

General Budget Overview

After an all-night legislative marathon, the Senate and Assembly have both voted Thursday morning (2/19) to pass a budget to the governor.

As you are aware, the budget had stalled in the past few days as a final needed vote in the Senate failed to materialize. What changed? Senator Abel Maldonado (R-Santa Maria) supplied the last vote after negotiating a compromise with the Governor and Democrats. What did Maldonado get? While there is no bill language available at this early morning hour, here is what we understand (subject to clarification):

- * A ballot measure, to establish an open primary system in California. The measure go on the June 2010 ballot. The open primary proposal would affect congressional and state races in 2012 and beyond. Under the plan, the top two candidates in a primary would face off in a general election. Candidates would not participate in partisan primaries, but they would be able to retain their party labels on the ballot. It is believed this approach would allow more moderate candidates to better compete.
- * Another ballot measure to ban legislative pay increases during deficit years. This measure is intended for a May 19, 2009 special election ballot, along with measures to make changes to the California lottery and establish a spending cap. Legislative leaders rejected Maldonado's proposal to eliminate legislative pay altogether when the budget is late, arguing the idea was unconstitutional.
- * Elimination of a 12-cent additional gas tax, which was estimated to bring in \$2.1 billion through June 2010. The revenue will be replaced with a 0.25 percent increase in the state income tax, federal stimulus dollars and more than \$600 million in line-item vetoes (while we are not aware of the exact cuts that make up the \$600 million, we are told they are not from education).

K-12 Education Budget

The education cuts and flexibility contained in the budget are identical to those reported over the weekend.

The budget reduces the Proposition 98 guarantee in the current year by \$7.3 billion through a mix of program reductions, deferrals and re-designation of funds and makes various statutory changes to implement these reductions. In total, mid-year and budget year reductions total \$8.6 billion.

Key Points of the K-12 Education Budget Package Include:

- * Does not suspend Prop 98, but reduces funding to the minimum guarantee.
- * \$8.6 billion in reductions (spanning 2008-09 and 2009-10) including:
- * \$2.3 billion in programmatic reductions;
- * \$3.2 billion deferral (current-year to budget year);
- * \$1.1 billion counting current-year appropriation toward Prop. 98 "settle-up; and,
- * \$618 million Using Public Transit Account (rather than GF) for Home-to-School Transportation.

- * Cuts are divided 50% to school district and county office revenue limits and 50% to categorical programs. The deficit factors for school district and county office revenue limits would be as follows (includes impact of no COLA for 2008-09 and no COLA for 2009-10):

	-----2008-09-----		
	Prior to this package	After this package	2009-10
School districts	4.713%	7.844%	13.094%
County Offices	4.396	7.839	13.360

- * Makes across-the-board cuts to 53 categorical programs of \$944 million in 2008-09. This results in approximately a 15% reduction to each program. These reductions continue in the budget year, growing to \$2.4 billion, an increase of approximately \$535 million. Categoricals protected from cuts are: special education, Economic Impact Aid, K-3 Class Size Reduction, and child nutrition. Deficit factors are established for revenue limit reductions in both years.
- * Implements the Governor's categorical flexibility proposal to allow school districts to use funding for 43 categorical education programs for any educational purpose for five years. Programs protected from this flexibility are: Economic Impact Aid, special education, K-3 class size reduction, child nutrition, adults in correctional facilities, apprenticeship programs, English Learner Student Assistance, Foster Youth services, K-12 High Speed Network, Partnership Academies, Student Assessments, Agricultural Vocational Education, Charter School Facility Grants, and Year Round Schools.
- * Allows prior-year categorical fund balances to be used for general purpose activities in the current year and budget year. Excludes access to fund balances for seven programs, including Economic Impact Aid, Special Education, Targeted Instructional Improvement Block Grant, Instructional Materials, Home-to-School Transportation, CAHSEE Supplemental Services, and Quality Education Intervention and Achievement.
- * Changes the K-3 CSR penalty structure for 2008-09 through 2011-12 as follows:
 - 20.5-21.5-5% penalty
 - 21.5-22.5-10 % penalty
 - 22.5-23.0-15% penalty
 - 23.0-25.0-20% penalty
 - Over 25-- 30% penalty
- * Increases the deferral from 2008-09 into 2009-10. Defers \$2 billion in revenue limit funding from February to July, \$570 million in K-3 CSR funding from February to July, and increases the existing June-to-July deferral by \$340 million.

- * Eliminates \$247 million for a partial COLA for K-12 revenue limits in the current year. In the budget year, no COLA is provided for K-12 education programs. This action saves approximately \$2.5 billion, reflecting an estimated statutory COLA of 5.02 percent. The deficit factors reported above reflect the elimination of these funds in both years.
- * The budget does not include the Governor's proposal to suspend K-14 education program mandates in 2009-10. The Governor had proposed to "suspend" all but two K-12 mandates and all community college mandates, in response to a recent lawsuit that requires the state to either fully fund or repeal education mandates.
- * Suspends statutory requirements that districts purchase newly adopted instruction materials in FY 2008-09 and 2009-10, and relieves county offices of education of the responsibility to confirm the purchase of such materials during site visits. Additionally, districts that do purchase materials with any state funds, they would be subject to the specified state law surrounding the purchase of such materials.
- * Reduces, for FY 2008-09 through 2012-13, the amount that school districts are required to set aside in routine restricted maintenance accounts from 3% to 1% of their General Fund budgets.
- * Suspends, for FY 2009-10, the requirement that funds be transferred from the Proposition 98 Reversion Account to the School Facilities Emergency Repair Account (created by the Williams lawsuit). Additionally, prohibits school districts from using School Facilities Emergency Repair Account funds to supplant state funds provided for deferred maintenance, and from depositing those funds into district deferred maintenance funds. Emergency repair funds can be used only for emergency repairs.
- * Authorizes, for FY 2008-09 and 2009-10, LEAs to use restricted ending fund balances (as of June 30, 2008) for any purpose. All ending balances can be accessed except balances from the following programs: Economic Impact Aid, Targeted Instructional Improvement Grants, Instructional Materials, Special Education, Quality Education Investment Act, CAHSEE Supplemental Instruction, and Home-to-School Transportation. Requires LEAs who elect to use this authority to submit a related report to the Superintendent of Public Instruction (SPI), and requires the SPI to compile those reports and submit the information to the Legislature by October 31, 2009.
- * Establishes for FY 2011 -12, a "post-SB 727" equalization formula. This formula is meant to ensure that at least 90 percent of average daily attendance (according to size and type of district) would receive the same level of base revenue limit funding.
- * Repeals Control Section 12.40 of the 2008 Budget Act (Mega-item), which allows LEAs to move funds between certain categorical programs. That limited flexibility will be replaced by the broader flexibility provided in the bill.
- * Eliminates all funding (\$114.2 million) for the High Priority Schools Grant Program in the budget year.

- * Authorizes the CDE to reduce principal apportionment payments to LEAs to the extent necessary to recapture payments made before mid-year cuts were implemented.
- * Allows an additional month for the encumbrance of various categorical funds that are being deferred from 2009-10 to 2010-11.
- * Suspends existing statute that specifies the division of Proposition 98 funding among K-12 Local Educational Agencies (LEAs), community colleges, and other state agencies, and reflects a division of funding that conforms to that of the 2008-09 Budget

Other Propositions Going to the Ballot: Constitutional Provisions and Ballot Propositions
 The budget package includes five provisions that will require voter approval to be enacted.

These provisions will appear on the ballot on May 19, 2009. These provisions are:

Spending Cap. ACA 1 / SCA 1 places a Constitutional provision on the ballot to cap spending by limiting the amount of revenue that can be appropriated for General Fund purposes. The provision requires that each year the Department of Finance forecast a revenue amount for the fiscal year that is derived from the last ten years of revenue growth amounts. Any revenue that exceeds this forecasted amount must be deposited in a new fund, the Budget Stabilization Fund, with the exception of revenue that is required for Proposition 98 purposes that exceed revenue growth.

The Budget Stabilization Fund can be used when State revenues are insufficient to cover prior year expenditures, adjusted for inflation and population. The funding in the Budget Stabilization Fund can also be used in cases of a declared emergency. Revenue accumulates in the fund until it equals 12.5 percent of General Fund revenue, at which point excess funding can be used for one-time expenditures. Up to \$5 billion of the amount deposited in this fund would be dedicated to retiring Deficit Recover Bonds over time.

In addition ACA 1 / SCA 1 requires that annually 1.5 percent of State General Fund revenue be deposited each year in the Budget Stabilization Fund and as of October 2011, 1.5 percent of revenue be deposited in the Supplemental Education Payment Account, which pays for the Proposition 98 obligations outlined in ACA 2 / SCA 2.

Proposition 98 Maintenance Factor Clarification. ACA 2 / SCA 2 places a Constitutional provision on the ballot that would require the State to increase annual school funding by \$9.3 billion in future years in lieu of any maintenance factors that could be required by Proposition 98. This additional funding would build up over several years, beginning in FY 2011-12.

Funding for this provision would come from the Supplemental Education Payment Account specified in ACA 1 / SCA 1.

Funding provided by this provision would be allocated to school districts in the same manner as the revenue limit per unit of average daily attendance. \$200 million would be appropriated in the FY 2011-12 for Equalization funding.

Proposition 63 - Mental Health Services Act (MHSA). Subject to approval by the voters at a

statewide election, utilizes MHSA funds in the amount of \$226.7 million in 2009-10 and up to \$234 million in 2010-11, if caseload adjustments require this marginal increase, to support the Early and Periodic Screening, Diagnosis, and Treatment (EPSDT) Program as administered by the State Department of Mental Health. Additional statutory changes are made in the Health Omnibus Trailer bill to improve the use and effectiveness of MHSA funds, consistent with the recommendations of recent audit reports.

Proposition 10 - California Children and Families Act of 1998. Subject to approval by the voters at a statewide election, expands use of Prop. 10 funds for health and human services through state programs for children up to five years of age. Transfers Prop. 10 reserve funds of \$340 million on a one-time basis for these state program purposes, and additionally transfers \$268 million annually for five fiscal years starting with 2009-10 to be appropriated by the Legislature as part of the annual budget process. Further directs the use of Prop. 10 funds to provide direct health care services, human services, including services for at-risk families who are involved in the child welfare system, and direct early education services, including preschool and child care.

Lottery. Makes changes to clarify education appropriations, clarify the lottery director's authority relative to state employees, and require that lottery audits be posted on the internet.

These changes would be placed before the voters, along with various sections of Chapter 764, Statutes of 2008 (AB 1654), the lottery modernization trailer bill for the Budget Act of 2008.

Of course, more comprehensive analysis regarding the various components of this budget will follow over the next few days and weeks.

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