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INITIATIVE COORDINATOR
ATTORNEY GENERAL'S OFFICE

Hon. Kamala D. Harris
Attorney General
1300 I Street, 17th Floor
Sacramento, California 95814

Attention: Ms. Ashley Johansson
Initiative Coordinator

Dear Attorney General Harris:

Pursuant to Elections Code 9005, we have reviewed the proposed statutory initiative (A.G. File No. 13-0034) relating to school payments.

## BACKGROUND

***State Law Sets Forth "5-5-9" Payment Schedule.*** School districts, county offices of education, and charter schools (hereafter collectively referred to as "schools") receive general purpose funding from a combination of state General Fund and local property tax revenues. Schools with lower local property tax revenues generally receive higher state General Fund payments. State law sets forth that General Fund payments to schools are to be made using a 5-5-9 schedule, with 5 percent of annual payments made in July and August and 9 percent of total payments made each month thereafter. (State law establishes a somewhat different payment schedule for small districts that rely more heavily on local property tax revenues.) Despite state law's 5-5-9 provisions, schools have not received funding according to this schedule due to payment deferrals adopted in recent years.

***State Has Used Intra-Year Deferrals to Help Manage Cash Flow.*** The fiscal year of the state and most public entities begins on July 1. Because the state generally disburses the majority of General Fund dollars in the first half of the fiscal year but collects the majority of General Fund receipts in the second half of the fiscal year, the state routinely runs monthly cash flow deficits through the first half of the fiscal year. To address this regular imbalance of receipts and disbursements, the state's General Fund routinely borrows from other state funds, as well as bond market investors. Such "cash-flow loans" typically are paid back with interest during the latter half of the state's fiscal year. The state's cash flow problems became particularly problematic from 2008-09 through 2011-12, when the state's budgetary problems created larger cash flow deficits in certain months. In these years, the Legislature provided the executive branch with more flexibility to delay up to $6 billion in payments to schools, universities, and local governments from the beginning of the fiscal year to the end of the fiscal year. In recent

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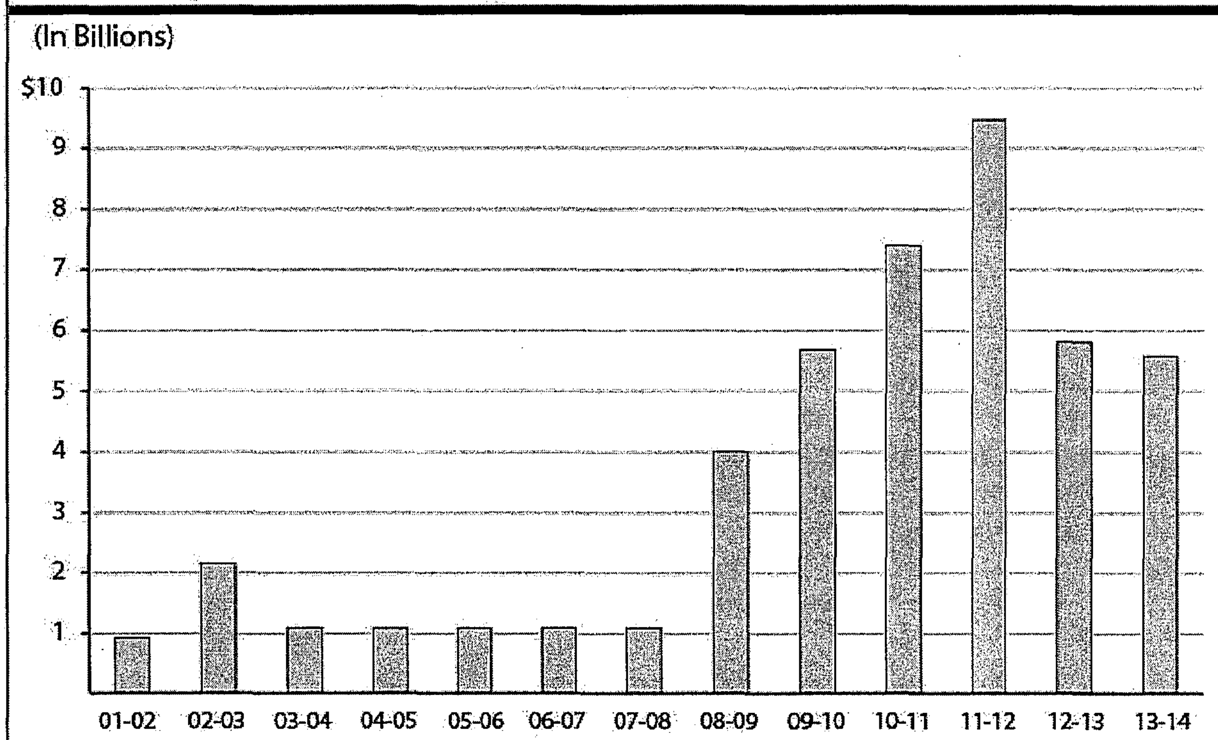
years, as the state's cash situation has improved, the state has not implemented intra-year deferrals.

***State Has Used Inter-Year School Deferrals for One-Time Budgetary Savings.*** In addition to using *intra*-year deferrals for short-term cash flow, the state has used *inter*-year deferrals for budgetary savings. As with intra-year deferrals, the state relied heavily on inter-year deferrals during the recent recession. As shown in Figure 1, over this period the state delayed an increasing amount of school payments into the subsequent fiscal year. In 2008-09, for example, the state deferred $2 billion from February 2009 (the 2008-09 fiscal year) until July 2009 (the 2009-10 fiscal year). This decreased 2008-09 General Fund costs by $2 billion, resulting in one-time budgetary savings (and a short-term cash flow problem for districts). Because the state made the late payment in 2009-10, it realized no ongoing savings. To avoid incurring additional one-time costs in 2009-10, the state continued deferring the February-to-July deferral in future years. School deferrals continued to be a principal tool for addressing the state's budgetary problems such that, by 2011-12, $9.5 billion in school payments were made late. The state began to pay down its existing school deferrals in 2012-13, when state revenues increased significantly. For example, the state eliminated the February-to-July deferral and returned the payment to its original schedule, incurring $2 billion in one-time costs. As of the 2013-14 budget plan, $5.6 billion in inter-year school deferrals remain outstanding.

Figure 1

School Payment Deferrals by Fiscal Year



# PROPOSAL

***Eliminates All Existing School Payment Deferrals.*** Beginning in 2015-16, the measure requires the state to use the 5-5-9 schedule for making monthly General Fund payments to schools, thereby eliminating all existing payment deferrals. Moving forward, school payments could be delayed by no more than 30 days and could not extend across the fiscal year. The measure allows the state to implement longer school payment deferrals only through a voter-approved initiative or legislation that receives three-fourths approval from both houses of the Legislature.

# FISCAL EFFECTS

## Effects on State Government

***One-Time State Costs to Eliminate Deferrals.*** Eliminating all existing school payment deferrals would create one-time state costs of up to $5.6 billion in 2015-16. (The exact cost would depend on the amount of deferrals outstanding at the end of 2014-15.) This additional cost would require the state to spend less on other education programs, spend less in other areas of the budget, implement budgetary deferrals for other programs, use budget reserves, and/or raise additional revenues to accommodate the additional spending.

***Reduced State Flexibility to Respond to Future Cash or Budgetary Problems.*** The measure also restricts the state's flexibility to respond to future budgetary crises. To the extent that future crises created state cash flow problems, the state would have to take other actions such as delaying payments to nonschool programs or increasing the size of its external borrowing. Increasing cash-flow loans likely would increase the state's interest costs related to that borrowing. To achieve budgetary savings, the state would need to rely more heavily on spending reductions in other areas of the budget, budgetary deferrals for other state programs, use of budget reserves, or additional revenues rather than deferring school payments.

## Effects on School Districts

***One-Time Funds Will Improve School District Cash Flow.*** As discussed above, the measure would require the state to make one-time payments in to schools to eliminate existing payment deferrals. These funds likely would reduce school borrowing costs and improve cash flow, but likely would have little effect on ongoing school spending.

***More Predictable Cash Flow for School Districts in Future Years.*** Due to the higher threshold required for delaying state payments, school districts would have greater certainty regarding their payment schedule in subsequent years. This likely would reduce school district cash flow problems in future years and could help reduce school districts' interest costs related to their own cash-flow (and infrastructure) borrowing.

***Future State Budget Problem Could Result in Deeper Cuts to School Programs.*** Because the measure limits the state's ability to implement school payment deferrals, the state likely would rely more heavily on spending reductions to address future budgetary problems. If the state responds to future budget crises by making reductions to state programs, the measure could result in programmatic reductions for schools.

**Summary of Fiscal Effects**

We estimate the measure would have the following fiscal effects on state and local governments:

- One-time state costs in 2015-16 of up to $5.6 billion to eliminate all existing school payment deferrals.
- Beginning in 2015-16, more predictable cash flow for schools and lower school borrowing costs.
- In future years, reduced state flexibility to respond to cash or budgetary problems.

Sincerely,

for Mac Taylor
Legislative Analyst

for Michael Cohen
Director of Finance