Detail on LAO Proposition 98 Analysis

Yesterday we provided the Legislative Analyst's Office (LAO) summary of their comments regarding the 2012-13 Governor's state budget proposal for education funding. The LAO clearly shows that even when adding in federal stimulus funds and counting deferrals as programmatic funding, the Governor's 2012-13 budget proposal has a 1.1% decrease in per pupil programmatic funding, continuing the slide that started in 2009-10. This decrease in per pupil programmatic funding assumes the November tax initiative is successful. If it is not successful the per pupil programmatic funding would drop by 6%.

K-12 Programmatic Funding

	2007–08 Final	2008–09 Final	2009–10 Final	2010–11 Final	2011–12 Revised	2012–13 Proposed	2012–13 With Trigger
Total Programmatic Funding (In Millions)							
K–12 ongoing funding	$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[a]	—	1,100	1,100	—	—	—	—
Federal ARRA funding[a]	—	1,192	3,575	1,192	—	—	—
Federal education jobs funding[a]	—	—	—	421	781	—	—
Totals	**$48,982**	**$50,130**	**$47,070**	**$46,616**	**$45,099**	**$44,604**	**$42,390**
Per–Pupil Programmatic Funding (In Dollars)							
K–12 attendance	5,947,758	5,957,111	5,933,761	5,953,259	5,947,368	5,950,041	5,950,041
Per–Pupil Funding	**$8,235**	**$8,415**	**$7,933**	**$7,830**	**$7,583**	**$7,496**	**$7,124**
Year–to–year percent change	—	2.20%	–5.7%	–1.3%	–3.2%	–1.1%	–6.0%
Percent change from 2007–08	—	2.2	–3.7	–4.9	–7.9	–9.0	–13.5

[a] Reflects LAO estimates of funds spent in each year.

ARRA = American Recovery and Reinvestment Act.

The LAO also raises questions about the rebenching of Proposition 98 and raises the possibility of litigation to the rebenching proposals. The LAO does not opine on whether the Governor's budget is or is not legal, but they do raise questions for the Legislature to consider regarding the rebenching proposals. These proposals include: 1) the changes to the gas tax; 2) the public safety realignment; 3) redevelopment agency property tax; and, 4) if the initiative fails, a potential shift of state school bond debt service into the Proposition 98 guarantee.

Governor's Multiyear Plan for Retiring Certain Existing Proposition 98 Obligations *(In Millions)*

	Proposed Payments Under Governor's Plan:				
	2012–13	2013–14	2014–15	2015–16	Total Payments Over Period
Payments to Be Made *Within* Annual Proposition 98 Appropriation:					
K–14 deferrals	$2,369	$2,469	$4,998	$594	$10,430
K–14 mandates	—	318	318	2,940	3,576
Totals	**$2,369**	**$2,787**	**$5,316**	**$3,534**	**$14,006**
Payments to Be Made *on Top of* Annual Proposition 98 Appropriation:					
Proposition 98 "settle–up"[a]	—	$857	$856	$856	$2,569
Quality Education Investment Act	$450	450	181	—	1,081
Emergency Repair Program[b]	12	150	150	150	462
Totals	**$462**	**$1,457**	**$1,187**	**$1,006**	**$4,112**

[a] Settle–up payments may be used to retire other obligations, such as mandates. If this approach is used, total General Fund payments would be reduced accordingly.

[b] Statute designates that these payments be made using Proposition 98 Reversion Account funds.

While generally supportive of the Governor's reform proposals for school finance and state mandate reimbursements, the LAO questions whether the proposals will meet the Legislature's goals for ensuring that funds are spent for the purposes for which they are appropriated.

The LAO also questions whether now is the time to use all new education funds for paying down the "Wall of Debt" rather than using some of the new funds as one-time money to provide school districts with flexibility. Essentially, the LAO is raising the issue of providing limited additional flexibility, but not ongoing program restoration which would restrict the Legislature's flexibility. This is part of the LAO suggestions that the Legislature be very careful in how they craft trigger cuts for schools if the tax initiative fails.

State Has Many Outstanding School and Community College Obligations

Obligation	Description	Authority	Funding
One–Time Obligations			
"Settle–Up"			
State generates a settle–up obligation when K–12 attendance or General Fund revenues increase after the budget is enacted—resulting in a higher minimum guarantee. State estimated to owe $2.6 billion ($1.6 billion for 2009–10, $352 million for 2010–11, and $661 million for 2011–12).		Constitutional	Non–P 98
K–14 Mandates			
State must reimburse school and community college districts for performing certain state–mandated activities. State deferred payments for seven consecutive years (2003–04 through 2009–10). It currently has an estimated backlog of $3.6 billion in unpaid mandate claims.		Constitutional	P 98
K–14 Deferrals			
The state has deferred certain K–14 payments from one fiscal year to the subsequent fiscal year, thereby achieving one–time state savings. The state instituted various new deferrals across the 2001–02 through 2011–12 period. Outstanding deferrals currently total $10.4 billion.		Statutory	P 98
Quality Education Investment Act			
Associated with a Proposition 98 suspension in 2004–05, the state agreed to provide an additional $2.7 billion to schools and community colleges. Annual payments of $450 million are to be provided until obligation has been retired. State has made $1,650 million in payments, with $1,081 million still owed.		Statutory	Non–P 98
Emergency Repair Program			
As part of the *Williams* settlement, state agreed to provide certain schools with $800 million for emergency facility repairs. State has made $338 million in payments, with $462 million still owed.		Statutory	P 98
Other Obligations			
Maintenance Factor			
Proposition 98 allows the state to provide less funding in certain situations (typically when General Fund revenue is growing sluggishly or declining), but it creates an associated obligation to increase funding in the future such that total funding is restored to the level it otherwise would have been absent the earlier reduction. The state currently is carrying a maintenance factor of $10.6 billion.		Constitutional	P 98
CalSTRS Pension Benefits			
For benefits already earned by current and past teachers and administrators, an unfunded liability of over $56 billion was reported as of June 30, 2010. In 2012–13, the state is projected to contribute $1.4 billion to the system, with districts and teachers contributing billions of dollars more. To address the unfunded liability over the next 30 years, additional contributions of about $4 billion per year (in current dollars) will be needed from some source. If a lower investment return rate is assumed, costs would be higher.		Constitutional	Non–P 98
CalPERS Pension Benefits			
For classified employee benefits, the existing unfunded liability is estimated to be $17 billion. Districts currently contribute about 11 percent of classified employee payroll ($1.2 billion in 2011–12) to these benefits, with employees also making contributions. Over the next several decades, part of the annual payments will go to retire the unfunded liability. District contributions may increase or decrease annually in accordance with CalPERS annual investment returns and other actuarial factors. If a lower investment return rate is assumed, costs would be higher.		Constitutional	Non–P 98

State Has Many Outstanding School and Community College Obligations (Cont.)

Debt Service on State General Obligation Bonds for K–14 Facilities		
The state has approved $31.9 billion in K–14 obligation bond authority in the past ten years to fund the construction and modernization of school and community college facilities. Bonds are paid off over a 30–year period. In 2011–12, K–14 debt–service costs total $2.5 billion.	Constitutional	Non–P 98[a]
K–12 Revenue Limits		
When the state has not provided a cost–of–living adjustment and/or has made a base reduction to revenue limits, it has created a "deficit factor" to keep track of the foregone funding. The current deficit factor (associated with funding foregone in 2008–09 through 2011–12) is 21.6 percent, or about $9 billion.	Statutory	P 98

[a] The Governor proposes to pay K–14 debt–service costs within the annual Proposition 98 appropriation beginning 2012–13 if his tax measure is rejected by voters.

Non–P 98 = Non–Proposition 98; P 98 = Proposition 98; CalSTRS = California State Teachers' Retirement System; CalPERS = California Public Employees' Retirement System.

LAO Recommendations

- ***Rebenchings of Proposition 98 Minimum Guarantee.*** Adopt Governor's proposal to eliminate the rebenching for the "gas tax swap." For other rebenchings, recommend consistent year–to–year approach.
- ***Payment Deferrals.*** Adopt Governor's proposal to retire some existing K–14 payment deferrals rather than provide K–14 program augmentations if the state has additional Proposition 98 resources to spend in 2012–13.
- ***Mandates.*** Adopt Governor's proposed concept but (1) review list of mandates eliminated or made optional and (2) create a working group to address implementation details.
- ***K–12 Funding Restructuring.*** Adopt Governor's proposal to change the way the state allocates K–12 funding, with modifications to incorporate legislative priorities.
- ***CCC Categorical Flexibility.*** Modify Governor's proposal to require CCC to use categorical funds for existing categorical–program purposes. Alternatively, create two block grants around thematic areas of student success and faculty support.
- ***Transitional Kindergarten (TK).*** Immediately adopt Governor's proposal to cancel initiation of new TK program. Would result in revenue limit savings of up to $224 million.
- ***Preschool.*** Shift $400 million into Proposition 98 to accurately reflect the amount currently spent on California State Preschool Program. Consider prioritizing slots for low–income children affected by the change in kindergarten start date. Reject Governor's proposal to reduce the rate the state pays preschool providers. To the degree Proposition 98 savings are needed, eliminate preschool slots.
- ***"Wall of Debt" Payment Plan.*** Use Governor's plan as a starting point for developing a multiyear plan to retire existing education funding obligations. To increase likelihood plan is consistently implemented, consider extending the payment period, spreading payments more evenly over period, designating settle–up funds for paying down mandates or deferrals, redirecting QEIA program savings to other obligations, and weighing trade–offs of retiring existing obligations versus making programmatic restorations.

LAO Recommendations (cont.)

- ***Trigger Plan.*** Build contingency plan. If plan assumes midyear cuts, be deliberate in both setting the magnitude of the cuts and specifying the allocation of the cuts. Alternatively, if plan assumes midyear augmentations, use funds to retire existing education obligations (such as paying down deferrals).
- ***Trigger–Related Flexibility Options for School Districts.*** Provide one–time tools to help districts respond to potential trigger cuts. Effective July 1, could remove additional categorical and mandate requirements, allow for a shorter school year, increase maximum statutory class sizes or suspend the caps, and authorize a special post–election layoff window.
- ***Trigger–Related Flexibility Options for Community Colleges.*** Provide one–time tools to help districts respond to potential trigger cuts. Effective July 1, could remove additional categorical and mandate requirements, suspend the requirements on the number of full–time faculty that districts must employ, modify the 50 percent law (which requires districts to spend at least 50 percent of their general operating budget on compensation of in–classroom faculty) to include expenditures on counselors and librarians or suspend the law for one year, and authorize a special post–election layoff window.

QEIA = Quality Education Investment Act.

The release of the LAO analysis is the traditional start of the Legislative review of the Governor's State Budget proposal. The Senate Budget and Fiscal Review Committee will hold their first hearing on February 16th with the Governor's Education Reform proposal as their first topic.

~Dave Walrath