

JANUARY 25, 2021

The 2021-22 Budget: Overview of Proposition 98 Budget Proposals



LEGISLATIVE ANALYST'S OFFICE

Update on the 2019-20 and 2020-21 Minimum Guarantee

(In Millions)

	2019-20			2020-21		
	June 2020 Estimate	January 2021 Estimate	Change	June 2020 Estimate	January 2021 Estimate	Change
Minimum Guarantee						
General Fund	\$52,656	\$54,470	\$1,815	\$45,066	\$56,942	\$11,876
Local property tax	25,022	25,073	51	25,824	25,887	62
Totals	\$77,678	\$79,544	\$1,866	\$70,890	\$82,828	\$11,938

Notable Increase in Current- and Prior-Year Estimates of the Guarantee

- Relative to June 2020 estimates, the guarantee is up \$1.9 billion (2.4 percent) in 2019-20 and \$11.9 billion (16.8 percent) in 2020-21.
- The increases are due almost entirely to higher General Fund revenue estimates. Whereas the June 2020 budget had assumed revenue would be down significantly in both years, the revenue estimates in the Governor’s budget are nearly back to pre-pandemic levels.
- The increase in the 2020-21 guarantee is the largest upward revision (relative to the enacted budget) since the passage of Proposition 98 in 1988.
- The state is required to “settle up” to the higher guarantee. These one-time settle-up payments account for most of the new Proposition 98 spending in the Governor’s budget.



Proposition 98 Funding Grows in 2021-22 Under Governor's Budget

(Dollars in Millions)

	2019-20 Revised	2020-21 Revised	2021-22 Proposed	Change From 2020-21	
				Amount	Percent
Proposition 98 Funding					
Minimum guarantee	\$79,544	\$82,828	\$85,796	\$2,967	3.6%
Supplemental payment	—	—	2,310	2,310	—
Totals	\$79,544	\$82,828	\$88,105	\$5,277	6.4%
Funding by Segment					
K-12 education	\$70,230	\$72,494	\$75,854	\$3,360	4.6%
Community colleges	9,313	9,588	10,011	423	4.4
Reserve deposit	—	747	2,241	1,494	—
Funding by Source					
General Fund	\$54,470	\$56,942	\$60,835	\$3,894	6.8%
Local property tax	25,073	25,887	27,270	1,383	5.3

Significant Growth in the 2021-22 Guarantee

- The guarantee is up \$3 billion (3.6 percent) over the revised 2020-21 level, and more than \$14.9 billion (21 percent) compared to the enacted 2020-21 level.
- Increases in General Fund revenue and local property tax revenue both contribute to the higher guarantee.

Proposition 98 Supplemental Payments

- Trailer legislation adopted last June requires supplemental payments beginning in 2021-22. The state created these payments to compensate for the anticipated drop in the Proposition 98 guarantee. The payments are scheduled to grow from \$2.3 billion in 2021-22 to about \$6 billion by 2024-25.
- The Governor's budget makes the 2021-22 payment, but proposes eliminating supplemental payments in subsequent years.



Proposition 98 Reserve Deposits and School District Reserves

Governor's Budget Deposits \$3 Billion Into the Proposition 98 Reserve

- Proposition 2 (2014) established the Proposition 98 Reserve and set forth rules requiring deposits and withdrawals under certain conditions. Generally, deposits are required when revenue from capital gains is relatively strong and the minimum guarantee is growing faster than per capita personal income.
- The estimated deposits are \$747 million in 2020-21 and \$2.2 billion in 2021-22.

Proposition 98 Reserve Deposits Trigger School District Reserve Cap

- A state law caps school district reserves the year after the balance in the Proposition 98 reserve exceeds 3 percent of the funding allocated for schools.
- The state would reach this threshold in 2021-22, making the cap apply in 2022-23.
- The cap is 10 percent of a school district's annual expenditures. Districts with 2,500 or fewer students are exempt.

Districts Could Respond to the Cap in Several Ways

- Data from 2018-19 indicate that approximately 130 medium and large districts currently maintain reserves exceeding the cap.
- Districts could avoid the cap by reclassifying their reserves or asking their county offices of education to approve an exemption. Alternatively, they could spend down their reserves.



Comments on Estimates of the Minimum Guarantee

Estimates of the Minimum Guarantee Are Reasonable

- The administration's General Fund revenue estimates are \$1.2 billion above ours over the three-year budget period.
- The administration's local property tax estimates are less than \$200 million below ours over the budget period.

Changes in General Fund Revenue Would Affect the Guarantee...

- The state faces significant uncertainty over the direction of the economy. General Fund revenue estimates could change notably over the coming months.
- "Test 1" is operative for calculating the guarantee. In Test 1 years, the guarantee increases or decreases about 40 cents for each dollar of higher or lower revenue.

... And the Required Reserve Deposit

- A larger Proposition 98 Reserve deposit is likely to accompany an increase in the minimum guarantee. Conversely, a smaller reserve deposit is likely to accompany a decrease in the guarantee.
- Changes in the reserve deposit help buffer the amount of funding available for programs.

Changes to Supplemental Payments Seem Reasonable

- The outlook for Proposition 98 funding over the next several years has improved significantly since the state adopted the supplemental payments.
- The state faces a multiyear operating deficit on the non-Proposition 98 side of the budget. Under the administration's projections, this deficit grows to more than \$11 billion by 2024-25. Without changes to the supplemental payments, the deficit would grow to more than \$17 billion.



Overview of Proposition 98 Spending Proposals

Budget Contains \$19.1 Billion in New Proposition 98 Spending

- Allocates \$16.5 billion for one-time activities.
- Allocates \$2.6 billion for ongoing augmentations.

\$8.4 Billion One Time for Paying Down Deferrals

- The June 2020 budget plan deferred \$12.5 billion in payments.
- After accounting for the proposed paydowns, slightly more than \$4 billion would remain deferred at the end of 2021-22.

\$6.6 Billion One Time for Academic Support and Reopening Schools

- Consists of \$4.6 billion for academic support and expanded learning (proposed for early action) and \$2 billion for reopening schools (proposed for immediate action).
- Districts could use this one-time funding for a variety of purposes.

\$2.6 Billion for Ongoing Augmentations (Mainly Cost-of-Living Adjustments)

\$1.5 Billion for Several One-Time Initiatives

- More than a dozen smaller proposals related to specific school or community college activities.
- Largest allocations include \$265 million for the Community Schools Grant Program and \$250 million to provide emergency grants for community college students.

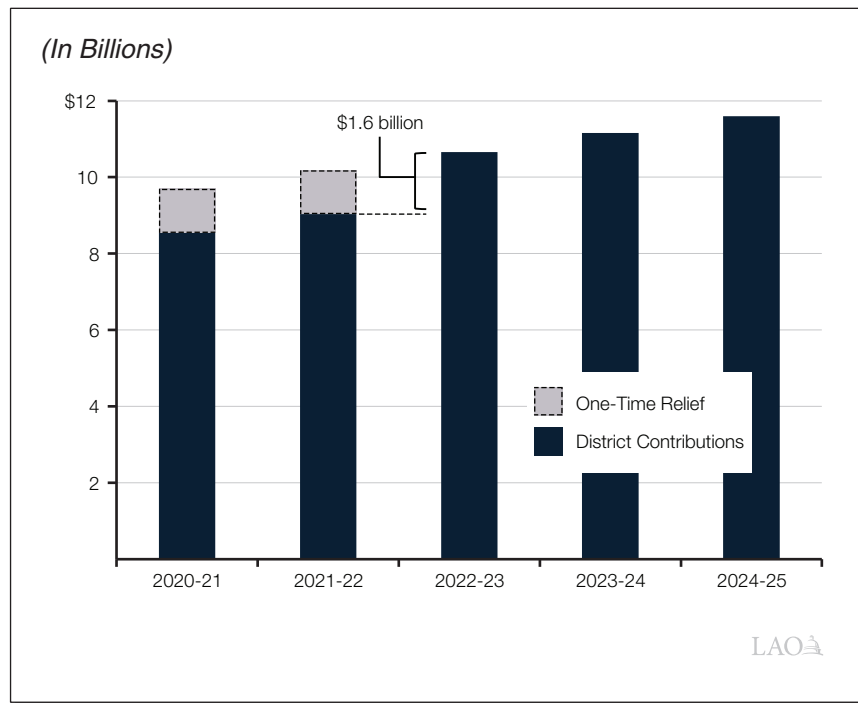


Governor's Proposition 98 Spending Proposals

<i>(In Millions)</i>	
K-12 Education	
Ongoing	
LCFF growth and COLA (3.84 percent)	\$1,991
Preschool-aged children with disabilities	300
COLA for select categorical programs (1.5 percent)	88
Mental health services incentive grants	25
Subtotal	(\$2,404)
One-Time	
Deferral paydown	\$7,318
Expanded learning and academic intervention	4,557
In-person instruction grants	2,000
Community Schools Grant Program	265
TK Expansion Incentive Grants	250
Educator Effectiveness Block Grant	250
Teacher Residency Grant Program	100
Training for TK teachers	50
Educator professional development for social-emotional learning	50
Classified Teacher Credential Program	25
Other	37
Subtotal	(\$14,903)
Total K-12 Education	\$17,306
California Community Colleges	
Ongoing	
COLA for apportionments (1.5 percent)	\$111
Student mental health and instructional technology	30
Enrollment growth (0.5 percent)	23
California Apprenticeship Initiative	15
COLA for select categorical programs	14
Other	20
Subtotal	(\$213)
One-Time	
Deferral paydown	\$1,127
Emergency student financial aid grants	250
Student basic needs	100
Student retention and enrollment strategies	20
Faculty professional development	20
Work-based learning initiative	20
Other	18
Subtotal	(\$1,555)
Total California Community Colleges	1,768
Total Spending Proposals	19,074



Update on District Pensions Costs



District Pension Costs Are Rising

- Districts make annual contributions to the California State Teachers' Retirement System for teachers, faculty, and administrators and the California Public Employees' Retirement System for classified employees.
- District pension contributions for both systems have increased notably since 2013-14. These increases largely relate to addressing unfunded liabilities.
- The June 2020 budget plan provided \$2.3 billion for one-time pension cost relief over 2020-21 and 2021-22.

Estimates of Additional Cost Increases

- \$0.5 billion increase projected for 2021-22.
- \$1.6 billion increase projected for 2022-23 as the one-time relief expires.



Recommendations for Overall Proposition 98 Spending

Build a Final Budget Package That Continues to Include a Large One-Time Cushion

- The budget contains a \$5.2 billion one-time cushion (nearly \$3 billion in one-time spending attributable to 2021-22 and the \$2.2 billion reserve deposit).
- This one-time cushion helps address economic uncertainty by reducing the likelihood of cuts to ongoing programs if the guarantee falls below projections.

Consider Smaller, Targeted Funding for Academic Support Given Recent Federal Action

- Districts received more than \$7 billion in one-time flexible funds in 2020-21. Recent federal legislation provides another \$6 billion that districts can use through 2021-22.
- Consider adopting a smaller allocation that better targets the state's highest priorities.

Consider Funding Fewer New Initiatives

- Some proposals seem reasonable, but funding so many new activities in the midst of the pandemic risks diluting their individual impact and diverting attention from core programs.

Allocate More Funding for Paying Down Deferrals and Addressing Pension Costs

- Paying down deferrals would realign ongoing program costs with the ongoing funding to pay for those programs.
- The Legislature could use one-time funding to smooth out the large increase in pension costs in 2022-23 and/or reduce costs over a longer period. Lower costs would ease local budget pressure and help districts sustain programs over time.

