

HIGHLIGHTS OF THE FY 2005 BUDGET

The Second Regular Session of the 46th Legislature convened in January 2004. By May, the Legislature had enacted a Fiscal Year (FY) 2005 budget for the year beginning July 1, 2004. The state's FY 2005 General Fund budget is \$7.36 billion. After accounting for non-General monies, the state's "all funds" budget is \$21.0 billion. See page BD-6 for information on appropriated fund spending and page BD-11 for total funds spending by agency.

Revised FY 2004 Budget — Unlike the prior two fiscal years, the FY 2004 budget did not require adjustments to resolve mid-year shortfalls. At the time of the publication of the *FY 2004 Appropriations Report* in August 2003, the projected FY 2004 General Fund ending balance was \$44.5 million. By the time the Second Regular Session adjourned, the projected ending balance was \$243.1 million. This higher ending balance was due to a \$297.6 million increase in projected revenues offset by \$99.0 million in net spending increases. See page 376 for further details on these FY 2004 changes.

The higher revenues resulted from stronger than expected economic conditions. While the budget assumed a FY 2004 General Fund base revenue growth rate of 5.3% in August 2003, the revised growth rate is now 9.9%. The supplemental spending increases were primarily for the Department of Economic Security, Department of Education and the Department of Corrections.

The FY 2005 Statutory and Funding Formula Shortfall — At the beginning of the Second Regular Session, the JLBC Staff calculated the growth in the state's anticipated FY 2005 General Fund spending based on existing statutory funding formulas and other technical requirements. The projected spending level was \$7.26 billion. Based on 7.5% revenue growth, General Fund revenues were anticipated to be \$6.93 billion. These assumptions resulted in a projected FY 2005 shortfall of \$(333) million at the beginning of session. See page 341 for further details on the original JLBC calculation.

The final FY 2005 budget added \$93 million in net additional spending above the JLBC budget. The final budget spent more than the JLBC budget in two key areas: the Department of Economic Security budget was \$103 million higher than JLBC and it incorporated a \$44 million state employee pay package. The enacted budget, however, spent \$53 million less than JLBC on AHCCCS spending and \$63 million less than the JLBC on the School Facilities Board.

After adjusting for the higher spending, the final budget resolved the original shortfall with both permanent and one-time revenue adjustments:

	<u>\$ in Millions</u>
• Higher Spending	\$(93)
• Higher Revenue Estimate	137
• Higher FY 2004 Surplus	64
• Fund Transfers	32
• Vehicle License Tax Deposit	118
• Withholding Adjustments	<u>76</u>
Total	\$334

Comparison to the FY 2004 Budget — General Fund revenues, including one-time monies, are projected to increase from \$6.74 billion in FY 2004 to \$7.36 billion in FY 2005. Of the overall \$614 million increase in revenues, \$525 million is from permanent revenues. This adjustment reflects an 8.3% increase in permanent base revenues. See page 316 for more details on the revenue adjustments.

General Fund spending is projected to grow by 13.2% from \$6.50 billion in FY 2004 to \$7.36 billion in FY 2005. This overall increase of \$855 million includes \$563 million of permanent spending and \$292 million of one-time spending. Excluding the one-time adjustments, permanent spending is expected to increase 8.5% in FY 2005.

The primary permanent spending adjustments are \$195 million for the Department of Education, \$101 million for AHCCCS and \$116 million for the Department of Economic Security. The one-time adjustments include \$120 million for the Ladewig lawsuit settlement, \$75 million for School Facilities Board building repair and \$97 million to replace lost Federal Funds. See the *Budget Units section* for information on individual agency budgets.

"Triggers" — The enacted budget provides conditional appropriations if excess revenues materialize at the end of FY 2004 or the first 6 months of FY 2005. The first extra \$50 million of General Fund revenues would be allocated to School Facilities Building Renewal (\$30 million), Child Care (\$5 million), and the state employer share of employee health insurance costs (\$15 million).

The next \$52 million of General Fund revenues is set aside for more Building Renewal (\$10 million), more health insurance costs (\$8 million), conversion of school repair bonding (\$25 million) to cash financing, the Department of Public Safety's communication system (\$3 million), and the Budget Stabilization (Rainy Day) Fund (\$6 million). After the first two triggers, additional revenues would be split in half between the Rainy Day Fund and the ending cash balance. See page BD-5 for additional information on the "trigger" appropriations.

This Appropriations Report does not include any of the triggered appropriations in the enacted budget numbers.

Structural Shortfall — The structural shortfall is the difference between permanent revenues and permanent spending. The state can have a balanced budget, but a structural shortfall, if it uses one-time revenues and/or one-time spending reductions in its budget plan. Under the enacted FY 2005 budget, the state’s structural shortfall is \$283 million when comparing permanent revenues and spending. The shortfall grows to \$388 million after considering that the state’s school facility building renewal formula is not fully funded (prior to the conditional “trigger” appropriations).

The FY 2005 budget continues: a) the \$191 million K-12 “rollover” which defers state payments to school districts to the following fiscal year and b) the lease-purchase of \$250 million in new school construction. The structural shortfall grows to \$829 million if these two items are not considered permanent financing mechanisms.

Vetos — The Governor vetoed two provisions of the budget legislation. See page BD-4. Neither veto affected FY 2005 General Fund spending.

Ending Balances — At the end of the Second Regular Session, the anticipated FY 2004 General Fund ending balance is \$243 million. This amount would be largely spent down in the enacted FY 2005 budget. The projected FY 2005 ending balance is \$2 million. As of this writing in June 2004, General Fund revenues are running ahead of the budgeted forecast. Depending on the level of additional revenues and the resulting triggered appropriations, these projected ending balances may increase.

STATEMENT OF GENERAL FUND REVENUES AND EXPENDITURES

	FY 2004 Estimate	FY 2005 Approved
REVENUES		
On-going Revenues	6,352,411,000	6,877,109,300
One-time Revenues, including Balance Forward	391,340,200	480,861,800
Total Revenues	\$6,743,751,200	\$7,357,971,100
EXPENDITURES		
Operating Budget Appropriations	6,537,650,900	7,288,766,800
Ladewig Litigation Allocation	0	120,000,000
Federal Fund Maximization Revertments	(25,000,000)	(25,000,000)
Administrative Adjustments	39,142,300	23,000,000
Revertments	(51,169,300)	(51,169,300)
Total Spending	\$6,500,623,900	\$7,355,597,500
 ENDING BALANCE	 \$243,127,300	 \$2,373,600

**STATEMENT OF GENERAL FUND REVENUES AND EXPENDITURES 1/2/
WITH ONE-TIME FINANCING SOURCES**

	<u>FY 2004 Estimate</u>	<u>FY 2005 Approved</u>
REVENUES		
On-going Revenues	\$6,717,476,100	\$7,250,183,500
Urban Revenue Sharing	(365,065,100)	(\$373,074,200)
Revised On-going Revenues	<u>6,352,411,000</u>	<u>6,877,109,300</u>
One-time Revenues		
Balance Forward	192,185,000	243,127,300
Fund Transfers (2003 Session)	54,500,000	11,700,000
Tax Amnesty (one-time portion)	43,000,000	0
Federal Cash Assistance	87,265,900	0
Judicial Collections	5,389,300	0
Legal Settlement	9,000,000	0
New FY 2005 Fund Transfers	0	32,034,500
Vehicle License Tax Transfer	0	118,000,000
Income Tax Withholding Adjustment	0	76,000,000
Subtotal One-time Revenues	<u>391,340,200</u>	<u>480,861,800</u>
Total Revenues <u>3/</u>	\$6,743,751,200	\$7,357,971,100
EXPENDITURES		
Operating Budget Appropriations	6,635,063,700	7,213,766,800
Capital Outlay <u>4/</u>	0	0
Maximizing Federal Fund Savings <u>5/</u>	(25,000,000)	(25,000,000)
Administrative Adjustments	39,142,300	23,000,000
Revertments	(51,169,300)	(51,169,300)
Subtotal Expenditures	<u>6,598,036,700</u>	<u>7,160,597,500</u>
One-time Expenditures		
SFB Deficiencies Corrections	0	75,000,000
Ladewig Litigation Payments	0	120,000,000
Federal Medicaid Match Rate <u>6/</u>	(97,412,800)	0
Subtotal One-time Expenditures	<u>(97,412,800)</u>	<u>195,000,000</u>
Total Spending	\$6,500,623,900	\$7,355,597,500
ENDING BALANCE	\$243,127,300	\$2,373,600
Structural Shortfall <u>7/</u>	(\$245,625,700)	(\$283,488,200)
Structural Shortfall w/SFB Building Renewal <u>8/</u>	(375,625,700)	(388,488,200)
Structural Shortfall w/SFB Building Renewal and Debt <u>9/</u>	(816,625,700)	(829,488,200)
Structural Shortfall - Governor's calculation <u>10/</u>	(53,440,700)	(40,360,900)

1/ This statement reflects the summary statement used to brief legislators during the course of the session. Significant one-time revenues and expenditures have been separately detailed so as to permit the calculation of the structural shortfall.

2/ Reflects status at the adjournment of the 2nd Regular Session. The enacted budget includes provisions for conditional "triggered" appropriations if revenues exceed the forecast for FY 2004 or the first 6 months of FY 2005. This statement does not reflect any of these "triggered" appropriations.

3/ Details on revenues can be found in the Economic and Revenue Forecast section.

4/ There were no General Fund Capital Outlay appropriations in either FY 2004 or FY 2005.

5/ Each budget assumed that there would be \$25 million in savings related to maximizing the use of Federal Funds. Savings will take the form of a revertment of appropriated funds.

6/ Represented a one-time increase in federal share of Title XIX costs, which resulted in one-time state savings.

7/ The structural shortfall in this calculation reflects the difference between permanent on-going revenues and permanent expenditures.

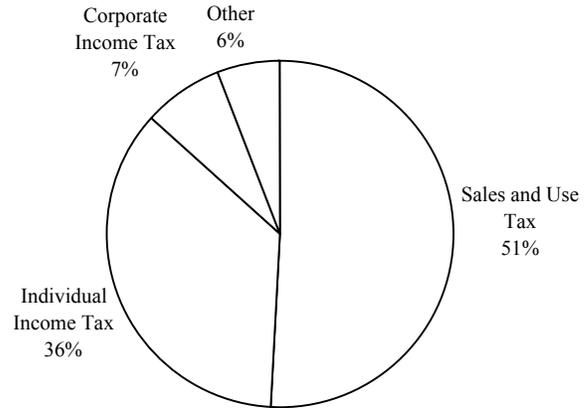
8/ Calculation if unfunded SFB Building Renewal obligation is included. In FY 2004, the formula amount was approximately \$130 million and there was no appropriation for this purpose. Therefore, the FY 2004 structural shortfall calculation includes \$130 million for SFB Building Renewal. In FY 2005, the formula amount is approximately \$135 million and there is a \$30 million appropriation (before conditional appropriations). Therefore, the FY 2005 calculation includes \$105 million for unfunded SFB Building Renewal.

9/ Calculation if SFB building renewal is included (footnote 7) plus \$191 million of K-12 rollover and \$250 million of SFB new construction obligation.

10/ Executive includes one-time Balance Forward in permanent revenues.

FY 2005 General Fund Revenue - Where it Comes From

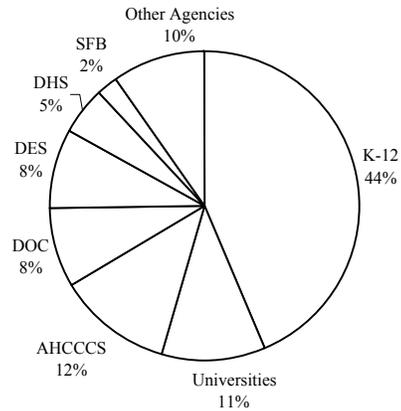
<u>Source</u>	Revenue (Millions)
Sales and Use Tax	\$ 3,501.4
Individual Income Tax	2,455.8
Corporate Income Tax	525.0
Other	394.9
TOTAL REVENUE	\$ 6,877.1 ^{1/}



^{1/} Includes all legislative revenue changes, but does not include beginning balance or other one-time revenue enhancements. The projected beginning balance is \$243.1 million. Other one-time revenues equal \$237.7 million.

FY 2005 General Fund Appropriations - Where it Goes

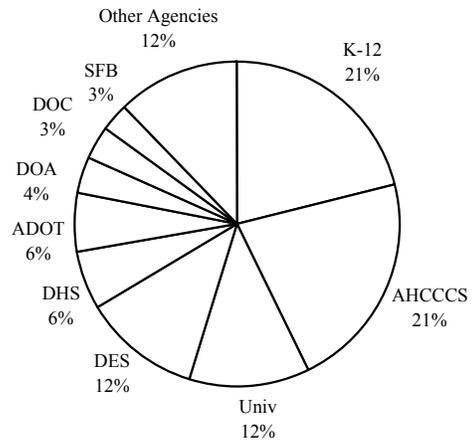
<u>Budget Unit</u>	Appropriation (Millions)
Education (K-12)	\$ 3,184.0
Universities	787.0
AHCCCS	860.0
Corrections	620.9
Economic Security	599.8
Health Services	366.7
School Facilities Bd	153.6
Other Agencies	716.8
TOTAL OPERATING BUDGET	\$ 7,288.8 ^{1/}



^{1/} Does not include administrative adjustments, revertments and maximizing federal funds adjustment.

FY 2005 Total Operating Spending - All Sources ^{1/}

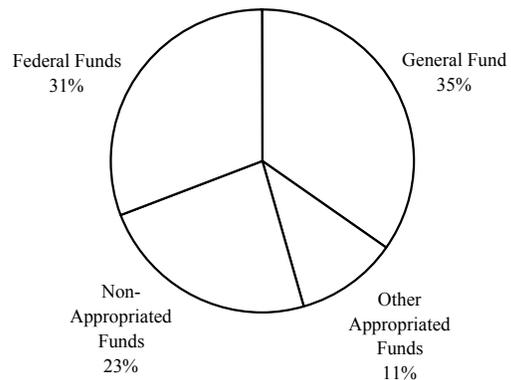
<u>Budget Unit</u>	Spending (Millions)
AHCCCS	\$ 4,541.8
Education (K-12)	4,395.8
Universities	2,519.7
Economic Security	2,430.0
Health Services	1,252.1
Transportation	1,228.0
Administration	748.1
Corrections	704.1
School Facilities Board	530.9
Other Agencies	2,583.6
TOTAL	<u>\$ 20,934.1</u>



^{1/} Mostly excludes direct state capital expenditures.

FY 2005 Total Operating Spending by Fund Source

<u>Fund Source</u>	Spending (Millions)
General Fund	\$ 7,288.8
Other Appropriated Funds	2,259.4
Non-Appropriated Funds	4,907.5
Federal Funds	6,478.4
TOTAL	<u>\$ 20,934.1</u>



THE FY 2005 STATE GENERAL FUND BUDGET – MAJOR CHANGES

Overall State Spending

- The enacted FY 2005 General Fund budget is \$7.36 billion. Of this amount, \$7.16 billion represents on-going spending and another \$195 million reflects one-time payments.
- General Fund spending is growing by \$855 million above FY 2004, an increase of 13.2%. Excluding one-time items, permanent spending is growing by \$563 million, or 8.5%.
- The FY 2005 ending balance would be \$2.4 million.
- The overall state budget, including both appropriated and non-appropriated funds, is projected to be \$21 billion.

General Fund Revenues

- The FY 2005 General Fund permanent revenue forecast is \$6.88 billion, an 8.3% increase over the current FY 2004 forecast.
- The budget also has \$481 million in one-time revenues, including:
 - ⇒ \$243 million from a projected FY 2004 surplus;
 - ⇒ \$118 million in vehicle license tax monies that otherwise would have been deposited into the Highway Fund;
 - ⇒ \$76 million in income tax withholding adjustments; and
 - ⇒ \$44 million in transfers from dedicated funds to the General Fund.

Structural Shortfall

- The structural shortfall is the difference between permanent revenues and permanent spending. The state can have a balanced budget, but a structural shortfall, if it uses one-time revenues and/or one-time spending reductions in its budget plan.
- The state's structural shortfall is \$283 million when comparing permanent revenues and spending. The shortfall grows to \$388 million after considering that the state's school facility building renewal formula is not fully funded.
- The FY 2005 budget continues a) the \$191 million K-12 "rollover" which defers state payments to school districts to the following fiscal year and b) the lease-purchase of \$250 million in new school construction. The structural shortfall grows to \$829 million if these two items are not considered permanent financing mechanisms.

State Employee Pay

- State employees will receive a \$1,000 increase in their annual salary as of July 1, 2004. The University system will be allowed to determine the distribution plan for their employees.
- Instead of the \$1,000 adjustment, DPS officers will have an average pay raise of \$3,500 while nurse salaries will rise by \$2,000.
- The General Fund cost of the salary adjustments is \$44 million.

Education

K-12 Operating Expenses

- Direct state assistance to the operations and maintenance of K-12 schools will grow by \$195 million, or 6.5%.
- The K-12 budget will fund 969,000 students, an increase of 30,200 from the prior year.
- The budget contains an across-the-board 2% inflation adjustment in state assistance.
- The budget adds \$25 million (including \$4 million in capital assistance) for full day kindergarten programs to serve schools with more than 90% low income students.
- Achievement testing funding is increased by \$1.8 million to combine the current Stanford and AIMS tests.

K-12 Capital Expenses

- The budget continues to provide \$250 million in lease-purchase financing for new schools. This amount will fund 38 new school projects that will house 27,300 students.
- \$100 million is set aside to finish the state's \$1.3 billion program to repair schools (known as deficiency corrections). Of the \$100 million, \$75 million is from cash and \$25 million is from bonding. Cash financing will replace the bonding if extra state revenues materialize.
- School facility building renewal will receive a minimum of \$30 million. In addition, school districts will receive another \$40 million for repairs if extra state revenues materialize.

Universities

- The total University General Fund budget of \$787 million will fund 102,300 students in FY 2005. General Fund spending will grow by \$38 million, or 5.1%.
- The budget funds projected FY 2005 enrollment growth except at ASU-East. Of the \$38 million increase in General Fund spending, \$22 million is for salary adjustments.

Community Colleges

- The total Community College General Fund budget will grow by \$16 million, or 12.0%. This amount provides 100% of the statutory funding formula.
- The budget increase will fund 7,200 added full-time equivalent students and bring total enrollment to 109,800.

Health and Welfare

AHCCCS

- AHCCCS' General Fund budget will increase by \$180 million, or 26.6%, to a level of \$860 million. Of the \$180 million, \$79 million replaces a one-time increase in the federal share of program costs in FY 2004.
- AHCCCS will provide indigent health care services to 24,000 additional recipients. Total caseload is expected to be 983,000. Health care provider payments will increase by an average of 7.5% for inflation.

Department of Health Services

- DHS funding will increase by \$42 million, or 12.9%. Of this amount, \$17 million will replace one-time increases in the federal share of program costs. Another \$18 million will fund the behavioral health component of federal indigent health care services.
- The Department also received an additional \$1.5 million for 66,000 new doses of children vaccines, \$150,000 to distribute scorpion anti-venom and \$100,000 for a diabetes education program.

Department of Economic Security

- DES funding will increase by \$116 million, or 23.9%. Of this amount, \$48 million replaces the use of one-time monies. The remainder includes:
 - ⇒ \$23 million of new funding for 1,500 new clients in the Developmental Disabilities program. Of this amount, \$6.4 million is dedicated for provider rate adjustments.
 - ⇒ \$16.2 million for new Child Protective Services funding and related Attorney General staff.
 - ⇒ \$8.7 million to double the current funding level of the Healthy Families program.
 - ⇒ \$9.7 million to expand Child Care subsidies. The program is expected to serve 40,100 children in FY 2005, an increase of 2,400 from FY 2004. In addition, the program will receive another \$5 million if additional state revenues materialize. In that circumstance, the caseload would increase to 41,400.
 - ⇒ \$4.7 million for welfare cash benefit caseloads.
 - ⇒ \$3.5 million for 65 new job training staff.

Criminal Justice

Department of Corrections

- The Department will receive a total of \$621 million to incarcerate 33,500 inmates by the end of FY 2005. The increased funding of \$14 million will allow 1,800 new beds to open during the year.
- ADC is expected to have a bed shortfall of 2,600 by the end of FY 2005. This compares to a shortfall of 4,100 prior to the added beds authorized in the fall 2003 Special Session.

Department of Juvenile Corrections

- DJC funding will increase by \$4.1 million, or 6.4%, to address issues identified in its federal audit as well as other staffing issues.

Department of Public Safety

- Sworn officer pay will increase by an average of \$3,500.
- The budget added \$2 million to improve communications access between law enforcement agencies. This initiative will receive another \$3 million if added state revenues materialize.

Transportation

Aviation Fund

- The state's airports will receive an additional \$7 million as all flight property tax collections will be deposited into the Aviation Fund.
- Vehicle License Tax proceeds of \$118 million will be transferred to the General Fund rather than the Highway Fund.

Other Issues

FTE Positions

- State appropriated fund employment would increase in the budget by 635 Full-Time Equivalent (FTE) Positions, or 1.3%, from 49,323 FTEs in FY 2004 to 49,958 FTEs in FY 2005. The primary employment gains were in the Department of Corrections (283 FTEs, a 2.8% increase) and the Department of Economic Security (214 FTEs, a 6% increase).

Ladewig Litigation Payments

- The budget sets aside \$120 million for the first of three years of payments to taxpayers to resolve the Ladewig litigation. This lawsuit involved the state's differential income tax treatment of dividends from Arizona and non-Arizona companies in the late 1980s.

Military Bases

- The effort to retain the state's current military bases will receive \$5 million annually.

Office of Tourism

- The Office of Tourism will receive its full formula allocation, which will increase its FY 2005 General Fund spending level by \$2.6 million, or 28.9%.

Federal Funds Maximization

- The FY 2005 budget continues the FY 2004 budget assumption that state appropriations will be reduced by \$25 million by increasing the state's use of Federal Funds. Savings will take the form of a reversion of appropriated funds.

"Triggers"

- The budget provides conditional appropriations if excess revenues materialize at the end of FY 2004 or the first 6 months of FY 2005.
- The first extra \$50 million would be allocated to School Facilities Building Renewal (\$30 million), Child Care (\$5 million), and the state employer share of employee health insurance costs (\$15 million).
- The next \$52 million is set aside for more Building Renewal (\$10 million), more health insurance costs (\$8 million), conversion of school repair bonding (\$25 million) to cash financing, the Department of Public Safety's communication system (\$3 million), and the Rainy Day Fund (\$6 million).
- After the first two triggers, additional revenues would be split in half between the Rainy Day Fund and the ending cash balance.

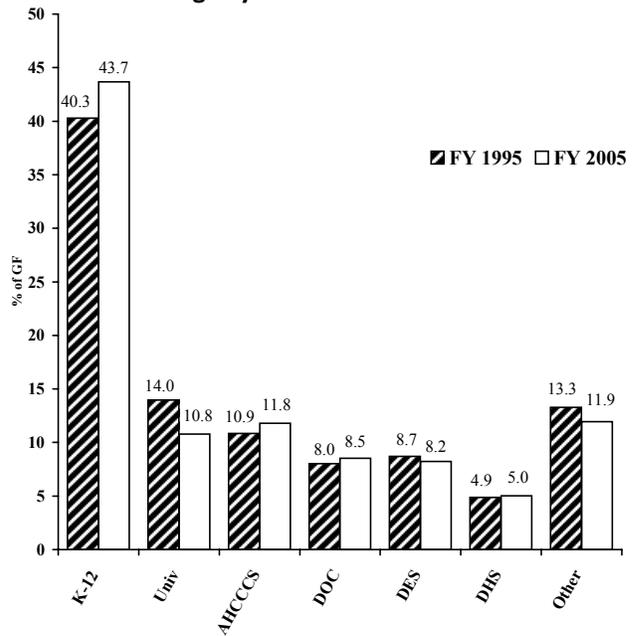
"THEN AND NOW" - FY 1995 vs. FY 2005 General Fund Spending

**Comparison of 9 Largest Operating Budgets
(\$ in Millions)**

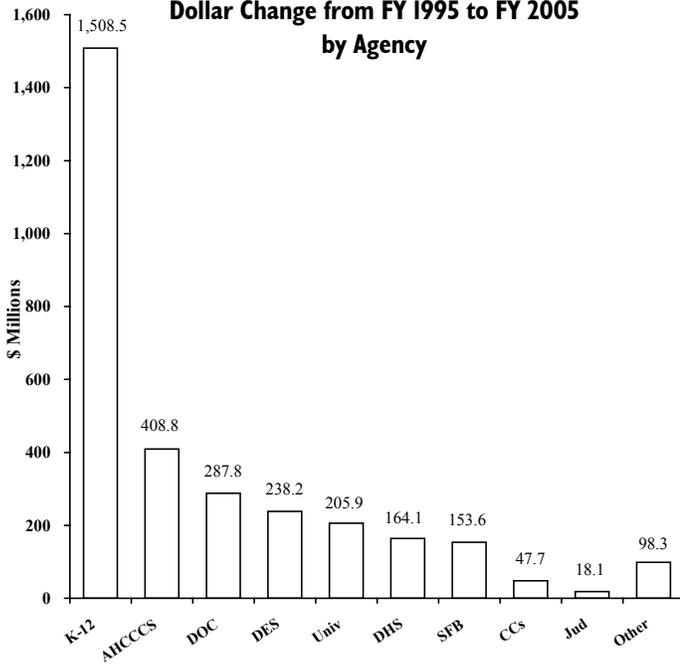
	FY 95 Actuals	FY 05 Approp.	\$ Change FY 95-05	% Change FY 95-05
Education (K-12)	\$ 1,675.5	\$ 3,184.0	\$ 1,508.5	90.0
AHCCCS	451.2	860.0	408.8	90.6
Universities	581.1	787.0	205.9	35.4
Corrections	333.1	620.9	287.8	86.4
Economic Security	361.6	599.8	238.2	65.9
Health Services	202.6	366.7	164.1	81.0
School Facilities Board	-	153.6	153.6	NA
Community Colleges	98.0	145.7	47.7	48.7
Judiciary	95.9	114.0	18.1	18.9
Other	358.8	457.1	98.3	27.4
TOTAL	\$ 4,157.8	\$ 7,288.8 ^{1/}	\$ 3,131.0	75.3%

^{1/} Excludes savings of \$25 M for maximizing federal funds.

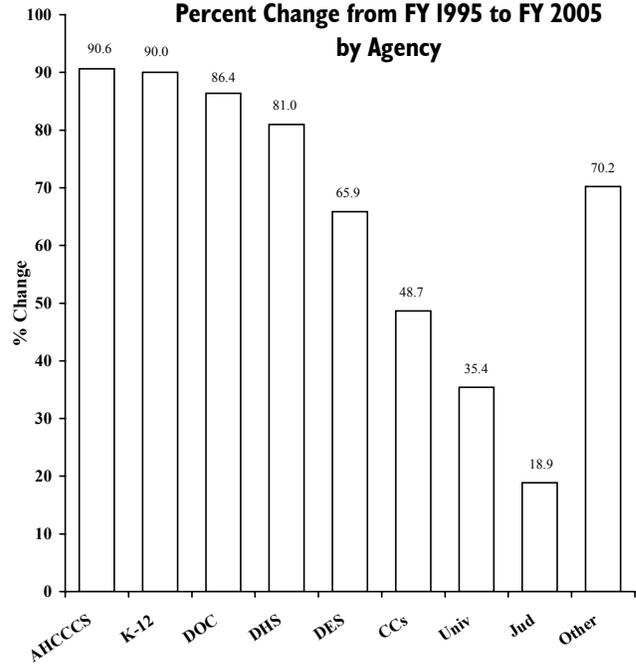
Agency Share of General Fund



**Dollar Change from FY 1995 to FY 2005
by Agency**



**Percent Change from FY 1995 to FY 2005
by Agency**



"THEN AND NOW" - FY 1995 vs. FY 2005 General Fund Revenue and Carry-Forward Balances

General Fund Revenue, Expenditures and Carry Forward Balances (\$ in Millions)

Fiscal Year	Revenue	Expenditures	Carry Forward	Carry Forward as a % of Revenue
1995	4,694.6 ^{1/}	4,425.1	269.5	5.7%
1996	4,932.5	4,532.6	399.9	8.1%
1997	5,410.3	4,894.3	516.0	9.5%
1998	5,745.4	5,232.0	513.4	8.9%
1999	6,148.7	5,893.3	255.4	4.2%
2000	6,215.7	6,012.3	203.4	3.3%
2001	6,381.0	6,367.7	13.3	0.2%
2002	6,339.6	6,338.6	1.0	0.0%
2003	6,232.8	6,040.6	192.2	3.1%
2004	6,743.7	6,500.6	243.1	3.6%
2005	7,358.0	7,355.6	2.4	0.0%

1/ Includes carry-forward of \$229.2 million.

General Fund Major Tax Sources as a Percent of Total Base Revenue

Fiscal Year	Sales	Individual Income	Corporate Income	Other
1995	44.1%	33.1%	9.3%	13.5%
1996	45.1%	32.0%	9.6%	13.3%
1997	43.9%	33.1%	11.9%	11.1%
1998	45.3%	35.6%	10.1%	9.0%
1999	45.7%	37.2%	9.7%	7.4%
2000	46.9%	38.9%	9.3%	4.8%
2001	48.3%	37.2%	8.8%	5.8%
2002	48.1%	33.4%	5.5%	12.9% ^{1/}
2003	48.8%	33.7%	6.3%	11.2% ^{2/}
2004	49.4%	33.8%	7.3%	9.6% ^{3/}
2005	49.2%	34.5%	7.4%	8.9% ^{4/}

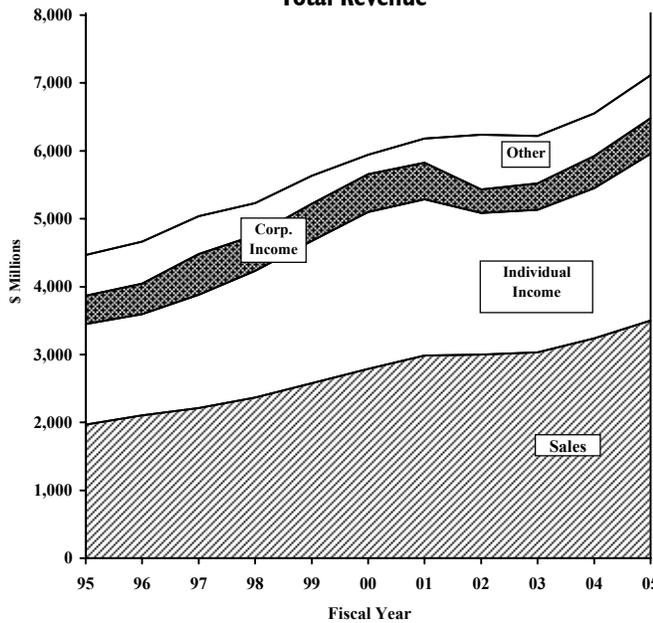
1/ Includes \$491.2 million in one-time revenue enhancements.

2/ Includes \$435.9 million in one-time revenue enhancements.

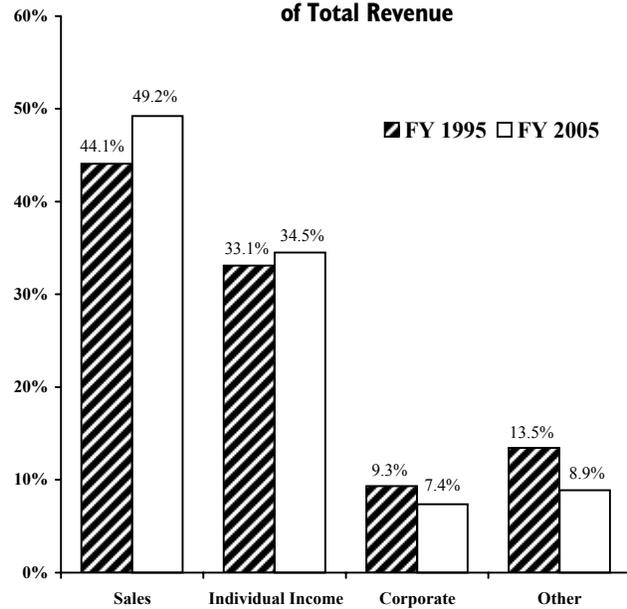
3/ Includes \$199.2 million in one-time revenue enhancements.

4/ Includes \$237.7 million in one-time revenue enhancements.

General Fund Major Tax Sources as a Share of Total Revenue



FY 1995 vs. FY 2005 Major Tax Sources as a Percent of Total Revenue



**MAJOR CHANGES TO STATE GENERAL FUND BUDGET
FY 2004 to FY 2005**

