

# FISCAL REPORT

PUBLIC EDUCATION'S POINT OF REFERENCE FOR MAKING EDUCATED DECISIONS

## An Overview of the 2020–21 Governor's May Revision

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### Preface

The announcement of the May Revision to the 2020–21 State Budget today was a sobering event. Governor Gavin Newsom laid out in vivid detail how local educational agencies (LEAs) would see the COVID-19 recession translate into their budgets and programs. While not as drastic in any given area as the previewed 22% cut to Proposition 98 overall, LEAs are facing cuts to the Local Control Funding Formula (LCFF) and the few remaining categorical program funds, cash deferrals, and little flexibility to weather the storm.

But there were a few silver linings: Governor Newsom is once again providing help outside of Proposition 98 with funds to lessen retirement system employer costs and by spending discretionary federal funds on the students most affected by the pandemic. He also laid out that certain cuts could be lessened if additional funds are received from the federal government and shared the intention to boost Proposition 98 funding above the minimum guarantee once the state has recovered. And he remains committed to increasing equity in special education base funding, though having to leave behind many aspects of his January State Budget proposal, when the state was booming and its surplus growing.

What follows is our understanding of the Governor's economic projections and proposals for the 2020–21 State Budget laid out today and how those specific actions, if adopted by the Legislature, would affect your district.

### Overview of the Governor's Budget Proposals

With the early release of the Department of Finance's revised revenue projections going into 2020–21, coupled with the Legislative Analyst's Office *California's Spring Fiscal Outlook*, our instinctual concerns about the economic effects of the global health crisis began to crystalize. Governor Newsom's May Revision—which marks the start of the final stretch of State Budget negotiations culminating in an adopted State Budget by June 15—symbolizes the somber realities of these times despite all efforts not to succumb to it. Our collective concerns were tempered by

the fact that before the state was crippled by the coronavirus, we were enjoying the prosperity of a sound and healthy economy and prudent State Budget choices, like stashing away over \$16 billion in our state's savings account and maintaining a healthy wad of cash in the state's wallet. Through the Spartan leadership of former Governor Jerry Brown, California not only survived the Great Recession and tore down its historic Wall of Debt—the albatross of the mid-2000s—we managed to reach a level of economic prosperity reminiscent of the times of our parents' youth.

This May Revision turns a sharp corner for California, particularly for public education. Constrained by the fact that California doesn't have a printing press, Governor Newsom's revised State Budget proposes a multiyear effort to address the state's budget shortfall through a combination of efforts. This includes drawing down reserves from the State Budget Stabilization Account over the next three years but uses all of the funds in the public education's Rainy Day Fund immediately, canceling planned program expansions and new programs that were proposed in the January Budget proposal, making programmatic reductions across almost all government programs, and deferring payments such as K–12 and community college apportionments.

### **The Economy and Revenues**

As all of us sat sheltered-in-place for the last two months, wondering when we might be able to resume our pre-COVID-19 lives, we knew that this virus was attacking our economy as well as the health of too many victims. In fact, before this crisis, the state had been enjoying the longest economic expansion in history and anticipated a State Budget surplus of nearly \$6 billion going into 2020–21. Unemployment had reached historic lows both across the nation and in the state, and the average Californian's income increased by 25% since the Great Recession.

Now, economists expect the national gross domestic product to decline between 26% to 40% in the second quarter of this year, and California anticipates losing over 22% of revenues that we expected at the time the Governor released his relatively joyous January Budget proposal—mostly from the “big three” taxes of personal income, sales and use, and corporation tax. By his estimation, the “big three” taxes will be down from January estimates by:

- 27.2% for the Sales and Use Tax
- 25.5% for the Personal Income Tax
- 22.7% for the Corporation Tax

These revenues make up the lion's share of the revenue the state relies on to fund most of its major programs, including education and child care. The May Revision proposal assumes that the state faces a \$54 billion State Budget deficit as it heads into the fiscal year 2020–21. According to the Governor's May Revision, this estimate includes a \$41 billion loss in state revenue compounded by the added costs of increases in the number of Californians participating in state-subsidized programs. No one knows the path that the COVID-19 recession will take, and if the federal government will provide any additional relief beyond the Coronavirus Aid, Relief, and Economic Security (CARES) Act. Federal action could help to mitigate this devastating hit to the national and state economy and the real losses that Americans and Californians feel as a result.

### **Rainy Day Fund**

Over the last several years, the state has been making consistent deposits into the Budget Stabilization Account (Rainy Day Fund), which currently stands at \$16.2 billion. In order to meet the constitutional requirement to balance the budget, the May Revision proposes to draw down the entirety of the state's Rainy Day Fund over three years, including nearly half (\$7.8 billion) of the current balance in fiscal year 2020–21. The reason that the state cannot use the entire \$16.2 billion in the 2020–21 State Budget year is because Proposition 2 (2014), which created the Rainy Day Fund, stipulates that a withdrawal may not exceed half of the Rainy Day Fund balance in the first year of a budget emergency.

## **Proposition 98**

Adopted by state voters in 1988, Proposition 98 sets in the State Constitution a series of complex formulas that establish the minimum funding level for K–12 education and community colleges from one year to the next. This target level is determined by prior-year appropriations that count toward the guarantee and (1) workload changes as measured by the change in average daily attendance (ADA), and (2) inflation adjustments as measured by the change in either per capita personal income or per capita state General Fund revenues, whichever is less.

The Governor's January Budget provided some year-over-year increases, but COVID-19 has erased any such gains. The May Revision proposal provides a much more sobering picture for the Proposition 98 guarantee over the three budget years (2018–19, 2019–20, and 2020–21), due to a precipitous drop in General Fund revenues as a result of the economic crisis currently being experienced across the nation, yet felt more keenly in California given the breadth and size of our economy.

The Governor's May Revision estimates that the minimum guarantee will decline approximately 23% from the 2019 State Budget Act over the three-year budget period. However, the May Revision is also proposing supplemental appropriations above the constitutionally required Proposition 98 funding level—from non-Proposition 98 funds—beginning in 2021–22 and going through 2023–24. The proposal provides for an allocation 1.5% of General Fund revenues per year up to a cumulative total of \$13 billion. While this will help accelerate the growth in the minimum guarantee in the long-term and increase the share of General Fund revenues to Proposition 98 in a Test 1 year from 38% to 40%, it does not blunt the cuts in the short-term.

In addition to other mitigation measures, the May Revision proposal also reflects the withdrawal of all of the funding in the Public School System Stabilization Account, which was projected to be approximately \$524 million in 2019–20 at the Governor's January Budget. This will help offset the decline in the minimum guarantee though it only reflects 3.5% of the total \$15.1 billion loss, so its effect is minimal.

### **Current- and Prior-Year Minimum Guarantee**

Proposition 98 funding levels have decreased from the Governor's January Budget for both 2018–19 and 2019–20. This is a reversal from January, where the funding levels for both 2018–19 and 2019–20 had increased from the 2019 State Budget Act due largely to an increase in property tax and General Fund revenues.

For the current year, the May Revision proposal adjusts the Proposition 98 guarantee down by \$4.2 billion from the Governor’s January Budget for an estimated \$77.4 billion. In 2018–19, a modest increase of \$300 million is reflected, increasing the minimum guarantee from \$78.4 billion to \$78.7 billion.

### **2020–21 Minimum Guarantee**

For 2020–21, the May Revision proposes an even larger decline, with the Proposition 98 guarantee at \$70.5 billion, a decrease of \$13.5 billion from the Governor’s January Budget and an almost \$7 billion decrease year over year. The guarantee is still projected to be based on Test 1—funding based on education’s proportion of General Fund revenues in 1986–87, which is estimated at 38%. Though, as noted above, this is proposed to be increased over the next four years to 40% by 2023–24.

### **Cost-of-Living Adjustment and Average Daily Attendance**

While the May Revision proposal acknowledges the statutory cost-of-living adjustment (COLA) of 2.31%—just slightly higher than the 2.29% included in the January State Budget proposal—it suspends the COLA in 2020–21 for all eligible programs, including LCFF, Special Education, Child Nutrition, Foster Youth, Preschool, American Indian Education Centers, American Indian Early Childhood Education, and the Mandate Block Grant. The Governor’s May Revision confirms the continued decline in statewide ADA for the upcoming fiscal year—with declines going from the 0.33% estimated in January to 0.67%.

### **Local Control Funding Formula**

As noted above, the May Revision proposal suspends the 2.31% statutory COLA. Therefore, the base grants—and subsequent grade span adjustments for the Transitional Kindergarten–3 and career technical education—as well as the supplemental and concentration grant amounts from 2019–20 will remain the same for 2020–21.

However, the May Revision proposes a reduction in addition to the statutory COLA suspension—for a total cut of 10%, or \$6.5 billion—to the LCFF absent additional federal funding. The cuts are meant to proportionately reduce LCFF with the reductions taken from the base grant, which lowers the amount upon which supplemental and concentration grant funding is calculated. The effects of the cuts on individual LEAs will vary depending on the unduplicated pupil percentage of each LEA. However, on average, a 10% cut to LCFF translates to \$1,050 per ADA.

During the press conference, Governor Newsom noted that a mechanism is being included within the proposed State Budget which he is providing to the Legislature so that the reduction would be “triggered off” if the federal government provides sufficient funding to backfill the cuts.

### **Deferrals**

Unfortunately, the May Revision proposal brings back deferrals. For those of you who were in school agencies during the Great Recession, you will recall that deferrals are a cash flow

management tool for the state, which require careful cash management by school agencies as they bridge the time gap between apportionments. The Governor proposes deferring approximately \$1.9 billion of LCFF funding in June 2019–20 to July in 2020–21. Further, LCFF deferrals are needed in 2020–21, increasing by \$3.4 billion to \$5.3 billion in total apportionments deferred to 2021–22. The Newsom Administration proposes that a process be established for LEAs to seek an exemption from the 2020–21 apportionment deferrals if they create a documented hardship, similar to what was provided for some of the cash deferrals implemented during the Great Recession.

## **Flexibilities for LEAs**

Recognizing the tremendous challenges LEAs face, the May Revision proposal attempts to balance the impact on public education stakeholders while maintaining the expectation that schools continue to make progress closing the achievement gap for students with disabilities, low-income students, English language learners, youth in foster care, and homeless youth. In order to balance these objectives, a number of proposed flexibilities are included in the Governor’s May Revision and many will require statutory changes to be implemented. The major areas of flexibility are detailed below.

Fiscal flexibilities include:

- Exemptions for LEAs if apportionment deferrals create a documented hardship
- The authority for LEAs to exclude state pension payments on behalf of LEAs from the calculation of required contributions to routine restricted maintenance
- Increased limits on LEA internal inter-fund borrowing to help mitigate the impacts of apportionment deferrals, and the maximum limit of borrowing between funds would increase from 75% to a new temporary maximum of 85%—this practice would be subject to public hearing
- The authority to use proceeds from the sale of surplus property for one-time General Fund purposes
- An extension of the statutory timelines to address the annual LEA audit due to COVID-19

Programmatic flexibilities include:

- Options for specified special education staff to utilize technology-based options to serve students
- Extension of the deadline for transitional kindergarten teachers to obtain 24 college units of early childhood education, from August 1, 2020, to August 1, 2021
- Migrant Education Program: the ability to allow summer programs to be offered through distance learning for the 2020 calendar year; the instructional minutes requirement waived for summer school instruction in 2020 (LEAs are encouraged to offer the minimum number of minutes to the extent practical); suspension of the requirement that school districts, county offices of education, and community college districts make facilities available for migrant summer programs in 2020 if facilities are closed due to COVID-19

While acknowledging the proposed flexibilities are not comprehensive or exhaustive, the administration states its openness to explore expanded flexibilities to protect core services and minimize the impact on students due to reduced funding.

## **Special Education**

Despite the dire economic circumstances, the Governor maintains a commitment to special education and improving outcomes of students with disabilities. The proposed May Revision continues the Governor's January Budget proposal to increase special education base rates to \$645 per student (reflects suspension of the COLA). The current statewide target rate (STR) is \$557.27 so the increase per student for those LEAs receiving the average STR will be \$87.73 (15.74% increase). With the suspension of the COLA, those LEAs funded above \$645 per ADA would not receive an increase. As in January, the proposal would apportion this base funding on a three-year rolling average of LEA ADA (but still allocated to Special Education Local Plan Areas) and would maintain the current funding model's categorical programs until a later date.

The May Revision also includes \$15 million in federal Individuals with Disabilities Education Act (IDEA) funds for the Golden State Teacher Scholarship Program to increase the number of fully-prepared special education teachers in the state (this has been a long-standing shortage area).

The Governor also proposes to utilize \$7 million in IDEA funds to assist LEAs in developing regional alternative dispute resolution services and statewide mediation services for cases arising from the pandemic and distance learning service delivery for students with disabilities.

The two workgroups to study current governance and accountability structures for special education service delivery and student outcomes remain in the budget but the \$1.1 million in funding was transferred from Proposition 98 to IDEA funding. In addition, \$600,000 in federal IDEA funds are proposed for a work group to study out-of-home care funding to better align with existing provisions to provide the service and to develop an Individualized Education Program addendum for distance learning.

## **CalSTRS and CalPERS Relief**

In times of plenty, the 2019–20 State Budget included \$3.15 billion non-Proposition 98 General Fund payment on K–14 employers' behalf to the California State Teachers' Retirement System (CalSTRS) and the California Public Employees' Retirement System (CalPERS) Schools Pool. A portion of the payment immediately paid down the CalSTRS and CalPERS employer contribution rates in 2019–20 and 2020–21 and the remaining \$2.3 billion was sent directly to the retirement systems towards the long-term unfunded liability of each system.

Instead, the Newsom Administration proposes to redirect that \$2.3 billion to further reduce employer contribution rates in 2020–21 and 2021–22. This reallocation of the same resources will reduce the CalSTRS employer rate from 18.4% to approximately 16.15% in 2020–21 and from 18.2% to 16.02% in 2021–22. The CalPERS employer contribution rate will be reduced from CalPERS recently set rate for 2020–21 of 22.68% to 20.7% and CalPERS 2021–22 estimated rate of 24.6% to 22.84%.

## **Investing Federal CARES Act Funds**

The Governor proposes to use discretionary federal funds available through the CARES Act to address learning loss related to COVID-19 school closures. California is receiving \$355 million total in the Governor's Emergency Education Relief (GEER) Fund which must be used for LEAs, higher education, or other education related entities to address the impact the coronavirus pandemic has had on students and families. The state also is receiving \$9.5 billion total in the Coronavirus Relief Fund (CRF), which can be used more broadly for any necessary expenditures incurred because of COVID-19.

The Governor proposes to use the \$355 million of GEER funds and \$4 billion of the CRF money to invest \$4.4 billion total for LEAs to mitigate learning loss. Funds will be allocated to LEAs using a formula that considers the number of students with disabilities, low-income students, English learners, youth in foster care, and homeless youth served by the LEA. These funds may be used for the following activities:

- Extending the instructional school year by implementing an earlier start date or increasing the number of instructional minutes or days
- Providing additional academic services for students, such as diagnostic assessments of student learning needs, or devices and connectivity for in-classroom and distance learning
- Learning supports that begin prior to the start of the school year, and continuing into the school year
- Student supports to address other barriers to learning, such as health, counseling, or mental health services; professional development in distance-learning for teachers and parents; access to school breakfast and lunch programs; or programs to address student trauma and social-emotional learning.

In addition, the Governor also unveils in the May Revision proposal how he proposes to invest approximately \$165 million that the state is receiving in federal Elementary and Secondary School Emergency Relief (ESSER) funds, also through the CARES Act. Grants totaling \$100 million will go to county offices of education for the purpose of developing networks of community schools and coordinating health, mental health, and social service supports for high-needs students. \$63.2 million will be used to provide training and professional development for educators that is focused on closing opportunity gaps, addressing trauma-related health and mental health barriers to learning, and developing strategies to support necessary changes in the educational program, such as distance learning and social distancing. The remaining \$1.5 million of the state-level ESSER funds will be provided to the CDE for state operations associated with the COVID-19 pandemic.

## **Categorical Cuts**

The May Revision proposes savings totaling \$352.9 million by reducing funding for various categorical programs. If federal funds materialize, then these cuts may be reversed. Funding for the following programs will be reduced by the following amounts:

- After School Education and Safety: \$100 million
- K–12 Strong Workforce Program: \$79.4 million

- Career Technical Education Incentive Grant Program: \$77.4 million
- Adult Education Block Grant: \$66.7 million
- California Partnership Academies: \$9.4 million
- Career Technical Education Initiative: \$7.7 million
- Exploratorium: \$3.5 million
- Online Resource Subscriptions for Schools: \$3 million
- Specialized Secondary Program: \$2.4 million
- Agricultural Career Technical Education Incentive Grant: \$2.1 million
- Clean Technology Partnership: \$1.3 million

## **Early Childhood**

A hallmark of the Newsom campaign to the Governor's office, early childhood continues to be a priority in the May Revision proposal; however, even it is not spared from having to absorb its fair share of cuts to help the state address the budget deficit. Similar to other January proposals, Governor Newsom pulls back on some of the investments he planned for childcare and preschool programs when the state expected a State Budget surplus. This included funding additional child care slots and inching ever closer to achieving universal targeted preschool in California. Additionally, the May Revision proposal captures savings from programs that were funded in the 2019 Budget Act like funding for improving the quality of the workforce and the renovation of existing, as well as the construction of new, preschool and child care facilities to house anticipated growth.

After multiple years of increasing the reimbursement rates for state subsidized child development programs, the May Revision proposes to suspend the statutory 2.31% COLA and reduce the Standard Reimbursement and Regional Market Rates for child care and preschool by 10%.

You may recall that Governor Newsom proposed the creation of a new Department of Early Childhood under the California Health and Human Services Agency to consolidate all child development programs except the State Preschool Program. Given the resources necessary to create the new department, the May Revision proposal modifies that plan and instead proposes to transfer child care programs administered by the Department of Education to the Department of Social Services and funds the transfer with \$2 million in state general funds. The Governor offers that this modified proposal achieves the goal of consolidating the state's early care programs and eases the administration of collective bargaining for family childcare providers with the passage of Assembly Bill 378 (Chapter 385, 2019).

Finally, the May Revision proposes to use the \$350 million California received from the federal CARES Act for child care to hold providers harmless as a result of COVID-19, provide one-time stipends for state-subsidized childcare providers to offer care during the COVID-19 crisis, increase access for at-risk children and children of essential workers, and to ensure that families do not have to pay childcare and/or preschool fees during such difficult times.

## **Closing Thoughts**



The Governor’s May Revision is the Administration’s response to the economic shutdown caused by the COVID-19 pandemic. We predict that unlike the prior year and many of the years during the Governor Brown era that not all issues will be resolved by the end of June when the State Budget is enacted. With the delay of the income tax filing deadline from April to July, the final adjustments for the 2020–21 State Budget might not be known until August or September.

LEAs should prepare their 2020–21 budgets using the assumptions in the May Revision as the building blocks for the district budget. We do not expect every assumption in the May Revision to hold true until State Budget adoption. But, in the absence of any other statutory foundation for the local agency budget, we continue to recommend that districts use the proposals in the May Revision to develop and adopt their budgets in June.

This year, because the Governor is proposing cash deferrals similar to those used during the Great Recession, we expect that many more districts will have cash flow problems. This is particularly true if the district, using the Governor’s January State Budget proposals, already had a less-than-positive certification. We recommend that districts plan to recalculate their multiyear projections immediately upon receipt of our updated Dartboard, which will be included in the [May Revision Workshop](#) materials on May 19.

Like we commented in an editorial written during the Great Recession, “remember that the only safety nets a district has are its cash reserves and the knowledge and skill of its business people.” It is too early to spend down the reserve; in fact, we recommend you hang on to all you can—at least until the State Budget is actually adopted.

As the journey to the final 2020–21 State Budget continues, we pledge to keep you informed along the way. Many of you carry the wisdom acquired during the last financial crisis and we encourage you to share your knowledge with those who will be dealing with it for the first time. For those of you that this is your maiden journey, we encourage you to seek out the counsel from those who travelled before you. We will “see you” at the School Finance and Management Conference in July!

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