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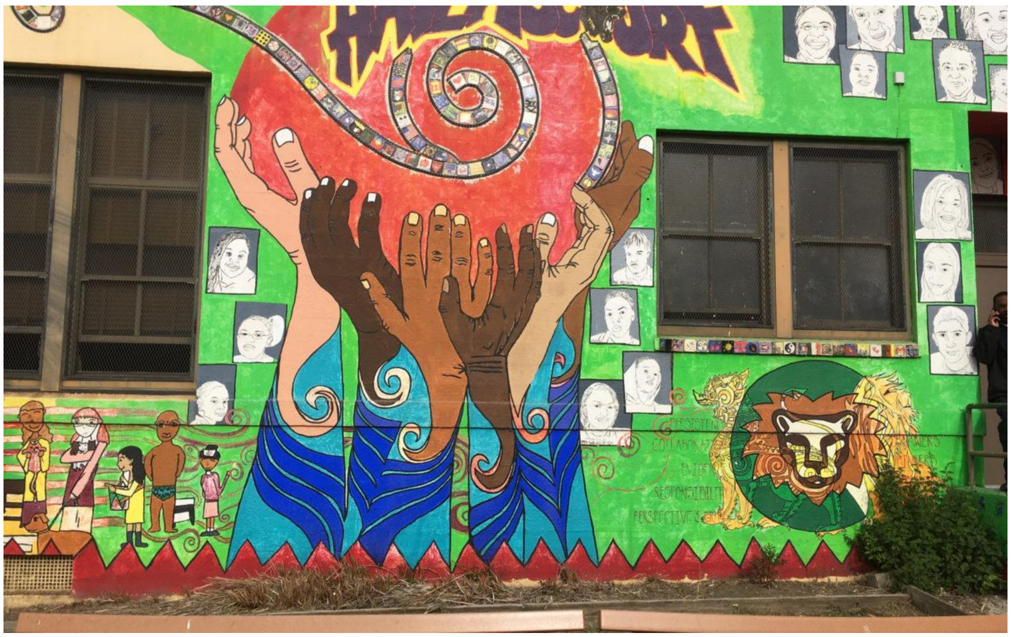
The coming storm: big budget cuts, rising costs for California schools

By one projection, a 15% cut may await schools in 2020-21



State officials insist it's too early to predict the size of the fiscal hole in the 2020-21 state budget. The filing deadline for the income and capital gains taxes for last year has been pushed back to July, and the path of the coronavirus remains unpredictable.

Next week, when he releases the May revision of the state budget from January, Gov. Gavin Newsom will likely say it'll be bad, but stay tuned for the details later this summer.

"We can build scenarios around different levels of cuts and reductions," said David Gordon, superintendent of the Sacramento County Office of Education, "but it's all speculation till we see the actual numbers."

Nonetheless, there are some ballpark estimates. As unemployment soars and the outlook for a steep recession looms, analysts are cranking new data into old forecasts, and the projected impact on education funding is ugly — probably a bigger dollar cut next year than the worst year in the Great Recession. Whether school districts, community colleges and early education programs will feel the full impact may depend on how much Newsom funds them beyond the statutory minimum.

Newsom this week acknowledged overall state revenue declines would be in the "tens of billions." The California Department of Finance pointed to a [scenario in the January budget](#) (page 228) of a "moderate" recession with revenue losses of $50 billion — $25 billion for each of the first two years — followed by further annual declines of $15 billion to $20 billion for years after that.

In testimony on April 16 before the Senate budget committee last month (starting at 13:50), Legislative Analyst Gabriel Petek applied COVID-19's financial equivalent of a coronary thrombosis to the Great Recession. His conclusion: a two-year, $35 billion hit in revenue, with 80% — $28 billion — falling in 2020-21 and only $7 billion in the current year that ends June 30. That's because plummeting personal income taxes in calendar 2020, which account for about two-thirds of General Fund revenue, will wallop the 2020-21 fiscal year and beyond.

When he closed schools in March, Newsom assured K-12 schools they'd get their full state funding for 2019-20 year as long as they agreed to feed low-income students, provide distance learning for all students and child care for essential workers. Districts won't directly be affected by a drop this year in the funding through Proposition 98, the formula that determines how much of the General Fund goes to K-12 and community colleges.

But 2020-21 will be painful. Prop. 98, a constitutional provision that voters passed in 1988, is a complicated formula. But as a rule of thumb, K-12 and community colleges receive 40% of the General Fund each year. A 40% slice of the LAO's estimated $28 million drop in revenue for the coming year would be $11.2 billion for K-12 and community colleges. That compares with a cut of $7.4 billion in Prop. 98 in 2008-09, the worst single year during the Great Recession.

In terms of percentages, the Prop. 98 drop in 2008-09 was 13%, about $1,200 per student. Prop. 98 has grown more than $30 billion since the nadir of the Great Recession and a loss of $11 billion next year would be 14 or 15%, about $1,700 per student. And that's for a "moderate" recession; the COVID-19 recession is looking to be severe, at least for the next year or two.

During the Great Recession, the American Recovery and Reinvestment Act, which Congress passed in 2009, helped school districts weather the recession with $6 billion in help during the first two years. When the money ran out, Prop. 98 cuts continued until 2011-12.

Newsom is fond of calling California, the world's fifth-largest economy, a "nation state," but he's counting on Washington, D.C., to help it and other states ward off financial disaster. Unlike the federal government, states have to balance their budgets each year.

By July 1, California's K-12 schools will receive $1.9 billion as its share of the $2.2 trillion in relief from the CARES Act, which Congress passed on March 27. California schools would get at least $20 billion more if Congress agrees to include $200 billion, sought by the Council of the Great City Schools and other education organizations, in the next round of relief. In an April 8 letter to House Speaker Nancy Pelosi, Newsom requested a $1 trillion package for state and local governments, including several hundred billion dollars for K-12.

Pelosi's all in for that plus more money for special education, but Senate Majority Leader Mitch McConnell isn't yet, and negotiations could be long and hard. In a column this week, longtime Capitol Hill observer Marguerite Roza, director of the Edunomics Lab and a research associate professor at Georgetown University, warned school systems not to engage in a "game of chicken" with Congress while they should be preparing for tough decisions.

Stocking up with cash

School districts have one advantage they lacked heading into the Great Recession: budget reserves that average 17% of their budgets, a historically high level, according to a recent LAO report. But there is a wide variation, too, with big districts tending to have smaller savings. They will need big reserves if, as expected, the state resorts to a tactic used extensively during the Great Recession to avoid additional funding cuts. That is to use "deferrals," which are late payments to school districts, by months or, as occurred in the Great Recession, into the next fiscal year. The advantage to districts is that they can budget the IOU as revenue and avoid layoffs. By 2012-12, $10 billion – about a quarter of what the state owed districts – was paid one to five month late.

The challenge is they have to borrow money to make payroll — a burden for some small districts, charter schools and larger districts living on the edge. In an April alert, the Fiscal Crisis and Management Assistance Team, the state agency that oversees districts' financial health, warned districts to build up their cash reserves. "Cash deferrals are more favorable than actual reductions in state funding," it said but districts have to pay attention to how much money they have on hand, it said.

"This is the time your school boards should bless those who stood strong and said, 'We are not going to eat into our reserves,'" said Gordon.

The state has built up a rainy day fund — the Budget Stabilization Account — that as of February was $17.5 billion, also a historic level. But there will be big demands for the money and no assurance that Newsom will direct any of it to schools. There is a separate Prop. 98 reserve, but the LAO reports it's only $377 million — less than 1% of school spending.

Unlike the Great Recession, the pandemic has imposed unprecedented expenses, from food to computer purchases. A return to school could compound staffing needs and add to expenses. Addressing learning deficits and issues of trauma will demand more counseling, after school programs or perhaps an extended year, adding cost pressures for districts looking to cut costs.

In an April 23 letter to Newsom, Assembly Speaker Anthony Rendon and Senate President Pro Tem Toni Atkins, 760 nonprofit children's organizations, advocacy groups and health agencies called on them to "prioritize kids" in the next state budget, "holding crucial children's programs and services harmless and increasing targeted supports as much as possible."

The release of the May budget revision next week may offer some early signals of Newsom's willingness and ability to do so:

Status of cost of living adjustment: In his pre-COVID-19 budget in January, Newsom proposed increasing spending by nearly $4 billion, including $1.2 billion for a 2.3% cost of living adjustment for the Local Control Funding Formula, the source for most district spending. Now, education groups would be happy with just the COLA alone and will be watching closely to see if it's included.

Pension increases: Some of the state's largest school districts have called on the Legislature to suspend school districts' contribution increases for two years to the two pension funds representing school employees. Since 2014, districts' payments to for teachers, through CalSTRS, and other school employees, through CalPERS have more than doubled. The increases are required to restore the pension funds' financial health from investment losses during the Great Recession and unwise benefits decisions before then. Postponing higher payments would free up nearly $2 billion for districts over the next two years. Districts are hoping Newsom will agree, in the May revision.

Learning loss: Last week, Newsom suggested that districts should start school early to mitigate the loss of learning that most students, but especially low-income children, have experienced during two months of school closures. He did not indicate how the interventions would be paid for. District leaders hope Newsom will identify a funding source in the May revision.