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January 26, 2009

To: Assistant Superintendents, Business Services
Directors, Business Services
ROC/Ps

From: Wendy Benkert, Ed.D., Assistant Superintendent
Business Services

**Subject: Governor's January 2009 Proposal and FY 2008-09
Second Interims**

Since May 2008, County Office Chief Business Officials have been working with various statewide agencies to craft common messages and advice to school districts on assumptions for budget and interim reports. Attached are points of agreement among the county offices that are being used as advice to school districts for developing the 2008-09 Second Interim Reports, multi-year projections for 2009-10 and 2010-11, and the Budget for 2009-10. School Services' Financial Projection Dartboard is also included for your reference. In an effort to solve a \$41.7 Billion deficit, the Governor's January proposal has significant budget reductions to education in the current and next fiscal year. Although the Governor's January proposal is the beginning of a long process culminating in a final budget adopted by the Legislature, and despite significant disparities between the Governor's January proposal and prior proposals from the Legislature, the Governor's proposal is the only written proposal available and thus our advice is based on this proposal.

If you have any concerns or questions regarding this information, please contact me at (714) 966-4229.

cc: Superintendents
Jean Buckley, Tamalpais Advisors Inc.
Dari Barzel, Moody's Investors Services

Attachment

CCSESA BASC DISTRICT FISCAL OVERSIGHT COMMON MESSAGE TALKING POINTS

2008-09 Second Interims
January 26, 2009

BACKGROUND

In May 2008, BASC (CCSESA's County Office CBO subcommittee) initiated the practice of developing common talking points for county offices to use as we prepare to advise districts on assumptions for budget and interim reports. This update reflects the Governor's 2009-10 Budget Proposal. In an effort to solve a \$41.7 billion deficit, this proposal has significant provisions that impact both the current 2008-09 fiscal year as well as the 2009-10 budget year. For K-12 education, this translates into cuts of approximately \$6.3 billion. The Governor's proposal reflects the beginning of a long process culminating in a final budget adopted by the Legislature and signed by the Governor. Currently, there is little consensus between the Governor and the Legislature relative to what actions will be necessary to balance the Budget. There may be many changes prior to a signed budget. We will update this message as major events occur. At present, the Governor's Budget proposal is the only written proposal available and thus our advice is based on this proposal.

We recognize that review and approval of budgets and interim reports requires analysis that involves many factors, including the State Board of Education's adopted Criteria and Standards and the FCMAT Predictors of School Agencies Needing Intervention. While recognizing and acknowledging the unique individual school district circumstances that will influence budget and financial review, we strongly recommend that the following guidelines be used by school districts as they develop their 2008-09 Second Interim Reports including multi-year projections for 2009-10 and 2010-11, as well as their 2009-10 Budget.

REVENUE LIMIT, SPECIAL EDUCATION AND CATEGORICAL PROGRAM COLAs

These are extraordinary times for school finance given the state budget structural deficit, the weak economy, the instability of financial markets, the increase in unemployment, a history of unfunded or partially funded cost of living adjustments (COLAs) in prior years, and other factors such as past and potential future mid-year cuts to funding. In recognition of these pressures on school funding, we recommend that school districts use the School Services of California (SSC) Financial Projection Dartboard in development of their 2008-09 Second Interim Report, their multi-year

projections and their 2009-10 Budget for both the revenue limits and categorical programs. The SSC dashboard has footnoted and addressed any differences in recommended COLAs for special education or categorical funds.

CATEGORICAL PROGRAM FLEXIBILITY

The Governor's Proposal makes mid-year cuts to the revenue limit and provides flexibility to help lessen the impact of those cuts. This approach differs from that of the stated approach by the Legislature. The Legislature would apply reductions to specific programs and not allow the same level of flexibility as the Governor. There will be significant debate over flexibility provisions prior to any agreement. It is difficult to project with any accuracy those flexibility provisions that will survive the debate. We are concerned about the flexibility proposals initiated by the Governor and would caution school districts about the inclusion of many of those in the 2008-09 Second Interim Report and the 2009-10 Budget. Our office has significant concerns about utilizing the Governor's proposed flexibility, especially in the areas of Class Size Reduction (CSR), Economic Impact Aid (EIA), Adult Education, Regional Occupational Programs (ROP), and Special Education. If districts elect to utilize the flexibility proposals, they must provide an alternate set of assumptions detailing the additional expenditure reductions that would be implemented if categorical program flexibility does not materialize. We believe that a more prudent approach would be to build the Second Interim projections assuming the most conservative scenario which could be no flexibility, or targeted cuts to the categorical programs as proposed by the Legislature in SBX1 4. District boards could consider adopting a list showing program restorations that would be made if any proposed flexibility option is approved.

It is more likely that the suspension of the Deferred Maintenance match requirement and the reduction of the Routine Restricted Maintenance Account (RRMA) set-aside requirement from 3% to 1% will survive. However, these are only for two years and would need to be restored in the third year.

It is our understanding that programs generated by initiatives and legal settlements such as After School Education and Safety (ASES), Quality Education Investment Act (QEIA), Valenzuela, and Williams will not be included in any final flexibility provisions.

RESERVE FOR ECONOMIC UNCERTAINTIES

In the Governor's Proposal, the minimum required levels for the reserve for economic uncertainties would be reduced by half. This would be effective for two years and would have to be restored in 2010-11. We would caution school districts on taking advantage of this reduction. We believe that the current percentages established in the Criteria and Standards for reserves are the BARE minimum. In these times of great economic and budgetary uncertainty, school districts need reserves that are greater than the minimum. Of particular concern is the use of one time reserve dollars for ongoing expenditures, as this may only compound financial problems when districts must both support the expenditures from ongoing revenues and restore one-time funds utilized from reserves.

BUDGET REDUCTIONS

School districts must be proactive and develop alternative expenditure reduction plans to meet the amount of flexibility options that have been incorporated in their 2008-09 Second Interim Report and their 2009-10 Budget. If school districts elect to utilize the flexibility proposals, they must provide an alternate set of assumptions detailing the additional expenditure reductions that would be implemented if categorical program flexibility does not materialize.

In light of the additional reductions included in the Governor's January Proposal, districts are required to submit detailed Board approved budget reduction plans for fiscal years 2008-09 and 2009-10. Board recognition of the total dollar amount of budget reductions for fiscal year 2010-11 will be sufficient.

NEGOTIATIONS

It is unlikely that any statutory deadlines will be extended. Therefore, school districts must adhere to the current deadlines and provide the necessary statutory employment notices that provide them with the most flexibility to deal with the final results of the Governor/ Legislative debates. Once those statutory dates have passed, the school district is limited in its options for expenditure reductions needed to meet the requirements of the final signed State budget. Programs and staff can always be re-instated once the final budget is enacted.

For the current and future years, school districts may want to consider delaying settlement of negotiations until after the 2009-10 Budget is adopted so that we know what the funding will be and the level of flexibility options available. We recognize that each school district's situation is unique; however, it is recommended that long term commitments not be made at this time. School districts may need to re-open contract language to implement some of the flexibility options. If considering a

multi-year contract, school districts need to be very flexible and have appropriate contingency language, such as basing compensation increases on “funded COLA” or “effective COLA”. Also recognize that there may be different COLAs and deficits for revenue limits versus categorical programs and this should be considered during negotiations.

The Governor is proposing rescinding the .68% COLA for 2008-09. If a negotiated agreement called for increasing the salary schedule by a funded COLA, it is suggested that you delay implementation of any increase until the final funded COLA is determined. In the event that the salary schedule has already been increased, you may want to review alternate plans with your legal counsel.

CASH MANAGEMENT

Increased emphasis must be put on cash flow analysis and monitoring, and the impact of reduced or late apportionments for this year and possibly future years. We must be proactive, not reactive. AB 1781 (Budget Act) defers apportionment payments from February to April 2009, impacting cash flow. The Governor’s current proposal would defer the April apportionment to July. These could become permanent deferrals implemented to address the State’s fiscal crisis. School districts should closely monitor their cash flow and be prepared to review options for borrowing.

In the section “RESERVE FOR ECONOMIC UNCERTAINTIES”, the importance of appropriate reserves was discussed. The cash management challenges make it even more imperative that we consider reserve levels greater than the minimums required under the Criteria and Standards. The reserves may be especially critical now to meet cash flow needs that guarantee our ability to provide adequate cash to meet payrolls and other obligations.

SUMMARY

These are very extraordinary economic times and it is difficult to gauge the future. It is important that school districts be proactive through developing contingency plans that allow the most flexibility possible. We recommend and strongly encourage districts to use these guidelines in the development of 2008-09 Second Interim Reports and associated multi-year projections as well as the development of the 2009-10 Budget.

2009 SSC School District and County Office Financial Projection Dartboard Governor's Budget Proposal

This version of SSC's Financial Projection Dartboard is based on the Governor's Budget Proposal on January 9, 2009. We have updated the COLA, CPI, and ten-year T-bill factors per the latest economic forecasts, and this resulted in changes to virtually every factor for 2008-09 and thereafter. We rely on various state agencies and outside sources in developing these factors, but we assume responsibility for them with the understanding that they are, at best, general guidelines.

Factor		2008-09	2009-10	2010-11	2011-12	2012-13	2013-14
Statutory COLA (use for K-12 and COE Revenue Limits)		5.66%	5.02%	0.50%	2.00%	2.50%	3.00%
Revenue Limit Deficits:							
Eliminates COLA		0.94643	0.90117	0.90117	0.90117	0.90117	0.90117
Further RL Cut		0.95433	0.93030	0.93030	0.93030	0.93030	0.93030
Total Deficit %		9.685%	16.161%	16.161%	16.161%	16.161%	16.161%
Net Revenue Limit Change: K-12		-4.57%	-2.52%	0.50%	2.00%	2.50%	3.00%
Special Education COLA (on state and local share only) ¹		0.00%	0.00%	0.50%	2.00%	2.50%	3.00%
State Categorical COLA (including adult education and ROC/P) ¹		0.00%	0.00%	0.50%	2.00%	2.50%	3.00%
California CPI		2.90%	1.70%	2.70%	2.90%	3.10%	3.20%
California Lottery ^{2,3}	Base	\$109.50	\$109.50	\$109.50	\$109.50	\$109.50	\$109.50
	Prop 20	\$11.50	\$11.50	\$11.50	\$11.50	\$11.50	\$11.50
Interest Rate for Ten-Year Treasuries		3.33%	3.55%	4.44%	4.80%	4.90%	5.00%

ESTIMATED STATEWIDE AVERAGE BASE REVENUE LIMITS PER ADA "UNDEFICITED"			
Year	Elementary	High School	Unified
2008-09 Statewide Average (est.)	\$5,882	\$7,069	\$6,150
2009-10 Inflation Increase @ 5.02% COLA	\$295	\$355	\$309
2009-10 Statewide Average (est.)	\$6,177	\$7,424	\$6,459

2009-10 ESTIMATED CHARTER SCHOOL RATES				
	K-3	4-6	7-8	9-12
General Purpose Block Grant (will change at each apportionment)	\$5,360	\$5,440	\$5,596	\$6,493
Categorical Block Grant (est.) ⁴	\$500	\$500	\$500	\$500
Total	\$5,860	\$5,940	\$6,096	\$6,993

¹ Based on prior State Budgets, when the revenue limit receives a deficated COLA, the COLAs on special education and other categorical programs are no higher than the deficated COLA and are often lower.

² The forecast for Lottery funding per ADA includes both base (unrestricted) funding and the amount restricted by Proposition 20 (2000) for instructional materials.

³ If securitization of the Lottery is passed by the voters, the years of 2009-10 through 2013-14 will no longer be based on Lottery sales.

⁴ The charter school categorical block grant rates provided by the Department of Finance shown do not include Economic Impact Aid funding, which is provided separately.