

The FISCAL REPORT an informational update

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Themes for the 2017-18 Governor's Budget

Introduction

One of the advantages of being Governor twice, separated by nearly three decades, is that the reflections we all have upon things that we could have done differently, for Governor Jerry Brown, this represents a second chance to replay the game. Reflections on a long history of predictable volatility in the state economy that quickly leaves decisions made based upon high social purpose in the ashes of the next downturn have been etched deeply into the fabric of the Governor's Budget proposals.

The economic data we see today remains more positive than it has been in recent years, however, there is more risk and uncertainty as to the continuation of these positive conditions. We see the Governor pulling back to a more conservative position in order to protect the substantial gains his Administration has achieved for all Californians. We think that is the right thing for him to do at this point; preparing to consolidate gains and maintain momentum on past initiatives provides protection for the successes that have benefited the people of our state over the past six years.

Further, we think the Governor's well-reasoned thinking provides a path for public education as well. Beginning with the 2016-17 Budget a year ago, our recommendations have been to think less about creating new programs and to think more about maintaining, operating, and creating success within the new initiatives already in place. At 96% implementation of the Local Control Funding Formula (LCFF) targets, we saw little room for further big gains for education, and as it has come to pass, 2017-18 shows no further progress toward the LCFF targets. We are in a cost-of-living adjustment (COLA) only situation even faster than we earlier predicted. The state is building its reserve; now is the time for state-funded agencies to do the same.

With that backdrop, we think the Governor's Budget proposals for 2017-18 very accurately and purposefully reflect the Governor's approach to managing what he, and we, see as an uncertain future.

Proposition 98 Still Controls Education Funding

The state plans to meet the minimum Proposition 98 guarantee and nothing more. Current revenue projections indicate that Proposition 98 was funded above the minimum in 2015-16 and 2016-17. Part of the Governor's plan is to recover the amounts above the minimum and count them toward meeting the 2017-18 minimum guarantee.

Further, the effect of extending temporary taxes by passage of Proposition 55 is more than offset by the more pessimistic revenue forecasts contained in the Governor's proposals. For the first time since 2012-13, new revenues will not cover new costs for most districts.

The ongoing operational costs caused by natural inflation and dramatic increases in California State Teachers' Retirement System (CalSTRS) and California Public Employees' Retirement System (CalPERS) employer contributions coupled with normal step and column and health and welfare increases, will not be covered by new revenues. The passage of Proposition 55 extends the income tax portion of the expiring Proposition 30 and is welcome, but does not provide new education funding. Districts will be challenged to maintain current programs under the Governor's plan for 2017-18.

Proposition 98 requires the state to account for state funding that falls below the long-term target established by Test 2 (i.e., adjustments required by annual changes in per capita personal income). This cumulative shortfall is termed Maintenance Factor. At the end of 2016-17 the Maintenance Factor will reach almost \$1.4 billion, an increase of \$864 million in the current year. While the expectation is that the Maintenance Factor will be made up at some point in the future, it is not available to deal with the challenges presented in the current year.

Expect Major Political and Legislative Changes, Particularly at the Federal Level

At the federal level we expect to see major shifts in education policy. The incoming Administration's cabinet choices in the areas of education and immigration suggest changes in policies and attitudes. We are likely to see greater focus on school choice, perhaps including voucher initiatives and expansion of charter schools.

California is heavily invested in the Affordable Care Act (ACA). Should there be a major change or full repeal of the ACA, tough decisions will be coming for the non-Proposition 98 side of the Budget which could impact education directly, as well as indirectly. Immigration policy is another area to watch as California's demographics and overall student population could be impacted.

We also have changes at the state level. We now have a supermajority of Democrats in both the Assembly and Senate. This political power is unprecedented. Without one single Republican vote needed, the Governor and his party have the power to prevail on almost all legislative issues. We are likely to have in California law mandatory union employee orientations in anticipation of the appointment of a conservative U.S. Supreme Court Justice.

LCAP Continues to Evolve

At 96% of full implementation of the LCFF, we are nearing the time when compliance with proportionality statutes can be clearly defined. The evaluation rubrics, also known as the "California School Dashboard" will take center stage in 2017-18. Used to develop each local educational agency's Local Control and Accountability Plan (LCAP), oversight agencies use them to assess levels of strength and levels of weakness to decide if and when intervention is necessary. In the end, the most important variable is whether or not there is evidence that the achievement gap is closing; that represents the "final test" for the state's new education initiatives.

Execution of the Budget Presents Operational Issues

Some of the upcoming operational issues are the result of positive events like the passage of Proposition 51 State School Facilities Bonds. Combined with the passage of \$23 billion in local school facility bonds, districts will need to gear up and prepare to build with \$32 billion in new dollars. With historically low interest rates and the real threat of interest rate increases, a sense of urgency is required.

Other operational issues are not so positive. At second interim most districts, as a result of the Governor's Budget proposal, will see less in their fund balance in the third year of the multiyear projection (MYP). This reflects the three-year cumulative effect of the revised projections for funding the LCFF. Prior to the revision, many districts were already deficit spending due to declining enrollment and other local factors. As the economic outlook dims, we expect the MYP to once again become the single most discussed and reviewed financial document as it was during the last recession.

The Road Ahead Is Uncertain

Uncertainty and risk are major factors in the Governor's rationale for this Budget. The Governor, over a lifetime, has learned that uncertain times create uncommon opportunities for those who are prepared to seize them. Uncertain times also serve to expose those who are unprepared to high levels of risk.

For the past 43 years, all of us at School Services of California, Inc., have had one goal; the success of public education in California. We work toward that goal by helping to prepare the legions of people who serve public education for whatever eventuality arises. We only succeed when public education succeeds.

We hope that you will carefully consider our viewpoints and recommendations, tempered by your own views and judgment, as you continue the essential work of educating our children. The recent national elections are a perfect illustration of the value of education. We expect every American to cast a vote based upon a clear understanding of issues and consequences. We do not teach children what to think, but we do teach them how to think. Every vote cast is equal, every American is equal, and public education provides an essential foundation for equality. We are proud to support you in your efforts to prepare our children for success in school and success in life.

—*Ron Bennett*

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