

INTEROFFICE CORRESPONDENCE

Los Angeles Unified School District
Independent Analysis Unit

FISCAL PERSPECTIVES

TO: Members, Board of Education

DATE: May 14, 2025

FROM: Andrew Thomas, Director, Independent Analysis Unit

SUBJECT: **Comments on Governor's May Revisions:** Economic Considerations for upcoming budget approval

Today, the governor released the May Revision, which presents the changes to his January budget proposal made considering recent revenue estimates and economic trends. You will soon receive a detailed summary of the revised 2025-26 California budget proposal and its implications for the District's finances from the Office of Government Relations and, next week, additional information from the Business and Finance Division. In this memo, we provide a quick summary of the May Revision, overall economic context, and some thoughts on what the IAU considers the most salient concerns related to the Board's fiscal stewardship duties.

Most importantly, **the state's current financial situation, while less positive than at the beginning of the year, supports a cost-of-living increase (COLA) of 2.3% and approximately \$1.3 billion in new funding for the governor's key education priorities of universal T-K with a pupil-to-staff ratio of 10-1, universal school meals, longer school days, literacy instruction, and community schools.**

That said, the May Revision accounts for **decreased revenue estimates going into FY 2025-26 and foresees rougher economic waters ahead.**

Macro-economic trends

1. **Revenues:** The Legislative Analyst's Office (LAO) and Governor's **projections for California tax revenue in the current fiscal year**, ending June 30, **are high**—nearly 20% higher than two years ago, with state income tax—and more specifically, stock market gains—being the primary driver. **However, the LAO projects flat revenues going forward.**
2. **Inflation:** The annual inflation rate in the US for April 2025 is 2.3%, according to the Bureau of Labor Statistics. This is the lowest since February 2021. The Consumer Price Index (CPI) rose 0.2% for the month, bringing **the 12-month inflation rate to 2.3%.**
3. **Unemployment:** The US unemployment rate is currently at 4.2%. This figure has been relatively stable at 4.0% to 4.2% since May 2024. **The California Unemployment Rate is at 5.30%**, compared to 5.40% last month and 5.10% last year. This is lower than the long-term average of 7.11%. However, the LAO reports that California has been experiencing a slowdown for the last two years, with slower new hiring and no new jobs so far in 2025.

4. **Recession: the likelihood of a 2025 U.S. recession is debated.** Forecasts for GDP growth in the next few quarters have hit record lows, according to the long-running Blue Chip Economic Indicators survey. Recession probabilities have climbed above 50% in prediction markets such as Kalshi and Polymarket, with certain projections exceeding 70%. Economists also have varying assessments, with some like JPMorgan Chase citing a 60% chance of a recession. Other models, like the New York Fed's model, suggest a lower probability of around 29%.
5. **Anticipated tariff impacts: \$16B revenue loss attributed to federal tariffs,** disproportionately affecting trade-reliant sectors (manufacturing, agriculture). This is projected to reduce GDP growth (↓ 0.7% in 2025, ↓ 0.3% in 2026). The governor projects corporate profits to decline as well (↓ 7.9% in 2025).
6. **Federal contributions:** Currently, **federal funding** linked to the Every Student Succeeds Act (ESSA) **has not been reduced**. The FY 2025 Continuing Resolution, which passed Congress in January, **flat-funded most federal education programs** (including Title I, IDEA, Impact Aid, Title III, and Title IV-A) at last year's (FY 2024) level. **However, funding is uncertain for some select education programs, including Title II and other educator training grants.** In addition, as the superintendent reported at the May 13 Board meeting, at least tens of millions of dollars in specialized grant funding has been denied to the District. (\$6M for Mental Health Career Pathway Grant, \$10M for Local Food for Schools, over \$600M statewide for Teacher Training Grants, and a balance of \$4M in COVID Relief funds used for early childhood education.)

Statewide Budget Shortfall

The Governor projects that California will face a **\$12 billion deficit** driven by lower revenues (↓\$5.2B) and higher Medi-Cal costs (↑\$10B over two years) going forward. The primary drivers are the anticipated tariff impacts, and increased Medi-Cal enrollment (15M beneficiaries, up from 12.7M in 2019-20 (+18%)), and \$10B additional costs, some of which is due to increased pharmacy spending.

The governor proposes that the state should withdraw \$7.1B from the Rainy Day Fund but maintain a \$15.7B total reserve balance to mitigate future risks. Overall in California, ongoing expenditures exceed revenues, necessitating one-time solutions (e.g., fund shifts, deferrals).

All of this means the **Proposition 98 Guarantee is reduced by \$4.6B** from the Governor's Budget in January. Consequently, LAUSD will receive a **lower COLA (adjusted to 2.3%, down from 2.43%)** than was anticipated in January.

Implications for LAUSD

1. In addition to the lower-than-expected Proposition 98 Guarantee and lower COLA, the Governor proposes \$1.8B in **LCFF payments deferred** from June 2026 to July 2026, impacting cash flow.
2. **State funding for universal TK is reduced to \$2.1B** ongoing (from \$2.4B proposed). LAUSD must ensure staffing ratios (10:1) are met.

3. **Expanded Learning Opportunities Program (ELOP) funding increased** to \$515.5M (from \$435M) to support districts with lower counts of unduplicated pupils.
4. **AB 602 base rate** increased to \$897/ADA (from \$887) in FY 2025 and will increase by the 2.3% COLA in FY 2026, which **will raise it to approximately \$917**. However, with federal IDEA funds remaining flat, LAUSD's cross-subsidy from the General Fund may grow.
5. **Medi-Cal Cuts:** If Congress curtails Medicaid, California may respond with reductions to dental benefits, tightened asset tests, and lower provider rates, all of which could strain student health services, increasing demand for school-based clinics. More than 51% of children in LAUSD are covered by Medi-Cal. If Medicaid cuts are implemented, surveys show districts expect to cut health-related staff.¹

Strategic Considerations for the Board

- **Revenue Volatility:** The flat revenue forecast going forward and the delayed effect of current national economic policies (i.e., unknown recession risk) argue for fiscal caution. The District should maintain its reserve while anticipating mid-year cuts if state revenues underperform.
- **Expenditure Pressures:** Salary increases and pension contributions must align with revenue constraints.
- **Enrollment declines:** Right-sizing strategies (e.g., facility consolidations) should be considered to match -2.2% annual enrollment loss.

¹ <https://www.publicnewsservice.org/2025-02-19/childrens/ca-schools-brace-for-harmful-cuts-to-medi-cal/a95344-1>;
<https://www.the74million.org/article/new-survey-finds-medicare-cuts-would-devastate-school-staffing-and-services/>