House Joint Resolution 03-1033 Study: TABOR, Amendment 23, the Gallagher Amendment, and Other Fiscal Issues

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September 2003

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Submitted herewith is the report on the study of constitutional and statutory provisions required by House Joint Resolution 03-1033. The resolution required this office to study the interaction of three provisions of the Colorado Constitution) Section 20 of Article X (TABOR), Section 17 of Article IX (Amendment 23), and Section 3 (1) of Article X (the Gallagher Amendment)) and any other relevant constitutional and statutory provisions that impact the ability of the state to provide funding for programs and services. Following the adoption of House Joint Resolution 03-1033, the General Assembly adopted House Joint Resolution 03-1060. This resolution designated the Legislative Council as the committee to receive this report.

Sincerely,

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EXECUTIVE SUMMARY

EXECUTIVE SUMMARY

During the past two years, beginning with the special session in the fall of 2001, the General Assembly has devoted significant time to grappling with the state budget within the constraints of declining revenues. General Fund revenues fell about $981 million during FY 2001-02 and another $94 million in FY 2002-03. Thus, over two years, General Fund revenues declined almost $1.1 billion. The General Assembly took a three-pronged approach in addressing the state's budget difficulties. First, it transferred about $1.2 billion in cash funds to the General Fund over the course of three budget years. Second, it freed up General Fund revenues and funding for specific programs by establishing new and increasing existing fees. Third, it cut spending. General Fund expenditures decreased by $221 million in FY 2001-02 and $96 million in FY 2002-03, before increasing by $82 million in FY 2003-04.

The revenue reductions that created the state's budget difficulties were caused by a severe downturn in the state economy that began in early 2001. Although the economy stalled in 1991 and 1992, the 2000 recession was the first major economic downturn since TABOR was adopted in 1992 and Amendment 23 was adopted in 2000. It was the first recession that occurred while TABOR, Amendment 23, and the Gallagher Amendment were all in place. In short, TABOR limits state revenue, requires voter approval for tax increases, and limits growth in property taxes.[1] Amendment 23 requires minimum increases in funding for elementary and secondary education, diverts a portion of income tax revenues to a special fund, and establishes minimum levels of appropriation increases for the school finance act.[2] Finally, the Gallagher Amendment holds down increases in the property tax base for local governments, including school districts by limiting the taxable value of residential property.[3]

During the 2003 legislative session, the General Assembly recognized that the three constitutional provisions interact in such a way as to limit the state's budgetary flexibility and the ability of the state to maintain current services during economic downturns. Questions also arose as to how the constitutional provisions would affect the state budget as the economy recovers. The General Assembly recognized that the three constitutional provisions were adopted at different times and more information is necessary to assess their combined impacts. In response, the General Assembly adopted House Joint Resolution 03-1033. This resolution requires the Legislative Council Staff to conduct a study of the interaction of TABOR, Amendment 23, the Gallagher Amendment, and any other relevant constitutional and statutory provisions. It also requires the report to include options for constitutional or statutory changes the General Assembly could pursue to better enable the state to fund necessary programs and services in times of economic weakness and reduced state revenues.

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[1] Article X, Section 20, Colorado Constitution

[2] Article IX, Section 17, Colorado Constitution

[3] Article X, Section 3 (1), Colorado Constitution

Organization of Report

This report is divided into six chapters, as follows:

- ✓ Chapter 1: The Business Cycle and Government Expenditures
- ✓ Chapter 2: Revenue and Spending Limits
- ✓ Chapter 3: Fiscal Emergencies
- ✓ Chapter 4: Property Taxes
- ✓ Chapter 5: Amendment 23 and State Fiscal Issues
- ✓ Chapter 6: Capital Construction Funding

In addition to these six chapters, the report includes four appendices. Appendix A is a copy of House Joint Resolution 03-1033, which contains the parameters for the study. Appendix B provides more in-depth information on state government expenditures for the six state departments that consume the greatest portion of General Fund money. Appendix C contains an overview of tax and expenditure limits in other states. The current TABOR refund mechanisms are summarized in Appendix D.

Overview of the Report

The following paragraphs highlight the major discussion points of each chapter.

Chapter 1: The Business Cycle and Government Expenditures

During the robust economic expansion of the 1990s, General Fund spending was constrained by the state's constitutional and statutory limits. The previous year's TABOR surplus had to be refunded, and, with some exceptions, General Fund appropriations could not increase by more than 6 percent each year. With revenues expanding steadily, the General Assembly was able to afford relatively high levels of highway and capital construction.

As the recession hit over the last three budget years, General Fund spending was no longer constrained by TABOR or the 6 percent limit, but by declining revenue. General Fund expenditures decreased 4 percent between FY 2000-01 and FY 2003-04. The recession also changed the distribution of General Fund spending. The Departments of Education, Corrections, and Health Care Policy and Financing were protected relative to other programs in state government. Cash fund revenue and reserves were drawn upon to help maintain General Fund appropriations, and the funding mechanisms for many programs changed, as the General

Assembly searched for programs that could be funded with other sources of revenue. Spending on capital construction was dramatically curtailed, and General Fund spending for highway construction went from $197.2 million in FY 2000-01 to zero during the last two budget years.

Chapter 2: Revenue and Spending Limits

Colorado is among 28 states that have tax and expenditure limits, although Colorado is generally considered to have the most restrictive limits in the country. State tax and expenditure limits differ in how they were enacted, their flexibility, how they handle the transfer of government programs, whether the limit is imposed on spending or revenue, how the limit is calculated, and the treatment of money over the limit. TABOR has three major provisions that qualify it as a state tax and expenditure limit. First, it requires voter approval for tax increases. Second, it limits the amount of revenue the state may collect each year. Third, through its provision requiring voter approval to weaken an existing limit, it limits General Fund appropriations. The report primarily addresses the latter two limits.

Limit on revenue. TABOR limits annual growth in most state revenue to inflation plus the percentage change in the state's population. When revenue is less than the allowable TABOR limit, the base for determining the following year's limit is reduced. Because the new limit is at a lower level than it otherwise would have been, the limit is said to have ratcheted down. Since revenue in FY 2001-02 and FY 2002-03 was lower than the limit, Colorado's allowable revenues are permanently reduced. Because the state typically experiences population growth and inflation, it will need to provide services to more people, at a higher cost, but with less revenue than in previous years.

- ✓ An option for addressing this conundrum to submit a constitutional amendment to the voters to eliminate the ratchet-down effect of TABOR.

Three states use the same measure as Colorado to limit spending or revenue, while fourteen states use personal income. Should the General Assembly decide the current TABOR limit factors are not the most appropriate indicators for limiting government revenues, it could consider a constitutional amendment to use the annual percentage change in personal income as the growth limit on state revenue. With either the current limit or personal income, the General Assembly could also consider a multi-year moving average of the limit.

Limit on General Fund appropriations. Continuing to increase General Fund appropriations by 6 percent or more will consume an increasing portion of allowable TABOR revenue.

- ✓ The General Assembly could consider making the appropriations limit the same as the TABOR limit so that the two limits would move in tandem.

Other issues. Additional options to make the state TABOR limits more responsive to changes in the economy include:

- ✓ permanently exempting from TABOR any spending for reimbursement of the homestead exemption; and

- ✓ excluding unemployment insurance taxes from the TABOR base.

Regarding the homestead exemption, the lack of a TABOR surplus meant that the General Fund paid the $44.1 million that was originally expected to come from reduced taxpayer refunds. The General Fund also paid the $17.4 million difference between the estimated cost and the actual cost. The unemployment insurance tax is the result of a federal mandate and is volatile and countercyclical to the economy. Because of its interaction with the economy, General Fund revenue available for spending increases during years when revenue is plentiful and is substantially reduced during years when it is not.

Chapter 3: Fiscal Emergencies

Colorado currently keeps two types of reserves. The first reserve is statutory and is equal to 4 percent of the state's General Fund appropriations. The second reserve is required by the state constitution and is equal to 3 percent of total TABOR revenue. The statutory reserve is available for most purposes while the constitutional reserve is very restrictive in its allowable usage and payback.

Unlike 45 other states, Colorado does not maintain a reserve fund specifically for fiscal emergencies. These funds are typically referred to as rainy day funds. Although the requirements surrounding these funds vary widely, they are usually very detailed in how money is deposited into the fund. Equally detailed are the restrictions for when money can be spent from the fund; rainy day funds typically have spending restrictions intended to limit the use of money to economic downturns. Should the General Assembly wish to create a rainy day fund, several options are available for accumulating money in the fund and restricting its use.

- ✓ Options for accumulating money in a rainy day fund include cutting spending elsewhere in the budget, using excess General Fund reserves, asking voters to change the constitutional reserve into a rainy day fund, and asking voters to allow the state to retain surplus revenue for such a fund.

- ✓ Options to limit the use of money in a rainy day fund to fiscal emergencies include setting economic or budgetary triggers, requiring a supermajority vote to spend money from the fund, and limiting the percentage of the fund that can be used at one time.

- ✓ Another option would be to ask voters to allow savings to be exempt from TABOR spending limits up to some specified amount and to require that the money count under TABOR limits when it is spent.

Chapter 4: Property Taxes

Property taxes play into the state's fiscal situation through the school finance act, which is funded primarily through a combination of property taxes and state aid. State aid makes up the difference between the total amount of funding provided through the school finance act and the amount available through local sources, mainly property taxes.

The data point to three important conclusions about Colorado's property tax system. First, the constitutional limits have been effective in holding down increases in property taxes. Second, the requirement to revalue property every two years creates a volatile pattern of growth in taxable property values that contrasts with the annual limits. As a result, the property tax often does not generate revenue sufficient to reach the limits allowed by law. Third, the state's share of funding under the school finance act has grown significantly and is expected to continue growing in the future, adding pressure to the state's budget. To varying degrees, these conclusions are the result of a decline in the residential assessment rate driven by Gallagher, TABOR limits on property tax revenue and mill levy increases, and the requirement in Amendment 23 to increase school finance act funding more than the maximum allowable growth in property taxes.

Several options exist for modifying the property tax system to make the system more equitable and improve the state's flexibility in funding necessary programs and services in times of economic weakness and reduced state revenues.

- ✓ One option would be to ask voters to restore the authority of the General Assembly to set property taxes for school finance. Or, voters could be asked to restore the link between changes in a district's wealth and its contribution for school finance.

- ✓ The General Assembly could ask voters to restore the floating mill levy for schools within certain limits, similar to temporary property tax reductions used by other local governments.

- ✓ The General Assembly could ask voters to make the constitutional school finance provisions consistent, either by reducing the Amendment 23 requirement for one additional percent or by increasing the TABOR limit to allow for the one additional percent through FY 2010-11.

- ✓ The General Assembly could address the state's biennial reassessment cycle in the context of TABOR's annual limits, either by changing the cycle for reassessing property or by modifying the calculation of the limit to account for two-years' worth of growth in values.

Chapter 5: Amendment 23 and State Fiscal Issues

Amendment 23 guarantees a minimum increase in per pupil funding in the school finance act and for categorical programs. To pay for the school finance act increases, the amendment requires the General Fund appropriation for state aid to increase by at least 5 percent annually,

except when state personal income increases by less than 4.5 percent. It also diverts one-third of one percent of taxable income on state income tax returns to the State Education Fund. The diverted income tax revenue is exempt from the state revenue limits of TABOR. Money in the State Education Fund can be used to help pay for the minimum increases in school finance and categorical funding or for programs to reform education, reduce class sizes, expand technology education, or meet state academic standards, among others.

Since Amendment 23's passage, the economic downturn has resulted in a number of unanticipated consequences. Income taxes, the primary revenue source for the State Education Fund, declined 19 percent in FY 2001-02. In addition to affecting revenue for the State Education Fund, the decrease in income and other taxes affected the General Fund's ability to support the appropriation increases necessary to develop a substantial balance in the State Education Fund. Therefore, the fund will not be in a position in the next several years to cushion General Fund increases for school finance. The drop in state revenues also means that the diversion of income tax revenues to the State Education Fund will affect the General Fund, rather than TABOR surpluses, now and in the future. At the same time, the minimum spending increases for school finance and categorical programs continue. Amendment 23 is estimated to account for $1.4 billion in increased education funding in its first seven years.

- ✓ The General Assembly's options to mitigate the impact of Amendment 23 on the state budget include asking voters to increase revenue, either by increasing taxes or further reducing taxpayer refunds, or to reduce the spending requirements of Amendment 23.

Chapter 6: Capital Construction Funding

State appropriations for capital construction and controlled maintenance projects are made from the Capital Construction Fund and the Controlled Maintenance Trust Fund. However, the funding source for these two funds is primarily the General Fund. Of the $2.9 billion appropriated for capital in the last 15 years, 74 percent has come from the General Fund.
The state has mostly relied on a "pay-as-you-go" system to fund projects. It has, however, borrowed money by issuing certificates of participation at times when General Fund revenue was insufficient to fund capital needs.

Because the General Fund is susceptible to changes in the economy, capital funding can be erratic and fluctuate from year to year. Over the past 15 years, state funding for capital projects in Colorado rose from less than $100 million in the early 1990s to a peak of $523 million in FY 1998-99, then plummeted to the current year's appropriation of $9.5 million. Of the $2.9 billion appropriated for capital projects since FY 1989-90, $264.3 million, or about 9 percent, was appropriated for projects funded through certificates of participation.

Colorado's capital needs tend to grow despite vacillations in the economy. Over the last 13 years, the state has increased its inventory of state-funded facilities by 38 percent, from 27.3 million gross square feet to 37.3 million gross square feet. Approximately 30 percent of the increase is due to the acquisition of existing facilities. As the state acquires existing facilities and

constructs new facilities, the cost to maintain the facilities increases. This cost is primarily borne by the General Fund.

The largest recipient of capital construction funding over the last 15 years has been higher education institutions, followed by the Department of Corrections. Higher Education and Corrections received about 65 percent of the capital construction budget for the 15-year period. The Department of Corrections' square footage grew by 175 percent between FY 1990-91 and FY 2003-04, from 2.4 million square feet to almost 6.6 million square feet. The square footage for Higher Education, by contrast, grew by 33 percent, from 17.7 million to 23.6 million square feet.

The primary factor contributing to the erratic funding for capital is its reliance on the General Fund as a source of revenue. The General Fund is subject to the growing and competing operating needs of state departments. It also suffers during economic downturns. Options available to the state to pay for its current and future capital needs include statutory changes as well as constitutional changes.

- ✓ Statutory options include extending the minimum annual General Fund transfer to the Capital Construction Fund, requiring appropriations for new projects to include costs for out-year maintenance, and using student fees to fund higher education facilities.

- ✓ Options requiring voter approval would include establishing a new dedicated tax or fee and allowing for general obligation debt.

CHAPTER 1

CHAPTER 1
BUSINESS CYCLE AND GOVERNMENT EXPENDITURES

This chapter describes the relationship between the business cycle and state General Fund expenditures. A business cycle is comprised of an expansion and a recession in the economy.[1] The chapter is divided into three sections. The first section describes the most recent business cycle, which began in Colorado in 1986. Since expenditures are constrained by revenue, the second section describes the relationship between the economy and General Fund revenue. The third describes government expenditures and their relationship to the economy. In summary, General Fund revenues and expenditures increase faster during periods of economic fortune than during periods of economic hardship. During the most recent recession, revenues and expenditures declined. The economy also changes the distribution of General Fund spending. The state's six largest departments receive a larger share of General Fund during lean years than during years in which revenue is plentiful. During economic downturns, General Fund spending on capital construction and highways can be dramatically curtailed, cash fund reserves may be drawn on to augment General Fund spending, and programs previously funded by the General Fund may become funded with user fees.

Appendix B provides a more detailed discussion of state expenditures in the six largest departments of state government. The information included in Appendix B is the basis for some of the observations and conclusions made regarding state spending during Colorado's most recent business cycle.

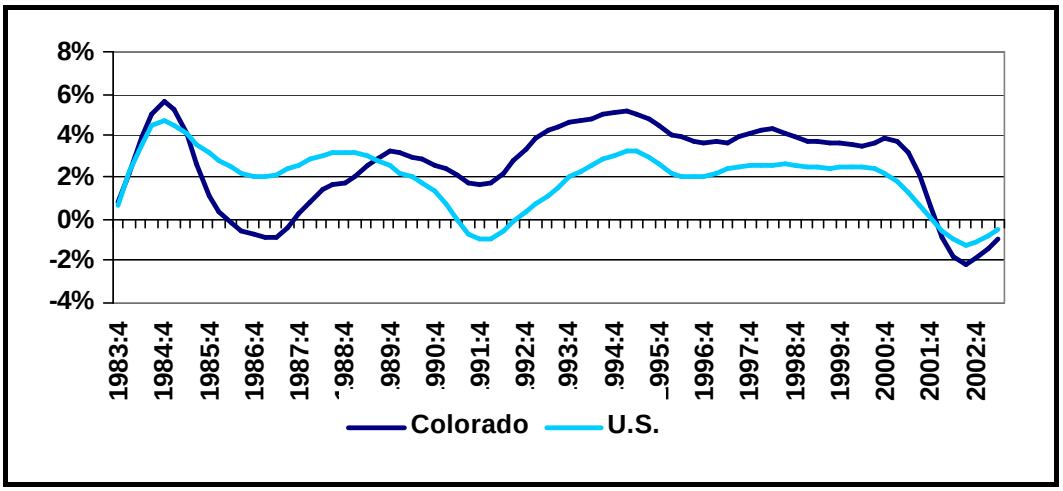
Colorado's Business Cycle: 1986 - 2003

Colorado's current business cycle is nearly 17 years old. The cycle began in late 1986, when employment in Colorado reached its lowest point in a regional recession. The recovery that followed was weak through the rest of the decade, and was just gaining steam in the early 1990s when it was temporarily stalled by a national recession. The period between early 1990 through late 1991 was characterized by growth below the normal trend, impeded by the national recession. Stronger growth resumed in 1992 and continued through the end of the decade. The peak in Colorado's economy occurred in late 2000. Colorado began to shed jobs in January 2001, and the losses accelerated through the remainder of the year. Colorado lost over 81,000 jobs between December 2000 and July 2003, equal to 3.6 percent of the peak in Colorado's

1. An expansion occurs between a trough and a peak in the economy. A recession occurs between a peak and a trough. The National Bureau of Economic Research (NBER), the organization responsible for dating peaks and troughs in the national business cycle, primarily bases dates of peaks and troughs on movements in inflation-adjusted Gross Domestic Product (GDP), inflation-adjusted income, employment, industrial production, and wholesale-retail sales. While the NBER tends to give more weight to changes in inflation-adjusted GDP than other economic variables, our analysis for Colorado's business cycle emphasizes changes in employment and inflation-adjusted income more heavily than changes in inflation-adjusted Gross State Product (GSP).

employment, which occurred in December 2000. The peak loss was 85,000 jobs, or 3.9 percent of December 2000 employment. Figures 1-1 through 1-3 show employment growth, inflation-adjusted per capita personal income growth, and retail trade growth since 1983. Where available, comparable national economic indicators are also shown.

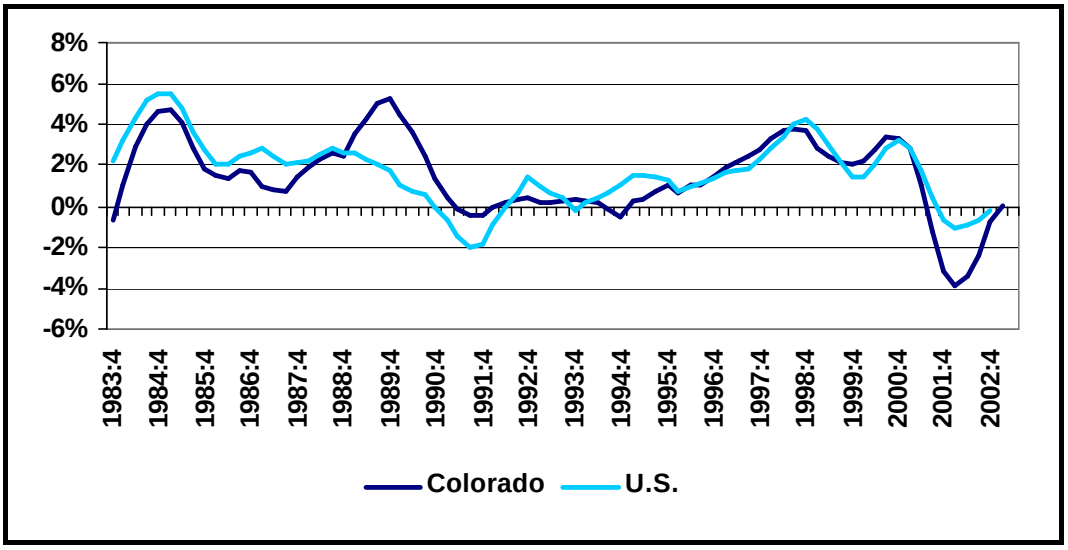
Figure 1-1
Employment Growth
Seasonally Adjusted, 4-Quarter Moving Average



1986 - 1990: Weak recovery. More than 30,000 jobs, or 2.1 percent of peak employment, were shed in two years between December 1984 and November 1986. It took another 19 months to attain the previous job peak. The regional recession was caused by the bursting of the oil and gas bubble and a bust in the real estate market that had become highly speculative in the early 1980s. The late 1980s were characterized by a slow recovery. Between 1987 and 1989, slow growth was seen in employment, income, and gross state product, while the unemployment rate slowly decreased. The data disguises continued pain during this period among many who, due to the changing mix of available jobs, were left out of the recovery. Although the state began adding jobs in 1987, 251,000 more people moved away from Colorado than moved into Colorado between 1986 through 1989. The construction sector did not fully recover until the early 1990s, after the large excess supply of homes and office buildings had been filled. By 1990, Colorado's economy was healthy, with past excesses corrected and the cost of living and cost of doing business in the state competitive with other parts of the nation. Colorado began to outperform the national economy.

1991 - 1992: A stalled expansion. By 1991, Colorado's costs of housing and office space had adjusted, leaving the state in a relatively favorable position to compete with other states. Thus, the Colorado economy was poised for sustained growth in 1991. While growth in employment, inflation-adjusted Gross State Product, and inflation-adjusted retail trade continued throughout this period, the economy experienced a slight slump and remained below the normal trend for nearly two years. Only inflation-adjusted per capita personal income suffered losses. Strong growth would have to wait for the national economy to recover from recession and war.

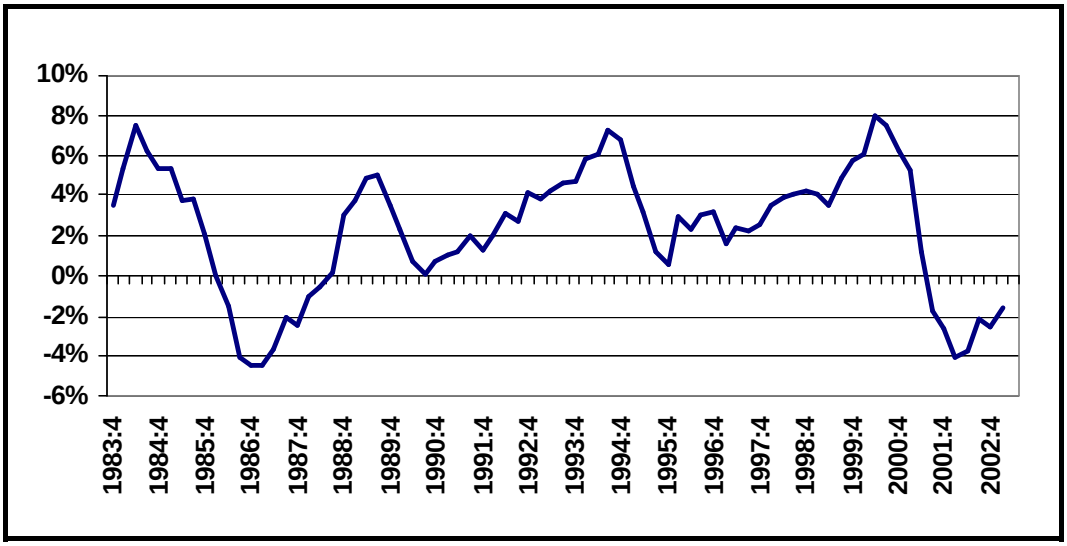
Figure 1-2
Inflation-Adjusted Per Capita Personal Income
4-Quarter Moving Average Growth Rate



1992 - 2000: Sustained expansion. The national and Colorado economies enjoyed strong and sustained growth between 1992 and 2000. By most measures, Colorado outperformed the nation. Employment in Colorado increased by nearly 670,000 jobs and at an average annual rate of 4.1 percent between 1991 and 2000. National employment increased at an average annual rate of 2.2 percent over the same time period. Colorado's population increased at the third-fastest rate in the nation between 1990 and 2000, growing by more than one million people on a base of 3.3 million. Personal income in Colorado increased at an average annual rate of 8.2 percent during the decade, the second fastest rate in the nation.

Growth in Colorado was fueled by strength in the advanced technology sector, a construction boom, and tourism. Within the advanced technology sector, the telecommunications industry was a particularly robust source of growth. Colorado's employment in the communications industry and its average wage paid doubled during the 1990s. The industry invested heavily in fiber-optic cable networks, creating excess capacity by the end of the decade. Software firms and advanced technology manufacturers also experienced strong growth over the decade as businesses nationwide invested heavily in computers and equipment designed to increase productivity. Meanwhile, Colorado's telecommunication and advanced technology firms, along with other less volatile sectors of the economy, invested heavily in office and industrial space. Residential construction also expanded steadily to fill the needs of a growing and upwardly-mobile population. Finally, the tourism industry benefitted from a strong national economy.

Figure 1-3
Inflation-Adjusted Retail Trade in Colorado
4-Quarter Moving Average Growth Rate



2001 - 2003: Recession. Colorado's economy followed the nation into recession in 2001. The sectors that fueled the boom in the 1990s were the hardest hit. The bubble burst in the advanced technology industry in March 2000, as the NASDAQ index fell precipitously, continuing to decrease through the summer of 2002. The telecommunications industry, saddled with an oversupply of cable and confronted with decreasing demand worldwide, contracted sharply. The tourism and airline industries were particularly hard hit after the September 11 terrorist attacks. Wildfires and a severe drought prevented whatever recovery may have occurred in the tourism sector in the summer of 2002. The drought caused widespread damage to Colorado's agriculture industry. Many crop harvests were substantially reduced, and for lack of adequate grazing land, ranchers found themselves forced to sell off cattle for slaughter.

Colorado began to shed jobs in January 2001, and the losses accelerated through the remainder of the year. Colorado lost over 81,000 jobs between December 2000 and July 2003, equal to 3.6 percent of its peak in December 2000. The peak loss was 85,000 jobs, or 3.9 percent of its December 2000 peak. Personal income growth slowed from 11.4 percent in 2000, to 3.6 percent in 2001, and to 0.8 percent in 2002. Adjusted for inflation, personal income in Colorado decreased 0.9 percent in 2001 and 1.1 percent in 2002. Retail trade in Colorado slowed from a 10.4 percent growth rate in 2000 to a 1.8 percent growth rate in 2001 before decreasing 0.6 percent in 2002. The construction sector sputtered, with the value of nonresidential construction decreasing 14.2 percent in 2000, 0.6 percent in 2001, and 20.9 percent in 2002. The correction in residential construction took longer to materialize. The number of home permits continued to expand through 2001, but decreased 12.2 percent in 2002. Buoyed by low mortgage rates, home prices continued to rise through the summer of 2003, although at diminished rates.

Colorado's recession was deeper than the nation's because it had a higher than average concentration in the advanced technology, telecommunications, airline travel, and tourism sectors. These were the sectors that fueled the boom in the late 1990s and were the hardest hit by

the national recession. To illustrate Colorado's economy relative to the nation's, Figure 1-4 shows a history of Colorado's national ranking for personal income growth, per capita personal income growth, employment growth, and population growth from 1995 through 2002.

Figure 1-4
Colorado Economic Indicators
1995-2002

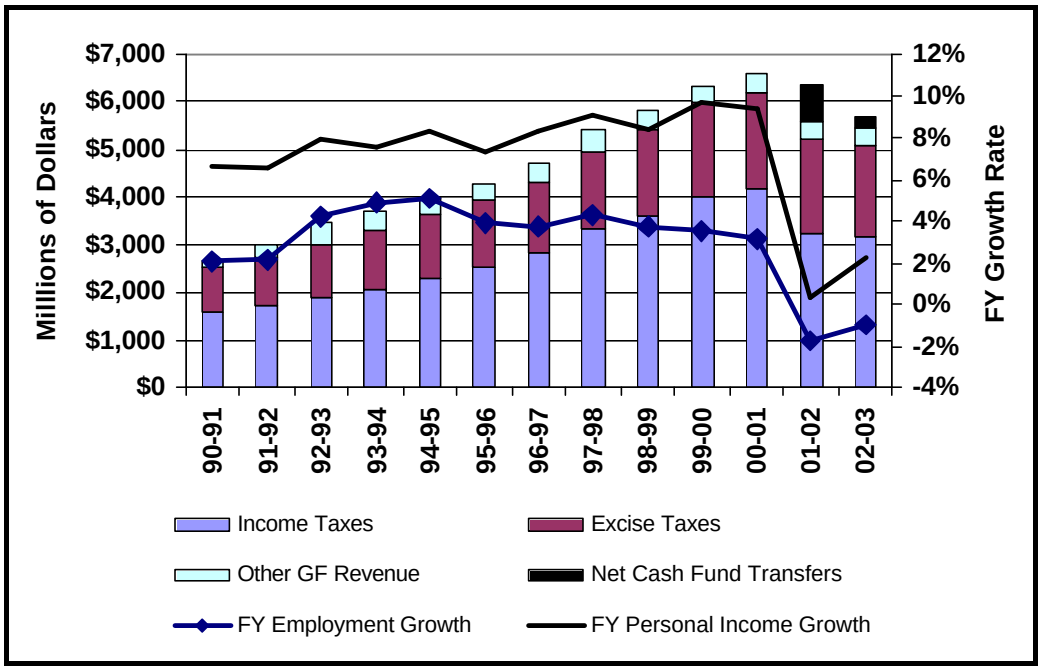
	Total Personal Income		Per Capita Personal Income		Employment		Population	
Year	Growth	Rank	Growth	Rank	Growth	Rank	Growth	Rank
1995	8.3%	3	5.4%	2	4.5%	4	2.8%	4
1996	7.6%	9	5.0%	14	3.6%	6	2.4%	4
1997	8.8%	3	6.1%	3	4.2%	4	2.5%	3
1998	8.9%	5	6.3%	15	3.9%	3	2.4%	3
1999	8.4%	1	5.6%	2	3.6%	3	2.7%	3
2000	11.4%	2	8.8%	5	3.8%	3	2.4%	3
2001	3.6%	26	1.2%	46	0.6%	17	2.4%	3
2002	0.8%	49	-0.9%	50	-1.9%	49	1.7%	6

Sources: Bureau of Economic Analysis, Bureau of Labor Statistics, U.S. Census Bureau

General Fund Revenue and Colorado's Economy

Economic conditions have a significant influence on General Fund revenue growth. Figure 1-5 shows General Fund revenue and growth in employment and personal income since FY 1990-91. Income and excise taxes, which are particularly vulnerable to economic conditions, comprised more than 90 percent of General Fund revenues during most of the time period shown in Figure 1-5. Income taxes were hit particularly hard by the recent recession; they declined by $1.0 billion between FY 2000-01 and FY 2002-03. Sales and use taxes, which represent about 95 percent of all excise taxes, fared better, decreasing $89.1 million between FY 2000-01 and FY 2002-03, and at an average annual rate of 2.4 percent. To help maintain core government services, the General Assembly chose to augment General Fund revenues with revenue from cash funds in FY 2001-02 through FY 2003-04. Prior to these recent transfers, the last transfer of cash fund revenue to the General Fund occurred in FY 1991-92, also a time of fiscal stress, when $11.6 million was moved from the Capital Construction Fund.

Figure 1-5
General Fund Revenue and the Economy



Individual income taxes. While wages and salaries are the primary influence on individual income tax revenue, capital gains introduce volatility to the tax revenues that is much different than the volatility of the overall business cycle. Individual income taxes increased at an average annual rate of 10.6 percent between FY 1990-91 and FY 2000-01, while personal income increased at an average annual rate of 8.2 percent. Capital gains were responsible for much of the double-digit growth in individual income taxes during the late 1990s and the large decreases in the past two years. In Colorado, capital gains were more than seven times higher in 2000 than in 1990. Personal income does not include capital gains income, and thus individual income taxes tend to be more volatile than personal income. Figure 1-5 shows that employment decreased and personal income growth was flat in FY 2001-02. These facts alone would not warrant a 16.7 percent decrease in individual income taxes. The large decrease in individual income taxes was likely attributable to a decrease in capital gains. While capital gains data specific to Colorado are not available, capital gains decreased 44.5 percent nationwide in 2001. Meanwhile, individual income taxes decreased an additional 6.7 percent in FY 2002-03.

Corporate income taxes. Corporate profits are substantially more volatile than the overall business cycle. Thus, corporate income taxes are also quite volatile. Corporate income taxes increased at an average annual rate of 11.1 percent between FY 1990-91 and FY 2000-01. Corporate income taxes decreased 46.0 percent in FY 2001-02 as a result of the recession and declining corporate profits, the telecommunications industry's struggles, accounting scandals, and the September 11 terrorist attacks. Corporate income taxes increased 26.4 percent in FY 2002-03, but remained $104.6 million lower than in FY 2000-01.

Sales and use taxes. Taxes on consumer spending tend to more closely mirror changes in income growth than do income taxes. Sales and use taxes increased at an average annual rate of 8.5 percent between FY 1990-91 and FY 2000-01, while personal income increased at an average annual rate of 8.2 percent. Although personal income was relatively flat at a 0.3 percent growth rate in FY 2001-02, sales and use taxes decreased 2.2 percent. A reduction in the tax rate from 3.0 percent to 2.9 percent in January 2001 contributed to the decrease. Sales and use taxes decreased an additional 3.0 percent in FY 2002-03.

General Fund Expenditures and Colorado's Economy

The economy affects General Fund expenditures because it influences the amount of General Fund revenue available to fund expenditures. The economy did little to restrain General Fund expenditures during the economic boom of the 1990s. The only restraints came from the state's constitutional and spending limits. The story is different during an economic downturn. Reduced revenues constrained General Fund expenditures during FY 2001-02 through FY 2003-04. The General Assembly responded with a combination of three strategies. First, programs that are constitutionally protected or deemed necessary for public health and safety were prioritized. Second, the General Assembly searched for programs whose General Fund appropriations could be reduced or replaced with another source of existing revenue or new fee revenue. Third, the General Assembly augmented General Fund revenues with cash fund revenues and reserves. Lower priority programs that couldn't easily be funded another way were reduced or eliminated. As a result, not only did the level of General Fund expenditures fall during the recession, but the distribution of General Fund spending changed.

General Fund expenditures: 1990-2004. The General Fund is used to pay the operating expenses of many state government agencies.[2] Among other things, it is also used to reimburse local governments for the homestead exemption, pay for lawsuit settlements, and construct, maintain, and renovate state buildings and highways. Figure 1-6 shows total General Fund expenditures since FY 1989-90, spending for the six largest departments, and spending for all other departments.[3] Excluding the TABOR refund, General Fund expenditures increased at an average annual rate of 7.8 percent between FY 1989-90 and FY 2000-01, from $2.60 billion to $5.94 billion. However, due to the state's recent economic downturn, General Fund expenditures decreased for two consecutive years: by $221 million in FY 2001-02 and $96 million in FY 2002-03. In FY 2003-04, the General Assembly increased General Fund spending by $82 million, or roughly 1.5 percent over FY 2002-03. Total General Fund obligations for FY 2003-04 are $5.70 billion, approximately $235 million lower than three years ago.

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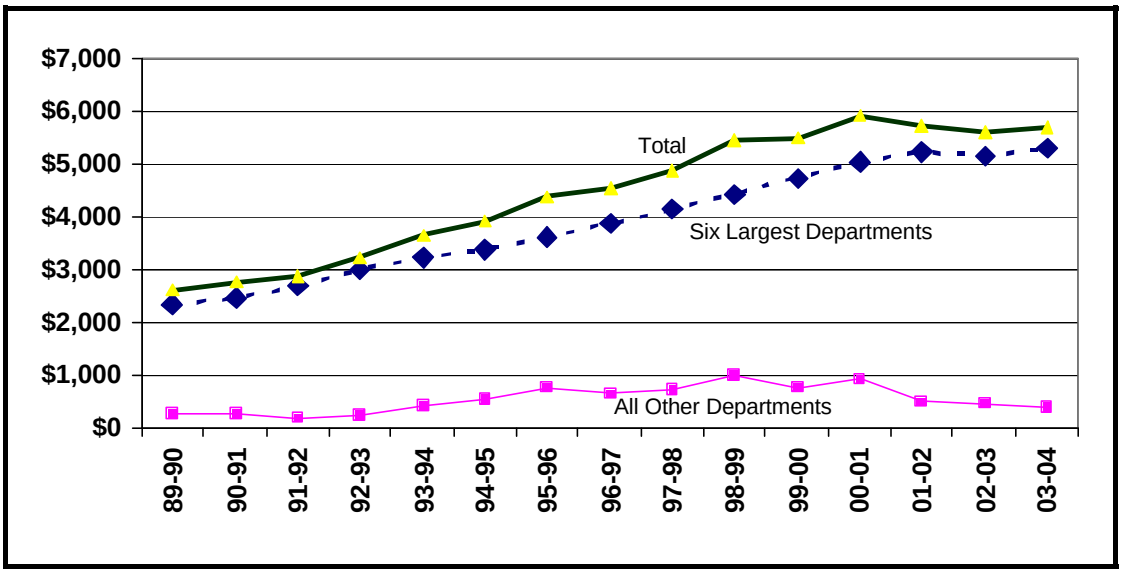
2. Operations for some agencies are paid for with cash fund revenue. For example, the Department of Transportation is primarily funded with state and federal gasoline taxes and with motor vehicle registration fees. The Department of Labor and Employment is entirely funded with state and federal unemployment insurance taxes and other cash fund revenue. The Department of State receives all of its operating revenue from fees and fines.

3. Spending data reflect actual expenditures for each year from FY 1989-90 to FY 2001-02, including capital spending and Senate Bill 97-1 diversions for highways. Data for FY 2002-03 and FY 2003-04 are total appropriations for operations and capital.

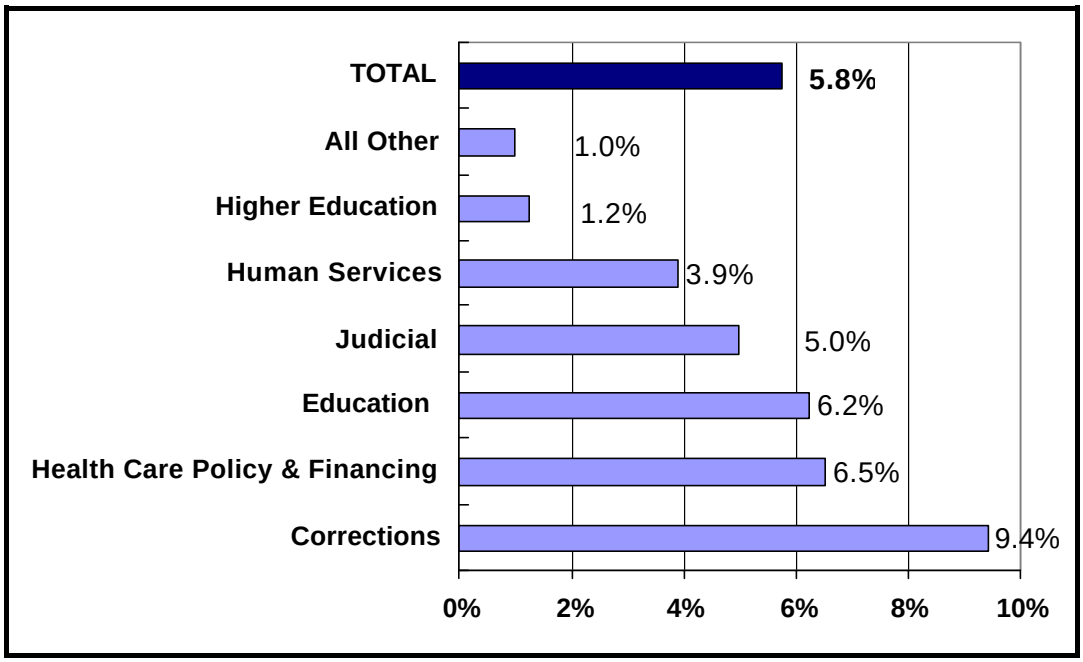
Figure 1-6
General Fund Expenditures
(dollars in millions)



These figures include the Senate Bill 97-1 diversion of sales and use taxes, even though technically these revenues, when diverted, never actually reach the General Fund. Senate Bill 97-1 diverts 10.355 percent of state sales and use tax revenue from the General Fund to the HUTF. Each year, the diversion occurs only if there is enough money available to fund General Fund appropriations at a six percent growth rate and the four percent statutory General Fund reserve. Between FY 1997-98 and FY 2001-02, $746.1 million was diverted to the HUTF. Only $35.2 million was diverted in FY 2001-02. Nothing has been diverted since FY 2001-02, and diversions are not expected to resume in the near future.

Figure 1-7 illustrates how the distribution among the major departments changed during this time period. Total General Fund expenditures increased at an average annual rate of 5.8 percent between FY 1989-90 and FY 2003-04. This roughly matches the TABOR-imposed revenue cap of inflation and population growth in this time frame. Three departments have grown faster than total General Fund expenditures since 1990: Corrections (9.4 percent), Health Care Policy and Financing (6.5 percent), and Education (6.2 percent). As a result, these three departments now account for a larger share of General Fund spending than in FY 1989-90. General Fund expenditures for the remaining large departments) Judicial, Higher Education, and Human Services) have all grown at a slower pace than total General Fund expenditures. Meanwhile, the average annual growth rate for all other departments was 1.0 percent.

Figure 1-7
Average Annual Growth in General Fund Expenditures
FY 1989-1990 through FY 2003-2004



2001 - 2004: What happened as a result of the recession? The recession changed the distribution of General Fund spending. The first half of Figure 1-8 shows the change in General Fund spending on each state department between FY 2000-01 and FY 2003-04. The second half shows the total budget for each department, including General Fund, cash funds, and federal funds revenue. General Fund spending on the six departments that consume the largest share of the General Fund (Education, Health Care Policy and Financing, Higher Education, Corrections, Human Services, and Judicial) showed modest gains between FY 2000-01 and FY 2003-04. Partially as a result of Amendment 23, General Fund spending on education increased 12.8 percent during this period, and the proportion of total General Fund expenditures received by the Department of Education increased from 37.3 percent to 42.4 percent. General Fund expenditures on the six largest departments increased from $5.0 billion in FY 2000-01 to $5.3 billion in FY 2003-04, an increase driven by caseload and cost increases in prisons, schools, and the Medicaid program. General Fund spending on the remaining departments, however, decreased by $82.3 million since FY 2001-02, or by 28 percent. Spending for capital construction decreased by 97 percent, or approximately $276 million. In addition, the General Assembly temporarily eliminated the homestead exemption on property taxes for seniors. Thus, one of the General Assembly's budgetary responses to declining state revenues has been to maintain General Fund support for the largest state agencies by cutting General Fund support for other departments.

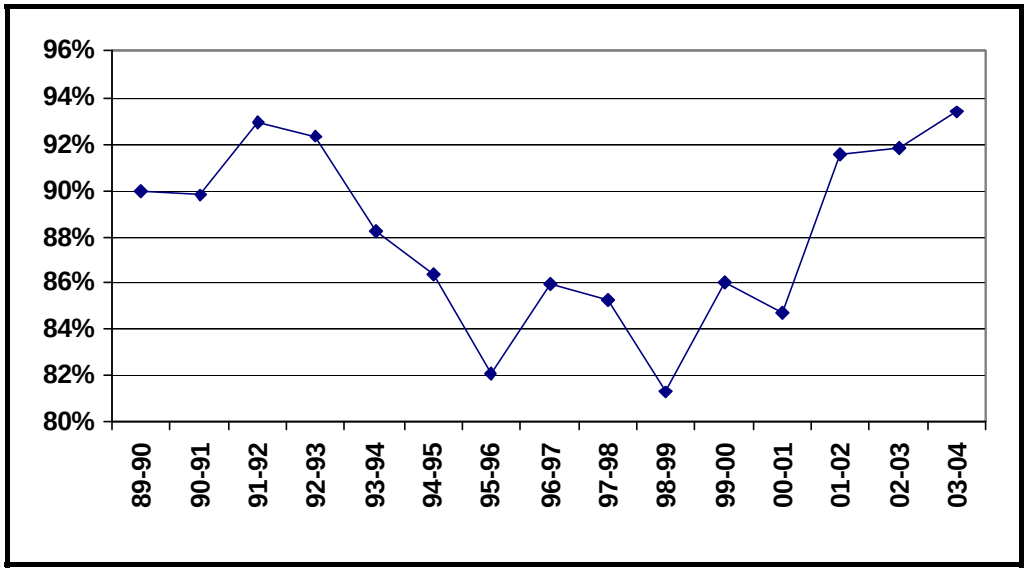
Figure 1-8
Change in Spending
(millions of dollars)

	General Fund Spending				Total Spending			
Department/Fund	**FY 2000-01**	**FY 2003-04**	**Change**	**% Change**	**FY 2000-01**	**FY 2003-04**	**Change**	**% Change**
Public Health & Environment	$33.5	$12.4	-$21.0	-63%	$255.8	$257.6	$1.8	1%
Revenue*	$78.3	$59.0	-$19.3	-24%	$446.2	$491.3	$45.1	10%
Natural Resources	$28.9	$19.6	-$9.3	-32%	$160.0	$168.9	$8.9	6%
Personnel & Administration	$14.8	$7.9	-$6.9	-47%	$145.3	$163.7	$18.4	13%
Governor	$19.8	$13.2	-$6.6	-33%	$36.8	$33.8	-$2.9	-8%
Local Affairs	$10.5	$4.8	-$5.7	-55%	$134.6	$174.0	$39.4	29%
Agriculture	$9.9	$4.2	-$5.7	-58%	$30.0	$29.0	-$1.0	-3%
Public Safety	$56.6	$54.2	-$2.4	-4%	$166.5	$195.5	$29.0	17%
Law	$8.6	$6.5	-$2.0	-24%	$31.8	$33.4	$1.6	5%
Treasury**	$2.4	$0.8	-$1.6	-68%	$247.3	$258.0	$10.7	4%
Regulatory Agencies	$2.0	$1.1	-$0.9	-46%	$61.5	$67.4	$5.8	10%
Legislature	$27.4	$27.0	-$0.4	-1%	$30.7	$28.5	-$2.2	-7%
Military & Veterans Affairs	$4.1	$3.8	-$0.3	-6%	$116.8	$127.4	$10.6	9%
Labor & Employment	$0.0	$0.0	$0.0	na	$123.6	$115.8	-$7.7	-6%
State	$0.0	$0.0	$0.0	na	$11.4	$15.5	$4.1	36%
Transportation	$0.0	$0.0	$0.0	na	$1,194.6	$846.5	-$348.1	-29%
Subtotal - All Other Departments	**$296.8**	**$214.5**	**-$82.3**	**-28%**	**$3,192.9**	**$3,006.3**	**-$186.6**	**-6%**
Higher Education	$747.3	$591.4	-$155.9	-21%	$1,534.3	$1,648.3	$114.0	7%
Human Services***	$489.8	$460.3	-$29.5	-6%	$1,782.9	$1,806.0	$23.1	1%
Judicial	$205.3	$207.3	$2.0	1%	$256.7	$273.2	$16.5	6%
Corrections	$417.7	$469.8	$52.1	12%	$482.9	$536.6	$53.7	11%
Education	$2,143.1	$2,417.7	$274.5	13%	$2,549.2	$3,252.6	$703.4	28%
Health Care Policy & Financing	$1,028.8	$1,177.6	$148.8	14%	$2,296.1	$2,879.4	$583.3	25%
Subtotal - Six Largest Departments	**$5,032.0**	**$5,324.0**	**$292.0**	**6%**	**$8,902.0**	**$10,396.1**	**$1,494.0**	**17%**
Capital Construction Fund	$285.3	$9.5	-$275.8	-97%	$525.4	$480.5	-$44.9	-9%
CMTF/Cash Flow Reserve	$0.0	$40.0	$40.0	na	$0.0	$40.0	$40.0	na
Transportation (SB97-001)	$197.2	$0.0	-$197.2	-100%	$197.2	$0.0	-$197.2	-100%
Other Transfers****	$125.5	$113.9	-$11.6	-9%	$125.5	$113.9	-$11.6	-9%
Subtotal-Capital/SB97-001/Transfers	**$608.0**	**$163.4**	**-$444.6**	**-73%**	**$848.1**	**$634.4**	**-$253.7**	**-30%**
TOTAL	**$5,936.6**	**$5,701.8**	**-$234.8**	**-4%**	**$12,943.1**	**$14,036.8**	**$1,093.7**	**8%**

na = Not applicable
**Excludes spending for cigarette rebate and aged property tax and heating credit*
***Excludes spending for the Fire and Police Pension Association, required by 31-30-1112, C.R.S*
****Excludes Old Age Pension Fund*
*****Includes transfers for Fire/Police expenditures, cigarette rebates, aged property tax and heating credit, and Old Age Pensions*

The proportion of General Fund spent on the six largest departments tends to be greater during economic downturns. Figure 1-9 shows the percentage of General Fund spending allocated to the six largest departments. Support for the six largest departments peaked in FY 1991-92 and FY 2003-04, years saddled with poor economic conditions. During periods of economic growth, however, ample General Fund revenues were available for other purposes. For example, while General Fund spending for the six largest departments increased in FY 1998-99, the overall share of support allocated to the six largest departments dropped to 81 percent of total spending as additional General Fund revenues were transferred to the Capital Construction Fund, the Controlled Maintenance Trust Fund, and the Department of Transportation for highway construction (Senate Bill 97-1). The percentage of total General Fund resources allocated to the six largest departments is at 93 percent in FY 2003-04, its highest level in the past 15 years.[4]

Figure 1-9
Allocation of Total General Fund Spending To Six Largest Departments



4. Total General Fund spending includes transfers for capital construction and controlled maintenance, as well as Old Age Pension Fund expenditures required by the State Constitution. If capital expenditures and Old Age Pension expenditures are excluded, the six largest departments would account for 96 percent of the total.

Constitutionally protected programs and other programs deemed necessary for the public health and safety were prioritized. As shown in Figure 1-10, the Departments of Education, Health Care Policy and Financing, and Corrections each experienced an increase in General Fund support, while the Departments of Higher Education and Human Services lost General Fund resources between FY 2000-01 and FY 2003-04. The Judicial Branch's General Fund appropriation in FY 2003-04 was roughly the same as in FY 2000-01. In absolute dollar terms, the Department of Education had the largest increase in General Fund support, at $275 million, followed by the Departments of Health Care Policy and Financing and Corrections at $149 million and $52 million, respectively. Conversely, General Fund support for the Departments of Higher Education and Human Services dropped by $156 million and $30 million, respectively.

Figure 1-10
Change in General Fund Expenditures, FY 2000-2001 to FY 2003-2004
(dollars in millions)

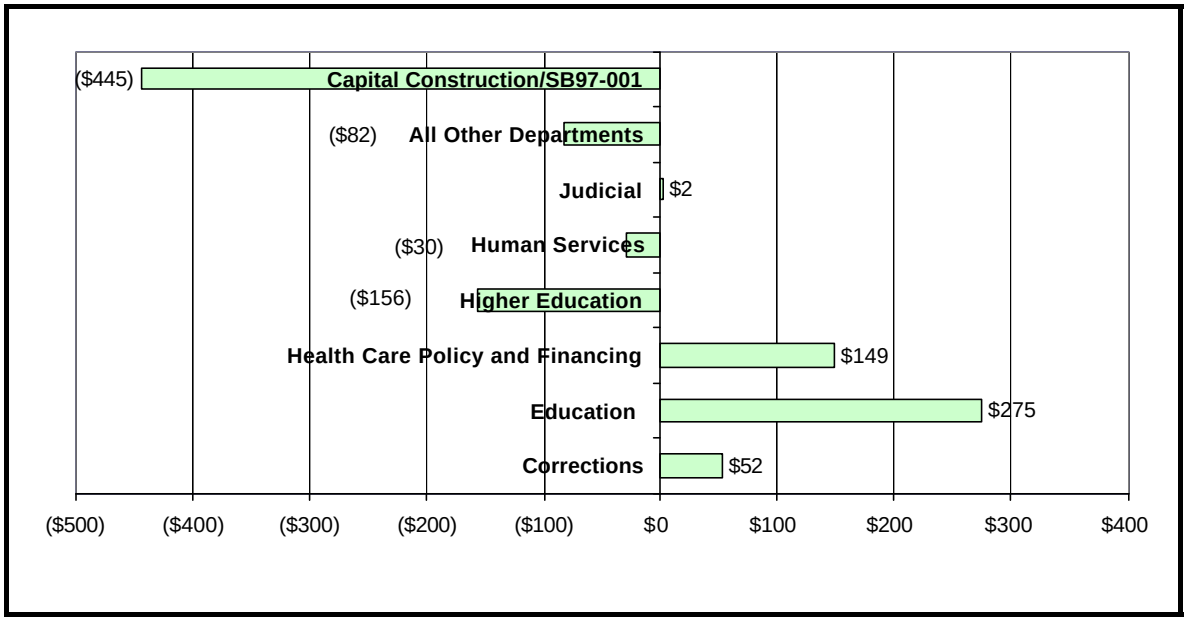
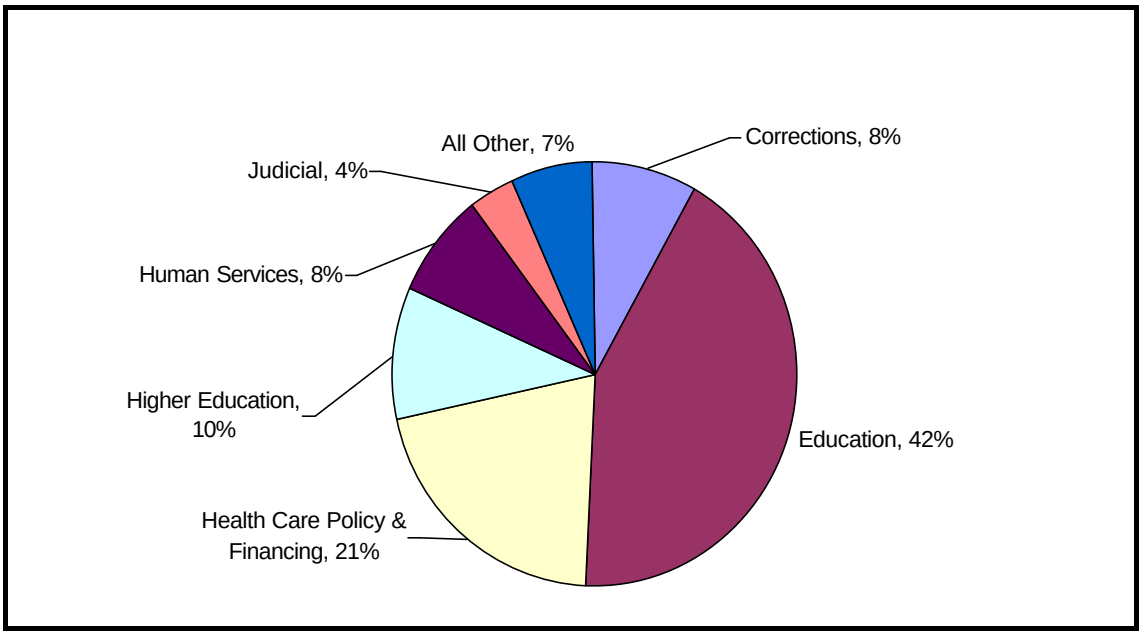


Figure 1-8 shows the components of the $526 million reduction in General Fund spending for all other departments and funds from FY 2000-01 to FY 2003-04. The single largest decrease was in General Fund transfers to the Capital Construction Fund, which amounted to $275.8 million. Senate Bill 97-1 diversions to the Department of Transportation also decreased by $197.2 million. All other departments lost General Fund support, with the largest being the Department of Public Health and Environment ($21.0 million), the Department of Revenue ($19.3 million), Department of Natural Resources ($9.3 million), and the Department of Personnel and Administration ($6.9 million).

Figure 1-11 shows the distribution of General Fund expenditures for FY 2003-04. Education is receiving the highest share at 42 percent, Health Care Policy and Financing the second highest share at 21 percent, followed by Higher Education at 10 percent, Corrections and Human Services both at 8 percent, and Judicial at 4 percent.

Figure 1-11
Share of General Fund Appropriations, FY 2003-2004 ($5.7 billion)



The funding mechanisms for many programs changed. Figure 1-8 also shows that many programs whose General Fund appropriation was reduced actually experienced gains in total funding over the three-year period. The funding shortfall in the General Fund forced the General Assembly to look for programs whose General Fund appropriations could be reduced or replaced with other sources of money. During the 2003 legislative session, many fees and fines were increased and multiple new fees and fines were created. For example, Senate Bill 03-261 enacted new fees and increased others to replace General Fund support to the Division of Property Taxation in the Department of Local Affairs. Fees were also imposed to increase the amount of funds the state can draw from the federal government. For example, Senate Bill 03-266 imposed a new daily fee per patient on certain nursing home facilities. Revenues from this fee will be used to reduce General Fund appropriations to the facilities, serve as a match for federal Medicaid funds, and reimburse for Medicaid services.

General Fund revenue was augmented with cash fund reserves and revenue. Substantial cash fund revenues were either diverted or transferred to the General Fund to increase spending for the Departments of Education, Health Care Policy and Financing, and Corrections. Net transfers from various cash funds totaled $1.0 billion in FY 2001-02 and $206.2 million in FY 2002-03. Net transfers of an estimated $42.0 million *from* cash funds *to* the General Fund

are scheduled for FY 2003-04. Diversions of existing cash fund revenue from two cash funds to the General Fund totaled $16.3 million in FY 02-03, including $14.6 million of unemployment insurance surcharge revenue from the Unemployment Compensation Fund and $1.7 million from the Family Stabilization Services Fund. The amount estimated to be diverted in FY 2003-04 totals $23.0 million, from the Unemployment Insurance Compensation Fund ($19.8 million), the Family Stabilization Services Fund ($2 million), and the Corrections Expansion Reserve Fund ($1.2 million).

Conclusion. During the robust economic expansion of the 1990s, General Fund spending was constrained by the state's constitutional and statutory limits. The previous year's TABOR surplus had to be refunded and, with some exceptions, General Fund appropriations could not increase by more than six percent each year. With revenues expanding steadily, the General Assembly was able to afford relatively high levels of highway and capital construction.

As the recession hit over the last three budget years, General Fund spending was no longer constrained by TABOR or the six percent limit, but by declining revenue. Amendment 23 added an additional constraint on the distribution of available revenue. In addition to the Department of Education, the Departments of Corrections (prisons) and Health Care Policy and Financing (Medicaid) were protected relative to other programs in state government. Cash fund revenue and reserves were drawn upon to maintain General Fund appropriations for those departments. The funding mechanisms for many programs statewide changed, as the General Assembly searched for programs with other sources of revenue that could supplant General Fund appropriations. Lower priority programs without other sources of revenue were reduced or eliminated. Very little General Fund was available for capital construction, and no General Fund revenue was spent on highway construction during FY 2002-03 and FY 2003-04. Finally, there was no longer any TABOR surplus to pay for the homestead exemption on property taxes for seniors. With the General Fund now permanently responsible for it, the exemption was eliminated during FY 2003-04 through FY 2005-06. During the next five years, General Fund spending will again be constrained by the state's spending and revenue limits as revenues recover with the economy.

CHAPTER 2

CHAPTER 2
REVENUE AND SPENDING LIMITS

Colorado is in its worst fiscal crisis since the Great Depression. State revenue plummeted in FY 2001-02 and declined again in FY 2002-03. Since the early 1940s, the state had only three previous year-over-year revenue declines. The revenue declines of FY 1962-63 and FY 1980-81 were at least partly attributable to tax cuts enacted by the General Assembly. The decline in FY 1944-45 was concurrent with a 5.3 percent drop in jobs in 1944 as more of Colorado's citizens went to fight in World War II.

To cope with the recent revenue declines, the state legislature reduced General Fund appropriations, stopped many capital and highway construction projects, and transferred more than $1 billion from other funds to keep the General Fund solvent. Other steps included an increase in fees for many services and the temporary suspension of the homestead exemption for senior citizens. Meanwhile, General Fund spending needs will continue to increase while revenue growth will not match the needs. Thus, the General Assembly is faced with potentially having to fund General Fund appropriations at less than the 6 percent maximum for the next two years, despite the need to increase cost- and caseload-driven parts of the budget by more than the projected total increase for appropriations.

In addition to the revenue decline, several fiscal issues complicate the General Assembly's ability to deal with the state budget in the short term, as well as the long term. This chapter examines the state's revenue and spending limits. These limits are the Taxpayer's Bill of Rights, commonly known as TABOR, and the state restriction on General Fund appropriations.

There are many issues regarding the state's revenue and spending limits. To address these issues, this chapter is divided into three sections:

Background on Tax and Expenditure Limits in Colorado. This section describes the genesis of Colorado's revenue and spending limits.

Other State Tax and Expenditure Limitations. How do Colorado's limits compare with other states' limits? What have other states chosen to do to limit government and how effective are their limits?

TABOR, the Six Percent Limit on Appropriations, and the State Budget. This section describes how each limit impacts Colorado's government and how each, individually and together, affect Colorado's budget. This section presents several options that the General Assembly may consider with respect to TABOR and the limit on General Fund appropriations. Brief arguments for and against each option are presented.

Background on Tax and Expenditure Limits in Colorado

Colorado has a long history of creating limitations on government growth and spending. The Colorado Constitution requires a balanced budget and limits the state's ability to incur debt. Further, Colorado was one of the first states to enact a statutory cap on the growth of state spending and Colorado voters have enacted what is generally considered to be the most restrictive law in the country limiting the growth of government. This section provides some background on Colorado's efforts to impose both statutory and constitutional limits on the fiscal powers of the state.

Initiative attempts to enact tax and expenditure limits. During the latter part of the 1970s, numerous tax and expenditure limits (TELs) were proposed in several states. New Jersey was the first state to pass a TEL in 1976. California's voters passed Proposition 13 in 1978. This measure limits property tax increases and is regarded as the measure that spurred numerous other states to enact TELs. By 1982, TELs had been enacted in 17 states. Much of the impetus for TELs was a belief that states needed to end the "boom and bust" budgeting syndrome, the pattern whereby government tended to increase spending in good times and raise taxes in bad times. Colorado's first attempt at a TEL occurred in 1966 through a citizen initiative which attempted to limit property taxes and gradually exempt certain personal property from taxation. Colorado voters also failed to pass other TEL proposals in 1972, 1976, and 1978.

In the middle and late 1980s, Colorado experienced an economic downturn, mostly due to the collapse of its energy and construction industries. At this time, a group of citizens started a grassroots tax reform effort for state and local governments. This new surge of citizen-initiated TELs began in November 1986 with Amendment 4, which would have required voter approval on all tax increases and required the state to backfill local governments for any state mandated spending increases. The latter initiative was not approved and other comprehensive proposals failed to pass in 1988 and 1990. After some modifications to these proposals, voters approved the TABOR Amendment in 1992.

Climate in which TABOR was approved. During the early 1990s, as the state was emerging from its own economic downturn, a national recession caused the state to once again face budgetary problems. Due to the budget shortfall, some legislators were advocating tax increases and a proposal was on the 1992 ballot to increase the state sales tax rate from 3 percent to 4 percent. The additional revenue would have provided funding for K - 12 education. Voters rejected this sales tax increase, while voters in several local elections approved just 10 of about 30 proposals to increase taxes or float bond issues. At the time of TABOR's passage, Colorado's per capita state and local taxes ranked in the middle of all states. Meanwhile, state and local taxes as a percentage of personal income were the 16th lowest in the country.

Legislative attempts to create TELs. The first statutory limit on growth in taxes came in 1913. The General Assembly limited increases in property taxes to 15 percent in 1913. (The state had its own property tax levy until 1964.) Subsequent limits were 5 percent until 1976, when the limit was changed to 7 percent. The current statutory limit of 5.5 percent was adopted for property tax years 1988 and later.

The first statutory limit on the growth of state General Fund appropriations, named the "Kadlecek amendment" after Senator Jim Kadlecek, was enacted in 1977. As first enacted, the Kadlecek amendment limited General Fund appropriations growth to 7 percent over the previous year. The amendment also required a 4 percent reserve, and provided that the excess revenues were to be used for property tax relief. The limit was due to expire in FY 1982-83 and in 1979 the limit was made permanent. An amendment to the limit in 1984 changed the limit to 7 percent over the previous year plus costs of property tax reappraisals. A portion of the state appropriation for school finance was exempted from the 7 percent limit up until FY 1985-86.

During the early 1990s, sensing growing public support to enact a state TEL, some legislators attempted to propose various comprehensive TELs for the state. However, none of these constitutional proposals won the necessary 2/3 majority of both houses to be placed on the ballot for voter consideration. One proposal would have required a 2/3 majority of both houses of the general assembly to approve any tax increase, while another would have limited state spending to 5 percent of the state's personal income. Other proposals would have created a constitutional spending limit based on population growth and inflation or growth in personal income. Under one proposal, taxes could have been raised without voter approval as long as spending did not exceed a certain limit.

The current statutory General Fund appropriations limit, sometimes called the Arveschoug-Bird limit after its sponsors, was enacted in 1991. A similar proposal failed to pass in 1990. This limit is expressed as the lesser of 5 percent of Colorado personal income or a 6 percent increase over the total state general fund appropriations from the previous fiscal year. The personal income part of the formula has not operated to limit appropriations, thus the limit is alternatively known as the 6 percent limit. The new limit was instituted during a time when revenue growth was weak and the state had budget problems. During the mid to late 1980s, when Colorado's economy experienced a downturn, revenue growth was consistently less than the 7 percent limit. It was also below the 6 percent limit in all but one year. There have been no significant changes to the Arveschoug-Bird limit since its enactment. However, a 5 percent limit was proposed, but defeated, in the 1999, 2000, and 2001 legislative sessions.

Other State Tax and Expenditure Limitations

Colorado is generally considered to have the most restrictive tax and expenditure limits (TEL) in the country. In this section, we analyze the characteristics of TELs across the states in order to provide a comparison with Colorado's TELs.

Twenty-eight states currently have TELs that statutorily or constitutionally restrict government revenue or spending. Some states, including Colorado, have more than one TEL. TELs vary significantly, and depending on their design and characteristics, certain TELs are considered to be more restrictive than others. Some state TELs have little or no impact on state budgeting.

TELs differ in how they were enacted, whether they are statutory or constitutional, their flexibility, how they handle the transfer of governmental programs, and whether the limit is imposed on spending or revenue. Perhaps most importantly, they also differ in how the limit on spending or revenue is calculated and the treatment of surplus money that is over the limit. In addition, some states base their limit solely on the prior year's limit, while others may base their limit on the actual revenue or spending of the prior year. Finally, states may have voter approval or supermajority requirements as other limitations on government revenue or spending.

TELs across the states generally fall into the following categories:

- ✓ *revenue limits* — tie yearly revenue increases to measures such as personal income, population, or inflation;
- ✓ *expenditure limits* — tie annual spending levels to growth indexes or other authorized levels (most common limitation); and
- ✓ *hybrids* — have combined limit features. For example, some states may impose limits tied to a measurable index and also have provisions to refund revenues that exceed the limit or have supermajority requirements for tax increases.

Appendix C provides an overview of the TELs in the 28 states. Specific information such as the year of adoption, type of limit, method of approval, how the limit is applied, the treatment of surpluses, and other provisions that may trigger or impact the implementation of the limitation, is provided.

Studies on the impacts of TELs. Academic studies that have investigated TELs have shown mixed results regarding whether they have a significant impact on limiting state spending. This could be due to the differences in the way TELs have been designed and whether or not state governments have been able to circumvent the limits. Further, state TELs have been found to

have more of an impact on the growth of government when combined with local government TELs.[5,6] The impact of TELs may also depend on differing state economies and tax systems.

Some studies have concluded that TELs have little or no impact on the growth of government. However, most of these studies did not analyze some of the most binding limitations that have passed since 1990. Other studies indicate that the characteristics of the TEL are a primary factor in determining how much a limitation impacts government spending and legislative fiscal discretion.

Characteristics of TELs

The following paragraphs analyze the characteristics of TELs. Colorado's tax and expenditure limits are generally classified as restrictive using the criteria established in the following paragraphs.

Origination of limit. TELs initiated by citizens are generally more restrictive than limitations enacted by legislatures. Citizen-initiated TELs are more likely drafted by citizens with an interest in enacting characteristics that place greater constraints on state spending. Seven TELs have been enacted through the citizen-initiative process and twelve have been enacted through the legislative process; the rest have been enacted through referenda or constitutional convention. *Colorado's TELs have been enacted by both the legislature and through citizen initiative.*

Revenue versus spending limit. Revenue limits are considered to be more restrictive than spending limits because states have more control over spending levels than revenue; it is difficult for states to anticipate incoming revenues accurately which makes it more difficult for states to formulate their budgets. Twenty-three TELs impose limits on spending, while eight are revenue limits. *Colorado has a revenue limit and an appropriations limit.*

Flexibility of limit. Certain TELs allow for more flexibility than others. For example, some TELs may exempt certain categories of spending or revenue from their limits. The most common exemptions are for debt service, federal mandates and court orders, Medicaid, capital outlays, and federal funds. In addition, some TELs have built-in flexibility by including provisions for emergencies or changes in their economy, such as a recession. For example, North Carolina's statutory TEL allows the appropriations limit to be exceeded if Medicaid, prison operations, or state health insurance increases exceed the percentage increase in state personal income growth. If this were to occur, the limit would be increased to reflect the adjustment for all

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5. Rafool, Mandy. 1996. "State Tax and Expenditure Limits", *National Conference of State Legislatures*. Legislative Finance Paper No. 104; Mullins, Daniel R. and Phillip G. Joyce. "Tax and Expenditure Limitations and State and Local Fiscal Structure: An Empirical Assessment." *Public Budgeting and Finance* Spring (1996): 75-101.

6. According to a 1995 study by the U.S. Advisory Commission on Intergovernmental Relations, 46 states have TELs that apply either to counties, municipalities, or school districts. These TELs include property tax rate limits, limits on revenue or expenditure increases, limits on assessment increases, or full disclosure to taxpayers of levy increase requirements. Only 10 states have TELs for local governments that are applied to annual increases in revenue or expenditures, which are considered to be more restrictive than other TELs.

subsequent fiscal years. According to the North Carolina Fiscal Research Division, the limit is significantly higher than the actual revenue used in state budgeting and the limit has not been a factor in state budgeting.

In Massachusetts, the revenue limit cannot be lowered if allowable revenue is calculated to be lower than the preceding fiscal year due to changes in the economy. In this case, the limit would equal the preceding year's limit. Connecticut excludes budget reserve fund expenditures from its limit, including expenditures to fund shortfalls. *Colorado's appropriations limit is more flexible than its revenue limit.* The flexibility stems from the many allowable exceptions to the appropriations limit.

Constitutional versus statutory. Constitutional limitations are more difficult to amend or circumvent than statutory limits. For example, a statutory limit may be amended by a legislature to exclude certain spending or a legislature may vote to raise the limit. Washington's legislature voted to suspend its statutory limit in 2001 until July 1, 2003, in order to pass a budget that exceeded its limit. Fifteen TELs are statutory and eighteen are constitutional. *Colorado's revenue limit is constitutional, while its statutory appropriations limit now requires voter approval to weaken its provisions.*

Transfer of responsibility of government programs. Some states allow for their limit to be changed if governmental programs are transferred between federal, state, or local governments. One way states may get around a limit is to shift programs and services (and thus expenditures) to local governments. Several of the states with TELs have provisions regarding the transfer of responsibility for government programs. For example, Missouri's limit may be adjusted if program responsibility is transferred from one level of government to another. In addition, the state is prohibited from reducing its current proportion of local services financed through state aid, and no new program can be required of local governments unless it is funded by the state.

In Arizona, the legislature is required to modify the limit if a court order or legislative act transfers program responsibility between federal, state, and local governments. Eighteen TELs do not have provisions relating to the transfer of responsibility for government programs. *In Colorado, TABOR provides that, except for K-12 education, a local government can reduce or end its subsidy for any state-mandated program.*

Limits used by the states. One important measure of the impact of TELs on government spending or revenue is the frequency that a limit is triggered. This is primarily determined by the index used to calculate the limit. For example, because an inflation plus population growth limit is generally less than a personal income growth limit, the use of the former limit would keep spending or revenue at a lower level.

Fourteen state TELs are designed to hold government spending increases to the growth rate of state personal income. Limits based on personal income are generally less restrictive than limits based on population growth and inflation because personal income tends to grow faster over time than population growth and inflation. Further, studies indicate that TELs based on

population growth and inflation may be the most restrictive type of limit.[7] Limits based on a fixed percentage increase over the prior year's appropriations are also considered to be more restrictive, depending on the amount of the percentage increase.

Figure 2-1 shows which states' limits are based on population growth and inflation, state personal income, a percentage of state revenue received, a percentage over prior year's expenditures, or a rate of growth based on some other economic indicator, such as a combination or average of indicators. *Colorado's revenue limit is based on inflation and population growth, thus is considered to be more restrictive. Its appropriation limit is based on a fixed percentage increase annually.*

Figure 2-1
Indicators Used to Calculate Tax and Expenditure Limits[8]

Population Growth and Inflation	Personal Income	Percentage of Revenue Received	Percentage Increase Over Prior Year's Appropriations	Other[9]
Alaska **Colorado** Nevada Washington	Arizona Florida Hawaii Idaho Louisiana Michigan Missouri Montana New Jersey North Carolina Oregon South Carolina Tennessee Texas	Delaware Iowa Mississippi Oregon Rhode Island	**Colorado**	California Connecticut Massachusetts Ohio Oklahoma Utah

7. New, Michael J. 2003. "Tax and Expenditure Limitations: A Comparative Political Analysis", Harvard University; Stansel, Dean. 1994. "Taming Leviathan: Are Tax and Spending Limits the Answer?" Washington, D.C. Cato Institute, (Policy Analysis No. 213).

8. [4]States that are listed more than once have more than one TEL.

9. Yearly appropriations growth in California is limited to the percentage increase in population and per capital personal income. Appropriations in Connecticut are limited to the average percentage change in state personal income over the preceding five years or the increase in inflation for the preceding 12 month period, which is greater. Massachusetts' growth in revenue cannot exceed the three-year average growth rate of wages and salaries. Ohio's limit is applied to the excess revenue above a statutorily set minimum year-end balance in the General Revenue and Budget Stabilization Fund. Oklahoma's appropriation of revenues is limited to a 12 percent yearly increase (adjusted for inflation) and 95 percent of certified revenue. In Utah, the yearly appropriations are tied to formulas that utilize population growth, inflation, and the percentage change in personal income.

Treatment of surpluses. States that require taxpayer refunds of surplus revenue exceeding their revenue or spending limits may have more restrictive limitations than those states that retain or divert moneys to a rainy day or other special fund.[10] Some of these states require the return of all the excess revenues over their limit, while other states require that some of the excess be placed into a reserve or other fund, while the remainder may be returned to taxpayers. Some states' limits may be set high enough so that refunds never occur. The laws that require the immediate refund of all surplus revenue are considered more restrictive in that they make it difficult for states to retain any excess revenue. Three states that mandate immediate refunds, Michigan, Missouri, and Colorado, enacted tax cuts during their recent surplus years to lower their revenue base. *Colorado is among ten states that require a taxpayer refund of surplus revenues.*

Enforcement provisions. Some state TELs give taxpayers the ability to sue to enforce the limit's provisions. TELs may also mandate that any revenue illegally collected over the limit must be refunded or require injunctive relief to prohibit any illegal taxes or spending while enforcement suits are pending. TELs with enforcement provisions can be considered more restrictive because they mandate what can happen when a government violates its TEL. Without enforcement provisions, a TEL may not be adhered to. Missouri's TEL gives taxpayers standing to sue to enforce its revenue limit provisions. Further, the courts must invalidate any taxes and fees that were enacted in violation of Missouri law and require a refund of money or a reduction in taxes to offset the excess revenue collected.

Colorado's TABOR amendment explicitly allows for the filing of individual or class action enforcement suits. Successful plaintiffs are allowed costs and reasonable attorney fees. The amendment states that any revenue collected, kept, or spent illegally for four fiscal years before a suit is filed must be refunded with 10 percent annual simple interest. There is no enforcement provision explicitly written into the 6 percent limit.

Ratchet-down effect. A ratchet-down effect occurs when a state's revenue is less than its allowable limit and reduces the limit for subsequent years. States that base their limit on the lesser of the prior year's limit or *actual* spending or revenue experience a ratchet-down effect when spending or revenue falls below the *maximum* allowable limit. States whose limits are based solely on the prior year's *maximum* allowable limit, and not on *actual* spending or revenue, would not experience a ratchet-down effect when spending or revenues decline.

Florida's revenue limit is determined by multiplying the average annual growth rate in state personal income over the previous five years by the maximum amount of revenue permitted under the limitation in the previous year, not the actual revenue the state receives. Therefore, a revenue decline will not ratchet down the base for which the next year's limit is calculated; the limit can continue to grow depending on state personal income growth.

Massachusetts' revenue growth limit is determined by the maximum amount of allowable state tax revenue based on a formula, not the actual revenue received. Utah's appropriations limit is based on formulas that involve either inflation and population growth or personal income growth. The limit is based on the maximum allowable growth and not on the previous year's

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10. New, Michael J. 2003.

actual spending. *Both of Colorado's limits contain the ratchet-down effect; they are based on the lower of the previous year's limit or on actual spending or revenue.*

Voter approval and supermajority requirements: other limitations on tax and spending increases. Voter approval and supermajority requirements also restrict state tax and expenditure options. *Colorado is one of four states with a voter approval requirement for tax increases or for spending increases over the limit.*

Supermajority requirements mandate either a 3/5, 2/3, or 3/4 majority vote in both chambers to pass tax increases or new taxes. Proponents of supermajority laws believe that such requirements place a limit on the ability to raise taxes and can effectively limit the growth of government. Opponents believe that supermajority requirements give too much power to a legislative minority that can block any tax increases. In states with one predominant party, the majority party may have enough votes to approve tax increases. In other states, the requirement can be very restrictive. *Colorado, with its emergency provisions for increasing taxes, is among 13 states that have a legislative supermajority requirement for increasing taxes.* Colorado's TABOR law does not define an emergency, rather it defines what an emergency is not. An emergency excludes economic conditions, revenue shortfalls, and governmental salary or benefit increases. An emergency may include natural disasters, such as tornados, earthquakes, forest fires, and blizzards. Colorado has not used the emergency tax provision of TABOR.

TABOR, the Six Percent Limit on Appropriations, and the State Budget

This section focuses specifically on TABOR and the 6 percent limit on General Fund appropriations. TABOR, a constitutional amendment enacted via initiative, limits most state government spending. It is a limit on General Fund and most cash fund revenue. The 6 percent limit is a statutory cap on increases in General Fund appropriations with some exceptions. TABOR provided that the appropriations limit could only be weakened by future voter approval and not by legislative action only.

The section describes how each limit was designed to limit Colorado's government and how each, individually and together, affect the state budget. Several options addressing issues raised in the discussion are presented. In particular, the discussion will examine:

- ✓ the major provisions of TABOR;
- ✓ the composition of the TABOR base;
- ✓ the history and projections of the TABOR surplus;
- ✓ how the state refunds the TABOR surplus;
- ✓ the relationship between TABOR and the economy;
- ✓ the ratchet-down effect;
- ✓ an alternative formula for TABOR's growth limit;
- ✓ tax increases under TABOR;
- ✓ the enterprise provision of TABOR;
- ✓ the relationship of cash fund revenue to TABOR; and
- ✓ the state's statutory limit on General Fund appropriations.

The Major Provisions of TABOR

TABOR has three major provisions: a requirement of voter approval for tax increases; a revenue growth limit; and a freeze on existing spending limits. The following sections examine these provisions.

Voter approval for tax increases. TABOR states that any tax district must ask voters to approve tax increases. These include: a new tax; a tax rate increase; a local mill levy increase; an increase in a property assessment valuation ratio; an extension of an expiring tax; or a tax policy change causing a net tax revenue gain. No approval is needed for a tax decrease. Any income tax rate increase or base change must occur the year after it is approved. TABOR also prohibits certain types of taxes, such as new or increased real estate transfer taxes, local income taxes, and state property taxes, as well as surcharges on state income taxes.

Revenue growth limit. TABOR limits the amount of revenue that a tax district may collect each year. The formula for determining the revenue limit varies by tax authority. For the state, TABOR limits annual growth in most state revenue to the Denver-Boulder-Greeley inflation rate plus the annual percentage change in state population. For local governments, including school districts, the inflation rate is included in the formula, but different criteria are used for the growth factor. Revenue collected above these limits, commonly referred to as the TABOR

surplus, must be returned to taxpayers in the form of refunds or credits, unless voters approve a plan for spending the TABOR surplus.

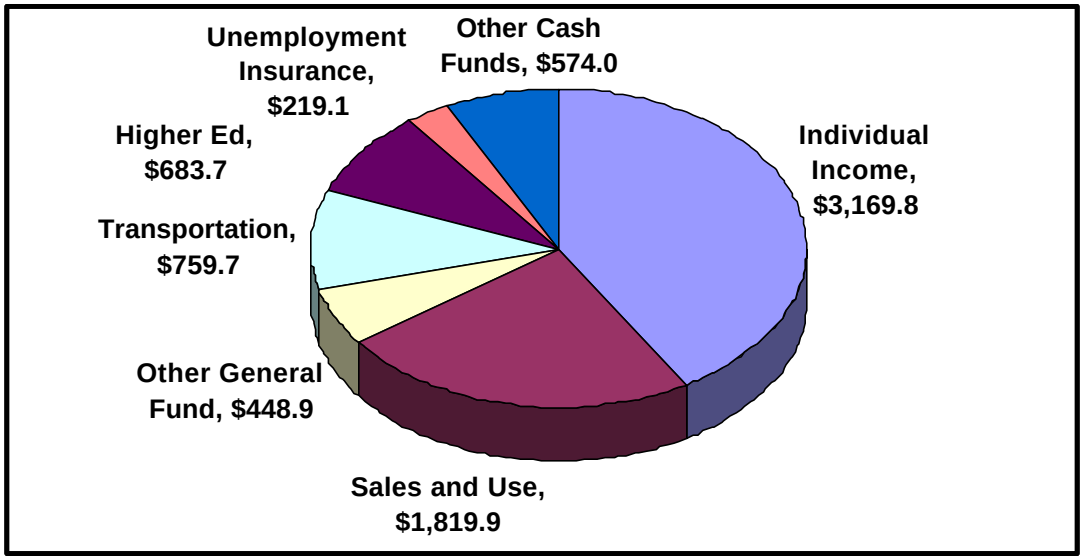
Existing spending limits cannot be weakened without voter approval. TABOR stipulated that existing limits on revenue, spending, and debt can be "weakened only by future voter approval." In the context of the state budget, the General Assembly has interpreted this phrase to refer to the 6 percent limit on General Fund appropriations. Prior to TABOR, this limit could be changed by the General Assembly.

What is the TABOR Base?

The TABOR revenue base does not include all revenue that the state receives. TABOR specifically excludes revenue from enterprises, federal funds, gifts, collections for another government, employee pension contributions, pension fund earnings, damage awards, and property sales. Thus, in FY 2002-03, the TABOR revenue base was an estimated 58.5 percent of the total state budget.

For FY 2002-03, TABOR revenue was nearly $7.7 billion. General Fund revenue made up 70.9 percent of the TABOR base. Individual income taxes are the largest component of the General Fund and were 38.4 percent of TABOR revenue. Sales and use taxes were 24.0 percent. There are over 200 cash funds that constitute nearly 30 percent of the TABOR revenue base. However, only three subject-related cash funds comprise about 73 percent of all cash fund revenue. Figure 2-2 shows the composition of all TABOR revenue.

Figure 2-2
Major Sources of TABOR Revenue, FY 2002-03
(millions of dollars)



History and Projections of TABOR Surpluses

The state did not incur a TABOR surplus until FY 1996-97, the fourth year that TABOR was in effect. Starting in FY 1996-97, the state exceeded the limit for five consecutive years, resulting in approximately $3.25 billion in surplus revenue during that time. We expect that the state will be at or below the revenue limit for FY 2001-02 through FY 2003-04. The state will again experience surpluses beginning in FY 2004-05 through FY 2007-08. The state will refund an estimated $1.3 billion to taxpayers over that time period. Figure 2-3 shows the history and projections of TABOR surpluses. A surplus will not occur in FY 2003-04 because of the population adjustment (see page 34 for an explanation of the population adjustment).

Figure 2-3
TABOR Surpluses
(dollars in millions)

Fiscal Year	Surplus	Fiscal Year	Surplus
96-97	$139.0	02-03	$0.0
97-98	$563.2	03-04 est.	$0.0
98-99	$679.6	04-05 est.	$113.6
99-00	$941.1	05-06 est.	$341.5
00-01	$927.2	06-07 est.	$477.4
01-02	$0.0	07-08 est.	$394.7

How is the TABOR Surplus Refunded to Taxpayers?

When the state incurs a TABOR surplus, it must be refunded within one year unless taxpayers allow the state to keep a part of the surplus. For the first two years that the state had a surplus, it was returned to taxpayers as a sales tax refund based on the amount of federal adjusted gross income on the income tax return. Additional methods of refunding the surplus have been added and the number of refund methods now totals 19. With the exception of the sales tax refund, each particular refund method is triggered only when the TABOR surplus reaches a certain threshold. Each method's threshold is increased annually by the percentage growth in personal income. Appendix D provides a brief description of each refund method.

Several attempts have been made to allow the state to either modify the TABOR base or keep a portion of the TABOR surplus. For example, in 1996, the General Assembly passed House Concurrent Resolution 96-1006, which referred a measure to the voters to amend the state constitution concerning unemployment compensation insurance taxes. The measure would have allowed unemployment insurance taxes to be increased without voter approval. Further, the measure would have excluded unemployment compensation revenues from the calculation of the TABOR revenue limit and the TABOR base. The measure was defeated at the general election in November 1996.

In 1998, the General Assembly passed House Bill 98-1256, which referred a measure to the voters of Colorado seeking to retain a portion of revenue in excess of the limitation on state fiscal year spending. The measure requested that the voters allow the state to retain and use the first $200 million of revenue in excess of the state constitution's revenue limit per year for five years, up to $1 billion in total. The money was to have been used for capital construction projects as follows: 50 percent for transportation, 30 percent for K-12 schools, and 20 percent for higher education. The transportation money would have been shared by the state, counties, and municipalities. The measure was defeated at the general election in November 1998.

Amendment 23 was a citizen initiative that passed in November 2000. The amendment provided for the diversion of one-third of one percent of Colorado taxable income on income tax returns to the State Education Fund. The diversion is exempt from TABOR's revenue limit, thus it reduced the amount of the TABOR surplus by $164.3 million in FY 2000-01. However, because of the lack of a TABOR surplus in the following two fiscal years, the state retained the same amount of revenue it would have without Amendment 23. In fact, the state's TABOR revenue limit fell to a lower level as a result of the ratchet down than would have been the case without Amendment 23. Therefore, the state will refund more revenue in the future and retain less revenue than would have been the case if Amendment 23 had not passed. The interaction between Amendment 23 and TABOR will result in more required spending on education and less state revenue to spend on other programs than would have been the case without the passage of Amendment 23.

Referendum A was a legislative proposal that was also approved by the state's voters in November 2000. Referendum A provided a property tax homestead exemption to qualifying senior citizens. The state's TABOR revenue limit was increased by the estimated amount of the property tax reduction, thus would have reduced the amount of taxpayers' refunds of the TABOR surplus. However, the lack of a TABOR surplus meant that the General Fund paid for the homestead exemption. Meanwhile, the eventual cost of $61.5 million for the homestead exemption was higher than the estimated cost of $44.1 million, and the General Fund was also responsible for the additional cost.

The Issue: *Referendum A of 2000 provided for the cost of the senior citizen homestead exemption by allowing for an offsetting increase in the TABOR limit during the first year of the exemption. However, because the TABOR limit ratcheted down in the same year, any funding of the homestead exemption must now be made from the General Fund.*

Option: *The General Assembly could ask voters to permanently exempt from TABOR any spending for reimbursement of the homestead exemption.*

Issues for consideration. The original intent of the provision was to pay for the senior homestead exemption by increasing the TABOR limit, thus using money from the TABOR surplus. However, due to the ratchet-down effect of TABOR, it is impossible for the tax cut to ever be funded from the TABOR surplus without further approval. This is an example of how different voter-approved measures did not work together as intended.

On the other hand, voters already approved the homestead exemption and raised the TABOR limit. The state should be responsible for funding the tax cut by whatever means is necessary without asking voters to fund the proposal a second time.

Accounting for the TABOR Surplus

Under TABOR, the state is required to refund any revenue collected over the limit to taxpayers in the next fiscal year after the surplus revenue is collected. House Bill 98-1414 allowed the state to use the cash basis of accounting for recognition of the state's TABOR liability. In other words, the liability was recognized in the year after the surplus was incurred. The state was not required to set aside or reserve the money for the refund in the year that the surplus revenue was collected. This worked well in years in which the surplus was larger than the previous year because each year's surplus could cover the prior year's refund and the difference could be (and was) used for other expenditures. The effect was to "pre-spend" the TABOR surplus. It proved difficult for the budget, however, when the state's $927.2 million surplus for FY 2000-01 was followed by a revenue decline of $981 million and no TABOR surplus in FY 2001-02. The state's decision to "pre-spend" the surplus in earlier years contributed to the many budget reductions that were made in FY 2001-02 and FY 2002-03. Because the state had used most of the available revenue for other projects and spending during FY 2000-01, the state was faced not only with the revenue shortfall but also with the need to refund the $927.2 million to the taxpayers.

The General Assembly repealed House Bill 98-1414 during the 2003 legislative session. When surplus revenue is collected in the future, the state will be required to account for the TABOR refund liability in the year that the surplus was collected. The refund will then have no impact on the following year's budget as the funds to make the refund will already be available. However, it will affect the budget in the current year because it no longer allows the pre-spending of the surplus. Other expenditures will potentially have to be reduced.

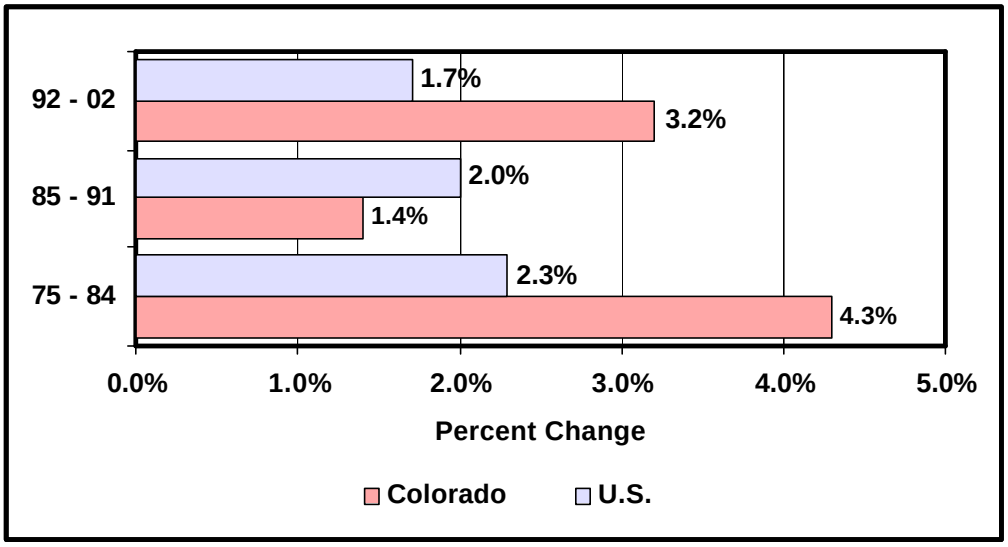
TABOR and the Economy

Colorado's economy began to surge in 1992. From 1992 through 2000, Colorado employment increased at a compound average annual rate of 4.3 percent. From 1984 to 1991, Colorado employment increased at an average pace of 1.4 percent. The relatively slow growth during this period was attributable to excess capacity in the state's office and retail markets and a downturn in the energy industry. High vacancy rates caused employment in the state's construction industry to fall from a cyclical peak of 90,700 in 1984 to 60,000 in 1989.

Construction jobs did not surpass the prior cyclical peak again until 1994. Similarly, a fall in oil prices caused employment in the energy sector to decline by more than one-half between 1983 and 1989. As a result of the weak economy, more people left Colorado than came to it between 1986 and 1990.

TABOR's contribution to the state's economic prosperity, if any, cannot be statistically quantified. When TABOR passed in late 1992, Colorado was well on its way to emerging from the economic doldrums of the 1980s as employment increased by 3.4 percent that year. Further, most of the country, particularly the Western region, did very well during the 1990s. Colorado was well positioned in 1992 to outperform the country as its relative costs for labor, housing, and commercial and industrial buildings were lower than those in competing areas. It is important to note that Colorado underperformed the nation from 1985 to 1991, as indicated in Figure 2-4. Colorado typically outperforms the nation. For example, from 1975 to 2002, Colorado employment increased at a 3.1 percent annual pace, while the nation's employment increased at a 2.0 percent clip. Finally, the state began to incur a TABOR surplus in FY 1996-97 when the stock market boomed. Realized capital gains increased nearly six-fold between 1992 and 2000. They were an important factor in Colorado's fiscal well-being in the late 1990s, contributing significantly to the TABOR surplus. The health of the stock market cannot be linked to the presence of Colorado's TABOR limits on government spending.

Figure 2-4
Employment Growth Comparisons



A national recession started in March 2001 and ended in November 2001. While national output and inflation-adjusted income are generally increasing, employment is still on a downward trend. While the economy is recovering by most measures, it is thus far a jobless recovery. Through August 2003, the nation continued to shed jobs.

Colorado was not immune from the national recession. In fact, Colorado had a greater exposure to some of the factors causing the national recession. Colorado had one of the nation's highest concentrations of high-tech and telecommunications workers. The collapse of these sectors because of excess capacity dominated layoff announcements in 2001 and 2002. Further, Colorado is a significant destination for national and international tourists. The recession, compounded by the impact of the September 2001 terrorist attacks, put a big crimp on tourism in Colorado. Consequently, the decline in the state's economy was more severe than much of the nation. For instance, Colorado's employment declined 1.9 percent in 2002. Only one state had a worse performance. By contrast, Colorado ranked third best in employment growth only two years previously.

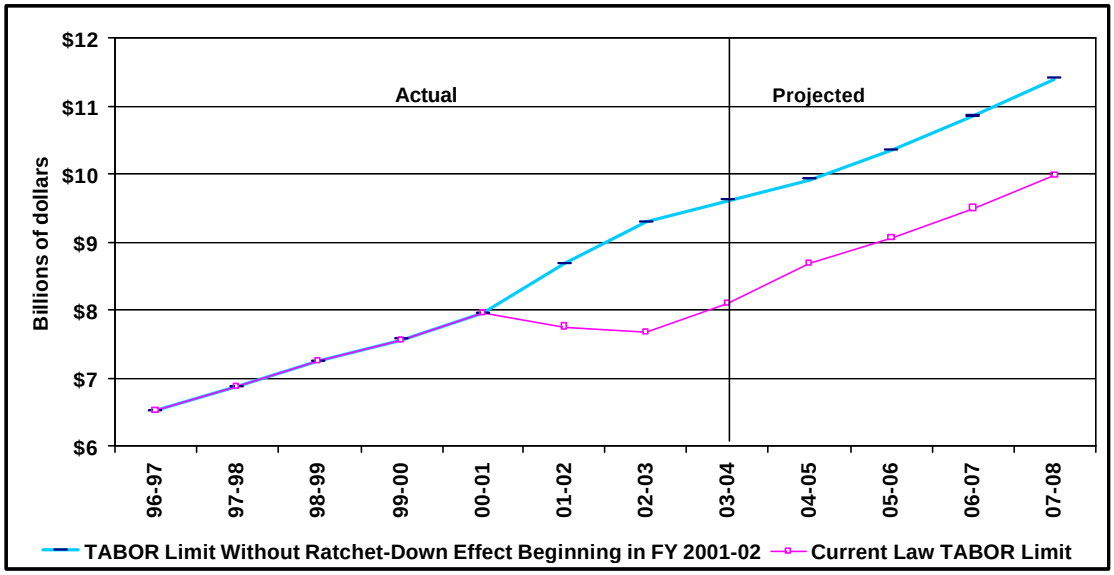
Colorado revenue that is subject to the TABOR limit declined by 12.6 percent in FY 2001-02 and by 1.1 percent in FY 2002-03. TABOR revenue declined by $1.2 billion during this time. Just as there is no evidence that TABOR was responsible for the economic boom of the 1990s,TABOR was also not responsible for the recent economic downturn. With or without TABOR, the state would have been forced into a combination of appropriations and capital construction spending reductions, as well as borrowing from other funds. Additionally, the state would still have to set future budgets based on revenue that is growing from a smaller base. Due to the revenue downturn, the state will not be able to increase General Fund appropriations by the typical 6 percent limit and maintain a balanced budget in FY 2004-05 and FY 2005-06.

At the same time, the state will be faced with TABOR surpluses again in FY 2004-05, compounding the General Fund's problems. TABOR ratcheted the state's revenue limit down to the level of actual revenue in FY 2001-02 and FY 2002-03.

The TABOR Ratchet Down

If revenue is less than the allowable TABOR limit, the base (actual revenue) for determining the following year's limit is reduced. Since the new limit is at a lower level than it otherwise would have been, the limit is said to have ratcheted down. In Figure 2-5, it can be seen that the state's TABOR limit was forced down when revenue declined in the past two fiscal years. The actual revenue in FY 2001-02, which became the new TABOR base to determine the following year's limit, was $365.7 million lower than the TABOR limit in FY 2001-02. In fact revenue fell so far in FY 2001-02 that it was $188.1 million below the previous year's TABOR limit. Additionally, revenue in FY 2002-03 was an estimated $703.6 million lower than the limit for that year. The top line in Figure 2-5 shows the limit without the ratchet-down effect. The bottom line shows where the limit will be under current law. As can be seen, the limit is permanently moved to a lower base due to the ratchet-down effect. Because the state typically experiences population growth and inflation, it will need to provide services to more people, at a higher cost, but with less allowable revenue than in previous years.

Figure 2-5
Ratchet-Down Effect In Colorado



Because of the ratchet-down effect of TABOR, the state will incur TABOR surpluses sooner when revenue growth again exceeds the inflation rate and population growth. Our office predicts that TABOR surpluses will resume in FY 2004-05. After application of the population adjustment (discussed in the next section), we expect that the cumulative surpluses will be over $1.3 billion during the four-year period beginning in FY 2004-05. Annual estimates of the TABOR surpluses can be found on page 28.

Because of the combination of the ratchet-down effect and the repeal of House Bill 98-1414, appropriations in FY 2004-05 and FY 2005-06 can only increase by 1.2 percent and 3.2 percent, respectively. These figures are based on our June 2003 forecast and assume a balanced budget with a 4 percent reserve. These increases are $270.2 million and $156.0 million, respectively, *below* the 6 percent limit.

An economic recovery will not necessarily improve the state's budget picture. Additional revenue resulting from an economic recovery may contribute to a TABOR surplus. When the state incurs a TABOR surplus, the liability is recorded in the same year as the surplus and the surplus will be refunded in the following year.

The Issue: *Because of the ratchet-down effect of TABOR, the state must permanently contend with a lower revenue limit.*

Option: *The General Assembly could submit a proposal for voter approval to eliminate the ratchet-down effect of TABOR. It could consider making FY 2001-02 the base for future spending limits.*

Issues for consideration. The option acknowledges that the costs of government services increase over time and the need for services expands as population grows. The ratchet-down effect makes it difficult to resume government services that are reduced or eliminated when TABOR revenues fall. Although this option would permit the state to keep more revenue than currently allowed, it maintains the requirement for voter approval of tax increases.

On the other hand, the ratchet-down effect forces a permanent reduction in government during economic downturns. Elimination of this provision would allow government to return to previous spending levels.

The TABOR Limit

This section discusses the population adjustment enacted by the General Assembly in 2002 to offset the population underestimates in the 1990s and explores the use of alternative limits on revenue.

The population adjustment. TABOR limits annual growth in most state revenue to inflation plus the percentage change in population. During the 1990s, the Census Bureau underestimated Colorado's population growth. Thus, the census in 2000 caused the "official" estimate of population growth during the previous year to be 6.0 percent. The underestimates during the 1990s caused the state's revenue limit to be lower than it should have been based on the actual population growth that the state experienced. As a result, the state refunded $483 million more than necessary to taxpayers during the 1990s. TABOR allows the state to adjust the limit every decade to account for such discrepancies. Therefore, the General Assembly determined that the state would carry forward all of the unused portion of population growth available under TABOR from the corrected 2000 census count until such time as revenue would allow for the use of the growth. Due to the drop in revenue experienced during FY 2001-02, the state was able to carry forward all six of the available percentage points of TABOR growth attributable to population growth in 2000. This carry-forward is called the population adjustment.

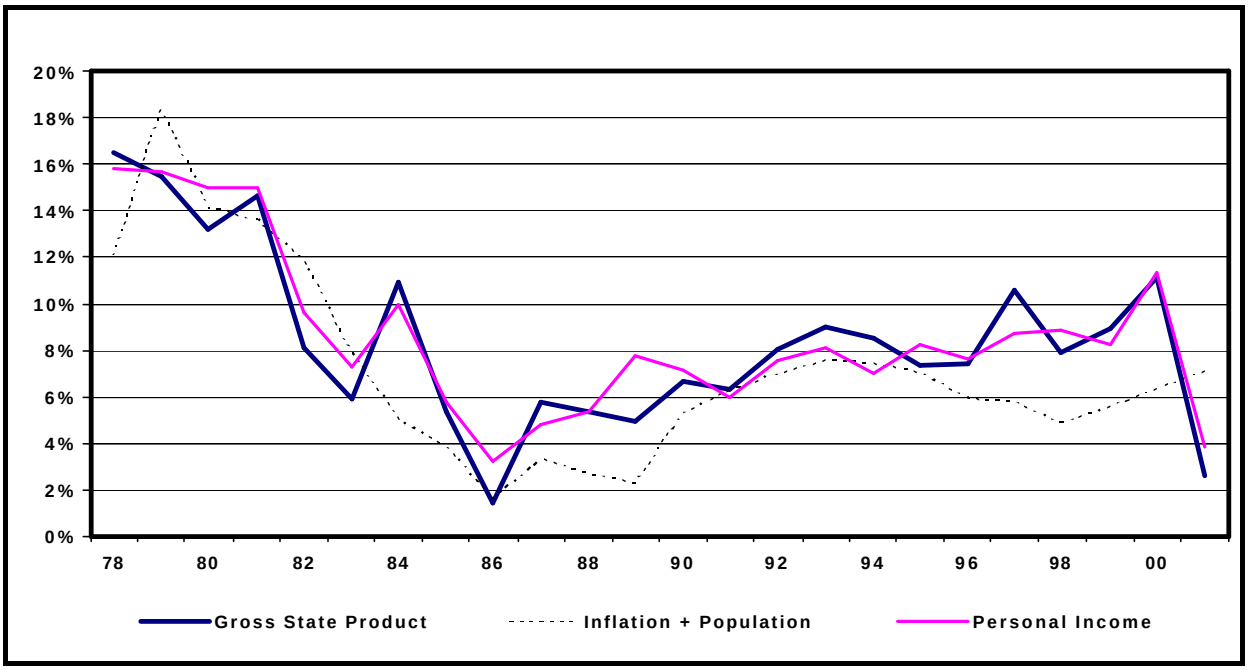
According to our June 2003 forecast, the state will be able to use 3.1 percentage points of its population adjustment in FY 2003-04 and the remaining 2.9 percentage points during FY 2004-05. During FY 2003-04, the state will retain $236.9 million that would have been refunded without the adjustment. During FY 2004-05, an incremental amount of $232.6 million will be retained. The combined impact of both years' adjustments will allow the state to keep an additional $477.2 million in FY 2004-05. Because the population adjustment permanently increases the state's TABOR base, the state will continue to retain this amount on an annual basis into the future as long as the state does not experience another ratchet down.

Use of alternative revenue limits. This section examines using personal income and a moving average of the current limits of inflation and population growth as alternatives to the current formula for the TABOR limit.

Colorado's use of inflation and population growth is generally considered the most restrictive of the revenue or spending limits that states have enacted. Three other states use inflation plus population growth as a limit, while 14 states use personal income.

Critics of TABOR contend that the use of the inflation rate and the percentage change in population does not allow government to at least match the growth rate of the economy as a whole. Gross state product (GSP) is a measure of the state's economic output. Figure 2-6 shows the relationship between GSP and the two separate economic indicators of personal income versus inflation plus population growth. There appears to be a stronger relationship between GSP and personal income. A statistical modeling of the relationships indicated a stronger correlation between GSP and personal income than with the existing TABOR growth factors.

Figure 2-6
Colorado Economic Growth and Economic Indicators



Use of the percentage change in personal income would generally allow a higher revenue limit than the existing TABOR growth factors of inflation and population growth. Since 1976, personal income growth exceeded the inflation rate plus population growth in all but seven years. Most of these occasions were during periods of a national or state recession.

If personal income is used as the revenue limit effective in FY 2004-05, the TABOR surplus would be $315 million less than under current law from FY 2004-05 through FY 2007-08. If the first effective period of the alternative limit is FY 2005-06, the TABOR surplus through FY 2007-08 would be $481 million less. Personal income growth in 2003 is projected to be less than the sum of inflation plus population growth. The 2003 economic indicators are used for determination of the FY 2004-05 limit.

Several states use a moving average of an economic indicator on the premise that wide swings in limits would be eliminated. Thus, a state government would be able to plan more efficiently.

We analyzed what would have happened in Colorado if a three-year moving average of inflation plus population growth had been in effect at the start of TABOR. Figure 2-7 compares the actual limits used and a three-year moving average of the limit factors.

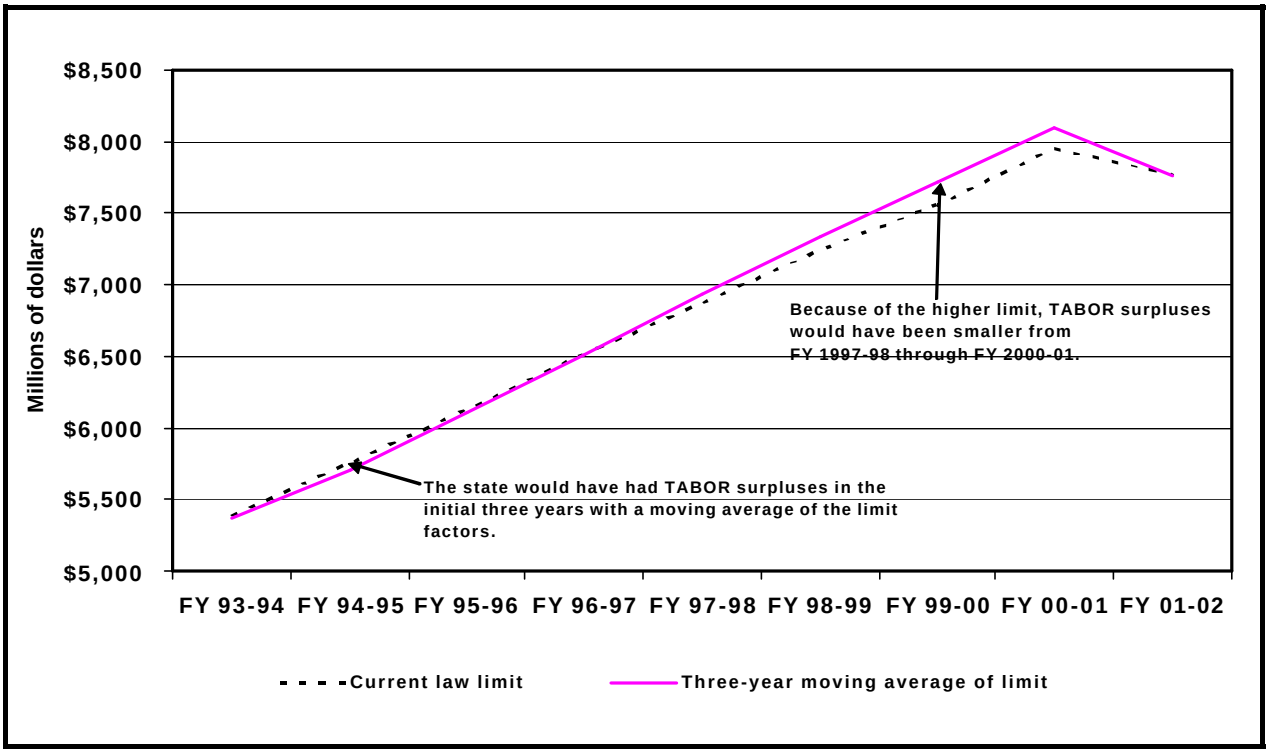
Figure 2-7
Comparison of TABOR Limit Factors and a Three-Year Moving Average of Inflation and Population Growth

Fiscal Year	Actual Limit Used	Three-Year Moving Average
93-94	6.5%	5.8%
94-95	7.1%	6.5%
95-96	7.0%	6.9%
96-97	6.6%	6.9%
97-98	5.5%	6.4%
98-99	5.3%	5.8%
99-00	4.4%	5.1%
00-01	5.1%	4.9%
01-02*	4.0%	4.5%

* Both limits use the inflation factor only for 2000. The General Assembly provided that the population factor would be used as necessary when TABOR surpluses resume.

Figure 2-8 shows what would have happened to the limit if the moving average concept had been used since TABOR's inception. From FY 1993-94 through FY 1995-96, the state would have incurred small surpluses with the use of a moving average for the limit. Colorado did not have TABOR surpluses during this time period. The results for FY 1996-97, the first year of actual TABOR surpluses, would not have been significantly different. However, from FY 1997-98 through FY 2000-01, the surpluses would have been smaller by a combined total of $448 million.

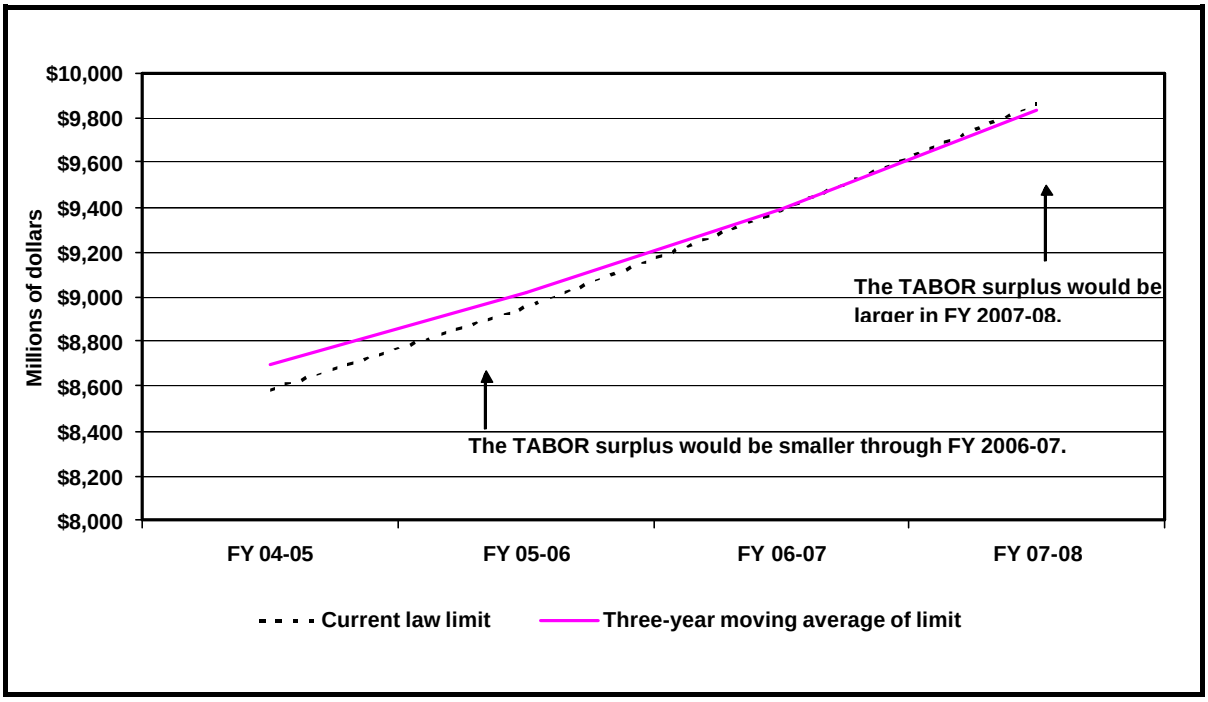
Figure 2-8
Comparison of Current Limit and Three-Year Moving Average of Inflation and Population Growth



The implications of smaller surpluses are mixed. While the TABOR surplus would have been less, the money would have been available as a cushion against the eventual downturn in revenue only if it had not been spent on capital or highway projects. However, when the revenue downturn did occur in FY 2001-02, the amount of money that would have been refunded that year would have been smaller. This would have been a critical issue in the environment of House Bill 98-1414 where the TABOR surplus was booked as a liability in the following year. The state had a surplus liability of $927 million at the same time that available General Fund revenue was declining by $981 million. Thus, with smaller TABOR surpluses, the level of budget cuts in FY 2001-02 and FY 2002-03 would have been lower.

We also applied a three-year moving average of inflation and population growth to our June 2003 revenue forecast. We assumed that the change in the limit would first be effective in FY 2004-05. Figure 2-9 shows these results. The TABOR surplus would be smaller from FY 2004-05 through FY 2006-07 and slightly larger in FY 2007-08. During the four-year period, the TABOR surplus would be $154 million lower. The surpluses are lower because the moving average would incorporate relatively high inflation and population growth rates in 2001. Both inflation and population growth eased after 2001. Thus, if the change in the limit is effective in FY 2005-06, *increased* TABOR surpluses of $327 million over three years would result.

Figure 2-9
Comparison of Current Limit and Three-Year Moving Average of Inflation and Population Growth, FY 2004-05 to FY 2007-08



While it is readily apparent that the additional money could be used to increase General Fund appropriations in FY 2004-05 and later, there are some hidden costs. The increased base in appropriations in FY 2004-05 would lead to higher levels of appropriations in future years. Because the budget is so tight, Senate Bill 97-1 diversions to the HUTF and the transfers of any excess reserve to the HUTF and the Capital Construction Fund would be reduced. Additionally, the partial payback of borrowed cash funds would not occur in FY 2007-08.

The Issue: *Should TABOR's limit of inflation plus population growth for the state be changed?*

Options: *The General Assembly could refer a measure for voter approval that amends TABOR to use the annual percentage change in personal income as the growth limit on state revenue. It could consider using a multi-year moving average of personal income growth to smooth out the economic cycle and the impact on the state budget. As a second alternative, a moving average of the current limit factors of inflation and population growth could be referred for voter approval. The General Assembly could consider specific uses for the additional funds that would become available, including the establishment of a rainy day fund.*

Issues for consideration. Use of the percentage change in personal income as a measure for allowable growth better mirrors changes in the state economy. Personal income implicitly includes a factor for productivity growth. Excluding a productivity factor from allowable growth in government revenue may not permit the state to adapt to technological changes or to reward its workers for their increased productivity.

However, some maintain that allowable growth in government spending should not need to account for increased productivity. The current limit forces government to be more efficient and selective in the services that it offers to its citizens.

Enterprises

This section defines enterprise status under TABOR, lists current state enterprise programs, and describes the impact on the General Fund when a program's enterprise status changes. Enterprise status can create additional budget flexibility for the particular program as well as the General Fund budget.

What is an enterprise? An enterprise is a self-supporting, government-owned business that receives revenue in return for the provision of a good or service and has the authority to issue its own revenue bonds. An enterprise may receive up to ten percent of its annual revenue from government sources. Other than that, an enterprise must be financially independent of any government.[11] It must be able to support itself much like a private business, with units of a good or service produced in exchange for a fee. The General Assembly must designate a particular function as an enterprise.

State enterprises. The state has designated several functions as enterprises. In FY 2002-03, these enterprises generated nearly $1.9 billion of TABOR-exempt revenue. Higher education auxiliary facilities, the state lottery, the higher education student loan program, correctional industries, and the state nursing home system were designated as enterprises at the initiation of TABOR. Following the passage of TABOR, the State Fair Authority, the Student Obligation Bond Authority, and the Division of Wildlife were granted enterprise status as long as they continued to qualify as such. The Colorado Tolling Enterprise was created as an enterprise in 2002.

How a change in enterprise status affects the General Fund. When a program whose revenue source is new to state government becomes an enterprise, there is no impact on the size of the TABOR surplus or the financial condition of the General Fund. Examples include the Student Obligation Bond Authority and the Colorado Tolling Enterprise.

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11. According to a March 11, 1997, opinion from then Attorney General Gale Norton, enterprises may receive a direct appropriation from the General Assembly as long as the appropriated revenues result from the provision of related goods and services on a fee-per-unit basis.

There is an impact on the General Fund when a program whose revenue was previously counted as state TABOR revenue becomes an enterprise or when a state enterprise loses its enterprise status. Examples include the State Fair Authority and the Division of Wildlife. TABOR requires that the "qualification or disqualification as an enterprise shall change district bases and future year limits." Thus, the state's TABOR base must be adjusted when a program's enterprise status changes. When a program becomes an enterprise, its revenue is no longer counted as TABOR revenue and the TABOR limit is likewise reduced. It may seem, then, that there should be no impact on the size of the TABOR refund and the condition of the General Fund. That is only true if the exempted revenue source increases each year at the same rate as the state's spending limit.

The General Fund is affected by a change in enterprise status because TABOR places a limit on all revenue without limiting growth in any individual revenue source. To the extent that an organization's revenue increases at a slower or faster rate than inflation plus population growth, that revenue source either contributes to a larger or smaller TABOR surplus. Thus, when it is no longer included as part of the TABOR base, the surplus will change accordingly. Because the General Assembly has elected to refund the surplus out of the General Fund, there will be a corresponding change in the amount of money available to pay for General Fund obligations. Figure 2-10 summarizes how a change in enterprise status will affect the state budget.

Figure 2-10
The Impact on the State Budget of a Change in a State Program's Enterprise Status

The Program's Revenue Grows:	Enterprise Status Gained	Enterprise Status Lost
Slower than the allowable TABOR rate	✓ TABOR surplus **increases.** ✓ GF revenue available to pay for GF obligations **decreases**.	✓ TABOR surplus **decreases.** ✓ GF revenue available to pay for GF obligations **increases**.
Faster than the allowable TABOR rate	✓ TABOR surplus **decreases.** ✓ GF revenue available to pay for GF obligations **increases**.	✓ TABOR surplus **increases.** ✓ GF revenue available to pay for GF obligations **decreases**.

Cash Funds, the General Fund, and TABOR

This section explores two ramifications of TABOR concerning cash funds. First, TABOR's passage, along with the General Assembly's decision to refund the TABOR surplus out of the General Fund, created a new relationship between cash funds and the condition of the General Fund. Second, TABOR introduced the potential for more volatility in cash fund revenue growth and fee levels statewide — a potential that was realized during the last decade.

Cash funds. Cash funds receive revenue from a specific source that is dedicated for a specific purpose. While some cash funds receive tax revenue, most receive the bulk of their revenue in fees paid in exchange for a good or service. In FY 2002-03, approximately 250 cash funds received a total of $2.3 billion in TABOR revenue. Most cash funds receive small amounts of revenue. The three largest cash funds — the Highway Users Tax Fund, the Unemployment Insurance Trust Fund, and Higher Education cash funds — collectively received 73.3 percent of cash fund revenue subject to TABOR in FY 2002-03.

Cash funds and the General Fund. TABOR limits growth in the sum of General Fund revenue and cash fund revenue. During years in which a TABOR surplus exists, a cash fund contributes to the TABOR surplus to the extent that, over time, its revenue increases faster than the allowable TABOR growth rate. Because the General Assembly has chosen to refund the surplus out of the General Fund, cash fund revenue growth that is greater than the TABOR limit reduces the amount of money available in the General Fund to pay for General Fund obligations. Likewise, when cash fund revenue increases at a rate slower than the allowable TABOR growth rate, it reduces the TABOR surplus and increases the amount available in the General Fund.

Example: unemployment insurance. For example, consider how fluctuations in unemployment insurance (UI) tax revenues can affect the General Fund. Based on guidelines in federal law, UI taxes are designed to fluctuate in the opposite direction of the economy.[12] Rates rise and fall depending upon the amount of benefits paid to an employer's former employees and the level of the UI trust fund balance. In addition, a solvency tax is levied when the UI Trust Fund balance at the end of the fiscal year falls below 0.9 percent of total private wages in the previous calendar year. Because of these mechanisms, UI tax revenues are countercyclical and can be volatile.

Figure 2-11 shows the actual and projected growth of UI revenues between FY 1995-96 through FY 2007-08. It also shows the extent to which UI revenues have affected the TABOR surplus since FY 1996-97 and is expected to affect the surplus through FY 2007-08. Slow growth in UI revenues reduced the size of the TABOR surplus during the boom years between FY 1996-97 and FY 2000-01 by a total of $62.1 million. Because the recent Colorado recession has depleted the UI reserve, higher tax rates are required to restore solvency to the UI Fund. Additionally, tax rates for individual employers are increasing because their benefit payments to their laid-off employees increased. Between FY 2004-05 and FY 2006-07, however, UI revenue will increase the TABOR surplus by a total of $227.6 million, nearly one-fourth of the surplus during that period. The increased surplus could hinder the ability of the General Assembly to fund other programs.

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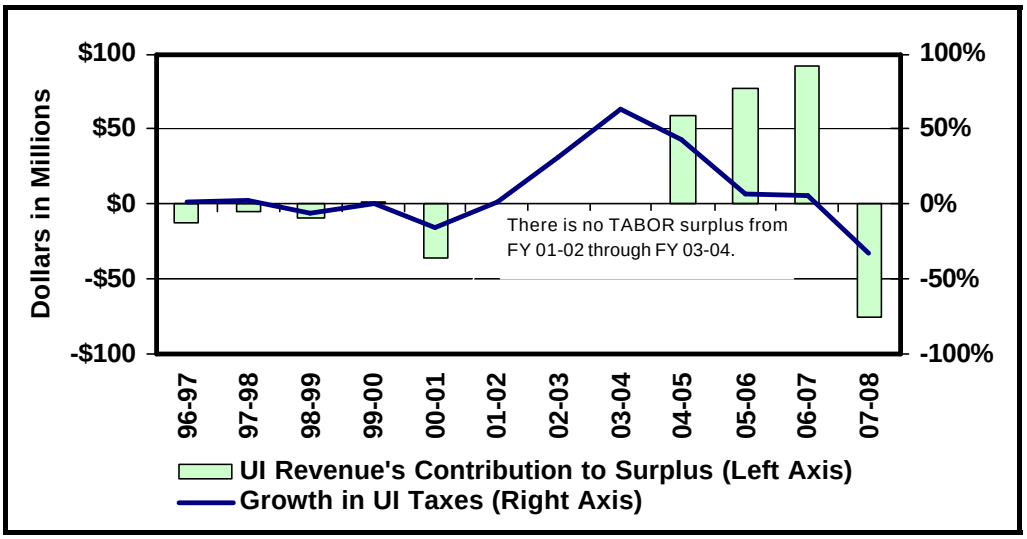
12. The Federal Unemployment Tax Act provides guidelines for the structure of state UI taxes. If a state program meets these requirements, employers can deduct taxes paid to state UI programs from their federal UI taxes up to 90 percent of the total UI taxes due to the federal government.

Figure 2-11
Unemployment Insurance Revenue's
Contribution to the TABOR Surplus and UI Tax Revenue Growth



The Issue: *The state has a federal mandate to maintain a UI tax structure that is volatile and countercyclical to the economy. This reduces the TABOR surplus during economic expansions and substantially increases the surplus following recessionary periods. As a result, General Fund revenue available for spending is increased during years when revenue is plentiful and substantially reduced during years when it is not.*

Option: *The General Assembly could refer a proposal for voter approval to exclude UI taxes from the TABOR base.*

Issues for consideration. The UI tax is a federally mandated tax that reduces available revenues in the General Fund during years in which revenues are scarce and boosts them during years in which revenue is plentiful. TABOR excludes revenue from the federal government. Taxes the federal government requires the state to collect should be treated in the same manner, particularly when they exacerbate budget difficulties resulting from revenue shortfalls.

UI taxes are mandatory payments, the same as any other tax. Exempting them from TABOR will increase government spending and reduce tax refunds. The idea was presented to voters in 1996 and failed. It was also considered and rejected by the General Assembly during the 2003 legislative session.

The impact of fee changes on the General Fund. Cash fund fee increases affect the General Fund for the same reasons that cash fund revenue volatility affects the financial status of the General Fund. Figure 2-12 illustrates a fee change's effect on the General Fund.

During years in which there is a TABOR surplus, the surplus increases by a dollar for each dollar in additional revenue resulting from a fee increase. Because the refund is paid for out of the General Fund, fee increases reduce the amount of money available for spending out of the General Fund. Likewise, fee reductions increase the amount of money available in the General Fund.

During years in which there is no TABOR surplus, a fee change's impact on the General Fund is more indirect and takes longer to materialize. Because the TABOR limit ratchets down to actual revenue during years in which there is no TABOR surplus, a fee change directly increases or decreases the TABOR limit. A fee increase will raise the TABOR limit in the current year and each year thereafter. Thus, when stronger growth in TABOR revenue resumes, the state will retain more revenue under the TABOR limit in future years. The opposite is true for decreases in fee revenue.

Figure 2-12
The Impact on the State Budget of a Fee Change

	When a TABOR Surplus Exists	**When a TABOR Surplus Does not Exist**
New Fee or Fee Increase	✓ TABOR *surplus* **increases.** ✓ GF revenue available to pay for GF obligations **decreases.**	✓ The TABOR *limit* **increases and future surpluses will be lower**.
Repealed Fee or Fee Decrease	✓ TABOR *surplus* **decreases.** ✓ GF revenue available to pay for GF obligations **increases.**	✓ TABOR *limit* **decreases and future surpluses will be higher**.

TABOR and fee volatility. TABOR has introduced the potential for more volatility in cash fund revenue growth and fee levels statewide — a potential that has been realized during the last decade. Reasons for increasing or decreasing fee revenue have traditionally been either to provide funding for a new service, eliminate funding for an obsolete service, or increase revenue in times of budget shortfalls. TABOR added additional reasons to alter fees. Since TABOR allows the legislature to increase fees without voter approval, and because of the way changes in fee revenue impact the General Fund, TABOR provides a new incentive to decrease fee revenue or minimize fee increases during prosperous times and adds to the incentive to increase fee revenue during times of economic hardship.

In the years following the passage of TABOR, the General Assembly took steps to reduce the growth rate of cash fund revenue in order to reduce potential TABOR surpluses. For example, after the first TABOR refund occurred in FY 1996-97, the General Assembly passed Senate Bill 98-194. This bill requires that fees in nearly every part of state government be reduced until the excess uncommitted reserves of the particular cash fund fall below a certain level. Higher

education provides another example. In FY 1995-96, the General Assembly assumed greater oversight of tuition rates from the Colorado Commission on Higher Education. This was done to curb growth in cash fund revenue under TABOR.

To cope with revenue shortfalls, 42 bills that either create, increase, or extend fees were enacted during the 2003 legislative session. Collectively, these bills will increase cash fund revenue subject to TABOR by an estimated $69.4 million in FY 2003-04. Many were enacted specifically to reduce the budget shortfall, thus causing many government services to be funded by fees rather than the General Fund. For example, Senate Bill 03-186 increases fees collected by the Judicial Department to offset a reduction in the department's General Fund appropriation. Some fees were also imposed to increase the amount of money the state can draw from the federal government. For example, Senate Bill 03-266 imposes a new daily fee per patient on certain nursing home facilities. Revenues from the fee will be used to reduce General Fund appropriations to the facilities, serve as a match for federal Medicaid funds, and pay Medicaid services.

Fee volatility, the General Fund, and TABOR. This additional volatility in cash fund revenue increases the hidden volatility discussed above in General Fund revenues available to fund General Fund obligations. Without the fee increases, many programs would have lost their funding this fiscal year. Once General Fund revenue becomes more plentiful in future years, however, the higher fees will cause the TABOR surplus to be larger than it otherwise would be. It would seem that the General Assembly could then choose to eliminate or reduce the fee increases and then resume funding of programs with General Fund revenue. However, there is a great demand for funding other services with the General Fund. As discussed in Chapter 1, the six largest departments in Colorado's state government received 93 percent of total General Fund expenditures in FY 2003-04. Caseloads for these departments are expected to continue rising. If the General Assembly chooses to fund caseload growth in these departments, there may not be room within the 6 percent appropriations limit to fund previously cash funded programs without making budgetary cuts elsewhere.

Could cash funds help pay for the TABOR refund? Cash fund revenue contributes to the TABOR surplus but the General Assembly has chosen to refund the surplus only with General Fund revenue. The legislative declaration in House Bill 99-1001, which created the sales tax refund, states that, although the surplus is derived from a wide variety of state taxes and fees, it is not feasible to refund the surplus to the individuals that actually paid the money to the state because it would be impossible to identify them. In addition, it would be administratively prohibitive to refund the surplus in a manner proportionate to the contribution of each revenue source to the surplus.

Refunding a portion of the TABOR surplus from cash funds is problematic because cash fund revenue is not general purpose revenue. Most cash fund revenue comes from fees paid in exchange for a particular good or service. Because most fees are set at a level designed to cover the costs of providing the good or service, using fee revenue to refund the TABOR surplus would deny many of these programs their primary source of operating revenue. For example, there is no constitutional or federal prohibition on using higher education revenues, which represented 31 percent of all cash fund revenue subject to TABOR in FY 2002-03, to refund the TABOR surplus.

However, using a portion of higher education tuition to refund the TABOR surplus would make it difficult to fund the state's higher education institutions. Unlike higher education, most fee-based programs are small. Without their fee revenue, many fee-based programs would be unable to provide the services that those who paid the fee would expect to receive.

Transportation-related revenues represented 36 percent of all cash fund revenue subject to TABOR in FY 2002-03. Once collected, transportation-related revenues are required by Article X, Section 18 of the state constitution to be used exclusively for the "construction, maintenance, and supervision of the public highways of this state." However, a refund method could be created by reducing the tax rate on gasoline or the level of transportation-related fees. This refund method would not violate the state constitution because the revenue would never be collected. This is similar to the refund method adopted in House Bill 00-1227, which lowered annual state registration fees for motor vehicles during years in which a TABOR surplus exists. That method, however, includes a backfill from the General Fund to the Highway Users Tax Fund.

Federal law precludes using unemployment insurance revenues to help refund the TABOR surplus. The Federal Unemployment Tax Act disallows the use of unemployment insurance revenues for anything other than unemployment insurance benefits, lest the state forfeit a large tax credit on business's federal unemployment insurance taxes. Unemployment insurance revenues represented 10 percent of all cash fund revenue subject to TABOR in FY 2002-03.

The General Assembly already has some degree of control on cash funds to limit any contribution to the TABOR surplus. In most cases, fee increases have been limited to the inflation rate or the amount required to cover the costs of specific goods or services. Additionally, under Senate Bill 98-194, fees have been reduced if the uncommitted reserves of a cash fund exceed a particular level. The General Assembly could choose to apply a cash fund's uncommitted reserves over and above the allowable level toward the TABOR refund. The uncommitted reserves of all cash funds totaled $21.7 million in FY 2000-01, the last year a TABOR surplus occurred.

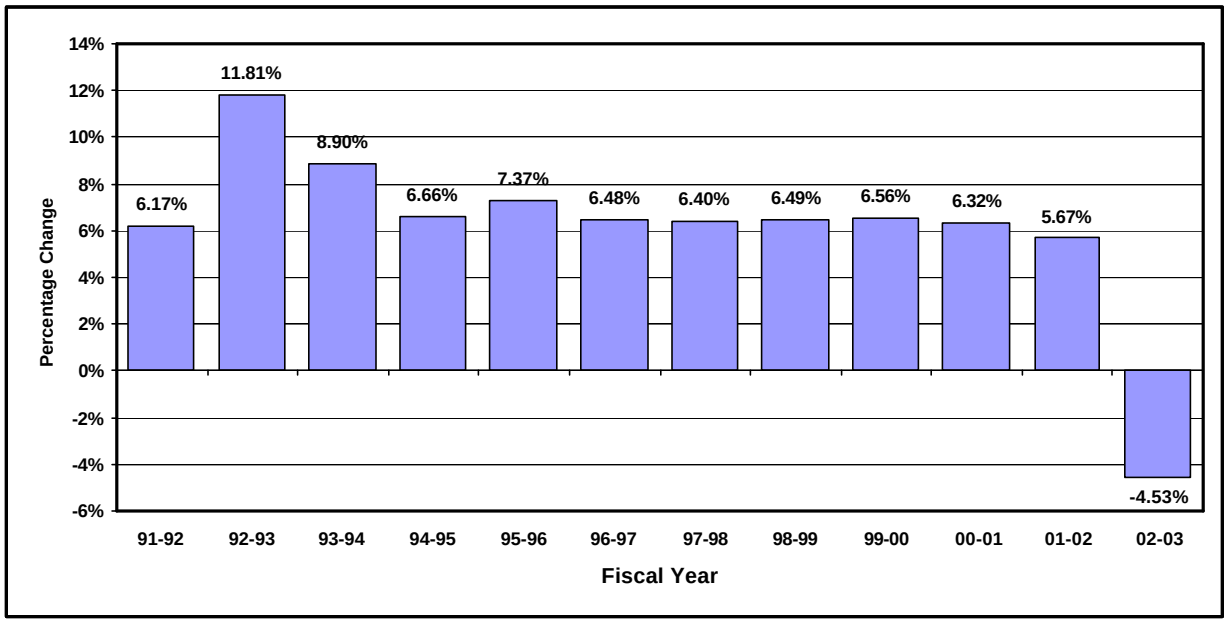
The Six Percent Limit on General Fund Appropriations

This section analyzes the limit on General Fund appropriations. While TABOR limits most revenue, General Fund appropriations are a smaller part of the overall budget and are limited to a 6 percent maximum annual increase. TABOR is a constitutional limit, while the appropriations limit is a statutory limit passed in 1991. The appropriations limit is commonly referred to as the 6 percent limit or the Arveschoug/Bird limit after its two sponsors. A provision in TABOR effectively prevents the appropriations limit from being weakened without voter approval.

Some General Fund appropriations are excepted from the 6 percent limit. There are two common examples of the exceptions. The first example is appropriations for new programs or increased service levels required by federal law or final state or federal court order. The second example is appropriations for Medicaid overexpenditures. Other exceptions include appropriations for property tax reappraisals, from voter-approved tax or fee increases, and for a state fiscal emergency. The amount of the exceptions varies from year to year. For example, in FY 1993-94, they totaled $91 million. However, there were only $3.6 million of exceptions in

FY 2001-02. The exceptions are typically added for purposes of calculating the allowable appropriations in the following year. For example, if General Fund appropriations under the 6 percent limit were $5 billion and exceptions were an additional $100 million, the allowable appropriations in the following year would be 6 percent higher than $5.1 billion. Thus, the exceptions to the limit have increased allowable General Fund appropriations. As Figure 2-13 shows, the actual increases in General Fund appropriations over the past 11 years are typically greater than 6 percent. The revenue downturn of the past two years forced appropriations below the 6 percent level.

Figure 2-13
General Fund Appropriations Increases



The 6 percent limit has operated more as a floor for appropriations rather than the intended ceiling. By appropriating less than 6 percent, it was considered a ratcheting down of the limit. Although appropriations increased by 5.66 percent in FY 2001-02, the increase would have been even smaller if the General Assembly had not reclassified other expenditures that are exempt from the limit to an appropriation subject to the limit. Thus, the appropriations base was increased. The ultimate result was to increase the level of reductions below the traditional 6 percent limit that needed to be made after FY 2001-02.

Based on our June 2003 forecast, General Fund appropriations can increase by the full 6 percent in only FY 2006-07 and FY 2007-08. There is little or no money in the excess General Fund reserve for additional program funding of highways and capital construction because of relatively weak growth in General Fund revenue and substantial TABOR refund liabilities generated by stronger growth in cash fund revenue.

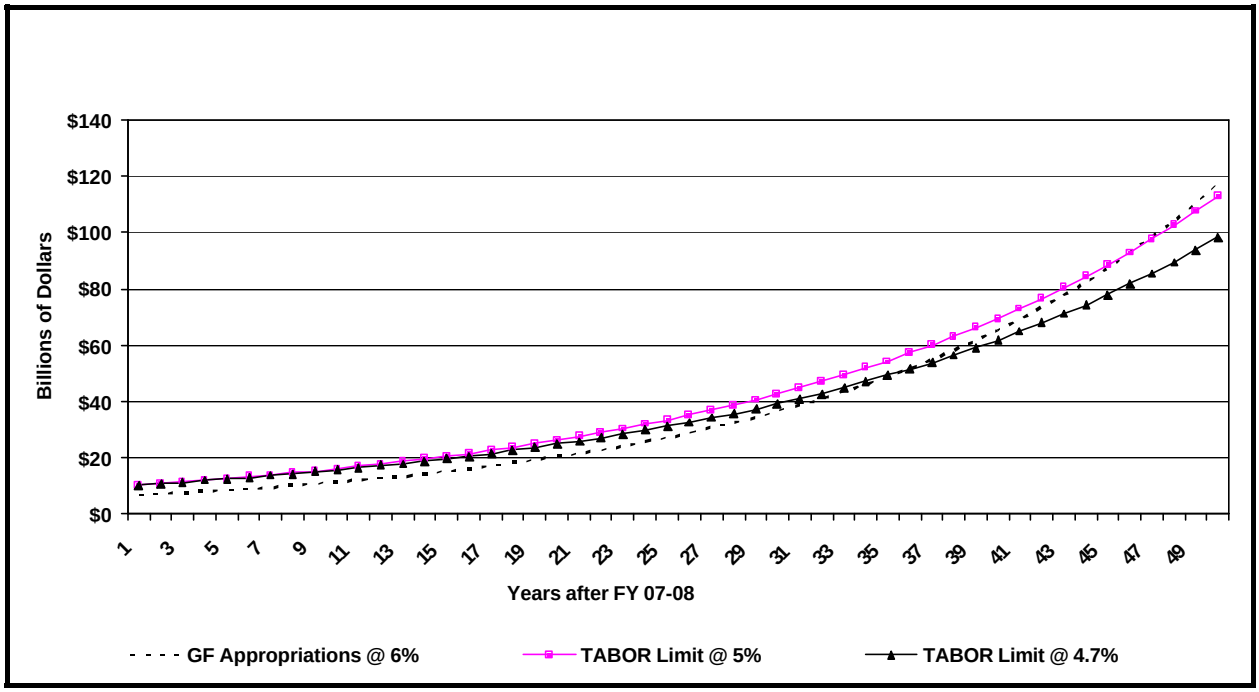
While the current appropriations limit of 6 percent can be increased only by voter approval, an increase in the limit could have implications for other parts of the state's budget. An

increase in the limit could result in reduced diversions of sales and use tax revenue to the Highway Users Tax Fund (HUTF) and would result in reduced transfers of excess General Fund reserve monies to the HUTF and the Capital Construction Fund. Additionally, increasing the 6 percent limit on General Fund appropriations would potentially conflict with the establishment of a rainy day fund.

While the TABOR and appropriations limits generally operate independently of each other, they do influence each other. For example, the TABOR limit applies to General Fund revenue and selected cash fund revenue. When cash fund revenue grows faster than General Fund revenue and a TABOR surplus exists, the state may not be able to increase General Fund appropriations by the maximum 6 percent. This occurs because the state has elected to refund any surplus TABOR revenue from the General Fund. Based on the our June 2003 forecast, the less-than-maximum appropriations increases will occur in FY 2004-05 and FY 2005-06. Increasing appropriations by less than 6 percent may be an oversimplification in that other General Fund expenditures could be reduced or refunds could be made from cash funds, but the point is that TABOR will restrain the growth of General Fund spending.

The interdependency of the TABOR and 6 percent limits is also illustrated by the fact that General Fund appropriations could eventually consume all of allowable revenue under TABOR. Appropriations are currently a smaller amount than allowable TABOR revenue. If appropriations increase at the 6 percent limit, while the TABOR limit increases 5 percent annually, General Fund appropriations would take up all of the revenue limit in about 50 years. This estimate assumes the FY 2007-08 starting points projected in our June 2003 revenue forecast and no additional appropriations that are exempt from the 6 percent limit. Convergence of the limits would occur even earlier if the TABOR limit increases by less than 5 percent annually as shown in Figure 2-14. An earlier convergence would also occur with additional exempt appropriations. For comparison purposes, the average increase in the allowable TABOR limit from its inception through FY 2000-01 was 5.9 percent. Our office projects an average limit of 4.4 percent from FY 2004-05 through FY 2007-08, while the actual sum of the inflation and population factors used for the FY 2003-04 TABOR revenue limit is 3.6 percent.

Figure 2-14
Appropriations and Revenue Limits



The Issue: *Continuing to increase General Fund appropriations by 6 percent or more will consume an increasing portion of allowable TABOR revenue.*

Option: *The General Assembly could consider changing the limit on General Fund appropriations. A maximum limit for appropriations equal to the TABOR limit of the inflation rate plus the percentage change in state population would move the two limits in tandem. This option would have to be referred to voters because it would constitute a weakening of the existing limit in some years. In addition, the General Assembly could repeal by statute the existing exceptions to the spending limit and incorporate the required spending within the limit.*

Issues for consideration. If the state does not change the appropriations limit to match the TABOR limit, it may eventually be forced to drastically reduce the rate of growth or even have year-over-year reductions in appropriations to balance the budget. The lack of a larger rainy day fund and planned spending for available revenue over the existing 4 percent reserve fund compound the problem. These issues will need to be addressed as well. The change would make the limit more restrictive in some years and less restrictive in others.

Some maintain that the existing 6 percent limit does not keep up with economic growth in many years. Further, voter mandates for increased funding of K-12 education create a significant demand on the existing budget. A reduction of the limit could crowd out other demands and needs for government-provided services.

CHAPTER 3

CHAPTER 3
FISCAL EMERGENCIES

During the recent economic downturn and subsequent state revenue shortfall, state budget writers had a limited number of options to cope with declining revenues and the constitutional requirement to balance the budget. This chapter discusses the current mechanisms that are available to use during revenue shortfalls, the measures the General Assembly and Governor undertook to balance the budget during the recent economic downturn, and other states' rainy day funds. It also presents several options with respect to fiscal emergencies and the state's reserve funds.

Current Mechanisms in Place to Use During Revenue Shortfalls

Other than reducing government spending, transferring money into the General Fund from other funds, and enacting General Fund revenue enhancements, the state has a limited number of options available to meet the constitutional requirement of a balanced budget during a revenue shortfall**.** Colorado does not have a budget stabilization fund, or "rainy-day fund," but by law it does maintain a General Fund reserve equal to 4 percent of appropriations. This reserve provides additional money to meet state obligations during the fiscal year. During a revenue shortfall, state law requires the Governor to reduce expenditures by any lawful means. During the recent revenue shortfall, the Governor was given authority to transfer money into the General Fund from other funds and spend reserve money if necessary. Further, TABOR affects the state's ability to cope with revenue shortfalls. While the state also maintains an emergency reserve, it cannot be used to offset revenue shortfalls.

Reserve Funds

This section describes the use of the statutory reserve, the creation of a cash flow emergency reserve, and the TABOR emergency reserve.

Use of the statutory reserve during revenue shortfalls. Section 24-75-201.1 (1) (d) (III), C.R.S., requires 4 percent of General Fund fiscal year appropriations to be set aside in case revenue is insufficient to meet the state's General Fund obligations. This statutory reserve must be replenished to the 4 percent level each year as part of the budget process. For example, when General Fund revenue is not sufficient to appropriate up to the maximum level *and* maintain a 4 percent reserve, appropriations are reduced so that a reserve level of 4 percent is maintained. In FYs 2001-02 and 2002-03, the General Assembly either eliminated or reduced the required amount of the General Fund reserve to free up money for appropriations. However, money from the statutory reserve provided only a fraction of the amount that was needed to cover state

expenditures. The legislature passed many other budget reduction measures and found additional revenue sources to balance the budget. The statutory reserve was also reduced below 4 percent during the early 1990s.

Cash flow emergency reserve. In addition to its reserve levels, the state must also be concerned with its cash flow position. Although the state may have a balanced budget from an accounting standpoint, the uneven flow of expenditures and revenues can cause the state to run out of cash for a period of time during the fiscal year. To help prevent this problem, the legislature passed two bills during the 2003 session. Senate Bill 03-342 authorized the state to sell one or more of its facilities to raise up to $160 million for the Controlled Maintenance Trust Fund for designation as cash flow reserves. Senate Bill 03-268 authorized the sale of up to 60 percent of the state's rights to future tobacco settlement payments in order to raise $260 million. The first $100 million would be earmarked to meet the constitutional reserve requirement and the remaining $160 million would be available to address cash flow emergencies. The bill also transferred $40 million from the General Fund to the Tobacco Litigation Settlement Cash Fund, making up to $200 million available for cash flow emergencies.

TABOR emergency reserve. TABOR requires that at least 3 percent of state fiscal year spending, excluding bonded debt service, be kept in an emergency reserve. The TABOR emergency reserve cannot be used to offset revenue shortfalls; it can only be utilized to pay for non-fiscal emergencies, such as natural disasters. The reserve is currently in several funds and includes nonfinancial assets.

While ensuring that moneys are available for emergencies, TABOR creates a significant disincentive to spending emergency reserves. Once emergency reserve moneys are spent, the required replenishment constitutes a reserve increase that counts as "fiscal year spending." Since the replenishment of the emergency reserve must fit within a government's fiscal year spending limit, money available for other government services and programs would likely be reduced.

Authority of the Governor During Revenue Shortfalls

This section explains the requirements placed on the Governor during revenue downturns and the options available to the Governor to meet these requirements.

Requirement to reduce General Fund expenditures. When the revenue estimate from the Governor's Office of State Planning and Budgeting for the fiscal year indicates that General Fund expenditures will result in the use of one-half or more of the required General Fund reserve, the Governor must reduce General Fund expenditures so that the reserve will be at least one-half of the required amount. The Governor is required to use the procedures set forth in Section 24-2-102 (4), C.R.S., Section 24-50-109.5, C.R.S., or any other lawful means to reduce expenditures. The Governor must notify the legislature of the plan to accomplish the reductions. The Governor may also consider recommendations for reducing General Fund expenditures at institutions of higher education submitted by the Colorado Commission on Higher Education, after consultation with their governing boards (Section 24-75-201.5 (2), C.R.S.).

Section 24-2-102 (4), C.R.S, grants the Governor authority to issue an executive order to suspend or discontinue the functions or services of any department, board, bureau, or agency of the state government for up to three months when there are not sufficient revenues available to carry on the functions of the state government. The Governor may extend the executive order if necessary. During the recent revenue shortfall, Governor Owens issued several executive orders requiring state agencies to suspend or discontinue functions and services in order to reduce expenditures.

Section 24-50-109.5, C.R.S., requires the Governor to reduce state personnel expenditures in the event of a fiscal emergency, defined as a significant General Fund revenue shortfall or significant reductions in cash or federal funds received by the state, which threatens the orderly operation of state government and the health, safety, or welfare of the citizens of the state. The fiscal emergency must be declared by joint resolution adopted by the General Assembly and approved by the Governor.

Actions that may be undertaken to reduce state personnel expenditures include separations, voluntary and mandatory furloughs, suspension of salary and fringe benefit survey increases, suspension of performance awards or merit increases, job-sharing, hiring freezes, or forced reallocation of vacant positions. The head of each department and the governing board of each institution of higher education are required to order measures in accordance with the actions taken by the Governor to reduce the personnel expenditures of their departments.

Authority to spend reserve and transfer funds. In addition to the Governor's authority to reduce expenditures during revenue shortfalls, the Governor is authorized to spend a portion of the reserve. On occasion, the Governor has also been allowed to transfer money from certain cash funds to the General Fund and make further use of the reserve. Further, if the Governor reduces General Fund expenditures by 1 percent or more for the fiscal year, the Governor may transfer moneys from the Capital Construction Fund into the General Fund.

TABOR and Revenue Shortfalls

Under TABOR, voter approval is required to raise taxes to deal with budgetary shortfalls. However, this option does not provide an immediate mechanism to handle revenue shortfalls because proposals to increase taxes can only be voted on in November of each year and, therefore, additional revenue would not be available until after the election. Again, the TABOR emergency reserve cannot be used to offset revenue shortfalls; it can only be used to pay for non-fiscal emergencies, such as natural disasters.

Emergency taxes. While TABOR permits governments to impose emergency taxes for non-fiscal emergencies without prior voter approval, this authority is severely limited. Emergency taxes can only be imposed after the emergency reserve is depleted. Also, emergency property taxes are specifically prohibited. Finally, separate two-thirds majority votes of the appropriate governing body are necessary to declare an emergency and to impose an emergency tax.

An emergency tax can only be imposed until the next election occurring more than 60 days after the emergency declaration, and the tax will lapse unless ratified by the voters. Emergency taxes are not included in fiscal year spending for purposes of calculating the government's spending limit. Finally, any emergency tax revenues not expended on the emergency must be refunded within 180 days after the end of the emergency.

Budget Reduction Measures and Revenue Enhancements During the Recent Revenue Shortfall

In response to the recent revenue shortfall, the legislature passed measures that either transferred moneys to the General Fund, increased General Fund revenues, reduced General Fund expenditures, or increased fees to meet the balanced budget requirement.

Cash fund transfers. For FY 2002-03, the General Assembly adopted numerous bills that transferred a net $206.2 million from cash funds to the General Fund. By comparison, the FY 2001-02 net cash fund transfers to the General Fund exceeded $1 billion. Some of these transfers require that the funds be paid back whenever there is a sufficient amount of General Fund revenue available. In FY 2003-04, a net amount of $42 million will be transferred back to cash funds from the General Fund. The Controlled Maintenance Trust Fund and the Major Medical Insurance Fund are the beneficiaries of these transfers. In sum, the transfers have significantly depleted state cash funds, thus precluding the transfer of money to the General Fund as an ongoing option. Further, since the transfers provide only a one-time solution to budget shortfalls, future budgets will be impacted as allowable revenues will not be sufficient to maintain the level of appropriations that these transfers permitted.

Measures impacting General Fund expenditures and revenue. Most of the legislation that reduced General Fund expenditures reduced appropriations by cutting programs and services, delaying scheduled reimbursements to certain state funds, or moving expenditures into future years. For example, Senate Bill 03-197 shifted the General Fund portion of the payroll for state employees for the month of June, 2003, from June 30 to July 1. This shift resulted in 11 payroll periods during FY 2002-03, rather than the normal 12. Other measures had a positive revenue impact on the General Fund. Senate Bill 03-185 created a 30-day tax amnesty program to allow state taxpayers who owe back taxes an opportunity to pay off their tax liability in full without penalties. Another bill, House Bill 03-1282, reduces the interest rate that the state pays on tax refunds. Other measures were enacted to use fees to pay for programs and services that were previously funded with General Fund moneys. For example, Senate Bill 03-272 allowed the Department of Revenue to raise fees to pay for the cost of manufacturing license plates.

State Rainy Day Funds

Budget stabilization funds, or rainy day funds (RDFs), are widely used by states. In fact, 45 states have RDFs that are intended to save money when annual revenues are increasing and to provide money for revenue shortfalls in order to avoid reducing core government services or increasing taxes. Many states adopted their RDFs after the early 1980s recessions. Colorado's

4 percent reserve, however, is generally not considered to function as a rainy day fund because of its size and the requirement that it be refilled each year.

According to the National Association of State Budget Officers, 22 states used some amount of their RDF as a strategy to deal with their FY 2002-03 budget shortfalls. Further, according to the Center on Budget and Policy Priorities, 16 states addressed one-third or more of their FY 2001-02 deficit with RDF withdrawals. For example, Massachusetts used about $1.4 billion from its RDF to help address a $2.3 billion deficit, while Maine withdrew $110 million from its RDF to help address a $150 million deficit.

Deposits to RDFs. According to data compiled by the National Conference of State Legislatures (NCSL), deposits to RDFs are usually based on year-end surpluses, are made by appropriations, or are a combination of the two. The most common deposit rule is that a portion of the state's year-end surplus be placed in the RDF. For example, Florida and Massachusetts require surplus revenue to be placed into their RDF. In these states, surpluses may be refunded to taxpayers when their RDFs reach a certain amount. Seven states require deposits into RDFs when revenue or economic growth exceeds certain levels. For example, Idaho contributes to its RDF when revenues are projected to grow by more than 4 percent. Only a small number of states require annual contributions to their RDFs regardless of the state's financial situation.

Withdrawal of money from RDFs. Most states limit the withdrawal of money from their RDFs to cover revenue shortfalls or other budget deficiencies. A small number of states do not place any limit on how the money in their RDF can be spent. In eight states, withdrawals from RDFs can only occur with a supermajority vote of the legislature. A few states require a supermajority vote when the RDF is to be used for purposes other than a revenue shortfall. Thirteen states limit the amount that can be used per occurrence. For example, Virginia can use its RDF for no more than one-half of a budget shortfall and can use no more than one-half of the fund annually. The limit on the maximum withdrawal from Michigan's RDF is dependent on the size of its budget shortfall.

Replenishment of RDFs. Six states require that withdrawals from RDFs be replenished over a specified time period. For example, Alabama's RDF must be repaid within five years and Rhode Island's RDF must be repaid within two years, although the legislature may set a longer repayment period.

Studies on RDFs. Studies on RDFs have generally found that the structure of the RDF — specifically the deposit and withdrawal rules — is an important factor in determining a state's ability to save.[13] State RDF laws that require money to be deposited into a fund and provide strict rules on the withdrawal of money to ensure that the RDF will only be used when necessary are considered to be effective in ensuring savings. An example of such an RDF is one that requires a

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13. Sobel, R.S. and R.G. Holcombe, 1996. "The Impact of State Rainy Day Funds in Easing State Fiscal Crises During the 1990-91 Recession, "*Public Budgeting & Finance*, 28-48; Wagner, G.A., 2002. "Are State Budget Stabilization Funds Only the Illusion of Savings? Evidence from Stationary Panel Data," *Quarterly Review of Economics & Finance* 43, Summer 2003, 213-238; and Wagner, G.A. and J.M. Gropp, 2002."The Municipal Bond Market and Fiscal Institutions: Have Budget Stabilization Funds Reduced State Borrowing Costs?", Unpublished manuscript, Duquesne University.

certain amount of revenue to be deposited when revenues are growing and that requires a supermajority to withdraw funds.

Size of funds. Thirty-five states have caps on the size of their RDFs; ten states have no caps. Nine states have caps at or above 10 percent of their budgets, eight states have caps between 5 and 10 percent, and 18 states have caps of 5 percent of their budget or less. However, money in state RDFs typically has not reached the legal cap, especially due to the use of such funds during the recent national economic downturn.

Recommended levels of RDFs. NCSL and most bond-rating agencies recommend an RDF equal to 5 percent of expenditures, while Wall Street analysts recommend that states maintain RDFs equal to 3 to 5 percent of their General Fund budgets. However, some economists contend that these figures should be used only to carry states through normal economic contingencies, such as an error in forecasting or extra expenditures. Other recommendations were higher than 5 percent. The Government Finance Officers Association recommends that governments maintain an unreserved fund balance in their General Fund of no less than 5 to 15 percent of their regular General Fund operating revenues, or no less than 8 to 16 percent of regular General Fund operating expenditures. The Center on Budget and Policy Priorities recommends that RDF balances be 10 to 15 percent of budgets, while a recent academic study also recommended an RDF balance in the 10 to 15 percent range.[14]

Colorado and the recommended level of an RDF. Colorado's circumstances generally point to the need for a larger-than-average level of reserves. First, Colorado receives a large share of its revenue from income taxes. These taxes tend to be volatile over the economic cycle as business profits and capital gains fluctuate. This was evident during the recent economic downturn. Second, while Colorado has expanded its economic base from a dependence on natural resources and construction that accompanied the oil boom of the late 1970s and early 1980s to a much more diverse economy, the state still tends to see its growth come from specific industries. During the last expansion, the state experienced tremendous growth in the advanced technology, communications, and financial sectors. However, these sectors also proved to be the hardest hit when the economy turned down. Therefore, the state saw great gains in revenue during the 1990s and then large declines when the recession hit. These volatile factors would indicate that Colorado needs a larger reserve than many other states to smooth out the revenue changes that occur throughout the business cycle.

Issues and Options

The state's current budget problems have many people considering an RDF in Colorado. The concern is that the statutory reserve is not large enough to protect the budget during an economic downturn and is also required to serve other purposes. In addition, the state's

14. Center on Budget and Policy Priorities, "Heavy Weather: Are State Rainy Day Funds Working?", May 13, 2003, and Wagner, G.A. "Fiscal Stress and State Rainy Day Funds: Are They the Answer for Brighter Days Ahead?" Duquesne University, 2002.

emergency reserve is overly strict in its usage and payback requirements, rendering it practically pointless. The existing statutory reserve is better suited for normal economic contingencies during the fiscal year, such as slight forecasting errors and unanticipated expenditures such as lawsuits and federal mandates. A new reserve, with a separate set of rules regarding its funding and the use of its funds, can provide the money to maintain services during an economic downturn, when the need for some state services increases. Such a reserve could also help the state's cash flow position.

However, an RDF would be the third reserve fund for the state; the state already has a statutory reserve and an emergency reserve. An additional reserve could further tie the legislature's hands in running the state. Under current TABOR limits, since allowable revenue can be reduced during bad economic times, an RDF could simply delay cuts in government programs. While revenue will rebound after the downturn, lower revenue limits could lead to larger refunds, and the need to cut government programs may still exist despite use of an RDF during the bad economic times.

The Issue: *How can the state fund an RDF?*

If Colorado creates an RDF, the following four funding options could be used as a source of money for the fund. The first two options could be done statutorily, while the last two options would require voter approval.

Option 1: *The General Assembly could increase savings by cutting spending elsewhere.*

Issues for consideration. It was clear during the current economic downturn that Colorado needs larger reserves. The only way the state can quickly build its reserves without voter approval is to cut existing spending. However, state laws may have to be changed for further cuts in spending. In addition, the state has already cut or eliminated many programs and is funding others with user fees. Further reductions could create a serious burden for citizens in order to save more money as opposed to recent cuts that were the result of the shortfall.

Option 2: *The General Assembly could increase savings by placing a portion of the excess General Fund reserve into the statutory reserve or an RDF before the money is distributed to the Highway Users Tax Fund and the Capital Construction Fund.*

Issues for consideration. Prior to the passage of House Bill 03-1238, the state was required to save the first $25 million of excess General Fund reserve each year in order to create a pool to pay for a change in the TABOR accounting methodology. The accounting change has now been made. Therefore, the excess revenue is an existing revenue source that could be used to fund an RDF. However, this option would mean that an additional reserve would be funded at the expense of highways and capital construction projects.

Option 3: *The General Assembly could increase savings by asking voters to substitute an RDF for the state's constitutional reserve or expand the definition of emergency to include revenue shortfalls.*

Issues for consideration. The state's constitutional reserve can only be used during certain rare circumstances that do not include fiscal emergencies. The state would be better served with these revenues available for both emergencies and revenue shortfalls. However, if the state's constitutional reserve is spent for an economic emergency money may not be available for non-economic emergencies.

Option 4: *The General Assembly could ask the voters to allow the state to retain a portion of any surplus revenues to fund an RDF up to a certain level.*

Issues for consideration. This option would allow the voters to decide if they want to fund an RDF to maintain state services during economic downturns. However, it would reduce taxpayer refunds.

The Issue: *How should money in an RDF be spent?*

The following spending options could be used to ensure that money in an RDF or other reserve account is available for economic downturns. Each of these options could be accomplished statutorily or in conjunction with a vote of the people. If they are implemented by statute, they could later be changed or amended by statute as well.

Option 1: *The General Assembly could limit spending from the statutory reserve or RDF to fiscal emergencies or when revenue falls below the initially budgeted amount.*

Issues for consideration. By limiting expenditures from reserves to revenue downturns, this option prevents reserves from being spent during the budget process and only allows them to be spent when revenue growth falls below budgeted levels. This option would prevent spending

from getting too high as the economy starts to decline and sustain spending during bad times. However, without incorporating changes to TABOR, additional reserves would only have delayed the cuts to state government as the ratchet-down provision of TABOR would have prevented the state from maintaining previous spending levels regardless of the size of the state's reserves.

Option 2: *The General Assembly could require a supermajority vote to allow the use of any or all of the reserve or a rainy day fund.*

Issues for consideration. This option could prevent the savings from being used to supplement spending rather than being used during times of need. However, it gives a minority of members of the General Assembly increased power in determining when and how the money can be spent.

Option 3: *The General Assembly could limit the amount of savings that may be used during any one fiscal year.*

Issues for consideration. Most downturns impact spending during more than just one fiscal year so a portion of the RDF should be maintained for use in subsequent years. The goal of an RDF is not to maintain full funding the first year only to experience drastic cuts during the next year. This requirement would allow any necessary cuts to be made over the course of several years rather than all at the same time. But, the General Assembly may not have the ability to use the money as needed depending on the situation and on what the future looks like. No limits can be set to perfectly account for the size and timing of every future downturn.

The Issue: *Since TABOR defines savings the same as spending, it is difficult for the state to set additional money aside in a savings account, especially during bad economic times.*

Option: *The General Assembly could ask the voters to amend TABOR so that additional money saved up to a certain level is exempt from spending limits at the time it is saved. The money would only count as spending under TABOR when it is used.*

Issues for consideration. It is clear that during the current economic downturn, the state needed larger reserves. This proposal would create a funding source for additional savings by exempting savings from the TABOR spending limit. The option also sets a strict limit on the use of reserve funds by counting the funds under TABOR when they are used. The cap on the needed level of savings would prevent the state from permanently reducing TABOR refunds to increase savings. Since the money is counted under TABOR when it is spent, it will not be used unless revenue has fallen below the spending limit, therefore no expansion of government will

take place. TABOR would become a spending limit that encourages governments to save money, not a revenue limit that discourages savings. On the other hand, this option would reduce taxpayer refunds.

CHAPTER 4

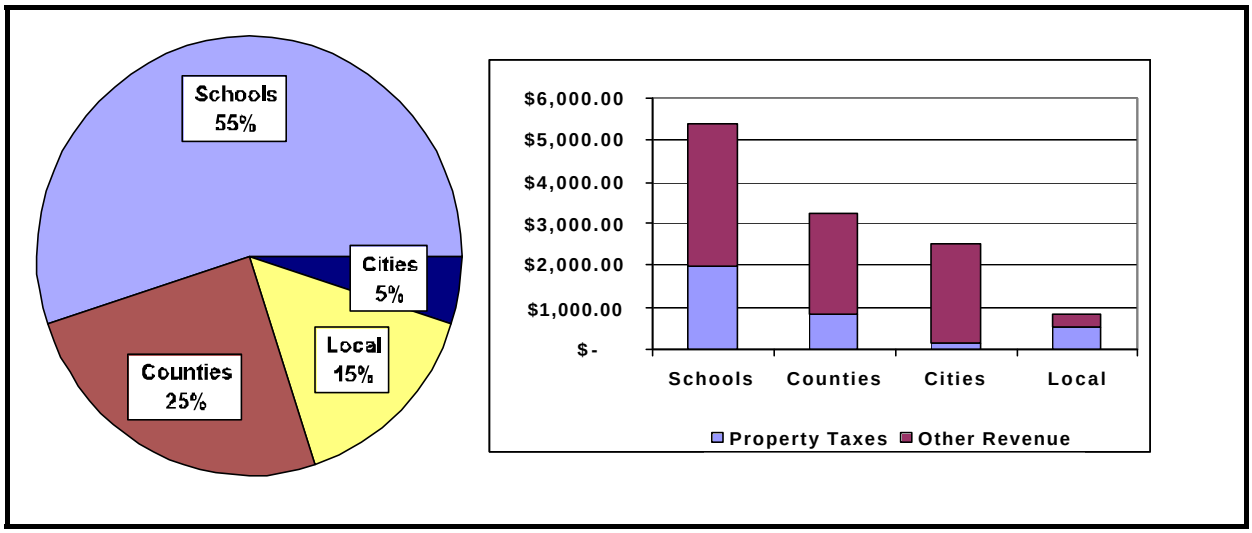
CHAPTER 4
PROPERTY TAXES

This chapter provides an overview of Colorado's property tax system and an analysis of two key constitutional provisions that govern property taxes — Gallagher and TABOR. These provisions affect all levels of local government, including school districts. This analysis focuses on school finance property taxes because these moneys have a direct impact on state expenditures, and because the impact of Gallagher and TABOR on school finance property taxes is similar to the impact on all property taxes.

Introduction

Property taxes have long provided a source of revenue for public services in Colorado. Today, property taxes are exclusively a local government revenue source, funding public schools, counties, cities, towns, and special districts. Property taxes have not been used to fund state-level functions since 1964. However, property taxes are a subject for debate at the state level because they are governed by state law, both constitutional and statutory. In addition, the property tax still represents a significant tax burden — in 2003, Colorado homeowners and businesses paid roughly $4.4 billion in property taxes, over half of which went to support public schools. Figure 4-1 shows the distribution of property taxes and the relative importance of this revenue source to local governments.

Figure 4-1
Where Do Property Taxes Go, and How important Are They to Local Governments?



Three facts become apparent in reviewing the property tax system. First, Colorado's constitutional limits have been effective in holding down increases in property taxes. Second, the requirement to revalue property every two years creates a volatile growth pattern in taxable property values that results in a situation where property tax collections often do not reach the limits allowed by law. Third, the school finance act, which relies heavily on both property taxes and state moneys, is experiencing a large and growing need for state aid to schools.

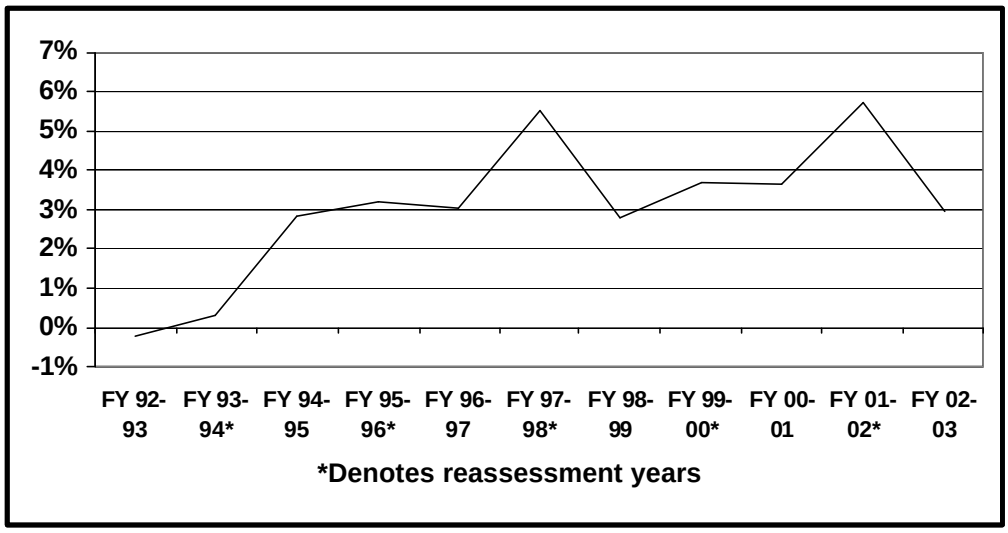
Property taxes are limited by law. Two constitutional provisions limit property taxes in Colorado. Gallagher sets a statewide cap on the taxable value of homes and other residences; TABOR restricts the amount that each local government's property taxes may increase each year and requires voter approval for most tax rate increases. Although property taxes, like property values, tend to increase over time, the limits have combined to hold down the increase, especially for homeowners. Figure 4-2 illustrates the change in property taxes for a Denver homeowner between 1991 and 2001.

Figure 4-2 Home Values, Taxable Values, Property Taxes and Personal Income in Denver

	1991	2001	Difference	Percent Change
Average Home Value	$75,454	$210,746	$135,292	179%
Residential Assessment Rate	14.34%	9.15%	-5.19%	-36%
Assessed (Taxable) Value	$10,820	$19,283	$8,463	78%
Total Mill Levy	77.419	60.377	-17.042	-22%
Average Property Taxes	$838	$1,164	$327	39%
Personal Income Per Capita	$24,118	$41,722	$17,604	73%
Avg Property Taxes as a Percent of Personal Income	3.47%	2.79%	-0.68%	-20%

The biennial reassessment cycle creates a "sawtooth" effect, whereby property taxes often grow by less than the law allows. Under current law, property in Colorado is reassessed on a two-year cycle. In odd-numbered reassessment years, values increase to reflect two years' worth of changes in the market. In the intervening even-numbered years, values increase only to reflect new construction for that year. Plotted on a graph, the growth in assessed values follows a "sawtooth" pattern both for taxpayers and tax collectors. The pattern is similar for property tax revenues, creating more pressure on state aid in non-reassessment years. Figure 4-3 shows the percentage change in school finance property taxes between FY 1992-93 and FY 2002-03.

Figure 4-3
Growth in School Finance Property Taxes



Although attempts have been made to switch to an annual reassessment cycle, the current system at least provides more up-to-date values than the four-year cycle that was in place until 1987. At one point, the legislature passed a law to require county assessors to update property values every year. However, the requirement was delayed for several years and eventually repealed because of the expense.

Total funding for schools is growing faster than property taxes. Colorado's school finance act is funded primarily through property taxes and state aid. Property taxes have always been a source of financial support for K-12 public schools. However, state funding has made up the larger of the two shares since 1991. The state's involvement in providing funding for K-12 public schools is grounded in the Colorado Constitution's requirement for a thorough and uniform system of free public schools. State courts have interpreted this and similar constitutional provisions in other states to mean that the state has a responsibility to ensure equity among school district resources. In Colorado, the level of state funding really only began to be substantial in 1974 following passage of the 1973 school finance act. Since that time, both the state share and the total appropriation for school finance have grown such that state funding now accounts for nearly 60 percent of total school finance expenditures and roughly $2.5 billion in state General Fund appropriations.

Dramatic growth in state funding has been seen over the last 15 years, and can be attributed to four significant changes. Two changes occurred when voters approved two constitutional amendments to the property tax system — Gallagher in 1982 and TABOR in 1992. A third change occurred when the General Assembly articulated a policy to increase the state's share to 50 percent under the 1988 school finance act. Finally, the last change was the passage of Amendment 23, guaranteeing certain increases in funding for schools.

The first three changes were part of a conscious effort to hold down the property tax burden. The trade-off, however, was added pressure on the state to meet the growing costs of school finance. Compounding this pressure on state expenditures is the requirement of

Amendment 23 to increase the per pupil funding of schools. Under Colorado's school finance act, state aid makes up the difference between total funding and the amount available from local sources. Since funding for schools must increase and the local share is limited, the difference in funding must be paid from state sources. Figure 4-4 illustrates the basic formula for determining the state's share of school finance funding. Thus, the trend toward an increasing state share of school finance is expected to continue.

Figure 4-4
The State Aid Formula Under the School Finance Act

State Aid Under the School Finance Act	=	Total Program Funding (formula-driven and guaranteed)	-	Local Share (limited)

Fiscal year 2002-03 brought the state's share of school finance act funding to nearly 60 percent. This level of funding represents an increase in state expenditures of about $690 million in FY 2002-03 over what would have been required if the state share had remained the same as in 1988. By FY 2007-08, the state is expected to be responsible for almost 64 percent of the cost of K-12 education under the school finance act. Today, each percentage point increase in the state share costs about $42 million. Figure 4-5 compares the state and local shares for school finance in 1987, the year before the constitutional amendments began to affect school finance funding, and in FY 2002-03. As shown in the figure, both the state share and state aid per pupil have increased, while the local share has declined and property tax revenues per pupil have increased only slightly.

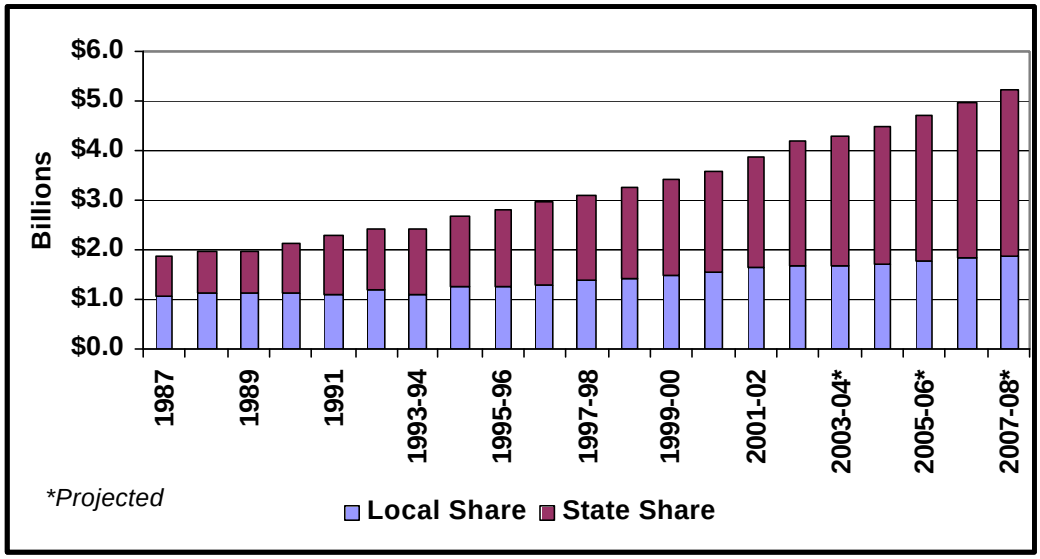
Figure 4-5
Comparison of State and Local Shares of School Finance Funding

	CY 1987 Actual	FY 2002-03 Actual	Difference
State Share	43.5%	59.7%	16.2%
Local Share	56.5%	40.3%	-16.2%
Average State Aid per Pupil	$1,508	$3,481	$1,973
Average Property Taxes per Pupil	$1,962	$2,097	$135

Note: Specific ownership taxes are included in the FY 2002-03 local share percentage, but not in the average property taxes per pupil.

Figure 4-6 illustrates the actual and projected state share of school finance act funding between 1987 and FY 2007-08.

Figure 4-6
Property Taxes and Total School Finance Act Funding



Determining the Taxable Value of Property — Gallagher

This section describes the history of the Gallagher Amendment, the factors that affect the calculation of the residential assessment rate, and the impact of changes in the residential assessment rate on taxpayers and local governments.

The Gallagher Amendment was part of a 1982 property tax reform effort. In response to concerns over a lack of uniformity in assessing property for tax purposes and the potential for significant property tax increases based on skyrocketing property values resulting from high inflation in the mid-1970s, voters in 1982 approved a property tax reform measure referred by the legislature. The measure was introduced in the legislature as House Concurrent Resolution 82-1005, and approved by voters at the November 1982 general election as Amendment 1. Along with the well-known Gallagher Amendment, the ballot measure included the following:

- ✓ provisions to ensure that properties are assessed in a uniform and fair manner and a requirement that counties reimburse the state for excess state school aid payments made because of undervalued property;
- ✓ a fixed assessment rate of 29 percent for most nonresidential (business) property;
- ✓ a property tax exemption for business inventories such as merchandise, materials, and supplies that were held for sale or consumption;
- ✓ a property tax exemption for livestock, agricultural and livestock products, and agricultural equipment used on a farm or ranch;
- ✓ a system for valuing agricultural property that existed previously in statute using earnings as a measure of the land's productivity capacity;

- ✓ a system for valuing producing mines and oil and gas properties that existed previously in statute using the value of the unprocessed material and procedures prescribed by law for different types of minerals; and
- ✓ a newly-constituted State Board of Equalization, including members with more knowledge and expertise in property tax valuation practices.

Gallagher limits taxes on residential property. As originally debated by the legislature, HCR 82-1005 provided immediate tax relief for residential property owners by lowering the residential assessment rate from 30 percent of actual value to 21 percent. Prior to approving the measure and submitting it to voters, however, the legislature adopted an amendment establishing a longer-term mechanism for providing residential property tax relief. This amendment, commonly referred to as the Gallagher Amendment, was drafted as a means for holding down residential property taxes in the future as home values rose or if business property taxes were reduced.

Figure 4-7
How are Property Taxes Determined?

Property taxes are determined by multiplying the taxable (assessed) value of property by the local tax rate (mill levy).
The assessed value represents only a portion of a property's actual value, which is determined by the county assessor. The portion is dictated by an assessment rate set in law, currently 7.96 percent for residential property (for taxes paid in 2004 and 2005) and 29 percent for most other property. Mill levies are set locally by each governmental entity imposing a property tax.

Assessed Value = Property Value x Assessment Rate

Property Taxes = Assessed Value x Mill levy

The Gallagher Amendment requires that the residential assessment rate be adjusted to ensure that the percentage of assessed value attributable to residential property remains the same as in the preceding year. Gallagher limits the residential share of taxable values to a historical proportion, which is modified to account for changes in value from new construction and changes in the volume of minerals and oil and gas produced. When the amendment was first implemented, residential property comprised roughly 45 percent of all taxable value. Since then, new construction has shifted the proportions somewhat, so that residential property currently makes up roughly 47 percent of all taxable value.

Many other states offer some form of residential property tax relief. Seventeen other states use different assessment rates to provide residential property tax relief, although none has a system quite like Gallagher. Other states offer credits and exemptions, or in the case of Oregon and California, limits on increases in property taxes for individual properties. Gallagher, on the other hand, limits the total share of taxes to be paid collectively by all residential property owners on a statewide basis, without regard to individual properties.

Figure 4-8
An Example of How the Residential Assessment Rate Works

When residential market values increase rapidly,

and nonresidential values increase by a slower rate,

then the residential assessment rate declines,

so that residential *assessed* values grow at the same rate as nonresidential *assessed* values.

Colorado assesses property on a biennial cycle. Under Gallagher, the residential assessment rate is adjusted every other year as property is revalued. The level of value changes according to a reassessment cycle set by law under which county assessors update property values to more accurately reflect the current market. In 1983, property values were scheduled to change from the 1973 level to the 1977 level, reflecting four years of inflation. Under current law, property in Colorado is reassessed on a two-year cycle in odd-numbered years. Twenty-five states assess property annually; the other 25 states assess property over cycles that range from two to ten years.

The residential assessment rate has declined over time. Under Gallagher, whenever residential property values rise faster or fall slower than nonresidential values, the residential assessment rate is lowered. When the legislature changes the residential assessment rate to comply with Gallagher, the new rate applies to assessed values in the current year. Taxes are paid in the subsequent year. Thus, the newest rate of 7.96 percent was enacted in 2003, based on 2003 assessed values, and will apply to property taxes paid in 2004. Since 1987, when the amendment was first implemented, the rate has declined from 21 percent to 7.96 percent, or a reduction of 62 percent. In the future, the residential assessment rate can only remain constant or decline, because TABOR requires voter approval for any increase in the assessment rate for a class of property. For example, in 1999, the rate would have been higher except for TABOR. Thus, the rate will never be higher than 7.96 percent unless voters approve the change.

Since the passage of Gallagher, actual values for residential real property have grown at a faster rate than those of nonresidential property. Between 1986, prior to the first change in the residential assessment rate under Gallagher, and 2002, the actual value of residential property grew nearly twice as fast as the actual value of nonresidential property. Residential property climbed from $35.4 to $314.1 billion, or an average of 14.6 percent per year, while nonresidential actual values increased from $31.2 to $103.1 billion, or 7.8 percent per year. Figure 4-9 shows that the actual values of residential real property had grown to over three times the amount of nonresidential property values by 2002.

Figure 4-9
Change in Statewide Actual Values

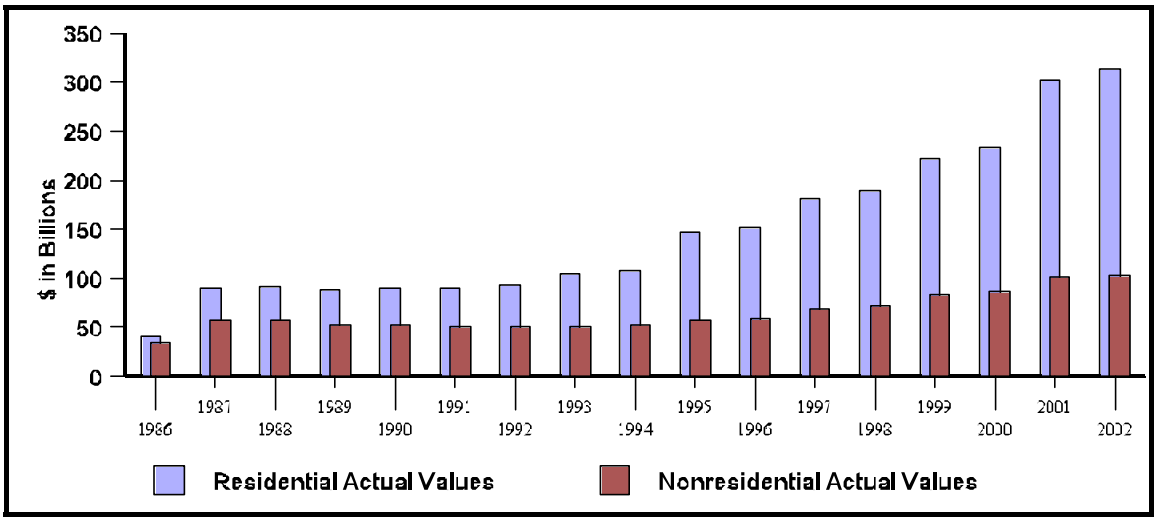


Figure 4-10 shows how the residential assessment rate has declined since Gallagher's inception in 1983. The chart also shows our projected decline in the residential assessment rate.

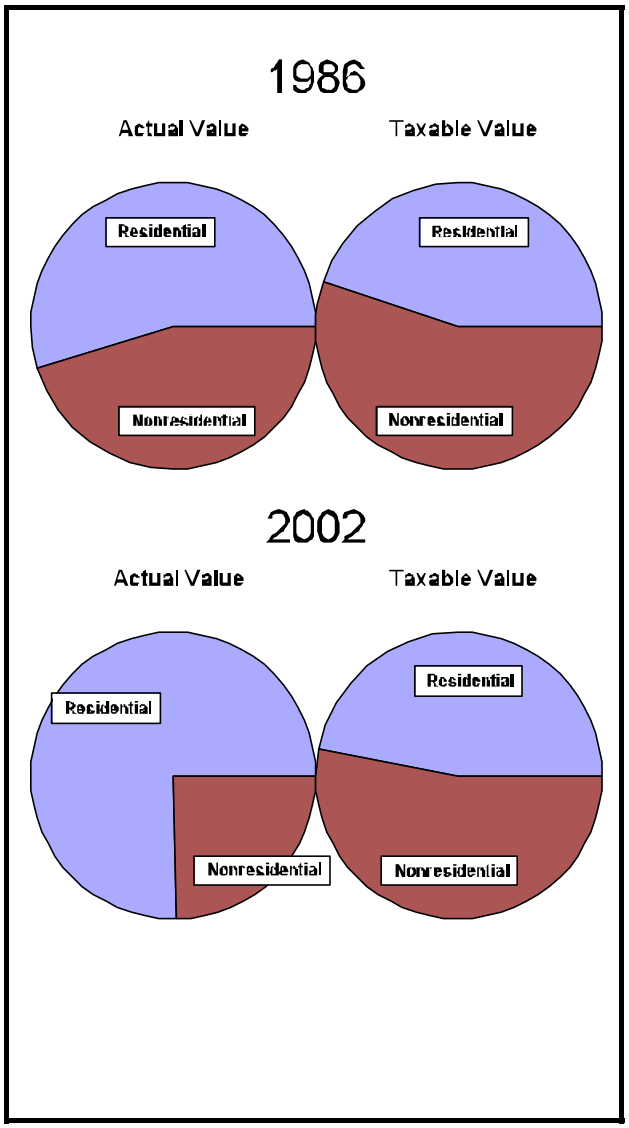
Figure 4-10
Changes in the Residential Assessment Rate

Assessment Years	Residential Assessment Rate
1983 - 1986	21.00%
1987	18.00
1988	16.00
1989 - 1990	15.00
1991 - 1992	14.34
1993 - 1994	12.86
1995 - 1996	10.36
1997 - 2000	9.74
2001 - 2002	9.15
2003 - 2004	7.96
2005 - 2006*	7.60
2007 - 2008*	7.25

* *Projected*

Figure 4-11 shows a comparison between actual and assessed values for residential property in 1986, before the first change in the residential assessment rate under Gallagher, and in 2002.

Figure 4-11
Residential and Nonresidential Values, 1986 and 2002



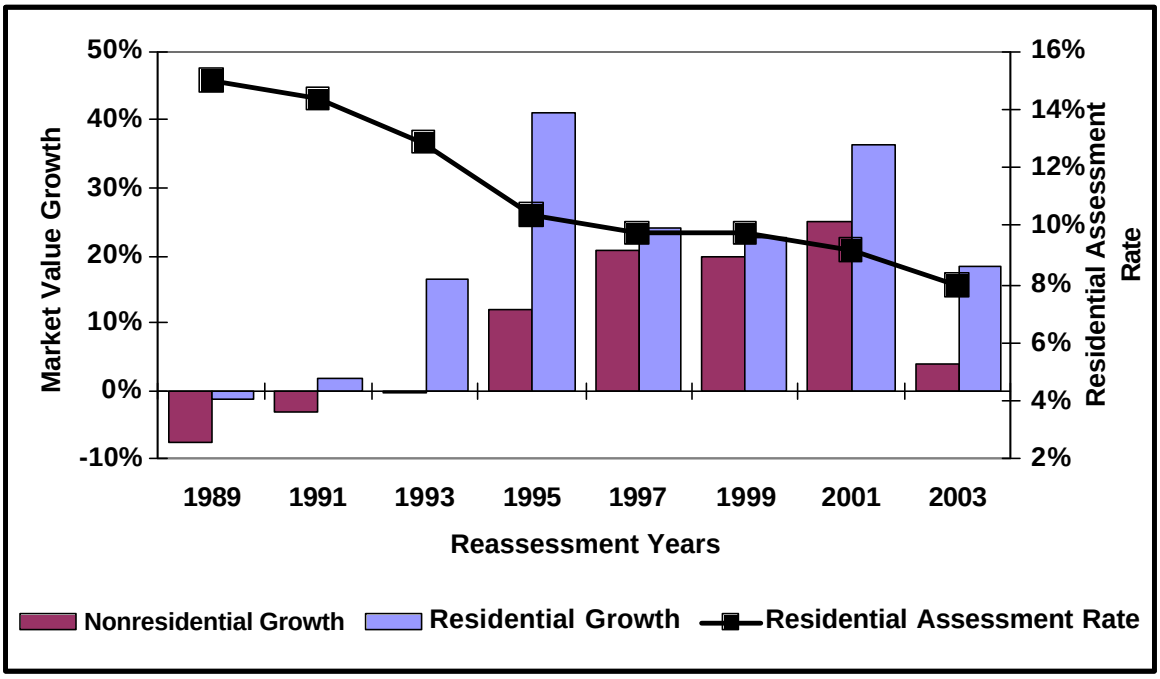
Several factors affect the residential assessment rate. Varying economic conditions affect changes in the residential assessment rate. In general, values of nonresidential property fluctuate more than home values. In good economic times, positive speculation helps to drive business investment, causing an increase in nonresidential property values. This increase contributes to growth in the property tax base in two ways. First, it adds value in nonresidential property. Second, it helps maintain a higher residential assessment rate, as the rate no longer has to decline as far in order to maintain the balance prescribed in Gallagher. At the height of the most recent boom, nonresidential values grew so fast that no decline in the residential assessment rate was needed for the 1999 reassessment cycle, the only time this has occurred.

Similarly, as the economy goes into a downward cycle, companies tend to act much more quickly and more severely than residential homeowners. For instance, when widespread layoffs occur, displaced workers vacate business space immediately, thereby lowering the demand for and value of the space. Additionally, new construction slows, limiting demand for vacant land. However, residential property values are slower to react to negative news. Laid off workers will not necessarily sell their homes immediately; they will seek other employment and subsist on unemployment, savings, and severance payments. In this situation, the slower growth of nonresidential property values also forces down residential taxable values through a lower residential assessment rate.

Other economic factors can also affect changes in the residential assessment rate. For example, low mortgage rates have helped keep home values increasing in an otherwise stagnant economy. Similarly, gains in the stock market have led to investment wealth and income that has helped residential values increase dramatically during the past decade, especially in Colorado's mountain communities.

Figure 4-12 illustrates the relationship between changes in the value of property and changes in the residential assessment rate.

Figure 4-12
Market Value Growth and Declines in the Residential Assessment Rate



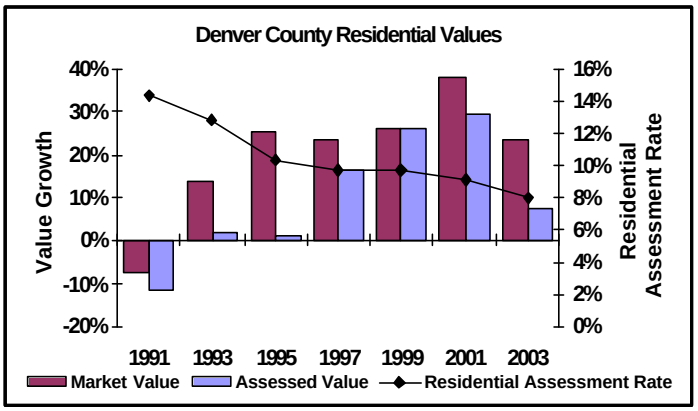
The Gallagher Amendment limits the property tax base of local governments. Gallagher limits growth in taxable values and can actually reduce the amount of taxable property in a jurisdiction. However, the impact of Gallagher varies widely between regions of the state, and even within a particular region. Since the residential assessment rate is calculated using statewide property values, but property taxes are exclusively a local revenue source, the impact of the declining residential assessment rate on local jurisdictions depends on what is happening to property values locally. Declines in the residential assessment rate affect property tax revenues based on the following two factors:

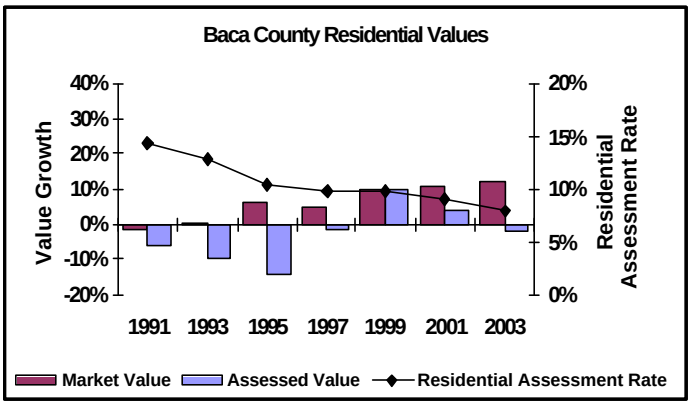
- ✓ growth in home values within a local jurisdiction; and
- ✓ the mix of properties within a jurisdiction.

For areas with significant home value growth, the increased property values may more than offset any impact of the declining residential assessment rate. In these areas, the tax base continues to grow. Whether this growth in the tax base translates into an increase in property taxes depends on the jurisdiction's property tax revenue limits. But, for areas where home values are growing slowly, a decline in the residential assessment rate under Gallagher may reduce the local tax base.

This phenomenon is illustrated by contrasting Denver with the eastern plains. Denver's residential property tax base has more than doubled since 1987. Meanwhile, residential property in Baca and Kiowa counties grew by roughly half as much over the same period. Figure 4-13 shows the disparity in residential property assessed value growth between Denver and Baca counties. Had the residential assessment rate remained at its original level of 21 percent, Baca County would have seen a 132 percent increase in residential assessed values instead of its actual 67 percent increase.

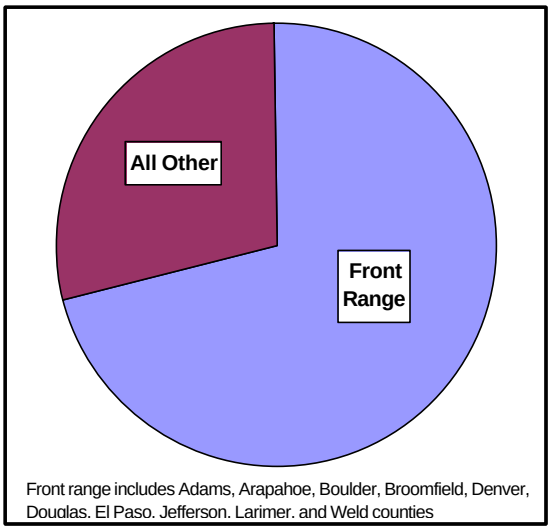
Figure 4-13
Market Value Growth and Declines in the Residential Assessment Rate





The second consideration is the mix of property that makes up a given local government's tax base.
The larger the portion of a jurisdiction that is residential property, the more susceptible that jurisdiction is to declines in the rate. The opposite is also true. For districts with large concentrations of nonresidential property, the property tax base in the area is more resilient to changes in the rate because the rate only affects a small portion of their base.

Figure 4-14
Concentration of Property Values in 2002



These two factors contribute greatly to inconsistencies between Colorado's urban and rural property tax bases. As shown in Figure 4-14, over 70 percent of property value is concentrated in ten counties along the Front Range. Fluctuations in the value of property in these ten counties effectively dictates the calculation of the residential assessment rate. Booming increases in home values in many of Colorado's urban areas, as well as mountain resort communities, have helped to drive down the residential assessment rate. Meanwhile, in many parts of rural Colorado, the decline in the residential assessment rate has been more rapid than increases in home values. That is, any growth in home values is more than offset by the declining residential assessment rate, resulting in a decrease in the taxable value of homes.

Impact of Gallagher on who pays property taxes. Gallagher prevents the shifting of a larger share of the property tax burden to residential property owners, either because of growth in residential property values or through law changes designed to reduce the property tax burden on nonresidential property. The value of residential property now accounts for 75 percent of all property in the state, yet the residential share of property taxes is estimated to be closer to 47 percent.

Figure 4-15 illustrates the savings that owners of residential property have received from Gallagher. According to the Division of Property Taxation, residential property owners have saved $6.8 billion between 1988 and 2003. This figure represents the cumulative difference between what was actually paid by residential property owners and what would have been paid if the residential assessment rate had remained at 21 percent and property tax collections had remained the same. Figure 4-15 divides the $6.8 billion in residential property tax relief savings into pre-TABOR and post-TABOR periods. The pre-TABOR savings represent the actual shift in property tax burden from residential to nonresidential property owners; the post-TABOR savings understate the shift because it is likely that property tax collections would have been greater.

Figure 4-15
Homeowner Savings under Gallagher
($ in billions)

	1988-1992 (pre-TABOR shift)	1993-2003 (post-TABOR shift)	Total
At a Residential Assessment Rate of 21%, Homeowners Would Have Paid This Amount	$5.9	$22.2	$28.1
Homeowners Actually Paid This Amount	$5.1	$16.2	$21.3
Total Gallagher Savings	**$0.8**	**$6.0**	**$6.8**

Source: Division of Property Taxation.

Prior to TABOR, Gallagher shifted taxes from residential property to nonresidential property. Prior to the adoption of TABOR, local governments were allowed to increase their property tax collections by 5.5 percent over the prior year's collections, although this limit could be exceeded under certain circumstances. If assessed values declined or remained relatively flat, local governments could increase the mill levy to achieve the desired revenue goal, within the 5.5 percent limit. As a result, any reduction in the residential assessment rate that led to an increase in mill levies caused a shift in property taxes from residential taxpayers to nonresidential taxpayers.

The TABOR requirement for voter approval for any increased mill levy would have prevented any further shift in property tax burden between residential and nonresidential property, if not for two things. First, the reduction in taxable values under Gallagher causes mill levies to be higher than they otherwise would be under the property tax revenue limits of TABOR. Second, courts have ruled that the TABOR limits do not apply to all mill levies. For

example, local governments may increase or "float" mill levies to cover the repayment costs for bonded debt and to cover property tax abatements and refunds.

The impact of Gallagher on state aid for schools. By limiting the share of residential taxable values, Gallagher acts as a limit on school district tax bases. When increases in tax rates are also limited, the need for state aid to schools increases. For example, if the residential assessment rate of 14.34 percent remained in effect for the last ten years, property taxes would have been about $91 million higher in FY 2002-03, reducing the need for state aid in that year by the same amount. This $91 million translates into 2.2 percentage points on the state share in FY 2002-03, or an increase in the state share from 57.5 percent to 59.7 percent. Figure 4-16 provides an estimate of how the decline in the residential assessment rate affected state aid for schools in each of the last ten years.

Figure 4-16
Ten-year Impact of the Gallagher Amendment on State Aid Under the School Finance Act

Budget Year	State Aid Increase from Decrease in Residential Assessment Rate	Incremental Change in State Aid Increase	Actual Residential Assessment Rate	Actual Percent Change in Assessed Value
1993-94	$40.7	$40.7	12.86%	1.23%
1994-95	$43.9	$3.2	12.86%	3.26%
1995-96	$62.2	$18.3	10.36%	8.90%
1996-97	$65.2	$3.0	10.36%	3.40%
1997-98	$69.2	$4.0	9.74%	14.84%
1998-99	$71.5	$2.3	9.74%	4.05%
1999-00	$73.9	$2.4	9.74%	16.24%
2000-01	$79.4	$5.5	9.74%	4.25%
2001-02	$85.7	$6.3	9.15%	20.01%
2002-03	$91.4	$5.7	9.15%	3.36%
Total	$683.1	N/A	N/A	110.91%

Looking at the historical impact of Gallagher on an annual basis is helpful because it provides information on what can be expected in the future.

- ✓ The impact of the Gallagher Amendment is related to the increase in values. That is, when growth in values is particularly strong, Gallagher has less of an impact on state aid than when growth is weak or declining. For example, in FY 1993-94 when statewide assessed value grew just over one percent, the impact of the Gallagher Amendment on state aid was almost $41 million. In FY 1995-96, assessed value grew almost 9 percent, and the incremental impact was $18.3 million. The reason that Gallagher has a smaller impact in high growth years is that more districts cap out

at their property tax revenue limit in spite of a decline in the residential assessment rate. For these districts, a higher residential assessment rate would raise assessed values, but would not produce any more property taxes. Instead, the district's mill levy would simply be lower.

- ✓ The impact of the Gallagher Amendment on school district property taxes is cumulative. An increase in property tax revenue in a given year provides a higher property tax base for calculating property tax revenue limits in future years.

- ✓ The Gallagher Amendment has only a limited impact on the "sawtooth" cycle of increases in property taxes.

- ✓ Eliminating the Gallagher Amendment shifts a portion of the property tax burden from nonresidential taxpayers to residential taxpayers. Although the total estimated increase in property taxes from holding the residential assessment rate at 14.34 percent is $91 million in FY 2002-03, taxes for residential property owners would have increased about $209 million, while taxes for nonresidential property owners would have decreased about $117 million. Under current law, residential property owners paid about 49 percent of school finance property taxes; this percentage would have increased to about 59 percent at the 14.34 percent residential assessment rate. Conversely, the share of nonresidential property taxes would have decreased from 51 percent to 41 percent.

The relationship between the Gallagher Amendment, growth in values, and school district property tax revenue limits is perhaps more clearly demonstrated in Figure 4-17. This table compares the number of districts that were capped out at their property tax revenue limit in the last ten years to those that would have been capped out had the residential assessment rate stayed at 14.34 percent.

Figure 4-17
Ten-year Impact of the Gallagher Amendment on School District Mill Levies

Number of School Districts with a Mill Levy Decrease from the Prior Year under:			
Budget Year	**Current Law**	**14.34% Residential Assessment Rate**	**Difference**
1993-94	52	71	19
1994-95	54	37	(17)
1995-96	100	125	25
1996-97	52	50	(2)
1997-98	139	150	11
1998-99	62	84	22
1999-00	137	139	2
2000-01	94	67	(27)

Figure 4-17 (cont.)
Ten-year Impact of Gallagher Amendment on School District Mill Levies

Number of School Districts with a Mill Levy Decrease from the Prior Year under:			
Budget Year	**Current Law**	**14.34% Residential Assessment Rate**	**Difference**
2001-02	139	153	14
2002-03	65	71	6

As shown in Figure 4-17, more districts in all but three of the years would have seen a decline in their mill levy if the residential assessment rate had remained at the pre-TABOR level of 14.34 percent. But the higher tax base would have yielded more in property taxes than was actually collected.

A proposal to modify Gallagher is on the 2003 ballot. Although options exist for providing residential property tax relief through means other than the Gallagher Amendment, a measure to modify Gallagher has already been proposed. Amendment 32, which will be decided by voters at the November 2003 election, would repeal the floating residential assessment rate and fix the rate at eight percent of actual value. Permanently setting the residential assessment rate creates greater increases in assessed values than would have otherwise occurred because residential assessed values would be tied to market value increases. However, even if voters were to approve an increase in the residential assessment rate, the resulting increase in assessed values may not necessarily increase school finance property taxes in all districts. For districts already at their revenue limit, such an increase in assessed value would only result in a lower mill levy, not an increase in local school property tax collections. The measure would shift a portion of the property tax burden from nonresidential taxpayers to residential taxpayers.

Limiting Growth in Property Taxes — The Taxpayer's Bill of Rights (TABOR)

This section describes various impacts of TABOR on property taxes, especially school finance property taxes.

TABOR limits property tax collections. TABOR was approved by voters in 1992 to limit the growth in government and require voter approval for any new or increased taxes. Three provisions directly affect property taxes. First, TABOR imposes a limit on property taxes equal to inflation in the prior calendar year plus a measure of growth. For schools, growth is measured as the percentage change in student enrollment, while for other local governments it is the net percentage change in the value of property from construction. Second, TABOR prohibits a district from imposing a mill levy above that for the prior year without voter approval. Third, TABOR requires voter approval for any increase in the assessment rate for a class of property.

TABOR's effect on school district property taxes. Prior to TABOR, the General Assembly set property taxes for school finance. Under the school finance act, the legislature used a variety of methods to determine property taxes. During various years, the Department of Education was directed to set the mill levy necessary to raise a dollar amount of property taxes set by law or to target a specified percentage state share or appropriation. In one year, the legislature established a mill levy in statute.

With the adoption of TABOR, the General Assembly has been less directly involved in determining school finance property taxes. Instead of actively controlling the level of property taxes available for schools each year, the General Assembly established a limit that is essentially the same as the TABOR limit on property tax revenues and mill levies. School districts levy the same number of mills from year to year, unless the mill levy would raise more property taxes than TABOR permits (inflation plus the percentage change in enrollment). The levy must be reduced to avoid exceeding the property tax revenue limit.

The impact of TABOR on state aid to schools, and therefore the state budget, cannot be determined without knowing the level at which the General Assembly would have set property taxes without TABOR. It is possible, however, to examine how state expenditures for school finance would have differed under a variety of situations, assuming that total program funding remained constant. Figure 4-18 illustrates how certain situations would have changed the current level of state aid.

Figure 4-18
State Aid Under Various Situations

Situation	FY 2002-03 State Aid Impact
Maintain a state share of 52.3 percent, the same that was in effect in FY 1992-93, the first year of TABOR	Savings of $308 million
Require a 50-percent state share	Savings of $404 million
Maintain property taxes at the FY 1992-93 level ($1.1 billion)	Increase of $508 million
Require property taxes statewide to increase annually by inflation plus enrollment growth	Savings of $473 million

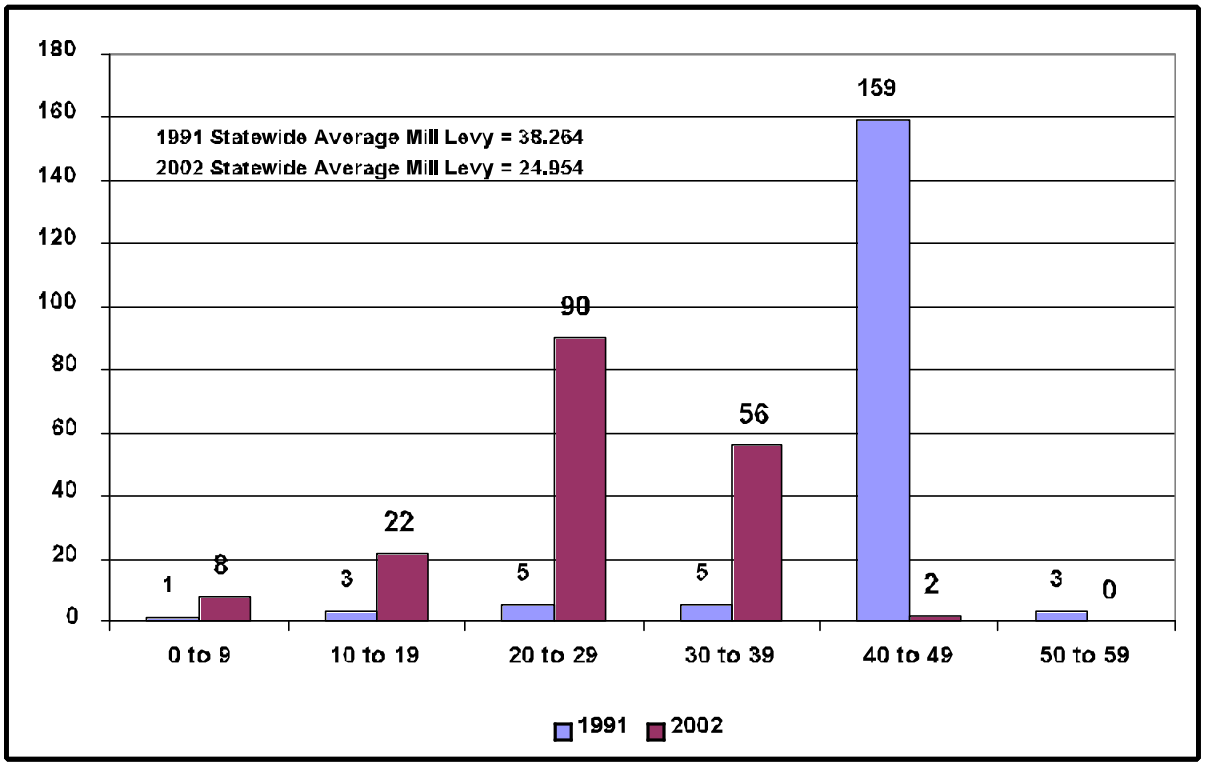
Because the TABOR limits are now the driving factors in school finance property taxes, changes in assessed value drive changes in property taxes. When assessed values are relatively stable statewide, property taxes can be expected to remain relatively constant. As assessed values increase, so too will property taxes. Because changes in property taxes are essentially limited to inflation plus the percentage change in enrollment, property taxes are capped and mill levies reduced when assessed values grow at a greater rate.

The current method for setting school district property taxes has resulted in the following phenomena:

- ✓ the dispersion in school district mill levies has increased;
- ✓ the state's subsidy for districts with low mill levies is growing;
- ✓ taxpayers in districts benefit from new construction and increasing values; and
- ✓ variations in oil and gas production can have a significant impact on mill levies.

The dispersion in school district mill levies has increased. Under TABOR, an increase in assessed value greater than inflation and the percent change in enrollment permanently reduces a district's mill levy. Sometimes these reductions are driven by rapid increases in assessed value, especially new additions of nonresidential property that are not accompanied by a similar increase in student enrollment. But, mill levies have also declined because the limit on property tax revenue incorporates one year of enrollment growth and inflation while the growth in assessed values reflects two years' worth of increase in property values. As a result of varied growth in assessed values, Colorado school districts now impose a wide range of mill levies. In 1991, 133 of the state's 176 school districts imposed the same mill levy: 40.080 mills. Figure 4-19 shows the distribution of current school district mill levies compared with 1991 mill levies, prior to the adoption of TABOR.

Figure 4-19
Dispersion of Mill Levies



For individual districts, the changes can be quite dramatic. Figure 4-20 shows the ten Colorado school districts that experienced the most significant change in mill levies between 1991 and the present. In all but one of the districts, changes in the mill levy were caused largely by changes in the value of natural resource, oil and gas, or producing mines property.

Figure 4-20
The 10 Most Significant Changes in Mill Levies

County	School District	1991 Mill Levy	2002 Mill Levy	Percent Change
Las Animas	Primero	40.080	4.588	-88.6%
Gilpin	Gilpin	40.080	5.488	-86.3%
La Plata	Ignacio	40.080	7.598	-81.0%
El Paso	Hanover	40.080	9.067	-77.4%
La Plata	Durango	40.080	11.314	-71.8%
Weld	Gilcrest	40.080	12.409	-69.0%
Rio Blanco	Meeker	40.080	14.449	-64.0%
Baca	Campo	40.080	15.082	-62.4%
Grand	East Grand	38.397	14.516	-62.2%
Garfield	Rifle	40.080	15.488	-61.4%

Some districts, however, have not experienced significant increases in assessed values. Figure 4-21 shows the ten school districts with the highest mill levies in 2002, as well as the percentage change in assessed value from 1991 to 2002. In 1991, these ten districts, along with 133 others, all imposed the uniform mill levy of 40.080 mills. Since then, however, mill levies for these ten districts have changed less than for any other districts, because assessed value growth in each of the districts has been insufficient to allow property tax collections to reach the property tax revenue limit.

Figure 4-21
The 10 School Districts With the Highest Mill Levies

County	School District	2002 Mill Levy	Assessed Value Change from 1991 to 2002
Baca	Vilas	40.080	-11.39%
Washington	Lone Star	40.080	-0.12%
Saguache	Moffat	38.976	-9.12%
Phillips	Holyoke	38.785	20.54%
Morgan	Weldon	37.416	8.74%
Logan	Buffalo	37.253	24.94%
Conejos	Sanford	37.024	11.37%
Weld	Windsor	36.748	82.45%

Figure 4-21 (cont.)
The 10 School Districts With the Highest Mill Levies

County	School District	2002 Mill Levy	Assessed Value Change from 1991 to 2002
Kit Carson	Arriba-Flagler	35.570	16.07%
Lincoln	Limon	35.546	14.34%
Statewide Average		24.954	113.10%

In addition to differences existing on a statewide basis, mill levies can vary substantially within a county. Figure 4-22 illustrates this phenomenon using El Paso County as an example. In 1991, most school districts in El Paso County levied 40.080 mills. The most notable exception was Edison, where the higher mill levy paid for additional funding under the 1988 school finance act's hold harmless provisions. The range of mill levies in El Paso County in 1991 was 15.548 mills. By 2002, the range had increased to over 27 mills.

Figure 4-22
School Finance Mill Levies in El Paso County, 1991 and 2002

School District	1991 Mill Levy	2002 Mill Levy	Difference
Calhan	42.351	33.271	(9.080)
Harrison	40.080	20.917	(19.163)
Widefield	40.080	26.324	(13.756)
Fountain	40.080	27.696	(12.384)
Colorado Springs	40.080	27.628	(12.452)
Cheyenne Mountain	41.760	33.207	(8.553)
Manitou Springs	40.080	25.324	(14.756)
Academy	40.080	28.274	(11.806)
Ellicott	40.080	32.833	(7.247)
Peyton	40.080	27.974	(12.106)
Hanover	40.080	9.067	(31.013)
Lewis-Palmer	40.080	26.659	(13.421)
Falcon	40.080	29.370	(10.710)
Edison	55.628	36.195	(19.433)
Miami-Yoder	40.080	24.130	(15.950)
Range of Mill Levies	15.548	27.128	11.580

The state's subsidy for districts with low mill levies is growing. Figure 4-23 shows the ten school districts with the lowest school finance mill levies in FY 2002-03, along with the percentage of school finance costs paid for by the state. In half of these districts, the percent state aid is higher than the state average; seven of these ten districts receive more than 50 percent of

their funding from the state. Two phenomena usually account for this anomaly. First, when a mill levy declines to account for an increase in assessed value, a future reduction of assessed value results in a decrease in property taxes and leaves the state heavily subsidizing a school district with a low levy. In this case, taxpayers in the district benefit from the permanent reduction in the tax rate while the state is obligated for a larger share of the district's costs.

Figure 4-23
The 10 School Districts With the Lowest Mill Levies

County	School District	2002 Mill Levy	FY 02-03 State Aid Share
Las Animas	Primero	4.588	58.5%
Rio Blanco	Rangely	4.638	65.1%
Pitkin	Aspen	5.088	20.4%
Gilpin	Gilpin	5.420	51.5%
La Plata	Ignacio	7.598	68.1%
San Miguel	Telluride	7.408	18.5%
El Paso	Hanover	9.067	78.2%
Garfield	Parachute	9.285	69.9%
Cheyenne	Cheyenne R-5	10.406	64.7%
Summit	Summit	11.094	7.6%

Telluride and Aspen, two school districts with such an abundance of property wealth that they paid for virtually all of the costs of public schools in the early 1990s, further illustrate this phenomenon. As recently as FY 1995-96, property taxes in Telluride and Aspen were almost fully funding the costs of total program in those districts. At the time, the mill levy in Telluride was 9.815 and the mill levy in Aspen was 7.316. By FY 2002-03, however, the state was paying for over 20 percent of total program costs in Aspen and over 18 percent of total program costs in Telluride. Together, these two districts accounted for over $3.1 million in state aid in FY 2002-03.

A school district need not have a reduction in value to have a low levy accompanied by a high percentage of state aid, however. A spike in assessed value reduces a district's levy so that the district collects the prior year's property taxes increased by its revenue limit. Thus, the school district's percentage state share is essentially frozen at the level it was before the increase in value. The district's assessed value may continue to increase over time and the district may continue to increase its property tax collections, but its state share does not reflect its low levy. Gilpin County is an example of this situation. In 1991, the year before limited gaming increased the assessed value of the school district, the district levied 40.080 mills, which was equivalent to a state share of 49 percent. Today, the district's state share is about 52 percent with a levy of 5.420 mills.

Taxpayers in districts benefit from new construction and increasing values. Unlike other local governments, where the property tax revenue limit includes a component for growth in the local tax base, the limit for schools does not. Therefore, in districts where new construction outpaces enrollment growth, mill levies are required to fall so that the district does not collect more property tax revenue than it is allowed. For a district that was already at its property tax revenue limit, the new construction provides no new revenue for the school district. This situation constrains growth in property tax revenue for school finance, while benefitting the taxpayers who live in these districts.

El Paso County illustrates how new construction can affect a district's mill levy. Recently, a new power plant was built in the Hanover school district which effectively tripled the property tax base and lowered the mill levy by 75 percent. (Figure 4-22 illustrates Hanover's levy and compares it to other districts in the county.) While the benefit to taxpayers in Hanover is self-evident, taxpayers in other districts in the county are left with a higher tax burden for school finance. For FY 2002-03, Colorado Springs residents and businesses paid a tax rate for school finance three times the rate paid by taxpayers in Hanover and taxpayers in Edison paid four times the rate paid in Hanover. It is notable that if the same power plant were to leave the Hanover school district, the constitutional limit on increases in district levies would prevent the school district from restoring its mill levy to the previous level. The lower property tax base would yield less revenue, and the district's dependency on state aid would increase.

Variations in the taxable values of oil and gas property can have a significant impact on mill levies. Another interesting phenomenon relates to oil and gas property, which is valued based on the revenue generated by resources extracted from the property. As prices for oil and gas rise, so does the value of oil and gas property. In 2001, oil and gas properties nearly doubled in value. For school districts with substantial oil and gas properties, mill levies declined dramatically. Later, as prices for the commodities fell, so did values — which are expected to drop by nearly 30 percent in 2003. Because mill levies cannot increase without voter approval, the spike in oil and gas values will cause certain districts to collect less in property taxes than the previous year while the state is obligated for a larger share of the district's school finance act funding.

The Ignacio School District in southwestern Colorado provides a good example of how TABOR limits on mill levies can affect local property tax revenue for schools with high proportions of oil and gas property. In FY 2002-03, nearly 85 percent of the school district property tax base was in oil and gas. This high dependence on a volatile class of property has led to declines in local property tax revenue despite increases in assessed value and steady enrollment. From FY 1998-99 to FY 1999-00, enrollment in the district remained essentially the same. However, local property tax revenue declined by 4.4 percent because of declines in assessed value and a mill levy that could not

Figure 4-24
The Impact of Oil and Gas Prices on Tax Rates

Between 2000 and 2001, natural gas production in La Plata County grew four percent while the value of property associated with this production grew 102 percent. This increase in value contributed significantly to the decline in the average school mill levy from 22.388 mills to 15.960 mills, causing the property tax rate per thousand cubic feet (Mcf) of natural gas to fall 32 percent. Thus, without a significant change in volume, producers were paying 32 percent less in property taxes for each Mcf produced.

increase. Over the same period, state aid increased 18.8 percent, or over $600,000, for a district whose total program was less than $6 million.

From FY 1992-93 to FY 2002-03, Ignacio's mill levy declined from 40.080 to 7.598 as a result of increasing values for oil and gas property in the district. When these values decline, the district may only use the previous year's levy, which results in lower property tax collections regardless of enrollment growth or inflation. In the Ignacio School District, local property tax revenue in FY 1999-00 was nearly 25 percent less than in FY 1994-95, despite over 50 percent growth in assessed value and no significant change in enrollment.

Temporary mill levy reductions. Local governments other than school districts have adapted to the property tax revenue limits in a variety of ways. For example, state law allows local governments to enact temporary property tax credits and temporary mill levy rate reductions as a means for refunding excess revenues. Under this mechanism, local governments certify the gross (original) levy, the temporary credit or mill levy reduction by which the refund is made, and temporary (reduced) levy on which taxes will be calculated. In 2002, the Division of Property Taxation reports that local governments enacted temporary tax credits totaling $128 million.

Increased Funding for Education — Amendment 23

The limitations on property taxes take on even greater relevance in light of Amendment 23. In the next four years, by FY 2007-08, state aid is expected to increase by over $715 million to $3.3 billion. During that same period, property taxes for schools are expected to increase $157 million. Amendment 23 adds pressure to state aid by requiring increases in school finance act funding that exceed the maximum allowable increase in property taxes through FY 2010-11:

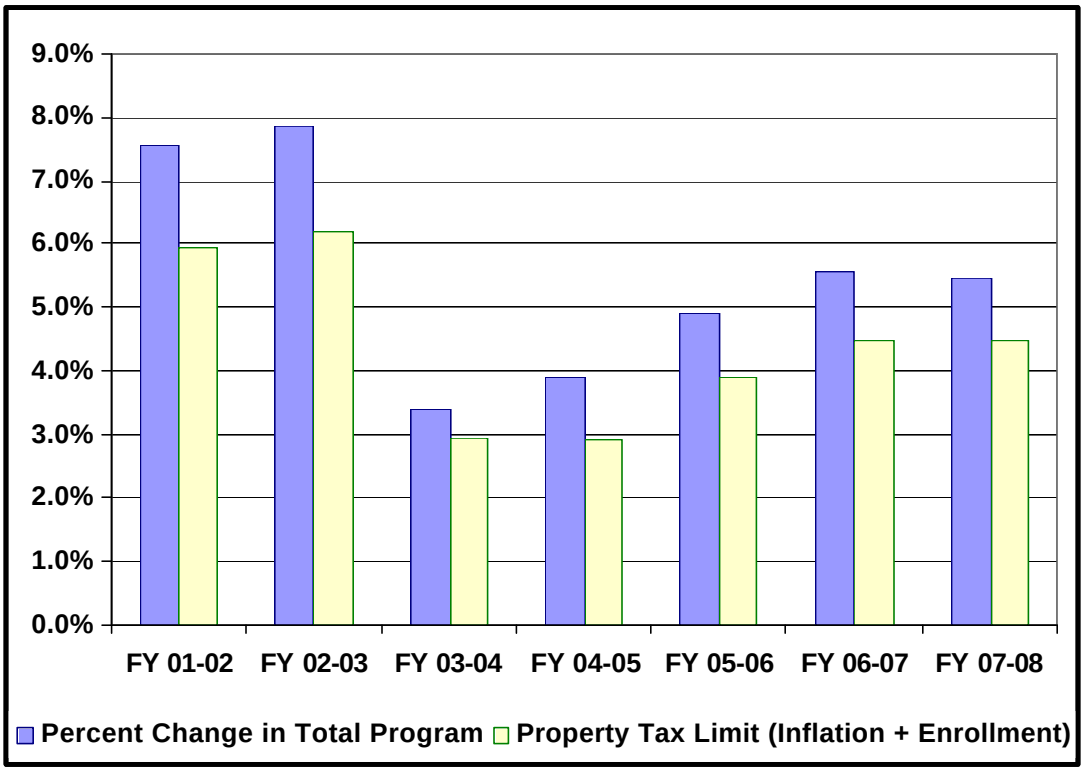
- ✓ Amendment 23 requires that the increase in the statewide base per pupil funding match inflation plus one percentage point through FY 2010-11. While admittedly oversimplified, this requirement means that total funding for schools will grow each year by inflation plus the percent change in enrollment plus one percentage point; and

- ✓ Under TABOR, the *maximum* increase in property tax revenue is the percent change in enrollment plus inflation. But, this growth only occurs if assessed values increase sufficiently each year, and such growth is not likely under the state's current biennial reassessment cycle.

Thus, Amendment 23 will require increases in school finance funding at least one percent above the allowable growth in property taxes each year until FY 2010-11. Through that year, the gap will grow by one percent per year plus the difference between the property tax revenue limit and actual property tax collections. Thereafter, the gap will grow annually by the amount that actual property tax collections are below the limit. One exception to this situation would be if the statutory formula for determining K-12 total program is amended by the legislature. That was the case for FY 2003-04, when the legislature reduced funding for the “size factor” portion of the formula. However, this statutory change still allowed for total program to increase more

than property taxes, but the gap between the two was diminished. Figure 4-25 compares the actual and projected growth in total program with the maximum allowable percentage change in property taxes.

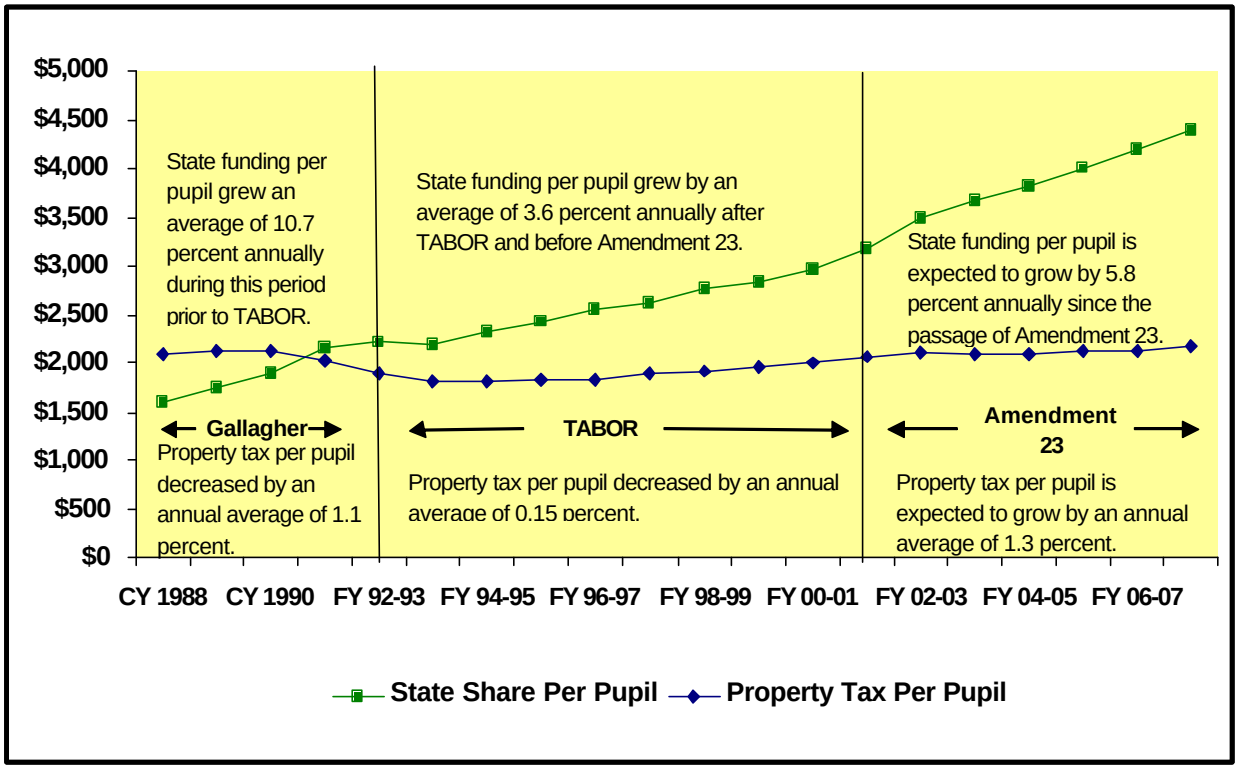
Figure 4-25
Growth in Total Program and Growth in Property Taxes



Impact of Gallagher, TABOR, and Amendment 23 on Property Taxes

Figure 4-26 breaks down school finance funding on a per pupil basis, both the state share and property taxes. The figure shows the points in time when the various constitutional amendments became effective. Prior to the passage of TABOR, the legislature made an effort to increase the state share, as can be seen in the figure. After the passage of TABOR, the legislature lost the ability to control property taxes and the property tax share of school finance. The figure shows state aid increasing, while property taxes remained relatively constant. Finally, after the passage of Amendment 23, state aid is seen increasing at an even faster rate.

Figure 4-26
School Finance Funding Per Pupil



Issues and Options

Within the property tax system, several options exist for constitutional or statutory changes to better enable the state to fund necessary programs and services in times of economic weakness and reduced state revenues. These options range from addressing inherent structural conflicts to simply modifying the existing structure to provide greater flexibility for state policymakers. This section reviews individual issues and presents options for addressing the concerns raised by the issue.

The Issue: *The mill levy and property tax revenue limits of TABOR and Gallagher are shifting an increasing share of the cost of school funding from local sources to the state. TABOR is resulting in tax rates that benefit taxpayers disproportionately based on district changes in assessed values.*

Option 1: *The General Assembly could consider asking voters to remove school district mill levies and property tax revenues from the limitations of TABOR.*

Option 2: *The General Assembly could consider asking voters to replace the individual school district mill levy and property tax revenue limits in TABOR with a statewide limitation on property taxes. For example, such a limit could be inflation plus the percentage change in enrollment, the percentage change in personal income, or the percentage change in total school district funding.*

Issues for consideration. These options recognize that school districts are simply different from other types of local governments, and that school finance requires a greater emphasis on equity and uniformity than on regional differences. The General Assembly has a constitutional mandate to provide for the establishment and maintenance of a thorough and uniform system of free public schools. Unlike other local governments where voters may choose to go without certain services in exchange for lower local taxes, the minimum level of school district funding is essentially set by the state. Since FY 2001-02, this minimum level has been set by the state within the parameters of another state constitutional provision, Amendment 23.

Removing individual district limitations on property taxes and mill levies would give the General Assembly the flexibility to determine property taxes for school finance. To the extent a plan developed by the General Assembly is different from the current constitutional provisions, taxpayers in some districts could see property tax increases. However, taxpayers in other school districts could experience decreases. In addition, eliminating the constitutional prohibition on mill levy increases means that the protection against tax rate increases when values decrease would be gone.

In the period immediately preceding TABOR, all taxpayers shared the benefits of increases in assessed value that occurred in individual districts from growth in property values, new construction, and increased value in mineral extraction industries. All taxpayers also shared

the effects of decreases in assessed value in individual districts. Now, benefits accrue to taxpayers in districts where property wealth is increasing, while taxpayers in districts where property wealth is declining or increasing slowly see no similar benefit. These options would allow the General Assembly to address perceived inequities of the current system, even if property taxes statewide stay within the levels currently permitted by TABOR. By divorcing school district levies from TABOR, one option the General Assembly could consider is reestablishing in statute a uniform mill levy for school finance. Such a system would more equitably spread the property tax burden across a broader tax base. The uniform levy could be set by the General Assembly each year within certain parameters designed to protect taxpayers from significant increases in taxes.

Future increases in state aid could be slowed by reducing funding, increasing property taxes, or a combination of the two. The options presented here make the General Assembly responsible for determining whether property taxes are increased. Option 1 delegates to the General Assembly the entire decision on the total amount of property taxes for school finance, while Option 2 sets a maximum statewide limit. In practice, however, a maximum statewide limit equal to the current district limit of inflation plus the percentage change in enrollment could still result in increased property taxes, especially in non-reassessment years. Now, school districts frequently do not collect the maximum revenue allowed in these years. Both options allow for a more consistent increase in property taxes, eliminating the sawtooth effect that puts more pressure on state aid in non-reassessment years.

The Issue: *The limits on school property taxes do not accommodate changes in the tax base from new construction and increased mineral production. As a result, property taxes are declining as a share of total school finance funding, and the need for state aid is increasing at a rate that the state cannot afford.*

Option: *The General Assembly could consider requesting voter approval to adjust the method of calculating school district property taxes to account for increases in assessed value attributable to new construction and to the increased volume of mineral and oil and gas production.*

Issues for consideration. Immediately before TABOR was adopted, school district property taxes were based on the wealth of the district: districts with high property wealth generated a significant portion of their funding from property taxes while districts with low property wealth did not and therefore received a higher proportion of their funding from state aid. With the current system, low wealth districts that become "richer" from new construction and increased mineral production may not contribute significantly more to the funding of schools. This option partially restores the link between changes in a district's wealth and its contribution for school finance, while taking some of the pressure off state aid. It would not affect the benefit that these districts and their taxpayers receive from the increase in value when funding discretionary programs, such as bond issues and mill levy overrides. The other side of the issue is that new construction and increased mineral production, especially when not accompanied by corresponding increases in enrollment, can reduce taxes for all taxpayers in the district in which

the assessed value increase occurred. This option will increase property taxes over what is currently allowed when new construction and mineral production occur.

The Issue: *The restriction in TABOR against increasing levies without voter approval reduces property taxes when district assessed values decline, thereby increasing the need for state aid.*

Option: *The General Assembly could consider asking voters to exempt school districts from the requirement to obtain voter approval for mill levy increases and substitute some historical levy as a cap on the district's levy.*

Issues for consideration. Providing more flexibility on the maximum number of mills a district can levy allows property taxes to better keep up with the required increases in spending mandated by Amendment 23. A historical cap on mill levies could still be imposed, but districts would be required to respond to declines in assessed values by "floating" their mill levy up to the historical cap. Further limits could be applied, including an element for enrollment growth to ensure that taxes stay proportional to total program. In addition, annual increases in mill levies over the prior year's level could be limited to a certain number of mills or a certain percentage. Regardless of the limits imposed, however, property taxes would still increase over the level currently allowed. In addition, the result could be that districts that are getting "richer" see mill levy declines, while districts that are becoming "poorer" see mill levy increases.

The Issue: *The limits on property taxes imposed by TABOR are mathematically inconsistent with the increased funding requirements of Amendment 23 through FY 2010-11.*

Option: *The General Assembly could consider asking voters to make the constitutional school finance provisions consistent, either by reducing the Amendment 23 requirement for one additional percent or by increasing the TABOR limit to allow for the one additional percent through FY 2010-11.*

Issues for consideration. The minimum requirements of Amendment 23 will exceed the maximum revenue from property taxes under TABOR by one percentage point through FY 2010-11. Voters approved both of these amendments; Amendment 23 was the amendment most recently approved. Increasing the maximum allowable property tax revenue under TABOR will increase taxes in some districts. Keeping both provisions in place over the next six years will put increased pressure on the state budget. In FY 2002-03, one percent of school district funding equated to about $42 million, a number which will increase each year. Enacting statutory reductions in the cost-based funding elements of the school finance formula will likely raise legal issues about the requirements of Amendment 23.

The Issue: *Property taxes are relatively flat in intervening years, but in reassessment years mill levies are driven down because the limit on property taxes incorporates two years' worth of increased property values but only one year of enrollment growth and inflation. This biennial cycle is inconsistent with the annual limits in TABOR which include inflation from the prior year plus the percentage change in student enrollment.*

Option 1: *The General Assembly could require counties to reassess property every year, instead of every other year.*

Option 2: *The General Assembly could consider asking voters to adjust the calculation of the TABOR property tax limit to make a consistent comparison by modifying the limit to include two years' worth of growth in assessed values measured against two years' worth of growth in inflation. Enrollment would be added to the limit annually.*

Issues for consideration. Property is currently assessed over a two-year cycle, with overall increases realized in the reassessment year, but only new construction contributing to growth in the intervening year. These options smooth out fluctuations in property taxes, making the need for state aid more predictable from year to year.

Option 1 — reassessing property annually — would significantly add to the workload of county assessors, but would allow for more current values. Currently, the lag in the reassessment cycle means that residential property tax bills are based on home values that are as much as three years old. Option 2 would allow property taxes to grow more in reassessment years, thereby reducing the need for state aid, to account for the new reassessment values. But, in intervening years, when values only growth because of new construction, the property tax revenue limit would only include the percentage change in enrollment. Taxes paid by property owners are likely to increase in reassessment years, and the increase would be sustained in the non-reassessment year.

CHAPTER 5

CHAPTER 5
AMENDMENT 23 AND STATE FISCAL ISSUES

This chapter presents information on the provisions of Amendment 23 and how it has affected the state's fiscal issues. In light of the state's current fiscal bind, options for changing Amendment 23 are also presented.

Provisions of Amendment 23

Amendment 23 was passed by the state's voters in 2000. The amendment provides for guaranteed increases in funding for public elementary and secondary education. It requires an annual increase in per pupil funding in the school finance act and total state funding for categorical programs of at least the inflation rate plus one percentage point from FY 2001-02 through FY 2010-11 and by the inflation rate thereafter.

The amendment requires the General Fund appropriation for state aid under the school finance act to increase by at least 5 percent annually, except when state personal income increases by less than 4.5 percent. This minimum required increase is frequently referred to as the "maintenance of effort" or MOE provision. The amendment also diverts one-third of one percent of taxable income on state income tax returns to the State Education Fund. The diverted income tax revenue, which averages about 7 percent of total state income tax collections, is exempt from the state revenue limits of TABOR. In other words, taxpayers were willing to give up part of their TABOR refund to create the State Education Fund. Money in the State Education Fund can be used to help pay for the minimum increases in school finance and categorical funding or for programs to reform education, reduce class sizes, expand technology education, or meet state academic standards, among others.

Spending Requirements under Amendment 23

Revenue received through the school finance act accounted for about 72 percent of non-bond-related revenue for school districts in FY 2001-02, the most recent data available. The programs defined as categorical programs in Amendment 23 accounted for an additional 3 percent. Before Amendment 23 passed, state policymakers had significant discretion over the amount of money that was appropriated for school finance and categorical programs. For school finance, the amount of money the General Assembly decided it could spend determined the amount of school district funding. Total school district funding is the sum of state aid and the two local revenue sources — property taxes and specific ownership taxes. In the nine years between the passage of TABOR and the implementation of Amendment 23, the local share was essentially set by the provisions of TABOR and the revenue received by school districts from the

specific ownership tax. Therefore, state aid became the guiding factor in setting total funding. Said another way, the General Assembly would set total funding based on what the state could afford, given that the local taxes were fixed. Funding for categorical programs was set through the budget process.

Since the passage of Amendment 23, the General Assembly's flexibility has been reduced in that the amendment contains minimum requirements for increases in the school finance act and for the categorical programs it governs. For categorical programs, the minimum increase of inflation plus one percentage point through FY 2010-11 and inflation thereafter applies to the sum of funding for all categorical programs. Therefore, the General Assembly can apportion the increase among the various categorical programs and it can increase funding above the minimum level, but it cannot fund the programs at a lesser rate of increase. The parameters of the General Assembly's discretion regarding school finance have been the focus of much discussion since Amendment 23's implementation in FY 2001-02. However, the local share still remains fixed, so state aid is the difference between the requirements of Amendment 23 and the local share. Figure 5-1 illustrates the pre- and post-Amendment 23 and the pre- and post-TABOR differences in calculating state aid for school finance.

Figure 5-1
Calculation of State Aid under the School Finance Act

Pre-TABOR and Pre-Amendment 23

State Aid = Total Funding - Local Share
(discretionary) (discretionary) (discretionary)

Post-TABOR and Pre-Amendment 23

State Aid = Total Funding - Local Share
(discretionary) (discretionary) (fixed)

Post-TABOR and Post-Amendment 23

State Aid = Total Funding - Local Share
(fixed) (fixed) (fixed)

Estimated impact of Amendment 23 on school district revenues. Calculating the impact of Amendment 23 on school district funding is an impossible task because such a calculation requires knowing what the level of funding would have been without Amendment 23. However, Figure 5-2 shows the estimated annual change in school district funding for two scenarios. First,

it shows the estimated increase in funding from the "one percentage point" requirement for school finance. Second, it provides the increase in total funding for categorical programs for the "inflation plus one percentage point" requirement. Figure 5-2 covers the period from FY 2001-02, the year that the Amendment 23 funding requirements were implemented, through FY 2007-08, the last year of our forecast period.

Figure 5-2
Estimated Funding Increase from Amendment 23
(millions of dollars)

Fiscal Year	School Finance Funding	Categorical Funding	Total
FY 2001-02	$36.9	$7.2	$44.1
FY 2002-03	78.6	15.7	94.3
FY 2003-04	109.4	20.3	129.7
FY 2004-05	156.0	25.2	181.2
FY 2005-06	207.1	31.5	238.6
FY 2006-07	264.0	38.5	302.5
FY 2007-08	325.9	45.9	371.8
Total	**$1,177.9**	**$184.3**	**$1,362.2**

Through FY 2003-04, the one-percentage-point requirement is expected to increase statewide average per pupil funding under the finance act by about $150; by FY 2007-08, the gap attributed to the one percent is expected to increase to $428. As previously mentioned, the impact of the amendment on individual categorical programs depends on how the General Assembly decides to allocate the funding increase. Figure 5-3 shows the results of its appropriation decisions to date, comparing the FY 2003-04 appropriation to FY 2000-01, the year before Amendment 23 took effect.

Figure 5-3
Comparison of FY 2000-01 and FY 2003-04 Appropriations for Categorical Programs

Categorical Program	Dollar Change	Percent Change
Transportation	$4,045,521	11.0%
Special Education - Disabled Children	12,661,983	17.7%
Gifted and Talented	690,647	12.6%
Vocational Education	1,949,540	11.0%
English Language Proficiency	516,289	16.7%
Small Attendance Centers	(99,546)	-10.5%
Expelled and Suspended Student Services Programs	427,979	7.4%
Comprehensive Health Education	0	0.0%
Total	$20,192,413	14.2%

Optional programs. In addition to increasing school finance and categorical program funding, the General Assembly created new programs that provided revenue to school districts, qualifying schools, and the Department of Education. These so-called optional programs are funded under the provisions of Amendment 23 that allow the State Education Fund to be used for specified types of programs. Over the course of the current and last two years, the General Assembly appropriated about $34.5 million for such programs as textbooks, school improvement grants, teacher pay incentives, summer school, and science and technology education. It also appropriated about $43 million for school district and charter school capital construction. A portion of the $43 million for capital construction was for new programs, while a portion of it replaced some of the General Fund dollars for a lawsuit settlement that were lost because of the revenue shortfall. Expansion of the Colorado Preschool Program and on-line education and a new full-day kindergarten program for children attending unsatisfactory schools were initiated from State Education Fund money, although they were funded through the school finance act. Many of these programs were short lived because of the state revenue situation.

Interaction between Amendment 23 spending requirements and the economy. The increases in spending under Amendment 23 for school finance and categorical programs are required to continue regardless of the state's budget situation or the status of the State Education Fund. For example, available revenue in the General Fund decreased by 15.0 percent in FY 2001-02, while income taxes, the funding source for the State Education Fund, declined by 19.0 percent. The General Assembly eliminated or reduced funding of some optional programs using State Education Fund money and substituted money in the State Education Fund for General Fund appropriations in order to prevent General Fund budget shortfalls. The safety valve for General Fund appropriations' support of education funding in the event of an economic downturn — personal income growth less than 4.5 percent — does not change the total funding requirement.

Diversions to the State Education Fund

At the time of Amendment 23's passage, the state was experiencing economic prosperity. In November 2000, employment was 4.2 percent higher than in November 1999. However, the cyclical peak for employment occurred in December 2000 and has since declined as much as 3.8 percent. Projections of perpetual TABOR surpluses that taxpayers would be willing to forego a part of proved wrong. Revenue that was $927.2 million *above* the TABOR limit in FY 2000-01 was $365.7 million *below* the limit in the following year and an estimated $703.6 million below the limit in FY 2002-03. The diversion of income tax revenue to the State Education Fund still occurs despite the lack of a TABOR surplus. The following paragraphs discuss the income tax diversion to the State Education Fund and how the diversion and the change in the state's TABOR surplus affect state finances.

What is the funding mechanism for the State Education Fund? Amendment 23 takes an amount equal to one-third of one percent of Colorado taxable income, exempts it from TABOR, and directs that it be deposited into the State Education Fund. During FY 2000-01, the state diverted $164.3 million to the fund for one-half of the fiscal year. In fiscal years 2001-02 and 2002-03, $272.9 million and $188.4 million, respectively, was diverted to the fund. Thus, the income tax diversion for the first two-and-a-half years of Amendment 23 totaled $625.6 million. In addition to the income tax diversion, Amendment 23 requires that interest earned on the fund be deposited in the fund. About $49 million in interest had been earned by the end of FY 2002-03.

Where does the income tax diversion actually come from? When Amendment 23 was passed in 2000, the state was in the process of collecting $927.2 million in surplus revenue for FY 2000-01, on top of $941.1 million that was collected during FY 1999-00. These high levels of surplus were being collected despite $450 million in annual tax cuts that were enacted in 1999 and 2000 and the diversion of $164.3 million to the State Education Fund in FY 2000-01. It was widely believed that the state's surplus had grown so large that an economic downturn would not eliminate it. Therefore, it looked like the State Education Fund would be permanently funded by taxpayers through reduced TABOR refunds, and the General Fund would not be affected by the diversion of income tax revenues. Although revenues to the General Fund would be reduced, the General Fund would also experience an equal and offsetting reduction in its liabilities — the amount of money required to be refunded to taxpayers. The end result would be that the General Fund would be held harmless and the State Education Fund would provide additional revenue for elementary and secondary education at the expense of the taxpayers.

The economy, in conjunction with the interaction of TABOR and Amendment 23, produced different results, however. After one-half year of diverting money to the State Education Fund, the state entered into a deep and prolonged recession. The entire TABOR surplus was eliminated and, in fact, the state did not collect enough revenue to reach its TABOR spending limit in FY 2001-02. This drop in revenue caused the state to "ratchet down" its spending limit under TABOR. (The "ratchet-down" effect is explained in detail in Chapter 2 of this report.) The recession continued into FY 2002-03 and the state saw its spending limit ratchet down again.

What was the impact of the state's recession on where the State Education Fund money actually comes from? Had Amendment 23 not passed, the revenue that is transferred to the State Education Fund would have been counted as TABOR revenue. Once state spending limits began to ratchet down, that revenue would have lessened the impact of the ratchet down. Therefore, the state would have retained more money in the General Fund each year than it does currently. In fact, for fiscal years 2001-02 through 2003-04, the entire diversion to the State Education Fund would have been deposited in the General Fund instead. So, in those three years, money was diverted to the State Education Fund at the expense of the state's General Fund. Although the revenue would have been in the General Fund, the state would not have had an education fund, so the state would have had the same total amount of available revenue with or without Amendment 23 for those years.

Beginning in FY 2004-05, the diversions to the State Education Fund will be larger than the reduction in the General Fund revenues. As a result, the state will have more total money under Amendment 23 than it would have had without the amendment. However, money diverted to the State Education Fund will come partially from taxpayer refunds and partially from revenue that would have been retained by the General Fund had Amendment 23 not passed. We can estimate the amount that comes from each by calculating the TABOR surplus with and without Amendment 23. Figure 5-4 illustrates the results of that calculation. It shows the amount of revenue deposited into the State Education Fund each year under current law, the portion that would have been refunded to taxpayers with the TABOR exemption in Amendment 23, and the portion that would have otherwise gone to the General Fund as allowable spending under TABOR.

Figure 5-4
General Fund and Taxpayer Refund Reductions
Attributable to the State Education Fund Diversion
(Millions of Dollars)

Fiscal Year	Diversion to the State Education Fund	Amount of Diversion that Reduced Taxpayer Refunds	Amount of Diversion that Reduced Allowable General Fund Revenue
2000-01	$164.3	$164.3	$0.0
2001-02	272.9	0.0	272.9
2002-03	188.4	0.0	188.4
2003-04	267.9	0.0	267.9
2004-05	290.8	76.8	214.0
2005-06	317.6	94.5	223.2
2006-07	339.8	105.9	233.9
2007-08	362.7	116.9	245.8
Total	$2,204.5	$558.4	$1,646.1

Of the $2.2 billion expected to be diverted to the State Education Fund through FY 2007-08, $558 million can be considered new money to pay for the mandates of Amendment 23, while the remaining $1.6 billion is a reduction in General Fund revenue.

Why does the source of the money for the State Education Fund matter?
Amendment 23 places requirements on the state for funding elementary and secondary education. These requirements cost the state money, and the State Education Fund was created to provide additional revenue to the state to meet these demands. However, since the revenue to the State Education Fund has primarily been revenue that would have otherwise gone to the General Fund, the state has not received the expected amount of new revenue to fund the mandates of Amendment 23. If fact, the mandates to increase education spending will cost the state an estimated $1.4 billion between fiscal years 2001-02 and 2007-08. The state will only collect $558 million in new revenue —through reduced taxpayer refunds — during that period to fund the mandates.

Outlook for State Education Fund and General Fund Appropriations

The income tax diversion to the State Education Fund provides an annual source of revenue for the fund. Interest income supplements the diversion. When the balance of the State Education Fund grows over time, it can be used as a mechanism to supplement General Fund appropriations. The General Assembly can weigh all its expenditure requirements and make a decision as to how much to spend from the fund as long as it meets its minimum General Fund appropriations requirements for school finance. When the State Education Fund balance is limited to annual revenues, it drives General Fund appropriations. That is, the General Fund must provide all required revenue that is not in the State Education Fund. This is the scenario that the General Assembly is now facing in the foreseeable future.

For the last three years, the State Education Fund has been somewhere between having a substantial balance and being limited to the annual diversion. The fund was not in existence long enough to develop a substantial balance, and the economy resulted in lower-than-anticipated revenues being diverted to the fund. However, the fund did carry forward a balance from the first half year of the diversion in FY 2000-01. This diversion preceded the implementation of the spending requirements of Amendment 23 and the ability of the state to spend money from the fund in FY 2001-02. Under current estimates, however, the FY 2004-05 General Fund appropriation increase for school finance cannot be any less than about 3.4 percent to pay for the act's requirements. (We anticipate that growth in personal income will again be lower than 4.5 percent, suspending the requirement for a 5 percent increase in General Fund appropriations for school finance.) At this appropriation level, almost all money in the State Education Fund would be spent until the fund is replenished in the following year with the income tax diversion. At higher appropriation increases, the State Education Fund is likely to carry some money forward into FY 2005-06; the amount of the carryforward depends on the appropriation increase in FY 2004-05. Figure 5-5 shows the percentage increases required in General Fund appropriations in fiscal years 2005-06, 2006-07, and 2007-08 if the school finance appropriation is increased by 4 percent, 5 percent, or 6 percent in FY 2004-05.

Figure 5-5
Estimated General Fund Increase for School Finance
Based on 4, 5, and 6 Percent Increases in FY 2004-05

Fiscal Year	Percent Increase in General Fund Appropriations Based on FY 2004-05 Appropriation Increase of:		
FY 2004-05	4.0%	5.0%	6.0%
FY 2005-06	10.3%	8.2%	6.2%
FY 2006-07	8.4%	9.4%	10.3%
FY 2007-08	6.4%	6.4%	6.4%

Although a high General Fund increase for school finance benefits the balance of the State Education Fund, and therefore long-term funding for education, it has implications for the rest of the General Fund budget. Our June 2003 revenue forecast indicates that General Fund appropriations can increase by only 1.2 percent in FY 2004-05 and by 3.16 percent in FY 2005-06. Figure 5-6 illustrates how a variety of percentage increases in General Fund appropriations for FY 2004-05 will affect the total amount of money available for other programs supported by the General Fund.

Figure 5-6
Impact of General Fund Increases for School Finance on
General Fund Appropriations

Fiscal Year	Growth in General Fund Appropriations ($ in millions)	School Finance Appropriation Increase as Percent of General Fund Appropriation Increase if FY 2004-05 General Fund Appropriation Increase for School Finance Is:			
		6 Percent	5 Percent	4 Percent	3.37 Percent
FY 2004-05	$65.1	207%	173%	138%	116%
FY 2005-06	$173.1	86%	112%	138%	155%
FY 2006-07	$339.5	77%	71%	64%	60%
FY 2007-08	$359.9	50%	50%	49%	49%

Issues and Options

This section presents two options for addressing the interaction between Amendment 23, TABOR, and economic downturns. These two options focus on increasing revenues and reducing spending. Chapter 4 describes the property tax impact of the Gallagher Amendment and TABOR on property taxes on school funding and presents additional options for relieving the pressure on the state budget of funding for schools.

The Issue: *The interplay between Amendment 23, TABOR, and the economy has resulted in less new money being available to the state to fund K-12 education than was expected. Amendment 23 mandates $1.4 billion of spending through fiscal year 2007-08, but will provide only $558 million of new revenue. This disparity in revenues and expenditures has added significantly to the burdens faced by the state's General Fund.*

The following two options either create another revenue source for Amendment 23 or reduce the requirements of the amendment so that they better fit within the constraints of available revenue.

Option 1: *The General Assembly could ask voters to increase revenue for schools to fund the requirements of Amendment 23 by increasing taxes or further reducing taxpayer refunds.*

Issues for consideration. Voters indicated a willingness to pay for increases in public elementary and secondary education when they passed Amendment 23. In 2000, the estimated reduction in taxpayer refunds and corresponding increase in funding for education was $4.58 billion over ten years. Current estimates suggest that the actual reduction in taxpayer refunds over seven years will be closer to $560 million. Voters may be inclined to support an increase in revenue for schools given that the money anticipated in 2000 did not materialize. However, economic times have changed since voters approved Amendment 23. Of the two means of increasing revenue, reducing refunds may be more preferable to increasing taxes. Taxpayers may view refunds as money that was already paid, as opposed to a new tax, which they perceive as coming out of their pockets. Also, many taxpayers are impacted less by the loss of refunds than they are by a tax increase because of the number of refund mechanisms and how these mechanisms affect taxpayers differently.

Option 2: *The General Assembly could ask voters to reduce the requirements for spending under Amendment 23 based on a trigger. For example, the requirement to increase spending by inflation plus one percentage point could be reduced or eliminated when personal income growth is less than 4.5 percent or the spending mechanism could be changed to require that the available new money to the state triggers what the required increase in spending is. Another example would be benchmarking the required increase in General Fund appropriations to personal income in a more proportional manner.*

Issues for consideration. This option provides the General Assembly with additional flexibility with regards to funding the mandates of Amendment 23, especially during recessionary periods. The current "trigger" during a slow economic period — personal income growth of less than 4.5 percent — applies only to General Fund appropriations and is ineffective because the amendment's total spending requirements continue. In addition, the trigger does not reflect the large variations that can occur in personal income. With the discrepancy that exists between the amount of money generated by Amendment 23 and its spending requirements, funding education to the requirements of Amendment 23 will come at the expense of other state programs. By providing a catch-up provision to eventually provide for ten years of inflation plus one percent increases, the original intention of Amendment 23 to correct for past inadequate funding of education could still be upheld.

Changing the existing mandated increases for education funding could reduce spending on K-12 education, at least in the short run. Proponents of the amendment indicated it was needed because inflation-adjusted per-pupil funding had declined since 1989. However, it should be noted it was difficult in many years to fund any state program to inflation given the constraints of the state's six percent limit on appropriations. From 1990 to 1999, the inflation rate and the percentage change in population averaged 6.12 percent. Nonetheless, a better-educated work force is a key to attracting businesses to Colorado. The financing of K-12 education suffered in previous economic slowdowns relative to other government programs. Amendment 23 is a tool to see that education funding is at the head of government programs for the next eight years regardless of available revenue.

CHAPTER 6

CHAPTER 6
CAPITAL CONSTRUCTION FUNDING

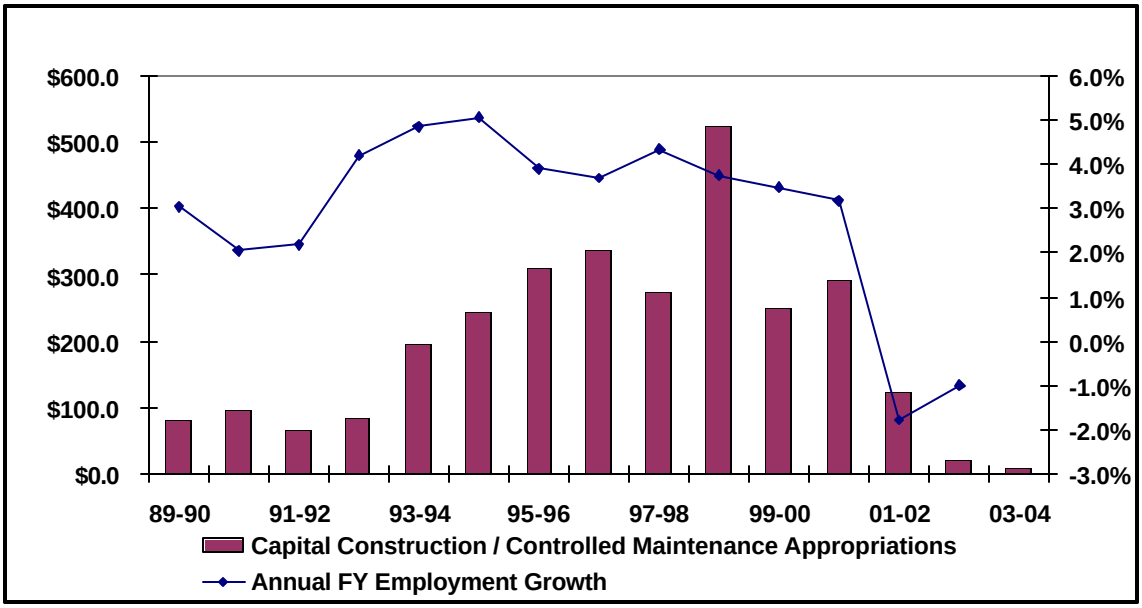
Colorado funds capital projects at the state level primarily through the General Fund. Given the state's other demands on the General Fund, this chapter looks at how capital projects have been funded and explores whether state constitutional provisions prevent the state from optimizing capital funding.

Colorado has spent considerable money, $2.9 billion, on capital projects over the past 15 years. This is an average of $193.9 million per year. The state has mostly relied on a "pay-as-you-go" system to fund capital projects, which includes both capital construction and controlled maintenance projects. It has, however, borrowed money by issuing certificates of participation (COPs) at times when General Fund revenues were not sufficient to fund capital needs. Certificates of participation were mostly authorized during the late 1980s, early 1990s, and more recently during the 2003 legislative session. Of the $2.9 billion appropriated for capital projects since FY 1989-90, $264.3 million, or about 9 percent, was appropriated for projects funded through COPs.

Capital Spending in a Fluctuating Economy

Changes in the economy significantly impact capital spending. Although funding for capital is appropriated from the Capital Construction Fund (CCF) and the Controlled Maintenance Trust Fund (CMTF), the money in these funds primarily comes from the General Fund. Of the $2.9 billion appropriated for capital in the last 15 years, 74 percent has come from the General Fund. Because capital funding is so dependent on the General Fund, and because the General Fund is susceptible to changes in the economy, capital funding can be erratic and fluctuate from year to year. Over the past 15 years, state funding for capital projects in Colorado rose from less than $100 million in the early 1990s to a peak of $523 million in FY 1998-99, then plummeted to the current year's appropriation of $9.5 million. Figure 6-1 compares appropriations for capital projects to Colorado's business cycle — as measured by employment growth — from FY 1989-90 to FY 2003-04.

Figure 6-1
State Capital Appropriations and the Economy



In the late 1980s and early 1990s, capital funding remained fairly constant at about $82 million per year. In the mid 1990s, however, this steady level of funding changed for two reasons. First, unlike the General Fund, state law does not limit the amount of money that can be expended from the Capital Construction Fund. Second, General Fund transfers to the Capital Construction Fund are not counted against the General Fund 6 percent appropriations limit. This means that General Fund moneys may be expended beyond the General Fund appropriations limit if the moneys are transferred to the Capital Construction Fund. In the mid and late 1990s, growth in state General Fund revenue exceeded the amount necessary to fund appropriations up to the General Fund appropriations limit. As a result, a large portion of General Fund moneys in excess of the appropriations limit were transferred to the Capital Construction Fund. Revenue above the 6 percent limit led to a $523 million appropriation in FY 1998-99, a $249 million appropriation in FY 1999-00, and a $288 million appropriation in FY 2000-01.

In one sense, the passage of TABOR has limited the amount of money available for capital projects. After the passage of TABOR, the General Assembly lost the ability to change the 6 percent appropriations limit. TABOR provided that the appropriations limit could only be weakened by future voter approval, rather than by legislative action. TABOR did not prevent revenue above the 6 percent limit from being spent on capital projects, but the revenue above the TABOR revenue limit is now refunded to the taxpayers rather than being identified as excess reserve that would be available for capital construction or highway projects.

In another sense, though, the legislative response to TABOR led to a one-time increase in the amount of money available for capital. In 1998, the General Assembly approved House Bill 98-1414 that allowed for the TABOR surplus to be booked in the fiscal year it was refunded

rather than the fiscal year it accrued. The FY 1998-99 appropriation of $523 million was partly attributable to this new law.

However, this multi-year elevated funding level for capital also led to large cuts to capital construction for FY 2001-02. For FY 2001-02, within available revenues, the legislature had to appropriate moneys for operating expenditures in addition to budgeting for a $927 million TABOR refund from the prior year. This resulted in a decision to cut capital expenditures for that year by $274 million.

The state's budget problems have also meant that less money has been available for capital projects in recent years. The General Assembly appropriated $9.5 million for capital for FY 2003-04, or about 5 percent of the average annual funding for the last 15 years. In addition, slightly under $310 million in capital appropriations has been cut since September 2001. Even if more prosperous times return to the state, though, the high appropriations of the late 1990s are unlikely to return. Under a law passed during the 2002 session, excess General Fund revenues will now be split between highway construction (two-thirds) and capital projects (one-third). According to our June 2003 revenue forecast, no excess General Fund revenues are expected until FY 2007-08.

Colorado's Capital Construction and Controlled Maintenance Need

Determining controlled maintenance and renovation need. Colorado's capital needs tend to grow despite vacillations in the economy. Over the last 13 years, the state has increased its inventory of state-funded (as opposed to cash-funded) facilities by 38 percent, from 27.3 million gross square feet (GSF) to 37.3 million GSF. Approximately 30 percent of the increase is due to the acquisition of existing facilities. As the state acquires existing facilities and constructs new facilities, the cost to maintain the state facilities inventory increases. This cost is primarily borne by the General Fund.

Colorado's State Buildings and Real Estate Programs Office explains that annual funding for controlled maintenance and renovation is guided by the "reinvestment rate" needed to attain a desired facility condition within a specific time frame. The reinvestment rate for controlled maintenance and renovation, recommended by a national study, is 1.5 percent to 3.0 percent of the total current replacement value of all facilities.[15] The study concluded that underfunding of maintenance and renovation of public buildings is a widespread and persistent problem, states that the level of annual funding depends on:

- ✓ the age of the buildings and infrastructure;
- ✓ the intensity and type of facilities used;
- ✓ the types and quality of construction materials;
- ✓ the climate;

15. Harvey H. Kaiser, *The Facilities Audit: A Process for Improving Facilities Conditions*. Alexandria, VA: APPA, the Association of Higher Education Facilities Officers, 1993.

- ✓ the status of regulatory compliance; and
- ✓ the effectiveness and efficiency of the maintenance organization.[16]

The State Buildings and Real Estate Programs Office values the current statewide General Fund building inventory at approximately $6.2 billion. The 1.5 to 3 percent guideline indicates that the state's annual controlled maintenance and renovation budget should range from $93 million to $186 million. Funding for controlled maintenance, one part of the controlled maintenance/renovation budget, has averaged about $26 million annually over the last 15 years. From FY 1997-98 to FY 2000-01, funding averaged almost $44 million. Renovation, by contrast is part of the capital construction budget. Capital construction appropriations have accounted for 89 percent of the total capital budget since FY 1989-90. A breakdown of renovation versus new construction is not available.

The State Buildings Office annually submits a long-term controlled maintenance budget recommendation to the Capital Development Committee. For the next five years, FY 2004-05 through FY 2008-09, the five-year need has been identified as $463 million, an average of about $93 million per year. This recommendation does not include renovation projects. Considering the low level of capital funding over the past three years, the renovation needs of the state continue to grow.

New construction. When the cost to renovate an existing facility reaches a certain point, it makes more economic sense to build a new facility. State agencies continue to submit annual requests for new construction projects, although funding for new projects has virtually halted.

Revenue Sources for Capital Projects

As previously noted, capital construction and controlled maintenance projects are funded from moneys in the Capital Construction Fund and the Controlled Maintenance Trust Fund, which primarily come from the General Fund. To a much lesser degree, capital projects are funded with interest earnings and borrowed money. Revenue to the Capital Construction Fund totaled $2.8 billion over the last 15 years, while interest revenue available from the Controlled Maintenance Trust Fund totaled $86.6 million, for a combined total of $2.9 billion.

16. American Public Works Association (AWPA) and the Building Research Board of the National Research Council, *Committing to the Cost of Ownership: Maintenance and Repair of Public Buildings*. Chicago: AWPA, 1991. The National Research Council is the working arm of the National Academy of Sciences and the National Academy of Engineering.

General Fund moneys. General Fund transfers are available for capital projects after the General Fund has satisfied operating needs and other statutory obligations. These transfers are exempt from the 6 percent appropriations limit. Consequently, the past practice of the General Assembly has generally been to transfer General Fund reserve moneys to the Capital Construction Fund. Since FY 1988-89, a statutory General Fund transfer has been in place to provide a minimum level of funding for capital construction. The current transfer amount of $100 million expires after FY 2005-06. In addition, this $100 million transfer was reduced by the legislature to about $9.5 million for FY 2002-03 and FY 2003-04.

Interest earnings. Money in the Capital Construction Fund can be invested to earn interest. All interest earned on the fund remains in the fund and is used to fund capital projects.

The Controlled Maintenance Trust Fund, created to allow the interest earned on the principal amount to be used for controlled maintenance projects, has provided $86.6 million of interest earnings for controlled maintenance projects since FY 1996-97. The principal of the Controlled Maintenance Trust Fund peaked at $248.1 million, but has since been transferred, along with existing interest earnings ($9.5 million), to the General Fund to help alleviate the General Fund revenue shortfall. As a result, no interest earnings have been appropriated from the trust fund for the last two fiscal years. Senate Bill 03-262 now calls for the repayment of the Controlled Maintenance Trust Fund to occur over two fiscal years: $138.2 million in FY 2004-05 and FY 2005-06. Figure 6-2 briefly summarizes the funding sources for capital construction and the amount received from each source.

Figure 6-2
Capital Construction Fund and Controlled Maintenance Trust Fund
Funding Sources: FY 1989-90 to FY 2003-04 ($ in millions)

Funding Source	Revenue Amount	Percent of Total	Description of Funding Source
Capital Construction Fund (CCF)			
General Fund	$2,151.0	74.2%	The amount includes moneys transferred from the General Fund, which are not subject to the 6 percent appropriations limit. In addition to transfers from the General Fund, the General Assembly has also appropriated money to the CCF. This has usually been done to maximize the appropriations base for succeeding years.
Interest and Reversions	$312.4	10.8%	All interest earned from the investment of moneys in the CCF remains in the fund for future expenditure. In addition, all unexpended project balances revert to the fund and are available for appropriation.
Lottery Revenue	$347.2	12.0%	When lottery games were first established in Colorado, the General Assembly directed that 50 percent of the revenues be transferred to the CCF. This changed by the passage of the Great Outdoors Colorado Program in 1992. The constitutional provision phased out the use of lottery moneys for state capital construction projects. It allowed lottery proceeds to only be used toward the payment of selected COPs through FY 1998-99.

Figure 6-2 (cont.)
Capital Construction Fund and Controlled Maintenance Trust Fund
Funding Sources: FY 1989-90 to FY 2003-04 ($ in millions)

Funding Source	Revenue Amount	Percent of Total	Description of Funding Source
Subtotal	**$2,810.6**	**97.0%**	**Capital Construction Fund Total**
Controlled Maintenance Trust Fund (CMTF)			
General Fund	$248.1	N/A*	General Fund transfers to the CMTF became the principal of the fund and were not available for appropriation. The amount transferred was not subject to the 6 percent appropriations limit. The principal, however, was depleted to help address the state's revenue shortfall.
Interest	$86.6	3.0%	The interest earned on the principal of the CMTF supplements the CCF and is only available to fund controlled maintenance projects.
Subtotal*	**$86.6**	**3.0%**	**Controlled Maintenance Trust Fund Total**
Grand Total	**$2,897.2**	**100.0%**	

* Only the interest from the Controlled Maintenance Trust Fund is counted in the total, since the General Fund amount was the principal of the fund and was not available for appropriation.

***Borrowed moneys*.** A handful of capital projects have been funded over the years with borrowed moneys through COPs. The amount appropriated for COP projects over the years has been used to repay the principal and interest for a number of capital projects, including:

- ✓ regional satellite facilities for the developmentally disabled;
- ✓ the Grand Junction State Office Building;
- ✓ the North Classroom Building on the Auraria campus;
- ✓ Division of Youth Services facilities;
- ✓ Department of Public Safety facilities; and
- ✓ Department of Corrections facilities.

Since the state began using COPs in the late 1970s, it has borrowed approximately $201 million for 11 projects. The repayment cost for these projects is approximately $301 million, and has been funded through both the General Fund and lottery proceeds.

In 2003, the General Assembly authorized two new COP projects through the passage of House Bill 03-1256. The bill funded projects that the Department of Corrections and the University of Colorado Health Sciences Center had attempted to receive funding for on a "pay-as-you go" basis. COPs were viewed as a way to get the projects going during the economic downturn, while extending their repayment over a long period of time. The total combined cost of these projects over the next 25 years, including estimated interest, is $549.1 million, based on a principal amount of $305.7 million. The payments are projected to be around $20 million annually through FY 2019-20, then to decrease to about $7 million annually through FY 2030-31.

Funding Mechanisms: Pay-As-You-Go Versus Debt Financing

The General Assembly weighs several factors, including capital need, available revenue, and the current and projected economy, when deciding how to fund capital projects. Depending on the combination of these factors, the General Assembly may decide to fund a project on a pay-as-you-go basis (based on annual available revenues) or to finance a project by borrowing money. A later section describes various types of debt in detail, while this section considers the advantages and disadvantages of debt financing and pay-as-you-go financing. Debt financing makes funds for capital projects immediately available, particularly in a time of reduced state revenues. Its major disadvantages, however, are financing costs, fixed long-term annual appropriations, and the potential for default. The primary advantage of pay-as-you-go funding is flexibility in prioritizing and funding projects from year to year. Figure 6-3 considers the advantages and disadvantages of pay-as-you-go financing and debt financing.

Figure 6-3
Pay-As-You-Go Versus Debt Financing

Pay-As-You-Go Financing	
Advantages	**Disadvantages**
Moneys are not used on interest payments and can instead be used to fund additional projects.	If there is a revenue shortfall: - high-priority projects may not be funded; and - capital needs begin to mount.
The state maintains flexibility in prioritizing projects for appropriations.	Projects are prioritized and funded based on available revenue, which can fluctuate from year to year.
There is a natural restraint on increasing project spending. Because revenues are limited, only necessary projects are funded.	When revenues are limited yet projects still require funding, a reserve fund may be spent down below an acceptable level.
Future taxpayers are not committed to funding current projects.	Major projects will benefit future generations, but they will not have to pay for them.
When a revenue shortfall exists, **and** if no projects have been financed, there is no need to cut funds from other state needs to make debt payments.	Projects can more easily be delayed or cut, which can increase the project cost due to inflation.

Figure 6-3 (cont.)
Pay-As-You-Go Versus Debt Financing

Debt Financing	
Advantages	**Disadvantages**
Money is immediately available for necessary projects, eliminating delay.	More projects with limited merit may be funded, because available revenue becomes less of a factor in weighing the merits of projects.
The cost of long-term improvements is shared by current and future taxpayers over a project's useful life.	A project's value may be skewed (project benefits may be over-estimated and project costs under-estimated) to classify it as urgent. This could result in higher project costs due to financing, particularly if the project cost exceeds its useful life.
Payments are made even during a revenue shortfall.	Fixed long-term annual appropriations make it more difficult to fund other projects or programs.
An ongoing debt financing program could allow for a consistent level of projects to be addressed each year, minimizing a backlog of projects that could increase in cost the longer the project is delayed.	If the state defaults on a debt payment: - the proceeds from the sale of the property would be used to pay off the investors, resulting in the loss of the entire investment; and - the state's credit rating could be negatively impacted, limiting its ability to obtain insurance and use the capital markets.
Annual payments can be structured to begin at a date of the state's choosing, which: - gives the state additional time to set aside funds for the annual payments; and - could mean that the payments are made in a more favorable economic climate.	Financing costs, including transaction costs and interest payments, increase the cost to complete the project and leave fewer funds available for other projects.

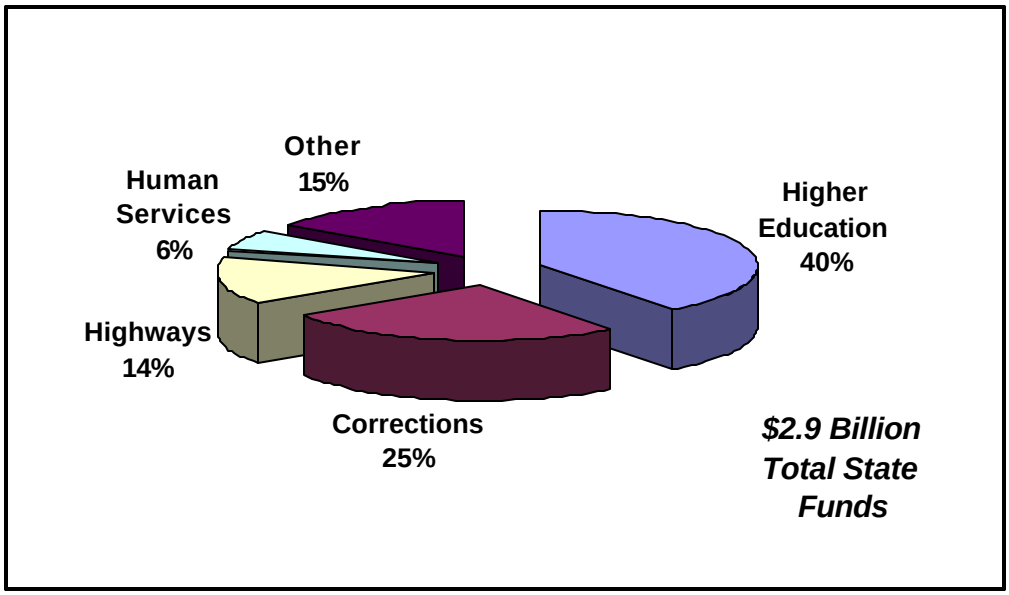
*Sources: Aronson, J. Richard, *Management Policies in Local Government Finance* (1996); Congressional Budget Office, *Innovative Financing of Highways* (January 1998).

Recipients of Funded Projects

Over the past 15 years, most of Colorado's capital appropriations have been for capital projects (89 percent), while 11 percent has been spent on controlled maintenance.

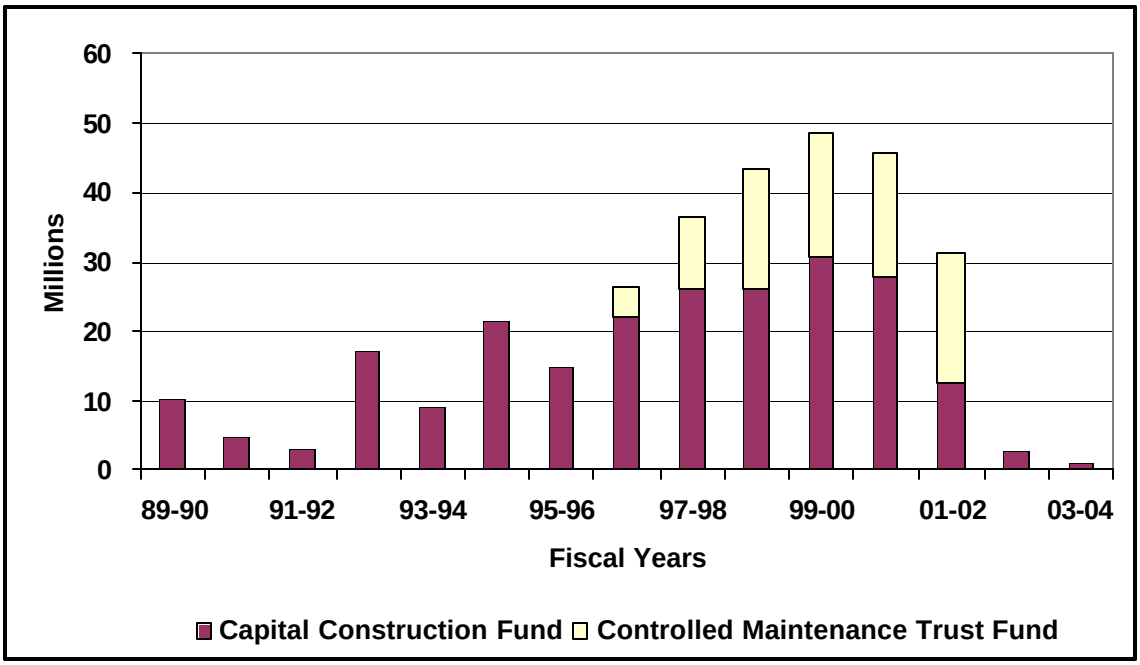
Capital construction projects. The largest recipient of capital construction funding over the last 15 years has been higher education institutions, followed by the Department of Corrections (DOC). Higher Education and DOC received about 65 percent of the capital construction budget for the 15-year period. The DOC's square footage grew by 175 percent between FY 1990-91 and FY 2003-04, from 2.4 million square feet to almost 6.6 million square feet. The square footage for Higher Education, by contrast, grew by 33 percent, from 17.7 million to 23.6 million square feet. Figure 6-4 summarizes appropriations by major recipients for the past 15 years.

Figure 6-4
Breakdown of State-Funded Capital Construction Appropriations by Department
FY 1989-90 to FY 2003-04



Controlled maintenance projects. Although controlled maintenance accounted for 11 percent of total capital funding over the past 15 years, the amount appropriated for controlled maintenance projects had been increasing annually until the recent economic downturn. Figure 6-5 shows the funding history for controlled maintenance and breaks out the amount appropriated from the Capital Construction Fund and the Controlled Maintenance Trust Fund. The graph demonstrates how the creation of a dedicated funding source, the trust fund, was used to increase controlled maintenance funding. As previously discussed, however, this fund has been depleted.

Figure 6-5
Controlled Maintenance Funding History
Funding from the CCF and CMTF



Constitutional Restrictions on Financing

This section explores the debt parameters established in Colorado's Constitution. In summary, Colorado's Constitution has been interpreted to bar the state from issuing general obligation debt. Due to TABOR, debt issued through revenue bonds is subject to voter approval. The constitution did once allow for a statewide property tax to fund building construction. However, TABOR eliminated the General Assembly's ability to assess a statewide mill levy.

General obligation debt. Article XI, Section 3 of the Colorado Constitution permits the state to contract general obligation debt to:

- ✓ provide for casual deficiencies of revenue;
- ✓ erect public buildings for the use of the state;
- ✓ suppress insurrection; or
- ✓ defend the state or, in time of war, the nation.

While debt is not limited to suppress insurrection, defend the state, or assist in defending the United States, allowable debt for casual deficiencies of revenue and for erecting public buildings is strictly limited. Other than these exceptions, Article XI, Section 3 has consistently been interpreted to prohibit the state from incurring general obligation debt, which is debt that is secured by the full faith, credit, and taxing powers of the state. In a 1933 ruling, the Colorado Supreme Court stated that the purpose of Article XI, Section 3, was to keep the state substantially

on a cash basis, to prohibit the pledge of future fixed revenues, to forbid the contracting of debts, and to make sure that one General Assembly would not paralyze the next by devouring the available revenues of both.[17]

The 1933 ruling was the result of interrogatories submitted by the legislature regarding the constitutionality of a House bill. The bill attempted to create a fund to repay bonds issued by the state. The bond proceeds were to fund highway improvements, while revenue to the fund was to come from an existing excise tax on motor fuels. The court found that the state could not rededicate revenue already provided in past years and already flowing into the state treasury for the payment of debt.

In a more recent opinion, *Submission of Interrogatories on House Bill 99-1325*,[18] the Colorado Supreme Court identified some of the characteristics of constitutionally prohibited debt as:

- ✓ obligations that pledge revenues of future years;
- ✓ obligations that require the use of revenue from a tax otherwise available for general purposes;
- ✓ obligations legally enforceable against the state in future years; or
- ✓ obligations for which future legislatures do not have the discretion to appropriate funds.

The opinion also stated that if the appropriation is purely discretionary and nonobligatory, it is not a payment on constitutional debt. The court identified previous court-approved financing mechanisms as:

- ✓ borrowed funds repaid from the revenue generated by the improvement;
- ✓ money borrowed by a public entity independent from the state; and
- ✓ lease-purchase agreements entered into by the state for a building or other improvement, where the parties are not bound to renew the lease.

Revenue bonds. Prior to the passage of TABOR, the legislature could have created a revenue stream and special fund from which to pay revenue bonds. TABOR, however, requires prior voter approval for any multiple-fiscal year direct or indirect district debt or other financial obligation, unless enough money is set aside to pay for the obligation in all years the payments are due. Further, TABOR requires a vote of the people to raise taxes. Therefore, the state cannot issue revenue bonds without a vote of the people.

Certificates of participation. Certificates of participation, or COPs, are publicly marketed lease-purchase agreements. Neither the Colorado Constitution nor the Colorado statutes specifically addresses COPs or defines them as debt or a financial obligation. In the past, both the

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17. *In re Senate Resolution No. 2, Concerning the Constitutionality of House Bill No. 6*, 31 P.2d 325, 94 Colo. 101.

18. 979 P.2d 549 (Colo. 1999)

state and local governments in Colorado have issued COPs to fund construction or improvements of facilities.

COPs issued by the state have included a clause stating that payments on the COP depend upon an annual appropriation by the state. This clause is meant to distinguish the lease from debt and release the state, if necessary, from financial obligation. Because they are subject to annual appropriation, the General Assembly has not considered COPs issued for capital construction projects to be debt.

None of the COPs entered into by the state to construct state facilities has been challenged in court. Some COP transactions, however, may require prior voter approval pursuant to TABOR's multiple-fiscal year restriction, depending on how they are structured. In *Submission of Interrogatories on House Bill 99-1325*, the Colorado Supreme Court held that some multiple-year transactions that do not create debt in violation of Article XI, Section 3, of the Colorado Constitution nonetheless require prior voter approval pursuant to TABOR. The court reasoned that the Colorado Department of Transportation's plan in House Bill 99-1325 to finance transportation projects through revenue anticipation notes constituted a multiple-fiscal year financial obligation that required prior voter approval. The court stated that, to make this determination, the entire obligation must be viewed as a whole. The court considered the size of the $1 billion-dollar transaction against the Department of Transportation's $585 million annual budget. The court also concluded that the extent of the security given by the state in the event of non-payment appeared to be a financial obligation spanning more than one year.

When does a financial transaction require voter approval? The Colorado Attorney General has provided a list of factors to consider when determining whether a financial transaction requires prior voter approval pursuant to the *House Bill 99-1325 Interrogatories* decision.[19] According to the Attorney General, the following factors may *exempt* a transaction from TABOR voting requirements:

- ✓ The transaction does not involve the issuance of negotiable instruments, such as bonds or notes by the state;
- ✓ The government receives tangible property for use rather than money to spend;
- ✓ The lender or investors have a security interest in tangible property, which can be repossessed in the event of non-payment;
- ✓ The lender or investors do not have a security interest in the balance of the unspent cash proceeds of the transaction;
- ✓ The transaction does not involve the use of credit enhancement mechanisms, such as bond insurance or letters of credit;
- ✓ The transaction has a finite duration for repayment. There is no open-ended commitment to pay until repaid in full;

19. *Formal Opinion of Ken Salazar, Attorney General, No. 01-5, AG Alpha No. PE CS AGBAQ, Certificates of Participation as Financing Method for Vehicle Purchases by the Division of Central Services*, December 10, 2001.

- ✓ The dollar amount of the transaction is a realistically manageable obligation and does not substantially consume or exceed the agency's total annual budget;
- ✓ A private lessor owns the equipment leased to the state; and
- ✓ Incurring the cost of holding an election would be absurd under the circumstances.

A statewide property tax for financing capital projects. Article X, Section 11, of the Colorado Constitution allows the state to assess a statewide property tax. However, the passage of TABOR has effectively eliminated this option since TABOR specifically precludes the assessment of a statewide property tax.

The statewide property tax was last imposed in 1964. Article X, Section 11 limits the property tax rate for state purposes to four mills. It also states that the General Assembly can approve an additional levy, not to exceed one mill, for "the erection of additional buildings at, and for the use, benefit and maintenance, and support of the state educational institutions."

Historically, state property taxes were dedicated to capital construction financing. In 1947, the state embarked on a major building program with the adoption of 23 separate bills for construction of statewide facilities through debt financing. A combined mill levy of 0.149 was in place for the first two years, increasing to 1.49 mills for the next eight years. This method of financing continued in 1955 with the adoption of additional legislation establishing a combined levy of 1.43 mills to fund new higher education facilities and buildings in the Capitol Complex. The debt for these buildings was retired in 1964.

Information from the Division of Property Taxation shows the history of the statewide mill levy from 1912 through 1964. The levy ranged from 1.3 to 4.53 mills. The revenue not dedicated for state buildings was used for general government purposes.

If the TABOR constitutional prohibition on a statewide property was removed from the constitution, a one mill levy on 2003 property values would produce approximately $60.5 million in revenue. This revenue would be subject to both the TABOR limits on property tax revenue (inflation plus the net increase in property valuation) and state fiscal year spending (inflation plus population growth).

Types of Financing

Three common types of debt financing are general obligation bonds, revenue bonds, and certificates of participation (lease-purchase agreements). General obligation bonds and revenue bonds are the two most common types of long-term debt in the United States, but only the latter may be used at the state level in Colorado, unless the constitution is amended. Figure 6-6 provides a comparison of general obligation bonds, revenue bonds, and certificates of participation.

Figure 6-6
Comparison of General Obligation Bonds, Revenue Bonds, and Certificates of Participation

General Obligation (GO) Bonds	Revenue Bonds	Certificates of Participation (COPs)
What is the repayment source?		
Property taxes are the usual source, but any revenue source may be used.	Revenue from the project being financed or a predetermined specific and related revenue source (which could include taxes).	Annual appropriations from the governing body in the form of lease payments.
Is the obligation considered long-term debt?		
Yes	Yes	No
Is the repayment guaranteed?		
Yes, by the full faith, credit, and taxing powers of the issuing government.	No	No
What happens if the planned repayment source is not sufficient?		
The government must find another source to repay the bonds. For example, a local government must levy taxes on all of its assessable property at whatever level needed to make the debt service payments. In other words, the bondholders have an unlimited claim on the issuing government's taxes and other revenues until the bonds are repaid.	Bondholders have no recourse to other revenues of the issuing government. The government may choose to repay the bonds using another revenue source, but is not obligated to do so.	The lease terminates and the trustee (which holds the title to the property being financed) may sell, re-let, or otherwise dispose of the property, using the proceeds to pay the investors. The government's investment to that point is lost.
Which option is the least expensive, or most expensive, for the government to issue?		
Because GO bonds are backed by the full faith, credit, and taxing powers of the government, they are more likely to be paid on time. GO debt therefore bears a lower interest rate than nonguaranteed debt.	Revenue bonds are more costly than GO bonds, but less costly than COPs. The repayment by the government is not guaranteed, and is therefore more risky.	COPs are more costly than GO or revenue bonds. Repayment is subject to annual appropriations, which makes them less reliable than the other two options.

Figure 6-6 (cont.)
Comparison of General Obligation Bonds, Revenue Bonds, and Certificates of Participation

General Obligation (GO) Bonds	Revenue Bonds	Certificates of Participation (COPs)
What is the difference in costs between the options, assuming $100 million is issued over 30 years?[20]		
The interest cost is estimated to be $95.4 million at 5.01 percent, assuming the issue is property-tax based, with no insurance.	The interest cost is estimated to be $97.4 million at 5.10 percent, assuming the issue is sales tax based, with no insurance.	The interest cost is estimated to be $101.7 million at 5.22 percent, assuming the issue includes AAA-rated insurance, the cost of which is included in the interest total.
What are the advantages of each option?		
(1) Appropriate for projects that benefit the entire community. (2) Least costly to the government, since it is backed by the full faith, credit, and taxing power of the issuing government.	(1) If the revenue source is insufficient to make debt service payments, the government is not legally obligated to appropriate other revenues for debt repayment. (2) Project is paid for by those who benefit the most from the project (the users).	(1) Voter approval is not required if the COPs meet certain court standards. (2) Lease payments can be structured to begin on a date of the state's choosing, giving the state additional time to set aside money for the annual payments. (3) Government has the option of not appropriating funds for the annual payment, if necessary.

20. Bill Dougherty, BD Advisors, Denver, CO.

Figure 6-6 (cont.)
Comparison of General Obligation Bonds, Revenue Bonds, and Certificates of Participation

General Obligation (GO) Bonds	Revenue Bonds	Certificates of Participation (COPs)
What are the disadvantages of each option?		
(1) If planned revenue source is insufficient, other programs will have to be cut, or taxes will have to be raised. (2) Requires voter approval. (3) Because of the voter approval requirement, general obligation bonds cannot be issued quickly to take advantage of low interest rates.	(1) Unlike most states, revenue bonds in Colorado require voter approval. (2) Because of the voter approval requirement, revenue bonds cannot be issued quickly to take advantage of low interest rates. (3) The bond market could react negatively to the government if a default occurs, even though the bonds are secured only by the revenue of the project being financed (Moody's indicates that it does not include revenue bonds in determining state debt burden, but it monitors and publishes information on this type of debt). (4) Generally more complex than general obligation bonds, which drives up administrative costs.	(1) If funds are not appropriated in any year, the project will be sold, re-leased, or disposed of, and there is no way of recouping the money already paid by the government. (2) More expensive than general obligation or revenue bonds. (3) Complex, which drives up administrative costs.

How Other States Pay for Their Capital Needs

This section considers how other states pay for their capital construction needs. This could be useful in considering changes to the Colorado Constitution or statutes. A survey of a number of states revealed dedicated revenue sources, in addition to debt financing, are routine methods to finance large capital construction projects. General Fund revenues are typically used for maintenance costs and debt service on general obligation bonds.

Currently, 45 states allow general obligation debt. Of these, however, four states require voter approval for the general obligation debt and seven states have debts limits of less than $2.0 million. Five states are prohibited from issuing general obligation debt — Colorado, Indiana, Nebraska, Oregon, and South Dakota.[21]

Figure 6-7 summarizes funding sources for capital construction most commonly used by other states.

21. National Association of State Budget Officers, *Budget Processes in the States, January 2002*

Figure 6-7
Typical Nationwide Funding Sources for Capital Construction

Controlled Maintenance	Higher Education	Corrections/State Departments
(1) General Fund; (2) Reserve accounts; and (3) Maintenance funds included with new building appropriations.	(1) General Fund; (2) Higher-education-issued bonds and state-issued debt; (3) Cash funds from tuition and student fees; (4) Public/private partnerships; (5) Gifts, grants, and donations; (6) Dedicated taxes.	(1) General Fund; (2) Debt financing / lease-purchase; (3) Lottery revenue; and (4) Fines.

Dedicated revenue sources. Dedicated revenue sources, in the form of a tax, fee, or constitutional/statutory requirement, direct general funds for capital construction purposes. The following are examples of taxes dedicated to capital construction financing in other states:

- ✓ Nevada dedicates 29.8 percent of the annual slot tax for higher education capital construction and debt retirement;
- ✓ Illinois allocates 5.5 percent of its sales tax, 4.9 percent of the hotel tax, and 4.1 percent of the racing privilege tax for capital development projects;
- ✓ Nebraska dedicates 3.1 percent of the sales, use, and excise tax on cigarettes for university facility improvements;
- ✓ Idaho requires 0.5 percent of individual and 0.2 percent of corporate income taxes go for construction and maintenance of public buildings; and
- ✓ Florida has a gross receipts utility tax for higher education capital construction.

Constitutional or statutory requirements directing general funds for capital construction purposes vary, as shown in the following examples:

- ✓ the Louisiana Constitution specifies that all excess general funds be used for capital outlay or debt service; and
- ✓ a 1998 New Jersey constitutional amendment requires general fund revenue to be used to preserve one million acres of open space over a ten-year period, resulting in a FY 2003-04 budget of $98 million.

Generally, states fund controlled maintenance projects through appropriations from the general fund. These moneys in some instances are transferred to a maintenance fund. Many states also rely on agency rent to generate a pool of money for maintenance, and some have established other dedicated revenue streams. Examples include the following:

- ✓ Utah statutes require that 1.1 percent of the replacement cost of its facilities be set aside from the General Fund for maintenance (this was reduced to 0.9 percent the last two years due to budget shortfalls);
- ✓ Missouri statutes allocate 0.1 percent of 1.0 percent of total General Fund revenues to a Facilities Maintenance Reserve Fund (due to budget shortfalls this transfer has not occurred in the last two biennial budgets);
- ✓ Indiana has developed replacement fund reserves for new buildings; and
- ✓ Virginia keeps a statewide maintenance reserve fund.

Debt financing. States that use debt financing view it as an equitable method of distributing costs and benefits to both present and future generations. To reduce the cost of issuing debt and to achieve lower interest rates, debt can be issued jointly rather than individually. For instance, Louisiana has a "bond bank" that issues debt in the state's name that is used for multiple jurisdictions. These "pooled debt" arrangements, where one entity issues debt and others borrow from the proceeds, result in more cost-effective terms.

In several states oversight of debt issuance, once adopted in a state budget bill or bond bill, is provided by separate commissions consisting of elected and governor-appointed officials. Generally, the commissions oversee bond issuance and reissues and monitor total state debt limits. Debt payments are generally processed through the state treasury. For example, the Georgia State Financing and Investment Commission manages Georgia's public debt. Its duties include the administrative responsibilities associated with issuing bonds and investing bond proceeds. The commission also manages capital construction projects related to the issuance of debt. The Georgia General Assembly annually authorizes the commission, through the Long Appropriations Bill, to issue general obligation debt to finance the construction of various projects. The commission's operating budget for FY 1999-00 was almost $2.9 million. The operating costs are funded from interest earned on the bond proceeds. The commission members include the Governor, President of the Senate, the Speaker of the House, the State Auditor, the Attorney General, and the Director of the Office of Treasury and Fiscal Services.

The majority of the states that allow debt financing have debt limits or restrictions. Several different types of limitations exist. They range from a specific dollar limit to formulas based upon certain state economic measures. Examples of debt restrictions include the following:

- ✓ the Virginia Constitution limits debt to an amount equal to 1.15 times the average annual state income and sales tax revenues based upon the previous three fiscal years;
- ✓ Louisiana constitutional requirements specify that annual debt service payments not exceed 6 percent of the total annual tax, license, and fee revenue;
- ✓ the Utah constitutional debt limit is 1.5 percent of the total fair market value of taxable property, with a statutory limit on general obligation bonds of 20 percent of

the maximum allowable appropriations (less debt service) from the General Fund, School Fund, and Transportation Fund; and

- ✓ Maryland has a state policy that outstanding debt shall not exceed 3.2 percent of state personal income, and debt service shall not exceed 8 percent of the revenue source dedicated for payment of the debt service.

Debt programs. States that use debt financing as a routine part of capital funding have debt policies that are established by the executive branch or commissions responsible for debt oversight. These polices include the types of projects that can be financed, term of the financing, and amounts that can be financed. Examples of policies follow.

Financing terms:

- ✓ the term of bond financing cannot exceed the expected useful life of the project;
- ✓ the average maturity of general obligation bonds must be at or below a certain number of years;
- ✓ on all debt-financed projects, a down payment of at least a certain percent of total project cost must be made from current revenues;
- ✓ where possible, special assessment, revenue, or other self-supporting bonds instead of general obligation bonds must be used;

Amount and types of projects to finance:

- ✓ total general obligation debt must not exceed a certain percent of the assessed valuation of taxable property;
- ✓ long-term borrowing must be confined to capital improvements or projects that cannot be financed from current revenues;
- ✓ long-term debt may not be used for current operations;

***Debt administration*:**

- ✓ tax anticipation debt must be retired annually and general obligation bond anticipation debt must be retired within six months after completion of the project;
- ✓ good communications with bond rating agencies about the government's financial condition must be maintained;
- ✓ a policy of full disclosure on every financial report and bond prospectus must be followed;
- ✓ proceeds must be invested during implementation to maximize earnings within federal arbitrage regulations;
- ✓ adequate property loss insurance must be retained on the assets pledged; and
- ✓ the earnings disclosure of financial information must be tracked, calculated, and documented.

Capital budget cuts. In the last three years, several states have cut or eliminated capital construction funding due to revenue shortfalls. According to the National Association of Budget

Officers, measures taken to reduce capital spending included: delaying capital projects (seven states), shifting pay-as-you-go capital projects to debt (four states), and freezing purchases (three states).[22]

Financing Options for Capital Construction and Controlled Maintenance

The previous parts of this chapter considered how Colorado and other states have funded capital construction and controlled maintenance projects. This section discusses several options for paying for the state's current and future capital needs.

The Issue: *Capital construction and controlled maintenance are on-going state expenditure requirements.*

Option: *The General Assembly could consider extending the General Fund transfer to the Capital Construction Fund.*

Issues for consideration. The state could continue funding capital projects through transfers from the General Fund to the Capital Construction Fund, by using interest earned on the Controlled Maintenance Trust Fund (assuming the principal of that fund is restored), and by the occasional use of COPs . However, the last $100 million General Fund transfer, a major source of capital funding, is scheduled for FY 2005-06. Continuing the statutory transfer beyond this point allows the Joint Budget Committee and the Capital Development Committee to assume the funding will be available annually unless the legislature, acting by bill, eliminates or reduces the transfer. Basically, the transfer "carves out" funding for capital.

The Issue: *Colorado does not have a dedicated revenue source to fund capital construction and controlled maintenance projects and therefore funding for such projects suffers during economic downturns.*

Options: *The General Assembly could consider submitting a proposal for voter approval to create a dedicated revenue source for capital projects. One option could be to eliminate TABOR's prohibition on a statewide property tax. A second option could be to identify a tax or fee that directs revenue for capital purposes.*

Issues for consideration. Prior to TABOR, the General Assembly had the option of imposing a statewide property tax of no more than four mills, plus one additional mill for educational facilities. The property tax was used by the state for capital construction from 1947

22. National Association of Budget Officers, Fiscal Survey of the States - June 2003.

to 1964. Repealing the prohibition in TABOR would provide the state with the flexibility to use this revenue source, which is limited to five mills, if it so desired. If a property tax question is subsequently presented to the voters, it could be structured to allow the General Assembly to impose anywhere from one to five mills and not require voter approval if a higher mill was imposed from one year to the next, as long as the total statewide mill did not exceed five mills. A statewide mill could be appropriate in that the state's building inventory, primarily higher education institutions and correctional facilities, are located throughout Colorado. A statewide mill levy could spread the cost of constructing and maintaining these buildings throughout the state.

Another option for creating a dedicated revenue source for capital construction and controlled maintenance could be a tax, fee, or constitutional/statutory requirement that directs the revenue for capital construction purposes. A dedicated revenue source would help to create a dependable source for capital construction. However, depending on the economic climate, the amount of revenue would vary on a year-to-year basis. As identified previously, other states have identified specific tax revenue, such as percentage of the sales and use tax, for capital construction purposes.

The Issue: *Colorado's Constitution prohibits general obligation debt.*

Option: *The General Assembly could consider asking voters to amend the constitution to allow for general obligation debt.*

Issues for consideration. The General Assembly could submit a proposal for voter approval to amend the constitution to allow for general obligation debt. As noted previously in this chapter, general obligation debt is the least costly financing method, because it bears a lower interest rate than nonguaranteed debt. The General Assembly could also consider asking voters to approve a mechanism for creating and managing debt for capital projects wherein requiring voter approval would not be required for each issue. Numerous states rely on general obligation debt to finance capital projects.

The Issue: *The Colorado Commission on Higher Education's Tuition & Fees Policy currently prohibits institutions from using student fees, tuition, or their general fund increases to pay for academic facility construction needs.*

Option: *The General Assembly could consider allowing student fees to fund academic facilities.*

Issues for consideration. Student fees are another potential source of funds for capital projects. The Governor's Blue Ribbon Panel on Higher Education for the 21st Century discussed the idea of assessing students a facility fee in the range of $100 per year that could be used to

pay for construction projects. One higher education official estimated that this would raise approximately $15 million per year statewide. The fees could be spent directly on projects, or could be a revenue source for a revenue bond or a COP.

The Issue: *New capital construction projects and buildings purchased by the state are not eligible for controlled maintenance dollars for five years after construction or purchase (starting with projects funded for FY 2002-03, the waiting period is 15 years), which means that the estimated future cost of maintaining new buildings is not included in the state's backlog of controlled maintenance projects. Once these facilities are eligible for controlled maintenance funding, however, they contribute to the backlog.*

Option: *The General Assembly could consider requiring capital construction requests to include the cost of out-year controlled maintenance costs.*

Issues for consideration. This proposal would add the estimated cost of future controlled maintenance to the total cost of a project. The estimated cost could be a percentage of the project construction cost, and could vary based on the type of project. The cost could also be reduced if the project is in compliance with certain standards (i.e., it exceeds standard quality of construction materials). Because departments and institutions have only three years to spend capital appropriations, the controlled maintenance line item could be deposited into the Controlled Maintenance Trust Fund. The moneys in the fund would not need to be tied to the specific project, but instead could be "banked" for general controlled maintenance needs.

This change would not necessarily reduce the state's controlled maintenance needs, but it would make more apparent how funding a new building will affect the state's future controlled maintenance needs. In other words, it would provide the General Assembly with a more accurate projection of the costs and benefits of a project. Along with the new 15-year waiting period for controlled maintenance, the change may encourage the construction of higher quality buildings.

APPENDIX A

2003

HOUSE JOINT RESOLUTION 03-1033

BYREPRESENTATIVES King, Spradley, Berry, Boyd, Butcher, Coleman, Fritz, Hall, Hodge, Hoppe, Miller, Romanoff, Rose, Sinclair, Stafford, Stengel, Weddig, and Williams T.;
also SENATORS Anderson, Andrews, and Nichol.

CONCERNING THE REQUIREMENT THAT THE LEGISLATIVE COUNCIL STAFF CONDUCT A STUDY OF CERTAIN CONSTITUTIONAL AND STATUTORY PROVISIONS.

WHEREAS, The state of Colorado is experiencing an economic downturn that has reduced state revenues and affected the ability of the state to provide various programs and services to its citizens; and

WHEREAS, Several amendments to the state constitution, including section 20 of article X (the TABOR amendment), section 17 of article IX (Amendment 23), and section 3 (1) of article X (the Gallagher amendment) of the state constitution, interact so as to limit the ability of the state to address the economic downturn and maintain current service levels for the citizens of the state; and

WHEREAS, Those constitutional amendments were approved by the voters of the state at different times and without full knowledge of the impact the amendments would have on each other and the state's budgetary flexibility; and

WHEREAS, The General Assembly needs to obtain thorough information on how these constitutional amendments interact with each other and certain existing statutory provisions and how they affect the state's budgetary flexibility in order to determine whether modifications to the amendments should be proposed to the citizens of the state; and

WHEREAS, Pursuant to section 2-3-304, Colorado Revised Statutes, the Legislative Council Staff is responsible for providing research services to the General Assembly and, upon direction of the General Assembly, is to conduct studies and provide information to the General Assembly; now, therefore,

Be It Resolved by the House of Representatives of the Sixty-fourth General Assembly of the State of Colorado, the Senate concurring herein:

(1) That the Legislative Council Staff shall conduct a study of the interaction of the TABOR amendment, Amendment 23, the Gallagher amendment, and any other relevant constitutional and statutory provisions and how the amendments impact the ability of the state to provide funding for various programs and services to its citizens.

(2) That, in conducting the study, the Legislative Council Staff may consult with and obtain input and information from appropriate individuals and organizations.

(3) That, upon completion of the study, the Legislative Council Staff shall report its findings to the Executive Committee of the Legislative Council of the Sixty-fourth General Assembly or such interim committee as it may designate by September 1, 2003. The report shall include options available to the General Assembly regarding what, if any, changes to constitutional or statutory provisions the General Assembly could pursue to better enable the state to fund necessary programs and services in times of economic weakness and reduced state revenues.

Lola Spradley SPEAKER OF THE HOUSE OF REPRESENTATIVES	John Andrews PRESIDENT OF THE SENATE
Judith Rodrigue CHIEF CLERK OF THE HOUSE OF REPRESENTATIVES	Mona Heustis SECRETARY OF THE SENATE

APPENDIX B

APPENDIX B
EXPENDITURES

This appendix provides a synopsis of the six largest departments of state government that receive the greatest share of General Fund appropriations. For FY 2003-04, these departments account for 93 percent of all General Fund obligations. In order, the departments are: Education; Health Care Policy and Financing; Higher Education; Corrections; Human Services; and Judicial. The departmental discussions are not comprehensive. Each synopsis focuses on the major programs of the department, expenditures and appropriations for those programs during the state's most recent business cycle, factors which drive expenditures, and recent cost containment measures, if any. This appendix includes information which is the basis for the general observations and conclusions made in Chapter 1. Legislative Council staff would like to thank both the Joint Budget Committee staff and department staff for their assistance in compiling the expenditure information included in this appendix.

Summary of General Fund budget drivers. Each of the six largest departments serves a discrete caseload of individuals. General Fund appropriations and expenditures are driven by the budgetary requirements of these caseloads, most notably caseload size and the cost of the services provided. The costs of serving these populations are influenced by legal, demographic, and economic factors.

Legal factors. Constitutional, statutory, and federal requirements can have a significant effect on caseloads, as noted in the examples below.

- ✓ *Constitutional requirements*. The Colorado Constitution requires the General Assembly to provide for the establishment and maintenance of a thorough and uniform system of free public schools throughout the state for all residents between the ages of 6 and 21.

- ✓ *Statutory requirements.* Criminal sentencing laws and statutory parole guidelines affect the number of inmates and the length of stay in correctional facilities. Similarly, the probation statutes define eligibility requirements, which affect the number of probationers for the Judicial Branch.

- ✓ *Federal requirements.* The federal government shares in the costs of a number of programs funded in the six largest departments. As such, the federal government establishes parameters for all of the programs it participates in. For example, because Colorado opts to participate in Medicaid, it must adhere to federally mandated rules and conditions of the program stipulating which populations must be served and what benefits they must receive.

Broadly speaking, the General Assembly has limited control over caseload growth for programs with constitutional and/or federal requirements, but direct control over caseload growth for those programs governed only by statutory requirements.

General economic conditions and population growth. Caseloads and the cost of providing services to individuals are affected by general economic conditions and population growth. When the state and national economies are booming, the state typically experiences an increase in tax revenues, population growth, and inflation, which in turn increases caseloads and program costs for certain departments. When the economy is stagnating, the state will usually experience a decrease or slowdown in tax revenues, lower net migration, and a reduction in inflationary pressures, but caseloads and program costs for specific departments will also increase. The following briefly describes how caseloads and program costs are affected by economic expansions and contractions.

First, caseloads for certain departments will increase during an economic downturn. This heightens budgetary pressures for the General Assembly because expenditures may be growing more rapidly than tax revenues. Of the six largest departments, caseload growth during an economic recession will be the most significant for the following:

- ✓ **Higher Education —** student enrollments tend to increase at a faster rate when the economy stagnates and jobs are not readily available. This places upward pressure on General Fund expenditures for public universities and colleges, or requires an increase in tuition to offset enrollment-related costs.

- ✓ **Health Care Policy and Financing** — Medicaid caseloads increase when employment conditions deteriorate and a greater number of people become indigent. The cost of providing Medicaid-related services for the department increases as a result.

- ✓ **Corrections and Judicial** — criminal activity, such as felonies and homicides, tends to increase when unemployment rises and income levels drop. This results in additional case filings with the Judicial Branch and puts additional people in correctional facilities.

Second, caseloads and program costs for certain departments will increase when the state's economy is growing. Of the six largest departments, caseload growth or program costs will be the most pronounced for the following during an economic expansion:

- ✓ **Education** — K-12 enrollments are directly related to population growth. When the economy is healthy and jobs are plentiful, more families move to Colorado, resulting in additional enrollment in elementary and secondary schools.

- ✓ **Health Care Policy and Financing and Human Services** — the costs of medical services and supplies, which have increased faster than the general rate of inflation, will increase program costs during economic expansions. Additionally, both departments contract with community providers to deliver services to eligible clients.

To ensure that community provider arrangements remain viable over the long term, the General Assembly has historically awarded annual inflationary increases for these providers.

- ✓ **Corrections and Judicial** — a robust economy encourages more people to move to Colorado, which increases case filings with the Judicial Branch. This increases workload and may ultimately increase the number of incarcerations.

Consequently, for the six largest departments, general economic conditions exert upward pressure on expenditures when the economy is both expanding and contracting. The principal reason for this anomaly is that caseloads are positively related to unemployment, income levels, and population growth.

DEPARTMENT OF EDUCATION

The Department of Education supports the State Board of Education in its duty to exercise general supervision over public schools, including accrediting public schools and school districts. It also develops, promotes, and delivers adult education and library services; distributes state and federal aid moneys to local public school districts; and administers direct educational services at the Colorado School for the Deaf and Blind.

Expenditures and Appropriations

Figure B-1 shows the total state expenditures and current appropriation to the Department of Education since FY 1990-91. Total expenditures have increased steadily during this time period from $1.3 billion in FY 1990-91 to $3.3 billion in FY 2003-04. This amount represents an average increase of 7.65 percent per year over the 13 years.

Figure B-1
Department of Education Expenditures
by Source of Funds

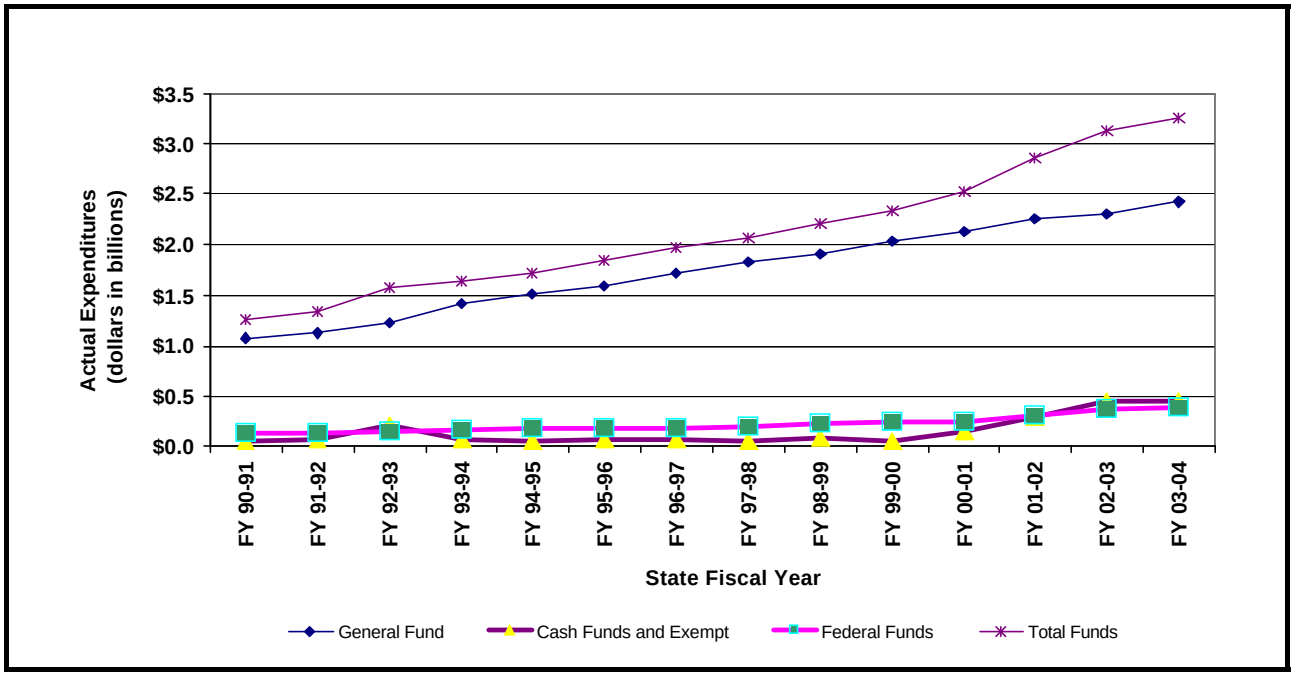
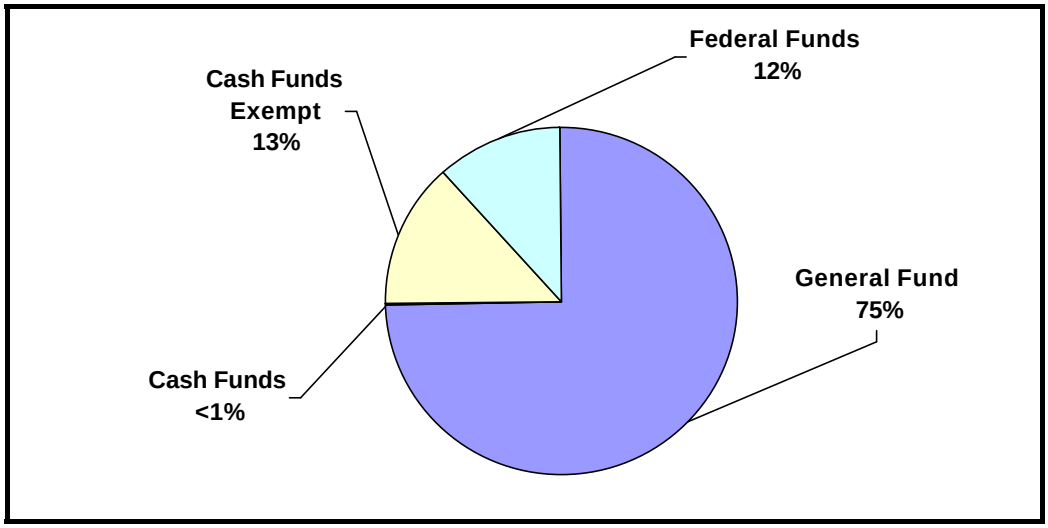


Figure B-2 shows the funding source and percentages that contribute to the total appropriation amount for FY 2003-04.

Figure B-2
Department of Education Funding Source
FY 2003-04 Appropriation



Colorado's School Finance Act

Colorado's school finance act distributes over $4.2 billion annually in state and local dollars to the state's 178 school districts for K-12 public education. Currently, these moneys are allocated under a law called the "Public School Finance Act of 1994." The school finance act contains a formula that calculates a per pupil funding amount for each school district based on the individual characteristics of the district, such as the cost to live in the district and the number of students enrolled.

As can be seen from Figure B-3 the state's share of funding has increased at a faster pace than the local share, particularly since the enactment of Amendment 23 in 2000. Figure B-3 shows both the state and local share of school funding since the creation of the new School Finance Act of 1994.

This increase is discussed further in the section explaining the *Effects of Amendment 23*. Associated with school finance funding, Figure B-4 shows the rate of growth of per pupil funding since the enactment of the 1994 Act.

The state's share of total program funding represented nearly 79 percent of the budget allocated to the Department of Education – almost entirely consisting of state General Fund.

Figure B-3
School Finance Act Funding

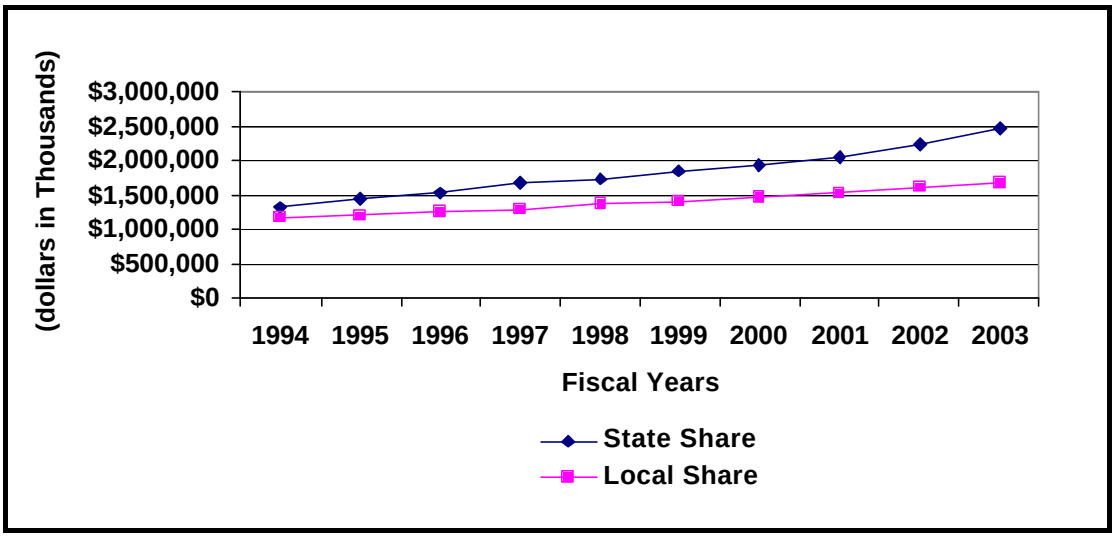
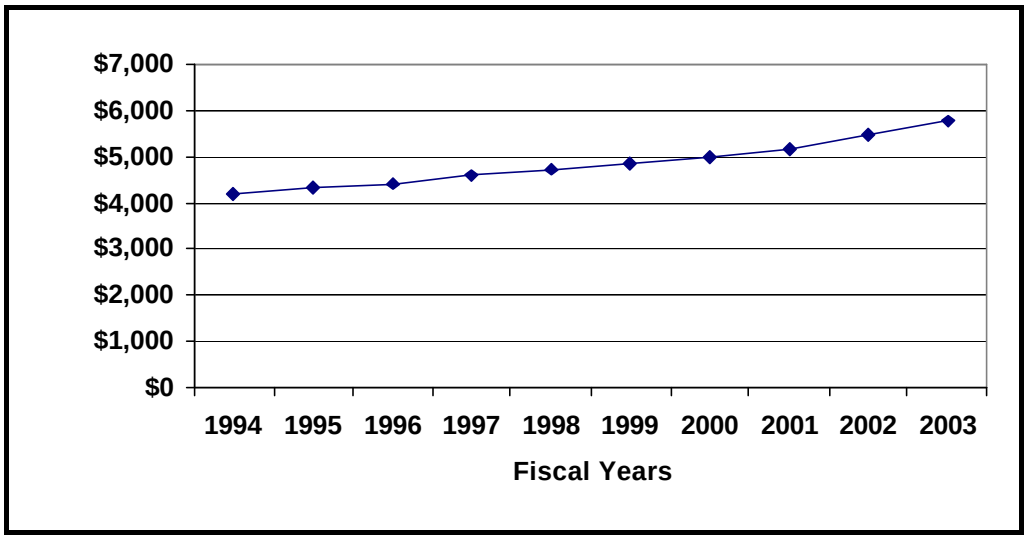


Figure B-4
School Finance Per Pupil Funding



K-12 enrollment growth. The number of students funded in the state's public schools has increased from 550,207 in FY 1990-91 to 715,793 in FY 2002-03 (last count). Figure B-5 shows the relative growth in enrollment compared to the growth in the state's general population. While enrollment tracks rather consistently with the increase in general population, its increase has been slightly below that of population.

Figure B-5
K-12 Enrollment Growth
Compared to State Population

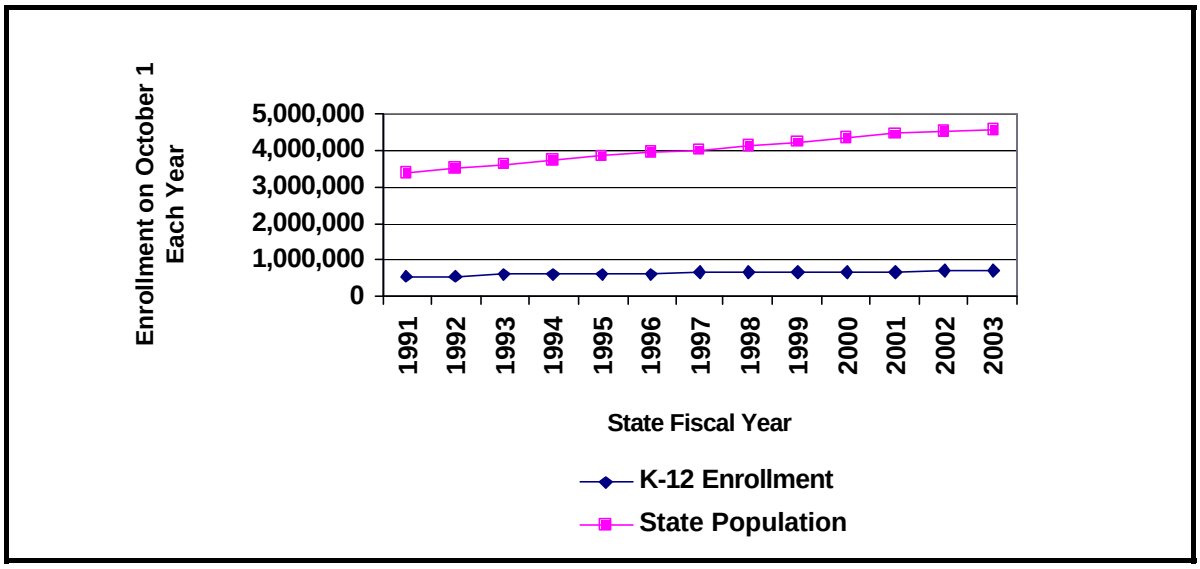
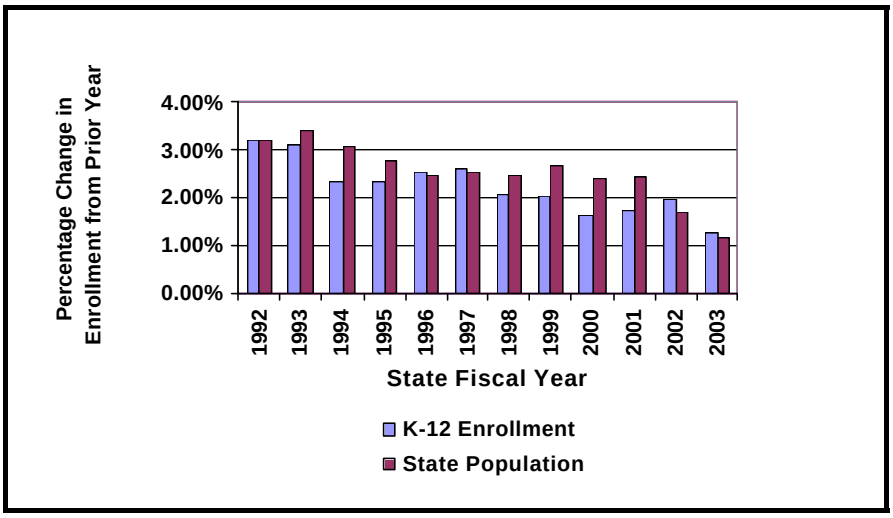


Figure B-6 show the percentage change in growth for both K-12 enrollment and population.

Figure B-6
K-12 Enrollment and State Population Growth



This figure also shows that growth rates have been and are declining since a peak rate during FY 1992-93. Growth rates for both enrollment and population were approximately 1.2 percent for FY 2002-03.

To the extent that the economy influences population migration, K-12 enrollment is likewise influenced by the economy. During a recovery period when jobs are created resulting in an increase in migration of population, it can be expected that Colorado will see a corresponding increase in enrollment in public schools.

Amendment 23

Amendment 23, passed by the voters in 2000, was designed to guarantee an increased level of funding to the state's public schools. It requires an increase in per pupil funding and total state funding for categorical programs by at least inflation plus one percent per year until FY 2010-11 and by the inflation rate thereafter.

It is not possible to predict what funding level would have been enacted by the General Assembly absent the passage of Amendment 23. However, given the recent economic conditions and the constraints on the state budget, it is reasonable to assume that the amendment has required an increase in state aid for K-12 education above what the General Assembly would have funded.

If the General Assembly would have increased K-12 education funding at the level of inflation, as was the case in recent years, then the requirement of Amendment 23 would indicate that the effects of the amendment would approximate the one percent requirement. Figure B-7 illustrates the difference in state aid without the one percent increase – state aid with inflation only.

Figure B-7
Effects of Amendment 23 on State Aid
K-12 Education Funding
(dollars in millions)

Fiscal Year	State Aid Inflation Plus 1 Percent	Inflation Only	Difference (1 Percent Requirement)
FY 2003-04	$2,619.7	$2,579.8	-$39.9
FY 2004-05	$2,762.2	$2,677.7	-$84.5
FY 2005-06	$2,928.9	$2,796.1	-$132.8
FY 2006-07	$3,144.8	$2,958.4	-$186.4
FY 2007-08	$3,336.0	$3,091.2	-$244.8

Amendment 23 also creates the State Education Fund (SEF) in the State Treasury. One-third of one percent of taxable income is diverted to the fund. Money in the SEF can be used to meet the funding requirements of the amendment. Further, the amendment requires the General Assembly to, at a minimum, annually increase the General Fund Appropriation for Total Program funding by an amount not below five percent of the prior year appropriation. The requirement does not apply in any fiscal year in which Colorado personal income grows less than four and one-half percent between the two previous calendar years.

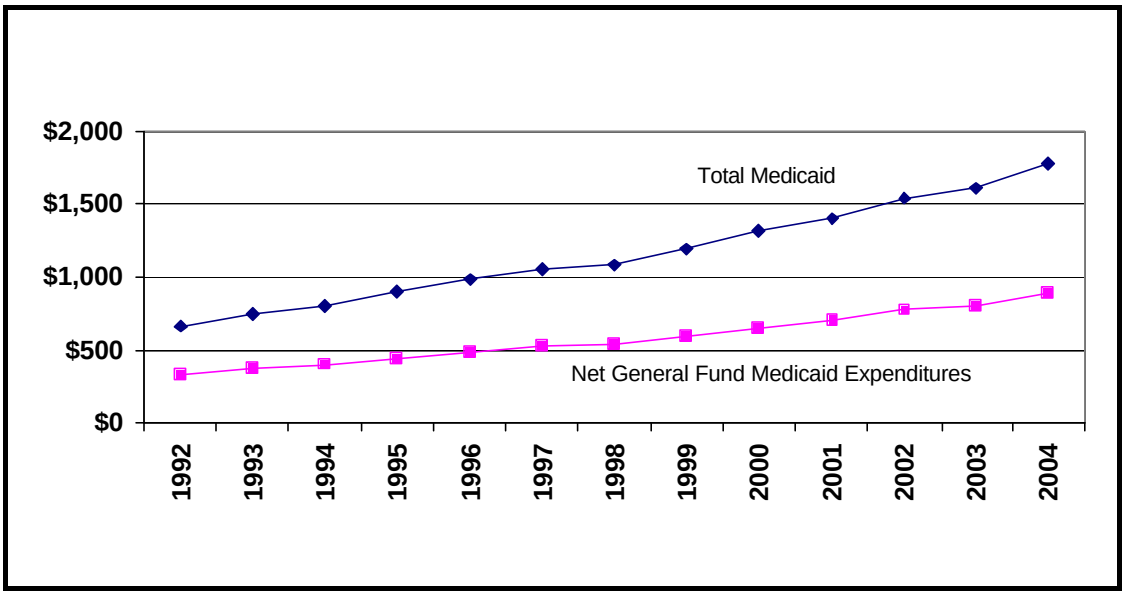
Effects of Gallagher and Tabor

The combination of the Gallagher amendment and TABOR effectively places the burden of increased funding for K-12 education from Amendment 23 on the state. The Gallagher Amendment limits the amount of property taxes paid by residential property. The residential assessment rate has decreased since enactment of Gallagher to keep the assessed value percentage of residential to nonresidential property about the same. Without the ability to increase the mill levy without a vote of the people (TABOR requirement), the slow growth of property tax revenue has shifted funding responsibility to the state. TABOR also limits the amount of property taxes that school districts can receive, further contributing to the shift in state funding.

DEPARMENT OF HEALTH CARE POLICY AND FINANCING

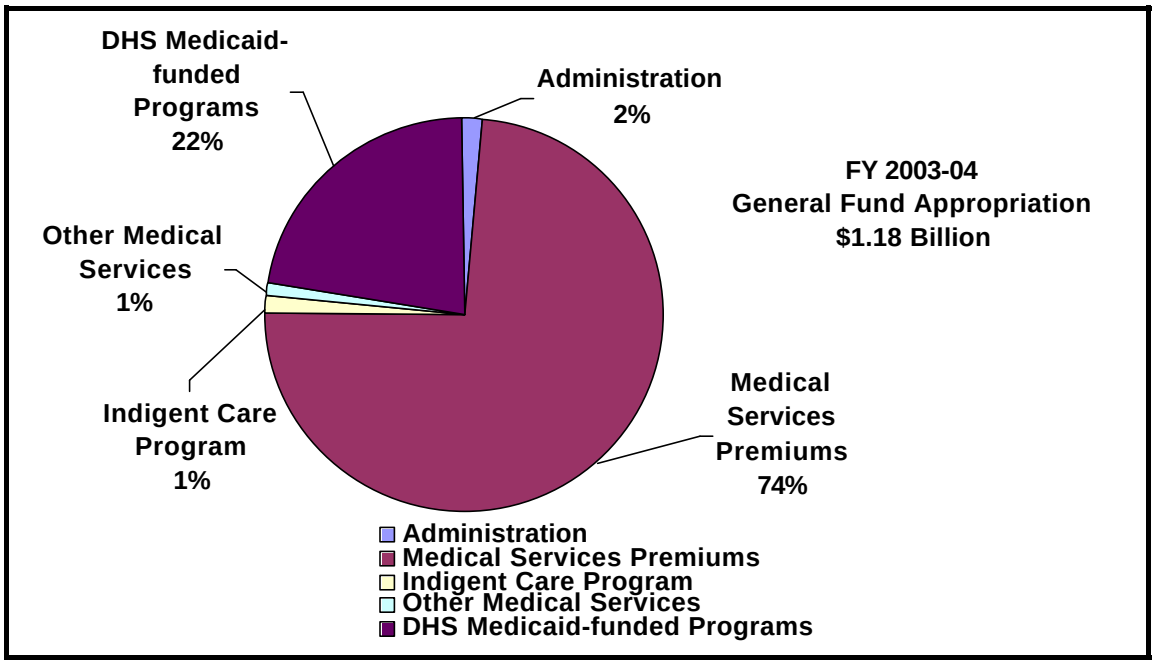
The Department of Health Care Policy and Financing (DHCPF) administers the state's Medicaid program, Indigent Care Program, the Comprehensive Primary and Preventive Care Grants Program, the Home Care Allowance and Adult Foster Care programs, the Children's Basic Health Plan, and Senate Bill 97-101 public school Medicaid-funded health care services, in conjunction with the Department of Education. The department is the single state agency for the receipt of federal Medicaid funds. For FY 2003-04, an estimated $300 million of the department's General Fund appropriation is transferred to other state departments receiving Medicaid funds: Education; Higher Education; Human Services; Public Health and Environment; and Regulatory Agencies.

Figure B-8
Total Medicaid and Net General Fund Medicaid Expenditures
(million of dollars)



The two largest General Fund appropriations made in the DHCPF are for the Medicaid program and the Department of Human Services Medicaid-funded programs. Together, funding for these programs in FY 2003-04 constitutes 96 percent of the department's General Fund appropriation. This section is limited to a discussion of the DHCPF Medicaid program which accounts for 74 percent of the department's budget (noted on Figure B-9 as Medical Services Premiums).

Figure B-9
DHCPF Programs Receiving General Fund



Medicaid

The Medicare and Medicaid programs were federally created in the Social Security Act Amendments of 1965:

Medicare	Medicaid
Medicare is a 100% federal health insurance program for the elderly funded by a dedicated tax (part of the FICA tax rate) and trust fund. Medicare provides acute care coverage but does not provide long-term care. Medicare is not a means-tested program and all eligible individuals 65 and older qualify.	Medicaid is a health insurance plan for the poor providing both acute and long-term care coverage, funded and administered jointly by the federal government and the states. Unlike Medicare which receives its funding through a dedicated tax, Medicaid funding at both the federal and state level relies on general taxation. Medicaid is a means-tested program wherein individuals must meet certain income criteria and asset tests in order to qualify.

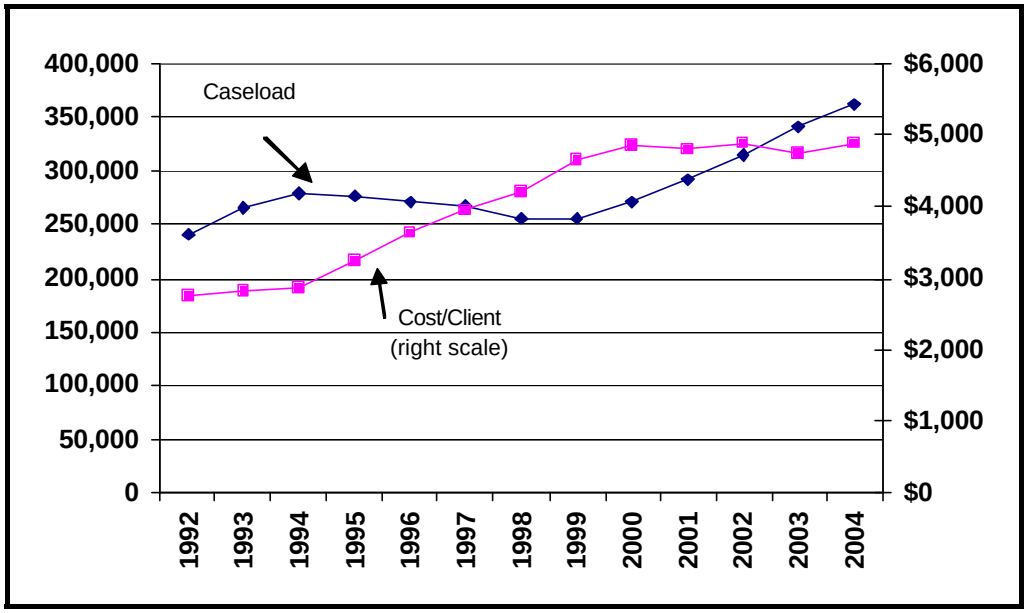
States are not required to have a Medicaid program. However, if a state opts to participate in Medicaid, the state must adhere to federally mandated rules and conditions of the program. Figures B-11 and B-12 identify the federally mandated populations and services to be included in state Medicaid plans in addition to federally approved optional populations and services. The federal government shares in the program's cost based on a state's per capita income compared with the national average. The matching rate cannot be lower than 50 percent or higher than 83 percent. Colorado's federal matching rate has been approximately 50 percent

over the past decade. Currently, all 50 states, the District of Columbia, and the five U.S. territories have Medicaid programs. Colorado created its Medicaid program in FY 1968-69.

As a health insurance program for the poor, disabled, and elderly, Medicaid provides essential medical services to Colorado's most vulnerable and at-risk populations. For FY 2003-04, an estimated 363,000 Medicaid clients will be served each month. In Colorado, Medicaid provides health insurance coverage for 1 out of 3 births, 1 out of 6 children, and 6 out of 10 persons in nursing home care.

Factors contributing to Medicaid expenditures. Two primary factors which contribute to Medicaid expenditures are caseload growth and the increased cost of providing medical services and supplies.

Figure B-10
Medicaid Caseload and Cost/Client



Medicaid caseload. From April 1990 through July 2001, Colorado's general population increased from 3.3 million to 4.4 million, or 33 percent. During this same time period, Medicaid's average monthly caseload grew from approximately 200,000 to 293,000, or 47 percent. The estimated monthly Medicaid caseload for FY 2003-04 is 362,537. Medicaid caseload growth is attributed to several factors: federal and state policy/program changes; growth in the general population; fluctuations in the economy; and length of stay.

Listed below are the major federal policy changes since 1988 which expanded Medicaid's caseload. As federal requirements changed, Colorado adopted statutory changes to comply with federal law.

Year	*Federal Changes in Medicaid Requirements*
1988	Congress requires states to cover pregnant women and infants up to 100 percent of the federal poverty level (FPL), and adds qualified Medicare beneficiaries to program.
1989	Congress requires states to cover pregnant women and children under age 6 up to 133 percent of FPL.
1990	Phased-in coverage for children ages 6 through 18 under 100 percent of FPL begins (last age cohort phased in during FY 2002-03).
1996	Congress enacts welfare reform. The Aid to Families with Dependent Children (AFDC) entitlement program is replaced with the Temporary Assistance for Needy Families (TANF) program. Under TANF, enrollment/termination of Medicaid is no longer automatic with receipt/loss of welfare cash assistance.
1997	Congress adopts the Children's Health Insurance Program. (Colorado's Children's Basic Health Plan was implemented as a stand-alone program and is not part of the state's Medicaid program.)

From January 1990 through July 1994, Colorado experienced 55 straight months of above average caseload growth, attributed in large part to the phasing in of new federally required populations, overall population growth, and an economic downturn. More recently, from March 1999 through March 2003, it has experienced 49 straight months of above average caseload growth due to the state's economic recession. Low-income children and low-income adults are responsible for Medicaid's recent caseload growth. As the economy improves, it is anticipated that the Medicaid caseload will slow and may actually decline because length of stay for low-income children and adults will be shortened. The Medicaid caseload was in decline between FY 1994-95 and FY 1998-99 because of Colorado's booming economy.

Cost of Medicaid services. Several factors contribute to what the state pays for medical services and supplies in the Medicaid program:

- ✓ medical inflation;
- ✓ a statutorily established formula for nursing home reimbursement rates;
- ✓ rates set through rule by the Department of Health Care Policy and Financing for a variety of medical services and supplies (i.e., hospital payments, pharmaceuticals, durable medical equipment, etc.);
- ✓ application of the Medicare reimbursement rate (or percentage of) for certain services; and
- ✓ policy initiatives adopted by the General Assembly that affect reimbursement rates for providers.

The medical inflation rate is higher than that for other goods and services. For 2002, the Denver/Boulder CPI inflation rate for "all items" was 1.9 percent and 3.6 percent for health care. Although medical inflation is currently lower than that of the early 1990s (7.4% in 1992), the U.S. Department of Labor states that medical inflation is on the rise, fueled largely by cost increases in prescription drugs and hospital services.

Factors such as the availability of health care workers/providers and the cost of malpractice insurance play a role for the DHCPF in setting rates through rule and for the General Assembly when setting provider rates during the budget process.

Health care costs are also attributable to the number of services clients use and a client's medical risk factors. New Medicaid clients often have "pent-up" medical needs and use more services than the general population. Additionally, costs are driven up by the acuity level of clients served by the program. For example, serving large numbers of clients with heart disease, diabetes, or biologically-based mental illnesses increases the Medicaid program's overall cost.

Cost per client. In FY 1991-92, the average cost per Medicaid client was $2,758.23. In FY 2001-02 (last year with actual expenditures), the average cost per Medicaid client was $4,867.29. This represents an increase in cost-per-client services of 76.4 percent over this time period. In addition to medical inflation and utilization of services, the cost-per-client was impacted by two other factors:

- ✓ *Expansion Populations:* During the early 1990s, the Medicaid expansion populations were mainly children, low-income adults, and elderly persons with Medicare coverage. Because children and low-income adults have little or no long-term care needs and are healthier than disabled and elderly populations, adding these populations tend to reduce the overall cost-per-client.

- ✓ *Spreading Risk/Acuity Mix*: Colorado's Medicaid caseload is comprised of core and fluctuating clients. Core clients are clients with acute illness or long-term disabilities who rely on Medicaid for insurance coverage for extended periods of time. Fluctuating clients are clients whose length of stay on Medicaid is relatively short (usually 1 year or less). During economic recessions, the Medicaid caseload expands with the fluctuating clients who usually have lower health care costs than the core clients. Therefore, the medical risk for the core clients is spread against a larger number of people and the overall cost per client decreases.

Cost containment measures. Colorado has attempted to contain Medicaid costs in both good and bad economic times. Over the years, several cost containment measures have been tried, from enacting community-based waiver programs in order to reduce expensive institutional care to experimenting with managed care. Despite these efforts, General Fund expenditures in the Medicaid program have grown, on average, 6.3 percent annually since FY 1990-91.

Senate Bill 03-176 is the most recent measure adopted by the General Assembly to control Medicaid's costs. Although the bill eliminated optional legal immigrants from the state's Medicaid plan, the matter is currently before the 10th Circuit Court of Appeals. To date, optional legal immigrants continue to receive Medicaid services.

Figure B-11
Medicaid Eligible Populations

Federally Mandated Populations	Federally Approved Optional Populations Colorado Serves
Children who are under age 6 and below 133% of the federal poverty level (FPL) and children ages 6 through 18 who are below 100% FPL and meet other eligibility requirements. FY 2003-04 estimated caseload is 190,588 (52.6% of total Medicaid caseload).	Persons whose income is up to 300% of the SSI payment level and require long-term care. Caseload not separately tracked and included in the mandatory SSI caseload.
All children who are recipients of foster care and adoption assistance under Title IV-E of the Social Security Act. FY 2003-04 estimated caseload is 13,397.	Medicaid Buy-In: Persons previously Medicaid eligible under an SSI category but due to employment income or improved medical condition are no longer eligible. Caseload not separately tracked and included in the mandatory SSI caseload.
Adults who meet the eligibility requirements that were in place under the AFDC program in 1996. FY 2003-04 estimated caseload is 47,215.	Children who are recipients of foster care but are ineligible in the mandatory category through Title IV-E of the Social Security Act. Caseload not separately tracked and included in the mandatory foster care and adoption assistance caseload.
Pregnant women at or below 133% of FPL. FY 2003-04 estimated caseload is 6,303.	Women with breast and/or cervical cancer who have been screened by the U.S. Department of Health, meet certain income guidelines, and have no insurance coverage. FY 2003-04 estimated caseload is 117.
Persons eligible for Supplemental Security Income (SSI). FY 2003-04 estimated caseload is 90,950 (3 subcategories).	**Federally Approved Optional Populations Colorado Does Not Serve**
Qualified Medicare Beneficiaries and Special Low-Income Medicare Beneficiaries (QMBs and SLMBs). FY 2003-04 estimated caseload is 9,450.	Optional Legal Immigrants — population was eliminated from Medicaid eligibility in SB 03-176. This matter is currently before the 10th Circuit Court of Appeals and has not yet been implemented.
Emergency Services for Noncitizens. FY 2003-04 estimated caseload is 4,634.	Poverty-related Groups: Women and children with incomes higher than that defined for the mandatory population.
	Medically Needy: Persons not meeting income requirements for benefits but have income with "medically needy" limits established by the state.

Figure B-12
Medicaid Services

Federally Mandated Services (§ 26-4-202, C.R.S.)	Federally Approved Optional Services Colorado Provides (§ 26-4-302, C.R.S.)
Inpatient Hospital Services	Prescribed Drugs
Outpatient Hospital Services	Clinic Services
Other Laboratory and X-ray Services	Home- and Community-Based Services for: the elderly, blind and disabled; developmentally disabled persons; persons living with AIDS; persons with major mental illness; and persons with brain injury
Physician Services	Optometrist Services
Nursing Facility Services	Eyeglasses (when necessary after surgery)
Home Health Services	Prosthetic Devices
Early and Periodic Screening, Diagnosis and Treatment (EPSDT) for Persons Under Age 21	Rehabilitation Services to Community Health Centers
Family Planning	Transportation
Rural Health Services	Intermedicare Care Facilities for the Mentally Retarded
Nurse-midwife Services	Inpatient Psychiatric Services for Persons Age 65+
Pediatric Nurse Practitioner Services	Case Management
Family Nurse Practitioner Services	Therapies Under Home Health Services (speech and audiology, physical, and occupational)
Federally Qualified Health Centers	Licensed Psychologist Services
Federally Appoved Optional Services Colorado Does Not Provide	Private Duty Nursing Services
Chiropractic Services	Podiatry Services
Medical Social Worker Services	Hospice Care
Dental Services (emergency care only)	Program of All-inclusive Care for the Elderly
Dentures	Treatment Program for High-Risk Pregnant Women (alcohol and drug addiction)
Christian Science Nurses	Disabled Children Care Program
Christian Science Sanitoriums	Residential Child Health Care
Tuberculosis-related Care	Children's Personal Assistance Services and Family Support

HIGHER EDUCATION

The Department of Higher Education's primary role is to provide education beyond K-12 for Colorado residents through its 26 state campuses, two local district junior colleges, and four area vocational schools. The Department's divisions include the Colorado Commission on Higher Education, Council on the Arts, Historical Society, Private Occupational Schools, Student Loan Program, and the Student Obligation Bond Authority.

Over the years, the department has been primarily funded by both General Fund support and by tuition paid by students. The latter is represented by cash funds in the following text and graphs. Beginning in FY 2002-03, cash funds have outpaced General Funds in support of the department. Because of the downturn of the economy and resulting cutbacks of state General Fund appropriations, Higher Education has been forced to rely more heavily on tuition paid by students. Federal funds and other cash funds such as fees also make-up total funding, but are a much smaller source compared to General Fund and cash funds. The following two figures illustrate the funding source and expenditure history of the department from FY 1990-91 through the appropriation for FY 2003-04 and the actual percentage funding splits for the current
FY 2003-04 appropriation.

Figure B-13
Higher Education Expenditures
By Source of Funds
(dollars in millions)

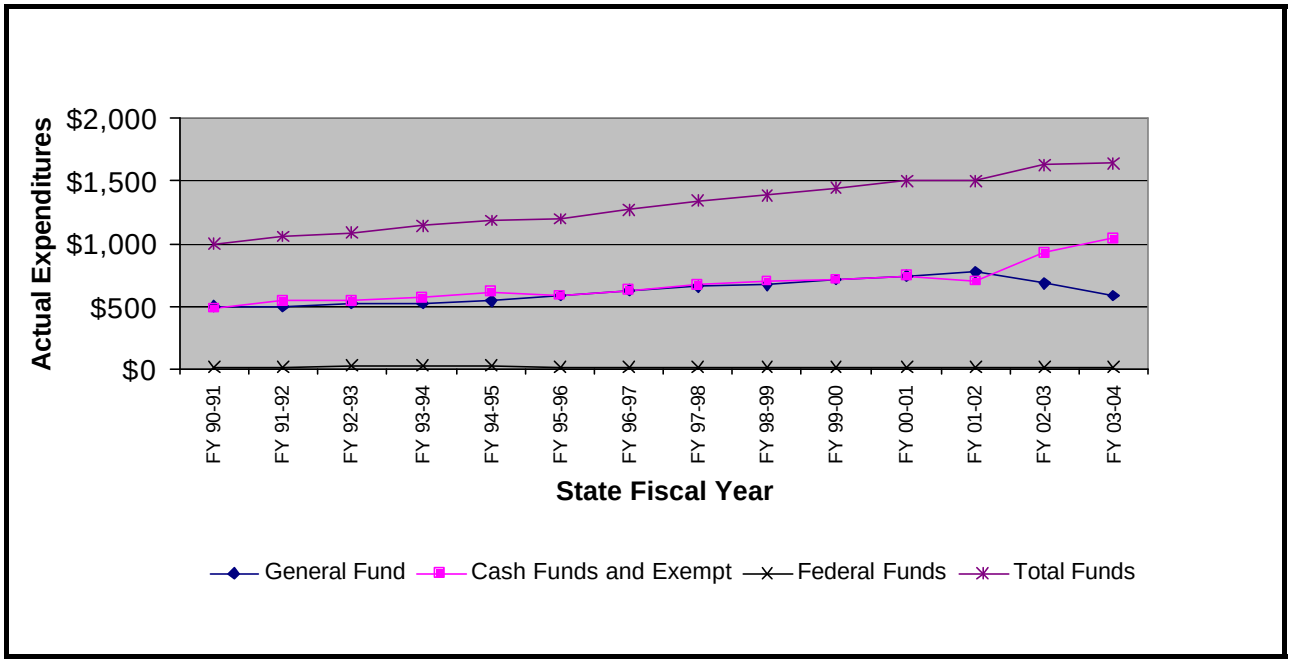
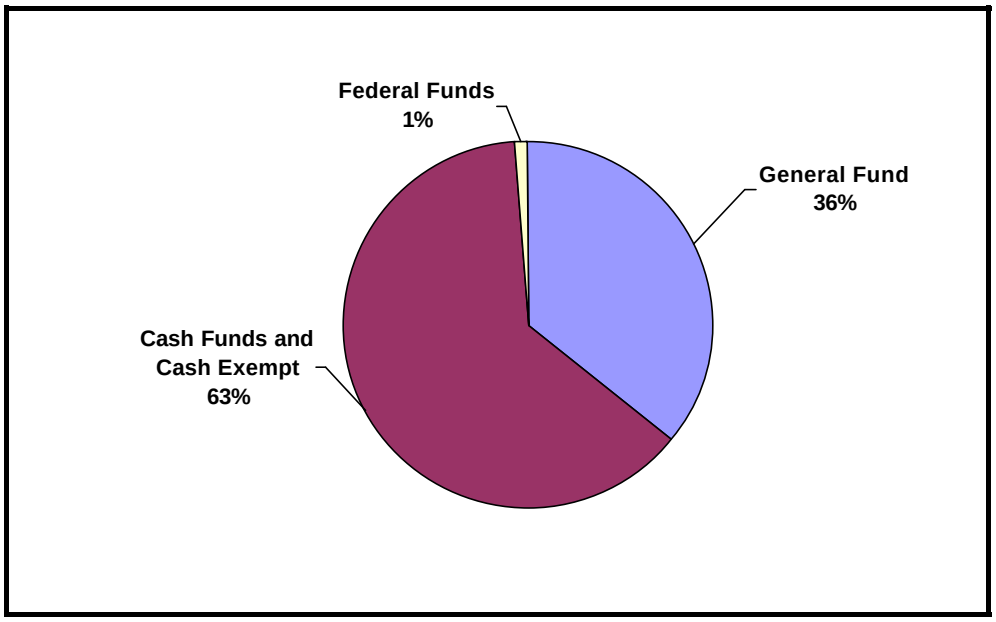


Figure B-14
Higher Education Funding Source
FY 2003-04 Appropriation



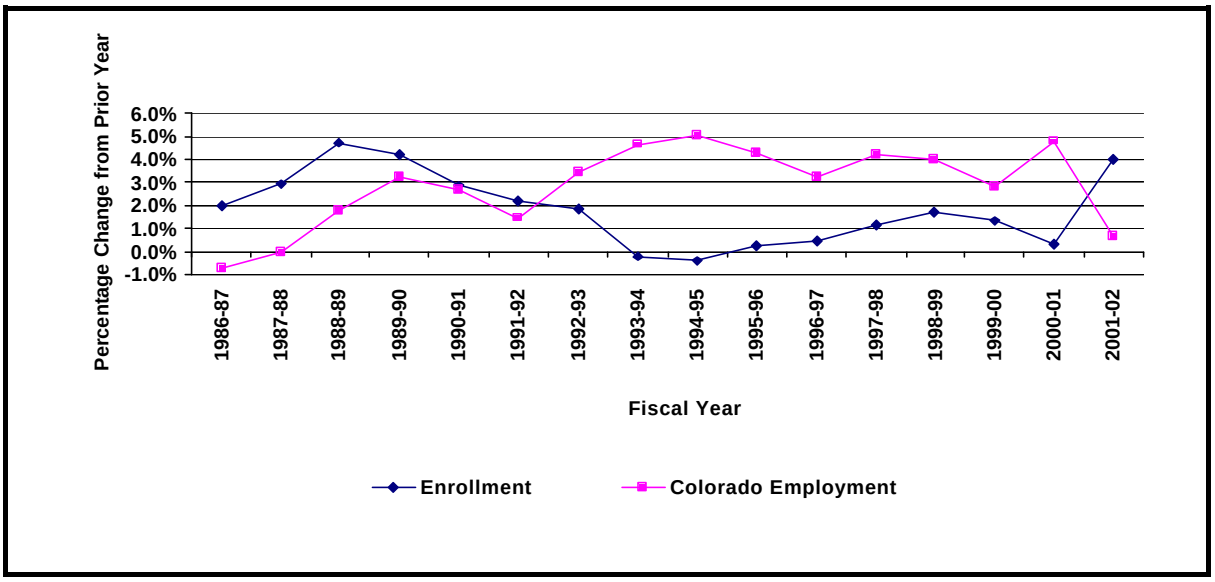
Factors Influencing Expenditures and Driving the Budget:

The major factors influencing the budget for higher education are as follows:

- ✓ enrollment growth;
- ✓ inflation;
- ✓ performance funding as measured by the quality indicator system; and
- ✓ tuition.

Enrollment growth. Enrollment growth tends to be counter to the economy. In Figure B-15, enrollment growth is compared to employment growth. As can be seen from the figure, enrollment tends to be higher in those years that employment growth is declining and vice versa. It is believed that a lack of jobs in the workforce causes students to either stay in school longer or enroll in programs in hopes of increasing their own marketability. This phenomena causes a higher demand on state resources during those years of larger enrollment growth when state resources available for expenditures are lower. Small increases in student enrollment can cause a significant need for General Fund support.

Figure B-15
Higher Education Enrollment Growth Compared to Employment Growth



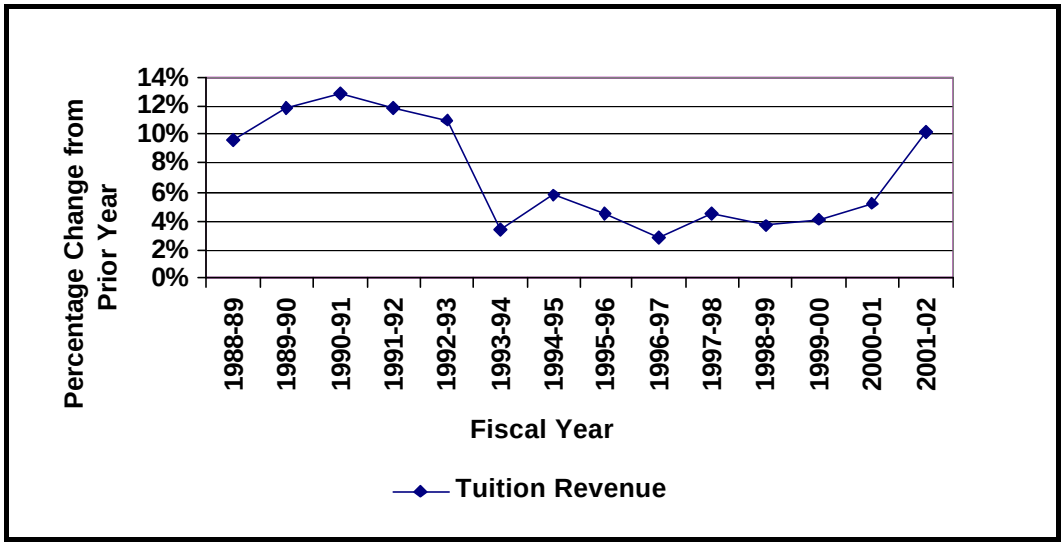
Inflation and performance funding. Similar to other state departments, institutions of higher education require an increase in base funds to keep up with rising costs such as supplies, maintenance, and faculty salary increases. Prior to FY 2000-01, the General Assembly appropriated increases in funding to higher education roughly equivalent to the inflation rate as measured by the Denver/Boulder Consumer Price Index (CPI). Beginning in FY 2001, the legislature appropriated funds based on the performance of higher education institutions as measured by the quality indicator system developed by the Colorado Commission on Higher Education (CCHE). Some funds continue to be appropriated based on inflation, primarily due to the unique characteristics of certain programs such as: CU Health Sciences Center, CSU Veterinary Medicine, CSU Cooperative Extension, CSU Forestry Service, and CSU Agriculture Experiment Station. Beginning in FY 2002-03, the Colorado School of Mines switched from being part of the performance funding formula to receiving an inflation-based increase.[1]

Tuition. Prior to the passage of TABOR, the governing boards generally had total authority to set tuition policy. TABOR authorizing legislation still allows that flexibility, but allows the General Assembly, through the appropriations process, to cap tuition and set the maximum revenue that schools can earn through legislative intent as stated in the long bill footnotes.

1. FY 2003-04 Budget Briefing. Staff Presentation to the Joint Budget Committee

Figure B-16 shows the decline in rate of growth in tuition beginning in FY 1993-94 followed by a relatively flat rate of increase until FY 2000-01 at which time the demands of the state budget severely cut General Fund moneys to higher education, causing a need for increased funding coming from tuition.

Figure B-16
Higher Education Tuition Revenue Growth



In some years, the legislature has attempted to "buy down" resident tuition by holding rate increases below the increase in the CPI and substituting General Fund for the difference in tuition revenue to the higher education institutions. In FY 2002-03 the General Assembly did this for just the Community Colleges, rather than the entire system, to reduce tuition increases by two percentage points.[2]

Unique Statutes Related to Funding Higher Education

The following are several aspects about the funding of higher education institutions that are unique from funding other state agencies:

- ✓ CCHE, after consulting with the governing boards, makes annual system-wide funding recommendations for the state funded higher education institutions to the General Assembly and the Governor, after consulting with the governing boards, CCHE establishes the distribution formulas of General Fund and tuition cash fund appropriations to each governing board to reflect:

2. FY 2003-04 Budget Briefing. Staff Presentation to the Joint Budget Committee

- the statutory roles and missions of the institutions;
- fixed institutional costs and those that vary with enrollment and program changes;
- an emphasis on decentralized decision making and stability of funding; and
- achievement of the statewide expectations and goals as measured by the quality indicator system.

✓ The amount of cash funds (i.e., tuition income, fees, indirect cost recoveries) appropriated in the Long Bill for the governing boards is the maximum amount of cash funds that the governing boards can raise for the fiscal year;

✓ The annual appropriations of General Fund and tuition cash funds are made as a single line item to each governing board for the operation of its campuses consistent with the distribution percentages developed by CCHE. The annual appropriations of non-tuition revenue are also made as a single line item to each governing board for the operation of its campuses;

✓ Each governing board allocates their appropriations to the institutions under its control in the manner deemed most appropriate by the board. In allocating its General Fund appropriations, each governing board is to consider the progress made by the institutions under its control toward achieving the statewide expectations and goals, as measured by data received through the quality indicator system. The governing board is also to ensure that any amount required to be set aside for application to achieving the statewide expectations and goals is allocated for that purpose;

✓ The governing boards are authorized to retain all moneys appropriated from fiscal year to fiscal year; and

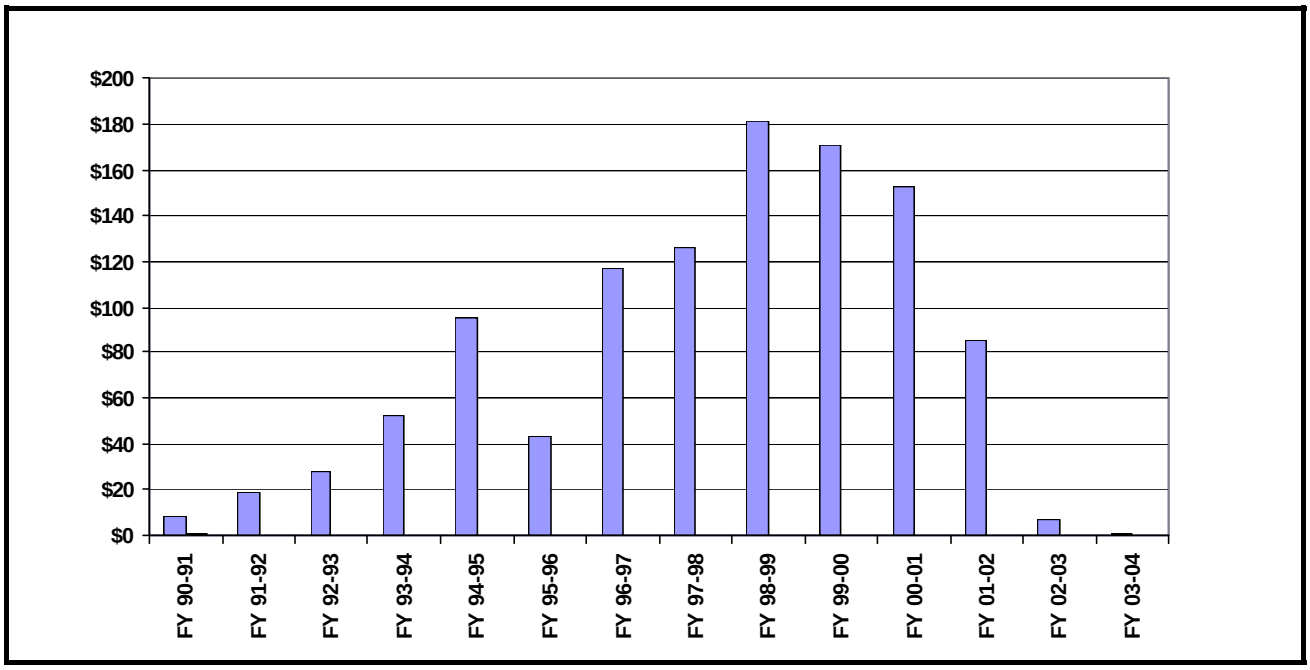
✓ All money raised by a governing board is available for expenditure only by that governing board and cannot be transferred or otherwise made available for expenditure by any other governing board.

Higher Education Capital Construction

Although higher education receives roughly 13 percent of the state's operating budget, it historically received 39 percent of capital construction funds because of the total square footage of buildings and structures. The square footage of higher education facilities amounts to roughly 63 percent of all state buildings. As Figure B-17 illustrates, state funding for capital construction and controlled maintenance grew steadily from FY 1990-91 through FY 1998-99 where it began a significant decline to the present FY 2003-04 appropriation level of $519,779.

Given the current constraints of the state's revenue and expenditure limitations, funding for capital construction and controlled maintenance is not likely to reach the funding level of FY 1998-99 in the foreseeable future even when the state revenue picture improves. To the extent possible, funding for these items in the short-term will more than likely come from other sources. Institutions may struggle to meet the balance of programs versus infrastructure.

Figure B-17
Higher Education Capital Construction/
Controlled Maintenance Appropriations
(dollars in millions)

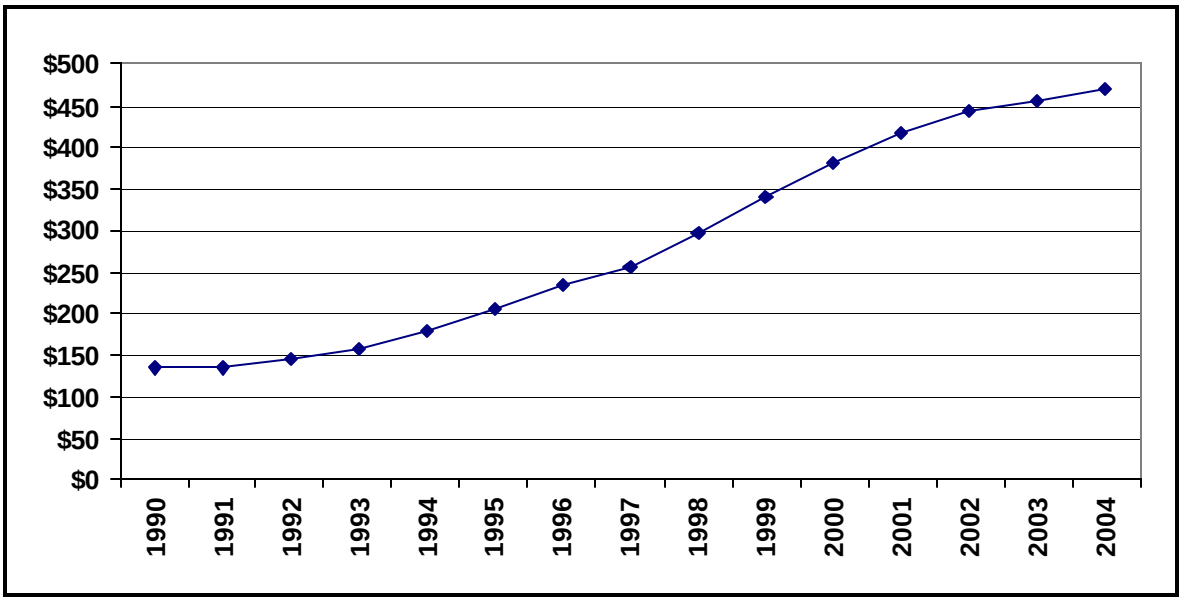


DEPARTMENT OF CORRECTIONS

The Colorado Department of Corrections is responsible for managing and supervising the penal, correctional, and reformatory institutions of the state; operating a counseling and parole supervision program to enable incarcerated persons to regain productive independence; and developing and administering a correctional industries program to supply manufactured products to state institutions and to provide rehabilitative benefits for inmates. Presently, the Department of Corrections operates 24 prisons throughout the state, each with varying levels of security. The department also contracts for prison capacity with several county and private facilities.

Of the department's total appropriation in FY 2003-04, approximately 88 percent comes from General Fund revenues. From 1989-90 until FY 2003-04, General Fund expenditures of the department have increased from $133 million to $470 million, or at an average annual rate of 9.4 percent. Of the six largest state agencies, the Department of Corrections had the fastest rate of growth in this period of time. In comparison, total General Fund expenditures have increased at an average annual rate of 5.8 percent since FY 1989-90. Figure B-18 displays the trend in General Fund spending for the Department of Corrections over the past 15 years.

Figure B-18
General Fund Expenditures: Department of Corrections*
(millions of dollars)

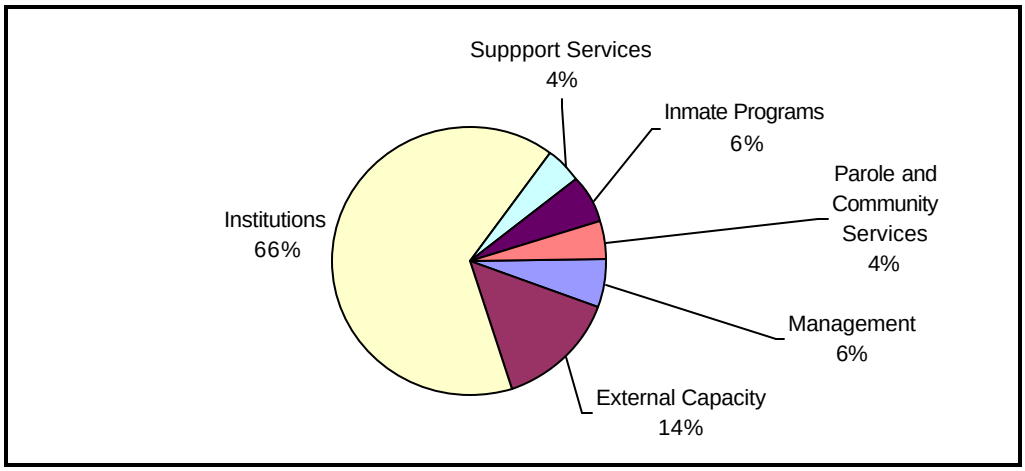


**FY 2002-03 and FY 2003-04 are appropriations, not expenditures.*

Of the department's total General Fund appropriation, about 66 percent is spent on correctional institutions for the costs of utilities, maintenance, housing and security, food services, medical services, superintendents, the Youth Offender System, and the specialized San

Carlos Correctional Facility, which houses mentally ill inmates. The second largest budget item, comprising 14 percent of the General Fund appropriation, is external capacity, which covers the costs of housing inmates in either private contract facilities or county jails. Approximately 380 inmates are being held in county jails and 2,307 inmates are being held in private contract prisons in the state. The balance of the department's budget is spent on support services, inmate programs, parole and community services, and management. Figure B-19 provides a breakdown of the FY 2003-04 General Fund appropriation to the Department of Corrections.

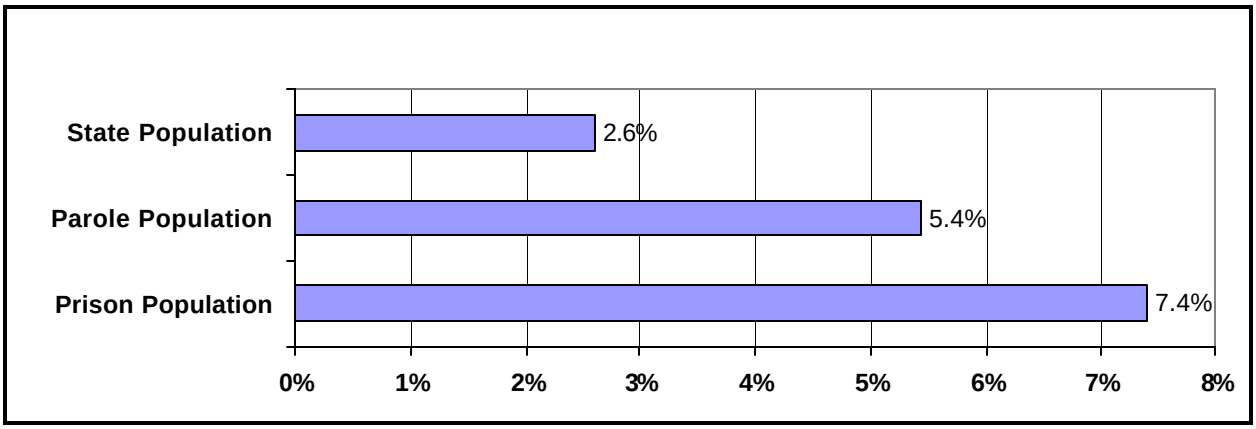
Figure B-19
Department of Corrections, GF Appropriation



FY2003-04, $469.8 million

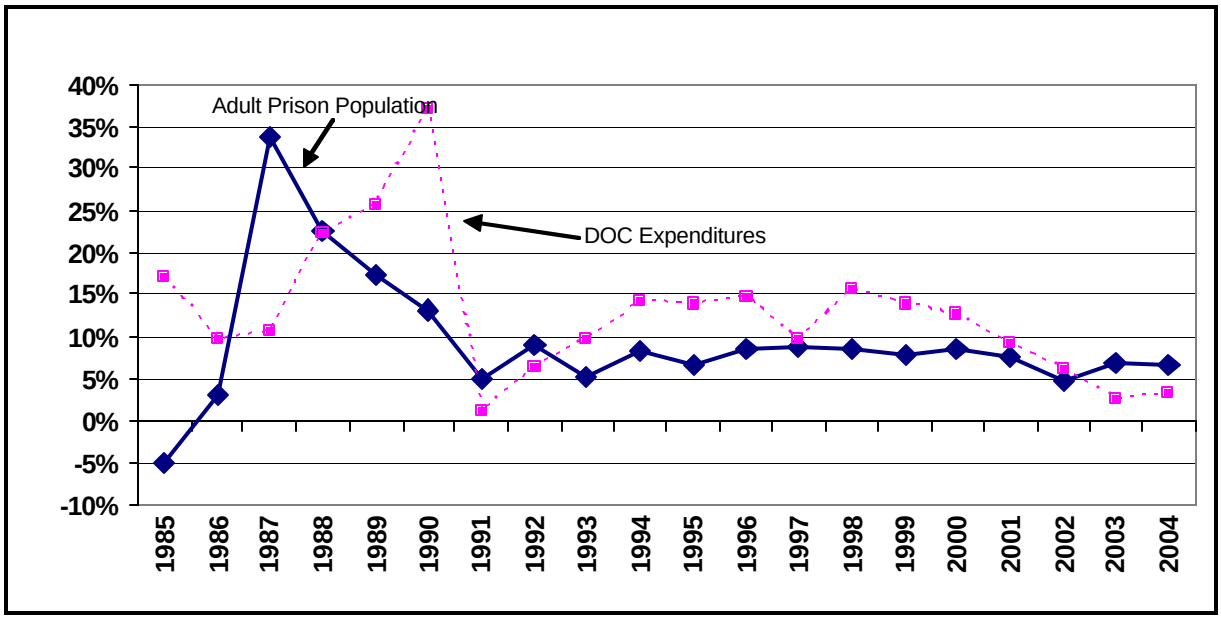
In general, spending by the department is driven by the number of inmates and parolees and the costs of incarcerating prisoners. More inmates require additional housing, security, food service, medical care, and other support services and programs. In turn, the number of inmates sentenced to the Department of Corrections is determined by the criminal codes and sentencing laws of the state. Since FY 1989-90, the adult inmate population has grown at an annual average rate of 7.4 percent, and the parole population has grown by 5.4 percent per year. Both groups have grown considerably faster than the state's population, which has increased at an average rate of 2.6 percent per year. Figure B-20 compares the state's population growth with prison and parole population growth over the period 1990-2002.

Figure B-20
DOC Prison and Parole Population, Average Annual Rates of Growth
1990-2002



In addition, Figure B-21 shows the direct correlation between department expenditures and inmate population since 1985. As indicated in the graph, the percent change in department spending closely tracks the percent change in inmate population, once the lagged impact of the run-up in prison population is accounted for in the late 1980s. The dramatic increase in prison population in the late 1980s was primarily the result of legislation passed in 1985 (HB85-1320) that doubled the maximum penalties of the presumptive ranges for all felony classes and mandated that parole be granted at the discretion of the Parole Board. As a result, the average length of stay for new commitments nearly tripled.

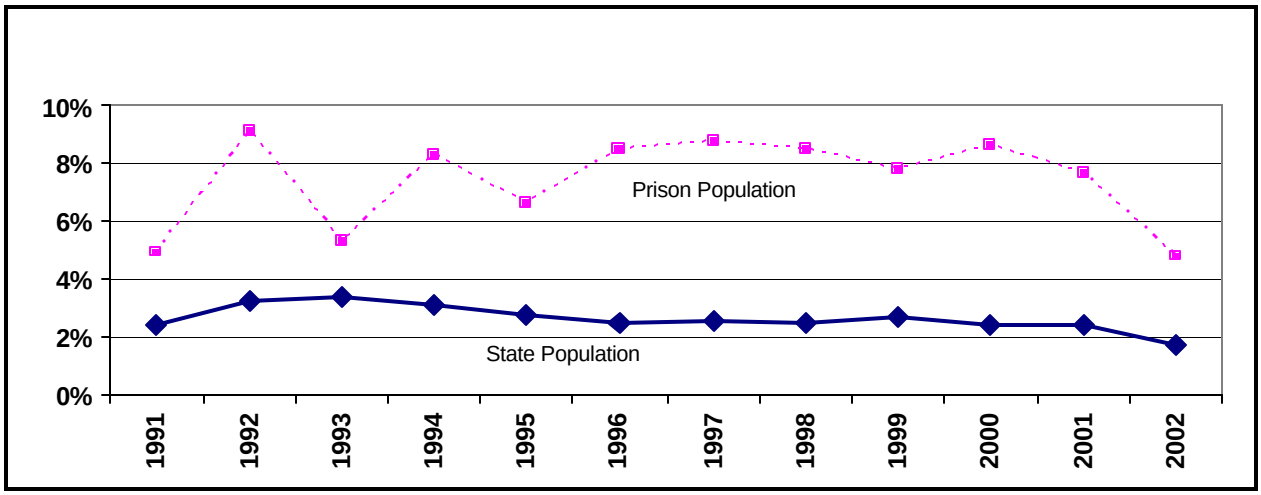
Figure 21
Percent Change in Adult Prison Population and Department of Corrections GF Expenditures



TABOR amendment considerations. The TABOR amendment to the state constitution specifies that non-exempt state revenue growth in any fiscal year cannot exceed the sum of inflation and population growth in the prior calendar year. This aggregate revenue limit effectively serves as a fiscal year spending limit for all state agencies.

For the Department of Corrections, expenditures are driven by the growth in inmates and the costs of incarcerating prisoners. If inmate population growth exceeds the state's population growth (assuming inflation affects the TABOR limit and departmental costs in the same amount), expenditures of the department may exceed the TABOR limit and create additional budgetary pressure for the legislature to meet the aggregate TABOR spending limit. Figure B-22 shows the yearly percentage growth in adult inmates in comparison with the state's population growth. As indicated, in every year since FY 1989-90, the growth in inmates has exceeded the state's population growth. Thus, the budgetary requirements of the Department of Corrections may create budgetary pressures for other state agencies receiving General Fund revenues.

Figure B-22



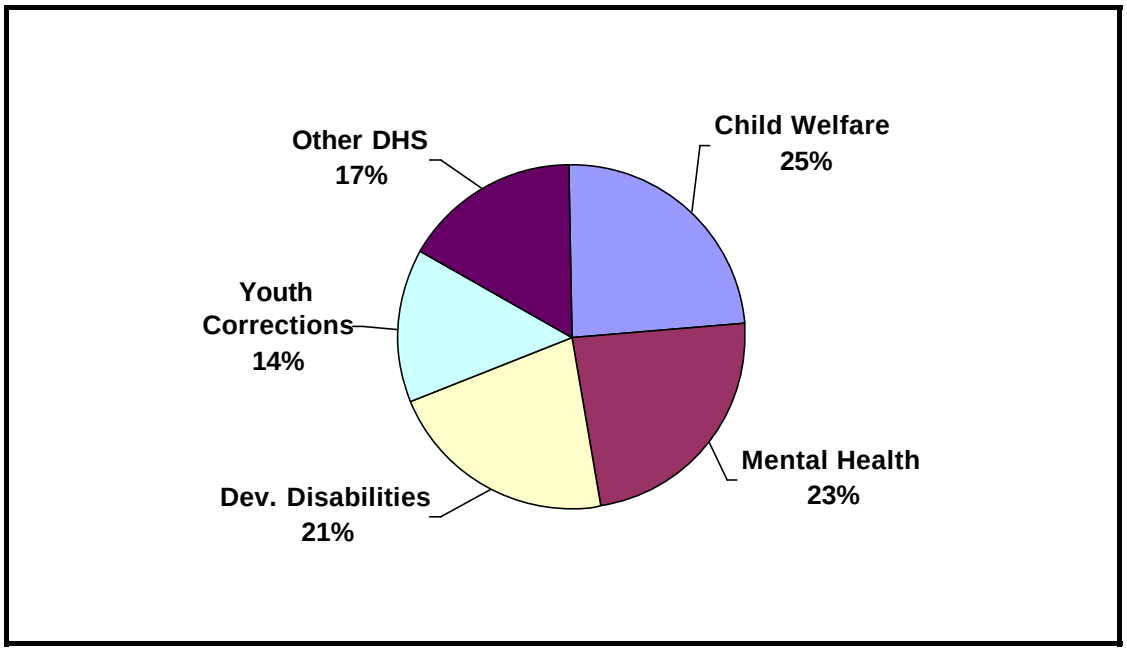
State Population Growth Limit vs. Prison Population Growth

DEPARTMENT OF HUMAN SERVICES

The Department of Human Services (DHS) administers and supervises the state's non-medical public assistance and welfare activities including cash and food assistance programs; child support enforcement, child welfare, and child care services; rehabilitation programs; veterans programs; alcohol and drug treatment programs; and programs for the aging. The DHS is also responsible for the care and treatment of dependent citizens who are mentally ill, developmentally disabled, or juvenile offenders.

Currently, direct General Fund for DHS programs represents 8.0 percent of total state General Fund appropriated ($460.3 million). The average annual growth in General Fund support for the DHS has been 4.3 percent since FY 1990-91. The department provides services to a number of client groups. However, four programs, including child welfare, mental health, developmental disabilities, and youth corrections, received 83.0 percent of the total General Fund appropriated to the DHS in FY 2003-04, compared with 67.1 percent in FY 1990-91. Because these four programs offer services eligible for Medicaid reimbursement, an additional $263.4 million General Fund is directly appropriated in the Department of Health Care Policy and Financing for DHS Medicaid-funded programs. Thus, the total General Fund appropriation for FY 2003-04 is $723.7 million. This section of the report is limited to a discussion of the four largest program areas in the department.

Figure B-23
Department of Human Services, General Fund Appropriations, FY 2003-04 ($723.7 million)



Child Welfare Services

Overview. Colorado's child welfare programs are designed to protect children from harm and assist families in caring for and protecting their children. These programs are supervised by the state department and administered by the 64 county departments of human services. Local, federal and state dollars provide funding for child welfare programs.

For FY 2003-04, 24.0 percent of DHS total General Fund is appropriated for child welfare services, compared with 9.3 percent for FY 1990-91. For FY 2003-04, $77.8 million of the department's child welfare appropriation is for those children placed in Medicaid-funded treatment programs ($38.9 million General Fund). Over 98 percent of the moneys appropriated for child welfare services is allocated to the counties to administer.

In general, federal law establishes requirements or "conditions of aid" for states to receive funding for child welfare programs. Relevant federal law is found in Title 42 of the *United States Code*. Relevant state law can be found in the Children's Code (Title 19, C.R.S.) and throughout various sections of Title 26, C.R.S.

Factors contributing to child welfare expenditures. The four major factors which have contributed to child welfare expenditures from FY 1990-91 to the present are:

- ✓ the *Child Welfare Settlement Agreement*;
- ✓ an increase in the number of children in out-of-home care (caseload growth);
- ✓ an increase in the the cost of out-of-home care; and
- ✓ a change in how the state funds social services programs as a result of federal welfare reform.

Child Welfare Settlement Agreement. In response to a 1992 lawsuit, the Governor and the Department of Human Services signed the *Child Welfare Settlement Agreement* in 1995, resulting in significant funding increases for child welfare programs. Moneys were appropriated to increase the number of county child welfare staff, increase rates paid to out-of-home care providers, and expand core services for children and their families (mental health services, drug and alcohol abuse services, day treatment, etc.). The requirements of the Settlement Agreement resulted in the establishment of a higher base for future program needs.

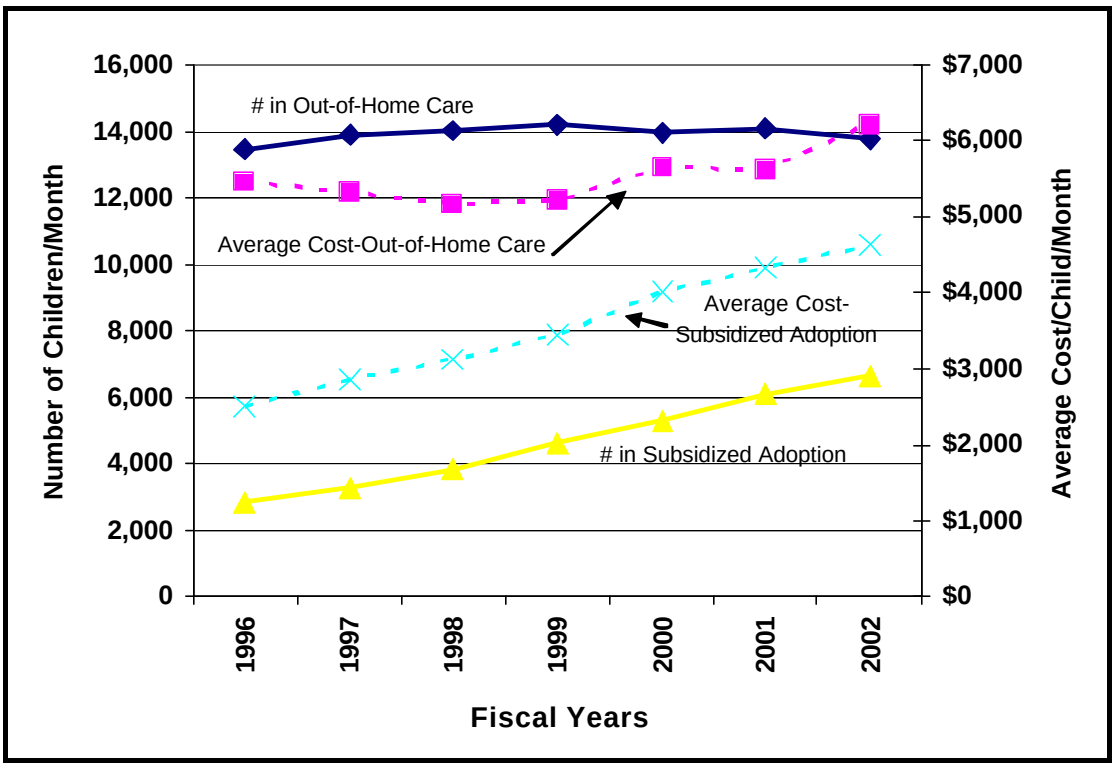
Caseload and cost of care. The out-of-home caseload rose dramatically in FY 1994-95 through FY 1996-97, the same time period during which new funding was provided for county child welfare staff pursuant to the Settlement Agreement. In FY 1994-95, 12,980 children were in an out-of-home placement, compared with 13,960 in FY 1996-97 (7.1% increase). The FY 2003-04 appropriation assumes a 2.8 percent caseload increase over the prior year. Individual provider rates have generally increased over time due to the following:

- ✓ Providers received a 10 percent rate increase in January 1996 in response to the Settlement Agreement. Additionally, cost-of-living adjustments averaging 2.4 percent were provided between FY 1998-99 and FY 2001-02; no increases have been funded since that time.

- ✓ Rates have increased as a result of refinancing initiatives designed to enhance rates paid to providers serving specific, high-need populations. Beginning in FY 1994-95, residential treatment centers (RTCs) qualified for Medicaid reimbursement for care and treatment.

- ✓ Caseload allocation among providers has also affected the average rate paid. Over time, shifts from county-administered foster and group homes to child placement agencies, and shifts from residential child care facilities to RTCs have resulted in increased average payments.

Figure B-24
Number of Children in Out-of-Home Care and Subsidized Adoption and Average Cost/Child/Month



State Funding for Social Services Programs Post Federal Welfare Reform. Senate Bill 93-254 established the Family Issues Cash Fund (FICF). General Fund savings realized as a result of earning federal Title IV-A Emergency Assistance funds for child welfare services were deposited into the FICF. Between FY 1993-94 and FY 1996-97, Colorado earned $99.2 million in federal funds, with a like amount of General Fund deposited into the FICF. Thus, these federal funds provided a significant source of additional revenues, allowing the state to improve its child welfare system as required by the 1995 *Child Welfare Settlement Agreement*. Beginning in FY 1997-98, federal welfare reform legislation consolidated federal funding for several programs under Title IV-A of the Social Security Act, creating a single block grant for states to

provide "temporary assistance to needy families" or TANF. This consolidation resulted in two significant funding changes for social services programs:

- ✓ The funding mechanism for the FICF effectively ended. Once the balance in the FICF was exhausted, other funding sources were required to continue support for ongoing programs that were reliant on the FICF.

- ✓ In FY 1997-98, General Fund appropriations shifted from the AFDC Program to child welfare services, and federal funds appropriations shifted from child welfare services to the Colorado Works Program. Although this action resulted in no net change in funding for either the Works Program or child welfare programs, it has significantly changed the funding mix for each program.

Cost containment measures. In response to out-of-home care cost increases that began in FY 1994-95, the General Assembly adopted legislation in 1997 to cap the state's reimbursement to counties for child welfare services. Counties were also authorized to use capped allocation moneys without category restriction and to negotiate rates, services, and outcomes with providers. Thus, counties now receive a "block grant" to cover the costs of out-of-home care, subsidized adoptions, and related administrative functions. From FY 1997-98 through FY 2003-04, the total amount appropriated for counties to provide child welfare services (including out-of-home care) has increased an average of 4.1 percent per year. Despite these increases, county child welfare expenditures have exceeded the annual appropriation for the last three fiscal years. Counties make up this shortfall with county-only funds as noted in the figure below.

Figure B-25
State and County Funding for Child Welfare Services

	FY 97-98	FY 98-99	FY 99-00	FY 00-01	FY 01-02	FY 02-03	FY 03-04
Funding for Child Welfare Services ($ millions)	$217.2	$232.8	$241.2	$263.1	$280.9	$289.9	$297.1
Percent Change		*7.2%*	*3.6%*	*9.1%*	*6.8%*	*3.2%*	*2.5%*
Shortfall: County Expenditures In Excess of Appropriation ($ millions)	none	none	$20.6	$21.4	$33.4	n/a	n/a
Shortfall as Percent of Total Expenditures			*7.9%*	*7.6%*	*11.0%*	*n/a*	*n/a*

Developmental Disability Services

Overview. The DHS provides community and institutional services for Coloradans of all ages with developmental disabilities and a work therapy program which provides supportive employment for people with developmental disabilities. Persons determined to have a developmental disability under state eligibility criteria may receive services in their local communities through 20 Community Centered Boards (CCBs). Additionally, persons may receive care in one of Colorado's three regional centers located in Grand Junction, Wheat Ridge, and Pueblo. The regional centers operate residential and support services in large congregate settings (institutions), or they operate group homes. The regional centers have traditionally served persons with developmental disabilities where appropriate community programs are not available.

Federal and state dollars provide funding for developmental disability services, in addition to client cash revenue (room and board costs charged persons in institutions). During the ten-year period, direct General Fund support to the DHS declined from $33.2 million to $26.0 million, but overall General Fund support increased due to a greater number of services qualifying for Medicaid funding. During this time period, total Medicaid funding increased 209 percent from $66.6 million to $205.7 million. Total funding for community services more than doubled in the ten-year period, increasing by 121 percent from $117.6 million to $260.0 million.

Generally speaking, all services provided to persons with developmental disabilities are discretionary. However, the vulnerability of this population makes significant reductions in services or in the number of people served difficult. Relevant state law regarding developmental disability services can be found in various sections of Title 26 and Title 27, C.R.S.

Factors contributing to Developmental Disability Services expenditures. The three major factors which have contributed to these services from FY 1990-91 to the present are: (1) community provider rate increases; (2) base rate increases; and (3) increases in the number of clients served.

Rate increases. To ensure that community provider arrangements are viable over the long term, the General Assembly provides them with annual cost-of-living increases. In the early 1990s, each type of community provider received a slightly different rate increase. Between FY 1999-00 and FY 2002-03, the average increase was 1.9 percent; no increase was provided in FY 2003-04. In FY 2001-02, the DHS received a 5.3 percent base rate increase for certain services provided by community providers. Continued base rate increases have the potential to double the impact of community provider rate increases on the developmental disability services budget.

Increases in number of clients served. Each CCB maintains a waiting list when the number of persons or families requesting services exceeds the resources available. Currently, there are waiting lists for all developmental disability services. In each of the last several years, the General Assembly has appropriated additional resources to reduce the number of persons and families on waiting lists. Furthermore, new resources are frequently requested for a partial year

(e.g., 9 months) because it takes planning time to set up services to meet each person's unique needs. Each appropriated "partial-year" resource will require additional dollars in the following year to ensure that funding is sufficient to provide services for a full year.

Cost containment measures. Since FY 1990-91, developmental disability services has experienced continued program growth. However, in FY 2003-04, the family support services program for families with children with developmental disabilities was reduced by half; inflationary increases provided in FY 2002-03 were eliminated; and only ten new resources were provided for individuals needing comprehensive services despite the existence of significant waiting lists.

Colorado's Mental Health System

The DHS delivers mental health services to Colorado residents via a network of community mental health centers and at the state's two public mental health institutes. Mental Health Services, a division of the Office of Behavioral Health and Housing, contracts with a network of mental health centers across the state to provide services to individuals in their communities. Individuals with serious conditions are served at the Colorado Mental Health Institute at Pueblo and the Colorado Mental Health Institute at Fort Logan.

Community mental health centers. The DHS contracts with 17 community mental health centers and six specialty mental health clinics across the state for mental health services. Figure B-26 shows appropriations for the state's community mental health program since FY 1990-91. Medicaid is a significant funding source for the community mental health system. The General Fund appropriations shown in Figure B-26 include the state match on Medicaid dollars required by the federal government. The state match is generally at 50 percent. General Fund appropriations to the community mental health system increased at an average annual rate of 5.6 percent between FY 1990-91 and FY 1996-97, from $31.9 million to $46.7 million. A sharp increase occurred in FY 1998-99, when the Medicaid Mental Health Capitation program became fully operational.[1] General Fund appropriations accelerated over the next few years before decreasing in recent years as a result of the revenue shortfall, increasing at an average annual rate of 3.3 percent during the five years since the Mental Health Capitation program was fully implemented. Total appropriations, including federal Medicaid dollars, increased at an average annual rate of 8.9 percent over the same period.

1. Implementation of the Mental Health Capitation program began in FY 1995-96. It was operating in 51 counties prior to FY 1998-99, but the program's funding was not reflected in the budget for the Department of Human Services until FY 1998-99.

Figure B-26
Community Mental Health Appropriations

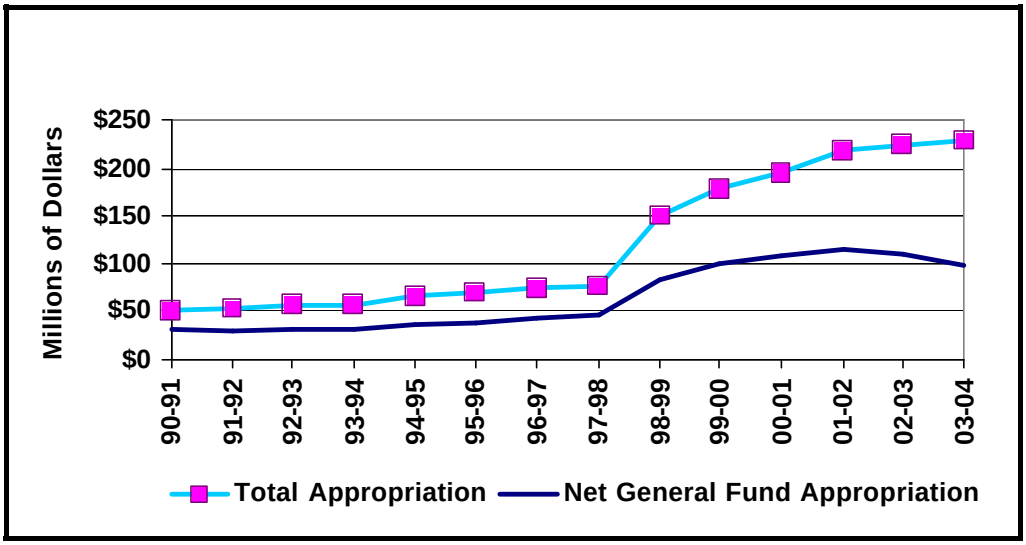
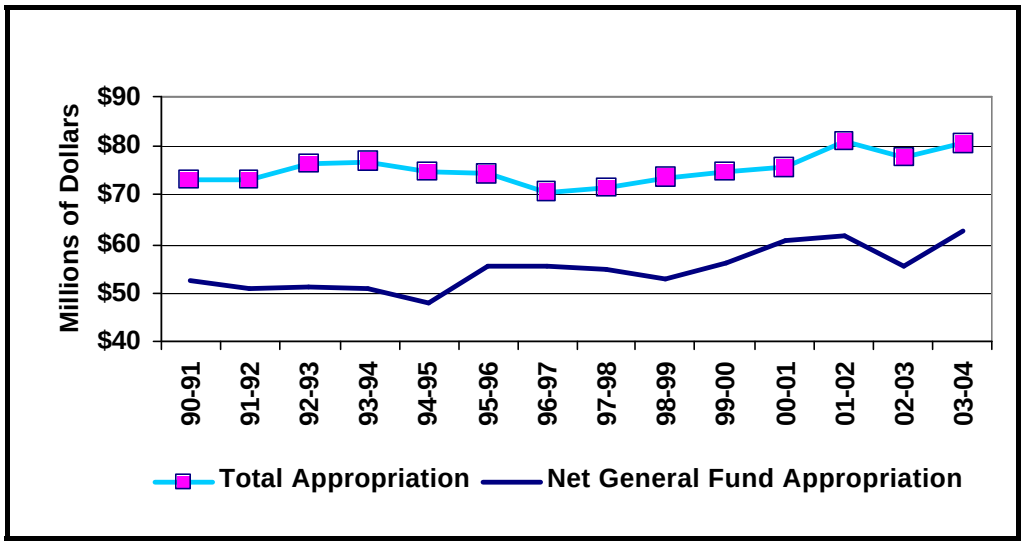


Figure B-27
Appropriations to Pueblo and Fort Logan Mental Health Institutes

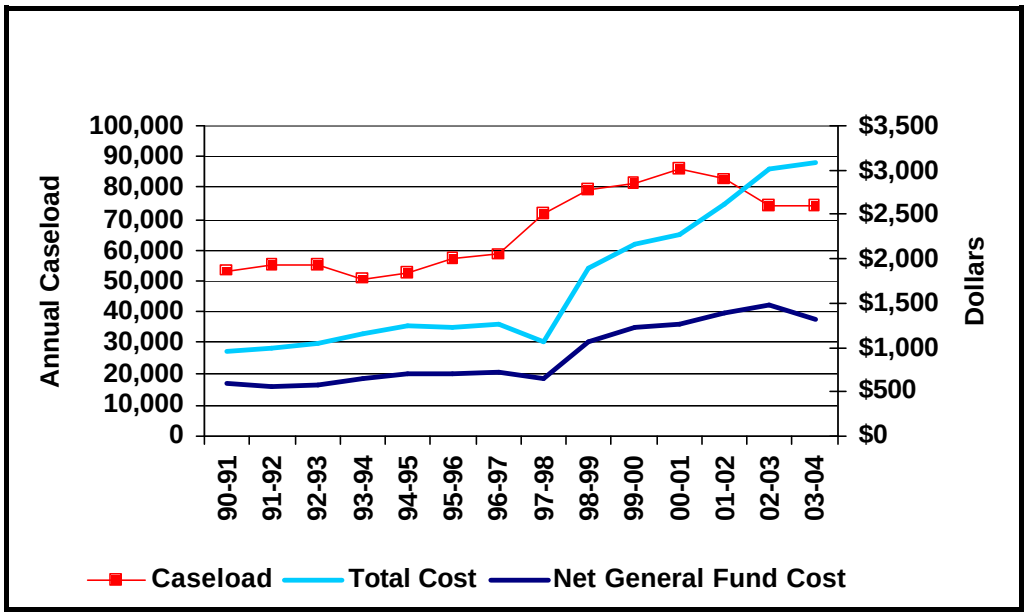


Mental Health Capitation program. The Medicaid Mental Health Capitation program is a managed mental health care system. Funded primarily with Medicaid dollars, approximately half of its funding originates in the General Fund. The program divides the state into eight geographic regions. In each region, the DHS is responsible for selecting an organization via a competitive bid process to manage the provision of mental health services in that region. The organization is referred to as a "Mental Health Assessment and Services Agency," or MHASA. Most Medicaid recipients in Colorado are automatically enrolled in the program. Under the program, the state pays each MHASA a flat fee per Medicaid recipient enrolled in the MHASA

on a monthly basis. In return, the MHASA is required to provide all necessary services to each patient free of charge. Medicaid patients are required to receive any needed mental health services from the MHASA. The funding for the Mental Health Capitation progam has remained fairly stable during the last three years at approximately $147 million.

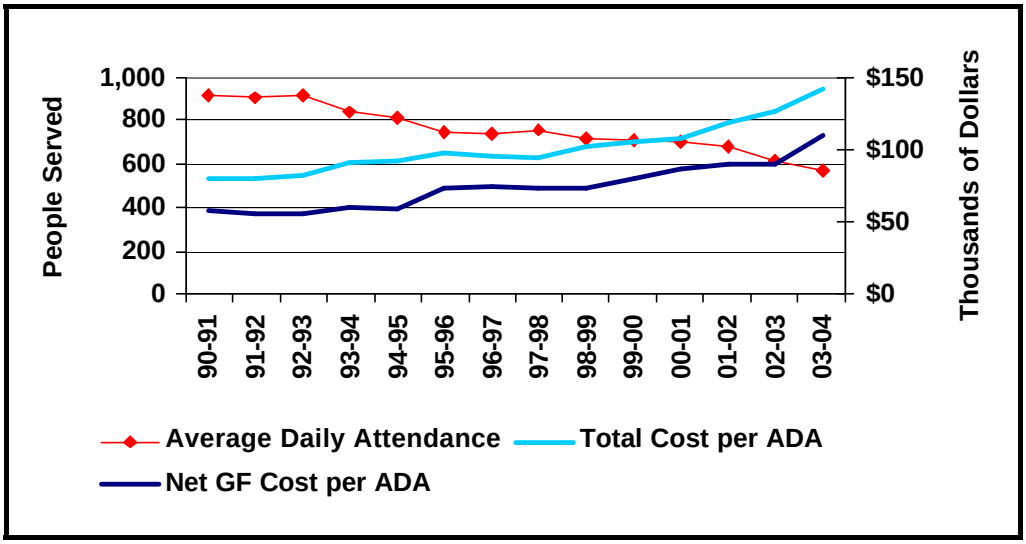
Factors contributing to Mental Health Capitation expenditures. Funding for the Medicaid Mental Health Capitation program is influenced heavily by Medicaid eligibility and the results of the competitive bid process, which determines the fee paid to each MHASA. Actual eligibility increased at an average annual rate of 9.5 percent since FY 1998-99, from 222,025 people to a projected 348,939 people in FY 2003-04. Funding for the program increased at an average annual rate of 4.0 percent during the same period, from an estimated $121.2 million in FY 1998-99 to $147.3 million in FY 2003-04. Eligibility increases were offset by two measures made to reduce the budget since FY 2001-02. First, capitation rates paid to MHASAs have been reduced 6.4 percent since FY 2001-02. Second, the Mental Health Performance Incentive program was eliminated in FY 2002-03, saving $2.6 million that year.

Figure B-28
Community Mental Health Caseload and Cost Per Case



Mental health institutes. Inpatient hospitalization for patients with serious mental health illnesses are provided by state mental health institutes in Pueblo and Fort Logan. Direct General Fund appropriations to the institutes increased at an average annual rate of 1.4 percent between FY 1990-91 and FY 2003-04, from $52.3 million to $62.5 million. However, Medicaid funding to the institutes decreased from $13.3 million to $3.3 million during the same period. The remainder of the funding comes primarily from patient revenues and the Department of Corrections.

Figure B-29
Pueblo and Fort Morgan Mental Health Institutes
Average Daily Attendance (ADA) and Cost per ADA



Factors contributing to institute expenditures. Figure B-28 illustrates that two opposing trends have driven costs out to the mental health clinics in recent years. Consistently falling demand for services at the institutes has been offset by increasing demands for staffing intensity for those remaining. Demand for bed space began to decline during the mid 1990s. As Figure B-29 shows, the average daily population at the two institutions decreased from 760 patients in FY 1997-98 to an estimated 570 in FY 2003-04. Meanwhile, staffing needs associated with patient severity and lower use of seclusion and restraint increased during this period. This occurred partially as a result of a lawsuit, which demanded higher staffing levels in forensics units, where people committed either as innocent by reason of insanity or mentally incompetent to stand trial for crimes are served. Staffing was increased by 58.2 FTE in FY 2001-02, 53.2 FTE in FY 2002-03, and 20.7 FTE in FY 2003-04.

Division of Youth Corrections

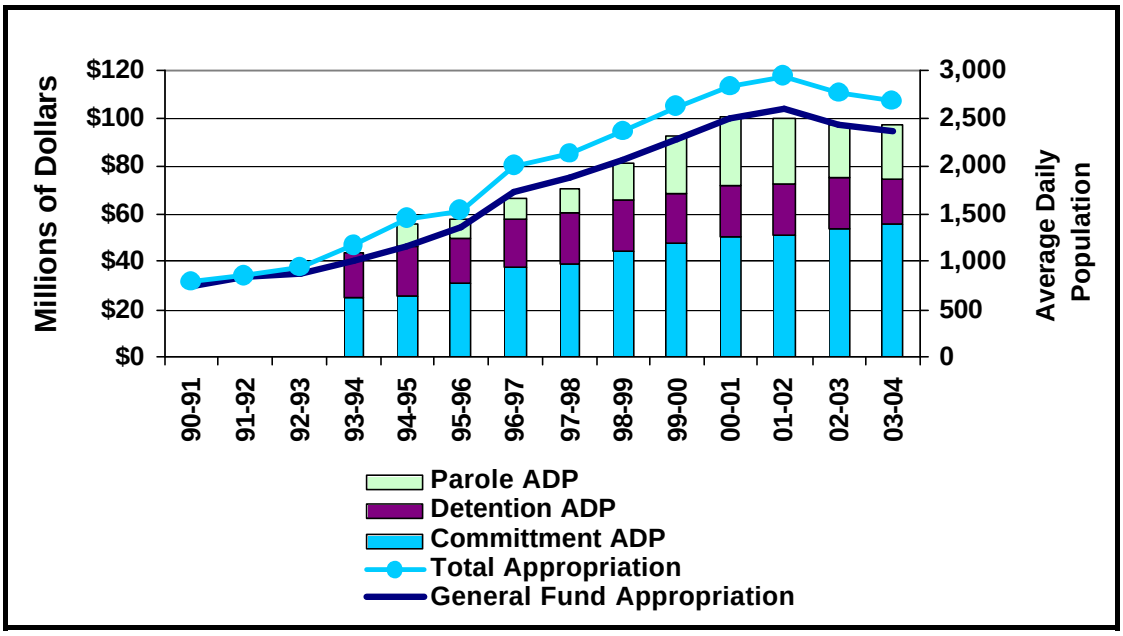
The Division of Youth Corrections (DYC) is responsible for the supervision, care, and treatment of detained juveniles awaiting adjudication[2], juveniles sentenced to the DHS by the courts, and juveniles on parole from a facility operated or contracted for by the division. Juveniles sentenced to the DYC may be sentenced either to commitment or detention. Commitment is a court-ordered transfer of legal custody to the DHS lasting up to seven years following the determination that the juvenile has been involved in a serious offense. Detention is typically for less serious offenses and involves a short-term confinment of no more than 45 days to a detention facility. The DYC owns thirteen residential facilities, two of which are privately

2. Adjudication occurs when a court determines that a juvenile has been involved in a delinquent act.

operated. Of these, four are detention facilities, four are commitment facilities, and five are multi-purpose facilities, housing both detention and commitment populations. The DYC augments these facilities by contracting with private facilities for additional detention and commitment beds. In addition, the DYC administers the Senate Bill 91-94 grant program, intended to divert juveniles from detention and commitment, or to reduce their length of stay.

Figure B-30 shows a history of appropriations to the DYC and the average daily population of youths receiving services. Approximately 88 percent of the DYC's funding comes from the General Fund. The remainder comes from Medicaid funding, with some funding from the federal government, local governments, private contractors, and the Department of Education. General Fund appropriations to the DYC, shown in Figure B-30 by the unmarked line, increased from $30.0 million in FY 1990-91 to a peak of $103 million in FY 2001-02. They decreased 6.1 percent in FY 2002-03 and 3.1 percent in FY 2003-04, to $94.3 million. While a lower caseload contributed to the decrease, funding for some programs were reduced or eliminated during both years to help the state cope with the budget shortfall.

Figure B-30
Caseloads are the Primary Budget Driver
DYC Appropriations and Average Daily Populations



Population is driving spending. As shown in Figure B-30, the primary driver for DYC spending is the average daily population at the commitment and detention facilities and in the parole program. The DYC population is influenced by demographic, legal, and social factors. The degree to which economic factors drive growth in DYC populations is unclear.

Demographic factors driving DYC population growth. The rate of growth in the state's population between the ages of 10 and 17 has a significant effect on DYC populations. While

this population increased 40 percent between 1990 and 2000, it is expected to increase less than 10 percent between 2000 and 2010. This should translate into slower growth in the DYC population during the current decade than was seen during the 1990s.

Federal, state, and local policy changes driving DYC population growth. Policies that change the capacity of detention and commitment facilities or create or restrict judges' sentencing alternatives affect the population. Several policy changes in recent years have significantly affected the detention and parole populations, in particular. Senate Bill 91-94, which allowed communities to create diversionary, alternative, community-based programs to prevent youths from being detained or committed by DYC, has been credited with substantially reducing DYC's detention population during the last five years. The 1995 federal court-ordered cap on the Denver Gilliam Youth Services Center's population also had an effect on the detention population. Youths released from detention or commitment did not receive parole services until FY 1996-97, after House Bill 96-1005 created the juvenile parole division and mandated a minimum parole period of one year for each juvenile. Since then, the minimum parole period has been reduced twice. Senate Bill 01-077 reduced it to nine months, and Senate Bill 03-284 further reduced it to six months. It is estimated that Senate Bill 03-284 will reduce the average daily parole population by 66.4 youths in FY 2003-04 and 108.8 youths in FY 2004-05.

Social factors driving DYC population growth. Social factors include school participation rates and the incidence of juvenile delinquency. School dropout and graduation rates are strongly correlated to juvenile delinquency. Colorado dropout rates for grades 7 through 12 have decreased during each of the last four school years from 3.5 percent in the 1997-98 school year to 2.6 percent in the 2001-02 school year. In addition, the social climate among youths regarding juvenile delinquency affects population growth. This is something that cannot be directly or precisely measured.

Economic factors driving DYC population growth. While it has been shown that household income and employment is linked to decreased participation in criminal activities among adults, the economy's effect on delinquency among youth is not clear. While it seems reasonable that teenage employment and/or labor market participation may reduce juvenile deliquency, we have not seen conclusive evidence that the current recession and dismal job environment for youths has led to a larger DYC population.

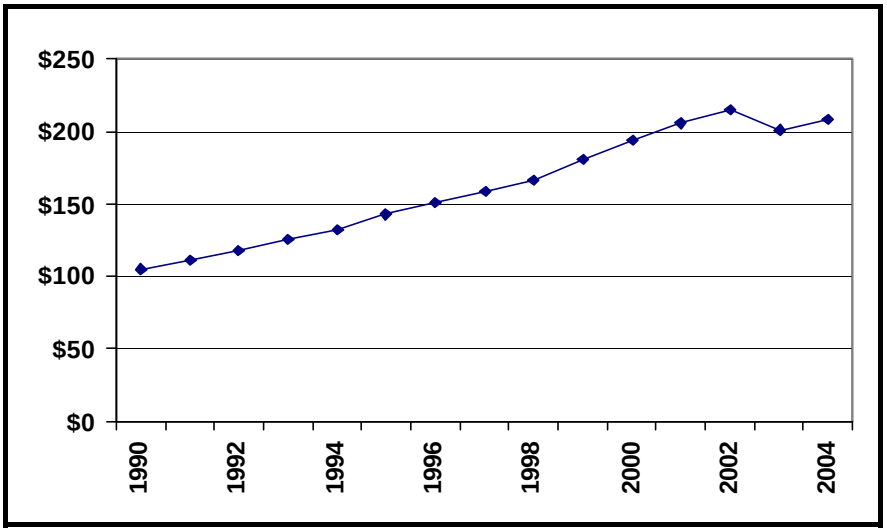
Appendix B: Expenditures.....39

JUDICIAL DEPARTMENT

The judicial branch is responsible for administering the state court system, including the Colorado Supreme Court, the Court of Appeals, district courts, county courts and water courts. The branch also administers adult and juvenile probation services in the state's 22 judicial districts. The General Fund appropriation to the judicial branch includes three independent agencies: the Colorado State Public Defender, the Office of the Alternate Defense Counsel, and the Office of the Child's Representative. The Public Defender's Office represents indigent criminal defendants and the Alternate Defense Counsel represents indigent defendants in cases where the Public Defender has a conflict of interest. The Office of the Child's Representative is responsible for representing the best interests of children who appear before the court, but who do not have counsel. From FY 1989-90 to FY 2003-04, General Fund expenditures of the judicial branch, including appropriations to these three independent agencies, increased from $105 million to $207 million, or at an average annual rate of 5.0 percent. In comparison, total General Fund expenditures increased at an average annual rate of 5.8 percent over the same time period.

However, General Fund appropriations for the branch decreased in FY 2002-03 and increased marginally in FY 2003-04. Staffing cutbacks accounted for most of the General Fund reduction, but some activities were cash funded, requiring fewer General Fund resources. In FY 1989-90, trial courts and probation services were 99 percent and 98 percent funded with General Fund resources, respectively. For FY 2003-04, these same functions are expected to be 73 percent and 67 percent funded with General Fund resources, respectively. Figure B-31 shows the trend in General Fund spending for the judicial branch since FY 1989-90.

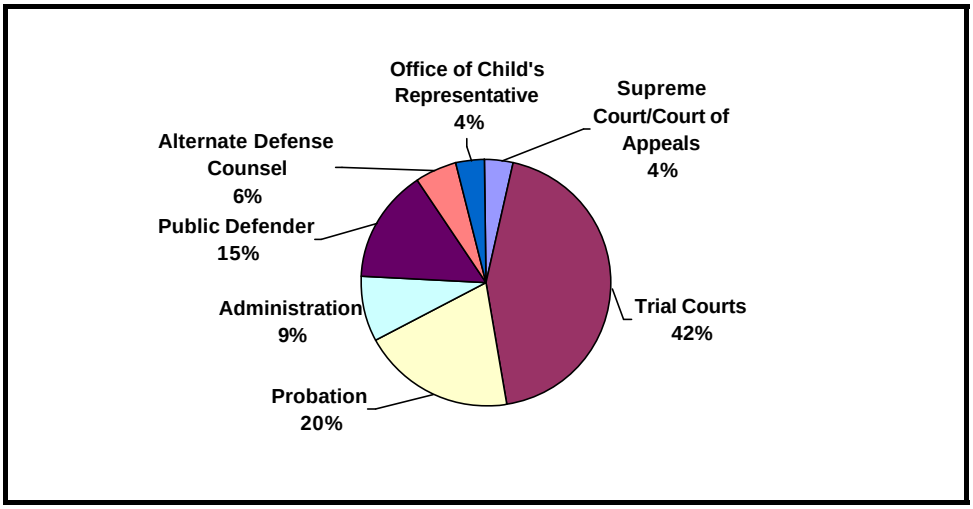
Figure B-31
General Fund Expenditures: Judicial Branch*
(millions of dollars)



**FY 2003 are appropriations, not expenditures.*

For the entire judicial branch, the majority of spending goes toward the activities of the trial courts and the Division of Probation Services. In FY 2003-04, trial courts and probation services accounted for 62 percent of the branch's General Fund appropriation. The Public Defender's Office, Alternate Defense Counsel, and the Office of Child's Representative accounted for 15 percent, 6 percent, and 4 percent respectively of the branch's total General Fund appropriation. In FY 1989-90, trial courts and probation services accounted for 71 percent of the branch's General Fund expenditures and the Public Defender's Office accounted for 15 percent. Figure B-32 displays the judicial branch's FY 2003-04 General Fund appropriation, by function.

Figure B-32
Judicial Branch GF Appropriation, FY 2003-04, $207.3 million



In general, spending by the branch is driven by three factors: the number of case filings, the number of adult and juvenile probationers, and the costs of providing court and probation services. These factors are, in turn, related to population growth, the criminal codes and sentencing laws of the state, and general inflationary pressures. The number of judges, magistrates, probation officers, public defenders, and judicial staff will increase with the caseload of the branch. Since 1990, case filings in all of the trial courts have increased by 1.8 percent per year, to more than 639,000 in FY 2001-02. District court case filings have grown by 1.5 percent per year and county court case filings have increased by 1.8 percent per year.[1] The number of probationers has grown by 5.0 per year since 1990, to more than 48,000 in FY 2001-02. Figure B-32 displays the average annual rate of growth of new case filings and probationers in comparison with the state's population growth; while Figure B-33 displays overall trends in new case filings and probationers since FY 1989-90. The latter graph does not clearly indicate any cyclical economic influences upon either caseload or the number of probationers, although it could be argued that criminal caseloads may be inversely related to the health of the state's economy. The reduction in caseloads in FY 1998-99, FY 1999-00, and FY 2000-01, when the

1. Case filings in district courts and county courts account for 99 percent of all new case filings.

state's economy was relatively healthy, is indicative of this potential economic effect. The increase in caseload in the last two years, when the economy has stagnated, also supports this relationship.

Figure B-33
Judicial Branch New Case Filings and Probationers
Average Annual Rates of Growth

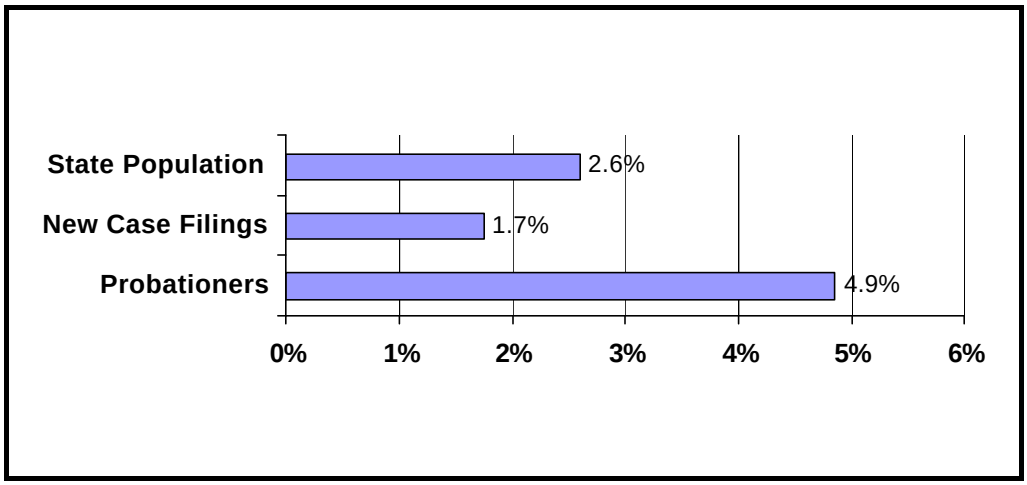
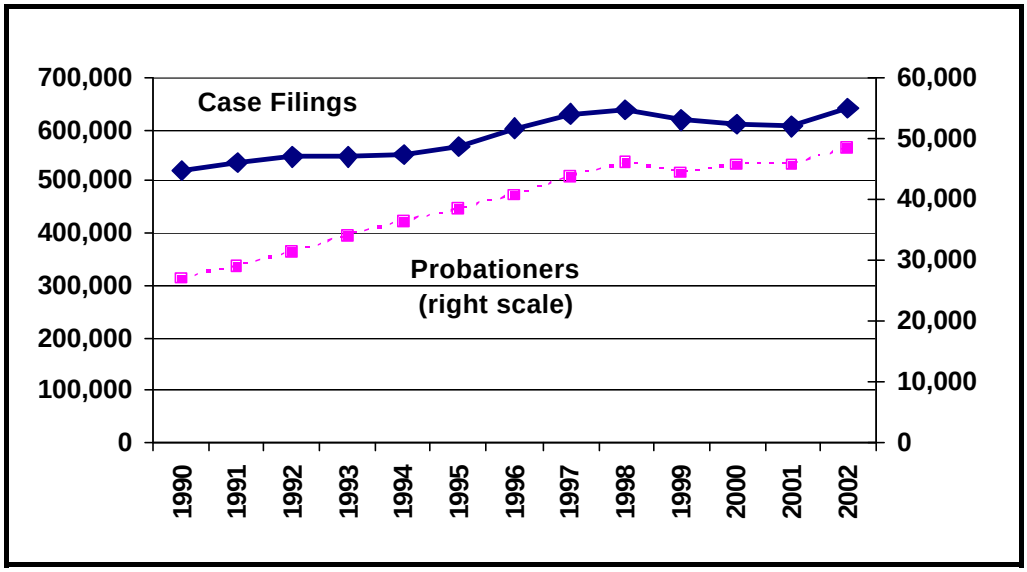


Figure B-34
Number of New Case Filings and Probationers



TABOR amendment considerations. For the judicial branch, expenditures are principally driven by the growth in caseloads and probationers. If the growth in caseloads and probationers exceeds population growth (assuming inflation affects the TABOR limit and departmental costs in roughly the same amount), expenditures of the branch may exceed the TABOR limit and

create additional budgetary pressure for the legislature to meet the aggregate TABOR spending limit. For example, the growth in case filings and probationers exceeded the state's population growth in FY 1994-95, FY 1995-96, and FY 1996-97, creating the potential for additional budgetary pressure. In other years, population growth exceeded the growth in case filings and probationers, e.g., in FY 1998-99 and FY 2000-01, which could lessen budgetary pressures for the General Assembly.

APPENDIX C

Appendix C: State Tax And Expenditure Limits

State and Year of Adoption	Method of Approval and Type of Law	Limit Applies To	The Limit Is	Provisions for Waiver	Provisions in the Case of Transfer of Responsibility for Government Programs	Treatment of Surpluses
Alaska 1982	Legislative referendum. Const.	State appropriations.	Yearly appropriations may not grow annually by more than the percentage increase in population and inflation.	Appropriations may be made from the Budget Reserve Fund if revenues decrease.	No provisions.	No provisions.
Arizona 1978	Legislative referendum. Const.	Appropriations of state tax revenues.	Annual appropriations growth is limited to 7.23 percent of state personal income.	Waiver requires two-thirds legislative approval for specific additional appropriations.	The Legislature is required to modify the limit if court order or legislative enactment transfers program responsibility between federal, state and local governments.	No provisions.

State and Year of Adoption	Method of Approval and Type of Law	Limit Applies To	The Limit Is	Provisions for Waiver	Provisions in the Case of Transfer of Responsibility for Government Programs	Treatment of Surpluses
California 1979	Citizen initiative. Const.	Appropriations of state tax revenues.	Yearly appropriations growth is limited to the percentage increase in population and per capita personal income.	During emergencies, the limit may be exceeded. But any increased expenditures must be compensated for by reduced expenditures over the following three years. Any voter-approved changes are only operative for four years.	(1) The limit must be altered if program responsibility is transferred from one government entity to another, or private entity. (2) The state must provide funding when it requires local governments to provide a program. (3) Any appropriation that is used to comply with federal requirements is exempt from the limit.	One-half of all surplus revenues are required to be returned to taxpayers through a reduction in tax rates or fee schedules within the next two fiscal years; one-half are allocated to Kindergarten - 12th grade school districts.

State and Year of Adoption	Method of Approval and Type of Law	Limit Applies To	The Limit Is	Provisions for Waiver	Provisions in the Case of Transfer of Responsibility for Government Programs	Treatment of Surpluses
Colorado 1991	Legislative vote. Statutory.	State General Fund appropriations.	Appropriations are limited to the lesser of 5 percent of Colorado personal income or a 6 percent increase over the prior year's General Fund appropriation.	The limitation may be exceeded upon the declaration of a state fiscal emergency by the General Assembly and the Governor. The 6 percent limitation does not apply to any appropriation made for new programs or services required by federal law or court order. The limitation also does not apply to Medicaid overexpenditures or any appropriation of moneys derived from any voter-approved tax or fee increase. Certain transfers are also not subject to the limit.	No provisions.	No provisions.

State and Year of Adoption	Method of Approval and Type of Law	Limit Applies To	The Limit Is	Provisions for Waiver	Provisions in the Case of Transfer of Responsibility for Government Programs	Treatment of Surpluses
Colorado 1992	Citizen initiative. Const.	All state revenue and tax increases.	Most state revenues are limited to population growth and inflation. Spending limits in place at the time of its passage cannot be weakened without voter approval.	All tax increases require voter approval. The General Assembly can declare a non-fiscal emergency by a two-thirds vote and raise emergency taxes subject to voter approval.	Locals can reduce or end their subsidy for any state-mandated program except for K-12 education; 90 days notice is required and adjustment can occur in a maximum of three equal annual installments. Local taxes supporting these programs must be reduced accordingly.	Revenues in excess of the limit must be refunded in the next fiscal year, unless voters agree to let the state keep the surplus.
Connecticut 1991, 1992[1]	Legislative vote. Statutory. Legislative referendum. Const.	State appropriations (but excludes debt service, state grants, expenditures from budget reserve fund, and certain other expenditures for federal mandates or court orders).	Appropriations are limited to the increase in state personal income that is averaged over the preceding five years, or the increase in inflation for the preceding 12 month period, whichever is greater.	Governor can declare an emergency or the existence of extraordinary circumstances; waiver requires approval by three-fifths vote of both House and Senate.	No provisions.	(1) Budget Reserve Fund (rainy day fund) (2) State Employees Retirement Fund (3) Reduction of debt.

[1] The constitutional amendment will not take effect until the legislature enacts definitions, by a three-fifths majority, to implement the limit. The statutory limit remains in effect until that time.

State and Year of Adoption	Method of Approval and Type of Law	Limit Applies To	The Limit Is	Provisions for Waiver	Provisions in the Case of Transfer of Responsibility for Government Programs	Treatment of Surpluses
Delaware 1978	Legislative referendum. Const.	State General Fund appropriations.	Appropriations cannot exceed 98 percent of estimated General Fund revenue and prior year's unencumbered funds.	Any portion of the amount between 98 and 100 percent of the estimated General Fund revenue for any fiscal year may be appropriated in the event of emergencies involving health, safety, or welfare. Waiver requires declaration of an emergency and three-fifths vote of each chamber.	No provisions.	Surpluses go into a cumulative cash balance and are available for appropriations in the following fiscal year.
Florida 1994	Legislative referendum. Const.	All state revenues including taxes, fees, licenses, and charges.	Revenue limit is determined by multiplying the average annual growth rate in Florida personal income over the previous five years by the maximum amount of revenue permitted under the limitation in the previous year.	Waiver requires two-thirds vote of the Legislature.	Legislature by statute can adjust the limit to reflect transfers in funding responsibilities between state and local governments.	Excess revenues go to the Budget Stabilization Fund. When the fund reaches a statutory maximum, the excess is rebated to taxpayers.

State and Year of Adoption	Method of Approval and Type of Law	Limit Applies To	The Limit Is	Provisions for Waiver	Provisions in the Case of Transfer of Responsibility for Government Programs	Treatment of Surpluses
Hawaii 1978	Const. convention. Const.	State General Fund appropriations.	General Fund appropriations are not to exceed the average state personal income growth rate for three previous years.	Specific appropriations over the limit require two-thirds approval in both legislative chambers.	The state must share the cost of any new program or service increase required of local governments by the Legislature.	If the state General Fund balance in each of two succeeding years exceeds 5 percent of General Fund revenues, the Legislature provides a tax refund.
Idaho 1980	Legislative vote. Statutory.	State General Fund appropriations (modified in 1994 to exclude one-time expenditures).	Appropriations are limited to 5.33 percent of state personal income.	No provisions.	Adjustments to the limit are made if court order or legislative enactment transfers responsibility between state and local governments or between federal and state governments.	No provisions.

State and Year of Adoption	Method of Approval and Type of Law	Limit Applies To	The Limit Is	Provisions for Waiver	Provisions in the Case of Transfer of Responsibility for Government Programs	Treatment of Surpluses
Iowa 1992	Legislative vote. Statutory.	State General Fund appropriations.	Appropriations cannot exceed 99 percent of adjusted General Fund receipts.	No provisions.	No provisions.	Excess goes to the Cash Reserve Fund, then to the Rebuild Infrastructure Account, and then to the Economic Recovery Fund.
Louisiana 1979	Legislative vote. Statutory.	State tax revenue.	Revenue is limited to the ratio of FY 1978-79 tax revenue to 1977 state personal income. Expenditures for any given year shall not exceed anticipated state revenues for that year.	Statute may be amended by vote of the Legislature.	No provisions.	State revenue in excess of limit shall be deposited in the Tax Surplus Fund; appropriations from that fund must be made for paying tax refunds.
Louisiana 1993	Legislative referendum. Const.	State General Fund appropriations.	State spending is limited to 1992 appropriations plus per capita personal income growth.	Waiver requires two-thirds vote by the Legislature.	No provisions.	Surplus may only be used to retire debt in advance of maturity.

State and Year of Adoption	Method of Approval and Type of Law	Limit Applies To	The Limit Is	Provisions for Waiver	Provisions in the Case of Transfer of Responsibility for Government Programs	Treatment of Surpluses
Massachusetts 1986	Citizen initiative. Statutory.	State revenue.	Growth in revenue cannot exceed the three-year average growth of wages and salaries.	Vote of Legislature.	Vote of Legislature.	Excess revenues are transferred to a Budget Stabilization Fund which is only allowed to grow to 5 percent of the state tax revenue. If the fund grows by more, the excess goes back to the taxpayers as an income tax credit in proportion to the tax liability.

State and Year of Adoption	Method of Approval and Type of Law	Limit Applies To	The Limit Is	Provisions for Waiver	Provisions in the Case of Transfer of Responsibility for Government Programs	Treatment of Surpluses
Michigan 1978	Citizen initiative. Const.	All state revenues less federal aid.	The growth of state revenue may not exceed 9.49 percent of prior year's personal income.	Provisions require the Governor to first specify an emergency; then the Legislature must concur by two-thirds vote in each chamber.	1) Limit may be adjusted if program responsibility is transferred from one government level to another by means of a constitutional amendment. 2) State is prohibited from reducing current proportion of local services financed through state aid. 3) No new program shall be required of local governments unless funded by state. 4) The proportion of total state spending paid to all units of local government as a group shall not be reduced below proportion for FY 1978-79.	Revenues exceeding limit by 1 percent or more shall be used for tax refunds set in proportion to income tax liability. Excess of less than 1 percent may be transferred to the State Budget Stability Fund.

State and Year of Adoption	Method of Approval and Type of Law	Limit Applies To	The Limit Is	Provisions for Waiver	Provisions in the Case of Transfer of Responsibility for Government Programs	Treatment of Surpluses
Mississippi 1992	Legislative vote. Statutory.	Budget recommendations and appropriations.	The budget and appropriations are limited to 98 percent of projected revenues.	No provisions.	No provisions.	One-half of year-end surplus remains in the General Fund and one-half goes into a working cash/stabilization reserve fund up to the 7.5 percent ceiling. The remainder goes into a special education fund.
Missouri 1980	Citizen initiative. Const.	Total state revenue.	Revenue is limited to the ratio of FY 1980-81 state revenue to 1979 state personal income, multiplied by the greater of state personal income in any calendar year or the average state personal income over the previous three calendar years.	Provisions require the Governor to first specify an emergency; then the legislature must concur by two-thirds vote in each chamber.	1) Limit may be adjusted if program responsibility is transferred from one level of government to another. 2) State is prohibited from reducing current proportion of local services financed through state aid. 3) No new program shall be required of local governments unless funded by the state.	Revenues exceeding the limit by 1 percent or more shall be used for tax refunds set in proportion to income tax liability. Excess of less than 1 percent may be transferred to the General Revenue Fund.

State and Year of Adoption	Method of Approval and Type of Law	Limit Applies To	The Limit Is	Provisions for Waiver	Provisions in the Case of Transfer of Responsibility for Government Programs	Treatment of Surpluses
Montana 1981	Legislative vote. Statutory.	State biennial appropriations.	Biennial appropriations are limited to state appropriations for the preceding biennium plus the product of preceding biennial appropriations and the growth percentage. The growth percentage is defined as the difference between average state personal income for three calendar years immediately preceding the next biennium and the average state personal income for the three calendar years immediately preceding the current biennium.	Provisions require the governor to declare an emergency. Legislature must then approve specific additional expenditures by two-thirds vote of each chamber.	No provisions.	No provisions.
Nevada 1979	Citizen Initiative. Statutory.	Governor's proposed General Fund expenditures.	State expenditures are limited to population growth and inflation using the 1975-76 biennium as the base.	Waiver provisions are not applicable.	No provisions.	No provisions.

State and Year of Adoption	Method of Approval and Type of Law	Limit Applies To	The Limit Is	Provisions for Waiver	Provisions in the Case of Transfer of Responsibility for Government Programs	Treatment of Surpluses
New Jersey 1990	Legislative vote. Statutory.	General Fund state appropriations less exemptions for debt service, state aid, grants-in-aid and capital construction.	Appropriations growth is limited to the average growth rate of state per capita personal income in the prior three years.	Provisions require two-thirds vote of the Legislature.	Any adjustments to the limit shall be made if program responsibility is transferred between state and local governments.	No provision, but the state has a rainy day fund.
North Carolina 1991	Legislative vote. Statutory.	State appropriations.	Appropriations growth is limited to 7 percent of the projected total state personal income for that fiscal year.	Limit may be exceeded to the extent that Medicaid, prison operations, or state health insurance increases exceed the percentage increase in state personal income.	No provisions.	No provisions.

State and Year of Adoption	Method of Approval and Type of Law	Limit Applies To	The Limit Is	Provisions for Waiver	Provisions in the Case of Transfer of Responsibility for Government Programs	Treatment of Surpluses
Ohio 1996	Legislative vote. Statutory.	Any excess above the annual year-end balances in the General Revenue Fund, Budget Stabilization Fund, and certain appropriations.	The limit is applied to the excess revenues above a statutorily set minimum year-end balance in the General Revenue and Budget Stabilization Fund. The General Revenue fund must have a year-end cash flow balance of 0.5 percent of prior-year revenue. The Budget Stabilization Fund must have a year-end balance of at least 5 percent of prior year General Revenue Fund revenue. Certain appropriated expenses are added to these balances. Revenues in excess of the year- end balances and appropriations become the basis for the surplus (tax cut).	Provisions require that there be sufficient moneys to pay for capital projects appropriated in prior capital bills. Moneys must also be available to offset an expected deficit in the next fiscal year.	No provisions.	By July 31st of each year, the surplus (if any) is certified and refunded to taxpayers through a proportional reduction in graduated state income tax rates. The reduction is based on estimated income tax collections.

State and Year of Adoption	Method of Approval and Type of Law	Limit Applies To	The Limit Is	Provisions for Waiver	Provisions in the Case of Transfer of Responsibility for Government Programs	Treatment of Surpluses
Oklahoma 1985	Legislative referendum. Const.	Appropriated revenues.	Appropriated revenues are limited to: 1) 12 percent yearly increase (adjusted for inflation); and 2) 95 percent of certified revenue.	No provisions.	No provisions.	Revenue to General Fund in excess of estimate (up to 10 percent) is deposited into a rainy day fund.
Oregon 2000[2]	Legislative referendum. Const.	Actual and forecast revenues.	General Fund actual revenue is limited to 2 percent over estimated revenue.	Two-thirds majority vote of each house may enact legislation declaring an emergency.	No provisions.	Taxpayers are given an income tax refund or credit if actual revenues are more than 2 percent of forecast at the time the budget is adopted. The credit or refund must be made in proportion to taxes owed.

[2] Originally passed by legislative vote in 1979.

State and Year of Adoption	Method of Approval and Type of Law	Limit Applies To	The Limit Is	Provisions for Waiver	Provisions in the Case of Transfer of Responsibility for Government Programs	Treatment of Surpluses
Oregon 2001	Legislative vote. Statutory.	State appropriations.	Appropriations growth is limited to no greater than eight percent of projected personal income for the biennium.	May be exceeded if governor declares an emergency and there is a three-fifths majority vote of each house.	No provisions.	No provisions.
Rhode Island 1992	Legislative referendum. Const.	State General Fund appropriations.	Appropriations growth is limited to 98 percent of estimated General Fund revenue and prior year's unencumbered funds.	No provisions.	No provisions.	Of the surplus, 2 percent must be put into a rainy day fund.
South Carolina 1980, 1984	Legislative referendum. Const.	State appropriations approved by the General Assembly.	State appropriations are limited to the average growth of personal income over three preceding years or 9.5 percent of total state personal income, whichever is greater. Also, the number of state employees is tied to state population.	Limit may be exceeded for one year by a two-thirds vote of the Legislature if it first declares a financial emergency. Also, every five years the Legislature can review the composition of the limit.	No provisions.	Excess revenues may be spent to match federal programs, for debt purposes, tax relief, or transferred to a reserve fund.

State and Year of Adoption	Method of Approval and Type of Law	Limit Applies To	The Limit Is	Provisions for Waiver	Provisions in the Case of Transfer of Responsibility for Government Programs	Treatment of Surpluses
Tennessee 1978	Const. convention. Const.	Appropriations of state tax revenue.	Appropriations growth is limited to the growth in state personal income.	Specific additional amount may be approved by majority vote of the Legislature.	State must share cost if it increases local government expenditure requirements.	No provisions.
Texas 1978	Legislative referendum. Const.	Appropriations (biennial) of state tax revenues not dedicated by the state constitution.	Biennial appropriations are limited to the growth of state personal income.	Specific additional amount may be approved by majority vote of the Legislature if it first adopts a resolution that an emergency exists.	No provisions.	No provisions.
Utah 1989	Legislative vote. Statutory.	State appropriations.	Yearly appropriations growth is based on formulas that use inflation, population growth, and growth in state personal income.	Waiver requires that an emergency must be declared by the governor and confirmed by more than two-thirds of both houses of the Legislature.	1) Adjustments to the limit shall be made if program responsibility is transferred between state and local governments. 2) Adjustment to the limit shall be made if program funding is transferred from general fund to non-general fund sources or vice-versa.	No provisions.

State and Year of Adoption	Method of Approval and Type of Law	Limit Applies To	The Limit Is	Provisions for Waiver	Provisions in the Case of Transfer of Responsibility for Government Programs	Treatment of Surpluses
Washington 1993	Citizen initiative. Statutory.	State expenditures.	Expenditures are limited to a three-year rolling average of inflation and population growth.	Waiver requires that an emergency must be declared and approved with two-thirds vote of the Legislature. Revenue increases need two-thirds vote in the Legislature if within expenditure limit. Voter approval is needed to exceed limit.	Prohibits state from imposing new mandates on local governments unless fully reimbursed.	Excess revenue goes into the Emergency Reserve Fund; if the fund exceeds 5 percent of General Fund revenue, the additional surplus is placed in the Education Construction Fund.

Source: NCSL survey of legislative fiscal officers, April 1996. The table has been updated and revised by Legislative Council Staff to reflect changes since April 1996

APPENDIX D

APPENDIX D: TABOR REFUND METHODS

The following paragraphs describe each of the TABOR refund mechanisms that are used to refund the TABOR surplus. Each method is used only if the TABOR surplus reaches a certain threshold that is adjusted annually by the percentage change in Colorado personal income. The projected thresholds for the FY 2004-05 surplus are indicated. The amount of the FY 2000-01 surplus returned via each refund method is also indicated.

House Bill 99-1383 and House Bill 00-1049 — Earned Income Credit. The Colorado earned income credit "piggybacks" off the federal earned income tax credit. Colorado taxpayers receive 10 percent of the federal credit amount. The federal credit may be claimed by certain taxpayers with modified federal adjusted gross incomes less than a certain amount. This threshold was approximately $34,200 in 2002. Colorado taxpayers who claim the federal credit may claim the state credit. *Projected threshold: $67.4 million; last amount refunded: $32.3 million.*

House Bill 00-1361 — Individual Development Account Credit. The Individual Development Account (IDA) program creates a new type of deposit account in financial institutions. The program allows persons earning 200 percent or less of the federal poverty income level to save money for post-secondary education, or, for persons earning 80 percent or less of the area median income, to save for the purchase of a home. Moneys deposited in an IDA may be matched with philanthropic donations. The funds can be used for post-secondary education, including occupational training, first-time purchase of a home, or business capitalization. This refund mechanism allows an income tax credit for donors who provide matching funds to an IDA. The maximum credit is 25 percent of the amount donated, but the total amount of the tax credits cannot exceed $5 million annually. No donor can receive a credit in excess of $100,000 per year. *Projected threshold: $237.2 million; last amount refunded: $9,000.*

House Bill 01-1313 — Foster Care Credit. This refund mechanism allows an income tax credit to taxpayers who incur non-reimbursed expenses in connection with providing foster care to children under18 years of age. *Projected threshold: $227.0 million; last amount refunded: $0.2 million.*

House Bill 99-1311 and House Bill 01-1287 — Business Personal Property Tax Refund. Businesses receive a refund equal to 100 percent of the first $700 in personal property taxes paid, plus 16 percent of the tax paid in excess of $700. *Projected threshold: $229.0 million; last amount refunded: $99.8 million.*

House Bill 00-1063 and House Bill 01-1257 — Credit for Rural Health Care Providers. The refund offered through this income tax credit is available to health care professionals who resided and practiced in a rural health care professional shortage area for at least 180 days of the income tax year and have committed to residing and practicing in the area for three to five years. The credit is equal to one-third of the amount of the student loan or one-third of the balance due and

owing on the student loan, up to the amount of the taxpayer's actual income tax liability. Unused portions of the credit may be carried forward for up to ten years. *Projected threshold: $355.7 million; last amount refunded: $0.2 million.*

House Bill 00-1351 — Child Care and Child Tax Credits. Colorado taxpayers already receive a child care credit and a child tax credit, though these credits are not TABOR refund mechanisms. As a TABOR refund mechanism, the existing child care tax credit is increased from 50 percent to 70 percent and the qualifying population is expanded to those with federal adjusted gross incomes greater than $60,000, but less than $64,001. The existing child tax credit for children under six years of age is increased from $200 to $300 and the income limitations are expanded in the same manner as for the child care tax credit. The age limit is expanded to 12 years of age for children who are cared for in their own family-operated child care home that is either licensed or legally exempt from licensing requirements. *Projected threshold: $361.9 million; last amount refunded: $23.5 million.*

House Bill 99-1137 and House Bill 00-1171 — Exclusion of Interest, Dividend, and Capital Gains Income. Individuals may deduct the lesser of $1,500 or their total amount of interest, dividend, and capital gains income on their state income tax return. Joint filers are allowed to deduct up to $3,000 of such income. House Bill 00-1171 increased the amount of the exclusion from the original $1,200 and $2,400 amounts. *Projected threshold: $436.8 million; last amount refunded: $44.0 million.*

House Bill 99-1237 — Exclusion of Capital Gains on Colorado Assets. Individuals and businesses may receive a deduction for capital gains taken on Colorado assets purchased prior to May 9, 1994. The gains must be taken during the preceding tax year. *Projected threshold: $350.3 million; last amount refunded: $49.8 million.*

House Bill 01-1081 — Sales and Use Tax Refund for Research and Development. This refund mechanism provides a refund of sales and use tax paid on purchases of tangible personal property used predominantly for research and development in the state. *Projected threshold: $407.0; last amount refunded: $0, this refund method was not effective until FY 2002-03 .*

House Bill 00-1355 — High Technology Scholarship Credit. This refund mechanism provides a 25 percent income tax credit for donations made to the Colorado High Technology Scholarship Program. The credit cannot exceed 15 percent of the amount of income tax due. Partnerships, S corporations, and other pass-through entities that donate to the scholarship program can allocate the credit to the entity's partners or shareholders in proportion to the partners' or shareholders' distributive shares of income from the entity. The program provides scholarships to in-state students earning high-technology related certificates or degrees. *Projected threshold: $411.9 million; last amount refunded: $3,000.*

House Bill 00-1227 — Reduction of Motor Vehicle Registration Fees. This refund mechanism reduces annual registration fees for motor vehicles. The fee for registering a passenger vehicle is reduced to $2.50 and the fee for registering other vehicles is reduced by 25 percent. *Projected threshold: $411.9 million; last amount refunded: $34.0 million.*

House Bill 00-1053 — Exemption for Certain Charitable Contributions. This refund mechanism allows individuals who claim the basic standard deduction on their federal income tax return to subtract charitable contributions in excess of $500 from federal taxable income on their state income tax return. *Projected threshold: $436.8 million; last amount refunded: $2.4 million.*

House Bill 00-1052 — Credit for Contributions to Telecommunication Education. This refund mechanism provides an income tax credit equal to 15 percent of a taxpayer's total monetary contribution made to the Colorado Institute for Telecommunication Education (CITE) for the purpose of funding grants or scholarships for students enrolled at the institute. The credit cannot exceed the smaller of $10,000 or the taxpayer's actual tax liability for the income tax year, and cannot be carried forward or refunded to the taxpayer. The CITE is an auxiliary unit at the University of Colorado to promote, support, enhance, and provide interdisciplinary education that relates to telecommunications and information technology. *Projected threshold: $436.8 million; last amount refunded: $0, the CITE had been eliminated by legislation; it has been restored and this credit will be effective again.*

House Bill 00-1259 — Sales and Use Tax Rate Reduction on Commercial Trucks. This refund mechanism reduces the sales and use tax rate on the sale of a new or used commercial truck, truck tractor, tractor, semitrailer that has a gross vehicle weight rating in excess of 26,000 pounds, to 0.01 percent. *Projected threshold: $436.8 million; last amount refunded: $4.2 million.*

House Bill 00-1257 — Sales and Use Tax Exemption for Pollution Control Equipment. This refund mechanism is for a sales and use tax exemption for purchases of equipment installed or used to detect, eliminate, reduce, or prevent air, water, or other environmental pollution. *Projected threshold: $436.8 million; last amount refunded: $1.9 million.*

House Bill 01-1086 — Agriculture Value-Added Development Fund Program. A board within the Department of Agriculture is authorized to offer tax credits, loans, and equity investments to eligible agricultural value-added cooperatives and other eligible agricultural businesses. The board may assess a fee to applicants for financial assistance and other services. This refund mechanism provides income tax credits that may be earned through value-added investments or purchased from the board. The board is allowed to certify $4 million in tax credits per year. *Projected threshold: $454.0 million; last amount refunded: $0.4 million.*

House Bill 00-1104 — Purchase of Private Health Benefit Plan Credit. This refund mechanism allows Colorado residents to claim an income tax credit for amounts paid for health benefit plans. The credit is restricted to individuals, spouses, and dependents who obtain private medical/health insurance and who were not covered by an individual health benefit plan or an employee or group health benefit plan during any portion of the income tax year immediately preceding the income tax year for which the credit is being claimed. The credit is limited to residents whose federal adjusted gross income does not exceed $25,000 for individuals with no dependents; $30,000 for two individuals with no dependents filing a joint return, or two married individuals with no dependents filing separate returns; and $35,000 for resident individuals with dependents. The maximum credit is limited to $500, is not refundable to the taxpayer, and cannot be carried forward. *Projected threshold: $499.2 million; last amount refunded: $2.4 million.*

House Bill 00-1209 — Capital Gains Deduction for Assets Held for One to Five Years. This refund mechanism modifies the refund provision of House Bill 99-1237 and establishes a new refund mechanism for other capital gains. House Bill 99-1237 established a deduction for certain Colorado assets that were held for a period of at least five years and purchased prior to May 9, 1994. While the original refund mechanism required the transaction to occur on or after January 1, 2000, this refund mechanism amends it to allow transactions that occurred in 1999 to qualify for the deduction. This refund mechanism applies to the capital gain arising from the sale of certain Colorado assets on or after January 1, 2001, that were held by the taxpayer for a period of from one to five years. *Projected threshold: $536.7 million; last amount refunded: $27.5 million.*

House Bill 99-1001 — Sales Tax Refund. This final refund mechanism allows individuals to receive a state sales tax refund based on six modified federal adjusted gross income tiers and the filing status of the taxpayer. The amount of excess revenue refunded through this mechanism is determined by subtracting the amount estimated for other refund methods from the total TABOR refund. The Department of Revenue sets the dollar amount of each tier and each tier's refund based on set percentages of the refund and taxpayers in each tier. *Projected threshold: no threshold; last amount refunded: $576.6 million.*