

## GOVERNOR'S 2012-13 JANUARY BUDGET PROPOSAL

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January 10, 2012

Traditionally, today is the day the governor releases his annual budget proposal, which begins the yearly budget conversation. However, in a surprise move, the governor released his budget 5 days earlier than expected. Based on ACSA's previous budget alert, this alert provides a broader analysis of the governor's budget proposal, in addition to a few corrections from a previous alert.

### Overview

After using mid-year budget triggers as the method to build a balanced budget, the governor again looks to this strategy as the way to build the 2012-13 state budget. In addition, the governor is pursuing a ballot initiative to raise revenues for public education and public safety. Last year the governor spearheaded the closure of a \$26.6 billion budget deficit. The 2011 Budget Act made billions of dollars in cuts to state services including mid-year cuts which took effect at the beginning of this calendar year. This year the governor faces a slightly less daunting task of closing a \$9.2 billion deficit. The only shining light in the budget is that the traditionally large structural deficit has shrunk to a more manageable \$5 billion ongoing gap.

The governor is continuing his approach of providing more local control and attempting to protect public safety and education. However, the governor's way of protecting programs is through a ballot initiative. If the ballot initiative is successful, Proposition 98 receives a significant increase. However, without these additional revenues, expect to see the similar flat year-to-year budget with mid-year cuts that public education is accustomed to seeing. Further, education will be front and center on any campaign regarding the ballot initiative.

### Overall Budget

The governor is projecting that the 2012-13 fiscal year will end with a budget deficit of \$9.2 billion without corrective action. The deficit is due to the following items:

- The problem left over from the prior year is \$1.9 billion worse than expected in June of 2011.
- Court orders and delayed federal approval related to several budget-balancing cuts in the health and human services area has increased costs by nearly \$2 billion.
- National and international economic developments have pulled state revenues downward for 2011-12. This revenue loss is partially offset by lower costs for Proposition 98 and the implementation of "trigger" spending reductions in the current year.
- The elimination of redevelopment agencies, recently validated by the California Supreme Court, results in less General Fund savings in 2011-12 but significantly greater savings going forward, beginning in 2012-13.

The Governor proposes to close the deficit through a combination of revenues and cuts which equates to \$10.3 billion in "solutions." In addition, the governor wants to maintain a \$1.1 billion reserve. The budget cuts include the following:

- \$1.4 billion from refocusing CalWORKs and subsidized child care by increasing income support to working families and reducing assistance to families who are not meeting work requirements
- \$842 million from Medi-Cal and Medicare by merging service delivery for those who are eligible for both programs.
- \$164 million by eliminating domestic and related In-Home Supportive Services for recipients in shared living arrangements
- \$544 million by eliminating supplemental funding for schools associated with the elimination of the sales tax on gasoline and making other Proposition 98 adjustments
- \$302 million by reducing grant amounts for students who attend private institutions and making other reductions to the Cal Grant program
- \$828 million by repealing, making permissive, or suspending many state mandates on local governments that are unnecessary and burdensome

## STATE'S FISCAL CONDITION AND REVENUES

*California economy* - California's economy is showing signs of recovery, however it is still lagging behind the nation. There are many negative and positive indicators that demonstrate that California is having an uneven economic recovery. These include a robust high technology sector balanced by a still sluggish housing market. An example of this unevenness is seen in the state's wages versus the unemployment rate. The state's wages have made substantial gains through late 2010 and all of 2011. California's personal income grew nearly \$100 billion in 2011, the most since 2006. However, the state's unemployment rate has remained one of the highest in the country at 11.3 percent.

The budget forecasts that there will not be another recession in the near future. Further, the budget forecasts that job growth will continue to improve through 2014 and wages and salaries will continue their upward climb that was seen in 2011. However, these strong indicators are balanced by the weakness of home construction and employment sectors.

*Revenues* - The budget proposal forecasts the revenue to be \$88.6 billion in 2011-12 and \$95.4 billion in 2012-13. The revenue forecast for 2012-13 is based on the assumption that the governor's tax ballot initiative is successful. The initiative increases taxes on the highest income earners and increases the Sales and Use Tax rate by .5 percent. These two changes will increase revenues to the tune of \$6.9 billion. The state relies on the Personal Income Tax (PIT), the Sales and Use Tax (SUT) and the Corporate Tax to sustain revenues for the state. Generally referred to as the "Big 3", these taxes account for approximately 90 percent of all General Fund revenues.

The PIT, which accounts for 62.4 percent of the General Fund, is forecast to be \$54.2 billion for 2011-12 and \$59.6 billion for 2012-13. The sales tax is expected to generate General Fund revenues of \$18.8 billion in 2011-12 and \$20.8 billion in 2012-13. While PIT and SUT revenues show increases, corporation tax revenues are expected to decline. They are estimated to decline by 1.4 percent to \$9.5 billion in 2011-12 and decline another 1.5 percent to \$9.3 billion in 2012-13. This is due mainly to policy changes implemented as part of the 2009 Budget Act. These include the ability to carry back net operating losses to prior years, and the expiration of a temporary limit on tax credits. Conversely, property tax revenues are estimated to increase 0.5 percent from 2010-11 to 2011-12, and increase 0.7 percent from 2011-12 to 2012-13.

## EDUCATION BUDGET

### Proposition 98

The governor has proposed a ballot initiative for the November Presidential Election that provides \$6.9 billion in temporary tax increases. The tax increases include an increase on the personal income tax of the state's wealthiest taxpayers and a one-half percent increase on sales tax. The governor's proposal assumes the passage of the initiative and adjusts the Proposition 98 minimum guarantee accordingly. The minimum guarantee is funded at \$52.5 billion which is approximately \$5 billion higher than the current year funded level of \$47.6 billion.

The budget also provides several Proposition 98 adjustments or rebenching. These include a reduction of \$375 million due to (1) the elimination of the policy to rebench the guarantee due to the elimination of the gas tax from the Proposition 98 calculation; (2) the inclusion of AB 3632 mental health services; and (3) the exclusion of child care from Proposition 98.

### Budget Triggers

The proposal once again includes budget "triggers" in case the initiative fails. The trigger includes a reduction of \$4.8 billion to Proposition 98 which becomes effective on January 1, 2013. The Proposition 98 guarantee will drop by \$2.4 billion in 2012-13 due to the natural decline of the guarantee without the additional revenues. In addition, Proposition 98 will be rebenched to shift K-14 General Obligation Bond debt service costs into Proposition 98, resulting in an additional cut of \$2.4 billion. (It is unclear at this time whether this is a legal manipulation of the minimum guarantee). The administration notes that this reduction equates to cutting the school year by three weeks. Further, the budget restores \$2.2 billion deferral, which was initially eliminated with the additional revenues. It should be noted that the administration has voiced the willingness to work with school leaders to determine the best method to implement this reduction in an effort to minimize the impact on education programs.

### Weighted Student Formula

The governor proposes to eliminate all categorical program funding with the exception of special education, school nutrition and Proposition 49 after school programs. These funds would then be distributed to school districts through a weighted student methodology. The funds would be targeted or weighted based on specific student populations. The student populations include English language learners and students that receive free and reduced priced meals. The formula will be phased in over a period of five years with districts receiving 20 percent of their funds through this weighted method until all funds are received in this manner. The administration acknowledges that there will be some "winners" and "losers" as this new funding model is implemented. Meaning that some districts will receive more than they did the previous year and some districts will receive less than they did the previous year.

This proposal also includes a system of accountability measures that will be the basis for evaluating and rewarding school performance under this finance model. These measures will include the current quantitative, test-based accountability measures, along with locally developed assessments and qualitative measures of schools.

### *Transitional Kindergarten*

In a previous alert, it was stated that the budget eliminated Transitional Kindergarten and moved the start date up to September 1. That was incorrect. The *mandate* that every district provide Transitional Kindergarten is eliminated. The administration believes that this will save the state \$223.7 million Proposition 98 General Fund dollars. Therefore, Transitional Kindergarten is now optional and not mandatory. The kindergarten start date will still be phased in over a three year period beginning with the 2012-13 school year (i.e. the kindergarten start for 2012-13 will be November 1, October 1 for 2013-14 and September 1 for 2014-15). The administration has noted that it is not the governor's intention to deny kindergarten services to students born after the start date. The administration has pointed to current law that authorizes districts to serve "under-age children" and receive an apportionment for serving those students. This provision will remain in place under the Governor's proposal. Districts can continue to serve students born after the Kindergarten start date and place them in a one or two-year Kindergarten program.

### *State Mandates*

The Budget provides a total of \$200 million to fund a mandates block grant incentive program for K-12 schools and community colleges. The governor proposes to eliminate almost half of all current K-14 mandates and create incentives for schools to continue to comply with the remaining mandated activities. Eliminated mandates include Graduation Requirements (Second Science Course) and Behavioral Intervention Plans. Alternatively, the governor's proposal plans to make those mandates that are not eliminated optional. The budget creates a block grant to encourage schools to continue meeting these requirements. Receipt of funding from this block grant will be conditioned on schools complying with these provisions. The proposal will sustain core programs, including school and county office fiscal accountability reporting. It will also continue to support sensitive notification and school safety functions like pupil health screenings, immunization records, AIDS prevention, School Accountability Report Cards, and criminal background checks.

### *Charter schools*

The governor maintains his affinity for charter schools by expanding the financial support and services for both traditional charter schools and non-classroom based charter schools. The rationale for these policy changes is to improve the operational and financial support for charter schools. The budget provides support in three key areas: Enhanced charter school funding, an investment in charter school facilities and improving access to working capital. The changes are reflected in the following:

- *Enhance Charter School Funding:*
  1. Fully fund non-classroom based charter schools and continue to provide growth funding for all charter schools through the charter school categorical block grant, until a weighted student formula replaces this funding mechanism
  2. Stabilize funding for the Charter School Revolving Loan Fund by providing additional access to proceeds available in the Charter School Security Fund
  3. Facilitate timely processing of charter school deferral exemption requests by eliminating the requirement that requests be reviewed by the charter authorizer
  4. Provide additional borrowing opportunities to charter schools by specifying in statute that Local Educational Agencies (LEAs) may include charter schools in their issues of County Treasury Revenue Anticipation Notes (TRANS). LEAs issuing TRANS will be statutorily identified as senior creditors for the purposes of the repayment of TRANS issued on behalf of a charter school.

- *Invest in Charter School Facilities*
  1. Allow non-classroom based charter schools to participate in the Charter School Facility Grant Program (Grant Program)
  2. Facilitate the timely release of Grant Program funds by eliminating some of the upfront application processes and streamlining eligibility determinations
  3. Specify in statute that the state be identified as the senior creditor for Grant Program fund accountability purposes
  
- *Improve Charter School Working Capital - authorize the California School Finance Authority to:*
  1. Refinance existing working capital revenue bonds
  2. Expand charter school payment intercepts to include categorical block grant funds
  3. Expand working capital financing to include charter management organizations

### **School Transportation**

The budget triggers implemented as part of the 2011 Budget Act cut \$248 million for the second half of 2011-12. It now appears that the governor's proposal treats this reduction as a complete elimination of the transportation program. This includes regular and special education transportation. This reduction equates to cutting \$618.7 million in 2012-13. The total reduction over a two-year period equals \$867 million.

### **Other Budget Proposal Items**

ADA growth - The budget provides funding for any growth in ADA. These funds include the following:

- \$50.3 million for charter school categorical programs growth
- \$12.3 million for special education ADA growth
- \$158 million for projected ADA growth for school districts and county offices of education (however, the budget also includes a reduction of \$694 million in 2011-12 for projected decrease in ADA from 2011 Budget Act).

Child Nutrition Programs - The budget decreases Non-98 General Fund money due to the elimination of a supplemental education reimbursement for free and reduced priced meals served at private school and private child care centers. However there is an increase of \$37.2 million in federal funds to address the growth of nutrition programs. Also the Fresh Fruit and Vegetable program contains an increase of \$2 million in federal funding.

K-12 Deferral Elimination - The governor proposes to eliminate \$2.2 billion in Proposition 98 General Fund inter-year budgetary deferrals. However, this deferral is restored if the ballot initiative fails.

Deficit Factor and Cost of Living Adjustment Increases – The Budget does not provide a cost of living adjustment (COLA) for any K-14 program in 2012-13. However, the budget projects that the COLA for 2012-13 is 3.17 percent. The COLA equates to \$1.8 billion. Instead of providing a COLA the deficit factor will be increased to 21.66 percent for school districts and 22.497 for county offices for education.

State Special Schools Unallocated Reduction - \$1.8 million in Non-98 General Fund is cut from discretionary funding for the California Schools for the Deaf in Fremont and Riverside and the School for the Blind in Fremont.

California State Library - A reduction of \$1.1 million non-98 General Fund to reflect a decrease in anticipated administrative workload resulting from 2011-12 trigger reductions that eliminated \$15.9 million in local assistance programs.

### Child Care

Total funding for CDE child care programs in 2011-12 was \$2 billion, while the proposed funding for 2012-13 is \$1.5 billion. Effectively, the result will be a loss of support for parents without current employment. The new plan includes movement away from supporting recently employed or unemployed parents, *and their children*, to only providing child care to families whose parents are securely employed and still have child care needs – “Over time, the three-stage child care system for current and former CalWORKs recipients, and programs serving low-income working parents, will be *replaced with a work-based child care system administered by county welfare departments.*” Within this new county system, there will be movement towards a voucher system, meaning parents that qualify for assistance will receive a voucher for child care, instead of waiting to be reimbursed.

Ultimately, the responsibility for approximately 142,000 children will shift from the CDE to the counties as a result of the proposed budget changes. The philosophy behind this movement lies in the idea that working parents deserve childcare, while parents who do not have a place of current employment do not – “By focusing the state’s subsidized child care programs on *supporting work*, the state will be able to maximize the number of available child care slots within constrained resources.” The reductions in funding come in several forms and equals \$69.9 million in total reductions in Proposition 98 funding. The decreases are as follows:

- A decrease of \$293.6 million in non-Prop 98 funding comes from eliminating services to families whose parents do not meet a required number of working hours. This will eliminate about 46,300 child care slots.
- A decrease of \$43.9 million on non-Prop 98 funding combined with a \$24.1 million reduction in Prop-98 funding allows for the income ceiling of working parents who still need child care to be lowered from \$42,216 to \$37,060. By removing a section of parents who seem to earn enough to provide their own child care, about 15,700 state provided slots are eliminated.
- The elimination of the statutory COLA for capped non-CalWORKs child care programs through a decrease of \$29.9 million in non-Prop 98 funding and \$11.7 million in Prop 98 funding.
- A reduction in the reimbursement rate ceilings for voucher-based child care programs is caused by a decrease of \$11.8 million in non-Prop 98 funding, while rates for license-exempt providers will remain comparable to current levels.
- A decrease of \$67.8 million in non-Prop 98 funding and \$34.1 million in Prop 98 funding will cause the reimbursement rate for direct-contracted Title 5 centers to be reduced by 10%.

### Government Consolidation

The governor continues the process of reducing state government and making state government more efficient. The governor proposes to collapse or eliminate several state government departments and move the administration of specific programs to different agencies. These include the following:

- Consolidate the California State Summer School for the Arts with the California Arts Council
- Eliminate Vocational Education Supplemental Leadership Programs
- Eliminate Non-Proposition 98 General Fund for Indian Education
- Eliminate the Department of Mental Health and the Department of Alcohol and Drug Programs
- The California Department of Education will administer the Early Mental Health Initiative grants.

## ACSA PERSPECTIVE

The governor's budget proposal is only the beginning of the yearly budget debate and discussion. Often in January, stakeholders tend to overreact to proposals which seem dire and certain to be implemented. Even as ACSA reviews the governor's proposal, it is challenging to keep the perspective that this is the first iteration of a budget that is likely to see some change in the coming months. Further, the public has heard for months about the governor's ballot initiative and the need to pursue additional revenues to prevent further reductions to public education. However, upon the release of the budget, the governor's proposal leaves more questions and raises more concerns than what was anticipated. For example, on one hand the governor states that now is not the time for reforms such as transitional kindergarten, but on the other hand proposes a landscape changing reform in the elimination of all categorical programs and replaces it with a weighted student funding method. This occurs even though all the reports written about weighted student formula method indicate that significant additional resources are needed before embarking on such a dramatic funding shift. Further, in a review of the budget numbers, there appears to be more hidden cuts and manipulations of Proposition 98 than what is expected in a budget that is using public education to pursue an initiative to increase taxes.

This year again will require school leaders to stay vigilant and vocal in their advocacy of public education. There are many moving parts to the state budget and the political landscape. The November election could have several initiatives before voters that impact public education and the state budget. There is no longer a two-thirds vote to pass a state budget and it is unclear how the Republican Caucus will adjust to the second state budget under these parameters. And finally, it is an election year under the newly drawn legislative seats. All of these conditions will impact and drive the budget discussion as we move forward.

ACSA will continue to monitor the budget discussion and provide updated information as the budget process develops. The next steps will include the Legislative Analyst's Office reviewing and analyzing the state budget, the budget committees in each house will begin their deliberations shortly followed by an updated revenue estimate and the May Revision. As the calendar year starts, the budget discussion gets under way.