

January 11, 2012

Hon. Kamala D. Harris
Attorney General
1300 I Street, 17th Floor
Sacramento, California 95814

Attention: Ms. Dawn McFarland
Initiative Coordinator

Dear Attorney General Harris:

Pursuant to Elections Code Section 9005, we have reviewed the proposed constitutional amendment related to the funding of local governments and schools and temporary taxes (A.G. File No. 11-0090).

BACKGROUND

State's Fiscal Situation

California's Recent Budget Problems. The General Fund is the state's core account that supports a variety of programs, including public schools, higher education, health, social services, and prisons. The General Fund has experienced chronic shortfalls in recent years due to trends in state spending and revenues. State budgetary problems since 2008-09 have been caused by a number of factors, including a severe economic recession that caused state revenues to decline sharply. To deal with the state's budgetary shortfalls, policymakers have reduced program expenditures, temporarily raised taxes, and taken a variety of other measures including various forms of borrowing from special funds and local governments.

Ongoing Budget Deficits Projected. The state's budget shortfalls are expected to continue over the next five years under current tax and expenditure policies. In November 2011, the Legislative Analyst's Office (LAO) estimated annual budget deficits of greater than \$5 billion through 2016-17, including a budget shortfall of roughly \$13 billion in 2012-13. In January 2012, the Department of Finance (DOF) estimated a budget shortfall of \$9.2 billion in 2012-13 and annual budget deficits of less than \$5 billion thereafter.

Taxes and Revenues

The General Fund is supported primarily from income and sales taxes paid by individuals and businesses.

Income Tax. The personal income tax (PIT) is a tax on income earned in the state and is the state's largest revenue source. Tax rates range from 1 percent to 9.3 percent depending on a taxpayer's income. Higher tax rates are charged as income increases, such that the 1 percent of tax filers with the most income now pay around 40 percent of state income taxes. An additional 1 percent rate is levied on taxable incomes in excess of \$1 million with the proceeds dedicated to mental health services rather than the General Fund.

Sales Tax. California's sales and use tax (SUT) is levied on the final purchase price of tangible consumer goods, except for food and certain other items. The SUT rate consists of both a statewide rate and a local rate. The current statewide rate is 7.25 percent. Approximately half of the revenue derived from the statewide rate is deposited into the General Fund, while the remainder is allocated to local governments. Localities also have the option of imposing, with voter approval, add-on rates to raise revenues for cities, counties, or special districts. As a result, SUT rates in California differ by county and locality, with an average rate of about 8.1 percent.

State School Funding

In 1988, voters approved Proposition 98. Including later amendments, Proposition 98 establishes a guaranteed minimum annual funding level—commonly called the minimum guarantee—for K-14 education (consisting of K-12 schools and community colleges). The minimum guarantee is funded through a combination of state General Fund appropriations and local property tax revenues. With a two-thirds vote in any given year, the Legislature can suspend the Proposition 98 guarantee for one year and provide any level of K-14 funding it chooses.

Minimum Guarantee Often Affected by Changes in State Revenues. In many years, the calculation of the minimum guarantee is highly sensitive to changes in state General Fund revenues. In years when General Fund revenues grow by a large amount, the guarantee is likely to increase by a large amount. Conversely, in years when General Fund revenues decline by a large amount, the guarantee is likely to drop by a large amount. In these years, however, the state typically generates an associated "maintenance factor" obligation that requires the state to accelerate future growth in Proposition 98 funding when General Fund revenues revive. Another type of Proposition 98 obligation is known as "settle-up." A settle-up obligation is created when the state ends a fiscal year having appropriated less than the finalized calculation of the minimum guarantee. Typically, the state pays off settle-up obligations in installments over several years.

2011 Realignment Legislation

Shift of State Program Responsibilities. The state and local governments in California operate and fund various programs. These programs are funded through a combination of state, federal, and local funds. The specific responsibilities and costs assigned to state and local governments vary by program. As part of the 2011-12 state budget plan, the Legislature enacted a major shift—or "realignment"—of state program responsibilities and revenues to local governments. The realignment legislation shifts responsibility from the state to local governments (primarily counties) for several programs including court security, adult offenders and parolees, public safety grants, mental health services, substance abuse treatment, child welfare programs, and adult protective services. Implementation of this transfer began in 2011.

Dedication of Revenues to Cover Program Costs. To fund the realignment of these programs, the budget dedicates a total of \$6.3 billion in revenues from three sources into a special fund for local governments. Specifically, the realignment plan directs 1.0625 cents of the statewide SUT rate to counties. Under prior law, equivalent revenues were deposited in the General Fund. In addition, the realignment plan redirects an estimated \$462 million from the 0.65 percent vehicle license fee (VLF) rate for local law enforcement programs. Under prior law, these VLF revenues were allocated to the Department of Motor Vehicles for administrative purposes and to cities and Orange County for general purposes. The budget also shifts \$763 million on a one-time basis in 2011-12 from the Mental Health Services Fund (established by Proposition 63 in November 2004) for support of the Early and Periodic Screening, Diagnosis, and Treatment Program and Mental Health Managed Care program.

Exclusion of Revenues From Proposition 98 Calculation. A budget-related law, Chapter 43, Statutes of 2011 (AB 114, Committee on Budget), stated that the 1.0625 cent SUT realignment revenues were to be excluded from the Proposition 98 calculation. This provision of Chapter 43, however, was made operative for 2011-12 and subsequent fiscal years contingent on the approval of a ballot measure by November 2012 that both (1) authorizes the exclusion of the 1.0625 cent sales tax revenues from the Proposition 98 calculation and (2) provides funding for school districts and community colleges in an amount equal to the reduction in the minimum guarantee due to the exclusion. If these conditions are not met, Chapter 43 creates a settle-up obligation for the lower Proposition 98 spending in 2011-12 to be paid over the next five fiscal years.

State-Reimbursable Mandates

State Required to Reimburse Local Governments for Certain Costs. The California Constitution generally requires the state to reimburse local governments when it “mandates” a new local program or higher level of service. In some cases, however, the state may impose requirements on local governments that increase local costs without being required to provide state reimbursements.

Open Meeting Act Mandate. The Ralph M. Brown Act (known as the Brown Act) requires all meetings of the legislative body of a local agency to be open and public. Certain provisions of the Brown Act—such as the requirement to prepare and post agendas for public meetings—are state-reimbursable mandates.

PROPOSAL

The measure amends the Constitution to permanently dedicate revenues to local governments to pay for the programs realigned in 2011 and temporarily increases state taxes.

2011 Realignment Legislation

Guarantees Ongoing Revenues to Local Governments for Realigned Programs. The measure requires the state to continue allocating SUT and VLF revenues to local governments to pay for the programs realigned in 2011. If portions of the SUT or VLF dedicated to realignment are reduced or eliminated, the state is required to provide alternative funding that is at least equal to the amount that would have been generated by the SUT and VLF for so long as the local governments are required to operate the realigned programs.

Constrains State's Ability to Impose Additional Requirements After 2012. Through September 2012, the measure allows the state to change the statutory or regulatory requirements related to the realigned programs. A local government would not be required to fulfill a statutory or regulatory requirement approved after September 2012 related to the realigned programs, however, unless the requirement (1) imposed no net additional costs to the local government or (2) the state provided additional funding sufficient to cover its costs.

Limits Local Governments From Seeking Additional Reimbursements. This measure specifies that the legislation creating 2011 realignment (as adopted through September 2012) would not be considered a state-reimbursable mandate. Therefore, local governments would not be eligible to seek reimbursement from the state for any costs related to implementing the legislation. Similarly, the measure specifies that any state regulation, executive order, or administrative directive necessary to implement realignment would not be a state-reimbursable mandate.

State and Local Governments Could Share Some Unanticipated Costs. The measure specifies that certain unanticipated costs related to realignment would be shared between the state and local governments. Specifically, the state would be required to fund at least half of any new local costs resulting from certain changes in federal statutes or regulations. The state also would be required to pay at least half of any new local costs resulting from federal court decisions or settlements related to realigned programs if (1) the state is a party in the proceeding, and (2) the state determines that the decision or settlement is not related to the failure of local agencies to perform their duties or obligations.

Open Meeting Act Mandate

The measure specifies that the Brown Act would no longer be considered a state-reimbursable mandate. Localities would still be required to follow the open meeting rules in the Brown Act but would not be eligible to seek reimbursement from the state for any associated costs.

Tax Rates

Increases Income Tax Rates on Higher Incomes for Five Years. Under current law, the maximum marginal PIT rate is 9.3 percent, and it applies to taxable income in excess of \$48,209 for individuals; \$65,376 for heads of household; and \$96,058 for joint filers. This measure temporarily increases PIT rates for higher incomes by creating three additional tax brackets with rates above 9.3 percent. Specifically, this measure imposes:

- A 10.3 percent tax rate on income between \$250,000 and \$300,000 for individuals; \$340,000 and \$408,000 for heads of household; and \$500,000 and \$600,000 for joint filers.
- A 10.8 percent tax rate on income between \$300,000 and \$500,000 for individuals; \$408,000 and \$680,000 for heads of household; and \$600,000 and \$1 million for joint filers.
- An 11.3 percent tax rate on income in excess of \$500,000 for individuals; \$680,000 for heads of household; and \$1 million for joint filers.

These tax rates would affect roughly 1 percent of California PIT filers due to the high income threshold. The tax rates would be in effect for five years starting in the 2012 tax year. (The additional 1 percent rate for mental health services would still apply to income in excess of \$1 million.)

Increases SUT Rate for Four Years. This measure temporarily increases the state SUT rate by 0.5 percent. The higher tax rate would be in effect for four years—from January 1, 2013 through the end of 2016. Under the measure, the statewide average SUT rate would increase to 8.6 percent.

State School Funding

Permanently Removes Realigned Sales Tax Revenues From Proposition 98 Calculation. The measure amends the Constitution to explicitly exclude the 1.0625 cent sales tax revenues directed to realignment programs from the Proposition 98 calculation.

New Tax Revenues Deposited Into New Account for Schools and Community Colleges. The measure requires that the additional tax revenues generated by the temporary increases in PIT and SUT rates be deposited into a newly created Education Protection Account (EPA). Appropriations from the account could be used for any educational purpose and would count towards meeting the Proposition 98 minimum guarantee. Of the monies deposited into the account, 89 percent would be provided to schools and 11 percent would be provided to community colleges. The EPA funds for schools would be distributed the same way as existing general purpose per-pupil funding, except that no school district is to receive less than \$200 in EPA funds per pupil. Similarly, EPA funds for community colleges would be distributed the same way as existing general purpose per-student funding, except that no community college district is to receive less than \$100 in EPA funds per full-time equivalent student.

FISCAL EFFECTS

Realignment Programs

Provides More Certainty to Local Governments. This measure would change the state's authority over the 2011 realignment. After September 2012, the state could not impose new requirements to 2011 realignment resulting in increased costs without providing sufficient funding. Also, the state would share certain new costs related to federal law or court cases. Consequently, the measure reduces the financial uncertainty and risk for local governments under realignment. Any impact would depend on how the state would have acted in the future absent the measure, as well as what, if any, actions are taken by the federal government or courts.

Limits State's Ability to Change 2011 Realignment. With regard to the state, the measure would have the related impact of restricting the state's ability to make changes resulting in new costs to local governments in the 2011 realignment without providing additional funding to local governments. The state could also bear additional costs associated with new federal laws or court cases beyond the funds provided by 2011 realignment.

State Revenues

Significant Volatility of PIT Revenues Possible. Most of the income reported by California's upper-income filers is related in some way to their capital investments, rather than wages and salary-type income. In 2008, for example, only about 37 percent of the income reported by PIT filers reporting over \$500,000 of income consisted of wages and salaries. The rest consisted of capital gains (generated from sales of assets, such as stocks and homes), income from these filers' interests in partnerships and "S" corporations, dividends, interest, rent, and other capital income. While upper-income filers' wage and salary income is volatile to some extent (due to the cyclical nature of bonuses, among other things), their capital income is *highly* volatile from one year to the next. For example, the current mental health tax on income over \$1 million generated about \$734 million in 2009-10 but has raised as much as \$1.6 billion in previous years. Given this volatility, estimates of the revenues to be raised by this initiative will change between now and the November 2012 election.

Revenue Estimates. The volatility described above makes it difficult to forecast this measure's state revenue gains from high-income taxpayers. As a result, the estimates from our two offices of this measure's annual revenue increases vary. Between 2013-14 and 2015-16 (the three years in which both the PIT and SUT increases would be in effect for the entire fiscal year), the LAO currently forecasts an average annual increase in state revenues of \$5.5 billion, and DOF currently forecasts an average annual increase in state revenues of \$6.9 billion. For the 2012-13 budget, the LAO forecasts this measure would generate \$4.8 billion of additional revenues, and DOF forecasts \$6.9 billion of additional revenues. (This essentially reflects six months of SUT receipts in 2013 and 18 months of PIT receipts from all of tax year 2012 and half of tax year 2013.) In 2016-17, the measure's PIT and SUT increases would be in effect for only six months of the fiscal year before expiring. In that fiscal year, the LAO forecasts this measure would generate \$3.1 billion of revenues, and DOF forecasts \$3.4 billion of revenues.

Proposition 98

Net Increases in Proposition 98 Minimum Guarantee Over Period. The measure affects the Proposition 98 calculations. The effect of the temporary tax increases would more than offset the state savings generated by the exclusion of the realignment SUT revenues. The exact increase in the minimum guarantee, however, would depend on a number of factors, including the amount of revenue raised by the measure, year-to-year growth in General Fund revenues, and the way in which Proposition 98 maintenance factor obligations are paid. The increase could be in the billions of dollars annually. By excluding the realignment SUT revenues from the Proposition 98 calculations beginning in 2011-12, the state would no longer have a 2011-12 settle-up obligation. As a result, the state would not need to pay hundreds of millions of dollars annually from 2012-13 through 2016-17.

State Budget

Deposits New Revenues in EPA. The new PIT and SUT revenues would be deposited in EPA. The measure dedicates EPA funds for spending on schools and community colleges and counts them towards the Proposition 98 minimum guarantee.

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No. 1

Overview of the 2012-13 Governor's Budget

The 2012-13 Governor's Budget paints a picture of a strained but improving state fiscal situation. When Governor Jerry Brown took office one year ago, the projected budget gap was \$26.6 billion for 2011-12, with future annual deficits of roughly \$20 billion.

One year later, Governor Brown asserts that the state has made considerable progress in reducing, but not entirely eliminating, that budget gap. According to the Governor's 2012-13 State Budget proposal, the projected gap for 2012-13 is \$9.2 billion, absent any corrective action. This gap is the result of the loss of some current-year savings (e.g., court decisions that block some Medi-Cal cuts and invalidate a portion of the redevelopment agency revenue shift) and a slow-growing economy.

The 2012-13 Governor's Budget acknowledges that the economy was picking up steam seven months ago at the May Revision, but was thrown off track as a result of the federal debt ceiling debate in Congress and the fiscal crisis in Greece and other European nations. In this slow growth environment, state employment is not expected to reach the pre-recession 2007 peak until 2016, a nine-year span. Absent Governor Brown's tax proposal, revenues in 2012-13 would total \$89 billion, about \$15 billion below the level five years ago.

The Governor's Budget proposes to bridge this \$9.2 billion gap through a combination of increased taxes and further spending cuts. The key revenue proposal, subject to voter approval in November 2012, is to raise the income tax rate on high income earners and increase the sales tax by one-half cent through 2016. These temporary taxes will provide \$4.4 billion for non-Proposition 98 programs and also raise the Proposition 98 guarantee by \$2.5 billion in the budget year.

Some of the other proposals to balance the Budget include more than \$2 billion in cuts to Health and Human Services programs, such as CalWORKs, Medi-Cal, and In-Home Supportive Services, \$544 million cut to Proposition 98, \$447 million cut to child care, and elimination of selected mandates for local educational agencies and local governments totaling \$828 million. In addition, the Governor's Budget proposes more than \$1.4 billion in funding shifts, payment deferrals, and fee increases.

Trigger Reductions

Repeating the strategy that led to the enactment of the current-year Budget, Governor Brown is again proposing midyear trigger reductions if the voters reject his proposal to increase state taxes. These cuts would be effective January 1, 2013, and include the following: \$4.8 billion cut to Proposition 98, \$200 million cut to the University of California, \$200 million cut to the California State University, \$125 million cut to the courts, and \$28 million in other cuts, including life guards, rangers, and state park wardens.

For Proposition 98, the trigger reduction would result in a cut of three weeks of instruction, according to the Governor's Budget. In addition, the Budget proposes to shift the cost of general obligation bond debt service for K-14 facilities into the Proposition 98 guarantee, "thereby reducing other General Fund costs."

Education Proposals

In this uncertain funding environment, the Governor's Budget nevertheless proposes several bold changes, both in policy and funding levels, for K-12 education. Among the major changes, the Budget proposes:

- **Weighted Student Funding**—Categorical programs that are not mandated by the federal government (e.g., special education) would be combined with revenue limits and allocated "on a single formula," based on the number of students in a school and the concentration of English learners and pupils eligible for free and reduced-price lunches. No cost-of-living adjustment is proposed for 2012-13.
- **Elimination of Home-to-School Transportation**—The Budget reaffirms the current-year trigger reduction of \$248 million for transportation and proposes a complete elimination of funding (\$619 million) for the program in 2012-13. No further details are available at this time.
- **Mandates**—The Budget provides \$200 million for a new K-12 and community college mandate incentive block grant and also proposes to eliminate more than half of the existing mandates.
- **Transitional Kindergarten**—No funding is provided for Transitional Kindergarten, but the change of kindergarten eligibility for children turning five in November is retained, resulting in a state savings of \$224 million.
- **Deferrals**—The Governor's Budget proposes to direct \$2.3 billion in Proposition 98 funding to reduce interyear apportionment deferrals for K-12 education and community colleges.
- **Child Care**—Funding for child care is proposed to be reduced by \$447 million in non-Proposition 98 funds and \$70 million in Proposition 98 funds, reflecting reduced reimbursement rates and the alignment of eligibility for state child care services with federal welfare-to-work participation requirements.

There are many other proposals contained in the Governor's Budget and many details need to be fleshed out. But for now, it appears that Governor Brown is eager to take bold steps toward balancing the state's Budget and reshaping its most critical responsibility—the education of our youth. Stay tuned for our Special Fiscal Report for further details.

—*Robert Miyashiro*

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Governor's Education Advisor Provides Insights into the State Budget

SSC Governor's Budget Workshop guests in Sacramento were privileged to hear the comments of Ms. Sue Burr who serves with distinction as the Executive Director of the State Board of Education and is Governor Jerry Brown's principle education advisor. Some will recall that the three former positions of Secretary of Education, Education Advisor to the Governor, and Secretary to the State Board of Education were consolidated by Governor Brown last year, making Ms. Burr the most influential voice in the Administration on education matters. Her background includes many high-powered state level jobs, but uniquely includes a stint as Chief Business Official in the Elk Grove Unified School District. Immediately prior to assuming her present responsibilities last year, Ms. Burr was Executive Director of California County Superintendents Educational Services Association, representing county offices of education.

In her comments, Ms. Burr emphasized the financial priorities of the Governor, including his number one priority to increase money for public schools, noting that schools have suffered "mightily" through the current economic downturn. Another of the Governor's priorities is to restore local control to schools, continuing his priority of shifting control from the state to the local level, which began last year with county government realignment. Ms. Burr noted provisions in the Governor's Proposal to accomplish this priority, including collapsing categorical funding into the base and making the funding 100% flexible.

The Governor also wants to simplify school funding through the weighted funding formula, which Ms. Burr described as "long overdue." Along the same lines, the mandate block grant proposal replaces the current system, which Ms. Burr described as "circuitous, difficult, and time consuming."

Ms. Burr also provided a sneak preview to tomorrow's State of the State address. The Governor will emphasize:

- Teacher and leader development, building capacity for all instead of working at the ends of the spectrum on which many approaches have focused
- Reexamining and streamlining testing in order to restore instruction time currently devoted to testing
- An accountability system for a broad-based curriculum, encompassing subjects beyond math and reading

In closing, Ms. Burr suggested districts "plan for the best and prepare for the worst" in case the Governor's tax initiative does not come to fruition and the trigger cuts are engaged. She also asked attendees to let the Administration know what tools are needed to make the contingency plan work for their district.

Ms. Burr's comments were recorded and will be made available tomorrow, January 18, 2012.

—Ron Bennett and Michelle McKay Underwood

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No. 1

The 2012-13 Midyear Trigger Reduction and District Budgeting

The Governor's Budget is based on the assumption that Governor Jerry Brown's tax proposal will be approved by state voters in November 2012 and will generate \$6.9 billion in additional revenues. If approved, K-12 education will not see a restoration of prior cuts or the establishment of new programs. Instead, the Governor proposes that \$2.5 billion in prior-year deferrals be bought back.

If, on the other hand, voters reject the tax proposal (or if it never even reaches the ballot), the Governor proposes to implement midyear trigger cuts totaling \$5.4 billion. Proposition 98 is targeted to be slashed \$4.8 billion, accounting for almost 90% of the total trigger cuts. Of this amount, about half would be covered by reversing his deferral buyback plan, and the balance would be achieved through a cut to K-14 education.

Planning for the Midyear Cut—The Department of Finance (DOF) indicates that this cut is about \$370 per ADA. Because of the timing of the vote, the uncertainty of its fate and the difficulty that districts would face attempting to make significant expenditure cuts after the school year has begun, we recommend that districts build their budgets assuming that the \$370 per-ADA cut is imposed. This reduction should be taken against the 2011-12 revenue limit before implementation of the \$13 per-ADA trigger reduction.

Should a COLA be Budgeted?—The Governor has indicated that schools will be flat funded in 2012-13, and we assume that is in reference to general purpose revenue limits, since his Budget fully eliminates all transportation funding in 2012-13. The DOF has estimated the statutory revenue limit cost-of-living adjustment (COLA) at 3.17% for 2012-13 and a deficit factor of 21.666% to eliminate the impact of the COLA. However, after reviewing these figures, we conclude that the DOF's deficit factor yields a \$37 per-ADA COLA increase (about 0.7%) for the average unified district, rather than a zero COLA. (Recall that last year the DOF's initial deficit factor resulted in a cut in funding of \$19 per ADA, rather than flat funding.)

We recommend, however, that districts disregard this slight increase since the Governor has indicated that no COLA will be provided. Like last year, we expect that both the COLA and the deficit factor will change at the May Revision and that these adjustments will indeed yield flat funding, rather than the \$37 per-ADA gain that appears in the January Governor's Budget.

—Ron Bennett and Robert Miyashiro

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Legislative Analyst Acknowledges Trigger Cuts Pose Problems for District Budgeting

The Legislative Analyst's Office (LAO) cautions that the uncertainty surrounding the Governor's proposal to raise taxes through a voter initiative will force school districts to develop their 2012-13 budgets conservatively, assuming that trigger cuts will be implemented. The Governor's Budget proposes to place a \$6.9 billion tax initiative before voters in November 2012, five months after the start of the new fiscal year. (The LAO's analysis of the initiative disputes the revenue estimates-see the recent *Fiscal Report* article.)

Should the voters approve the tax initiative, K-12 education would be flat funded, except for the elimination of the transportation program. However, if the initiative fails, K-12 school districts would face a \$2.2 billion midyear cut, beginning in January 2013.

Legislative Analyst Mac Taylor and his staff issued their *Overview of the Governor's Budget* on January 11, 2012, noting that the Legislature and the Governor have made significant progress in closing the State Budget gap, but cautioning that the Governor's tax proposal and the associated trigger cuts make budgeting very difficult, especially for school districts. The LAO points out that the Governor's trigger reductions are concentrated on K-14 education, with schools accounting for 90% of the cuts if the tax initiative fails.

On a positive note for the Governor, the LAO concludes that several of his education reform proposals have merit and that the Legislature should adopt the Governor's basic restructuring approaches regardless of the state's revenue situation. The LAO agrees with the Administration's approach to providing greater local budget flexibility through the weighted student funding formula. According to the LAO, especially beneficial would be provisions that allow for immediate increases in categorical flexibility, a five-year phase-in period, and additional funding for disadvantaged students.

The LAO also recommends that the Legislature adopt the Governor's reform proposal to reimburse state mandates. The Governor proposes to eliminate 31 of 57 existing mandates and to amend the remaining mandates to make them permissive. School districts that elect to implement the permissive mandates would receive incentive funding from a mandates block grant funded at \$178 million for 2012-13.

The revenue forecasts of the Administration's Department of Finance (DOF) and the LAO differ, with the LAO's revenue projections falling below the Administration's by \$4.7 billion for the current year and 2012-13 combined. The majority of this difference is attributable to their differing views about the rebound in capital gains income of high bracket taxpayers. The report indicates that the top 1% of the income earners account for 40% of income tax receipts and whose income is largely driven by capital gains. The LAO is forecasting lower capital gains than the DOF. Moreover, the Governor's tax initiative depends heavily upon revenues generated from high income earners, thus making the overall Budget plan all the more risky.

Finally, the LAO warns that school districts will likely assume that the Governor's tax proposal will not be enacted and thus build their budgets conservatively, anticipating a significant cut in state support. The LAO estimates that programmatic funding would be cut about 6% from 2011-12 levels if the trigger cuts are imposed. The LAO points out that districts that do not budget conservatively could face severe budget problems in 2012-13, including an inability to make payroll, fiscal insolvency, and ultimately a state takeover of district operations.

THE SACRAMENTO BEE sacbee.com

Rural school districts hard hit by transportation cuts

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Four of the six schools in the Eastern Sierra Unified School District are scattered along Highway 395, a two-lane road that meanders through scenic Mono County in the eastern Sierra Nevada mountains.

Students often travel as far as 35 miles – each way – to school and back. The drive can be treacherous, especially in winter when rain and snow make the roadways slippery. Traffic near schools and a dearth of street- lights make travel hazardous for drivers pulling into school parking lots and students traveling on foot, said Stacey Adler, superintendent of Mono County schools.

But things could get much worse come Jan. 2. That's when the district's 500 students will have to find their own way to school, unless they live more than six miles away.

Last week, still grappling with a budget crisis, California became the first state in the nation to completely eliminate transportation funding for public schools. Gov. Jerry Brown cut \$248 million in state funding that helps put school buses on the road and reduced student attendance funding by \$79.6 million. Those cuts take effect the second half of the academic year.

Eastern Sierra Unified is among the districts that will pare back busing for the remainder of the school year. But school officials say most rural districts don't have the luxury of completely abandoning bus service, given the distances their students travel to school. They call transportation a safety issue for students and an economic necessity for working families.

"It really hurts small rural districts and puts us in a place where we can't recover," said Jim Shock, superintendent and principal of Arcohe School in rural south Sacramento County. "We're in a situation where we have to do busing. No one lives within a safe distance to walk to school."

Rural school officials worry that parents will pull their children from classes and enroll them in schools closer to their jobs if busing is eliminated. This would take even more attendance dollars away from school coffers.

In addition, said officials from the Small School Districts Association, cutting transportation funding means unequal cuts across districts.

The Millbrae Elementary School District in San Mateo County, for example, will lose \$1 per student in state transportation funding, while Desert Center Unified in Riverside County has the biggest cut per student – \$2,216, according to data from Strategic Education Services, a lobbying group.

The reductions equal the amount districts would have received in state busing funds.

"It's devastatingly disproportionate," said Dick Glock, superintendent of Amador County schools. Amador County will lose about \$172 per student in transportation funds, he said.

"I read that it will be about \$14 for other districts. It's zero for Beverly Hills. So how can that be fair?" Glock asked.

Elizabeth Ashford, spokeswoman for the governor, acknowledged that the cuts are unfair.

"The reason they are unfair is that they were avoidable," Ashford said. The governor was forced to pull the trigger on cuts because voters weren't given the chance to weigh in on tax increases, she said.

The Small School Districts Association will ask lawmakers to restore transportation funding when the Legislature reconvenes in January, said David Walrath, a lobbyist for the association. The group is recommending the state cut education funding by \$42 per student instead of eliminating bus funds, he said.

California's largest school district, Los Angeles Unified, said last week that it will sue the state to halt the school bus cut. The district says it is required to bus 35,000 students under a desegregation court order, and another 13,000 students with special needs under state and federal laws.

Statewide, about 18 percent of California school students take the bus, said Bob Riley of the National Association of State Directors of Pupil Transportation Services.

Most Sacramento County districts already have only limited busing, offering service to students in rural areas and those with special needs. But they are reluctant to cut back further.

"You are relying on attendance, and transportation for your students in rural areas is pretty critical," said Priscilla Cox, a trustee with Elk Grove Unified.

The cuts will be especially painful to rural districts, where up to 90 percent of the students take the bus, said Cox, who is the California School Board Association director for the region that includes Amador, Alpine, Mono, El Dorado, Sacramento and Yolo counties.

At this point, few school districts in the outlying areas are planning to completely eliminate busing – at least not this school year.

"In the foothills, we have steep, winding, sharp-curved roads, and it's very dangerous to have 40 or 50 private vehicles traveling those roads as opposed to yellow buses," said Amador County's Glock.

The Rescue Union School District near El Dorado Hills tried to cut three bus routes at the end of last school year in anticipation of state cuts.

"We found within the first few weeks of school that it wasn't going to work," said Ellen Driscoll, president of the school board.

The district has a challenging geography, Driscoll said, noting that five of the district's seven schools don't have sidewalk access. "We strongly feel that providing transportation to schools that can't be accessed and to rural families is the right thing to do," she said.

Many Yolo County families don't have the financial means to provide transportation for their children, said Jorge Ayala, superintendent of Yolo County schools. He said many parents don't have cars or the flexibility to leave work to get their children to and from school.

Arcohe School would lose about 100 of its 400 students if the district stopped busing, Shock said.

"It's not an option for us," Shock said.

He said the district will find another way to absorb the \$80,000 loss this year.

Children in the Elverta Joint Elementary School District may have to spend as much as 1 1/2 hours on the bus if the district takes another bus off the road because of scarce funding, said Michael Borgaard, superintendent.

He said his district is made up of long, rural roads and low-income families.

"It's just baffling," Borgaard said. "It seems to affect the most vulnerable children."

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Governor's Proposals for the 2012-13 State Budget and Education

Preface

The economic recovery, weak at best, has created the need for yet another crisis spending plan for the state of California. The Governor's Budget Proposal for 2012-13 represents a heroic effort to balance the increasingly heavy demands of an under-employed population with the stark reality that, on the natural, there will be little new revenue available to the state over the next few years.

As a result, this will be the fifth straight year that education cuts will be maintained. Five years ago, California's education spending on a per-student basis was among the lowest in the nation, even before a cut of roughly 15% was imposed. That cut remains the baseline as we enter yet another difficult year.

Even under the most optimistic assumptions, education recovers only a small portion of the ongoing cuts imposed beginning in 2008-09. But at this point, any gain for education would be more than welcome and will be difficult for the state to afford.

Notwithstanding the difficult economic climate, we think the Governor, while facing hard choices, is indeed attempting to avoid further cuts to public education. But the assumption that he will have to rely completely on solutions that can be accomplished with a 50% vote of the Legislature severely limits the options available. Though the Budget can be passed by the existing Democratic majority in each house, tax measures still require a two-thirds vote, which has not been available to this Governor. Recognizing this, the Governor will instead seek a ballot proposal that bypasses the Legislature, allowing state voters to weigh in on his tax proposal directly.

Potential Gains or Midyear Cuts?

While the Governor has proposed increases to education funding, they are contingent on the passage of a major tax initiative in November. This means it will be difficult to plan and budget again this year. The state has not solved its budget problems on a permanent basis. We will, therefore, continue to recommend that districts plan conservatively and maintain prudent reserves.

What constitutes a prudent reserve? While it is difficult to give a specific number that would apply to all districts, the average district finished 2010-11 with a reserve of about 14%. We see no reason to reduce that amount in 2012-13. Districts will need to assess the risk of a midyear cut, make an informed estimate of the potential exposure, and plan accordingly. We, at SSC, are analyzing the exposure now and will offer our specific recommendations in the revised SSC Education Dartboard that will accompany our Governor's Budget Workshop materials.

Revolutionary Changes

Beyond the very significant financial portrayal offered by the Budget, there are also revolutionary proposals that fundamentally alter the manner in which public education is funded and delivered in California.

- **Weighted Student Funding**—Categorical programs that are not mandated by the federal government (e.g., special education) would be combined with revenue limits and allocated "on a single formula,"

based on the number of students in a school and the concentration of English learners and pupils eligible for free and reduced-price lunches.

- Cost of Living (COLA)—No COLA adjustment is proposed for 2012-13.
- Elimination of Home-to-School Transportation—The Budget reaffirms the current-year trigger reduction of \$248 million for transportation and proposes a complete elimination of funding (\$619 million) for the program in 2012-13. No further details are available at this time.
- Mandates—The Budget provides \$200 million for a new K-12 and community college mandate incentive block grant and also proposes to eliminate more than half of the existing mandates.
- Transitional Kindergarten—No funding is provided for Transitional Kindergarten, but the change of kindergarten eligibility for children turning five in November is retained, resulting in a state savings of \$224 million.
- Deferrals—The Governor's Budget proposes to direct \$2.3 billion in Proposition 98 funding to reduce interyear apportionment deferrals for K-12 education and community colleges.
- Child Care—Funding for child care is proposed to be reduced by \$447 million in non-Proposition 98 funds and \$70 million in Proposition 98 funds, reflecting reduced reimbursement rates and the alignment of eligibility for state child care services with federal welfare-to-work participation requirements.

Conclusion

We are not going to get a stable and reliable budget until we have a stable and reliable economy. That is not going to happen this year. We have therefore added materials to our Governor's Budget Workshop to help deal with what has become a new reality in California. We depend heavily on our highest earners to fund government operations in California and the nation; a "tax the rich" strategy only works when the rich are doing well. Until the economy recovers, neither the rich nor the poor will do all that well, but you can be assured that the demand for government services, including education, will increase.

We applaud the Governor's tenacious approach in trying to put California's finances on a stable footing. But this year, he is unlikely to get much help; not from the Republicans, the economy, or the Feds. His one, last best hope is some temporary help from the voters. That help will be very difficult to secure.

So, despite the Governor's best hopes and intentions, we believe public education is in for another rough year. Now is the time to keep options open and to plan conservatively. As in past years, public school agencies will need to do it better, do it cheaper, and do it locally. The long-term effects on our society and our economy of doing less are unthinkable. We look forward to seeing you at our workshops.

In order to provide our analysis of the Governor's Budget Proposal in the shortest possible time, we have relied on information provided by the Administration and the Department of Finance on Thursday, January 5, 2012. Unfortunately, a copy of the proposed Budget Bill was not yet available, nor were there draft bills for some of the Administration's proposals. In other words, there may be some surprises and later information might be different.

As we gather further information about the Governor's proposal in the coming days, we will provide updates and any necessary corrections on our website. Simply go to www.sscal.com.

Overview of the Governor's Budget Proposals

The Economy and Revenues

The Economy

The U.S. economy has finally begun to show signs of a sustained recovery, and concerns about a double-dip recession seem to be fading. It is important to remember that the Great Recession began in December 2007, more than four years ago. And while it was "officially" declared over in June 2009, the path of this recovery has left most wondering whether the official economists in Washington are seeing the same economy as the rest of us.

For the national economy, the Governor's Budget describes a "slow, steady economic expansion" with more encouraging signs emerging in recent months. For example, the Index of Leading Indicators for October 2011 posted the largest monthly increase since November 2010, and the U.S. unemployment rate has dropped from 9.2% in June to 8.6% in November. Similarly, the Consumer Confidence Index posted its largest monthly gain in November in more than eight years, and in the same month, auto sales reached their highest level since June 2008.

With these signs of improvement, the Governor's Department of Finance is forecasting that U.S. Gross Domestic Product will increase 1.7% in 2012 and 2.5% in 2013, still modest by historical standards. The greatest risk to the U.S. recovery continues to be the European debt crisis, with a number of nations still striving to reduce their level of deficit spending. This crisis is expected to slow economic growth in Europe, which will, in turn, hold back the U.S. expansion.

For California, the Governor's Budget acknowledges that the fate of California is largely tied to the national economy. California will experience strong growth in some sectors, like technology and professional services, but also will be held back by the continuing drag of the housing market. The export sector, which rose 19% from 2009 to 2010, is expected to continue to expand, but an economic slowdown in Europe or China could significantly curtail California's growth.

The Governor's Budget forecasts personal income in California to increase 3.8% in 2012 and 4.1% in 2013, again low by historical standards for this phase of an economic recovery. Fortunately, however, the Administration does not foresee a near-term economic downturn. The state's employment outlook will improve in the coming years, but the unemployment rate will remain one of the highest in the nation, at 11.7% in 2013.

State Revenues

The key component of the Governor's Budget is a proposal to increase the state income tax rate by up to 2% on high income earners and to raise the state sales tax by ½ cent, effective upon the approval by state voters in the November 2012 General Election. This temporary tax increase would generate \$6.9 billion in new revenues annually from 2013 through 2016. The Governor's Budget, however, counts about \$2.3 billion of this gain in 2011-12.

In addition to the gain from the temporary taxes, the Governor's Budget counts on about \$1.5 billion from other revenue sources, including payment delays, fee increases, and loans.

In total, General Fund revenues are expected to increase 7.7% in 2012-13 under the Governor's plan, reaching \$95.4 billion, an increase of \$6.8 billion from the current year estimated total. Absent the temporary tax proposal, baseline revenue growth is projected at 3.5% or a \$3 billion increase.

For the current year, the Governor's Budget shows that revenues are expected to fall short \$2.1 billion when compared to the 2011-12 Budget Act. This shortfall triggered the midyear cuts to the state's higher education segments and the loss of \$248 million in K-12 transportation funding. In addition, the revenue shortfall results in a revenue limit cut of about 0.25% of districts' deficiated revenue limit, or about \$13 per average daily attendance (ADA) on average.

Proposition 98

Proposition 98 sets, in the State Constitution, a series of complex formulas that establish the minimum funding level for K-12 education and the community colleges from one year to the next. This target level is determined by prior-year appropriations that count toward the guarantee, plus (1) workload changes as measured by the change in ADA and (2) inflation adjustments as measured by the change in either per-capita personal income or per-capita state General Fund revenues, whichever is less. Under certain circumstances the minimum level is set by a fixed percentage of General Fund revenues, called "Test 1," and it is this percentage that determines the Proposition 98 funding level for both 2011-12 and 2012-13.

The Governor's Budget estimates that the Proposition 98 guarantee will be \$48.3 billion in 2011-12, or \$661 million above the \$47.6 billion level forecast in the 2011-12 Adopted Budget. While acknowledging that this increase must be paid in support of K-14 education, the Budget assumes that it will be appropriated for schools at some time in the future as "settle-up" funding after 2012-13. For 2012-13, the Budget projects that the Proposition 98 guarantee will grow to \$52.5 billion, a \$4.9 billion increase that comes from a combination of anticipated growth in base state revenues and a Proposition 98 share of new temporary taxes proposed for the November 2012 ballot.

The Governor's Budget Proposal is dependent on voters taking action to adopt a new round of temporary taxes—a ½ percentage point increase in the sales tax and higher tax rates for the state's wealthiest taxpayers—which is expected to garner \$6.9 billion in additional revenues. All of the additional tax revenue is allocated to an Education Protection Account created by the ballot measure, and used to fund Proposition 98, but only \$2.5 billion actually increases funding for education programs. The remaining \$4.4 billion will benefit other state programs because it reduces Proposition 98 spending from the state General Fund.

If the proposed temporary taxes aren't approved by voters, the Proposition 98 guarantee will drop by about \$2.5 billion. The Budget proposes a second round of "trigger" reductions, with a loss of \$4.8 billion falling on K-14 education. To achieve this level of reduction, the Budget proposes two changes: first, the proposed \$2.2 billion repayment of deferred apportionments would be rescinded. Relative to current practice, this will have no net impact on education funding.

Secondly, the Governor's Budget proposes to recast debt service costs for school construction bonds—historically funded with non-Proposition 98 dollars—as Proposition 98 expenditures. Doing so without also rebenching the guarantee means that funds for education program spending will be reduced by the amount of debt service, set at \$2.4 billion. Other programmatic spending cuts of \$200 million will result in a real loss of \$2.6 billion in funds for education, or about 15 instructional days. The Budget proposal indicates that the Administration will, ". . . work with school officials and stakeholders to develop legislation that protects education programs, but allows schools to develop and implement necessary contingency plans."

Revenue Limits and Categorical Programs

Revenue limits provide about two-thirds of school districts' revenues and the vast majority of general purpose funding.

In recent years, the multitude of non-federally required categorical programs in the state have been provided significant flexibility when compared to historical trends, and just last year were extended two additional years of temporary flexibility.

For the current year, the Governor's Budget contains a proposal that would completely change the way revenue limit and categorical program funding (excluding federally required programs) is distributed to schools, whereby these important funding categories would be consolidated into one revenue stream on a permanent basis. Funding from this new consolidated source would reportedly be distributed based upon a single weighted allocation formula that takes into account the school's number of disadvantaged pupils, and that is reportedly intended to increase local involvement in decision making. The weighted formula, which takes into consideration a variety of factors proposed by the Administration, would be phased in over a five-year period. This dramatic revision could alter the funding landscape for California schools quite demonstrably.

Transitional Kindergarten

Senate Bill (SB) 1381 (Chapter 705/2010) amended Education Code Sections (E.C.) 46300, 48000, and 48010, to change the required birthday for admission to kindergarten and first grade and established an ongoing Transitional Kindergarten program beginning in the 2012-13 school year. Transitional Kindergarten programs were to be the first year of a two-year kindergarten program using a modified kindergarten curriculum that is age and developmentally appropriate.

The 2012-13 Governor's Budget Proposal does not fund the Transitional Kindergarten program for the 2012-13 school year, and eliminates the requirement that schools provide Transitional Kindergarten instruction beginning in 2012-13. The Proposal redirects the cost savings of \$223.7 million to support existing education programs.

Many districts are already working to determine staffing needs for the first year of implementation of the program this fall, and may have hoped to avoid some certificated layoffs by assigning appropriately credentialed teachers to the Transitional Kindergarten program. At this time, it is not likely that the Transitional Kindergarten program will be funded for 2012-13. Districts should plan their staffing needs for the 2012-13 school year based upon updated enrollment projections and the elimination of the Transitional Kindergarten program, and notice any affected certificated staff by March 15, 2012.

Special Education

The Governor's proposed 2012-13 Budget contains some positive news for special education. The Budget includes \$98.6 million in Proposition 98 funding to replace the one-time \$98.6 million in Proposition 63 (mental health services act) funds used in 2011-12 to pay schools for the cost of providing educationally necessary mental health services to students with disabilities. The Budget proposes to rebench the Proposition 98 guarantee to reflect this increase. Additionally, the Governor proposes to provide \$12.3 million to fund special education ADA growth. As part of his mandate proposal, Governor Brown proposes to eliminate the Behavioral Intervention Plan (BIP) mandate, noting "local districts may choose to continue these activities at local discretion." Similar to other programs, special education programs will not receive a COLA.

Transportation

The Governor's Budget proposal officially takes the state out of the business of providing funding for school transportation (home-to-school and special education). Funding also is eliminated for Small School District Bus Replacement.

In our article, "Glass Half Empty or Glass Half Full?" in the December 22, 2011, *Fiscal Report*, we reported the impact of the 2011-12 trigger cuts to transportation and shared Director of Finance Ana Matosantos' statement that while the midyear cuts are one time in nature, they will be carried forward into next year as adjustments to baseline funding for affected programs. This, in effect, makes all of the midyear cuts ongoing, contrary to the language in AB 114 (Chapter 43/2011) specifying they are one time.

Mandate Reimbursements

Under current statutory and constitutional law, the state may direct local agencies to provide new services to the public, but must also reimburse those agencies for costs incurred in providing those services.

In 2012-13, the Governor's Budget proposes sweeping reform to K-14 mandates. The Budget Proposal will eliminate nearly half of all existing mandates, including Graduation Requirements (Second Science Course) and Behavioral Intervention Plans. Local educational agencies (LEAs) may choose to continue the eliminated mandates at their discretion.

Mandates that are not eliminated will be made optional; however, the Proposal creates a block grant in order to encourage LEAs to continue meeting these requirements. Receipt of block grant funding will be contingent on schools performing the activities. Some of the continuing mandates include sensitive notification and school safety functions like pupil health screenings, immunization records, AIDS prevention, School Accountability Report Cards, and criminal background checks. The Governor's Budget provides a total of \$200 million to fund the mandates block grant incentive program for K-12 schools and community colleges.

Deferrals

There is a \$2.2 billion increase in funding to reduce interyear budgetary deferrals as part of the \$52.5 billion in Proposition 98 funding contained in the Governor's Budget. The details regarding the timing of receipt of cash from the additional deferral has yet to be determined. Dollars used to "buy back" deferrals count toward Proposition 98, but do not provide more spending authority to schools.

Child Care

Total funding proposed for California Department of Education child care programs in 2012-13 is \$1.5 billion, consisting of \$585.3 million in non-Proposition 98 General Fund, \$310.2 million in Proposition 98 General Fund, and \$557.9 million in federal funds. The \$1.5 billion in total funding reflects a \$516.8 million reduction in child care, nearly \$69.9 million of which is Proposition 98 funding, and \$446.9 million of which is non-Proposition 98 funding. Primary reductions to child care are the result of the following reductions:

- A decrease of \$293.6 million in non-Proposition 98 General Fund by requiring families to meet welfare-to-work participation requirements. **This reduction will eliminate about 46,300 child care slots.**
- A decrease of \$43.9 million in non-Proposition 98 General Fund and \$24.1 million in Proposition 98 General Fund by reducing the income eligibility ceilings from 70% of the state median income to 200% of the federal poverty level. **This reduction will eliminate about 15,700 child care slots.**
- A decrease of \$29.9 million in non-Proposition 98 General Fund and \$11.7 million in Proposition 98 General Fund by eliminating the statutory COLA for capped non-CalWORKs child care programs.
- A decrease of \$11.8 million in non-Proposition 98 General Fund by reducing the reimbursement rate ceiling for voucher-based programs.
- A decrease of \$67.8 million in non-Proposition 98 General Fund and \$34.1 million in Proposition 98 General Fund by reducing the standard reimbursement rate for direct-contracted Title 5 centers by 10%.

Child Nutrition

The Governor's Budget includes increases in federal funding for child nutrition to support program growth and additional funding for the Fresh Fruits and Vegetable Program. A total of \$37.2 million in federal funding is proposed for Child Nutrition Program growth, along with \$2 million for the Fresh Fruit and Vegetable Program to provide an additional fruit or vegetable snack to students during the school day.

Charter Schools

The Governor's Proposal includes an increase of \$50.3 million for charter school funding—General Purpose Block Grant and Categorical Block Grant—due to growth in ADA.

In addition, the Governor's Proposal includes changes to "improve in general the operational and financial playing field for charter schools." The Budget Proposal identifies several areas of financial support in which charter schools lag behind traditional schools. The Proposal states, "charter schools receive less per ADA funding than traditional public schools and are not eligible for mandate reimbursements. They have limited options for borrowing funds at affordable interest rates and may not issue bonds."

To address these issues, the Governor's Proposal includes the following:

- **Enhance Charter School Funding**—The Governor's Proposal eliminates the requirement of the authorizing agency's review of charter school deferral exemption and allows for the authorizing agency's inclusion of charter schools in their issues of County Treasury Revenue Anticipation Notes (TRANS).
- **Invest in Charter School Facilities**—The Governor's Proposal opens the participation of the Charter School Facility Program to the non-classroom based charter schools as well as eliminates some of the red tape to expedite the program's funding to the charter schools.
- **Improve Charter School Working Capital**—The Governor's Proposal authorizes the California School Finance Authority to refinance existing working capital revenue bonds and expand financings to include charter management organizations.

Redevelopment

Recently, the state Supreme Court issued its decision regarding a contested budget action in which two bills enacted as part of the 2011-12 State Budget were challenged by redevelopment agencies (RDAs). The Court ruled that Assembly Bill 26 of the First Extraordinary Session (ABX1 26), which dissolved RDAs, was constitutional. Its companion bill, ABX1 27 was ruled unconstitutional. ABX1 27 would have allowed an RDA to remain in existence if it provided a payment to the county treasury to support local schools and other agencies, which the state would have used to offset its General Fund spending. The decision effectively dismantles the 400-plus RDAs throughout California.

As a result of the decision, the state will not recapture the RDA revenues, estimated to be about \$1.7 billion in the first year of implementation and \$400 million each year thereafter, that were anticipated when the bills were adopted last year. However, with the termination of the RDAs, local property tax dollars will go back to local government and to local schools. This will effectively allow the state to recapture a smaller portion, roughly \$1 billion each year, through school district revenue limits and community college apportionments. This adjustment is reflected in the 2012-13 Governor's Budget.

The RDA legislation, if they had both been upheld, would have provided additional local revenues to school districts in future years outside of the revenue limit, resulting in real increases in discretionary local funds available for education programs. This proposed funding was not included in the Governor's Budget for next year.

School Facilities

The Governor's Budget Proposal includes the proposition to shift existing School Facilities Program bond authority from the Overcrowding Relief Grant Program to the New Construction Program and to regulate the allocation of new construction and modernization funds to ensure continued construction of new classrooms and modernization of existing classrooms. The Budget Proposal states "this action will delay local authority to impose a third level of construction fee while continuing construction of new classrooms using bond proceeds, fee revenues, and local funds."

While the proposed Budget focuses primarily on the operating budget for 2012-13, capital budgets are also affected. While the district operating budget benefits from continuation of flexibility in deferred maintenance and routine restricted maintenance, the capital budget suffers to an equal degree. Flexibility, once envisioned as temporary, continues through 2014-15. Facility planners know that even though the dollars may be desperately needed on the operating budget side, seven years of minimal maintenance expenditures will most certainly lead to big repair bills later. Coupled with the absence of a new statewide school facilities bond, facilities funding is minimal indeed. Thus, in the context of protecting programs for students now, we support continuation of this flexibility. However, this is not a cost-free option; there will be a piper to be paid.

Deferred Maintenance

The Governor's Budget proposal includes a line item for Deferred Maintenance with the state funding its contribution with \$250.8 million in the 2012-13 State Budget. LEAs are not required to make the match to receive the funds through 2014-15.

Routine Restricted Maintenance Account

LEAs continue to have the ability to reduce the amount they must deposit into a routine restricted maintenance account through 2014-15. The flexibility was allowed beginning with the 2008-09 fiscal year through 2014-15.

The exemption allows a district to reduce its contribution from 3% of General Fund expenditures to 1%; however, if the school district maintains its facilities in good repair, as defined in E.C. 17002, it shall be exempt from this 1% requirement.

As with all flexibility, agencies must review their options locally and utilize the flexibility provisions as reasonable and applicable.

Emergency Repair Program

The Governor's Budget Proposal includes an increase of \$12.3 million, in one-time funding in 2012-13 for the Emergency Repair Program (*Williams Settlement*).

Federal Programs

In late December, the 2012 Consolidated Appropriations Act (H.R. 2055) was passed by Congress and signed into law by the President, which set the funding levels for various federal programs, including education. While there has been much speculation that school funding would be drastically reduced, the focus on other key issues, such as extension of the Social Security payroll tax cut, dominated the debate. The U.S. Department of Education has released budget tables, which can be found at <http://www2.ed.gov/about/overview/budget/budget12/12action.pdf>.

The charts reflect the impact of a 0.189% across-the-board cut that will be applied to all education programs. One sliver of good news is that both Special Education Basic Grants and Title I Basic Grants received small increases, and Pell Grants received enough funding to maintain the maximum grant at \$5,500, albeit with several modifications on student eligibility and the elimination of some existing benefits. Nationally, Title I funding increased by \$60 million and Individuals With Disabilities Education Act funding by \$100 million, less the across-the-board cut. Additionally, Head Start Programs will receive a \$424 million increase and a new literacy program is established and funded at \$160 million. While many of the current federal education programs will receive flat funding in 2012, Race to the Top Grants were reduced from \$700 million to \$550 million, and Teacher Incentive Funds were reduced from \$400 million to \$300 million nationally. On average, California receives about 10% of the funds.

There is recent word from Congress that draft bills addressing several No Child Left Behind reauthorization issues—such as teacher quality, accountability, and Adequate Yearly Progress—are being debated, but it remains unclear if bipartisan support can be reached on an overhaul this year. Driving the renewed interest was the President's decision in August to authorize U.S. Education Secretary Arne Duncan to issue conditional waivers to states, something our California political leaders have yet to embrace.

November Ballot

The Governor's Budget Proposal relies significantly on new tax revenues generated from passage of the Governor's proposed tax initiative at the November 2012 General Election. The proposed initiative, introduced in December 2011, would temporarily increase the state sales tax by ½% and raise the personal income tax for the state's top earners by up to 2%. The tax increases would expire at the end of 2016.

Together, these two tax increases would raise an estimated \$6.9 million in the 2012-13 Budget year with those funds directed to LEAs.

However, it may not be the only tax proposal on the November ballot. Several other tax proposals are being drafted and prepared for circulation, including a \$10 billion increase in personal income taxes for all taxpayers but the state's poorest. Proposed by attorney Molly Munger (sister of Charlie Munger Jr., the proponent of 2010's successful redistricting initiative Proposition 20), the proposal would dedicate the first \$3 billion to retiring state bond debt, with the remaining \$7 billion going to public schools.

Another tax proposal comes by way of the Think Long Committee, a bipartisan group of former elected officials and policy makers led by billionaire Nicolas Berggruen. The proposal would reduce the state sales tax while extending the state sales tax to services to generate about \$10 billion. Revenues would be used to pay down debt first, then \$5 billion would go to public schools and community colleges.

A third proposal from the California Federation of Teachers would increase the marginal income tax for those earning more than \$1 million annually by up to 5%. Sixty percent of the revenues from the increased taxes would go to K-12 schools and higher education, with the remaining 40% going to local government. Finally, an oil extraction tax estimated to bring in roughly \$3.5 billion earmarked for education could also appear on the ballot.

Recognizing that more than \$36 billion in tax proposals might potentially be on the November 2012 ballot would prove problematic to passage of his proposal, Governor Brown is trying to convince the proponents of the initiatives to back off or modify their proposals so that they don't run afoul of each other, making it harder for him to promote the need for *his* tax proposal to voters.

Pension Reform

The Budget document refers to the Governor's Twelve-Point Pension Reform plan, unveiled in October 2011, and which we detail in our previous article, "[Governor Brown Releases Pension Reform Plan](#)" in our October 28, 2011, *Fiscal Report*. The Budget document cites that, when fully implemented, the reforms should cut the cost to taxpayers of providing pension benefits to state employees roughly in half. There are no other proposals with regard to pension reform in the Governor's 2012-13 Proposed Budget.

Collective Bargaining

The Governor's Proposal suggests, but does not explicitly state, that should his temporary tax initiative fail, the school year would need to be reduced by more than three weeks. Specifically, the proposal states that "a reduction of this magnitude would result in a funding decrease equivalent to more than the cost of three weeks of instruction." Budget documents go on to say that the "Administration will work with school officials and stakeholders to develop legislation that protects education programs, but allows schools to develop and implement necessary contingency plans."

The Administration's strategy for protecting education programs from trigger cuts in the 2011-12 enacted Budget was to require that LEAs maintain student programs and staffing at a prescribed level. The ability to reduce the school year by seven additional days was offered as the contingency plan.

Current law allows districts to provide as little as 175 days of instruction, and many districts have successfully negotiated agreements with certificated employees to reduce their work year to this level. Remember that 175 days is needed for teachers to receive a full year of service credit per E.C. 22138.5. The Administration has opposed fixing E.C. 22138.5 in anticipation of a service credit problem for teachers. Likewise, it is unreasonable to assume that certificated employees will agree to reduce their work year below 175 days if the contingency plan does not include a service credit fix.

—SSC Staff

