COMMUNITY COLLEGE UPDATE

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Preparing Multiyear Financial Projections in the Current Environment

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The Legislative Analyst's Office (LAO) recently updated its California Economy & Taxes blog and highlighted that preliminary tax collections have come in approximately 5% ahead of budget projections with income tax withholding "surprisingly stable." However, other state tax categories do not appear to be faring as well. The LAO's analysis of credit and debit card spending, which provides some indication of sales tax revenue, shows that the tax bottomed out in March and April of 2020 and has since begun recovering. That said, one can imagine that the repeated closures of retail businesses due to the rising number of COVID-19 cases throughout the state could slow that recovery. The LAO's blog also opines on the state's economy as a whole. Similar to the sales tax trend, the economy experienced an unprecedented decline in March and April and started to recover in May and June of 2020, though more recent data suggests employment has declined since then.

Proposition 98

Why are we discussing state tax revenues and the economy in an article about your multiyear financial projections? Because the state of the economy and tax revenues directly impact education funding as determined by Proposition 98. Through a series of complex formulas that take changes in K–12 average daily attendance and inflation adjustments—as measured by the change in either per capita personal income or per capita state General Fund revenues, whichever is less, Proposition 98 establishes the minimum funding level for K–12 education and community colleges from one year to the next. So, as the economy goes, so go state revenues and, subsequently, education funding.

Similar to what we recommend for community colleges for preparing multiyear financial projections going forward at least three years, the state's budget also tracks revenues and expenditures over a three-year period—the difference being that the state looks at the two prior years and the current year. After years of historic growth, with the 2020–21 State Budget, the Proposition 98 minimum guarantee has decreased significantly for the most recent prior year (2019–20) and the current year (2020–21), resulting in an almost 10% reduction over the three-year period and a $6.8 billion year-over-year decrease (from $77.7 billion in 2019–20 to $70.9 billion in 2020–21).

Deferrals and Reserves

The state, however, was able to stave off significant budget cuts to education largely through the implementation of deferrals and the use of reserves—both of which directly impact how you plan for the next three years as you prepare your multiyear financial projections during this time. We say this because deferrals and reserves are solutions that can only be used once—at least, until the economy and state revenues recover enough to buy the deferrals down and sock away additional reserves.

It is looking less likely that more federal bailout funds will be received in order to buy down some of the deferrals. Given that, we believe that additional deferrals implemented after this year will need to be minimal, or else many community colleges will be pushed to the brink of insolvency. To put this in perspective, during the Great Recession, cash deferrals were implemented over several years, totaling $961 million. In this first year of the COVID-19 induced recession, the deferrals of $1.4 billion already far exceed this amount. At the local community college district level, this means that only about 70% of the state aid from the various programs will be received in the current year. How much less cash can community colleges operate on and remain solvent?

Factors for Multiyear Planning

What follows is an excerpt from the most recent version of our 2020–21 Financial Projection Dartboard:

Factor	2019–20	2020–21	2021–22	2022–23	2023–24
Statutory Cost-of-Living Adjustment (COLA) for Student Centered Funding Formula (SCFF) and Latest DOF Projections*	3.26%	2.31%	2.48%	3.26%	N/A
Funded COLA	3.26%	0.00%	N/A	N/A	N/A
SSC-Estimated Statutory COLA	3.26%	2.31%	0.60%	0.70%	1.60%
SSC's Recommended Planning COLA	3.26%	0%	0%	0%	0%

*Department of Finance (DOF) projections carried forward from May Revision

Note that the "SSC-Estimated Statutory COLA" percentages for 2021–22 through 2023–24 are much lower than the latest estimates provided by the DOF, which were prepared before the May Revision. This is because we used more current economic factors to develop our estimated COLAs.

However, the most important row in the table above is the bottom row. Based on economic projections at the time this information was prepared, the Proposition 98 minimum funding level was not expected to recover to the 2019–20 level during the forecast period, which is why we are recommending that community colleges plan on no funded COLA in the out years.

Now, as we consider that California has once again closed down much of its commerce due to COVID-19 concerns, we are even more concerned about what our state policymakers will be faced with as the 2021–22 Governor's State Budget Proposal is prepared for its January 2021 release. If suppressed economic activity persists, the option to use additional deferrals or reserves will be limited and likely not a significant part of the solution. Funding and program cuts could very well be headed our way. Remember that the Governor's 2020–21 May Revision proposed smaller deferrals, but a 7.92% year-over-year cut in SCFF revenues (a 10% cut including the unfunded COLA of 2.31%). Also consider that community colleges can have funding deficits due to shortfalls in local property taxes, student enrollment fees, and/or Education Protection Account funds in a given year.

Conclusion

Because of all these considerations, we recommend that community colleges prepare "what if" scenarios when preparing multiyear projections, including potential cuts in funding starting in 2021–22. It will be important to evaluate the impact of these different scenarios on your district's fiscal health so that contingency plans can be prepared.

We will continue to monitor developments in the economy and state revenues, and at each State Budget juncture we will continue to update our Financial Projection Dartboard to reflect the latest information. In the meantime, please do not hesitate to contact us if we can be of further assistance as you prepare your multiyear projections or for other budget support.