Teachers: Pupils Subject to Suspension or Expulsion I and II and Pupil Discipline Records, County Treasury Withdrawals, Financial and Compliance Audits, Graduation Requirements, Habitual Truants, Notification of Truancy, Physical Education Reports, Physical Education Tests, Pupil Residency Verification, Pupil Suspensions, Expulsions, Expulsion Appeals, Removal of Chemicals, School Bus Safety I and II, Scoliosis Screening.

   - **Community Colleges (5):** Health Fee Elimination, Integrated Waste Management, Law Enforcement Jurisdiction Agreements, Reporting Improper Governmental Activities, Sexual Assault Response Procedures.

   - **K-14 Education (8):** Absentee Ballots, Agency Fee Arrangements, Grand Jury Proceedings, Health Benefits for Survivors of Peace Officers and Firefighters, Law Enforcement Sexual Harassment Training, Mandate Reimbursement Process, Student Records, Threats Against Peace Officers.

- **Continues Most Remaining Mandates & Includes in New Block Grant**. The Governor proposes to continue 26 K-14 mandates and cover the mandated activities for each within the new mandates block grant. These mandates include: 21 K-12-only mandates, two community college-only mandates, and three mandates that apply to both K-12 schools and community colleges, including:

   - **K-12 Education (21):** AIDS Instruction and AIDS Prevention Instruction, California State Teachers Retirement System Services Credit, California High School Exit Exam, Charter Schools I, II, and III, Comprehensive School Safety Plans, Consolidation of Annual Parent Notification/Schoolsite Discipline Rules/Alternative Schools, County Office of Education Fiscal Accountability Reporting, Criminal Background Checks, Criminal Background Checks II, Differential Pay and Reemployment, Immunization Records, Immunization Records-Hepatitis B, Intra-District Attendance, Juvenile Court Notices II, Pupil Health Screenings, Pupil Promotion and Retention, Pupil Safety Notices, School Accountability Report Cards II and III, School District Fiscal Accountability Reporting, School District Reorganization, Stull Act.

   - **Community Colleges (2):** California State Teachers Retirement System, Sex Offenders: Disclosure Requirements.

   - **K-14 Education (3):** Collective Bargaining, Open Meetings/Brown Act, Prevailing Wage.

Proposed Funding for New Mandate Block Grant Program. Provides a total of **$200 million** to establish separate block grants to provide incentive funding for K-12 schools and community colleges that comply with mandates in 2012-13. Block grant funds would be allocated on a per-pupil basis to K-12 schools and community colleges that choose to participate in the new mandate block grant. The $200 million in funding for new K-14 block grants represents an increase of **$110 million,** which more than doubles the amount of funding appropriated for K-14 mandates in the 2011-12 budget.

Mandate Funding Proposal (dollars in millions)

Dollars in Millions	Budget Act Item	2011-12	2012-13	Change
K-12 Education	6110-295-0001	$80.4	$178	97.6%
Community Colleges	6870-295-0001	9.5	22	12.5%
Total		**$89.9**	**$200**	110.1%

The Governor's new block grant proposal would provide **$178 million** for K-12 education and **$22 million** for community colleges. The Administration estimates that the new block grant will provide a **340 percent increase** in funding and will encourage schools to sustain core education, health and safety, and accountability mandates.

Two Large Mandates Eliminated. The Governor's plan includes elimination of two of the most costly K-12 mandates including High School Science Graduation Requirements and Behavioral Intervention Plans. Each of these mandates carries significant prior year and ongoing costs to the state. Additional detail is provided below for each of these mandates.

Science Graduation Requirement Mandate.

As part of major education reform legislation in the early 1980s, the Legislature increased the state's high school graduation requirements. Among other changes, the law required that all students complete two high school science classes prior to receiving a diploma (the previous requirement was one science class). This change raised the total number of state-required courses from 12 to 13.

The costs associated with providing an additional science class were the basis of an eventual mandate claim. In 1987, CSM determined that providing an additional science class imposes a higher level of service on districts and, therefore, constituted a reimbursable mandate.

In 2004, a court ruling indicated that school districts had full discretion to increase their total graduation requirements and total instructional costs. Based on this 2004 ruling, CSM decided the state could not increase the number of courses it requires for graduation above 12 courses without providing reimbursement.

According to the latest data from the State Controller's Office, annual costs for the science graduation requirement total about **$250 million** a year. Prior year claims are estimated at **$2.5 billion** for this mandate.

A number of mandate reforms were enacted in the 2010-11 budget package. These reforms included modifications to the Science Graduation Requirement mandate intended to retain the underlying statute, while eliminating mandate cost requirements.

Behavior Intervention Plan Services Mandate.

Federal law entitles children with disabilities to a "free and appropriate education" (FAPE) tailored to their unique needs. In order to achieve these goals, districts are responsible for providing special education and related services pursuant to an Individualized Education Program (IEP), which is developed by an IEP team -- including parents -- with special education expertise and knowledge of a child's particular needs.

Chapter 959, Statutes of 1990 (AB 2586, Hughes), sought to regulate the use of behavioral interventions and encourage the use of positive behavioral strategies with special education students, as a part of the IEP process. In so doing, Chapter 959 required the State Board of Education (SBE) to adopt regulations that (1) specified the types of behavioral interventions districts could and could not use; (2) required IEPs to include, if appropriate, a description of positive interventions; and (3) established guidelines for emergency interventions.

The SBE adopted regulations that require districts to conduct a "functional assessment analysis" and develop a Behavioral Intervention Plan (BIP) for students with disabilities exhibiting serious behavior issues. SBE regulations also require districts to train staff to implement BIPs.

In 1994, three school districts filed a claim arguing that BIP-related requirements constituted a reimbursable mandate. In reviewing the claim, the Commission on State Mandates staff found that state statute, "on its face, does not impose any reimbursable state mandated activities," **however, regulations adopted pursuant to state law were found to constitute a state mandate.**

At the time BIP-related regulations were implemented, federal law was silent on the use of behavioral interventions. In 1997, however, federal law was amended to include behavioral interventions in the IEP process. Per the LAO, under state law, if a student with a disability exhibits behavior that impedes his or her education, school districts are required to perform three primary activities: (1) assess the student's behavior using a "functional analysis assessment," (2) implement a plan for addressing the behavior (the BIP), and (3) ensure teachers are properly trained to perform BIPs. Per the LAO, after state laws and regulations were adopted, the federal government essentially chose to require the same primary activities.

According to recent estimates, annual claims costs for the BIP mandate total about **$65 million** a year. Prior year claims are estimated at **$1.0 billion** for this mandate.

BIP statutes were also updated in 2010-11 budget package to clarify federal special education mandates covering positive behavior services for students with disabilities. The intent of these changes was to retain the underlying BIP statute, but eliminate mandated cost requirements.

ISSUES TO CONSIDER:

Does the Administration anticipate long–term savings or other efficiencies with this proposal? The Governor proposes an increase of $110 million in 2012-13 – which will provide a total of $200 million to K-12 schools and community colleges for the new mandate block grant. How does this compare to the long-term costs that will be incurred if the mandates continue under the current mechanism? In addition, the block grant approach will presumably distribute the mandate expenditures in a more equitable and uniform way. Given the current system is fraught with inequities as different districts get reimbursed for different amounts for what are ostensibly the same activities. Furthermore, a significant number of claims are found to be ineligible for reimbursement and the block grant approach would seem to streamline the significant administrative effort that goes into the claiming process which is sometimes for not.

Under the Governor's plan do mandates in the block grant remain mandates? Could districts still claim for these mandates, if they chose to do so? Is there a risk to retaining mandates within the block grant? Would it be better to suspend the mandates and continue the activities within the new block grant?

The Governor proposes to fully address the backlog of prior year mandate claims by the end of 2015-16. The Department of Finance estimates that the state's backlog of unpaid, K–14 mandate claims totaled **$3.6 billion** at the end of 2011–12. The Governor has identified these obligations as a part of his Wall of Debt, and would retire this debt over the next few years if the tax initiative is approved by voters.

How does the Governor's plan address future mandates? How would the activities of the Commission on State Mandates and State Controller's Office (SCO) change? The Commission on State Mandates has a number of mandate claims in the pipeline. Would all new mandates be added to the new block grant? Under the block grant, how would mandates be audited to assure that K-12 schools and community colleges were providing the mandated services?

The Governor's plan eliminates the mandate claiming reimbursement mandate? What is the reason for this? How much do K-12 schools and community colleges spend annually on mandate claiming? Reportedly, school districts spend in the tens of millions of dollars on the mandate claiming process? Some districts hire outside contractors to perform this function. Other districts provide this service in-house or simply do not file mandate claims because benefits outweigh the costs.

Under the Governor's plan, how would the new block grant be administered? The Administration has provided preliminary language that would authorize funding for the Department of Education to administer the new mandate block grant.

Why does the Governor eliminate the Science Graduation Requirement? The estimated cost of the science graduation mandate is large – more than double all other K-12 mandates combined. In addition, the backlog of prior year costs covers more 15 years of claims. However, the Science Graduation Requirement mandate was modified in 2010-11 as a part of mandate budget reforms to retain the mandate but remove any required costs. Does the Administration believe these changes were insufficient to protect the State from additional claims?

Why does the Governor eliminate the Behavior Intervention Plan (BIP) mandate? The BIP mandate was also modified in 2010-11 to retain the mandate but remove any required costs. Does the Administration believe another approach is required to protect the State from additional claims?

Child Care and Early Childhood Education

BACKGROUND:

There are many different programs that invest in child care and early childhood education. Direct child care and early childhood education services are currently funded by every level of government (federal, state, and local), including local school districts and the First 5 County Commissions. These programs have developed through separate efforts to achieve a variety of goals, including but not limited to, providing the child care necessary so that parents can work, and providing an educational environment that helps prepare young children for success in school.

State Funded Programs. Historically, the state has funded the following programs:

- CalWORKs Child Care (Stages 1, 2 and 3) – recipients of CalWORKs assistance are eligible for subsidized child care. This care is administered in three stages. All CalWORKs providers are paid through a voucher reimbursement system based on regional market rates (RMR).
- Non-CalWORKs Child Care (General Child Care [Title V Centers and Family Child Care Homes], Alternative Payment programs, and Migrant and Severely Handicapped programs) – low-income families not receiving CalWORKs assistance also are eligible for subsidized child care, though demand typically exceeds funded slots.
- State Preschool – early childhood education programs for three-to-five year old children from low-income families. This is the only program that does not require the parents to be working or engaged in some other qualifying activity.

These state-funded programs are primarily administered by the State Department of Education (CDE) with the exception of Stage 1 CalWORKs Child Care, which is administered by the Department of Social Services (DSS). Until the 2011-12 fiscal year, the vast majority of these programs were funded from within the Proposition 98 Guarantee for K-14 education. Currently, all of these programs are supported by non-98 General Fund spending and federal funds, with the exception of part-day State Preschool which continues to be funded from within Proposition 98.

The portion of the General Child Care program that was serving three-and four-year-old children in center-based settings was consolidated with the State Preschool program in 2009 after the passage of Chapter 308, Statutes of 2008 (AB 2759, Jones). A significant portion of the funding for the General Child Care program is now supporting preschool programs and many of them are run by school districts.

In 2011-12, around $1 billion was allocated for CalWORKs Child Care, $933 million for Non-CalWORKs Child Care, and $374 million for State Preschool. These programs were funded with a mix of Proposition 98 General Fund (part-day State Preschool only), Non-Proposition 98 General Fund ($1 billion), and federal funds ($941 million).

Head Start Programs. The federal government invests directly in Head Start programs around the State. These programs serve preschool-age children and their families. Many Head Start programs also provide Early Head Start, which serves infants, toddlers, pregnant women, and their families who have incomes below the federal poverty level.

Head Start programs offer a variety of service models, depending on the needs of the local community. Programs may be based in:

- Centers or schools that children attend for part-day or full-day services;
- Family child care homes; and/or
- Children's own homes, where a staff person visits once a week to provide services to the child and family. Children and families who receive home-based services gather periodically with other enrolled families for a group learning experience facilitated by Head Start staff.

The federal Administration for Children and Families reports that nearly $860 million was expended on Head Start in California in 2009 and nearly 98,000 children were served.

California First 5 and County First 5 Commissions. The California Children and Families Program (known as First 5) was created in 1998 upon voter approval of Proposition 10, the California Children and Families First Act. There are 58 county First 5 commissions as well as the State California and Families Commission (State Commission), which provide early development programs for children through age five. Funding is provided by a Cigarette Tax (50 cents per pack), of which about 80 percent is allocated to the county commissions and 20 percent is allocated to the State Commission. This Act generates about $475 million in new revenues annually.

The First 5 programs are generally directed by the State and County Commissions. Both the State and County Commissions have made early child care and education a priority for expenditure. According to the latest annual report available from First 5 California from 2009-10, the State Commission has invested in the following efforts:

- Power of Preschool - $15.2 million to fund Power of Preschool demonstration projects in certain counties. Power of Preschool provides free, voluntary, high-quality, part-day preschool to assist three- and four-year old children in becoming effective learners with a focus on developing preschool in underserved and high-priority communities.
- School Readiness - $51.7 million to counties for the School Readiness Program that strives to improve the ability of families, schools, and communities to prepare children to enter school ready to learn. Services are provided to focus on family functioning, child development, child health, and systems of care with a specific target to children and their families in schools with an Academic Performance Index score in the lowest three deciles.
- Low Income Investment Fund Constructing Connections - $600,000 to support Constructing Connections that coordinates and delivers technical assistance, training, knowledge, and facility financing information to support child care facilities development through local lead agencies. The Commission indicates that it leveraged more than $86 million in resources to create and renovate child care facilities and spaces.

There is considerable variation county to county; but, on a whole, County Commissions invested $265 million in 2009-10 to improve child development. The County Commissions predominantly invested these funds in Preschool for three- and four-year-olds and State school readiness programs.

Local School Districts. Local school districts have also made considerable investments in early childhood education. Many elementary schools have preschool programs and child care programs on site. In some cases these programs are those described in earlier sections (State Preschool for low income kids, Head Start, or First 5 funded programs). However, in some cases these programs are funded directly by school districts using other funds, including local property tax and parent fees. In addition, school districts have flexibility to use some of their major funding streams on early childhood education. The Title I federal funding that is dedicated to improving the academic achievement of the disadvantaged can be used to support early childhood education. In addition, federal special education funding can also be used to support children demonstrating special needs prior to entering school. The State also has a categorical program called California School Age Families Education (Cal SAFE) that provided money specifically for child care and other supports for parenting students. This program was added to categorical flexibility in 2008-09 and the funds allocated to districts are no longer restricted to the CalSAFE program. The State also provides local school districts with After School Educational and Safety (Proposition 49) funding of about $680 million annually.

Furthermore in 2010, legislation was enacted to create a two-year kindergarten program for students who turn five between September 1 and December 1. The 2012-13 fiscal year is the first year that this two-year program is required to be offered for students that have a birthday between November 1 and December 1. School districts have had the option to offer this early Transitional Kindergarten program on a pilot basis prior to this year and districts have varied greatly in their implementation of this program. Kindergarten (whether one year or two year) is not compulsory in California.

In summary, local school districts have invested in early childhood education, but there is no easy way to quantify the investments that they have made.

Community College Districts. There is also a small amount of funding allocated to the Community College Districts to support subsidized child care for students. This includes funding for the following programs:

- CalWORKs - $9.2 million for subsidized child care for children of CalWORKs recipients. This program is proposed to be part of the Governor’s categorical reform and would no longer be restricted for this purpose.
- CARE (Cooperative Agencies Resources for Education) - $9.3 million to provide eligible students with supplemental support services designed to assist low-income single parents to succeed in college. Child care is one of many supports funded by this program. This program is proposed to be part of the Governor’s categorical reform and would no longer be restricted for this purpose.
- Child Care Tax Bailout - $3.3 million for certain districts to provide assistance for child care. This program was included in the categorical flex item adopted in the 2009-10 budget, but there has been no change to this program since that time.

GOVERNOR'S PROPOSAL:

Overall Funding. The Governor's budget proposes $1.9 billion in funding for child care programs. This includes $1.5 billion in funding for programs administered by CDE and $442 million in funding for Stage 1 child care administered by DSS. This reflects a reduction of $450 million General Fund or approximately 20 percent of the total program when compared to 2011-12. The Department of Finance (DOF) estimates that this will result in 62,000 fewer child care slots in the budget year.

Child Care and Preschool Program Reductions. The Governor's budget proposes the following reductions to the state funded child care reductions in 2012-13:

- **New Requirements and Reduced Time Limits for Welfare Recipients -** $293.6 million in savings in non-Proposition 98 General Fund by reducing time limits on welfare to work services for adults who are not working sufficient hours in unsubsidized jobs and making other changes. This change will eliminate services for 109,000 families as of April 2013. This reduction will eliminate about 46,300 child care slots. Part-day preschool programs will not be affected by this reduction.

- **Reduce Income Eligibility -** $43.9 million in non-Proposition 98 General Fund savings and $24.1 million in Proposition 98 General Fund savings by reducing the income eligibility ceilings from 70 percent of the state median income to 200 percent of the federal poverty level. Per the Administration, this level equates to 61.5 percent of the state median income for a family size of three, reflecting a reduction in the income ceiling from $42,216 to $37,060. This reduction will eliminate about 15,700 child care slots. This reduction is extended to State Preschool.

- **Eliminate COLA -** $29.9 million in non-Proposition 98 General Fund savings and $11.7 million in Proposition 98 General Fund savings by eliminating the statutory COLA for capped non-CalWORKs child care programs.

- **Reduce Reimbursement Market Rate (RMR) Ceilings -** $11.8 million in non-Proposition 98 General Fund savings by reducing the reimbursement rate ceilings for voucher-based programs from the 85th percentile of the private pay market, based on 2005 market survey data, to the 50th percentile based on 2009 survey data. Per the Administration, to preserve parental choice under lower reimbursement ceilings, rates for license-exempt providers will remain comparable to current levels, and these providers will be required to meet certain health and safety standards as a condition of receiving reimbursement. (A corresponding $5.3 million General Fund decrease is made to Stage 1 in the Department of Social Services budget.)

- **Reduce State Reimbursement Rate (SRR) for Title 5 Centers -** $67.8 million in non-Proposition 98 General Fund savings and $34.1 million in Proposition 98 General Fund savings by reducing the standard reimbursement rate for direct-contracted Title 5 centers by 10 percent.

Child Care Program Redesign and Realignment. The Governor also proposes major changes that would restructure the administration of the child care programs. These changes are consistent with the Administration's proposal to restructure CalWORKs, whereby the Administration intends to focus state funding on low income families working a required number of hours (30 hours per week or 20 hours per week if the family has small children). The Administration proposes to replace the three-stage child care system for current and former CalWORKs recipients and programs serving low-income working parents with a work-based child care system administered by county welfare departments starting in 2013-14. The Governor is proposing a two year process to implement these changes.

- **Year 1--2012-13 Structure.** The Governor proposes to consolidate all funding for Stage 2, 3 and non-CalWORKs Alternative Payment (AP) programs into one block grant to the AP contractors. This block grant would fund child care for families whose children are recipients of child protective services, or at risk of being abused, neglected or exploited, and cash-aided families. Only families meeting the new work requirements would be eligible for the subsidy. Priority would be based on income and the previously listed factors.

DSS**: CalWORKs Child Care Stage 1** will continue to be administered by County Welfare Directors subject to the new work participating requirements. $442 million, 60,313 slots.

CDE: **CalWORKs Child Care Stage 2** is an entitlement for families for two years after the family stops receiving a CalWORKs grant.

CDE: **CalWORKs Child Care Stage 3** is for families that have exhausted the time limit in Stage 2 and are otherwise eligible for child care. Stage 3 is a capped program.

CDE: **Alternative Payment Programs** provide low income families with vouchers for care in a licensed center, family child care home, or by a licensed-exempt provider.

CDE: **New consolidated block grant** to the Alternative Payment contractors to provide vouchers to serve eligible families with priority given to families whose children are recipients of child protective services, or at risk of being abused, neglected, or exploited, and cash-aided families meeting work requirements. $571 million, 82,834 slots.

CDE: Administration of the **General Child Care** program which funds Title 5 centers through direct contracts with the State would not change in the budget year, except for the reduction in income eligibility and reimbursement rate, which would reduce the size of this program considerably. $470 million, 52,809 slots.

- **Year 2--2013-14 Structure.** In Year 2 of the redesign, larger fundamental changes occur regarding the oversight and management of the child care programs. In Year 2 all of the child care funding at CDE (except part-day Preschool) would be consolidated with Stage 1 (administered by DSS) to provide a new consolidated block grant to the Counties. Furthermore, all families including those currently enrolled in Title 5 centers will receive vouchers for a payment to a provider of their own choice.

DSS: **CalWORKs Child Care Stage 1**	Counties: **Consolidated child care block grant** to serve eligible families with priority given to families whose children are recipients of child protective services, or at risk of being abused, neglected, or exploited, and cash-aided families meeting work requirements. Counties would have authority to continue to contract with Alternative Payment contractors locally like 27 counties currently do with the Stage 1 program. The DSS would oversee this consolidated program, including the federal Child Care Development Funds.
CDE: **New Consolidated block grant** (formerly CalWORKs Stages 2 and 3 and Alternative Payment Programs)	
CDE: **General Child Care** program.	

- **Future of Quality and Other Child Care Activities Uncertain**. The Governor continues the expenditure of $76 million in quality and other child care activities that provide support, development, and referral networks for the child care network through CDE in the budget year. The Administration has indicated that it plans to have DSS and CDE work together on a new plan on how to allocate the quality dollars in 2012-13. Furthermore, the Administration was recently awarded a Race to the Top federal grant to further develop quality child care programs. Generally, the Administration seems to still be developing a long-term plan for the quality and other child care funding components that have historically been administered by CDE.

- **Preschool and AB 2759.** The CDE will continue to administer part-day Preschool under the Governor's proposal. However, as mentioned in the background, a significant amount of the funding in the General Child Care program is currently funding Preschool. In 2009, after the implementation of AB 2759 (Jones), some of the contracts with Title V centers funded with General Child Care program funding were consolidated with State Preschool contracts. The Governor has proposed to unwind this relationship over the next year and realign the General Child Care funding along with other funding to the counties as part of the block grant.

- **Oversight.** The Governor's proposal centers oversight and design of the child care system with the counties starting in 2013-14 and has proposed legislation to provide counties and alternative payment programs with the tools needed to identify and collect overpayments and to impose sanctions on providers and families that commit intentional program violations. Any savings identified would be reinvested in child care slots.

Other Early Childhood Programs. The Governor has also proposed to eliminate a new two-year Kindergarten program (known as Transitional Kindergarten) to save $223.7 million in Proposition 98 funding in the budget year. This program would have commenced a new, early childhood education program for children no longer eligible for Kindergarten. Unlike other early childhood programs, funding would not be needs-based. For example, funding would not be targeted on the basis of income, as is the case with most other child development programs, such as state preschool. Instead, program funding would be provided to all children with birthdays that fall within a three month range. (*There is additional discussion on this proposal in the K-12 section of this report.)*

ISSUES TO CONSIDER:

How Do We Minimize Impacts to Crucial Investments in Child Care? The Governor has proposed a significant redesign of the current state-funded child care programs. However, ultimately the reduced number of child care and early childhood education slots (62,000) will have real impacts on the access to child care, the ability of families to work, and the reduced school readiness for low-income children. Furthermore, recent studies have found that child care and early childhood education efforts have returns on investment to the public ranging from $2.69 to $7.16 per dollar invested. Studies have found that investments in child care and early childhood education have consistently found substantial savings derived from reduced need for remedial and special education, reduced incarceration, and lower rates of teen pregnancy, among many other factors.

While the economy has started to improve, along with State revenues, the budget continues to be extremely constrained. Ultimately, the Legislature will need to weigh options for balancing the budget. However, it will be important to focus these reductions in an effort to minimize impacts to direct services and preserve key infrastructures that would be difficult to rebuild. Furthermore, since part-day Preschool continues to be funded by the Proposition 98 guarantee for K-14 education, the Legislature may wish to further evaluate the mix of funding sources for support of child care and early childhood education.

What About the Governor's CalWORKs Requirements? The single largest reduction in the Governor's child care proposal is to the CalWORKs child care program due to stricter work requirements and lower time limits. The Governor's proposal would require that a parent be working 30 hours per week in unsubsidized employment after two years of services in the CalWORKs program, with minimal exceptions, in order to be eligible for child care. Because the Governor's proposal drops families from the program after a six month period, the number of families losing child care services is especially high in the budget year. In summary, the child care proposal is intertwined with the Governor's larger CalWORKs proposal and these reductions will need to be evaluated together. *(See the discussion of the CalWORKs proposal in a separate section of this report.)*

Who Should Administer Child Care Funding? The Governor has proposed a major shift in the allocation of the child care funding from a program primarily administered by CDE to a program mainly administered by the counties with some oversight from DSS. Nevertheless, it is important to note that the vast majority of the child care programs (CalWORKs and Alternative

Placement programs) are currently run by locally based Alternative Placement agencies and in 27 counties the Alternative Placement agency also manages the Stage 1 contract for child care, which is allocated to the counties by DSS.

In summary, a large portion of the current system is managed locally with some variation from county to county. The exception to this is the Title V centers and Family Child Care Homes, which directly contract with the State through the General Child Care program. This program has the potential to change significantly under the Governor's proposal as the state requirements related to Title V would become optional and counties would not be required to contract with these centers. Furthermore, the Governor's proposal would provide vouchers for all programs in the second year of implementation and given the considerable fixed per classroom costs associated with running a Title V center it is unlikely that these centers could continue without the certainty of a contract or other partnerships with a local school district. In addition, the Governor's rate reduction to the Title V centers in the budget year is likely to provide significant hardship and result in many centers closing their doors, because they have few alternatives to reduce costs and live within the lower rate. In some areas of the state, the Title V centers are reimbursed at a lower rate than other child care centers.

Generally, programs that are good candidates for realignment are programs that would benefit from local innovation and are programs where the State can tolerate some variation in the delivery of services. A large portion of the child care programs fit these qualifications. However, this is not the case with the Title V centers and Family Child Care Homes that are currently directly contracting with the State and adhere to State standards for operation and reimbursement. The Legislature will need to evaluate and determine what role the State will play in preserving the current network of Title V centers.

How Do We Maximize Coordination? There have been significant efforts at the state and federal levels of government to try and reduce the achievement gap of low-income children before they enter school. Furthermore, the voters also passed the First 5 initiative that specifically focuses resources to children ages zero-to-five and their families. Also, the State currently funds numerous separate programs for child care and early childhood education. The Governor's proposal has taken significant steps to streamline and consolidate the State child care programs into a block grant to the counties. This could help to enhance coordination among child care programs and the different early childhood education efforts that are generally locally driven (local First 5 Commissions, local school districts, and others).

One aspect of the Governor's proposal, however, seems to reduce recent gains made to coordinate funding streams. Assembly Bill 2579 (Jones) allowed State contractors to blend State part-day Preschool funds and General Child Care programs to provide three-and four-year-olds with State Preschool and wrap around child care that is needed to help support working parents. This coordination was enacted after there was a general consensus that State part-day Preschool could not be accessed by working parents that needed full day care. The Governor's proposal does away with this effort. Nevertheless, the underlying goals of AB 2759 continue to be extremely important to providing more low-income three-and four-year-olds, with working parents, access to these proven State Preschool programs. The Legislature will want to examine ways in which we can maximize the use of existing child care and early childhood education funding given the numerous funding sources and separate efforts in this area.

California State Library

BACKGROUND:

Founded in 1850, the California State Library (Library) is the oldest and most continuous cultural agency in the state. Among its responsibilities, the Library supports a transparent government by collecting, preserving, and ensuring access to government publications; ensures access to books and information for the visually impaired or those who are otherwise physically handicapped and unable to read standard print; provides library and information services to the legislative and executive branches of state government, members of the public, and public libraries; administers and promotes literacy outreach programs; and develops technological systems to improve resource sharing and enhance access to information.

Federal Library Service and Technology Act Funding

Over the past five years, the state has received each year an average of over $16 million in federal Library Service and Technology Act (LSTA) funding. In 2011, due to cuts at the federal level, the state received about $15.4 million. The federal funds are available for expenditure for two years, require a state match, and support services consistent with the priorities set forth by the LSTA legislation. These federally-supported programs include the following: Braille and Talking Book Library, California Government Information Access/California Portal, Library Materials and Database Acquisition, and Historic California Photograph Digitization.

In order to be eligible for LSTA funding, the state is required to meet federal maintenance of effort (MOE) requirements, as determined by a three-year rolling average of state funds spent on libraries. If the state's average falls, the allotment of dollars to California falls by the similar percentage. Each December, the Library is required to report to the federal government on the amount of state funds expended consistent with the purposes of the LSTA. That state expenditure level, via the MOE calculation, determines the amount of federal funding the state receives the following October (beginning of the federal fiscal year).

State-Funded Local Assistance Library Programs

State-funded local assistance library programs comprise the majority of the state's federal MOE calculation because they demonstrate the state's commitment to libraries and are consistent with the purposes of the LSTA. These programs include the following: (1) <u>California Library Literacy Services</u> provide community-centered assistance to low-literacy adults and their families, including funding for the mobile library program; (2) <u>California Library Services Act</u> promotes resource sharing and reimburses public libraries for loans to individuals living outside their jurisdiction; and (3) <u>California Newspaper Project</u> identifies, describes, and preserves California newspapers. Two other programs are also included in the calculation: (1) <u>Telephonic Reading Program</u> allows persons with visual impairments to use their telephones to listen to more local news, TV Guide listings, archived radio shows, bus schedules, newsletters, and shopping advertisements; and (2) Library Development provides leadership and support of the future of California through its libraries.

As part of the triggers included in the 2011-12 budget, funding for the three local assistance programs, as well as the Public Library Foundation (PLF) and the California Civil Liberties Public Education Program (CCLPEP), were eliminated. These reductions (excluding for PLF and CCLPEP) total nearly $12 million and jeopardize the Library's 2012-14 allotment of federal funds.

Major Sources of Funding (in thousands)

Funding Source	2010-11	2011-12	2011-12 revised	2012-13
General Fund	$10,190	$10,770[2]	$10,770[2]	$12,740[3]
General Fund - Local Assistance	$31,056	$15,866	$0	$0
Central Service Cost Recovery Fund	$1,368	$1,734	$1,734	$1,275
Federal Funds – State Operations[1]	$7,259	$7,257	$7,257	$7,380
Federal Funds – Local Assistance[1]	$12,518	$12,518	$12,518	$12,518
Other Funds (excludes debt service)	$3,655	$2,539	$3,091	$2,616
Total	**$66,046**	**$50,684**	**$35,370**	**$36,529**

[1]Due to calendar differences between the state and federal fiscal years, and the fact that the federal funds are available for expenditure over two years, the amount of federal funding displayed in a given state fiscal year totals greater than $16 million total received from the federal government.
[2]Increased General Funds in 2011-12 were the result of various adjustments, including for the end of employee furloughs.
[3]The 2012-13 General Fund allocation reflects an increase over 2011-12, even in light of the $1.1 million reduction in the budget, due to several factors, including costs associated with the Library's relocation back into the Library & Courts Building which has been under extensive renovations.

GOVERNOR'S PROPOSAL:

The budget continues the January 2012 "trigger cuts" to local assistance library programs through 2012-13. In addition, the budget reduces General Fund support for the Library's operating budget by $1.1 million to reflect the reduced workload due to the elimination of the four local assistance programs.

ISSUES TO CONSIDER:

Library Faces Reductions in Future Federal Grants. The January 2012 "trigger" reductions prevent the Library from fully meeting the federal MOE requirements. The Library's December 2012 report will show a 22 percent drop in meeting the MOE, which means that the Library's allotment for 2012-2014 will be reduced by 21 percent, resulting in additional programmatic reductions in state fiscal year 2013-14. If these local assistance library programs continue to go unfunded in the 2012-13 budget (as currently proposed), the Library anticipates that its December 2013 report to the federal government will show a 85.4 percent drop in meeting the MOE; this will translate to an 85.4 percent reduction in the allotment for 2013-2015, resulting in the need for significantly more programmatic reductions in state fiscal year 2014-15.

What Programs are at Risk by Loss of Federal Funds? A reduction of 85.4 percent would translate to total federal funds of approximately $2.3 million, which is insufficient funding to support even the Braille and Talking Book program and the Southern Braille Institute, which use about $2.6 million of the federal funds each year to operate. More than 42,000 people statewide would lose service and access to information and resources that they can get nowhere else. The Library would also not be able to fund other important information services and projects as about 30 percent of its staff participate in federal projects and are funded through federal funds. Examples of other programs potentially impacted include: California Government Information Access/California Portal; Library Materials and Database Acquisition; Historic California Photograph Digitization; and Library Development.

A Waiver of the Federal MOE Requirements is Possible. States can apply to the federal government for a waiver of the MOE requirements. The guidelines state that a waiver would be equitable due to "exceptional or uncontrollable circumstances such as a natural disaster or a precipitous and unforeseen decline in the financial resources of the state." The waiver application also requires documentation of whether or not the reductions to the state library are proportionate to all other state agencies. In 2011, 12 state libraries could not meet their MOE and 10 of those states applied for waivers. In 2012, the Library anticipates that at least 27 state libraries will not be able to meet the MOE requirements. The Library indicates that they plan to submit a waiver.

How Much Funding is Needed to Meet the Federal MOE Requirements? The Library indicates that approximately $17.1 million in funding is needed in 2012-13 in order to fully meet the federal MOE requirements and maintain the historical level of LSTA funding.

Local Library Reliance on State Funds. The Library reports that 110 public libraries reported a decrease in funding in 2010-11, representing 60 percent of the public libraries in California. Some local libraries are far more reliant on state funds than others. There are 182 local library jurisdictions that receive some state funds, of which 17 get more than 10 percent of their total funding from the state (and another 46 get more than five percent of their total funding from the state). Those local libraries that receive a greater share of their funding from the state rely on state support heavily and may be forced to close or take drastic measures (such as charging patrons for book loans) if they lose state funding.

Higher Education

BACKGROUND:

California's public higher education system involves three "segments": the University of California, the California State University, and the California Community Colleges (CCC). It also includes the Hastings College of the Law. The state's Master Plan for Higher Education, originally adopted in 1960, ascribes distinct missions to each of the segments and expresses a set of general policies for higher education in the state, including the state's intent that higher education remain accessible, affordable, high-quality, and accountable.

University of California (UC)

Drawing from the top 12.5 percent of the state's high school graduates, the UC educates approximately 237,800 undergraduate and graduate students at its ten campuses and is the primary institution authorized to independently award doctoral degrees and professional degrees in law, medicine, business, dentistry, veterinary medicine, and other programs. UC manages one U.S. Department of Energy national laboratory, partners with private industry to manage two others, and operates five medical centers that support the clinical teaching programs of the UC's medical and health sciences schools and handle more than 3.8 million patient visits each year.

California State University (CSU)

Drawing students from the top one-third of the state's high school graduates, as well as transfer students who have successfully completed specified college work, the CSU provides undergraduate and graduate instruction through master's degrees and independently awards doctoral degrees in education, nursing practice, and physical therapy, or jointly with UC or private institutions in other fields of study. With 23 campuses and approximately 412,000 students, the CSU is the largest and most diverse university system in the country. It also is one of the most affordable. The CSU plays a critical role in preparing the workforce of California.

California Community Colleges (CCC)

The CCC are publicly supported local educational agencies that provide educational, vocational, and transfer programs to approximately 2.6 million students. The CCC system is the largest system of higher education in the world, with 72 districts, 112 campuses, and 71 educational centers. In addition to providing education, training, and services, the CCC contributes to continuous workforce improvement. The CCC also provides remedial instruction for adults across the state through basic skills courses and adult non-credit instruction.

Hastings College of the Law (Hastings)

Hastings was founded in 1878 and on March 26, 1878, the Legislature provided for affiliation with the UC. Hastings is the oldest law school and one of the largest public law schools in the

West. Its mission is to provide an academic program of the highest quality, based upon scholarship, teaching, and research, to a diverse student body of approximately 1,150 students.

Higher Education Funding

From 2008-09 through 2011-12, the state reduced funding for UC, CSU, CCC, and Hastings by $2.65 billion General Fund (as illustrated in Figure 1 below). The most notable consequences of these reductions have been significant student tuition fee increases (as illustrated in Figure 2 on the next page) and declining course offerings, which have made it difficult for students to complete their certifications and degrees in a timely manner.

Figure 1 – Higher Education Core Funding (dollars in millions)

		2007-08 Actual	2008-09 Actual	2009-10 Actual	2010-11 Actual	2011-12 Revised	2012-13 Proposed
UC	GF[1]	$3,257.4	$2,418.3	$2,591.2	$2,910.7	$2,273.6	$2,570.8
	Net Tuition[2]	1,365.3	1,437.4	1,751.4	1,793.1	2,403.7	2,444.1
	ARRA		716.5		106.6		
	Lottery	25.5	24.9	26.1	27.0	32.9	32.9
	subtotal[1]	**4,648.2**	**4,597.1**	**4,368.6**	**4,837.3**	**4,710.2**	**5,047.8**
CSU	GF[1]	2,970.6	2,155.3	2,345.7	2,577.6	2,002.7	2,200.4
	Net Tuition[2]	1,045.8	1,239.3	1,351.7	1,362.4	1,626.0	1,626.0
	ARRA		716.5		106.6		
	Lottery	58.1	42.1	42.4	42.4	47.8	47.8
	subtotal[1]	**4,074.5**	**4,153.2**	**3,739.9**	**4,089.1**	**3,676.5**	**3,874.3**
CCC	GF	4,272.2	3,975.7	3,735.3	3,994.0	3,276.7	3,740.2
	Fees	281.4	302.7	353.6	316.9	353.9	359.2
	LPT	1,970.8	2,028.8	1,992.6	1,959.3	2,107.3	2,101.1
	ARRA			35.0	4.0	0.0	
	Lottery	168.7	148.7	163.0	172.8	178.6	178.6
	subtotal	**6,693.1**	**6,455.9**	**6,279.6**	**6,447.0**	**5,916.4**	**6,379.0**
Hastings	GF[1]	10.6	10.1	8.3	8.4	6.9	8.8
	Net Tuition[2]	21.6	26.6	30.7	36.8	36.5	34.8
	Lottery	0.1	0.1	0.1	0.2	0.2	0.2
	subtotal[1]	**32.3**	**36.8**	**39.1**	**45.3**	**43.6**	**43.8**
GRAND TOTALS		**$15,448.0**	**$15,243.1**	**$14,427.2**	**$15,418.7**	**$14,346.8**	**$15,344.9**
	GF	10,510.8	8,559.4	8,680.5	9,490.7	7,559.9	8,520.2
	Fees/Tuition	2,714.1	3,006.1	3,487.3	3,509.2	4,420.1	4,464.1
	ARRA	0.0	1,433.0	35.0	217.2	0.0	0.0
	LPT	1,970.8	2,028.8	1,992.6	1,959.3	2,107.3	2,101.1
	Lottery	252.4	215.8	231.7	242.4	259.5	259.5

[1]2012-13 amount includes GO bond debt service.

[2]Includes systemwide and nonresident tuition and fee revenues less amounts redirected to institutional financial aid programs.

Figure 2 – Higher Education Annual Tuition Fees

Full-Time Resident Students							Change from 2007-08	
	2007-08	2008-09	2009-10	2010-11	2011-12	2012-13*	Amount	Percent
University of California								
Undergraduate	$ 6,636	$ 7,126	8,373**	$ 10,302	$ 12,192	$ 12,192	$ 5,556	84%
Graduate	7,440	7,986	8,847	10,302	12,192	12,192	$ 4,752	64%
California State University								
Undergraduate	2,772	3,048	4,026	4,440**	5,472	5,472	$ 2,700	97%
Teacher credential	3,216	3,540	4,674	5,154**	6,348	6,348	$ 3,132	97%
Graduate	3,414	3,756	4,962	5,472**	6,738	6,738	$ 3,324	97%
Doctoral	7,380	7,926	8,676	9,546	10,500	10,500	$ 3,120	42%
California Community Colleges	600	600	780	780	1,080	1,380	$ 780	130%
Hastings College of the Law	21,303	26,003	29,383	36,000	37,747	43,486	$ 22,183	104%

*Proposed
**Amount reflects full effect of mid-year increase.

GOVERNOR'S PROPOSAL:

The Administration presents a long-term plan for higher education rooted in the belief that higher education should be affordable and student success can be improved. The Administration proposes stable and increasing state funding to higher education and provides fiscal incentives to improve management of all expenditures. The significant components of the long-term plan include the following:

1. *Affordability*. The plan will curtail tuition fee increases and will lessen the pressure for students to take out loans.
2. *Student Success*. The plan will make annual General Fund augmentations contingent upon each institution achieving the Administration's priorities, including improvements in specific accountability metrics, such as graduation rates, time to completion, transfer students enrolled, faculty teaching workload, and, for community colleges, successful credit and basic skills course completion.
3. *Stable Funding Source*. The state will increase its General Fund contribution to each institution's prior year base by a minimum of four percent per year, from 2013-14 through 2015-16, contingent upon the passage of the Governor's tax initiative in November 2012.
4. *Fiscal Incentives*. The state currently budgets separately for, and adjusts annually, retirement program contributions and general obligation and lease revenue bond debt service for higher education capital improvement projects. The budget proposes to move these appropriations into each segment's base budget (except retirement program and general obligation bond debt service for the CCC) in 2012-13. The budget further states that no augmentations for these purposes will be provided in 2013-14, and beyond, to encourage the segments to factor these costs into their overall fiscal outlook and decision-making process.

Consistent with the above principles – to move all segment-specific costs onto the segments' base budgets and to provide the maximum flexibility to the segments – the budget includes the following segment-specific adjustments and proposals:

University of California

- $90 million increase for base operating costs, which the Administration indicates can be used to address costs related to retirement program contributions.
- $5.2 million increase for retired annuitant benefits.
- $206.6 million increase to move capital outlay debt service costs into UC's base budget.
- Eliminates budget bill language earmarking funds for specific programs and purposes, such as the Charles R. Drew Medical Program, AIDS research, and the California State Summer School in Mathematics and Science (COSMOS).
- "Trigger" reduction of $200 million, effective January 1, 2013, if the Governor's tax initiative is rejected by the voters.

California State University

- Decreases CSU's employer contribution to CalPERS by $38.5 million due to lower employer contribution rates. CSU's base budget includes a total of $404 million for the required CalPERS employer contribution.
- $1.1 million increase for retired annuitant benefits.
- $195.3 million increase to move capital outlay debt service costs into CSU's base budget.
- Eliminates budget bill language earmarking funds for specific programs and purposes, such as the Science and Math Teacher Initiative and nursing enrollments.
- "Trigger" reduction of $200 million, effective January 1, 2013, if the Governor's tax initiative is rejected by the voters.

California Community Colleges

- Reduces 2011-12 apportionment funding by $146.9 million to reflect an identical increase in offsetting property taxes available to community college districts resulting from the recent Supreme Court decision on redevelopment agencies.
- $218.3 million increase to partially pay off apportionment funding that had been previously deferred, contingent upon passage of the Governor's tax initiative. This action would reduce the total of the inter-year deferral from $961 million to $743 million.
- $109.4 million increase to backfill a fee revenue shortfall.
- Consolidates nearly all categorical programs (total of $411.6 million) and provides flexibility to community college districts to use the "flexed" categorical funds for any general operating cost.
- Eliminates 13 mandates deemed unnecessary, suspends five others, and maintains four mandates related to enrollment fees and financial aid. With regard to the five suspended mandates, funds a $22 million "block grant incentive program" to incent continued compliance with the previously mandated activities. For the four retained mandates, *continues* to offset any costs incurred by districts through the categorical funding allocation. Note, K-14 mandate reform is discussed in greater detail in the K-12 Mandates section of this report.
- Specifies that CCC funding in 2012-13 will be allocated to districts on the same proportionate share that districts received in 2011-12; states that the CCC Chancellor's Office may deviate from this methodology if it develops an alternative methodology that is approved by the Board of Governors and Department of Finance.

- Should the Governor's tax initiative be rejected by the voters, the CCC budget would be reduced as part of an overall $4.8 billion K-14 Proposition 98 reduction, as follows: (1) $218.3 million in apportionment funding would again be deferred (returning the total inter-year deferral to $961 million) and (2) $292 million programmatic reduction ($262 million of which is related to moving K-14 general obligation debt service into Proposition 98, which is discussed further in the K-12 section of this report).

Hastings College of the Law

- $1.8 million increase to move capital outlay debt service costs into Hastings' base budget.

ISSUES TO CONSIDER:

Overall Theme to Higher Education Budget. At a 1,000 foot level, the Administration is proposing to reform the higher education funding model across the segments. First, the Administration proposes to "reset" the higher education budgets with most costs included and, via a "block grant" approach, provide the funding with significant new flexibility in 2012-13. Then, beginning in 2013-14 and contingent upon passage of the Governor's tax initiative, the Administration proposes a "long-term funding agreement" through 2015-16 that increases each segment's base by a minimum of four percent per year if the segment achieves the Administration's priorities. While the operational specifics vary by segment, and many aspects of the Administration's proposal remain undefined (such as the accountability metrics) or under-defined (such as the mechanics of the "reformed" CCC budget), the overall approach presents a number of broad questions for the Legislature to consider as outlined below.

This is the New "Normal." In many respects, the budget acknowledges the reality of what has happened to not only the state, but the segmental, budgets in recent years. Akin to the state's overall resources dramatically decreasing in recent years, so have the General Fund resources available to higher education. Whether we want to acknowledge it or not, the budget is the new normal. There is no likely current scenario whereby $2 billion plus General Fund is going to materialize to restore the segments' budgets. Rather, after years of significant state funding reductions, the Governor is resetting the segments' budgets to their current workload and, by providing increased autonomy and flexibility, directing the segments to do the best they can to manage their budgetary demands from within those resources. This raises a key question: If this is the funding level that the state can afford for higher education, what does the Legislature expect the segments to achieve? This is also a question that the segments and their governing boards should be considering as they review the budget.

Budgetary Impacts in 2012-13 Versus Future Years. Broken down, the budget contains the following parts: (1) basically flat year-to-year funding for higher education in 2012-13; (2) removal of budgetary strings including earmarks and enrollment targets for UC and CSU, and categorical and mandate reform and a new allocation methodology for the community colleges, in 2012-13; and (3) increased funding in 2013-14 through 2015-16, contingent upon voter approval of the Governor's tax initiative and segment performance on yet-to-be defined accountability metrics. The budget presents these three items as one set of actions, but that is not the operational reality. While the first and second items occur with the adoption of the budget, the third is a complete unknown, not only from the standpoint of election outcomes but also to the specifics of the Administration's performance metrics. Further, one Legislature cannot ties the hands of another; at best, any budget decision made this year about 2013-14 or beyond is a statement of legislative intent. This raises two key questions: (1) Does the Legislature want to move toward granting more flexibility/autonomy to the segments (perhaps accompanied by increased accountability measures)? (2) Does the Legislature want to commit to out-year budget increases?

The State Lacks a Higher Education Oversight Structure. In 2011, the Governor vetoed funding for the California Postsecondary Education Commission (CPEC), citing the agency's ineffectiveness in higher education oversight. In light of this action, the future of higher education oversight remains unclear. While the public segments have stepped in to assume some roles previously performed by CPEC, there are concerns about how institutional and public interests will be balanced. In its January 6, 2012, report entitled, "*Improving Higher Education Oversight*," the LAO focused on the need for oversight that enables policymakers and others to monitor how efficiently and effectively the postsecondary system is serving the state's needs, and make changes to improve its performance. The specific recommendations of that report include that the Legislature: (1) define the state's postsecondary education needs, such as setting specific goals; (2) use performance results to inform policy decisions; and (3) establish an independent oversight body with limited and clear responsibilities.

Noting the difficulty of creating a new public organization in the current fiscal environment, the LAO offered a number of short-term measures to strengthen oversight in the interim: (1) amending statute to ensure pertinent data remain available to policymakers and researchers; (2) increasing direct legislative oversight and limiting new long-term funding commitments until an effective oversight structure is in place to support the legislature's decision-making; and (3) monitoring segments' allocation decisions, including investment in new programs and other major program changes, until mechanisms are in place for outcome review. The absence of a CPEC, as well as any defined set of mutually agreed upon goals for the state and its higher education system, raise another question about the budget: What is the Legislature's role here; e.g., what role should the Legislature play, if any, in determining the outcomes and the metrics used to measure performance of the segments?

The Segments Will Likely Budget as if the "Trigger" Cuts Will Happen. Should the voters reject the Governor's tax initiative, the "trigger" reductions for UC and CSU total $200 million each. For the CCC, $218.3 million in apportionment funding would again be deferred and there would be a $292 million programmatic reduction. All of these reductions would come at the end of the fall semester, making the reductions so disruptive that the segments likely would feel compelled to adopt budgets assuming the reductions will happen. This is largely the approach taken in 2011-12, as the budget contained trigger reductions based on revenue assumptions that did not subsequently materialize. In January 2012, UC and CSU were cut by $100 million each; the CCC by $102 million. The segments generally included these "worst case scenario" cuts in their budget planning so as to avoid dramatic mid-year cuts. However, taking the same approach in 2012-13 will be even more challenging for the segments. Since 2008-09, the state has reduced funding for UC, CSU, CCC, and Hastings by $2.65 billion General Fund. Therefore, after years of reduced state funding, it is appropriate to question what budgetary levers remain for the segments in planning for further reductions. This question is especially crucial in light of the budget proposal to cede autonomy to the segments, including allowing UC or CSU to set their own enrollment targets. In the absence of these types of controls or goals on the state level, a potential scenario is that enrollments could be severely curtailed, disproportionately impacting the transfer of community college students to UC and CSU which is a long-identified state priority.

A New Approach to Financing UC and CSU Capital Outlay. The budget adjusts UC and CSU budgets for capital outlay debt service costs and proposes no future adjustments. In the future, the state would presumably still issue bonds, but covering the debt service costs associated with those bonds would be a question for UC and CSU to consider in light of the available resources in their base budgets. Some of the details of this proposal remain unclear, including what, if any, budget trailer bill language the Administration will propose as well as applicability of the new approach to lease-revenue bonds versus general obligation bonds. It is also unclear if UC and CSU would be required to seek Administration and legislative approval for specific projects in future years.

Regardless of these unknowns, this approach is a departure from how UC and CSU capital outlay has been historically addressed. Under the current system, and in the last ten years, the LAO reports that the state spent an estimated $10.1 billion on higher education infrastructure; 80 percent of that support came from general obligation bonds and an additional 19 percent from lease-revenue bonds. Associated higher education debt-service costs more than doubled during this same time period, from about $516 million in 2000-01 to an estimated $1.1 billion in 2010-11. Most of the general obligation bond spending was from bonds approved by the voters in 1998, 2002, 2004, and 2006. In general, the state provides less funding for higher education projects when the balance of general obligation bonds is exhausted. In the case of UC and CSU, the state has typically offset some of this reduction by funding some projects with lease-revenue bonds. In contrast, the community colleges have not pursued lease-revenue bonds in recent years because repayment counts toward their Proposition 98 funding allotment (and therefore comes at the expense of other CCC programs).

This new approach to capital outlay for UC and CSU raises several questions for the Legislature to consider, including: (1) Is the 2012-13 funding provided adequate to annually service the segments' existing bond debt in the coming years? (2) Is the proposed total base funding (which could grow by four percent annually) reasonable to cover the UC and CSU various operational and bond-related costs? (3) Are the universities in the best position to determine how much of their base budgets to devote to capital and non-capital costs? (4) To what extent, and in what ways, will the Legislature have a say in the segments' commitment of General Fund support toward capital projects?

UC and the University of California Retirement System (UCRP). From 1990 to 2010, UC and its employees enjoyed a two-decade pension funding holiday due to: (1) substantial overfunding of UCRP during the 1980s by the state and UC (and its employees) and (2) very strong investment returns for UCRP during the 1980s and 1990s. The state also benefited from the holiday, since it had contributed to UCRP in prior decades and used the elimination of contributions as a budget solution during the fiscal crisis of the early 1990s. During the contribution holiday, UC continued to add employees and provide additional service credit to existing employees – making it impossible for the holiday to continue forever. The investment market downturn of 2008 caused the already dwindling surplus to fade away and UCRP now has an unfunded liability. In the past several years, UC has reinstituted employee and employer contributions and repeatedly sought additional state funding so it can cover normal costs and retire unfunded liabilities over the next several decades. To date, and despite UC's requests, the Legislature has chosen not to provide additional funding to UC for this purpose. UC projects that total state costs would peak at around $400 million plus.

The LAO has highlighted that these pension costs are real obligations that need to be paid, and it is reasonable for the state to cover the retirement costs of UC's state-funded employees, just as it does for other agencies. One over-arching challenge is that it is not clear what the "state share" should be given that UC also has non-state funded employees (such as through federal funds or patient revenues at the academic medical centers). There are also questions about what legal obligations the Legislature could incur by restarting contributions. Therefore, the LAO has advised that the Legislature proceed with caution and not simply pay whatever bill UC presents, given that UC (rather than the state) controls its pension costs and sets benefits levels for its employees; i.e., the state may choose to re-start state contributions to UC under the right conditions.

As discussed in greater detail in the higher education section of this report, the budget includes a $90 million base budget augmentation which the Administration indicates "can be used to address costs related to retirement program contributions." That these funds are not directly tied to retirement program contributions is indicative of issues identified above by the LAO. In considering the Administration's approach, the Legislature may want to clarify how any such augmentation could be construed. For example, under one view, the $90 million is a budget backfill for internal shifts and/or reductions that have already been implemented in light of the fact that UC restarted employer contributions to UCRP several years ago. In the alternative, the $90 million could also be viewed as representing new state costs (in 2012-13).

CSU Retirement Costs. The budget proposes to adjust CSU's budget one last time for retirement costs, including its required employer contribution to CalPERS and for retired annuitant health benefits. These costs, and any future adjustments, would then be covered from within CSU's base budget; i.e., the state General Fund would no longer account for the annual adjustment, be it a cost increase or a cost decrease. Per the "funding agreement" and contingent on CSU's performance on specific metrics, CSU's base budget could grow but these retirement costs would be covered from within the base budget.

By bringing these costs onto CSU's base budget, the Administration intends for CSU to consider them in its budget and fiscal outlook; in essence, the Administration is trying to incent CSU to operate efficiently and effectively and balance all of its needs within its budget. From CSU's perspective, this approach adds costs that have been historically covered by the state budget and, further, is not completely within the employer's control. For instance, the CalPERS Board sets the employer contribution rate. But this is not unique to CSU as an employer; this also applies to the state as well as every other public employer who contracts with CalPERS. Employee pension contributions are negotiable; however, as the LAO has reported, there are strict legal protections that limit government's flexibility to impose increased employee contributions. Rather, for many current employees such contribution increases would be implemented only through negotiations, and in any event, would result in many employers providing comparable offsetting advantages, such as increasing pay or other compensation, to offset the financial effect of the higher pension contributions. This would tend to erode any savings from increased employee pension contributions.

Given that the state does not collectively bargain with CSU employees (note, the 2010 reforms described above pertaining to reduced pension benefits for new hires effective January 15, 2011, includes new CSU hires as of that date), the Administration has identified a valid issue with CSU and its management of its retirement costs – whether the state General Fund should continue to cover changes in CSU's retirement-related costs beyond the amount provided in the base budget. However, if the budget proposal is not the "right" approach, the Legislature may wish to consider other possible approaches and what changes might be needed to implement those other approaches.

Early Action Requested on CCC Local Property Taxes. The budget reduces 2011-12 apportionment funding by $147 million to offset for increased property tax revenues available to districts due to the elimination of redevelopment agencies. The Administration has requested early action on this adjustment – by March 2012 – to ensure the savings can be achieved. However, the reliability of the estimate is unclear. This is an important consideration for the CCC, as unlike K-12 education, the CCC do not receive an automatic General Fund backfill if local property tax revenue falls short of budget expectations. Therefore, should the $147 million in increased local property taxes not materialize, and absent a proactive action to backfill the CCC budget with General Fund, the CCC would face a current year funding shortfall on top of $102 million in "trigger" cuts they absorbed in January 2012.

Change in Allocation Methodology for CCC Districts. As noted earlier in this section, many aspects of the Administration's proposal remain undefined or under-defined. This is particularly true with the proposed changes to the CCC budget. This is, in part, a function of the budget process. Proposed budget trailer bill language is not due to the Legislature until February 1 of each year and implementation of many of the CCC proposals would require trailer bill language. Not having this detail available now creates challenges to gaining a full understanding of the CCC budget reforms. However, some details have been conveyed. For instance, the Administration indicates that the reforms to the categorical and mandate programs are proposed regardless of any election outcome this fall. In addition, the budget bill requires that 2012-13 district-level apportionment funding be allocated in the same proportion as districts received in 2011-12, regardless of any changes such as in enrollment at the district level, unless the CCC Chancellor's Office develops an entirely new methodology for allocating district-level funding.

In directing this use of the 2011-12 methodology, the budget bill eliminates the historical model, which is dictated in statute and allocates funding on a full-time-equivalent student (FTES) basis. The yet-to-be-developed alternative methodology would be subject to the approval of the Department of Finance before it could be utilized. While it would theoretically be an option for the Chancellor's Office to conclude that retention of the current model is the best approach, is that outcome even possible given that the budget rejected that model. In addition, while the overall approach is consistent with the Administration's intent to provide maximum flexibility (similar to UC and CSU), and the CCC are a higher education system, the CCC have a K-12 governance structure with 72 local districts, each with its own elected board members. In addition, there are separate statutory requirements dictating expenditure levels on faculty salaries and the percentage of full-time versus part-time faculty. It is not readily clear how the UC and CSU model can apply to the CCC reality without major structural and statutory changes, some of which would take significant time to implement. Further, the budget does not provide a role for the Legislature in approving the alternative funding methodology should it be developed by the Chancellor's Office.

CCC Student Success Task Force (SSTF). Chapter 409, Statutes of 2010 (SB 1143; Liu), required the CCC Board of Governors (BOG) to establish a task force to examine best practices for promoting student completion and adopt a plan for improving student success rates within the CCC. After a year of fact finding, deliberation, and public engagement, the SSTF finalized its recommendations and submitted them to the BOG in January 2012. The recommendations were subsequently adopted by the BOG and, per Chapter 409, will be reported to the Legislature at a joint hearing of the Senate Education and Assembly Higher Education Committees on or before March 1, 2012. With these actions, the conversation will effectively move from "what" recommendations to "how" the recommendations are implemented, as the SSTF's work has resulted in a thorough set of recommendations that warrant legislative consideration.

There is, however, an interesting juxtaposition between the SSTF recommendations and the Governor's CCC budget reforms. While there is some overlap between the SSTF recommendations and the budget reforms (such as granting the Chancellor authority to allocate apportionment funding differently), other SSTF recommendations address issues not identified in the budget reforms (such as adopting new systemwide enrollment priorities and strengthening BOG waiver requirements), and some of the budget reforms go well beyond the SSTF recommendations (such as with regard to categorical reform). As noted above, the budget also eliminates the current funding model and provides increased autonomy and flexibility, but in so doing effectively removes many of the tools the Legislature would ostensibly use to address its concerns that prompted passage of Chapter 409. Given the extensive intersections between the SSTF recommendations and the Administration's budget reforms, careful legislative consideration is warranted of all proposals.