

MEMORANDUM



JOINT BUDGET COMMITTEE

TO Members of the Joint Budget Committee
FROM Craig Harper, JBC Staff (303-866-3481)
DATE March 18, 2022
SUBJECT Updated School Finance Scenarios (March 2022 LCS Revenue Forecast)

During figure setting for school finance and categorical programs for FY 2022-23, staff recommended that the Committee move forward with a scenario intended to eliminate the budget stabilization factor (BSF) over a two year period, with elimination in FY 2023-24. However, the updated revenue forecasts, and especially the increasing inflation rate anticipated for this calendar year (which will impact FY 2023-24 appropriations), appears to make that scenario untenable.

Based on the assumptions at figure setting, staff had anticipated a need for an average annual increase of \$175.8 million General Fund through FY 2024-25 to achieve that goal. Based on the March 2022 forecast, staff estimates that doing so would now require an average increase of \$308.4 million General Fund per year.

Staff is providing this memorandum to summarize changes in assumptions and to provide an updated scenario based on the Committee's request.

- The updated scenario would reduce the BSF to \$321.2 million in FY 2022-23, a decrease of \$250.0 million below the *original* FY 2021-22 appropriation and \$182.0 million below the *current* FY 2021-22 appropriation as adjusted by H.B. 22-1186 (Adjustments to School Funding for Fiscal Year 2021-22).
- The scenario then holds the BSF at that level throughout the forecast period.

CHANGES IN ASSUMPTIONS

Assumptions about inflation and local revenues are central to projections of school finance for the next several years. Inflation assumptions have changed significantly since the February discussion and there is still uncertainty regarding the local revenues.

INFLATION: The inflation rate driving appropriations for FY 2022-23 is a fixed number: 3.5 percent based on the CY 2021 Denver-Aurora-Lakewood CPI. However, there is increased uncertainty and risk for the out-years. Based on the December 2021 Legislative Council Staff (LCS) Revenue Forecast, the February 2022 staff recommendation assumed that inflation would *decrease* from 3.5 percent for FY 2022-23 to 3.4 percent for FY 2023-24 and then 1.8 percent in subsequent years.

- However, the March LCS Forecast anticipates that inflation will rise to 7.0 percent for FY 2023-24. It would then fall to 3.8 percent for FY 2024-25, and then 2.4 percent for FY 2025-26. The OSPB forecast projects 7.2 percent, 3.0 percent, and 2.7 percent, respectively, for those years.
- Based almost entirely on the change in inflation, legislative staff now project that total program before the budget stabilization factor would cost \$313.2 million more in FY 2023-24 than was expected in February, using the 7.0 percent projected by LCS. The increased costs compound in the out-years because the inflationary increases are base building and inflation projections are higher throughout the forecast period than they were in December.

MARCH 18, 2022

LOCAL REVENUES: As discussed during figure setting, an anticipated increase in local revenues in FY 2023-24 is a key component of the sustainability of any significant reduction to or elimination of the BSF. Conversely, reductions in local revenues would threaten the sustainability of any given option, as every decrease in the local share has to be offset with state funds to avoid growth in the BSF.

Legislative Council Staff only forecasts assessed values in December, so the official forecast of local share revenues has not changed. Based on current law, including the sunset of S.B. 21-293 and anticipated growth in assessed values, the December LCS forecast anticipates that the local share will increase by \$473.3 million in FY 2023-24, with another large increase anticipated in FY 2025-26.

During figure setting, staff based the recommendation on a more conservative assumption – cutting the increase in FY 2023-24 in half, with an increase of \$236.6 million in FY 2023-24. Staff is not changing that assumption but does note that there may be additional downside risk to the local share.

- The Title Board approved a set of ballot measures this week that LCS has estimated would reduce revenues below the current law forecast from December by approximately \$360 million in FY 2023-24, \$383 million in FY 2024-25, and \$531 million in FY 2025-26. Those would reduce revenues below staff's "conservative" assumptions.

OTHER CHANGES: Staff has also updated the projections based on the March 2022 LCS projections of revenues to the State Education Fund and the State Public School Fund, as well as the inclusion of new cost of living factors certified by LCS. Relative to the assumptions used during figure setting:

- Anticipated total revenues to the State Education Fund increased by approximately \$54.3 million for FY 2021-22 but expectations decreased for FY 2022-23 and FY 2023-24.
- Total Revenues to the State Public School Fund increased by approximately \$10 million per year, driven by increased expectations for federal mineral lease revenues.
- The certification of new cost of living factors increased the cost of total program before the application of the BSF for FY 2022-23 by \$3.1 million (0.04 percent).

UPDATED MULTI-YEAR SCENARIO

Based on the Committee's request for additional modeling, JBC Staff has worked with LCS to develop multi-year projections incorporating the new assumptions outlined above based on two benchmarks for the local share: (1) as anticipated in the December 2021 LCS forecast; and (2) the JBC Staff conservative assumption, with 50.0 percent of the anticipated increase in FY 2023-24, resulting in a lower local share in both FY 2023-24 and FY 2024-25. Each scenario includes the following additional assumptions:

- *BSF:* At the Committee's request, the scenario would reduce the BSF to \$321.2 million in FY 2022-23, a decrease of \$250.0 million below the *original* FY 2021-22 appropriation, and then hold the BSF at that level throughout the forecast period.
- *General Fund Required:* Staff has worked to "smooth out" the annual General Fund increases under each scenario. Beyond reducing and then maintaining the BSF at a lower level, the core goal of staff's analysis is to attempt to stabilize the General Fund increases to avoid dramatic fluctuations in the General Fund required.
- *SEF Balances:* Consistent with the figure setting recommendation, staff has targeted an ending balance of no less than \$150.0 million. The scenarios below would spend the SEF balance down over the forecast period, with the conservative local share scenario requiring more rapid use of

MARCH 18, 2022

the fund. Staff targeted an ending balance of \$150.0 million at the end of FY 2024-25, while trying to make the General Fund increases as consistent as possible.

TABLE 1 - MARCH 2022 SCHOOL FINANCE FIGURE SETTING UPDATE				
	FY 2021-22	FY 2022-23	FY 2023-24	FY 2024-25
<i>Projected Pupil Count</i>	886,249	880,808	877,292	873,610
Total Program Before the BSF	\$8,492,431,600	\$8,741,407,344	\$9,309,889,004	\$9,623,108,273
Local Share - December 2021 LCS	\$3,280,192,851	\$3,356,661,199	\$3,829,950,429	\$3,941,018,991
Local Share - Conservative Growth	\$3,280,192,851	\$3,356,661,199	\$3,593,305,814	\$3,697,511,683
Budget Stabilization Factor	<u>(503,267,250)</u>	<u>(321,243,484)</u>	<u>(321,243,484)</u>	<u>(321,243,484)</u>
Total Program After BSF	\$7,989,164,350	\$8,420,163,860	\$8,988,645,520	\$9,301,864,789
Statewide Average Per Pupil	\$9,015	\$9,560	\$10,246	\$10,648
Local Share - December 2021 LCS	\$3,280,192,851	\$3,356,661,199	\$3,829,950,429	\$3,941,018,991
State Share of Total Program Funding	<u>\$4,708,971,499</u>	<u>\$5,063,502,661</u>	<u>\$5,158,695,091</u>	<u>\$5,360,845,798</u>
General Fund	4,040,848,829	4,161,264,207	4,293,497,400	4,429,211,191
State Education Fund	474,824,576	789,307,591	777,101,971	838,538,887
State Public School Fund	193,298,094	112,930,863	88,095,720	93,095,720
Annual Increase in General Fund	\$287,912,910	\$120,415,378	\$132,233,193	\$135,713,791
SEF Ending Balance	820,840,935	725,000,000	500,000,000	250,000,000
Staff Rec. - Conservative Local Share	\$3,280,192,851	\$3,356,661,199	\$3,593,305,814	\$3,697,511,683
State Share of Total Program Funding	<u>\$4,708,971,499</u>	<u>\$5,063,502,661</u>	<u>\$5,395,339,706</u>	<u>\$5,604,353,106</u>
General Fund	4,040,848,829	4,235,751,683	4,421,374,906	4,606,998,131
State Education Fund	474,824,576	714,820,115	885,869,080	904,259,255
State Public School Fund	193,298,094	112,930,863	88,095,720	93,095,720
Annual Increase in General Fund	\$287,912,910	\$194,902,854	\$185,623,223	\$185,623,225
SEF Ending Balance	820,840,935	799,487,476	465,720,368	150,000,000

It is important to note that the two scenarios do not differ in the state share required for FY 2022-23. The local share assumptions diverge in FY 2023-24, and staff's goal is to enable the Committee to plan over the multi-year period without larger spikes in General Fund. Achieving that goal with a reduced local share in FY 2023-24 and FY 2024-25 requires keeping some additional balance in the SEF at the end of FY 2022-23 to allow for larger appropriations in FY 2023-24 and FY 2024-25. If the local share is higher than anticipated in FY 2023-24 then that would reduce pressure on the General Fund and the SEF. However, reducing the local share (through either policy or lower-than-anticipated assessed values) would increase pressure.

REVISED STAFF RECOMMENDATION – LONG BILL AND SCHOOL FINANCE BILL

Based on the Committee's requested scenario, staff offers the following recommendations for appropriations for total program funding (summarized below and in Table 2):

- Based on current law, the recommendation for the *Long Bill* would hold the BSF at the current FY 2021-22 dollar amount of \$503,267,250. The School Finance Bill would then provide an additional \$182.0 million in state funds to reduce the BSF to \$321,243,484.
- In alignment with Table 1 above, the recommendation includes a *total* increase of \$194,902,854 General Fund above the FY 2021-22 appropriation.
- The recommendation below assumes that the Committee would approve the entire General Fund increase in the Long Bill and then set a placeholder for \$182.0 million in the SEF. Conversely, the Committee could appropriate a combination of General Fund and SEF in the Long Bill and establish a General Fund placeholder for the amount required in the School Finance Bill.

MARCH 18, 2022

- The total state share is based on the best available estimates required to reach the BSF targets. However, the Committee could also appropriations between the General Fund and SEF if desired, although spending more from the SEF in FY 2022-23 would reduce the amount available in subsequent years and therefore increase pressure on the General Fund.

TABLE 2: REVISED STAFF RECOMMENDATION FOR FY 2022-23 TOTAL PROGRAM FUNDING

	FY 2021-22 APPROPRIATION	GOVERNOR'S REVISED (JANUARY 18) REQUEST	MARCH 2022 LONG BILL RECOMMENDATION	MARCH 2022 SCHOOL FINANCE BILL	CHANGE FROM GOVERNOR'S REVISED REQUEST
Funded Pupil Count	886,222	880,808	880,808	880,808	0
Inflation Rate	2.0%	3.5%	3.5%	3.5%	0.0%
Statewide Base Per Pupil Funding	\$7,225	\$7,478	\$7,478	\$7,478	\$0
Total Program Funding					
Total Program before BSF	\$8,492,431,600	\$8,738,301,732	\$8,741,407,344	\$8,741,407,344	\$3,105,612
Budget Stabilization Factor	(503,267,250)	(366,243,484)	(503,267,250)	(321,243,484)	45,000,000
<i>Budget Stabilization Factor as Percentage</i>	<i>-5.93%</i>	<i>-4.19%</i>	<i>-5.76%</i>	<i>-3.67%</i>	<i>0.52%</i>
Adjusted Total Program	\$7,989,164,350	\$8,372,058,248	\$8,238,140,094	\$8,420,163,860	\$48,105,612
Statewide Average Per Pupil	\$9,015	\$9,505	\$9,353	\$9,560	\$55
Local And State Shares					
Local Share	<u>\$3,280,192,851</u>	<u>\$3,356,659,952</u>	<u>\$3,356,661,199</u>	<u>\$3,356,661,199</u>	<u>\$1,247</u>
Property Tax	3,062,155,118	3,132,081,087	3,132,082,334	3,132,082,334	1,247
Specific Ownership Tax	218,037,733	224,578,865	224,578,865	224,578,865	0
State Share	<u>\$4,708,971,499</u>	<u>\$5,015,398,296</u>	<u>\$4,881,478,895</u>	<u>\$5,063,502,661</u>	<u>\$48,104,365</u>
General Fund	4,040,848,829	4,040,848,829	4,235,751,683	4,235,751,683	194,902,854
Cash Funds (SEF)	474,824,576	858,891,998	532,796,349	714,820,115	(144,071,883)
Cash Funds (SPSF)	193,298,094	115,657,468	112,930,863	112,930,863	(2,726,605)
Annual General Fund Increase		0	194,902,854	194,902,854	194,902,854
Statutory Change Required		Yes		Yes	

POINTS TO CONSIDER – AND INHERENT RISK

Staff's multi-year scenarios and the specific staff recommendations are built on the assumptions outlined above, with state revenues based on the March 2022 LCS Revenue Forecast and pupil counts and local revenues based on the December forecast. Given the current degree of uncertainty in nearly every major variable, staff has attempted to construct the scenario to mitigate against potential risk, including reducing the local share below the forecast amount. Should conditions improve (e.g., with a lower inflation rate or increased local share), the General Assembly could be in a position to further reduce the BSF in FY 2023-24 when more information will be available to assess the sustainability of those changes.

However, staff also notes that both forecast discussions on March 17 included significant downside risk. With respect to school finance, staff recommends that the Committee specifically consider the following risks:

- Inflation:* Anticipated inflationary increases for FY 2023-24 have increased from 2.0 percent under the December LCS Forecast to 7.0 percent in March. The discussions during the forecast presentations indicated that inflation may continue to rise in the current year, which would increase costs. In addition, both forecasts anticipate that inflation would decrease significantly for FY 2024-25, to 3.8 percent under the LCS forecast and 3.0 percent under OSPB. Sustained increased inflation would create additional costs.

MARCH 18, 2022

- *Local Share:* Staff's has adjusted the local share estimates to mitigate against potential revenue reductions as a result of either policy change through legislation or lower-than-anticipated assessed values. However, staff notes that local revenues could still fall below those assumptions for either of those reasons – or as a result of the ballot initiatives discussed above.
- *Student Counts:* The forecast projects continued gradual decreases in funded pupil counts statewide. As the Committee has discussed, the anticipated declines align with pre-COVID 19 demographic expectations. However, the system could still see some rebound in student counts given our current circumstances. Holding everything else constant, an unanticipated increase in the student count would drive increased costs for the State.