

May 28, 2008

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To: Assistant Superintendents, Business Services
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From: Wendy Benkert, Ed.D., Assistant Superintendent
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Subject: **GOVERNOR'S MAY REVISED 2008-09 BUDGET PROPOSAL
AND PROJECTED LOCAL REVENUES FOR 2008-09**

On Wednesday May 14, 2008, Governor Schwarzenegger released the May Revision of the 2008-09 Proposed January Budget. The following are highlights of the Governor's proposal pertaining to K-12 education, along with assumptions for local property tax receipts and interest rate projections from the offices of the Orange County Auditor-Controller and Treasurer. The following information is intended to assist districts in the development of the 2008-09 budget and multi-year projections. Please note that the information presented is based on the Governor's May Revision, and is subject to change through the legislative process.

For the current year, the Proposition 98 ("Prop 98") minimum guarantee is estimated to be \$56.6 billion due to lower tax collections in addition to mid-year reductions enacted by the Legislature during the Special Session in February that lowered the Prop 98 minimum guarantee by \$507 million for the current year.

The Governor's May Revision clearly identifies K-14 education as a funding priority and proposes to fully fund Prop 98 at \$56.8 billion for the Budget Year 2008-09 (this is with a zero COLA and a maintenance factor). Although this is only \$200 million above the current year Prop 98 minimum funding level, the May Revision is a greatly improved budget for education with \$1.8 billion more funding for schools as compared to the Governor's Proposed January Budget. You may recall that in January, the Governor proposed suspending Prop 98 by \$4 billion. At that time, Prop 98 was estimated to be at \$59.7 billion for the budget year 2008-09. The May Revision Prop 98 funding of \$56.8 billion represents \$1.1 billion more than the \$55.7 billion proposed in January. In addition, the May Revision includes an estimated \$521 million to backfill for lower estimates of property taxes and funding for a slightly higher enrollment than was previously estimated in January resulting in a total of \$1.8 billion in General Fund support above the Governor's Proposed January Budget.

The May Revision also avoids additional cuts in the current year, cuts to special education, and provides a number of flexibility provisions. Despite the \$7.5 billion mid-year reduction enacted by the Legislature during the Special Session in February, the deteriorating economy causes the budget gap to grow to an estimated \$17.2 billion as of the May Revision. The Governor proposes to balance the budget through a combination of budget reductions and by borrowing against the State Lottery revenue streams along with a back-up plan of a one (1) cent sales tax increase should the State Lottery securitization plan not come to fruition.

REVENUE LIMITS:

COLA

The Governor's May Revision provides zero funding for the revenue limit COLA. The (2.4%) revenue limit reduction proposed by the Governor in January is eliminated and districts no longer need to budget for this reduction. This represents a restoration of \$841.1 million to school district revenue limits.

As you may recall in January, the Governor proposed changing the statutory COLA to be indexed to the CPI-W which is at 4.40%. The May Revision continues to propose using the CPI-W index, so zero funding for the COLA would mean a 4.214% revenue limit deficit. The current statutory COLA, which is based on the Implicit Price Deflator for the Federal Government's cost of goods and services, has increased from 4.94% in January to 5.66%. A deficit factor of 5.357% would be required to zero out the statutory COLA for the 2008-09 Budget Year. Regardless of which index is used to determine the COLA, a corresponding deficit factor will be applied to effectively zero out the COLA. School Services of California (SSC) recommends using the statutory COLA tied to the Implicit Price Deflator and our office concurs with the recommendation to use the 5.66% COLA with a 5.357% deficit factor.

The 5.66% COLA yields the following estimated increases for K-12 school district base revenue limits:

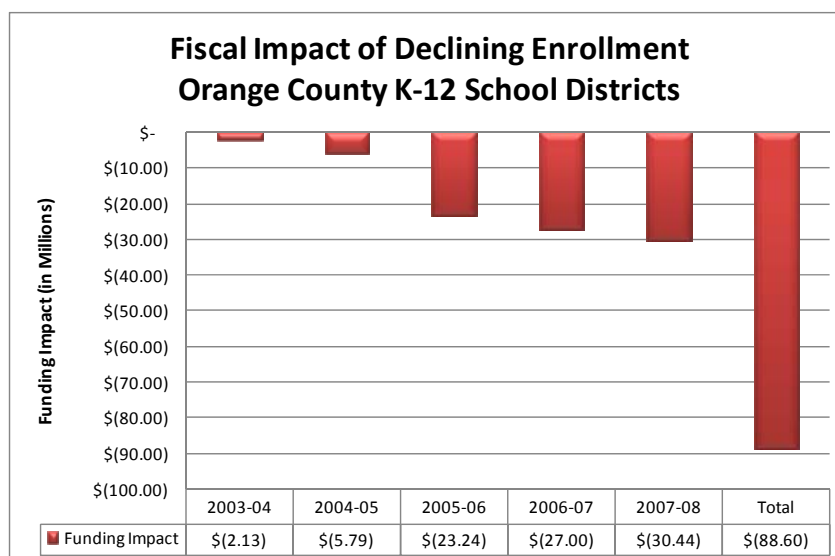
District	2008-09 Statutory COLA of 5.66% Undeficit	2008-09 Funded COLA
Elementary	\$315	0
High School	\$379	0
Unified	\$329	0

The attached schedule A, illustrates the estimated 2008-09 base revenue limits for Orange County school districts. The May Revision provides no equalization funding for districts.

Declining Enrollment

There is no change proposed to the current funding formula for declining enrollment whereby the funding is based on average daily attendance (ADA) for either the current or prior fiscal year, whichever is greater. Consequently, districts experiencing declining enrollment may see significantly lower increases in revenue limit funding depending on actual ADA loss sustained. In the current fiscal year, based on October 2007 student enrollment counts, Orange County has seventeen out of twenty-seven K-12 school districts that are experiencing declines in enrollment and the County will decline in enrollment as a whole for the fifth consecutive year. The graph

below illustrates the fiscal impact of declining enrollment on Orange County districts over the past 5 years.



With the enactment of Senate Bill (SB) 1446 sponsored by the California Declining Enrollment Coalition, there is some relief for declining enrollment districts with charter schools. Prior to SB 1446, when determining the prior year ADA, sponsoring districts of charter schools had to reduce the ADA of pupils who transferred from a district's regular school in the prior year to a district sponsored charter school in the current year. The reduction of prior-year ADA can now be offset by the ADA of pupils who transfer from a district-sponsored charter school in the prior year to a district school in the current year.

PERS Reduction

The Public Employees Retirement System (PERS) Board has set the school employer contribution rate for 2008-09 at 9.428%, thus the PERS revenue limit reduction rate will be 3.592% (13.020%-9.428%).

PROPOSED BUDGET FLEXIBILITY:

Economic Uncertainty Reserve Flexibility

The May Revision also proposes to lower the Economic Uncertainty Reserve requirement to one-half the current level. Our office has always expressed concern regarding any proposed reduction to the minimum reserve requirement. We believe that the current percentages established in the Criteria and Standards for reserves are the **bare minimum**. Furthermore, in times of economic and budgetary uncertainty, it is imperative that reserve levels be maintained at levels greater than those that have been established in the Criteria and Standards. We also believe that using one time reserve dollars for ongoing expenditures only compounds the problem, as the flexibility is short term and districts must replenish and restore the reserve to the original level by 2010-11.

Routine Restricted Maintenance

The May Revision lowers the annual routine restricted maintenance requirement from 3% to 2% of the total General Fund expenditures, including transfers out and other financing uses. As in previous years, Education Code Section 17070.75(b)(2)(C) allows for the exclusion of special education pass-through funds for districts that act as the administrative unit for a SELPA.

Deferred Maintenance

The State did not budget for their portion of the deferred maintenance match. Instead, the May Revision proposes to redirect \$222.6 million in what would have been Prop 98 General Fund contribution to deferred maintenance as follows: \$83 million to fully restore Special Education funding, \$100 million for the Emergency Repair Program, and the remaining \$39.6 million to be reserved for hardship projects.

The Administration also proposes to eliminate the local matching requirement for the deferred maintenance program in 2008-09. Districts may or may not make a deferred maintenance contribution for 2008-09, depending upon each individual district's budget priorities. Districts with General Obligation Bond Programs may need to make a deferred maintenance contribution.

Redirecting Categorical Funds to Unrestricted General Fund

The Governor's May Revision proposes to reauthorize the flexibility provisions that were adopted in 2003-04 allowing districts to temporarily use categorical program balances for unrestricted purposes and to increase apportionments sufficient to ensure a 2% increase from restricted categorical sources.

The redirection of restricted to unrestricted General Fund is allowed for all funds, unless otherwise excluded by law, such as funds committed for capital outlay, bonds, sinking funds, federal funds, balances in High Priority Schools Grant, Targeted Instructional Improvement Grant, Economic Impact Aid, Instructional Materials, and Special Education. Districts participating in Federal Food Programs may also have limited flexibility in moving funds from the Cafeteria Fund. We recognize that districts may choose to build budgets based on the flexibility provisions proposed in the May Revision. However, we believe that this area of the May Revision will be subject to the most changes, as it works its way through the legislative process. We advise districts to be cautious when taking advantage of these flexibility provisions and to ensure that they are matching one time solutions with one time expenditures.

As for the redirection of categorical funds, it is unlikely that budget priorities would allow additional dollars to be freed up for redirection after categorical funds are reduced by (6.5%) and unspent balances become available as unrestricted funds. In addition, there is great uncertainty regarding the meaning and intent of the language proposed in the May Revision. Therefore, we strongly advise districts NOT to budget or plan on this portion of the flexibility proposal until final Legislation is enacted.

Mega-Item Flexibility

The May Revision provides for growth and COLA and continues to allow for transfers of 10% out and 15% in. Note that when combined with the AB825 flexibility, the maximum transfers into eligible programs can be up to 35% (20% AB 825 + 15% Mega-Item transfer in). The following are the major programs eligible for the Mega-Item transfer flexibility:

- Home to School and Special Education Transportation
- Gifted and Talented Education
- Year Round Education Grants
- Peer Assistance and Review
- Education Technology

AB 825 – Block Grants

For 2008-09, each block grant will be adjusted from the 2007-08 levels by a (6.5%) reduction along with the projected (0.52%) statewide decline in growth. Because the AB 825 block grants are tied to Statewide enrollment growth, funding will be impacted Statewide.

Program Description	2008-09 Estimated Funding	Resource
Pupil retention block grant	2007-08 funding adjusted for (6.5%) reduction and negative statewide growth of (.52%.)	7390
School Safety Consolidated Competitive Grant	By competitive grant	7391
Teacher Credentialing Block Grant	Based on teacher count	7392
Targeted Instructional Improvement Block Grant	2007-08 funding adjusted for (6.5%) reduction and negative statewide growth of (.52%.)	7394
Professional Development Block Grant	2007-08 funding adjusted for (6.5%) reduction and negative statewide growth of (.52%.)	7393
School and Library Improvement Block Grant	2007-08 funding adjusted for (6.5%) reduction and negative statewide growth of (.52%.)	7395

Under AB 825, flexibility transfers of 15% out and 20% in can be made to any stand-alone categorical program, such as Class Size Reduction (CSR), Transportation, or Special Education. The Pupil Retention and Teacher Credentialing Block Grants **allow for transfers in only**. The May Revision increases the flexibility transfer limits by 5% allowing for 20% transfers out and 25% transfers in.

MAJOR CATEGORICAL PROGRAMS:

With the exception of Special Education, the May Revision provides no COLA for categorical programs and maintains the (6.5%) net reduction to most categorical programs, as proposed by the Governor in his January Budget.

There are a few exceptions to the (6.5%) net reduction to categorical programs:

- Special Education: the net (6.5%) reduction is restored and no COLA is funded.
- Quality Education Investment Act: this is not a discretionary item in the Budget, but a legal settlement so the funding rates will be based on the settlement agreement. Current year estimated funding is \$333 for K-3, \$600 for grades 4-8, and \$667 for grades 9-12. For 2008-09 to 2013-14, funding is estimated to be \$500 for K-3, \$900 for grades 4-8, and \$1,000 for grades 9-12. Note that changes in enrollment and staffing will affect funding.

- High Priority Schools Grant Program: the funding is \$400 per student at eligible schools.
- After School Education and Safety Grants: funding is at the same rate and maximums as approved in the grant award letter.
- Federal programs: not affected by state reductions.

All other categorical programs are subject to the zero COLA and a net (6.5%) reduction. These programs include, but are not limited to:

- Supplemental / Hourly Programs
- Apprentice Program
- ROC/Ps
- Adult Education
- AB825 Block Grants
- K-3 Class Size Reduction
- 9th Grade CSR
- Instructional Materials Funding Realignment Program (IMFRP)
- Economic Impact Aid
- Arts and Music Block Grant
- Physical Education Grants.
- California High School Exit Exam (CAHSEE)
- School Counseling Programs
- Certificated Staff Mentoring

Supplemental/Hourly Programs

The May Revision maintains the (6.5%) reduction to overall funding for supplemental hourly programs in line with other categorical programs. The resulting impact is a projected reduction in the hourly rates from \$4.08 in 2007-08 to \$3.81, representing a reduction of (27¢) per hour.

There are no changes to the caps on the K-12 Core Academic and Grade 2-6 Remedial Programs. Both remain capped at 5% of prior year's enrollment times 120 hours. There are no changes proposed to the uncapped Grades 2-9 Retained or Recommended for Retention and Mandated 7-12 Program for pupils who have not demonstrated sufficient progress to pass the California High School Exit Exam (CAHSEE). However, three of the hourly programs continue to be under-funded and the following deficits are projected in 2007-08 and 2008-09:

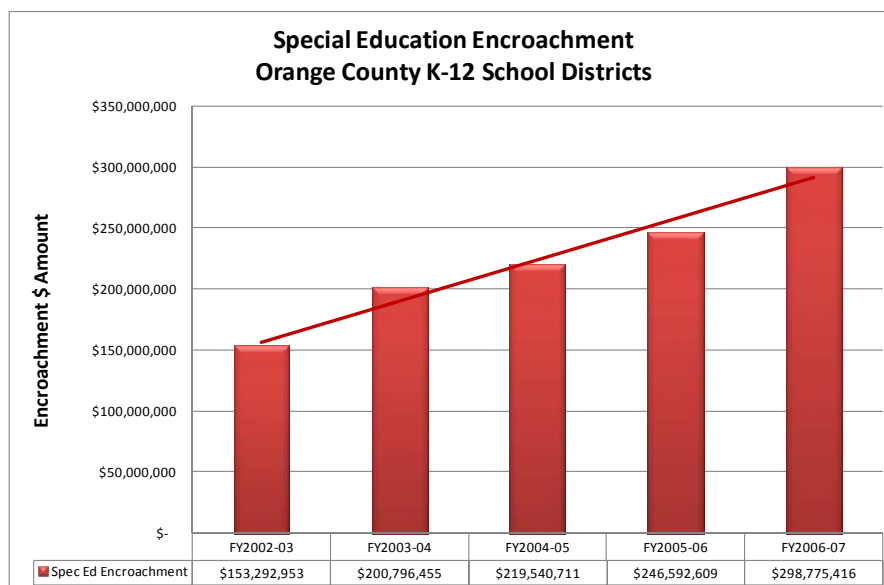
Hourly Program	Projected Funding Deficits for 2007-08	Projected Funding Deficits for 2008-09
K-12 Core Academic	(12%)	(43%)
Grade 2-9 Retained or Recommended for Retention	(19%)	(17%)
Grade 2-6 Remedial Program	(28%)	(36%)

Special Education

The May Revision reverses the (6.5%) cuts to Special Education and provides an increase of \$234.1 million over the amount proposed in the Governor's January Budget. In addition to reinstating the cuts proposed in the January Budget which total \$189.2 million, the May Revision proposes to shift a portion of the deferred maintenance funds to cover the remainder of the

Special Education budget. Federal funding for Special Education is expected to increase by almost \$13 million in 2008-09 and is estimated to be \$2.15 per SELPA ADA.

As with the revenue limit funding, the May Revision does not provide State funding for the COLA. Continuing escalations in costs associated with Special Education without corresponding increases in Special Education revenues, have significantly increased the encroachment on the unrestricted portion of the General Fund for Orange County school districts. The following graph illustrates the Special Education encroachment over the past five years. The General Fund contribution to Special Education totaled \$1.1 billion for all of the Districts in Orange County.



Home to School Transportation

The May Revision has language to authorize up to \$592.9 million from the Public Transportation Account to be used to reimburse the General Fund for the Home-to-School Transportation Program, including Special Education Transportation; however, transportation funding is reduced by (6.5%) as are other State categorical programs.

Lottery

On May 20, 2008, the California Lottery Commission met and lowered revenue estimates for 2007-08 from \$3.35 billion to \$3.075 billion. Consequently, the CDE is lowering its fiscal year 2007-08 projection of lottery revenues for education from \$143 per unit of average daily attendance (ADA) to \$131 per ADA (from \$121 to \$115 for unrestricted lottery revenues, and from \$22 per ADA to \$16 per ADA for Proposition 20 restricted revenues).

Lottery revenue is expected to remain flat for the next couple of years. We are advising districts to use the following lottery revenue projections for the current and subsequent years in building the multi-year projections. The Lottery Commission will release updated revenue projections in late June of 2008.

Projections	2007-08	2008-09	2009-10	2010-11
Non-Proposition 20	\$ 114.75	\$ 115.00	\$ 115.50	\$ 115.50
Proposition 20	\$ 16.10	\$ 16.50	\$ 16.75	\$ 16.80
Total	\$ 130.85	\$ 131.50	\$ 132.25	\$ 132.30

OTHER:

Multi-year Projections

The revised School Services of California Inc. (SSC) dashboard is projecting a COLA of 4.83% for 2009-10 and 2.7% for 2010-11. Given the weak economy and less than optimistic future outlook, SSC cautions that there is no assurance that the COLAs for the out-years will be funded. Therefore, our office advises districts to be very cautious in budgeting for funded COLAs in 2009-10 and 2010-11 and to have an alternative plan in place in the event that these out-year COLAs are not funded.

Mandates

The Governor's May Revision contains no augmentation in mandate funding from the January proposal of \$38,000 for 2008-09 mandate claims. Once again the State is deferring the payment of mandate claims. Our office advises Districts to continue to file mandate claims in the event future funding becomes available for repayment of these outstanding claims.

State Lottery Securitization

As part of the budget balancing solution, the Governor proposes to borrow \$15 billion from Wall Street against future increased profits from the State Lottery over a period of up to 32 years, with the first \$5.1 billion dedicated to the 2008-09 Budget and the remaining \$10 billion seeding a budget stabilization "rainy day" fund. The Governor states that the State Lottery is an underperforming asset ranking at 28th in the nation and there is opportunity to improve the lottery's performance. The \$15 billion in state revenues from the securitization of the lottery is dependent on this improved performance. While the proposal guarantees that schools will continue to receive their current share of revenues from the lottery, approximately \$1.2 billion annually, it also subordinates this guarantee to the bond holders.

A Revenue Stabilization Fund (RSF) would be seeded with the initial \$10 billion from the proceeds of the lottery securitization. Education would be held harmless relative to existing Proposition 98 guarantees. A portion of the stabilization fund would be earmarked specifically for education, but if necessary the non-education portion of the RSF could be used for education. Transfers out of the RSF are authorized only during years in which the General Fund revenues underperform the ten year average growth rate. Once the maintenance and deficit factor repayments are made and the reserve is fully funded, the Governor's proposal would restrict the ability to suspend Proposition 98. This proposal will require voter approval – most likely in the November 2008 elections.

One cent Sales Tax Back-up Plan

As a back-up plan to the State Lottery securitization, the Governor proposes a one cent temporary increase in sales tax to be triggered based on balances available in the RSF. The sales tax would remain in effect until the RSF has accumulated a fund balance equal to 15% of the General Fund tax revenues (approximately \$15 billion). The temporary sales tax would expire on June 30, 2011 and Californians will receive rebates equal to the amount of the sales tax collected. No details are available on how the rebates would be implemented. Furthermore, this sales tax increase proposal would require two thirds vote in each house to be enacted.

GASB 45

Governmental Accounting Standards Board Statement No. 45 (GASB 45) requires all state and local government agencies – including school agencies – that cover any portion of the cost of other postemployment benefits (OPEB), to begin recognizing the liability in the financial statements. GASB 45 has an implementation timeline beginning in 2008-09 and the subsequent two years based on the size of a district's budget. Although there currently is no requirement for an agency to fund the liability, districts are encouraged to develop a plan to address funding of the liability.

CHARTER SCHOOLS:

Charter school general purpose rates are based on statewide average revenue limits and thus reflect the zero COLA. The categorical block grant rates also reflect the net reduction of (6.5%).

Estimated Charter School Rates: The following table lists the estimated charter school rates for 2008-09:

	K-3	4-6	7-8	9-12
General Purpose	\$5,566	\$5,654	\$5,824	\$6,798
Categorical	\$447	\$447	\$447	\$447
Total Funding Rates	\$6,013	\$6,101	\$6,271	\$7,245

PROPERTY TAX AND INTEREST EARNINGS:

Property Taxes

The Orange County Auditor-Controller's Office is projecting a 4% increase in the Secured Roll, zero growth for the Unsecured Roll, and a 15% decline in Supplemental taxes due to the continued anticipated slowing of the housing market for 2008-09.

Interest Yield Projection

Interest for the fiscal year 2007-08 is estimated at 3.85% and at 3.5% for 2008-09. These interest rate projections are provided by the Orange County Treasurer and are based on the current yield environment taking into account any possible action from the Federal Open Market Committee. This information is updated throughout the year in the Orange County Treasurer's Monthly Management Reports.

SUMMARY:

We recognize that the Governor's May Revision is an improvement over his Proposed January Budget with a zero COLA for revenue limit funding as opposed to a (2.4%) reduction, and the restoration of the (6.5%) reduction to Special Education funding. We anticipate that Districts will be revisiting their budget reductions and reprioritizing in the context of the provisions in the May Revision. We understand the individual nature of these decisions for each district based on factors such as increased costs for step and column, escalating health benefit costs, declining enrollment, deficit spending, special education encroachment, and encroachment as a result of proposed cuts to categorical programs.

In addition to these factors, we are also very concerned about California's structural deficit that has not been fully addressed in the May Revision. The May Revision also depends on a November Voter initiative to approve the securitization of the State Lottery, which leaves K-12 education vulnerable in the future to mid-year budget reductions. Furthermore, the economic indicators of fiscal health for California do not indicate recovery in the near future and it is questionable whether the economy would be able to support funding the future year COLAs. **Given all of these factors, we urge Districts to be extremely cautious in taking advantage of the flexibility provisions provided in the May Revision and recommend that Districts maximize ending fund balances and reserves to prepare for a potentially volatile future.**

The above information is based on the Governor's May Revision of the Proposed January State Budget for 2008-09, and is subject to change through the legislative process. We will continue to update districts as changes become known. If you have any questions or concerns regarding this information, please contact me at 714-966-4229 or Darren Dang at 714-966-4176.

WB:dd

cc: Superintendents
Michael Ricketts, Deputy Executive Director, CCSESA
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Attachments



WILLIAM M. HABERMEHL
County Superintendent of Schools

Projected COLA Change in Revenue Limit Funding (per ADA) K-12 Districts in Orange County

	2007-08 Base R/L	2008-09 Est. Base R/L with 5.66% COLA	2008-09 Deficited Base R/L	Projected Change in R/L Funding*	Projected % Change in R/L Funding*
			(0.94643 deficit factor)		
<u>Elementary</u>					
Anaheim City	\$5,531.56	\$5,846.56	\$5,533.36	\$1.80	0.03%
Buena Park	\$5,541.49	\$5,856.49	\$5,542.76	\$1.27	0.02%
Centralia	\$5,530.80	\$5,845.80	\$5,532.64	\$1.84	0.03%
Cypress	\$5,530.14	\$5,845.14	\$5,532.02	\$1.88	0.03%
Fountain Valley	\$5,515.36	\$5,830.36	\$5,518.03	\$2.67	0.05%
Fullerton	\$5,557.24	\$5,872.24	\$5,557.66	\$0.42	0.01%
Huntington Beach City	\$5,526.41	\$5,841.41	\$5,528.49	\$2.08	0.04%
La Habra City	\$5,529.81	\$5,844.81	\$5,531.70	\$1.89	0.03%
Magnolia	\$5,535.06	\$5,850.06	\$5,536.67	\$1.61	0.03%
Ocean View	\$5,523.12	\$5,838.12	\$5,525.37	\$2.25	0.04%
Savanna	\$5,529.73	\$5,844.73	\$5,531.63	\$1.90	0.03%
Westminster	\$5,522.22	\$5,837.22	\$5,524.52	\$2.30	0.04%
<u>High Schools</u>					
Anaheim Union	\$6,648.36	\$7,027.36	\$6,650.90	\$2.54	0.04%
Fullerton Joint Union	\$6,683.76	\$7,062.76	\$6,684.41	\$0.65	0.01%
Huntington Beach Union	\$6,676.02	\$7,055.02	\$6,677.08	\$1.06	0.02%
<u>Unified</u>					
Brea-Olinda	\$5,783.92	\$6,112.92	\$5,785.45	\$1.53	0.03%
Capistrano	\$5,783.18	\$6,112.18	\$5,784.75	\$1.57	0.03%
Garden Grove	\$5,780.35	\$6,109.35	\$5,782.07	\$1.72	0.03%
Irvine	\$5,774.41	\$6,103.41	\$5,776.45	\$2.04	0.04%
Laguna	\$5,784.77	\$6,113.77	\$5,786.26	\$1.49	0.03%
Los Alamitos	\$5,931.12	\$6,260.12	\$5,924.77	-\$6.35	-0.11%
Newport-Mesa	\$5,833.90	\$6,162.90	\$5,832.75	-\$1.15	-0.02%
Orange	\$5,786.71	\$6,115.71	\$5,788.09	\$1.38	0.02%
Placentia-Yorba Linda	\$5,822.02	\$6,151.02	\$5,821.51	-\$0.51	-0.01%
Saddleback Valley	\$5,784.66	\$6,113.66	\$5,786.15	\$1.49	0.03%
Santa Ana	\$5,777.84	\$6,106.84	\$5,779.70	\$1.86	0.03%
Tustin	\$5,786.25	\$6,115.25	\$5,787.66	\$1.41	0.02%

* The dollar amounts in the "Projected Change in R/L Funding" and percentages in the "Projected Percent Change in R/L Funding" vary by district because of the use of the statewide funding average.