

**Meeting Date:** January 24, 2012

**Item Title:** Report on Governor's Budget Proposal for Fiscal Year 2012/2013

**Item Type:** Information

**BACKGROUND:** Governor Jerry Brown unveiled his State Budget Proposal on January 5, 2012. The Governor reported his Budget eliminates an estimated \$9.2 billion 2012-13 Budget deficit through a combination of program cuts and temporary revenues assumed from the enactment of a ballot measure in November 2012.

The outcome of the November election would yield the following results:

- In the event that the tax measure passes, the budget maintains "Flat-Funding" for K-12 education.
- In the event that the tax measure fails, the Budget contains another round of midyear trigger cuts, including \$4.8 billion in education reductions which will be the equivalent of taking three weeks of instruction out of the school year for K-12 schools.

As always, the Governor's proposed budget is but a starting point for negotiations with the Legislature, and modifications will take place as part of the annual Budget process.

Staff will present information from the January 17<sup>th</sup> School Services Governor's Budget Workshop held in Sacramento.

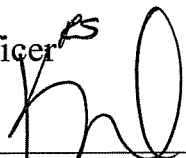
**FISCAL ANALYSIS:** None

**RECOMMENDATION:** This item is presented for information only.

**AUSD Guiding Principle:** #5-Accountability, transparency and trust are necessary at all levels of the organization. #6-Allocation of funds must support our vision, mission and guiding principles.

**Submitted by:** Robert Shemwell, Chief Business Officer

**Approved for Submission to Board of Education**

  
Kirsten Vital, Superintendent

# **Report on Governor's Budget Proposal for Fiscal Year 2012/13**

**January 24, 2012**

# Themes for 2012 Governor's Budget



- Education funding remains at risk for the fifth straight year
- Governor produces another “crisis” Budget
- Economics still drive all policy decisions
- Reasons for optimism
- Reasons for pessimism
- Risk is the “game changer”
- Bottom line – plan for the long term



# Another “Crisis” Budget

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- The Governor’s Budget Proposals for 2012-13 represent another desperate effort to get through a bad time, not a permanent solution
  - The Budget depends on passage of new temporary taxes midway through the year
  - The structural imbalance continues to dog the state’s recovery
- Specific proposals include:
  - 100% of home-to-school and special education transportation funding is cut under both alternatives
    - Disproportionate effect on districts is a huge problem

# Another “Crisis” Budget

A-5

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- Governor’s Budget: Assumes voters approve a \$6.9 billion tax measure
  - Funding the statutory increase in Proposition 98 by manipulating deferrals
  - This alternative provides no additional spending for education, but maintains revenue limits at about 2011-12 pre-trigger-cut levels
- Alternative: Assumes voters reject the tax measure
  - Education is cut \$2.4 billion, about \$370 per average daily attendance (ADA)
- The mechanics of the Budget are complex, but this outcome is the bottom line



# Contingent Trigger Cuts

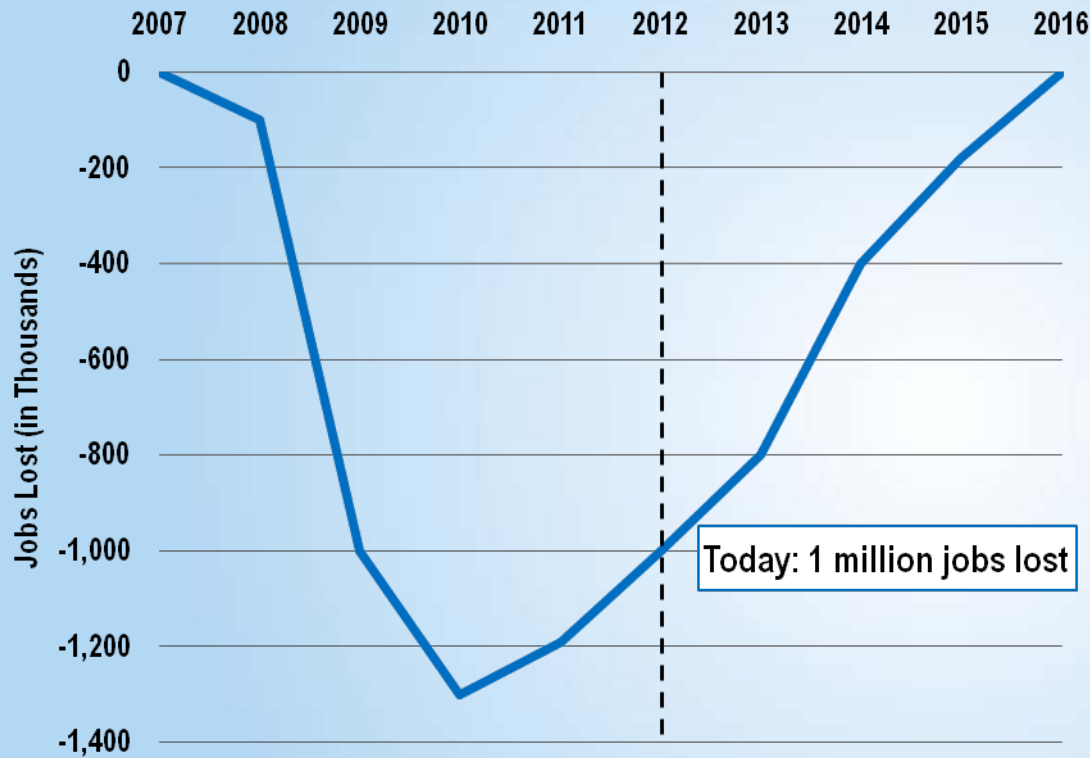


- Like the 2011-12 Budget Act, the Governor’s Budget Proposal for 2012-13 contains automatic trigger reductions
  - The trigger reductions total \$5.4 billion
  - The cuts are linked to the failure of the proposed temporary tax increases, not a general revenue shortfall
- The trigger reductions hit education the hardest, especially Proposition 98

Programs Targeted for Trigger Cuts		
Program	Amount	% Share
Proposition 98	\$4,837 million	89.7%
University of California	\$200 million	3.7%
California State University	\$200 million	3.7%
Courts	\$125 million	2.3%
All Other	\$28 million	0.6%
<b>Total</b>	<b>\$5,390 million</b>	<b>100.0%</b>

# California's Labor Market

### Jobs Lost During Recession Not Recovered Until 2016



- California lost 1.3 million payroll jobs in the recession
- About one-third of this job loss has been recovered
- It may take four and a half more years to reach California's prerecession employment peak

# Recovery Takes a Long Time



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- Recovery for education funding requires:
  - First, the threat of more current or future cuts must end
  - Then, the state must have the money to begin funding current-year cost-of-living adjustments (COLAs) and other program growth
  - Then, the state must fund at least some portion of the deficit factor, now at 21.666% in addition to funding the current-year COLA
  - Then, the state must deal with restoration of the deferrals
- During the recession of the early 1990s, the deficit was smaller and there were no deferrals, but recovery still took six years
  - So, the state has a lot of work to do and it will take time
- And at the point of full restoration, we would perhaps rise to 46<sup>th</sup> in the nation again!
  - Only after that would California be in a position to increase its level of effort to begin to match other states



# Recovery Takes a Long Time



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## The Economic Cycle



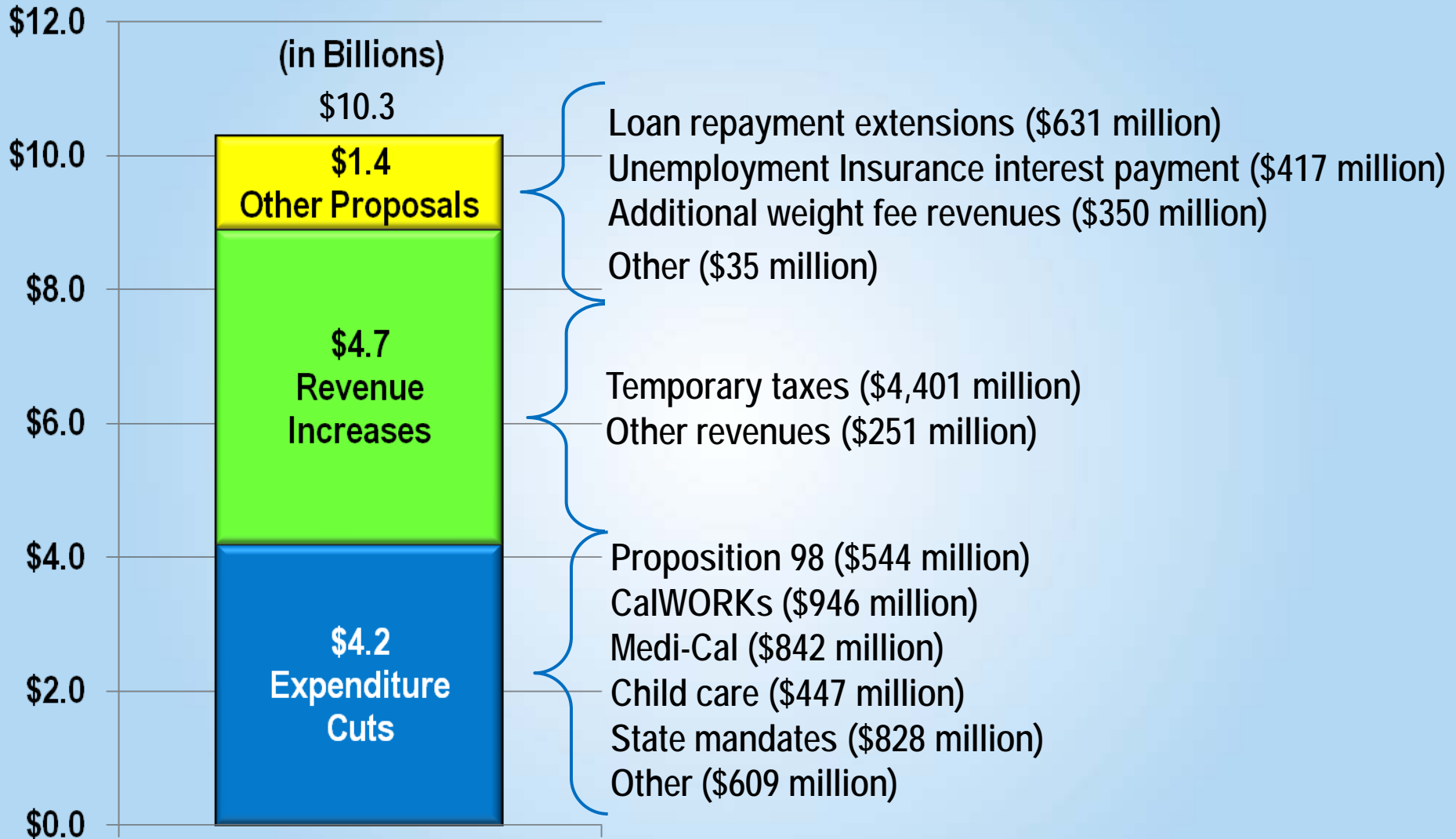
Stabilization

December  
2007

Spring  
2010

~~2015~~  
2016 ???

# Governor's Budget Solutions



# Prior-Year Budget Solutions and Challenges

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- Court challenges to budget solutions have increased costs for 2011-12
  - Redevelopment agency decision added \$700 million to the problem
  - Medi-Cal provider rate reductions were stayed because of the potential adverse impact on the availability of services to eligible recipients
  - Proposition 98 reduction due to shift of state General Fund tax revenues to a local revenue fund is pending court action – potential cost of \$2 billion to the state – and a potential gain to Proposition 98
- Federal intervention in state-funded programs, such as corrections, means that some budget reductions require the approval of the federal courts or government before they can be implemented

# Budget Contingency Plan

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- The Governor's Budget assumes that new temporary taxes are approved by the voters for five years at the November 2012 ballot
- The Budget also proposes severe additional reductions in funding for schools in the event that the tax initiative is not approved
- This leaves schools in a position of needing at least two plans
  - Governor Brown's Proposal: Flat funding – continues the funding level contained in the enacted Budget for 2011-12, except for transportation
  - Alternative: A \$2.4 billion reduction in K-14 funding – results in a loss of about \$370 per ADA for the average district
- Districts will need to plan for both eventualities until the fate of the tax initiative is determined
- Additionally, economic changes between now and enactment of the 2012-13 Budget could cause a revision, up or down

# What Does it Mean to be Protected?

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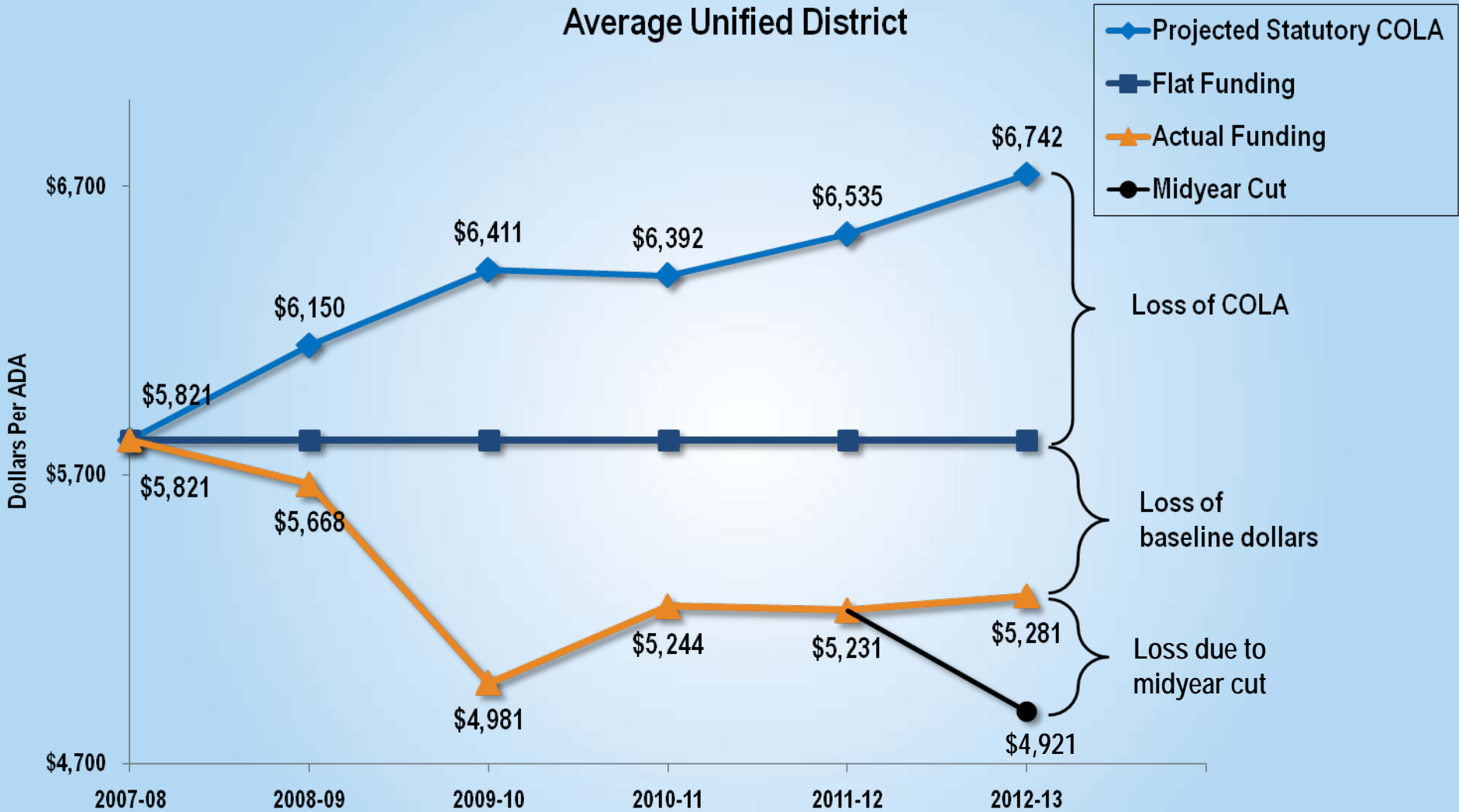


- Governor Brown again features “protecting education” as a theme
  - He acknowledges that education had taken the brunt of past cuts, and Proposition 98 funding has fallen by 16% since 2007-08
- Similar to last year, protection in 2012-13 means:
  - Holding general purpose funding for schools flat
    - But only if new temporary tax increases are passed in November
  - Home-to-school and special education transportation funding is totally eliminated whether the initiative passes or not
- It means that we will have to fight for approval of a tax initiative just to minimize the cuts
- We think, in light of past cuts and a straightforward reading of the requirements of Proposition 98, education should be protected whether the taxes pass or not

# Funding Per ADA – Actual vs. Statutory Level



## Average Unified District



# Per-ADA Revenue Volatility



- As in the recent past, we continue to have very high volatility in revenues directed toward education
- 2012-13 continues the roller-coaster ride because of yet another contingency
- Under the Governor's Budget for 2012-13, revenue levels are maintained at the 2011-12 Proposition 98 pre-trigger level except for home-to-school and special education transportation
- Revenues would be an estimated \$370 per ADA lower than 2011-12 if the tax measure does not pass
- California needs to provide a more stable revenue stream for schools





# K-12 Education Took Big Cuts



	Proposed Cuts		Enacted Cuts	
	Revenue Limit	Categorical	Revenue Limit	Categorical
2008-09	-2.40%	-6.50%	-2.63%	-15.38%
2009-10	-2.52%	-	-7.64% + \$252.83 per ADA	-4.46%
2010-11	-0.38%	-0.38%	+5.17%*	-
2011-12	-.369% + \$330 per ADA	-	-0.25%	-\$248 million in Transportation
2012-13	-\$2.1 billion (Equivalent of 15 instructional days)	-\$495 million Transportation elimination		

\*Net increase in 2010-11 revenue limit is because of the nature of the \$252.83 per-ADA reduction in 2009-10



# The Governor's Initiative – "The Schools and Local Public Safety Protection Act of 2012"

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- The centerpiece of Governor Brown's 2012-13 Budget is a \$6.9 billion tax increase
- "The chief purpose of this measure is to protect schools and local public safety by asking the wealthy to pay their fair share of taxes." (Excerpt from Section 3 of the Governor's Initiative)
- Public safety protection – amends the Constitution to affirm the state/local realignment enacted in the 2011-12 State Budget
- Schools – establishes the "Education Protection Account" for revenues derived from temporary, five-year tax increases:
  - Half-cent sales tax increase; effective January 1, 2013, until January 1, 2017
  - Increase income tax rates on annual earnings more than \$250,000; effective for the 2012 tax year through the 2016 tax year

# The Governor's Initiative – "The Schools and Local Public Safety Protection Act of 2012"

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- All-new revenue is deposited in the Education Protection Account (EPA), available for K-12 schools (89%) and community colleges (11%)
- Like local property tax revenues, EPA funds can be used for any educational purpose and count toward the Proposition 98 minimum guarantee
- Reduces state General Fund contributions toward Proposition 98 dollar for dollar
- Distributed the same as existing general purpose per-pupil funding
- EPA allocations may not be used for salary or benefits of administrators or any other administrative costs
- Local educational agencies (LEAs) must annually post on their websites an accounting of funding received and how it was spent

# Why is Education Flat Funded?

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- How does a nearly \$5 billion increase in Proposition 98 provide no real growth in funding for schools? The answer is deferrals.
  - \$2.4 billion is used to maintain current-year spending levels – the cost of maintaining existing programs after the 2011-12 deferral
  - \$2.5 billion buys down K-14 interyear deferrals by moving the state expenditures back into the current year
- Buying down deferrals increases cash available in the budget year, and can reduce borrowing costs, but does not increase spending authority

# What Happens if Taxes Aren't Approved?

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- If the tax initiative fails, Governor Brown proposes to cut K-14 education by \$4.8 billion
  - Proposition 98 drops by \$2.4 billion because of the loss of new tax revenues
  - The interyear deferral buyout is rescinded, and existing deferrals are maintained, saving \$2.4 billion
- State payments for debt service on school bonds are re-categorized as Proposition 98 expenditures
  - Historically, debt service has been funded outside of Proposition 98
  - By moving debt service into Proposition 98, K-14 costs are increased by \$2.4 billion
  - Requires corresponding cuts to other K-14 spending of an equal amount – divided between K-12 (89%) and community colleges (11%)
  - Governor Brown equates this reduction to eliminating three weeks of instruction from the school year

# Revenue Limits and Funding Flexibility

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- Governor Brown has concluded that California's current school finance system is "too complex, administratively costly and inequitable"
  - Complexity – There are too many categorical programs with separate funding streams, allocation formulas, and spending restrictions
  - Administrative burden – These programs require staff in school districts to administer the programs and staff at CDE to ensure compliance
  - Lack of equity – Many program allocations have been frozen at the 2008-09 funding level and do not reflect demographic changes
- Revenue limits provide school districts with their largest source of unrestricted income, accounting for about two-thirds of their funds
- The Tier III categorical block grant also provides districts with a source of unrestricted income, but this funding provision is temporary
- The Governor's Budget calls for a major change: Weighted Pupil Funding

# Weighted Student Funding Formula

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- To promote greater local decision-making authority, Governor Brown proposes a weighted student funding formula to replace revenue limits and most categorical program funding formulas
  - All of the categorical programs included in the formula “will immediately be made completely flexible” to support any local education priorities
- Elements of the formula
  - Special education, child nutrition, Quality Education Investment Act (QEIA), After School Education and Safety (ASES), and other federally mandated programs are exempt
  - Additional funding is based on the demographics of the schools, including:
    - English Learner population
    - Pupils eligible for free and reduced-price lunches
- Accountability: Qualitative and test-based measures
- Timeline: Phased in over five years



# Local Budget Impact of Weighted Student Funding Formula



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- The Department of Finance (DOF) indicates that for 2012-13, 80% of a district's funding will be based on current law formulas and 20% will be based on the weighted student formula
  - Governor Brown is not proposing a "hold-harmless" provision; therefore, some districts will gain and some will lose under the new formulas
    - In general, districts with high concentrations of English Learners and low income students will gain funding and those with few of these students will lose funding
- There are currently no details that would allow a school district to determine its funding gain or loss for 2012-13, or for any year thereafter
- The Legislature must enact this measure as a change to current school finance statutes
- We will provide more information as the details of this proposal are released

# Caution – Deficit Factor Provides Funding Increase

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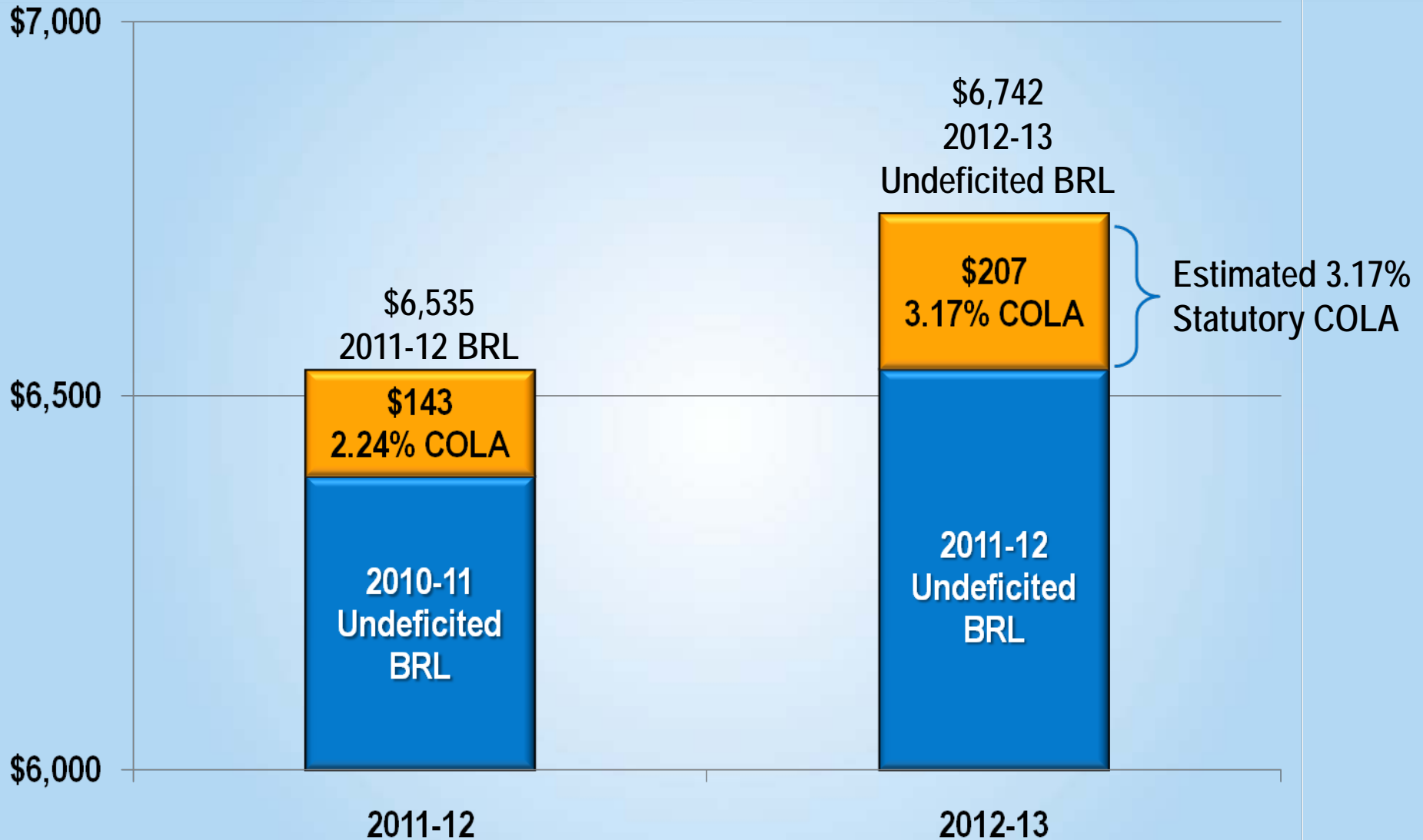


- The Governor's Budget acknowledges that the projected statutory COLA is 3.17% and that this funding is to be eliminated through the deficit factor
  - The DOF has provided a K-12 deficit factor of 21.666% to eliminate this COLA
  - Our analysis finds that this deficit factor does not fully eliminate the COLA and instead provides a \$37 per-ADA increase for the average unified school district
- The proposed Budget also reflects the \$13 per-ADA "trigger" reduction in 2011-12 and restores this amount in 2012-13
- Therefore, the net increase under the Governor's Budget from 2011-12 to 2012-13 is \$50 per ADA, or just under 1%

*However*, we recommend that districts budget flat funding in 2012-13 (i.e., the amount prior to the \$13 per-ADA "trigger" reduction), consistent with the policy stated in the Governor's Budget



# Undeficited Base Revenue Limit – Unified School District Example



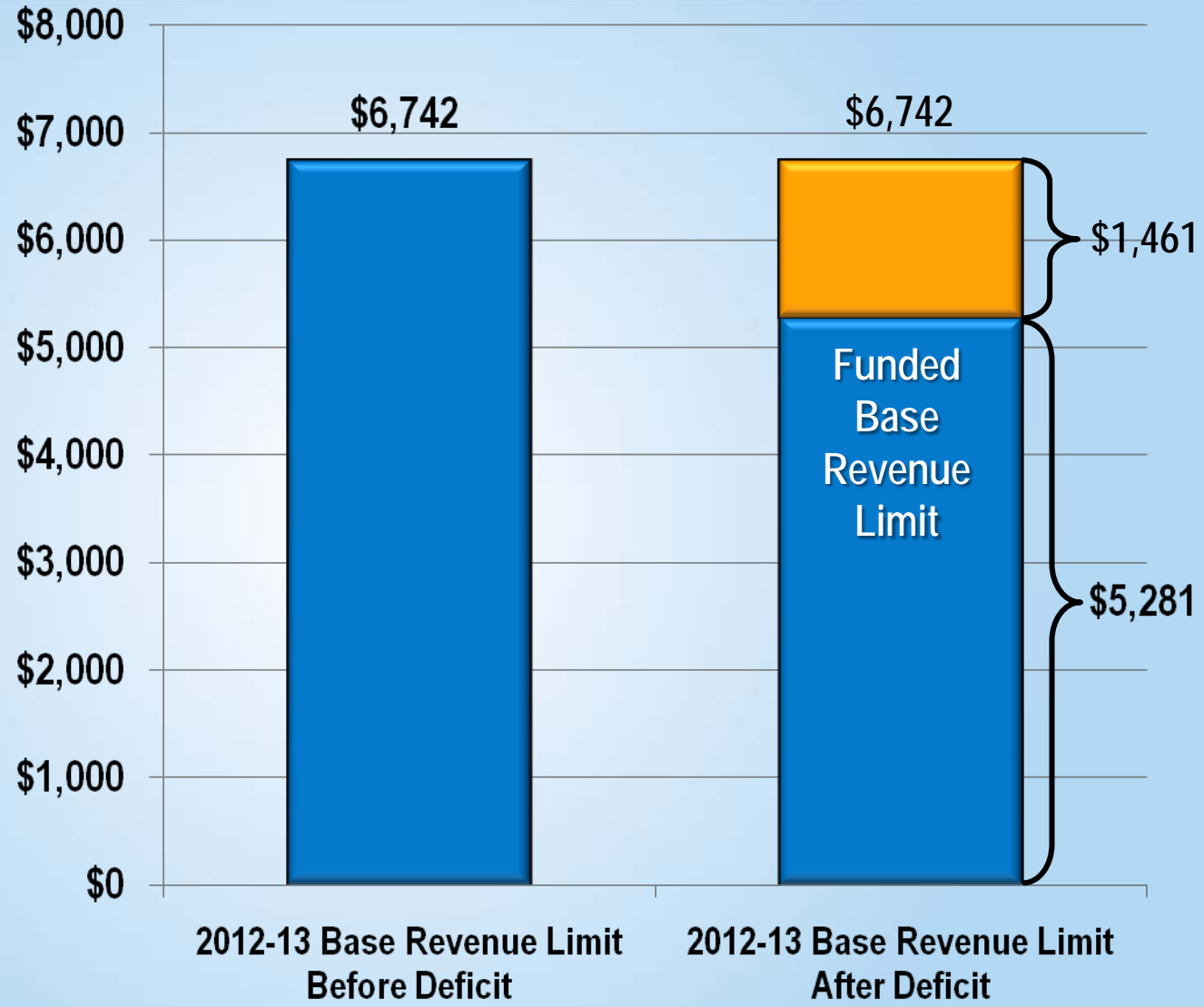
# Base Revenue Limit after Deficit Factor



Apply the 2012-13 deficit of 21.666% to the undeficit base revenue limit

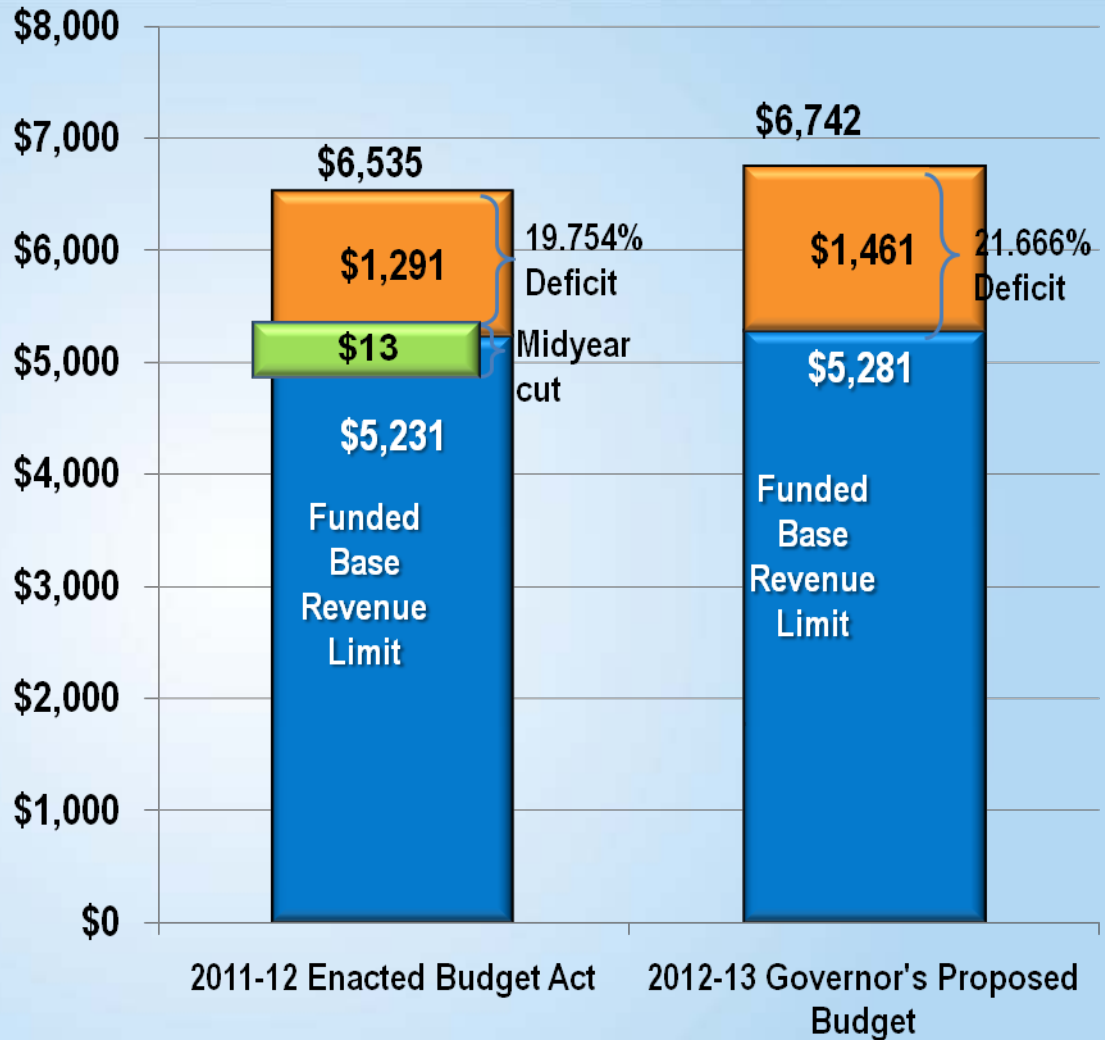
Example for Average Unified District

Funded revenue limit  
=  $\$6,742 \times (1 - 0.21666)$   
=  $\$6,742 \times 0.78334$   
=  $\$5,281$



# 2012-13 Governor's Budget vs. 2011-12 Budget Act for Average Unified School District

- The 2011-12 "trigger" cut of \$13 per ADA is restored in 2012-13
- The 2012-13 Governor's Budget provides for a slight increase in funding
- This funding level is contingent upon the enactment of new taxes



# Revenue Limit Funding if Taxes Fail

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- The Governor's Budget Proposal is based on the assumption that voters approve \$6.9 billion in new taxes
  - If these higher taxes are not enacted, the Governor's Budget proposes midyear cuts of \$2.4 billion for K-14 education, or about \$370 per ADA
  - The Budget acknowledges that the cut is equal to about three weeks of instruction
  - At this point, there are few details on how this reduction would be implemented

# Contingency Planning for a 2012-13 Midyear Cut

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- The Governor's Budget assumes that in November 2012 voters will approve a \$6.9 billion tax increase
- There is no assurance that the temporary taxes will be approved and the Governor proposes automatic trigger reductions if the tax proposal fails
  - The DOF estimates that the amount of the trigger reduction for K-12 education programs would be \$370 per ADA
- Districts should therefore prepare their budgets assuming a loss of \$370 per ADA
  - The starting point for this adjustment is the district's 2011-12 per ADA revenue limit, prior to the implementation of the \$13 per ADA on average midyear cut
  - For the average unified district, the starting point would be \$5,244 per ADA, and after the \$370 per ADA reduction, the funding level will be \$4,874 per ADA



- In their 2011-12 budgets, many school districts set aside funds in anticipation of midyear revenue limit cuts from the state
  - The amount set aside depended upon which State Budget document they used – if districts used:
    - The 2011-12 Governor’s Budget, they set aside \$349 per ADA
    - The 2011-12 May Revision, they budgeted for flat funding but set aside \$330 per ADA
    - The 2011-12 enacted State Budget, they set aside \$260 per ADA
- Ultimately, the 2011-12 midyear cut to revenue limits turned out to be \$13 per ADA so districts may have already established a significant portion of the amount needed to guard against a \$370 per-ADA midyear cut in 2012-13
- For districts that did not set aside funds in 2011-12, significant reductions will be required to remain in balance in 2012-13 if a new “trigger cut” is imposed

# Transitional Kindergarten Postponed for 2012-13

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- SB 1381 (Chapter 705/2010):
  - Changed the eligible birth dates enrolling in kindergarten and 1<sup>st</sup> grade
  - Established “Transitional Kindergarten”
- According to current law, Transitional Kindergarten is to start in 2012-13
  - Requirement and funding are proposed to be eliminated as a Budget solution
  - Future start date now unclear
  - Transitional Kindergarten is optional and will be a local decision
- Results in state cost avoidance of \$223.7 million
  - Funds will be used to support other unspecified existing education programs
  - Could increase special education preschool costs



# Temporary Flexibility – Current Law

- Past Budget Acts have included several coping strategies for districts including, but not limited to, categorical flexibility and school-year length
- The options remain available for 2011-12, but some flexibility may change or look different based on the Governor’s 2012-13 Budget Proposal

Expires	Education Code Section (E.C.)	Description of Flexibility
June 30, 2010	N/A	Use of certain restricted account balances as of June 30, 2008, for any educational purpose (ending balance “sweeps”)
June 30, 2013	33128.3	Minimum reserve requirement is one-third of statutory requirement in 2011-12, progress is shown in 2012-13, and full statutory requirement is restored in 2013-14
January 1, 2014	17463.7	Sale of surplus property to benefit General Fund (with significant requirements)
<i>June 30, 2014</i>	<i>52124.3</i>	<i>Reduced penalties for K-3 Class-Size Reduction (CSR) (for up to the number of classes applied for as of January 31, 2009)</i>

Note: Italicized print indicates this could change according to the Governor’s Budget Proposal



# Temporary Flexibility – Current Law



Expires	E.C.	Description of Flexibility
June 30, 2015	1240.3	Standards-aligned instructional materials sufficiency ( <u>Williams</u> compliance) – suspends required textbook adoptions
	<i>2550</i>	<i>Base year of 2007-08 for ADA-funded flexible programs (adult education, regional occupational programs, etc.)</i>
	17070.766	Routine restricted maintenance set aside reduced to zero (except as necessary for <u>Williams</u> compliance)
	17587	Deferred maintenance hardship funding suspended
	N/A	Suspension of deferred maintenance local match requirement
	<i>42605</i>	<i>Flexibility of Tier III categorical programs; funding level based on 2008-09 (with public hearing requirement)</i>
	<i>46201(2)</i>	<i>Reduction of school year by up to five days and/or equivalent in instructional minutes (effective starting 2009-10)</i>
	60200.7, 60422.1	Suspension of instructional materials adoption requirement

Note: Italicized print indicates this could change according to the Governor’s Budget Proposal

# K-3 Class-Size Reduction

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- The relaxed penalties for K-3 CSR are set to expire on June 30, 2014
- MYPs that are prepared as a part of the 2012-13 Budget submission are affected by the expiration of this flexibility
  - Projections for the 2014-15 fiscal year should not include existing flexibility
- A possible game changer:
  - K-3 CSR ceases to exist as a separate program and becomes a part of the Governor's Budget Proposal for a weighted student formula
    - Stay tuned . . .

# Transportation – Eliminated in 2012-13

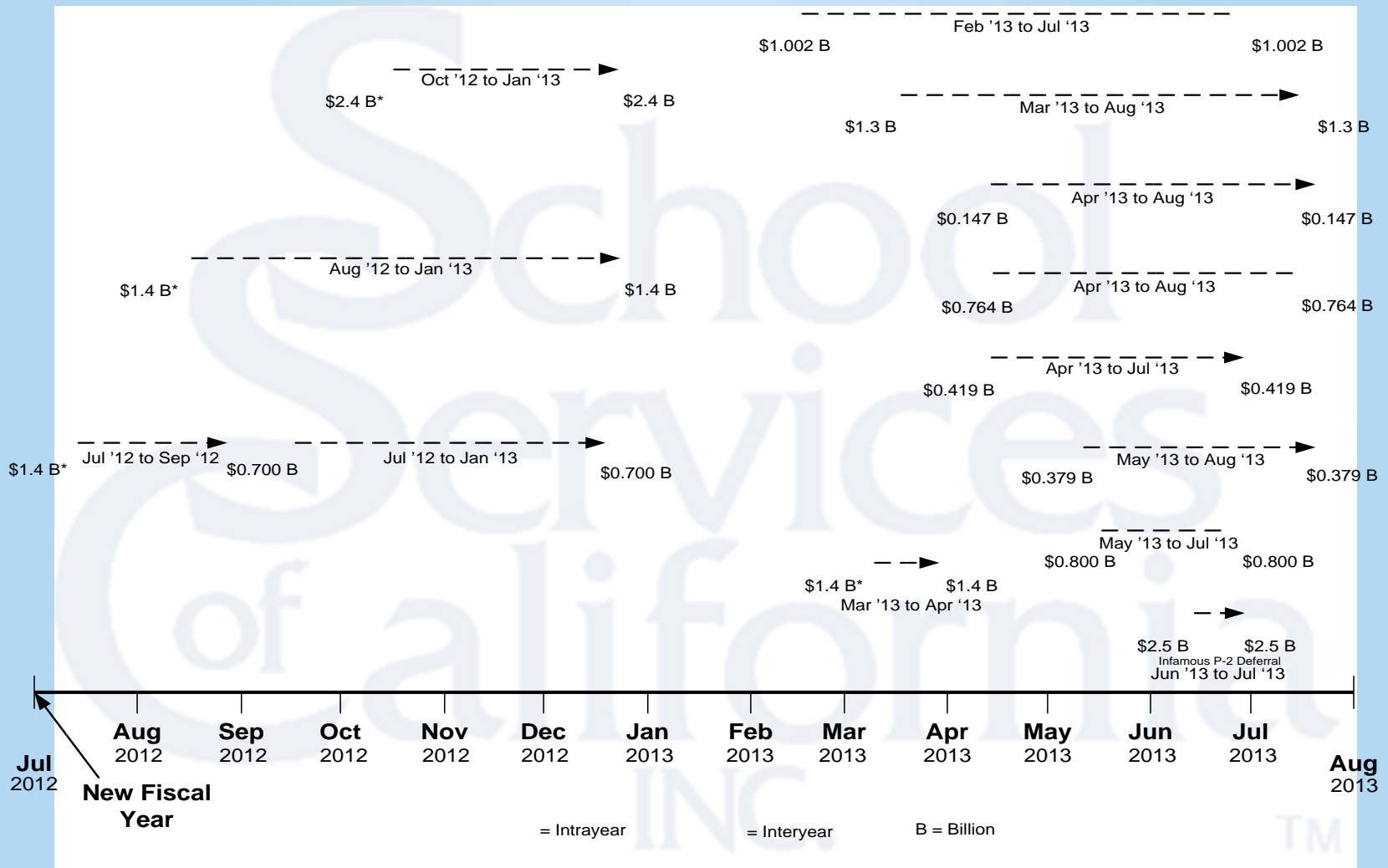
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- Districts that receive home-to-school and special education transportation must plan for the loss of all funding based on the Governor's January Budget Proposal
- Local educational agencies (LEAs) should plan for and consider the following:
  - Plan for zero dollars (\$0) in 2012-13 and thereafter
  - Review transportation routes to determine if services can be further streamlined
  - Analyze special education transportation policies and ensure individualized education program (IEP) teams are aware of the policies
    - Do not provide transportation if it is not necessary
  - Discuss consequences if transportation is not provided or if fees are assessed/increased
  - Budget for higher expenditures in the unrestricted General Fund

# 2012-13 Apportionment Deferrals



\*The amounts reflect Senate Bill 82 (Chapter 12/2011) statutory language

# Unrestricted Fund Balance – Statewide Averages

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2009-10 Unrestricted General Fund Balance as a Percent of the Total General Fund	
Unified School Districts	10.16%
Elementary School Districts	16.99%
High School Districts	15.27%

2009-10 Unrestricted General Fund Balance Plus Fund 17 Special Reserve as a Percent of the Total General Fund	
Unified School Districts	11.00%
Elementary School Districts	19.18%
High School Districts	17.58%