MEMORANDUM
November 19, 2020

Via Email

TO: California Community Colleges - All

FROM: Lizette Navarette, Vice Chancellor, College Finance and Facilities Planning

RE: Analysis of the 2021-22 LAO Fiscal Outlook

Chancellor's Office Analysis of the 2021-22 LAO California Fiscal Outlook

Background

On November 18, the nonpartisan Legislative Analyst's Office (LAO) released the annual publication, *California's Fiscal Outlook*, including the revenue summaries for the first quarter of the fiscal year as well as a five-year fiscal forecast. The release of the report serves as a prelude to the annual budget deliberation process that begins every January with the release of the Governor's Budget Proposal.

Every year, state policymakers anticipate the *Fiscal Outlook* report as a first look at state revenue and spending commitments affecting the General Fund. Through an analysis of the economy, *Fiscal Outlook* outlines possible state revenue and spending trajectories over the next five years. For education stakeholders, the LAO's analysis of Proposition 98 provides an insight into potential revenue growth or downturns. The report also discusses policy choices faced by the state, including debt repayment, budgetary commitments, and economic conditions.

The 2021-22 *Fiscal Outlook* follows a 2020 Budget Act which responded to an abrupt recession prompted by the coronavirus disease 2019 (COVID-19) beginning in March 2020 which resulted in a $54.3 billion shortfall in the state budget. The lower revenue estimates led to a $13.6 billion drop in the Proposition 98 guarantee ($3.4 billion in 2019-20 and $10.2 billion in 2020-21).

Following is the California Community Colleges Chancellor's Office analysis and perspective on the LAO's *Fiscal Outlook* report.

Economic Conditions

California has entered the ninth month of the pandemic with few indications of a return to "normal" life. The surprising, yet positive, *Fiscal Outlook* projections are released against the backdrop of another strict shutdown amid the fastest increase in COVID-19 cases since spring. This week alone, 41 of the state's 58 counties were placed in the strictest of the four-tier system for reopening based on virus cases and infection rates.

Prior month economic data however is not as grim as anticipated. The November 2020 Department of Finance (DOF) Finance Bulletin reports that state revenues continue to outperform earlier projections. Following a tumultuous spring of high unemployment, U.S. jobs continue to steadily recover. In October 2020, national unemployment was 6.9% compared to its peak of 14.7% in April. For California, the housing market continues to be a bright spot in the economy with single family housing activity up. Additionally, resources previously spent on untaxable services appear to have been expended on taxable goods.

State Budget Outlook: Improved But Cautious

California faces the dichotomy of an economic recovery that exacerbates inequalities for our most vulnerable residents while further enriching the wealthy. In many ways, the LAO's report corroborates this concern. For example, professional industries have done particularly well. The stock market surpassed its pre-pandemic level in August and many technology companies experienced strong growth. What remains to be seen is the impact on low-wage workers and individuals relying on temporary relief, such as unemployment insurance, who experienced job losses at higher rates and remain unemployed. Of concern is a finding that employment is not expected to fully recover until 2025 or later.

While still below pre-pandemic levels, the LAO estimates a more positive budget outlook than anticipated in the 2020 Budget Act. Between August and October 2020, collections from the state's three largest taxes were 22 percent ($11 billion) ahead of budget act assumptions. Similarly, the DOF November Bulletin also reports that, year-to-date, the state has accrued $11.3 billion more in revenue than originally assumed in the 2020 Budget Act and that each of the "big three" taxes are higher than previous expectations. These positive returns lead to a one-time $26 billion recovery.

However, the State faces an operating deficit by 2021-22 with revenues from the state's big three growing at less than 1 percent while General Fund expenditures grow at an average 4.4 percent per year. The result is an operating deficit of around $17 billion by 2024-25. This is important context to keep in mind as the California Community Colleges continue to advocate for greater support of our students through the Cal Grant program.

Proposition 98 Outlook

For education, Test 1 is expected to be operative in 2021–22 and in the near future. Under this scenario, Proposition 98 receives just over 38% of every new state dollar. Based on stronger revenue projections, the LAO estimates the guarantee grows to $84.6 billion in 2021-22, up $13.7 billion from the $70.9 billion in the 2020-21 enacted budget. Specifically, the LAO projects the 2020-21 guarantee (current year) is up $13.1 billion (18.5 percent) over the 2020 Budget Act. They estimate the 2021-22 guarantee is up another $595 million (0.7 percent). The LAO also estimates the state would be required to make an additional $2.3 billion supplemental payment on top of the guarantee in 2021-22.

Using the approximate 11 percent statutory split for community colleges, and to the extent these revenues materializes and the Governor agrees with these estimates in his January budget, colleges could receive an estimated $1.5 billion in one-time funds for the 2021-22 fiscal year.

Debt and Educational Deferrals

Given total K-12 and Community Colleges deferrals of $12.6 billion ($1.45 billion deferred for community colleges), the $13.7 billion estimated Proposition 98 rebound is just enough to retire 2020-21 deferrals. The state also continues to operate an education budget deficit as funding is still below pre-pandemic levels. As a result, these higher revenues only shrink the deficit margin for future years.

A 1.14 percent statutory cost-of-living adjustment (COLA) is estimated. Covering the 1.14 percent statutory COLA would cost nearly $900 million for K-14 education.

LAO Projected COLA Rates	
2021-22	1.14 percent
2022-23	1.36 percent

Higher Education Issues

While the report provides a more optimistic assessment compared to what we saw in the budget approved in June, it is still an estimate with a great deal of uncertainty. Growing pension costs continue to be a primary concern for community colleges. District contribution rates for CalPERS will increase 3 percent to 23 percent by 2021-22. In 2021-22, district costs are likely to increase by at least $200 million. The CalSTRS and CalPERS contribution rates are as follows:

Year	CalSTRS	CalPERS
2020-21	16.15%	20.7%
2021-22	16%	23%

After the one-time employer contribution rate relief expires in 2022-23, district pension costs are expected to grow significantly. For 2022-23, the contribution rates currently are projected to grow more than 2 percent of pay for CalSTRS and nearly 4 percent of pay for CalPERS.

Enrollment

The LAO report again illustrates a steady decline in K-12 average daily attendance. While this trend is not new, it may begin to materialize in higher education. It is critical trend to note as future enrollment growth may also need to come from individuals who haven't recently been in an education setting, including adult learners and those seeking workforce pathways.

Analysis

California Community Colleges rapidly mobilized in response to the coronavirus pandemic, converting from in-person to remote or online instruction for nearly every course. However, as a system of 2.1 million students, California Community Colleges we still face many challenges in adapting to multiple technologies and strategies, including financial aid, to serve the state's most vulnerable and deeply affected populations.

Given the uncertainly and threat posed by the ongoing pandemic, prudence is encouraged until resources fully materialize. The *Fiscal Outlook*, however, presents an important finding – the opportunity to retire community college payment deferrals adopted in the June 2020 Budget Act. Paying down deferrals could improve cash flow for colleges and protect ongoing programs in case the guarantee drops in the future. Further, the report illustrates resources for some modest investments that support continuity of education and a more equitable recovery, all which align with the California Community Colleges 2021-22 System Budget Request.