

As required by Indiana Code 4-12-1-12(a), the State Budget Agency hereby transmits to Governor Mitch Daniels, Auditor of the State Connie Nass, and the Indiana General Assembly the following report on the appropriations made during the 2005 regular session of the Indiana General Assembly.

## **Appropriations**

The total General Fund and Property Tax Replacement Fund appropriations made by the 2005 regular session of the Indiana General Assembly are \$12.08 billion for FY 2006 and \$12.25 billion for FY 2007. The annual rate of growth in appropriations is 2.2% (FY 2006 over FY 2005) and 1.4% (FY 2007 over FY 2006). This represents the smallest rate of growth in 50 years and compares to an average annual growth rate over the past ten years of 5.71%.

## **K-12 Education**

Funding for elementary and secondary education comprises the largest component of Indiana's state budget. The General Assembly has appropriated \$3.76 billion for FY 2006 (an increase of 1.59% over the FY 2005 appropriation) and \$3.75 billion for FY 2007 (essentially flat with the FY 2006 appropriation) for K-12 tuition support. Two notable changes have been made to the school formula: (1) the minimum guarantee was removed from the formula, (2) the growing enrollment grant and ISTEP remediation grant were removed as separate categoricals and rolled into the school formula. The school corporations were again granted the authority to pay expenditures for utilities and property insurance out of their capital projects funds and to increase their local capital projects fund levy to cover those costs. The budget also paid the unfunded liability in the post 96 Teachers Retirement Fund, which accrued due to the transfer of teacher pensions liabilities from the pre 96 fund. This elimination of the unfunded liability in the post 96 fund allowed the employer contribution paid by school corporations to the Teachers Retirement Fund to significantly decline. Total appropriations for all K-12 are \$5.80 billion in FY 2006 (an increase of 1.24% over FY 2005) and \$5.84 billion in FY 2007 (an increase of 0.47% over FY 2006).

## **Higher Education**

Total state appropriations for higher education increased \$28.6 million (1.9%) for FY 2006 over the appropriations in FY 2005, and an additional \$44.8 million (2.9%) for FY 2007 over the appropriations for FY 2006. The State Student Assistance Commission (SSACI) received appropriation increases of 4.8% in FY 2006 and an additional 10.7% in FY 2007. This increase funds the tuition assistance grants at the same per student funding as FY 2005. In addition to the appropriations above, the General Assembly approved \$243 million in bonding authority for new buildings and infrastructure needs and \$9.7 million in cash for capital projects for the state's colleges and universities.

## **Health and Human Services**

Health and Human Services will receive approximately \$2.3 billion of state General Funds in FY 2006 and approximately \$2.4 billion in FY 2007. This is an increase of \$257.2 million in FY 2006 and \$351.4 million in FY 2007 from the FY 2005 appropriation levels. The largest increases will be in the areas of Medicaid Assistance, home and community based services for persons with developmental disabilities, and child protection services.

The state appropriation for Medicaid Assistance increases by \$187.5 million in FY 2006 from the FY 2005 appropriation. This increase is a result of the FY 2005 appropriation being insufficient to cover the projected expenses. When compared to actual expenditures, the increase from FY 2005 is \$66.5 million, or 5.0%. The FY 2007 appropriation increases an additional 5.0%, or \$69.9 million from FY 2006. With historic growth rates for Medicaid exceeding 5%, the Family and Social Services Agency (FSSA) will be undertaking several initiatives to contain the growth rate to 5%. Some of these initiatives include the expansion of managed care, increasing the efficiency of Medicaid waiver programs, decreasing the dispensing fee for pharmaceuticals, and reducing rate increases for nursing homes and other institutional settings.

FSSA's former Division of Disability, Aging, and Rehabilitation Services is divided into the Division of Aging and the Division of Disability and Rehabilitation Services. The FY 2006 state appropriation for Residential Services for Developmentally Disabled Persons represents a \$20.4 million increase over the FY 2005 appropriation and an additional \$16.2 million is appropriated in FY 2007. These increases will allow individuals with developmental disabilities to receive services so that they may continue to live in home and community based settings.

The FY 2006-FY 2007 budget reflects the creation of the new Department of Child Services. This department was created by moving child protection services, foster care, adoption, independent living, child support, and other programs from FSSA. In addition to becoming a cabinet level agency, the Department of Child Services will receive almost \$8 million annually in additional state appropriations in FY 2006 and FY 2007 in order to hire additional caseworkers. This additional funding will allow for 400 new caseworkers over the biennium to strengthen the state's child protection system.

The Indiana State Department of Health (ISDH) will receive approximately \$56.7 million from the Tobacco Master Settlement Agreement as well as \$12.7 million in state General Funds in both FY 2006 and FY 2007. State appropriations are increasing by \$1.6 million in the biennium and will allow the Department to continue providing valuable public health services such as childhood vaccinations, certification of nursing homes, and programs for children with special health needs.

The special institutions, which include Silvercrest Children's Developmental Center, the Indiana Soldiers' and Sailors' Children's Home, and the Indiana Veterans Home received state appropriations in the amount of \$31.8 million annually in the FY 2006-FY 2007 biennium. Funding for the special institutions has increased slightly to ensure services for some of Indiana's most vulnerable children and veterans.

## **General Government**

The budget appropriates money to fund the newly created Office of Management and Budget, Office of Inspector General, Office of Faith Based and Community Initiatives, and Office of Technology.

The budget includes \$28.2 million over the biennium for salary increases for court officers including trial court judges, appellate court judges, and prosecutors. To provide the necessary revenue for the salary increases, the General Assembly established or increased several court fees. The court fees will produce approximately \$30.2 million in revenues during the biennium. The General Assembly also created five new courts, added four judges to existing courts, and provided for the appointment of two new magistrates. The budget includes \$2.1 million over the biennium to fund the new judicial officers. Court fees have been increased to provide the revenue for the new officers.

The budget includes an appropriation of \$62.7 million for the biennium for the state's share of the plan losses of the Indiana Comprehensive Health Insurance Association. The association is the state's health insurance program for high risk individuals.

General Fund Appropriations include \$89.0 million over the biennium for the Personal Services/Fringe Benefits Contingency Fund to provide funding for expected increases in health insurance premiums and general salary adjustments.

## **Teachers' Retirement Fund**

The 2006-2007 budget fully funds the projected pension obligations for retired teachers in the Pre 1996 Plan for the biennium. Unlike the 2004-2005 budget, the 2006-2007 budget does not include a transfer of additional money from the Pension Stabilization Fund to the Teachers' Retirement Fund to assist in the funding of current pension obligations of the Pre 1996 Plan. The budget does transfer \$30.0 million from the Lottery Fund to the Pension Stabilization Fund in FY 2006 and FY 2007.

To improve the funding of the new 1996 Plan, member transfers from the Pre 1996 Plan to the 1996 Plan are stopped and the necessary amount from the Pension Stabilization Fund to the 1996 Plan to fund the unfunded liability of individual members who previously transferred is allocated to the new 1996 Plan.

The budget includes language that requires the Teachers' Retirement Fund to include in its determination of the appropriation, contribution rate, and liability the amount necessary to fully fund any past and estimated future cost of living adjustments.

## **Public Safety**

The 2006-2007 biennium budget appropriates approximately \$1.3 billion for the operation of the Indiana correctional system. This appropriation will provide for the incarceration of

approximately 25,000 adult and juvenile offenders in state correctional facilities and community correction programs. The biennium appropriation includes additional funds for community corrections, funding for juvenile transition programs and the return of all out of state offenders to Indiana correctional facilities.

The budget also appropriates a total of approximately \$296.4 million for the operations of the State Police, including the funding for laboratory services from the Motor Vehicle Highway Account during the biennium. An additional \$15 million of dedicated funds is appropriated to the State Police. The budget also provides the State Police with \$10 million in capital expenditures which includes \$7 million in vehicle purchases.

The Adjutant General's Office is appropriated \$2.5 million for the development of a state of the art Urban Training Center in year one of the biennium. The cost of the Training Center in the second year of the biennium will be paid with 100% federal funds.

### **Conservation and Environment**

The 2006-2007 biennium budget appropriates \$570 million for the environment and conservation programs in Indiana. This includes an additional \$9 million dollars for the operation of Indiana's parks and reservoirs. There is also increased dedicated funding for Fish and Wildlife and Lake and River Enhancement Programs.

### **Transportation**

The 2006-2007 biennium budget for transportation includes \$3.5 billion in state dedicated and federal funds. This is a decrease of 9.2% from the previous biennium. This reduction is due mainly to a reduction in federal funds while INDOT awaits the passage of a new highway act by Congress. The budget for transportation includes additional lease payments for bonding projects thus reducing funding for construction.

### **Capital and Construction**

The capital budget for the 2006-2007 biennium represents a commitment to the preservation of basic infrastructure. This includes \$40.4 million for preventative maintenance, \$107.1 million for repair and rehabilitation projects, \$262.6 million for lease payments, and \$57.4 million for university repair and rehabilitation.

Preventive maintenance increased approximately 2.5%, repair and rehabilitation funded by the General Fund increased by 7.2%, and lease payment appropriations increased by 10% as a result of the increased number of facilities requiring bond payments. The capital budget also increased appropriations to universities for repair and rehabilitation by 100%. Universities received 50% of the university formula for the 2006-2007 biennium compared to 25% in the 2004-2005 biennium. Overall, capital appropriations increased by about 12.5% in the 2006-2007 biennium from the 2004-2005 biennium.

The Department of Correction capital budget includes funding for renovation of donated military buildings, a new visitation building at the State Prison, replacement of the security perimeter at the Women's Prison and renovation of the infirmary at the Plainfield Correctional Facility. In addition, various HVAC renovations and roof replacements are appropriated for in the department's capital budget.

The capital budget for the Department of Natural Resources includes funding for drinking water and wastewater projects and dam upgrades at various state parks. Also included, is preservation of existing buildings at the state parks museums and historic sites. Various projects such as the rehabilitation of campgrounds, cabins, and pools at the state parks are included in the department's appropriations. Funds were also appropriated for the Shafer-Freeman Lakes dredging.

The capital budget includes funding for the War Memorials Commission, Maumee River Basin Commission, Indiana Port Commission and the Little Calumet River Basin Commission. Airport development funds are appropriated to be used for federal matching grants. Also included is Family and Social Services Administration's transitional care unit for Logansport State Hospital.

### **Outside Acts**

The Indiana General Assembly enacted several pieces of legislation that impacts General Fund and Property Tax Replacement Fund revenues and expenditures. The most notable revenue measures include Senate Enrolled Act (SEA) 1 which provides a sales tax exemption on research and development purchases; SEA 213 which changes the sales tax rate paid on recreational vehicles that are purchased in Indiana but the owner lives outside Indiana; House Enrolled Act (HEA) 1001 which updates the Indiana code to the federal tax code, extends the earned income tax credit to 2011, permits counties that are past due on their juvenile debt to repay that debt through a bond issue or over 4 years through reduced property tax replacement credits, and makes permanent the transfer of abandoned property revenues to the General Fund; HEA 1004 which creates a tax amnesty program; HEA 1113 which increases court fees for a judicial salary increase; and HEA 1662 which permits a Medicaid health facility quality assessment.

The most notable expenditure impacts are: SEA 363 which increased judges' salaries; and HEA 1001 which made various changes to the Medicaid program to constrain Medicaid's rate of expenditure growth. A detailed list of the revenue and expenditure impacts is located in Section E of this document.

### **Revenues**

During the 1990's, state tax revenues were propelled by the longest economic expansion on record and a tremendous increase in realized wealth by individual investors. In 2001, the U.S. economy experienced a recession lasting eight months, terrorist attacks on U.S. soil, and the collapse of stock prices. Recovering from these dynamics has proven slow.

General Fund and Property Tax Replacement Fund revenues declined by 1.0% in FY 2001 and by 3.8% in FY 2002 - the first back-to-back declines in recorded history. General Fund and

Property Tax Replacement Fund revenues increased by 13.4% in FY 2003 and 7.5% in FY 2004 due largely to increases in sales and cigarette taxes and the redirection of riverboat wagering taxes to the Property Tax Replacement Fund. Absent these revenue measures, revenues would have increased by an estimated 1.5% in FY 2003 and by 1.8% in FY 2004. The April 2005 revenue forecast is for General Fund and Property Tax Replacement Fund revenues to increase by 6.3% in FY 2005, 4.1% in FY 2006, and 5.3% in FY 2007.

### **Reserve Balances**

The State Budget Agency estimates that Indiana's total combined reserve balance will be just over \$660 million to begin the FY 2006 – FY 2007 biennium. This combined balance includes reserves of approximately \$125 million in the General Fund, \$290 million in tuition reserve, and \$245 million in rainy day reserves. The estimated combined reserve balance at the end of the biennium is in excess of \$750 million. The growth in the combined reserve balance reflects the projected surplus over the biennium. It falls short of balancing in the first year; however, the surplus of the second year more than covers the first year's deficit.

This budget transfers \$100 million of the aforementioned surplus to the Rainy Day Fund and permits the repayment of the payment delays to local schools, local units of government, and the public universities and colleges if the surplus materializes.

A Combined Statement of Net Actual and Estimated Unappropriated Reserve (the Reserve Statement) follows this cover letter and is intended to reflect the estimated reserve balance at the time the budget passed the General Assembly.

### **Summary**

This budget reverses the trend of the last ten years of running substantial budget deficits and establishes the first honestly balanced budget in many years without gimmicks. If the economy avoids a downturn during this biennium, Indiana will be well on its way to achieving the financial stability for which Governor Daniels campaigned.

Respectfully submitted,

Charles E. Schalliol, Director  
Office of Management & Budget