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# **FY 2011 and FY 2012 JLBC Baseline**

**January 14, 2011**

**JLBC**

# Summary of the Current Budget Status

## Improving, but Long Term Problems Remain

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- ❑ The JLBC Baseline provides an estimate of the General Fund budget shortfall using a consensus revenue forecast and an estimate of statutory funding formula costs.
- ❑ An improving economy since the summer has increased tax collections and reduced caseload growth in the Medicaid programs.
- ❑ As a result, the budget shortfall is estimated to be \$(530) million in FY 2011 and \$(975) million in FY 2012.
- ❑ While the shortfall estimates have improved, long term problems remain:
  - 265,000 lost jobs and 41,000 foreclosures will delay full recovery
  - The shortfalls do not reflect more than \$1 billion in annually suspended funding formulas still in statute
  - The state will lose nearly \$1 billion in revenue in FY 2014 with the expiration of the 1 cent sales tax.

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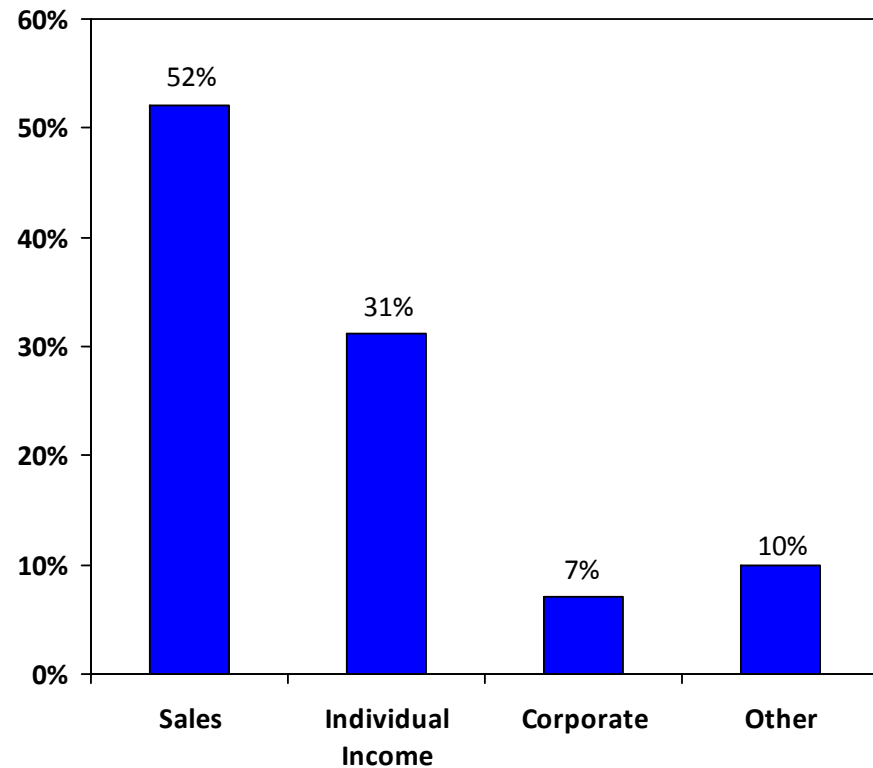
# Revenue Overview

JLBC

# FY 2011 General Fund Revenue

- 90% Generated by 3 Taxes

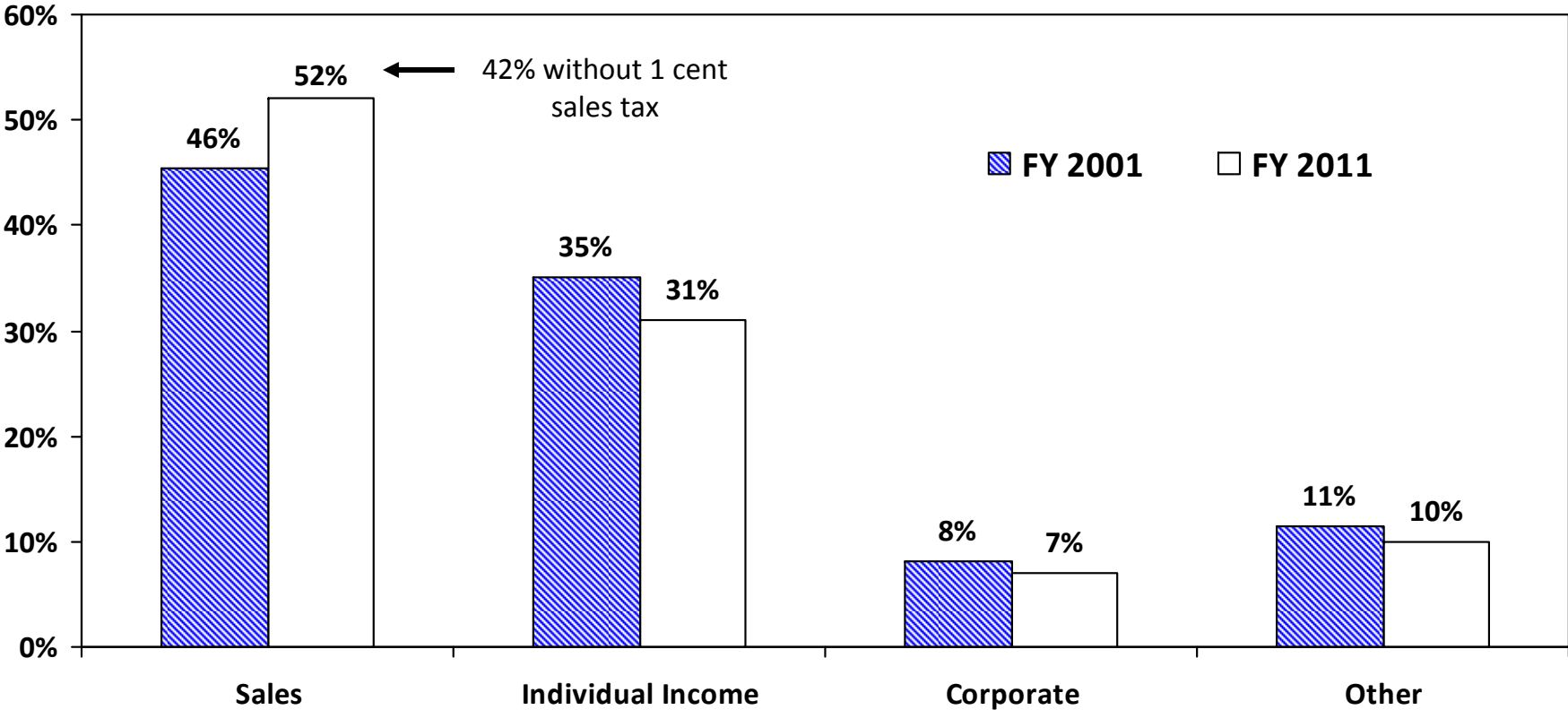
<u>Source</u>	<u>(Millions)</u>
Sales and Use Tax	\$ 4,269.6
Individual Income Tax	2,558.9
Corporate Income Tax	573.4
Other	<u>794.6</u>
<b>TOTAL REVENUE</b>	<b>\$ 8,196.5 <sup>1/</sup></b>



<sup>1/</sup> January 2011 estimate. Excludes beginning balance, urban revenue sharing, and one-time revenue adjustments.

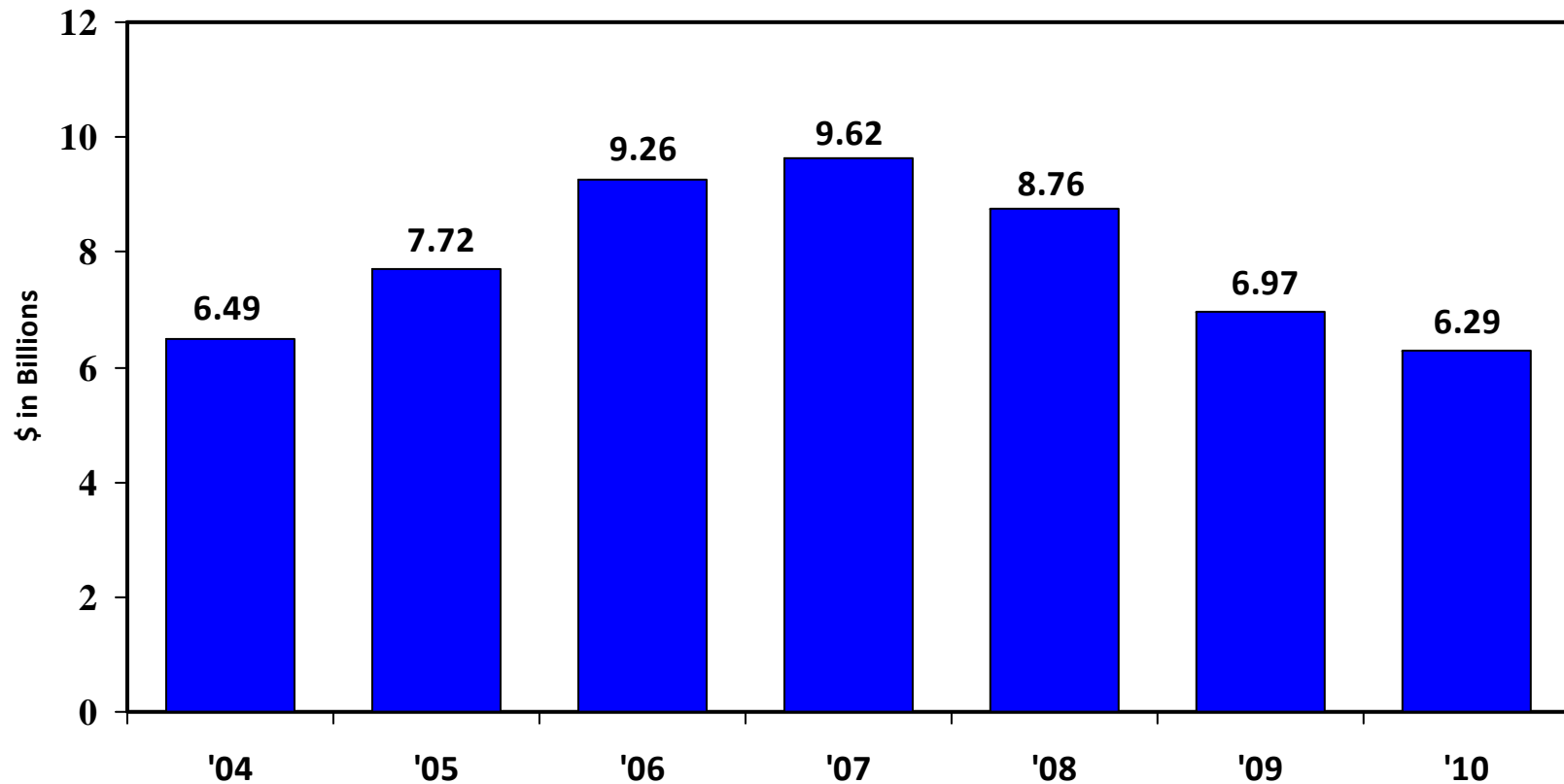


# Since '01, Greater Reliance on Sales Tax Due to 1 Cent Tax Increase



- Excludes beginning balance, urban revenue sharing, and one-time revenue adjustments.

# Unprecedented 3 Year General Fund Revenue Decline of (33)%



- Excludes statutory and one-time changes.



# Revenue Update - Base Growth of 7.4% Through December

## - May Not Be Sustainable for Entire Fiscal Year

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	YTD FY '11 Over <u>YTD FY '10</u>
Sales Tax	-0.6%*
Individual Income Tax	9.7%
Corporate Income tax	115.4%

\* Without 1 Cent

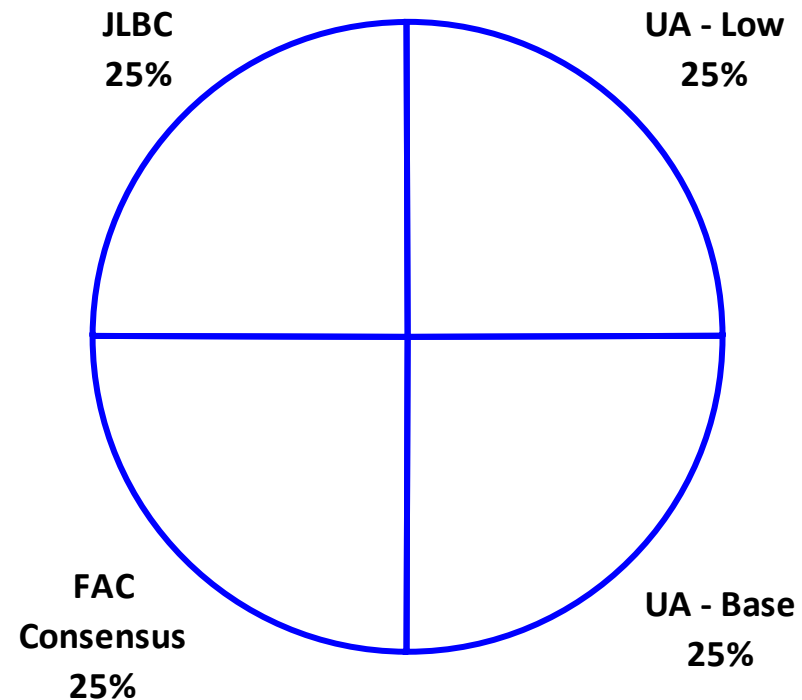
- ❑ Unusually low '10 collections and higher business profits boosted corporate %.
- ❑ Individual Income Tax artificially high due to withholding change.
- ❑ After negative summer, sales tax collections are beginning to turn positive.
- ❑ Revenues \$(18) M below forecast through 12/2010.

# How Does JLBC Forecast Revenues?

- A Consensus Process with 4 Inputs
  - Focuses on Sales, Individual and Corporate Income Tax
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4-sector forecast equally weights:

- FAC average
- UofA model – base
- UofA model – low
- JLBC Staff forecast
- Remaining revenues (10% of total) are staff forecast



\* The Finance Advisory Committee is a 15-member panel of public and private sector economists that publicly meets 3 times a year to advise the Legislature on the state of the Arizona economy.



# Any Revenue Forecast Will Have Significant Constraints in Predicting the Next 18 Months

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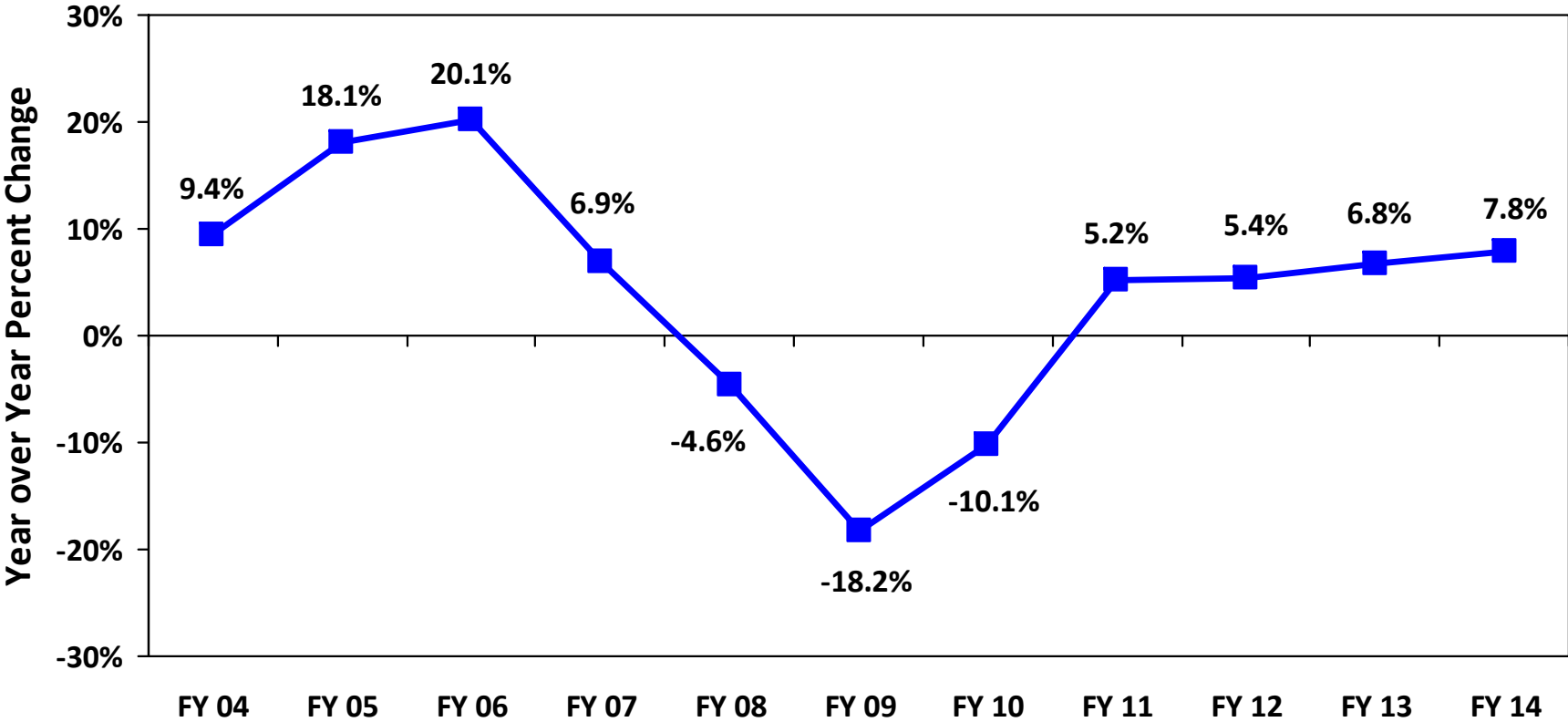
- ❑ Current economic instability makes forecasting especially challenging.
- ❑ Current forecasts are most useful in determining the direction of the economy, not its precise landing point.
- ❑ Certain structural factors limit potential for rapid growth.

# The Road to Recovery Will Still Be Long

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- ❑ 265,000 jobs lost since December 2007
  - Have gained 32,000 jobs in the last year.
  
- ❑ Housing problems persist
  - While pending Valley foreclosures declined from 51,000 in December 2009, there are still 41,000 in the pipeline
  - 49% of Arizona-wide mortgages “underwater”

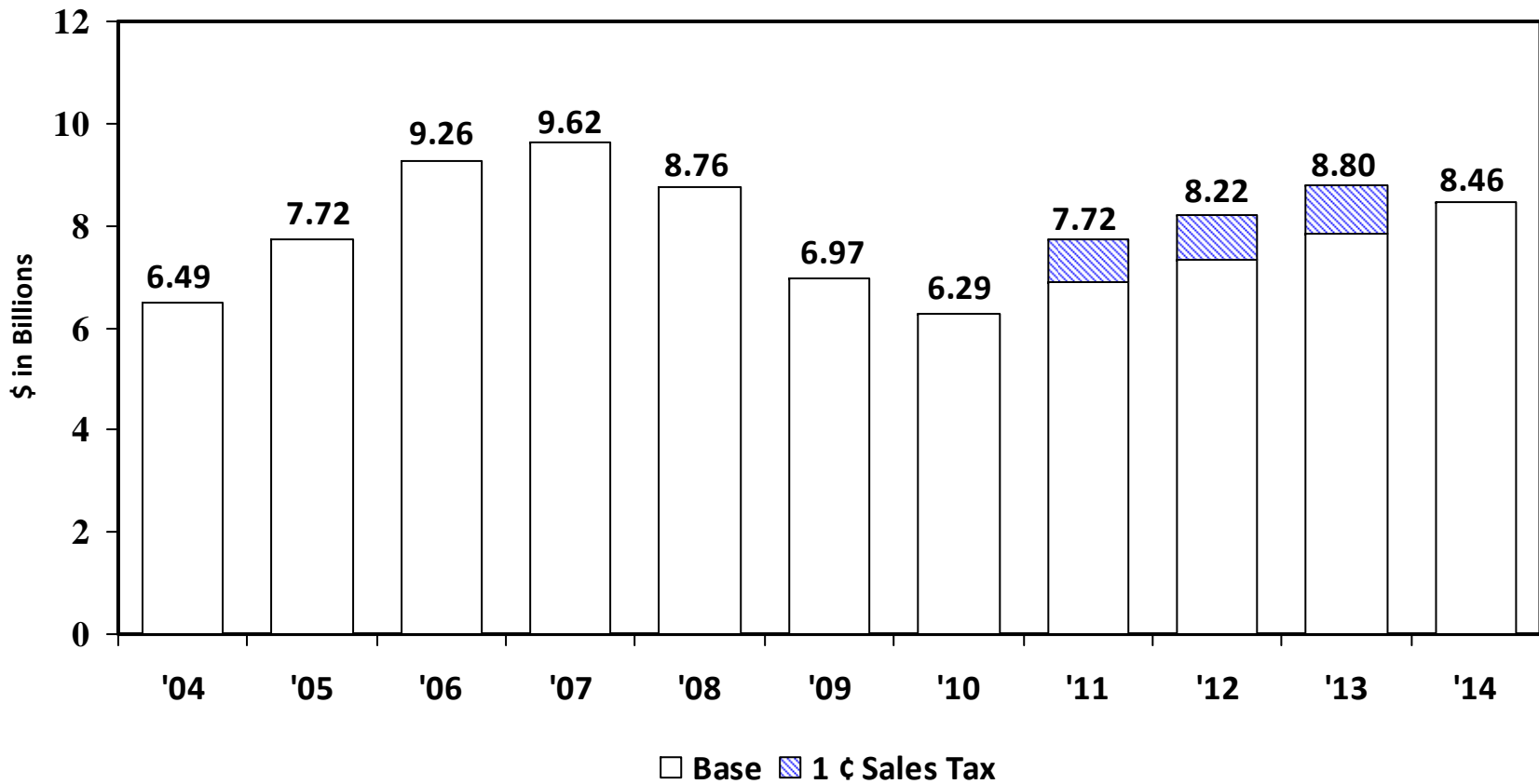
# Consensus Forecasts Base Revenue Growth Rate Above 5% Through FY '14



- To reflect underlying economic growth, “Base” revenues exclude balance forward, tax law changes, one-time revenues, and urban revenue sharing



# Consensus Forecasts Still Below FY '07 Level



- Excludes balance forward and other one-time revenues

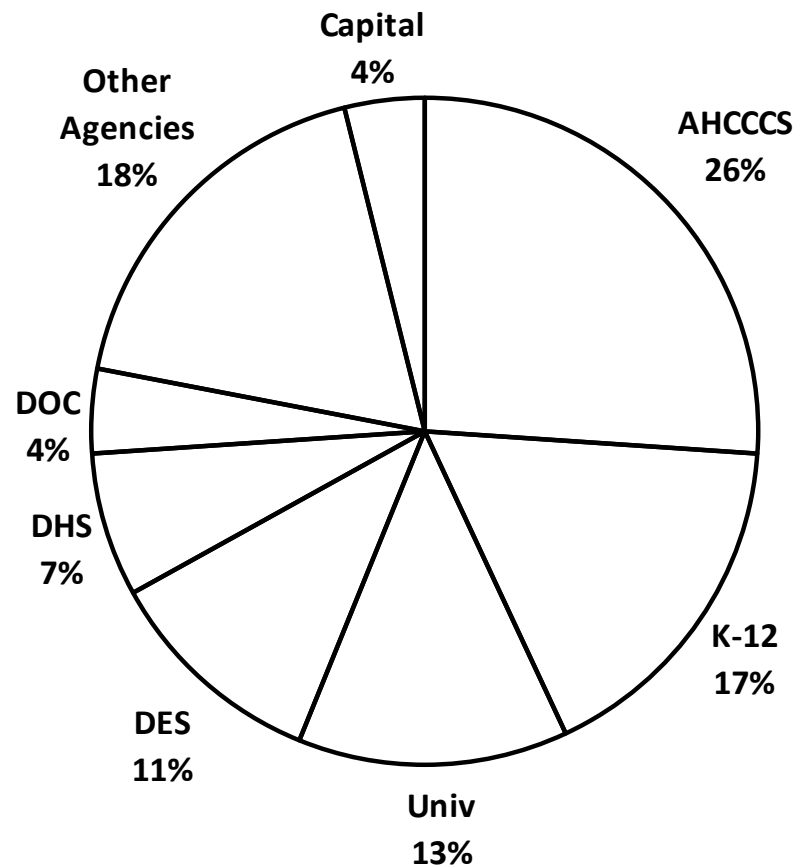
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# Spending Overview

# FY 2011 Total Spending is \$29 Billion

## - General and Non-General Fund

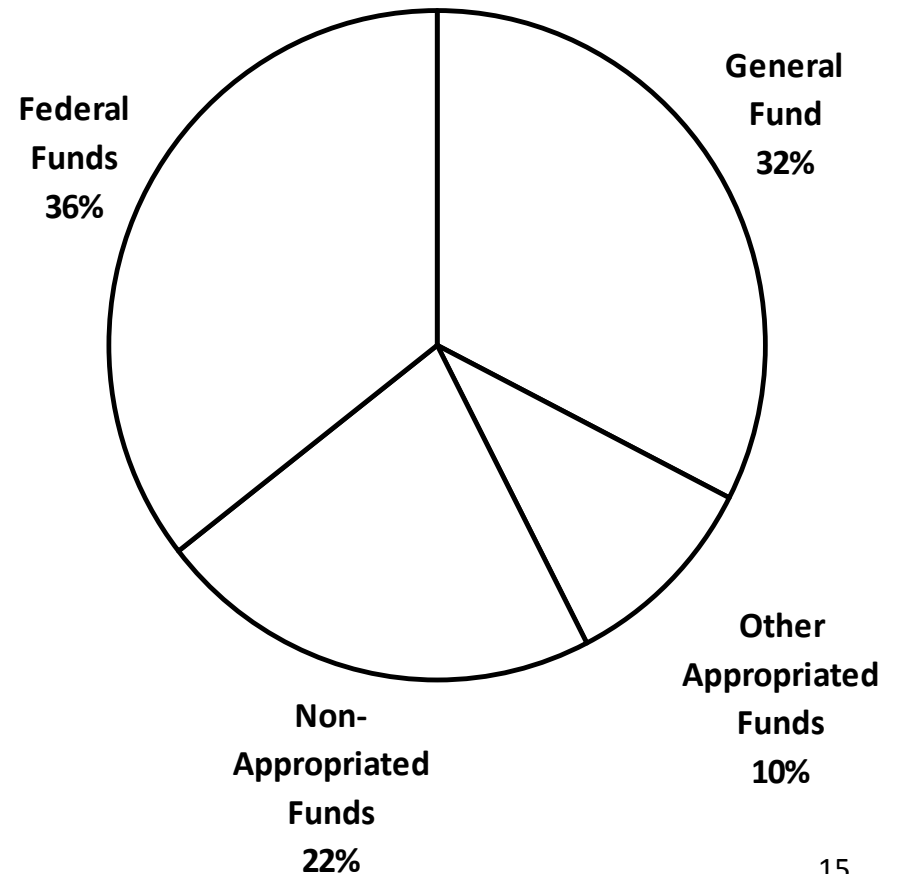
<u>Budget Unit</u>	<u>(Millions)</u>
AHCCCS	\$ 7,855.6
Education (K-12)	5,059.1
Universities	3,916.1
Economic Security	3,237.2
Health Services	1,999.1
Corrections	1,052.4
Other Agencies	5,197.7
Capital	<u>1,082.8</u>
<b>TOTAL</b>	<b>\$ 29,400.0</b>



# The \$9.5 B General Fund Share is 32% of Total Funds

## - General Fund Share Down from 39% in '08

<u>Fund Source</u>	<u>(Millions)</u>
General Fund	\$ 9,524.3
Other Appropriated Funds	2,928.4
Non-Appropriated Funds	6,479.6
Federal Funds	<u>10,467.7</u>
<b>TOTAL</b>	<b>\$ 29,400.0</b>



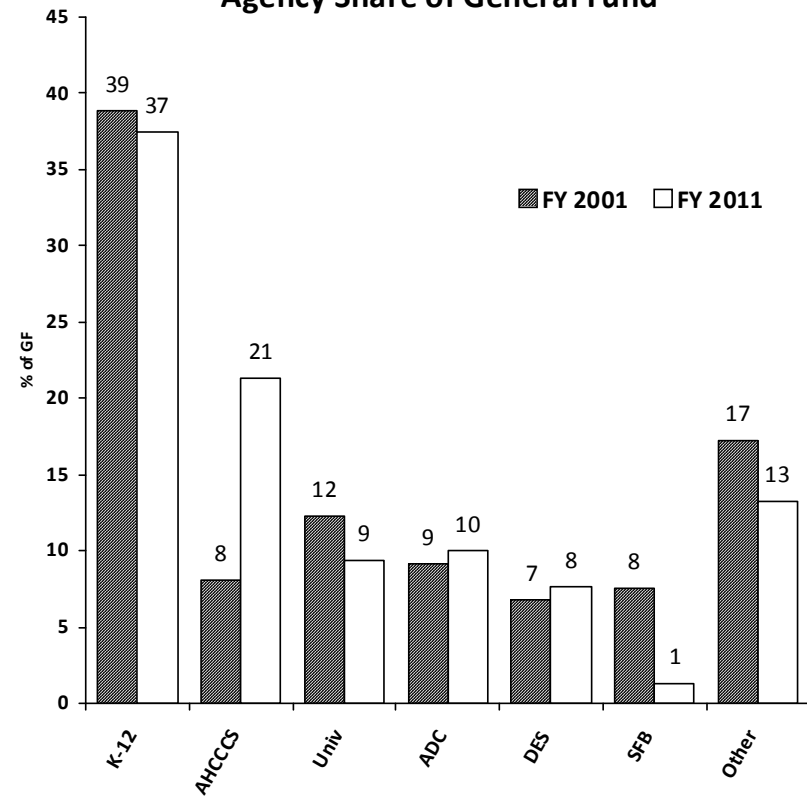
# 10 Year History of General Fund Spending by Agency

Comparison of 9 Largest General Fund Operating Budgets 1/  
(\$ in Millions)

	FY 01 Actuals	FY 11 On-Going	\$ Change FY 01-11	% Change FY 01-11
Education (K-12)	\$ 2,443.1	\$ 3,584.0	\$ 1,140.9	46.7
AHCCCS	506.0	2,029.6	1,523.6	301.1
Corrections	571.6	948.7	377.1	66.0
Universities	772.8	890.2	117.4	15.2
Economic Security	427.3	679.2	251.9	59.0
Health Services	246.7	581.7	335.0	135.8
Community Colleges	137.4	135.3	(2.1)	(1.5)
School Facilities Board	474.0	127.6	(346.4)	NA
Public Safety	76.2	43.1	(33.1)	(43.4)
Other	624.4	504.9	(119.5)	(19.1)
<b>TOTAL</b>	<b>\$ 6,279.5</b>	<b>\$ 9,524.3</b>	<b>\$ 3,244.8</b>	<b>51.7%</b>

1/ Represents individual agency spending adjusted for one-time Federal and other savings

Agency Share of General Fund





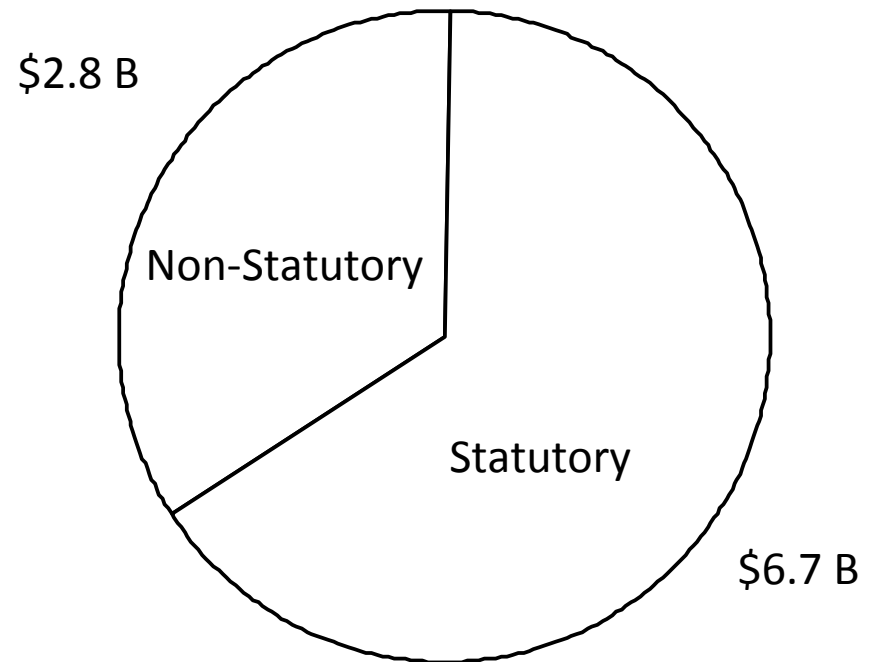
# Statutory Formulas Determine 70% of General Fund Spending

- \$6.7 Billion in Statutory Spending Excludes over \$1B in Suspended Formulas

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Examples of Formulas:

- K-12 Operating
- K-12 Construction
- Medicaid



\$9.5 B GF Budget  
On-Going \$

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# What Is the Current Status of the Budget?

# FY '11 Shortfall Now Estimated at **\$(531) M**

- Down from **\$(825) M**

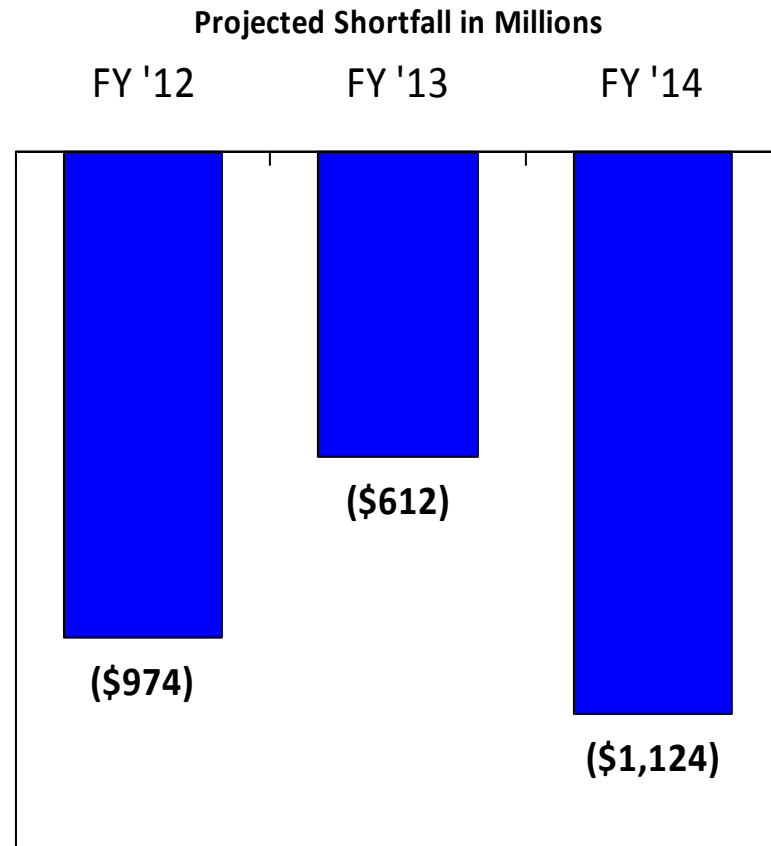
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- ❑ Failure of November ballot props – **\$(469) M**
- ❑ Projected revenue shortfall – **\$(86) M**
  - Prior estimate was **\$(200) M**
- ❑ Projected Health/Welfare Caseload Savings – **\$19 M**
  - Prior **\$(158) M** lower Federal match shortfall offset by caseload savings and rate cut
- ❑ **\$100 M** K-12 shortfall – offset with federal funds

# A Projected Cash Shortfall of \$(974) M in FY '12

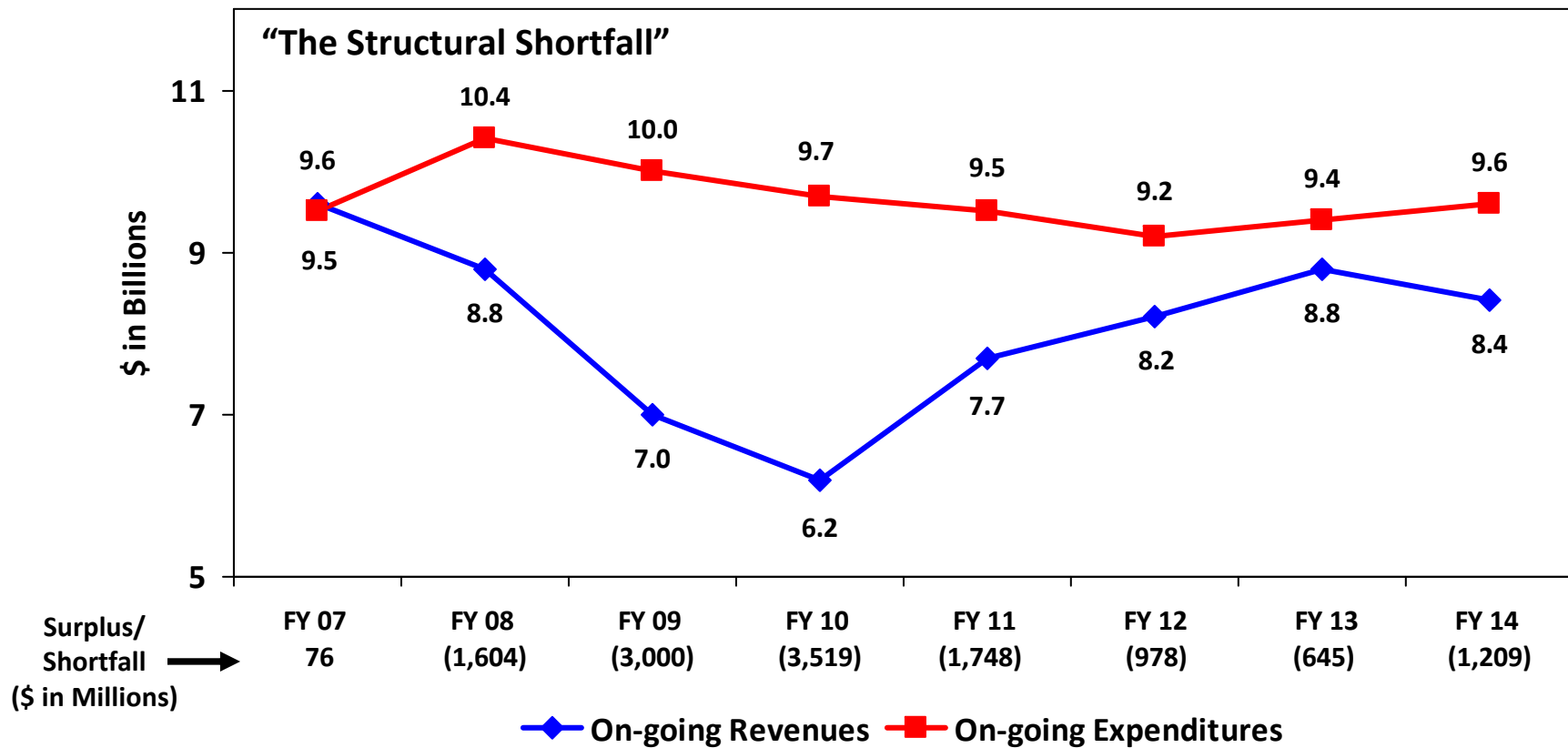
- Any Permanent Solutions in FY '12 Reduce FY '13 and FY '14 Gaps

- Based on consensus revenues and active formula growth
- FY '12: Federal assistance expires
- FY '14: Sales tax expires and increases shortfall
- Does not include \$1 B+ In suspended formulas (Appendix)



# Structural Gap Comparable to Cash Gap in FY '12-'14

## - Represents On-Going Revenues Versus On-Going Expenditures



# Another Aspect of State's Fiscal Policy is its Credit Rating

## - Arizona's Rating is 3<sup>rd</sup> Lowest of All States

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- ❑ Arizona issuances are investment grade – 5<sup>th</sup> highest level (out of 10) for GF-backed financing
- ❑ Recent downgrade due to:
  - Economic and financial weakness
  - Structural imbalance and reliance on one-time solutions
  - Constitutional limits on raising revenues and reducing spending
- ❑ But outlook has shifted from “negative” to “stable” reflecting:
  - Recent revenue improvement
  - Recent efforts to reduce structural deficit

## Detail of the FY '12 General Fund Baseline Increases

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	(\$ in M)
Issue	FY 2012 Cost
Federal Assistance Backfill	\$876
K-12 Formula	55
SFB Debt Service	97
University Furlough Begins	(53)
Health and Welfare Formula	(171)
Extra 27 <sup>th</sup> Pay Period	80
Other	(42)
<b>TOTAL</b>	<b>\$842</b>

# Backfilling One-Time Federal Assistance Costs \$876 M in FY '12

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Return To Regular Medicaid Match	\$ 783 M
Eliminate Use of Federal Funds For K-12 Formula	93 M
No Backfill of Discretionary Programs	--



# FY '12 K-12 Operating Formula Growth is \$55 M

## - Plus \$93 M for Federal Funds Backfill

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\$ in M

\$108	–	1.9% enrollment growth
4	–	0.9% inflation – on limited base
50	–	Base adjustment for one-time prior year shortfall
(36)	–	2.3% new property growth
(71)	–	No Homeowner's Rebate for discretionary K-12 taxes
		• Already enacted with FY '12 start date
<hr/>		
\$55		Total

## FY '12 School Facilities Board Growth is \$97 M

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- ❑ FY '12 Baseline includes an increase of \$97 M for debt service which includes:
  - \$60 M to backfill the one-time FY '11 refinance savings
  - \$10 M due to the FY '11 bond issuances
  - \$27 M related to bond issuances prior to FY '10
- ❑ Assumes no new cash payments for construction authorized in FY '12
- ❑ Baseline continues \$2.7 M for Building Renewal Grants Fund

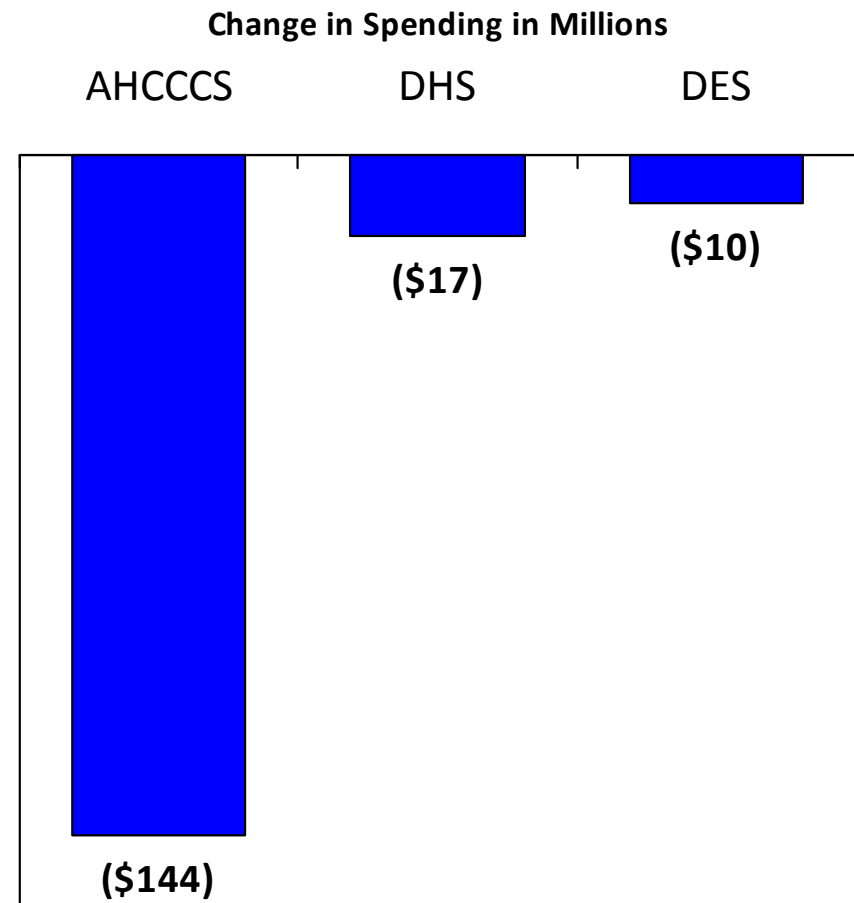
## No Higher Education Funding Growth in FY '12 - Continuation of FY '11 Policy

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- ❑ University funding declines \$(53) million
  - FY '11 budget begins pay cut/6 day furlough in FY '12
  - 4.3% growth would have cost \$28.4 M based on non-statutory “22 to 1” formula
  
- ❑ Community Colleges decline \$(2.1) M
  - \$(1.7) M savings due to property growth in equalization districts
  - Operating/Equalization would have otherwise cost \$9.0 M primarily due to 9.7% student growth

# FY '12 Health/Welfare Spending Would Decrease \$(171) M - Plus \$783 M For Federal Fund Backfill

- AHCCCS: 5% April 2011 Rate Cut, pharmacy rebates and FY '11 caseload savings offset 1.9% FY '12 caseload growth
- DHS: 2.3% caseload growth offset by reversing use of benefit \$ for administration
- DES: 5% DD caseload growth offset by decline in TANF caseload



# AHCCCS FY '12 Savings of \$(144) M

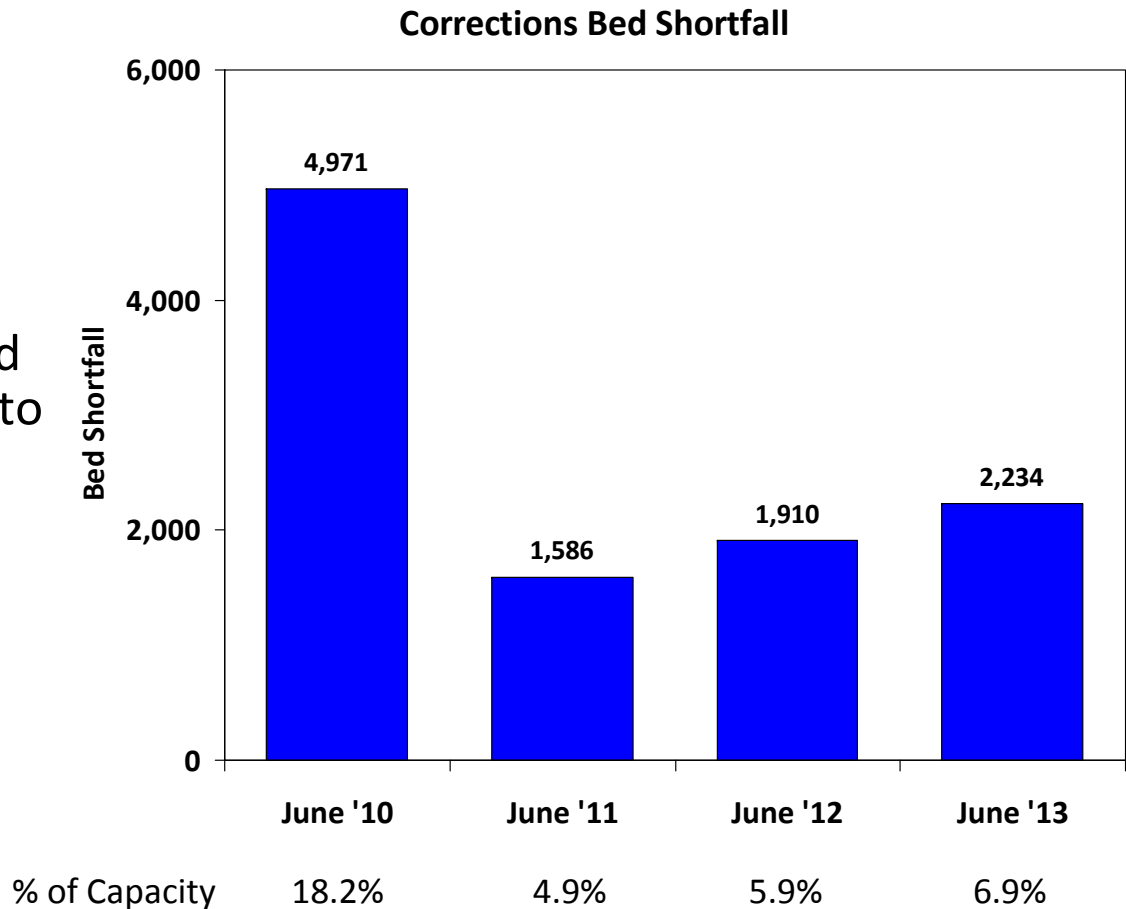
## - Offset By \$582 M to Backfill Federal Funds

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	<u>\$ in M</u>
<input type="checkbox"/> FY '11 Caseload Savings <ul style="list-style-type: none"> <li>• 0.2% instead of 3.0% Growth</li> </ul>	\$(57)
<input type="checkbox"/> Oct. 2010 Capitation Rate Savings	(30)
<input type="checkbox"/> New April 2011 5% Rate Cut	(62)
<input type="checkbox"/> Drug Rebate	(20)
<input type="checkbox"/> FY '12 1.9% Caseload Growth	<u>25</u>
TOTAL	\$ (144)

# Department of Corrections Has Minimal Changes as No New Beds Will Open in FY '12

- ❑ Bed shortfall declines as new beds opened in FY '11
- ❑ 5,000 previously authorized private beds not expected to open until FY '13
- ❑ Prison population grew 0.2% in FY '10
- ❑ Projected bed growth of 0.8% through FY '12



Excludes 5,000 New Private Beds



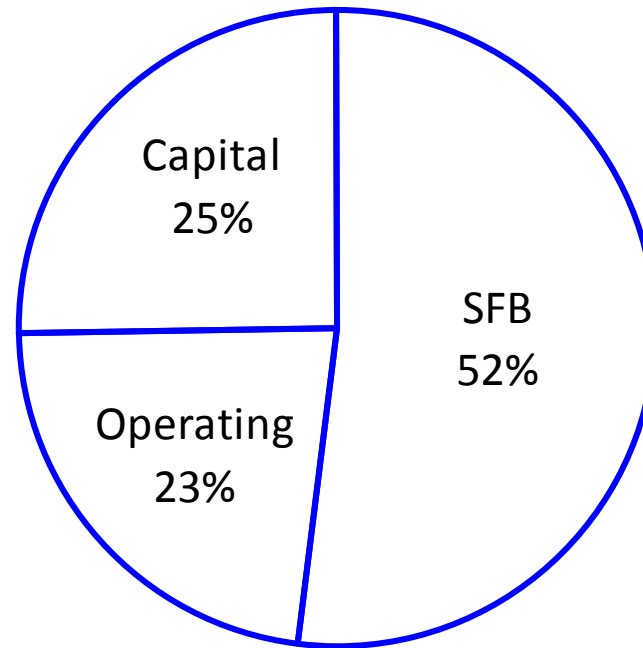
# General Fund Debt Service Will Cost \$308 M in FY '12

## - Represents 7th Largest Budget Unit

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	<u>\$ in M</u>
Capital	78.1
SFB	160.1
Operating	<u>69.7</u>
<b>TOTAL</b>	<b>\$ 307.9*</b>

\*Includes \$20.7 M in diverted  
General Fund lottery revenue



# How Does Employee Retirement Affect Spending?

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- ❑ Annual General Fund Cost is \$130 M
  - \$1.3 B Cost Reflects all State/Local Fund Sources
- ❑ ASRS General Fund Cost Expected to Increase by \$14 M Over Next Several Years
  - Other Systems' General Fund Cost Will Increase by \$4 M in FY '12
- ❑ Retirement Systems Have Constitutional Protections
  - Benefits Cannot Be Reduced
  - Assumptions Must Be Actuarially Sound

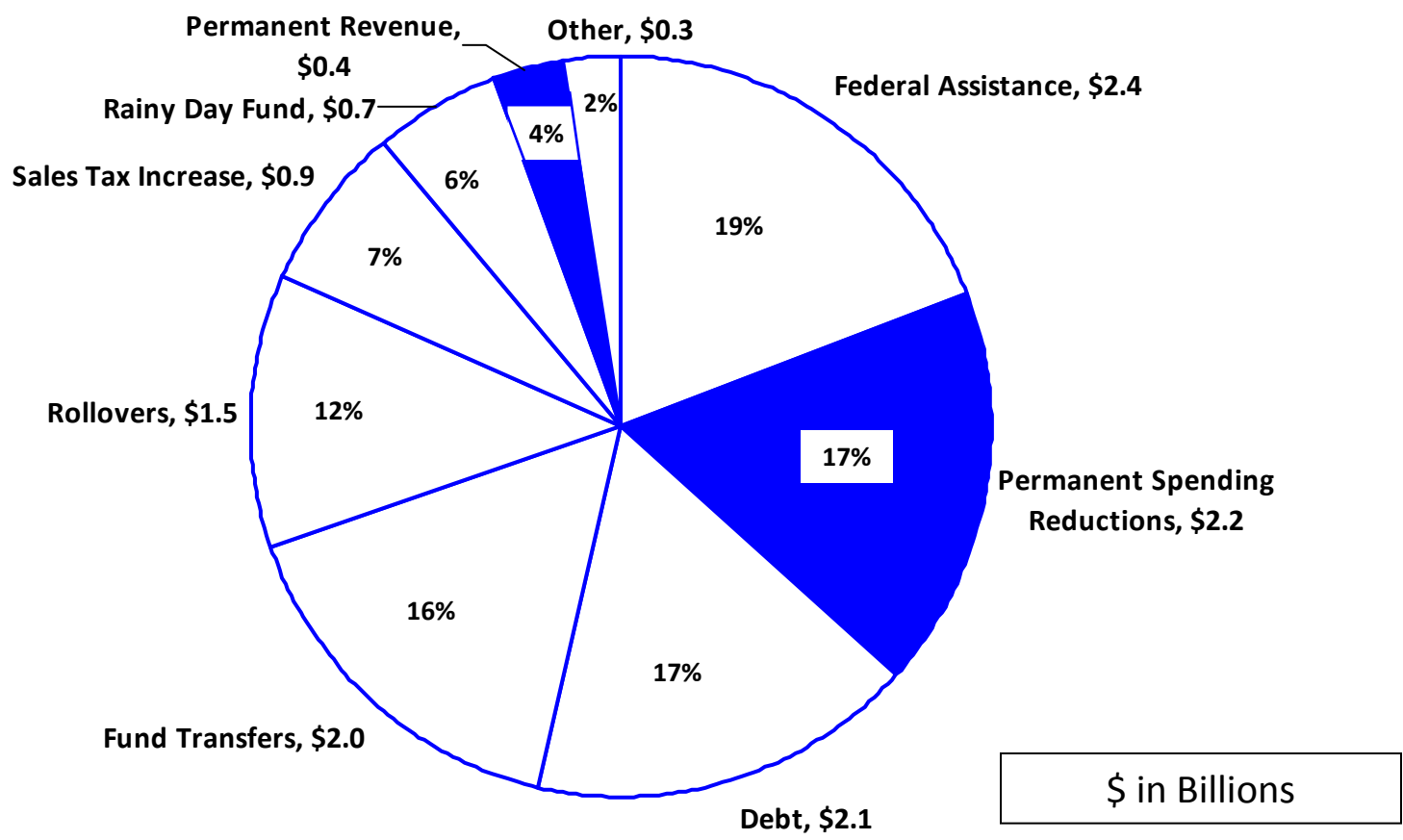


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**Where Do We Go From Here?**

# Since FY '08, State Has Used Mostly Temporary Solutions to Resolve Budget Shortfalls

## - \$12.5 B In Cumulative Solutions



Budget solutions as share of shortfall

# Federal Maintenance of Effort (MOE) Requirements May Affect State's Flexibility

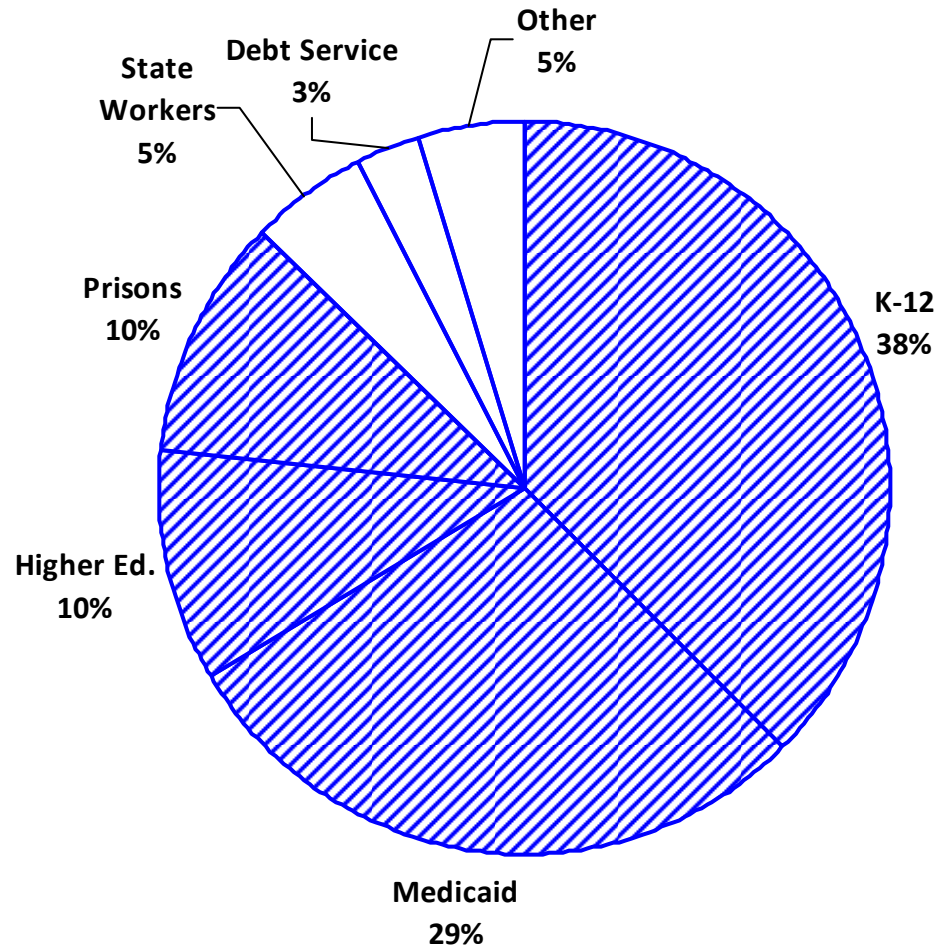
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- ❑ Federal health care legislation prevents state from changing most Medicaid eligibility
  - Changes could result in loss of \$6.4 B in federal matching
  - Can still modify rates at any time
  
- ❑ Federal education stimulus requires maintenance of FY '06 spending level
  - K-12 and Higher Education already at FY '06 level
  - Requirement expires at end of FY '11

# The 3 Main Drivers of General Fund Spending Are Education, Health, and Prisons

- Represents 87% of On-Going General Fund Budget

	<u>(FY '11 \$ in Millions)</u>
Education (K-12)	\$ 3,559.1
Medicaid	2,749.7
Higher Education	990.9
Prisons	985.8
State Workers	509.0
Debt Service	270.7
Other	<u>459.1</u>
<b>TOTAL</b>	<b>\$ 9,524.3</b>



# STAFF OF THE JOINT LEGISLATIVE BUDGET COMMITTEE

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- Director
  - Richard Stavneak
  - Linda Monsanto
  - Steve Schimpp
  - Stefan Shepherd
- Assistant Directors
  - Eric Jorgensen
  - Leatta McLaughlin
  - Hans Olofsson
- Chief Economist
  - Bob Hull
- Principal Fiscal Analysts
  - Amy Upston
- Senior Fiscal Analysts
  - Eric Billings
  - Jack Brown
  - Steve Grunig
  - Art Smith
- Fiscal Analysts
  - Marge Zylla
  - James Alcantar
  - Benjamin Beutler
  - Aaron Galeener
  - Ted Nelson
- Administrative Assistant/JLBC Clerk
  - Sandy Schumacher
- Administrative Assistant/JCCR Clerk
  - Mya Trivison

# Appendix: Funding Formula Suspensions

## Statutory Funding Formula Suspensions

<u>Agency</u>	<u>Formula</u>	<u>Savings</u>
Community College	Operation and Equalization Formula	\$7,486,100
	Capital State Aid Suspension	\$20,652,500
Department of Education	Soft-Capital Formula	\$165,120,700
	New Utilities Formula	\$100,000,000
	Charter School Additional Assistance	\$10,000,000
Department of Emergency & Military Affairs	Military Installation Fund Deposit	\$2,800,000
	Governor's Emergency Fund	\$2,100,000
Department of Environmental Quality	WQARF	\$8,000,000
Judiciary	Probation Revocation Payment	\$2,410,300
School Facilities Board	Building Renewal	\$231,715,400
Tourism	Tourism Funding Formula	\$14,613,300
State Treasurer	Justice of the Peace Salaries	\$1,115,000
Universities	Financial Aid Trust	\$2,797,800
Department of Water Resources	Water Protection Fund Transfer	<u>\$5,000,000</u>
Subtotal		\$573,811,100
Future Year Cost – Department of Education	Teacher Performance Pay (by FY 2018)	\$278,000,000
Future Year Cost – School Facilities Board	New School Construction (If enrollment returns to pre-recession level)	<u>\$386,000,000</u>
Total		\$1,237,811,100

## Non-Statutory Formula Suspensions

Department of Administration	Building Renewal	\$33,400,000
Universities	Enrollment	\$32,390,800
	Building Renewal	<u>\$88,957,100</u>
Subtotal		\$154,747,900

