Santa Barbara
SCHOOL DISTRICTS

Excellence for All

720 Santa Barbara Street, Santa Barbara, CA 93101
Phone (805) 963-4338, Fax (805) 963-5685

To: Dr. J. Brian Sarvis, Superintendent

From: Eric D. Smith, Deputy Superintendent

Subject: Public Hearing on State Categorical Flexibility and Mid-Year Budget Reductions

Date: February 19, 2009

Conference Item: (20 minutes)

Background
On December 9, 2008, our Board was presented with its First Interim Financial Report. At that time, the districts self certified the report as "positive", meaning that we were able to demonstrate that we could meet our current and subsequent two year fiscal obligations. Yet perhaps more importantly, we were able to report that the districts' ended the 2007-08 fiscal year with a combined unrestricted reserve of 8.58 percent making last year's fiscal recovery ostensibly complete.

However, on the heels of our fiscal recovery, the Governor unveiled his proposed budget for fiscal year 2009-2010. The Governor's budget identifies an unprecedented $41.6 billion gap, inclusive of a $2 billion reserve. Three quarters of the gap is attributed to the collapse in state revenues (about $14.5 billion in the current year and $16.3 billion projected for fiscal year 2009-2010) with the remainder attributed to higher case load costs and general fund costs necessary to backfill lost property taxes due to the decline in the housing credit markets.

This falloff in economic activity is also reflected in the employment market, which is expected to fall three straight years through 2010. Currently, California suffers from one of the highest unemployment rates in the nation at 8.4 percent; one year ago, the state's unemployment rate stood at 5.9 percent. Between 2007 and 2010, the administration is projecting that the state will lose almost 380,000 jobs, a decline of 2.5 percent. Keep in mind that the state's population is expected to continue to grow even during the recession, which makes the competition for jobs even more fierce. As in prior economic downturns, one of the chief reasons for the shortfall in 2008-2009 general fund revenues is the state's heavy reliance on the personal income tax and the steeply progressive nature of this tax. Personal income tax revenues are expected to fall short by $8.9 billion in the current year. In California, because of the steeply progressive design of income tax rates, the highest one percent of income earners contributes almost one-half of the personal income tax. These taxpayers also derive a disproportionate share of their income from capital gains, and these gains are expected to plummet from $127 billion statewide in 2007 to $57 billion in 2008, resulting in a drop in capital gains tax revenues of $6.3 billion. In October, we reported that the state had to attack the budget problem quickly and aggressively, making permanent improvements through major programmatic reductions and revenue increases. More than three months have passed, and the budget outlook has turned even darker. The time available to achieve current–year savings has been diminished, and the state's cash problems have worsened.

Now after months of political gridlock, it appears that a budget deal has finally been brokered. However, at the time of this writing, the Senate remained gridlocked over the new proposal, needing an additional vote in the Senate to move the proposal to the Governor for his signature. Nevertheless, there is general consensus that the final version of the budget will look substantially similar to what the "Big Five" have negotiated. The details are as follows:

Current year cuts (2008-09)
Total cuts to K-12 in the current year would be about $2.3 billion, with the .68 percent COLA being repealed and a further cut to revenue limits of $944 million (about $160 per ADA or about $2.2 million for our districts—far less than the $4.3 million originally envisioned in the Governor's December budget proposal). In addition, there would be a separate $944 million cut to certain categorical programs. Categorical programs are treated differently by being considered three separate ways:

- ***Those programs that will receive no cuts and are not subject to program flexibility:*** Included in this category are Economic Impact Aid, Child Development, QEIA, K-3 Class Size Reduction (K-3 CSR), Special Education, Home-to-School Transportation, Proposition 49 After School Programs, and Child Nutrition.
- ***Those programs that will be subject to a 15 percent cut, but are not subject to program flexibility:*** Included in this category are Adults in Correctional Facilities, Apprenticeship Programs, English Language Acquisition Program, Foster Youth, K-12 High Speed Network, Partnership Academies, State Testing, Ag Vocational Education, Charter School Facility Grants, and Multi-track Year Round Education.
- ***Those programs that are subject to a 15 percent cut and are subject to the program flexibility provisions:*** Everything not listed above in included in this category. This list of programs includes, but is not limited to, Adult Education, ROC/Ps, Instructional Materials, Professional Development, Deferred Maintenance, GATE, etc. If the program is not listed in the first two bullets, it is included in this provision

Program Flexibility
Programs not explicitly excluded from the flexibility provisions (i.e. those listed in the first two bullets above) are subject to the governor's flexibility proposal. This means that school districts will be able to use funds from these programs in any way. Program flexibility will begin immediately in the current year and continue through the 2012-13 fiscal year.

Also included in the flexibility provisions is the ability to tap into 2007-08 ending balances for use in the current year and 2009-10 (this does not include tapping into 2008-09 ending balances). School districts would also be able to reduce their contribution to routine restricted maintenance to one percent, and there would be no deferred maintenance match.

K-3 CSR Penalties
While K-3 CSR is not included in the program flexibility provisions, the penalties under the program are being modified significantly as follows:

- No penalty up to 20.5:1
- 5 percent penalty 20.5:1 up to 21:1
- 10 percent penalty up to 22:1
- 15 percent penalty up to 23:1
- 20 percent penalty between 23:1 and 25:1
- 30 percent penalty above 25:1

Budget year cuts (2009-10)

- There will be no COLA provided in 2009-10 to revenue limits and categorical programs. Additionally, there will be $265 million in cuts to the revenue limit (about $45 per ADA or $616,995 for our districts—versus the $2,111,494 originally envisioned in the Governor's December proposal) and another across-the-board cut to categorical programs of $265 million. The cuts to categorical programs will be allocated in 2009-10 the same way as in the current year (see current year reference above) and will amount to an additional cut of about five percent. Additionally, the budget eliminates the High Priority Schools.

Revenue Limit Deficits
With the actions described above, the school district revenue limit deficit factor would be 7.844 percent in 2008-09 and 13.094 percent in 2009-10. For county office revenue limits, the deficit factor would be 7.839 percent in the current year and 13.360 percent in 2009-10.

Mandates
There is no provision proposed to change, repeal, or suspend any K-12 education mandates.

2007-08 Categorical Ending Balances
With some major exceptions, the Budget authorizes school districts to transfer categorical ending fund balances that accrued as of June 30, 2008, (2007-08 fiscal year) to any educational purpose. The exceptions to this transfer authority include the following programs:

- Special Education
- QEIA
- EIA
- Targeted Instructional Improvement Grants (TIIG)
- Instructional Materials
- California High School Exit Exam (CAHSEE)
- Supplemental Instruction
- Home-to-School Transportation

Reserve for Economic Uncertainties
The Legislature rejected the Governor's proposal to reduce the minimum reserve requirement by one-half (from 3.0 percent to 1.5 percent for most districts). School districts will be required to maintain the statutory minimum reserve for the current year and budget year.

<u>Results</u>
Before school districts can use the program flexibility included in the budget proposal, it is necessary to have a public hearing on the proposed flexibility. Currently, it is staff's intent to fully avail itself of the categorical flexibility provided in law to offset budget cuts in the current subsequent four fiscal years. This may include restricted sweeping ending balances in fiscal year 2007-08 and 2009-10, using budget year flexibility to move state categoricals from the restricted side to the unrestricted side of the ledger in fiscal years 2008-09 through fiscal 2012-13. A list identifying the categorical programs to be affected in the current year will be identified in the Second Interim Financial Report.