California Community Colleges
2015-16 Budget Workshop
The Economy, Revenues, and Proposition 98

Presented by:
Robert D. Miyashiro, Vice President
Michelle McKay Underwood, Director, Legislative Services

July 28 and 30, 2015
The World Economy

- Greece and China have been in the headlines lately

- Greece teeters on the brink
  - A deal keeping Greece on the Euro is uncertain
  - Its economy is the size of Ohio, but a “Grexit” could destabilize the European Union

- China is a big problem
  - Their stock market plunged 30% between June and mid-July
  - China’s economy is second only to the U.S.
The U.S. economy continues to add jobs

- 280,000 jobs added in May
  - On average, about 200,000 jobs per month have been added during the past year
  - Professional and business services, leisure and hospitality, and health care account for most of the gain
- The unemployment rate in May was 5.5%, unchanged from April

First quarter 2015 Gross Domestic Product (GDP) was not as weak as initially estimated

- The severe winter on the east coast had been blamed for the drop in GDP, estimated at -0.7%
- The most recent revision puts first quarter GDP decline at -0.2%

However, unemployment is still a big challenge, especially for some groups
U.S. Unemployment Rate

May 2015

<table>
<thead>
<tr>
<th>Ethnicity</th>
<th>Unemployment Rate</th>
</tr>
</thead>
<tbody>
<tr>
<td>Asian</td>
<td>4.1%</td>
</tr>
<tr>
<td>White</td>
<td>4.7%</td>
</tr>
<tr>
<td>Hispanic</td>
<td>6.7%</td>
</tr>
<tr>
<td>African American</td>
<td>10.2%</td>
</tr>
<tr>
<td>Teenagers</td>
<td>17.9%</td>
</tr>
</tbody>
</table>

U.S. Average: 5.5%

Since the release of the May Revision, the California economy continues to show strength.

The state added 54,200 jobs in May, outperforming the U.S. average.
- If the state had added only its proportionate share of jobs based on population, it would have gained 35,000 jobs.

California’s unemployment rate in May was 6.3%, still above the U.S. average.
- One year ago, the state’s unemployment rate was 7.5%.

The state’s housing market continues to strengthen.
- The statewide median home price in April was $481,800, up 7.4% from April 2014.
- Residential building permits are up almost 21% for the first four months of 2015, compared to the same period one year ago.
- UCLA’s June 2015 report forecasts continuing growth in both the U.S. and California economies.

- Though rising, the price of oil is still below last year’s level:
  - The lower price is equivalent to a $150 billion tax cut.
  - For California, this equates to about $18 billion, or $1,850 in savings for a family of four.

- U.S. GDP is expected to increase at a 3% rate for the remainder of the year.

- UCLA expects the Federal Reserve (commonly referred to as “The Fed”) to raise short-term interest rates 0.25% beginning in September, ultimately reaching a target rate of 3.75% by late 2017.

- Recently, California job gains have outpaced the nation, even in regions that have traditionally lagged.
California Regional Job Gains

April 2014 to April 2015

Source: UCLA Anderson Forecast, June 2015
In January and May, we focus on the Governor’s State Budget proposals. But the Legislature plays an important role in shaping the state’s spending plan and developed its own proposal through the Conference Committee process.

On June 15, the Legislature met its constitutional requirement to approve the Budget Bill – Assembly Bill (AB) 93 (Chapter 10/2015) – which had some significant differences compared to Governor Brown’s proposals:

**Increased:**
- Proposition 98 Level
- Local Control Funding Formula (LCFF) Gap Closure
- Transportation and After School Education and Safety (ASES) Programs
- Preschool/Child Care

**Decreased:**
- Discretionary Dollars
- Charter Facility Grant Program
- Internet Infrastructure Grants
A day later, an agreement was reached between legislative leadership and Governor Brown

- As in years past, Governor Brown’s revenue forecast prevailed
  - Meaning reductions to AB 93 would need to be made to bring the 2015-16 State Budget in line with the Administration’s forecast

Along with a dozen implementing trailer bills, Senate Bill (SB) 97 (Chapter 11/2015) was amended on the day of the announced negotiated deal

- Dubbed “Budget Jr.,” SB 97 reduces spending levels to reflect the negotiated agreement levels
  - Reductions were made in LCFF gap funding, one-time discretionary funding, child care and preschool slot increases, and other funding areas
STATE OF CALIFORNIA

I gave at the office. ... Now, was it 1983-84 or was it 1981-82?

TRANSPORTATION

Back in 1988...
Despite the Legislature’s attempt to build the 2015-16 state spending plan based on the higher revenue forecast of the Legislative Analyst’s Office (LAO), the Governor’s Department of Finance (DOF) forecast prevailed.

- 2014-15: $111.3 billion, up 8.9% from 2013-14
- 2015-16: $115.0 billion, up 3.3% from 2014-15

The LAO had forecast $3.1 billion more than the DOF for 2015-16.

- The biggest difference was in the outlook for the personal income tax:
  - DOF forecasts a 3.1% or $2.3 billion increase
  - LAO forecasts a 7.9% or $6 billion increase

Which forecast will ultimately be more accurate?
General Fund Revenues – Budgeted vs. Actual

(In Billions)

<table>
<thead>
<tr>
<th>Year</th>
<th>As Enacted</th>
<th>At May Revision, 10 months later</th>
</tr>
</thead>
<tbody>
<tr>
<td>2013-14</td>
<td>$97.1</td>
<td>$102.2</td>
</tr>
<tr>
<td>2014-15</td>
<td>$105.5</td>
<td>$111.3</td>
</tr>
<tr>
<td>2015-16</td>
<td>$115.0</td>
<td>???</td>
</tr>
</tbody>
</table>

Per LAO
General Fund revenues for June 2015, the last month of the 2014-15 fiscal year, came in a whopping $815 million above the May Revision forecast.

- The personal income tax accounted for 90% of the gain.

After adjusting for a minor shortfall in May, the state closed out the fiscal year $732 million above the revised level.

- This amount boosts the beginning balance of 2015-16.
Revenues and transfers are budgeted to increase only 3.3%

Proposition 98 expenditures actually decline $192 million

The reserve for economic uncertainties and the budget stabilization account together is 4% of revenues and transfers

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Prior-Year Balance</td>
<td>$5,589</td>
<td>$2,423</td>
</tr>
<tr>
<td>Revenues and Transfers</td>
<td>$111,307</td>
<td>$115,033</td>
</tr>
<tr>
<td>Total Resources</td>
<td>$116,896</td>
<td>$117,456</td>
</tr>
<tr>
<td>Non-Proposition 98 Expenditures</td>
<td>$64,865</td>
<td>$65,953</td>
</tr>
<tr>
<td>Proposition 98 Expenditures</td>
<td>$49,608</td>
<td>$49,416</td>
</tr>
<tr>
<td>Total Expenditures</td>
<td>$114,473</td>
<td>$115,369</td>
</tr>
<tr>
<td>Fund Balance</td>
<td>$2,423</td>
<td>$2,087</td>
</tr>
<tr>
<td>Reserve for Encumbrance</td>
<td>$971</td>
<td>$971</td>
</tr>
<tr>
<td>Special Fund for Economic Uncertainties</td>
<td>$1,452</td>
<td>$1,116</td>
</tr>
<tr>
<td>Budget Stabilization Account</td>
<td>$1,606</td>
<td>$3,460</td>
</tr>
</tbody>
</table>

Source: 2015-16 State Budget Summary, page 8
With the enactment of Proposition 98 in 1988, voters amended the State Constitution to set a minimum funding level for K-12 education and community colleges, based on changes in workload and inflation

- Workload is measured by changes in K-12 average daily attendance (ADA)
- Inflation is measured by:
  - Test 1: Percentage share of General Fund revenues
  - Test 2: Per-capita personal income growth
  - Test 3: Per-capita General Fund revenue growth, plus 0.5%

The Governor’s May Revision proposed to fully fund Proposition 98, without manipulations or reinterpretations of the constitutional provisions

- 2014-15 minimum guarantee: $66.3 billion, based on Test 1
- 2015-16 minimum guarantee: $68.4 billion, based on Test 3
● While the Legislature had sought to use a higher Proposition 98 level based on the LAO’s higher revenue forecast, ultimately the Governor’s May Revision estimates were adopted for both the current year and for 2015-16.

● The Legislature, however, did prevail with regard to funding for full-day State Preschool:
  - Shifted $145 million in General Child Care funding from outside of Proposition 98 to State Preschool funding within the guarantee so that local educational agencies (LEAs) can “access a single funding stream (Proposition 98) in their full-day State Preschool contracts”

● The Legislature, however, did not re-bench the Proposition 98 guarantee for these former non-Proposition 98 costs:
  - In order to pay for this, the Legislature lowered the amount provided for LCFF gap closure in 2015-16 by $182 million, or about $30 per ADA.
Programs Funded Within Proposition 98

May Revision

- California Community Colleges
- Special Education
- Child Nutrition
- Other Programs

LCFF

Final State Budget

- California Community Colleges
- Special Education
- Child Nutrition
- Other Programs
- Full-Day Preschool
- $145 million

LCFF

$68.4 Billion

© 2015 School Services of California, Inc.
What to Expect in January 2016

- Our expectations are that state revenue projections for 2015-16 are understated
  - We would expect that at either next year’s January Budget or May Revision, Governor Brown will announce more one-time dollars
  - If we are right about revenues, the maintenance factor will be paid off in 2015-16 and our share of new revenues in future years will drop
- The economics for 2016-17 still look good; we expect continued progress toward the LCFF target – but, stand by until Governor Brown declares his intentions
- Our recommendation:
  - Think conservatively

“Be cautious when others are greedy and greedy when others are cautious.”

–Warren Buffett
I hope it gets into orbit before the boosters fall off!
The Next Recession – When and How Severe?

● What will cause the next recession?
  ❑ The collapse of debt in Greece, Puerto Rico, or Spain?
  ❑ The drought, fires, and power shortages in the western states?
  ❑ Another oil-driven energy crisis?
  ❑ Nuclear threats by Iran or North Korea?
  ❑ Terrorism or warfare by ISIS or other “U.S. haters”?
  ❑ Rising inflation spurred by burdens placed on U.S. employers for sick leave, overtime pay, healthcare, and minimum wage?
  ❑ Regular corrections in the U.S. or world economies?

● We ask the question differently: What is the probability that we avoid all of these factors for one year? Two years? Three years?
  ❑ We think that probability is low and we need to be prepared for a correction
The 2015-16 enacted State Budget shifts $145 million in costs for general childcare into Proposition 98, thus relieving the non-Proposition 98 side of the State Budget of that cost.

While earlier this year the LAO suggested a methodology for reducing the state’s obligation to schools by up to $600 million, we were pleased that Governor Brown did not accept that recommendation at the May Revision; likewise, we were disappointed that he accepted this proposal in the enacted State Budget.

As a matter of policy, we believe the state has an obligation to “re-bench” Proposition 98 whenever added programs or costs are to be charged to Proposition 98.
The financial impact of the shift is mitigated by the extraordinarily large increases in funding for schools this year.

- But that hasn’t always been true when costs have been shifted to Proposition 98.

- And we see the potential for more shifts in the future, just as growth in school funding will predictably slow.
● 2015-16 is another banner year for K-12 education and the community colleges under Proposition 98

● The Administration’s conservative revenue forecast will likely yield billions in one-time funding, similar to what occurred in 2014-15

● Sooner or later, the economy will slow
  □ Proposition 30 revenues expire beginning in 2016

● Prudent fiscal management will guide you through the next downturn
Thank you