

Federal Assistance Update

Today the U.S. House of Representatives concurred with legislation approved by the U.S. Senate which would extend certain federal assistance to Arizona. The bill is expected to be signed by the President.

In total, the legislation would provide an estimated \$444 million of additional funding to Arizona in FY 2011. Of this amount, \$236 million is due to an extension of the enhanced Medicaid match rate, which requires the federal government to pay for a greater share of the state's Medicaid program. This assistance was originally scheduled to expire January 1, 2011. The remaining \$208 million comes from the creation of the "Education Jobs Fund", which would provide additional funds to Arizona to retain or create education jobs.

In July, JLBC Staff estimated the FY 2011 General Fund budget could run a shortfall between \$0 and \$(1.03) billion. (See the [July Monthly Fiscal Highlights](#) (MFH), for more information). Two major components of the shortfall were related to areas affected by the additional federal assistance: 1) \$394 million if Congress did not extend the enhanced federal match rate and 2) \$100 million for a possible shortfall in ADE formula programs.

The federal legislation would help reduce the upper end of the \$(1.03) billion shortfall range by up to \$340 million. As a result, the upper-end shortfall would become approximately \$(700) million. The economic recovery, however, may be stalling which could eventually cause an upward adjustment in the shortfall estimate.

Enhanced FMAP Extension

The federal government funds a proportion of the state's Medicaid program, known as the Federal Medical Assistance Percentage (FMAP). The American Recovery and Reinvestment Act of 2009 (ARRA) temporarily increased Arizona's FMAP from October 2008 through December 2010. ARRA included several maintenance of effort (MOE) requirements in order to qualify for the enhanced FMAP funds, one of which prohibited the state from changing its eligibility standards.

With the enhanced FMAP (and associated MOE requirement) scheduled to end in December 2010, the FY 2011 budget eliminated General Fund support for the Proposition 204 and KidsCare programs, effective January 1, 2011. However, the federal government subsequently enacted health care legislation in March which appears to require the state to maintain all existing Medicaid populations as of that date. This would prevent any eligibility changes to the Proposition 204 or KidsCare programs.

In response to the federal health care legislation, the state enacted Laws 2010, Chapter 232 (SB 1043), which appropriated \$385 million from the General Fund to fund the Proposition 204 population for the remainder of FY 2011, contingent on extension of the enhanced FMAP. In addition, Chapter 232 appropriated \$9 million from the General Fund in order to continue the KidsCare program (but not contingent upon the enhanced match extension).

The 6-month extension of the enhanced FMAP was estimated to generate \$394 million of savings, which would leave SB 1043 with no General Fund impact. This \$394 million extension estimate assumed that the enhanced rate would remain at the same level as in the first 6 months of FY 2011. However, the current federal assistance proposal would phase out the FMAP extension over the additional 6 months, only saving the state \$236 million in FY 2011.

The FMAP extension, even at its reduced level, would trigger the \$385 million Proposition 204 appropriation contained in Chapter 232 while only saving the state \$236 million. After accounting for the KidsCare appropriation, the state would have a FY 2011 shortfall of \$(158) million related to this issue.

Education Jobs Fund

The proposed legislation is estimated to provide \$208 million to Arizona through the newly created Education Jobs Fund. This funding is similar to the Stabilization Fund program that was implemented under ARRA, and is available only for K-12 teacher funding through the end of FY 2011. Unlike the ARRA Stabilization Funds, these monies are not required to be distributed to the higher education system.

To qualify for the funding, a state must comply with certain MOE requirements. Since Arizona's revenue collections in calendar year 2009 were below calendar year 2006, the state must maintain its funding at the FY 2006 level for both K-12 and the higher education system (even though higher education does not qualify for any of the funding). The state operated under a similar MOE requirement for the ARRA Stabilization Fund.

Since the FY 2011 budget already funds both the K-12 and higher education system at the FY 2006 level, the state qualifies for the Education Jobs Fund. It is likely the state could use \$100 million of these funds to offset the portion of the potential FY 2011 shortfall related to ADE formula programs. As reported in the July MFH, the potential ADE shortfall consists of: 1) the use of \$49 million in Stabilization Funds in FY 2010 that were originally budgeted for FY 2011; 2) \$21 million in unpaid "Homeowner's Rebate" funding for FY 2010 and 3) \$30 million of the FY 2010 shortfall that is expected to be reoccurring and continue into FY 2011. Since an additional \$100 million in ADE formula costs would take the state above the FY 2006 MOE requirement, the Education Jobs Fund can be used for this potential supplemental expense.

While this use accounts for \$100 million of the Education Jobs Fund, it is unclear whether the state could use the remaining \$108 million for deficit reduction purposes. Arizona could achieve additional savings by reducing existing ADE General Fund spending and replacing it with the remaining Education Job Fund monies (otherwise known as a "cut and backfill.") Since any reduction in the base would appear to take the state below the FY 2006 MOE, that use of funds may not be allowed. The state's MOE requirement will need further review once the legislation is enacted and the U.S. Department of Education provides guidance on this topic.

In summary, the Education Jobs Fund appears to help reduce the potential FY 2011 budget shortfall by at least \$100 million. The savings could be up to \$208 million, depending on federal guidance regarding our ability to use the funds to offset existing expenditures.

Other Shortfall Components

JLBC Staff's July shortfall estimate included 2 other issues: the potential rejection of 2 ballot propositions in November and a potential revenue downturn. The enacted FY 2011 budget included \$469 million of savings related to 2 ballot propositions which would: 1) repeal the Early Childhood Development and Health Board and transfer the remaining fund balance to the General Fund and shift the ongoing tobacco tax revenues to the General Fund for health and human services for children; 2) transfer any unexpended monies in the Land Conservation Fund to the General Fund.

The shortfall estimate also included up to \$(130) million for a potential revenue shortfall. The enacted budget requires FY 2011 revenues to grow by 5.3% above FY 2010. In the July MFH, the JLBC Staff noted "due to recent mixed economic news, there are concerns about the State achieving the budgeted revenue growth." For example, June 2010 revenues were below June 2009, after April and May had posted positive growth. Given the potential economic uncertainty, the JLBC Staff noted in the July MFH that the four-sector consensus estimate may ultimately prove to be a better forecast for FY 2011. The consensus forecast had originally projected revenue growth of 3.4% in FY 2011. At that level, revenues would be \$(130) million below forecast.

While July revenue numbers have yet to be finalized, they appear to provide further evidence that the recovery may not arrive quickly. July 2010 General Fund revenues are approximately 6% above July 2009 due to the new 1 cent temporary sales tax increase. After adjusting for this factor, revenue would have actually declined by over (3)%. Final numbers will be reported in the August MFH at the end of the month.

Revenues will next be re-estimated as part of the four-sector consensus forecast update at the September 29th Finance Advisory Committee meeting. Given the disappointing June collections and preliminary July numbers, the potential exists for a further downward adjustment in even the 3.4% growth path. Such an adjustment would increase the \$(130) million revenue shortfall.

Revised Shortfall Estimate

Table 1 below summarizes the newly revised FY 2011 shortfall estimate, along with JLBC Staff's July projection.

Table 1**Impact of Federal Assistance Legislation on
Upper End FY 2011 Shortfall Estimate
(\$ in Millions)**

	<u>July Estimate</u>	<u>August Estimate</u>
Enhanced FMAP	\$(394)	\$(158)
K-12 Formula Shortfall	(100)	0
Ballot Propositions	(469)	(469)
Revenue Shortfall	(130)	(130)
Budgeted Ending Balance	<u>63</u>	<u>63</u>
Upper End FY 2011 Shortfall	\$(1.03) B	\$(694) M

The revised FY 2011 shortfall estimate should be considered preliminary, as it may be adjusted in the future due to changing revenue trends and other fiscal issues.