



School Finance Highlights 2004–05

Another year of financial difficulty for the state of California led to the suspension of the minimum-funding guarantee that has provided some financial protection for schools in recent years. Even so, enough money was available for school districts to receive funding increases to cover inflation and enrollment growth, plus augment a few specific programs.

Education funding is central to resolving the state budget

For 2004–05 the Proposition 98 guarantee entitled education to a net increase in funding of about \$3 billion over 2003–04. Given Republican lawmakers' unwillingness to consider tax increases, the state could not provide that increase for K–I4 without cutting other state and local programs. To provide less to education, two-thirds of the state Legislature had to vote to suspend Proposition 98. In previous years that action seemed to be a huge political risk that lawmakers avoided through a complicated scheme of deferrals, transfers, and mid-year cuts.

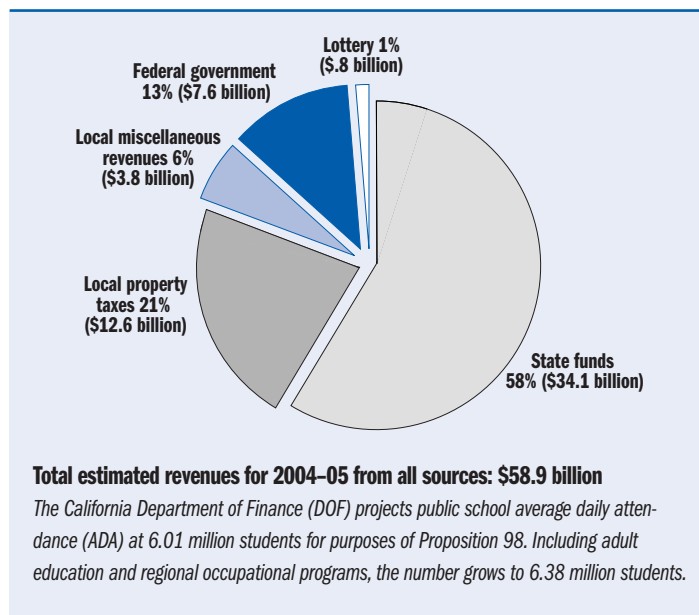
This year, Gov. Arnold Schwarzenegger used his considerable influence to implement a different, less convoluted approach to K–I4 funding that made the actual suspension of Proposition 98 palatable to education leaders. The idea was to suspend Proposition 98 while at the same time guaranteeing a net increase in school funds over 2003–04 and promising clear priorities for the eventual repayment of the funding schools have lost in recent years.

Faced with the very real possibility that the budget situation would eventually necessitate a suspension of Proposition 98 anyway, education leaders agreed to “the deal.” Education funding was “rebased” at a level \$2.3 billion below what the Proposition 98 guarantee amount would otherwise have been. The funding of \$47.2 billion includes \$42.1 billion for K–I2 education and \$4.8 billion for community colleges, with another \$400 million for other state agencies and to create a reserve.

K–I2 education's Proposition 98 funding, which combines local property taxes and state general fund revenues, increases by about \$833 million this year. However, school districts will have substantially more money to spend, including increases for the cost of living, growth in student population, and some specific programs.

This confusing situation is in part a result of the manner in which—between 2001–02 and 2003–04—the state kept year-to-year program funding relatively constant by deferring some of its obligations until future years. In 2004–05 the deferral amount the state owed was about \$I billion less than it had been in 2003–04, freeing that amount to go to districts for their current program needs. In addition, some funds allocated in 2003–04 were not spent and are

figure 1 | 2004–05 K–I2 funding comes from five sources



FUNDING DATA: CALIFORNIA DEPARTMENT OF EDUCATION (CDE)
ADA PROJECTIONS: CALIFORNIA DEPARTMENT OF FINANCE (DOF)

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available this year. Taken together, that gives the state about \$2 billion more to provide directly to school districts compared to last year.

This year the state budget provided general purpose and categorical funds in approximately the same proportion as has been the case for the past decade. Lawmakers created no substantive new programs and made very few changes in existing programs. “Revenue limit” funding, used for general purposes, makes up two-thirds of the state monies that districts receive. The balance is “categorical aid” earmarked for special programs or targeted to particular groups of students.

For 2004–05 all districts will receive a 2.41% cost-of-living adjustment (COLA) in their revenue limit funding and most categorical programs—a total allocation of \$980 million. They also receive \$509 million statewide to cover student population growth. In addition, the state allocated \$270 million, another 0.9% approximately, to partially repay a revenue limit shortfall in 2003–04. The budget also included increases in funding for instructional materials, deferred maintenance, and to reimburse districts for an increase in unemployment insurance rates.

Some districts will also benefit from the \$I10 million set aside for the equalization of revenue limits. The state provided about one-fourth of the funding needed to implement an equalization plan first passed in 2001–02. Lawmakers expect to revise the equalization process and formula during the next legislative session.

A growing share of K-12 funds come from sources besides the state

In 2004–05 public education will receive almost \$17 billion more than the state allots through Proposition 98 alone. As Figure I shows, these funds come from the federal government, the California State Lottery, and “local miscellaneous” sources. There is also \$4.6 billion—from state and local property tax sources—that is not part of Proposition 98 funding.

In recent years, federal education support—earmarked for categorical programs—has grown steadily in terms of dollars and as a proportion of California’s total K–12 budget. For more than a decade, up until 2000–01, federal funds provided about 8% of California’s K–12 budget in California. By 2003–04 the contribution represented 13%. This year the largest funding increases included \$172 million for Child Nutrition, \$140 million for Special Education, and funding for two programs under the No Child Left Behind Act (NCLB).

The local miscellaneous category comes from sources that are controlled locally. As such, it varies widely from one district to another both in terms of the amount per pupil and as a percentage of total funding. While there are exceptions, the districts with the highest amounts tend to serve students from the wealthiest neighborhoods.

Williams v. California settlement redirects funds and adds oversight

Along with the passage of the budget, the other important decision regarding funding for K–12 schools was the settlement of the *Williams v. California* lawsuit. First filed in 2000, the suit called on the state to assure that basic services are provided at every school. The plaintiffs focused on adequate instructional materials, certificated teachers, and decent facilities. An out-of-court settlement specified that the state would provide additional funding for low-performing schools, plus set up a new system for oversight of districts’ resource allocations.

After the settlement was announced, the Legislature rapidly passed four bills that detailed how the funds were to be spent and the oversight responsibilities assigned. County offices of education were charged with making sure that school districts provide their lowest-performing schools with appropriate instructional materials, teachers, and facilities.

The funding, which totaled \$188 million in one-time funds in 2004–05, included \$138 million for instructional materials plus another \$50 million to conduct an assessment of facility conditions, supplement county superintendents’ capacity to oversee low-performing schools, fund emergency repairs, and cover other costs of implementation. The settlement also commits the state to \$800 million for facilities in future years. For the most part, these resources are to be directed to the state’s lowest-performing schools based on their status in Deciles 1–3 on California’s Academic Performance Index (API).

Education holds a large I.O.U. from the state

With its budget decisions in recent years, the state has accrued a substantial debt to K-14 education. That debt includes:

A \$302 million reserve in this year’s budget, set aside for Proposition 98 spending but not allocated to schools.

“Settle up” money totaling \$1.2 billion that accrued in years when end-of-year accounting showed that the state did not fully meet its Proposition 98 obligation. The state promises to begin paying this in 2006–07, at a minimum rate of \$150 million annually.

\$1.5 billion in district claims for reimbursement for meeting state mandates, though some of these claims are under dispute.

In addition, a \$3.6 billion “maintenance factor” includes the \$2 billion from this year’s suspension of Proposition 98, plus another \$1.6 billion as a result of decisions in prior years. Thus the state has an obligation to eventually restore \$3.6 billion to the Proposition 98 minimum guarantee. This restoration effort is not required to begin until state General Fund revenues grow faster than personal income.

Legislators take action to increase spending flexibility and oversight

In response to continued criticism directed at the state’s complex collection of categorical programs, legislators passed Assembly Bill (AB) 825. Effective in 2005–06, it consolidates about two dozen categorical programs into six block grants: Pupil Retention, Targeted Instructional Improvement, School and Library Improvement, Teacher Credentialing, Professional Development, and School Safety. The affected programs represent almost \$2 billion of the state’s total annual categorical spending of about \$11 billion.

AB 825 also authorizes districts to shift up to 15% of funds from four of the block grants to any other categorical program for which a district is eligible. (No transfers from the Pupil Retention or Teacher Credentialing block grants are allowed.) Districts can only use these transferred funds to increase spending in any categorical program by up to 20%.

Even as they granted this flexibility, lawmakers also passed AB 2756, which expands and makes important changes in county offices’ ability to review school district finances. It also makes more explicit the consequences for districts that accept emergency loans from the state in order to avoid bankruptcy, and gives county offices and the state greater ability to monitor the performance of school district auditors. [EE](#)

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