

November 15, 2007

California's Fiscal Outlook: Proposition 98 Briefing

LEGISLATIVE ANALYST'S OFFICE





Update on the 2007-08 State Budget

What Happened to the \$4 Billion Reserve?	
<i>(In Millions)</i>	
	Reserve as of June 30, 2008
2007-08 Budget Act (August 2007)	\$4,070
Revenues on the Decline	
Lower 2006-07 major tax revenues	-\$604
Receipt of 2006-07 Medi-Cal quality assurance fee revenues	180
Lower 2007-08 tax forecast	-2,082
Lower property taxes (Proposition 98)	
2006-07	-356
2007-08	-686
EdFund sale not achievable in 2007-08	-1,000
Delayed implementation of tribal compacts	-210
Delayed child support penalty rebate	-198
Expenditures on the Rise	
CalSTRS payment	-\$500
Correctional officer pay increase	-258
Unallocated reductions not achievable	-240
Higher firefighting costs	-174
Other (net savings)	184
LAO Revised Reserve (November 2007)	-\$1,874

- General Fund revenues are down (about \$3.7 billion across 2006-07 and 2007-08).
- Local property tax revenues are down (about \$1 billion across 2006-07 and 2007-08), thereby raising General Fund Proposition 98 costs.
- EdFund sale unlikely to occur in 2007-08 (project state will receive roughly \$500 million from sale in 2008-09).
- State recently lost CalSTRS court case (required to pay \$500 million in 2007-08).



A Look at the 2008-09 State Budget

LAO Projections of General Fund Condition			
<i>2006-07 Through 2008-09 (In Millions)</i>			
	2006-07	2007-08	2008-09
Prior-year fund balance	\$10,435	\$4,114	-\$1,129
Revenues and transfers	95,578	98,916	103,512
Total resources available	\$106,013	\$103,030	\$102,383
Expenditures	\$101,899	\$104,159	\$111,428
Ending fund balance	\$4,114	-\$1,129	-\$9,045
Encumbrances	\$745	\$745	\$745
Reserve	\$3,369	-\$1,874	-\$9,790
Budget Stabilization Account	\$472	— ^a	— ^a
Special Fund for Economic Uncertainties	\$2,897	— ^a	— ^a

^a Under current law, the General Fund will deposit \$1 billion in 2007-08 and \$1.6 billion in 2008-09 into the Budget Stabilization Account for use as a budgetary reserve. Due to the projected budget shortfalls, however, these funds and any funds in the Special Fund for Economic Uncertainties are assumed to be used to partially address the shortfalls.

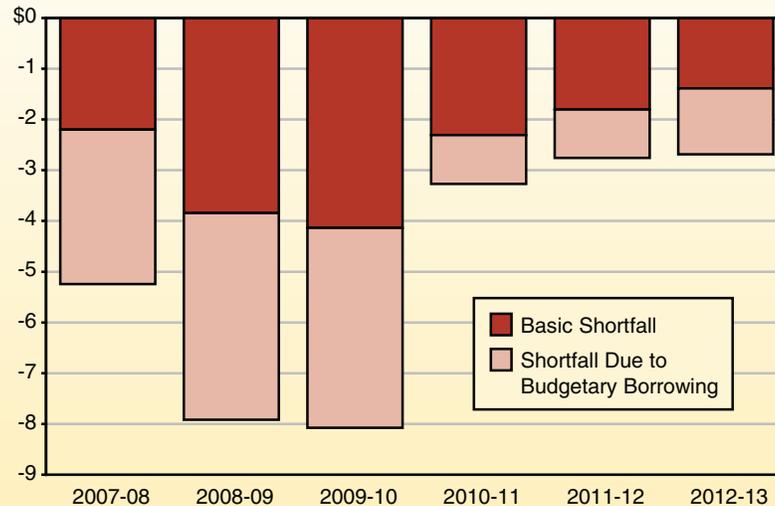
- State expected to end 2007-08 with a \$1.9 billion deficit.
- We project an \$8 billion operating shortfall in 2008-09.
- State needs to adopt almost \$10 billion in solutions to balance the 2008-09 budget.



Operating Shortfalls to Persist

Large Operating Shortfalls Projected Throughout Forecast Period

General Fund (In Billions)



- ☑ We project slightly more than an \$8 billion operating shortfall in 2009-10.
- ☑ We project the operating shortfall will drop to roughly \$3 billion for each year thereafter.



Array of Options for Balancing State Budget

- Slow program growth by reducing or eliminating cost-of-living adjustments (COLAs).
- Roll back recent program expansions.
- Reduce program benefits.
- Eliminate duplicative or ineffective programs.
- Shift costs to special funds or user fees.
- Eliminate tax credits and tax expenditure programs.
- Increase efforts to enforce existing tax laws.
- Raise tax rates.



The Proposition 98 Forecast

Proposition 98 Forecast						
<i>(Dollars In Billions)</i>						
	2007-08^a	2008-09	2009-10	2010-11	2011-12	2012-13
General Fund	\$42.2	\$43.3	\$45.3	\$46.0	\$49.0	\$52.1
Local property tax	15.0	15.9	16.3	18.3	19.8	21.0
Totals^b	\$57.1^c	\$59.2	\$61.6	\$64.3	\$68.7^c	\$73.1
Percent change	3.9%	3.6%	4.1%	4.3%	7.0%	6.3%

^a Reflects 2007-08 Budget Act spending level, with revised General Fund and local property tax contributions.

^b These totals do not include the \$2.7 billion appropriated as part of Chapter 751, Statutes of 2006 (SB 1133, Torlakson). This legislation provides annual payments of \$300 million to \$450 million over a seven-year period between 2007-08 and 2013-14.

^c Does not add due to rounding.

- Current Year.** The Proposition 98 minimum guarantee for 2007-08 has dropped by about \$400 million from the budget act level (due to the drop in General Fund revenues).
- Budget Year.** We project the Proposition 98 minimum guarantee will grow by \$2.1 billion, or 3.6 percent, from the current-year spending level.
- Out Years:**
 - In 2009-10 and 2010-11, we project the Proposition 98 minimum guarantee will grow by about 4 percent annually (due primarily to moderate growth in General Fund revenues).
 - In 2011-12 and 2012-13, we project the Proposition 98 minimum guarantee will grow by more than 6 percent (due primarily to healthier growth in General Fund revenues).



Underlying Forecast Factors

Proposition 98 Underlying Forecast Factors						
	2007-08	2008-09	2009-10	2010-11	2011-12	2012-13
Annual Percent Change						
K-12 average daily attendance	-0.5%	-0.4%	-0.3%	—	0.2%	0.3%
Per capita personal income (Test 2)	4.4	4.1	3.6	4.0%	4.2	4.2
Per capita General Fund	1.9	3.4	4.4	5.9	5.8	5.0
CCC full-time equivalent students	1.7	1.7	1.6	1.2	0.9	0.7
K-14 COLA	4.5	4.8	2.7	2.4	2.4	2.4
Share of General Fund Revenues						
Projected	43.8%	42.9%	42.5%	40.2%	39.9%	39.9%
Test 1 ^a	40.9	40.9	40.9	40.2	39.9	39.9
Proposition 98 "Test"	3	3	2	1	1	1

^a LAO estimates for Test 1 factor, as adjusted due to transfers of local property tax revenues between schools and local governments.



We project:

- Virtually flat K-12 attendance over the forecast period.
- Growth in per capita General Fund to outpace growth in per capita personal income over most of the forecast period.
- A drop in the COLA rate—from almost 5 percent in 2008-09 to less than 3 percent for the remainder of the forecast period.
- Test 1 to become operative in 2010-11.



Difficult but Critical K-14 Decisions In Year Ahead

- ☑ State may want to consider K-14 options for addressing overall state budget shortfall in 2008-09.
- ☑ We project year-to-year growth in Proposition 98 funding will be insufficient to cover baseline costs in 2008-09.
- ☑ These near-term issues are accompanied by the significant issue of planning for future education reform. By the end of the period, K-14 education is projected to benefit from about \$7 billion in ongoing funding above baseline costs that could go toward reform.

Difficult Year Ahead, Major New Discretionary Funds Still Expected in Out-Years					
<i>(In Millions)</i>					
	2008-09	2009-10	2010-11	2011-12	2012-13
Growth in Proposition 98	\$2,076	\$2,412	\$2,683	\$4,489	\$4,336
Baseline Expenditures					
K-12 Enrollment Changes	-\$11	\$7	\$47	\$134	\$192
CCC Enrollment Growth	104	105	82	64	52
K-14 COLA	2,690	1,557	1,437	1,516	1,611
Restore prior year shortfall ^a	782	—	—	—	—
Totals	\$3,565	\$1,669	\$1,566	\$1,714	\$1,855
Available Funds	-\$1,489^b	\$743	\$1,117	\$2,774	\$2,480

^a Includes \$567 million shortfall for transportation, deferred maintenance, and school intervention as well as \$215 million shortfall for mandates.

^b Assumes state finds ongoing solution of this amount. If a part of the solution is one-time, funds available in future years likely would go first to backfill the ongoing shortfall.