LAO
70 YEARS OF SERVICE

November 20, 2013

California's Fiscal Outlook: Proposition 98 Briefing

LEGISLATIVE ANALYST'S OFFICE

LAO
70 YEARS OF SERVICE

Projected 2013-14 Operating Surplus Has Grown

- ☑ 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 spending up $3.4 billion, with $3.1 billion of this spending attributable to Proposition 98.
- ☑ Projected operating surplus of $2.2 billion, up $1.3 billion from the level assumed in the *2013-14 Budget Act*.

LAO
70 YEARS OF SERVICE

$3.2 Billion Operating Surplus Projected in 2014-15

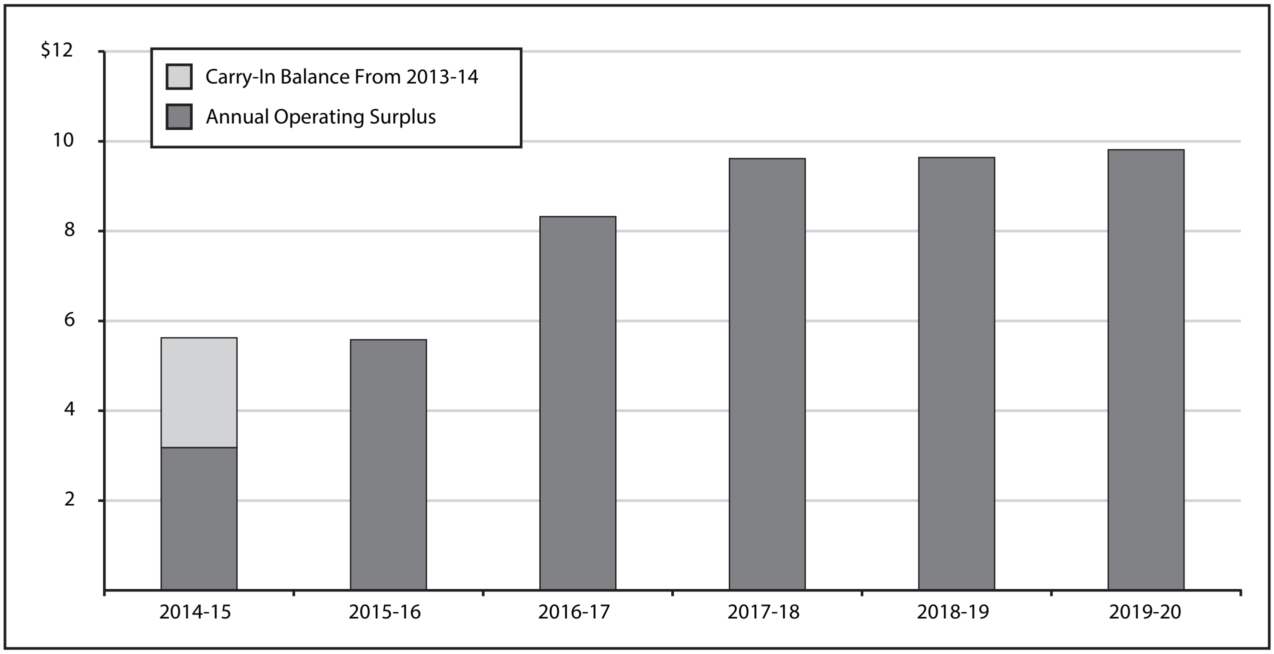
- ☑ Projected revenues up by $5.8 billion, primarily driven by increases in the PIT.

- ☑ Projected state spending up by $4.8 billion, primarily due to increases in:
  - General Fund Proposition 98 costs ($3.3 billion).
  - Infrastructure debt-service costs ($630 million).
  - Other spending ($900 million).

- ☑ Projected operating surplus of $3.2 billion, $1 billion higher than our projected 2013-14 surplus.

Out-Year Surpluses Projected Throughout Forecast period

(In Billions)



- ☑ Budget surplus of $3.2 billion projected for 2014-15, increasing to $9.6 billion by 2017-18.
- ☑ Growth in surpluses begins to level off as Proposition 30 PIT increases phase out.
- ☑ Higher property tax revenues contribute to surpluses by reducing General Fund Proposition 98 costs.

LAO
70 YEARS OF SERVICE

Recommend Balanced Approach to Budget Surplus

(In Billions)

	2013-14	2014-15	2015-16	2016-17	2017-18[a]	2018-19[a]	2019-20[a]
LAO Operating Surpluses	**$2.4[b]**	**$3.2**	**$5.6**	**$8.3**	**$9.6**	**$9.6**	**$9.8**
Prepare for Next Downturn							
Build $8 billion reserve by 2016-17	2.4	1.9	1.9	1.9	—	—	—
Pay off remainder of "wall of debt"[c]	—	—	1.2	2.3	3.1	—	—
Pay for Past Commitments							
Pay down unfunded retirement liabilities (CalSTRS, retiree health, and UC pensions)	—	0.5	1.0	1.5	2.0	2.5	3.0
Maintain Existing Programs							
Inflation increases for various state programs[d]	—	0.4	0.6	1.2	1.8	2.5	3.2
Create New Commitments							
Program expansions, tax reductions, and infrastructure	—	0.5	1.0	1.5	2.0	2.5	3.0

[a] Operating surpluses not entirely allocated in these years.
[b] Reflects projected year-end reserve of $2.4 billion.
[c] Cost of paying off Governor's wall of debt in excess of amounts already assumed in our baseline forecast. Includes Proposition 98 settle-up, deferred Medi-Cal costs, June/July payroll deferral, and California Public Employees' Retirement System deferral. Includes partial repayment of special fund loans and mandate reimbursements to cities and counties, as some of these amounts are assumed to be repaid in our baseline forecast.
[d] Cost of providing inflation increases to state programs that are not assumed to receive such increases in our baseline forecast, such as UC, CSU, SSP grants, the judicial branch, and California Department of Corrections and Rehabilitation. Amounts in 2014-15 and 2015-16 are net of recently negotiated employee compensation increases already assumed in our baseline forecast.
CalSTRS = California State Teachers' Retirement System; retiree health = other post employment benefits (health and dental); and SSP = State Supplementary Payment.

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

LAO
70 YEARS OF SERVICE

Large Increases in 2012-13 and 2013-14 Minimum Guarantees

(In Millions)

	2012-13			2013-14		
	2013-14 Budget Plan	November LAO Forecast	Change	2013-14 Budget Plan	November LAO Forecast	Change
Minimum Guarantee						
General Fund	$40,454	$42,212	$1,758	$39,055	$42,123	$3,068
Local property tax	16,011	15,994	-17	16,226	15,833	-393
Totals	**$56,465**	**$58,206**	**$1,741**	**$55,281**	**$57,956**	**$2,675**

- ☑ Our estimates of the minimum guarantee for the prior year and the current year are up a combined $4.4 billion over the amounts assumed in the 2013-14 spending plan.

- ☑ Increases in the minimum guarantee are due to growth in General Fund revenues and (in 2012-13) the state's treatment of maintenance factor, which results in the guarantee increasing more than a dollar for each dollar of additional revenue.

LAO
70 YEARS OF SERVICE

Additional Funding Could Be Used to Pay Down One-Time Obligations

☑ **Payment Deferrals ($6.2 Billion)**

- Retiring deferrals provides greatest benefit to districts that rely heavily on state funds.
- Improved cash flow would reduce need for districts to borrow internally or externally.

☑ **Mandate Backlog ($4.8 Billion)**

- Reducing mandate backlog provides greatest benefit to districts that have filed many high-cost claims. Also benefits districts serving high school students (due to graduation requirements mandate) and districts seeking reimbursement for Behavioral Intervention Plans.
- 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 ($462 Million)**

- Provides funding to low-performing districts that filed repair requests several years ago.
- Since emergency repairs have likely been made already, funds could be used for one-time local purposes, including additional maintenance.

LAO
70 YEARS OF SERVICE

Significant New Funding Projected for 2014-15

(In Millions)

***2013-14 Budget Act* Spending Level**	**$55,281**
Back out one-time actions:	
Deferral pay downs	-272
Common Core implementation	-250
Career Pathways program	-250
Governor vetoes	-35
CCC building maintenance	-30
CCC adult education planning grants	-25
CCC technology initiative adjustment	-7
Total One-Time Actions	-$869
2013-14 Ongoing Spending	**$54,412**
New Funds Available in 2014-15	**$7,748**
2014-15 Minimum Guarantee	**$62,160**

☑ 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.

☑ Recommend adopting a plan that balances one-time and ongoing spending.

- Balanced approach helps districts plan for and accommodate programmatic growth.
- Using funds for one-time purposes reduces the likelihood of needing programmatic cuts if revenues fall below projections.

70 YEARS OF SERVICE

Proposition 98 Minimum Guarantee Projected To Increase More in Initial Years of Period

(Dollars in Billions)

	2014-15	2015-16	2016-17	2017-18	2018-19	2019-20
Minimum Guarantee						
General Fund	$45.4	$47.4	$47.4	$48.7	$48.6	$49.1
Local property tax	16.8	17.9	20.6	21.9	23.1	24.6
Totals	**$62.2**	**$65.3**	**$68.1**	**$70.7**	**$71.7**	**$73.7**
Year-to-Year Change in Guarantee						
Amount	$4.2	$3.2	$2.8	$2.6	$1.1	$1.9
Percent change	7.3%	5.1%	4.2%	3.8%	1.5%	2.7%

☑ Minimum guarantee projected to grow by about $3 billion annually between 2015-16 and 2017-18.

☑ Slower growth projected in 2018-19 and 2019-20 due to the expiration of the Proposition 30 tax revenues at the end of calendar year 2018.

☑ Increases in Proposition 98 are largely covered by growth in local property tax revenues. This growth is caused by:

- Rising property values.
- Growth in property tax revenues associated with the dissolution of redevelopment agencies.
- The expiration of the "triple flip" in 2016-17. (The end of the triple flip results in property tax revenues shifting back from cities and counties to schools and colleges.) This, in turn, reduces the amount of General Fund needed to meet the minimum guarantee.

Proposition 98 Key Factors

	2014-15	2015-16	2016-17	2017-18	2018-19	2019-20
Proposition 98 "Test"	1	2	3	3	3	3
K-12 average daily attendance	-0.1%	-0.2%	-0.3%	-0.4%	-0.3%	-0.3%
Per capita personal income (Test 2)	-0.8	4.9	4.6	5.0	4.8	4.8
Per capita General Fund (Test 3)	6.4	5.8	4.1	3.7	1.1	2.3
K-14 cost-of-living adjustment	0.9	2.2	2.3	2.6	2.6	2.5

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

LAO
70 YEARS OF SERVICE

Proposition 98 Maintenance Factor Fluctuates Over Period

(In Billions)

	2012-13	2013-14	2014-15	2015-16	2016-17	2017-18	2018-19	2019-20
Amount created/paid (+/-)	-$5.4	$0.9	-$3.6	-$0.2	—	$0.6	$2.1	$1.3
Total outstanding	5.6	6.8	3.2	3.1	$3.2	3.9	6.2	7.8

- ☑ Project state will be making a $5.4 billion maintenance factor payment in 2012-13.
- ☑ Project state will create an additional $941 million maintenance factor obligation in 2013-14.
- ☑ Projected state will make a $3.6 billion maintenance factor payment in 2014-15.
- ☑ Total outstanding maintenance factor projected to drop to $3.2 billion by 2016-17.
- ☑ Outstanding maintenance factor projected to increase to $7.8 billion by 2019-20 following several years in which per capita General Fund revenues grow slower than per capita personal income.

LAO
70 YEARS OF SERVICE

Additional Time May Be Needed to Implement LCFF

- ☑ The administration estimated the state could fund all districts at or above their Local Control Funding Formula (LCFF) targets by 2020-21.

- ☑ Assuming the state funds at the minimum guarantee, we estimate funding would be sufficient to provide 90 percent of the total cost of the LCFF for districts by 2019-20, or roughly $6 billion less than the level needed for full implementation.

- ☑ Our estimate also assumes the state creates no new programs other than adult education, existing K-12 programs receive growth and COLAs, and community colleges receive 11 percent of Proposition 98 funding.