FY 2021 BASELINE SUMMARY

Overview

The FY 2021 Baseline provides an estimate of the state's General Fund balances. The revenue projections reflect a consensus economic forecast while the spending estimates represent active funding formula requirements and other obligations. The Baseline does not represent a budget proposal, but an estimate of available resources after statutory requirements.

The JLBC Baseline parameters are as follows:

- Total FY 2021 General Fund revenue is projected to be $12.57 billion. Ongoing revenues are forecast to grow by $505 million, or 4.1%, above FY 2020. After adjusting these estimates for changes in one-time monies and Urban Revenue Sharing, however, total revenue growth would be just $26 million, or 0.2% above FY 2020.
- In comparison, FY 2021 Baseline formula spending is projected to be $11.53 billion. This amount reflects a $(368) million, or (3.1)%, decrease in expenditures below FY 2020. While ongoing spending would increase by $570 million above FY 2020, that is offset by a $(938) million decrease in one-time spending.
- The projected FY 2021 cash balance is $1.04 billion. This amount is in addition to more than $1 billion available in the Budget Stabilization Fund (BSF) by the end of FY 2021.
- Under the Baseline projections, the Legislature would have the ability to dedicate $300 million of the $1.04 billion Baseline balance to ongoing initiatives without creating a shortfall through the 3-year planning period.
- The JLBC Staff recommends setting aside at least $50 million for a cash balance each year.
- The remaining $685 million of the Baseline balance would be available for one-time initiatives.

These estimates overstate the level of available resources in the FY 2021 budget in part because the Baseline eliminates $1.06 billion of spending that was labeled as "one-time" in the FY 2020 budget. While much of that spending appears to be legitimately one-time, such as the deposit of $271 million into the Budget Stabilization Fund and the use of $190 million to pay off a 2010 debt issuance, some may be less one-time in nature. Of the $1.06 billion, $117 million is for spending that has been included as one-time spending in multiple years' budgets (*see Table 1*). There may be legislative interest in retaining some of this spending, as well as in other new discretionary spending or tax decreases.

Table 1
Multiple-Year One-Time Initiatives

	$ in M
SFB Building Renewal	63
Universities	35
State Employee Health	11
Maricopa/Pima DJC Offset	8
Total	117

FY 2020

The FY 2020 budget is currently projected to have a $643 million balance, an increase of $578 million from the original budget estimate of a $65 million balance. Total revenues, including the beginning balance, are forecast to be $12.55 billion compared to spending of $11.90 billion. The net $578 million adjustment has 3 components:

- Ongoing revenues are $433 million greater than anticipated, the result of both higher actual FY 2019 and projected FY 2020 growth as compared to the original FY 2020 budget.
- One-time revenues are a net $193 million greater than anticipated as a result of a higher FY 2019 ending balance.
- Spending is projected to be a net $48 million higher than originally budgeted in FY 2020, primarily due to higher-than-budgeted caseloads in AHCCCS.

FY 2021 Baseline Revenues

Total FY 2021 revenue collections would increase by 0.2% to $12.57 billion, or $26 million above the revised FY 2020 estimate. The major adjustments are:

- Based on JLBC's 4-sector consensus, FY 2021 ongoing revenues are projected to grow by $505 million, or 4.1%. Ongoing revenues reflect the underlying growth in the economy and exclude one-time adjustments, urban revenue sharing, but do incorporate enacted tax law changes (*see the General Fund Revenue section for more information*).
- The state set-aside for urban revenue sharing formula distributions would increase from $738 million to $828 million, thereby decreasing state revenue by $(91) million.
- A $(314) million decrease in the balance forward between FY 2020 and FY 2021 is the third major adjustment. The state started FY 2020 with a cash balance of $957 million, but significant one-time expenditures as authorized in the FY 2020 budget are expected to produce an ending balance carried forward into FY 2021 of $643 million.
- Elimination of one-time FY 2020 fund transfers would reduce revenues by $(74) million.

FY 2021 Baseline Spending

Based on statutory funding formulas and other obligations, FY 2021 Baseline spending is projected to decrease by (3.1)% to $11.53 billion, or $(368) million less than FY 2020. The major adjustments are:

- Department of Education formula spending would have a net increase of $338 million due to 0.6% growth in student enrollment and a 1.77% inflation factor. The FY 2019 budget also authorized an additional 5% teacher pay adjustment in FY 2021. These growth factors would be partially offset by savings associated with higher K-12 property tax collections.
- AHCCCS formula spending would grow by $136 million, reflecting 0.5% caseload growth, a 2.6% capitation rate increase, and increased match costs for the Children's Health Insurance Program (KidsCare) and certain Proposition 204 adults.
- The Department of Economic Security (DES) budget would increase by $59 million, primarily for Developmental Disabilities Medicaid growth.
- Arizona Department of Corrections (ADC) spending is unchanged from FY 2020.
- University spending would decrease by $(36) million, including the elimination of $(35) million in one-time FY 2020 assistance.
- Community College spending would decrease by $(33) million, including the elimination of $(35) million of one-time monies for specific projects at Pima and Maricopa Community Colleges and rural community college aid.
- School Facilities Board funding would be reduced by $(181) million, reflecting the elimination of $(63) million of one-time building renewal monies, $(54) million for decreased costs of new school construction, and $(65) million for decreased lease-purchase debt obligations. The Baseline includes a total of $59 million for new construction, including $46 million for the second and final year of FY 2020 authorizations and $13 million for the first year of 2 new FY 2021 authorizations.
- Department of Water Resources (DWR) spending would decline by $(53) million to reflect the elimination of spending associated with the Drought Contingency Plan.
- Department of Housing spending would be reduced by $(15) million associated with removal of a one-time deposit to the Housing Trust Fund.
- Agency budgets would be reduced by $(11) million statewide to eliminate a one-time state employer health insurance increase but would also be increased by $43 million one-time for the costs of a 27th pay period in FY 2021.
- A decrease of $(24) million is associated with the payoff of the "2010B" debt issuance in FY 2020.
- The Baseline also eliminates significant FY 2020 one-time spending for a Budget Stabilization Fund deposit ($271 million), payoff of the "2010B" debt issuance ($190 million), and transportation funding ($95 million).

The $11.53 billion spending level would support a Full-Time Equivalent (FTE) Position ceiling of 53,423 state employees from both General Fund and Other Appropriated Funds.

Long-Term General Fund Estimates

A.R.S. § 35-125 requires the annual General Appropriation Act to include 3-year revenue and expenditure projections. To assist in this effort, the JLBC Staff has developed General Fund Baseline estimates through FY 2023, as shown on page S-6. Based on the assumptions described below, the Baseline ending balance is estimated to be $302 million in FY 2022 and $455 million in FY 2023.

After adjusting for the planning targets of $300 million in ongoing initiatives and $685 million in one-time allocations, the available cash balances would be $54 million in FY 2022 and $209 million in FY 2023.

These estimates exclude the Budget Stabilization Fund (BSF) monies. The BSF is estimated to have a fund balance of $1.04 billion by the end of FY 2021.

Baseline Revenues
As with FY 2021 revenues, the Baseline long-term revenue estimates are based on a consensus forecasting process and average 4 different forecasts. This process is described in more detail in the *General Fund Revenue* section.

The "4-sector" consensus projected an average General Fund base revenue growth of 3.3% in FY 2022 and 4.1% in FY 2023. These growth rates reflect revenue growth prior to Urban Revenue Sharing. Total General Fund revenue would decrease from $12.57 billion in FY 2021 to $12.35 billion in FY 2022 as a result of a significant decrease in the balance forward, then increase to $12.82 billion in FY 2023.

Baseline Spending
The long-term General Fund expenditures reflect the requirements of existing statutory funding formulas and other obligations. This spending is projected to increase by $512 million in FY 2022 (4.4%) above FY 2021 and $323 million in FY 2023 (2.7%) above FY 2022.

These spending adjustments include normal caseload growth in caseload-driven agencies such as the Arizona Department of Education (ADE) and AHCCCS, including continued implementation of adjustments for school additional assistance authorized in the FY 2019 budget. The FY 2022 number also includes $30 million to eliminate a portion of the K-12 rollover and $20 million for the University-related costs of a 27th pay period in that year; due to differences in pay periods, the Universities will have a 27th pay period one year after the rest of state government.

Overall spending would be $12.05 billion in FY 2022 and $12.37 billion in FY 2023.

Other Fiscal Challenges

There are 3 important aspects to consider in creating a budget: 1) manage risk in determining the Baseline revenue and spending forecast, 2) maintain ongoing and cash balances through the 3-year planning period, and 3) set spending and revenue priorities.

Manage Forecast Risk
There are both positive and negative risks to the JLBC Baseline revenue estimates:

- *Length of Expansion:* The length of the current national economic recovery has now set the record for the longest expansion in recorded history. The forecast assumes that the economy does not enter a recession during this time period. If this turns out to be true, it would mean the national economy had experienced 168 months of economic expansion. The previous record for longest expansion was 120 months.
- *Recession Likelihood:* While recessions are more commonly the result of a "shock" rather than "old age," many economists think one could occur by the end of calendar year 2021. A little more than half of 60+ leading economists in recent *Wall Street Journal* surveys predict the onset of a recession by that time. The likelihood of a recession has been revised down in recent months.
- *Current Strong Revenue Growth:* As of now, however, Arizona's economy and its revenue growth are still strong. The state ranks third overall in the country in terms of its economic momentum (personal income, population, and employment growth). Arizona has experienced healthy revenue growth of 10.2% in FY 2019 and 9.7% year-to-date in FY 2020.

Because small percent changes in growth assumptions can have a substantial impact – over 3 years, a 1% change in revenue growth could change available revenues by $725 million through FY 2023 – these risks could significantly change the final results of these budgets.

The state also faces ongoing litigation that may impact budgets such as:

- The K-12 Capital Funding litigation in Maricopa Superior Court.
- Litigation against the Department of Child Safety in United States District Court.
- Litigation against the Arizona Department of Corrections in United States District Court regarding inmate health care.

Plan for 3-Year Ongoing and Cash Balances
Under the Baseline projections, the Legislature would have the ability to dedicate $300 million of the $1.04 billion Baseline balance to ongoing initiatives in FY 2021 without creating a shortfall through the 3-year planning period. The JLBC Staff recommends setting aside at least $50 million for a cash balance each year. The remaining $685 million of the Baseline balance would be available for one-time initiatives.

Set Priorities
As noted above, the Baseline is only a starting point for budget discussions as it reflects changes to active statutory and other funding formulas and does not include discretionary changes. The Legislature will need to set priorities in allocating the $300 million in available ongoing monies. In distributing the $685 million in one-time funds, the Legislature may consider such initiatives as:

- Continuation of the $117 million in reoccurring "one-time" spending from FY 2020 and zeroed-out in the Baseline
- Budget Stabilization Fund deposit
- K-12 building repair spending
- Transportation projects
- Debt repayment
- "Buy down" of K-12 rollover
- Repair or replacement of Arizona prison facilities

In terms of managing its risks, the state may also want to consider funding for several other issues identified during the past year:

- Due to malfunctioning locks, there were prisoner disturbances at ADC's Lewis facility. While ADE estimates that $27 million in FY 2021 would address the particular Lewis issue, ADC has a considerable backlog of repairs at its other facilities. Over the next decade, ADC projects the cost of systemwide repairs at $380 million.
- DWR has identified 31 “high-hazard” dams with safety deficiencies, of which 15 are labeled as “unsafe.” Additional funding would be utilized to make more detailed assessments of the structural issues and the design solutions as well as set aside resources for the repair themselves.
- The Auditor General found that the Department of Health Services has substantial delays in investigating complaints against long term care nursing facilities. In a sample survey, the Auditor General estimates that 42% of complaints went uninvestigated for at least 7 months.

Debt

At the end of FY 2021, the state’s projected level of lease-purchase and bonding obligations will be $6.7 billion. The associated annual debt service payment is $779 million.

Of the $6.7 billion in total obligations, the General Fund share is $1.3 billion. The General Fund annual debt service is projected to be $223 million in FY 2021 (*see the Debt and Lease-Purchase Financing section of the Capital Outlay narrative for additional information*).

As a remnant of the Great Recession, the state also pays $931 million of current year K-12 obligations in the next year (the “rollover”). The $6.7 billion estimate of total obligations also does not include any unfunded retirement liability.

Arizona's debt rating was last changed in November 2019, when Moody's upgraded its rating from Aa2 to Aa1. Aa1 represents Moody's second highest credit rating. In comparison to other states, 14 have a higher rating, 19 have the same rating, and 16 have a lower rating or are not rated due to a lack of state level debt. Standard & Poor's, the other major credit rating agency, last changed its overall Arizona rating in November 2015 when it upgraded the rating to AA, which represents Standard & Poor's third highest credit rating.

Along with an overall rating, credit agencies also provide an outlook in terms of the future direction of rating changes. In November 2019, when Arizona's credit rating was increased by Moody's, Arizona was given a stable outlook. In adopting its credit ratings for Arizona in November 2019, Moody's listed as concerns absence of authority for the Executive to make mid-year budget reductions on its own and reduced financial flexibility due to restrictions enacted by Proposition 105 and Proposition 108. While noting these challenges, Moody's also indicated Arizona's growing reserves, comparably decreasing debt levels, demonstrated budget discipline, and a strengthening economy as positive trends.

Other Funds

Besides the General Fund, the state has dedicated special revenue funds. Only a portion of these monies is subject to legislative appropriation. The Baseline includes a FY 2021 Other Fund appropriated spending level of $4.6 billion, or (1.4)% below FY 2020.

The level of FY 2021 non-appropriated state funds is expected to be $11.0 billion, while non-appropriated Federal Funds are forecast to be $17.7 billion. When all appropriated and non-appropriated fund sources are combined, total FY 2021 state spending would be $44.8 billion.

JANUARY BASELINE PRIOR TO TARGETS
STATEMENT OF GENERAL FUND REVENUES AND EXPENDITURES 1/

	FY 2020 Baseline	FY 2021 Baseline	FY 2022 Baseline	FY 2023 Baseline
REVENUES				
Ongoing Revenues	$12,234,610,600	$12,739,841,900	$13,158,304,500	$13,693,047,000
Urban Revenue Sharing	(737,573,600)	(828,492,900)	(846,621,100)	(885,172,100)
Net Ongoing Revenues	$11,497,037,000	$11,911,349,000	$12,311,683,400	$12,807,874,900
One-time Financing Sources				
Balance Forward	$957,241,000	$642,962,800		
Wells Fargo Settlement	20,000,000			
Water Infrastructure Repayment			20,000,000	
Fund Transfers	70,840,700	16,700,000	16,700,000	16,700,000
Subtotal One-time Revenues	$1,048,081,700	$659,662,800	$36,700,000	$16,700,000
Total Revenues	$12,545,118,700	$12,571,011,800	$12,348,383,400	$12,824,574,900
EXPENDITURES				
Ongoing Operating Appropriations	$10,838,429,200	$11,447,324,800	$11,980,684,600	$12,328,419,400
FY 2020 Supplementals/Ex-Approp.	46,459,700			
Administrative Adjustments	128,000,000	146,000,000	155,000,000	162,000,000
Revertments	(173,000,000)	(184,000,000)	(192,000,000)	(198,000,000)
Subtotal Ongoing Expenditures	$10,839,888,900	$11,409,324,800	$11,943,684,600	$12,292,419,400
One-time Expenditures				
Capital Outlay	$4,575,000			
Transportation Funding	95,310,000			
Reduce K-12 Rollover			30,000,000	
Budget Stabilization Fund Deposit	271,107,000			
2010B Debt Payoff	190,000,000			
Operating One-Time Spending	501,275,000	81,516,800	52,595,400	76,876,700
Additional (27th) Pay Period		43,078,600	20,052,100	
Subtotal One-time Expenditures	$1,062,267,000	$124,595,400	$102,647,500	$76,876,700
Total Expenditures	$11,902,155,900	$11,533,920,200	$12,046,332,100	$12,369,296,100
Ending Balance 2/	$642,962,800	$1,037,091,600 4/	$302,051,300	$455,278,800
Ongoing Balance 3/	*$657,148,100*	*$502,024,200*	*$367,998,800*	*$515,455,500*

1/ Significant one-time revenues and expenditures are separately detailed so as to permit the calculation of ongoing revenue and expenditures.
2/ This calculation reflects the difference between total revenues and total expenditures. Excludes any Budget Stabilization Fund balance.
3/ This calculation reflects the difference between ongoing revenues and expenditures and excludes one-time adjustments. The Legislature makes the ongoing and one-time classifications as part of its 3-year spending plan. Excludes any Budget Stabilization Fund balance.
4/ The FY 2021 cash balance is presumed to be allocated as part of the FY 2021 budget process.

JANUARY BASELINE WITH TARGETS
STATEMENT OF GENERAL FUND REVENUES AND EXPENDITURES 1/

	FY 2020 Baseline	FY 2021 Baseline	FY 2022 Baseline	FY 2023 Baseline
REVENUES				
Ongoing Revenues	$12,234,610,600	$12,739,841,900	$13,158,304,500	$13,693,047,000
Urban Revenue Sharing	(737,573,600)	(828,492,900)	(846,621,100)	(885,172,100)
Net Ongoing Revenues	$11,497,037,000	$11,911,349,000	$12,311,683,400	$12,807,874,900
One-time Financing Sources				
Balance Forward	$957,241,000	$642,962,800	$52,091,600	$54,142,900
Wells Fargo Settlement	20,000,000			
Water Infrastructure Repayment			20,000,000	
Fund Transfers	70,840,700	16,700,000	16,700,000	16,700,000
Subtotal One-time Revenues	$1,048,081,700	$659,662,800	$88,791,600	$70,842,900
Total Revenues	$12,545,118,700	$12,571,011,800	$12,400,475,000	$12,878,717,800
EXPENDITURES				
Ongoing Operating Appropriations	$10,838,429,200	$11,447,324,800	$11,980,684,600	$12,328,419,400
FY 2020 Supplementals/Ex-Approp.	46,459,700			
Administrative Adjustments	128,000,000	146,000,000	155,000,000	162,000,000
Revertments	(173,000,000)	(184,000,000)	(192,000,000)	(198,000,000)
Subtotal Ongoing Expenditures	$10,839,888,900	$11,409,324,800	$11,943,684,600	$12,292,419,400
One-time Expenditures				
Capital Outlay	$4,575,000			
Transportation Funding	95,310,000			
Reduce K-12 Rollover			30,000,000	
Budget Stabilization Fund Deposit	271,107,000			
2010B Debt Payoff	190,000,000			
Operating One-Time Spending	501,275,000	81,516,800	52,595,400	76,876,700
Additional (27th) Pay Period		43,078,600	20,052,100	
Subtotal One-time Expenditures	$1,062,267,000	$124,595,400	$102,647,500	$76,876,700
Total Expenditures	$11,902,155,900	$11,533,920,200	$12,046,332,100	$12,369,296,100
Ongoing Planning Target		$300,000,000	$300,000,000	$300,000,000
One-Time Planning Target		$685,000,000		
Adjusted Ending Balance	$642,962,800	$52,091,600	$54,142,900	$209,421,700
Adjusted Ongoing Balance	*$657,148,100*	*$202,024,200*	*$67,998,800*	*$215,455,500*

1/ The figures displayed above reflect the January Baseline estimates adjusted for planning targets to display the amount of ongoing and one-time resources estimated to be available during the FY 2021 budget process. The planning targets maintain at least $50 million annually in the ending balance.