

FINAL (AND FINALLY) 2010-11 BUDGET SUMMARY

The Legislature finally passed, and the governor has now signed into law, a 2010-11 state budget – exactly 100 days into the budget year. And it appears the governor may have gotten the last word, using his line-item veto authority to reject over \$1 billion in state spending that had been included in the final deal, including the elimination of \$963 million in general fund spending and another \$162 million in special fund and bond fund spending. The line item vetoes were heavily concentrated in health and human services and education, including \$256 million in child care funding, and another \$141 million in vetoes impacting K-12 education programs. The remaining vetoes primarily targeted health and human service programs.

The final budget is balanced on paper only, resolving the state's \$19.3 billion budget shortfall through a combination of program cuts (43 percent), assumed federal funding increases (28 percent), and a laundry list of “other solutions” (28.4 percent). There are no new ongoing taxes in this budget, although it does delay the Net Operating Loss (NOL) tax credit for 2 years, saving the state \$1.2 billion in 2010-11.

The budget assumes federal dollars of \$5.4 billion, at least \$2 billion higher than earlier estimates of what the state could reasonably expect. And among the long list of “other solutions” are assumed state revenue increases that are almost \$1.4 billion above earlier administration estimates, despite the fact that state revenues continue to come in at the lower estimate levels. The other solutions include the sale and leaseback of eleven state properties (\$1.2 billion), and over \$1 billion in various “loans” to the state general fund from several state and local transportation and vehicle accounts.

In brief, this is another smoke and mirrors budget that avoids real budget solutions and further compounds the size, complexity and depth of the state's future budget woes.

Key budget elements

More money for education: K-12 education is at least temporarily spared from cuts beyond the May Revise and even receives additional funding in the neighborhood of \$285 per ADA, above that May budget number.

Health and social service cuts partially restored: The governor's May budget proposed \$12.4 billion in cuts that included the elimination of welfare-to-work and subsidized child care. The budget passed by the Legislature saved many of these safety net programs, reducing the cuts to about \$7.5 billion. It still included some major cuts to some programs, including approximately \$300 million in cuts to the in-home support service (IHHS) program and about \$200 million in child care reductions.

However, to the deep dismay of legislative Democrats, the governor chose to use his line

item veto authority to make further cuts. Of the \$963 million in general fund budget vetoes, over \$800 million came from health and human service programs, including the elimination of all funding for CalWORKS Stage 3 childcare.

Pension reform: The governor scored a victory with the inclusion of major public pension reforms. Those reforms, outlined in more detail below, include a reduction in retirement benefits for new state PERS members hired after November 10, an increase in PERS employee retirement contributions, and additional transparency and reporting requirements imposed on PERS administration.

Budget reform: The governor did score budget reform proposals. Although it requires voter approval in the March 2012 election, it would establish a new state “rainy day fund” to be funded annually based on a specified formula tied to revenue growth. It provides that any new revenue that is needed to meet the Proposition 98 obligation is excluded from this calculation, thus protecting Prop 98. The obvious goal of this rainy day fund is to mitigate against the sharp swings in state revenue that have worsened over the last decade.

Major components of education budget

Below are details on the education portion of the final budget, starting with the governor’s education vetoes:

Governor’s vetoes target Proposition 98

Child care: The governor used his veto power to fully eliminate all Proposition 98 funding for CALWORKS Stage 3 child care (\$256 million), indicating that he was leaving only \$128.8 million of federal funds in the budget to *“support existing Stage 3 child care services through October 2010.”* His stated rationale on this and many other vetoes was the need to bring state spending in line with revenues.

AB 3632 mental health services: In some very difficult news for education, the governor chose to veto \$133 million in prior-year mandate funding to counties for the provision of mental health services to special education students. The governor noted that with this action he was suspending the AB 3632 mandate on counties to provide these services. Under the requirements of federal IDEA, local education agencies will immediately be required to provide these services – without the additional dollars or time needed to build capacity to do so. This one may end up in court.

CalPADS: The governor blue-penciled \$6.444 million in funding to CDE for the ongoing development and implementation of the CALPADS and CALTIDES statewide student and teacher data systems. His decision to zero out all funding for these efforts came with a sharp rebuke of the Department for its inability to get a statewide student and teacher data system in place, despite seven years and \$150 million in funding. His veto came with a request that the Legislature act to statutorily move the responsibility for the system to another (unspecified) entity that can ensure a statewide student and teacher data system is quickly put in place and operational.

Alternative accountability system (ASAM): The governor followed through on his earlier proposal to eliminate the Alternative Schools Accountability Model (ASAM) by vetoing \$775,000 for the development of an accountability system to track the progress of students served through alternative education programs.

Early Learners Advisory Commission (ELAC): The governor vetoed just over \$500,000 and eliminated three CDE positions in support of the State Advisory Council on Early Childhood Education and Care (ELAC), saying the increase in workload noted in the budget was not justified. The remaining ELAC funding still provides authority for two limited-term positions in the Department in support of ELAC's work.

History/Social Science frameworks: Included in his vetoes was the elimination of a \$144,000 budget augmentation targeted to the Curriculum Commission to complete the History/Social Science frameworks. The governor said his intent was that, instead, to redirect this funding to activities related to the California Common Core Standards, under the direction of the State Board of Education.

School funding increased; Prop 98 suspended

The 2010-11 budget suspends Proposition 98, but still manages to provide K-14 education with approximately \$3.5 billion more in 2010-11 state funding than the level proposed in the governor's May Revision.

This figure includes \$1.5 billion to restore the cut to child care proposed in the May Revision (subsequently reduced by about 15 percent with the governor's veto of Stage 3), \$1.7 billion to K-12 to restore the governor's proposed May Revision revenue limit cuts and negative COLA, \$300 million in one-time Prop 98 settle-up funds targeted to mandates, and \$50 million for community colleges.

For K-12, the \$1.7 billion in new revenue limit funding effectively zeroes out the governor's proposed \$1.5 billion revenue limit cut (roughly \$250 per ADA), zeroes out his proposed negative 0.39 percent COLA, and then provides another roughly \$35 per ADA above that. With these changes, the 2010-11 revenue limit deficit factor is 17.963 percent for districts and 18.621 percent for county offices of education.

The Proposition 98 suspension comes with language to ensure schools are paid back with a specified maintenance factor obligation in statute. In addition, the budget contains language to require a two-thirds vote to lower the Proposition 98 level any further in 2010-11. Without this latter provision, the Legislature could take additional funding away from schools later in the fiscal year with a simple majority vote, given the minimum guarantee has been suspended for the fiscal year.

Also included in the budget is an additional one-time "repayment" of \$300 million to schools – as "settle-up" funds from prior year dollars owed to schools. This additional one-time pot of money is directed toward paying for mandated costs, explained below.

Finally, a very good piece of news - the budget does not touch or attempt to offset the \$1.2 billion in federal jobs funds that have come to California's schools. In other words, these dollars continue to be on top of the aforementioned increases to schools.

Most of new K-12 money subject to new deferral

The budget specifies that the additional \$1.7 billion to K-12 revenue limits will be deferred and paid to schools in 2011-12. This deferral would mean that schools can book the \$1.7 billion in 2010-11, but won't be paid for it until 2011-12. The deferral will be made in the April and May 2010 apportionments, with a portion of those payments deferred to July 2011. Up to \$300 million of this deferral to be foregone and instead paid to schools, if the state's cash position allows it at that time. Additional language would allow up to \$100 million of the existing June deferral to be paid on time to charter schools and regular schools who meet specified hardship criteria.

The net effect of this deferral is that K-12 schools technically will see only about \$250 million in additional revenue limit funding (or "real cash") in the 2010-11 year.

Categorical/CSR programs: Some changes

The budget contains no changes to categorical funding levels, and makes only relatively minor changes to categorical flexibility. In good news for county court school programs, the budget includes language making county-operated juvenile court school programs eligible for EIA funding beginning in the 2010-11 budget year.

For K-3 CSR, the budget includes language sought by teacher unions in an effort to protect that program in the future. The new provision makes CSR dollars subject to a continuous appropriation, similar to the revenue limit continuous appropriation. It is an effort to try to ensure districts are fully paid for their claims in the future, with no deficiencies. In addition, the budget assumes (and captures) \$340 million in savings from the K-3 CSR program in 2009-10, and another \$550 million in 2010-11, due to expectations of lower state expenditures under CSR flexibility and increased class sizes.

In relation to categorical flexibility, the budget includes a \$2.6 million cut and the elimination of 22 positions from CDE's budget, in recognition that categorical flexibility has resulted in less need for Department staff to monitor and provide technical support to schools for these programs.

Mandates: One-time funding, reforms, suspensions

One-time funding: The budget contains \$300 million in one-time Prop 98 settle-up money that is directed toward mandates. Of that amount, \$89 million is directed to fund education mandate claims through the usual process of paying oldest claims first with dollars provided in the budget.

The remaining \$210 million will be provided directly to K-12 schools and community colleges based on a per student formula. More specifically, the funds directed to K-12 schools will be allocated on a per ADA basis to all LEAs, including county offices of education and charter schools, based upon 2009-10 P2 ADA. For LEAs with unpaid mandate reimbursements, the funding they received will *“first be deemed to be paid in satisfaction of any outstanding [mandate reimbursement claims] for state-mandated local costs for any fiscal year.”* Any dollars in excess of that amount, and dollars received by LEAs without outstanding mandate claims, can be used for any one-time purpose approved by the local governing board.

LEAs with outstanding claims will be notified by the State Controller as to which claims (plus interest owed) are deemed paid by the funding the district received, and those claims will be subject to the normal mandate audit process and rules. The Controller will identify as paid those LEA claims that are oldest first, in chronological order. The Controller will be charged with reporting to schools, and to state agencies and the Legislature, which claims were deemed paid by the funding provided.

Mandate reforms: The budget suspends and amends a number of local government and education mandates, including the suspension of all local government mandates not related to elections, law enforcement, and property taxes. Included in that action is the suspension of the AB 3632 mental health services mandate noted above as part of the governor’s vetoes. For schools, the budget also includes some mandate suspensions and amendments of significance, including the following:

- *Truancy:* Amends the current “truancy letter” mandate to instead allow LEAs to inform parents using *“the most cost-effective method possible.”*
- *Behavioral intervention/high school science:* Attempts to statutorily define away the state’s obligation to pay for the “behavioral intervention program” (BIP) and the “high school science graduation requirement” mandates. The budget language attempts to achieve this by specifying that first call on federal special education dollars received by districts is deemed as payment on any BIP claims, and state revenue limit dollars received by districts are deemed to cover the costs of the high school graduation science requirement mandate. This one will most assuredly end up in court.
- *Collective bargaining:* Requires the Department of Finance to submit a new test claim with regard to whether collective bargaining is a state mandate.
- *SARC:* Suspends two School Accountability Report Card (SARC) mandates, including the requirement to report average verbal and math SAT scores and the requirement to report the degree to which pupils are prepared to enter the workforce.
- *PE reporting:* Amends the physical education report mandate to reduce requirements.
- *National Board for Professional Teaching Standards:* Eliminates the requirement that schools provide specified data to support the candidacy of teachers seeking certification under this program.

- *Grades 2-9 supplemental instruction for students retained, at risk of retention:* Suspends until July 1, 2013, the mandate that schools provide supplemental instruction to these students.

Finally, the budget establishes a state level task force to review the future of education mandates, including review of the process and the merits of current mandates. The task force is charged with reporting its recommendations to the Legislature by March of 2011.

Pension reforms

The major public employee pension reforms included in the budget include a reduction of pension benefits for future state employees only.

The changes to state pensions for new state employees hired on or after November 10, 2010 will impact state employees in bargaining units that do not currently have an MOU with the state, as well as employees of CSU, the judicial branch of government, and the Legislature. The agreement initially included classified school employees, but an eleventh hour push by CSEA to have local school employees exempted was successful, and school PERS members will not be included in the provisions reducing benefits for new hires.

Under the agreement, new state employees' retirement benefits would be returned to the lower pension benefit levels that existed prior to the adoption of SB 400 (Chapter 555, Statutes of 1999). The reform would also require a three-year final compensation methodology for calculating benefit levels (instead of single highest year) for new state employees in bargaining units not already subject to the three-year calculation. The reforms also require additional analysis and oversight of CalPERS' actuarial assumptions. Again, these changes impact only state PERS members and there were no changes to the STRS retirement program made as part of this provision.

Finally, for all new and current state PERS employees, there will be an increase in employee contributions ranging from 2 to 5 percent.

Child care

Cap on local reserves: The budget includes a decrease of \$83.1 million to reflect a one-time state savings by requiring contractors to utilize accumulated reserves to offset contract amounts, and reduce their reserves to no more than 5 percent or \$2000, whichever is greater.

Reimbursement rates cut: The budget includes a decrease of \$18.7 million tied to reducing license-exempt provider reimbursement rate limits from 90 percent of the licensed provider limits to 80 percent. This solution is also supposed to generate ongoing savings of \$12.4 million in the Department of Social Services Stage 1 Child Care program budget.

Administrative overhead cap lowered: The budget includes yet another reduction in the administrative and support services cost allowance for voucher-based contractors, reducing the level from 19 percent of the contract amount to 17.5 percent.

Labor law reforms? None

None of the administration's reform proposals related to teacher dismissal, layoff, and evaluation were included in the final budget agreement. The sheer number and weight of the issues on the budget table, along with legislative Democrats' solidarity with the teacher unions and legislative Republicans' general lack of interest in this area all contributed to the failure to move any reforms.

Nonetheless, there remains growing public interest in these issues, the federal government is continuing to insist on such reforms, and we are already hearing from state legislators interested in pursuing these issues next year. It does appear that this year's unprecedented public consideration of these "third rail" issues may have finally opened the door on these long-ignored issues.

Summary: Proceed with caution!

The final education budget would pump about \$285/ADA into school district revenue limits in the current (2010-11) school year, beyond the May Revise. In addition to the positive revenue limit changes, LEAs in 2010-11 will see \$300 million in one-time funding dispersed as mandate payments. And this is all on top of the one-time federal "jobs funding" already received by districts.

Further, all of this is protected by provisions that suspend Proposition 98 but ensure future repayment through a specified maintenance factor in statute. And it includes language requiring a two-thirds vote to lower the Proposition 98 level any further in 2010-11.

The good news is that if this budget were to hold and as long as districts are able to float TRANS to cover the new \$1.7 billion inter-year deferral, 2010-11 funding levels to schools will be significantly above the May Revision level that had been anticipated.

So what's not to celebrate? The very bad news is that this budget deal is not founded in reality. As stated earlier, this budget assumes billions in revenue not likely to actually appear. In the context of these troubling budget assumptions, school leaders will be forced to assess their expanded liabilities created by an additional \$1.7 billion apportionment deferral that brings the total of all inter-year deferrals to approximately \$7.3 billion (or roughly \$1,260 per student for an average school district).

This budget will more than likely be very significantly out-of-balance when the new governor takes office in January 2011. Most analysts agree that the mid-year shortfall could easily exceed \$10 billion dollars, making mid-year cuts and/or more substantive

cuts in 2011-12 a very real possibility. We are concerned that the \$1.7 billion "new deferral" could easily turn into a mid-year or end-of-year cut to schools.

In 2011-12, continuing the deferral generates no new revenue for schools. So districts that build the \$1.7 billion into their budgets for 2010-11 will on the natural see a drop of \$1.7 billion in their available revenue in 2011-12, unless the state comes up with additional revenue or yet another deferral, which seems unlikely, as the deferral tab is already over \$7 billion.

And the fiscal forecast for 2011-12 is grim, if only because of the likely loss of the 2008-09 temporary tax increases. In other words, this \$1.7 billion is highly unlikely to be sustained and should not be seen as available for ongoing commitments.

It would appear that limiting the expenditures of these new dollars to one-time purposes is essential. And given the extraordinary uncertainty facing us in the second half of 2010-11 and 2011-12, the most appropriate utilization for these dollars may be to strengthen the district's "reserve for economic uncertainty."

Districts may want to hold these dollars aside, for they are likely to prove far more critical in 2011-12 than in the current year.