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2012-13 Budget Advisory Based on the 2012-13 Enacted State Budget Act

BACKGROUND

The advice contained in this version incorporates the Enacted State Budget (Chapter 21, Statutes of 2012) and other changes since the "2012-13 Budget Advisory Based on the Governor's May Revision" which was issued on May 30, 2012. This Budget Advisory is intended for any revisions necessary per Education Code 42127(i)(4). This section states, "not later than 45 days after the Governor signs the annual Budget Act, the school district shall make available for public review any revisions in revenue and expenditures it has made to its budget to reflect the funding made available by the Budget Act".

On June 27, 2012, Governor Brown signed the 2012-13 Enacted State Budget (Chapter 21/2012). This Budget closes a budget deficit of \$15.7 billion and rebuilds a nearly \$1 billion reserve. The final Budget closed this gap with \$16.640 billion in total solutions including, \$8.089 billion in additional expenditure reductions, \$6.033 billion in increased revenues (primarily from temporary taxes), and \$2.518 billion in "other miscellaneous solutions" (borrowing, new fees and interest payments).

The cornerstone of this budget assumes passage of a new tax initiative proposed by the Governor, named the, "Schools and Local Public Safety Protection Act of 2012" which qualified (on June 20, 2012) for the November 2012 General Election ballot. The final 2012-13 Budget assumes the initiative will generate \$8.5 billion through 2012-13. According to the Legislative Analyst's Office (LAO), the initiative would generate an additional \$6.8 - \$9 billion in 2013 and \$5.4 - \$7.6 billion for each year thereafter through 2018. This initiative, if passed by the voters in the November 2012 election, would temporarily increase the state sales tax by .25% until the end of 2016 and would increase the income tax rate by up to 3% on the state's wealthiest taxpayers for seven years.

Regardless of the outcome of the November election, cash management becomes more critical. Even if the tax initiative passes on the November 2012 general election, school districts, charter schools and county offices of education will have less cash in 2012-13 for the period January through May 2013 than they received in 2011-12. **Please carefully read the Cash Management section of this Advisory.**

The 2012-13 Enacted State Budget increases the K-14 Proposition 98 spending by about \$5.4 billion. Currently the 2011-12 Proposition 98 spending is about \$48.7 billion, but would increase to \$53.6 billion in 2012-13. **However, the Enacted State Budget will essentially maintain programmatic funding at current levels.** The K-12 Proposition 98 increase will be primarily used as follows;

- \$2.1 billion (K-12) to fund the 2011-12 deferral in 2012-13.
- \$2.065 billion (K-12) to pay down the cross fiscal year deferral credit card already on the books. K-12 cross fiscal year deferrals would be reduced from \$9.5 billion to \$7.4 billion in 2012-13. If the tax initiative ballot measure fails on November, 2012, this deferral will be reinstated.
- \$98.6 million increase in Special Education funding for mental health services to disabled students that backfills one-time Proposition 63 funding used in 2011-12.
- \$450 million in funding for the Quality Education Investment Act (QEIA) included inside Proposition 98 spending guarantee for one-year.
- \$86.2 million increase in funding for K-12 mandates.
- \$53.7 million increase for charter school growth.
- \$183 million increase for Transitional Kindergarten.
- \$163.9 million increase to shift the Title 5 part-day center-based child care services into the State Preschool program.

“TRIGGER LANGUAGE”

The Enacted State Budget provides for 2012-13 “trigger reductions” of \$5.4 billion to K-14 education should the Governor’s tax initiative not pass on the November 2012 election. These reductions would become effective on January 1, 2013. Proposition 98 funding would then be projected at approximately \$48.2 billion. The reduction to K-12 school district apportionments (\$2.739 billion) would represent approximately \$457/ADA for an average school district. **We are recommending that districts update their 2012-13 budget, multi-year projections, and cash flow to reflect the on-going \$457/ADA trigger cut.**

This also applies to county offices of education, basic aid school districts and charter schools. This represents an additional loss of more than \$16 per ADA from the May Revision. Additionally, the \$2.065 billion K-12 cross fiscal year deferral reduction would be reversed.

In an attempt to mitigate this loss of revenue limit funding, the Enacted Budget allows more flexibility for schools districts by authorizing a reduction to the school year (or the equivalent number of instructional minutes) by up to 15 more days in 2012-13 and in 2013-14 if the Governor’s tax measure fails in November, in addition to the 5 days currently in law (175 day year). This would have to be negotiated through the collective bargaining process. In 2014-15, the minimum instructional day/minutes statutes will revert back to current law of 5 days per year (175 day year). **Please note that this language is different than the May Revision proposal which would have authorized a reduction of 15 days combined over two years: 2012-13 and 2013-14. The budget also allows that any reductions to the work year will constitute a full year of service credit for CalSTRS members.**

Recommendations

Based on the uncertainty relative to the passage of the Governor’s tax initiative, we recommend the following guidance:

- School districts should update their 2012-13 budget, multi-year, and cash flow projections to reflect the \$457/ADA trigger cut.
- If school districts build their budgets using flat revenue limit funding, financial projections should have contingency plans for the possible failure of the Governor’s tax initiative.
- School district contingency plans must be realistic and ready for timely implementation if necessary.
- School districts must carefully review their MYPs for one-time revenues and note the ending date of the revenues to avoid over projecting those revenues.
- Cash flow becomes a critical consideration. School districts may find it more difficult to issue TRANS and the cost of any borrowing may increase. Cash flow should be looked at over an 18 month cycle rather than a 12 month cycle.

**THE FOLLOWING SECTIONS PROVIDE MORE DETAILED ADVICE
RELATIVE TO CHANGES SINCE THE 2012-13 MAY REVISION BUDGET
ADVISORY DATED MAY 30, 2012**

Revenue Limit and COLAs

The Enacted State Budget does not provide a statutory cost of living adjustment (COLA) for any program in 2012-13. The actual statutory COLA of 3.24% is not funded; therefore, the deficit factor will be increased to reflect this loss of funding. The budget provides funding of \$169 million in 2012-13 for enrollment growth.

The 2012-13 Enacted State Budget specifies the statutory COLA and deficit factor for the revenue limits for 2011-12 and 2012-13 as defined in the following table:

	2011-12 Actual Statutory COLA	2012-13 Enacted State Budget Statutory COLA	2013-14	2014-15
Statutory Cost of Living Adjustment (COLA)	2.24% (unfunded)	3.24% (unfunded)	2.5%	2.7%
K-12 Deficit	20.602% (.79398) ¹	22.272% (.77728)	22.272% (.77728)	22.272% (.77728)
County Office Deficit	20.691% (.79309)	22.549% (.77451)	22.549% (.77451)	22.549% (.77451)

Although unfunded, the 2.24% statutory COLA for 2011-12 and the 3.24% statutory COLA for 2012-13 translate into the following statewide average base revenue limit amount per ADA:

School District Type	2011-12 Actual Statutory COLA 2.24%	2012-13 Enacted State Budget Statutory COLA 3.24%	2013-14 Statutory COLA 2.5%	2014-15 Statutory COLA 2.7%
Elementary	\$137	\$203	\$161	\$178
High School	\$164	\$243	\$194	\$214
Unified	\$143	\$212	\$169	\$187

The following are factors to be considered as a school district calculates its 2012-13 revenue limit;

- The 3.24% statutory COLA is not funded for 2012-13.
- The .848% or average of \$55/ADA revenue limit “trigger reduction” was implemented beginning in February 2012 for fiscal year 2011-12 only.
- As discussed earlier, the Enacted State Budget is based on the passage of the tax initiative. If this initiative fails on the November 2012 Election, the budget has an automatic “trigger reduction” of \$2.739 billion for K-12 education. Per the Department of Finance calculations, this would result in a loss of approximately \$457/ADA (for an average unified school district).

¹ The Education Trailer Bill (Chapter 38/2012) lists the 2011-12 K-12 deficit as 20.404%. This did not include the \$13 mid-year reduction but did include the \$42 reduction to restore the transportation apportionment. As a result, the effective COLA deficit will be 20.602% after the \$13 mid-year reduction is added.

The School Services of California Financial Projection Dashboard provides additional information relative to statutory COLAs and revenue limit deficits. **It is recommended that school districts utilize this information in preparing their Multi-Year Projections (MYPs). Given the uncertainty of the State's economic recovery, school districts should have a contingency plan for any reduction to the out year COLAs if incorporating future statutory COLAs.**

Basic Aid School Districts

Beginning with ABX4 2 (Chapter 2/2009), basic aid districts have been subject to "fair share" reductions. A basic aid district's "fair share" reduction is calculated against their total revenue limit funding subject to deficit. This amount is then taken from categorical revenues to the extent that categorical revenues are available, including AB602 Special Education revenues and State mental health funding.

The "fair share" reduction in 2011-12 of 8.92%, is increased to 9.57% in 2012-13, and will be 8.92% in 2013-14 as a result of SB 81, which shifted the mid-year transportation "trigger" reductions to a revenue limit reduction, including "fair share" reductions for basic aid districts.

Historically, a school district receives a "fair share" reduction if the district was basic aid in the prior year. However, in no event would that reduction be more than the amount of local property tax revenues that exceed the district's revenue limit. ABX4 2 also specified that the reduction shall not violate the constitutional funding requirement that the state provide \$120 per ADA or \$2,400 per school agency, whichever is greater.

If the Governor's tax initiative fails, then basic aid districts will be subject to an additional fair share trigger reduction of approximately \$457 per ADA in 2012-13, in addition to the 9.57% cut discussed above. It is critical for basic aid districts to note that this represents a departure from previous fair share cuts in that the trigger cut for 2012-13 would apply in the current budget year. Districts should develop contingency plans now to prepare for the possibility that the additional trigger cut is applied in 2012-13, to the extent sufficient categorical revenues - including AB602 and State mental health funding - are available for the State to capture (but the protections noted above regarding the \$120 per ADA minimum and the revenue limit would still apply).

It is important for basic aid districts to carry higher than minimum reserves. Dependency on property taxes means dependency on assessed property values. Greater than minimum reserves provide a buffer in the event that assessed values fall short of projections. Due to the continuing economic uncertainties and its impact on assessed values, reserves are more critical than ever before. Moreover, basic aid districts whose student population is growing do not receive additional funding. For these reasons and the growing loss from "fair share" reductions, higher than minimum reserves are important.

Special Education

The Enacted State Budget for special education provides no additional statewide funding for ADA growth and leaves the appropriation at the 2011-12 level. No COLA is provided for special education.

- Special Education Local Plan Areas (SELPA's) with growth are expected to receive an estimated \$465.44 per ADA. This is the same as last year. This will come from SELPA's that are declining in ADA.
- Also, a \$17.4 million increase in federal funding will be allocated to SELPA's, estimated at \$2.94 per ADA.
- Under current law, school districts need to meet maintenance of effort (MOE) requirements irrespective of any reduced work or school year.

AB 3632 mental health services, to students with disabilities, continue to be the responsibility of school districts for 2012-13. A total of \$417 million is provided to support mental health services including the \$98.6 million augmentation to backfill the loss of the Mental Health Act funding (Proposition 63).

Mental Health Funding Formula - One Year Phase-In Established - For the 2012-13 year there will be a one-year phase-in of mental health services funding to SELPA's with seventy five percent (75%) of the

\$69 million in federal IDEA Mental Health funds allocated using CASEMIS student data and twenty five percent (25%) of IDEA funds allocated based on ADA. The \$98.6 million in Proposition 98 mental health funding will be allocated on an ADA basis. These funds pay for educationally necessary mental health services. This provides a one year transition to the per-ADA mental health funding model.

The Governor vetoed all state funding (\$15 million) for the Early Mental Health Intervention (EMHI) program as proposed by the Legislature.

Transportation

2012-13 FISCAL YEAR

The Education Trailer Bill (Chapter 38/2012) continues the Governor's proposal to restore \$496 million in transportation funding for 2012-13. School districts will receive the funding as a restricted transportation apportionment. The funds will not be flexible. The current education code restrictions on its use and the requirements to maintain a minimum level of transportation services are still in force.

Child Care and Preschool Programs

The Enacted State Budget made significant changes to child care and preschool programs. The budget achieves \$294.3 million in non-Proposition 98 savings and includes the elimination of 14,000 child care slots. Following are specific reductions and savings:

- Shifting all of Title 5 part-day center-based child care services into the State Preschool program (Proposition 98) to achieve \$163.9 million in general fund savings (partially offset by a new requirement to collect family fees).
- Requiring fees to be assessed and collected for families with children in part-day preschool programs, families receiving wraparound child care services, or both. Providing an 8.7% across the board reduction to the General Child Care Program, Migrant Day Care Program, Alternative Payment Program, CalWORKs Stage 3 Program, and Allowances for Handicapped Programs. Achieves \$100 million in savings.
- Suspending the cost of living adjustments for child care and development programs for fiscal years 2012-13, 2013-14, and 2014-15. Achieves \$30 million in savings starting in 2013-14.
- Aligning state preschool eligibility to new kindergarten cutoff dates. Specifically, defines that state preschool programs are to facilitate the transition to kindergarten for 3 and 4-year old children who have their 3rd or 4th birthday, respectively, on or before November 1 of the 2012-13 fiscal year, October 1 of the 2013-14 fiscal year, and September 1 of the 2014-15 fiscal year and each fiscal year thereafter.
- Providing that for 2012-13, the family fee schedule for child care and development services in effect for 2011-12 shall remain in effect, and continues existing policy that the family fees cannot exceed 10 percent of the family's total income.

Quality Education Investment Act (QEIA)

The Education Trailer Bill (Chapter 38/2012) moved the final year of the QEIA program from 2013-14 to 2014-15. This is accomplished by clarifying that the original funding for QEIA was provided by Assembly Bill 3 of the Fourth Extraordinary Session (ABX4 3) (Chapter 3/2009-10) and ABX3 56 (Chapter 31/2009-10).

There are no changes to the current funding rates. For 2012-13 the rates continue to be:

- \$500 per enrolled pupil for kindergarten and grades 1-3
- \$900 per enrolled pupil Grades 4-8
- \$1,000 per enrolled pupil Grades 9-12

QEIA is funded within Proposition 98 in 2012-13. The change is a result of an over appropriation to Proposition 98 in 2011-12 and the subsequent 2012-13 budget act decision to pay for QEIA within Proposition 98. In addition to these 2012-13 general fund savings, the budget act calls for \$181 million in 2013-14 and \$40.8 million in 2014-15 of Proposition 98 funding to be directed to QEIA.

Property Taxes

We recommend that school districts align their 2012-13 property taxes with 2011-12 actuals. P-1 tax estimates will be provided by November 15. Please assume the same level of Education Revenue Augmentation Fund (ERAF) for 2012-13 as apportioned in 2011-12. Note that community redevelopment funds (residual property taxes) will be apportioned by the Auditor-Controller on January 16, 2013 and June 1, 2013.

Interest Yield Projections

The projected average gross interest yield for 2012-13 is 0.32%. This projection is provided by the Orange County Treasurer-Tax Collector and is 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 by the Orange County Treasurer Tax Collector.

Lottery

Please note that Lottery funding will be calculated in the same manner as prior years, with the exception that through 2014-15, the following programs will be funded based on 2007-08 ADA rather than the prior year ADA:

- Adult Education
- Regional Occupational Center and Programs (ROC/P)

On April 8, 2010, the Legislature passed AB142 (Chapter 13 / 2010) which requires that not less than 37% of the total annual revenues from the sale of lottery tickets be distributed to education.

The current projection for 2011-12 is \$120.00 per ADA (unrestricted) and \$26.00 per ADA (Prop. 20 restricted). On July 3rd, the Lottery Commission released estimates for 2012-13 of \$122.00 per ADA (unrestricted) and \$28.00 per ADA (Prop. 20 restricted).

Mandated Costs

The Enacted State Budget provides \$166.6 million to create a block grant funding allocation for K-12 schools. Funding would be based on pupil counts for school districts and would approximate \$28/pupil for 2012-13. Participation in the block grant would waive the existing claiming process; thus providing that all school districts are reimbursed at the same rate for providing services for the same mandated requirements. School districts will be subject to compliance audits. These have yet to be determined and will be included in the supplemental regulations issued for the Annual Audit Guide.

School districts will also have the option to decline the block grant funding and continue to claim reimbursements under the existing mandate claims process with the same mandate requirements. Districts opting to receive block grant funding will need to elect to participate in the block grant by September 30 of each year.

The mandates suspended in 2011-12 will continue to be suspended in 2012-13.

Transitional Kindergarten

SB 1381, Chapter 705, Statutes of 2010 changed the birth date for enrollment in kindergarten by moving the date for eligible age requirement from December 2nd to September 1st. Under current law these changes are scheduled to be phased in over three years as follows:

- Eligibility by November 1 for 2012-13
- Eligibility by October 1 for 2013-14
- Eligibility by September 1 for 2014-15

This bill mandated a Transitional Kindergarten Program for students displaced as a result of the changes in eligibility birthdates. School districts are currently eligible to collect ADA for these transitional

kindergarten students. Under current law, school districts may not receive ADA funding to serve a four year old unless that child has his or her fifth birthday according to the appropriate phase-in period noted above. Children admitted during the school year who do not meet the phase-in period criteria may only be enrolled on a case-by-case basis upon having attained the age of five.

The Transitional Kindergarten program is not required to be operated at every school site, just by the school district so it meets the needs of the school district.

The Enacted State Budget did not repeal the Transitional Kindergarten requirements. Therefore Transitional Kindergarten is required beginning with 2012-13. School districts must implement Education Code 48000(b) as it currently reads.

Expansion of Categorical Flexibility and New Tier III Public Hearing Requirements

The Enacted State Budget did not make any further changes to the current Tier III flexibility provisions or the programs placed in Tier III.

Please note that most of the temporary flexibility provisions were extended to June 30, 2015 with the exception of the K-3 Class Size Reduction (CSR) reduced penalty provisions. The flexibility provisions for the CSR reduced penalties expires on June 30, 2014 instead of June 30, 2015. This would impact the school district MYPs.

Weighted Student Formula (WSF)

The Governor has indicated that California's school finance system has become "too complex, administratively costly and inequitable." The Governor proposed a major school finance reform to remedy these issues and to provide greater flexibility in the use of funding. The reform included the Weighted Student Formula (WSF) funding model. The Enacted State Budget rejected this proposal and therefore, it will not be implemented in 2012-13.

Advancement Via Individualized Determination (AVID)

The state budget submitted to the Governor proposed to fully fund \$8.1 million for AVID. However, the Governor vetoed the funding.

Charter Schools

The Enacted State Budget includes an increase of \$53.7 million for the Charter School General Purpose Block Grant and Categorical Block Grant.

The General Purpose Block Grant rates are based on statewide average revenue limits. The rates listed below are based on the CDE 2011-12 P-2 Certification. CDE will recalculate these rates at the 2012-13 P-1 Certification. The CDE recalculates the General Purpose rates at each apportionment. The Categorical Block Grant rate reflects flat funding for 2012-13. The estimated rates for 2012-13 are (based on the 2011-12 P-2 Certification):

	K-3	4-6	7-8	9-12
General Purpose Block Grant	\$5,076	\$5,153	\$5,308	\$6,141
Categorical Block Grant	\$398	\$398	\$398	\$398
Total	\$5,474	\$5,551	\$5,706	\$6,539

Charter schools are subject to the "trigger reduction", and therefore should have contingency plans for the potential revenue limit reduction of \$457/ADA should the Governor's tax initiative fail in the November

2012 elections. Charter schools are authorized to reduce the school year for 2012-13 and 2013-14 by an additional 15 days each year.

The Enacted State Budget addresses additional changes for charter schools:

- The Education Trailer Bill (Chapter 38/2012), in Section 37.1 and 37.3, requires the governing board of any school district seeking to sell or lease any real property, designed to provide direct instruction or instructional support it deems to be surplus property, to first offer that property for sale or lease to any charter school that has submitted a written request to the school district to be notified of any surplus property offered for sale or lease by the school district. The bill outlines in detail the process for how a purchase, and under what terms, the sale of school property would take place.
- Authorizes County Boards of Education, subject to the concurrence of the County Superintendent of Schools to loan moneys from the proceeds of Revenue Anticipation Notes to charter schools.
- Allows all new and existing non-classroom based charters to receive full funding without needing State Board of Education review and approval and would eliminate the funding determination process and will ultimately allow all non-classroom based charters to receive full funding.
- Authorizes county treasurers to lend to charter schools.
- Charter schools are now authorized to receive the proposed mandate block grant at the rate of \$14/pupil.
- Establishes charter schools as a local agency for the purpose of issuing Tax and Revenue Anticipation Notes (TRANs).
- Authorizes charter schools to directly seek an exemption from the intra-year deferrals and requires the charter school authorizer be notified of the request.

CASH MANAGEMENT

Intra-Year Principal Apportionment Deferrals

SB 82 was chaptered on March 24, 2011 and allows for intra-year deferrals in the 2011-12 fiscal year. AB 103, signed by the Governor on May 23, 2012, reduced intra-year deferrals for 2012-13 (see table below).

Timeframe	2011-12 Intra-Year Deferrals (SB 82)	2012-13 Intra-Year Deferrals (AB 103)
July to September	\$700 million	\$700 million
July to January	\$700 million (\$541 million was actually deferred)	\$500 million
August to January	\$1.4 billion (\$1.2 billion was actually deferred)	\$600 million
October to January	\$2.4 billion (\$2.2 billion from Principal Apportionment and the difference is a 100% deferral of the October consolidated categorical payment plus a 7% deferral of the October Instructional Materials Realignment Program (IMFRP) payment)	\$800 million
March to April	\$1.4 billion (\$837 million from Principal Apportionment and the difference will come from a 100% deferral of the March consolidated categorical payment plus a 100% deferral of the March Economic Impact Aid (EIA) payment)	\$900 million

Entitlement Reduction to Revenue Limit State Aid and Charter School General Purpose Funding

The 2012-13 State Budget Act assumes passage of the Schools and Local Public Safety Protection Act of 2012 (the Governor's tax initiative) and establishes a \$6.92 Billion entitlement reduction to revenue limit state aid that begins with the 2012-13 Advance Principal Apportionment in July 2012. The entitlement reduction reflected in the 2012-13 Advance will be calculated based on 2011-12 P-2 total deficated revenue limit funding.

Per the California Department of Education, the \$6.92 Billion entitlement reduction is estimated to be equivalent to a 21.5% reduction to the total deficated revenue limit. In other words, the district's apportionment will be reduced by 21.5% of their total base revenue limit. State deferrals have disproportionally impacted districts that receive more state aid than property taxes. This entitlement reduction process was established to provide more equity for low property tax districts. Please refer to the chart below for an illustration of the effect of the entitlement reduction.

		High Property Tax District	Low Property Tax District
A	Total Deficated Revenue Limit	\$100 Million	\$100 Million
B	21.5% Entitlement Reduction (-0.215*A)	(\$21.5 Million)	(\$21.5 Million)
C	Property Taxes	\$70 Million	\$20 Million
D	State Aid	\$30 Million	\$80 Million
E	21.5% Entitlement Reduction from above	(\$21.5 Million)	(\$21.5 Million)
F	Total State Aid on July Advance (D+E)	\$8.5 Million	\$58.5 Million
G	Effective % State Aid Reduction as a result of the entitlement reduction (E/D)	71.7%	26.9%

As the example shows, each local education agency will be impacted differently depending upon the makeup of their revenue limit funding (the split between state aid and local property taxes) and this could have significant cash flow implications. Unlike other state deferrals, districts that receive proportionally more property taxes than state aid will be more adversely impacted by the entitlement reduction.

If the initiative passes, the entitlement reduction will be repaid 10 days before the close of the state's fiscal year. If the initiative fails, repayment of these entitlement reductions may be begin at P-1 in February 2013. In addition, the \$2.74 billion trigger reduction (estimated \$457 per ADA) may begin at the same time. Attachments A-1 and A-2 illustrate the delayed principal apportionment funding scenarios; the green money bags have been added to show the statewide cash impact of the \$6.92 billion entitlement reduction.

Also please note that due to the inclusion of the \$6.92 billion entitlement reduction in the Final 2012-13 Enacted State Budget, the cash position for any local education agency receiving revenue limit state aid will be worse between January through May 2013 compared to 2011-12, regardless of the outcome of the November election. Attachment B presents a graphical comparison of the 2011-12 and 2012-13 Principal Apportionment Deferrals. The blue bar represents the existing 2011-12 deferral schedule and shows the cumulative outstanding apportionments through a specific month. The green line represents the scenario where the tax initiative is approved by the voters and the red line, the scenario where the tax initiative fails. The red and green lines are the same for the months of July through January and assume that if the tax initiative fails, repayment of the entitlement reduction will begin at P-1 in February. Please note that this is a statewide illustration of the deferrals, each district will be impacted differently depending upon the makeup of their revenue limit funding.

Cross Fiscal Year Principal Apportionment Deferrals

The Governor's 2012-13 January Budget proposed an increase of \$2.1 billion in Proposition 98 funding for the purpose of reducing ongoing K-12 school district revenue limit deferrals. The May Revision proposed to reduce those deferrals by an additional \$140 million for a total of \$2.24 billion. The 2012-13 Enacted State Budget actually buys down \$2.065 billion in deferrals if the tax initiative is successful. If the tax initiative is unsuccessful, there is no change to the existing cross fiscal year cash deferral schedule. Changes since the 2012-13 May Revision are indicated below in **bold red text**. For cash flow projections we recommend that school districts assume that the Governor's tax initiative does not pass until the outcome of the November 2012 election is known.

2012-13		
Timeframe	If Tax Initiative Fails (status quo)	If Tax Initiative Passes (As of 5/15/2012)
February 2013 to July 2013	\$2.0 billion	\$532 million (\$1.468 billion is restored)
March 2013 to August 2013	\$1.3 billion	\$1.029 billion (\$270.5 million is restored)
April 2013 to August 2013	\$763.8 million	\$763.8 million
April 2013 to July 2013	\$419 million	\$419 million
April 2013 to August 2013	\$678.6 million	
April 2013 to July 2013		\$175.6 million (\$503 million is restored)
May 2013 to July 2013	\$800 million	\$800 million
May 2013 to August 2013	\$1.0 billion	
May 2013 to July 2013		\$1.177 billion (\$177 million is added)
June 2013 to July 2013	100% of the June apportionment, which has been \$2.5 billion in prior years	100% of the June apportionment which has been \$2.5 billion in prior years
Deferred across fiscal years	\$9.46 billion	\$7.4 billion

Also note that the relationship between property taxes and state aid within district revenue limits can significantly affect cash flow. Additionally, the change in status from a Revenue Limit school district to a Basic Aid school district will impact the receipt of cash from monthly to primarily paid in December and April.

Other Cross Fiscal Year Payment Deferrals

In addition to the cross fiscal year principal apportionment cash deferrals, there are three cross fiscal year cash deferrals applicable to K-3 Class Size Reduction, School Safety Violence Prevention, and Targeted Instructional Improvement Grant. The deferral amounts are listed below:

- \$570 million for K-3 Class Size Reduction (CSR)
- \$38.7 million for School Safety Violence Prevention
- \$100.1 million for the Targeted Instructional Improvement Block Grant

Apportionment Schedules

In addition to apportionment cash deferrals, the State of California modified the principal apportionment payment schedules in 2009-10 to enhance the State's cash position in future years. In light of the reduced and deferred apportionments and change in timing of distribution of funds from the State, a great deal of emphasis must be placed on cash flow analysis and monitoring.

Please note that the principal apportionment deferrals will impact each school district differently depending upon: (1) the amount of State Aid revenue limit funding that each district receives and (2) the

principal apportionment schedule that is dictated by Education Code Section 14041. There are three separate principal apportionment schedules outlined in Education Code Section 14041(a). Most LEAs in California receive apportionments that are in accordance with Education Code Section 14041(a)(1)(2)(3)(4). However, there are a small number of districts in California that receive apportionments in accordance with Education Code Section 14041(a)(7) or Education Code Section 14041(a)(8).

Cash Management Planning

As a result of all the deferrals, policy changes, and uncertainty with respect to school district apportionments, it is important to plan ahead and establish a cash management plan that maximizes flexibility. Districts that have never issued tax revenue anticipation notes (TRANS) may have to consider doing so if they don't have sufficient cash resources or the ability to utilize temporary interfund borrowing. Some districts may need to consider a two-step cash management plan utilizing two separate TRANS issuances or a combination of TRANS and temporary borrowing from the Education Investment Pool to meet cash flow needs.

These cash management challenges make it even more imperative that we consider reserve levels greater than the minimums required within the State's Criteria and Standards. Reserves are especially critical in order to have sufficient cash to meet payroll and other obligations.

RESERVE FOR ECONOMIC UNCERTAINTIES

The revised 2009-10 Enacted Budget lowered the minimum reserve requirement levels for economic uncertainties to 1/3 the percentage level adopted by the State Board of Education as of May 1, 2009. SB 70 extended this provision for both 2010-11 and 2011-12. However, school districts are required to make progress in the 2012-13 fiscal year to return to compliance with the specified standards and criteria adopted by the State Board of Education. By fiscal year 2013-14, school districts must meet compliance and restore the reserves to the percentage adopted by the State Board of Education as of May 1, 2009. We believe that the percentages established in the Criteria and Standards for reserves prior to the current Enacted Budget are the BARE MINIMUM. If a school district reduces the minimum reserve levels, it would take budget reductions of twice the amount of the lowered reserve levels to fully restore the reserve by June 30, 2014. With the continued deferral of apportionments, it is more critical than ever to maintain higher levels of reserves for cash flow purposes. A school district needs a state loan when they run out of cash and do not have any other borrowing options, even if the school district has a positive fund balance.

County Offices of Education (COEs) and basic aid school districts are advised to maintain reserves much greater than the State required minimum because they do not have the prior year ADA protection provided to school districts under Education Code 42238.5, whereby revenue limit funding is based on ADA for either the current or prior fiscal year, whichever is greater.

NEGOTIATIONS

When 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." There may be different COLAs and deficits for revenue limits versus categorical programs and this should be considered during negotiations.

It is important to remember that the 2012-13 Enacted State Budget provides flat revenue limit funding, but is predicated on the passage of the November 2012 tax initiative. If it fails, "trigger language" would be implemented effective January 1, 2013 and would result in a reduction of approximately \$457/ADA per Department of Finance (DOF) calculations.

The Enacted State Budget provides increased flexibility for school districts by authorizing a reduction to the school year by up to 15 more days for 2012-13 and 2013-14. This would have to be negotiated through the collective bargaining process. School districts that intend to seek a reduction in employee compensation through negotiations should be advised to begin those negotiations immediately. Case law and PERB decisions underscore the duty to meet and negotiate in good faith. This requires the parties to begin negotiations as early as necessary to allow for sufficient time to complete the lengthy legal process in order for an agreement to be reached, or for the resolution of an impasse. School districts need to consider this as they negotiate changes to collective bargaining agreements.

SUMMARY

We recognize that these are extraordinary economic times and it is difficult to gauge the future. School district budgets should be managed with an eye to the significant downside risk created by the State's ongoing structural deficit and any mid-year reductions that would result under the Enacted State Budget related to the failure of the proposed tax measure. In these times of great economic and budgetary uncertainty, school districts need reserves that are much greater than the minimum.

It is recommended that school districts continue to be cautious and focus on a multi-year strategy when recommending decisions and obtaining agreements. Attention should be focused on the multi-year projections for 2013-14 and beyond. School districts should develop financial projections and contingency plans accordingly.

We understand how difficult it is for school districts to deal with the increased pressures, significantly reduced funding, apportionment deferrals, and the uncertainty associated with a volatile economy. It is important to be proactive to maintain fiscal solvency through developing contingency plans that allow the most flexibility possible.

Enclosures

cc: Superintendents
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Assistant Superintendents, Instructional Services
Directors, Business Services
Directors, Special Education Services
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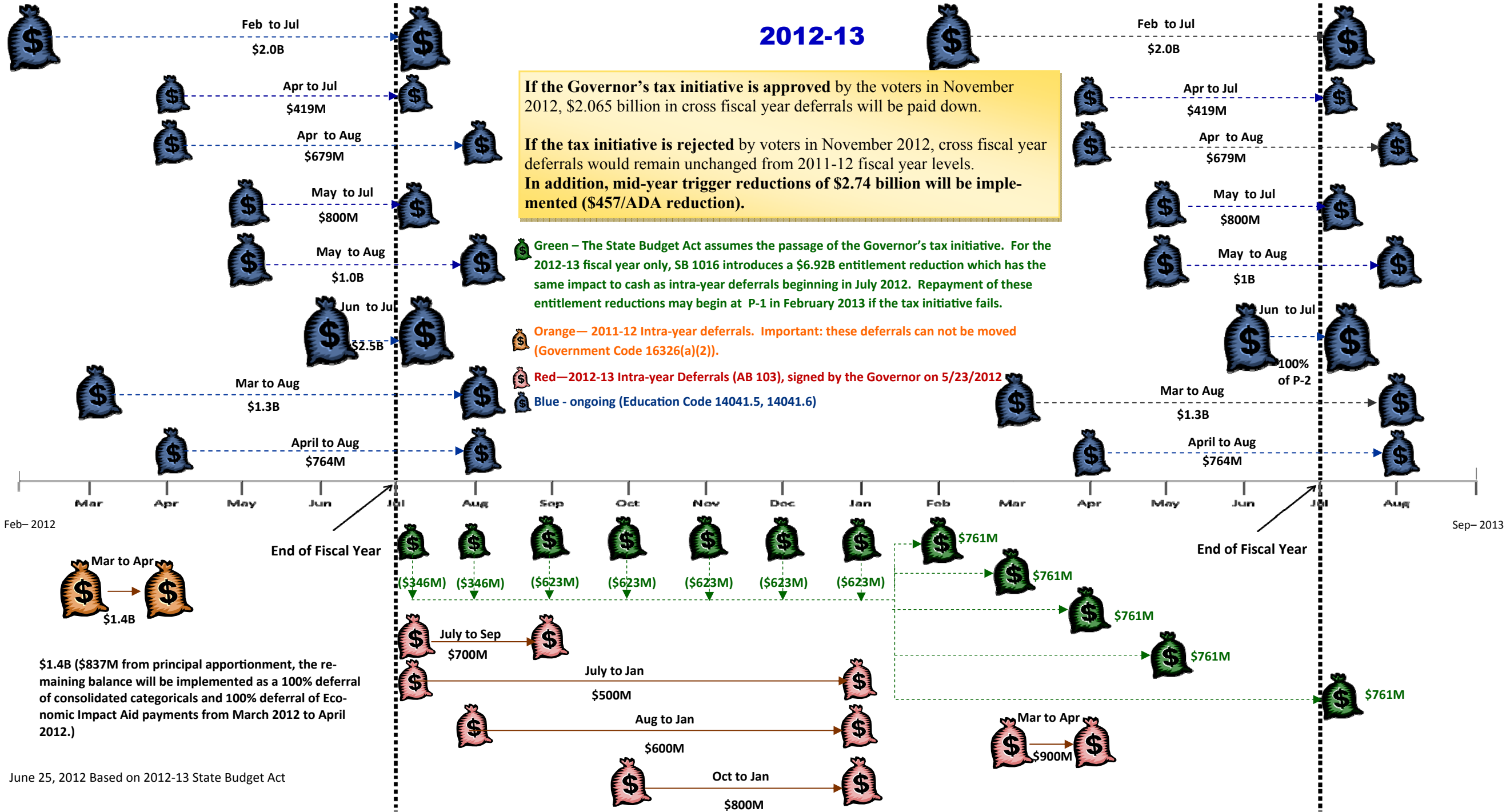
Delayed Principal Apportionment Funding

2012-13 State Budget Act — Taxes Fail

2011-12

2012-13

2013-14



\$1.4B (\$837M from principal apportionment, the remaining balance will be implemented as a 100% deferral of consolidated categoricals and 100% deferral of Economic Impact Aid payments from March 2012 to April 2012.)

Comparison of 2011-12 and 2012-13 Principal Apportionment Deferrals

