Legislature adopts FY 03 budget

Huge deficit looms for FY 04

The tumultuous deliberations over the fiscal year (FY) 2003 budget came to an end at the Arizona State Legislature on May 23.

Faced with a deficit surpassing $931 million, lawmakers used a combination of debt financing, a sizeable expenditure deferral into next year, and a series of agency cuts to fulfill, technically at least, their constitutional obligation of maintaining a balanced budget.

According to a summary from the Joint Legislative Budget Committee (JLBC), the FY 2003 budget fix was achieved by using $197 million in “one time fund transfers and other revenues” and a $735 million “reduction in the FY 03 spending level.”

A significant part of the spending “reduction” involved deferring until FY 2004 $191 million in state aid payments to K-12 school districts (otherwise known as the K-12 rollover).

Several sizeable budget changes involved the School Facilities Board (SFB), where legislators found $401 million (43%) of the $931 million deficit. $90 million was cut from the $128 million called for in building renewal formulas.

The largest “savings” came from the SFB’s new school construction fund. The $311 million the SFB had originally requested from the State Treasury for new construction was whittled down to $240 million, which is now designated to be paid for in future years through a “lease-to-own” (LTO) plan requiring no payments in FY 2003 (see page 4).

The remaining amount (approximately $143 million) in cuts are attributable to 3.125% or 2.25% lump sum reductions and other changes to agency budgets.

See Lease-to-own, page 4.

May budget revisions get some school districts around excess utilities freeze

Similar last-minute increases over deseg caps may be disallowed

Despite efforts to freeze school districts’ access to property taxes and state subsidies to offset homeowner levies, several school districts made last minute budget changes last month that, in effect, wipe out any associated general fund savings that were part of the state budget finalized on May 23.

The education budget bill, House Bill (HB) 2710, included a provision freezing school district budgets for excess utilities for two-years at their current (FY 2001-2002) levels. In addition, HB 2550, passed earlier in the session, enacted a two-year freeze on budgeted expenditures for desegregation.

Excess Utilities Budget Revisions Unravel General Fund Savings

State law provides a formula that determines a maximum amount districts can spend on utilities (heating, cooling, electricity, telephone, etc.) Any amounts in excess of that amount (thus excess utilities) are funded primarily through school district property taxes.

Proposition 301 enacted laws that, after FY 2009, eliminates the ability for school districts to exceed their budget limits and levy property taxes for excess utilities.

However, Prop. 301 did not cap excess utilities or phase it out. Meanwhile, budgeted excess utilities expenditures have increased from approximately $60 million last year to $68 million in FY 2002.

The Legislature’s decision to make a two-year cap on excess utilities part of the state budget was a direct result of ATRA’s support for legislation during the last two sessions to cap excess utilities budgets at current levels.

A fiscal note from the Joint Legislative Budget Committee (JLBC), assuming a two-year average growth of 8.5%, pegged the FY
School elections for capital add to SFB spending

Arizona’s Students FIRST legislation is now about four years old. Enacted in 1998 the School Facilities Board (SFB), a creation of Students FIRST, began spending enormous sums of money on school construction and repairs by 1999.

In fact, since it began its work, the SFB has encumbered $1.3 billion in new school construction, $1.2 billion to correct deficiencies, and distributed another $380 million in building renewal.

The prospect of so much new spending on school capital was the rationale state leaders had for their claim that Students FIRST was “the biggest property tax cut in Arizona history.”

At the time, ATRA expressed skepticism that it would indeed reduce school district property taxes, and the evidence so far has not lent itself to relieving us of that skepticism.

The Debt Oversight Commission has reported that between FY 1998-99 (the year just prior to SFB’s startup) and FY 2000-01, school district outstanding bonded indebtedness increased $45.7 million.

That report misses, however, much of the recently incurred debt. Since 1999, $424.6 million of new bonds (called “Class B” bonds to distinguish from the older “Class A” bonds issued prior to Students FIRST), have been approved at the polls. A handful of districts that are impacted by federal land, such as reservations, have been using the new authority to issue “impact aid revenue bonds,” of which over $32 million were approved last November.

Infrequently used in the years prior to Students FIRST, districts appear to be turning to capital override elections more often in recent years. Although several overrides have been rejected by voters, $24 million have succeeded. Our prediction is that, at least under current law, capital overrides may become more popular. These tax levies can exist for seven years and can overlap previous overrides.

There are also indications that efforts are underway to make such overrides easier to pass at the polls. For example, the Cave Creek Unified governing board recently deliberated on eliminating the word “override” from the district’s proposal, citing the word’s bad connotations.

There are several other funds designated for capital as well. The capital outlay revenue control limit (CORL), the main capital component of K-12 funding formulas, produced approximately $204 million in FY 2002, 76% of which was transferred to M&O. Districts statewide budgeted about $35 million in property taxes for capital projects under adjacent ways. Some districts that levy property taxes under state law for desegregation and OCR earmarked over $13.3 million of those revenues for capital in FY 2002.

Students FIRST also provided additional revenue as part of the soft capital allocation (SCA). Replacing the old capital levy revenue limit (CLRL), which produced about $134 million in 1998, the SCA was projected to add an additional $36.5 million by 1999. Although CLRL and the SCA are not tracked separately, simply recognizing the $36.5 through a four-year period means at least $146 million was injected into school district spending for soft capital as part of the Students FIRST package.

Michael Hunter
Budget revisions get some school districts around new two-year caps (Continued from page 1)

2003 savings at $1,077,100 and the FY 2004 savings at $2,245,800. These figures represent projected amounts the state would have had to pay (without the freeze) to school districts in “additional state aid” because of the 35% homeowner rebate and the constitutional one-percent cap on homeowner property taxes.

Several school districts appear to have taken the May 15 deadline as an opportunity to increase their excess utilities capacity before the two-year freeze was locked in.

It is not uncommon, and is specifically authorized in statute, for school districts to revise the excess utilities budgets prior to the May 15 deadline. In fact, net changes to budgeted excess utilities during FY 2000-2001 totaled $3.8 million and no individual district’s revision reached $1,000,000.

This year, however, net changes to budgeted excess utilities came to $10.4 million.

Several school districts appear to have revised their budgets as they normally would without consideration of the pending freeze.

Some districts, however, revised their budgeted excess utilities specifically to increase their budget capacity for the duration of the freeze.

“It will not cost taxpayers anything.”

Chandler Unified’s business officer, Joel Wirth

Chandler Unified’s governing board, for example, increased budgeted excess utilities by $1,000,000 on May 8. Minutes from the board meeting leave no doubt as to the reasons for the increase. Following is an excerpt for the adopted minutes recounting the recommendation of district business officer, Joel Wirth.

“Mr. Wirth also made one request based on action going on at the Legislature today. When Prop 301 was passed it was agreed that Excess Utilities would go away in the year 2008. The latest thing he has heard is that Excess Utilities may be frozen at this year’s budget limit. Therefore, he recommended that the district increase the Excess Utilities Budget limit by $1,000,000. It will not cost the taxpayers anything. It would protect the limit for future use.” [emphasis added]

Similar last-minute increases took place in school districts across the state. Mesa Unified adopted a revised budget on May 14 that included a $1.9 million (49%) increase.

The largest increase was in the Tucson Unified School District (TUSD). On May 14, TUSD’s governing board approved a $3.4 million increase in budgeted excess utilities, taking that line item from the originally adopted $4.2 million to $7.6 million, an 81% increase.

Because the effective primary property tax rate for homeowners in TUSD is over the one-percent constitutional cap, all of the increase for homeowners is picked up by the state general fund. Thus in TUSD’s case, a $3.4 million levy increase results in about a $1.7 million hit to the state, effectively wiping out the anticipated savings from the two-year excess utilities freeze.

A TRA learned of the revisions just prior to the finalization of the state budget and had an amendment prepared that would have been offered by Senator Ken Bennett in conference committee. Bennett told colleagues in the Senate Republican Caucus that the district budget revisions had seriously jeopardized the effort to balance the state budget.

However, the Senate overrode Bennett’s appointment to the conference committee and a new sponsor for the amendment could not be found. A TRA argued that the revisions would undo the anticipated impact of the two-year freeze and that only those districts with paid lobbyists at the Legislature would know to take advantage of the revision opportunity.

Despite the fact that several key legislators recognized that the last minute school adjustments may have thrown the budget out of balance (the ending budget balance was a meager $3.5 million), the amendment met with a degree of reluctance to disrupt the budget process as it limped toward the finish line.

Unprecedented May Revisions to Desegregation Budgets

Similar to the increases in excess utilities, two districts’ unprecedented revisions to budgeted desegregation expenditures may be disallowed by the Arizona Department of Education (ADE).

Of the 19 districts currently levying property taxes under state desegregation funding laws, the Flagstaff Unified School District (FUSD) and the Phoenix Union High School District (PUHSD) saw fit to revise their budgeted desegregation expenditures and increase their deseg budget capacity before the two-year freeze required by HB 2550 (see the ATRA Newsletter for April/May 2002). PUHSD’s board increased budgeted desegregation expenditures for FY 2001-2002 by $2,260,577 to $48,700,656 (a 5% increase) on May 2, mere days after passage of HB 2550.

“I sincerely hope this is not an indication of Phoenix Union’s willingness to cooperate in the future,” said Representative Steve Huffman, sponsor of HB 2550.

FUSD’s board revised its FY 2001-2002 deseg expenditures by $526,877 (27% increase).

An ADE official told ATRA that they believe school districts do not have the authority to revise their budgeted desegregation expenditures, even without the passage of HB 2550.

The department representative said ADE will soon inform ATRA and the districts whether the increases will not be allowed.

Michael Hunter
**LEASE-TO-OWN**

No payments for 12 months

The LTO provisions in the budget came to the fore after a significant number of House members expressed their reluctance to vote for a budget that contained debt financing through revenue bonds for new school construction.

Ultimately, SFB received statutory authority to enter into $400 million in LTO arrangements for FY 2003 and $200 million each year starting with FY 2004. SFB staff anticipate needing $250-$300 million in FY 2003.

No monies were appropriated in FY 2003 for the LTO arrangements. The lease payments, the nature of which are unclear at this time, would not come due until FY 2004.

Several questions were raised by representatives from the financial and construction industries, not to mention ATRA, about the feasibility of a LTO mechanism to build schools.

At this point, the new LTO law appears to provide for the SFB to lease a facility on behalf of a school district from a private company who maintains ownership of the building. At some contractually designated point in the future, SFB can either: 1) purchase the facility in full and turn it over to the district; or 2) fulfill the lease contract and relinquish the facility back to its private owner.

Although much of the new law deals with separate “local” LTO arrangements for individual school sites, it is possible that the SFB will issue “certificates of participation” in large enough sums to continue to pay for school construction in a manner similar to that which they would have done with revenue bonds.

The new law states that the LTO “obligation . . . is a current expense, payable exclusively from appropriated monies, and is not a general obligation indebtedness of this state or the school facilities board.”

If such appropriations do not take place, the LTO agreement “terminates at the end of the current term and this state and the school facilities board are relieved of any subsequent obligation.”

Much of the details of LTO arrangements remains to be determined. Ultimately, the question remains as to the practical differences between LTO arrangements and other forms of debt.

Several members of the Arizona Senate, concerned that the LTO provisions would unnecessarily increase school construction costs, tried to amend the bill with authorization for more traditional revenue bonds. However, any inclusion of revenue bonds undermined the agreement struck between House and Senate Appropriations Committee chairs.