

## FY 2006 BUDGET JLBC BOOK II - ADDITIONAL DETAIL

The JLBC Book II supplements information on the FY 2006 budget already provided in the main JLBC Budget Book. The following information is provided for each state agency: 1) a side by side listing of the JLBC Baseline and Executive Budget changes; 2) a five-year total funds chart; and 3) line item detail of the budget estimates. The JLBC line item detail also includes non-appropriated funds.

### The JLBC Baseline Budget

The JLBC has already released its FY 2006 General Fund Baseline estimates (*see JLBC Budget Book*). This General Fund Baseline provides an estimate of the cost of statutory funding formulas and other obligations in comparison to a projection of available revenues. The Baseline does not represent a complete budget as it does not address program expansions or program reductions. These types of policy issues will be considered by the full Legislature during the Legislative session.

The FY 2006 JLBC General Fund Baseline spending estimate is \$8.36 billion. When compared to projected FY 2006 General Fund revenues of \$7.88 billion, the Baseline has a \$(477) million shortfall. Solutions to bridge this gap will be identified during the Legislative session.

The FY 2006 JLBC Budget includes recommended Other Appropriated Fund spending levels for operating and capital expenditures. Unlike the General Fund Baseline, these Other Fund estimates may include program expansions and reductions.

### The Executive Budget Proposal

This volume provides information on the Executive budget proposal as required by A.R.S. § 41-1273.

#### *General Fund Revenues*

The FY 2006 Executive proposal includes a General Fund revenue estimate of \$7.84 billion. This amount includes \$39 million of revenue enhancement proposals, including \$25 million from fund transfers, \$3 million from changing the Lottery distribution formula and \$11 million from Revenue Generating Plan II. The latter is a follow up to a FY 2004 initiative that added 153 Department of Revenue audit and collection staff. The Executive forecasts that spending \$18

million for another 280 audit and collection staff would increase General Fund revenues by \$30 million in FY 2006 and \$52 million in FY 2007.

The FY 2006 JLBC General Fund Baseline revenue estimate is \$7.88 billion, or \$39 million greater than the Executive. Without the Executive's \$39 million revenue enhancement proposal, however, the JLBC Baseline estimate is \$79 million higher. This difference represents a better comparison of the on-going revenue growth in both estimates. The JLBC Baseline assumes on-going revenue growth of 7.2% in FY 2006 while the Executive budget has a 6.0% on-going revenue growth rate. See page S-45.

#### *General Fund Spending*

The FY 2006 Executive budget includes a General Fund spending level of \$7.84 billion. In comparison, the FY 2006 JLBC FY 2006 Baseline spending estimate is \$8.36 billion, or \$524 million higher than the Executive. Unlike the JLBC Baseline, however, the Executive budget does not provide cash financing of \$300 million in K-12 new school construction projects. The Executive instead relies on debt financing of this expense. The Executive budget also does not provide for a General Fund deposit into the Budget Stabilization Fund (BSF). The JLBC Baseline sets aside \$189 million for this purpose, as determined by the BSF formula.

Aside from these two issues, the Executive spending level is a net \$(35) million below the JLBC Baseline. While the latter does not include program expansions or reductions, the Executive budget has numerous policy proposals that account for this \$35 million difference.

The Executive budget has approximately \$160 million in new or expanded programs, including:

- \$24 million for an expansion of the Department of Education's full day kindergarten and school tutoring programs;
- \$23 million for Department of Economic Security (DES) Child Protective Services and related functions;
- \$21 million for DES child care subsidies;
- \$10 million for health care initiatives, such as an expansion of the Kids Care program;
- \$17 million for non-enrollment university expansions, including \$6 million for a new University of Arizona Phoenix Medical School;

- \$28 million for correctional officer pay and other improvements at the Departments of Corrections and Juvenile Corrections; and
- \$24 million for a pay adjustment to offset an increase in state employees' retirement contributions.

The Executive further reduces spending by approximately \$(200) million, including:

- \$(70) million elimination of School Facilities Board (SFB) building renewal expenses. If General Fund revenues exceed the forecast, the Executive proposes to dedicate these surplus monies for this purpose;
- \$(22) million reduction in SFB debt service obligations by creating a one-time "payment holiday;"
- \$(15) million elimination of K-12 English Learner grants. The state is currently the defendant in a lawsuit that seeks to increase English Learner funding;
- \$(58) million savings from debt financing the state's Ladewig settlement payments. In FY 2006, the state will be in the second year of a three-year settlement to reimburse taxpayers for the state's differential income tax treatment of corporate dividends. The debt financing would be generated through the sale and lease-back of state assets. The lease-back payments would begin in FY 2007; and
- \$(20) million to offset AHCCCS costs with additional Tobacco Tax collections. This offset requires a 10% increase in tobacco tax collections over 2 years, a revenue source that has historically declined. There has been a recent increase in tobacco tax collections that may be due to the addition of 14 new enforcement staff in the FY 2005 budget. This new staff was originally expected to generate \$1.8 million in higher tobacco tax collections. At this time, it is highly uncertain that collections will increase by as much as \$20 million.

Beyond these program expansions and reductions, the Executive funding formula estimates are similar to the JLBC Baseline. Among the highlights:

- The Executive's estimate for growth in the AHCCCS and Department of Health Services Title 19 low-income health programs is \$15 million higher than the JLBC Baseline;
- University enrollment funding is \$5 million higher than the JLBC Baseline, which offsets part of the cost increase with the tuition collections from new students; and
- The Executive's Department of Education K-12 formula estimate is \$(16) million less than the JLBC Baseline, primarily due to a higher estimate of property value growth at the local level.

## Ending Balance and Structural Shortfall Estimates

The FY 2006 JLBC Baseline has a shortfall of \$(477) million, while the FY 2006 Executive budget has a \$7 million surplus. The budget can also be viewed from the perspective of its "structural shortfall." This concept represents the difference between on-going permanent revenues and expenditures. The state can have a structural shortfall but have a balanced budget through the use of one-time revenue increases and/or expenditure savings.

In the JLBC Staff calculation, permanent revenues only include on-going revenues and exclude any one-time monies, including any carry forward balance of funds from the prior year. This "balance forward" has varied widely in the last several years, from \$1 million at the beginning of FY 2003 to \$360 million at the beginning of FY 2005. This variability demonstrates the difficulty in making these monies part of any "on-going" revenue calculation. The Executive, however, believes that any "balance forward" should be included as part of the structural shortfall estimate.

Using the JLBC Staff definition of permanent revenues, the projected FY 2005 Executive budget structural shortfall in FY 2005 is \$(48) million. The nominal shortfall grows to \$(164) million in FY 2006. This estimate, however, does not include SFB building renewal or new K-12 school construction financing. If adjusted for these factors, the Executive's FY 2006 shortfall is \$(534) million. In comparison, the JLBC Baseline structural shortfall is \$(351) million.

If the balance forward is included in permanent revenues, the nominal FY 2006 structural shortfall of \$(164) million in the Executive budget would become \$(18) million.

## FY 2007

The Executive's FY 2006 budget defers some expenses to FY 2007 and also creates new obligations that will begin in FY 2007, including:

- \$22 million to increase SFB debt service payments to reflect the one-time nature of the FY 2006 "payment holiday;"
- \$28 million in new debt service for the FY 2006 \$300 million new school construction lease financing. The debt service begins in the year after the proceeds are generated.
- \$50 million to implement the Executive's proposed change in the SFB construction formula, which will count all kindergarten students as full-time students for purposes of capital expenditures.
- Approximately \$7 million in debt service for the \$58 million FY 2006 sale and lease-back of state assets to pay for the Ladewig litigation.

- Unknown funding to expand the University of Arizona Phoenix Medical School, which will begin operation in FY 2006.
- \$1.5 million for a judicial salary increase with a full year annualization cost of \$3 million in FY 2008. Under the provisions of the state's non-legislative elected official salary adjustment law, this increase will go into effect unless one house of the Legislature approves a resolution to the contrary in the first 90 days of the legislative session.
- Unknown revenue loss associated with the Executive's proposed changes in research and development income tax credits and business property taxes.

The JLBC Staff has already provided a FY 2007 estimate of the ending balance and structural shortfall. Using the FY 2006 JLBC Baseline as a starting point, the estimated FY 2007 ending balance has a \$(453) million shortfall and the structural shortfall is \$(326) million.

If those same JLBC Staff FY 2007 growth assumptions are applied to the FY 2006 Executive budget, the FY 2007 budget would have an ending balance shortfall of \$(306) million and a structural shortfall of \$(557) million.

### **Annual and Biennial Budget**

The state has both an annual and biennial budget process. Under state law, the annual budget process is limited to 16 large agencies, while the remainder of the state's 117 budget units have a two-year appropriation cycle. Due to the state's budget shortfalls, however, more medium-sized agencies had their budgets reviewed annually during the past budget cycle. For the 47<sup>th</sup> Legislature, the JLBC is recommending that the annual budget cycle include 51 agencies.

The Executive is recommending that the annual appropriation cycle be limited to the 16 annual agencies as prescribed by statute, plus the Community Colleges and the Board of Dispensing Opticians.

### **FY 2005**

The Executive budget and JLBC Baseline both re-estimate the enacted FY 2005 General Fund budget. Both alternatives have virtually the same FY 2005 General Fund revenue forecast of approximately \$7.84 billion. In addition, the Executive and JLBC Baseline have similar estimates of the cost of the Title 19 low-income health care supplemental of approximately \$61 million to \$65 million.

Unlike the JLBC Baseline, the Executive is also proposing a FY 2005 \$18 million supplemental for the Department of Corrections to address compensation issues and other topics. The Executive budget, however, has a higher estimate of unspent FY 2005 appropriations, otherwise known as "revertments." The

Executive's FY 2005 revertment savings is \$84 million, which is \$33 million higher than the standard revertment estimate used in the JLBC Baseline. Of this amount, \$20 million is due to an unexpected Department of Education surplus. The revertment estimate also includes \$9 million associated with specific projects to draw down additional federal funds.

Both the JLBC Baseline and the Executive budget have separate revertment estimates associated with federal revenue maximization efforts that are not related to specific projects. The JLBC Baseline includes \$25 million in such savings, which is the same amount that was included in the originally enacted FY 2005 budget assumptions. The Executive savings estimate is \$16 million, after having moved \$9 million in savings to the overall revertment estimate of \$84 million. It is unlikely that either the JLBC Baseline or Executive budget estimates for these unspecified revenue maximization efforts will be achieved in FY 2005.

The FY 2005 ending balance in the JLBC Baseline and Executive budget are comparable -- \$144 million in the Executive Budget and \$141 million in the JLBC Baseline.

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

	<b>FY 2005 Executive</b>	<b>FY 2005 JLBC <sup>1/</sup></b>	<b>FY 2006 Executive</b>	<b>FY 2006 JLBC Baseline <sup>2/</sup></b>
<b>REVENUES</b>				
On-going Revenues	\$7,622,019,400	\$7,620,183,500	\$8,078,740,000	\$8,168,836,700
Dept of Revenue - Revenue Generator II	0	0	11,398,300	0
Lottery Distribution Change	0	0	3,000,000	0
Urban Revenue Sharing	(373,074,200)	(\$373,074,200)	(417,315,300)	(425,228,900)
Revised On-going Revenues	<u>7,248,945,200</u>	<u>7,247,109,300</u>	<u>7,675,823,000</u>	<u>7,743,607,800</u>
One-time Revenues				
Balance Forward	360,388,900	360,000,000	143,819,400	141,003,600
Prior Fund Transfers	37,341,200	43,734,500	0	0
New FY 2006 Fund Transfers	0	0	25,000,000	0
Vehicle License Tax Transfer	118,000,000	118,000,000	0	0
Income Tax Withholding Adjustment	76,000,000	76,000,000	0	0
Subtotal One-time Revenues	<u>591,730,100</u>	<u>597,734,500</u>	<u>168,819,400</u>	<u>141,003,600</u>
<b>Total Revenues</b>	<b>\$7,840,675,300</b>	<b>\$7,844,843,800</b>	<b>\$7,844,642,400</b>	<b>\$7,884,611,400</b>
<b>EXPENDITURES</b>				
Operating Budget Appropriations	7,283,016,800	7,285,121,200	7,892,609,400	8,147,553,800
FY 05 Supplementals	91,728,000	79,756,000	0	0
Capital Outlay	0	0	0	0
Maximizing Federal Fund Savings <sup>3/</sup>	(16,100,000)	(25,000,000)	(25,000,000)	(25,000,000)
Administrative Adjustments	23,000,000	23,000,000	23,000,000	23,000,000
Revertments	(84,069,300)	(51,169,300)	(51,169,300)	(51,169,300)
Subtotal Permanent Expenditures	<u>7,297,575,500</u>	<u>7,311,707,900</u>	<u>7,839,440,100</u>	<u>8,094,384,500</u>
One-time Expenditures				
SFB Deficiencies Corrections	100,000,000	100,000,000	20,000,000	20,000,000
SFB Payment Holiday	0	0	(22,190,200)	0
Ladewig Litigation Payments	134,280,400	134,300,000	0	58,300,000
Budget Stabilization Fund Deposits	165,000,000	157,832,300	0	188,618,100
Subtotal One-time Expenditures	<u>399,280,400</u>	<u>392,132,300</u>	<u>(2,190,200)</u>	<u>266,918,100</u>
<b>Total Spending</b>	<b>\$7,696,855,900</b>	<b>\$7,703,840,200</b>	<b>\$7,837,249,900</b>	<b>\$8,361,302,600</b>
<b>ENDING BALANCE</b>	<b>\$143,819,400</b>	<b>\$141,003,600</b>	<b>\$7,392,500</b>	<b>(\$476,691,200)</b>
Structural Shortfall <sup>4/</sup>	(\$48,630,300)	(\$64,598,600) <sup>5/</sup>	(\$163,617,100)	(\$350,776,700)
Structural Shortfall with SFB Cash and Bldg Renewal <sup>6/</sup>			(\$533,617,100)	

<sup>1/</sup> Reflects current status of FY 2005, including updated revenues and "triggered" appropriations.

<sup>2/</sup> Represents estimate of cost of statutory funding formulas and other obligations. Does not include policy considerations such as program expansions and/or reductions.

<sup>3/</sup> Savings related to maximizing the use of Federal Funds. Savings will take the form of a revertment of appropriated funds.

<sup>4/</sup> The structural shortfall in this calculation reflects the difference between permanent on-going revenues and permanent expenditures

<sup>5/</sup> If K-12 construction cash expenses were included, the FY 2005 amount would have been \$(315) million.

<sup>6/</sup> Same calculation as above, but Executive is adjusted for comparability by counting SFB New Construction Cash and Building Renewal Expenditures.

## STATEWIDE ISSUES JLBC - Executive Comparison

	<b>JLBC</b>	<b>EXECUTIVE</b>
<i>Statewide Expenditures</i>		
State Employer Health Insurance	<ul style="list-style-type: none"> <li>• \$27.0 M for increases in the state employer share of employee health insurance costs</li> </ul>	<ul style="list-style-type: none"> <li>• \$ 18.0 M for increases in the state employer share of employee health insurance costs</li> </ul>
State Employer Retirement	<ul style="list-style-type: none"> <li>• \$30.5 M for increases in the state employer share of employee retirement costs</li> </ul>	<ul style="list-style-type: none"> <li>• \$30.8 M for increases in the state employer share of employee retirement costs</li> </ul>
Statewide Employee Pay Increase	<ul style="list-style-type: none"> <li>• Does not include</li> </ul>	<ul style="list-style-type: none"> <li>• \$24.1 M General Fund (GF) for 2.5% increase to offset higher retirement rates</li> </ul>
<i>Revenue Generating Proposals</i>		
Fund Transfers	<ul style="list-style-type: none"> <li>• Does not include.</li> </ul>	<ul style="list-style-type: none"> <li>• \$25 M transfer of dedicated fund balances to the General Fund. Transfers are not specified.</li> </ul>
Revenue Generating Plan II	<ul style="list-style-type: none"> <li>• Does not include.</li> </ul>	<ul style="list-style-type: none"> <li>• \$11.4 M in net FY 06 Revenues and \$52.1 M in FY 07 from adding 280 new Department of Revenue audit/collection staff. Net revenue consists of: <ul style="list-style-type: none"> <li>-- Gross Revenue of \$30.2 M in FY 06 and \$52.1 M in FY 07</li> <li>-- Increased costs of \$18.8 M in FY 06 and \$18.5 M in FY 07</li> </ul> </li> </ul>
Lottery Distribution	<ul style="list-style-type: none"> <li>• Does not include.</li> </ul>	<ul style="list-style-type: none"> <li>• \$3 M by changing distribution of Lottery proceeds</li> </ul>
<i>Debt Financing</i>		
New School Construction	<ul style="list-style-type: none"> <li>• Does not include debt financing. Includes \$300 M of cash for new FY 06 school construction</li> </ul>	<ul style="list-style-type: none"> <li>• \$300 M of debt financing for new FY 06 school construction</li> </ul>
Ladewig Litigation	<ul style="list-style-type: none"> <li>• Does not use debt finance. \$58 M in cash to fund payments</li> </ul>	<ul style="list-style-type: none"> <li>• Payment is generated through sale and lease-back of state assets. Debt service would begin in FY 07.</li> </ul>
<i>Budget Stabilization Fund</i>		
FY 05 Deposits	<ul style="list-style-type: none"> <li>• Estimated \$158 FY 05 General Fund deposit from provision requiring transfer of 50% of July-December surplus.</li> </ul>	<ul style="list-style-type: none"> <li>• Estimated \$165 M FY 05 deposit from provision requiring transfer of 50% of July-December surplus</li> </ul>
FY 06 Deposit	<ul style="list-style-type: none"> <li>• \$189 M FY 06 General Fund deposit, based on funding formula. Would result in total fund balance of \$360 M.</li> </ul>	<ul style="list-style-type: none"> <li>• No FY 06 General Fund deposit</li> </ul>
Medical School Set-Aside	<ul style="list-style-type: none"> <li>• Does not include</li> </ul>	<ul style="list-style-type: none"> <li>• \$20 M set aside for Phoenix Medical School</li> </ul>

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