

# Research Brief

December 3, 2021

## Summary of LAO Fiscal Outlook for 2022-23

Each November, the Legislative Analyst's Office (the non-partisan advisor for the state Legislature) prepares a fiscal outlook in anticipation of the state budget process that kicks off in January with the governor's budget proposal. There is a fiscal outlook prepared for the state budget as a whole, and one focused on Prop. 98 and K-14 education spending specifically. This summary of the reports is for union leaders.

*For reference, see:*

- The 2022-23 Budget: California's Fiscal Outlook | <https://lao.ca.gov/Publications/Report/4472>
- Fiscal Outlook for Schools and Community Colleges | <https://lao.ca.gov/Publications/Report/4473>

### ANTICIPATED STATE BUDGET SURPLUS: \$31 BILLION

Revenues are growing at historic rates and LAO estimates the state will have a \$31 billion surplus (available revenue in excess of current law commitments) to allocate in 2022-23. An operating surplus (after accounting for revisions to the 2021-22 budget) of \$5.2 billion is estimated for 2022-23. Operating surpluses in the range of \$3-8 billion per year are also expected for the coming few years.

The surplus is a result of revenues being higher than expected (especially income/sales/corporation taxes), and spending being lower than expected (especially from changes to Medicaid funding and transportation costs related to legislation that did not pass). General Fund revenues are estimated to be \$28 billion above the June 2021 estimates.

### \$20 BILLION FUNDING SURGE FOR SCHOOLS AND COMMUNITY COLLEGES

The Prop. 98 guarantee for 2022-23 is estimated to be \$11.6 billion (12.4%) above the 2021-22 enacted budget. LAO estimates \$9.5 billion will be available for new commitments and \$10.2 billion will be available for one-time spending — due to revised guarantee amounts for 2020-21 and 2021-22. This totals about \$20 billion available for allocation in the upcoming budget.

### PROP 98: 2020-21 AND 2021-22

For 2020-21 and 2021-22, the LAO estimates increases in the minimum guarantee of \$1.8 billion and \$8.9 billion, respectively. Test 1 is in effect.

The Prop. 98 reserve deposits required for last year and this year are also revised, and result in an overall increase to the Prop. 98 reserve.

The revised calculations mean an estimated \$10.2 billion in one-time Prop. 98 funding will be required to “settle up” and these funds could be allocated for any school or community college programs.

## OUTLOOK FOR 2022-23 TO 2025-26

The LAO forecast shows state revenue growth to continue but be more moderate over the coming months. This would mean the minimum guarantee grows to \$105.3 billion in 2022-23; this is 12.4% higher than the enacted budget this year, and 2.6% above the revised amount. Figure 5 from the report summarizes the outlook and is copied below.

The minimum guarantee estimates reflect anticipated changes to state General Fund revenue, growth in local property tax revenue, and the funding to support the planned expansion of Transitional Kindergarten.

## Proposition 98 Outlook Under Main Forecast

(Dollars in Millions)

	2021-22	2022-23	2023-24	2024-25	2025-26
<b>Minimum Guarantee</b>					
General Fund <sup>a</sup>	\$75,399	\$76,660	\$77,146	\$81,644	\$87,777
Local property tax	27,279	28,661	30,188	31,838	33,524
<b>Totals</b>	<b>\$102,678</b>	<b>\$105,321</b>	<b>\$107,334</b>	<b>\$113,482</b>	<b>\$121,302</b>
<b>Change From Prior Year</b>					
General Fund	\$5,950	\$1,261	\$486	\$4,499	\$6,133
Percent change	8.6%	1.7%	0.6%	5.8%	7.5%
Local property tax	\$1,465	\$1,382	\$1,527	\$1,650	\$1,686
Percent change	5.7%	5.1%	5.3%	5.5%	5.3%
Total guarantee	\$7,415	\$2,643	\$2,013	\$6,148	\$7,819
Percent change	7.8%	2.6%	1.9%	5.7%	6.9%
<b>General Fund Tax Revenue<sup>b</sup></b>	<b>\$198,365</b>	<b>\$200,575</b>	<b>\$200,290</b>	<b>\$210,272</b>	<b>\$223,301</b>
<b>Growth Rates</b>					
K-12 average daily attendance <sup>a</sup>	-2.5%	1.1%	1.1%	0.9%	0.3%
Per capita personal income (Test 2)	5.7	5.1	4.1	3.2	3.3
Per capita General Fund (Test 3) <sup>c</sup>	9.6	1.6	0.0	4.9	6.1
<b>Proposition 98 Reserve</b>					
Deposit (+) or withdrawal (-)	\$3,488	\$3,123	\$1,145	—	—
Cumulative balance	5,147	8,270	9,415	\$9,415	\$9,415
<sup>a</sup> Estimates account for the expansion of Transitional Kindergarten eligibility over the 2022-23 through 2025-26 period.					
<sup>b</sup> Excludes non-tax revenues and transfers, which do not affect the calculation of the minimum guarantee.					
<sup>c</sup> As set forth in the State Constitution, reflects change in per capita General Fund plus 0.5 percent.					
Notes: Test 1 is operative throughout the period. No maintenance factor is created or paid.					

## RESERVES

The LAO forecast expects the state to make required deposits into the Prop. 98 Reserve of \$3.1 billion and \$1.1 billion in 2022-23 and 2023-24, respectively. The funding levels in the current year triggered the local district reserve cap for 2022-23. The forecast assumes the cap will be in effect through at least 2025-26.

This cap on local reserves affects medium and large districts with reserves of more than 10%. To achieve this, there are provisions in the law that allow districts to designate reserves for specific purposes, request exemptions, or spend down the reserves. It does not affect community colleges or K-12 basic aid districts.

## COLAS AND INFLATION

The statutory COLA is currently estimated at 5.35% for 2022-23; this would translate to \$4.4 billion for schools and community colleges next year. The actual statutory COLA is based on a formula and will not be known until spring 2022. The LAO’s analysis forecasts the following COLA rates, and assumes inflation will moderate over the next year (an assumption that is aligned with most economic forecasts).

	2022-23	2023-24	2024-25	2025-26
Estimated COLA	5.35%*	3.5%	3.00%	3.00%

## ATTENDANCE

The LAO outlook assumes there will be about 3% lower ADA this year, relative to pre-pandemic levels. Then, over the next four years, the analysis shows overall ADA will rise again to slightly above the pre-pandemic levels by 2025-26. Their forecast assumes falling attendance due to declining birth rates (about 170,000), an expansion of TK that adds 230,000 students by 2025-26, and a recovery of about 140,000 students

The state is on schedule to return to the policy of applying the higher ADA of the prior or current year. At the district level, declining attendance next year is being reported by some districts. As a result, the LAO projections assume a reduction of about 2.5% in LCFF funding. The lower ADA does not affect the total overall funding allocated through the minimum guarantee.

Community colleges are also experiencing enrollment losses, however there are “hold harmless” provisions in place so that this would not affect minimum SCFF funding next year.

## STATE APPROPRIATIONS LIMIT (SAL)

The LAO expects the SAL to be an influential factor in the state budget development process this year. The SAL restricts how revenues above a certain threshold (determined by a formula) can be used. When the SAL is in effect, the requirements can be met through lowering tax revenues; taxpayer rebates and additional spending on K-14 education; or spending more in areas excluded from the SAL (e.g, debt service, court mandates, capital outlay).

The impact of the SAL on schools and community colleges will depend on actions the Legislature takes. Some options would add funding to the Prop. 98 guarantee while others could reduce the guarantee. We should expect to hear a lot more about the SAL during the coming budget discussions.

## PENSION CONTRIBUTIONS

The LAO forecast shows the **state** contribution rate to CalSTRS will increase by the maximum allowable for the next few years. This is based on CalSTRS' most recent actuarial analysis. However, last year, CalSTRS experienced significantly higher than anticipated investment returns – 27% compared with an assumed rate of 7%. The next actuarial report will not be available for several more months, but the pension fund is projecting that these returns will result in a dramatic decrease in the state contribution rate over the next few years. For CalPERS, the LAO forecast uses the projected state contribution rates published for the April 2021 CalPERS meeting. CalPERS also had higher than anticipated investment returns last year, which were not factored into the April report, and the CalPERS board will be adopting new actuarial assumptions. Therefore, the LAO forecast regarding CalPERS rates is also unlikely to hold up.

However, **district employer** contribution rates are determined through different formulas and rules; the windfall returns are not expected to reduce employer contribution rates. Rather, the CalSTRS and CalPERS employer contributions are expected to increase in 2022-23. For technical details, the LAO has an in-depth report on CalSTRS funding and contribution rates.

*See:* Update on the Progress of the CalSTRS Funding Plan | <https://lao.ca.gov/Publications/Report/4475>

## LAO RECOMMENDATIONS

The LAO offers a number of comments for the Legislature, highlighting options for the Legislature to consider. These include the following ideas:

- Allocate additional funds to K-12 schools, such as through the Expanded Learning Opportunities program created in the 2021-22 budget; Add-Ons to the LCFF; Special Education reforms.
- Allocate additional funds to community colleges, such as through increasing funding for SCFF; funding facility maintenance; offering more direct student support.
- Spend funds to address pension liabilities and costs.
- Funding to improve climate resiliency and emergency preparedness.
- Additional reserve deposits.

However, remember these are not budget proposals. The next step in the budget process is the release of the governor's budget proposal in January, and this will be followed by several months of legislative budget hearings.

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