Overview of the Governor’s 2016-17 May Revision

Last week, Governor Brown released the May Revision to his 2016-17 January Budget proposal, including his adjusted plans for public education funding and policy.

As expected, the Governor acknowledged that substantial overall General Fund (GF) revenue decline has occurred in the current year and he confirmed that his Department of Finance is now projecting revenues in 2016-17 will fall below January estimates, as well. In his press conference, the Governor emphasized his “resolve to resist new spending programs”, warned that “deficit spending in California is on the horizon” and quoted a recent Moody’s Research report that concluded California is one of the least prepared states in the country to withstand a recession due to “its revenue volatility, weak financial flexibility, and low reserve levels”. Expanding upon the issue of budget reserves, the Governor went on to say that because California reserves remain inadequate, out-year budget cuts will be required. When asked by a reporter about the proposed extension of Proposition 30 on the November ballot, the Governor declined to support the proposal, saying he would “leave that to the voters” and concluded by saying he would remain resolute in protecting the reserves proposed in his budget.

This summary is based upon information obtained from the Governor’s written summary, press conference, and a phone briefing provided by administration staff.

General Fund Revenue Adjustments

The Governor’s revised budget now estimates General Fund (GF) revenues will be $1.938 billion lower over the three-year forecast period (2014-15, 2015-16 and 2016-17). The specific revenue estimate changes include:

- $471 million in increased GF revenue in the prior year (2014-15).
- $1.491 billion in reduced GF revenue in the current year (2015-16)
- $918 million in reduced GF revenue in the budget year (2016-16).

To soften the impact of these overall reduced revenues estimates, the administration has reduced its proposed Rainy Day reserve contributions by $1.319 billion, as follows:

- $954 million in 2015-16
- $365 million in 2016-17

2016-17 May Revision
General Fund Revenue Forecast
(Dollars in Millions)

Source	Governor's Budget	May Revision	Change	
Fiscal 14-15: Final				
Personal Income Tax	$76,079	$76,169	$90	0.1%
Sales & Use Tax	23,709	23,682	-27	-0.1%
Corporation Tax	9,007	9,417	410	4.6%
Insurance Tax	2,445	2,445	0	0.0%
Alcoholic Beverage	357	357	0	0.0%
Cigarette	86	86	0	0.0%
Pooled Money Interest	21	21	0	0.0%
Other Revenues	1,594	1,592	-2	-0.1%
Subtotal	$113,298	$113,769	$471	
Transfers [1]	-1,980	-1,980	0	0.0%
Total	**$111,318**	**$111,789**	**$471**	0.4%
Fiscal 15-16				
Personal Income Tax	$81,354	$79,962	-$1,392	-1.7%
Sales & Use Tax	25,246	25,028	-218	-0.9%
Corporation Tax	10,304	10,309	5	0.0%
Insurance Tax	2,493	2,486	-7	-0.3%
Alcoholic Beverage	366	370	4	1.2%
Cigarette	84	87	3	3.6%
Pooled Money Interest	36	38	3	7.7%
Other Revenues	1,584	1,695	111	7.0%
Subtotal	$121,466	$119,975	-$1,491	
Transfers [1]	-3,929	-2,975	954	-24.3%
Total	**$117,537**	**$117,000**	**-$537**	-0.5%
Fiscal 16-17				
Personal Income Tax	$83,841	$83,393	-$448	-0.5%
Sales & Use Tax	25,942	25,727	-215	-0.8%
Corporation Tax	10,956	10,993	37	0.3%
Insurance Tax	2,549	2,345	-204	-8.0%
Alcoholic Beverage	373	376	3	0.9%
Cigarette	81	85	4	4.9%
Pooled Money Interest	89	63	-26	-29.3%
Other Revenues	1,247	1,176	-71	-5.7%
Subtotal	$125,078	$124,160	-$918	
Transfers [1]	-4,445	-4,080	365	-8.2%
Total	**$120,633**	**$120,080**	**-$553**	-0.5%
Three-Year Total			**-$619**	

Note: Numbers may not add due to rounding.
[1] Includes transfers to the Budget Stabilization Account for each year.

In addition, the administration reports that local property tax collection estimates in the current and budget year have been revised upward by a combined $408 million and that this will free up an equivalent amount of GF revenue for non-Proposition purposes.

Long Term Economic Forecast

The Governor's May Revision economic forecast continues to estimate growth over the next four years. The projected average growth rate in U.S. real gross domestic product over the next four years is 2.5 %. While the forecast does not project a recession, the Governor cautions that "current expansion has already exceeded the average post-World War II expansion by over two years."

The May Revision forecast for the largest three General Fund sources indicates that these revenues will grow from $109.3 billion in 2014-15 to $129.5 billion in 2019-20. The average year-over-year growth rate during this period is 4.8%.

Long-Term Revenue Forecast - Three Largest Sources

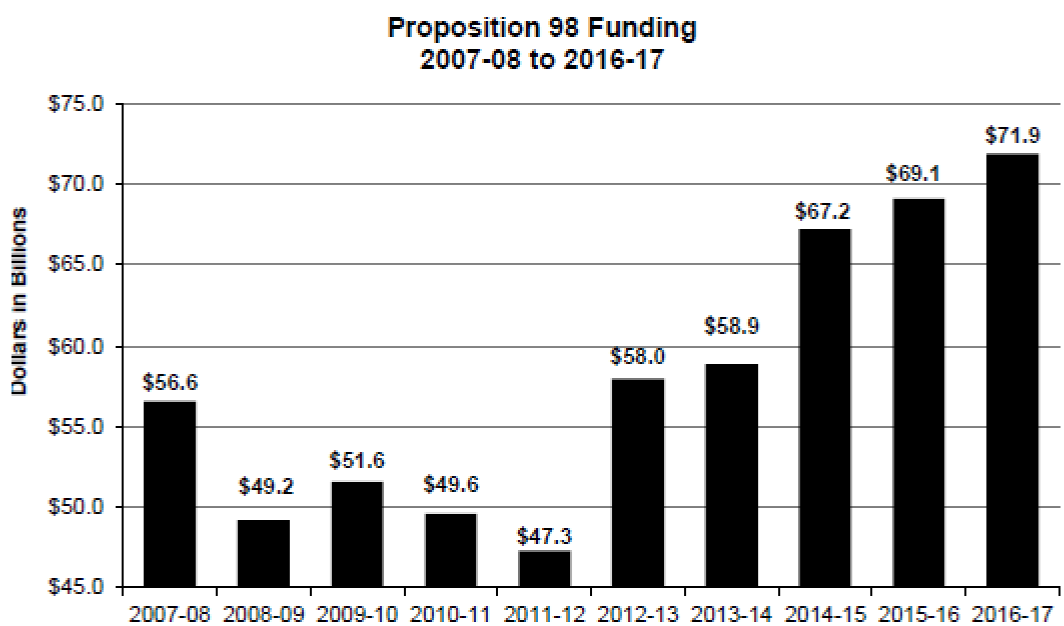
(General Fund Revenue - Dollars in Billions)

	2014-15	2015-16	2016-17	2017-18	2018-19	2019-20	Average Year-Over-Year Growth
Personal Income Tax	$76.2	$80.0	$83.4	$86.7	$85.9	$88.1	4.7%
Sales and Use Tax	$23.7	$25.0	$25.7	$26.2	$27.4	$28.7	4.0%
Corporation Tax	$9.4	$10.3	$11.0	$11.5	$12.1	$12.8	6.1%
Total	**$109.3**	**$115.3**	**$120.1**	**$124.5**	**$125.4**	**$129.5**	4.8%
Growth	11.3%	5.5%	4.2%	3.6%	0.7%	3.3%	

K-14 Education (Proposition 98) Guarantee Adjustments

It is important to note that the Governor's May Revision continues to protection the Proposition 98 constitutional guarantee. The most critical piece of the May Revise is the combined effect of higher prior-year (2014-15) GF revenues. Along with reduced revenue growth in 2015-16, and modest projected growth in 2016-17 (in a test 3 year), the May Revise generates an overall increase in K-14 education (Proposition 98) spending of $626 million over the three-year period of 2015-16 to 2017-18. Specifically, the Proposition 98 guarantee:

- increases by $463 million to $67.2 billion in 2014-15,
- decreases by $125 million to $69.1 billion in 2015-16
- increases by $288 million to $71.9 billion in 2016-17.



While the Governor's May Revision continues to propose that all prior and current year revenue increases be in one-time investments, K-12 school districts and charters will receive an additional $2.9 billion in 2016-17 LCFF gap funding. These increases are made with on-going funds.

K-12 Education Adjustments at May Revision

Local Control Funding Formula — The May Revision increases funding for the formula by providing an additional $154 million in LCFF gap funding to school districts and charters — building upon the $2.8 billion provided in the January Budget. This $2.979 billion increases LCFF gap funding from 49.08% to 54.84% in 2016-17.

Mandate Reimbursement Payments — The January Budget proposed $1.28 billion ($214 per ADA) in discretionary one-time Proposition 98 mandate repayments for school districts, charter schools, and county offices of education. The May Revision provides an additional $134.752 million in Proposition 98 resources for a total of $1.416 billion ($237 per ADA) in one-time funding. The Governor identifies investments in professional development, teacher induction to beginning teachers, and instructional materials and technology as likely expenditures that LEAs will make with these funds. All of the funds provided will offset any applicable mandate reimbursement claims for LEAs, and is intended to be consistent with the approach initiated in the 2014 Budget Act where one-time funding was provided for both general purpose activities and mandates reimbursement.

Proposition 98 Maintenance Factor — The Governor's January Budget had projected that the Proposition 98 Maintenance Factor would be repaid in full by the end of the 2015-16 fiscal year, prior to the creation of additional projected maintenance factor at the end of the 2016-17 fiscal year. Due to reduced revenue estimates for 2015-16 and increased growth in per capita personal income for 2016-17, maintenance factor balances of $155 million and $908 million are now projected for 2015-16 and 2016-17, respectively.

Cost-of-Living Adjustments — A decrease of $18.6 million in Proposition 98 spending in selected categorical programs for 2016-17 and $1.7 million to county offices of education to reflect a change in the cost-of-living factor from 0.47% at the Governor's Budget to 0.00% at May Revision.

Early Education Block Grant (EEBG) — In January, the Governor proposed to consolidate state-subsidized early education programs into a $1.6 billion Block Grant. The May Revision proposes a more detailed implementation plan that includes the following components:

- Beginning in 2017-18, establishes the Early Education Block Grant, to be administered by school districts with support from county offices of education and the California Department of Education, to provide one year of subsidized pre-kindergarten education for low-income and at-risk four-year-old children.
- Eliminates transitional kindergarten as of July 1, 2017.
- Prioritizes service for children who are either homeless, foster youth, at risk of abuse or neglect, children with exceptional needs, non- or limited-English-speaking, or low-income, as defined as either eligible for free or reduced-price meals or income-eligible for state child care programs.
- Identifies school districts as the provider of state-subsidized pre-kindergarten programs, with a requirement to serve no fewer than the number of subsidized children served in the district through transitional kindergarten or State Preschool in the 2016-17 school year. School districts may contract with other entities meeting minimum quality requirements to provide pre-kindergarten programs. School districts are also encouraged to participate in consortia to promote local efficiency and program continuity.
- Identifies county offices of education as the provider of pre-kindergarten program regional capacity building and technical assistance for both school districts and community based-organizations. County offices of education become the lead agencies for maintaining the regional quality rating and improvement system and creating priorities for local child care and pre-kindergarten program funding. County offices of education are also encouraged to

participate in consortia to promote regional efficiency and program continuity. For 2016-17, county offices of education are allocated $10 million one-time and $10 million ongoing to begin implementation of the Early Education Block Grant.

- Identifies the California Department of Education as the provider of technical assistance to county offices of education.
- Requires county offices of education and school districts to create early learning plans, tracking access to subsidized pre-kindergarten programs in their respective jurisdiction, setting goals to increase access, setting priorities for program outcomes, and aligning activities with priorities.
- Sets minimum state requirements for programs, including:
  - A minimum school day and year equivalent to a school district's kindergarten program, with strong encouragement to provide full-day programs.
  - A minimum Tier 4 quality rating on the county Quality Rating and Improvement System matrix, with required public notification of the rating system.
  - Locally determined curriculum aligned with the school district's early learning plan, with strong encouragement to use the Preschool Learning Foundations.
- Allows school districts to create a family fee schedule to serve additional children; school districts are not allowed to charge fees to families with children meeting the definition of low-income or at-risk.
- Allows school districts to serve children beyond those prioritized for subsidized pre-kindergarten if all prioritized children have been served.
- Allows county offices of education to provide services on behalf of school districts that lack the capacity to do so.
- Provides a three-year hold harmless of both school district and local State Preschool funding to school districts, with the requirement that schools may not lose more than five percent of funding per year after the hold harmless expires, and only if due to a reduction in school district average daily attendance (with some exceptions).
- Requires that additional future funding for the Early Education Block Grant be allocated based on unmet need; specifically, the amount of Early Education Block Grant funding a school district receives compared to its estimated number of unserved eligible children.
- Sets the per-pupil funding amount for the Early Education Block Grant as $6,200 per year, adjusted for COLA.
- Requires an assessment of program equity across the state, to be completed at least once every three years.

Local Property Tax Adjustments — Due to higher offsetting local property tax collections, the GF contribution to Proposition 98 decreases by $196.5 million in 2015-16 and $211.3 million in 2016-17, thus freeing up additional GF revenue for non-Proposition 98 spending.

Special Education Property Tax Adjustment — An increase of up to $28.5 million in Proposition 98 spending in 2015-16, provided on a contingency basis, for an anticipated shortfall in redevelopment agency property taxes for special education local plan areas. Related language provides a mechanism to distribute up to $28.5 million based on a determination of property taxes reported for special education local plan areas as of the second principal apportionment certification in early June.

Average Daily Attendance (ADA) — An increase of $11.2 million in 2015-16 and a decrease of $2 million in 2016-17 for school districts, charter schools, and county offices of education under the LCFF as a result of an increase in ADA in 2014-15 which drives projections for 2015-16, and a decrease in ADA for 2016-17.

Proposition 39 Energy - The California Clean Energy Jobs Act was approved by voters in 2012, and increases state corporate tax revenues. For 2013-14 through 2017-18, the measure requires half of the increased revenues, up to $550 million per year, to be used to support energy efficiency projects. The May Revision increases the amount of energy efficiency funds available to K-12 schools in 2016-17 by $33.3 million to $398.8 million to reflect increased revenue estimates.

Categorical Program Growth - A decrease of $5.7 million Proposition 98 General Fund for selected categorical programs, based on updated estimates of projected ADA growth.

Teacher Workforce Development —The May Revision proposes two augmentations that were not a part of the January Budget to address the current teacher shortage in California:

- *Integrated Teacher Credential Programs* - $10 million in one-time GF (non-98) funding is proposed for grants to California postsecondary institutions to improve upon or develop four-year integrated teacher credential programs. Grants of up to $250,000 would provide postsecondary institutions with funding to improve existing or create new integrated programs. Preference would be given to proposals that include partnerships with local community colleges and K-12 local educational agencies. The competitive grant program would be administered by the Commission on Teacher Credentialing, with the funds primarily provided for release time for faculty, creation of courses, summer scholarships for students, and program coordinators. Both public and private universities would be eligible to compete for the grants.
- *CA Center on Teaching Careers* - $2.5 million in one-time Proposition 98 funding for the California Center on Teaching Careers. Funds is proposed for use to “strengthen statewide recruitment” through a competitive multi-year grant to be administered by the Commission on Teacher Credentialing and awarded to a local educational agency to administer the center. The center would support public service announcements, employment referrals, the distribution of recruitment publications and information on financial aid and the availability of teacher preparation programs for prospective teachers, and outreach to high school students, college students, out-of-state teachers, and current credential holders.

Emergency Repair Revolving Loan Program — The May Revision proposes $100 million in one-time Proposition 98 funding to establish a “bridge loan program to provide temporary funding to schools with insufficient resources to expeditiously address imminent health and safety issues.” The administration notes that these funds are proposed to address “emergency facilities needs — structures or systems that are in a condition that poses a threat to the health and safety of pupils and staff while at school”. As a condition of participation, a school would be required to provide independent verification that the school site has been deemed unsuitable for occupation, and the school would have to self‑certify that no alternative facilities are available to educate the displaced students. Subject to an expedited review and approval process by the Department of Education, loan funds “could be released in a matter of days to address the necessary repairs and ensure students can quickly return to the classroom”. After funds are released, schools would have the option of repaying the loans in full within one year of disbursement without interest, or by structuring a long‑term low‑interest repayment plan not to exceed 20 years.

Child Care — The Governor’s January Budget proposed requiring the Department of Education to develop a plan for subsidized child care that transitions away from the use of contracts toward a voucher system over the next five years. Based upon two stakeholder workgroups that were convened to recommend needed state actions to increase the administrative efficiency of state-subsidized child care contracts, the administration now proposes statutory language to streamline the processes for single-parent verification and notices to families regarding changes in care

The May Revision further clarifies that the new child care plan should provide for a streamlined system that:

- consolidates the number of child care programs
- provides a single reimbursement rate structure (rather than the flat rate and market rate models the state currently uses) that improves provider payment processes
- creates one statewide set of minimum program quality standards
- is more efficient for families to access
- can be implemented within existing resources

Significant budget adjustments to child care in the May Revision include:

- Stage 2 — A decrease of $884,000 in non-Proposition 98 spending in 2016-17 to reflect a lower estimated increase in the cost per case. Total Stage 2 costs are $421.4 million.
- Stage 3 — A decrease of $42.3 million non-Proposition 98 spending in 2016-17 to reflect a lower estimated increase in the cost per case and reduced caseload. Total Stage 3 costs are $273.6 million.
- Child Care and Development Funds — A net increase of $55.6 million federal funds in 2016-17 to reflect an increase to the base grant amount and an increase in one-time funds carried over from prior years. Of this increase, $9.2 million is allocated for child care quality activities in accordance with the requirements of the federal Child Care and Development Block Grant Act of 2014. Total ongoing and one-time federal funding is $648.9 million.
- Capped Non-CalWORKs Programs — A net decrease of $3.5 million non-Proposition 98 General Fund to reflect a change in the cost-of-living adjustment from 0.47% at the Governor's Budget to 0.00% at the May Revision.
- Child Care Quality Activities — Provisional language in the May Revision directs the Department of Education to update its Child Care and Development Block Grant State Plan for quality expenditures to prioritize Quality Rating and Improvement System activities.

May Revise Looks Good But Battle Lines Now Drawn

The Democratic majority in the Legislature will now react to the Governor's proposals—working hard to find opportunities to fit their priorities into the Governor's plan. Unlike 2015, when significant new Proposition 98 resources (over $6 billion) were available May Revision, there will be only $626 million in new K-14 (Proposition 98) resources above the amount proposed in January. This budget scarcity will no doubt increase tensions between the Governor, legislative leaders and their respective caucuses in budget deliberations over the next month.

The Governor has once again underscored his commitment to fiscal discipline, building reserves and resisting efforts to create new or expand existing programs. The Governor's resolve and adherence to his longstanding principles will continue to make it difficult for the Legislature to expand the health and social service safety net let alone add any new programs.

It is almost certain that the Governor's Early Education Block Grant (EEBG) will be the most contentious topic in budget discussions over the next month. There has been very little, if any, support for the Governor's original proposal since it was introduced in January. The Governor continues to propose an elimination of the Transitional Kindergarten (TK) program and a fundamental re-alignment of state subsidized preschool programs where funding is based on need. The specific of this proposal, where the funds are controlled by LEAs is viewed as an existential threat by community-based (non-LEA) providers. Eliminating TK and the ADA-based entitlement that is now in current law for all year-olds will no doubt be strongly opposed by an overwhelming majority of LEAs, parents and community organizations such as Early Edge California.

In the next few days, the Legislative Analyst will analyze the Governor's proposals and provide revenue estimates in comparison to those made by the Department of Finance. Prior to June 1, we can expect the Senate and Assembly Budget Committees to pass budgets that reflect the priorities of the majority Democrats in the respective houses. A budget conference committee will be created through which the Governor and Democrat leaders will negotiate a final compromise budget. Slight modifications to the Governor's budget – with the inclusion of program spending prioritized by the Democratic leaders will be discussed and agreed to by the three parties.

As we have now seen for the past five years, that final budget will reflect the Governor Brown's priorities - with a few exceptions - to obtain the needed support from Democratic leaders in the two Houses. In the end, the vast majority of the K-14 budget proposed by the Governor in this May Revision will ultimately be approved by the legislature. We will keep you informed of any changes.