

GA 4.2/F49/2002



Colorado General Assembly

Financial Issues Affecting Colorado in 2003

State Limits on Appropriations and Spending

Capital Construction

Managing Colorado's Water Resources

Colorado's Tax Structure

Factors Driving the State Budget

Transportation and Finance

The above documents were used in Colorado's new member orientation program in December 2002. They explain many facets of Colorado's financial picture including our state and local tax structure, the issues driving the state's budget, and the limits on state revenue and spending.

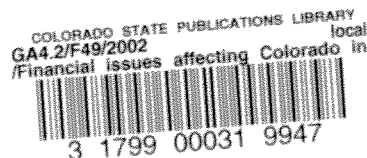
Staff Presentation to the Joint Session on February 24, 2003

This information was used in a staff presentation to a joint session of the General Assembly on February 24, 2003. Information was provided on Colorado's economy, revenues, and budget.



[[State Home Page](#) | [Colorado General Assembly](#) | [Legislative Agencies](#)]

This page last updated on 02/25/2003 17:26:12



State Limits on Appropriations and Spending

There are two limits that affect the General Assembly's ability to collect and spend money. The first limit is contained in state law and relates only to state General Fund appropriations. The second limit, which is in Article X, Section 20, of the Colorado Constitution, was adopted by voters in 1992 as Amendment No. 1, most

commonly referred to as TABOR, the Taxpayer's Bill of Rights. This constitutional limit is broader than the limit on state General Fund appropriations and affects a larger portion of state spending. The constitutional limit is, in effect, a limitation on state revenues.

STATE GENERAL FUND APPROPRIATIONS LIMIT

The current state General Fund appropriations limit was enacted in 1991 and is sometimes referred to as the "Arveschoug-Bird limit" after its sponsors, Representative Steve Arveschoug and Senator Mike Bird. The General Fund appropriations limit is also sometimes referred to as the "6 percent limit." The Arveschoug-Bird limit has not been amended since 1991.

- General Fund appropriations from voter-approved tax or fee increases; and
- General Fund appropriations for a state fiscal emergency.

Chart A
Calculation of the Limit on Total State General Fund Appropriations

" The Appropriations Limit"

Total State General Fund Appropriations Shall Be Limited To:

Property Tax
Reappraisal Costs

Plus the Lesser of

5% of Colorado Personal Income
or
6% Over Previous Year's Total State General Fund Appropriations

The Arveschoug-Bird/ 6 Percent Limit

State law describes a limit on the annual growth of total appropriations from the state General Fund for Fiscal Year (FY) 1991-92 and each fiscal year thereafter. The limit on annual growth is expressed as the lesser of 5 percent of Colorado personal income or 6 percent over the total state General Fund appropriations for the previous fiscal year. Since FY 1991-92, the 6 percent limit has described a lesser amount than 5 percent of Colorado personal income. The calculation of the limit is illustrated in Chart A.

Exceptions from the Arveschoug-Bird limit. Certain state General Fund appropriations are excepted from the limit:

- General Fund appropriations for property tax reappraisals;
- General Fund appropriations for new programs or increased service levels required by federal law or final state or federal court order;
- General Fund appropriations for Medicaid overexpenditures;

Exclusions from the Arveschoug-Bird limit. Certain transfers and expenditures from the General Fund are not subject to the limiting effect of the state General Fund appropriations limit:

- General Fund transfers to the Capital Construction Fund. This transfer is used to fund capital construction projects, is authorized by permanent statute, and is to occur annually over a specified period of time;

- General Fund transfers to the Controlled Maintenance Trust Fund. The statutory provision authorizing this transfer was added by permanent statute in 1993 and is made for the purpose of creating a trust fund which will generate interest income that can be used to fund state controlled maintenance projects; and
- Statutorily-required rebates and expenditures from the General Fund. A portion of state cigarette tax revenues credited to the General Fund is required by permanent statute to be rebated to local governments. General Fund revenues are also required by permanent statute to be expended for grants to the elderly to assist with property tax and heat/fuel expenses and for state contributions to the statewide fire and police pension plan.

Effect of the limit on cash fund appropriations. The Arveschoug-Bird limit specifically applies to "state General Fund appropriations." As a general principle, cash fund appropriations are not subject to the limit; however, certain state cash fund appropriations are affected by the limit. State law prohibits an appropriation of a fee-based cash fund which either supplants a state General Fund appropriation or, if not made, would necessitate a state General Fund appropriation if the effect of the state cash fund appropriation would be to circumvent the General Fund appropriation limit.

How the General Fund appropriations base grows for purposes of the Arveschoug-Bird limit. The base for calculating the 6 percent limit on annual growth is the total General Fund appropriations for the previous year. The base includes General Fund appropriations not subject to the limit because, although excepted in the year of actual appropriation, such appropriations are General Fund appropriations. Excluded General Fund appropriations included in the base, if continued, are subject to the limit in the following year.

Relationship between Senate Bill 00-181 and General Fund Revenues

Enacted during the 2000 session, Senate Bill 00-181 established several methods for providing state financial assistance to school districts for capital improvements. One method established the school capital construction expenditures reserve to provide funding for qualified school district capital construction projects. The General Assembly was required to appropriate \$5

million from the General Fund into this reserve for FY 2000-01 with the required appropriation increasing to \$10 million for FY 2001-02 through FY 2010-11. Senate Bill 00-181 also requires the appropriation of \$5 million from the General Fund for FY 2002-03 to the School Construction and Renovation Fund, which was established in 1998, with the required appropriation increasing to \$10 million for FY 2003-04 through FY 2010-11.

Under Senate Bill 00-181, \$190 million would be appropriated over eleven years to fund capital construction, repair, and maintenance in public schools. However, these appropriations are not required to be made in a given fiscal year if the amount of the General Fund reserve does not exceed \$80 million after all General Fund obligations are met and the amount of Senate Bill 97-1 revenue is allocated to the HUTF.

The \$80 million General Fund reserve requirement was not met in FY 2001-02 or FY 2002-03. Although not required by Senate Bill 00-181, \$10 million was appropriated from the General Fund to the school capital construction expenditures reserve in FY 2001-02. In FY 2002-03, \$10 million was appropriated from the state education fund to the school capital construction expenditures reserve and \$5 million was credited to the school construction and renovation fund due to a \$900,000 appropriation from the State Education Fund and a \$4.1 million transfer of lottery proceeds. Under current General Fund revenue projections, no appropriations will be required to be made to either the school capital construction expenditures reserve or the School Construction and Renovation Fund for FY 2003-04 through FY 2007-08.

Frequently Asked Questions about the Arveschoug-Bird Limit

The following paragraphs attempt to provide answers to some of the basic questions about how the Arveschoug-Bird limit operates.

Question #1: *How does state law limit General Fund appropriations and how is the limit calculated?*

Answer: State law places a limit on the growth of General Fund appropriations (minus some specifically excluded appropriations) in any given fiscal year to the amount necessary for property tax reappraisals, if any, plus the lesser of: (a) an amount equal to 5 percent of Colorado personal income, or (b) 6 percent over the

total state General Fund appropriations for the previous fiscal year (hereinafter referred to as the "appropriations base"). The total dollar figure which results from this formula becomes the "General Fund appropriations limit" for the following fiscal year (hereinafter referred to as "the appropriations limit"). For FY 1991-92 and each fiscal year thereafter, the appropriations limit was calculated by multiplying the appropriations base for the prior fiscal year by 106 percent. There were no property tax reappraisal costs.

Question #2: *Does the appropriations limit apply to all General Fund appropriations?*

Answer: No. General Fund appropriations to which the limit does not apply include the following:

- Appropriations for a new program or service or for an increase in the level of service of an existing program which result from a federal mandate or from a final state or federal court order;
- Appropriations of revenue derived from a voter-approved increase in the rate or amount of any tax or fee;
- Overexpenditures from the General Fund for Medicaid programs; and
- Appropriations for fiscal emergencies.

Question #3: *Are cash fund appropriations subject to the appropriations limit?*

Answer: No, unless the cash fund appropriation is made to circumvent the limit.

Question #4: *Are statutory transfers from the General Fund to the Capital Construction Fund and the Controlled Maintenance Trust Fund subject to the appropriations limit?*

Answer: No. The statutory provisions authorizing transfers to the Capital Construction Fund and the Controlled Maintenance Trust Fund specifically state that the transfers "shall not be deemed to be appropriations" subject to the General Fund appropriations limit.

Question #5: *Are transfers which are not subject to the appropriations limit included in the appropriations base?*

Answer: No. Since transfers from the General Fund to other state funds are not General Fund appropriations, in addition to not being subject to the appropriations limit, these transfers are not included in the appropriations base for the fiscal year in which the transfer occurred.

Question #6: *Are appropriations from the General Fund to a cash fund included in the appropriations limit?*

Answer: Yes. There is no provision in the law that would exclude General Fund appropriations to cash funds from the appropriations limit.

Question #7: *Are appropriations which are excluded from the appropriations limit included in the appropriations base for that particular year for purposes of determining the appropriations limit for the following fiscal year?*

Answer: Yes, unless the appropriation was made for a state fiscal emergency. Even though an appropriation is excluded from the appropriations limit in the year in which the appropriation is made, such appropriation is still a "General Fund appropriation" and included in the calculation of the appropriations base for the year in which the appropriation was made. The exception is any appropriation made for a state fiscal emergency.

Question #8: *If the appropriations limit has not been reached in a particular fiscal year, can the General Assembly make additional General Fund appropriations solely for the purpose of reaching the appropriations limit and increasing the appropriations base?*

Answer: Yes. The law imposes a limit on General Fund appropriations which is not to be exceeded. Continuing to make General Fund appropriations is within the discretion of the General Assembly so long as the limit is not exceeded. It may be advantageous to reach the appropriations limit because it adds flexibility in future years. Maximizing the appropriations base results in a greater appropriations limit for subsequent fiscal years. In comparison, when the General Assembly chooses not to make General Fund appropriations up to the limit or when there are not sufficient General Fund revenues for the General Assembly to appropriate up to the limit, the appropriations base is lower and results in a lower appropriations limit for subsequent fiscal years.

Question #9: *Is the Arveschoug-Bird limit a limit "on district revenue, spending, [or] debt" which is referred to in TABOR, the constitutional spending limit?*

Answer: Technically, the Arveschoug-Bird limit is a limit on increases in General Fund *appropriations*, not on revenue or spending. However, a court would probably conclude that, for purposes of TABOR, the Arveschoug-Bird limit is a limit on spending for the following reasons:

Spending and appropriations are closely related concepts. Agencies normally cannot make expenditures unless they have an appropriation, and placing limits on appropriations indirectly limits spending;

For purposes of implementing TABOR, the General Assembly defined "expenditure" as "the *appropriation* or disbursement of any state General Fund or cash fund moneys for any expense incurred by the state.";

The proponent of TABOR stated, prior to the 1992 election, that the statutory 7 percent limit then in effect

was the kind of limit that could not be weakened except with voter approval; and courts will construe constitutional language to give it a natural and obvious significance, as opposed to a narrow, literal, or technical meaning.

Question #10: *Would a modification of the Arveschoug-Bird limit "weaken" the limit, thus requiring submission to the voters?*

Answer: Yes. The plain meaning of the phrase "to weaken" is to lessen the strength of something, or to reduce it in intensity or effectiveness. Therefore, while we have certainly not foreseen all the possible ways of modifying the Arveschoug-Bird limit, an amendment to Arveschoug-Bird which permits greater expenditures of funds than would have been allowed under the current limit appears to weaken the limit. For example, changing the limit from 6 percent of current year's appropriations to 7 percent of current year's appropriations seems to weaken the limit. In contrast, voter approval is not required to make the limit more restrictive, such as reducing it to 5 percent of current year's appropriations.

CONSTITUTIONAL LIMIT ON SPENDING

In addition to the General Fund appropriation limit imposed by state law, the state constitution places restrictions on the amount of total General Fund and cash funds that can be collected and, consequently, spent by the General Assembly. This constitutional limit on spending was adopted by the voters in 1992 as Amendment No. 1 and is commonly referred to as the TABOR limit.

The Constitutional/TABOR Spending Limit

The constitutional spending limit and the state budget. The constitutional spending limit has several key points affecting the state budget:

- The constitution defines "fiscal year spending" as expenditures or reserve increases. In other words, **all** revenues received by the state that are not specifically exempt are considered "spending".
- The change in fiscal year spending from one year to the next is restricted to the percentage change in inflation plus the percentage change in state

population in the prior calendar year, adjusted for revenue changes approved by the voters after 1991.

- Any revenues received in excess of the allowable change in fiscal year spending must be refunded in the next year unless the voters approve keeping the excess.

Calculations for the constitutional limit. In order to comply with the limits contained in the state constitution, several calculations are necessary.

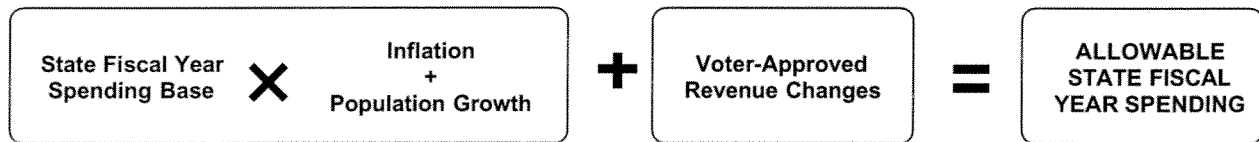
- Because the constitutional limit makes no distinction between General Fund and cash funds collected by the state, it has been necessary to forecast all the separate cash funds as well as the General Fund.
- The estimated total of the General Fund and cash funds are then increased by the estimated changes in inflation and population to project the allowable increase in fiscal year spending.

Population adjustment. In calculating the constitutional limit, the percentage change in state population in the prior calendar year is based upon annual federal population estimates. That number is adjusted every decade to match the federal census. Since population estimates are only estimates, the census is used every ten years to obtain a more accurate determination of the state's population. During the 1990's, the federal government underestimated Colorado's population. Due to these population underestimates, the state refunded \$480 million that would not have been refunded if the correct population numbers were used for calculating the constitutional limit for FY 1993-94 through FY 2000-01.

forward to the following year. This would continue until all 6 percentage points are used or a new census is conducted.

For FY 2002-03, state revenue will not exceed the constitutional limit, so the population adjustment will not be applied. Current revenue projections show that the population adjustment will allow the state to retain an additional \$323.6 million in FY 2003-04 and \$500.9 million in FY 2004-05. At that point, all of the population adjustment will have been applied. It is estimated state revenues will once again exceed the constitutional limit starting in FY 2004-05 through FY 2007-08. Chart B, below, illustrates the formula used for calculating the constitutional limit.

Chart B
Formula for Calculating the Limit Imposed on the State by TABOR or
Article X, Section 20 (7) (a), of the State Constitution



When the 2000 census gave a more accurate count of population in the state, the change in population, from the artificially low number that was used in 1999 to the accurate number generated for 2000, was 6 percent. When combined with the applicable 4 percent inflation rate for that year, the state's constitutional limit for FY 2001-02 grows by 10 percent. However, the drop off in state revenues resulting from the current recession did not allow the state to use any of the 6 percent population portion of the constitutional limit. Therefore, the state was unable to recoup any of the money that had been previously over refunded.

Table 1 (following page) provides the latest estimates on revenues subject to the constitutional limit for FY 2002-03 and, based upon these estimates, Table 2 shows the calculation of the constitutional limit for FY 2002-03. As these tables indicate:

Senate Bill 02-179 and House Bill 02-1310 addressed this issue by creating a multiple-year census adjustment, commonly referred to as the "population adjustment". This population adjustment allows the state to recapture the population not reflected in the low population estimates used during the 1990's.

- The General Fund made up over 70.7 percent of the total revenues subject to the constitutional limit in FY 2002-03. Sales and use tax comprises 23.8 percent of the total revenues while individual and corporate income tax comprises 42.1 percent of the total revenues. Reductions in either of these sources of General Fund revenues have a large impact on revenues subject to the constitutional limit.
- It is estimated that state TABOR revenues will be \$278.2 million below the constitutional limit in FY 2002-03.
- The estimated FY 2002-03 allowable growth rate under the constitutional limit is 6.9 percent with inflation at 4.7 percent and population growth at 2.2 percent.
- Most of the cash funds are growing at a slower rate than the growth rate allowed under the constitutional limit. This slower cash funds growth rate allows the state to absorb the higher growth rate in General Fund revenues in fiscal years when state fiscal year spending exceeds the constitutional limit.

Consequently, the state can apply the unused 6 percentage points from the FY 2001-02 constitutional limit. The percentage points will be used to change the constitutional limit in those years when state revenue exceeds the constitutional limit. For instance, assume the constitutional limit allows state spending to grow by 5 percent, but actual revenues for the year grow by 7 percent. Under this scenario the state could apply 2 of its 6 population adjustment percentage points and allow the constitutional limit to grow by 7 percent. The remaining 4 percentage points would be carried

Table 1
FY 2002-03 State Revenues Subject to the Constitutional Limit
(in millions)

| TABOR REVENUES: | FY 2002-03 | % Growth | % of Total Revenues |
|-------------------------|-------------------|-----------------|----------------------------|
| General Fund: | | | |
| Sales and Use Tax | \$1,904.2 | 2.0% | 23.78% |
| Individual Income Tax | 3,167.9 | 2.7% | 39.55% |
| Corporate Income Tax | 203.1 | 23.4% | 2.54% |
| All Other | 385.6 | -3.2% | 4.81% |
| Subtotal - General Fund | \$5,660.8 | 2.6% | 70.68% |
| Cash Funds: | | | |
| Transportation (HUTF) | \$833.4 | 2.4% | 10.41% |
| Higher Education Funds | 686.8 | 8.1% | 8.58% |
| Unemployment Insurance | 242.9 | 23.9% | 3.03% |
| Gaming | 105.8 | 6.8% | 1.32% |
| Other Cash | 479.3 | -1.8% | 5.98% |
| Subtotal - Cash Funds | \$2,348.2 | 5.2% | 29.32% |
| TOTAL | \$8,009.0 | 4.7% | 100.00% |

Table 2
FY 2002-03 Allowable State TABOR Revenues
Under the Constitutional Limit
(in millions)

| | |
|--|-----------|
| FY 2001-02 State Fiscal Year Spending Base | \$7,752.2 |
| Allowable Growth Rate (Inflation + Population Growth) | X 1.069 |
| FY 2002-03 Constitutional Limit on TABOR Revenues | 8,287.1 |
| Estimated FY 2002-03 TABOR Revenues | 8,009.0 |
| Estimated FY 2002-03 TABOR Revenues Over/ (Under) Constitutional Limit | (\$278.1) |

REFUNDING REVENUES IN EXCESS OF THE CONSTITUTIONAL LIMIT

Strong economic activity, combined with a surge in capital gains income, led to exceptionally strong growth in income tax receipts and other state revenues beginning in 1996. As a result, the state's revenue growth exceeded the limit for five consecutive years from FY 1996-97 through FY 2000-01 (Table 3). A recession beginning in March 2001, combined with the negative impacts of the terrorist attacks later that year and the stock market drop beginning in Spring 2000, caused a dramatic reduction in state tax receipts in FY 2001-02. However, as the economy turns around

and the population adjustment enacted in the 2002 session is exhausted, surpluses will return beginning in FY 2004-05.

Refund Mechanisms. The state refunds surplus TABOR revenues in the fiscal year following the fiscal year in which the revenues are collected. The refunds take place through the use of 19 separate refund mechanisms. Each of these mechanisms, except for the sales tax refund, has a threshold trigger amount that dictates when they are in effect. There must be enough

surplus TABOR revenues to exceed a mechanism's threshold for the mechanism to be used that year. The current economic recession, coupled with the passage of the population adjustment during the 2002 session, will prevent the constitutional limit from being exceeded until FY 2004-05. Therefore, no refunds will take place prior to FY 2005-06. The sales tax refund does not have a trigger because it acts as a "catch all" refund mechanism and refunds any revenues that are not refunded through the other 18 mechanisms. Table 4 displays the refund mechanisms and their threshold triggers.

**Table 3
Actual and Estimated TABOR Surplus Revenues**

| Fiscal Year | Amount |
|------------------|---------|
| 1996-97 | \$139.0 |
| 1997-98 | \$563.2 |
| 1998-99 | \$679.6 |
| 1999-00 | \$941.1 |
| 2000-01 | \$927.2 |
| 2001-02 | \$0.0 |
| Forecast 2002-03 | \$0.0 |
| 2003-04 | \$0.0 |
| 2004-05 | \$117.5 |
| 2005-06 | \$290.7 |

Frequently Asked Questions about the Constitutional Refunds

May the state spend any of the surplus revenues? The state must obtain voter approval to keep and spend surplus revenues. An example of this, although initiated by citizens rather than the state, is Amendment 23, which allows the state to retain and spend surplus TABOR revenues for education. House Bill 98-1414 allows the state to use revenues in the year they are received as long as the revenues are made available for any necessary refunds during the following year.

Can the state reduce surplus revenues by cutting taxes? Yes, any tax cut will reduce the amount of TABOR revenues collected and therefore the surplus. However, because the state refunds the TABOR surplus the year after it is received, the General Fund experiences a "one-time" reduction in revenues when

**Table 4
TABOR Refund Mechanisms and Triggers**

| Description | Threshold Trigger (Estimated) |
|--|-------------------------------|
| Earned Income Credit | \$62.4 |
| Foster Care | \$210.1 |
| Business Personal Property | \$211.9 |
| Individual Development Accounts | \$219.4 |
| Capital Gains Prior to May 9, 1994 | \$324.2 |
| Rural Health Care | \$329.1 |
| Children's Issues | \$334.9 |
| Research and Development | \$376.4 |
| Vehicle Registration Fees | \$381.2 |
| High Tech Scholarships | \$381.2 |
| Pollution Equipment | \$404.2 |
| Charitable Contributions | \$404.2 |
| Interest, Dividends, and Capital Gains | \$404.2 |
| Commercial Trucks | \$404.2 |
| Telecommunication Education | \$404.2 |
| Agricultural Value Added Cooperatives | \$420.1 |
| Health Benefit Plans | \$462.0 |
| Capital Gains Held 1 to 5 Years | \$496.7 |
| Sales Tax Refund | Not Applicable |

tax cuts are enacted in a TABOR surplus situation. The state experiences a reduction in revenues (the impact of the tax cut) one year before it will experience a reduction in the amount of the liability for the TABOR refund. In addition, the effects of a tax cut will be experienced annually even when the state is no longer in a TABOR surplus situation.

Can the state eliminate any future refunds by cutting taxes? No. If the state cuts taxes enough to eliminate the surplus, or cuts taxes when there is no surplus, then the TABOR limit is recalculated based on actual collections. If, in the following year, revenues increase at a greater rate than TABOR allows there will once again be a refund required, regardless of how far taxes were cut in the prior year.

Can the state create new refund mechanisms or eliminate existing mechanisms? Yes, the state can create as many or as few refund mechanisms as it wants. There are currently 19 refund mechanisms. Under current law, new refund mechanisms are funded by reducing the amount of surplus revenues that are refunded through the six-tier sales tax refund. New refund mechanisms have been given threshold levels to determine which mechanisms are funded if there is not sufficient surplus TABOR revenues to fund all of the refund mechanisms. Under current law, if an existing refund mechanism is eliminated, any revenues that would have been refunded through that mechanism will be refunded through the six-tier sales tax refund.

Key Provisions of Law

Section 24-75-201.1 (1), C.R.S.: Contains limit on state General Fund appropriations.

Section 24-75-302 (2), C.R.S.: Excludes transfers from the General Fund to the Capital Construction Fund from the limit on General Fund appropriations.

Section 24-75-201.1 (1) (c.5) (II), C.R.S.: Excludes transfers to the Controlled Maintenance Trust Fund from the limit on General Fund appropriations.

Section 39-26-123 (2), C.R.S.: Allocates 10.355 percent of state sales and used tax revenues to the Highway Users Tax Fund.

Staff contacts: Sharon Eubanks, Legislative Legal Services Staff, 303-866-2045
John Ziegler, Joint Budget Committee Staff, 303-866-4956
Mike Mauer, Legislative Council Staff, 303-866-4794

Are refund mechanisms the same as tax cuts? No. Refund mechanisms are simply a method of refunding revenues to the taxpayers that the state is constitutionally required to give back to the taxpayers. An additional refund mechanism does not increase the amount of money returned to the taxpayers; it only changes how the surplus is refunded.

New tax cuts allow taxpayers to pay less money to the state relative to what they would pay under current law. Tax cuts continue in the absence of a TABOR surplus, while TABOR refunds cease in the absence of a surplus.

Section 24-75-201.1 (4), C.R.S.: Contains funding requirements for the school capital construction expenditures reserve and the school construction and renovation fund.

Article X, Section 20, Colorado Constitution: Contains the constitutional limit on state fiscal year spending or, in effect, state revenues.

Section 24-77-102, C.R.S.: Defines terms for purposes of implementing the constitutional spending limit.

Section 24-77-103 (2), C.R.S.: Specifies the procedures used in determining state population growth for purposes of calculating the constitutional spending limit.

Capital Construction

State law contains special provisions for prioritizing and funding capital projects. This document provides an overview of Colorado's process for allocating money to capital projects. A description of the state's capital needs is also included.

Types of Projects that Qualify for State Funding

Capital projects include both capital construction projects and controlled maintenance projects. Capital construction projects include the following:

- the purchase of land, buildings, or other facilities such as utilities and state highways;
- the construction, renovation, or remodeling of buildings or other facilities;
- the purchase and installation of equipment necessary to operate the buildings or facilities; and
- the architectural, engineering, or other consultant services associated with a capital construction project.

Examples of capital construction projects include constructing a new state prison, renovating a chemistry building at a state university, and developing an automated fingerprinting identification system. In other words, capital construction projects are program-driven. An institution or department must justify a capital request based on how the project will allow it to improve or alter its ability to provide a certain program.

Controlled maintenance projects, by contrast, are defined as corrective repairs or replacement of utilities, equipment, and site improvements at existing

state-owned, general-funded buildings and other physical facilities. Replacing deteriorated mechanical equipment and upgrading fire alarm systems are examples of controlled maintenance projects. Controlled maintenance projects are system-driven, not program-driven.

Process for Prioritizing and Funding State Capital Projects

State departments and higher education institutions submit all requests for state funding of capital projects to the General Assembly's Capital Development Committee. The Capital Development Committee, which consists of three members of the Senate and three members of the House of Representatives, reviews these requests and develops recommendations for funding priorities. The Capital Development Committee considers the recommendations of the Office of State Planning and Budgeting and the Colorado Commission on Higher Education in developing its funding priorities.

Generally, the Capital Development Committee conducts hearings to review the requests during the months of November and December. It uses the months of January and February to set its capital construction and controlled maintenance priorities. The committee then submits its recommendations, findings, and comments to the Joint Budget Committee. The Joint Budget Committee considers and incorporates the recommendations into the Long Bill for the following fiscal year. The Joint Budget Committee may make changes to the Capital Development Committee's recommendations.

Revenue Sources for Capital Construction Projects

The Capital Construction Fund is the primary source of

funding for state-funded capital projects. The fund currently receives revenue from three sources. Table 1 identifies the amount credited to the fund from each revenue source for the past five years.

Table 1
Revenue to the Capital Construction Fund
(in millions)

| Revenue Source | | FY 1998-99 | FY 1999-00 | FY 2000-01 | FY 2001-02 | FY 2002-03 | Five-Year Total |
|---|---|----------------|----------------|----------------|---------------|---------------|------------------|
| General Fund | | | | | | | |
| 1a | Ongoing Statutory General Fund Transfer (Section 24-75-302 (2), C.R.S.) | \$50.0 | \$100.0 | \$100.0 | \$100.0 | \$9.5 | \$359.5 |
| 1b | Additional Statutory General Fund Transfer | 418.3 | 73.6 | 174.5 | (174.9) | 1.1 | 492.6 |
| 1c | General Fund Appropriations | 1.9 | 0.0 | 10.7 | 79.1 | 0.0 | 91.7 |
| Interest | | | | | | | |
| 2 | Interest Earnings & Carryforward | 35.7 | 66.0 | 37.0 | 61.2 | 0.0 | 199.9 |
| Deposits | | | | | | | |
| 3 | Deposits Pursuant to Legislation | 0.0 | 2.8 | 0.0 | 0.0 | 0.2 | 3.0 |
| Lottery (No Longer a Revenue Source) | | | | | | | |
| 4 | Lottery | 11.0 | N/A | N/A | N/A | N/A | 11.0 |
| Total | | \$516.9 | \$242.4 | \$322.3 | \$65.3 | \$10.8 | \$1,157.7 |

* The negative transfer of \$174.9 million in FY 2001-02 is a result of the General Assembly's decision to transfer money from the Capital Construction Fund back to the General Fund to help address the state's revenue shortfall. Generally, funds are transferred to the Capital Construction Fund.

General Fund

(1) (a) The statutes provide for an annual transfer of General Fund moneys to the Capital Construction Fund. This annual, ongoing transfer helps the Capital Development Committee establish its base budget recommendation for capital construction and controlled maintenance projects, and also assists with long-range planning. The amount to be transferred has steadily increased over the past decade, and is currently \$100 million annually through FY 2005-06. Because of declining state revenues, however, the General Assembly reduced the FY 2002-03 transfer from \$100 million to \$9.5 million.

(b) The General Assembly may also decide to increase the transfer amount from the General Fund. Unlike the ongoing statutory transfer, the additional transfer amount is determined during annual budget deliberations. Over the past five years, the ongoing statutory transfer was increased by an additional \$492.6 million. Of this additional transfer, \$100 million, or 20.3 percent, was directed in law to be spent on highway projects.

(c) The General Assembly, through the Long Bill or separate legislation, may designate General Fund moneys to be appropriated to the Capital Construction Fund. Because the moneys are appropriated, rather than transferred, they are counted against the General Fund 6 percent appropriations limit. This method of funding capital projects was used in FY 2001-02 in an effort to appropriate General Fund dollars up to the appropriations limit.

Interest Earned on the Capital Construction Fund

(2) Interest accruing to the Capital Construction Fund, through investment of money in the fund, is retained in the Capital Construction Fund and does not revert to the General Fund. Unexpended fund balances are also retained in the fund from year to year. In 2002, however, the General Assembly passed legislation that transferred the fund's interest earnings for FY 2001-02 (\$21.4 million) to the General Fund. The purpose of the transfer was to help address the General Fund revenue shortfall. No provision for repayment was made.

Deposits Pursuant to Legislation

(3) Legislation may specify that moneys be deposited into the Capital Construction Fund. Usually, this is from the proceeds of a real estate transaction.

Lottery Proceeds (No Longer a Revenue Source)

(4) Under the Great Outdoors Colorado Program, the use of lottery proceeds for state capital construction project ended in FY 1998-99. As a result, this is no longer a revenue source for the Capital Construction Fund. It is listed here, however, because it was a revenue source in FY 1998-99, the first year of the five years included in Table 1.

Revenue credited to the Capital Construction Fund over the past five fiscal years totaled \$1.16 billion, a reduction from the previous five-year period (FY 1993-94 through FY 1997-98), which had a revenue total of \$1.36 billion.

Capital Construction Fund and State Spending Limits

As shown in Table 1, state-funded capital projects are primarily funded through General Fund transfers to the Capital Construction Fund. Unlike the General Fund, state law does not limit the amount of money that can be expended from the Capital Construction Fund. In addition, the transfer from the General Fund to the Capital Construction Fund is not counted against the General Fund 6 percent appropriations limit. In essence, this means that the statutes allow for General Fund moneys to be expended beyond the General Fund appropriations limit if the moneys are used for capital construction purposes.

Until recently, the state's economic growth resulted in state General Fund revenue that exceeded the amount necessary to fund appropriations up to the statutory General Fund appropriations limit. As a result, General Fund moneys in excess of the appropriations limit were available for transfer to the Capital Construction Fund. Because of the state's revenue shortfall, however, no excess General Fund moneys were available for FY 2002-03, and excess General Fund moneys transferred to the Capital Construction Fund for FY 2001-02 were transferred back to the General Fund.

Further, 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). No excess General Fund revenues are expected for the duration of the Legislative Council Staff revenue forecast period, FY 2002-03 through FY 2007-08.

Revenue Sources for Controlled Maintenance

The General Assembly created the Controlled Maintenance Trust Fund in 1993 with the intent of establishing a stable, predictable, and consistent source of revenue for controlled maintenance projects. The interest earned on the principal of the Controlled Maintenance Trust Fund supplements the Capital Construction Fund. The General Assembly can transfer up to 50 percent of General Fund revenues for the prior fiscal year in excess of expenditures and required reserves to the Controlled Maintenance Fund, not to exceed \$50 million.

Interest income was available for appropriation for controlled maintenance projects beginning in FY 1996-97. The amount available for appropriation is up to 50 percent of the amount of interest expected to be earned on the principal of the trust fund for the current fiscal year and any interest actually earned during the previous fiscal year not already appropriated.

Since FY 1996-97, a total of \$86.6 million in interest has been appropriated from the fund, ranging from \$4.3 million in FY 1996-97 to \$18.8 million in FY 2001-02. No funds were available for appropriation for FY 2002-03. The estimated interest available for appropriation for FY 2002-03 (\$9.5 million) was transferred to the General Fund because of the state's revenue shortfall.

In addition, the Controlled Maintenance Trust Fund's principal, stable for several years at \$248.1 million, has now been reduced to \$0. In FY 2000-01, \$4.2 million was transferred from the fund for flood relief. The remaining balance in the fund, \$243.9 million, was transferred to the General Fund on July 1, 2001. The intent at that time was to repay the fund \$276.4 million on July 1, 2002 (principal plus interest). Because the state continued to experience declining revenues,

however, the repayment did not occur. Under current law, the fund is now scheduled to be repaid in two equal installments: \$138.2 million on July 1, 2003, and \$138.2 million on July 1, 2004. The Governor's Office of State Planning and Budgeting, however, has recommended that the first installment, \$138.2 million on July 1, 2003, be deferred once again.

Table 2 summarizes General Fund transfers made to and from the Controlled Maintenance Trust Fund, as well as interest earned and appropriated.

Five-Year History of Appropriations from the Capital Construction Fund and Controlled Maintenance Trust Fund

Capital projects were appropriated a total of \$1.24 billion over the past five years. Spending on adult prisons, highway construction projects, and higher education facilities accounted for 76 percent (or \$942.5 million) of this total.

Table 2
Controlled Maintenance Trust Fund (CMTF) Overview
(in millions)

| | FY 1998-99 | FY 1999-00 | FY 2000-01 | FY 2001-02 | FY 2002-03 |
|---|---------------|---------------|---------------|---------------|--------------|
| Principal | | | | | |
| Beginning Balance of CMTF | \$248.1 | \$248.1 | \$248.1 | \$243.9 | \$0.0 |
| General Fund Transfer (no money has been | 0.0 | 0.0 | (4.2) | (243.9) | 0.0 |
| Principal Balance of CMTF | \$248.1 | \$248.1 | \$243.9 | \$0.0 | \$0.0 |
| Interest | | | | | |
| Interest Earned in CMTF* | \$17.9 | \$18.0 | \$18.4 | \$0.5 | \$0.0 |
| Interest Transferred from CMTF | 0.0 | 0.0 | 0.0 | (9.5) | 0.0 |
| Interest Appropriated from the CMTF | 17.4 | 17.8 | 17.8 | 18.8 | 0.0 |
| Additional Amount Appropriated from the Capital Construction Fund | 25.9 | 30.6 | 28.4 | 35.8 | 2.5 |
| Total Appropriated for Controlled Maintenance | \$43.3 | \$48.4 | \$46.2 | \$54.6 | \$2.5 |
| % of Total Appropriated from the CMTF | 40.1% | 36.8% | 38.6% | 34.4% | 0.0% |

*Figure provided for FY 2002-03 is an estimate.

Graph A highlights the appropriations from the Capital Construction Fund and Controlled Maintenance Trust Fund made to these departments over the last five fiscal years.

Cuts to Capital Construction and Controlled Maintenance Projects Enacted in FY 2001-02

The General Assembly had already convened for a special session in Fall 2001 when the fiscal year's first quarterly economic forecast was released. The lower-than-expected revenues caused the General

Assembly to pass SB 01S2-023, which reduced capital funding by \$216.0 million. This bill primarily affected capital construction projects funded in the then-current fiscal year, FY 2001-02. During the 2002 regular session, the state's continued revenue shortfall led to the passage of three additional capital supplemental bills. These bills included further cuts (and a limited amount of increases) to FY 1998-99 through FY 2001-02 projects, but primarily affected FY 2000-01 projects. The projects cut during the regular session included both capital construction and controlled maintenance projects. Table 3 divides the total cut amount of \$274.1 million by bill and by the year affected.

Graph A
Five-Year History of Appropriations
Capital Construction Fund and Controlled Maintenance Trust Fund
(in millions)

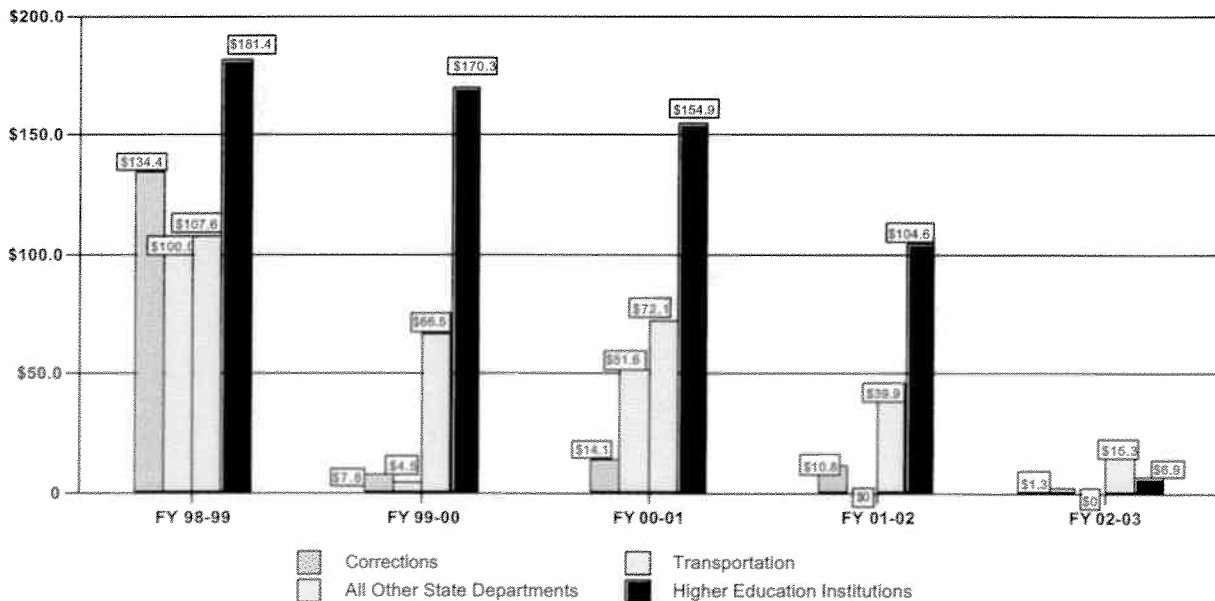


Table 3
Capital Construction and Controlled Maintenance Cuts by Year of Appropriation
(in millions)

| Year | FY 1998-99 | FY 1999-00 | FY 2000-01 | FY 2001-02 | Total |
|--|------------|------------|------------|------------|-----------|
| Total Appropriation as of August 2001 (Capital Construction and | \$525.0 | \$262.0 | \$337.1 | \$370.4 | \$1,494.5 |
| Cuts by Bill | | | | | |
| SB 01S2-023 | 0 | (2.9) | (2.0) | (211.0) | (216.0) |
| HB 02-1388 | (0.1) | (0.3) | 0.1 | 0.2 | (0.1) |
| HB 02-1438 | (1.4) | (9.6) | (42.5) | (4.3) | (57.8) |
| HB 02-1471 | 0 | (0.2) | 0 | 0 | (0.2) |
| Total Amount Cut | (\$1.6) | (\$13.0) | (\$44.5) | (\$215.0) | (\$274.1) |
| Remaining Appropriation | \$523.4 | \$249.0 | \$292.6 | \$155.3 | \$1,220.4 |
| % of Total Appropriation Cut | 0.3% | 5.0% | 13.2% | 58.1% | 18.3% |

More money was cut from the University of Colorado system than any other higher education system or any state department (\$86.1 million, or 31.4 percent of the total amount cut). Next hardest hit was the Department of Corrections, at \$57.3 million, or 20.9 percent of the total amount cut. Third on the list is the Department of Human Services, with \$36.2 million in cuts (13.2 percent).

totalled \$431.7 million. Of this, the Department of Corrections requested \$171.3 million, the Department of Transportation requested \$50 million, and higher education requested \$160.2 million (combined, this represents 88 percent of the total request). Because of the state's continuing revenue shortfall, however, the Office of State Planning and Budgeting and the Colorado Commission on Higher Education are recommending that only \$17.2 million of the \$431.7 million request be funded.

Requests for Funding for FY 2003-04

Requests for funding for FY 2003-04, submitted to the Capital Development Committee on September 1,

Capital Construction and Controlled Maintenance Funding Needs

One estimate of the state's capital construction needs is provided by the five-year plans state departments and higher education institutions submitted this fall as a part of their annual request for capital funding. These five-year plans are subject to change, but they do show what departments and institutions believe are necessary over the next five years. As Table 4 indicates, the total amount requested is \$1.57 billion over five years.

Controlled maintenance requests, by contrast, are not submitted until later in the fall. The most recent five-year projection of controlled maintenance needs

was submitted in November 2001. The five-year need at that point was \$346.8 million. Because only \$2.5 million of that total was funded for FY 2002-03, that same estimate is used here. Combined with the capital construction need of \$1.57 billion, the total need for capital projects over the next five years is \$1.91 billion.

By contrast, the estimated available revenue for capital projects is presented in Table 5. The difference between the estimated revenue of \$325.5 million and the estimated need of \$1.91 billion is \$1.59 billion. Further, the \$1.59 billion shortfall assumes that the \$100 million statutory transfer is not reduced in FY 2003-04, FY 2004-05, or FY 2005-06. The Office of State Planning and Budgeting has recommended that most of the FY 2003-04 transfer not take place.

Table 4
State Departments and Higher Education Institutions Five-Year Capital Plans (State Funds Only)
(in millions)

| | FY 2003-04 | FY 2004-05 | FY 2005-06 | FY 2006-07 | FY 2007-08 | Total |
|-------------------|----------------|----------------|----------------|----------------|----------------|------------------|
| State Departments | \$230.9 | \$101.2 | \$56.5 | \$148.4 | \$110.2 | \$647.2 |
| Higher Education | 9.9 | 204.2 | 337.7 | 236.5 | 132.5 | 920.8 |
| Total | \$240.8 | \$305.5 | \$394.1 | \$384.9 | \$242.7 | \$1,568.0 |

Table 5
Five-Year Estimate of Revenue to the Capital Construction Fund
(in millions)

| Source | FY 2003-04 | FY 2004-05 | FY 2005-06 | FY 2006-07 | FY 2007-08 | Total |
|---|----------------|----------------|----------------|--------------|--------------|----------------|
| Ongoing Statutory General Fund Transfer | \$100.0 | \$100.0 | \$100.0 | \$0 | \$0 | \$300.0 |
| Additional Statutory General Fund Transfer for Corrections Expansion Reserve Fund projects (must be spent on prisons) | 1.2 | 1.8 | 0.4 | 0 | 0 | 3.4 |
| Interest Earnings | 5.7 | 5.0 | 4.3 | 3.8 | 3.3 | 22.1 |
| Total | \$106.9 | \$106.8 | \$104.8 | \$3.8 | \$3.3 | \$325.5 |

Apart From the Requested Need for All Types of Projects, What Amount Should Be Spent on the State's Existing Facilities?

The \$1.91 billion in capital needs from state departments and higher education institutions is not limited to new construction. It includes projects to renovate existing buildings and controlled maintenance projects. The following discussion, however, considers how much money the state should spend each year to maintain its existing facilities.

State Buildings and Real Estate Programs, within the Department of Personnel and Administration, has valued the current statewide building inventory (state-funded buildings only) at approximately \$5.3 billion.

The National Research Council's Building Research

4 percent of the buildings' current replacement value be allocated each year for controlled maintenance and renovation. These guidelines are also endorsed by the International Facility Management Association and the Association of Higher Education Facility Officers.

The low or high end of the 2 to 4 percent "minimum level" range 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;
- the status of regulatory compliance; and
- the effectiveness and efficiency of the maintenance organization.

1. The National Research Council is the working arm of the National Academy of Sciences and the National Academy of Engineering.

With a statewide building inventory of 5.3 billion, the 2 to 4 percent guideline suggests that the state's minimum annual controlled maintenance and renovation budget should range from \$106 million to \$212 million.

Key Provisions of Law

Section 2-3-1305, C.R.S.: Directs the Capital Development Committee to make written recommendations to the Joint Budget Committee regarding funding for capital projects.

Section 24-75-302.5, C.R.S.: Creates the Controlled Maintenance Trust Fund and defines appropriations that may be made from the fund.

Section 24-75-201.1 (1) (d), C.R.S.: Specifies, for each fiscal year, the amount of unrestricted General Fund balances that are to be retained as a reserve.

Section 24-75-301, C.R.S.: Defines capital construction.

Section 24-75-302 (1) (a), C.R.S.: Creates the Capital Construction Fund and delineates the types of projects for which the fund may be used.

Section 24-75-302 (1) (a), C.R.S.: Requires all interest in the Capital Construction Fund earned from the investment of moneys in the fund to remain in the fund and not revert to the General Fund. Also, unexpended or unencumbered moneys are to remain in the fund and not revert to the General Fund.

Section 24-75-302 (2), C.R.S.: Stipulates that General Fund transfers made to the Capital Construction Fund, pursuant to Section 24-75-302 (2), are not deemed to be appropriations subject to the General Fund appropriations limit.

Staff Contacts: Lori Johnson or Amy Zook, Legislative Council Staff, 303-866-3521

Managing Colorado's Water Resources

The recent drought and Colorado's rapid population growth have heightened interest in Colorado's water supply. During the upcoming session, Colorado's citizens may look to the legislature and state government for long-term solutions to the state's water supply challenges. The purpose of this pamphlet is to outline the major features of Colorado's water policy landscape including its water law, state water agencies, state financing mechanisms for water supply projects, and water supply alternatives.

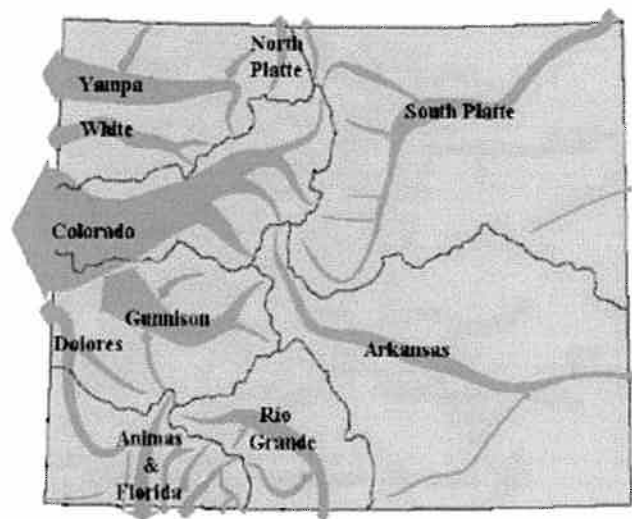
Overview of Colorado's Water Challenges

Irregular precipitation. Colorado is a semi-arid state that receives a statewide average annual precipitation of 15 inches, with large areas receiving less than 10 inches annually. It periodically experiences extended droughts. In an average year, approximately 16 million acre feet (MAF) of water flows in Colorado's rivers. However, this year, natural flows were only 4 to 6 MAF. One acre foot of water is the amount of water needed to flood an acre of land to a depth of one foot, or 325,851 gallons.

Reliance upon snow melt and water storage. The majority of water in the state falls as snow in the mountains. Consequently, most of the annual stream flow occurs during the three-month spring run off, from May through July. To manage the state's inconsistent water supply, over 2,000 dams and reservoirs have been constructed throughout the state. Combined, these reservoirs can hold over 6 MAF of water. As of October 1, 2002, statewide storage was 48 percent of average. The Continental Divide also runs through the state and separates much of Colorado's water supply from its population centers. Approximately 80 percent of the rain and snow falls in the state west of the divide, however, most of the state's population lives on its eastern side. Colorado is a headwaters state. Its waters flow out to many states but very little water flows in. In fact, the state is the source for several major river

systems including the Arkansas, Platte, Colorado, and the Rio Grande that provide water to a number of neighboring states.

River Water Flows



Water Law for a Semi-Arid Land

To address the state's unique water supply challenges, Colorado developed a legal system that is very different from the riparian system used in the wetter eastern states. In the riparian system, the landowners own the water that is found on their land. In Colorado, however, water is a property interest that is separate from the land. By creating a separate property interest, Colorado's water law allows water to be moved across the state to where it can be used. Eight other western states have adopted a similar water law, called the doctrine of prior appropriation, including Alaska, Arizona, Idaho, Montana, Nevada, New Mexico, Utah, and Wyoming. The remaining western states have adopted a modified version of this law.

Different laws for different waters. In Colorado, there are two basic types of water: water in streams and ground water that is not connected to streams. Water in streams is regulated according to the doctrine of prior appropriation. This law has governed the use of the state's water since before statehood. Colorado also contains large amounts of ground water that is isolated from streams and essentially nonrenewable. To help address the unique challenges of using this water, Colorado created a different law and regulatory system.

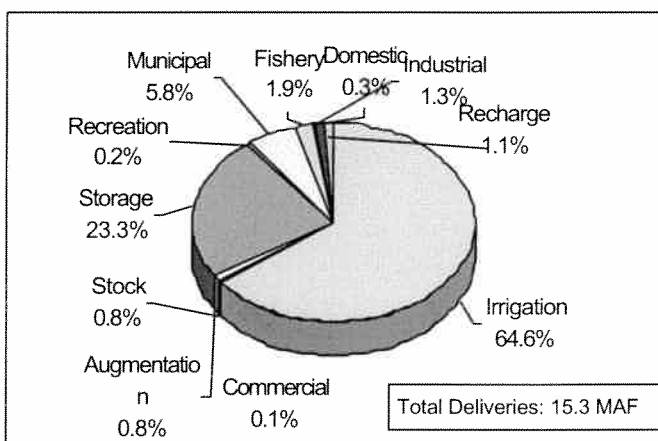
Water Law for Streams

Stream water right. A water right is created by using available river water for a legally recognized use. In general, a potential water user first goes to water court to determine if water may be removed from the stream without injuring existing water rights. If approved, a water judge sets a priority for the right to use a specific amount of water, the location of the diversion, the purpose, and if necessary any conditions to protect senior water rights. The earlier the date of the appropriation, the more "senior" the water right. Some of Colorado's most senior water rights date to the 1860s. Court recognition of a water right enables the owner to make an enforceable "call" for the curtailment of upstream uses by "junior" water rights until senior water rights have been satisfied. Once granted, a water right may be changed, amended, or transferred if approved by a water court.

A use-right. A water right is a right to use water. People who take water from a stream, also known as appropriators, must allow all unconsumed water to return to the stream for use by others. For example, an acre of corn consumes approximately 40 percent of the water applied to it. The law requires that the remaining 60 percent of the water taken from the stream be allowed to return to the stream for use by others. Water users may lose all or part of their rights if a water court determines that the water has not been put to a beneficial use within legal deadlines or the user has abandoned his or her right.

Types of water rights. Water rights may be obtained for a number of beneficial uses. Agricultural, domestic, and mining are the oldest types of legally recognized uses. To accommodate changing public values, beneficial uses now include the impoundment of water for recreation and the preservation of natural habitat.

2001 Water Deliveries



Source: Colorado Division of Water Resources

Tributary ground water. Many wells in Colorado pump ground water that is connected to a nearby river, called tributary ground water. For example, over 600,000 AF is pumped annually from wells near the South Platte and Arkansas rivers, primarily for agricultural purposes. Tributary ground water is regulated according to the same principles as water in streams. This policy helps maximize the use of Colorado's large tributary aquifers while protecting surface water rights. Consequently, most well users along the South Platte and other Colorado rivers are administered in priority. During times of shortages, pumping may be curtailed to protect senior water rights.

Interstate compacts. Approximately 10.7 MAF flow across Colorado's borders each year. Of this amount, 8 to 9.6 MAF is legally obligated to downstream states and Mexico by interstate compacts and federal court decisions. A compact is an agreement between two or more states that is approved by Congress. Compacts and court-ordered decrees are administered in the same

manner as other water rights in the state. During times of shortage, certain in-state water rights may be prohibited from diverting water until a compact obligation is satisfied.

| Average Stream Flow for Colorado's Major Rivers at the State Border in Acre Feet | |
|--|-----------|
| Colorado | 4,632,000 |
| Yampa | 1,656,000 |
| Animas | 680,500 |
| White | 590,100 |
| Dolores | 573,100 |
| South Platte | 408,900 |
| Rio Grande | 328,400 |
| North Platte | 316,900 |
| Arkansas | 163,200 |

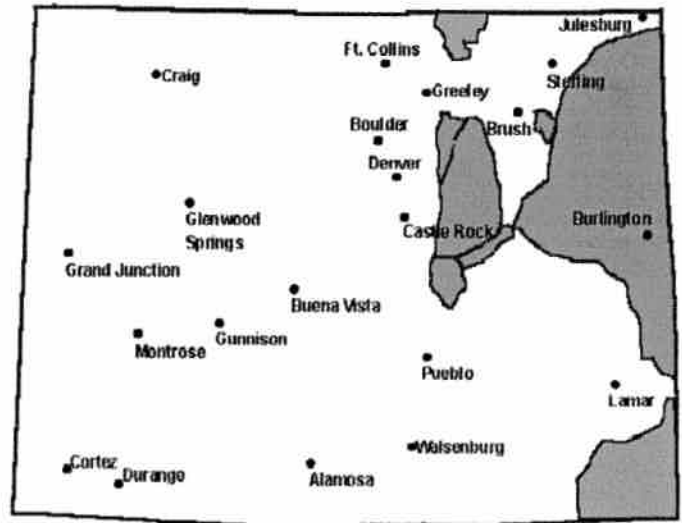
Water Law for Ground Water that Is Separate from Streams

In eastern Colorado, there are few rivers but large ground water resources that are important to agriculture. These waters include Colorado's portion of the Ogallala Aquifer that extends from South Dakota to Texas. Ground water in this area is essentially nonrenewable and isolated from surface streams. Wells are the primary source of water used in this area. To administer these wells, the General Assembly created designated ground water basins that are regulated according to a modified doctrine of prior appropriation. Colorado also has large ground water resources in deep underground rock aquifers, called nontributary ground water. Most of this water is found outside of designated basins. These waters include the Denver Basin Aquifer that underlies much of the Denver metro area and contains as much as 260 MAF of nontributary ground water.

Designated ground water. Over one MAF of water is pumped each year from designated ground water basins in Colorado. Designated basins are created by the

12-member Ground Water Commission. The commission is authorized by the General Assembly to manage and control designated ground water resources according to statutory guidelines. For example, the commission may grant a right to use designated ground water only if the use will not significantly impair existing water rights. Once a basin has been designated, electors in the basin may create ground water management districts. Each district is empowered to regulate the use, control, and conservation of ground waters within the district. District rules and regulations are subject to review by the commission. The water court does not have jurisdiction over water in designated basins.

Designated Ground Water Basins

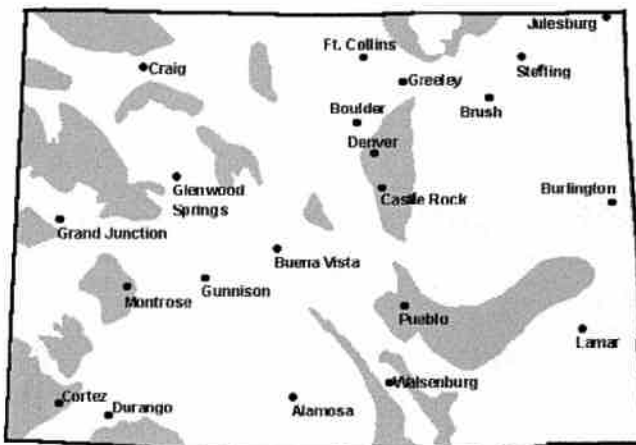


Source: Colorado State University

Nontributary ground water. Use of nontributary groundwater is based on legislatively defined criteria that allows for the gradual depletion of this nonrenewable resource. These criteria are commonly known as the "SB 5 criteria" after the Senate Bill that was enacted in 1985. Nontributary ground water is defined in statute as ground water that will not, within 100 years, deplete the flow of a stream at an annual rate greater than one-tenth of one percent of the annual pumping rate. Ownership of nontributary ground water is based on overlying landownership. Annual well

pumping is also limited to one percent of the underlying nontributary ground water. A well permit from the State Engineer must be obtained prior to drilling for nontributary ground water. Unlike water in streams, claims for nontributary ground water do not go through water court.

Nontributary Ground Water Basins



Source: Colorado State University

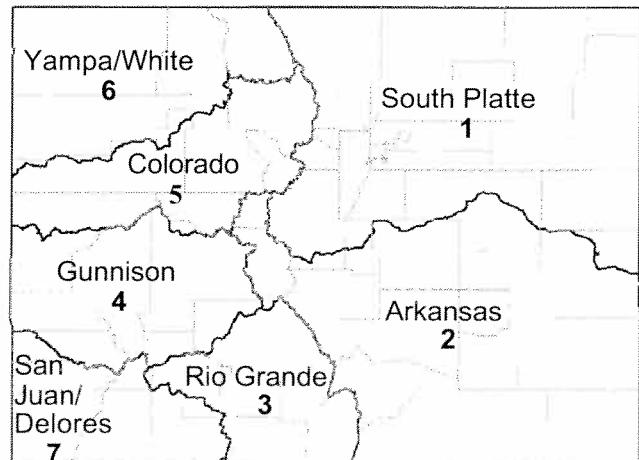
What Are the Primary State Water Agencies?

Four state entities are primarily responsible for the allocation of water and water policy and planning in Colorado: water courts, the Division of Water Resources, the Colorado Water Conservation Board, and the Ground Water Commission. However, numerous other state agencies also have water-related responsibilities. For example, the Division of Wildlife protects and enhances aquatic wildlife, the Division of Parks and Outdoor Recreation manages water-based recreation, and approximately nine state agencies address water quality issues including the Water Quality Commission and the Colorado Department of Local Affairs.

Water courts. Seven water divisions are established in statute that correspond to the state's seven major river basins. These are: the Arkansas, Colorado, Rio Grande, Gunnison, San Juan/Dolores, South Platte, and Yampa/White river basins. Each water division has a water

court. The Colorado Supreme Court appoints district judges from each water division to act as water judges. Water judges have exclusive jurisdiction over determination of water rights, changes of water rights, approval of plans to protect senior water rights, findings of reasonable progress on water construction projects, approval of exchanges, and approvals to use water outside the state. A water judge may also order a water user to obey a division engineer's order to cease injury to senior water rights or to cease diversions that are not being used beneficially. There are no juries in water court cases and judgments entered by water courts may only be reviewed by the Colorado Supreme Court. The General Assembly appropriated \$1.08 million in Fiscal Year 2002-03 from the General Fund for water judges and their staff.

Colorado Water Divisions



Division of Water Resources (DWR). The DWR is headed by the State Engineer and housed in the Department of Natural Resources. The State Engineer administers water rights, issues water well permits, monitors stream flows and water uses, inspects dams for safety, and represents Colorado in interstate water compact proceedings. The State Engineer and his staff are allowed to enter private property and inspect the transportation, storage and uses of water, and to stop diversions that injure senior water rights or are not being used beneficially. For FY 2002-03, the General Assembly appropriated

\$18.3 million and 246.6 full time employees (FTE) to the division, primarily from the following sources: \$16 million from the General Fund, \$620,000 from fees, and \$1.6 million from other sources, primarily the Colorado Water Conservation Board Construction Fund.

Colorado Water Conservation Board (CWCB). The CWCB is the state's primary water policy and planning agency. Its 15-member board is charged with conserving the state's waters to promote utilization and prevent floods. Nine of its members are appointed by the Governor for three-year terms to represent eight river basins and the City and County of Denver. Other members include the Executive Director of the Department of Natural Resources, the Commissioner of Agriculture, the State Engineer, the Colorado Attorney General, the Division of Wildlife Director, and the CWCB Director. Its major programs include water supply protection, flood protection, water supply planning and finance, stream and lake protection (instream flow program), and conservation and drought planning. The CWCB is part of the Department of Natural Resources. For FY 2002-03, the General Assembly appropriated \$11.3 million and 38.5 FTE to the board primarily from the following sources: \$1.3 million from the General Fund, \$8.8 million primarily from the CWCB Construction Fund and the Operational Account of the Severance Tax Trust Fund (funded by a tax on the extraction of nonrenewable natural resources), and \$223,409 from federal funds.

Ground Water Commission. The 12-member Ground Water Commission regulates the use of water in designated ground water basins. Nine of the board members are appointed by the Governor for four-year terms, including six agriculturalists from designated ground water basins, one agriculturalist from the San Luis Valley, and two municipal or industrial water users from the state.

What Are Some of the Major Water Supply Alternatives and Challenges?

Colorado's rapid population growth and current drought have caused many water providers to look at other ways

to manage supply and demand. Depending on geography, financial resources, and other factors, a community and its water supplier may have several sources from which to obtain water, including river water, ground water from the Denver Basin Aquifer, transfers from agricultural water rights, and vegetation management. Water providers may also be able to extend existing supplies through water conservation and water reuse.

River water. Water rights have been granted for most of the water in Colorado's rivers or the water is obligated to downstream states. Of Colorado's seven river basins, only the Colorado River Basin has a significant amount of water that may be developed for new diversions. The Colorado River Basin may have between 200,000 and 450,000 AF of water that may be used by municipalities, farmers, and anyone else in the state who can apply it to a legally recognized use. Although substantially less than the Colorado River, the lower South Platte River also may have some developable water.

Several obstacles could delay or limit the use of additional river water. For example, new diversions potentially affect many water rights, including rights that have been granted for projects that are being planned or constructed. Consequently, the legal process for determining the availability of developable water could be long and contentious. Also, several endangered species depend on water from Colorado's rivers. The federal government may prohibit or greatly restrict proposed and existing water diversions that threaten the survival or recovery of these species. Large dams typically require more than 20 years to plan and build. Legal challenges based on federal environmental laws may add to a project's cost and delay construction. Public opposition may also limit the development of river water if the proposed project will flood a popular recreational resource such as a scenic canyon or trout stream. Water projects that divert Colorado River water to eastern Colorado, called transbasin or transmountain diversions, may also face opposition because such diversions remove water that could be used for future economic development in western Colorado.

Denver Basin Aquifer. The Denver Basin Aquifer underlies the front range metropolitan area and may contain up to 260 MAF of potentially useable water. According to state law, water in the basin is allocated to overlying landowners, municipalities, and special districts. In addition to providing a long-term water supply for some users, these aquifers may also offer protection from extended droughts or provide an interim water supply until renewable supplies can be obtained. The aquifer may also provide a more environmentally friendly method for storing surplus river water during wet years than dams.

Water in the Denver Basin Aquifer is essentially nonrenewable, and well pumping typically exceeds the natural rate of recharge from rain and snow. Some Denver Basin Aquifer users have had to deepen wells to stay within the declining water table or drill new wells to offset declines in the water level. As the water level in an aquifer declines, well pumping becomes costlier due to additional drilling and well pumping costs. Eventually, use of the aquifer may become cost prohibitive.

Transfers of agricultural water rights. A water right is a property interest that may be sold or transferred, provided that no other water right is injured and the transfer is approved by the division water court. Currently, most of Colorado's water is used by agricultural interests. The market value of this water is steadily increasing as demand for municipal water increases. Selling a water right to a municipality may be the most profitable way for a farmer to benefit from his or her water right.

Large tracts of agricultural lands have been taken out of production to provide water to Colorado's growing municipalities. Permanently transferring a water right from a farm to a municipality may adversely affect local agricultural economies. Farms that have sold their water rights typically pay less property tax, employ fewer persons, and no longer purchase agricultural supplies from local businesses. Temporary transfers of agricultural water to municipalities during droughts may impose fewer impacts on the agriculture community than permanent transfers. However, these transfers may require the construction of additional storage projects to

hold agricultural water until needed by a municipality. Also, the water quality of some agricultural water may not be good enough for use by a municipality.

Vegetation management. Trees, shrubs, and other plants consume large amounts of water that could be used for other purposes. For example, tamarisk and Russian olive are two invasive, non-native shrubs that are estimated to infest as many as 75,000 acres of river lands in Colorado and may consume 250,000 AF per year in Colorado. Controlling these rapidly spreading plants may increase stream flows and help restore valuable wildlife habitat. Colorado's forests are also growing denser and using more water due to declines in commercial logging. One study estimates that logging during the first half of the 20th century allowed an additional 116,000 AF annually to flow into the North Platte Basin. Other Colorado river basins are experiencing similar increases in forest density.

Controlling tamarisk and other invasive plants is expensive and may require a long-term treatment program. For example, aerial herbicide treatment costs approximately \$200 per acre, and hand clearing may cost \$2,000 per acre. Also, the direct incentive for controlling tamarisk is limited because the saved water may only be used after senior water rights have been satisfied, potentially leaving little, if any, water for the controller of the tamarisk. Most of Colorado's forests are on federal lands. Fewer timber harvesting opportunities may be available than 50 years ago due to federal environmental restrictions. Public concerns may also limit logging in roadless areas, near popular recreation areas, or in older growth forests that include more marketable trees.

Water conservation and reuse. Water conservation and reuse help extend existing water supplies and reduce demand for new water sources. Water conservation measures include preventing leaks in pipes, replacing high-water-using appliances, pricing water to encourage wise water use, public education, and landscaping with lower-water-consuming plants. Water may be reused by capturing effluent from municipal sewage treatment plants, agricultural runoff, or other sources and applying it to another use such as irrigation. For example, a municipality could capture the discharge from its

sewage treatment plant, further treat it, and then use the water on a city golf course. Reusable water may also be exchanged with stream water to allow diversions upstream. Current technology can treat sewage water to a level that satisfies federal drinking water standards. According to state law, only certain types of water may be reused including water that is introduced into a river basin from another basin or from nontributary ground water.

The public may be reluctant to pay a premium for increased use or increase conservation if it must convert their lawns to lower water consuming landscapes or pay to install water savings appliances. With regards to water reuse, the public may be reluctant to drink treated effluent, regardless of the taste and quality. Consequently, reused water may require a separate distribution system for nonpotable uses, such as landscape irrigation. Water conservation and reuse may also reduce return flows to a river that may otherwise benefit downstream users or provide wildlife habitat.

What Are the Primary State Funding Sources for Water Projects?

Most of Colorado's largest water projects were constructed with federal moneys, local property taxes, and user fees. The state funds several smaller programs for the planning, construction, and rehabilitation of private and public water supply projects.

The CWCB Construction Fund. This revolving loan program funds projects that increase the consumption of Colorado's undeveloped river entitlement and that repair and rehabilitate existing water storage and delivery facilities. The CWCB may also provide grants up to 50 percent of the cost of feasibility studies and water supply investigations. Loans may not be used for domestic water treatment and distribution systems. The fund receives revenue from the repayment of loans, interest on the fund in the state treasury, and federal mineral royalty distributions. As of June 30, 2002, the fund's value was \$238 million including \$142 million in outstanding loans, \$11 million in authorized projects under contract, \$30 million in special funds, \$29 million in authorized projects not yet under contract, and \$26

million available for new loans. The CWCB is authorized to adjust loan interest rates that currently range from 2.75 percent for agricultural loans to 5.75 percent for commercial loans. Spending from the fund is approved annually by the General Assembly in a bill. In 2002, the General Assembly approved loans from the fund of \$5.3 million and grants of \$4.9 million.

Severance Tax Trust Fund Perpetual Base Account loans. The CWCB is also authorized to issue loans for water projects from moneys in the Severance Tax Trust Fund's Perpetual Base Account that was created by the General Assembly in 1997. As of June 30, 2002, the fund's value was \$75 million including \$27 million in outstanding loans, \$1 million for projects under contract, \$32 million for projects not yet under contract, and \$14 million available for new loans. The severance tax is paid by producers of oil, gas, coal, and other minerals. In 2002, the General Assembly approved two loans from the fund totaling \$26 million and \$1 million for emergency drought relief for agricultural well users.

Colorado Water Resources and Power Development Authority (the authority). The authority is an independent public entity created by the General Assembly in 1981 to finance water supply projects and later authorized to finance water quality projects. The authority is authorized to issue revenue bonds that are the indebtedness of the authority and do not obligate the state or any political subdivision. The authority is governed by a nine-member board appointed by the Governor. In 2001, the authority committed \$20 million for water resources development. These moneys are primarily used to help offset the cost of borrowing money by a project sponsor. For example, the authority's program for small water resources projects finances projects costing up to \$15 million by providing bond insurance for small, non-investment grade borrowers. This enables the project sponsor to issue lower-cost AAA-rated bonds. The authority's water revenue bond program helps investment grade borrowers finance projects ranging from \$15 million to \$100 million by purchasing bond insurance, pooling borrowers, investing proceeds, and providing other cost-saving services. The authority is allowed to provide similar assistance for larger loans, provided the projects are determined to be feasible by the CWCB.

The General Assembly must also adopt a joint resolution authorizing the authority to consider the project, and the resolution must be signed by the Governor. Due to the streamlined approval process, projects under \$100 million may receive funds approximately three months after applying for the money. Due to the legislative cycle, the projects over \$100 million may require up to one year to complete the approval process.

Key Provisions of Law

Section 5 of Article XVI, Colorado Constitution: Guarantees the right to appropriate available water for a legally recognized use.

Section 6 of Article XVI, Colorado Constitution: Establishes the doctrine of prior appropriation.

Section 7 of Article XVI, Colorado Constitution: Allows for the construction of right-of-ways for ditches, canals, or flumes.

Section 37-60-101, et seq., C.R.S.: Specifies membership and the powers and duties of the Colorado Water Conservation Board including administration of CWCB Construction Fund.

Section 37-80-101, et seq., C.R.S., Section 37-92-301, et seq., C.R.S., and Section 37-92-501, et seq.: Specifies the powers and duties of the State Engineer and the Division of Water Resources.

Section 37-90-101, et seq., C.R.S.: Colorado Ground Water Management Act regulates the use of designated ground water including defining the powers and duties of Ground Water Commission and Ground Water Management Districts.

Section 37-90-137, C.R.S.: Regulates the use of Denver Basin Aquifer and other nontributary ground water located outside of designated basins.

Section 37-92-101, et seq., C.R.S.: The Water Right Determination and Administration Act regulates the use of river water and ground water connected to rivers.

Section 37-92-102, C.R.S.: Defines the basic tenets of Colorado water law.

Section 37-92-301 through 308, C.R.S.: Establishes the water court's process and criteria for determining and administering water rights.

Section 37-95-101, et seq., C.R.S.: Specifies membership and the power and duties of the Colorado Water Resources and Power Development Authority.

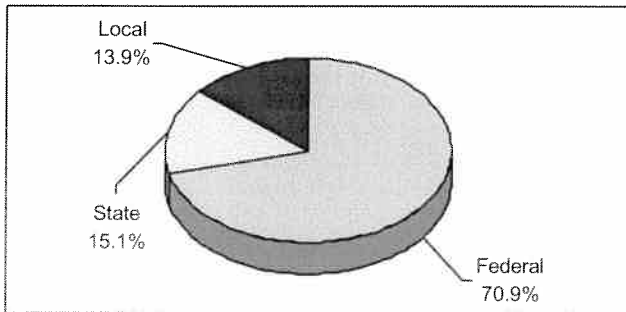
*Staff contacts: David Beaujon and Scott Grosscup, Legislative Council Staff, 303-866-3521
Thomas Morris, Legislative Legal Services, 303-866-2045*

Colorado's Tax Structure

Colorado's Tax Structure

Coloradans paid nearly 33 percent of their income in federal, state, and local taxes in 2000. Approximately 71 percent of these taxes are paid to the federal government, primarily in the form of income and Social Security taxes. The remaining 29 percent of taxes paid by Coloradans is split fairly evenly between state and local governments (Graph 1). The tax burden of Colorado citizens and businesses has been gradually rising since 1991. However, the increase of 3.4 percentage points is entirely attributable to a rising federal tax burden. The state and local tax burden decreased from 1991 to 2000.

Graph 1
Where Do Our Taxes Go?
2000 = \$46.8 billion



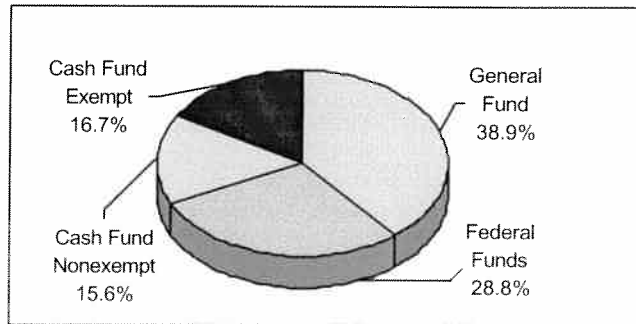
This pamphlet analyzes Colorado's state and local tax structure. First, the revenue sources for both state and local governments are examined. We examine the state tax cuts of recent years. This follows with a general discussion of tax policy considerations — tax competitiveness, who pays state and local taxes, and revenue stability.

State Revenue Structure

State revenue comes from a variety of sources. In FY 2001-02, the state collected \$14.3 billion of revenue (Graph 2). Nearly 39 percent of state revenues were General Fund money and were primarily comprised of

income and excise taxes. The General Fund share is a marked downturn from the 46 percent level two years ago. The downturn was attributable to the decline in the economy and the stock market and to the diversion of a portion of income tax revenue to the State Education Fund. Cash Fund revenues, both exempt and nonexempt, accounted for roughly 32 percent of state revenues. Nonexempt cash fund revenue is part of TABOR revenue subject to the inflation and population growth constraints. Whereas the General Fund is used for most of the state's operating purposes, Cash Funds are earmarked for specific purposes. Federal funds comprised the remaining 29 percent of state revenues.

Graph 2
Colorado State Budget
Revenue Sources by Fund Type, FY 2001-02



General Fund revenue sources have changed significantly since the 1970s. The state has become more reliant on individual income taxes and less reliant on sales and use taxes since FY 1975-76. In FY 2001-02, 55 percent of the state's General Fund came from individual income taxes, compared with only 39 percent in FY 1975-76 (Graph 3). Meanwhile, sales and use taxes comprised 34 percent of General Fund revenues versus 37 percent in FY 1975-76.

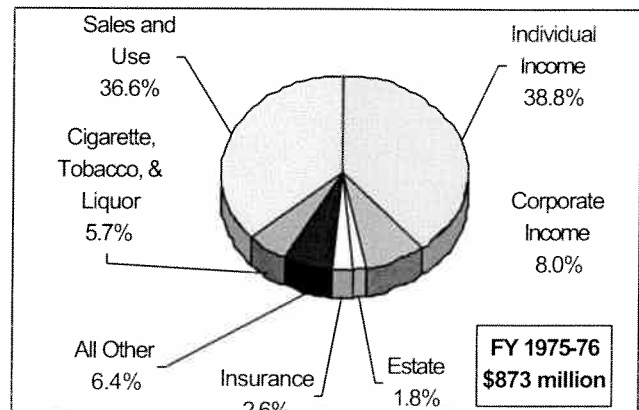
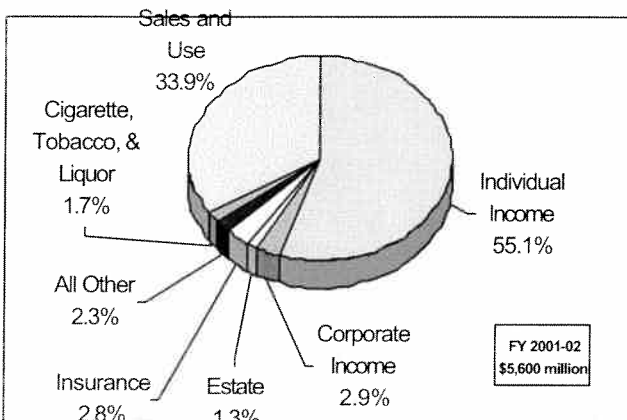
Three primary reasons account for this shift. First, many sales tax exemptions were enacted in the late 1970s and early 1980s when the state had significant surpluses. When the large budget surpluses evaporated

in the mid-1980s recession, the sales tax exemptions were not repealed. While the state also enacted many income tax reductions in the late 1970s and early 1980s, these reductions were largely repealed to help the budget. The largest such exemptions from the sales tax were food for home consumption and fuel and electricity for residential use. Based on FY 2000-01, all sales and use tax exemptions accounted for approximately \$503 million.

A second reason for the shift is that federal tax reform in

state income tax returns is diverted to the State Education Fund. When the General Fund has revenue above the statutory reserve requirement, the first \$25 million will be transferred to a reserve fund to eventually put the state's TABOR refund back on an accrual accounting basis. Any additional revenue above the statutory reserve will be transferred to the Highway Users Tax Fund (2/3) and the Capital Construction Fund (1/3). These diversions and transfers are explained in greater detail in other portions of the program.

**Graph 3
Comparison of General Fund Revenues**

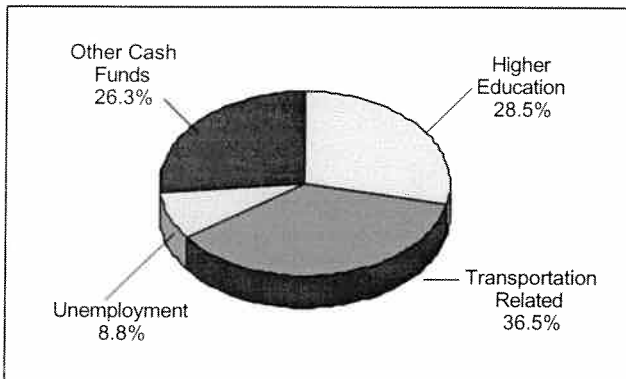


1986 significantly broadened the tax base upon which income taxes are levied. Since Colorado uses federal taxable income as its starting point for calculation of Colorado's income tax base, the broadening of the federal tax base, which Colorado adopted for the most part along with its own tax law changes in 1987, increased the state's reliance on individual income taxes. Finally, the income tax responds more to changes in income than any other tax. The economic downturn in 2001 and 2002 did alter the shares of income and sales taxes somewhat. Income taxes declined more sharply than sales taxes.

Revenue that traditionally was for the General Fund has been dedicated, both directly and indirectly, in recent years. When the state has enough revenue to appropriate to the 6 percent limit, 10.355 percent of sales and use taxes is diverted to the Highway Users Tax Fund. One-third of 1 percent of state taxable income on

Nonexempt **cash fund** revenues are earmarked for a variety of specific purposes. Graph 4 displays the relative importance of the cash fund revenue sources. The largest cash funds are earmarked for transportation (37 percent), higher education (29 percent), and unemployment insurance (9 percent). The transportation funds primarily receive money from gas taxes and registration fees. Higher education revenues are largely derived from tuition fees, while most of the unemployment insurance revenues come from the unemployment insurance tax. Cash fund revenues typically grow at a slower rate than General Fund revenue. Because a large portion of the tax revenue is tied to unit consumption (motor fuel taxes) or has a maximum threshold for taxation (first \$10,000 of wages for unemployment insurance taxes), inflation has less of an impact on cash fund revenue relative to the General Fund.

Graph 4
Major Cash Fund Revenue Sources, FY 2001-02



Non-exempt cash fund revenue sources can have an indirect impact on the General Fund in a number of ways. First, an increase in the amount of revenue generated in a cash fund (e.g., an increase in a license fee) will increase the TABOR surplus (when it exists) and reduce the amount of money available in the General Fund because the TABOR refund has been made from the General Fund.

Second, when the state does not have a TABOR surplus in a given year, the state could increase revenue in a cash fund up to the state's TABOR revenue limit, and reduce TABOR surpluses in future years. Finally, because cash fund revenue typically grows at a slower rate than General Fund revenue, it helps the General Fund during a surplus year in that it reduces the overall growth rate of TABOR revenue and therefore the amount of the refund.

State Tax Reductions

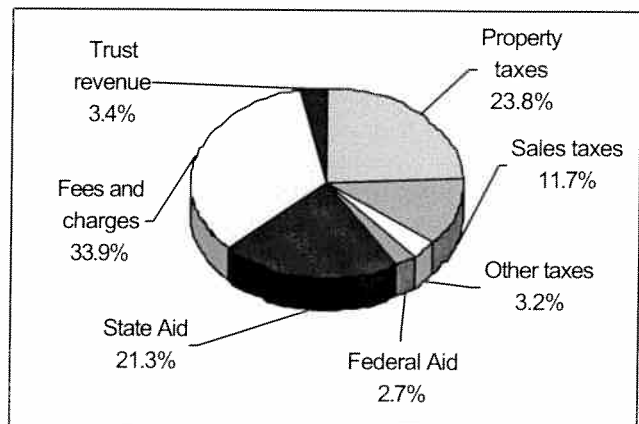
As Colorado experienced growing economic prosperity, the state began to accrue TABOR surpluses in FY 1996-97. The General Assembly enacted many tax reduction bills from 1999 through 2001 that reduced the size of the TABOR surplus. The tax reductions returned an estimated \$456.1 million to Colorado taxpayers in FY 2001-02 and nearly \$1.3 billion from FY 1998-99 through FY 2001-02. The income and sales tax rate reductions accounted for 78.5 percent of the reduction in FY 2001-02, while

targeted provisions accounted for the remainder.

Local Revenue Structure

There are nearly 2,200 units of local governments in Colorado. As a group, school districts generate the most revenue, followed by municipalities. The primary revenue source for local governments is fees and charges, accounting for almost 34 percent of revenues (Graph 5).

Graph 5
Total Local Government Revenues by Source
FY 1998-99

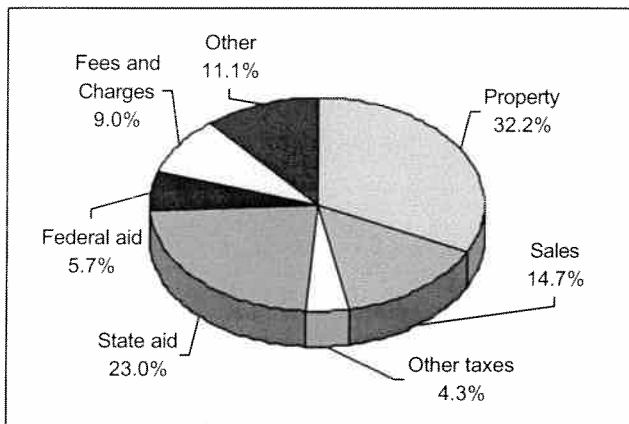


Intergovernmental receipts, primarily from the state, are the second-largest revenue source (24 percent), followed closely by property taxes (23.8 percent).

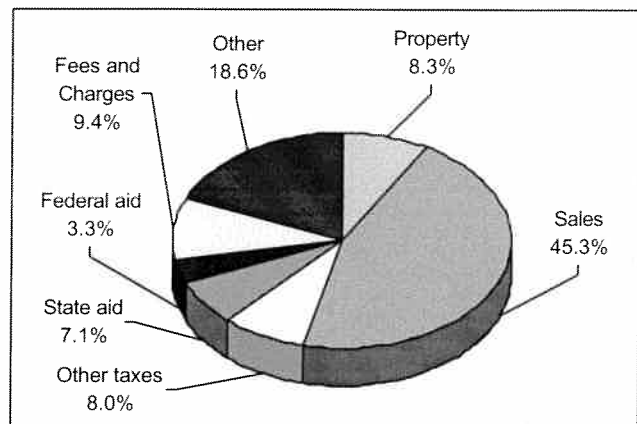
The importance of the revenue sources differs among the various types of local governments. The primary revenue sources for counties are the property tax (32 percent) and state aid (23 percent), while municipalities are dependent upon the sales tax (45 percent), and school districts rely primarily on state aid (41 percent) and local property taxes (37 percent).

The importance of state aid to counties and municipalities is tied primarily to social services funding and highway revenues, while state aid to schools is to provide equalization of total funding for all school districts. Graphs 6 through 9 display the relative importance of the different revenue streams by level of government.

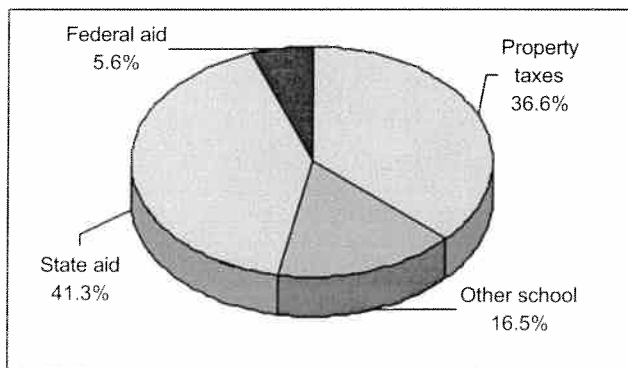
Graph 6
2000 County Government Revenues by Source
(excludes Denver)



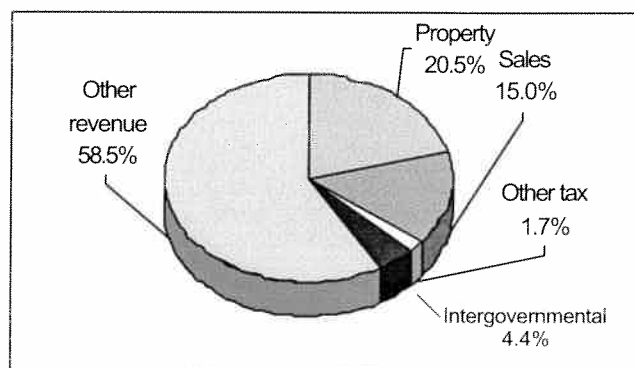
Graph 7
2000 Municipal Government Revenues by Source
(includes Denver)



Graph 8
2000-01 School District Revenues by Source



Graph 9
2000 Special District Revenues by Source



CONSIDERATIONS FOR TAX POLICY

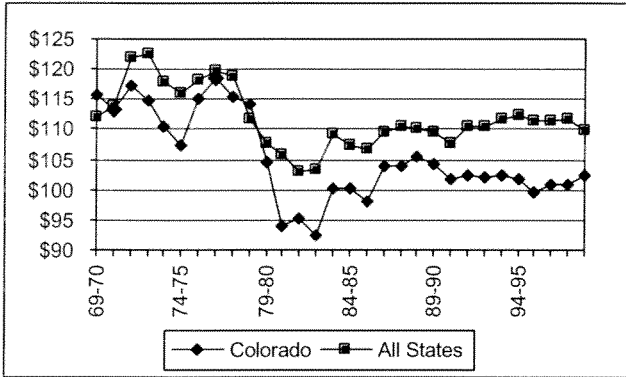
When analyzing tax policy, several important considerations are usually taken into account. These issues include how Colorado's tax burden ranks among the states, who pays the various taxes, and the stability of tax revenues. These issues are discussed in turn.

How Does Colorado Compare with Other States in State and Local Taxes?

Rankings of state and local taxes provide a national perspective for evaluating the relative tax burdens of Coloradans and for comparing differences in overall tax

structures. The basis used to rank the states is collections per \$1,000 of income. This statistic is used for the rankings because it provides a more accurate measure of the ability of taxpayers to pay taxes than, for example, tax collections per capita. (It should be noted that Colorado generally ranks higher on a per capita basis.) Colorado ranked 11th lowest in the nation in *combined* state and local tax collections in FY 1998-99 (latest available data for state *and* local taxes). On average, state and local governments collected \$102.33 for every \$1,000 of Colorado personal income. Graph 10 shows the trend in state and local tax collections as a percentage of Colorado personal income. Colorado generally follows the national trend.

Graph 10
State and Local Taxes per \$1,000 of Income



The state tax burden was lower in 2001 than it was in 1999, largely attributable to the tax reductions enacted during the 1999 and 2000 legislative sessions (Graph 11). Moreover, the state tax burden in Colorado was consistently below the national average during that time period. Table 1 shows the tax burden comparisons for selected state taxes. In terms of the major state taxes, Colorado ranked *above the national average* in individual income taxes and gasoline taxes, but below average in corporate income, gas, and liquor and tobacco taxes. With the exception of the individual income tax, Colorado was below the median rank. Colorado's total state tax burden ranked fifth lowest in the nation.

Graph 11
State Taxes per \$1,000 of Income

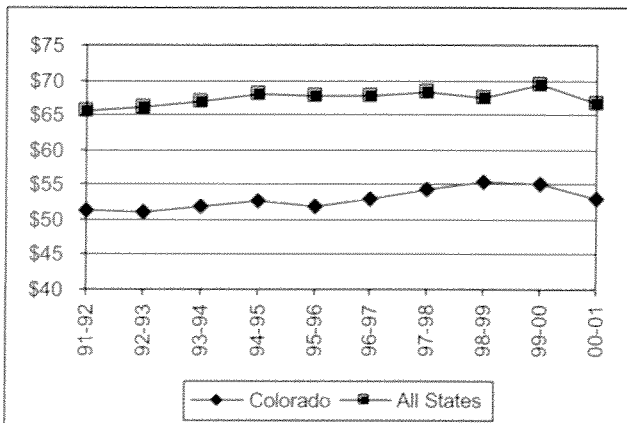


Table 1
Colorado's Rank in Selected State Taxes Per \$1,000 Income, FY 2000-01

| Tax | Colorado | | National | | |
|--------------------|-----------|----------------|-----------------|----------------|----------------|
| | Rank | Tax | High | Avg. | Low |
| Sales/Use | 42 | \$13.80 | \$47.80 | \$21.37 | \$0.00 |
| Individual Income | 19 | \$27.27 | \$45.95 | \$24.72 | \$0.00 |
| Corporate Income | 37 | \$2.38 | \$21.33 | \$3.78 | \$0.00 |
| Gas | 32 | \$4.00 | \$8.66 | \$3.61 | \$0.77 |
| Liquor and Tobacco | 48 | \$0.69 | \$3.51 | \$1.53 | \$0.47 |
| Total Taxes | 46 | \$53.01 | \$102.24 | \$66.65 | \$42.66 |

The local tax burden was \$4.46 lower in 1999 than in 1992. However, unlike the state tax burden, Colorado's local taxes were consistently higher than the national average. Colorado's local tax rankings for 1998-99 are shown in Table 2. The state ranked high — eighth — in local taxes relative to income. Colorado's local sales taxes were significantly higher than the national average, thus ranking the state second highest. Property taxes were less than the national average. The state's high ranking in local taxes can be attributed to the level of fiscal decentralization in the state. Most cities and counties collect sales taxes, while all property taxes are collected at the local level. Colorado is one of 16 states that does not collect a statewide property tax. Meanwhile, *combined state and local* sales and use tax collections were \$28.56 per \$1,000 of personal income in FY 1998-99, 19th highest in the country, and above the national average of \$27.04.

Table 2
Colorado's Rank in Selected Local Taxes Per \$1,000 Income, FY 1998-99

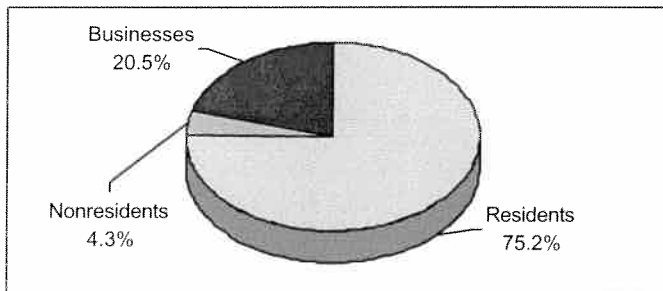
| Tax | Colorado | | National | | |
|--------------------|----------|----------------|----------------|----------------|----------------|
| | Rank | Tax | High | Avg. | Low |
| Sales/Use | 2 | \$14.17 | \$21.35 | \$4.89 | \$0.00 |
| Property | 27 | \$28.83 | \$57.11 | \$30.79 | \$10.64 |
| Total Taxes | 8 | \$46.86 | \$73.60 | \$42.57 | \$20.17 |

Who Pays State and Local Taxes?

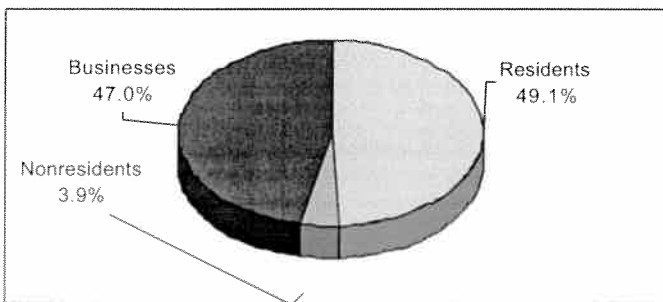
Colorado's tax burden is shared among residents, businesses, and nonresidents. Colorado residents paid 63 percent of all state and local taxes in 2000; businesses paid 33 percent; and nonresidents paid the remaining 4 percent. As Graph 12 shows, the split varies for state and local taxes — *residents* paid 75 percent of state taxes, but only 49 percent of local taxes. The larger share paid by individuals for state taxes is due to the state's reliance on the individual income tax. *Businesses* pay an estimated 21 percent of state taxes and 47 percent of local taxes. The higher business share in local taxes is the result of localities' relative dependence on property and sales taxes.

Graph 12
Distribution of State and Local Taxes

State Taxes FY 2001-02



Local Taxes 2000



Taxes Relative to Income. A study as to the relative burdens of taxes by income groups has not been conducted since 1994. However, all previous studies have shown that Colorado's overall state and local tax system is regressive. This means that low-income taxpayers pay a larger share of their income on taxes

than high-income taxpayers. Although low-income households pay a larger *share* of their income in state and local taxes, most of the tax revenues are collected from households in the upper income groups.

Sales and Use Taxes. The majority of sales and use taxes (nearly 55 percent) are paid by Colorado residents. Businesses pay 36 percent, and nonresidents, primarily tourists, pay 10 percent. The sales tax is regressive. At the state level, the exemptions for many necessities, such as food, residential heat, light, and power, and prescription drugs, lessen the regressive nature of the sales tax.

Income Taxes. Individuals paid nearly 95 percent of income taxes in FY 2001-02, while corporations paid the remainder. Colorado's income tax is progressive, despite the single tax rate of 4.63 percent. Fixed levels of exemptions and deductions account for the progressive nature of the state's income tax, in that they are worth relatively more to persons with low incomes.

Property Taxes. Nearly 51 percent of local property taxes collected in 2002 came from businesses. Colorado residents paid an estimated 48 percent, while nonresidents paid an estimated 1 percent. The property tax is regressive.

Stability of State and Local Tax Revenues

The state's income tax is based on federal tax law. Thus, when definitions of income subject to tax or deductions are changed, the state's income tax revenues will show a change in the same direction. For example, the federal Tax Reform Act of 1986 created a broader base of income subject to tax and reduced deductions. Colorado received a "windfall" of revenue as a result. During the last two years, federal tax laws increased deductions and Colorado's income tax revenues are lower as a result. The reduced income tax revenue stream also affects the amount of money diverted to the State Education Fund. It should be noted that additional federal tax credits do not affect Colorado income taxes because the credits do not change the definition of taxable income.

Both the growth patterns and volatility of major government revenue sources are important when assessing dependence on various revenue streams. Historically, income taxes tend to register the strongest growth, followed by sales and use taxes, then property taxes.

Table 3 displays the average annual growth rates for the major state and local tax collections for FY 1982-83 through FY 2001-02 and for FY 1992-93 through FY 2001-02. The latter time period is included to show the effect that the TABOR amendment has had on property taxes since its passage in 1992.

Table 3
Average Annual Revenue Growth

| Revenue Source | FY 1983 through FY 2002 | FY 1993 through FY 2002 |
|---------------------------------|-------------------------|-------------------------|
| State Sales and Use Taxes: | 5.9% | 7.4% |
| Sales | 6.1 | 7.3 |
| Use | 4.1 | 8.2 |
| State Income Taxes: | 8.3 | 7.1 |
| Individual Income | 8.6 | 7.4 |
| Corporate Income | 5.3 | 2.8 |
| Local Property Taxes: | 5.1* | 6.1 |
| School Property | 2.0* | 3.5 |
| Non-School Property | 7.7* | 8.0 |
| Addendum: Benchmark Comparisons | | |
| Personal Income | 7.2 | 8.0 |
| Inflation + Population | 5.4 | 6.0 |
| Corporate Profits | 7.0 | 5.5 |
| Assessed Values | 4.2* | 8.4 |

* Measured since FY 1988

Individual Income Tax. As the table shows, the state's individual income tax has registered the highest growth during the 19-year period analyzed, 8.6 percent per year. Individual income taxes typically grow faster than personal income. While growth in income is loosely

tied to growth in population and inflation, income growth includes a productivity factor in its annual increases, thus contributing to faster growth in taxes. Additionally, personal income does not include capital gains income. The relative importance of capital gains income more than doubled, increasing from 4.6 percent of adjusted gross income in 1993 to 11.3 percent in 2000. However, the decline of the stock market that began in 2000 and continued in 2001 had a large impact on capital gains income, resulting in individual income taxes growing at a slower rate than personal income during the past nine years. Although we will not have final data on capital gains income until next year, partial data from Colorado's income tax returns filed this year indicate that this income may have declined by 32 percent. Individual income taxes declined by 16.7 percent in FY 2001-02, compared with personal income growth of 3.6 percent in 2001, indicating that capital gains were a large factor for the decline of income tax revenue. Colorado's ranking of individual income taxes as a percentage of total state taxes was fifth in FY 2000-01. Thus, the state had a higher risk than most other states from the downturn in the stock market.

Corporate Income Tax. The positive difference between corporate income tax growth and national corporate profits growth increased in the more recent years prior to FY 2001-02. This was explained by the high performance of the Colorado economy *vis-a-vis* the national economy in the 1990s. The state's personal income growth ranked second, employment growth ranked fourth, and the unemployment rate was the sixth lowest in the country. Colorado's poor economy during 2001 and 2002 turned the spread between corporate income tax and corporate profits growth from positive to a large negative in FY 2001-02.

Sales and Use Tax. Sales and use taxes registered a 5.9 percent annual increase throughout the 19-year period, and this growth has accelerated to 7.4 percent since FY 1992-93. In general, sales and use taxes react noticeably and swiftly to changes in economic activity, with use taxes reacting in a more exaggerated fashion than sales taxes. Both revenue sources declined in the two most recent state recession periods. Typically, consumer spending closely matches income growth, as it does during the longer comparison period.

However, short-term deviations from the long-term trend occur as shown in the FY 1992-93 to FY 2001-02 comparison. Factors such as consumer confidence, lower mortgage rates that increased disposable income, and wealth from stock market and housing gains contributed to the recent surge in sales tax receipts relative to personal income increases.

Property Taxes. Property taxes, particularly school-related property taxes, displayed the slowest growth among the primary revenue sources. There are two distinct growth periods for property taxes. Prior to the passage of TABOR, local governments were able to increase their tax rates (mill levies) without voter approval. Thus, when assessed values declined or were relatively stagnant, local governments were able to maintain or increase their revenue streams by increasing mill levies without voter approval. For example, from FY 1987-88 to FY 1992-93, property taxes increased at a compound annual average rate of 3.2 percent while assessed values declined at a 3.0 percent annual rate. Since the passage of TABOR, property taxes increased at an annual pace of 6.2 percent, somewhat less than the annual average increase of 8.4 percent for assessed values.

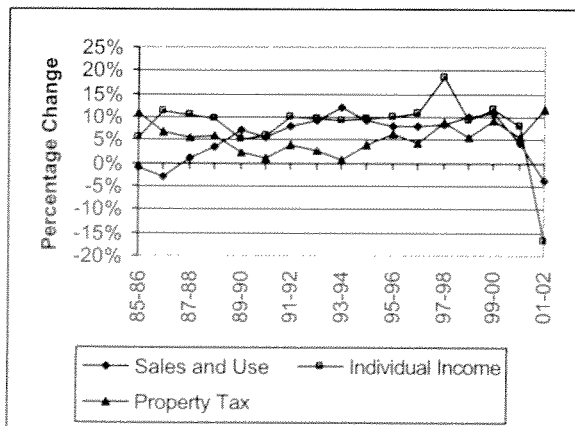
The volatility of the major revenue streams is displayed

in Graphs 13 and 14. Graph 13 shows that in all but the first and last years, individual income tax growth outpaced property tax growth, and in all but three years income tax gains grew faster than sales and use taxes. Since FY 1988-89, property tax growth has generally lagged both income and sales tax growth.

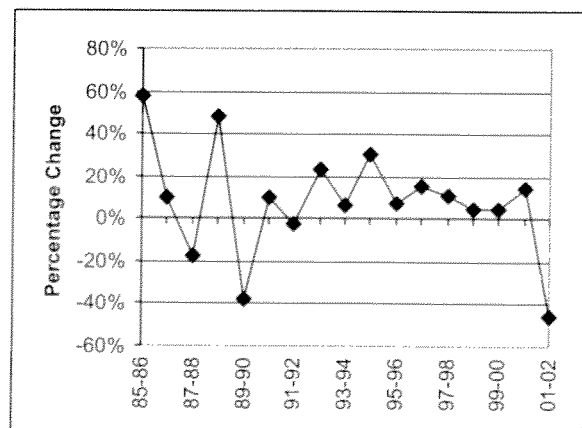
Property taxes tend to react more slowly to economic changes than the other revenue sources. Because of the assessment and collection cycles, there is approximately a two-year lag in how property taxes react to the economy. As previously noted, sales and use taxes tend to be more reactive to economic changes. This cycle occurs because Colorado exempts many items that are necessary for sustenance — food for home consumption, for example.

As a result, the sales tax is levied on more "discretionary" purchases, which tend to be curbed in difficult economic times. The most volatile revenue source among those examined is the corporate income tax (Graph 14), particularly in the early years because of numerous tax rate changes. However, corporate income taxes fell precipitously in FY 2001-02. The 46 percent decline was much more severe than the 14 percent decline for national corporate profits in 2001.

Graph 13
State Sales/Use Tax, Individual Income Tax, and Property Tax Growth



Graph 14
Corporate Income Tax Growth



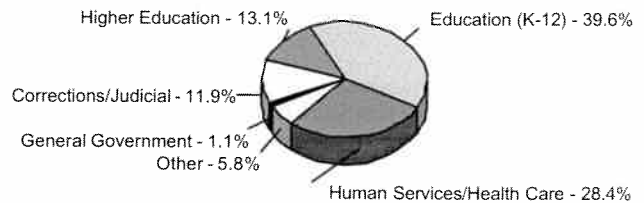
Staff contacts: Tom Dunn and Mike Mauer, Legislative Council Staff, 303-866-3521

Factors Driving the State Budget

Four program areas account for 93.0 percent of the state General Fund budget. Public elementary and secondary (K-12) education consumes 39.6 percent of the General Fund budget; human services and health care, 28.4 percent; higher education, 13.1 percent; and corrections and the judicial branch, 11.9 percent.

Because of the importance of these program areas to the state General Fund budget, the factors that drive these budgets are described below.

Graph 1
General Fund Appropriations, by Program Area
(FY 2002-03 = \$6.1 billion)



CRIMINAL JUSTICE: CORRECTIONS

The primary factor driving the Department of Corrections' (DOC) General Fund operating budget is the prison population. From June 30, 1992, to June 30, 2002, the prison population grew by nearly 106 percent, from 8,774 inmates to 18,045 inmates. Consequently, the DOC's General Fund operating budget increased from \$144.0 million in FY 1991-92 to \$442.1 million for FY 2001-02. The \$144.0 million appropriated in FY 1991-92 was 5.1 percent of the total state General Fund operating budget, whereas the \$442.1 million appropriated for FY 2001-02 represented 7.9 percent of total state General Fund operating appropriations. As these figures indicate, a greater portion of the state's resources are dedicated to housing adult criminal offenders than was the case ten years ago. For the current fiscal year, the DOC has been appropriated \$495.6 million, or 8.2 percent of the total state General Fund operating budget.

"The General Fund operating budget for the Department of Corrections is expected to continue growing at a rapid pace."

The General Fund operating budget for the department is expected to continue growing at a rapid pace. The prison population growth that the state has experienced in the last ten years is not expected to level off. Rather the population is projected to reach 24,798 by the end of FY 2007-08, according to Legislative Council Staff's August 2002 prison population projections.

General Assembly's Response to the Prison Capacity Shortfall

To address the increasing prison population over the last ten years, the General Assembly has appropriated \$453.6 million from the Capital Construction Fund to construct and maintain additional prison beds. These appropriations added 6,140 additional prison beds. Table 1 lists the facilities funded by the General Assembly in the last ten years. The table includes appropriations, the number of beds, and projected occupancy dates for those facilities. Most facilities have already come on line. In addition to incarcerating prisoners in state facilities, DOC contracts with Colorado counties to send inmates to privately operated facilities in Colorado. Even with the additional contract beds, offenders are housed in county jails awaiting placement in the DOC system. For FY 2002-03, \$47.3 million has been appropriated from the General Fund to pay for offenders housed in private facilities and \$5.4 million has been appropriated from the General Fund to pay for offenders in county jails awaiting placement in DOC facilities.

Prison Population Drives the Need for New Facilities

Despite additional prison space from the new and expanded facilities, the state will not be able to house the projected prison population through the forecast period ending in FY 2006-07.

Table 2 compares the current DOC capacity, facilities requested for construction, and private contracts to Legislative Council Staff's projected prison population.

As Table 2 illustrates, the current shortfall in prison space increases to 1,900 beds in FY 2006-07. Private

prison beds are used to house minimum and medium level inmates when possible. However, by the end of FY 2004-05, all of the available 3,458 private prison beds in Colorado will be filled and additional minimum and medium beds will be required. The current shortage of high security beds is estimated to continue through the end of FY 2005-06.

Table 1
Correctional Facilities Funded During the Last Ten Legislative Sessions (1)

| Facility | Total Appropriation in Millions of Dollars (2) | Net Beds | Occupancy Date |
|--|--|--------------|----------------|
| Delta Correctional Center | \$7.5 | 180 | Occupied |
| Colorado State Penitentiary | \$19.9 | 250 | Occupied |
| Sterling Correctional Facility | \$171.5 | 2,445 | Occupied |
| Arrowhead Correctional Facility | \$2.6 | 120 | Occupied |
| Colorado Territorial Correctional Facility | \$4.6 | 94 | Occupied |
| Four Mile Correctional Facility | \$18.0 | 180 | Occupied |
| Fremont Correctional Facility | \$23.2 | 363 | Occupied |
| Pueblo Minimum Center | \$0.6 | 28 | Occupied |
| Rifle Correctional Facility | \$10.4 | 42 | Occupied |
| Buena Vista Minimum Center | \$14.1 | 78 | Occupied |
| Youthful Offender System | \$36.3 | 480 | TBD (3) |
| Fort Lyon Correctional Facility | \$12.3 | 500 | September 2002 |
| Trinidad Correctional Facility | \$34.9 | 480 | September 2002 |
| Denver Women's Correctional Facility | \$93.8 | 900 | July 2003 |
| Total | \$449.7 | 6,140 | |

Notes:

(1) Source: Colorado Department of Corrections FY 2000-01 Statistical Report.

(2) In addition to the appropriations shown, \$24.0 million was appropriated by H.B. 95-1352 to pay for additional beds reflected in this table. Also, \$3.9 million was appropriated since the 2000 session for planning expansions at San Carlos, Denver Reception and Diagnostic Center, and Arkansas Valley. Funding to continue with these projects was included in the Department's five-year bed plan submitted to the Capital Development Committee.

(3) The Youthful Offender System has 480 beds. As of June 30, 2002, 120 of these beds were occupied by adult males, 271, were occupied by youths sentenced to the Youthful Offender System, and the remaining 89 beds were unoccupied. No estimates are available regarding the estimated occupancy date for these 89 vacant beds.

Table 2
Department of Corrections' Capacity vs. Population Projections (1)

| Fiscal Year | Projected DOC Capacity (2) | In-State Contracts (Bent, Burlington, Huerfano; and Olney Facilities) | Additional Community Transition Beds | Additional Beds Requested (3) | Total Capacity | Legislative Council Staff Population Projections (4) | Prison Bed (Shortfall) / Surplus |
|-------------|----------------------------|---|--------------------------------------|-------------------------------|----------------|--|----------------------------------|
| 2002-03 | 14,747 | 2,736 | 134 | 739 | 18,356 | 18,856 | (500) |
| 2003-04 | 15,620 | 3,361 | 88 | 191 | 19,260 | 19,851 | (591) |
| 2004-05 | 15,899 | 3,458 | 93 | 61 | 19,511 | 20,792 | (1,281) |
| 2005-06 | 16,053 | 3,458 | 106 | 247 | 19,864 | 21,849 | (1,985) |
| 2006-07 | 16,406 | 3,458 | 100 | 1,124 | 21,088 | 22,988 | (1,900) |

Notes:

(1) All facility capacities (including state contract beds and additional beds added in each fiscal year) assume a 1.4 percent vacancy rate for male population and a 1.1 percent vacancy rate for female population due to natural movement throughout the system. FY 2002-03 capacities based on total population reported by DOC as of June 30, 2002.

(2) Includes 24 state-run facilities and the community transition population (the community transition population is maintained at 10 percent of jurisdictional population).

(3) The FY 2002-03 figure includes available beds at the following facilities: (a) 379 beds at Trinidad; (b) 296 beds at Ft. Lyons; and (c) 64 beds are unoccupied at Denver Women's Correctional Facility. The FY 2003-04 figure reflects existing capacity at DWCF. The remaining beds are based on funding which has been requested by the Department but not yet approved by the General Assembly.

(4) Legislative Council Staff August 2002 prison population projections. Assumes 2.4 percent of the male population and 4.5 percent of the female population are off-grounds at all times (escapes, court appearances, and hospital stays).

Budget Implications. To accommodate the prison bed shortfall, the department has submitted a five-year capital construction plan for new/expanded facilities to the Capital Development Committee. This plan is estimated to cost \$266.0 million: (1) \$127.6 million in FY 2003-04; (2) \$40.2 million in FY 2004-05; (3) \$5.4 million in FY 2005-06; and (4) \$92.8 million in FY 2006-07. The FY 2003-04 request would fund 1,077 additional beds. Even if these additional beds are built on schedule, the prison system will still have an estimated shortfall of 1,900 beds by the end of FY 2006-07.

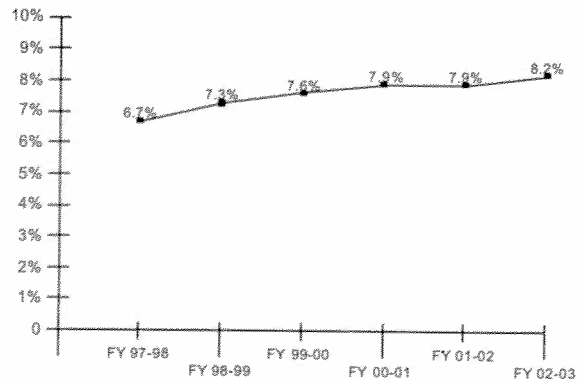
in FY 2003-04. Also, the state currently pays \$54.66 per day for inmates housed in private prisons, and it pays \$51.65 per day for inmates held in county jails while awaiting placement in DOC facilities.

Graph 2 notes the department's actual General Fund operating budget as a percent of the total state General Fund operating budget. It demonstrates that an increasing percentage of the state's General Fund operating budget has been dedicated to housing offenders in recent years.

Prison Facilities Drive Operating Costs

The current operating budget (FY 2002-03) for the department is \$495.6 million General Fund and 6,339.3 FTE. In FY 1997-98, the department's General Fund operating appropriation was \$300.5 million General Fund and 4,168.4 FTE. The General Fund appropriations grew an average of 10.5 percent per year during that five-year period. During the 2002 legislative session, the fiscal note assumptions reflected an estimated average operating cost of \$27,251 per bed for FY 2002-03. Using these costs and the August 2002 Legislative Council forecast for new inmates, an additional \$27.1 million would be required

Graph 2
DOC General Fund Operating Budget
% of Total State General Fund Appropriation



Staff contact: Karl Spiecker, Joint Budget Committee Staff, 303-866-3481

HIGHER EDUCATION

Budget Structure

Statutes provide higher education institutions a greater degree of autonomy over their budget than most state agencies. Significantly, statutes direct: (1) the Colorado Commission on Higher Education (CCHE) to develop a formula for taking money provided by the General Assembly and distributing it to governing boards that oversee operation of the campuses; and (2) the General Assembly must appropriate funds in lump sums to the governing boards rather than in detailed line items. The governing boards are then responsible for allocating the appropriations to each campus. Generally, each campus sets its own budget within the funds disbursed by the governing boards, although the governing boards are ultimately responsible.

“The governing boards are . . . responsible for allocating . . . appropriations to each campus.”

For FY 2002-03, the General Assembly appropriated \$1.6 billion for higher education with \$797.9 million of this amount coming from the General Fund.

Governance

The eight governing boards and the institutions under their purview are listed in Table 3.

Table 3
FY 2001-02 Student Population

| Public Institutions | Resident Student FTE (FY 2001-02) |
|--|-----------------------------------|
| Regents of the University of Colorado: | |
| UC - Boulder | 16,007 |
| UC - Colorado Springs | 4,930 |
| UC - Denver | 7,065 |
| UC - Health Sciences Center | 2,162 |
| Colorado State University System: | |
| Colorado State University | 16,593 |
| Colorado State University - Pueblo (formerly USC) | 3,045 |
| Trustees of Colorado School of Mines | 2,358 |
| Trustees of University of Northern Colorado | 9,088 |
| Trustees of the State Colleges: | |
| Adams State College | 1,920 |
| Mesa State College | 4,030 |
| Western State College | 1,499 |

Table 3 (continued)
FY 2001-02 Student Population

| Public Institutions | Resident Student FTE (FY 2001-02) |
|---|-----------------------------------|
| Trustees of Metropolitan State College of Denver | 12,761 |
| Trustees of Fort Lewis College | 2,800 |
| Community College System: | |
| Arapahoe CC | 4,080 |
| Northwestern CC | 796 |
| CC of Aurora | 2,711 |
| CC of Denver | 3,925 |
| Front Range CC | 7,719 |
| Lamar CC | 640 |
| Morgan CC | 979 |
| Northeastern Junior College | 1,513 |
| Otero Junior College | 1,072 |
| Pikes Peak CC | 5,507 |
| Pueblo CC | 3,492 |
| Red Rocks CC | 4,032 |
| Trinidad State Junior College | 1,340 |

The Community College System has authority over, in addition to the schools listed in Table 3, the state's occupational education programs. This includes, among other things the Colorado Vocational Act, which provides funding for high school occupational education, and the four area vocational schools: Emily Griffith Opportunity School, T.H. Pickens Technical Center, Delta-Montrose Vocational Technical Center, and San Juan Basin Area Vocational School.

There are also two local district junior colleges, Aims and Colorado Mountain College, that receive state General Fund but also receive local tax revenues, and so operate independent of the governing boards.

Performance Funding

Since FY 2000-01, the distribution formula for General Funds developed by CCHE has been based on how well schools do on selected performance indicators measuring things like time to graduation, faculty productivity, and achievement rates on standardized tests. This base adjustment provides funds for faculty and classified staff salary increases, and increases in operating expenses such as utilities and classroom materials.

The amount dedicated to performance funding has varied in accordance with the amount of pressure exerted on the overall state budget by less discretionary programs in other departments. However, the General Assembly typically considers the Denver/Boulder CPI in determining the total for performance funding.

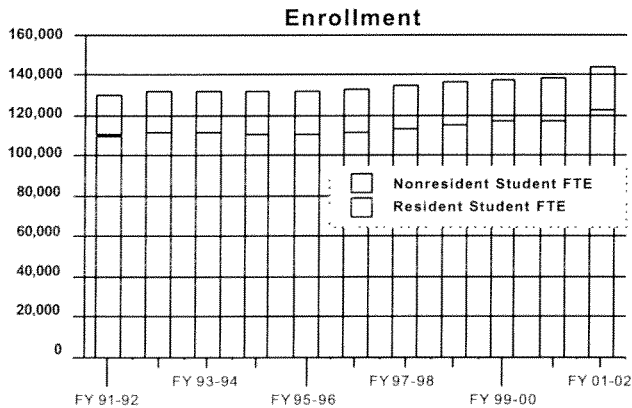
Enrollment

In addition to base increases for salaries, schools need funds to accommodate resident enrollment growth. Nonresident enrollment is important in terms of total revenues, since nonresident tuition helps subsidize resident education.

Enrollment tends to be counter-cyclical. In other words, when the economy slows higher education enrollment increases.

Graph 3 below charts enrollment for the last 10 years.

**Graph 3
Ten-Year Enrollment History**



Tuition

The authority to set tuition policy is statutorily delegated to the governing boards. However, after the enactment of TABOR, the General Assembly passed legislation stipulating that the cash funds spending authority appropriated in the Long Bill acts as a cap on the revenues higher education institutions can raise, thereby limiting the extent to which schools can raise tuition. In FY 2002-03 the General Assembly expressed its intent through a footnote to the Long Bill that both resident and nonresident tuition could increase up to 7.7 percent. There was an exception for the community colleges, where General Fund was provided to "buy down" resident tuition to 5.7 percent growth. Also, select

programs at the University of Colorado and Colorado State University were allowed to increase more than 7.7 percent. However, the Governor vetoed the footnote, and actual tuition increases were as follows:

- resident tuition at the University of Colorado, Colorado State University, Colorado School of Mines, University of Northern Colorado and Fort Lewis College grew roughly 6.2 percent;
- resident tuition at all other campuses grew 4.7 percent;
- nonresident tuition at the University of Colorado, Colorado State University, and the Colorado School of Mines grew 9.0 percent;
- nonresident tuition at all other campuses grew 7.7 percent.

Resident tuition covers roughly 30 percent of the total cost of education at most institutions. Nonresident tuition covers in excess of 100 percent of the total cost of education.

Financial Aid

In recent years, the General Assembly has provided significant increases for student financial aid. The compound annual average rate of growth over the last six years is 8.1 percent. State need-based aid, including the Governor's Opportunity Scholarship program, topped \$51.5 million in FY 2002-03. State merit-based aid totaled \$14.9 million General Fund, work study received \$16.6 million General Fund, and miscellaneous other state financial aid grants provided \$8.0 million General Fund.

These funds are appropriated to CCHE and then allocated to the institutions based on financial need at the schools and student enrollment.

State financial aid programs trail federal financial aid distributions in Colorado. For example, in Colorado it is expected the federal government will provide in excess of \$80 million in need-based Pell grants to students, and guarantee loans to students and their parents worth more than \$500 million.

Institutions themselves also provide a noteworthy amount of financial aid with funds raised from alumni, private individual donations, and businesses. There is great variance in the ability of schools to raise money from non-state sources. The total institutional financial aid available in the state in FY 1999-00 was \$164 million.

Staff contact: Eric Kurtz, Joint Budget Committee Staff, 303-866-4952

K-12 EDUCATION: SCHOOL FINANCE

The largest single item in Colorado's General Fund budget is K-12 school finance. During the last legislative session, the General Assembly appropriated \$2.46 billion dollars for this purpose. Local taxes also help pay for public schools, bringing the total amount spent on school finance this year to \$4.14 billion. The state constitution sets the minimum increase in school district funding, and state law determines how funding is allocated among districts.

"The largest single item in Colorado's General Fund budget is K-12 school finance."

The State Constitution Sets the Minimum Increase in School District Funding

For the upcoming budget year, the state constitution requires that the statewide base per pupil funding amount increase by at least the inflation rate plus one percentage point. Similar to the foundation of a building, the "statewide base" is the underlying support for allocating money to school districts through the state school finance law. As its name implies, the statewide base is provided to every pupil who is funded in public schools. The constitutional provision that sets this minimum increase in funding was enacted through Amendment 23 at the 2000 election.

School Finance Moneys Are Distributed Under a Formula in the School Finance Act

The \$4.14 billion in state and local school finance money is allocated to school districts through a formula contained in a law called the Public School Finance Act of 1994. This formula calculates a per pupil level of funding for each school district, as well as the state and local share of funding for each district.

The calculation of each district's per pupil funding starts with the *statewide base* per pupil funding amount, which is set annually by the General Assembly. The statewide base for the current budget year is \$4,441.51. As mentioned earlier, the state constitution requires that this amount increase by inflation plus one percentage point in the 2003-04 budget year. The General Assembly can increase it by a higher amount if it so desires. The statewide base is then adjusted for each district using four factors: (1) the *cost-of-living* factor reflects differences among the state's 178 school districts in cost of living; (2) the *personnel costs* factor

indicates the portion of a district's budget that relates to personnel and is affected by cost of living; (3) the *size* factor compensates districts for enrollment-based economies of scale; and (4) the *at-risk* factor provides additional funding for students who may be at risk of failing or dropping out of school or who have limited English skills and meet specific criteria.

The law also guarantees a minimum level of per pupil funding for all districts. The adjustments to the base are what differentiate funding among districts and result in an average funding level of \$5,783 per pupil. Each district's per pupil funding is multiplied by its pupil count to determine its total funding.

Local property and specific ownership taxes provide the first source of revenue for school district funding, and the remainder is covered by state funds. For example, in the current budget year, school districts will receive a total of \$4.14 billion through the finance act. Local taxes will contribute about \$1.68 billion, or 41 percent of the total, so the General Assembly appropriated \$2.46 billion in state money—primarily General Fund dollars—to cover the difference.

Two Factors Drive the Increase in School Finance Funding

Two primary factors drive the increase in funding for school districts:

- the increase in the number of pupils enrolled in public schools; and
- the increase in the statewide base.

Pupil count. In FY 2003-04, an estimated 7,600 new pupils will enroll in Colorado public schools, bringing the total number of pupils funded to about 723,400. These 7,600 new pupils—frequently referred to as "growth"—create a need for about \$42 million in additional revenue just to maintain the existing level of per pupil funding. Any increase in per pupil funding further increases costs.

"...the General Assembly must increase the statewide base by at least inflation plus one percentage point."

Increases in per pupil funding. The minimum required increase in the statewide base is currently

estimated at 2.9 percent: 1.9 percent for inflation plus the additional percentage point. (The actual inflation rate will be available in mid-February.) In general, each percentage point increase in the statewide base costs about \$41.8 million. Thus, a base increase of 2.9 percent translates into a total increase in funding for school districts of about \$121 million. During the 2003 legislative session, the General Assembly must set the statewide base for FY 2003-04.

Total increase in funding. The estimated required increases in the pupil count and inflation drive a total increase in school finance funding of about \$163 million.

| Estimated Increase in School District Funding in 2003-04 Budget Year | |
|--|----------------------|
| Increase in Pupil Count | \$42 million |
| plus Minimum Increase in Statewide Base | \$121 million |
| equals Total Increase in School District Funding | \$163 million |

The Increase in Funding is Divided Between the State and Local Districts

Since the state provides the difference between district funding and local tax revenues, the annual increase in *total state* funding for school finance is driven by changes in local tax revenues. Further, the impact on the state General Fund depends on the General Assembly's decisions on how to allocate the increase in state aid among the General Fund, the State Education Fund, and various other sources of revenue earmarked for education spending.

“...the General Fund appropriation must increase by at least 5 percent in any budget year that follows growth in personal income of 4.5 percent or more.”

Local taxes. Local property and specific ownership taxes make up the local share of school finance costs. Property taxes are based on each district's mill levy and the assessed, or taxable, value of property in each district. Projections of assessed values indicate that school district property taxes will increase about

\$24 million in the upcoming budget year. Specific ownership taxes are similar to property taxes paid on motor vehicles. When specific ownership taxes are included, local taxes are projected to increase about \$33 million in FY 2003-04.

State aid. State aid will be required to make up the \$130 million difference between the total increase in funding of \$163 million and the \$33 million increase in local taxes.

| Estimated Increase in State Aid for School Finance for the 2003-04 Budget Year | |
|--|----------------------|
| Increase in School District Funding | \$163 million |
| minus Increase in Local Taxes | \$33 million |
| equals Total Increase in State Aid | \$130 million |

Traditionally, state aid to schools has come primarily from the *General Fund*. Beginning with the 2001-02 budget year, the *State Education Fund* has also been used to help provide the state aid necessary to fund the school finance act. The State Education Fund, created in the state constitution by Amendment 23, consists of a portion of state income tax revenue. The General Assembly makes the decision as to how much money comes from each of the funds, with one caveat: the General Fund appropriation must increase by at least 5 percent in any budget year that follows growth in personal income of 4.5 percent or more.

Each percentage point increase in the current General Fund appropriation translates to slightly more than \$22 million, or about \$111 million for a 5 percent appropriation increase in FY 2003-04. Personal income is not expected to grow by 4.5 percent between 2001 and 2002, thereby negating the requirement that the General Fund appropriation increase by 5 percent.

Finally, other sources of revenue, such as rents on state lands, interest income on the Public School Fund, and federal mineral lease moneys, contribute to school finance funding. Although the total amount of these revenues is relatively small—about 2 percent of total school finance funding—changes in the amount of money available affect the amount of money that must be appropriated from the General Fund or the State Education Fund. Further, the amount of money that can be appropriated is limited by the amount actually received.

Staff Contact: Deb Godshall, Legislative Council Staff, 303-866-3521

HEALTH CARE: MEDICAID, CHILDREN'S BASIC HEALTH PLAN, & INDIGENT CARE

The Department of Health Care Policy and Financing (DHCPF) administers three major health care programs for low-income individuals: the Medical Premiums Program (includes the Medicaid Program and State-only Old Age Pensioners' Medical Fund), the Children's Basic Health Plan, and the Colorado Indigent Care Program. These three programs provide health care services to over 500,000 Colorado residents. Additionally, DHCPF is designated as the Single State Agency for all Medicaid funds, including the programs administered by the Department of Human Services. With a total budget of \$2.7 billion (\$1.2 billion General Fund), DHCPF is the 2nd largest budget in state government and consumes over 19 percent of the state's General Fund.

Medical Premiums Division

The Medical Premiums Division is responsible for administering the Medicaid Program and the state-only Old Age Pensioners' Medical Fund. The FY 2002-03 total appropriation for the division is \$1.7 billion or 63 percent of the department's total appropriation. Expenditure increases in the division result from caseload growth, increased health care utilization, and increased costs for health care services.

Medicaid: The Medicaid Program was created in the mid-1960s as a federal and state medical assistance program for low-income individuals. As a federal and state program, the Colorado Medicaid Program is funded by approximately 50 percent federal funds and 50 percent state funds. Medicaid is an optional state program. However, if a state participates in Medicaid, then the state must abide by certain federal laws and regulations. While many aspects of the Medicaid program are required by the federal government, Colorado has some flexibility in determining how the state's program is managed and if optional populations or services are provided.

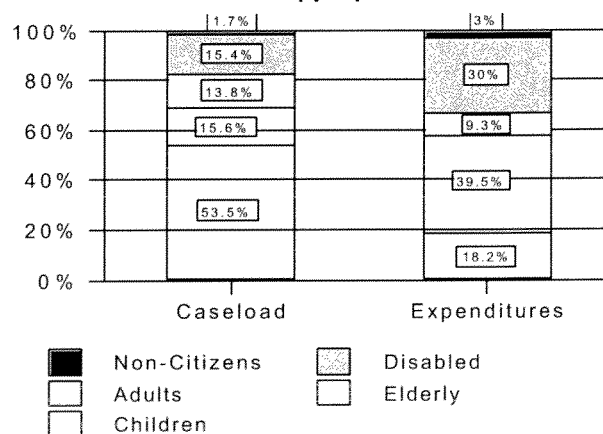
If an individual is eligible for Medicaid, the individual is entitled to receive the program's services. Medicaid eligibility is based partly on an individual's financial status and varies for the different populations covered under the program. For FY 2002-03, the Medicaid appropriation was based on approximately 322,003 individuals being enrolled in Medicaid, an increase of 9.7 percent over the prior year. Of the 322,003 individuals served, 172,365 are children (53.5 percent); 44,403 are adults with eligible children (13.8 percent); 50,152 are elderly (15.6 percent); 49,669 are disabled

(15.4 percent); and 5,414 are non-citizens (1.7 percent).

After caseload, the next two major factors driving the Medicaid budget are utilization of health care services and the cost of those services. Medicaid provides both acute care services (inpatient care, doctor visits, etc.) and long-term care services (nursing home and home and community-based services). Medical costs for the different caseloads vary because of the number and type of health services utilized by the caseload.

For example, while the elderly account for only 15.6 percent of the Medicaid caseload, they account for over 39.5 percent of program expenditures. Conversely, children are approximately 53.5 percent of the Medicaid caseload but account for only 18.2 percent of expenditures.

**Graph 4
Medicaid Client Expenditures
FY 2002-03 Appropriation**



The elderly are more expensive to serve because they typically utilize more and higher cost services (such as nursing home care, hospital care, and prescription drugs), while children tend to need mainly primary care (doctor visits). Women diagnosed with breast and cervical cancer (added as an optional population in 2001) and the disabled population also have high health care costs based on their medical and long-term care needs.

In recent years, health care services that have seen the greatest increases in costs have included inpatient hospital care, prescription drugs, and long-term care.

State-only Old Age Pensioners

The state serves another 4,046 low-income elderly

clients through a state-only program that predates Medicaid. This program is established in Article XXIV, Section 7, of the Colorado Constitution. The program provides health and medical care to individuals who are over age 60 who meet the income eligibility for Medicaid, but generally not the asset limit. Services available to this population are the same as for Medicaid except they cannot access inpatient psychiatric care or long-term care services. The Colorado Constitution caps the Old Age Pensioners' Medical Fund at \$10 million a year.

However, last year the General Assembly supplemented the fund with an additional \$1.0 million. Because this is a state-only program, no federal funds are received for this population.

Children's Basic Health Plan

The Children's Basic Health Plan (CBHP) is a federal and state health insurance plan for uninsured children (passed in 1997). This program receives 65 percent of its funding from the federal government and 35 percent from the state. The state match is paid from a trust fund established for the program. The trust fund receives monies from the Tobacco Litigation Settlement Trust Fund, the General Fund, co-payments and enrollment fees charged to recipients, and private donations.

The CBHP is not an entitlement program. Therefore, enrollment into the program can be capped based on available funding. The FY 2002-03 appropriation anticipates a monthly enrollment of 48,398 children in the plan. In addition, beginning July 1, 2002, prenatal care is available for low-income eligible women under the CBHP. The FY 2002-03 appropriation assumes 2,928 women will receive prenatal care through this program.

The FY 2002-03 total appropriation for CBHP is \$75.6 million (of which, \$6.6 million is a transfer from the General Fund into the CBHP Trust Fund), or 3 percent of the department's total appropriation.

Colorado Indigent Care Program

The Colorado Indigent Care Program (CICP) is a federal and state medical program to partially reimburse health care providers for care furnished to the medically indigent. This program is funded by approximately 50 percent federal funds and 50 percent state funds and provider payments.

While aspects of the CICP are required by federal law, the program is not an "entitlement" program or an insurance plan. Rather, the program provides financial assistance to medical providers that serve a disproportionate share of medically indigent individuals. Funding for this care is through the Major Teaching Hospitals and the Disproportionate Share (DSH) Hospital programs (the key programs under CICP). Eligible providers include hospitals, birth centers, or community health clinics. Eligible individuals are state residents not eligible for Medicaid whose combined net income and assets do not exceed 185 percent of the federal poverty level and are otherwise uninsured or under-insured.

Approximately, 67 providers participate in the program with over 160,000 individuals receiving services. Currently, expenditures for the DSH program are capped by federal law. The FY 2002-03 total appropriation for CICP is \$229.6 million (of which \$15.6 million is General Fund), or 8 percent of the department's budget.

Graph 5 below summarizes the eligibility for the Medicaid, CBHP, and CICP programs for the populations based on federal poverty guidelines.

**Graph 5
Department of Health Care Policy and Financing -
Medicaid, Children's Basic Health Plan (CBHP), and
Colorado Indigent Care Program (CICP) Eligibility
Graph (populations based on Federal Poverty Level)**

| | | | | | |
|---|------------------|----------------|-----------|-----------------|-------------|
| Family Income as % of Federal Poverty Level | 185% | CICP & CBHP | | | |
| | 133% | | | CICP | |
| | 100% | Medicaid | | | |
| | AFDC Need (=40%) | | | Medicaid & CICP | |
| | 0 | | | | |
| | | Pregnant Women | 0-5 Years | 6-18 Years | 18 + Adults |
| | | Eligible Ages | | | |

*The AFDC need standard varies based on the number of adults in the household. Currently, the need standard ranges from 29 percent to 50 percent of the Federal Poverty Level. The table above shows the AFDC need standard for a family of three with one adult.

Currently, the federal poverty guidelines for a family of three are as follows:

| Poverty Level | Annual Income |
|---------------|---------------|
| 40% | \$6,008 |
| 100% | \$15,020 |
| 133% | \$19,977 |
| 185% | \$27,787 |

Some populations are eligible for Medicaid because they are eligible to receive Supplemental Security Income (SSI) payments from Social Security (a federal program). These individuals are eligible based on their income and on their status as an elderly, blind, or disabled individual. Individuals eligible for SSI

payments are categorically eligible for Medicaid. However, Colorado has elected to expand coverage for these populations to individuals whose gross income does not exceed 300 percent of the SSI benefit level and are medically at-risk for institutional care.

Currently, the SSI benefit for an individual is \$545 per month or \$6,540 per year. State statute allows elderly and disabled individuals to qualify for Medicaid whose gross annual income is between \$6,540 to \$19,620 (300 percent of the SSI benefit level).

Other Department Programs

The other 26 percent of the department's budget provides funds for programs administered by the Department of Human Services (21 percent), other medical programs (2 percent) and administration (3 percent).

Staff contact: Melodie Jones, Joint Budget Committee Staff, 303-866-4958

HUMAN SERVICES

The Department of Human Services is responsible for all 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 department is also responsible for the care and treatment of dependent citizens who are mentally ill, developmentally disabled, or juvenile offenders.

“Programs administered by the Department of Human Services account for 13.7 percent of total FY 2002-03 General Fund appropriations...”

Programs administered by the department account for 13.7 percent of total FY 2002-03 General Fund appropriations, including \$548 million (9.0 percent) appropriated directly to the Department of Human Services, plus \$282 million (4.6 percent) appropriated to the Department of Health Care Policy and Financing for programs that are financed through the federal Medicaid program but are administered by the Department of Human Services (e.g., services for mentally ill and developmentally disabled persons).

Social Service Programs

Colorado public assistance and child welfare programs are administered by county departments of social services and are supervised by the state Department of Human Services. In general, counties are responsible for funding 20 percent of social service program costs; the remaining program costs are funded with a combination of state and federal funds.

Cash Assistance. The three primary cash assistance programs include:

- Old Age Pension (serving about 25,000 low income individuals age 60 and over);
- Aid to the Needy Disabled (serving about 10,000 low income disabled adults); and
- Colorado Works (serving about 13,000 low income families).

The **Old Age Pension Program** is funded with inheritance and incorporation taxes and a portion of license fees, and liquor and excise taxes; excess revenues are transferred to the General Fund. Appropriations for the Old Age Pension Program (\$73.8 million for FY 2002-03) are subject to Article XXIV

of the State Constitution and not under the control of the General Assembly.

General Fund moneys provide 65 percent of the funding for **Aid to the Needy Disabled programs** (\$23.8 million for FY 2002-03). Appropriations for this program are at the discretion of the General Assembly and are driven by the number of individuals eligible for services and any cost-of-living increases applied to monthly cash payments.

The General Assembly created the **Colorado Works Program** in 1997 in response to federal welfare reform legislation. The federal legislation replaced the open-ended federal reimbursement provided under the Aid to Families with Dependent Children program with the Temporary Assistance for Needy Families ("TANF") block grant. States are now required to maintain a certain level of spending on such programs (called a maintenance of effort or MOE), rather than paying a fixed percent of program costs. The General Assembly provides an annual block grant to each county to implement and administer the Colorado Works Program (a total of \$152.5 million is appropriated for FY 2002-03). The program is primarily financed with federal TANF funds. Over 90 percent of the state's annual federal TANF block grant is made available to counties each year; the remainder is appropriated for the development and operation of statewide information systems, for state administration, and for a five-year evaluation of the program.

Child Welfare Services. County departments of social services are required to investigate reports of abuse or neglect of a child, including third-party abuse, neglect by persons under age ten, and institutional abuse of a child. Following an investigation, a county is required to provide necessary and appropriate child welfare services to the child and the family. If the court determines that a child's removal from the home is necessary and in the best interests of the child and the community, the court may place the child in the legal custody of the county department for placement in a foster care home or other child care facility.

The total appropriation for the Division of Child Welfare (\$349.3 million for FY 2002-03) consists of 53 percent General Fund, 32 percent federal funds, and 15 percent county funds and various cash fund sources.

In response to a 1992 lawsuit, the Governor and the Department of Human Services signed the Child Welfare Settlement Agreement, which resulted in significant increases in funding and staff for child

welfare programs. While about one-third of child welfare funding is expended for county staff and administrative costs, about one-half is paid directly to families and providers who care for children who have been removed from their homes. Out-of-home care costs have increased significantly, more than doubling from FY 1993-94 to FY 1996-97. In response to such cost increases, the General Assembly adopted legislation in 1997 to cap the state's reimbursement to counties for the cost of providing child welfare services.

Since FY 1997-98, the total amount appropriated for counties to provide child welfare services (including out-of-home care) has increased an average of 6.2 percent per year. Despite these increases, county child welfare expenditures have exceeded the annual appropriation for the last three fiscal years. In FY 2001-02, the shortfall between the appropriation and actual county expenditures was over \$32 million (11 percent of expenditures).

Detained and Committed Youth

The Division of Youth Corrections is responsible for housing and rehabilitating juveniles committed to the Department of Human Services as the result of a delinquent act. In addition, the Division of Youth Corrections is responsible for youth held by law enforcement awaiting adjudication. Facilities for these youth are referred to as detention centers and are similar in their role to adult jails, although they are operated by the state rather than local governments.

In the early 1990s, expenditures for the Division of Youth Corrections increased dramatically with growth in the number of committed and detained youth. In the late 1990s, growth in the commitment and detention populations remained strong but tapered somewhat from the pace in the early 1990s, and this trend is projected to continue. In FY 2000-01, there was an average daily population of 1,280.7 committed and 557.6 detained youth. The compound annual average rate of growth (CAARG) from FY 1998-99 to FY 2000-01 was 4.8 percent for committed youth and 0.7 percent for detained youth. The projected CAARG from FY 2002-03 to FY 2006-07 is 3.4 percent for committed youth and 1.0 percent for detained youth. *Note:* actual figures for FY 2001-02 are not available at this time.

Mental Health Services

The Department of Human Services operates two state

mental health institutes and provides funding for nonprofit **community mental health centers** and for **mental health assessment and service agencies** that manage mental health care for people who are eligible for the federal Medicaid program. The FY 2002-03 operating budget for the Mental Health Institutes totals \$88.5 million, including \$68.2 million General Fund. The FY 2002-03 budget for community mental health programs for children and adults totals \$238.4 million, including \$30.9 million General Fund and \$182.0 million in Medicaid funds (consisting of 50 percent state General Fund and 50 percent federal funds).

Between FY 1995-96 and FY 1998-99, mental health services for Medicaid-eligible persons were shifted from a fee-for-service system to a managed care "capitated" system. Under the capitated system, the Medicaid mental health budget is driven by: (1) changes in the number of persons eligible for Medicaid, and (2) rates per eligible person; such rates are established through a competitive bidding process. Since FY 1998-99, the budget for capitated Medicaid mental health services has increased by an average of 6.5 percent per year. The increase from FY 2001-02 to FY 2002-03 is anticipated to be 4.0 percent, based primarily on increases in Medicaid eligibility figures (particularly in the foster care category). Program costs would have been higher in recent years were it not for a program "rebid" that cut \$8.5 million from the program's FY 2001-02 budget, with reductions carried forward into FY 2002-03. Medicaid anti-psychotic pharmaceutical expenditures, which are not included in the capitation program, are anticipated to increase by 25 percent from FY 2001-02 to FY 2002-03.

Costs at the state mental health institutes have been driven by declining numbers of beds, counter-balanced by increasing personnel costs. Medicaid mental health capitation has contributed to reduced hospitalizations. The number of beds at the mental health institutes declined from 880 in FY 1994-95 to 724 as of July 1, 2002, driven largely by reductions in demand. Despite this, General Fund increases have been significant, primarily due to increases in staffing costs and stagnant revenue from non-General Fund sources. The FY 2002-03 budget reflected a General Fund increase of 14.0 percent over FY 2001-02. On August 1, 2002, the department closed an additional 24 beds in response to statewide revenue shortfalls.

Services for Persons with Developmental Disabilities

The department provides community-based and

institutional services to people with developmental disabilities by providing funding to nonprofit **community centered boards** (CCBs) and by operating three **regional centers**. The regional centers serve 163 individuals in institutional settings at a cost of \$96,000 per person per year and an additional 250 people in community settings. These facilities are funded through the Medicaid program, with the state and the federal government each paying about half of the cost. For FY 2002-03, the department was appropriated \$260 million (including \$122 million General Fund) to provide community services to over 11,600 people through the CCBs.

Over the last three years, funding for community services has increased an average of 5 percent per year. Such increases were driven by initiatives to: (1) downsize state-run institutions by serving more individuals in community (less restrictive) settings; (2) serve individuals currently on the waiting list for developmental disability services; and (3) provide annual cost-of-living increases to community providers. Currently, over 700 individuals are waiting for residential support services; of these, approximately 600 individuals indicate an immediate need for residential service. Additionally, approximately 2,300 individuals are on waiting lists for family and children's services.

Traditionally, the General Assembly has determined the level of program expenditures and number of people served in the developmentally disabled services system. However, a current lawsuit is challenging this policy, contending that developmentally disabled individuals eligible for Medicaid are entitled to residential services.

Information Technology Services

For the past several years, the General Assembly has provided significant funding to the Department of Human Services for several major information system projects that will be used by staff at the department and at county departments of social services to administer various social service programs. The **Children, Youth and Families Automation Project ("Colorado Trails")** replaced systems used by state and county child welfare staff and the Division of Youth Corrections to track clients. An initial version of the system was released during the summer of 2001, but modifications to expand functionality and to fix a wide array of problems associated with the initial release, are expected to continue through FY 2002-03. The FY 2002-03 operating budget for the system is \$11.2 million, including \$6.0 million General Fund. The **Colorado Benefits Management System** will

replace multiple systems used by county staff to determine eligibility for financial, medical, and food stamp benefits. This system is currently under development and is now slated for completion in April 2004. The estimated total cost for the project, from FY 1996-97 through FY 2007-08 (including four years of

system maintenance) is \$201.9 million, including \$68.4 million General Fund and Capital Construction Fund moneys. Appropriations to date total \$107.0 million, including capital appropriations of \$59.7 million and operating appropriations of \$47.3 million (\$13.1 million for FY 2002-03).

Staff contact: Joscelyn Gay, Joint Budget Committee Staff, 303-866-2061

Transportation Finance

Background

Transportation finance issues have received a significant amount of attention in recent years. Much of the debate was framed in the context of the 1995 report from the Colorado Department of Transportation (CDOT) on the 20-year outlook for state and local transportation needs. The report indicated that Colorado was facing a transportation funding shortfall of \$13 billion (\$8 billion for state transportation and \$5 billion for local transportation) for the 1995 to 2015 time period. The General Assembly took several steps during the next five years to address the shortfall. The General Assembly enacted Senate Bill 97-1, which diverts a portion of the state's sales and use tax revenues for highway construction; referred a measure to the voters in 1999 to allow CDOT to borrow against future payments from the federal government, and transferred money from the General Fund to the Capital Construction Fund for transportation purposes.

In 2000, CDOT released a new 20-year outlook for state and local transportation needs. Based on their most fiscally constrained plan for transportation needs, the new estimate placed the shortfall at \$1.9 billion for the 2000 to 2020 time period. During the 2002 regular legislative session, the General Assembly enacted Senate Bill 02-179 and House Bill 02-1310, identical bills intended to further reduce the shortfall with measures addressing both highway and transit funding. The bills addressed highway funding by directing that two-thirds of the excess General Fund reserve be transferred to CDOT each year and creating a statewide tolling enterprise authorized to issue revenue bonds and levy tolls to finance the construction of toll highways or new toll lanes on existing highways. To address transit

funding, the bills authorized the Regional Transportation District (RTD) to ask voters in their district for an increase in the RTD sales tax rate, allowed counties within the RTD to contribute government monies to transit projects, and directed that 10 percent of the Senate Bill 97-1 diversion be required, rather than merely allowed, to be used for transit purposes.

The remainder of this briefing paper focuses on how highways and transit projects are funded in Colorado, the outlook for future transportation revenues, and the administration of Colorado's transportation funds.

How are Highways Funded?

Colorado's highways are funded through five primary sources. They include the Highway Users Tax Fund (HUTF), a portion of the state's sales and use taxes (the Senate Bill 97-1 diversion), the General Fund, federal highway funds, and proceeds from the sale of Transportation Revenue Anticipation Notes. In addition, the Colorado Tolling Enterprise was recently created by the Colorado Transportation Commission and is authorized to finance new toll highways and lanes. Each of these sources is discussed below.

Highway Users Tax Fund. The HUTF is the primary source of highway funds in Colorado, bringing in a total of \$739.7 million in FY 2001-02. About 74 percent of the HUTF comes from motor and diesel fuel tax revenue, 20 percent comes from vehicle registration fees, and the remainder comes from driver's license fees, court fines, and interest earnings.

In Colorado, motor and special fuel taxes are levied on a per-gallon basis. The motor fuel tax rate is 22 cents per gallon (in addition to the federal tax of 18.4 cents), while the diesel fuel tax rate is 20.5 cents per gallon (in addition to the federal tax of 24.4 cents). Registration fees are based on the age and weight of a vehicle. These fees differ from the *specific ownership tax* which is levied in lieu of the local property tax and is distributed to local governments.

The money in the HUTF is used to fund the construction and maintenance of both state and local roads, and the distributions of HUTF monies to the state, counties, and cities are statutorily determined. Table 1 illustrates the distribution formula for the fuel taxes. The majority of vehicle registration fees and other HUTF revenues are distributed the same as the first seven cents of the fuel tax after the off-the-top deductions. In FY 2001-02, the state received \$404.3 million from the HUTF, the counties received \$152.7 million, and the cities received \$100.4 million.

**Table 1
Distribution of Fuel Taxes**

| | |
|----------------------|---------------------------|
| First 7 cents | |
| A. | "Off-the-top" deductions |
| B. | Remaining funds: |
| | 65% to State Highway Fund |
| | 26% to counties |
| | 9% to cities |
| Above 7 cents | |
| A. | All funds: |
| | 60% to State Highway Fund |
| | 22% to counties |
| | 18% to cities |

The "off-the-top" deductions noted in Table 1 are appropriations to the Ports of Entry (Department of Revenue) and the State Patrol (Department of Public

Safety) for highway-related administrative functions. The off-the-top deductions occur before distributions to state and local governments and totaled \$82.1 million in FY 2001-02.

Senate Bill 97-1 Diversion of Sales and Use Taxes. 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 6 percent growth rate (i.e., meet the Arveschoug-Bird /6 percent limit) and to fund the 4 percent statutory General Fund reserve. Between FY 1997-98 and FY 2001-02, \$746.1 million was diverted to the HUTF. Because of the state's budget problems, only \$35.2 million was diverted in FY 2001-02.

Unlike other HUTF revenues, the Senate Bill 97-1 diversion is not shared with local governments. Colorado law requires that 90 percent of these monies be spent on a specific list of prioritized state highway projects, referred to as the "Seventh Pot," and that 10 percent be spent on transit projects.

General Fund. Per Senate Bill 02-179 and House Bill 02-1310, two-thirds of the excess General Fund reserve will be transferred to the HUTF each year. The excess General Fund reserve is made up of whatever money is left over after the TABOR refund, General Fund appropriations, the Senate Bill 97-1 diversion, and other smaller obligations are fully funded. The Capital Construction Fund will receive the remaining one-third.

Prior to Senate Bill 02-179 and House Bill 02-1310, monies from the General Fund have come in the form of appropriations within the 6 percent limit and transfers to the Capital Construction Fund outside of the 6 percent limit. CDOT received a total of \$400.4 million of General Fund money between FY 1995-96 through FY 2000-01, of which \$45.0 million was appropriated from within the 6 percent limit.

If these transfers are used in the future, they will be made prior to the distribution of the excess General Fund reserve between the HUTF and the Capital Construction Fund.

Federal Funds. Colorado receives money each year from the federal government, which collects taxes on gasoline and special fuels and redistributes them to the states under the Transportation Efficiency Act for the 21st Century (TEA-21). Colorado received an average of \$317 million each year between FY 1997-98 and FY 2001-02, and will receive at least \$295 million in FY 2002-03, after which TEA-21 is scheduled to end. Before Colorado can continue receiving federal funds after FY 2002-03, Congress must reauthorize the TEA-21 legislation.

Transportation Revenue Anticipation Notes (TRANS). In 1999, Colorado voters approved Referendum A, which authorized CDOT to borrow up to \$1.7 billion by selling Transportation Revenue Anticipation Notes (TRANS), with a maximum repayment cost of \$2.3 billion. Debt service on the notes is paid with money from the federal government and state matching funds. TRANS proceeds are exempt from the TABOR revenue limit and can be used only for a list of 28 prioritized statewide projects, referred to as the "Seventh Pot." In effect, the use of TRANS is allowing CDOT to accelerate construction on the Seventh Pot projects by pre-spending payments from the federal government. Using TRANS, CDOT has raised \$1.3 billion thus far to spend on the Seventh Pot projects, including \$56.7 million in bond premiums. To do so, CDOT has issued \$1.24 billion of TRANS in three installments toward the \$1.7 billion limit, with a repayment cost of just under \$2.0 billion. In addition, CDOT refinanced portions of the first two issues in August 2002, cutting debt service by \$14.7 million. In FY 2002-03, CDOT expects to raise approximately \$200 million more before nearly reaching the \$2.3 billion limit on total debt service.

Colorado Tolling Enterprise. Per Senate Bill 02-179 and House Bill 02-1310, the Transportation Commission created the Colorado Tolling Enterprise in October 2002. The enterprise, which functions as a division of CDOT, is authorized to issue revenue bonds to finance the construction of toll highways or new toll lanes on existing highways. The commission is responsible for setting the toll rates to pay the debt service on the bonds. When the bonds have been paid off, the commission is directed to adjust the toll rates to a level sufficient to pay the toll highway's operating and maintenance costs. According to CDOT, plans are in the very early stages for new toll lanes on Interstate-70 and Colorado-470.

How is Transit Funded?

Of the funding required to meet the most conservative estimate for transportation needs in CDOT's most recent estimate, 36 percent is for transit projects. The state is not a primary funding source for transit projects. However, per Senate Bill 02-179 and House Bill 02-1310, 10 percent of the Senate Bill 97-1 diversion is now required to be spent on transit projects. Primary funding sources for transit include fares, local governments, dedicated taxes, and the federal government. In its 2020 Plan, CDOT identified 90 separate transit providers in the state of Colorado, including 11 urban service providers, 10 rural service providers, 5 intercity service providers, 14 that provide services for specific resorts, and 50 that provide specialized services for the elderly or disabled. The extent to which a particular transit provider relies on each funding source varies among providers.

Colorado's largest transit provider is the Regional Transportation District (RTD). The RTD includes all of Denver, Boulder, and Jefferson counties, and parts of Broomfield, Adams, Arapahoe, and Douglas counties. Although the RTD receives substantial funding from

passenger fares and the federal government, most of its revenue comes from a sales tax levied on purchases made within the district. Senate Bill 02-179 and House Bill 02-1310 authorized the RTD to, upon receiving a valid petition, ask voters within their district for an increase in the RTD sales tax rate from 0.6 percent to 1.0 percent and to allow the RTD to increase its debt to pay for new transit construction. At this time, RTD has not decided on when to pursue an election. In addition, the bills allowed counties within the RTD to contribute government revenues to transit. Prior to the bills, they were specifically prohibited from doing so.

Outlook for Future Transportation Revenues

The outlooks for the five major transportation revenue sources (HUTF, Senate Bill 97-1, General Fund, TRANs, and federal funds) are shown in Table 2. Table 3 shows how these revenues will be distributed.

The Legislative Council Staff (LCS) provides quarterly estimates of the fuel tax and other HUTF monies as part of its overall forecast of state revenues. HUTF revenue growth will slow from the strength of recent years, but will remain healthy. After increasing 3.0 percent in FY 2001-02, HUTF revenues will increase 2.5 percent in FY 2002-03, and 3.4 percent in FY 2003-04. Fuel tax revenues will increase 2.0 percent in FY 2002-03 and 3.8 percent in FY 2003-04, while registration fees will increase 0.8 percent in FY 2002-03 and 4.5 percent in FY 2003-04.

The Senate Bill 97-1 diversion was capped at \$35.2 million in FY 2001-02 because of budget shortfalls. Based upon current forecasts, General Fund revenues will not be sufficient to fund a Senate Bill 97-1 diversion in FY 2002-03 through at least FY 2007-08, the end of the forecast period. A statutory trigger reduces the Senate Bill 97-1 diversion dollar-for-dollar when General Fund revenues fall short of fully funding the 6 percent limit on appropriations. The Senate Bill

97-1 diversion was \$197.2 million in FY 2000-01, the last year a full diversion was made. Likewise, General Fund revenues will not be sufficient to allow any transfers from the excess General Fund reserve to the HUTF over the duration of the forecast period. However, depending upon future budgeting decisions, both transfers could begin earlier.

CDOT issued the third TRANs series in June 2002 for \$220.4 million, and expects to raise approximately \$200 million more in a fourth issue during FY 2002-03. In August, CDOT refinanced portions of the first two issues made in 2000 and 2001. The refinance reduced total debt service costs by \$14.7 million, but did not increase the amount available to be spent on programs. Meanwhile, based on information from CDOT, at least \$971.0 million will be received from the federal government between FY 2001-02 and FY 2003-04, assuming TEA-21 is reauthorized.

Table 2
Major Colorado Transportation Revenues
Prior to Distribution
(millions of dollars)

| | Actual FY 2001-02 | Estimated FY 2002-03 | Estimated FY 2003-04 |
|-----------------------|------------------------------|---------------------------------|---------------------------------|
| Total HUTF | \$739.7 | \$758.0 | \$784.1 |
| Senate Bill 97-1 | \$35.2 | \$0.0 | \$0.0 |
| General Fund | \$0.0 | \$0.0 | \$0.0 |
| TRANs Proceeds | \$220.4 | \$200.0 | \$0.0 |
| Federal Funds /A | \$372.0 | \$295.1 | \$304.0 |
| TRANs Debt Service | (\$66.8) | (\$71.1) | (\$77.8) |
| TOTAL | \$1,300.5 | \$1,182.0 | \$1,010.2 |

Totals may not sum due to rounding.

Source: Colorado Legislative Council Staff, Colorado Department of Transportation.

/A Implementing legislation for federal funds (TEA-21) will expire in FY 2002-03. Estimates for FY 2003-04 assume that Congress will continue current practices.

Table 3
Major Colorado Transportation Revenues After Distribution
(millions of dollars)

| | Actual FY 2001-02 | Estimate FY 2002-03 | Estimate FY 2003-04 |
|--------------|----------------------|------------------------|------------------------|
| State /A | \$965.1 | \$836.9 | \$651.9 |
| Counties | \$152.7 | \$155.9 | \$160.7 |
| Cities | \$100.4 | \$102.2 | \$105.4 |
| Off-the-top | \$82.1 | \$87.0 | \$92.2 |
| TOTAL | \$1,300.5 | \$1,182.0 | \$1,010.2 |

Totals may not sum due to rounding.
 Source: Colorado Legislative Council Staff, Colorado Office of the State Treasurer.
 /A CDOT revenues. Includes the state's share of the HUTF, Senate Bill 97-1 diversions, two-thirds of the excess General Fund reserve, General Fund transfers, TRANs proceeds, and federal funds less debt service on TRANs.

How are State Transportation Funds Administered?

The decision-making authority for the majority of transportation revenues received by the state rests with the 11-member Colorado Transportation Commission.

Members of the commission are appointed by the Governor and confirmed by the Senate. The commission sets budgetary priorities for and gives policy direction to CDOT. Execution of highway maintenance and construction projects is conducted by CDOT. Table 4 depicts how the estimated \$1.1 billion budget will be allocated in FY 2002-03. The item labeled "Seventh Pot" refers to a prioritized list of 28 statewide projects culled from the six transportation planning districts.

The Seventh Pot projects will be funded with \$86.4

million from the HUTF and \$326.9 million of TRANs proceeds in FY 2002-03. Ninety percent of the Senate Bill 97-1 diversions are also earmarked for the Seventh Pot projects, but the diversion will not occur in FY 2002-03 under current revenue forecasts.

Table 4
Expenditure of State Transportation Funds, FY 2002-03
(millions of dollars)

| | | |
|-------------------------------|------------------|-------|
| "Seventh Pot" Projects | \$413.3 | 37.4% |
| Other Construction | \$76.6 | 6.9% |
| Maintenance | \$188.1 | 17.0% |
| Surface Treatment | \$125.0 | 11.3% |
| Operations and Administration | \$81.9 | 7.4% |
| Local Projects | <u>\$221.4</u> | 20.0% |
| TOTAL | \$1,106.3 | |

FY 2002-03 budget does not equal FY 2002-03 revenues because not all TRANs proceeds are used the year in which they are received.

Frequently Asked Questions Regarding Transportation

How much does one cent of the motor and diesel fuel tax rate generate? *One cent of the motor fuel tax currently generates approximately \$21 million and diesel fuel tax generates approximately \$5 million.*

Are transfers from the General Fund to the Capital Construction Fund for transportation purposes or the diversions of the state sales and use tax to the HUTF subject to the General Fund 6 percent appropriations limit? *No. Because the transfers from the General Fund are for capital construction purposes and the Senate Bill 97-1 monies never reach the General Fund, neither are considered General Fund appropriations.*

Can revenues in the HUTF be used for other areas of the state budget? *No. The Colorado Constitution specifically requires that the monies in the HUTF, not including the Senate Bill 97-1 diversion, be used only for the construction, maintenance, and operations of the state's highways. The requirement that 90 percent of the Senate Bill 97-1 diversion be spent on the Seventh Pot projects is contained in statute. The other 10 percent is required to be spent on transit projects.*

How much does Colorado receive in federal transportation money relative to what it pays? *The TEA-21 legislation attempts to return a minimum*

of 90.5 percent of the money paid to the federal government. In federal FY 1999-00, the Federal Highway Administration reported that 86.7 percent had been returned to Colorado.

How do the Colorado motor and special fuel tax rates and collections compare to other states? *The gasoline tax in Colorado (22 cents per gallon) is the 15th highest in the nation, while the 20.5 cents per gallon diesel fuel tax is the 26th highest. As a percentage of personal income, Colorado's fuel taxes were the 32nd highest in the nation in FY 2000-01.*

Staff Contact: Natalie Mullis, Legislative Council Staff, 303-866-4778