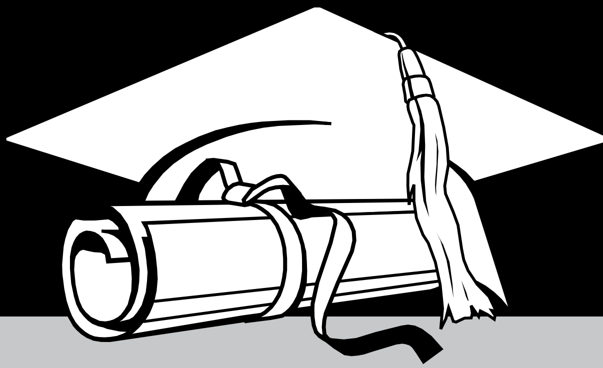
EDUCATION



LAO

65 YEARS OF SERVICE

2008-09 Analysis

Major Issues

Education

☑ **Maintain Current Level of Proposition 98 Programmatic Support**

- We offer an alternative Proposition 98 spending plan that would provide K-12 schools and community colleges roughly the same amount of ongoing program support in 2008-09 as in the current year ($57.7 billion).
- The alternative plan accounts for all K-14 growth-related adjustments as well as covers the ongoing costs of mandated education activities. It would not provide a COLA, and it would make targeted reductions (totaling almost $180 million) to programs that are poorly structured, duplicative, or technically overbudgeted.

☑ **Achieve Substantial Additional K-14 Savings**

- The alternative plan relies heavily on adjusting current-year Proposition 98 spending down to the minimum guarantee—identifying almost $1 billion in funds that likely will not be spent by the end of the current year and designating an additional $409 million in Public Transportation Account monies for Home-to-School transportation.
- We recommend suspending the Quality Education Investment Act (QEIA) in 2008-09 (for savings of $450 million). To ramp up QEIA while at the same time not providing a cost-of-living adjustment to base programs supporting QEIA schools would be counterproductive.

☑ Reform K-14 Funding System

- We recommend consolidating more than 50 K-14 categorical programs into a few large block grants. Categorical reform of this magnitude would offer districts multiple benefits—including a simplified, streamlined, more transparent funding system; greater ability to focus on student success rather than program compliance; and, perhaps most relevant in tight fiscal years, greater latitude to use available funds to address critical local needs.

☑ Unknown Impact of Governor's Proposal on Higher Education Access and Affordability

- The Governor's proposal for higher education relies on large unallocated reductions to the University of California (UC) and the California State University (CSU). The budget assumes the universities will make their own decisions for absorbing these reductions through some combination of enrollment reductions, fee increases, and other means. The Governor's proposal also phases out a Cal Grant program that provides financial aid to needy students (see page E-145).

☑ LAO Alternative Budget Adheres to State Master Plan Objectives

- We recommend an alternative to the Governor's proposal that avoids making unallocated reductions and adheres to the State Master Plan for Higher Education. Our alternative would fund anticipated enrollment growth at the three segments. It would also modestly increase the share of education cost paid by students in the form of fees, while increasing financial aid to cover these fee increases for financially needy students. Our alternative maintains all existing Cal Grant programs (see page E-151).

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Education

INTRODUCTION

Proposition 98

For 2008-09, the Governor proposes to provide $55.6 billion in Proposition 98 funding for K-14 education. This represents a reduction in funding for K-12 schools and community colleges. There are three primary comparison points from which to consider these reductions. First, compared to his proposed 2007-08 level, the Governor's proposal would result in a decline in funding of $1.1 billion. Second, because the Governor's proposal assumes suspension of the Proposition 98 minimum guarantee, it would result in a funding level that is $4 billion less than would otherwise be required for K-14 education. Finally, in building his budget proposal for 2008-09, the Governor first builds a workload budget for K-14 education and then makes across-the-board reductions totaling $4.8 billion.

BACKGROUND

California voters enacted Proposition 98 in 1988 as an amendment to the State Constitution. The measure, which was later modified by Proposition 111, establishes a minimum annual funding level for K-12 schools and California Community Colleges (CCC). (A small amount of annual Proposition 98 funding provides support for direct educational services provided by other agencies, such as the State Special Schools and the California Youth Authority.) Proposition 98 funding constitutes around three-fourths of total K-14 funding.

The minimum Proposition 98 funding level is determined by one of three formulas. Figure 1 (see next page) briefly explains these formulas (or "tests") and some other key funding provisions. The five major factors underlying the Proposition 98 tests are: (1) General Fund revenues, (2) state population, (3) personal income, (4) local property taxes, and (5) K-12 average daily attendance (ADA). In most years, the key determinants of the Proposition 98 "minimum guarantee" (or required funding level) are the year-to-year changes in ADA, per capita personal income, and per capita General Fund revenues.

Figure 1

Proposition 98 Basics

✓ ***Most years, K-14 funding increases to account for growth in K-12 attendance and growth in the economy.***

✓ ***Three Formulas ("Tests") Used to Determine K-14 Funding:***

- ***Test 1—Share of General Fund.*** Provides roughly 40 percent of General Fund revenues to K-14 education. This test has not been used since 1988-89.
- ***Test 2—Growth in Per Capita Personal Income.*** Increases prior-year funding by growth in attendance and per capita personal income. This test has been operative 13 of the last 20 years.
- ***Test 3—Growth in General Fund Revenues.*** Increases prior-year funding by growth in attendance and per capita General Fund revenues. Generally, this test is operative when General Fund revenues fall or grow slowly. This test has been operative 6 of the last 20 years.

✓ ***Legislature can provide more or less K-14 funding than formulas require.***

The Legislature can provide more or less than required by the formulas. For example, in 1999-00 when state revenues were booming the Legislature decided to spend $1.8 billion more than the minimum guarantee. Alternatively, in 2004-05 the Legislature suspended the minimum guarantee and provided $2 billion less than would have been required. To suspend the minimum guarantee and provide less funding for Proposition 98 requires a two-thirds vote of the Legislature.

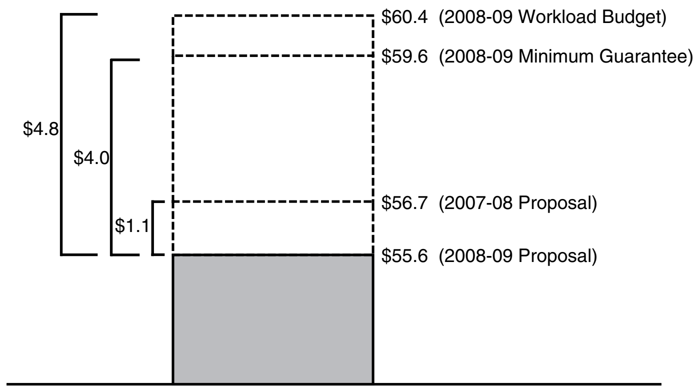
GOVERNOR'S BUDGET PROPOSAL

The Governor proposes to provide a total of $55.6 billion in Proposition 98 funding for K-14 education in 2008-09. To put this funding level into some context, Figure 2 compares it to three comparison points: the Governor's proposed funding level for the current year ($56.7 billion), the Governor's estimate of the 2008-09 Proposition 98 minimum guarantee ($59.6 billion), and the Governor's estimate of how much it would cost to fund a "workload" budget in 2008-09 ($60.4 billion). As shown in the figure, the Governor's proposed funding level for 2008-09 is lower than all three of these comparison points.

Figure 2

Three Perspectives on the Governor's Proposition 98 Reductions

(In Billions)



- ***Compared to 2007-08:*** The Governor's proposal for 2008-09 is $1.1 billion less than what he proposes to provide in the current year.
- ***Compared to the Minimum Guarantee:*** The Governor proposes to suspend the Proposition 98 requirement in 2008-09. His proposed funding level is $4 billion less than what schools and community colleges would receive if the minimum guarantee were met.
- ***Compared to Workload Budget:*** In building his Proposition 98 proposal the Governor first constructed a hypothetical workload budget (see below for more detail). From this amount, he then applied an across-the-board reduction roughly equal to the 10 percent level used throughout the budget. His ultimate K-14 funding proposal is $4.8 billion lower than his workload budget total.

Below, we provide further discussion of the Governor's budget proposal in the context of each of these three comparisons.

Compared to Current Year

Figure 3 (see next page) displays the Governor's proposals for Proposition 98 spending in 2007-08 and 2008-09. From his proposed current-year funding level of $56.7 billion, the Governor's budget for 2008-09 would reduce Proposition 98 spending by an additional $1.1 billion, or 1.9 percent. General Fund support for Proposition 98 would drop by $2.1 billion compared to the revised current-year level, offset by a projected increase of $1.1 billion in local property tax revenue.

Figure 3

Governor's Proposition 98 Proposal

(Dollars in Millions)

	2007-08		2008-09 Proposed	Change From 2007-08 Revised	
	Budget Act	Revised[a]		Amount	Percent
K-12 Education					
General Fund	$37,203	$37,473	$35,460	-$2,013	-5.4%
Local property tax revenue	13,594	12,949	13,850	901	7.0
Subtotals	($50,797)	($50,423)	($49,310)	(-$1,112)	(-2.2%)
Community Colleges					
General Fund	$4,157	$4,116	$4,027	-$89	-2.2%
Local property tax revenue	2,052	2,052	2,196	144	7.0
Subtotals	($6,209)	($6,167)	($6,223)	($55)	(0.9%)
Other Agencies[b]	**$119**	**$119**	**$106**	**-$13**	**-10.6%**
Total Proposition 98					
General Fund	$41,479	$41,707	$39,593	-$2,114	-5.1%
Local property tax revenue	15,646	15,001	16,046	1,045	7.0
Totals	**$57,125**	**$56,709**	**$55,640**	**-$1,069**	**-1.9%**

a Reflects Governor's proposal for 2007-08.

b Funding that goes to other state agencies for educational purposes is all General Fund.

K-12 Education Funding Drops While Community Colleges See Slight Funding Increase. As shown in Figure 3, the budget proposal would provide about $1.1 billion less in Proposition 98 support for K-12 education than what is proposed for the current year, a drop of 2.2 percent. In contrast, community colleges would receive a slight funding increase ($55 million, or 0.9 percent). The community college augmentation is due largely to the Governor's proposals for funding CCC enrollment growth (discussed in greater detail in the "Higher Education" section of this chapter).

Compared to Minimum Guarantee

Spending at the Governor's proposed level in 2008-09 ($55.6 billion) would require a two-thirds vote of the Legislature to suspend Proposition 98. This is because the Governor's proposal is $4 billion less than his calculation of the Proposition 98 minimum guarantee—the funding level that otherwise would be required. Suspending the minimum guarantee allows the Legislature to fund K-14 education at whatever level it chooses. (See the "Proposition 98 Technical Update" section of this chapter for more discussion of suspending Proposition 98.)

Compared to Workload Budget

Figure 4 (see next page) displays the Governor's approach to constructing the Proposition 98 budget proposal. For 2008-09, the Governor first increases K-14 spending by $3.8 billion for workload adjustments, then makes $4.8 billion in reductions.

Governor First Creates Workload Budget...In constructing his 2008-09 budget for K-14 education, the Governor first built a hypothetical workload budget, providing workload adjustments to existing K-14 programs totaling almost $3.8 billion. Most of this increase ($2.7 billion) is to provide an estimated 4.9 percent cost-of-living adjustment (COLA) to K-14 apportionments and most categorical programs. Almost $1 billion more results from making existing programs "whole" by restoring (1) the $400 million reduction to K-12 and CCC apportionments the Governor proposes for 2007-08, and (2) the $566 million in ongoing K-12 costs that are being funded with one-time monies in the current year. The other significant workload adjustments are an estimated $182 million in costs to fund 3 percent enrollment growth for CCC, partially offset by $120 million in savings from a projected 0.5 percent decline in statewide K-12 ADA. Notably, the Governor's workload budget exceeds his estimate of the Proposition 98 minimum guarantee for 2008-09 by $800 million.

...Then He Implements Budget Balancing Reductions. From his workload budget level of $60.5 billion, the Governor makes a 10.9 percent across-the-board reduction to General Fund support for every K-12 and CCC program. These reductions lower the workload budget by $4.8 billion—$4.3 billion for K-12 education and $483 million for CCC—resulting in the Governor's final spending proposal of $55.6 billion.

Effect of Reductions on K-14 Education

The net effect of the across-the-board reductions on actual year-to-year funding levels varies by program. This is because programs received different workload increases—growth and COLA adjustments—before being

Figure 4

Governor's Approach to Building Proposition 98 Budget

(In Millions)

2007-08 Budget Act	**$57,124.7**
Reduction to apportionments	-$400.0
Technical adjustments	-16.1
2007-08 Revised[a]	**$56,708.6**
"Workload Budget" Adjustments	
Cost-of-living adjustment (4.94 percent)	$2,738.1
Restore funding for ongoing programs	566.6[b]
Restore 2007-08 reduction to K-14 apportionments base	400.0
Community college enrollment growth	182.2
K-12 decline in average daily attendance	-121.0
Other	-9.6
Subtotal	($3,756.3)
Governor's "Workload" Estimate for 2008-09	**$60,464.9**
Governor's "Budget Balancing Reductions"	
K-12 education	-$4,335.8
Community colleges	-483.5
Other educational agencies	-6.0[c]
Subtotal	(-$4,825.3)
2008-09 Proposal	**$55,639.6**

a Reflects Governor's proposal for 2007-08.

b Portions of three K-12 programs were funded using one-time funds in 2007-08.

c A small amount of Proposition 98 funding (slightly more than $100 million) goes to support other state agencies that provide education services.

cut. Furthermore, for programs that receive increases in local property tax revenue—including apportionments and special education—the General Fund reduction is partially offset. However, in all cases, the reductions fully eliminate the 4.9 percent COLA and, for most programs, they also result in lower funding levels than were provided in the current year. These cuts, which range from 2 percent to 11 percent (year-to-year), would generally be achieved by reducing existing funding rates or program participation. The "K-12 Introduction" and "California Community Colleges" sections of this chapter describe programmatic funding changes in greater detail.

Additional One-Time Funds for K-14 Education

In addition to the $55.6 billion in ongoing Proposition 98 funds, the 2008-09 budget proposal includes $600 million in one-time General Fund monies for K-14 education. These funds are scored as Proposition 98 payments for prior years.

$450 Million for Quality Education Investment Act (QEIA). Chapter 751, Statutes of 2006 (SB 1133, Torlakson), continuously appropriates approximately $2.7 billion in General Fund monies over a seven-year period beginning in 2007-08 for QEIA. Consistent with this legislation, the Governor's budget assumes a $450 million payment in 2008-09 ($402 million for K-12 education and $48 million for CCC). The K-12 funds are to be used primarily for reducing class sizes in grades 4 through 12, whereas the CCC funds are for expanding career technical education.

$150 Million for "Settle-Up" Payment. Consistent with Chapter 216, Statutes of 2004 (SB 1108, Committee on Budget and Fiscal Review), the budget proposal also includes $150 million from the General Fund to settle up an outstanding Proposition 98 obligation from 2002-03. As directed by Chapter 216, these funds would go to reimburse schools and community colleges for the costs of prior-year mandates ($125 million for K-12 and $25 million for CCC).

OUTLINE

The "Proposition 98" part of this chapter contains three sections, which immediately follow. In "Proposition 98 Priorities," we offer an alternative plan for the Legislature to consider when constructing a budget for K-14 education. In "Proposition 98 Technical Update," we describe various Proposition 98 issues, based both on the administration's revenue forecast and the LAO's alternative forecast. Finally, in "COLA," we discuss the Governor's proposal to change the index used to provide inflationary adjustments for K-14 programs and recommend the Legislature adopt an alternative measure.

BUDGET ISSUES

Education

PROPOSITION 98 PRIORITIES

This section lays out an alternative to the Governor's Proposition 98 budget proposal. Under the alternative, K-12 schools and community colleges would receive roughly the same amount of ongoing program support in 2008-09 as in the current year ($57.7 billion). Relative to the administration's plan, the alternative would provide about $2 billion more in ongoing Proposition 98 funding and result in a Proposition 98 suspension of about $800 million (rather than $4 billion). As part of the alternative, we recommend funding certain core costs while obtaining savings from programs that are duplicative, poorly structured, or technically overbudgeted. In addition, to help schools and community colleges respond to a potentially tight budget, the alternative includes a major categorical reform component—collapsing more than 50 K-14 categorical programs into a few large block grants.

In this section, we provide an alternative Proposition 98 spending plan for the Legislature's consideration. This is one piece of the overall budget alternative we lay out in *The 2008-09 Budget: Perspectives and Issues*. The Proposition 98 alternative, as the overall state budget alternative, is intended to give the Legislature more options in developing its 2008-09 budget package.

Alternative Takes Different Approach to Building Proposition 98 Budget

Figure 1 (see next page) summarizes our alternative. As shown in the figure, the alternative would provide $57.7 billion in ongoing Proposition 98 funding for K-14 education in 2008-09, or $2.1 billion more than under the Governor's budget. The amount provided under our alternative is roughly the amount needed to support existing programmatic spending—essentially resulting in a flat year-to-year budget.

Figure 1

Alternative Approach to Building 2008-09 Proposition 98 Budget

(In Millions)

2007-08 Budget Act	**$57,124.7**
Baseline Adjustments	
Restore funding for ongoing K-12 programs	$566.6[a]
Restore funding for ongoing child care programs	108.2
Technical adjustments	-16.1
Subtotal	($658.7)
2007-08 Programmatic Spending	**$57,783.4**
Growth Adjustments	
Decline in K-12 average daily attendance	-$121.0
Enrollment growth for community colleges	20.0[b]
Growth for child care	10.0
Other technical adjustments	-12.4
Subtotal	(-$103.4)
Program Adjustments	
Ongoing funding for mandates	$205.0
Ongoing funding for charter school facilities	18.0[c]
High Priority schools exiting program	-26.0
Categorical program reductions	-178.7[d]
Subtotal	($18.3)
2008-09 Alternative	**$57,698.3**

a Portions of the Home-to-School Transportation, deferred maintenance, and High Priority Schools Grant programs were funded with one-time monies in 2007-08.

b Funds 1.7 percent growth when combined with additional fee revenues.

c Program has been funded with one-time monies since its inception.

d See Figure 2 for more detail on these reductions.

Takes More Selective, Strategic Approach. Whereas the administration proposes across-the-board cuts that reduce virtually all K-14 programs, our alternative takes a more strategic approach. It does so by making selective adjustments—weighing the merits of various programs and funding certain core costs while obtaining savings from programs that are duplicative, poorly structured, or technically overbudgeted.

Restores Ongoing Funding for Ongoing Programs. As shown at the top of Figure 1, we restore ongoing funding for programs that were funded with one-time monies in the current year. In 2007-08, the state funded substantial portions of the Home-to-School Transportation, High Priority Schools, and Deferred Maintenance programs with one-time funds. Maintaining these programs in 2008-09 requires backfilling with a like amount of ongoing funding. As part of our current-year alternative, we also recommend capturing substantial unspent monies from child care and development (CCD) programs. Although those monies are not needed in 2007-08, the CCD budget would need to be partly restored in 2008-09 to ensure no reduction in service.

Funds Growth but No COLA. The alternative would make various growth adjustments. Specifically, it would fund 0.7 percent growth for child care programs, reflecting projected growth in the number of children under 5 years of age, and 1.7 percent enrollment growth at the California Community Colleges (CCC), reflecting projected demographic growth in the underlying student population. (Part of community colleges' enrollment growth costs would be covered by increased student fee revenues.) In addition, the alternative recognizes savings from a projected decline of 0.5 percent in K-12 average daily attendance (ADA). The alternative would not fund a cost-of-living adjustment (COLA). For 2008-09, providing a COLA to all K-14 programs (including apportionments) that typically receive one would cost about $3 billion.

Covers Additional Ongoing Cost of K-14 Mandates ($205 Million). The alternative would fund the estimated full-year cost of already approved K-14 mandates. In contrast, the Governor's plan includes only $4 million for the annual ongoing cost of CCC mandates and virtually nothing for the ongoing cost of K-12 mandates (although it does include $150 million in one-time funds to pay prior-year costs). For many years, we have recommended the Legislature fund mandated local activities. (See the "Mandate" section of this chapter for a discussion of recently approved education mandates.)

Alternative Achieves More Than $200 Million in Program Savings

To cover the various costs described above, the alternative would make various targeted reductions totaling almost $200 million. Figure 2 lists these reductions. The reductions are recommended for one of the following three reasons.

Figure 2

Recommended Categorical Program Reductions for 2008-09

(In Millions)

Program	Amount[a]	Rationale[b]
Physical Education Incentive Grants	$41.8	Poorly structured
Adult education	30.0	Technical realignment
Economic Impact Aid	25.0	Technical realignment
Year Round Schools	19.0	Reduced participation
School safety competitive grants	18.1	Duplicative
Home-to-School Transportation	11.0	Technical realignment
Targeted Instructional Improvement	10.0	Technical realignment
High Priority Schools (corrective action)	6.0	Duplicative
Alternative certification/intern	3.0	Technical realignment
National Board certification	2.0	Technical realignment
Paraprofessional teacher training	1.8	Technical realignment
CCC economic development	11.0	Noncore program
Total K-14 Reductions	**$178.7**	

a Reflects reduction from *2007-08 Budget Act* level.

b See text for description of various rationales.

Aligns Funding With Expected Spending. After reviewing the account balances of many K-12 categorical programs, we identified several programs that routinely end the fiscal year with unspent monies. Thus, we recommend a one-time correction to realign the budgeted funding level to the anticipated spending level. Some of these programs have savings because of declines in K-12 ADA whereas others routinely have less-than-expected participation. Similarly, we recommend reducing funding for adult education to align the program's budget with growth in the adult population. (See the "Adult Education" section of this chapter for further discussion.)

Eliminates Programs That Are Poorly Structured, Duplicative, or Have Significantly Reduced Participation. We recommend eliminating the Physical Education Incentive Grant program because it is poorly structured and the School Safety Consolidated Competitive Grant program because it is duplicative of a larger school safety program. Similarly, we recommend eliminating the corrective action component of the High Priority Schools program because it is duplicative of a federal program. Finally, we recommend phasing out the Year Round Schools program because these types of schools are becoming less common. (See the "Other Issues" section of this chapter for further detail on the rationale behind several of these reductions.)

Reduces Funding for CCC Program. We recommend reducing funding for the economic development program offered by community colleges, as it is not directly related to CCC's core mission of providing educational services to students. (See the "California Community Colleges" section of this chapter for further discussion.)

Alternative Taps Other K-14 Savings

To support the ongoing Proposition 98 funding level under our alternative, we identify additional savings elsewhere in the K-14 budget. Specifically, the alternative would achieve additional savings in the current year, use current-year funds to prepay a budget-year obligation (thereby yielding budget-year savings), and suspend a $450 million appropriation associated with a K-14 program expansion.

Recap of Current-Year Alternative. We continue to recommend the Legislature achieve as much savings as possible in the current year by identifying funds that likely will not be spent by the end of the fiscal year. We have identified almost $1 billion in existing Proposition 98 funding that is not expected to be needed before the close of the fiscal year. (This is about $600 million more in current-year savings relative to the Governor's plan.) These funds can be used to reduce spending that counts toward the Proposition 98 minimum guarantee without affecting schools' current operations.

Using Settle-Up in Current Year Has Multiple Benefits. Another piece of our current-year alternative involves "settle-up" funding. A settle-up obligation is incurred when the minimum guarantee exceeds the funding level of the enacted budget. When this happens, the state is required to provide more funding to meet the higher funding requirement (to settle up). In contrast, when the reverse happens (as in the current year), and the minimum guarantee falls after the budget is enacted, the state has no automatic tool for reducing spending (to settle down). In the current year, we recommend designating some funding already going to schools as payment toward an existing settle-up obligation. Such action would avoid midyear cuts to schools. It also would ensure the state meets the requirements of Proposition 98 for prior years before exceeding the requirement for the current year. Using settle-up in this way has the added benefit of allowing the state to prepay the settle-up payment scheduled for 2008-09 ($150 million), thereby yielding additional budget-year solution.

Suspends Quality Education Investment Act (QEIA). Our alternative suspends QEIA, a program established pursuant to Chapter 751, Statutes of 2006 (SB 1133, Torlakson). Chapter 751 appropriates $450 million in 2008-09—$402 million for a class size reduction program for K-12 schools and $48 million for community colleges, most of which is designated for career technical education (CTE). Although little information is available on how much the 488 K-12 schools participating in QEIA are spending in 2007-08, virtually none of the community college CTE funding has been awarded to date. To ramp up such a program in the budget year while at the same time not providing a COLA to existing core programs (such as revenue limits, special education, Economic Impact Aid, and existing CTE programs—programs that also serve QEIA schools) would be counterproductive. Rather than take such an approach, we recommend suspending the program until more ample resources are available. (Suspending by a year also would allow the Legislature to consider possible program improvements, such as better integrating QEIA with other state and federal programs that focus on low-performing schools and districts.)

Alternative Includes Major Categorical Reform Component

To help districts respond to a tight fiscal year, our alternative includes recommendations that would provide districts with greater fiscal flexibility. Specifically, we recommend consolidating 43 K-12 categorical programs into one base grant and three supplemental block grants. For the base grant, we recommend consolidating revenue limits with five revenue limit "add-ons" and two class size reduction programs. For the supplemental block grants, we recommend consolidating 8 existing programs into a special education block grant, 11 other programs into an "Opportunity to Learn" block grant centered around at-risk students, and 16 other existing programs into a school improvement block grant largely centered around teachers. (See the "Categorical Reform" section of this chapter for further discussion.) For the community colleges, we recommend consolidating ten categorical programs into two block grants—six existing programs would be consolidated into a "Student Success" block grant and four programs would be consolidated into a faculty support block grant. (See the "California Community College" section of this chapter for further discussion.)

Categorical Reform Offers Districts Multiple Benefits. Reforming the state's existing system of categorical programs has several very important benefits for schools and districts. Perhaps most relevant in tight fiscal years, categorical reform offers greater flexibility to use available funds to address local needs. Given such needs can differ substantially across the state, categorical reform offers districts latitude to identify and resolve the most pressing local problems. Such an approach also creates incentives for districts to develop local capacity to respond to local issues. Streamlining the finance system—a byproduct of categorical reform—also reduces confusion among parents, teachers, and administrators about the level of resources provided by the state and the method used to distribute those resources. This, in turn, enhances transparency and fosters stronger incentives to distribute resources equitably. Lastly, categorical reform allows districts to focus less on complying with state rules and regulations and more on student success.

Various Factors Affect Minimum Guarantee in Budget Year

Below, we describe the ways in which revenue proposals and current-year spending levels affect the Proposition 98 minimum guarantee in 2008-09. As shown in Figure 3 (see next page), the Proposition 98 minimum guarantee in 2008-09 under our alternative package is estimated at $58.5 billion—more than $1 billion lower than the estimate of the guarantee under the Governor's plan ($59.6 billion).

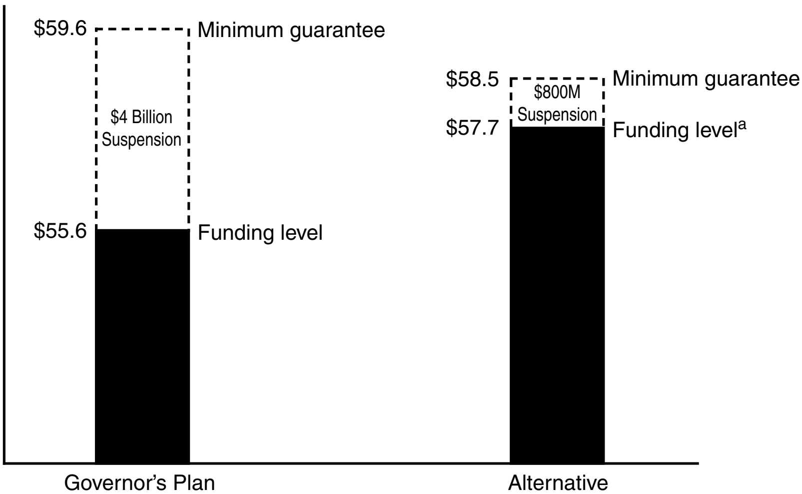
Minimum Guarantee Affected by Revenue Proposals. Whereas the Legislature typically funds the Proposition 98 minimum guarantee, the large projected budget deficit makes funding the guarantee in 2008-09 especially difficult. Neither the administration's plan nor our alternative meets the Proposition 98 minimum guarantee (suspending by $4 billion and $800 million, respectively). Even raising taxes in 2008-09 would not make meeting the Proposition 98 guarantee easier. This is because higher revenues in 2008-09 result in a higher Proposition 98 guarantee—meaning efforts to find overall budget solution work at cross-purposes with trying to fund the Proposition 98 guarantee. For example, if the state were to raise an additional $4 billion in General Fund tax revenue, the Proposition 98 spending requirement would increase by $2 billion—leaving only $2 billion in budget solution.

Minimum Guarantee Also Affected by Current-Year Actions. The interaction between revenue proposals and the Proposition 98 minimum guarantee in the budget year underscores the significance of funding at the minimum guarantee in the current year. Given that revenue proposals will drive up the Proposition 98 minimum guarantee and the budget-year guarantee drives off the current-year spending level, the starting point is especially important. If spending were adjusted all the way down to the minimum guarantee in the current year, then the minimum guarantee in 2008-09 would be more than $1 billion lower than under the Governor's plan. Indeed, under our alternative, the minimum guarantee is lower and the suspension is smaller almost entirely because we assume current-year spending has been adjusted all the way down to the guarantee.

Figure 3

Comparing 2008-09 Proposition 98 Budget Plans

(In Billions)



[a]Provides roughly the same amount of ongoing program support as in 2007-08.

Conclusion

In sum, our alternative would provide schools and community colleges roughly the same amount of ongoing program support in 2008-09 as in the current year ($57.7 billion). Within that funding level, it would support growth in child care programs and enrollment growth at community colleges. It also would cover the ongoing costs of mandated education activities. It would not provide a COLA, and it would make targeted reductions to programs that are poorly structured, duplicative, experiencing notable drops in participation, lower priorities, or working at cross-purposes with funding districts' core program. The alternative also includes a major categorical reform component that would maximize districts' flexibility in responding to a potentially tight budget.

PROPOSITION 98 TECHNICAL UPDATE

In this section, we provide technical detail on the Proposition 98 budget. Specifically, we discuss estimates for the Proposition 98 minimum guarantee under both the Governor's and LAO's forecasts. We also provide information on suspending Proposition 98, forecasts of local property tax revenues, and an update on various other Proposition 98 funding issues (including "settle-up" obligations, unfunded mandate claims, and maintenance factor).

PROPOSITION 98 FORECASTS

Prior Year

Administration Estimates State Owes $37 Million in Settle-Up for 2006-07. Due to changes to revenue estimates, the administration estimates the Proposition 98 minimum guarantee requirement for 2006-07 has increased slightly—by $68 million—from the $55 billion assumed when the 2007-08 budget was enacted. About one-half of this increased spending requirement has already been met through higher-than-expected revenue limit payments for 2006-07. Therefore, the administration estimates the state still owes $37 million to meet the minimum guarantee for the prior year. (The budget proposal does not include these funds, meaning the state would have to settle up with a one-time payment of $37 million to schools at some point in the future.) While the total Proposition 98 funding level has changed only slightly for 2006-07, the General Fund share has increased significantly—by over $600 million—due to a decline in local property tax revenue. Later in this section, we discuss the effect of changes in property taxes on Proposition 98.

Settle-Up Obligation Now Estimated to Be About $160 Million. Based on updated 2006-07 data that became available after the Governor's budget was put together, the minimum guarantee is about $190 million higher than assumed in the *2007-08 Budget Act*. As a result, the future settle-up obligation for 2006-07 is now estimated at about $160 million (or roughly $125 million higher than the administration's estimate).

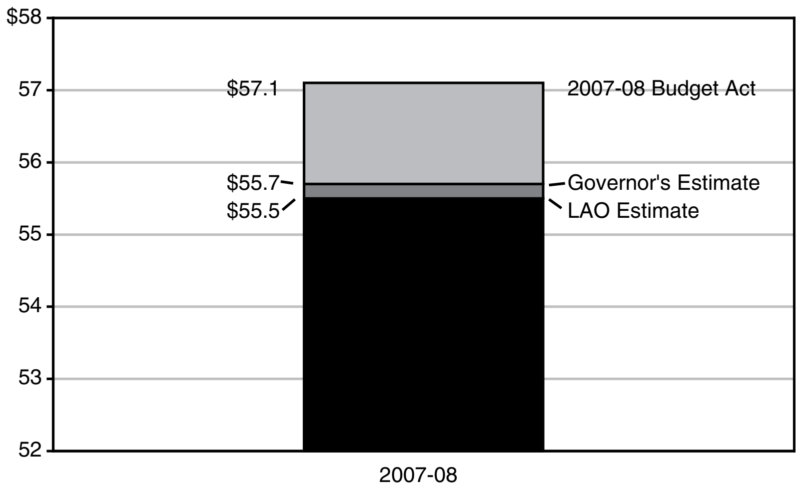
Current Year

Estimates for state tax revenues in the current year have declined significantly from when the 2007-08 budget was enacted. Correspondingly, the estimate of the Proposition 98 minimum guarantee has also dropped. Figure 1 compares the Governor's and our estimates for the revised 2007-08 Proposition 98 requirement, based on our different forecasts of General Fund revenues.

Figure 1

Estimates for 2007-08 Minimum Guarantee Have Dropped Since Budget Act

(In Billions)



Governor Estimates Minimum Guarantee Has Dropped by $1.5 Billion. The Governor estimates General Fund revenues have declined by around $4 billion compared to what was assumed when the 2007-08 budget was enacted. As a result, the administration's estimate of the minimum guarantee is about $55.7 billion. This is almost $1.5 billion lower than the Proposition 98 budget act funding level.

LAO Estimates Minimum Guarantee Has Dropped an Additional $125 Million. As discussed in our companion publication, *The 2008-09 Budget: Perspectives and Issues (P&I)*, our estimate of 2007-08 General Fund tax revenues is roughly $300 million lower than the Governor's forecast. Consequently, our estimate for the minimum guarantee is also slightly lower. As shown in the figure, the minimum guarantee is now estimated to be $55.5 billion, or roughly $1.6 billion below the budget act spending level.

Action Needed to Reduce Spending to Minimum Guarantee. Estimates for the minimum guarantee will continue to fluctuate until General Fund revenues are finalized in the fall of 2008. While the K-14 funding *requirement* may drop in response to decline in General Fund revenues, Proposition 98 *spending* does not adjust on the natural. The Legislature would need to take action in the current year to reduce Proposition 98 spending to the minimum guarantee.

Minimum Guarantee for 2007-08 Now Based on "Test 3." Under both the Governor's and our forecasts, the decline in revenue estimates has shifted the calculation used to determine the 2007-08 minimum guarantee from "Test 2"—which was assumed when the budget was enacted—to Test 3. In a Test 2 year, the minimum guarantee is based on growth in per capita personal income. When year-to-year growth in General Fund revenues is relatively sluggish, the state is allowed to provide less than would be required under Test 2. In such years, the minimum guarantee is based on growth in per capita General Fund revenue (Test 3).

Budget Year

In most years, the Proposition 98 minimum guarantee is based on the amount provided in the previous year. Thus, without knowing what the Legislature will ultimately decide to spend on Proposition 98 in 2007-08, it is difficult to predict the funding requirement for 2008-09. Nonetheless, this section describes the Governor's 2008-09 Proposition 98 proposal and explains how it would change under the updated LAO revenue forecast.

The Governor Proposes to Provide $55.6 Billion for K-14 Education in 2008-09. In response to a decline in the 2007-08 minimum guarantee, the Governor proposes to reduce current-year spending by $400 million. Figure 2 (see next page) shows how the Governor's proposed funding level of $56.7 billion in 2007-08 results in a minimum guarantee of slightly more than $59.6 billion in 2008-09. The figure also shows that the Governor's proposed funding level for 2008-09—$55.6 billion—is around $4 billion less than his calculation of the guarantee. Funding at this lower level would require the Legislature to suspend the Proposition 98 requirement. Please see the box on page 27 for more detail on how a Proposition 98 suspension works.

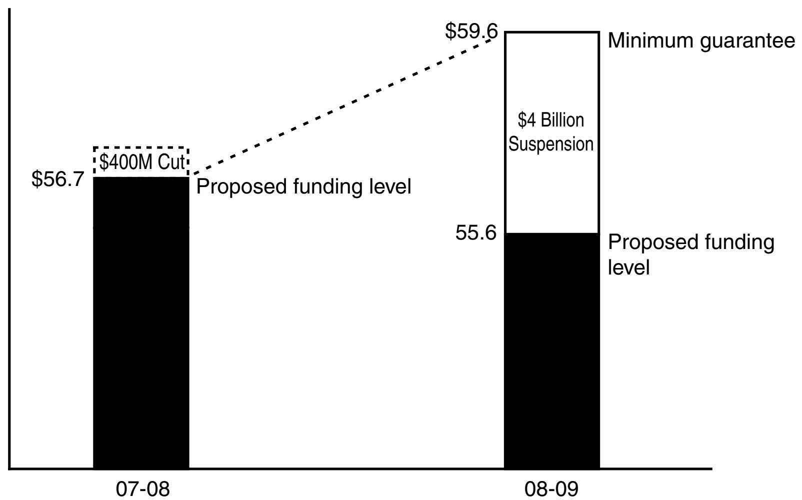
Governor's Accrual Proposal Helps Trigger Test 2 Year. As part of his budget package, the Governor proposes to attribute $2 billion in tax revenue that would be collected in 2009-10 back to 2008-09. (The details of this proposal and our concerns with this approach are discussed in our

P&I [Part V].) Accruing these dollars back to 2008-09 significantly increases the year-to-year General Fund per capita growth rate compared to what it otherwise would be—5.9 percent compared 3.8 percent. This one-time boost in General Fund revenues means the Proposition 98 minimum guarantee is calculated based on Test 2.

Figure 2

Governor's Budget-Year Guarantee Is Based on Current-Year Spending Level

(In Billions)



LAO Revenue Forecast Would Lower Amount of Governor's Suspension by $400 Million. Notwithstanding the issue of the accrual proposal, our forecast of *underlying* 2008-09 General Fund tax revenues is almost $1.2 billion lower than that of the administration. However, we have a slightly higher estimate of per capita personal income, the Test 2 growth factor (4.4 percent instead of 4.2 percent). The net result of these two differences is a somewhat lower estimate for the 2008-09 minimum guarantee. Specifically, we estimate a minimum guarantee of $59.3 billion in 2008-09 under the Governor's plan—around $400 million less than the Governor's estimate. Under his plan, a $400 million drop in the minimum guarantee would simply reduce the gap between the minimum guarantee and his proposed spending level. That is, the amount of the suspension would be reduced to $3.6 billion. The amount of funding going to schools in 2008-09, however, would remain unchanged.

Suspending Proposition 98

Although the State Constitution establishes a guaranteed level of funding for K-14 education each year, it also permits the Legislature to waive that requirement for a single year at a time. By a two-thirds vote in legislation separate from the budget bill, the Legislature can "suspend" the Proposition 98 minimum guarantee and provide less education funding than would otherwise be required by the constitutional formulas. Suspension is a tool that allows the Legislature to balance K-14 priorities with its other General Fund priorities without being constrained by formula-driven requirements.

Suspension has taken place only once since Proposition 98 was enacted—in 2004-05. Chapter 213, Statutes of 2004 (SB 1101, Senate Budget and Fiscal Review), authorized the suspension. Certain language in Chapter 213 led to a disagreement over the size of the suspension. The disagreement ultimately led to a statutory commitment to provide additional funding to K-14 education. Specifically, a dispute arose over whether Chapter 213 intended to lock in place the amount of the *suspension* or a specific *spending* level.

To avoid future disagreement, the Legislature could vote to suspend the minimum guarantee without regard to the dollar amount of the suspension, spending at whatever level it deems appropriate. Suspending Proposition 98 gives the Legislature *full* discretion over what the K-14 funding level will be for that year.

While suspending the minimum guarantee allows the Legislature to fund K-14 education at whatever level it chooses, in subsequent years the state is required to accelerate growth in Proposition 98 funding. When General Fund revenues strengthen, the Constitution requires a relatively large share of new funding to go to Proposition 98—until overall K-14 funding is back to where it otherwise would have been absent the suspension. In this way, a Proposition 98 suspension can provide several years of savings for the state, but it only represents a limited-term funding reduction for schools and community colleges. The mechanism for accelerating growth in the K-14 funding base is known as maintenance factor and is described in more detail later in this section.

Revenue-Related Actions Will Affect Proposition 98 Requirements. If the Legislature chooses to make changes to the revenue-related policies included in the Governor's proposal, it will have an effect on the Proposition 98 minimum guarantee. In general, for each dollar of tax revenue the state raises, the minimum guarantee will increase by about 50 cents—until it reaches $59.7 billion (the "long-term Test 2 level"). Conversely, if the Legislature rejects the Governor's accrual proposal (or if General Fund tax revenues decline), the minimum guarantee would drop by about one-half of each dollar lost.

LOCAL PROPERTY TAX REVENUE

Lower Estimates of Local Property Tax Revenue Increase General Fund Obligation by Almost $1.4 Billion. Proposition 98 funding for school districts and community colleges is composed of both General Fund and local property tax revenue. In general, property tax revenue offsets the General Fund obligation for Proposition 98, so decreases in local revenue support result in a dollar-for-dollar increase in General Fund support. As shown in Figure 3, the amount of local property tax revenue available to support Proposition 98 has declined dramatically from what was assumed when the 2007-08 budget was enacted—by a cumulative total of almost $1.4 billion across 2005-06, 2006-07, and 2007-08. This downward adjustment results in an automatic increase in General Fund spending by a like amount.

Figure 3

Local Property Tax Revenue Going to Schools Lower Than Expected

(In Millions)

	2005-06	2006-07	2007-08
2007-08 Budget Act	$13,608	$14,203	15,646
Governor's budget	13,478	13,604	15,001
Differences[a]	**-$130**	**-$599**	**-$645**
Three-Year Total			**-$1,374**

[a] As a result of these reductions, the General Fund share of Proposition 98 spending increases automatically by a like amount.

Shortfall Largely Due to Overestimates. Of the $1.4 billion decline in local property tax revenues, $130 million is related to 2005-06. The administration states this decrease is due to a technical error that occurred when the *2007-08 Budget Act* was put together. The remainder of the shortfall results from an overestimate of K–14 property taxes for the prior and current years. In 2005-06, initial property tax receipts reported by school districts came in several hundred million dollars lower than the administration had originally projected. Believing mistakes might be occurring in county allocations or school district reporting, the state built the 2006-07 and 2007-08 budgets assuming the discrepancy was a one-time glitch and the "missing" property tax revenue from 2005-06 would be restored to base levels in subsequent years. A subsequent audit by the State Controller's Office found no major errors in county allocation of property taxes or K-14 revenue reporting. Thus, the administration had to revise its estimates for the prior and current years, leading to a downward adjustment of around $600 million in each year.

Updated Data Suggest Slightly Higher Property Taxes for 2006-07 and 2007-08. Based on updated 2006-07 property tax data obtained by the LAO after the Governor's budget was prepared, it appears school property tax revenues might be higher in both the prior and current years. As shown in Figure 4, property tax revenues for 2006-07 are $185 million higher than estimated in the Governor's budget. We assume this 2006-07 base will carry forward, and thus have a higher estimate for the current year (up $119 million). These additional revenues result in a like amount of General Fund savings. They also partly offset the large shortfall described above.

Figure 4

Property Tax Revenues Likely Higher Than Forecasted for Prior and Current Year

(In Millions)

	2006-07	2007-08	2008-09
Governor's budget	$13,604	$15,001	$16,046
LAO forecast	13,789	15,120	16,047
Differences	**$185**	**$119**	**$1**

School Property Tax Forecast Same for 2008-09. Compared to the administration, we forecast slower growth in local property tax revenue going to schools (6.1 percent compared to 7 percent). Although we anticipate a higher property tax revenue base in 2007-08, as a result of the interaction of these two factors (base and growth rate), our estimate for the amount of revenue schools will receive in 2008-09 is almost exactly the same as that of the administration ($16 billion).

OTHER PROPOSITION 98 FUNDING ISSUES

In addition to the annual minimum guarantee, the state faces a number of other Proposition 98-related funding issues. Many of these are obligations left over from the state's last budget downturn in the early part of the decade. In some cases, addressing these commitments will require additional General Fund resources, whereas some can be funded from within the annual Proposition 98 appropriation. Figure 5 provides a brief summary of these funding issues under the Governor's budget proposal. Below, we discuss them in greater detail.

Proposition 98 Settle-Up Obligations

A settle-up obligation is generated when K-12 attendance or General Fund revenues *increase* after the budget is enacted—resulting in a Proposition 98 minimum guarantee that is higher than the funding level included in the budget act. In 2006, the California Department of Education and the Director of Finance determined the state owed schools roughly $1.4 billion to meet the minimum guarantee for four prior years—1995-96, 1996-97, 2002-03, and 2003-04.

In 2006-07, the state paid $300 million towards this obligation, leaving the amount owed at $1.1 billion. Chapter 216, Statutes of 2004 (SB 1108, Committee on Budget and Fiscal Review) calls for annual payments of $150 million beginning in 2008-09 for the purposes of repaying these settle-up obligations. As Figure 5 displays, the proposed budget includes the budget-year payment. As directed by Chapter 216, first call on these funds is to pay schools and community colleges for the costs of prior-year mandates.

As discussed earlier in this section, recently updated 2006-07 data suggest the minimum guarantee calculation is higher than the amount of funding provided in that year, meaning the state currently owes an estimated $160 million in settle-up payments for 2006-07.

Chapter 751

In addition to settle-up, the state made a statutory commitment relating to the Proposition 98 suspension in 2004-05. Chapter 751, Statutes of 2006 (SB 1133, Torlakson), appropriates $2.8 billion for K-14 education to be paid out over a seven-year period. This funding comes from the General Fund and is in addition to ongoing Proposition 98 funding provided each year. The state provided an initial payment of $300 million in 2007-08.

Figure 5

Proposition 98 Funding Issues

(In Millions)

	Description	Governor's 2008-09 Proposal: Amount Added (+) Or Paid (-)	Governor's 2008-09 Proposal: Total Left
Settle-Up	***Constitutional Obligation.*** Results when Proposition 98 minimum guarantee increases after budget has been enacted. State still owes $1.1 billion for 2002-03 and 2003-04. Under current law, scheduled to be paid in $150 million installments from the state General Fund over next eight years (to be used first for mandate reimbursements).	-$150	$951
Chapter 751	***Statutory Commitment.*** Relates to disagreement over Proposition 98 suspension in 2004-05. Under current law, $2.5 billion scheduled to be paid in $450 million installments from the state General Fund over next six years. Funds are on top of ongoing Proposition 98 funding.	-450	2,097
Mandates	***Constitutional Obligation.*** Reimburses K-14 education for mandated activities. Payments have been delayed for several years. Prior-year claims can be paid with one-time Proposition 98 funds (such as settle-up funds). Annual ongoing costs for already approved mandates can be funded with ongoing Proposition 98 monies.	55[a]	567
Deferrals	***Current Practice.*** Pays schools and colleges in July for activities they undertake in June of previous fiscal year. Funding shift helped state get one-time savings. Shifting payments back to June can be accomplished with one-time Proposition 98 funds.	—	1,303
Revenue Limit Deficit Factor	***Proposed Statutory Commitment.*** Governor proposes to reduce revenue limits and create new statutory deficit factor. Would require specific percentage growth to be added to revenue limit funding base in the future. Would be funded with ongoing Proposition 98 monies.	2,146[b]	2,146[b]
Maintenance Factor	***Constitutional Obligation.*** When Proposition 98 funding is less than the "long-term Test 2" level, a maintenance factor is generated. In subsequent years, formula accelerates growth in Proposition 98 funding until the long-term Test 2 level is reached.	4,053	4,077

[a] Governor's proposal would pay $154 million towards mandate claims ($150 million in settle-up and $4 million ongoing). However, annual costs of mandates are estimated to be $209 million, so proposal increases unpaid obligations by $55 million.

[b] Reflects Governor's proposal to change the factor used to calculate K-12 cost-of-living adjustments (COLAS). The Governor's calculation of the deficit factor under the existing statutory COLA rate is $2.6 billion.

For 2008-09, the Governor's budget includes $450 million from the General Fund to meet the terms of Chapter 751. Of this amount, $402 million would support the "Quality Education Investment Act," which pays for reduced class sizes and other instructional improvements in low-performing schools across the state. The other $48 million would go to the community college system for a career technical education improvement program ($38 million) and a block grant for equipment and supplies ($10 million).

Mandates

Since 2001-02, the state has delayed reimbursing schools and community colleges for mandate claims. In essence, the state has required that schools undertake certain activities but has not paid them for the costs they have incurred. We estimate the annual costs of funding existing mandated activities would be around $209 million ($180 million for K-12 education and $29 million for community colleges). While the state made a large payment for outstanding mandate claims in 2006-07—eliminating debts from several prior years—in recent years it has provided virtually no funding for *ongoing* mandate costs. As a result, the balance of outstanding mandate claims continues to grow, as shown in Figure 6.

Figure 6

K-14 Unfunded Mandate Claim Balance Grows

Governor's Budget
(In Millions)

	2006-07	2007-08	2008-09
K-12 Education			
Outstanding from prior years	$1,018	$226	$398
Ongoing cost	165	172	180
Payment	-957	—	-125
Subtotals, K-12 outstanding claims	($226)	($398)	($453)
California Community Colleges (CCC)			
Outstanding from prior years	100	89	114
Ongoing cost	29	29	29
Payment	-40	-4	-29
Subtotals, CCC outstanding claims	($89)	($114)	($114)
Totals, Outstanding Claims	**$315**	**$512**	**$567**
Totals, Mandate Claim Payments	**$997**	**$4**	**$154**

In accordance with Chapter 216, the Governor's budget includes $150 million in one-time funds to reimburse districts for prior-year mandate costs ($125 million for K-12 and $25 million for community colleges). (As described earlier, these one-time General Fund payments are scored as meeting Proposition 98 settle-up obligations.) However, the budget proposal contains only $4 million in ongoing funding for community college mandates and virtually none for K-12 schools. As a result, we estimate that under the Governor's proposal the total outstanding mandate obligation will grow to $567 million at the end of 2008-09.

Deferrals

In 2001-02, when the Proposition 98 minimum guarantee dropped in the middle of the year, the Legislature needed to find a way to reduce spending without causing great disruption to schools. In response, it deferred significant education costs to the subsequent fiscal year. Rather than schools taking an actual midyear cut, these deferrals resulted in school districts and community colleges receiving some state funds a few weeks later than normal. Because payments were made in July instead of June, the state was able to score the expenditures in 2002-03 instead of 2001-02. To achieve further budget savings in 2002-03, the state deferred additional payments to 2003-04. In subsequent years the Legislature has opted to continue the majority of these deferrals ($1.3 billion in total—$1.1 billion for K-12 education and $200 million for community colleges). Retiring the deferrals—that is, shifting the payments back a month so schools receive the funds in the same fiscal year they incur the related costs—would require a one-time Proposition 98 payment. The Governor's budget proposes to not only continue these deferrals, but to shift the payments from July to September in order to help the state's cash flow.

Deficit Factor

To achieve budget solution in 2003-04, the state made reductions to K-12 revenue limits. Rather than making these reductions permanent, the Legislature opted to create an obligation to add the foregone amount—referred to as the "deficit factor"—to the revenue limit base in future years. (This was accomplished in 2005-06.) As part of his budget balancing reductions, the Governor proposes to create a new revenue limit deficit factor in 2008-09 totaling $2.1 billion. (The Governor is also proposing to change the factor used to calculate K-12 cost-of-living adjustments [COLAs]. Using the Governor's estimate for the existing statutory COLA rate, the deficit factor would be $2.6 billion.)

Alternatively, the Legislature could decide to accept some or all of this reduction but *not* establish a deficit factor. That is, it could lower base revenue limits *without* establishing a statutory commitment to restore the reduction in the future. This would give the Legislature the option of spending future Proposition 98 monies to enhance revenue limits or for other K-14 priorities. Under the Governor's proposal, the state would spend future Proposition 98 monies to build up the revenue limit funding base by this amount.

Maintenance Factor

Over the long run, the Proposition 98 minimum guarantee is determined by the Test 2 factor—growth in K-12 attendance and growth in per capita personal income. As discussed earlier, the Constitution allows the Legislature to appropriate funding for K-14 education below this long-term Test 2 level under two circumstances:

- ***Suspension.*** The Legislature suspends the spending requirements of Proposition 98.
- ***Test 3.*** The Constitution automatically reduces the minimum guarantee when per capita General Fund revenues grow more slowly than per capita personal income.

The difference between the minimum guarantee in any particular year and the long-term Test 2 level of spending is known as maintenance factor. Whenever maintenance factor is created, the Constitution requires the state to provide accelerated growth in Proposition 98 funding in future years—until it has reached the long-term Test 2 level. The Constitution requires the state to provide maintenance factor funding only in Test 1 or Test 2 years, when General Fund revenues grow faster than personal income. These required augmentations often boost K-14 revenues substantially when the state is emerging from an economic slowdown.

Governor's Proposal Would Result in a Maintenance Factor of $4.1 Billion. As discussed earlier, the Governor proposes to suspend Proposition 98 in 2008-09. The $4 billion gap between the Governor's minimum guarantee (roughly $59.6 billion) and his proposed spending level ($55.6 billion) creates a like amount of maintenance factor. Coupled with a small amount of existing maintenance factor, the Governor's proposal would leave K-14 spending about $4.1 billion below the long-term Test 2 level. Over the coming years, the constitutional formulas will accelerate growth in K-14 funding such that this amount is built into the Proposition 98 minimum guarantee until the long-term Test 2 level is reached.

COLA

The current index used to calculate cost-of-living adjustments (COLAs) for K-12 programs—the state and local government price deflator—is not a particularly good indicator of increases in school costs. In response, the Governor proposes to switch the COLA index to a modified version of the California Consumer Price Index for Wage Earners and Clerical Workers. Because his proposed index focuses on cost increases experienced by **employees** ***rather than those of*** **employers*****, we recommend the Legislature reject the administration's proposal. Instead, we recommend the Legislature modify the current K-12 COLA index to focus on projected compensation cost increases. Because neither the Governor's proposal nor our suggested alternative is likely to have an immediate effect in the budget year, we believe 2008-09 is the ideal time to make this switch.***

Each year, the budget provides most Proposition 98 programs with a cost-of-living adjustment (COLA), or an increase in funding to reflect the higher costs schools and community colleges experience due to inflation. For K-12 education, some programs (including revenue limits, or general purpose funds) are statutorily required to receive this adjustment, whereas others receive the adjustment at the Legislature's discretion. Although there is no statutorily required COLA for community colleges, the budget typically adjusts their apportionments (general purpose monies) and about one-quarter of their categorical programs based on the K-12 COLA rate. School districts and community colleges generally use a portion of this new funding to provide annual increases to employee salaries through "step and column" salary schedules and raises. Depending on local collective bargaining agreements, the rate of the employee adjustment may be more or less than the COLA rate the state is providing. In addition to salary adjustments, COLA funding also goes to address cost increases for local operating expenses including employee benefits, utilities, materials, and supplies.

Both the administration and our office have concerns with the existing index used to calculate the K-12 COLA. Namely, it is heavily influenced by cost increases in areas that do not significantly affect schools and community colleges. Below, we describe problems with the existing K-12 COLA index, discuss our concerns with the Governor's proposed change, and offer an alternative we believe would better measure schools' primary inflationary pressures. Finally, we compare rates and costs of the existing index with the two proposed alternatives from 2003-04 through 2008-09 (projected). Because a COLA might not be provided to K-14 education in the budget year, we believe 2008-09 is the ideal time to change the COLA formula, as it would have no fiscal effect on districts.

Current COLA Index Not a Good Measure of Typical School Cost Pressures

Under current law, the K-12 COLA rate is based on the gross domestic product price deflator for purchases of goods and services by state and local governments (GDPSL). This index, calculated by the federal government, is designed to reflect changes in costs experienced by state and local governments around the country. (Local governments include cities, counties, schools, and special districts such as fire districts.) To reflect the multiple categories in which state and local governments spend money, the GDPSL has several components. Figure 1 displays the primary components of the GDPSL and the types of costs they include.

Figure 1

Primary Cost Components of the State and Local Price Deflator

- ✓ ***Employee Compensation.*** Includes salaries and benefits for government employees.
- ✓ ***Services.*** Includes utilities and contracted services (such as financial, professional, and business services).
- ✓ ***Structures/Gross Investment.*** Includes capital outlay, construction, and deferred maintenance.
- ✓ ***Nondurable Goods.*** Includes gasoline, office supplies, and food.
- ✓ ***Durable Goods.*** Includes books, tools, and equipment.

Two GDPSL Components Have Been Growing Rapidly in Recent Years. Figure 2 compares the K-12 COLA rate with the growth rates for the primary inputs to the GDPSL over the most recent five-year period. The figure shows that costs for structures and nondurable goods have experienced rapid growth rates in recent years. Several national and international factors have contributed to these cost increases, including the hurricanes of 2005, instability in the Persian Gulf, and growing demand for steel on the international market. The recent increases in these two categories have contributed to a higher overall GDPSL and K-12 COLA.

Figure 2

The K-12 Cost-of-Living Adjustment (COLA) and Its Underlying Components

Annual Growth Rates

	2004-05	2005-06	2006-07	2007-08	2008-09[a] Estimate
K-12 COLA	2.4%	4.2%	5.9%	4.5%	5.4%
Underlying Components					
Employee compensation	3.3%	3.0%	3.9%	4.1%	4.3%
Services	2.6	3.7	5.4	3.8	4.2
Structures	2.5	6.6	7.7	6.5	5.9
Nondurable goods	4.4	11.8	14.0	6.0	9.9

a Based on LAO projections. The Governor's budget projected a K-12 COLA of 4.9 percent for 2008-09, but recently released fourth quarter 2007 data indicate the annual COLA rate likely will be higher.

Current COLA Index Not Reflective of Typical School Expenses... The cost factors that school districts and community colleges actually face are somewhat different from those reflected in the GDPSL. Although the GDPSL measures the costs of state and local government agencies, schools and colleges typically have different expenditure patterns than many other government entities. Figure 3 (see next page) compares the expenditure patterns of a typical California school to the relative component "weights" of the GDPSL. (Expenditure patterns for community colleges are comparable to those of K-12 schools.) The figure shows a typical school spends about 85 percent of its annual General Fund budget on employee salaries and benefits. In contrast, employee compensation makes up only around 56 percent of the GDPSL. Conversely, the overall GDPSL is significantly more affected by cost increases in energy and construction than are typical K-14 General Fund budgets. (K-14 construction expenditures are typically supported by bond funds and developer fees rather than Proposition 98 and have an alternative COLA mechanism.)

Figure 3

Current COLA Not Reflective of Typical School Expenses

	Share of Average School Expenditures	"Weight" in K-12 COLA Calculation
Employee compensation	83%	56%
Services and nondurable goods	14	35
Structures and durable goods	3	17
Income[a]	—	-8
Totals	**100%**	**100%**

[a] Some government agencies receive income from activities such as charging tuition or fees. This income offsets costs in other areas.

...So Current COLA Does Not Reflect Schools' Actual Costs of Inflation. Because the make-up of the GDPSL differs from the makeup of typical school expenditures, in some years the GDPSL may overstate and in others underestimate actual school costs. For example, as shown in Figure 2, in 2004-05, inflation for the employee compensation component of the GDPSL was 3.3 percent, but the K-12 COLA rate was 2.4 percent. Because compensation costs are schools' and community colleges' primary expenditure, in 2004-05 they likely had to absorb compensation increases without corresponding COLA funding from the state. In contrast, the overall K-12 COLA rate has been driven upward in recent years by inflation in gasoline and construction costs, causing it to be significantly higher than growth in the employee compensation component. For example, in 2006-07, general government employee compensation costs increased by 3.9 percent, while the K-12 COLA provided to schools and community colleges was 5.9 percent. This indicates using the GDPSL as the COLA for Proposition 98 programs likely has overcompensated schools for the costs they faced in recent years.

Governor's Proposed COLA Not Based on Employer Costs

In an effort to better align the COLA with the cost pressures schools actually face, the Governor proposes to change the index used to calculate the K-12 COLA from the GDPSL to a modified version of the California Consumer Price Index for Wage Earners and Clerical Workers (CA CPI-W). The proposed change would take effect beginning in the budget year. As of early January, the Governor estimated this change would lower the 2008-09 K-12 COLA from 4.94 percent to 3.65 percent. Based on updated economic data, the proposed change would lower the rate from 5.43 percent (GDPSL) to 4.40 percent (CA CPI-W).

The CPI Measures Changes in Consumer Prices. The United States Consumer Price Index (CPI) measures changes in the prices consumers in urban areas pay for a fixed "market basket" of goods and services. This market basket is constructed based on surveys of consumer expenditure patterns. Figure 4 displays the broad consumer purchase categories included in the CPI price calculation, with each category covering many items. The CPI-W is a subset of the CPI based on the spending patterns of urban consumers who work in clerical or wage occupations. While wage earners' spending patterns tend to differ slightly from those of the larger urban population, the items included in the market basket for the CPI-W are the same as displayed in Figure 4.

Figure 4

Categories of Goods and Services Included in the Consumer Price Index

- ✓ Food and beverages
- ✓ Housing
- ✓ Apparel
- ✓ Transportation
- ✓ Medical care
- ✓ Recreation
- ✓ Education and communication

Administration's Proposal Based on CA CPI-W. Although the CPI-W is a national index, it is built up from metropolitan-area information throughout the country. As a result, the federal government also produces data reflecting consumer prices in California's two largest urban areas—Los Angeles and San Francisco. State economists use data from the two regions to calculate a state-specific urban price index, known as the CA CPI-W. Many of the state's county public health departments use this index to calculate annual COLAs for their employee salaries. The Governor's proposed change for the K-12 COLA would use an unweighted version of the CA CPI-W.

Administration Believes CA CPI-W Better Measure of School Costs. Because employee salaries are the largest expenditure category for both K-12 school districts and community colleges, the administration suggests *employees'* inflationary pressures (that is, increases in their own costs of living) are what drive most of *schools'* inflationary pressures. Therefore, according to the administration, a measure reflecting employees' consumer costs is a more appropriate COLA than the GDPSL.

Proposed Index Does Not Reflect Employer Cost Pressures. Because the CA CPI-W focuses exclusively on consumer costs, it may be influenced by cost increases that have no bearing on schools' operational expenses. For example, housing costs make up around 43 percent of the CPI-W market basket. As such, an upsurge in housing and rental prices would have a large effect on the CA CPI-W. In contrast, this market trend would have little *direct* effect on school costs. Moreover, the CA CPI-W does not include certain employer-driven costs schools might incur. For example, the CA CPI-W does not account for the rising costs of providing employee benefits, which make up one-fifth of the average school's budget. Employee benefits include both health care and retirement.

Modify Current COLA Index to Better Reflect School Costs

Because the state is providing K-12 COLA funding to schools and colleges—the employers—and not directly to the employees, we believe the GDPSL is a more appropriate inflationary measure than the administration's proposal. However, the overall GDPSL index does not accurately reflect cost increases schools actually face. Therefore, we recommend the Legislature change statute to modify the way the K-12 COLA is calculated. Specifically, instead of using the total GDPSL, we recommend using just the employee compensation component of the index. This would account for inflationary changes in employer costs for both salaries and benefits.

Employee Compensation Component Most Reflective of School Costs. Using all of the various GDPSL components to reconstruct a new K-14 inflationary index would be complicated and likely still inaccurate. For this reason, focusing on the largest cost category seems to make the most sense. Because employee compensation (salaries and benefits) make up 85 percent of total school expenditures, inflation in this area is their primary cost pressure. Changing the K-12 COLA to be based on this factor would better track with the inflationary pressures schools and colleges experience. This approach also results in greater simplicity and transparency, making it easier for all parties to understand.

Other Costs Make Up Relatively Small Share of School Budgets. Depending on inflationary trends in other school cost categories (such as utilities and supplies), focusing on employee compensation will slightly over-compensate schools in some years and under-compensate in other years. However, no existing index or inflationary component perfectly compensates schools for their actual cost increases.

National Index Provides More Independent Reflection of Cost Increases. Although one might argue that a California-specific employee compensation index would be a better inflationary measure than one based on national trends, no such measure exists. (As discussed, the CA CPI-W, while California specific, does not measure employer costs.) Moreover, annual salary increases for school and college employees are generally established through local collective bargaining agreements, so basing the K-12 COLA on employee compensation trends only in California could conceivably create a scenario where local bargainers are able to influence the state COLA rate. Under this scenario, each time local unions negotiated a higher local COLA, it would increase statewide employee compensation rates, which in turn would increase the statewide COLA. As a result, the state would end up "chasing its tail," with local efforts driving the statewide COLA ever higher. By using an index of employee compensation trends across the country, compensation changes in California schools and colleges would have a limited influence on the overall COLA factor.

Maintain Methodology and Timing of Current Index. Although we recommend a change in how the current index is used, we would suggest maintaining the same timing used to calculate the current K-12 COLA. That is, for 2008-09 the COLA would be based on GDPSL data from the final three quarters of 2007 and the first quarter of 2008, compared to data from the previous four quarters. This methodology allows the state to base the K-12 COLA on the most recent data available while still being able to "lock in" a rate in time for the May Revision and final budget planning.

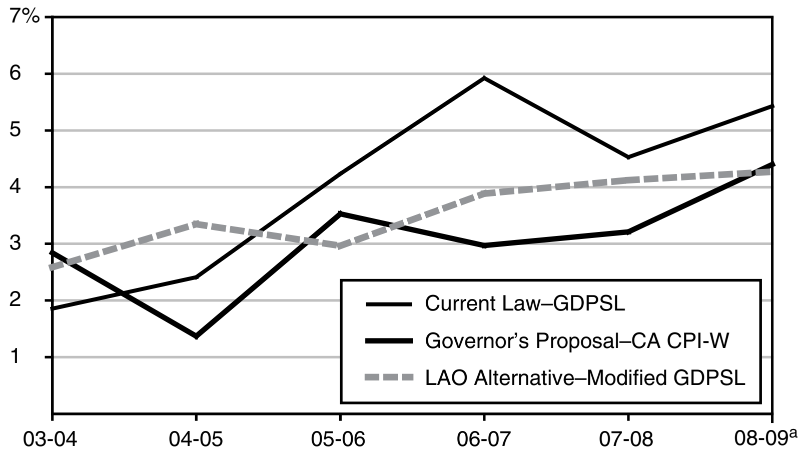
Comparing K-12 COLA Options Over Time

Figure 5 (see next page) displays actual growth rates for the GDPSL, the CA CPI-W, and the employee compensation component of the GDPSL from 2003-04 to 2007-08, as well the projected growth rates for 2008-09. As shown, no one index is consistently higher than the others. Growth in the GDPSL was lower in the first part of the decade, then spiked in recent years due to rising gasoline and construction costs. Gasoline and construction costs had less of an effect on the CA CPI-W and no effect on the compensation component of the GDPSL. As a result, the growth rates for these indices have been lower in recent years. However, looking back at the GDPSL and its components over the past 20 years, the employee compensation component has grown more quickly than the overall index 75 percent of the time.

Figure 5

Comparison of K-12 COLA Rates Under Different Indices

2003-04 Through 2008-09



[a] Estimated. Based on revised data.

Costs of Existing COLA Rate Higher Than Alternatives in Recent Years. Over the past four years (2004-05 through 2007-08), the state paid approximately $8.3 billion to fund COLAs for K-14 education. Had the K-12 COLA been calculated over the same time period using either the Governor's proposed index or our alternative, the costs would have been less—$5.4 billion or $6.9 billion, respectively. This is because, as illustrated in Figure 5, the existing COLA rate has been notably higher than the two proposed alternatives in recent years.

Existing COLA Rate Expected to Be High Again in 2008-09. As shown in Figure 6, we project the GDPSL will continue to be higher than the two alternatives in 2008-09. The figure shows that providing COLAs at the current statutory rate of 5.4 percent to the K-14 programs that typically get them would cost the state approximately $3 billion in 2008-09. In contrast, estimates are lower for both the Governor's proposed index and our alternative—4.4 percent (revised) and 4.3 percent, respectively—each resulting in a cost of around $2.4 billion.

Figure 6

Comparing 2008-09 COLA Costs Under Each Option

(Dollars in Millions)

	Current Law	Governor's Proposal	LAO Alternative
COLA Rate[a]	5.43%	4.40%	4.27%
COLA Costs:			
K-12 revenue limits[b]	$1,943	$1,574	$1,528
K-12 categoricals[c]	729	591	573
Community colleges[d]	341	276	268
Totals	**$3,013**	**$2,441**	**$2,369**

a Based on updated data. The Governor's budget estimated a current law K-12 COLA rate of 4.94 percent and CA CPI-W rate of 3.65 percent.

b Includes revenue limits for both K-12 districts and county offices of education.

c Cost for K-12 programs that typically receive an annual COLA.

d Includes apportionments and categoricals that typically receive a COLA.

Because COLA Rate Likely Will Not Matter in 2008-09, the Time Is Right to Make a Change. Neither the Governor's proposal to base the K-12 COLA on the CA CPI-W nor our alternative is likely to have an immediate effect in the budget year. This is because K-14 education programs may not receive a COLA in 2008-09. (Neither the Governor's proposed budget nor the LAO alternative include COLAs.) As a result, the budget year seems the ideal time to switch to a better measure. The Legislature has the opportunity to consider the merits of the different proposals without being overly concerned about fiscal "winners and losers" in the budget year. (Depending on whether the Legislature chooses to create a deficit factor for foregone COLAs, making the change in 2008-09 could have a fiscal effect on future K-12 revenue limits, as described in the box on the next page.)

If Legislature Creates a Deficit Factor in 2008-09, Budget-Year COLA Rate Would Have Out-Year Fiscal Effect

While the Governor's budget proposal does not include COLAs for K-14 education programs, the administration does propose to create a "deficit factor" for K-12 revenue limits. In the past when the budget provided less than a full COLA for revenue limits, the state kept track of the difference and after a number of years restored K-12 revenue limits to where they otherwise would have been absent the reduction. (The deficit factor is discussed in "Introduction: K-12 Education," a subsequent section of this chapter.) The Legislature, however, is under no obligation to create a deficit factor. If the Legislature *does* opt to create a deficit factor for foregone COLAs in 2008-09, switching the COLA factor would have an out-year fiscal effect. Figure 6 shows the calculated revenue limit COLA under each of the three proposals. Because it is a higher rate, maintaining the current statutory COLA would have a greater out-year fiscal effect ($1.9 billion), compared to both the Governor's and our proposed changes ($1.6 billion and $1.5 billion, respectively).

Conclusion

No existing index provides a truly accurate measure of the inflationary costs experienced by California K-12 schools and community colleges. Among the few reasonable options that exist, we believe the employee compensation component of the GDPSL provides the Legislature the best option for estimating schools' and community colleges' actual cost increases. This alternative is simple and transparent and reflects the vast majority of typical school expenditures. Because changing the COLA factor likely will not have an effect on school funding in 2008-09, we believe the time is right for the Legislature to take action to more closely align the K-12 COLA rate with the costs schools and community colleges actually face.

Introduction

K-12 Education

Under the administration's proposal, total K-12 education funding from all sources would decline by $2.2 billion, or 3.1 percent, compared to 2007-08. Changes in Proposition 98 funding account for about one-half of this decrease. The budget proposes to decrease K-12 Proposition 98 funding by $1.1 billion, or 2.2 percent, from the revised 2007-08 level. The Proposition 98 budget proposal would reduce funding for all K-12 programs compared to current-year levels, although the size of the reduction would vary by program.

Overview of K-12 Education Funding

Figure 1 (see next page) displays all significant funding sources for K-12 education for 2006-07 through 2008-09. As the figure shows, Proposition 98 funding constitutes over 70 percent of overall K-12 funding. The Governor's Proposition 98 funding level for K-12 education in 2008-09 is $1.1 billion, or 2.2 percent, less than the 2007-08 level. An even greater decline in General Fund support (-$2 billion) is partially offset by a year-to-year increase in local property tax revenue ($0.9 billion). Other funding for K-12 education declines by roughly $1.1 billion, or 5.3 percent, from the 2007-08 level. The figure also shows Proposition 98 funding per average daily attendance(ADA) would decline year over year by $145. Under the Governor's proposal for 2008-09, Proposition 98 per pupil funding would be $8,368. This is discussed in more detail in the "Per Pupil Funding" section of this chapter.

Teachers' Retirement Costs (Decrease of $424 Million). The Governor's budget includes $1.1 billion in 2008-09 for the state's annual K-12 contributions to the California State Teachers' Retirement System (CalSTRS)—down $424 million from the state's contributions in 2007-08. Year-to-year comparisons are complicated because the 2007-08 amount is inflated by a $500 million payment resulting from the state losing a court case involving a one-time reduction of payments to CalSTRS four years ago. The 2008-09 amount also contains an $80 million payment to comply with other court-ordered obligations. This is offset by an $80 million reduction related to the administration's proposal for the state to guarantee—for the first time—one category of CalSTRS benefits in exchange for a reduction in the state's payments to the program. Absent all these factors, state contributions are projected to rise about 7 percent between 2007-08 and 2008-09 due to rising teacher payroll. Please see the "CalSTRS" section of this chapter for more discussion of these issues.

Figure 1

K-12 Education Budget Summary

(Dollars in Millions)

	Actual 2006-07	Revised 2007-08[a]	Proposed 2008-09	Changes From 2007-08	
				Amount	Percent
K-12 Proposition 98					
State General Fund	$37,264	$37,473	$35,460	-$2,013	-5.4%
Local property tax revenue	11,753	12,949	13,850	901	7.0
Subtotals	($49,017)	($50,423)	($49,310)	(-$1,112)	(-2.2%)
Other Funds					
General Fund					
Teacher retirement	$876	$1,535	$1,111	-$424	-27.6%
Bond payments	1,764	2,084	2,381	297	14.3
Other programs	440	1,221	985	-236	-19.3
State lottery funds	979	936	936	—	—
Federal funds	6,832	6,698	6,316	-382	-5.7
Other	7,226	7,791	7,467	-324	-4.2
Subtotals	($18,117)	($20,264)	($19,197)	(-$1,068)	(-5.3%)
Totals	**$67,134**	**$70,687**	**$68,507**	**-$2,180**	**-3.1%**
K-12 Proposition 98					
Average daily attendance (ADA)	5,951,933	5,922,913	5,892,449	-30,464	-0.5%
Budget amount per ADA	$8,235	$8,513	$8,368	-$145	-1.7%

[a] Reflects Governor's proposal for 2007-08.

Totals may not add due to rounding.

Repaying Bonds for School Facilities (Increase of $297 Million). The bulk of this increase in debt service is due to recent investments the state has made in school facilities through Proposition 47 (2002) and Proposition 55 (2004). These measures authorized the state to sell a total of $21.4 billion in bonds for school facilities. Proposition 1D, approved by the voters in November 2006, authorized an additional $7.3 billion for school facilities. (Not reflected in Figure 1, and distinct from debt-service payments on already sold bonds, is the Governor's proposed $4.4 billion in expenditures from yet unused prior-year bond monies as well as new bond monies available from Proposition 1D. This is discussed in more detail in the "School Facilities" section of this chapter.)

Other Programs (Decrease of $236 Million). The figure shows a $236 million decrease in funding for other programs supported by the General Fund. This is the net result of both decreases and increases in one-time spending compared to 2007-08—roughly $500 million less from the Proposition 98 reversion account, offset by an additional $134 million for the Quality Education Investment Act and $125 million in spending for mandates to meet prior-year Proposition 98 "settle-up" obligations. This category also includes the Governor's proposed across-the-board reductions to non-Proposition 98 K-12 state programs, including administrative activities at the California Department of Education and State Special Schools.

Federal Funding (Decrease of $382 Million). Because the Governor's budget was prepared before final information was available from the federal government, the federal funding totals in Figure 1 will be updated in the coming weeks. Based on the information available at the time, the Governor's budget assumed a year-to-year decrease in federal funding of $382 million. The bulk of this change ($278 million) is an anticipated loss in federal funding resulting from the Governor's proposal to reduce state support for special education in 2008-09. This action would put the state out of compliance with a federal maintenance of effort requirement. This is discussed in more detail in the "Special Education" section of this chapter.

Governor's K-12 Proposition 98 Proposal

The Governor's budget package makes reductions to K-12 Proposition 98 spending in both the current and budget years. Figure 2 (see next page) shows the Governor's proposal to reduce K-12 spending in 2007-08 by $360 million compared to what the budget act provided, for total K-12 spending of $50.4 billion. Also shown in the figure, the Governor's proposed Proposition 98 spending level for K-12 education in 2008-09 is $49.3 billion—a reduction of more than $1.1 billion from the revised current-year level. Figure 2 summarizes the approach the administration used to build the K-12 budget for 2008-09.

Figure 2

K-12 Proposition 98 Budget Proposal

(In Millions)	
2007-08 Budget Act	**$50,796.7**
Reduction to revenue limits	-$360.0
Technical adjustments	-14.0
2007-08 Revised	**$50,422.6**
"Workload Budget" Adjustments	
Cost-of-living adjustment (4.94 percent)	$2,428.1
Restore funding for ongoing programs	566.6[a]
Restore 2007-08 reduction to revenue limit base	360.0
Make charter school facilities grant ongoing	18.0
Decline in average daily attendance	-121.0
High Priority Schools program adjustment	-29.0[b]
Other	0.9
Subtotal	($3,223.6)
Governor's "Workload" Estimate for 2008-09	**$53,646.2**
Governor's "Budget Balancing Reductions"	
Revenue limits	-$2,607.9
Categorical programs	-1,727.9
Subtotal	(-$4,335.8)
2008-09 Proposal	**$49,310.4**

a Portions of the deferred maintenance, Home-to-School Transportation, and High Priority Schools Grant programs were funded using one-time funds in 2007-08.

b Funding for the program is reduced due to schools exiting the program.

Governor's Workload Budget Adds $3.2 Billion. In constructing his 2008-09 budget for K-12 education, the Governor first built a hypothetical workload budget, providing adjustments to existing K-12 programs totaling $3.2 billion. Most of this increase ($2.4 billion) is for an estimated 4.9 percent cost-of-living adjustment (COLA) for revenue limits and categorical programs. Almost $1 billion more results from making existing programs "whole" by restoring the $360 million reduction to revenue limits and $566 million in ongoing costs funded with one-time monies in the current year. The workload budget also includes $18 million in ongoing funds for charter school facilities, a program previously funded using one-time funds. These increases are offset by about $120 million in projected savings from a 0.5 percent decline in statewide ADA and $29 million from schools exiting the High Priority Schools Grant Program.

Budget Balancing Reductions Total $4.3 Billion. From his workload budget level of $53.6 billion, the Governor makes a 10.9 percent across-the-board reduction to General Fund spending for each K-12 program. These reductions lower the workload budget by $4.3 billion—$2.6 billion from school district and county office of education (COE) revenue limits and $1.7 billion from categorical programs—resulting in the Governor's final K-12 Proposition 98 spending proposal of $49.3 billion.

Proposal Would Rebuild Revenue Limit Funding Levels in the Future. Consistent with past practice, the administration proposes trailer bill language that would *eventually* build the proposed reduction for K-12 district and COE revenue limits back into the revenue limit/funding base. This approach creates a new out-year obligation. Specifically, the proposed language creates a "deficit factor" that reduces revenue limits from the administration's workload budget—by 7 percent, or $2.6 billion, for K-12 districts, and 4.5 percent, or $33 million, for COEs. While schools would receive less than what statute calls for in 2008-09, the revenue limit funding base would be restored in future years. (The administration's proposal to change the K-12 COLA index would result in a smaller amount being restored in the future. See the "COLA" section of this chapter for more discussion of this proposal.) In contrast to the revenue limit deficit factor, the administration does not propose language to rebuild funding for reductions applied to K-12 categorical programs.

Proposition 98 Spending by Major Program

While the Governor measures reductions from his workload budget, a comparison of year-to-year funding levels shows the *actual* reductions schools would experience. Figure 3 (see next page) shows proposed Proposition 98 spending for major K-12 programs in 2007-08 and 2008-09. As shown in the figure, most large programs would be reduced between 6 percent and 8 percent from 2007-08 spending levels. The actual year-to-year change depends upon various underlying budget assumptions. In general, year-to-year program reductions fall into one of the following categories:

- ***No Growth or COLA—10.9 Percent Reduction.*** Roughly 20 Proposition 98 programs do not typically receive annual growth or COLA adjustments. As a result, the year-to-year change for these programs reflects the Governor's full 10.9 percent reduction. The largest program in this category is the After School Education and Safety Program. (This program is discussed in more detail in the "After School Programs" section of this chapter.)

Figure 3

Major K-12 Education Programs Funded by Proposition 98

(Dollars in Millions)

	Revised[a] 2007-08	Proposed 2008-09	Change	
			Amount	Percent
Revenue Limits				
General Fund	$22,847.4	$21,328.5	-$1,518.9	-6.6%
Local property tax revenue	12,549.9	13,413.2	863.3	6.9
Subtotals	($35,397.3)	($34,741.7)	(-$655.6)	(-1.9%)
Categorical Programs				
Special education[b]	$3,565.4	$3,359.6	-$205.8	-5.8%
K-3 class size reduction	1,829.7	1,689.2	-140.4	-7.7
Child care and development	1,761.4	1,626.3	-135.0	-7.7
Targeted Instructional Improvement Block Grant	1,075.7	1,000.8	-75.0	-7.0
Economic Impact Aid	994.3	929.7	-64.6	-6.5
Adult education	753.7	722.4	-31.3	-4.2
Home-to-School Transportation[c]	629.7	588.8	-40.9	-6.5
After School Education and Safety Program	547.0	487.4	-59.6	-10.9
Regional Occupational Centers and Programs[b]	524.6	492.0	-32.6	-6.2
School and Library Improvement Block Grant	465.5	433.0	-32.4	-7.0
Summer school programs	420.8	393.5	-27.3	-6.5
Instructional Materials Block Grant	419.8	390.5	-29.3	-7.0
Deferred maintenance[c]	277.4	262.2	-15.1	-5.5
Professional Development Block Grant	274.7	255.6	-19.1	-7.0
Grades 7-12 counseling	209.1	195.5	-13.6	-6.5
Public School Accountability Act[c,d]	149.2	107.1	-42.1	-28.2
Other	1,694.1	1,635.1	-59.0	-3.5
Subtotals	($15,591.9)	($14,568.7)	(-$1,023.2)	(-6.6%)
Totals	**$50,989.2[c]**	**$49,310.4**	**-$1,678.9**	**-3.3%**
Ongoing Proposition 98	**$50,422.6**	**$49,310.4**	**-$1,112.3**	**-2.2%**

a Reflects Governor's proposal for 2007-08.

b Includes local property tax revenue.

c Includes funding from one-time sources used for ongoing purposes in 2007-08.

d In addition to the 10.9 percent budget balancing reduction, the High Priority Schools Grant Program is reduced by an additional $29 million in 2008-09 due to schools exiting the program.

- ***COLA Only—6.5 Percent Reduction.*** Following statutory guidelines and typical practice, the Governor's budget assumes about 15 programs would otherwise have received a 4.9 percent COLA but no adjustment for changes in population. This results in a 6.5 percent year-to-year reduction. These programs include summer school and counseling.
- ***COLA and Growth Adjustment—Reduction Varies Based on Statutory Growth Rate.*** Statewide ADA is projected to decline at a rate of 0.5 percent in the budget year. Therefore, those programs that are typically adjusted for COLA *and* changes in ADA experience a net year-to-year funding reduction of 7 percent. The net change for programs with different statutory growth rates—including adult education, K-3 class size reduction, and child care and development—varies based on the specific growth factor applied.

Programs Funded With Local Property Tax Revenue Experience Smaller Reduction. Four K-12 programs receive some funding from local property tax revenue. Because the K-12 share of local revenues is projected to increase by 7 percent, the proposed 10.9 percent General Fund reduction is partially offset. These programs therefore would experience a smaller year-to-year decline in funding than many other Proposition 98 programs. Specifically, revenue limits for K-12 districts and COEs would experience a net combined decrease of 1.9 percent. Special education would decline by 5.8 percent, and funding for Regional Occupational Centers and Programs would decline by 6.2 percent. (Each program has a distinct growth rate and share of property tax revenue.)

Effect of Cuts on Schools. The effect of the Governor's proposed reductions would vary by district and by program. Generally, districts would have to reduce the level of services they provide. This could be accomplished either by reducing program *services* (serving the same number of students but less often, with fewer staff, or with lower quality) or by reducing program *participation* (providing the same program service but to fewer students). For programs that are required to maintain certain services for qualifying students, such as special education and mandated supplemental instruction programs, districts would have to backfill the loss of state funds with their general purpose dollars or reserves.

Enrollment Trends

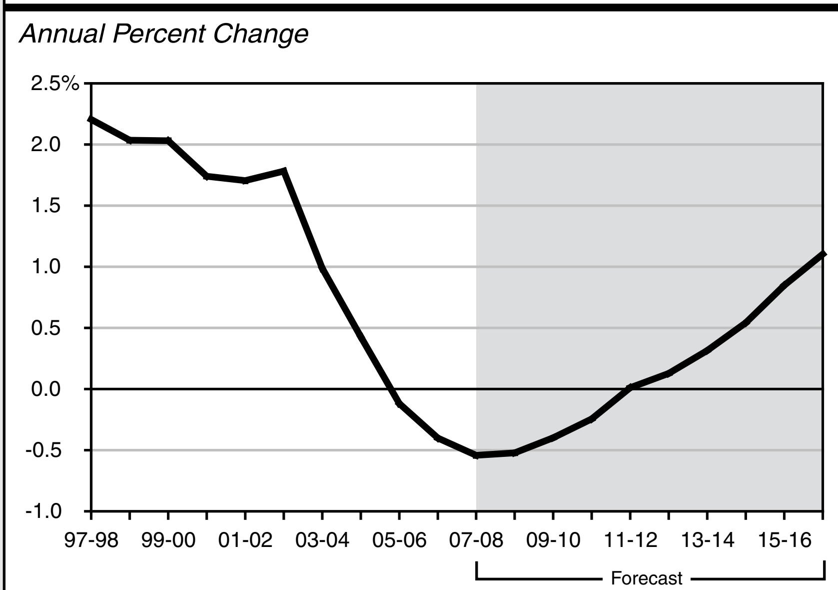
Enrollment levels are a major driver of K-12 budget and policy decisions. When enrollment grows rapidly (as it did in the 1990s), the state must dedicate a larger share of new resources to meeting statutory K-12 funding obligations. Conversely, when enrollment levels increase slowly or decline, fewer resources are needed to meet statutory funding obligations for revenue limits and categorical programs. This can leave more General Fund resources available for other budget priorities. In light of the important implications of enrollment levels, this write-up highlights major trends in the K-12 student population. We also discuss how enrollment trends and their implications may vary across different regions of the state.

The enrollment numbers used in this section are from the Department of Finance's Demographic Research Unit and reflect aggregate, statewide enrollment. While the enrollment trends described here will likely differ from those in any given school district, they reflect the overall patterns the state is likely to see in the near future.

K-12 Enrollment on the Decline. K-12 enrollment is projected to decline in 2008-09 for the fourth consecutive year—dropping by about 0.5 percent, for total enrollment of 6.2 million students. Figure 4 shows how enrollment growth has steadily slowed since the mid-1990s, with enrollment levels actually dropping since 2004-05. The figure also shows that K-12 enrollment is projected to continue declining until 2011-12.

Figure 4

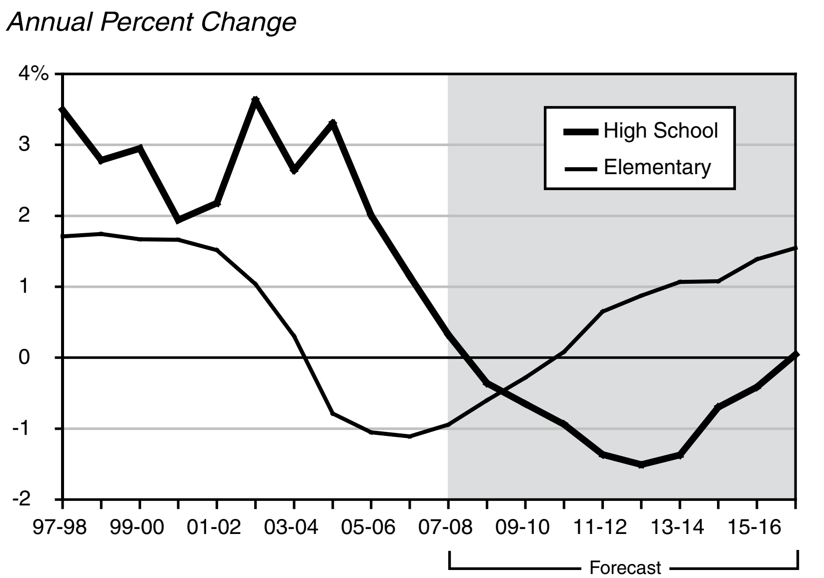
K-12 Enrollment Growth



Divergent Trends in Elementary and High School Enrollment. Figure 5 shows that the steady decline in K-12 enrollment growth masks two distinct trends in elementary (grades K-8) and high school (grades 9 through 12) enrollment. Elementary school enrollment growth has slowed sharply since 2001-02, with actual declines in recent years. It is projected to begin growing again in 2010-11. In contrast, high school enrollment grew rapidly from 1996-97 through 2004-05. Beginning in 2005-06, however, high school enrollment growth also began to slow significantly. This trend is expected to continue, with actual declines projected beginning in 2008-09. Between 2008-09 and 2016-17, high school enrollment is projected to fall by more than 130,000 students, whereas elementary enrollment is projected to grow by almost 280,000 students.

Figure 5

Elementary and High School Enrollment Growth



Statewide Trends Mask Regional Differences. Despite the general downward trend in enrollment growth, significant variation is expected to occur across counties. For example, over the next eight years, K-12 enrollment in Los Angeles County is expected to decline by about 200,000 students (a 13 percent decline), whereas K-12 enrollment counts in Riverside County are expected to increase by about 170,000 students (a 39 percent increase). Growing regions of the state will have a greater need for new school facilities and new construction dollars, whereas declining areas will be closing school sites.

Effects of Declining Student Population on State Budget. A decreasing K-12 student population also could lead to a significant change in future Proposition 98 requirements. In most years, the Proposition 98 minimum funding requirement—referred to as the minimum guarantee—is based partially on growth in K-12 attendance. Thus, as enrollment continues to decline, a smaller share of the state's new revenues will be required for K-14 education. However, once the "Test 1" component of Proposition 98 becomes operative, spending for K-14 education will be locked in at roughly 40 percent of the General Fund. As a result, the overall state budget will no longer benefit from declines in enrollment.

BUDGET ISSUES

K-12 Education

PER-PUPIL FUNDING

The Governor's budget provides total K-12 per-pupil funding (PPF) of $11,626 for 2008-09. This is roughly $300, or 2.6 percent, less than total PPF for 2007-08. In inflation-adjusted terms, the reduction is about double—roughly $600, or 5 percent. This per-pupil amount is calculated by dividing total proposed funding for K-12 education from all sources by the estimated average daily attendance (ADA). This particular calculation is only one of many ways to look at PPF. In this chapter, we (1) describe various factors that should be considered when calculating PPF, (2) compare PPF across states, and (3) compare PPF over time in California.

Calculating PPF

The basic PPF formula appears simple—divide the total amount spent on K-12 students in a year by the total number of students taught that year. The complexity in comparing PPF comes from the various types of funding that can be included and the various ways students can be counted. In this section we explore these issues.

Consider Funding Source. Funding for K-12 education comes from numerous sources. Funding can be provided by federal, state, or local government. Each of these categories, in turn, has several funding sources. For example, state funding sources include Proposition 98 General Fund monies, Non-Proposition 98 General Fund monies, and Lottery funds. Occasionally other sources are also used to fund K-12 activities. For example, in 2007-08 Public Transportation Account funds were used to pay for a portion of Home-to-School transportation costs. The PPF will appear relatively low if only Proposition 98 monies are included and much higher if all funding sources are included.

Consider Nature of Funding. Funding can also be of a one-time or ongoing nature. One-time funding for K-12 education includes: unspent funds from prior years (carryover), one-time grants for special activities or projects, one-time payments to schools due to court case rulings, and one-time payments related to unmet prior-year Proposition 98 obligations. By comparison, ongoing funding typically is used to support school districts' ongoing education programs. The PPF will be somewhat lower if only ongoing funds are counted and higher if both ongoing and one-time fund are counted. Including one-time funds, however, can skew year-to-year PPF comparison.

Consider Purpose of Funding. Finally, one also needs to consider the purpose of the monies. For instance, if funds are spent on an activity that does not directly serve students in the classroom, should that count toward PPF? Should state operations expenses at the California Department of Education count? Should payments to the teachers' retirement fund count? Should debt-repayment monies count toward PPF? Whereas funds used for classroom instruction presumably would be included in virtually any PPF calculation, including funds used for other related educational purposes would depend on one's particular objective. For example, debt-service payments would not be included in a PPF calculation designed only to reflect schools annual operating costs but would be included in a calculation designed to reflect all annual costs incurred in serving a K-12 student.

Consider Student Count. Counting students typically is done one of two ways: enrollment or ADA.

- ***Enrollment.*** Enrollment is a point-in-time count of the number of students enrolled in the public school system. Official enrollment counts in California are typically taken on a given day in October. All students enrolled as of that day are included in the count regardless of attendance. The enrollment for the state is the sum of the enrollment for each school.

- ***Average Daily Attendance.*** As the name implies, ADA is the aggregate attendance divided by the number of school days in session. Only days on which the student is under the guidance and direction of teachers are considered "days in session." The ADA for the state is the sum of the ADA for each school.

Because enrollment counts are higher than ADA counts, PPF calculations based on enrollment counts result in lower per-pupil rates.

A Final Consideration—PPF Levels Do Not Shed Light on Actual Support Per Pupil. Regardless of the formula used, PPF calculations represent averages. None of these numbers reflects the actual amount of money that was spent on a particular student in a particular district. Funding is distributed to districts in varying amounts (due to categorical formulas and historical allocation factors) and districts may make different choices in spending. Thus, actual spending per student varies significantly across districts and school sites.

Comparing PPF Across States

One of the most commonly cited sources of PPF is the National Center for Education Statistics (NCES), which is a division of the United States Department of Education. The NCES calculates PPF for each state and publishes the comparisons. The total PPF reflected for each state includes two components: (1) student support expenditures, and (2) other expenditures. The student support category includes teacher salaries, staff development, instructional materials, libraries, health services, nutrition, operations, and maintenance. The "other" category includes capital outlay and school debt. The NCES excludes funding for direct support of state educational agencies. The NCES uses enrollment as the measure of student counts.

California Ranks Right in the Middle of the Pack. Figure 1 (see next page) shows the NCES PPF rankings by state for 2003-04 (the most recent data available). As shown in the figure, California provided $9,266 per pupil in 2003-04. Excluding capital outlay and interest on debt, it provided $7,673 per pupil. It ranked 25th among the states, spending slightly less than the national average.

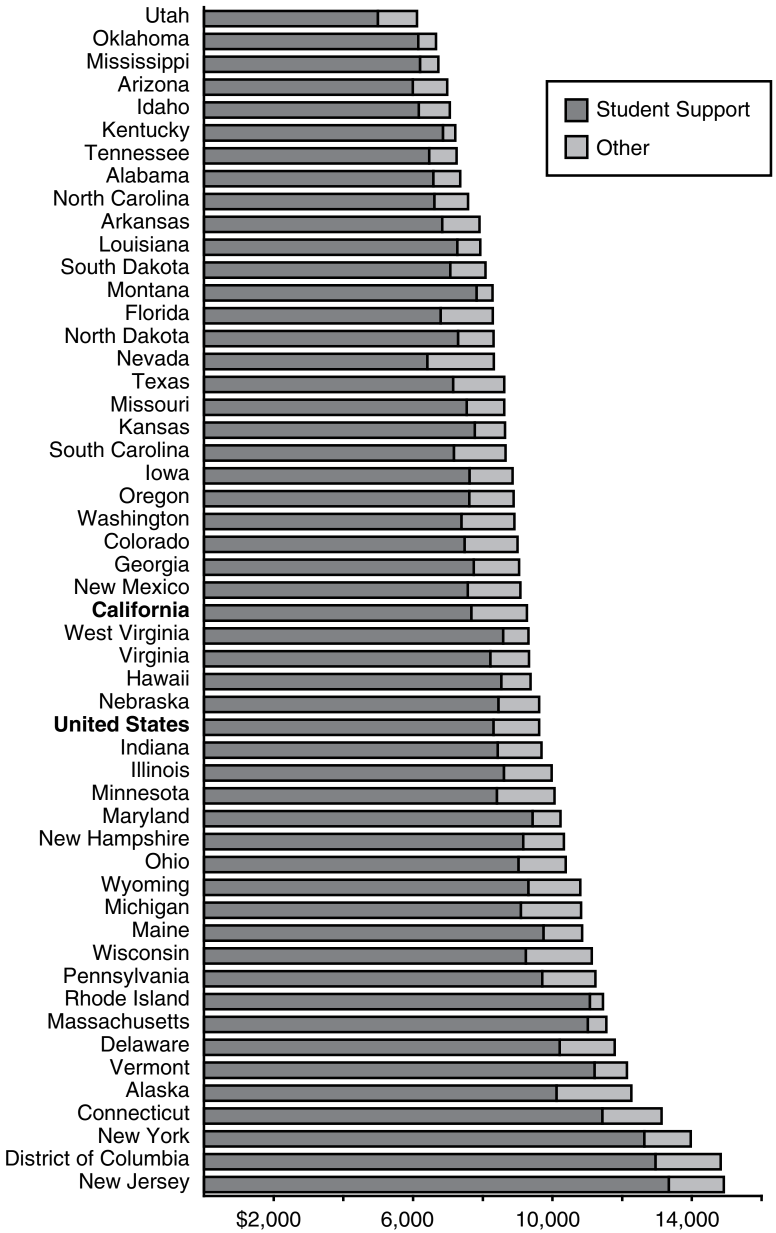
Comparing PPF in California Over Time

Figure 2 (see page 59) shows PPF by funding source for 2008-09 (as proposed by the Governor) and the two preceding years. Proposition 98 funding (both state and local shares) totals $8,368 per pupil using anticipated ADA for 2008-09. (This amount is lower than the Governor's reported Proposition 98 PPF of $8,458 because it does not include one-time funding for the Quality Education Investment Act.) By adding in other state funding, federal funds, and other local funds, a total PPF of $11,626 is proposed.

Figure 1

Per-Pupil Funding Across States

(2003-04)



Source: National Center for Education Statistics

Figure 2

Detailed Breakdown of Per-Pupil Funding (PPF) in California

	Actual 2006-07	Revised 2007-08	Proposed 2008-09	Changes From 2007-08	
				Amount	Percent
Proposition 98					
State General Fund	$6,261	$6,327	$6,018	-$309	-4.9%
Local property tax revenue	1,975	2,186	2,351	164	7.5
Subtotals, Proposition 98	($8,235)	($8,513)	($8,368[a])	(-$145)	(-1.7%)
Other Funds					
State General Fund, Non-Proposition 98	$517	$817	$760	-$57	-7.0%
State Lottery funds	164	158	159	1	0.5
Federal funds	1,148	1,131	1,072	-59	-5.2
Other local funds	1,214	1,315	1,267	-48	-3.7
Subtotals, Other Funds	($3,044)	($3,421)	($3,258)	($164)	(-4.8%)
K-12 Totals[b]	**$11,279**	**$11,935**	**$11,626**	**-$308**	**-2.6%**
Inflation-Adjusted Totals[c]	**$12,099**	**$12,232**	**$11,626**	**-$606**	**-5.0%**

a The Governor reports a Proposition 98 PPF of $8,458. The $90 difference is due primarily to the treatment of Quality Education Investment Act (QEIA) funding. Whereas the Governor reflects the QEIA appropriation in his Proposition 98 level, we include it in the Non-Proposition 98 category, as it technically is provided in addition to ongoing Proposition 98 funding level.

b Totals may not add due to rounding.

c Reflects 2008-09 dollars.

Adjusting for Inflation, PPF Has Been Relatively Flat. Figure 3 (see next page) shows that PPF in California has increased nearly $3,000 over the last ten years. Adjusting for inflation, however, allows for more meaningful comparisons of PPF over time, as this demonstrates purchasing power in present dollar terms. Figure 4 (see next page) shows that PPF in California in adjusted terms has remained relatively flat over the last decade.

Figure 3

**Per-Pupil Funding in California–
Actual Dollars**

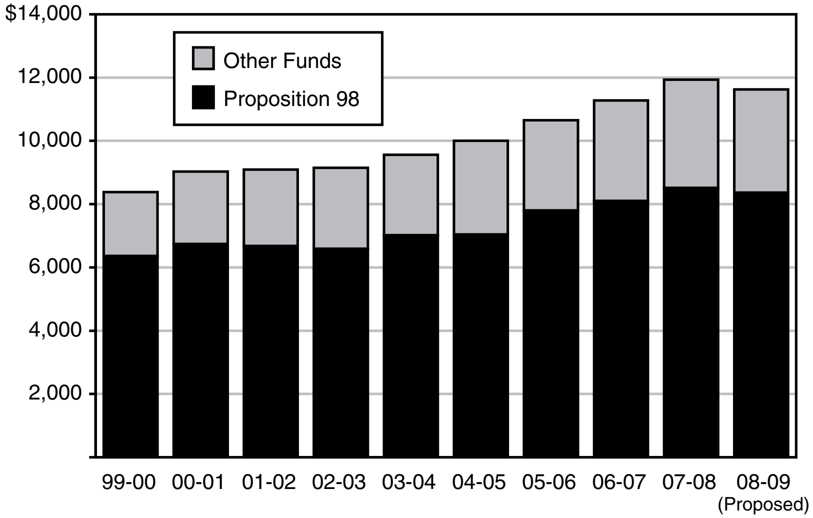
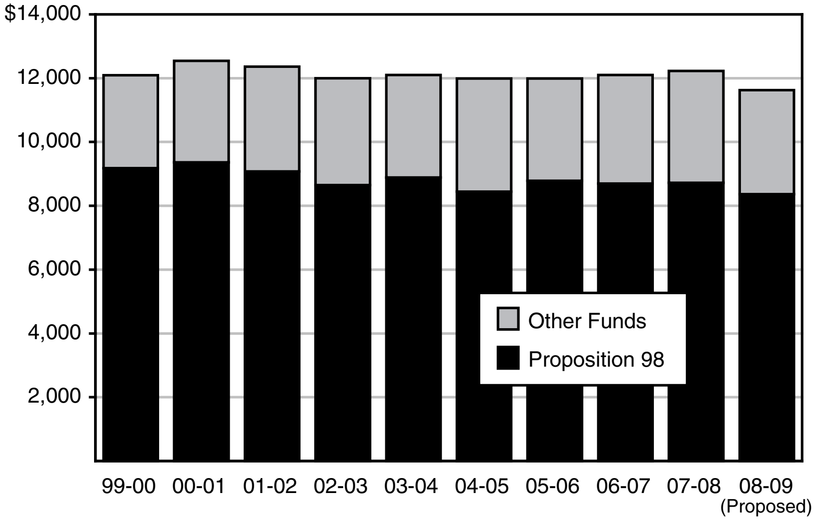


Figure 4

**Per-Pupil Funding in California–
Inflation-Adjusted Dollars**



K-12 CATEGORICAL REFORM

The state administers K-12 funding through more than 100 individual funding streams. Reform of the funding system would have several local benefits, including greater flexibility to use funds to support high-priority district programs.

The *2007-08 Budget Act* devotes $14.9 billion in General Fund support for 62 K-12 categorical programs. These programs fund a broad array of program activities. Among the largest are K-3 class-size reduction ($1.8 billion), child development ($1.8 billion), and Economic Impact Aid ($994 million). Many programs, however, are relatively small—30 of the 62 programs received an appropriation of less than $50 million in the current year. Many of these programs also are comprised of several separate subprograms. The child development program, for example, has eight individual subprograms that serve different subgroups of infants and toddlers using different payment mechanisms. Similarly, the special education program is comprised of more than 15 individual subprograms.

In addition to categorical programs, the K-12 school finance system contains a significant number of other funding programs. The state is obligated, for example, to pay for 38 mandated local programs in K-12 districts. As we discuss elsewhere in this chapter, district costs of administering these mandated programs totals about $180 million in 2008-09. Additionally, nine "add-on" categorical programs are funded as additions to district base revenue limits. These revenue limit add-ons total about $1.5 billion to school districts in the budget year.

REFORM WOULD HELP DISTRICTS AND SCHOOLS

The *Getting Down to Facts* studies, published by Stanford University in 2007, strongly criticize the state's K-12 funding system, finding it "broken," and the system of categorical programs "especially troublesome." Specifically, researchers found that the restrictions created by the reliance on categorical funding "impose meaningful compliance costs and make it difficult for local actors to respond to incentives embedded in the accountability system."

Since the early 1990s, we have recommended the Legislature consolidate and rationalize the school finance system. Our recommendations include creating a simple base grant that combines existing revenue limit funds and most of the revenue limit add-ons. We also have called for consolidating categorical funds into block grants that would provide districts greater flexibility over the use of funds.

Reforming the system of categorical programs would have several very important benefits for schools and districts, including:

- ***Flexibility to Use Funds to Meet Local Priorities.*** Since student and school needs can vary substantially among districts, funding should allow schools and districts the latitude to identify and resolve the most pressing local problems.
- ***Ability to Find Local Solutions to Problems.*** Allowing teachers and administrators to develop solutions to local issues helps build school-site problem-solving capacity and a shared commitment to the improvement process.
- ***Increased Focus on Outcomes.*** The push for greater student success requires adaptation and change at the local level. Increasing local flexibility helps educators to feel safe about trying new things rather than focusing on complying with state rules and regulations.
- ***Increased Understanding of Available Resources and Options.*** Increasing the transparency of the finance system reduces confusion among parents, teachers, and administrators about the level of resources provided by the state and how those funds may be used.

Some Categorical Programs May Be Necessary

Categorical funding, however, may serve legitimate state purposes. In general, categorical funding streams represent a tool used by the state to correct negative local incentives—forces that encourage districts and schools to engage in behavior that is not in the best interests of students. District incentive problems include:

- ***Weak Subgroup Accountability.*** Local accountability for outcomes may not be sufficiently strong for some subgroups of students. Accountability for foster children, for instance, is weak because (1) there are relatively few foster children in each school and (2) some groups of foster children change placements frequently.

- ***Strong District Spending Incentives.*** District behavior may be skewed by local factors that favor spending for specific inputs. Categorical programs, for instance, shield state funding from the employee union bargaining process.
- ***Lack of Uniformity.*** Some state policies require uniform application across the state as a critical condition for program success. The most important example of this is statewide testing, which requires all students in a grade (or subject) take the same test.
- ***Cost Shifting.*** Local incentives exist for schools and other local governments to shift costs to each other. For instance, failure of county mental health agencies to provide mental health services to students may result in school costs due to a greater number of "problem" students. Similarly, failure to address student academic and social needs can result in higher dropout rates, with the accompanying costs for local government in the form of higher crime and welfare costs.

MANY OPTIONS FOR IMPROVING SYSTEM

Over the years, several options for reforming the system of categorical programs have been discussed. The options offer different strengths and weaknesses. We discuss three general options below.

Pupil-Weighted Formula

Many states distribute funds to schools or districts based on the number and types of students in attendance. The formulas begin with a base grant that supports the basic cost of education for each student. Added to the base grant are weights that reflect the higher cost of educating specific groups of students. The pupil weights add a percentage of the base grant for each type of targeted student.

For instance, imagine the state wants to provide districts with a base grant of $5,000, $500 (an additional 10 percent) for each student whose primary language is not English, and $1,000 (and a weight of 20 percent) for each low-income student. If all students in a district were English Learners (EL) and low-income, the district would receive $6,500 per student from the formula. For a district with no low-income or EL students, the state funding entitlement would remain at $5,000 per student.

Most states use these weighted formulas to provide *general purpose* funding to districts. The formula compensates districts for students who need additional services to be successful (such as EL or low-income students) through the use of student weights. The funds, however, generally can be used for any local purpose. Because the formula does not contain the "strings" or restrictions that are common to categorical programs, a weighted formula promotes significantly greater district flexibility.

The formula also increases transparency of the funding system and helps ensure a fair distribution of funding among districts. The weighted formula is a simple mechanism for distributing funds to districts, which makes it easy to understand for local educators, parents, and community members. The transparency of a weighted formula also helps to ensure that similar districts receive a similar amount of state funding.

A weighted student formula works best in distributing general purpose funds to districts. While restrictions and requirements may be attached to a weighted formula, the greater the restrictions, the more the funding takes on the characteristics of a categorical program. Pupil formulas, therefore, tend to be used when district accountability for student outcomes is strong and effective.

Block Grants

Block grants provide an effective way to distribute state funds for activities where the state seeks special restrictions on the use of funds to counteract negative local incentives but where flexibility, transparency, and fairness are desired. The difference between a categorical block grant and a categorical program is in the scope of activities funded and flexibility in the use of funds. A block grant generally covers an entire category of local program activity (staff development) rather than one particular element within it (mathematics training). Block grants usually also provide districts with flexibility in determining which specific activities to fund and the way to deliver services.

Block grants, therefore, can have many of the positive attributes of a pupil-weighted formula while also restricting the use of funds to a broad category of activities. They can distribute funds based on pupil counts or other district data, thereby providing transparency and fairness. Block grants also can provide considerable flexibility over the local use of funds—although not as much as a pupil weighted formula.

By restricting the use of funds, block grants can counteract local incentives that cause districts to underinvest in specific activities. In California, categorical funds have been used to prevent funding from being subject to local collective bargaining agreements. In many districts, local bargaining agreements contain provisions that trigger increases in local salary schedules when state general purpose funding increases. Since salaries and benefits account for about 85 percent of district operational spending, these contract provisions mean a significant proportion of whatever new general purpose funds are provided through the budget will automatically be used to increase employee salaries. Given this connection, the state has sometimes restricted new funds in categorical programs to "keep the funds off the bargaining table."

Program Clusters

The significant number of categorical programs in some policy areas offers the Legislature a third option for reform—clustering programs together. Program clusters allow the state to consolidate similar programs into one larger grant while retaining the individual programs within the single grant. The state could, for instance, group the nine existing staff development programs into such a cluster. This would allow districts to move funds among the programs within the cluster, and use available staff development funding for the programs that best match local needs.

Clusters represent a limited step towards the types of funding mechanisms that would be most helpful to districts. Flexibility over the use of funds is only as broad as the range of programs included in the cluster. Similarly, district authority over program design remains limited by the specific restrictions on programs within the cluster. In general, we do not recommend using the cluster concept as the gains from clustering are too limited. Clusters, however, may be an attractive option in those areas where the Legislature desires to expand local flexibility in very small steps.

SIMPLIFY STATE FUNDING SYSTEM

We recommend the Legislature consolidate 43 individual K-12 funding streams totaling $42 billion (Proposition 98) into a base funding grant and three block grants.

Our evaluation of the options suggests that the state could streamline the K-12 fiscal system by consolidating a large number of categorical programs into three block grants. In addition, we suggest the Legislature create a new base grant by consolidating base revenue limits with selected add-on and categorical programs. Figure 1 (see next page) summarizes our recommendations for the reform of the K-12 fiscal system.

We propose to consolidate 43 categorical funding streams into four new grants. The "base" grant is largest of our proposed grants, at almost $35 billion. The new grant would include existing revenue limit funding and seven other individual funding programs. The special education grant would consolidate seven existing special education programs into the existing perpupil special education funding grant that was created by Chapter 854, Statutes of 1997 (AB 602, Poochigian and Davis), for a total new grant that provides $3.2 billion. The proposed Opportunity to Learn grant would provide $3.1 billion in state funds by merging 11 existing programs that are targeted to meet the needs of students who need additional services to succeed in school. The school improvement block grant would consolidate 16 existing programs in these areas in order to provide greater local flexibility over the uses of $1.3 billion in state funds.

All told, our recommendations include about 80 percent of all Proposition 98 K-12 funds. The remaining 20 percent of funds are allocated through remaining categorical programs—such as child development, adult education, and necessary small school funding. While many of these funding streams could be improved or consolidated, these programs present different issues from the programs we include in our four new grants.

Figure 1

LAO Proposed K-12 Finance Reform Proposed New Grants

(In Billions)

	2007-08 Amounts
Base	$34.8
Special education	3.2
Opportunity to learn	3.1
Instructional improvement	1.2
Total	**$42.3**

Below, we briefly outline our recommendations. For each new grant, we describe the purpose of the grant and any restrictions on the use of funds in the proposed grant that we believe are needed. In addition, we discuss data that districts would be required to collect and report to the state. The data creates an additional level of accountability for funds and provides feedback on district success in using the grant funds for the intended purposes.

Our proposal also has two important design features that apply to all four grants. First, our proposal would not alter the distribution of funding that is currently provided by the individual programs that we consolidate into block grants. Districts would continue to receive the same amount as in the past. In the future, grants would be equalized based on the formulas contained in each block grant. Second, the underlying requirements of the programs that are merged into the block grants would be eliminated as part of the reform. That is, the programs would cease to exist when the new grants are implemented. This, in our view, is a critical step to foster autonomy and flexibility at the local level.

Create a New Base Grant

The first step in our proposal is to simplify and consolidate existing base funding streams. Figure 2 displays the programs and amounts that we would consolidate in our proposed base grant. The current base revenue limit represents the single largest source of funds to schools—$31 billion in state funds and local property taxes—and is designed to pay for the basic cost of education for students. To this amount, we added seven categorical funding streams that we believe are general purpose in nature or provide basic support for the operation of classrooms.

Figure 2

LAO Proposed K-12 Base Grant

(In Billions)

Current Program	2007-08 Amounts
Base revenue limits	$31.4
K-3 class size reduction	1.8
SB 813 incentives	1.4
Meals for needy pupils	0.2
9th grade class size reduction	0.1
Minimum teacher salary	0.1
Unemployment insurance[a]	—
PERS[b] reduction	-0.2
Total	**$34.8**

[a] Less than $100 million.
[b] PERS = Public Employees' Retirement System

Five of the eight programs—Meals for Needy Pupils, SB 813 incentive programs, minimum teacher salary incentive, unemployment insurance, and the Public Employees' Retirement System reduction—are known as revenue limit add-ons because they are calculated and apportioned to districts as part of the revenue limit formula. As we discuss in our 2004 report *The Distribution of K-12 General Purpose Funds*, the add-ons provide widely differing perpupil amounts to districts based primarily on historical factors. Consolidating these adjustments into a new base grant would reduce district paperwork, clarify district funding levels, and ensure future equalization adjustments reflect the base amounts that are actually provided to districts.

We also include class size reduction (CSR) funds in our base grant. We have recommended several times in the past to loosen the restrictions on CSR funds that make the program unnecessarily expensive to administer. In addition, evaluations of smaller class sizes show small learning gains despite the significant investment associated with CSR. As a result, the program's focus on a 20 to 1 student-teacher ratio precludes districts from using the funds for other supplemental classroom services that could have a larger impact on student achievement.

As a result, CSR fits the description of a state categorical program that unduly restricts local practice in using funds most efficiently. For these reasons, we include K-3 and 9th grade CSR funds in our base grant. Rather than spread the CSR funds across all grades, however, we recommend the Legislature adopt specific *grade-span* base grants that reflect the higher funding levels for K-3 and 9th grade CSR. Similar to the base grants provided to charter schools, our proposal would establish specific perpupil funding rates for grades K-3, 4-6, 7-8, and 9-12.

By including the K-3 CSR funds into the K-3 grade span rate, districts would be required to spend the funds on services for students in the primary grades. Districts could determine the best mix of smaller classes and other supplemental instructional services to address student needs. In addition, greater flexibility over the use of CSR funds would provide another resource to assist districts in focusing on effective primary grades instructional programs that help all students to achieve at state standards in mathematics and reading by the end of third grade.

We do not recommend requiring districts to provide any additional accountability data as part of the new base grant. State and federal accountability programs provide sufficient information on the academic progress of students.

Consolidate Special Education Funding

Similar to our new base grant, we also propose a consolidated special education grant. The grant would merge funding from seven existing programs into the existing perpupil funding formula. Figure 3 illustrates the programs we would consolidate into the new grant. As the figure shows, our recommendations would create a $3.2 billion state grant for special education.

Figure 3

LAO Consolidated Special Education Grant

(In Millions)

Program	2007-08 Amounts
Attendance-based apportionment	$ 3,021.5
SELPA[a] base funding	88.1
Workability	39.6
Vocational education	5.3
Small SELPA base funding	2.6
Personnel development	2.5
Low incidence services	1.7
Necessary small SELPA	0.2
Total	**$ 3,165.5**

[a] Special Education Local Plan Area.

The purpose of consolidating these special education funding sources is no different than for the previous grants—to provide additional flexibility in the use of funds. In addition, while most of the funding streams that would be merged into the formula are small, the multiple sources of money obscure the amounts individual Special Education Local Plan Areas (SELPAs) receive from the state for special education. By consolidating funding sources, therefore, the Legislature also could clarify actual funding levels and set the stage for future equalization efforts.

In identifying the programs to consolidate, we focused on programs that distribute funds to most of the SELPAs or support core special education activities. Federal law, for instance, requires that the individual education plan (IEP) for each special education student in high school contain a transition plan that outlines the classes or other services a student needs for a successful transition to adult life. The Workability program and vocational education funds in our block grant help SELPAs pay for services identified in the student transition plans. Since the underlying activities are required by student IEPs, merging these funds into the base perpupil allocation would give SELPAs more options for the use of these funds without affecting student IEPs.

Because our proposal primarily would simplify the special education funding system, we think additional accountability provisions are unnecessary. We would recommend, however, that the Legislature require California Department of Education (CDE) to submit an annual performance report on the progress of special education students using data from Standardized Testing and Reporting (STAR) and California High School Exit Examination (CAHSEE). This report would highlight for policymakers the academic status of the special education population and identify districts with especially effective or ineffective special education programs.

An Opportunity to Learn Grant

Our third grant is called the Opportunity to Learn (OTL) grant. This grant would merge 11 different programs aimed at students who need additional services to succeed in school. As shown in Figure 4, this new grant would provide $3.1 billion in funds to districts. The new grant is split into two parts: an academic support grant would provide compensatory instructional services to disadvantaged students and a student support grant would fund other types of services or activities that promote learning in schools.

As the figure suggests, our new grant would consolidate existing programs that target disadvantaged students. The academic support grant includes the Targeted Instructional Improvement grants, Economic Impact Aid and English Learner Assistance program, which are the primary source of *additional* classroom services to students who need additional help to succeed. We also included supplemental instruction funding and the High School Exit Examination supplemental instruction funds, which pay for *remedial* classes after school or during the summer for students who are struggling to meet state standards.

Ending the categorical nature of the supplemental instruction funds represents a significant policy shift. By including these funds in our grant, our proposal makes districts responsible for determining the mix of additional classroom services and remedial services, and whether those services are delivered during or after the regular school day.

Similarly, we believe that the After School Education and Safety (ASES) program also in an ideal candidate for inclusion in the support component of the OTL grant. Unfortunately, however, the requirements of Proposition 49 do not allow the kind of flexibility that would justify including these funds in our block grant. (For more information on ASES, please see the "After School Programs" section of this chapter.) Should the rules for this program become more flexible, we would recommend its inclusion in the OTL grant.

Figure 4

LAO Proposed Opportunity to Learn Grant

(In Millions)

	2007-08 Amounts
Academic Support	
Targeted Instructional Improvement	$1,075.7
Economic Impact Aid	994.3
Supplemental Instruction	420.8
CAHSEE[a] Supplemental Instruction	72.8
English Learner Assistance	63.6
Advanced Placement Fee Waivers	3.1
Subtotal	($2,630.3)
Student Support	
Grade 7-12 Counseling	$209.1
School safety	100.6
Pupil retention	97.5
Community English Tutoring	50.0
AVID[b]	9.0
Subtotal	($457.2)
Total	**$3,087.5**

[a] California High School Exit Examination.
[b] Advancement Via Individual Determination.

Our proposal also emphasizes the importance of an *effective* program of additional class room services. Districts sometimes complain that the state provides too little remedial support. Need for remediation, however, reflects a district's problems in providing the regular classroom services students need to learn the required material. Thus, the state's current remedial funding approach lets districts "off the hook" for ineffective instructional programs. By combining the many funding sources targeted at disadvantaged and struggling students, therefore, the Legislature would also make districts more accountable for the quality of classroom instruction.

The student support grant aggregates $457 million in funds that the state currently dedicates to six programs, including student safety and counseling programs. As with our other grants, our proposal would increase local flexibility over the use of these funds while reserving their use for nonacademic support to students and their parents. These support activities would include counseling, outreach to parents, and school safety activities.

The OTL grant funds would be distributed based on the number of disadvantaged students in each district. Specifically, grants would be based on a count of the number of EL students and students with at least one parent who had not graduated from high school. This formula is based on our analysis that parent graduation is a more accurate indicator of need for funding than available measures of family income.

We recommend giving districts some flexibility to move money from one grant to the other. This would ensure district funding was not "locked in" to the amounts for instruction and support that are currently provided by the state. We also suggest continuing the requirements that districts provide counseling and remedial instruction to students who fail or are likely to fail CAHSEE.

Similar to our recommendation for special education, we also suggest monitoring district performance on the OTL grants. As we discussed in our 2005 report *Improving High School: A Strategic Approach*, research shows that very low academic progress is a major factor in the decision of students to drop out of high school. Research also indicates that student academic problems usually are evident in elementary and middle school. A focus on giving all students an opportunity to learn, therefore, means giving students a good education in every grade and ensuring that schools assist students when their performance begins to falter.

Based on this finding, we suggest monitoring performance in several critical areas. For instance, district performance on the grant could be assessed by the (1) proportion of students in grades 3, 6, and 9 scoring "below basic" on the STAR program mathematics and language arts test, (2) the proportion of ninth grade students who fail to graduate within four years, and (3) the proportion of ninth grade students who, by the end of 12th grade have not prepared for life after high school by taking all of the "A through G" courses that are required for admission into the University of California and California State University or earned an employer-certified vocational certificate. As supplemental information on the effectiveness of the student support grant in improving campus safety, we also would suggest the report include data on the number of student suspensions and expulsions and the number of incidents of on-campus violence.

Finally, we recommend the Legislature require CDE to submit an annual performance report on the progress of disadvantaged students using the program data discussed above. This report would highlight for policymakers the academic status of the at-risk population and districts that make below- and above-average progress. The report would help the Legislature provide oversight on districts' performance in serving at-risk students.

An Expanded School Improvement Grant

The final grant we recommend is a new school improvement grant. As shown in Figure 5, we would merge the funding currently provided by 16 programs to provide $1.2 billion for the new grant. As the figure also shows, the new grant is comprised of two parts, one targeted at instructional improvement and the second focused on staff development.

As suggested by its name, the purpose of the grant is to ensure a flexible source of funding for school improvement activities. The two-part nature of our grant reflects the fact that school improvement often requires a focus on a coordinated instructional approach and the development of teacher and administrator capacity.

Figure 5

LAO Proposed School Improvement Grant

(In Millions)

	2007-08 Amounts
Instructional Improvement	
School & Library Improvement	$465.5
Arts and Music	109.8
Gifted and Talented	51.3
Partnership Academies	23.5
Education Technology	17.7
Specialized Secondary Program	6.2
Civic Education	0.3
Subtotal	($674.3)
Staff Development	
Professional Development	$274.7
Teacher Credentialing	128.7
Mathematics and Reading Professional Development	56.7
Staff Development	32.7
Alternative Certification (Intern)	31.7
Certificated Staff Mentoring	11.7
Paraprofessional Teacher Training	7.9
Teacher Incentives National Board	6.0
Principal Training	5.0
Subtotal	($555.1)
Total	**$1,229.4**

As with the other grants, our school improvement grant consolidates existing programs that provide district support for instructional improvements and staff development. As a result, the grant would free districts from the specifics of the existing grants but would still require districts to use the funds to improve student achievement through better instructional approaches and training. We propose distributing funding for the two grants based on average daily attendance.

We also recommend several restrictions on the use of funds. While the division of funds between the two types of activities mirrors the existing division of funding, we would suggest providing significant district flexibility to transfer funds between the two grants. As with special education, we do not propose additional accountability measures for the block grant. We think school accountability under existing state and federal law is sufficient.

Conclusion

Our recommendations would significantly reduce the number of categorical funding streams—consolidating 43 current programs into four new grants. The significant reduction in the number of programs would greatly simplify the K-12 finance system, reduce district paperwork, clarify the amounts districts actually receive from the state, focus districts on program outcomes rather than state rules and regulations, and provide greater district flexibility over the uses of state funds.

As dramatic as our proposals may seem, they are rather modest compared to reform models that are under discussion as part of the school reform efforts linked to the *Getting Down to Facts* studies. One proposal, for instance, would consolidate all K-12 funding into one of three state formulas. These formulas would distribute funding based on the number and type of students in each district, regional cost factors, and the population density of each district.

According to the authors, however, this model assumes that state and federal school and district accountability are sufficiently strong and fine-tuned that no categorical programs are needed. In other words, the model assumes that all major local incentive problems have been addressed. While we think school and district accountability has increased the local focus on student achievement, we do not think these programs are sufficiently strong to counteract all significant local incentive problems, such as weak subgroup accountability or local spending pressures.

Therefore, we suggest a middle road between total reform and the status quo. Our proposal would increase local flexibility and responsibility while also shedding more light on the impact of supplemental funds on student achievement. In the current tight fiscal environment, the additional flexibility would prove especially helpful to districts as they look to support high-priority services within the district. Our proposal also offers the Legislature a way to monitor the impact of funds on student achievement that we think would be much more effective than the current system. Overall, therefore, we think the benefits of K-12 finance reform warrants the Legislature's consideration as part of the 2008-09 budget.

Child Care and Development

The state supports a variety of child care and development programs. It also supports efforts to improve the quality and availability of these programs through community, parent, and provider education. Although the specific objective of each program is unique, collectively the programs aim to provide high-quality supervision and/or early education experiences to children from birth through age 12 (or longer for children with special needs). As shown in Figure 1, in 2008-09, the Governor proposes to spend nearly $3.1 billion to provide these services to more than 437,000 children.

In the remainder of this write-up, we:

- Provide background on child care and development programs, including details on program objectives, administrative control, participation, and funding.
- Discuss the administration's budget reduction proposals and the consequences of these proposals.
- Raise concerns with the Child Care and Development (CCD) budget and offer recommendations for addressing them.

Child Care and Development Programs

Of the entire CCD budget, approximately 83 percent is used for child care programs, 14 percent is for preschool programs, and about 3 percent is for related support activities.

Child Care and Development Programs

In general, child care programs are designed primarily to supervise children whereas child development programs have a focus on early childhood education. In reality, these programs frequently have many points of overlap and coordinate to serve the same children. The state programs serve children of families in the California Work Opportunity and

Figure 1

California Child Care and Development Programs

2008-09 All Funds
(Dollars in Millions)

Program[a]	2007-08	Proposed 2008-09	Change Amount	Change Percent
CalWORKs[b] Child Care:				
Stage 1[c, d]	$511	$554	$43	8.4%
Stage 2[d, e]	489	497	8	1.5
Stage 3	405	420	15	3.8
Subtotals	($1,405)	($1,471)	($66)	(4.7%)
Non-CalWORKs[b] Child Care:				
General child care	$805	$753	-$52	-6.5%
Other child care programs	336	313	-24	-6.8
Subtotals	($1,141)	($1,066)	(-$75)	(-6.6%)
State Preschool	$442	$413	-$29	-6.6%
Support Services	$106	$100	-$6	-6.0%
Totals—All Programs	**$3,094**	**$3,050**	**-$43**	**-1.4%**

[a] Except where noted otherwise, all programs are administered by the California Department of Education.
[b] California Work Opportunity and Responsibility to Kids.
[c] Administered by California Department of Social Services.
[d] Does not include reserve funding.
[e] Includes funding for centers run by California Community Colleges.

Responsibility to Kids (CalWORKs) program as well as non-CalWORKs low-income families.

CalWORKs Guarantees Families Child Care. In exchange for engaging in work or work preparation activities, the state guarantees child care to CalWORKs recipients. Thus, the demand for CalWORKs child care is driven by CalWORKs caseload. CalWORKs child care is supported by state General Fund (Proposition 98), federal Temporary Assistance for Needy Families (TANF), and federal Child Care and Development Fund (CCDF) monies. The program involves three stages of child care.

CalWORKs Stage 1. This stage begins when a participant enters the CalWORKs program. The child care component is administered by the Department of Social Services through county welfare departments. It is funded completely with TANF monies. In 2008-09, the Governor's budget includes $554 million to serve more than 63,000 children in Stage 1 care.

CalWORKs Stage 2. The CalWORKs families are transferred to Stage 2 when the county determines that participants' schedules become stable. Families remain eligible for Stage 2 as long as they are participating in CalWORKs and up to two years after the family stops receiving a CalWORKs grant. This stage is administered primarily by the California Department of Education (CDE), although the California Community Colleges also have a small administrative role. It is funded with a combination of Proposition 98 and TANF monies. In 2008-09, the Governor's budget includes $497 million to serve approximately 75,000 children in Stage 2 care (including nearly 3,000 children served in community college centers).

CalWORKs Stage 3. When they have exhausted their two-year limit in Stage 2 (referred to as "timing out"), a family is eligible for Stage 3 as long as their income remains below 75 percent of the State Median Income (SMI) level and their children are younger than age 13. Stage 3 also is administered by CDE. It is funded with a combination of Proposition 98 and CCDF grant monies. In 2008-09, the Governor's budget includes $420 million to serve approximately 60,000 children in Stage 3 care.

Non-CalWORKs Families Not Guaranteed Child Care. In addition to CalWORKs Stage 2 and 3, CDE administers general and targeted child care programs to serve non-CalWORKs, low-income children at little or no cost to the family. (See the nearby box for a brief description of the various types of non-CalWORKs child care programs.) The base eligibility criterion for these programs is family income at or below 75 percent of SMI relative to family size. Because the number of eligible low-income families exceeds available child care slots, waiting lists for this care are common. These programs are funded with a combination of Proposition 98 and CCDF monies. In 2008-09, the Governor's budget includes almost $1.1 billion to serve approximately 130,000 non-CalWORKs, low-income children. The Governor's proposal also includes freezing SMI at the 2007-08 level (see box on the next page for discussion). The CDE estimates approximately 200,000 eligible children are on the wait-list for non-CalWORKs child care. The majority of those children need full-time care.

Over 110,000 Low-Income Children Currently Served by State Preschool Each Year. In California, CDE administers two preschool programs for low-income and/or disadvantaged children: State Preschool and the Pre-Kindergarten Family Literacy (PKFL) program. Both state preschool programs are part-day, developmental programs for three to five year-old children from low-income families. In addition to educational activities, the programs require some level of parental education or involvement, provide meals or snacks to children, and refer families to health and social services agencies. The PKFL program, started in 2006-07, gives priority for funding to providers in the attendance areas of low-performing elementary schools. In all other regards, this program is very similar to the larger State Preschool program. Preschool programs are run by local educational agencies, community colleges, community-action agencies, and private nonprofit agencies. Funding comes entirely from the state. In 2008-09, the Governor's budget includes more than $413 million to provide preschool to approximately 110,000 low-income children. Currently more than 40,000 children who meet eligibility requirements for state preschool are on CDE's wait-list.

Support Activities and Services

A small portion of total Proposition 98 and CCDF monies are used to fund programs that do not provide direct services to children but rather

Types of Non-CalWORKs Child Care

There are various types of non-California Work Opportunity and Responsibility to Kids (CalWORKs) child care available to low-income families in California.

- ***General Child Care.*** State licensed child care providing supervision and child development services for children from birth through age 12 as well as older children with exceptional needs. Also includes campus child care for the children of parents enrolled in community college.
- ***School-Age Community Child Care Services (Latchkey).*** A safe environment with age and developmentally appropriate activities for school-age children during the hours when school is not in session.
- ***Severely Handicapped Care.*** Available in the San Francisco Bay Area only. Child care, developmentally appropriate activities, and therapy for eligible children and young adults (with an authorizing plan from a special education program) from birth to age 21.
- ***Migrant Child Care.*** Child care in a licensed facility for children of agricultural workers. Hours and locations of care are structured around local agricultural activities. These programs are also required to reserve slots for children of migrant workers in anticipation of families moving.

State Median Income (SMI) Impacts Families and Providers

The decision of whether to freeze SMI is a complicated matter that the Legislature and the administration have debated frequently in recent years. Freezing SMI results in families becoming ineligible for service earlier than they would if SMI was increased with inflation. If a family at the upper end of the eligibility range received an income increase equal to inflation while SMI stayed flat, that family would lose eligibility for subsidized child care. This would, in turn, free up a child care slot—which would be filled by the lowest-income family on the wait-list. Thus, the decision of whether to freeze SMI becomes a question of priorities—keeping higher-income families eligible for service or serving lower-income families now on the wait-list.

provide support services designed to improve program effectiveness. Some support programs are geared toward parents and providers. For example, resource and referral agencies provide information to parents and the community about child care available in the area and offer training to providers. By comparison, some are geared more toward government planning. For example, the county-based Local Planning Councils are responsible for assessing need, planning, and coordinating child care services within the county. The CDE also maintains a Centralized Eligibility (wait-) List. Other support programs, collectively called "Quality Programs," are intended to improve the quality and availability of child care. In 2008-09, the Governor's budget provides approximately $100 million for these support services.

TWO TYPES OF SERVICE MODELS

Currently, the state funds child care and development programs through two main mechanisms: vouchers to families and direct contracts with providers.

Most Families Receive Child Care Through a Voucher System. The CalWORKs families in any of the three stages of child care usually receive a voucher from an Alternative Payment (AP) organization or their county welfare department. In addition, the state provides vouchers for non-CalWORKs working poor families through AP organizations. In total, approximately 70 percent of the children in state-subsidized child care are served through a voucher system. Families may use vouchers in one of three settings: licensed centers, licensed family child care homes, and license-exempt care. The licensed programs must adhere to the requirements of Title 22 of the California Code of Regulations and are often referred to as Title 22 programs.

Voucher Providers Are Reimbursed Using the Regional Market Rate. Title 22 providers are reimbursed for services up to a maximum of 85 percent of the rates charged by private-market providers for the same service in the same region. License-exempt providers may earn a maximum of 90 percent of Title 22 providers in the same region. The cost of child care in specific regions of the state is determined via the Regional Market Rate (RMR) survey of public and private child care providers. The RMR survey is conducted every year, new regional maximums are posted in October, and providers may adjust their rates for their voucher clients after that time. Although the RMR increase for a particular region may vary from less than 1 percent to nearly 10 percent depending on market factors, the *average* RMR increase is typically around 2 percent each year. Thus, a slight increase in RMR is typically built into budget projections. The Governor has assumed an average cost of care increase of 2.8 percent for the CalWORKs voucher programs in his proposed 2008-09 budget. The Governor has assumed no cost of care increase for the non-CalWORKs voucher program.

CDE Contracts Directly With Child Care and Preschool Centers. For non-CalWORKs child care and preschool, CDE contracts directly with over 750 different agencies through approximately 1,300 different contracts. These providers must adhere to the requirements of Title 5 of the California Code of Regulations and are generally referred to as Title 5 providers.

Title 5 Providers All Receive Same Rate. These providers are reimbursed at the Standard Reimbursement Rate (SRR). The SRR is adjusted for factors such as the age of the child or for special needs. (For instance, the reimbursement rate for an infant is 1.7 times the SRR, and the reimbursement rate for a severely handicapped child is 1.5 times the SRR). It is not adjusted for regional market differences. The Governor has proposed to maintain the current SRR of $34.38 per day per child for full-day care (either full-day child care or part-day preschool/part-day child care) and $21.22 per day per child for preschool only.

STATE NEEDS TO ADDRESS UNDERLYING BUDGET PROBLEM

We recommend the Legislature adjust the Child Care and Development budget by making a one-time alignment to correct for chronic carryover, funding growth, and then taking steps to reduce the amount of unspent funds in the future. Although our alternative budget funds Child Care and Development at the same level as the Governor's plan (nearly $3.1 billion), we recommend taking additional action to correct the root problems that generate chronic carryovers.

The Governor's budget provides $3.1 billion for CCD in 2008-09. As with K-12 programs, the Governor first builds a workload budget for 2008-09—including a cost-of-living adjustment (COLA) for all programs, growth for non-CalWORKs programs, and caseload adjustments for CalWORKs programs (see Figure 2). From that workload budget, the Governor proposes to reduce Proposition 98 General Fund support for CCD by $199 million, resulting in a total year-to-year reduction of $44 million, or 1.4 percent. The Governor estimates this proposal will result in a loss of approximately 8,000 existing full-time equivalent (FTE) slots but assumes that normal attrition rates in these programs should reduce the likelihood of a currently enrolled child losing his or her slot. The Governor's proposal effectively results in eliminating funding for growth and COLA and proportional reductions across all programs (except CalWORKs child care, which would still receive a minor increase in an attempt to fully fund that entitlement program). This approach to building a 2008-09 workload budget would be appropriate if the 2007-08 budget was a good reflection of existing CCD expenditures. However, this is not the case.

Figure 2

Governor's Proposed Child Care and Development Budget

(In Millions)

2007 08 Budget Act	**$3,094**
"Workload Budget" Adjustments	
Cost-of-living adjustment (4.94 percent)	$80
Growth adjustment (.69 percent)	11
California Work Opportunity and Responsibility to Kids (CalWORKs) caseload adjustment	66
Total Workload Adjustments	**$157**
2008-09 "Workload" Estimate	**$3,249**
Budget Bill Reductions	
Reduce General Fund contribution to all non-CalWORKs programs proportionately	-$199
2008-09 Proposed	**$3,050**

Governor's Approach Leaves Underlying Budget Problems Unaddressed. The state's CCD budget has chronic carryover of unspent funds.

For each of the past five fiscal years, at least $200 million of the CCD appropriation has gone unspent (and has been "carried over" to fund future years of service). Although the bulk of unspent funds for a particular fiscal year are typically identified within 12 months after the close of that fiscal year, it may take up to five subsequent years to identify all unspent funds. There are many reasons that these funds go unspent but they generally fall into two categories:

- ***Unobligated Funds.*** The first situation is the result of CDE being unable to award contracts up to the level of the full appropriation. This could be due to staffing issues at CDE, the required to conduct a Request for Application, or lack of interest from providers.
- ***Unearned Funds.*** The second situation is the result of providers not serving the exact number of children, or spending money on allowable expenses, up to the full amount of their contracts. The reasons for this so-called "under-earning" are many but can include such things as delays in planned facilities expansions, difficulty filling slots when children exit the program, or just the sheer complexity of tracking allowable expenses and calculating earnings.

The result of chronic carryover is that less children are served than intended and more children remain on the waiting list.

Governor's Proposal Overstates the Impact of Proposed Reduction. Figure 3 shows that the Governor's proposed funding level would result

Figure 3

Number of Reduced Slots Would Be Less Than Number of Currently Unused Slots

	2007-08 Funded Slots	2008-09 Proposed Slots	Change
Non-CalWORKs Child Care:			
General	86,974	81,374	-5,600
Alternative Payment	38,301	35,835	-2,466
Other[a]	13,493	12,624	-869
Preschool	117,624	109,963	-7,661
Totals	**256,392**	**239,796**	**-16,596**
Unused Slots[b]			**22,000**

[a] Includes Migrant, Latchkey, and Severely Handicapped child care programs.

[b] Reflects average number of unused slots across all non-CalWORKS child care programs from 2003-04 through 2007-08.

in the loss of roughly 16,600 FTE slots from non-CalWORKs programs. However, it is unlikely that any child currently in care will lose a slot based on these reductions. As mentioned above, CCD programs have an average of $200 million in unspent funds each year. That equates to approximately 22,000 slots (using an average cost of care) across the non-CalWORKs programs. As shown in Figure 3, this level is consistent with the number of unused slots in recent years. In fact, for 2007-08, CDE has already identified $102 million in unspent funds ($80 million of which the Governor has proposed to carry forward to fund the 2008-09 budget), which equates to more than 18,000 slots. Based on recent trends, we anticipate additional unspent 2007-08 funds will materialize in the coming years. Thus, the Governor's proposal would unquestionably result in a reduction in *funded* slots but not a reduction in *used* slots.

LAO Alternative Cleans Up Budget. Our recommended alternative approach to the CCD budget (see Figure 4) arrives at the same funding level as the Governor but with different assumptions. From the 2007-08 budget, we adjust for the chronic CCD carryover—using $120 million as a conservative estimate of 2007-08 funds likely to go unused. Unlike the Governor's plan, we recommend the Legislature fund growth (calculated at $10 million after adjusting the 2007-08 budget for chronic carryover). This growth adjustment maintains the relative size of the wait-list to the pool of children receiving service. Then we include the same adjustment for CalWORKs caseload estimates as the Governor ($66 million) and, like the Governor, would not provide a COLA. Under our alternative, the 2008-09 CCD budget is nearly $3.1 billion (the same level as under the Governor's plan).

Recommend Action to Address Underlying Issues. Our alternative includes a one-time alignment of funding with service. However, if the systemic issues that cause chronic carryover are not addressed, the problem will continue. Every year fewer children will be served than intended and funds will go unused. Although there likely is not one easy solution to this problem, various groups have made valid reform suggestions. These include: (1) procedural changes enabling CDE to reallocate contract funds among existing providers in good standing who are under-earning or over-earning (shifting funds from under- to over-earners), (2) grant-based contracts with minimum attendance requirements instead of reimbursement-based funding, and (3) increasing flexibility to allow providers to shift funds between separate CCD programs. We recommend the Legislature hold an informational hearing this year to consider these various options. We believe that solving the problems that cause chronic carryovers likely will require a multifaceted approach, possibly with different solutions for different programs. We also believe that new options might need to be explored to ensure the underlying incentive problems are adequately overcome.

Figure 4

Alternative Child Care and Development Budget

(In Millions)

2007-08 Budget Act	**$3,094**
Recommended Adjustments	
Reduce chronic carryover	-$120
Growth adjustment (.69 percent)	10
California Work Opportunity and Responsibility to Kids caseload adjustment	66
Total Adjustments	**-$44**
2008-09 LAO Proposed	**$3,050**

SPECIAL EDUCATION

In 2006-07, 680,000 students age 22 and under were enrolled in special education programs in California, accounting for about 11 percent of all K-12 students. Special education is administered through a regional planning system consisting of Special Education Local Plan Areas (SELPAs). Currently, there are 120 SELPAs.

Figure 1 summarizes the Governor's budget proposal for special education in 2007-08 and 2008-09. The budget provides a total of $4.5 billion for special education in 2008-09. This reflects a decrease of $189 million, or 4 percent, from the current-year level. Under his proposal, General Fund support for special education would decrease by $231 million, or 7.3 percent. The General Fund reduction is partly offset by an expected increase in local property tax revenue.

Governor's Proposal Violates Federal Maintenance-of-Effort Requirement

We recommend the Legislature reject the Governor's proposal to reduce special education funding. Such a reduction would violate a federal Maintenance-of-Effort (MOE) requirement, resulting in a dollar-for-dollar loss in federal funding, as well as put a financial strain on local education agencies.

The Governor proposes to reduce special education funding as part of his across-the-board budget balancing reductions. From his workload budget for special education (which assumed a 4.94 percent cost-of-living adjustment and 0.51 percent decline in student enrollment), he proposes a reduction of $358 million. As mentioned above, the actual *year-to-year* reduction would be $189 million. The Governor offers no rationale for this reduction other than General Fund savings and does not provide guidance on how to make cuts within special education.

Governor's Proposal Violates IDEA Requirements. Under the federal Individuals with Disabilities Act (IDEA), states must not reduce state funding for special education below the amount of state funding provided in the previous fiscal year. This is known as a MOE requirement. According to federal regulations, if a state does not meet its MOE requirement, federal special education funding for the following fiscal year is to be reduced dollar-for-dollar. That is, the federal allocation is reduced by the same amount as the prior-year reduction in state funding. As shown in Figure 2, we estimate that the Governor's proposal falls $189 million short of meeting its MOE requirement. As a result, the state would lose that amount of federal special education funding in 2009-10. (The Department of Finance [DOF] estimated the shortfall at $278 million, but that point-in-time estimate has since been updated.) To avoid losing federal funds, the state could try to obtain a waiver from the MOE requirement, but such a waiver has never been granted. (See box on next page for discussion.)

Figure 1

Special Education Funding

(Dollars in Millions)

	Revised 2007-08	Proposed 2008-09	Change	
			Amount	Percent
General Fund	$3,158.3	$2,927.2	-$231.1	-7.3%
Local property taxes	406.4	432.4	26.0	6.4
Federal funds	1,150.2	1,166.0[a]	15.8	1.4
Totals	**$4,714.9**	**$4,525.6**	**-$189.3**	**-4.0%**

[a] Reflects most recent estimate of federal grant.

Figure 2

Maintenance-of-Effort (MOE) Shortfall

(In Millions)

	Enacted 2007-08	Proposed 2008-09	Difference
State funding[a]	$3,539.8	$3,334.6	-$205.2
Growth adjustment[b]		16.6	16.6
MOE Shortfall			**-$188.6**

[a] Includes General Fund and local property taxes, both of which count toward the state's MOE requirement. Excludes $25 million in settlement funds that do not count towards the state's MOE.

[b] Student enrollment in California is projected to decline in 2008-09 by 0.51 percent, resulting in savings of $16.6 million.

Makes Flawed Assumptions. The administration assumes districts can backfill the state reduction in special education funding, thereby allowing the state to meet its MOE requirement. That is, DOF believes both state and local funding combined can be counted towards the *state* MOE requirement. We believe the Governor's assumption is incorrect. Federal regulations do not permit states to count local funds in calculations of its MOE—only funding allocated by the state for special education purposes can be counted. If the state cuts special education funds, it directly violates its MOE because the amount of *state* support falls below the previous-year level. Thus, districts backfilling the drop in state funding for special education will not prevent the state from losing federal funds.

Puts Financial Strain on LEAs. The IDEA requires local education agencies (LEAs) to develop and implement an individualized education plan (IEP) for each special education student. They cannot legally reduce the special education services outlined in a special education student's IEP. Although districts could try to provide services using fewer resources, districts likely would have to backfill some of the loss in state funds by redirecting funds from other activities. The reduction in state funds therefore would translate into a redirection of districts' general purpose funds, thereby affecting all students.

Given these concerns, we recommend the Legislature reject the Governor's proposal. As discussed earlier in "Proposition 98 Priorities," we recommend funding special education at roughly its 2007-08 level (with a reduction of $16.6 million to account for a slight decline in student

Federal Waiver Possible but Unlikely

The Individuals with Disabilities Act allows for a waiver if it "would be equitable due to exceptional or uncontrollable circumstances such as an unforeseen decline in the financial resources of the State." Although the Governor has declared a fiscal emergency, California is not experiencing a year-over-year decline in state revenues. That is, growth is lower than expected, but state revenues have not declined from the previous year. Therefore, it seems very unlikely the federal government would grant California a waiver. In response to an inquiry from the California Department of Education during a more severe fiscal crisis in 2003-04, the federal government indicated it would not grant a waiver under the existing circumstances. Furthermore, the Office of Special Education has never granted a waiver from maintenance-of-effort requirements due to financial hardship.

enrollment). Total funding for special education in 2008-09 would be $4.7 billion. Of this amount, $3.1 billion would be General Fund support. Federal funding would not be compromised, as the state would meet the MOE requirement.

ADULT EDUCATION

The budget proposes $722 million for the adult education program in 2008-09. This is $89 million, or 10.9 percent, below the estimated "workload budget" for the program ($811 million). This workload budget reflects higher spending than in the current year with the addition of $32.2 million for a 4.94 percent cost-of-living adjustment and $18.8 million for a 2.5 percent growth adjustment. Adult education provides education courses in ten instructional areas including basic skills, English as a second language (ESL), vocational education, home economics, and parent education.

Align Funding With Population Growth

We recommend enactment of legislation to modify the growth adjustment formula for the adult education program to reflect the projected increase in the adult population. We also recommend the Legislature fund the program (Item 6110-156-0001) at $30 million below its current-year level to reflect the "excess" growth the program has received over the past four years.

State statute calls for a 2.5 percent growth adjustment for the adult education program each year. This statutory rate was enacted in 1983-84 and has resulted in adult education funding growing considerably faster than the adult population. In the 1980s, the actual growth averaged 2.3 percent, only slightly lower than the statutory rate. In the 1990s, however, the state's growth slowed appreciably, increasing at an average annual rate of 1.2 percent. Since 2000, the adult population rate has grown by an estimated 1.8 percent on average each year. We project a 1.6 percent growth rate in the budget year.

The difference between these two rates, accumulated over more than two decades, has resulted in the program growing about 25 percent (about $200 million) larger than it would have been if its statutory growth adjustment was set using the increase in adult population. That is, if the actual adult population growth rate had been used in lieu of the statutory rate, the program would be funded at about $600 million in the budget year, instead of $800 million.

Because the program has grown so large, the "excess" growth caused by the statutory rate accumulates into fairly large amounts of additional funding after only a few years. From 2003-04 through 2007-08, for instance, state funding exceeded actual state population growth by a cumulative 4 percent. The cost to the state in 2007-08 of this 4 percent excess growth on the adult education budget was $30 million.

Our review of adult education fiscal and program data over the past few years suggests that the relatively high growth rate is affecting local adult education programs in several ways, including:

- ***Difficulty Spending State Funds.*** In 2004-05, about one-half of all adult education programs failed to earn their full state funding entitlement. In 2006-07, 60 percent of programs could not serve enough students to earn their entitlement. In fact, many of these programs are actually shrinking. Under state law, districts lose funding when they do not use it for two years in a row. For about two-thirds of these programs, 2006-07 was the *third* successive year the programs lost adult education funding because they were not able to earn the amount made available by the state.
- ***Exploring New Markets for Services.*** "Innovative" ESL programs have expanded significantly over the past several years, with participation reaching 49,500 in 2005-06, an increase of 40 percent from 2001-02. State law allows adult programs to spend up to 5 percent of state funds on innovative programs, which frequently employ Internet-based learning programs or independent study to deliver instruction to students.
- ***Significantly Expanding "Enrichment" Classes.*** Enrollment in enrichment courses—such as parenting, health and safety, and home economics classes—increased by 19 percent from 2001-02 through 2006-07. Enrollment in core classes (including ESL, basic skills, high school diploma, citizenship, and vocational classes) remained flat, rising only 3 percent over this period.

Revise Growth Formula—Reduce Funding Base. The mismatch between the statutory growth rate and the adult population rate—and the effect the higher growth rate has had on local programs—raises the question of whether the Legislature should continue giving adult education funding this special priority. In our view, the data suggest that many local programs have reached the point where they can no longer easily absorb additional funding by expanding core academic and vocational adult classes.

For these reasons, we recommend two changes to the adult education budget for 2008-09. First, we recommend the Legislature adopt trailer bill language to eliminate the 2.5 percent statutory growth formula and instead base growth in adult funding on increases in the underlying adult population. Second, we recommend the Legislature fund adult education in the budget year at $30 million below the program's 2007-08 funding level (this is roughly the same level as proposed in the Governor's budget for 2008-09). This reduction would adjust the program's funding level for the excess growth it received since 2003-04 because of the current statutory growth formula. It would also bring the adult education growth formula in line with the underlying growth in demand for services.

After School Programs

Two after school programs are currently operated in California. These programs are run through partnerships between local educational agencies and local community resources. The objective of these programs is to provide safe and educationally enriching alternatives for students from kindergarten through high school during non-school hours. As shown in Figure 1, the Governor proposes to spend $618 million on these programs, in 2008-09. An estimated 450,000 children are expected to be served.

Figure 1

Funding for After School Programs Increased Significantly in 2006-07

(Dollars in Millions)

	2005-06	2006-07	2007-08	2008-09 Proposed	Change	
					Amount	Percent
ASES[a]	$123	$550[b]	$550	$490	-$60	-11%
21st Century[c]	183	165	189	128	-61	-32
Total	**$306**	**$715**	**$739**	**$618**	**-$121**	**-16%**

a After School Education and Safety, a state-funded program.

b Proposition 49 triggered, resulting in a $426 million increase in local assistance funding.

c 21st Century Community Learning Centers, a federally funded program.

In the remainder of this write-up, we:

- Provide background on after school programs.
- Describe outstanding issues with Proposition 49.
- Discuss the administration's after school proposal and recommend an alternative.

AFTER SCHOOL PROGRAMS AVAILABLE KINDERGARTEN THROUGH HIGH SCHOOL

The state funded After School Education and Safety (ASES) program and the federally funded 21st Century Community Learning Centers (21st Century) program have very similar objectives and approaches. Figure 2 compares the two programs' grant levels, grade spans, and underlying requirements.

Figure 2

Two After School Programs Are Similar

	After School Education and Safety (ASES)	21st Century Community Learning Centers (21st Century)
Grants		
Grade span served	Kindergarten - grade 9	Kindergarten - grade 12[a]
Length of grant	Three years	Five Years
Maximum grant		
Elementary school	$112,500	$50,000
Middle school	$150,000	$50,000
High school	—	$25,000
Funding priority	Programs serving schools with more than 50 percent of students eligible for free or reduced price meals.	Schools in need of improvement under Title I.
Requirements		
Submit to annual audit	No	Yes
Report semiannual attendance	Yes	Yes
Report annual self evaluation	Yes	Yes
Report quarterly expenditures	Yes	Yes
Provide academic component	Yes	Yes
Provide enrichment component	Yes	Yes
Provide nutritional snack	No	Yes[b]
Provide family literacy component	No	Yes
Operate minimum number of hours/days	Yes	Yes[b]

a Roughly one-half of funds reserved for high schools.

b Elementary and middle school programs only.

The ASES Program Serves Elementary and Middle School Students

The ASES program provides grants to providers of before and after school programs for students in kindergarten through ninth grade. Each program must provide an educational component and an educational enrichment element. The educational component generally consists of tutoring and/or homework assistance in core academic subjects. The enrichment component generally involves physical activities, art, or other general recreation activities. Providers are also required to run the program at least five days a week, provide a nutritious snack, and remain open specified hours. Providers receive a three-year grant contingent upon meeting two requirements—performing a self-evaluation annually and maintaining at least 75 percent of attendance targets. In 2008-09, the Governor's budget includes $490 million to serve more than 300,000 students through ASES.

The 21st Century Program Primarily Serves High School Students

The 21st Century program is very similar to the ASES program. The program serves students from kindergarten through high school but priority is given to high school programs. As with the ASES program, each 21st Century program must provide both an educational component and an educational enrichment element. Providers of elementary and middle school programs are required to adhere to the same requirements as ASES providers regarding days/hours of operation and providing nutritious snacks. Providers receive a five-year grant contingent upon meeting these requirements. In 2008-09, the Governor's budget includes slightly more than $125 million in federal funds to serve more than 100,000 students through 21st Century.

Open Issues Remain for ASES

The ASES program was created by Proposition 49 in 2002. The ballot measure restricts the types of changes that can be made to its provisions absent voter approval. The Legislature was able to clarify and modify certain provisions of ASES (and 21st Century) via Chapter 380, Statutes of 2006 (SB 638, Torlakson), but open issues remain. In this section, we describe the history of ASES governance and funding and discuss unresolved issues.

The ASES Program Significantly Expanded in 2006-07. Proposition 49 expanded and renamed a preexisting after school program and required the state to dramatically increase funding for this program once a complicated set of criteria was met. These criteria were trigged in 2006-07 and local assistance funding for ASES was increased by $426 million, for a total funding level of $550 million ($547 million for local assistance and

$3 million for state operations). This same funding level was appropriated in 2007-08.

The ASES Program Requires Autopilot Spending Despite Budget Difficulties. Proposition 49 requires a certain amount to be spent on after school programs, essentially without regard to the state's fiscal situation or other budget priorities. Without going back to the voters for reform of Proposition 49, the state is required to fully fund ASES at $550 million. The only exception is if (1) the state is facing a "Test 3" year for purposes of calculating Proposition 98 (see the "Proposition 98 Introduction" section of this chapter for background on Proposition 98 tests), and (2) year-to-year spending on Proposition 98 is decreasing. California has only experienced this situation once in the history of Proposition 98. Given 2008-09 is not expected to be a Test 3 year, the state is required to spend $550 million on ASES absent voter reform.

Some Program Elements Can Only Be Changed With Voter Approval. The initiative prohibits legislative amendments to key portions of the measure. The Legislature would need to seek voter approval if it wanted to: (1) change the amount of funds provided or (2) change the provisions regarding how the initiative interacts with the requirements of Proposition 98.

EXPAND GOVERNOR'S REFORM PROPOSAL AND ELIMINATE AUTOPILOT SPENDING

We recommend the Legislature expand upon the Governor's proposal to reform Proposition 49 via a ballot measure that would be placed before the voters. We recommend repealing the autopilot funding formula in Proposition 49 to allow After School Education and Safety funding to be determined by the state in the context of overall budget priorities.

The Governor proposes to reduce Proposition 98 General Fund support for ASES below the Proposition 49-required amount by $60 million. The Governor estimates this proposal will result in a minimal reduction of services offered but does not quantify the impact. Because of the Proposition 49 restrictions discussed above, the Governor also proposes to sponsor a ballot measure that would allow after school funding to be reduced in years when the state suspends the Proposition 98 minimum guarantee.

Governor's Ballot Proposal Is Too Narrow. We agree with the administration that the state should have the option to reduce funding for after school programs when Proposition 98 is suspended and funding for other education programs is being reduced. There are, however, other situations in which state revenues are declining or growing very slowly and cuts are made to K-12 programs even though the Proposition 98 minimum guarantee is met. Modifying Proposition 49's autopilot funding formula to try to account for every possible fiscal situation in which the state might benefit from fiscal flexibility merely confounds the root problem.

Address Root Issue and Eliminate Autopilot Funding Formula. Rather than adding another layer of complexity to Proposition 49's existing autopilot funding formula, we think the formula itself should be eliminated. Such action would retain all the programmatic features of Proposition 49 without requiring the state to appropriate a fixed amount of funding for after school programs every year. As with the administration's proposed change, this change would need to be made via a ballot measure. Once the autopilot formula was eliminated, funding for the ASES program would be determined by the state in the context of all other budget priorities. Funding could be increased or decreased at the discretion of the Legislature after considering program demand, evaluations, other budget priorities, and the fiscal outlook. For example, rather than having to provide $550 million for after school programs while simultaneously reducing funding for programs that serve foster youth, English learners, and at-risk students, the state could weigh these competing priorities and budget accordingly.

2008-09 Budget Should Not Depend or Reform. If the Legislature decides to place such a measure on the ballot in 2008, it could assume savings in its 2008-09 budget package. However, given the uncertainty of when the measure would be placed on the ballot and whether it would be approved, our recommended budget plan for K-12 education does not depend upon any budget-year savings.

K-12 MANDATES

MANDATE FUNDING IS PART OF THE BASE

We recommend the Legislature fully fund the annual estimated costs of state-mandated local programs.

The Governor's budget again proposes to defer the costs of state-mandated local programs in K-12 education in 2008-09. (Technically, the budget includes $1,000 for each of the 38 currently recognized mandates affecting K-12 districts and county offices of education.) Even though payments are deferred, schools districts would be required to perform the mandated activities. We estimate that district claims for 2008-09 for reimbursable mandates will total about $180 million.

The annual budget has not contained ongoing funding for K-12 mandates since 2001-02. Periodically, however, the state has appropriated "one-time" Proposition 98 funds to pay a portion of past mandate claims. The proposed budget, for instance, includes $125 million in one-time funds that would reduce the backlog of mandate claims for past years. (These one-time "settle-up" payments satisfy outstanding Proposition 98 obligations from 2002-03 and 2003-04.)

As a result of past deferrals, the state has accumulated a significant debt in the form of unpaid K-12 mandate claims. As discussed in the Proposition 98 "Technical Update" section of this chapter, we estimate that outstanding claims through 2008-09 for approved K-12 mandates total $430 million under the Governor's plan. In addition, districts have submitted claims of $560 million for multiple years of costs for four mandates that are now in the approval process (two are discussed below). In total, therefore, we estimate districts would have almost $1 billion of unpaid mandate claims on file with the state by the end of 2008-09.

Unlike K-12 mandates, the state is constitutionally barred from deferring local government mandate payments. Proposition 1A, passed in 2004, requires the state to reimburse local governments each year for mandated costs or relieve the local agencies of the required activities. In November

2007, five school districts and the California School Boards Association sued the Department of Finance and the State Controller seeking payment of past mandate claims and an end to deferrals.

Mandates Are Part of the Base K-12 Budget. We have recommended in the past that the Legislature pay for the annual expected cost of mandates as part of the budget act. State-mandated programs are not fundamentally different than other K-12 categorical programs. Mandates represent programmatic activities the state requires districts to perform each year—such as collective bargaining, state testing programs, and student health screenings. In fact, because mandates require very specific activities, districts often have less flexibility over mandated activities than they have over the level of services provided through other categorical programs.

If mandates are part of the state's base K-12 program, funding for mandates should be part of its base K-12 budget. For these reasons, we recommend the Legislature add funding to the *2008-09 Budget Bill* to pay for the ongoing costs of reimbursable state-mandated local programs. Under current law, this budget-year amount would be $180 million—estimated budget-year district claims. The administration, however, proposes to change the timing of mandate payments. If adopted, the 2008-09 mandate payment for K-12 education would be $165 million—the amount claimed by districts for the 2006-07 fiscal year. (Please see our assessment of this proposal in the "General Government" chapter—Item 8885—of this *Analysis*.)

Commission Approves Two New Mandates

Chapter 1124, Statutes of 2002 (AB 3000, Committee on Budget), requires the Legislative Analyst's Office to review each mandate included in the Commission on State Mandate (CSM) annual report of newly identified mandates. In compliance with this requirement, this analysis reviews two new education mandates. Figure 1 (see next page) displays the new mandates and the associated costs. Neither of the new mandates is recognized in the *2008-09 Governor's Budget*.

The Stull Act requires districts to evaluate teachers periodically. Originally passed in 1971, the commission determined that updates of the law passed in 1983 and 1999 created new reimbursable mandates. The CSM reports total district claims of $166 million for the Stull Act mandates for the period 1997-98 through 2007-08. Based on these reported claims, we estimate the budget-year cost of the Stull Act mandates at about $22 million.

Figure 1

New K-12 Mandates Approved by the Commission on State Mandates in 2007

(In Millions)

Mandate	Requirement	Accrued Costs Through 2007-08	Estimated Cost in 2008-09
Stull Act teacher evaluation	Evaluate teacher performance in specific areas	$165.8	$22.0
High School Exit Examination	Administer state test to high school students	37.4	7.7
Totals		**$200.2**	**$29.7**

The commission also approved a finding of reimbursable costs for administering the California High School Exit Examination (CAHSEE). Districts submitted $37 million in claims for eight years of costs. Presumably, these claims represent costs on top of the $5 per test the state apportions to districts each year through the budget. We project costs of $7.7 million in 2008-09 based on the district data.

Our review of the two mandates identified three issues for the Legislature's consideration. First, we recommend the Legislature refer the Stull Act mandate back to the CSM to assess whether legislation created offsetting savings that would reduce district claims for this mandate. We also propose a method for developing unit costs for mandates that will reduce district workloads and provide greater assurance that local claims are reasonable. We conclude with a discussion of whether the Stull Act evaluations are cost-effective in the current policy environment.

CSM Decision Misses Offsetting Savings

We recommend the Legislature adopt trailer bill language requesting the Commission on State Mandates to review its "statement of decision" in the Stull Act mandate to determine whether there are offsetting savings to the mandated costs identified by the commission.

Our review of the new mandates raised only one issue with the commission's decisions. Specifically, the commission failed to recognize that the 1999 statute that created the mandated Stull Act costs also created savings for school districts. The original Stull Act was passed in 1971—before the passage of the constitutional provision requiring the state to reimburse local governments for new mandate costs. This original law required districts to evaluate most teachers every two years.

Ensuing legislation, passed in 1983 and 1999, expanded the scope of the evaluation process, which the commission determined created new reimbursable mandates. The 1983 law focused the required evaluations on instructional techniques and strategies and required districts to conduct annual evaluations of employees who receive an unsatisfactory performance review. The 1999 changes required districts to review student test results as part of each teacher's performance evaluation.

The 1999 law, however, also *reduced* the scope of the original mandate by scaling back the frequency of evaluations for more experienced teachers beginning in 2004. The legislation reduced evaluation requirements to every five years for "highly qualified" teachers (as defined by federal law) with at least ten years of experience. The CSM decision fails to recognize the reduction in district workload that is created by this change. Specifically, senior teachers, who were subject to evaluations every other year under the *original* Stull mandate now must undergo reviews once every five years. Since many teachers have ten years of experience and meet the federal definition of highly qualified, the district savings may be considerable.

When the Legislature believes the commission has erred in its assessment of a mandate, the standard procedure is to refer the mandate back to CSM with a request to reconsider its previous statement of decision. In this case, the appropriate action would be to request the commission review whether the 1983 or 1999 legislation created offsetting savings that should be reflected in district claims. Because the Stull Act is a new mandate, the Legislature should also make clear that it expects the reconsideration would apply to district claims back to 1997-98.

Therefore, we recommend adoption of trailer bill language requesting CSM reconsider its statement of decision on the Stull Act mandate to determine whether legislation creating the new mandates also created offsetting savings in district personnel evaluation costs.

Develop "Unit Costs" for New Mandates

We recommend the Legislature add trailer bill language directing the Commission on State Mandates to reconsider the "parameters and guidelines" established for the, California High School Exit Examination and Standardized Testing and Reporting mandates. We also recommend the language require the State Controller to submit to the commission a proposed reasonable reimbursement methodology based on district "cost profiles" as part of the reconsideration of the cost guidelines for these mandates.

In the development of statewide cost estimates for the two new mandates, CSM found a number of problems with district claims. These problems will be familiar to those who follow mandate reimbursement issues in K-12 education. For the CAHSEE mandate, for example, CSM reports that a significant number of districts—including large districts—failed to submit a claim for specific years. This suggests that districts do not have the cost documentation they need to submit a valid claim for those years. The CSM also reports widely different cost estimates from districts for the same required activities. Underlying assumptions in some claims also appear to conflict with the commission's parameters and guidelines. The CSM also found claims that failed to recognize offsetting revenues that are available to pay for mandated activities.

The State Controller's Office (SCO) audits of school district mandate claims find these same problems—and more. In particular, large disallowances frequently result from the auditors' findings of inadequate documentation for the claimed costs. In fact, it is common for the Controller's audits to disallow most of a district's mandate claim. As a result, mandate payments have developed into a source of considerable conflict between the state and school districts.

Responding to school district concerns, SCO helped two districts develop a revised claim for a mandate related to Standardized Testing and Reporting (STAR) testing. In both districts, the SCO's initial audits disallowed virtually the district's entire claim—in part, because claims sought reimbursement for nonmandated activities. Recognizing that the districts performed the mandated testing duties, the SCO developed a methodology to estimate what each district could reasonably claim from the state. Based on this process, the SCO issued a revised audit statement that allowed a portion of the claims submitted by the two districts.

While the SCO's approach to the STAR audits represents a significant change in the role of auditors, we think it may offer a way to simplify the mandate reimbursement process. Specifically, instead of requiring all districts to develop detailed expenditure reports to justify their annual mandate claims, the state could adapt the methodology used by the Controller's staff to develop a proposed reasonable reimbursement methodology (RRM).

State law permits the use of an RRM as a way of simplifying mandate claims based on a representative sample of local cost data. The underlying concept of the RRM is to develop an average cost estimate that establishes a fair, but approximate, reimbursement level for state-mandated local programs. One of the barriers to developing an RRM has been the state's lack of confidence in district claim data. The cost profile approach used for two districts' STAR mandate claims provides a possible way to collect consistent, reliable, cost data that would provide the basis for a proposed RRM.

We think the STAR and CAHSEE mandates are good candidates for such an approach for several reasons. First, since costs for these mandates will vary primarily depending on the number of students tested, it is possible that an RRM could fairly reimburse districts based on a standard per student amount. Second, an RRM would reduce audit disallowances of past-year claims for the two mandates. According to our review of the two new mandates, significant disallowances in district claims could be avoided through the RRM approach. Unfortunately, the need to reconsider the Stull Act mandate on the issue of offsetting savings precludes the development of an RRM at this time (please see our recommendation above).

The development of an RRM for STAR offers a way to resolve the backlog of payments for this mandate. Districts have filed STAR claims totaling about $200 million for the years 1997-98 through 2004-05. In 2005, however, CSM determined the STAR mandate applied to only a small portion of the testing program. As a result, it appeared likely that district STAR mandate claims included reimbursement for activities that are not recognized as a reimbursable mandate by the commission. This concern was validated by the SCO audits. Unless school districts and the state agree on an RRM, the state has little recourse but to withhold payment on STAR until district claims are audited.

From a district perspective, an RRM has several advantages. It minimizes district paperwork, offering local cost savings, and provides greater certainty over future state mandate payments. An RRM also provides a fairer distribution of funding for mandates, especially for smaller districts that find the claiming process difficult. For the state, the RRM provides greater assurance that the state is paying a reasonable amount for the mandated activities.

The advantages of developing a reimbursement methodology are clear if the state and districts can agree on an amount. We think the Controller's cost profile process offers the best avenue for obtaining data needed for developing a methodology that both the state and districts would support. We think this process would work well for the two new mandates as well as the STAR mandate. For these reasons, we recommend the Legislature add trailer bill language requiring the CSM to reconsider the approved parameters and guidelines for the CAHSEE and STAR mandates. To assist the commission in its reconsideration, we also recommend that trailer bill language require the State Controller to submit to the commission a proposed RRM using data from a representative sample of districts.

Are Stull Act Evaluations Worth the Money?

The Stull Act evaluations exist in a system that provides little local flexibility for building stronger employee incentives into the evaluation process. We suggest the Legislature undertake a broad review of teacher policies, including the Stull Act, as part of future K-12 reform discussions.

The Stull Act requirements raise a major policy consideration: What does mandating teacher evaluations accomplish for the state? Employee evaluations represent an important management activity that can help improve employee performance. These evaluations, however, are typically part of a broader set of processes and incentives for employees. For many employers, staff salary increases are linked to evaluations. Similarly, in cases where employees fail to perform to expectations over an extended time period, they may be terminated.

In K-12 education, however, teacher raises are not linked to evaluations or performance. In fact, state law requires that districts provide salary increases based on educational attainment and years of service. Other salary arrangements are permitted only with the agreement of the local union (and, to our knowledge, none have been negotiated to date). In addition, while state law does permit districts to fire teachers for unsatisfactory performance, this tenure law has proved to be very difficult to use at the local level. As the recent *Getting Down to Facts* studies found, one-quarter of surveyed principals would like to dismiss or transfer three or more teachers at their schools but believe it is "almost impossible" to do so.

Thus, the Stull Act requirements exist within a system that severely limits district flexibility to establish a broader system of incentives for employees. In addition, mandates represent a particularly clumsy way to encourage *effective* evaluation practices. A state mandate can force districts to conduct the required evaluations, but it cannot require districts to make the process meaningful.

In this policy environment, it seems difficult to conclude that the Stull Act produces benefits that justify its cost. Eliminating the mandate, however, could erode management practices in schools. The mandate provides leverage for districts and principals that understand the importance—to the district and to its employees—of providing clear and honest feedback on employee performance. In addition, because the law requires a minimal level of evaluations, districts cannot trade teacher evaluations for another district priority during collective bargaining.

Now that the requirements have become reimbursable, the state faces the question of whether, on net, the mandate is worth paying for. In most circumstances, we would recommend eliminating requirements like the

Stull Act mandate. At the current time, however, issues of teacher tenure and compensation are at the core of educational reform debates in California. In this environment, therefore, we think the Legislature should undertake a broad review of the state's teacher policies—including the Stull Act—to give districts better tools for managing employees and creating a cadre of skilled and motivated teachers.

FEDERAL FUNDS

In recent years, the Legislature has not received timely and transparent information from the California Department of Education (CDE) on available federal funding for K-12 education. This has hindered the Legislature's ability to make well informed decisions. To promote transparency and improve the timeliness of information, we recommend the Legislature require CDE to report annually on federal funding. This would allow the Legislature to consider all options and priorities when making budget and program decisions.

Currently, CDE is responsible for tracking federal funds appropriations, expenditures, and carryover by year and by program. The CDE provides information about federal funds to the Department of Finance and Legislature upon request. However, communication issues have, at times, resulted in federal funds reverting because decisions about how best to spend the funds could not be made in a timely manner. We believe routine, consistent reporting of federal funding for K-12 education will improve communication, increase transparency, and foster better decision making, thereby helping to ensure the funds benefit students. Below, we provide some background on the federal funds supporting K-12 education and then discuss our recommendation in more detail.

The CDE Currently Tracks Numerous Pots of Federal Funds

The federal government appropriates funds to California for a variety of programs—each with unique requirements on how the funds can be expended and when they will revert if unspent. The CDE is responsible for tracking the funds and adhering to the federal requirements for each "pot" of funding. Figure 1 demonstrates the complexity of tracking federal funds for K-12 education. For each of the programs, CDE needs to track prior- and current-year carryovers as well as budget appropriations.

Figure 1

Federal Funding for K-12 Education
California's Allocation

(Dollars in Millions)

	Estimated 2007-08	Budgeted 2008-09	Change From 2007-08	
			Amount	Percent
No Child Left Behind (NCLB) Programs				
Title I				
Title I Basic	$1,643.5	$1,696.4	$52.9	3.2%
School Improvement	16.6	61.8	45.2	272.3
Reading First	137.0	49.0	-88.0	-64.2
Even Start	9.5	7.2	-2.3	-24.2
Migrant	126.9	29.0	2.1	1.7
Neglected and Delinquent	2.5	2.5	—	—
Impact Aid	53.6	65.2	11.6	21.6
Advanced Placement	3.1	3.1	—	—
Title II				
Improving Teacher Quality	$331.2	$333.4	$2.2	0.7%
Mathematics and Science Partnerships	23.6	21.9	-1.7	-7.2
Educational Technology	32.8	30.5	-2.3	-7.0
Title III				
Language Acquisition	$169.1	$177.1	$8.0	4.7%
Title IV				
Safe and Drug-Free Schools	$41.5	$35.2	-$6.3	-15.2%
21st Century After School	127.7	132.0	4.3	3.4
Title V				
State Grants for Innovative Programs	$12.1	—	-$12.1	-100.0%
Title VI				
State Assessments	$33.4	$33.4	—	—
Rural and Low-Income Schools	1.2	1.3	$0.1	8.3%
Small, Rural School Achievement	6.0	6.1	0.1	1.7
Non-NCLB Programs				
Homeless Children and Youth	$7.7	$7.6	-$0.1	-1.3%
Cal-Serve/Service America	1.8	1.8	—	—
Special Education	1,242.9	1,257.8	14.9	1.2
Vocational and Adult Education	140.8	137.4	-3.4	-2.4
Charter Schools	32.6	48.0	15.4	47.2
Child Nutrition[a]	1,647.7	1,644.8	-2.9	-0.2
Child Development[a]	557.3	559.7	2.4	0.4
Totals	**$6,402.1**	**$6,442.2**	**$40.1**	**0.6%**

[a] Funding for these programs is based on the federal fiscal year (beginning October 1). Funding for all other programs is aligned with the state fiscal year (beginning July 1).

Current Approach Results in Delays, Inconsistencies, and Extra Administrative Burden. Because only CDE officially tracks the many pots of federal funds, others involved in the K-12 budget process must rely on CDE for updates on available monies. Without a regular reporting cycle for this information, all other interested parties must make ad hoc requests for information. This situation puts a burden on CDE as it often answers the same question multiple times each year. The lack of a regular reporting cycle also results in delays and inconsistency in information for various decision makers (who may ask for information at different times and then have trouble reconciling different answers).

Lack of Transparency Results in Less Effective Decision Making. Without formal dissemination of consistent information, all decision makers do not have a complete picture of information as they begin budget deliberations. For example, only CDE knows the carryover balances for each program. Occasionally, this lack of transparency about available carryover has resulted in federal funds going unspent and reverting to the federal government. For instance, in December 2007, months after the *2007-08 Budget Act* was signed, CDE disclosed that $18 million in Title I, School Improvement funds were in danger of reverting to the federal government if not expended at the local level by September 2008. Many policy makers were not aware that these funds were in danger of reverting when the budget act was being finalized, so specific expenditure options were not discussed. We believe scheduled and consistent reporting of federal funding could help avoid such situations in the future.

Two Annual Reports Could Improve Budget Process

We recommend the California Department of Education provide the administration and the Legislature with two annual reports on federal funding—a three-year budget summary and a summary of carryover balances. To maximize efficient use of federal funds, we recommend both reports be produced prior to annual budget deliberations.

To address the concerns noted above, we recommend that CDE produce two new, annual reports.

Report on Actual Expenditures and Budgeted Appropriations Would Help Inform Budget Process Up Front. We recommend the Legislature require CDE to provide a three-year picture of federal funds, by program, no later than January 15 of each year. For each type of activity (state operations, state level activity, local assistance, or capital outlay), this budget summary should include: (1) actual expenditures for the prior year, (2) a revised estimate of current-year expenditures, and (3) the budget-year appropriation. Although too late to be helpful to the administration in preparing its budget proposal, the January 15 deadline would help ensure more accurate information is disseminated—as the federal budget should be enacted and information distributed to the states by that time. In addition, the January 15 deadline would ensure the Legislature has timely information before beginning its budget deliberations. This deadline also allows for timely current-year corrections.

Report on Available Carryover Would Enable Timely Response and Minimize Reversions. As noted previously, lack of transparency on federal carryover amounts has been a point of miscommunication in recent years. At times the Legislature and administration have been unaware of carryover that has not been allocated and may revert to the federal government. As a result, they were unable to develop expenditure plans for those funds in a timely manner. We recommend an annual report of carryover amounts and potential reversion dates for each pot of federal funds (by program and fiscal year) be provided by November 1 of each year. We believe this report could be provided earlier than the three-year budget summary report because it does not rely on recent passage of the federal budget. The somewhat earlier deadline for this report would benefit the administration in its budget development as well as the Legislature in its budget deliberations. The deadline would also facilitate timely actions to deal with monies in danger of reverting.

SCHOOL FACILITIES

The Governor's budget estimates that $4.4 billion in already approved state general obligation bonds will be allocated for K-12 school facilities in 2008-09. In addition, as part of his Strategic Growth Plan, the Governor proposes a total of $11.6 billion in new state general obligation bonds for K-12 education facilities to be put before the voters in 2008 and 2010. Below, we provide background on the School Facilities Program (SFP) and discuss the Governor's Strategic Growth Plan. We then highlight several concerns we have with his plan and offer recommendations to address them.

SCHOOL FACILITIES PROGRAM

The SFP, established in 1998, provides state funding to K-12 school districts to buy land, construct new buildings, and modernize existing buildings. The SFP is funded with general obligation bonds approved by California voters. As shown in Figure 1, voters have approved more than $35 billion in general obligation bonds for K-12 school facilities over the last decade.

The SFP provides funding for various types of projects and schools, including new construction, modernization, overcrowded schools, charter schools, joint-use facilities, and career technical education facilities. To qualify for funds to construct new facilities, school districts generally must show the capacity of their current facilities is insufficient to house all students in the district. To qualify for modernization funds, school districts must have facilities that are over 25 years of age.

The state grants provided to districts from the SFP are only intended to provide a share of total project costs. The state generally covers 50 percent of new construction costs and 60 percent of modernization costs. A district facing difficult financial circumstances can apply for "financial hardship" to have the state cover a greater share of project costs (up to 100 percent). School districts raise most of their matching funds with local general obligation bonds. These can be authorized with approval by 55 percent of voters in the district and are repaid using property tax revenues. Districts also can use other local revenue sources, including developer fees, redevelopment funds, Mello-Roos bonds, and School Facility Improvement District bonds. Although the use of these additional revenue sources varies by district, they generally constitute a small portion of school district matching funds.

Figure 1

State Has Approved Over $35 Billion In K-12 Bonds Since 1998

(In Billions)

	Propositions				
	1A 1998	47 2002	55 2004	1D 2006	Totals
School Facilities Program:					
New construction	$2.90	$6.25	$4.96	$1.90[a,b]	$16.01
Modernization	2.10	3.30	2.25	3.30[b]	10.95
Charter schools	—	0.10	0.30	0.50	0.90
Career technical education	—	0.00	0.00	0.50	0.50
Overcrowded schools	—	1.70	2.44	1.00	5.14
Joint use	—	0.05	0.05	0.03	0.13
Green schools	—	—	—	0.10	0.10
Class-size reduction	0.70	—	—	—	0.70
Financial hardship	1.00	—	—	—	1.00
Totals	**$6.70**	**$11.40[c]**	**$10.00[c]**	**$7.33**	**$35.43**

a Up to $200 million is available for earthquake-related safety projects.

b A total of $200 million is available from new construction and modernization combined as incentive funding to promote the creation of small high schools.

c Up to $20 million available for energy conservation projects.

STRATEGIC GROWTH PLAN

The Governor proposes an additional $11.6 billion in general obligation bond funds for K-12 education, to be presented to the voters via ballot measures in November 2008 and November 2010. These funds are intended to provide sufficient state resources for school facilities over the next four years (through 2011-12). Figure 2 (see next page) shows the amount of bond funds proposed by the administration.

Figure 2

Governor's Proposed Bond Measures for K-12 Education

(In Billions)

	2008	2010	Totals
School Facilities Program:			
New construction	$4.4	$2.3	$6.8
Modernization	—	0.8	0.8
Charter schools	1.0	1.0	2.0
Career technical education	1.0	1.0	2.0
Totals	**$6.4**	**$5.2**	**$11.6**

Detail may not total due to rounding.

Fewer Specific Types of Projects Funded. As shown in the figure, the Governor's 2008 and 2010 bond proposals provide funding for fewer specific types of facility projects than Proposition 1D. Neither the 2008 nor 2010 measures would provide funding for overcrowded schools and environmentally friendly (or "green") schools. In addition, the proposed ballot measure for 2008 would provide no funding for modernization of school facilities. School districts have been applying for modernization funds at much lower rates than expected, leaving a significant amount of the $3.3 billion provided by Proposition 1D unspent. As of January 30, 2008, only $591 million in modernization funds had been "reserved" by local school districts.

Changes to Charter School Programs. The Governor's bond proposal also includes various changes to the current program for charter school construction, as well as the charter school grant program that provides funding for rent and lease costs. We discuss these issues in more detail later in this write-up.

Creates a Small High School Pilot Program. The Governor proposes a new pilot program to fund the construction of small high schools. The pilot would provide $20 million from prior-year bond funds to districts who are proposing to build a small high school. The pilot program would require districts to cover only 40 percent of project costs. It is intended to fund a group of schools that is representative of the state.

Changes State/Local Share. The Governor also proposes to change the state/local share for new construction projects. Beginning with the 2008 bond allocations, districts would be required to pay 60 percent of new construction projects, compared to the 50 percent that they must currently cover. (Given the bond would not include funding for modernization projects, the district share of those projects—40 percent—would be unchanged.)

Concerns With Governor's Plan

We have a number of concerns with the Governor's Strategic Growth Plan proposal. Specifically, it fails to address underlying data issues and problems with the financial hardship program. In addition, we think it misses opportunities to further improve school facility programs. We discuss these issues below.

Virtually Impossible to Assess Statewide Need For Additional Bonds

The state has more than $8 billion in previously approved bond funds available for K-12 facilities and has no good data to estimate the need for additional school facilities. Without better data, determining an appropriate amount of bond funding for any K-12 facilities program is virtually impossible. If the state is going to maintain its current facilities program, then we recommend it build a school facilities data system that includes information on the age, capacity, and cost of K-12 facilities. This would enable the Legislature to determine the amount of bond funding needed to meet the needs of K-12 schools in the future.

Significant Funds Remain From Prior Bonds. As shown in Figure 3 (see next page), a significant amount of prior-year bond funds remains unspent. The SFP program has over $8 billion in available funds—funds that have not been set aside for any school district. Over $4 billion of these funds are in the programs the Governor proposes to fund in the 2008 bond—almost $3 billion remains available for new construction, $500 million for career technical education facilities, and $634 million for charter school facilities. An additional $3.9 billion in funds have been approved for specific school district projects but remain unspent because the district has not entered into a construction contract. Given the bulk of this funding is in programs that have struggled to spend all fund reservations, it is quite likely some of this funding will eventually go unused, as districts have their grant awards rescinded.

Virtually None of Proposition 1D Funds Has Been Allocated. As Figure 3 shows, virtually all of the bond funds authorized by Proposition 1D ($7.33 billion) remain unallocated and unspent as of December 2007. Although applications have been submitted for the various programs in Proposition 1D, the State Allocation Board (SAB) has not yet approved them. Given the amount of time required to review and approve projects, it may be premature to approve additional K-12 bonds at this time.

Figure 3

Considerable Prior-Year Bond Funds Remain Unspent

As of December 12, 2007
(In Millions)

Program	New Construction	Modernization	Overcrowded Schools	Charter Schools	Joint Use	Totals
Proposition 47						
Reserved but unspent	$42	$10	$1,238	$30	$4	$1,324
Available	11	—	270	58	—	340
Totals, Unspent	**$53**	**$10**	**$1,508**	**$88**	**$4**	**$1,664**
Proposition 55						
Reserved but unspent	$305	$7	$1,799	$195	$27	$2,333
Available	810	42	288	77	2	1,218
Totals, Unspent	**$1,115**	**$49**	**$2,086**	**$271**	**$29**	**$3,551**
Proposition 1D						
Reserved but unspent	—	$234	—	—	$36	$269
Available	$1,894	2,749	$1,000	$500	5	6,748[a]
Totals, Unspent	**$1,894**	**$2,983**	**$1,000**	**$500**	**$40**	**$7,017**
All Propositions						
Reserved but unspent	$346	$251	$3,037	$225	$67	$3,926
Available	2,715	2,792	1,558	634	7	8,305
Totals, Unspent	**$3,062**	**$3,043**	**$4,595**	**$859**	**$74**	**$12,232**

[a] Total funds available for Proposition 1D also includes $500 million for Career Technical Education Facilities and $100 million for green schools.

Detail may not total due to rounding.

*No Good Data on School Facilities...*In addition to having substantial funds available from prior bonds, the state has no good data to determine the amount of funding that is needed to meet the facility needs of K-12 schools. Currently, it does not collect comprehensive district data on school capacity, making an estimate of overall statewide facility needs difficult. School districts are required to provide enrollment and capacity data when they apply for new construction funding, but they are not required to update this information in years when they do not apply for new construction grants. Thus, the state has no good measure of overall district capacity. Similarly, districts are required to provide information on the age of their facilities when applying for modernization funding. However, they are not required to provide this information for all facilities, and the information is not updated in future years.

...Or Facility Costs. The state also lacks good data on the cost of constructing K-12 facilities. Data from a recent report by the Macias Consulting Group for the SAB contains some information on construction costs, but it does not provide district-specific information on the planning costs, such as architectural and design costs. The Office of Public School Construction (OPSC) does conduct close-out audits for all school projects that receive state funding. However, the purpose of these audits is to ensure that schools have complied with the rules and regulations of the SFP. Because the audit process can be very time-consuming, districts often provide only enough information to show that they have complied with program requirements.

Build New Data Set. If the state is going to maintain its current facilities program, we recommend the Legislature authorize the creation of a statewide database that includes information on the capacity, age, and cost of facilities for school districts. The OPSC would develop and maintain the database, using bond funds to cover associated costs, as it now does for other administrative activities. To encourage widespread participation, the Legislature could require school districts to provide this needed facility data as a condition of receiving funds through the state's Deferred Maintenance Program (almost all school districts participate in this program). However, to help ensure data is collected only when likely to be needed for making state bond decisions, we recommend requiring reporting only every odd-numbered year. With the new facility data, the state would have better information to project future needs and determine reasonable estimates for the amount of future general obligation bonds.

Different Approach Needed for Financial Hardship Program

A recent study highlighted several fundamental problems with the state's financial hardship program. We recommend the state consider an alternative approach to assessing financial hardship that focuses on the local revenue sources available to the district.

Approximately 15 percent of funds provided by the SFP for new construction and modernization projects are through the state's financial hardship program, which provides funding for school districts that are determined unable to provide their matching share of project costs. Since the inception of the SFP (1998), the state has provided on average almost $300 million a year for the financial hardship program. A recent study (conducted by the Macias Consulting Group for the SAB) found that many school districts that applied for financial hardship for new construction and modernization projects were taking on short-term debt and temporarily transferring funds out of their capital outlay accounts to appear financially needy. Such action allowed them to qualify for additional state funding and reduce or eliminate their local share. Any funding provided to school districts for financial hardship cannot be provided for additional facility projects. The Governor, however, does not propose any changes to address these issues.

Focus on Revenue Sources Rather Than Account Balances. Given these problems, we recommend the Legislature take a new approach to determining financial hardship. Specifically, we recommend the Legislature set reasonable expectations of what a district should contribute, without looking at specific account balances. This approach would look at two indicators of district resources—the assessed value of property within the district and the amount of revenues from developer fees—to determine an expected district contribution. The state would provide hardship funding if the costs of construction projects exceeded the expected district contribution. This approach would be more equitable—expecting all districts to contribute but linking their contribution to objective measures of their property values. Such an approach also would reduce incentives for school districts to incur short-term debt merely to appear needy. In addition, it would neither penalize financially needy districts that have good reasons for saving up capital outlay resources, nor create incentives for clever accounting practices that advantage some districts at the expense of other districts.

Charter School Facilities

Charter schools are publicly funded K-12 schools that adopt local education contracts in exchange for flexibility from many laws relating to specific education programs. This flexibility is designed to allow charter schools to develop innovative education practices. For a charter school to operate and receive state funding, it must be authorized by a district school board, county board of education, or the State Board of Education. Charter schools are funded primarily through a base grant and a categorical block grant. Both grants can be used for general school operations. Charter schools also are eligible to apply and receive funding for certain categorical programs. Most charter schools do not receive specific funding for leasing or operating classroom facilities. Instead, they use general purpose funds to cover these costs.

Proposition 39 Intended to Address Facility Issues. Proposition 39, approved by the voters in 1998, requires school districts to provide charter schools with facilities that are similar in quality to those of other district school facilities. If the district incurs costs for providing the facilities, the district can charge the charter school for the cost of operating the facilities. The district, however, is not required to use its own general purpose monies to operate the facilities. Charter schools must submit a timely request to the district with estimates of the number of students that will need to be housed.

Proposition 39 Not Working as Well as Intended. Although no data exists on the number of charter schools that are housed in district facilities, these arrangements are not common. This is because the facilities offered by the district often do not suit the needs of the charter school given their location or capacity. Other times districts and charter schools cannot come to an agreement on the amount that the charter school will pay for using district facilities. These issues have caused considerable conflict among charter schools and school districts throughout the state. Indeed, several charter schools have sued their local school districts over failing to provide equivalent facilities.

Grant Programs for Charter School Facilities

Although most charter schools do not receive funding for facilities, charter schools located in low-income areas currently can receive funding from two grant programs. One program is state funded and operated by the California Department of Education. The other is federally funded and operated by the State Treasurer's Office (STO). These two programs are discussed below.

Charter School Facility Grant Program. This program was established in 2001 through Chapter 892, Statutes of 2001 (SB 740, O'Connell), and is commonly referred to as the SB 740 program. To qualify for the program, charter schools must have enrolled or be located in the attendance area of an elementary school where at least 70 percent of students qualify for free or reduced-price meals. Qualifying schools can receive grants of up to $750 per unit of average daily attendance (ADA), but their allocation cannot exceed 75 percent of their annual lease costs. If funding is insufficient to meet demand, grant awards are prorated so that all qualified applicants can receive an award. In 2006-07, the grants were prorated such that each school received 57 percent of its eligible grant award. For 2007-08, $18 million was provided, which is expected to fully fund all 134 qualifying schools. Since its inception, the number of ADA funded by the program has increased from 10,930 in 2002-03 to 32,072 in 2006-07. Funding is provided on a reimbursement basis at the end of the school year. Schools must establish eligibility every year.

State Charter School Incentive Grants. In addition to the SB 740 program, the state operates the State Charter School Facilities Incentive Grants program. For these incentive grants, the state was awarded an annual federal grant of $9.9 million for four years, beginning in 2004-05. A total of 86 charter schools have received incentive grants. Like the SB 740 program, schools receive $750 per pupil, not to exceed 75 percent of lease costs, but the annual grant amount is capped at $250,000. The incentives grant program differs from the SB 740 program in that schools can use funds not only to cover lease costs but also to cover mortgages and debt obligations related to facilities. In addition, schools can use grants to pay for construction costs or purchase property for a new facility. Schools who use the grant for construction costs can receive up to $1,000 per pupil, not to exceed 75 percent of eligible costs and no more than $500,000 per year. Incentive grants are provided through a competitive process. Schools are given preference if they serve low-income students, are located in the attendance area of an overcrowded district, are operated by a nonprofit entity, and have met their Academic Performance Index growth targets. Grant recipients are eligible to receive their award for three years. Current law prohibits charter schools from receiving funding through both the SB 740 and incentive grants program.

Bond Programs for Charter School Facilities

In addition to providing funding for charter school facilities through per-pupil grants, the state provides funding for the construction of new charter school facilities. In 2002, through Proposition 47, the Charter School Facility Program (CSFP) was established. The measure provided $100 million in general obligation bond funds for the construction of charter school facilities or the rehabilitation of existing facilities. Additional funds were provided for the CSFP through Proposition 55 ($300 million) and Proposition 1D ($500 million).

Application Process. To qualify for funding, charter schools must submit applications to the Office of Public School Construction and be considered financially sound by the STO. Charter schools are given preference if they serve low-income students, are located in the attendance area of an overcrowded district, are operated by a nonprofit entity, or are renovating existing facilities. The program is designed to provide 50 percent of project costs—charter schools must provide the other 50 percent of costs. Charter schools typically use low-interest state loans to cover their costs. Schools that are selected are given a "preliminary apportionment," which means that the funds are reserved for the school by the state for their specific project. Schools have four years after being awarded a preliminary apportionment to enter into a construction contract and move forward with the project. At this point, the project receives a "final apportionment" and funding is released to the charter school. The school can apply for a one-year extension if they are unable to enter into a construction contract after four years.

After Five Years, Little Progress. Although the state has provided far more funding for the CSFP than its existing grant program, charter schools have struggled to use the funds. Through Propositions 47 and 55, the state provided funding for 34 charter school projects. At this time, no charter school projects have been completed from CSFP funding. Although three schools have converted their awards to final apportionment and are beginning construction, six charter schools have had their awards rescinded because they were unable to meet the requirements of the program. Last July, the SAB provided one-year extensions to three schools that received funding through Proposition 47. In addition, there are 20 schools funded through Proposition 55 funds that remain in the program. At this point it is uncertain if these schools will be able to find an appropriate site and enter into a construction contract before their apportionments expire. Considering the difficulties that other charter schools have faced trying to build a new school, it is likely that many of these applicants will be unable to construct a new school and will have their grants rescinded.

Proposition 1D Funds Yet to Be Awarded. Grant awards for Proposition 1D funding are expected to be awarded to schools in March 2008. Much like previous funds, it is expected that all available funds will be awarded to charter schools. However, given the difficulties that charter schools have faced in previous years, it is likely that a substantial number of schools will be unable to construct a new school with Proposition 1D funds.

Charter Schools Face Many Roadblocks to Constructing Facilities

Most of the problems charter schools have had in moving forward on construction projects are due to charter school's unique characteristics. Although charter schools benefit from being exempt from many state laws and regulations, they also are hindered by being unable to take advantage of many powers that school districts possess. We discuss problems with the current approach to funding charter school facilities below.

Cannot Use Eminent Domain. The process of finding and purchasing an appropriate school site can be very difficult for charter schools. School districts are able to use the power of eminent domain, which allows them to take private property for public use (even if an owner is disinclined to sell the property) as long as the current owner is compensated fairly. Often the threat of using eminent domain powers is enough to convince private property owners to come to an agreement with the school district. Charter schools, however, do not have the power of eminent domain. This makes finding an appropriate school site very difficult, particularly in large urban areas where the majority of land has been developed.

Must Comply With Zoning Restrictions. In addition, charter schools must comply with local zoning laws that restrict the types of buildings that can be built in certain neighborhoods. School districts are exempt from these zoning restrictions, but charter schools must comply or request that local agencies make changes to these restrictions to accommodate the school.

Tension With Districts. Current facility laws and regulations often place school districts and charter schools in competition with one another. Current law requires the local school district to own title to a charter school facility constructed through the CSFP. To receive state construction funding, charter schools must submit a memorandum of understanding (MOU) signed by the charter school and the local school district that gives title of the property to the school district. (The MOU must also be signed by the state if the charter school is taking out a loan from the state for its 50 percent match.) By signing the MOU, the school district is liable for any problems that occur on the site. If the school were to lose its charter or go bankrupt, the district would take possession of the land. School districts are typically hesitant to enter into this type of agreement. They are generally not interested in owning the particular site and are concerned about the liability issues in the school. Under current law, a school district is not required to sign the MOU, effectively giving it the power to veto a charter school project.

Charter Schools Cannot Raise Local Revenue. Charter schools typically take out a loan from the state to pay for their local match requirements. The loan is paid off using general purpose revenues. Unlike school districts, they are not able to initiate local general obligation bond measures. Proposition 39 allowed school districts to use proceeds from local general obligation bonds to provide funding for charter schools located within the district but did not explicitly require it.

Charter Schools Face More Risk. Given charter schools do not have identified attendance areas like school districts, they are more vulnerable to fluctuations in student enrollment. A drop in enrollment would reduce the school's state revenue and make raising funds to pay the 50 percent matching share of construction costs more difficult. In addition, building an appropriately sized school when enrollment levels are unstable involves greater risk. Unlike school districts, charter schools also must face the risk of having their charter revoked by their authorizer. Since charter schools are up for renewal every five years, they may be less willing to incur long-term debt to construct a new school. These risks likely would make creditors less willing to provide loans to charter schools to construct a school outside of the state program.

Governor's Charter School Proposals Moving in Right Direction

As part of his 2008 bond proposal, the Governor proposes several changes to existing law regarding the CSFP and the SB 740 grant program. These changes will likely make charter schools more successful in completing construction projects and will provide more flexibility through the SB 740 program.

Additional Options With Regards to Holding Title. The Governor's proposal would allow another local government entity besides a school district—such as a city, county, or county board of education—to own title of a charter school facility. In addition, if a charter school is unable to find a local government agency to agree to hold title to the facility, the charter school may hold title. In such cases, the state would be able to recover the property if the school's charter was revoked or if the charter school was unable to pay back its loan from the state. This eliminates one of the significant obstacles that charter schools face in constructing a new school.

Gives Preference to Low-Performing Districts. Under the current CSFP, charter schools are given priority if they are in an overcrowded district, a low-income area, are operated by a nonprofit group, or utilize existing school district facilities. The Governor proposes to eliminate the preference for schools in overcrowded districts and would instead include a preference for charter schools in low-performing school districts.

More Flexibility for SB 740 Program. The Governor proposes to apply some of the flexibility of the federal incentive grant program to the SB 740 program. In addition to using funds for lease costs, charter schools would be able to use the funds for debt service or mortgage payments related to construction of new facilities.

Further Improvements Could Be Made for Funding Charter School Facilities

While the Governor's proposals would make significant improvements to the system, additional changes could be made to further improve facilities programs for charter schools. In addition to approving many of the Governor's proposals, we recommend the Legislature explore three other options: (1) providing more resources to per-pupil grant programs rather than increasing bond funds; (2) expanding eligibility for the SB 740 program; and (3) as a condition of participating in

the state facility program, requiring local school districts to provide charter schools with proceeds from local bonds.

The Governor's proposal makes many changes that would help improve the system of funding for charter schools facilities. Schools, for example, should be better able to construct their own facilities if they are able to hold title. In addition, the flexibility provided in the SB 740 program would provide another avenue for schools to build new facilities outside of the CSFP, while still providing support to schools who are renting and leasing facilities. The Legislature, however, could make additional changes to further improve charter school facilities programs. We discuss these additional changes below.

Provide Ongoing Per-Pupil Grants Rather Than Additional Bond Funding. Because of the high risks that charter schools face, leasing facilities is generally a more attractive option than building a new school. As a result, we recommend the Legislature consider providing additional funding for per-pupil grants rather than authorize additional bond funds for new construction. For example, rather than providing $1 billion in bond funds for new charter school facilities (as proposed by the Governor for the 2008 bond), the Legislature could provide an equivalent annual amount in per-pupil grants. Paying off debt service for $1 billion in general obligation bonds typically requires annual payments of approximately $65 million per year for the next 30 years. The state could provide this funding through the SB 740 program, with the flexibility proposed by the Governor to allow schools to use SB 740 funds for new facilities. This funding could be provided using the annual budget process.

Allow More Charter Schools to Participate. With an increase in ongoing funds for the SB 740 program, the Legislature could expand eligibility to charter schools that are not located in low-income areas. The state could allow all charter schools not housed in district facilities to be eligible for the program, with priority given to charter schools located in low-income areas, low-performing or overcrowded districts, and schools undertaking renovation projects. The Legislature would need to amend current law to change the eligibility criteria.

Require Districts to Provide Charter Schools With Local Bond Funds. In order to improve the ability of charter schools to raise funds for construction projects, the state could amend current law and require school districts to set aside a share of local general obligation bonds for K-12 facilities that is equivalent to the share of students living in the district who attend charter schools. Charter schools could use their local share to participate in the CSFP. This also would enable charter schools to have an available source of revenue to pay for site acquisition and design costs prior to receiving state funds. (If a charter school was not interested in constructing a new facility, it could choose to turn down the funds, thereby freeing up the funds for other school district facility purposes.)

California State Teachers' Retirement System (1920)

The California State Teachers' Retirement System (CalSTRS) administers pension and other benefits for about 800,000 current and former educators of school and community college districts. In order to fund defined monthly benefits to eligible retired teachers, CalSTRS uses (1) returns generated from its $174 billion investment portfolio and (2) contributions made pursuant to state law by teachers, districts, and the state.

Under current law, the state must make two separate annual payments to CalSTRS from the General Fund:

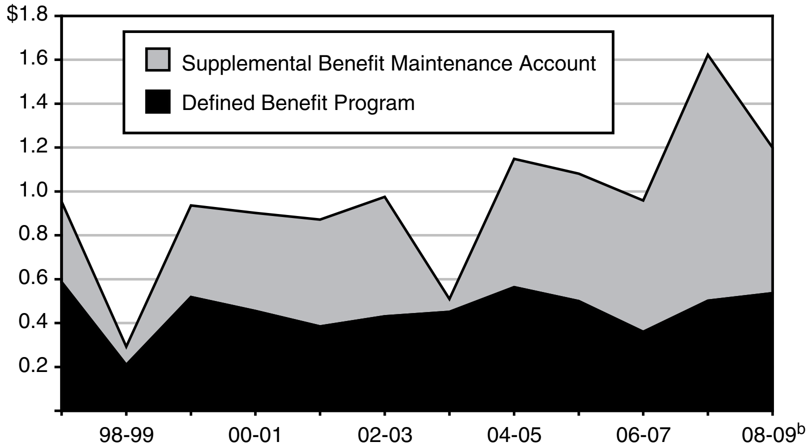
- A payment of about 2 percent of prior-year teacher payroll for CalSTRS' Defined Benefit (DB) Program, which funds the basic pension benefits of retired teachers.
- A payment of 2.5 percent of prior-year payroll for the Supplemental Benefit Maintenance Account (SBMA), which is also known as the "purchasing power account." The SBMA funds prevent erosion of the purchasing power of retirees' benefits by the effects of inflation.

Figure 1 shows that the state's contributions to CalSTRS in recent years have been volatile due to several prior legislative actions that have produced one-time budget savings. The *2008-09 Governor's Budget* proposes $1.1 billion to cover the two regular annual payments to the DB Program and SBMA, about the same amount as those two regular payments during 2007-08. In addition, the budget reflects increased expenditures in 2007-08 and 2008-09 due to a court order described below which reverses legislative action in 2003-04. In total, the administration estimates that state contributions to CalSTRS will total $1.6 billion in 2007-08 and proposes $1.2 billion in contributions in 2008-09.

Figure 1

State Contributions to CalSTRS[a]

(In Billions)



[a] State contributions declined in 1998-99, 2003-04, and 2006-07 due to statutory actions that generated one-time budget savings. Contribution rates for the Defined Benefit Program were adjusted pursuant to statutes in 1998 and 2000.
[b] Proposed.

System's Funded Status Improved in Most Recent Valuation

The most recent California State Teachers' Retirement System actuarial valuation reported that the system's unfunded liability declined for a second consecutive year to $19.6 billion in 2006. Measured as a percentage of the system's total liabilities, this unfunded liability is about average among comparable pension systems.

System Is 87 Percent Funded, With $19.6 Billion Unfunded Liability. The system's actuaries reported that, as of June 30, 2006, CalSTRS' unfunded actuarial obligation for its DB Program was $19.6 billion, and the actuarially determined value of DB Program assets on hand was $150 billion (the bulk of the system's assets). This means that the program is 87 percent funded. According to a recent report by the Pew Center for the States, the average state pension system in the U.S. is 85 percent funded.

Proposal to Address Liabilities Would Require Legislative Approval. In 2006, the Teachers' Retirement Board (TRB), the governing body of CalSTRS, formulated a general proposal to address the unfunded liability but has yet to formally submit it to the Legislature. Among other provisions, the proposal would give TRB the authority to increase required contributions by teachers, districts, and the state. The Legislature must approve any such change in TRB's authority.

Proposal to Delay Court-Ordered Interest Payment Is Risky

The administration complied with part of a recent court order and paid in 2007-08 $500 million withheld from the California State Teachers' Retirement System (CalSTRS) purchasing power account in 2003-04. To comply with another part of the order—to pay over $200 million in interest—the administration proposes to pay the costs over a three-year period beginning in 2008-09. Unless CalSTRS and other parties in the case agree to this payment plan, we recommend that the Legislature reject it because it probably would be legally unworkable. If CalSTRS and the other parties do not agree to the plan, we recommend that the Legislature comply with the court order and appropriate funds to pay the entire interest obligation, as well as other court-ordered costs, in the* 2008-09 Budget Act *or earlier.

Administration Lost Its Appeals on CalSTRS SBMA Lawsuit. In our *Analysis of the 2007-08 Budget Bill* (see page F-67), we described the lawsuit related to the state's withholding $500 million from CalSTRS' purchasing power account on a one-time basis in 2003-04. In 2007, an appellate court ruled against the administration, and the California Supreme Court declined to hear further appeals. To comply with the court order, the state made a $500 million principal payment to CalSTRS in September 2007. In addition to the principal payment, the courts have ordered the state to pay (1) interest in specified amounts "until the date that the $500 million is deposited into the SBMA" and (2) costs of the other parties in the case. The administration estimates that the interest costs total about $210 million. The other parties' legal costs may total around $11,000.

Budget Proposal Would Pay Interest Costs Over Three-Year Period. The $500 million principal payment was paid to CalSTRS under the terms of the continuous appropriation for the SBMA. In contrast, the payment of interest requires an appropriation by the Legislature. The administration proposes that the Legislature approve a plan to pay the court-ordered interest over three years beginning with a payment of $80 million in 2008-09. Specifically, the administration proposes that the payments for interest and court costs be appropriated in the annual claims bill.

Ability to Delay Interest Payments Is Uncertain. The court order does not mention the possibility of paying interest over a multiyear period. In addition, we are not aware of precedent in similar cases to pay interest costs over a multiyear period without agreement from the other litigating parties. (In this case, the other parties are CalSTRS and a group representing retired teachers.) If these other parties were to agree to such a payment plan, they probably would insist on *even larger* payments from the state over time to compensate for the investment returns that CalSTRS would likely forego as a result of giving up the ability to begin investing the entire interest payment immediately. In short, without the other parties agreeing to the administration's payment plan, the viability of such a measure in the courts is very uncertain. With such an agreement, state costs would likely increase even more in future years.

Recommend Paying Interest in One Lump Sum. Barring an agreement from the other parties to pay the required interest over several years at no additional state cost, we recommend that the Legislature comply with the court order and appropriate funds to pay the entire interest obligation (as well as any court-ordered costs) in the 2008-09 budget or earlier. This would increase General Fund costs over the two-year period of 2007-08 and 2008-09 by over $130 million, compared to the administration's budget plan. This approach, however, limits the potential for any future liabilities from this case.

Recommend That Legislature Again Reject Plan to Guarantee Teacher Benefit

We recommend that the Legislature reject the administration's proposed trailer bill language to (1) guarantee retirees' purchasing power benefits through the California State Teachers' Retirement System (CalSTRS) and (2) reduce General Fund costs by $80 million in 2008-09. There are major risks in assuming that the proposed change will generate budget savings, and we are concerned about the idea of the **state** ***guaranteeing another benefit through CalSTRS, which serves employees of*** **local** ***districts.***

Budget Proposes Changing State Payments and Guaranteeing the Benefit. As the administration proposed one year ago, the Governor's budget again proposes changing the annual SBMA appropriation from 2.5 percent of prior-year teacher payroll to 2.2 percent. The administration proposes amending the law to guarantee CalSTRS members that they will receive the current SBMA benefit: 80 percent of the purchasing power of the retiree's original monthly benefit, as measured by annual inflation increases. Currently, this benefit is not guaranteed and instead must be paid to retirees by CalSTRS only to the extent funds are available in the account. This year's administration proposal, unlike last year's, also proposes that the annual SBMA payments be made in two equal payments on November 1 and April 1 of each year. Currently, the state makes one SBMA payment each year on July 1.

This Year's Proposal Is Less Likely to Be Workable Than Last Year's. Longstanding California case law in the area of public employees' retirement benefits requires that a government's changes in pension benefits resulting in disadvantages to employees be accompanied by "comparable new advantages" for those same employees. In the *Analysis of the 2007-08 Budget Bill* (see page F-68), we discussed some of the legal risks of the administration's earlier SBMA proposal. The Legislature did not approve the administration's proposal, and a payment equal to 2.5 percent of prior-year teacher payroll was paid to CalSTRS' SBMA account in early July under its continuous appropriation (while the Legislature was still deliberating on the *2007-08 Budget Act*.) This year's administration proposal carries greater legal risks. The new advantages to CalSTRS members under the proposal (a guarantee of the current SBMA benefits for the first time) are clear, though not quantifiable in their value. At the same time, the disadvantages to employees (reduction in the state's annual payments and the delay in those payments past July 1, which would diminish CalSTRS' ability to earn investment returns) are substantial and able to be estimated. The addition of the proposal to delay the state's payments, therefore, reduces the chance that the plan would be legally workable. (Statutory changes related to SBMA probably would need to be enacted into law prior to July 1 in order to reduce 2008-09 General Fund costs.)

Proposed Language Could Add State Costs. On January 31, 2008, the administration submitted trailer bill language to implement its proposals. These provisions would give TRB the authority to set the state's contribution rates for SBMA beginning in 2009-10. Based on prior actions of the TRB and statements by CalSTRS' consulting actuaries, this raises the strong possibility that state contribution rates would rise back to 2.5 percent of prior-year payroll *or even higher* after the budget year. As a result, the state could end up paying more each year under the administration's proposal. We will provide additional analysis of these provisions during budget subcommittee hearings.

Legislature Should Pursue Broader Reforms. An actuarial valuation obtained by the administration indicates that the current-law contributions to SBMA may, over time, lead to the account accumulating a significant fund balance. In contrast to the Governor's proposal, we believe that any excess moneys should be used to first shore up the financial condition of the DB Program as part of a comprehensive reform of CalSTRS. We recommend reforms that (1) place clear responsibility on local districts to fund their own teacher retirement benefits in the future and (2) give districts and their teachers and administrators greater flexibility to determine the level of retirement benefits they wish to fund. The administration's proposal, by contrast, means the state would be guaranteeing yet another benefit for local districts' employees. This proposal moves CalSTRS in the wrong direction.

Recommend Rejecting Administration's Proposal to Change SBMA Benefits. Given both the legal risks and our policy concerns, we recommend that the Legislature reject the administration's proposed changes to SBMA benefits. This would increase General Fund costs by $80 million in 2008-09.

Recommend Applying Commission's Independent Performance Audit Recommendation to CalSTRS

The Public Employee Post-Employment Benefits Commission recommends that all public pension plans have periodic performance audits performed by independent auditors. Current law requires the California State Teachers' Retirement System (CalSTRS) to have an independent audit annually, but restricts the ability of the Bureau of State Audits or Department of Finance to review CalSTRS' books and operations. This restriction lacks clarity and could be construed to limit the Legislature's authority to request performance audits of certain CalSTRS programs. Accordingly, we recommend that the Legislature enact a law that repeals or clarifies this restriction.

PEBC Report Contains 34 Recommendations for the State and Local Governments. The Public Employee Post-Employment Benefits Commission (PEBC) report lists 34 recommendations for California state and local policy makers—grouped into eight general categories. The report contains several recommendations to promote independent analyses of pension system operations and transparency for policy makers, system members, and the general public.

Commission Recommends More Independent Audits of Pension Systems. The PEBC recommends that "all public pension plans should have periodic performance audits performed by an independent auditor." Pension systems, including CalSTRS, already are required to hire an outside, independent accounting firm each year to audit their financial records to ensure compliance with generally accepted accounting rules. However, current law, the commissioners conclude, "does not provide for regular performance audits of public retirement systems," which "could look at any aspect of the workings of a retirement system (administrative, investment, or benefit delivery), compare policies to practice, and provide valuable insight into how operations might be improved." We concur with this recommendation.

Current Law Restricts Ability of Legislature to Request Such Audits. Section 22217 of the Education Code requires CalSTRS to have its financial records audited annually by an independent accountant. The law, however, states that "the audits shall not be duplicated by the Department of Finance (DOF) or the State Auditor." In state government, DOF and the

Bureau of State Audits (BSA) are the principal entities that the Legislature may direct to conduct performance audits of government programs. This code section is unclear if these restrictions also apply to DOF and BSA concerning performance audits.

Recommend Repealing or Clarifying Restriction. Accordingly, we recommend repealing or clarifying the law so that DOF and BSA may conduct performance audits on the programs of CalSTRS. This would allow the Legislature, including the Joint Legislative Audit Committee, to request performance audits of CalSTRS without any restrictions, similar to the way that lawmakers may request audits of other state programs.

Other Issues

In the "Proposition 98 Priorities" section of this chapter, we outline our recommendations for aligning the budget-year spending plan with the amount of funding that would be available under our alternative budget. Below, we discuss several of our specific program recommendations in greater detail.

Eliminate Physical Education Teacher Incentive Grants

We recommend the Legislature eliminate the Physical Education Teacher Incentive grant program (for savings of $42 million, Proposition 98 General Fund) because it does not distribute funds based on need, has no built-in accountability measures, and prioritizes physical education above other subject areas.

The *2006-07 Budget Act* established the Physical Education Teacher Incentive (PETI) grant program, which provides $35,000 to 1,142 K-8 schools to hire a teacher specifically to provide physical education instruction to students. Schools were selected randomly but were to be representative of schools statewide, based on the size, type, and geographic location of the school. In 2007-08, the program was continued for the same schools and recipients were provided a 4.5 percent cost-of-living adjustment. For the budget year the Governor proposes to reduce program funding by 6.9 percent, which would result in schools' grants amounts being reduced by the same percentage.

Three Major Concerns With Program. We have several concerns with the PETI program:

- Rather than distribute funding to schools based on demonstrated need, the PETI provides funding to a randomly selected group of schools that is locked in place into perpetuity. Such a program therefore magnifies inequities among schools without any underlying rationale.

- The program has no built-in accountability measures for assessing its effectiveness. Aside from verifying that the grant was spent on teacher salaries, participating schools have no additional reporting requirements.
- Currently the state does not provide supplemental funding to K-8 schools for other essential services, such as science instruction. This places physical education as a priority over other core subject areas.

For these reasons, we recommend that the program be eliminated, for an annual savings of $42 million.

Eliminate Duplicative School Safety Grants

We recommend the Legislature eliminate a relatively small school safety program that largely duplicates the efforts of the state's larger school safety program. Eliminating the School Safety Consolidated Competitive Grant program would save $18 million in Proposition 98 General Fund monies (from the* 2007-08 Budget Act *level).

The School Safety Consolidated Competitive Grant program (SSCCG) awards grants of up to $500,000 for a five-year period for local educational agencies (LEAs) to address school safety and violence prevention issues. This competitive grant is open to LEAs serving kindergarten through grade twelve for school safety activities involving community collaboration. No accountability, reporting, or evaluation requirements exist for SSCCG. In 2007-08, the state provided $18 million for this program. This funding level resulted in 31 grants to serve 46 schools. For 2008-09, the Governor has proposed a funding level of $17 million.

State Has Another, Larger, More Flexible School Safety Program. In addition to SSCCG, the state funds the School Safety Block Grant program. This program serves the same purpose as SSCCG—providing grants to LEAs to address school safety and violence prevention issues. Funds may be used for personnel, materials, strategies, programs, or any other purpose that would materially contribute to reducing violence among students and providing safe schools. The Superintendant of Public Instruction is required to report annually to the Legislature regarding this program and grantees are required to provide information, as requested. In 2007-08, the state provided $101 million for this program and over 950 LEAs received apportionments—including all 31 of the LEAs receiving SSCCG grants. For 2008-09, the Governor has proposed a funding level of $94 million.

Eliminate Duplicative Program. We recommend the Legislature eliminate the SSCCG for the following reasons:

- ***No Accountability.*** Recipients are not required to achieve any particular results nor report any information to the state, such as incidents of violence or how funds are spent.
- ***Less Flexible than Larger Program.*** The competitive grant program is less flexible than the block grant in allowing LEAs to address school safety issues.
- ***Complete Overlap in Participation.*** In 2007-08, 100 percent of competitive grant recipients also received block grant funding.

Phase Out Year Round Schools Grant Program

We recommend the Legislature reduce funding for the Year Round Schools grant program by $19 million in 2008-09 (from the* 2007-08 Budget Act *level) and phase out the entire program over a four year period because fewer school districts are participating in the program and most schools are expected to be off multitrack calendars by 2012-13.

The Year Round Schools (YRS) grant program provides funding for schools that operate on a multitrack year round calendar and enroll more students than the state's facility capacity standards. Under a multitrack calendar, students are split into "tracks." Schedules are staggered so one track is on vacation at a time, allowing schools that are over capacity to still adequately provide classroom space for all students. For example, a school of 1,000 students operating with four tracks only needs to have school facilities sufficient to instruct 750 students at one time. The YRS program provides a dollar amount per pupil that is adjusted depending on the degree to which a school site is above its capacity. The *2007-08 Budget Act* provided $97 million for the YRS program. The Governor proposes to reduce funding to $91 million in the budget year.

Schools Are Moving Off Multitrack Calendars. Over the last several years, the YRS program has experienced a significant decline in the number of participating school districts. In 2004-05, 16 school districts received funds through the program. Only four districts have requested funds in 2007-08. Due to statewide enrollment declines, some schools no longer qualify for the program. In addition, a majority of the schools that currently receive YRS funding are not expected to be on a multitrack calendar by 2012-13. The settlement of the *Williams* lawsuit in 2004 also requires the state to eliminate by 2012 the "Concept 6" calendar, a type of multitrack calendar that reduces the number of days of instruction but increases the length of the school day.

Because of the expected decline in the program and fiscal challenges facing the state, we recommend reducing the program to $78 million in the budget year, a reduction of $13 million from the proposed level. We further recommend the state reduce the program by $19 million each subsequent year until 2012-13, at which time we recommend sunsetting the program.

Reduce STAR Testing

We recommend the Legislature eliminate the norm-referenced test portion of the Standardized Testing and Reporting program for budget-year savings of $2.5 million in federal Title VI funds. (Reduce Item 6110-113-0890 by $2.5 million.)

The administration's workload budget proposes $117 million in state and federal funds for the state's assessment program in 2008-09. This includes $71 million for the Standardized Testing and Reporting (STAR) program ($62 million Proposition 98, $8.6 million federal Title VI). This is virtually the same spending level as in the current year (after accounting for one-time expenditures in 2007-08).

Under STAR, students in grades 2 through 11 take at least two tests each year—mathematics and English language arts. In grades 3 and 7, students also take a national norm-referenced test in the same subjects. In addition, students may be assessed in writing, history, and science depending on the grade level. The STAR program also includes tests for special education and Spanish-speaking students.

Eliminate the Norm-Referenced Tests. The bulk of the STAR assessments have been administered for several years. The maturation of the testing system provides the opportunity to take stock of the various tests within STAR. The state could save about $2.5 million annually by eliminating the national norm-referenced tests in grades 3 and 7 with—in our view—little loss of information about the progress of students in California.

This change could be made because the tests no longer serve a critical statewide purpose. As originally enacted, the STAR tests included *only* national norm-referenced tests. The norm-referenced tests, however, are not aligned with California's content standards. For this reason, the state developed the California Standards Tests (CSTs), and norm-referenced testing continued only in grades 3 and 7. Since the early 2000s, the state has relied on the CSTs to assess student progress based on the state standards. These tests have been proven accurate and aligned to standards.

One rationale for continuing the norm-referenced tests was to provide information on how students in California perform compared to the rest of the nation. This link to national performance standards is also provided through the federal National Assessment of Educational Progress (NAEP). The NAEP annually assesses a sample of 4^{th} and 8^{th} grade students in each state. While it is not perfect, NAEP represents an assessment of the relative progress of the state's students compared to students in other states.

As a result, the norm-referenced tests no longer play an important role in the state's testing program. We recommend, therefore, the Legislature eliminate the tests and save $2.5 million in the budget year. In terms of testing time, this recommendation would save 2.5 hours of testing in third grade and three hours in seventh grade. This represents about a 30 percent reduction in testing time for most students in these grades.

Use Federal Funds for CalPADS

We recommend the Legislature use federal Title VI funds in lieu of $3.2 million in General Fund (non-Proposition 98) proposed for the California Pupil Assessment Data System in 2008-09. (Reduce Item 6110-001-0001 by $3.2 million, increase Item 6110-001-0890 by $3.2 million.)

The budget proposes to spend $10.9 million from various sources for the development and administration of the California Pupil Assessment Data System (CalPADS). Of this amount, the budget includes $3.2 million in non-Proposition 98 General Fund dollars. These funds are proposed to pay for the California Department of Education's (CDE) operational costs ($1 million) and for hardware and software purchases and other development costs for the program ($2.2 million). The Governor's budget request is consistent with 2008-09 costs outlined in CDE's recently signed contract for the development of CalPADS.

The CalPADS system has been in the development process for several years. When complete, it will provide access to student-level information on state assessments, graduation and dropouts, and other data. As a result, CalPADS will provide significantly more information about the progress of students over time. According to the department, CalPADS will be operational in 2009.

We recommend approval of the amount proposed for CalPADS. We recommend, however, that the Legislature support the data system with federal funds rather than state General Fund monies. Given the state's fiscal situation, the Legislature should take every opportunity to use federal funds in lieu of the state's General Fund to pay for program activities in the coming year. Title VI is an appropriate funding source to pay for CalPADS. By substituting federal funds for non-Proposition 98 support for CalPADS, our recommendation would free-up $3.2 million that could be used for any General Fund program across the budget.

The $3.2 million in federal funds would come from two sources. First, the Legislature could use the $2.5 million in savings that would result from our recommendation to eliminate the norm-referenced tests in the STAR program. The other $700,000 in federal funds can be added to the budget without any corresponding program reductions because the Governor's Budget proposes to spend *less* in new Title VI funds than are available in the budget year.

Therefore, we recommend the Legislature reduce the department's General Fund support item (6110-001-0001) by $3.2 million and augment the department's federal fund support item (6110-001-0890) by the same amount.

Introduction

Higher Education

The Governor's budget proposes a net reduction of $261 million in General Fund support for higher education in 2008-09. This represents a 2.3 percent reduction from the revised 2007-08 amount. For the University of California (UC) and the California State University (CSU), the reductions are almost all unallocated. However, student fee increases would generate significant revenues for the universities. General Fund support for the California Community Colleges (CCC) would be reduced by $40 million in the current year and an additional $112 million in 2008-09. However, the budget assumes increased property tax revenues in 2008-09 that could more than backfill this reduction. No fee increase is proposed for CCC. The California Student Aid Commission (CSAC) would receive a net General Fund increase of $48 million, largely to fund increased costs of the Cal Grant entitlement program. The budget would also support 151 capital outlay projects at the three segments, using $1.6 billion in funding from higher education bonds.

Total Higher Education Budget Proposal

As Figure 1 (see next page) shows, the 2008-09 budget proposal provides a total of $33.4 billion from all sources for higher education support costs. (This total could change depending on decisions by UC and CSU on fee levels, as discussed in more detail below.) This amount is $401 million, or 1.2 percent, less than the Governor's revised current-year proposal. The total includes funding for UC, CSU, CCC, Hastings College of the Law, CSAC, and the California Postsecondary Education Commission. Funded activities include instruction, research, and related functions, as well as other activities, such as providing medical care at UC hospitals and managing three major U.S. Department of Energy laboratories. (Capital outlay expenditures are discussed at the end of this section.)

Figure 1

Governor's 2008-09 Higher Education Budget Proposal

(Dollars in Millions)

	2007-08 Revised	2008-09 Proposed	Change	
			Amount	Percent
UC				
General Fund	$3,260.7	$3,162.2	-$98.5	-3.0%
Fees	2,151.5	2,331.3[a]	179.8	8.4
Subtotals	($5,412.3)	($5,493.5)	($81.3)	(1.5%)
All other funds	$12,656.9	$13,210.1	$553.2	4.4%
Totals	**$18,069.2**	**$18,703.7**	**$634.5**	**3.5%**
CSU				
General Fund	$2,970.7	$2,873.1	-$97.6	-3.3%
Fees	1,376.9	1,521.1[a]	144.2	10.5
Subtotals	($4,347.6)	($4,394.2)	($46.6)	(1.1%)
All other funds	$2,598.7	$2,550.5	-$48.2	-1.9%
Totals	**$6,946.3**	**$6,944.7**	**-$48.2**	—
CCC				
General Fund[b]	$4,146.7	$4,034.9	-$111.8	-2.7%
Local property tax	2,051.7	2,196.2	144.5	7.0
Fees	281.4	284.4	3.0	1.0
Subtotals	($6,479.8)	($6,515.4)	($35.6)	(0.5%)
All other funds[c]	$269.4	$257.5	-$11.9	-4.4%
Totals	**$6,749.2**	**$6,773.0**	**$23.7**	**0.4%**
CSAC				
General Fund	$842.9	$890.5	$47.6	5.7%
All other funds	1,160.8	30.8	-1,130.1	-97.4
Totals	**$2,003.7**	**$921.3**	**-$1,082.5**	**-54.0%**
Other Agencies				
General Fund	$12.8	$12.1	-$0.7	-5.6%
Fees	28.7	33.2	4.5	15.6
All other funds	21.5	42.4	20.9	97.1
Totals	**$63.1**	**$87.7**	**$24.6**	**39.0%**
Grand Totals	**$33,831.5**	**$33,430.3**	**$401.2**	**-1.2%**
General Fund	$11,233.9	$10,972.8	-$261.1	-2.3%
Fee revenue	3,838.5	4,170.0	331.5	8.6
Local property tax	2,051.7	2,196.2	144.5	7.0
All other funds	16,707.3	16,091.3	-616.1	-3.7

[a] Assumes fee increases of 7.4 percent at UC and 10 percent at CSU. However, the Governor's budget makes no specific fee proposal, deferring this decision to the segments.

[b] Excludes teachers' retirement funds and bond payments.

[c] Excludes other funds maintained in local budgets.

Major Funding Sources

General Fund. The 2008-09 budget proposal provides $11 billion from the General Fund for higher education. This amount is $261 million, or 2.3 percent, less than proposed current-year funding. The budget also projects that local property taxes will contribute $2.2 billion for CCC in 2008-09, which reflects an increase of $145 million, or 7 percent, from the revised current-year estimate.

Student Fees. Student fee revenue at all the public higher education segments (including Hastings College of the Law) would support at least $4.2 billion of proposed expenditures. As discussed in more detail below, actual fee revenue will depend on decisions still to be made by UC and CSU.

Other Funds. The budget also includes about $16.1 billion in other funds, which reflects a decline of about $616 million, or 3.7 percent. Almost all ($15.2 billion) of these other funds constitute nonstate revenue—including federal funding and private contributions. The remainder is made up of various state revenues, including lottery and tobacco funds. In addition to the amounts reflected in Figure 1, local community colleges are projected to receive an additional $1.8 billion from locally budgeted resources. (These funds are identified in the "California Community Colleges" section of this chapter.)

Major Funding Changes by Segment

Major funding changes are shown in Figure 2 (see next page). For UC, the Governor proposes General Fund appropriations of $3.2 billion, which is $99 million, or 3 percent, less than the revised current-year estimate. Of this reduction, $31 million would come from UC's administrative support budget, while the remainder would be unallocated. The Governor's proposal also includes at least $125 million in new student fee revenue, from a fee increase of at least 7.4 percent. When all fund sources are considered, UC's budget increases by 3.5 percent.

For CSU, the budget includes $2.9 billion in General Fund support, which is $98 million, or 3.3 percent, less than the current-year estimate. Of this reduction, $2.4 million would come from CSU's administrative support budget, while the remainder would be unallocated. The Governor's proposal also includes an augmentation of at least $110 million in new student fee revenue, from a fee increase of at least 10 percent. When all fund sources are considered, CSU's budget remains essentially unchanged.

For CCC, the Governor's budget includes $4 billion in General Fund support, which is $112 million, or 2.7 percent, less than the revised current-year amount. Local property tax revenue (the second largest source of CCC funding) would increase by 7 percent, to $2.2 billion. Fee revenue would provide an additional $284 million, reflecting an increase of 1 percent (due to budgeted enrollment growth).

Figure 2

**Higher Education
Proposed Major Funding Changes
From 2007-08 Revised Budget**

University of California	**General Fund: -$98.5 Million** **Other Funds: +$733 Million**
General Fund Reduction: Reduces administrative support by $30.8 million. The remainder of the General Fund reduction is unallocated. ***New Revenues:*** Proposed augmentations from other fund sources include at least $125 million from fee increases (the exact amount to be determined by UC).	
California State University	**General Fund: -$97.6 Million** **Other Funds: +$96 Million**
General Fund Reduction: Reduces administrative support by $2.4 million. The remainder of the General Fund reduction is unallocated. ***New Revenues:*** Proposed augmentations from other fund sources include at least $110 million from student fee increases (the exact amount to be determined by CSU).	
California Community Colleges	**General Fund: -$112 Million** **Other Funds: +$135 Million**
General Fund Reduction: The net General Fund reduction is more than offset by a $145 million increase in local property tax revenue. ***Programmatic Funding Changes:*** Includes funding for 1 percent enrollment growth, no funding for a cost-of-living adjustment, and reductions to categorical programs averaging about 7 percent.	

Enrollment

As shown in Figure 3, the administration proposes budgeted enrollment growth of 2.5 percent at UC and CSU, and 1 percent at CCC. However, the Governor's budget acknowledges that UC and CSU may decide to enroll less than the proposed level of students as a way to accommodate part of proposed General Fund reductions. We discuss enrollment trends in more detail later in this chapter.

Figure 3

Higher Education Enrollment

State-Supported Full-Time-Equivalent Students

	Actual 2006-07	Budgeted 2007-08	Proposed 2008-09	Change	
				Amount	Percent
University of California (UC)					
Undergraduate	159,781	160,824	164,469	3,645	2.3%
Graduate	24,280	25,400	26,455	1,055	4.2
Health Sciences	13,030	12,231	12,531	300	2.5
UC Totals	**197,091**	**198,455**	**203,455**[a]	**5,000**	**2.5%**
California State University (CSU)					
Undergraduate	292,032	294,175	301,530	7,354	2.5%
Graduate/postbaccalaureate	48,362	48,718	49,935	1,218	2.5
CSU Totals	**340,394**	**342,893**	**351,465**[a]	**8,572**	**2.5%**
California Community Colleges	1,137,144[b]	1,171,258	1,183,541	12,283	1.0%
Hastings College of the Law	1,264	1,250	1,225	-25	-2.0
Grand Totals	**1,675,893**	**1,713,856**	**1,739,686**	**25,830**	**1.5%**

a The Governor's proposal indicates that UC and CSU may accommodate a portion of unallocated General Fund reductions by reducing proposed enrollment levels.

b Department of Finance estimate.

Student Fee

As shown in Figure 4 (see next page), student fees would be increased at all segments except for CCC. For UC and CSU, the figure reflects increases of 7.4 percent and 10 percent, respectively. These amounts reflect fee increases envisioned by the segments when they developed their budget plans in the fall. However, the Governor's budget does not formally propose any specific fee level, acknowledging that the segments may increase their fees above their initially envisioned levels in order to backfill some or all of the proposed unallocated General Fund reductions.

Financial Aid

Funding for the Cal Grant entitlement programs would be augmented to accommodate projected enrollment growth and fee increases in excess of the levels noted above. However, the Governor proposes to fund no new grants in the Cal Grant *competitive* programs in the budget year and beyond, for estimated General Fund savings of $57 million in 2008-09.

Students receiving a grant in the current year would still be eligible for renewal awards. As these students graduated over the next several years, the competitive programs would be phased out.

The proposed budget also authorizes 7,200 new awards in the Assumption Program of Loans for Education (APLE), as well as 100 new warrants each for the State Nursing APLE and the Nurses in State Facilities APLE.

Figure 4

Annual Education Fees for Full-Time Resident Students[a]

	Actual 2006-07	Actual 2007-08	Proposed 2008-09[b]
University of California (UC)			
Undergraduate	$6,141	$6,636	$7,126
Graduate[c]	6,897	7,440	7,986
Hastings College of the Law	$19,725	$21,303	$26,003
California State University (CSU)			
Undergraduate	$2,520	$2,772	$3,048
Teacher education	2,922	3,216	3,540
Graduate	3,102	3,414	3,756
California Community Colleges	$690[d]	$600	$600

a Figures do not include campus-based fees.

b For UC and CSU, reflects increases of 7.4 percent and 10 percent, respectively. Governor's budget notes that actual fee levels would depend on how the governing boards decide to accommodate unallocated General Fund reductions.

c The UC charges special fee rates for 12 professional programs, such as medicine and nursing. Most of these fees would increase by roughly 7 percent, with proposed 2008-09 fee levels ranging from $3,685 to $22,049.

d Reflects average fee over the academic year. Actual fees were $26 per unit in fall 2006 and $20 per unit, beginning in spring 2007.

Capital Outlay

As shown in Figure 5, the Governor's budget proposal includes about $1.6 billion in new capital outlay funding for 2008-09. In addition to this funding, the budget provides $418 million in carryover and reappropriated funding that was originally appropriated in prior years. For CSU, the budget also includes $50 million in bond funding for special repairs that is counted as part of CSU's support budget.

All of the proposed funding would come from general obligation bonds. Under the Governor's proposal, $457 million would come from bonds authorized by Proposition 1D and $1.1 billion would come from a proposed bond that would be placed before voters in November 2008.

Figure 5

Governor's Proposed New Higher Education Capital Outlay Appropriations

2008-09
(In Millions)

University of California	$388
California State University	358
California Community Colleges	894
Total	**$1,640**

BUDGET ISSUES

Higher Education

INTERSEGMENTAL: GOVERNOR'S BUDGET SOLUTIONS

Similar to its approach in other areas of the budget, the Governor's higher education proposal generally includes 10 percent reductions to estimated General Fund "workload" funding levels. However, because more than one-half of these budget solutions take the form of unallocated reductions to the University of California (UC) and the California State University (CSU), it is not clear what effect these proposals would have on critical aspects of higher education, including college access and affordability.

Two Perspectives on the Budget Solutions

The changes proposed to higher education funding can be viewed in two basic ways: in comparison to what was provided in the current year, and in comparison to the estimated 2008-09 workload funding level.

Modest Year-to-Year Decline in General Fund Support. The Governor proposes to fund higher education with General Fund support of $11 billion, which is $261 million, or 2.3 percent, lower than the revised current-year level. As shown in Figure 1 (see next page), net General Fund reductions would be experienced at all higher education segments and agencies except for the California Student Aid Commission (CSAC), which would receive $47.6 million more than in the current year.

Figure 1

2008-09 Higher Education Budget Proposal

General Fund (Dollars in Millions)

	2007-08 Revised	2008-09 Proposed	Difference	
			Amount	Percent
University of California	$3,260.7	$3,162.2	-$98.5	-3.0%
California State University	2,970.7	2,873.1	-97.6	-3.3
California Community Colleges	4,146.7	4,034.9	-111.8	-2.7
California Student Aid Commission	842.9	890.5	47.6	5.7
Hastings College of the Law	10.6	10.1	-0.5	-4.9
California Postsecondary Education Commission	2.2	2.0	-0.2	-9.2
Totals	**$11,233.9**	**$10,972.8**	**-$261.1**	**-2.3%**

Larger Decline From Governor's Workload Level. When compared to the Governor's estimate of 2008-09 workload costs, the Governor's proposed General Fund reductions appear larger. The reductions for UC and CSU appear especially large because the workload estimates are based on the Governor's compact with those segments. (See box on page 148 for a discussion of how the administration characterizes the magnitude of these proposed General Fund reductions.) Overall, as shown in Figure 2, the proposed budget would provide $1.1 billion less than the General Fund workload estimate. We discuss the Governor's proposed reductions in more detail below.

UC and CSU

General Fund Reduction Virtually All Unallocated. Virtually all of the proposed General Fund reduction to UC and CSU is unallocated. The exception (aside from several technical adjustments) are reductions to the two segments' "institutional support" budgets, which fund administrative and management functions (both systemwide and at the campuses).

Governor Makes No Fee Proposal, but Assumes Increases Will Be Part of Budget Solution. The budget proposal defers to UC and CSU on the allocation of General Fund reductions and the setting of student fee levels. Although the UC Board of Regents and the CSU Board of Trustees had earlier considered plans to enact fee increases of 7.4 percent and 10 percent, respectively, for the 2008-09 academic year, both boards delayed final approval of fee increases pending release of the Governor's budget proposal. Neither segment had acted on a fee increase at the time this *Analysis* was prepared. Although the Governor's budget makes no specific fee proposal for UC and CSU, it provides funding for increases in the Cal Grant entitlement program to cover fee increases of up to 30 percent and 33 percent, respectively. The lack of specificity on fee levels means the Legislature has no way of knowing the overall funding level (General Fund plus fee revenue) that the Governor's proposed budget would provide for core programs at the universities.

Figure 2

Governor's Proposed Higher Education Funding Compared to Workload Estimates

General Fund (Dollars in Millions)

	2008-09 "Workload"	2008-09 Proposed	Difference	
			Amount	Percent
University of California	$3,494.1	$3,162.2	-$331.9	-9.5%
California State University	3,186.0	2,873.1	-312.9	-9.8
California Community Colleges	4,519.4	4,034.9	-484.5	-10.7
California Student Aid Commission	892.7	890.5	-2.2	-0.2
Hastings College of the Law	11.2	10.1	-1.1	-10.0
California Postsecondary Education Commission	2.2	2.0	-0.2	-10.0
Totals	**$12,105.7**	**$10,972.8**	**-$1,132.9**	**-9.4%**

CCC

As earlier shown in Figure 1, the budget proposes to reduce the California Community Colleges' (CCC's) 2008-09 General Fund support by $112 million from the revised current-year level. (The current-year amount reflects a one-time, midyear reduction of $40 million.) This reduction is based on a 10 percent reduction to CCC's General Fund workload funding. The colleges' General Fund support is combined with local property tax revenues and counted toward the state's Proposition 98 expenditures. As a result of growth in property tax revenues, CCC's Proposition 98 funding would actually increase by $55 million in the budget year.

The proposed budget includes funding for 1 percent enrollment growth, does not include any funding for a cost-of-living adjustment, and reduces funding for all categorical programs across the board.

UC and CSU Budgets Start With Compact

The administration calculated "workload" budgets for the University of California (UC) and the California State University (CSU) that reflect the level of General Fund support the university systems would expect to receive under the 2004 "compact." The compact is a nonstatutory agreement between the segments and Governor that envisions annual spending increases through 2010-11. Major components of that plan for 2008-09 include $126 million for enrollment growth of 2.5 percent and $301 million for base increases of 5 percent. The administration's calculation of the 2008-09 workload budget also includes adjustments for retirement costs, lease revenue payments, and various other expenses. Overall, the UC and CSU workload budgets reflect combined General Fund costs that exceed the current-year amount by $449 million.

As the figure below shows, the Governor's budget proposal starts with this workload base for UC and CSU, and then reduces those amounts by roughly 10 percent, generating budgetary solutions of over $300 million for each segment. The figure also shows how these calculations result in net General Fund reductions for UC and CSU of $98.5 million and $97.6 million, respectively, from their current-year levels.

Governor's Budget Proposal for UC and CSU General Fund Workload Budget and Budget-Balancing Reductions

(In Millions)

	UC	CSU
2007-08 Estimated Budget	**$3,260.7**	**$2,970.7**
Workload augmentation	233.4	215.3
2008-09 Workload Budget	**$3,494.1**	**$3,186.0**
Budget-balancing reduction	-331.9	-312.9
2008-09 Proposed Budget	**$3,162.2**	**$2,873.1**
Net reduction from 2007-08	-$98.5	-$97.6

CSAC

The CSAC would receive a net $47.6 million increase in General Fund support. The major augmentation is $107 million for increased Cal Grant costs, most of which would cover fee increases for eligible students at UC and CSU. (As noted earlier, while the Governor's budget does not propose any specific fee level for UC and CSU, this Cal Grant augmentation would cover fee increases of 30 percent and 33 percent respectively.) Offsetting this augmentation is a $57.4 million reduction achieved by eliminating new student participation in the Cal Grant competitive program.

The proposed CSAC budget also contains various adjustments to reflect the sale of EdFund, which is an auxiliary organization carrying out federal loan guarantee functions on behalf of CSAC. The 2007-08 budget package assumed EdFund would be sold for $1 billion in the current year. The Governor's 2008-09 budget proposal assumes instead that $500 million will be realized from the sale.

LAO Assessment

Because the Governor's budget proposal leaves many of the decisions about allocating reductions and increasing fees to the university systems, we cannot estimate the full effect of this budget on higher education. The ability of the segments to maintain their commitments under the state Master Plan for Higher Education will depend on the outcome of a variety of issues not resolved by the Governor's budget proposal. Two of the most critical issues include:

- ***Effect on Affordability.*** Two key factors influencing college affordability are student fee levels and financial aid. Under the Governor's budget proposal, student fee costs at community colleges would decline slightly (in inflation-adjusted dollars). However, the proposed budget includes no specific proposal for UC and CSU fee levels. Instead, it defers to those segments decisions about how much additional revenue should be collected from student fee increases and, by extension, what share of education costs should be borne by students. At the same time, the proposed phasing out of competitive Cal Grants would eliminate an important source of financial assistance for up to 22,500 additional students in 2008-09 (current recipients would still be able to receive support in the budget year).

- ***Effect on Access.*** We project that population growth will increase enrollment demand by 1.8 percent at UC and 1.6 percent at CSU and CCC. If UC and CSU accommodated some portion of the proposed General Fund reductions by reducing enrollment, eligible applicants might be denied access. In addition, the proposed 1 percent growth in CCC enrollment funding is somewhat less than our projection of 1.7 percent enrollment growth for that segment.

In the following section, we offer an alternative to the Governor's budget proposal that minimizes adverse effects on affordability and access, and ensures greater transparency and accountability in the higher education budget.

INTERSEGMENTAL: LAO ALTERNATIVE BUDGET PROPOSAL

In the *Perspectives and Issue,* our companion publication to this *Analysis*, we outline an alternative to the Governor's 2008-09 budget proposal. Our approach is distinguished from the Governor's in several notable respects. For example, while the Governor's budget relies largely on spending reductions to close a large projected budget shortfall, we have sought to incorporate a mix of expenditure reductions and increased revenues. We have also avoided the Governor's across-the-board approach to spending reductions in favor of more tailored reductions that take into account the consequences of potential reductions to various programs, weighing the relative costs and benefits of the different options.

The portion of our alternative budget related to higher education is described in this section. In general, we have sought to ensure that the state would be able to maintain its commitments of access and affordability as embodied in its Master Plan for Higher Education. More specifically, our alternative budget would accommodate anticipated budget-year enrollment growth, fund nondiscretionary cost increases, limit student fee increases to affordable levels, and expand funding for financial aid—both through the Cal Grant programs and campus-based institutional aid—to cover those fee increases for financially needy students. We have avoided making unallocated reductions, which can weaken the link between the Legislature's intent and budget actions, thus harming budgetary accountability.

Figure 1 (see next page) shows the main elements of our higher education budget proposal (excluding those that relate to Proposition 98 funding, which we discuss in the "California Community Colleges" section of this chapter). As the figure shows, our recommendations would result in General Fund savings of $553 million relative to the Governor's workload level.

Below we describe three main facets of our proposal: (1) accommodating enrollment growth, (2) adjustments to base budget, and (3) maintaining affordability for students. Because funding for the California Community

Colleges (CCC) falls under the unique provisions of Proposition 98, we discuss CCC only summarily in this overview of our alternative budget, and present the fuller discussion of our CCC proposal in the "California Community Colleges" section that appears later in this chapter.

Figure 1

Summary of LAO Alternative Budget For Higher Education[a]

(General Fund, in Millions)

	Change From Governor's Workload Budget
Fund LAO estimate of enrollment growth	-$38.4
Fund nondiscretionary cost increases, but no cost-of-living adjustments	-206.5
Reduce administrative support costs	-75.7[b]
Increase UC and CSU student fees by 10 percent	-276.2[c]
Increase UC and CSU institutional financial aid	61.0
Restore funding for Cal Grant competitive program that was eliminated in workload budget	58.3
Fully fund Cal Grant entitlement program assuming LAO fee levels (which are lower than assumption in Governor's budget)	-74.3
Other savings proposals	-1.1
Total Savings From LAO Alternative	**-$552.8**

a Excludes Proposition 98 funding for the California Community Colleges (CCC), which is discussed later in this chapter.

b Includes $200,000 reduction to the CCC Chancellor's office (non-Proposition 98).

c Unlike the Governor's budget, our proposal treats fee increases as a source of revenue for funding workload costs. This amount is shown as a negative number because it reduces the General Fund amount required to support workload costs.

Accommodating Enrollment Growth

We recommend the Legislature fund enrollment growth at all three segments based on our estimates of demographic change: 1.8 percent for the University of California, 1.6 percent for the California State University, and 1.7 percent for California Community Colleges.

Recent Enrollment Trends

Determining the amount of additional enrollment to fund each year can be difficult. Unlike enrollment in compulsory programs such as elementary and secondary schools, which corresponds exclusively with changes in the school-age population, enrollment in higher education responds to a variety of factors. Some of these factors (such as population growth and unemployment rate) are, for the most part, beyond the control of the state. Others (such as higher education funding levels, fees, financial aid, and outreach programs) stem directly from state policy choices. Determining how all of these factors will interact to influence enrollment demand is challenging.

There are two main factors influencing enrollment growth in higher education:

- ***Population Growth.*** Other things being equal, an increase in the state's college-age population causes a proportionate increase in those who are eligible to attend each segment. Most enrollment projections begin with estimates of growth in the potential student "pool" (18- to 24-year old population), which for the rest of the decade is expected to range from 1.6 percent to 2 percent annually.
- ***Participation Rates.*** For any subgroup of the general population, the percentage of individuals who are enrolled in college is that subgroup's college participation rate. Participation rates can be affected by a variety of factors—state enrollment policies, the job market, and changes in the financial situation of students and their families.

Differences Between Actual and Budgeted Enrollment. The Legislature typically provides General Fund augmentations in the annual budget act to support specific increases in enrollment for all segments. Because the number of eligible students enrolling at the segments cannot be predicted with complete accuracy, the segments often enroll slightly more or fewer students than budgeted. For the current year, the University of California (UC) and the California State University (CSU) estimate they are exceeding their budgeted enrollment levels by about 3,200 and 10,000 full-time equivalent (FTE) students, respectively. No current-year estimates for CCC were available at the time this *Analysis* was prepared.

LAO Growth Projection. In order to project enrollment demand for 2008-09, we calculated the ethnic, gender, and age makeup of each segment's existing student population, and then projected separate growth rates for each group based on statewide demographic forecasts. In this way, we were able to account for different growth and participation rates of different demographic groups. We also assumed that each group's participation rate would not change over the coming year. While we acknowledge these rates could change, they have been relatively flat over recent years and we not aware of any evidence to support alternative assumptions.

Using our demographic model, we project that enrollment demand will increase by 1.8 percent at UC, 1.6 percent at CSU, and 1.7 percent at CCC. The differences in these numbers reflect the different racial, gender, and age makeups of the three segments' populations.

Governor's Proposal Would Not Ensure Growth Is Accommodated

The Governor's budget proposal nominally includes funding for 2.5 percent enrollment growth at UC and CSU, but then allows the segments to use all, or a portion of, this funding to backfill unallocated General Fund reductions. In fact, the Governor's budget requires only that UC and CSU enroll as many students in 2008-09 as they were budgeted to serve in 2007-08. Because both segments estimate they currently are serving more students than they are budgeted to serve, the Governor's proposal would actually permit the segments to reduce enrollment from actual current-year levels.

For CCC, the Governor's proposal would provide funding for 1 percent enrollment growth. While this funding would be earmarked only for actual enrollment, it falls short of the 1.7 percent growth we project for CCC.

Fund Enrollment Growth to Accommodate Projected Increase

We recommend the Legislature fund budgeted enrollment growth of 1.8 percent for the University of California (UC), 1.6 percent for the California State University (CSU), and 1.7 percent for California Community Colleges. For UC and CSU, we recommend this funding be based on the Legislature's marginal cost methodology. We also recommend the Legislature amend budget bill language to ensure the funding is used to support only new growth above the actual level in the current year. (Reduce Item 6440-001-001 by $16.4 million and Item 6610-001-0001 by $22 million.)

Fund Anticipated Growth. In order to ensure that the segments are able to accommodate all anticipated growth in the budget year, we recommend funding growth based on our projections of 1.8 percent for UC, 1.6 percent for CSU, and 1.7 percent for CCC. (Enrollment funding for CCC is more complicated than that for the universities. We discuss this and related issues in the "California Community Colleges" section of this chapter.)

Use Legislature's Marginal Cost Methodology. The Governor's proposal bases UC and CSU growth funding calculations on a marginal cost methodology that the Legislature has repeatedly rejected. (The past two budget acts instead employ a compromise methodology adopted by the Legislature. For a comparison of these two methodologies, please see our *Analysis of the 2007-08 Budget Bill* (pages E182 - E190). For 2008-09, the Governor's proposed marginal cost rates for each FTE student at UC and CSU are $11,274 and $8,173, respectively. Using the methodology adopted by the Legislature, however, the rates would be several hundred dollars lower for UC ($10,967) and several hundred dollars higher for CSU ($8,500). We used the Legislature's methodology in our recommended enrollment funding levels for UC and for CSU.

Restrict UC and CSU Growth Funding to New Enrollment. As noted earlier, in the current year both segments are estimated to be serving more students than they are budgeted to serve. In order to accommodate those "extra" students, the segments have taken steps such as increasing average class size and redirecting funding from other areas of their budgets. We recognize that such steps are not desirable as a long-term strategy. However, given the state's fiscal situation, we recommend that the segments continue to serve these extra students in the budget year. In other words, we recommend that any new growth funding be used exclusively to enroll *additional* students above the current-year level. Accordingly, we recommend the Governor's proposed budget bill language be amended to require UC's enrollment to increase by 1.8 percent, and CSU's enrollment to increase by 1.6 percent, *from their actual current-year levels.* Any shortfall in these enrollment targets would result in a corresponding reduction in the associated enrollment growth funding.

Adjustments to Base Budget

Responding to Price Increases

We recommend providing $49.5 million to the University of California and $45 million to the California State University to fund nondiscretionary cost increases. Given the state's fiscal situation, we do not recommend funding salary increases at the segments. (Reduce Item 6440-001-0001 by $105 million and Item 6610-001-0001 by $101 million.)

In addition to augmentations for enrollment growth, the higher education segments customarily receive annual augmentations to compensate for the increased costs of labor and other operating expenses. For CCC, these cost increases are typically accommodated through the same statutory cost-of-living adjustment (COLA) formula that applies to K-12 schools. As a consequence of broader Proposition 98 considerations that we explain in the "California Community Colleges" section of this chapter, we recommend the Legislature not fund CCC's or K-12's COLAs in 2008-09.

In contrast to K-12 schools, statute provides no guidance for funding cost increases at UC and CSU. Since the mid 1990s, the universities have entered into agreements with different governors (such as their current compact with Governor Schwarzenegger) that specify multiyear funding targets which include "base increases" to account for inflation, among other things. However, none of the past compacts has entirely been reflected in enacted budgets, as the segments have in some years received more, and in some years less, than called for in those agreements.

Proposed Unallocated Reductions Overwhelm Base Increases. The current compact calls for base increases of 5 percent for UC and CSU. Although such increases are included in the UC and CSU's workload budgets, the Governor also proposes unallocated reductions of twice this amount for both segments. As a result, it is unclear how much funding would actually be available for cost increases.

Recommend Augmentations for Nondiscretionary Price Increases. In general, the universities face two kinds of potential cost increases: those related to (1) goods and services that are purchased from outside the university (such as utilities, equipment, and supplies), and (2) salaries and benefits for faculty, staff, and administrators that are employed by the university. We consider the first category of costs to be largely nondiscretionary in the short term. For example, as utility companies increase their rates, the universities are generally obligated to pay those higher rates. As these costs increase, therefore, the universities must either receive budget augmentations to cover these cost increases or they must redirect funding from other parts of their budgets. (This assumes that it is not feasible to cut back on the purchases themselves.) In other words, not including funding for nondiscretionary cost increases is tantamount to an unallocated reduction to other, discretionary programs.

For these reasons, we recommend the Legislature include funding in UC and CSU's budgets to cover anticipated nondiscretionary cost increases. Although defining nondiscretionary costs can be a matter of some debate, we estimate that the segments will encounter nondiscretionary cost increases of $49.5 million for UC and $45 million for CSU.

Recommend No Employee COLAs. Given the state's fiscal situation, we do not recommend the Legislature fund a COLA for UC and CSU employees. This is consistent with our recommendations for most employees at state agencies. We recognize that some UC and CSU campuses and programs compete in a national labor market for faculty. We also note that both segments have commissioned recent studies that found their faculty benefit packages were well above the average of their public and private comparison institutions.

Reduce Funding for Administrative Costs

We recommend the Legislature adopt the Governor's proposed reductions to the University of California's and the California State University's "institutional support" budgets. These budgets have been the subject of considerable controversy in recent years, and the universities are currently taking steps to reduce spending in these areas. (Reduce Item 6440-001-0001 by $32.3 million and Item 6610-001-0001 by $43.2 million.)

The Governor proposes 10 percent reductions to the workload budgets for UC and CSU's institutional support budgets. These budgets include executive management and related administrative functions at the systemwide level and on campuses. Spending by both segments in this area—especially in the form of executive compensation—has been the subject of considerable controversy in recent years. The Legislature has held hearings on the subject and requested the State Auditor to investigate the segment's executive compensation practices. In general, the Legislature and the Auditor found that both segments lacked transparency and violated their own policies in relation to executive compensation. In addition, legislative hearings revealed that the segments spend a larger share of their budgets on executive administration than comparable universities.

In the wake of these reports, both universities have taken steps to change their executive compensation practices, and UC is undertaking a major reorganization of the Office of the President. In light of these efforts, we believe UC and CSU should both be able to achieve the savings level proposed by the Governor.

MAINTAINING AFFORDABILITY FOR STUDENTS

Up to this point, our analysis has considered the amount of funding needed to maintain higher education programs, including accommodating enrollment growth and covering nondiscretionary costs. We now discuss how that cost should be shared between students and the state.

Student Fees Contribute Toward Education Costs

California does not have a long-term policy for determining the respective shares of cost to be paid by the state and by students at each of the three segments. In 2003-04, the Legislature approved—and the Governor vetoed—legislation establishing fee and financial aid policy for UC and CSU (AB 2710, Liu). As passed by the Legislature, the bill established several principles:

- The cost of higher education is a shared responsibility of students, families, and the state.
- Changes in student fees should be gradual, moderate, and predictable, and should not exceed 8 percent in a given year.
- Fees should approach a fixed share of total educational cost at each segment, namely, 40 percent at UC and 30 percent at CSU.

Given the Governor's veto of this legislation, the state still lacks a statutory fee policy. However, we believe that the principles noted above are helpful in thinking about student fees. (See nearby box for some key

LAO Findings and Recommendations on Student Fees

- ***The State Provides Two Types of Subsidies for Higher Education—Targeted and Untargeted.*** Targeted subsidies include grants made directly to financially needy students. The base support provided to the segments to cover a portion of educational costs is an untargeted subsidy. Every resident student receives a large untargeted subsidy, regardless of the ability to pay. Given limited resources, the Legislature must decide how much to invest in each type of subsidy.
- ***Fees Are an Important Source of Support for Higher Education.*** Fee revenue works interchangeably with General Fund support to fund the core instructional mission of the segments. In building a budget, the Legislature should account for fees as a source of revenue to support these core programs.
- ***Fees Give Students a Financial Stake in Their Education.*** When students and their families have a direct financial stake in their education, they are more inclined to hold their schools accountable for providing high-quality educational services.
- ***Current Fee Levels Are Modest by National Standards.*** Fees at California's public higher education segments are relatively low by almost any state comparison measure.
- ***Existing State Aid Programs Offset Fee Increases for Needy Students.*** By statute, the fee-coverage portion of the Cal Grant adjusts to cover fee increases each year. In addition, the segments supplement aid for financially needy students whose fees are not fully covered by Cal Grants.

findings and recommendations our office has recently made concerning student fees.)

Current Share of Cost. Figure 2 shows 2007-08 fee levels and the share of educational cost they cover for all three segments. As the figure shows, systemwide fees for California resident undergraduate students at UC are less than one-third of the total cost of education , while at CSU and CCC, systemwide fees are about one-quarter and one-tenth of the total cost of education, respectively. These fees apply primarily to non-needy students at each segment. As further discussed in the financial aid section of this piece, many students pay much less than the "sticker price" represented by these amounts.

Figure 2

Systemwide Fees for Full-Time Resident Undergraduates And Corresponding Percent of Educational Cost

2007-08

Segment	Fee Level[a]	Percent of Cost
University of California	$6,636	31%
California State University	2,722	25
California Community Colleges	600	10

[a] Excludes campus-based fees.

Governor's Budget Envisions Unspecified Fee Increases for University Students

Fee Increases Were Part of UC and CSU Budget Requests. Last fall, UC and CSU submitted to the administration 2008-09 budget proposals that reflected fee increases of 7.4 percent and 10 percent, respectively. Both segments delayed final decisions on student fees pending release of the Governor's budget and the subsequent response from the Legislature.

Governor's Budget Suggests Fees Could Increase Further. The Governor's budget package acknowledges that the universities may raise fees beyond the levels envisioned in their budget proposals in order to absorb proposed General Fund reductions. The Governor does not propose any specific fee level. However, his budget includes "placeholder" funding for the state's Cal Grant program to cover maximum fee increases of 30 percent at UC and 33 percent at CSU.

We have two concerns about the Governor's approach to university student fees for 2008-09. First, by deferring decisions on fee levels and the allocation of General Fund reductions to the governing boards, the budget proposal would remove the Legislature from key higher education budget and policy decisions. Second, the Governor's proposal treats fee revenue independently from other resources. This approach fails to acknowledge the interrelationship of funding sources in a context of shared responsibility.

Governor's Budget Would Leave CCC Fees Unchanged. The Governor proposes to maintain the current fee level of $20 per unit at the community colleges. Given the effect of inflation, the value of these fees (and the share of cost paid by students) would decline under the Governor's proposal.

Recommend Specific, Moderate Fee Increases

We recommend that the University of California and the California State University systemwide fees be raised 10 percent from their current levels in order to modestly increase the share of total education cost paid by non-needy students. (In the "California Community Colleges" section of this chapter, we also recommend a $6 per unit increase in California Community Colleges fees.) (Reduce Item 6440-001-0001 by $167.5 million and Item 6610-001-0001 by $108.7 million.)

Fee Increases Should Be Reflected in General Fund Appropriations. Given the state's fiscal situation, we recommend that student fees be raised at UC and CSU by 10 percent, thus increasing somewhat the share of cost paid by nonneedy students at those segments. Although UC and CSU fee levels are set by the segments' respective governing bodies, fee revenue is an integral part of the overall higher education budget adopted by the Legislature. Indeed, because this revenue is interchangeable with General Fund support, the fee increases would result in General Fund reductions of the same amount. We recommend the Legislature adopt budget bill language stating its intent with regard to UC and CSU fee levels, and making the segments' General Fund support contingent on the expected fee levels. In this way, any fee increase above that intended by the Legislature would result in a dollar-for-dollar reduction in General Fund support.

Under our recommendation, the share of education cost paid by undergraduate students would increase from 31 percent to 34 percent at UC, and from 25 percent to 27 percent at CSU. This is below the upper limits the Legislature sought to establish in AB 2710. Fees at this level would also be well below the average of comparable public university systems. Moreover, our recommendations (below) to increase campus-based financial aid and Cal Grant awards would help ensure that these fee increases would not harm access for financially needy students.

Recommend Corresponding Increases to Financial Aid

We recommend increasing financial aid awards to reflect increased student fee levels. Specifically, as we discuss in more detail in the "California Student Aid Commission" section of this chapter, we recommend increasing Cal Grant funding and rejecting the Governor's proposal to phase out competitive Cal Grant awards. In addition, we recommend increasing institutional financial aid budgets by $32.5 million at the University of California and $28.5 million at the California State University. (Increase Item 6440-001-0001 by $32.5 million and Item 6610-001-0001 by $28.5 million.)

While we believe our recommended UC and CSU fee levels would be affordable to most students, they could create a hardship for financially needy students and their families. We therefore recommend several augmentations to financial aid support.

Cal Grants Would Cover Fee Increases for Many, but Not All, Students. The Governor's budget proposal offsets fee increases for many students through the Cal Grant entitlement program. The Governor proposes an augmentation that would cover fee increases of up to 30 percent at UC and 33 percent at CSU for Cal Grant entitlement recipients. However, the Governor also proposes to phase out the Cal Grant competitive program, which serves many financially needy students who do not qualify for entitlement awards.

Our alternative budget, like the Governor's, includes an augmentation to the Cal Grant program to fully offset fee increases. Our recommended augmentation is smaller than the Governor's, however, because our recommended fee levels are lower than the Governor's maximum fee levels. Unlike the Governor, we propose maintaining the Cal Grant competitive program to serve needy students. We also recommend augmenting that program for the fee increases. (Please see the "California Student Aid Commission" section of this chapter for a description of the Cal Grant programs and our detailed recommendations.)

Institutional Aid Bridges Some Gaps in State Financial Aid System. Both UC and CSU maintain "institutional aid" programs to supplement state and federal aid for their financially needy students. The segments generally allocate this aid based on financial need, but have a great deal of flexibility in how they measure need. For 2007-08, the University Student Aid Program (USAP) at UC is funded with $283 million, while the CSU's State University Grants (SUG) program receives about $277 million.

Segments Lack Need-Based Methodology for Funding Institutional Aid. The segments have traditionally augmented institutional aid equal to a fixed proportion (usually one-third) of revenue generated from fee increases. For example, in 2003-04 UC increased fees sharply, resulting in over $300 million in added fee revenue. The university augmented institutional aid by nearly $100 million that year. This approach has resulted in large shifts in the criteria for allocating aid. In some years with large fee increases (and thus large increases in institutional aid), the segments have extended aid to students from families with relatively high incomes. In other years, they have tightened aid eligibility criteria, such as by increasing the expected contributions from students and families. While student need generally increases when fees are raised, the cost of covering that increased need is unlikely to match a fixed percentage of fee revenue each year.

Fee Waivers Protect Needy CCC Students From Fee Increases. Although CCC does not administer institutional aid, the CCC Board of Governors provides fee waivers for all needy students. This mechanism serves the same purpose as campus-based financial aid.

Recommend Augmenting UC and CSU Institutional Aid for Estimated Increase in Need. We recommend augmenting UC and CSU's institutional aid budgets to cover our recommended fee increases for financially needy students whose fees are not fully covered by Cal Grants. We estimate this amount to be $32.5 million for UC and $28.5 million for CSU. For comparison, this amount is equivalent to 22 percent of combined new fee revenues (19 percent at UC and 26 percent at CSU). Our recommended funding for institutional aid is based on our estimates of student need resulting directly from fee increases, rather than an arbitrary proportion of new fee revenue, such as the traditional one-third.

In our alternative budget for CCC, we take into account the cost of continuing to waive fees for financially needy students.

CONCLUSION

Our recommended alternative budget for higher education achieves substantial savings relative to the Governor's workload level without unduly harming core educational programs. It fully funds our projections of enrollment growth; provides augmentations for nondiscretionary cost increases; and increases the share of cost borne by nonneedy students in the form of fees, while at the same time increasing campus-based financial aid funding and maintaining the integrity of the state's Cal Grant programs. By avoiding unallocated reductions, our alternative budget provides a measure of budgetary transparency that is lacking in the Governor's proposal. It would also achieve $553 million in General Fund savings relative to the

Governor's workload budget. In summary, we believe that our alternative budget provides a reasonable plan for funding higher education given the state's fiscal situation.

INTERSEGMENTAL: ADDRESSING THE LOCAL IMPACTS OF CAMPUS GROWTH

Over the last 15 years, enrollment at the California's public universities and community colleges increased by approximately 320,000 full-time equivalent students, or about 25 percent. As enrollment expands, campuses need to accommodate the space needs of more students, faculty, and staff. Likewise, the growing campus populations put pressure on the infrastructure of surrounding communities.

The California Environmental Quality Act (CEQA) requires each campus to identify measures for reducing the anticipated impacts of their expansion on surrounding communities. In recent years, the responsibility of paying to mitigate these effects has become a contentious issue between communities and campuses. In 2006, the California Supreme Court's decision in *City of Marina v. California State University Board of Trustees* clarified that a campus is responsible, when feasible, for mitigating the significant environmental impacts of its expansion, even if the mitigation involves paying local agencies for off-campus infrastructure. As a result of the *Marina* decision, the higher education segments and other state agencies may need to reconsider how their growth plans affect surrounding communities and whether they have an obligation to provide payments to local agencies for infrastructure improvements.

In the following discussion, we provide an overview of the higher education segments' environmental review process, discuss the *Marina* case and its implications, and offer our recommendations to the Legislature on how to address the local impacts of campus expansion.

Campus Planning and the Environmental Review Process

All three public higher education systems require that their campuses develop land use plans that guide the physical development of the campus as its enrollment grows. Although the segments use different names for their campus plans, their processes for formulating these plans are similar, including final approval by each school's governing body—the Regents of the University of California (UC), the Board of Trustees for California State University (CSU), and the local board for each California Community College (CCC) district. The campus plans show existing and anticipated facilities necessary to accommodate a specified enrollment level. Figures 1 and 2 (see next page) provide summary information for UC, which refers to its documents as Long Range Development Plans (LRDPs), and for CSU, which refers to them as physical master plans. Each campus plan is an important policy document that outlines a campus' development, growth, and priorities.

Figure 1

UC Long Range Development Plan Status

Campus	Approval Date	Horizon Year	Headcount Enrollment Ceiling	2006 Fall Headcount
Berkeley	January 2005	2020	33,450	33,154
Davis	November 2003	2015	30,000	28,369
Irvine	November 2007	2025	37,000	24,621
Los Angeles[a]	March 2003	2010	37,630	38,218
Merced	January 2002	2025	13,966[b]	1,286
Riverside	November 2005	2015	25,000	16,826
San Diego	September 2004	2015	29,900	25,229
Santa Barbara	—[c]	—	25,000	21,082
Santa Cruz	September 2006[d]	2020	19,500[b]	15,364

a All sites, including the medical center.

b Full-Time equivalent students.

c Developing updated plan for Regents' approval in 2008 with 2025 horizon year. Current plan created in 1990 with 2005 horizon year.

d Plan and associated Environmental Impact Report currently voided by Santa Cruz County Superior Court decision.

Figure 2

CSU Physical Master Plan Status

Campus	Most Recent Approved Revision To Master Plan[a]	Master Plan Enrollment (FTE[b])	2006 FTE Enrollment
Bakersfield	2007	18,000	6,554
Channel Islands	2000	15,000	2,617
Chico	2005	15,800	14,882
Dominguez Hills	2005	20,000	8,435
East Bay	2001	18,000	10,560
Fresno	2007	25,000	18,399
Fullerton	2003	25,000	26,587
Humboldt	2004	12,000	6,797
Long Beach	2003	25,000	27,845
Los Angeles	1985	25,000	15,397
Maritime Academy	2002	1,100	992
Monterey Bay	2006[c]	8,500	3,518
Northridge	2006	35,000	26,029
Pomona	2000	20,000	17,072
Sacramento	2004	25,000	22,537
San Bernardino	2004	20,000	13,226
San Diego	2007	35,000	28,040
San Francisco	2007	25,000	23,573
San Jose	2002	25,000	23,156
San Luis Obispo	2001	17,500	17,217
San Marcos	2001	25,000	6,917
Sonoma	2000	10,000	7,312
Stanislaus	2006	12,000	6,724

a Not all revisions increase enrollment ceiling. For example, CSU Stanislaus has not increased its enrollment ceiling in more than 20 years.

b FTE= Full-time equivalent.

c Environmental Impact Report (EIR) vacated by the *Marina* case. Expected to submit revised EIR to Board of Trustees in 2008.

A previous LAO report entitled *A Review of UC's Long Range Development Planning Process* (January 2007), outlined the campus planning process, specifically highlighting planning issues within the UC system. The report found that the UC's planning process:

- Lacked state accountability and oversight.
- Lacked standardization in public participation.

- Provided minimal systemwide coordination for projecting future enrollments.
- Incurred higher costs and delays due to a lack of clarity in CEQA.

Below, we provide a closer examination of the role that CEQA and the environmental review process play in campus planning for all three segments.

Environmental Impact Report (EIR) Required for Each Campus Plan

Although campuses are exempt from local land use control in the development of a campus plan, they are subject to CEQA. The CEQA requires that state agencies prepare a comprehensive EIR for any proposed project with potentially significant environmental impacts. There are two types of EIRs depending upon the type of project:

- ***Program-Level EIR.*** Since a campus plan includes numerous projects, the accompanying EIR is typically referred to as a program-level EIR. Since the growth in enrollment and facilities outlined in a campus plan occurs in tiers or phases, a program-level EIR considers the cumulative environmental impacts of all the separate projects identified in the campus plan.
- ***Project-Level EIR.*** As each project covered by the campus plan begins implementation, CEQA requires that the campus prepare a project-level EIR. However, given the certification of a program-level EIR on the entire campus plan, these project-level EIRs are not required to be as detailed.

The program-level EIR must (1) provide detailed information about the likely effect of the envisioned expansion on the environment (such as traffic), (2) identify measures to mitigate significant environmental effects (such as mitigating traffic impacts by constructing physical improvements like traffic signals or roundabouts), and (3) examine reasonable alternatives to the proposed campus plan. Each campus must first prepare a preliminary EIR for public review and allow at least 30 days for public comment. The campus must then evaluate all comments and prepare written responses to them, which must be included in the final EIR. Under CEQA, UC Regents, CSU Board of Trustees, or the local board of trustees for individual CCC districts act as "the lead agency" which must certify the EIR before approving a campus plan.

CEQA's Mitigation Requirements

As described above, the EIR identifies all of the significant environmental impacts of a campus plan. For each significant impact, the EIR must either (1) describe one or more specific mitigation measures that could be implemented to reduce the impact to a less than significant level or (2) declare that the impact is "significant and unavoidable" (see nearby box).

Mitigation of Off-Campus Impacts. A campus plan may identify significant environmental impacts not on the campus' property, such as increased traffic in local communities or increased stormwater runoff into local waterways. Impacts on local communities can be mitigated in two ways:

- ***On-Campus Measures.*** If possible, the EIR can propose on-campus mitigation measures that can be implemented by the campus to reduce these off-campus environmental impacts, such as on-campus housing to reduce commuter traffic or on-campus catch basins to reduce stormwater runoff.
- ***Off-Campus Measures.*** In the event that on-campus mitigation measures cannot adequately mitigate the environmental impacts of a proposed campus plan, the EIR must attempt to identify mitigation measures to be performed off campus such as a new traffic signal or enlarged storm drains. Since such mitigation measures are performed on property outside of the campus' jurisdiction, they must be carried out by the local government agency (city, county, or special district) responsible for improvements to local infrastructure.

What Is a Significant and Unavoidable Impact?

Declaring an impact to be significant and unavoidable allows the lead agency to proceed with the project without mitigating that impact. In order to make such a declaration, the lead agency must adopt a Statement of Overriding Considerations which justifies how (1) economic, legal, social, technological, or other considerations render mitigation infeasible (for example, space constraints prevent the widening of a street to reduce traffic); and (2) the benefits of the project outweigh the significant and unavoidable effects on the environment (for example, the benefits to the state of increased college enrollment outweigh the impacts of increased traffic). When the lead agency certifies the EIR, it agrees as part of the implementation of the campus plan to perform all of the identified mitigation measures while the significant and unavoidable impacts may remain unmitigated.

Who Pays for Off-Campus Mitigation Measures? Campuses and their surrounding communities sometimes disagree about the responsibility for mitigation measures occurring outside of the university's jurisdiction. For example, an EIR may identify a new signal light at a city intersection to mitigate traffic from campus expansion. While the city is responsible for constructing the new signal, it may expect the campus to provide a portion of the funding since the campus' expansion is contributing to the traffic. However, the city and campus might disagree about how the costs should be shared. Such disagreements have led to numerous lawsuits between campuses and local communities. A recent California Supreme Court ruling on one of these lawsuits—*City of Marina v. CSU Board of Trustees*—clarified how CSU campuses must consider making payments for off-campus mitigation.

THE *MARINA V. CSU BOARD OF TRUSTEES* DECISION

In 1994, CSU committed to establish a Monterey campus on a portion of the former Fort Ord military base as part of the Fort Ord Reuse Authority (FORA) Act. (The state Legislature created FORA—which includes Monterey County and the Cities of Monterey, Salinas, Carmel, Marina, and Pacific Grove—to manage the transition of the base from military to civilian use.) The CSU Board of Trustees in 1998 certified the new campus' master plan and an accompanying EIR, which identified significant environmental impacts to various off-campus resources. Specifically, the EIR determined that the mitigation of some off-campus impacts—including increased traffic and a greater demand for fire protection services—was within the jurisdiction of FORA and therefore not the responsibility of CSU.

The CSU declared these off-campus impacts to be "significant and unavoidable" by filing a Statement of Overriding Considerations which made two assertions:

- Mitigation of off-campus impacts was legally infeasible because it would require payments to local agencies for infrastructure improvements, which constituted an illegal gift of public funds.
- The benefits of CSU's educational mission outweighed these specific adverse effects on the environment.

The CSU maintained that funding for improvements to local infrastructure was the responsibility of local agencies such as FORA rather than CSU. Accordingly, CSU proceeded with the proposed developments without providing funding to FORA for mitigation of the off-campus environmental impacts.

In response, FORA and the City of Marina challenged the Trustees' decision to certify the EIR as a violation of CEQA since it did not mitigate all of the identified impacts. In July 2006, the California Supreme Court reversed an earlier Court of Appeal's decision by concluding that the Trustees had abused their discretion, and thus their approval of the EIR was not valid. Specifically, the Supreme Court ruled that:

- ***Off-Campus Impacts Must Be Mitigated When Feasible.*** The CEQA does not limit the CSU's mitigation obligation to environmental effects on the university's own property. Rather, the university is required to mitigate a project's significant effects not just on its own property, but on the environment as a whole.

- ***Voluntary Payments Are a Feasible Form of Mitigation.*** If CSU cannot adequately mitigate off-campus environmental effects with mitigation measures on campus, then it can voluntarily pay a third party (such as FORA) to implement the necessary measures off campus. Such a payment is *not* a gift of public funds, as CSU had argued, because "while education may be CSU's core function, to avoid or mitigate the environmental effects of its projects is also one of CSU's functions." As a way of meeting its CEQA obligation, the university may voluntarily contribute its proportional share of the cost of improvements to local infrastructure necessitated by a campus' expansion.

- ***Lead Agency Has Authority to Determine Fair Share.*** As the lead agency, CSU has the discretion to determine the appropriate fair-share payment for off-campus infrastructure improvements. Thus, the *Marina* decision does *not* require CSU to contribute whatever amount cities, counties, and fire districts deem fitting for mitigation efforts. The CSU retains the responsibility for determining CSU's share of the cost of implementing an off-campus mitigation measure. As described in the nearby box, the fair-share payment should be based on CSU's actual impact on the local infrastructure.

IMPLICATIONS OF THE *MARINA* DECISION

The *Marina* decision prohibits the CSU Trustees, and potentially other governmental agencies, from certifying an EIR that does not provide mitigation for significant off-campus environmental impacts when feasible. Below, we describe how CSU has changed its policy in response to the decision. We also examine how the *Marina* decision might affect the growth of the other higher education segments and the construction projects of other state agencies.

What Is a Fair Share?

In many instances, a campus' expansion is not the only contributor to environmental impacts on a locality. For example, nearby shopping malls or housing developments also contribute to increased traffic on local roadways. In such instances, California Environmental Quality Act guidelines state that a campus plan's mitigation measures "must be roughly proportional to the impacts of the project." Numerous court decisions, including the *Marina* decision, routinely refer to these as proportional-share or fair-share payments.

There is no standardized method for determining the proper fair-share payment. The most widely used approach is to determine the proportion of the impact that the campus is responsible for and to provide that proportion of the mitigation measure's cost. For example, if the campus is responsible for 30 percent of the traffic on a local street, then the campus would contribute 30 percent of the cost of a new traffic signal. Determining a campus' proportional share of the impacts is a subjective process dependent upon numerous assumptions and measurements. Reaching an agreement on the methodology for calculating the fair share often leads to disputes between a campus and community.

However, a lead agency could consider another method which accounts for the positive impacts the campus has on a surrounding community. Lead agencies have argued that fair-share payments should be less if it can be demonstrated that the project provides other offsetting benefits to the locality. For example, if a campus has open space that is used by local residents, this might provide a benefit that offsets some negative environmental impacts. However, it is unclear how impacts of a differing nature—such as traffic and open space—should be combined.

How Does the *Marina* Decision Affect CSU?

In response to the *Marina* decision, the CSU has adopted new language relating to off-campus mitigation in its campus plan EIRs. In EIRs developed for campus plans completed since the *Marina* decision, CSU agrees to pay its fair share of the costs incurred by a local agency for implementing off-campus mitigation measures, provided that the Legislature appropriates money specifically for this purpose. The CSU uses an upfront approach that attempts to determine the appropriate fair-share payments for off-campus mitigation measures prior to certifying the EIR.

CSU Negotiates Fair-Share Contribution with Local Agencies. The CSU will enter into negotiations with local agencies to reach a consensus on the campus plan's environmental impact and CSU's fair share of mitigation. Under CSU's process, if the parties reach an agreement, they enter into a Memorandum of Understanding (MOU) which stipulates the fair-share amount or the process by which the fair-share amount will be determined. By outlining each party's responsibilities for off-campus mitigation, the MOU seeks to avoid any future disputes over the amount of fair-share payment. The MOU is also useful because it estimates the mitigation costs the campus will incur as part of implementing the updated campus plan.

What If an Agreement Can't Be Reached? Failure to reach an MOU with the local agency does not necessarily prevent CSU from proceeding with the project. As mentioned previously, CSU maintains the legal authority to determine the fair-share amount. If CSU and the local government cannot reach agreement on a mitigation payment, the CSU Board of Trustees can adopt the mitigation approach it feels is fair, certify the EIR, and adopt the campus plan.

The CSU's decision, however, is not necessarily final. The local agency could challenge the EIR by arguing that the adopted mitigation plan does not cover CSU's actual fair share of the necessary infrastructure improvements. If a court determines that the certified EIR does not provide CSU's fair-share obligation, approval of the EIR could be vacated for abuse of discretion. The CSU would be required to adopt a new methodology for determining its fair share or abandon the projects causing the significant environmental impacts.

CSU Makes Fair-Share Payments Contingent on State Funding. The CSU's interpretation of the *Marina* decision concludes that it is required to request funding for voluntary fair-share mitigation payments from the Legislature. According to EIR language and resolutions passed by the CSU Trustees, if CSU receives full funding for off-campus mitigation from the Legislature, it will provide that funding to local agencies as it proceeds with the proposed projects in its master plans. On the other hand, if CSU does *not* receive funding or receives only partial mitigation funding, it will continue with the proposed projects, but provide local agencies only whatever was appropriated, if anything, for the implementation of identified off-campus mitigation.

Each of CSU's recently revised EIRs and MOUs include language that voids fair-share agreements with local agencies if the Legislature does not provide funding specifically for off-campus mitigation. The CSU asserts that without state funding the fair-share payments for off-campus mitigation are infeasible. This, in turn, allows them to reclassify adverse environmental impacts requiring off-campus mitigation as "significant and unavoidable" and therefore proceed with the project.

While the *Marina* decision directs CSU to request funds from the Legislature before declaring voluntary mitigation payments infeasible, it does not explicitly state that CSU is no longer responsible to mitigate off-campus impacts if the Legislature denies funding. Similarly, CEQA states that "All state agencies, boards, and commissions shall request in their budgets the funds necessary to protect the environment in relation to problems caused by their activities," without clarifying what happens if such requests are not fully funded.

Mixed Results for CSU's Fair-Share Language. The CSU Trustees have certified three EIRs containing fair-share language since the *Marina* decision. At the time this analysis was prepared, these EIRs have resulted in different outcomes:

- The EIR for CSU Bakersfield's revised master plan included statements that the campus would negotiate its fair share for any necessary improvements to off-campus streets and intersections. The City of Bakersfield and CSU Bakersfield decided to postpone such negotiations until enrollment growth caused the traffic impacts to reach a significant threshold. As described above, the CSU Trustees' certification of the EIR in September 2007 included a resolution that any fair-share payments would be contingent upon legislative funding.
- San Francisco State University (SFSU) signed an MOU with the City of San Francisco on its fair-share obligation for off-campus mitigation prior to the CSU Trustees' certification of the campus' EIR in November 2007. Under the agreement, SFSU agrees to provide $175,000 for intersection improvements and $1.8 million towards a public transit project. If the Legislature appropriates money for this purpose, SFSU will contribute the funds after the city begins implementation of the projects.
- San Diego State University (SDSU) reached an agreement with the City of La Mesa on fair-share payments but failed to reach an agreement in its negotiations with the City of San Diego. La Mesa and SDSU agreed to the cost of $45,686 for two intersection improvements, payable only if legislative action provided the funds. The City of San Diego asserted SDSU's fair share for traffic improvements was at least $14 million, while SDSU estimated its fair share to be $6.4 million. The city also objected to CSU's assertion that it was not required to pay for mitigation if the Legislature did not appropriate funding. The SDSU documented its efforts to negotiate with the city, and the CSU Board of Trustees, employing

its discretion as the lead agency, certified the EIR with a $6.4 million voluntary contribution to the city. At the time this analysis was prepared, the City of San Diego and other local agencies were preparing to legally challenge the CSU Trustees' calculation of its fair-share payment for abuse of discretion.

How Does the *Marina* Decision Affect the Other Higher Education Segments?

The *Marina* decision also sets a precedent for other higher education lead agencies, including UC and CCC districts. Below, we discuss how these two segments approach off-campus mitigation with their host communities.

UC Uses Various Methods of Off-Campus Mitigation. The UC has adopted various formal and informal methods for compensating local communities for impacts on their infrastructure. Some examples include:

- UC Santa Cruz contributed $1.4 million to local agencies from 1991 to 2005 as part of "University Assistance Measures" identified in its 1988 campus plan.
- UC Berkeley, in response to a lawsuit challenging its 2005 LRDP and EIR, reached a settlement agreement with the City of Berkeley in May 2005 in which the campus agreed to provide $1.2 million annually to the city through 2020 for sewer and storm drain infrastructure, fire and emergency equipment, transportation and pedestrian improvements, and neighborhood projects.
- UC Santa Barbara, as part of the mitigation associated with its San Clemente Housing Project, is constructing $5 million in improvements to El Colegio Road as part of an agreement with Santa Barbara County.
- Additionally, UC has incorporated fair-share language for off-campus mitigation into its LRDPs developed since 2002. Unlike CSU, the UC does not attempt to negotiate these agreements prior to certifying the EIR, but waits until impacts reach their trigger points (such as an off-campus intersection reaching a certain level of congestion) before negotiating with local agencies. As a result, UC has not reached any fair-share agreements because the impacts requiring mitigation in LRDPs developed since 2002 (when UC adopted the fair-share language) have not yet reached their trigger points.

The UC's strategy for compensating local governments for the environmental impacts of campus expansion has not shielded UC from controversy and litigation. As described above, the City of Berkeley's legal challenge to UC Berkeley's LRDP resulted in the annual settlement payment for off-campus mitigation, while UC Santa Cruz's recently approved LRDP for campus expansion has been placed on hold by a Superior Court due to the inadequacy of its EIR in meeting CEQA obligations. Specifically, the court found that UC Santa Cruz's EIR lacked specificity and an enforceability mechanism for its fair-share payments to the city and did not adequately analyze the significant impacts on water and housing supply.

UC Does Not Receive State Funds Earmarked for Off-Campus Mitigation. Rather than request funds from the Legislature specifically for off-campus mitigation, UC directs funding from within its budget (including nonstate funds) to compensate local agencies for off-campus infrastructure improvements. This means that UC's EIRs do not contain any language that the funding of fair-share agreements is contingent upon legislative approval. However, since fair-share agreements are not negotiated until a trigger point is reached, many local agencies have expressed skepticism about UC following through when the mitigation becomes necessary.

CCC Process for Off-Campus Mitigation. The CCC Chancellor's Office (CCCCO) views local college districts as responsible for negotiating with and funding fair-share payments to local governments. If a college's new campus plan identifies off-campus mitigation measures that require fair-share payments, CCCCO directs the district to use local funds for those payments as the state generally will not provide funding for these costs. The CCCCO does provide districts with state funds for off-site development costs that it considers to be unrelated to CEQA—such as utility connections and improvements to the college's side of immediately adjacent local streets.

Legal Challenge Implies Greater Costs for Local CCC Districts. The CCC also faced a legal challenge relating to off-campus mitigation payments—*County of San Diego v. Grossmont-Cuyamaca Community College District* (2006) in the California Court of Appeal. The district argued that its traffic impacts were "significant and unavoidable" because statutory restrictions prohibited it from expending funds on non-educational purposes and making improvements to streets that do not front the campus boundaries. The court found that the applicable provisions of the law did not prohibit improvements on non-adjacent streets and directed the district to comply with CEQA's mandate to adopt all feasible mitigation measures. As a result of the *Grossmont-Cuyamaca* decision, the district was required to vacate its original campus plan and EIR and replace them with plans that provided the necessary off-campus mitigation funding. In November 2006, the district settled its dispute with the county by agreeing to contribute $858,000 from district funds to a county fund for road improvements. This contribution covers only the first two projects in the campus plan and payments for subsequent projects will be negotiated as they near construction.

Since the *Grossmont-Cuyamaca* and *Marina* decisions require CCC to mitigate all significant impacts, including those requiring off-campus mitigation measures, and CCCCO does not provide state bond funding for most off-site mitigation payments, local CCC districts must continue to rely on local funds (such as local bond proceeds) to cover any off-campus mitigation payments.

How Does the *Marina* Decision Affect Other State-Funded Projects?

All state-funded projects are obligated to meet CEQA's mitigation requirements, unless they are exempted in statute. Below, we discuss how the *Marina* decision potentially affects other state-funded projects outside of higher education.

K-12 Facilities. The State Allocation Board (SAB) provides state bond funds for the construction projects of local K-12 school districts. The regulations of the SAB limit off-site mitigation funds to adjacent streets. Specifically, the SAB only allocates state funds for half the cost of improvements on up to two streets immediately adjacent to the site. A reasonable interpretation of the *Marina* and *Grossmont-Guyamaca* decisions suggests that all significant impacts, adjacent to the site or not, must be mitigated by a lead agency. In fact, the language in the Education Code that SAB uses to justify providing funding for only two adjacent streets was rejected as a basis for limiting off-campus mitigation payments by the Court of Appeal in the *Grossmont-Cuyamaca* decision. This means that, absent a change in SAB policy, local school districts will have to provide mitigation payments for nonadjacent improvements solely with local funds (similar to local CCC districts).

Other State Facilities. In the construction of state office buildings and prisons, the state is also obligated to meet CEQA's mitigation requirements. Even prior to the *Marina* decision, the Department of General Services (DGS) incorporated fair-share language into its EIRs and negotiated payments with local agencies. For example, DGS agreed to negotiate fair-share payments with the City of Sacramento for local intersections negatively affected by the state's East End Office Complex project. Similarly, the state has negotiated its CEQA obligations with local communities in the construction of state prisons. Thus, we do not expect DGS' policies to be affected by *Marina*.

POLICY ISSUES

As the preceding sections have shown, college campuses and the communities that host them have a shared stake in how the effects of campus expansion are accommodated, reduced, or avoided. The Legislature also can play an important role in planning for campus growth. This can take several different forms:

- ***Assessing the Need for Growth.*** The Legislature can limit the environmental impact and the associated mitigation costs of campus growth by requiring fuller utilization of facilities on a year-round basis and scrutinizing the segments' assumptions about growth in campus plans.
- ***Clarifying CEQA.*** The Legislature can reduce the legal conflicts between campuses and communities by clarifying key provisions of CEQA. Even after the *Marina* decision, some parts of the law are the source of some disputes.
- ***Appropriating Mitigation Funding.*** The Legislature will be asked to address the off-campus mitigation costs associated with campus growth. It will confront difficult policy choices concerning the oversight, source, and timing of these payments.

Assessing the Need for Enrollment Growth

Future student enrollment is one of the main drivers of a campus' physical plan. For example, the demand for new academic facilities and housing units depends in part upon how many additional students enroll at the campus. Thus, a campus will develop a campus plan by first projecting the number of additional students it plans to enroll in future years.

The demand for mitigation payments to local agencies results from new campus plans that expand enrollments at California's public colleges and universities. In order to minimize the mitigation costs of campus plans, the Legislature should consider if the expansion in capacity outlined in each campus plan is necessary. Specifically, the Legislature should consider whether (1) the envisioned level of growth in the campus plan is reasonable and (2) alternative methods of accommodating enrollment growth could have smaller environmental impacts.

Both Demographic Changes and Policy Choices Affect Enrollment Growth

Unlike enrollment in compulsory programs such as elementary and secondary schools, which corresponds almost exclusively with changes in the school-age population, enrollment in higher education responds to a variety of factors. Some factors, such as population growth, are largely beyond the control of the state. Others, such as financial aid policies, stem directly from policy choices. In general, enrollment growth corresponds to:

- ***Demographics—Population Growth.*** Other things being equal, an increase in the state's college-age population causes a proportionate increase in those who are eligible to enroll in each of the state's higher education segments. Enrollment projections, particularly for UC and CSU, are heavily affected by estimates of growth in the college-age "pool" (18-to 24-year old population). This population has grown modestly in recent years (see Figure 3). Annual growth rates will peak around 2009, and will slow thereafter. In fact, between 2014 and 2020, the state's college-age population is projected to decline each year.
- ***Policy Choices and Priorities—Participation Rates.*** For any subgroup of the general population, the percentage of individuals enrolled in college is that subgroup's college participation rate. However, projecting future participation rates is difficult because students' interest in attending college is influenced by various factors (including student fees and the attractiveness of job opportunities). In addition, policy actions to expand outreach or financial aid can increase overall participation.

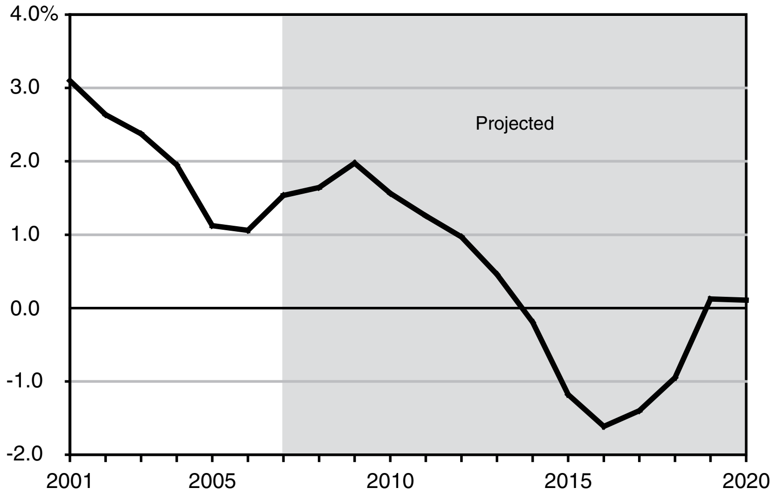
UC and CSU Enrollment Projections. The Legislature requested UC and CSU to provide systemwide enrollment projections through at least 2020 by March 25, 2008. Each segment is expected to explain and justify the assumptions and data used to calculate the enrollment projections. As mentioned above, assumptions about population growth, demographic changes, participation rates, and state funding will be important factors to consider in evaluating the segments' enrollment projections.

CCC Enrollment Projections. Since community colleges tend to serve local populations, rather than the statewide population like UC and CSU, changes in statewide demographics and participation rates are not as useful in enrollment planning. For example, even if the college-age population is declining in the state as a whole, individual community college districts in rapidly growing areas may experience expanding enrollment demand. Consequently, any discussion about expanding enrollment capacity at community colleges should focus on projections for local demographic changes. As described below, however, even rapidly growing districts could consider other methods for accommodating growth in addition to expanding physical capacity.

Figure 3

College Age Population Growth[a]

Annual Percentage Change



[a]All 18- to 24-year olds.

Accommodating Growth with Existing Resources

Student enrollment increases do not necessarily require a proportionate expansion of facilities. This is because all three segments have unused capacity that can accommodate additional students. Some campuses could make fuller use of their existing space and accommodate more students during the traditional academic year without expanding physical capacity, while virtually all campuses could accommodate more students during the summer term. Prior to approving campus growth projects, the Legislature should evaluate if a campus is fully utilizing its existing facilities.

Operating campuses on a year-round schedule—which more fully utilizes the summer term—is an efficient strategy for serving more students while reducing the costs associated with constructing new classrooms, including any fair-share payments required for increasing campus capacity.

Accordingly, the Legislature has encouraged both UC and CSU to serve more students during the summer term.

Over the last five years, UC has steadily increased summer enrollment, while CSU's summer enrollment is still below its 2002 and 2003 levels. Both segments still have significant unused capacity in the summer. The UC's summer 2006 enrollment was 21 percent of fall 2006 enrollment and CSU's was 12 percent. As shown in Figure 4, the summer enrollment for each segment varied significantly by campus.

Summer enrollment at CCC was approximately 30 percent of fall enrollment in 2005. The community colleges have many districts in growing areas of California experiencing increased enrollments that will have to be addressed. If these districts improve their year-round operation, their need to expand physical capacity will be considerably smaller. For example, eight CCC campuses with projects to expand their physical capacity in the Governor's budget have summer enrollments that are less than 20 percent of their primary-term enrollment.

Once the above issues concerning enrollment growth and increased utilization of facilities have been resolved, it is likely that some campuses would still need to increase their capacity in developing new campus plans. This leads to two additional issues that the Legislature will encounter—continued legal disputes over CEQA requirements and the structure of legislative appropriations for mitigation costs.

Clarifying Legal Issues Concerning CEQA and Campus Plans

Generally, the *Marina* decision states that fair-share payments to local agencies are a feasible alternative for complying with CEQA's requirement to mitigate off-campus environmental impacts, and that the lead agency retains responsibility for determining the size of that payment. However, parts of the *Marina* decision and the CEQA statute itself remain subject to conflicting interpretations, as discussed further below, and as highlighted by CSU's adopted policy for off-campus mitigation (see the "How Does the *Marina* Descision Affect CSU" discussed earlier in this write-up). The Legislature could clarify its intent through budget language or by amending the statute. In any event, we expect the following issues to be the focus of future legal conflicts between the higher education segments and local communities.

What Is an Appropriate Arrangement for a Fair-Share Payment?

The *Marina* decision specified that a campus may make fair-share payments to localities as a means of mitigating off-campus impacts. There are, however, still points of dispute. For example, neither CEQA nor the

Figure 4

Year Round Operations at UC and CSU

Campus	Full-time Equivalent Students		Summer As Percent of Fall
	Summer 2006	Fall 2006	
University of California			
Berkeley	3,928	30,911	13%
Davis	5,676	25,419	22
Irvine	6,684	23,358	29
Los Angeles	7,620	31,052	25
Merced	34	1,259	3
Riverside	3,435	15,204	23
San Diego	3,930	24,450	16
Santa Barbara	5,847	19,567	30
Santa Cruz	2,202	14,849	15
Totals	**39,356**	**186,069**	**21%**
California State University			
Bakersfield	756	6,979	11%
Channel Islands	—	2,640	—
Chico	330	15,025	2
Dominguez Hills	1,207	8,640	14
East Bay	4,253	10,979	39
Fresno	—	18,844	—
Fullerton	3,496	27,025	13
Humboldt	465	6,876	7
Long Beach	3,620	28,592	13
Los Angeles	6,216	16,187	38
Maritime Academy	—	886	—
Monterey Bay	119	3,612	3
Northridge	2,481	26,650	9
Pomona	4,874	17,527	28
Sacramento	1,395	23,153	6
San Bernardino	3,146	13,776	23
San Diego	2,753	28,920	10
San Francisco	2,725	23,950	11
San Jose	1,451	23,304	6
San Luis Obispo	2,152	17,620	12
San Marcos	586	7,089	8
Sonoma	—	7,466	—
Stanislaus	718	6,314	11
Totals	**42,741**	**342,055**	**12%**

Marina decision addresses how an EIR must define the amount or timing of fair-share payments. Is it sufficient to simply state in the EIR that the campus will contribute its fair share toward the cost of off-campus mitigation measures once they are triggered? Localities would likely prefer more specificity on how the campus' fair share will be calculated and its method of payment, as well as some guarantee that the campus will follow through. This issue has already caused some host communities to file lawsuits challenging campus plans. In deciding one such suit, in August 2007, a Superior Court concluded there was inadequate specificity and enforceability in two mitigation measures identified in the EIR committing UC Santa Cruz to make fair-share payments for transportation improvements under the control of the City of Santa Cruz.

How Should the Legislature Respond to CSU's Off-Site Mitigation Policy?

The language of CEQA and the *Marina* decision requires state agencies to mitigate significant impacts when it is feasible to do so, while simultaneously requiring them only to "request" funds in their budgets for those mitigation efforts. As mentioned previously, CSU has implemented a policy whereby it requests funds for off-campus mitigation payments, but will proceed with the implementation of campus plans whether or not the Legislature actually appropriates the funding. At the time this analysis was prepared, the City of San Diego was in the process of filing a lawsuit arguing that a campus plan should not be allowed to proceed if fair-share mitigation payments are not guaranteed.

CSU's Policy Raises a Variety of Concerns. Although a court will ultimately evaluate CSU's policy on legal grounds, CSU's policy also raises serious policy concerns. First, CSU's policy appears to ignore the Legislature's intent concerning CEQA and the mitigation of environmental effects—that is, in the absence of legislative funding or in the event of partial funding, CSU's policy allows projects to proceed without mitigating their environmental impacts. The CEQA is designed to ensure that government agencies consider the environmental effects of their development decisions. In view of this stated policy as well as the *Marina* decision, we think it is reasonable to treat mitigation costs for off-campus impacts as part of the cost of implementing the campus plan. The costs for off-campus mitigation are as much a part of the campus plan as the costs of constructing buildings and infrastructure. Considering these costs independently, as CSU proposes, means that environmental effects are not being considered equally with other development decisions as CEQA intends. Allowing a campus plan to proceed without mitigating the environmental impacts that are feasible, including off-campus mitigation costs, is inconsistent with CEQA.

The CSU's policy regarding off-campus mitigation costs is also inconsistent with its policy for on-campus mitigation measures. That is, while CSU requires dedicated appropriations for off-campus mitigation payments, it does not require such appropriations for on-campus mitigation measures. It seems incongruous for CSU to require a specific legislative appropriation for one type of mitigation but not the other.

Lastly, CSU's policy presumes that by declining to fund all or a portion of off-campus mitigation for a campus, the Legislature nonetheless intends for the campus plan to go forward without mitigating off-campus impacts. Although this could be its intent, the Legislature may deny funding because it expects CSU to use other funds for off-site mitigation or because it does not wish for CSU to proceed with implementation of the campus plan.

Legislature Has Many Options in Considering CSU's Request for Mitigation Funding. Given the policy concerns noted above, it is important to recognize that the Legislature has many choices on how to respond to CSU's (or other segments') requests for off-campus mitigation funds. We discuss the range of choices below.

- ***Provide Fair-Share Funding with State Funds.*** If the campus' growth is a state priority and the fair-share payment is reasonable, the Legislature may make a specific appropriation for off-site mitigation or redirect funds within a segment's budget for this purpose.
- ***Share Funding with Segment's Nonstate Sources.*** Since campus plans also include the development of nonstate funded buildings that contribute to environmental impacts, the Legislature could make funding contingent upon the segment contributing to off-site mitigation with nonstate capital funds.
- ***Reject the Request.*** The Legislature may find that the requested fair-share payment is unreasonably high or greater than the benefits of implementing the campus plan. It also may find that the campus plan does not reflect state priorities. The Legislature could then direct the segment to alter the campus plan or renegotiate the fair-share payment.

In view of CSU's intention to proceed with campus plans if the Legislature does not approve its funding request, we recommend the Legislature adopt budget language clarifying its intent concerning each budget request for off-site mitigation funds. For example, if the Legislature elects to support a campus plan's mitigation costs using both state funds and CSU's nonstate capital funds, it should explicitly state that it expects CSU to meet the balance of off-site CEQA obligations from nonstate sources.

Similarly, if the Legislature rejects a mitigation-funding request because it concludes the mitigation costs are not worth the project benefits, it should state its intent as well.

Alternatively, the Legislature could strengthen its role in overseeing mitigation efforts by amending CEQA to clarify that the lack of a specific state appropriation for mitigation shall not by itself allow a lead agency to declare an impact as "significant and unavoidable" and move forward with the project. This would require CSU to revise its policy and provide the Legislature with all the funding options outlined above.

How Should CCC and K-12 Practices Relate to CEQA?

The CEQA is designed to ensure that the costs of environmental protection are addressed when undertaking new developments. Current practices of the CCCCO and SAB only provide state funds for onsite mitigation costs and those on immediately adjacent streets. In view of the *Marina* decision and in order to better align CEQA with state policy, therefore, we recommend that the Legislature direct CCC and SAB to modify their regulations to allow all reasonable off-site mitigation costs to be covered with state bond funds.

Appropriating Mitigation Funding

If the Legislature decides to provide state funding to campuses as one source for fair-share payments to local agencies, it will encounter a number of difficult policy questions concerning the source and timing of payment.

What Is the Appropriate Payment Source?

The majority of offsite mitigation payments go toward capital investments such as road improvements. The useful lives of these projects make them appropriate for funding from state and local general obligation bonds. Other fair-share payments will be for services such as fire protection. These would most likely take the form of annual disbursements for personnel and operating costs. Current operations should be funded from the segments' support budgets rather than general obligation bonds.

When Should Mitigation Costs Be Identified?

The Legislature should be aware of potential mitigation costs associated with a campus plan *prior to* approving any projects outlined in that plan. Determining the fair-share mitigation cost upfront is a good practice because it provides the Legislature and the public a better understanding of the true costs associated with a campus plan. Without such a calculation, a campus plan could move forward without discussion of significant future offsite mitigation costs. Disclosing the mitigation costs of a campus plan and its associated projects allows the Legislature to make project decisions with full information on all the costs associated with that project. An additional advantage is that it requires campuses and localities to meet and negotiate early in the process about the appropriate method for determining fair-share payments.

As described earlier, CSU has done this in its post-*Marina* campus plans by determining the total fair-share payments necessary for its recent updated Master Plans at SFSU and SDSU. The campuses negotiated with their host cities early in the process so that the CSU Trustees were aware of the off-campus mitigation costs and any disputes surrounding them prior to certifying the EIR and campus plan. Similarly, the mitigation costs and contentious issues can be presented to the Legislature as it considers the campus plans or the specific projects included in them. On the other hand, UC does not negotiate estimated costs with communities in the approval process for its campus plans. This practice prevents the Legislature from understanding the full costs of a campus plan under its consideration.

When Should Payments Be Made?

When an offsite mitigation payment is linked to a specific project such as in a project-level EIR, the timing of the funding is straightforward. The offsite mitigation costs for a single project such as a prison or office building should be included directly in the total project cost and appropriated along the same time frame as the phases of the project. Funds can be transferred to local agencies as they start the specific mitigation measures identified in the EIR.

The timing of funding is more complicated when an offsite mitigation measure is linked to a tiered or phased project with cumulative impacts—such as a campus plan. Such mitigation measures are not implemented until specific trigger points or levels of use are attained (for example, traffic at an intersection reaches a predetermined level of congestion). If a campus plan includes ten new projects that add capacity, it is difficult to determine if the trigger point will be reached after completion of the third building or the tenth building. The phasing of a campus plan's implementation makes the timing of fair-share payments more complex:

- If the trigger point is reached at the addition of, say, the sixth building, should the project cost of that building include all the mitigation payments?

- Alternatively, should the mitigation payments be spread among all six projects since each contributed to the cumulative impact? Or even among all ten projects envisioned in the plan?
- What if funds are set aside for the mitigation payment and the trigger point is never reached because growth does not meet the expectations of the campus plan?

As a result of these uncertainties, the appropriate funding method for one campus plan might not be appropriate for another due to differing circumstances. Off-campus mitigation can be funded in a number of different ways. We identify three distinct approaches below.

The Upfront Funding Approach. If the estimated costs of off-campus mitigation payments are determined prior to the certification of the EIR and campus plan, one approach for the Legislature is to appropriate the entire payment to the segment upon the certification of the campus plan. The segment would hold the funds in reserve until the locality begins implementing the specified mitigation measures. An added value of this approach is that through the budget process the Legislature would have an opportunity to evaluate the details of the off-campus mitigation payments. Providing the appropriation upfront is also beneficial because it provides guaranteed funding to the segment and locality as they move forward with their capital plans. This approach of appropriating the lump sum amount upfront, however, has one significant disadvantage. Given the uncertainty of the timing of the trigger points and the locality's schedule for starting the project, the funds could remain unspent while other pressing capital needs are unfunded.

The Incremental Funding Approach. This approach spreads the appropriations out over a number of years, most likely as an addition to the cost of each capital project. As projects move forward, the segment would build a mitigation reserve fund which could be transferred to locals as trigger points are reached. Alternatively, this approach would be appropriate for campuses that agree to make annual payments into a community's local infrastructure fund. The incremental approach provides more certainty to the segments and localities that at least a minimum amount of funds will be available for mitigation as projects are approved. The incremental approach also reduces the amount of funds sitting in the reserve account for a long period of time. However, given the uncertainty of growth and trigger points, there could be insufficient money in the reserve fund to cover necessary mitigation payments at a given time.

The Trigger Point Funding Approach. The last alternative provides funding for offsite mitigation payments as the trigger points are reached and localities begin to implement the mitigation measures. The major advantage of this approach is that funds are made available when the actual timing and cost of the mitigation measures are known. From the segments' and local governments' budgeting perspective, however, this creates difficulties because there are no guarantees the funds will be available when the fair-share payment is necessary. Without providing a dedicated funding source like the upfront or incremental approach, local agencies cannot be certain about the ability to mitigate the impacts caused by the campus and may be hesitant to endorse the campus plan. From an oversight perspective, this approach also does not provide the Legislature with critical information at the appropriate time concerning the full cost of the projects that led to the campus reaching the trigger point. For instance, the Legislature could provide funding for five projects at a relatively low cost only to find that they cumulatively resulted in a large fair-share payment for which CEQA now requires payment.

Determine Funding Approach on a Case-by-Case Basis. As described earlier, the segments have different policies pertaining to fair-share negotiations for off-campus mitigation measures and the campuses have different relationships with their host communities. As a result, we conclude that the Legislature should consider state funding for off-campus mitigation on a case-by-case basis. Allowing each campus the flexibility to negotiate the payment methodology will accommodate the various relationships that exist between campuses and their host communities. Delaying the payment using the trigger point approach is more appropriate for campus plans such as SFSU that reach detailed agreements on the cost and timing of payment. Meanwhile, more contentious campus plans might benefit from the upfront approach so that the Legislature is aware of the approximate cost of the campus plan implementation and local governments are assured of a funding source.

CONCLUSION

This analysis of off-campus mitigation issues has highlighted the importance of the Legislature's early involvement in planning for higher education enrollment growth. In our earlier report on UC's campus planning, we recommended that UC and CSU provide draft campus plans to the Legislature, and that the Legislature hold hearings to review these draft plans in order to express any concerns about the plans before they become final. This process would allow the segments to amend the plan as needed to accommodate any legislative concerns.

In this analysis we have outlined how the *Marina* decision obligates the campuses of the UC, CSU, and CCC to consider—and most likely pay their fair share for—the negative environmental impacts that their growth has on surrounding communities. Depending upon the policy choices of the Legislature, CEQA requirements to mitigate off-campus impacts could result in significant costs to the higher education segments and the state. We continue to recommend greater legislative oversight over the campus planning process at all three segments—particularly, holding hearings on draft campus plans. Specifically, we recommend the Legislature consider the following issues in its review of campus plans:

- ***How Much Growth Is Necessary?*** Prior to expanding its enrollment ceiling, each campus should demonstrate evidence of enrollment demand and adequate year-round utilization of its facilities.
- ***What Are the Estimated Costs of Off-Site Mitigation?*** We recommend that the segments include a preliminary estimate of fair-share mitigation costs in order to provide the Legislature a better understanding of the true costs that would be associated with the implementation of the proposed plans.
- ***What Is the Status of Negotiations With Local Agencies?*** Given the potential for litigation to add costs and delays to the planning process, it is important for the campuses to initiate discussions with their host communities early in the planning process. Ideally, mitigation costs will be negotiated prior to the legislative hearing and the governing body's approval of the campus plan and its EIR.
- ***How Will Mitigation Costs Be Funded?*** The segments should report on the sources of funding they will use for any off-campus mitigation payments, including any anticipated requests for state funding.

With greater oversight over the campus planning process, we envision that the Legislature will be able to develop campus plans that balance the state's priorities of increasing college attendance and adequately addressing the concerns of surrounding communities. This approach should reap benefits in the future. Given the immediate effect of the *Marina* decision, however, we also highlight the following recommendations for the near term:

- ***Include Language Allowing Payments for Off-Campus Mitigation in Future Bond Proposals.*** The Legislature has many options in how it decides to pay for off-site mitigation costs. Allowing future bond proposals to provide payments for these costs ensures that the Legislature can include state bond funds as a policy option.
- ***Directly Address CSU's Off-Campus Mitigation Policy.*** The CSU's off-campus mitigation policy raises numerous concerns

which the Legislature should address through budget language or statutory changes.

- ***Direct CCC and SAB to Allow State Funds for Off-Site Mitigation Costs.*** The current policies of CCC and SAB, which restrict state funds to specific mitigation costs, are inconsistent with the intent of *Marina*.

UNIVERSITY OF CALIFORNIA
(6440)

The University of California (UC) offers undergraduate, graduate, and professional degree programs across ten campuses. It also serves as the state's primary public research institution. For 2008-09, the Governor's budget proposes General Fund support for UC of $3.2 billion. This is $98.5 million, or 3 percent, less than the revised current-year amount. When all fund sources are considered (including student fees, federal funds, and other funds), UC would receive total funding of $18.7 billion—an increase of $635 million, or 3.5 percent.

General Fund Proposals

Figure 1 summarizes the Governor's General Fund proposal for UC. As shown in the figure, the Governor first calculates a "workload budget" that is largely based on a multiyear funding plan (or "compact") he negotiated with UC in 2004. The major components of this workload budget are a 5 percent base increase and funding for 2.5 percent enrollment growth, as well as various other adjustments. The General Fund workload budget exceeds UC's revised current-year funding by $233 million (7.1 percent). However, rather than providing the workload level of funding, the Governor's budget reduces this amount by $332 million—roughly 10 percent. As a result, UC would receive $98.5 million less in 2008-09 than the revised current-year amount.

The $332 million reduction to the workload budget includes two components:

- $32 million would come from UC's "institutional support" budget, which generally funds executive and other administrative costs. This represents a 10 percent reduction to the workload budget for these administrative costs.
- $300 million would be unallocated, allowing the UC Regents to decide how the reduction would be accommodated.

Figure 1

University of California General Fund Budget Proposal

(Dollars in Millions)

2007-08 Budget Act	**$3,273.9**
Lease-revenue bond adjustments	-$13.2
2007-08 Revised Budget	**$3,260.7**
"Workload Budget" Adjustments	
Base increase (5 percent)	$154.8
Enrollment growth (2.5 percent)	56.4
Lease-revenue adjustment	14.1
Retirement costs	11.1
Expand medical education initiative	1.0
Phase out supplemental UC Merced funding	-4.0
Subtotal	($233.4)
Governor's "Workload" Estimate	**$3,494.1**
"Budget Balancing Reductions"	
10 percent reduction to institutional support	-$32.3
Unallocated reduction	-299.6
Subtotal	(-$331.9)
2008-09 Proposed Budget	**$3,162.2**
Change From 2007-08 Revised Budget	
Amount	-$98.5
Percent	-3.0%

Student Fee Increases

The Governor's workload budget envisions that UC would increase student fees by 7.4 percent for 2008-09, generating about $125 million in new revenue. However, the budget proposal acknowledges that the university may increase fees above this level to backfill some or all of the unallocated General Fund reduction. The Governor defers the decision on actual fee levels to the Regents.

Intersegmental Issues Involving UC

In the "LAO Alternative Budget" section earlier in this chapter, we describe our recommended alternative to the Governor's higher education budget proposal. Figure 2 summarizes the UC component of this proposal, showing the General Fund impact relative to the Governor's workload funding level.

Figure 2

LAO Alternative General Fund Budget For the University of California

(In Millions)

LAO Recommendations	Change From Governor's Workload Budget
1.8 percent enrollment growth[a]	-$16.4
No cost-of-living adjustment, but provide increases for utilities and other nondiscretionary costs	-105.3
10 percent reduction to administrative support	-32.3
10 percent student fee increase[b]	-167.5
Institutional financial aid (increased need due to fee increase)	32.5
Total LAO Recommendations	**-$289.0[c]**

a Uses Legislature's marginal cost methodology.

b Unlike the Governor's budget, we treat fee revenue as an integral funding source for the segment. As such, a fee increase has the effect of offsetting General Fund costs.

c By comparison, the Governor proposes reductions of $332 million from the workload budget.

In developing our alternative UC budget, we gave priority to funding all anticipated enrollment growth, which we estimate at 1.8 percent. Consistent with our approach for most other budgets in our LAO alternative budget, our proposal for UC does not include a cost-of-living adjustment for personnel costs or general base augmentation, but does include a General Fund augmentation (equal to about 1.5 percent of General Fund base support) to cover identified, nondiscretionary cost increases. Our proposal incorporates the Governor's proposed reduction to UC's administrative support budget. However, unlike the Governor's proposal, our alternative does not include any unallocated reductions, which can undermine budgetary transparency and accountability. Finally, we recommend a student fee increase of 10 percent, as well as an augmentation to financial aid funding to fully cover increased fee charges for students who demonstrate need.

Overall, our alternative UC budget would increase general purpose funding (General Fund and student fee revenue) by about $167 million (3.1 percent) from the 2007-08 level. This funding level would cover expected increases in enrollment and nondiscretionary cost increases, as well as financial aid to cover increased fee costs for needy students. At the same time, our proposal would reduce General Fund spending by $289 million relative to the Governor's workload budget.

Transportation Research Initiative

We recommend the Legislature reject the proposed augmentation of $5 million from the Public Transportation Account. The proposed use is not fully consistent with the Account's intended purpose, and the Account's balance is precarious. (Reduce Item 6440-001-0046 by $5 million.)

The UC maintains an Institute for Transportation Studies (ITS) at three of its campuses. The ITS conducts research on various transportation issues. According to UC, the Institute's research agenda is largely defined by outside agencies and companies, which contribute about $30 million in annual funding. In addition to this support, the *2007-08 Budget Act* includes $250,000 from the General Fund and $980,000 from the Public Transportation Account (PTA).

The Governor's budget proposal would augment PTA funding for ITS by $5 million. This funding would be used to expand research at the three existing ITS campuses, and to expand ITS to all of UC's nine general campuses. It would also support the development of program proposals to federal and other agencies.

We recommend the Legislature reject this proposal for several reasons. First, the proposal is broadly drawn and we believe that some of the proposed research is inconsistent with the Legislature's intent that the PTA support transit projects and planning. For example, the proposal would fund the study of tradable carbon caps, telecommunication services, and greenhouse gas emissions on housing permit approval processes. Second, the Institute has been able to attract considerable nonstate funding which has reduced the need for state support. Third, the PTA's fund balance is precarious. As we discuss in the Transportation chapter of this *Analysis*, the PTA will require a loan from the Traffic Congestion Relief Fund in 2008-09 simply to remain solvent. Given these concerns, we think the proposal to augment the ITS appropriation from the PTA is ill advised.

CAPITAL OUTLAY

The budget proposes $388 million in bond funds for 28 UC capital projects in the budget year. Most of this amount—$336 million—would come from a proposed bond on the November 2008 ballot.

Implementation of Proposition 1D

Proposition 1D, the Kindergarten-University Public Education Facilities Bond Act of 2006, was passed by voters in November 2006. Among the various education segments receiving funding under the bond act, UC was allotted $690 million to construct new buildings and related infrastructure, alter existing buildings, and purchase major equipment for use in these buildings. The bond act also provided UC an additional $200 million for capital projects to expand capacity in the Programs in Medical Education (PRIME) and telemedicine programs. As Figure 3 shows, the majority of these funds have already been committed to specific projects.

Figure 3

UC's Proposition 1D Spending

(In Millions)

	2006-07	2007-08	Total	Unspent
General capital outlay projects	$337	$320	$657	$33
PRIME[a]/Telemedicine projects	—	131	131	69
Totals	**$337**	**$451**	**$788**	**$102**

[a] Programs in Medical Education.

Capital Outlay Spending. Of the $690 million authorized for general capital outlay projects, approximately $33 million remains uncommitted at this time. The Governor's budget proposes to commit about half of the remaining funds to specific projects in the budget year and reserve the other half for potential augmentations and state administrative costs in subsequent years.

Past appropriations from the general capital outlay portion of Proposition 1D contributed funding to 45 projects. Figure 4 shows that only 27 of the projects funded from Proposition 1D can be completed with appropriations made to date. The remaining 18 projects will require additional appropriations. Since nearly all authorized bond funds for UC are already committed, most of the 18 remaining projects will be dependent upon new capital funding for completion. The total estimated cost to finish the UC projects begun with Proposition 1D funding is $304 million. (The Governor proposes to cover $202 million of this in the budget year with funds from the proposed 2008 bond.)

Figure 4

Summary of UC Projects Funded With Proposition 1D[a]

As of 2007-08 Budget Act
(Dollars in Millions)

		Projects Needing Additional Funding	
Type of Project	**Projects With Funding Complete**	**Number**	**State Funds**
New buildings	10	10	$108
Replacement buildings	1	1	65
Renovations/modernizations	8	2	22
Seismic improvements	1	2	79
Campus infrastructure	7	3	30
Totals	**27**	**18**	**$304**

[a] Excluding Programs in Medical Education/Telemedicine projects.

A review of the 45 projects funded by Proposition 1D shows that they cover a wide variety of purposes—new classrooms, teaching labs, and research space; renovation and replacement; campus infrastructure; and seismic-related improvements. As shown in Figure 5 (see next page), most of the new assigned space resulting from Proposition 1D projects is for faculty offices and research space. Many projects such as renovations, seismic improvements, and campus infrastructure upgrades typically do not add space to a campus.

PRIME and Telemedicine Spending. Of the $200 million authorized to implement a systemwide telemedicine program and expand medical school enrollments, approximately $69 million remains uncommitted. The Governor's 2008-09 proposal includes $29 million to finish one project and UC plans to request the remaining amount in 2009-10. Including the Governor's proposal, committed funds from Proposition 1D have funded construction of new facilities at UC Davis, UC Irvine, and UC San Diego; renovation of space at UC San Francisco; and acquisition of telemedicine equipment and minor renovations at UC Los Angeles and UC Riverside.

Figure 5

Net Changes in Space Resulting From Proposition 1D Projects[a]

(Assignable Square Feet)

Classroom Space	
Lecture space	45,317
Teaching lab space	124,392
Subtotal	(169,709)
Noninstructional Space	
Office and research space	732,009
Other space	264,035
Subtotal	(996,044)
Total Increase	**1,165,753**

a Excluding telemedicine projects.

The Governor's 2008-09 Proposal

The budget proposes to spend $388 million from various existing and anticipated bond funds on 28 UC capital projects. The proposal relies heavily on the proposed 2008 education bond, with 24 projects receiving at least partial funding from this source. The proposed funding would support new phases of 14 projects previously funded by the state and 14 new projects.

The 2008 Bond Proposal. The Governor's proposal for the 2008 education bond would provide UC with about $2 billion in funding for capital projects over five years. This amounts to $395 million per year, or $50 million more than the annual funding UC received from Proposition 1D. The UC has suggested that the additional $50 million will be directed toward expanding capacity in the health sciences, but cautioned that specific decisions on the spending allocations of the proposed 2008 bond depend upon many factors—including enrollment trends.

Governor's Proposal Potentially Worsens Funding Shortfall. Rather than prioritize the completion of previously approved projects, the Governor's proposal allocates existing bond funds to new projects. As described above, the available balance of authorized bonds is insufficient to finish all previously funded UC projects and, regardless of budgeting choices, some will be dependent upon a new source of funding (such as a

2008 bond) for completion. However, by funding new projects with available bond balances—rather than focusing on the completion of existing projects—the Governor's budget commits the state to even more projects without a guaranteed source of funding for completion. For example, the budget proposal will commit state funds to seven new projects even if the 2008 bond is not approved. Although existing funds would start these seven new projects, the state would not have the $254 million needed to complete them. In total, the Governor's proposal—by not prioritizing the completion of projects and relying so heavily on approval of a 2008 bond proposal—will result in 26 projects that lack a guaranteed source for completion. The total amount necessary to complete these projects from another source would be approximately $541 million.

Use Remaining Bond Funds to Finish Existing Projects

We recommend that the Legislature budget higher education capital outlay in a way that minimizes the undertaking of capital projects that are dependent on future bonds. Specifically, we recommend that existing bond funds be used exclusively to complete nine projects already approved by the Legislature. We further recommend that the balance of continuing projects and the new projects included in the budget be funded from the proposed 2008 bond.

Under the Governor's proposal, existing bond funds would be directed toward phases of projects for which sufficient funding for completion is uncertain (due to their reliance on the proposed 2008 bond). We recommend that existing bond funds instead be redirected to complete funding for previously approved projects. Redirecting existing bond funds in 2008-09 and 2009-10 to the projects shown in Figure 6 (see next page) would maximize the number of projects guaranteed funding for completion.

Even with these changes, some previously funded projects will still lack guaranteed funds for completion. Their later phases would need to be funded by the proposed 2008 bond or—if the 2008 bond is not approved—by another source, at a cost of approximately $304 million. Also, in order to free up previously authorized bond funds to complete the projects shown in Figure 6, we recommend that each *new* state funded project proposed in the Governor's budget be funded exclusively with the proposed 2008 bond. Making new projects contingent on the approval of the 2008 bond limits the number of projects started without guaranteed funding for completion. In other words, if the 2008 bond is not approved, the projects do not start.

Figure 6

Recommended Projects for Allocation of Existing Bond Funds[a]

(In Millions)

Campus	Project	Funds Needed For Completion
2008-09		
Irvine	Social and Behavioral Sciences Building	$2.8
Riverside	Materials Science and Engineering Building	4.6
Riverside	Student Academic Support Services Building	0.9
Santa Barbara	Education and Social Sciences Building	2.6
2009-10		
Irvine	Humanities Building	$2.1
Irvine	Arts Building	2.6
Merced	Social Sciences and Management Building	1.9
San Diego	Structural and Materials Engineering Building	3.1
Santa Cruz	Biomedical Sciences Facility	2.1
Total		**$22.7**

a Excluding 2006 bond funds directed for Programs in Medical Education/Telemedicine programs.

Overall, realigning bond funds as outlined above would reduce the state's risk as it relates to the uncertainty of the 2008 bond proposal. As shown in Figure 7, our recommendations would increase the number of projects with funds for completion while simultaneously reducing the number of projects in need of future funds. By making all new projects contingent on passage of the 2008 bond, our recommendation would eliminate the risk of starting new projects without a secure source of funding. At the same time, if the 2008 bond is approved, our proposal implements the same projects as the Governor's budget.

Authorized Amount of the 2008 Bond Should Match State's Commitments

We recommend that the 2008 bond measure be of sufficient size to complete all the University of California (UC) projects approved by the Legislature—plus any amount that the Legislature wishes to reserve for new projects in subsequent years. If the Legislature approves all of the projects in the Governor's 2008-09 proposal, the 2008 bond's allocation to UC should be at least $795 million.

Figure 7

Status of UC Capital Projects if the 2008 Bond Proposal Is Not Approved

(Dollars in Millions)

	Governor's Budget	LAO Proposal
Projects with sufficient funds for completion	2	9
New projects started in 2008-09	7	—
Total projects without funding for completion	26	12
Total cost to complete projects	$541	$304

If it were to approve all of the projects in the proposed budget (whether under the Governor's proposal or the LAO proposal), the Legislature would commit to over $795 million in spending from the 2008 bond to finish UC projects—$336 million in 2008-09 and approximately $459 million in subsequent years. (This amount is greater than the amount shown in Figure 7 because it includes new projects that would begin with funding from the 2008 bond.) The Governor's proposal for the 2008 bond would provide sufficient funds to cover these projects. However, if the Legislature elects to authorize a different amount to UC in a 2008 bond, we recommend it include sufficient money to cover the future funding requirement for UC projects. For example, pending legislation to authorize a 2008 education bond (AB 100, Mullin) allocates $690 million, which would be insufficient to cover the projects in the 2008-09 budget proposal. An even higher amount would be required if the Legislature wishes to commit 2008 bond funds to new projects in subsequent years.

Four Projects Initiated Without Legislature's Review and Approval

In view of the University of California's (UC's) decision to use nonstate funds to proceed with the preliminary plans phase of four projects without the Legislature's approval, we recommend UC report to the Legislature on any upcoming projects which it intends to initiate with nonstate funds.

The proposed budget includes funds for four projects at UC Los Angeles initiated by UC using nonstate funding sources. These projects include an update of the electrical infrastructure, improved fire safety in a high-rise building, and two seismic renovations. The university used its own funds to prepare the preliminary plans for the projects. Because of this approach, the Legislature has not had an opportunity to review and consider the need for the projects or how they fit with the Legislature's statewide priorities for spending limited bond funds. A department's request for preliminary plans money is the most important part of the planning process for the Legislature's involvement since this is when it evaluates the programmatic needs for each project and assesses its scope and cost. The UC's practice puts the Legislature in the awkward position of stopping a project in mid-stream if it has concerns about it. While UC should be encouraged to obtain nonstate funding to assist in meeting its capital outlay needs, we believe any projects that would eventually require state funding should be undertaken only with the explicit consent of the Legislature.

We recommend that the Legislature provide the same level of scrutiny to projects initiated with nonstate funds and deny projects that do not meet the state's needs and priorities. Our review indicates that the four projects proposed for additional phases in the budget year are reasonable, and we do not take issue with their inclusion in the Governor's proposal. However, we also recommend that the Legislature ask UC to report at budget hearings on any upcoming projects which it intends to initiate with nonstate funds. The university identifies all future projects in its five-year plan and should be able to report on these projects in advance. This would allow the Legislature to review the proposed scope of the projects prior to their being initiated and presented as a *fait accompli* in a subsequent budget cycle.

California State University (6610)

The California State University (CSU) consists of 22 university campuses and the California Maritime Academy. The university provides instruction in the liberal arts and science, and applied fields that require more than two years of college education. The CSU provides teacher education at both the undergraduate and graduate level, through the master's degree. (As a result of recent legislation, CSU is adding doctoral programs as well.)

For 2008-09, the Governor's budget proposes General Fund support for CSU of $2.9 billion. This is $97.6 million, or 3 percent, less than the revised current-year amount. When all fund sources are considered (including student fees, federal funds, and other funds), CSU would receive total funding of $6.9 billion—essentially unchanged from the current-year level.

General Fund Proposals

Figure 1 (see next page) summarizes the Governor's General Fund proposal for CSU. As shown in the figure, the Governor first calculates a "workload budget" that is largely based on a multiyear funding plan (or "compact") he negotiated with CSU in 2004. The major components of this workload budget are a 5 percent base increase and funding for 2.5 percent enrollment growth, as well as various other adjustments. The workload budget exceeds CSU's current-year funding by $215 million (7.2 percent). However, rather than providing the workload level of funding, the Governor's budget reduces this amount by $313 million—roughly 10 percent. As a result, CSU would receive $97.6 million less in 2008-09 than the revised current-year amount.

Figure 1

California State University General Fund Budget Proposal

(Dollars in Millions)

2007-08 Budget Act	**$2,985.9**
Retirement cost adjustment	-$8.6
Lease-revenue bond adjustments	-6.6
Revised 2007-08 Budget	**$2,970.7**
"Workload Budget" Adjustments	
Base increase (5 percent)	$146.2
Enrollment growth (2.5 percent)	70.1
Lease-revenue bond adjustment	1.7
Other technical adjustments	-2.6
Subtotal	($215.3)
Governor's "Workload" Estimate	**$3,186.0**
"Budget Balancing Reductions"	
10 percent reduction to institutional support	-$43.2
Unallocated reduction	-269.7
Subtotal	(-$312.9)
2007-08 Proposed Budget	**$2,873.1**
Change From 2007-08 Revised Budget	
Amount	-$97.6
Percent	-3.3%

The $313 million reduction to the workload budget includes two components:

- $43 million would come from CSU's "institutional support" budget, which generally funds executive and other administrative costs. This represents a 10 percent reduction to the workload budget for these administrative costs.
- $270 million would be unallocated, allowing the CSU Board of Trustees to decide how the reduction would be accommodated.

Student Fee Increases

The Governor's workload budget envisions that CSU would increase student fees by 10 percent for 2008-09, generating about $110 million in new revenue. However, the budget proposal acknowledges that the university may increase fees above this level to backfill some or all of the unallocated General Fund reduction. The Governor defers the decision on actual fee levels to the Trustees.

INTERSEGMENTAL ISSUES INVOLVING CSU

In the "LAO Alternative Budget" section earlier in this chapter, we describe our recommended alternative to the Governor's higher education budget proposal. Figure 2 summarizes the CSU component of this proposal, showing the General Fund impact relative to the Governor's workload funding level.

Figure 2

LAO Alternative General Fund Budget For the California State University

(In Millions)

LAO Recommendations	Change From Governor's Workload Budget
1.6 percent enrollment growth[a]	-$22.0
No cost-of-living adjustment, but provide increases for utilities and other nondiscretionary costs	-101.2
10 percent reduction to administrative support	-43.2
10 percent student fee increase[b]	-108.7
Institutional financial aid (increased need due to fee increase)	28.5
Total LAO Recommendations	**-$246.5[c]**

a Uses Legislature's marginal cost methodology.

b Unlike the Governor's budget, we treat fee revenue as an integral funding source for the segment. As such, a fee increase has the effect of offsetting General Fund costs.

c By comparison, the Governor proposes reductions of $313 million from the workload budget.

In developing our alternative CSU budget, we gave priority to funding all anticipated enrollment growth, which we estimated at 1.6 percent. Consistent with our approach for most other budgets in our LAO alternative budget, our proposal for CSU does not include a cost-of-living adjustment (COLA) for personnel costs or a general base augmentation, but does include a General Fund augmentation (equal to about 1.5 percent of General Fund base support) to cover identified, nondiscretionary cost increases. Our proposal incorporates the Governor's proposed reduction to CSU's administrative support budget. However, unlike the Governor's proposal, our alternative does not include any unallocated reductions, which can undermine budgetary transparency and accountability. Finally, we recommend a student fee increase of 10 percent, as well as an augmentation to financial aid funding to fully cover increased fee charges for students who demonstrate need.

Overall, our alternative CSU budget would increase general purpose funding (General Fund and student fee revenue) by about $112 million (2.6 percent) from the 2007-08 level. This funding level would cover expected increases in enrollment and nondiscretionary cost increases, as well as financial aid to cover increased fee costs for needy students. At the same time, our proposal would reduce General Fund spending by $247 million relative to the Governor's workload budget.

CSU Capital Outlay

The budget proposes $358 million in bond funds for 24 CSU capital projects in the budget year. Most of this amount—$315 million—would come from a proposed 2008 bond which would appear on the November ballot.

Implementation of Proposition 1D

Proposition 1D, the Kindergarten-University Public Education Facilities Bond Act of 2006, was passed by voters in November 2006. Among the various education segments receiving funding under the bond act, CSU was allotted $690 million to construct new buildings and related infrastructure, alter existing buildings, and purchase major equipment for use in these buildings. As Figure 3 shows, almost all of these funds have already been committed to specific projects, in addition to providing funds for minor capital outlay (upgrades and renovations less than $400,000) and capital renewal (for replacement of building components and systems). Only $26 million of CSU's Proposition 1D allocation remains uncommitted.

Figure 3

CSU's Proposition 1D Spending

(In Millions)

	2006-07	2007-08	Totals
Capital outlay projects	$202	$337	$539
Capital renewal	50	50	100
Minor capital outlay	25	—	25
Totals	**$277**	**$387**	**$664**

Past appropriations from Proposition 1D contributed funding to 36 CSU projects. Figure 4 shows that 22 of these projects will be completed with appropriations made to date. The remaining 14 projects will require additional appropriations. Since nearly all authorized bond funds for CSU are already committed, most of the 14 remaining projects will require new capital funding for completion. The total estimated cost to finish CSU's projects begun with Proposition 1D funds is $272 million. (The Governor proposes to cover $246 million of this in the budget year mainly with funds from the proposed 2008 bond).

Figure 4

Summary of CSU Projects Funded With Proposition 1D

As of 2007-08 Budget Act
(Dollars in Millions)

		Projects Needing Additional Funding	
Type of Project	Projects With Funding Complete	Number	State Funds
New buildings	12	5	$45
Replacement buildings	—	5	133
Renovations/modernizations	5	1	50
Seismic improvements	2	2	20
Campus infrastructure	2	1	24
Land acquisition	1	—	—
Totals	**22**	**14**	**$272**

A review of the 36 projects funded by Proposition 1D shows that they cover a wide variety of purposes—new classrooms, teaching labs, and faculty offices; renovations and replacements; campus infrastructure; seismic-related improvements; and land acquisition. As shown in Figure 5, the projects funded with Proposition 1D will increase CSU's systemwide capacity by almost 13,000 full-time equivalent (FTE) students.

Figure 5

Proposition 1D Projects

Net Increase in Capacity

Instructional Space	Additional FTE Students Accommodated
Lecture	12,063
Teaching lab	879
Total	**12,942**

FTE = Full-time equivalent.

The Governor's 2008-09 Proposal

The budget proposes to spend $358 million on 24 CSU capital projects including $50 million for systemwide capital renewal and $25 million for minor capital outlay projects. The proposed budget does not include any funding from Proposition 1D. The proposal relies heavily on the proposed 2008 bond, with 20 projects receiving at least partial funding from this source. The proposed funding would support new phases of 13 projects previously funded by the state and 11 new projects.

The 2008 Bond Proposal. The Governor's proposal for the 2008 education bond would provide CSU with about $2 billion in funding for capital projects over five years. This amounts to $395 million per year, or $50 million more than the annual funding CSU received from Proposition 1D. According to CSU, the distribution of 2008 bond funds would follow CSU Board of Trustees' adopted categories and criteria, which gives highest priority to completing previous starts and addressing the capital needs outlined in CSU's Five Year Capital Improvement Plan. The segment also notes that additional funds may be needed to fund off-site mitigation costs (an issue we discuss in the "Addressing Local Impacts of Campus Growth: Questions and Issues" section in this chapter) and energy matching grants in support of AB 32 (Nuñez) greenhouse gas reduction programs.

Governor's Proposal Increases Risk of Funding Shortfall. Rather than prioritize the completion of previously approved projects, the Governor's proposal allocates some existing bond funds to new projects. As described above, the available balance of authorized bonds is insufficient to finish all previously funded CSU projects and, regardless of budgeting choices, some will be dependent upon a new source of funding (such as a 2008 bond) for completion. However, by funding new projects with available bond balances—rather than focusing on the completion of existing projects—the Governor's budget commits the state to even more projects without a guaranteed source of funding for completion. For example, the budget proposal will expend some of the state's current bond funds on three new projects even if the 2008 bond is not approved. Although existing funds would start these three projects, the state would lack the $143 million to complete them. In total, the Governor's proposal—by not prioritizing the completion of projects and relying so heavily on approval of a 2008 bond proposal—will result in 18 continuing projects that lack a guaranteed source for completion. The total amount necessary to complete these projects would be approximately $398 million.

Use Remaining Bond Funds to Finish High-Priority Projects

We recommend that the Legislature budget higher education capital outlay in a way that minimizes the undertaking of capital projects that are dependent on future bonds. Specifically, we recommend that existing bond funds be used to complete 11 projects already approved by the Legislature (plus one small new project that can be completed with existing funds). We further recommend that the balance of continuing projects and the new projects included in the budget be funded from the proposed 2008 bond.

Under the Governor's proposal, existing bond funds would be directed toward phases of projects for which sufficient funding for completion is uncertain (due to their reliance on the proposed 2008 bond). We recommend instead that existing bond funds be redirected to complete funding for previously approved projects, as well as one new project that is part of a legal settlement with disabled students. (This project can be fully funded with existing bond monies.) Redirecting existing bond funds in 2008-09 and 2009-10 to the projects shown in Figure 6 (see next page) would maximize the number of projects guaranteed funding for completion.

Even with these changes, some previously funded projects will still lack guaranteed funds for completion. Their later phases would need to be funded by the proposed 2008 bond or—if the 2008 bond is not approved—by another source, at an estimated cost of $247 million. Also, in order to free up previously authorized bond funds to complete the projects shown in Figure 6, most new state funded projects proposed in the Governor's budget would have to be funded exclusively with the proposed 2008 bond. Making new projects contingent on the approval of the 2008 bond limits the number of projects started without guaranteed funding for completion.

Figure 6

Recommended Projects for Allocation of Existing Bond Funds

(In Millions)

Campus	Project	Funds Needed For Completion
2008-09		
Chico	Student Services Center	$2.4
Dominguez Hills	Educational Resource Center Addition	3.7
East Bay	Student Services Replacement Building	2.0
Los Angeles	Forensic Science Building	0.6
Northridge	Science I Replacement	4.5
Northridge	Performing Arts Center	6.0
San Bernardino	Access Compliance Barrier Removal	10.5
2009-10		
Long Beach	Peterson Hall 3 Replacement	$4.7
Los Angeles	Corporation Yard and Public Safety	0.7
Los Angeles	Science Replacement, Wing B	3.9
Pomona	College of Business Administration	1.9
San Marcos	Social and Behavioral Sciences Building	1.7
Total		**$42.6**

Overall, realigning bond funds as outlined above would reduce the state's risk connected to the uncertainty of the 2008 bond proposal. As shown in Figure 7, our recommendations would increase the number of projects with funds for completion while simultaneously reducing the number of projects in need of future funds. By making all new projects requiring future appropriations contingent on passage of the 2008 bond, our recommendation would eliminate the risk of starting new projects without a secure source of funding. At the same time, if the 2008 bond is approved, our proposal for realigning bond funding could implement the same projects as the Governor's budget. (Below, however, we recommend the Legislature delete one new project proposed in the Governor's budget and reduce the scope of another.)

Figure 7

Status of CSU Capital Projects If the 2008 Bond Proposal Is Not Approved

(Dollars in Millions)

	Governor's Budget	LAO Proposal
Projects with sufficient funds for completion	2	12
New projects started in 2008-09	4	1
Total projects without funding for completion	18	6
Total Cost to Complete Projects	$398	$247

Authorized Amount of the 2008 Bond Should Match State's Commitments

We recommend that the 2008 bond measure be of sufficient size to complete all California State University (CSU) projects approved by the Legislature—plus any amount that the Legislature wishes to reserve for new projects in subsequent years. If the Legislature approves all of the projects in the Governor's 2008-09 proposal, the 2008 bond's allocation to CSU should be at least $692 million.

If it were to approve all of the projects in the proposed budget (whether under the Governor's proposal or the LAO proposal), the Legislature would commit to over $692 million in spending from the 2008 bond to finish CSU projects—$315 million in 2008-09 and approximately $377 million in subsequent years. (This amount is greater than that shown in Figure 7 because it includes new projects that would begin with funding from the 2008 bond.) The Governor's proposal for the 2008 bond would provide sufficient funds to cover these projects. However, if the Legislature elects to authorize a different amount to CSU in a 2008 bond, we recommend it include sufficient money to cover the future funding requirement for CSU projects. For example, pending legislation to authorize a 2008 education bond (AB 100, Mullin) allocates $690 million to CSU, which would almost cover the projects in the 2008-09 budget proposal. The Legislature would need to consider an even higher amount if it wishes to commit 2008 bond funds to new projects in subsequent years.

Sacramento: Science II, Phase 2

We recommend the Legislature reduce $490,000 from the preparation of preliminary plans and working drawings for a new science complex at the Sacramento campus and reduce future costs by $6.1 million because (1) the increased capacity in laboratory space could be accommodated by improving year-round operations, and (2) the proposal includes project elements unrelated to the campus' programmatic needs and state priorities.

The budget proposes $4.8 million in bond funds for preparation of preliminary plans and working drawings for an 81,490 assignable square foot (asf) science complex. This facility would replace Brighton Hall and Humboldt Hall, which would be demolished in a later capital outlay project. It would also allow the biological sciences and chemistry departments to relocate from Sequoia Hall to more modern laboratory space in the new science complex. The project would also include a science museum and 100-seat planetarium. An estimated $87.6 million of state bond funds would be required to complete construction of the project.

Although we agree that the existing buildings are in need of replacement or renovation, we have concerns that this project would add unneeded capacity to Sacramento's campus and that certain project elements are not justified in comparison to the segment's capital outlay priorities. Rather than increase instructional space and include the museum and planetarium, we recommend the Legislature direct CSU to reduce the scope of the project so that the science complex only replaces the space removed by the demolition and renovation of the three vacated buildings. This reduction in scope would reduce budget-year spending on the project by $490,000 and spending in subsequent years by $6.1 million.

Increase in Laboratory Space Unjustified. Replacing the existing buildings with the proposed science complex would create additional laboratory capacity for the campus. Additional capacity at the campus is not justified since facilities are currently underutilized in the summer. The campus reports it only enrolls about 1,400 FTE students in the summer compared with over 23,000 FTE students in the fall term. If campus instructional facilities were utilized year round, several thousand more students could be accommodated without the need to expand physical capacity.

Museum and Planetarium Are Not a Programmatic Priority. In view of other statewide needs in higher education, we question the expenditure of limited bond funds on the museum and planetarium. These two portions of the project are not critical to the program of the university, and would not be a priority if they were not included with the replacement of instructional space in this project. We also have concerns with the process in which these elements were added to the project. In the university's most recent five-year capital plan, the museum and planetarium were identified as a separate Space Science/Natural History Museum to be funded by donors. Unable to raise the private funding and facing a federal grant deadline for the planetarium equipment, the university reduced the project's scope and incorporated it into the science complex. Inclusion in an instructional building effectively allowed the museum and planetarium to move ahead of other capital outlay projects that—if compared to a separate facility encompassing only a museum and planetarium—would have received higher priority.

Chico: Taylor II Replacement Building

We recommend the Legislature delete $2.6 million for preparation of preliminary plans and working drawings for a replacement facility to accommodate the College of Humanities and Fine Arts at the Chico campus because the increase in instructional capacity is not justified due to the underutilization of facilities during the summer term. Estimated future state cost to complete the project is $52.2 million. (Delete $2,637,000 from Item 6610-301-6074 [5].)

The budget proposes $2.6 million in bond funds for the preparation of preliminary plans and working drawings for a replacement building to the 42-year-old Taylor Hall. Taylor Hall's mechanical systems are obsolete and the building requires renovations to meet current instructional requirements. Both Taylor Hall and the temporary Yuba Hall would be demolished and replaced with the 67,000 asf Taylor II Replacement Building. The replacement building would include lecture classrooms, instructional laboratories, and faculty and administrative offices for the College of Humanities and Fine Arts. It would also include a new recital hall, dance studio, recording studio, and art gallery.

Although we agree with the need to replace Taylor Hall due to its physical condition, we have concerns about the size of the replacement building. Currently Taylor Hall and Yuba Hall (the two buildings being demolished) total approximately 26,000 asf, while the replacement building will be 67,000 asf and add instructional capacity for 751 FTE students. The replacement building adds certain programmatic space that may well be justified—such as the recital hall and dance studios. As shown in Figure 8 (see next page), however, the replacement building still adds significant capacity above what is being replaced. Such additional capacity is not justified at Chico's campus since facilities are not being used in the summer. The campus reports it only enrolls 330 FTE students in the summer compared with over 15,025 FTE students in the fall term. If campus instructional facilities were utilized year round, several thousand more students could be accommodated without the need to expand physical capacity. Since removing the excess capacity would significantly reduce the scope of the project, we recommend the Legislature reject the current proposal and direct CSU to return with a project of a smaller scope that matches CSU Chico's needs.

Figure 8

Excess Space in Proposed Taylor II Replacement Building

(Assignable Square Feet)

Proposed Space	**67,000**
Space demolished (Taylor Hall and Yuba Hall)	-25,897
Additional programmatic space (recital hall, studios, and galleries)	-17,300
Excess Space of Proposal	**23,803**

California Community Colleges (6870)

California Community Colleges (CCC) provide instruction to about 1.6 million students (fall headcount enrollment) at 109 colleges operated by 72 locally governed districts throughout the state. The state's *Master Plan for Higher Education* and existing statute charge the community colleges with carrying out a number of educational missions. The system offers academic and occupational programs at the lower division (freshman and sophomore) level, as well as recreational courses and precollegiate basic skills instruction. In addition, pursuant to state law, many colleges have established programs intended to promote regional economic development.

CCC Budget Overview

Slight Funding Increases Proposed. As shown in Figure 1 (see next page), the Governor's proposal would increase total Proposition 98 funding (General Fund and local property taxes) for CCC by $55 million, or 0.9 percent, over the revised current-year proposal. (The current-year amount reflects a proposed one-time, midyear reduction of $40 million, as discussed below.) This increase is the net effect of two factors: an $89 million (2.2 percent) decline in Proposition 98 General Fund and a $145 million (7 percent) increase in projected funding from local property taxes. Counting all fund sources—including student fee revenue and federal and local funds—community colleges would receive $9.1 billion in 2008-09.

CCC's Share of Proposition Funding. As shown in Figure 1, the Governor's budget includes $6.2 billion in Proposition 98 funding for CCC in 2008-09. This is over two-thirds of total community college funding. Overall, Proposition 98 provides funding of approximately $56 billion in support of K-12 education and CCC, as well as a small amount of funding for several other state agencies. As proposed by the Governor, CCC would receive 11.2 percent of total Proposition 98 funding. The CCC's share in the current year is 10.9 percent.

Figure 1

Community College Budget Summary

(Dollars in Millions)

	Actual 2006-07	Revised 2007-08	Proposed 2008-09	Change From 2007-08	
				Amount	Percent
Community College Proposition 98					
General Fund	$4,029.6	$4,115.8	$4,026.5	-$89.2	-2.2%
Local property tax	1,851.0	2,051.7	2,196.2	144.5	7.0
Subtotals, Proposition 98	($5,880.7)	($6,167.5)	($6,222.7)	($55.2)	(0.9%)
Other Funds					
General Fund	($292.4)	($285.2)	($373.8)	($88.7)	(31.1%)
Proposition 98 Reversion Account	22.3	21.2	—	-21.2	-100.0
State operations	9.7	10.0	9.3	-0.8	-7.5
Teachers' retirement	83.0	87.8	88.1	0.3	0.4
Bond payments	147.3	166.2	277.3	111.2	66.9
Loan for Compton CCD[a]	30.0	—	—	—	—
Compton CCD[a] Loan Payback	—	-0.3	-0.9	-0.7	—
State lottery funds	173.9	167.5	167.5	—	—
Other state funds	23.3	16.7	17.8	1.1	6.5
Student fees	317.4	281.4	284.4	3.0	1.0
Federal funds	251.3	263.2	261.4	-1.7	-0.7
Other local funds	1,729.7	1,797.8	1,797.8	—	—
Subtotals, Other Funds	($2,788.0)	($2,811.6)	($2,902.8)	($91.2)	(3.2%)
Grand Totals	**$8,668.6**	**$8,979.0**	**$9,125.5**	**$146.4**	**1.6%**

[a] Community college district.

Detail may not total due to rounding.

Major Budget Changes

Figure 2 details the changes proposed for community college Proposition 98 spending in the current and budget years. The administration proposes a one-time reduction of $40 million to apportionment funding in the current year. (Apportionments are available to districts for general purposes such as faculty salaries, equipment, and supplies.) The Governor proposes to restore this cut to CCC's base in the budget year.

Figure 2

California Community Colleges
Governor's Proposition 98 Budget Proposal

(Dollars in Millions)

2007-08 Budget Act	**$6,208.8**
Reduction to apportionments	-$40.0
Technical adjustments	-1.4
2007-08 Revised	**$6,167.5**
"Workload Budget" Adjustments	
Restore 2007-08 reduction to apportionments	$40.0
Cost-of-living adjustment (COLA) for apportionments (4.94 percent)	291.7
Enrollment growth for apportionments (3 percent)	172.0
COLA and enrollment growth for categorical programs	28.5
Technical adjustments	6.5
Subtotal	($538.7)
Governor's "Workload" Estimate for 2008-09	**$6,706.2**
Governor's "Budget Balancing Reductions"	
Eliminate COLA for apportionments	-$291.7
Reduce enrollment growth for apportionments to 1 percent	-111.9
Reduce categorical programs across the board	-80.0
Subtotal	(-$483.5)
2008-09 Proposal	**$6,222.7**
Change From 2007-08 Revised Budget	
Amount	$55.2
Percent	0.9%

The Governor begins his proposal for 2008-09 by estimating "workload" cost increases based on statutory and customary formulas. As shown in Figure 2, these workload factors include a 4.9 percent cost-of-living adjustment (COLA) and 3 percent enrollment growth for apportionments (as well as a COLA and/or enrollment growth for a handful of categorical programs that have customarily received such augmentations). As a budget-balancing measure, the Governor then reduces the General Fund share of the workload calculation for apportionments and each categorical program by 10.9 percent. As a result, the budget proposal ultimately includes no COLA for apportionments, funds enrollment growth for apportionments at a level $112 million less than the workload amount of

$172 million, and reduces categorical funding by a total of $80 million from the workload level. Overall, the Governor's budget-year proposal for community colleges is $484 million less than his 2008-09 workload calculation.

Under the proposed 2008-09 budget, community colleges would receive a slight Proposition 98 increase of $55 million, or 0.9 percent, from the revised current-year level. This is due largely to higher apportionment funding (resulting from a restoration of the current-year cut and a $60 augmentation for enrollment growth) which more than offsets the proposed reductions to categorical programs.

Proposition 98 Spending by Major Program

Figure 3 shows Proposition 98 expenditures for community college programs. As shown in the figure, general purpose (apportionment) funding totals $5.5 billion in 2008-09, an increase of $98 million, or 1.8 percent, from the revised current-year level. Apportionment funding in the budget year accounts for 88 percent of CCC's total Proposition 98 expenditures.

Categorical programs also are shown in Figure 3. The Governor's budget would reduce total funding for categorical programs by about 7 percent from the revised current-year level. Cuts to programs would range from 3.7 percent to 10.9 percent. (The reduction to financial aid/outreach is higher for technical reasons.) The exact percentage reduction depends on whether the administration first builds in a COLA (and/or growth for enrollment) in the workload estimate prior to cutting the program by 10.9 percent. (We discuss the Governor's proposed reductions in more detail earlier in the "Proposition 98 Priorities" section of this chapter.)

Student Fees

Effective January 2007, student fees on credit courses decreased from $26 to $20 per unit. (There continues to be no fee charged for noncredit courses.) The Governor proposes no change to the student fee level in the budget year. Under the Governor's budget, student fee revenue would account for 4.6 percent of Proposition 98 funding for community colleges. (We discuss student fees in more detail later in this chapter.)

Overview of CCC Alternative Budget

Our alternative budget for the community colleges generally adheres to the principles and priorities that guide our recommendations for other education agencies. These include:

Figure 3

Major Community College Programs Funded by Proposition 98[a]

(Dollars in Millions)

	Revised 2007-08	Proposed 2008-09	Change	
			Amount	Percent
Apportionments				
General Fund	$3,346.9	$3,300.4	-$46.5	-1.4%
Local property tax revenue	2,051.7	2,196.2	144.5	7.0
Subtotals	($5,398.6)	($5,496.6)	($98.0)	(1.8%)
Categorical Programs				
Basic skills improvement	$33.1	$29.5	-$3.6	-10.9%
Matriculation	101.8	98.0	-3.8	-3.7
Career technical education	20.0	17.8	-2.2	-10.9
Nursing	22.1	19.7	-2.4	-10.9
Extended Opportunity Programs and Services	122.3	117.8	-4.5	-3.7
Disabled students	115.0	110.8	-4.2	-3.7
Apprenticeships	15.2	14.2	-1.0	-6.5
Services for CalWORKs[b] recipients	43.6	38.8	-4.7	-10.9
Part-time faculty compensation	50.8	45.3	-5.5	-10.9
Part-time faculty office hours	7.2	6.4	-0.8	-10.9
Part-time faculty health insurance	1.0	0.9	-0.1	-10.9
Physical plant and instructional support	27.3	24.4	-3.0	-10.9
Economic development program	46.8	41.7	-5.1	-10.9
Telecommunications and technology services	26.2	23.3	-2.9	-10.9
Financial aid/outreach	51.6	45.0	-6.6	-12.8
Child care funds for students	6.8	6.4	-0.4	-6.5
Foster Parent Training Program	5.3	4.7	-0.6	-10.9
Fund for Student Success	6.2	5.5	-0.7	-10.9
Other programs	8.2	7.8	-0.5	-5.6
Subtotals, Categorical Programs	($710.5)	($658.0)	(-$52.5)	(-7.4%)
Other Appropriations				
Lease revenue bond payments	$58.3	$68.1	$9.8	16.8%
Totals	**$6,167.5**	**$6,222.7**	**$55.2**	**0.9%**

a Excludes available funding appropriated in prior fiscal years.

b California Work Opportunity and Responsibility to Kids.

- Accommodating anticipated enrollment growth.
- Maintaining base funding for the state's highest-priority programs by concentrating reductions in lower-priority programs.
- Creating fiscal and program flexibility for districts to meet local needs.
- Increasing students' share of cost in an affordable manner.
- Funding ongoing costs of mandated local programs.

Main Features of Alternative Budget for Proposition 98 Support of CCC. As Figure 4 shows, our recommended Proposition 98 funding level for the community colleges is $6.2 billion, which is similar to the Governor's. At the same time, our alternative budget provides sufficient funding for 1.7 percent enrollment growth in 2008-09, compared with the Governor's proposal for 1 percent growth. We provide more total resources to the community colleges to meet this anticipated growth rate by augmenting student fee revenue, which would supplement Proposition 98 support. (As we note later in this chapter, our recommended fee increases would have no effect on financially needy students, and would be fully offset for many middle-income students.)

Rather than making across-the-board reductions (which affect high legislative priorities such as financial aid outreach and nursing), we recommend targeted cuts to a selected program. Our alternative approach also increases flexibility for districts to meet local needs by consolidating similar categorical programs into block grants.

As noted previously in the "Proposition 98 Priorities" section earlier in this chapter, Proposition 98 has unfunded ongoing obligations of about $25 million annually for state-mandated community college programs. In order to help reduce the state's education credit card debt, our alternative budget augments base funding for mandate costs by $25 million.

Consistent with our overall approach to Proposition 98 spending, our alternative budget does not provide a COLA to the community colleges in 2008-09. As we discuss in the "COLA" section earlier in this chapter, we recommend an alternative COLA index to the one proposed by the administration.

Non-Proposition 98 CCC Issues. Finally, considering current workload and staffing levels at the Chancellor's Office, we recommend a smaller funding reduction than the Governor's plan. Our proposed reduction reflects modest workload savings resulting from our proposed consolidation of several categorical programs.

Figure 4

California Community Colleges LAO Alternative Proposal

Ongoing Proposition 98 Spending (Dollars in Millions)

2007-08 Budget Act	**$6,208.8**
Technical adjustments	-$1.4
2007-08 Revised	**$6,207.4**
Technical adjustments	$6.5
LAO Proposals	
Enrollment growth for apportionments (1.7 percent)	$20.0[a]
Mandates	25.0
Reduction to economic development program	-11.0
Subtotal, LAO Proposals	($34.0)
2008-09 LAO Proposal	**$6,247.9**
Change From Governor's Proposal	
Amount	$25.2
Percent	0.4%

[a] Funds 1.7 percent growth when combined with proposed additional fee revenues.

ENROLLMENT LEVELS AND FUNDING

The state's community college system is the nation's largest system of higher education and accounts for about 22 percent of all community college students in the country. Three out of four public postsecondary students in the state are enrolled in CCC.

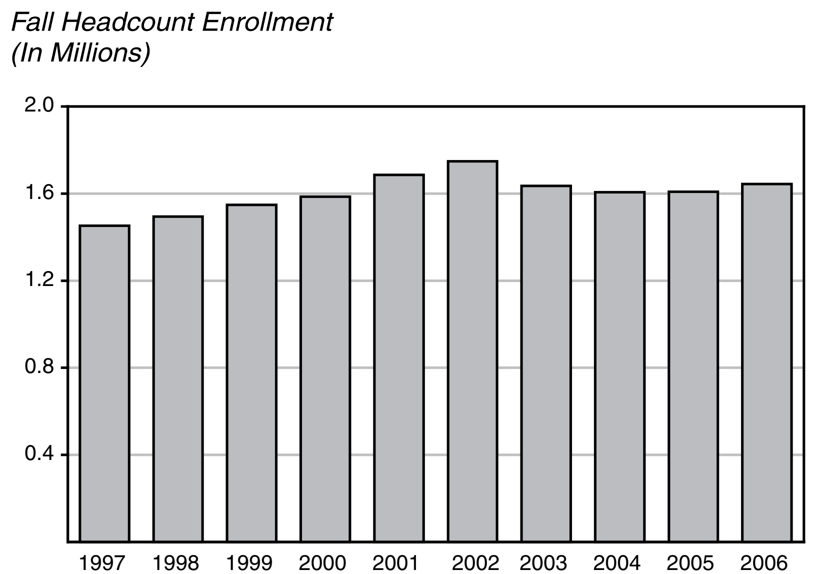
Recent Trends

What Influences Enrollment at CCC? The state's Master Plan and existing statute require the community colleges to serve as "open enrollment" institutions. As such, community colleges do not deny admission to college. (Instead, students simply register for classes that have available space, usually on a first-come, first-served basis.) Many factors affect the number of students that attend a community college. Changes in the state's population, particularly among college-age residents, can be a major factor affecting enrollment levels. Fluctuations in the percentage of the population that enrolls in college (participation rates) affect enrollment at CCC as well, but these are much more difficult to project. Factors such as state educational policies—relating to fees and financial aid, for example—and personal choices of potential students help determine participation rates. Factors such as the availability of specific classes, local economic conditions, and the perceived value of the education to potential students also affect participation rates.

Enrollment Rebounding, but Still Below Earlier Levels. As shown in Figure 5, headcount enrollment—the number of individual part-time and full-time students attending a community college—is higher (by about 190,000 students, or 13 percent) than a decade ago. Yet, growth has been uneven, fluctuating on a year-to-year basis. Enrollment peaked in fall 2002, but subsequently declined by about 8 percent (140,000 students) in fall 2004. (As we discussed in our *2006-07 Analysis of the Budget Bill* [page E-250], several factors may have contributed to this decline, including students opting for employment as a result of an improving state economy.) Enrollment between fall 2004 and fall 2005 was essentially flat, then increased by 35,000 students (or about 2 percent) in fall 2006. Headcount figures for fall 2007 will not be available until the spring, but a census survey suggests that CCC enrollment may have grown further relative to fall 2006.

Figure 5

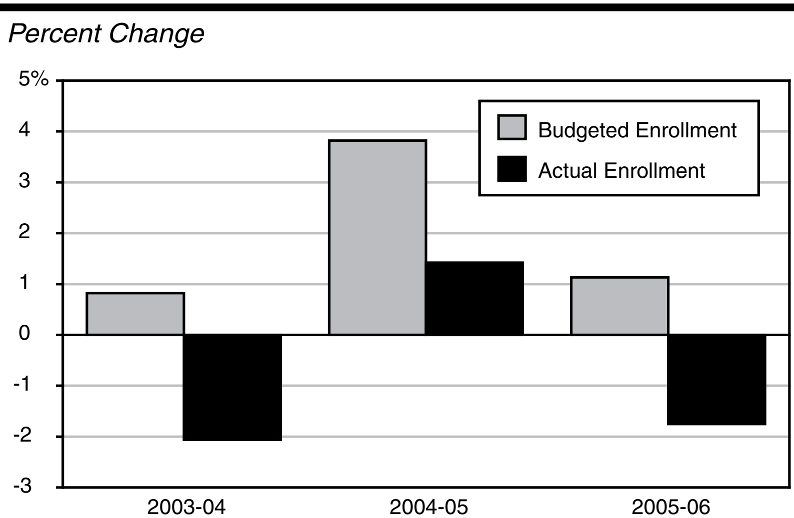
CCC Enrollment Levels Up and Down in Recent Years



Enrollment Growth Overfunded Between 2003-04 and 2005-06. Typically, the annual CCC budget includes an augmentation to accommodate estimated enrollment growth. In some years, funding has been insufficient to cover actual growth. For example, enrollment significantly exceeded budget projections in 2001-02, due in part to individuals returning to attend college at the time of a tight job market. After the peak of 2002, however, enrollment fell below budgeted levels. Figure 6 compares budgeted and actual enrollment between 2003-04 and 2005-06. As the figure shows, budgeted enrollment funding grew faster than actual enrollment (measured as full-time equivalent [FTE] students) during each of the three fiscal years. For example, the community colleges were funded for enrollment growth of almost 4 percent in 2004-05, but actual enrollment increased by less than 1.5 percent. In 2005-06, the community colleges were funded for enrollment growth of slightly more than 1.1 percent, but FTE enrollment levels actually *declined* by 1.8 percent.

Figure 6

Funding for Enrollment Growth Exceeded Actual Enrollment in Recent Years[a]



[a] Based on full-time equivalent students.

2007-08 Budget Act ***Adjusts CCC Base to Account for Overfunding.*** As a result of these enrollment trends, CCC accumulated a growing amount of unused enrollment funding. (See box on next page for an explanation of how these so-called "enrollment restoration" funds are handled at the

Enrollment Restoration

Since 2002, over one-half of community college districts have experienced declining enrollment. State law allows these districts to retain enrollment funding for vacant slots in the year they become vacant in order to cushion district budgets from year-to-year enrollment volatility. However, districts *lose* enrollment funds from their base budgets for slots that remain vacant for a second year. Although individual districts lose funding in these cases, they are entitled to restore this reduction to their base budgets if they earn back the lost enrollment within three years. Unless the Legislature takes action to rebench these monies (as it did in 2007), the unrestored funding remains in the overall community college base budget during that three-year period. After three years, unused funds revert to the Proposition 98 Reversion Account.

district and state level.) In order to bring funding into line with the lower enrollment levels, the *2007-08 Budget Act* permanently rebenched the CCC system's base funding by $80 million. This is the amount of funding associated with approximately 20,000 unfilled slots that became vacant before 2006-07. The base budget was allowed to retain another $55 million in funding for an estimated 12,000 enrollment slots that became newly vacant in 2006-07.

At the same time, the *2007-08 Budget Act* included an augmentation of $108 million to fund new enrollment growth of 2 percent in 2007-08, or about 22,000 FTE students. When these new growth funds are combined with the unused slots from 2006-07, the 2007-08 budget provides CCC with a total of 3 percent growth to accommodate an additional 34,000 FTE students.

2008-09 Enrollment Growth Funding

The Governor's budget proposes an augmentation of $60 million to fund 1 percent enrollment growth at the California Community Colleges (CCC). This level of enrollment growth falls short of the statutory growth guideline of 1.5 percent, as well as our own 2008-09 growth forecast of 1.7 percent. We recommend the Legislature fund 1.7 percent enrollment growth, which would more accurately reflect the level of enrollment CCC is likely to experience in the budget year.

Governor Proposes Funding for 1 Percent Enrollment Growth. Chapter 631, Statutes of 2006 (SB 361, Scott), requires CCC's annual budget request to include funding for enrollment growth at least as large as the average growth rate of two state population groups (19- to 24-year olds and 25- to 65-year olds), as determined by the Department of Finance (DOF). (While the Chancellor is required to *request* at least this amount, there is no statutory requirement for the state to *fund* this or any other CCC growth level.)

The 2008-09 budget requests $60 million for enrollment growth to fund about 12,000 additional FTE students—a 1 percent increase over current-year levels. (See the nearby box for an explanation of the Governor's workload estimates for enrollment growth.) With this augmentation, the Governor's budget would support a total of about 1.2 million FTE students in 2008-09.

Recommend 1.7 Percent Enrollment Growth Funding. We believe the growth rate proposed by the Governor is insufficient to meet projected enrollment demand. This is because we project that demographically driven enrollment in the community colleges (which accounts for growth rates in the underlying population and assumes constant participation rates) will increase by about 1.7 percent in the budget year.

For 2008-09, we thus recommend the state provide additional funding to accommodate CCC enrollment growth of 1.7 percent. The Master Plan calls on CCC to be open to all adults who can benefit from instruction, and we believe that this would more accurately reflect the level of enrollment CCC is likely to experience in the budget year. This growth rate would require $37 million more than the Governor's budget proposal ($97 million more than the current-year base) to accommodate roughly 8,000 additional

California Community Colleges' Budget Starts With Workload Estimate

The Governor's budget documents include both his "workload" estimates and actual funding proposals. The community college budget begins with workload estimates for enrollment growth and a cost-of-living adjustment. The workload budget for enrollment assumes $172 million to fund enrollment growth of 3 percent. (This rate is made up of 1.5 percent growth derived from the statutory guideline plus an additional 1.5 percent in "discretionary" growth.) As part of his budget-balancing measures, the Governor then reduces the growth allocation by $112 million—ultimately arriving at $60 million in proposed growth funds.

FTE students. In the following section, we offer a way to fund such an increase that minimizes cost pressures on the General Fund.

STUDENT FEES

The Governor's budget proposes no changes to fee levels for community college students. As we discuss earlier in the "LAO Alternative Budget" section of this chapter, we recommend the Legislature restore CCC fees to their 2006 level.

Fee Decisions Affect College Funding, Student Choices, and Outcomes

Fee Revenue Can Supplement Proposition 98 Apportionment Funds. Community college apportionment funding—which supports general operating costs—comes from three major sources. Two of these—local property taxes and the state General Fund—together constitute CCC's Proposition 98 funding. In addition, student fees collected by local districts are a smaller, but still significant, source of apportionment funding.

CCC Fees Are Low by National Standards. Over the past decade, community college fee levels for credit courses have fluctuated between $11 and $26 per unit. (There continues to be no charge for *noncredit* courses.) Figure 7 shows the changes in fees during this period, both in actual dollars and 1997-98 dollars. The state currently has no official policy for setting CCC fees. Often, fees have been increased during fiscally challenging periods, and reduced when budget situations improved. Despite this fluctuation, CCC fees have consistently been the lowest in the country. Most recently, fees were reduced from $26 to $20 per unit in January 2007. As a result, a full-time student taking 30 units per academic year pays $600. This is about one-half that of New Mexico ($1,140), which has the next lowest fees among public two-year colleges. Figure 8 shows that the national average for public two-year colleges ($2,360) is almost four times the amount charged by CCC.

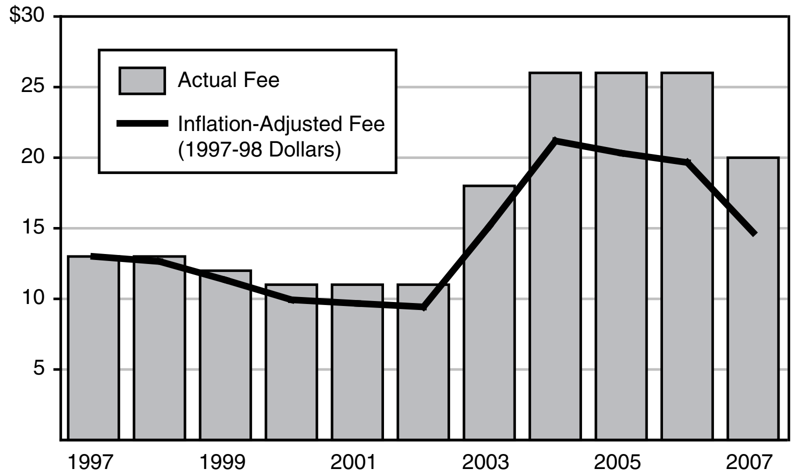
In 2007-08, the CCC system receives an average of about $5,700 to educate each full-time student. A student paying full fees covers about 10 percent of that cost. This is considerably lower than the University of California (UC) and the California State University (CSU), where undergraduate student fees cover about one-third and one-quarter, respectively, of educational costs.

Financially Needy Students Do Not Pay Fees. Fees interact with financial aid programs to determine overall affordability. For low- to middle-income CCC students, affordability is preserved thought the Board

Figure 7

CCC Fee Levels[a]

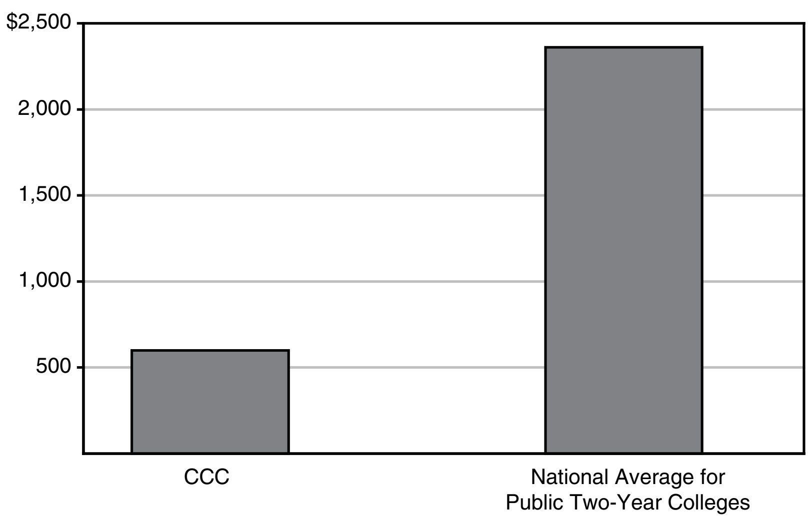
Fall 1997 Through Fall 2007



[a] Cost per credit course unit for non-needy students.

Figure 8

CCC Fees Are Well Below National Average[a]



[a] Average annual fees for a full-time student in 2007-08.

of Governors' (BOG) fee waiver program. This program is designed to ensure that community college fees will not pose a financial barrier to any California resident. It accomplishes this by waiving the educational fees for all residents who demonstrate financial need. Currently, about 30 percent of CCC students receive fee waivers (accounting for over 40 percent of all units taken). Generally, a community college student living at home, with a younger sibling and married parents, could qualify for a fee waiver with annual family income up to roughly $65,000. By definition, therefore, no needy students (who are residents of the state) are required to pay fees, and thus are unaffected by fee increases.

Many Non-Needy Students Receive Tax Breaks to Offset Fee Costs. As we discussed in our *2005-06 Analysis of the Budget Bill* (page E-194), many of the students who do not qualify for BOG waivers are still eligible for financial assistance that covers all or a portion of their fees. For example, students (or their parents) with family incomes of up to $94,000 in 2007 are eligible for a federal tax credit equal to their entire fee payment (up to $1,100 per year) for their first two years of college. (This assumes that the family had a federal tax liability at least equal to the fee payment, which would usually be the case.) Therefore, while students pay their fees up front, they are fully reimbursed for this cost as a federal income tax offset. In other words, for those students or families with federal tax liabilities, the federal government in effect pays for the entire cost of their fees—including any fee increase.

Other Considerations. We believe that there are distinct benefits from having non-needy college students pay some share of their educational costs. When students make a financial investment in their own education, they are more inclined to demand high quality services from the college. In addition, students tend to be more deliberate in their selection of courses and programs when they have a financial stake. Finally, fees help students to make choices that consider the relative costs of different postsecondary options open to them—for example, choosing between a community college and state university for completing their lower division coursework.

Recommend Restoration of 2006 Fee Level

We recommend that the Legislature restore community college student fees to their fall 2006 level of $26 per unit. This change would increase California Community Colleges' revenue by about $80 million, without increasing costs for financially needy students, whose fees are entirely waived. In addition, middle-income students would continue to qualify for a full refund of fees in the form of a federal tax credit (provided they have sufficient tax liability). The revenue generated by

restoring this fee level would help fund anticipated workload increases at community colleges.

A Fee Increase Would Augment CCC's Total Funding Level. The Governor's proposed 2008-09 budget would provide the community colleges with about $5.8 billion in apportionment funding (Proposition 98 funds and fee revenues). As discussed earlier in the "LAO Alternative Budget" section of this chapter, this amount of funding is below the amount required to fund our alternative budget for the community colleges. In order to help the CCC system meet these additional costs, while keeping a community college education affordable, we recommend the Legislature raise the per-unit student fee from $20 to $26. This would generate roughly $80 million in new resources to the community colleges on top of support provided by the General Fund and local property taxes.

Student Share of Cost Would Still Be Modest. While we believe that a $6 per unit increase is reasonable when compared with the total cost of education and with fees in other states, there is a separate question of how large an increase students should be expected to absorb in a given year. Our recommendation would increase the current fee by 30 percent. As a percentage, this could appear to not meet the goal of "moderate" fee increases called for in the past expressions of legislative intent and in our own recommendation for a UC and CSU fee level.

Viewed in other ways, however, the proposed increase appears less dramatic. For the average full-time student, our recommendation would cost an additional $180 per year. Part-time students, who constitute the majority of community college students, would of course pay less than this. Compared with the total cost of attendance (including books, housing, transportation, and other costs), the proposed increase is much smaller. In addition, we believe any potential "sticker shock" effect can be mitigated by raising student awareness about the availability of financial assistance such as BOG fee waivers and the tuition tax credit program.

COMMUNITY COLLEGE CATEGORICAL PROGRAMS

The Governor's budget proposes across-the-board reductions to community college categorical programs. We believe that, rather than reducing funding for all programs, the Legislature should preserve base funding for programs that most directly support the system's core mission of educating students. Accordingly, we recommend that the Legislature focus its efforts to address the state budget shortfall on a targeted reduction to the economic development program. In addition, we recommend consolidating several categorical programs into two

block grants in order to allow districts greater flexibility in directing resources where they are most needed.

As noted earlier, community colleges use apportionment monies to meet basic operating costs such as employee compensation, utilities, and supplies. By contrast, they must spend categorical funds for specific purposes as prescribed by statute. Categorical programs support a wide range of supplemental activities—from services for disabled students to health insurance for part-time faculty.

Proposed Budget-Year Cuts to CCC Categorical Programs

As detailed in Figure 3 earlier in this chapter, the Governor's budget proposal would reduce funding for all 22 CCC categorical programs by a total of $52.5 million as compared with current-year levels (or $80 million as compared with the Governor's workload estimates for 2008-09). The proposed cuts together amount to a 7 percent year-over-year reduction in Proposition 98 General Fund support for these programs. While the impact would vary from program to program, generally these cuts would result in lower funding rates and/or reductions in the number of recipients served.

Legislature Should Adopt Targeted Cuts Rather Than Across-the-Board Approach. In making reductions to all categorical programs, the administration states that it is attempting to "protect essential services by spreading reductions as evenly as possible so that no single program is singled out for severe reductions." We think this approach mistakenly assumes that all programs are of equal importance to the state. We recommend instead that the Legislature seek to preserve funding for those programs and services that are most critical to the state, and achieve needed budget savings by eliminating or further reducing lower-priority programs. Below, we identify one such program.

Recommend Reducing Support for Economic Development Program

In order to preserve the California Community Colleges' core priority of student services, we recommend the Legislature reduce funding for the economic development program by $11 million, returning program funding to its 2005-06 level. (Reduce Item 6870-101-0001 [16] by $11 million.)

The purpose of CCC's economic development program is to provide job-related training and technical assistance to businesses and organizations. The program provides a variety of grants to community colleges to assist businesses in industries such as biotechnology, health care, and small business development.

Two years ago, base funding for the program was $35.8 million. In 2006-07, base funding was increased by $15 million to $46.8 million. This augmentation was provided to help various businesses enhance training of their existing workforces—not to educate additional students at the community colleges. The Governor's 2008-09 budget would reduce funding for the economic development program by $5.1 million (10.9 percent), from $46.8 million to $41.7 million.

As we noted in our *2002-03 Analysis of the Budget Bill* (page E-253), the economic development program is not directly related to CCC's core mission of educating students. Instead, the program's primary purpose is to provide services to business. In order to avoid reductions in core educational programs, we thus recommend additional reductions to the economic development program (beyond the Governor's proposed 2008-09 level). Specifically, we recommend the program's budget be reduced to $35.8 million, which is the same level of funding provided to the program in 2005-06. We note that businesses that benefit from this program could backfill this General Fund reduction with private funding.

Categorical Reform

Many Categorical Programs Are Inflexible and Inefficient. Categorical programs are designed to ensure that districts address specific priorities. Generally speaking, categorical programs address situations where circumstances might otherwise lead districts to underinvest in a particular service that the state views as critical to the educational process.

However, CCC's categorical programs—like those of other state agencies—have several drawbacks, including:

- ***Inflexibility.*** The CCC's categorical programs are highly prescriptive in terms of how funds are spent. Yet, California's 109 community colleges have different student populations and local resources, and thus the needs of students can vary. By requiring districts to spend funds for a specific purpose (such as part-time faculty office hours), categoricals limit local flexibility to direct funding in ways that address student needs most effectively and efficiently.
- ***High Administrative Costs.*** Categorical funds are expensive for districts and the CCC Chancellor's Office to administer. Districts must apply for, track, and monitor the appropriate use of categorical funds, and the Chancellor's Office must oversee districts' compliance with numerous statutory and regulatory requirements.

- ***Focus on Inputs, Not Results.*** Because of the focus on how categorical funds are spent, the state and districts often lose sight of the outcomes the programs are intended to achieve (such as student achievement).

Recommend Consolidating Categoricals Into Block Grants

We recommend the Legislature combine ten separate categorical programs into two block grants in order to increase local flexibility.

As we discuss earlier in the "K-12" section of this chapter, we believe that block grants are a better alternative to categorical programs. A move to block grants could have several advantages over the current system of categorical programs, namely:

- ***Increasing Fiscal and Program Flexibility.*** With block grants, districts would be permitted to decide for themselves the way and amount of money they allocate to targeted purposes. For example, districts would be free to create a new program model that best suits their students, such as combining previously separate pots of categorical funds to help underprepared students.
- ***Creating Administrative Savings.*** Block grants could generate savings to districts due to the elimination of numerous application, accounting, and monitoring requirements.
- ***Increasing Accountability.*** Eliminating categorical program requirements reduces the state's emphasis on what kind of activities districts fund. To the extent that this is accompanied by a renewed emphasis on outcomes, it would allow districts to select for themselves the best strategies for achieving student-focused results, as well as permit the Legislature to evaluate the results of local efforts.

In order to help districts make the most efficient use of state support, we recommend that funding for several existing categorical programs be combined into two block grants—Student Success and Faculty Support. Figure 9 summarizes the elements of our two proposed block grants. As the figure shows, the component programs receive a total of $490.7 million in 2007-08. We recommend the same total funding (though provided in two block grants) for 2008-09. Under our proposal, roughly two-thirds of CCC's categorical funds would be included in these block grants.

Figure 9

LAO's Proposed Consolidation of Funding for Categorical Programs

(General Fund, In Millions)

	2007-08 Amounts
Student Success Block Grant	
Financial aid/outreach	$51.6
Extended opportunity programs and services	122.3
Disabled students	115.0
Fund for Student Success	6.2
Matriculation	101.8
Basic skills initiative	33.1
Total	**$430.0**
Faculty Support Block Grant	
Faculty and staff outreach/training	$1.7
Part-time faculty compensation	50.8
Part-time faculty office hours	7.2
Part-time faculty health insurance	1.0
Total	**$60.7**
Grand Total	**$490.7**

Student Success Block Grants. Our proposed Student Success block grant includes six related programs. By combining funding for these programs into one block grant, community college districts would be able to allocate student service funding in a way that best meets the needs of their students. As detailed in Figure 9, under our alternative proposal, the block grant would total $430 million, which is higher than the proposed individual funding for the six categoricals totaling $407 million under the Governor's budget. (Our proposed funding level for the block grant in 2008-09 is equal to the total amount provided to community colleges for the six programs in the current year.)

Faculty Support Block Grants. Our proposed Faculty Support block grant includes funding for four programs to improve faculty performance and to recruit and retain part-time faculty. As Figure 9 shows, we recommend providing $60.7 million for the block grant, which is the same amount the four programs received in 2007-08. Since these monies would be distributed as a block grant, districts would have flexibility to allocate faculty resources to meet local campus needs.

Other Issues

CCC Chancellor's Office

The Governor proposes an unallocated reduction of $1 million (non-Proposition 98 General Fund) from the Chancellor's Office's workload budget. Given current staffing needs at the Chancellor's Office, we instead recommend a smaller reduction of $200,000 to reflect workload savings resulting from our separate recommendation to implement categorical reform.

The purpose of the Chancellor's office is to oversee the statewide CCC system. Key functions of the Chancellor's office include:

- Administering statewide programs.
- Providing technical assistance to districts.
- Issuing annual reports on the fiscal condition and educational effectiveness of districts.

In 2007-08, the Chancellor's office is budgeted $20.5 million (all fund sources) for about 150 FTE staff, including $9.9 million in General Fund (non-Proposition 98) support.

Governor Proposes Unallocated Reduction. The Governor's budget for the Chancellor's Office begins with workload adjustments. These include $174,000 for technical adjustments (to cover employee compensation increases and other costs), and $200,000 for two new staff. One of these positions would be assigned to the nursing program at the Chancellor's Office, and the other would help administer CCC's career technical education program. The administration asserts that these staff are necessary given the significant expansions that these programs have experienced in the past few years.

As part of his budget-balancing reductions, the Governor then proposes a 10 percent unallocated reduction of $1 million to the Chancellor's Office General Fund workload budget of $10.3 million. As a result of these workload and budget-balancing changes, the budget would provide $9.3 million General Fund to the Chancellor's Office in 2008-09, a net reduction of $660,000 (or 6.6 percent) compared with the current year.

Recommend Smaller Reduction. We believe that the Chancellor's Office performs a critical oversight function of the community colleges with a limited number of staff. The Chancellor's Office has been subject to various base reductions since 2002-03, and is currently operating with 30 percent fewer funded positions than in 2001-02. We are concerned that the proposed $1 million (10 percent) cut to the Chancellor's Office workload budget would leave the office with insufficient resources to perform its responsibilities.

Instead, we recommend a smaller reduction of $200,000 from the 2008-09 workload level. We believe that the Chancellor's Office could maintain current service levels with this level of funding. This is because, as discussed earlier in this chapter, we propose to convert a number of categorical programs into block grants. As a result of such a consolidation, there would likely be a modest reduction in administrative costs associated with the administration of these categoricals.

CCC CAPITAL OUTLAY

The budget proposes $894 million in bond funds for 99 CCC capital projects in the budget year. Most of this amount would be funded from two bond funds—Proposition 1D (authorized by voters in November 2006) and a proposed bond measure which would appear on the November 2008 ballot. The proposed projects would also be supported by approximately $505 million in local CCC district funds in the budget year. Of the 99 projects, 44 would require additional appropriations beyond 2008-09 at an estimated cost to the state of $544 million.

The proposed funding would support new phases of 27 projects previously funded by the state and 72 new projects. All but eight of the new projects would be funded with the proposed 2008 bond. As shown in Figure 10, the 72 new projects cover a wide variety of purposes—new classrooms, teaching labs, and faculty offices; renovations and replacements; campus infrastructure; and seismic-related improvements.

Figure 10

New CCC Projects in 2008-09 Budget Proposal

	Number
Seismic improvements	2
Infrastructure improvements	4
Increase instructional capacity	21
Modernize instructional space	34
Promote a complete campus concept	5
Modernize or increase capacity of support space	6
Total	**72**

Implementation of Proposition 1D

Proposition 1D, the Kindergarten-University Public Education Facilities Bond Act of 2006, was passed by voters in November 2006. The bond act authorized $1.5 billion for CCC to construct new buildings and related infrastructure, alter existing buildings, and purchase major equipment for use in these buildings. As Figure 11 shows, $860 million—or 60 percent—of these funds have been allocated as of the *2007-08 Budget Act.*

Figure 11

Proposition 1D Spending California Community Colleges

(In Millions)

Total Authorized	**$1,507**
Allocated:	
2006-07	$431
2007-08	430
2008-09 (Proposed)	411
Subtotal	($1,272)
Unspent	**$235**

In contrast to UC and CSU, the remaining balance in CCC's allocation of Proposition 1D ($235 million) is sufficient to complete all previously approved projects and those proposed to be started with Proposition 1D funds in 2008-09.

2008 Bond Proposal

The Governor's proposal for the 2008 education bond would provide CCC with $3.8 billion for capital projects over five years. This amounts to $750 million per year, which is equal to the annual funding Proposition 1D provided to CCC. Since previously authorized bonds will provide enough funding for CCC to finish current projects, the proposed 2008 bond would be used only for new projects in the budget year, at a cost of $453 million. The cost to complete these projects in subsequent years would be approximately $419 million. The CCC will select projects for the 2008 bond funds based upon CCC BOG's criteria, the same criteria used to choose projects for Proposition 1D.

CCC Chancellor's Office Oversight of Capital Outlay Projects

In June 2007 the Legislature expressed concerns that the CCC Chancellor's Office was not sufficiently overseeing the implementation of state-funded capital outlay projects by local districts. Central to these concerns were three CCC requests to reduce the scope of authorized projects in order to remain within budget. The Legislature raised the following concerns with the three projects:

- ***Failure to Follow the Established Process.*** For each of the three projects, the established process of legislative notification prior to making the scope change was circumvented. In each case, the required notifications came after the fact—the colleges proceeded with the scope change and completed preliminary plans without notifying DOF or the Legislature. This undermined the Legislature's authority and its ability to review and potentially propose an alternative course of action.
- ***Significant Reductions in Program Space Without Justification.*** In each project, the community college district reduced the program space from that originally authorized by the Legislature. In each case, the community college district did not provide any information on how the programmatic purpose of the project would be met after reducing the project scope.
- ***Schedule Delays Increased Costs and Contributed to Scope Reduction.*** Each project experienced significant delays. This increased costs beyond budgeted amounts. Rather than request additional funding, the only remaining option was a decrease in scope. The community colleges, however, did not provide any reasons for these delays.

In response to the Legislature's concerns, the CCC Chancellor's Office sent a letter to all 72 CCC districts that reiterated reporting requirements and procedures of the State Public Works Board and the Legislature for changes in project scope. The Chancellor's Office is also implementing strategies to improve communication with DOF concerning changes in scope, cost, and project schedule. In view of these circumstances, we recommend the Legislature continue to exercise careful oversight of the implementation of state-funded capital outlay projects.

California Student Aid Commission (7980)

The California Student Aid Commission (CSAC) provides financial aid to students through a variety of grant and loan programs. The proposed 2008-09 budget for the commission includes state and federal funds totaling $921 million. Of this amount, $891 million is General Fund support, primarily for direct student aid for higher education.

Below, we summarize the Governor's major budget proposals. We then offer our recommendations related to the Governor's proposals on fee levels and the proposed phase-out of a category of need-based grants. Finally, we review administrative issues related to the planned sale of CSAC's auxiliary, EdFund.

Budget Proposals

Figure 1 compares the commission's revised 2007-08 budget with the proposal for 2008-09. As the figure shows, funding for state financial aid programs would increase by $49 million, or 5.7 percent, from the current year. This increase is primarily due to additional costs associated with the Cal Grant Entitlement Award Program ($109 million), offset by reductions in the Cal Grant Competitive Award Program ($60 million).

As part of the Governor's across-the-board spending cuts, the proposed budget makes 10 percent reductions to the Governor's workload estimate for state operations (-$1.6 million) and to the California Student Opportunity and Access Program, or Cal-SOAP (-$637,000). The proposed budget also includes a net augmentation of $1 million for state operations related to the planned sale of EdFund, and an augmentation of $200,000 in federal funds to maintain the Cash for College Program, previously funded through EdFund. We discuss the impact of the planned EdFund sale later in this piece.

Figure 1

Student Aid Commission Budget Summary

(Dollars in Millions)

	2007-08 Revised	2008-09 Proposed	Change Amount	Change Percent
Expenditures				
State Operations[a]	$15.8	$14.6	-$1.2	-7.7%
Financial Aid Programs				
Cal Grant Programs				
Entitlement	$664.7	$773.9	$109.2	16.4%
Competitive	117.1	57.5	-59.6	-50.9
Pre-Chapter 403/00[b]	0.5	0.2	-0.3	-68.8
Cal Grant C	7.9	7.9	—	-0.5
Subtotals, Cal Grant	($790.2)	($839.5)	($49.3)	(6.2%)
APLE[c]	$40.7	$40.6	-$0.1	-0.4%
Graduate APLE	0.4	0.4	—	—
State Nursing APLE—faculty	—	0.2	0.2	—
State Nursing APLE—state facilities	—	0.1	0.1	—
National Guard APLE	0.2	0.3	0.1	48.5
Law Enforcement Scholarships	0.1	0.1	—	—
Cal-SOAP[d]	6.4	5.7	-0.6	-10.0
Cash for College Program	—	0.2	0.2	—
Other Grant Programs[e]	19.5	19.5	—	—
Totals, Financial Aid Programs	**$857.5**	**$906.7**	**$49.1**	**5.7%**
Grand Totals	**$873.3**	**$921.2**	**$47.9**	**5.5%**
Funding Sources				
General Fund	$842.9	$890.5	$47.6	5.7%
Federal Trust Fund[f]	10.6	11.0	0.3	3.1
Reimbursements	19.8	19.8	—	—

a Reflects "budget balancing reduction" of $1.6 million in 2008-09. Expenditures by EdFund are not included.

b These programs predate the Cal Grant Entitlement programs and are being phased out.

c Assumption Program of Loans for Education.

d California Student Opportunity and Access Program. The 2008-09 amount reflects "budget balancing reduction" of $637,000.

e Byrd Scholarship, Child Development Teacher and Supervisor Grant, and California Chafee programs—all of which are supported entirely with federal funds reimbursed by other state agencies.

f These monies pay for Cal Grant and Cash for College program costs.

Cal Grant Entitlement Awards. As Figure 1 shows, the Governor's budget would increase funding for the Cal Grant entitlement programs by $109 million, or 16 percent. This increase largely reflects augmentations to increase the fee coverage portion of Cal Grants to match potential fee increases at the University of California (UC) and the California State University (CSU). The Governor defers to the segments' governing boards regarding fee levels but provides sufficient Cal Grant funds to offset increases of up to 30 percent at UC and 33 percent at CSU. The Governor's budget proposes 3,875 fewer High School Entitlement awards in 2008-09 than in the current year, primarily to reflect a decline in the number of high school graduates based on current population estimates. The proposed number of Transfer Entitlement awards remains flat, at about 7,700 awards. The maximum Cal Grant award for needy students at private institutions would remain unchanged from the current year level of $9,708. (The nearby box provides more detail on the commission's major award programs.)

Cal Grant Competitive Awards. The Governor's budget proposes to end the Cal Grant Competitive Awards Program. Although current law authorizes 22,500 new competitive awards annually, the Governor's budget

Cal Grant Programs

High School Entitlement Program. Under this program, every graduating high school senior who meets financial need and academic eligibility criteria, and applies by the deadline in the year of graduation or the following year, is guaranteed a Cal Grant A or B award. Cal Grant A awards cover full systemwide fees at the University of California and California State University, and provide tuition support at private California colleges and universities. Cal Grant B awards are for students with greater financial need, and cover books and living expenses in the first year and also help pay for fees beginning in the second year. About 173,000 new and continuing high school entitlement awards are projected for 2008-09.

Transfer Entitlement Program. The transfer entitlement is for graduates of California high schools who transfer from a California Community College to a qualifying baccalaureate-degree granting institution. Students must also meet financial and academic eligibility criteria, and be under the age of 28 at the end of the year in which they first receive an award. This was recently raised from 24 years by Chapter 822, Statutes of 2006 (AB 2813, DeLaTorre). As under the high school entitlement, transfer entitlements include both A and B awards, with the same maximum for books and living expenses. About includes no funding for new awards under this program in 2008-09. The administration intends that the program be entirely phased out as existing recipients graduate or otherwise leave the program. This accounts for $57 million of the $60 million reduction to the competitive program shown in Figure 1.

APLE and Other Loan Assumption Programs. The Governor's budget maintains current funding levels for the Assumption Program of Loans for Education (APLE) and Graduate APLE, which are loan forgiveness programs for undergraduate and graduate students who fulfill teaching commitments.

The Governor's proposal does not authorize any new warrants for the National Guard APLE (NG APLE), which provides loan forgiveness for qualifying members of the National Guard, State Military Reserve, or Naval Militia who fulfill military commitments. Last year the Governor proposed to extend the July 1, 2007 sunset for NG APLE to July 1, 2010, but did not seek authorization of new warrants under the program. At the same time, the Governor proposed a new Tuition Assistance Program

8,000 new and continuing transfer entitlement awards are projected for 2008-09.

Competitive Program. The Cal Grant Competitive Award Program is for students who meet the basic eligibility criteria of the entitlement program (such as income and grade point average), but do not qualify for those awards. This may be because of age, or a delay in attending college following high school graduation. Recipients are selected for A and B awards from the applicant pool through a competitive process based largely on family income and grade point average, with special consideration for disadvantaged students. For example, students are more likely to receive an award if they received a GED, have been out of high school for several years, or attended a high school with a low college-going rate or a high proportion of students eligible for free and reduced-price lunch. Because of limited funding, only about 18 percent of qualified applicants receive awards. About 57,000 new and renewal competitive grants were awarded in the current year.

Cal Grant C. This program provides up to $2,592 for tuition and fees and up to $576 for other costs for eligible low- and middle-income students preparing for occupational or technical careers. About 7,900 new awards are authorized for 2008-09.

(TAP) in the Military Department for National Guard recruits that would provide direct grants to eligible National Guard members. In our *Analysis of the 2007-08 Budget Bill* (please see page E-291), we recommended that the Legislature reject the TAP proposal, and noted that if the Legislature wished to continue to provide student financial aid as a way to help recruit National Guard members, renewing the NG APLE would be a better approach. The Legislature rejected the Governor's TAP proposal and authorized no additional NG APLE warrants in the *2007-08 Budget Act*. For 2008-09, the Governor again proposes a new tuition grant program in the Military Department, as described in the "General Government" chapter of this *Analysis*. The proposed program is similar to TAP and would be jointly administered with CSAC. To the extent the Legislature wishes to provide fee support for National Guard members, we would again suggest that renewing the NG APLE is a better mechanism than the proposed new program.

The Governor's budget authorizes CSAC to issue 100 new warrants under each of the recently created loan assumption programs for nurses. The State Nursing APLE (SNAPLE) for faculty provides loan repayment for nursing faculty who teach at eligible California colleges or universities, and the SNAPLE for nurses in state facilities provides loan repayment for nurses who fulfill employment commitments at state facilities with high vacancy rates for registered nurses. The budget year is the first year that loan repayments will be made for warrants issued earlier under these programs.

Reduce Funding Based on Lower Recommended Fee Increases

We recommend that the Legislature adjust Cal Grant funding based on the Legislative Analyst's Office fee recommendations. (Reduce Item 7980-101-0001 by $74.3 million.)

In the "LAO Alternative Budget" intersegmental write-up earlier in this chapter, we recommend that UC and CSU fees be raised 10 percent from their current levels in order to modestly increase the share of total education costs paid by students without financial need. In order to maintain affordability for financially needy students, we further recommend that Cal Grant awards be increased to fully cover our recommended fee levels. This would require substantially less than the "placeholder" funding the Governor's budget includes for potential fee increases of up to 30 percent and 33 percent. As a result, our recommendation would result in General Fund savings of $74.3 million.

Recommend Retaining Competitive Program

We recommend that the Legislature reject the Governor's proposal to phase out the Cal Grant Competitive Program. (Increase Item 7980-101-001 by $58.3 million.)

Program Serves Nontraditional Students. Figure 2 compares average age, income, grade point average (GPA), and family size for recipients of the high school entitlement and competitive programs. The differences in the designs of the two programs are reflected in the data. The entitlement program is aimed at students who go to college directly from high school. This explains both the lower average age and, as these students are typically still financially dependent on their parents, the higher family income and size. The competitive program, on the other hand, is aimed at students who have been out of high school for several years. As a result, these students are more likely to be older and financially independent from their parents.

Figure 2

Cal Grant Recipient Characteristics

2006-07 Academic Year

Averages	Entitlement Program[a]	Competitive Program
Age	18	30
Income	$29,011	$15,645
GPA	3.10	3.27
Family size	4.2	3.0

[a] High school component only.

Source: California Student Aid Commission.

While Figure 2 reflects these programmatic differences, it also shows two key similarities. First, both programs serve very low-income, financially needy students. Second, both programs serve academically successful students—in fact, the competitive program recipients have a higher average GPA than those in entitlement programs.

The Governor's budget does not offer a programmatic rationale for its disparate treatment of the two programs—that is, full funding for the entitlement program and elimination of the competitive program. We believe the Cal Grant competitive program is an important component of the state's financial aid system. It serves nontraditional students who are seeking education and training. (Almost three-fourths of these students attend California Community Colleges.) In our view, eliminating the state competitive program undermines a key part of the state's affordability strategy.

In order to maintain the state's commitment to affordability in higher education, we recommend the Legislature reject the Governor's proposed reduction of $57.4 million in the Competitive Cal Grant program. In addition, we recommend augmenting this amount by $925,000 to fully cover our recommended fee levels for new competitive award recipients.

Planned EdFund Sale and Impact on Administrative Operations

The California Student Aid Commission (CSAC) faces numerous unresolved administrative and financial concerns related to the planned sale of EdFund. We will update the Legislature on CSAC's transition plan as more information becomes available, and will provide recommendations on related funding issues during budget hearings.

The *2007-08 Budget Act* authorizes the Director of Finance to sell EdFund, which is a nonprofit public benefit corporation that acts on behalf of CSAC to administer federal loan guaranty programs. The enacted budget assumed that the state would receive $1 billion for this sale. With the sale of EdFund, it is expected that CSAC would relinquish its status as California's federally designated guarantor for the Federal Family Education Loan Program. In anticipation of EdFund's sale, the budget ceases the recent practice of supporting CSAC's administrative and selected programmatic costs with funding generated by EdFund's activities. To replace this lost revenue, the enacted current-year budget includes $21.7 million in General Fund support for state operations and Cal-SOAP.

Subsequent to the enactment of the *2007-08 Budget Act*, the federal government made changes to its loan programs that are affecting the revenue retained by guaranty agencies. Partly as a result of this development, the Governor's budget proposal reduces the anticipated revenue from EdFund's sale by half, to $500 million. The proposal anticipates completion of the sale by June 30, 2008.

In early January 2008, the Department of Finance engaged Bear Stearns as its advisor to assist in the sale of EdFund. The administration expects to solicit offers to purchase EdFund in March, when it intends to release a request for proposals.

The Governor's budget includes several adjustments for 2008-09 related to the planned sale of EdFund. The budget proposal removes $1 million in funding for CSAC's Federal Policy and Programs Division, as oversight responsibilities will terminate with the sale of the corporation. However, the budget bill provides contingency language allowing CSAC to maintain the division and related funding in the event the EdFund sale is not finalized until 2008-09.

Conversely, EdFund has been providing a number of administrative services for CSAC, including telephone, Internet, and mail processing services. These benefits will terminate with the sale of EdFund, and CSAC will have to procure these services. The Governor's budget provides a $2 million augmentation for these costs.

EdFund and CSAC currently share facilities. The lease for shared facilities expires August 31, and EdFund has leased a new facility beginning July 1, 2008. The commission also intends to lease a new facility and plans to move in early 2008-09. Finally, CSAC is transferring several civil service employees from EdFund to vacancies at the commission, but lacks enough vacant positions to accommodate all who are interested in transfers.

We will update the Legislature on the sale of EdFund and CSAC's transition plan during budget hearings as more information becomes available, and provide recommendations on budget issues at that time.

FINDINGS AND RECOMMENDATIONS

Education

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Proposition 98 Priorities

E-15 ■ **Proposition 98 Priorities.** We offer an alternative Proposition 98 budget that would provide K-14 education with roughly the same amount of ongoing program support in 2008-09 as in the current year ($57.7 billion).

COLA

E-35 ■ **Modify K-12 Cost-of-Living Adjustment (COLA) Index to Focus on Employee Compensation.** Recommend the Legislature base K-12 COLA on employee compensation component of current index. This alternative is simple and transparent and reflects more accurately the cost increases schools and community colleges actually face.

Per Pupil Funding

K-12 Categorical Reform

E-65 ■ **Simplify State Funding System Via Major Categorical Reform.** Reform of the funding system would have multiple benefits, including greater transparency, fairness, flexibility, and performance-oriented accountability. To these ends, we recommend consolidating $42 billion and 43 individual K-12 funding streams into a base funding grant and three block grants.

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Child Care and Development

E-81 ■ **Clean Up Child Care and Development (CCD) Budget and Hold Informational Hearing on Underlying Issues.** Recommend the Legislature adopt a 2008-09 CCD budget of $3.1 billion. This funding level includes growth, funding for an estimated increase in the California Work Opportunity and Responsibility to Kids caseload, and a one-time alignment to correct for chronic carryover. Also, recommend the Legislature hold an informational hearing to consider options for addressing CCD's chronic carryover.

Special Education

E-86 ■ **Meet Special Education Maintenance-of-Effort (MOE) Requirement. Increase Item 6110-161-0001 by $189 Million. Increase Item 6110-161-0890 by $278 Million.** Recommend the Legislature reject the Governor's proposal to reduce special education funding by $189 million because it violates the federal MOE requirement.

Adult Education

E-90 ■ **Adult Education—Align Funding With Population Growth.** Recommend enactment of legislation to base future growth adjustments for the Adult Education program based on the projected increase in the adult population. Also recommend the Legislature fund the program (Item 6110-156-0001) at $30 million below its current-year level to reflect the "excess" growth the program has received over the past four years.

After School Programs

E-96 ■ **Ballot Measure to Eliminate Proposition 49's Autopilot Funding Formula.** Recommend the Legislature support a ballot measure to eliminate Proposition 49's autopilot funding formula and allow funding for the After School Education and Safety program to be decided within the context of the overall state budget.

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K-12 Mandates

E-98 ■ **Mandate Funding Is Part of the Base.** Recommend the Legislature fully fund the estimated costs of state-mandated local programs in the budget year.

E-100 ■ **Recognize Offsetting Savings in the Stull Act.** Recommend the Legislature adopt trailer bill language requesting the Commission on State Mandates to review its decision on the Stull Act for possible offsetting savings.

E-101 ■ **Develop Unit Costs for New Mandates.** Recommend the Legislature add trailer bill language directing the Commission on State mandates to reconsider the parameters and guidelines for the Standardized Testing and Reporting and California High School Exit Examination mandates. Also recommend language directing the State Controller to propose a reasonable reimbursement methodology for the two mandates based on "cost profiles" of a representative sample of school districts.

E-104 ■ **Are the Stull Act Evaluations Worth the Money?** Recommend the Legislature review the need for the Stull Act mandates as part of a comprehensive review of K-12 teacher policies.

Federal Funds

E-108 ■ **Require California Department of Education (CDE) to Report Regularly on Federal Funds.** Recommend Legislature require CDE to produce (1) a three-year budget summary of federal funds due no later than January 15 of each year, and (2) a listing of carryovers (by program and fiscal year) due no later than November 1 of each year. These reports would reduce overall workload for CDE, provide more consistent information to all parties, better inform decision makers by helping them consider all budget and program options, and allow for timely corrective action to avoid reverting federal dollars.

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School Facilities

E-113 ■ **Create a School Facilities Data System.** Recommend the state build a school facilities data system that provides information on age, capacity, and cost of school facilities.

E-115 ■ **Improve Financial Hardship Program.** Recommend a new approach to assessing financial hardship that focuses on the local revenue soures available to the district.

E-121 ■ **Make Further Improvements to Charter School Facilities Programs.** Recommend the Legislature explore additional solutions, including enlarging per-pupil grant programs, expanding eligibility for the SB 740 program, and requiring local school districts to provide charter schools with a share of local bond proceeds equal to the share of students they serve.

California State Teachers' Retirement System

F-125 ■ **System's Funded Status Improved in Most Recent Valuation.** The most recent California State Teachers' Retirement System (CalSTRS) actuarial valuation reported that the system's unfunded liability declined for a second consecutive year to $19.6 billion in 2006. Measured as a percentage of the system's total liabilities, this unfunded liability is about average among comparable pension systems.

F-126 ■ **Proposal to Delay Court-Ordered Interest Payment Is Risky.** Recommend complying with a court order concerning CalSTRS' purchasing power account by paying the entire court-ordered interest obligation and other court-ordered costs in the *2008-09 Budget Act* or earlier, barring an agreement from the other parties in the case to pay the required interest over several years at no additional state cost. This would increase General Fund costs over the two-year period of 2007-08 and 2008-09 by over $130 million, compared to the administration's plan.

F-127 ■ **Recommend That Legislature Again Reject Plan to Guarantee Teacher Benefit.** Recommend rejecting the administration's proposed trailer bill language to (1) guarantee retirees' purchasing power benefits through CalSTRS and (2) reduce General Fund

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costs by $80 million in 2008-09. There are major risks in assuming that the proposed change will generate budget savings, and we are concerned about the idea of the *state* guaranteeing another benefit through CalSTRS, which serves employees of *local* districts.

F-129 ■ **Recommend Applying Commission's Independent Performance Audit Recommendation to CalSTRS.** Recommend that the Legislature repeal or clarify a restriction in current law that could be construed to limit the ability of the Bureau of State Audits or Department of Finance to conduct periodic performance audits of CalSTRS programs.

Other Issues

E-131 ■ **Eliminate Physical Education Teacher Incentive Grants Program. Reduce Item 6110-226-0001 by $42 Million.** Recommend the Legislature eliminate the Physical Education Teacher Incentive grants program for a savings of $42 million in the budget year.

E-132 ■ **Eliminate School Safety Consolidated Competitive Grants Program. Reduce Item 6110-248-0001 by $18 Million.** Recommend the Legislature eliminate the School Safety Competitive Consolidated grants program (for a savings of $18 million in the budget year) because the program is duplicative of a larger, more flexible block grant.

E-133 ■ **Phase Out Year Round Schools Grant Program. Reduce Item 6110-224-0001 by $19 Million.** Recommend reducing the Year Round Schools Grant Program by $19 million in the budget year and each subsequent year until 2012-13.

E-134 ■ **Reduce Standardized Testing and Reporting (STAR) Testing. Reduce Item 6110-113-0890 by $2.5 Million.** Recommend the Legislature eliminate the norm-referenced portion of the STAR test for a savings of $2.5 million in the budget year.

E-135 ■ **Use Federal Funds for the California Pupil Assessment Data System. Reduce Item 6110-001-0001 by $3.2 Million. Augment Item 6110-001-0890 by $3.2 million.** Recommend the Legis-

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lature use federal Title VI funds in lieu of the proposed $3.2 million General Fund (non-Proposition 98) for the California Pupil Assessment Data System.

Intersegmental: Governor's Budget Solutions

E-145 ■ **Two Perspectives on Budget Solutions.** The Governor's higher education proposal can be seen as making a modest year-to-year reduction in General Fund support, or as a larger decline from an estimated "workload" level.

E-146 ■ **Proposals Include Large Unallocated Reductions, Potential Fee Increases, and Financial Aid Cuts.** All segments would receive significant reductions from estimated workload levels.

E-149 ■ **Critical Decisions About Allocating Reductions Deferred to Segments.** Depending on how the universities chose to absorb the reductions, the budget could have significant negative effects on affordability and access.

Intersegmental: LAO Alternative Budget Proposal for Higher Education

E-154 ■ **Fund Enrollment Growth to Accommodate Projected Increase. Reduce Item 6440-001-0001 by $16.4 Million and Item 6610-001-0001 by $22 Million.** Recommend funding the University of California (UC) and the California State University (CSU) enrollment growth of 1.8 and 1.6 percent, respectively, using Legislature's marginal cost methodology. Also recommend adopting budget bill language to ensure that funding is used for new enrollment.

E-155 ■ **Fund Nondiscretionary Price Increases But Not Cost-of-Living Adjustments. Reduce Item 6440-001-0001 by $105.3 Million and Item 6610-001-0001 by $101.2 Million.** Given the state's fiscal situation, we think salary increases are not feasible for 2008-09.

E-157 ■ **Reduce Funding for UC and CSU Administrative Costs. Reduce Item 6440-001-0001 by $32.3 Million and Item 6610-001-0001**

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by $43.2 Million. Recommend adoption of the Governor's proposed 10 percent reductions to estimated workload levels of UC and CSU's "institutional support" budgets.

E-160 ■ **Increase UC and CSU Fees by 10 Percent. Reduce Item 6440-001-0001 by $167.5 Million and Item 6610-001-0001 by $108.7 Million.** Recommend that UC and CSU systemwide fees be raised 10 percent from their current levels to modestly increase the share of total education cost paid by non-needy students.

E-161 ■ **Increase UC and CSU Institutional Financial Aid. Increase Item 6440-001-0001 by $32.5 million and Item 6610-001-0001 by $28.5 million.** Recommend augmenting UC and CSU's institutional aid budgets to cover our recommended fee increases for those financially needy students whose fees are not fully covered by Cal Grants.

Intersegmental: Addressing the Local Impacts of Campus Growth

E-169 ■ **State Supreme Court Decision Affects CSU's Off-Campus Mitigation Policy.** A recent state Supreme Court's decision invalidated CSU's approval of a campus expansion plan, resulting in the need for CSU to revise its policy on funding off-campus mitigation.

E-177 ■ **Legislature Plays Important Role in Planning for Campus Growth.** We find that the Legislature's role in campus growth planning can take three forms: assessing the need for growth, clarifying the California Environmental Quality Act, and appropriating funds to mitigate environmental impacts.

University of California

E-192 ■ **Adopt Legislative Analyst's Office (LAO) Alternative Budget Proposal for the University of California (UC). Reduce Item 6440-001-0001 by $289 Million.** Our alternative budget (detailed in the "LAO Alternative Budget" section of this chapter) would fund 1.8 percent enrollment growth and nondiscretion-

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ary price increases, raise student fees by 10 percent and make corresponding increases to financial aid, and reduce funding for administrative support.

E-193 ■ **Reject Transportation Research Initiative. Reduce Item 6440-001-0046 by $5 Million.** We recommend the Legislature reject the proposed $5 million augmentation for UC's Institute for Transportation Studies, using funding from the Public Transportation Account (PTA). Some proposed uses are not consistent with the PTA's intended purpose, and the PTA lacks sufficient resources to support this augmentation.

E-197 ■ **Direct Existing Bond Funds to Complete Previously Approved Capital Outlay Projects.** Recommend the Legislature redirect existing bond funds to complete previously approved capital outlay projects rather than undertake new projects. This would maximize the number of projects guaranteed funding for completion.

E-198 ■ **A 2008 Bond Proposal Should Match State's Commitments.** A legislative proposal for a 2008 education bond should include sufficient funds to cover the cost of UC's approved capital outlay projects.

E-199 ■ **Initiation of Capital Outlay Projects With Nonstate Funds.** Recommend that UC report to the Legislature on any upcoming projects which it intends to initiate with nonstate funds prior to requesting state funds.

California State University

E-203 ■ **Adopt LAO Alternative Budget Proposal for the California State University (CSU). (Reduce Item 6610-001-0001 by $246.5 Million).** Our alternative budget (detailed in the "LAO Alternative Budget" section of this chapter) would fund 1.6 percent enrollment growth and nondiscretionary price increases, raise student fees by 10 percent and make corresponding increases to financial aid, and reduce funding for administrative support.

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E-207 ■ **Direct Existing Bond Funds to Complete Previously Approved Capital Outlay Projects.** Recommend the Legislature redirect existing bond funds to complete previously approved capital outlay projects rather than undertake new projects. This would maximize the number of projects guaranteed funding for completion.

E-209 ■ **A 2008 Bond Proposal Should Match State's Commitments.** A legislative proposal for a 2008 education bond should include sufficient funds to cover the cost of CSU's approved capital outlay projects.

E-210 ■ **Sacramento: Science II, Phase 2. Reduce Scope of Science II Facility at Sacramento Campus.** Recommend reducing $490,000 from the Governor's proposal for preliminary plans and working drawings for this project because (1) additional instructional space is not justified and (2) project elements do not meet state's priorities.

E-211 ■ **Chico: Taylor II Replacement Building. Reduce Item 6610-301-6074 (5) for Preliminary Plans and Working Drawings for the Taylor II Replacement Building at the Chico Campus by $2,600,000.** Recommend deletion of this project because the increase in instructional capacity is not justified due to the underutilization of facilities in the summer term.

California Community Colleges (CCC)

E-222 ■ **Fund 1.7 Percent Enrollment.** The Governor proposes to fund enrollment growth of 1 percent. We recommend funding enrollment growth of 1.7 percent, which is consistent with our demographically driven projection of enrollment in the budget year.

E-226 ■ **Restore Student Fees to 2006 Level.** Recommend the Legislature restore student fees to $26 per unit, which is $6 more than the current fee. This would provide approximately $80 million in additional resources to the CCC system, without affecting financially needy students.

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E-228 ■ **Reduce Support for Economic Development Program.** In order to preserve funding for CCC's core priority of student services, we recommend the Legislature reduce support for the economic development program by $11 million from the program's current-year base.

E-230 ■ **Consolidate Categorical Programs Into Block Grants.** In order to increase local flexibility, we recommend the Legislature combine six categorical programs into a "Student Success" block grant, and combine four additional categorical programs into a "Faculty Support" block grant. Recommend providing $430 million to the Student Success block grant, which is $23 million more the Governor's proposal for the six individual programs. Recommend providing $60.7 million for the Faculty Support block grant, which is $6.6 million more than the Governor's total funding level for the four categorical programs.

E-232 ■ **Require Smaller Reduction to Chancellor's Office.** Given staffing needs, recommend the Legislature reduce the Chancellor's Office's budget by $200,000, rather than the Governor's proposed amount of $1 million. This smaller reduction would reflect modest workload savings resulting from our recommendation to consolidate categorical programs into block grants.

E-235 ■ **Concerns With Chancellor's Office Oversight of Capital Outlay Projects.** In response to concerns expressed by the Legislature, the CCC Chancellor's Office is implementing changes that warrant the Legislature's attention.

California Student Aid Commission

E-240 ■ **Reduce Funding Based on Lower Recommended Fee Levels. Reduce Item 7980-101-0001 by $74.3 Million.** Recommend covering fee increases of 10 percent at University of California and California State University, rather than higher increases the Governor's budget would accommodate.

E-241 ■ **Reject the Governor's Proposal to Phase Out the Cal Grant Competitive Program. Increase Item 7980-101-001 by $58.3 Million.** Recommend continuing to fund competitive grants for new students.

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E-242 ■ **Administrative and Financial Concerns Related to the Planned Sale of EdFund.** We will update the Legislature on the Student Aid Commission's transition plan during budget hearings as more information becomes available, and provide recommendations on related funding issues at that time.