

FEBRUARY 7, 2019

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

PRESENTED TO:

Senate Budget and Fiscal Review Committee
Hon. Holly J. Mitchell, Chair



LEGISLATIVE ANALYST'S OFFICE

The Governor's Proposed 2019-20 Budget Structure

- **Increases Reserves by \$2.1 Billion.**

Total Reserves in Governor's Budget Proposed for the End of 2019-20 <i>(In Millions)</i>	
Budget Stabilization Account	\$15,302
Special Fund for Economic Uncertainties	1,808
Safety Net Reserve	900
School Stabilization Account	—
Budget Deficit Savings Account	—
Total	\$18,010

- **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 <i>(In Millions)</i>	
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 4 th 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).



Key Considerations in Structuring the Budget

Determining a Target Level of Reserves

- What is the size of the recession for which the Legislature would like to prepare?
- What are the current levels of one-time and ongoing commitments in the budget?
- How willing is the Legislature to take other actions during a recession?
- Would the Legislature like to mitigate reductions to both school and nonschool programs?

Allocating One-Time Commitments Between Debt and Programs

- Would the Legislature prefer to address the state's immediate needs or save money to address more future needs?
- Would the Legislature prefer to address state debts or debts of other entities first?

Setting the Level of Ongoing Commitments

- How quickly are revenues expected to grow under various economic conditions?
- How quickly are existing spending commitments expected to grow under various economic conditions?



Reserves

Governor Proposes Total Reserves of \$18 Billion

Reserve Targets Assuming No Other Actions

- Our past reports have estimated \$20 billion in reserves would be needed to cover a budget problem associated with a mild recession and \$40 billion would be needed for a 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.

LAO Options

- ***Build More Cash Reserves.***
- ***Prepay CalPERS Retirement Contribution.***



Debt and Liabilities: Retirement

Governor Proposes Making Three Supplemental Pension Payments:

- **\$3 Billion to CalPERS for Unfunded Liability.**
- **\$1.1 to 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

CalPERS Contribution Generates General Fund and Other Fund Benefit

(Dollars in Billions)

CalPERS Plan	General Fund Share of Contribution	Other Funds' Share of Contribution	Proposed Supplemental Payment	Expected Net Benefit (Savings)
Miscellaneous	48%	52%	\$1.4	\$2.9
Industrial	70	30	0.1	0.2
Safety	45	55	0.2	0.4
Peace Officer / Firefighter	98	2	1.4	2.7
Highway Patrol	0	100	0.0	0.0
Totals			\$3.0	\$6.3



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) maximize 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 uses General Fund resources to generate savings for both the General Fund and other funds. Options to maximize General Fund savings are:

- Make Entire Contribution to Peace Officers / Firefighters Fund.
- Require Other Funds to Repay the General Fund.

Recommend Making These Transfers Later in the Fiscal Year.



Debt and Liabilities: Budgetary Borrowing

Governor's Proposals to Repay Budgetary Borrowing Repays

\$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 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.

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

