Santa Clara COE CBOs' Meeting

Economic and Revenue Outlook
and
Preview of 2016 Political Issues

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Economic and Revenue Outlook

Legislative Analyst's Office and UCLA Forecasts

The LAO Forecasts Surpluses

- The Legislative Analyst's Office (LAO) released its five-year forecast of the economy, state revenues, and expenditures on November 18, 2015
  - It concludes that the State Budget is better prepared for a downturn than at any point in over 20 years
  - However, the LAO is not forecasting a recession
    - It has never predicted a recession; its forecasts are based on standard assumptions of moderate growth
  - State revenues are forecast to grow at an average annual rate of 3.7% through 2019-20, while expenditures grow at a 3.2% rate
    - An operating surplus of $3.9 billion could materialize by 2019-20

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LAO's Words of Warning

- The LAO's forecast is based on current law, including the expiration of Proposition 30 temporary tax revenues
  - The forecast does not assume the establishment of new programs or the expansion of existing programs
  - Eligibility for state entitlement programs, entrance into the state's higher education system, and incarceration into the state corrections system all assume current law requirements and restrictions
- The LAO warns that the current expansion will not last forever and that a sizable reserve is the key to managing the next downturn
  - Keeping state spending in check now will avoid deeper cuts when revenue growth slows

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Proposition 98 Outlook

- The LAO identifies a significant boost in the 2014-15 Proposition 98 guarantee of $1.3 billion and $739 million in 2015-16
  - This recent pattern has been repeated several years because the adopted State Budget has been based on the more conservative revenue forecasts of the Administration's Department of Finance (DOF)
  - The $6.6 billion maintenance factor from June 2014 will be fully repaid by the end of the current fiscal year
  - Much of these increases will be funded from property tax growth rather than the state's General Fund
- Proposition 98 for 2016-17 is forecast to increase 3.3%, or $2.3 billion, from the revised current-year level

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Issues for Proposition 98

- *Recession* – Under the LAO's recession scenario, Proposition 98 would drop $4.6 billion in 2017-18
- *CalSTRS Rate Increases* – Scheduled rate increases for the California State Teachers Retirement System (CalSTRS) will consume almost 40% of all new Proposition 98 revenues
- *Out-Year COLAs* – In 2018-19 and 2019-20 the growth in Proposition 98 will be less than the increase in cost-of-living adjustments (COLAs) due to the anticipated expiration of Proposition 30 revenues
- *LCFF Implementation* – Implementation of the Local Control Funding Formula (LCFF) will stall out in 2017-18 at about 96% of the statewide target

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District Reserve Cap

- The LAO indicates that the cap on district reserves will not be triggered during its forecast period (2015-16 through 2019-20)
  - The key criterion that will not be met is Proposition 98 funding based on Test 1 (i.e., a fixed share of General Fund revenues)
    - A revenue surge of several billion dollars would be required in order to trigger a Test 1 year
  - The other criteria are either likely or very likely to be met
    - Capital gains income over 8% of state revenues
    - Full funding of enrollment growth and COLA
    - Repayment of the Proposition 98 maintenance factor

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UCLA's Outlook for the U.S. Economy

- UCLA forecasts the national and state economies four times a year; it does not forecast state revenues
  - Nevertheless, the DOF pays careful attention to UCLA's conclusions as it crafts the Governor's State Budget forecasts for the economy and General Fund revenues
- On December 2, 2015, UCLA released its quarterly forecast for 2015, concluding that gross domestic product (GDP), the broadest measure of the national economy, will increase 3.1% in 2016, the strongest increase since 2005
- The biggest risk to its forecast is the assumption that the global recession is behind us and that U.S. exports will begin to rise

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UCLA's Take on the California Economy

- UCLA expects California to continue to outperform the U.S. economy, making up for the losses the state suffered during the Great Recession
  - State job growth has outpaced the nation as a whole, but population constraints will begin to slow this expansion
    - The state is expected to reach "full employment" in 2017
  - State personal income is expected to increase 3.4% in 2016 and 3.2% in 2017, a healthy, but not spectacular, gain
- California is a big export state; if UCLA's assumption about the global economy proves too optimistic, then California's fortunes will fall disproportionately
  - Pacific Rim trade is a big deal for the state

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Current-Year One-Time Funds

- The 2015-16 State Budget included more than $3.2 billion in one-time discretionary funding
  - To be allocated to local educational agencies (LEAs) on a $529 per-ADA (2014-15 P-2) basis
  - These funds will be distributed in four installments:
    - December 2015 (43% of the funds)
    - January 2016 (43%)
    - March 2016 (3%)
    - April 2016 (11%)
- These dollars are unrestricted and can be used for any purpose determined by an LEA's governing board
  - The State Budget encourages using these funds for professional development, beginning teacher induction and mentoring, instructional materials, technology infrastructure, and other Common Core State Standards implementation efforts

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Preview of 2016 Political Issues

Likely and Potential Legislation

2016 Legislative Year

- The Legislature returns from its break on January 4, 2016
  - One of the first issues to hit will be the Governor's proposal for the 2016-17 State Budget
    - Expected to be released on January 8
    - Overview hearings will happen quickly, but the detail work will be months away
  - Bills introduced in 2015 that didn't make it out of their first house will need to do so by January 31
  - Legislators have until February 19 to introduce bills for the year

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Union Fees

- The *Friedrichs v. California Teachers Association* (CTA) case addresses the constitutionality of nonmember "fair share" fees and fees used to fund political activities
- This case is on the docket of the U.S. Supreme Court in 2016
- In the final days of the 2015 legislative year, a proposal was being discussed that would grant union representatives 30 minutes with public employees to discuss the benefits of union membership
  - This mandatory union orientation proposal was nearly identical to one imposed on In-Home Support Services care providers earlier this year

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Union Fees

- The proposal also would require existing contracts to be reopened for purposes of negotiating employer programs for current employees during which bargaining unit representatives can provide information on the benefits of union membership

- Governor Brown signaled he wasn't willing to take on this issue at the 11th hour
  - Over the legislative break, the Administration has been working on a legislative proposal to mitigate a potential Supreme Court decision that in part or in whole sides with the plaintiffs

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Teacher Evaluations

- In 2015, Assembly Bill (AB) 575 (O'Donnell, D-Long Beach) and Senate Bill (SB) 499 (Liu, D-La Cañada Flintridge) were introduced to repeal and replace various provisions of existing law governing the evaluation of certificated employees and, beginning July 1, 2018, require school districts to implement a best practices teacher evaluation system
  - Management groups oppose these bills because academic and student progress issues would be placed on the bargaining table and a board's sole right to determine the standards and criteria for job performance and student achievement would be removed
- Neither bill was heard in the second policy committee in 2015, but could come back in 2016
  - However, CTA may be singularly focused enough on the *Friedrichs* issue and hold this issue for another year

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Reserve Cap

- The cap on district reserves remains a threat to school districts
- SB 799 (Hill, D-San Mateo) was unveiled in August 2015 to reform the reserve cap, but the bill stalled in the legislative process
- In its current form, SB 799 makes positive changes to the cap:
  - Cap of 17% of unassigned General Fund balances and Special Reserve Fund for Other than Capital Outlay Projects
  - Requirement for adoption of board policy on fund balances
  - Require county offices of education to adopt policy on appeal procedures
  - Exempt small (under 2,501 ADA) and basic aid districts
- The LAO does not foresee the cap being triggered through the length of its forecast – 2019-20 – which means there is still time to get the issue resolved

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Facilities

- The California Association for Adequate School Housing (CASH)-sponsored facilities bond is eligible for the November 2016 ballot
- But the Administration has been unwilling to support additional statewide debt in this area, and CTA is concerned the initiative would pull votes from its Proposition 30 extension
  - The Administration's position, as of January 2015, focused on:
    - Reducing or eliminating future state debt obligations for school facilities
    - Increasing local options to fund facility construction and modernization, including an increase to the cap of bonded indebtedness and higher developer fees
    - Prioritizing state money for districts with the greatest need
- A smaller bond with a needs-based focus is a potential legislative alternative to a large scale bond based on the current facilities program

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Early Childhood Education

- Aligned with a national push, California legislators are interested in expanding early childhood education (ECE)
- Transitional Kindergarten (TK) was created in 2010 to accompany an age eligibility change for kindergarten
- Since then, ECE proponents have sought to expand TK
  - Governor Brown has at times sought to eliminate it
    - But agreed to a moderate expansion to allow school districts to offer TK to four year olds, but no funding will be provided until the child turns 5 years old
- Alternatively, ECE proponents have pushed for additional preschool slots

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Early Childhood Education

- The Legislature and Administration negotiated additional slots in the 2015-16 State Budget
- And included intent language to expand full-day, full-year preschool to all low-income children

- Approved by the Legislature, AB 47 (McCarty, D-Sacramento) proposed to provide all non-TK children with a year of preschool starting in June 2018
  - Governor Brown vetoed the measure, with his veto rationale focused on the intent language in the State Budget
- Expect a continued emphasis on ECE, including in the area of special education where the Statewide Special Education Task Force has recommended additional resources

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Notes

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Ballot Initiatives

Eligible and Potential Education Propositions

Facilities

- The "Kindergarten Through Community College Public Education Facilities Bond Act of 2016" has gathered sufficient signatures to be placed on the November 2016 General Election ballot
  - $9 billion school facilities bond on the ballot for K-14 (unlike past state bonds, which included California's universities) as follows:
    - $3 billion for new construction of K-12 facilities
    - $3 billion for modernization of K-12 facilities
    - $2 billion for the California Community Colleges
    - $500 million for school facilities for charter schools
    - $500 million for facilities for career technical education programs
  - Funds for K-12 facilities would be utilized under the existing Leroy F. Greene School Facilities Act of 1998

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Education Funding

- The education community is rightly concerned about the impending expiration of Proposition 30 (2012)
- Two ballot initiatives were initially introduced to extend the personal income tax increases adopted through Proposition 30

	School Funding and Budget Stability Act	Invest in California's Children Act
Income Tax Rate Increase?	Yes, resulting in tax rates ranging from 10.3% to 12.3%	Yes, resulting in tax rates ranging from 10.3% to 14.3%
Revenue Eligible for State/Education Rainy Day Accounts?	No, excludes revenue from Rainy Day funds	No, deposits revenues into special funds: • 50% for K-14 Education • 40% for Medi-Cal • 10% for CalWORKS
Expiration Date	December 1, 2030	None, permanent increase

- The two competing initiative proponents – CTA and the California Hospitals Association (CHA) – came together to draft a compromise proposition

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Education Funding

- The "California Children's Education and Health Protection Act of 2016" would extend Proposition 30's income tax rate increases to 2030
  - 45% of the revenues available after providing for growth and COLA for Proposition 98 would be allocated to the California Department of Health Care Services
    - To provide critical, emergency, acute, and preventative health services to children and their families through hospitals and Medi-Cal providers
    - This allocation would be capped at $2 billion annually
- Proponents will have to work quickly to collect the 585,407 signatures required to qualify the initiative
  - June 30 is the deadline to qualify for the November 2016 general election

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Pension Reform

- "Voter Empowerment Act of 2016"
  - Prohibits a government employer from providing benefit enhancements (defined as any change that increases the value of an employee's benefit) to an employee in a defined benefit pension plan, unless approved by voters
  - Prohibits a government employer from enrolling new government employees (hired after January 1, 2019) in a defined benefit plan, unless approved by voters
  - Prohibits a government employer from paying more than one-half of the total cost of retirement benefits, unless approved by voters
- It is currently unknown whether the proponents of this initiative – Carl DeMaio and Chuck Reed – will fund a signature-gathering campaign to qualify the initiative

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Recent Polling

- The most recent survey of issues likely to come before voters is from the Public Policy Institute of California (PPIC)
  - 54% of likely voters support extending the Proposition 30 tax increases, although only 37% state this is a “very important” issue
    - The percentage of supporters will likely change as voters hear about the specific Proposition 30 extension initiative
      - The sales tax in Proposition 30 is eliminated
      - Unknown how voters will react to funds being directed to health services
  - 55% of likely voters identified the issue of school facilities to be very important when asked to rank various issues that will likely appear on the November 2016 general election ballot

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Questions?

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