

1716 W. Adams
Phoenix, AZ 85007

Phone:
(602) 926-5491
Fax:
(602) 926-5416



www.azleg.gov/jlbc.htm

“Overall, first quarter [base revenue] growth totaled 4.1%, the highest quarterly increase since the 3rd quarter of FY 2007.”

This report has been prepared for the Arizona Legislature by the Joint Legislative Budget Committee Staff on October 28, 2010.

Summary



Led by a substantial growth in Corporate Income Tax collections, adjusted September General Fund revenues grew by 10.7% over last year. Overall, first quarter growth totaled 4.1%, the highest quarterly increase since the 3rd quarter of FY 2007.

While the General Fund revenue growth is a positive sign, the pace of the recovery remains very uneven as September sales tax collections declined for the fourth consecutive year.

September General Fund collections totaled \$800.7 million, or \$10.5 million above forecast. Given July and August losses, however, year-to-date revenues are still \$(28.7) million below budget.

In comparison, September General Fund spending was \$820 million, or \$339 million above last year. The increase was primarily due to a different monthly payment schedule for the Arizona Department of Education (ADE) and the Universities.

Year-to-date revenues of \$2.1 billion have been offset by \$3.4 billion in spending. This imbalance caused the state's operating fund balance to decline to \$236.3 million at the end of September. The state pays its bills out of the operating fund balance, which consists of General Fund monies and certain dedicated funds.

Background

September is a key revenue month as the State receives both quarterly Corporate and

Individual Income tax payments. In September, Corporate collections were \$49.9 million, or 73.5%, above September 2009. Given income tax confidentiality requirements, little is known about the specifics of this rebound. There are, however, at least 2 possible reasons for the September results.

First, the 3-year Corporate collections decline has been so precipitous that it is not as difficult to generate some large gains on the recovery side. Between FY 2007 and FY 2010, Corporate tax receipts declined from \$986 million to \$413 million. While the FY 2007 revenues probably included one-time monies due to the overheated real estate market, the FY 2010 returns were likely artificially low. In the last year, companies may have taken advantage of some of their unused carry-forward tax credits on a one-time basis to improve their balance sheets.

A second factor in the Corporate tax growth is the increased profitability of businesses. At the national level, corporate profits are projected to have grown by 37% in the last year. The increased profitability may have resulted from cost-cutting measures in the last year rather than substantial revenue gains. Corporate Income taxes are based on net income which reflects both revenues as well as expenses.

While the corporate sector is looking healthier, concerns remain that the consumer side may hamper the economic recovery. September Sales tax collections declined by (2.0)%

Table of Contents

Summary

- Background 1
- September Revenues 2
- Economic Indicators 4
- JLBC Meeting 7
- Summary of Recent Agency Reports
- AHCCCS – Healthcare Group 7

- DES – Rates for DD Program 8
- DES – Child Care Expenditures 8
- DES – TANF Grant Diversion Program 8
- DEQ – Progress of WQARF 8
- Supreme Court – Automation Projects 8
- Water Resources – Interstate Water Banking. 9
- September Spending 10

Summary (Continued)

Table 1

| | General Fund Revenues (\$ in Millions) | | |
|--------------|--|--|------------------------------------|
| | <u>FY 2011 Collections</u> | <u>Difference From Budget Forecast</u> | <u>Difference From FY 2010</u> |
| September | \$ 800.7 | \$ 10.5 | \$ 94.4 |
| Year-to-Date | \$ 2,109.1 | \$ (28.7) | \$ 306.0 |

excluding the impact of the recent 1 cent increase. Compared to September 2006, sales tax collections have fallen by (25.7)%. Since consumer spending accounts for over two-thirds of the nation's economic activity, a broad-based recovery will require more growth in that sector of the economy.

Several factors continue to serve as a drag on consumer spending in Arizona. Despite

recent small increases in consumer confidence, the levels remain significantly below pre-recession levels. With over 40,000 pending foreclosures and half of all mortgages being "underwater," consumer spending may remain suppressed for the foreseeable future.

September Revenues

Sales Tax collections were \$348.3 million in September. Excluding the \$66.2 million from the temporary 1-cent increase, collections were \$282.2 million, or (2.0)% below September 2009.

Including the 1-cent increase, collections were \$(27.0) million below the forecast. The year-to-date loss is \$(74.6) million.

Table 2 displays the September growth rates for the largest categories

| | Sales Tax Growth Rates Compared to Prior Year | |
|------------------|--|------------|
| | <u>September</u> | <u>YTD</u> |
| Retail | (2.1)% | (1.9)% |
| Contracting | (14.2)% | (22.3)% |
| Utilities | 5.6% | (1.0)% |
| Use | (12.0)% | 0.9% |
| Restaurant & Bar | 4.4% | 2.2% |

Retail and contracting together account for about 60% of all sales tax revenues. While contracting had another month of decline, a (14.2)% decrease compared to September of last year, it was the smallest month over month decline since June 2008. Retail declined by (2.1)% compared to the same month last year.

The temporary 1-cent increase generated \$66.2 million for September, or \$(8.4) million below forecast. Collections of the temporary

tax are expected to increase over the next several months as the impact of exemptions to the rate decreases. (See the August MFH for additional information.)

Individual Income Tax net revenues were \$287.0 million in September, or 7.5% above the prior year. Collections were \$2.9 million above the forecast. Year-to-date, revenues have grown 6.7% and are \$21.1 million above forecast through September.

As indicated in *Table 3* below, withholding tax payments increased by 5.0% in September, making 6 of the past 8 months positive. This increase continues to be difficult to interpret due to changes in the state withholding system. (See the August MFH for additional information.)

Table 3

| | Individual Income Tax Growth Rates Compared to Prior Year | |
|-------------------------------|--|------------|
| | <u>September</u> | <u>YTD</u> |
| Withholding | 5.0% | 3.3% |
| Estimated + Final Payments | (1.2)% | 0.8% |
| Refunds | (25.5)% | (25.6)% |

Corporate Income Tax net collections were \$117.9 million in September, or 73.5% above the prior year. Collections were \$24.8 million above the forecast.

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September Revenues (Continued)

Year-to-date through September, revenues are up 48.5% and are \$30.7 million above forecast. In September, corporate collections continue to grow substantially with increased business profitability.

The **Lottery Commission** reports that September ticket sales were \$41.2 million, which is \$(0.6) million, or (1.4)%, below sales in the prior year. Year-to-date, ticket sales are \$126.0 million, equal to last year's sales. The General Fund share of sales has increased, however, due to changes in the distribution formula.

Non-General Fund

Tobacco Tax revenues were \$28.3 million in September. Collections were up 9.5% compared to the prior year, and were \$2.5 million above the budget estimate for the

month. Year-to-date collections are up by 0.4% and are \$0.6 million above the budget estimate.

Less than 10% of tobacco taxes are deposited directly into the General Fund. The remainder primarily goes to AHCCCS and the Department of Health Services to defray the General Fund cost of operating those Programs, along with funding the Early Childhood Development and Health Board.

Highway User Revenue Fund (HURF) revenues consist of gasoline and use fuel (diesel) tax, motor carrier fees (commercial carriers), vehicle license tax and registration fees, and various other fees. HURF collections of \$98.0 million in September were down \$4.5 million or (4.4)% compared to September of last year. Year-to-date, revenues have grown 2.0%.

Table 4

General Fund Revenue: Change from Previous Year and Enacted Budget Forecast September 2010

| | Current Month | | | | | FY 2011 YTD (Three Months) | | | | |
|------------------------------------|--------------------------|--------------------------|---------------|---------------------|-----------------|----------------------------|--------------------------|----------------|-----------------------|-----------------|
| | Actual September 2010 | Change From | | Forecast | | Actual September 2010 | Change from | | Forecast | |
| | | September 2009 Amount | Percent | Amount | Percent | | September 2009 Amount | Percent | Amount | Percent |
| Taxes | | | | | | | | | | |
| Sales and Use w/o 1¢ * | \$282,192,808 | (\$5,635,416) | (2.0) % | (\$18,566,596) | (6.2) % | \$841,642,448 | (\$24,418,487) | (2.8) % | (\$51,195,621) | (5.7) % |
| Income - Individual | 286,997,435 | 19,990,630 | 7.5 | 2,944,534 | 1.0 | 781,919,599 | 49,018,374 | 6.7 | 21,072,282 | 2.8 |
| - Corporate | 117,874,711 | 49,928,264 | 73.5 | 24,761,811 | 26.6 | 159,539,760 | 52,096,328 | 48.5 | 30,710,560 | 23.8 |
| Property | (753,482) | (789,468) | -- | (793,482) | -- | (502,362) | (766,607) | -- | (752,362) | -- |
| Luxury - Tobacco | 2,888,869 | 290,991 | 11.2 | 375,869 | 15.0 | 6,877,125 | (118,614) | (1.7) | (1,138,875) | (14.2) |
| - Liquor | 2,138,439 | 175,921 | 9.0 | (420,561) | (16.4) | 6,007,569 | 83,133 | 1.4 | (413,431) | (6.4) |
| Insurance Premium | 53,314,746 | 7,731,704 | 17.0 | 15,214,746 | 39.9 | 134,726,526 | 4,897,787 | 3.8 | 9,926,526 | 8.0 |
| Estate | 196 | 196 | -- | 196 | -- | 437,372 | 143,266 | 48.7 | 437,372 | -- |
| Other Taxes | 31,421 | (2,347) | (6.9) | (21,079) | (40.2) | 163,232 | 38,914 | 31.3 | 5,732 | 3.6 |
| Sub-Total Taxes | \$744,685,143 | \$71,690,475 | 10.7 % | \$23,495,438 | 3.3 % | \$1,930,811,268 | \$80,974,093 | 4.4 % | \$8,652,182 | 0.5 % |
| Other Revenue | | | | | | | | | | |
| Lottery | 4,287,755 | 840,755 | 24.4 | (912,245) | (17.5) | 8,627,609 | 2,421,409 | 39.0 | (1,772,391) | (17.0) |
| License, Fees and Permits | 2,167,111 | 339,987 | 18.6 | 67,111 | 3.2 | 6,990,451 | 157,294 | 2.3 | 790,451 | 12.7 |
| Interest | 593,230 | 582,742 | -- | 593,230 | -- | 1,241,127 | 64,651 | 5.5 | 1,241,127 | -- |
| Sales and Services | 2,134,744 | (1,132,134) | (34.7) | (1,065,256) | (33.3) | 4,739,187 | (2,891,541) | (37.9) | (2,460,814) | (34.2) |
| Other Miscellaneous | 4,322,518 | 937,334 | 27.7 | (1,877,482) | (30.3) | 8,413,271 | (1,447,464) | (14.7) | (8,386,729) | (49.9) |
| Disproportionate Share | 0 | 0 | -- | 0 | -- | 0 | 0 | -- | 0 | -- |
| Transfers and Reimbursements | 1,010,044 | 413,044 | 69.2 | (1,389,956) | (57.9) | 3,854,099 | (1,701,506) | (30.6) | (3,345,901) | (46.5) |
| Sub-Total Other Revenue | 14,515,401 | 1,981,728 | 15.8 % | (4,584,599) | (24.0) % | 33,865,744 | (3,397,156) | (9.1) % | (13,934,256) | (29.2) % |
| TOTAL BASE REVENUE | \$759,200,544 | \$73,672,204 | 10.7 % | \$18,910,839 | 2.6 % | \$1,964,677,013 | \$77,576,938 | 4.1 % | (\$5,282,073) | (0.3) % |
| Other Adjustments | | | | | | | | | | |
| Urban Revenue Sharing | (39,500,543) | 12,886,509 | -- | (0) | 0.0 | (118,501,629) | 38,659,528 | -- | 0 | 0.0 |
| 1¢ TPT Increase* | 66,155,030 | 66,155,030 | -- | (8,437,916) | (11.3) | 194,976,184 | 194,976,184 | -- | (23,398,579) | (10.7) |
| Budget Plan Transfers | 14,884,011 | (58,304,948) | (79.7) | 0 | 0.0 | 67,980,706 | (5,208,254) | (7.1) | 0 | 0.0 |
| Sub-Total Other Adjustments | 41,538,498 | 20,736,590 | 99.7 % | (8,437,917) | (16.9) % | 144,455,260 | 228,427,458 | -- % | (23,398,579) | (13.9) % |
| TOTAL GENERAL FUND REVENUE | \$800,739,042 | \$94,408,794 | 13.4 % | \$10,472,922 | 1.3 % | \$2,109,132,273 | \$306,004,395 | 17.0 % | (\$28,680,653) | (1.3) % |
| Non-General Funds | | | | | | | | | | |
| Highway User Revenue Fund | \$98,018,000 | (\$4,524,000) | (4.4) % | (\$2,001,000) | (2.0) % | \$297,413,000 | \$5,822,000 | 2.0 % | \$1,149,000 | 0.4 % |
| Tobacco Tax (All Funds Total) | \$28,260,164 | \$2,458,780 | 9.5 % | \$2,458,780 | 9.5 % | \$82,386,612 | \$345,478 | 0.4 % | \$623,493 | 0.8 % |

* Sales and Use line excludes revenue from the temporary 1¢ increase approved by the voter in May 2010. That revenue is shown under One-Time Revenues. Total September collections including the 1¢ increase were \$348.3 million. This amount is \$60.5 million, or 21.0%, above September 2009 and \$(27.0) million, or (7.2)%, below forecast. Year to date, total collections including the 1¢ increase were \$1,036.6 million. This amount is \$170.6 million, or 19.7%, above September 2009 and \$(74.6) million, or (6.7)%, below forecast.

Economic Indicators

NATIONAL

The Conference Board's **U.S. Consumer Confidence Index** increased from a revised level of 48.6 in September to 50.2 in October. The slight uptick in consumer confidence in October was primarily driven by expectations over the next 6 months as opposed to current conditions. The survey responses were mixed. While consumers were somewhat more optimistic about business conditions in the near future, they were also simultaneously more pessimistic about their future job prospects and earnings. While October saw a slight improvement in consumer sentiments, the Conference Board noted that the index remains at historically low levels.

The Conference Board's **U.S. Index of Leading Economic Indicators** rose 0.3% in September, following a 0.1% gain in the previous month. Increasing stock prices, an expanding money supply, decreasing jobless claims, and a favorable interest-rate spread outweighed the negative implications of decreasing building permits and slower delivery times. Apart from June 2010, the index has advanced in each of the last 18 months. While the most recent data continue to point toward a recovery, the divergence of the leading indicator's components suggests a multi-track recovery.

Consumer prices, as measured by the **U.S. Consumer Price Index (CPI)**, rose by 0.1% in September. Food prices increased by 0.3% and energy prices advanced by 0.7%. The core CPI, which exclude food and energy prices, was flat for the second consecutive month. Year over year, the index is up by 1.1%. This month's CPI report could serve as further impetus for the Federal Reserve to launch another round of quantitative easing in the near future.

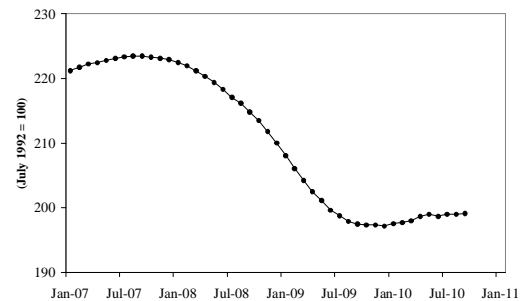
The Semiconductor Industry Association (SIA) reported that **Semiconductor Billings** (3-month moving average) in the U.S. were \$4.84 billion in August, a 2.0% improvement over July and a 47.1% increase over the same month in the prior year. According to SIA, the continued growth in semiconductor billings is primarily attributable to increased sales of personal computers and wireless related products. Chip sales in August were at the highest level since January 2001.

ARIZONA

The Federal Reserve Bank of Philadelphia's **coincident index** gauges current economic activity in each state. The index combines 4 indicators: employment, average hours worked in manufacturing, unemployment rate, and inflation-adjusted wages.

Arizona's coincident index increased by 0.1% in September. While this was a slight improvement over the prior month, the index remains virtually unchanged from May, as seen in the graph below. The Arizona and U.S. coincident indexes have been essentially flat over the last 4 months, suggesting that the economic recovery is stalling at both the state and national level. See [Tracking Arizona's Recovery](#), for additional historical information.

Arizona Coincident Economic Activity Index



The Behavior Center's Rocky Mountain Poll conducted in the first half of October showed a marked improvement of the **Arizona Consumer Index**. The October reading of 56.3 was 7.2 points, or 14.7%, above the consumer confidence level in July, and a reversal of the declines reported in each of the previous 3 quarters.

More than 90% of the improvement in consumer sentiments was attributable to the outlook over the next 6 months as opposed to the appraisal of current conditions. The latest reading of consumer sentiments, however, is still 45% below the pre-recession level reported in the third quarter of 2007.

Employment

Revised employment data released by the Arizona Department of Commerce earlier this month shows that Arizona's 30-month streak of

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Economic Indicators (Continued)

“In September, the number of new Maricopa County foreclosure notices declined (0.8)% from August levels...the level of notices has fallen (29.8)% from its peak of 10,689 in March 2009.”

year-over-year losses was broken in August. Instead of the previously reported year-over-year job loss of (0.1)%, the revised data showed an actual net gain of 0.3% in August. The same report indicates that **nonfarm employment** in September was 0.5% above the level in the prior year.

The state added a total of 16,000 jobs in September, or 0.7% over the prior month. However, almost all of the monthly net gain (15,300) was due to an increase in government payrolls as public schools resumed their classes in September. Most of the net gains in private sector employment (700 jobs) could be attributed to the employment services industry. This industry is mostly comprised of temporary staffing agencies and often serves as a leading indicator for the labor market as a whole. This industry has expanded its payrolls by 9.3%, or 7,600 positions, in the last 12 months.

While the state experienced its first year-over-year net gain of jobs in August, the state has lost (310,000) jobs, or (11.4)% of its workforce since December 2007. Almost one-third of these jobs losses occurred in the construction industry. See [Tracking Arizona's Recovery](#), for additional historical information.

The improved employment outlook was also matched in September by a continued slide in **initial claims for unemployment insurance**. The Department of Commerce reported a total of 23,569 initial claims for jobless benefits in September, a (14.2)% decline over the prior month. The seasonal decline in claims was larger than the average (10.4)% in the 10-year period preceding the last recession.

September marked the 11th consecutive month with year-over-year declines in first-time claims. Claims peaked in April 2009 when more than 41,000 individuals filed for initial jobless benefits. See [Tracking Arizona's Recovery](#), for additional historical information.

The **average weekly hours** of production workers in manufacturing industries is a leading indicator since “factory hours” tend to lead the business cycle as employers usually adjust work hours before increasing or decreasing the size of their workforce.

According to the Arizona Department of Commerce, preliminary data indicates that the average work week in September was 40.3 hours, a 1.5% increase over the prior month, and the best performance in almost 2

years. The measure has increased year-over-year in each of the last 8 months. While businesses remain cautious in adding new employees to their payrolls, these figures suggest that more hiring may occur in the coming months.

Housing

In September, the number of new Maricopa County **foreclosure notices** declined (0.8)% from August levels to 7,501. The level of notices has fallen (29.8)% from its peak of 10,689 in March 2009.

Similarly, the number of Maricopa County **pending foreclosures** continued to decline, albeit at a slower rate, for the 7th straight month. In September it totaled 41,039 and is (18.2)% below levels a year ago and (20.3)% below the peak in December 2009 (51,466). See [Tracking Arizona's Recovery](#), for additional historical information.

While foreclosure notices and pending foreclosures continue their decline from recent highs, they continue to be a major influence on existing home sales and the respective prices. In the Metropolitan Phoenix area in September, there were a total of 9,005 **existing single-family home sales** that resulted in a **median resale home price** of \$137,000. Relative to the prior year, the number of sales and prices are down (0.7)% and (2.0)% respectively. Of the existing sales, 45.6%, or 4,110 were foreclosure.

State Agency Data

Participation in income driven programs continued its downward trend last month, as reflected by the data presented below.

In October, **AHCCCS caseloads** equaled 1.34 million members, a (0.5)% decrease over the prior month. AHCCCS caseloads are currently 1.1% above October 2009 levels. The FY 2011 budget funded a projected October 2010 caseload growth of 5.2% above October 2009 levels, for a total of 1.40 million members.

There were 41,887 **TANF recipients** in the state in September, a monthly caseload decrease of (13.8)%. Year-over-year, the number of TANF recipients has declined by (50.1)%. This decline is the result of changes to the statutory lifetime limit a person may receive cash assistance. (See the September MFH for

Economic Indicators (Continued)

additional information). This change resulted in a caseload decline of approximately (16,000) recipients. The FY 2011 budget assumed caseloads of approximately 70,000 in FY 2011.

The **Supplemental Nutrition Assistance Program (SNAP)**, formerly known as Food Stamps, provides assistance to low-income households to purchase food. In September, there were a total 1.08 million food stamp recipients in the state, virtually flat over the prior month.

Compared to the same month last year, food stamp participation was up by 10.5%. The number of food stamp recipients began increasing steadily in July 2007, after several years in the 550,000 to 575,000 range.

The 3-month average count of the **Department of Correction's (ADC) inmate population** fell to 40,311 inmates between July and September 2010. Relative to the prior month and a year ago, the population has declined by (66) and (269) inmates, respectively.

Economic Indicators (Continued)

Table 5

ECONOMIC INDICATORS

| Indicator | Time Period | Current Value | Change From Prior Period | Change From Prior Year |
|---|---|-----------------|--------------------------|------------------------|
| Arizona | | | | |
| - Unemployment Rate | September | 9.7% | 0.0% | 0.3% |
| - Initial Unemployment Insurance Claims | September | 23,569 | (14.2)% | (23.1)% |
| - Unemployment Insurance Claimants | August | 86,789 | 0.2% | (26.0)% |
| - Non-Farm Employment - Total | September | 2.40 million | 0.7% | 0.5% |
| Manufacturing | September | 147,600 | (0.5)% | (1.2)% |
| Construction | September | 116,100 | 0.2% | (5.0)% |
| - Average Weekly Hours, Manufacturing | September | 40.3 | 1.5% | 5.8% |
| - Contracting Tax Receipts (3-month average) | Jul-Sep | \$30.8 million | (0.7)% | (22.3)% |
| - Retail Sales Tax Receipts (3-month average) | Jul-Sep | \$126.8 million | (2.2)% | (1.9)% |
| - Residential Building Permits (3-month moving average) | | | | |
| Single-unit | Jul-Sep | 842 | (8.0)% | (36.1)% |
| Multi-unit | Jul-Sep | 142 | 72.5% | (8.0)% |
| - Greater Phoenix Existing Home Sales | | | | |
| Single-Family | September | 9,005 | 2.4% | (0.7)% |
| Townhouse/Condominium | September | 1,470 | (6.2)% | 15.7% |
| - Greater Phoenix Median Home Sales Price | | | | |
| Single-Family | September | \$137,000 | (1.9)% | (2.0)% |
| Townhouse/Condominium | September | \$94,500 | 0.9% | (15.4)% |
| - Foreclosure Activity, Maricopa County | | | | |
| Foreclosure Notices (Notice of Trustee's Sales Recorded) | September | 7,501 | (0.8)% | (4.5)% |
| Pending Foreclosures (Active Notices) | September | 41,039 | (0.7)% | (18.2)% |
| - Greater Phoenix S&P/Case-Shiller Home Price Index (Jan. 2000 = 100) | August | 108.84 | (1.3)% | 0.4% |
| - Arizona Months Supply of Housing, (ARMLS) | August | 7.4 months | (0.4) months | 1.5 months |
| - Phoenix Sky Harbor Air Passengers | July | 3.32 million | (0.9)% | (0.7)% |
| - Arizona Average Natural Gas Price (\$ per thousand cubic feet) | July | \$6.29 | 5.9% | 0.3% |
| - Arizona Consumer Confidence Index (1985 = 100) | 4 th Quarter 2010 | 56.3 | 14.7% | N/A |
| - Arizona Coincident Index (July 1992 = 100) | September | 199.12 | 0.1% | 0.8% |
| - Arizona Personal Income | 2 nd Quarter 2010 | \$223.6 billion | 1.3% | 1.7% |
| - Arizona Population | July 1, 2009 | 6.60 million | N/A | 1.5% |
| - AHCCCS Recipients | October | 1,343,955 | (0.5)% | 1.1% |
| - TANF Recipients | September | 41,887 | (13.8)% | (50.1)% |
| - SNAP (Food Stamps) Recipients | September | 1,078,339 | 0.0% | 10.5% |
| - ADC Inmate Growth (3-month average) | Jul-Sep | 40,311 | (66) inmates | (269) inmates |
| - Probation Caseload (Adult/Juvenile) | | | | |
| Non-Maricopa | August | 19,639 | 60 | (339) |
| Maricopa County | August | 26,936 | 59 | (2,880) |
| United States | | | | |
| - Gross Domestic Product (Chained 2005 dollars, SAAR) | 3 rd Quarter 2010 (Final Estimate) | \$13.2 trillion | 1.7% | 3.0% |
| - Consumer Confidence Index (1985 = 100) | October | 50.2 | 3.3% | 3.1% |
| - Leading Indicators Index (2004 = 100) | August | 110.4 | 0.3% | 6.0% |
| - U.S. Semiconductor Billings (3-month moving average) | Jun-Aug | \$4.84 billion | 2.0% | 47.1% |
| - Consumer Price Index, SA (1982-84 = 100) | September | 218.4 | 0.1% | 1.1% |

JLBC Meeting

At its October 6, 2010 meeting, the Joint Legislative Budget Committee considered the following issues:

Arizona Board of Regents – Review of FY 2011 Tuition Revenues – The Committee gave an unfavorable review of ABOR's expenditure plan for tuition revenue amounts greater than the amounts appropriated by the Legislature and all non-appropriated tuition and fee revenue for FY 2011.

Attorney General – Review of Allocation of Settlement Monies – The Committee gave a favorable review of a total of \$809,500 from 2 settlements: 1) a \$300,000 allocation resulting from mediation as part of ongoing Average Wholesale Price (AWP) litigation with pharmaceutical companies, of which \$273,000 will be deposited into the Consumer Protection-Consumer Fraud Revolving Fund; and 2) a \$509,500 settlement with several vitamin manufacturers, \$50,900 of which will be deposited into the Antitrust Enforcement Revolving Fund and \$458,500 that will be distributed to the Arizona Association of Food Banks.

Government Information Technology Agency – Review of the Arizona Public Safety Communication Advisory Commission – The Committee gave a favorable review of GITA's FY 2010 fourth quarter report and progress for the statewide interoperability design project, as well as the plan for use of \$2.2 million in anti-racketeering funds. The Committee will next review the project after the fourth quarter of FY 2011. The fourth quarter report will focus on GITA's accomplishments throughout FY 2011.

Arizona Department of Administration – Review of Risk Management Deductible – The Committee gave a favorable review of continuing the deductible amounts charged to agencies for risk management losses at the current \$10,000 statutory cap, and recommended that the Legislature consider raising the cap.



Summary of Recent Agency Reports

AHCCCS – Report on Healthcare Group: Quarterly Financial Statement – Pursuant to A.R.S. § 36-2912Z, the Arizona Health Care Cost Containment System (AHCCCS) submitted its quarterly financial report for Healthcare Group (HCG) for the period April 1, 2010 to June 30, 2010. The agency reports that HCG's revenues were \$2.0 million greater than their expenditures after adjustments for FY 2010. Of this amount, about \$353,000 was from the fourth quarter. HCG ended FY 2010 with total unpaid prior year obligations and other liabilities of \$12.4 million. These obligations and liabilities are \$(1) million less than they were at the beginning of the fiscal year. (Amy Upston)

AHCCCS – Report on Healthcare Group: Newly-Created Plans – Pursuant to A.R.S. § 36-2912AA, the Arizona Health Care Cost Containment System (AHCCCS) submitted its analysis that was used to determine Healthcare Group (HCG) rates of 2 newly-created plans. HCG currently offers 6 health care plans, and these 6 plans have been

updated to meet all of the "grandfathered" requirements of the Affordable Care Act (ACA). These include adding coverage of all children up to age 26, the phasing out of annual limits, and coverage of pre-existing conditions for children under age 19. Since these plans were in existence as of March 23, 2010, they are considered "grandfathered" plans.

When employers change insurance plans, they lose their "grandfathered" status. Thus, any new employers enrolling in HCG plans may not enroll in "grandfathered" plans. To account for this, AHCCCS created 2 new plans. The plans' rates are 10.5% and 6.2% more expensive than comparable "grandfathered" plans. As required by ACA, the new plans also cover preventive care and emergency service for out-of-network providers at the same cost sharing level as provided for in-network providers. (Amy Upston)

Summary of Recent Agency Reports

Department of Economic Security - Report on Reimbursement Rates for Developmental Disabilities Programs

– Pursuant to A.R.S. § 36-2959, the Department of Economic Security (DES) has provided its annual study of Medicaid reimbursement rates to service providers in the developmentally disabled (DD) program. The study states that the FY 2011 rates are adequate and appropriate, or clearly consistent with Title XIX principles. The study states rates are adequate based upon evidence that the division's network sufficiently provides the number, mix, and distribution of providers of services.

The study states that the current adopted rates are at approximately 84% of hypothetical benchmark rates, which are estimates of what the benchmark rates would be had they been adjusted for inflation. The decline compared to the benchmark rates is largely due to a 10% reduction in the rates paid to providers implemented by DES in response to the funding reduction adopted by the Legislature in the midyear FY 2009 budget revisions. The study also notes that since the benchmark indicators were not developed in the context of the current economic downturn, it is not suitable to compare the indicators to current actual rates to determine their appropriateness. (Aaron Galeener)

Department of Economic Security – Report on Annual Child Care Expenditures – A.R.S. § 46-810 requires the Department of Economic Security (DES) to provide an annual child care report to the Committee. The FY 2010 report shows that the average number of children served decreased to 33,352, or (26.6)% below FY 2009; the number of families served decreased by (29.5)%. Across categories, the number of children served in the Low Income Working category decreased (36.7)%, CPS-related placements decreased by

(14.6)%, and the number of TANF-related children increased by 0.5%, while the number of children receiving transitional child care decreased by (19.4)%.

The amount spent by DES on child care subsidies decreased to \$136,241,993, or (29.6)% below FY 2009.

The average monthly subsidy paid per child declined (3.1)% to \$340.41. The total amount of co-payments decreased (32.1)% from FY 2009 to \$10,639,457. (Aaron Galeener)

Department of Economic Security – Annual Report on Temporary Assistance for Needy Families (TANF) Grant Diversion Program

– Pursuant to A.R.S. § 46-298, the Department of Economic Security (DES) has provided the 2010 annual report on the Temporary Assistance for Needy Families Grant Diversion Program. The Grant Diversion Program's purpose is to divert applicants from long-term TANF cash assistance by offering immediate, one-time assistance to resolve a financial crisis. In FY 2010, 9,276 applicant households chose the grant diversion option and were diverted from long-term assistance. A total of 5,254 households obtained employment within 90 days of receiving assistance under the diversion program in FY 2010. Through September 2010, the most recent month for which data is available, 475 households reapplied for long-term assistance within 180 days of their participation in the diversion program. Complete data for FY 2009 indicates 288 households of the total 2,951 households receiving diversion payments reapplied within 180 days. (Aaron Galeener)

Department of Environmental Quality (DEQ) – Report on Progress of Water Quality Assurance Revolving Fund Sites – Pursuant to a General Appropriation Act footnote, DEQ is required to report

the status of each site listed on the Water Quality Assurance Revolving Fund (WQARF) registry sites.

There are 10 steps in the WQARF process, beginning with a preliminary investigation, continuing through various studies and remediation once a site has been placed on the registry, and ending with the delisting of a site once the investigation or cleanup has been completed.

The FY 2010 report contained a listing of the 35 WQARF sites on the registry. Progress goals were met at 25 of these sites. Of the 35 reported sites, 12 were listed in the Early Response Action phase at least partially during FY 2010. Eleven sites had advanced to the Implementation of Remedy Phase or further during this same period.

The department had estimated that 1 site would be delisted by the end of FY 2010, but the site remains on the report. (James Alcantar)

Supreme Court – Report on Current and Future Automation Projects

– Pursuant to a General Appropriation Act footnote, the Administrative Office of the Courts (AOC) has provided its FY 2011 report to the JLBC on current and future automation projects coordinated by the AOC. The AOC estimates total state automation expenditures in FY 2011 will be approximately \$18.4 million. Of this amount, approximately \$8.1 million, or 44% will be spent on 7 new projects, \$5.7 million, or 31% will be spent on shared infrastructure, and \$4.7 million, or 25% will be spent on ongoing automation support in FY 2011. Of the 7 new projects, the larger projects include:

- Updating the limited jurisdiction case management system for statewide utilization (\$4,153,781)
- Updating and enhancing the Juvenile On-Line Tracking System (JOLTS) (\$972,863)

Summary of Recent Agency Reports (Continued)

- Further development of electronic filing (\$2,559,294) (James Alcantar)

Department of Water Resources – Report on Interstate Water Banking
– Pursuant to A.R.S. § 45-2473, the Department of Water Resources has submitted a report accounting for all monies received through the Interstate Water Banking Agreement with Nevada and other obligations.

In 2001, the Southern Nevada Water Authority (SNWA) agreed to pay the Arizona Water Banking Authority (AWBA) \$230 million for delivery and storage, if available, of 1.25 million acre-feet of unused Arizona water. Equal payments of \$23 million per year from Nevada to the AWBA were to begin in 2009 and continue through 2018. Pursuant to the 2009 modified agreement, and because no Arizona water was available to be stored in FY 2009, the payment of \$23 million was delayed upon SNWA's request. In FY 2010, AWBA received \$12.7 million from SNWA to bank 59,024 storage credits of water from Nevada's unused Colorado River allocation, instead of purchasing water from Arizona. The subaccount ending FY 2010 balance was \$18,000.

In 2004, SNWA agreed to pay an additional \$100 million to AWBA in exchange for a guarantee that the 1.25 million storage credits would be available for Nevada. If the additional \$100 million is not needed to guarantee the credits in the short term, Arizona may use this amount for its own purposes, subject to legislative appropriation. AWBA received the \$100 million from SNWA in 2 installments in 2005, which were deposited in a subaccount with the State Treasurer. Of this amount, approximately \$80 million has been used to bank 541,418 storage credits for Nevada. The remaining \$20 million has been transferred to

the General Fund, including \$11.1 million as part of the mid-year FY 2010 budget revisions. The subaccount FY 2010 ending balance was approximately \$5,100.

In total, the AWBA has banked 600,442 in storage credits, or 48% of the 1.25 million credits guaranteed to Nevada. The combined FY 2010 ending balance was approximately \$23,100. (Aaron Galeener)

September Spending

FY 2011 Spending

September 2010 General Fund spending of \$819.8 million was \$339.1 million higher than September 2009. Year-to-date, spending is \$3.4 billion through September, or \$591.0 million above last year. (See Table 6).

- In September, the Arizona Department of Education spending was \$212.1 million higher than the prior year. September expenditures were higher due to ADE making a monthly payment to school districts which was not made in the prior year.
- University spending was \$255.2 million in September, or \$107.8 million higher than the prior year. The increased expenditure amount reflects a change in the payment schedule.
- September spending by individual agencies compared to the prior year was lower than it otherwise would have been due to employer health insurance contributions. These contributions were made in August this year, compared to September in the prior year.

“September 2010 General Fund spending of \$819.8 million was \$339.1 million higher than September 2009.”

Table 6

General Fund Spending (\$ in Millions)

| Agency | <u>Sept 11</u> | <u>Change from Sept 10</u> | <u>Year to Date</u> | <u>YTD Change from FY 10</u> |
|-------------------------|-----------------------|-----------------------------------|----------------------------|-------------------------------------|
| AHCCCS | 121.9 | 0.6 | 430.7 | 27.8 |
| Corrections | 62.4 | 25.5 | 217.3 | 24.3 |
| Economic Security | 33.4 | 15.9 | 351.7 | 23.1 |
| Education | 308.7 | 212.1 | 1,601.2 | 517.9 |
| Health Services | 5.7 | (10.5) | 123.2 | (29.7) |
| Public Safety | 2.3 | (0.4) | 24.3 | (18.6) |
| School Facilities Board | 0.1 | - | 32.9 | (49.0) |
| Universities | 255.2 | 107.8 | 370.4 | 49.1 |
| Leaseback Debt Service | - | - | 52.1 | 52.1 |
| Other | <u>30.1</u> | <u>(11.9)</u> | <u>200.1</u> | <u>(6.0)</u> |
| Total | 819.8 | 339.1 | 3,403.9 | 591.0 |

| Agency | General Fund Spending (\$ in Thousands) | | | YTD Change from FY 10 |
|---|--|-------------------------------------|---------------------|----------------------------------|
| | September 10 | Change from September 09 | Year-to-Date | |
| Department of Administration | 949.7 | 129.1 | 9,410.1 | 3,370.3 |
| Department of Admin Sale/Leaseback D/S | - | - | 52,066.9 | 52,066.9 |
| Office of Administrative Hearings | 8.1 | (112.3) | 280.3 | 3.5 |
| Department of Agriculture | 454.4 | (1,016.0) | 3,721.1 | 995.2 |
| AHCCCS | 121,876.6 | 614.8 | 430,646.8 | 27,776.4 |
| Arizona Commission on the Arts | 118.2 | 66.5 | 206.3 | 52.7 |
| Attorney General | 1,032.0 | (3,576.1) | 3,558.2 | (3,939.5) |
| AZ Capital Post Conviction Public Defender | 49.1 | (13.2) | 166.7 | (39.5) |
| State Board of Charter Schools | 39.6 | (99.8) | 219.1 | (9.8) |
| Board of Chiropractic Examiners | - | - | - | (148.0) |
| Department of Commerce | 2,092.6 | 1,982.3 | 2,343.3 | 1,996.0 |
| Community Colleges | - | - | 33,106.6 | - |
| Corporation Commission | 36.5 | 64.7 | 179.6 | 34.3 |
| Department of Corrections | 62,413.1 | 25,504.8 | 217,332.6 | 24,346.2 |
| AZ Criminal Justice Commission | - | 2.1 | - | 4.6 |
| AZ St. Schools for the Deaf & Blind | 2,040.3 | 1,229.6 | 5,578.7 | 389.0 |
| Department of Economic Security | 33,419.8 | 15,866.3 | 351,746.9 | 23,074.5 |
| Department of Education | 308,670.6 | 212,084.2 | 1,601,192.3 | 517,946.0 |
| DEMA | 1,110.0 | 425.6 | 3,259.0 | 1,305.6 |
| Department of Environmental Quality | (0.6) | (353.7) | 0.6 | (1,247.8) |
| DEQ –WQARF | 7,000.0 | - | 7,000.0 | - |
| Office of Equal Opportunity | 8.4 | (4.2) | 58.8 | 10.8 |
| State Board of Equalization | 52.5 | (31.7) | 140.1 | (39.8) |
| Board of Executive Clemency | 34.8 | (254.7) | 380.9 | (59.1) |
| Department of Financial Institutions | 525.6 | 110.2 | 1,130.0 | 190.6 |
| Department of Fire, Life, Bldg Safety | 611.0 | 447.6 | 834.6 | (44.7) |
| Office of the State Forrester | 76.4 | 76.4 | 721.1 | 721.1 |
| Board of Funeral Directors | - | (100.0) | - | (100.0) |
| Arizona Geological Survey | 18.8 | (126.0) | 98.6 | (150.0) |
| Government Information Tech. | 27.8 | (47.9) | 149.3 | (28.2) |
| Governor | 431.5 | (46.9) | 2,357.5 | 666.0 |
| Gov. - OSPB | 239.2 | 148.8 | 551.6 | 136.2 |
| Department of Health Services | 5,732.6 | (10,477.1) | 123,219.0 | (29,726.9) |
| Arizona Historical Society | 283.1 | (1,112.1) | 3,406.6 | 1,503.1 |
| Prescott Historical Society of AZ | 33.7 | (4.0) | 120.6 | (40.4) |
| Independent Redistricting Comm. | - | - | - | (24.8) |
| Commission on Indian Affairs | 1.1 | (6.6) | 11.7 | 3.4 |
| Department of Insurance | 295.6 | (815.3) | 2,322.9 | (81.9) |
| Judiciary | | | | |
| Supreme Court | 1,308.8 | 28.8 | 12,529.7 | 5,199.1 |
| Superior Court | 195.8 | (1,081.1) | 17,313.0 | (2,688.8) |
| Court of Appeals | 273.4 | (984.3) | 5,197.0 | 1,602.6 |
| Dept. of Juvenile Corrections | 3,465.0 | (708.7) | 20,964.0 | 4,827.7 |
| State Land Department | 2.5 | (990.2) | 768.3 | (3,992.0) |

| Agency | September 10 | Change from September 09 | Year-to-Date | YTD Change from FY 10 |
|---|------------------|-----------------------------|--------------------|--------------------------|
| Law Enforcement Merit System | 7.1 | 1.6 | 24.9 | 4.3 |
| Legislature | | | | |
| Auditor General | 1,094.3 | (693.4) | 6,125.3 | 1,110.1 |
| House of Representatives | 838.4 | (1,188.0) | 2,650.5 | (1,465.9) |
| Joint Legislative Budget Comm. | 158.5 | (244.2) | 800.4 | 13.6 |
| Legislative Council | 230.4 | (508.2) | 1,832.2 | 146.7 |
| Senate | 678.4 | (913.1) | 3,115.6 | 53.0 |
| Department of Liquor Licenses | - | (165.3) | - | (537.8) |
| Board of Medical Student Loans | 63.7 | (121.9) | 191.8 | (191.3) |
| Mine Inspector | 42.7 | (148.8) | 413.2 | (44.7) |
| Department of Mines & Mineral Resources | 597.4 | 503.6 | 708.5 | 538.0 |
| Nav. Streams & Adjudication | 43.2 | 37.1 | 56.1 | 1.9 |
| Board of Osteopathic Examiners | - | (100.0) | - | (100.0) |
| Arizona State Parks Board | - | 0.3 | 20,000.0 | (1,900.6) |
| Board of Pharmacy | - | (200.0) | - | (200.0) |
| Pioneers' Home | 74.7 | 74.7 | 281.1 | 281.1 |
| Board of Psychologist Examiners | - | (300.0) | - | (300.0) |
| Comm. for Postsecondary Ed. | 157.7 | (174.6) | 157.7 | (424.7) |
| Department of Public Safety | 2,305.1 | (412.5) | 24,281.2 | (18,644.4) |
| Arizona Department of Racing | 1,941.3 | 1,661.8 | 2,620.7 | (89.0) |
| Radiation Regulatory Agency | - | (55.3) | 396.9 | (16.7) |
| Arizona Rangers Pension | 1.2 | 0.2 | 3.5 | - |
| Real Estate Department | 175.8 | (3.0) | 1,348.1 | 662.8 |
| Department of Revenue | 1,105.6 | 364.3 | 11,320.9 | 826.7 |
| School Facilities Board | 124.6 | 17.6 | 32,885.4 | (49,040.1) |
| Secretary of State | 1,128.1 | 140.1 | 5,952.7 | 3,526.0 |
| Tax Appeals Board | 20.0 | (20.7) | 97.8 | 14.4 |
| Office of Tourism | - | (200.0) | - | (200.0) |
| Department of Transportation | 0.5 | (2.5) | 12.1 | 1.6 |
| State Treasurer | - | (198.7) | - | (1,087.0) |
| Universities | | | | |
| Board of Regents | 283.9 | (3,869.6) | 5,772.9 | 935.9 |
| Arizona State University | 114,772.5 | 51,011.8 | 163,162.2 | 21,780.7 |
| Northern Arizona University | 39,045.4 | 16,204.0 | 56,149.3 | 7,364.4 |
| University of Arizona | 101,064.0 | 44,469.8 | 145,334.1 | 19,021.0 |
| Veterinary Medical Examiners Board | - | - | - | (250.0) |
| Department of Veteran Services | (1,663.2) | (2,063.1) | 1,933.9 | 98.2 |
| Department of Water Resources | 420.4 | (623.6) | 1,654.5 | (2,308.5) |
| Department of Weights & Measures | 80.6 | (19.8) | 229.2 | (80.1) |
| Other | 67.4 | 26.6 | 119.2 | (14,359.5) |
| Grand Total | 819,787.3 | 339,107.1 | 3,403,922.3 | 591,000.7 |