Santa Clara County Office of Education
Charles Weis, Ph.D.
County Superintendent of Schools

DATE: May 31, 2012

TO: District Chief Business Officials
District Fiscal Directors
Charter School Executive Directors

FROM: Nimrat Johal
Director, District Business and Advisory Services

VIA: Kenneth Shelton
Interim Chief Business Officer

SUBJECT: **2012-13 Budget Guidelines**

Education Code section 42127 requires the Governing Board of each school district to hold a public hearing on the annual budget of the school district and submit the adopted budget to the County Superintendent for review and approval. These actions must be completed on or before July 1 of each year. The following represents the general assumptions and parameters we are recommending that districts use in the preparation of their Budgets for Fiscal Year (FY) 2012-13.

<u>Background</u>
The cornerstone of the 2012-13 State Budget assumes passage of a new tax initiative proposed by the Governor. Included in the May Revised budget are $5.9 billion of additional revenues to be generated by this tax initiative. Going into fiscal year 2012-13, the State is facing a $15.7 billion shortfall. The Governor hopes to close this gap as follows:

- $8.3 billion in additional cuts
- $5.9 billion in additional temporary revenues
- $1.5 billion in Prop 98 savings

The May Revision provides both challenges and potential opportunities for school districts. The budget emphasizes that education continues to be a priority for the Governor. There is also acknowledgement that education has taken a majority of the budget reductions in past years. While the actual impact of the May Revision to individual school district budgets will vary, Districts are advised to "**plan for the best, and prepare for the worst**".

<u>Prop 98 Impact</u>
The May Revision increases the K-14 Proposition 98 spending by about $6.7 billion. **However, the budget proposal will only maintain programmatic funding at current levels.** The Proposition 98 increase will be primarily used as follows;

- $2.229 billion ($2.1 billion K-12) to fund the new 2011-12 deferral.
- $2.555 billion ($2.242 billion K-12) to pay down the cross fiscal year deferral credit card already on the books. K-12 cross fiscal year deferrals would be reduced from $9.5 billion to $7.3 billion in 2012-13.
- $98.6 million increase in Special Education funding for mental health services to disabled students that backfills one-time Proposition 63 funding used in 2011-12.

In an attempt to mitigate the loss of revenue limit funding, the May Revision allows more flexibility for schools districts by authorizing a reduction to the school year by up to 15 more days over 2012-13 and 2013-14 in addition to the 5 days currently in law (175 day year). This means that any school district would be able to use any combination of days in 2012-13 and 2013-14 but the total of the days in those two years cannot exceed 15 days, in addition to current law which already allows the school year to be reduced by up to 5 days each year. Once the 15 days have been used for the two year period of 2012-13 and 2013-14, this provision is eliminated and the statutes will revert back to current law of 5 days per year (175 day year). Any reduction in the number of school days would have to be negotiated through the collective bargaining process.

Revenue Limit Districts

We recommend use of the School Services of California (SSC) Dartboard in the development of the 2012-13 Budget report and the related Multi Year Projections (MYPs) for 2013-14 and 2014-15. We agree with SSC's Dartboard which includes items listed below.

2012-13 Budget Projections

- 3.24% COLA, deficit factor of 22.272%
- Unrestricted lottery revenue of $118 per Average Daily Attendance (ADA) and restricted lottery revenue of $23.75 per ADA
- $441 per ADA on-going Revenue Limit reduction should the tax measure not pass

NOTE: ***While the Dartboard recommends building an on-going $441 per ADA reduction in the School Districts' revenue calculations, we advise School Districts to base their calculation on the Governor's budget proposal. Districts are also advised to eliminate COLA from their revenue calculation. However, Districts are strongly advised to build contingency plans to address revenue shortfalls should the trigger cuts be enacted. The contingency plans must accompany the budget submitted to the County Office.***

2013-14 Budget

- 2.5% COLA, deficit factor of 22.272%
- Eliminate COLA
- Unrestricted lottery revenue of $118 per ADA and restricted lottery revenue of $23.75 per ADA

2014-15 Budget

- 2.7% COLA, deficit factor of 22.272%
- Eliminate COLA

- Unrestricted lottery revenue of $118 per ADA and restricted lottery revenue of $23.75 per ADA

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

- The 3.24% statutory COLA is not funded for 2012-13.
- The .848% or average of $55/ADA revenue limit "trigger reduction" was implemented beginning in February 2012 for fiscal year 2011-12 only.

The May Revision is based on the passage of this tax initiative. If this initiative fails on the November 2012 ballot, the proposed budget has an automatic "trigger reduction" of $2.644 billion for K-12 education. Per the Department of Finance (DOF) calculations, this would result in a loss of approximately $441/ADA**.** These reductions would become effective on January 1, 2013. Proposition 98 funding would then be projected at approximately $48.2 billion.

While there is a commitment on the part of the Governor to protect K-12 funding by keeping it flat, there are inherent uncertainties in the proposal due to the reliance on resources that may not materialize.

<u>Basic Aid Districts</u>

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

The "fair share" reduction taken in 2012-13 is 9.57% as a result of SB 81, which shifted the 2011-12 mid-year transportation "trigger" reductions to a revenue limit reduction, thus increasing "fair share" reductions for basic aid districts from 8.92%. Assuming that tax initiative passes in November, the "fair share" reduction taken in 2013-14 and 2014-15 will be 8.92%.

A school district receives a "fair share" reduction based on the district's Basic Aid status at the Second Principal Apportionment in the prior year. This means that for a school district to be subject to the "fair share" cut in 2011-12, it must be a Basic Aid district in 2010-11. If a school district becomes Basic Aid in 2011-12, it will be "subject" to the "fair share" reduction in 2012-13. However, in no event would that reduction be more than the amount of local revenues that exceed the district's revenue limit. ABX4 2 also specified that the reduction shall not violate the constitutional funding requirement that the state provide $120 per ADA or $2,400 per school agency, whichever is greater.

In the event the Governor's Tax Initiative fails, Basic Aid school districts should be prepared for additional "fair share" reductions as part of the "trigger language." Basic Aid districts that do not have sufficient reserves in their MYPs necessary to absorb the impact of additional "fair share" reductions, as calculated in 2012-13 and taken in 2013-14, are advised to develop contingency plans using the loss of $441/ADA (trigger reduction), or to the extent that categorical revenues are available for the State to reduce, including AB602 Special Education revenues and State mental health funding.

Additionally, under the Weighted Student Formula proposed in the May Revision, it appears that Basic Aid school districts would not be held harmless in 2012-13, nor would they be held to the same phase-in as revenue limit districts. In other words, Basic Aid districts would realize the full impact of the Weighted Student Formula in 2012-13, under the current proposal.

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

Transportation

On December 13, 2011, the Department of Finance (DOF) issued its revenue forecast and determined that revenues for fiscal year 2011-12 were $2.2 billion below the budget assumptions made in June. As a result, Tier 1 and Tier 2 reductions were fully enacted effective January 1, 2012. Reductions to current year funding for K-12 revenue limit apportionments are $79.6 million which translates to roughly $13 per Average Daily Attendance (ADA) and $248 million was cut from school transportation; however, Senate Bill (SB) 81 restored the transportation cut and further cut revenue limit funding instead. These cuts increased the deficit factor from 19.754% to 20.602% and to ensure a reduction commensurate with the revenue limit reduction, the Basic Aid fair share reduction will increase from 8.92% to 9.57% for 2011-12 and will be taken in 2012-13.

In January, when the Governor unveiled his 2012-13 Budget Proposal, funding for transportation was completely eliminated for 2012-13 and thereafter. Since then, there have been many speculations on whether the Governor would stay firm on his proposal to cut transportation funding. The May Revision now proposes to continue these allocations permanently to the school districts receiving them as revenue limit "add-ons" separate from the Weighted Student Formula. As a result, school districts currently receiving state funding for transportation would continue to receive allocations of a similar amount each year, but without restrictions on its use or requirements to maintain a minimum level of transportation services. It is recommended that school districts plan for their 2012-13 transportation apportionment for home-to-school and special education transportation.

Although, this may appear to be somewhat of a relief for Local Education Agencies (LEAs), we still caution that this can change since state revenues are lagging projections at this point and there is no official trailer bill language guaranteeing transportation funding beyond 2012-13.

Transitional Kindergarten

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

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

This bill mandated a Transitional Kindergarten Program for students displaced as a result of the changes in eligibility birthdates. School districts are currently eligible to collect ADA for these transitional kindergarten students. Under current law, school districts may not receive ADA funding to serve a four year old unless that child has his or her fifth birthday according to the appropriate phase-in period noted above. Children admitted during the school year who do not meet the phase-in period criteria may only be enrolled on a case-by-case basis upon having attained the age of five.

The May Revision continues to propose the elimination of the requirement that school districts provide transitional kindergarten instruction beginning with the 2012-13 school year. Both the Senate and Assembly budget subcommittees rejected the Governor's proposals to eliminate Transitional Kindergarten. **School districts are advised to budget according to current law.**

Categorical Flexibility and Tier III

The May Revise includes a clause for all categorical programs, including K-3 Class Size Reduction (CSR) and Economic Impact Aid (EIA), to be moved into "Tier III" categorical flexibility in 2012-13. The exceptions are Special Education, QEIA, Child Nutrition, Proposition 49 After-School, and preschool (Federal Programs are outside the purview of the state legislative action). Should this flexibility not be enacted, the flexibility provisions for the CSR reduced penalties expire on June 30, 2014 instead of June 30, 2015.

We recommend school districts to consider the extension of Class Size Reduction (CSR) to June 30, 2015 based on the assumption that either the Weighted Student Formula or the extension of Tier III flexibility date for CSR occurs.

Weighted Student Funding Formula

The May Revise proposes major school finance reform to provide greater flexibility in the use of school district funding. This Weighted Student Formula (WSF) model would reflect the following elements;

- replace revenue limits and most state categorical programs. Attachment A provides a list of those categorical programs that would be included and those that would be excluded per the Department of Finance.
- eliminate most categorical program requirements allowing total flexibility in use of the funds. However accountability requirements would be implemented at a future date.
- phased in over a seven year period with a "hold harmless" provision for 2012-13 only.
- based on the following three components – a base grant, a supplemental grant and a concentration grant. It will be calculated as follows:
    - The "base grant" for 2012-13 will be $5,421 per average daily attendance (ADA) adjusted per grade levels as follows:

        - $5,466/ADA for K-3
        - $4,934/ADA for 4-6
        - $5,081/ADA for 7-8
        - $5,887/ADA for 9-12
    - The “supplemental grant” will be based upon the unduplicated count of English learners and free and reduced-price meal recipients and is 20% of the “base grant”. The unduplicated count is converted to a percentage of the total student enrollment.
    - A “concentration grant” will be available for school districts with more than 50% of their unduplicated student population identified as English learners and free and reduced-price meal recipients. The additional grant will be equal to 40% of the base grant, times the percentage of pupils designated as English Learners or free and reduced meals recipients that exceed 50% enrollment threshold

Phase in of the new funding formula will be as follows:

- 2012-13 ---5% (also contains “hold harmless”)
- 2013-14---10%
- 2014-15---20%
- 2015-16---40%
- 2016-17---60%
- 2017-18---80%
- 2018-19---100%

The difference between the percentages listed for the phase in for each year 2012-13 through 2018-19 and 100% shall be allocated to each school district in proportion to the amounts it received per ADA during fiscal year 2011-12. The current Home-to-School Transportation and Targeted Instructional Improvement (TIIG) Grant program funding formula allocations are continued as weighted student formula “add-ons” and are not being added into the categorical program block that will make up the weights. For 2012-13 funding is provided for “any educational purpose”. Beginning in 2013-14, school districts meeting accountability criteria to be adopted by the State Board of Education will be eligible for “incentive funding” equal to 2.5% of the base grant funding for that year. It currently appears that there is no separate funding for Adult Education and ROC/P. If the November 2012 tax initiative does not win voter approval, the WSF proposal is withdrawn.

At this time, it is recommended that school districts continue to maintain the current level of funding for revenue limits and categorical programs for current and subsequent fiscal years. Moreover, school districts should assume no further changes in categorical flexibility programs.

<u>Cash Projections and Cash Flow</u>

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

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

The Governor's 2012-13 January Budget proposed an increase of $2.1 billion in Proposition 98 funding for the purpose of reducing ongoing K-12 school district revenue limit deferrals. The May Revision proposes to reduce those deferrals by an additional $140 million for a total of $2.24 billion. The pay down of 2012-13 deferrals only takes place if the tax initiative is successful. If the tax initiative is unsuccessful, there is no change to the existing cross fiscal year cash deferral schedule. Please refer to the table below for a list of principal apportionment cross fiscal year cash deferrals for 2012-13. See Attachment B for a graphic illustration of all intra-year and inter-year principal apportionment deferrals.

2012-13		
Timeframe	**If Tax Initiative Fails (status quo)**	**If Tax Initiative Passes (As of 5/15/2012)**
February 2013 to July 2013	$2.0 billion	$532 million ($1.468 billion is restored)
March 2013 to August 2013	$1.3 billion	$1.029 billion ($270.5 million is restored)
April 2013 to August 2013	$763.8 million	$763.8 million
April 2013 to July 2013	$419 million	$419 million
April 2013 to August 2013	$678.6 million	$175.6 million ($503 million is restored)

May 2013 to July 2013	$800 million	$800 million
May 2013 to August 2013	$1.0 billion	$1.0 billion
June 2013 to July 2013	100% of the June apportionment, which has been $2.5 billion in prior years	100% of the June apportionment which has been $2.5 billion in prior years
Deferred across fiscal years	**$9.46 billion**	***$7.22 billion***

While we are recommending planning on the tax initiative passing, we also strongly recommend school districts to analyze cash flows in the even the tax initiative does not pass. In light of the all the deferred apportionments coupled with decreases in fund balances, we recommend extra care and attention be placed on district cash demands. While cash-flow analyses and monitoring are always important, the dynamics of this State budget proposal will place additional pressures on districts to meet their obligations. The Budget Cash Flow projections need to reflect this careful analysis as well as the new apportionment schedule. To fully assess the impact of the these deferrals on district solvency, we are requesting school districts to submit additional cash-flow data to include the first quarter of fiscal year 2013-14.

Payroll Rates

PERS – 7% Employee and 11.417 % Employer for 2012-13

STRS – 8% Employee and 8.25% Employer for 2012-13
This rate has been the same for many years. We do not anticipate any changes for now.

Social Security - 4.2% Employee and 6.2% Employer for 2012

Medicare - 1.45% for Employee and Employer for 2012
This rate has been the same for many years (1986)

Multi-Year Projection

Please include with your Budget report, a clear statement of assumptions including the ADA that is being used to calculate revenue limit income. If reductions are reflected in MYP, we request that the district provide details of the reductions including the number of Full Time Equivalents (FTE) being reduced, if applicable.

Reserve for Economic Uncertainty

The revised 2009-10 Enacted Budget lowered the minimum reserve requirement levels for economic uncertainties to 1/3 the percentage level adopted by the State Board of Education as of May 1, 2009. SB 70 extended this provision for both 2010-11 and 2011-12. However, school districts are required to make progress during fiscal year 2012-13 to return to compliance with the specified standards and criteria adopted by the State Board of Education. By fiscal year 2013-14, school districts must meet compliance and restore the reserves to the percentage adopted by the State Board of Education as of May 1, 2009. We believe that the percentages established in the Criteria and Standards for reserves prior to the current Enacted Budget are the BARE MINIMUM. If a school district reduces the minimum reserve levels, it would take budget reductions of twice the amount of the lowered reserve levels to fully restore the reserve by June 30, 2014.

With the continued deferral of apportionments, it is more critical than ever to strive to maintain higher levels of reserves for cash-flow purposes. We remind districts that a state loan is precipitated when the district exhausts cash and does not have any other borrowing options even if the school district has a positive fund balance. Again, we advise school districts to maintain compliance with the reserve requirements identified in the Criteria and Standards even under the current revenue/budget reduction environment.

Charter Schools

The May Revision includes an increase of $50.3 million for the Charter School General Purpose Block Grant and Categorical Block Grant.

The General Purpose Block Grant rates are based on statewide average revenue limits. The estimated 2012-13 funding rates include a 3.24% COLA, a 22.272% deficit, and ADA growth. The CDE will recalculate the General Purpose rates at each apportionment. The Categorical Block Grant rate reflects flat funding for 2012-13. The estimated rates for 2012-13 are:

	K-3	4-6	7-8	9-12
General Purpose Block Grant	$5,117	$5,193	$5,346	$6,188
Categorical Block Grant	410	410	410	410
Total	$5,527	$5,603	$5,756	$6,598

Charter schools should also have contingency plans for the potential revenue limit reduction of $441/ADA should the Governor's tax initiative fail in the November 2012 elections.

The May Revision addresses additional changes for charter schools as follows:

- The Budget requires school districts to convey surplus property to any charter school opting to claim property and provides an incentive for school districts to sell property to charters without having to declare the property surplus and without losing eligibility in the state school facilities program.
- Allows all new and existing non-classroom based charters to receive full funding without needing State Board of Education review and approval and would eliminate the funding determination process and will ultimately allow all non-classroom based charters to receive full funding.
- Under this proposal, county treasurers will be authorized to lend to charter schools. Also, charters, as a condition of directly applying to the state for deferral exemption, will be

required to provide a copy of their application for a deferral exemption to their charter authorizer.

- Charter schools are now authorized to receive the proposed mandate block grant.

Other Factors

Some factors that should be kept in focus as districts plan for the upcoming year:

- 2012 is a "presidential" election year.
- There are many controversial and competing initiatives that could be on the November ballot. The number of ballot initiatives could impact a voter's support of any tax initiative.
- The California Legislature may not support the proposed expenditure reductions to the health and human services areas as currently proposed by the Governor in his budget.
- There are court challenges that could hinder the full implementation of budget reductions such as the Medi-Cal provider rate reduction which was stayed by the courts.

In developing their 2012-13 Budget Reports and related MYPs, it is recognized that each School District will need to take into consideration the uniqueness of the district's financial situation and its ability to develop and implement realistic contingency plans in the event that the Governor's proposed tax initiative fails to win voter approval on the November 2012 ballot. Some of the factors a School District should consider include:

- Maintaining "best fiscal practices."
- If the budget uses flat revenue limit funding, financial projections should have contingency plans for the possible failure of the Governor's tax initiative.
- Contingency plans must be realistic and ready for timely implementation if necessary.
- MYPs should be analyzed for one-time revenues and the ending date of the revenues should be noted to avoid over projecting those revenues.
- Cash flow is a critical consideration. School districts may find it more difficult to issue TRANs and the cost of any borrowing may increase. Cash flow should be looked at over an 18 month cycle rather than a 12 month cycle.

Timeline

We remind districts that Budget Reports are due to the County Office no later than July 1st, 2012. Reports may be submitted earlier than this due date and we appreciate early submissions.

If you have any questions regarding this advisory, please feel free to call your District Advisors: Ann Redd-Oyedele at (408) 453 6593, Jason Vann at (408) 453 6576, Jenina Salcedo at (408) 453 6594 or Kolvira Chheng at (408) 453 6510.

K-12 Categorical Programs Included in the Weighted Student Formula Proposed by the 2012-13 Governor's May Revision

Program
Adult Education
Adults in Correctional Facilities
Advanced Placement Grant Programs
Agricultural Vocational Education
Alternative Credentialing
Apprentice Programs
Arts and Music Block Grant
California High School Exit Exam
California School Age Families Education Program
Certificated Staff Mentoring
Charter Schools Block Grant
Civic Education
Community-Based English Tutoring
Deferred Maintenance
District Revenue Limits
Economic Impact Aid (EIA)
Educational Technology
Gifted and Talented Education
Grade 7-12 Counseling
High School Class-Size Reduction (CSR)
Instructional Materials Block Grant
K-3 Class-Size Reduction (CSR)
National Board Certification
Oral Health Assessments
Partnership Academies
Physical Education Block Grant
Principal Training
Professional Development Block Grant
Professional Development Institutes for Math and English
Pupil Retention Block Grant
Regional Occupational Centers and Programs (ROC/Ps)
School and Library Improvement Block Grant
School Safety Block Grant
School Safety Competitive Grant
Specialized Secondary Program Grants
Staff Development
Student Leadership/California Association of Student Councils
Summer School Programs
Teacher Credentialing Block Grant
Teacher Dismissal Apportionments

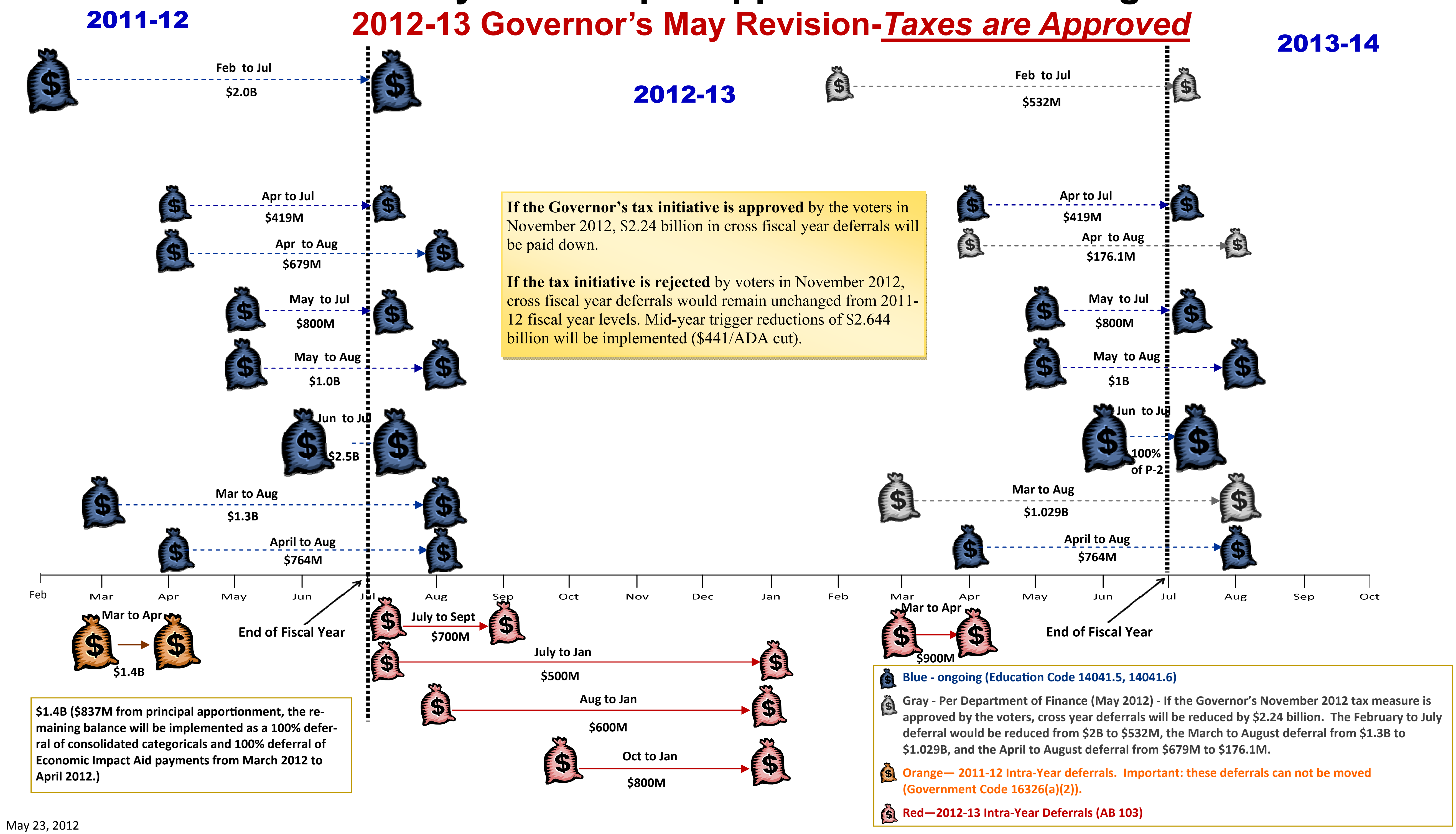
K-12 Categorical Programs Not Included in the Weighted Student Formula

Program
After-School Programs
Home-to-School Transportation
Necessary Small Schools
Preschool Program
Quality Education Investment Act (QEIA)
School Nutrition
Special Education
Targeted Instructional Improvement Grant

Source: Department of Finance

Delayed Principal Apportionment Funding

2012-13 Governor's May Revision-*Taxes are Approved*

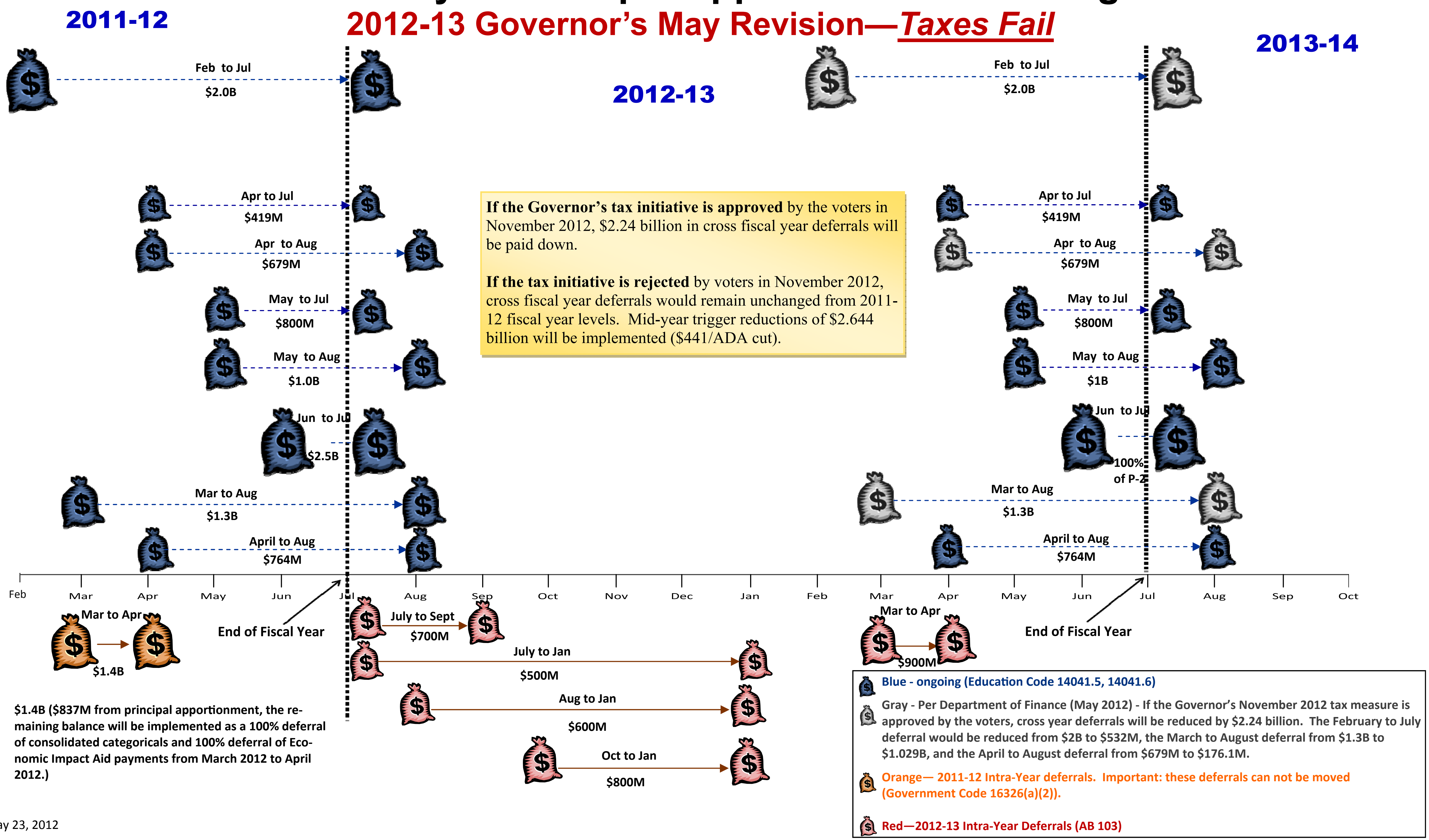


May 23, 2012

Attachment C-1

Delayed Principal Apportionment Funding

2012-13 Governor's May Revision—*Taxes Fail*



If the Governor's tax initiative is approved by the voters in November 2012, $2.24 billion in cross fiscal year deferrals will be paid down.

If the tax initiative is rejected by voters in November 2012, cross fiscal year deferrals would remain unchanged from 2011-12 fiscal year levels. Mid-year trigger reductions of $2.644 billion will be implemented ($441/ADA cut).

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

Blue - ongoing (Education Code 14041.5, 14041.6)

Gray - Per Department of Finance (May 2012) - If the Governor's November 2012 tax measure is approved by the voters, cross year deferrals will be reduced by $2.24 billion. The February to July deferral would be reduced from $2B to $532M, the March to August deferral from $1.3B to $1.029B, and the April to August deferral from $679M to $176.1M.

Orange— 2011-12 Intra-Year deferrals. Important: these deferrals can not be moved (Government Code 16326(a)(2)).

Red—2012-13 Intra-Year Deferrals (AB 103)

May 23, 2012