

**FY 2007
JLBC Update**

**JLBC Staff
January 10, 2006**

JLBC

The FY 2007 JLBC Baseline Estimate

As a starting point for discussions on the FY 2007 budget, the JLBC has developed:

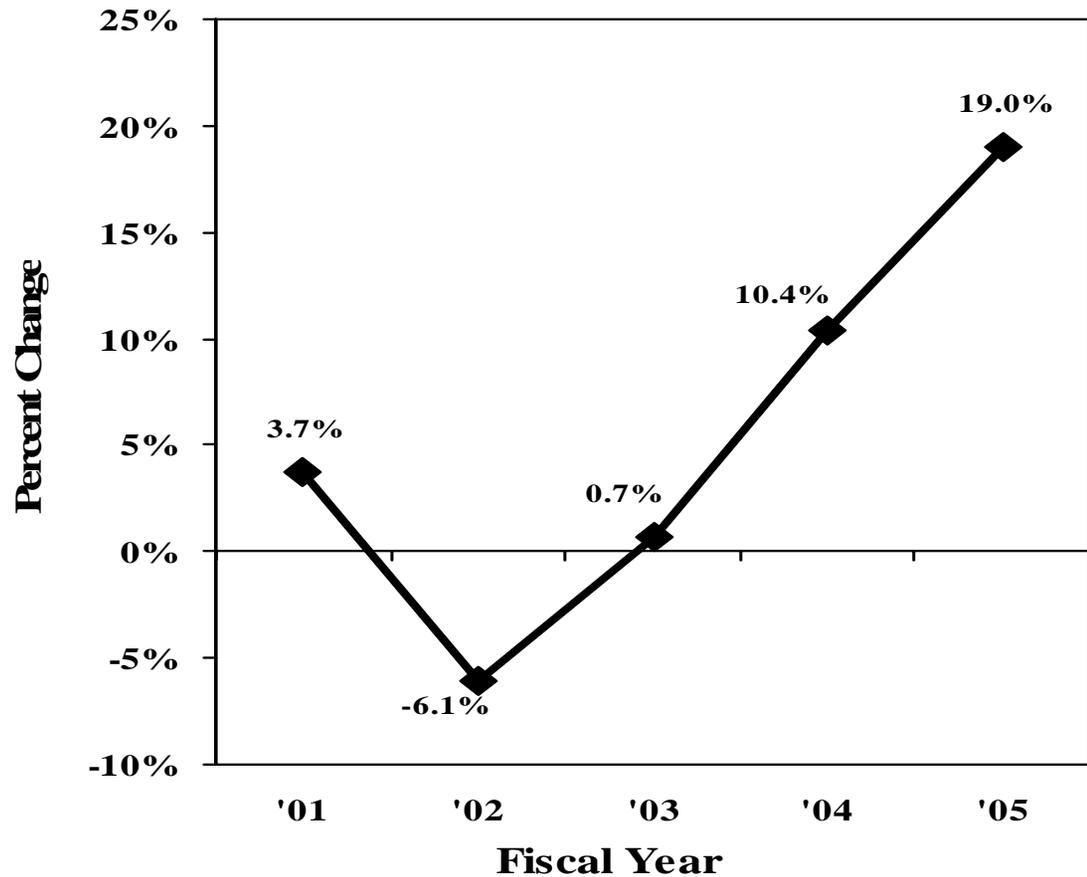
- An estimate of baseline revenues, reflecting a consensus economic forecast.
- An estimate of baseline spending, representing funding formula requirements and other obligations.
- An estimate of available resources after adjusting for baseline revenues and spending.

The JLBC has also made recommendations for enhancing Legislative oversight of agency operations.

Revenue Overview

Setting the Context for the FY 06 and FY 07 Estimates - FY 2005 General Fund Revenue Growth of 19.0% Was the Largest in 30 Years

- Sales Tax = 11.1%
- Individual Income Tax = 21.6% (adj. for withholding)
- Corporate Income Tax = 42.1%
- April 2005 biggest collection month ever



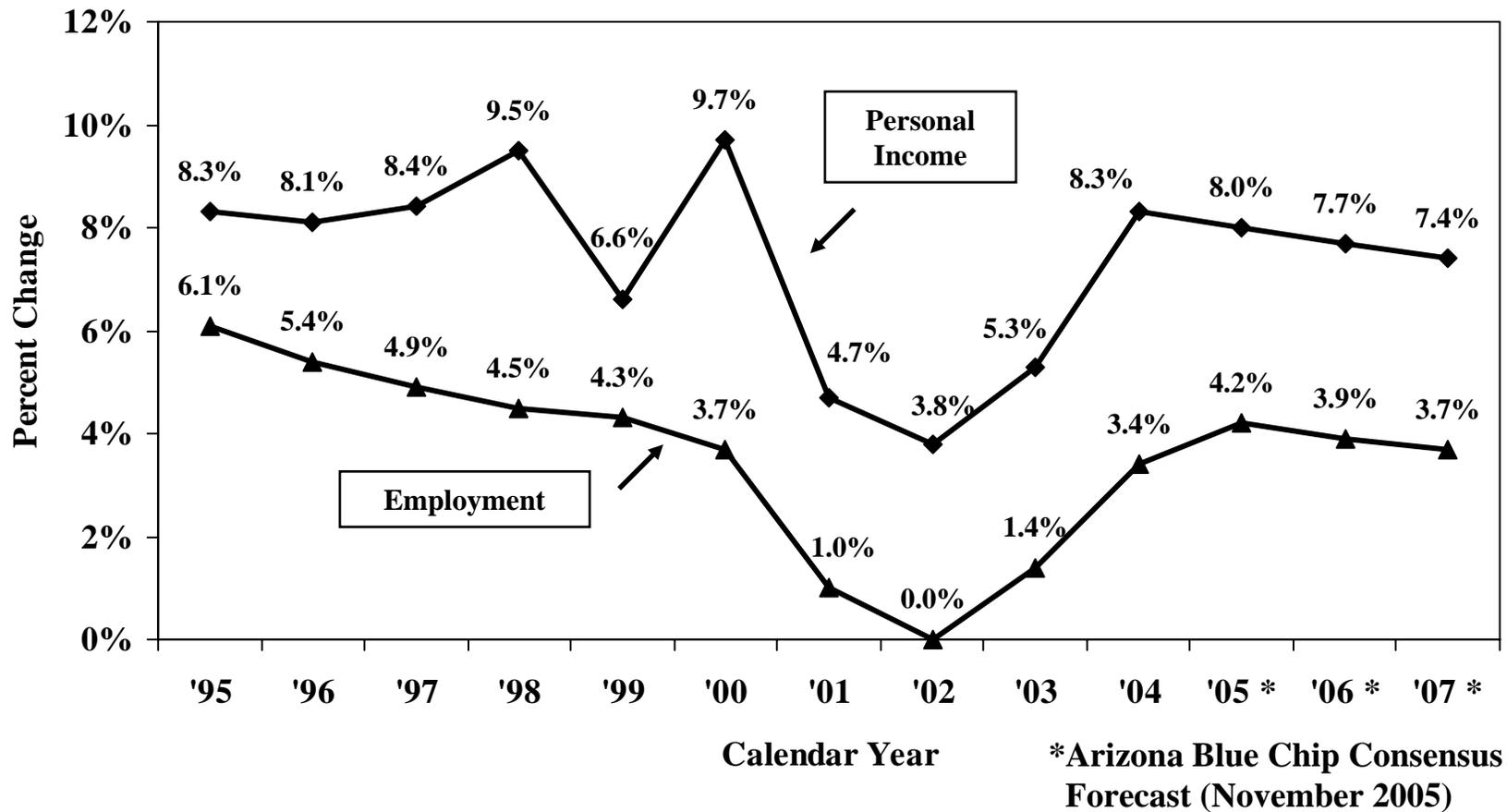
What is the Economic Outlook for the Next 18 Months?

-- The Finance Advisory Committee Met in December to Discuss

- National economic outlook is positive and Arizona will post solid gains -- but not as high as FY 05.
- Arizona's real estate market has begun to slow -- but no discussion of bursting bubbles.
- While not forecasting a recession during the FY 07 budget cycle, several members predicted that the next downturn is likely to be severe.

The Economic Consensus Forecasts Solid Growth

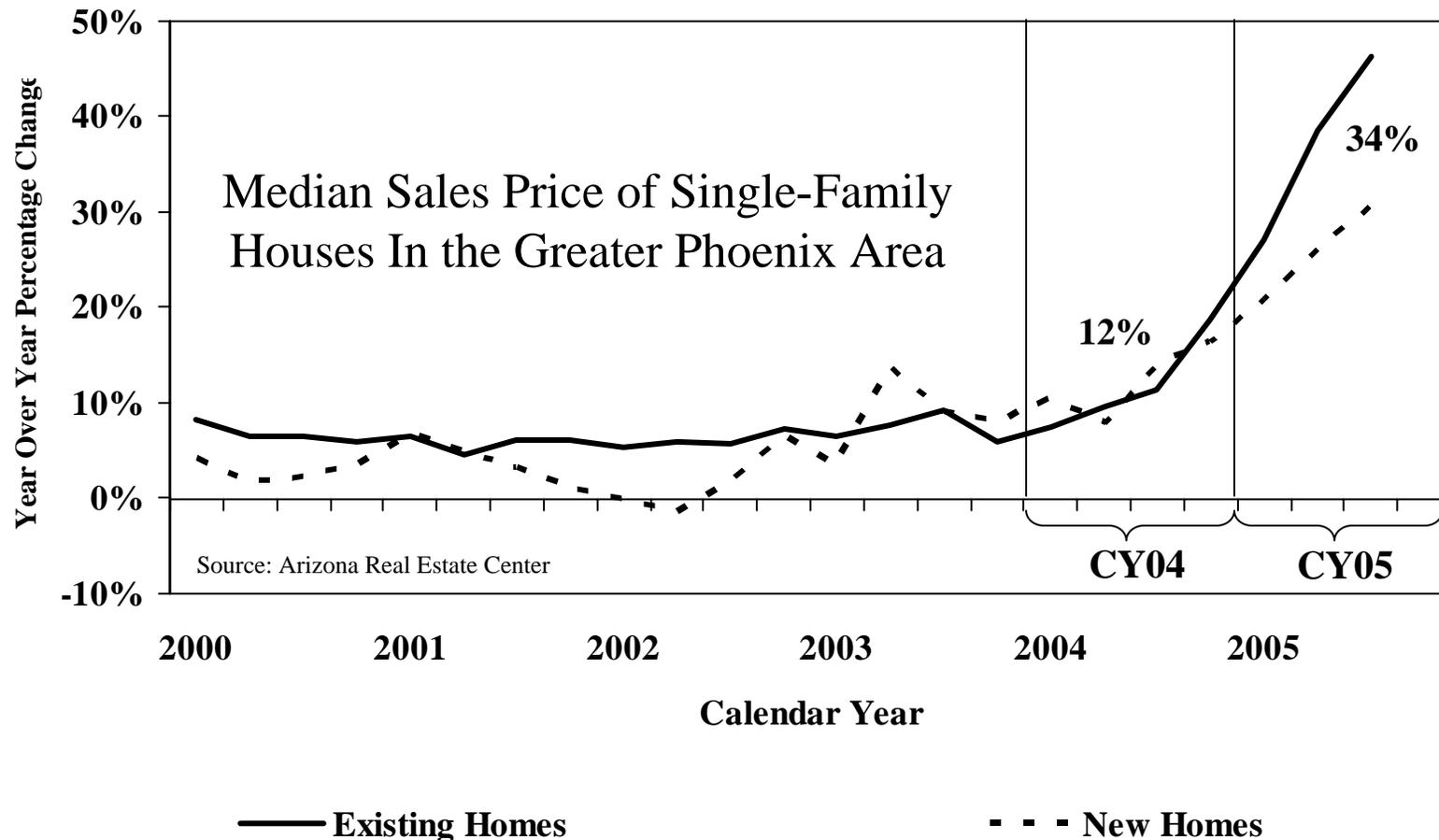
- Personal Income Would Increase by \$14 Billion to \$191 Billion,
- 96,500 New Jobs Would Increase Employment to 2.5 Million



◆ Personal Income ▲ Employment Growth

Real Estate Sector Has Helped Fuel General Fund Revenue Growth

- CY 04 Gains May Have Added \$150 M to '05 Collections
- Even Greater CY 05 Gains May Show Up in April 2006 Tax Filings



With Recent Rapid Growth - General Fund Revenue Is More Vulnerable During A Recession

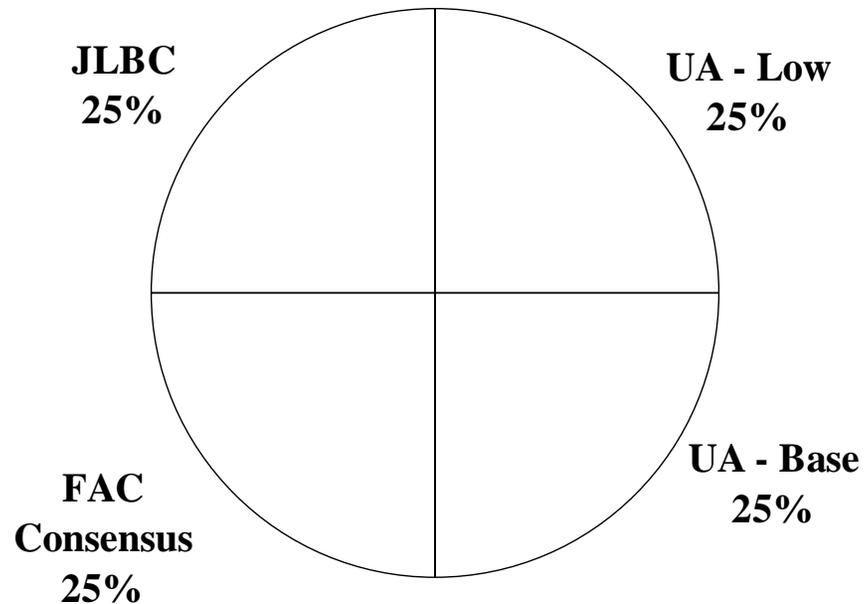
- The Arizona economy expanded by 8% in FY 05, while General Fund revenue grew by 19%.
 - As a result, some of the revenue gain was likely to be short-lived.
 - High level of revenue growth could result in increased vulnerability during a downturn.
- Annual corporate income tax collections increased by more than \$350 M since the last recession.
- Individual income tax collections increased by \$668 M in FY05 -- \$100 M of the increase is attributed to small business.

“Big 3” Tax Forecast Uses Four-Sector Consensus

-- Translates Broad Economic Projections into General Fund Revenues

Big 3 forecast equally weights:

- **FAC average**
- **UofA model - base**
- **UofA model - low**
- **JLBC Staff forecast**
- **Remaining revenues (6% of total) are staff forecast**

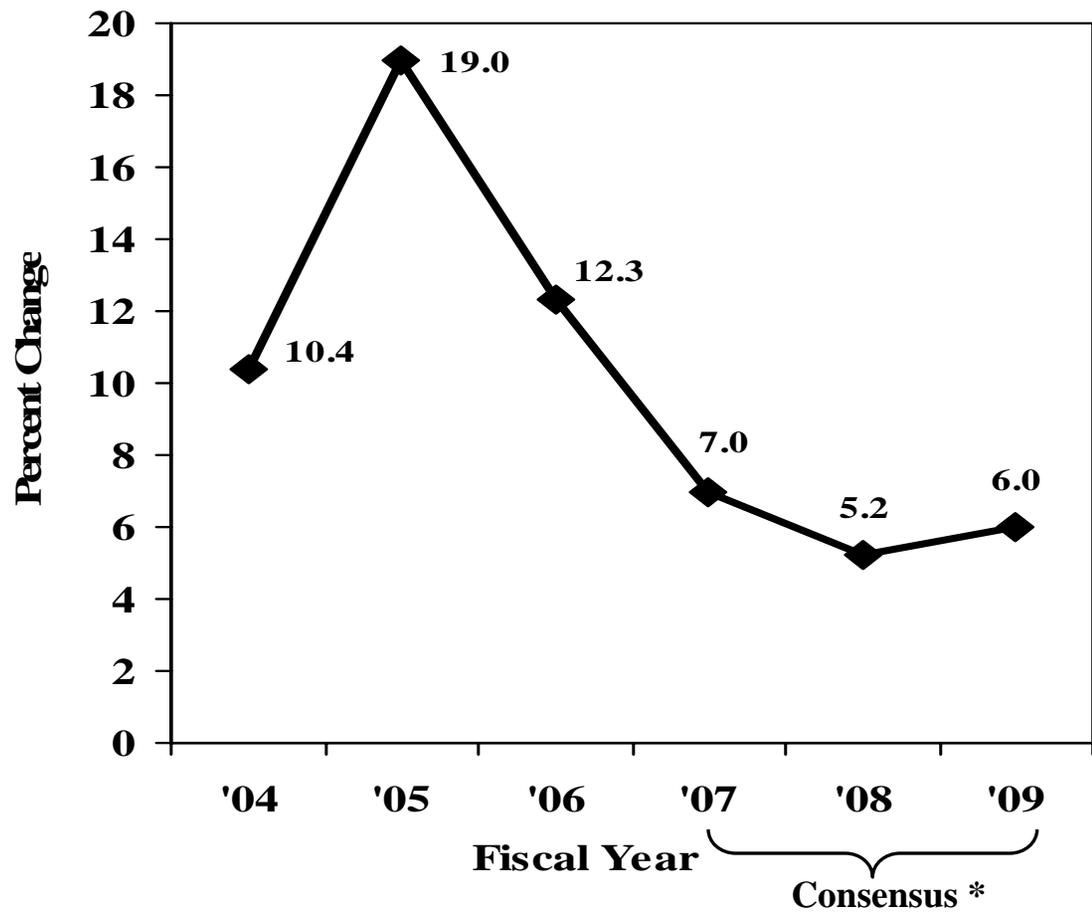


In FY 05, these 3 revenues grew by 17.7%. The March JLBC Staff forecast component, which forecasted 12.5% growth, came closest to predicting actual growth.

How Much Revenue Will Be Available?

Forecast Growth of 12.3% in '06 and 7.0% in '07

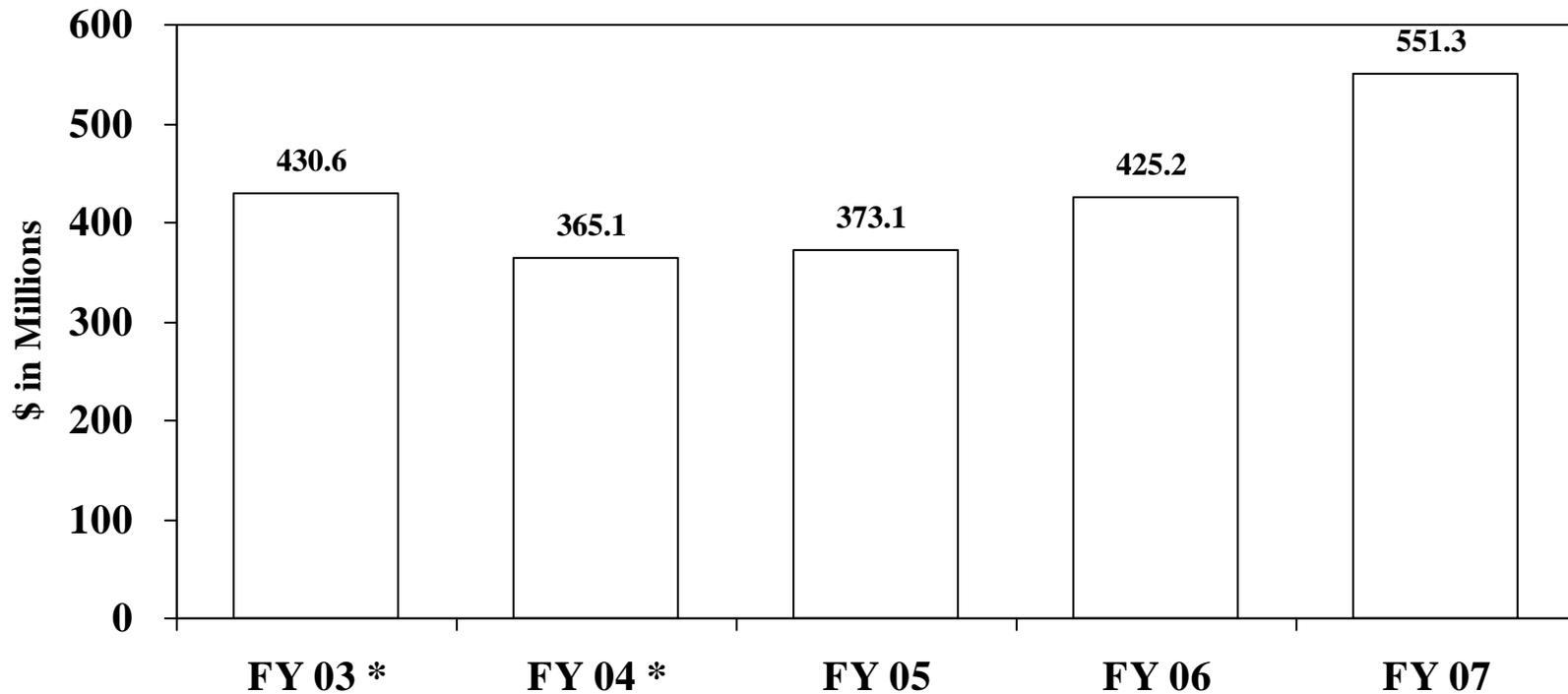
- '06 YTD rate = 16.7%
(thru November)
- '06 revised rate = 12.3%
- Extra '06 revenues above original budget = \$741 M at 12.3% rate
- '07 consensus = 7.0% and \$497 M in new revenue



Reflects consensus forecast of Big 3 plus staff forecast for minor categories.

Urban Revenue Sharing Grows Significantly in FY 2007

**-- City Distributions Will Increase 30% Based on
Income Tax Collections 2-Years Prior**



*** Distributions to cities for FY 03 and FY 04 were based on
14.8% of income tax collections 2-years prior rather than 15%.**

Spending Overview

Potential FY 2006 Shortfalls

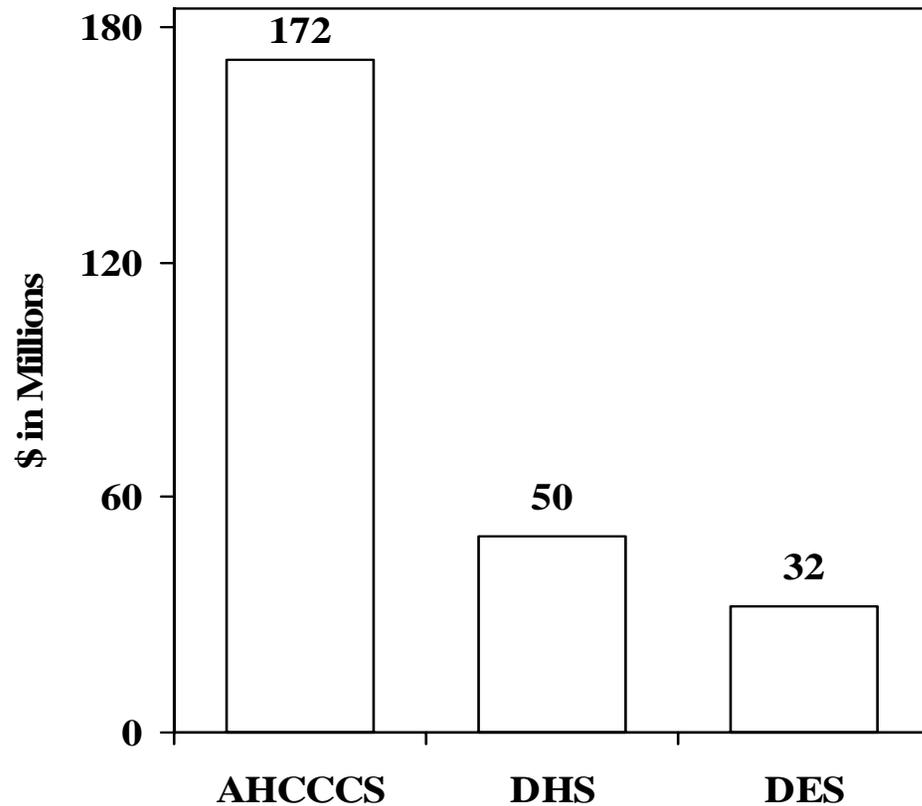
- ADE - \$32 M
 - '05 Student growth was 3.4% vs. budgeted 2.9%.
- DHS - \$10 M
 - DHS expanded mental health funding after the Legislature had rejected their request – no supplemental is recommended.

Title 19 and Health & Welfare Programs

FY 07 Statutory Spending is \$255 M Above FY 2006

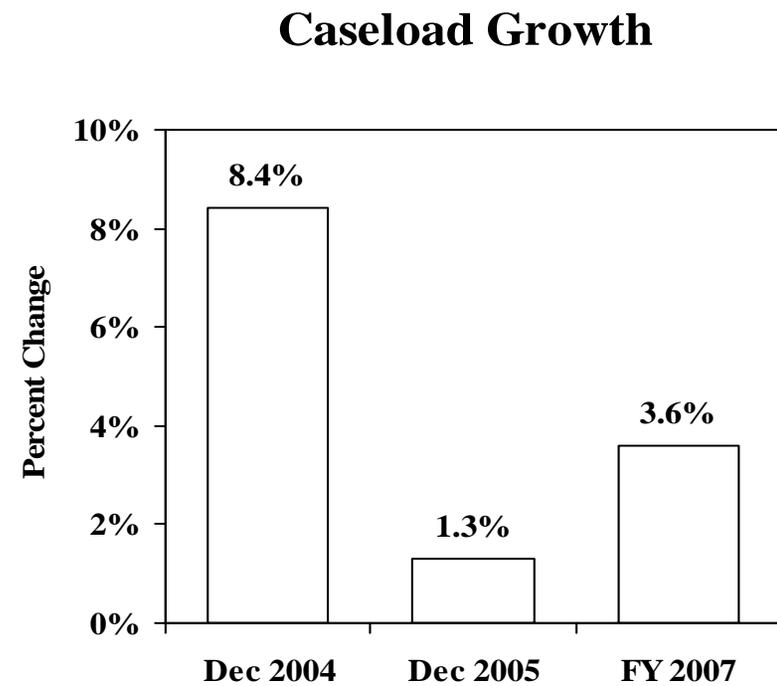
FY 2007 Title 19 Growth Rates

	<u>Population</u> <u>June/June</u>	<u>Cap Rate</u>
AHCCCS	3.6%	6.0%
DHS	3.6%	7.0%
DES	6.5%	3.0%



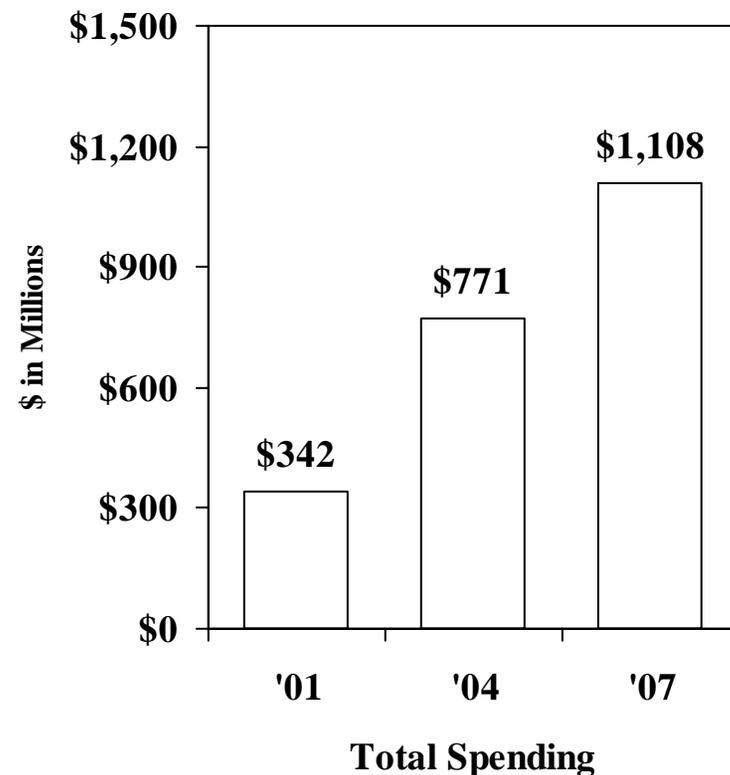
AHCCCS Growth Has Moderated

- JLBC Staff has a new consensus caseload forecasting model.
- Model consists of:
 - JLBC Staff projection
 - UA econometric model
 - AHCCCS model
- Total FY 2007 caseload: 1.1 million



DHS Behavioral Health Total Funds Would Increase by \$108 M in FY 2007 -- Despite 224% Increase in Funding Since FY 2001, Quality of Service Remains Unclear

- Maricopa RBHA failed to meet 75% of its performance standards.
- Auditor General review by 11/06.
- JLBC recommends expanded performance measures.



DES Spending Growth Is Projected at \$32 M GF for FY 2007

- \$20.9 M for caseload growth in Long Term Care.
- \$6.3 M to complete a 2-year 25% rate increase for Adoption Subsidy and Foster Care payments.
- \$4.8 M for CPS caseload growth in permanent placements.
- JLBC recommends enhanced legislative oversight to ensure limited use of temporary high cost CPS placements.
 - Performance measures to track progress
 - Limit transfer of funding without JLBC approval

Pending Federal Changes May Affect the State Budget

- The U.S. Senate has approved the following changes and the House will take up the bill upon reconvening:
 - Medicaid: increased cost-sharing and benefit package flexibility, and verification requirements.
 - TANF: increase in work participation rates may result in penalties to the state.
 - Child Care: additional \$200 M/year nationally.
 - Child Support Enforcement: cost-sharing change would require \$3.6 M in additional state monies.
 - Foster Care: federal reimbursements may also decrease, due largely to long licensing times in the state.

FY 2007 K12 Formula Growth is \$225 M

-- Student Count Tops 1 Million for the 1st Time

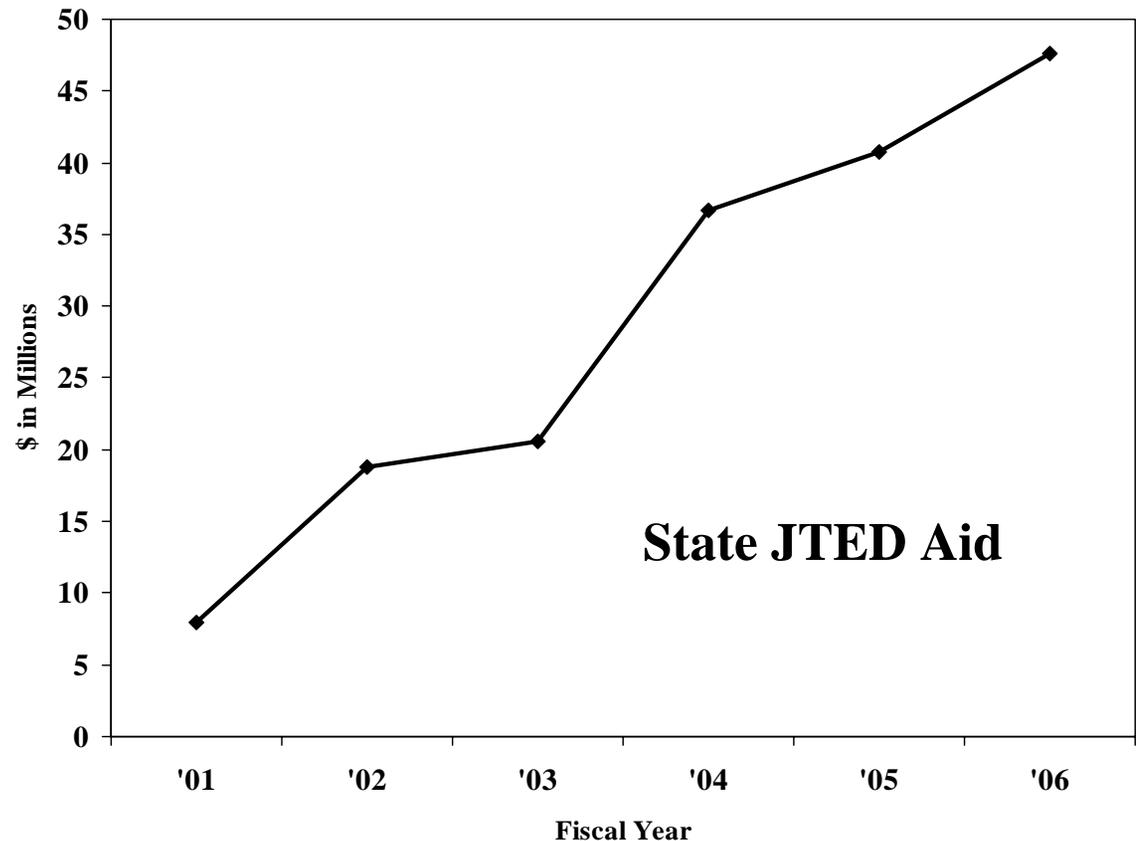
	<u>\$ M</u>
• 3.25% enrollment growth – new '07 consensus forecast of JLBC Staff and UA econometric model	\$165
• 2% inflation	81
• Base adjustment – '06 shortfall	46
• 10% assessed value growth	(138)
• 4% TNT rate cut to offset property growth	55
• Business property tax phase-down	13
• JTED growth for continuing FY 06 session law	1
• Other	<u>2</u>
Total	\$225

In addition, \$30 M set aside for Flores litigation legislation.

JTED's Funding Has Grown Significantly

- '07 Has Minimal Increases Based on Continuing '06 Provisions
- '08 Impact Could Be Much Higher

- JLBC would continue '05 session law caps.
- '05 law allows Pima County to create JTED - probably will wait until '08.
- Without permanent changes, Auditor General estimates added costs of \$85 M.



School Facilities Board

FY 2007 Formula Growth is \$21 M

- New construction costs estimated to be \$315 M in FY 07, including \$250 M from the General Fund.
 - Would fund 22 new schools housing 22,000 students, plus 27 on-going projects.
 - Requires no increase above FY 06.
 - Recent inflation adjustments will affect FY 08 estimates.
- Add \$25 M to restore one-time payment holiday savings.
- Reduce \$(20) M for completion of deficiency corrections program.
- Add \$16 M to fully fund a revised building renewal formula of \$86 M.
- Funds will be subject to appropriation.

Universities

Fund Formulas and Enhance Oversight

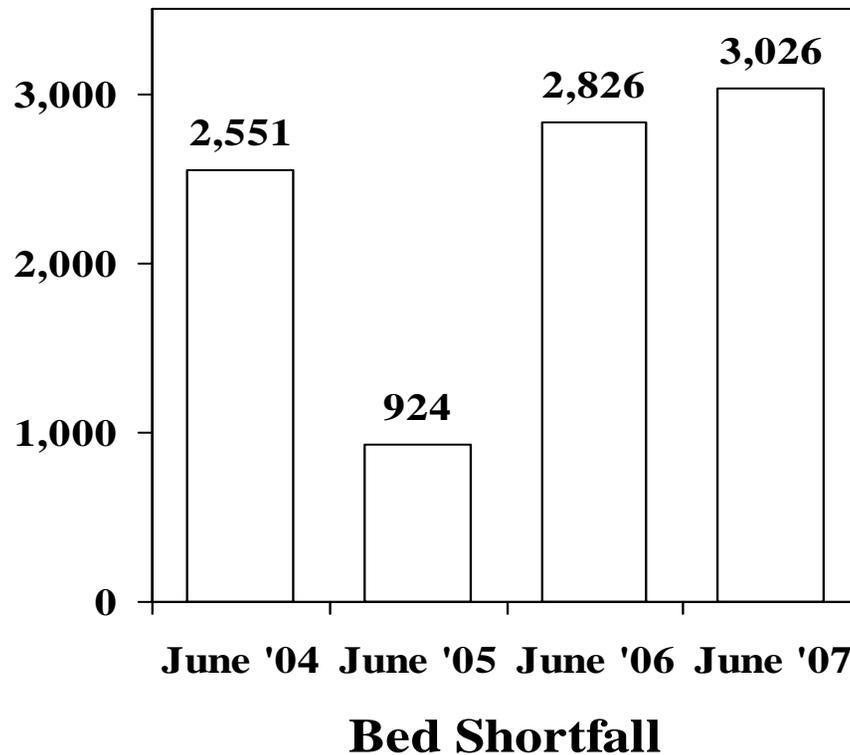
- University funding grows by \$7.2 M, or 0.9%.
 - Enrollment formula growth of 2.7% would cost \$14.5 M.
 - \$(8.0) M reduction for 155 credit hour funding cap.
 - \$672 K to fund an additional 32 WICHE students.
 - Retains \$7 M Phoenix Med Campus funding in base.
- Enhance oversight of operations.
 - Progress report on rural residencies and clinical rotation access.
 - Require reports on ASU Downtown Campus plans.
 - Performance measure on % of classes taught by professors -- currently less than 50%.
 - Require JLBC review of all tuition spending and JCCR review of indirect debt financing.

Department of Corrections

-- FY '07 Growth is \$35 M

-- Open 3,000 Private Beds in '08 to Address Bed Shortfall

- FY 07 increases include:
 - \$15 M to open 1,000 private beds.
 - \$4 M for population growth.
 - \$16 M to replace 1-time fed \$.
- Enhance legislative oversight
 - More detailed budget structure.
 - JLBC review of RFP to privatize Perryville.



Department of Public Safety

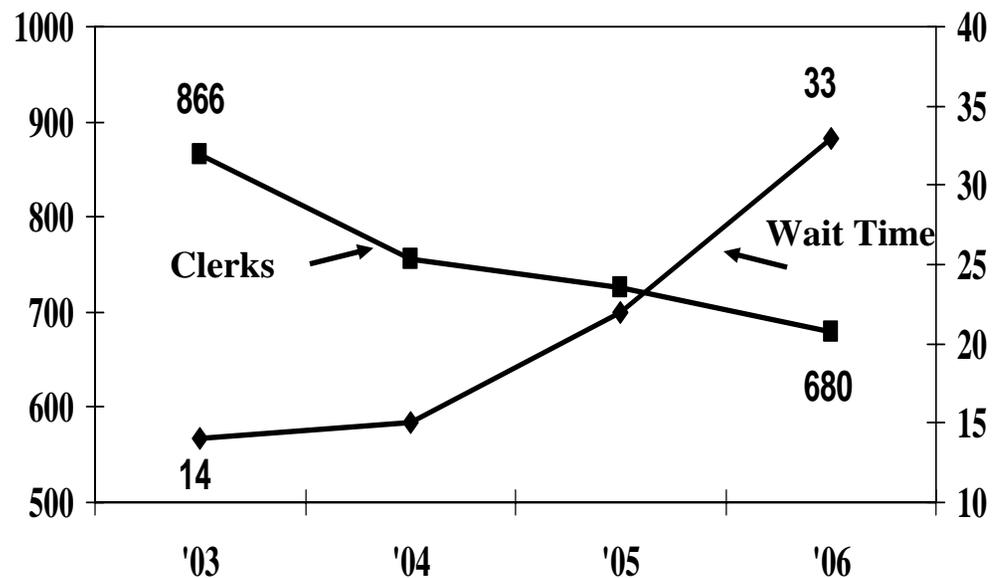
-- Add New Officers and Enhance Oversight

- Provide \$2.7 M from newly-enacted Parity Fund (VLT monies) for 3.1% Highway Patrol salary increase.
- Add 46 Highway Patrol positions with \$4.8 M from HURF.
- In FY '06, DPS diverted new officers' funding to unauthorized pay raises.
- To ensure that legislative intent is fulfilled, require reporting on filling the new FY '07 positions.

MVD Wait Times Have Grown Significantly

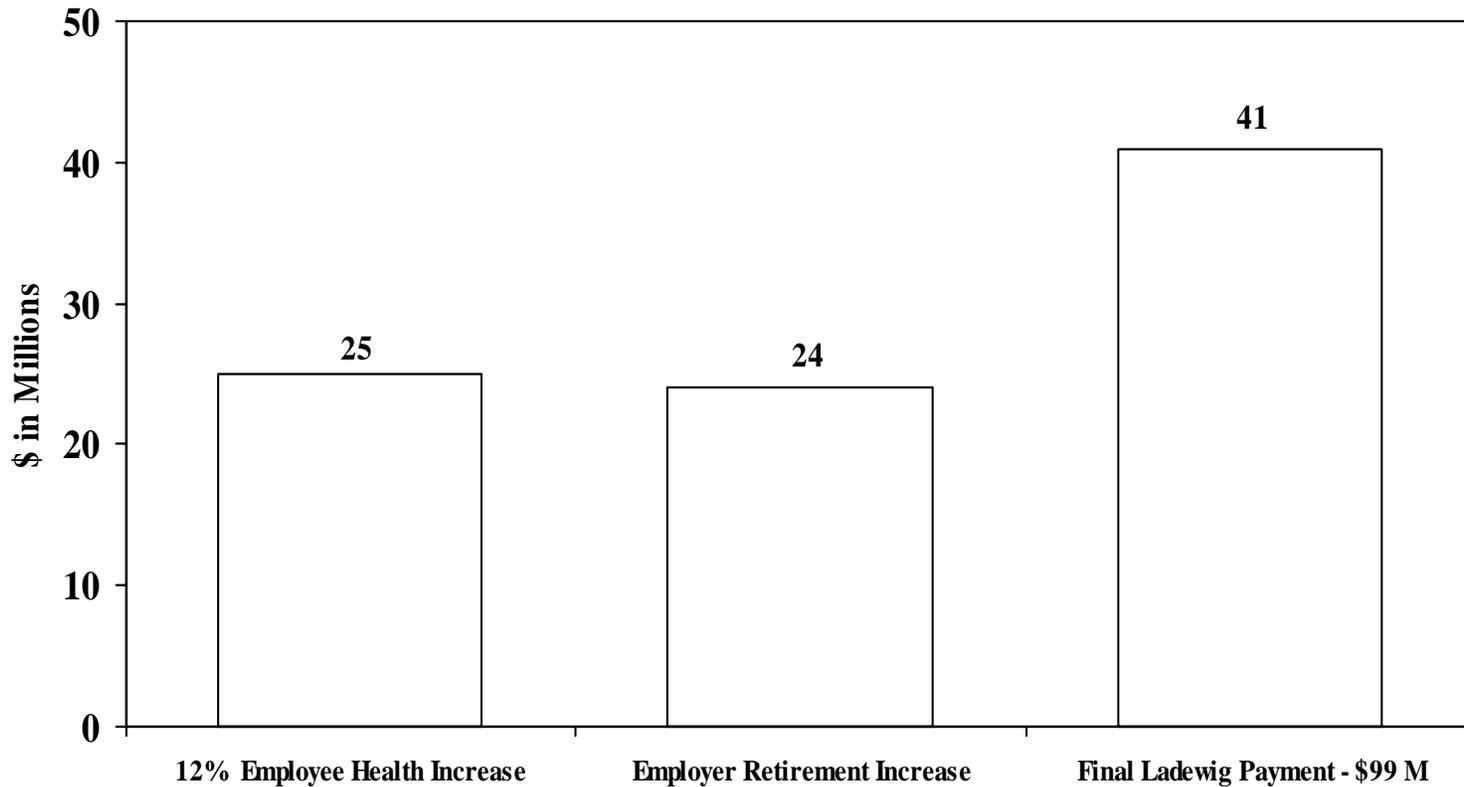
- Wait time understated – does not include total visit
- Wait time increased despite fewer in-person customers
- Enhance oversight through reporting and limit funding transfers.

Wait Times Have Risen, While Clerks Declined



Other Spending Adjustments

-- New JLBC Actuarial Resources Will Help Evaluate Future Health/Retirement Cost Increases

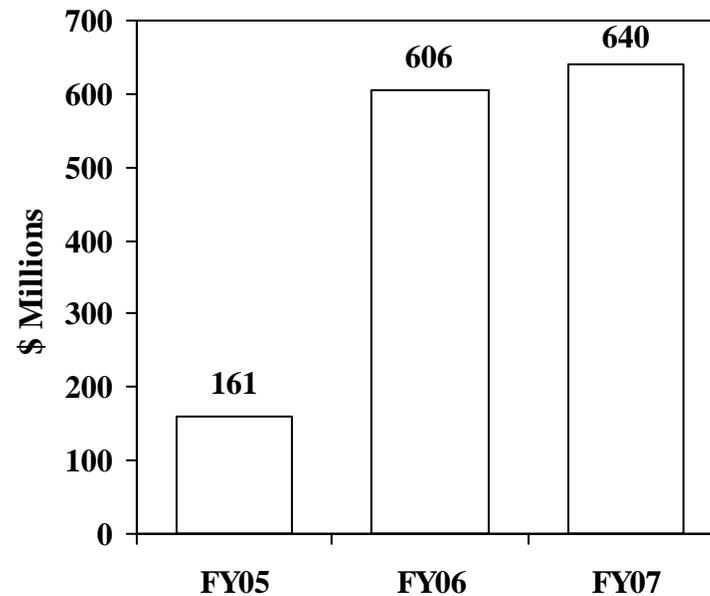


Budget Stabilization Fund

- Recommend Funding at 7% of GF Revenues
- \$606 M in '06, Rising to \$640 M in '07

- Session law deposits excess '06 revenues to BSF
- Permanent statute caps balance at 7% of GF
- '06 deposit = \$440 M + interest
- '07 deposit = \$10 M + interest

Total Fund Balance



FY 2007 JLBC Baseline Estimate

\$850 M in Available Resources After Funding Formulas

REVENUE

New Revenue - \$1,454 M

*New Revenues of \$497 M +
Carry Forward of \$610 M +
Net One-Time Changes of \$347 M*

SPENDING

K-12 Operating and Capital Formula
\$242 M

Title 19/Health and Welfare Formula
\$255 M

Corrections/DJC - \$38 M

Higher Ed - \$15 M

Employee Health/Retirement - \$49 M

Other - \$5 M

Net New Available \$1,454 M

**\$850 M
Available**

Net New Spending \$604 M

\$850 M Would Be Set Aside for Legislative Initiatives

- Tax Relief
- Employee Pay (\$20.5 M GF per 1%)
- Border Enforcement
- Truth in Budgeting (Repay Fund Sweeps & Shifts, Rollover)
- New Capital Projects
- Education Reform
- Ending Balance

\$850 M Available in '07, but Only a \$368 M Structural Surplus

**-- Structural Balance is the Difference Between
Permanent Revenues and Spending**

	Total \$ <u>(\$ in M)</u>	Permanent \$ <u>(\$ in M)</u>
• Total Revenues	\$ 9,751	\$ 9,145
• Total Formula Expenditures	<u>8,900</u>	<u>8,776</u>
Available Resources	\$ 850	\$ 368
% Spending Increase	2.5%	7.4%

To Prevent Overallocating Permanent Resources, the JLBC Would Distribute the \$850 M as Follows:

On-going Initiatives: Up to \$368 M

One-time Initiatives: At least \$481 M

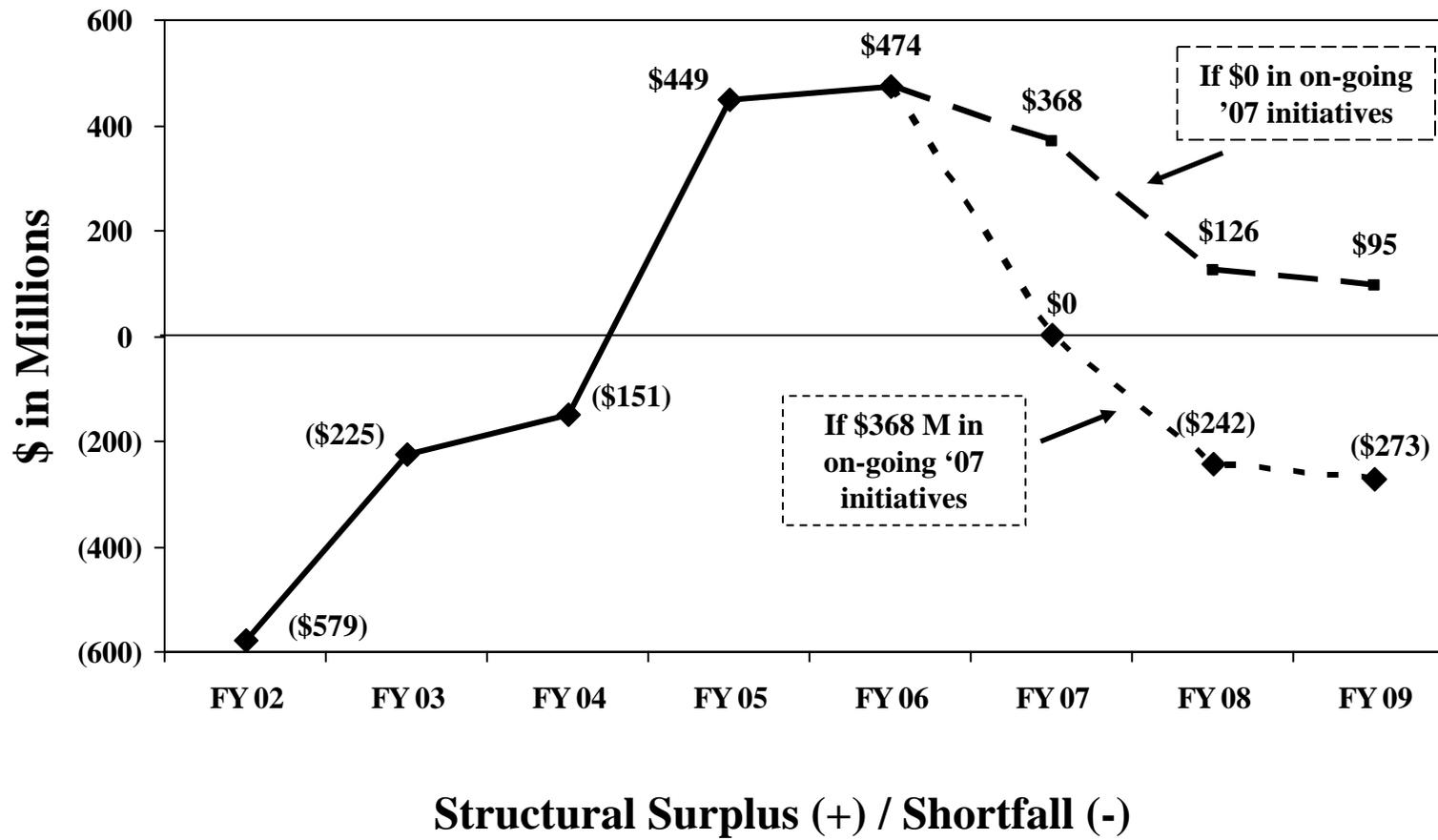
What is the Longer Term Structural Balance Through FY 2009?

- Revenue growth is based on consensus estimates:
 - 5.2% in '08 and 6.0% in '09.
- Spending growth is based on JLBC '07 base plus formula growth in '08 and '09.
- Long term numbers are very sensitive to small % changes:
 - A 1% change in revenues in '07-'09 would change the shortfall calculation by almost \$600 M.

The Long Term Structural Balance Will Depend on Our FY 2007 Decisions

-- Budget is Structurally Balanced in '07

-- Use of One-Time Initiatives in '07 Improves '08 and '09 Balance



JLBC Staff Recommended Process Improvements

-- Focus on Operating Balances and Other Forecasting Improvements

- \$2 B operating balance much higher than ending balance.
- Recommend joint Executive/Legislative review of balances.
- Expand and refine consensus spending forecasts.
- Implement actuarial reviews.
- Review SPAR results and outdated fund list.

