Arizona Economy and Budget

FY 2011 and FY 2012
February 8, 2012
Overview

- Economy
- Structural Deficit
- Reductions
## Population Growth

<table>
<thead>
<tr>
<th></th>
<th>2007</th>
<th>2009</th>
<th>2010</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>U.S.</strong></td>
<td>1.0%</td>
<td>0.9%</td>
<td>0.7%</td>
</tr>
<tr>
<td><strong>Arizona</strong></td>
<td>3.1%</td>
<td>-0.4%</td>
<td>0.2%</td>
</tr>
<tr>
<td></td>
<td>195,000</td>
<td>-22,712</td>
<td>14,900</td>
</tr>
</tbody>
</table>
Housing – Vacant Units

60,000 to 75,000 excess units in the system
Housing

Case Schiller 20 City Index
Index vs. Change

based on a graph from ECONOMICDATA

3.1% annualized

Cumulative Change (%)

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Housing

Case Schiller Phoenix Index

Index vs. Change

0.367% annualized
Housing – Negative Equity

Las Vegas, NV
Phoenix, AZ
Sacramento, CA
Washington-Alexandria, VA
Denver, CO
Chicago, IL
Bethesda, MD
Newark-Union, NJ-PA
St. Louis, MO-IL
Baltimore-Towson, MD
Philadelphia, PA

0.0% 10.0% 20.0% 30.0% 40.0% 50.0% 60.0% 70.0% 80.0%
# Commercial Construction

## Commercial Construction Volume
Peak to 2009

<table>
<thead>
<tr>
<th>Percent Decline</th>
<th>Office</th>
<th>Retail</th>
<th>Industrial</th>
</tr>
</thead>
<tbody>
<tr>
<td>U.S.</td>
<td>-15.4%</td>
<td>-51.4%</td>
<td>-57.5%</td>
</tr>
<tr>
<td>Greater Phoenix</td>
<td>-63.3%</td>
<td>-60.3%</td>
<td>-65.8%</td>
</tr>
</tbody>
</table>

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Commercial Space

Office Space Vacancy Rates U.S. versus Greater Phoenix
Source: CB Richard Ellis and Marcus & Millichap

![Bar chart showing office space vacancy rates from 2003 to 2010 Q3 for Greater Phoenix and National, with Greater Phoenix rates generally higher than National rates.]

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Commercial Space

Currently no multi-tenant office space under construction (2010 q3)

Back To Normal Vacancy?

- Office = 2014-2015
- Industrial = 2013-2015
- Retail = 2014-2015
Arizona
Job Loss Non-Farm Seasonally Adjusted

Number of Months After Peak Employment

Percent Change from Peak Employment

-12% -10% -8% -6% -4% -2% 0% 2% 4% 6% 8% 10% 12%

Lowpoint
Sept 2009
(296,000)

National

Current
Dec 2010 up
35,300 from
Lowpoint

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# Job Losses by Industry

August 2007 (peak) to current

<table>
<thead>
<tr>
<th>Industry</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>Construction</td>
<td>-49.6%</td>
</tr>
<tr>
<td>Manufacturing</td>
<td>-18.9%</td>
</tr>
<tr>
<td>Information</td>
<td>-14.3%</td>
</tr>
<tr>
<td>Professional and Business</td>
<td>-12.0%</td>
</tr>
<tr>
<td>Other Services</td>
<td>-11.6%</td>
</tr>
<tr>
<td>Financial Activities</td>
<td>-11.1%</td>
</tr>
<tr>
<td>Transportation, Trade &amp; Utilities</td>
<td>-7.4%</td>
</tr>
<tr>
<td>Leisure &amp; Hospitality</td>
<td>-5.8%</td>
</tr>
<tr>
<td>Government</td>
<td>-4.2%</td>
</tr>
<tr>
<td>Natural Resources</td>
<td>-2.8%</td>
</tr>
<tr>
<td>Education &amp; Health</td>
<td>13.8%</td>
</tr>
</tbody>
</table>
Job Growth 2006

Source: US BLS

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Job Growth 2007

Source: US BLS

Office of Governor Janice K. Brewer
Job Growth 2008

Source: US BLS

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Job Growth 2009

- Alaska 2
- Hawaii

Source: US BLS

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Job Growth Update: Arizona Ranked 11th
November 2010 v November 2009

Alaska 8
Hawaii 10

Jobs growing
Top 10
Jobs declining

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Overview

• Economy
• Structural Deficit
• Reductions
State Budget – Structural Deficit

General Fund Ongoing Expenditures and Revenues

- GF Expenditures
- GF Revenue
- Expenditure with ARRA & Rollover

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Revenue Losses

Between FY 2007 and FY 2010

Individual income: -35.3%
Corporate: -58.1%
Sales: -23.2%

Total Losses: -32.4%
Enrollment Growth FY 2001 to FY 2010

- Total Pop: 1,072,000 (20.2% growth)
- Corrections: 13,677 (51.1% growth)
- K-12: 199,168 (23.5% growth)
- Universities: 31,770 (34.3% growth)
- Medicaid: 778,724 (133.4% growth)
- Revenue: $285 M (4.6% growth)
## Major Budget Actions To Date

**FY 2008 – FY 2011**

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Permanent Spending Reductions</td>
<td>$2.2 B</td>
</tr>
<tr>
<td>Federal Assistance</td>
<td>$2.7 B</td>
</tr>
<tr>
<td>Revenue Increases</td>
<td>$1.2 B</td>
</tr>
<tr>
<td>Fund Transfers</td>
<td>$1.8 B</td>
</tr>
<tr>
<td>Payment Deferrals</td>
<td>$1.6 B</td>
</tr>
<tr>
<td>Rainy Day Fund</td>
<td>$0.7 B</td>
</tr>
<tr>
<td>Debt</td>
<td>$2.2 B</td>
</tr>
</tbody>
</table>
Debt

Arizona’s Constitution does not authorize the issuance of general obligation bonds:

- Sale/Leaseback of state buildings: $1 B
- Lottery bonds: $450 M
- School Construction Recapture bonds: $404 M

FY 2012 proposal

Day loan: $330 M

Annual debt service requirement will grow 61% over the next three years.
Other One-time Initiatives

Payment deferrals: $1,585 M
  K-12: $1,200 M
  Universities: $200 M
  Medicaid: $185 M

Federal stimulus: $2,700 M

Rainy day fund: $710 M

Other fund sweeps: $1,800 M
Tax Increases

Arizona has raised taxes in excess of $1 billion
## FY 2012 State Ongoing Expenditures

<table>
<thead>
<tr>
<th>Budget Unit</th>
<th>(Millions)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Education (K-12)</td>
<td>$3,620.3</td>
</tr>
<tr>
<td>Medicaid</td>
<td>2,802.9</td>
</tr>
<tr>
<td>Universities</td>
<td>855.6</td>
</tr>
<tr>
<td>Prisons</td>
<td>948.7</td>
</tr>
<tr>
<td>Debt Service</td>
<td>281.7</td>
</tr>
<tr>
<td>Other</td>
<td>1,141.0</td>
</tr>
<tr>
<td><strong>TOTAL</strong></td>
<td>$9,656.2</td>
</tr>
</tbody>
</table>

**Budget Shortfall** $1,147.1

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[Diagram showing budget distribution:]

- **Education** 37%
- **Medicaid** 29%
- **Universities** 9%
- **Corrections** 10%
- **Debt Service** 3%
- **Other** 12%
Expenditure Changes FY 2007-FY 2012*

Total GF expenditures grew .6%

*For FY 2012, projected baseline budget

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FY 2007 vs. FY 2012*

*For FY 2012, projected baseline budget

Office of Governor Janice K. Brewer
Overview

- Economy
- Structural Deficit
- Reductions
# FY 2012 Reduction Plan

## Budget Reductions

<table>
<thead>
<tr>
<th>Category</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Medicaid Reform</td>
<td>$541.5</td>
</tr>
<tr>
<td>Universities</td>
<td>$170.0</td>
</tr>
<tr>
<td>DES</td>
<td>$91.0</td>
</tr>
<tr>
<td>Medicaid Provider Rate Reduction</td>
<td>$89.0</td>
</tr>
<tr>
<td>K-12</td>
<td>$83.7</td>
</tr>
<tr>
<td>Community Colleges</td>
<td>$72.9</td>
</tr>
<tr>
<td>Convention Center Payment</td>
<td>$15.0</td>
</tr>
<tr>
<td>Juvenile Corrections</td>
<td>$7.2</td>
</tr>
<tr>
<td>Other</td>
<td>$7.2</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>$1,077.5</strong></td>
</tr>
</tbody>
</table>
K-12 Education

- Arizona per pupil support is ranked 49th in the country
- Arizona ranks 10th in K-12 enrollment per capita
- Since FY 2008:
  - Reduced per pupil expenditures by 18 percent
    - Eliminated state support for full-day kindergarten
    - Reduced equipment funds by 77%
  - Eliminated building renewal support

FY 2012 proposal - $83.7 M cut
- Phase out teacher career ladder pay
- Reduce capital expenditures
University Funding

Since FY 2008:

- Reduced per student support by 25 percent
- Average tuition increase: 53%

FY 2012 proposal - $170 million cut
- 5 percent pay reduction
- Reduce per student support an additional 22 percent
Community College Funding

Since FY 2008:

- Reduced General Fund support 19.3%

FY 2012 proposal - $72.9 M Cut

- Reduce General Fund support by an additional 52%
Health and Welfare

Since FY 2008:
- Reduced child care enrollees by 37 percent (18,000 children)
- Reduced the number of families on cash assistance by 48 percent (19,000 families)
- Reduced state benefits for the SMI population
- Provided no inflation for health care providers for the last three years – no capitation growth for the last two
Health and Welfare (cont.)

- Implementing a 5 percent reduction in provider rates on April 1, 2011, combined with other reductions provider rates in general down 10 percent
- Eliminated most non federally mandated Medicaid services
- Reduced number of children in KidsCare by 22,900

FY 2012 proposal - $91 M cut

Reducing support for Arizona’s human services agency (Department of Economic Security) an additional 12 percent
Public Safety

Since FY 2008:
- Shifted support for Highway Patrol from General Fund to transportation funds
- Eliminated more than 236 administrative positions
- Current Corrections bed deficit over 3,000 inmates (about 8 percent) – peaked at 5,486 inmates
- Due to bed deficit, limited savings in correctional reform

FY 2012 Proposal
$8 million increase to address Correctional Officer safety concerns
Prisoner Assaults on COs

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Personnel

Last pay increase was July 1, 2007 (3%)
Since that time

- Employee pay cut of 2.75%
- Mandatory furlough days equivalent to 2.25%
- Increase in retirement contribution 5.49%
- Average health premium increase 54.2%

- Headcount reduction through RIF and freeze 12.9%
- Total GF personal services costs are down 18.9%
General Government

Eliminated or reduced General Fund support for:

- Tourism
- Parks
- Environmental Quality
- Arts
- Water Resources
- Mines and Minerals
Other Issues

Unemployment Trust Fund

CY 2010 balance: -$241.5 M

Suspended Statutory Formulas: $587 M
AHCCCS Update
Arizona Health Care Cost Containment System (AHCCCS) Summary

- AHCCCS model has been documented to provide higher quality coverage at lower cost
- AHCCCS has had to administer significant reductions in response to ongoing fiscal crisis
- Arizona has implemented or is pursuing all suggestions from Secretary to Governors
- Waiver proposal promotes the objectives of Title XIX by maintaining core program for members and providers
- Waiver proposal is term limited until January 1, 2014
AHCCCS Milestones

- 1965 – Congress enacts Medicaid
- 1982 - Arizona was the last state to join Medicaid –
  - Created Arizona Health Care Cost Containment System (AHCCCS)
  - Established Mandatory Managed Care through 1115 waiver
- 2000 Voters approve Proposition 204 providing coverage up to 100% of the federal poverty limit
- 2010 – Federal Health Care Reform is enacted
Arizona Medicaid Income Eligibility

Proposition 204 sets minimum eligibility at 100% of FPL

1/ Excluding ALTCS
2/ Previously covered under a state-only program up to 40% of FPL
3/ Previously covered under a state-only program and “Federalized” at the same time as the Proposition 204 waiver.
AHCCCS Population as of July 1, 2010

1985 – 2010

144,450
456,385
508,917
318,383
1,047,982

1985
1986
1987
1988
1989
1990
1991
1992
1993
1994
1995
1996
1997
1998
1999
2000
2001
2002
2003
2004
2005
2006
2007
2008
2009
2010

1,352,908
AHCCCS Total Population

- Child 0-21: 54%
- Adult 22-64: 41%
- Adult 65+: 5%

Legend:
- Child 0-21
- Adult 22-64
- Adult 65+
Arizona/AHCCCS Overview

- 6.5 million people in state - 14th largest
- 80% of Population in Maricopa (Phoenix) and Pima (Tucson) counties
- Arizona 6th largest State in size
- All members enrolled in mandatory managed care except American Indians and Federal Emergency Services
- AHCCCS contracts with 10 plans for Acute – geographically based
- AHCCCS contracts with 9 Long Term Care plans – geographically based
- AHCCCS contracts with Department of Health Service for Behavioral Health carve-out – In turn contract out with 4 entities – geographically based
American Indians in AZ & AHCCCS

Arizona Residents
- Arizona population: 6,343,952
- 285,183 AI Arizona residents

AHCCCS Members
- AHCCCS members: 1,344,173
- 140,442 AI AHCCCS members

Arizona has 22 different tribes located throughout the State.
State conducted 12 consultations in 2010 – 2 on tribal lands.
AHCCCS Model for Medicaid Managed Care

- Member choice & Competitive Plans
  - 6 plan options in Phoenix metro (Maricopa)
  - 5 plan options in Pima County
  - 3 Long Term Care plan options (Maricopa)
  - Acute care choice statewide

- Cost Containment –
  - Overall lowest cost – *Kaiser*
  - Overall lowest pharmacy PMPM – *Part D Implementation* – *Lewin Report*
  - Gold Standard for Managed Care Purchasing – *Rockefeller Institute*
  - Arizona employs “best practice” for date of death records – *HHS OIG*
AHCCCS Model for Medicaid Managed Care

- Quality Measures – 17 of 25 quality measures are above HEDIS Medicaid Mean
- Member Satisfaction – less than 3% of members change plans annually
- Provider Participation – remains high with little change even after rate reductions
- Plan Oversight – 2 plans with membership caps in past 18 months – transparent actions on WEB – System CYE 2009 profitability <2%
Arizona Model and Health Care Reform

- Population Expansion – Childless adults – Only limited number of states cover this population to 100%
- Appropriate Payment to ensure access – Professionals 95% of Medicare – outpatient at Medicare
- Emphasize home and community services
  - Over 70% EPD – over 98% DD
- Dual Eligible Population – National leader – Members in managed care - one third members aligned in SNP – application submitted for CMMI contract
- Streamlined Eligibility – Web based Application – 30-40% of applications submitted using Health E – Arizona – Great community response
Effective Use of Home and Community Based Care

ALTCS Trend in HCBS Utilization
Health E-Arizona Applications

![Bar chart showing Health E-Arizona Applications from FY 2006 to FY 2010. The chart compares Public and Subscriber applications. The number of applications ranges from 0 to 450,000. From FY 2006 to FY 2008, the number of applications is relatively low, with FY 2009 showing a slight increase. FY 2010 has a significant increase in applications, with the majority being from Public users.](chart-image)
AHCCCS Program Integrity

- Agency created central Office of Inspector General
- IG received Medicaid Integrity Inst. Distinguished Service Award
- Even with 30% reduction in agency staff, resources dedicated to program integrity have increased
- Signed contract with Data analytics vendor
- Had 3rd lowest error rate of 17 states in national study (PERM)
- Conducted two significant date of death comparisons with minimal findings
- Developed and distributed 3 training modules to staff – plans – members and providers
- Applied for OMB Program Integrity Funding Grant
- Program Integrity Results – FY 2010
  - Cases investigated – AHCCCS – 1183
  - Total Convictions – 14
  - Total OIG Fraud Avoidance and Recoveries - $34.7 m
  - Total Prepayment Coordination of Benefits - $1,376.4 million
Arizona 2008 PERM results
AHCCCS Budget

- 3 Options for Policy Makers when dealing with AHCCCS budget reductions
  - Eligibility – Limit - Health Care Reform
  - Payment Rates – Limit–Network & Access to Care
  - Benefits – several optional services eliminated 10-1-10 –
- Each has limitations but to date all have been utilized
AHCCCS Budget changes to Date

- AHCCCS Program is $874 million less in FY 2011 as a result of policy changes (total fund)
  - $413 million in provider rate reductions
  - $241 m in institutional rate freezes
  - $121 m in eligibility reductions (KidsCare & KC parents)
  - $39 m in benefit changes
  - $29.5 m in admin reductions
  - $28 m in increased member cost sharing
- Additional 5% reduction scheduled 4-1-11 $300 m
AHCCCS Budget Cont.

- Difficult decisions have been made with the elimination of most optional services – very few left – pharmacy and HCBS
- Approval of sales tax helped program avoid additional 10% rate reduction
- Establishing annual Inpatient limit for adults on Oct 1, 2011
- Cost Sharing has been maximized at federal limits for acute
AHCCCS Staffing Levels
Secretary Sebelius Checklist

- **Benefits**
  - Eliminate Optional Benefits – Done
  - Limit Benefits – Done – IP 10-1-11
  - Cost Sharing – Done – beyond federal limits through waiver – still awaiting final SPA approval (13 months)

- **Manage Care**
  - Integrate Acute and Long Term Care – Done
  - Emphasize HCBS – Done
  - Primary Care/Medical Home – Done
  - ACA – 90% Health Home – Community 1st Choice Option - Ready
Secretary Sebelius Checklist

- Pharmacy
  - Reduce Spend – Done - # 1 in Country

- Program Integrity
  - Ongoing – Analytics – Increased resources – PERM results – OIG recognition – date of death –Grant request OMB

- Duals Eligible Members
  - National Leader with aligned managed care model and applied for CMMI contract authority

Executive Budget makes painful reductions throughout State Government but still $500 million short in FY 2012– Now What??
1115 Waiver Proposal

- In 2000, voters expanded Medicaid coverage to all residents at or below 100 percent of the federal poverty limit – Proposition 204
- FY 2012 General Fund support for the expansion population is estimated to be $810 million
- The Executive recommends limiting Prop. 204 costs to dedicated tobacco settlement and tobacco tax revenues
- Would be time limited until January 1, 2014
1115 Waiver Proposal

- Arizona requests a waiver from the Maintenance of eligibility requirements
  - Eliminating coverage for childless adults and medical expense deduction category (250,000)
  - Capping TANF parents at a level that can be sustained (30,000 parents lose coverage – approx 90,000 maintain)
  - Continuing coverage for 30,000 Aged, Blind and Disabled
- The State is requesting a waiver from the Transitional Medical Assistance requirements for those categorically eligible that would lose coverage
- FY 2012 General Fund savings are estimated at $541.5 million ($1.1 billion in federal match)
- FY 2013 proposal would generate almost $1.0 billion GF savings
1115 Waiver Proposal

Section 1115 Waiver – Promoting the objectives of Title XIX - focus on maintaining “core” Medicaid Program

- Preserve core provider network – cannot keep reducing provider rates – >25% additional reduction in FY 2012 to generate same dollars as waiver proposal
- Allows Arizona to Preserve coverage for traditional Medicaid groups – children – elderly - disabled
- Preserve remaining benefits
- Preserve core plan and administrative infrastructure
- Maintain federal/state partnership and flexibility that are core principles of Medicaid program
- Establishes Eligibility levels similar to other states
Mitigation Proposal

The Executive recommends two steps to mitigate the impact of the change in eligibility:

- Create a $151.0 million uncompensated care pool ($50.0 million GF, $101.0 million matching funds)
- Allocated to Arizona healthcare providers for uncompensated care. (hospitals – clinics – emergency transportation)
- Funds will be available to reimburse healthcare providers for continuing care for the most seriously ill.
- Majority would be allocated to hospitals but other providers could qualify
Mitigation Proposal

Seriously Mentally Ill
- Provide $10.3 million state only to DHS to fund prescription drug coverage
- 5,200 SMIs are in childless adult category
- Agency working with DHS and expects to reclassify >80% of SMIs into different category.

Children
- Currently 11,000 kids in adult category due to family unit budgeting
- Looking at a SPA change to have kids made eligible for SOBRA category
Proposition 204 Language

- Ballot language stated
  - “A ‘yes’ vote shall have the effect of providing funding for …increasing healthcare coverage eligibility…using tobacco litigation settlement money”
  - “A ‘no’ vote shall have the effect of not requiring appropriation of tobacco settlement money to support these programs.
- The ballot language also directed that the Tobacco Settlement monies shall be “supplemented, as necessary, by any other available sources and federal monies”
- Legislature has authority based on no available sources and case law is supportive of this position
- Ultimately State Supreme Court would decide if litigated
Provider Tax Status

- Hospitals have been discussing provider tax for 2+ years
- 1% of revenues equals approximately $100m
- Proposal would be for $300 m tax
- Would want $100 m for rate increases
- Requires two-thirds vote from legislature
- Proposal currently insufficient
- Still significant details to work through
- Proposal is for 1 year Assessment
Summary

- AHCCCS model has been documented to provide higher quality coverage at lower cost
- AHCCCS has had to administer significant reductions in response to fiscal crisis
- Arizona has implemented or is pursuing all suggestions from Secretary to Governors
- Waiver proposal promotes the objectives of Title XIX by maintaining core program for members and providers
- Waiver proposal is term limited until January 1, 2014