

## K-12 Inflation Funding Lawsuit Update

*NOTE: Since publication of this document on July 11, 2014, the JLBC Staff has published updated revenue estimates. The cost estimates of the litigation itself (see table 1), however, remain unchanged. Please see the [July Monthly Fiscal Highlights](#) for an update on how the updated revenue estimates plus these K-12 litigation costs would affect the state's fiscal condition.*

The Maricopa Superior Court ruled on July 11, 2014 that the state is required to reset the K-12 base level as if it had been fully inflated every year. This JLBC Staff Report outlines the fiscal implications of this ruling.

### Background

In *Cave Creek v. Ducey*, the Arizona Supreme Court ruled in September 2013 that under Proposition 301 (from November 2000) the state must adjust the K-12 “base level” annually for inflation. The base level serves as the starting point for computing formula funding for Arizona public schools and for FY 2014 equaled \$3,327 per pupil (A.R.S. § 15-901B2). If always inflated under Proposition 301, it instead would equal \$3,560 per pupil for FY 2014, or \$233 more per pupil. In its September 2013 ruling, the Arizona Supreme Court sent the case back to Maricopa Superior Court to determine the state’s financial commitment for base level inflation adjustments not made in recent years. In such years, the state inflated the transportation and charter school “additional assistance” portions of the K-12 formula, but did not also inflate the base level.

The plaintiffs are seeking funding for 2 issues:

- 1) an increase in the base level to \$3,560 per pupil prior to any additional inflation adjustment being made for FY 2015, and
- 2) \$1.26 billion in back payments for unfunded inflation since FY 2009 to be paid out over 5 years starting in FY 2015.

In July 2014, the [Maricopa Court Superior Court concurred](#) with the plaintiff’s first request and ordered that the FY 2015 base level be adjusted using the \$3,560 per pupil amount as the starting point. The Court did not rule on the second request and instead ordered an evidentiary hearing to further consider the issue of back payments.

### Cost Impact of Litigation

Table 1 below shows that the \$3,560 base level “reset” would cost approximately \$317 million in FY 2015. The “back payments” would cost another \$253 million. The 5-year cumulative cost of the reset and back payments would be approximately \$2.9 billion.

<b>Table 1</b>			
<b>Plaintiff Proposal on K-12 Inflation Lawsuit</b>			
<b>\$ in Millions</b>			
<b><u>Fiscal Year</u></b>	<b><u>Base Level Increase</u></b>	<b><u>Back Payments</u></b>	<b><u>Total</u></b>
2015	\$ 316.8	\$ 252.6	\$ 569.4
2016	320.6	252.6	573.2
2017	324.8	252.6	577.4
2018	329.4	252.6	581.9
2019	334.3	252.6	586.9
5-year total	1,625.9	1,263.0	2,888.9

## Balance Sheet Impact

FY 2015 At the conclusion of the Department of Child Safety Special Session, the state had a projected FY 2015 General Fund ending balance of \$130 million. That estimate was based on the enacted budget's use of the January Finance Advisory Committee (FAC) forecast. In the last several months, however, General Fund revenue collections have lagged that forecast. Through the end of May, General Fund revenues are \$(55) million below the January projection. Given these results, the JLBC Staff has been measuring the Special Session action against the more conservative April FAC forecast. In that circumstance, the FY 2015 projected ending balance is \$96 million.

If the July 11 Superior Court "base level reset" ruling stands, the FY 2015 balance would become a shortfall of between \$(187) million and \$(220) million. The range depends on the use of the January versus April FAC forecast.

If the Court were ultimately to concur with the plaintiff's back payment proposal, the FY 2015 shortfall would further increase to a range of \$(440) million to \$(473) million. *See Table 2.*

FY 2016 Even without the K-12 litigation, the FY 2016 budget is already projected to have a shortfall due to the significant reduction in the large beginning balances that have helped balance the books since the elimination of the temporary 1 cent sales tax. At the end of the Special Session, the forecasted FY 2016 shortfall was \$(237) million to \$(295) million, depending on the January versus April forecast.

With the second year of "reset" funding under the court ruling, the FY 2016 shortfall range would be between \$(874) million and \$(932) million.

A second year of back payments would then further increase the shortfall to \$(1.4) billion.

Each of the FY 2016 estimates assumes that the FY 2015 shortfall is rolled forward into FY 2016. *See Tables 3 and 4.* If the FY 2015 shortfall were eliminated through permanent adjustments, the FY 2016 shortfall would be reduced by a corresponding amount.

Budget Stabilization Fund The ending balance estimates do not include the projected \$459 million in the Budget Stabilization Fund. In comparison, the combined FY 2015 and 2016 "reset only shortfall" is \$(874) million to \$(932) million.

<b>Statement of General Fund Revenues and Expenditures</b>				
<b>\$ in Millions</b>				
	<b>FY 2015</b>		<b>FY 2016</b>	
	<b>Jan FAC</b>	<b>Apr FAC</b>	<b>Jan FAC</b>	<b>Apr FAC</b>
Child Safety Special Session	\$129.5	\$96.4	\$(236.8)	\$(294.6)
K-12 Litigation - Reset Only	\$(187.3)	\$(220.5)	\$(874.2)	\$(932.1)
K-12 Litigation - Reset and Back Payments	\$(439.9)	\$(473.1)	\$(1,379.4)	\$(1,437.3)

**Table 3**  
**JANUARY FAC**

**STATEMENT OF GENERAL FUND REVENUES AND EXPENDITURES 1/  
WITH ONE-TIME FINANCING SOURCES**

	<b>FY 2014 Enacted</b>	<b>FY 2015 Enacted</b>	<b>FY 2016 Estimate</b>	<b>FY 2017 Estimate</b>
<b>REVENUES</b>				
Ongoing Revenues	\$8,993,809,900	\$9,470,966,700	\$9,842,375,900	\$10,257,757,800
Previously Enacted Changes		(127,300,000)	(115,600,000)	(108,700,000)
Newly Enacted Changes		18,638,000	(12,652,900)	(508,100)
Urban Revenue Sharing	(561,001,200)	(608,935,700)	(620,454,200)	(651,407,600)
Net Ongoing Revenues	\$8,432,808,700	\$8,753,369,000	\$9,093,668,800	\$9,497,142,100
One-time Financing Sources				
Balance Forward	895,475,000	595,520,600	(187,309,100)	(874,232,100)
Previously Enacted Changes	(24,800,000)	(1,800,000)		
Newly Enacted Changes			(6,100,000)	
Fund Transfers	153,591,600	53,900,000		
Subtotal One-time Revenues	\$1,024,266,600	\$647,620,600	(\$193,409,100)	(\$874,232,100)
<b>Total Revenues</b>	<b>\$9,457,075,300</b>	<b>\$9,400,989,600</b>	<b>\$8,900,259,700</b>	<b>\$8,622,910,000</b>
<b>EXPENDITURES</b>				
Operating Budget Appropriations	\$8,816,495,400	\$9,311,780,500	\$9,493,852,100	\$9,789,667,500
<b>K-12 Litigation (reset only)</b>		<b>316,837,500</b>	<b>320,639,700</b>	<b>324,808,100</b>
FY 2014 Supplementals	2,736,300			
Administrative Adjustments	62,980,200	51,480,700	60,000,000	60,000,000
Reversions	(70,600,000)	(116,000,000)	(100,000,000)	(100,000,000)
Subtotal Ongoing Expenditures	\$8,811,611,900	\$9,564,098,700	\$9,774,491,800	\$10,074,475,600
One-time Expenditures				
Capital Outlay	\$49,942,800	\$24,200,000		
Subtotal One-time Expenditures	\$49,942,800	\$24,200,000	\$0	\$0
<b>Total Expenditures</b>	<b>\$8,861,554,700</b>	<b>\$9,588,298,700</b>	<b>\$9,774,491,800</b>	<b>\$10,074,475,600</b>
<b>Ending Balance 2/</b>	<b>\$595,520,600</b>	<b>(\$187,309,100)</b>	<b>(\$874,232,100)</b>	<b>(\$1,451,565,600)</b>
<i>Structural Balance 3/</i>	<i>(\$378,803,200)</i>	<i>(\$810,729,700)</i>	<i>(\$680,823,000)</i>	<i>(\$577,333,500)</i>

1/ Significant one-time revenues and expenditures are separately detailed so as to permit the calculation of ongoing revenue and expenditures.

2/ This calculation reflects the difference between total revenues and total expenditures. Excludes any Budget Stabilization Fund balance.

3/ This calculation reflects the difference between ongoing revenues and expenditures and excludes one-time adjustments. Excludes any Budget Stabilization Fund balance.

**Table 4**  
**APRIL FAC**

**STATEMENT OF GENERAL FUND REVENUES AND EXPENDITURES 1/  
WITH ONE-TIME FINANCING SOURCES**

	<b>FY 2014 Enacted</b>	<b>FY 2015 Enacted</b>	<b>FY 2016 Estimate</b>	<b>FY 2017 Estimate</b>
<b>REVENUES</b>				
Ongoing Revenues	\$8,993,809,900	\$9,437,791,700	\$9,817,691,200	\$10,227,336,800
Previously Enacted Changes		(127,300,000)	(115,600,000)	(108,700,000)
Newly Enacted Changes		18,638,000	(12,652,900)	(508,100)
Urban Revenue Sharing	(561,001,200)	(608,935,700)	(620,454,200)	(632,312,600)
Net Ongoing Revenues	\$8,432,808,700	\$8,720,194,000	\$9,068,984,100	\$9,485,816,100
One-time Financing Sources				
Balance Forward	895,475,000	595,520,600	(220,484,100)	(932,091,800)
Previously Enacted Changes	(24,800,000)	(1,800,000)		
Newly Enacted Changes			(6,100,000)	
Fund Transfers	153,591,600	53,900,000		
Subtotal One-time Revenues	\$1,024,266,600	\$647,620,600	(\$226,584,100)	(\$932,091,800)
<b>Total Revenues</b>	<b>\$9,457,075,300</b>	<b>\$9,367,814,600</b>	<b>\$8,842,400,000</b>	<b>\$8,553,724,300</b>
<b>EXPENDITURES</b>				
Operating Budget Appropriations	\$8,816,495,400	\$9,311,780,500	\$9,493,852,100	\$9,789,667,500
<b>K-12 Litigation (reset only)</b>		<b>316,837,500</b>	<b>320,639,700</b>	<b>324,808,100</b>
FY 2014 Supplementals	2,736,300			
Administrative Adjustments	62,980,200	51,480,700	60,000,000	60,000,000
Reversions	(70,600,000)	(116,000,000)	(100,000,000)	(100,000,000)
Subtotal Ongoing Expenditures	\$8,811,611,900	\$9,564,098,700	\$9,774,491,800	\$10,074,475,600
One-time Expenditures				
Capital Outlay	\$49,942,800	\$24,200,000		
Subtotal One-time Expenditures	\$49,942,800	\$24,200,000	\$0	\$0
<b>Total Expenditures</b>	<b>\$8,861,554,700</b>	<b>\$9,588,298,700</b>	<b>\$9,774,491,800</b>	<b>\$10,074,475,600</b>
<b>Ending Balance 2/</b>	<b>\$595,520,600</b>	<b>(\$220,484,100)</b>	<b>(\$932,091,800)</b>	<b>(\$1,520,751,300)</b>
<i>Structural Balance 3/</i>	<i>(\$378,803,200)</i>	<i>(\$843,904,700)</i>	<i>(\$705,507,700)</i>	<i>(\$588,659,500)</i>

1/ Significant one-time revenues and expenditures are separately detailed so as to permit the calculation of ongoing revenue and expenditures.

2/ This calculation reflects the difference between total revenues and total expenditures. Excludes any Budget Stabilization Fund balance.

3/ This calculation reflects the difference between ongoing revenues and expenditures and excludes one-time adjustments. Excludes any Budget Stabilization Fund balance.