

November 10, 2010

# California's Fiscal Outlook: Proposition 98 Briefing

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LEGISLATIVE ANALYST'S OFFICE





## Update on 2010-11 State Budget

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- We project a \$6.1 billion shortfall in 2010-11.
- Less funding/revenues than expected:**
  - \$3.5 billion in funding/flexibility not yet approved by federal government.
  - Revenues down \$447 million for 2009-10 and 2010-11.
- General Fund expenditures higher than expected.**
  - \$3 billion in other solutions at risk—Prisons and Medical Receiver, employee compensation, Medi-Cal, In-Home Supportive Services, property tax revenues, information technology.
  - We assume Proposition 22 reduces 2010-11 solutions by nearly \$800 million.
- State would exhaust \$1.3 billion reserve assumed in 2010-11 budget package.



## A Look at the 2011-12 State Budget

### LAO Projection of General Fund Condition if No Corrective Actions Are Taken

(In Millions)

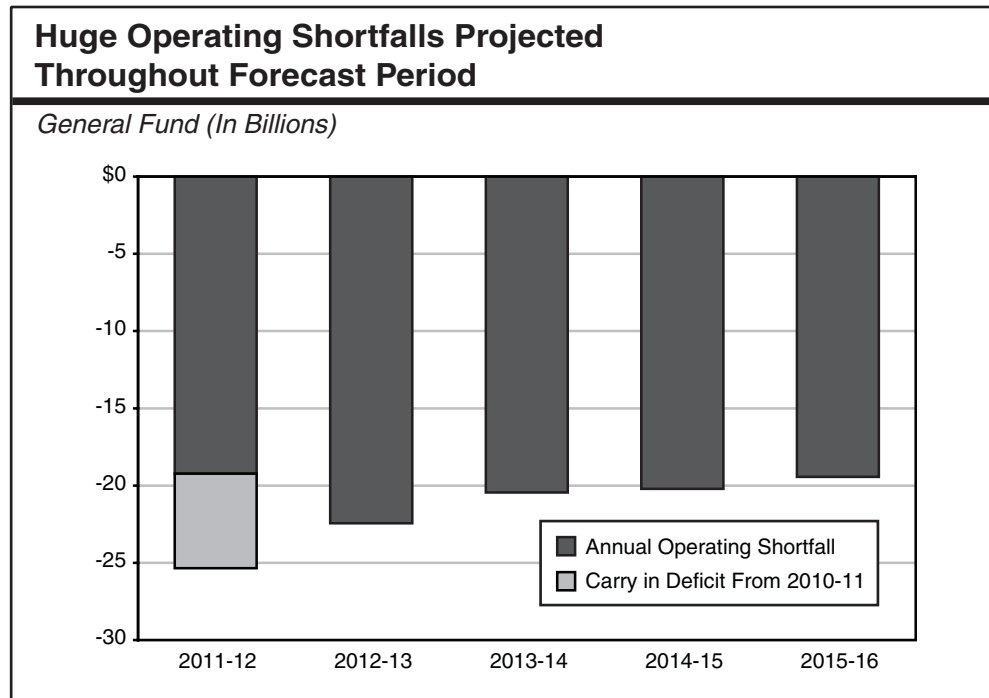
	2009-10	2010-11	2011-12
Prior-year fund balance	-\$5,375	-\$5,371	-\$4,591
Revenues and transfers	87,041	93,284	83,530
Expenditures	87,037	92,505	102,756
Ending fund balance	<b>-\$5,371</b>	<b>-\$4,591</b>	<b>-\$23,817</b>
Encumbrances	1,537	1,537	1,537
<b>Reserve<sup>a</sup></b>	<b>-\$6,908</b>	<b>-\$6,128</b>	<b>-\$25,354</b>

<sup>a</sup> Special Fund for Economic Uncertainties. Assumes no transfer to the state's Budget Stabilization Account.

- We project \$19 billion shortfall in 2011-12. When coupled with the 2010-11 "carry-in" deficit, the state has a \$25 billion problem to address through 2011-12.
- Major causes of 2011-12 shortfall:**
  - Expiration of \$8 billion in temporary tax revenues.
  - Majority of 2010-11 budget solutions were one-time or temporary.
- Key considerations:**
  - Forecast already assumes Proposition 98 allocation reduced \$2 billion from 2010-11 to 2011-12.
  - Ongoing federal constraints on reducing health programs.
  - Revenue uncertainty.



## Lingering \$20 Billion Shortfall for Years to Come



**Projections likely understate scale of state's fiscal woes:**

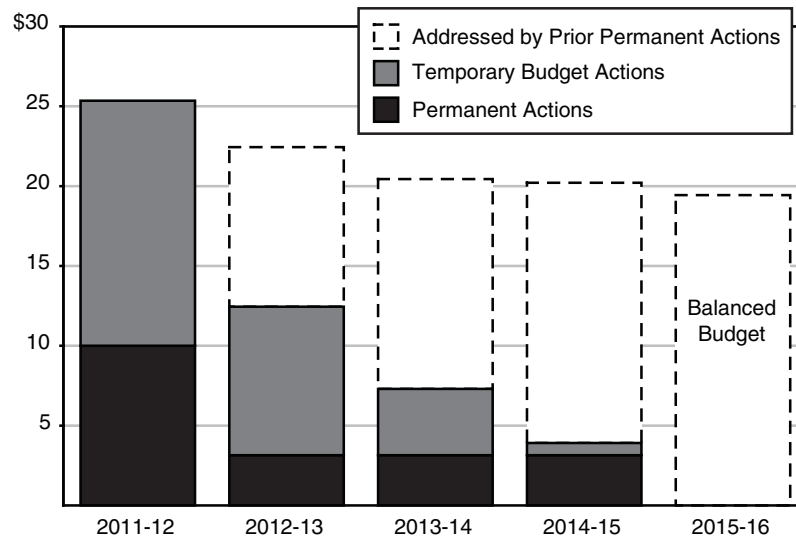
- Assume no cost-of-living or inflationary increases.
- Excludes unfunded liabilities related to pensions and retiree benefits.



## Multiyear Approach to Balance Budget Must Begin Now

### Multiyear Approach Could Involve Mix of Permanent and Temporary Solutions

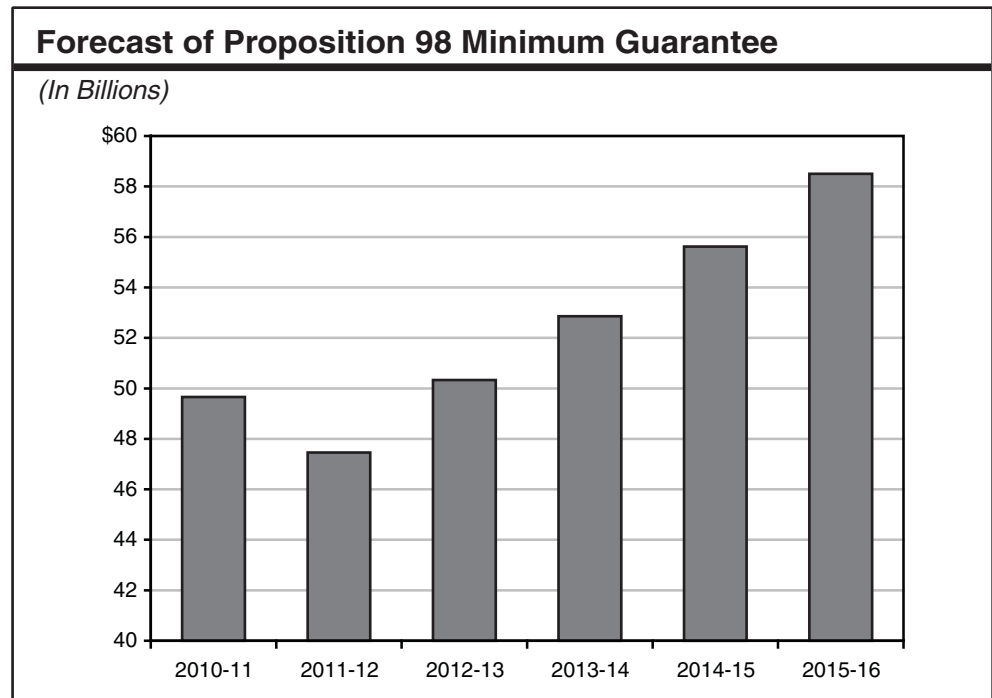
General Fund Budget Solutions (In Billions)



- Not possible to solve whole problem in one year.
- Need permanent budget solutions.
- Revenues need to be part of the mix.
- Permanent and temporary budget solutions are needed in 2011-12.
- Each year, continue making some permanent reductions until entire problem addressed on an ongoing basis.



## Proposition 98 Forecast

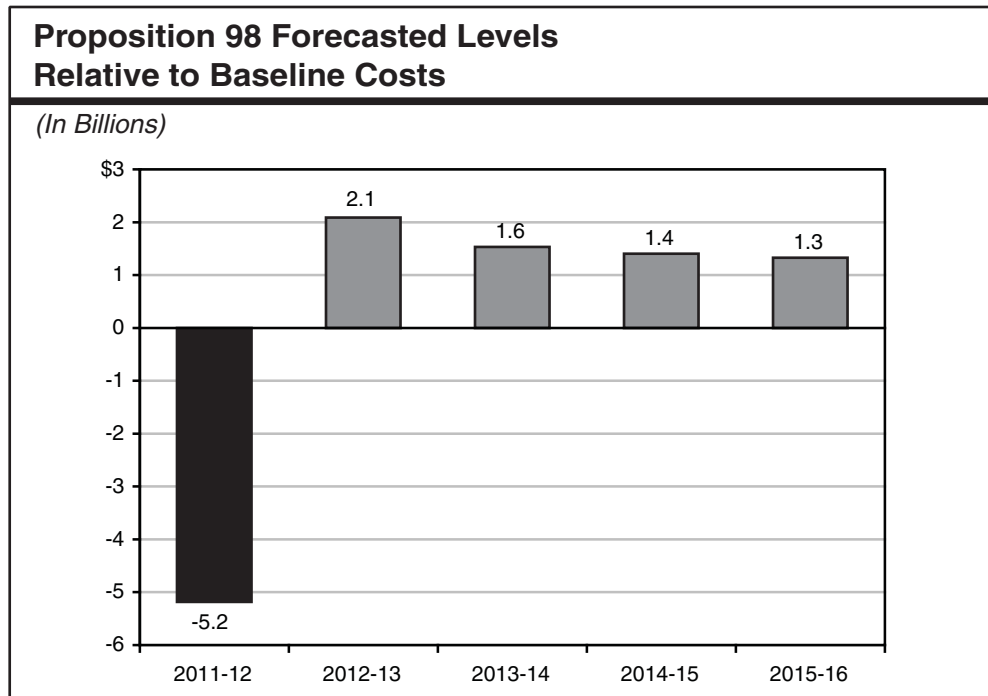


- ☑ We project a decline of \$2 billion in the Proposition 98 minimum guarantee in 2011-12.
- ☑ We project steady increases in minimum guarantee between 5 percent and 6 percent from 2012-13 to 2015-16.
- ☑ Local property taxes to grow modestly, steadily over forecast.
- ☑ Both minimum guarantee and local property taxes to reach pre-recession levels in 2015-16.
- ☑ Low rates of growth in attendance and cost-of-living throughout forecast period.



## Proposition 98 Forecast

(Continued)



- 2011-12 minimum guarantee would fall \$5.2 billion short of funding baseline K-14 costs.
- School districts will also face additional programmatic reductions in 2011-12 as they exhaust one-time federal funds.
- Growth from 2012-13 through 2015-16 enough to fund increases in attendance and cost of living.
  - By 2015-16, Proposition 98 minimum is sufficient to fund all baseline cost increases and restore any reductions made in 2011-12, but insufficient to restore reductions made in 2008-09, 2009-10, and 2010-11.
- Settle-up (\$300 million) and Quality Education Investment Act (\$450 million) payments assumed to be paid throughout period.



## Major Proposition 98 Issues

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- Estimated \$25 billion shortfall already assumes state reduces funding to Proposition 98 minimum guarantee in 2011-12.
- Potential reductions suggests rethinking deferrals:
  - Legislature may want to consider eliminating \$1.8 billion in deferred payments.
  - Relying on deferrals becoming increasingly problematic for district financial management.
- Help districts by maximizing flexibility and sending signals early.





## Proposition 98 Maintenance Factor Issues

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- Unresolved maintenance factor issues reemerge:**
  - State could create additional maintenance factor obligation in 2011-12 (\$3.9 billion).
  - Issue of how maintenance factor payments should be made reemerges in 2012-13 (\$900 million effect).
  
- Maintenance factor obligation projected to grow by almost \$4 billion in 2011-12, increasing total outstanding obligation to \$13.7 billion.
  
- State to make relatively small maintenance factor payments each subsequent year of the forecast period—ending the period with an outstanding obligation of \$13.1 billion.