

Proposition 98 Overview

LEGISLATIVE ANALYST'S OFFICE

Presented to:
Assembly Budget Subcommittee No. 2
On Education Finance





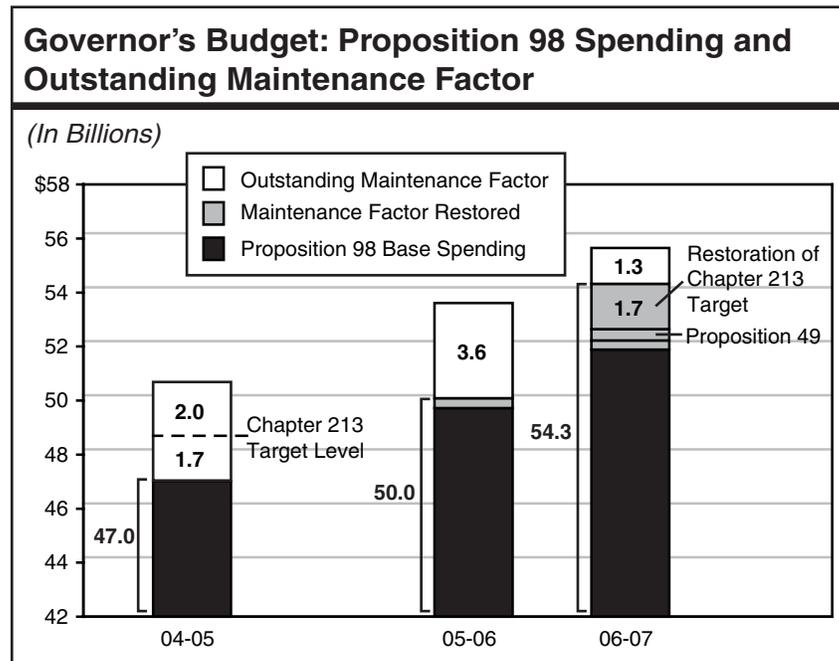
Proposed Proposition 98 Spending

Proposed Proposition 98 Funding				
<i>(Dollars in Millions)</i>				
	Revised 2005-06	Proposed 2006-07	Change From 2005-06 Revised	
			Amount	Percent
K-12	\$44,637	\$48,366	\$3,729	8.4%
California Community Colleges	5,242	5,848	606	11.6
Totals^a	\$49,968	\$54,318	\$4,332	8.7%
General Fund	(\$36,311)	(\$40,455)	(\$4,144)	(11.4%)
Local property tax revenue	(13,675)	(13,862)	(187)	(1.4)
Per Student Spending				
K-12 average daily attendance	6,010,454	6,023,040	12,586	0.2%
K-12 funding per pupil	\$7,427	\$8,030	\$604	8.1
^a Total Proposition 98 amounts include around \$105 million in funding that goes to other state agencies for education purposes.				

- Governor proposes total Proposition 98 funding of \$54.3 billion for 2006-07—a \$4.3 billion increase over the current-year estimate.
- Most of the increase in proposed spending is supported by General Fund revenues (\$4.1 billion). This is primarily due to the end of a two-year transfer of local property taxes from local governments to schools.
- \$48.3 billion of Proposition 98 spending would go to K-12 education, which is \$3.7 billion, or 8.4, percent over the proposed 2005-06 level.



Maintenance Factor



- The Governor's proposed spending for 2005-06 would restore \$265 million in maintenance factor by appropriating above the Proposition 98 minimum guarantee.
- The Legislative Analyst's Office's revenues suggest the state actually owes \$200 million in additional funding for the current year.
- The Governor proposes restoring a total of \$2.4 billion in maintenance factor in 2006-07:
 - \$334 million required by law.
 - \$426 million for Proposition 49.
 - \$1.7 billion to meet the Chapter 213 target.



State Owes Proposition 98 Settle-Up For Past Years

Outstanding Settle-Up Owed for Proposition 98				
<i>(In Millions)</i>				
1995-96	1996-97	2002-03	2003-04	Total^a
\$76.3	\$165.9	\$540.8	\$617.6	\$1,400.6

^a The Governor proposes to pay schools \$133 million in settle-up payments in 2006-07, reducing the outstanding obligation to \$1.3 billion.

- Current law continuously appropriates \$150 million annually to repay settle-up obligations. Unless the Legislature directs it for another purpose, this funding is used to repay K-12 schools and California Community Colleges for prior-year mandates.
- In 2006-07, the Governor proposes to provide \$133 million in settle-up payments to K-12 schools for the costs of prior-year mandates. (\$17 million of settle-up was “prepaid” in the 2005-06 budget.)



LAO Recommendation: Minimize Impact of Proposition 98 on Structural Budget Gap While Funding Baseline Program

Proposition 98 Increases in 2006-07					
<i>(In Billions)</i>					
Sources			Uses		
	Governor	LAO		Governor	LAO
Minimum guarantee	\$2.2	\$2.3	Baseline adjustments	\$2.9	\$3.3
Chapter 213 target	1.7	—	New or expanded programs	1.4	—
Proposition 49	0.4	—			
Additional funding for baseline program	—	1.0			
Totals	\$4.3	\$3.3	Totals	\$4.3	\$3.3

- We project a slightly higher minimum guarantee than the Governor, as well as slightly higher baseline costs.
- We recommend the Legislature fully fund the baseline program, but not provide additional funding for new or expanded programs (including Proposition 49).



LAO Estimate of 2006-07 Proposition 98 Baseline Cost Is Higher

2006-07 Proposition 98 Baseline: Difference Between Governor's Budget and LAO Alternative	
<i>(In Millions)</i>	
Baseline Adjustments	Difference
Cost-of-living adjustment	\$306.9
Attendance	
Declining enrollment	75.0
CCC reduction	-62.0
Mandates	39.4
Total	\$359.3

- We estimate that an additional \$359 million is needed to fully fund school district and community college baseline budgets.
- Most of this increase is due to our higher projected cost-of-living adjustment—5.8 percent compared to the budget's proposed 5.2 percent.
- Attendance costs also will be higher, by a net of \$13 million. This is due to higher costs for the declining enrollment adjustment, partially offset by a reduction for community colleges to reflect the growth in the underlying population (rather than the Governor's budget 3 percent growth adjustment).
- We also add \$39.4 million to fully fund ongoing K-12 mandates in 2006-07.



Option 1: Use One-Time Funds To Pay for Past Mandates

Status of the Education Credit Card Under the Governor's Budget Proposal				
<i>(In Millions)</i>				
	2003-04	2004-05	2005-06	2006-07
Deferrals				
K-12	\$1,097	\$1,083	\$1,103	\$1,103
Community colleges	200	200	200	200
Mandates				
K-12	\$946	\$1,096	\$1,234	\$1,110
Community colleges	55	73	91	109
K-12 revenue limit deficit	883	646	300	100
Totals	\$3,181	\$3,098	\$2,928	\$2,623

- The budget continues to defer around \$1.3 billion in costs to budget year +1.
- If the Legislature wants to provide more than our baseline adjustments, it could retire existing settle-up obligations and pay off most prior-year K-14 mandate claims.
- Because these obligations are “one-time” in nature, this option would not increase the state’s structural budget gap.
- It would also improve the state’s financial situation by retiring the settle-up obligation sooner than the current ten-year plan.
- Paying districts for past mandate claims would also provide a large infusion of one-time funds that districts could use to address pressing fiscal issues.



Option 2: Limit Discretionary Spending, Address K-12 Fiscal Condition

LAO Recommendations for the Use of 2006-07 Discretionary Funds in K-12	
<i>(In Millions)</i>	
	Amount
Deny Governor's Proposals	
Proposition 49 after school	\$426.2
K-12 revenue limit increases	406.2
Recruitment and retention	100.0
Arts and music	100.0
Physical education	85.0
Beginning teacher support	65.0
Digital classroom grants	25.0
Fresh Start	18.2
Subtotal	\$1,225.6
LAO Proposed Uses of Funds	
Reduce Proposition 98 spending	\$426.2
Fiscal solvency block grant	411.7
K-12 Baseline increases	387.7
Subtotal	\$1,225.6

- If the Legislature wants to provide additional ongoing funds above the baseline level, it could take an approach that recognizes the need to address state and district fiscal conditions.
- This option redirects the \$1.2 billion in discretionary funds proposed in the budget for three purposes.
 - \$388 million would fully fund the K-12 baseline budget (would apply to all options).
 - \$426 million would return to the General Fund to reduce the structural budget gap and increase the state's fiscal flexibility.
 - \$412 million would be dedicated to our proposed "Fiscal Solvency Block Grant."



Fiscal Solvency Block Grant LAO Proposal for 2006-07

- Actions taken during lean budget years (2002-03 and 2003-04) combined with declining enrollment have left many districts on shaky financial ground.
- More than 60 percent of districts face the challenge of paying for retiree health benefits—although the scope of district liabilities is not yet clear.
- Recommendation: Rather than use discretionary funds for new or expanded programs, we recommend using \$412 million for a fiscal solvency block grant.
- Funds would be distributed on a per-pupil basis for five years, when it would be folded into base revenue limits.
- The block grant would establish priorities for the use of funds.
 1. Districts would use funds to address pressing fiscal issues and begin budgeting for the “normal” cost of retiree health benefits.
 2. One-half of any remaining funds could be used for any short-term costs created by declining enrollment.
 3. The other half of the remaining funds would be used to begin reducing district liabilities for retiree health benefits for current employees and retirees.