

STATE OF ARIZONA

Joint Legislative Budget Committee

STATE
SENATE

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HOUSE OF
REPRESENTATIVES

RUSSELL K. PEARCE
CHAIRMAN 2005
ANDY BIGGS
TOM BOONE
MEG BURTON CAHILL
PAMELA GORMAN
STEVE HUFFMAN
LINDA J. LOPEZ
STEPHEN TULLY

MINUTES OF THE MEETING

JOINT LEGISLATIVE BUDGET COMMITTEE

October 26, 2005

The Chairman called the meeting to order at 9:40 a.m., Wednesday, October 26, 2005, in House Hearing Room 4. The following were present:

Members: Representative Pearce, Chairman Senator Burns, Vice-Chairman
 Representative Biggs Senator Arzberger
 Representative Boone Senator Bee
 Representative Burton Cahill Senator Cannell
 Representative Gorman Senator Garcia
 Representative Huffman Senator Harper
 Representative Lopez Senator Martin
 Senator Waring

Absent: Representative Tully

APPROVAL OF MINUTES

Representative Pearce moved that the Committee approve the minutes of September 28, 2005. The motion carried.

EXECUTIVE SESSION

Senator Burns moved that the Committee go into Executive Session. The motion carried.

At 9:41 a.m. the Joint Legislative Budget Committee went into Executive Session.

Senator Burns moved that the Committee reconvene into open session. The motion carried.

At 11:20 a.m. the Committee reconvened into open session.

Senator Burns moved that the Committee approve the recommended settlement proposal by the Attorney General's Office in the case of Bond v. State of Arizona. The motion carried.

ARIZONA DEPARTMENT OF ADMINISTRATION (ADOA) – Review of Risk Management Deductible.

Mr. Tyler Palmer, JLBC Staff, said the deductible amounts are reviewed annually by the Committee. ADOA is not recommending any change from the \$10,000 deductible.

Representative Pearce asked if they have ever assessed the deductible against the Arizona Department of Transportation (ADOT).

Mr. Palmer said that during FY 2005, ADOA planned to assess a deductible against ADOT resulting from a case related to inadequate highway maintenance. However, ADOT avoided being assessed a deductible by submitting an accepted Agency Response regarding its maintenance program.

Representative Pearce asked if there was an explanation for the deductible being waived.

Mr. Ray DiCiccio, State Risk Manager, ADOA, said they have always used the deductible as incentive for all the agencies to minimize risks.

Representative Pearce said there have been several cases where clearly action by ADOT was needed to make a repair or improvement and it has taken months or even years to get it done and they were never assessed a deductible.

Representative Biggs said that if the deductible is never going to be enforced why have it.

Senator Martin said that it should be reversed and make the deductible automatic. The agency would then have to come before the Committee to get it waived.

Senator Burns moved that the Committee give a favorable review as recommended by the JLBC Staff to approve the current deductible amounts with no changes from the previous year. The motion carried.

JLBC STAFF – Consider Approval of Index for Construction Costs.

Mr. Jake Corey, JLBC Staff, said that this item was heard last month but action was deferred. He said that JLBC Staff has provided some additional information that will help the Committee regarding minimum school facilities guidelines and historical construction index data.

In response to Representative Boone, Mr. Corey said the numbers do not include a retroactive adjustment. Only projects that SFB approves in the current fiscal year can be adjusted. He said for the Bureau of Economic Analysis (BEA), a 9% retroactive amount would roughly add an additional \$20 million, and for Marshall Valuation Service (MVS) a 16.7% would roughly be \$40 million. This is just for new building construction.

Testimony was taken from parents in support of increasing the index for funding.

Representative Huffman noted that the Committee could only adjust the index on a prospective basis and not retroactive.

Representative Lopez noted that this is a crisis situation and would like legal advice on whether the Committee has the authority to take action on retroactivity and also what the Committee can do. In trying to bring the costs of the new schools down they are now taking on the appearance of a warehouse. She said it is not appropriate for children to be in that kind of environment.

Representative Pearce said that this is a review that is in statute and not a legal opinion. He said there would need to be a bill before the whole Legislature to deal with the retroactivity.

Representative Lopez said she would like to hear from the School Facilities Board (SFB) about how many schools have currently been approved.

Mr. John Arnold, Acting Director, SFB, said that he did not have that data but that there were 26 projects in 2005 with a total value of about \$263 million. He said he would have to provide the precise numbers. He said 5 or 6 have started construction already, with about 20 that have not yet started.

Representative Lopez asked if the Committee approved a cost increase last year.

Mr. Corey said last year the Committee approved a BEA increase of 1.4%.

Representative Burton Cahill asked how, with the schools having to strip down to the bare bones because the funding does not equal the actual cost of construction, do the schools deal with this.

Mr. Arnold said that the SFB works with square footage and the dollars that are tied to it. They meet with a school district and if they are going to build a K-6 school for 900 students, which gets 90 square feet per student, using the index they would determine how much money to award for that project. The district must produce the 90 square feet per student. If the estimate is over the formula amount, SFB looks at it to see if it is possible to be redesigned. Once SFB is satisfied that the design meets the guidelines of a new school, they would require that the district go out and bid the school. They would not allow an alternative bidding process. If the school is over budget SFB would go through their bidding process and make sure it was a fair bid. If that is the cost of the school they will award the additional cost.

In response to Senator Martin, Mr. Arnold said that what the law requires is that the state provides a minimum adequacy school. The guidelines do not speak directly to construction elements, however, a roof, windows, and doors would be included. He said in some cases carpeting might not be included.

Senator Cannell noted that if the taxpayers in a particular district are not happy with what the SFB award is they could tax themselves and build the school.

Mr. Arnold said they could always pass a bond.

Representative Pearce said that when Students First was being debated part of the original debate was that there would be no bonding because it was a response to a court order. They decided they would leave bonding for those districts that wanted to pay additional money for the items that were above what was called standard construction.

Senator Garcia asked if furring of block walls was included in the description of minimum standards.

Mr. Arnold said that furring block walls was done in order to insulate the walls. However, there have been some cases where that was determined to be beyond minimum guidelines. He said in some cases, data was presented to the SFB stating that temperature standards could not be met unless you fur the walls. That will need to be worked out and have a public discussion on it.

Representative Biggs asked if a school district can choose to bypass the SFB and build their own school.

Mr. Arnold said they can build their own school. The school is called "invisible space" and statute exempts it from the SFB formula. When the SFB examines a district to determine if new space is needed the invisible space does not show up.

Representative Boone noted that when SFB gives additional money above the square footage, they require the school district to do a hard bid to justify the additional expense. He said he wanted to publicly ask the SFB to take a look at the qualified select bidders list, which would eliminate taking a low bid from someone who may not be qualified for the job. He also asked Mr. Arnold which index more accurately reflects construction costs and inflation.

Mr. Arnold said that the BEA index is a national index and the MVS index is published with data specific to Phoenix. He said the MVS index would probably be more accurate for the Phoenix area.

Mr. Corey said that with any index you will see some negatives as well as positives. The BEA measures government activity and is nationwide. The MVS is local but only local to Phoenix so it potentially does not show what is happening in the whole state. It is a more specific index so there is more chance for it to fluctuate from year to year.

Mr. Richard Stavneak, Director, JLBC Staff, said that the choice between BEA and MVS is really a policy choice.

In response to Representative Boone, Mr. Corey said with the \$70 million in building renewal that was funded in FY 2006, the formula actually generated \$130 million: it would increase by \$11.7 million for 9% and \$21.7 million for 16.7%.

Mr. Jim Drake, Attorney, House Rules, said, in response to Representative Lopez's request for a legal opinion on the retroactive adjustment, that statutory law does not allow the Committee to "tweek" a retroactive adjustment. He agreed that it may be an issue for next session.

Senator Bee asked what constitutes a project moving forward and how many projects are moving forward.

Mr. Corey said that any projects that have been submitted to SFB but have not been approved to date would be considered moving forward.

Mr. Arnold said he does not know how many projects have been submitted but he would find out.

Senator Burns asked if a district submits a plan, is there a provision that allows the district to withdraw that plan and then resubmit.

Mr. Arnold said the statute requires that districts submit their capital plan by September 1 and then SFB has 6 months to address those plans. He said the board adopted a policy that does allow for cancellation of a project. However, the application is fairly narrow and that policy is for projects that were mistakenly approved. Projects are approved based on a 2-year projection. The projection shows the growth in the district. However, approximately 1 year later when it is time to build the school, SFB looks at the district's growth and if they have not met the growth, SFB will put the project on hold until they grow into the school. SFB allows districts at that point, to request cancellation of the project. The policy states they cannot request a cancellation and resubmittal of the project in the same year.

Senator Waring asked if you pick option 2 in the JLBC recommendation letter of 6.4% then all projects going forward starting today would get 6.4%, but if someone ran a bill next session to do the retroactive, they could also be in line for that too.

Mr. Arnold said if the board adopts 6.5% then every project initially approved but slated to go forward from this point would receive the 6.5%.

Representative Pearce said the 6.5%, or whatever is approved, would not apply to retroactive projects, it would only allow the others to be brought up to that amount.

Representative Boone asked if a district could come back to SFB and show that they cannot build a school at that cost if they had initial approval prior to today. He thought the SFB had flexibility to do that.

Mr. Arnold said that if the district goes through that process and says they have a school they cannot build within the square footage formula the SFB is required to build a minimum school regardless of the cost.

Mr. Arnold said that the Attorney General issued an opinion last year and it carefully lays out how SFB approves schools, including when inflation is appropriate.

Senator Burns moved that the Committee approve a 9% increase in the cost-per-square-foot factors using the new School Facilities and Building renewal formulas. For new construction the adjustment will apply to any future projects that received their initial approval to the design phase on or after October 26.

Senator Garcia made a substitute motion that the Committee approve a 12% increase in the cost-per-square-foot factors using the new School Facilities and Building renewal formulas. For new construction the adjustment will apply to any future projects that received their initial approval to the design phase on or after October 26.

Senator Waring asked what the percentage difference is in dollars.

Mr. Corey said that the first motion of 9% would cost about \$20 million per new construction, and the 12% would cost \$27 million.

The Garcia substitute motion failed.

Representative Boone stated that he wanted to make a substitute motion because of the difference between BEA and the MVS index. One is on the high side and one is on the low side. The testimony, both by the JLBC Staff and the SFB, indicates that a more accurate figure for the index should probably be somewhere between the 2. Exactly half of the difference between the 2 would be 12.85% and would be an additional \$8.5 million for construction costs. It will not affect building renewal for this year or for 2007.

Representative Boone made a substitute motion that the Committee approve a 12.85% increase in the cost-per-square-foot factors. For new construction the adjustment will apply to any future projects that received their initial approval to the design phase on or after October 26.

Representative Pearce said the Committee could revisit this issue as frequently as necessary if they find their numbers are not adequate.

Representative Huffman said that the Committee is trying to solve a puzzle with 1 small piece of the puzzle. There are clearly layers and layers of problems in terms of statutory authority, decisions that the SFB is making, and it is a classic case of a state bureaucracy trying to make some local decisions and the tools that are available are not exactly what is needed to deal with this specific issue. He said Representative Boone's substitute motion seemed reasonable.

Representative Pearce said staff has worked on this problem and has come up with a number that is fair based on their research and he did not want to move on using another number that they have not worked on. If they find they need to revisit this to make an adjustment it can be done at a future meeting.

Representative Huffman said that with BEA and MVS being different they are best-guessing at what will work the best for the SFB and the school districts and for a number of reasons construction costs have been greatly affected.

Representative Boone said he did not want to have to come back and revisit this issue next year.

The Boone substitute motion carried.

ARIZONA BOARD OF REGENTS (ABOR) – Review of FY 2006 Tuition Revenues.

Ms. Amy Strauss, JLBC Staff, said that this item is a request for review of their expenditure plan for tuition revenue amounts greater than the amounts appropriated by the Legislature. Footnotes for ASU, NAU and the UofA in the FY 2006 General Appropriation Act appropriate all tuition collections for operating expenditures, capital outlay, and fixed charges and mandate the Committee's review. At the September 28, 2005 JLBC meeting, the Committee did not take action on this item until the universities could provide additional information related to financial aid allocations, Alumni Association funding, and tuition collections from first-year and continuing students. JLBC Staff has included this information in the agenda book.

In response to Senator Martin, Mr. Stavneak said the circumstance exists where the university raises tuition, they then decide how much they are going to keep in their non-appropriated portion. Typically, financial aid is funded from the non-appropriated portion. Then whatever is left after they make that decision ends up in their appropriated budget. There is a footnote in the General Appropriation Act that says appropriated money cannot be spent on scholarships.

Senator Burns asked how ABOR decides as to how much is appropriated or non-appropriated.

Mr. Mark Denke, ABOR Assistant Executive Director for Academic and Student Affairs, said each institution decides for itself and makes recommendations to the board for approval of what their needs are in terms of revenues and financial aid. The board requires an institution to set aside at least 14% of their tuition revenue for financial aid.

Representative Pearce said that if the state does not give the institution enough money then the tuition revenue is redirected to take care of the things that ABOR thinks the university should have.

Mr. Denke said the state appropriation has a direct impact on the setting of tuition as well as applications for financial aid.

Senator Burns asked what kind of tracking is taking place relative to students that receive financial aid. He said it has been brought to his attention that there may or may not be a rather significant failure rate of some of the students on financial aid.

Mr. Denke said they do have accountability reports that they require from the institutions.

Representative Pearce said he would like information on how many students who get financial aid drop out and how many graduate.

Senator Burns said he would like that information for all 3 universities available to the Committee. He would like actual numbers of students as opposed to percentages.

Mr. Jim Rund, Vice President for Undergraduate Initiatives, Arizona State University, said they have tracked those success rates and they are at or above the all-student average.

Senator Waring said that the all-student average is very low and the graduation rate in Arizona needs to be higher.

Mr. Rund said that there is national data that speaks to the issue of financial support and its success. There is a direct correlation between the level of institutional need-based financial aid and the college success rate. They have seen their success rates increase.

Representative Pearce said there has been a 70% increase in tuition in a very short period of time. He has a concern that middle class students are being forced out by these tuition increases. He asked how many students is a needs-based versus those with scholarships or subsidy for their education.

In response to Senator Martin, Mr. Rund said that 14% is the standard ABOR set to be used for assistance in tuition.

Mr. Rick Crock, Assistant Vice President for Enrollment and Research, University of Arizona, said they do track students who receive financial aid and are concerned with increasing the attrition rate. If they are receiving a merit aid award they have to maintain a certain GPA, basically a B average. A lot of the merit-based aid goes to students who have demonstrated financial needs.

Senator Waring asked what would be a good percentage of students on financial aid graduating.

Mr. Crock said some institutions have graduation rates of around 90%. Those institutions have many students with a 4.0 GPA. But institutions where there is wider access such as theirs, they have a rate of 57% and they think they can get it into the 70s.

Senator Burns asked if UofA would also provide tracking data on students receiving financial aid.

Mr. Crock said they would provide that data.

Senator Martin said that in total 31.73% went to financial aid and asked what happened to the other dollars collected from tuition. He noted that it does not look like all the money raised for financial aid is going to financial aid.

Senator Burns said one connection he cannot make is that tuition money is used to support the Alumni Association. He said it does not make sense to use tuition money for that purpose.

Senator Cannell said he agreed with Senator Burns with the exception that if the Alumni activity brings in a lot of money to the university it would make sense to allow that.

Mr. Scott Smith, Arizona State University, wanted Mr. Rund to elaborate on the things they are doing for undergraduates to improve retention and ultimately graduation rates.

Mr. Rund said that it is the desire of ASU, and he believes with the other 2 universities, to rely more heavily on their development efforts to shift the burden of financial aid to relieve the impact on tuition. The university president did

remark at a private fund raising effort that \$150 million is benchmarked from private sources to reduce the amount of tuition that is needed. In respect to performance, the goals are to improve the quality of learning in the classroom, to increase the level of academic support for all their students. They have seen marked improvement in success rates from these efforts. There is no question that demographics has an impact in a comparative way on their success rate.

Mr. Smith said that the Alumni Association has an advocacy roll on behalf of the university. Those efforts are funded out of private contributions that are made to the Alumni Association or revenues that they generate. No public monies are dedicated for those purposes.

Senator Harper said he suggests that they keep their Alumni Association 501C3 and the 501C4 separate because he believes that is a clear violation of law to co-mingle those funds.

Senator Burns moved that the Committee give a favorable review to the expenditure plan for tuition revenue amounts greater than the amounts appropriated by the Legislature. The Committee further recommended that the universities do not use tuition revenues in support of their alumni associations. The motion carried.

Chairman Pearce adjourned the meeting at 1:10 p.m.

Respectfully submitted:

Cheryl Kestner, Secretary

Richard Stavneak, Director

Representative Russell Pearce, Chairman