

Governor's Proposal for the 2009-10 State Budget and K-12 Education

Including Proposed
Mid-Year Reductions
for 2008-09



ECONOMIC OVERVIEW: THE RECESSION



How Long Will It Last and How Deep Will It Go?

- The recession
 - Worldwide credit crisis
 - Unemployment
 - affects sales and income taxes, as well as economic and social opportunity
 - Public services face greater demands with dramatically lower resources
 - Probably at least two, and more likely three, years before recovery
- California continues to spend more and provide more services than other states

Beyond the Recession: What Is the Long-Term Prognosis?

- A dysfunctional state funding system providing volatile revenue streams
 - Neither the Governor, the Legislature, nor the voters alone can fix it
 - Prospects for a long-term solution hinge on a willingness to put everything, including Proposition 13, on the table – that is not likely to happen anytime soon
- Real reform would also set new priorities for spending
 - Economically, California places a lower priority on education than other states
 - California has had less success in controlling other costs, such as prisons and welfare, than other states

Is There Any Way Out of This Mess?

- Short term
 - More one-time and temporary solutions on the revenue side
 - Deep cuts in expenditures
 - Lack of consensus, leadership, and a sense of urgency result in paralysis
 - Past plans for economic health : “wait for a good year”
- Reduce the two-thirds vote for a parcel tax
 - SCA 6 (Simitian) would do that
 - Now is the time for the Legislature to pass this bill and give the voters a choice on Educational funding

Is There Any Way Out of This Mess?

- Long term, it really depends on the voters
 - Will they continue to accept the results the current system produces?
 - Will they demand real change and be willing to pay for it?
 - Under current law, Proposition 98 guarantees that sooner or later education will have a recovery year – but when?
- But for this year, the die is cast:
 - Education will take at least its share of cuts
 - We will share in the “misery index” level of the state

The Size and Duration of the Budget Shortfall

- The projected State Budget shortfall is huge and continues to grow

November 2007	\$10 Billion
December 2007	\$14 Billion
December 2008	\$28 Billion
January 2009	\$41.6 Billion

- A “normal” State Budget has expenditures of about \$100 billion
 - So the shortfall equates to 40% of a single year Budget or 20% of the combined expenditures for two years – either way, a huge number

From September State Budget Adoption: 9/30/08

National Economics

- Are we in a recession? No – at least not yet
 - A recession is defined as two quarters of negative growth in Gross Domestic Product (GDP) – we haven't had even one
 - But with GDP growth below 1%, it sure feels like a recession
- The U.S. unemployment rate exceeds 6.1%, but California's is 7.7%
- Oil price increases have killed the domestic auto and airline industries, among others – and the same is true in Europe
 - But, since July, oil prices have declined 37%
 - And the dollar has gained 11% against other currencies
 - And, in August, the Consumer Price Index (CPI) change was actually negative
- But major businesses, particularly banks and insurers, are melting down at an alarming rate

Actions Taken To Deal With The Deficit: Mid-Year Reductions in 2008-09

- Special Legislative Sessions November - ??:
 - Governor's proposal
 - Democratic Proposal
 - Republican Proposal
- The Legislature agrees with the Governor on the size of the problem – \$40 billion plus
- Both parties agree on the size of the problem – it is the approach taken by each that is different
 - The Governor has vetoed the Legislature's plan
 - The Legislature has rejected the Governor's plan

The Size and Duration of the Budget Shortfall

- Meanwhile, time marches on and the cumulative deficit grows unabated
- The Proposition 98 floor has fallen dramatically in parallel with state revenues
 - Suspension is not needed to make billions in cuts to education
- This 2009-10 Governor's Budget represents yet another proposal that has not yet been accepted
 - The overall reduction to Proposition 98 proposed for 2008-09 is about \$6.3 billion

Mid Year Reductions: FY 2008-09



Governor's Proposition 98 Proposals

2008-09

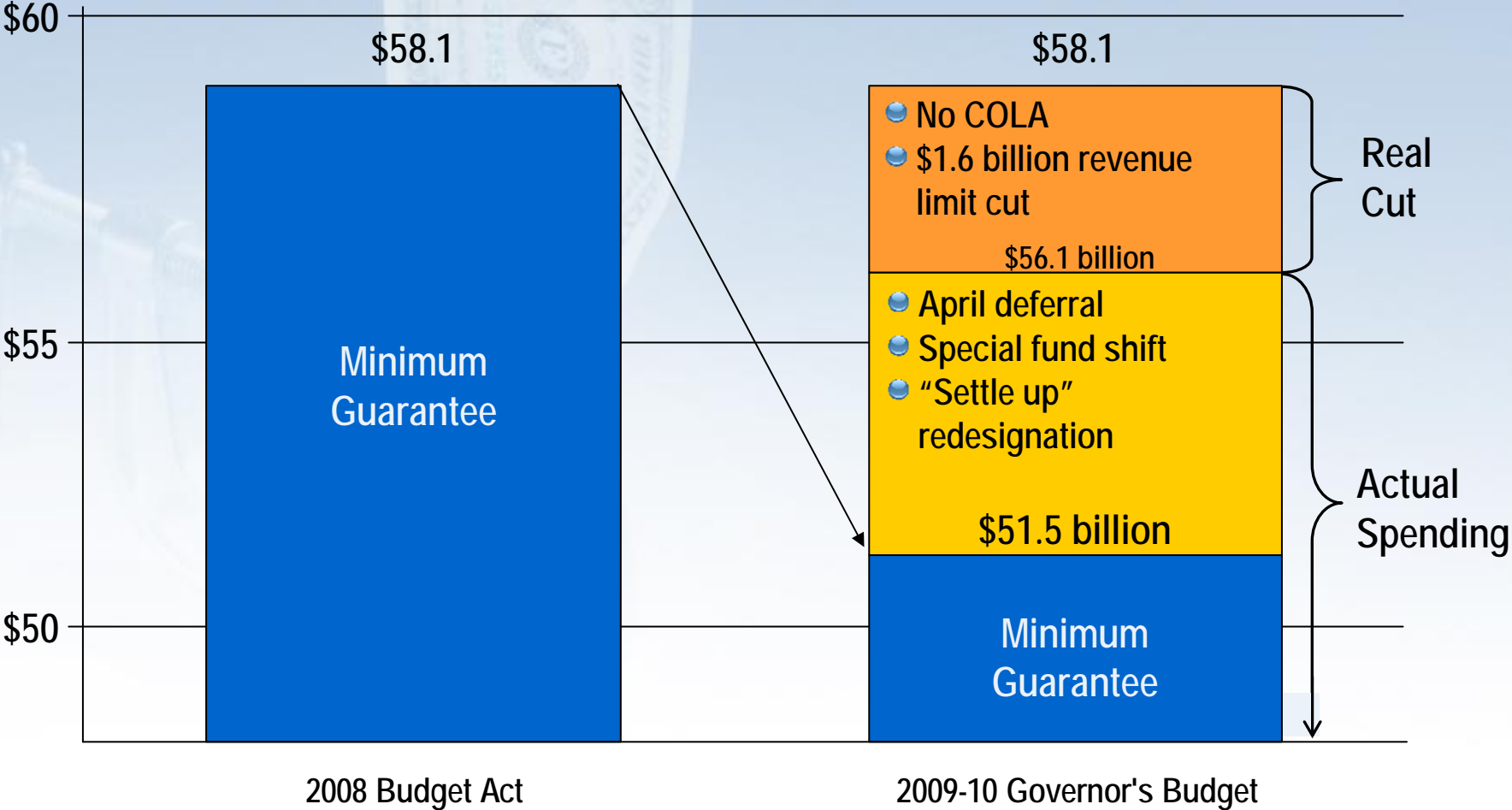
- The Governor's Budget assumes a loss of current-year General Fund revenues of \$14.5 billion, which in turn drives down the Proposition 98 guarantee from \$58.1 billion to \$51.5 billion

➔ Remember, the Proposition 98 guarantee will float throughout the year, but education appropriations in satisfaction of the guarantee are fixed, unless changed by the Legislature

- The Governor is not proposing to cut education funding by \$6.6 billion to the revised minimum guarantee
 - Instead, actual funding cuts – while huge – are limited to \$2.1 billion
 - Another \$4.5 billion in appropriations subject to the guarantee are deferred to 2009-10

2008-09 Proposition 98 Guarantee

(\$ in Billions)



Mid-year reductions 2008-09

- Major common elements of both Governor's and legislative proposals
 - Elimination of the 0.68% COLA
 - Elimination of the Deferred Maintenance match requirement
 - Reduction of the Routine Restricted Maintenance Account (RRMA) set-aside requirement from 3% to 1%
 - Some form of flexibility in the use of state categorical funds
 - Excluding programs generated by initiatives (Lottery IMF)
 - Excluding programs generated by lawsuits (Williams)
- However, the Governor's proposal is the only one still in play
 - Reflects a 4.5% reduction in revenue limit funding

Actions to Take Now – Prepare for Flexibility

- Be ready to take advantage of additional flexibility in case it's in the final solution
 - Hold onto unspent funds from last year
 - Scrimp and save from this year's allocations
 - except in "Use it or lose it"
 - or limited carryover funds
 - Set both aside in the ending balance

State Lottery: 2008-09

- Lottery for the first quarter of 2008-09 was lower than the first quarter of 2007-08
- The updated 2008-09 estimates based on the reduction are:
 - \$109.50 per annual ADA unrestricted
 - Down from \$118
 - \$11.50 per annual ADA for Proposition 20
 - Down from \$19

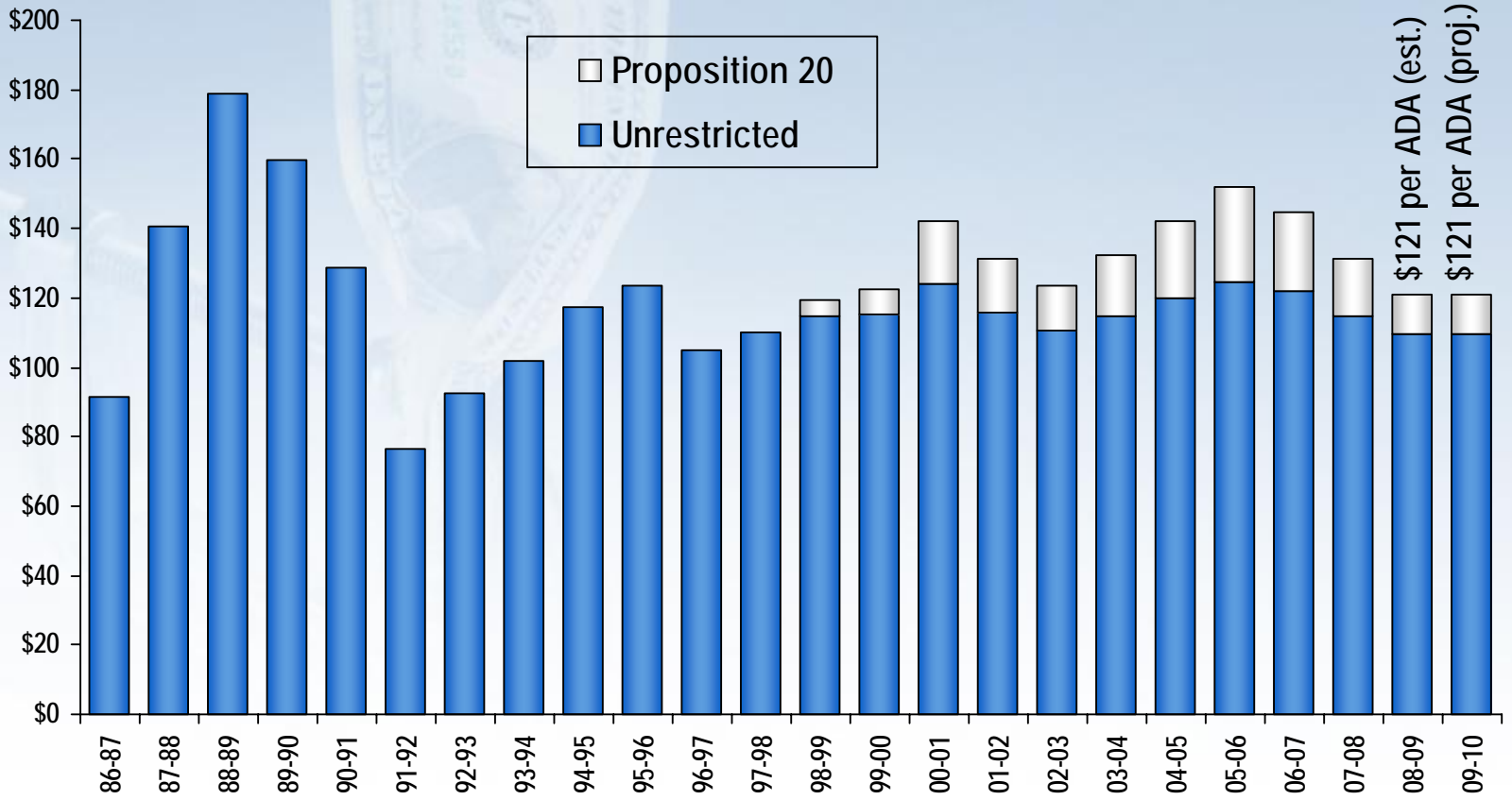


Securitization of the Lottery: A Key Budget-Balancing Technique

- Budget relies on voter approval of a plan to borrow against an increase in future Lottery sales
 - Lottery revenues, which have been declining, are assumed to double
- The impact on education (effective in 2009-10):
 - Lottery revenues no longer go to public education
 - Revenue capped at 2008-09 level, replaced with General Fund dollars, increased by the COLA each year
 - Proposition 98 would be re-based to make the proposal neutral
- This proposal runs the risk of:
 - Voter rejection
 - Court challenge
 - may violate Prop 58 (prohibits borrowing for budgetary purposes)
 - No acceptance in the market

State Lottery: Funding

Funding per Annual ADA



Educational Funding FY 2009-10



Governor's Approach to 2009-10

- For 2009-10, the Governor's proposals include:
 - COLA is declared at 5.02%, but not funded
 - Revenue limit deficit is imposed at <16.161%> of new base revenue limit
 - Categorical and other flexibility is proposed to help school agencies deal with the loss of funding
- Between the two years, education loses both COLA and another \$7.5 billion

Revenue Limit Cuts, COLAs

- Governor's Budget Proposal for:
 - 2008-09 reduces budgeted COLA of 0.68%, eliminating the entire 5.66% statutory COLA
 - 2009-10 provides a zero funded COLA, eliminating the projected statutory COLA of 5.02% through the deficit
- Governor's Budget made further cuts to revenue limit funding
 - \$1.6 billion in 2008-09 is equal to a cut of 4.565%
 - \$1.1 billion in 2009-10 is equal to a reduction of 2.515%

Revenue Limits – COLAs

	Statutory COLAs	
	Actual	Estimated
	2008-09	2009-10
All Unified Districts	\$319	\$309

- Statutory COLAs for both 2008-09 and 2009-10 would be eliminated through the deficit factors

Cumulative Effects of Deficits and Cuts

	2008-09		2009-10	
	Statutory COLA	Deficit Factor	Statutory COLA	Deficit Factor
COLA Proposal	5.66%	.94643	5.02%	.90117
	% Cut	Deficit Factor	% Cut	Deficit Factor
Revenue Limit Cut	4.565%	.95433	2.515%	.93030

Cumulative Loss from Statutory Level: 16.161%!!

Revenue Limit Reduction Impacts: First Interim Calculations

*First Interim
Revenue Limit*

A. **REVENUES**

1) Revenue Limit Sources

	2008-09 Projected Budget	2009-10 Projected Budget	2010-11 Projected Budget
1) Revenue Limit Sources	14,695,055	14,366,824	14,652,910

Budget Assumptions
Revenue Limit

	<u>2008-09</u>	<u>2009-10</u>	<u>2010-11</u>
<u>Revenues</u>			
Revenue Limit (Revenue Limit COLA)	5.66%	5.60%	3.50%
Revenue Limit (Deficit Factor 1)	0.94643	0.89575	0.89575
Revenue Limit (Deficit Factor 2)	1.00000	1.00000	1.00000
COLA	\$329.00	\$344.00	\$227.00

Revenue Limit Reduction Impacts: Second Interim Calculations – Statutory Cola Changes

Second Interim Revenue Limit

	2008-09 Projected Budget	2009-10 Projected Budget	2010-11 Projected Budget
REVENUES			
1) Revenue Limit Sources	14,695,055	14,288,723	14,147,353
First Interim Revenue Limit Sources	14,695,055	14,366,824	14,652,910
Change in Revenue Limit Sources	0	(78,101)	(505,557)

Budget Assumptions

Revenue Limit

Revenues

	<u>2008-09</u>	<u>2009-10</u>	<u>2010-11</u>
Revenue Limit (Revenue Limit COLA)	5.66%	5.02%	0.50%
Revenue Limit (Deficit Factor 1)	0.94643	0.89575	0.89575
Revenue Limit (Deficit Factor 2)	1.00000	1.00000	1.00000
COLA	\$329.00	\$309.00	\$32.00

Revenue Limit Reduction Impacts: Second Interim Calculations – Cola & Deficit Factor Changes

Second Interim Revenue Limit

	2008-09 Projected Budget	2009-10 Projected Budget	2010-11 Projected Budget
REVENUES			
1) Revenue Limit Sources	14,018,229	13,364,457	13,232,100
First Interim Revenue Limit Sources	14,695,055	14,366,824	14,652,910
Change in Revenue Limit Sources	(676,826)	(1,002,367)	(1,420,810)

Budget Assumptions

Revenue Limit

	<u>2008-09</u>	<u>2009-10</u>	<u>2010-11</u>
<u>Revenues</u>			
Revenue Limit (Revenue Limit COLA)	5.66%	5.02%	0.50%
Revenue Limit (Deficit Factor 1)	0.94643	0.90117	0.90117
Revenue Limit (Deficit Factor 2)	0.95433	0.93030	0.93030
COLA	\$329.00	\$309.00	\$32.00

Revenue Limit Reduction Impacts: Second Interim Calculations – Cola & Deficit Factor Changes

Second Interim Revenue Limit

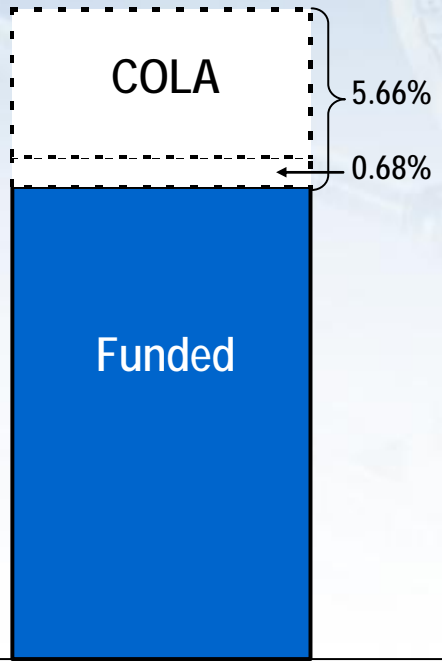
	2008-09 Projected Budget	2009-10 Projected Budget	2010-11 Projected Budget
REVENUES			
1) Revenue Limit Sources	14,018,229	13,364,457	13,166,311
First Interim Revenue Limit Sources	14,695,055	14,366,824	14,652,910
Change in Revenue Limit Sources	(676,826)	(1,002,367)	(1,486,599)

Budget Assumptions

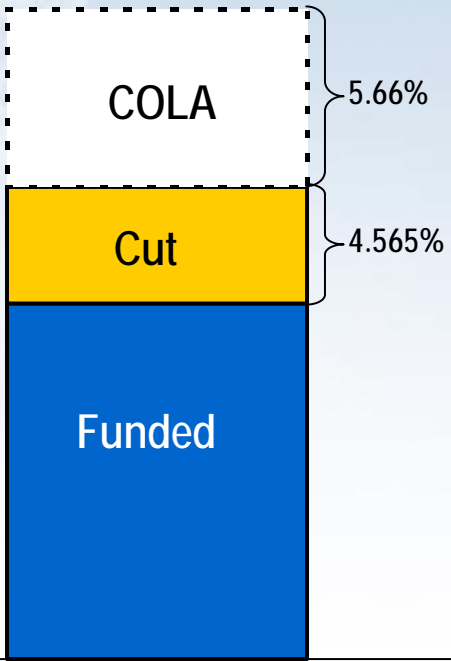
Revenue Limit

	<u>2008-09</u>	<u>2009-10</u>	<u>2010-11</u>
<u>Revenues</u>			
Revenue Limit (Revenue Limit COLA)	5.66%	5.02%	0.00%
Revenue Limit (Deficit Factor 1)	0.94643	0.90117	0.90117
Revenue Limit (Deficit Factor 2)	0.95433	0.93030	0.93030
COLA	\$329.00	\$309.00	\$0.00

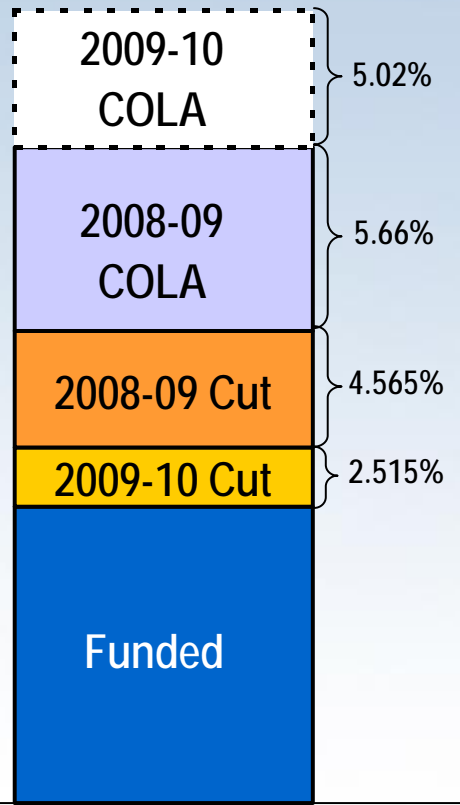
2008-09 and 2009-10 K-12 Revenue Limits



2008-09 Budget Act



2008-09 Proposed Governor's Budget



2009-10 Proposed Governor's Budget

Supplemental Hourly/Programs

- Governor proposes increasing flexibility for the current and budget year
 - Districts funded on hours of support provided, up to the amount funded in 2007-08
 - Hours would come in a block vs. designated to individual programs
 - choose where program support is most needed
 - Funding has not met the demand for program support in recent years

	Deficit Projection	
	2008-09	2009-10
K-12 Core Academic	12%	12%
Grade 2-6 At Risk	28%	28%
Grade 2-9 Retained	14%	14%
Grade 7-12 CAHSEE Intervention	0%	0%

2009-10 Education Program Changes

- The Budget axe falls on the revenue limit, but the Governor would like categorical programs to provide the life support
- Major proposals affecting school operations and programs include:
 - Allowing LEAs to reduce the length of the school year
 - Providing additional funding for special education
 - Broadening budget and program flexibility



Flexibility and Opportunity

- In addition, the Governor proposes providing permanent categorical flexibility
 - Proposal calls for rolling virtually all state categorical funding into one block grant
 - Base year selected to determine funding levels
 - To extent funding is available, provision for growth and COLA
 - Proposal emphasizes outcomes and accountability over accounting
- Essentially, moves regular K-12 funding closer to charter school model

Fewer Days, Fewer Dollars

- The Governor has proposed cutting back the work year for state employees, as well as for schools and students
- As part of the Governor's proposal, the state would:
 - Reduce funding for revenue limits by \$1.092 billion, or an additional 2.8%
 - Permit schools to drop from a minimum of 180 days of instruction to 175 days (five fewer days)
- The Governor's proposal reduces revenue and makes it possible to legally reduce expenditures
 - But, ultimately, each District would need to renegotiate contracts to realize expenditure savings

The Bottom Line

- Whether the cuts come from the revenue limit or categorical programs, Districts will need to make adjustments
- Planning under the Governor's proposal means considering how best to reduce expenses in all areas of the Budget and this could mean:
 - Requirements are waived
 - Funding is flexible
 - The school year could be shorter

Budget Development: County Office of Education Expectations

- Multiyear projections are required by AB 1200 and AB 2756
 - Use the SSC Dartboard for multiyear projections
- Develop three plans
 - Cuts to revenue limit, no categorical flexibility
 - Cuts to revenue limit, categorical flexibility
 - Targeted categorical cuts, smaller revenue limit reductions
- Plan on providing detailed expenditure reduction information to the COE if cuts are incorporated into your multiyear projections

2009 SSC School District Financial Projection Dartboard

Factor		2008-09	2009-10	2010-11	2011-12	2012-13	2013-14
Statutory COLA (use for K-12 and COE Revenue Limit)		5.66%	5.02%	0.50%	2.00%	2.50%	3.00%
K-12 Revenue Limit Deficit		9.685%	16.161%	16.161%	16.161%	16.161%	16.161%
Net Revenue Limit Change		-4.57%	-2.52%	0.50%	2.00%	2.50%	3.00%
Special Education COLA (on state and local share only)		0.00%	0.00%	0.50%	2.00%	2.50%	3.00%
State Categorical COLA (including adult education and ROC/P)		0.00%	0.00%	0.50%	2.00%	2.50%	3.00%
California CPI		2.9%	1.7%	2.7%	2.9%	3.1%	3.2%
California Lottery	Base	\$ 109.50	\$ 109.50	\$ 109.50	\$ 109.50	\$ 109.50	\$ 109.50
	Prop 20	\$ 11.50	\$ 11.50	\$ 11.50	\$ 11.50	\$ 11.50	\$ 11.50
Interest Rate for Ten-Year Treasuries		3.33%	3.55%	4.44%	4.80%	4.90%	5.00%

K-3 Class-Size Reduction

- Governor proposes rolling into categorical block grant and removing program caps
- But, if the Governor's Proposal does not move forward, keep in mind existing flexibility

Class Size Ranges	Penalties
20.45 - 20.94	\$4,284 (20% of class stipend)
20.95 - 21.44	\$8,568 (40% of class stipend)
21.45 - 21.84	\$17,136 (80% of class stipend)
21.85 and above	\$21,420 (100% of class stipend, and perhaps other classes too)

Instructional Materials

- Funding level remains unchanged – \$65 per prior-year CBEDS enrollment
- But, this is proposed along with most other categorical programs, to be rolled into the permanent categorical block grant
- The Governor's Proposal would also temporarily suspend new textbook adoption requirements
 - However, E.C. 60119 sufficiency requirements still apply

Child Nutrition Programs

- 2008-09 state funding for free and reduced-price meals will run out before the end of the fiscal year
 - Claims are still outstanding from May and June of 2008
- 2009-10 Budget proposes \$8.4 million for growth
- Fresh fruit and vegetable incentive will remain intact and has a proposed increase in funding of \$4 million



Facilities – Deferred Maintenance

- The proposed Budget for 2009-10 includes \$312.89 million for the Deferred Maintenance program
 - Eliminates the matching requirement of one-half of one percent
- The 2007-08 Deferred Maintenance Program funding was not submitted for SAB approval in December
 - Due, in part, to shifts in responsibility from CDE to OPSC for calculation
- The allocation delay may impact LEAs' plans for:
 - Projects in progress or planned
 - Interfund (short-term) borrowing

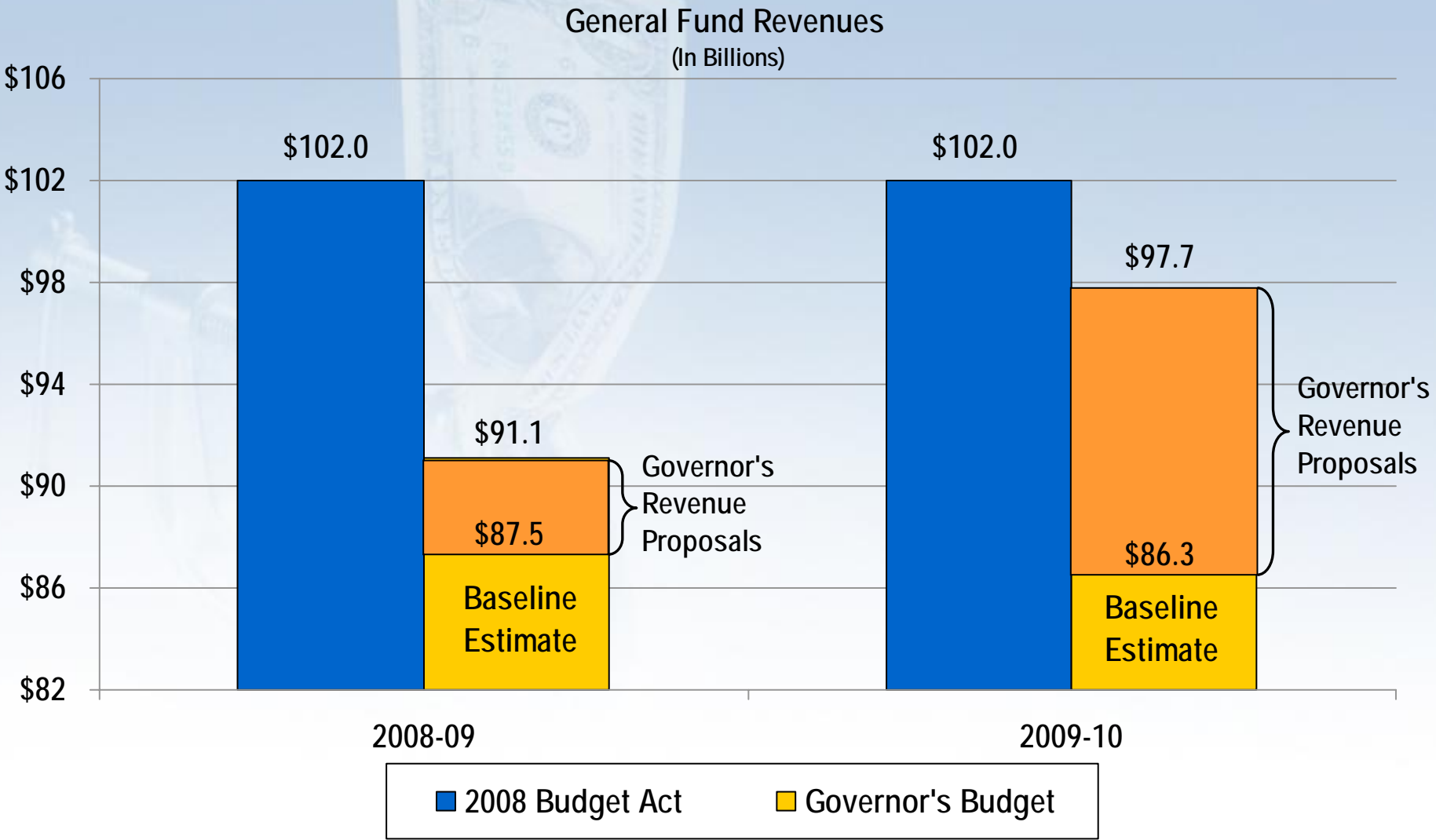
Routine Restricted Maintenance Account (RRMA)

- Districts in the SB 50 school facilities program are required to set aside 3% of total General Fund expenditures
 - Under the January Budget Proposal, contribution requirements are reduced to 1% in 2008-09 and 2009-10
 - Continue to use caution in spending these dollars, since the flexibility option may allow for a sweep of the ending fund balance
- Be sure to have a contingency plan if your budget is built on the 1% requirement and flexibility doesn't materialize

BUDGET DEFICIT: ADDITIONAL IMPACTS



Governor's Budget Projections



Additional Cash Deferral

- As the state's cash continues to feel pressure from the economic turmoil, school agencies can expect deferrals as an ongoing practice into future years
- The 2008-09 Governor's Budget Proposal includes a multiyear deferral of \$2.6 billion of the April 2009 Principal Apportionment and K-3 CSR payment to July 2009
 - This deferral continues in the 2009-10 proposed Budget
 - The Department of Finance is proposing a cash shift of \$1 billion from the July 2009 apportionment and \$1.5 billion from the August 2009 apportionment to September 2009

Ballot Initiatives

- Two propositions, placed on the ballot by the Legislature in 2008, will appear in the next statewide election as part of the Budget deal
 - SCA 12 permits securitization of future Lottery revenues
 - Failure to pass will leave a \$5 billion gap in future Budgets
 - SCA 13 increases the size of the Budget Stabilization Fund and limits how and when funds can be removed from the fund
- The LAO has recommended that the Governor move the June election to April in order to have more certainty on the revenue side of the State Budget

Ballot Initiatives

- Ballot initiatives pending circulation:
 - “Pass Our Budget Act”
 - If a State Budget is not enacted by June 30, the Legislature and Governor’s terms will be terminated and the prior-year’s Budget will stay in effect and be modified based on revenue projections
 - “California Budget Efficiency Act”
 - Changes vote requirement to pass the Budget bill and related tax levies from two-thirds to 55% of each house
- Ballot initiative in circulation:
 - Legislators’ Terms in Office
 - Allows legislators to serve an additional term in office if they do not receive campaign contributions or accept privately funded junkets

Actions to Take Now:

- Prepare for worst-case scenario
- Prepare timeline and process for both certificated and classified layoffs
- Prepare stakeholders
- Prepare seniority lists
 - Post them for employee review, verification, and questions
- Implement each stage as necessary
 - Until the facts and circumstances warrant a change in direction or scope

Actions to Take Now:

- Your board, staff, and community members need to know:
 - What may come down from the state
 - How that will impact your local agency – financially and operationally
 - What your agency is doing to prepare
 - What they can do to help
- Forums
 - School site council meetings
 - Staff meetings
 - Board meetings
 - Community meetings

Closing Thoughts

- The Governor's January Proposal as a beginning point
 - Nothing is in law; no legislative votes have been cast
 - But Districts must prepare the Second Interim and multiyear projections using the Governor's Proposal as a base
- But as evidenced over the past year – things can change rapidly
- This is a year to engage all stakeholders in solutions – not a year to get mired in the problems
- The next statutory checkpoint is the May Revision – unless there are midyear cuts from the special session