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PRACTICAL SOLUTIONS FOR PUBLIC SCHOOLS

May 5, 2015

May Revision Preview – Funding the Non-98 Side of the Budget

With the May Revision looming, it's time for another look at what could be in store.

We know that revenues continue to surge – April income tax collections were more than $1.5 billion above January projections and the Legislative Analyst's Office now believes revenues could exceed projections by $4 billion before the end of the Fiscal Year June 30. On the natural, Proposition 98 is positioned to sweep up most of this money for K-14 schools.

Now the big question is how – or if – the Legislature and the Administration can shift some of this revenue surge into the non-Proposition 98 side of the Budget. Because of current interpretation of how Prop 98 repays prior-year shortfalls (the "Maintenance Factor"), virtually all of the billions in increased revenue for 2014-15 above the Governor's January projections would be locked in to K-14 expenditures. But as we've mentioned earlier, there is intense interest from many directions in spreading some of this money around outside the Prop 98 umbrella – to social services and healthcare, childcare, transportation, and elsewhere.

We have been speculating that perhaps a simple reinterpretation of the Maintenance Factor repayment technicalities could accomplish the redistribution, eliminating the "double bite" of revenue increases that is the reason Prop 98 claims almost all of the new revenue. This reinterpretation could be accomplished simply through the Budget process with sign-off from the Governor and the Democratic Leadership in each house, but in process would also engage Prop 98's watchdog, the CTA, and lead to potentially unpleasant Budget trade-offs (approval of the CTA's teacher evaluation package?) or even lawsuits.

Now another tack appears to be under discussion – reducing Prop 98's share of the revenue windfall by attributing some of the Current-Year (2014-15) revenues to the Prior Year (2013-14). While not changing the total amount of revenue collected over the two-year period, this would have the effect of reducing Prop 98's share of that revenue, thereby freeing up non-98 dollars in the Budget Year (2015-16) and beyond, providing the Administration and the Legislature with resources for their non-98 priorities.

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(Feel free to skip the following paragraphs in italics explaining how this could work.)

Transferring revenues out of 2014-15 to 2013-14 reduces Prop 98's share of the Budget in two ways.

First, it reduces the one-time windfall by removing the revenue from a Test 3/Maintenance Factor Repayment year (2014-15) that takes two bites of increased state revenues for Prop 98, and inserts them into a Test 3 year (2013-14) that only takes one bite of the apple. (In 2014-15 increased revenues are claimed for Prop 98 not only by growth in the Test 1 "slice of the pie" – about 40% of all State General Fund Revenues – but also by an increase in the yield in Maintenance Factor Repayments, which are driven by the increase year-over-year in the percentage growth in State General Fund revenues. In 2013-14, increased revenues factor only into the Test 3 growth factor, based on year-to-year State General Fund revenue growth, as there is no Maintenance Factor Repayment on top of that.) As a result, while close to 100% of new revenue growth in 2014-15 is captured by Prop 98, only about 50% goes to Prop 98 in 2013-14, and the difference is available for non-98 priorities.

Second, because transferring dollars from 2014-15 back to 2013-14 reduces Current-Year revenues and consequently the Proposition 98 minimum funding guarantee, it has the effect of reducing Prop 98's claim on the Budget Year (2015-16) State Budget. The Prop 98 minimum guarantee is in most years based upon the prior-year, so reducing this year's minimum guarantee would almost certainly reduce the 2015-16 guarantee.

A strong case can – and will – be made that Proposition 98 took an enormous hit during the Great Recession, and that California schools deserve every penny and more of any new revenue that the formula can generate. There is, however, very little sympathy in the Legislature for this argument. The final 2015-16 State Budget will certainly be substantially better to K-12 schools than the Governor's Budget Proposal in January, but don't be surprised if the rest of the State Budget finds a way to benefit from the revenue surge, as well.

In discussing this scenario with colleagues, there is some incredulity that hundreds of millions or billions in state revenue could simply stray from one fiscal year into another. But remember the old story about the corporate CEO hiring a new controller, and interviewing three accountants for the job.

> CEO to Accountant # 1: "What's two plus two?"
> Accountant # 1: "Three."
> CEO: "Next!"

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CEO to Accountant # 2: "What's two plus two?"
Accountant # 2: "Four."
CEO: "Next!"

CEO to Accountant # 3: "What's two plus two?"
Accountant # 3: "What would you like it to be?"
CEO: "Hired!"

Revisiting prior-year revenues is a part of every State Budget process. And as long as Governor Brown and the Legislative Leadership of each house agree on the outcome, there is plenty enough talent at the Capitol to find a way to "make it so."

As always, don't hesitate to contact us with any questions, comments, or concerns.

Bob