Expenditure Limitation Issue Summary and Potential Impact on PCC

Background:

In 1980, Senate Concurrent Resolution 1001 established 10 propositions to amend Article IX of the Arizona Constitution to define, modify, and generally restrict debt and taxation rules for local agencies. One of the propositions, Proposition 109, created expenditure limitations for school districts and community college districts. Following high inflation and concerns about growth in government and spending, the amendments were passed by popular vote. The subsequent changes to the Arizona Constitution were considered to be equivalent to California's proposition 13, which passed two years prior.

Arizona Constitution Title IX, Section 21:

Arizona's Constitution Title IX, Section 21. details the precise manner in which the expenditure limitation (EL) is implemented for both community college districts and school districts. A key phrase to remember is that EL is a cap on "EXPENDITURES OF LOCAL REVENUES," which is intended to be a control on tax-based public spending. As such, it does not constrain total spending, just spending from certain funding sources for operating purposes. Because the language is constitutional, changes would require a majority approval in a statewide election. This presents a particular problem as Section 21 specifies, in considerable detail, how expenditure limitation is implemented:

1. The base year, fiscal year (FY) 1979-80, from which the expenditure cap will be adjusted (*indexed*) for:
   a. Growth in demand (measured by enrollment), and
   b. Cost of living
2. The specific indexing methodology to be used for Cost of Living, which is either:
   a. The Implicit Price Deflator (also referred to as the Gross Domestic Price Deflator), or
   b. An alternate measure adopted by the legislature by concurrent resolution upon affirmative vote of two-thirds of each house to be implemented for subsequent fiscal years
3. Twelve specific exclusion categories that are not counted against the expenditure limitation
   a. Several of these exclusions are referred to as revenues, which creates significant confusion when projecting and accounting for EL. The most pertinent revenue-based exclusions for PCC include:
      i. Tuition & Fees,
      ii. Grants, and
      iii. Investments

      In other words, if all of the College's revenues came from Tuition & Fees, Grants, and Investments, the EL cap would exist, but there would be no expenditures against the cap.
   b. Additional exclusions include:
      i. Intergovernmental contracts (when the EL impact is borne by the other party),
      ii. Long-term debt, and
      iii. "Amounts accumulated by a community college district for the purpose of purchasing land, buildings, or improvements or constructing buildings or improvements."
4. The Economic Estimates Commission sets the expenditure limits each year (41-563. Expenditure limitations: determination by the commission: definitions), and the legislature develops a uniform reporting system (41-1279.07. Uniform expenditure reporting system: reports by counties, community college districts, cities and towns: certification and attestation: assistance by auditor general: violation: classification)

KEY POINT: Most general fund and operating expenses are not excludable, including personnel costs; most computing equipment; license agreements; and utilities.

The Formula

As previously mentioned, the EL cap is based on the amount of expenditures in each district in 1979/80 increased for growth in "student population" and adjusted for "inflation:" Community college student population is based on full time student equivalents (FTSE), which is defined in statute [15-1466.01. Calculation of full-time student enrollment; report] and audited annually by the state. Prior to FY18, community colleges utilized an estimated FTSE for the EL calculation. [Senate Bill (SB) 1322] amended the definition of FTSE for EL purposes, which is to be based on audited actual FTSE while also adding an extra 30% weight for Career and Technical Education (CTE) FTSE. For the purposes of the EL calculation, SB1322 also enabled colleges to use either: prior year audited weighted FTSE; the average of the past five years' audited figures; or prior year weighted plus 5% (if a college has fall-over-fall growth).

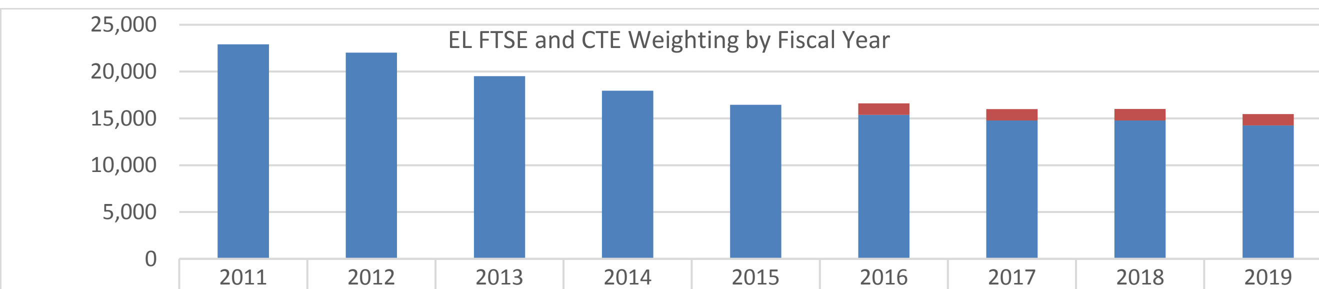
A [presentation was provided to the Governing Board] summarizing the changes from SB1322 (the [video] starts at the 2:20:45 mark). For the first three years of the new law (until FY21), the colleges can use a 10-year average for the population figure. Following is the EL formula:

Expenditure Limit = (FY80 Expenses) X (current weighted FTSE/FY80 FTSE) X (Cost of Living factor)

Utilizing the formula, the Current Year (FY19) PCC EL is:

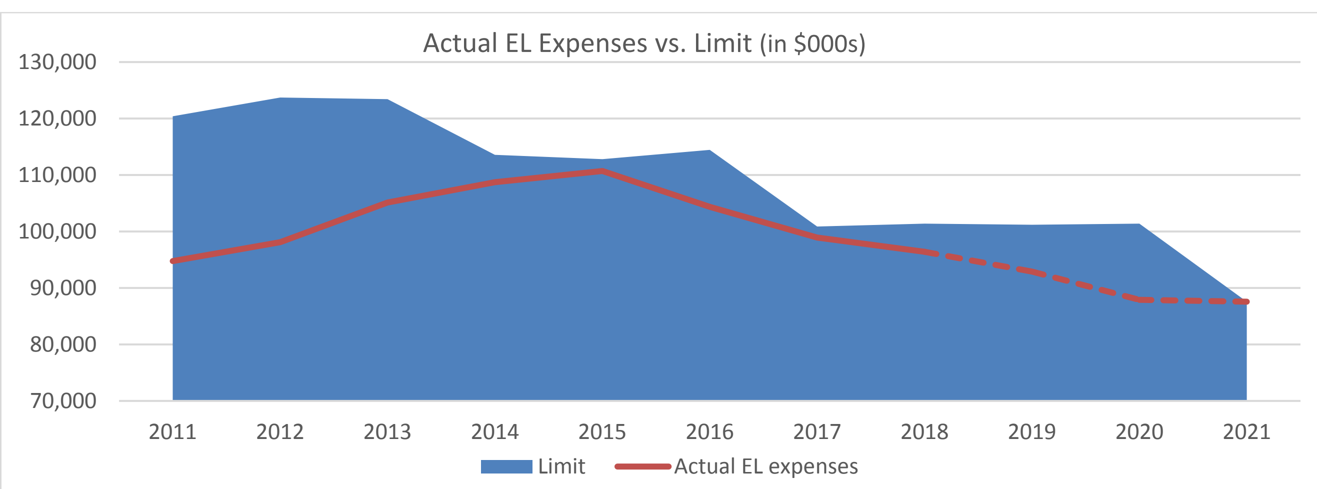
$19,071,763 X (19,461/11,038) X (3.0093) = $101,188,106

PCC's historical FTSE for EL purposes is demonstrated below:



	2011	2012	2013	2014	2015	2016	2017	2018	2019
CTE Weight						1,226	1,216	1,221	1,221
Base	22,907	22,028	19,514	17,963	16,458	15,382	14,779	14,783	14,247

FTSE has been in decline since the peak in fiscal year 2011, and the provision for calculating the EL using a 10-year average (thus maintaining peak enrollment as long as possible) ends in FY20. The impact to the calculation presents a challenge to the College, and the corresponding effect on the EL is projected below:



The EL drop in FY21 is approximately $15 million from the current level and is the primary driver of the three-year budget plan ("Scenario B") adopted by the College, which will reduce EL expenses by $5 million per year, from fiscal year 2018 to fiscal year 2020. The dotted part of the line indicates the College's planned expenses to meet the future EL level. The current fiscal year (FY19) is the second year of this reduction plan.

Other Issues of Note

Expenditure limitation was derived to limit local government operational growth and taxes, but the law does not necessarily reduce taxes the College could generate. The ability to tax and the significant restrictions pertaining thereto are outlined separately in the constitution and numerous state statutes. As PCC is currently at the levy maximum, it can increase taxes by two percent per year. The process follows a statutorily required, public Truth in Taxation Notification process prior to approval by the Governing Board; enrollment growth does not affect the ability to tax. The College can continue to levy at the maximum and use the funds for facility additions or improvements, or can reserve the funds for future facility needs and improvements, which are excludable expenses under EL.

SB1322 also clarified that gifts, grants, contract, auxiliary, and entrepreneurial revenues are excluded from expenditure limitation. These exclusions are included within 15-1444: General powers and duties of district governing boards.

Future Efforts to Minimize Impact of Expenditure Limitation

Although the structure of the three-year budget plan decreases net expenses to fall below the projected expenditure limit by the conclusion of FY20, the College will continue to be constrained until enrollment increases. Other Arizona community colleges are also presently facing EL challenges, or anticipating the possibility thereof, and their Presidents and Chancellors, who comprise the Arizona Community College Coordinating Council (AC4), have tasked their business officers with reviewing potential legislative strategies to reduce the adverse effects of EL. As with SB1322, Pima Community College will play a leading role with this effort.

There is also the possibility of a voter-approved base reset, as defined in 15-1471, but such an effort would be costly and carry significant uncertainty.