May 24, 2012

To: Marin County School District Superintendents

Marin County School District Business Officials

From: Terena Mares,
Assistant Superintendent, Business Services

Common Message to Marin County School Districts: Budget guidance for the 2012-2013 Governor's May Revision Budget

On January 5, 2012, Governor Brown introduced his Proposed 2012-13 State Budget. The introduction of the Governor's Proposed 2012-13 State Budget began the legislative process and many changes have and will take place prior to the enactment of a 2012-13 State Budget. On May 14, 2012, the Governor released his May Revision to his proposed 2012-13 State Budget. This May Revision attempts to address the budget deficit which has grown since January from $9.2 billion to $15.7 billion for 2011-12 and 2012-13. The Governor stated that the budget deficit increase is a result of lower revenues of about $4.3 billion (primarily capital gains), an increase in Proposition 98 obligations of about $2.4 billion and adverse decisions by the courts that negate about $1.7 billion in the Governor's previous proposals. The Governor proposes to close this gap with $8.3 billion in additional cuts inclusive of $1.5 billion in Proposition 98 savings, $5.9 billion in increased revenues (primarily from temporary taxes), $1.77 billion in new borrowing, and $747.4 million in "other miscellaneous solutions".

> The May Revisions increase Prop 98 spending by about $6.7 billion…K-12 programmatic funding remains at current levels.

The cornerstone of this budget assumes passage of a new tax initiative proposed by the Governor, named the, "Schools and Local Public Safety Protection Act of 2012". According to the Legislative Analyst's Office (LAO), the initiative would generate an additional $6.8 - $9 billion in 2013 and $5.4 - $7.6 billion for each year thereafter through 2018. This initiative, if passed by the voters in the November 2012 election, would temporarily increase the state sales tax by .25%

until the end of 2016 and would increase the income tax rate by up to 3% on the state's wealthiest taxpayers for seven years.

The May Revision increases the K-14 Proposition 98 spending by about $6.7 billion. Currently the 2011-12 Proposition 98 spending is about $47 billion, but would increase to $53.7 billion in 2012-13. The $1.2 billion increase over the January budget proposal is primarily due to the new higher estimates from the temporary tax initiative. **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.

The proposed budget also incorporates major reforms to K-12 education including increased categorical flexibility and a new weighted student formula. Further details of these proposed reforms are included in the following pages of this message.

"TRIGGER LANGUAGE"

The May Revision provides for 2012-13 "trigger reductions" of $5.49 billion to K-14 education should the Governor's tax initiative not pass in the November 2012 election.

These reductions would become effective on January 1, 2013. The May Revision states that: *"As education spending accounts for 53 percent of General Fund spending and the May Revision substantially increases K-14 spending and protects the University of California and California State University from deeper cuts, schools and universities would be most affected without the additional revenues."* Proposition 98 funding would then be projected at approximately $48.2 billion. Based on Department of Finance (DOF) estimates, the impact on K-12 school districts apportionments ($2.644 billion) would represent approximately $441/ADA reduction to the revenue limit. Additionally, the $2.555 billion ($2.242 billion K-12) K-14 cross fiscal year deferral reduction would be reversed.

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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 (i.e.: 8 days in 2012-2013 and 7 days in 2013-2014 for a total of 15 days over the two year period), 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.) This would have to be negotiated through the collective bargaining process.

A MESSAGE FROM THE GOVERNOR'S OFFICE

The May Revision provides both challenges and potential opportunities for school districts. Ms. Sue Burr, the Governor's Chief Education Policy Advisor and Executive Director of the State Board of Education, has emphasized that education continues to be the number one fiscal and programmatic priority of the Governor. The Governor has acknowledged that education has taken a majority of the budget reductions in past years. He offers to "protect education" through the proposed tax initiative which is intended to provide education with the same level of revenue limit funding as received in 2011-12 based on the total state revenue limit appropriation level. It is important to understand his proposal does not guarantee total flat funding of revenues for individual school districts. The total impact of the May Revision to individual school district budgets will vary because of other proposed funding changes that may or may not affect each school district. Additionally, the Governor states his commitment to restoring local control to school districts through his proposed weighted student formula and his elimination of categorical funding restrictions as proposed in his 2012-13 budget. Ms. Burr has advised that school districts should "plan for the best, and prepare for the worst".

There are other important factors to also consider that may impact the development of financial projections. Some of those factors are listed below and categorized as "Economic and Other".

ECONOMIC FACTORS

- California has reduced its budget deficit from $26.6 billion in 2011-12 to $15.7 billion in 2012-13 per the May Revision.
- The stock market, while showing signs of recovery, is still volatile.
- Corporate profits are growing; however, corporate taxes paid are declining.
- There has been growth in the commercial sector of the construction industry although the housing market has not rebounded, particularly in California.
- The unemployment rate for the US dropped to 8.1% in March 2012. Although the unemployment rate for California has dropped, it still remains higher than the national rate at 11.0%.
- The European debt crisis is slowing economic growth in Europe and will likely impact the US economic growth.

OTHER FACTORS

- 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.

As we perform our budget reviews we will do so while assessing the uniqueness of each school district's financial situation and your 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 we will include in our analysis include:

- The district's reserve for economic uncertainties.
- The cash flow projections and the school district's ability to meet its expenditure obligations for at least an 18 month period.
- The ability to immediately implement expenditure reductions if necessary.
- The status of the school district's negotiations.
- Other reserves available for immediate use.
- The impacts of revenue limit reductions if triggered by a failed tax initiative in November.
- If school districts build their budgets using flat revenue limit funding, financial projections should have contingency plans for the possible failure of the Governor's tax initiative.
- School district contingency plans must be realistic and ready for timely implementation if necessary.
- School districts must carefully review their MYPs for one-time revenues and note any ending dates of revenue sources to avoid over projecting those revenues.
- Cash flow becomes a critical consideration. School districts may the cost of any borrowing may increase. Cash flow should be looked at over an 18 month cycle rather than a 12 month cycle.

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THE FOLLOWING SECTIONS PROVIDE MORE DETAILED ADVICE RELATIVE TO CHANGES SINCE THE 2011-12 SECOND INTERIM REPORT COMMON MESSAGE DATED FEBRUARY 11, 2012:

Revenue Limit and COLAs

The Governor's May Revision does not provide a statutory cost of living adjustment (COLA) for any program in 2012-13. The projected statutory COLA of 3.24% is not funded; therefore, the deficit factor will be increased to reflect this loss of funding. The proposed budget provides funding of $169 million in 2012-13 for enrollment growth.

The 2011-12 Enacted State Budget and the Governor's May Revision specifies the statutory COLA and deficit factor for the revenue limits for 2011-12 and 2012-13 as defined in the following table:

	2011-12 Enacted State Budget COLA	2012-13 Governor's Proposed Budget Statutory COLA	2012-13 Actual Statutory COLA
Statutory Cost of Living Adjustment (COLA)	2.24%	3.17%	3.24%
K-12 Deficit	19.754% (.80246)	21.666% (.78334)	22.272% (.77728)
County Office Deficit	20.041% (.79959)	22.497% (.77503)	22.549% (.77451)

Although unfunded, the 2.24% statutory COLA for 2011-12 and the 3.24% actual COLA for 2012-13 translate into the following statewide average base revenue limit amount per ADA:

School District Type	2011-12 Actual Statutory COLA 2.24%	2012-13 Estimated Statutory COLA 3.17%	2012-13 Actual Statutory COLA 3.24%
Elementary	$137	$198	$203
High School	$164	$238	$243
Unified	$143	$207	$212

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.
- As discussed earlier, the May Revision is based on the passage of his tax initiative. If this initiative fails on the November 2012 Election, the proposed budget has an automatic "trigger reduction" of $2.644 billion for K-12 education. Per the Department of Finance calculations, this would result in a loss of approximately $441/ADA**.**

The School Services of California Financial Projection Dartboard provides additional information relative to statutory COLAs and revenue limit deficits. It is recommended that school districts utilize this information in preparing their Multi-Year Projections (MYPs). Given the uncertainty of the State's economic recovery, school districts may need to have a contingency plan for any reduction to the out year COLAs when incorporating future statutory COLAs.

Basic Aid School Districts

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 in 2011-12 is 8.92%, is increased to 9.57% in 2012-13, and will be 8.92% in 2013-14 as a result of SB 81, which shifted the mid-year transportation "trigger" reductions to a revenue limit reduction, including "fair share" reductions for basic aid districts.

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.

…under the current Weighted Student Formula proposed in the May Revision, it appears that basic aid school districts would not be held harmless in 2012-13

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 who 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.

Our guidance for basic aid districts, relative to the Weighted Student Formula is as follows:

- Continue to budget revenues according to current law for 2012-13
  - Budget Tier III Categoricals to the extent that these are not captured through 9.57% "fair share" calculations in 2012-13, (and 8.92% in 2013-14)
  - Recognize the impact of the Weighted Student Formula through a contingency reserve in 2012-13 only.
- Recognize that if the tax initiative fails, the Weighted Student Formula will not be implemented
  - Build contingency reserve amounts for additional "fair share" reductions in 2013-14 based on $441/ADA in your MYPs.
  - The $441/ADA "fair share" reduction in 2013-14 would be in addition to the current 8.92% "fair share" reduction that is ongoing.
- Recognize that even if the Weighted Student Formula fails passage through the Legislature for 2012-13, there is speculation that it may still be implemented in 2013-14.

Special Education

The May Revision for special education provides $12.3 million for ADA growth. No COLA is provided for special education.

- Special Education Local Plan Areas (SELPAs) with growth will receive an estimated $465.44 per ADA. This is the same as last year.
- Also, a $17.4 million increase in federal funding will be allocated to SELPAs, estimated at $2.94 per ADA.
- Under current law, school districts need to meet maintenance of effort (MOE) requirements irrespective of any reduced work or school year.
- Under the Governor's mandate proposal, he would eliminate the Behavioral Intervention Plan (BIP) and would make its continuation optional for each school district.

AB 3632 mental health services to students with disabilities continue to be the responsibility of school districts for 2012-13. A total of $417 million is provided to support mental health services including the $98.6 million augmentation to backfill the loss of the Mental Health Act funding (Proposition 63).

The Governor also proposes to eliminate the Early Mental Health Intervention (EMHI) program. Those funds would be redirected for other K-12 purposes and would be available to all school districts.

> It is recommended that school districts plan for their 2012-13 transportation apportionment for home-to-school and special education transportation.

Transportation

2012-13 FISCAL YEAR

SB 81 restored the transportation appropriation. 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 (WSF). 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.

Child Care Programs

The Governor's May Revision proposes significant changes to three of the child care and preschool budget reduction and policy reform proposals included in the January budget:

Reduce Child Care Costs: The May Revision maintains $452.5 million in child care cost savings included in the January budget. The Governor also proposes to reduce the number of child care slots to be eliminated from 54,800 to 29,600 with the following changes:

- Provides an increase of $180.1 million to allow families who are engaged in education or training to receive child care services on that basis for up to two years.
- Provides a decrease of $184.2 million by reducing reimbursement rates ceilings for licensed voucher-based providers from the 85th percentile to the 40th percentile of the private pay market, based on the 2005 Regional Market Rate (RMR) survey data. License-exempt providers will be reimbursed based upon 71 percent of the lowered licensed ceilings.

Part-Day Preschool Programs: The May Revision redirects $91.5 million from Transitional Kindergarten funding to:

- Restore the 10-percent reduction to the Standard Reimbursement Rates for part-day preschool programs included in the Governor's Budget ($34.1 million)
- Expands part-day preschool for 15,500 children from low-income families ($57.5 million).

Restructure Administration of Child Care: The January Budget proposed to shift the eligibility and payment functions for child care services from the alternative payment programs and Title 5 centers to the county welfare departments, beginning in 2013-14. Concerns were raised that shifting to a voucher-only child care system administered by the counties would reduce access to higher quality Title 5 centers. Additional concerns were raised that non-cash-aided families would not be able to access services because funding associated with child care services would be capped at the appropriation level and prioritized for cash-aided families. The May Revision proposes the following policy changes to address these concerns:

- A child care block grant will be created, separate from the county single allocation, to ensure that eligible low-income working families can continue to access child care services.
- County welfare departments will contract with Title 5 centers, based on the allocation of Title 5 center slots in 2012-13, as a condition of receiving child care block grant funds. Counties will be provided flexibility to deviate from this allocation up to 10 percent. After a specified period of time, counties will be allowed to reallocate Title 5 center slots to voucher-based providers within the county to align service needs with available resources.
- Some funding will be shifted from California Department of Education (CDE) to Department of Social Services (DSS) to fund state operations costs associated with the transition of child care services to the county welfare departments, and to enable

counties that are prepared to assume responsibility for these services to implement the transition in 2012-13.

- The DSS will develop a plan in 2012-13, in consultation with CDE that outlines the quality activities to be funded in 2012-13 and 2013-14. The plan would require that DSS conduct quality activities to promote the health and safety of children in care, and that CDE conduct activities to promote early learning and readiness for school. The plan would also reflect an allocation to county welfare department to target quality funds to local needs and priorities.

Quality Education Investment Act (QEIA)

The Education Trailer Bill proposes to move the final year of the QEIA program from 2013-14 to 2014-15. This is accomplished by clarifying that the original funding for QEIA was provided by Assembly Bill 3 of the Fourth Extraordinary Session (ABX4 3) (Chapter 3/2009-10) and ABX3 56 (Chapter 31/2009-10).

There are no changes to the current funding rates. For 2012-13 the rates continue to be:

- $500 per enrolled pupil for kindergarten and grades 1-3
- $900 per enrolled pupil Grades 4-8
- $1,000 per enrolled pupil Grades 9-12

QEIA is now funded within Proposition 98.

Lottery

Please note that Lottery funding will be calculated in the same manner as prior years, with the exception that through 2014-15, the following programs will be funded based on 2007-08 ADA rather than the prior year ADA:

- Adult Education
- Regional Occupational Center and Programs (ROC/P)

On April 8, 2010, the Legislature passed AB142 (Chapter 13 / 2010) which requires that not less than 37% of the total annual revenues from the sale of lottery tickets to be distributed to education.

The current projection for 2011-12 is $118.00 per ADA (unrestricted) and $23.75 per ADA (Prop. 20 restricted). The Lottery Commission will report the projections for 2012-13 in June 2012. Until that time, it is recommended the 2012-13 lottery projection remain the same as 2011-12; $118.00 per ADA (unrestricted) and $23.75 per ADA (Prop. 20 restricted).

Mandated Costs

The May Revision has substantially changed the original proposals outlined in the January Budget. The January proposal to either eliminate or make permissive all state mandates has been withdrawn.

The May Revision would provide $166.6 million to create a block grant funding allocation for K-12 schools. Funding would be based on ADA for school districts and would approximate $28/ADA for 2012-13.

The existing claiming process would be eliminated; thus providing that all school districts are reimbursed at the same rate for providing services for the same mandated requirements.

The six highest cost mandates would be suspended until permanently repealed beginning in 2012-13. These would include: Graduation requirements for second science course; Behavior Intervention Plans; Habitual Truants; Notification of Truancy; Notification of Teachers and Pupil Discipline Records; and Pupil Suspension, Expulsion and Expulsion Appeals. The remaining mandates suggested for repeal in the January Budget will be suspended in 2012-13 until subsequent legislation is introduced to permanently repeal those activities.

At this time it is recommended that school districts continue to adhere to all mandate requirements and budget revenue on a cash basis. Legislation would be required to eliminate any mandates.

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.

Expansion of Categorical Flexibility and New Tier III Public Hearing Requirements

The Governor is proposing that virtually all categorical programs, including K-3 CSR and Economic Impact Aid (EIA), 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, please note that most of the temporary flexibility provisions were extended to June 30, 2015 with the exception of the K-3 Class Size Reduction (CSR) reduced penalty provisions. The flexibility provisions for the CSR reduced penalties expire on June 30, 2014 instead of June 30, 2015. Because CSR may be folded into the Weighted Student Formula, we would advise districts to consider the extension of Class Size Reduction (CSR) to June 30, 2015. This advice assumes that either the Weighted Student Formula occurs or the extension of Tier III flexibility date for CSR.

Current law (Education Code 42605), states that as a condition of receiving funds for Tier III categorical programs, the governing board of a school district must hold a public hearing to discuss and approve or disapprove the proposed explicit uses of each Tier III Programs' funding. This hearing must take place regardless of whether districts opt to use funds for their original purpose or for another purpose. Previously, the hearing was allowed to take place at any time, and many districts chose to hold this hearing in conjunction with their budget adoption.

The Governor is proposing that virtually all categorical programs, including K-3 CSR and Economic Impact Aid (EIA), be moved into "Tier III" categorical flexibility in 2012-13.

Assembly Bill (AB) 189 (Chapter 606/Statutes 2011), became effective January 1, 2012, and changed the public hearing requirement regarding the use of the Tier III funds. Specifically, the change relates to when the board meeting is held and what is to be included in the agenda. **The Tier III public hearing must now be held prior to and independent of a meeting at which the budget is adopted. AB 189 also requires a governing board to identify in the notice of the public hearing any Tier III program that is proposed to be closed.** Noncompliance puts your entire Tier III entitlement at risk. Given this potentially significant penalty, it is critical to make sure that the public hearings are held and contain the required elements above.

Weighted Student Formula (WSF)

The Governor has indicated that California's school finance system has become "too complex, administratively costly and inequitable". The Governor proposes major school finance reform to remedy these issues and to provide greater flexibility in the use of funding. This Weighted Student Formula (WSF) model would reflect the following elements;

- This funding formula would 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.
- The model would eliminate most categorical program requirements allowing total flexibility in use of the funds. However accountability requirements would be implemented at a future date.
- The May Revision language indicates that the model would be phased in over a seven year period with a "hold harmless" provision for 2012-13 only.
- The formula would be 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 in the 2011-12 fiscal year
- 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 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.

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.

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:

- 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.

Cash Management

Intra-Year Principal Apportionment Deferrals

SB 82 was chaptered on March 24, 2011 and allows for intra-year deferrals in the 2011-12 fiscal year. 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

Cross Fiscal Year Principal Apportionment Deferrals

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. **For cash flow projections we recommend that school districts assume that the Governor's tax initiative does not pass until the outcome of the November 2012 election is known.** Please refer to the table below for a list of principal apportionment cross fiscal year cash deferrals for 2012-13. See Attachments C-1 and C-2 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***

Also note that the relationship between property taxes and state aid within district revenue limits can significantly affect cash flow. Additionally, the change in status from a Revenue Limit school district to a Basic Aid school district will impact the receipt of cash from monthly to primarily December and April.

Other Cross Fiscal Year Payment Deferrals

In addition to the cross fiscal year principal apportionment cash deferrals, there are three cross fiscal year cash deferrals applicable to K-3 Class Size Reduction, School Safety Violence Prevention, and Targeted Instructional Improvement Grant. The deferral amounts are listed below:

- $570 million for K-3 Class Size Reduction (CSR)
- $38.7 million for School Safety Violence Prevention
- $100.1 million for the Targeted Instructional Improvement Block Grant

Potential Impact of Weighted Student Formula (WSF) on Cash

Currently, a majority of other state categoricals are apportioned based on the 5-5-9 schedule. If the WSF is adopted, payments for all of the categorical programs that are part of the WSF will be gradually phased over to principal apportionment payment schedule. The proportion of funds being phased into the principal apportionment payment schedule will be subject to both intra-year and inter-year deferrals. This essentially will increase the amount of funds deferred within the year and across fiscal years.

Potential Impact of the Governor's Initiative with the Education Protection Account

If approved, the Governor's tax initiative establishes an Education Protection Account (EPA). The EPA will offset State Aid in the same manner that local property taxes offset State Aid and will be paid on a quarterly basis to LEAs. However, in 2012-13, funds will accumulate in EPA and the first payment will not be made until June 2013. Based on the proposed implementation of EPA, there could be significant cash flow challenges for LEAs.

Impact of Redevelopment Agency Dissolution

For 2011-12, the State assumed $1.7 billion in savings due to the implementation of ABX1 26 and ABX1 27. As a result, principal apportionments were reduced by $1.7 billion in the Advance and by $890 million in the P-1 Principal Apportionment. The May Revision estimates that residual property taxes from Redevelopment Property Tax Trust Funds (RPTTF) will be $818 million for 2011-12 and $991 million for 2012-13. The State's actual savings has yet to be determined for 2011-12; however, it is unclear if the $818 million estimate for 2011-12 will materialize. Department of Finance (DOF) and CDE officials have told us that they will honor the county auditor P-2 estimates for local property taxes reported through the CDE Revenue Software.

Apportionment Schedules

In addition to apportionment cash deferrals, the State of California modified the principal apportionment payment schedules in 2009-10 to enhance the State's cash position in future years. In light of the reduced and deferred apportionments and change in timing of distribution of funds from the State, a great deal of emphasis must be placed on cash flow analysis and monitoring. We continue to be prepared to work with the County of Marin in exercising cash borrowing assistance that can be provided by the Treasurer's Office.

Please note that the principal apportionment deferrals will impact each school district differently depending upon: (1) the amount of State Aid revenue limit funding that each district receives and (2) the principal apportionment schedule that is dictated by Education Code Section 14041. There are three separate principal apportionment schedules outlined in Education Code Section 14041(a). Most LEAs in California receive apportionments that are in accordance with Education Code Section 14041(a)(1)(2)(3)(4). However, there are a small number of districts in California that receive apportionments in accordance with Education Code Section 14041(a)(7) or Education Code Section 14041(a)(8).

Cash Management Planning

As a result of all the deferrals, policy changes, and uncertainty with respect to school district apportionments, it is important to plan ahead and establish a cash management plan that maximizes flexibility. Districts that have never issued tax revenue anticipation notes (TRANs) may have to consider doing so if they don't have sufficient cash resources or the ability to utilize temporary inter-fund borrowing. Some districts may need to consider a two-step cash management plan utilizing two separate TRANs issuances to meet cash flow needs.

These cash management challenges make it even more imperative that we consider reserve levels greater than the minimums required within the State's Criteria and Standards. As always, reserves are especially critical in order to have sufficient cash to meet payroll and other obligations.

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In addition, the advance principal apportionment will be reduced by $1.2 billion. The May Revision includes a proposal that will require "successor agencies to transfer cash assets not obligated or reserved for legally authorized purposes to cities, counties, special districts, and K-12 schools in 2012-13." This money will be redirected to K-12 school districts as local property tax revenues, thereby reducing the State's general fund obligations for Proposition 98.

Reserve for Economic Uncertainties

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 in the 2012-13 fiscal year 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 maintain higher levels of reserves for cash flow purposes. A school district needs a state loan when they run out of cash and do not have any other borrowing options even if the school district has a positive fund balance.

Basic aid school districts are advised to maintain reserves much greater than the State required minimum because they do not have the prior year ADA protection provided to school districts under Education Code 42238.5, whereby revenue limit funding is based on ADA for either the current or prior fiscal year, whichever is greater.

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 critically important.

Negotiations

When considering a multi-year contract, school districts need to be very flexible and have appropriate contingency language, such as basing compensation increases on "funded COLA" or "effective COLA." There may be different COLAs and deficits for revenue limits versus categorical programs and this should be considered during negotiations.

It is important to remember that the Governor's May Revision Proposed 2012-13 State Budget provides flat revenue limit funding, but is predicated on the passage of the November 2012 tax initiative. If it fails, "trigger language" would be implemented effective January 1, 2013 and would result in a reduction of approximately $441/ADA per Department of Finance (DOF) calculations.

The May Revision provides increased flexibility for school districts by authorizing a reduction to the school year by up to 15 days combined over 2012-13 and 2013-14. This would have to be negotiated through the collective bargaining process. School districts that intend to seek a reduction in employee compensation through negotiations should be advised to begin those negotiations prior to the adoption of the 2012-13 budget. Case law and PERB decisions underscore the duty to meet and negotiate in good faith requires the parties to begin negotiations prior to the adoption of the final (school district) budget for the ensuing year sufficiently in advance of such adoption date so that there is adequate time for agreement to be reached, or for the resolution of an impasse. School districts need to consider this as they negotiate changes to collective bargaining agreements.

Summary

We recognize that these are extraordinary economic times and it is difficult to develop financial plans. School district budgets should be managed with an eye to the significant downside risk created by the State's ongoing structural deficit and any mid-year reductions that would result under the Governor's budget proposals related to the failure of his proposed tax measure. In these times of great economic and budgetary uncertainty, school districts need reserves that are much greater than the minimum. We commend the districts of Marin County for their efforts in maintaining strong reserves.

It is recommended that school districts continue to be cautious and focus on a multi-year strategy when recommending decisions and obtaining agreements. Attention should be focused on the multi-year projections for 2013-14 and beyond. School districts should develop financial projections and contingency plans accordingly.

We understand how difficult it is for school districts to deal with the increased pressures, reduced funding, apportionment deferrals, and the uncertainty associated with a volatile economy. It is important that school districts be proactive to maintain their fiscal solvency through developing contingency plans that allow the most flexibility possible.

Thank you for your efforts and dedication to the children of Marin County.