

## 2013-14 May Revision

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Association of Chief Business Officials

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### Themes for the May Revision

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- Economic growth, though the pace is slow, and the passage of Proposition 30 provide the state with more revenue in 2012-13
  - But Governor Jerry Brown projects slower growth for 2013-14
- The level of Proposition 98 is increased by the higher revenues
  - Much of the increase is used to quicken the pace of deferral buy backs
  - Programmatic funding in 2013-14 is increased minimally over the Governor's January proposal
- Details provided on the community college augmentation proposal
- The state recognizes a substantial increase of \$4.5 billion in revenues for 2012-13, most of which are committed by statute to Proposition 98
  - The Governor has the responsibility for determining how much of the revenue is one time or ongoing, and then adjusting his State Budget proposal accordingly
  - No major increases are proposed for any area of the State Budget other than education

## The Rest of the Budget

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- Additional current-year and budget-year funding for K-12 education
  - Major finance reform proposal remains on the table
  - One-time, current-year augmentation of \$1 billion for implementation of Common Core State Standards
- An additional \$467 million in Medi-Cal costs primarily due to the federal government and courts rejecting or delaying approval of previously adopted legislative actions
- State short- and long-term borrowing costs decreased by \$484 million
- An additional \$72 million for county probation departments as they assist the state in lowering its prison population
- An additional \$48 million for California Work Opportunity and Responsibility to Kids (CalWORKs) for job training and subsidized employment opportunities

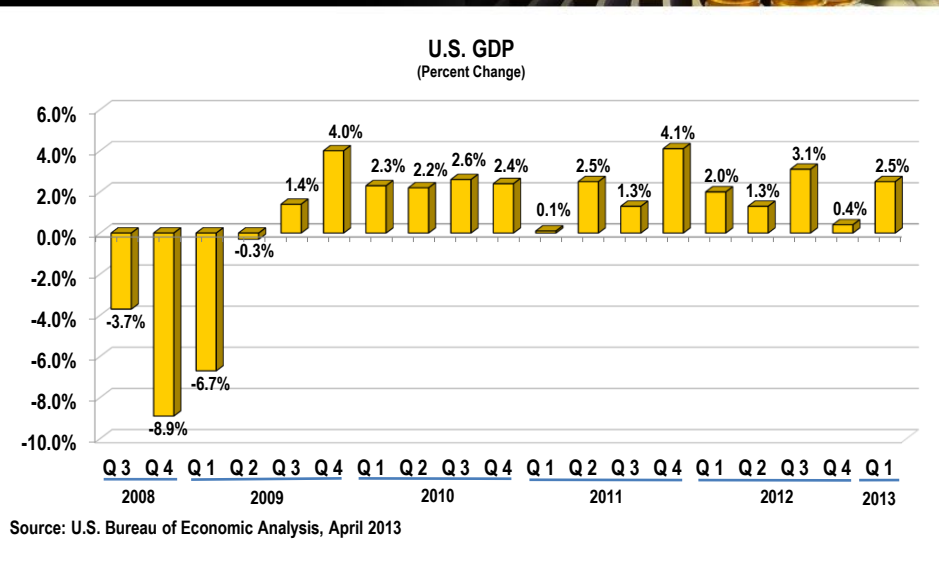
## The National Economy

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- The U.S. economy is beginning to ramp up
  - UCLA projects gross domestic product (GDP) to increase from 2% annually in the current year to 3% in 2014 and beyond
    - Unfortunately, this is below the 4% to 6% rates of prior recoveries
- Strength is attributed to:
  - Historically low interest rates
  - Rising prices in the housing market
    - Multifamily housing is particularly strong
  - Increasing auto sales, with the vehicle fleet the oldest on record
- But risks remain:
  - Federal sequestration and the long-term budget deficit
  - Recessions in Europe and Japan
  - Higher payroll and income taxes and the Affordable Care Act (ACA) implementation
  - International financial or political crises

## U.S. Economic Outlook

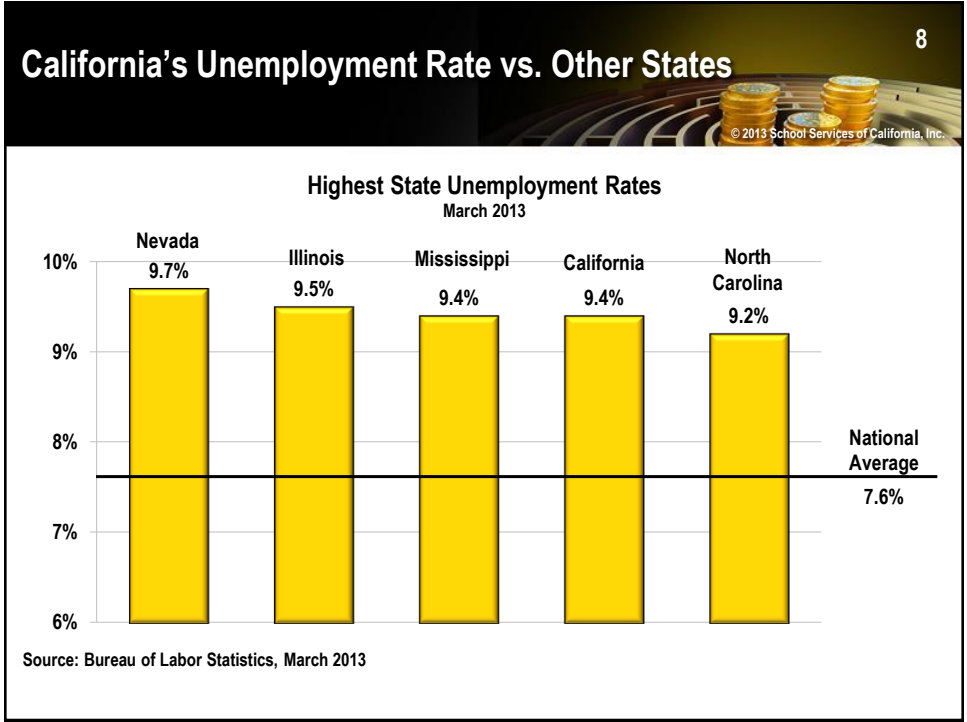
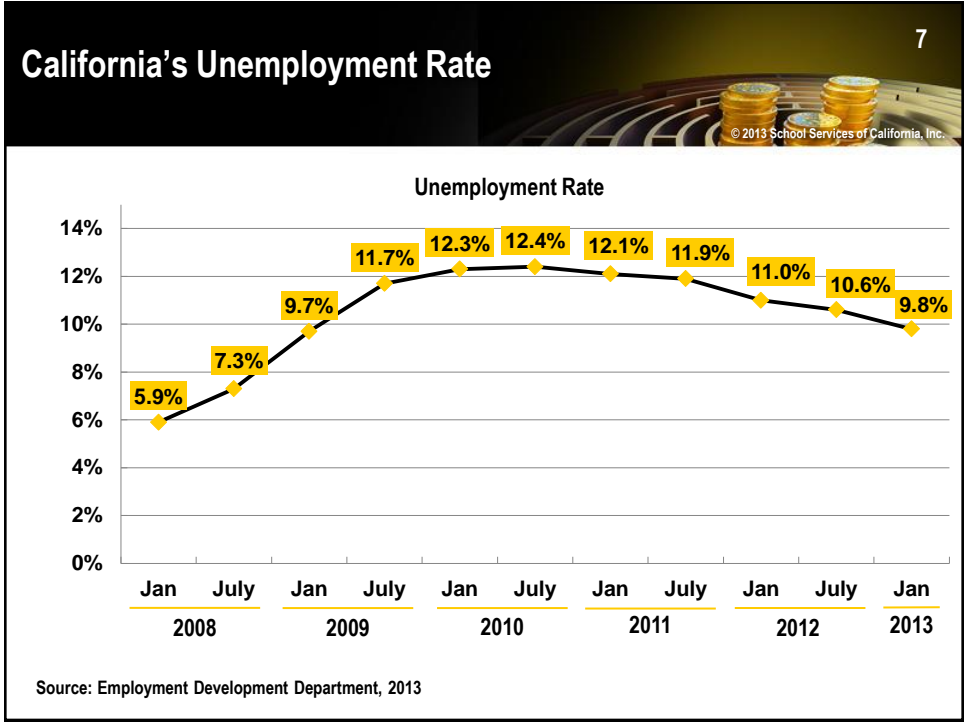
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## The California Economy

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- The California economy continues its slow path of recovery
  - Inflation-adjusted personal income is expected to increase 1.4% in 2013 and 3.6% in 2014, according to UCLA
  - By 2014, the California unemployment rate is expected to fall to 8.4%, one percentage point higher than the U.S. rate, but 1.4% lower than currently
- Of concern, however, is the bifurcated path of the state economy
  - The inland regions are characterized by continuing high unemployment and ailing housing markets
  - The coastal regions enjoy relatively low unemployment, improving housing markets, and higher average incomes
  - This situation has led to out migration from the inland counties and net inflows into coastal counties



## Budget Risks Are Lower in 2013-14

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- Compared to prior years, the proposed 2013-14 State Budget faces considerably less risk of falling out of balance
  - Unlike the 2012-13 spending plan, it is not dependent upon voter approval of a major tax initiative
    - Proposition 30 provides both sales tax and income tax revenues
  - Unlike the 2011-12 State Budget, it is not dependent upon an unrealistic revenue projection
  - The plan does not rely on an infusion of federal funds to maintain programs
  - It is not reliant on unrealistic operational efficiencies in state programs
  - The overall economic outlook is the best it has been in more than five years

## The Administration's Downward Revision

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- The Governor's May Revision paints a more pessimistic economic outlook in 2013 and 2014
- On the plus side, the forecast acknowledges:
  - The economy was gaining strength in the first quarter of this year
  - The unemployment rate continues to fall, and jobs are being created
  - The housing market is recovering
  - Inflation remains low, and business profits are up
- However, the January Budget assumed that the federal lawmakers would avoid across-the-board tax hikes and budget cuts
  - Tax rates for high-income earners have risen, and the payroll tax holiday was allowed to expire
  - Sequestration cuts have been imposed

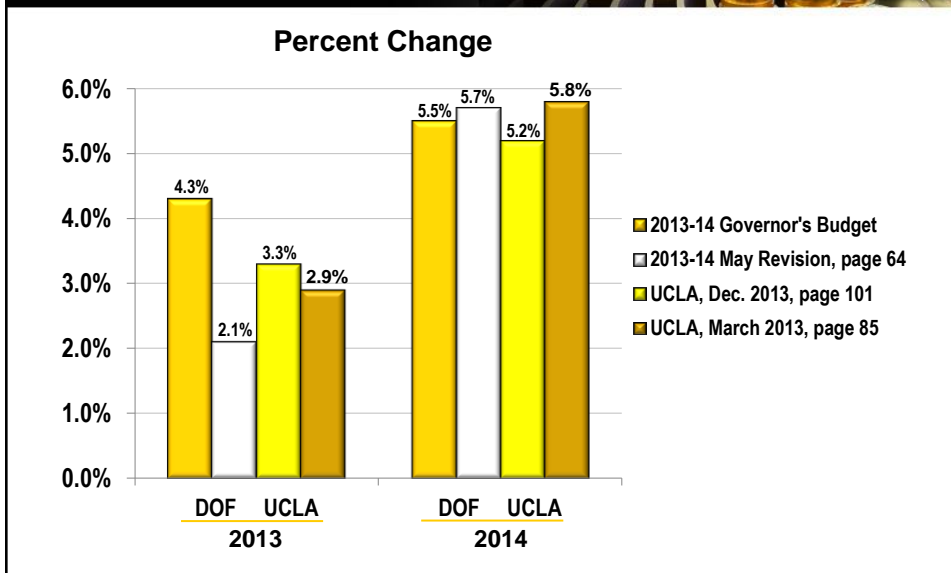
Slower Growth in 2013-14

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- As a result of the drag that the federal tax hikes and spending cuts will have on the economy, the Department of Finance (DOF) has lowered the outlook for California personal income growth in 2013 from 4.3% in January to 2.1% in the May Revision
- This slowdown in the economic outlook in turn lowers the revenue forecast for 2013-14
  - Total 2013-14 General Fund revenue drops \$1.3 billion from the January estimate to \$97.2 billion
    - Each of the three major taxes are revised downward
- A rebound, however, is forecast to begin in 2014-15, with the three major taxes combined expected to grow 9.3% in that year and 6.7% in 2015-16

California Personal Income Forecast

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## General Fund Revenues — Current Year

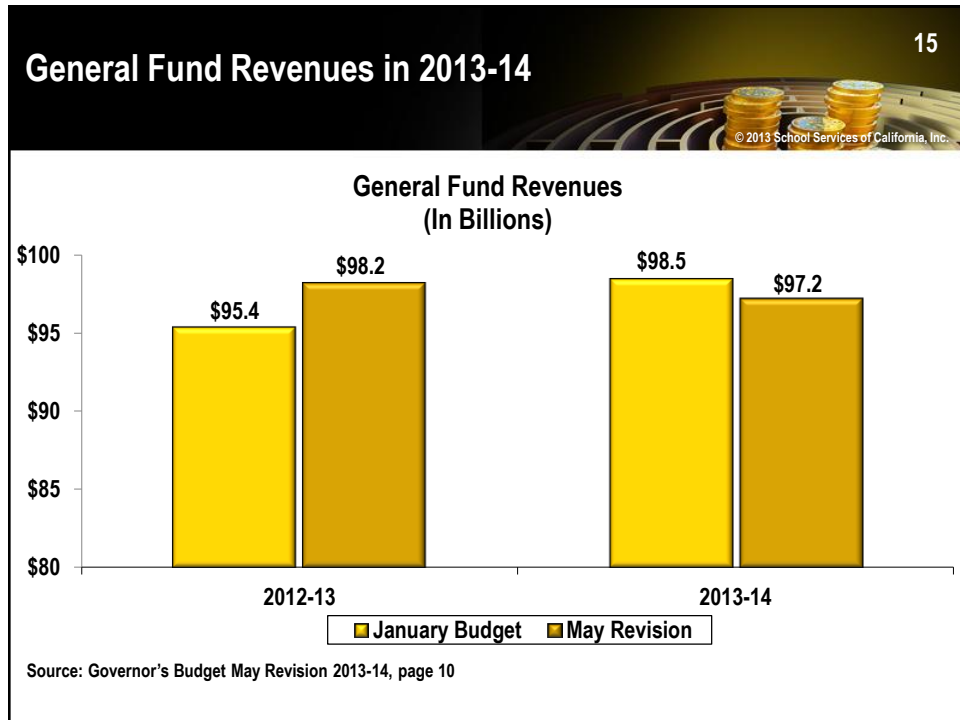
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- Two major tax increases have combined to boost current-year revenues above the Governor's Budget forecast:
  - The passage of Proposition 30 in November 2012, which raised the sales tax on all consumers and the income tax on high-income earners
  - The increase in federal tax rates for high-income earners, causing an acceleration of income recognition
- Also, an improving economy is adding payroll jobs, but there may be a decline in hours worked per week
- These factors have resulted in an upward revision in current-year General Fund revenue of \$2.8 billion
- The question for state revenue forecasters: How much of the current-year gain has come at the expense of 2013-14 revenues, and how much will be ongoing?

## General Fund Revenues in 2013-14

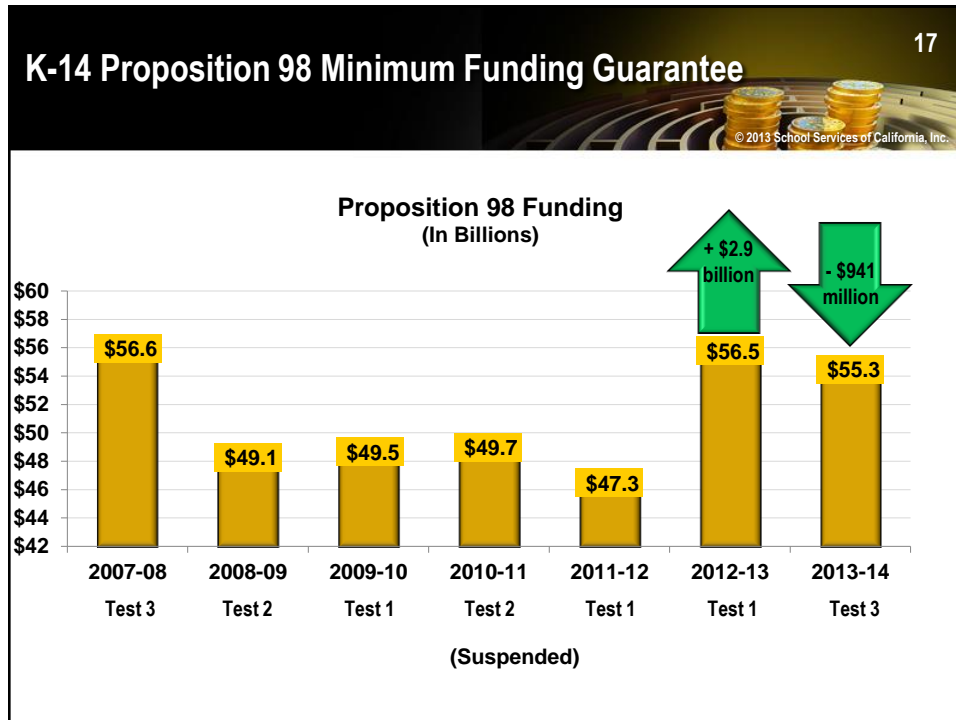
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- The January Governor's Budget forecasted General Fund revenues and transfers in 2013-14 of \$98.5 billion, a 3.3% gain over the expected current-year total, reflecting an expanding economy
- The May Revision, however, lowers the forecast for the budget year to \$97.2 billion, a reduction of \$1.3 billion from the January estimate
  - With this revision, General Fund revenues decline 1% from 2012-13
    - Most of this decline is in the personal income tax, with the outlook for capital gains income falling significantly
- The Administration's long-term forecast, however, shows a substantial boost in 2014-15, with revenues from the three major taxes growing a combined 9.3%, or almost \$8 billion



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- ### Proposition 98 Minimum Funding Guarantee
- Compared with the January Budget:
    - The 2012-13 Proposition 98 minimum guarantee increases by \$2.9 billion, to a total of \$56.5 billion – a 5.4% increase since January and a 19.5% change from 2011-12
    - For 2013-14, Proposition 98 *declines* by \$941 million, to \$55.3 billion
  - What changed?
    - \$4.5 billion in revenues, unanticipated for the current year, boost 2012-13
    - Pessimistic economic outlook depresses revenue forecast for the remainder of this year and into 2014, causing Proposition 98 to drop in the budget year





- ### In Broad Strokes
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- Apportionment increase increased
    - Allocated to cost-of-living adjustment, restoration, and student success
  - Adult education proposal withdrawn
    - Proposes status quo for two years
    - Intent to reinvestment in 2015-16
  - Deferrals buy down accelerated
  - Proposition 39 funding increase to reflect additional revenues
  - 90-unit cap and census date policy proposals removed
    - Instead “process to develop a broad-based framework to improve student success and establish appropriate incentives”
  - Postpones proposal to require that each student be required to fill out a Free Application for Federal Student Aid and include both parent and student income

**Comparing the Proposals**

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	January	May Revision
<b>Apportionment Increase</b>	\$196.9 million	\$226.9 million
<b>Allocation Methodology</b>	To be determined by the Board of Governors	\$87.5 million for the 1.57% cost-of-living adjustment (COLA) \$89.4 million (1.63%) for workload restoration \$50 million for student support services in accordance with the Student Success Act of 2012
<b>Deferral Buy Down</b>	\$179.9 million for cross-year deferrals	\$243.6 million total
<b>Timeline</b>	2013-14	\$179.9 million in 2012-13 \$63.7 million in 2013-14
<b>Deferrals Remaining After 2013-14</b>	\$621.2 million	\$557.5 million