

ARIZONA
MONTHLY FISCAL HIGHLIGHTS
May 2004

General Fund revenue collections continued to be strong in May. The state collected \$507.4 million, which was 21.8% above May 2003.

May collections resulted in a year-to-date surplus of \$144.5 million above the recently enacted budget estimates. The enacted budget includes “triggers,” which dedicate revenue for certain purposes above the approved budget.

The actual enactment of the FY 2004 triggers will depend on revenues through the end of June. If the current revenue surplus of \$144.5 million holds through June, three sets of triggers would be enacted. The first two sets of triggers would add a total of \$102 million in funding for School Facilities Board Building Renewal and Deficiencies Correction, Child Care, State Employer Health Insurance charges, Department of Public Safety communications system improvements, and the Budget Stabilization Fund. In addition, this level of surplus would provide \$42.5 million to be divided evenly between the General Fund and the Budget Stabilization Fund.

This report also includes summaries of the May JLBC meeting and the June JCCR meeting.

General Fund Revenues				
Compared to Revised FY 2004 Forecasts and FY 2003 Collections				
(\$ in Millions)				
	<u>FY 2004 Collections</u>	<u>Difference From 1/04 Forecast ^{1/}</u>	<u>Difference From 5/04 Forecast ^{2/}</u>	<u>Difference From FY 2003 ^{3/}</u>
May	\$ 507.4	\$ 70.2	N/A	\$ 53.3
Year-to-Date	\$ 5,836.7	\$ 222.5	\$ 144.5	\$ 505.9

^{1/} Revised FY 2004 forecast (January 2004).
^{2/} Revised FY 2004 forecast (budget signed by Governor).
^{3/} Excludes federal cash assistance grant, URS, judicial enhancement and amnesty deposit.

Sales Tax revenue in May increased by 10.3%, bringing the year-to-date growth rate up to 8.7%. Due to its new computer system, the Department of Revenue does not have final May receipts available by category as of this date.

Individual Income Tax collections in May were significantly above last year. Withholding tax collections increased by \$1.4 million or 2.5%. Estimated payments were up \$1.3 million over last May, and final payments were up \$14.5 million. In addition, refunds were \$16.2 million less than last year, a 13.2% decline.

The overall individual income tax revenue growth rate of 37.2% for May brings the year-to-date growth rate up to 10.6%. Growth for the category has been led by significantly higher than anticipated levels of estimated and final payments during this year’s tax season.

Corporate Income Tax revenue increased by \$25.4 million in May compared to last year. Year-to-date corporate income tax revenue is 32% above last year’s results. May collections included approximately \$9.4 million in corporate audit revenue which was taken in through the amnesty program.

Tax Amnesty distributions were completed by the Department of Revenue (DOR) in May. Total amnesty collections distributed to the General Fund were \$69.1 million. This amount had already been incorporated into the enacted budget revenue estimates. Of this amount, \$27.6 million was distributed in November, and the remaining \$41.5 million was distributed in May. DOR has indicated that \$22 million of the total amnesty collections represent “normal” corporate income tax audit activity. This amount has been included in year-to-date corporate collections. The remaining \$47.1 million represents tax amnesty revenue. Amnesty collections by revenue category are provided in the following table:

FY 2004 Tax Amnesty Collections	
\$ in Millions	
Sales Tax ^{1/}	\$ 12.3
Individual Income Tax	\$ 3.0
Corporate Income Tax ^{2/}	\$ 31.7
Other	<u>\$ 0.1</u>
Total	\$ 47.1

^{1/} Amount is net of distributions to local jurisdictions.
^{2/} Does not include \$22 million of normal audit activity.



Recent Economic Indicators: The latest economic data reflected continued growth. **U.S. Semiconductor Billings** (three-month moving average) climbed 3.7% in April to almost \$3.2 billion, a 30.4% advance from a year ago. The Semiconductor Industry Association reported that strong growth in the U.S. and China helped to propel sales higher.

Strengthening economic growth renewed concerns about inflation, which trended upward in recent months. The **U.S. Consumer Price Index (CPI)** (three-month moving average) jumped 0.5% in May, with rising energy prices fueling much of the gain. Over the same period, the core CPI, excluding fuel and energy costs, increased 0.3%.

Consumer sentiment held steady last month, with the Conference Board’s **Consumer Confidence Index** edging up 0.2% in May. The index now stands at 93.2, an 11.5% improvement from a year ago. The assessment of current conditions component was the most significant factor driving May’s results. The **U.S. Index of Leading Economic Indicators** increased 0.5% in May, with 8 of the 10 components scoring gains. Average weekly manufacturing hours made the largest positive contribution.

The state economy continued to demonstrate growing strength. The **Arizona unemployment rate** dipped to 5.1% (seasonally adjusted) in May, reversing much of the increase from the prior month. Meanwhile, **non-farm employment** increased by 3,000, or 2.5%, in May in spite of a loss of (500) manufacturing jobs. Once again, the health care and construction sectors led the way.

The **Arizona Business Conditions Index (BCI)** declined to 63.8 in May but remained well above the 50% mark associated with an expanding economy. New orders and production fell, but the employment component gained strength. The **Arizona Tourism Barometer** dropped from its recent high in April but remained 10.1% above the level reported a year ago.

Looking ahead, the **Arizona Index of Leading Economic Indicators** advanced 0.7% in April. Hours worked in manufacturing was the primary positive force behind the improvement.

The most recent statistics from AHCCCS and DES continue to show lower caseloads. The number of acute-care **AHCCCS clients** declined (1.1)% during the last three months. The **Proposition 204 caseload** decreased (2.7)% during the latest three-month period, but the number of clients remained 6.3% higher than a year ago.

The **number of TANF recipients** (three-month average) declined to 119,440 in April, a (4.5)% drop from the previous three months. The caseload was (3.2)% below last year’s level and (6.3)% below the forecast.

The **Department of Corrections’ inmate population** (three-month average) expanded by an average of 171 inmates per month from March through May, which was well above the budgeted rate of 118 new inmates (net) per month. The head count continued to be influenced by the unusually large number of inmates that entered the system in March.

RECENT ECONOMIC INDICATORS				
Indicator	Time Period	Current Value	Change From Prior Period	Change From Prior Year
Arizona				
-Unemployment Rate	May	5.1%	(0.3)%	(0.8)%
-Jobs	May	2,350 million	0.1%	2.5%
-Contracting Tax Receipts (3 month average)	March-May	\$48.4 million	5.3%	18.1%
-Retail Sales Tax Receipts (3 month average)	March-May	\$133.3 million	(4.3)%	9.9%
-Arizona Tourism Barometer	April	91.6	(2.0)%	10.1%
-Leading Indicators Index	April	124.9	0.7%	4.2%
-Business Conditions Index (>50 signifies expansion)	May	63.8	(3.3)%	20.9%
-AHCCCS Recipients (3 month average)				
Regular	March-May	562,348	(1.1)%	0.9%
Proposition 204		168,041	(2.7)%	6.3%
-TANF Recipients (3 month average)	February-April	119,440	(4.5)%	(3.2)%
-DOC Inmate Growth (3 month average)	March-May	31,832	171 inmates	1,193 inmates
U.S.				
-Consumer Confidence Index	May	93.2	0.2%	11.5%
-Leading Indicators Index	May	116.5	0.5%	4.4%
-U.S. Semiconductor Billings (3 month moving average)	February-April	\$3.189 billion	3.7%	30.4%
-Consumer Price Index (3 month moving average)	March-May	186.3	0.5%	2.4%

State of Arizona

General Fund Revenue: Change from Previous Year and January Revised Forecast May, 2004

	Current Month					FY 2004 YTD (Eleven Months)				
	Actual May 2004	Change From May 2003		Revised Forecast		Actual May 2004	Change from May 2003		Revised Forecast	
		Amount	Percent	Amount	Percent		Amount	Percent	Amount	Percent
<u>Taxes</u>										
Sales and Use	\$277,369,244	\$25,789,288	10.3 %	\$10,487,110	3.9 %	\$3,008,759,935	\$240,482,556	8.7 %	\$67,079,390	2.3 %
Income - Individual	135,278,064	36,650,404	37.2	26,504,758	24.4	2,066,692,325	198,525,783	10.6	123,009,451	6.3
- Corporate	37,998,517	25,369,764	200.9	25,369,764	200.9	403,474,561	97,861,754	32.0	24,615,287	6.5
Property	6,203,222	(1,650,068)	(21.0)	1,342,388	27.6	30,084,280	1,755,475	6.2	(5,193,767)	(14.7)
Luxury	5,141,687	(188,831)	(3.5)	72,112	1.4	56,080,641	(3,383,878)	(5.7)	1,150,517	2.1
Insurance Premium	26,640,793	3,944,750	17.4	2,694,594	11.3	248,892,790	56,822,305	29.6	7,896,855	3.3
Estate	4,513,856	(206,964)	(4.4)	1,287,156	39.9	36,686,789	(49,258,636)	(57.3)	(85,778)	(0.2)
Other Taxes	47,872	13,796	40.5	(463,028)	--	2,735,005	(5,904,591)	(68.3)	(1,518,540)	(35.7)
Sub-Total Taxes	\$493,193,255	\$89,722,139	22.2 %	\$67,294,854	15.8 %	\$5,853,406,326	\$536,900,768	10.1 %	\$216,953,415	3.8 %
<u>Other Revenue</u>										
Lottery	0	(2,159,400)	(100.0)	0	--	31,000,000	1,435,000	4.9	0	0.0
License, Fees and Permits	1,697,283	(246,784)	(12.7)	30,875	1.9	22,985,710	(336,172)	(1.4)	967,318	4.4
Interest	1,343,816	342,712	34.2	229,098	20.6	23,398,484	9,644,721	70.1	(1,276,395)	(5.2)
Sales and Services	3,469,135	355,280	11.4	369,575	11.9	43,185,171	2,486,768	6.1	578,126	1.4
Other Miscellaneous	5,905,104	8,136,468	--	8,208,836	(356.3)	38,401,192	25,360,637	194.5	14,134,536	58.2
Disproportionate Share	0	0	--	0	--	5,625,187	5,625,187	--	0	--
Transfers and Reimbursements	158,592	(42,596,701)	(99.6)	(6,076,104)	(97.5)	13,433,412	(70,746,217)	(84.0)	(9,200,131)	(40.6)
BSF Transfer for Alt. Fuels	0	(276,364)	(100.0)	0	--	187,594	(4,441,240)	(95.9)	187,594	--
Sub-Total Other Revenue	12,573,930	(36,444,789)	(74.3) %	2,762,280	28.2 %	178,216,750	(30,971,316)	(14.8) %	5,391,048	3.1 %
TOTAL BASE REVENUE	\$505,767,185	\$53,277,350	11.8 %	\$70,057,134	16.1 %	\$6,031,623,076	\$505,929,452	9.2 %	\$222,344,463	3.8 %
<u>One-Time Revenue</u>										
Urban Revenue Sharing	(30,422,097)	5,457,824	(15.2)	0	0.0	(334,643,067)	60,036,064	(15.2)	0	0.0
Tax Amnesty	32,043,121	32,043,121	--	123,527	--	47,123,527	47,123,527	--	123,527	--
Federal Cash Assistance	0	0	--	0	--	87,234,214	87,234,214	--	0	--
Judicial Enhancement	0	0	--	0	--	5,393,000	5,393,000	--	0	--
Sub-Total Transfers In	1,621,024	37,500,945	--	123,527	--	(194,892,326)	199,786,805	(50.6)	123,527	(0.1)
TOTAL REVENUE	\$507,388,209	\$90,778,295	21.8 %	\$70,180,661	16.1 %	\$5,836,730,750	\$705,716,257	13.8 %	\$222,467,990	4.0 %

VP% = Percent change from comparable period in prior year

VF% = Variance from forecast

F% = Forecast percent change for the fiscal year.

R% = Average percent change from comparable period in prior year which must be attained over remaining months to realize the forecast for year.

JLBC MEETING

At its May 25th meeting, the Joint Legislative Budget Committee considered the following issues:

Department of Administration – Review of Self-Insurance for State Employee Health Insurance –

The Committee gave a favorable review of the Department of Administration's (ADOA) plan to self-insure state employee health benefits. The favorable review included the following conditions: 1) that ADOA report to the Committee on whether final negotiated integrated rates are lower than current estimates; 2) that ADOA report to the Committee on what performance measures they will establish to evaluate the new contracts; 3) that ADOA report quarterly to the Committee on the implementation of self-insurance including feedback from state employees and retirees; 4) that ADOA should structure the contribution strategy to treat the administrative costs of integrated contracts nearly the same as non-integrated contracts.

ADOA's proposal is to move from a fully insured system for state employee health insurance benefits to a self-insured system, where the state assumes the risks associated with providing health care coverage to its employees. ADOA was required to self-insure by October 1, 2003. Due to concern that there was insufficient time to implement self-insurance by the October 1 deadline, Laws 2003, Chapter 2 removed the deadline but established language allowing the department to self-insure upon review of the Committee.

Self-insured and fully-insured options have comparable direct costs in FY 2005. Actuarial analysis (contracted by ADOA) has determined that administrative costs under self-insurance are lower than under the state's fully insured contract, which would be offset by the need to establish a \$50 million reserve under the self-insurance option. ADOA actuaries believe that administrative costs in the long run under self-insurance (5% growth) will rise less quickly than administrative costs under a fully integrated system (14% growth). This savings could reach \$40 million by FY 2009. CIGNA, the company that has the current state employee health insurance contract, disputes this analysis.

ADOA had originally proposed non-integrated multiple vendors, and had issued an RFP for these contracts. A non-integrated plan would allow vendors to bid on 5 contracts separately on distinct components – medical services, pharmacy benefits, utilization review/disease management, stop-loss insurance and a third party administrator. There was concern, however, that there was no integrated option, in which one company would provide all of these services for the entire network. As a result, ADOA issued an RFP in April for an integrated plan.

Subsequent to the May 25th meeting, ADOA has moved forward on awarding various contracts for state-employee health care benefits. Contracts were awarded by geographic area and type of plan.

- Employees in Maricopa, Gila, Pinal, Pima and Santa Cruz Counties have a choice between 3 non-integrated and 1 integrated plan.
- Employees in all other counties have only 2 non-integrated plans to choose from.
- Employees will be required to pay \$10 more per month if they select an integrated plan (ADOA had originally proposed a \$15 differential) than a non-integrated plan.
- Walgreen's Health Initiative will be the pharmacy manager. Walgreens, however, is contracting with non-Walgreen pharmacies throughout the state.
- Patients will be able to see more specialists without first seeing a primary care physician than under the current contract.

Department of Economic Security – Approval of Transfer of Appropriations for TANF Cash Benefits – The Committee favorably reviewed the Department of Economic Security's (DES) plan to transfer \$6.5 million of federal Temporary Assistance for Needy Families (TANF) Block Grant monies from the JOBS Special Line Item (SLI) into the TANF Cash Benefits SLI.

This transfer was temporary and was reversed once FY 2004 supplemental funding for TANF Cash Benefits became available to the agency.

JCCR MEETING

At its June 22nd meeting, the Joint Committee on Capital Review considered the following issues:

Maricopa Community College District Bond Projects – The Committee gave a favorable review to the district's ten-year, \$951.4 million General Obligation bond proposal. Proceeds from the issuance will fund \$651.4 million in capital projects and \$300.0 in technology upgrades. Debt service will extend 22 years, ranging between \$21.0 million and \$97.2 million annually, paid through increases to secondary property taxes in the district. These tax rates will fluctuate with outstanding debt, but will average \$16 for every \$100,000 of property value. The Committee recommended that the district obtain Committee review before each actual bond issuance. The district will sell the bonds in five biennial installments of \$190.3 million each. The total issuance still requires voter approval in November.

Department of Transportation – The Committee gave a favorable review to the ADOT FY 2005 highway construction budget expenditure plan for consulting services, totaling \$105 million. Additionally, the Committee adopted traffic congestion performance measures and required the department to report on those measures as part of its FY 2006 expenditure plan review. The Committee also requested a complete list of over-capacity state highway segments by September 1, 2004.

Game and Fish Canyon Creek Hatchery – The Committee gave a favorable review to the Arizona Game and Fish Department (AGFD) Canyon Creek fish hatchery clarifier project. AGFD will combine a total of \$685,000 from

previously appropriated and federal grant monies to upgrade effluent treatment facilities at the hatchery.

NAU Research Infrastructure Lease-Purchase Projects – The Committee gave a favorable review to the issuance of \$39.3 million in Certificates of Participation (COP) for the College of Engineering and Technology Renovation, as well as to the Applied Research and Development Facility. The COP issuance will be \$15.0 million for the College of Engineering, \$18.0 million for the Applied R&D Facility, and \$6.3 million to capitalize interest until General Fund support becomes available in FY 2008. Starting in FY 2008, debt service will extend 23 years at \$2.9 million annually. The financing will increase NAU's debt ratio (debt service as a percent of total expenditures) from 4.2% to 5.3%. The statutory cap is 8%.

The Committee requests that NAU report on any project changes that exceed 10% of the budgeted contingency. The Committee's favorable review does not endorse future General Fund appropriations for related operational costs. Lastly, the Committee requested a cost-benefit analysis of the building's "green building" standards.

U of A Arizona Capital Project Revisions – The Committee gave a favorable review to the revised cost of the Chemistry Building Expansion research infrastructure lease-purchase project. At its September 2003 meeting, the Committee favorably reviewed a total project cost of \$45,000,000. Since then, construction material costs, especially for steel, rose significantly. To address these cost increases, U of A will reduce the expansion from 88,500 to 85,000 square feet, reallocate \$2.6 million of contingency funds, and spend an additional \$1.1 million of indirect cost recovery and gift monies. Some Committee members expressed concerns that this university research infrastructure project, originally more costly than any other by \$50 per square-foot, now requires an additional \$30 per square-foot to complete. Building expansions tend to have a higher cost than new construction.

U of A also reported to the Committee on contingency reallocations for two other projects, both related to rising construction material costs.

ASU Academic Renovations and Maintenance – The Committee gave a favorable review to the issuance of \$10.0 million in system revenue bonds for Academic Renovations and Deferred Maintenance Phase I. Debt service will extend 15 years at \$1.0 million annually, paid through tuition collections. This financing will increase ASU's debt ratio from 5.8% to 5.9%. The statutory cap is 8%.

The Committee requested that ASU report on any project changes that exceed 10% of the budgeted contingency. The Committee's favorable review does not endorse future General Fund appropriations to offset tuition collection shortfalls. Lastly, the Committee recommended that bonding not finance any repairs whose typical life span is less than the bond repayment period.

School Facilities Board – The Committee approved conversion of \$247.1 million in short-term variable-rate taxable bonds to long-term fixed-rate tax-exempt bonds. The Committee approved the original short-term bond issuance at its August 2003 meeting to fund deficiencies correction in light of certain IRS issues, but requested that SFB obtain approval before converting the bonds.

Converting to tax-exempt bonds will save SFB \$33.4 million in taxes over the life of the issuance. However, bond-rating agencies indicated they would issue a junk bond rating to SFB unless the board established a reserve fund. The poor rating resulted from uncertain annual revenues to the Permanent State School Fund, which SFB will use for debt service. To obtain the highest bond rating, SFB had to purchase \$7.2 million in insurance and establish a \$12.8 million reserve fund. Some Committee members expressed concerns that the board did not anticipate the IRS issues, conversion fees, or its potential low credit rating.

The Committee also gave a favorable review to the board's list of potential new school construction projects, to be financed with \$230 million in lease-purchase agreements. The list covers 35 projects in 27 school districts. Debt service will extend 15 years at approximately \$18.6 million annually.

State Parks Board Yuma Crossing Transfer – The Committee approved a land transfer of approximately 2.2 acres at Yuma Crossing State Historical Park to the City of Yuma. The City of Yuma requested this land as part of its downtown redevelopment, while the state originally obtained the land at no cost and the board had no plans to develop it. The Committee recommended that the U.S. General Services Administration also approve the transfer.

ADC Prison Reports – The Committee received a report from the Arizona Departments of Administration and Corrections on prison projects that the Committee approved at its March 2004 meeting. The 1,000-bed state prison expansion projects are on schedule for completion in November 2004. Meanwhile, ADC is reviewing contract proposals for 1,000 new private prison beds and expects to award the contract in July 2004, with occupancy beginning March 2005. The Committee requested continuing reports at least every other month.

Telecommunications Privatization – The Committee received an informational update on the State Telecommunications Privatization Solicitation, issued by the Arizona Department of Administration (ADOA). Some Committee members expressed concerns that the released request for proposals, by allowing the possibility of full scale telecommunications outsourcing, could reduce competition. The Committee requested more detail on ADOA planned oversight and control of any final contracts. ADOA must secure Committee review and award any final contracts by mid-August.