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COMMUNITY COLLEGE UPDATE

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Proposition 98—The Road Ahead, Part 2

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In our recent *Community College Update* article, Proposition 98—The Road Ahead, we attempted to measure the potential gap that exists between current program expenditures and the minimum guaranteed funding calculated under Proposition 98 in 2021–22. We are continuing this conversation by expanding on some of the underlying factors that lead to a $6.2 billion shortfall.

Defining the Shortfall

The current recession and the precipitous decline in the Proposition 98 minimum guarantee was sudden and immediate with a drop in the minimum guarantee of $3.7 billion in the middle of 2019–20 that the state addressed through an unplanned K–14 deferral. However, the impact will continue to reverberate into the future.

	2020–21
Current Program	$80.9
Proposition 98 Funding	$70.9
Projected Shortfall	$10.0
Note: Dollar amounts are in billions	

The gap was filled by introducing more than $12 billion in budget deferrals from 2020–21 to 2021–22. Although the deferrals are assumed to continue in an ongoing manner, the question becomes: Why is there still a budget gap if Proposition 98 is projected to increase? The simple answer is that budget deferrals only generate a one-time savings for the state. The table below illustrates this concept.

	2020–21	2021–22
Current Program	$80.9	$80.9
On-Going Budget Deferrals	-$12.5	-$12.5
Repay Prior Year Deferrals		$12.5
Other Adjustments	$2.5	-$6.2
Proposition 98 Minimum Guarantee	$70.9	$74.7
Note: Dollar amounts are in billions		

The budget deferrals in 2020–21 will be repaid in the months of July 2021 through November 2021, in addition to the normal principal apportionment payments for 2021–22. Effectively, local educational agencies (LEAs) will receive a significant influx of state aid over this period, but more importantly the deferrals will occur again in February 2022 through June 2022 unless the state dedicates resources to pay them down. Because of the repayment of the 2020–21 deferrals in 2021–22, the on-going deferrals in the second half of the year do not provide any budget savings for the state beginning in 2021–22. Using the economic assumptions from the 2020–21 Enacted State Budget, the minimum guarantee will grow to $74.7 billion leaving a gap of $6.2 billion between current spending levels and the budget year minimum guarantee.

LAO Updates

The Legislative Analyst's Office (LAO), the Legislature's non-partisan budget and policy advisor, provides an economic update highlighting some stark differences between the economic assumptions used for the 2020–21 Enacted Budget and what's happened since. Tax collections for the "Big Three" state taxes—personal income, sales and use, and corporation taxes—for the period of April 2020 through August 2020 are more than $6 billion ahead of projections, and income tax withholdings through October 2020 are slightly ahead of the withholdings at the same point in 2019. Recall that Governor Gavin Newsom assumed that the "Big Three" taxes would decline by more than 20% from the 2019–20 year. The LAO cautions that risks still abound, but the recovery thus far is well ahead of the Enacted Budget assumptions.

Options for January

The Governor will ultimately decide what revenue projections to use in the January State Budget Proposal, but the data points highlighted by the LAO will make it difficult to maintain the assumptions used under the 2020–21 Enacted State Budget. Assuming that the Governor increases his revenue assumptions, the anticipated Proposition 98 shortfall of $6.2 billion will decrease because the minimum guarantee will be determined by Test 1, which is approximately 38 percent of general fund revenues.

The LAO contemplates two scenarios: (1) if the minimum guarantee rises to the level at or greater than current program expenditures, or $80.9 billion, the state could avoid program cuts, or new deferrals, and potentially eliminate some of the existing deferrals; or (2) if the minimum guarantee is less than current program expenditures, the state could mitigate this by either imposing additional deferrals, reducing current spending (cuts), or spending above the minimum guarantee.

In terms used by the LAO, there are three plausible planning scenarios for LEAs: (1) flat funding, with no cost-of-living-adjustment (COLA); (2) flat funding, no COLA, and additional deferrals; or (3) small year-over-year funding decrease, with no additional deferrals.

Conclusion

The prudent pathway for those responsible for ensuring the fiscal solvency is to provide several scenarios, knowing that the Governor can go a few different ways in January. Flat funding with no additional deferrals is likely the ceiling of what can be expected, absent a robust recovery and a vaccine and effective therapies for COVID-19. More likely is the existence of a gap between current program spending levels ($80.9 billion) and the Proposition 98 minimum guarantee which could take the form of additional deferrals or spending cuts.

The November election and the weeks thereafter will go a long way towards shaping the Governor's economic assumptions that will be used in the January State Budget Proposal for 2021–22.