

ARIZONA

MONTHLY FISCAL HIGHLIGHTS

September 2006

August General Fund revenue collections were \$704.9 million, or 7.1% above August 2005. This amount was \$(3.6) million below the forecast for the month. The forecast comparison is based on projected FY 2007 revenues from the enacted budget. For the fiscal year-to-date, collections are \$(5.8) million below the forecast.

Of the major tax categories, August sales tax grew at a rate of 5.8%, and individual income collections increased 7.5%. While exhibiting good rates of growth, both categories increased more slowly than last year. Along with the lower growth of last month, the August figures provide further evidence that there may be a slowdown in FY 2007 collections. Additional months of data are needed, however, to see if this lower rate of growth is a trend.

In other fiscal news this month, the Finance Advisory Committee (FAC) met on September 14th (page 5). The FAC is a panel of 16 leading economists that advises the Legislature 3 times a year on the state's economy. The FAC generally had a cautious outlook for the economy, and expected lower state revenue growth than in recent years. Based on the FAC's input and 3 other models, the largest revenue categories are forecasted to grow 8.0% in FY 2007 and 4.4% in FY 2008.

The JLBC and the JCCR met on September 21st (pages 5 – 6). Highlights included:

- The JLBC favorably reviewed the Arizona Board of Regents report on FY 2007 tuition revenues. Of the \$77 million estimated increase in collections, the Universities plan to allocate \$31 million for financial aid.
- The JLBC unfavorably reviewed the Arizona Department of Transportation's report on their decision to reduce funding for Motor Vehicle Division counter clerks. At least in part, this funding has been used to generate a larger surplus of license plates and tabs. The Committee requested more information on the need for a larger plate surplus along with more details on up to \$3.75 million in unexplained shifts.
- The JCCR heard a report from ADOT on its 5-year highway construction plan. Over the next 5 years, ADOT expects to spend a total of \$5.8 billion on projects. (See page 6 for a list of the largest items.)

The September Monthly Fiscal Highlights includes a summary of recent statutory reports submitted to JLBC, including the Department of Environmental Quality's WQARF Program (page 7), Homeland Security funding (page 8), and State Trust Land sales (page 8). The Highlights also include a summary of a University of Arizona report on the state's 30-year economic outlook (page 10). According to the report, Arizona's population could be as high as 14.6 million in 2036, and the state could be 1 of the 5 most populous. Over the course of 30 years, 3.7 million jobs could be created, with the largest growth occurring in the professional and business, healthcare and social assistance sectors.

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State of Arizona

General Fund Revenue: Change from Previous Year and June Forecast

August 2006

	Current Month					FY 2007 YTD (Two Months)				
	Actual	Change From		Revised Forecast		Actual	Change from		Revised Forecast	
	August 2006	August 2005		Amount	Percent	August 2006	August 2005		Amount	Percent
		Amount	Percent	Amount	Percent		Amount	Percent	Amount	Percent
Taxes										
Sales and Use	353,466,457	\$19,261,555	5.8 %	(\$6,927,543)	(1.9) %	\$743,926,688	\$62,100,457	9.1 %	\$4,777,188	0.6 %
Income - Individual	283,590,385	19,890,386	7.5	(4,407,215)	(1.5)	516,472,978	28,819,790	5.9	(14,787,922)	(2.8)
- Corporate	32,017,766	8,587,994	36.7	(804,034)	(2.4)	71,051,008	12,343,211	21.0	(2,042,492)	(2.8)
Property	89,436	7,761	9.5	(510,564)	(85.1)	391,754	24,351	6.6	(508,246)	(56.5)
Luxury	5,718,058	580,875	11.3	93,058	1.7	10,766,682	506,800	4.9	(483,318)	(4.3)
Insurance Premium	50,207,660	6,567,995	15.1	1,807,660	3.7	82,603,612	3,022,119	3.8	2,203,612	2.7
Estate	28,307	(6,754,641)	(99.6)	(71,693)	(71.7)	104,714	(7,503,732)	(98.6)	(95,286)	(47.6)
Other Taxes	46,087	(2,896)	(5.9)	(19,038)	(29.2)	114,047	2,565	2.3	(16,203)	(12.4)
Sub-Total Taxes	\$725,164,156	\$48,139,029	7.1 %	(\$10,839,369)	(1.5) %	\$1,425,431,483	\$99,315,561	7.5 %	(\$10,952,667)	(0.8) %
Other Revenue										
Lottery	3,372,900	906,700	36.8	(127,100)	(3.6)	3,372,900	906,700	36.8	(127,100)	(3.6)
License, Fees and Permits	5,451,046	2,549,754	87.9	2,095,246	62.4	7,457,941	2,748,376	58.4	1,551,941	26.3
Interest	10,836,057	6,629,214	157.6	5,336,057	97.0	10,703,611	6,772,671	172.3	5,603,611	109.9
Sales and Services	3,711,237	(2,035,808)	(35.4)	(581,563)	(13.5)	5,570,716	(1,691,748)	(23.3)	(1,177,084)	(17.4)
Other Miscellaneous	2,219,214	1,062,275	91.8	1,158,714	109.3	3,400,360	1,237,413	57.2	1,487,760	77.8
Disproportionate Share	0	0	--	0	--	0	0	--	0	--
Transfers and Reimbursements	37,862	(167,128)	(81.5)	(662,138)	(94.6)	196,483	(129,037)	(39.6)	(2,203,517)	(91.8)
Sub-Total Other Revenue	25,628,316	8,945,007	53.6 %	7,219,216	39.2 %	30,702,011	9,844,375	47.2 %	5,135,611	20.1 %
TOTAL BASE REVENUE	\$750,792,472	\$57,084,036	8.2 %	(\$3,620,153)	(0.5) %	\$1,456,133,494	\$109,159,936	8.1 %	(\$5,817,056)	(0.4) %
One-Time Revenue										
Urban Revenue Sharing	(45,935,888)	(10,500,144)	29.6	0	0.0	(91,871,776)	(21,000,288)	29.6	0	0.0
'05 Budget Balancing Transfers	0	0	--	0	--	0	0	--	0	--
'07 Disproportionate Share	0	0	--	0	--	0	0	--	0	--
'06 In-Lieu Transfer	0	0	--	0	--	0	0	--	0	--
Sub-Total Transfers In	(45,935,888)	(10,500,144)	29.6 %	0	0.0 %	(91,871,776)	(21,000,288)	29.6 %	0	0.0 %
TOTAL REVENUE	\$704,856,584	\$46,583,892	7.1 %	(\$3,620,153)	(0.5) %	\$1,364,261,718	\$88,159,648	6.9 %	(\$5,817,056)	(0.4) %

AUGUST REVENUES

Sales Tax collections were \$353.5 million in August, which was 5.8% above August of last year. The following table displays the August and year-to-date growth rates for the major categories:

Table 2**Sales Tax Growth Rates**

	<u>August</u>	<u>Year-to-Date</u>
Retail	2.8%	4.8%
Contracting	15.3%	18.8%
Utilities	3.8%	8.5%
Use	(4.5)%	7.8%
Restaurant & Bar	7.6%	8.2%

Collections for almost all the major sales tax categories continued to grow at a slower pace in August, while use tax collections actually declined from last year. The lower level of collections likely reflects a slowing real estate market as well as decreasing energy prices. For the month, revenues were \$(6.9) million below the forecast.

Individual Income Tax collections were \$283.6 million in August, or 7.5% above last year. The following table displays the August and year-to-date growth rates for the individual income tax categories:

Table 3**Individual Income Tax Growth Rates**

	<u>August</u>	<u>Year-to-Date</u>
Withholding	9.5%	7.6%
Estimated + Final Payments	(8.9)%	0.6%
Refunds	13.1%	26.8%

At a rate of growth of 9.5%, the August increase in withholding was greater than July, but still below FY 2006 levels of growth. While withholding collections were slightly above forecast for the month, estimated and final tax payments decreased from last year, and refunds for the month were again higher than anticipated. Total revenues, therefore, were \$(4.4) million below the forecast for the month.

Corporate Income Tax collections were \$32.0 million in August, or 36.7% above last year. While this is a significant increase, August accounts for only a small portion of overall collections.

RECENT ECONOMIC INDICATORS

The latest estimate from the Bureau of Economic Analysis (BEA) indicated that **U.S. Gross Domestic Product (GDP)** increased at a 2.9% annual pace in 2006's 2nd quarter, which was stronger than the 2.5% rate previously reported. BEA also reported that corporate profits increased 20.5% from a year ago, following a 12.5% increase for all of 2005.

Meanwhile, **U.S. semiconductor billings** (3-month moving average) jumped 4.1% in July to \$3.69 billion, a 17.7% increase from a year ago. The gains were based on rapid growth in unit volume while product prices continued to decline. The Semiconductor Industry Association noted that average personal computer prices fell by 7% on a year-over-year basis and that computer products represent more than 40% of the demand for semiconductors.

The **U.S. Index of Leading Economic Indicators** decreased (0.2)% in August, the 4th decline in the last 5 months. Just 3 of the 10 components increased in August: stock prices, manufacturers' new orders, and the money supply.

Consumer sentiment was among the negative factors influencing the economy. The Conference Board's **U.S. Consumer Confidence Index** dropped (6.9)% in August to its lowest level in 2006. Consumers' assessment of current conditions dimmed significantly, while their assessment of the labor market and the outlook for the next 6 months also were negative factors.

The 3-month moving average for the **U.S. Consumer Price Index (CPI)** advanced 0.2% in August and was 4.1% higher on a year-over-year basis. Energy prices moderated after surging for several months, but food prices accelerated slightly. Excluding food and fuel costs, the core CPI increased 0.2% in August and stood 2.8% higher than a year ago.

Arizona's total **non-farm employment** surged in August, with much of the gain attributable to seasonal factors. With the beginning of the school year, local government education generated more than 24,000 of the 36,900 jobs added from July to August. Overall, 115,900 jobs were created since August 2005, a 4.6% increase. While services and government accounted for most of the new jobs, each of the goods-producing sectors – construction, manufacturing and mining – posted increases. The seasonally adjusted statewide

Table 4

**General Fund Revenues
Compared to Enacted Forecast and FY 2006 Collections**
(\$ in Millions)

	<u>FY 2007 Collections</u>	<u>Difference From Forecast ^{1/}</u>	<u>Difference From FY 2006</u>
August	\$ 704.9	\$ (3.6)	\$ 46.6
Year-to-Date	\$ 1,364.3	\$ (5.8)	\$ 88.2

^{1/} Enacted FY 2007 budget (June 2006)

unemployment rate plunged to 3.6% in August and was well below the 4.7% U.S. average. However, it is too soon to tell whether the August estimate was a statistical aberration.

The **Arizona Business Conditions Index (BCI)** climbed 11.2% to 60.5 in August and stood well above the mark of 50 associated with an expanding economy. While most of the improvement in the index was produced by the purchases component, new orders also posted an increase. Although the price component fell, it remained relatively high at 72.7, which suggested continued upward pressure on materials costs.

The August BCI report contrasted with the 4th quarter 2006 **Arizona Business Leaders Confidence Index**. The latest survey of state business executives yielded a reading of 48.1, down (3.0)% from the 3rd quarter. It remained close to the neutral point of 50 but reflected ongoing concern about the housing market, inflation, and the national outlook.

Arizona personal income reached an annualized total of \$194.3 billion in 2006's 2nd quarter, an increase of 2.0% from the 1st quarter. The state's 9.8% year-over-year increase ranked 1st in the nation.

The Real Estate Center at Arizona State University reported that the Greater Phoenix **single-family median resale home price** was \$262,500 in August, a (0.9)% decrease from July and a 1.5% increase from a year ago. The **townhouse-condominium median price** dropped (5.0)% to \$170,000 in August but remained 6.9% higher than a year ago. Although the number of existing single-family homes sold increased slightly from the prior month, it was (46.9)% less than the number sold in August 2005. The number of multi-family units sold in August was down (44.3)% from a year ago.

New home construction also was slowing statewide in response to the softer housing market. The number of **single-family residential building permits** issued (3-month moving average) declined (7.7)% in July and was (24.5)% below the number issued a year ago. Although the number of **multi-family housing units authorized** increased on a year-over-year basis, it was trending downward in recent months.

The **Department of Corrections' inmate population** increased by an average of 186 inmates per month from June through August. The total population increased by 2,166 inmates from a year ago.

Table 5

RECENT ECONOMIC INDICATORS

<u>Indicator</u>	<u>Time Period</u>	<u>Current Value</u>	<u>Change From Prior Period</u>	<u>Change From Prior Year</u>
Arizona				
- Unemployment Rate	August	3.6%	(1.1)%	(1.2)%
- Jobs	August	2.62 million	1.4%	4.6%
- Contracting Tax Receipts (3-month average)	Jun-Aug	\$82.6 million	7.8%	20.9%
- Retail Sales Tax Receipts (3-month average)	Jun-Aug	\$164.6 million	(1.3)%	7.2%
- Residential Building Permits - (3-month moving average)				
Single-unit	May-Jul	5,427	(7.7)%	(24.5)%
Multi-unit	May-Jul	967	(8.4)%	36.6%
- Greater Phoenix Existing Home Sales				
Single-Family	August	5,685	2.5%	(46.9)%
Townhouse/Condominium	August	1,100	(2.2)%	(44.3)%
- Greater Phoenix Median Home Sales Price				
Single-Family	August	\$262,500	(0.9)%	1.5%
Townhouse/Condominium	August	\$170,000	(5.0)%	6.9%
- Arizona Tourism Barometer	June	106.9	3.0%	4.9%
- Phoenix Sky Harbor Air Passengers	June	3.61 million	1.0%	1.1%
- Arizona Average Natural Gas Price (\$ per thousand cubic feet)	June	\$6.74	(3.3)%	4.3%
- Leading Indicators Index	July	117.9	(0.3)%	(1.1)%
- Business Conditions Index (>50 signifies expansion)	August	60.5	11.2%	(4.8)%
- Consumer Confidence Index	3 rd Quarter 2006	102.7	0.3%	2.4%
- Business Leaders Confidence Index	4 th Quarter 2006	48.1	(3.0)%	(12.1)%
- Arizona Personal Income	2 nd Quarter 2006	\$194.3 billion	2.0%	9.8%
- Arizona Population	July 1, 2005	5.94 million	3.5%	3.5%
- AHCCCS Recipients	September	1,027,471	(0.4)%	(2.2)%
- TANF Recipients	July	85,768	(0.1)%	(13.2)%
- DOC Inmate Growth (3-month average)	Jun-Aug	34,974	186 inmates	2,166 inmates
United States				
- Gross Domestic Product (seasonally adjusted annual growth rate)	2 nd Quarter 2006	\$11.4 trillion	2.9%	3.6%
- Consumer Confidence Index	August	99.6	(6.9)%	5.6%
- Leading Indicators Index	August	137.6	(0.2)%	0.4%
- U.S. Semiconductor Billings (3-month moving average)	May-Jul	\$3.69 billion	4.1%	17.7%
- Consumer Price Index (3-month moving average)	Jun-Aug	203.4	0.2%	4.1%

The number of TANF recipients decreased (0.1)% to 85,768 in July and was (13.2)% below the level from July 2005. The **AHCCCS caseload** decreased (0.4)% in September from the prior month and was (2.2)% below the level from a year ago.

FINANCE ADVISORY COMMITTEE MEETING

At its September 14th meeting, the Finance Advisory Committee (FAC) heard presentations on General Fund revenue collections, the U.S. economy, and Arizona's real estate market. The FAC is a 16 member panel comprised of leading economists in the state. The panel meets 3 times a year and advises the Legislature on the state economy.

The Committee discussed the strong Arizona economy, the real estate market and corporate profitability as factors contributing to a sharp increase in FY 2006 General Fund collections. However, the Committee expressed concern that a slowing national economy, flagging consumer expenditures, inflation, and a cooling Arizona housing market could reduce FY 2007 revenue growth rates to historical levels. Although the Committee agreed that economic signals were less positive than in recent years, they did not come to a consensus on the probability, timing or extent of an economic slowdown.

The FAC panel members were also asked to provide their FY 2007 – FY 2010 forecasts for the 3 largest revenue categories: sales, individual income and corporate income taxes. The FAC is one of the 4 inputs into the JLBC Staff's 4-sector consensus forecast. The other 3 inputs are:

- The University of Arizona Economic and Business Research (EBR) General Fund baseline model;
- The EBR conservative forecast model; and
- JLBC Staff projections.

Based on the 4-sector consensus, the "Big 3" revenues are forecasted to grow 8% in FY 2007 and 4.4% in FY 2008 (see Table 6). The FAC input alone predicted "Big 3" revenue growth rates of 10.9% in FY 2007 and 6.9% in FY 2008, which are higher than the 4-sector consensus. The 4-sector consensus is lower due to the EBR's cautious baseline and conservative forecast models, with the latter model anticipating a recessionary scenario in FY 2008.

JLBC MEETING

At its September 21st meeting, the Joint Legislative Budget Committee considered the following issues:

Department of Transportation – Review of Motor Vehicle Division Counter Clerk Funding Shift Report – The Committee gave an unfavorable review to the Department of Transportation's (ADOT) Motor Vehicle Division (MVD) Counter Clerk Funding Shift Report. Customer wait times at MVD offices statewide have increased from 14.2 minutes in FY 2003 to 27.8 minutes in FY 2006 while the number of clerks staffing MVD offices has declined. ADOT explained that funding was shifted from clerk salaries in order to create a 7 to 9 month supply of license plates. The Committee sought more information from ADOT to 1) understand the need for a license plate supply of that magnitude; and 2) a more complete description of the overall funding shift, as the license plate supply issue explains only \$2 million of the total \$5.75 million transfer.

Arizona Board of Regents – Review of FY 2007 Tuition Revenues – The Committee gave a favorable review to the Arizona Board of Regents' (ABOR) expenditure plan for tuition revenue amounts greater than the amounts appropriated by the Legislature and all retained tuition and fee revenue expenditures for the current fiscal year. Of the \$77 million in increased tuition collections, \$31 million would be for additional financial aid. The Committee asked for additional information on the amount of the \$77 million increase that is due to higher enrollment, and the amount due to tuition increases.

Department of Education – Review of Kinder Morgan Settlement – The Committee gave a favorable review to the Department of Education's request to provide \$1.6 million in additional Basic State Aid to school districts in Maricopa and Cochise Counties due to assessment evaluation changes pertaining to the recent Kinder Morgan settlement.

Administrative Office of the Courts – Review of Reimbursement of Appropriated Funds – The Committee gave a favorable review to the Administrative Office of the Court's (AOC) expenditure of \$3.6 million in reimbursements.

Government Information Technology Agency – Arizona Web Portal – The Committee heard testimony on the State of Arizona's main web portal, which generates a profit by charging user fees. The fees currently remain with the vendor but are used for state automation projects. Starting in FY 2007, the legislature required that these funds be deposited into a state fund. The major components of the FY 2007 expenditures are a \$2.0 million purchase and installation of new web portal servers and \$1.2 million for other web portal projects.

Table 6

4-Sector "Big 3" Consensus Forecast: FY 2007 – FY 2010

	FY 2007	FY 2008	FY 2009	FY 2010
Sales Tax	7.2%	4.1%	4.8%	5.2%
Individual Income Tax	9.0%	5.6%	6.2%	6.5%
Corporate Income Tax	7.6%	0.7%	(2.2)%	1.8%
Overall Weighted Growth	8.0%	4.4%	4.7%	5.5%

JCCR MEETING

At its September 21, 2006 meeting, the Joint Committee on Capital Review (JCCR) considered the following issues:

Arizona Department of Transportation Construction Budget Operating Expenditure Plan – The Committee gave a favorable review to the Arizona Department of Transportation (ADOT) \$103 million Professional and Outside Services expenditure plan for FY 2007. At prior meetings the Committee had favorably reviewed the use of \$34.6 million of this expenditure plan, but wanted additional information from an Auditor General report before reviewing the remaining amount. Even though the budgeted amount for this expenditure plan is in line with previous years, the Auditor General recommended ADOT decrease its use of consultants. The Committee expressed interest in continuing its consideration of the appropriate level of consultant usage during the FY 2008 budget process.

Arizona Department of Transportation 5-year Transportation Plan – The Committee received the ADOT 5-year Transportation Facilities Construction Program for FY 2007 – FY 2011. The information provided estimated expenditures and revenues by fiscal year for major highway projects totaling \$5.8 billion over the 5-year period. The 5-year highway program does not include the \$307 million appropriated in the FY 2007 budget to accelerate certain highway programs.

Table 7 lists the 11 new major projects added to the 5-year plan.

Table 7	
ADOT 5-Year Plan Major Projects	
	FY07 – FY11
	(\$ in millions)
<u>North Valley</u>	
I-17 – Jomax/Dixileta Interchanges	\$40
L303 (Estrella) – Happy Valley Rd to I-17, interchange	30
<u>West Valley</u>	
I-10 – Sarival Rd to Dysart Rd, widen & HOV	90
I-10 – Dysart Rd to L101 (Agua Fria), widen & HOV	54
<u>East Valley</u>	
I-10 – SR 51 to 40 th St, collector distributor road	140
L101 (Pima) – Tatum Blvd to Princess Dr, HOV	28
<u>Tucson</u>	
Tucson I-10 – Ina Rd, interchange	38
Tucson I-19 – Valencia Rd to Ajo Way, widen	38
<u>Balance of State</u>	
Safford US 191 – MP 151 to Threeway, widen	33
Kingman US 93 – Hoover Dam to MP 17, widen	80
Prescott SR 260 – Little Green Valley, widen	27
SR – State Route HOV – High Occupancy Vehicle Lane	

The Committee also requested that ADOT report on the 5-year Transportation Facilities Construction Program for FY 2008 – FY 2012 by July 31, 2007, and that the report include additional

information on changes in the project lists and reconciliation of project funding obligations with cash flow projections.

University of Arizona Residence Life Building Renewal – The Committee favorably reviewed the issuance of \$21.9 million in system revenue bonds for Phases III and IV of the Residence Life Building Renewal Projects. The Residence Life Building Renewal Projects consists of 5 phases with an estimated cost of \$40.9 million. Phases III and IV include the plumbing systems in Coronado and Apache Santa-Cruz Halls, the fire sprinkler systems in Cochise and Apache Santa-Cruz Halls, and the bathrooms in Colonia De La Paz Hall.

The University of Arizona plans to issue the 25-year bonds in the spring of 2007, with a blend of fixed rate interest bonds at 7.5%, and variable rate interest bonds under 6.0%. Based on these projected interest rates the annual debt service payments will be approximately \$1,859,000, with payments over the 25-years totaling \$46.5 million. Debt service payments will be funded from student housing fees.

Arizona State University Polytechnic Academic Complex Lease-Purchase Project – The Committee favorably reviewed the issuance of the \$103 million in Certificates of Participation (COPs) for the Polytechnic Academic Complex. ASU plans on issuing the 30-year COPs in October 2007, with an estimated interest rate of 6%. Based on this projected interest rate the annual debt service payments will be approximately \$7.5 million, with payments over the 25-years totaling \$224.5 million.

The FY 2007 General Appropriations Act allocated ASU \$10.6 million as discretionary funding for any operational or capital purpose at any campus. ASU plans to use \$7.5 million of this amount for the annual debt service.

Arizona Exposition and State Fair Board Building Renewal Allocation – The Committee favorably reviewed the \$430,600 Building Renewal Plan. In FY 2007, the Arizona Exposition and State Fair received \$1,508,400 for building renewal projects. The State Fair will submit for review the remaining \$1,077,800 prior to its expenditure. The favorably reviewed amount will be used for 4 paving projects and 1 temporary roof repair and study.

SUMMARY OF RECENT AGENCY REPORTS

ADOA / GITA – Quarterly Report on AZNet Implementation – In December 2004, the Joint Committee on Capital Review requested the Arizona Department of Administration (ADOA) and the Government Information Technology Agency (GITA) to report quarterly on the Arizona Network (AZNet), as created by the Statewide Telecommunications Management Contract. The primary contractor completed the migration of all state users to the new network in April 2006. The contract also requires state agencies to install 22,000 new internet phones by April 2010. As of July 1, ADOA reported 1,594 installations complete and another 566 underway.

In the 4th quarter, a \$3.5 million lease was used to offset increases to agency seat costs. Additionally, state agencies invested \$3.6 million in 29 capital projects under the contract during the 4th quarter, of which 5 are still active in the 1st quarter of FY 2007. Overall during FY 2006, 42 projects were completed costing \$3.3 million.

While GITA generally concurs with ADOA on the status of AZNet, the agency notes that the management contractor failed to provide guaranteed service levels on 5 occasions in the 4th quarter. As a result, the contractor provided the state with \$1,400 in credits for the 1st quarter in FY 2007. Also, departments are still experiencing difficulty and significant delays with the billing system, although the contractor continues to implement improvements.

AHCCCS – Report on Alternative Benchmark – Pursuant to Laws 2006, Chapter 344, the Arizona Health Care Cost Containment System (AHCCCS) is providing its report on which benefit alternative was selected as a benchmark in determining cost sharing estimates. This requirement is part of a larger report on the fiscal impact of implementing certain provisions in the federal Deficit Reduction Act (DRA) of 2005 that is due to the JLBC on November 30, 2006. The larger report will address the fiscal impact associated with cost sharing for an alternative benefit package that is actuarially equivalent to federal "benchmark" benefit packages.

The DRA identified 4 benchmark benefit package alternatives. Of these alternatives, AHCCCS recommends developing cost sharing estimates for the November report using the state employee benefit package for the following reasons: 1) The AHCCCS benefit package has historically been viewed by some as being more extensive than the state employee benefit package. Therefore, it seems appropriate to conduct an actuarial analysis that compares those 2 benefit structures. 2) Data and benefits associated with the state employee health plan are readily available. This will ensure a more accurate, comprehensive, efficient and timely comparison. 3) The exercise may also provide a tool to policymakers when evaluating the benefits and structure of the state employee benefit package.

AHCCCS – Report on Medicaid Direct Service Claiming Program – Pursuant to Laws 2006, Chapter 344, the Arizona Health Care Cost Containment System (AHCCCS) is providing its annual report on the Medicaid Direct Service Claiming (DSC) program. This program was previously called the Medicaid in Public Schools (MIPS) program. This program is designed to provide funding for certain medically necessary Title XIX covered services furnished through the public school system special education programs. These services include nursing services, health aide services (attendant care), occupational therapy, speech therapy, physical therapy, transportation, behavioral health services, and audiology services.

In FY 2006, the DSC program provided payments for 19.5 million claims. This is a decrease of (8.5)% from FY 2005.

In FY 2006 participating schools received a total of \$49,975,693 in Medicaid Federal Financial Participation (FFP) funds, which is a decrease of \$(8,132,972) or approximately (14)% below FY 2005. AHCCCS reports that this decrease is likely due to a change in the registration process for Health Aides implemented April 1, 2006. As a result, delays were caused in billing for Health Aide services during the final few months of the state fiscal year. The Health Aide portion, which includes attendant care, accounted for approximately 45.5% of total FFP funds and 50% of all claims. In contrast, the Therapy Codes portion of the program, including the audiology services covered beginning in January 2005, was responsible for 21.5% of FFP funds received but accounted for only 3.4% of claims. The total reimbursement represents approximately 67% of the total cost of the services, while the remaining monies were provided by the participating schools.

Department of Corrections – Report on Inmate Utility Fees – Pursuant to A.R.S. § 31-239, the Department of Corrections annually reports on monies collected from inmates who use electrical appliances. The report also includes information on the expenditure of any monies collected. Statute requires the department to charge a fee, not to exceed \$2.00 per month, to inmates possessing at least one electrical appliance. For FY 2006, the department assessed a monthly utility fee of \$1.00 and collected \$181,956. This collection represents a 4.5% increase above FY 2005 (\$174,042 collected), which the department attributes to population growth during FY 2005. The department reports that the monies collected were utilized to reduce electrical expenditures at the institutions from which fees were collected. Total inmate utility collections represent 1.9% of ADC's total electrical expenditures of \$9,760,147 in FY 2006.

Department of Environmental Quality – Report on Water Quality Assurance Revolving Fund for FY 2006 – Pursuant to a General Appropriation Act footnote, the Arizona Department of Environmental Quality (ADEQ) is required to report annually by September 1 to the JLBC on the progress of activities in the Water Quality Assurance Revolving Fund (WQARF) Program. The WQARF Program is similar to the federal Superfund program in that it is designed to monitor, contain, and remediate contaminated groundwater at specified sites. Based on the report, actual expenditures for the year were \$19,593,900. Unexpended funds at the end of FY 2006 totaled \$1,000,000.

The WQARF Program maintains a list of contaminated sites, called the Registry. According to the report, at the end of FY 2006 there were 35 sites on the WQARF Registry. Sites on the registry have not changed since 2004. The report contained no information regarding the expected duration or total remediation costs for these sites.

In FY 2007, program expenditures for individual sites are projected to be \$14,478,800, with an average per site cost of \$402,200.

The report includes information about cost recovery and cleanup activities at both the site and program level of detail. The following is a breakdown of cleanup results in FY 2006:

Table 8			
WQARF Activities			
Activity	FY 2004	FY 2005	FY 2006
Groundwater Treated (in billions of gallons)	10.5	13.4	16.3
Volatile Organic Compounds Removed (in pounds)	32,299	28,573	113,946
Metals Removed (in millions of pounds)	3.3	3.3	3.4
Contaminated Soil Removed (in tons)	91.6	248.2	2,816.4

The program showed large increases in volatile organic compounds removed and contaminated soils removed in FY 2006 as compared with FY 2005 due to increased remediation activity at state-lead federal superfund sites.

ADEQ is also required to submit a report to the JLBC by October 2 detailing the remediation status of each site listed on the WQARF registry at the end of FY 2006, and expected progress in FY 2007 and FY 2008.

Arizona Historical Society – Report on Non-Appropriated Expenditures – Pursuant to A.R.S. § 41-821E, the Arizona Historical Society is required to report on non-appropriated fund expenditures for the society. The table below summarizes FY 2006 expenditures by fund source. Non-appropriated expenditures for FY 2006 were \$1,092,600, an increase of \$158,500 above the FY 2005 total of \$934,100. In addition to the non-appropriated fund expenditures, the Arizona Historical Society had appropriated expenditures of \$4,308,300 in FY 2006.

Table 9	
Arizona Historical Society Non-Appropriated Expenditures	
Fund Name	FY 2006
Grants	\$ 49,600
Permanent Arizona Historical Society Revolving	6,700
Preservation and Restoration	38,500
Private	540,100
Restricted	448,200
Trust	9,500
TOTAL	\$1,092,600

Arizona Department of Homeland Security – Quarterly Report on Homeland Security Funding – The Arizona Department of Homeland Security (DHLS), in response to a request by the Joint Legislative Budget Committee, has submitted a quarterly expenditure and allocation report for homeland security grant monies.

In FFY 2004, approximately \$55.7 million of homeland security funding was awarded to Arizona. Of this amount, \$32.5 million was reported as expended or encumbered,

leaving a balance of \$23.2 million which has yet to be spent. DHLS noted that all FFY 2004 funds would be encumbered by November 30, 2006 and would be expended by February 2007.

In FFY 2005, Arizona received \$41.7 million in homeland security grants. An amount of \$15.6 million was reported as encumbered or expended. DHLS reported that all FFY 2005 funds would be encumbered by March 31, 2007, and would be fully expended by June 2007.

Arizona was awarded \$20.2 million in homeland security grants for FFY 2006. The department has reported allocating \$10.8 million of these funds, leaving \$9.3 million which has yet to be awarded to grantees. DHLS reported it is currently in the process of allocating these funds, and will include them in the next quarterly report.

State Land Department – Quarterly Report on State Trust Land Activities – The FY 2006 General Appropriation Act (GAA) provided the State Land Department with \$3.1 million in additional monies for the planning and disposition of state trust lands. A GAA footnote also required the department to submit quarterly reports to the JLBC regarding state trust land activities. During the fourth quarter of FY 2006, the State Land Department completed 11 auctions, selling 2,226.8 acres valued at \$184 million. The department also expended \$1.2 million for planning and engineering projects for 343,734 acres of trust land and processed over 350 right-of-way applications resulting in \$7.4 million in revenue.

For FY 2006 as a whole, the department sold 3,426 acres valued at \$544.3 million, up from \$254.5 million in FY 2005. The department also entered into long-term leases for 114 acres of trust land on 2 parcels valued at a combined \$34.5 million. Of the \$544.3 million in total sales value, \$82.4 million was received in the fiscal year as cash sales. The balance was financed directly through the Land Department and will be paid off over time.

The department recorded FY 2006 revenues of \$409.1 million. That total includes the \$82.4 million in cash sales from FY 2006, plus principal and interest payments on financed sales from previous years, payments on commercial and school leases, special use permits, right-of-way applications, natural resources leases, and other revenue sources for the department. Total revenues rose from \$393.6 million in FY 2005.

Arizona Board of Regents – Report on Technology and Research Initiative Fund (Proposition 301) – A.R.S. § 15-1648 mandates an Arizona Board of Regents (ABOR) report on the Technology and Research Initiative Fund (TRIF). Proposition 301, enacted into law by voters during the November 2000 General Election, established TRIF to support public higher education, and research initiatives in emerging technologies. TRIF receives funding from a portion of the Transaction Privilege (Sales) Tax.

In FY 2006, ABOR had an initial TRIF budget of \$77 million. Revenues came in at \$92 million, of which ABOR expended \$58 million.

In FY 2007, ABOR estimates \$91 million in revenues, of which they plan to expend \$88.9 million. Of that \$88.9 million, \$12 million is for projects yet to be determined. Major spending items for ongoing projects at the universities include:

- ASU Biodesign Institute – \$20 million for 3 new centers housed within the Institute.
- NAU E-Learning – \$3 million for various initiatives dealing with technological systems that support e-learning.
- NAU Workforce Development – \$3 million for various initiatives, including certification of teachers, and training for nurses and other health professionals.
- UA BIO5 Institute – \$8 million primarily for support of biological research.
- UA Optical Sciences and Technology Initiative – \$5 million for the development of new optical technologies and research methods.

Supreme Court – Report on Current and Future Automation Projects – Pursuant to a footnote in the General Appropriation Act, the Administrative Office of the Courts (AOC) is required to report annually to the JLBC on current and future automation projects coordinated by the AOC.

The AOC estimates total state automation expenditures in FY 2007 will be approximately \$13.7 million. Of this amount, approximately \$9.8 million (72%) will be spent on on-going automation support, and \$3.9 million (28%) will be spent on 12 new projects in FY 2007. Of the 12 new projects, the larger projects include: updating and enhancing the Juvenile On-Line Tracking System (JOLTS) (\$1,418,600), updating the limited jurisdiction case management system for statewide utilization (\$768,400), implementation of a new case management system for Pima County Superior Court, later to be distributed statewide (\$684,000), and further development and expansion of the Fines/Fees and Restitution Enforcement (FARE) program (\$270,500). Additionally, the AOC anticipates costs relating to “New Projects” in FY 2008 and FY 2009 to be \$5.3 million and \$4.0 million, respectively. FTE Positions required to complete all automation projects categorized as “New Projects” is estimated to be 26.8.

The report does not meet the reporting guidelines as required by Laws 2006 Chapter 344 (General Appropriation Act) for the \$9.8 million in on-going projects, as it does not itemize funding levels for specific projects.

University of Arizona College of Medicine – Phoenix Update – Pursuant to a General Appropriation Act footnote, the Arizona Board of Regents (ABOR), with input from the University of Arizona (UA) and Arizona State University (ASU), is required to provide an update to the JLBC on the University of Arizona Phoenix Medical Campus. Laws 2005,

Chapter 330 directed the UA to establish the Phoenix Medical Campus in collaboration with the Arizona State University Department of Biomedical Informatics, utilizing the former site of Phoenix Union High School.

The Phoenix Medical Campus is on track to accept its first class of 24 students in the fall of 2007. ASU and UA have jointly developed a Phoenix program curriculum that incorporates bioinformatics, personalized medicine and a four-year scholarly work initiative. A formal accreditation package will be sent in November to the Liaison Committee on Medical Education, the accrediting body for the College of Medicine. Accreditation, if granted, would occur in February 2007. The renovation of the 3 Phoenix Union High School buildings and relocation of the Phoenix program to these facilities was completed in September 2006. These buildings will provide classroom, administrative and support space for the first entering classes of the program. Construction of the first research building on campus, the Arizona Biomedical Collaborative 1, has been initiated and will house UA College of Medicine faculty as well as the ASU Department of Biomedical Informatics. In terms of staffing, a core basic medical science faculty has been recruited as well as several key administrative team members.

The report submitted by ABOR includes information on the following topics:

Creation of New Residencies - In FY 2007, a combined \$16 million in new state and federal funding for the Arizona Health Care Cost Containment System (AHCCCS) Graduate Medical Education program will be used to develop new residency programs and expand existing residency programs. According to ABOR’s report, the number of residency positions statewide will increase from approximately 1,200 to at least 1,500 positions as a result of this additional funding.

Additionally, the UA College of Medicine intends to seek accreditation for seven or more residency programs scheduled to start in July 2008, which would contribute more residency positions statewide. The College of Medicine is currently in the process of developing a pilot program with Yuma Regional Medical Center to establish a new residency program and plans to identify other rural locations in which they will develop similar programs. Additionally, the Rural Workforce Taskforce, formed by the UA College of Medicine, plans to work with private medical schools to expand residency positions in rural areas, including the establishment of joint allopathic and osteopathic accreditation in the first year of residency.

Clinical Rotations - The UA Phoenix Medical Campus will include clinical rotations for its students in the first 2 years of medical education, which traditionally are restricted to basic medical science education. The UA College of Medicine is in the process of working with multiple clinical partners in Phoenix to secure the necessary agreements for clinical education for students. Clinical education for the Phoenix Medical Campus will include both outpatient and inpatient

opportunities, as well as new areas of clinical education, such as simulation laboratories.

Rural Expansion - Several efforts are being made to expand medical services in the state's rural areas. The Tucson UA College of Medicine program at the University Physicians Healthcare Hospital at Kino (UPHK) will provide care to underserved populations, which will include rural communities in particular.

Doctor Shortage - To prevent doctor shortages in the state and its rural communities, the Phoenix Medical Campus will encourage medical students to complete their residencies in Arizona and encourage those who leave the state to return and work in underserved areas. It will also include efforts to interest students in high school, or possibly earlier in healthcare. The UA has been selected by the Association of American Medical Colleges as a pilot site for the Closing the Gap initiative, which will test new strategies to attract minority students to medicine. The UA College of Medicine and UPHK are developing a program that would address physician shortages in rural areas by establishing physician offices linked to UPHK and faculty and serve as training sites for residents.

Additional Reporting Requirements - ABOR's report does not include additional information on efforts to attract out-of state medical students to practice in the state of Arizona. No further update is provided as to the development of formal relationships with area hospitals and private medical schools. The UA College of Medicine in Tucson has in place relationships with 9 area hospitals in Maricopa County that accept UA medical students for both clinical rotations and residency programs. The UA Phoenix Medical Campus plans to work with these existing partnerships, but will develop more partnerships with area hospitals as medical students progress through the Phoenix program.

Arizona Department of Water Resources – Report on Assured and Adequate Water Supply Expenditure Plan – Pursuant to a FY 2007 General Appropriation Act footnote, the Arizona Department of Water Resources (DWR) has submitted an expenditure plan detailing how the monies in the Assured and Adequate Water Supply (AAWS) Special Line Item (SLI) will be used to accelerate the program's applications process.

DWR reports that historically, the 14 FTE Positions utilized by the program were funded through the agency's General Fund appropriation. Of the \$2.8 million FY 2007 appropriation to the AAWS SLI, \$1.7 million from the General Fund is allocated to fund those 14 FTE Positions. The remaining \$1.1 million of the appropriation consists of monies appropriated from the new AAWS Administration Fund. The fund was created assuming a new, higher fee structure. The new fee structure was approved by the Governor's Regulatory Review Council in September 2006. Fees are estimated to generate between \$1.2 and \$1.4 million in revenue per year to the AAWS Fund and is based on the

assumption that the number of applications to the program will mirror the actual number received in FY 2005.

DWR reports that within the first year the department will complete a new database at an estimated cost of \$700,000. The system is expected to improve the workflow of staff and add web-based functionality so customers can retrieve information over the internet, increasing the amount of time staff can devote to working on application files and analysis. Also, within the first year after the approval of the new AAWS rules, DWR plans to hire up to 12 new FTE Positions that will be dedicated to the processing of AAWS applications and assessing water supplies. The estimated ongoing cost to fund all 12 FTE Positions is \$1.1 million. The department reports that the priority of the program is the completion of the new database and then the phase-in of new staff.

DWR reports that of the 14 FTE Positions currently in the program, 4.5 are dedicated to processing and managing of the applications, each having responsibility for 124 applications in FY 2006. As a result of the new funding, 5 of the 12 new FTE Positions will be hired for this purpose, dropping the number of applications per FTE to approximately 60. The department also states that the average number of days to process applications in FY 2006 was 109. Although the database improvements will contribute to a reduction in processing time, the department states that the addition of both project management staff and hydrologists will have a greater effect. However, no estimated decrease in processing time was reported for any of these improvements.

30-YEAR ECONOMIC OUTLOOK

On August 21 the University of Arizona Economic and Business Research Center issued a report on the state's 30 year economic, demographic, and business outlook.

Projecting out to 2036, the Arizona population could be approximately 14.6 million, with almost 10 million people living in the Phoenix metro area. By that time Arizona could be in the top 5 in terms of state population nationwide. In September 2007 it is expected that Arizona will be the 13th most populous state, surpassing Tennessee, Indiana, Washington and Massachusetts during the next year. Most of the population growth will be driven by net migration from California, the Northeast, the Upper Midwest and Latin America.

The majority of the population growth will occur in areas near Tucson and Phoenix. The report pointed to research that indicates a "Megalopolis" area stretching from Sierra Vista to Flagstaff will develop in the state. The "Arizona Sun Corridor" is projected to be 1 of nearly 10 such regional corridors nationwide connecting communities with similar economic, social and environmental characteristics.

From an employment perspective, by 2036 about 3.7 million jobs are expected to be added to the current 2.6 million. The biggest growth will come from professional and business

services, healthcare, and social assistance with more modest growth in the leisure and hospitality, transportation and warehousing, and financial industries. Declining employment growth rates are anticipated in manufacturing, mining and utilities.

Meanwhile, the share of the state population 65 or older is predicted to be 20%, up from 12% today just as the state's working age population declines from 66% to 58% in the next 30 years, a level last seen in the 1960s.

The biggest inhibitors to population and economic growth identified in the presentation were whether rising house prices would dissuade skilled workers to come to the state as home affordability drops and whether the state's available water resources could accommodate population growth of as much as 8.5 million.