

INTEROFFICE CORRESPONDENCE

Los Angeles Unified School District
Independent Analysis Unit

INFORMATIVE

DATE: January 29, 2019

TO: Members, Board of Education
Austin Beutner, Superintendent

FROM: Glenn Daley, Director, Independent Analysis Unit
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SUBJECT: GOVERNOR'S 2019-2020 K-12 EDUCATION BUDGET PROPOSAL

This informative is an overview of Governor Newsom's 2019-2020 K-12 education budget, as presented to the public on January 10, 2019.¹ Included are details about how various aspects of the proposed California education budget may affect current budget development in L.A. Unified.

SUMMARY

- California education spending will be higher next year than now. However, **growth in K-12 education funding in coming years will be incremental** and probably insufficient to meet L.A. Unified's needs without major changes in funding, spending, or both.
- **The cost-of-living-increase (COLA) applied to the Local Control Funding Formula-based (LCFF) funding will increase by about 1% more than anticipated;** the statutory COLA for 2019-2020 is 3.46% instead of the projected 2.57%.²
- **One-time (non-recurring discretionary) dollars, which were plentiful in recent years, and last year amounted to at least \$80 million, are becoming scarce.** The governor has expressed a preference for using state discretionary funds in a targeted way rather than passing them to districts as discretionary funds.
- The governor proposes investing hundreds of millions of state discretionary dollars in early childhood education (ECE). This ECE investment is intended for Community Based Organizations (CBOs), and **will benefit the District only indirectly, if at all.**
- However, **the District will receive new special education dollars** on top of the AB602 COLA increase, and the governor's budget contains proposals that suggest ways to reduce special education spending in the long term. These dollars may be restricted, but they should free up an equal amount of unrestricted funds for general student population expenses.
- The governor's budget contains **some pension cost relief** for the District.

PROPOSITION 98 AND LCFF

Though the governor's budget is positive and the proposed Proposition 98 minimum guarantee for all California education spending in 2019-2020 is up 3.6% from last year, this growth represents a slow-down from the increases of recent years. The LCFF has reached its targets, and absent new funding

¹ Dept. of Finance. (2019) California Budget 2019-20. *State of California*. Retrieved from <http://www.ebudget.ca.gov/>

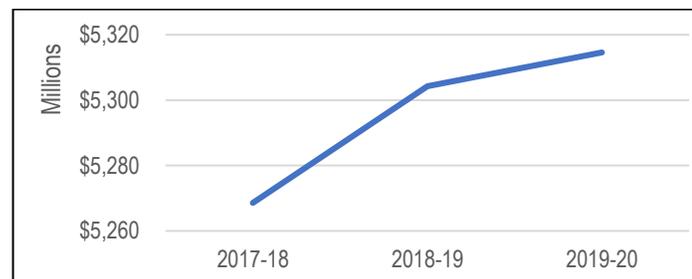
² IAU LCFF target entitlement projections are the results of calculations based on reported or estimated grade-span ADA, grade-span base rates and adjustments, and the count of unduplicated students. As such, these projections may not match the actual amounts shown in District budget documents.

streams, large increases in state revenue, or shifts in policy priorities the California K-12 education budget has reached a steady state that will grow by cost-of-living only.

The specific dollar amounts the governor has proposed for Proposition 98 and LCFF for 2019-2020 are:

- The Proposition 98 minimum guarantee for all statewide education funding is projected at \$81 billion, up from \$78 billion last year, which is a \$2.8 billion difference. This increase is allocated between K-12 education and higher education, but is not required to be divided the same way as it was in previous years. The K-12 LCFF portion of this statewide increase this year is the largest slice—at \$2 billion. This amount funds a 3.46% statutory cost-of-living (COLA) increase that will be applied to the LCFF funds sent to school districts across the state.
- The IAU projects the 2019-2020 LCFF entitlement for Non-charter L.A. Unified to be about \$5,315,000,000, which is approximately \$10 million more than last year. (Last year’s corresponding amount was \$5,304,000,000.)³⁴
- Though the District continues to receive more money from the state each year, the rate of increase has changed substantially. Between 2016-2017 and 2018-2019, the District’s LCFF entitlement increased by \$36 million, but between 2018-2019 and 2019-2020, the increase is expected to be only \$10 million (see Figure 1.)
- At the same time, the District’s enrollment—and therefore attendance—will continue to shrink. If Average Daily Attendance (ADA) decreases by the expected 3% in 2019-2020, revenue will remain stable because the COLA increase will make up for decreased attendance.

Figure 1. L.A. Unified’s LCFF Entitlement Increase



The biggest difference in this year’s proposed budget from the budgets of recent years is the lack of non-recurring discretionary (one-time) dollars. In the past several years, the legislature sent discretionary dollars to school districts. These dollars appeared in the District budget as *mandated cost reimbursements* and amount to approximately \$100 million in the 2018-19 operating budget. But the governor intends to stop this practice with the 2019-2020 budget proposal. Looking forward to the next few years, the IAU projects revenues, in the absence of further policy changes at the state level, to grow by COLA only, without substantial discretionary non-recurring dollars.

EARLY CHILDHOOD EDUCATION

The governor has said he will prioritize early childhood education (ECE), and his budget investments reflect this prioritization. However, L.A. Unified does not stand to benefit much from the governor’s budget proposals. His 2019-2020 budget contains \$125 million for 10,000 full-day preschool slots for

³ The IAU’s projection of the LCFF entitlement is designed to be used for year-over-year growth comparisons and is an underestimate of actual LCFF revenue. It takes grade-level base grants and augmentations per-ADA into consideration, but does not calculate separate locally-funded charter school ADA.

⁴ The most recent reported projection for the 2019-2020 LCFF entitlement from the *LAUSD 2018-19 First Interim Financial Report* was based on a 2.57% COLA and was approximately \$40 million less than what is now expected. It is typical for out-year projections to change after the Governor’s Budget is released in January and then again when it is revised in May of each year.

low-income children, but these funds are intended to go to community-based organizations (CBOs) that run pre-school programs and not to local education agencies (LEAs).

Even though L.A. Unified is ineligible for this money, the District should evaluate whether suitable space is available at District facilities for leasing to preschool providers who will receive state funding. Using District facilities for CBO-operated preschools is an opportunity for the District to benefit from the growth of state spending on early childhood education. Having community preschools in L.A. Unified sites also has a secondary effect of introducing families to local schools where they may be more likely to enroll their children when they are old enough for kindergarten. The IAU made related recommendations in the “Transitional Kindergarten and Student Outcomes” report (2018).⁵

SPECIAL EDUCATION

Special education receives some attention from the governor’s budget as well. He proposes an ongoing Proposition 98 investment of \$390 million and a one-time injection of \$187 million to districts based on number of unduplicated pupils with disabilities to fund special education services. The IAU projects that the District may receive approximately \$40 million additional special education dollars. Because the District already subsidizes special education from the general fund, this may free up unrestricted dollars for other purposes.

However, the Legislative Analyst’s Office found that the governor’s special education proposal lacks specification, and recommended that the legislature consider targeting this spending to specific programs with measurable goals. Based on this recommendation from the LAO, the IAU expects that the special education money may have strings attached by the time the legislature passes the budget in June 2019, which may or may not bring relief to the District.

PENSION RELIEF

L.A. Unified provides pensions as benefits to employees mainly through one of two public employee pension plans: the California State Teachers’ Retirement System (CalSTRS) for certificated employees—mainly teachers—and the California Public Employees’ Retirement System (CalPERS) for classified employees.⁶ Rising employer contribution rates to CalPERS and CalSTRS have added pressure to the District budget. Employer and employee contributions have increased and have been projected to increase further to stabilize the pension plans, which have experienced declining returns on investments. The governor’s budget affects these plans in different ways.

CalSTRS

The proposed 2019-2020 state budget attempts to ameliorate some of those pressures with \$3 billion in one-time non-Proposition 98 dollars to CalSTRS. Approximately 24% of that payment (\$700 million) will bring down employer contribution rates over two years, and the remaining 76% (\$2.3 billion) will be used to reduce K-12 and community college districts’ unfunded liability.⁷ With this funding, the CalSTRS contribution rates would decrease by about one percent for two years and then half a percent for two years

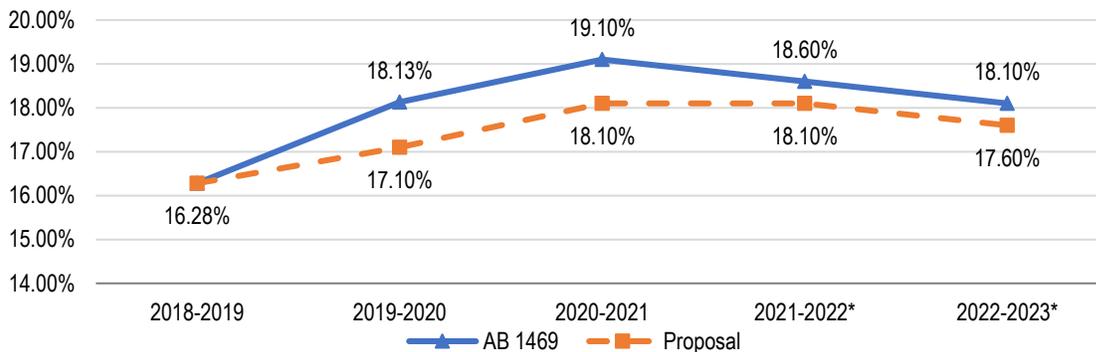
⁵ Ganon, S. et al. (April 2018). Transitional Kindergarten and Student Outcomes. *Independent Analysis Unit*. Retrieved from <http://laschoolboard.org/sites/default/files/04-18-18TransitionalKindergarten.pdf>

⁶ CalSTRS and CalPERS are both defined benefit pensions, which means that after earning five years of service credit, an employee is eligible for a guaranteed lifetime retirement benefit based on a formula set by law. The formula incorporates the amount of time employed, age, and the final average monthly compensation to determine an employee’s pension in retirement.

⁷ An unfunded liability is a funding gap. It exists when the sum of a pension program’s assets (including contributions and investments) is less than the amount the pension projects it will need for current pension benefits earned to date. It is a ratio of future liabilities to current assets.

from what was proposed in Assembly Bill (AB) 1469.⁸ See Figure 2 for the proposed changes to CalSTRS employer contribution rates.

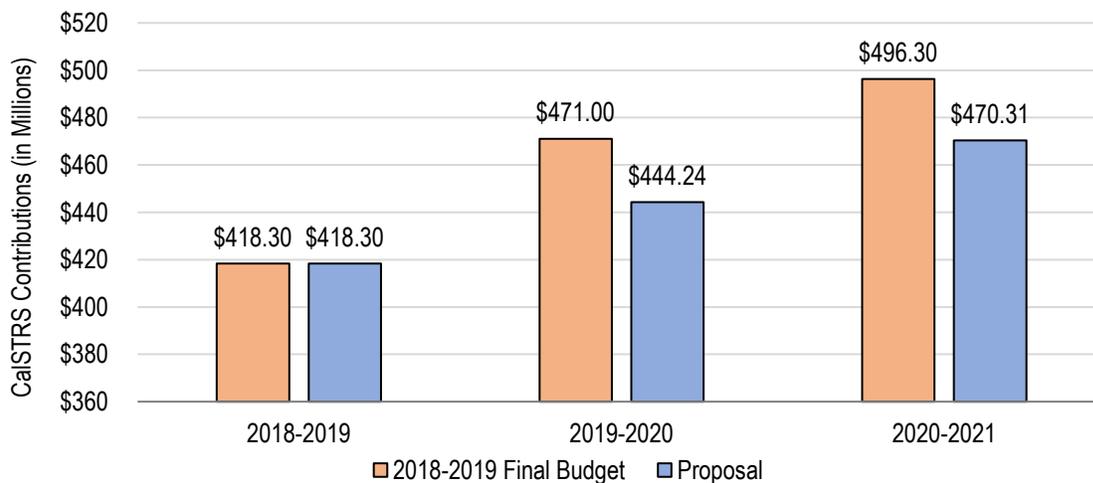
Figure 2. Governor’s Proposed Changes to CalSTRS Employer Contribution Rates, 2019-2020



Source. School Services of California (2019). Governor’s Proposals for the 2019-20 State Budget and K-12 Education.
 Note. Currently the contribution rates for CalSTRS must be set by state legislation, but starting in 2021-2022, the CalSTRS Board can increase or decrease the employer contribution rate in order to fully fund the unfunded liability by 2046.

Using the estimated CalSTRS employer costs from the 2018-2019 Superintendent’s Final Budget, adjusted with the lower projected contribution rates seen in Figure 1, the IAU estimates that L.A. Unified will save approximately \$50 million in CalSTRS contributions over the next two years. These savings are illustrated in Figure 3.

Figure 3. Comparison of CalSTRS Employer Contribution Amounts in L.A. Unified Superintendent’s Budget and Governor’s Proposal



Source. Superintendent’s 2018-2019 Final Budget. Estimated changes under the proposal calculated by the IAU using new CalSTRS rates from the Governor’s 2019-2020 proposed budget, Dept. of Finance (2019), California Budget 2019-20, *State of California*. Retrieved from <http://www.ebudget.ca.gov/>

In addition to reducing the contributions districts must make to the CalSTRS fund for their employees, the Governor proposes making a supplemental \$1.1 billion payment for the state’s share of CalSTRS. This payment would be on top of the required annual \$3.3 billion. The governor projects that these extra

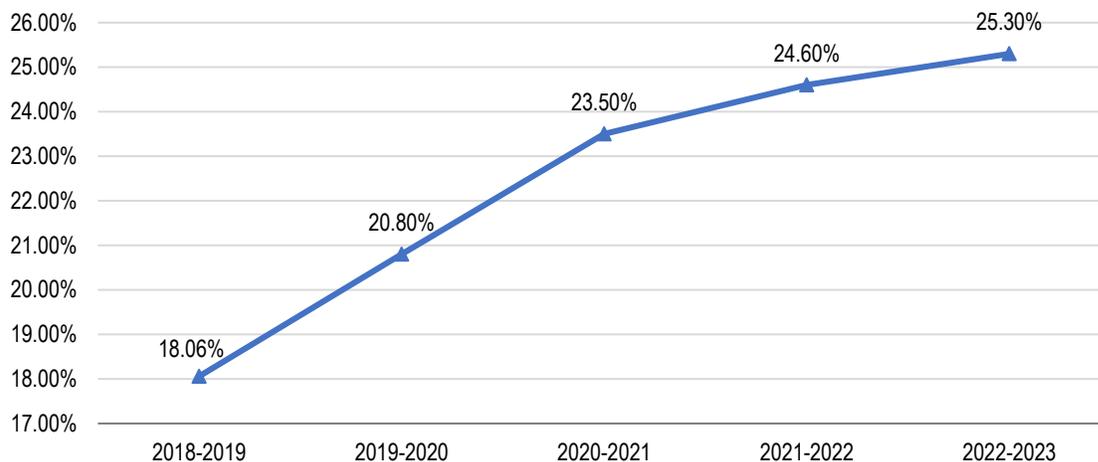
⁸ Bonta, R. (2014 June 24). Assembly Bill No. 1469 State teachers’ retirement: Defined Benefit Program: funding. Retrieved from https://leginfo.ca.gov/faces/billNavClient.xhtml?bill_id=201320140AB1469

payments will continue through 2022-2023 for the state’s portion of the CalSTRS unfunded liability. The goal is to have the CalSTRS unfunded liability fully funded by 2045-2046.

CalPERS

In 2017-2018, the state made a supplemental payment of \$6 billion to the CalPERS fund to help pay down the long-term pension liability for classified employees. Governor Newsom proposes continuing supplemental payments with \$3 billion for 2018-2019. This payment does not change the employer contribution rates for CalPERS, and so has no short-term budget impact for L.A. Unified. However, since it reduces the long-term liability, it will benefit the District in the future. The most recent projections from CalPERS show increases in employer contribution rates until 2024-2025, hitting a high of 26% of classified payroll before decreasing slightly the following year. When applicable, updated employer contribution rates are made available by CalPERS in the spring, impacting the subsequent year's budget.

Figure 3. CalPERS Employer Contribution Rates



Source: CalPERS. (2018 April 17). Schools Valuation and Employer/Employee Contribution Rates. Retrieved from https://www.calpers.ca.gov/docs/board-agendas/201804/financeadmin/item-7b-00_a.pdf

CONCLUSION

With the required funding increases for the LCFF now complete, **the California education budget will level off unless new fund sources are found or policy priorities established.** No longer can the District count on large “gap funding” increases to the annual budget. In addition, the District cannot expect large discretionary grants, as under Governor Brown’s administration. Instead, Governor Newsom has declared more interest in promoting specific proposals that aid early childhood education and combat childhood poverty. Though positive, these proposed investments are likely to benefit the District only indirectly.

In this new leadership environment, the District can only count on LCFF revenue increasing every year by the statutory cost of living increase, although pension relief and additional special education funding may be experienced on a year-to-year basis as available.

Notably, even as District enrollment falls, per-student funding will increase by a small percentage per year. This incremental growth in state funding will keep the overall L.A. Unified revenue relatively flat or declining slowly. However, the District’s needs at present exceed expected revenues, and certain costs must grow in coming years even as enrollment shrinks. It is essential both to search for new sources of

revenue and to search for ways to cut costs while reaching educational goals for our students. **The governor's new budget has some bright spots, but it does not make the District whole.**

On the positive side, the governor has signaled a new willingness to use non-Proposition 98 dollars to pay down liabilities that affect school districts—and perhaps also to fund other school-related expenses. Proposition 98 was intended to set a minimum level of funding for schools, but in recent years it has served more as a cap. Reaching beyond Proposition 98 into the state's general fund is a way to expand education spending. The governor's willingness to do so may be an indication that, even in a COLA-only environment for LCFE funds, education funding can grow. However, **the relatively small increases for—and indirect impacts on—LEA general education budgets seen in the governor's proposal serve as a forceful reminder that fundamental changes are still needed in how and how much public schools are funded in this state.**