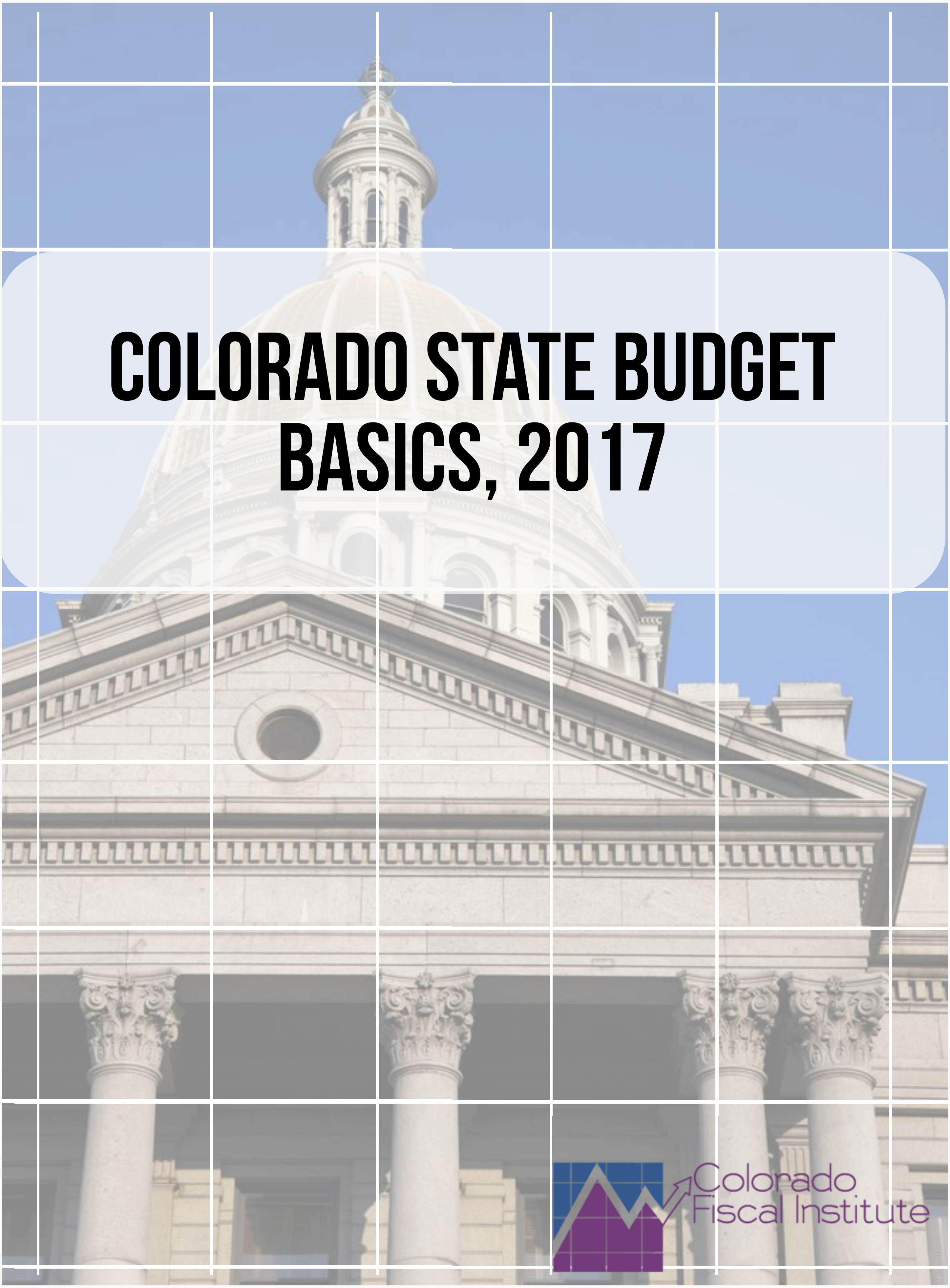


COLORADO STATE BUDGET BASICS, 2017

Colorado Fiscal Institute

TABLE OF CONTENTS

INTRODUCTION: SMART INVESTMENTS TO HELP CREATE HEALTHY, WEALTHY AND WISE COLORADANS

The public sector plays an important role in sustaining and expanding the middle class and building an economy that works for all. A key component of that role in Colorado is the state budget.

State budgets are more than the mere balancing of revenues and expenditures for a given fiscal year. Through budgets, policymakers set priorities. The state should have adequate resources to allocate in ways that promote economic prosperity and enhance opportunities for all Coloradans. Policies that govern our shared investments should ensure that all people, regardless of their race, gender, income or address, get a fair shot at economic opportunity and greater future economic stability.

In addition, the state budget and the constitutional structures that govern the state's budget process should:

- Facilitate strategic investments
- Foster responsive government and institutions that can adapt to the changing needs of the state, its economy and its people
- Fuel innovation and entrepreneurialism through greater economic security for working families

These outcomes require a sound budget process. A good state budget process should incorporate a long-term perspective, establish a link to state priorities and focus on results. In addition, the process should include stakeholders, identify issues and concerns, involve regular and frequent reporting to provide accountability, educate and inform stakeholders and improve confidence in government.

These aspects of the process ensure that budgeting is not a short-term process focused on balancing revenues and expenditures one year at a time. Instead, these practices ensure a long-term and transparent process that allocates resources for all.

Unfortunately, Colorado's budget process has far to go in meeting these standards. Due to restrictions on spending and a lack of meaningful public input, the budget process in the state falls short. Legislators are unable to set long-term priorities and are unable to ensure adequate resources for necessary services for all. In addition, there are limited opportunities for meaningful stakeholder participation. The Colorado Fiscal Institute's 2017 Colorado State Budget Basics outlines the budget process in Colorado, laying out a roadmap to its steps, key players, dates and terms.

CHAPTER ONE: FUNDAMENTALS OF A GOOD TAX SYSTEM

WHAT EXACTLY IS THE STATE BUDGET?

Colorado vests primary responsibility for the annual state budget with the General Assembly. When Coloradans think of the state budget, they usually think first of the "Long Bill," developed and adopted by the legislature each year. This chapter maps out the role of key players and steps in the process of developing the Long Bill.

The General Assembly's permanent fiscal and budget review agency, the six-member Joint Budget Committee (JBC) and its staff, prepares the Long Bill each year for approval of the full legislature and signature of the governor. The JBC and its staff exercise the greatest control over the Long Bill and, consequently, a great deal of power over the state budget. The JBC consists of the chairperson of the House Appropriations Committee plus one majority party member and one minority party member, and the chairperson of the Senate Appropriations Committee plus one majority party member and one minority party member of the Senate. Members of the committee are selected from each house in the same manner as members of other standing committees.[1] Historically, the Senate elects its JBC members. In the House, the speaker appoints the majority party members and the minority party elects its members.[2] The JBC is a year-round committee, functioning during the legislative sessions and during the interim between sessions.

While the primary authority to write and adopt the state budget falls to the legislature, the governor's office and executive agencies play an important role in directing funding priorities and administering the budget over the course of the fiscal year. Colorado's fiscal year begins July 1, and the budget process is really a collaboration between the legislative and executive branches over the entire year.

THE BUDGET PROCESS

Executive Action

By statute, the governor, as chief executive, must annually evaluate the plans, policies and programs of all departments of state government. He or she must formulate priorities into a financial plan encompassing all revenues and expenditures. The governor and executive staff must then propose this plan for consideration by the General Assembly in the form of an annual executive budget no later than Nov. 1. The budget consists of operating expenditures, capital construction expenditures, and estimated revenues. Proposed expenditures in the executive budget must not exceed estimated available revenue as determined by the Governor's Office of State Planning and Budgeting (OSPB). The executive budget submitted to the JBC provides a skeletal outline of funding priorities, revenues and expenditures. The JBC and its staff also has access to detailed background information, as prepared by the executive departments.

The library of the Capitol and the OSPB website house full departmental requests.[3] The governor is charged with administering the budget during

1 C.R.S. §2-3-201(1)
2 Joint Budget Committee "The Role of the Joint Budget Committee," 8 January 2016 <http://www.tornado.state.co.us/gov_dir/leg_dir/jbc/jbcrole.pdf>.
3 http://www.colorado.gov/ospb Click on "Department Budget Requests" and the appropriate Budget Cycle

the year after any legislative review and modification of the budget is made.[4]

Joint Budget Committee Action

Immediately following the submission of the governor's executive budget request, the JBC schedules hearings with departments. The JBC divides state departments and programs among staff analysts. This allows individual staff members the opportunity to develop specific areas of budget expertise. JBC analysts review the requests submitted by the executive branch, meet with agency personnel and present detailed information to JBC members prior to a hearing with a department. JBC staff briefings are oral and written presentations designed to stimulate discussion among JBC members around programs, operations and funding needs of the departments. Briefings take place in November and December, before the start of the legislative session in January, and are open to the public. Unfortunately, public comment is not allowed during briefings.

Staff briefing documents and a schedule of briefing times are posted on the JBC website at: http://www.tornado.state.co.us/gov_dir/leg_dir/jbc/2014-15/jbcstaffdocs.htm

After staff briefings, JBC members decide on the issues and priorities they wish to discuss with the departments at hearings. JBC hearings provide an opportunity for members to question department staff about programs, needs, new funding initiatives and other issues for the upcoming fiscal year. JBC hearings with departments are also open to the public, but again, no public comment or testimony is permitted.[5]

The JBC generally has a good sense of the governor's priorities and executive agency needs by the start of the legislative session in early January and is ready to begin the process of developing the Long Bill. The Colorado constitution requires the legislature to adopt a balanced budget each year. Thus, the revenue figure certified by the General Assembly is critical. All appropriations decisions must eventually align with the amount certified — that figure becomes the target for balancing the budget.

When certifying a revenue figure, the General Assembly has access to revenue projections submitted by OSPB and Legislative Council, its own economic research agency. The Legislative Council is an 18-member legislative committee. The president of the Senate appoints six members of the Senate to the council while the speaker of the House appoints six members of the House to the council. Appointments are subject to the approval of the respective houses. The president of the Senate and the majority and minority leaders of the Senate, as well as the speaker of the House and majority and minority leaders of the House, serve as ex-officio members of the council. The council employs a research director who oversees a permanent research staff to work for the General Assembly. The Legislative Council staff, often known simply as "Leg Council," provides support to legislative committees, responds to requests for research and constituent services, prepares fiscal notes and provides revenue projections.

During February and March, the JBC, with the help of its staff, makes decisions on the level of funding necessary to maintain all state operations through a process known as "figure setting." The JBC votes on each line item recommendation, formulates head notes or footnotes which explain or request additional information for a specific line item, and the staff calculates, balances and begins drafting the Long Bill.

Staff figure setting recommendations for each department are available online once they have

4 C.R.S. §24-37-301.
5 Joint Budget Committee, "The Role of the Joint Budget Committee." http://www.tornado.state.co.us/gov_dir/leg_dir/jbc/jbcrole.htm

been presented to the JBC.

http://www.tornado.state.co.us/gov_dir/leg_dir/jbc/2015-16/figuresetting.htm

Once written, the Long Bill moves to the full General Assembly for consideration. It is introduced in the chamber that the JBC chairman serves in. The chairmanship alternates annually between the House and Senate. A perfunctory hearing in the Appropriations Committee during this time presents the only opportunity for the public to comment or testify on the Long Bill. The Long Bill then proceeds through the legislature as any other bill.

For more detail about the legislative process, please see "The Legislative Process" at https://www.colorado.gov/pacific/cga-legislativecouncil/other-information

Legislative consideration starts in the party caucuses. Here JBC members and staff explain the budget items and funding decisions contained in the bill and answer questions from their fellow legislators. JBC prepares a "Long Bill Narrative" as part of this process (the public may obtain a copy of this narrative). The public can attend caucus meetings, but there is no official process for public participation. A party caucus can propose changes or a legislator may offer changes to the bill as an amendment for consideration when the Long Bill moves to the floor for debate by the full House or Senate. After both houses pass the Long Bill, it returns to the JBC if the House and Senate versions differ. The JBC acts as the conference committee for the bill and JBC members must resolve any differences between the House and Senate changes. After differences are resolved, the JBC conference committee report is sent to both houses for approval.

Executive Approval/Veto

The governor has line-item veto power for the Long Bill. This means the governor can strike individual line items from the budget but does not have the authority to increase, decrease or otherwise amend appropriations in the bill. The Long Bill becomes an act after executive action. After final approval, the JBC staff publishes the Appropriations Report by July 1. The Appropriations Report and the narrative that accompanies it can be found on the JBC website at https://leg.colorado.gov/publications/fy-2016-17-appropriations-report After passage, the state budget moves to executive departments for implementation and oversight.

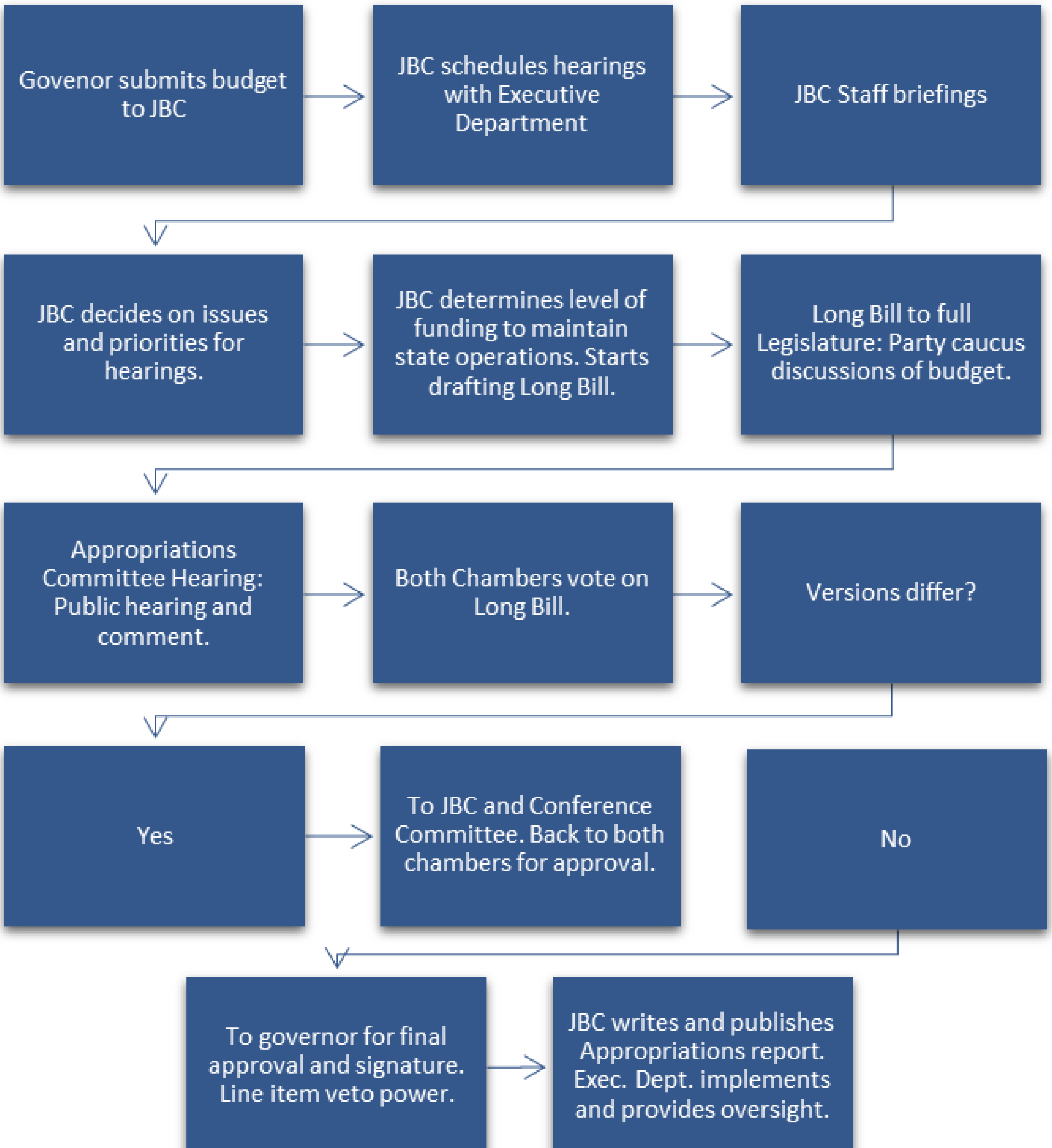
Post-passage Action

The state budget, like any budget, often requires revision during the course of the year as circumstances change. Executive departments may request funding changes during a current fiscal year via "supplementals." In general, OSPB or a state agency must submit supplemental requests to the JBC by Jan. 15 of each year, at the latest. However, agencies can submit requests later if unusual or unforeseen circumstances demand.[6] The state's balanced budget requirement restricts budget changes to those that align with available revenues and fall within allowable spending limits.

The JBC and its staff review these requests for funding changes, determine which requests can or should be granted, explore where cuts can be made to accommodate the request if necessary and submit their decisions to the entire General Assembly through supplemental appropriations bills.

6 C.R.S.§2-3-208

LEGISLATIVE BUDGET PROCESS



Calendar of the Budget Process		
January	**Jan. 2-15**	Budget amendments and supplemental requests due to the JBC for consideration.
	Wednesday, 2nd week of Jan.	Legislature convenes 10 a.m.
	Ongoing	Throughout January, JBC considers supplemental requests.
February	**Ongoing**	Throughout February JBC makes funding decisions — figure setting.
March	**Ongoing**	Throughout March, the General Assembly acts on supplemental appropriations bills. JBC figure setting continues and staff begin drafting the Long Bill.
	Mid-March	Focus Colorado: Economic & Revenue Forecast released by Legislative Council can be found at https://www.colorado.gov/pacific/cga-legislativecouncil/forecast The Colorado Economic Outlook, released by OSPB is available at https://sites.google.com/a/state.co.us/ospb-live/live-form The Long Bill is introduced and continues through process of consideration and approval by both bodies of the General Assembly — moves to party caucuses first. Only opportunity for public input and testimony on the budget is when the Long Bill moves to the Appropriations Committee prior to introduction on the floor.

April	**Early April**	Long Bill goes through conference committee. Long Bill goes to the governor. Governor can exercise his line-item veto power on select appropriations in the Long Bill.
May	**May 10**	Legislature adjourns.
June	**June 20**	Focus Colorado: Economic & Revenue Forecast released by Legislative Council can be found at https://www.colorado.gov/pacific/cga-legislativecouncil/forecast The Colorado Economic Outlook, released by OSPB is available at https://sites.google.com/a/state.co.us/ospb-live/live-form
July	**July 1**	State fiscal year begins. Department performance plans due. Plans are meant to provide the JBC with information to prioritize any department funding requests. JBC staff releases the "Appropriations Report" for current fiscal year and narrative. Available on the web at http://www.tornado.state.co.us/gov_dir/leg_dir/jbc/2014-15/jbcstaffdocs.htm Executive agencies begin internal budget process for upcoming fiscal year.
August	**Ongoing**	Executive agencies continue internal budget process for upcoming year and begin working with OSPB on budget request.
September	**Sept. 1**	OSBP must ensure submission of all capital construction and controlled maintenance requests and proposals for the acquisition of capital assets by each state department, institution and agency to the Capital Development Committee. Focus Colorado: Economic & Revenue Forecast released by Legislative Council can be found at https://www.colorado.gov/pacific/cga-legislativecouncil/forecast The Colorado Economic Outlook, released by OSPB is available at https://sites.google.com/a/state.co.us/ospb-live/live-form

October	**Ongoing**	Executive agencies continue work with OSPB and governor's office on budget requests.
<u>November</u>	**Nov. 1** **Ongoing**	Governor's office must submit to the JBC all agency requests for the upcoming year. OSPB must submit the recommended priority of funding of capital construction projects of all state departments, institutions and agencies to the Capital Development Committee. JBC staff briefings and department hearings. Each department of state government must start to meet with committees of reference to discuss whether the department is meeting predetermined performance-based goals (in compliance with the State Measurement for Accountable, Responsive, and Transparent — or SMART — Government Act). Each joint committee will hear a presentation from each department assigned to the committee regarding regulatory agendas, budget requests, any associated legislative agendas and performance plan. Governor's budget request available from OSBP at http://www.colorado.gov/ospb
December	**Early December** **Ongoing**	OSPB must ensure submission of all requests for supplemental appropriations for capital construction and controlled maintenance requests and proposals for the acquisition of capital assets by each state department, institution, and agency to the capital development committee. JBC staff briefings and department hearings. SMART hearings continue. Focus Colorado: Economic & Revenue Forecast released by Legislative Council can be found at https://www.colorado.gov/pacific/cga-legislativecouncil/forecast The Colorado Economic Outlook, released by OSPB is available at https://sites.google.com/a/state.co.us/ospb-live/live-form

IMPORTANT TERMS CHAPTER ONE

Appropriation — The authority to spend a specific amount of money.

Conference committee — One committee, of House and Senate appointees, meeting together to attempt to work out language acceptable to the Senate and House on some measure upon which agreement was not reached through committee or floor amendments.

Executive budget — The governor's budget request to the General Assembly.

Figure setting — The process of setting line items with footnotes and head notes of the Long Bill.

Joint Budget Committee (JBC) — The General Assembly's permanent fiscal and budget review panel, composed of six members of the legislature and served by a staff of budget analysts.

JBC Briefing — Written and oral presentations of JBC staff to JBC members of budget issues and a review of expenditures and requests by executive agencies for funding.

JBC Hearing — A JBC meeting that is open to the public where members of the committee have the opportunity to question executive agencies about their programs, priorities and budget requests.

Legislative Council Staff — The nonpartisan, permanent research arm of the General Assembly.

Line Item — An item that is listed in an appropriations bill on a separate line.

Line-Item Veto — The governor has the power to selectively veto items in appropriations bills. Usually, this means items in the Long Bill.

Long Bill — Colorado's annual general appropriations act — the major funding bill for the operations of state government for a fiscal year.

OSBP — The Governor's Office of State Planning and Budgeting assists the governor with oversight of the budget and development of the executive budget. OSBP provides revenue projections, economic analysis and other information. OSPB is the primary economic research arm of the executive branch.

Supplementals — Requests for funding changes during a current fiscal year.

CHAPTER TWO: THE BUDGET

WHERE DOES THE MONEY COME FROM?

Colorado raises money from a variety of sources, including grants to states from the federal government, general taxes such as income and sales tax, fees and fines and many others. For budgeting purposes, the state divides revenues into five broad fund categories: Federal Funds, Cash Funds, Reappropriated Funds, General Funds and General Funds Exempt. In general, the amount of cash and general fund revenue the state is allowed to collect and spend (or save) in any given year is limited by Article X, Sec. 20 of the Colorado Constitution, otherwise known as TABOR.

Federal funds are monies received from the federal government. Some federal funds are earmarked for specific short-term purposes; others support ongoing state-federal programs, such as Medicaid, and may require the state to match those funds with state dollars. Federal funds are not included in the calculation of allowable revenue under Article X, Sec. 20.

Cash Funds are funds received from fees and fines and specific taxes. These are funds earmarked for specific programs and are usually related to the identified revenue source. For instance, fees raised by vehicle registration are cash funds earmarked for road maintenance. Or a portion of marijuana tax revenue goes into the Marijuana Tax Cash Fund. Some of the largest Cash Funds in the state budget come from taxes and fees related to transportation, gaming and resource extraction.

Several Cash Funds are exempt from the provisions of Article X, Section 20 of the Colorado Constitution. These exempt funds include money awarded to the state from the tobacco settlement, donations to the state, and most of the tobacco tax revenue generated through a voter-approved measure known as Amendment 35 and other voter approved exemptions, such as the Marijuana Tax Cash Fund. These particular Cash Funds are counted for budget purposes, but their values are exempt from any revenue restriction in Article X, Section 20 (for more see Chapter 3: Limits on State Spending).

Reappropriated Funds describe any funds given to a particular department that are then transferred to another department as payment for services. The funds are marked as "Reappropriated Funds" by the department that receives the fund. Essentially these are double counted funds.

General Funds are those funds the state receives from general tax revenues, such as the state sales and income taxes. The General Fund operates like the state's general checking account. The fund pays for many general state programs and operations, such as education, health care, higher education and corrections.

General Funds Exempt are funds exempt from the revenue limits under Article X, Section 20 of the Colorado constitution. In 2004, voters approved Amendment 35, increasing tobacco taxes.

Three percent of Amendment 35 tobacco taxes are exempt from TABOR and deposited into the General Fund, exempt from TABOR revenue restriction. When voters approved Ref C in 2005, they authorized the state to retain and spend revenues over the limit set by TABOR. These revenues are deposited in the General Fund Exempt account and only appropriated for health care, education, firefighter and police retirement plans, and strategic transportation projects.

Quarterly revenue projections, developed independently by OSPB and Leg Council, estimate General Fund revenue and Cash Fund revenue. These reports become available around March 20, June 20, Sept. 20 and Dec. 20.

Focus Colorado: Economic & Revenue Forecast released by Legislative Council can be found at https://www.colorado.gov/pacific/cga-legislativecouncil/forecast

The Colorado Economic Outlook, released by OSPB is available at https://sites.google.com/a/state.co.us/ospb-live/live-form

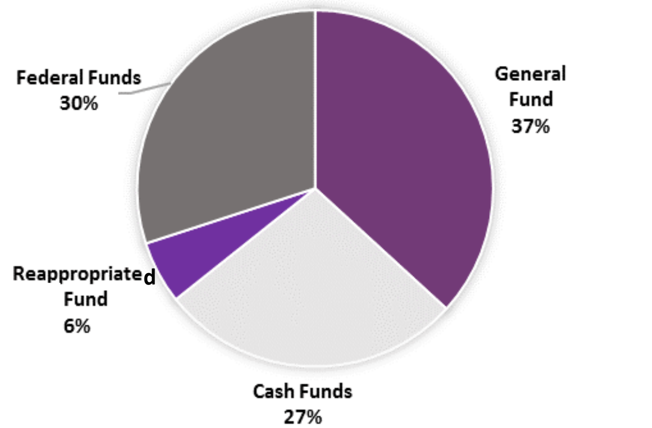
For FY 2016-17, the Colorado budget totals more than $27.15 billion. The chart below (Figure 1) shows the four major categories of source of funds for the state budget. Although the General Fund is the largest portion of revenue for the state budget, federal aid and a wide variety of earmarked taxes and fees also account for large portions of the state budget.

HOW DOES THE STATE SPEND THE MONEY IT RECEIVES?

Figure 2 shows that the largest portion of the state budget goes to cover the costs of health care, human services and education. Health care includes Medicaid, child health or CHP+, and other public health programs. Education, which includes kindergarten through 12th grade, captures the second-largest portion of the entire state budget.

Figure 1

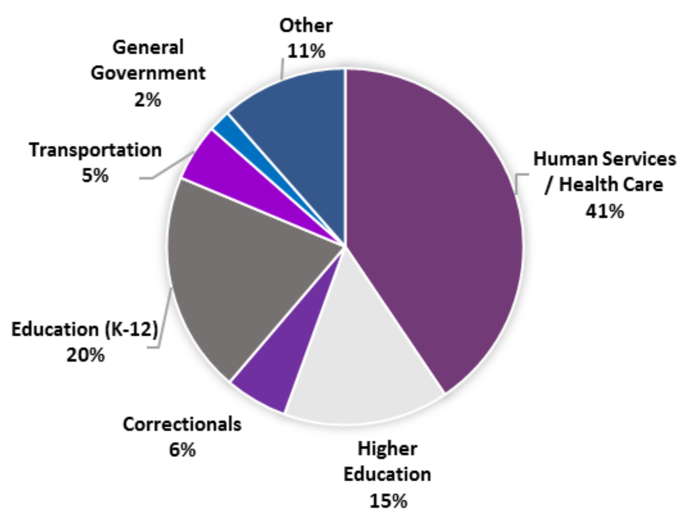
Source of Funds for FY 2016-2017 State Budget



Source: Colorado Joint Budget Committee

Figure 2

Colorado Budget Appropriations (all funds, $27.15 billion), FY 2016-2017

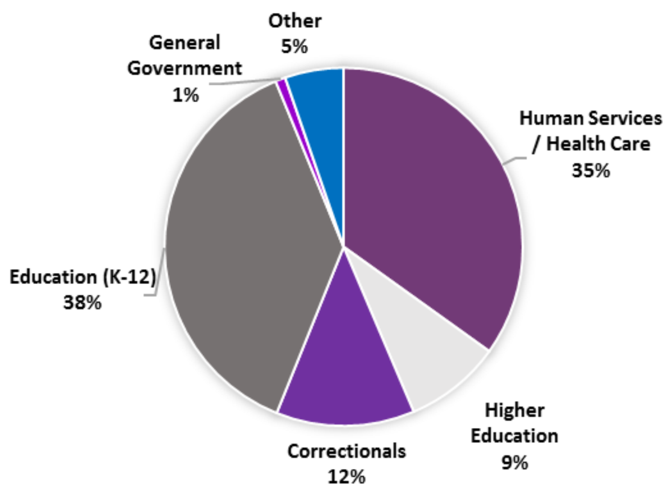


Source: Colorado Joint Budget Committee

Focusing on spending from the General Fund only, the appropriations picture for FY 2016-17 looks a little different from the budget as a whole. Total General Fund appropriations were roughly $9.99 billion. The largest share of total General Fund appropriations went to K-12 education, which accounts for 37.7 percent of General Fund spending, or $3.7 billion (Figure 3). Education funding is declining in terms of percentage of General Fund spending. Six years earlier, Colorado spent $3.2 billion from the General Fund on K-12, roughly 45.6 percent of all General Fund spending that year.

Figure 3

Colorado Budget Appropriations (General Fund , $9.99 billion), FY 2016-2017



Source: Colorado Joint Budget Committee

Health care and human services comprises 34.9 percent of General Fund spending. (Figure 3) Six years ago, those two departments combined to equal just 26.9 percent of General Fund appropriations.

For every general revenue dollar the state takes in, about 95 cents goes to the five most essential services provided by the state — K-12 education, higher education, health care, human services and corrections.

IMPORTANT TERMS CHAPTER TWO

Cash Funds – Restricted funds set up to receive earmarked revenues, such as fines, fees and limited taxes. These funds typically pay for the programs for which the revenues are collected. Examples include the Hospital Provider Fee, the Highway Users Trust Fund, the Wildlife Cash Fund and funds for Higher Education tuition.

Federal Funds – Funds received from the federal government. Federal funds are also exempt from the TABOR revenue limit.

General Funds – Fund into which general tax revenues are deposited. The General Fund is used to pay for a broad array of state programs such as education, corrections and human services.

General Funds Exempt – A fund exempt from TABOR restrictions generated from revenue allowed by Referendum C and from a portion of the Amendment 35 tobacco taxes. Appropriations from it are limited to certain programs.

Reappropriated Funds – A category of "revenue" that was first established in the 2008-09 state budget. It represents all of the revenue that one department gets in the form of transfers from other departments. Essentially it represents revenue that is counted twice in the budget. For example, state agencies use a portion of the funds appropriated to them to purchase legal services from the Department of Law, known more commonly as the Attorney General's Office. The Department of Law identifies that "revenue" as reappropriated funds because the General Assembly has appropriated that "revenue" from other agencies to the Department of Law to be used to pay their attorneys and paralegals.

CHAPTER THREE: LIMITS ON REVENUE AND SPENDING

Colorado law contains unique provisions in its Constitution and statutes that restrict the authority of elected officials to raise and spend money. Every legislative body in the country faces challenges funding public services. Inflation means it costs more to provide the same level of service, technological innovations spur high replacement costs and increases in health care are particularly impactful for public institutions since the vast majority of their expenditures are associated with personnel. Although these are challenges faced by budget writers in every state, Colorado's unique tax and expenditure limits compound the problems and severely restrict the discretionary authority of budget writers in our state.

As noted in Chapter 2, the General Fund typically offers legislators the greatest flexibility in spending. Cash funds and federal funds, by definition, are restricted in how they can be used. In Colorado, our most flexible fund, the General Fund, contains many limitations. Some of these limitations are based in history while others are found in law. This chapter describes the most significant legal constraints on legislative authority to make budget decisions that reflect a changing economic and demographic landscape.

TAXPAYER BILL OF RIGHTS

The most significant restriction on state revenue and spending is Article X, Section 20 of the Colorado Constitution, or the Taxpayer's Bill of Rights (TABOR). Passed as a voter initiative in 1992, TABOR contains many provisions that affect the government's ability to raise and spend revenue. It applies to every level of government in Colorado, from special library districts and municipalities to school districts, county governments and the state. More than 1,900 words long, the TABOR amendment governs practically every revenue and expenditure decision made in the state of Colorado.

TABOR can be broken into four main provisions.

1. VOTER APPROVAL — Section 4 requires prior voter approval of any new tax or debt, tax or debt increase, increase in mill levy or any tax policy change that will result in a net revenue gain for the government. In total, TABOR requires voter approval of more than 14 different types of provisions.[7]
2. SPENDING LIMITS — Section 7 restricts the amount of revenue that a government or tax district can collect and retain. The formula for determining the amount of revenue the state can collect each year is the Denver-Boulder-Greeley Consumer Price Index (CPI) inflation rate, plus the annual percentage change in state population, applied to the prior year's formula. For example, if the CPI were 2.2 percent and the state's population grew by 2.5 percent, the state would be allowed to collect and retain 4.7 percent more revenue than it was allowed to keep the prior year. Any revenue, collected above the allowable limit, must be returned to taxpayers in the form of rebates or credits, unless voters approve a measure for allowing the government to keep and spend it. For local governments, including

7 In 2009, the Colorado Supreme Court clarified what constituted a "net revenue gain" in the Mesa County Board of County Commissioners v. State of Colorado case. The case grew out of legislation that allowed mil levy rates to remain stable year after year (rather than automatically declining due to other revenue factors) in school districts that had previously voted to allow the school district to keep all revenue above the TABOR limit. In the ruling, the court defined the phrase "tax policy change" for the first time. The court ruled that elected bodies can make changes to tax policy so long as any revenue generated from the change is "de minimis" and does not exceed the annual revenue increase allowed in TABOR.

school districts, special districts, municipalities and counties, the inflation rate is included in the formula, but different criteria are used for the growth factor. Local governments must also refund surplus dollars unless approved by voters. Property taxes collected by local governments are subject to an additional and separate limit in Section (3)(c). All state General Fund revenue and Cash Funds, not approved by voters in an election, are counted as revenue subject to the TABOR limit. Federal funds, litigation settlements, inter-governmental transfers and voter-approved changes are classified as exempt funds, meaning that they are not included when computing revenue subject to TABOR's revenue limit.

3. LIMITS ON TYPES OF TAXES — Section 8 prohibits certain specific taxes and revenue-raising options, even if local voters approve them. TABOR prevents Colorado communities from creating any new or increased real estate transfer taxes, a local income tax, a state real property tax or a graduated state income tax. If a local community wanted a real estate transfer tax, it would first need to amend the constitution and then vote locally to approve the tax. TABOR, in effect, creates a constitutional bias against certain revenue measures.

4. ELECTION PROVISIONS — Section 3 prescribes specific language for ballot titles for all revenue increase initiatives and requires publication of estimates of the amount of money raised by a proposed increase as well as the total amount of revenue, not related to the increase, raised by the district. The elections provision requires refunds of tax revenue if actual revenue collections for the new or increased tax or total amount of revenue exceed projections. Section 3 also creates new statewide elections in odd numbered years to address revenue issues.

By all accounts, TABOR is the most restrictive tax and expenditure limit in the country, making budgeting and changing budget priorities in Colorado an extremely difficult task for lawmakers. TABOR's strict limits on revenue, expenditures, revenue-raising options and voter requirements severely limit the flexibility and authority of Colorado governments to carry out their budgeting responsibilities in an effective and timely manner.

The most inflexible aspects of TABOR were made evident during the recession of 2001. Colorado, like the rest of the country, slipped into a deep recession in early 2001. The state lost more jobs and income than almost any other state. The faltering economy and growing unemployment took a heavy toll on Colorado's already lean state government. In just two years, Colorado's General Fund revenues fell by an unprecedented 17 percent, the second largest decline in the country. In response to the revenue shortfall, the General Assembly utilized an array of one-time fixes available to them, including raising fees, shifting payroll dates for state employees and transferring funds. Yet despite their efforts and the growing need, lost revenues forced almost $2 billion in reductions from a $13 billion annual budget.

TABOR compounded these problems. Its revenue limit, which allowed the state to grow by population and inflation over the lesser of the prior year's actual collections, or what would have been allowed under the formula, meant that Colorado could never make up for the drop in revenue. In other words, TABOR's revenue limit would have kept state spending at recession levels regardless of the level of economic activity in the state. This quirk in the formula became known as the "ratchet effect."

The untenable situation led to a statewide effort to suspend TABOR's revenue limit for five years and fix the flaw in the formula that ensured the ratcheting down of allowable revenue in times of recession. The measure, also known as Referendum C, was passed by voters in November 2005.

REFERENDUM C

Referendum C is known as a basic "debrucing" measure — a term derived from the name of TABOR's author, Douglas Bruce. A debrucing measure gives voters in any district the chance to suspend, either for a specific period or indefinitely, the revenue limit imposed by TABOR. The practical effect of "debrucing" allows the district to keep and spend all the revenue it collects from the tax rates in effect at the time of the election.

Approved by voters in 2005, Referendum C allowed the state to retain all revenue through June 30, 2010 without regard to the population growth and inflation limits imposed by TABOR. The revenue retained by this change funded health care, public elementary and high school education and higher education, pension plans for firefighters and police officers and transportation projects.

Another critical component of Referendum C is that it eliminated the ratchet in TABOR. It established a new base for the revenue formula starting with the highest revenue collection year between fiscal years 2006 and 2010. The base is adjusted annually for inflation and population change to determine each year's annual limit. This approach of building the limit from the prior year's formula-defined limit (not actual revenues), eliminates the ratcheting down effect in future years. The Ref C base year (the year with the highest collections between FY 2006 and FY 2011) was FY 2008.

The final major provision requires the state controller, as part of the annual compliance audit, to report on revenues that the state is authorized to retain and spend pursuant to this referendum.

Referendum C was a necessary step to help Colorado recover from the recession that began in 2001 and prevent further budget cuts in that post recession period. The action of voters in approving Referendum C has allowed the state to invest an additional $12.2 billion through FY 2014 -2015. The relief provided by Ref C was initially limited due to the constraints of an additional statutory provision that restricted growth in General Fund spending.

GENERAL FUND APPROPRIATIONS LIMIT— ARVESCHOUG-BIRD — SENATE BILL 09-228

For decades, Colorado lawmakers operated under a limit on the amount of General Fund money that could be spent on general operating expenses. That law, known as Arveschoug-Bird, or the 6 percent limit, placed a limit on General Fund appropriations of either 6 percent over the previous year's General Fund appropriations or 5 percent of Colorado personal income, whichever was less. General Fund money above the limit was allocated to capital construction projects, transportation and a state "excess General Fund reserve." This law limited the effectiveness of Referendum C's ability to deliver on its promise to help restore funding for education and health care. The Great Recession resulted in the second huge dip in revenue collections in a decade and further limited the impact of Ref C on state investments.

In 2009, through Senate Bill 09-228, the General Assembly sought to increase its flexibility to respond to ever-changing economic conditions and significantly amended Arveschoug-Bird by adopting new General Fund allocation requirements. SB 09-228 changed the General Fund appropriations limit to 5 percent of Colorado personal income.

TRANSFERS TO TRANSPORTATION, CAPITAL CONSTRUCTION AND A RAINY DAY FUND

SB 09-228 also rewrote the state's appropriation language while providing new assurances to fund transportation, capital construction and increase state reserves when the economy began to recover from the Great Recession.

SB 09-228 defined the recovery as the first fiscal year after Colorado personal income grew by 5 percent. In that year, transfers will be made each year for a period of five years to the Highway Users Tax Fund (HUTF) for transportation, capital construction and the General Fund Reserve. Transportation will receive a general fund revenue transfer equal to 2 percent of General Fund appropriations, capital construction a transfer equal to 0.5 percent and the statutory reserve increases by 0.5 percent of General Fund appropriations. In the last three years of the five, capital construction will receive a 1 percent transfer.

The required growth in Colorado personal income was met in FY 14, so the SB 09-228 transfers requirements were applied in FY 15-16 and will end FY 19-20.

These transfers, however, are subject to reduction if state revenue is sufficient to require TABOR rebates (Table 1).

TABLE 1 228 Transfers and TABOR Rebates, beginning FY 15/16 to FY 19/20

Years with no TABOR rebates:				Year 3-5: If there are TABOR rebates, and TABOR rebates equal:		
	Transfer Period			Less than 1% of General Fund revenues	More than 1% but less than 3% of General Fund revenues	More than 3% of General Fund revenues
Use/Fund	**Year 1**	**Year 2**	**Years 3-5**			
Capital Construction Fund	Fixed transfer of $49.8 million from General Fund revenues	Fixed transfer of $52.7 million from General Fund revenues	Amount equal to 1% of total General Fund revenues	No reduction	50% reduction	100% reduction
Highway Users Tax Fund	Fixed transfer of $199.2 million from General Fund revenues	Fixed transfer of $158 million from General Fund revenues	Amount equal to 2% of total General Fund revenues	No reduction	50% reduction	100% reduction

AMENDMENT 23— MINIMUM FUNDING FOR K -12 EDUCATION

In 2000, voters approved Amendment 23, a constitutional amendment intended to guarantee annual increases in funding for public elementary and secondary education. The required increases in per pupil funding for FY 2001-02 through FY 2010-11 were inflation plus 1 percent. After FY 2010-11 the annual increases were set at the rate of inflation. Amendment 23 also contained a "maintenance of effort" (MOE) provision that required General Fund appropriations for state aid under the School Finance Act to increase by at least 5 percent annually, except when state personal income grows by less than 4.5 percent. This provision expired in 2010.

Finally, Amendment 23 establishes a State Education Fund and diverts income tax revenue equal to one-third of 1 percent of state taxable income to the fund. The revenues diverted into the fund are exempt from the TABOR revenue limit. State Education Funds can be used to meet the minimum funding requirements for K-12 education as long as the MOE provision is met, and for a variety of education-related purposes.[8]

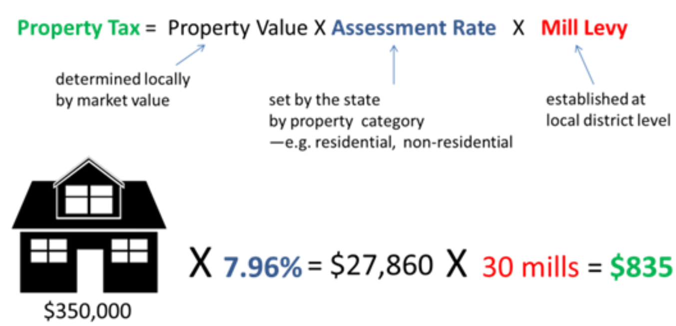
The language of Amendment 23 appears to require annual increases in per pupil funding for K-12 education. However, during the Great Recession, the required increases in funding were set aside by the General Assembly based on an interpretation of Amendment 23 that limited required increases to just a portion of per pupil funding (base per pupil and categorical funding) allowing the creation of a budget reduction tool referred to as the Negative Factor. The Negative Factor allows for a reduction in total per pupil funding by subtracting funding from the third component of the school finance formula (factor funding). The General Assembly began using this budget reducing tool in FY 2009-10, ultimately subtracting over a billion dollars annually from school funding. In FY 2015-16 the negative factor is $855 million meaning that total per pupil funding is nearly $1 billion below the levels originally interpreted as Amendment 23 required levels.

In 2014, a group of students, parents and school districts filed a legal challenge to the constitutionality of the use of the Negative Factor. That lawsuit, Dwyer v. the State of Colorado, went to the Colorado Supreme Court, which ruled that the negative factor does not violate Amendment 23.

THE GALLAGHER AMENDMENT AND PROPERTY TAXES

Property taxes have long been a source of revenue for public services in Colorado. Today, property taxes are used exclusively by local governments, including special districts, and are the primary source of local funding for schools.

A 1982 constitutional provision, known as the Gallagher Amendment (CO Const. Art. X sec. 3), has weakened the property tax base of school districts and other local governments and has forced the state to pay a larger portion of the total bill for educating children. That, in turn, has reduced money available for other areas of the state budget, such as roads, human services,



8 Colorado State, Legislative Council Staff, "House Joint Resolution 03-1033 Study: TABOR, Amendment 23, the Gallagher Amendment, and Other Fiscal Issues" (Denver: Legislative Council, 2003) 93.

health care, etc.

Art X section 3, contains many provisions that created a more regularized property valuation process including biennual reappraisal and market value basis for valuation. In addition, it sets two key elements of property valuation that affect overall property tax collections. First, it requires that residential property can account for no more than roughly 45 percent of the statewide taxable value in Colorado, leaving approximately 55 percent of taxable value coming from non residential property (which includes several property types like commercial and agricultural.) Second, the constitution sets the assessment rate for non residential property at 29 percent. While the assessment rate for nonresidential property is fixed, the residential assessment rate (RAR) fluctuates in order to maintain the required ratio. In years when the value of residential property grows more than the value of nonresidential property, the assessment rate for residential property drops in order to preserve the rough 45/55 percent ratio.

In many years since 1982, the value of residential property statewide has increased faster than the value of non-residential property. As a result, the assessment rate for residential property has declined since 1983 from 21 percent down to 7.96 percent, where it has stayed since 2003. However, between roughly 2011 and 2015, non residential property value growth statewide outpaced residential value growth, resulting in the need to increase the RAR in order to maintain the required ratios. The Legislature, however, did not increase the RAR because of a conflict with another constitutional provision, Art X Sec 20 (TABOR)

For example, the residential assessment rate should have been 9.13 percent for 2013 and 2014 and 8.24 percent for 2015 and 2016 in order to keep the ratios between residential and non residential values at approximately 45/55. The General Assembly, however, kept the residential rate at 7.96 percent, because TABOR requires voter approval to increase an assessment rate. Not raising the residential assessment rate means less property tax revenue raised locally and increased reliance on state funding for education.

Residential property values are again outpacing non residential values so the residential assessment rate is expected to decrease from 7.96 percent to 6.85 percent for 2017 and 2018, according to December 2016 Legislative Council projections. The General Assembly will need to set the new RAR through legislation during the 2017 session to comply with the Gallagher Amendment. This drop to 6.85 percent will require the state General Fund to backfill an estimated $178 million in lost local property taxes.

The impact of Gallagher varies widely between regions of the state, and even within particular regions. Both the rate of growth in value of property and the mix of properties within a jurisdiction affect the impact of Gallagher on the local tax base. In all jurisdictions, however, the percentage of non residential property value subject to property taxation is over three times higher than the percentage of residential value subject to taxation.

Because of Gallagher and TABOR, the state share of K-12 education funding in Colorado has grown from 43 percent in 1988 to 64 percent in 2016. As the state spends more on K-12, it has less to spend on other services.

Taken together, these policies — TABOR, Amendment 23 and Gallagher — reduce the flexibility of state lawmakers to set or alter budget priorities on a continuing basis and to respond to changing economic conditions.

IMPORTANT TERMS CHAPTER THREE

Amendment 23 — Constitutional amendment approved by voters in 2000 that mandates minimum funding levels for K-12 education.

Article X Section 20 Colorado Constitution — Known as the Taxpayer's Bill of Rights or TABOR. Requires voter approval of new and increased taxes and debt, limits the amount of revenue any taxing district in Colorado may collect and retain requiring excess revenues to be refunded to taxpayers, prohibits specific taxing options and maintains strict election provisions.

Arveschoug-Bird — Repealed in 2009, it was the 6 percent statutory General Fund appropriations limit.

Highway Users Tax Fund — The primary source of highway funds in Colorado, generated primarily from motor and diesel fuel taxes. Funds from other highway-related revenues, such as vehicle registration fees, driver's license fees, court fines and interest earnings also contribute to the fund.

Gallagher Amendment — Constitutional amendment from 1982 that limits property tax revenue in Colorado. Gallagher mandates that residential property account for no more than 45 percent of the total assessed value of all property and that non residential be assessed at a fixed rate of 29 percent. Thus, in years when the value of residential property grows more quickly than non residential property, the assessment rate of residential property goes down.

Maintenance of Effort (MOE) — MOE provision, as it relates to Amendment 23, requires General Fund appropriations for state aid under the school finance act to increase by at least 5 percent annually, except when state personal income grows by less than 4.5 percent.

State Education Fund — Established by Amendment 23, which authorized a diversion of one-third of 1 percent of taxable income on state income tax returns to the fund. The revenues diverted into the fund are exempt from the TABOR revenue limit. State Education Funds can be used to meet the minimum funding requirements for K-12 education as long as the MOE provision is met, and for a variety of education-related purposes.

Statutory 6.5 percent Reserve — According to C.R.S. §24-75-201.1 (1)(d)(III), a 6.5 percent reserve must be set aside to fund General Fund obligations in years where there is insufficient revenue. Money taken from the reserve account must be repaid each year.

TABOR — The Taxpayer's Bill of Rights or Article X Section 20 of the Colorado Constitution.

The Colorado Fiscal Institute provides credible, independent and accessible information and analysis of fiscal and economic issues facing Colorado. Out aim is to inform and influence policy debates and contribute to sound decisions that improve the economic well-being of individuals, communities and the state as a whole.

Contact us 720.379.3019 or visit www.coloradofiscal.org. Our offices are located at 1905 Sherman St., Suite 225, Denver, CO, 80203.