



League Analysis of the 2016-17 California's *Fiscal Outlook*

Background

On November 18, the nonpartisan Legislative Analyst's Office (LAO) released the annual publication, *California's Fiscal Outlook*, including the revenue summaries for the first quarter of the 2016 fiscal year as well as a five-year fiscal forecast. The release of the report serves as a prelude to the annual budget deliberation process that begins every January with the release of the Governor's January Budget Proposal.

Every year, state budget policymakers anticipate the *Fiscal Outlook* report as a first look at state revenue, reserve estimates, and spending commitments affecting the General Fund. Through an analysis of the economy, *Fiscal Outlook* outlines possible state revenue and spending trajectories over the next five years and illustrates any progress towards building budget reserves under Proposition 2, which was approved by voters in 2012. For education stakeholders, the analysis of Proposition 98 provides an insight into potential revenue growth or downturns. The report also discusses policy choices faced by the state, including debt repayment, budgetary commitments, and economic conditions. This *Fiscal Outlook* report does not assume an extension of Proposition 30 sales tax or personal income tax revenues. The following is the Community College League of California's analysis and perspective on this report.

Economic Conditions

The *Fiscal Outlook* notes that California's economic expansion continues but warns that this expansion is at a midpoint. Revenue growth has been primarily driven by personal income, which is expected to grow by 7% in 2015-16 but predicted to only increase by 3.2% in 2016-17 due to a weaker stock market. It is important to note that the sales and use tax (SUT) and corporate tax (CT) revenues were lower than anticipated in the current year. This is an important distinction since the higher tax rate on personal income taxes is set to expire in 2018. Proposition 30 extension proposals are currently under negotiation but polls of likely voters show that an extension is not likely if the tax is seen as permanent.

State Budget Outlook

The LAO predicts a positive outlook for the 2016-17 budget. The report illustrates that the state is better prepared for an economic downturn than in past years. This optimistic outlook is based on the assumption no new budget commitments are made, providing for 2016-17 to end with reserves of \$11.5 billion. Proposition 2's rules require that nearly two-thirds of these reserves be held in the Budget Stabilization Account (BSA). The Legislature has control over the remaining \$4.3 billion estimated in the Special Fund for Economic Uncertainties (SFEU) balance. As a result, the LAO warns that if the Legislature were to make new commitments in the 2016-17 budget, it will be more likely to face difficult choices by the end of the five-year forecast of 2019-20.

Current Year 2015-16

The 2015-16 Budget Act assumed revenue at \$113.3 billion. The LAO now estimates an increase of \$3.6 billion due primarily to personal income tax (PIT), largely from Bay Area tax filers.

Budget Year 2016-17

The *Fiscal Outlook* predicts that revenues increase \$6.9 billion, or 5.9 percent, in 2016-17. Consequently, General Fund spending grows by \$5.9 billion, or 5.1 percent, in 2016-17 under their main scenario. The state's largest growing spending categories include Proposition 98 and Medi-Cal.

Proposition 98 Outlook

From 2016-17 through 2019-20 of the LAO forecast, Test 3 of Proposition 98 is operative. Generally, Test 3 is operative when General Fund revenues fall or grow slowly. Through 2017-18, the LAO estimates that growth in the Proposition 98 minimum guarantee will be higher than the statutory COLA for those years, therefore allowing for continued program expansion. However, they predict that in the latter years of their forecast, growth in the guarantee will be lower than COLA increases. For 2016-17, the LAO estimates the statutory COLA at 1.99%.

One-Time Resources

The LAO indicated that the Proposition 98 Guarantee for 2014-15 and 2015-16 combined is up \$2.39 billion. This means that if LAO predictions hold true, community colleges could receive approximately \$253 million in one-time funds.

New Proposition 98 Funds Available in 2016-17

The LAO projects the minimum guarantee will increase 3.3%, or \$2.3 billion, from \$69.1 billion (the adjusted guarantee) in 2015-16 to \$71.4 billion in 2016-17. Since only \$67.9 billion of the Proposition 98 guarantees were allocated as on-going resources, the LAO estimates the state will have \$3.6 billion available for its 2016-17 Proposition 98 priorities. Under the approximate 11% split between K-12 and community colleges, colleges would receive an estimated \$396 million in on-going increases for the 2016-17 fiscal year.

2015-16	
On-Going Funds Allocated in Budget Act	\$67.9 billion
2016-17	
LAO Estimated Prop 98 Guarantee	\$71.4 billion
New Prop 98 Funds	
	\$3.6 billion
LAO Estimated CCC 2016-17 Split	\$396 million

Out-Year Projections

Growth in the Proposition 98 minimum guarantee is relatively strong in the near term, with the guarantee projected to grow another 4.4 percent in 2017-18. However, the LAO projects slower growth in the Proposition 98 guarantee as Proposition 30 revenues phases out.

Higher Education Issues

Growing pension costs continue to be a primary concern for community colleges. District contribution rates for CalSTRS increase from 10.7 percent of payroll in 2015-16 to 18.1 percent by 2019-20. Both CalPERS and CalSTRS boards have recently considered proposals to reduce risks in their investment portfolios. If they decide to lower their assumptions concerning future investment returns, state contributions could be significantly higher by 2019-20.

The report again illustrates a steady decline in K-12 average daily attendance. While this trend may take some time to materialize in higher education, it is nonetheless a critical trend to note, as future enrollment growth may also need to come from individuals who haven't recently been in an education setting.

Lastly, there remains much uncertainty about the expiration of Proposition 30. While the sales tax portion will expire on December 31, 2016, the current forecast illustrates that this portion of Proposition 30 should not have a major impact on education spending. On the other hand, the economy would have to remain steady, albeit slow, in order to avoid drastic reductions upon the expiration of the personal income tax portion of Proposition 30. Negotiations are underway for a modified proposal that extends these both taxes.

League Analysis

As we have seen in previous years, the LAO revenue estimates are generally higher than those identified by the Governor and Department of Finance, and even those adopted in the Budget Act. The *Fiscal Outlook* serves as a preview of the upcoming budget discussions.

The availability of one-time resources, estimated at about \$253 million in 2016-17, provides an opportunity to think strategically about programmatic needs both in technology infrastructure and in curriculum and resources development. Colleges can view the prospect of one-time funds as start-up monies for programmatic improvements or accelerated implementation of current initiatives that can lead to student success. The system is poised to utilize one-time funds on new efforts such as the implementation of the Strong Workforce Task Force recommendations. It is important to note that anticipated new funds for community colleges of about \$396 million are significantly lower than the 2016-17 System Budget Proposal.

Over the next several years, colleges will need to continue to focus on long-term cost pressures. The League's primary analysis is to be cautious of the state's heavy reliance on personal income tax, especially since much of the growth comes from Bay Area technology industries. Based on the forecasted economic conditions and long-term cost pressures, the League advises districts to exercise optimistic restraint.