
Budget Status Update

August 27, 2010

JLBC

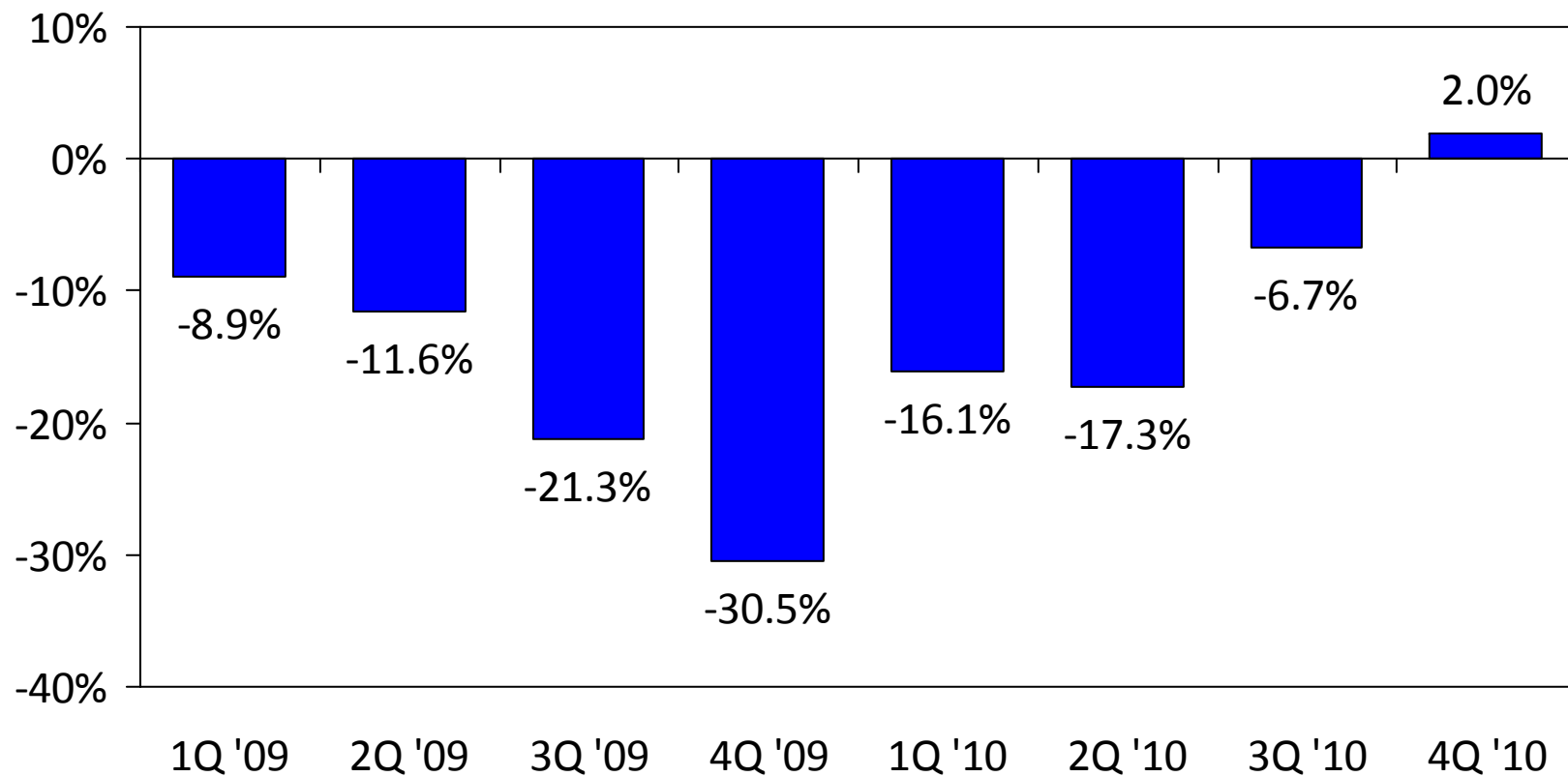
Summary of the Current Budget Status

Still Weak – But Better Than Last Year

- ❑ FY '10 revenues declined by (10.1)% - unprecedented 3rd consecutive year of decline
- ❑ 4th quarter revenues, however, grew 2.0%
- ❑ FY '10 year-end cash balance will likely be positive
- ❑ Due to recent change in K-12 payment schedule, operating fund should be able to pay bills through at least first half of FY '11
- ❑ FY '11 shortfall estimated at up to \$(700) Million

FY '10 Base Revenues Were (10.1)% Below FY '09

- Collections \$(20) M Below Enacted March Budget



Percent Change From Prior Year

*Excludes urban revenue sharing and one-time revenues



There Has Been Some Good News

- ❑ 4th Quarter revenues showed the first positive year-over-year gain since the 1st Quarter of FY '08
- ❑ From July 2009 to July 2010, employment declined only (0.3)% - will likely turn positive in next few months for first time since January 2008
- ❑ After \$480 million FY '09 cash shortfall, FY '10 cash balance will likely be positive

But the Road to Recovery Will Still Be Long

- ❑ Revenue rebound may be stalling
 - After positive growth in April and May, June and July General Fund revenues declined (adjusted for 1¢ sales tax increase)

- ❑ 364,500 jobs lost since December 2007
 - Summer is high-water mark due to seasonal lay-offs

- ❑ Foreclosures still too high
 - While pending foreclosures have declined from 51,000 in December 2009, there are still 42,152 in the pipeline

- ❑ The FY '11 Structural Shortfall – the difference between ongoing revenues and ongoing spending – is projected to be \$(1.7) Billion

FY '11 Shortfall Could Be Up to \$(700) Million

- Estimate Was \$(1.0) Billion Prior to New Federal Assistance

□ 4 Potential Problems:

- Potential failure of November ballot props – \$469 M
- Continuation of Prop 204 with new Federal help – \$158 M
- Possible revenue shortfall – \$130 M
- Possible K12 shortfall – Offset with new federal aid

* \$63 M budgeted balance available to offset shortfall

FY '11 Budget Contingent On 2 November Ballot Propositions

- Generate \$469 M in Revenue

- Early Childhood Development: \$345 M
 - \$325 M in fund balances
 - \$60 M in redirected tobacco tax revenue offset by \$40 M in DES spending

- Land Conservation Fund Transfer: \$124 M
 - Even if it were to pass, pending sales could reduce transfer by \$50 M

Continuation of Prop. 204 Would Have Cost \$394 M If Congress Did Not Approve Extra Federal Funds

- ❑ Enacted budget eliminated General Fund support for Prop. 204 in January, 2011
- ❑ New Federal health care law requires maintenance of effort
 - Or risk losing all \$7 billion in Medicaid Match
- ❑ State restored Prop. 204 if Congress extends enhanced Federal Match:
 - In April, savings from 6-month extension were estimated to offset costs

Congress Approved Additional Funding

- Still Leaves \$158 Million Medicaid Shortfall

- ❑ Enacted August federal aid package extends enhanced match, but at a lower level than anticipated
- ❑ Feds will provide \$236 M of anticipated \$394 M
- ❑ Results in \$(158) M shortfall in covering full cost of Proposition 204 population

Need 5.1% Growth to Meet Budgeted Revenue Level

- Enacted budget assumed 4.2% base revenue growth (excluding impact of 1¢ sales tax).
- With lower FY '10 revenue base, we would now need 5.1% growth to meet budgeted revenue level
- Given mixed economic news, unclear if growth rate of 5.1% is achievable
- In April, FAC projected 3.4% growth

Potential \$130 M Revenue Shortfall

- The 3.4% rate would result in \$130 M shortfall from budgeted amount
- Preliminary July collections declined (4.5)% from the prior year (excluding the 1¢ sales tax increase)
- July revenues were \$(26.3) M below budget

FY '11 K12 Budget Could Be Up To \$100 M Short

- Legislature will need to decide about backfilling

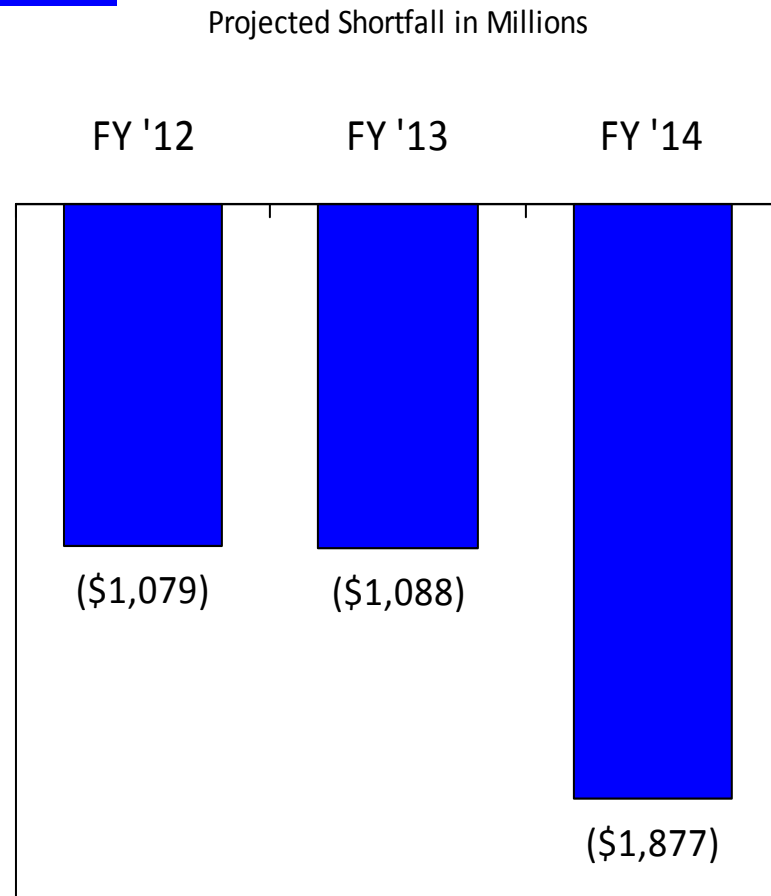
- \$20 M in unpaid FY '10 Homeowners Rebate costs (State's 40% subsidy of school property taxes)
- \$50 M in education stimulus funds intended for FY '11 were shifted to FY '10
- \$30 M higher than expected FY '10 base continues in FY '11

New Federal Assistance May Be Used to Offset K-12 Shortfall

- ❑ Enacted August federal aid package provides Arizona \$212 M for K-12 teacher funding
- ❑ State may be able to use \$100 M to offset the potential K-12 shortfall
- ❑ Whether the State can use the remaining \$112 M for deficit reduction (“cut and backfill”) depends on federal guidance
 - Federal law has a FY 2006 maintenance of effort (MOE) requirement through FY 2011 – current K-12 spending is already at the FY 2006 level

State Budget Has A Projected Cash Shortfall Thru FY '14

- FY '12: Federal assistance expires
- FY '14: Sales tax would expire and increase shortfall



Assumes Ballot Propositions Pass – Shortfall \$80 M Higher If They Fail

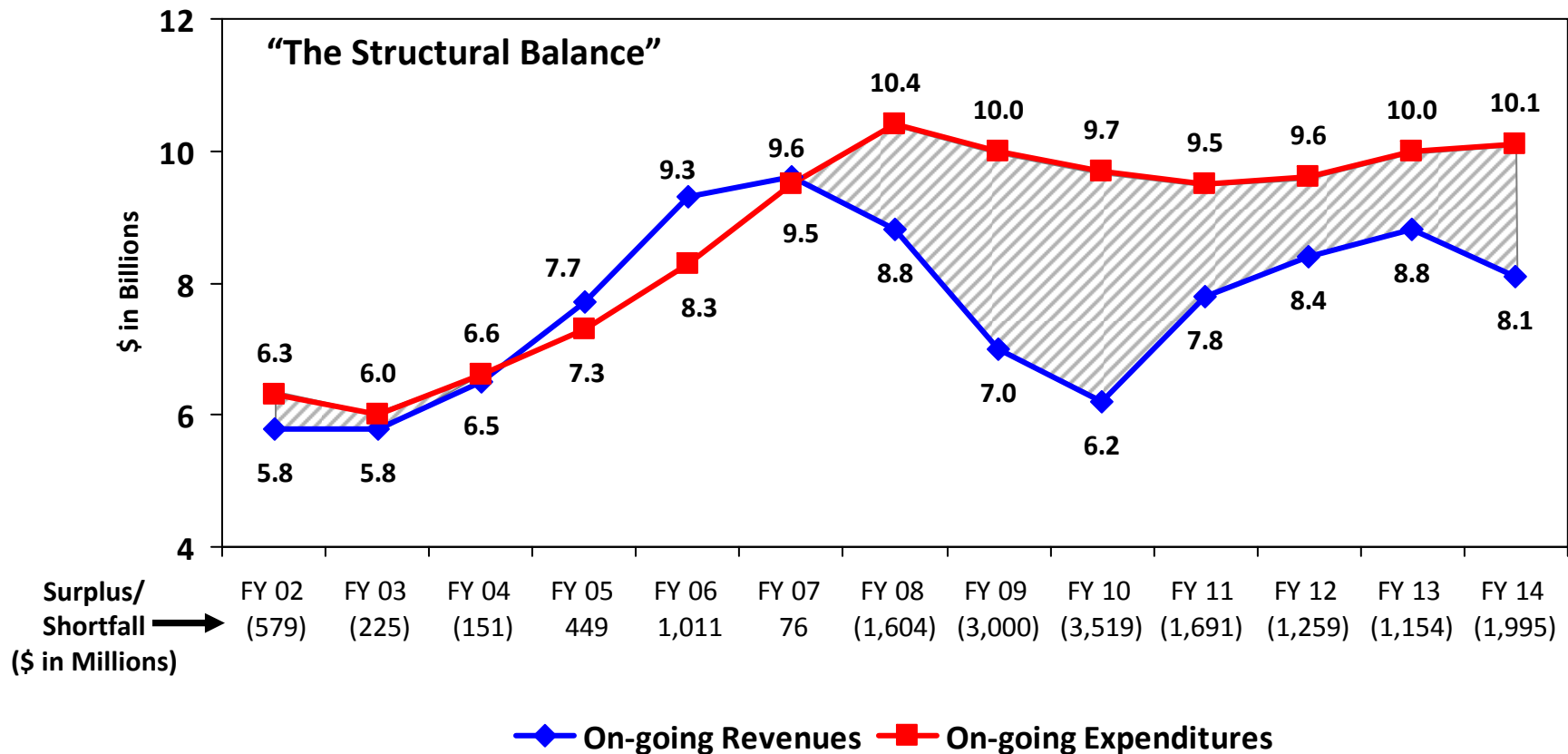
FY '12 – FY '14 Shortfall Could Grow, If:

- Budget includes inflation
 - Forecast excludes K-12 or state wage adjustments
- Medicaid growth exceeds 3% per year – AHCCCS estimates 6-9%
- School Facilities Board resumes new school construction
 - Forecast excludes new funding; 3% student growth could cost \$625M over 3 years
- Revenue growth is lower than expected

Besides Cash Balance, There are 2 More Measures of State's Fiscal Condition

- ❑ General Fund Structural Balance
- ❑ Operating Fund Balance – the “checkbook”

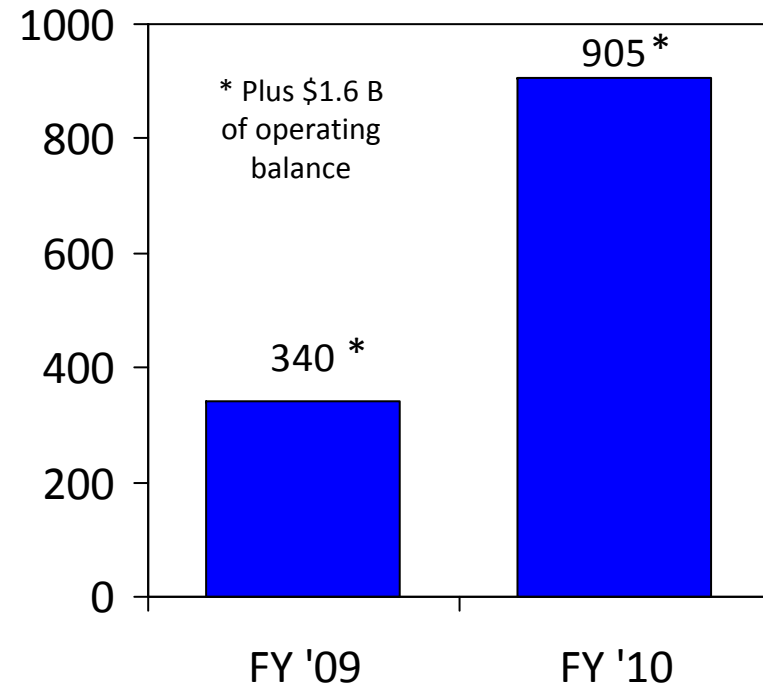
Structural Gap Narrows Through FY '13, Grows in FY '14 with End of 1¢ Sales Tax - Represents Ongoing Revenues Versus Expenditures



Operating Fund Balance Was Negative in FY '09 and FY '10 - 1st Time Since 1930's

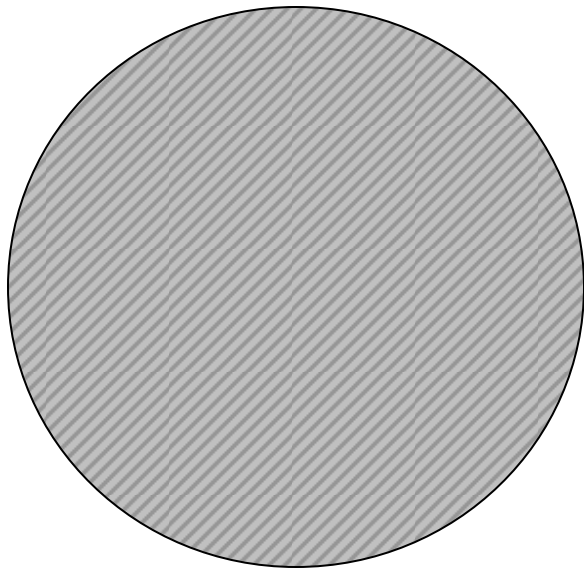
- ❑ State pays daily bills from this Fund > \$30 B per year
- ❑ Since General Fund short, state uses \$1.6 B in non-GF accounts to pay GF bills
- ❑ When negative, state borrows daily
- ❑ In FY '10 had \$700 M bank line of credit – not extended to FY '11
- ❑ Instead would now borrow from other state funds

Single Highest Daily Borrowing \$ in Millions



After Operating Fund, Borrow From Pool 3

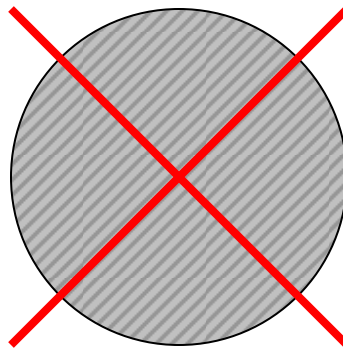
- Borrowing Capacity is \$500 M



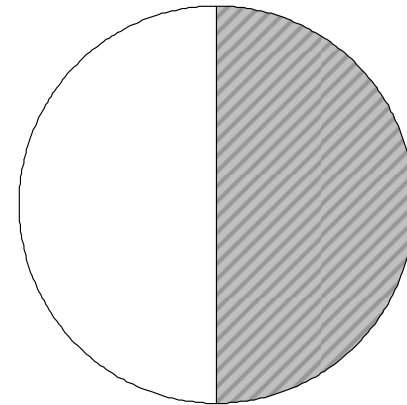
Operating Fund
\$1.6 B

Non Interest Fund Examples

- Employee Health
- Risk Management
- University Collections
- Land Clearing Funds



Bank Loan
Up to \$700 M



50% of Pool 3
\$500 M

Interest Fund Examples

- Early Childhood Development Fund
- Land Conservation Fund Heritage
- DES Long Term Care

Operating Fund Expected to Remain Positive in FY '11

- ❑ Due to debt financing proceeds and rollovers, operating fund has been positive since mid-June
- ❑ Treasurer and ADOA had expected to begin borrowing again in September and October
- ❑ To smooth out cash flow, September and November K-12 payments will be rolled over to FY '12 (rather than May and June)
- ❑ Districts will receive one-third of their yearly funds by end of August – new rollover schedule should have minimum impact

State's Credit Rating Recently Downgraded

- ❑ Still Investment Grade – but moved down to 5th highest level (out of 10) for GF-backed financing
- ❑ Downgrade due to:
 - Economic and financial weakness
 - Structural imbalance
 - Constitutional limits on raising revenues and reducing spending
- ❑ But outlook has shifted from “negative” to “stable” reflecting:
 - Recent revenue improvement
 - Recent efforts to reduce structural deficit