

1 PRESENTATION TO THE LEGISLATURE ON ALABAMA'S
FINANCIAL CONDITION

2 FEBRUARY 26, 2007

3 I. Introduction

A. Usually at this presentation I would discuss with you the revenue structure of the state; sources of revenue to the General Fund and the Education Trust Fund; appropriations of state funds for FY 2007; the forecasts for the U.S. and Alabama economies; and the status of the General Fund and the Education Trust Fund for FY 2006

1. however, I spoke to you about those issues in December at Legislative Orientation so I will not repeat those comments today
2. if you were unable to attend the LFO presentation in December or you want a refresher course on those issues, the exhibits and presentation for that speech are on the LFO website for your review

B. Today, I would like to focus on

1. the status of the General Fund and Education Trust Fund for the remainder of FY 2007 giving to you this office's revised estimates of revenue for the current year
2. LFO revenue projections for FY 2008 for both funds
3. Fiscal outlook for the ETF and General Fund for FY 2008
4. And update you on a few general fiscal issues

4 II. Exhibit 1 shows the LFO Projected Condition of the
General Fund for FY 2007 and FY 2008

A. the FY 2006 actual condition of the General Fund is on the LFO website

B. the General Fund began FY 2007 with \$263.2 million

(that is \$42 million more than LFO had originally projected)

- C. LFO revised estimated receipts for FY 2007 are \$1.53 billion (this is \$41 million more than LFO original estimates for FY 2007)
- D. there are several additional transfers of funds into the General Fund expected for the current year
 - 1. transfers from state agencies-\$5.3 million
 - a. Public Service Commission-\$3.8 million
 - b. Securities Commission-\$1.5 million
 - 2. a transfer from the abandoned property reserve account-\$25 million over the regular amount that the General Fund receives from abandoned property
 - 3. a transfer from tobacco revenues-\$10.6 million (this is less than what we expected when the transfer was made, I will discuss tobacco revenues further)
 - a. this was the amount originally allotted from tobacco revenues to the Department of Education for alternative programs, summer school and other programs to reach at-risk students
 - b. the Education Trust Fund picked up this appropriation for FY 2006 and FY 2007
 - 4. a transfer from capital gains in the Alabama Trust Fund-\$35 million
- E. that makes total receipts of \$1.61 billion for FY 2007
- F. when added to the beginning balance there is a total of \$1.87 billion available
- G. the current estimated appropriations for FY 2007 are \$1.67 billion
- H. that leaves an ending balance of \$197.68 million which will be affected by
 - 1. any increase or decrease in open-ended expenditures such as the payment for indigent defense attorneys (that I will discuss later in this presentation) or matching funds required by FEMA for natural disasters

and by

2. conditional appropriations released by the Governor
 - a. there are \$65 million in conditional appropriations in the FY 2007 General Fund appropriation act
 - b. the Governor decides which, if any, conditional appropriations are released
 - c. to date, \$4.5 million in conditional appropriations have been released
 - i. Industrial Relations-\$1,140,000 for mine safety inspectors and inspections (the Department has hired 12 additional mine inspectors)
 - ii. Military Department-\$1,200,000 for the Youth Challenge Program
 - iii. Attorney General-\$140,000 to supplement funding the 5% salary increase for the current year
 - iv. ADECA-\$500,000 for legal fees and costs related to the interstate water disputes and
 - v. Board of Pardons and Paroles-\$1.5 million for general operating expenses
 - d. there are an additional \$13.5 million in conditional appropriations that we understand have been authorized for release but have not been released
 - i. Corrections-\$10 million for operating expenses and
 - ii. Mental Health-\$3.5 million to provide acute care services to mentally ill patients
 - iii. these amounts are not included in these numbers
3. also supplemental appropriations could be made by the Legislature for FY 2007
4. any remaining ending balance will be carried over to be appropriated in the FY 2008 budget
- I. if the entire current projected ending balance for FY 2007 were carried over, FY 2008 would begin with \$197.68

million

- J. the LFO projected receipts to the General Fund for FY 2008 are \$1.55 billion
 - 1. our office has been informed by the State Treasurer that she intends (if possible) to transfer an additional \$15 million from the abandoned property reserve fund in FY 2008
 - 2. if the Legislature provides for transfers from state agencies and/or tobacco revenues, those amounts will be added to the total available at that time
 - 3. the Alabama Trust Fund Board has chosen to recognize realized and unrealized capital gains in the last 3 years; the Board makes that decision in October based on the previous year's capital gains; that action is discretionary with the Board and therefore cannot be projected by this office
- K. the projected receipts for the General Fund reflect only a 1.46% growth due mainly to this office's belief that 1) oil and gas severance taxes will continue to decline (we are already seeing that happen); and 2) interest on state deposits will also decline (interest rates will not continue to increase and state balances available to invest will begin to decline)
- L. this equates to only \$22.4 million increase in recurring revenue
- M. total receipts for FY 2008 are estimated to be \$1.57 billion
- N. adding the currently projected beginning balance makes a total available of \$1.76 billion
- O. this amount is \$93.5 million more than current estimated expenditures but keep in mind that the beginning balance will be affected by any of those actions that I mentioned earlier; if the \$13.5 million in conditional appropriations are released to Corrections and Mental Health, the amount becomes \$66.5 million instead of \$93.5 million
 - 1. several other agencies are expected to actively seek

release of their conditionals including the Department of Public Health-\$6.9 million of their \$23.9 million conditional for 500,000 flu pandemic vaccines

2. please be aware that releasing conditional appropriations or enacting supplemental appropriations affect not only the ending balance for FY 2007 but also the current level of expenditures which will increase the amount of money needed to level fund agencies in FY 2008 (unless the appropriation is for a one-time expenditure such as capital outlay)

P. also remember that \$60.7 million in debt service payments that are obligations of the General Fund and certain state agencies are being paid from the Alabama Capital Improvement Trust Fund in FY 2007

1. those amounts by entity are
 - a. G.O. bonds (GF)-\$24.7 million
 - b. G.O. bonds (DOT)-\$18.1 million
 - c. Public Health Care Authority (DPH)-\$3.6 million
 - d. Mental Health Finance Authority (MHMR)-\$5.5 million
 - e. Judicial Building Authority (UJS)-\$4 million
 - f. Building Renovation Finance Authority (Finance)-\$2.8 million and
 - g. Corrections Institution Finance Authority (Corrections)-\$2.2 million

2. the Legislature will decide whether to continue making those debt payments from the ACITF for FY 2008

Q. there are 2 additional sources of revenue that we have counted on as available revenue in the last several years to balance the General Fund if needed; since these sources have not been depleted, they could be available for appropriation in FY 2008 (if not needed in FY 2007)

1. there is \$20 million in an Exxon escrow account (that I will talk about later in the presentation) that is available and

2. \$35 million in a corporation escrow account where the business privilege tax is deposited pending distribution to the counties and the General Fund
 - a. funds remaining in the account are held to pay refunds from challenges to the old franchise tax that was held unconstitutional in 1999

5  III. Outlook for the General Fund for FY 2008

A. State employees

1. the employers' retirement rate will increase from 7.78% to 9.84% for FY 2008 (law enforcement rate will increase from 24.12% to 30%)
 - a. total increased cost-\$33.2 million
 - b. General Fund cost-\$11 million
2. the employers' rate for health insurance will increase from \$717 to \$775 per employee per month
 - a. total cost-\$24.9 million
 - b. General Fund cost-\$8.3 million
3. the cost of a 1% pay increase for state employees
 - a. total-\$18 million
 - b. General Fund-\$6 million

B. Medicaid

1. the Agency is requesting an increase of \$71.5 million from the General Fund for FY 2008 to keep the Medicaid program with the same benefits as current year
2. Katrina relief
 - a. the federal government gave some Medicaid relief to those states struck by Hurricane Katrina
 - b. Alabama did not have to pay the state match for federal Medicaid funds from August, 2005 to September, 2006 (the original deadline was June, 2006) for the 11 counties that were hit by the hurricane
 - c. including the extension from June to September,

the federal law saved Medicaid and other state agencies that provide Medicaid services a total of \$225 million

d. those savings should allow Medicaid to carry forward an estimated balance of \$133 million from FY 2007 into FY 2008

3. change in FMAP

a. in FY 2008 the federal match is being lowered from 68.85% to 67.62% (that means Alabama will have to put up more state matching funds)

b. Alabama will receive in FY 2008 approximately \$2.09 in federal funds for each \$1 in state funds (down from \$2.21 in the current fiscal year)

c. that equates to a required increase of a total of \$60.9 million in state funds

i. Medicaid-\$50.7 million

ii. Mental Health-\$5.4 million

iii. Human Resources-\$3.1 million

iv. Public Health-\$.9 million

v. Senior Services-\$.5 million and

vi. Rehabilitation Services-\$.3 million

C. Department of Human Resources

1. the Department is requesting an increase of \$29.7 million from the General Fund for FY 2008

2. R.C. consent decree

a. since June 1991, the Department has been operating under a consent settlement (known as the R.C. consent decree) that required the state to implement new initiatives in staff training, service development, and advocacy for the child welfare system with the goal of developing and implementing a system of care that focused on placement prevention, family re-unification and permanency

b. on January 16, 2007, the court ruled that

Alabama's child welfare system now "substantially complies" with the R.C. settlement agreement and released the Department from further judicial oversight

c. however, the plaintiff's have filed a motion to appeal the Department's release from court supervision

3. foster care

a. at the end of FY 2006, there were 6,555 children in foster care

b. the Department is requesting an increase of \$3.7 million from the General Fund for FY 2008 in order to increase foster care payments

D. Department of Mental Health

1. the Department is requesting an increase in funding for FY 2008

a. \$3.8 million from the ETF and

b. \$44.7 million from the General Fund

E. Department of Public Health

1. the Department is requesting increases in FY 2008 of

a. \$8.3 million from the ETF and

b. \$17.7 million from the General Fund

2. the requested increase from the General Fund includes \$9.3 million for the Children's Health Insurance Program (CHIP)

a. CHIP is a state/federal program to provide health insurance coverage to children (ages birth through 18) who do not qualify for Medicaid and whose family income is less than 200% of the federal poverty level (\$41,300 for a family of four)

b. there are co-payments based on income

c. Alabama's match rate for federal funds is 78.2% (in FY 2007 Alabama is receiving approximately \$3.58 in federal funds for every \$1 of state funds)

d. at the end of FY 2006, CHIP enrollment was 65,343

and the Department is projecting enrollment to be 71,067 at the end of FY 2008

F. Department of Corrections

1. the Department has requested an increase of \$92.2 million from the General Fund for FY 2008
 - a. of this requested increase, \$13 million is for capital outlay
2. an Atlanta-based law firm is pursuing a lawsuit to have Julia Tutwiler Prison for women shut down; the Department is studying the feasibility of constructing a 1600-bed correctional facility for women (the total projected cost is \$117.5 million based on preliminary data)
3. the Department is requesting an increase of \$2.9 million for community correction programs
 - a. in FY 2006, community correction programs were available in 38 counties
 - b. an additional 13 counties are projected to be added in FY 2007 (the Department is budgeting \$6.1 million in FY 2007 for community corrections)
4. the Department is requesting legislation to give correctional officers a 10% increase in pay (Correctional Officer I would go from a starting salary of \$26,620 to \$29,283); this increase would cost the Department \$12.3 million in FY 2008 and is included in the Department's request
5. in December 2005 the State Employees' Insurance Board began including state inmates in its negotiation for health care facility rates; SEIB reported a savings of \$7.3 million for the Department in 2006 due to the discounted hospital rates
6. the SEIB is now looking at the possibility of purchasing inmate prescription drugs through the Federal Drug Discount Program which could save the Department of Corrections an estimated \$3 million annually

G. Department of Public Safety

1. the Department is requesting an increase of \$28.3 million from the General Fund for FY 2008
2. troopers
 - a. the most recent graduation of troopers was held January 25, 2007, with 30 new troopers bringing the total number of troopers to 705
 - b. the Department has requested funding to hire 100 additional troopers in FY 2008 at an estimated cost of \$5.6 million
 - c. the Legislature provided a 10% increase in trooper pay in the last session; other arresting officers received either a 5% or 7.5% increase in pay depending on their rank
3. federal Real ID Act
 - a. like all states, Alabama is faced with implementation of the federal Real ID Act
 - b. this Act requires that certain standards, procedures and requirements be met for the issuance of driver's licenses and identification cards if those documents are to be accepted as identity documents by the federal government
 - c. although the U.S. Department of Homeland Security has not yet published regulations for implementation of the Act, the Act is expected to mean that a person who does not possess a Real ID-compliant driver's license or identification card would be prohibited from receiving federal services such as Social Security, entering a federal building or boarding an airplane
 - d. the deadline for complying with the Act is May 11, 2008
 - e. the Alabama Department of Public Safety is awaiting release of the federal regulations before finalizing the state cost of complying with the federal law

H. Fair Trial Tax Fund

1. I talked to you about the Fair Trial Tax Fund in December
2. you will remember that the issue was payment of overhead expenses to attorneys representing indigent defendants
3. an Attorney General opinion in February, 2005 stated that attorneys representing indigent defendants were not entitled to reimbursement for overhead expenses
4. on December 22, 2006, the Alabama Supreme Court ruled that criminal defense lawyers who represent indigent defendants should be paid for their office overhead
5. the Comptroller's Office estimates that the amount due criminal defense lawyers as a result of this decision will be \$3.4 million for FY 2005 and \$11.3 million for FY 2006 from the State General Fund
6. although no retroactive payments have yet been made, the decision is expected to cost the General Fund
 - a. \$14.7 million for retroactive payments and
 - b. an additional \$13.2 million annually
- I. total budget requested increases from the General Fund for FY 2008 are \$435 million

6 IV. Exhibit 2 LFO Projected Condition of the ETF for FY 2007 and FY 2008

- A. as with the General Fund, the actual FY 2006 condition for the ETF is on the LFO website
- B. the beginning balance in the ETF for FY 2007 was \$695 million including the \$8.8 million reserve for the October 1, 2006 debt service payment
- C. the LFO revised estimated receipts for FY 2007 are \$5.95 billion (this represents a growth rate of 8.12% over FY 2006 receipts and \$370 million more than LFO original estimates)

1. I must apologize for an estimate that is that far off the mark, but our office did not foresee the high level of growth in the ETF for 3 years straight (FY 2004-9.5%, FY 2005-11.5% and FY 2006-10.7%)
 2. and to be completely honest with you, we are not comfortable with forecasting that level of growth for FY 2007 or FY 2008
 3. we are not attempting to be conservative in our revenue estimates, but we truly do not think that level of growth can be sustained
 4. however after saying that, income taxes through January (the first four months of FY 2007) continue to grow at a rate of 14.68%
 - a. after growing 11.43% in FY 2004;
 - b. 16.4% in FY 2005; and
 - c. 12.04% in FY 2006
 5. the LFO revised FY 2007 estimated growth rate for income taxes is 8.5%
 6. the highest annual growth rate for income taxes in the decade-long growth in the 1990's was 9.17% (the average growth rate over that 9 year growth period was 6.4%)
- D. current estimated appropriations include
1. \$5.92 billion in regular appropriations
 2. \$150 million transfer to the statutory proration prevention account
 - a. in 1999, the Legislature amended a statutory proration prevention account providing that the account would receive 20% of any unanticipated and unappropriated beginning balance of ETF funds
 - b. as the economy turned down, there was little money deposited into the account
 - c. in FY 2005, \$17 million was deposited into the account
 - d. the Legislature provided, in the FY 2006 and again

in the FY 2007 ETF appropriation acts, that (regardless of the provisions of the Code) 75% of any unanticipated and unappropriated beginning balance would be transferred to the statutory proration prevention account

- i. pursuant to that provision, \$199 million was transferred in October 2005
 - ii. in addition, this office estimates approximately \$25 million will be deposited as interest income during FY 2006 and FY 2007
 - iii. \$150 million was deposited into the account in October 2006 pursuant to the 75% provision in the FY 2007 ETF appropriations act
3. there was a court-ordered appropriation of \$45.6 million from the beginning balance for the final settlement agreement in Knight v. Alabama
- a. in 1981, Knight and others filed lawsuits alleging vestiges of discrimination in the higher education system of Alabama
 - b. in 1991, a federal court ruled that there were still vestiges of discrimination and ordered a remedy
 - c. from 1993 through 2006, the state has paid \$235 million to Alabama State University, Alabama A&M University and other programs identified in the remedial decree
 - d. the \$45.6 million that was set aside by the court to accommodate the final settlement will be expended by
 - i. ACHE-for the Student Assistance Program for needs-based scholarships-\$10 million
 - ii. the PSCA-Alabama A&M University for capital programs-\$7.3 million
 - iii. the PSCA-Alabama State University for capital programs-\$25.8 million
 - iv. plaintiff attorney fees-\$1 million and
 - v. court fees and expenses-\$1.5 million

4. the Legislature made a direct appropriation of \$16 million into the statutory proration prevention account for FY 2007
 5. the Legislature appropriated \$72 million to repay the constitutional Rainy Day Account
 - a. in 2002, voters approved an amendment to the Alabama Constitution to provide a funding source in the event of proration in the Education Trust Fund that set aside \$248 million that could only be accessed if the ETF were prorated
 - b. in 2003, \$180 million was withdrawn from this fund to mitigate the effect of 4.4% proration in the ETF
 - c. the Constitution provides that the Legislature will repay any amount withdrawn within 5 years
 - d. \$36 million was appropriated in FY 2006 representing the 3rd year of repayment
 - e. the Legislature appropriated \$72 million for FY 2007 which will complete the final 2 years of repayment
 6. and finally the appropriation of \$4.3 million for the reserve account for the October 1, 2007 debt service payment
- E. total estimated appropriations are \$6.21 billion
- F. this leaves a current projected ending balance (including the debt service reserve) of \$432 million which will be affected by
1. any increase or decrease in open-ended appropriations or
 2. conditional appropriations which could be released by the Governor
 - a. there are \$21.3 million in conditional appropriations in the FY 2007 ETF budget
 - b. conditionals released to date are to
 - i. University of North Alabama-\$350,000
 - ii. University of Montevallo-\$350,000

- c. the conditional appropriation for K-12 Other Current Expense of \$17 million is in the process of being released but is not reflected in these numbers
- 3. the Legislature could enact supplemental appropriations for the current year
 - a. our office is aware that the State Department of Education may request a supplemental appropriation of \$2.75 million to cover the 5% cost-of-living increase on the 5 additional instructional school days added to this school year that was not included in the Foundation Program calculations
- 4. and any remaining balance will be carried over to be available for appropriation in FY 2008
- G. if the entire current projected ending balance is carried over, FY 2008 will begin the year with a balance of \$432 million
- H. the LFO estimated receipts for FY 2008 are \$6.29 billion
- I. this represents a growth rate of 5.84% and \$347 million in recurring revenue
- J. the estimated receipts added to the estimated beginning balance would make \$6.72 billion available for appropriation for FY 2008
 - 1. this is \$800 million more than the current estimated regular appropriations
- K. Exhibit 3 shows you the projected status of the statutory proration prevention and constitutional Rainy Day accounts at the end of FY 2007
 - 1. our office estimates that the statutory proration prevention account will have a balance of \$425 million at the end of FY 2007
 - a. these funds may be withdrawn by the Governor to prevent proration of the ETF or may be appropriated by the Legislature with a 2/3 vote
 - 2. the constitutional Rainy Day Account will have a balance of \$248 million at the end of FY 2007

- a. this is the full amount provided for by Amendment 709 (6% of FY 2002 appropriations) and reflects the repayment of funds from the FY 2003 proration
 - b. these funds may be withdrawn only to prevent proration for certain appropriations from the ETF; other appropriations are not protected and must be prorated
 - c. although \$248 million represented 6% of FY 2002 appropriations, it is only approximately 4% of regular appropriations in FY 2007
3. these 2 funds will have a combined total of \$673 million at the end of FY 2007; this represents approximately 11% of the FY 2007 appropriations from the ETF
- L. the Alabama economy is great right now, there is unprecedented economic growth but remember that economic patterns are cyclical
1. the ETF responds readily to economic cycles and we have seen double digit growth rates in the ETF for the last 2 years
 2. when an economic downturn occurs, the ETF will be affected quickly
 3. no one can pinpoint when and how severe the next economic turndown will be, so I want to thank you for providing for a hedge against that time

7 V. Outlook for the ETF for FY 2008

A. Teacher and education employee benefits

1. the TRS employer rate for FY 2008 will increase from 9.36% to 11.06%
 - a. the cost to the ETF for K-12 and the 2-year college system-\$52 million
2. the PEEHIP employer rate for FY 2008 will increase from \$717 to \$775 per employee per month
 - a. the cost to the ETF for K-12 and the 2-year college system-\$55 million

3. the cost of a 1% pay increase
 - a. K-12 teachers, support personnel and 2-year college system-\$38 million
- B. Exhibit 4 shows the K-12 Foundation Program and Financial Assistance to Local Board components for FY 2007 and the State Board of Education request for FY 2008
 1. the increase in salaries is \$16.8 million which reflects the increase in the number and salaries of teachers; it does not reflect a cost-of-living increase
 2. the increase of \$81.7 million in the cost of fringe benefits reflects the TRS rate increase and the increase in the PEEHIP rate
 3. the Board is requesting an increase of \$44.5 million in Other Current Expense; much of this increase is due to increases in fringe benefit costs for support personnel paid from this line; however, \$20 million is for inflationary increases
 4. the Board is requesting level per unit funding for student materials, technology, library enhancement, professional development and the common purchase fund
 - a. the Legislature funded the common purchase fund for the current year at \$200 per teacher unit
 - b. this appropriation frees up the entire \$525 per teacher unit for student materials for teachers to spend in their classrooms without the need to contribute to buy common purchases (such as copy machines)
 5. the Board is requesting an increase from \$67.50 to \$72.50 per student for textbooks at an increased cost of \$3.7 million
 6. the Board is requesting an additional \$5 million for school nurses
 - a. the Legislature passed an act in 1998 providing for the phase-in of school nurses over a 12 year period

- beginning in FY 2000 with the goal of having a minimum of 1 registered nurse per system plus 1 registered nurse for each 2000 students
 - b. the state appropriation for FY 2000 was \$5 million
 - c. the appropriation was basically level until FY 2007 when that appropriation increased from \$6.8 million to \$26.6 million
 - d. the FY 2007 appropriation funded approximately 520 nurses; this fully funds the 1998 act
7. an additional \$17.4 million for transportation (much of the \$11 million for operations are fringe benefit cost increases); and an increase of \$950,000 for technology coordinators
8. the State Board of Education is requesting a total increase of \$131 million from the ETF for FY 2008 for the Foundation Program and Financial Assistance to Local Boards
- C. the State Board is also requesting an increase of \$85.5 million for FY 2008 through the State Department of Education for other K-12 programs including
- 1. Home Instruction for Parents of Preschool Youngsters (HIPPY)
 - a. this is a school readiness program for parents with 3, 4 and 5 year old children-\$2 million
 - 2. a program for gifted education-\$3.3 million
 - 3. a program for after school/extended day-\$2 million
 - 4. a program for career tech-\$5 million and
 - 5. a program for dropout prevention-\$13 million
- D. Reading Initiative
- 1. the Alabama Reading Initiative (ARI) is a statewide program designed to improve the reading ability of Alabama students by training teachers how to teach reading most effectively
 - 2. the program began in FY 1999 with 16 schools and \$1.5 million in private funds

3. in FY 2007, the state appropriation is \$56 million and the program is in 899 schools which includes all K-3 schools (there are approximately 1500 public schools)
4. the State Board's request of an additional \$5 million in FY 2008 will maintain the program in those schools

E. Math/Science/Technology Initiative (AMSTI)

1. this program is modeled after the Reading Initiative and is designed to improve math, science and technology education
2. the Legislature appropriated \$200,000 in FY 2001 for start-up funding
3. the first AMSTI site, located at the University of Alabama in Huntsville, opened in FY 2002 with a federal grant of \$3 million from NASA
4. the FY 2007 appropriation of \$22 million allowed the program to expand to 10 of the planned 11 regional sites and serve 350 schools
5. the State Board is requesting an increase of \$11 million for FY 2008 to increase the regional sites to 11 and expand the number of participating schools to 501

F. Distance Learning

1. the Legislature appropriated \$10.3 million for FY 2006 to the State Department of Education to develop and begin the Alabama Connecting Classroom, Educators and Students Statewide (ACCESS) program
2. the Legislature appropriated another \$10.3 million in FY 2007
3. in this school year ACCESS is in 44 sites (21st Century Classrooms) with 43 different courses available for distance learning
4. the goal is to have a 21st Century Classroom in every high school by 2010
5. the Board has requested an increase of \$14.7 million for FY 2008

G. Public School and College Authority

1. there has been a lot of discussion about a bond issue for education
2. Exhibit 5 shows the estimated annual debt service payments on various levels of bond issues if financed for 20 years
3. \$500 million bond issue-\$39.8 million
4. \$750 million-\$59.7 million
5. \$850 million-\$67.7 million
6. \$1 billion-\$79.6 million
7. other issues to be decided
 - a. K-12/higher education split of bond proceeds
 - b. the basis for distribution to recipients within each group

H. Higher education requests

1. the Commission on Higher Education Unified Budget Recommendations (UBR) is requesting an increase of \$252 million for FY 2008 for all higher education
 - a. 4-year institutions-\$170 million
 - b. 2-year institutions-\$30 million
 - c. new programs
 - i. \$50 million for the Alabama Consolidated Research Initiative and Technology Effort (ACRITE)
 - a) funds appropriated to ACHE for ACRITE would be distributed to public 4-year and 2-year schools based on project proposals related to research, technology and workforce development initiatives
 - ii. \$1.5 million for a Pre K-20 Initiative
 - a) I have no details of this request

- I. Requested increases from the ETF for FY 2008 total \$644 million



VI. General Fiscal Issues

A. Alabama Capital Improvement Trust Fund

1. this trust fund was established by Constitutional Amendment 666 ratified in November, 2000 and is funded with 28% of the royalties deposited into the Alabama Trust Fund in the previous fiscal year
 - a. \$450 million has been deposited into the ACITF since 2002
2. the amendment created a Bond Commission with authority to issue up to \$350 million in economic development bonds
 - a. the Commission has issued \$305 million in bonds to date
 - b. the remaining bond authority is \$45 million
 - c. royalties are used to pay debt on these bonds
 - d. the remaining royalties in the ACITF may be used for other debt of the state or economic development purposes
3. the Legislature is being asked to increase the bonding authority from \$350 million to \$750 million during this Special Session (this will require a Constitutional Amendment)
 - a. the Commission is composed of the Governor, Finance Director, the Revenue Commissioner, the Chair of the Senate Finance and Taxation General Fund Committee and the Chair of the House Ways and Means General Fund Committee (now known as the Government Appropriations Committee)
4. Exhibit 6 shows the history and status of the ACITF
 - a. the beginning balance in the Alabama Capital Improvement Trust Fund for FY 2006 was \$95.3 million
 - b. the 28% of royalties deposited into the Capital Improvement Trust Fund in FY 2006 amounted to \$75.6 million
 - c. expenditures from the ACITF for FY 2006 were \$107.2 million

5. the ending balance in the ACITF for FY 2006 was \$63.7 million
6. the royalties for FY 2007 are \$103.4 million; the ending unobligated balance in the ACITF for FY 2007 will be \$31.5 million if additional bonds are not issued by the Commission; the Legislature does not make any additional appropriations from the ACITF; and the State Docks expends the remainder of its allocation in FY 2007
7. of the amount appropriated from the ACITF to date
 - a. \$184 million has been appropriated for new economic development projects and
 - b. \$234.3 million has been appropriated to pay existing debt service payments
 - i. from 2002 through 2005, the ACITF has paid \$110.8 million in existing debt service that benefited the General Fund, the ETF and other state funds
 - ii. in 2006, the ACITF paid \$62.8 million formerly paid by the General Fund, state agencies and the Public Road and Bridge Fund
 - iii. in 2007, the ACITF will pay \$60.7 million in debt service formerly paid by the General Fund, state agencies and the Public Road and Bridge Fund

B. Tobacco revenues

1. I discussed in December the Master Settlement Agreement (MSA) that Alabama entered into in 1998 with the major tobacco manufacturers that has resulted in \$774 million in payments to Alabama since FY 2000
2. FY 2006 payments were affected, and future payments will be affected, by the outcome of current litigation in Alabama and other states concerning the interpretation and application of a provision in the MSA that the amount paid to states would be reduced if

- a. the participating manufacturers' market share falls more than 2 percent compared to 1997 and
- b. a determination is made by an independent auditor that the MSA was a significant factor in that decline
3. however, a state's payment is exempt from the reduction if the state "diligently enforced" its statute that requires companies not participating in the MSA to create escrow accounts to pay judgments in any future litigation
4. in March, 2006 an independent auditor determined the participating manufacturers' market share for 2003 had fallen more than 2 percent and that the MSA was a significant factor, but also determined that all states qualified for the "diligent enforcement" exemption because they were "presumed" to have diligently enforced their statutes
5. the manufacturers contend they are entitled to a \$1.2 billion reduction in the April, 2006 payment and some companies paid their share of the \$1.2 billion into an escrow account rather than to the states
6. this reduced Alabama's FY 2006 payment by 10% (from \$105.4 million to \$94.6 million); it is anticipated this will happen again with the April, 2007 payment and each year thereafter until the dispute is resolved
7. the amount we now project to receive for FY 2007 is \$89.7 million, which is \$13.9 million less than the amount appropriated
8. Exhibit 7 shows FY 2007 appropriations; based on current projections some of these amounts will be prorated by up to 13%; however, the 21st Century Fund (used for debt service) cannot be prorated; others may not be prorated the full 13% because of prior year balances in their accounts
9. if we assume that all the companies will escrow the disputed amount in April 2008, rather than pay it to the states, our current estimate for FY 2008 is \$105.8

million (which includes \$6.3 million from a supplemental payment the MSA provides that will be paid from FY 2008 through FY 2017 and which is not subject to adjustment)

- C. Governmental Accounting Standards Board (GASB) rule
 - 1. historically, state and local governments have funded retiree healthcare benefits on a “pay-as-you-go” or cash basis
 - 2. the Governmental Accounting Standards Board has adopted a new rule (Rule 45) that will require governments to begin providing information about these incurred costs when they issue their financial statements; Alabama will be required to provide this information beginning with its financial statement for FY 2008
 - 3. the GASB rule requires governments to disclose their liability for future retiree healthcare costs prospectively
 - 4. the rule requires states to report their annually accruing cost of future health benefits; whether or not they have provided funds to meet that cost; and the amount of the cost that is unfunded
 - 5. the GASB rule does not require states to fund these costs but the fear is that a large unfunded liability could affect a state’s credit rating
 - 6. the actuaries have valued the liability for the State Employees’ Insurance Board (SEIB) and the Public Education Employees’ Health Insurance Board (PEEHIB) as of September 30, 2005
 - a. the liability for SEIB was valued at \$5.29 billion
 - b. the liability for PEEHIP was valued at \$14.61 billion
 - c. for a total of \$19.9 billion
 - 7. both insurance boards have proposed legislation that is included in the call for this Special Session to respond to the GASB rule; provisions of the legislation include
 - a. establishing trust funds to hold assets pledged for

retiree healthcare and

- b. authorizing the Board to use existing reserves as beginning capital for the trust fund

D. Amendment 778

1. the voters ratified a proposed amendment to the Alabama Constitution to require and to levy a minimum of 10 mills of ad valorem tax in each school district
2. there are 28 counties and 32 school systems that are affected by this requirement
3. the affected systems and the millage increase are identified in Exhibit 8

E. Status of selected pending litigation

1. Update on Exxon litigation
 - a. in 1999, Alabama filed a lawsuit against Exxon alleging that the company intentionally underpaid oil and gas royalties owed the state
 - b. in 2000, a jury awarded the state \$3.5 billion (\$3.42 billion in punitive damages and \$87.7 million in compensatory damages)
 - c. Exxon agreed to give the state an \$18.2 million non-refundable payment in lieu of posting 10% of the judgment as a supersedeas bond for the appeal
 - d. in 2002, the Alabama Supreme Court reversed the verdict and remanded the case for a new trial
 - e. in 2003, a second jury awarded the state \$11.9 billion (\$11.8 billion in punitive damages and \$102.8 million in compensatory damages)
 - f. the court reduced the verdict to \$3.6 billion (\$3.5 billion in punitive damages and \$102.8 million in compensatory damages)
 - g. Exxon appealed and the Alabama Supreme Court heard oral arguments on February 6, 2007
 - h. lawyers for the state argued that Exxon committed intentional fraud against the state and thus justify the juries' award of punitive damages while Exxon

attorneys argued that the case is a contract dispute and punitive damages are therefore inappropriate

2. Update on Reynolds lawsuit
 - a. this lawsuit was filed against the Department of Transportation in 1985 alleging racial discrimination in hiring and promotion practices
 - b. the Department has paid a total of \$184.5 million
 - i. \$67.5 million in legal costs
 - ii. \$41.8 million in consultant costs
 - iii. \$61.6 million in hiring and promotion settlement costs
 - iv. \$13.6 million in non-compliance fines
 - c. the provisions of the consent decree expired on December 31, 2006
 - d. however, several issues remain unresolved
 - i. the settlement process continues as the grievances for one class of plaintiffs never hired or offered jobs have not been heard
 - ii. the disposition of the remaining non-compliance fines being held in escrow (\$13.6 million) and
 - iii. some plaintiff attorney fees that have not been settled

F. Gulf of Mexico Energy Security Act

1. Congress passed an act that will open over 8 million acres of deepwater areas in the Gulf of Mexico for energy production and send 37.5% of federal royalties from the new energy exploration 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
 - a. 20% of each state's share will be paid directly to the coastal political subdivisions
3. 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 that the lessee must pay until production begins and
 - c. the royalty once production begins
4. 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
 5. beginning in 2017, the four Gulf states will receive 37.5% of royalties from all Gulf leases entered into beginning in 1982
 6. and beginning in 2022, the states share in all lease revenue from all blocks in the Gulf