

March 6, 2012

Overview of Proposition 98 Budget

LEGISLATIVE ANALYST'S OFFICE

Presented to:
Assembly Budget Subcommittee No. 2 on Education Finance
Hon. Susan Bonilla, Chair





Overview of Governor's January Budget Proposal

Identifies \$9 Billion Budget Problem

- \$4 billion deficit in 2011-12.
- \$5 billion shortfall in 2012-13.

Proposes \$10 Billion in Solutions

- Raises \$7.2 billion in revenue, primarily through tax increase to be on November ballot. (Tax increase offset by \$2.5 billion increase in Proposition 98 funding.)
- Makes \$4 billion in expenditure reductions.
- Takes \$1.4 billion in other actions.
- Leaves state with roughly \$1 billion reserve.

LAO February Forecast Has Lower Baseline Revenues

- In our recently published report, *The 2012-13 Budget: Economic and Revenue Update*, we project state revenues to be \$6.5 billion lower than the Governor's January estimates (\$3 billion lower in 2011-12, \$3.5 billion lower in 2012-13).



Adjustments to Minimum Guarantee

Governor's January Proposal

- Revenues from proposed ballot measure would increase minimum guarantee by \$879 million in 2011-12 and \$2.4 billion in 2012-13.
- Proposes to eliminate gas tax rebenching for savings of \$596 million.
- Proposes to change rebenching methodology for adjustments made in 2011-12 budget.

Major Adjustments to Proposition 98 Minimum Guarantee

(In Millions)

2011-12 Budget Act **\$48,651**

Update for changes in baseline revenues	-\$883
Update for changes in other Proposition 98 factors ^a	-131
Change child care rebenching	298
Change redevelopment agencies rebenching	267
Change AB 3632 rebenching	-197
Eliminate gas tax rebenching	-596
Add Governor's new revenues accrued to 2011-12	879

2011-12 Revised **\$48,288^b**

Add Governor's new revenues attributed to 2012-13	\$2,444
Baseline growth	1,790
Additional AB 3632 rebenching	5

2012-13 Proposed **\$52,527**

^a Includes updated estimates for revenues from local property taxes, redevelopment agencies, and the sales tax on gasoline.

^b If the Governor's tax measure were to fail, the 2011-12 minimum guarantee would drop to \$47.4 billion. The state therefore would owe no settle-up for 2011-12 (spending would be \$218 million above the revised minimum guarantee).



Adjustments to Minimum Guarantee

(Continued)

LAO Recommendation



Adopt a consistent rebenching approach.

- Lack of consistency in rebenching approach across years could result in arbitrary changes to the minimum guarantee from year to year.



Proposed Changes to Proposition 98 Funding Levels

Governor’s January Proposal

- The Governor’s plan increases Proposition 98 funding by \$4.9 billion (10 percent) from 2011-12 to 2012-13.
- K-12 funding increases by \$4.4 billion (11 percent).
- Funding for California Community Colleges increases by \$459 million (9 percent).
- Property tax revenues virtually flat.

Proposition 98 Funding				
<i>(Dollars in Millions)</i>				
	2011-12 Revised	2012-13 Proposed	Change From 2011-12	
			Amount	Percent
K-12 Education				
General Fund	\$29,329	\$33,755	\$4,426	15%
Local property tax revenue	12,891	12,908	17	—
Subtotals	(\$42,220)	(\$46,663)	(\$4,443)	(11%)
California Community Colleges				
General Fund	\$3,217	\$3,683	\$465	14%
Local property tax revenue	2,107	2,101	-6	—
Subtotals	(\$5,324)	(\$5,784)	(\$459)	(9%)
Other Agencies	\$83	\$80	-\$2	-3%
Totals, Proposition 98	\$47,627	\$52,527	\$4,900	10%
General Fund	\$32,629	\$37,518	\$4,889	15%
Local property tax revenue	14,998	15,009	11	—

LAO February Forecast Has Lower Minimum Guarantee

- Using our updated estimates, the Proposition 98 minimum guarantee would be \$51.6 billion, \$951 million lower than the Governor’s January estimate.



Major Spending Changes

Proposition 98 Spending Changes	
<i>(In Millions)</i>	
2011-12 Budget Act Spending	\$48,651
Revenue limit adjustments	-\$588
K-12 revenue limit trigger reductions	-328
CCC trigger reductions	-102
Preschool trigger reductions	-6
Other technical adjustments	-1
Total Changes	-\$1,024
2011-12 Revised Spending	\$47,627
Technical Changes	
Backfill one-time actions	\$2,688
Make revenue limit technical adjustments	162
Fund revenue limit growth	158
Backfill Proposition 63 mental health funding	99
Adjust for revised CCC fee revenue estimate	97
Make other technical adjustments	66
Subtotal	(\$3,271)
Policy Changes	
Pay down K-12 deferrals	\$1,565
Pay down CCC deferrals	218
Create K-12 mandate block grant	98
Hold harmless for weighted student formula	90
Create CCC mandate block grant	12
Do not initiate Transitional Kindergarten program	-224
Reduce preschool funding	-58
Swap one-time funds	-57
Eliminate Early Mental Health Initiative	-15
Subtotal	(\$1,629)
Total Changes	\$4,900
2012-13 Proposed Spending	\$52,527



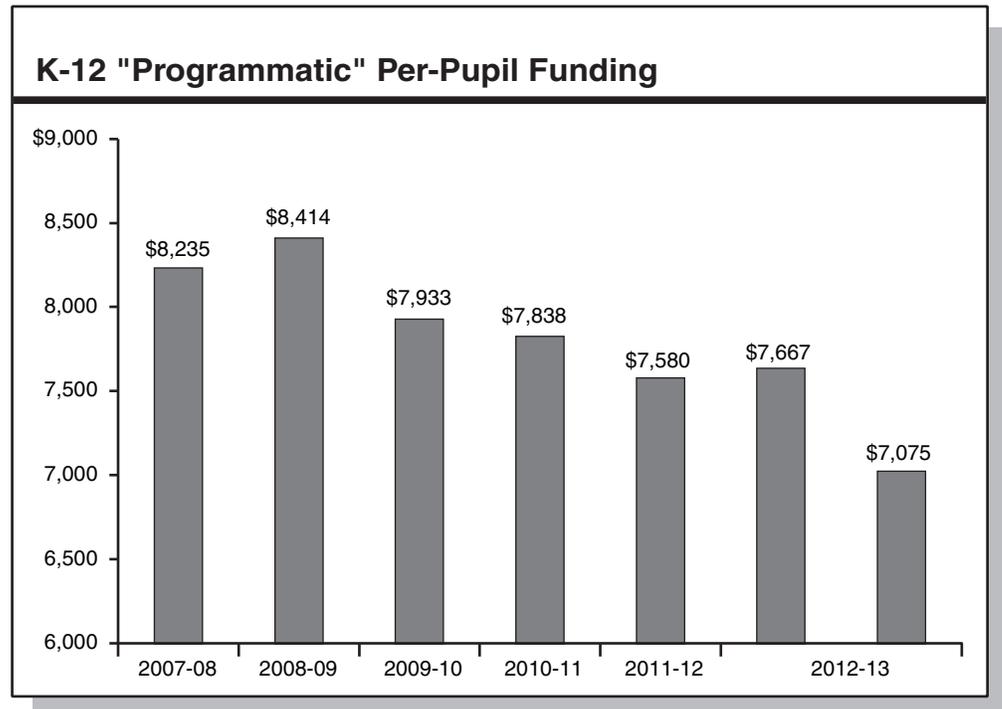
Major Spending Changes

(Continued)

- Proposes to retire \$1.8 billion in K-14 deferrals.
- Provides an additional \$110 million for a K-14 mandate block grant.
- Provides \$90 million to hold districts harmless from proposed shift to weighted student formula.
- Does not initiate Transitional Kindergarten program (\$224 million savings).



K-12 Programmatic Funding



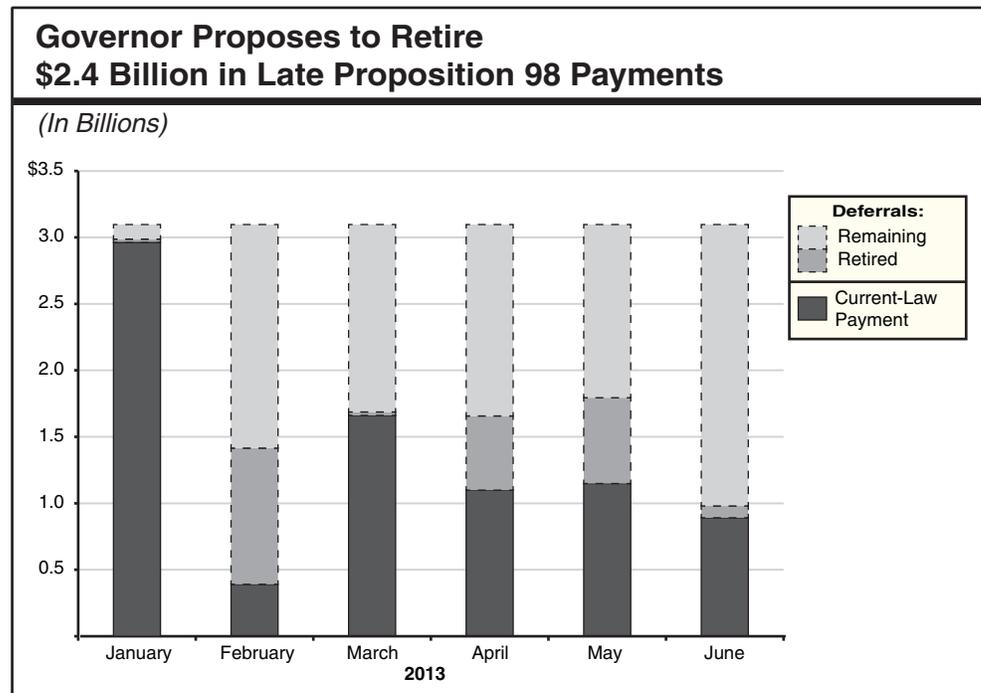
- Programmatic funding would grow to \$7,667 under the Governor's proposal. This is 1 percent higher than 2011-12 but 7 percent less than 2007-08.
- If ballot measure fails, per-pupil funding would drop to \$7,075. This is 7 percent less than 2011-12 and 14 percent less than 2007-08.



Deferrals Primary Component of Spending Plan

Governor's January Proposal

- Proposes to retire \$1.8 billion in existing K-14 payment deferrals.
- As a result, deferrals would represent 17 percent of Proposition 98 payments (compared to 21 percent in 2011-12).



LAO Recommendation

- Adopt Governor's approach rather than provide programmatic augmentations.
 - Helps mitigate existing district cash management issues.
 - Reduces uncertainty regarding programmatic funding available in 2012-13.



Wall of Debt Plan

Governor’s January Proposal

- Governor’s plan retires all obligations related to K-14 deferrals, K-14 mandates, settle-up funds, the Quality Education Investment Act (QEIA), and the Emergency Repair Program (ERP).

Governor’s Multiyear Plan for Retiring Certain Existing Proposition 98 Obligations					
<i>(In Millions)</i>					
	Proposed Payments Under Governor’s Plan:				Total Payments Over Period
	2012-13	2013-14	2014-15	2015-16	
Payments to Be Made <i>Within</i> Annual Proposition 98 Appropriation:					
K-14 deferrals	\$2,369	\$2,469	\$4,998	\$594	\$10,430
K-14 mandates	—	318	318	2,940	3,576
Totals	\$2,369	\$2,787	\$5,316	\$3,534	\$14,006
Payments to Be Made <i>on Top of</i> Annual Proposition 98 Appropriation:					
Proposition 98 “settle-up” ^a	—	\$857	\$856	\$856	\$2,569
Quality Education Investment Act	\$450	450	181	—	1,081
Emergency Repair Program ^b	12	150	150	150	462
Totals	\$462	\$1,457	\$1,187	\$1,006	\$4,112

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

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

LAO Recommendation

- Consider extending payment period and spreading payments more evenly over period.
- Designate settle-up funds for mandates and deferrals.
- Redirect QEIA savings to pay off ERP obligation.
- Consider trade-offs of retiring existing obligations versus making programmatic restorations.



State Has Many Outstanding School and Community College Obligations

State Has Many Outstanding School and Community College Obligations			
Obligation	Description	Authority	Funding
One-Time Obligations			
“Settle-Up”	State generates a settle-up obligation when K-12 attendance or General Fund revenues increase after the budget is enacted—resulting in a higher minimum guarantee. State estimated to owe \$2.6 billion (\$1.6 billion for 2009-10, \$352 million for 2010-11, and \$661 million for 2011-12).	Constitutional	Non-P 98
K-14 Mandates	State must reimburse school and community college districts for performing certain state-mandated activities. State deferred payments for seven consecutive years (2003-04 through 2009-10). It currently has an estimated backlog of \$3.6 billion in unpaid mandate claims.	Constitutional	P 98
K-14 Deferrals	The state has deferred certain K-14 payments from one fiscal year to the subsequent fiscal year, thereby achieving one-time state savings. The state instituted various new deferrals across the 2001-02 through 2011-12 period. Outstanding deferrals currently total \$10.4 billion.	Statutory	P 98
Quality Education Investment Act	Associated with a Proposition 98 suspension in 2004-05, the state agreed to provide an additional \$2.7 billion to schools and community colleges. Annual payments of \$450 million are to be provided until obligation has been retired. State has made \$1,650 million in payments, with \$1,081 million still owed.	Statutory	Non-P 98
Emergency Repair Program	As part of the <i>Williams</i> settlement, state agreed to provide certain schools with \$800 million for emergency facility repairs. State has made \$338 million in payments, with \$462 million still owed.	Statutory	P 98
Non-P 98 = Non-Proposition 98; P 98 = Proposition 98; CalSTRS = California State Teachers' Retirement System; CalPERS = California Public Employees' Retirement System.			



State Has Many Outstanding School and Community College Obligations *(Continued)*

State Has Many Outstanding School and Community College Obligations			
Obligation	Description	Authority	Funding
Other Obligations			
Maintenance Factor	Proposition 98 allows the state to provide less funding in certain situations (typically when General Fund revenue is growing sluggishly or declining), but it creates an associated obligation to increase funding in the future such that total funding is restored to the level it otherwise would have been absent the earlier reduction. The state currently is carrying a maintenance factor of \$10.6 billion.	Constitutional	P 98
CalSTRS Pension Benefits	For benefits already earned by current and past teachers and administrators, an unfunded liability of over \$56 billion was reported as of June 30, 2010. In 2012-13, the state is projected to contribute \$1.4 billion to the system, with districts and teachers contributing billions of dollars more. To address the unfunded liability over the next 30 years, additional contributions of about \$4 billion per year (in current dollars) will be needed from some source. If a lower investment return rate is assumed, costs would be higher.	Constitutional	Non-P 98
CalPERS Pension Benefits	For classified employee benefits, the existing unfunded liability is estimated to be \$17 billion. Districts currently contribute about 11 percent of classified employee payroll (\$1.2 billion in 2011-12) to these benefits, with employees also making contributions. Over the next several decades, part of the annual payments will go to retire the unfunded liability. District contributions may increase or decrease annually in accordance with CalPERS annual investment returns and other actuarial factors. If a lower investment return rate is assumed, costs would be higher.	Constitutional	Non-P 98
Debt Service on State General Obligation Bonds for K-14 Facilities	The state has approved \$31.9 billion in K-14 obligation bond authority in the past ten years to fund the construction and modernization of school and community college facilities. Bonds are paid off over a 30-year period. In 2011-12, K-14 debt-service costs total \$2.5 billion.	Constitutional	Non-P 98 ^a
K-12 Revenue Limits	When the state has not provided a cost-of-living adjustment and/or has made a base reduction to revenue limits, it has created a "deficit factor" to keep track of the foregone funding. The current deficit factor (associated with funding foregone in 2008-09 through 2011-12) is 21.6 percent, or about \$9 billion.	Statutory	P 98
^a The Governor proposes to pay K-14 debt-service costs within the annual Proposition 98 appropriation beginning 2012-13 if his tax measure is rejected by voters. Non-P 98 = Non-Proposition 98; P 98 = Proposition 98; CalSTRS = California State Teachers' Retirement System; CalPERS = California Public Employees' Retirement System.			



Governor's Backup Plan

Proposition 98 Changes Under Back-Up Plan^a	
<i>(In Millions)</i>	
Changes in Minimum Guarantee	
Revenue drop due to measure failing	-\$2,444
Rebench for debt service payments	200
Total Changes	-\$2,244
Changes in Spending	
Accommodate K-12 debt service payments	\$2,331
Accommodate CCC debt service payments	262
Rescind K-12 deferral pay downs	-1,565
Rescind CCC deferral pay downs	-218
Reduce K-12 general purpose funding	-2,761
Reduce CCC general purpose funding	-292
Total Changes	-\$2,244
^a Minimum guarantee/Proposition 98 spending falls from \$52,527 million to \$50,283 million, a drop of \$2,244 million.	

- If ballot measure fails, minimum guarantee would drop \$2.4 billion.
- Governor proposes to count K-14 general obligation bond debt service towards meeting Proposition 98 minimum guarantee, with an associated rebenching of \$200 million.
- Would no longer pay down outstanding deferrals (\$1.8 billion).
- Would make \$3.1 billion in programmatic reductions (\$2.8 billion for K-12 education, \$292 million for community colleges).



LAO Assessment of Backup Plan

Two Major Concerns

- Including debt service in Proposition 98 funding could increase volatility for other Proposition 98 programs.
- Treatment of realignment-related sales tax revenues is risky.

Key Issues in Crafting Back-Up Plan

- Be deliberate in crafting backup plan since most districts will use trigger reductions to build their 2012-13 budgets.
- Provide districts with more flexibility effective July 1.



Comparison of Various Education-Related Initiatives

Comparing Tax Measures				
Initiative	Our Children, Our Future (Version 1)	Our Children, Our Future (Version 2)	California Funding Restoration Act of 2012	Schools and Local Public Safety Protection Act of 2012
Type of revenue raised:	Personal income tax	Personal income tax	Personal income tax	Personal income tax and sales and use tax
Revenues raised in 2012-13:	\$5-\$5.5 billion	\$5-\$5.5 billion	\$6-\$9.5 billion	\$4.8-\$6.9 billion
Revenues raised in 2013-14:	\$10-\$11 billion	\$10-\$11 billion	\$4-\$6 billion	\$5.5-\$6.3 billion
Revenues used for:	Schools, early childhood education, and debt service on education bonds	Schools, early childhood education, and debt service on education and other state bonds	Public education and other local public services	All state-funded services
Excluded from Proposition 98 calculation?	Yes	Yes	Yes	No
K-12 share of new revenue	About 85 percent	60 percent first few years, about 85 percent thereafter	36 percent	Largely determined by Proposition 98 formulas
Operative time period	12 years (2013-2024)	12 years (2013-2024)	Ongoing, beginning 2012	Five years (2012-13 through 2016-17)