

Compromise on rainy day fund downplays Prop 98 reserve

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By John Fensterwald



Gov. Jerry Brown and legislative leaders cut a deal last week that, voters willing, would divert more money annually into a rainy day fund for general spending and less into a separate reserve for K-12 and community college spending than the governor had proposed in January.

The revised proposal may mollify some of the education leaders who opposed the idea of an education reserve, saying it implied that, even in good revenue years, spending for schools is sufficient. [Brown's original plan](#) included a number of conditions on when money from Proposition 98, the law that determines annual spending levels for schools and community colleges, would be set aside. Those restrictions would become even tighter.

The Legislature could vote this week on the new plan, which would be placed on the November ballot. It would replace a ballot version that the Legislature had agreed four years ago, in a compromise with Gov. Arnold Schwarzenegger, to put before voters this year. Brown didn't like it, because he said it failed to directly address the spikes in revenue from the capital gains tax that are the primary cause for gyrations in annual state spending.

Key elements in the latest proposal are:

- A rainy day fund would consist of two reserves, one for up to 10 percent of Prop. 98 funding, the other for up to 10 percent of General Fund spending. (The current rainy day fund, which voters created in 2004, calls for a maximum of 5 percent of General Fund spending.);
- No more than 50 percent of the rainy day fund can be tapped in the first year of a recession;
- For the next 15 years, half of the money transferred to the rainy day fund would go toward accelerating the payment of state debt;
- There would be additional restrictions to ensure that the rainy day fund is not depleted before there is a fiscal crisis. (The current rainy day fund was quickly depleted during the recession and not replenished.);
- The first 1.5 percent of revenue from the General Fund would be transferred annually to the rainy day fund. Brown agreed to this because Republicans, whose support Brown needs, insisted on a mechanism that guarantees rainy day fund revenue every year. However, Nick Schweizer, a Department of Finance analyst,

confirmed in an email that this requirement would apply only to the non-education reserve and not to Prop. 98 funding.

- In addition, when capital gains tax receipts exceed 8 percent of General Fund revenue, the amount above the threshold would fill both the Prop. 98 reserve and the non-education portion of the rainy day fund. This is a higher level than the 6.5 percent threshold that Brown originally had requested and would further limit how often money would go into the Prop. 98 reserve.

In his January proposal, Brown set several preconditions before Prop. 98 money would be transferred to the education reserve. Those restrictions would remain in the revised proposal. Money could be placed in the reserve only if:

- School districts' funding levels have been restored to pre-recession levels. This requires fully paying off what is called the Prop. 98 maintenance factor, an IOU that accumulates whenever the annual Prop. 98 funding does not cover the growth in student enrollment and the growth in per capita state income. The maintenance factor is currently \$7 billion, and the Legislative Analyst is predicting that it won't be paid off until at least 2019-20;
- There's sufficient funding to meet that year's full Prop. 98 obligation, including mandated cost increases;
- The Legislature has not suspended its requirement to fund the Prop. 98 obligation that year, which it has the authority to do with a two-thirds vote.

The proposed 8 percent threshold for diverting capital gains tax revenue is above the historical average of revenue from the tax. But Brown is projecting that money from the capital gains tax will comprise close to 10 percent of the General Fund revenue next year, and he says the long-term trend is more state reliance on that tax. That's why he's pushing his plan, which would take effect with the 2015-16 budget.

Although the latest changes and the restrictions that Brown already agreed to will likely sharply limit the number of years that money will find its way to the Prop. 98 reserve, the California Association of School Business Officials will not drop [its opposition](#), Jeff Vaca, deputy executive director, said Monday. "We agree it is unlikely that the 98 reserve would be in effect in very many years," Vaca wrote in an email, "but we remain concerned that having a 98 reserve in place will result in the impression at the public level that schools are adequately funded, and complicate discussions about the long-term adequacy of school funding – particularly when the temporary revenues from Prop 30 expire."

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