

Legislative Analyst Office Annual Forecast and Prop. 98 Implications
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The Legislative Analyst Office (LAO) released its annual forecast, *The 2014-15 Budget: California's Fiscal Outlook*¹, and a *Proposition 98 Briefing*² document on Wednesday, November 20, 2013. The purpose of the forecast is to provide the Legislature with the best estimate of the resources that will be available in next year's budget deliberations and to provide a general sense of the future health of the General Fund budget.³

The materials provide summaries of the LAO projections of California's economy and budget condition and contain projections of tax revenues and expenditures from the General Fund through 2019-20, including the Education Protection Account created by Proposition 30. This is the first time the LAO has done a 6-year projection and it goes through the first full fiscal year after expiration of Proposition 30.

The report contains positive news for the state revenues and for Proposition 98 funding. The LAO projects budget surpluses through this forecast period and year-to-year increases in the Proposition 98 minimum guarantee. While acknowledging pent-up demand after years of budget cuts, the LAO recommends the Legislature take a balanced approach to this good news -- build and maintain prudent reserves, retire outstanding commitments and create new commitments gradually.

In a reported prepared statement, the head of the Department of Finance spoke positively about the LAO's caution on making ongoing spending commitments and noted that "the focus must continue to be on paying down the state's accumulated budgetary debt and maintaining a prudent reserve to ensure that we do not return to the days of \$26 billion deficits." The Governor is to release his 2014-15 budget January 10, 2014.

Here's a highlight summary of the LAO report:

¹ <http://lao.ca.gov/reports/2013/bud/fiscal-outlook/fiscal-outlook-112013.pdf>

² <http://lao.ca.gov/handouts/education/2013/Fiscal-outlook-Prop98-briefing-112013.pdf>

³ California Fiscal Outlook. p.2.

A. State General Fund

Projected 2013-14 Operating Surplus of \$2.2 billion.

- Projected General Fund revenues up \$4.7 billion, largely driven by increases in capital gains and corresponding increases in personal income tax (PIT) collections.
- Projected state funding up \$3.4 billion, with \$3.1 billion of this spending attributable to Proposition 98.

Projected 2014-15 Operating Surplus of \$3.2 billion.

Out year surpluses projected throughout the forecast period.

LAO recommends a balanced approach to use of budget surplus:

- Build prudent reserve to prepare for the next economic downturn
- Retire outstanding commitments and pay down liabilities
- Provide inflationary adjustments to maintain current programs.
- Create new commitments gradually.

Strong Revenue Growth in the Near and Medium Term and two major assumptions:

- Continued economic growth is assumed, “typical of that seen during a mature economic expansion.”⁴
- Some of the state’s budgetary and retirement liabilities are repaid. For example, the LAO assumes that the state payments to CalPERS are increased. Note that other large liabilities identified include the retirement liabilities related to the California State Teachers Retirement System. These are not required to be retired, but additional payments could be made which would reduce the operating surpluses.

B. Proposition 98

Increases in minimum guarantee through the forecast period:

- Large increases in Prop 98 minimum guarantee in 2012-13 and 2013-14 of \$1.7 billion and \$2.7 billion.

⁴ Fiscal Outlook, p. 6-7.

- Significant new funding projected for 2014-15: *The minimum guarantee in 2014-15 is projected to be \$62.2 billion, or \$7.7 billion higher than the level of ongoing spending in 2013-14.*
- Minimum guarantee projected to grow by about \$3 billion annually 2015-16 through 2017-18.
- Slower growth in 2018-19 and 2019-20 due to expiration of Proposition 30 tax revenues at end of calendar year 2018; *but not a steep decline.*

Key Factors in Proposition 98 during the forecast period:

- Attendance is projected to decline slowly.
- Cost of living adjustments (COLAs) are projected to be low.
- Test 3 projected to be operative beginning in 2016-17 as per capital General Fund revenues grow slower than per capita personal income.

Local Control Funding Formula Implementation

- An intuitively surprising estimate regarding the timeline to implement Local Control Funding Formula:
 - The LAO assumes that the state will fund Proposition 98 at the minimum guarantee and estimates that by 2019-20 this would provide funding sufficient to fund 90% of total cost of LCFE for districts; about \$6 billion less than the level needed for full implementation.

LAO identifies three options for use of additional funding:

Deferral pay down.

- Now estimated at \$6.2 billion. The LAO notes that retiring deferrals will improve cash flow of districts and reduce need for districts to borrow.

Mandate Backlog.

- Estimated at \$4.8 billion. LAO notes that since districts have generally paid mandate costs already, funds could be used for any one-time local purposes, such as Common Core implementation.

Emergency Repair Program.

- Estimated at \$462 million. This program provides funds to low-performing schools and districts that filed repair requests several years ago.
- Since emergency repairs have likely already been made, funds could be used for one-time local purposes, including additional maintenance.

C. What's Next?

- We'll discuss what the coming budget year has in store at the CSBA Annual Education Conference:
 - Thursday, December 5, 2013 at 4:00 p.m. "*California's Fiscal Outlook and K-12 Education Funding*" and
 - Saturday, December 7, 2013 at 10:00 a.m. "*State of the State General Session*"
- The Governor will release his 2014-15 budget on January 10, 2014.
- Overview hearings in budget committees will begin shortly thereafter.
- CSBA's Economic Forecast Webcast is scheduled for Thursday, January 16, 2014. Register now at:
<http://www.csba.org/TrainingAndEvents/EventDetails.aspx?eventid=14FORCST>
- You can read CSBA's letter to the Governor on 2014-15 budget priorities at:
http://www.csba.org/Advocacy/LegislativeNews/~media/CSBA/Files/Advocacy/LegislativeAdvocacy/2013_1119_LtrtoGovBudget.ashx