

May 25, 2011

Proposition 98: Overview of May Revision Proposals

LEGISLATIVE ANALYST'S OFFICE

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Senate Budget and Fiscal Review Subcommittee No. 1
On Education Finance

Hon. Carol Liu, Chair





May Revision Has Positive Aspects but Considerable Uncertainty Remains



Budget Outlook Improved

- Baseline General Fund revenues up \$6.6 billion.
- State has adopted \$11 billion in solutions.
- Remaining budget shortfall of \$10.8 billion.



LAO Comments

- May Revision has reasonable budget assumptions and would have a multiyear plan for paying off state's outstanding obligations.
- Plan continues to have uncertainty because of Governor's proposal to seek voter approval for major tax proposals.
- Legislature has many options to address remaining shortfall.



Proposed Changes to Proposition 98 Funding Levels

Overview of Proposition 98 Funding						
<i>(In Millions)</i>						
	2010-11			2011-12		
	March Package	May Revision	Change	March Package	May Revision	Change
K-12 Education						
General Fund	\$32,239	\$31,722	-\$517	\$32,494	\$34,430	\$1,936
Local property tax revenue	11,557	12,147	589	11,406	12,123	717
Subtotals	(\$43,796)	(\$43,868)	(\$72)	(\$43,900)	(\$46,553)	(\$2,653)
California Community Colleges						
General Fund	\$3,885	\$3,885	—	\$3,542	\$3,807	\$265
Local property tax revenue	1,892	1,949	\$57	1,873	1,949	75
Subtotals	(\$5,777)	(\$5,834)	(\$57)	(\$5,415)	(\$5,756)	(\$340)
Other Agencies	\$85	\$85	—	\$87	\$85	-\$2
Totals, Proposition 98	\$49,658	\$49,787	\$129	\$49,402	\$52,394	\$2,992
General Fund	\$36,209	\$35,691	-\$517	\$36,123	\$38,322	\$2,199
Local property tax revenue	13,449	14,096	646	13,279	14,072	793



2010-11. Increase of \$129 million in Proposition 98 funding.

- \$72 million in higher-than-expected K-12 costs.
- \$57 million in higher-than-expected community college property tax revenues (do not offset General Fund costs).
- General Fund costs are notably reduced (\$517 million) due to higher property tax revenues offsetting K-12 revenue limit costs.



2011-12. Increase of \$3 billion in Proposition 98 funding.

- \$2.8 billion for paying down existing K-14 deferrals.
- \$222 million for student mental health services (responsibility shifted to schools).
- General Fund costs only increase by \$2.2 billion due to higher property tax revenues (\$793 million).



Proposition 98 Minimum Guarantee Up \$3 Billion From March Level

Summary of Changes in 2011-12 Proposition 98 Minimum Guarantee

(In Millions)

General Fund Adjustments:

Baseline General Fund increase	\$1,451
Accrual/policy changes	573
Tax proposal changes	-375
Other minor revenue changes	-106
Subtotal—Revenues	(\$1,543)

Property Tax Increase \$793^a

Rebenching:

Gas tax shift	\$630
AB 3632 mental health shift	222
Change in value of existing LPT shifts/other	-196
Subtotal—Rebenching	(\$656)

Total Changes **\$2,992**

^a In 2011-12, the Proposition 98 minimum guarantee is determined by Test 1, in which a fixed percentage (roughly 41 percent) of state General Fund revenues must be provided to K-14 education. When Test 1 is applicable, any increases in local property tax revenues do not offset state General Fund spending and instead result in additional funding for school districts and community colleges.
LPT = local property tax.



Improvement in Baseline Revenues. Increase of \$2.7 billion due to baseline improvements.



Tax Proposals. Net decrease of \$375 million from Governor's January General Fund tax proposal.

- If Governor's May General Fund tax package were rejected, minimum guarantee would decrease by \$1.7 billion.



Rebenching. Net increase of \$656 million due to "rebenching" of Proposition 98 minimum guarantee.

- Rebenching raises numerous legal, policy, and implementation issues.



Proposition 98 Spending Changes

May Revision Budget-Year Spending Changes

(In Millions)

	Change
Technical	
K-12 revenue limit adjustments	\$11
Child care caseload adjustments	-90
Other adjustments	31
Policy	
Eliminate new 2011-12 K-12 deferral	2,064
Pay down prior-year K-12 deferrals	434
Fund mental health services ^a	222
Pay down prior-year CCC deferrals	221
Eliminate new 2011-12 CCC deferral	129
Provide flexed categorical funds to new charter schools	8
Augment clean partnership academies	3
Eliminate specified K-12 mandates	-32
Eliminate specified CCC mandates	-9
Total Spending Changes	\$2,992

^a Reflects Governor's proposal to eliminate AB 3632 mandate and make school districts responsible for student mental health services.



Per-Pupil Programmatic Funding Virtually Unchanged From March Level

K-12 "Programmatic" Funding^a							
<i>(Dollars in Millions Unless Otherwise Specified)</i>							
	2007-08 Final	2008-09 Final	2009-10 Final	2010-11 Revised	2010-11 May Revision	2011-12 March Package	2011-12 May Revision
Programmatic Funding							
K-12 ongoing funding ^b	\$48,883	\$43,215	\$40,717	\$42,945	\$43,017	\$43,044	\$45,794
Payment deferrals	—	2,904	1,679	1,719	1,719	2,063	-434
Settle-up payments	—	1,101	—	267	267	—	—
Public Transportation Account	99	619	—	—	—	—	—
Freed-up restricted reserves ^c	—	1,100	1,100	—	—	—	—
ARRA funding ^c	—	1,192	3,575	1,192	1,192	—	—
Federal education jobs funding ^c	—	—	—	421	421	781	781
Totals	\$48,982	\$50,130	\$47,070	\$46,544	\$46,616	\$45,888	\$46,141
Per-Pupil Programmatic Funding							
K-12 attendance	5,947,758	5,957,111	5,933,761	5,951,826	5,953,259	5,964,800	5,966,942
K-12 per-pupil funding (in dollars)	\$8,235	\$8,415	\$7,933	\$7,820	\$7,830	\$7,693	\$7,733
Percent Change From 2007-08	—	2.2%	-3.7%	-5.0%	-4.9%	-6.6%	-6.1%
^a Excludes federal funds not associated with stimulus packages, lottery, and various other local funding sources. ^b Includes ongoing Proposition 98 funding, Proposition 98 accounting adjustments, and funding for the Quality Education Investment Act. ^c Reflects LAO estimates of funds spent in each year. ARRA = American Recovery and Reinvestment Act.							



Bulk of Additional Funding in May Plan Not Used for New Program. Programmatic funding virtually unchanged despite higher Proposition 98 funding because bulk of new funds designated for payment deferrals (that is, making existing payments on time).



Slight Increase Due to Shift of Student Mental Health Responsibilities to Schools. Programmatic per-pupil funding in 2011-12 increased by \$40 due almost entirely to additional funding for student mental health services.



LAO Recommendations



Adopt Governor's May Revision Proposals to:

- Pay down deferrals.
- Shift student mental health services to schools.
- Eliminate 27 K-14 mandates and reduce the costs of 13 K-14 mandates.

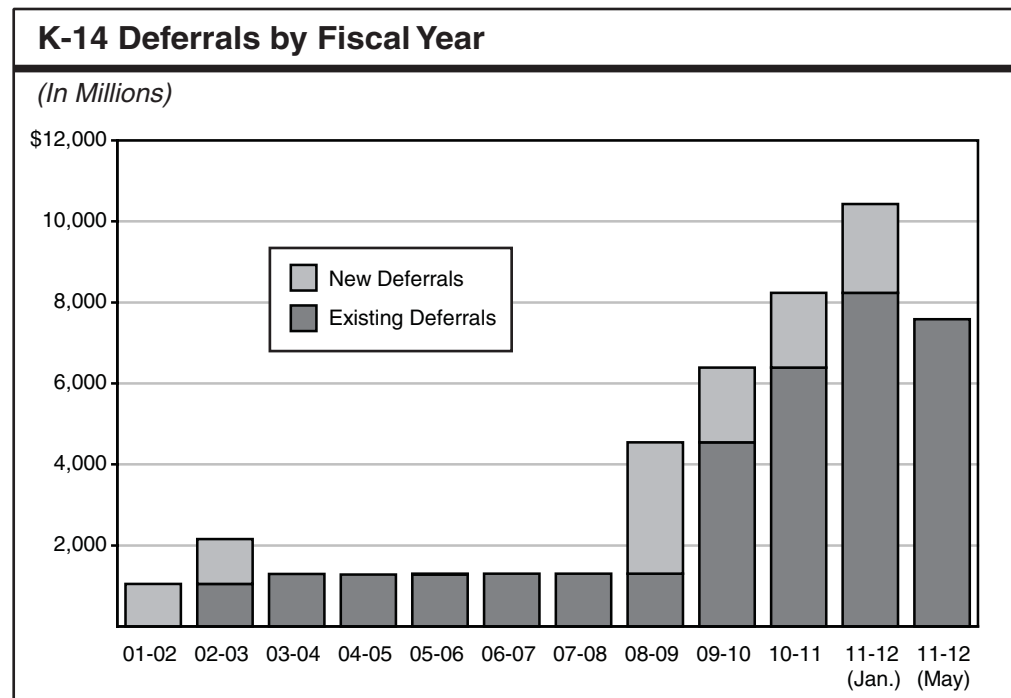


Reject Governor's May Revision Proposals to:

- Eliminate funding for state's student and teacher data systems.
- Provide Proposition 98 funding for Clean Technology Partnership Academies.



Outstanding K-14 Deferrals Would Decrease to \$7.6 Billion



May Revision Proposal. Rescinds recently adopted deferrals (\$2.2 billion) and eliminates \$655 million in existing payment deferrals.

- For the 2011-12 fiscal year, 15 percent of Proposition 98 program would be paid late (down from 20 percent under the January budget).



Benefits. Using additional Proposition 98 funding to pay down payment deferrals improves school district financial health, reduces district borrowing costs, and reduces risk of insolvency.



Out-Year Plan. Governor proposes to use future increases in Proposition 98 funding to pay off remaining deferrals.



Improved Budget Outlook, but Districts Still Face Uncertainty and Timing Issues

- ☑ ***“Worst-Case” Scenario Is Better.*** Due to improvements in baseline revenues, K-12 reductions of \$4.5 billion are now very unlikely.
- ☑ ***Uncertainty Regarding Tax Proposals.*** Since districts must adopt budget plans by July 1, they will likely make budget decisions without knowing if the Governor’s tax proposal will be adopted.
- ☑ ***Some Districts Still Likely to Make Cuts.*** Due to the uncertainty regarding the tax proposals, some school districts still are likely to plan for budget reductions.
 - If tax proposals not adopted, minimum guarantee would fall \$1.7 billion, with state potentially needing to consider whether to suspend the guarantee and make further reductions.