



School Finance 2008–09

Fiscal Crisis Meets Political Gridlock

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As 2009 begins, California lawmakers face a state budget crisis that seems to get worse by the day. This crisis could have been moderated if leaders had addressed a fundamental budget imbalance that has existed in California since 2001.

For years California’s elected leaders have used various forms of borrowing and deferral to avoid making the tough revenue and expenditure decisions that would have balanced the state’s budget. If they had done so, that could have placed the state in a solid position for weathering the current, larger economic storm.

California’s public education system has been at the mercy of this political process because state officials largely control how much funding is available for schools and how it is allocated. Few Californians could be more anxious than school district leaders to hear what Gov. Arnold Schwarzenegger says in his January “State of the State” report and Budget Proposal and to see what action state leaders will take. The change in federal leadership will also eventually affect schools,

though that could take much longer. Meanwhile, the relentless pressure for performance improvement created by the No Child Left Behind Act continues despite the economic uncertainties schools have to manage.

Regardless of what happens in Sacramento—or in Washington—the schoolhouse doors remain open. Teachers prepare for each day’s lessons and children come to school. For their part, school district officials attempt to protect their classrooms from the fiscal worries and budget reductions that have become standard operating procedure.

This report summarizes what is currently known about the financial decisions state leaders made related to education for 2008–09, but it does not reflect decisions made after mid-December. For additional updates, check our website at www.edsource.org.

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Even a looming fiscal catastrophe has not broken Sacramento's long-term deadlock

When state policymakers enacted the 2008–09 budget—the latest in state history—not even those who voted for it thought that it solved the state's long-term fiscal challenges. However, the budget avoided dramatic reductions in state education spending. With rising energy and salary and benefit costs that must be covered, however, school districts have already had to cut back on “discretionary” expenditures such as vice principals, classroom aides, and maintenance and security staff, which are considered essentials in many other states.

Soon after the budget's enactment in late September, it began to unravel as most observers had predicted. The May 2008 revenue assumptions on which the budget was based had proven overly optimistic as the effects of an international fiscal crisis hit California hard. First quarter revenues came in substantially short of what was projected. The newly appointed head of California's Legislative Analyst's Office (LAO), Mac Taylor, who advises the Legislature on fiscal and policy matters, said the fiscal picture may be the worst he has seen in his 30 years with the LAO.

In response to the projected shortfall and the general economic situation, Gov. Arnold Schwarzenegger called a special legislative session immediately following the November 2008 election. However, that session ended with no action, and the new Legislature sworn in on Dec. 1 faced even more pressure to address the state's fiscal challenges, having already been called into a special session of its own.

In December, state budget analysts predicted that, absent any correction, the state would have a \$14.8 billion deficit by the end of 2008–09, which would grow to more than \$40 billion by the end of 2009–10.

Lawmakers operate under multiple constraints when enacting a state budget

Delays in the state budget-making process, which have become something of a habit in Sacramento, are frustrating for local education agencies trying to create reliable spending plans of their own. Contributing to the

delay of this year's budget were declining revenues due to the large-scale economic downturn and the substantial political, legal, and fiscal constraints that state policymakers face.

California law requires that two-thirds of the Legislature, plus the governor, agree on the final budget and any tax increases. California is one of only three states with this two-thirds requirement. Given the current make-up of the Legislature—60% Democrats and 40% Republicans—this generally means that a few Republicans must join the Democrats in passing a budget or tax bill, despite an environment in which disagreements along strict party lines are the norm.

Policymakers also face dramatic fluctuations in state revenues. One underlying cause is a state tax system that relies heavily on income taxes on high earners whose income includes stock earnings, which can rise and fall quickly. In the late 1990s and very early 2000s, state revenues increased dramatically as stock prices shot up and many Californians began paying taxes on large capital gains. State policymakers increased spending, particularly for education, and cut taxes. However, when revenues declined substantially soon thereafter, elected officials only gradually reversed most of the spending increases and did not restore some of the taxes they cut. Rather than aggressively matching ongoing revenues and expenditures, elected officials in Sacramento have for several years pieced together budgets that were balanced using borrowing, funding shifts, accounting maneuvers, and other temporary solutions.

Policymakers have not gone further in reducing spending partly because of the set of spending priorities in the state constitution established by voters through ballot measures. For example, voters have decided to require tougher criminal-sentencing guidelines for adults and juveniles, which increases the share of the budget dedicated to corrections. Voters have also approved large capital projects financed by bonds, which are repaid from the state's General Fund. In yet another example, Californians have supported protection of local government revenues so the state cannot “borrow” their funds to help solve its fiscal problems. Expenditures on schools and community colleges are also somewhat protected by the minimum spending guarantee created by Proposition 98 in 1988, but that guarantee fluctuates along with state revenues. (The Proposition 98 guarantee is discussed in greater detail later in this report.) Suspending that requirement may have been tempting at times during this year's budget difficulties because education spending represents about 40% of the budget. But, as with other budget actions, suspending Proposition 98 requires a two-thirds majority in the Legislature and approval of the governor. In sum, fiscal and procedural constraints put in place by voters limit policymakers' choices, adding to the difficulty of enacting a budget.

This year's budget relies mainly on temporary solutions

When crafting the 2008–09 budget that was enacted in September, state leaders tried to

eliminate a \$15.2 billion deficit with a combination of revenue increases, spending cuts, funding shifts, and diversions of reserve funds. Some of their policy actions work only in the short term.

To raise revenues, policymakers relied on several strategies, including primarily bonds, accelerated tax collections, revised accounting practices, new penalties on corporations for underpaying taxes, and higher taxes on businesses in exchange for reduced future tax burdens beginning in 2010 or 2011. In addition, policymakers will be asking voters to approve a ballot measure that would enable the state to borrow funds—the hope is for as much as \$10 billion—by securitizing lottery revenues. The money would be repaid over two years with future lottery income. (See the box to the right.)

On the spending side, policymakers did not provide full cost-of-living increases to many programs and state workers' salaries, suspended a requirement to build up the state's reserves, and made other programmatic reductions, including to services for low-income citizens.

The budget also relies on shifting money to the state General Fund from other sources, including \$1.7 billion in transportation funds and \$350 million from redevelopment agencies. Finally, the governor suspended a transfer of funds to the state's Budget Stabilization Account, a type of reserve fund. As a result, \$1.5 billion will not be spent on retiring some state debt.

Some policy proposals aim to prevent future fiscal crises

Although the 2008–09 budget was rife with stopgap measures, policymakers also took some steps to deal with the state's ongoing

imbalance of revenues and expenditures. The budget agreement between the governor and Legislature contained a proposal that they will put before voters on a statewide ballot in 2009. The measure would affect how much money the state will set aside in reserve and the requisite conditions for dipping into the reserve. It would also give the governor the authority to make midyear cuts when a substantial shortfall is projected to arise. However, the governor would not be able to unilaterally make cuts affecting K–14 districts, except perhaps to the cost-of-living adjustment on certain earmarked revenues.

In addition, the state formed a commission to recommend changes to tax policies that would reflect today's more service-oriented, global economy and help stabilize

revenues. The Commission on the 21st Century Economy will consist of 12 members appointed by the governor and Legislature. It is expected to unveil its recommendations by April 15, 2009.

Aside from these proposals related to future policy changes, lawmakers in 2008–09 focused mainly on the political compromises necessary to garner a two-thirds vote and the governor's signature on the budget. After the longest budget delay in state history, they needed to get cash flowing again to local agencies. One priority among policymakers was to avoid a level of cuts to education that would have required suspending Proposition 98. Advocates for schools, though not celebrating the budget, knew that the allotments for education could have been worse.

Policymakers propose borrowing against the state lottery

Included in the 2008 budget package is a proposal to borrow against future lottery revenues. For the proposal to become a reality, voters would have to approve the idea in a statewide election, which will occur in 2009.

Under the proposal, the state would borrow \$5 billion in 2009–10 and another \$5 billion in 2010–11. The debt would be paid off with hoped-for increases in lottery revenues resulting from a leaner lottery administration and increased ticket sales because of larger prizes. Proceeds from bond sales would be put into the General Fund.

If the measure passes, the lottery revenues that K–14 education receives would be replaced by General Fund dollars. (The amount of lottery revenues allocated to K–14 education fluctuates annually; but in recent years, it has represented a little less than 2% of total annual revenues.) Beginning in 2009–10, education would receive the same amount of General Fund money that it received from the lottery in 2008–09, adjusted for inflation and changes in student attendance.

If voters adopt this proposal to borrow against future lottery revenues, the state would likely find a way to provide the agreed-upon General Fund monies to K–14 education even if the lottery revenues fell short, which could happen if the revenue assumptions are too optimistic. This approach would effectively remove the lottery per se as a separate source of education funding.

Soon after the budget's enactment in late September, it began to unravel as most observers had predicted. The May 2008 revenue assumptions on which the budget was based had proven overly optimistic as the effects of an international fiscal crisis hit California hard.



Education received “flat funding” in the enacted 2008–09 budget—but cuts may occur midyear

The state’s 2008–09 budget allocates a combination of federal, state, and local monies to K–12 schools. (See Figure 1 on page 8.) All combined, those sources of funding are providing what education policy insiders generally call “flat funding” because most education programs are receiving the same amount in 2008–09 as in the prior year.

Policymakers provided enough funding in the budget to meet the minimum funding for schools and community colleges guaranteed by Proposition 98. However, lawmakers chose not to provide a cost-of-living adjustment (COLA) based on the federal index used when the state’s finances are healthy. Instead, they provided just a partial COLA. The education budget also does not cover the cost of reimbursing local school agencies for implementing state mandates and, with the worsening economic news, the funding provided in the budget appears likely to be reduced midyear.

Policymakers met the Proposition 98 minimum

When policymakers were crafting the 2008–09 budget that they approved in September, they based it on May 2008 revenue estimates. At that time, fiscal analysts projected that the Proposition 98 minimum funding level for K–12 schools and community colleges would be \$58.1 billion, which is what the budget provided. This was based on “Test 3” of Proposition 98 (See the box on page 5.) Within that amount, the state allocated more than \$51.6 billion for K–12 schools and \$6.4 billion for community colleges. Given the economic climate, policymakers did not contemplate spending substantially more than the minimum required under Proposition 98.

According to the Department of Finance, this statewide Proposition 98 funding level translates to \$8,784 per K–12 pupil, up from \$8,509 in 2007–08, for an increase of \$275 per pupil. However, from another perspective, that year-to-year increase is overstated. In 2007–08, the state used some one-time

monies to pay for ongoing programs. Counting those one-time monies as part of 2007–08 Proposition 98 spending, the amount districts received last year goes up and the difference between 2007–08 and 2008–09 falls to a fraction of the \$275 reported by the Department of Finance.

Shortly after this year’s budget was enacted, it became apparent that state revenues were coming in far below what was projected. As a result, the Proposition 98 minimum guarantee for the current year is being recalculated substantially downward. To help with the overall budget, there is some chance that policymakers will reduce education funding to that revised minimum. This would create significant difficulties for local education agencies, which are well into the school year with their programs and personnel in place based on their adopted budgets. Their ability to cut costs midyear is also seriously constrained. By law, districts are limited in the staffing cuts they can make, and in many cases they have already signed collective bargaining agreements with teachers and other employees for the current year. (For more on the difficulties that districts are facing, see page 9.)

The budget includes a small cost-of-living increase for revenue limits only

Given the amount of the Proposition 98 minimum guarantee this year, lawmakers chose not to provide districts with the full cost-of-living adjustment called for in state law. According to statute, local education agencies are to receive a COLA based on a governmental index, which was 5.66% this year. However, policymakers provided only

How the cost-of-living adjustment (COLA) usually works

In a typical year, the COLA is applied to districts’ general purpose funding and most earmarked revenues. The general purpose operating money that a school district receives each year is based on a specific amount per pupil. This amount is the district’s per-pupil base revenue limit. It is calculated using historical funding levels and a formula set by law.

The per-pupil amount is intended to be relatively equal within each of six categories of districts—elementary, unified, and high school, each of which can be large or small. A district’s total revenue limit allocation is the product of its per-pupil amount multiplied by its average daily attendance (ADA).

The state places few restrictions on how districts can spend revenue limit funds. The portion varies from district to district, but on average represents about two-thirds of total district allocations. The other third comes from categorical programs for which districts receive funds in varying amounts depending on student populations, district characteristics, and the programs districts operate.

0.68% in the 2008–09 budget enacted in September. And the governor has proposed eliminating the COLA altogether because the 2008–09 Proposition 98 minimum spending guarantee will be lower due to the decrease in state revenues since the budget was enacted.

Proposition 98 sets a minimum funding guarantee for education

Proposition 98, passed by voters as an amendment to the California Constitution in 1988, is designed to guarantee a minimum level of funding for public schools and community colleges that at least keeps pace with growth in K-12 student population and the personal income of Californians and at best increases the amount schools receive. It was revised in 1990 by Proposition 111.

Proposition 98 dollars are state funds raised primarily through income, sales, corporate, and capital gains taxes, combined with local property tax revenues. They represent about 72% of the funds that K-12 schools receive (Figure 1 on page 8 provides details on all sources of funding for K-12 schools. For information on community college funding, see a brief on this issue at: www.edsources.org)

The minimum spending level under Proposition 98 is determined by one of three “tests” or formulas, which are described in detail in the table below. Several factors influence which test is used to set the minimum guarantee, but the most important

are the annual changes in statewide K-12 student attendance, per capita personal income, and per capita General Fund revenues. (The General Fund is the state’s largest pot of money and is not dedicated to one specific program.)

Because of weakness in current revenues, the state used Test 3 to determine the Proposition 98 guarantee for 2008–09. Test 3 also includes a mechanism for making up, at some point in the future, the difference between what education received and what it would have received under Test 2. This mechanism is called the “maintenance factor.” The amount of the maintenance factor created in 2008–09 is \$1 billion. This sum will gradually be built back in to the Proposition 98 funding base in years when General Fund growth exceeds personal income growth, which means that the amount may be restored over several years. Indeed, before 2008–09, the state already had a maintenance factor of \$900 million from previous years that must still be restored.

Understanding the Three Tests of Proposition 98

TEST 1 Percentage of General Fund Revenues Times used: 1	Requirement K-14 education must receive a minimum percentage of General Fund revenues, currently about 41%.
	When is it Operative? When it would provide more money than Test 2 or 3. It has been used only once, in 1988–89.
	Requirement K-14 education must receive at least the same amount of state aid and local property tax dollars (collected locally but the distribution among local governments is determined by the state) as received in the prior year, adjusted for changes in enrollment and growth in per capita personal income.
TEST 2 Adjustment Based on Statewide Personal Income Times used: 12	When is it Operative? Basically, when General Fund revenues experience normal or strong growth over the prior year. (Specifically, it is used when percentage growth in state per capita personal income is less than or equal to the percentage growth in per capita General Fund revenues plus 0.5%.)
	Requirement K-14 education must receive at least the same amount of state aid and local property tax dollars as received in the prior year, adjusted for changes in enrollment and per capita General Fund revenues, plus 0.5% of the prior year Proposition 98 spending amount.
	When is it Operative? Basically, when General Fund revenues fall or grow slowly over the prior year. The intent is for the K-14 education funding requirement to be responsive to reduced revenue. (Specifically, it is used when statewide per capita personal income is greater than the percentage growth in per capita General Fund revenues plus 0.5%.)
TEST 3 Adjustment Based on Available Revenues Times used: 7, including in 2008–09	Requirement K-14 education must receive at least the same amount of state aid and local property tax dollars as received in the prior year, adjusted for changes in enrollment and per capita General Fund revenues, plus 0.5% of the prior year Proposition 98 spending amount.
	When is it Operative? Basically, when General Fund revenues fall or grow slowly over the prior year. The intent is for the K-14 education funding requirement to be responsive to reduced revenue. (Specifically, it is used when statewide per capita personal income is greater than the percentage growth in per capita General Fund revenues plus 0.5%.)
SUSPENSION Times used: 1	Proposition 98 can be suspended for a year with a two-thirds vote of the Legislature and concurrence of the governor. If suspended, policymakers have great discretion as to the level of funding they provide.
MAINTENANCE FACTOR	If Test 3 is used, or if Proposition 98 is suspended, the amount saved (the difference between what Test 2 would have provided and what was provided) must be restored over time to the minimum guarantee level, beginning in the next year in which the percentage growth in per capita General Fund revenues exceeds the percentage growth in per capita personal income.
“SETTLE UP”	When state leaders craft a budget for the upcoming fiscal year, they must estimate what the minimum Proposition 98 spending level will be before the fiscal year starts. If, during the course of the fiscal year, the estimate turns out to be too low, the state must later make up the shortfall. The amount of the shortfall is often referred to as the “settle up” amount.

State law authorizes a COLA for revenue limit (or general purpose) funding and almost all categorical (or earmarked) programs. (See the box on page 4.) But the approved budget includes a COLA for revenue limit funding only.

The adjustment to Proposition 98 spending for student attendance “growth” is negative due to declining statewide enrollment

The number of students attending K–12 schools influences how much is spent on education under Proposition 98. For 2008–09, the Department of Finance is projecting that statewide student attendance will decline slightly, just as it did last year. This trend of statewide declining enrollment is relatively recent. From 1988 (when Proposition 98 was enacted) until 2005, the number of students consistently increased. And enrollment is projected to begin growing again in 2010. (Because enrollment has traditionally increased, the shorthand term for the attendance adjustment is “growth.”) In 2008–09, “growth” funding for K–12 education is a negative \$128 million, though the impact on individual local education agencies varies depending on their specific attendance trends.

Local agencies will not be reimbursed for state mandates this year, which will increase a huge backlog of overdue payments

Since the passage of Proposition 4 in 1979 (the Gann Limit), the California Constitution has required the state to repay local government agencies, including school districts, the cost of implementing new programs or an increased level of service that the state has required. However, one of the ways that the state has dealt with its fiscal difficulties in recent years is to defer reimbursing local school agencies for the cost of implementing several mandates. (Eventually, the state must repay schools with interest.) As long as policymakers provide a token minimum amount of funding—\$1,000 per mandate for the entire state—school districts must continue to perform the mandated activities. That is what the state has done several times in recent years, including in the 2008–09 budget.

Three pending lawsuits concern mandate reimbursement

Superior Court rules that the state's deferral of reimbursements is unconstitutional—but the state is expected to appeal

In November 2007, the California School Boards Association Legal Alliance and four local education agencies (LEAs) filed suit to compel the state to pay LEAs for the costs incurred in meeting state mandates. The plaintiffs also argued that state law allowing the deferral of state mandate payments was unconstitutional. At a hearing in September 2008, the state argued that because the state constitution did not specify a reimbursement timetable and districts would eventually be paid with interest, the state was not violating the constitution. The CSBA argued that deferment passed the financial burden of compliance onto districts, which is what the constitutional provision on mandate reimbursement was designed to prevent. On Dec. 8, 2008, a San Diego Superior Court judge ruled that the state's deferral of reimbursements is unconstitutional. However, given the amount of reimbursements that have been deferred and the court's inability to appropriate funds, the judge did not direct the Legislature to reimburse school districts from undesignated funds. The state is expected to appeal the decision.

Districts are fighting for re-establishment of reimbursement claims

Also in 2007, the California School Boards Association Legal Alliance filed suit against the state and the Commission on State Mandates (COSM), challenging a 2005 bill that authorized the state to deny reimbursement claims for three activities that had previously been reimbursable. Under Assembly Bill 138, the COSM could no longer order reimbursement for the cost of completing the School Accountability Report Card, the act of filing a mandate claim, and for meeting certain Brown Act requirements (which pertain to open meetings of public agencies). In March 2007, the Sacramento Superior Court ruled that the provisions of AB 138 were unconstitutional and ordered the COSM to set aside its prior denials of those claims. A decision is expected in January 2009.

Challengers of mandate claim audits win a partial victory

Finally, 11 districts, led by Clovis Unified, have charged that the audits of mandate reimbursement claims by the State Controller's Office (SCO) are “arbitrary and capricious.” In their 2006 litigation, the plaintiffs contended that the SCO had imposed unreasonable contemporaneous documentation requirements in its audits, preventing districts from receiving reimbursement. School and community college districts are asking the SCO to provide \$17.5 million in denied claims from 1997–98 to 2002–03. In August 2008, the judge gave school districts a partial victory with respect to two programs, holding that districts did not have to meet the SCO's contemporaneous employee salary documentation requirements for collective bargaining and intradistrict attendance programs because the SCO had not properly notified districts of the need to do so. The judge has been asked to clarify whether his decision should be expanded to audits in those programs before the contemporaneous documentation requirement became effective. A final ruling is expected soon.

Beginning in the 1990s, the state ran up a large debt of unpaid mandate reimbursements. Policymakers signaled their intent in 2003–04 to begin repaying this debt to K–14 education by using \$150 million of Proposition 98 “settle up” funding (see the box on page 5) each year until the reimbursement debt was retired. (This includes \$125 million for K–12 and \$25 million for community colleges.) In addition, leaders in Sacramento appropriated more than \$900 million in the

2006–07 budget for mandate reimbursements. However, there was still a deficiency of \$275 million at the end of that fiscal year, partly because the state appropriated only \$30 million for reimbursement of 2006–07 claims. The debt grew again in 2007–08 when the state provided only the minimum amount to keep 38 instructional, fiscal, and safety mandates in force.

For 2008–09, the state is providing only \$38,000 of the approximately \$160 million

needed to fully reimburse K–12 school agencies for meeting these annual requirements. In addition, policymakers have canceled the \$150 million payment for 2007–08, which adds to the state’s mandate debt.

In addition, the Commission on State Mandates has recently required the state to reimburse districts for the cost of providing an additional high school science course, which includes covering past (back to 1995) and future costs. The ongoing cost of the additional science course alone is estimated to be \$250 million per year, which is on top of the roughly \$160 million per year needed for the already identified mandates.

These postponed payments mean the state could now have an accumulated debt to K–12 schools of several billion dollars, according to Department of Finance estimates. With such a large reimbursement debt, and a recent court decision regarding the state’s deferral of payments (see the box on page 6), policymakers may give mandate reimbursement reform serious consideration.

Charter school funding is similar, but it allows more flexibility

Although the number of students in California’s public schools is declining overall, enrollment in the state’s charter school segment—which represents about 4% of all public K–12 students—is growing steadily. State officials estimate that attendance in charter schools will grow by another 10% or more in 2008–09.

Charters receive a general purpose block grant that is similar to districts’ revenue limit funding in purpose and amount. In addition, charters automatically get categorical program dollars through a discretionary block grant and may apply for other categorical funding. Charters also receive lottery funding and a discretionary grant in lieu of Economic Impact Aid (EIA), a program to support instruction of disadvantaged students.

Charters’ general purpose block grant amounts vary depending on the grade span and are based on the average of what the state pays in revenue limit funding. School Services of California estimates that the

Comparing the charter school general purpose block grant to the Proposition 98 per-pupil amount is problematic

Although it may be tempting to compare the charter general purpose block grant amounts detailed below with the Proposition 98 per-pupil amounts described on page 4, there are two problems with doing so. First, the two sets of figures are not completely separate in that the Proposition 98 per-pupil amounts on page 4 include funds allocated to charters. More importantly, the charter block grants reflect only general purpose funds, but the Proposition 98 per-pupil amounts represent funds for categorical programs and services outside of K–12 instruction in addition to general purpose funding.

per-pupil charter grant amounts in 2008–09 will be:

- \$5,624 for kindergarten–grade 3;
- \$5,709 for grades 4–6;
- \$5,872 for grades 7–8; and
- \$6,813 for grades 9–12.

Charter schools’ categorical block grant of \$500 per pupil is provided in place of a few dozen categorical programs for which districts receive funding. Charters cannot apply

separately for categorical programs included in the block grant, but they can apply (either directly or through their chartering agency) for other categorical funds. These include some very large programs, such as school lunches and K–3 Class Size Reduction, as well as small funding sources, such as grants for student councils. Like noncharters, charter schools also receive Special Education funding and must use a portion of their general purpose funds to cover the costs of educating any special-needs students whom they serve when state and federal funds are inadequate to fully fund those costs.

Charter schools also receive extra general purpose money for each student who is identified as low-income or an English learner. This is in lieu of the EIA funding that school districts receive. Charters are getting about \$318 per eligible pupil in 2008–09, and students who are both low-income and English learners generate double the amount, similar to what happens with noncharter schools. Some charter schools also receive federal Title I funds to provide extra support to these students. In addition, they receive the same per-pupil amount that districts get from the state lottery.

Finally, charters can access state bond funds for facilities construction or, if they are serving a low-income population, can receive rent or lease assistance through a separate program for charters.

Districts’ ability to cut costs midyear is seriously constrained. By law, districts are limited in the staffing cuts they can make, and in many cases they have already signed collective bargaining agreements with teachers and other employees for the current year.

figure 1 | Revenues for K-12 education come from multiple sources

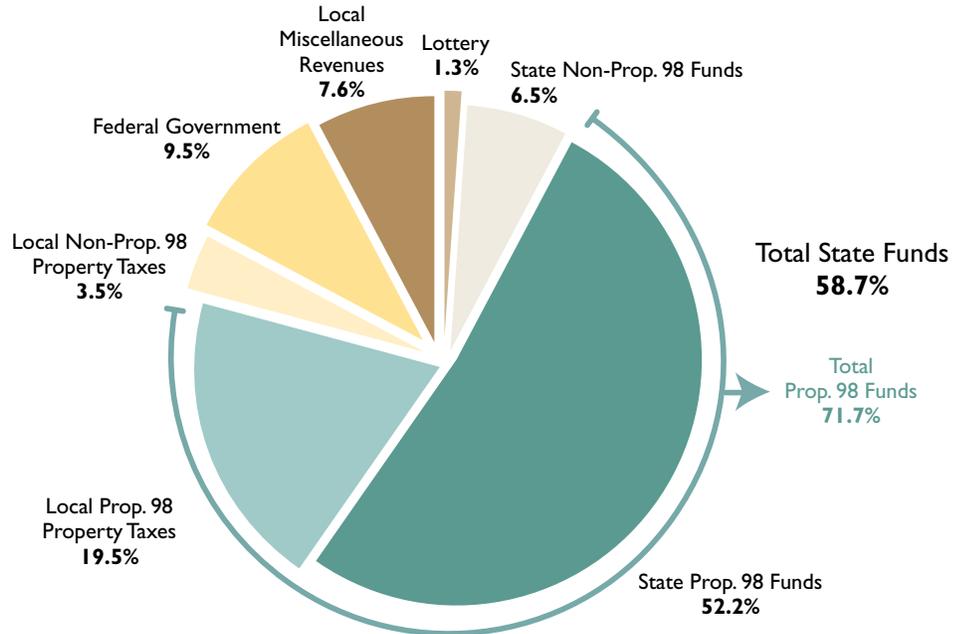
In addition to Proposition 98 revenues, local education agencies receive lottery funds, local miscellaneous revenues, and federal funding. In the enacted budget, some of those funding sources—such as state funds, local property taxes, and local miscellaneous revenues—are providing more funding this year than last year. In contrast, other sources—namely federal revenues and the state lottery—are not changing significantly compared with 2007-08.

The Proposition 98 spending level is an ongoing obligation and thus is normally funded with ongoing revenue sources. However, in 2007-08, some ongoing education programs were partially funded with one-time revenue sources. To continue operating those programs in 2008-09, the state had to use ongoing funding streams again. Much of the year-to-year increase in state funds (\$800 million) and local property taxes (\$900 million) is going toward backfilling the “holes” created when the one-time monies used in 2007-08 were exhausted.

If projections for 2008-09 prove to be accurate, local miscellaneous revenues will have increased substantially—from \$4.3 billion in 2007-08 to \$5.4 billion in 2008-09. These revenues come from a mix of local fundraising efforts, fees on land developers, and parcel tax revenues, among other sources. Policymakers’ expectation of a large increase in local miscellaneous revenues may in part reflect a continued surge of parcel tax income that began in 2007-08. (See page 15 for more details.)

Federal funding is increasing slightly, from \$6.7 billion to \$6.8 billion. This reverses the downward trend seen in the past few years. The small change in federal funding overall masks some substantial increases and decreases in component programs. For example, federal funding for school and district improvement is more than doubling, and support for child nutrition is increasing from \$1.65 billion to \$1.76 billion, a 6.7% increase. In contrast, Reading First funding, which has been mainly spent on reading coaches and instructional materials, is being cut by two-thirds. In addition, money for the 21st Century Schools program, which supports after-school and anti-drug programs, is decreasing by more than 10% this year. (See Figure 2b on page 11.)

2008-09 revenues for K-12 education based on the enacted budget



Note: Not all K-12 Proposition 98 funds support K-12 education. For example, \$791 million will support adult education programs and \$1.8 billion will finance child care programs. The percentages do not add up to 100% due to rounding.

Similar to overall federal funding, lottery revenues are not expected to change much in 2008-09. This projection of flat funding may be part of the reason that some education stakeholders find the proposal to borrow against future lottery revenues overly optimistic. (See the box on page 3.)

Total estimated revenues for 2008-09 from all sources are about \$71.9 billion including:

State funds \$42.2 billion (including \$37.5 billion Proposition 98)

mostly from California sales and income taxes, including about \$4.6 billion not counted toward the Proposition 98 guarantee.

Local property taxes \$16.5 billion (including \$14.0 billion Proposition 98)

are collected and distributed locally, but the state determines the distribution among school districts and other local governments. The \$16.5 billion includes \$2.5 billion not counted toward the Proposition 98 guarantee, such as \$2.1 billion in local debt service.

Local miscellaneous revenues \$5.4 billion

includes such sources as community and foundation contributions, interest income, developer fees, and revenues from local parcel tax elections.

Federal government \$6.8 billion

earmarked for special purposes, most notably Child Nutrition, No Child Left Behind (NCLB), and Special Education.

Lottery \$0.9 billion

Per-pupil estimates for 2008-09 are unavailable. In 2007-08, with the same total dollars, districts received \$121 per pupil (ADA)* in unrestricted revenues plus \$22 for instructional materials only. However, enrollment is slightly lower in 2008-09.

Projected California public school average daily attendance (ADA)*

5.92 million K-12 students (for the purposes of Proposition 98) plus about 297,000 students in adult education and 137,531 in regional occupational programs.

*ADA or “average daily attendance” is the total number of days of student attendance divided by the total number of days in the regular school year. A student attending every day would equal one unit of ADA.



Districts face additional fiscal constraints but no additional flexibility to help make ends meet

With about 84% of the average school district's budget directed toward staff salaries and benefits, districts are hard-pressed to reduce expenditures without affecting at least some aspect of the hiring, retention, or salaries and benefits of employees. In the past, during especially difficult fiscal years, legislators have allowed districts increased flexibility to make cuts based on their local needs. This flexibility can take two forms—relaxing fiscal requirements (such as minimum reserve levels) and allowing districts to shift funds among earmarked programs. Legislators so far this year have not provided either type of flexibility despite requests from some education stakeholders.

In addition, compared with last year, more districts and schools will be involved in programs that specify how some monies and staff are used. For example, the Quality Education Investment Act (QEIA)—in which 488 schools are participating—comes with specific requirements for staffing ratios.

Additional fiscal flexibility has not materialized so far in 2008–09, but it may—along with midyear cuts

In the recent past, when the education budget has been especially challenging, the state has relaxed some of the fiscal restrictions on local agencies. For example, the state has increased the amount that districts could transfer among a set of categorical programs and has added programs to that set. Such increased flexibility allows district officials to focus their resources where they think they are most needed. In addition, state policymakers have twice in recent years halved the amount that local agencies were required to maintain as a reserve for economic uncertainties. When the fiscal climate improved, the state tightened the strings again; for example, removing large programs from the set of transferable categoricals and restoring the percentage of funds to be held in reserve.

Some education stakeholders have called for loosening the strings in 2008–09 as well. However, policymakers apparently decided to keep the priorities embedded in existing policies on categorical funding and reserves rather than grant flexibility. This year's

budget, as enacted, was not originally as challenging as was the case in 2003–04, when policymakers last granted substantial flexibility. That year, the budget not only had no COLA for categoricals or revenue limit funding, but also contained a \$350 million reduction to revenue limit funding.

As lawmakers pondered the possibility of midyear cuts for education during the

November 2008 special session, additional flexibility was a topic of debate. But the governor and the Democratic majority in the Legislature differed dramatically in their approach. This debate remains unresolved as this publication goes to press, and local districts remain unsure what combination of cuts and regulations they will have to respond to midway through the school year.

Special Education receives a small funding increase

In compliance with the Individuals with Disabilities Education Act (IDEA), local education agencies must provide a free and appropriate education to students with disabilities regardless of the funding they receive from state and federal Special Education programs. This year's funding picture for Special Education is even more challenging than in prior years. Local agencies will receive only a partial "growth" adjustment and no COLA for their Special Education funding. A small bright spot is a 1% increase in federal aid for educating special-needs students.

Of the estimated \$15.8 million federal increase, \$800,000 will go to preschools, \$2.3 million will go to the California Department of Education to help implement programs, and \$12.7 million is a permanent increase. That last item will amount to about \$2.15 per pupil for all Special Education Local Plan Areas (SELPAs), which coordinate Special Education services in their jurisdiction.

Special Education funding is based on the average daily attendance (ADA) of the total number of students in the K–12 public schools served by SELPAs rather than on the number of Special Education students and the services they receive. Last year, SELPAs received an average of \$643 per ADA. This year, the SELPAs that are growing will continue to receive \$643 for their existing K–12 students but only \$465 per ADA for new students.

These funding levels can be seen in the context of a gap between what districts receive from state and federal programs for Special Education and what they must spend. Districts must provide Special Education services and draw from general operating funds to supplement state and federal dollars.

School Services of California states that the amount contributed from local districts for these services was about \$3 billion in 2006–07 in addition to state and federal dollars. When the data for 2007–08 and 2008–09 are calculated, School Services adds, that amount is likely to be higher because of rising costs.

figure 2a | State education money is earmarked for special purposes

Major State Programs (All dollar figures are in millions)	2007-08	2008-09
Special Education	\$3,159	\$3,116
Class Size Reduction (K-3)	1,830	1,815
Child Care and Development (includes preschool)	1,756	1,772
Targeted Instructional Improvement Block Grant	1,076	1,070
Economic Impact Aid	994	994
Adult Education (includes \$17.8 million for adult education in correctional facilities in 2007-08 and \$18.2 million in 2008-09)	771	791
Pupil Transportation	228 ¹	566
Proposition 49 After-School Programs	550 ²	550 ²
Regional Occupational Centers and Programs	486	483
Library Improvement Block Grant (includes library materials and school improvement programs)	465	463
Summer School/Supplemental Instruction	421	421
Instructional Materials	420	418
Deferred Maintenance	162 ³	277
Professional Development Block Grant	275	273
High School Counseling (7th-12th grade)	209	209
Charter School Categorical Programs	151	190
Child Nutrition	136	138
Teacher Credentialing Block Grant (includes Beginning Teacher Support and Assessment or BTSA)	129	129
High Priority Schools Grant Program (includes \$6 million in funds for corrective action in 2007-08)	47 ⁴	114
Arts and Music Block Grant	110	110
Class Size Reduction (9th grade)	107	101
School Safety Block Grants	101	100
Pupil Retention Block Grant (includes supplemental instruction, 10th grade counseling, dropout prevention programs, etc.)	97	97
Year-Round Education Grant Program	97	97
Student Assessment	85	91
California High School Exit Exam (CAHSEE) Intensive Instruction and Services	73	73
English Learners	64	63
CalSAFE (California School Age Families Education) Program	58	58
Professional Development for Math and Reading	57	57
Community Day Schools	52	52
Gifted and Talented Education (GATE)	56	55
Community-Based English Tutoring (CBET)	50	50

Additional programs are funded for lesser amounts. Go to www.edsource.org to find a more extensive list of programs.

Note: Funding deferred from the previous year is included in the figures. Appropriations from the Proposition 98 Reversion Account are not included in the figures. However, the footnotes below list Reversion Account appropriations for three programs that would otherwise appear to have been significantly cut.

1 This figure does not include \$250 million from the Reversion Account and \$99 million from the Public Transportation Account.

2 This funding does not appear in the Budget Act but is continuously appropriated because the program was established in the state constitution in 2002.

3 This figure does not include \$115.5 million from the Reversion Account.

4 This figure does not include a total of \$102 million reappropriated from the Budget Acts of 2005 and 2006.

DATA: DERIVED FROM CDE-PROVIDED DATA AND THE 2007-08 AND 2008-09 BUDGET ACTS AND OTHER LEGISLATION.

EdSource 1/09

More schools and local education agencies will face the regulatory requirements of Program Improvement

Nearly a quarter of the state's school districts face increased pressures and additional constraints related to their students' academic

performance, based on the requirements of the federal accountability system.

When a local education agency (LEA) accepts a Basic Grant under Title I—a federal program to help educate disadvantaged students—it agrees to accept the consequences of

not meeting federal academic performance targets. The vast majority of districts in California receive a Basic Grant, and they spend those monies on schools with significant percentages of students from low-income families. Basic Grant funding can be substantial—for example,

figure 2b | Federal education money is earmarked for special purposes

Major Federal Programs (All dollar figures are in millions)	2007-08	2008-09
ESEA Title I – Extra Support for Students Who Live in Poverty	\$2,012	\$2,037
Basic Grants	1,608	1,631
Reading First	170	57
Migrant Education	133	136
School/LEA Improvement	71	190 ¹
Even Start	17	8
Homeless Children Education (McKinney-Vento)	7	9
Advanced Placement Fee Waiver	3	4
Neglected and Delinquent Children	3	2
Child Nutrition	1,645	1,756
Special Education	1,161	1,174
Child Care and Development Programs (includes CalWORKs)	601 ²	538
ESEA Title II – Improving Teacher and Administrator Quality	376	380
Part A – Improving Teacher Quality	311	315
Education Technology	32	31
Math and Science Partnership Grants	27	23
Subject Matter Projects	4	10
Administrator Training Program	2	2
ESEA Title IV – 21st Century Schools	221	198
After-School Programs (21st Century Community Learning Centers)	186	170
Safe and Drug-Free Schools and Communities	35	29
ESEA Title III – English Learners and Immigrant Students	164	175
Vocational Education	140	138
Adult Education	77	75
Charter School Grants	21	36
ESEA Title VI – Assessment Funding	33	23
ESEA Title V – Innovative Programs	11	6
Robert C. Byrd Honors Scholarships	5	5
CalServe K-12 Service Learning Initiative	2	2
Instructional Support (Rural and Low-Income Schools)	1	1

Note: Subprograms may not add up to the total funding for an ESEA Title due to rounding.

1 Most of the increase from 2007–08 results from a large new effort to help local education agencies in corrective action.

2 Funding was substantially lower than in prior years partly because of a shift of \$269 million in federal funds. The shift was offset by an increase in state spending on child care.

DATA: DERIVED FROM CDE-PROVIDED DATA AND THE 2007–08 AND 2008–09 BUDGET ACTS AND OTHER LEGISLATION.

EdSource 1/09

\$25 million in Oakland Unified in 2007–08 and \$43 million in San Diego Unified. Both LEAs and schools that receive the funds are subject to consequences, some of which are finance-related. In addition, the student achievement targets increase every year. As a result, more schools and LEAs are falling short of the performance objectives. When a school or LEA misses the target two years in a row, it enters Program Improvement, an intervention program with increasingly severe consequences for each year

that the school or LEA does not make the required progress. (See Figure 3 on page 12.)

In 2007–08, 36% of the state's Title I schools and 19% of Title I LEAs were in Program Improvement. In 2008–09, those figures grew to 37% (2,241 schools) and 26% (242 LEAs) in the program.

Whether a school or an LEA is in Program Improvement, the LEA must fulfill specified duties because it is the school's fiscal agent and has oversight responsibilities.

When a school is deemed in need of improvement, the LEA must:

- provide technical assistance to help the school improve;
- inform parents of the school's status;
- set aside 5% of its Title I allotment to help the school improve teacher quality; and
- review the school's revised Title I plan.

In addition, depending on what level of Program Improvement (PI) the school is in, the LEA must:

- provide or pay for the transportation of students who exercise their right to transfer to a non-PI school;
- provide supplemental educational services to struggling low-income students;
- take corrective action, such as implementing a new curriculum; and
- help develop and execute a restructuring plan.

Besides implementing the changes that the district calls for, the school must use 10% of its Basic Grant funds for the professional development of its teaching staff.

When the LEA itself is in PI, it faces a number of additional duties. In Years 1 and 2, the LEA must notify and consult with parents, revise its Title I plan and implement the change, and reserve 10% of its Basic Grant for staff professional development. If the LEA reaches Year 3, it must implement any corrective actions that the state deems necessary, such as replacing staff or working with appointed consultants.

For more details on the history of intervention programs and how they work, see: www.edsources.org/iss_sta_interventions.html

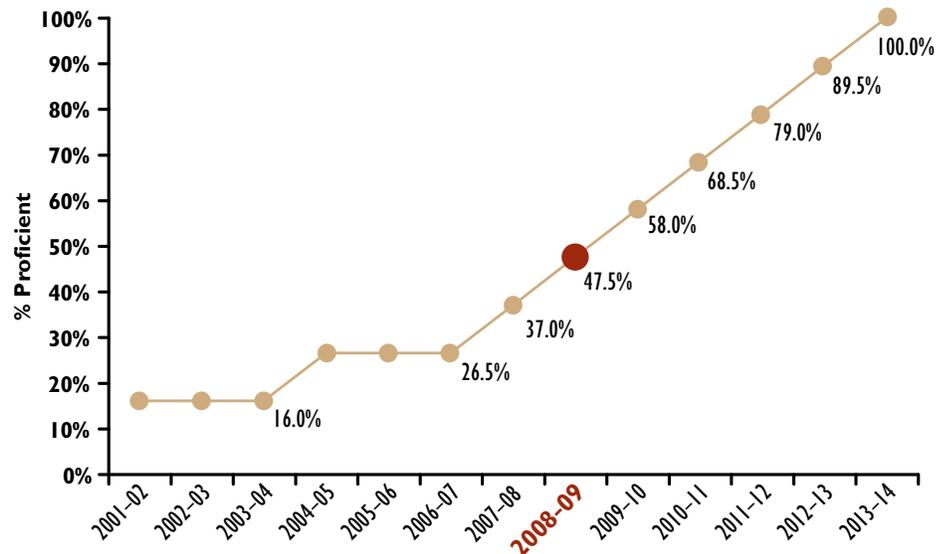
Quality Education Investment Act provides supplemental funding for struggling schools—but with heavy strings

Despite the severe budget situation, the state continued implementation of one major new program, the Quality Education Investment Act. The QEIA grew out of the settlement of a lawsuit brought by the California Teachers Association against the state regarding education funding in 2004–05 and 2005–06. The QEIA is a seven-year, \$2.68 billion program, with \$402 million in 2008–09 funding for K–12 schools.

In return for the funds, schools must meet annual benchmarks for ratios of pupils to teachers and counselors, teacher qualifications and experience, and Academic Performance Index (API) growth targets.

For example, the average teacher experience level at participating elementary schools must exceed the average level at other elementary schools in the district. In addition, most schools participating in QEIA must agree to reduce class sizes in grades 4–12 to

figure 3 | California's annual measurable objectives for elementary school mathematics under the No Child Left Behind Act are steadily increasing



DATA: CALIFORNIA DEPARTMENT OF EDUCATION (CDE)

EdSource 1/09

Compared with last year, more districts and schools will be involved in programs that specify how monies and staff are used.

roughly 25 students per class. (The exact requirement is determined through a complex formula.) Grades K–3 must participate in the existing Class Size Reduction program.

Schools in the bottom 20% of the 2005 API rankings were eligible to apply in March 2007 for QEIA funding. In July 2007, 1,260 of the 1,455 eligible schools applied for QEIA, and 488 schools were chosen to participate. For those selected, 2007–08 was a planning year for meeting the program's benchmarks during the next six years. The schools received two-thirds of "full funding," which meant \$333 for each K–3 pupil, \$600 for each pupil in grades 4–8, and \$667 for each 9th–12th grader. From 2008–09 through 2013–14, the schools will receive \$500, \$900, and \$1,000 per student for their respective grade spans. This means that a typical 650-student, K–6 elementary school eligible for the program would receive about \$436,000 per year for six years.

The amount of funding that districts receive depends on the number of participating schools and the grade levels and number

of students those schools serve. (The funding goes to the central district office but must be spent on participating schools.) Districts with similar numbers of schools participating may receive vastly different amounts due to the types of schools and the enrollment in those schools. For example, Oakland Unified and Fresno Unified both have 19 schools participating in QEIA. However, in Fresno Unified, Fresno High School, with an enrollment of 2,783, receives \$2,783,000. In Oakland Unified, Claremont Middle School, with an enrollment of 433, receives \$389,700.

The first allocation of full QEIA funding went to school districts in early July 2008. This occurred independent of the state budget. The LAO has suggested suspending the program, saying that it would be counterproductive to fund QEIA while not providing a full COLA on some of the core programs that serve the same schools. But any decision to alter or suspend the program or its funding could have prompted the plaintiffs to try to reopen the case, and lawmakers allowed the program to proceed.



The economic situation means managing finances is more difficult for school districts

State and local governments can count on taking in revenues; but in difficult economic times such as these, their income can fluctuate. With constituents counting on them for services and employees expecting compensation for their work, governments can run into cash flow difficulties when revenues take a dramatic dip. California's state government has been facing problems with cash flow and has passed—directly and indirectly—some of those problems down to local school agencies. This has made it especially important for local agencies to monitor their cash flow carefully this year. Districts in California have a few methods at their disposal for managing their cash balances. But their options for increasing revenues are extremely limited, as is their ability to reduce expenditures. The net result is an increasing number of districts in financial trouble.

Cash flow is a growing concern for the state and thus for school districts

The state receives revenues unevenly throughout the year, and annual totals fluctuate while demand for services generally remains steady or rises. As a result, the state sometimes experiences shortages of cash on hand. Some shortages are predictable and even routine. To get through those routine periods, the state issues revenue anticipation notes (RANs), a form of borrowing against expected income.

Very soon after the 2008–09 budget was enacted—when credit and financial markets were in serious disarray—the ability to successfully issue RANs was in doubt and Schwarzenegger notified federal officials that California might need to borrow up to \$7 billion from the federal treasury. In the end, borrowing from the federal government was not necessary because a large RAN issue was successful. This was not the only time in the past year that the state was at risk of running out of cash, and such ebbs have raised concerns about the state's ability to repay the bonds that have helped California manage its finances in recent years. State officials—worried about what such a default would mean for California's fiscal standing—have taken steps to address these cash shortages. For example, they have brought local school agencies' cash flow schedules more in line with

the state government's. However, this can create serious disruptions at the local level.

The state has adjusted K–12 allocations to help balance its budget and improve cash flow

In February 2008, the state enacted legislation (Assembly Bill 4 of the Third Extraordinary Session or “ABX3 4”) to reduce the General Fund contribution to education under Proposition 98. The legislation affected fiscal years 2007–08 and 2008–09. The bill achieved savings for 2007–08 in two ways. First, it used \$295 million that was set aside in prior years for a variety of K–14 programs to instead pay part of the 2007–08 cost of the Targeted Instructional Improvement Block Grant. (This block grant is for implementing any court-ordered desegregation requirements and to supplement a variety of programs.) This allowed the state to forego spending the same amount of General Fund dollars. Second, the bill captured \$211 million in unspent categorical funds and swept them back into the state General Fund.

For 2008–09, the bill did not achieve real savings but helped the state with cash flow needs. It delayed a disbursement of \$1.1 billion to local school agencies from July to September. Subsequently, as part of the 2008–09 budget, the state deferred half of the February 2009 installment of revenue limit funding and a large portion of February's K–3

Class Size Reduction allocation until late April 2009.

The state first set a precedent for delayed funding in 2001–02, when it pushed the allocation of about \$1.3 billion for the Principal Apportionment (an installment of revenue limit funding plus some add-ons) from June to July. However, that shift started as more of a bookkeeping maneuver than an attempt by the state to ease its cash flow problems. The June-to-July deferral was aimed at counting education spending in one fiscal year versus another to help minimize the monies needed to meet Proposition 98's ongoing funding requirements.

In addition to the funding shifts described above, the state indirectly shifted some of its cash flow problem to local school agencies by legislative inaction. Because policymakers did not enact a 2008–09 budget until three months after the start of the fiscal year, state officials in charge of allocating funds could not distribute categorical program monies. To be clear, even when the budget is enacted on time, state administrators do not send local agencies an entire year's allotment for every categorical program at the beginning of the fiscal year. Funding for programs is distributed starting at various times and in installments. The state budget delay meant that initial installments for many categorical programs arrived later than usual.

The delayed receipt of categorical funding can be quite serious for some districts. Overall, categorical funds comprise about one-third of total funding for the average district. But that state average masks the fact that some districts receive a much greater-than-average portion of their funding from categoricals. For example, about 45% of Los Angeles Unified School District's revenues are from state and federal categorical programs. In general, districts with higher proportions of low-income and English learner students receive a higher proportion of their funding from categoricals. Thus, it could be argued that the budget delay had a greater effect on school districts with the most vulnerable students.

Districts need to monitor cash flow especially closely this year

Districts are facing extra fiscal management demands this year for a number of reasons. They are not receiving funds when expected. Funding is flat though costs are rising. And many districts are also constrained by contracts with employees based on revenue assumptions that will probably not materialize. Yet they cannot lay off personnel without notice because of mandated, statutory timelines. In order to meet their obligations, districts need to regularly monitor cash on hand so they can anticipate shortages, if any, and act in advance to prevent problems.

Changes in when districts receive revenues will have varying effects on districts throughout the state. Some districts, especially those with strong cash reserves, will be able to adjust through additional planning and by temporarily transferring internal funds. Others may need to borrow funds from external sources. The latter action requires a certain amount of lead time, however. A district that is not monitoring cash flow and making arrangements to compensate for anticipated shortages will have few sound options for meeting expenses.

Some local agencies may need to use "internal borrowing" to keep enough cash on hand

Local education agencies can address cash flow dips by using "internal borrowing." This involves temporarily moving funds from

certain accounts to others with more pressing payment obligations. State law requires that the original accounts be repaid within the same year or in the following year if the borrowing occurs within 120 days of the end of the fiscal year. In addition, local agencies cannot transfer more than 75% of any one fund, and the borrowing fund must earn enough income during the current fiscal year to repay the amount transferred. Should lawmakers agree on some additional flexibility related to categorical spending or reserves, districts would have additional internal spending flexibility.

Three types of "external borrowing" can also help districts manage cash

Another option for districts is "external borrowing" from an outside source, such as their local county office of education. Such loans provide discretionary money for the district.

Districts can also issue tax and revenue anticipation notes (TRANs). These are very similar to the RANs referred to earlier that the state can issue. Some districts issued TRANs to help them get by during the state budget delay when categorical funding was held up. The lean budget that was enacted—and the possible midyear cuts—will likely make it necessary for some districts to issue additional TRANs. These notes are generally available within, and not across, fiscal years.

Yet another source of external borrowing is the county treasury. State law puts certain restrictions on these loans, however. For example, the amount lent must not exceed 85% of taxes levied on behalf of the school district. In addition, loans must be made before early April, and the county treasury gets first call on the district's subsequent revenues until the loan is repaid. Even if a district can work within those restrictions, the option is not available if the county treasury has troubles of its own. For example, San Mateo County recently lost \$150 million when Lehman Brothers, an investment bank handling many of the county's investments, declared bankruptcy in September 2008.

More local agencies are at risk of insolvency

Because local agencies are largely dependent on the state for their revenues, many districts'

financial statements are reflecting some of the trouble that the state has had over the past several years.

At least twice per year, local education agencies self-certify their ability to meet their financial obligations and submit that certification to their overseeing agency for approval. Districts submit the documents to county offices of education, and county offices submit theirs to the California Department of Education. The three possible certifications are:

- Positive: the LEA will meet its obligations for the current fiscal year and subsequent two fiscal years;
- Qualified: the LEA may not be able to meet its obligations for the current fiscal year or two subsequent fiscal years; and
- Negative: the LEA will be unable to meet its obligations for the remainder of the fiscal year or the subsequent fiscal year.

When a district receives a qualified or negative certification, it loses some of its financial autonomy. Its collective bargaining agreements are subject to county office scrutiny at least 10 days prior to board approval, and it faces limitations in incurring financial obligations, such as TRANs. It will also have additional reporting obligations. Often the district will work with the state's Fiscal Crisis and Management Assistance Team (FCMAT) to evaluate its financial position and develop a plan for improvement.

During the past 10 years, the number of districts receiving qualified or negative certifications in at least one of the two reporting periods has ranged from a low of 21 in 1998–99 to a high of 128 in 2007–08. Qualified or negative certifications have spiked in recent years, most notably in 2007–08. (See Figure 4 on page 15.) In addition to the large number of districts receiving unfavorable certifications last year, two county offices were also certified as qualified or negative. The unfavorable certification of county offices is a relatively new phenomenon. It has happened only to Amador County Office of Education for each of the past three years and Los Angeles COE in 2007–08.

Information about 2008–09 certifications will be posted on: www.cde.ca.gov/fg/fi/ir/interimstatus.asp

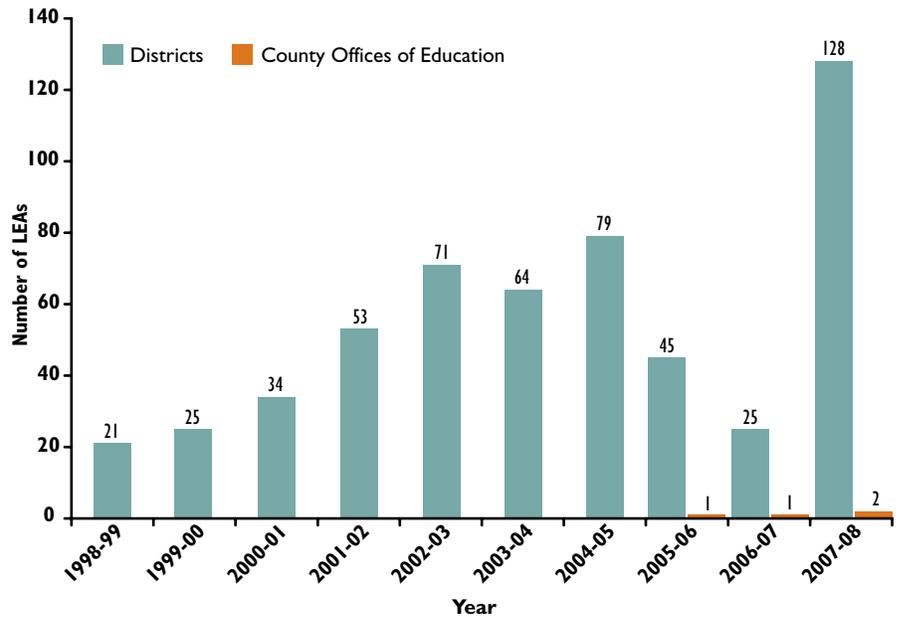
More districts are relying on local revenues to cope

School districts in California have very limited opportunity to increase their revenues, but some are quite successful at doing so. One major local source is the parcel tax. This levy on each parcel of property—not based on assessed value—must generally be approved by two-thirds of the voters in a school district.

When proposing parcel tax elections, districts must indicate how the money will be used. Proceeds are generally spent on educational programs rather than school construction or renovation, which is normally financed through a combination of local general obligation bonds, state matching funds, and fees on local development. Several districts this year stated that they needed parcel taxes to compensate for unreliable state funds. Other districts said they wanted to maintain small class sizes and attract and retain high-quality teachers and that a parcel tax was the only mechanism that would allow them to do so.

In 2008, 41 school districts put parcel tax measures on the ballot. Since EdSource began tracking parcel taxes in November 1983, the number on the ballot each year has ranged from 5 to 43 (in 2004). Of the 41 elections held in 2008, 30 were successful. The successful elections were overwhelmingly in northern California and most often in small suburban districts. Notable exceptions to the latter include Oakland Unified and West Contra Costa Unified school districts. The rate of success among districts holding elections in 2008—73%—is notable. During the prior 25 years, 51% of parcel tax elections were successful.

figure 4 | The number of local education agencies with “qualified” or “negative” certification of their finances grew to 130 in 2007–08



DATA: CALIFORNIA DEPARTMENT OF EDUCATION (CDE)

EDSOURCE 1/09

School construction projects are in jeopardy due to the credit crisis

School construction and modernization projects are often funded by a combination of local and state funding. At both governmental levels, money for such projects is raised through the sale of bonds and repaid over time. However, the deteriorating credit market is severely harming the state's ability to raise its portion of the funds.

On Dec. 8, 2008, during a rare joint session of the State Assembly and Senate, State Treasurer Bill Lockyer testified that the state had not been able to sell infrastructure bonds because of frozen credit markets. The inability to sell those bonds has meant that the state has not been able to replenish its Pooled Money Investment Account (PMIA), the source of funds for infrastructure projects. As a result, hundreds of infrastructure projects appear likely to come to a halt. As an example, Lockyer indicated that \$3.1 billion in school construction projects will lose funding.

More information can be found on the California Treasurer's Office website: www.treasurer.ca.gov

The rate of success among districts holding parcel tax elections in 2008—73%—is notable. During the prior 25 years, 51% of those elections were successful.



The legislative session made only minor changes in education policy

With the budget as their chief concern, elected officials in Sacramento did very little to change education policies. The notable exceptions were three changes to the state's testing and accountability system, plus some attention to career technical education programs. They modified the Standardized Testing and Reporting (STAR) program, the California High School Exit Exam (CAHSEE), and the indicators that might some day be used to calculate a high school's Academic Performance Index (API).

Policymakers eliminate the state's norm-referenced test

Consistent with a recommendation from the Legislative Analyst's Office, legislators chose to eliminate the norm-referenced test from the Standardized Testing and Reporting (STAR) program. Norm-referenced tests are those in which an individual's or group's performance is compared with a larger group, such as a nationally representative sample of students. The STAR program originally included only nationally norm-referenced tests, but it now includes a full battery of tests aligned to state content standards, the California Standards Tests.

Since 2005, the state has administered a nationally norm-referenced test—the California Achievement Test, Sixth Edition Survey or “CAT/6”—to students in grades 3 and 7 only. In recommending the elimination of the CAT/6, the LAO asserted that the National Assessment of Educational Progress (NAEP) was sufficient to compare California with other states, and that “norm-referenced tests no longer play an important role in the state's testing system.” This freed up \$2.5 million in federal Title VI funds for other purposes. Title VI provides funding for states to improve their testing systems and for support of small, rural school districts. (For more on NAEP, see *To Learn More About California School Finance* on page 19.)

Alternative means of passing the exit exam for students with disabilities is in the works

The class of 2006 was the first class required to pass the exit exam to graduate. However, a lawsuit settlement made students with

disabilities in the classes of 2006 and 2007 who met certain conditions exempt from the CAHSEE requirement. This variance ended in May 2007, and all Special Education students need to pass the exam starting with the class of 2008.

Almost half of Special Education students in California have not been able to pass the CAHSEE, according to CDE data through December 2007. Assembly Bill 2040 addresses that situation by calling for a panel—the majority of whose members must be classroom teachers—to recommend alternative means for students with disabilities to satisfy the CAHSEE requirement. The legislation requires the State Board of Education—to the extent it deems feasible based on its review of the panel's recommendations—to establish the alternative means by Oct. 1, 2010. When signing the bill, Schwarzenegger expressed concern that any alternative method “does not compromise the high level of expectations that we have for all our students and accountability for all our schools.”

In another bill this year, legislators sought to reinstate the Special Education exception until the State Board established alternative means in 2010. But the governor vetoed that bill, saying that he did not want to effectively waive the CAHSEE requirement for students with disabilities. This means that Special Education students in the classes of 2008 and 2009 will not have an alternative means of passing the CAHSEE available to them. Students who do not pass the exam but have completed other high school graduation requirements can receive a certificate of completion.

The state gets specific about eventually including graduation rates in the API

When policymakers created the API in 1999, they envisioned that it would encompass not only test scores, but also other factors, such as attendance and high school graduation rates. However, so far only test scores have been considered reliable enough to be included.

That may change as the state moves closer to having a data system that uses student-level information. After the superintendent of public instruction determines that these data meet an acceptable level of accuracy, four-year graduation rates will be included in high schools' API scores.

Senate Bill 1251 takes an additional step by giving high schools some credit in their API scores for students who graduate after five or six years. Schools will receive full credit for students with disabilities who graduate in their fifth or sixth year and partial credit for other students who graduate late. Schools will receive half credit for fifth-year graduates and one-quarter credit for sixth-year graduates.

Although many education stakeholders salute efforts to add nontest measures to the API, not all are pleased. Opponents assert that such additional measures take attention away from mastery of the state's content standards as measured by test scores.

Legislators pay some attention to career technical education

Policymakers enacted a number of bills related to career technical education (CTE) in 2008. Preparation for “green jobs” was the focus of one bill. Other bills strengthen the

involvement of the state's public university systems in CTE, call for a feasibility study regarding the expansion of "multiple pathways" programs, and address a technical funding issue pertaining to regional occupational centers and programs.

■ **New Partnership Academies focus on green technology and "goods movement."** Assembly Bill (AB) 2855 creates two new types of Partnership Academies—one in green technology and one in goods movement (the latter term meaning truck, rail, air, and seaport industries). There is no additional funding, but the law allows schools to access existing program funding for these new academies beginning in 2009–10. A Partnership Academy integrates academic and career technical education, business partnerships, mentoring, and internships for students in grades 10–12 in a "school within a school."

CDE will issue grants for their establishment in each of the nine economic regions delineated by the state and will give priority to academies that aim to educate young people in emerging green technologies. CDE must also give priority to goods movement academies until at least one such academy has been established in each of California's four transportation corridors.

■ **Legislators want higher education to become involved with career technical education.** AB 876 states that the Legislature intends for the California State University (CSU) and the University of California (UC) systems to allow students to record "non-a-g" courses, including career technical education courses, on their admissions applications starting July 1, 2009. (Courses labeled "a-g" are those required for entrance into a CSU

or UC. And "non-a-g" courses are those that have not been certified by UC as satisfying the subject-area course requirements established for CSU and UC admissions eligibility.)

The legislation also asks the universities to offer their expertise to CDE and school districts to help develop career technical education curricula. Finally, the legislation requests that the CSU and UC systems create, by July 1, 2011, two online resources to aid students who are trying to prepare for college. One would help high school students identify community college courses they could take to satisfy CSU/UC admission requirements. The other would help high school students determine which universities, if any, have agreements with their school to grant college credit or advanced standing for completing certain high school programs.

■ **Policymakers seek a report on expanding career multiple pathway programs.** AB 2648 requires CDE, in conjunction with other specific offices, organizations, and stakeholders, to write a feasibility report on expanding and establishing career multiple pathway programs. The multiple pathways approach tries to integrate college- and career-preparatory curricula and create more than one route to academic and career success. An interim report is due to the Legislature by July 1, 2009, and a final report with recommendations is due by Dec. 1, 2009.

■ **Senate Bill 1197 streamlines the funding of regional occupational centers and programs (ROCPs) run by joint powers agencies (JPAs).** The bill requires such ROCPs to receive funding directly from their county office, instead of from each school district that participates in the JPA.

Legislators use federal funds to support the state's longitudinal data system

After several years of hard work, the long-anticipated California Longitudinal Pupil Achievement Data System (CALPADS) is nearing completion. The statewide system will allow California to monitor individual K–12 students' test scores over time, which will help researchers and policymakers to better assess the impact of various policies and instructional approaches on student achievement. Its development has taken much longer than expected in large part because of fiscal and political constraints, though progress was made in both the 2008 legislative session and in the 2008–09 state budget.

In fall 2008, Gov. Arnold Schwarzenegger signed Senate Bill 1298. This bill makes initial progress toward future linkages between CALPADS and the state's other education segments. It also authorizes the state's chief information officer to release nonpersonally identifiable student data from CALPADS to eligible parties.

Additionally, the 2008–09 state budget appropriated almost \$8 million for the Best Practices Cohort Project, a voluntary program that works with districts to improve their data management practices and prepare them to submit data to CALPADS. This funding is enough for all eligible local education agencies to participate if they so choose.

For more information on CALPADS, see the October 2008 EdSource publication, *California's Emerging Data System: A Status Report*, which can be ordered at: www.edsource.org

After several years of hard work, the long-anticipated California Longitudinal Pupil Achievement Data System (CALPADS) is nearing completion.



Tough times and tougher choices lie ahead

Considering the dismal global and local economic situation, education advocates might have been somewhat relieved when the 2008–09 budget provided funding comparable to the previous year. But local school districts are nevertheless facing rising costs and accelerating expectations related to student achievement. Worse, the budget adopted in September did not reflect the deteriorating condition of the state’s finances.

With California’s fiscal problems increasingly dire, the situation for K–14 education will likely deteriorate in the short term. The bad news for education relates both to the state’s ability to fund schools and additional problems that may occur due to the international financial crisis.

California’s Republican governor and its Democratic assemblymembers and senators agree on a general approach to revising the enacted 2008–09 budget to account for a worsening economic situation. Although they differ on some of the details, they both think cutting programs and raising taxes should be part of the solution. However, Republican legislators in both houses have held firm for nearly a year on their pledge to not raise taxes, regardless of the extent of the state’s budget problem or attempts by Democrats to reach a compromise. In early December, the state looked like it would start 2009 without a plan that reflected rapidly decreasing revenue projections.

For K–14 education, the lack of a budget agreement means things look grim for the near term:

- Midyear cuts to education spending in 2008–09, if not announced yet, will almost certainly become a reality.
- In late 2008, the LAO predicted that Proposition 98 spending for K–12 schools could decrease by \$3.8 billion from 2008–09 to 2009–10 if the state did not act quickly to make midyear cuts and/or raise taxes.
- Even a minimal COLA on revenue limit or categorical funding is unlikely in 2009–10. Substantial cuts to revenue

limit funding may be proposed, which could divide the education community. Some may advocate for protecting revenue limit funding but cutting categorical funding and giving local agencies flexibility. Other K–12 leaders may prefer to live with revenue limit cuts to ensure that specific programs are protected.

- In light of a December 2008 court ruling, state policymakers may have to return to providing adequate funding for mandate reimbursements. But what would such funding displace within Proposition 98 spending?

Even in these very difficult economic times, Proposition 98 continues to provide K–14 education with a modicum of financial protection. The proposition ensures that education benefits when state revenue increases exceed growth in personal income—though it also shares in the pain during difficult times.

On Dec. 8, 2008, State Treasurer Bill Lockyer added to the bad news, reporting to a joint legislative session that the state had not been able to sell infrastructure bonds that support school construction. He estimated that \$3.1 billion in school construction projects would lose funding before the year ended. In addition, absent swift and

meaningful action by the Legislature, the state could end up unable to send school districts their July allocations on time, according to the Department of Finance.

Given the circumstances, local education agencies must plan for the worst. Some will be better off than others. Districts that have succeeded in local revenue raising efforts, such as parcel taxes, could be somewhat buffered in terms of funding, as are the 50 or so districts with particularly high property tax income that give them relative financial independence from the state. On the other side of the coin, districts with declining enrollments or that otherwise are on shaky financial ground could face extremely serious financial challenges, including the potential of insolvency.

It is clear that the state and its school districts are facing an unprecedented fiscal crisis as 2009 begins. Californians will be listening anxiously to the governor’s January budget announcement and President-elect Barack Obama’s inaugural address weeks later. What is already apparent is that the solutions will be neither simple nor swift. Less clear is the extent to which elected leaders will be able and willing to make the compromises necessary to keep the state’s finances from collapsing completely. ■■

With California’s fiscal problems increasingly dire, the situation for K–14 education will likely deteriorate in the short term.

To Learn More About California School Finance

EdSource provides the most comprehensive information about California's complex school finance system.

For more information related to this report, go to the EdSource website, www.edsource.org for:

- A new EdSource brief about funding for the California community colleges.
- A more extensive list of categorical programs and their funding amounts including for past years.

Tools for understanding and explaining the system

- **School Finance Basics**—For information organized and accessed by topic on sources of funding and the laws, court decisions, and ballot measures that shaped California's system, start at: www.edsource.org/iss_fin_sys.html
- **The Basics of California's School Finance System**—This two-page summary was updated January 2009 and is ideal for community meetings. Download for free at: www.edsource.org/pub_QA_FinanceSyst06.html
- **School Finance FAQs**—EdSource has compiled detailed answers to some of the most frequently asked questions on school funding at: www.edsource.org/iss_fin_FAQ.html. If you have additional questions, e-mail EdSource at: edsource@edsource.org
- **Selected Readings on California School Finance**—The definitive textbook on California school finance used by education faculty and graduate students has all of our most popular school finance publications in one place. It is available in PDF format beginning Jan. 5, 2009 at: www.edsource.org/selected-readings.html
- **School Finance in California: Understanding Our Complex System**—This 30-slide PowerPoint presentation in PDF format explains the basics of California school finance and is also available at: www.edsource.org/selected-readings.html
- **2008 Resource Cards on California Schools**—This set of cards contains concise, at-a-glance facts on California's education system, including finance data and background. Order online at www.edsource.org/pub_resourcecards4-08.html. The *2009 Resource Cards* will be available in April.
- **Ed-Data Partnership**—This website provides an online resource to access, compare, analyze, and download current and past California school data, including financial reports for school districts at: www.ed-data.k12.ca.us

For links to the latest education budget news and analysis

- Watch for EdSource updates on our homepage : www.edsource.org

Additional resources from official state agencies

- To view the 2008–09 state budget, go to the California Department of Finance (DOF) website: www.dof.ca.gov
- To see the analysis of the budget by the Legislative Analyst's Office (LAO), go to: www.lao.ca.gov
- To view the governor's proposed budget for 2009–10 when it is released on Jan. 9, 2009, go to: www.dof.ca.gov

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EdSource's 32nd Annual Forum on California Education Policy

Friday, April 17, Irvine, California, at the Hyatt Regency Hotel

What's Next? BIG Issues for California Education!

The State Budget Given the current budget situation and EdSource's record for reporting on school finance, it's only natural that the BIGGEST issue at the 2009 EdSource Forum will be education funding.

California's fiscal crisis has already hamstrung schools, and the news just keeps getting worse. EdSource will offer an up-to-date presentation on the state's financial disaster and potential impacts on K-12 and community colleges.

Mac Taylor, California's newly appointed Legislative Analyst, will kick off the school finance update and talk about the LAO's analysis of the state's current fiscal crisis. A Princeton graduate, Fresno native, and 30-year veteran of the LAO, Taylor will offer his thoughts on what policymakers might do to turn the situation around. A variety of respondents will present differing views and discuss solutions for this very BIG issue for California and for our public schools.

The Future of K-12 Education and Community Colleges in California Another BIG issue given the size of this system and the number of students it educates. What does K-12 face in the coming years with the current fiscal crisis, growing expectations to educate students to higher levels, and the uncertainty of federal legislation and state policies related to education? Come hear State Superintendent Jack O'Connell address these important issues during these challenging times.

More speakers to be added! Check our website frequently to get updates on new topics and speakers for EdSource's always informative annual public Forum on California Education Policy!

Register Now! This year's EdSource Forum will be held as a single statewide event in Irvine, California, on Friday, April 17, 2009, from 9 a.m. to 3 p.m.

Forum registration is now open at: www.edsource.org/event_forum09.html

Register today for this important event!



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