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Structuring the 2019-20 Budget: Reserves, Debt, and Liabilities

PRESENTED TO: Assembly Budget Subcommittee No. 4
On State Administration
Hon. Jim Cooper, Chair

LEGISLATIVE ANALYST'S OFFICE

The Governor's Proposed 2019-20 Budget Structure

Increases Reserves by $2.1 Billion.

Pays Down $10.8 Billion in Debts and Liabilities. Includes two components: (1) $6.4 billion for retirement liabilities and (2) $4.4 billion for budgetary borrowing.

Debt and Liability Proposals in the 2019-20 Governor's Budget

(In Millions)

Debt Repayment	Amount
Retirement Liabilities	
CalPERS	$3,000
CalSTRS (districts)	2,300
CalSTRS (state)[a]	1,117
Budgetary Borrowing	
Special fund loans	$2,051
June-to-July payroll deferral	973
CalPERS 4th quarter deferral	707
Settle up	687
Total	**$10,835**

[a] Counts toward state's Proposition 2 debt payment requirement.

Provides $5.1 Billion in One-Time Spending.

Provides $2.7 Billion in Ongoing Spending. Full implementation cost of these proposals would grow to $3.5 billion ongoing (under the administration's estimates).

Reserves

Governor Proposes Total Reserves of $18 Billion.

Reserve Targets Assuming No Other Actions.

- Our past reports have estimated $20 billion to $40 billion in reserves would be needed to cover a budget problem associated with a mild or moderate recession (assuming the Legislature prefers not to take other actions like increasing revenues or reducing spending).

- Our *Fiscal Outlook* from November found $3 billion in ongoing spending was feasible under two economic scenarios—provided the Legislature entered the recession scenario with $25 billion in reserves.

Building More Reserves Would Reduce the Need for Programmatic Cuts in the Future. If the Legislature would like to make around $3 billion in new ongoing commitments and wants to minimize reductions to ongoing programs in a recession, building more reserves than proposed by the Governor would be prudent.

Debt and Liabilities: Budgetary Borrowing

Governor's Proposals to Repay Budgetary Borrowing

$2.1 Billion in Special Fund Loans. This would eliminate the multiyear plan to repay these debts under Proposition 2. The Governor uses capacity under Proposition 2 (2014) freed up by this proposal to make additional contributions to CalSTRS.

Uses $1.7 Billion to Undo Two Budgetary Deferrals. These are: (1) the June-July payroll deferral and (2) the fourth-quarter payment to CalPERS. Undoing these deferrals would eliminate ongoing budgetary savings for the General Fund. (The June-July payroll deferral has no effect on when paychecks are issued to employees.)

LAO Recommendations

Recommend Prioritizing Retirement Liabilities Over Budgetary Borrowing. Instead of using $2.1 billion to repay special fund loans (a low-interest liability), we recommend the Legislature use these funds to pay down additional CalPERS liabilities (a high-interest liability), saving the state at least hundreds of millions of dollars over the long term.

Recommend Rejecting Proposal to Undo Deferrals. We suggest the Legislature instead consider using $1.7 billion to build more reserves.

Debt and Liabilities: Retirement

Governor Proposes Three Supplemental Pension Payments:

- ***$3 Billion to CalPERS for Unfunded Liability.***
- ***$1.1 Billion to the California State Teachers' Retirement System (CalSTRS) for State Unfunded Liability.*** Also proposes additional payments over multiyear period.
- ***$2.3 Billion to CalSTRS for District Unfunded Liability.*** In addition, the Governor proposes providing another $700 million to CalSTRS for district rate relief.

State Savings From Supplemental Payments Likely to Vary.

Debt and Liabilities: Retirement

(Continued)

LAO Comments and Options

Consider Goal of Supplemental Payment. The Legislature may have the goal to: (1) address the systems' unfunded liabilities and/or (2) achieve state savings over the next few decades. If the Legislature has a preference to maximize state savings, making contributions to CalPERS—rather than CalSTRS—for the state's unfunded liability might be preferable.

Maximize General Fund Savings When Using General Fund Resources. The Governor's plan does not maximize General Fund savings, does not provide much benefit for the Motor Vehicle Account (MVA), and provides benefit to federal funds without requesting reimbursement.

- ***Alternative to Governor's Proposal.*** The Legislature could distribute the supplemental payment by fund according to unfunded liability and require other funds that benefit to repay. This would result in slightly higher General Fund benefit. In addition, all plans and funds, including MVA, would benefit from the supplemental payment.