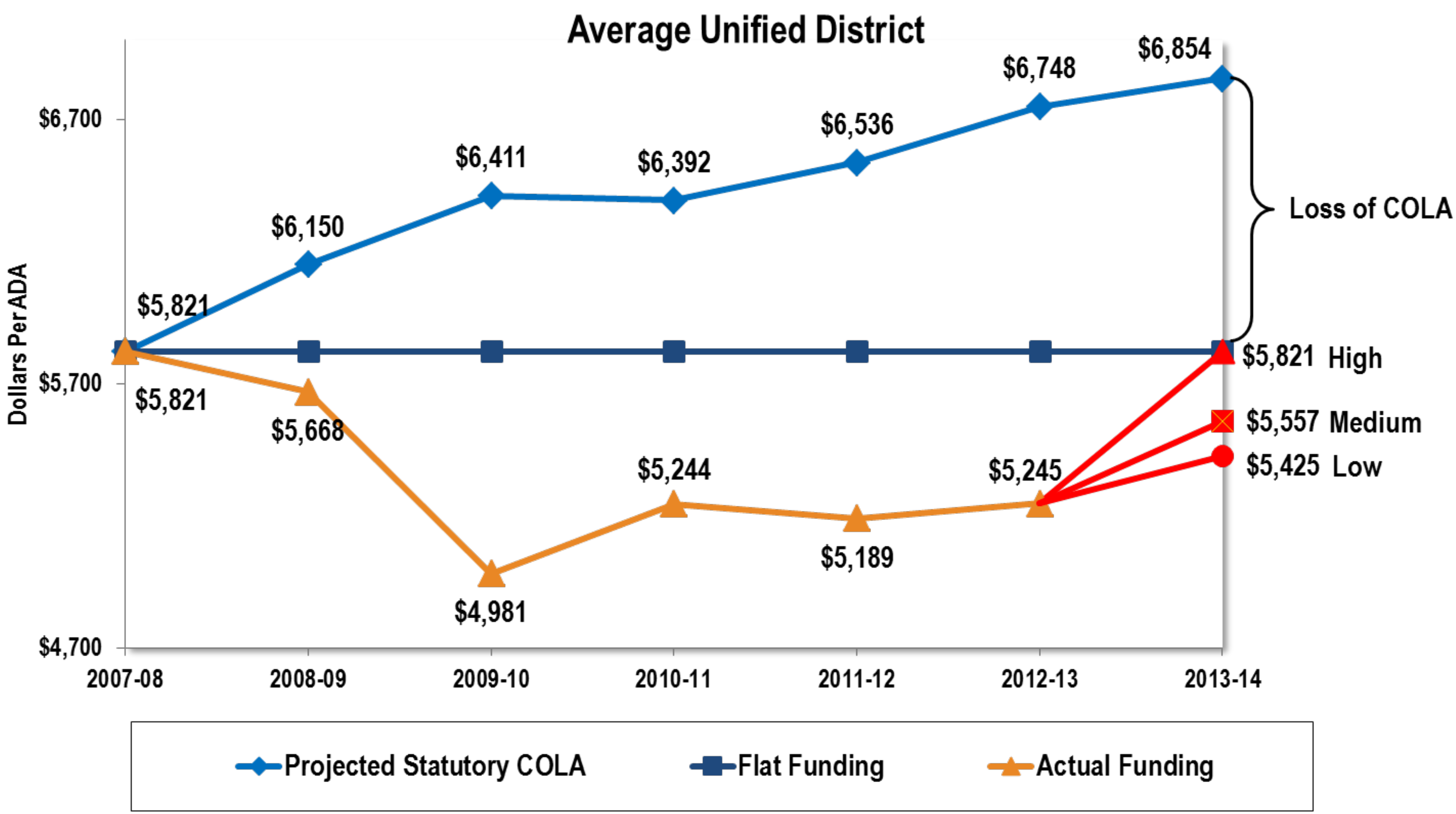
School Services of California INC.™

California School Finance and Management Conference 2013-14

1-3 The Budget in Broad Strokes

- The 2013-14 State Budget is balanced and has the first real reserve in years
- The structural deficit has been eliminated, at least for the duration of Proposition 30
- Education gets its first slice of restoration of cuts that began in 2008-09
  - But not all districts benefit equally
  - And the level of funding for most districts remains well below 2007-08
  - The Governor uses the bulk of the unexpected 2012-13 Proposition 98 revenues for one-time purposes, like buying down deferrals and CCSS start-up allocations
- But the State Budget also understates 2013-14 revenues
  - The Legislative Analyst's Office (LAO) and other independent economists estimate that revenues will actually come in more than $3 billion higher
  - That portends greater flexibility in future funding
- No other area of the State Budget gets increased significantly

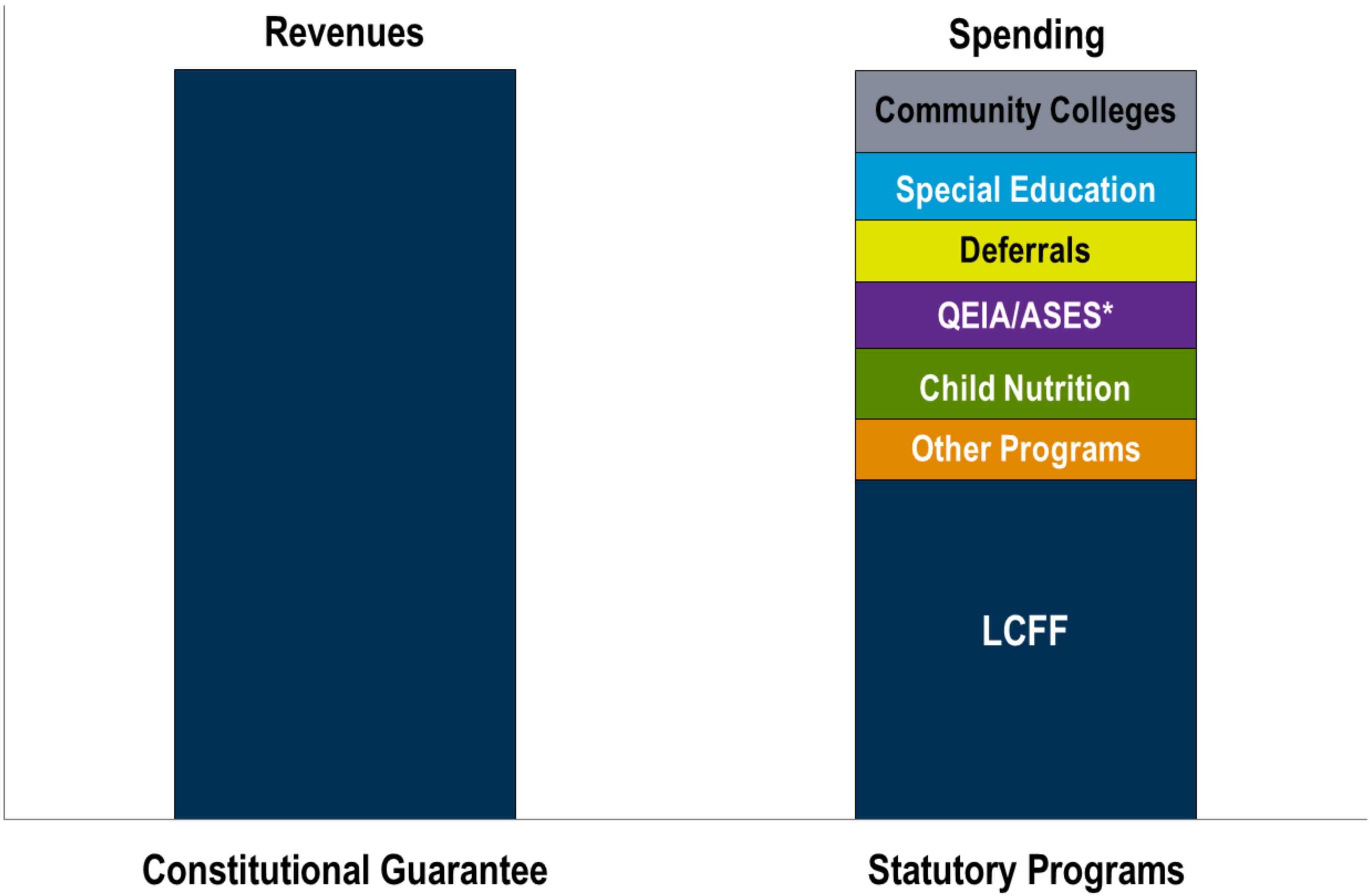
1-5 Funding Per ADA – Actual vs. Prior Statutory Level



Proposition 98 Funding Guarantee

- Proposition 98 sets the minimum funding level for K-12 education and the community colleges, based on the prior-year funding level and changes in workload (as measured by K-12 average daily attendance [ADA]) and inflation (as measured by the lesser of per-capita personal income or per-capita General Fund revenues)
  - Adopted by state voters in 1988, this is a constitutional guarantee
  - The measure specifies only the minimum funding level, it does not determine what programs will be funded
- For 2013-14, the state fully funds Proposition 98 at $55.3 billion, a decline of $941 million from 2012-13
  - There are no manipulations or reinterpretations of the constitutional guarantee as there have been in prior years
  - The 2013-14 guarantee declines about 2% because of the lower General Fund revenue forecast in the May Revision

3-2 Proposition 98 Revenues and Spending



* Quality Education Investment Act/After School Education and Safety Program

LCFF Policy Goals and Features

- The Governor's policy goals in pursuing reforms to the state's school finance system have remained consistent since January 2012 when he unveiled the Weighted Student Formula, the precursor to the LCFF:
  - Increase transparency and reduce complexity
  - Reduce the administrative burden
  - Improve funding equity across school districts
  - Improve local accountability
- To attain these goals, the LCFF
  - Eliminates revenue limits and almost all categorical programs, except those established by state initiative, federal statutes, or court orders or settlements
  - Establishes base grants for four grade spans, which will provide absolute dollar equalization at full implementation
  - Establishes supplemental/concentration grants to provide supplemental services to low income and English learner students

Base Year Funding and LCFF Target

- A school district's LCFF entitlement will be based on three key elements:
  - Its base year funding in 2012-13
  - The demographics of its student population, specifically the percentage of students who qualify for supplemental/concentration grants
  - The state appropriation for LCFF
- In general, a school district is better off under the LCFF if:
  - Its base year funding is below the statewide average
  - The proportion of students qualifying for supplemental/concentration grants is above the statewide average
  - The state provides a significant amount for LCFF growth in a given year
    - The January Budget proposed $1.6 billion, increasing to $1.9 billion at the May Revision, and to $2.1 billion upon State Budget enactment

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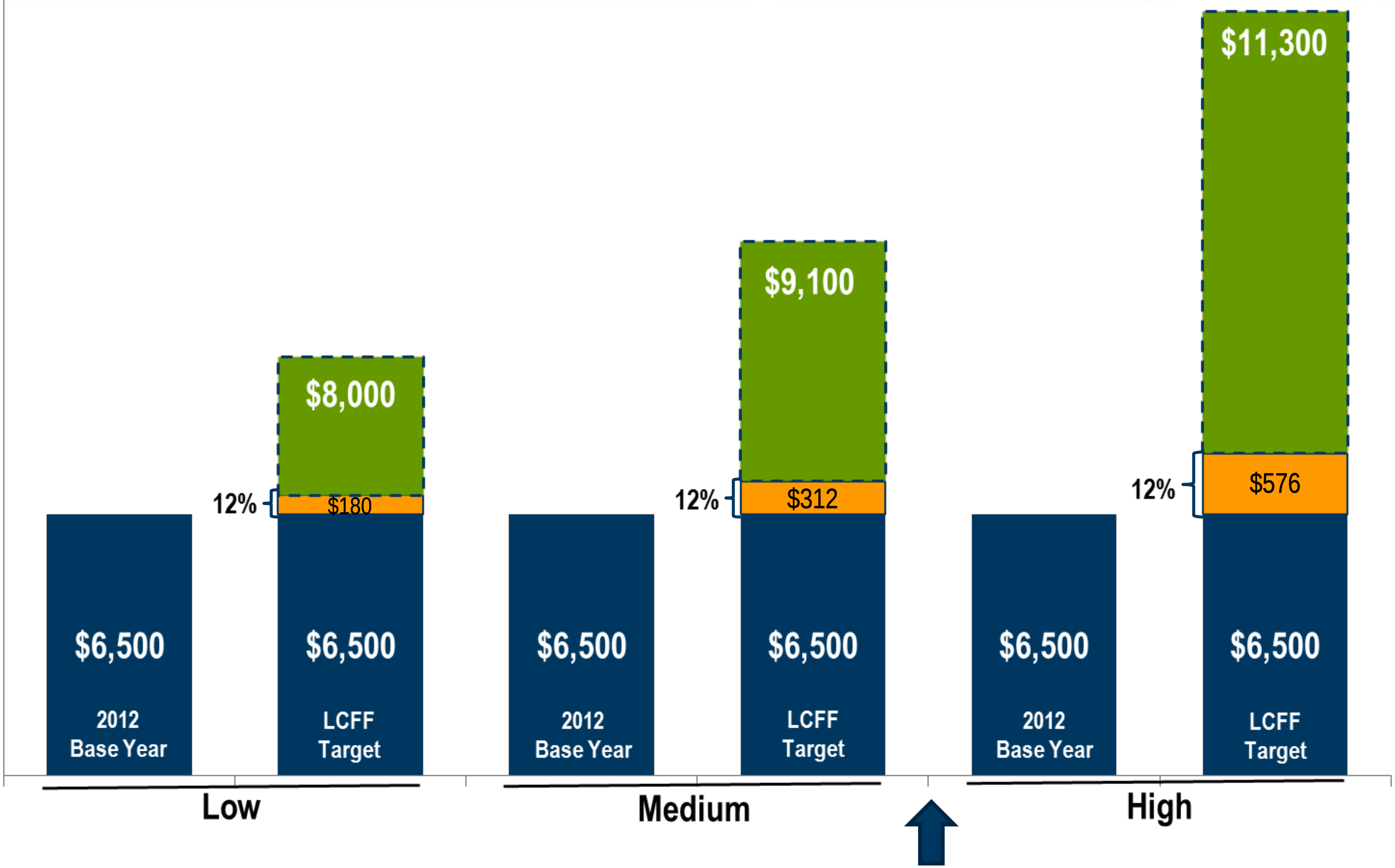
2013-14 Growth Toward Target



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LCFF Implementation Phase

- There are two distinct phases of the LCFF: (1) the eight-year implementation phase, and (2) the fully funded phase
  - The eight-year implementation phase is not set in statute and can be longer or shorter than eight years, depending upon the annual LCFF appropriation
  - Numerous fiscal inequities could arise during the implementation phase
    - Even if the state appropriates sufficient funds to support the statutory cost-of-living adjustment (COLA) applied to the base grant, individual districts are not guaranteed a funding increase equivalent to this adjustment
    - Significant revenue volatility will be imposed on districts with high proportions of students eligible for supplemental/concentration grants
- Once the LCFF is fully implemented, these funding anomalies will be eliminated

Differential Risks Under the LCFF

- School districts will face vastly different levels of risk during the implementation phase of the LCFF
  - School districts experiencing significant annual funding gains can face major declines as well
    - While the statutory COLA is forecast to average 2.3% between 2013-14 and 2016-17, some districts could see gains under the LCFF of 6% to 8% annually
  - Multiyear contracts that assume high annual increases in LCFF revenues could fall out of balance when/if state LCFF appropriations fall
- In 6 years over the last 20, the state either provided no increase to fund the statutory COLA or cut funding levels due to downturns in the economy and revenues
  - It is simply a matter of time when the next downturn occurs

3-15

Conclusions About Multiyear Budgeting

- Because of the differential risks under the LCFF, all school districts, but especially high-funded districts, will have to make prudent out-year revenue assumptions
  - There is no longer a statewide standard for expected revenue growth in the form of an expected inflationary adjustment
  - Each district will have to carefully assess its demographic projections
    - The total projected ADA
    - The demographic composition of the ADA, i.e., low-income students, English learners, and foster youth
- State Budget priorities can change from year to year with no guarantee that LCFF growth will be provided or that the LCFF will be fully funded
  - The statutory protection of annual COLAs is eliminated
- Local conditions and budget decisions will be more important than ever in maintaining each district's solvency

4-5

Categorical Programs and the LCFF

- Over the years, a variety of programs and purposes were supported by categorical program funding
  - Some were general purpose, such as instructional materials and deferred maintenance
  - Some were intended to be targeted to meet the needs of specific students or circumstances, such as Economic Impact Aid (EIA) and Home-to-School Transportation
- The LCFF replaces most categorical programs with two weighting factors applied against the LCFF base grant
  - 20% on behalf of each eligible student (down from 35% in the Governor's proposal)
  - An additional 50% for the eligible students exceeding 55% of total enrollment (up from 35% in the Governor's proposal)
    - The combination of the two factors still equals 70%, as in the May Revision

Elements of the Formula

- Additional funding based on the demographics of the school district:
  - English learners
  - Pupils eligible for free and reduced-price meals program
  - Foster youth
- An unduplicated count
  - The number of unduplicated pupils enrolled for each school district and charter school as a percentage of total enrollment
- A three-year rolling average of California Longitudinal Pupil Achievement Data System (CALPADS) reported counts
  - 2013-14 uses one year of data; 2014-15 uses the average of two years of data; 2015-16 and future years use three years of data

4-10 Elements of the Formula

- Special Education, Child Nutrition, Quality Education Investment Act (QEIA), After School Education and Safety (ASES), and other federally mandated programs stay outside of the formula
- Transportation and TIIG funding continue as formula add-ons for those school districts that currently receive funding through these programs – frozen at 2012-13 levels, no COLA
  - TIIG funds can be used for any purpose
  - Districts must expend no less on Home-to-School Transportation than the amount expended in 2012-13
- Creates the Economic Recovery Target (ERT) rate – establishes a minimum level of funding increase for each school district from 2013-14 through 2020-21
- Timeline: implementation to be completed in 2020-21

LCFF – Base Grant Entitlement Calculation

- 2013-14 target entitlement calculation
  - Grade span per-pupil grants, based on 2013-14 statewide average initial target of $7,357 per ADA, are increased annually for a COLA

Factors	K-3	4-6	7-8	9-12
Base Grant per ADA	$6,845	$6,947	$7,154	$8,289
COLA @ 1.565%	$107	$109	$112	$130
Base grants – 2013-14	$6,952	$7,056	$7,266	$8,419

LCFF – K-3 CSR and CTE Adjustments

- 2013-14 target entitlement calculation
  - K-3 CSR and 9-12 CTE adjustments are additions to the base grant
  - CTE is unrestricted; CSR requires progress toward maximum site average of 24 students enrolled in each class

Factors	K-3	4-6	7-8	9-12
Base grants – 2013-14	$6,952	$7,056	$7,266	$8,419
Adjustment percentage	10.4% CSR	-	-	2.6% CTE
Adjustment amount	$723	-	-	$219
Adjusted grant per ADA	$7,675	$7,056	$7,266	$8,638

LCFF – Supplemental and Concentration Grants Per ADA

- 2013-14 target entitlement calculation
  - Supplemental and concentration grant increases are calculated based on the percentage of total enrollment accounted for by English learners, free and reduced-price meal program eligible students, and foster youth

Factors	K-3	4-6	7-8	9-12
Adjusted grant per ADA	$7,675	$7,056	$7,266	$8,638
20% supplemental grant	$1,535	$1,411	$1,453	$1,728
50% concentration grant (for eligible students exceeding 55% of enrollment)	$3,838	$3,528	$3,633	$4,319

LCFF – An Example

- 2013-14 target entitlement calculation
  - Statewide, students eligible for supplemental and concentration grants account for about 60% of total enrollment
  - A district with 60% eligible students would calculate the following LCFF target grants for 2013-14

Factors	K-3	4-6	7-8	9-12
Adjusted grant per ADA	$7,675	$7,056	$7,266	$8,638
% Enrollment eligible (example)	60%	60%	60%	60%
60% of Supplemental	$921	$847	$872	$1,037
5% of Concentration (percentage above 55%)	$192	$176	$182	$216
Total 2013-14 LCFF target grant per ADA	$8,788	$8,079	$8,320	$9,891

LCFF and K-3 CSR Penalties

- The LCFF specifies that districts must, as a condition of receiving the 10.4% K-3 CSR funding adjustment, limit class enrollment in grades K-3, eventually reaching a maximum average enrollment per class of no more than 24 students at each school site, unless an alternate ratio is locally negotiated
  - 24-student average must be reached at full implementation of the LCFF (planned for 2020-21)
  - During the intervening years, districts are to meet intermediate targets, based on the funding provided to move all districts to their LCFF target
  - A district’s failure to meet the target at one school site would result in the loss of all K-3 CSR funds districtwide – a penalty that is likely to be out of proportion to the error

5-2 CCSS Funding

- The State Budget provides $1.25 billion statewide in one-time funds from 2012-13 for the implementation of the CCSS
  - Funds will be allocated based upon prior-year enrollment to school districts, COEs, charter schools, and special state schools
    - Estimated to be about $200 per student
  - Funds will be apportioned in July 2013 (50%) and August 2013 (50%)
  - LEAs can encumber funds any time during the 2013-14 and 2014-15 school years
  - Remember: this is one-time money – plan accordingly!!

CCSS Expenditure Rules

- LEAs can spend the funds for the following allowed purposes:
  - Professional Development
    - For teachers, administrators, and paraprofessional educators or other classified employees involved in the <u>*direct instruction*</u> of pupils that is aligned to the CCSS academic content standards
  - Instructional materials and supplemental instructional materials aligned to the CCSS academic content standards
  - Technology
    - Funds can be used for the integration of the content standards through technology-based instruction for the purposes of improving the academic performance of pupils including, but not limited to:
      - The administration of computer-based assessments and providing adequate Internet connectivity to support the computer-based assessments

CCSS Expenditure Reporting Requirements

- As a condition of the receipt of funds, an LEA must:
  - Develop and adopt an expenditure plan detailing how the funds shall be spent
    - Plan must be adopted and a public hearing must be held on the plan
  - On or before July 1, 2015, report detailed expenditure information to the CDE including:
    - Specific purchases made
    - Number of teachers, administrators, and paraprofessional educators who received professional development
  - CDE will determine the expenditure reporting format

Federal Issues

- Federal sequestration reductions are implemented
  - On March 26, 2013, the President signed Public Law (PL) 113-6, which provides funding for the remainder of fiscal year 2013
  - Programs are reduced an estimated 5.23% from 2012 funding levels, beginning July 1, 2013, affecting most federal education programs, including:
    - Title I – Elementary and Secondary Education Act (ESEA) and Title II – Teacher Quality Grants
    - IDEA Part B and IDEA Preschool Grants
    - 21st Century After School Programs

Note: State and school district amounts will vary based on specific formula criteria such as population and poverty

6-1

Balances, Reserves, and Planning

- The LCFF revenue model leads to an entirely new way of thinking about revenues, reserves, balances, and planning for the future
  - Gone are the anchors of the past: base revenue limit, deficit factor, current-year COLA, etc.
  - They are replaced with a “commitment” by the state to make a contribution to “closing the gap” each year
    - But there is no statutory calculation for how much the state will contribute – and no obligation to fund any certain amount
- This has huge implications for districts
  - Many districts will need to maintain much larger reserves
  - Much of the “new money” will still be tied to expenditures for specific programs
  - Our SSC Dartboard will be more subjective than in the past, but more relevant than ever for conservative and reasonable planning
- This new section is intended to address all of these issues

There Is No Such Thing as a Good Budget That Does Not Have an Adequate Reserve!

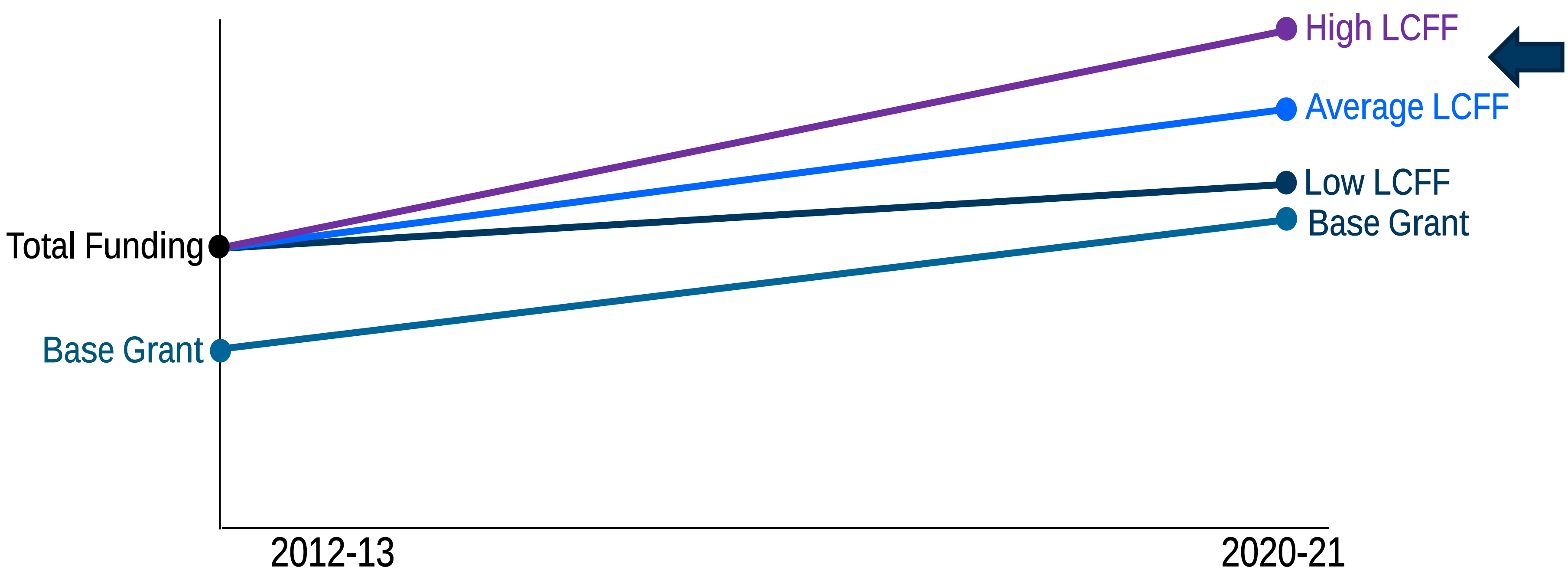
- Good budgets have good reserves; but how much is really needed?
  - Under revenue limits, the State Board of Education (SBE) set reserve levels as a percentage of expenditures based on district size – that won’t work anymore
  - Some districts will have much more risk and volatility than similar-sized districts – they may need ten times the amount of the state’s recommended reserves
  - All state-recommended reserve levels will now be too low
    - As we will explain, both calculation and contribution risks will increase with the LCFF
    - We may not see the consequences of low reserves immediately because the state is providing an increase, but we will see it in the first downturn
- So, what constitutes an adequate reserve?

6-3 Volatility Increases Reserve Requirements

- Under the old rules, all districts could plan for similar changes in revenue limits – not so under the LCFF
  - Every district has its own starting point and its own unique goal
  - Some districts will project very large increases and others very modest increases
  - And while the percentage contributed by the state toward the goal is said to be consistent, the actual dollar differences are huge
- A good year, with a very high percentage contribution, will drive expenditures higher
  - But what happens when times are not so good and there is no increase or even another cut?
    - By the way – this just in – there will be another recession!
- Districts will need a larger buffer to provide time to make ongoing budget adjustments

High LCFF Districts Are Particularly Vulnerable

- Because of the variability in rates of increase, a district with a high number of students who qualify for supplementary funding will be especially vulnerable
  - The district that has few LCFF supplementary dollars will plan to get nearly nothing, and if it gets nothing, its planning is still close
  - But the district that has high supplemental and concentration grants will plan for much higher increases, and in a bad year has much further to fall



What Constitutes a Reasonable Reserve?

- We have already concluded that a reserve level dictated solely by district size is no longer relevant when volatility and exposure is disparate
- We recommend that every district first observe the current SBE-required reserve level for the traditional economic uncertainties
- Then we recommend the establishment of a separate LCFF reserve
  - We recommend that districts develop a plan to bring the level of the LCFF reserve to at least one year's revenue growth in the MYP
- The purpose of this reserve is to provide a "softer landing" when the next downturn occurs, as it surely will
- This is a similar methodology to what we have recommended for basic aid districts due to their reliance on local property tax revenues above the revenue limit

Deferred Maintenance and Routine Restricted Maintenance

- The funding LEAs previously received for the Deferred Maintenance program is included in the LCFF base grant
  - LEAs may continue to use the Deferred Maintenance Fund for the purposes of major repair
- As part of the State Budget Act, the requirement for districts receiving state General Obligation bond funding for facilities to set aside 3% of General Fund expenditures in a Routine Restricted Maintenance Account (RRMA) has been repealed
  - E.C. 17583-17587
- LEAs must continue to make budget planning decisions to include expenditures in the area of deferred maintenance and routine restricted maintenance
  - *Williams* requirements
  - Safe, clean, functional instructional environments for student success

K-3 Class-Size Reduction – Planning for 2013-14

- In the absence of a locally bargained ratio, under the LCFF, progress must be made toward a school site average classroom student-to-teacher ratio of 24:1
  - For 2013-14, the starting point is the average class enrollment for each school site for grades K-3, inclusive, in the 2012-13 school year
  - Progress to the 24:1 target is measured on the relative increase of revenues toward the target of full funding of the LCFF
    - Estimated to be approximately 12% for 2013-14
  - Therefore, in 2013-14, this would require a 12% effort toward reducing class size
    - This adjustment will need to be calculated for each school site to determine the progress each site must show toward the 24:1 target for 2013-14

K-3 Class-Size Reduction – Sample Calculation

- Example of school site calculation for relative progress for 2013-14 school year, based on 12% revenue increase toward full implementation of LCFF

Sample Calculation for K-3 CSR School Site Progress 2013-14	
2012-13 average class enrollment for school site: ABC Elementary School (Grades K-3, inclusive)	29:1
Target for K-3 CSR at LCFF full implementation, 2020-21	24:1
Difference	5
Progress required in 2013-14 (12%)	5 x 12% = 0.6
Average class enrollment target progress for 2013-14 for ABC Elementary School	29 – 0.6 = 28.4:1

- If school sites already have a site ratio of 24:1 or less, they must permanently maintain the 24:1 ratio starting in 2013-14 for districts to be eligible for K-3 CSR funds

9-4 Summary

- We are getting 40 years of change in a single year
  - No one could defend the results produced by 40 years of underfunding public education in California
    - Last in funding and nearly last in student performance – not acceptable
  - We have proven that high standards and low funding don’t work
  - All the focus is on the distribution system, but it is the level of funding that will determine student success
- So, you have to ask yourself, “Are you feelin’ lucky?”
  - Will California’s economy hold up?
  - Will the policy focus on education be sustained?
  - Will we see big improvements in student performance soon enough?
- The winds of change bring opportunities and challenges – we encourage you to embrace them both