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Sent: Friday, November 12, 2010 6:31 PM
To: SO2CEO@LISTSERV.CCCNEXT.NET
Subject: Budget Update--November 12, 2010

Dear Colleagues:

Informed budget watchers knew we were not out of the woods yet, but this week brought troubling news of just how large the state's remaining fiscal challenges are. On Wednesday, the Legislative Analyst's Office (LAO), the Legislature's nonpartisan budget and policy advisor, released its annual *Fiscal Outlook* which provides an assessment of the state's current fiscal condition as well as a five-year economic and budget forecast. In the report, LAO projects that, absent corrective action, California will face a two-year budget shortfall of \$25.4 billion. Of this amount, \$6.1 billion is attributed to 2010-11 and \$19.2 billion is attributed to 2011-12. In reaction to this news, Governor Schwarzenegger announced that he will call for a special session of the Legislature to address the current-year shortfall. More details are provided below.

LAO Fiscal Outlook

As noted above, the LAO projects a \$25.4 billion budget shortfall over the 2010-11 and 2011-12 fiscal years, combined. Of this amount, \$6.1 billion is projected for the current year, despite the ink on the current-year budget barely having dried. The cause for the major deterioration in the current year includes a variety of unrealistic revenue and expenditure assumptions that were included in the budget package adopted just a month ago. Major items include:

- Federal revenues overstated by \$3.5 billion
- State General Fund revenues overstated (combined total of \$447 million over two years)
- Underestimated prison costs of \$965 million
- Loss of \$800 million due to passage of Proposition 22 which prevents the state from borrowing from local governments
- Overestimated local property tax revenues (combined total of \$400 million over two years)
- Underestimated Medi-Cal costs of \$400 million
- Underestimated In-Home Supportive Services costs of \$195 million

For 2011-12, LAO projects the current-year liabilities will roll forward and be compounded by the expiration of a number of temporary budget solutions used in 2010-11. These include:

- Expiration of \$8 billion in temporary tax increases agreed to as part of the 2009-10 state budget
- Phase out of \$4.5 billion in one-time federal funds used to balance the current-year budget

For 2011-12, LAO estimates that the constitutional Proposition 98 minimum funding guarantee will decline by \$2 billion compared to funding levels provided to K-12 schools and community colleges in 2010-11. This drop is due to the effect of declining State General Fund Revenues on the Proposition 98 calculation. It is important to note that LAO uses this lower Proposition 98

funding level in their forecasts, meaning that a \$2 billion cut is built into their baseline projections. If the Legislature and Governor want spending cuts to K-12 schools and community colleges to “contribute” to closing the \$25.4 billion gap, they will need to cut Proposition 98 by even more than \$2 billion.

LAO advises the Legislature to take a multi-year approach to tackling this budget gap. Specifically, they recommend using a combination of ongoing and one-time solutions to balance the budget in 2011-12, then adding more ongoing solutions in 2012-13, and so on over several years until the state budget has been brought into full alignment. In addition, LAO urges that added revenues be included as part of the overall package. Among revenue solutions, they recommend that the Legislature consider limiting tax breaks, extending temporary taxes, charging additional user fees, and making changes to corporate tax structures.

Taken as a whole, LAO’s report offers a sobering assessment that suggests California’s biggest budget challenges are still ahead of us. At this time, we are still working with LAO to fully understand the details behind the *Fiscal Outlook*. In particular, we are seeking additional information on their downgraded local property tax revenue estimates which could have a material impact on the community colleges. We will provide additional information on these forecasts as needed.

An LAO handout outlining the Proposition 98 implications of the *Fiscal Outlook* forecast is attached to this email. The full LAO report is available at:

http://www.lao.ca.gov/reports/2010/bud/fiscal_outlook/fiscal_outlook_2010.pdf

Governor Calls for Special Session on Budget

Following LAO’s release of the *Fiscal Outlook*, Governor Schwarzenegger announced that he would call a special session of the Legislature to begin on December 6, the day that newly elected legislators are sworn in. This will be the eighth special session on the budget that the Governor has called in the past seven years. While the Governor has not yet released any specific budget proposals, his press releases on the special session indicate that he will be proposing budget cuts to bridge the \$6.1 billion current year shortfall.

The Department of Finance, which is working closely with both the outgoing and incoming Administrations, will play a key role in shaping the special session budget proposals. So far, legislative leaders have provided little public reaction to the proposed special session or announced how they plan to approach the budget problem.

Implications for the Community Colleges

While it is too early to know how the Legislature and the incoming Brown Administration will react to these developments, it safe to say that the information included in the LAO report increases the probability of cuts in both the current year and budget year. The specific fallout for the colleges will depend on a number of factors, including how much of the budget problem state leaders choose to tackle in the current year as well as the extent and timing of revenue solutions.

In any event, it is hard to imagine a scenario that does not include significant negative consequences for the community colleges. Accordingly colleges should be prepared for the likelihood of mid-year cuts in the current year. A realistic scenario is that the Legislature would take back the \$126 million in enrollment funding provided as part of the recently enacted 2010-11 State Budget. For the budget year, even under the LAO's baseline scenario, community colleges would likely face cuts of over \$230 million (based on the colleges' proportionate share of Proposition 98 funding). Again, there is much we do not know about how this will play out, including the extent to which new revenues might mitigate program cuts; however, districts are well advised to prepare for budget reductions.

If there is any good news to share, it is that state leaders are well aware of the important role community colleges are playing to provide the education and training Californians need to achieve their workforce, basic skills, and transfer goals. As long as we can maintain the focus on the colleges' contributions in these areas, we will fare no worse than other sectors of the state budget and better than most. In the coming months, our advocacy—both at the state and the local level—will be key as we work to limit the negative impacts on our system.

As the situation unfolds, we will continue to keep you posted.

Regards,

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