Senate Budget and Fiscal Review—Mark Leno, Chair

SUBCOMMITTEE NO. 1 Agenda

Senator Marty Block, Chair
Senator Benjamin Allen
Senator John M. W. Moorlach

Thursday, March 3, 2016
9:30 a.m. or upon adjournment of session
State Capitol - Room 3191

Consultants: Elisa Wynne and Anita Lee

AGENDA PART A

Pursuant to the Americans with Disabilities Act, individuals who, because of a disability, need special assistance to attend or participate in a Senate Committee hearing, or in connection with other Senate services, may request assistance at the Senate Rules Committee, 1020 N Street, Suite 255 or by calling (916) 651-1505. Requests should be made one week in advance whenever possible.

6110 Department of Education
6870 California Community Colleges

Issue 1: Overview of Proposition 98 and 2016-17 Budget Proposals (Information Only)

Panel I:
- State Superintendent of Public Instruction Tom Torlakson

Panel II:
- Lisa Mierczynski, Department of Finance
- Kenneth Kapphahn, Legislative Analyst's Office
- Debra Brown, California Department of Education
- Dan Troy, Chancellor's Office of California Community Colleges

Background:

California provides academic instruction and support services to over six million public school students in kindergarten through twelfth grade (K-12) and 2.3 million students in community colleges. There are 58 county offices of education, approximately 1,000 local K-12 school districts, more than 10,000 K-12 schools, and more than1,200 charter schools throughout the state, as well as 72 community college districts, 113 community college campuses, and 70 educational centers. Proposition 98, which was passed by voters as an amendment to the state Constitution in 1988, and revised in 1990 by Proposition 111, was designed to guarantee a minimum level of funding for public schools and community colleges.

The proposed 2016-17 budget includes funding at the Proposition 98 minimum guarantee level of $71.6 billion. The budget proposal also revises the 2015-16 Proposition 98 minimum guarantee to $69.2 billion, an increase of $766 million from the 2015 Budget Act, and revises the 2014-15 Proposition 98 minimum guarantee to $66.7 billion, an increase of $387 million from the 2015 Budget Act. The Governor also proposes to pay $257 million in Proposition 98 settle-up towards meeting the 2009-10 Proposition 98 minimum guarantee. Together, the increased guarantee levels and settle-up payments reflect a total of $4.3 billion in increased funding for education over the three years, as compared to the 2015 Budget Act.

The Governor proposes to use one-time Proposition 98 funds to provide discretionary funding that will also help to reduce the mandate backlog, as well as to fund one-time programs, like the career technical education incentive grant program that was included in the 2015 Budget Act. Most of the ongoing Proposition 98 increase is proposed to be used towards implementing the Local Control Funding Formula (LCFF). The Governor's proposal also includes several other initiatives in the areas of career technical education for community colleges, early education, and special education, among others. These proposals are more fully described later in this section and in separate sections of this report.

Proposition 98 Funding. State funding for K-14 education—primarily K-12 local educational agencies and community colleges—is governed largely by Proposition 98. The measure, as modified by Proposition 111, establishes minimum funding requirements (referred to as the "minimum guarantee") for K-14 education. General Fund resources, consisting largely of personal income taxes, sales and use taxes, and corporation taxes, are combined with the schools' share of local property tax revenues to fund the Proposition 98 minimum guarantee. These funds typically represent about 80 percent of statewide funds that K-12 schools receive. Non-Proposition 98 education funds largely consist of revenues from local parcel taxes, other local taxes and fees, federal funds and proceeds from the state lottery.

The table below summarizes overall Proposition 98 funding for K-12 schools and community colleges since 2007-08, or just prior to the beginning of the steep recent recession. 2012-13 marked a turning point for education funding, and resources have grown each year since then. The economic recession impacted both General Fund resources and property taxes. The amount of property taxes has also been impacted by a large policy change in the past few years—the elimination of redevelopment agencies (RDAs) and the shift of property taxes formerly captured by the RDAs back to school districts. The guarantee was adjusted to account for these additional property taxes, so although LEAs received significantly increased property taxes starting in 2012-13, they received a roughly corresponding reduction in General Fund.

Proposition 98 Funding
Sources and Distributions
(Dollars in Millions)

	Pre-Recession **2007-08**	Low Point **2011-12**	**2012-13**	**2013-14**	Revised **2014-15**	Revised **2015-16**	Proposed **2016-17**
Sources							
General Fund	42,015	33,136	41,682	42,996	49,554	49,992	50,972
Property taxes	14,563	14,132	16,224	15,905	17,136	19,183	20,613
Total	**56,577**	**47,268**	**57,907**	**58,901**	**66,690**	**69,175**	**71,585**
Distribution							
K-12	50,344	41,901	51,719	52,392	59,329	61,096	63,243
CCC	6,112	5,285	6,110	6,431	7,281	7,997	8,259
Other	121	83	78	78	80	82	83

Source: Legislative Analysts' Office and Department of Finance

Calculating the Minimum Guarantee. The Proposition 98 minimum guarantee is determined by comparing the results of three "tests", or formulas, that are based on specific economic and fiscal data. The factors considered in these tests include growth in personal income of state residents, growth in General Fund revenues, changes in student average daily attendance, and a calculated share of the General Fund. When Proposition 98 was first enacted by the voters in 1988, there were two "tests", or formulas, to determine the required funding level. Test 1 calculates a percentage of General Fund revenues based on the pre-Proposition 98 level of General Fund that was provided to education, plus local property taxes. Test 2 calculates the prior year funding level adjusted for growth in student average daily attendance and per capita personal income. K-14 education was guaranteed funding at the higher of these two tests. In 1990, Proposition 111 added a third test, Test 3 which takes the prior year funding level and adjusts it for growth in student average daily attendance and per capita General Fund revenues. The Proposition 98 formula was adjusted to compare Test 2 and Test 3, the lower of which is applicable. This applicable test is then compared to Test 1 and the higher of the tests determines the Proposition 98 guarantee level.

Proposition 98 Tests
Calculating the Level of Education Funding

Test	Calculated Level	Operative Year	Times Used
Test 1	Based on a calculated percent of General Fund revenues (currently around 38.1%).	If it would provide more funding than Test 2 or 3 (whichever is applicable).	4
Test 2	Based on prior year funding, adjusted for changes in per capita personal income and attendance.	If growth in personal income is ≤ growth in General Fund revenues plus 0.5%.	14
Test 3	Based on prior year funding, adjusted for changes in General Fund revenues plus 0.5% and attendance.	If statewide personal income growth > growth in General Fund revenues plus 0.5%.	9

Generally, Test 2 is operative during years when the General Fund is growing quickly and Test 3 is operative when General Fund revenues fall or grow slowly. The Test 1 percentage is historically-based, but is adjusted, or "rebenched", to account for large policy changes that impact local property taxes for education or changes to the mix of programs funded within Proposition 98. In the past few years, rebenching was done to account for property tax changes, such as the dissolution of the RDAs, and program changes, such as removing childcare from the Proposition 98 minimum guarantee and adding mental health services. In the budget year, the Test 1 calculation is adjusted to reflect the end of the "triple flip" and the retirement of the Economic Recovery Bonds and for RDA changes. Proposition 98 tests are based on estimated factors during budget planning; however, the factors are updated over time and can change past guarantee amounts and even which test is applicable in a previous year. Statute specifies that at a certain point the Proposition 98 minimum guarantee for a given year shall be certified and no further changes shall be made.

The Governor's proposal assumes that in 2016-17, the Proposition 98 guarantee is calculated under Test 3, the current year is a Test 2 year, and prior year is a Test 1. A Test 3 is reflective of strong per capita personal income growth in comparison to relatively lower General Fund growth. Generally, the Proposition 98 minimum guarantee calculation was designed in order to provide growth in education funding equivalent to growth in the overall economy, as reflected by changes in personal income (incorporated in Test 2). In a Test 3 year, the Proposition 98 minimum guarantee does not grow as fast as in a Test 2 year, in recognition that the state's General Fund is not reflecting the same strong growth as personal income and the state may not have the resources to fund at a Test 2 level, however a maintenance factor is created as discussed in more detail later. As noted in the table above, in most years the Proposition 98 minimum guarantee has been determined by the application of Test 2.

Suspension of Minimum Guarantee. Proposition 98 includes a provision that allows the Legislature and Governor to suspend the minimum funding requirements and instead provide an alternative level of funding. Such a suspension requires a two-thirds vote of the Legislature and the concurrence of the Governor. To date, the Legislature and Governor have suspended the Proposition 98 minimum guarantee twice—in 2004-05 and 2010-11. While the suspension of Proposition 98 can create General Fund savings during the year in which it is invoked, it also creates obligations in the out-years, as explained below.

Maintenance Factor. When the state suspends the Proposition 98 minimum guarantee or Test 3 is operative (that is, when the Proposition 98 guarantee grows more slowly due to declining or low General Fund growth), the state creates an out-year obligation referred to as the "maintenance factor." When growth in per capita General Fund revenues is higher than growth in per capita personal income (as determined by a specific formula also set forth in the state Constitution), the state is required to make maintenance factor payments, which accelerate growth in K-14 funding, until the determined maintenance factor obligation is fully restored. Outstanding maintenance factor balances are adjusted each year by growth in student average daily attendance and per capita personal income.

The maintenance factor payment is added on to the minimum guarantee calculation using either Test 1 or Test 2.

- In a Test 2 year, the rule of thumb is that roughly 55 percent of additional revenues would be devoted to Proposition 98 to pay off the maintenance factor.

- In a Test 1 year, the amount of additional revenues going to Proposition 98 could approach 100 percent or more. This can occur because the required payment would be a combination of the 55 percent (or more) of new revenues plus the established percentage of the General Fund—roughly 38.4 percent—that is used to determine the minimum guarantee.

Prior to 2012-13, the payment of maintenance factor was made only on top of Test 2, however in 2012-13, the Proposition 98 guarantee was in an unusual situation as the state recovered from the recession, it was a Test 1 year and per capita General Fund revenues were growing significantly faster than per capita personal income. Based on a strict reading of the Constitution, the payment of maintenance factor is not linked to a specific test, but instead is required whenever growth in per capita General Fund revenues is higher than growth in per capita personal income. As a result the state funded a maintenance factor payment on top of Test 1 and this interpretation continues today and results in the potential for up to 100 percent or more of new revenues going to Proposition 98 in a Test 1 year with high per capita General Fund growth, as is the case in 2014-15, when the maintenance factor payment is approximately $5.4 billion.

The Governor's proposal includes maintenance factor payments of $810 million in the 2015-16 year, completely paying off the outstanding maintenance factor balance. However, in 2016-17, the Governor's proposal projects a Test 3 year and the creation of $548 million in maintenance factor owed in future years.

Settle-Up. Every year, the Legislature and Governor estimate the Proposition 98 minimum guarantee before the final economic, fiscal, and attendance factors for the budget year are known. If the estimate included in the budget for a given year is ultimately lower than the final calculation of the minimum guarantee, Proposition 98 requires the state to make a "settle-up" payment, or series of payments, in order to meet the final guarantee for that year. The Governor's budget assumes General Fund settle-up payments of $362 million in 2014-15 and $814 million in 2015-16 (due to increases in the guarantees for those years.) The Governor's budget proposal also includes a settle-up payment of $257 million counting towards the 2009-10 minimum guarantee. After this payment, the state would owe $975 million in settle-up for years prior to 2014-15.

Spike Protection. Proposition 98 also has a built-in formula to prevent large increases in the guarantee, referred to as "spike protection". This constitutional formula specifies that in years when a Test 1 is operative and is greater than the Test 2 amount by 1.5 percent of General Fund revenues, then when calculating the guarantee level in the subsequent year, the excess amount over the 1.5 percent of General Fund revenues is not included in the calculation. This part of the formula has only been in play twice, spikes in revenues in the 2012-13 and 2014-15 years, resulted in spike protection reducing the impact of these revenue gains on the 2013-14 and 2015-16 minimum guarantees, respectively.

Proposition 98 Rainy Day Fund and District Reserve Caps. Proposition 2 passed in the November 4, 2014 general election and requires certain debt payment and reserve deposits in some years. As part of these reserve requirements, a deposit in a Proposition 98 Rainy Day Fund is required under certain circumstances. These conditions are that maintenance factor (accumulated prior to 2014-15) is paid off, that Test 1 is in effect, that the Proposition 98 guarantee is not suspended, and that no maintenance factor is created. Related statute requires that in the year following a deposit into this fund, a cap on local school district reserves would be implemented. Both the Governor and the Legislative Analyst's Office (LAO) continue to project that a Test 1 will not be in effect in their forecast period over the next few years. The conditions needed to trigger Test 1 include significant year-over-year revenue gains that are unlikely given the modest growth projections and potential for a slowing economy in the near future.

Outstanding Obligations. The state currently has paid most of the outstanding obligations to school districts and community colleges that built up over the last recession. However, as of the 2015 Budget Act, the state still has nearly $2.6 billion in unpaid mandate claims. The Governor's proposal for 2016-17 would retire approximately $786 million of these mandate obligations.

<u>Governor's Proposal:</u>

K-14 Proposition 98 Education Overall. The budget estimates that the total Proposition 98 guarantee (K-14) for 2014-15 increased by $387 million, compared to the level estimated in the 2015 Budget Act. Similarly, for 2015-16, the Governor estimates an increase in the total guarantee of $766 million. Both of these adjustments lead to Proposition 98 "settle-up" obligations, which result in additional one-time resources. The Governor proposes to use these additional one-time resources primarily to provide discretionary funding to LEAs, a portion of which would reduce the backlog of mandate claims. The budget estimates a total Proposition 98 funding level of $71.6 billion (K-14). This is a $3.2 billion increase over the 2015-16 Proposition 98 level provided in the 2015 Budget Act.

K-12 Education Proposition 98 Major Spending Proposals. The budget includes a proposed Proposition 98 funding level of approximately $63.2 billion for K-12 programs. This includes a year-to-year increase of more than $2.1 billion in Proposition 98 funding for K-12 education, as compared to the revised Proposition 98 K-12 funding level for 2015-16. Under the Governor's proposal, ongoing K-12 Proposition 98 per pupil expenditures increase from $10,223 provided in 2015-16 to $10,591 in 2016-17. This 2016-17 proposed funding level in Proposition 98 funds for K-12 reflects a per-pupil increase of 3.5 percent, as compared to the revised per-pupil funding level provided for 2015-16. The Governor's major K-12 spending proposals are identified below.

- **K-12 Local Control Funding Formula.** The 2013 Budget Act changed how the state provides funding to school districts and county offices of education by creating the Local Control Funding Formula (LCFF). The budget proposes an increase of approximately $2.8 billion to implement the LCFF. This investment would eliminate about 50 percent of the remaining funding gap between the formula's current year funding level and full implementation for school districts and charter schools. Overall, this investment results in the formula being 95 percent fully funded in 2016-17. County offices of education reached full implementation with the LCFF allocation in the 2014 Budget Act. The accountability system for LCFF is also not yet fully implemented. Implementation of LCFF is more fully discussed in *K-12 Education Reform: Finance, Accountability, and Standards* in this report.

- **Mandate Backlog Reduction.** The budget proposes more than $1.2 billion in discretionary one-time Proposition 98 funding be provided to school districts, charter schools, and county offices of education to offset outstanding mandate debt. The Administration indicates that, while the use of this funding is discretionary, it allows school districts, charter schools, and county offices of education to continue to invest in implementing state adopted academic content standards, upgrade technology, provide professional development, support beginning teacher induction and address deferred maintenance projects.

- **Enrollment and Cost-of-Living Adjustments.** The proposed budget reflects an estimated decrease in student enrollment in the K-12 system. Specifically, it reflects a decrease of $150.1 million in 2015-16, as a result of a decrease in the projected average daily attendance (ADA), as compared to the 2015 Budget Act. For 2016-17, the budget reflects a decrease of $34.1 million to reflect a projected decline in ADA for the budget year. The budget also proposes an increase of $61 million in Proposition 98 funds to reflect an increase in charter school ADA. The proposed budget also provides $22.9 million to support a 0.47 percent cost-of-living adjustment for categorical programs that are not included in the new LCFF. These programs include special education and child nutrition, among others. The proposed funding level for the LCFF includes cost-of-living adjustments for school districts and county offices of education.

- **K-12 School Facilities.** The budget does not include a specific K-12 school facilities proposal, but notes continued concerns with the existing program, including but not limited to, program complexity, costly administrative burdens, inequalities in funding allocation, and lack of alignment with actual local facility needs. The Administration acknowledges that a new program is needed, but states that the $9 billion school bond on the November 2016 ballot fails to make needed changes, while adding significant debt service costs. The Administration proposes to continue the dialogue with the Legislature and stakeholders about the best way to fund school facilities going forward, specifically focused on funding for the highest-need schools and districts, and increased local flexibility.

Other K-12 Education Budget Proposals
Additional proposals contained within the budget related to K-12 education include the following**:**

- **Charter School Startup Grants.** The budget proposes to allocate $20 million in one-time Proposition 98 funds to provide start-up grants for new charter schools. In previous years, new charter schools were eligible for start-up funding through the federal Public Charter Schools Grant program. California was not selected to participate in the latest cohort of this grant program.

- **K-12 High Speed Network**. The budget proposes $8 million Proposition 98 funds ($4.5 million ongoing and $3.5 million one-time) to support the operations of the K-12 High Speed Network. The 2015 Budget Act required the program to use existing reserves to fund operations in 2015-16.

- **Proposition 47.** The budget proposes $7.3 million in Proposition 98 funding to support improved outcomes for students who are truant, at risk of dropping out of school, or are victims of crimes. Proposition 47 reduced penalties for some crimes and required that 25 percent of the resulting savings be invested in K-12 truancy, dropout prevention, victim services, and drug and mental health treatments.

- **Systems of Learning and Behavioral Supports**. The budget proposes to allocate $30 million in one-time Proposition 98 funds to support an effort (beginning in 2015-16 with $10 million in one-time Proposition 98 funds) to help LEAs establish and implement schoolwide systems of academic and behavioral support for students.

- **Proposition 39 Energy Efficiency Investments.** The budget proposes to allocate $419 million in Proposition 39 energy funds available in 2016-17 as follows:

    - $365.4 million to K-12 school districts, for energy efficiency project grants.

    - $45.2 million to community college districts, for energy efficiency project grants.

    - $5.4 million to the California Conservation Corps, to provide technical assistance to school districts.

    - $3 million to the Workforce Investment Board, for continued implementation of job-training programs.

- **Special Education.** The budget proposes a decrease of $15.5 million in Proposition 98 funds to reflect a decrease in special education ADA.

- **Child Care and Development**. The budget provides $3.6 billion total funds ($948 million federal funds; $1.7 billion Proposition 98 General Fund; and $998 million non-Proposition 98 General Fund) for child care and early education programs.

California Community Colleges Proposition 98 Major Spending Proposals.

- **Creates New Workforce Program, Makes Another Permanent.** The budget includes $200 million in new ongoing funding to implement recommendations of the Board of Governors Task Force on Workforce, Job Creation, and a Strong Economy. The new "Strong Workforce Program" would require community colleges to collaborate with education, business, labor, and civic groups to develop regional plans for career technical education (CTE). The regions would be based on existing planning boundaries for the federal Workforce Innovation and Opportunity Act (WIOA).

- **Extends Career Technical Education Pathways Initiative.** The budget also includes $48 million in ongoing funding to support the CTE Pathways Program. Over the last 11 years, this program has supported regional collaboration among schools, community colleges, and local businesses to improve career pathways and linkages. The state had scheduled to sunset the program at the end of 2014–15 but extended it through 2015–16 using one–time funding. The Governor proposes to make the program permanent and align future CTE Pathway funding with the regional plans developed under the Strong Workforce Program. The Pathway program would continue to have separate categorical requirements.

- **Basic Skills Initiative.** The budget proposes $30 million ongoing Proposition 98 General Fund increase for the Basic Skills Initiative, bringing total spending on this program to $50 million, to implement practices that increase student mobility from remedial math and English courses to college-level courses. Trailer bill language repeals the previous categorical program and ties increased funding to the use of evidence-based practices and improved outcomes in transitioning students from basic skills courses to college-level work.

Other Community College Budget Proposals

- **Apportionments.** The budget provides $115 million Proposition 98 General Fund for two percent enrollment growth and $29 million for a 0.47 percent cost-of-living adjustment (COLA).

- **Institutional Effectiveness Initiative.** The budget proposes $10 million ongoing Proposition 98 General Fund for the Institutional Effectiveness Initiative, bringing total funding to $27.5 million. This includes $8 million for workshops and training and $2 million for technical assistance to local community colleges and districts.

- **Zero-Textbook-Cost Degrees.** The budget provides $5 million ongoing Proposition 98 General Fund for campuses to develop “zero-textbook-cost” degree and certificate programs using open educational resources. Colleges would be eligible for up to $500,000 per degree program.

- **Telecommunications and Technology Infrastructure Program.** The budget proposes $3 million ongoing Proposition 98 General Fund to improve systemwide data security.

- **Cost-of-Living Adjustments for Categorical Program.** The budget provides $1.3 million Proposition 98 General Fund for a 0.47 percent COLA for Extended Opportunity Programs and Services, Disabled Student Programs and Services, and the CalWORKs Program. The Administration also provides $1.8 million Proposition 98 to raise the apprenticeship funding rate to the highest noncredit rate.

- **Deferred Maintenance.** The budget proposes $289 million one-time Proposition 98 increase for deferred maintenance, instructional equipment, and specified water conservation projects. Community colleges will not need to provide matching funds for deferred maintenance in 2016-17. This is one-time funding, although $255 million is from ongoing sources.

- **Mandate Debts.** The budget provides $76.3 million one-time Proposition 98 General Fund increase to pay-down outstanding mandate claims. These payments will further reduce outstanding mandate claims and open up one-time resources to address various one-time needs, such as campus security, technology and professional development.

- **Innovation Awards.** The budget proposes $25 million Proposition 98 General Fund for innovation awards focusing on technology, transfer pathways and successful transition from higher education to the workforce. This award would only be available to community colleges seeking to implement programs that allow students to simultaneously earn high school diplomas and industry credentials or transfer degrees, develop online basic skills or zero-textbook-cost degree programs. Similar to previous innovation awards, colleges would submit proposals f, and a committee chaired by the Department of Finance would select awardees. Each awardee would receive at least $4 million.

<u>**LAO Analysis and Recommendations**</u>

The LAO recently released “The 2016-17 Budget: Proposition 98 Education Analysis” which includes detailed information on the calculation of the Proposition 98 Guarantee and programs provided with Proposition 98 funding. The LAO’s analyses of specific Proposition 98 funded programs will be discussed in detail when the subcommittee hears the related program area.

In general, the LAO and the Administration are in agreement about the calculation of the Proposition 98 guarantee and the related state revenue estimates. Both the Administration and the LAO will continue to monitor economic trends and update estimates at the May Revision. The LAO notes that over the three-year period, changes in revenues could impact different years very differently:

- The 2014-15 guarantee calculation is highly sensitive to changes in revenue, such that an increase or decrease in the state’s General Fund revenue would result in approximately a dollar for dollar change in the guarantee. However spike protection would prevent any increase in the guarantee from impacting the 2015-16 guarantee.

- The 2015-16 guarantee calculation is relatively insensitive to changes in state revenues. The LAO estimates that the state’s General Fund revenues in 2015-16 could increase by as much as $7 billion or decrease by up to $1.3 billion with no impact to the guarantee.

- The 2016-17 guarantee calculation is moderately sensitive to revenue changes. Similar to historical “normal” guarantee calculation years, for each additional dollar of General Fund revenue the guarantee would increase by approximately 50 cents.

The LAO does differ with the Administration in the calculation of local property tax revenues. The LAO estimates that the Administration is under estimating local property taxes by $1.1 billion ($520 million in 2015-16 and $620 million in 2016-17), primarily due to differences in the way the Administration estimates redevelopment-related ongoing revenue and assessed property values. The LAOs property tax estimates would result in no change to the overall Proposition 98 guarantee level, but would offset the amount General Fund under the formula, freeing up a like amount of General Fund for other non-Proposition 98 uses.

Subcommittee Questions

1. Are the Department of Finance and the LAO working together to identify and resolve differences in the calculation of local property taxes?

2. What rate of growth are LAO and the Department of Finance estimating for the Proposition 98 guarantee in the out years (2017-18 and later)? How does this impact the ability of the state to meet Proposition 98 funding obligations?

Staff Recommendation

No action, this issue is information only and the Proposition 98 guarantee calculation will be updated at the May Revision.

6110 DEPARTMENT OF EDUCATION

Issue 2: Local Control Funding Formula

Panel:

- Aaron Heredia, Department of Finance
- Ryan Anderson, Legislative Analyst's Office
- Debra Brown, California Department of Education

Background:

K-12 School Finance Reform. As of the 2015 Budget Act, the state appropriates more than $60 billion in Proposition 98 funding (General Fund and local property taxes) annually for K-12 public schools. In 2013-14, the state significantly reformed the system for allocating funding to school districts, charter schools, and county offices of education. The LCFF replaced the state's prior system of distributing funds to local education agencies (LEAs) through revenue limit apportionments (based on per student average daily attendance) and approximately 50 state categorical education programs.

Under the old system, revenue limits provided LEAs with discretionary (unrestricted) funding for general education purposes, and categorical program (restricted) funding was provided for specialized purposes, with each program having a unique allocation methodology, spending restrictions, and reporting requirements. Revenue limits made up about two-thirds of state funding for schools, while categorical program funding made up the remaining one-third portion. For some time, that system was criticized as being too state-driven, bureaucratic, complex, inequitable, and based on outdated allocation methods that did not reflect current student needs.

Local Control Funding Formula. The LCFF combines the prior funding from revenue limits and more than 30 categorical programs that were eliminated, and uses new methods to allocate these resources and future allocations to school districts, charter schools, and county offices of education, allowing LEAs much greater flexibility in how they spend the funds than under the prior system. There is a single funding formula for school districts and charter schools, and a separate funding formula for county offices of education that has some similarities to the district formula, but also some key differences.

School Districts and Charter Schools Formula. This formula is designed to provide districts and charter schools with the bulk of their resources in unrestricted funding to support the basic educational program for all students. It also includes additional funding, based on the enrollment of low-income students, English learners, and foster youth, provided for increasing or improving services to these high-needs students. Low-income students, English learners, and foster youth students are referred to as "unduplicated" students in reference to the LCFF because for the purpose of providing supplemental and concentration grant funding, these students are counted once, regardless of if they fit into more than one of the three identified high-need categories. Major components of the formula are briefly described below.

- **Base Grants** are calculated on a per-student basis (measured by student average daily attendance) according to grade span (K-3, 4-6, 7-8, and 9-12) with adjustments that increase the base rates for grades K-3 (10.4 percent of base rate) and grades 9-12 (2.6 percent of base rate). The adjustment for grades K-3 is associated with a requirement to reduce class sizes in those grades to no more than 24 students by 2020-21, unless other agreements are collectively bargained at the local level. The adjustment for grades 9-12 recognizes the additional cost of providing career technical education in high schools.

- **Supplemental Grants** provide an additional 20 percent in base grant funding for the percentage of enrollment that is made up of unduplicated students.

- **Concentration Grants** provide an additional 50 percent above base grant funding for the percentage of unduplicated students that exceed 55 percent of total enrollment.

- **Categorical Program** add-ons for Targeted Instructional Improvement Block Grant and Home-to-School Transportation provide districts the same amount of funding they received for these two programs in 2012-13. The transportation funds must be used for transportation purposes. Charter schools are not eligible for these add-ons.

- **LCFF Economic Recovery Target** add-on is provided to districts and charter schools if their undeficited per-ADA funding under the old funding model (adjusted to projected 2020-21 levels) is at or below the 90^{th} percentile and the district or charter school would have been better off under the old funding model rather than the LCFF model. ERT payments are frozen based upon the calculations made by the California Department of Education in 2013-.

- **Hold Harmless Provision** ensures that no school district or charter school will receive less state aid funding under the LCFF than its 2012-13 funding level under the old system.

County Offices of Education Formula. The County Offices of Education (COE) formula is very similar to the school district formula, in terms of providing base grants, plus supplemental and concentration grants for the students that COEs serve directly, generally in an alternative school setting. However, COEs also receive an operational grant that is calculated based on the number of districts within the COE and the number of students county-wide. This operational grant reflects the additional responsibilities COEs have for support and oversight of the districts and students in their county.

Excess Taxes and Basic Aid Districts. Most school districts receive a mix of local property taxes and Proposition 98 General Fund to meet their LCFF funding level. Under LCFF and under the prior revenue limit system, some county offices and school districts received local property tax revenue that exceeded the revenue limit and now exceeds their LCFF targets (or LCFF transition funding). Districts, consistent with pre LCFF policy, retain local property taxes above their LCFF funding level and can use them for any educational purpose. These school districts are referred to as “basic aid”. County offices, also consistent with pre-LCFF policy, do not keep their excess taxes. Prior to LCFF this funding rolled over to the following year and under LCFF it is swept and used for other purposes within the county.

During the recent recession, the state reduced revenue limit funding for all districts and also cut categorical funding for basic aid districts. This categorical funding policy was called a “fair share” reduction in that non-basic aid districts were impacted through cuts to their revenue limit funding due to the recession, but basic aid districts were not impacted by revenue limit cuts because they already received no state funding for revenue limits and therefore would share the burden of reduced funding through categorical cuts. While most basic aid districts have long histories of being considered basic aid, there are some that were cut into basic aid status when the state made these reductions to revenue limit and categorical funding.

In calculating the LCFF funding provided to districts each year, pursuant to statute, the Department of Education calculates the LCFF floor, the total of the district’s 2012-13 revenue limit and categorical funding. The LCFF floor of some districts included the reduced categorical funding, in additional to the reduced revenue limits that all district LCFF floor calculations were based on. For basic aid districts that were on the border of being basic aid and were “cut” into this status during recession, this lower floor means that these districts receive less in total LCFF funding during the transition to full implementation than they would have absent the inclusion of the categorical reductions when calculating their LCFF floor.

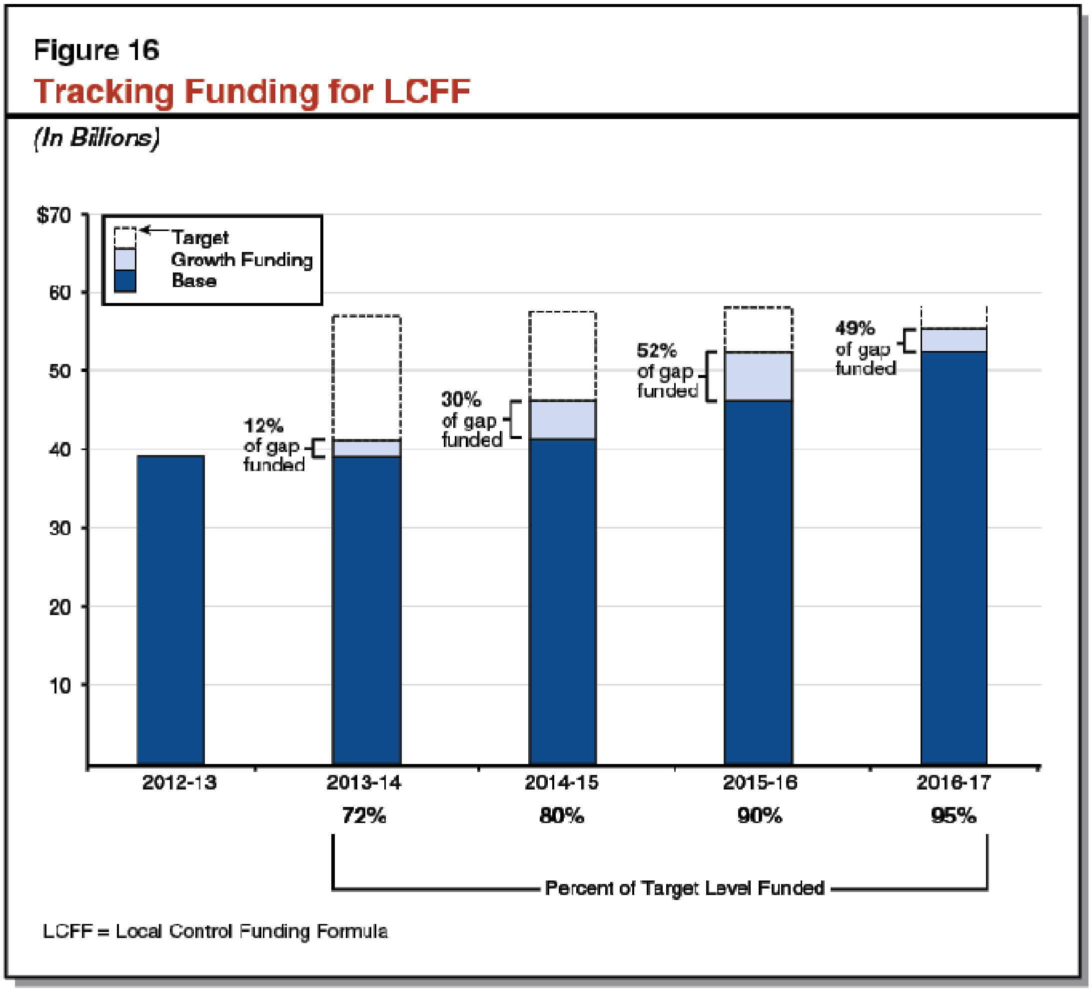
Budget Appropriations. The LCFF establishes new “target” LCFF funding amounts for each LEA, and these amounts are adjusted annually for COLAs and pupil counts. When the formula was initially introduces, funding all school districts and charter schools at their target levels was expected to take eight years and cost an additional $18 billion, with completion by 2020-21. The Department of Finance (DOF) has not released an updated estimate of the completion date at this point. County offices of education reached their target funding levels in 2014-15 and adjust each year for COLAs and ADA growth.

Over the past three years, the state has made considerable investments towards implementing the LCFF, as shown in the tables below. The 2015-16 funding closed almost 52 percent of the remaining gap to full funding of the LCFF target levels for school districts and charter schools, The remaining gap is recalculated annually based on funding provided but also on annual adjustments to the LCFF funding targets. The proposed 2016-17 funding would close 50 percent of the remaining gap. Overall, the LCFF is about 90 percent fully funded as of the 2015 Budget Act and the proposed additional investment would bring that up to 95 percent.

Amounts Provided in the Annual Budget to fund increased costs for LCFF
(Dollars in Billions)

Fiscal Year	Original Estimated Need to Fully Fund LCFF	Gap Appropriation	Remaining Need to Fully Fund LCFF
2013-14	$18.0	$2.1	$15.8
2014-15	N/A	$4.7	$11.3
2015-16	N/A	$6.0	$5.3 (estimated)

Figures may not sum due to changes between years for growth and cost of living adjustments.
Source: California Department of Education



Source: Legislative Analyst's Office

The significant ongoing allocations of funding for the LCFF was made possible by considerable growth in the Proposition 98 guarantee over the past few years. A strong economic recovery has accelerated growth in the Proposition 98 guarantee, including funding to make up for years of low growth beginning in 2008-09.

Governor's Proposal:

The budget provides an increase of $2.8 billion in Proposition 98 funding for schools for the fourth year of LCFF implementation. The DOF indicates this funding level represents closing approximately 50 percent of the gap between the school districts' 2015-16 funding levels and the LCFF full implementation target rates as of the budget year. Under the budget, the LCFF would be 95 percent funded in 2016-17. County offices of education, which reached full implementation in 2014-15, would receive a cost-of-living increase.

LAO Analysis and Recommendations

The LAO supports the Governor's budget proposal to provide additional ongoing funding towards implementation of the LCFF. They note that the use of funding to move towards full implementation is consistent with the priorities of the Legislature and the Governor over the past few years, and under the adoption of the LCFF.

The LAO has identified a concern that the county office of education LCFF formula results in significant funding advantages for some county offices of education that are above their LCFF targets. Under the LCFF, county offices of education have two hold harmless provisions (these also apply to school districts). County offices of education will receive at least as much funding as they received from revenue limits and categorical programs in 2012-13, and at least as much Proposition 98 General Fund as they received in 2012-13 for categorical programs, called "minimum state aid." County offices of education historically have varied widely in their amount of Proposition 98 funding and the LAO notes that county offices of education that receive the minimum state aid amount on top of their LCFF allocation (due to strong property tax growth or in county offices that were already funded at high levels prior to LCFF) further widens the variance among funding levels between county offices of education.

The LAO recommends repealing the minimum state aid allocation for county offices of education while still holding the county offices of education harmless to their 2012-13 funding level. The LAO estimates that eliminating the minimum state aid allocation would reduce the amount of Proposition 98 resources being provided to county offices of education in 2016-17 by $75 million (contrasts with the Administration's estimate of $35 million) and make those resources available for other Proposition 98 priorities.

Staff Comments

LEAs have seen large investments in ongoing funding for the LCFF as the state's economy recovers from the last recession. This trend continues with the 2016-17 Governor's budget proposal, however both the LAO and the Department of Finance show the pace of economic growth slowing in future years. The Legislature may wish to continue to monitor investments in the LCFF to ensure LEAs reach meet their LCFF targets. Funding for any new ongoing programs within the Proposition 98 guarantee over the next few years should be considered within the context of meeting LCFF funding obligations.

Changing to a new funding formula was a complex process, involving considerable workload on the part of the Administration and the Legislature to develop and enact authorizing statute and of the CDE fiscal staff, to overhaul their systems for the calculation and apportionment of funding. While simple in concept, the implementation of LCFF continues to reveal complexities in implementation, as in the case of some districts and county offices of education funding. The Legislature should continue to monitor implementation and engage in discussions with the Administration and stakeholders on potential improvements.

Subcommittee Questions

1. Does the Department of Finance or the LAO have an updated projection on whether the state will reach full implementation of LCFF by 2020-21? If not, when will that be available?

2. If there are additional Proposition 98 funds available at the May Revision, does the Department of Finance anticipate proposing to increase the amount of ongoing funds committed to fully funding the LCFF?

3. Is the Department of Finance considering any changes to the funding formula for districts or county offices of education?

Staff Recommendation

Hold open pending May Revision funding projections.

6110 DEPARTMENT OF EDUCATION

Issue 3: Federal Every Student Succeeds Act Update (Information Only)

Panel:

- Edgar Cabral, Legislative Analyst's Office
- Debra Brown, California Department of Education

Background

On December 10th, 2015, the federal Elementary and Secondary Education Act (ESEA) was reauthorized with the passage of the Every Student Succeeds Act (ESSA). This replaces a prior version of the law, passed in 2002, known as No Child Left Behind (NCLB). The ESEA was originally passed in 1965 by the Lyndon B. Johnson administration, with a primary goal of supporting low-income students. Under ESEA, states are eligible for both formula and competitive grants, with the largest being Title I formula grants that states receive on the basis of the number of low-income students. In general, the new ESSA law is very similar to NCLB, but with some key differences in as noted below.

Title I. Title I provides funding to support the academic achievement of low income students. Under ESSA, as under NCLB, states receive funding based on the number of low-income students, most of which goes out on a formula basis to local educational agencies (LEAs). Of the total grant, states may use up to 1 percent for state administration. For the 2016-17 year, California anticipates receiving $1.8 billion in Title I funds.

Federal accountability is also included in Title I. Under ESSA, of the total Title I grant amount, states must set aside 7 percent for school improvement interventions and technical assistance. The majority of these funds must be used to provide 4 year grants to LEAs. States may also set aside 3 percent of the total Title I allocation for direct services to students. Additionally, under Title I states are required to adopt challenging academic standards (federal approval is not required) and implement standards-aligned assessments in specified grade spans and subject areas (the same as under NCLB).

States must develop accountability systems that rate schools using academic achievement, growth rates (K-18), graduation rates (high school), English learner progress in language proficiency, and other factors determined by the state. Academic growth must have the greatest weight. Title I requires identification of and intervention in the lowest performing five percent of schools, high schools with graduation rates lower than 2/3 and schools in which any subgroup is in the lowest performing five percent and has not improved over time.

Title II. Title II provides funding to increase the quality of teachers and principals. The changes to Title II under ESSA include formula adjustments to weight poverty more heavily than population than the current program. Under ESSA, Title II also prohibits the Secretary of Education from requiring or controlling teacher evaluations, definitions of effectiveness, standards, certifications, and licensing requirements. Under NCLB, Title II funding for California is approximately $250 million.

Title III. Title III provides funding specifically for the education of English learner students. Under ESSA, Title III includes reporting on English learners; numbers, percentages, attainment of proficiency, and long term academic performance. Under NCLB, Title III included accountability provisions called annual measurable achievement objectives. Under the ESSA reauthorization, accountability for English Learners is included in the new accountability system under Title I. Under NCLB, Title III funding for California is almost $145 million.

Other Changes. There are some changes to other Title programs under ESSA. Title IV includes a new grant program that provides funds for supporting students in a variety of ways (e.g. enrichment activities, school climate, health and safety, technology access. There are new competitive preschool grants administered jointly by ED and the Health and Human Services departments. Additionally, the granting of waivers has changed, LEAs must first submit waiver requests to the State Educational Agency (in California this is the SBE) who must forward eligible waivers to the federal Department of Education.

ESSA Implementation Timeline. Different components of the ESSA have different timelines. However, the Legislature can expect that ESSA funding changes will impact the state's budget process for the 2017-18 fiscal year. Other timelines related to ESSA are as follows:

- Waivers provided under the old ESEA end August 1, 2016

- New ESSA for competitive grants effective October 1, 2016

- New ESSA for formula grants effective July 1, 2016. However, additional federal statute, notwithstands this timeline and provides that formula grants authorized under ESEA for the 2016-17 school year shall be administered in accordance with the prior ESEA, meaning that formula grant changes will not take effect until the 2017-18 school year.

- New ESSA for accountability will take effect in 2017-18.

- Generally, programs may finish out existing grant funds and requirements before transitioning to new ESSA requirements.

A regulations process at the federal level will be underway this year, and will result in additional information and formal guidance for states in implementing the ESSA.

ESSA State Plan. The ESSA State Plan is a comprehensive plan that includes all of the federal requirements as reflected in Titles I through IX. A stakeholder process to contribute to the ESSA State Plan will be provided through the California Practitioners Advisory Group (CPAG). The SBE solicited applications for the constituted advisory committee to provide input to the SBE federal Title I requirements and efforts to establish a single coherent local, state, and federal accountability and continuous improvement system. CPAG Meetings will be open to the public. The following table describes the timeline shared by CDE and the SBE for completing the ESSA state plan.

Proposed Development of ESSA State Plan

February 2016	Announced application for the California Practitioners Advisory Group (CPAG)
March 2016	The State Board of Education Screening Committee recommendations for

	appointments to the CPAG. The CDE submits an assurance letter to Federal Department of Education (ED) concerning its transition plan for supplemental educational services (SES) and public school choice in the 2016-17 school year.
April 2016	Proposed orientation and first meeting for CPAG.
May 2016	The CDE posts the one-year transition plan for SES and public school choice for the 2016-17 school year. CDE solicits input from stakeholders on select components of the ESSA State Plan.
June 2016	Early June- CPAG Meeting Proposed SBE Information Memorandum on draft concepts of the ESSA State Plan.
July 2016	CDE drafts ESSA State Plan to conform to rules and regulations. Propose concepts for integrating federal requirements with state accountability.
September 2016	**CDE presents early draft of ESSA State Plan based on stakeholder input.**
October 2016	Proposed CPAG meeting.
November 2016	**Draft ESSA State Plan for SBE Review.**
December 2016	Proposed CPAG meeting.
January 2017	CDE revises ESSA State Plan based on stakeholder feedback and submits to SBE for approval at January meeting. CDE then submits approved ESSA State Plan to ED; ED has up to 120 days to review ESSA State Plan.
June 2017 (or earlier)	Accepted ESSA State Plan is published.
July 2017	**New Accountability System begins August 2017.** The ESSA State Plan takes effect 2017-18 and implements process to identify schools for assistance.
2018-19	**The new interventions under ESSA are implemented.**

Source: State Board of Education and California Department of Education

Staff Recommendation: No action. This item is informational only.