November 16, 2011

California's Fiscal Outlook: Proposition 98 Briefing

LEGISLATIVE ANALYST'S OFFICE

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2011-12 Update

LAO Projections of General Fund Condition If No Corrective Actions Are Taken

(In Millions)

	2010-11	2011-12	2012-13
Prior-year fund balances	-$4,507	-$1,695	-$2,239
Revenues and transfers	94,292	84,764	86,038
Expenditures[a]	91,480	85,308	95,787
Ending fund balance	-$1,695	-$2,239	-$11,988
Encumbrances	770	770	770
Reserve[b]	**-$2,465**	**-$3,009**	**-$12,758**

[a] Under the LAO November 2011 revenue forecast, a total of $2.04 billion of expenditure trigger reductions would be implemented, as revenues are $3.7 billion below the amount assumed in the *2011-12 Budget Act*. This represents all of the first tier of trigger cuts and around three-quarters of the second-tier trigger cuts.

[b] Special Fund for Economic Uncertainties. Assumes no transfer to the state's Budget Stabilization Account.

- ☑ General Fund revenues down $3.7 billion, triggering $2 billion in reductions ($1.5 billion from Proposition 98).
- ☑ An additional $1.2 billion in 2011-12 solutions unlikely to be achieved.
- ☑ Estimated 2011-12 year-end deficit of $3 billion.

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Proposition 98 Trigger Reductions

All Tier I and Most Tier II Proposition 98 Reductions To Be Triggered

(In Millions)

	Authorized Cut	Estimated Cut
Tier 1 Reductions		
Reduce CCC Apportionments	$30	$30
Reduce Preschool Funding	6	6
Subtotal	$36	$36
Tier II Reductions		
Reduce K-12 Revenue Limits	$1,540	$1,116
Eliminate Home-to-School Transportation	248	248
Further Reduce CCC Apportionments	72	72
Subtotal	$1,860	$1,436
Total	**$1,896**	**$1,472**

☑ School districts would have discretion to reduce the school year by up to seven days but negotiating such changes midyear is likely to be difficult.

☑ Trigger reductions limited by minimum guarantee.

☑ Reduction equates to 3.3 percent reduction in 2011-12 revenue limit payments.

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2012-13 Outlook

- ☑ Estimated $13 billion budget problem.
  - $3 billion “carry-in” deficit from 2011-12.
  - $10 billion 2012-13 operating shortfall (revenues are up about $1 billion but expenditures are up almost $11 billion).
- ☑ Proposition 98 costs projected to increase by almost $6 billion.
  - Minimum guarantee increases by $4 billion.
  - Loss of $1.4 billion one-time redevelopment funds.
  - State begins paying $400 million annual settle-up payments.
  - No growth in local property tax revenues.
- ☑ Other notable increases in expenditures:
  - State must repay $2 billion Proposition 1A loan.
  - Assume state repays $1 billion in loans to special funds.

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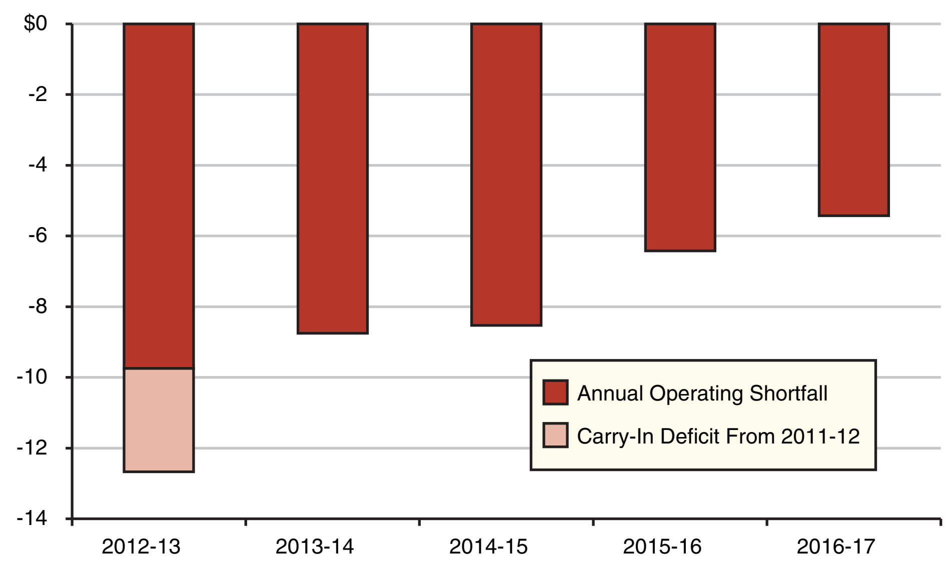
Projected Out-Year Imbalances Gradually Decline

Operating Shortfall of More Than $5 Billion Throughout Forecast Period



- ☑ Budget shortfalls decline as economy expands and state revenues recover.

- ☑ Forecast assumes no cost-of-living adjustments (COLAs) and excludes unfunded liabilities for pension and retiree health benefits.

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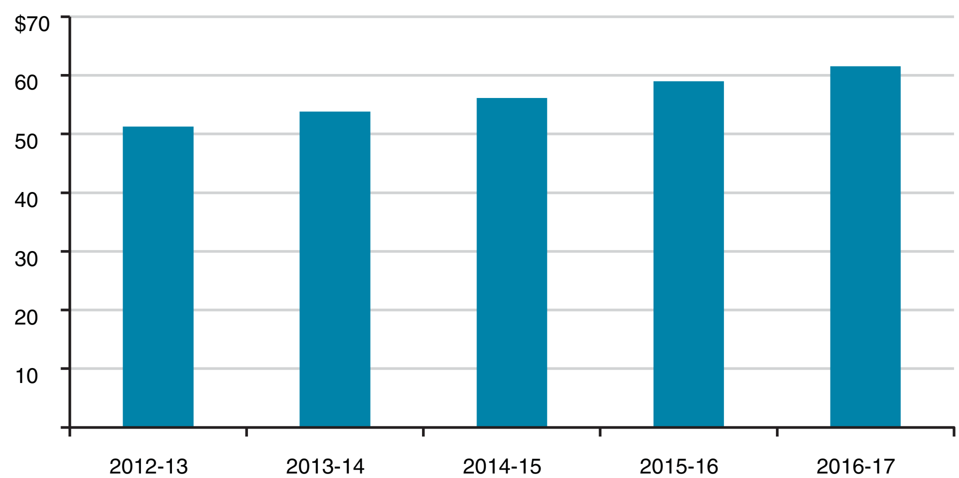
Proposition 98 Forecast

Forecast of Proposition 98 Minimum Guarantee



☑ Minimum guarantee in 2012-13 is projected to be $4 billion higher than revised 2011-12 spending level.

☑ We assume no ballot measure is approved in November 2012.

- Realignment sales tax revenues included in Proposition 98 calculation in each year (including 2011-12).
- State owes $2 billion in settle-up to meet 2011-12 Proposition 98 obligation.
- Settle-up obligation scheduled out in $400 million payments from 2012-13 through 2016-17.

☑ Annual growth of 4 percent to 5 percent throughout forecast period.

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Key Factors

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	2012-13	2013-14	2014-15	2015-16	2016-17
K-12 average daily attendance	0.08%	-0.07%	-0.24%	-0.13%	0.01%
Per capita personal income (Test 2)	4.04%	3.41%	3.61%	4.74%	4.10%
Per capita General Fund (Test 3)	4.28%	5.29%	4.81%	5.85%	4.74%
K-12 COLA	3.09%	1.75%	2.16%	2.41%	2.51%

- ☑ Attendance projected to be virtually flat.
- ☑ Low COLAs.

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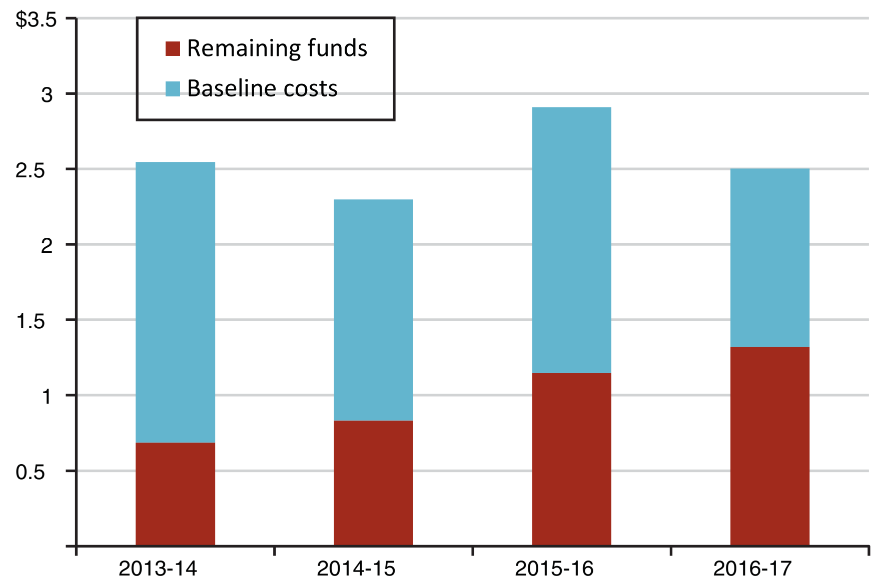
Growth Sufficient to Provide COLAs, but Not to Retire All Existing Obligations

Proposition 98 Minimum Guarantee Grows $10 Billion Cumulatively Over Period



- ☑ Growth in Proposition 98 minimum guarantee would provide $10 billion more than needed to fund COLAs.

- ☑ If all Proposition 98 growth is dedicated to funding revenue limits, the state would still end the period with $1 billion in revenue limit obligation. Over the period, the state would have foregone COLAs for all other Proposition 98 programs and continued to make more than $10 billion in late payments. It also would end the period with more than $10 billion in outstanding maintenance factor and $1.5 billion in outstanding settle-up obligations (from 2009-10).

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Major Issues for Legislature and Education Community

- ☑ Effect of trigger reductions will vary depending on each district's fiscal situation.
  - Districts that have already made programmatic reductions are likely to draw down reserves and avoid midyear reductions.
  - Districts that budgeted based on more optimistic assumptions and made fewer initial programmatic reductions will be more likely to impose midyear reductions.

- ☑ Given the $13 billion budget problem, the Legislature will need to determine if state can afford to fund the Proposition 98 minimum guarantee in 2012-13. The effect on districts also will depend on the extent to which they already have downsized the overall program.

- ☑ Given uncertainty regarding whether a ballot measure will be approved raising additional revenue for school districts and community colleges, the Legislature/school districts will need to decide what to assume for budgeting purposes.

- ☑ Given projected growth in the minimum guarantee in the out years, the Legislature should begin setting priorities about which existing Proposition 98 obligations should be retired first, with the goal of retiring as many existing obligations as possible during the course of the economic recovery.

- ☑ Maintenance factor issues remain.