The FISCAL REPORT an informational update

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What Should We Plan For in 2011-12?

There have been many questions raised regarding prudent planning for 2011-12, given the options proposed in the Governor's Budget Proposal released January 10, 2011. After the enactment of the current-year Budget on October 8, 2010, 100 days late, we advised districts not to spend the average 5.17% increase contained in that Budget. Our reasoning was that the 5.17% restoration of previously proposed cuts did not represent economic realities, but more the political realities of an election less than a month away.

Our view at that time was that the very best we could hope for in January 2011 was a Budget Proposal that kept the current and subsequent year flat. We opined that we could definitely see the risk that there would be cuts at the state level in one or both of the years and that they could further affect public education.

The Governor's Plan

Governor Jerry Brown, immediately after the November election, held sessions around the state to discuss the depth of the Budget problem. After concluding that the gap was more than $25 billion, the Governor highlighted from the start that education had taken more than its proportional share of past cuts. He continued that theme in his Budget Proposal and proclaimed that education would be flat funded if the Legislature and the voters supported continuation of certain existing temporary taxes for an additional five years. The Governor's flat funding proposal would maintain education spending at about the 2010-11 level, but an additional cash deferral of $2.1 billion would be created.

The Governor went on to say that the expiration of the taxes, set to expire this year, would have the effect of lowering the Proposition 98 minimum guarantee for K-14 education by $2.3 billion. School Services of California, Inc. (SSC) and the Legislative Analyst's Office (LAO) agree that absent a change in economic conditions, that number is about right.

The Governor has a heavy burden in attempting to extend the temporary taxes. First, he has proposed a June ballot measure which would require the Legislature to authorize placing the measure on the ballot roughly by March 10. We say roughly because no election date has been formally selected, but we think it would usually be June 7. In order to place the measure on the ballot, the Legislature must act with a two-thirds majority in each house. That means the measure would require at least two Republican votes in each house if every single Democrat votes for the measure. Once on the ballot, the measure would be enacted by a majority vote of the electorate.

At this point the Governor has, therefore, left us with two initial impressions: flat funding with the tax extensions, and a drop in Proposition 98 funding if the extensions are not granted.

The Additional Cash Deferral

Do we regard the latest deferral any different than in the past? No, we do not.

Since the first K-12 deferral from 2001-02 to 2002-03, we have voiced our concern that the deferral path was likely to be problematic in the future. This first deferral was proposed to be $1 billion for one week—the last week in June to the first week in July. But that deferral put us on a slippery slope that has now resulted in a deferral of more than $7 billion for 2010-11 and nearly $10 billion proposed for 2011-12.

But we see this deferral as we have seen past deferrals in terms of certainty of collection. The state has language in statute to pay the cash deferrals in the following year and has done so in every year since 2002-03. Financial institutions have recognized the collectability of the deferrals and have been willing to loan cash to districts based upon the deferred amounts. So, while we have technical and professional objections to the deferrals, they are not a cut to your local spending authority.

In essence, California law now provides two separate funding statutes for schools. The first is the level of budget or spending authority provided on an average daily attendance (ADA) basis. The second is the timing of the cash flow to the district. Prior to 2001-02, the statutory funding level and the cash flow to the districts reflected the same amount and occurred in the same fiscal year. But since that time, districts build their budgets based on spending authority then build a cash budget to include any borrowing required to cover the cash delays from the state.

Although the amount has grown, for the stated reasons, we do not advise districts to treat the new cash deferral differently from the old ones.

The Math

When we do the math, we find that flat funding means different things to different people. Most of us would consider flat funding to be the same amount of funding per student from one year to the next. But the Department of Finance (DOF) might consider it to be the same commitment to Proposition 98 at the macro level, ignoring enrollment and other changes. In any event, the deficit factor adopted by the DOF results in, on average, a loss of about $19 per unit of ADA.

The math for expiration of the taxes is fairly simple. Of the estimated $8.8 billion in temporary taxes, only about $5 billion are credited against Proposition 98. We agree that in this Test 1 year that means about $2.3 billion of the loss is attributable automatically to a reduction in the minimum guarantee for K-14 education. After deducting the community college share, we estimate that absent other changes, the K-12 share is about $330 per ADA, in addition to the $19 identified above.

So, if the economic forecast doesn't change, and the taxes fail, and the Legislature and the Governor reduce Proposition 98 by $2.3 billion, the effect on K-12 education would be about $349 per ADA. But that is a lot of "ifs."

What Else Could Happen?

Remembering that under the Governor's Proposal, the extension of taxes account for only approximately half of the solution and that $12.5 billion in cuts are proposed for the noneducation side of the Budget, we see quite a number of alternative scenarios that could emerge.

First, former Governor Arnold Schwarzenegger once proposed a Budget that was contingent on election results. He offered one plan if the taxes passed and another if they failed. Sound familiar? The taxes failed, and Governor Schwarzenegger abandoned both plans and came up with a new one. That could happen again.

Also, in 2009-10, the Budget gap was a heart-stopping $60 billion, but the state solved only about $9 billion on a permanent basis and let the rest ride. Not a great solution—and one that has made the situation worse—but one that could be repeated.

Another scenario is that the economy gets better or worse, and the Proposition 98 minimum guarantee is affected accordingly, which has happened before. A variation that has also occurred is that the Governor decides that whatever conditions exist, warrant a suspension of Proposition 98 and a bigger cut to education; this has also occurred in recent years.

There is the matter of the deferrals. Some may worry that, for the first time, the state would renege on its statutory provision to fund the deferrals. While, unlike the items above, this has never happened, we would not stand between the wolves and the last ounce of meat. However unlikely, it is yet another factor for concern.

Finally, in every instance where we have been cut, we have been given at least some measure of relief. And just this weekend, State Treasurer Bill Lockyer opened the door to proposing an even shorter school year if education funding is reduced further.

So What Do We Plan For?

First, your County Superintendent is your primary source of direction; only the County Superintendent can give you binding direction in the area of financial management and planning. SSC and the Fiscal Crisis and Management Assistance Team (FCMAT) work with the county offices through California County Superintendents Educational Services Association (CCSESA) in order to stay on the same page, but in the end, you must follow the direction given by the County Superintendent.

Having said that, our goal is to inform the discussion in order to help the County Superintendents decide what is appropriate. There will be an abundance of recommendations, some well reasoned and some that simply assume that the highest cut number possible is the appropriate number. And what is the highest cut number possible? Well, the state could take it all. And the lowest number? The state could take nothing or even provide additional funding. So, we don't work in the world of absolutes; rather we assess possibilities, and we don't see either extreme as likely.

What we do know is that under current law the taxes expire. So unless and until they are extended, we think you have to plan on a Budget that takes those taxes away. That means that your minimum planned reduction from the 2010-11 funding level should be about $349 per ADA. That is on top of declining enrollment, deficit spending, loss of the federal funds, and any other conditions unique to your district. If a loss of $349 is the minimum, your reduction may well be higher because of factors outside the State Budget plan.

We do not recommend that you increase the amount of your budget reduction to accommodate the state reneging on payment of the cash deferrals or on a suspension of Proposition 98. Neither of these options has been proposed, and at this point, we think they are purely speculative.

We also recommend that you include in your planning the two-year extension of flexibility measures proposed by the Governor. We think those will pass regardless of what happens to the funding level. In addition, unless directed otherwise by your County Superintendent, we strongly urge you to use the planning factors in the SSC Dartboard in your multiyear projections. Click here to access the 2011-12 SSC Governor's Budget Proposal Financial Projection Dartboard.

Checkpoints

We know that nearly every number you work with is likely to change, some multiple times, before this Budget is put to bed. At this point, we offer our recommendations as planning factors.

But we will reassess when we see if the tax measures are to be put before the voters, and during the May Revision, and after the special election—if there is one. Be prepared to adjust.

It would not have taken an article of this length simply to tell you only what we think you should plan for. We have put forth this detail because we think it is far more important for you to understand how we think about these topics than what we actually recommend. We hope we have illuminated the topic sufficiently for you to map your own path to the next checkpoint.

—***Ron Bennett***

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