
Revenue and Budget Update

November 19, 2010

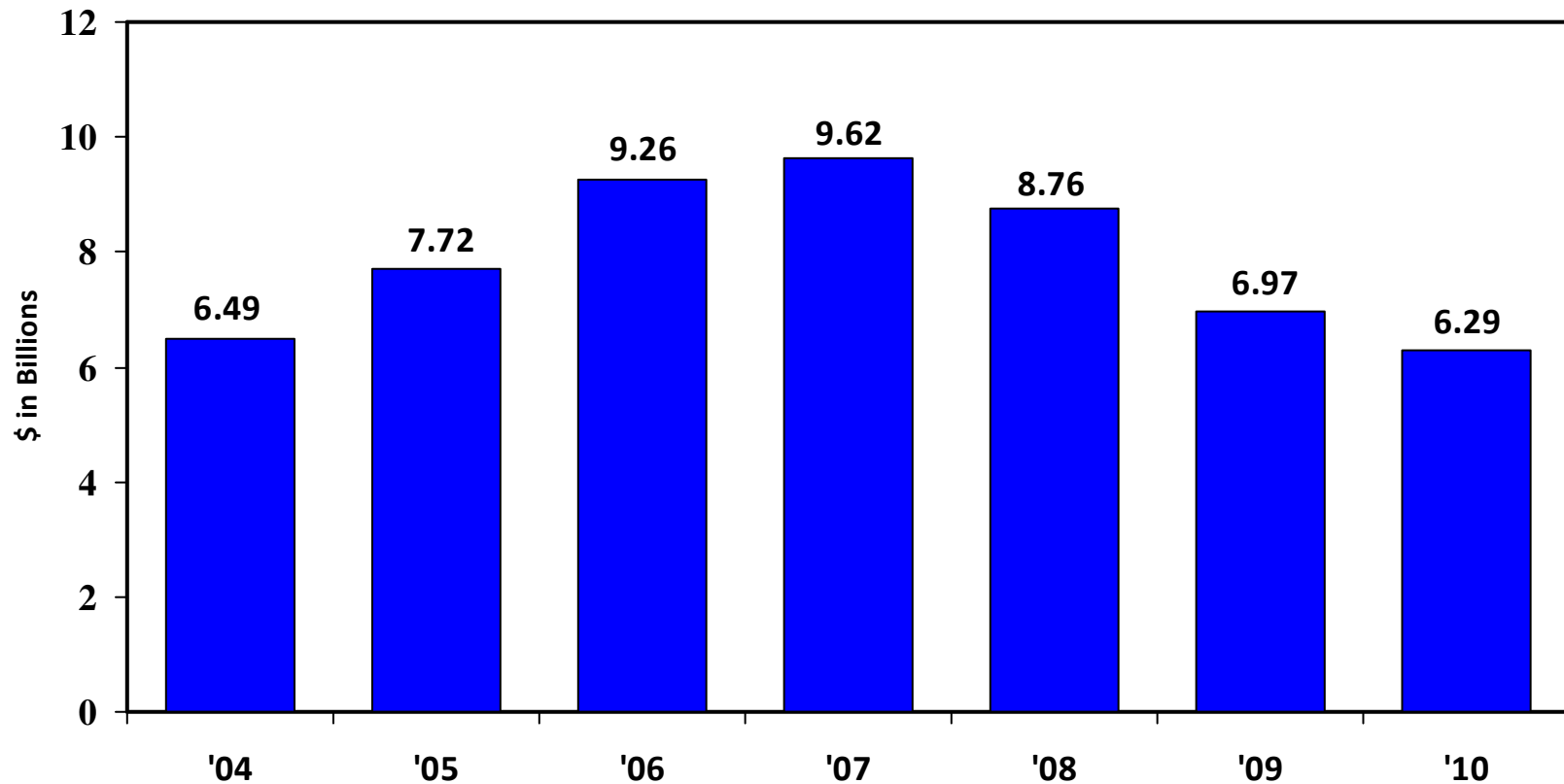
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Summary of the Current Budget Status

Still Weak – But Better Than Last Year

- ❑ General Fund revenues have declined by one-third in the last 3 years – but are beginning to grow
- ❑ 300,000 lost jobs and 40,000 foreclosures will delay full recovery
- ❑ FY '11 shortfall estimated at up to \$(825) M followed by \$(1.4) B in FY '12 – excludes more than \$1 B in suspended funding formulas
- ❑ 80% of our prior year budget shortfall solutions have been one-time – while not preferred, some temporary measures still available.
- ❑ Federal restrictions may affect spending options

Unprecedented 3 Year General Fund Revenue Decline Of (33)%



Excludes statutory and one-time changes.



Good News: 4% 1st Quarter Revenue Growth - But Rebound Is Uneven and Volatile

	% Change over 1 st Qtr. FY '10
Sales Tax	-2.8%
Individual Income Tax	6.7%
Corporate Income tax	48.5%

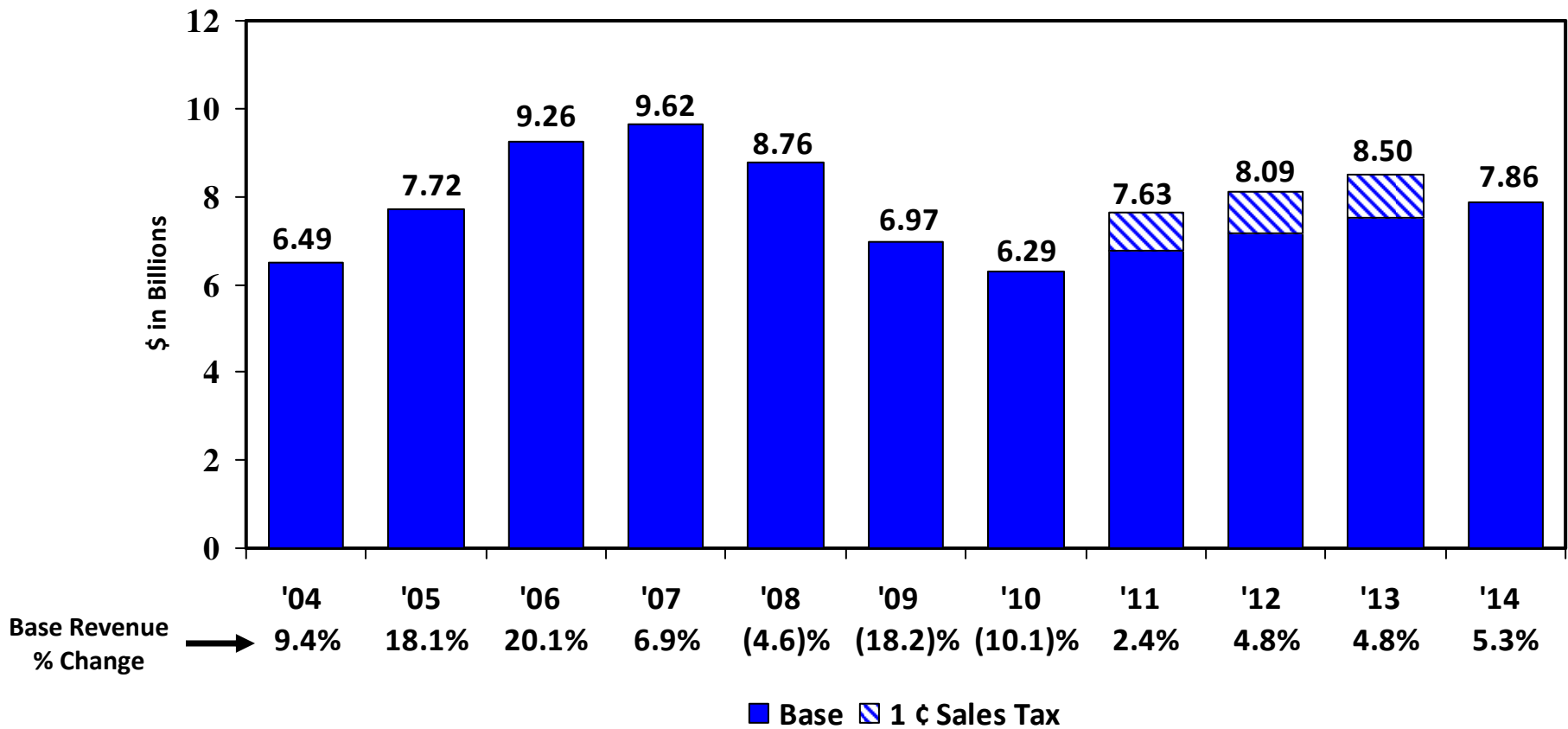
- ❑ Higher business profits boosted corporate tax receipts
- ❑ No recovery without consumer and their sales taxes
- ❑ As a result, revenues \$(30) M below forecast

The Road to Recovery Will Still Be Long

- ❑ 310,000 jobs lost since December 2007
 - 30% of lost jobs were in construction

- ❑ Housing problems persist
 - While pending Valley foreclosures declined from 51,000 in December, there are still 41,039 in the pipeline
 - 50% of Arizona-wide mortgages “underwater”

Consensus Forecasts Gradual Recovery In Revenue - Still Below FY '07 Level Through FY '14



- Excludes balance forward and other one-time revenues



FY '11 Shortfall Could Be Up to \$(825) M

□ 4 Problems:

- Failure of November ballot props – \$469 M
- Lower Federal Matching Funds - \$158 M
- Possible revenue shortfall with new forecast – \$206 M
- \$100 M K-12 shortfall – offset with federal funds

Baseline FY '12 Spending is Projected to Grow \$900 M - Represents Funding of Active Formula Requirements

- Most of the growth due to elimination of one-time federal assistance for Medicaid and K-12

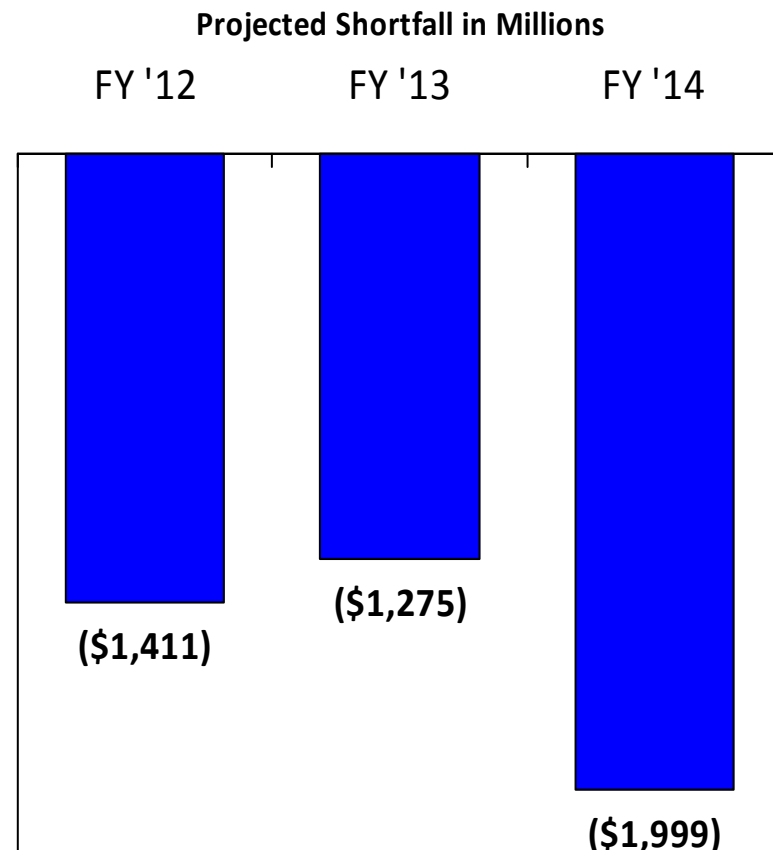
- K-12 and AHCCCS normal formula growth expected to be relatively limited
 - Population growth moderated
 - Assumes continuation of limited inflation policy

- SFB debt service requirements will increase \$94 M due to one-time FY '11 savings

A Projected Cash Shortfall Of \$1.4 B In FY '12

- Any Permanent Solutions in FY '12 Reduce FY '13 and FY '14 Gaps

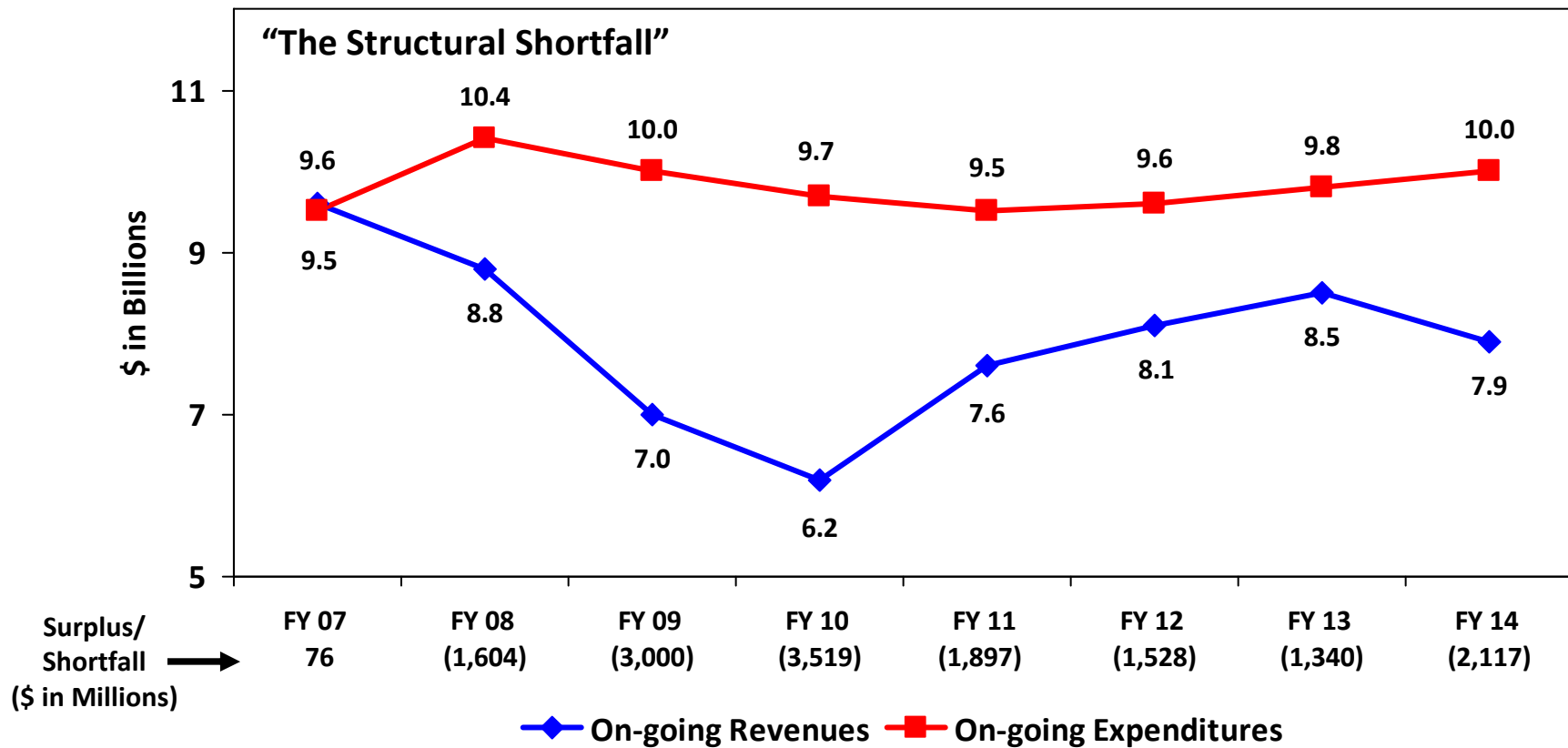
- Based on consensus revenues and active formula growth
- FY '12: Federal assistance expires
- FY '14: Sales tax expires and increases shortfall
- Does not include \$1 B+ In suspended formulas (Appendix)



Prop 302 Failure Increases Shortfall Another \$80 M

Structural Gap Exceeds Cash Gap

- Represents On-Going Revenues Versus On-Going Expenditures



State Fiscal Policy As Measured By Its Credit Rating

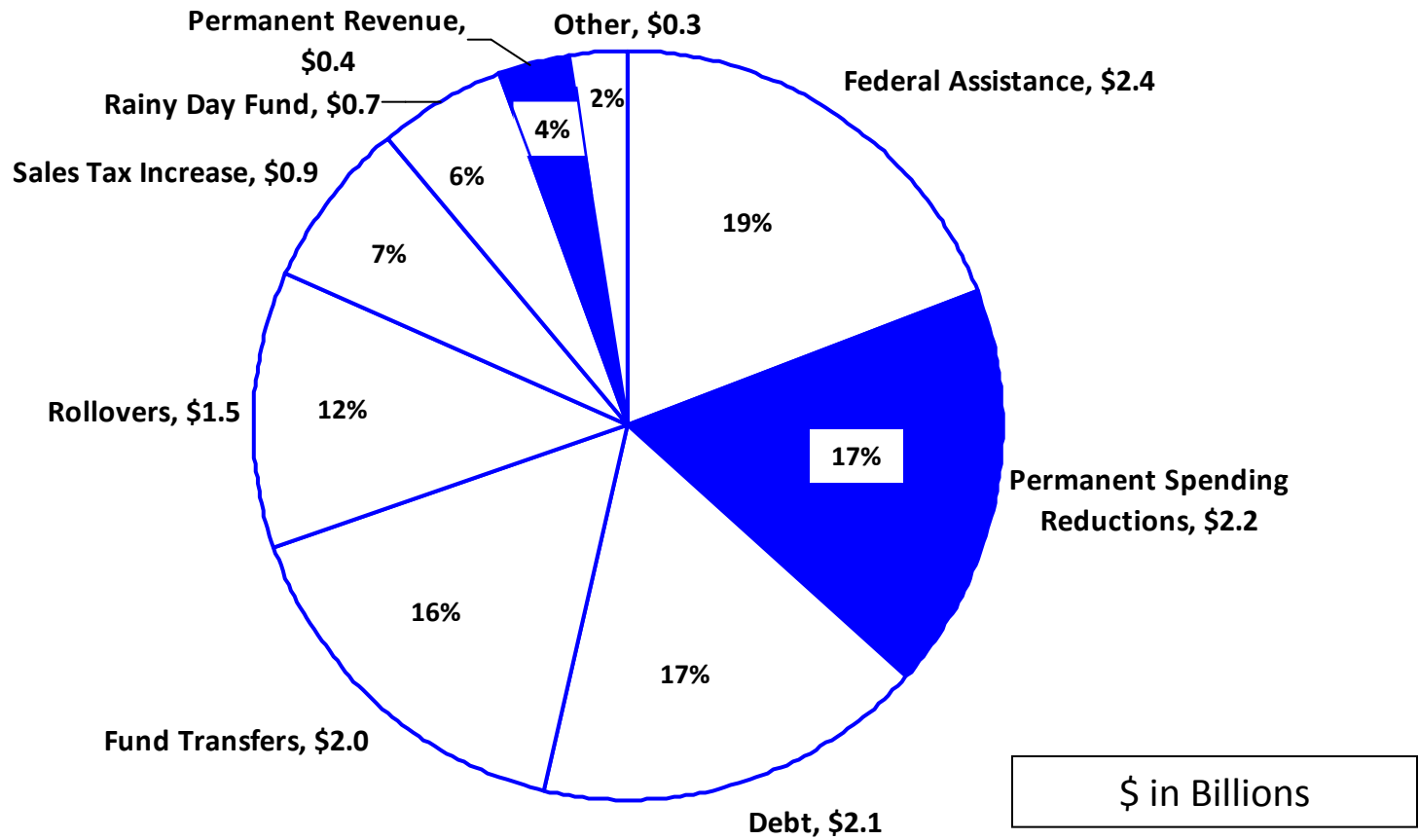
- Rating Is Lower Than Most Other States

- ❑ Still Investment Grade – 5th highest level (out of 10) for GF-backed financing
- ❑ Recent downgrade due to:
 - Economic and financial weakness
 - Structural imbalance and reliance on one-time solutions
 - 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

Where Do We Go From Here?

Since FY '08, State Has Used Mostly Temporary Solutions to Resolve Budget Shortfalls

- \$12.5 B In Cumulative Solutions



Federal Maintenance of Effort (MOE) Requirements May Limit State's Flexibility

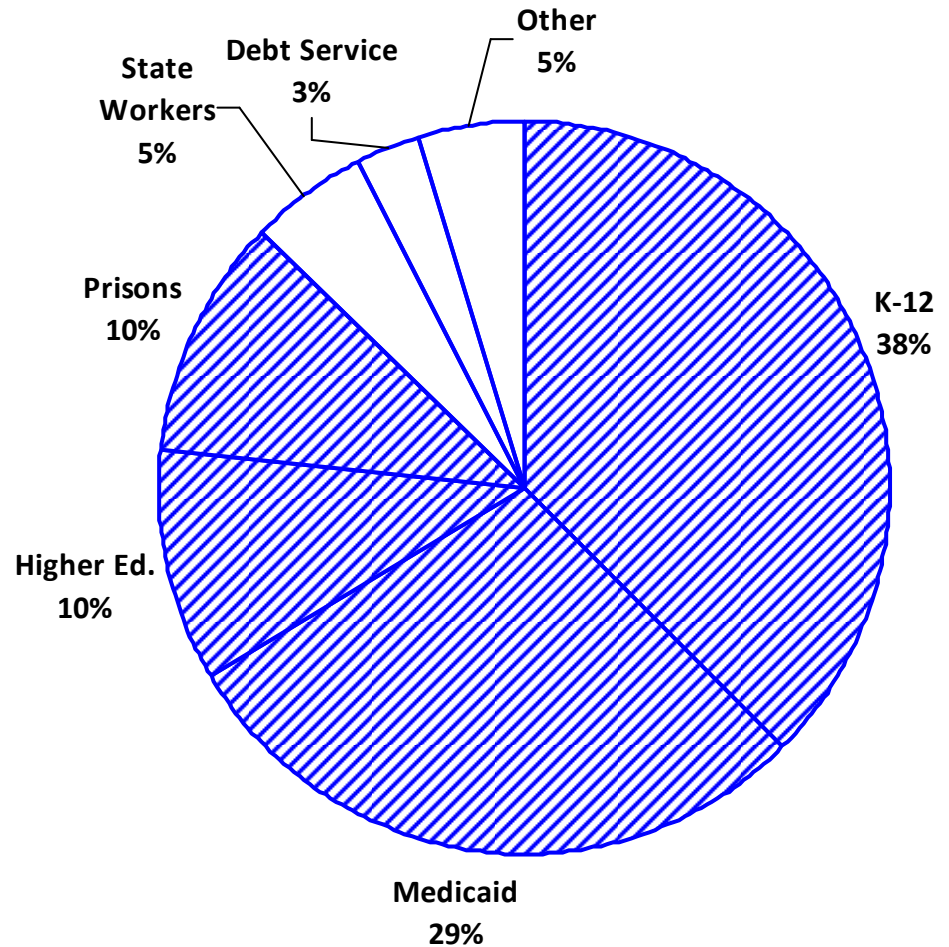
- ❑ Federal health care legislation prevents state from changing most Medicaid eligibility
 - Changes could result in loss of \$7 B in federal matching
 - Can still modify rates at any time

- ❑ Federal education stimulus prevents state from reducing spending below FY '06 level
 - K-12 and Higher Education already at FY '06 level
 - Requirement expires at end of FY '11

The 3 Main Drivers of General Fund Spending Are Education, Health, and Prisons

- Represents 87% of On-Going General Fund Budget

	<u>(FY '11 \$ in Millions)</u>
Education (K-12)	\$ 3,559.1
Medicaid	2,749.7
Higher Education	990.9
Prisons	985.8
State Workers	509.0
Debt Service	270.7
Other	<u>459.1</u>
TOTAL	\$ 9,524.3



Appendix: Funding Formula Suspensions

Statutory Funding Formula Suspensions

<u>Agency</u>	<u>Formula</u>	<u>Savings</u>
Community College	Operation and Equalization Formula	\$7,486,100
	Capital State Aid Suspension	\$20,652,500
Department of Education	Soft-Capital Formula	\$165,120,700
	New Utilities Formula	\$100,000,000
	Charter School Additional Assistance	\$10,000,000
Department of Emergency & Military Affairs	Military Installation Fund Deposit	\$2,800,000
	Governor's Emergency Fund	\$2,100,000
Department of Environmental Quality	WQARF	\$8,000,000
Judiciary	Probation Revocation Payment	\$2,410,300
School Facilities Board	Building Renewal	\$231,715,400
Tourism	Tourism Funding Formula	\$14,613,300
State Treasurer	Justice of the Peace Salaries	\$1,115,000
Universities	Financial Aid Trust	\$2,797,800
Department of Water Resources	Water Protection Fund Transfer	<u>\$5,000,000</u>
Subtotal		\$573,811,100
Future Year Cost – Department of Education	Teacher Performance Pay (by FY 2018)	\$278,000,000
Future Year Cost – School Facilities Board	New School Construction (If enrollment returns to pre-recession level)	<u>\$386,000,000</u>
Total		\$1,237,811,100

Non-Statutory Formula Suspensions

Department of Administration	Building Renewal	\$33,400,000
Universities	Enrollment	\$32,390,800
	Building Renewal	<u>\$88,957,100</u>
Subtotal		\$154,747,900

