

Presentation to the Legislature on Alabama's Financial Condition
December 14, 2009

I. Introduction

- A. Today, I will discuss with you the revenue and appropriation structure of the state; the status of the General Fund and the Education Trust Fund for FY 2008 and FY 2009; the revised LFO revenue estimates for FY 2010; the LFO revenue forecasts for FY 2011; and a few general fiscal issues
- B. I will not discuss agency-specific issues today because this Committee will talk with agency directors directly this week

II. Revenue and Appropriation Structure of the State

- A. Exhibit 1 shows the appropriation of all state funds for FY 2010 as of November 30, 2009 (after 7.5% proration of the ETF and including reverted and reappropriated funds)
 - 1. For FY 2010, the General Fund appropriations total \$1.6 billion of the grand total of \$10 billion in state appropriations
 - 2. The ETF appropriations total \$5.3 billion and other earmarked appropriations total \$3.2 billion
 - 3. The Alabama Medicaid Agency will receive the largest amount of General Fund appropriations, \$308 million, or 19.6% of the entire fund for FY 2010

- a. This is an artificially low percentage because of the appropriation of federal stimulus funds for Medicaid in FY 2010
- b. In FY 2009, before the federal enhanced matching rate due to the federal stimulus program, Medicaid received an appropriation of \$623.8 million from the General Fund, which represented 30% of the fund
- c. Medicaid will also receive other earmarked state funds in FY 2010 totaling \$620.3 million (excluding departmental transfers)
 - i. this is also the largest amount of earmarked funds outside of the Education Trust Fund
- d. Medicaid has a total of \$928 million in state funds which are used to match federal funds primarily at the rate of \$3.47 in federal funds for every \$1 in state funds for FY 2010 as the result of the enhanced federal match
 - i. As part of the American Recovery and Reinvestment Act passed by Congress in February, states were allowed to draw down a larger federal match from October, 2008 to December, 2010
 - ii. The regular federal match in Alabama results in a drawdown of

approximately \$2.13 in federal dollars for every \$1 in state funds

e. Medicaid expenditures are a major economic factor in Alabama and are a driving force in the General Fund budget

4. The Departments of Corrections and Youth Services were appropriated \$269.7 million from the General Fund, representing 17.2% of the fund for FY 2010

a. that amount is artificially low as well, since the Department of Corrections received an appropriation of \$118.6 million in federal stimulus funds from the Fiscal Stabilization Fund that is a part of the American Recovery and Reinvestment Act that was available for states to spend as needed

b. no federal fiscal stabilization funds are expected to be available for FY 2011 for General Fund purposes

c. in FY 2009, the Department of Corrections and Youth Services received \$387.4 million from the State General Fund, or 18.7% of the fund

5. In a regular year, Medicaid and Corrections make up almost 50% of the General Fund

B. Exhibit 2 shows the percentage that certain revenue sources contributed to the General Fund in FY 2009

1. insurance premium taxes accounted for the largest single source of revenue at 14.9% of

the fund (this tax is in lieu of income taxes for insurance companies)

a. CAPCO credits

- i. An act in 2002 created the CAPCO program, which allowed the Alabama Development Office to allocate up to \$100 million in insurance premium tax credits to insurance companies making investments in ADO-certified venture capital firms
- ii. The maximum amount of credits available in a fiscal year under this act was \$12.5 million
- iii. The negative effect of these credits on the General Fund was first realized in FY 2006
- iv. An act passed in 2007 extended the CAPCO program by allocating an additional \$100 million of insurance premium tax credits (the maximum amount of credits in any one year allowable under this act will be \$17.5 million)
- v. The negative effect of these additional credits will first be realized in FY 2011 and it is projected that \$3.5 million in additional credits will be taken in FY 2011

2. Interest income accounted for almost 8% of the General Fund
 - a. this includes interest on regular state deposits as well as interest earned on the Alabama Trust Fund
 - b. the extremely low interest rates and the lower balances in state funds and within the Alabama Trust Fund have lowered receipts to the General Fund
3. Oil and gas severance taxes accounted for 5.9% of the fund
4. Property taxes accounted for 8.6% of the fund-the General Fund receives 2.5 mills of the state's 6.5 mills of ad valorem tax (most property taxes are levied by local governments)
5. One-time receipts accounted for 12.4% of the fund, for a total of \$198.8 million, including
 - a. a transfer from the business privilege tax escrow account-\$108 million
 - b. a transfer from the Incentives Financing Authority-\$38.8 million
 - c. transfers from pharmaceutical settlements-\$52 million
6. You can see the other major sources of revenue to the General Fund on this pie chart

C. Exhibit 3 shows the percentage that certain revenue sources contributed to the ETF for FY 2009

1. income taxes (both corporate and individual) accounted for 53.4% of the ETF
2. sales taxes accounted for 25.8% of the fund
3. utility taxes accounted for 7.2% of the fund
4. the “other” category accounted for 9.3% of the fund, which is a higher percentage than usual because of the transfer of \$437.5 million from the Constitutional Rainy Day Account
5. there are fewer sources of revenue to the ETF than the General Fund, but most of the growth taxes are earmarked for the ETF
6. this is a double-edged sword in that these revenue sources respond quickly to shifts in the economy
 - a. the downward shift in the economy was fully evidenced in FY 2008 and FY 2009
 - b. I have asked the Legislature each year to spend less than LFO revenue estimates to allow for economic cycles, which affect the ETF very quickly
 - c. this Legislature provided a mechanism in past years of high growth for setting aside funds in the Statutory Proration Prevention Account, which allowed the state to avoid cuts to educational entities in FY 2008
 - d. a balance of \$439 million accumulated in this account over a 3-year period (FYs 2004, 2005, and 2006), mainly as

- a result of the Legislature setting aside 75% (instead of the statutory requirement of 20%) of unanticipated and unappropriated beginning balances
- e. this 75% requirement was permanently adopted in the 2008 Special Session
- f. when the economy *does* improve, the ETF will once again have a statutory savings account

III. Economy

A. National Economy

1. according to the National Bureau of Economic Research, the current recession began in January 2008 and has lasted longer (23 months thus far) than any recession since the Great Depression (43 months)
2. the U.S. economy began losing jobs in June of 2008
3. the U.S. economy had 4.8 million fewer jobs in November 2009 than in November 2008
4. the Federal Reserve Board's Open Market Committee, in the minutes of its November 3rd and November 4th meetings, noted that overall economic activity in the U.S. had shown signs of improvement in recent months
 - a. For example, the manufacturing, housing, and household spending

sectors of the economy showed signs of improvement

5. however, the Committee also noted that the labor market continues to weaken
 - a. The Committee expects the national unemployment rate to remain above 9% throughout 2010 and above 8% throughout 2011
6. some economists are predicting that the recession has either already ended or will end in 2010
7. however, the recovery is expected to be gradual, especially in the labor market
8. there are still segments of the economy that are extremely unstable, including the commercial real estate and credit markets

B. Alabama's Economy

1. the growth in employment in Alabama began to decline in February 2008
2. however, Alabama continued to add jobs at a slower rate through August 2008
3. in October 2009, Alabama's number of employed declined by 95,600 from October 2008 resulting in an October, 2009 unemployment rate of 10.9%
4. true gross state sales tax receipts (after factoring in timing issues) have been negative for the past 15 months
5. three areas of state government directly illustrate the dire economic conditions

- a. Medicaid enrollment increased by 48,764 individuals in FY 2009 as the result of more people meeting the eligibility requirements
- b. Initial unemployment claims increased by 213,840 in FY 2009 (a 77.3% increase)
- c. The number of food stamps issued increased by a monthly average of 48,885 households in FY 2009 (contrast that with an average monthly increase of 10,823 in FY 2008)

IV. Exhibit 4 shows the Condition of the General Fund for FY 2008 and FY 2009

- A. I am showing you both FY 2008 and FY 2009 conditions of the General Fund to illustrate the effects of the federal stimulus funds on the General Fund budgets
- B. The General Fund began FY 2008 with a beginning balance of \$239 million
- C. Normal receipts for the year were \$1.5 billion
 - 1. transfers from various agencies and funds totaled \$53.7 million
 - a. Public Service Commission: \$3.8 million
 - b. Securities Commission: \$1.5 million
 - c. Additional abandoned Property Receipts: \$15 million
 - d. Corrections' Asset Sales Proceeds: \$17 million
 - e. Tobacco Revenues: \$12.2 million

- f. Regular reversions:\$4 million
- 2. I do want to mention 4 significant sources of extraordinary revenue
 - a. a transfer from the business privilege tax escrow account of \$19 million
 - i. this is the escrow account that has been used to pay refunds for claims against the old franchise tax, which was declared unconstitutional in 1999
 - ii. you will see when we talk about FY 2009 that we transferred most of the remainder of the balance in that account
 - b. \$85.8 million was received from the Exxon litigation
 - i. The state sued Exxon in 1999 alleging that Exxon had intentionally underpaid oil and gas royalties owed to the state
 - ii. Two jury trials awarded the state compensatory and punitive damages
 - iii. The Alabama Supreme Court threw out the punitive damages and reduced the compensatory damages to \$142.5 million
 - iv. \$85.8 million was the General Fund's share of that award

- c. at the beginning of FY 2008, the Alabama Trust Fund Board recognized \$165.4 million in unrealized capital gains
 - i. the General Fund's share was \$117.3 million
- d. transfer from pharmaceutical settlements of \$4.7 million

D. Therefore, there were Total Receipts of \$1.8 billion

E. Total Available was \$2.1 billion

F. Total Appropriations were \$1.9 billion

G. There were \$48.9 million in reversions

- 1. the FY 2009 budget reappropriated to state agencies those reverted funds

H. The General Fund ended FY 2008 with a balance of almost \$219 million and began FY 2009 with that amount

I. Normal receipts in FY 2009 were \$1.4 billion, a reduction of almost \$154 million from the previous fiscal year

- 1. the revenue sources mainly responsible for this decline included
 - a. Interest income receipts (both regular deposits and the interest from the Alabama Trust Fund) declined by \$45 million (\$172 million to \$127 million)
 - b. Oil and gas severance tax receipts declined by \$52 million (from \$146 million to \$94 million)

- c. Abandoned property tax receipts declined by \$13 million (\$30 million to \$17 million)
 - d. Insurance premium taxes declined by \$24 million (\$262 million to \$238 million)
 - e. Sales tax on autos declined by \$20 million (\$80 million to \$60 million)
2. transfers from other agencies and funds totaled \$23.5 million
- a. Public Service Commission: \$3.8 million
 - b. Securities Commission: \$1.5 million
 - c. Deposit from court order for DA in the 5th Judicial Circuit: \$437,500
 - d. Tobacco Revenues: \$14 million
 - e. Regular transfers and reversions of \$4 million
3. Three transfers that I will discuss are the
- a. \$108 million transfer from the business privilege tax escrow account which I mentioned earlier
 - b. \$52 million from pharmaceutical settlements
 - c. \$38.8 million transfer from the Incentives Financing Authority as a result of refinancing bonds

J. Total Receipts were \$1.6 billion

K. Total Available was \$1.8 billion

L. However, total appropriations for FY 2009 were almost \$2.1 billion

M. The Governor instituted a “Deficit Prevention Plan” in which he

1. Required many state agencies to transfer 10% of their appropriation into an “1800 Account” from which they were not allowed to expend
2. Instituted a hiring freeze
3. Froze merit raises for a year

N. The state began to see the effects of the American Recovery and Reinvestment Act that was signed by the President in February 2009

1. Two aspects of the federal stimulus act directly benefited the General Fund in FY 2009, FY 2010, and, to a much lesser extent, FY 2011
2. One aspect was the enhanced federal match for Medicaid and other state agencies that provide Medicaid services
 - a. In FY 2009, Alabama received approximately \$354 million in General Fund savings from the enhanced federal match
 - i. Of this amount, \$291 million was saved by the Alabama Medicaid Agency and \$63 million was saved by other state agencies that provide Medicaid services
 - ii. The enhanced match is available for services provided between

October 1, 2008 through December 30, 2010

- b. In FY 2010, we expect approximately \$395 million in savings (\$323 million for Medicaid and \$72 million for other state agencies)
- c. In FY 2011, Alabama will save approximately \$102 million (\$83 million for Medicaid and \$19 million for other state agencies)
- d. The House-passed version of health care reform in Congress would extend the enhanced FMAP to June 30, 2011 which would increase the savings to an estimated \$299 million in FY 2011 if that provision were actually enacted into law

O. In a supplemental appropriation bill enacted during the last Regular Session

- 1. The Legislature reduced Medicaid's appropriation from the General Fund by \$165 million as the result of the enhanced federal matching funds
- 2. General Fund appropriations to other state agencies that provide Medicaid services were reduced by \$60.4 million
 - a. Public Health: \$9.6 million
 - b. Mental Health: \$38.9 million
 - c. Human Resources: \$8.6 million
 - d. Senior Services: \$3.2 million
 - e. Youth Services: \$133,000

3. The Legislature also provided a mechanism to capture any funds in the “1800 Accounts” for the General Fund, which resulted in a reduction in appropriations from the General Fund of \$53.5 million
4. There were \$71.2 million in reversions from state agencies but those amounts were reappropriated to those agencies for FY 2010

P. Resulting appropriations and obligations from the General Fund for FY 2009 were \$1.7 billion

Q. This represented a reduction of \$118.3 million from the expenditure level of FY 2008

R. The ending balance for FY 2009 was \$105.4 million

V. Exhibit 5 shows the LFO Projected Condition of the General Fund for FY 2010 and FY 2011

A. The General Fund began the current fiscal year with a beginning balance of \$105.4 million

B. The Governor has restricted allotments for most state agencies to 22% of their General Fund appropriation in each of the first three quarters of this fiscal year

C. LFO revised estimated normal receipts for FY 2010 are \$1.3 billion

1. This is \$114 million less than LFO original estimates, due mainly to reductions in
 - a. Interest income due to lower balances to invest and extremely low interest rates (\$26.5 million)

- b. Oil and gas production taxes as the result of lower natural gas prices (\$33 million)
- c. Insurance premium taxes (\$19 million)
- d. Leasing and rental taxes (\$8 million)
- e. Sales tax on autos (\$5 million)
- f. Cigarette taxes (\$5 million)

D. Transfers from other state agencies, reversions and tobacco revenues total \$28.9 million

E. Adding these transfers to the beginning balance makes \$1.4 billion available for expenditure in FY 2010

F. Appropriations for FY 2010 currently total \$1.5 billion

- 1. This appropriation includes the FMAP savings in other state agencies of \$63.6 million

- 2. General Fund reappropriations of \$42 million

- a. Even though \$71.2 million was actually reverted by state agencies, the reports from the Finance Office as of the end of November indicate that only \$42 million has been reallocated to the agencies

G. Making total appropriations and obligations at this point in time \$1.6 billion

H. Based on LFO revised estimates and current obligations, the deficit for FY 2010 is \$120 million

I. This means that based on LFO estimates, the General Fund will be in proration of 7.6%

J. That level of proration will change if other open-ended appropriations are increased; the remainder of

reversions (\$29.2 million) are allotted to the respective state agencies that the General Fund budget reappropriated those reverted funds to; or the Constitutional Rainy Day Account is accessed

1. The voters ratified a Constitutional Amendment that created a Rainy Day Account within the Alabama Trust Fund for the benefit of the General Fund
2. If the General Fund is prorated, the Governor can access up to 10% of the previous year's appropriation (\$179 million for FY 2010) but only up to the amount that would bring receipts to the General Fund up to the average of the amount available certified by the Legislative Fiscal Officer and the Finance Director at the beginning of the 2009 Regular Session
 - a. Based on LFO revised estimates that amount is \$84.4 million for FY 2010 that could be accessed
3. The General Fund has 10 years to repay any amount borrowed
4. Based on LFO estimates and current obligations if the Governor declared proration in the General Fund, he could withdraw \$84.4 million and reduce proration from 7.6% to 2.3% for FY 2010

K. LFO estimates for FY 2011 are \$1.4 billion

L. Exhibit 6 shows the effect of the Federal Stimulus Funds on General Fund expenditures

1. You can see that actual expenditures from the General Fund totaled \$1.8 billion in FY 2008
2. In FY 2009, the General Fund appropriations were \$1.7 billion but there were \$354 million in federal stimulus funds that supplemented General Fund agencies
3. I have discussed how the federal enhanced Medicaid match supplemented the General Fund
4. Alabama had \$132.7 million available from the Fiscal Stabilization Fund that could be used to supplant General Fund appropriations
 - a. All of those funds were appropriated in FY 2010
 - b. The Department of Corrections was appropriated \$118.6 million
 - c. The Departmental Emergency Fund was appropriated the remaining \$14.1 million
5. In FY 2010, appropriations from the General Fund were \$1.6 billion supplemented by a total of \$528 million in federal stimulus funds
6. For FY 2011, LFO estimates for the General Fund total \$1.4 billion with only \$102 million remaining from the federal stimulus funds to supplement the General Fund for a total of \$1.5 billion
 - a. This leaves a deficit of \$642 million in FY 2011 from what is being budgeted in

FY 2010 from the General Fund and federal stimulus funds

VI. Federal Stimulus Funds

- A. Exhibit 7 shows the major non-education federal stimulus funds that Alabama is expected to receive from the \$787 billion American Recovery and Reinvestment Act passed by Congress in February 2009
- B. I have already talked about the parts of the stimulus package that directly impacted General Fund appropriations
- C. This exhibit shows total non-education parts of the stimulus package

VII. Exhibit 8 shows the Condition of the ETF for FY 2008 and FY 2009

- A. I wanted to show you the last two actual fiscal years to give you a context for just how bad these economic times have been
- B. You can see that in FY 2008 we began seeing the recession, even though we began the year with a balance of \$280 million (which was less than expected)
- C. There was a repayment from the PSCA bond issue to the ETF for an appropriation to Enterprise City Schools for the March 1, 2008 tornado
- D. The Governor was forced to utilize all of the Statutory Proration Prevention Account of \$439.4 million to avoid proration
 - 1. This gave educational entities some advance notice that the FY 2009 budget would have to be reduced

2. At the end of FY 2008, the Finance Director was able to get certain taxpayers to prepay approximately \$40 million in taxes that would normally have been paid in FY 2009; this exacerbated the revenue problem for FY 2009 but avoided proration in FY 2008
 - a. \$16 million in sales tax receipts;
 - b. \$16 million in utility tax receipts; and
 - c. \$8 million in corporate tax receipts
3. If we had been unable to transfer the \$439.4 million and prepay the \$40 million, the ETF would have been in 7.2% proration
4. Education entities were allowed to revert unspent FY 2008 funds and carry them forward to be reappropriated in FY 2009
 - a. a total of \$34.4 million was reverted and reappropriated

E. FY 2009 began the year with no balance

F. Receipts were further reduced by \$701.7 million from FY 2008, coming in at \$5.2 billion

G. The voters ratified an amendment creating a new Constitutional Rainy Day Account, which made available from the Alabama Trust Fund an amount up to 6.5% of the previous year's appropriations from the ETF

1. That amount was \$437.5 million and the entire amount was transferred in FY 2009
2. The amount borrowed has to be repaid within 6 years of the withdrawal

3. The Legislature did not make a repayment appropriation for FY 2010, so there remains only 5 years in which to repay this amount
- H. The Governor, early in FY 2009, declared 12% proration in the ETF and borrowed \$221 million from the Rainy Day Account, which brought proration down to 9%
 - I. However, as the economy declined even further, the Governor borrowed the remainder of the Rainy Day Account and increased proration to 11%
 - J. You can see on this chart that expenditures from the ETF decreased by over \$1 billion from FY 2008 to FY 2009, even with the transfer of \$439 million from the Proration Prevention Account in FY 2008 and the \$437.5 million transfer from the Rainy Day Account in FY 2009
 - K. The ETF would have been in proration of 18% in FY 2009 had the Rainy Day Account not been available
 - L. You might question how we all missed these estimates so badly
 1. Last year at this time, the LFO revised our FY 2009 estimates downward
 - a. Gross individual income taxes were revised from 4.5% growth to 0% growth
 - b. Gross sales taxes were revised from 3% growth to -4% growth
 2. However, in FY 2009, gross sales tax collections declined by -9.9% from the previous fiscal year, a reduction of \$200 million

- a. Gross sales tax collections have had a negative growth rate only 4 times since the state started collecting them in FY 1937
- b. The largest decline before FY 2009 was a -3.5% growth rate in FY 1954
- 3. In FY 2009, gross individual income tax collections declined by -7.9%, a reduction of \$286 million
 - a. Gross individual tax receipts have had a negative growth rate only 3 times since FY 1970 (as far back as we have good records)
 - b. The largest decline before FY 2009 was a -1.8% growth rate in FY 1982

VIII. Exhibit 9 shows the LFO Projected Condition of the ETF for FY 2010 and FY 2011

- A. FY 2010 began the year with no beginning balance
- B. LFO revised receipts for FY 2010 are \$5.3 billion
- C. This is \$402 million less than original estimates
 - 1. The taxes that were reduced include
 - a. Income taxes by \$289 million
 - b. Sales tax receipts by \$93 million
 - c. Use tax receipts by \$24 million
- D. LFO revised receipts reflect our belief that the sharp decline in tax receipts is over but that there will be little, if any, growth until the labor market reflects some growth

- E. There will be a reversion of \$11 million from the Department of Human Resources as a result of increased food stamp issuance
 - 1. The Department is reimbursed from the sales tax collection for the cost of food stamps issued
 - 2. This represents the amount that the Department did not use to administer the program in FY 2009
- F. Other transfers and reversions are \$778,000
- G. Total Available is projected to be \$5.3 billion for FY 2010
- H. Current appropriations total \$5.7 billion
- I. Reappropriated reversions total \$23 million
- J. The Governor has already called proration of 7.5%, a reduction of \$426.7 million
- K. Total appropriations and obligations as of November 30, 2009 are \$5.3 billion
- L. Based on LFO revised estimates, that would leave a balance of only \$1.4 million
- M. LFO estimates support proration at the 7.5% level
- N. LFO estimates for FY 2011 are \$5.3 billion
 - 1. LFO estimates show basically no growth
 - 2. We expect that the decline has moderated, but this office is unwilling to project growth in the ETF until we see some growth in employment and/or growth in receipts
 - 3. DHR has projected that it will revert \$18.6 million from Food Stamp receipts in FY 2011

O. Based on LFO FY 2011 projections, there will be \$5.3 billion available for appropriation

1. This results in \$32.6 million less than current projected expenditures for FY 2010 after 7.5% proration
2. LFO estimates reflect no growth
3. The decrease is mostly associated with PSCA debt that is taken off the top of receipts and income tax refund changes

P. Federal tax considerations

1. Some tax cuts enacted in the previous administration are scheduled to expire at the end of December, 2009
2. Some of those tax cuts have already been made permanent and there is discussion about extending or making permanent other measures
3. If the federal tax cuts expire and that increases federal taxes owed, that will affect Alabama income taxes since Alabama allows a deduction for federal taxes paid
4. LFO will adjust our estimate for Alabama income taxes, if needed, once we know what Congress will do regarding those tax policies

Q. Exhibit 10 shows the effect of Federal Stimulus funds on education appropriations

1. This chart is not as dramatic as the same one for the General Fund

2. We are only showing the education appropriation from the Fiscal Stabilization Fund because those funds could be used to supplant ETF appropriations
3. The decision was made to split those federal funds appropriating ½ in FY 2010 and ½ in FY 2011

IX. Exhibit 11 shows the Education-Related Federal Stimulus Funds that Alabama is Expected to Receive

- A. The decision was made to split the federal funds from the Fiscal Stabilization Fund, Title I, and IDEA (special education) between FY 2010 and FY 2011; approximately \$502 million is available each year
- B. Alabama is scheduled to receive \$338 million for Qualified School Construction Bonds - \$169 million for FY 2009 and \$169 million for FY 2010
 1. The Legislature passed an act in the First Special Session of 2009 to allow the Public School and College Authority to issue “Qualified School Construction pool bonds” on behalf of local school systems
 2. The local system must irrevocably pledge a local source to pay debt service for the life of the bonds
 3. The holder of the bond gets a federal tax credit

X. General Fiscal Issues

- A. Children’s Health Insurance Program (CHIP)

1. During the 2009 Regular Session, the Legislature increased funding by \$11.2 million for FY 2010
2. \$7 million of this increase was to extend coverage to children in families who have incomes greater than 200%, but less than 300%, of the federal poverty level
 - a. this means that children within a family of four with an income between \$44,101 and \$66,150 will qualify for CHIP
 - b. according to the Department of Public Health, approximately 14,000 uninsured children in Alabama will qualify for this expansion
 - c. the Department expects to enroll 10,000 of these children in FY 2010
3. At the end of FY 2009, there were approximately 69,800 children participating in the CHIP Program
4. At the end of October, 1,925 children had been added to the CHIP program as the result of the expansion to 300% of the federal poverty level
5. According to a recent report by the Kaiser Commission on Medicaid and the Uninsured, the percentage of uninsured children in Alabama dropped from 7.5% in 2007 to 4.4% in 2008

B. Health Care Reform

1. Congress is currently debating health care reform
2. It is unclear what will emerge
3. However, provisions under discussion will affect state Medicaid programs, CHIP programs and potentially state employees' and teacher health insurance plans

C. Reduction in State Workforce

1. The State Personnel Board reports that as of September, 2009 there were 545 fewer state employees than at that same time in 2008
2. The Department of Education reports that there are 1,229 fewer certificated education employees and 1,101 fewer non-certificated personnel in 2009 than in 2008

D. Unfunded Liability of the Retirement Systems of Alabama

1. Teachers' Retirement System
 - a. you can see a history of the unfunded liability of the Teachers' Retirement System
 - b. the TRS went from 88.8% funded in FY 1996 to 77.7% in FY 2008
2. Employees' Retirement System
 - a. the Employees Retirement System went from 94.3% funded in FY 1996 to 74.3% in FY 2008

b. the State Police Retirement System went from 97.1% funded in FY 1996 to 71.7% in FY 2008

E. Discovery of oil on Department of Corrections property

1. The Department of Corrections, working through the Department of Conservation's Lands Division and the state Oil and Gas Board, has signed a 5-year contract with an oil and gas company to explore for oil near the Fountain Correctional Center in Atmore
2. The Department has received a \$400,000 bonus bid from the company. It will receive 25% of the royalties and a \$300 bonus-per-acre on any oil and natural gas that is extracted

F. Alabama Trust Fund History

1. In 1982, the state received \$467 million from off-shore oil and gas leases that were deposited into the Heritage Trust Fund
2. Amendment 450 to the Alabama Constitution, ratified in 1985, established the Alabama Trust Fund (ATF), which was funded with \$333.6 million received by the state from off-shore oil and gas leases
3. The Heritage Trust Fund merged with the ATF in 2001
4. The assets in the ATF had grown to \$3.2 billion as of September 2008

5. However, those assets were only \$2.6 billion as of September 2009 (not including the ETF Rainy Day account receivable)
6. The assets of the ATF are held in perpetual trust and cannot be appropriated, expended, or disbursed except as provided by constitutional amendments, such as those that created the Alabama Capital Improvement Trust Fund (ACITF) and Rainy Day Accounts for the ETF and General Fund

G. Alabama Capital Improvement Trust Fund

1. This trust fund was established by Amendment 666 to the Alabama Constitution, ratified in November 2000, and is funded with 28% of the royalties deposited into the Alabama Trust Fund in the previous fiscal year
2. \$667.8 million has been deposited into the ACITF since its inception
3. The amendment created a Bond Commission with authority to issue up to \$350 million in economic development bonds
 - a. A constitutional amendment was ratified by the voters in June 2007 to increase this bonding authority to \$750 million
 - b. \$610 million in bonds have been issued
 - c. The remaining bonding authority is approximately \$140 million

- d. Royalties are used to pay off these bonds
 - e. The remaining royalties in the ACITF may be used for other debt of the state or for economic development purposes
4. Exhibit 12 shows the history and status of the ACITF
- a. The beginning balance in the ACITF for FY 2009 was \$18.1 million
 - b. The 28% of the royalties deposited into the ACITF in FY 2009 amounted to \$96.7 million
 - c. Expenditures from the ACITF for FY 2009 were \$95 million
 - d. the ending balance in the ACITF for FY 2009 was \$19.8 million
 - e. The royalties for FY 2010 are only \$49.3 million, which was much lower than expected
5. There will be a deficit in the ACITF of \$12.4 million in the current year which could affect the General Fund budget in FY 2010
6. Of the amount appropriated from the ACITF to-date:
- a. \$106.6 million has been appropriated for new economic development projects; and
 - b. \$573.6 million has been appropriated to pay existing debt service payments

- i. for FY 2010, the Legislature appropriated \$79.4 million for existing debt service (of which \$26.9 million was for General Fund debt relief)

H. Public Road and Bridge Fund Status

- 1. Exhibit 13 shows you receipts to the Public Road and Bridge Fund since FY 2000

- a. The fund is made up of gasoline taxes, motor fuel taxes and related fees, and inspection fees

- b. You can see that the fund showed an actual decrease in FY 2007 through FY 2009

- i. Alabama's gasoline tax is based on volume rather than price, so it is influenced by consumption and not by price at the pump

- ii. DOT has traditionally used state funds in the Public Road and Bridge Fund to match federal transportation funds available to Alabama and the remainder of state funds are used for maintenance of state roads

- c. A component of the Federal Economic Stimulus Package is "shovel-ready" infrastructure projects, including roads and bridges. Alabama has received a total allocation of \$560.2 million from the

American Recovery and Reinvestment Act

- i. \$513.7 million for roads and bridges; and
 - ii. \$46.5 million for public transit
 - iii. No state match was required for the stimulus funds
- d. Currently, the Department has allocated all federal stimulus funds and has spent \$49 million to begin work on 82 highway projects
- e. The Department has reported that 6,700 jobs have been created or sustained with stimulus funds

I. Tobacco Settlement Revenues

1. Exhibit 14 shows FY 2010 appropriations from tobacco revenues of \$106 million
2. The state received \$116.6 million in FY 2009
3. Alabama is expected to receive \$99.7 million in FY 2010 and \$94.6 million FY 2011

J. Gulf of Mexico Energy Security Act (GOMESA)

1. Congress passed an Act that opened over 8 million acres of deepwater areas in the Gulf of Mexico for energy production and sent 37.5% of federal royalties from the new energy explorations to the four Gulf States of Alabama, Louisiana, Mississippi, and Texas

2. The 37.5% will be allocated among the 4 states based on each state's proximity to the center of the leased tract. However, each state will receive at least 10% of the amounts available each year
3. 20% of each state's share will be paid directly to the coastal political subdivisions
4. The states receive funds in 3 ways
 - a. the bonus bid, which is the up-front amount the winning bidder pays for the lease
 - b. annual rent payments that the lessee must pay until production begins
 - c. the royalties, once production begins
5. There are 4 purposes within the federal law for which these funds may be expended
 - a. Projects and activities for the purpose of coastal protection
 - b. Mitigation of damage to fish, wildlife, or natural resources
 - c. Implementation of a federally-approved marine coastal or comprehensive conservation management plan
 - d. Mitigation of the impact of Outer Continental Shelf activities through funding of onshore infrastructure projects
6. Beginning in 2017, the four Gulf States will receive 37.5% of royalties from all Gulf leases entered into beginning in 1982

7. And beginning in 2022, the states' share in all lease revenue from all blocks in the Gulf
8. Revenues from GOMESA are distributed to states and coastal political subdivisions in the fiscal year following receipt
9. According to the Minerals Management Service (MMS), the first leases affected by this law went out for bid in March 2008 and bids totaling \$65 million were received
10. Alabama's share of the bonus bid payments in FY 2009 was \$6.2 million
 - a. Baldwin and Mobile Counties split an additional \$1.5 million
11. In November, the MMS announced that \$2.7 million in FY 2009 revenues were being distributed
 - a. Alabama's share of these revenues is \$651,000
 - b. Baldwin and Mobile counties will split an additional \$163,000

K. Coastal Impact Assistance Fund (CIAP)

1. The Energy Policy Act of 2005 passed by Congress authorized funds to be distributed to Outer Continental Shelf oil and gas producing states and coastal political subdivisions to mitigate the impacts of oil and gas activities
2. The legislation authorized the appropriation of \$250 million annually for the program for each of the fiscal years 2007 through 2010

- a. The distribution to each state is determined by the percentage of revenues generated from leases off its coast compared to the total amount of revenue from all leases
3. The total allocation for Alabama for FY 2007 and FY 2008 was \$51.1 million split evenly between the years
 - a. Of which \$17.9 million was allocated to Baldwin and Mobile counties
4. The allocation for FY 2009 and FY 2010 will be \$39.4 million split evenly between the two years
 - a. Of which \$13.8 million will be allocated to Baldwin and Mobile counties
5. Alabama's funds are administered by the Department of Conservation's Land Division
 - a. States must submit a CIAP spending plan to the Minerals Management Service for approval
6. CIAP funds can only be used for similar purposes that GOMESA funds may be used

L. Status of Selected Pending Litigation

1. Medicaid Pharmaceutical Litigation
 - a. I have talked about pharmaceutical settlements when discussing the conditions of the General Fund in FY 2008 and FY 2009
 - b. The state filed a lawsuit against approximately 70 pharmaceutical

- companies alleging those companies defrauded the Alabama Medicaid Agency by inflating drug prices
- c. The General Fund has received a total of \$56.8 million from settlements with a number of those companies
 - d. In addition to the settlements, 4 cases actually went to trial
 - e. The state won each case at the trial court level
 - f. A total of \$182 million in compensatory damages and \$170 million in punitive damages were awarded to the state in those 4 cases
 - g. Each company appealed
 - h. The Alabama Supreme Court ruled in October 2009 in three of those cases that the state failed to prove that Medicaid had reasonably relied on the misrepresentations and/or fraudulent suppression which it alleged
 - i. This decision will vacate the \$352.7 million in compensatory and punitive damages in those cases assuming the fourth case would also be found in favor of the pharmaceutical company

2. SWAP litigation

- a. In March, 2002 the Public School and College Authority entered into a series

- of agreements with JPMorgan Chase Bank known as Swap Options
- b. Under the terms of the agreement, the State received approximately \$12.6 million upfront and JPMorgan was granted an option to require the PSCA to enter into fixed interest rate swaps
 - c. JPMorgan gave notice of exercise of the first option in June 2008 and has since given notice of its intent to exercise each of the other options
 - d. The PSCA filed a declaratory judgment action in federal district court requesting the court to determine the rights and obligations of the parties
 - e. JPMorgan has filed a counterclaim seeking approximately \$122 million plus interest and attorney fees from the ETF
 - f. The case is set for trial in October 2010

XI. Closing Remarks

A. Website: www.lfo.state.al.us

- 1. Outline
- 2. Exhibits
- 3. Budget Hearings Schedule
- 4. Budget Fact Book
- 5. Tax Guide