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California County Superintendents
Educational Services Association

Promoting, influencing, and advocating for high-quality education.

Background

On Wednesday, November 17th, The Legislative Analyst's Office (LAO) published their annual *California's Fiscal Outlook* report. This publication addresses the state's current revenues and spending commitments, and projects the potential fiscal outlook in 2022-23 and forward. This provides policy makers with key information ahead of the upcoming budget process.

The 2021 Budget Act included a total of $93.7 billion Proposition 98 General Fund for K-12 education programs. This represented a per-pupil funding of $13,976 per pupil in Proposition 98 General Fund. The Proposition 98 Guarantee remained in a Test 1 for the 2019-20 through 2021-22 fiscal years. In total, the Guarantee was equivalent to approximately 38 percent of the total General Fund revenues, in addition to local property tax revenues. The Budget Act also included a payment in 2021-22 of $2.6 billion to the Public School System Stabilization Account, bringing the total balance to $4.5 billion.

High-Level Economic Outlook

California's schools will continue to ride the wave of tremendous economic growth next year. Under the LAO's assumptions, the state will have a surplus of $31 billion in 2022-23 to be spent on non-Proposition 98 priorities, with up to $8 billion ongoing. Further, nearly $20 billion would be available for *new* K-14 commitments in the coming year, as compared to projections from the June budget act. Less than half that amount, $9.5 billion, would be available for ongoing purposes, while most arise from current and prior year adjustments.This totals $51 billion available for new commitments. This is the result of rapid revenue growth in recent months. With this revenue growth also comes Gann Limit, otherwise known as the State Appropriations Limit (SAL) implications.

State appropriations limit (Gann Limit) may drive decision-making

The Gann Limit was established by voters in 1979 to cap state spending levels. The LAO forecasts the state will exceed its limit by $25.7 billion in the current and prior budget years. The state can avoid exceeding this limit through specified expenditures, like infrastructure, tax relief, debt service, and emergencies. Revenues that exceed the limit must be split between schools and tax rebates. Look for lawmakers to funnel excess revenues into politically salient programs early in the budget cycle (think: last year's Golden State Stimulus checks).

Proposition 98 Guarantee

The higher than anticipated General Fund revenues will cause the Proposition 98 Guarantee to be increased by about $1.8 billion in 2020-21 and $8.9 billion in 2021-22 over the amount provided in the 2021 Budget Act. After accounting for these increases to the minimum guarantee, slightly lower than projected program costs, and the need to increase the reserve deposit, the LAO projects that there will be approximately $10.2 billion needed in one-time payments to meet the minimum Proposition 98 guarantee. These funds will be available for one-time costs.

The LAO assumes that this rapid revenue growth will be tempered in the budget year. In contrast to the 7 percent growth assumption in 2021-22, they project a 2 percent growth in 2022-23. They project that the minimum guarantee will be increased by $11.6 billion, indicating growth of 12.4 percent compared to the 2021 Budget Act. After factoring in the required reserve deposit, COLA, and costs for previous commitments, $9.5 billion is available for new commitments.

Public School System Stabilization Account

Under these assumptions, the state would make a $3.1 billion deposit into the Proposition 98 Reserve in 2022-23. The 2021 Budget Act estimated that the Proposition 98 Reserve balance would exceed 3 percent of funding allocated in schools for 2021-22, thus triggering the reserve cap in 2022-23. The LAO projects that the balance will remain above the specified threshold, therefore maintaining the reserve cap.

Other policy issues raised by the LAO

The LAO highlights several opportunities -- and risks -- as the Legislature and Governor head into the budget cycle this January.

Enrollment and attendance trends. The 2021-22 average daily attendance (ADA) is projected to have declined approximately 3 percent compared to pre-pandemic levels. The LAO makes several assumptions in projecting ADA in the coming years. They anticipate a decline in the school age population due to declining birth rates, and an increase in students due to the expansion of Transitional Kindergarten over the next several years. When accounting for the expansion of Transitional Kindergarten, the LAO projects a growth in average daily attendance (ADA) that will raise statewide attendance to be slightly above the pre-pandemic level by 2025-26.

Long-standing enrollment declines, combined with higher rates of absenteeism during the pandemic, are likely to create a precarious fiscal situation once the current hold-harmless for school districts expires. The LAO predicts an attendance-driven drop in the LCFF of $1.8 billion (2.5 percent) in 2022-23. The effects of attendance and enrollment impact county offices in a more direct manner, as they do not have a one-year soft landing and many have not reached their LCFF target level.

Supporting Existing Commitments. The 2022-23 Cost of Living Adjustment (COLA) is projected to be 5.35 percent. The total cost for providing the COLA for K-14 programs will be $4.4 billion. The COLA in future years is anticipated to be closer to the annual average, at 3.5 percent in 2023-24 and 3 percent in 2024-25.

The 2021-22 Budget Act created four new commitments -- the Expanded Learning Opportunities Program, Transitional Kindergarten (TK) expansion, universal meals, TK staffing, and special education backfill -- that will create $8.2 billion in annual costs by 2025-26. Only one of those programs (TK expansion) will generate adjustments to the minimum guarantee.

Special education at the forefront. The political water can get choppy when proposing changes to long-standing programs like special education. But for policy makers seeking to ease a path to reform, a significant budget surplus can be like wind in their sails.

Pension liabilities continue to rise. Employer pension obligations are estimated to increase by about $1.4 billion for K-12 employers in 2022-23. Climbing contribution rates will coincide with the expiration of prior relief from non-Proposition 98 general fund in 2019-20. Legislators may wish to again smooth or reduce these ongoing liabilities.

A caution on new ongoing commitments. If higher inflation continues to persist, the annual COLA increases to new and existing programs could quickly consume expected budget growth. A mild economic downturn would accelerate this issue.