Budget Update: Governor's 2012-13 Proposal

Governor Brown surprised everyone by releasing his proposed 2012-13 budget on January 5th rather than on the 10th, as has been the custom. The Governor identifies an initial deficit of $9.2 billion ($4.1 billion carried over from the 2011-12 year) which he proposes to close through a combination of deep programmatic cuts and a temporary revenue increase that would need to be approved by the voters on the November ballot. <u>There are no reductions proposed for the California Community Colleges, contingent on the passage of the November initiative. If the initiative fails, however, the Colleges would be subject to significant trigger cuts in the middle of the year.</u>

The Budget Summary notes that operational deficits that had been in excess of $20 billion just a year ago have been significantly reduced to the extent that, even without any new solutions, the operational gap would be reduced to $5.1 billion in 12-13 (this figure excludes the prior year debt) and would be under $2 billion as of 2014-15. While the state's fiscal condition is stabilizing, it is a very slow recovery that was further hampered by the European financial crisis and the federal debt limit debate. The summary notes that the state's General Fund revenues are not expected to return to 2007-08 levels until the 2014-15 fiscal year.

Closing the Gap

In order to close the budget gap, the Governor proposes the following programmatic reductions:

- <u>Health and Human Services</u> - $2.04 billion (includes reductions to Medi-Cal, CalWORKs, In-Home Supportive Services, and other programs.
- <u>Education</u> - $1.321 billion (includes $544.6 million in Prop 98 savings related to rebenching the Prop 98 guarantee to account for the elimination of sales tax on gasoline, plus $446.9 million in cuts to child care, and $301.7 million in reduction to Cal Grants).
- <u>State Mandates</u> - $828.3 million
- <u>Other cuts</u> - $27.3 million

The Governor further proposes temporary increases in the sales tax (one-half percent) and in personal income for filers with incomes over $250,000 for an annualized total of $6.9 billion, of which, approximately $4.4 billion would be collected during the 12-13 fiscal year. Other solutions total over $1.4 billion. All told, these solutions would eliminate the $9.2 billion deficit and provide for a reserve of $1.1 billion.

Proposition 98

Under the Governor's proposal, the Prop 98 guarantee would be funded at $52.5 billion, up from $47.8 billion in the 2011-12 fiscal year. This increase is highly dependent on the passage of the temporary taxes. Without voter support, the guarantee would drop to $47.7 billion due to the severe trigger cuts (described in more detail below). The Governor expresses a desire to provide more control to local K-12 districts regarding educational decisions, including the elimination of many categorical and mandated program requirements.

California Community Colleges

The budget would augment base funding for the California Community Colleges by $218.3 million (assuming passage of the November initiative – detail on trigger cuts below). This increase is targeted toward buying back a portion of the $961 million in total year-over-year deferrals that have been assigned to the system. There is no new funding proposed for growth, COLA, or for restoration of the categorical programs that were reduced in the 2009-10 budget. There is also no new proposal to increase student fees beyond the $46 per-unit level. The budget does include a current year Proposition 98 General Fund reduction of $146.9 million in CCC apportionments to reflect an identical increase in offsetting property taxes resulting from the elimination of redevelopment agencies, so the change is intended to be neutral.

Further, the Governor proposes to consolidate all categorical programs into a single budget schedule and allow districts the flexibility to use the dollars for any categorical purpose (we are told there will be protection for DSPS and Foster Care Educational Program funding). The Governor also proposes to eliminate nearly half of all existing mandates and create a $200 million K-14 mandates block grant program to incentivize districts to continue providing any remaining mandated duties.

The Governor proposes to provide annual funding increases of at least 4% to CCCs (as well as UC and CSU) for the fiscal years 2013-14 through 2015-16. Again, these increases are subject to voter approval of the tax initiative in November. Additionally, the Budget Summary notes that the Governor will review the recommendations of the Student Success Task Force and will explore ideas for expanding CCC operational flexibility and fee management for inclusion in the May Revision.

Higher Education (Non-CCC)

The Governor proposes no new reductions or funding increases for UC and CSU, except in the event that the triggers are pulled. In that case, UC and CSU will each receive a $200 million reduction.

Cal Grants

The Governor proposes nearly $302 million in savings from the Cal Grant program. Approximately $59 million would be saved by lowering grant awards to $4,000 for students attending private, for-profit schools. An additional $112 million would be saved by lowering the award amount for students attending independent, non-profit schools to the CSU award amount.

Additionally, $131.2 million would be saved by raising Cal Grant GPA requirements. Among the changes, CCC transfer students would now need a GPA of 2.75 rather than the current 2.4.

More Triggers

For the second year in a row, the Governor proposes to make the budget financeable through the use of automatic trigger reductions. If the Governor's proposed revenue plan is rejected by the voters in November, a total of $5.390 billion in reductions would be enacted as follows:

- Prop 98 - $4.837 billion

- UC and CSU - $400 million
- Courts - $125 million
- Forestry/Fire - $15 million
- Fish & Game - $3.5 million
- Parks - $2 million
- DOJ - $1 million

For Proposition 98, the reductions would include the elimination of the deferral buyback ($218.3 million for CCCs, and an additional $2.2 billion for K-12), and other unspecified program cuts to accommodate the absorption of $2.6 billion in outstanding GO debt repayment costs.

While adding the debt repayment obligations into the Proposition 98 guarantee requires rebenching, the impact of that rebenching only increases the guarantee by about $200 million (reflecting allocations provided in the 1986-87 fiscal year), so absorbing $2.6 billion in debt service requires a net K-14 programmatic reduction of $2.4 billion. Assuming CCCs account for 11% of that figure (the exact amount has not been confirmed at this time), the system would be subject to a reduction of about $264 million beyond the loss of the deferral repayment for a total potential midyear reduction of $482.3 million. While more detail is needed to confirm the exact figure, the trigger reduction would certainly represent a major midyear hit to the system.

Clearly, under the Governor's proposal, passage of the November tax initiative is absolutely crucial to the security of our budget.

Conclusion

The Governor's proposed 2012-13 budget shows a slowly recovering economy that, combined with recent budget reductions, has helped narrow a gaping budget deficit. The Governor expresses a desire to cede control of many programmatic decisions from the state to local entities. While the Governor indicates a willingness to provide stable funding streams to higher education, his ability to do so is contingent on voter approval of new revenues.

It is also far from clear how easy it will be to convince the Legislature to go along with some of the proposed reductions. There are already indications that the Senate is not willing to make any cuts until May Revision, while the Governor is hoping that some will be enacted as early as March. A further caution is that the Governor's base revenue projections are more optimistic than those from the Legislative Analyst's Office's November Revenue Outlook. If the Department of Finance's projections are too high, funding proposed for the CCCs may disappear as the budget process progresses. We are not out of the woods, yet.

Please note that, at this point, our office has received only summary descriptions of the budget proposal. All of the preceding comments may be subject to revision as more details are revealed. Naturally, we will keep you posted of any significant changes to our understanding of the proposal as they become available to us.