Joint Caucus Budget Update

January 14, 2009

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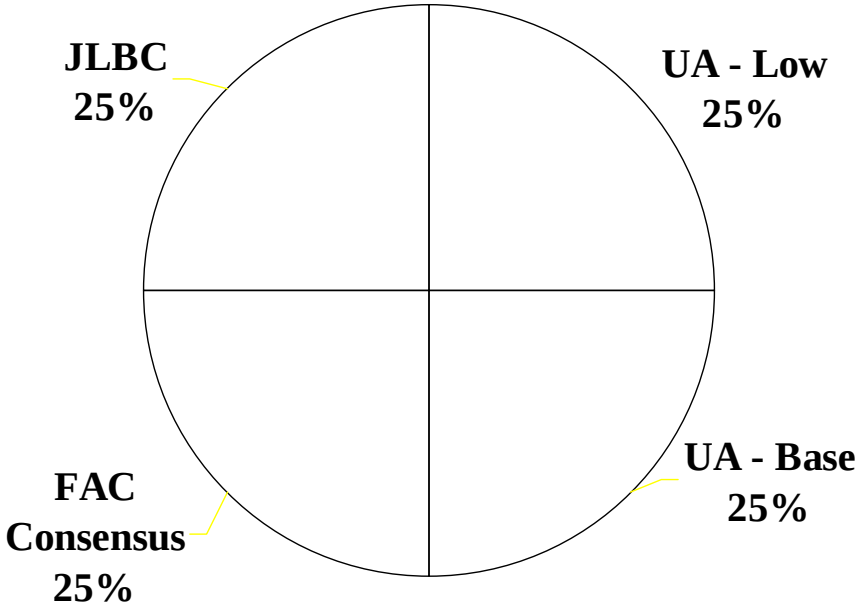
Revenue Summary

How Does JLBC Forecast Revenues?

- - A Consensus Process with 4 Inputs

Sales and income tax forecast equally weights:

- **FAC average ***
- **UofA model - base**
- **UofA model - low**
- **JLBC Staff forecast**
- **Remaining revenues (9% of total) are staff forecast**



* The Finance Advisory Committee is a 15-member panel of public and private sector economists that publicly meets 3 times a year to advise the Legislature on the state of the Arizona economy.

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Any Revenue Forecast Will Have Significant Constraints In Predicting the Next 18 Months

- Current economic instability makes forecasting especially challenging.
- The impact of Federal stimulus is difficult to gauge.
- Current forecasts can indicate the direction of the economy, not its precise landing point.

Housing Oversupply Will Exist For Several Years - - Limits Potential For Rapid Recovery

- There are roughly 50,000 surplus housing units in Metro Phoenix.
- Market has begun to correct itself – building permits have slowed significantly.
- Current demand may only absorb 10,000 – 15,000 units a year.
- Once permits increase again, it will take 12 – 18 months to complete construction.

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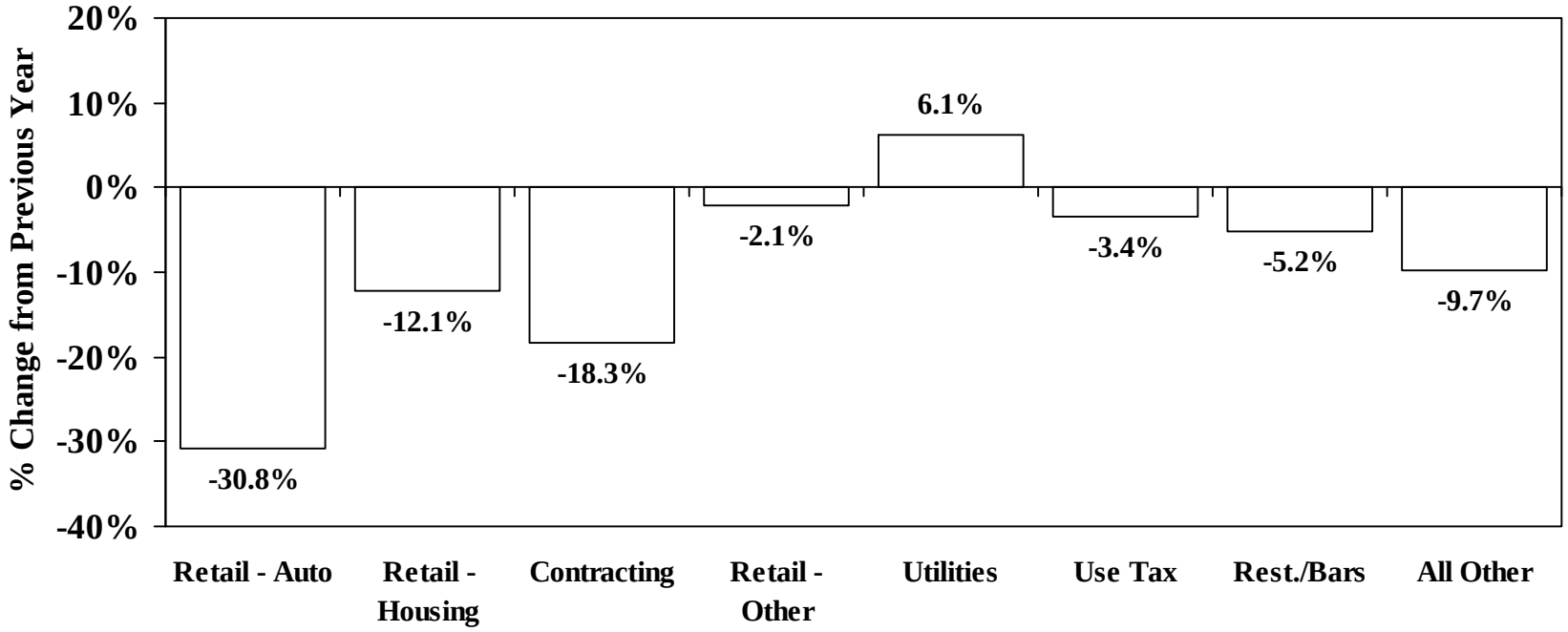
Construction and Vehicle Spending Have Declined Significantly

- Represents 37% of Sales Tax Collections



FY 2009 Year to Date Sales Tax Revenues – (Through November)

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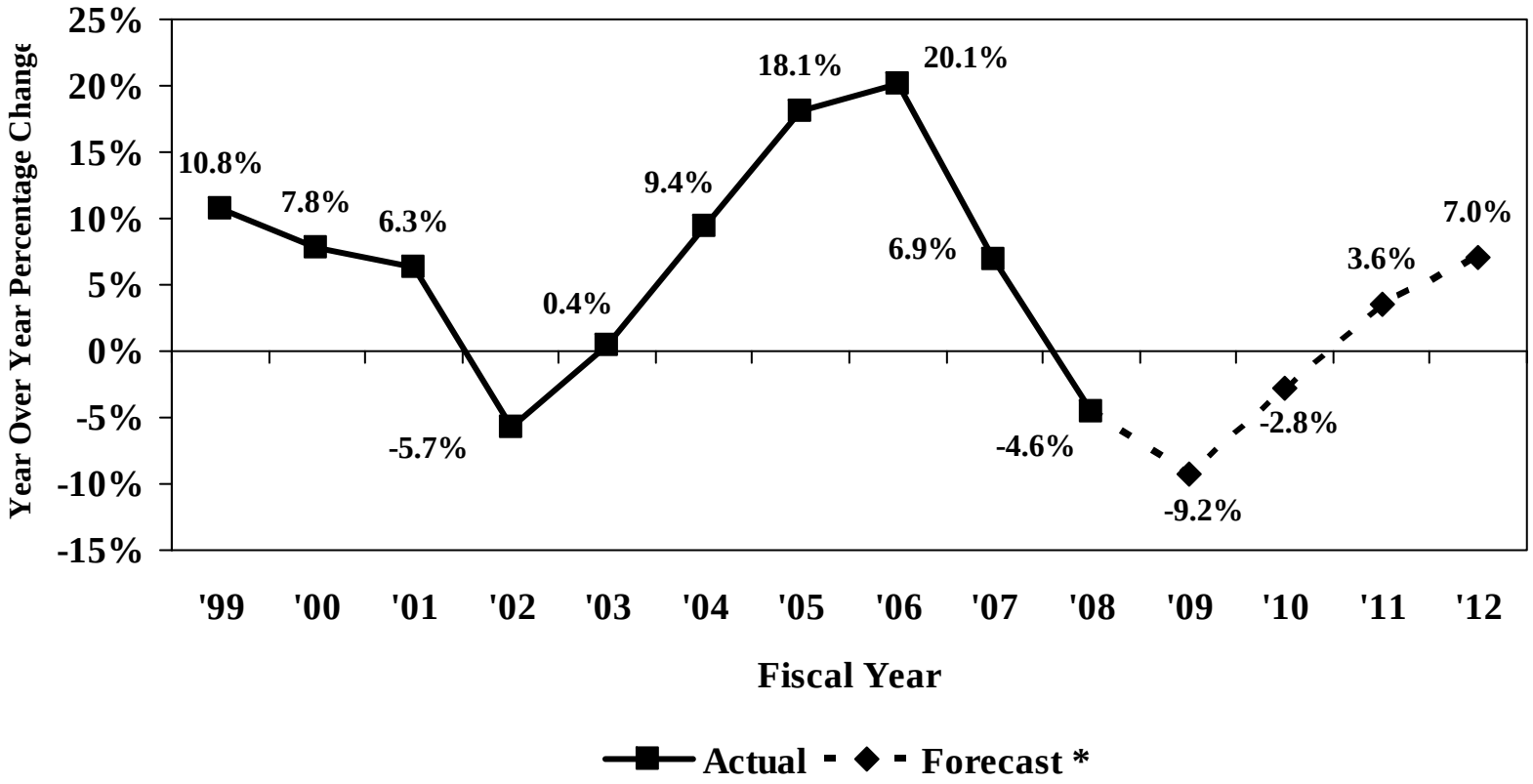
4-Sector Consensus Returns to Normal Growth In FY 2012



* 4-sector forecast weighted average growth.

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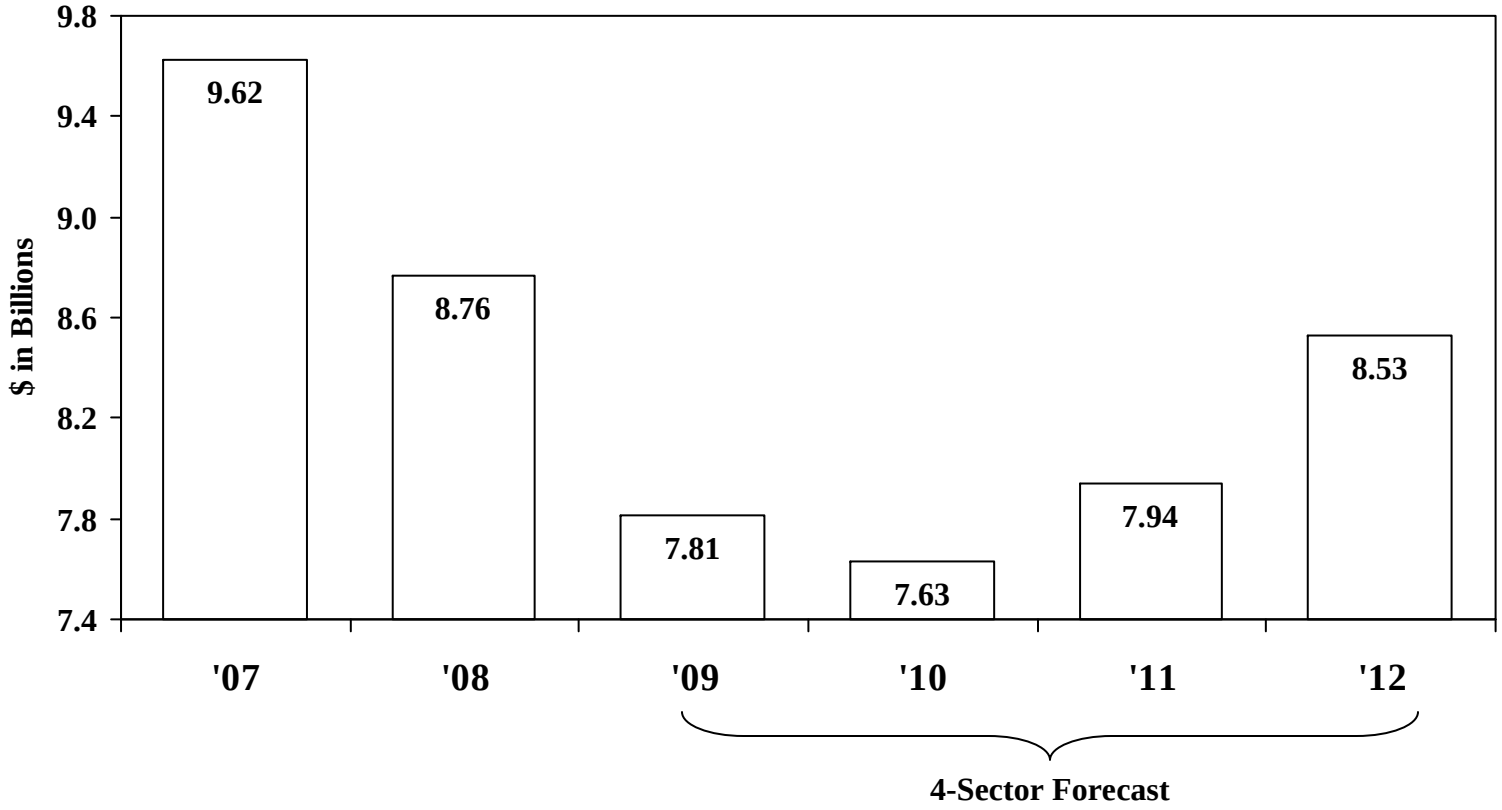
On-Going General Fund Revenue

- Collections Will Not Return to ’08 Level Until After FY ’12



Includes Urban Revenue Sharing and enacted tax law changes
- excludes balance forward and other one-time revenues.

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What Is the Current Status of the Budget?

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Projected FY ’09 Shortfall is $(1.6) B
- Revised Upward from Prior $1.2 B estimate

- Assumes updated 4-sector revenue decline of (9.2)%.
- Includes Title 19 shortfall of $(98) M
  - $(87) M in AHCCCS and $(11) M in DHS.
- Unpaid ’08 bills are projected to grow by $81 M above budget, while revertments will save $7 M more than expected.
- Will need to address $30 M local contribution issue.

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Modified Baseline Spending Guidelines

- FY ’10 Baseline includes statutory funding formula growth. The modified baseline essentially excludes inflation.
- Assumes one-time enacted ’09 solutions continue in ’10.
- Does not account for any permanent reductions to resolve $(1.6) B ’09 shortfall.
- Assumes repeal of equalization tax.

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Baseline Continues $384 M of Enacted ’09 One-Time Solutions

	$ in M
• Local Contributions ($28 M ALTCS, $30 M cash)	$ 57.7
• Community College Reductions	25.6
• SFB Repair Grants at $20 M in Lieu of Building Renewal	66.3
• SFB New Construction Moratorium	187.0
• Suspension of Military Airport Land Preservation	4.8
• Vehicle License Tax Deposit to General Fund	8.4
• Suspension of Temporary Medical Coverage Program	8.4
• Selected AHCCCS and DES Title 19 Rate Freezes	19.5
• Other	8.0

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Modified Baseline Is Projected to Grow by $442 M in FY ’10

Title 19 Health and Welfare Formula $389 M	No Inflation →	Title 19 Health and Welfare Formula $271 M
K-12 Formula* $189 M	Limited Inflation → No Excess Utilities →	K-12 Formula* $27 M
Higher Ed $45 M	No Univ. Growth →	Higher Ed $7 M

Corrections $42 M

SFB Debt Service
$29 M

’09 Non-Lapsing 1-Time $50 M

Admin Adj/Revertments - $18 M

Other $(3) M

Net New Spending $442 M*
Total Spending $10.7 B

* Plus $330 M Increase Due to K-12 Rollover

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General Fund Cash Shortfall

- **$(1.6) B in FY ’09 and $(3.0) B in FY ’10**
- **Any Permanent ’09 Solutions Reduce ’10 Shortfall**

($ in Billions)

	FY ’09	**FY ’10**
Beginning Balance	$ 0.0	$ 0.0
Revenues	8.5	7.7
Total Revenues	8.5	7.7
Spending	10.1	10.7
Shortfall	$ (1.6)	$ (3.0)

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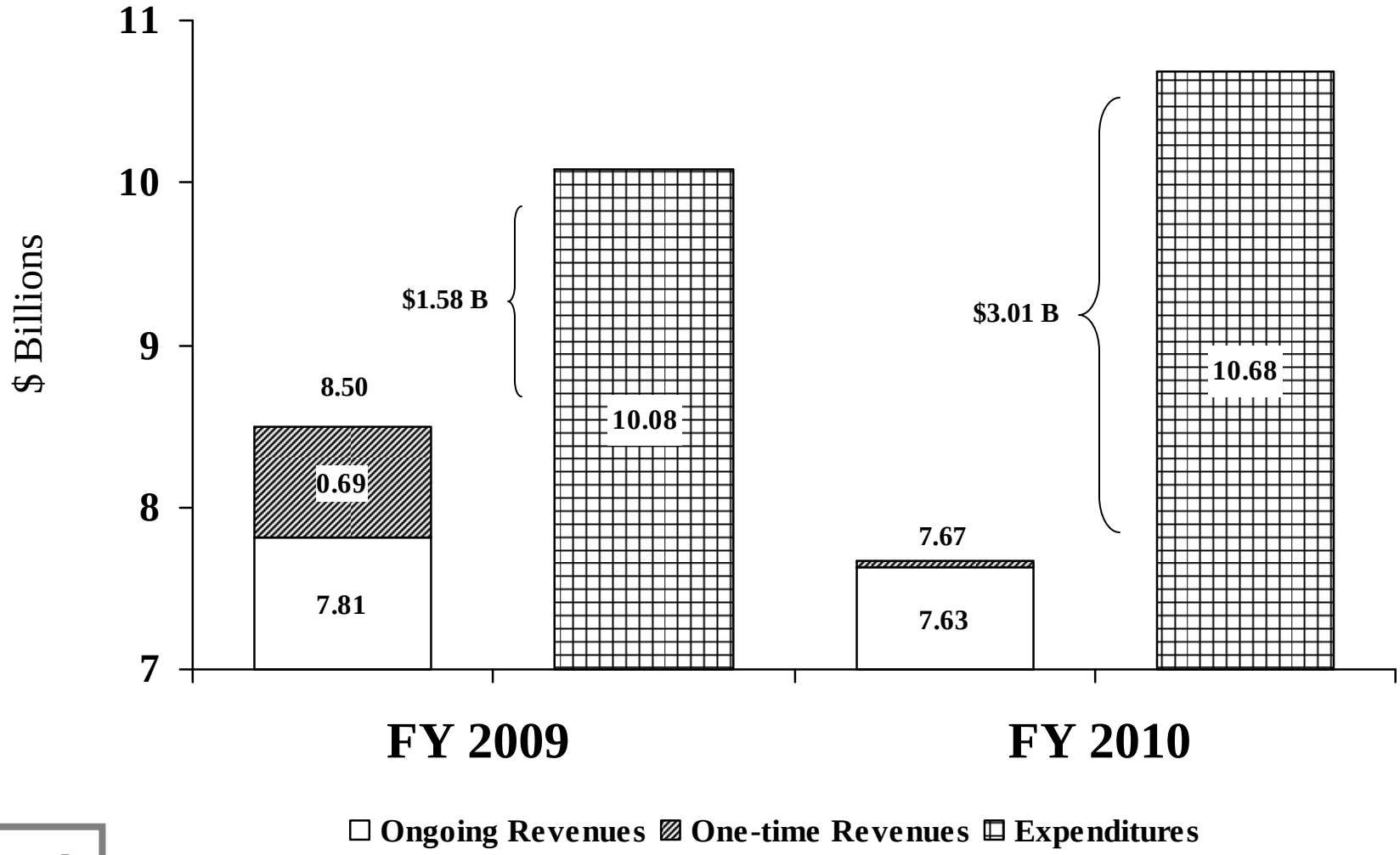
General Fund Shortfalls

• Any Permanent ’09 Solutions Reduce ’10 Shortfall



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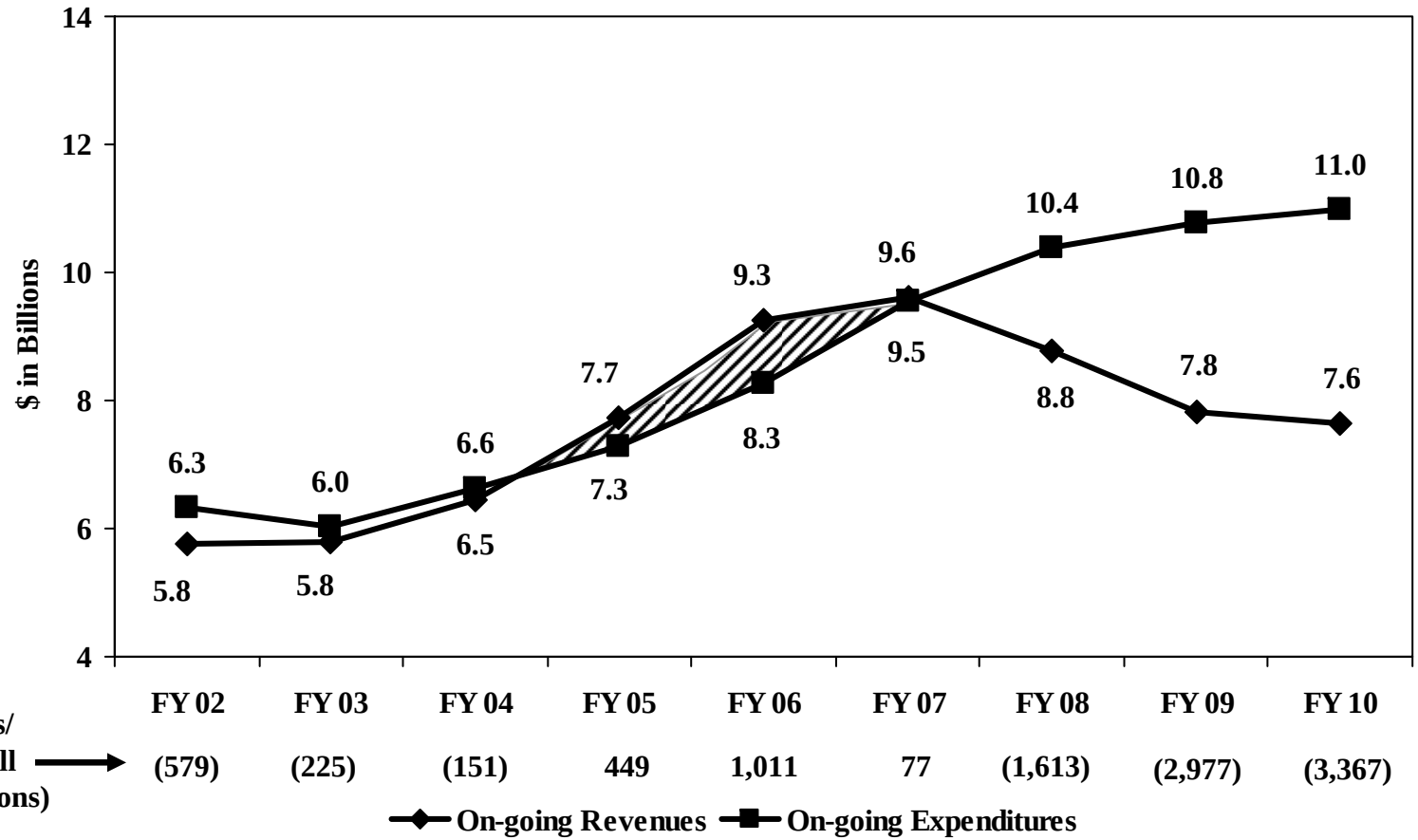
FY ’10 Structural Shortfall is $(3.4) B

- Represents Difference Between On-Going Revenues and Expenditures



	FY 02	FY 03	FY 04	FY 05	FY 06	FY 07	FY 08	FY 09	FY 10
Surplus/ Shortfall ($ in Millions)	(579)	(225)	(151)	449	1,011	77	(1,613)	(2,977)	(3,367)

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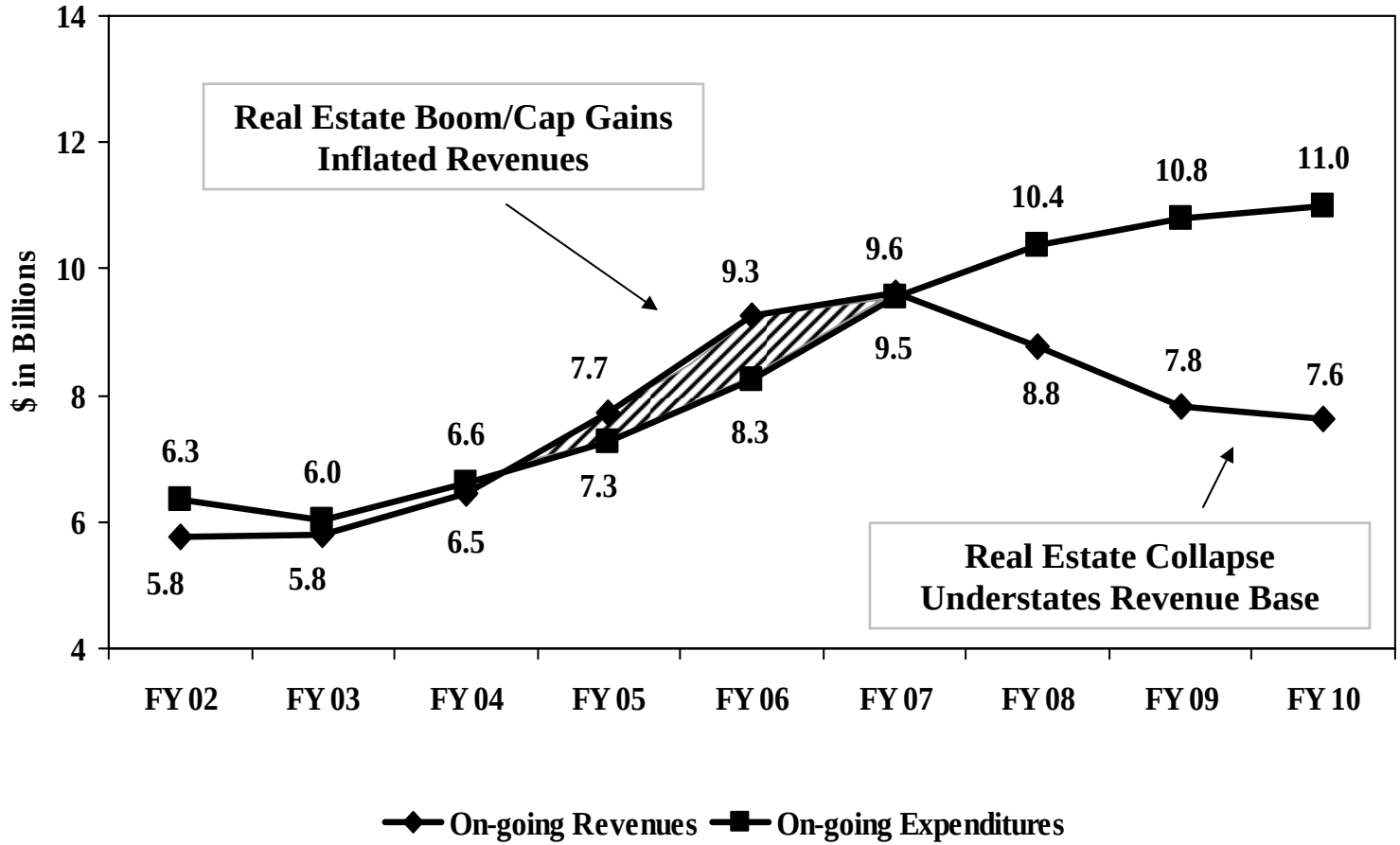
The Challenge of the Structural Shortfall
- How to Evaluate On-Going Level of Revenue



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FY 2010 Spending Issues
By Agency

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Title 19 and Health & Welfare Programs
FY 2010 Statutory Spending Above FY 2009

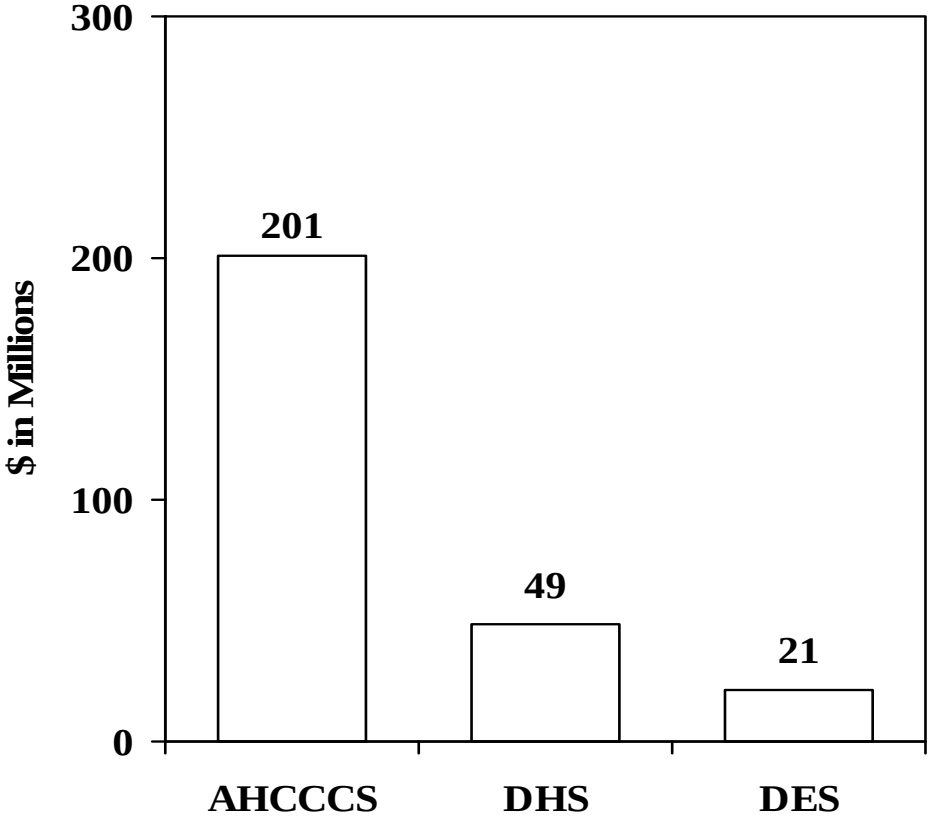
- - Excludes 6.0% capitation adjustment of $118 M

- - Capitation changes usually reflect inflation/utilization increases

FY 2010 Title 19 Growth Rates

	June ’09/June ’10
AHCCCS	9.6% *
DHS	9.0%
DES	5.5%

*** 9.6% includes traditional and Prop 204 populations**



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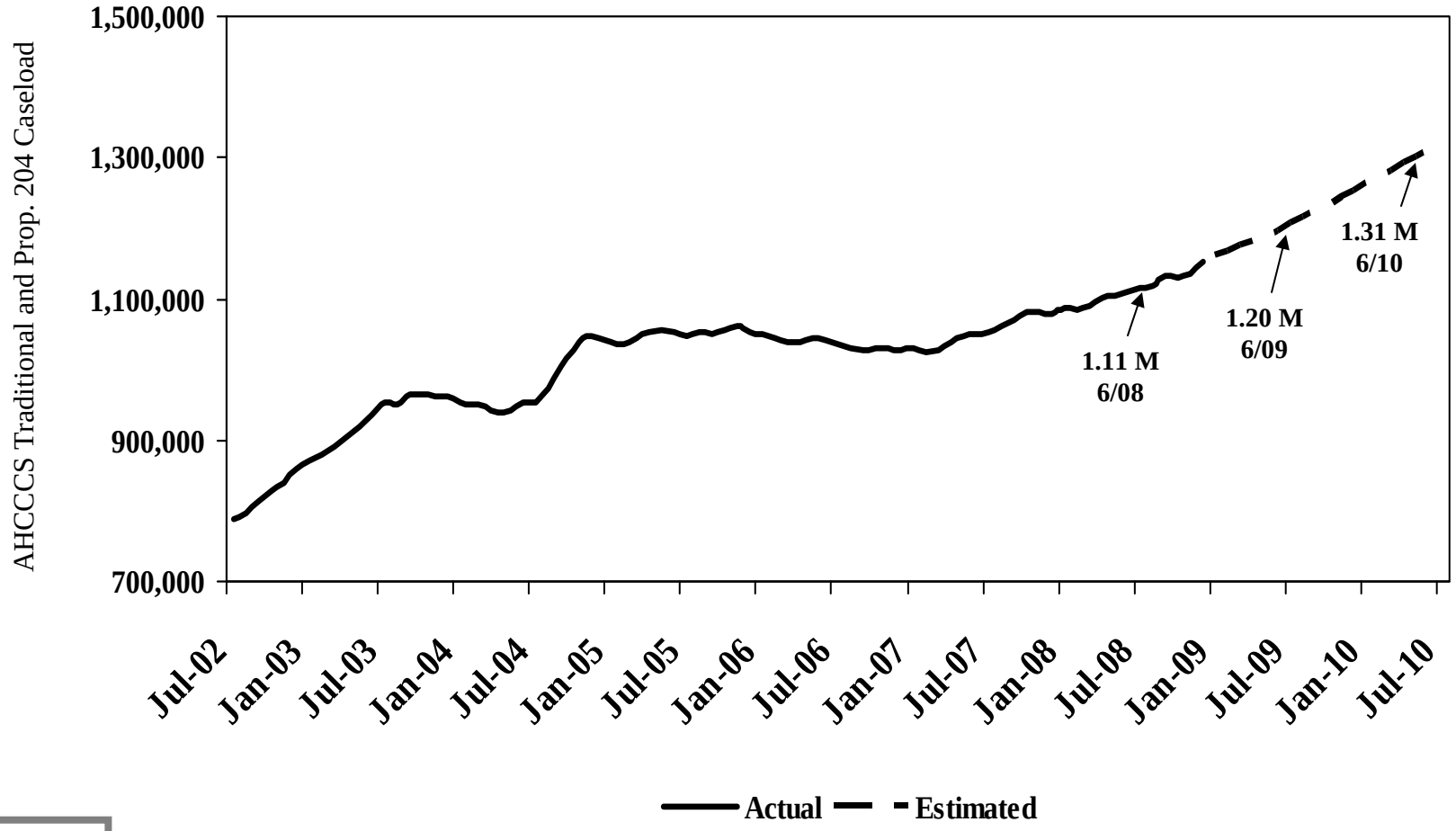
AHCCCS Caseloads Higher Than Projected

-- FY ’09 Budgeted at 2.6%, Now: 7.8% - - $87 M Shortfall

-- FY ’10 Growth Estimated at 9.6%

-- Excludes $85 M for 6% Capitation Increase



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DHS' Title 19 Spending Estimated to Grow by $49 Million

- FY '09 shortfall is projected at $(11.1) M
- Includes $46 M for 9.0% caseload growth and 0% capitation adjustment in FY '10.
- Capitation growth would have cost $23 M
- Includes $3.1 M for State Hospital lease purchase payment.
- Arnold vs. Sarn litigation
  - Court Monitor just released its annual findings.

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DES Statutory Spending Is Projected at $21 M GF for FY 2010

- $3 M for 2.5% TANF cash growth.
- $17.5 M for 5.5% caseload growth in Long Term Care, with no capitation adjustment.
- LTC Capitation growth would have cost $9 M.
- Does not include CPS-related adjustments.

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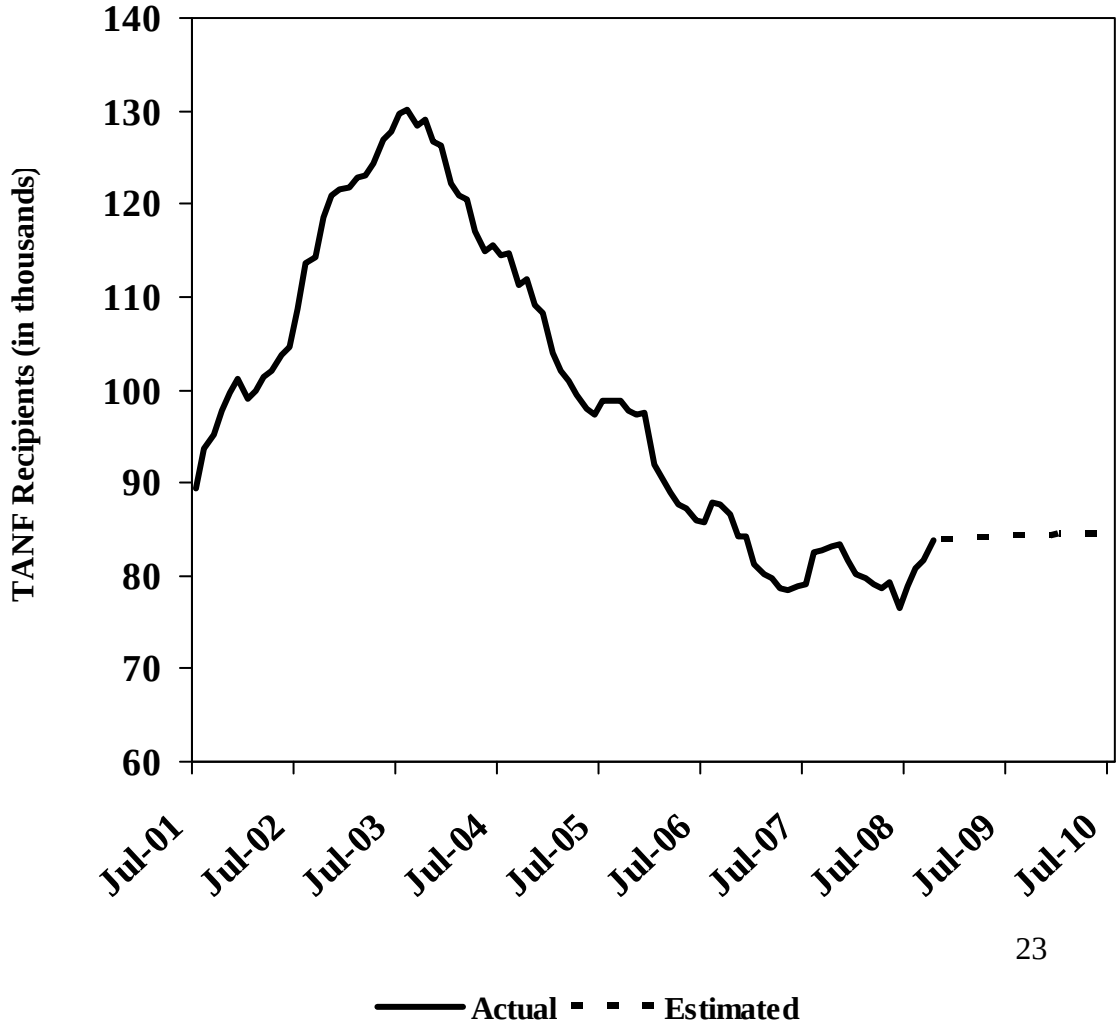
TANF Cash Spending Has Potential to Grow Substantially More Than Projections

- Caseloads are projected to increase 2.5% versus 21% annually during last downturn.
- If caseloads increase similarly, spending could increase another $23 M in FY ’10.
- Growth may be lower due to lifetime benefit caps.



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K-12 Operating
FY 2010 Formula Growth is $27 M

$ in M		
$94	–	1.6% enrollment growth
8	–	2% inflation (Limited base)
(33)	–	Base adjustment for prior year ADM savings
(177)	–	11% property growth
135	–	TNT offset 8.0% existing property growth
(1)	–	Endowment earnings
$27		Total

Continues ’09 JTED State Aid Cap
Assumes Continued Repeal of Equalization Tax

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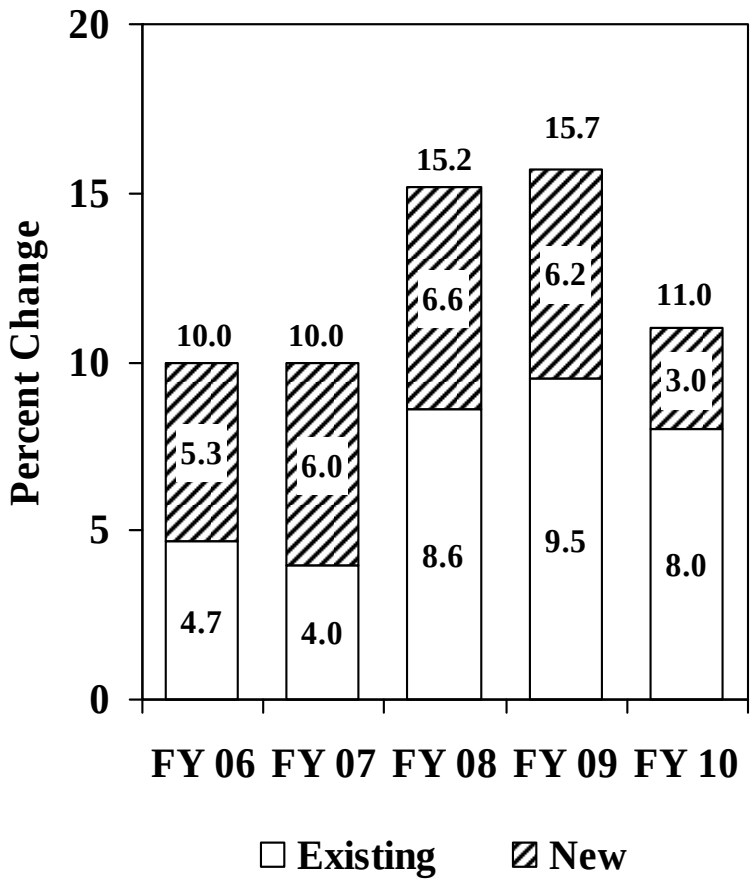
K-12 Inflation Is Governed By Prop 301

- Prop 301 requires inflation adjustment of base support <u>or</u> transportation components.
- Attorney General has opined that both components are to be inflated.
- Inflating both costs $110 M, while adjusting transportation costs $8 M.

11% Property Growth Is High Due to Deferred Impact of Past Housing Price Increases

- Assessed value growth for homes restricted in the Constitution.
- Maximum = 10% of prior year primary or 25% primary/secondary difference.
- ’10 estimate based on Jan ’08 value.
- Property value growth increases local share of formula.



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School Facilities Board
FY 2010 Formula Growth is $29 M

- FY ’10 JLBC Baseline includes an increase of $29 M for debt service of FY ’09’s debt financing of $580 M.
- Assumes continuation of new construction moratorium, including full-day kindergarten.
- Baseline continues funding for Building Renewal Grants Fund at $20 M – formula requires $228 M.

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Higher Education
FY 2010 Formula Growth is $7.3 M

- FY ’10 Baseline does not fund university enrollment growth - - traditionally funded, but not statutory.
- 4.4% university enrollment growth would have cost $38 M
- Community College statutory formulas cost $7.3 M
  - Includes $6.9 M for 25% equalization growth.
  - No restoration of $25.6 M reduction from ’09.

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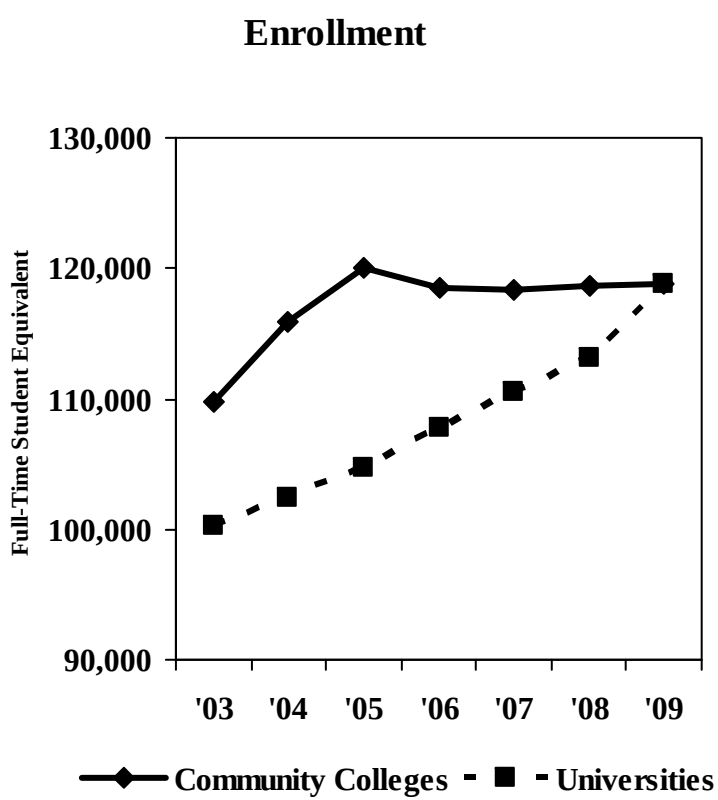
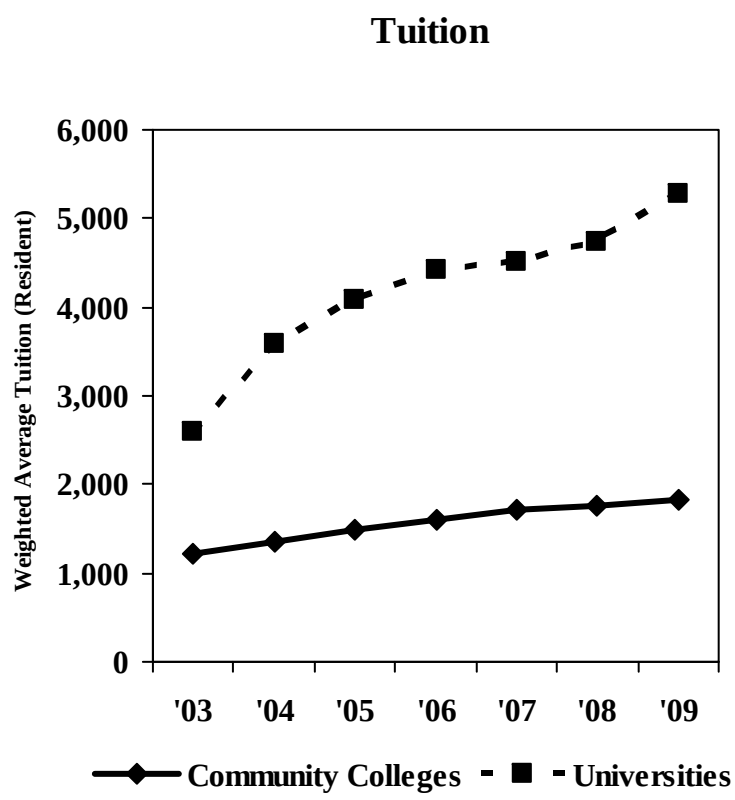
Average Tuition Increased 105% at U's and 50% at CC's in Last 6 Years

-- At the Same Time, Enrollment Increased 18% at U's and 8% at CC's





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Corrections
FY 2010 Growth is $42 M

- ’07 Legislature authorized 4,000 public and 2,000 private beds to open at same time.
- New Beds - $65 M
  - Open all 6,000 beds between January and October 2010.
- Temporary rented (provisional) bed savings - $(46) M
  - Phase out all 4,900 beds
- Other - $23 M
  - $2 M for 194 additional in-state beds.
  - $4 M for population growth (151/month).
  - $5 M for 6% Health Care.
  - $12 M for on-going costs previously funded by 1-time savings.

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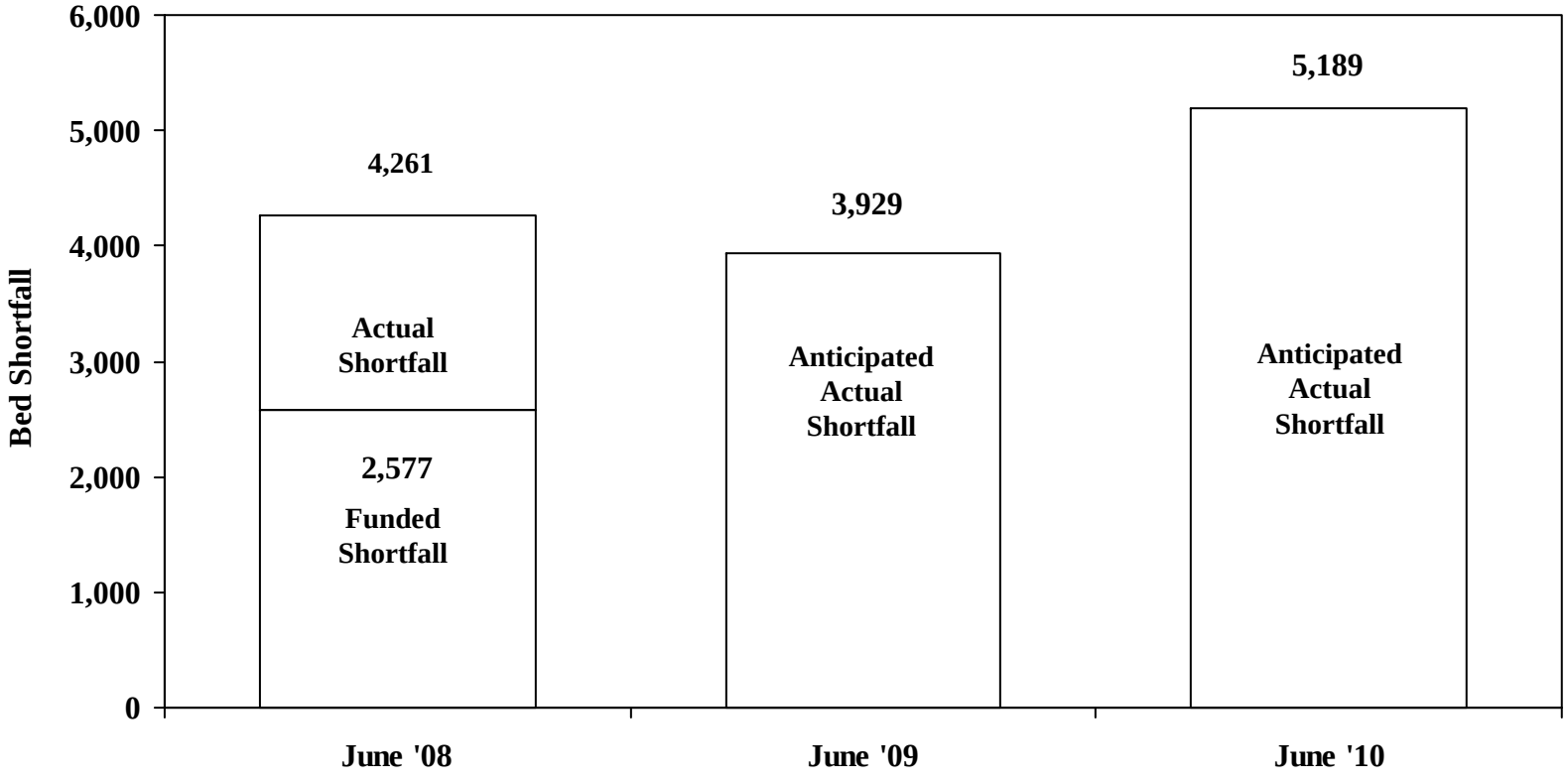
Corrections Bed Shortfall



Assumes opening 1,250 (of 2,000) private beds, 4,000 public beds, eliminating 4,892 provisional beds, and adding 194 private beds. Remaining new beds open in FY 2011.

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JLBC Baseline Assumptions Include $10 M for Increased Employee Benefit Costs

- Most retirement rates will decline.
- Retirement rates determined as of June 30th – does not reflect recent stock market losses.
- General Fund health insurance cost is estimated to grow $42 million in FY ’10, which includes backfilling last year’s one time solutions.
- The baseline includes $10 M. Funding options could include employee contributions and lowering program reserve levels.

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Shortfall As A Percentage of General Fund Budget

Arizona's National Rank

	November Percent	Rank*	January Percent
Mid Year 2009	12 %	2nd	16 %
Full 2010	26 %	1st	29 %

* NCSL Budget Update November 2008

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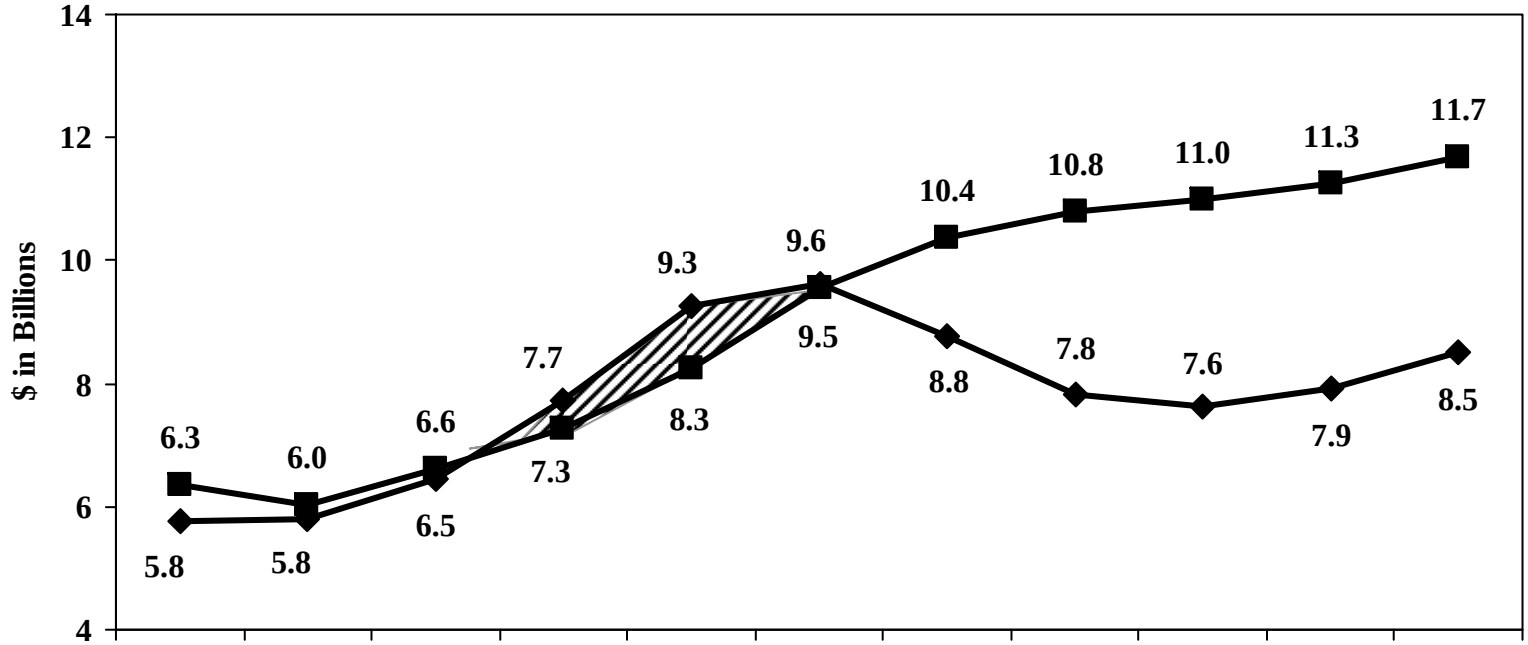
The Structural Shortfall Remains Substantial Through FY 2012

- **Long Term Consequences of FY 2010 Decisions Will Need To Be Evaluated**



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Surplus/ Shortfall ($ in Millions)	(579)	(225)	(151)	449	1,011	77	(1,613)	(2,977)	(3,367)	(3,334)	(3,144)

On-going Revenues — On-going Expenditures

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