



LEGISLATIVE ISSUES

Impact of 2015 State Budget Shortfall

Arizona projects a budget deficit of \$520 million in FY15 and \$1 billion in FY16 according to the State's Joint Legislative Budget Committee, and yet, only two years ago, the State was sitting on a \$900 million surplus. How did the State move from a significant surplus of revenue to a large shortfall? Top among several issues causing the budget shortfall is a \$336 million yearly cost for the next five years to resolve a pending lawsuit that requires the State to increase inflation funding for K-12 education to all public schools. Governor Jan Brewer is appealing the ruling, but Governor-elect Doug Ducey may advocate for a settlement. In addition, there is another \$252 million a year potential payment required for five years in back pay to K-12 teachers resulting from the failure of legislative appropriations to keep up with inflation. This could bring the projected shortfall to over \$1 billion annually until 2018.

The State is also facing a structural deficit, meaning that ongoing annual revenues do not keep up with ongoing annual expenditures. In 2010, the Legislature used a 1¢ sales tax to temporarily increase revenue. When that \$900 million sales tax terminated in 2013, the State enjoyed a one-time carry forward in 2014. That carry forward is now gone. In addition, the following issues contribute to the budget shortfall:

- State tax revenue has not grown as projected and is only growing at 1.8%.
• Corporate tax receipts are 10% lower than projections for 2014.

- In 2011, a law was passed which reduced the corporate income tax rate. Beginning in FY15, the corporate income tax rate reduces over five years from 6.968% to 4.9%. The result is a revenue loss of approximately \$35 million in FY15 and an additional \$35 million in each of the ensuing four years.
• A statutory change which increased the sales tax exemption for out-of-state services provided by Arizona companies, further diminishing State revenue by between \$21 million and \$25 million annually.

Further complicating the revenue projections for the State is slower job growth of only 2% as opposed to the typical 3.9%. The population growth is still lagging at between 1% and 1.5% compared to the historical level of 3.1%. Building permits are only 18,000 for the last year—far below the pre-recession level of 39,000. Finally, Arizona has also suffered lower tax revenue as a result of the reductions in federal defense contracts for companies in the State.

To address the budget shortfall, the Legislature may have to use a \$500 million rainy day fund. As stated above, the State's budget deficit is calculated to reach \$520 million this fiscal year. Therefore, the Legislature must make additional budget cuts, fund sweeps, and implement efficiency measures which could impact a variety of State services. Conversely, tax increases do not seem to be a viable option, as the newly-elected Governor and many members of the House and Senate have loudly rejected any tax increases.

FOR FURTHER INFORMATION, PLEASE CONTACT:

Rob Dalager (602) 530-8540 rob.dalager@gknet.com
Alexis Glascock (602) 530-8324 alexis.glascock@gknet.com
Deb Gullett (602) 530-8399 deb.gullett@gknet.com



2575 East Camelback Road | Phoenix, Arizona 85016-9225
Phone (602) 530-8000 | Fax (602) 530-8500



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Governor-Elect Ducey: His Budget and Other Transition Teams

The Governor-elect asked former Senator Jon Kyl, former House Speaker Kirk Adams, and Former Brewer Chief of Staff Eileen Klein to co-chair his transition team. Ducey has just named former House Speaker Kirk Adams to serve as his Chief of Staff. Among Ducey's transition teams, the Budget team was quickly assembled because State law requires the Governor to present a budget proposal to the Legislature by January 16, 2015. Ducey created a transition "budget study committee" so that he has a prepared budget before he is sworn into office on January 5th. The members are John Arnold, Governor Brewer's Director of the Office of Strategic Planning and Budget, and Michael Hunter, Governor Brewer's Director of Policy and tax-reform adviser. Other budget study committee members are Jennifer Stielow, Vice President of the Arizona Tax Research Association, Tom Manos, Maricopa County Manager, and D.J. Cole, CEO of the Community Association Management Company and former Chief Financial Officer of Cold Stone Creamery (the Governor-elect's former company). Ducey promises to go through the budget "line by line" and not increase taxes.

Other transition teams announced to date include committees on state trust lands, tax reform, health, local government and transportation, rural and tribal affairs, federalism and state's rights, water, environment and energy, crime justice and child safety, regulatory reform, military affairs, and education.

House and Senate Leadership Decisions

Both chambers have elected their majority and minority caucus leadership teams and appointed the chairs of their respective committees. In the House, the new Speaker will be Republican David Gowan, the Majority Leader Representative Steve Montenegro, and the Majority Whip Representative David Livingston. In the Senate, the President will continue to be Republican Andy Biggs, the Majority Leader Senator Steve Yarborough, and the Majority Whip Senator Gail Griffin. The top, and possibly only, priority for the Legislature is passing a balanced budget. However, as with every legislative session, there will be a plethora of interesting and unexpected bills sufficient to divert everyone's attention.

Preview of Legislative Issues
Coming in January

The Government Relations and Lobbying team at Gallagher & Kennedy has years of experience monitoring the Legislature and the issues our clients care most about that can affect their businesses, including:

- Tax
- Industry Regulations
- Employment Issues
- Economic Development

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<u>Deb Gullett</u>	(602) 530-8399	<u>deb.gullett@gknet.com</u>

Gallagher & Kennedy

2575 East Camelback Road | Phoenix, Arizona 85016-9225
Phone (602) 530-8000 | Fax (602) 530-8500

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