

BUDGET BRIEF

2011-12 May Revision

New Revenues Reduce Deferrals in 2011-12 Budget May Revision

Overview

On May 16, the Governor released the May Revision to his January Budget proposal for the 2011-12 fiscal year. The May Revision typically updates the budget for changes in variables such as population, economic indicators, and tax revenue assumptions. This year, the revision also acknowledges changes already implemented by the Legislature to close what was predicted to be a \$25.4 billion budget gap. In good economic news, the May Revision predicts that state revenues are increasing, and projections for General Fund revenues are \$6.6 billion higher through 2011-12 than what the Department of Finance (DOF) had predicted in January.

As you recall, the Governor's January proposal was balanced with a proposed extension of taxes that are due to expire June 30. The Governor proposed a special election for June to enact these extensions. While the Legislature implemented many cuts in March, they did not act on the tax extension, leaving a wide gap in the Governor's original plan. The May Revision plan continues to assume an extension of taxes. The tax plan has been adjusted downward to reflect the anticipated new revenue increases. Nonetheless, questions remain on the viability of the Legislature and the voters approving this plan, and the Governor did not offer a timeline on when such a plan might be put before the voters.

The information in this *Brief* is based on the proposals outlined in the Governor's May Revision. Therefore, we focused primarily on changes from the January proposal. Please refer to our *2011 Governor's Budget Brief* for details on the original plan. Legislative approval is required before any of these ideas are enacted and the Legislature may still have different ideas on how to close the gap. Though the Legislature is required by the state constitution to adopt a balanced budget by June 30, the deadline is typically ignored and the timeline for any final budget agreement is unclear. For details on the Governor's proposal, visit: www.dof.ca.gov.

State Budget Outlook

Both California and the nation appear to be in a slow and steady economic recovery. California revenues have increased a rate higher than anticipated in the first few months of 2011. Though still high, unemployment rate has dropped at a faster rate than anticipated and industrial output has been strong. But, weak real estate and construction markets and the public sector fiscal crisis appear to be major impediments to strong growth. Projected revenues still lag well behind projected expenditures and the long term forecast for full recovery remains uncertain. Therefore, the Governor is seeking more sustained structural budget fixes.

Due the increases in projected revenues, early action on some budget issues by the Legislature in March, and other updated projections, the remaining budget problem is \$9.6 billion through the end of 2011-12. To include a modest reserve, a total of \$10.8 billion in solutions must still be adopted.

K-12 Budget Overview

Proposition 98

The provisions of Proposition 98 establish a minimum funding guarantee for K-14 education based on complex calculations and interactions of a number of economic and demographic variables. However, in 2010-11 the Legislature “suspended” the Proposition 98 formula for one year and provided Proposition 98 funding at a specified amount of \$49.7 billion. The Governor’s May Revision does not propose any changes in the current year. Average K-12 Proposition 98 expenditures are still estimated to be \$7,358 per pupil. Because the Proposition 98 guarantee was suspended for 2010-11, the additional state revenues realized this spring will not affect the current year budget for K-12 education.

For the budget year, 2011-12, the Governor proposes fully funding the constitutional guarantee, as he did in January. However, because of the projected increases in state revenues overall, the Proposition 98 guarantee also increases in 2011-12 above the January estimate. The revised Proposition 98 guarantee increases by approximately \$3 billion above the January projection of \$49.3 billion to \$52.4 billion. However, if the tax proposal does not pass, the Proposition 98 guarantee would be \$50.4 billion, \$2 billion lower than proposed, but still higher than the initial January estimate.

Major May Revision Adjustments for 2011-12

Funding Deferrals

Due to the improving economic conditions, the Governor’s May Revision prioritizes paying off state debt obligations and removing accounting gimmicks to get the state’s fiscal house in order. For education, that means reducing dependence on deferrals. The \$3 billion increase in Proposition 98 funding is dedicated to reversing the trend of deferring earned revenues into future fiscal years.

Because charter schools often lack the access to lower cost borrowing that is available to most school districts, the proposal to eliminate many cross-year deferrals is a positive development for charter schools. However, we caution that this proposal does not eliminate many of the deferrals. The Governor has not proposed to reduce the deferrals that occur *within* the fiscal year, so schools must plan their cash flow carefully.

The May Revision proposes to eliminate the \$2.1 billion cross-year deferral that was scheduled from 2011-2012 to 2012-13. It also proposes a \$400 million reduction to the February to July 2012 deferral. In total, 10 deferrals are planned, including four intra-year deferrals. Even with these changes, approximately 26 percent of 2011-12 state apportioned general purpose block grant and categorical block grant funds would still be deferred out into 2012-13.

CCSA continues to advocate for greater access to short term borrowing for charter schools. We will provide updates to the apportionment schedule as they are available and will keep you posted regarding any new or additional deferrals and exemption requests.

The chart on the following page shows our latest estimate of the 2011-12 deferrals.

| 2011-12 State Deferral Schedule | | | | | | | | | | | | | | | |
|---------------------------------|--------|--------|--------|--------|-------|-------|--------|--------|--------|--------|--------|--------|---------|--------|-------|
| 2011-12 | | | | | | | | | | | | | 2012-13 | | |
| | Jul | Aug | Sep | Oct | Nov | Dec | Jan | Feb | Mar | Apr | May | Jun | TOTAL | Jul | Aug |
| Planned % | 5.00% | 5.00% | 9.00% | 9.00% | 9.00% | 9.00% | 9.00% | 9.00% | 9.00% | 9.00% | 9.00% | 9.00% | 100.00% | | |
| Deferral | -5.00% | -5.00% | 2.53% | -9.00% | | | 2.47% | -6.14% | -5.38% | -2.61% | -3.84% | -9.00% | | 6.14% | |
| Deferral | | | | | | | 5.00% | | | -1.61% | -3.07% | | | 1.61% | 2.61% |
| Deferral | | | | | | | 9.00% | | | -5.38% | | | | 3.07% | 3.84% |
| Deferral | | | | | | | | | | | | | | 9.00% | |
| Actual % | 0.00% | 0.00% | 11.53% | 0.00% | 9.00% | 9.00% | 25.47% | 2.86% | 3.62% | 10.16% | 2.09% | 0.00% | 73.72% | 19.83% | 6.45% |

| | Deferral |
|--|----------|
| July Apportionment Deferred Until September | 2.53% |
| July Apportionment Deferred Until January (New to 2011-12) | 2.47% |
| August Apportionment Deferred Until January (New to 2011-12) | 5.00% |
| October Apportionment Deferred Until January | 9.00% |
| February Apportionment Deferred Until July | 6.14% |
| March Apportionment Deferred Until April | 5.38% |
| April Apportionment Deferred Until July | 1.61% |
| April Apportionment Deferred Until August | 2.61% |
| May Apportionment Deferred Until July | 3.07% |
| May Apportionment Deferred Until August | 3.84% |
| June Apportionment Deferred Until July | 9.00% |

COLA

Under the statutory formula, the Cost of Living Adjustment (COLA) is estimated to be 2.24 percent. This is an increase over the January COLA estimate. However, no COLA has been proposed to be funded for any K-12 programs. The cost of the COLA will add approximately \$900 million to the K-12 maintenance factor to be owed in future years.

Revenue Limit Block Grant

The May Revision provides an increase to the overall charter school block grant appropriation to accommodate the projected increase in ADA. However, this caseload adjustment will not provide additional funds on a per-pupil basis. Block grant rates per pupil are still expected to remain relatively flat between 2010-11 and 2011-12, though May Revision estimates for 2011-12 are slightly lower than CDE's posted P-1 rates for 2010-11. However, the proposal to pay-down the cross-year deferrals will provide more funding within the fiscal year.

Categorical Block Grant

No change is expected in the per pupil rate for the Charter School Categorical Block Grant. However, the May Revision includes additional funding in categorical block grant and economic impact aid, to accommodate projected increases in charter school enrollment overall.

Categorical Flexibility and New Schools Supplement

In March, the Legislature extended by two years the provisions of the categorical flexibility through 2014-15. While this is generally considered a positive option for schools districts, it has

created some problems for many new and growing charter schools that were not included in the “base year” in which funding access was frozen.

One of the top budget priorities for the Association last year was to ensure that new schools received categorical funding for programs that were locked in to base year funding levels under the “Categorical Flexibility” model. The Legislature responded by providing a categorical block grant “supplement” of \$127 per 2010-11 P-2 ADA for start-up charter schools that began operation in 2008-09 and later. The budget funds this supplement for 2011-12 by maintaining the rate at \$127 per ADA including new schools. The May revision provides an increase in this budget item to accommodate increased projections of new charter ADA. This augmentation will not increase the per-pupil rate of \$127.

The Governor’s proposal still does not address access to new and growing charter schools to the K-3 Class Size Reduction (CSR) program. K-3 CSR is not included in the block grant supplement noted above. However, access to CSR funding is capped at the number of classes reported by a local education agency for 2008-09. Schools without a base identified in 2008-09 should not budget staffing or dollars for K-3 CSR implementation.

Charter School Facility Grant Program (SB 740)

The Governor also retains his January proposal to fully fund the SB 740 Charter Schools Facility Grant Program in 2011-12. Consistent with SB 658/09, funding for the facility grant program continues to increase through a transfer from the phase-out of year round school grants to districts. Grant levels and eligibility requirements remain the same, but CCSA continues to advocate for program changes to allow more charter schools to access the program. With total funding of approximately \$80 million, this is the largest amount of funds ever budgeted for this program. In budget hearings earlier this year, the Legislature raised questions as to whether the funding level exceeds projected eligibility. Additional data that has recently become available clearly supports the need for the full amount.

Special Education: AB 3632 Mental Health Services

The May Revision withdraws the Governor’s earlier plan to address the AB 3632 mental health mandate as part of realignment. Instead, the May Revision proposes to eliminate the local mandate for AB 3632 for counties and shift the responsibility to LEAs to provide mental health services through IDEA. This proposal comes with a funding shift of \$389.4 million to education from state general fund, federal funds and Proposition 63 funds. Since this would constitute a new Proposition 98 purpose it would trigger a realignment of the Proposition 98 guarantee.

Mandates

The May Revision proposes to eliminate several K-12 mandates and shift to a block grant approach to mandate reimbursement. Under current practice, charter schools cannot access mandate reimbursement funds. While charter schools are not required to perform some activities that are mandated for districts, we believe that they should receive reimbursement for any mandate that applies to them. It is unclear how this proposal will address this issue. But, to the extent this new plan reduces mandates or provides a more streamlined “block grant” approach to repayments, charter schools may recognize some benefit.

State Data and Testing Systems

The May Revision proposes to eliminate CALPADs and CALTIDES funding and suspend all activity on development and implementation pending continued review of the system. The

Governor's proposal suggest that all federally required data collection and reporting can be done through CBEDS or other systems used by CDE. The Governor notes that "a number of problems have been identified with California's state testing, data collection and accountability regime" and therefore "proposes to deal with these issues by carefully reforming testing and accountability requirements". Neither the details nor timelines associated with this significant policy reform proposal have been provided. CCSA will keep you posted if and when this proposal develops. In the meantime, schools should continue to participate in data systems as they are directed by the California Department of Education.

Legislative Analyst's Office Response

The Legislative Analyst's Office (LAO) has posted a summary analysis in response to the release of the Governor's May Revision at: www.lao.ca.gov. In it, the LAO generally concurs with the Governor's economic assumptions, but raises concern about the uncertainty of the tax extension assumption. The LAO suggests that other solutions may be available. For education, the LAO notes that the Governor's plan to begin paying down deferrals is a positive step toward improving the financial health of LEAs.

Next Steps

The May Revision is another step in the consideration of a complete budget plan for 2011-12. Budget Committees will be debating the Governor's proposal over the next few weeks. The Legislature still needs to act on these changes, and until they are approved, nothing is final. Though the Legislature is required by the state constitution to adopt a balanced budget by June 30, the deadline is typically ignored and the timeline for any final budget agreement is unclear. The complicating factor of when and if a tax extension proposal will get to the voters further exacerbates the uncertainty around this proposal.

CCSA will continue to advocate for positive improvements to charter school funding as budget hearings progress and we will keep you informed. Keep an eye out for our *Capitol Updates* and look for regular updates to our Budget Information page at: www.calcharters.org/budgetupdate

What if the Tax Extension Measure Fails?

If the ballot measure to extend the taxes is not successful, deeper cuts to education should be expected. Adding to the uncertainty is the lack of clear timing on when such a proposal might be presented to voters. It appears that "all bets are off" if the tax measure is not adopted. If the taxes are not approved, then the Proposition 98 guarantee would drop by about \$2 billion to \$50.4 billion for 2010-11. However, because other areas of the budget would also be severely impacted, the Governor cannot commit to funding education at the Proposition 98 guarantee. DOF stated that "an 'all cuts' budget would require a suspension of the Proposition 98 minimum guarantee and deep reductions".

DOF suggest that without the tax extension another \$5 billion cut to education could be necessary to balance the state's budget. We estimate that each billion dollars of education funding equates to approximately \$165 per pupil on average. This number is a good rule-of-thumb estimate for schools to keep in mind as they plan for various scenarios moving into 2011-12. Therefore, if the Proposition 98 minimum declines by \$2 billion without the extended taxes, we might expect a funding reduction of about \$330 per ADA below the rates estimated in this brief. If Proposition 98 were suspended and reduced by \$5 billion, this would amount to a per

ADA cut of about \$825 below the posted rates. At a minimum, schools should be building contingency budgets to reflect these various scenarios.

Some of these cuts would likely result in the imposition of substantial apportionment deferrals such as those proposed in January. But the real impact and degree of cuts cannot be known until it happens. The Governor has been hesitant to offer a “Plan B” and has encouraged schools to budget based on the May Revision assumptions. While this may be a fair position for the Governor, given the uncertainty of the timing or result of a final budget deal, we encourage schools to consider the impact of various levels of cuts and establish a few contingency plans.

Budget Planning Projector

The May Revision is the next step in enacting the budget for 2011-12. The Legislature must act on this proposal, and will no doubt have its own priorities and ideas for closing the gap. Given the volatility of the budget adoption process and the assumptions on the passage of the tax extension that were used in the budget proposal, the figures noted on the following tables only offer a rough estimate of potential revenues for charter schools under the Governor’s proposal. Schools may also wish to plan contingency budgets that reflect different scenarios and assumptions. In addition, schools should pay close attention to the apportionment schedules and deferrals that will have a significant impact on their monthly cash flow.

Below is our latest estimate of charter school funding rates revised per CDE certified P-1, February 2011, and the Governor’s May Revision Proposal.

| 2010-11 Budget Estimate Block Grant Rates | | | | |
|---|-----------------|-----------------|-----------------|-----------------|
| | K-3 | 4-6 | 7-8 | 9-12 |
| General Purpose Block Grant* | \$ 5,077 | \$ 5,153 | \$5,306 | \$6,158 |
| Categorical Block Grant | \$ 400 | \$ 400 | \$ 400 | \$ 400 |
| Total estimate for 2010-11 | \$ 5,477 | \$ 5,553 | \$ 5,706 | \$ 6,558 |
| Economic Impact Aid (per eligible pupil) | \$ 318 | \$ 318 | \$ 318 | \$ 318 |
| Categorical Block Grant supplement for schools starting in 2008-09 and later | \$127 | \$127 | \$127 | \$127 |
| * These rates are revised estimates posted by CDE certified at PI, February 2011 and subject to change. | | | | |
| 2011-12 May Revision Estimate Block Grant Rates* | | | | |
| | K-3 | 4-6 | 7-8 | 9-12 |
| General Purpose Block Grant | \$ 5,049 | \$ 5,125 | \$5,271 | \$6,116 |
| Categorical Block Grant | \$ 400 | \$ 400 | \$ 400 | \$ 400 |
| Total estimate for 2011-12 | \$ 5,449 | \$ 5,525 | \$ 5,671 | \$ 6,516 |
| Economic Impact Aid (per eligible pupil) | \$ 318 | \$ 318 | \$ 318 | \$ 318 |
| Categorical Block Grant supplement for schools starting in 2008-09 and later | \$127 | \$127 | \$127 | \$127 |
| *These rates are revised estimates based 2011 May Revision assumptions and are subject to change. | | | | |