

FY 2006 JLBC BUDGET

The JLBC Staff has been asked to provide an estimate of the FY 2006 General Fund budget under the following assumptions:

- Adjust spending as required by statutory funding formulas,
- Open previously authorized prison beds,
- Pay cash for new K-12 school construction rather than use debt financing; and
- Freeze most other spending at FY 2005 levels.

FY 2005

As a first step in developing a FY 2006 budget, the enacted FY 2005 budget has been re-estimated. The General Fund balance being carried forward from FY 2004 to FY 2005 had originally been anticipated to be \$243 million. Due to strong revenue growth at the end of FY 2004, the FY 2004 ending balance is currently estimated to be \$360 million.

During the first six months of FY 2005, General Fund revenue growth has continued to exceed expectations. The JLBC Staff now forecasts that the state will collect an added \$370 million in new General Fund revenues above the enacted FY 2005 budget forecast. Total FY 2005 General Fund revenues are forecasted to be \$7.84 billion.

The original FY 2005 budget requires a portion of the extra revenue growth to be deposited into the state's budget reserve, otherwise known as the Budget Stabilization Fund (BSF). *See Budget Stabilization Fund section for more information.* Of the \$370 million, \$135 million will go to the BSF. In combination with a \$23 million deposit from excess FY 2004 revenues, the BSF is projected to receive \$158 million in FY 2005.

In terms of spending, the federal Title 19 low-income health care programs in AHCCCS and the Department of Health Services are expected to exceed their enacted budget due to higher-than-expected caseloads. The revised FY 2005 budget sets aside \$80 million for these supplemental expenses.

The original FY 2005 budget had a projected FY 2005 year-end balance of \$2 million. After adjusting for higher revenue, BSF deposits and supplementals, the year-end balance is now forecast to be \$141 million.

FY 2006 Revenues

A FY 2006 General Fund revenue estimate was developed using a consensus forecasting process. This consensus averages the results of the following four forecasts:

- The projections of the Finance Advisory Committee (FAC), an independent 18 member group of public and private sector economists,
- The University of Arizona Economic and Business Research (EBR) General Fund baseline model,
- EBR's conservative forecast model, and
- The JLBC Staff forecast.

This four-sector consensus forecast yields a FY 2006 growth rate of 7.2%. This rate represents underlying growth in state revenues, excluding urban revenue sharing and one-time monies. Overall, the projected increase in on-going FY 2006 General Fund revenues is \$496 million, which would result in General Fund revenue of \$7.74 billion.

The FY 2006 revenue estimate also reflects the loss of \$560 million in one-time FY 2005 monies, including a \$360 million FY 2004 carry-forward balance, \$162 million in transfers from dedicated funds, and a \$76 million income tax withholding adjustment.

In FY 2006, the only one-time monies are a projected \$141 million carry-forward from FY 2005. In combination with on-going revenue of \$7.74 billion, total General Fund revenues would equal \$7.88 billion. *See the General Fund Revenue section for more information.*

FY 2006 Spending

Statutory funding formulas and other obligations are expected to generate the following new FY 2006 General Fund costs:

- K-12 Operating Aid: \$136 million;
- K-12 New School Construction: \$300 million;
- Health and Welfare formulas: \$207 million.
- Prison operating expenses: \$43 million;
- Higher Education formulas: \$15 million;
- State Employer Retirement and Health Insurance expenses: \$57 million.

These issues are discussed in the Individual Agency Detail section of the JLBC Budget Book.

The JLBC FY 2006 budget would increase total permanent spending by \$783 million, or 10.7%, to a level of \$8.09 billion. This amount continues the prior year assumption that the Executive will generate \$25 million in savings to existing programs by maximizing the state's draw down of federal funds.

The budget also includes adjustments in certain one-time expenditures:

- The K-12 school repair program, known as "Deficiencies Corrections" would decline from \$100 million in FY 2005 to a final payment of \$20 million in FY 2006.
- The Ladewig lawsuit settlement payment would decline from \$134 million in FY 2005 to \$58 million in FY 2006.
- The General Fund deposit to the state's budget reserve, the Budget Stabilization Fund, would increase from \$158 million in FY 2005 to \$189 million in FY 2006.

When adjusting for these one-time expenses, total FY 2006 General Fund spending would equal \$8.36 billion. This amount represents an increase of \$658 million, or 8.5% over FY 2005.

FY 2006 Ending Balance

Given forecasted revenues of \$7.88 billion and a spending level of \$8.36 billion, the FY 2006 JLBC Budget would have a \$(477) million shortfall. Solutions to bridge this gap will be identified during the legislative session.

Structural Shortfall

The budget can also be viewed from the perspective of its structural surplus or shortfall. This concept represents the difference between on-going revenues and expenditures. The state can have a structural shortfall but have a balanced budget through the use of one-time revenue and/or expenditure savings.

The FY 2006 JLBC budget has a structural shortfall of approximately \$(351) million. In comparison, the projected FY 2005 structural shortfall is \$(65) million. The primary reason for the growth is that the FY 2006 estimate includes \$300 million for cash

financing of K-12 school construction, which had been debt financed in FY 2005.

Annual and Biennial Budgets

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 47th Legislature, the JLBC is recommending that the annual budget cycle include 51 agencies.

Other Funds

Besides the General Fund, the state has dedicated special revenue funds. Only a portion of these monies is subject to legislative appropriation. The JLBC recommends a FY 2006 Other Fund appropriated spending level of \$2.29 billion, or (1.0)%, below FY 2005.

The level of FY 2006 non-appropriated state funds is expected to be \$5.39 billion, while non-appropriated federal funds are forecast to be \$7.33 billion. When all appropriated and non-appropriated fund sources are combined, total state spending would be \$23.36 billion in FY 2006.

Other Information

This summary volume also includes sections with information on the following topics:

- Number of State Employees
- Statutory provisions associated with enacting a FY 2006 budget and
- Long-term General Fund projections.

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

	FY 2005 Adjusted ^{1/}	FY 2006 JLBC
REVENUES		
On-going Revenues	\$7,620,183,500	\$8,168,836,700
Urban Revenue Sharing	(\$373,074,200)	(425,228,900)
Revised On-going Revenues	<u>7,247,109,300</u>	<u>7,743,607,800</u>
One-time Revenues		
Balance Forward	360,000,000 ^{2/}	141,003,600
Fund Transfers (2003 Session)	11,700,000	0
New FY 2005 Fund Transfers	32,034,500	0
Vehicle License Tax Transfer	118,000,000	0
Income Tax Withholding Adjustment	76,000,000	0
Subtotal One-time Revenues	<u>597,734,500</u>	<u>141,003,600</u>
Total Revenues	\$7,844,843,800	\$7,884,611,400
EXPENDITURES		
Operating Budget Appropriations	7,285,121,200	8,147,553,800
FY 05 Supplementals	79,756,000	0
Capital Outlay	0	0
Maximizing Federal Fund Savings ^{3/}	(25,000,000)	(25,000,000)
Administrative Adjustments	23,000,000	23,000,000
Revertments	(51,169,300)	(51,169,300)
Subtotal Permanent Expenditures	<u>7,311,707,900</u>	<u>8,094,384,500</u>
One-time Expenditures		
SFB Deficiencies Corrections	100,000,000	20,000,000
Ladewig Litigation Payments	134,300,000	58,300,000
Budget Stabilization Fund Deposits	157,832,300	188,618,100
Subtotal One-time Expenditures	<u>392,132,300</u>	<u>266,918,100</u>
Total Spending	\$7,703,840,200	\$8,361,302,600
ENDING BALANCE	\$141,003,600	(\$476,691,200)
Structural Shortfall ^{4/}	(\$64,598,600) ^{5/}	(\$350,776,700)

^{1/} Reflects current status of FY 2005, including updated revenues and "triggered" appropriations.

^{2/} FY 2005 Balance Forward estimate had not been finalized as of this writing.

^{3/} Savings related to maximizing the use of Federal Funds. Savings will take the form of a revertment of appropriated funds.

^{4/} The structural shortfall in this calculation reflects the difference between permanent on-going revenues and permanent expenditures.

^{5/} If K-12 construction cash expenses were included, the FY 2005 shortfall would have been \$(315) million.