January 22, 2008

Special Session Guide To Building the Proposition 98 Budget

LEGISLATIVE ANALYST'S OFFICE

Presented to:

Assembly Budget Subcommittee No. 2
On Education Finance

Hon. Julia Brownley, Chair

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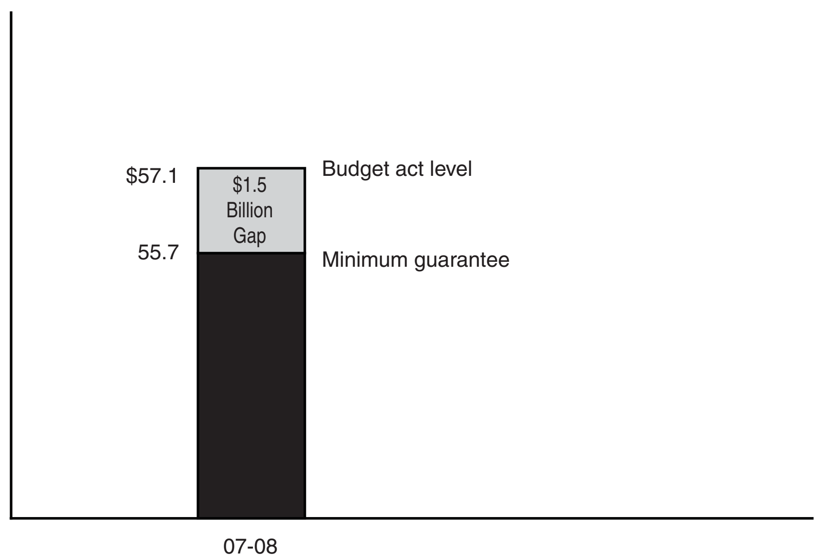
Current-Year Proposition 98 Situation

Figure 1

Proposition 98 Guarantee Below Budget Act Funding Level

(In Billions)



- ☑ The administration estimates that current-year General Fund tax revenues have declined roughly $4 billion from the *2007-08 Budget Act* level.

- ☑ The drop in revenues results in a drop in the Proposition 98 minimum guarantee.

- ☑ The administration estimates the Proposition 98 minimum guarantee is almost $1.5 billion below the Proposition 98 budget act funding level.

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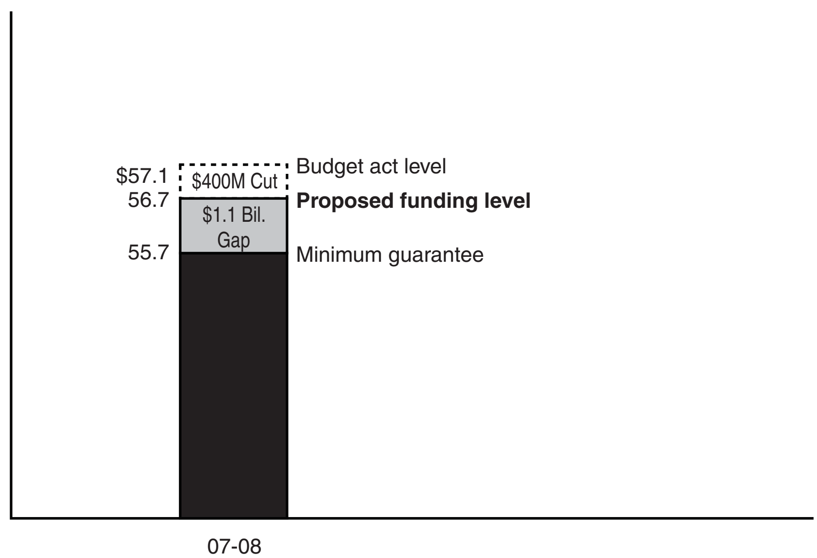
Governor's Current-Year Proposition 98 Proposal

Figure 2

Governor Proposes Reducing Spending by $400 Million

(In Billions)



☑ Of the proposed $400 million reduction:

- K-12 revenue limits reduced by $360 million (or 1 percent).
- Community college apportionments reduced by $40 million (or 0.7 percent).

☑ For K-12 revenue limits, the administration proposes to create a "deficit factor" of 1 percent. It does not propose creating a deficit factor for community college apportionments.

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Concerns With Governor's Current-Year Plan

Governor's current-year proposal would:

- ☑ Result in actual midyear cuts to schools and colleges.
- ☑ Establish a new out-year obligation for K-12 education.
- ☑ Lose an opportunity in current year to achieve additional savings that could help in budget year.
- ☑ Increase the Proposition 98 minimum guarantee beyond what otherwise would have been required.

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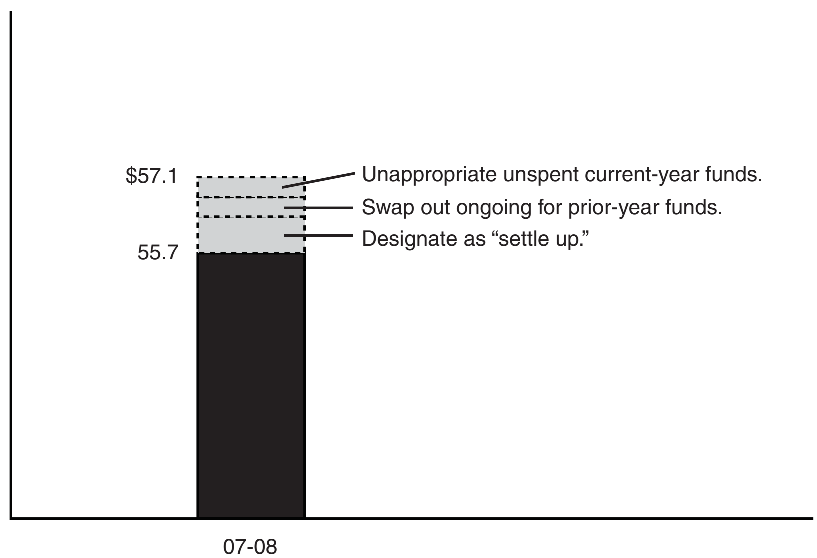
LAO Current-Year Alternative

Figure 3

LAO Alternative Closes Entire $1.5 Billion Gap

(In Billions)



☑ We recommend the Legislature adjust Proposition 98 spending all the way down to the minimum guarantee.

☑ To close the $1.5 billion gap, we recommend using a combination of three strategies:

- Unappropriate any current-year funding that likely would not be spent by end of fiscal year. Would not affect current school operations.
- Swap out ongoing monies for unspent monies from prior years. Would not affect amount of funding going to schools.
- Attribute any remaining spending above the minimum guarantee "settle up." Would not affect amount of funding going to schools.

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Advantages of LAO Current-Year Alternative

Compared to administration's plan, LAO alternative:

- ☑ Obtains more budget solution in the current year.
- ☑ Does not result in real midyear cuts to schools and colleges.
- ☑ Does not create any new out-year obligations.
- ☑ Retires portion of existing out-year obligation.
- ☑ Maximizes Legislature's budget-year options.

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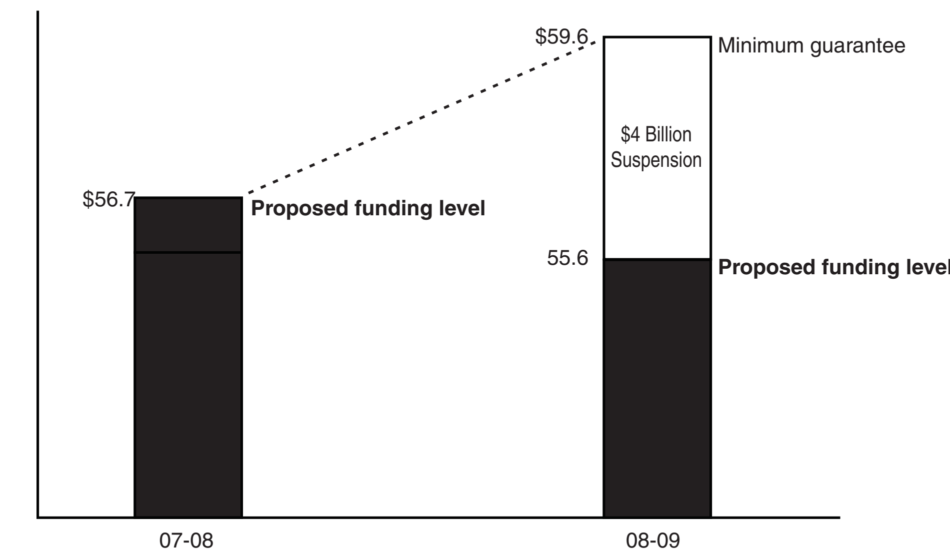
Governor's Budget-Year Proposal

Figure 4

Governor's Current-Year Plan Affects Budget-Year Guarantee[a]

(In Billions)



[a] Based on Governor's revenue projection and accrual proposal.

- ☑ The administration proposes to suspend the Proposition 98 minimum guarantee by $4 billion.
- ☑ Year over year, Proposition 98 funding would decline by $1.1 billion, or about 2 percent.

Governor's Budget-Year Proposal *(Continued)*

- ☑ The Governor's proposal for K-14 education is built off a "workload" budget. The workload budget assumes most programs receive growth and cost-of-living adjustments (COLAs).

- ☑ From the workload budget, the Governor proposes a 10.9 percent General Fund reduction. He applies the reduction to apportionments and virtually every categorical program.

- ☑ To achieve part of the reduction, the Governor proposes no COLA for K-14 education. The remaining cuts generally would be achieved by reducing existing funding rates or program participation.

- ☑ As with his current-year proposal, the Governor would create a deficit factor for K-12 revenue limits.

- ☑ Although it would have no effect in the budget year, the administration proposes to change the statutory COLA index for K-12 programs.

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Concerns With Governor's Budget-Year Proposal

- ☑ Administration's across-the-board cut would affect virtually all programs regardless of merit. Effective, high-priority programs would be cut to the same extent as ineffective, low-priority programs.

- ☑ The administration's plan includes funds for a major program expansion ($450 million for the Quality Education Investment Act) while simultaneously cutting base program.

- ☑ The administration's plan offers only very modest increases in fiscal flexibility.

- ☑ The administration's proposed reduction to special education violates a federal maintenance-of-effort requirement.

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LAO Alternative Approach to Budget Year

- ☑ Takes a more strategic approach to evaluating programs and making funding reductions.
- ☑ Tries to preserve funding for effective programs and mandated activities while reassessing funding for other base programs.
- ☑ Tries to preserve quality of base program before funding program expansions.
- ☑ Tries to offer meaningful flexibility through broad categorical reform.

Delayed Payment Proposal Still Under Review

- ☑ ***Proposal.*** Delay payment of the $1.3 billion Proposition 98 deferral ($1.1 billion K-12, $200 million community college) from July 2008 to September 2008. The delay would be ongoing (each year thereafter payment would not be made until September).

- ☑ ***Rationale.*** The state's cash reserves might be insufficient to pay for the state's obligations in July and August 2008.

- ☑ ***Cash Situation Is Tight.*** Our review shows that reserves will be low and actions to increase cash reserves are warranted.

- ☑ ***Defer Schools Payments as a Last Resort.*** The proposal could have significant impacts on the many small school districts in the state (about 55 percent of all school districts serve fewer than 1,000 students).

- ☑ ***Explore Other Options.*** We are working with the Department of Education and the Chancellor's Office to determine whether other early payments to schools and colleges could be delayed with less financial effect.