May Revise, 2012-13

The Big Picture:

The Budget shortfall, which in January was $9.2 billion, is now estimated at $15.7 billion. Why has the problem increased?

- CY revenues were $4.3 billion short of January estimates
- The Prop 98 Guarantee has grown by $2.4 billion over the 2-year period.
- The federal government and court decisions have removed about $1.7 billion in potential savings solutions.

The Governor proposes $4.1 billion in new spending reductions in the May revise, bringing total proposed reductions to $8.3 billion.

Proposition 98:

Prop 98 grows to about $54 billion in the 2012-13 fiscal year, up from the $52.4 billion estimated in January.

Why does P98 grow when revenues are down? Because the Governor merged his tax initiative with the Millionaire’s Tax initiative, the initiative would generate more revenue in the 12-13 year ($8.5B rather than $6.9B). Also, the P98 calculation is driven on year-over-year growth, so diminished CY revenues makes the year-over-year percentage change higher.

CCCs:

While there are still a number of assumptions and moving pieces to sort through, the Governor does not make major changes to his January proposal for the California Community Colleges. The increased growth of the P98 guarantee (assuming successful passage of the November ballot initiative) would continue to be used to buy down the cost of deferrals. Under May Revise, $313M in deferrals would be bought down, while only $218M was proposed in January. Given the major reductions absorbed in recent years, we believe it is reasonable to request any new money should go to supporting student services and adding back course sections.

The Governor continues to pursue his proposal to consolidate categorical funding and to revise the current FTES funding model, though we note that the Legislature has shown little interest in these proposals. Similar to January, there is no proposal to fund growth, COLA, or increase funding for categorical programs.

The Governor proposes to fund the $48 million in SB 70 programmatic money through Proposition 98 in the Budget Year. Generally, these funds, part of the QEIA agreement, have been funded as non-Prop 98. This proposal would help save the state money on the non-Prop 98 side of the budget.

The Governor also alters his mandates block grant reform proposal to include two newly adopted mandates and increase the funding per FTES to $28. Total funding proposed is $33.4 million. Further,
the Governor would eliminate the mandate claiming process, which would more or less force districts to participate in the block grant program (or file suit, perhaps...).

RDAs – The Governor now anticipates $116M in current year property tax revenue, as opposed to the $146.7M estimated in January, due to the dissolution of RDAs. We remain concerned that these dollars will not materialize as estimated and that enacting the General Fund cuts may add to the current year deficit.

Triggers:
If the November initiative fails, K-14 education is slated for a trigger cut of nearly $5.5 billion. The CCCs would lose the $313M in deferral repayments mentioned earlier and then take an additional base cut of approximately $300 million. We note the Governor has not broken down the triggers between K-12 and the CCCs, so we are assuming an 11% share of the reduction. A base reduction of that magnitude would represent an approximate workload reduction of 6%. Clearly, this would be a devastating hit to our colleges.

Cal Grants:
The Governor maintains the $311 million in cuts to Cal Grants that he proposed in January. The May Revise further proposes to restrict Cal Grant awards to institutions that graduate students at a rate of at least 30% and where default rates are below 15%. Our initial understanding is that this new proposal will not impact the CCCs.

Current Year Deficit:
In February, the Chancellor’s Office had the regrettable duty to inform the CCC community that the P1 report showed a deficit of $179 million, of which $149 million was unanticipated (the other $30 million was a statutory trigger cut).

While the Governor does not address the issue in his May Revise proposal, we can report that the deficit will be lower at P2. While not final, we believe the revised deficit will be approximately $125 million. The improvement in the situation comes from a modest increase in fee revenues and from the San Mateo Community College District’s shift into basic aid status. Overall, the statewide deficit will decrease from approximately 3.3% to approximately 2.4%. We still have significant work remaining to finalize P2, but we thought it best to communicate this news as quickly as possible for planning purposes.

Conclusion:
The Governor chooses to spend the higher growth in the Prop 98 guarantee to pay down more deferrals. This does not seem like the best use of new dollars given the needs of the CCC districts, students, and the state. We will work with the Administration and the Legislature to shift these funds back into program so we can serve more students and serve them better.
Just as the January proposal included many risks, so does the May Revise. We remain concerned about the estimates of new property tax revenues that owe to the dissolution of RDAs. We are also concerned about the lack of specificity of the triggers. The Governor does not specify the K12/CCC split trigger split. Also unanswered is the impact of adding SB 70 funding to Proposition 98 – would those $48 million need to be tacked on the trigger in order to make room within the guarantee? That has not yet been answered. Further, the May revise includes significant new reductions to Medi-Cal, IHSS, state employee compensation, and other areas. If the Legislature is unwilling to make some or all of these cuts, would they consider cuts in Proposition 98?

Of course, the biggest uncertainty remains the willingness of the voters to pass the November tax initiative. A recent poll showed the proposal passing at 54% of the vote. While a full campaign has not yet been run for the initiative, generally, successful ballot initiatives tend to start out with a higher level of support early on. Further, the Molly Munger initiative appears to have enough signatures to also make the ballot. Will competing initiatives split the support vote or turn off enough voters to kill the Governor’s initiative? It’s too early to say. It should further be noted that the Munger initiative would cancel out the Brown initiative if it receives a higher vote total, so CCCs could also be subject to trigger cuts in a scenario where the Brown initiative reaches 50% but receives less support than the Munger initiative.

Clearly, the CCC budgets look much better with the successful passage of Governor’s initiative than without it. At this point, I cannot recommend that districts assume that the ballot initiative will pass. The outcome is too uncertain, and the repercussions of making drastic midyear are too large. I strongly advise districts to budget very cautiously for the 2012-13 fiscal year.

I will provide more information to you as it becomes available.

Regards,

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