

# FISCAL REPORT

PUBLIC EDUCATION'S POINT OF REFERENCE FOR MAKING EDUCATED DECISIONS

## Overview of the Governor's Proposals for the 2024-25 State Budget and K-12 Education



Copyright 2024 School Services of California, Inc.

posted January 10, 2024

### Overview of the Governor's Budget Proposals

When you expect a budget gap of \$68 billion, a budget gap of \$37.9 billion feels like a good day. While there is no debating the magnitude of unrealized revenues from 2022, Governor Gavin Newsom today framed the current budget situation as the state returning to a more normal economic environment from recent years of explosive growth. This is a key difference from the expectations set last fall by the Legislative Analyst's Office (LAO) Fiscal Outlook and the tone set today by Governor Newsom.

The good news for education: no mid-year cuts, no deferrals, no program rollbacks. The bad news for education: a shrinking Local Control Funding Formula (LCFF) due to heavy declining enrollment and a meager cost-of-living adjustment (COLA).

California is better prepared to weather the proverbial storm due to the significant rainy day deposits made during the good years that allows the state to address this budget gap. In addition to reserve withdrawals (including the Proposition 98 Rainy Day Fund), the Governor proposes reductions, internal borrowing, funding delays, funding shifts, and non-Proposition 98 deferrals. It remains to be seen whether one-time funds successfully create a bridge to increased future revenues, or if they eventually run dry and are merely delaying cuts to align actual spending to revenues.

### The Economy and Revenues

Governor Newsom assumes a continued slow-growth economy for 2024-25 and notes a possible resurgence of higher inflation and continued elevated interest rates as the biggest near-term threats to the economy. Additional risks include, but aren't limited to, geopolitical tensions, climate change impacts, and the high cost of living in California. Importantly, no recession is forecasted. The Governor's Budget assumes Gross Domestic Product growth to slow to 1.6% in 2024 and 1.2% in 2025, and California unemployment is projected to increase to 5.1% and 5.2% in 2024 and 2025, respectively. Headline inflation is projected to drop to 2.6% in 2024 and 2% in 2025.

As he did last year, the Governor began his press conference standing beside a chart showing fluctuations in capital gains revenues as a percentage of personal income, which he again likened to an electrocardiogram, or EKG. The Governor described the economic situation as a story of correction and normalization following a period of distortion, highlighting the unprecedented surpluses in revenue a couple of years ago followed by the deficits experienced in the current year and projected for the 2024-25 budget year.

The largest source of state General Fund revenues is derived from taxes on personal income, including capital gains, and relies heavily on high-income taxpayers. Personal income tax makes up 65% of pre-transfer General Fund revenue for 2022-23 and is projected to account for 74% of pre-transfer General Fund revenue in 2024-25. One percent of the state's highest income earners paid 50% of all personal income taxes in 2021, a slight increase from the prior year. According to the Governor's Budget summary,

“[t]hese two related phenomena—significant reliance of the General Fund on capital gains and stock-based compensation, and on taxes paid by a small portion of the population—underscore the difficulty in forecasting personal income tax revenue” and, by extension, General Fund revenues.

Capital gains revenue as a percentage of annual General Fund revenues are projected to stabilize and make up 8.4%, 8.3%, and 8.7% of total annual General Fund revenues for 2022, 2023, and 2024, respectively. The Newsom Administration assumes a stock market that is largely consistent with Wall Street’s mid-November 2023 levels.

The Governor’s Budget recognizes a budget shortfall of \$44 billion over the three-year budget window (2022-23, 2023-24, and 2024-25). The Governor’s Budget draws primarily on the following measures to balance against the shortfall:

- \$13.1 billion in draw down of reserves
- \$8.5 billion in funding reductions without cuts to Proposition 98 programs
- \$5.7 billion in borrowing
- \$5.1 billion in funding delays over three years
- \$3.4 billion in funding shifts from the General Fund to other funds
- \$2.1 billion in deferrals to payroll and University of California/California State University
- \$5.7 billion in withdrawals from the Public School System Stabilization Account (PSSSA)
- \$402 million in tax revenue proposals

The Governor’s Budget makes significant reductions to the “Big Three” tax revenues relative to the 2023-24 Enacted Budget across the three-year budget window, for a total downward adjustment of \$42.9 billion.

Big Three Tax Revenues (In millions)						
	2022-23		2023-24		2024-25	
	2023-24 Enacted Budget	Governor’s Budget	2023-24 Enacted Budget	Governor’s Budget	2023-24 Enacted Budget	Governor’s Budget
Personal Income Tax	\$122,769	\$101,749	\$118,161	\$113,768	\$118,903	\$114,730
Corporation Tax	\$42,091	\$37,140	\$42,081	\$36,913	\$43,369	\$38,055
Sales and Use Tax	\$33,072	\$33,186	\$33,366	\$34,643	\$34,383	\$35,123

Again, the Governor’s Budget revenue estimates do not forecast a recession—even a mild one. Risks to the projected continuing slow-growth economy are noted and could lead to a recession in which case a mild recession could lead to General Fund revenue losses between \$20 billion to \$30 billion over the budget window.

Proposition 98 Minimum Guarantee, Rainy Day Fund, and Local Reserve Requirements

Proposition 98 Minimum Guarantee

Based on the Governor’s revenue estimates, which account for lower-than-expected 2022 tax collections, the Proposition 98 minimum guarantee for 2022-23 and 2023-24 are reduced by \$9.1 billion and \$2.7 billion from the 2023-24 Enacted Budget levels, respectively. Further, the Governor expects state revenues to rebound from current levels, which will result in an increase in funding for K-12 and community college agencies in 2024-25, bringing the minimum guarantee to \$109.1 billion by the end of the budget window. Proposition 98 in 2024-25 includes additional funding to cover the increased LCFF costs resulting from

Transitional Kindergarten (TK) expansion and the required set-aside to support arts and music programs in public schools. Under the Governor’s estimates, Test 1 is operative across the budget window, which means that K-14 education receives nearly 40 cents of every state General Fund dollar.

Proposition 98 Minimum Guarantee, Prior and Current Year (In billions)			
	2023-24 Enacted Budget	2024-25 Governor's Budget Adjustments	Minimum Guarantee
2022-23	\$107.4	-\$9.1	\$98.3
2023-24	\$108.3	-\$2.7	\$105.6

**Proposition 98 Rainy Day Fund and Local Reserve Requirements**

Changes in state General Fund revenues have similar impacts on the state’s requirement to make deposits into and withdrawals from the Proposition 98 Rainy Day Fund (or the PSSSA). The Governor’s Budget proposes the following activity in the reserve account.

Proposition 98 Rainy Day Fund (In billions)				
	2021-22	2022-23	2023-24	2024-25
Deposits		\$0.3	\$0.3	\$0.8
Withdrawals			-\$3.0	-\$2.7
Fund Balance	\$8.1	\$8.4	\$5.7	\$3.8

For 2024-25, the Proposition 98 Rainy Day Fund balance of \$5.7 billion in fiscal year 2023-24 requires non-basic aid districts with average daily attendance (ADA) greater than 2,500 to maintain a local reserve balance of 10%.

**LCFF Entitlements for School Districts and Charter Schools**

Recall that the 2023-24 Enacted Budget utilized \$1.6 billion in one-time Proposition 98 General Fund monies to fully fund the 8.22% COLA. Based on the Administration’s current projections, there is insufficient new revenue to fill the gap left by the use of those one-time funds in 2023-24 and ongoing obligations.

To address the shortfall, Governor Newsom’s State Budget once again utilizes one-time funds. Of the proposed \$5.7 billion PSSSA withdrawals across the current and budget year, the Administration is proposing to allocate \$5.0 billion for purposes of supporting the LCFF—approximately \$2.8 billion for 2023-24 and another \$2.2 billion for 2024-25. Further, the Governor’s Budget notes that an additional \$38.6 million in available reappropriation and reversion funding will also be utilized to support ongoing LCFF costs in 2024-25.

With this funding, the base grants by grade span for 2024-25 are increased over 2023-24 by the estimated statutory COLA of 0.76%.

Grade Span	2023-24 Base Grant Per ADA	0.76% COLA	2024-25 Base Grant Per ADA
TK-3	\$9,919	\$75	\$9,994
4-6	\$10,069	\$77	\$10,146

Grade Span	2023–24 Base Grant Per ADA	0.76% COLA	2024–25 Base Grant Per ADA
7–8	\$10,367	\$79	\$10,446
9–12	\$12,015	\$91	\$12,106

The TK–3 base grant increase for the class-size reduction (CSR) grade span adjustment is \$1,039 per ADA in 2024–25 and the grade 9–12 base grant per ADA is increased by \$315 in recognition of the need for Career Technical Education (CTE) courses provided to students in the secondary grades.

School districts and charter schools are entitled to supplemental grant increases equal to 20% of the adjusted base grant (including CSR and CTE funding) for the percentage of enrolled students who are English learners, eligible for the free or reduced-price meals program, or in foster care. An additional 65% per-pupil increase is provided as a concentration grant for each percentage of eligible students enrolled beyond 55% of total enrollment, with 15% of the concentration grant to be used to increase the number of adults providing direct services (nurses, teachers, counselors, paraprofessionals, and others) to students.

### Cost-of-Living Adjustment

The Governor’s Budget estimates, and fully funds, a statutory COLA of 0.76% for the LCFF, which is lower than the LAO estimated in its November Fiscal Outlook report (1.26%). Both are significantly lower than the estimate of 3.94% from the 2023–24 Enacted Budget. While there are still two data points outstanding in order to calculate the final statutory COLA—one anticipated in a matter of weeks and the other at the end of April—time will tell whether the Administration or the LAO have a clearer crystal ball, it is very apparent that the statutory COLA will be closer to 1% than 4%.

The Governor’s estimated COLA would also be applied to other education programs funded outside of the LCFF, including the LCFF Equity Multiplier, Special Education, Child Nutrition, Sate Preschool, Foster Youth, Mandate Block Grant, Adults in Correctional Facilities Program, Charter School Facility Grant Program, American Indian Education Centers, and the American Indian Early Childhood Education Program—as well as county offices of education and community colleges.

### Instructional Continuity

In response to multiple years of academic interruption due to increased student absences, the Governor’s Budget includes a series of instructional continuity proposals aimed at offsetting student absences and mitigating learning loss. These proposals include:

- Expanding the allowable days and times of day used for the purpose of recovering attendance both for the purpose of apportionment and chronic absentee mitigation,
- Requiring local educational agencies (LEAs) to offer remote instruction during emergencies, including instruction through enrollment at a neighboring LEA, and
- Encouraging hybrid or remote learning opportunities for students who are unable to attend school

The Governor’s Budget also proposes an appropriation of \$6 million in one-time Proposition 98 funds for the purpose of researching and developing models of hybrid learning to enable instructional continuity and to identify opportunities for LEAs to report more detailed absence data when absences occur due to emergency events.

### Master Plan on Career Education

On August 31, 2023, Governor Newsom signed [Executive Order N-11-23](#), launching the development of a new Master Plan on Career Education (Master Plan) that will look to adequately prepare students for the workforce of tomorrow. The Executive Order (EO) requires specified state agencies to develop and submit the proposed Master Plan to the Governor’s Office by October 1, 2024.

The first phase in the development of the Master Plan is for the Governor's Office to convene interagency teams at both the state level (under the [Governor's Council for Career Education](#)) and at the regional level (as part of the [K-16 Regional Collaboratives](#)) that will drive results on the tens of billions in workforce investments made in the first four years of the Newsom Administration. The second phase is to engage in a 13-month planning process to investigate how existing policies, investments, and structures can be improved, culminating in the Governor's Master Plan scheduled for publication in the winter of 2024. The three goals of the plan are to ensure that all Californians are:

1. On-ramped into well-paying, purposeful careers.
2. Empowered to build real-life skills.
3. Able to access and afford a quality education throughout life.

While the Governor's Budget proposal does not offer any new information on the Master Plan, it does clarify that the Governor intends to pursue the timeline stipulated in the EO despite the state's challenging budget circumstances.

## **Learning Recovery Emergency Block Grant**

The Governor's Budget does not include any cut to the Learning Recovery Emergency Block Grant. However, the Budget proposes to change the use of these funds to focus remaining dollars on students most impacted by learning loss. A needs assessment and the development process used for the Local Control and Accountability Plan will guide how unspent funds are used. The allowable uses for these funds will also be amended to include professional development for the recently adopted mathematics framework.

## **Educator Pipeline Access**

The Governor's Budget includes modest solutions to the teacher shortage. The proposal directs the California Commission on Teaching Credentialing (CTC) to create a new Elementary Arts and Music Education authorization as an additional Career and Technical Education credential. This will allow for additional pathways for artists to provide instruction in schools. In addition, the proposal includes credentialing flexibilities to meet subject matter requirements by recognizing a bachelor's degree in a subject area to satisfy the basic skills requirement and direction to the CTC to improve the process to review transcripts to verify subject matter competency.

## **Early Childhood Education**

The Governor's Budget maintains prior commitments to expand access to California's subsidized child care and preschool system by an additional 200,000 slots, but defers reaching this goal to 2026-27. The Governor's Budget includes funding roughly 146,000 new slots, expected to be filled by 2024-25.

The 2023-24 Enacted Budget included a commitment for the state to move to a single rate system based on cost of care. The Governor's Budget states that by July 2024 the state will submit a plan to the federal government for approval of the alternative cost of care methodology for rates.

In addition, to help address the budget shortfall, the Governor's Budget proposes to delay \$10 million General Fund annually from the Preschool Inclusion Grant Program until 2026-27.

Finally, Governor Newsom proposes specific investments to support certain children served by the California State Preschool Program (CSPP). He proposes applying the 0.76% COLA, as well as backfill \$53.7 million General Fund to support reimbursement rate increases that were previously supported by available one-time federal stimulus funds.

## **Facilities**

In an effort to address the projected budget shortfall, the Governor's Budget proposes additional reductions and delays to funding previously intended for school facilities.

The 2022-23 Enacted Budget included \$1.3 billion in 2022-23 for the School Facility Program (SFP), with intent language for an additional \$2.1 billion appropriation in 2023-24 and \$875 million in 2024-25. The \$2.1 billion was reduced by \$100 million as part of the 2023-24 Enacted Budget, and now, the Governor's Budget proposes to reduce 2024-25 funding by \$500 million—from \$875 million to \$375 million.

Further, the 2022-23 Enacted Budget appropriated \$100 million for the California Preschool, Transitional Kindergarten and Full-Day Kindergarten Facilities Grant Program, with the intent to appropriate an additional \$550 million in 2023-24. The 2023-24 Enacted Budget delayed the \$550 million investment by one year—from 2023-24 to 2024-25. The Governor's Budget further delays this investment to 2025-26.

Additionally, the Governor notes that negotiations on a statewide school bond initiative will begin in the spring with the intention of placing the measure before the voters at the November 2024 General Election.

## **Minimum Wage**

Governor Newsom does not make any changes to the already enacted California state minimum wage of \$16.00 an hour or to Assembly Bill 1228 (Holden, Statutes of 2023) which raises the minimum wage for fast food workers to \$20.00 an hour, effective April 1, 2024. The Governor's Budget does include an annual budgetary "trigger" which could delay the effective date of Senate Bill 525 (Durazo, Statutes of 2023) which was written to increase the minimum wage for health care workers to \$25.00 an hour effective June 1, 2024.

## **Retirement Systems**

Governor Newsom does not propose additional funding for the California State Teachers' Retirement System (CalSTRS) or the California Public Employees' Retirement System (CalPERS) employer contribution rate relief for LEAs. Based on current assumptions, CalPERS employer contributions would increase from 26.68% to 27.80% in 2024-25, while CalSTRS employer contribution rates are expected to remain the same from the prior year at 19.10%.

## **Closing**

The education world had been expecting the worst since the release of the LAO's economic forecast this past fall, leaving many to let out a sigh of relief at the Governor's Budget release—although a skeptical one. The Governor's Budget benefits from historic rainy day funds to address spending levels that ultimately did not align with the level of revenues generated in 2022-23. For education, these one-time dollars sustain programs that were created or grew significantly during exceptional economic times and lead the community to wonder how they will be sustained after 2024-25.

While not facing mid-year cuts, deferrals, or unfunded COLAs, with the combination of a COLA below 1% and significant declining enrollment, the sigh of relief may be short lived.

We look forward to diving deep into the Governor's education budget with all of you and helping our local educational leaders and partners operationalize all of what this means for public agencies, staff, students, and local communities at next week's [Governor Budget Workshop](#).