Governor Introduces 2014-15 Budget – School Funding a Top Priority

Governor Brown unveiled his 2014-15 Budget Proposal a day early thanks to the budget document being leaked to reporters. In his press briefing today, the Governor reflected upon "lessons learned" from recent budgets that committed one-time or temporary revenue to permanent spending obligations. The Governor recounted the painful cuts in programs that were required when these "revenue spikes" disappeared to underscore his commitment to fiscal discipline and the elimination of debt in the proposals made public today. The Governor focused a several critical themes which are outlined below. These include the need to be careful with how one-time funding is used, prioritizing the implementation of the Local Control Funding Formula with the increase in funding and buying down the state's debt.

Use of One-Time Funds - The Governor acknowledges that extraordinary 2013 stock market gains have produced very large increases in capital gain tax revenue for the state's general fund (GF) impacting three budget years: 2012-13, 2013-14, and 2014-15. These one-time income tax revenues are, for the most part, producing $9.7 billion in higher revenue for K-14 schools over these three budget years. Accordingly, the Governor is proposing to eliminate the $6.4 billion in K-14 inter-year deferrals that remain on the state's books--by the end of 2014-15.

Deferral Buydown & Increased LCFF Funding - The one-time spike in GF revenue and additional deferral buydown expenditures in 2012-13 and 2013-14 also allows the Governor to significantly increase Local Control Funding Formula (LCFF) gap funding in 2014-15 (from 16% to 28%) for K-12 school districts and county offices.

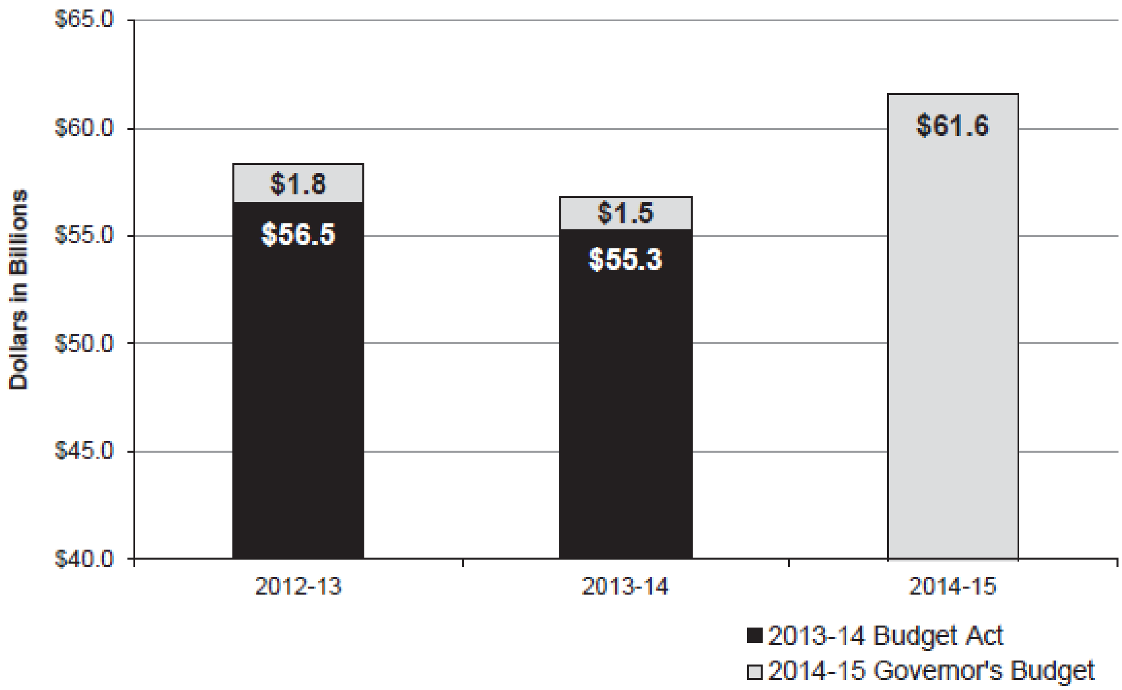
Rainy Day Fund & Prop 98 Reserve - The Governor also uses the state's reliance on a very progressive income tax system, the volatility of capital gain revenue and the soon-to-expire Proposition 30 tax revenue to justify a new constitutional amendment proposal to strengthen the existing Rainy Day Fund (ACA 4 enacted in 2010). A key component of the proposal involves creating a Proposition 98 reserve, whereby spikes in K-14 funding, produced in years when capital gains revenue exceeds 6.5% of total general fund revenue, would instead be saved for future years of decline. Governor Brown argues that this would prevent education cuts in recession years when the state would otherwise be unable to meet Proposition 98 obligations.. The Governor also asserts that the creation of this "Proposition 98 reserve" would require no changes to the guaranteed level of funding dedicated to schools under Proposition 98 in any year.

Key Education Budget Elements

Under the Governor's budget, K-14 education (Proposition 98) spending levels are increased by $9.7 billion over three years: 2012-13, 2013-14 and 2014-15. Increases in 2012-13 ($1.8 billion) and 2013-14 ($1.5 billion) are used exclusively to buydown inter-year deferrals.

The 2014-15 K-14 (P 98) spending level is now projected to be $61.6 billion, a $4.8 billion increase over the adjusted 2013-14 level of $56.8 billion (see figure K12-01 from the Governor's Budget Summary).

Figure K12-01
Major Changes to Proposition 98 Guarantee Levels



Consistent with the his commitment to fiscal discipline and the LCFF, the Governor is proposing to use most all of these additional funds in 2014-15 to eliminate all inter-year deferrals (using $3.1 billion of the one-time deferral buydown increases from prior years) and provide school districts, county offices and charter schools additional LCFF gap funding (approximately $4.5 billion). The Governor's proposed spending level is approximately $600 million lower than the Legislative Analyst's estimate from last November, reflecting the Department of Finance's more conservative revenue projections.

Key Budget Adjustments
The Governor's use of these new resources in K-12 education for 2014-15 is as follows:

K-12 Deferrals – The budget provides an increase of more than $2.2 billion Proposition 98 General Fund in 2014-15, when combined with the $3.3 billion Proposition 98 General Fund provided from 2012-13 and 2013-14 funds, to eliminate all remaining outstanding deferral debt for K-12. The budget allocates another $235.6 million to reduce community college inter-year deferrals.

School District LCFF - Additional growth of approximately $4.5 billion in Proposition 98 General Fund for school districts and charter schools in 2014-15 which is an increase of 10.9 percent.

County Office of Education LCFF - An increase of $25.9 million Proposition 98 General Fund for county offices of education in 2014-15.

Charter Schools - An increase of $74.3 million Proposition 98 General Fund to support projected charter school ADA growth.

Special Education - A decrease of $2.2 million Proposition 98 General Fund to reflect a decline in Special Education ADA.

Cost of Living Adjustment Increases - The Budget provides $33.3 million to support an 0.86 percent cost of living adjustment for categorical programs that remain outside of the new student funding formula, including Special Education, Child Nutrition, American Indian Education Centers, and the American Indian Early Childhood Education Program. Cost of living adjustments for school districts and county offices of education are provided within the increases for school district and county office of education Local Control Funding Formula implementation noted above.

Emergency Repair Program - An increase of $188.1 million in one-time Proposition 98 General Fund resources for the Emergency Repair Program.

Local Property Tax Adjustments - An increase of $287.1 million Proposition 98 General Fund for the school district and county office of education local control funding formulas in 2013-14 as a result of lower offsetting property tax revenues. There is also a decrease of $529.7 million in Proposition 98 General Fund for school districts and county offices of education in 2014‑15 as a result of increased offsetting local property tax revenues.

Average Daily Attendance - A decrease of $214.5 million in 2013-14 for the school district and county office of education local control funding formulas as a result of a decrease in projected ADA from the 2013 Budget Act. A decrease of $42.9 million in 2014-15 for school districts and county offices of education as a result of projected decline in ADA for 2014-15.

Key Programmatic Changes in the Budget

Increased Instructional Flexibility - The Governor's budget indicates a desire to address the current problems with independent study. The primary non-classroom based instructional method available to local educational agencies is through the use of non‑classroom based independent study. Under current law, students work independently according to a written agreement and under the general supervision of a teacher. Funding for average daily attendance in these courses is calculated on a "time value of student work," which requires each teacher to individually calculate a classroom time equivalent value for every activity assigned to a student engaged in independent study. The budget document argues that the requirements that schools must meet to provide and receive funding for this type of instruction are administratively burdensome, requiring teachers to spend time on paperwork instead of providing instruction. The budget goes on to argue that in some cases, these requirements may provide a disincentive to schools contemplating the use of these types of courses. This is also the case for districts seeking to expand online educational programs because under current attendance accounting requirements online can only be provided via an independent study format. In 2013, SB 714 (Block) was introduced to establish a separate attendance accounting option for online courses as a means of addressing the burdensome issues outlined here.

To address the deficiencies in the existing independent study process and provide schools with additional instructional flexibility, the Budget proposes legislation to both streamline and expand the instructional opportunities available through this process.

This mode of learning has the potential to solve problems that are not easily addressed in traditional classroom-based settings and may help fill instructional gaps, while stabilizing or increasing the attendance of students who may have otherwise dropped out or transferred to other private instructional providers to accelerate their educational progress.

This legislation would require schools offering instruction through this new streamlined process shall provide every student with a high quality education, and must ensure that independent study courses meet the following requirements:

- Are of the same rigor and educational quality as their classroom-based equivalent courses;
- Maintain the same number of total educational minutes as their classroom-based equivalent courses;
- Provide adequate teacher and student interaction, including at least one meeting per week to verify the student is working toward successful course completion;
- Maintain classroom-based equivalent pupil-to-teacher ratios unless a new alternative ration is collectively bargained;
- Do not result in the local educational agency claiming more than one total unit of ADA per year for each student enrolled in independent study.

School Facilities The budget outlines a plan to address the state's K-12 school facilities funding shortage – but at no point does the document support a 2014 statewide school bond. While the administration understands that there is overall statewide facilities needs and that facilities projects are an economic driver of the economy, they remain reticent about accruing additional bond debt. Approving a 2014 school bond that is significantly smaller in size than prior bonds may prove to be the most prudent approach.

The budget outlines the recent history of facilities funding and makes the case that this bond funding has been very costly and established significant state debt. The budget states that since 1998, voters have approved approximately $35 billion in statewide general obligation bonds to construct or renovate public school classrooms used by the state's roughly six million K‑12 students. These bonds cost the General Fund approximately $2.4 billion in debt service annually. In addition to general obligation bonds, school districts may use developer fees, local bonds, certificates of participation, and Mello Roos bonds to construct additional classrooms or renovate existing classrooms. There is currently no bond authority remaining in the core school facilities new construction and modernization programs.

As part of the 2014 Five Year Infrastructure Plan, the Administration proposes to continue a dialogue on the future of school facilities funding, including consideration of what role, if any, the state should play in the future of school facilities funding. This infrastructure discussion should also include the growing debt service costs associated with the state's increased reliance on debt financing.

The Administration is proposing that any future program be easy to understand and provide school districts appropriate local control and fiscal incentives. The budget document argues that the following problems are inherent in the current program and must be addressed:

Fragmentation - The current program is overly complex and reflects an evolution of assigning over ten different specialized state agencies fragmented oversight responsibility. The result is a structure that is cumbersome and costly for the state and local school districts.

Link Facilities to Other Cost Decisions - The current program does not compel districts to consider facilities funding within the context of other educational costs and priorities. For example, districts can generate and retain state facility program eligibility based on outdated or inconsistent enrollment projections. This often results in financial incentives for districts to build new schools to accommodate what is actually modest and absorbable enrollment growth. These incentives are exacerbated by the fact that general obligation bond debt is funded outside of Proposition 98.

Rethink First-Come First-Serve - The current program allocates funding on a first come, first served basis resulting in a substantial competitive advantage for large school districts with dedicated personnel to manage facilities programs.

Establish Local Control - The current program does not provide adequate local control for districts designing school facilities plans. Program eligibility is largely based on standardized facility definitions and classroom loading standards. As a result, districts are discouraged from utilizing modern educational delivery methods.

Any future program should be designed to provide districts with the tools and resources to address their core facility gaps, but should also avoid an unsustainable reliance on state debt issuance that characterizes the current school facilities program. While the state examines the future of its role in school facilities, the Budget also includes the following proposals totaling an investment in school facilities of nearly $400 million:

- Transfer $211 million of remaining School Facility Program bond authority from the specialized programs to the core new construction ($105.5 million) and modernization ($105.5 million) programs to continue construction of new classrooms and modernization of existing classrooms for districts that have been awaiting funding. Approximately $163 million, $3 million, $35 million, and $10 million of general obligation bond authority currently remains in the Seismic Mitigation, Career Technical Education, High‑ Performance Incentive Grant, and Overcrowding Relief Grant programs, respectively.

- Dedicate $188.1 million of one-time Proposition 98 General Fund to the Emergency Repair Program to provide grants or reimbursement to local educational agencies for the cost of repairing or replacing building systems that pose a health and safety threat to students and staff at eligible school sites. Schools previously identified by the California Department of Education as ranked in deciles one, two, or three based on the 2006 Academic Performance Index are eligible for funding.

Adult Education - The 2013-14 Budget established a controversial maintenance of effort requirement on adult education funding as a way to “hold the current programs in place” while local community colleges and adult programs worked cooperatively on planning for ways to improve services for adult learners. To this end, the 2013 Budget Act provided $25 million

Proposition 98 General Fund for two-year planning and implementation grants to regional consortia of community college districts and K - 12 districts.

Adult education consortia plans are to be completed by early 2015, and the budget indicates that the Administration intends to make an investment in the 2015 - 16 Budget for adult education, including adult education provided in county jails, through a single restricted categorical program. The Administration will continue to work jointly with the State Department of Education and the California Community Colleges Chancellor's Office to complete the adult education consortia plans, while working with the Legislature to ensure that any legislation pertaining to adult education aligns with and supports the planning process currently underway, and provides consistent guidance to the K‑ 12 and community college districts.

Additionally, $15.1 million Proposition 98 General Fund Reversion for the Adults in Correctional Facilities program, and required K‑ 12 districts to maintain the 2012‑ 13 level of adult education and career technical education programs in 2013‑ 14 and 2014‑ 15.

Common Core Implementation & Student Assessment - The 2013 Budget Act provided $1.25 billion in one-time Proposition 98 General Fund to support the implementation of the Common Core state standards. Funding was provided to support necessary investments in professional development, instructional materials, and technology. The 2014-15 budget does not increase this funding level. Instead, the budget does propose an increase of $46.5 million in Proposition 98 General Fund to implement Chapter 489, Statutes of 2013 (AB 484), which established a revised student assessment system aligned to the new state standards. Beginning with the administration of English language arts and mathematics assessments developed by the Smarter Balanced Assessment Consortium, additional assessments will be included and developed using computer based testing, whenever feasible, to assess the full breadth and depth of the curriculum.

Energy Efficiency Investments - Proposition 39, The California Clean Energy Jobs Act, was approved in 2012 and increases state corporate tax revenues. For 2013-14 through 2017-18, the measure requires half of the increased revenues, up to $550 million per year, to be used to support energy efficiency. The California Energy Commission recently approved a set of regulations controlling the implementation of this funding stream. The $363 million in the budget is a decrease of $80 million over the amount provided in 2013-14. It appears that this is the result of the calculations done by the Franchise Tax Board on the revenue generated by Prop 39. This will be a topic of scrutiny during the upcoming budget subcommittee process. Finally, the budget eliminates the Energy Conservation and Assistance Act which is a loan program that allows districts to leverage larger amounts of funding in order to complete projects.

The Budget proposes to allocate the $363 million of energy efficiency funds available in 2014-15 as follows:

- $316 million and $39 million to K‑ 12 school and community college districts, respectively, for energy efficiency project grants.
- $5 million to the California Conservation Corps for continued technical assistance to K-12 school districts.
- $3 million to the Workforce Investment Board for continued implementation of the Job-training program.

While the Budget does not propose funding for additional revolving loans under the Energy Conservation Assistance Act (which was provided $28 million in 2013-14), this program will continue to be considered for future funding.

Pension Reform

While acknowledging the state's historic commitment to the California State Teachers' Retirement System (CalSTRS) system, the Governor's budget acknowledges CalSTRS faces a growing $80.4 billion unfunded liability and will be unable to meet its obligations in 30 years. Moreover, the Governor points out that CalSTRS estimates that fully funding the system could cost more than $4.5 billion a year—"overwhelming other education priorities as well as other policy initiatives".

The Governor laments that while CalPERS (and retirement systems) have the authority to charge employers more money to make up their funding gaps, school district and teacher contributions to CalSTRS can be changed only by the Legislature. Because CalSTRS cannot act on its own, the Governor's budget proposes that he will begin working with the Legislature, school districts, teachers, and the pension system on a plan of shared responsibility to achieve a fully funded, sustainable teachers' pension system within 30 years. It is expected that this plan will be adopted as part of the 2015-16 Budget.

The Governor concludes by saying: *"A new funding strategy should phase in contribution increases for employees, employers, and the state to allow parties to prepare for cost increases. Because retirement benefits are part of total compensation costs, school districts and community colleges should anticipate absorbing much of any new CalSTRS funding requirement. The state's long-term role as a direct contributor to the plan should be evaluated."*

What Happens Now

The Governor's Budget and, more specifically, his commitment to fiscal restraint and resistance to new policy priorities from the Legislature will face both policy and budget committee scrutiny in the coming months.

Legislative Democrats have already made it clear that they intend to implement universal transitional kindergarten/preschool for all 4 year-olds at a cost in excess of $1 billion in 2014. Additional common core funding is another high priority among many Democrats up for election this November. No additional Common Core funding was provided by the governor in this budget. These will be significant battle ground issues. Additionally, there will no doubt be a great deal of discussion around the actually LCFF statutory language. A number of technical fixes will be necessary. The question is how extensive these changes become and whether key policy components of the LCFF are debated yet again.

Governor Brown has made it clear that after enactment of his LCFF reforms, his commitment is to resist new programmatic spending obligations until state debt (both to schools and elsewhere) is eliminated. As this is an election year for the Governor as well, he will no doubt run on his accomplishments to date related to these priorities. It is unlikely that the Governor will be open to much movement and the enactment of universal preschool, in particular, is likely to face considerable resistance from the administration.

Without question, the Governor's budget is the most promising for public schools in the last decade. The Governor has now packaged increases in general purpose funding with expanded local flexibility and the elimination of inter-year deferral reductions to craft a budget that most school leaders will appreciate.

Given the voters strong expression of support for public education through the passage of Proposition 30 in November 2012 and the health of our economy, it is hard to imagine the Legislature reducing overall K-12 spending in this budget. Absent significant general fund revenue deterioration in the first quarter of 2014, school leaders can expect the overall spending levels proposed by the Governor to be approved by the Legislature. No matter what changes the Legislature makes to this budget prior to its enactment this summer, California schools will be in a much improved position to better serve their students in the fall of 2014.