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The 2023-24 Budget: Proposition 98 Overview and K-12 Spending Plan

PRESENTED TO: Assembly Budget Subcommittee No. 2 on Education Finance
Hon. Kevin McCarty, Chair



LEGISLATIVE ANALYST'S OFFICE

Update on the Guarantee in 2021-22 and 2022-23

(In Millions)

| | 2021-22 | | | 2022-23 | | |
|--------------------------|--------------------------|-----------------------------|--------------|--------------------------|-----------------------------|-----------------|
| | June 2022 Estimate | January 2023 Estimate | Change | June 2022 Estimate | January 2023 Estimate | Change |
| Minimum Guarantee | | | | | | |
| General Fund | \$83,677 | \$83,630 | -\$47 | \$82,312 | \$79,103 | -\$3,210 |
| Local property tax | 26,560 | 26,785 | 225 | 28,042 | 27,889 | -153 |
| Totals | \$110,237 | \$110,415 | \$178 | \$110,354 | \$106,991 | -\$3,363 |

Slight Upward Revision to Guarantee in 2021-22

- Relative to the June 2022 estimate, the guarantee is up \$178 million (0.2 percent) in the prior year.
- The increase primarily reflects updated estimates of local property tax revenue.

Notable Downward Revision to Guarantee in 2022-23

- Relative to the June 2022 estimates, the guarantee is down \$3.4 billion (3 percent) in the current year.
- The decrease primarily reflects the administration's lower estimate of General Fund revenue. Since June, certain areas of the economy that affect state revenue have shown notable weakness. For example, the housing market has cooled, consumer spending has slowed, and business startup activity has decreased.
- The administration also anticipates slightly slower growth in local property tax revenue.



Estimate of the Guarantee in 2023-24

(Dollars in Millions)

| | 2021-22 Revised | 2022-23 Revised | 2023-24 Proposed | Change From 2022-23 | |
|---------------------------|--------------------|--------------------|---------------------|---------------------|-------------|
| | | | | Amount | Percent |
| Minimum Guarantee | | | | | |
| General Fund | \$83,630 | \$79,103 | \$79,613 | \$510 | 0.6% |
| Local property tax | 26,785 | 27,889 | 29,204 | 1,315 | 4.7 |
| Totals | \$110,415 | \$106,991 | \$108,816 | \$1,825 | 1.7% |
| Funding by Segment | | | | | |
| K-12 education | \$94,403 | \$93,535 | \$95,881 | \$2,346 | 2.5% |
| Community colleges | 12,301 | 12,360 | 12,569 | 209 | 1.7 |
| Reserve deposit | 3,710 | 1,096 | 365 | -730 | -66.7 |

Proposition 98 Guarantee Estimated to Grow Slowly 2023-24

- The Governor’s budget estimates the guarantee is \$108.8 billion in 2023-24, an increase of \$1.8 billion (1.7 percent) over the revised 2022-23 level.
- Although the guarantee is growing, it remains \$1.5 billion (1.4 percent) below the 2022-23 level enacted last June.

Growth in the Guarantee Reflects Two Main Factors

- Most of the increase in the guarantee is due to growth in local property tax revenue.
- The increase in the General Fund portion of the guarantee is due to the expansion of transitional kindergarten.
 - The June 2021 budget established a plan to expand eligibility for transitional kindergarten over a four-year period.
 - The plan requires the state to “rebench” the guarantee for the costs of the expansion. In 2023-24, this adjustment increases the guarantee by \$690 million.
 - Without this adjustment, the General Fund portion of the guarantee would have declined slightly.



Proposition 98 Reserve

Proposition 98 Reserve Established in 2014

- Formulas in the State Constitution require the state to make deposits into the reserve when the state receives large amounts of capital gains revenue and the guarantee is strong relative to growth in student attendance and inflation. The formulas also require withdrawals when the guarantee is weak relative to growth in student attendance and inflation.
- The Legislature can make discretionary withdrawals if the Governor declares a budget emergency (based on certain types of disasters or weakness in state revenues).
- Withdrawals from the Proposition 98 Reserve supplement the guarantee.

Balance in Reserve Would Reach \$8.5 Billion in 2023-24

- Includes estimated deposits of \$1.1 billion in 2022-23 and \$365 million in 2023-24.
- Balance equates to 7.8 percent of the estimated guarantee in 2023-24.

Cap on School District Reserves Would Remain Operative

- A state law caps the reserves medium and large school districts may hold for undesignated purposes once the balance in the Proposition 98 Reserve exceeds 3 percent of the Proposition 98 funding allocated for schools the previous year.
- The cap became operative for the first time in 2022-23. Under the administration's estimates, it would remain operative in 2023-24 (and potentially future years).
- Districts could respond by (1) designating reserves for specific purposes, (2) asking their county offices of education for an exemption, or (3) spending down reserves.



Comments on the Minimum Guarantee

General Fund Revenue Likely Lower Than the Administration Estimates

- Recent data show continuing weakness in certain parts of the economy.
- Revenue collections to date have been tracking below the Governor's budget estimates.
- Our best estimate is that revenues will be about \$10 billion lower over the budget period (\$5 billion in 2022-23 and \$5 billion in 2023-24).

Reductions in General Fund Revenue Would Reduce the Guarantee

- The guarantee is determined by one of three "tests" (formulas) in the State Constitution. The operative test for the 2021-22 through 2023-24 period is "Test 1," which links the guarantee to a percentage of General Fund revenue.
- For each dollar of higher or lower revenue, the guarantee would increase or decrease about 40 cents.

Two Other Adjustments Could Mitigate Reductions in General Fund Revenue

- Local property tax revenue seems likely to exceed the estimates in the Governor's budget by up to \$200 million in 2022-23 and between \$500 million and \$900 million in 2023-24.
- The Proposition 98 Reserve would change in response to lower revenue:
 - A moderate revenue reduction could eliminate required deposits in 2022-23 and 2023-24.
 - A significant revenue reduction could lead to required withdrawals.



Overview of K-12 Spending Plan

Governor's Budget Has \$5.2 Billion Available for K-12 Augmentations

Available Funding Mainly Reflects Three Key Baseline Adjustments

- Costs for the Local Control Funding Formula (LCFF) are lower than anticipated in 2021-22 and 2022-23. The budget anticipates further declines in 2023-24.
- One-time costs funded in the June 2022 budget are expiring.
- The Constitution requires smaller deposits into the Proposition 98 Reserve due to lower revenue estimates.

Governor's K-12 Spending Plan Has Three Main Components

- **Ongoing Augmentations (\$6 Billion)**
 - Most funding is for an 8.13 percent statutory cost-of-living adjustment (COLA).
 - Also includes \$300 million for new equity multiplier proposal.
- **One-Time Activities (\$376 Million)**
 - Includes \$250 million for a second round of literacy grants.
 - Includes \$100 million to fund arts and cultural enrichment activities for high school seniors.
- **One Reduction to an Existing Program (-\$1.2 Billion)**
 - The June 2022 budget plan approved more than \$3.6 billion for the Arts, Music, and Instructional Materials Discretionary Block Grant.
 - The Governor's budget would reduce this funding to slightly less than \$2.5 billion.



K-12 Spending Proposals

| (In Millions) | |
|---|----------------|
| Ongoing Augmentations | |
| LCFF growth and COLA (8.13 percent) | \$4,117 |
| Transitional kindergarten expansion ^a | 856 |
| COLA for select categorical programs (8.13 percent) ^b | 669 |
| Equity Multiplier | 300 |
| State Preschool for students with disabilities | 64 |
| Access to opioid overdose reversal medication | 4 |
| K-12 High Speed Network | 4 |
| California College Guidance Initiative | 4 |
| Preschool assessment tool | 1 |
| Fiscal Crisis and Management Assistance Team | 1 |
| Subtotal | (\$6,018) |
| One-Time Activities | |
| Literacy coaches and reading specialists | \$250 |
| Arts and cultural enrichment | 100 |
| Charter School Facility Grant Program | 30 |
| CCEE adjustment for unspent prior year funds | -4 |
| Testing consortium membership fee | 1 |
| Update to digital learning and standards integration guidance | 0.1 |
| Subtotal | (\$376) |
| One-Time Reductions | |
| Arts, Music, and Instructional Materials Discretionary Block Grant | -\$1,174 |
| Total | \$5,221 |
| ^a Reflects additional LCFF costs associated with serving more students in transitional kindergarten, including costs of lower transitional kindergarten staffing ratios. | |
| ^b Applies to Special Education, State Preschool, Child Nutrition, K-12 mandates block grant, Charter School Facility Grant Program, Foster Youth Program, American Indian education programs, and Adults in Correctional Facilities. | |
| LCFF = Local Control Funding Formula; COLA = cost-of-living adjustment; and CCEE = California Collaborative for Educational Excellence. | |



Implementation of Proposition 28

Establishes New Program to Fund Arts Education

- Proposition 28 (2022) requires the state to set aside an annual amount for arts education equal to 1 percent of the total Proposition 98 funding allocated to schools in the previous year.
- For 2023-24, the Governor's budget estimates the required amount is \$941 million.

Provides Rules for Allocating and Using Funds

- The measure allocates 70 percent of the available funding to school districts, charter schools, and county offices of education through a formula based on prior-year enrollment of students in preschool, transitional kindergarten, kindergarten, and grade 1 through grade 12. It allocates the remaining 30 percent based upon the share of low-income students enrolled in those entities in the prior year.
- The measure allows school principals to determine how they will use their share of the funds, subject to two constraints:
 - Schools with at least 500 students must use at least 80 percent of their funds to hire new arts staff.
 - Funds must supplement any funding a school already allocates for arts education.

Adjusts the Proposition 98 Guarantee Upward

- In 2023-24, funding is on top of the guarantee otherwise calculated for the year.
- Beginning in 2024-25, funding for the program is folded into the guarantee and the guarantee is adjusted upward by a corresponding amount.



Strengths of Governor's K-12 Plan

Prioritizes Core Programs

- Most of the available funding is dedicated to COLA for existing programs.
- Providing COLA would help districts (1) address inflationary pressures, (2) sustain recent program expansions, and (3) address difficulty hiring certain types of staff.

Preserves the Proposition 98 Reserve

- Saving the reserve for now helps the state prepare for the possibility that revenue deteriorates significantly in the coming months or years.
- The funds in the Proposition 98 Reserve would help protect school programs from reductions or deferrals in the event of a recession.



Concerns With Governor's K-12 Plan

Plan Relies on \$1.4 Billion in One-Time Funds to Cover Ongoing LCFF Costs

- This approach creates a deficit in the Proposition 98 budget because the guarantee would need to grow at least \$1.4 billion to cover those ongoing costs in the following year (holding other factors constant).
- Relying on one-time funds makes future Proposition 98 budgets more difficult to balance and compounds the risks associated with an economic downturn.

Rationale for Some New Proposals Is Unconvincing

- Equity multiplier funding does not address the key issue of ensuring districts use existing funding to target the highest need schools and student subgroups.
- Additional literacy funding seems premature given the state does not yet have any information on outcomes from the previous funding round.
- Cultural enrichment activities could be funded in other ways, such as through LCFF or Proposition 28.

Reduction to Arts, Music, and Instructional Materials Discretionary Block Grant Likely Disruptive for Districts

- Many districts have already adopted plans for using these funds, often after discussions in the community and with school employee groups.
- Significantly reducing these funds likely would require districts to revisit these plans and could require changing larger aspects of their budgets.



Recommendations

Build Proposition 98 Budget That Does Not Create Future Deficits

- Avoid relying on one-time funds for ongoing costs. Instead, reduce ongoing spending by \$1.4 billion.
- Reducing ongoing spending would mitigate the need to reduce the Arts, Music, and Instructional Materials Discretionary Block Grant.

Reject Governor's Three Main Proposals for New Programs

- Recommend rejecting the (1) equity multiplier funding, (2) additional literacy funding, and (3) cultural enrichment grant.
- Rejecting these proposals would yield one-time savings of \$350 million and ongoing savings of \$300 million, which would ease some of the pressure on existing K-12 programs.

Consider Funding Lower COLA Rate

- As a starting point, we recommend funding a COLA rate that is no higher than the Governor's budget level—even if the statutory rate is slightly higher by May.
- Consider additional COLA rate reductions as one possible way to reducing ongoing spending. Each 0.5 percent change in COLA rate equates to around \$400 million in costs for K-12 programs.
- Reductions in the COLA rate could become particularly important if (1) state revenue decreases significantly or (2) the Legislature prefers to avoid reducing funding in other ways.



Recommendations

(Continued)

Consider Certain Reductions to Existing Programs

■ Expanded Learning Opportunities Program (ELOP)

- Initial feedback indicates some districts are not on track to spend any or all of their ELOP funds due to slow program ramp up, difficulty hiring staff, and the continued use of temporary federal relief funds to cover expanded learning costs. Moreover, some districts indicate that not all students may express interest in participating in ELOP.
- The state could reduce funding to reflect lower levels of student participation. For example, it could no longer assume 100 percent participation in the program.
- Alternatively, the state could reduce district allocations to account for funding districts already receiving through two existing after school programs.
- Either option could produce savings of several hundred million dollars.

■ State Preschool

- We estimate the Legislature could reduce ongoing spending on State Preschool and maintain the program as it currently operates.
- These savings primarily are associated with overbudgeted costs for COLA and unallocated funding for recent slot increases.
- The savings within Proposition 98 could range from tens of millions of dollars to more than \$100 million.

