


Association of Chief Business Officials
2016 Fall Conference

Economic Outlook and
the State Budget



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October 26, 2016

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- U.S. and California Economic Outlook
 - U.S. Gross Domestic Product (GDP) and Exports
 - State Labor Market
- State Budget Update
 - State Revenue Collections
- The November Election
 - Proposition 51 – School Bond
 - Proposition 55 – Tax Extension
 - The Legislature

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U.S. and California Economic Outlook

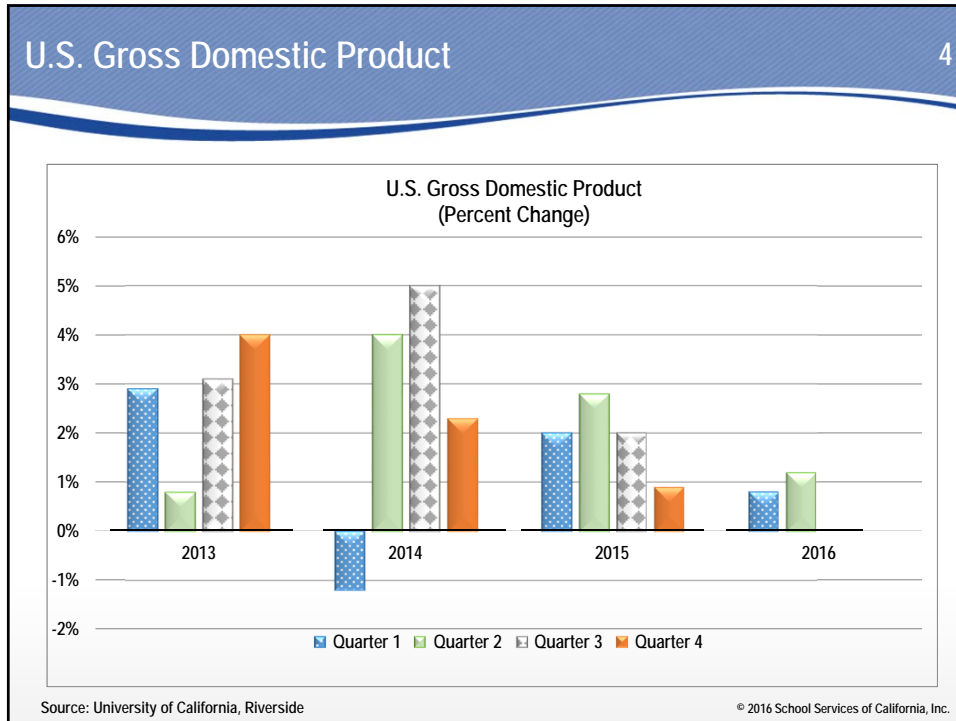
U.S. Gross Domestic Product and Exports
State Labor Market

Recent National Economic Developments

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- Gross Domestic Product (GDP), the broadest measure of the U.S. economy, has been growing weakly in the first two quarters of this calendar year
 - 0.8% growth in Quarter 1 and 1.4% growth in Quarter 2
- GDP growth has been slow
 - 2014 was 2.5%
 - 2015 was 2%
 - For 2016, University of California, Los Angeles (UCLA) had forecast a 3% increase
- UCLA's latest forecast for 2016 is for 1.5% growth
 - To blame: low productivity
 - Neither presidential candidate's policies will have an immediate impact

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- ### UCLA's Economic Forecast
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- UCLA sees a slow but expanding U.S. economy
 - 1.5% GDP growth in 2016 and 2.4% in 2017
 - Historically, GDP growth is in the 3% range
 - Most of this year's growth is due to strong consumer spending, but this cannot last forever
 - Auto sales are at record levels, but are expected to taper off
 - Business investment must pick up in the second half of the year
 - The big "wild card" is:
 - The global economy and exports
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Exports and the Global Economy

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- UCLA's forecast for U.S. export
 - In September 2015: Exports increase 4.2% in 2016 and 4.9% in 2017
 - In September 2016: Exports decrease -0.3% in 2016 and increase 3% in 2017
- Forecasters acknowledge that assumptions about the global economy are very risky, with many unknowns
 - Brexit and the consequences for Great Britain and the European Union
 - The fate of the Trans Pacific Partnership and a potential trade war
 - Middle East political and military turmoil
- California is a major export state and would suffer a global slowdown

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California Labor Market

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- California added 63,100 jobs in August, 18,600 jobs in July, and 40,300 jobs in June
 - This level is well above the amount needed to absorb population-related growth of about 10,000 to 15,000 jobs monthly
- The state's unemployment rate held steady in August at 5.5%, which compares to 4.9% for the U.S.
 - At the peak of the recession, California's unemployment rate was more than 2% higher than the U.S. rate
 - December 2009: California's rate was 12.4% versus 10% for the U.S.
- UCLA lowered its forecast for the California economy in 2016 from 3.8% growth in personal income to 2.6%; however, they raised the forecast for 2017 from 3.4% to 3.7%

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State Budget Update

State Revenue Collections

2016-17 Budget Act

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- The 2016-17 Enacted State Budget assumes modest revenue growth of 2.8% to \$120.3 billion and expenditure growth of 6% to \$122.5 billion
- Reserves total \$8.5 billion, including \$6.7 billion in the Budget Stabilization Account (BSA)
 - Governor Jerry Brown insisted on appropriating \$2 billion more than the required minimum contribution
 - The required minimum contribution to the BSA was \$1.3 billion
 - The BSA now stands at 54% of the maximum goal of 10% of General Fund revenues



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Rocky Start for General Fund Revenues

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- While the employment picture looks good, state revenues since the May Revision forecast have fallen short by just over \$920 million
 - Revenues for the 2015-16 fiscal year ended short of the forecast level by \$706 million
 - July short \$330 million; August up \$140 million; September short \$32 million
- The current shortfall stands in stark contrast to state revenues for the prior three years through August
 - 2015-16 up \$1.5 billion
 - 2014-15 up \$710 million
 - 2013-14 up \$2.2 billion



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Implications for the State Budget

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- It is still too early to conclude that a negative trend is developing, and this shortfall can be reversed in a few months
- Nevertheless, revenue collections, which underperformed a conservative forecast and weak national GDP growth for the first two quarters of 2016, do not inspire confidence in the broader outlook
- We'll closely monitor revenue collections month to month



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What to Watch 12

- We believe that it is important to:
 - Monitor General Fund revenue collections as reported by the Department of Finance in its monthly *Finance Bulletin*
 - Follow the performance of the Dow Jones and the S&P 500, given the market sell off in late January of this year
 - Though the market has more than recovered, California's progressive tax structure contributes to revenue volatility
- Also, watch the polling on Proposition 55, the measure to extend the high-bracket income tax
 - The 2016-17 State Budget assumes expiration of the temporary taxes; passage of Proposition 55 would boost state revenues in 2018-19

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The November Election

Proposition 51 – School Bond
Proposition 55 – Tax Extension
The Legislature

The November Election

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- The November election presents the voter with a multitude of key issues beyond the selection of the President of the United States
- In California, voters will decide the fate of 17 initiatives from carryout bags to the death penalty
 - The Official Voter Information Guide runs 224 pages
- Two measures will directly affect public K-12 education finance
 - Proposition 51 – School Facilities Bond
 - Proposition 55 – Extension of High-Bracket Income Taxes
- In addition, the makeup of the California Legislature could also affect future funding and policy for public education

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Proposition 51 – \$9 Billion School Bond

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- Proposition 51, the \$9 billion statewide facilities bond is on the November 2016 ballot, with \$7 billion for K-12 and \$2 billion for community colleges
 - Interest costs will total \$8.6 billion
 - General Fund will pay debt service of \$500 million per year for 35 years
- Additionally, more than \$25 billion in local education bonds will be on the November 2016 ballot



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School Facilities Funding

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- This last spring, the State Allocation Board (SAB) determined that state funds for new construction are no longer available, paving the way for the implementation of Level III developer fees
 - From 1998 through 2006 voters approved \$36 billion for K-12 facilities; these funds are now exhausted
 - But before the SAB could take the next step, the California Building Industry Association (CBIA) filed for a preliminary injunction and temporary restraining order to stop implementation
 - On August 22, 2016, the Honorable Michael Kenny issued a final ruling denying the CBIA's request
- The latest poll from the Public Policy Institute of California (PPIC) shows the measure with only 47% support

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Proposition 55 – Tax Extension

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- Proposition 55 extends the high-bracket income tax for 12 years until 2030
 - The ¼ cent sales tax will expire as originally planned
 - These funds boost the Proposition 98 guarantee and provide up to \$2 billion in additional funds for Medi-Cal
- The Legislative Analyst's Office estimates that the tax extension will generate General Fund revenues of between \$4 billion and \$9 billion annually
 - The tax extension will boost Proposition 98 funding compared to current law, which repeals the higher tax rates
 - However, the state's tax structure will become even more volatile with greater reliance on tax payments from the top income earners

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Proposition 55 – Tax Extension

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- Will Proposition 55 pass? Recent polling is unclear:
 - The PPIC shows support slipping from 58% in May to 54% in September
 - Field Poll shows support at 60% vs. 30% opposed as of September
- "Conventional wisdom" suggests that the measure is in trouble if support drops below 50% prior to the election
 - Governor Brown proved this conventional wisdom wrong on Proposition 30, which dropped below support 50% just weeks prior to the 2012 election
 - However, the Governor is not weighing in on Proposition 55
 - He insists it's up to the voters
- Education and hospital organizations are strongly backing the measure

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How Much Will My District Receive?

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- If Proposition 55 passes, how much will community college districts receive?
- Proposition 98 is based on three “tests,” which adjust funding for workload and inflation
 - If Test 1 (share of General Fund revenues) or Test 3 (change in General Fund revenues), the Proposition 55 revenues will boost Proposition 98
 - \$8 billion in Proposition 55 revenues will result in an increase in Proposition 98 of \$4 billion (full-year effect), with roughly \$400 million going to the community colleges
- With 1.176 million full-time equivalent students (FTES), community colleges districts could receive about \$340 per FTES

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The Legislature

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- The Legislature and the Governor establish educational policy and funding levels that shape the state’s education system
- This November, half of the Senate seats and all of the Assembly seats will be decided by the voters
 - There are 40 Senators and 80 Assembly members
- The original 1990 term limits led to significant turnover in the Legislature, reducing the influence of the Legislature compared to the Governor
 - In 2012, voters amended the term limits law to allow legislators to serve a maximum of 12 years, without regard to the legislative house
- Both houses of the Legislature have been controlled by the Democrats since 1970, with the exception of 1995 and 1996, when Republicans controlled the Assembly

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The Composition of the Legislature

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- The Democrats hold majorities in both houses, but they do not account for two-thirds of the membership
 - Assembly: 52 Democrats and 28 Republicans
 - Senate: 26 Democrats and 14 Republicans
- If Democrats pick up two seats in the Senate and one seat in the Assembly, they will have the necessary two-thirds majority to raise taxes without any Republican votes (the Budget is now passed by majority vote)
- Governor Brown, nevertheless, will remain in office for two more years and will likely prevail over the Legislature, regardless of the outcome of the 100 legislative races

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