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October 12, 2020

RTAC LEGISLATIVE UPDATE

THE STATE'S FINANCE ADVISORY COMMITTEE UPDATES THE STATE BUDGET AND ECONOMIC OUTLOOK:

Last Thursday, the Joint Legislative Budget Committee (JLBC) Finance Advisory Committee (FAC) provided their updated forecast for the state's budget and economy. State revenue collections continue to far exceed the initial pandemic estimates of substantial losses. Here's a chart of how budget projections have dramatically changed over the last half year since the pandemic first hit:

REPORT & DATE	FY20 Ending Balance	FY21 Ending Balance
4/9 JLBC April Revenue & Budget Update	(\$638M) projected	(\$462M) projected
6/19 JLBC June Budget Update	(\$190M) projected	(\$518M) projected
8/20 JLBC Monthly Fiscal Report	\$377M actual	(\$62M) projected
10/8 JLBC Finance Advisory Committee	\$372M actual	\$411M projected

The swing is rather startling. That initial April forecast estimated a combined cash shortfall of \$1.1 billion for FY20 & FY21. The new numbers indicate we will now end FY21 with a \$411 million carry forward balance. That's an upwards adjustment of more than \$1.5 billion! To be fair to the forecasters, that initial estimate came with the caveat of a high margin of error set at \$500 million in either direction of that \$1.1 billion mark, so they were at least spot on anticipating the high level of un-predictability and volatility.

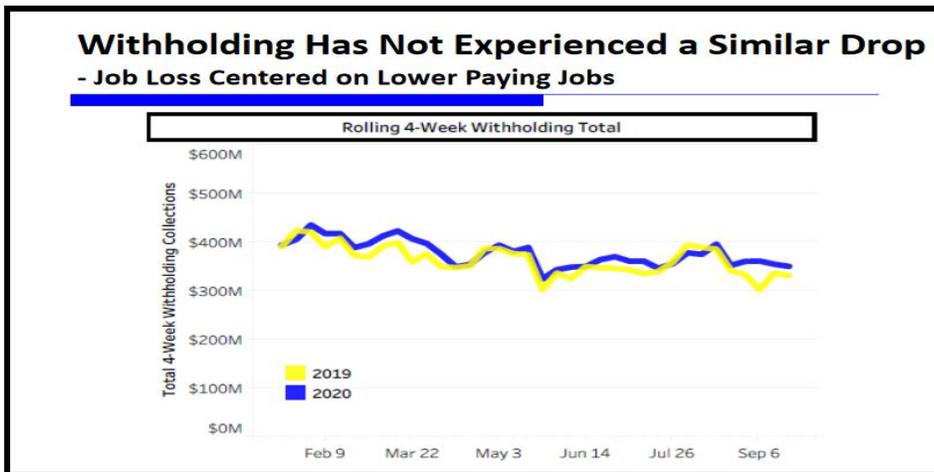
The FAC asserted that two main factors greatly mitigated the expected impacts to state revenues and the economy; the concentration of lost jobs at lower wage levels and federal relief funding.

At what is hopefully the peak of unemployment, roughly 32 million Americans were receiving some level of unemployment assistance. In mid-September, that included 430,000 Arizonans. However, most of the state's major tax revenue categories have continued to experience strong growth, including sales and income, which seems inconceivable with the massive, record-setting job losses. While it has been widely reported that the bulk of lost jobs have been low wage, it is still difficult to grasp the extent to which this has minimized the impacts on overall tax collections but is captured very well by the following: *despite 100,000 less jobs in Arizona compared to last year, state individual income tax withholdings have actually increased by 1%!*

The following further illustrate the massive number of job losses incurred and growth that will be needed to fully recover, but also the minimal impact that those job losses have had on individual income tax withholdings by comparing this year's income tax collections to last year's:



JLBC 10/8/20



JLBC 10/8/20

The FAC also emphasized and articulated the many ways that federal relief assistance has been a key factor in minimizing the state budget and economic impacts. To date, the state government has received \$1.86 billion in relief aid. Much of that relief funding was used for new spending necessitated by COVID-19, but \$390 million supplanted the use of state general fund revenues that would have otherwise been expended. While the state budget outlook has improved dramatically due to the better than expected revenue collections, the reduced use of general fund revenues substituted with federal funding has also contributed.

Relief has also provided tremendous support directly to the private sector assisting both individuals and businesses as Arizona has received an estimated \$30 billion in stimulus checks, unemployment assistance, and business support. This impact has also been dramatic as *the Arizona personal income growth rate has doubled since the pandemic support started but has actually declined when excluding the federal assistance!*

Much of that federal relief has run out or expired and the impacts from a prolonged lapse of continuing support for struggling businesses and the massive number of unemployed remains to be seen. While enhanced unemployment assistance expired earlier in September, payroll protection loans for many businesses expired at the end of the month. As an example, the airlines' acceptance of CARES Act loans prohibited the firing and furloughing of employees through the end of September. Now, just this last week without an extension of that relief support, American Airlines laid off 19,000 while United released over 13,000.

Also last week, Federal Reserve Chairman Jerome Powell warned that a lack of further assistance could derail the economy and slip the U.S. into a tragic cycle of layoffs and economic decline. Despite the urgency, negotiations on another round of relief funding were on and off again throughout the week. The split partisan control of Washington and fast approaching elections have certainly complicated the ability to reach a consensus and there is much speculation that further support will not likely come until after Election Day on November 3rd.

TRANSPORTATION IMPACTS: For transportation, efforts to offset lost state-generated transportation revenue in the next round of federal relief funding continue. State departments of transportation nationwide are expected to lose \$37 billion as a result of the pandemic. The American Road & Transportation Builders Association (ARTBA) has already identified \$10.9 billion in canceled or delayed transportation projects across 18 states and 25 localities.

In Arizona, ADOT's most recent forecast from September projects a loss of \$500 million in HURF revenues over the next five years. Roughly half of that would have been distributed to counties and municipalities for local road systems and an estimated \$206 million will be lost from the ADOT five-year transportation construction program. That loss of direct funding will also trigger additional program losses due to a diminished bonding capacity and less potential match funding to pursue federal grants.

Also, as the FAC reviewed budget challenges for the upcoming year, the repeal of the annual \$32 Highway Safety Fee was identified. The Fee was enacted to end the long-time over-reliance on HURF revenue to pay for Highway Patrol operations but is now set to expire on June 30th. Prior to the Fee, more than \$2 billion was transferred away from highways and roads in this manner dating back to 2000. The repeal will *create a \$161 million funding gap for Highway Patrol in FY22*, the state budget year that will need to be addressed during this next legislative session.

When the legislature enacted the repeal date two sessions ago, many lawmakers insisted that they would not start raiding HURF again. Despite these assurances, this sizable lost revenue for the Highway Patrol budget will need to be backfilled during these very uncertain budget times and *could trigger another HURF raid battle*. Obviously, the better the state budget revenues, the less the pressure will be to raid HURF.

However, prior to that fight, the more immediate challenge is the direct loss of revenues attributed to the pandemic and here's a breakdown of the projected impact to the ADOT construction program:

Funding Gap & Mitigation Strategies

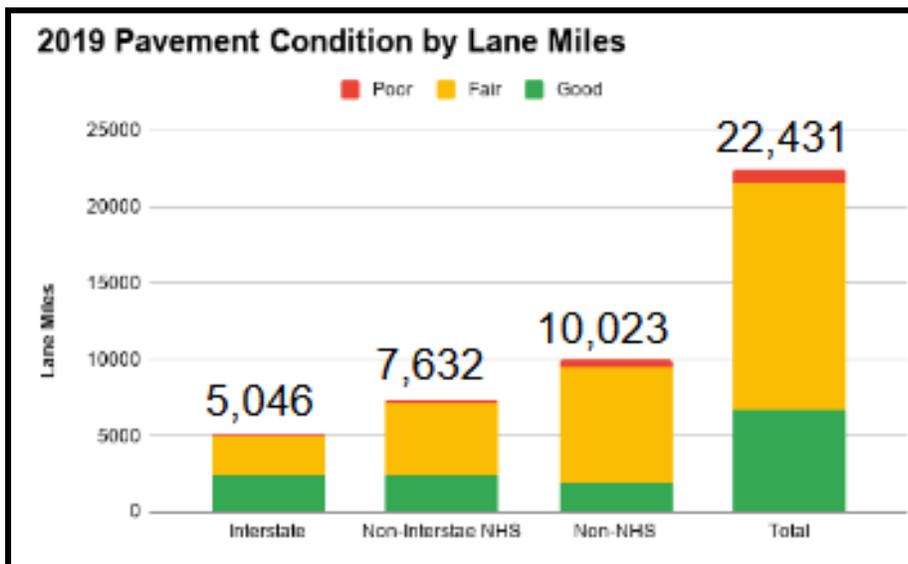
\$206.2M less State Highway Funds available
\$260.0M less bonding capacity
\$466.2M Total Funding Gap

Mitigation Strategies:

(\$206.6M) Operating & L,B,&I Budget Reductions
 (\$175.3M) 5Yr Hwy Construction Program Reductions
 (\$84.3M) Use of SHF Cash Balance
(\$466.2M) Total Mitigation Strategies

ADOT FINANCIAL SERVICES 9/18/20

Fortunately, the new ADOT projections are far better than the last and will likely enable ADOT to retain the I-17 expansion project and continue the HURF Exchange Program. Both had previously appeared to be in jeopardy. However, the new projected losses are still substantial and will come from what was already a very “lean” construction program, under-investing by more than \$1.1 billion annually according to ADOT’s current Long Range Transportation Plan. As a result, new construction across Greater Arizona was already at a bare minimum and maintenance will likely be the most impacted by these new revenue losses. At the last State Transportation Board meeting, ADOT Planning Director Greg Byres estimated it would take an additional \$4.2 billion to bring the entire existing highway system into “good” condition. Reducing maintenance funding will accelerate the deterioration of highways, roads and bridges that were already trending in the wrong direction and are of growing concern.



ADOT MULTIMODAL PLANNING DIVISION, 9/18/20