FY 2024 JLBC Baseline

January 13, 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 **B**illion in FY 24 but the balance declines to $1 **M**illion 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

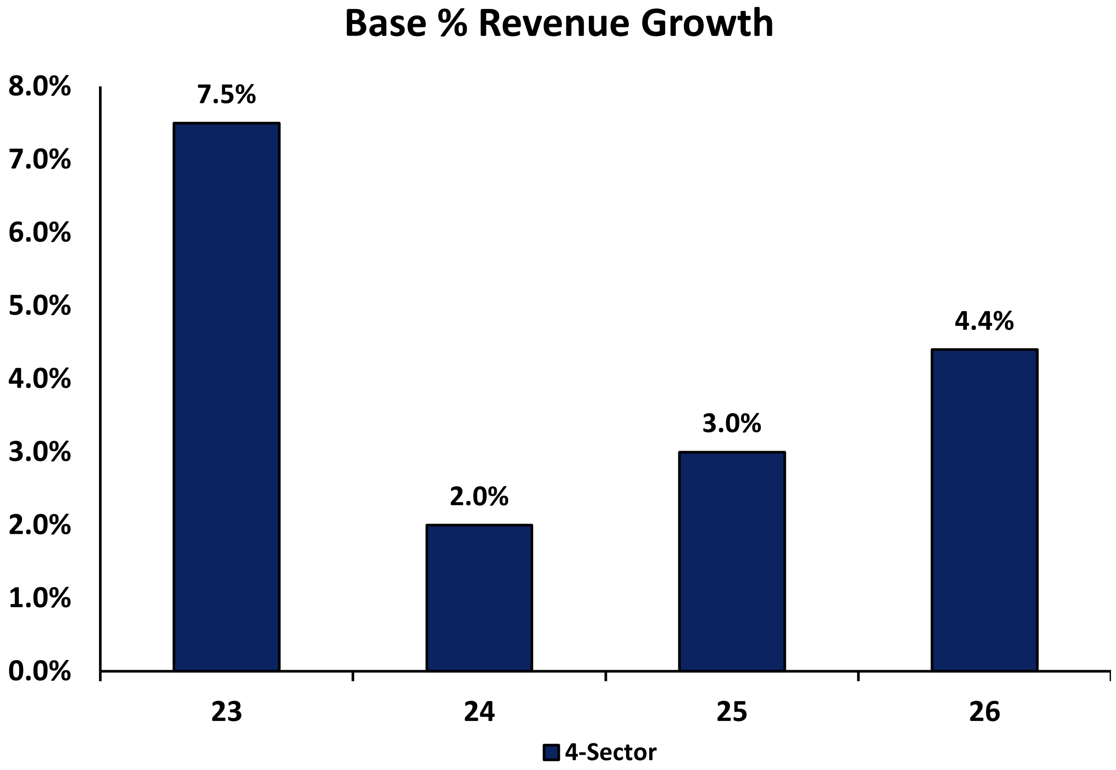
January 4-Sector “Consensus”: Much Slower Growth in FY 24 & FY 25
- With Moderate Recovery in FY 26

<u>4-Sector Components</u>

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

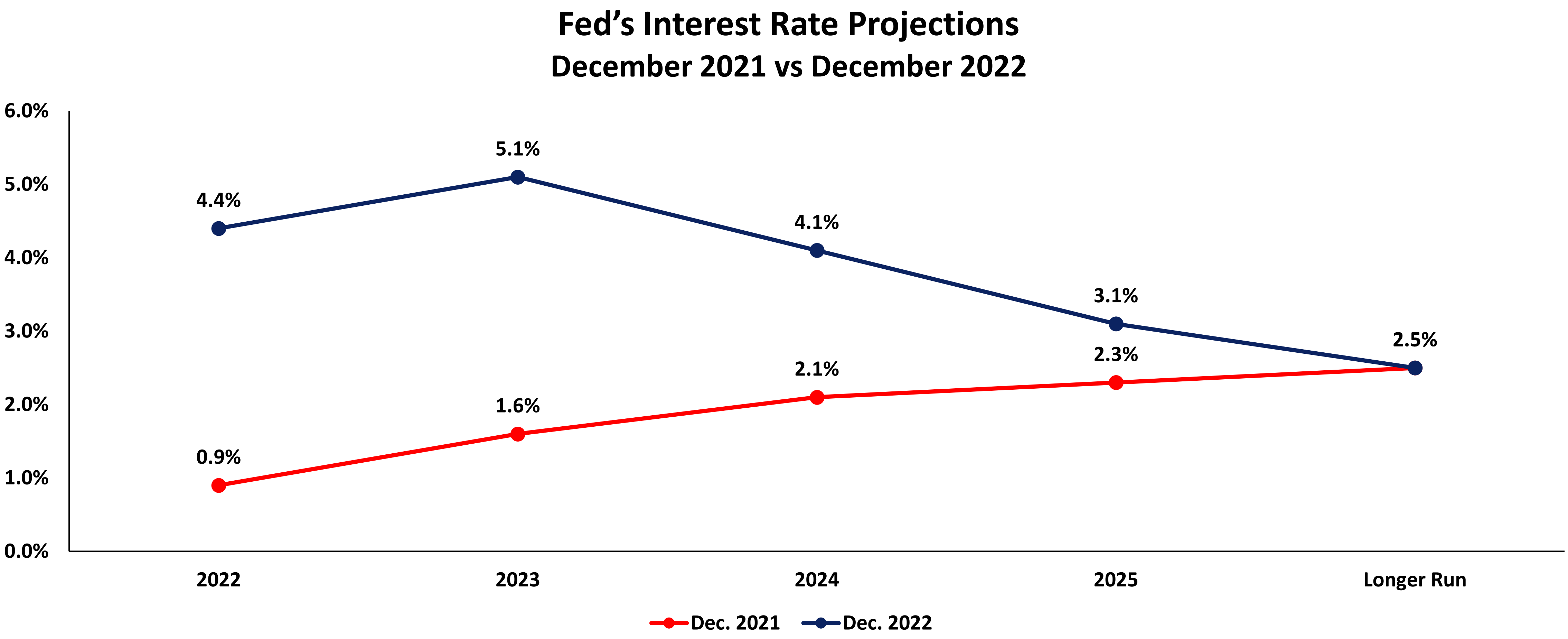
<u>Other Considerations</u>

- 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

Economic Projections Are Inherently Uncertain
- Latest Example: Federal Reserve Board's Projected CY 23 Interest Rates



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	
	$ in M
Medicaid Formula	321
ADE – K-12 Formula	356
Pension Payoff Savings	(100)
Other	27
Technical Adj. (Unspent Appropriations)	(140)
Total	**464**

Total Spending Changes	**$(47) M**
Total Spending	**$15,547 M**
% Change	**(0.3)%**

FY 24 1-Time Spending Additions/Deletions	
	$ in M
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	(219)
Total	**(511)**

K12 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

- Prop 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 Prop 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

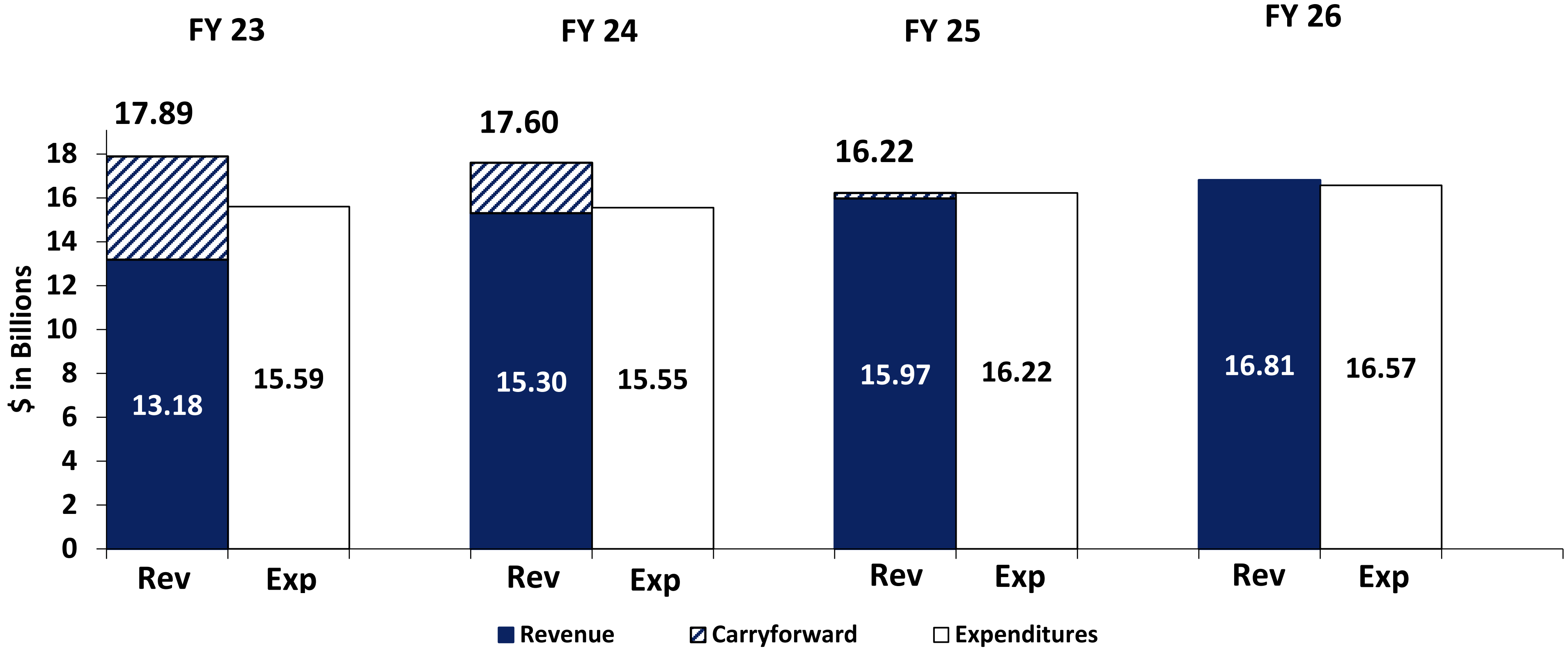
K-12 Baseline Issue 3: Aggregate Expenditure Limit (AEL)

- 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.

Final 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

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