JLBC - Monthly Fiscal Highlights

July 2011

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"With higher than expected revenues, we currently anticipate that at least $300 million of the $332 million budgeted shortfall will be eliminated by the time of official book closing."

This report has been prepared for the Arizona Legislature by the Joint Legislative Budget Committee Staff on July 27, 2011.

Summary

The state's fiscal year ended on June 30th. While the books are still not closed on FY 2011, several preliminary conclusions can be drawn from the data:

- General Fund base revenues grew by 11.6% during FY 2011, which was the first annual increase since FY 2007. The budgeted growth rate was 5.6%.
- Base revenues were supplemented by $873 million from the 1-cent temporary sales tax. Total FY 2011 base and one-time revenues equaled $8.34 billion.
- The FY 2011 rebound appears to be more a reflection of one-time factors than a rapidly expanding economy. It may still take 2 to 4 years before the state replaces the jobs lost in the recession and substantially reduces its "underwater" mortgages.
- The primary reason for the revenue overage is the unexpectedly high 18.5% increase in individual income taxes. Given the lack of job and wage growth, this spurt may have been caused by higher capital gains and the loss of mortgage interest deductions.
- The enacted April budget assumed that the state General Fund would end FY 2011 with a $(332) million shortfall. With higher than expected revenues, we currently anticipate that at least $300 million of the $332 million budgeted shortfall will be eliminated by the time of official book closing. The Executive is scheduled to provide a preliminary FY 2011 balance estimate by mid-September.
- The enacted April budget assumed using FY 2012 revenue to pay off the FY 2011 shortfall. Since at least $300 million of the $332 million will no longer be needed for that purpose, those monies will be freed up in the FY 2012 budget. The ultimate magnitude of the FY 2012 ending balance, however, will depend on a multitude of factors.
- Given the higher than expected FY 2011 base, FY 2012 revenues may be higher than budgeted. Several factors, however, could result in unbudgeted FY 2012 costs, including the outcome of federal budget negotiations, Federal decisions on the AHCCCS Medicaid waiver proposal, and court rulings that could overturn state budget policy.
- The FY 2012 ending balance will also depend on Internal Revenue Service (IRS) requirements for the state to begin potential early pay off of its FY 2010 sale/leaseback and lottery bond issuances.

The status of the budget projections will be updated at the next Finance Advisory Committee (FAC) meeting in October. At the April FAC meeting, FY 2014 was projected to have a $(600) million shortfall with the expiration of the 1-cent sales tax. While the higher-than-expected FY 2011 revenues would bring the state closer to a balanced budget in FY 2014, it does not create a structural surplus.

All of these issues are also summarized in a Budget Status Update slideshow presentation on the JLBC website.

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FY 2011 Revenues

FY 2011 ended the unprecedented 3 consecutive years of General Fund base revenue declines. Based on preliminary data, FY 2011 base revenues grew by 11.6%. Base revenues exclude the balance forward, tax law changes such as the 3 year 1-cent sales tax, one-time revenues and urban revenue sharing.

Including all one-time adjustments, FY 2011 General Fund revenues totaled $8.34 billion, which was $335 million above forecast. Even with substantial growth in FY 2011, however, revenues remain far below their peak levels. After excluding one-time adjustments for comparability, FY 2011 base revenues are estimated to be $7.22 billion. At this level, FY 2011 is more than $2 billion below the high water mark of $9.62 billion in FY 2007 and is even below the FY 2005 level of $7.72 billion.

The 11.6% FY 2011 rebound was led by substantial growth in income taxes – both individual and corporate. As displayed in *Table 1*, individual income taxes grew by 18.5% while corporate income taxes grew 35.6%.

Table 1

Growth Rates Compared to Prior Year By Revenue Category

	Budgeted	**Prelim. Actual**
Sales*	2.9%	2.5%
Ind. Income	5.9%	18.5%
Corp. Income	40.8%	35.6%

* Without 1-cent

Upon closer examination, the high FY 2011 growth rate may be a reflection of one-time factors:

- FY 2010 was the bottom of the state's worst economic downturn since the 1930's, making it easier to post high percentage gains off such a low base. For example, FY 2010 corporate income tax collections were almost 60% below their peak collection year of 2007. While the 35.6% FY 2011 gain appears substantial, the $560 million in collections is $400 million less than the FY 2007 level.
- The large corporate tax growth does reflect increased profitability, but many analysts believe that business has been able to generate these gains through higher productivity rather than substantially higher sales growth.
- A significant share of the individual income tax growth of 18.5% appears related to higher capital gains and a reduction in mortgage deductions.

Compared to the substantial gains in income taxes, sales tax collections excluding the 1-cent grew by 2.5% in FY 2011. But as a potential sign of growth in the economy, collections were noticeably higher in the second half of the fiscal year. The retail sector of sales taxes grew by over 10% while contracting increased by over 7%.

The Surprising Increase in Withholding Collections

The individual income tax is the single largest factor in explaining the error in the FY 2011 revenue forecast. Of the $335 million forecast overage, $305 million is due to the individual income tax. There were several reasons why the 18.5% growth was difficult to predict in advance.

First, withholding grew by a surprising 7.3% in FY 2011 in light of the underlying economic data. Withholding increases are typically related to some combination of growth in jobs and average wages. According to the most recent data, however, Arizona:

- Employment growth was less than 0.5%
- Average private wages were up 2-3%

These results were inconsistent with the much stronger withholding growth of 7.3%. As a result, when the withholding gains started to appear in the summer of 2010, there was speculation that the growth was due to the July 2010 change in withholding tables. At that point, the withholding percentages were changed to delink the state from federal withholding. Taxpayers had to choose a new withholding rate based on a percentage of their income rather than as a percent of their federal withholding.

Given the high collection levels, the transition to the new withholding tables may have caused some taxpayers to be overwithheld. Based on available data, the level of overwithholding has been difficult to quantify. If taxpayers had been substantially overwithheld as a result of the new tables, some would have likely lowered their withholding rates after they filed their taxes in April. In the last quarter, however, the 12% withholding growth rate exceeded all prior quarters in the year.

While strong state withholding growth may be difficult to explain, it is part of a national trend. Nationwide state income tax withholding grew by 8.3% in the 3rd quarter of FY 2011. One possible explanation is that the economic data – such as employment – is not accurately capturing the economy's expansion. For example, the survey methodology may not always accurately reflect job formation, especially in new firms. More complete wage and job data will probably not be available until next year.

Capital Gains and Mortgage Deductions

Beyond withholding, individual income tax estimated and final payments grew by 13.3% and refunds fell by (9.6)%. Payments and refunds accounted for approximately $250 million of the $304 million individual

Summary (Continued)

income tax overage. While there is no definitive explanation for this growth in taxpayer liability, higher capital gains and fewer mortgage deductions are 2 potential reasons.

Capital gains appear to have grown significantly in tax year 2010, which led to higher tax filings in April 2011. The Internal Revenue Service will eventually publish Arizona-specific capital gains data, but that is unlikely to occur for a year. Several factors, however, suggest that the gains will be substantial:

- Recovery in the stock market - Nationwide, stock market values increased by 17% in tax year 2010.
- Growth in investor residential real estate transactions - "Flipping" of foreclosure properties likely produced substantial profits for some investors. Investors have been estimated to account for 30% to 45% of recent Arizona residential real estate transactions.

Income tax liability probably also grew as fewer households took advantage of the residential mortgage interest deduction due to the downturn in the state's real estate market. While data is not specifically available on the mortgage interest deduction, the dollar value of total itemized deductions on Arizona state income taxes fell 30% in tax year 2010. A decline in mortgage interest is a likely reason. As evidence of this possible trend, outstanding mortgage debt in Arizona fell $18 billion between calendar years 2009 and 2010.

Relationship to Overall Economy

The strong revenue growth in FY 2011 did not translate into a healthy economy. While there has been some positive news, the key economic indicators suggest problems remain:

- State employment remains 300,000 below the high point in December 2007. Over the last 6 months, job growth has generally been less than 0.5%. As noted earlier, however, current employment data may not be accurately capturing job creation based on the state's 7.3% withholding growth.
- Pending Maricopa County foreclosures total 26,000. While there would typically be less than 5,000 foreclosures annually, at least the trend is in the right direction. Pending foreclosures have fallen from 51,000 in December 2010.
- Almost 50% of mortgage holders continue to be "underwater" – their outstanding loan exceeds the value of their house. This trend serves to inhibit higher consumer spending.
- The annual level of new housing permits is below 10,000, compared to 40,000 to 50,000 in a normal expansion.

Given the magnitude of these problems, a full recovery would appear to take 2 to 4 years.

FY 2011 Ending Balance

While FY 2011 ended on June 30th, the state's books do not officially close until July 29th. During this "13th month," the state continues to record FY 2011 revenues and spending obligations. After July 29th, it will take several months to confirm year-end adjustments and calculate the state's official fiscal year ending balance.

The General Appropriation Act requires the Executive Branch to provide a preliminary estimate of the FY 2011 ending balance by September 15, 2011. The Department of Administration is required to publish its final FY 2011 accounting by December 1, 2011.

Prior to 13th month adjustments, FY 2011 total base and one-time revenues are $8.34 billion, which would exceed the enacted April budget forecast by $335 million. Pre-13th month General Fund spending is also $8.34 billion *(see page 12)*, which would essentially match the revenue level. This expenditure level is approximately $10 million higher than budgeted, potentially due to revertments being less than anticipated. Revertments are an estimate of unspent appropriations at the end of the year.

Year-end adjustments could result in the ending balance being either slightly positive or negative. The enacted April budget assumed that the state's General Fund cash balance would end FY 2011 with a $(332) million shortfall. We currently anticipate that at least $300 million of the $332 million budgeted shortfall would be eliminated by the time of official book closing.

In addition to a cash balance, the state's fiscal condition can also be evaluated from the perspective of its operating fund balance. The cash balance reflects General Fund revenues minus General Fund spending on a fiscal year basis. In contrast, the state pays its bills out of the operating fund balance, which consists of General Fund monies and certain dedicated funds. As opposed to the cash balance, the operating fund balance at the end of FY 2011 is approximately $1.6 billion. Unlike FY 2010, the operating fund balance remained positive throughout the course of FY 2011 and the state did not need to borrow funds overnight from a private bank to pay its bills.

FY 2012 Implications

The enacted April budget assumed using $332 million of FY 2012 revenue to pay off the FY 2011 shortfall. Since at least $300 million of the $332 million will no longer be needed for that purpose, those monies will be freed up and available at the end of FY 2012. The ultimate magnitude of the FY 2012 ending balance, however, will depend on the outcome of multiple issues.

Summary (Continued)

For example, FY 2012 General Fund revenues could be higher than budgeted in light of the FY 2011 experience. The enacted budget presumed that FY 2012 base revenues would grow by 5.7% to $7.83 billion. (Total General Fund revenues including one-time 1-cent sales collections, urban revenue sharing and all other adjustments were estimated at $8.33 billion.) With the higher than expected FY 2011 base, revenues would now need to grow by 1.8% to meet the budgeted level. Based on FY 2011 and first quarter FY 2012 estimates, the revenue projection will probably be raised when the consensus forecast is updated as part of the Finance Advisory Committee (FAC) meeting in early October.

The magnitude of the FY 2012 ending balance, however, will also depend on several significant issues that could result in unbudgeted FY 2012 costs:

- The impact of federal budget negotiations on assistance to states, specifically the federal government's share of the Medicaid program. One recent federal deficit reduction proposal would have increased the states' collective share of Medicaid costs by $100 billion over 10 years.
- While they have permitted the freeze on the Medicaid childless adult coverage, the federal government has yet to approve all $480 million in budgeted AHCCCS waiver savings.
- The state is subject to numerous "budget" lawsuits, including attempts to eliminate AHCCCS' childless adult coverage freeze.
- Early payoff of the state's $1.5 billion state building sale/leaseback and lottery bond issuances due to IRS requirements.

In terms of this last issue, the state generated $1.5 billion in proceeds from 20-year tax-exempt issuances involving the sale and leaseback of state buildings and lottery bonds to finance ongoing state operations in FY 2010. The IRS does not normally permit tax-exempt issuances to be used for operating funds. The state was able to proceed, however, by agreeing to use any operating surplus above 5% to begin to pay back the issuances early. Since the issuances were structured to guarantee at least 10 years of payments to investors before being paid off or "called", the potential payback in FY 2012 would be deposited into a reserve fund.

The payback calculation has a number of steps and is calculated each December by the Department of Administration. As a rough approximation, the General Fund ending balance would need to exceed $400 million before the payback mechanism was triggered (5% of an $8.3 billion budget). At that level, the balance above $400 million would be dedicated to the payback. Due to the uncertainty regarding FY 2012 revenues and potential unbudgeted costs, it is uncertain whether the state's FY 2012 ending balance will exceed the $400 million level.

Long Term Budget Implications

As of last April's Finance Advisory Committee meeting, the FY 2014 budget was projected to have a $(600) million shortfall after accounting for the long term revenue forecast, active funding formula spending requirements and expiration of the 1-cent sales tax. While the higher than expected FY 2011 revenues would bring the state closer to a balanced budget in FY 2014, it does not create a structural budget surplus.

In addition, the April estimates assumed the continuation of the existing funding formula suspensions, which would otherwise add $800 million in new spending. The 2 primary suspensions are approximately $300 million in annual K-12 operating funds and $400 million in annual School Facilities Board capital expenditures.

June Revenues

Table 2

General Fund Revenues ($ in Millions)

	FY 2011 Collections	Difference From April Forecast	Difference From FY 2010
June	$ 955.5	$ 59.6	$ (759.5)
Year-to-Date	$ 8,342.5	$ 334.7	$ 23.4

"Total FY 2011 [Individual Income Tax] revenues grew 18.5% to $2.86 billion. This amount was $304.8 million above the enacted budget forecast."

Sales Tax collections were $392.3 million in June. Excluding the $108.7 million from the temporary 1-cent increase, collections were $283.6 million, or 16.8% above June 2010. The unusually large increase is mainly due to estimated payments (see below). Total fiscal year collections were $3.46 billion, or 2.5% above FY 2010 collections, making FY 2011 the first positive year since FY 2007. In addition, the 1-cent sales tax collections were $872.7 million.

Table 3 displays the June growth rates (excluding the 1-cent tax) for the largest categories.

Table 3

Sales Tax Growth Rates Compared to Prior Year

	June	YTD
Retail	12.7%	7.0%
Contracting	5.8%	(4.7)%
Utilities	3.0%	0.9%
Use	(99.3)%	(15.6)%
Restaurant & Bar	0.6%	3.2%

Retail and Contracting together account for about 60% of all sales tax revenues. While Contracting has traditionally been the second largest category, for the second year in a row, the steep decline in Contracting revenues have left the category in the number 3 position, behind Utilities, which generated $408.6 million, or 6.7% more than Contracting.

Of the increase in June Retail, about 9% of the 12.7% growth, along with the abnormal decline in Use Tax revenue, is due to a one-time shift of prior month collections from the Use Tax category to Retail.

While economic activity explains a portion of the June growth, estimated payments also played a role. In all months but June, Retail sales taxes are due the month after the purchase. In June, however, most large retailers are required to make an estimated payment based on actual collections in May or June. This payment is then credited against July tax liabilities. At this time each year, the Department of Revenue (DOR) calculates the impact of this payment shift as part of June revenue collections. This calculation typically helps the bottom line, as sales traditionally grow from one summer to the next.

Last year, estimated payments, excluding tax law changes, reduced collections by $(19) million. For FY 2011, estimated payments actually increased total collections by $36.9 million, most of which is attributable to the 1¢ tax increase. The lack of a negative estimated payment accounts for half of the increase in collections this year.

Including the 1-cent increase, year-to-date collections were $35.0 million, or 0.8%, above the enacted April budget forecast.

Individual Income Tax net revenues were $312.5 million in June, or 15.5% above the prior year. Collections were $36.1 million above the forecast. Total FY 2011 revenues grew 18.5% to $2.86 billion. This amount was $304.8 million above the enacted budget forecast. As with the Sales Tax, this was the first positive year for the individual income tax since FY 2007.

As indicated in *Table 4* below, withholding grew by 7.0% in June for a FY 2011 increase of 7.3%. This was the first year that the state had positive withholding growth since FY 2008 when collections increased by 1.5%.

Table 4

Individual Income Tax Growth Rates Compared to Prior Year

	June	YTD
Withholding	7.0%	7.3%
Estimated + Final Payments	13.2%	13.4%
Refunds	(42.6)%	(9.5)%

Corporate Income Tax net collections were $109.4 million in June, or 20.8% above the prior year. Collections were $(4.8) million below the forecast. Total FY 2011 revenues were up 35.6% to $560.2 million, the first positive year since

June Revenues (Continued)

"Total [Insurance Premium Tax] collections [were] $413.7 million, or 2.1% above the prior year."

FY 2007, but are $(21.7) million below the enacted budget forecast. While Corporate collections were not expected to maintain their 115.5% growth of the first half of the year, they have not grown as quickly as expected since January.

Insurance Premium Tax collections were $400.2 million through June, or (1.2)% below the prior year. Collections were $(12.4) million below forecast. According to the Department of Insurance, an additional $13.4 million will be credited to the General Fund during the "13th month," which would put total collections at $413.7 million, or 2.1% above the prior year and $1.1 million above forecast.

The **Lottery Commission** reports that June ticket sales were $46.2 million, which is $1.9 million, or 4.4%, above sales in the prior year. Year-to-date, ticket sales are $583.5 million, which is 5.8% above last year's sales. These amounts are not the final FY 2011 revenues, as they exclude some "13th month" distributions. The General Fund share of sales has increased significantly more than overall sales, however, due to changes in the distribution formula.

<u>Non-General Fund</u>

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 $102.2 million in June were down $(0.4) million, or (0.4)%, compared to June of last year. Total FY 2011 revenues have grown 0.9%.

Table 5

General Fund Revenue:

Change from Previous Year and Enacted April Budget Forecast
June 2011

	Current Month					FY 2011 YTD (Twelve Months)				
		Change From					Change from			
	Actual	June 2010		Forecast		Actual	June 2010		Forecast	
	June 2011	Amount	Percent	Amount	Percent	June 2011	Amount	Percent	Amount	Percent
Taxes										
Sales and Use w/o 1¢ *	$283,571,773	$40,822,188	16.8 %	($3,293,967)	(1.1) %	$3,463,327,544	$85,764,446	2.5 %	($12,984,756)	(0.4) %
Income - Individual	312,510,464	41,965,002	15.5	36,113,030	13.1	2,863,657,979	447,361,674	18.5	304,804,079	11.9
- Corporate	109,404,169	18,848,679	20.8	(4,799,458)	(4.2)	560,235,651	147,036,605	35.6	(21,717,749)	(3.7)
Property	4,180,971	638,032	18.0	215,038	5.4	20,333,503	63,872	0.3	333,503	1.7
Luxury - Tobacco	2,414,738	(1,251,353)	(34.1)	0	0.0	25,308,849	(2,273,284)	(8.2)	(572,151)	(2.2)
- Liquor	2,550,225	(80,268)	(3.1)	0	0.0	30,021,762	1,166,802	4.0	1,026,862	3.5
Insurance Premium	58,539,673	(13,414,765)	(18.6)	(14,628,471)	(20.0)	400,218,867	(4,889,025)	(1.2)	(12,381,133)	(3.0)
Estate	0	(4,760)	(100.0)	(62,628)	(100.0)	437,372	73,617	20.2	(62,628)	(12.5)
Other Taxes	41,173	10,663	34.9	(81,354)	(66.4)	2,136,331	690,024	47.7	636,331	42.4
Sub-Total Taxes	$773,213,186	$87,533,418	12.8 %	$13,462,190	1.8 %	$7,365,677,859	$674,994,731	10.1 %	$259,082,359	3.6 %
Other Revenue										
Lottery	8,409,900	(7,235,100)	(46.2)	(27,659,370)	(76.7)	59,459,889	12,814,889	27.5	(18,441,011)	(23.7)
License, Fees and Permits	2,828,382	134,275	5.0	387,526	15.9	27,798,332	1,144,235	4.3	2,798,332	11.2
Interest	1,421	(6,385)	(81.8)	(288,579)	(99.5)	1,894,793	1,422,025	300.8	(2,105,208)	(52.6)
Sales and Services	10,807,949	6,716,987	164.2	6,920,016	178.0	36,567,153	8,263,596	29.2	12,059,553	49.2
Other Miscellaneous	38,733,322	17,024,366	78.4	22,175,485	133.9	60,254,726	6,977,873	13.1	17,754,726	41.8
Disproportionate Share	0	(18,700,000)	(100.0)	0	--	87,578,591	68,878,591	368.3	25,986,291	42.2
Transfers and Reimbursements	41,517,587	41,437,377	--	5,353,660	14.8	57,348,999	23,018,733	67.1	(10,295,001)	(15.2)
Sub-Total Other Revenue	102,298,561	39,371,520	62.6 %	6,888,738	7.2 %	330,902,483	122,519,943	58.8 %	27,757,683	9.2 %
TOTAL BASE REVENUE	**$875,511,747**	**$126,904,938**	**17.0 %**	**$20,350,928**	**2.4 %**	**$7,696,580,342**	**$797,514,674**	**11.6 %**	**$286,840,042**	**3.9 %**
Other Adjustments										
Urban Revenue Sharing	(39,500,543)	12,886,509	--	0	0.0	(474,006,517)	154,638,108	--	0	0.0
1¢ TPT Increase*	108,739,170	108,739,170	--	39,342,237	56.7	872,716,949	872,716,949	--	47,960,649	5.8
Budget Plan Transfers	10,744,520	(81,865,255)	(88.4)	(110,695)	(1.0)	247,181,105	(139,904,395)	(36.1)	(110,695)	(0.0)
Budget Legislation	0	(176,178,100)	(100.0)	0	--	0	(176,178,100)	(100.0)	0	--
Leaseback Proceeds	0	(750,000,000)	(100.0)	0	--	0	(1,485,419,300)	(100.0)	0	--
Sub-Total Other Adjustments	79,983,147	(886,417,676)	(91.7) %	39,231,542	96.3 %	645,891,537	(774,146,738)	(54.5) %	47,849,954	8.0 %
TOTAL GENERAL FUND REVENUE	**$955,494,894**	**($759,512,738)**	**(44.3) %**	**$59,582,470**	**6.7 %**	**$8,342,471,879**	**$23,367,936**	**0.3 %**	**$334,689,996**	**4.2 %**
Non-General Funds										
Highway User Revenue Fund	$102,172,000	($405,000)	(0.4) %	($1,943,959)	(1.9) %	$1,205,074,000	$10,658,000	0.9 %	($7,258,794)	(0.6) %

* Sales and Use line excludes revenue from the temporary 1¢ increase approved by the voters in May 2010. That revenue is shown under One-Time Revenues. Total June collections including the 1¢ increase were $392.3 million. This amount is $149.6 million, or 61.6%, above June 2010 and $36.0 million, or 10.1%, above forecast. Year to date, total collections including the 1¢ increase were $4.37 billion. This amount is $958.5 million, or 28.4%, above June 2010 and $35.0 million above forecast.

Economic Indicators

"...the state lost (57,200) nonfarm jobs in June over May. Job losses typically occur in June as schools begin their summer recess. The job loss this June, however, was significantly larger than the average June workforce reduction of (36,400) in the prior 10 years."

NATIONAL

The Conference Board's **U.S. Consumer Confidence Index** fell by (5.2)% in June to 58.5, the lowest reading since November 2010. The mostly negative economic and financial news over the last few months have taken a toll on consumer confidence. The index has declined in each of the last 3 months. Consumers are feeling less confident about their job prospects and earning potential and are therefore more likely to cut back on their discretionary spending in the near term.

The Conference Board's **U.S. Index of Leading Economic Indicators** rose by 0.3% in June, to 115.3. This increase came on top of May's 0.8% advance. Five of the 10 components that make up the index made positive contributions in June. The largest positive contributions came from the financial components - interest rate spread and money supply. May's improvement was muted primarily due to the negative contributions from lower stock prices and weaker consumer expectations.

Consumer prices, as measured by the **U.S. Consumer Price Index (CPI),** decreased by (0.2)% in June, the first decline in a year. The CPI decline was primarily due to falling energy prices, especially the price of gasoline, which fell by (6.8)% in June. Core inflation, which excludes energy and food prices, edged up by 0.3% for the second month in a row. In spite of the recent increase in core inflation, most analysts believe that the likelihood of a wage-price spiral developing is low due to the considerable slack in labor markets.

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 was 1 of 20 states for which the coincident index declined in June. From May to June, Arizona's index decreased by (0.1)% compared to an increase of 0.1% for the nation as a whole. June's Arizona index was 0.6% above last year.

While Arizona's index has improved compared to the same time period last year, the index remains (13.7)% below its peak reading in August 2007. In contrast, the national coincident index has declined (4.9)% since its historical peak in January 2008. See Tracking Arizona's Recovery for additional historical information.

Employment

According to the Employment and Population Statistics Unit of the Department of Administration, the state lost (57,200) **nonfarm jobs** in June over May. Job losses typically occur in June as schools begin their summer recess. The job loss this June, however, was significantly larger than the average June workforce reduction of (36,400) in the prior 10 years.

In June, the state had 7,300, or 0.3%, more persons on the payrolls than 1 year ago. This net gain is unevenly distributed between the private sector and government, however, as the former has gained 21,300 jobs while the latter has shed (14,000) jobs since June 2010. Even within the private sector, there is a considerable difference in terms of job creation, as 5 out of 10 industry sectors (mining, construction, information, professional and business services, and other services) have yet to increase their payrolls relative to last year.

The data above suggests that job gains in the state are concentrated to relatively few sectors of the economy. One of the sectors that have performed well is the manufacturing industry, which has added jobs in each of the last 5 months. Compared to June 2010, manufacturing employment has grown by 2.0%, or 3,000 jobs. With a workforce of 151,200 employees, the manufacturing sector is now employing more persons than at any time since August 2009. Two-thirds of the job gain in the manufacturing sector has occurred in the durable goods industry, which generally pay higher wages than most other industries.

Another silver lining in an otherwise less than encouraging work report is that year-over-year job losses in the construction sector appear to be coming to an end soon. The year-over-year job loss of (0.3)% in June was the smallest such decline since January 2007. With a total of 112,500 individuals on their payrolls, the construction industry now employs 55% fewer workers than during the height of the housing boom 5 years ago.

Economic Indicators (Continued)

"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."

The longest and deepest recession in postwar era ended in June 2009. Two years later, nonfarm employment in Arizona remains (361,800) below the pre-recession peak of 2.72 million jobs. For the first 6 months of 2011, the state has seen an average net gain of 4,900 jobs compared to the same period in the prior year. At this pace, it would take another 6 years before the state returned to pre-recession levels. While job growth typically accelerates as the business cycle improves, the statistics suggest at a minimum that Arizona is not months but years away from regaining the jobs lost during the recession. See Tracking Arizona's Recovery for additional historical information.

The state's seasonally adjusted **unemployment rate** rose from 9.1% to 9.3% in June**.** This marked the first month-over-month increase of the jobless rate since November 2009. By way of comparison, the unemployment rate in June 2010 was 10.0%. The U.S. jobless rate is currently at 9.2%. Arizona's unemployment rate has been above the national average in 35 of the last 37 months.

The federal Bureau of Labor Statistics (BLS) reported that 27,951 Arizona residents filed **initial claims for unemployment insurance** in June, a 4.3% increase from the prior month. The 10-year average increase for June prior to the onset of the recession in 2007 was 6.0%. This suggests that June's increase in first-time jobless claims was primarily due to seasonal factors. Initial claims in June were (9.8)% below last year's level. 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.

Housing

In June, the number of new Maricopa County **foreclosure notices** increased 1.1% from May levels to 4,477. The number of Maricopa County **pending foreclosures** decreased from 28,670 in May to 26,473 in June. The June total is (48.6)% 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 June, there were a total of 10,475 **existing single-family home sales** that resulted in a **median resale home price** of $128,560. Relative to the prior year, the number of sales is down (2.3)%, while prices are (12.8)% lower. Of the existing sales, 31.3%, or 3,280 were foreclosures.

State Agency Data

In July, **AHCCCS caseloads** equaled 1.37 million members, a 0.6% increase over the prior month. AHCCCS caseloads are currently 1.2% above July 2010 levels. The FY 2012 budget funded a projected July caseload decline of (0.6)% for a total of 1.34 million members.

There were 41,136 **TANF recipients** in the state in June, a monthly caseload decrease of (1.3)%. Year-over-year, the number of TANF recipients has declined by (42.0)%. This decline is the result of changes to the statutory lifetime limit a person may receive cash assistance. The FY 2011 budget reduced the lifetime limit to 36 months. The FY 2012 budget further reduces this limit to 24 months. Previously, the maximum had been 60 months. 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 June, there were a total 1.1 million food stamp recipients in the state, a 1.9% increase over the prior month. Compared to the same month last year, food stamp participation was up by 4.4%. 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** increased to 42,203 inmates between May and July 2011. Relative to the prior 3-month period, the population has increased by 103 inmates. Compared to a year ago, however, the population has declined by (371) inmates.

Economic Indicators (Continued)

Table 6

ECONOMIC INDICATORS

Indicator	Time Period	Current Value	Change From Prior Period	Change From Prior Year
Arizona				
- Unemployment Rate (SA)	June	9.3%	0.2%	(0.7)%
- Initial Unemployment Insurance Claims	June	27,951	4.3%	(9.8)%
- Unemployment Insurance Claimants	May	67,641	3.4%	(19.6)%
- Non-Farm Employment - Total	June	2.36 million	(2.4)%	0.3%
Manufacturing	June	151,200	0.5%	2.0%
Construction	June	112,500	2.9%	(0.3)%
- Average Weekly Hours, Manufacturing	May	40.4	(0.7)%	1.0%
- Contracting Tax Receipts (3-month average)	Apr-Jun	$32.8 million	3.0%	6.3%*
- Retail Sales Tax Receipts (3-month average)	Apr-Jun	$154.0 million	3.1%	19.3%*
- Residential Building Permits (3-month moving average)				
Single-family	Mar-May	981	7.2%	(14.9)%
Multi-unit	Mar-May	83	(55.6)%	(26.4)%
- Greater Phoenix Existing Home Sales				
Single-Family	June	10,475	(3.9)%	(2.3)%
Townhouse/Condominium	June	1,475	(6.1)%	(14.5)%
- Greater Phoenix Median Resale Home Price				
Single-Family	June	$128,560	(0.3)%	(12.8)%
Townhouse/Condominium	June	$80,500	(1.7)%	(19.4)%
- Foreclosure Activity, Maricopa County				
Foreclosure Notices (Notice of Trustee's Sales Recorded)	June	4,477	1.1%	(27.4)%
Pending Foreclosures (Active Notices)	June	26,473	(7.7)%	(37.5)%
Greater Phoenix S&P/Case-Shiller Home Price Index (Jan. 2000 = 100)	April	100.36	0.1%	(8.8)%
- Greater Phoenix Total Housing Inventory, (ARMLS)	June	29,203	(7.8)%	(31.9)%
- Phoenix Sky Harbor Air Passengers	May	3.48 million	1.3%	6.6%
- Arizona Average Natural Gas Price ($ per thousand cubic feet)	February	$6.23	(3.3)%	(14.0)%
- Arizona Consumer Confidence Index (1985 = 100)	2nd Quarter 2011	51.9	(17.4)%	4.6%
- Arizona Coincident Index (July 1992 = 100)	June	176.48	(0.1)%	0.6%
- Arizona Personal Income	1st Quarter 2011	$229.9 billion	1.8%	4.3%
- Arizona Population	April 1, 2010	6.39 million	N/A	N/A
- AHCCCS Recipients	July	1,369,731	0.6%	1.2%
- TANF Recipients	June	41,136	(1.3)%	(42.0)%
- SNAP (Food Stamps) Recipients	June	1,108,977	1.9%	4.4%
- ADC Inmate Growth (3-month average)	May-July	42,203	103 inmates	(371) inmates
- Probation Caseload (Adult/Juvenile)				
Non-Maricopa	May	18,990	(37)	(936)
Maricopa County	May	26,184	(73)	(1,645)
United States				
- Gross Domestic Product (Chained 2005 dollars, SAAR)	1st Quarter 2011 (Final Estimate)	$13.4 trillion	1.9%	2.3%
- Consumer Confidence Index (1985 = 100)	June	58.5	(5.2)%	7.7%
- Leading Indicators Index (2004 = 100)	June	115.3	0.3%	6.0%
- U.S. Semiconductor Billings (3-month moving average)	Feb-Apr	$4.50 billion	(3.7)%	9.5%
- Consumer Price Index, SA (1982-84 = 100)	June	224.30	(0.2)%	3.4%

*Adjusted for 1¢ sales tax

Summary of Recent Agency Reports

Arizona Department of Corrections – Report on Community Accountability Pilot Program – A.R.S. § 41-1609.05 required the Arizona Department of Corrections (ADC) to establish a Community Accountability Pilot Program (CAPP). Statute authorizes the department to contract with a private or non-profit entity to provide supervision and treatment services for eligible offenders who have violated the terms and conditions of community supervision. The pilot program is scheduled to end July 1, 2012.

The department awarded the CAPP contract to a private vendor and the program began in April 2006. For FY 2011, a total of 60 eligible offenders were referred to the program. Of those referred to CAPP:

- 2 (3.3%) declined to participate,
- 23 (38.3%) remain enrolled in the program,
- 19 (31.7%) successfully completed the program, and
- 16 (26.7%) were terminated from the program.

(Stefan Shepherd)

Department of Economic Security - Report on Arizona Training Program at Coolidge (ATP-C) Campus and Other Placements - A footnote in the FY 2011 General Appropriation Act requires the Department of Economic Security (DES) to report on placements of developmentally-disabled (DD) clients into state-owned Intermediate Care Facilities for the Mentally Retarded (ICF-MR), or at the ATP-C campus in FY 2011. DES reports that there were no new permanent placements at the ATP-C campus or a state-owned ICF-MR in FY 2011. (Aaron Galeener)

Public Programs Eligibility Report – As enacted in the 2006 election, Proposition 300 limits participation in certain state programs to citizens, legal residents, and other persons lawfully present in the United States and requires semi-annual reports to the Joint Legislative Budget Committee. Below is a summary of the reports:

Community Colleges – Statewide for the spring 2011 semester, the Community Colleges reported a total of 254,874 students classified as in-state. They reported 1,994 students who were not entitled to be classified as in-state because of a lack of lawful immigration status. Additionally, 100,252 students applied for financial aid. Of those who applied, the community colleges reported that 284 were not entitled to any aid because they were not lawfully present in the United States.

Universities – At the 3 universities, 125,196 students registered for the spring 2011 semester. Of the total students registered, the universities were able to verify the legal immigration status of 113,528 students. Additionally, the universities reported that 8,475 of these students did not require verification because they had either not requested or received in-state tuition or state supported financial aid. The universities reported that a total of 94 students were unverifiable due to their inability to provide the requisite documentation.

Department of Economic Security – The department reported that 6,896 applications were received for child care assistance during the reporting period of December 1, 2010 to May 31, 2011. Of this number, 4 were denied because criteria for citizenship or legal residency were not met.

Department of Education – Previously, the Department of Education reported the number of applicants and applicants ineligible for enrollment for the Family Literacy Program and the Arizona Adult Education Program. Funding for these programs was discontinued as of December 1, 2009 and July 1, 2010, respectively, resulting in no information to report.
(James Alcantar)

June Spending

"June 2011 spending of $506.5 million was $361.5 million higher than June 2010."

FY 2011 Spending

June 2011 spending of $506.5 million was $361.5 million higher than June 2010 (*See Table 7*).

Year-to-date, preliminary FY 2011 spending was $8.34 billion, or $523.4 million above FY 2010. This was largely due to a decline in the use of funds from the American Recovery and Reinvestment Act (ARRA) relating to education and a reduced federal Medicaid match rate.

The June expenditure amounts do not reflect 13th month expenditures. Agencies have until July 29th to pay their FY 2011 obligations.

- In June, the Arizona Department of Education spending was $261.3 million higher than the prior year. June expenditures were higher compared to the prior year due to differences in the timing of the K-12 rollover.
- Year-to-date expenditures for the Department of Education were $3.50 billion, or $341.6 million higher than the prior year due to a decline in the use of funds from the ARRA fiscal stabilization fund.
- University spending was $56.9 million in June, or $47.3 million higher than the prior year. The increased expenditure amount reflects the rollover being spread out over the course of the fiscal year.
- Year-to-date expenditures of $890.3 million for the Universities are $96.2 million higher than the prior year due to one-time savings in FY 2010 from increasing the system's payment deferral.
- AHCCCS, Department of Economic Security (DES), and Department of Health Services (DHS) spending were a combined $70.2 million higher than June of the prior year. This increase generally reflects a phase-out of an increase to the federal Medicaid assistance percentage (FMAP) rate as part of the ARRA as well as a change in the timing of the AHCCCS rollover.
- Year-to-date AHCCCS expenditures were $136.9 million above FY 2010, while the DES budget grew by $20.4 million. The increased expenditure amount reflects a phase-out of the enhanced FMAP rate as part of the ARRA. DHS expenditures declined by $(50.1) million primarily due to FY 2011 reductions to non-Medicaid Behavioral Health Services.

Table 7

General Fund Spending ($ in Millions)

Agency	June 11	Change from June 10	Year to Date	YTD Change from FY 10
AHCCCS	89.6	51.2	1,365.8	136.9
Corrections	71.3	(7.8)	880.0	21.1
Economic Security	5.5	10.7	542.7	20.4
Education	248.3	261.3	3,498.7	341.6
Health Services	8.9	8.3	427.6	(50.1)
Public Safety	2.7	0.1	41.9	(0.7)
School Facilities Board	-	-	67.4	(37.3)
Universities	56.9	47.3	890.3	96.2
Leaseback Debt Service	-	-	52.1	52.1
Other	23.3	(9.6)	578.2	(56.8)
Total	506.5	361.5	8,344.7	523.4

Table 8

General Fund Spending
($ in Thousands)

Agency	June 11	Change from June 10	Year-to-Date	YTD Change from FY 10
Department of Administration	1,304.5	328.0	19,232.9	409.5
Department of Admin Sale/Leaseback D/S	-	-	52,066.9	52,066.9
Office of Administrative Hearings	49.8	(6.1)	905.1	(28.2)
Department of Agriculture	604.2	20.2	8,265.4	(95.5)
AHCCCS	89,636.6	51,279.2	1,365,774.8	136,936.7
Arizona Commission on the Arts	32.5	36.2	650.0	(167.1)
Arizona Exposition and State Fair Board	-	-	-	(400.0)
Attorney General	1,325.8	(90.2)	16,797.7	(934.9)
AZ Capital Post Conviction Public Defender	(1.8)	(41.3)	634.4	(11.9)
State Board of Charter Schools	28.1	(15.8)	667.4	(18.7)
Board of Chiropractic Examiners	-	-	-	(148.0)
Department of Commerce	330.4	119.2	3,438.9	6.3
Community Colleges	-	-	132,426.3	--
Corporation Commission	68.8	8.1	616.5	33.2
Department of Corrections	71,331.8	(7,847.2)	879,966.3	21,124.6
Board of Cosmetology	-	-	-	(252.0)
AZ Criminal Justice Commission	-	-	-	4.6
AZ State Schools for the Deaf & Blind	71.0	(690.5)	20,732.4	(238.1)
Department of Economic Security	5,519.7	10,654.6	542,748.5	20,397.2
Department of Education	248,321.1	261,273.6	3,498,714.3	341,564.7
DEMA	971.0	(574.7)	10,903.3	602.0
Department. of Environmental Quality	-	(700.6)	0.6	(5,769.6)
DEQ – WQARF	-	-	7,000.0	-
Office of Equal Opportunity	32.6	23.0	189.1	(1.1)
State Board of Equalization	50.1	8.7	557.4	(87.9)
Board of Executive Clemency	60.7	19.7	846.2	(28.7)
Department of Financial Institutions	324.2	147.6	2,754.8	(202.5)
Department of Fire, Life, Bldg Safety	103.0	7.6	1,960.7	(158.9)
Office of the State Forester	1,969.8	1,969.8	5,670.4	5,670.4
Board of Funeral Directors	-	-	-	(100.0)
Arizona Geological Survey	179.2	77.6	789.0	(11.9)
Government Information Tech.	67.1	35.9	511.3	66.6
Governor	135.8	(245.8)	5,885.2	(1,016.1)
Gov. - OSPB	113.7	(2.1)	1,816.9	(96.4)
Department of Health Services	8,948.9	8,348.6	427,573.9	(50,124.5)
Arizona Historical Society	159.5	(26.3)	5,264.5	1,399.4
Prescott Historical Society of AZ	37.1	(8.0)	686.0	30.5
Independent Redistricting Comm.	66.4	66.4	102.9	76.8
Commission on Indian Affairs	9.3	(24.2)	62.3	(54.1)
Department of Insurance	317.4	11.7	5,409.5	(129.1)
Judiciary	-			
Supreme Court /Superior Court	2,257.1	(1,107.2)	97,560.9	(5,940.3)
Court of Appeals	1,020.8	(46.3)	14,531.7	507.9
Department of Juvenile Corrections	3,658.5	290.6	50,949.5	(10,529.0)

Agency	June 11	Change from June 10	Year-to-Date	YTD Change from FY 10
State Land Department	150.7	(3,189.5)	3,276.0	(10,226.3)
Law Enforcement Merit System	2.8	1.9	68.0	(3.9)
Legislature				
Auditor General	(51.2)	(1,382.5)	15,635.0	687.4
House of Representatives	818.2	117.6	11,730.0	(285.2)
Joint Legislative Budget Comm.	116.3	(32.9)	1,956.6	(275.0)
Legislative Council	367.0	98.6	4,585.0	(217.4)
Senate	373.9	(175.4)	8,104.2	(470.5)
Department of Liquor Licenses	-	-	3.3	(744.4)
Board of Medical Student Loans	-	-	360.7	(441.2)
Mine Inspector	122.2	65.3	1,086.7	7.1
Department of Mines & Mineral Resources	(1.5)	(71.7)	814.3	(40.9)
Nav. Streams & Adjudication	5.0	(4.5)	122.5	(5.8)
OSHA	-	(4.8)	-	(19.2)
Arizona State Parks Board	-	-	20,000.0	(214.2)
Pioneers' Home	5.7	5.7	1,566.0	1,566.0
Board of Psychologist Examiners	-	-	25.0	(275.0)
Comm. for Postsecondary Ed.	-	(136.3)	1,220.8	(2,333.2)
Department of Public Safety	2,725.3	578.2	41,851.9	(733.4)
Arizona Department of Racing	386.9	191.3	4,181.1	(683.5)
Radiation Regulatory Agency	14.9	(45.7)	1,392.6	(24.1)
Arizona Rangers Pension	-	(1.2)	8.3	(5.7)
Real Estate Department	192.3	20.2	2,667.9	(332.3)
Department of Revenue	4,395.4	(1,988.7)	42,970.3	4,073.1
School Facilities Board	25.0	(32.2)	67,430.7	(37,327.7)
Secretary of State	583.6	(333.9)	14,980.3	1,631.7
Tax Appeals Board	16.5	1.3	248.2	(3.7)
Office of Tourism	-	-		(200.0)
Department of Transportation	(5.8)	(10.4)	44.7	(12.7)
State Treasurer	-	(157.7)	-	(2,548.1)
Universities				
Board of Regents	171.8	(490.9)	17,251.2	(3,825.0)
Arizona State University	25,400.9	20,528.5	395,388.3	45,281.2
Northern Arizona University	8,551.9	8,059.4	133,116.7	15,251.3
University of Arizona	22,135.0	19,214.2	344,549.5	39,467.4
Veterinary Medical Examiners Board	-	-	-	(250.0)
Department of Veteran Services	(126.2)	200.2	11,579.8	3,117.0
Department of Water Resources	690.0	(2,026.9)	6,643.3	(10,873.4)
Department of Weights & Measures	183.2	97.2	1,170.1	(29.7)
Other	174.3	(865.6)	3,981.1	(19,585.3)
Grand Total	**506,529.4**	**361,528.8**	**8,344,674.0**	**523,448.2**