
FY 2024 JLBC Baseline with Executive Comparison

January 17, 2023



Key Points of the January Baseline

- After a 17% increase in FY 22, General Fund revenue growth is expected to moderate to 7.5% in FY 23 and 2% in FY 24.
- The declining growth rate is related to recession concerns as the Fed raises interest rates in an attempt to lower inflation.
- The state will have a large 1-time balance of \$1.8 Billion in FY 24 but the balance declines to \$1 Million by FY 25.
- We have substantial capacity for 1-time budget proposals, but ongoing initiatives would create a shortfall in FY 25.

Forecasting State Revenues

January 4-Sector “Consensus”: Much Slower Growth in FY 24 & FY 25

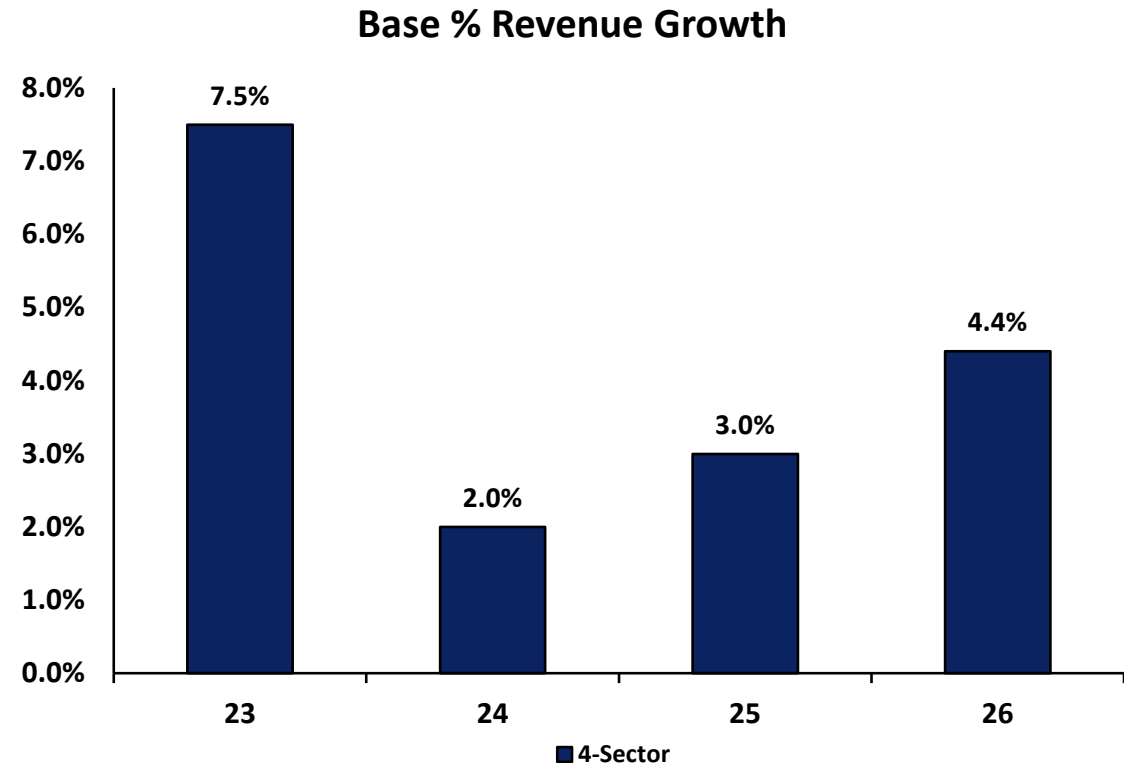
- With Moderate Recovery in FY 26

4-Sector Components

- Finance Advisory Committee
- UA model – base forecast
- UA model – more cautious
- JLBC Staff

Other Considerations

- Rates are Prior to Enacted Tax Cuts
- With Tax Cuts, FY 23 & FY 24 net growth is negative



Excludes balance forward, one-time transfers, tax law changes and urban revenue sharing

Forecasters' Assessment of Recession Risk

- Difficult to Translate into AZ General Fund Impact

- National Association for Business Economics (NABE)
 - 57% of respondents believe probability of a recession starting in CY 2023 is greater than 50%
- Bloomberg's Monthly Survey of Economists
 - Survey respondents see a 70% risk of recession in CY 2023
- IHS Markit Forecasting
 - Risk of recession in CY 2023 is 80%

JLBC – Executive Revenue Differences

- Combined '23/'24 Difference is Small; Executive is Less in '24 & '25

<u>FY</u>	<u>(\$ in M)</u> <u>Exec < JLBC</u>
'23	555
'24	(493)
'25	(218)
'26	(238)

- #s Exclude New Executive Tax Cuts. Executive proposes:
 - A new Child Tax Credit at a cost of \$50 M
 - TPT exemptions for feminine hygiene products and child diapers at a cost of \$40 M

Spending Adjustments

Baseline Spending Projections

- Baseline reflects projected changes to the cost of statutory funding formulas like K-12 and Medicaid
- Also reflects the enacted FY 23 budget's 3-year spending plan
 - Assumes spending classified as one-time does not continue
 - Includes future year spending increases that were agreed to in the budget
- Certain budget items are continuously budgeted as one-time rather than as ongoing: K-12 building repairs & state employee insurance

FY 24 Baseline Spending Projected To Decrease By \$(47) M

FY 24 Ongoing Spending Changes	
	<u>\$ in M</u>
Medicaid Formula	321
ADE – K-12 Formula	356
Pension Payoff Savings	(100)
Other	27
Technical Adj. (Unspent Appropriations)	<u>(140)</u>
Total	464
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Total Spending Changes	\$(47) M
Total Spending	\$15,547 M
% Change	(0.3)%

FY 24 1-Time Spending Additions/Deletions	
	<u>\$ in M</u>
Loss of Medicaid Match Savings	482
Water Supply Funding	333
Remove K-12 Rollover Payoff	(65)
Wildfire Expenses	(65)
State Employee Health Insurance	(103)
K-12 Capital – Building Repair Grants	(183)
K-12 Capital – Fewer New Schools	11
University Funding	(123)
Other Agency Spending	(506)
Transportation Projects	(73)
Capital Projects	<u>(219)</u>
Total	(511)

K-12 Baseline Issue 1: ESA Program Universal Enrollment

- Outside of the budget, 2022 legislation authorized universal enrollment in the Empowerment Scholarship Account program
- To date, there are 30,000 new “universal” students – represents an unbudgeted cost of \$200 M
 - Since K-12 spending largely governed by law, ADE does not have the flexibility to manage this shortfall and will require a FY 23 Supplemental appropriation
- We have no template for forecasting future growth. Our best guess is that universal enrollment will be 52,500 in FY 24 at a cost of \$376 M.

K-12 Baseline Issue 2: The Future of Proposition 123

- Proposition 123 is scheduled to expire at the end of FY 25
- If not extended or revised, the level of land trust distributions to K-12 schools will be reduced in FY 26
- Absent any other statutory change, the General Fund would backfill the Proposition 123 loss at a cost of \$300 M in FY 26
- Our Baseline includes this cost to ensure this obligation is covered if no other action is taken

K-12 Baseline Issue 3: Aggregate Expenditure Limit (AEL)

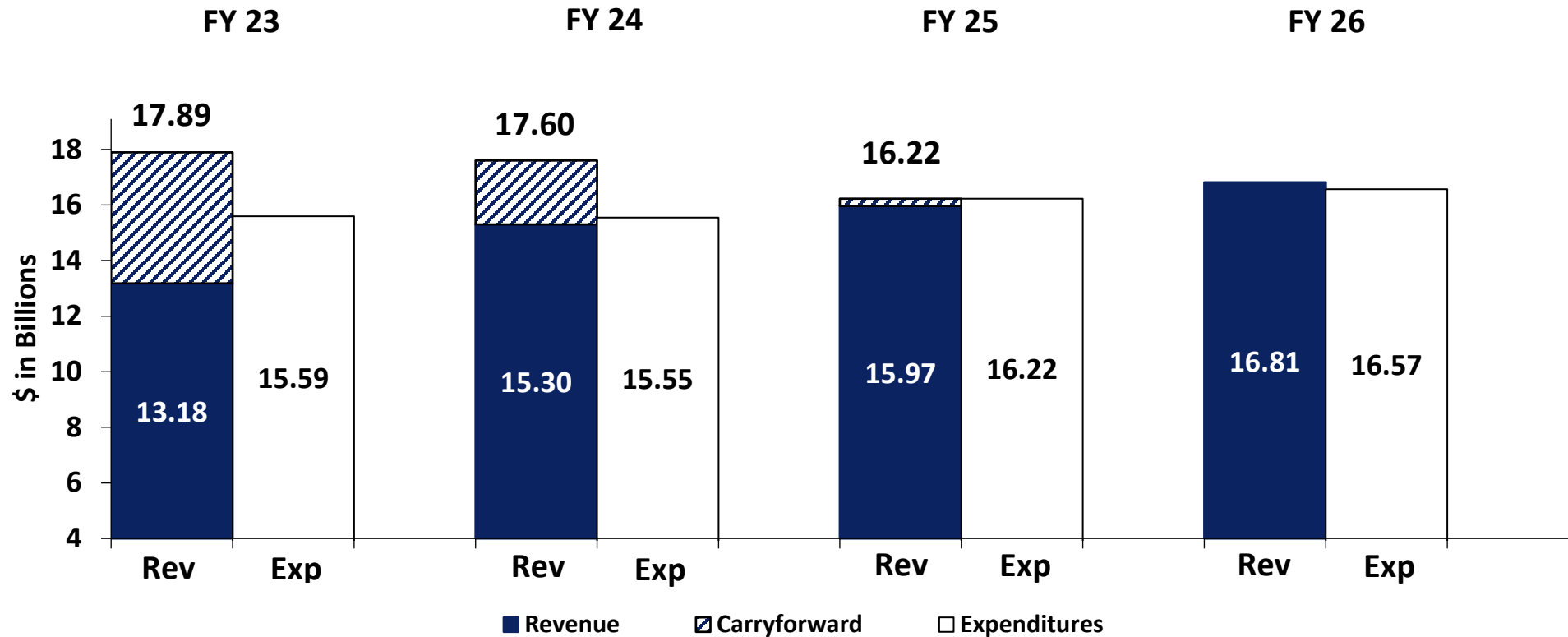
- ADE calculates district spending compared to AEL by 11/1 of each year
- School district budgets for FY 23 are \$1.4 B above the AEL; 2/3rds of the Legislature can override the limit by 3/1/23
- With no override, districts would need to reduce their budgets in the current fiscal year
- District budget reductions would not generate state savings because ADE is still required to make full Basic State Aid (BSA) payment

Projected Ending Balances

Excludes \$1.4 B in Budget Stabilization Fund

Available Balances: \$1.8 B for One-Time Initiatives Only

- Any Ongoing Initiatives Would Create FY 25 Shortfall
- FY 25 Initially Was \$(260) M Short; Solved by Using Part of FY 24 Surplus



Cash Balance

\$2.3 B

\$1.8 B *

\$1 M

\$242 M

* This amount is after \$260 M is carried into FY 25 to resolve that year's shortfall.



Additional Thoughts

- Given the economic uncertainty, our revenue estimates will likely change considerably as we go through the FY 24 budget process.
- Due to all the uncertainty, we may not want to allocate the entire \$1.8 B 1-time surplus in FY 24 to maintain flexibility.
- Given this budget picture, there will be an incentive to label ongoing initiatives as 1-time
 - This technique can create future budget problems – hard to change labeling in future years

Executive Budget

Executive Proposes to Add \$561 M of Ongoing FY 24 Initiatives

- Above JLBC Baseline

(\$ in M)

90	Child Tax Credit and TPT Exemptions
210	K-12 Extra 2.6% Base Level Increase + DAA Inflation
21	K-12 Dual Enrollment Assistance
95	Universities (Dreamers \$40m; Promise \$40m; ATA \$15m)
20	AHCCCS - Expand Kids Care from 200% to 300% FPL
48	DCS Caseloads, Congregate Care and Salary Adjustments
15	DES Adult Protective Services – Fed Backfill + 50 FTEs
17	DHS Family Planning & Arizona State Hospital
7	Judiciary – County Probation Salary Increases (+ \$8 M one-time)
<u>38</u>	All Other
561	Total

Executive Proposes to Delete \$(508) M of Ongoing Funding

- Relative to JLBC Baseline

(\$ in M)

(376)	Eliminate Universal ESAs (JLBC Scoring; Exec estimate of \$144 M)
(69)	ADE – Eliminate Results-Based Funding
(32)	Forester – Convert Wildfire Mitigation to One-time
(11)	DPS – Convert Local Border Strike Force Funding to 1-time & shift \$17m of State-level BSTF to the Operating Budget
(10)	Dept of Gaming – Eliminate Race Track and Purse Enhancement \$
(10)	Homeland Security – Convert Local Government Cybersecurity Grants to One-Time
(508)	Total

Executive Proposes \$1.7 B of One-Time FY 24 Initiatives

- Above/(Below) JLBC Baseline

(\$ in M)

250	Budget Stabilization Fund Deposit (Rainy Day Fund)
200	State Employee Retention (Not Specified)
189	State Employee Health Insurance (Employer Contribution)
332	School Facilities Building Repairs
100	Health & Human Services Automation Projects (Not Specified)
50	Commerce Authority Rural Broadband Match
150	Housing Trust Fund Deposit
54	Florence Prison Closure/Food Costs/Private Prison Contract
14	Community Colleges Rural Aid
247	ADC/ADOA/DHS/ADOT Capital Projects
--	ADOT I-17 Widening (Reallocate \$76m from unspecified FY 23 ADOT projects)
<u>154</u>	All Other
1,740	Total

Executive FY 25 Cash Balance Estimates

(\$ in M)	
96	Executive FY 25 Cash Balance
(93)	AHCCCS formula growth – not included in Executive budget
<u>(107)</u>	New School Facilities – not included in Executive budget
(104)	Revised Executive FY 25 Cash Balance

- Executive also excluded these costs in their FY 26 estimates:
 - \$202 M for AHCCCS formula
 - \$208 M for New School Facilities
 - \$300 M for Prop 123 Backfill

Further Considerations

- K12 Capital Litigation – the cost to resolve?
 - Executive budget funds building repair grants one-time at \$332 M
- Prison Health Litigation – the cost to resolve?
 - The federal courts have imposed new requirements. Executive budget has a placeholder. The FY 23 budget increased funding by \$70 M to a total of \$270 M.
- ADOT I-10 Widening from Casa Grande to Phoenix – now what?
 - State funded \$400 M, but Feds did not approve our \$360 M request
- ARPA State Fiscal Recovery Funds – how were these monies allocated?
 - State received \$4.2 billion. We lack an allocation plan for about \$1 B of these funds.

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