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COMMUNITY COLLEGE UPDATE

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LAO Offers Initial Reaction to May Revision

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Within days of the release of Governor Gavin Newsom's 2020–21 May Revision proposal, the Legislative Analyst's Office (LAO) issued its initial impressions of the revised spending plan based upon the Governor's latest economic projections. The LAO's assessment is generally favorable to the approach the Governor is taking to tackle California's historic budget problem while raising a few nuanced concerns worth noting.

The May Revision utilizes an assumption that state revenues will decline from the estimates used to inform the Governor's January State Budget proposal by $41 billion over the budget window, which include fiscal years 2018–19 through 2020–21. You may recall that this estimate aligns more closely to the LAO's L-shaped recession scenario included in its *Spring Outlook* report. This revenue shortfall is compounded by increased state spending obligations as a result of caseload adjustments to government-supported programs. When combining declining revenues with increased costs, the May Revision proposal assumes that California faces a budget problem in excess of $54 billion going into 2020–21.

The LAO highlights that, after taking into account the cornucopia of solutions to address the state's budget problem, the May Revision would leave California with a positive ending fund balance of nearly $2 billion in the state's reserve for economic uncertainties—or one of the state's rainy day funds—which cannot be less than zero at the time of budget enactment and has historically been used by the state to respond to unforeseen disasters such as wildfires. While that may be a good thing in the eyes of some, others may argue that this is not a time to be stashing away cash for a rainy day—that we don't need forecasters to tell us that a fiscal torrential downpour is heading our way in just a few short weeks.

As we at School Services of California Inc. have been reporting, the LAO distills the Governor's approach to the state deficit as a multi-year effort using a combination of tools, including:

- Budget adjustments that do not require legislative action
- Using state reserves
- Increased revenues
- Reducing spending across all budget-supported programs
- Adjusting the Proposition 98 minimum guarantee to reflect the constitutional spending requirement
- Reducing state spending obligations
- Shifting costs (e.g., K–14 apportionment deferrals)
- Using federal funds

The LAO notes that $15 billion in one-time and ongoing cuts included in the May Revision are subject to "trigger off" provisions in the event that the federal government provides at least $14 billion in additional aid. Also, to avert the need for deeper reductions, the Governor proposes the draw down of $7.8 billion from the Budget Stabilization Account in 2020–21; however, none of it is proposed to be used to shield K–12 education and community colleges from cuts or deferred state payments. Instead, the Administration recalculates the Proposition 98 minimum guarantee based on the state's revised estimates and then proposes to reduce it from the January estimates by a total of $17.5 billion across fiscal years 2019–20 and 2020–21. That said, the LAO is quick to point out that Governor Newsom proposes a suite of mitigating actions that arguably leaves funding for K–12 education and community colleges relatively flat from current year (2019–20) levels. These mitigating efforts include the use of deferred state payments to local educational agencies, the canceling out of proposals included in the January State Budget proposal, and the use of $5.8 billion in federal relief funds—which, while benefitting K–12 education, does little if anything to benefit community college districts.

One of the bigger mitigating measures included in the May Revision is the proposal to repurpose funds the state intended to use to reduce California State Teachers' Retirement System (CalSTRS) and California Public Employees' Retirement System pension contributions rates over time for K–12 and community college employers in 2020–21 and 2021–22. The May Revision proposes to similarly supplant state contributions while also proposing to suspend the authority of CalSTRS to increase the *state's* contribution rate from 2020–21 through 2023–24—a dangerous precedent, according to the LAO.

The other proposal drawing criticism from the LAO is the Administration's proposal to provide supplemental payments to Proposition 98 equal to 1.5% of General Fund revenues beginning in fiscal year 2021–22, up to $13 billion to help hasten K–14 education's recovery from the COVID-19 recession. The LAO argues that the constitutional formulas that determine the state's obligation sufficiently account for economic growth and that providing the supplemental payments create a higher outyear obligation for the state.

Outside of some of these nuanced concerns, the LAO believes that the Governor's use of budgetary tools to address California's budget crisis is reasonable given the magnitude of the problem we must tackle in the absence of a state printing press, despite being the fifth largest economy in the world.

As a reminder, the Legislature has until June 15 to pass a budget and present it to Governor Newsom for action. We will keep you apprised of budget deliberations through our *Community College Update*.