Budget Update and Review of Voter Protection

November 18, 2008

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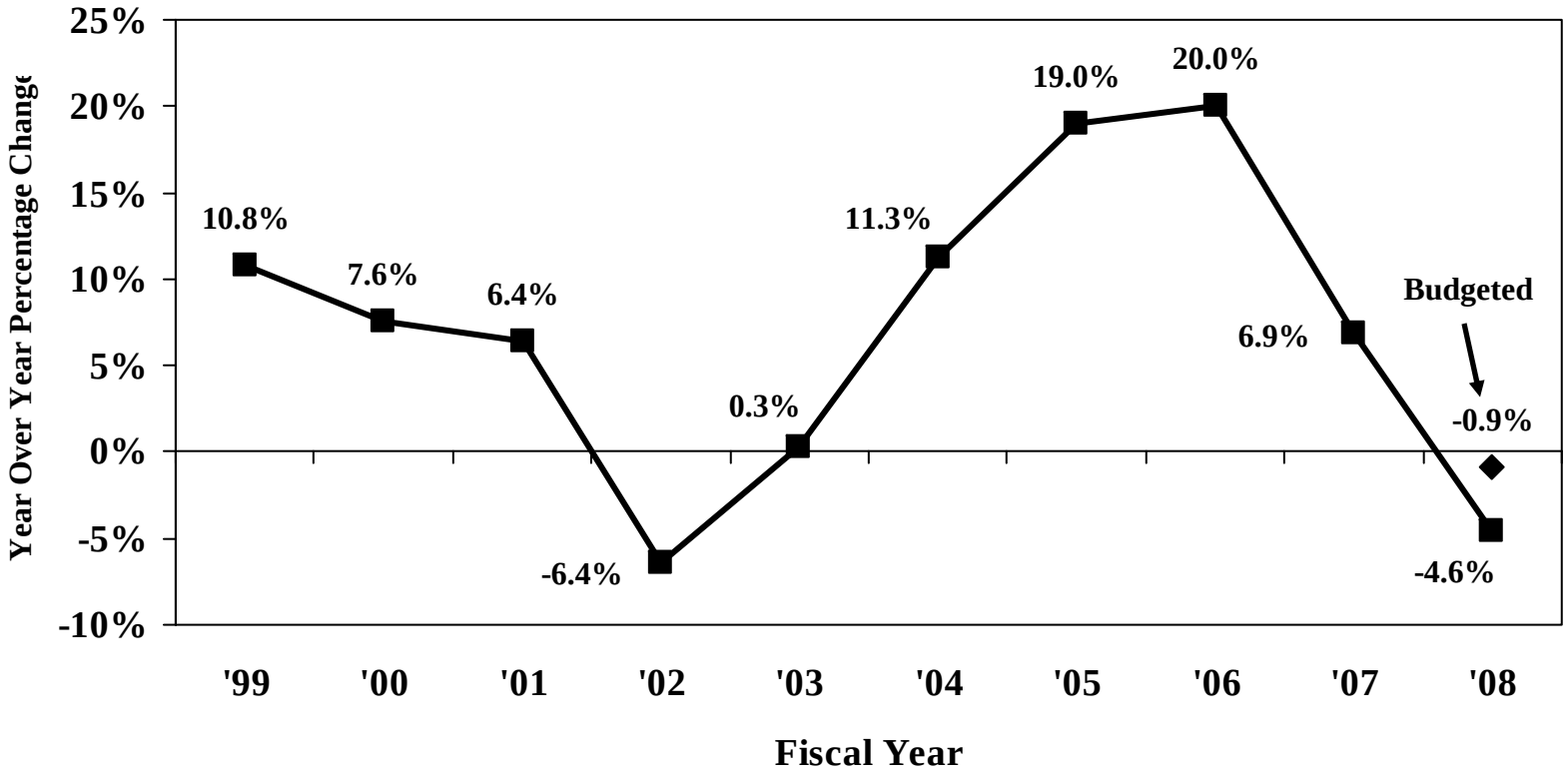
’08 General Fund Base Revenue Decline of (4.6)% Was Greater Than Budgeted



Excludes statutory and one-time changes.

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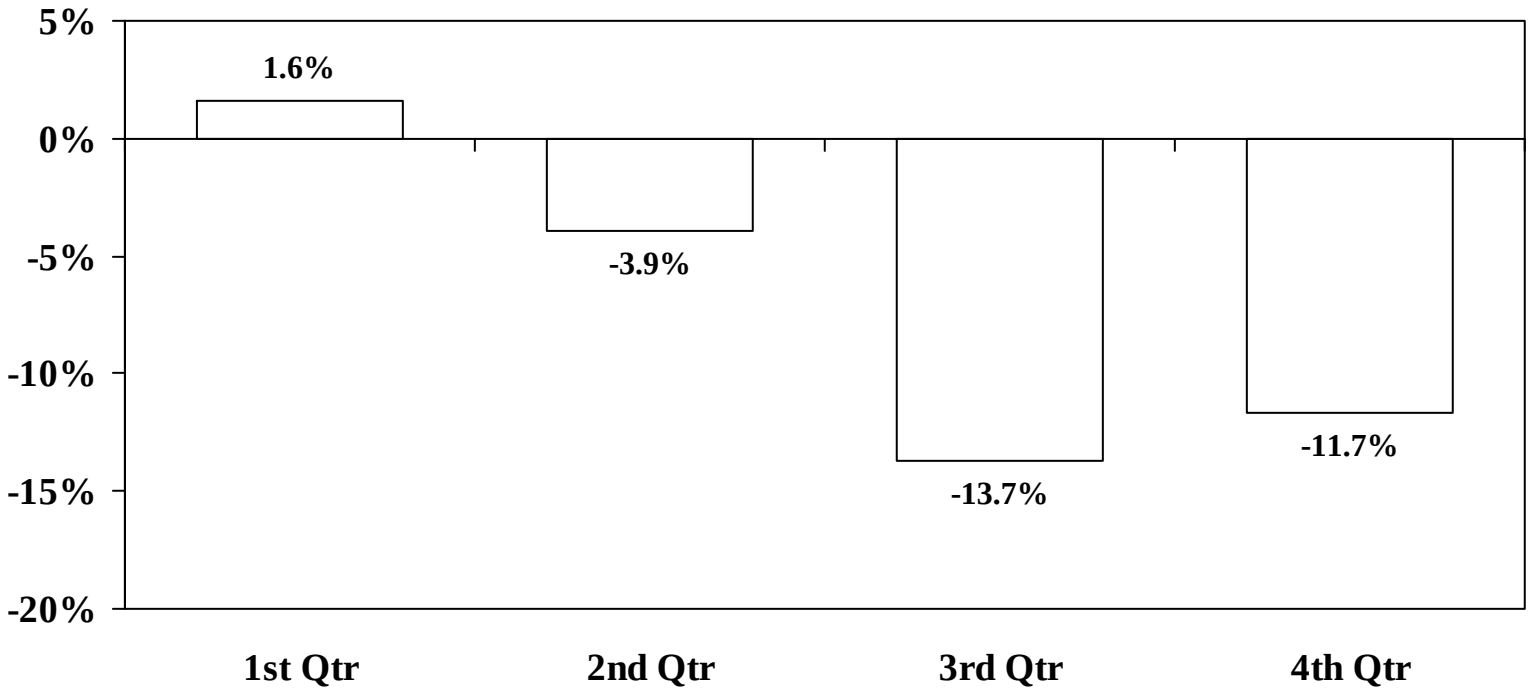
Decline Accelerated in Second Half of FY ’08



Percent Change From FY 2007

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FY ’09 Revenues Will Need to Grow By 6.1% to Meet $10.0 B Budgeted Level

• Original budgeted FY ’09 growth compared to enacted ’08 Budget	1.9%
• Growth adjusted for lower ’08 Base	6.1%

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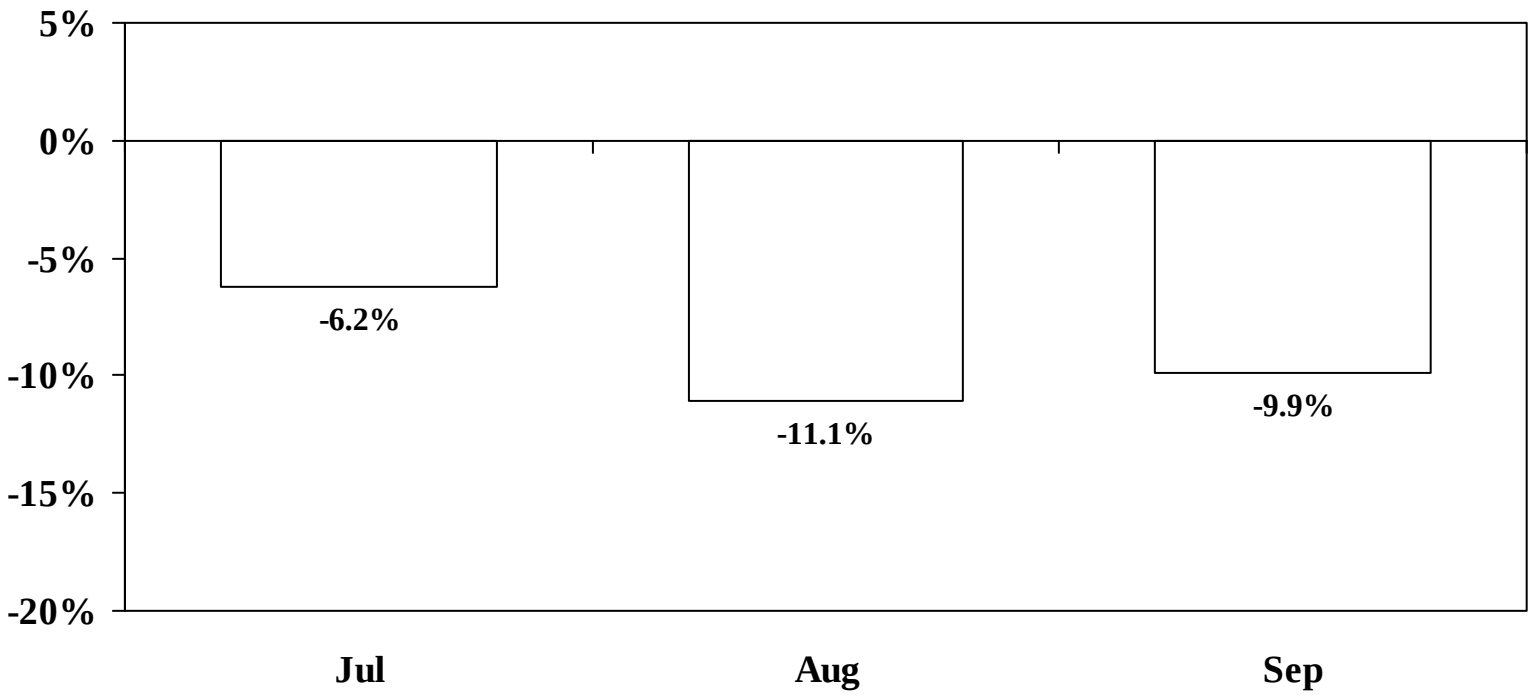
’09 Revenue Collections Continuing to Decline

- First Quarter Decline = (8.9)%



Percent Change Below FY 2008

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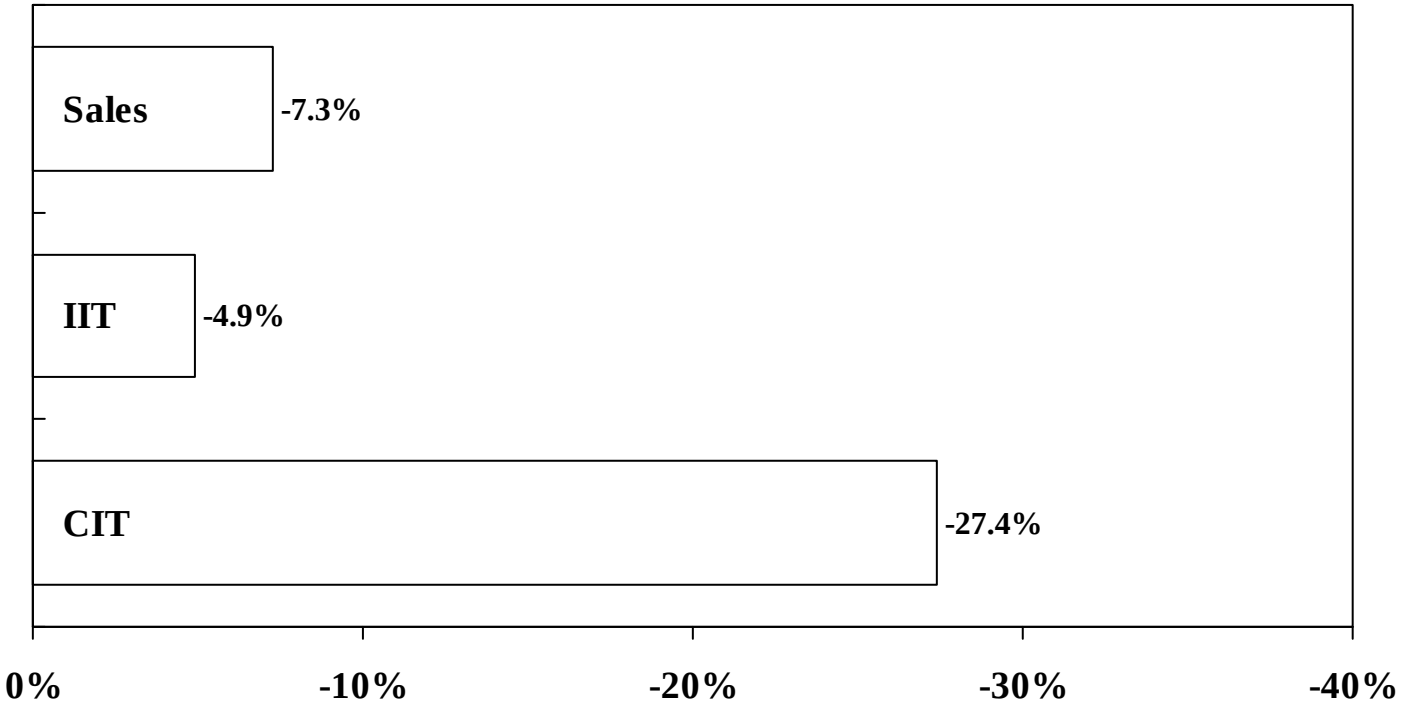
All Major Tax Categories Declined in 1st Quarter of FY '09



Excludes statutory and one-time changes.

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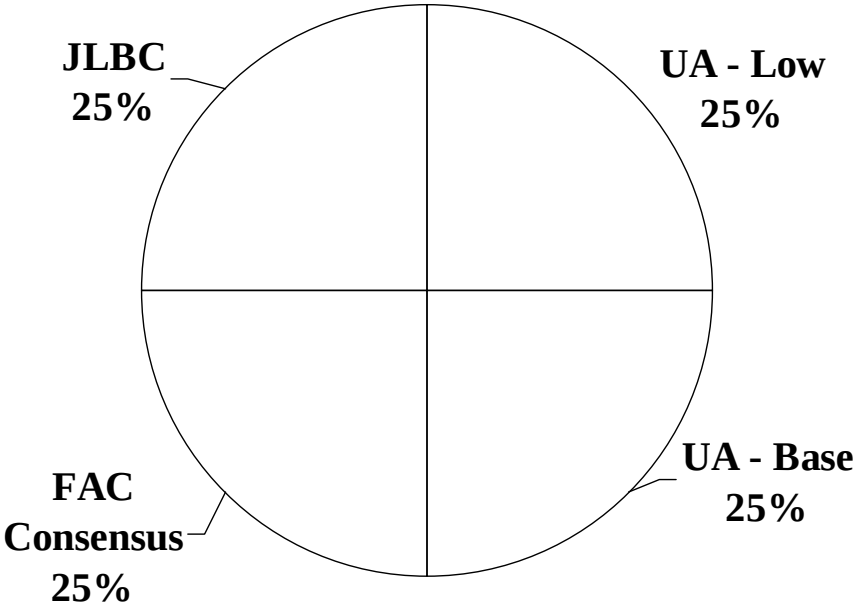
Where Are We Headed Over the Next Few Years?
- Four-Sector Consensus Forecast Incorporates Different Economic Views

4-sector forecast equally weights:

- **FAC average**
- **UofA model - base**
- **UofA model - low**
- **JLBC Staff forecast**
- **Remaining revenues (2% of total) are staff forecast**



*** Includes Big 3 categories of sales tax, individual income and corporate income taxes.**

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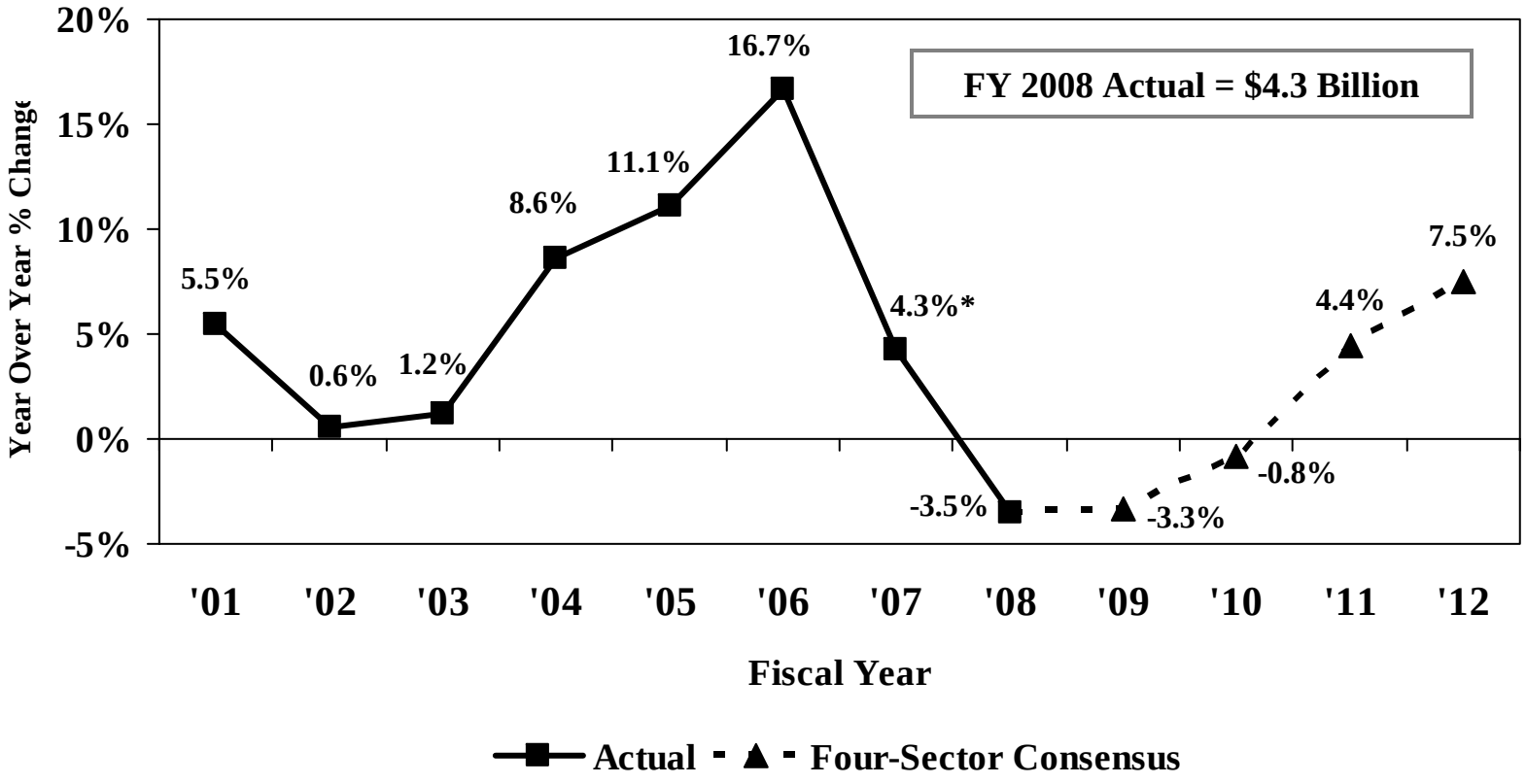
Sales Tax

- The Consensus Forecasts Declines of (3.3)% in ’09 and Another (0.8)% in ‘10



* 5.6% without the $(55.2) million estimated payment threshold change.

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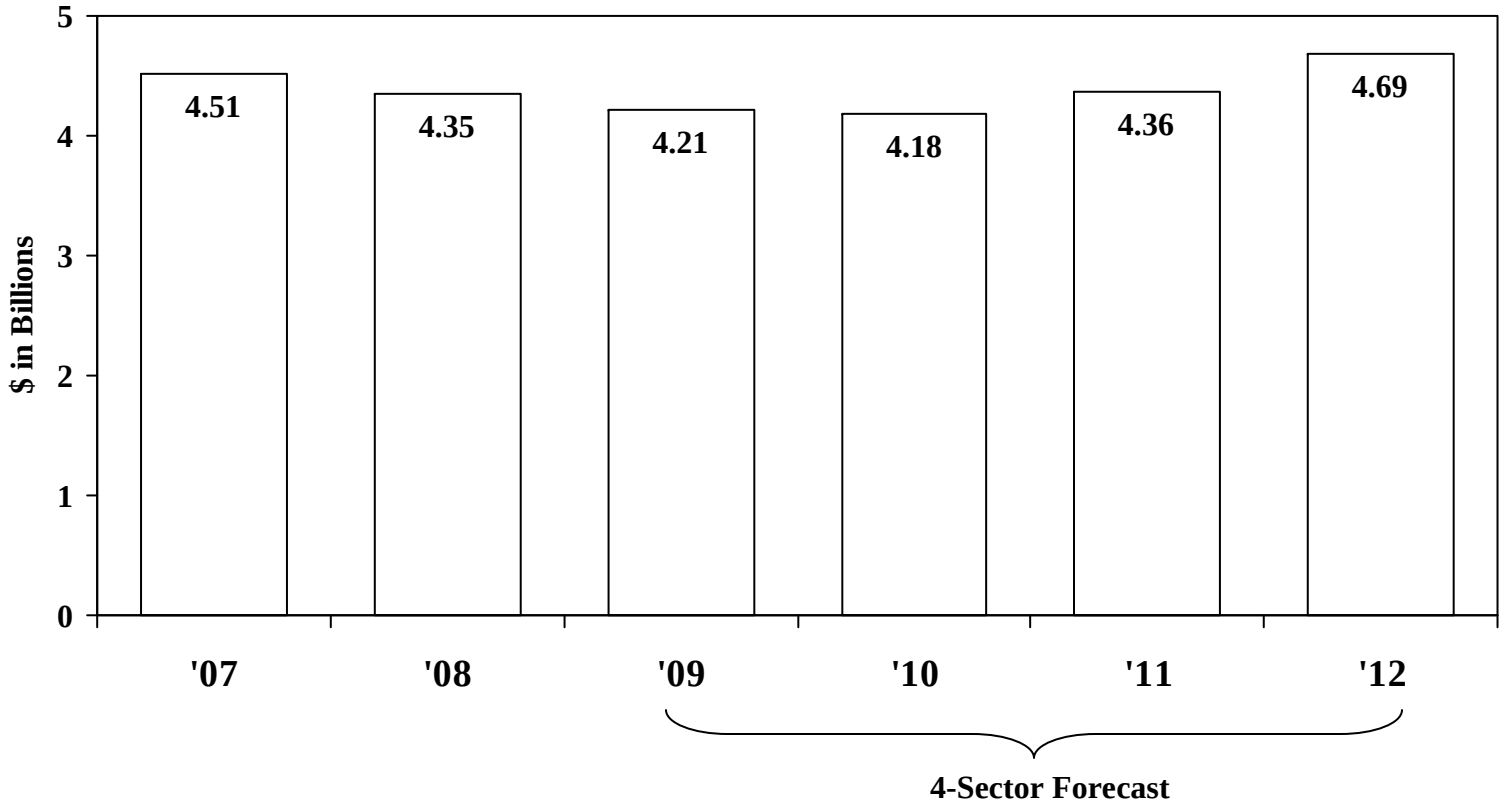
Sales Tax

- Collections Below FY ’07 Level Until FY ‘12



Includes enacted tax law changes.

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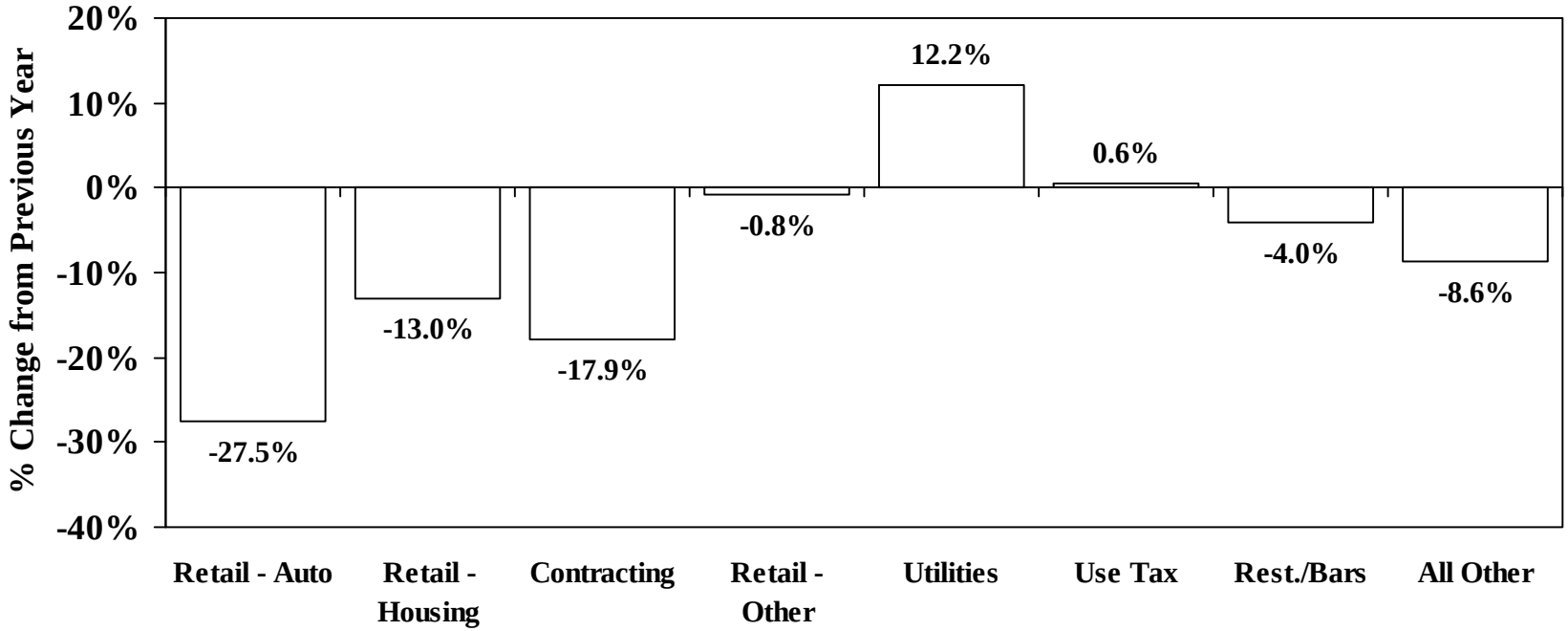
Construction and Vehicle Spending Have Declined Significantly



FY 2009 Year to Date – (Through September)

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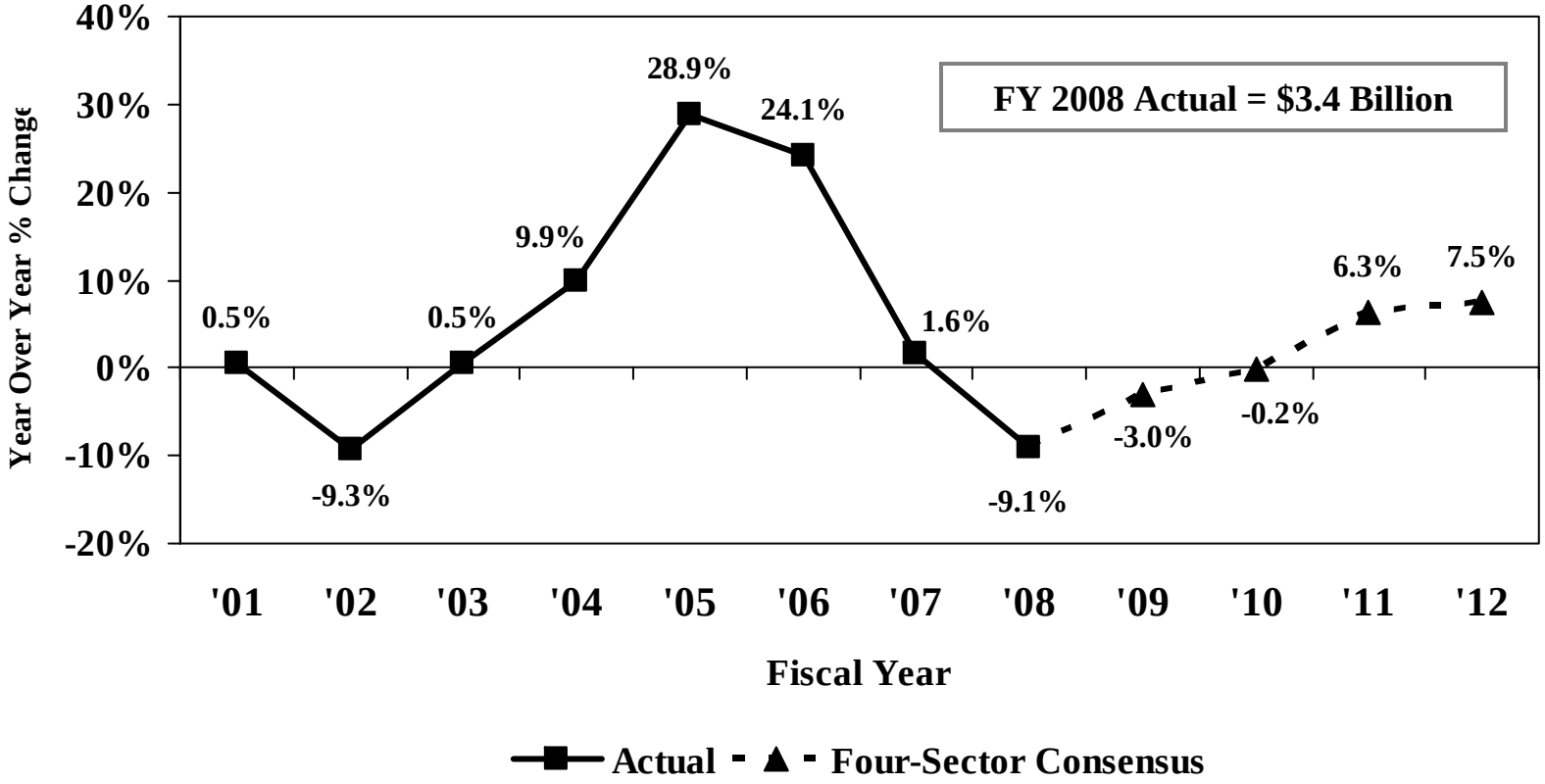
Individual Income Tax

- The Consensus Forecasts On-Going Declines Through ’10
- Collections Return to ’07 Level in ‘12



* Excluding the 10% phased-in rate reduction, growth would have been 6.3% in ‘07, and (4.1)% in ’08.

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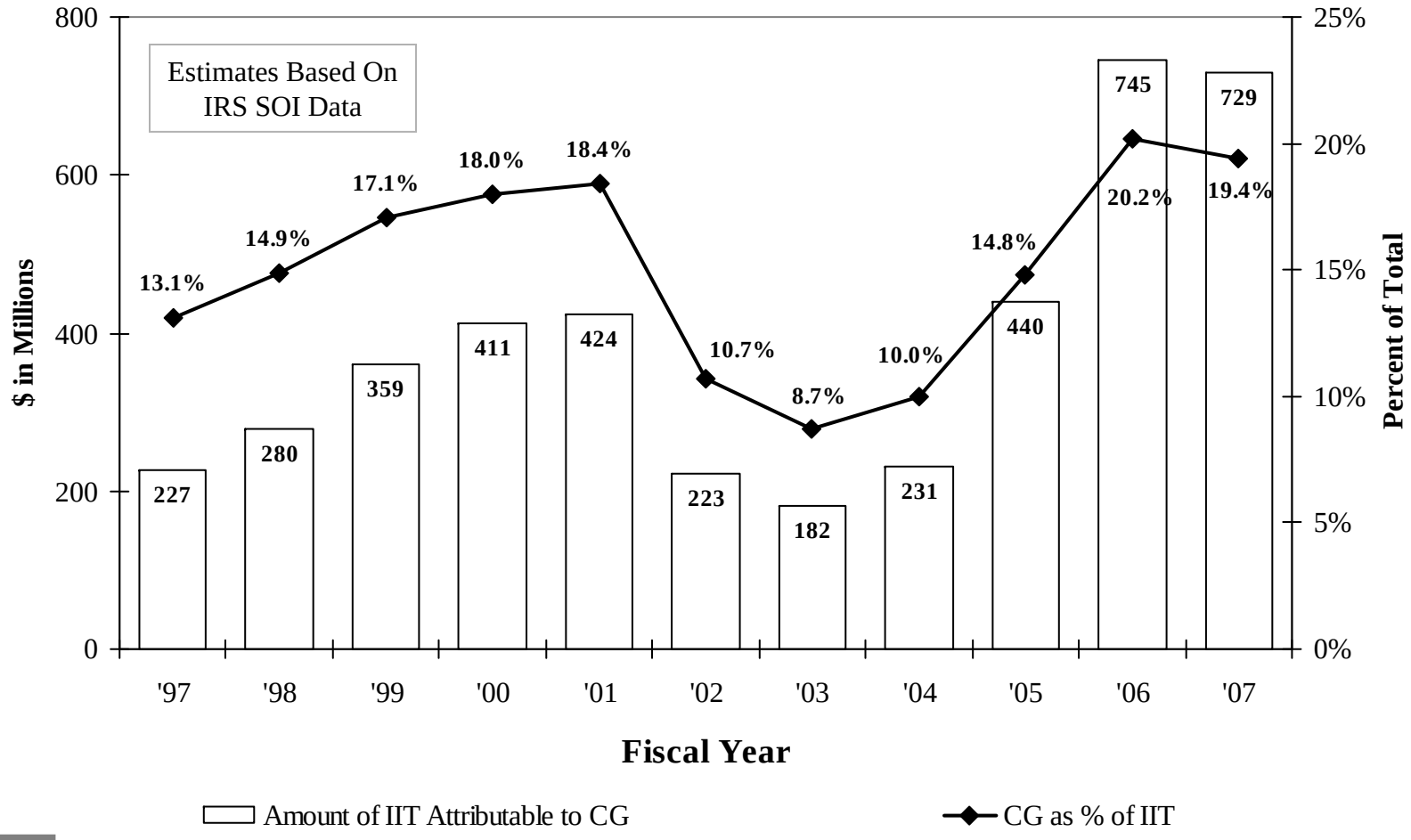
Individual Income Tax

Capital Gains Are A Volatile Source of Income Tax Collections



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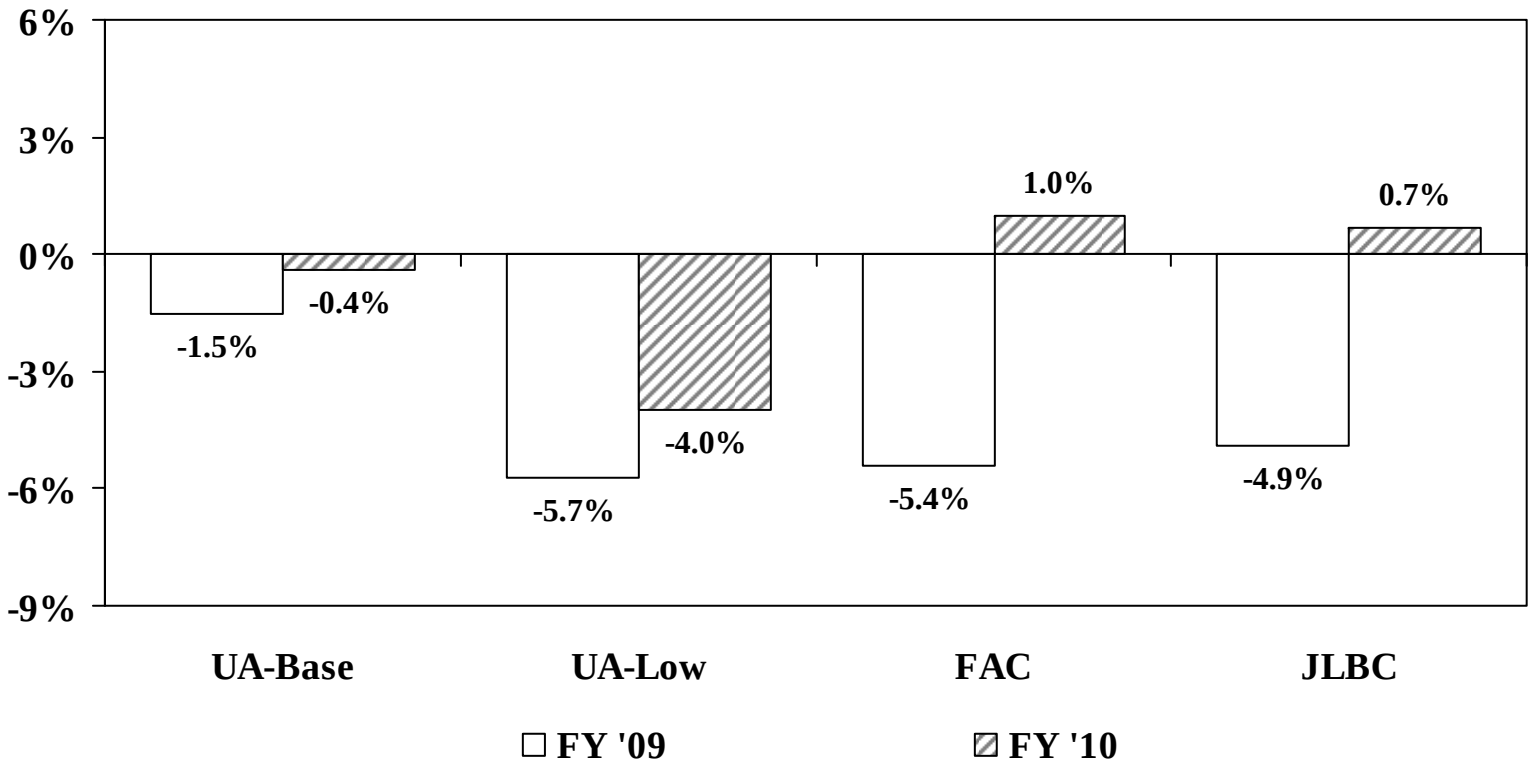
October 4-Sector General Fund Revenue Forecast

- Decline of (4.4)% in FY ’09 and (0.7)% in FY ’10



Weighted Big 3 Average
Prior to Tax Law Changes

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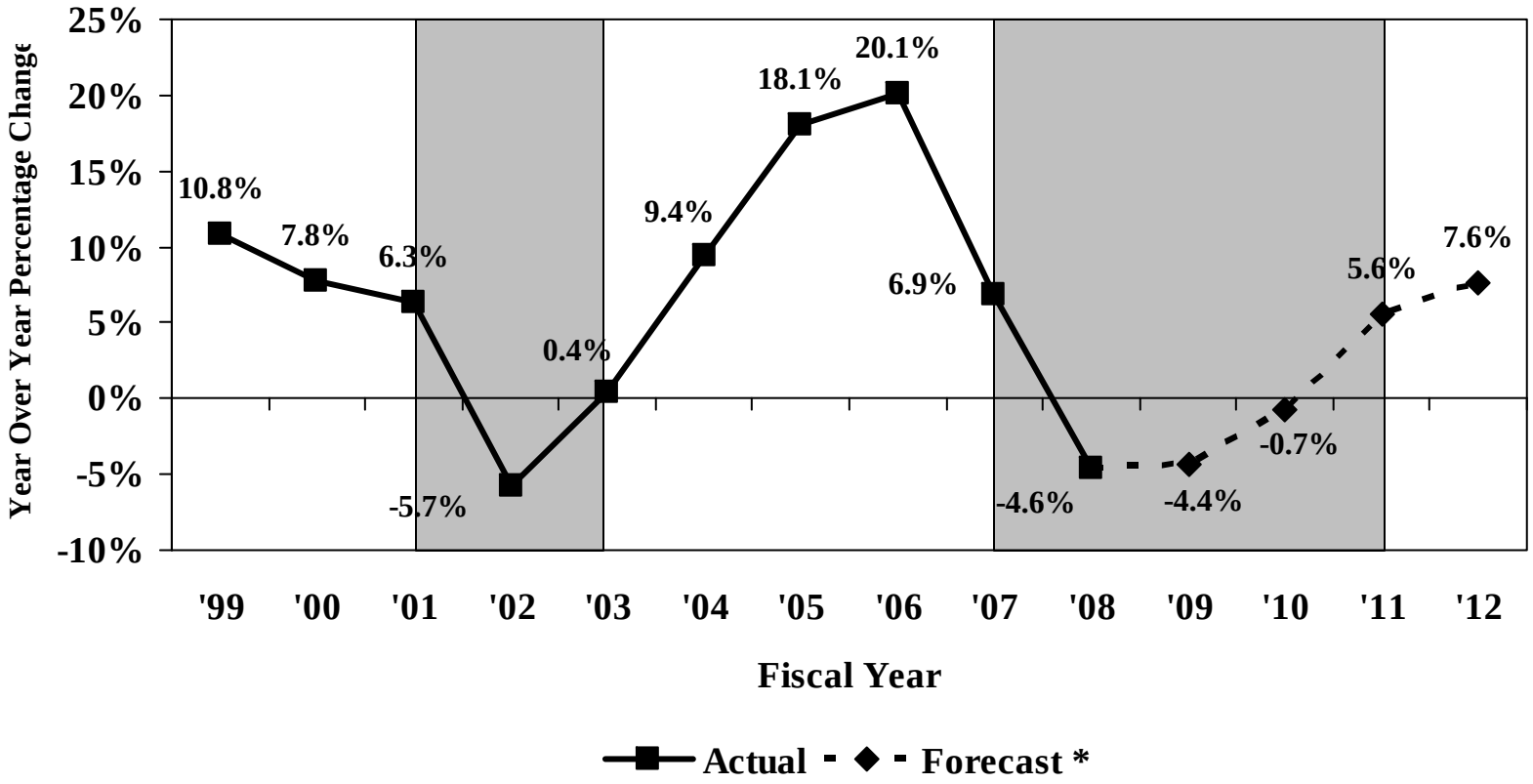
Growth Remains Slow Until FY 2011



* 4-sector forecast weighted average growth.

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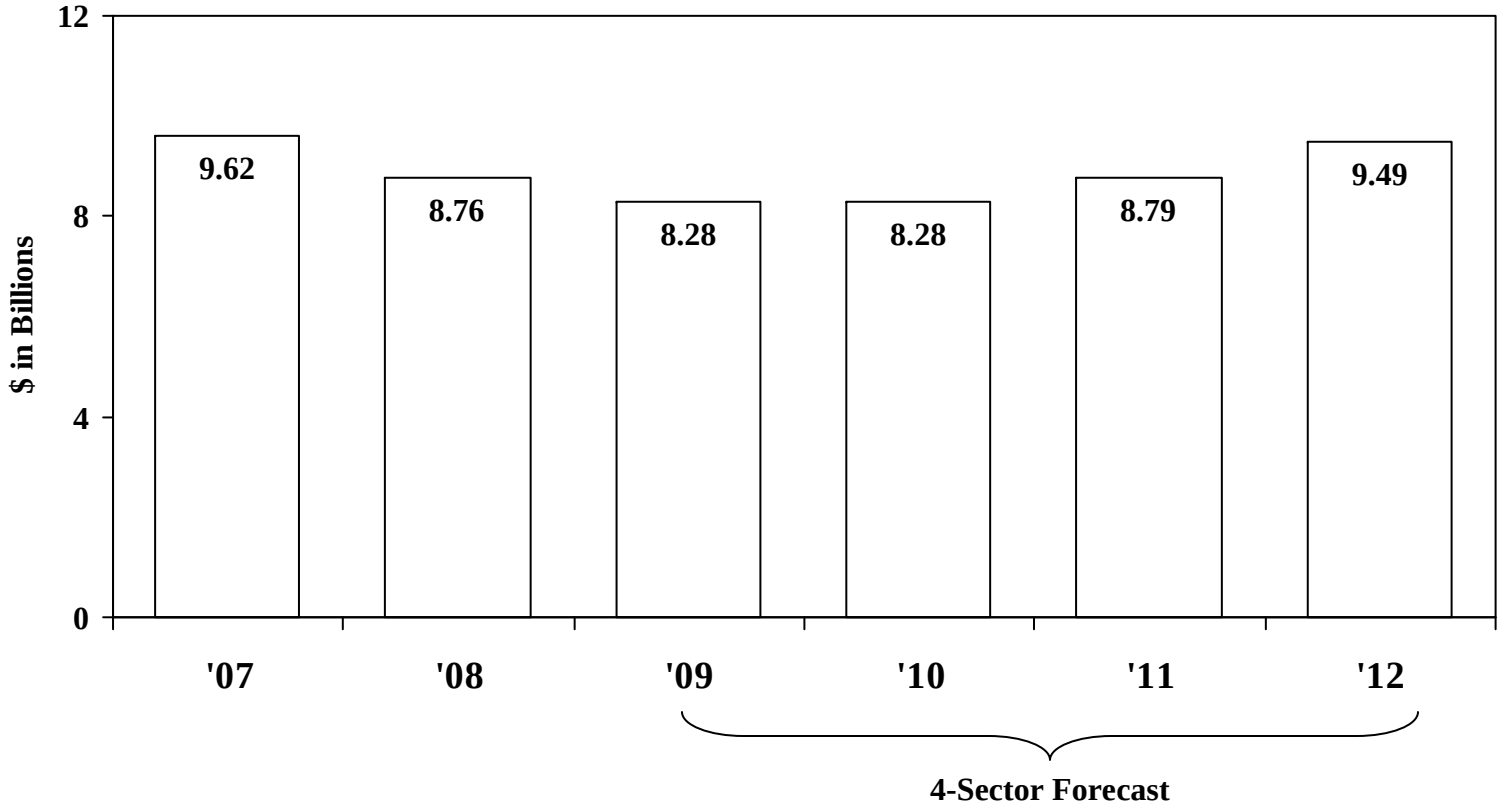
On-Going General Fund Revenue

- Collections Below FY ’07 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 General Fund Shortfall?

- $1.2 B in FY ’09, based on updated forecast.
- $2.2 B to $3.0 B in FY ’10, depending on ’09 resolution and other factors.

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’09 Revenue and Expenditure Comparison

($ in Billions)

Revenues	
On-going	$ 8.1
One-time	0.7
Total	8.8
Spending	
On-going	10.7
One-time	(0.7)
Total	10.0
Balance	$(1.2)

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What Are the Possible Solutions?

- Revenue
- Spending
- Fund Transfers
- Borrowing
- Accounting

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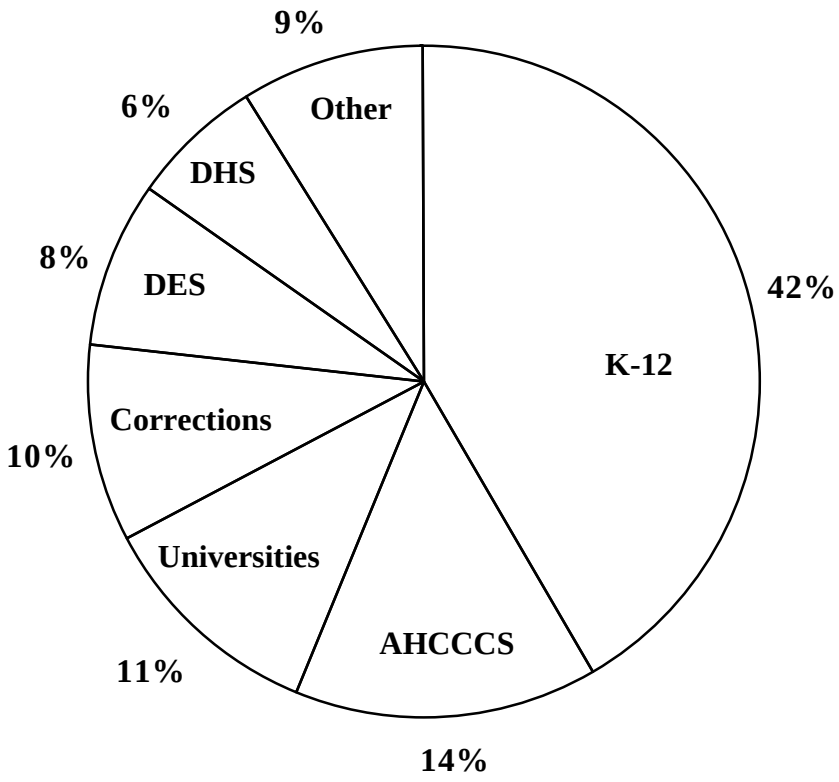
Another Perspective on the State Budget: State Spending Priorities and Voter Protection

6 Largest State Agencies Account for 91% of General Fund Spending

	$ in M
K-12	$ 4,141
AHCCCS	1,425
Universities	1,080
Corrections	948
DES	808
DHS	612
Other	892
Total	$ 9,906



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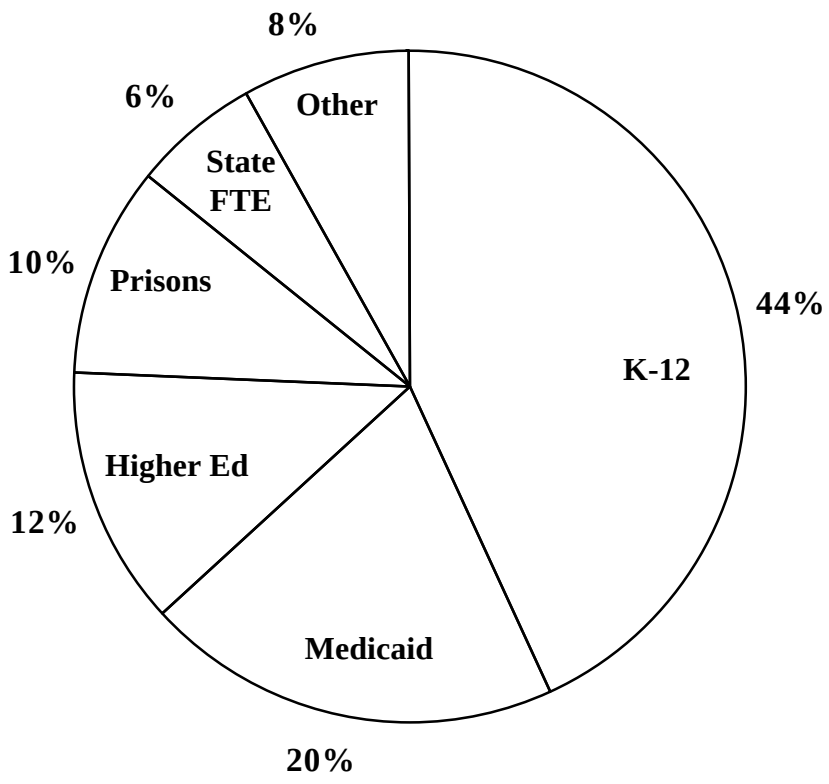
5 Major Activities Account for 92% of General Fund Spending

	$ in M
K-12	$ 4,253
Medicaid	2,002
Higher Ed	1,228
Prisons	1,022
State Workers	604
Other	797
Total	$ 9,906



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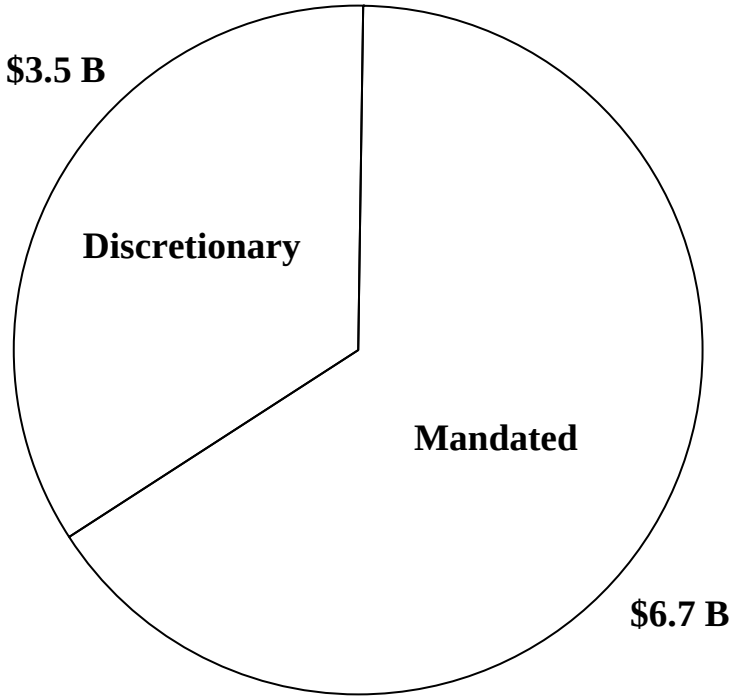
What Spending is Voter Protected?

- Prop 105 prohibits legislative changes to propositions without a 75% vote to "further the purpose".
- Prop 301 Education and Prop 204 AHCCCS have greatest impact on state budget.
- This "voter protection" limits, <u>but does not eliminate</u>, our ability to modify ADE and AHCCCS.
- There has been no litigation to clarify the scope of Prop 105.

What is the Difference Between Voter Protected and Mandated Spending?

- Mandated spending is based on statutory formulas.
- Legislature can revise certain mandates.
- Voter-protected spending is a subset of mandates.



$10.2 B GF Budget
Rollover-Adjusted

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How Does Prop 105 Affect K-12 Spending?

- Prop 301 guaranteed 2002 “base level” and inflation.
- Inflation is applied to base level and transportation – the “and/or” debate.
- Prop 301 does not apply to:
  - Formula weights.
  - Capital outlay revenue limit.
  - Soft capital.
  - Charter’s additional assistance.

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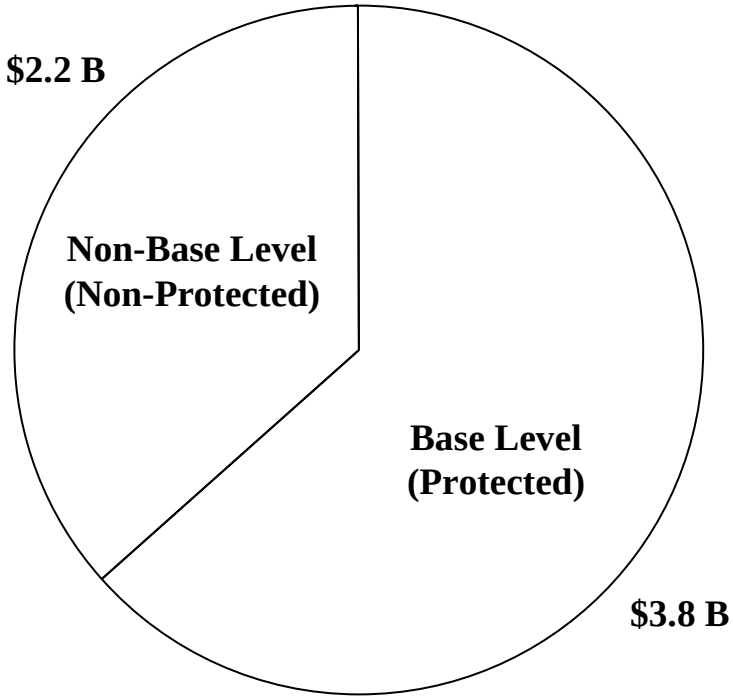
At Least $2.2 B of K-12 Spending is Not Subject to Prop 105

- State and local K-12 budget = $6 B.
- As funding expands or contracts, marginal impact is on the state.
- Non-base level spending is $2.2 B.



State and Local K-12 $
State = $4.4 B Local = $1.6 B

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How Does Prop 204 Affect Title 19 Spending?

- Prop 204 guarantees Title 19 coverage below 100% of federal poverty line.
- AHCCCS services below 100% of FPL cost $990 M of $1.4 B budget.
- DHS Title 19 behavioral health cost another $380 M.
- Prop 204 does not protect the benefit package nor health plan rates.
- Non-100% FPL cost includes Kid's Care, special hospital payments, optional services and administration.

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Can We Modify the Benefit Package or the Plan Rates?

- Feds require certain services and "actuarially sound" rates that maintain access to care.
- $277 M in optional services below 100% FPL
  - $237 M are long term care services and drugs.
- Executive's '09 proposal froze hospital rates – extend to all rates?
- Can also increase recipient cost of share to 5% – but feds limit.

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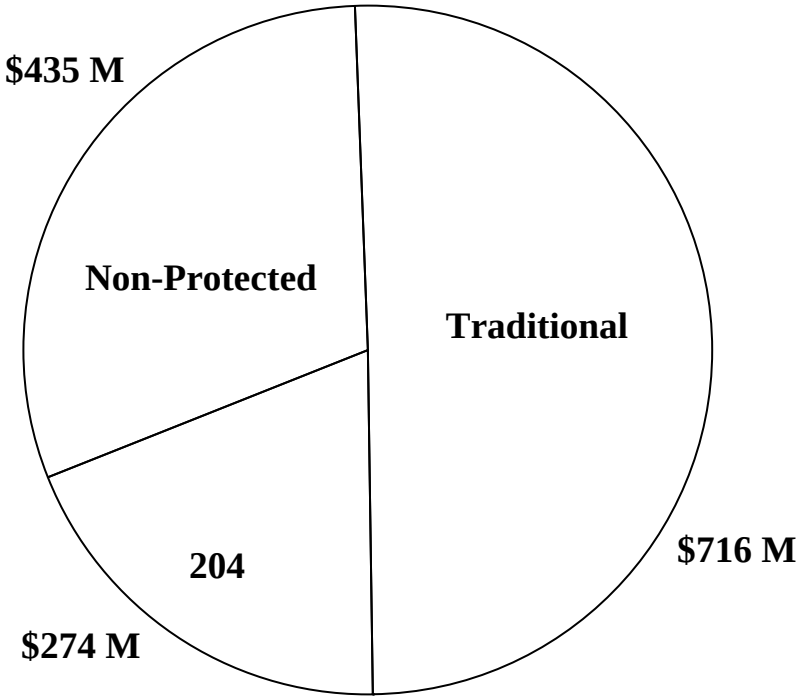
AHCCCS Non-Protected Share is at Least $435 M

- Feds May Permit Limited Adjustments to Rates

- Non-protected includes $237 M in drugs/ALTCS costs.
- California injunction against 10% rate cut.



$1.425 B GF ’09 Total

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Summarizing the General Fund Impact of Voter Protection

- K-12: At least $2.2 B of $4.4 B General Fund budget is not protected.
- AHCCCS: $435 M of $1.4 B is not protected
  - Limited ability to reduce remaining $1 B.
- Parks Board: $20 M Growing Smarter payments
  - Ends in FY 2011.
- Clean Election Tax Credits: $7 M
  - Offset by periodic reversions.

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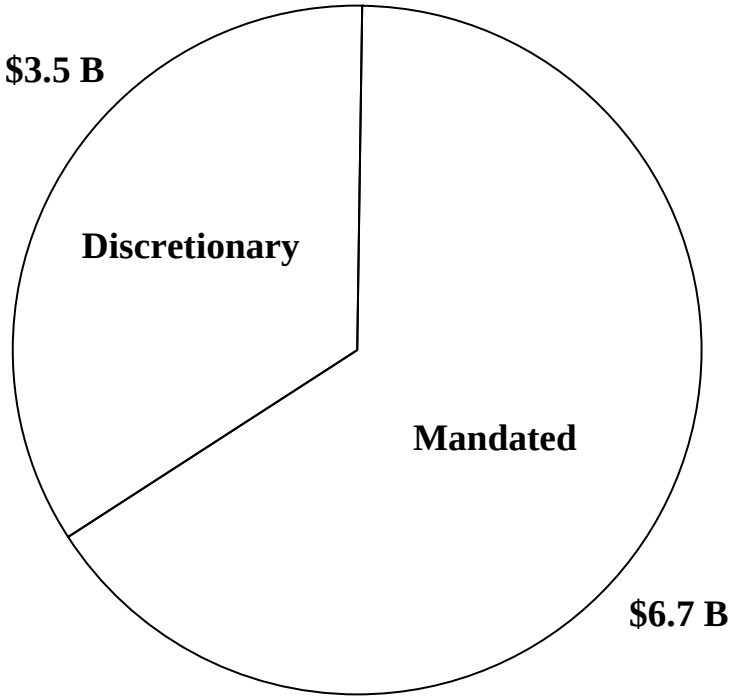
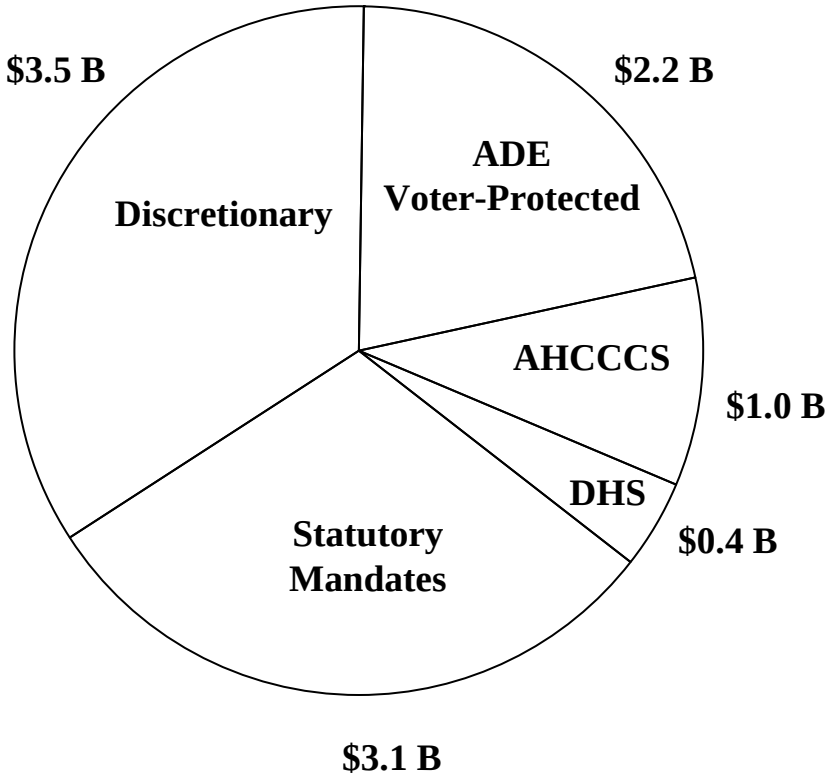
What Is Voter Protected Share of GF Spending?

- No Definitive Answer, But Near $3.5 B





$10.2 B GF Budget
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