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# Governor's Budget Proposes Full Funding for LCFF While Bolstering State Reserves

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Eric Premack
Executive Director & Founder
Charter Schools Development Center



Governor Brown's proposed 2018-19 state budget would fully fund the Local Control Funding Formula (LCFF), boost funding for the Charter School Facility Grant Program, and provide substantial "one-time" grants for schools, all while bolstering the state's budget reserves. Continued economic expansion, surging state tax revenues, and a booming stock market continue to generate a positive budget outlook. This article provides CSDC's annual in-depth review of the Governor's budget, including our suggestions on initial budget development for charter schools' 2018-19 budget.

## Economy and State Budget Picture

Estimated state General Fund revenues continue to grow as favorable economic conditions are projected by the Governor to continue through the 2018-19 fiscal year. State revenues will grow to an estimated $130 billion in 2018-19. Compared with estimates used to build the state's current (2017-18) budget last June, estimated revenues, which were already anticipated to grow, are up another $4.7 billion through the end of 2018-19.

This optimistic outlook, however, is subject to a substantial downside. California's economy is at significant risk if the stock market drops, geopolitical conflicts arise, or if a recession occurs. The economic recovery is now in its eighth year, and arguably "overdue" for a correction or recession. The governor's staff estimate that state revenue losses during a moderate recession "would exceed $20 billion per year for two years, continue with several more years of revenue declines in the range of $15 billion, and lead to a permanently lower revenue."

Federal tax law changes enacted at the end of 2017 could have various and major impacts on the state's economy and state tax revenues. Since the tax reform laws were enacted after most of the key Governor's budget proposals were completed, Finance Director Michael Cohen emphasized that the budget proposal does not contemplate the impact of federal tax law changes, although the upcoming May Budget Revision will, and that their full impact may not be known until 2019 or later.

California's tax and revenue structure is highly dependent on volatile sources. The largest source is the personal income tax and the top one percent of earners now pay nearly half of total income taxes. During his budget press conference, Governor Brown noted that due to federal tax laws that now cap the deductibility of state and local taxes, "people with higher incomes will be tempted to leave . . . we'll have to look at it very carefully." Capital gains taxes now constitute over 10 percent of state revenues and are highly dependent on volatile stock prices.

To help cushion against a downturn, the Governor proposes adding a $3.5 billion supplemental deposit to the state's "Rainy Day Fund," bringing the fund to $13.5 billion, or roughly 10 percent of revenues by the end of 2018-19. For now, however, the surging state revenues make for a positive budget climate and the state's constitutional education funding formulas compel large funding increases for schools.

## Proposition 98, Expiring One-Time Expenditures Make $6 Billion Available for Education

Funding for California's K-12 schools and community colleges is dictated largely by constitutional funding formulas that establish a minimum funding floor for K-14 education and require the state to spend at least amounts specified by formula for education purposes. These formulas, known as the Proposition 98 funding guarantee, often serve as the central focus of state funding proposals for California's schools. These complex formulas center on three "tests" that generally require the state to spend at least 40 percent of the state's general-purpose tax revenues, or at least an inflation-adjusted per-pupil amount for schools and community colleges.

The complex, formulaic tests are driven by factors such as state tax revenues, school enrollment, and other factors and can be sensitive to peculiar, year-over-year changes. With continued increases in state revenues, these formulas compel large increases in funding for schools in 2018-19. The Governor estimates that Proposition 98 funding increases by a total of $3.8 billion over current levels, including a $3.1 billion increase in 2018-19, plus an additional estimated $687 million due to the increasing 2017-18 funding guarantee.

This $3.8 billion increase, combined with $2.2 billion of funding that is available due to expiring "one-time" programs and $215 million in unspent funds, allows the Governor to propose $6.3 billion of augmentations for K-14 education. Of this, approximately $5 billion is proposed for funding K-12 schools while the remainder is for community colleges. As explained in more detail below, the Governor proposes to spend the bulk of this $5 billion on a mix of ongoing and one-time items, including increasing funding for the Local Control Funding Formula, a $1.8 billion "one-time" per-ADA grant, and a handful of smaller initiatives.

## Governor Seeks to Cement Legacy by Fully Funding LCFF

The Governor proposes a $3 billion increase in funding for the Local Control Funding Formula, including over $100 million to provide a 2.51 percent cost-of-living adjustment (COLA) and $2.9 billion to close the gap between current funding and fully fund the target rates established by LCFF. When the LCFF was established in 2013-14, so-called "target" funding rates were established, largely based on what funding schools would have received if the budget cuts during the Great Recession had not occurred.

At the time LCFF was initiated, shortly after the Great Recession, the state could not afford the then-estimated $17 billion additional cost to fully fund these target LCFF rates. Instead, the state computed "base" rates reflecting each local education agency's historical funding, compared these with the target LCFF amounts, and used available state funding to fund the gap between the base and target rates. State budget officials estimated it would take eight years for the state to reach full funding under the LCFF. Since 2013-14, the state has poured billions of additional dollars into the LCFF to bring funding closer to target levels each year. The state will come close to full funding in the current year (97 percent per the Governor's estimates).

If approved, the Governor's proposed funding augmentation for 2018-19 would complete the shift to full funding, two years ahead of the original estimate. The resulting target funding rates for 2018-19 are displayed in the table below.

| Governor's Proposed 2018-19 LCFF Rates | | | | |
|---|---|---|---|---|
| | Grade Span | | | |
| | K-3 | 4-6 | 7-8 | 9-12 |
| Target Base Rate (including 2.51% COLA) | $7,374 | $7,484 | $7,707 | $8,931 |
| K-3 CSR Grade Span Adjustment | $767 | | | |
| 9-12 Career/Tech Grade-Span Adjustment | | | | $232 |
| K-3 and 9-12 Adjustment Percentage | 10.4% | | | 2.6% |
| Supplemental and Concentration Factors | | | | |
| Supplemental Add-On | 20 percent | | | |
| Concentration Threshold | 55 percent | | | |
| Concentration Add-On | 50 percent for eligible unduplicated pupils above a 55 percent threshold | | | |

As in prior years, FCMAT has posted an updated version of the LCFF Calculator to help estimate school-specific LCFF funding. Version v18.2c includes updated assumptions that reflect the Governor's proposal to fully fund LCFF in 2018-19 and provide a 2.51 percent COLA along with future year estimated COLAs for those preparing multi-year revenue estimates. As the state transitions to full funding, CSDC presumes complex calculators like this will no longer be needed because the relatively simple LCFF target rates are easier to compute. For now, however, CSDC continues to recommend the FCMAT calculator.

The FCMAT calculator also reflects the Department of Finance's estimated LCFF COLAs for fiscal years 2018-19 through 2022-23, as follows:

| Estimated LCFF Cost-of-Living Adjustments (Department of Finance January 2018 Governor's Budget Estimates) | | | | | |
|---|---|---|---|---|---|
| **Year** | **2018-19** | **2019-20** | **2020-21** | **2021-22** | **2022-23** |
| **Estimated COLA** (no recession) | 2.51% | 2.41% | 2.80% | 3.17% | 3.12% |

These COLAs, in turn, reflect the Department's assumption of no recession and continued economic growth—arguably a "rosy scenario." CSDC suggests "dual track" long-term funding estimates, including both using the more optimistic ones reflected in the table above and in the updated FCMAT calculator as well as separately estimating LCFF revenues after zeroing out the 2019-20 and subsequent years to reflect a less optimistic scenario.

## Governor to Propose Additional LCFF "Proportionality" Linkages

While the budget proposes to fully fund LCFF and the formula's simplicity is drawing kudos from many quarters, others continue to criticize the shift to local control. Various child advocacy organizations continue to call for more restrictions how schools and districts spend the additional supplemental and concentration dollars generated by low-income, English learner, and foster youth ("unduplicated pupils" in finance-speak).

The current Local Control Accountability Plan (LCAP) template requires (1) displaying the increase in funding generated by unduplicated pupils and (2) requires a general description of how services for them have been increased or improved and how this increase is proportional to the increase in supplemental and concentration funding. The law does not, however, require strict accounting for such spending and the law gives schools substantial flexibility to spend the additional funds "schoolwide" for all pupils, not just the unduplicated, high-need ones. In practice, most schools and districts are spending a large share of the increased funding on schoolwide expenditure such as higher teacher salaries and to meet the spiraling cost of employer retirement contributions.

This spending pattern infuriates some child advocacy groups who have filed lawsuits against a few districts to compel more restrictive spending. Some legislators are also critical, including Assembly Member Shirley Weber (D—San Diego) who has authored legislation to compel additional reporting on expenditures of the LCFF funds for unduplicated pupils.

To date, Governor Brown and the State Board of Education have resisted pressure to further restrict expenditure of supplemental and concentration funds. Veteran Capitol reporter Dan Walters challenged Brown on this issue during his budget press conference. Brown offered a spirited defense of LCFF, noting "the only thing the state can do is add regulations and administrative burden" and concluded "the age of micro-management from Washington or Sacramento is over as far as I am concerned."

The budget summary document, however, notes that "to improve student achievement and transparency, the Budget proposes requiring school districts to create a link between their local accountability plans and their budgets to show how increased funding is being spent to support [unduplicated pupils]." What this means in practice is unclear, especially given that the required LCAP template arguably already requires doing so. CSDC asked Brown's staff about what they had in mind: they noted that they plan to post the computations yielding supplemental and concentration funds on the internet—something that the CDE already does, albeit in somewhat cryptic form. They also said forthcoming budget trailer bill language will speak to the issue, but assured that they were not proposing formally restricting LCFF supplemental and concentration funds.

As noted above, the current LCAP template requires schools and districts to display the percentage increase in funding for unduplicated pupils and describe the increase in the quantity or quality of services provided for such students, above and beyond what is provided for all students. This is a somewhat slippery task because it requires schools to compare a very precise percentage increase in funding with a more subjective gauge of the quantity and/or quality of services offered. With the shift to fully funding LCFF, current law calls for changes to the complex "proportionality" computation that schools must use.

More specifically, for the past several years while the state transitions from "base" to "target" funding under LCFF, the law has called for a complex, six-step computation that compares prior *spending* of supplemental and concentration grant funds with future budgeted supplemental and concentration grant *revenues*. With full funding, however, the law shifts to call for different and simpler computation that will serve as the basis for gauging proportionality. Specifically, law calls for simply dividing the anticipated LCFF supplemental and concentration funds by all other LCFF funds (for charter schools this includes LCFF base plus grade span adjustments). CSDC plans to publish additional guidance on this topic after the Governor's proposals on point are available. For now, charter schools that are just starting to develop their 2018-19 LCAPs should keep in mind that the proportionality topic remains controversial and that they will likely need to beef up the section of their LCAP that addresses this topic.

## Proposed $28 Million Boost to Charter Facilities Grant May Still Fall Short of Need

The Governor proposes increasing funding for the Charter School Facility Grant Program by $28.3 million over current-year levels. Under current law, the program reimburses up to 75 percent of eligible lease and other specified costs, not to exceed $1,117 per ADA for eligible schools. Eligible schools include those serving student populations where 55 percent or more of the students enrolled are from low-income households and/or if the charter school is located in an attendance area of a district-operated elementary school where 55+ percent of the students are low income. While this augmentation is welcome, it may fall far short of amounts needed to fund a looming deficit in current-year funding and growth in 2018-19 demand as detailed below.

Recent expansions of this program, including increasing the maximum reimbursement from a cap of $750 to $1,117 per ADA in 2017, requires increased funding. The fixed $112 million line-item appropriation for this program was not increased in the current, 2017-18 state budget despite this expansion. While the program had a surplus of funds in prior years, including an estimated $12.5 million surplus in 2016-17, CSDC anticipates a substantial shortfall in funding for 2017-18. While this shortfall would shrink significantly in 2018-19 under the Governor's proposal for increased funding, he proposes no additional funds to cover the looming deficit for 2017-18 and sweeps the surpluses from prior years back into state coffers.

The size of the current-year (2017-18) shortfall is difficult to estimate due to the newly increased cap and lack of data on current-year attendance and school costs. Current figures indicate that reimbursing estimated 2017-18 lease costs alone will exceed the $112 million appropriation. The estimated shortfall is likely to grow substantially after increased attendance and other reimbursable costs such as maintenance are figured in. Key data elements will not be known until after the close of the fiscal year.

CSDC has carefully reviewed all known entitlement and funding data for 2017-18. Based on this analysis, we estimate the 2017-18 shortfall at between 15 and 35 percent. After extrapolating based on current known data, factoring-in recent trends and other adjustments*, CSDC currently suggests budgeting for a 25 percent shortfall in funding for this program for the current, 2017-18 fiscal year* and reducing estimated entitlements accordingly until additional information is available.

Under current law, any deficit remaining from 2017-18 would have first call on funds appropriated in the 2018-19 budget. The Department of Finance, however, has not yet released its proposed "trailer bill" legislation and tells

CSDC they are considering amendments to current law. While they have been tight-lipped about the specifics, CSDC anticipates they may propose deleting the above-referenced provision that gives prior-year deficits first call on current-year funds. If so, the entire $140 million, if approved for 2018-19, would be directed toward reimbursing 2018-19 entitlements and any 2017-18 deficit would remain unfunded.

Recent law also gave this program a cost-of-living adjustment, increasing the estimated entitlement to $1,145 per ADA for 2018-19. Given all of the unknown factors, estimating actual funding is especially difficult for 2018-19. As noted above, we do not know current-year baseline funding figures, nor do we know how the Legislature will react to the Governor's proposal to increase funding, whether prior-year deficits will continue to have first call, etc. Nonetheless, schools will need to make guesstimates as they assemble their budgets over the next several months.

Extrapolating the above-described estimates for 2017-18, CSDC estimates that funding could fall perhaps 5 to 15 percent short in 2018-19, even if the Governor's proposed $28.3 million augmentation is approved and if none of the 2018-19 funds are used to backfill any 2017-18 deficit. If current law holds firm and 2018-19 funds are used to backfill the 2017-18 deficit, the 2017-18 deficit would shrink of course, and the 2018-19 deficit would grow. Pending release of trailer bill language and gauging legislative reaction, CSDC suggests that schools budget for a 25 percent shortfall in 2017-18 and a 10 percent shortfall in 2018-19—and that schools monitor CSDC's updates throughout the budget process. New schools may want to budget for a larger 2018-19 deficit, perhaps in the 25-30 percent range, in case current law holds firm and 2018-19 funds are used to backfill the 2017-18 deficit.

The Governor also proposes allowing the state to issue $640 million in state school facilities bonds in 2018-19 as part of the $9 billion authorized when voters approved Proposition 51 in 2016. The Governor also proposes no additional funding for the Clean Energy Grant Program because the requirement to direct funds toward this five-year program ends in the current year after the voters authorized it in 2012. Schools have until February 28 of this year to file an expenditure plan to claim funding from the ample remaining funds and must encumber the funds by June 30, 2019.

## One-Time Per-ADA Grant

The Governor proposes spending $1.8 billion for yet another round of per-ADA grants. CSDC estimates this would, if approved, provide just over $300 per ADA for eligible schools. According to Administration staff, the proposal would allocate the funds using the same grant terms as in 2017-18, including allocating the funds on the basis of prior-year ADA and allowing the funds to be spent on any one-time purpose designated by recipients' governing boards. The funds would also be scored against any outstanding state-mandated cost claims for those school districts that are still owed for prior years. Many school districts and no charter schools currently have outstanding mandated cost claims, but they would share in the funding nonetheless.

Based on recent years' experience, CSDC anticipates that the Legislative Analyst and legislators may oppose this proposal and/or seek to redirect some of the funds toward other priorities. The Analyst continues to urge the Legislature to target these funds on those districts with outstanding mandate reimbursement claims—a move that would disadvantage charter schools and those districts with no pending claims. In recent years, legislators have been inclined to divert some of the funds the Governor proposes to provide through unrestricted grants toward other, more restricted purposes, including recent budgets that targeted some such funds on teacher professional development and other items. Given this trend, CSDC cautions against banking on these funds for high-priority needs until later in the budget process as funding prospects become clear.

## Statewide System of Support

The Governor proposes to spend $76 million on various initiatives to provide a so-called "statewide system of support" to assist schools and districts that are failing to meet their LCAP goals. These proposals include the following:

- $55.2 million for county offices of education, allocated through a mix of base grants plus additional funds for counties supporting districts that are eligible for "differentiated assistance" under a kinder and gentler system of intervening in low-performing districts
- $4 million for selected county offices to serve as regional leads in the evolving support system
- $10 million to special education local plan areas (SELPAs) to provide technical assistance to county offices and districts that are struggling to meet performance goals for special education students
- $7 million to augment the budget of the California Collaborative for Educational Excellence to provide assistance to the above-referenced county offices and SELPAs and to bring its total funding to $11.3 million/year

## Lottery

At the beginning of the fiscal year, CDE and the Lottery Commission estimated 2017-18 lottery revenues at $194 per ADA, including $146 per ADA for unrestricted purposes and $48 per ADA for instructional materials. First quarter revenues have come in a bit higher, but CSDC suggests continuing to budget at the above-referenced levels for both the 2017-18 and 2018-19 school years pending further updates.

## CalPERS and CalSTRS Rate Increases Holding Steady, For Now

Estimated employer contribution rates for CalPERS and CalSTRS remain at levels previously reported by CSDC and as summarized in the following tables.

The italicized rates shown below for 2018-19 and beyond are CalPERS' most recent estimates. CalPERS typically adjusts these rates each year and we will provide an update on these estimates in our May Budget Revision update.

| Increasing CalPERS Employer Contribution Rates | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|
| | **2016-17** | **2017-18** | **2018-19** | **2019-20** | **2020-21** | **2021-22** | **2022-23** | **2023-24** | **2024-25** |
| Employer Rate | 13.888% | 15.531% | *18.1%* | *20.8%* | *23.8%* | *25.2%* | *26.1%* | *26.8%* | *27.3%* |

The CalSTRS employer contribution rates shown below are fixed in statute and will be as follows, unless the Legislature amends them. CSDC is not aware of any current proposals to change them.

| CalSTRS Contribution Rates | | | | | | |
|---|---|---|---|---|---|---|
| | **2015-16** | **2016-17** | **2017-18** | **2018-19** | **2019-20** | **2020-21** |
| Employer | 10.73% | 12.58% | 14.43% | 16.28% | 18.13% | 19.10% |

While both pension systems posted major investment gains in 2016-17 and are likely doing so again this year as the stock market soars, both remain seriously underfunded. Three major appellate lawsuits are also pending that address various high-stakes questions over the sanctity of current public employees' pensions.

We anticipate that these cases will be consolidated and argued before the California Supreme Court in the near future. The outcome of these cases could dictate whether public employers, including charter schools, are allowed to reduce the pension benefits of current employees—so CSDC is monitoring them closely. The Supreme Court currently has one vacancy. Given the court's current composition, Governor Brown's appointment of a new justice could play a strong role in the outcome of these cases.

## Federal Government Budget Mess Makes Funding Picture Especially Foggy

At the time this article was drafted, the federal government was operating without an adopted budget and the continuing resolution that had allowed the government to remain open had expired, thereby forcing much of the government to shut down. While a new, temporary continuing resolution is in place, there is still no actual budget. Given this uncertainty, CSDC is deferring offering funding estimates—stay tuned for further updates when the dust settles.

## Governor Proposes LCAPs for SELPAs

Governor Brown has largely backed off his efforts of last year to substantially reform the state's inequitable special education funding formulas and opaque special education local plan areas (SELPAs). CSDC is very disappointed to hear this, especially since charter schools generally are on the short end of the special education funding stick and would likely benefit from equalization and because many charter schools complain that their local SELPAs are often unsupportive and have opaque funding allocation practices.

The Governor's budget summary did, however, note that achievement by special education students is lagging and that poor special education subgroup performance is a leading cause for identifying schools and districts in need of improvement under the evolving "Dashboard" accountability system. To address this, he proposes that each SELPA develop its own LCAP document (some are already calling it a "SELCAP") that would, much like a school or district LCAP, describe how the funds and services provided by the SELPA will align with the expenditures and services specified in the LCAPs of the member schools and districts.

CSDC was curious as to how SELPAs with multiple members could accomplish this goal, especially when the instructional practices and expenditures of member schools and districts vary widely. Department of Finance staff offered few specifics in response, other than to note that they are aware of the challenge and that forthcoming budget trailer bill language will address the issue.

The budget also proposes fully funding the 2.51 percent statutory COLA for state special education funding and providing an additional $10 million in ongoing funding for SELPAs to work with county offices of education to provide assistance to LEAs failing to make progress with special education students.

## Schools, Colleges Arm Wrestle for Control of Career-Technical Education

The current, 2017-18 year is the last of the three-year Career Technical Education Incentive Grant (CTEIG) program—a program designed to provide three years of start-up funds to help districts and charter schools to launch CTE programs. The Governor proposes no additional funding for this program and he has consistently asserted that ongoing funding should come from the LCFF, without the state dictating how much districts and schools should spend on CTE.

The Governor is, however, proposing a $200 million augmentation to the community college system budget to add a K-12 component to the college system's Strong Workforce Program. While details on this proposal are scant at this time, pending release of budget trailer bill language, the proposal will provide funding "to encourage the establishment and support of K-12 CTE programs that are aligned with needed industry skills." The budget also will provide $12 million "to fund local industry experts who will provide technical support to local educational agencies operating, or proposing to operate, CTE programs."

The Governor's proposal appears to reflect skepticism regarding the capacity of the K-12 system to play a controlling role in the direction of CTE programs and emphasizes the need for both K-12 schools and community colleges to engage industry experts when designing CTE programs.

Assembly Education Committee Chair Patrick O'Donnell (D—Long Beach) disagrees with the Governor. He is authoring Assembly Bill 1743, which would provide $500 million/year to continue and expand CTEIG. O'Donnell said,

> "The proposal to shift responsibility for the program to the California Community College Chancellor's Office is a step in the wrong direction . . . CTE is a critical component of robust K-12 education programs designed to ensure that students are well prepared for both college and a career . . . [D]edicated state funding for K-12 CTE programs is essential to the ongoing success of these important programs."

O'Donnell is a 20-year middle and high school social studies teacher and is known for his strong ties to the California Teachers Association (CTA); he states that "this is a top priority for me this session." CSDC presumes this issue could reflect a budding turf war between the CTA and the separate organization that represents unionized community college faculty.

## Mandate Block Grant

The budget includes funding to continue the Mandate Block Grant and to continue last year's new practice of adding a tiny COLA. Estimated funding rates for charter schools (which are substantially lower than school districts') are as follows:

- Grades K-8: $16.30/ADA
- Grades 9-12: $45.15/ADA

## Teacher Workforce

The Governor proposes allowing existing, "one-time" teacher workforce programs to expire while offering two new proposals focusing on the perennial shortage of special education teachers, including the following:

- $50 million, one-time, to support locally sponsored, one-year, intensive, mentored clinical residency preparation programs for special education teachers, and
- A second $50 million for one-time competitive grants for districts to attract and retain special education teachers.

These grants would be administered by the Commission on Teacher Credentialing. Few other details on these proposals is available until the related budget trailer bill language is available.

CSDC reminds charter schools that the 2015-16 state budget provided one-time teacher professional development grants of $1,466 per certificated staff member for various professional development activities. As a condition of funding, recipients' boards needed to approve an expenditure plan and must file an expenditure report no later than July 1, 2018. CDE has posted a template, instructions, and has an online reporting portal available; all recipient schools should file by the July 1 deadline.

## Child Care, State Preschool, And Early Education

Governor Brown proposes to increase funding for Child Care and State Preschool programs, including the following:

- Expanding the existing State Preschool program, the third of three previously agreed upon expansions, adding another 2,959 slots;
- Providing a 2.51 percent COLA plus an additional 2.8 percent increase for State Preschool funding; and
- Providing a 2.51 percent COLA for Child Care grants plus additional regional rate adjustments.

The Governor also proposes a new, one-time Early Education Expansion Program. The program would provide "$167 million of one-time state and federal funds to increase the availability of inclusive early education and care for children age 0 to 5 years old, especially in low-income areas and in areas with relatively low access to care." Here, too, details are scant pending the release of budget trailer bill language. CSDC is told that school districts and other prospective providers, including charter schools, would be eligible to apply for these grants.

## Minimum Wage & Overtime Exemption Reminders

We remind charter schools that the state minimum wage increased to $11/hour for employers with 26 or more employees ($10.50/hour for 25 or fewer employees) on January 1, 2018, and will increase again next year as part of a multi-year shift toward a minimum wage of $15/hour by 2022 (2023 for employers with 25 or fewer employees). Some localities have higher minimum wages.

Charter schools should ensure that their hourly staff wages meet these requirements (or local ones if higher). We also remind charter schools that salaried employees who are exempt from overtime must generally earn at least twice the state minimum wage for full-time employment when computed on a monthly basis (i.e., $3,813.33/month for large employers in 2018). If not, the employee generally does not qualify to be exempt from overtime.

Since some charter schools employ teachers or administrative staff who make less than this on a monthly basis, they must either raise the affected staff members' salaries or reclassify them as hourly staff who are subject to overtime. These computations can be very complex, so CSDC recommends actively monitoring them with assistance from an expert to ensure compliance. The liability of back wages, taxes, and penalties is not worth taking a risk in this area. Schools should also figure this in to their long-term planning because when the minimum wage reaches $15/hour, the minimum monthly salary for exempt staff will reach $5,200/month.

## Budgeting and Planning Prospects for 2018-19 and Beyond

Reactions to the Governor's proposals have been generally positive or muted. The Legislative Analyst's initial review notes that the Governor's funding estimates for education are reasonable and fairly close to the Analyst's independent estimates. The Governor's estimates, however, do differ in a few key respects, including an assumed increase in statewide K-12 enrollment in 2017-18 that may not materialize and could put downward pressure on the funding formulas when actual data becomes available before the May Budget Revision.

The Analyst also noted that, even if estimated state revenues increase significantly, little additional education funding would be guaranteed under the Proposition 98 formulas. Thus, while the Proposition 98 formulas have driven significant increases in funding for education and provide a higher funding floor, the downward potential for these formulas is significant and the upward potential is limited. The Analyst also uses the word "reasonable" to describe many of the Governor's key education funding proposals, noting the Legislature may have differing priorities. As noted above, however, the Analyst is critical of the $1.8 billion one-time grant and suggests targeting it on districts with outstanding mandated cost claims but is supportive of the notion of using one-time appropriations to spend much of the funding increase to avoid making ongoing commitments in case education funding declines in a recession.

CSDC believes the Governor's budget proposals generally are a reasonable starting point for preliminary 2018-19 budgeting purposes, with the caveats and exceptions noted above. As in recent years, longer-term estimates remain iffy given the volatile nature of state tax revenues, the age of the current economic recovery cycle, and the vulnerability of the economy to the vagaries of the stock and other markets and geopolitical events.

A moderate recession could cost the state $20 billion/year for two or more years. Fortunately, the state's growing budget reserves would provide a significant cushion for perhaps one year in the event of a recession. The Proposition 98 education funding guarantee and schools would still likely take a hit during a recession, wiping out "one-time" funds, while tempting the state to suspend or cut the Proposition 98 guarantee, enact funding deferrals, eliminate COLAs, and perhaps enact some baseline cuts.

To accommodate the wide range of potential scenarios, CSDC continues to suggest dual-track long-term financial planning wherein schools model scenarios both with (1) continuation of existing funding programs and COLAs as well as (2) with zero COLAs. We also continue to suggest that schools attempt to build toward or maintain cash reserves that can meet two to three months' worth of expenses in order to withstand potential funding deferrals and other contingencies. As always, CSDC will continue to closely monitor the state budget process and provide additional updates as warranted.

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