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FISCAL REPORT

COVID-19 Decimates State Revenues, Education Funding



BY SSC TEAM

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In a letter issued by the Department of Finance (DOF) this morning in advance of Governor Gavin Newsom's May Revision release scheduled for next Thursday, May 14, the economic impact of COVID-19 is dramatically greater than the impact of the financial crisis of 2008.

Governor Newsom's financial advisors are now estimating that state revenue losses from the health pandemic that shut down the state, national, and global economies amount to \$41.2 billion. For comparison, when the financial crisis hit in December 2008, early state revenue losses were estimated at \$28 billion. The COVID-19 impact on personal income tax alone—that accounts for two-thirds of the funding the state uses to finance all programs—is estimated to be three times greater than during the Great Recession.

The DOF estimates state revenue losses of \$9.7 billion in the current year and an additional \$32.2 billion in the coming budget year. These losses are compounded by growing caseloads in state social services programs that bring the total shortfall to \$54 billion going into fiscal year 2020–21.

Impact on Proposition 98 and Education Funding

A \$41 billion reduction in state revenues from the Governor's January estimates correspond to an \$18.3 billion reduction in Proposition 98 for the 2019–20 and 2020–21 fiscal years. Recall that Governor Newsom estimated the 2020–21 Proposition 98 minimum guarantee would be \$84 billion, up from an estimated \$81.6 billion in the current year. Although the DOF did not provide a fiscal year breakdown of the total reduction in Proposition 98, our best estimate is that the current-year guarantee is reduced by approximately \$3.7 billion while the 2020–21 guarantee would be reduced by \$14.6 billion. This means that based on the Governor's January estimates, the current-year and budget-year minimum guarantees are \$77.9 billion and \$69.4 billion, respectively.

Across both fiscal years, the new estimated loss in education funding is equivalent to a -22.0% cost-of-living adjustment. On a per average daily attendance (ADA) basis for the Local Control Funding Formula (LCFF), the average reduction is approximately \$2,300 in 2020–21. Total per-ADA revenues, inclusive of the LCFF, would

be down by \$2,600–\$2,700.

The state's rainy day fund, while at its highest level ever, would provide only a modicum of relief. The fund's balance is approximately \$18 billion, with less than \$500 million specifically reserved for K–14 education. Under current law, only half of the balance can be drawn down in any given year. Given that the state's reserves are inadequate to offset the total revenue loss, including the loss in education funding, we anticipate that the state will impose budget deferrals for the 2019–20 fiscal year. Unlike cash deferrals, budget deferrals allow the state to put cash in the hands of local educational agencies (LEAs) while accounting for those payments in the next fiscal year. It is both too early to tell and too magnitudinous to know how the state intends to manage the 2020–21 Proposition 98 reduction.

May Revision and Beyond

Given the magnitude of the economic crisis, we expect that the May Revision will offer a suite of measures to help LEAs mitigate the devastating impact; although it is difficult to fathom that any or all of them would be sufficient to protect students and staff from the wrath of revenue cuts if they are not accompanied by offsetting federal or state aid.

While we at School Services of California Inc. are having a difficult time wrapping our minds around this recent news, we remain committed to serving each of you by helping you operationalize these data for your respective agencies and providing the latest and most accurate information coming from the state. We also know that everyone is wondering how long this current recession will last, and how quickly we can expect the state to recover from it. Once the Governor's May Revision is released, we intend to address this and more in our *Fiscal Report* and at our May Revision Workshop. We are both humbled and honored to be with and serve each of you during this time.