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"August collections were \$(64.5) million below the monthly forecast based on the recently enacted state budget."

This report has been prepared for the Arizona Legislature by the Joint Legislative Budget Committee Staff on September 28, 2007.

This Month



August General Fund revenue collections were \$685.7 million. This amount was (2.7)% below August of last year. August collections were \$(64.5) million below the monthly forecast based on the recently enacted state budget. For the fiscal year-to-date, General Fund revenue collections are \$(89.0) million less than forecast. (See page 12.)

The August performance of the major categories was again disappointing:

- Individual income tax collections decreased (5.7)%, and were \$(41.9) million short of the monthly forecast.
- Corporate income tax collections were (9.1)% lower than last August, or \$(6.4) million less than expected.
- While sales tax collections were 3.7% above last year, this revenue level was \$(14.8) million below forecast.

FY 2007 Ending Balance – We first reported in the July Monthly Fiscal Highlights that preliminary FY 2007 year-end General Fund revenues were \$(226) million below the forecast. Based on this preliminary figure, the FY 2007 ending balance would be \$303 million.

We had planned to provide an update on the status of the FY 2007 ending balance in the

current edition of the Monthly Fiscal Highlights. Laws 2006, Chapter 344 requires that the Executive provide the JLBC by September 15, 2007 with an estimate of the FY 2007 ending balance, including projections of total FY 2007 revenues and expenditures. To date, the Executive has not provided this information. The Department of Administration's General Accounting Office is responsible for these initial estimates.

While the JLBC Staff has already calculated a preliminary FY 2007 revenue number, the Executive estimates would provide an initial perspective on the level of unspent of FY 2007 appropriations, otherwise known as "revertments." The budget annually includes an estimate for revertments, which can be especially significant if caseloads in entitlement programs are less than anticipated. The FY 2007 budget, as revised during the last session, included estimated revertments of \$113 million.

Based on a JLBC Staff analysis, we believe that FY 2007 revertments may be significantly higher than expected, which would offset some of the \$(226) million revenue shortfall. The Depart-

Table of Contents

August Revenues	3	Summary of Recent Agency Reports (cont'd)	
Recent Economic Indicators	4	• Gov. Council on Workforce Policy – Annual Report	8
Finance Advisory Committee Meeting	6	• DHS – MethSMART Prevention Program	9
JLBC Meeting Summary		• Homeland Security – Funding	9
• DES – Long Term Care Capitation Rates.....	7	• Supreme Court – Automation Projects	9
• DES – Family Preservation Projects	7	• Supreme Court – Case and Cash Management System.....	10
• ADE – eLearning Pilot Program	7	• ASRS – Retirement Contribution Rate	10
• ADE – Structured English Immersion Models...	7		
• ADOT – Third Party Progress Report.....	7	Other Issues	
• ABOR – FY 2008 Tuition Revenues.....	7	• ABOR – Technology and Research Initiative Fund.....	11
Summary of Recent Agency Reports		• Early Childhood Health & Development Bd. – FY 2007 Administrative Developments	11
• DEMA – Camp Navajo Fund	8		

This Month (Continued)

ment of Education and the Arizona Health Care Cost Containment System (AHCCCS) both appear to have had FY 2007 caseloads that fell below budget. As a result, reverments may be as high as \$216 million, which would provide \$103 million in savings above the budgeted amount and would offset the \$(226) million revenue loss from FY 2007.

Some of these savings may evaporate in FY 2008. Agencies have a year to use their reverments to pay any remaining bills from FY 2007. Nonetheless, it is important to get an initial reading on our FY 2007 book closing so that any estimates of the FY 2008 shortfall can be further refined.

FY 2008 Shortfall – While August is too early to provide an exact estimate of a FY 2008 revenue shortfall, some extrapolations may be made from existing data. After accounting for the lower-than-expected FY 2007 ending balance, the overall FY 2008 shortfall appears to be in the range of \$(525) million to \$(675) million. JLBC Staff provided this information to the Governor's staff two weeks ago. Last week, the Governor's office estimated the size of the shortfall at \$(600) million.

Finance Advisory Committee – The Finance Advisory Committee (FAC) met on September 12th (page 6). The FAC is a panel of 15 leading economists that advises the Legislature 3 times a year on the state's economy. Based on the FAC's input and 3 other models, the largest General Fund revenue categories are forecasted to grow 3.5% in FY 2008 and 2.6% in FY 2009, prior to tax law adjustments. FY 2008 revenues need to grow by 8.4% to meet the budgeted levels.

Members' economic outlook for the next year was unfavorable. Of primary concern was the real estate market, particularly the oversupply of residential housing. In addition, members were concerned over the level of loan defaults associated with the subprime mortgage market, which has resulted in higher lending standards. Members generally believed that economic growth would reach bottom in FY 2008 or FY 2009, to be followed with a gradual recovery.

FY 2008 Spending – On September 27, AHCCCS reported that it may have a \$(57) million shortfall due to rising caseloads. While the budget included a 2.6% growth in caseload,

the current AHCCCS population is 4.2% above last year.

JLBC Staff also previously reported that the School Facilities Board (SFB) may have a \$(73) million shortfall in its new school construction costs. Neither the AHCCCS nor the SFB shortfalls have yet been factored into the JLBC FY 2008 shortfall estimates.

Other News – The Monthly Fiscal Highlights include a summary of the September JLBC meeting (page 7). Among the items considered, the Committee gave a favorable review to the Structured English Immersion models proposed by the English Learner Task Force.

The Highlights also include a summary of recent statutory reports submitted to JLBC (pages 8-10). Of note, the Arizona Department of Homeland Security reports it received \$28.0 million from the federal government in Federal Fiscal Year (FFY) 2006. Of this amount, the state will retain \$8.4 million, with the remaining \$19.6 million for local governments. The \$28.0 million amount is well below the \$53.8 million received in FFY 2004 and the \$43.3 million received in FFY 2005. The FFY 2007 federal grants, however, are expected to reverse this loss in funding, and rebound to \$51.5 million.

In other fiscal news this month, the Arizona Board of Regents reports that the Universities plan to spend approximately \$100 million from the Technology and Research Initiative Fund in FY 2008. This amount is about \$20 million greater than last year. (See page 11.)

The Early Childhood Development and Health Board reports FY 2007 revenues of almost \$75 million, of which the board spent \$330,100. Proposition 203, which was enacted by voters at the November 2006 election, established the board and an \$0.80 per pack cigarette tax to fund the activities of the board.

In addition, the board approved a FY 2008 budget at its June 2007 meeting. The board projects FY 2008 revenues of \$156.6 million. Of this amount, the board has currently approved a total of \$27.2 million in expenditures, including \$13.5 million for program activities and \$13.7 million for administration. (See page 11.)



August Revenues

Sales Tax collections were \$366.6 million in August. This amount was 3.7% above last year, but \$(14.8) million below forecast. *Table 1* displays the August and year-to-date growth rates for the major sales tax categories.

	August	Year-to-Date
Retail	0.0%	(0.3)%
Contracting	3.9%	(1.1)%
Utilities	5.8%	9.6%
Use	14.4%	11.0%
Restaurant & Bar	6.0%	4.9%

Retail collections, which account for almost half of all sales revenues, were flat in August. As a result of the continued housing slump and tighter lending standards, consumers were cautious and limited their spending.

While retail was stagnant, other categories showed some positive signs of growth. Contracting, which had declined for 4 months, increased 3.9%. Average contracting receipts over the last 3 months, however, are (1.7)% below the same period last year. Another bright spot was the use tax, which grew by 14.4%. The use tax is a tax on items bought outside of Arizona and brought into the state.

Individual Income Tax collections were \$267.4 million, or (5.7)% below last year. *Table 2* displays individual category growth rates.

	August	Year-to-Date
Withholding	(1.1)%	6.2%
Estimated + Final Payments	10.8%	5.9%
Refunds	89.9%	41.9%

Withholding was (1.1)% below last year. This is the second time in the last three months that monthly withholding collections have decreased. Withholding payments can vary in any one month, however, depending on the

timing of when they are processed. In July, for example, withholding grew 14.9%.

August refunds were \$32.4 million, an increase of \$15.3 million, or 89.9%, over last year. This increase appears to be due to the continued processing of 2006 tax returns.

While estimated and final payments grew at a double digit pace, August payments represent only a small portion of the yearly total. Therefore, the gains were minimal.

Due to its poor performance, individual income tax collections were \$(41.9) million less than expected.

Corporate Income Tax collections were \$29.1 million in August, or (9.1)% below last year. For the fourth month in a row, corporate revenues were less than the prior year. For the month, corporate was \$(2.9) million below the forecast. August, however, represents only a small portion of annual corporate collections. Looking ahead, however, September is one of the largest months for corporate collections.

Transfers and Reimbursements were \$11.0 million over the forecast. This is due to the distribution of \$11.1 million in State Criminal Alien Assistance Program (SCAAP) monies from the prior fiscal year. SCAAP provides federal assistance to states for the costs of incarcerating illegal immigrants. These funds are usually distributed in the spring of each year. However, the FY 2007 SCAAP distribution was delayed until August 2007.

Urban Revenue Sharing (URS) payments were \$57.0 million, which was 24.2% higher than last August. Under URS, the state shares 15% of income tax revenues, from 2 years prior, with the cities. The 24% gain in state income taxes in FY 2006 is now resulting in these large URS payments. While August base General Fund revenue collections were (1.1)% below last year, the increase in URS lowered total collections to (2.7)% below FY 2007.

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“For the fourth month in a row, corporate revenues were less than the prior year.”

	FY 2008 Collections	Difference From Forecast ^{1/}	Difference From FY 2007
August	\$ 685.7	\$ (64.5)	\$ (19.1)
Year-to-Date	\$ 1,373.9	\$ (89.0)	\$ 9.6

^{1/} Enacted FY 2008 budget (June 2007).

Recent Economic Indicators

NATIONAL

According to final estimates provided by the Bureau of Economic Analysis (BEA), the **U.S. Gross Domestic Product (GDP)** increased at an annual rate of 3.8% in the 2nd quarter of 2007, a (0.2)% revision to the preliminary August estimates. BEA attributed the downward revision to lower business spending on nonresidential structures and higher imports.

The **U.S. Index of Leading Economic Indicators** declined (0.6)% in August. The index has been alternating between monthly increases and decreases this year, and as a result, it is essentially at the same level as in January 2007. Of the 10 components that make up the composite index, only real money supply was a positive contributor in August.

U.S. semiconductor billings increased 5.1% in July (3-month moving average) to \$3.47 billion. However, year over year, chip sales were down (6.2)%. The Semiconductor Industry Association (SIA) attributed the July growth to increases in the sales of microprocessors, MOS logic devices, and flash memory products.

September marked the second month in a row with a (5.5)% decline in The Conference Board's **U.S. Consumer Confidence Index**. The index is currently at its lowest level in almost 2 years. The Conference Board believes that the combination of weaker business conditions and a softening labor market has contributed to the recent erosion in consumer confidence.

The **U.S. Consumer Price Index (CPI)** (3-month moving average) remained unchanged in August. The year-over-year increase was 2.3% compared to 2.6% in the prior month. The August deceleration in price inflation was mostly due to lower gasoline and natural gas prices. Excluding the impact of food and energy prices, the core CPI increased 0.2% in August and was 2.1% higher than a year ago.

ARIZONA

Total statewide **non-farm employment** increased, year over year, by 2.7% in August. By comparison, the August year-over-year average growth rate in the prior 10 years was 3.5%. Arizona's unemployment rate remained unchanged at 3.7%, which was considerably below the 4.6% U.S. average.

The **construction** sector lost (2,600) jobs in

August from July, which left statewide construction employment (3.4)% below the level reported a year ago. The average year-over-year growth rate for August in the prior 10 years was 6.3%.

Manufacturing employment was essentially flat in August but compared to the same month last year, the industry is employing (1,700) fewer workers.

Recent problems in the subprime lending market were also evident in August employment data, as businesses engaged in credit intermediation shed 1,800 jobs (or 2.2% of its workforce) in the state that month.

The impact of the ongoing housing slump was reflected in statistics released by the Realty Studies group at Arizona State University. According to its news release, the Greater Phoenix **single-family median sales price** for existing homes was reportedly \$255,000 in August, a decline of (2.9)% from the same month last year. The number of existing Greater Phoenix **single-family homes sold** decreased (2.1)% in August from July and was (25.4)% below the number sold in August 2006.

The existing **townhouse-condominium median sales price** grew 0.8% in August to \$182,500, or 7.4% above the August 2006 figure. The increase in the median resale price is due in part to first-time buyers seeking affordable housing. The **number of units resold** fell by (2.6)% from the prior month and was also (13.2)% less than the number sold a year ago.

The growing excess supply of homes in the real estate market continues to adversely affect permitting activity. Statewide **single-family residential building permits** (3-month moving average) were down (4.0)% from the prior period and (30.1)% on a year-over year basis. The multi-family segment had similar results, with month-to-month and year-to-year declines of (2.3)% and (23.7)%, respectively.

Through the first 7 months of 2007, 33,781 housing units were authorized statewide, which was (26.1)% less than the number authorized for the same period in 2006. The total value of housing units permitted was \$5.65 billion for the year to date through July 2007, a (28.1)% drop from a year ago.

The BEA reported that **Arizona personal income** reached an annualized total of \$209.2



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Recent Economic Indicators (Continued)

billion in the 2nd quarter of 2007. Compared to last year, personal income is up 7.5%.

The general downshift in the economy could also be inferred from August's **Arizona Business Conditions Index (BCI)**, which dropped (9.7)% to 58.8, the largest percent decline recorded since December 2006. While all of the components of the index fell in August, it was primarily the decline in new orders and prices that contributed to the lower reading. Because the overall index has displayed considerable volatility this year, it is still too early to identify a discernable trend.

The 4th quarter **Arizona Business Leaders Confidence Index** fell 8 points, or (15.8)% to the lowest reading since the inception of the index 4 years ago. While the general slowdown in the economy was clearly weighing on panelists' minds, it was likely the bad economic news related to the problems in the high-risk mortgage lending industry

(which coincided with the timing of the survey) that contributed to the record-low reading. An index below 50 indicates a contracting economy.

The **Department of Corrections' inmate population** increased by an average of 269 inmates per month from June through August. The total population grew by 2,333 inmates from a year ago. The budget for FY 2008 anticipates inmate population growth of 1,920, or a net increase of 160 inmates per month.

The **number of TANF** recipients decreased (1.5)% to 77,689 in July and was (9.4)% below the level reported in July 2006. The FY 2008 budget projects the TANF caseload will grow by 2.5%. The **AHCCCS caseload** increased 0.8% in September and is now 4.2% higher than one year ago. The FY 2008 budget projects growth of 1.9% from June 2007 to June 2008.

Table 4

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	3.7%	0.0%	(0.2)%
- Non-Farm Employment – Total	August	2.71 million	1.4%	2.7%
Manufacturing	August	186,400	(0.1)%	(0.9)%
Construction	August	242,300	(1.1)%	(3.4)%
- Contracting Tax Receipts (3-month average)	Jun-Aug	\$81.2 million	6.6%	(1.7)%
- Retail Sales Tax Receipts (3-month average)	Jun-Aug	\$163.8 million	(5.1)%	(0.4)%
- Residential Building Permits (3-month moving average)				
Single-unit	May-Jul	3,795	(4.0)%	(30.1)%
Multi-unit	May-Jul	738	(2.3)%	(23.7)%
- Greater Phoenix Existing Home Sales				
Single-Family	August	4,240	(2.1)%	(25.4)%
Townhouse/Condominium	August	955	(2.6)%	(13.2)%
- Greater Phoenix Median Home Sales Price				
Single-Family	August	\$255,000	(3.8)%	(2.9)%
Townhouse/Condominium	August	\$182,500	0.8%	7.4%
- Phoenix Sky Harbor Air Passengers	June	3.66 million	0.3%	1.3%
- Arizona Average Natural Gas Price (\$ per thousand cubic feet)	June	\$8.11	(2.3)%	20.3%
- Leading Indicators Index	July	121.1	1.0%	2.3%
- Business Conditions Index (>50 signifies expansion)	August	58.8	(9.7)%	(2.9)%
- Consumer Confidence Index	3 rd Quarter 2007	101.9	(4.1)%	(0.8)%
- Business Leaders Confidence Index	4 th Quarter 2007	42.5	(15.8)%	(11.6)%
- Arizona Personal Income	2 nd Quarter 2007	\$209.2 billion	1.1%	7.5%
- Arizona Population	July 1, 2006	6.17 million	3.6%	3.6%
- AHCCCS Recipients	September	1,069,769	0.8%	4.2%
- TANF Recipients	July	77,689	(1.5)%	(9.4)%
- DOC Inmate Growth (3-month average)	Jun-Aug	37,307	269 inmates	2,333 inmates
United States				
- Gross Domestic Product (seasonally adjusted annual growth rate)	2 nd Quarter 2007	\$11.5 trillion	3.8%	1.9%
- Consumer Confidence Index	September	99.8	(5.5)%	(5.8)%
- Leading Indicators Index	August	137.8	(0.6)%	0.6%
- U.S. Semiconductor Billings (3-month moving average)	May-Jul	\$3.47 billion	5.1%	(6.2)%
- Consumer Price Index (3-month moving average)	Jun-Aug	208.2	0.0%	2.3%

Finance Advisory Committee Meeting

At its September 12th meeting, the Finance Advisory Committee (FAC) heard presentations on General Fund Revenue collections, the U.S. economy, and implications of the slumping housing market and the resultant credit crunch. The FAC is a 15-member panel comprised of leading economists in the state. The panel meets 3 times a year and advises the Legislature on the state economy.

JLBC staff provided members with the latest 4-sector consensus estimates for “Big 3” revenue collections. The 4-sector consensus estimate is a composite of equally-weighted estimates from:

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

Based on the 4-sector consensus, revenues are projected to grow 3.5% in FY 2008, prior to any tax law changes. *(See Table 5 below.)* This is down from the March FAC meeting, at which time the 4-sector consensus projected a FY 2008 growth rate of 4.3%.

The enacted FY 2008 budget was based on the Executive projected growth rate of 6.0% (prior to tax law changes). Since FY 2007 revenues were less than expected, FY 2008 would instead have to grow by 8.4% to generate the same level of revenues included in the enacted budget.

In FY 2009, the 4-sector consensus predicts growth will be 2.6%. The FAC panel projects a higher rate of growth in FY 2009, while the University of Arizona models were both below the 4-sector consensus.

	<u>FY 2008</u>	<u>FY 2009</u>
UofA Baseline	4.2%	2.3%
UofA Conservative	1.0%	(1.3)%
FAC Panel	3.6%	4.7%
JLBC Staff	<u>5.0%</u>	<u>4.9%</u>
Weighted Average	3.5%	2.6%

Panel members then heard formal presentations from Elliott Pollack and Tracy Clark, in addition to comments from other panel members.

The Committee had an unfavorable outlook with regard to economic and revenue growth going forward. Members cited the downturn in the real estate market, and the resulting excess supply of housing currently on the market, as the primary reason for concern. In addition, the Committee believes that high levels of loan defaults and delinquencies, mainly associated with the subprime mortgage market, have resulted in higher lending standards, which may exacerbate the housing slump by limiting the pool of potential borrowers going forward.

The Committee expects economic growth to bottom out sometime in FY 2008 or FY 2009, but was divided on the exact timing of when this would occur. With regard to the duration of the slowdown, most members believe it will last several years, and be followed by a gradual recovery.

Some members maintained that, to date, the adverse impacts of the housing slump and credit crunch have been limited to only certain sectors, and have yet to be felt throughout the entire economy. As evidence of this, members suggested that banks are still lending to creditworthy borrowers, consumers are still spending, albeit at a slower rate, and income growth remains strong.

Overall, the 4-sector consensus model projects two to three years of below trend revenue growth before returning to the 7% trend level in FY 2011. In general, the FAC panel concurred with these projections, but was slightly more optimistic than the 4-sector consensus in FY 2009 and FY 2010.

The Committee presentations and a video of the meeting can be viewed at the following link: www.azleg.gov/jlbc/meeting.htm.

JLBC Meeting

Department of Economic Security – Review of Long Term Care Capitation Rate Changes – The Committee gave a favorable review of DES' capitation rate changes with the provision that the favorable review does not constitute an endorsement of a supplemental request. Capitation rates are a fixed amount paid for every person in the Developmentally Disabled Long Term Care Program. The new total enrolled capitation rate is \$3,556.71, representing a 3.86% increase from last year. Assuming the same caseload growth rate as FY 2007, the expected costs for the program is expected to exceed the General Fund budgeted amount by \$2.4 to \$4.4 million in FY 2008.

Department of Economic Security – Review of Family Preservation Projects – The Committee gave a favorable review of the DES proposal to spend \$1 million for Adoption Services' Family Preservation Projects in FY 2008, with the provisions that: 1) the Department provide additional details on the expenditure plan to JLBC Staff, and 2) JLBC Staff finds that the detailed expenditure plan is consistent with legislative intent.

The Legislature appropriated \$1 million in FY 2007 for Family Preservation Projects. Last December DES submitted a plan to the Committee to spend about \$600,000 in FY 2007 and \$1.8 million in FY 2008. The Committee gave DES a favorable review, with the provision that DES restructure their spending to remain within the \$1 million appropriation in FY 2008, if the appropriation were to be continued. The Department has since stated that expenditures will remain within the \$1 million limit.

Department of Education – Review of Draft Request for Proposals for eLearning Pilot Program – The Committee gave a favorable review to the preliminary Request for Proposals (RFP) for the eLearning Pilot Program. Laws 2006, Chapter 375

appropriated \$3 million in one-time funding from the General Fund in FY 2007 to fund an eLearning Pilot Program. The purpose of the program is to provide mathematics instruction through a digital curriculum to students in grades 6 through 9.

Department of Education – Review of Research Based Models of Structured English Immersion for English Language Learners – The Committee gave a favorable review to the proposed Structured English Immersion models that were developed by the English Learner Task Force established by Laws 2006, Chapter 4. These models provide a curriculum for teaching English to students who are not proficient in English. The Committee's review had two conditions; 1) the review is limited to compliance with Laws 2006, Chapter 4, and 2) the models will be implemented in a manner that is consistent with requirements of Proposition 203 from the November 2000 General Election.

Department of Transportation – Review of Third Party Progress Report – The Committee gave a favorable review of ADOT's third party report, given the progress that ADOT is making in increasing its use of third parties and reducing the quality assurance backlog. Motor Vehicle Division (MVD) third parties allow the public to conduct certain MVD transactions through private sector third party entities instead of using MVD customer service offices. With the exception of traffic survival schools, ADOT continues to increase its number of third parties. ADOT's backlog of title transactions decreased from 16 business days in the third quarter of FY 2007 to 11 business days (down from 31 business days in FY 2006).

Arizona Board of Regents – Review of FY 2008 Tuition Revenues – The Committee took no action on the Arizona Board of Regents (ABOR) expenditure plan for tuition revenues

for FY 2008, requesting further information on how financial aid is determined and disbursed by the universities. Each year, ABOR sets aside a portion of tuition and fee collections to be locally retained by the universities. These monies are non-appropriated and are primarily used for financial aid and debt service payments. Non-appropriated, locally retained tuition and fees in FY 2008 are estimated at \$354.3 million, or \$31.1 million higher than FY 2007. Of that amount, \$224.1 million is dedicated to student financial aid, an increase of \$18.7 million above FY 2007.

The remaining portion of tuition and fee collections in FY 2008 is subject to legislative appropriation. Appropriated tuition collections in FY 2008 are expected to be \$468.4 million, representing a \$62.3 million increase above the FY 2007 total, and \$25.3 million above the original FY 2008 budget. The overall increase in collections is primarily due to higher tuition and fees, which ABOR indexed for inflation.

Summary of Recent Agency Reports



Department of Emergency and Military Affairs – Report on Camp Navajo Fund – Pursuant to A.R.S. § 26-152, the Department of Emergency and Military Affairs (DEMA) submitted its annual report on the activity in the Camp Navajo Fund. The Camp Navajo Fund pays for the National Guard to operate a regional training site and storage facility located at Bellemont. Fund revenues consist of monies received from federal and other government sources for storage of government commodities and services provided by the camp. DEMA reports that the Camp Navajo Fund received revenues of \$9.1 million and had expenditures of \$9.1 million in FY 2007. This left a fund balance of \$2.1 million at the end of the fiscal year due to a beginning balance. In FY 2006, the Camp Navajo Fund received revenues of \$7.2 million and had expenditures of \$7.3 million. The increase in revenues for FY 2007 is attributable to higher fees, which are adjusted for inflation, and the increased use of facilities due in part to marketing efforts.

Governor’s Council on Workforce Policy – Report on FY 2007 Annual Report – Pursuant to A.R.S. § 41-1542, the Governor’s Council on Workforce

Policy (GCWP) submitted its annual report on workforce development. Total workforce spending from state, federal, and local sources for FY 2007 was \$473.9 million. Of this total, DES accounted for \$190.6 million, ADE for \$17.5 million, ADOC for \$6.9 million, and the Community Colleges for \$258.9 million. These totals do not include \$274.3 million for the Unemployment Insurance (UI) program included in the report. Most of the UI expenditures represent cash payments to unemployed individuals, and not workforce development services.

Among the community colleges, Maricopa has the largest program, spending \$178.8 million in FY 2007. Pima had the second highest amount at \$22.5 million. Other large programs in FY 2007 include the JOBS program, which provides employment and training services to TANF recipients (\$24 million), Vocational Rehabilitation (\$79.5 million), and the Workforce Investment Act program at (\$38.8 million). The Job Training program, which provides incentives to companies to provide training programs, is expected to spend \$26.4 million in FY 2008, up from \$6.1 million FY 2007.

Total FY 2007 state workforce development spending was \$254.8 million, of which the largest recipient was Maricopa Community Colleges with \$158.6 million in expenditures.

Table 6 below shows the total reported funding for FY 2006 – FY 2008 by agency. Table 7 summarizes FY 2007 funding by source and agency.

The report includes federal and state-mandated performance measures pursuant to A.R.S. § 41-1542, such as the number of individuals trained and businesses’ recruited. The report did not include several changes that were requested in response to last year’s report. The information provided was not standardized across years, and a summary table displaying expenditures by agency and fund type was not included. Additionally, results were not reported for many of the performance measures identified in the Council’s submission. Finally, a strategic plan that addresses how the workforce programs met the state mandated performance measures was not included as required by statute.

Table 6

FY 2006 – FY 2008 Workforce Development Funding

<u>State Organization</u>	<u>FY 2006</u>	<u>FY 2007</u>	<u>FY 2008</u> ^{1/}
Department of Economic Security	\$148,543,500	\$162,407,600 ^{1/}	N/A ^{2/}
Department of Education	15,151,500	17,457,400 ^{1/}	\$ 17,575,600
Department of Commerce	6,832,200	6,919,600	27,277,300
Community Colleges	\$203,467,900	\$258,855,300	\$282,827,200

^{1/} Estimated
^{2/} Information was not provided

Table 7

FY 2007 Workforce Development Funding

<u>State Organization</u>	<u>Total Funds</u>	<u>State</u>	<u>Federal</u>	<u>Other</u>
Department of Economic Security ^{1/}	\$162,407,600	\$ 20,516,200	\$140,827,400	\$ 1,064,000
Department of Education ^{1/}	17,457,400	4,443,800	13,013,600	-
Department of Commerce	6,919,600	6,296,200	623,400	-
Community Colleges	<u>258,855,300</u>	<u>223,577,800</u>	<u>9,202,500</u>	<u>26,075,100</u>
Total	\$445,639,900	\$254,834,000	\$163,666,900	\$27,139,100

^{1/} Estimated

Summary of Recent Agency Reports (Continued)

Department of Health Services – Report on MethSMART Prevention Program – Pursuant to Laws 2006, Chapter 337, Section 5, the Department of Health Services has submitted a quarterly report on the effectiveness of the department’s curriculum based methamphetamine prevention services. In FY 2007, \$500,000 of General Fund monies was appropriated to the department for methamphetamine prevention programming for youth. Grants were provided to 15 Boys and Girls Clubs across the state to implement the MethSMART prevention program. During the fourth quarter, the program expended the remaining \$120,000 appropriated for the program.

The MethSMART program provides separate curriculum for children, youth, and teens and also includes a workshop for parents. The department reports that 5,328 youth and teens participated in the program during the fourth quarter of FY 2007, for a total of 9,719 during FY 2007. The department reports that there was a 27% increase in knowledge about methamphetamine for 6-9 year olds and a 40% increase for 10-13 year olds during this quarter; teens were not asked the same question. Increases were noted in ability to identify that a person is using methamphetamine with an average percentage increase of 5% for 6-9 year olds, 42% for 10-13 year olds, and 18% for children 14 and over. In addition, understanding of ways in which methamphetamine can harm

the body increased by 10% for 6-9 year olds, 46% for 10-13 year olds, and 14% for children 14 and over.

Arizona Department of Homeland Security – Report on Homeland Security Funding – Pursuant to A.R.S. § 41-4255, the Arizona Department of Homeland Security has submitted an annual report detailing grant allocations and expenditures for Homeland Security Grants from FFY 2001 through FFY 2006. *(See Table 8 below.)*

The state was allocated and the Arizona Department of Homeland Security awarded \$28.0 million in homeland security grants for FFY 2006. The department reported total expenditures of \$7.8 million, leaving \$20.2 million unexpended. State agencies were awarded \$8.3 million, of which \$5.1 million has been expended. Local governments were awarded \$19.6 million, of which \$2.6 million has been expended. The largest local grantee was the City of Phoenix (\$3.0 million). The largest state grantee was the Arizona Department of Emergency and Military Affairs (DEMA) (\$6.0 million). The largest individual grant of \$3.6 million went to DEMA to help structure individual emergency management programs, strengthen emergency management capabilities, and develop systems that encourage the building of partnerships with the public and private sector. FFY 2006 represented a reduction from the amounts received in FFY 2004 and FFY 2005. While Arizona

only received \$28 million in FFY 2006, the state received \$53.9 million and \$43.3 million in FFY 2004 and FFY 2005, respectively. Of the funds received, 99% have been expended for FFY 2004, and 81% have been expended for FFY 2005. The department has reported that the FFY 2007 award is expected to be significantly larger than FFY 2006, with anticipated grants of \$51.5 million.

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 2008 report to the JLBC on current and future automation projects coordinated by the AOC. The report is to include a list of court automation projects that receive state monies in the current fiscal year, as well as projects planned for the next 2 fiscal years. In addition, the report is to provide a description of each project as well as the funding source, estimated cost for each fiscal year, the number of Full-Time Equivalent (FTE) Positions, the entities involved, and the goals and anticipated results for each automation project.

The AOC estimates automation expenditures in FY 2008 will be approximately \$22.1 million. Of this amount, approximately \$14.6 million, or 66%, will be spent on ongoing automation support, and \$7.4 million, or 34%, will be spent on 11 new projects in FY 2008. Of the 11 new projects, the larger projects include:

	<u>FFY 2004</u>	<u>FFY 2005</u>	<u>FFY 2006</u>
State Awards	\$15,724,800	\$12,886,100	\$ 8,354,900
Local Government Awards	<u>38,132,600</u>	<u>30,418,700</u>	<u>19,625,900</u>
Total Awards	\$53,857,400	\$43,304,800	\$27,980,800
State Expenditures	\$15,712,700	\$12,148,700	\$5,148,000
Local Government Expenditures	<u>38,101,500</u>	<u>23,030,700</u>	<u>2,645,200</u>
Total Expenditures	\$53,814,200	\$35,179,400	\$7,793,200
Percentage of Total Awards Currently Expended	99.92%	81.24%	27.85%

Summary of Recent Agency Reports (Continued)

- Updating the general jurisdiction case management system for 13 of the 15 counties in Arizona (\$4,514,400)
- Updating and enhancing the Juvenile On-Line Tracking System (JOLTS) (\$1,319,000)
- Updating the limited jurisdiction case management system for statewide utilization (\$658,900)
- Further development of electronic filing (\$395,200)

Additionally, the AOC anticipates costs relating to “New Projects” in FY 2009 and FY 2010 to be \$8.1 million and \$6.6 million, respectively. FTE Positions required to complete all automation projects categorized as “New Projects” is estimated to be 50.8.

The report does not meet the reporting guidelines as required by the FY 2008 General Appropriation Act for the \$14.6 million in ongoing projects, as it does not itemize funding levels for specific projects associated with the \$14.6 million in ongoing automation projects and support.

Supreme Court – Report on Case and Cash Management System – Pursuant to a footnote in the FY 2007 General Appropriation Act (Laws 2006, Chapter 344), the Administrative Office of the Courts (AOC) is required to report to the JLBC on the monies expended from the Case and Cash Management System (CMS) line item and progress related to the development and deployment of the system. Monies are to be used for the replacement of the aging case management systems in the larger-volume Superior and limited jurisdiction courts within Maricopa and Pima Counties, as well as in 145 of the 180 state, county and municipal courts throughout the state. The report also shall include a timeline and expenditure plan for the project, identify the courts involved, and their financial and non-financial contributions.

Funding and Expenditure Plan

The Case and Cash Management project was established with monies from the Supreme Court’s operating budget and Automation line item. AOC has estimated that the upgrade of these systems will continue through FY 2012. As of June 30, 2007, the report listed current expenditures of \$370,200 and planned expenditures of \$23,453,900. The planned expenditure estimate increased by \$14,668,500 from the amount reported in January 2007. AOC reports that part of the reason for this increase comes from the assumption that the costs would only be for the implementation of the new system being developed by Pima County. AOC adjusted the estimate when it was determined that the Pima County system was no longer an option for other general jurisdiction courts. As a result, the Commission on Technology issued an RFP and the Arizona Judicial Council selected a vendor whose software package fit the courts’ needs. The cost estimates were increased due to the acquisition and implementation of the vendor’s software package.

Progress

As noted above, AOC reports that the Pima County general jurisdiction (Superior Courts) CMS, called AGAVE, is no longer a viable statewide option and has been terminated from further statewide consideration. However, AOC does report working with the Superior Courts in Yavapai, Yuma, Coconino, Cochise, Navajo, Mohave and Pinal Counties to assess needs and options for a new CMS and compare the findings with the Pima AGAVE reported functionality. AOC along with these counties participated in the RFP review and selection process of the new software package.

Arizona State Retirement System – Report on Board Discussion and Actions to Minimize the Contribution Rate – A footnote in the General Appropriation Act requires that the Arizona State Retirement System

(ASRS) submit quarterly reports to the Joint Legislative Budget Committee (JLBC) “on the discussions and actions of the ASRS Board regarding their efforts to minimize the retirement contribution rate.” ASRS has submitted a report covering the fourth quarter of FY 2007.

In the 2007 legislative session, ASRS has sought 4 legislative changes to help minimize the contribution rate. The Legislature passed 1 of the 4 initiatives, HB 2145. This bill modifies the Social Security offsets to 85% for a member who becomes disabled on or after July 1, 2008; modifies the pre-existing condition look back to 6 months for a member hired on or after July 1, 2008; and requires ASRS to recover any overpaid money by reducing a benefit owed to any member, beneficiary, or alternate payee. These changes are expected to reduce total annual contributions by \$16.0 million and reduce the contribution rate of each employer and employee by 0.09% after all claims subject to current offset and pre-existing condition rules have terminated.

Additionally, during the summer of 2007, ASRS staff convened a series of work groups aimed at developing proposals to mitigate the upward pressure on the contribution rate. Each work group was tasked with looking at a different aspect of the retirement system (i.e., plan design, return to work/membership rules, employer enrollment oversight) and determining whether weaknesses, leakages, or inefficiencies existed that could be addressed. The work groups are still meeting, but it is anticipated that these groups will provide legislative proposals that will further reduce the contribution rate.

Other Issues

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 2007, ABOR received \$71.8 million in TRIF revenues along with a carry forward of \$32.5 million, of which they expended \$77.3 million.

In FY 2008, ABOR estimates \$74.3 million in TRIF revenues along with a carry forward of \$27.2 million, of which they plan to expend \$98.6 million. Major spending items for ongoing projects at the universities include \$42.2 million for support of the

Biodesign/Biomedical campuses and health science programs. Additionally, the universities budgeted \$23.3 million for support of workforce development and e-learning initiatives at the universities, and \$11.9 million for infrastructure.

Early Childhood Development and Health Board - Report on Administrative Developments in FY 2007

The passage of Proposition 203 in November 2006 created the Early Childhood Development and Health Board and increased tobacco taxes to generate revenues for deposit in the Early Childhood Development and Health Fund. The bulk of revenue garnered from the taxes is a \$0.80 per pack cigarette tax. The Board uses revenues generated from the taxes to fund early childhood development and health at the local level. Proposition 203 states that all FY 2007 revenues can be deposited into an Administrative Fund, while in subsequent years 10% of monies go toward Administration and 90% go into a Program Fund. In FY 2007, \$74,929,400 in tax revenue was deposited into the Administrative Fund with expenditures of \$330,100.

The Early Childhood Development and Health Board approved an FY 2008 budget during its June 2007 meeting. The FY 2008 budget includes expected revenues of approximately \$156.6 million. Of approximately \$141 million, or 90% of tax revenues, that is expected to be available to spend from the Program Fund, the Board has approved expenditures of \$13.5 million in costs that are as yet undetermined. Furthermore, the Board has approved expenditures of \$13.7 million from the Administrative Fund to cover the estimated costs of additional staff. The Administrative Fund will have a

balance of approximately \$75 million from unused FY 2007 monies.

In FY 2007, the Early Childhood Development and Health Board was established with 9 members appointed by the Governor and 3 non-voting ex officio members including the Superintendent of Public Instruction, the Director of the Department of Health Services and the Director of the Department of Economic Security.

There are currently 14 staff members, including an Executive Director. It is not known how large the administrative staff will eventually be; however, some estimates have put full staffing between 50 and 150 positions. With an expected increase in staffing, the Board will move into a permanent office space this fall with a five year, \$20 million lease.

One factor affecting hiring is the amount of staff needed to run a grants administration program. The Board is currently researching approaches to grants administration in Virginia and North Carolina, as well as organizations in Arizona, in order to gauge potential workloads and personnel requirements.

Another factor that will affect the number of staff members is the number of Regional Partnership

Councils that will be established. The Board is seeking to establish 30 Regional Partnership Councils throughout the state, although this number may increase should Arizona Tribal Governments opt to serve as their own regions, rather than be part of a board determined region. The Board estimates that each Regional Partnership Council will require at least two staff members from the Board to provide direct support.

Pursuant to A.R.S. § 8-1173, the Regional Partnership Councils are required to forward recommendations to the Board by May 15 of each year with action taken on grant proposals by the following June 15, beginning in 2009. The 9 voting members of the Board have the discretion to approve or deny the recommendations of a regional council. Proposition 203 authorizes the Board to approve distribution of monies to Regional Partnership Councils in order to award grants to public and private grantees whose proposals are recommended by local council members.

Monies can be used to serve children before entering kindergarten and their families by providing parent and family support programs, child care, preschool, health screenings, and access to preventive health services.

State of Arizona

General Fund Revenue

Change from Previous Year and Enacted Forecast August 2007

	Current Month					FY 2008 YTD (Two Months)				
	Actual August 2007	Change From				Actual August 2007	Change from			
		August 2006		Forecast			August 2006		Forecast	
	Amount	Percent	Amount	Percent	Amount	Percent	Amount	Percent		
Taxes										
Sales and Use	366,627,555	\$13,161,098	3.7 %	(\$14,762,745)	(3.9) %	\$759,517,377	\$15,590,689	2.1 %	(\$42,008,123)	(5.2) %
Income - Individual	267,438,218	(16,152,167)	(5.7)	(41,906,782)	(13.5)	535,467,755	18,994,776	3.7	(33,226,445)	(5.8)
- Corporate	29,100,662	(2,917,104)	(9.1)	(6,434,638)	(18.1)	62,903,871	(8,147,137)	(11.5)	(13,294,329)	(17.4)
Property	84,584	(4,852)	(5.4)	(815,416)	(90.6)	356,374	(35,380)	(9.0)	(893,626)	(71.5)
Luxury	3,660,318	(2,057,740)	(36.0)	(2,254,682)	(38.1)	7,625,048	(3,141,634)	(29.2)	(4,204,952)	(35.5)
Insurance Premium	45,888,890	(4,318,770)	(8.6)	(5,211,110)	(10.2)	86,758,038	4,154,426	5.0	(2,041,962)	(2.3)
Estate	31,220	2,913	10.3	31,220	--	254,076	149,362	142.6	254,076	--
Other Taxes	39,410	(6,677)	(14.5)	(25,715)	(39.5)	103,901	(10,146)	(8.9)	(26,349)	(20.2)
Sub-Total Taxes	\$712,870,857	(\$12,293,299)	(1.7) %	(\$71,379,868)	(9.1) %	\$1,452,986,440	\$27,554,956	1.9 %	(\$95,441,710)	(6.2) %
Other Revenue										
Lottery	3,557,419	184,519	5.5	375,519	11.8	3,557,419	184,519	5.5	375,519	11.8
License, Fees and Permits	3,476,046	(1,975,000)	(36.2)	(1,026,554)	(22.8)	5,426,790	(2,031,151)	(27.2)	(1,529,910)	(22.0)
Interest	6,943,912	(3,892,145)	(35.9)	(2,237,388)	(24.4)	7,575,159	(3,128,452)	(29.2)	(1,311,941)	(14.8)
Sales and Services	3,209,955	(501,282)	(13.5)	(1,372,045)	(29.9)	5,208,086	(362,630)	(6.5)	(1,677,214)	(24.4)
Other Miscellaneous	1,550,098	(669,116)	(30.2)	135,498	9.6	1,589,693	(1,810,667)	(53.2)	(695,007)	(30.4)
Disproportionate Share	0	0	--	0	--	0	0	--	0	--
Transfers and Reimbursements	11,181,042	11,143,180	--	10,971,042	--	11,655,353	11,458,870	--	11,235,353	--
Sub-Total Other Revenue	29,918,472	4,290,156	16.7 %	6,846,072	29.7 %	35,012,500	4,310,489	14.0 %	6,396,800	22.4 %
TOTAL BASE REVENUE	\$742,789,329	(\$8,003,143)	(1.1) %	(\$64,533,796)	(8.0) %	\$1,487,998,940	\$31,865,445	2.2 %	(\$89,044,910)	(5.6) %
One-Time Revenue										
Urban Revenue Sharing	(57,044,911)	(11,109,023)	24.2	0	0.0	(114,089,821)	(22,218,044)	24.2	0	0.0
Sub-Total One-Time Revenue	(57,044,911)	(11,109,023)	24.2 %	0	0.0 %	(114,089,821)	(22,218,044)	24.2 %	0	0.0 %
TOTAL REVENUE	\$685,744,418	(\$19,112,166)	(2.7) %	(\$64,533,796)	(8.6) %	\$1,373,909,119	\$9,647,401	0.7 %	(\$89,044,910)	(6.1) %