
FY 2016 JLBC Baseline

**Summary Version with
Executive Budget Comparison**

January 27, 2015

JLBC

Summary of JLBC Baseline Shortfall Status

- Compares Cost of Consensus Revenue vs Funding Formulas

	\$ in M	
<u>Ending Balance</u>	<u>FY '15</u>	<u>FY '16</u>
• January FAC	\$(148)	\$ (678)
• January FAC + K-12 Reset	(480)	(1,015)

- Excludes \$464 M available in Budget Stabilization Fund
- Estimates assume that '15 shortfall is resolved with 1-time solutions prior to '16
- Does not reflect impact if litigation back payments are awarded

Forecast Risks

- 1% Variance Yields \$575 M Over 3 Years

Potential Gains

- National economic recovery may provide upside gain, in part, by generating more in-state migration
- Gas price windfall will also help stimulate retail sales, but is likely temporary

Potential Losses

- Uncertainty of international events
- Litigation – prison health, retirement, hospital assessment

Revenue Overview

JLBC

'15 Improved Over Slow '14 Due to Corporate Collections

- Otherwise Weak Growth

	<u>'14 Budgeted</u>	<u>'14 Actual</u>	<u>'15 1st Half</u>
Sales	5.7%	5.5%	3.4%
Individual Income	3.7%	1.9%	3.2%
Corporate Income	(3.5)%	(13.1)%	21.4%
Overall	3.9%	2.7%	4.6%

- ❑ Without corporate income tax collections, year-to-date overall increase would be 3.6%
- ❑ December is first month that revenues have been above forecast since March 2014
- ❑ Through December, year-to-date revenues \$(60) M below forecast

AZ Economy is Growing, But Slower than Average

- Given Our Size, Historical Norm May Not be Realistic

Main Factors Behind Slow Growth

	<u>Historical</u>	<u>Current</u>
Overall Job Growth	3.9%	2.6%
Construction Employment	5.7%	(3.5)%
Population Growth	3.1%	1.5%
Building Permits	38K	17K

Other Factors

- Great Recession “hangover” may be hampering investment
- Tougher loan standards and declining household formation have hurt housing demand
- Flat wages have limited consumer purchases
- Reduced Federal defense contracts in Arizona

4-Sector Forecast Has Slow Growth Until '18

Components of 4-Sector

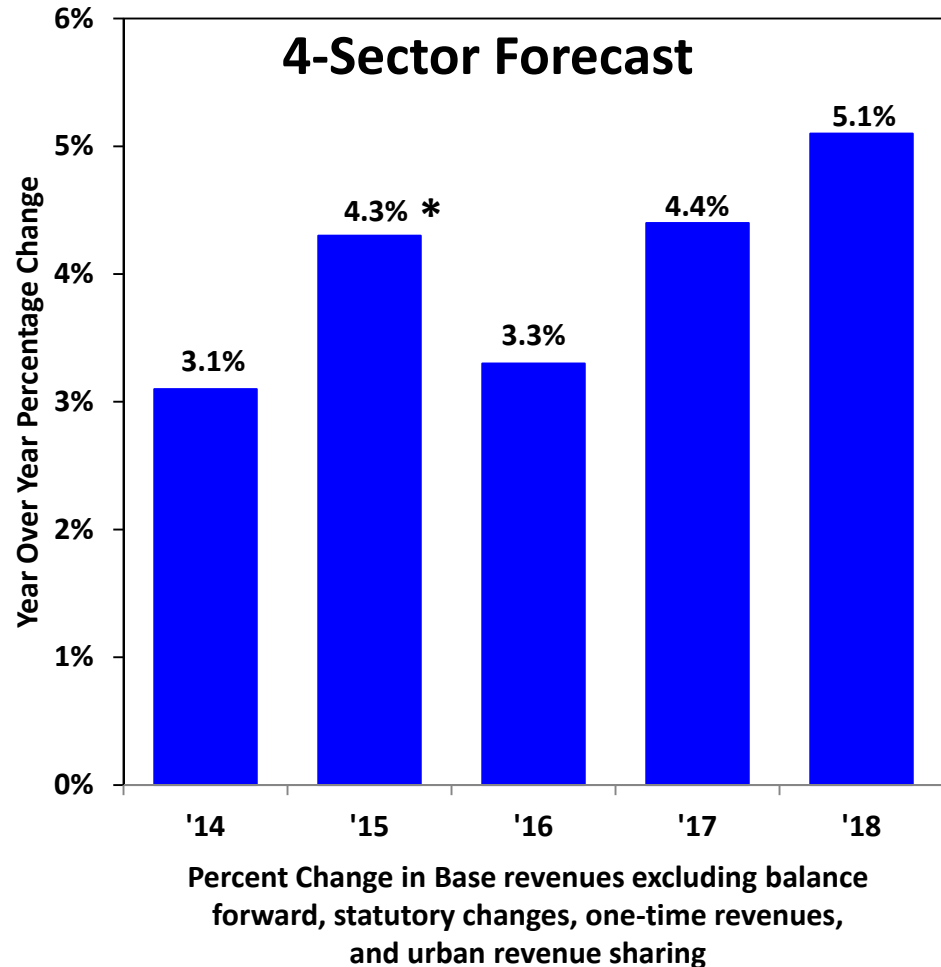
- Finance Advisory Committee
- UA base model
- UA lower model
- JLBC Staff

Chance of Exceeding Forecast

- 60%

Long Run Average Growth

- 4.75%



* Adjusted for corporate YTD collections

Tax Law Phase-In Reduces '16 Growth Rate to 1.6%

	\$ in M Above Prior Year		
	<u>'16</u>	<u>'17</u>	<u>'18</u>
Base Revenue Growth (3.3%/4.4%/5.1%)	300	413	495
Elimination of Fund Transfers	(54)	--	--
Previously Enacted Tax Legislation	(112)	(78)	(77)
Urban Revenue Sharing	<u>3</u>	<u>(10)</u>	<u>(5)</u>
Total	137	325	413
% Change	1.6 %	3.7%	4.5%

Spending Overview

Projected Baseline Spending Changes

	\$ in M Above Prior Year		
	'16	'17	'18
K-12 Formula	181	210	164
Medicaid Formula	29	121	137
DCS 1-Time Backlog	(10)	(8)	0
ADC Operating	8	0	0
Capital	(42)	0	0
HURF Shift (\$30 M to \$60 M)	0	30	0
One-Time/Other	(76)	(16)	2
Additional Spending	90	337	303
Total Spending	\$9,447	\$9,784	\$10,087
% Growth	1.0%	3.6%	3.1%
K-12 Inflation Reset	\$337	\$341	\$346
Revised Total	\$9,784	\$10,125	\$10,433

Main Caseload Assumptions

- ❑ Before “reset”, K-12 would grow by \$181 M
 - 1.6% inflation/1.4% student growth/property tax cut
- ❑ Medicaid ‘16 spending grows 1.2%
 - 2.0% caseload, 3.0% capitation, and better federal match rates
- ❑ DCS funding adjusted consistent with May 2014 plan
- ❑ ADC reflects annualized cost for opening 1,000 new beds

Projected Ending Balance Estimates

Updated '15 – '18 Ending Balance Projections

- January FAC Revenue With Projected Spending

Baseline	'15	'16	'17	'18
Balance Forward	\$577 M	--	--	--
Revenues	\$8.63 B	\$8.77 B	\$9.09 B	\$9.51 B
Spending	\$9.36 B	\$9.45 B	\$9.78 B	\$10.09 B
Ending Balance	\$(148) M	\$(678) M	\$(690) M	\$(581) M
K-12 Reset	\$332 M	\$337 M	\$341 M	\$346 M
Revised Balance	\$(480) M	\$(1.02) B	\$(1.03) B	\$(928) M

Does not include \$464 M Rainy Day Fund

The Path from a \$900 M Surplus to a Large Shortfall

- ❑ Current shortfall is not unexpected -- '15 budget projected shortfalls of \$(237) M in '16 and \$(490) M in '17
- ❑ The state had an underlying structural shortfall in past several years
- ❑ When the \$900 M 1-cent sales tax ended in '13, we replaced it with a \$900 M 1-time carryforward in '14
- ❑ Lower than expected revenue growth
- ❑ Phase-in of tax law changes enacted in '11 and '12
- ❑ K-12 inflation litigation

Suggestions to Improve Fiscal Policy

- Currently 4th Worst Credit Rating Among States

- ❑ Align ongoing revenues and spending – develop multi-year targets
- ❑ Reduce reliance on 1-time solutions over time
- ❑ Set aside 1-time revenues into a separate fund
 - Excess ending balances
 - Excess capital gains
 - Windfalls (retail gain with gas price plunge)
- ❑ Dedicate 1-time \$ for 1-time purposes
 - Rebates/Operating debt buyback/Infrastructure/IT Modernization

California Initiative Addresses Volatility

- ❑ Voter approved in November 2014
- ❑ 1.5% of annual General Fund revenue will be deposited into Rainy Day Fund
- ❑ Excess capital gains income tax collections will be deposited into the fund as well
- ❑ 50% of fund will be used to buy down state debts, including unfunded retirement and operating loans
- ❑ Rainy Day Fund capped at 10% of GF revenue; excess dedicated to infrastructure
- ❑ Emergency provisions allow deposit requirements to be suspended

Executive Comparisons

'16: How JLBC \$(678) M Shortfall Becomes Executive \$137 M Balance

<u>\$ in M</u>	
\$(678)	Baseline '16 shortfall (without K-12 litigation)
140	Lower Executive K-12 and Medicaid technical caseload
106	Higher Executive base revenues
	<u>Policy Issues</u>
62	Revenue increases
303	Fund transfers
(201)	Spending increases
388	Spending reductions
17	Other
\$137	Executive '16 Ending Balance

'16 Executive Caseloads \$(140) M Less than JLBC

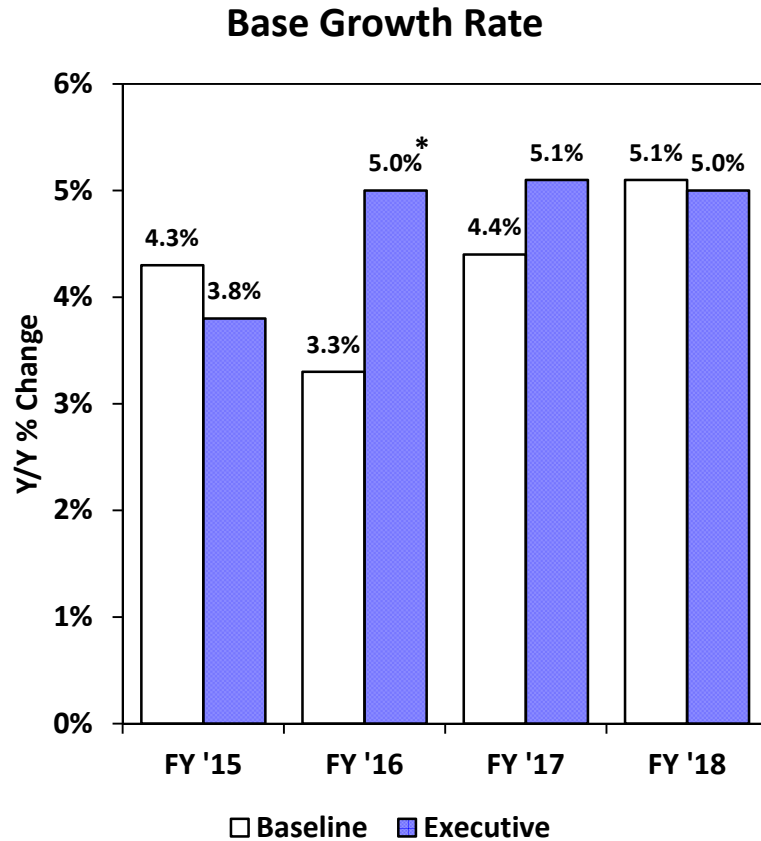
- Baseline Statutory Formula Growth

\$ in M

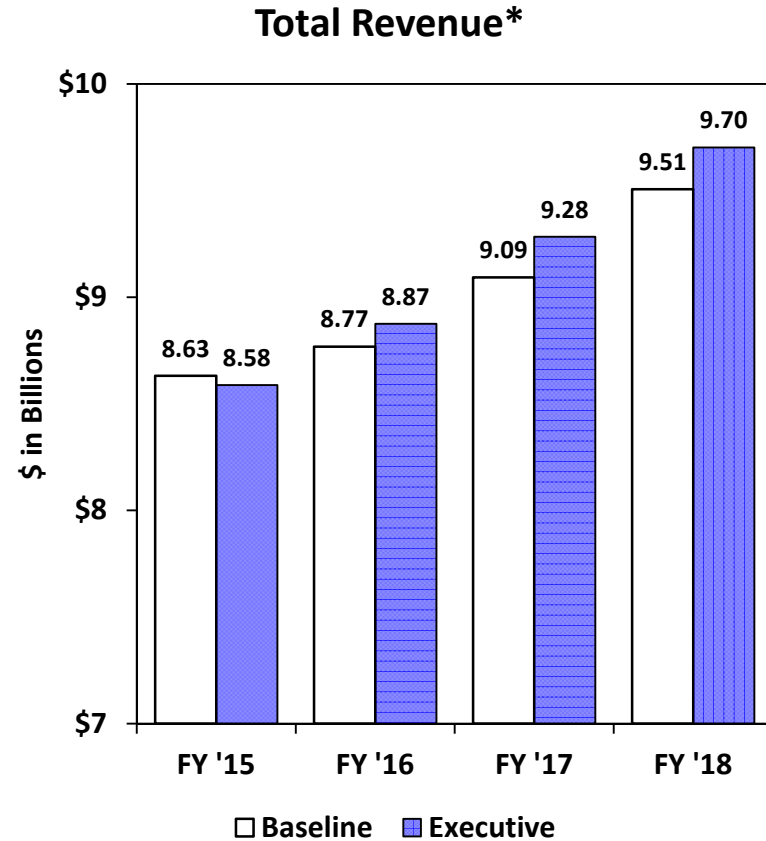
\$(96)	K-12: JLBC \$181M vs OSPB \$85 M - JLBC funds \$24 M '15 shortfall - JLBC 1.4% enrollment growth vs OSPB 0.7%
(49)	AHCCCS/DHS Medicaid: JLBC \$8 M vs OSPB \$(40) M - Both have higher capitation and federal match - JLBC 2% caseload growth; awaiting OSPB detail
5	All other
<hr/>	
\$(140)	Total

'16 Executive Revenue \$106 M Higher

- But JLBC Higher by \$54 M in '15



* 4.3% when compared to JLBC '15 base



* Excluding Balance Forward and Executive proposals



Executive Revenue Increases/Fund Transfers

<u>\$ in M</u>	<u>Revenue Increases</u>
\$33	Sales tax enhanced collections
9	Income tax fraud detection
16	Private hospital disproportionate share \$ to GF
4	Other
<hr/> 62	Subtotal
	<u>Fund Transfers</u>
90	State Employee Health
75	Commerce Authority Deal-Closing
25	Commerce Authority Job Training
20	ADOT HELP
15	ADOT Aviation
10	Registrar of Contractors
7	Parks Off-Highway Vehicle
7	AHCCCS Health Care Group
<hr/> 54	16 Other Funds
\$303	Subtotal

\$201 M in Executive Spending Increases

- Outside Standard Baseline Adjustments

<u>\$ in M</u>	
\$74	ADE – extra inflation
24	School facilities loan guarantee
28	Employer retirement increase (mostly ADC/DPS)
18	ADC – prison health
7	ADC – prison population growth
5	ADC – 1 st 1,000 of 3,000 private beds
18	DCS – service growth
10	Capital outlay emergency projects
17	Other
<u>\$201</u>	Total

\$388 M in Executive Spending Reductions

<u>\$ in M</u>	
\$124	ADE – Additional Assistance reduction
22	ADE – Eliminate performance funding
18	ADE – Freeze homeowners rebate at 44%
20	ADE – Limit state liability for 1% property tax cap
75	Universities 10% reduction
9	Community Colleges – 50% of Maricopa/Pima/Pinal
39	AHCCCS/DHS capitation freeze/reduction
15	Juvenile Corrections – local cost sharing
14	Department of Revenue – local cost sharing
30	Shift DPS Highway Patrol to higher Motor Vehicle Fee
0	Hiring freeze/consolidations – \$21 M in '17
22	Other
<u>\$388</u>	Total

Major Agency '16 Change in GF Spending

(\$ in M)

\$ Change Above '15

<u>Agency</u>	<u>JLBC Baseline</u>	<u>Executive</u>
K-12 Education	181	(24)
School Facilities Board	2	25
Universities	(3)	(78)
Community Colleges	(1)	(10)
AHCCCS	(2)	(73)
Health Services	9	(7)
Economic Security	22	23
Child Safety	(10)	5
Corrections	8	52
Juvenile Corrections	0	(16)
Public Safety	(1)	(16)

'15 – '18 Executive Budget Ending Balance Projections

Executive	'15	'16	'17	'18
Balance Forward	\$579 M	\$1 M	\$137 M	\$149 M
Revenues	\$9.16 B	\$9.23 B	\$9.31 B	\$9.70 B
Spending	\$9.28 B	\$9.09 B	\$9.30 B	\$9.55 B
Ending Balance	<i>\$(125) M</i>	<i>\$137 M</i>	<i>\$149 M</i>	<i>\$303 M</i>

- Executive uses \$126 M of \$464 M Rainy Day Fund to balance '15

Executive Structural Balance with JLBC “Technicals”

- JLBC Revenue and ADE/Medicaid Caseload

\$ in M

<u>Fiscal Year</u>	<u>Executive Nominal</u>	<u>Executive W/JLBC</u>	<u>Exec W/ JLBC & "Reset"</u>
2016	(184)	(414)	(677)
2017	4	(338)	(605)
2018	155	(180)	(452)

- ❑ Structural balance represents difference between on-going revenues and spending
- ❑ Reset reflects full funding of Superior Court ruling on K-12 inflation reset, but no back payments

'15: How JLBC's \$(148) M Shortfall Becomes Executive \$1 M Balance

<u>\$ in M</u>	
\$(148)	Baseline '15 shortfall (without K-12 litigation)
(54)	Executive lower revenues
27	Executive excludes ADE caseload supplemental
6	Executive lower Medicaid/revertments
17	Capital spending difference
	<u>Policy Issues</u>
11	Private hospital disproportionate share \$ to GF
8	April Medicaid capitation reduction
5	DES reductions
126	Rainy Day Fund transfer
3	All other
<u>\$1</u>	Executive '15 Ending Balance

Appendix A: January 2015 4-Sector Forecast

	<u>2015</u>	<u>2016</u>	<u>2017</u>	<u>2018</u>
Sales Tax				
JLBC Forecast	4.0%	4.4%	4.8%	5.0%
UA – Low	2.5%	1.1%	3.3%	5.4%
UA – Base	4.0%	4.4%	5.8%	6.6%
FAC	4.5%	4.4%	5.0%	5.2%
Average:	3.7%	3.6%	4.7%	5.6%
Individual Income Tax				
JLBC Forecast	3.6%	5.4%	5.9%	5.9%
UA – Low	1.8%	1.0%	3.0%	4.7%
UA – Base	3.0%	3.8%	5.0%	6.0%
FAC	3.7%	4.4%	5.0%	5.1%
Average:	3.0%	3.7%	4.8%	5.4%
Corporate Income Tax				
JLBC Forecast	15.0%	3.1%	3.5%	4.5%
UA – Low	(2.0)%	(6.6)%	(8.8)%	(11.7)%
UA – Base	(1.2)%	0.7%	(0.2)%	(7.2)%
FAC	2.9%	3.1%	5.1%	7.3%
Average:	3.7%	0.1%	0.2%	(0.9)%
JLBC Weighted Average	4.6%	4.7%	5.2%	5.4%
UA Low Weighted Average	1.9%	0.5%	2.5%	4.4%
UA Base Weighted Average	3.2%	3.9%	5.1%	5.7%
FAC Consensus Weighted Average	4.0%	4.3%	5.0%	5.3%
“Big-3” Weighted Average*	4.2%	3.4%	4.5%	5.2%
Consensus Weighted Average**	4.3%	3.3%	4.4%	5.1%
Adjusted Consensus Weighted Average***	3.0%	2.1%	3.6%	4.3%
* '15 Adjusted for corporate year-to-date collections				
** Represents on-going revenue adjusted for small revenue categories				
*** Represents on-going revenue adjusted for tax law changes; excludes Urban Revenue Sharing				

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