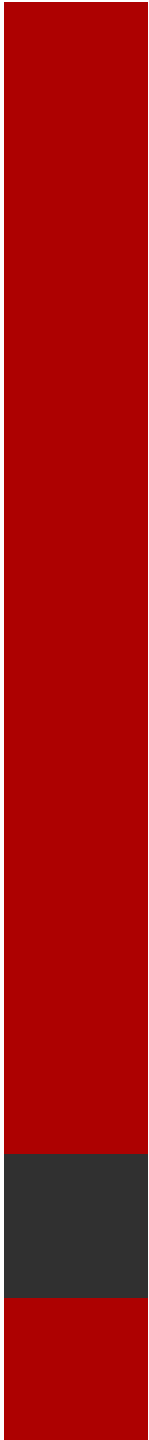


Fiscal Year 2016

Executive Budget Recommendation

January 16, 2015

Governor Douglas A. Ducey



Defining the Problem

- Economy and Revenues
- Budget Summary

The Plan

- Public Safety
- Classrooms First
- Health and Welfare
- Misc. Government

Where We End Up

Risks

The Economy

Same story: Projecting slow but steady improvement in the AZ economy.

Personal Income

- 2014 YTD: +4.7% (annualized)
- Forecast: 4-5% (average growth)

Employment

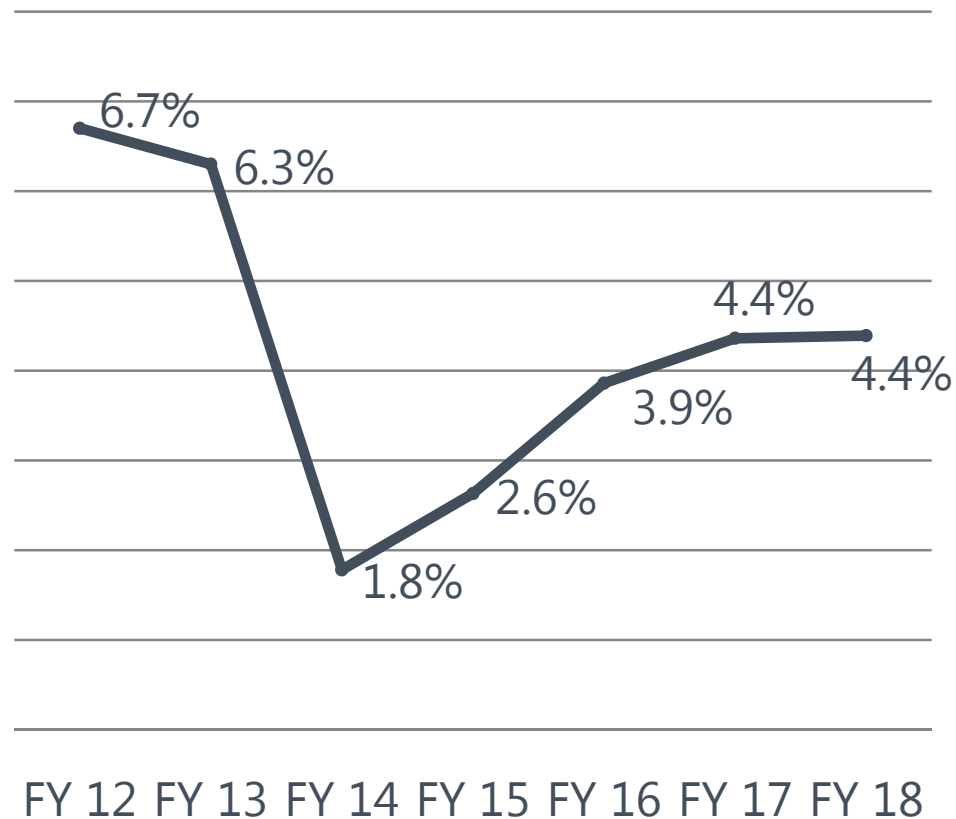
- 2014 YTD: +2.1% (annualized)
- Forecast: 2-3% (average growth)

General Fund Base Revenues

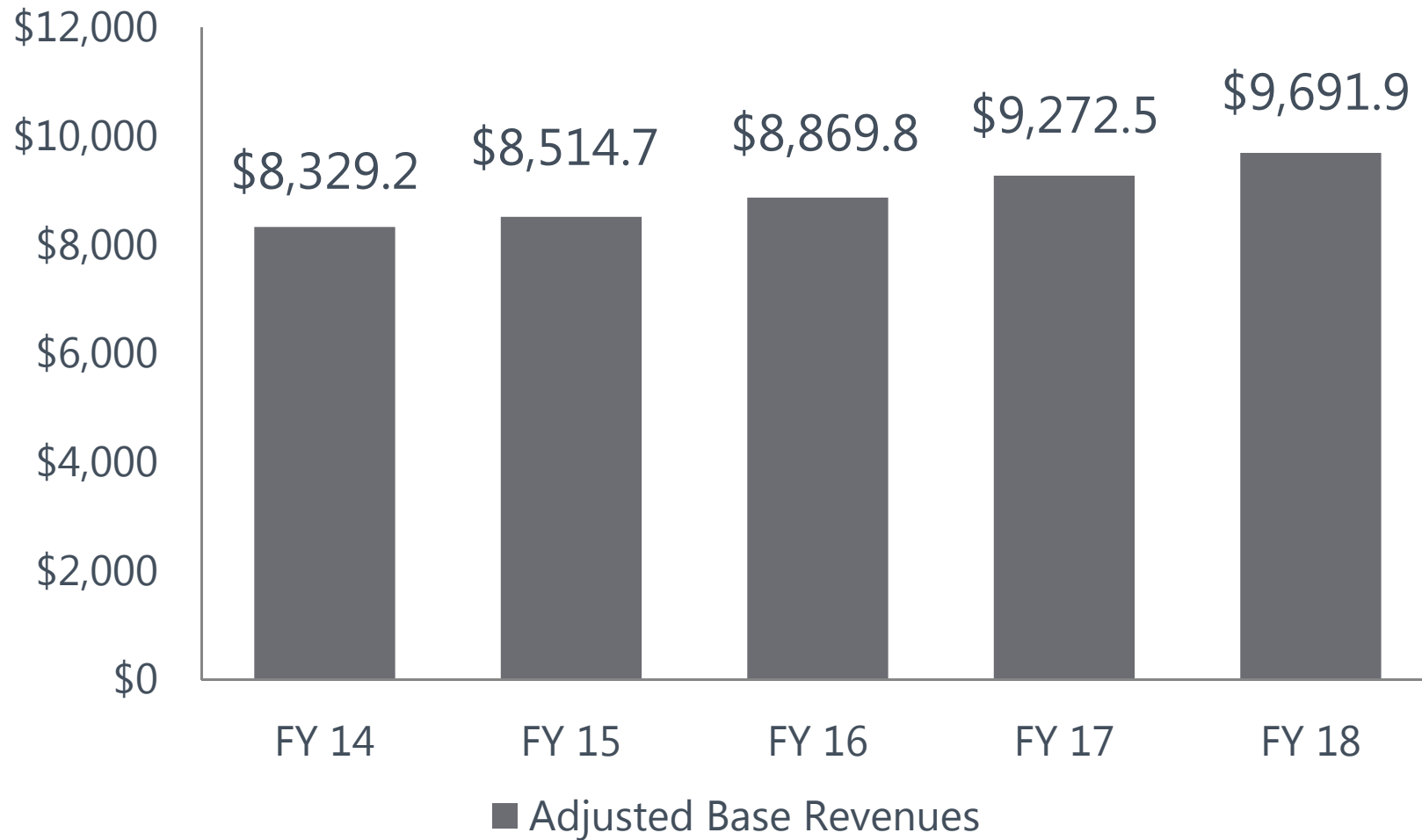
Base Forecast

- Conservative but realistic, given disappointing past results
- Set below baseline forecasts
- Revenue growth excludes URS, temporary and new tax measures

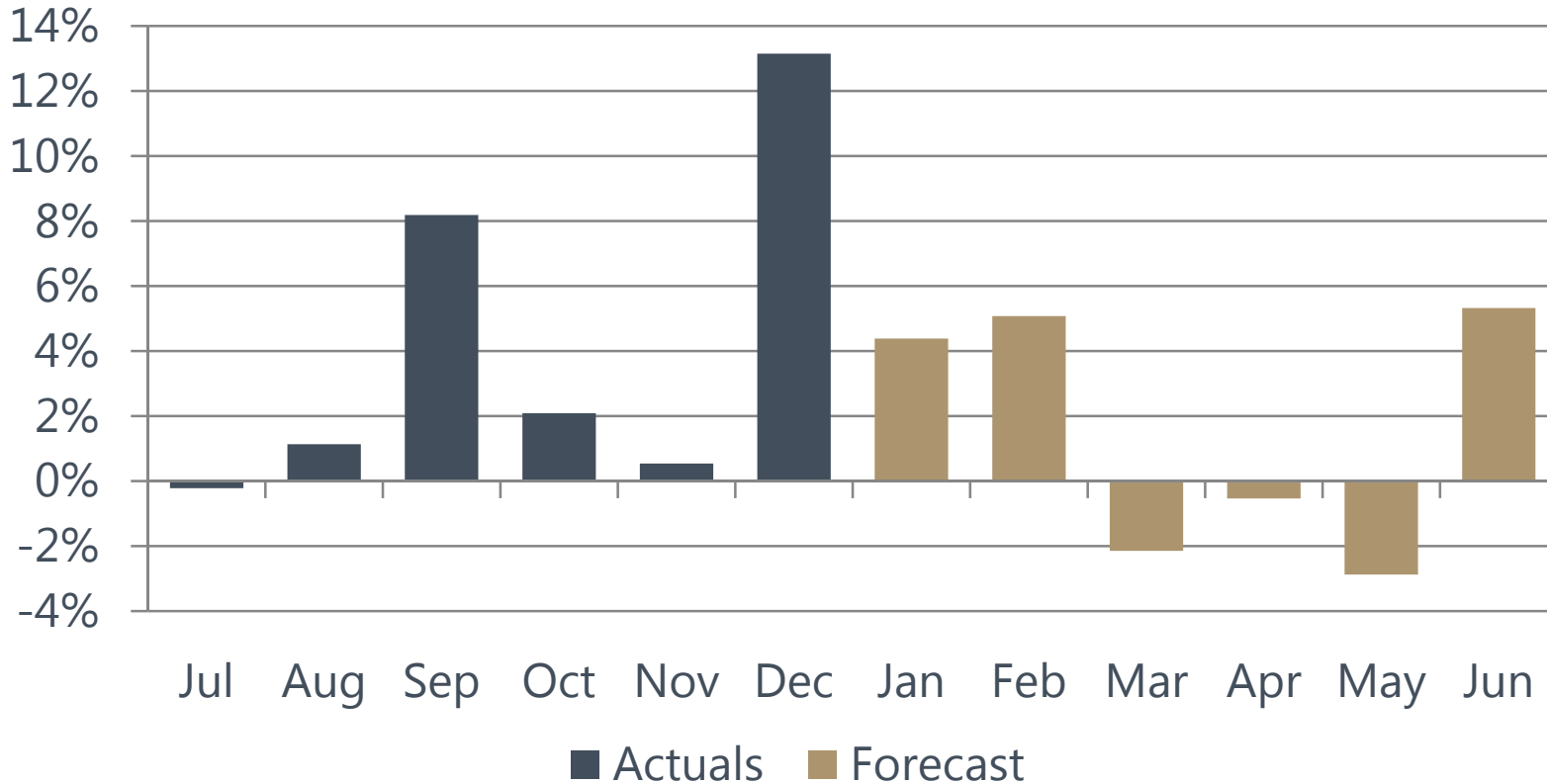
GF Base Revenue Growth



Total Base Revenues



FY 2015 Collections Year-Over-Year



Forecast calls for 2.6% growth. To date, revenue is up 4.6%.

* Excluding tax-law changes

How Big is the Problem?

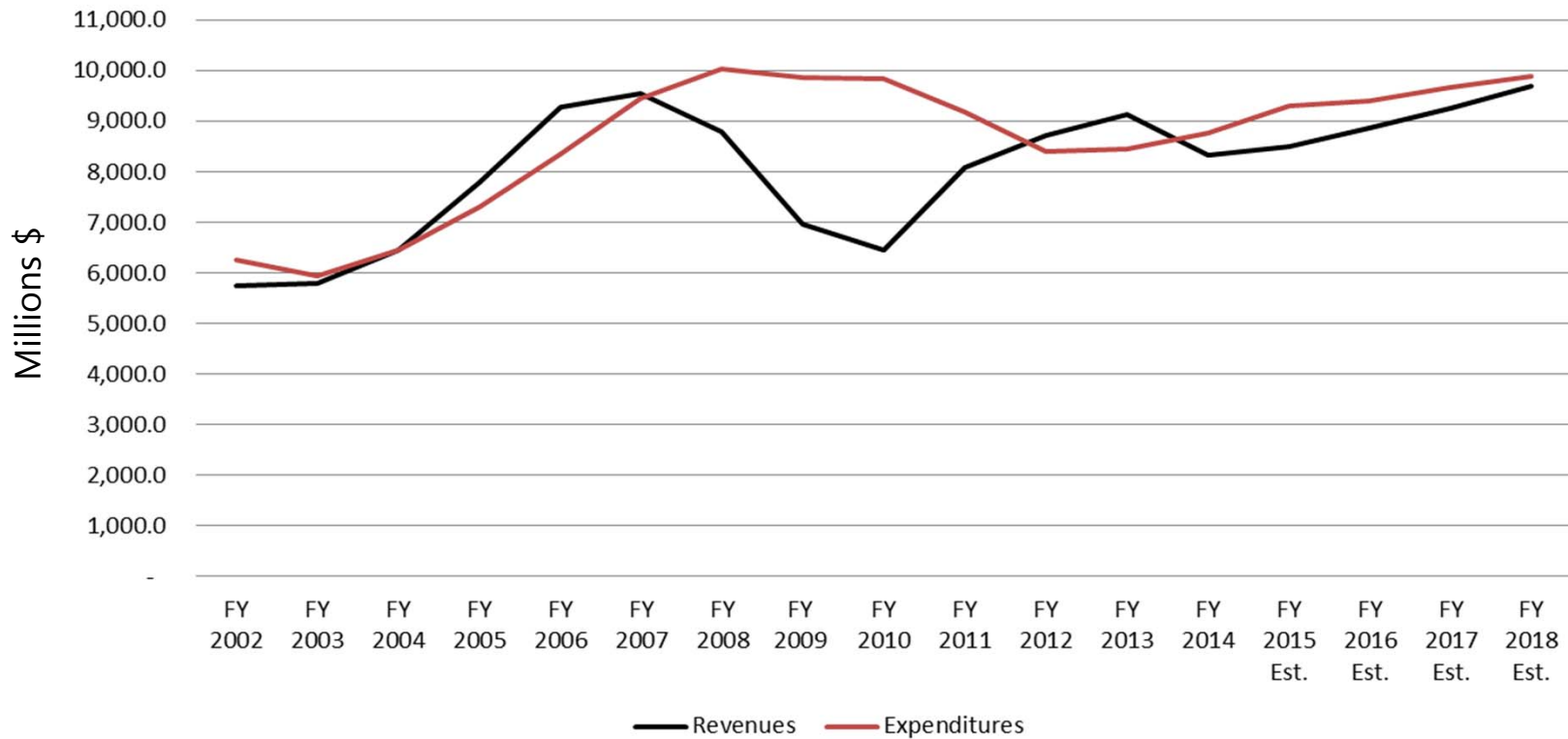
	FY 2015	FY 2016*	FY 2017	FY 2018
Shortfall (millions \$)	(\$159.6)	(\$533.7)	(\$929.0)	(\$1,133.3)

Budget Goal

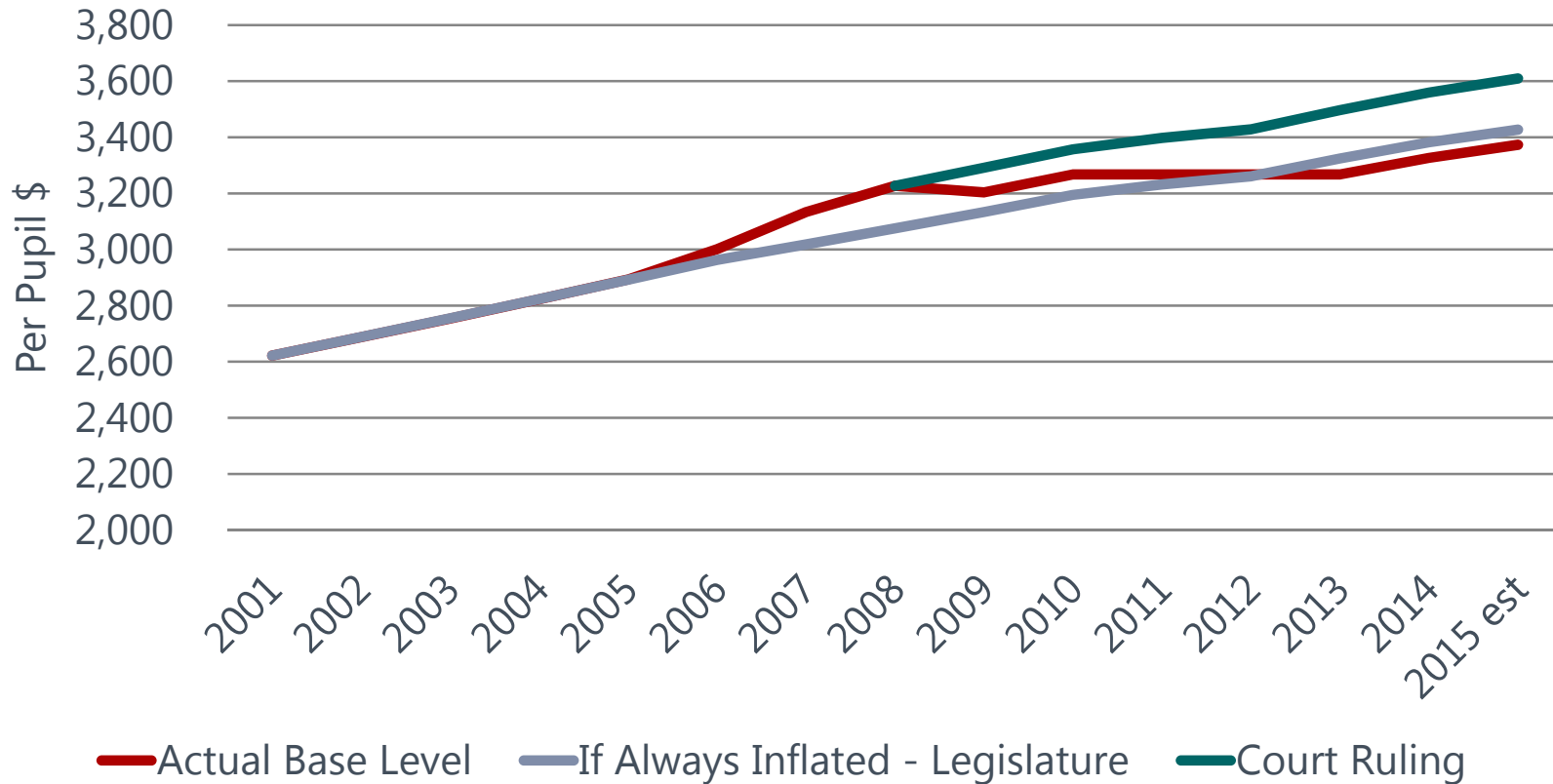
No structural deficit in FY 2017

*Assumes FY 2015 is solved

On-Going Structural Deficit



K-12 Base Level Inflation Litigation



The Executive Recommendation includes \$74.4 million to adjust the base to the Legislatively-proposed level.

FY 2015 Budget Summary

Shortfall..... \$159.6M

Solution Set

Raise DSH Cap..... \$11.0M

SFB Refinance..... 9.4M

April 1 Provider Rate Reduction..... 8.4M

DES Additional Federal Funds..... 4.0M

DES New Program Elimination..... 1.1M

WIFA Water Supply Funding..... 1.0M

Total Budget Changes..... \$34.9M

Rainy Day Fund Transfer..... \$125.7M

Total Solution Set..... \$160.6M

FY 2016 Budget Summary

<i>Shortfall</i>	<i>\$533.7M</i>
<i>New Spending</i>	<i>\$44.3M</i>
<i>Solution Set</i>	
Spending Reductions.....	<i>\$348.5M</i>
Maximizing Revenues.....	<i>\$62.2M</i>
One-Time Transfers.....	<i>\$303.9M</i>
<i>Total Solutions</i>	<i>\$714.6M</i>

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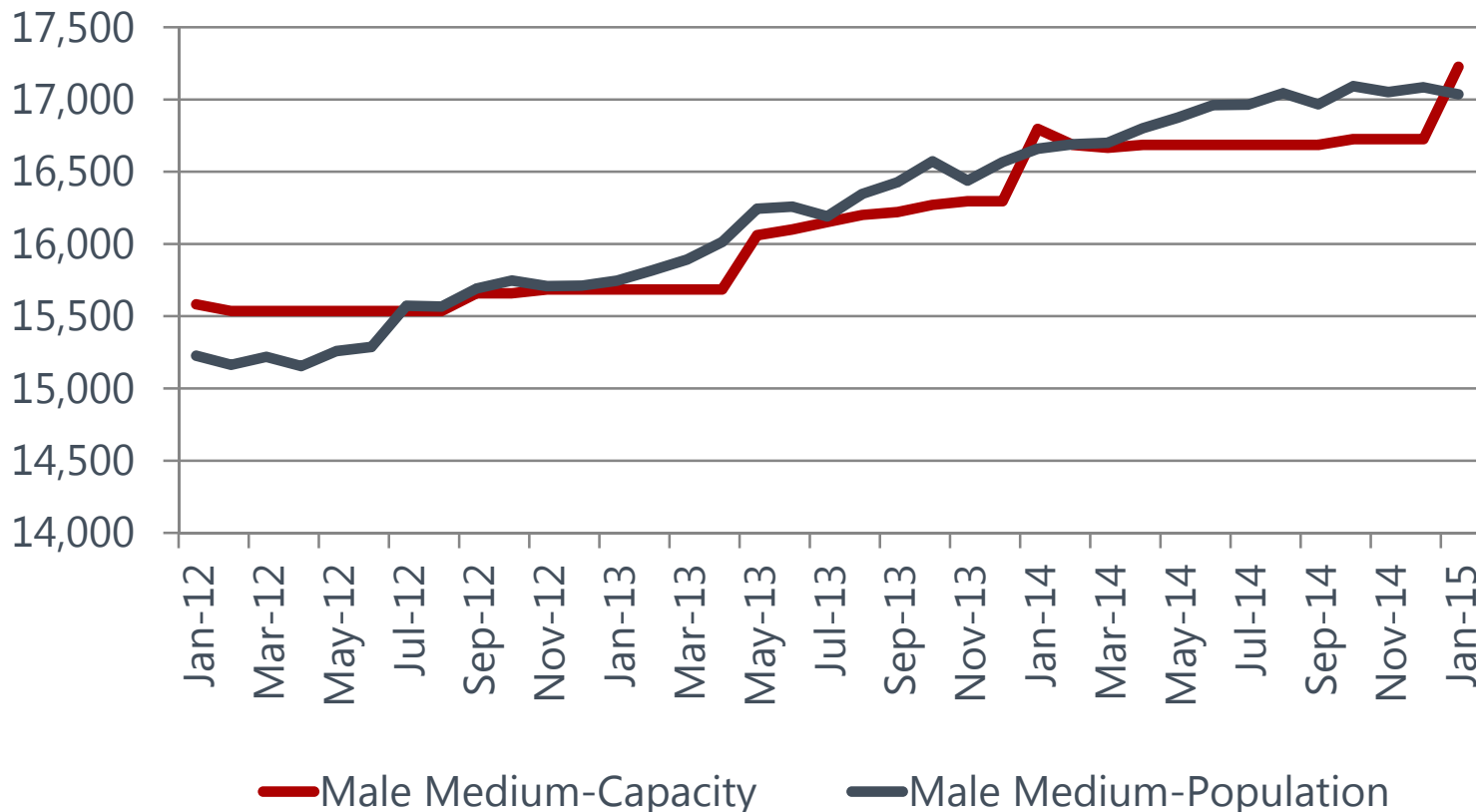
Where We End Up

Risks

Department of Corrections

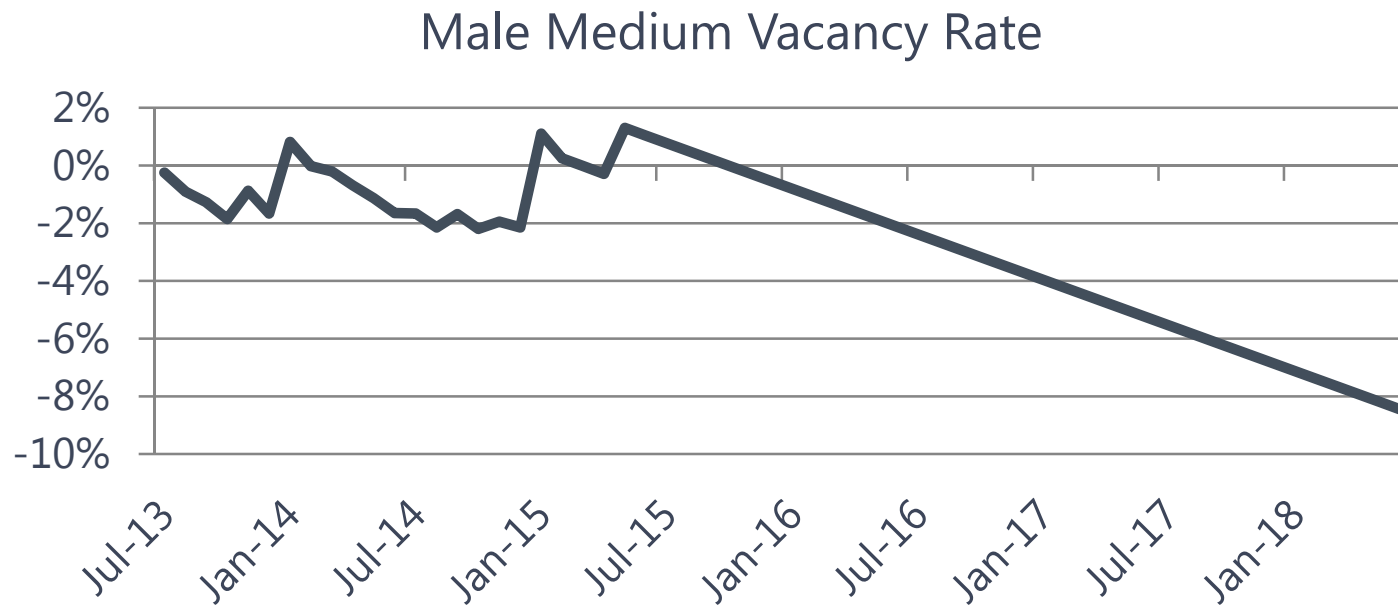
Since FY 2013

- Total inmate population has grown by 2,259 inmates
- Male Medium population has grown by 1,252 inmates



Inmate Population Growth

The Male Medium population is projected to grow by 46 inmates per month.

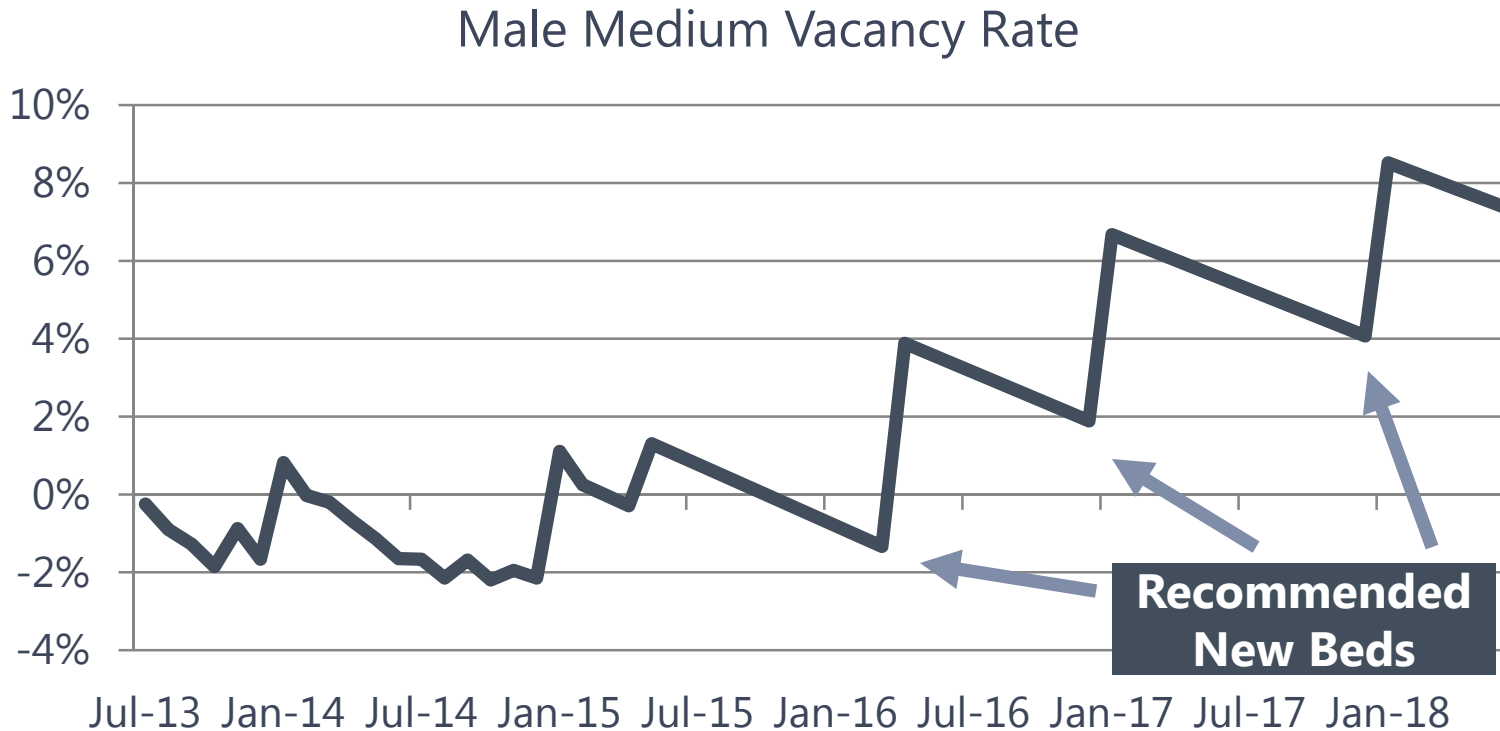


A vacancy rate of 5% within each custody level is recommended for the safe management of inmates.

New Beds

The Executive recommends DOC issue Requests for proposals for up to 3,000 Male Medium beds.

(1,000 new beds for April 2016, January 2017 and January 2018)



Inmate Healthcare

- The Department was sued for inadequate inmate healthcare
- In the settlement, the Department agreed to comply with 103 health performance measures, 12 of which constitute a change in scope

The Executive recommends \$8.1M to fund the changes in scope to the healthcare contract.

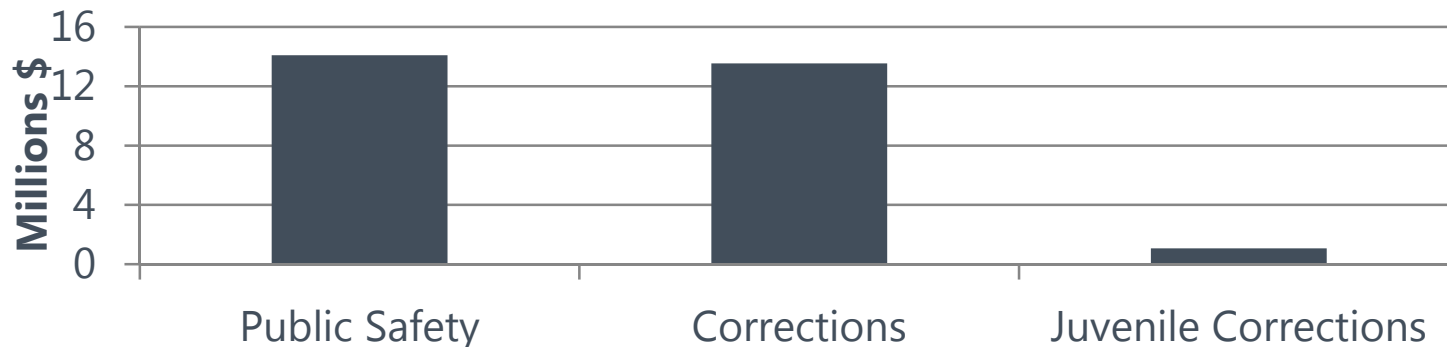
PSPRS Litigation Liabilities

Following Arizona Supreme Court decision *Field v. EORP*, the State must:

- Recognize the entire liability in FY 2016 (76.0% contribution) *or*
- Phase in the liability from this decision over three years (62.2% contribution in FY 2016)

The Executive recommends \$28.7 M to recognize the entire liability in FY 2016.

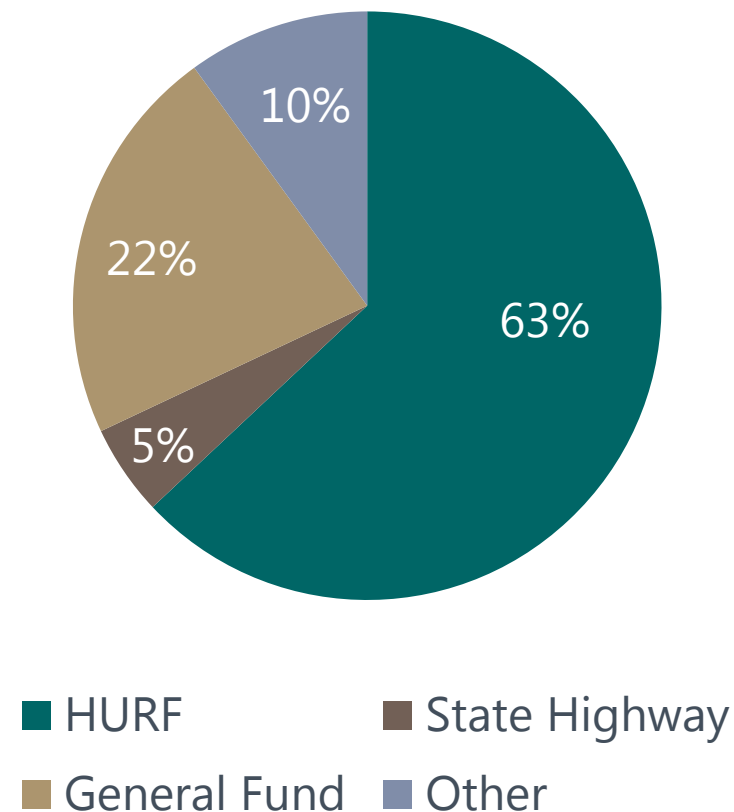
General Fund Impact of Recognizing Entire Liability



Highway Patrol

- Highway Patrol is currently funded with several funds
- This mix changes every year based on available General Fund resources
- Funding the Highway Patrol this way places public safety needs in conflict with local transportation needs

2015 Highway Patrol Funding



New DPS Revenue Stream

The Executive recommends dedicating the Motor Vehicle Registration fee permanently to the support of highway law enforcement operations.

- The Director of the Department of Transportation would set the fee
- Fee would cover 50% of highway law enforcement operations, approximately \$65M
- Current fee is \$8.00 per vehicle – raising \$35M

New DPS Revenue Stream

- Protects the General Fund
- Protects local HURF Funds
- Provides DPS with long-term stability

Highway Patrol Funding			
	FY 2015	FY 2016	FY 2017
HURF Transfer	89.3	54.3	54.3
General Fund	30.0	--	--
State Highway Funds	6.4	6.4	6.4
Other	11.3	11.3	11.3
Motor Vehicle Registration Fee	--	65.0	65.0
Total (millions \$)	\$137.0	\$137.0	\$137.0

New DPS Revenue Stream

Transferring the Registration Fee revenues to the Highway Patrol Fund will reduce HURF by \$35M (fee revenues currently).

To keep the DPS impact on HURF at \$89M, the HURF transfer to DPS will be reduced by \$35M, to \$54M.

DPS Impact on HURF				
	FY 2014	FY 2015	FY 2016	FY 2017
HURF Transfer	(119)	(89)	(54)	(54)
Motor Vehicle Registration Fee	0	0	(35)	(35)
Total (millions \$)	(\$119)	(\$89)	(\$89)	(\$89)

Department of Juvenile Corrections

Young children and those who commit lesser offenses have better outcomes if they are treated closer to home, in their own communities.

Secure Care Admissions			
	FY 2012	FY 2013	FY 2014
Total Youth	446	394	347
Total Misdemeanors	125	103	95
Misdemeanors with no Felony or SMI	69	44	33
Youth under 14	4	6	4

At the end of FY 2014, 33 youth housed at DJC had no felony convictions, and 4 were under the age of 14.

Admissions Eligibility

The Executive recommends admission reforms:

- Admitted children must be 14+ years old
- Offense must include a current or prior felony
- Exception for seriously mentally ill

*Net Impact to the General Fund: \$3M savings,
resulting from the reduction in population.*

County Service Contribution

Juvenile justice mainly happens at county level

- Counties maintain their own juvenile justice infrastructure
- Counties determine which youth are sentenced to the State facility

The Executive recommends that each county contribute 25% of the average cost of youth sent to the Department from that county.

This will encourage counties to only send youth who will benefit from State services.

Net Impact to General Fund: \$12M savings

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Where We End Up

Risks

Arizona Public School Achievement District

The Arizona Public School Achievement District will expand the impact of our best public schools.

- Participating schools must demonstrate high academic progress and enrollment need
- 50% of approved projects will be in low-income communities

New *Access Our Best Public Schools Fund* will help public schools expand existing facilities or construct new ones

- Repeal Student Success Funding
- Move the funding from the Department of Education to the School Facilities Board (\$23.9M in FY 2016; \$21.5M in FY 2017)

Classrooms First

The Executive Recommendation prioritizes classroom spending.

New Classroom Spending.....\$ 134.1M

Inflation Increase to Basic State Aid..... 85.2M

Increase Base Support Level..... 74.4M

Remove One-time Charter Conversion Funds..... (24.5M)

Phase-Out Career Ladders..... (0.7M)

Phase-Out District-Sponsored Charters..... (0.4M)

Non-Classroom Reductions.....\$ (123.7M)

5% Reduction in Non-Classroom Spending..... (113.4M)

3.5% Reduction in Charter Additional Assistance..... (10.3M)

Stabilizing General Fund Support

One Percent Cap

- The Arizona Constitution limits primary resident taxes to 1% of the property's net assessed value
- The Homeowner's Rebate pays for any portion of the homeowner's primary property taxes that exceeds 1% of the full cash value of the home
- 27 school districts are in taxing jurisdictions where the total rate exceeds the 1% cap, at a cost to the State of \$23.7M

The Executive Recommends capping the State's share of the 1% cap at \$1M per county and prorating the remaining cost among the taxing jurisdictions.

Net Impact to the General Fund: \$20.2M savings

One Percent Cap Example

Pima County

	Tax Rate	Percentage	Prorated Cost (millions \$)
State*	0.51	4.4%	1.8
TUSD**	4.96	42.9%	8.0
County	5.61	48.5%	9.0
City	0.48	4.2%	0.8
Total	\$11.56		\$19.5

*State share includes the first million over the cap

**The TUSD rate is reduced by \$1.84 due to the Homeowner's Rebate

Stabilizing General Fund Support

Homeowner's Rebate Cap

- The State pays a portion of each homeowner's school district primary tax rate, up to \$600 per parcel, through the Homeowner's Rebate
- Beginning in 2014, the rebate changed from a fixed 40% to a floating rate that is calculated by the Department of Revenue
- The cost to the General Fund has grown as the rate has increased from 40% to 43.6%

The Executive recommends capping the Homeowner's Rebate at 44% of the Qualifying Tax Rate (QTR).

Net General Fund Impact: \$3.6M in FY16, \$26.5M savings in FY17

Universities

The Executive recommends university reductions of \$75M, distributed on an enrollment basis.

University	Amount (millions \$)	% Total Revenue
Arizona State University	40.3	1.7%
Northern Arizona University	13.1	2.4%
Arizona University	21.6	1.0%
Total	\$75.0	

Community Colleges

The Executive recommends the General Fund support for Maricopa, Pima and Pinal community colleges each be reduced by 50% (\$8.8M total savings).

District	State Aid Amount (millions \$)	% Total Revenue
Maricopa	4.1	0.4%
Pima	3.3	1.5%
Pinal	1.4	1.7%
Total	\$8.8	

Defining the Problem

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Where We End Up

Risks

Department of Child Safety

To reduce instances of child abuse, the Executive recommends shifting \$4M from the Department's Backlog funding to Preventive Services funding.

Preventive Services

- Counseling, drug rehabilitation, parent aides, etc.
- Provided to families where children are safe but risk factors are present
- Rendered in partnership with community-integrated organizations, from contacts made during hotline calls, and as direct intervention in open cases

Foster Care Recruitment

To improve outcomes for children and reduce costs, the Executive Recommends a foster care recruitment initiative.

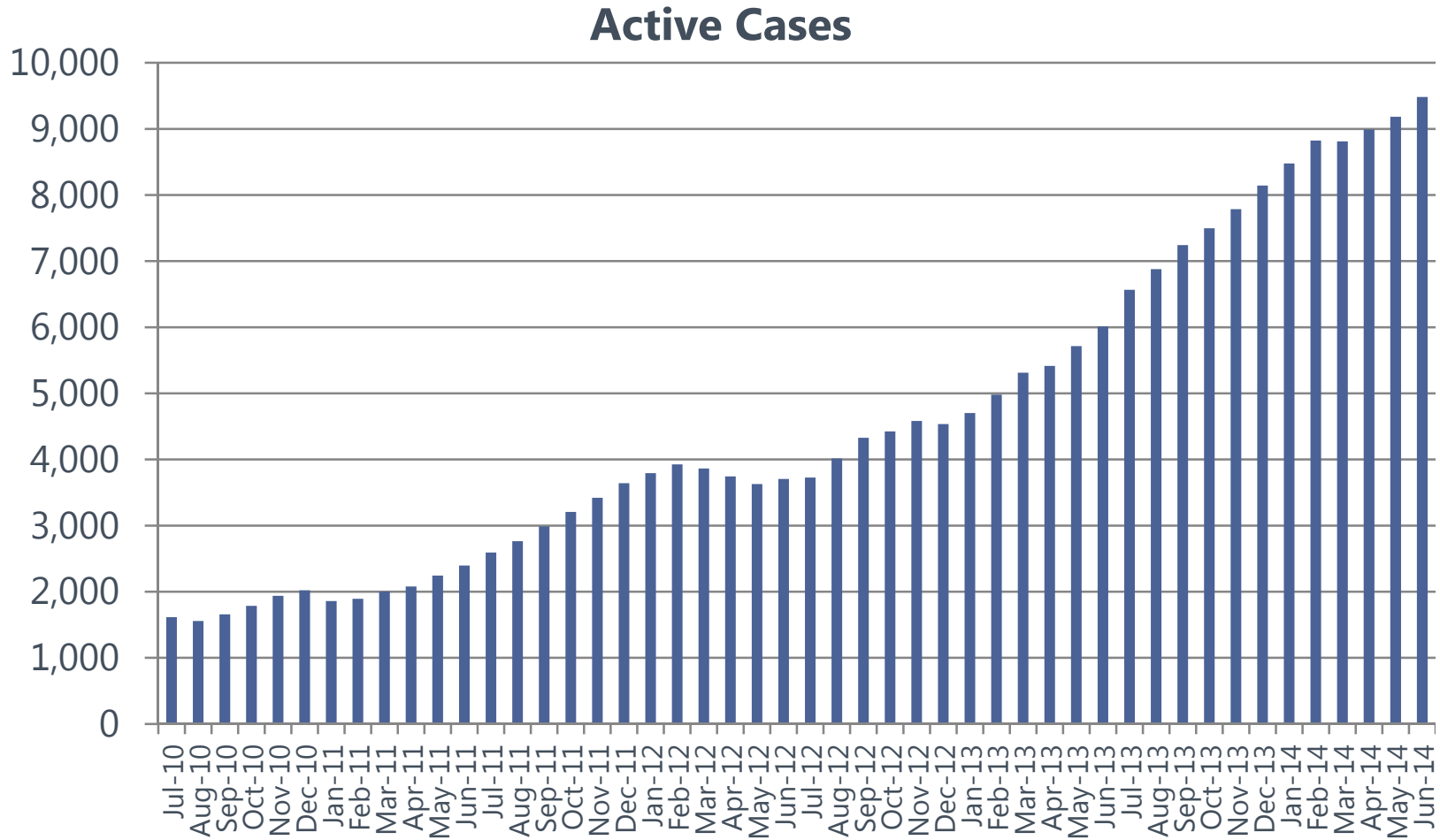
- Return foster care stipend for children 12-18 years old to pre-recession levels
- Increase foster bed availability and use by 3% (~210 children)
- Approximately 1,500 children in congregate care, 76% 12 years old or older

Cost Comparison – Average per Month per Child

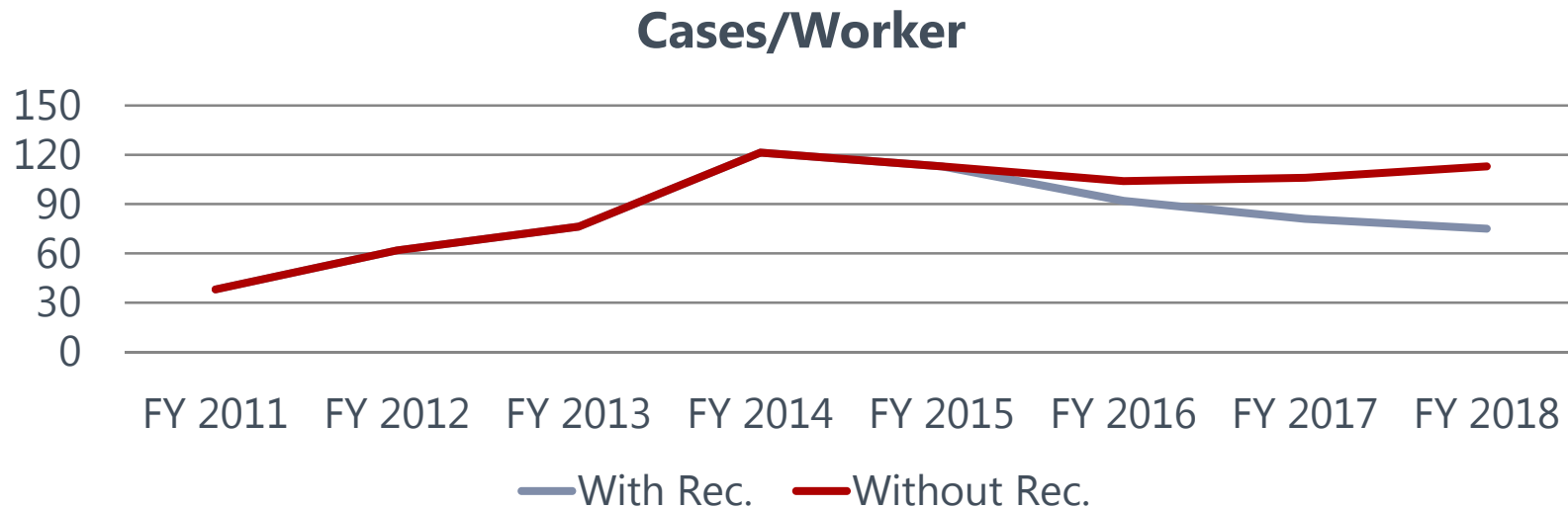
\$3,198	Residential care
\$2,477	Emergency care
\$653	Foster stipend
\$816	Foster stipend for 12-18 year olds after increase

Net Impact to General Fund: \$2M savings

DES Adult Protective Services Caseload Growth



Adult Protective Services Caseload Growth



To reduce the caseload, the Executive recommends \$1.2M from the General Fund for 11 additional positions.

This will provide sufficient resources to start closing cases faster than they are added.

*National Adult Protective Services Association recommended caseload: 35 to 40 cases per investigator.

DD ALTCS Adult Preventative Dental

- Individuals with disabilities are at a greater risk for oral diseases
- Without proper dental care, developmentally disabled clients may exhibit behavioral problems that result in inappropriate intervention

The Executive recommends \$1.1M to reinstate the ALTCS adult preventive dental benefit for the developmentally disabled.

DES Program Reduction

Increased funding from the federal Child Care and Development Fund will allow the Department to maintain current levels of service while reducing General Fund support.

Federal Funding for Child Care Subsidy....\$ (4.0M)

Eliminating new programs.....\$ (1.1M)

Homeless Capital Grant..... (0.5M)

Autism Parenting Skills – Rural Areas..... (0.3M)

Long Term Care Assisted Living..... (0.3M)

Net Impact to General Fund: \$5.1M savings

Behavioral Health Consolidation

Currently, AHCCCS provides acute care and DHS provides behavioral health for the same 1.3 million members.

The Executive recommends consolidating behavioral health services into AHCCCS by July 1, 2016.

- Improve coordination of care for members
- Provide efficiencies at Agency level
- Delay important to give agencies time to prepare

*Net Impact to the General Fund: No change in FY 2016 budget.
Savings expected starting in FY 2017.*

Provider Rate Reduction

The Executive recommends a 3% provider rate reduction, effective April 1, 2015.

- No cuts to Developmentally-Disabled provider rates
- Allow AHCCCS flexibility to implement

The Executive also recommends restoring ambulance rates to levels in place in FY 2014, prior to recent increases.

Net Impact to the General Fund: \$40.1M savings

Disproportionate Share Hospital (DSH)

Disproportionate Share Hospital program is a federal program to provide payments to hospitals serving a disproportionate share of Medicaid patients. States may keep DSH funds for political subdivision hospitals. Arizona generates funds from:

- Maricopa Integrated Health Systems and the Arizona State Hospital
- In FY 2014 DSH produced \$75.4M in General Fund revenue

DSH that does not flow into the General Fund is currently distributed to hospitals through a match program.

The Executive recommends increasing the General Fund deposit by \$11.0M in FY 2015 and \$16.5M in FY 2016 by reducing the available funds for the local match program.

Defining the Problem

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Where We End Up

Risks

TPT Revenue

Problem

\$300M in outstanding TPT obligations

Solution

\$2M Investment for 30 additional staff (not auditors)

\$51M Expected returns in revenue

Appropriation to be made prior to revenue sharing.

Returns will benefit state and local governments.

Net Impact to General Fund: \$32.6M

Local Government Impact: \$16.6M

DOR Appropriation Shift

- The Department of Revenue processes taxes that benefit local governments as well as the State
- In FY 2016, it is estimated that 17.5% of tax dollars processed by DOR will be distributed to local governments

The Executive recommends local governments fund the Department's appropriation by the prorated share of tax dollars received from the Department.

	Cities and Towns	Counties	Total
Share of Tax Dollar	10.2%	7.3%	17.5%
Appropriation Funded	\$8.2M	\$5.9M	\$14.1M

Net Impact to General Fund: \$14.1M

Fraudulent Tax Prevention

Problem

0.7% Potentially fraudulent State tax returns

\$8.8M Potential revenue loss due to fraudulent returns

Solution

\$3.1M Investment for fraud detection services

If fraudulent refunds caught are less than annual service fee, State will only pay up to amount of fraud prevented.

Net Impact to General Fund: \$5.7M savings

Department of Financial Institutions Reform

Restructure funds to align operating expenditures for regulation and supervision under one fund

- Increases operational efficiency
- Stabilizes operations cash flow

Reallocate revenue

- Split revenue 80/20 between the Department and the General Fund
- Deposit surplus balance to General Fund annually

Consolidate the State Board of Appraisal under the Department of Financial Institutions

- Streamline appraisal licensing and investigation
- Reduce administrative costs

Net Impact to General Fund: \$6.8M savings

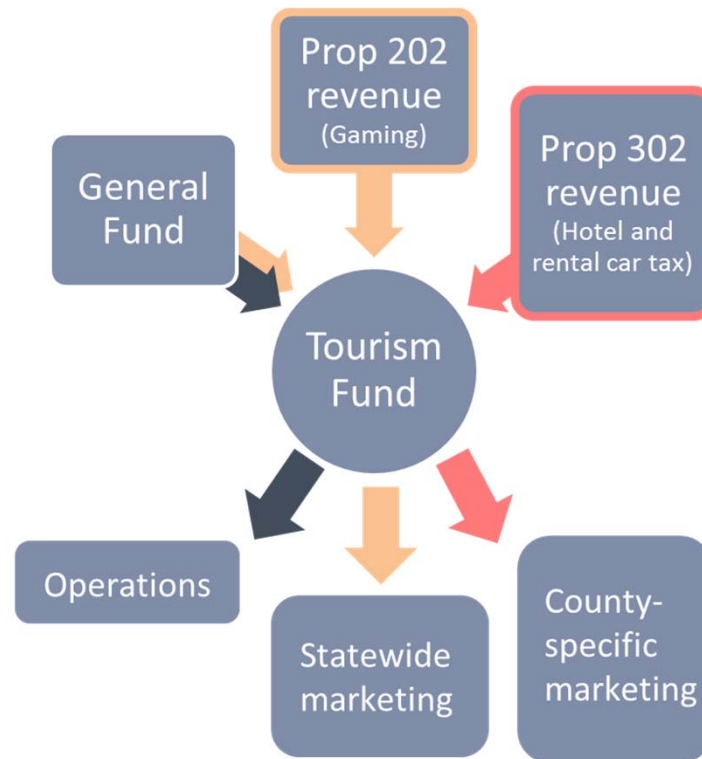
Tourism Marketing Reduction

FY2014 Actuals.....\$ 21.1M

- General Fund: Operations..... 2.6M
- General Fund: Marketing..... 4.5M
- Prop 202: Marketing..... 6.8M
- Prop 302: Marketing..... 7.2M

FY 2016 Solution.....\$ 16.2M

- General Fund: Operations..... 2.6M
- Prop 202: Marketing..... 6.4 M
- Prop 302: Marketing..... 7.2M



Net Impact to General Fund: \$4.5M savings

Hiring Freeze and Restructure



Institute State Hiring Freeze

- Exemptions include public safety and child safety
- No Agency cuts until specific restructuring decisions are made

Initial Restructuring Recommendations

- Integrate the Division of Behavioral Health Services at the Department of Health Services into AHCCCS
- Consolidate the Department of Racing and Department of Gaming

Net Impact to General Fund: \$20.7M savings

Capital

The Executive recommends continuing the process of maintaining and correcting major facility issues.

- \$10M from the General Fund for urgent projects
- \$9M from the Capital Outlay Stabilization Fund for general building renewal

Projects will focus on replacing and upgrading:

- Fire alarms
- Roofs
- Building assets (walls, doors, windows, etc.)
- Major building systems (HVAC, electrical, plumbing, etc.)

One-Time Transfers

<i>Agency</i>	<i>Fund Name</i>	<i>Amount (millions \$)</i>
Administration	Special Employee Health Fund	90.0
Commerce Authority	Arizona Competes Fund	75.0
Commerce Authority	Work Force Recruitment and Job Training Fund	25.0
Transportation	Highway Expansion and Extension Loan Program Fund	20.0
Transportation	State Aviation Fund	15.0
AHCCCS	Healthcare Group Fund	7.3
Parks	Off-Highway Vehicle Fund	7.0
Other	Across 18 Funds	64.7
<i>Total</i>		<i>\$ 303.9</i>

FY 2017 Budget Summary

Ongoing Spending.....\$ 67.6M

Ongoing Solutions.....\$ 411.7M

New Solutions.....\$ 63.2M

Maintain HURF Shift..... 30.0M

Hiring Freeze/Restructure..... 20.7M

Land Dept. Self-Funding..... 12.5M

Local Government Impacts

	FY 2016		FY 2017	
	Cities and Towns	Counties	Cities and Towns	Counties
TPT	6.5	10.1	6.5	10.1
DOR Appropriation Shift	(8.2)	(5.9)	(8.2)	(5.9)
Eliminate direct payments	0.0	(1.7)	0.0	(1.7)
25% DJC Contribution	0.0	(12.0)	0.0	(12.0)
Maintaining DPS Funding	0.0	0.0	(16.0)	(14.0)
TPT Implementation*	<u>(2.9)</u>	<u>0.0</u>	<u>0.0</u>	<u>0.0</u>
Total (millions \$)	\$(4.6)	\$(9.5)	\$(17.7)	\$(23.5)

**This fee will only apply to non-program cities*

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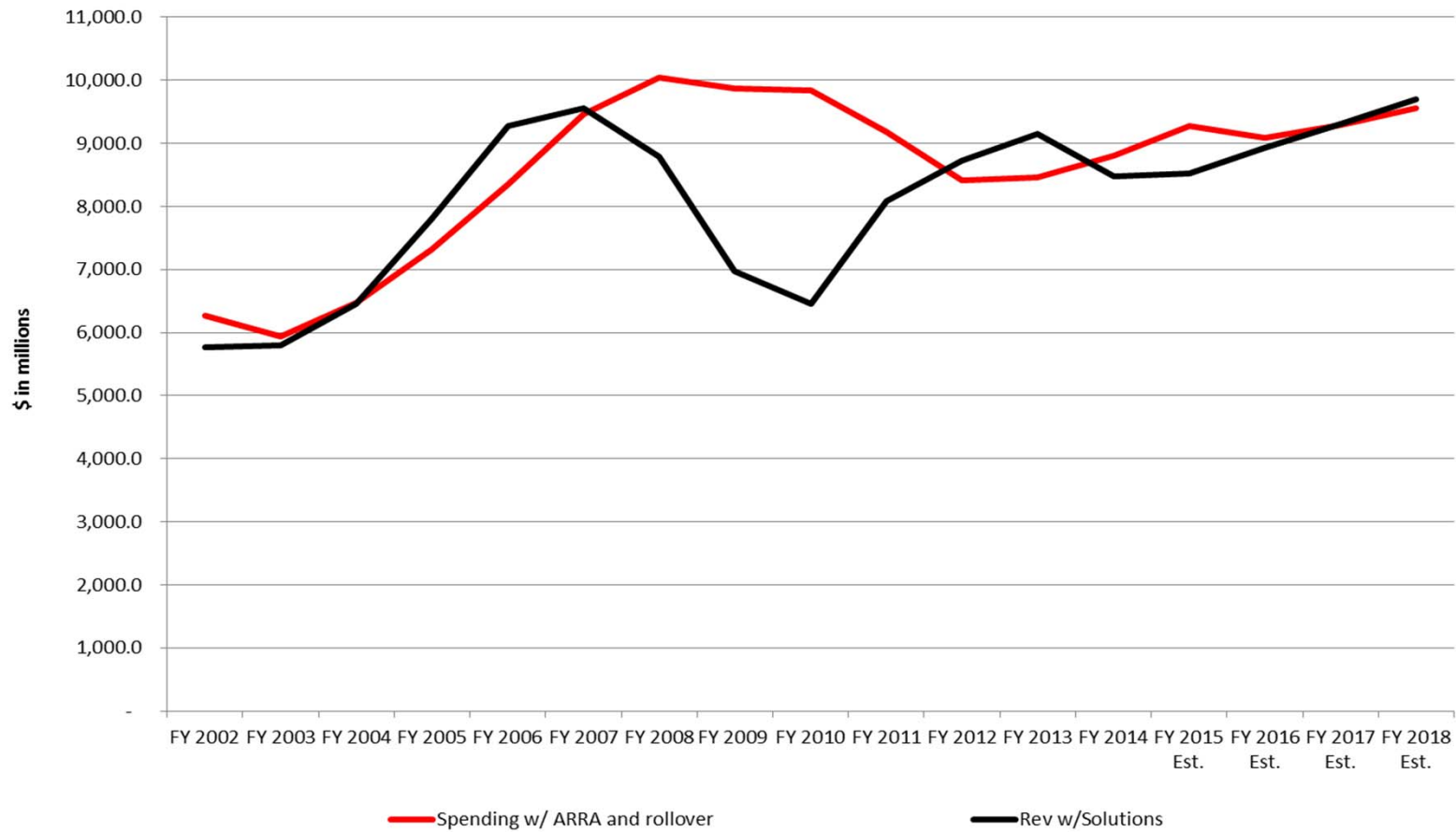
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Where We End Up

Risks

Where We End Up

Arizona General Fund Ongoing Expenditures and Revenues FY 2002-FY 2018



Where We End Up

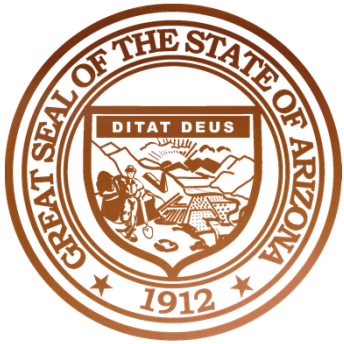
	FY 2015	FY 2016	FY 2017	FY 2018
On-going Revenue	8,512.9	8,909.4	9,300.2	9,703.4
Spending	9,281.7	9,093.3	9,296.7	9,548.9
Ending Balance	1.0	136.8	148.9	303.5
Structural Balance	\$(768.8)	\$(183.9)	\$3.5	\$154.6

Risks

The Executive Budget Recommendation leaves a Rainy Day fund balance and a cash balance at the end of FY 2018.

These funds will be available to address potential budget risks including:

- Federal action
- Lawsuits
- Economic disruptions



The Full FY 2016 Executive Budget
Recommendation is available at

AZGOVERNOR.GOV

AZOSPB.GOV

Governor Douglas A. Ducey

