

# COMMUNITY COLLEGE UPDATE

PUBLIC EDUCATION'S POINT OF REFERENCE FOR MAKING EDUCATED DECISIONS

## LAO's Fiscal Outlook for Education—Positive, but Modest

 [BY MEGAN BAIER](#)

 [BY PATTI F. HERRERA, EDD](#)

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Wednesday, November 20, 2024, the Legislative Analyst's Office (LAO) released its *2025-26 Budget Fiscal Outlook (Fiscal Outlook)* report that includes a specific forecast for Proposition 98 affecting TK-12 and community college agencies. This annual report offers an updated multiyear forecast of the State Budget condition, including economic and revenue assumptions that impact the annual State Budget and the programs that rely on it, such as public education.

The report predicts that, while better-than-expected General Fund revenues are offset by higher spending, the state can anticipate a relatively balanced budget for the 2025-26 fiscal year. The LAO warns, however, that the state is likely to face deficits in the outyears due to anomalously high spending obligations that lawmakers would need to address either through program reductions or increased revenue vis a vis tax increases.

### **Proposition 98: Outlook for TK-12 and Community College Funding**

Within the broader context of the multiyear State Budget condition, the *Fiscal Outlook* revises estimates of the Proposition 98 minimum guarantee for 2024-25, issues an estimate for 2025-26, projects a statutory cost-of-living adjustment (COLA) for 2025-26 of 2.46%, and explains why the state will be required to make a deposit into the Proposition 98 reserve and will not be required to make a restoration (or maintenance factor) payment to public education. Following the shifting pieces of Proposition 98 can be difficult, so below we provide a brief summary of the LAO's report as it relates to public education.

- **2024-25 Minimum Guarantee up \$3.0 Billion**

Due to upward revisions in General Fund revenues and local property taxes, the LAO estimates that the current-year minimum guarantee will be \$3.0 billion higher than the 2024-25 Budget Act estimates from June, now totaling \$118.3 billion (up from \$115.3 billion). However, this increased revenue will not be available as the state will be required to deposit the funds into the Proposition 98 reserve. This is because the State Constitution requires deposits into the reserve when robust revenues are due largely to increases in capital gains. The *Fiscal Outlook* assumes a revised 2024-25 required deposit of \$3.7 billion (\$1.1 billion of which was already included in the June budget). This higher deposit will once again trigger caps on TK-12 district reserves in fiscal year 2025-26.

- **\$2.8 Billion Proposition 98 Surplus in 2025-26**

Based on the constitutional formulas to calculate Proposition 98, the *Fiscal Outlook* estimates that the minimum guarantee for 2025-26 will be \$116.8 billion, which is notably lower than the LAO's revised 2024-25 level of \$118.3 billion. This funding level is driven by Test 1 remaining operative (meaning, K-14 education receives approximately 40 cents of every General Fund dollar) and a constitutional provision that protects the state from unsustainable Proposition 98 obligations when there are temporary spikes in revenue (referred to as "spike protection").

Despite the year-over-year modest decline in the minimum guarantee levels, the LAO estimates that Proposition 98 will enjoy a \$2.8 billion surplus in 2025-26, resulting from the net of \$3.7 billion freed up from expired, one-time costs, offset by an ongoing cost of a 2.46% COLA.

- **No Required Restoration (Maintenance Factor) Payment in 2025-26, but New Obligation Created in 2026-27**

The state’s decision to use their constitutional authority to suspend Proposition 98 in fiscal year 2023-24 creates an obligation to restore funding for TK-12 and community colleges to the level the state *should* have provided, an obligation known as the “maintenance factor.” The 2024-25 Budget Act included a \$4.1 billion maintenance factor payment based on June revenue assumptions. According to the LAO’s revised revenue estimates in the *Fiscal Outlook*, the maintenance factor and payment obligation to TK-12 and community college agencies increases by \$761 million, leaving an outstanding obligation at the end of the current fiscal year of \$3.3 billion.

However, because the LAO’s broader economic assumptions include robust capital gains revenues, the *Fiscal Outlook* assumes that the state will not be required to make a restoration payment in 2025-26. This is because the State Constitution requires maintenance factor payments only in fiscal years in which General Fund revenue growth outpaces per capita personal income growth. Finally, the LAO estimates that the Proposition 98 minimum guarantee will be determined by Test 3 in fiscal year 2026-27, which will create a new maintenance factor obligation of approximately \$2.0 billion, totaling \$5.9 billion at the end of 2026-27 when added to the existing obligation. Any remaining balance in the state’s obligation to restore education funding is adjusted each year for changes in average daily attendance and per capita personal income. At the end of the *Fiscal Outlook*’s forecast period in 2028-29, the total maintenance factor obligation is estimated to be \$6.5 billion.

- **Minimum Guarantee Experiences Moderate Increases After 2025-26 — up \$17.4 Billion by 2028-29**

Finally, tracking with the LAO’s larger state economic and revenue forecast, the *Fiscal Outlook* projects that, after a sluggish 2025-26, education funding will enjoy annual increases averaging \$5.8 billion over the three-year period. It assumes that the minimum guarantee will benefit from increases in both state General Fund revenue and local property taxes.

**Proposition 98 Minimum Guarantee**  
Dollars in billions

	2024-25	2025-26	2026-27	2027-28	2028-29
General Fund	\$ 84.8	\$ 81.7	\$ 85.2	\$ 89.7	\$ 94.1
Local Property Taxes	33.5	35.1	36.1	38.1	40.1
<b>Total</b>	<b>\$ 118.3</b>	<b>\$ 116.8</b>	<b>\$ 121.3</b>	<b>\$ 127.8</b>	<b>\$ 134.2</b>

- **Proposition 98 Reserve**

As noted earlier, better-than-expected revenues resulting from strong capital gains increase the required deposit into the Proposition 98 reserve in 2024-25. Under the LAO's forecast assumptions, there would be no required deposits into, nor withdrawals from, the fund in 2025-26. However, the state would be required to make a \$2.0 billion and a \$1.7 billion withdrawal in fiscal years 2026-27 and 2027-28, respectively. The \$1.7 billion account balance at the end of 2026-27 and the depletion of the account the following year would make the cap on TK-12 district reserves inoperative beginning in 2027-28 through the remainder of the forecast period.

- **Annual Statutory COLA Increases**

The LAO's forecast of the statutory COLA increases to above-average trends of 3.00% beginning in 2026-27 through the 2028-29. The Proposition 98 costs associated with estimated outyear COLAs are \$3.2 billion, \$4.0 billion, and \$4.3 billion in 2026-27, 2027-28, and 2028-29, respectively.

<b>Statutory COLA</b>			
<b>2025-26</b>	<b>2026-27</b>	<b>2027-28</b>	<b>2028-29</b>
2.46%	3.10%	3.80%	4.00%

The LAO concludes its forecast cautioning its susceptibility to over- and under-projections, depending on state General Fund revenue performance. Consistent with its broader concern about budget headwinds in the outyears, the LAO recommends that the Legislature consider using its modest \$2.8 billion Proposition 98 surplus to build resiliency in the education budget, which could include retiring deferrals and using the surplus to fund one-time investments. Each fiscal policy decision comes with trade-offs, of course, which the LAO begins to outline for lawmakers in advance of spring budget hearings.

Those hearings will begin in the weeks following the release of Governor Gavin Newsom's 2025-26 January State Budget proposal, which he must release no later than January 10, 2025. His proposed budget will lay the fiscal framework for the budget discussion and negotiations, as well as highlight his priorities for California and public education.