

STATE OF ARIZONA

Joint Legislative Budget Committee

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MINUTES OF THE MEETING

JOINT LEGISLATIVE BUDGET COMMITTEE

October 2, 2008

The Chairman called the meeting to order at 9:38 a.m., Thursday, October 2, 2008, in Senate Appropriations Room 109. The following were present:

Members:	Senator Burns, Chairman	Representative Pearce, Vice-Chairman
	Senator Aguirre	Representative Adams
	Senator Garcia	Representative Biggs
	Senator Verschoor	Representative Boone
	Senator Waring	Representative Cajero Bedford
		Representative Lopez
		Representative Rios
		Representative Yarbrough

Absent: Senator Aboud
Senator Harper

APPROVAL OF MINUTES

Hearing no objections from the members of the Committee to the minutes of August 12, 2008, Chairman Burns stated that the minutes would be approved.

DIRECTOR'S REPORT

Mr. Stefan Shepherd, Deputy Director, JLBC, gave a presentation on the Budget Update. (*See Attachment 1*)

Mr. James Apperson, Deputy Chief of Staff, Governor's Office, gave a presentation on the Governor's Budget Management Plan Scenarios. (*See Attachment 2*)

DEPARTMENT OF EDUCATION

A. Review Proposed Transfer of Funds from Basic State Aid to the Structured English Immersion Fund under A.R.S. § 15-901.03.

Mr. Steve Schimpp, JLBC Staff, stated that the chairman is requesting Committee consideration of a transfer of approximately \$650,000 from Basic State Aid to the Structured English Immersion Fund. The FY 2009 budget includes \$40.6 million for this item. The Department of Education (ADE), however, has received some revised requests from districts as well as restoration of federal impact aid monies that ADE now indicates should not have been deducted in prior calculations and as a result believes it needs another \$646,300 to fully fund this program.

(Continued)

Mr. John Stollar, Associate Superintendent of Accountability, Department of Education, responded to member questions.

Representative Pearce moved that the Committee give a favorable review to the transfer of \$646,300 from Basic State Aid to the Structured English Immersion Fund. The motion carried.

B. Review of Joint Technological Education District Intergovernmental Agreements.

Mr. Schimpp stated that this item is a review of the Joint Technological Education District (JTED) Intergovernmental Agreements (IGAs) that have been developed with the member school districts and affiliated community college districts. The JLBC Staff recommends a favorable review of the submitted IGAs.

Representative Pearce moved that the Committee give a favorable review of the submitted JTED IGA's. In addition, the Committee requires the JTEDs to: 1) submit to the Committee by December 30, 2008 the data that is missing in the Cost Summary that was given to the Committee for review, and 2) Include in all subsequent IGA's: (a) non-supplanting worksheets pursuant to USFR Memo 219, and (b) subtotals for district, JTED and community college funding for each member district's JTED courses as a whole. The motion carried.

C. Report of Plan to Fund AIMS Study Guides with Achievement Testing Monies.

Mr. Schimpp stated that this item is for information only. The Department of Education is reporting that they plan to use some unused achievement monies to fund AIMS study guides as they have done in the past.

DEPARTMENT OF ECONOMIC SECURITY - Review of Requested Transfer of Appropriations and Report on Additional Domestic Violence Shelter Fund and Child Support Enforcement Administration Fund Spending.

Mr. Jay Chilton, JLBC Staff, stated that this item is a review of requested transfer of appropriations for the Department of Economic Security (DES). DES intends to transfer \$58 million General Fund dollars from the Day Care Subsidy Special Line Item (SLI) to Temporary Assistance for Needy Families (TANF) Cash Benefits SLI and \$58 million TANF dollars from the TANF Cash Benefits SLI into the Day Care Subsidy SLI. The total funding does not change. This is required for DES to meet its federal matching requirement for the TANF block grant.

The second piece is a Tribal Pass -Through transfer. Earlier this year the San Carlos Apache Tribe started operating its own TANF program. DES intends to transfer just under \$800,000 from the TANF Cash Benefits SLI to the Tribal Pass-Through SLI to cover the San Carlos Apache Tribe TANF program. These 2 items require Committee review.

The final 2 items on Domestic Violence and Child Support do not require Committee review.

Representative Pearce moved that the Committee give a favorable review to the following transfer of funds for the Department of Economic Security:

- *\$58,000,000 General Fund from the Day Care Subsidy SLI to the TANF Cash Benefits SLI and a corresponding transfer of \$58,000,000 of TANF Block Grant monies from the TANF Cash Benefits SLI to the Day Care Subsidy SLI.*
- *\$793,600 General Fund from the TANF Cash Benefits SLI to the Tribal Pass-Through SLI.*

The motion carried.

ARIZONA DEPARTMENT OF ADMINISTRATION - Review of Risk Management Deductible.

Mr. Dan Hunting, JLBC Staff, stated that statute requires the Joint Legislative Budget Committee to annually review deductible amounts charged to agencies for risk management losses as submitted by the Arizona Department of Administration (ADOA). ADOA recommends a continuation of the current \$10,000 deductible.

(Continued)

Representative Pearce moved that the Committee give a favorable review to the \$10,000 deductible amount. The motion carried.

DEPARTMENT OF HEALTH SERVICES - Review of Children's Rehabilitative Services Capitation Rate Changes.

Mr. Art Smith, JLBC Staff, stated that this item is a review of Department of Health Services (DHS) capitation rate changes for the Children's Rehabilitative Services population. The proposed capitation rates actually cost less than the budgeted amount and would save the General Fund approximately \$1.4 million in FY 2009.

Representative Pearce moved that the Committee give a favorable review to the change in the Children's Rehabilitative Services capitation rate. In addition, the Committee requires that any capitation rate savings be reverted and not transferred for program expansions or to offset lump sum reductions. The motion carried.

Mr. Richard Stavneak, Director, JLBC, stated that the following items are for informational purposes only. The Chairman wants to understand what the financial consequences are and how we are going to resolve this year's shortfall before moving forward with these items.

AHCCCS - Review of Proposed Acute Care and ALTCS Capitation Rate Changes -- Agency Request (Information Only).

Ms. Amy Upston, JLBC Staff, stated that this item is a review of the capitation rates for the AHCCCS Acute Care and Long Term Care programs. Using budgeted caseload growth, JLBC Staff expect that these 2 programs will cost the General Fund approximately \$34 million more than was initially budgeted.

Mr. Tom Betlach, Deputy Director, AHCCCS, responded to member questions.

ARIZONA BOARD OF REGENTS - Review of FY 2009 Tuition Revenues -- Agency Request (Information Only).

Ms. Leah Kritzer, JLBC Staff, stated that this item is the Arizona Board of Regents' report on tuition revenues for FY 2009 which is an information only item. Appropriated tuition collections for FY 2009 were estimated at \$481.4 million. The universities now estimate they will receive \$538.1 million, or an increase of \$56.7 million.

Ms. Christine Thompson, Assistant Executive Director, Government Affairs, Arizona Board of Regents, responded to member questions.

JLBC STAFF - Index for School Facilities Board Construction Costs -- Agency Request (Information Only).

Ms. Leatta McLaughlin, JLBC Staff, stated that this item is for information only. This item provides information on possible construction cost indices for the School Facilities Board new school construction and building renewal formulas.

Mr. John Arnold, Director, School Facilities Board, responded to member questions.

EXECUTIVE SESSION - Arizona Department of Administration - Risk Management Annual Report

Due to a lack of a quorum, no action was taken on this item. The Chairman believed the item could wait until the next meeting.

Without objection, the meeting adjourned at 12:08 p.m.

Respectfully submitted:

Sandy Schumacher, Secretary

Richard Stavneak, Director

Senator Bob Burns, Chairman

NOTE: A full audio recording of this meeting is available at the JLBC Staff Office, 1716 W. Adams. A full video recording of this meeting is available at <http://www.azleg.gov/jlbc/meeting.htm>.

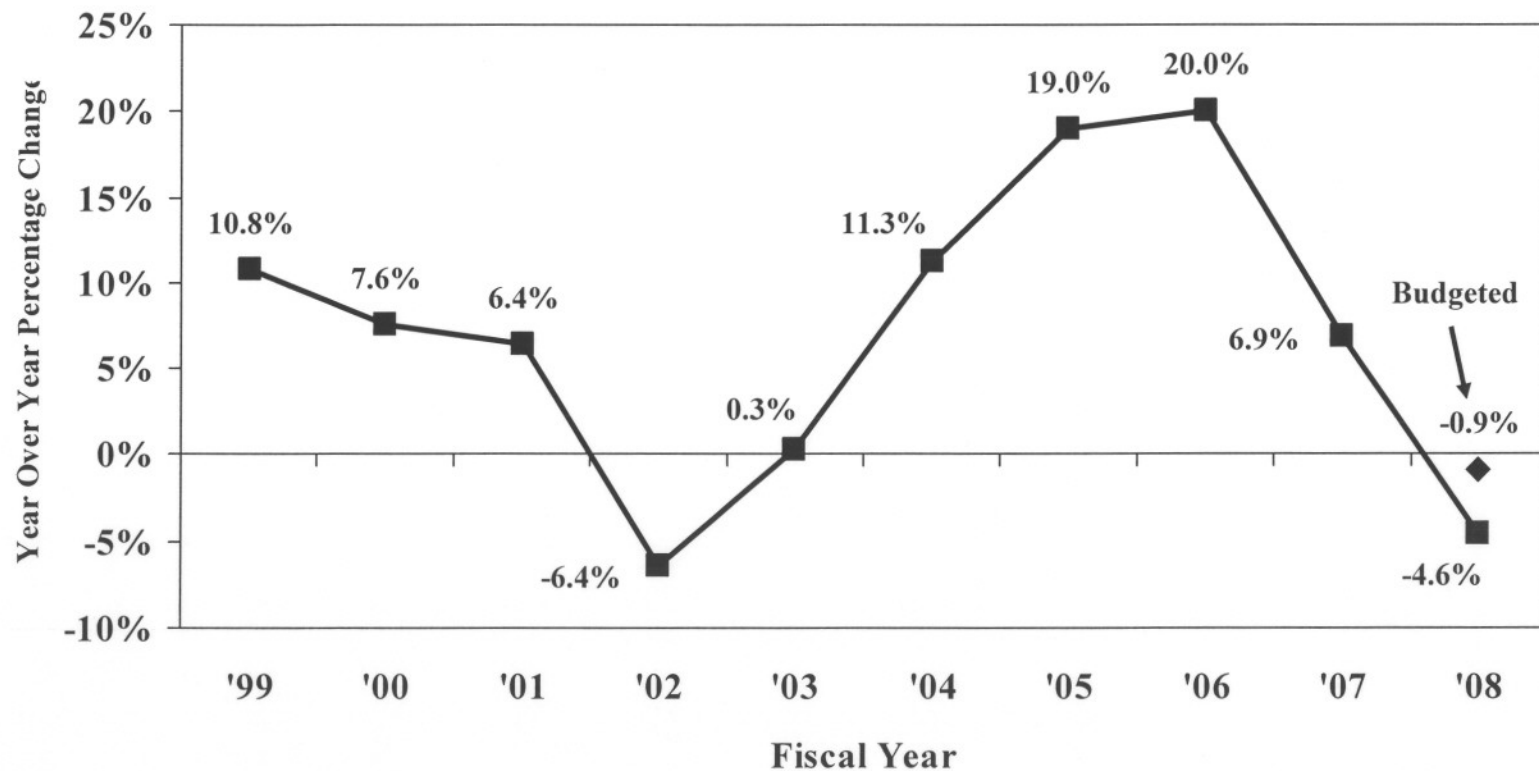
Budget Update

JLBC/JCCR Meeting

October 2, 2008

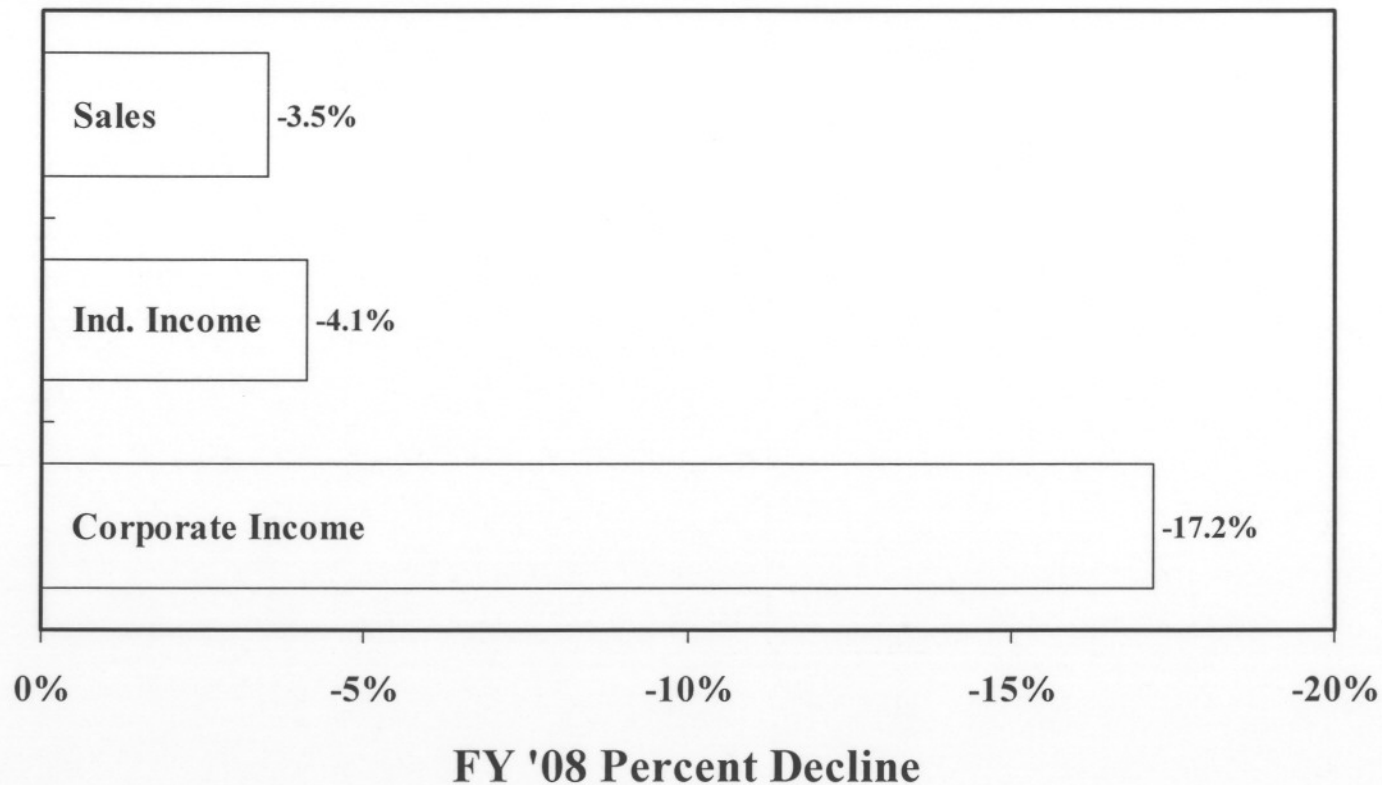


'08 General Fund Base Revenue Decline of (4.6)% Was Greater Than Forecasted



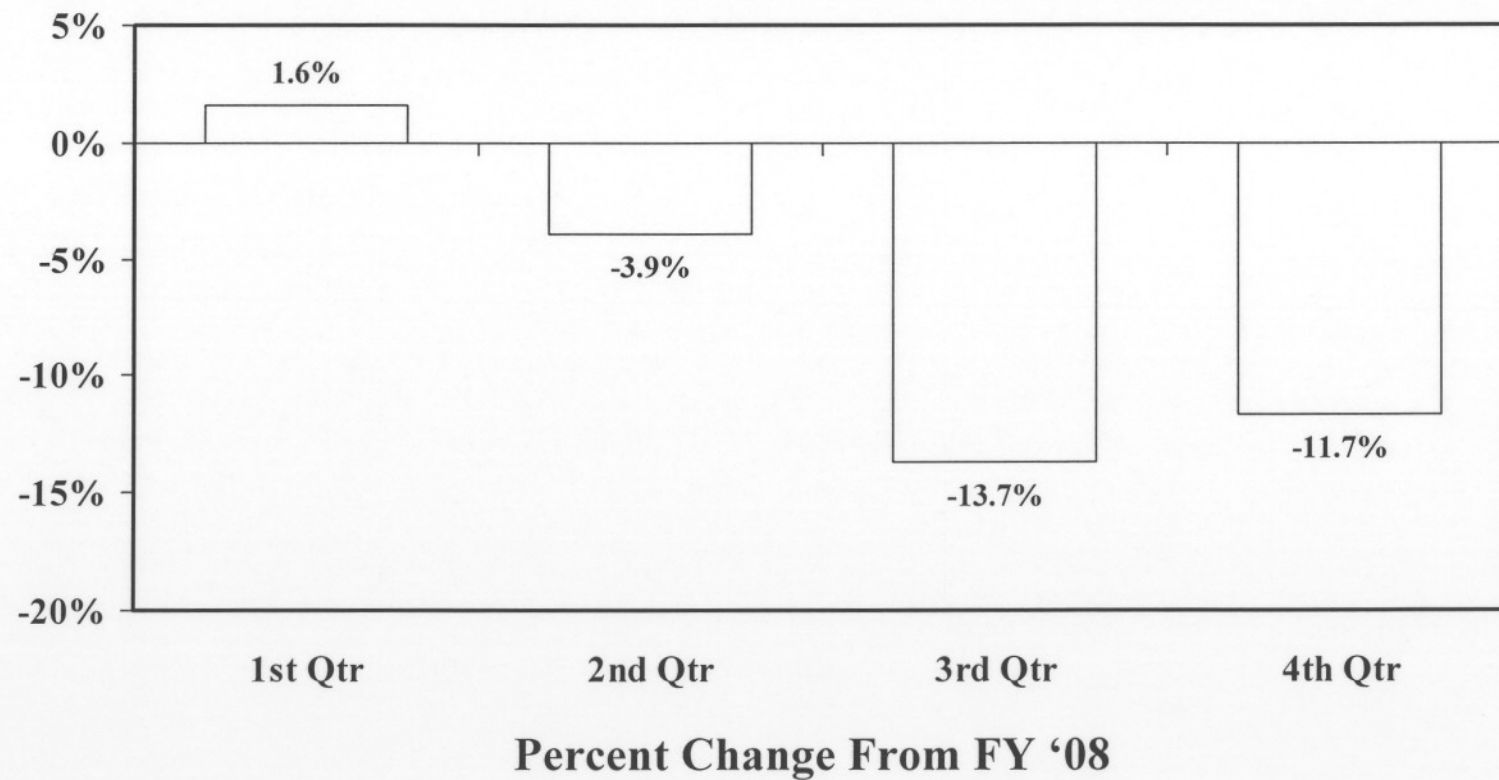
Excludes statutory and one-time changes.

Revenue Declines Were Across The Board



Excludes statutory and one-time changes.

Decline Accelerated in Second Half of FY '08



FY '08 Revertments Were Much Higher Than Anticipated

- Budget savings of \$85 M — Actual was \$189 M
 - But Will Result in Higher '09 Adjustments.
- ADE: \$97 M
 - 50% Due to Rollover Mistake.
- AHCCCS: \$54 M
 - 60% Probably Will Be Paid Out in '09.
- FY '09 Budget included \$55 M for unpaid '08 bills (“Admin Adjustment”) — likely to be underestimated by \$50 M.

FY '08 End of Year

The Problem and Its Solution

\$ in M

Problem

Revenue Shortfall	\$ (356)
Extra Revertment Savings	<u>104</u>
	\$ (252)

Solution

Ch. 53 Reserves	\$ 152
Extra BSF Contribution	<u>100</u>
	\$ 252

\$98 M Left in the Budget Stabilization Fund

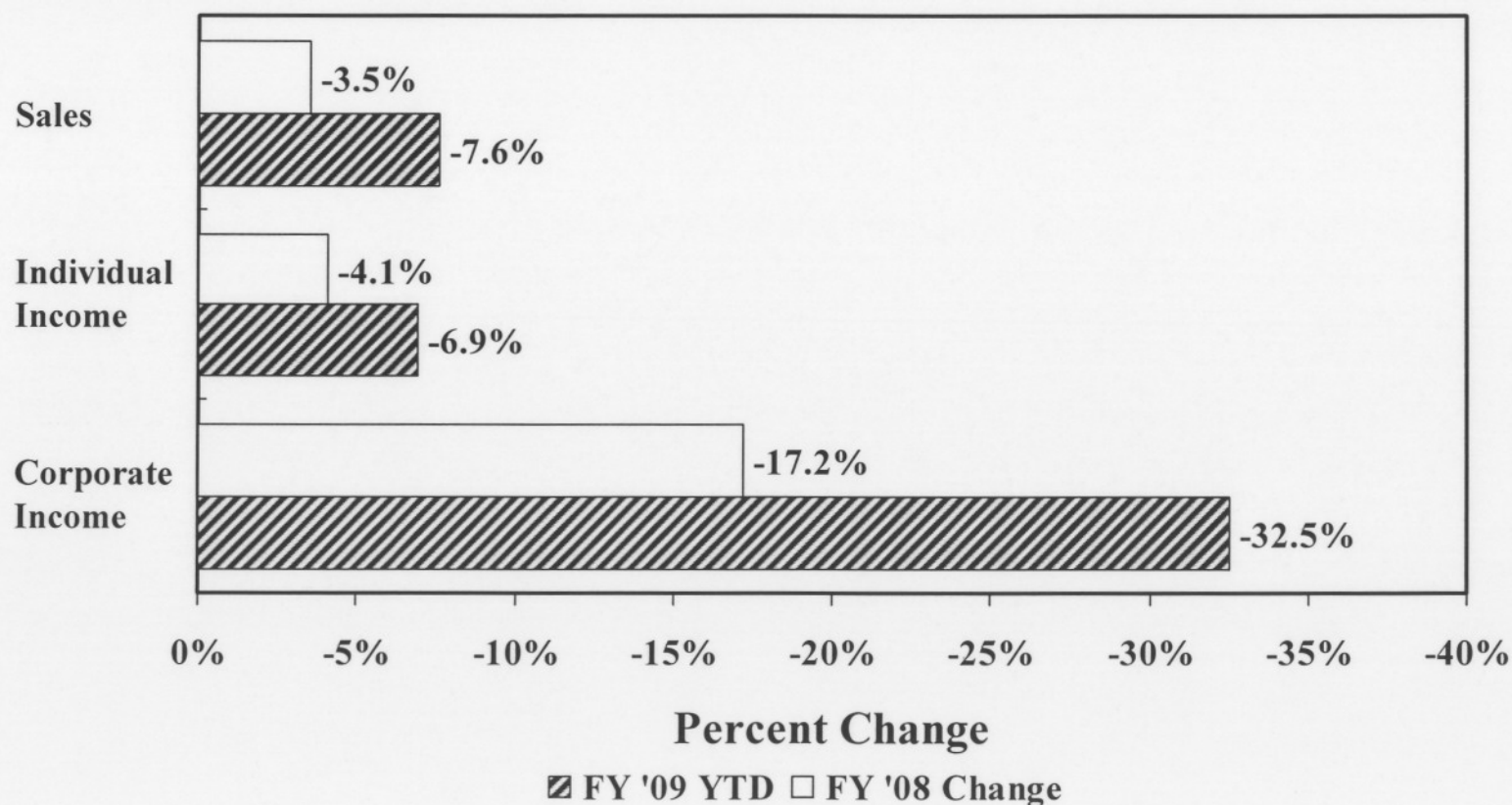
- Used \$587 M to balance '08, including the \$100 M.
- Already budgeted \$20 M for '09.
- \$98 M remains available for '09 - - could be as high as \$120 M.

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%

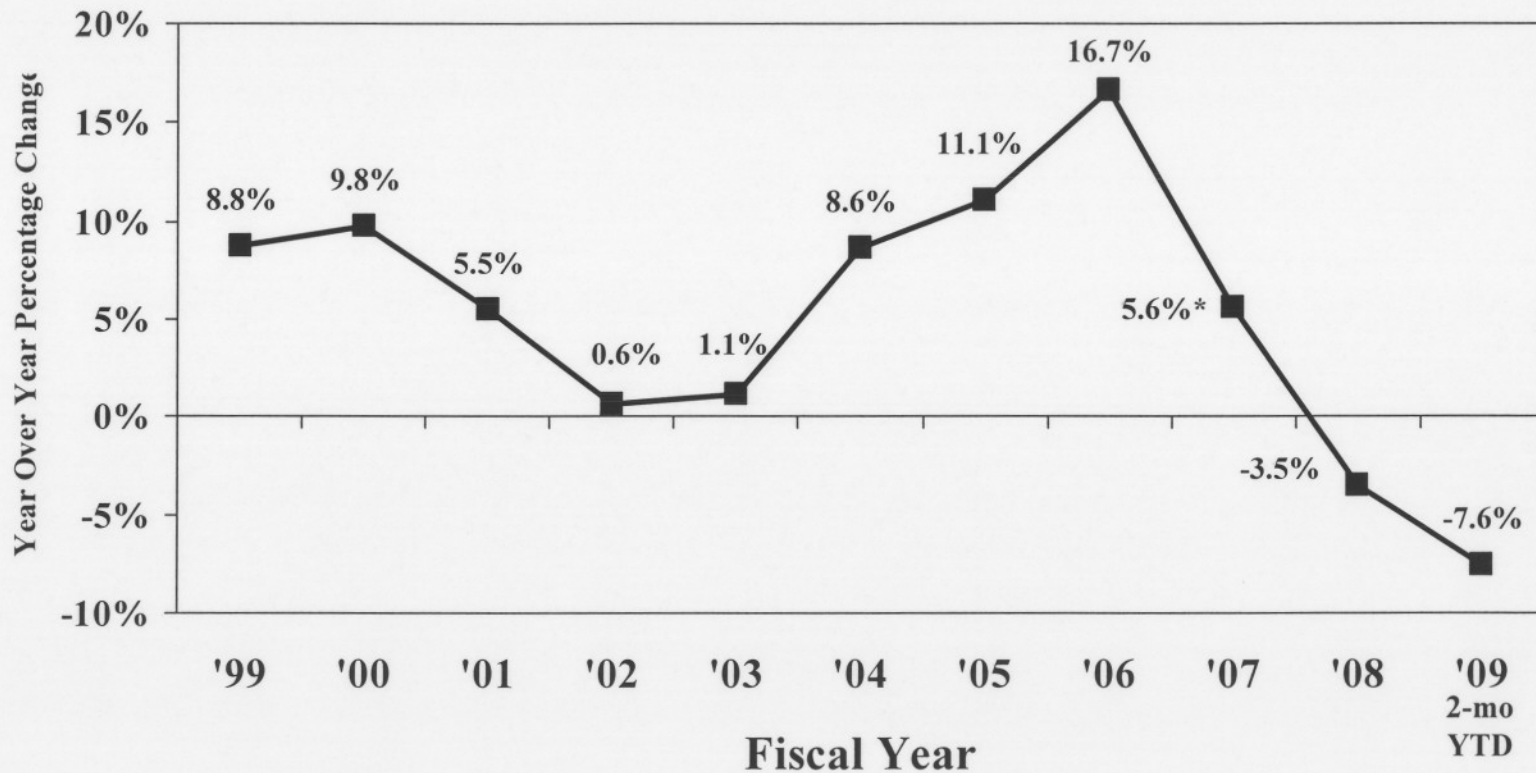
Through August, Revenues Continue To Decline

- - (8.6)% or \$(180) M Below Forecast



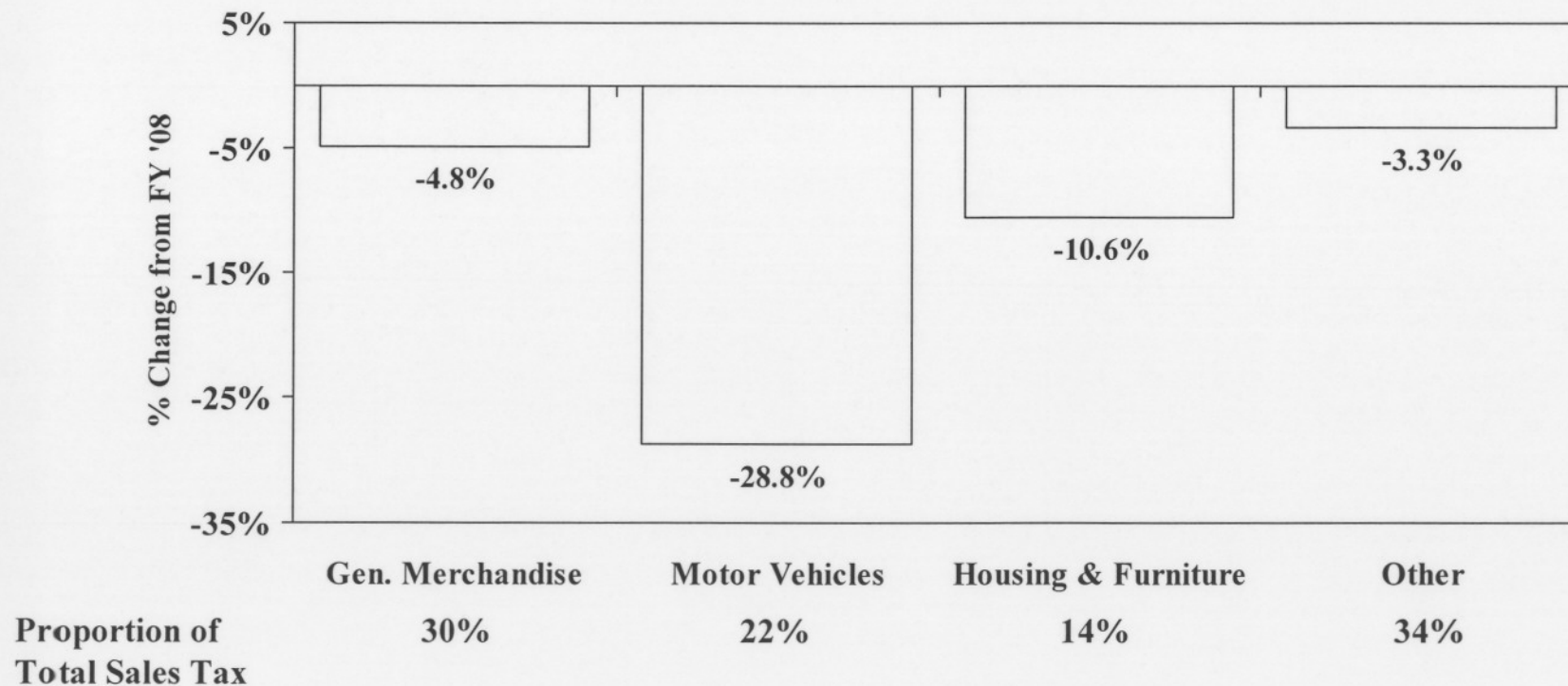
Excludes statutory and one-time changes.

Sales Tax Growth Rate Is Far Below FY '02-'03 Levels



* Does not include the one-time impact of a change to the estimated payment threshold enacted by the Legislature. Including the impact of the one-time change, actual collections grew by 4.3%

Sales Tax Revenues Change By Sector



July Retail Sales

While JLBC Has 2-Month Shortfall Of \$180 M, Executive Estimate Is \$118 M

- Both offices agree revenues are down (8.6)% YTD.
- Both use same forecast for entire year, but have different monthly flows.
- JLBC forecasted 3.5% growth YTD vs. Executive's (0.7)%.
- JLBC spreads the forecast losses more evenly throughout the year.

Preliminary September Results Continue the Revenue Decline

- (8.6)% below September 2007.
- Preliminary September revenues are \$(120) M below forecast.
- September YTD revenues would be \$(300) M below forecast.

Economic Slowdown Affects More Than the General Fund

- FY '08 HURF collections were down (2.7)% from '07. This represents \$89 M less than the ADOT forecast.
- In the first two months of FY '09, lottery sales were (13.3)%, or \$(10.5) M below last year.

Next Formal Forecast Update is Mid-October

- New 4-sector information will be available for October 15th FAC meeting.
- Given the accelerating decline in '08, may be easier to generate better performance as the year progresses.
- Given the current economic uncertainties, an '09 forecast is more speculative than usual.
- For planning purposes, we are currently projecting a decline of between 0% and (5)%.

Current FY '09 Shortfall Estimate: \$(550) M to \$(1) B

- At flat growth, shortfall would be \$(550) M.
- If revenues decline (5)%, shortfall would grow to \$(1) Billion.
- Both estimates include an added \$50 Million for unpaid '08 bills.
- There are no known agency supplemental requests, but AHCCCS is reporting a \$50 M shortfall.

‘09 Revenue and Expenditure Comparison

(\$ in Billions)

	\$550 M Option	\$1.0 B Option
<u>Revenues</u>		
On-going	8.7	8.2
One-time	<u>0.7</u>	<u>0.7</u>
Total	9.4	8.9
<u>Spending</u>		
On-going	10.7	10.7
One-time	<u>(0.7)</u>	<u>(0.7)</u>
Total	10.0	10.0
Balance	(0.5)	(1.0)

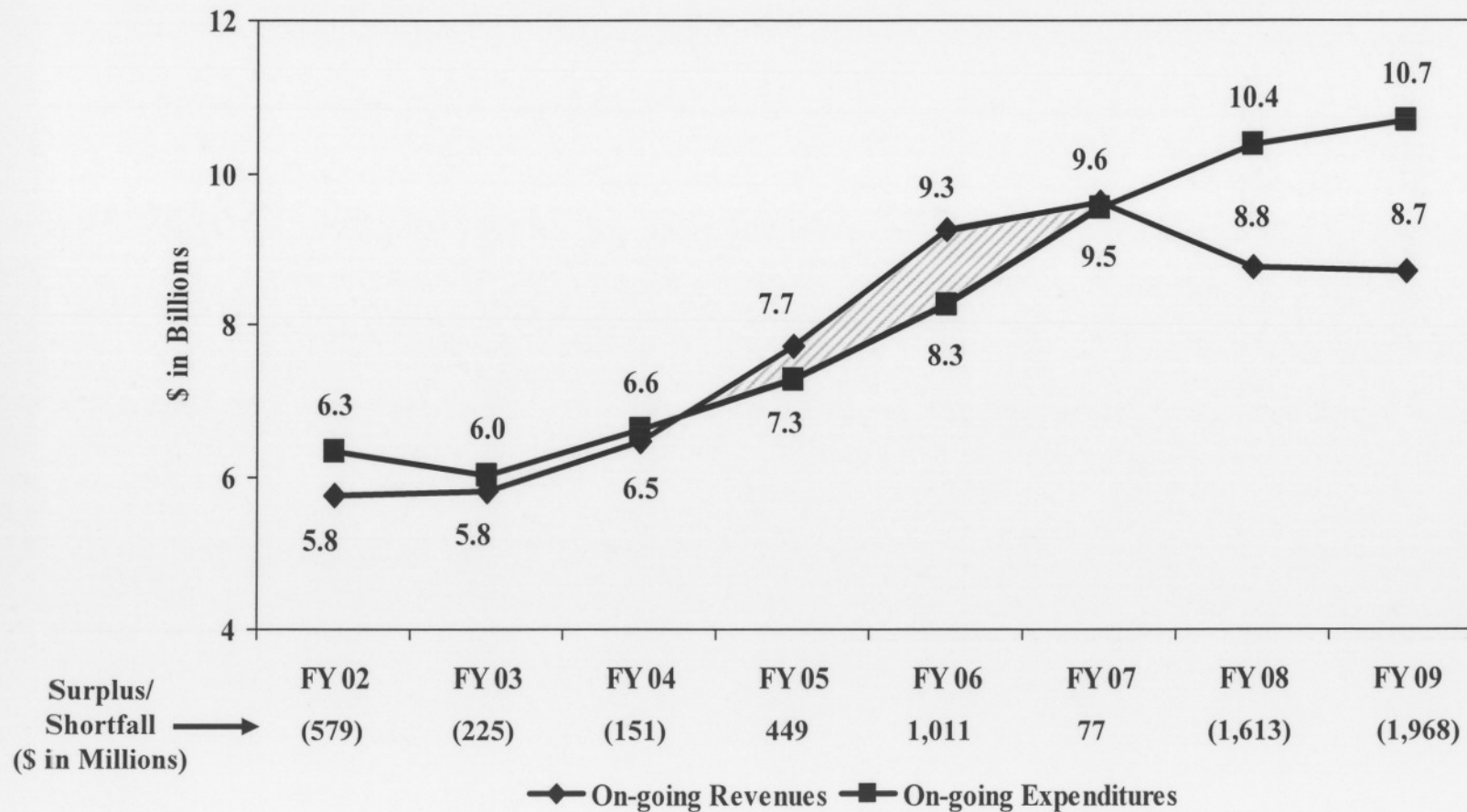
‘09 Structural Shortfall Near \$2 B

(\$ in Billions)

	\$550 M Option	\$1.0 B Option
On-going Revenues	8.7	8.2
On-going Spending	10.7	10.7
Structural Shortfall	(2.0)	(2.4)

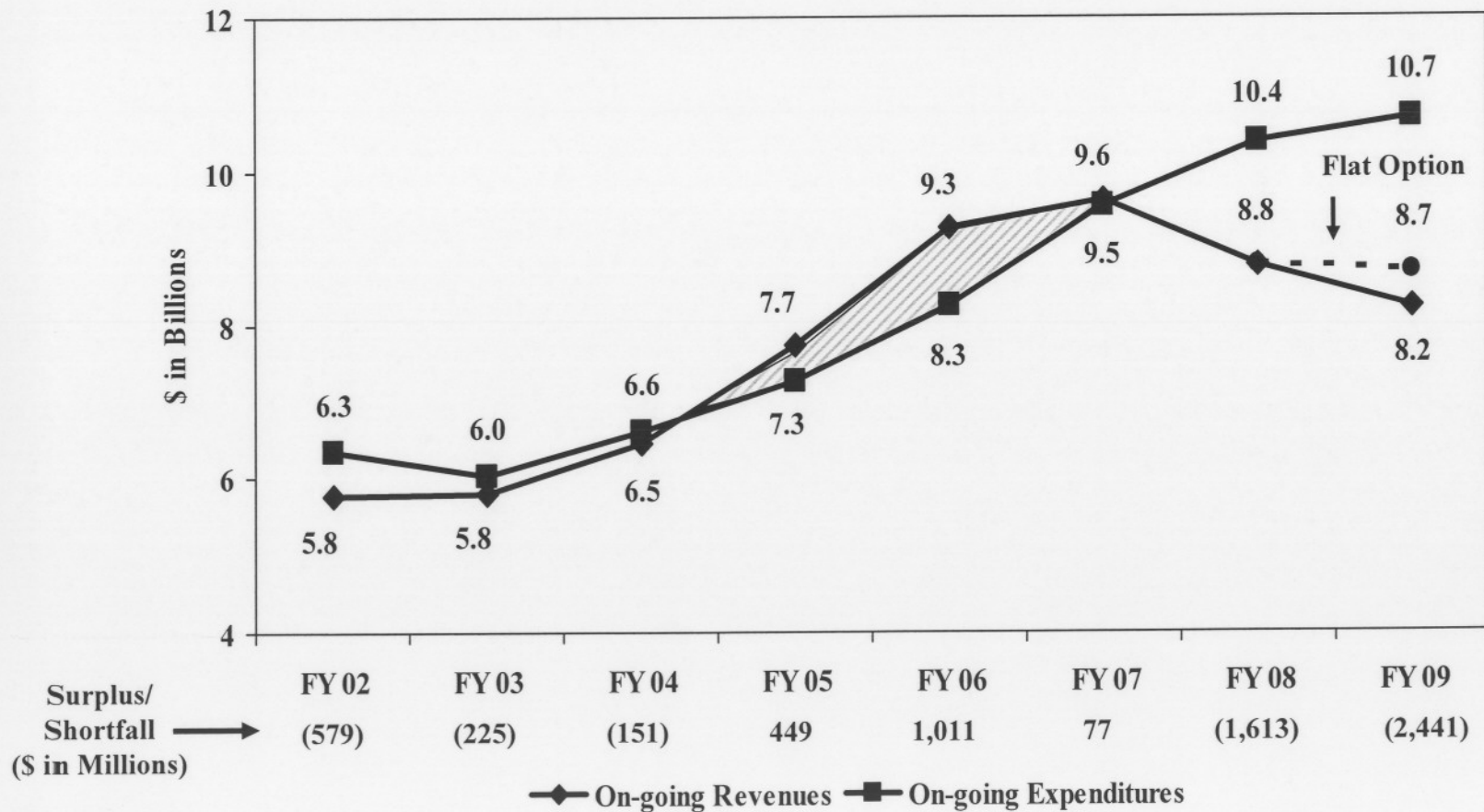
Structural Shortfall

Flat FY '09 Revenue Growth Option

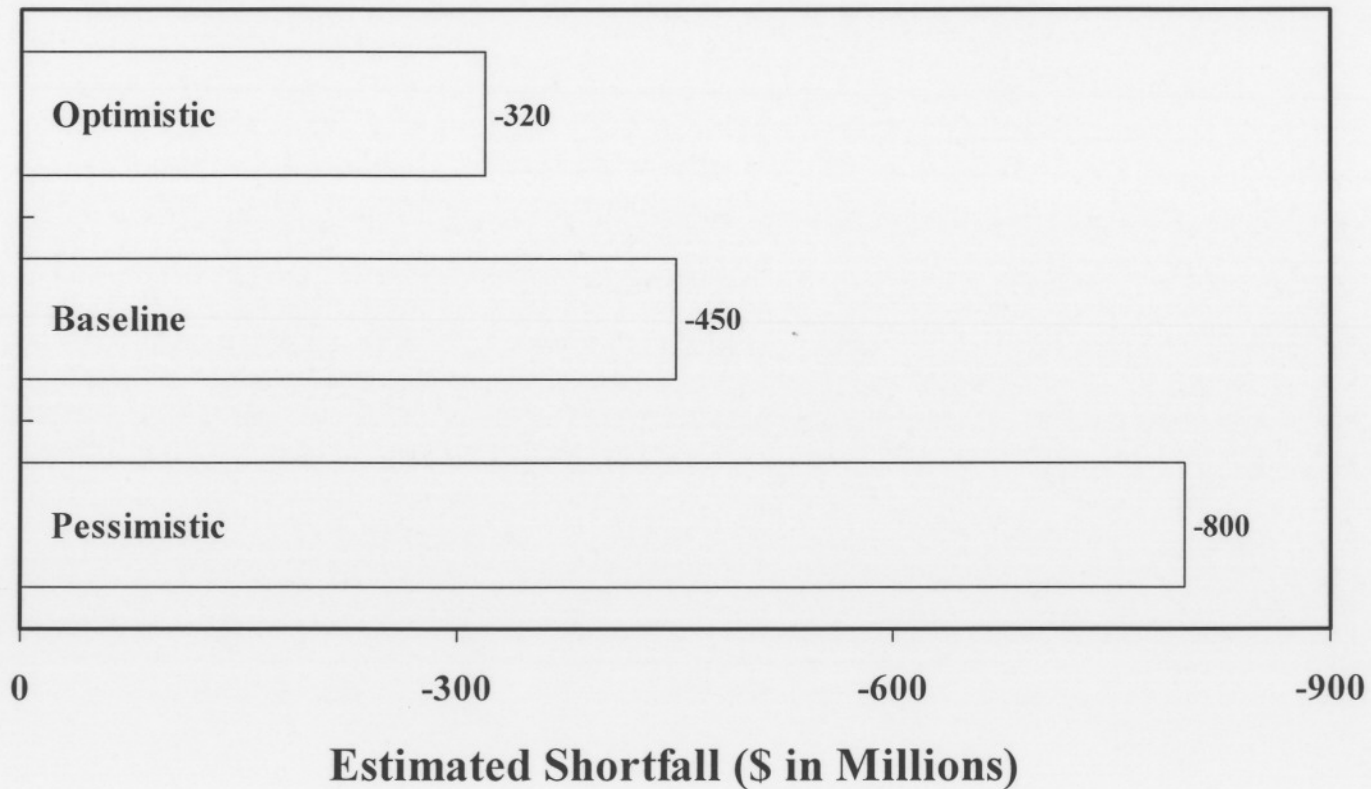


Structural Shortfall

(5)% FY '09 Revenue Decline Option



The Executive's FY '09 Shortfall Estimate Consists of Three Scenarios



Executive's Solutions to the Worst Case Scenario - - \$(800) M Shortfall

\$ in M

State Agency Budget Savings

250

Rainy Day Fund

120

Fund Transfers

50

Additional Budget
Management Options

380

Total

\$800

What Is The Maximum FY '10 Shortfall?

- - \$(2.6) B Based On Several Assumptions

- '10 revenue growth rate (March 4-Sector = 3.8%).
- \$400 M in enacted one-time '09 items are not continued.
- Resolution of new '09 shortfall uses only one-time solutions.
- State equalization tax is repealed.

Changing Policy Assumptions Could Reduce '10 Shortfall - - Would Drop By \$1.2 B To A Total Of \$(1.5) B

\$ in M

• Make 50% of new '09 shortfall solutions on-going	\$510
• Keep enacted '09 one-time solutions in '10	400
• Restore equalization tax per statute	<u>260</u>
Total	\$1,170

State of Arizona

Janet Napolitano, Governor

Budget Management Plan Scenarios

Fiscal Year 2009

October 1, 2008

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Section I: Background and Context for Managing the FY 2009 Budget

Since the passage of the FY 2009 budget in June 2008, economic conditions have further deteriorated. The housing downturn continues, and consumer confidence is at historically lows.

National Outlook

The U.S. economy finished the first half of CY 2008 better than expected, thanks to the stimulus package enacted by Congress and strong exports. However, the housing downturn is not over, as the government takeover of Fannie Mae and Freddie Mac made clear. The economy continued to weaken recently as Lehman Brothers declared bankruptcy, Bank of America bought Merrill Lynch, the federal government bailed out AIG, and other firms struggled to raise capital. Although it is still pending, government action to pump massive liquidity into the system is expected to help to unfreeze the credit market and allow the economy to recover.

- ❑ **GDP growth:** Global Insight forecasts U.S. GDP growth to follow a W-shaped profile, with the second and third quarters of CY 2008 the strongest due to the stimulus package. The forecast expects a sustainable recovery as housing prices bottom out in mid-2009, with GDP growth bouncing back to 2% in quarter 2 of 2009. Consumer spending in 2008 is expected to slip to 1% from 2.8% in 2007.
- ❑ **Employment growth:** Payroll employment has declined for eight months in a row, averaging 76,000 fewer jobs per month between January and August compared to the same period last year. The unemployment rate has risen to 6.1%. However, unemployment rates are better than those faced during the 1990-91 and the 2001 recessions.
- ❑ **Interest rates:** As inflation fears ease and credit conditions continue to tighten, Global Insight expects the Fed funds rate to hold at 2%. Due to weakness in the financial system, rate cuts are not out of the picture.

Potential risks: An even steeper housing downturn coupled with another spike in energy prices could drag the economy into a deeper downturn than previously forecasted. Potential risks to the economy include a bigger sub-prime decline, a continuing U.S. housing downturn, a weaker job market, a bigger consumer retrenchment, and more risk aversion by businesses, plus any geopolitical shock.

Arizona Outlook

Arizona was heavily affected by the housing downturn. Although the economy is expected to be close to bottoming out, according to Global Insight, Arizona's growth is expected to stay weak through the end of 2008 as housing prices and construction continue to decline. Revenue collections have shown further weakness, as employment deteriorates and consumers continue to hold back, evidenced by July-August collections falling more than \$100 million below the enacted forecast.

- ❑ **Employment:** Arizona employment growth has been weak in the past few months. From January through August, Arizona employment decreased by 18,700 jobs from the same period last year, while the unemployment rate rose to 5.6% in August. The most recent forecast from the Arizona Department of Commerce suggests that Arizona will experience a slight job loss of (0.5)% in calendar year 2008 before returning to modest growth 0.1% in calendar year 2009.
- ❑ **Real estate:** The deepening housing decline has resulted in declining retail sales in the State, and coupled with recent Wall Street crises, Capital Gains income is likely to diminish. It is expected that Arizona residential real estate activity growth will decrease further in the last two quarters of calendar year 2008 and will start to stabilize in 2009.

Potential risks: A prolonged national downturn will adversely affect the State as in the past.

Conclusion: As a result of economic events and a revised outlook, it is prudent to take action to prepare Arizona for a challenging economic environment to continue into 2009.

Section II: Overview of the Budget Management Plan

At the Governor's direction, the Governor's Office of Strategic Planning and Budgeting (OSPB) prepared three Budget Management Plan scenarios, covering a range of FY 2009 revenues. These plans have been developed to ensure the FY 2009 budget remains in balance.

The policies used to achieve this plan are as follows:

1. The integral functions of State government must not be compromised.
2. Recommended spending reductions will be on an agency-by-agency and program-by-program basis, not across-the-board.
3. All voter-protected and constitutionally created programs will be exempt from spending reductions.
4. Appropriate application of previously used and accepted budgetary practices will be employed.

The Budget Management Plan consists of four elements:

- A **State agency budget savings strategy**, which will reduce State General Fund expenditures by \$75 million to \$250 million in FY 2009.
- Use of the **Budget Stabilization Fund** (Rainy Day Fund), with approximately \$120 million available in FY 2009.
- **Fund Transfers** of approximately \$50 million from balances of other funds to the General Fund.
- **Additional FY 2009 Budget Management Options** are expected to generate between \$75 million and \$380 million toward balancing the General Fund.

Sections III, IV, and V of this Plan provide additional details regarding each of the elements of the Plan.

The following chart summarizes the key elements of the Plan (in millions of dollars):

	Optimistic	Baseline	Pessimistic
State Agency Budget Savings	75	150	250
Rainy Day Fund	120	120	120
Fund Transfers	50	50	50
Additional Budget Management Options	<u>75</u>	<u>130</u>	<u>380</u>
Total Budget Management Plan	320	450	800

The total revenue shortfall is subject to revenue updates and could decrease if proposed Federal assistance is approved.

Pursuant to an agreement between the Governor, Speaker of the House and President of the Senate, OSPB and JLBC shall meet between now and November 6, 2008 to arrive at a consensus revenue forecast.

If the shortfall for FY 2009 is more or less than projected, the State Agency Budget Savings and Additional Budget Management Options will be adjusted.

Triggered Adjustments

The Budget Management Plan includes two types of triggers:

The first trigger deals with a situation that occurs if the fiscal deficit is greater than the anticipated baseline estimate of \$450 million. This trigger will adjust the Budget Management Plan to accommodate a shortfall of up to \$800 million.

Conversely, the second trigger will allow for the restoration of Budget Management Plan agency reductions once the deficit has fallen below the anticipated baseline estimate of \$450 million. This trigger will restore agencies' funding back to the amounts enacted in June 2008 for FY 2009 before any other actions are taken (such as Rainy Day Fund deposit, tax cuts, etc).

Section III: Budget Savings Directive

Summary

In July 2008, the Governor instructed state agency directors to reduce spending and control costs in FY 2009. At the Governor's direction, all agencies are reporting expenditures on a monthly basis and are providing expected expenditures for all funds.

The Governor and OSPB will continue to meet with agency directors to focus on budget reductions and their associated implications for statutory mandates and services provided.

Of the \$9.97 billion appropriated for FY 2009 expenditures by state agencies, the following amounts are protected from budget reductions:

Voter protected	\$1.38
Constitutionally established	0.27
Judicial/Legally protected	0.22
Federal Entitlement or mandate	2.18
Federal match	<u>0.44</u>
Total Protected Amount	<u>\$4.49</u>
Unprotected Amount	<u>\$5.48</u>

Rather than across-the-board percentage cuts, specific budget reduction goals will be set for each agency.

October 2008

Dear Agency Director:

As you are well aware, revenue collections for FY 2009 remain below the budget forecast. It is not known at this time when the economic cycle will turn again to stimulate growth in revenues. We anticipate that up to \$300 million in savings, over-and-above expected revertments and not including fund transfers or shifts, need to be identified. Rather than waiting, Governor Napolitano directs that all state agencies take immediate action to reduce spending and control costs.

The Governor appreciates the manner and spirit in which state employees have already worked to achieve savings and cut costs.

While many of you may have already planned or initiated spending reductions, the Governor directs the following budget savings measures be continued:

- Set aside funds for possible budget reductions
- Expand vacancy savings beyond the enacted hiring freeze amount
- Restrict travel
- Use teleconferencing and telecommuting to reduce expenses
- Defer signing new services contracts; review existing contracts for possible savings
- Defer replacement of equipment
- Eliminate or reduce overtime expenses not critical to public health or safety
- Eliminate any expenses that are not mission critical and absolutely necessary
- Eliminate expenses for employee training that is not critical
- Increase productivity, e.g., number of inspections per day per staff member
- Reduce energy consumption and expenses, e.g., gasoline, electricity
- Increase collection of monies owed to the state
- Transfer expenses to non-general fund accounts wherever possible
- Obtain additional federal funds; leverage them to do more.

If you have recommendations for additional actions that might be helpful, please contact your OSPB analyst so your suggestions may be shared with all State agencies.

I believe our collective efforts and timely implementation of these budget spending reductions will help generate savings to enhance our ability to continue to deliver vital public services during this slow economic phase. Please let me know if you have any questions regarding these steps.

Sincerely,

James J. Apperson,
Deputy Chief of Staff for Finance and Budget
Director, Governor's Office of Strategic Planning & Budgeting

Section IV: Fund Transfers

OSPB will identify available fund balances that can be used to support General Fund expenditures without reducing mandated services of state agencies.

Some of the funds that may have available balances are:

- Citizens Clean Elections Commission Fund
- Drinking Water Fund
- Emergency Telecom Revolving Fund
- Indirect Cost Fund
- Industrial Commission Administrative Fund
- Job Training Fund
- Local Transportation Assistance Fund II
- Motor Vehicle Liability Insurance Enforcement Fund
- Parks State Lake Improvement Fund
- Risk Management Revolving Fund
- State Aviation Fund
- State Lottery Fund
- Tourism Fund
- Underground Storage Tank Revolving Fund
- Vehicle License Tax
- Water Banking Fund

The amount, if any, that is available for transfers from each of the more than 1,000 state funds is currently being evaluated. A preliminary list of amounts is expected to be available within two to three weeks, with a final list completed shortly thereafter.

Section V: Budget Stabilization Fund (Rainy Day Fund) Transfer

Summary

The Budget Stabilization Fund (BSF) for Arizona was enacted in 1990 (A.R.S. § 35-144). The BSF is designed to set revenue aside during times of above-trend economic growth and to utilize this revenue during times of below-trend growth. It is, in essence, the state's savings account. In prior years, the BSF has been tapped for uses not originally intended by the statute. For example, funds from the BSF were used to pay for the Arizona State Hospital in Fiscal Years 2000-2003. In Fiscal Years 2001-2007, BSF funds were transferred for payments on the Alternative Fuels Tax Credit. After these raids, the BSF was entirely replenished by FY 2008. The use of the BSF in the Governor's Budget Management Plan is exactly consistent with the intended use of the fund.

Funds from the BSF were used to help with the FY 2008 budget shortfall when the economy starting turning down. The current cash balance in the BSF is \$201,562,584.62¹, and approximately \$80 million is estimated to be used to balance the FY 2008 budget per Laws 2008, Chapter 53, Section 26. The Governor's proposal is to transfer \$120 million to the General Fund to help balance the FY 2009 budget, utilizing the BSF for its intended purpose.

¹Cash balance as of the end of August 2008 per the Arizona Financial Information System.