



The Executive Budget

S U M M A R Y

Fiscal Years 2006-2007

Janet Napolitano
GOVERNOR



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To the Honorable Members of the
Forty-Seventh Arizona Legislature:

In a handful of words, the old adage that “a statesman is any politician it’s considered safe to name a school after” offers timely wisdom to us as we inaugurate this Legislative session. It reminds us that, in governing, the true value of our best efforts and wisest decisions is rarely discernable in the here and now. Indeed, much of the distinction between a statesman and a politician relates to the former’s willingness to accept, and desire to achieve, delayed gratification – subordinating the lure of fleeting political gain to the opportunity to endow the people with a legacy whose benefits may not be felt until long after the statesman returns to private life.

Regardless of our political or philosophical leanings, as honorable public servants our desire to accomplish great and lasting things for our state is primal. That is why I am confident that this Legislative session will be noteworthy for our collective focus on Arizona’s long-term future and on the budgetary seeds that we must sow this spring – in such areas as education, health and welfare, water management and economic development – to secure that future without increasing the tax burden to our citizens.

Education. In a global economy, Arizona’s children compete academically with children around the world; every time a first-grader cannot read, or a ninth-grader fails algebra, Arizona falls behind. No function of State Government offers a greater investment in the future than providing the financial resources necessary for our young people to enjoy educational excellence and an ensuing life of opportunity and achievement.

- The simple act of funding tutoring for high school students who need such help to pass the AIMS test can improve graduation rates among the members of the class of 2006. In shaping the adult lives of many at-risk students, a high school diploma can mean the difference between success and failure, financial independence and poverty, and hope and despair – key variables in the equation that determines our state’s long-term economy and quality of life.
- Expanding opportunities for low-income parents to choose to enroll their children in all-day kindergarten at qualifying schools will help prepare kindergarten-age children for first grade by developing their language and reading skills and by helping teachers identify and respond to students’ learning needs.

- Public schools directly benefit from the sale and lease of State Trust Lands. Providing additional funding to the State Land Department will increase its capacity to prepare for the sale and lease of those lands, thereby increasing the revenues available to public schools.
- Physical surroundings and facilities have a profound impact on students' ability to learn. Increased funding for school construction, deficiencies corrections, and building maintenance and renovation will allow thousands of Arizona students to be educated in an environment more conducive to learning.
- Arizona's community colleges have evolved into higher education opportunity centers that welcome all students, including working-age adults, who wish to learn new skills and expand existing skills. The community colleges' relationship to the State's universities and their role in enhancing economic development are valuable assets that can be optimized by fully funding student enrollment growth.
- Phoenix is the largest U.S. city without a medical school. We will eliminate that distinction, and enhance the long-term quality of and access to Arizona health care, through initial funding that will allow the University of Arizona – in cooperation with Arizona State University, the City of Phoenix, and the state's medical and biotechnology communities – to launch a medical school class in downtown Phoenix in July 2006.

Services for the Needy. As the economic health of our state and nation improves, State Government has the opportunity to help many needy Americans free themselves of government services and assistance. That transition represents a significant boon to Arizona's economic development and quality of life; increased funding now for selected services to needy adults and children will pay valuable dividends for many years to come.

- As was noted earlier, children are better able to learn if they are in a positive learning environment. Even more important, children are better able to develop and succeed if they are safe and healthy. Increased funding for Child Protective Services, Children Services, Healthy Families, and the KidsCare health coverage program will enhance the overall health and safety of Arizona's needy children and improve their prospects for growing into strong and productive adults.
- Low-income working parents need to be able to go to work knowing that their young children are in safe hands. Childcare subsidies have proven to be important tools in providing effective child supervision for working parents and freeing those parents from welfare. The effectiveness of these subsidies warrants a continued investment by State Government.
- To improve the safety of Arizona's childcare facilities, we must increase the staff available to properly oversee them.
- Families are strengthened when parents enjoy the protection of adequate health care coverage. The KidsCare Parents program provides health insurance to approximately 12,000 parents of children enrolled in the KidsCare program. By ex-

panding coverage for this population, Arizona can further utilize enhanced federal participation, resulting in direct savings to the State.

Water Management. Arizona's economic vitality and quality of life depend on advances along two sometimes-conflicting fronts: economic development and conservation. That conflict has reached unprecedented heights as a result of our prolonged drought, which has also increased competition for water among rapidly growing southwestern states.

- The Governor's Drought Task Force provided the critical first measures toward long-term management of Arizona's water for drought preparation and water conservation. Funding will be necessary to restore prior year budget cuts to the Department of Water Resources; provide technical and engineering support in the State's hydrology and water management programs; and establish an agency to focus on statewide conservation, drought mitigation and rural studies.
- We will create a "virtual water university" coordinated among the State's three universities. The UofA will concentrate on water sustainability, quality and policy and on water in high technology manufacturing. ASU will focus on improving the state's climate model and projecting the supply and demand for water by a growing population. NAU will concentrate on the state's rapid growth and the water supply as it relates to northern Arizona and the Colorado Plateau.

Economic Development. Last year, Arizona's economy outperformed all but a handful of states, and healthier performance for the nation will further stimulate our state's economy. To foster employment and business growth throughout Arizona, State Government must capitalize on the state's momentum and continue to explore all opportunities for economic development.

- As we widen the pool of highly skilled workers among many industries, we should offer incentives to businesses to create more high-wage jobs. A series of tax relief measures, from guidelines for evaluating tax reduction to tax credits for new companies, will help spur job growth and improve Arizona's position in the competition for new jobs.
- State Government should also provide tax relief in the form of research and development tax credits for businesses that partner with our State universities and for individuals and companies that invest in early-stage small businesses.
- In a change that will especially benefit small business owners, the assessment ratio on business personal property between \$56,298 (the amount of business personal property that is exempt from taxation) and \$100,000 should be reduced from 25% to 1%. For manufacturers, the business personal property tax assessment ratio should drop from 25% to 13%, to make Arizona's manufacturing industry more competitive with other states and nations.
- The ability of Arizona's economy to outperform most states in 2004 is due in part to the state's transportation infrastructure. In this session we will adopt an integrated plan to enhance highway safety and mobility, improve bridge maintenance and safety, reduce congestion, increase retention of experienced highway maintenance

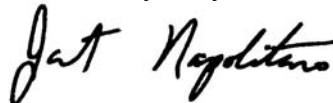
nance staff, balance transportation needs with environmental quality, and further stimulate our economy.

Our challenge. A few years ago, a national news magazine mentioned a bit of jargon popular among groundskeeping crews of sports stadiums. The term “chasing snakes” refers to the futile efforts of inexperienced grass cutters to mow in a straight line. A veteran groundskeeper noted that the phenomenon occurs when one looks down to follow the edge of the row just mowed. The secret to mowing a straight line, he explained, is to fix your gaze on a distant target and mow toward it.

As we work together toward the successful completion of this Legislative session, there will be no lack of advocates who would have us “chase snakes” – that is, pursue causes and make decisions based on narrow interests, dubious reasoning or short-term considerations. To govern effectively, we must resist influences that distract us from our “distant target.”

Our citizens have only one advocacy group, and we are it. Together, we will produce a budget that reflects the best practices of State Government and moves us on a straight line toward an even brighter, more vibrant future for the people of Arizona.

Yours very truly,

A handwritten signature in black ink, reading "Janet Napolitano". The signature is written in a cursive, flowing style.

Janet Napolitano
Governor

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ACKNOWLEDGEMENTS

Enhancing Our Resources

It takes a mixture of human, financial and natural resources to make an economy

NURTURING THE STATE'S fiscal and human resources so that it is positioned to compete in the 21st Century economy is imperative. The Executive Budget Recommendation for FY 2006 strategically moves the State forward on that path. The Recommendation recognizes that:

- children are better able to develop and succeed if they are healthy;
- families are strengthened when the children of working parents are in safe daytime environments;
- Arizona must have a superior education system that offers each child the best chance to determine his or her path to growth and achievement;
- our natural resources are not only a state treasure; they also contribute to a vibrant educational system and economy; and
- public safety must be strengthened by recruiting and retaining the highest quality law enforcement and correctional officers.

Effectively managed and maximized through targeted incentives, these factors will combine to produce a world-class economy in Arizona for years to come.

STRENGTHENING FAMILIES

Childcare. The Executive Budget builds on the momentum of the FY 2005 Budget by continuing to provide funding for low-income working parents so that their children can be in safe and secure childcare facilities while the parents earn a living. To that end, \$22.6 million is provided for childcare subsidies. To ensure that those monies are spent at suitable childcare facilities, an

additional \$521,500 is provided for licensing and regulation.

Healthy Families. Additionally, funds are added to the Healthy Families Program, to bring its total funding to \$20 million. The return on this investment is achieved through the reduced likelihood that Healthy Families participants will require other services – such as Child Protective Services – provided by the social safety net. However, even at the \$20 million funding level Healthy Families cannot cover the entire need; thus, it is critical that advances made by Child Protective Services since 2003 be continued. The Executive Budget provides an additional \$11.7 million to provide 184.5 caseworkers for families with children in need.

Finally, the Executive Budget provides an additional \$1.5 million to increase bed space in domestic violence shelters.

IMPROVING ACCESS TO HEALTH CARE

Children's health. Ensuring that children are healthy and ready to succeed is another pillar of Arizona's economic foundation. Accordingly, the Executive Recommendation:

- continues the funding of health care services under KidsCare Parents,¹ a program for parents of children that are covered by AHCCCS; and
- contains \$4 million for a Kids-Care outreach program to ensure that all eligible children have access to needed services.

Rural hospitals. It is essential that all Arizona residents, regardless of their

place of residence, have medical services available to them. In recognition of that fact, the Executive Budget provides an additional \$2.5 million for rural hospitals.

Phoenix medical school. Phoenix is the largest U.S. city without a medical school. To take the first steps toward remedying this deficiency, the Executive Budget proposes spending \$7 million in the University System to initiate a process that will result in a group of students beginning their medical training in Phoenix in July 2006. Additionally, the Executive recommends setting aside \$20 million of the amount in the Budget Stabilization Fund for future use for the medical school.

ENHANCING EDUCATIONAL OPPORTUNITIES

K-12 and Community Colleges. Continuing last year's commitment, the Executive Budget fully funds the K-12 and Community College formulae. Additionally, the Voluntary Full Day Kindergarten Program initiated in FY 2005 is continued with an additional \$20.9 million. Voluntary Full Day Kindergarten is the largest school choice program in Arizona; it offers a valuable educational launching pad for young children, and it alleviates supervisory pressures on parents during their working hours.

AIMS testing. Among high school students in their junior year, the failure rate on AIMS practice tests has been disappointing. Accordingly, the Executive Recommendation provides \$5 million in FY 2006 to help students pass the AIMS test and graduate.

Universities and financial assistance. In addition to providing funding for enrollment growth and a new medical school, the Executive recognizes stu-

¹ The \$1.4 million investment is more than paid for in the long run and brings to Arizona additional federal funding.

dents' needs for financial assistance in achieving educational goals. For the first time in many years, the Executive Recommendation provides full matching funding – effectively doubling the State's investment – for the Arizona Financial Aid Trust, adding \$2.25 million to the program and bringing the State's share to \$4.5 million.

LAND AND WATER MANAGEMENT

Environmental stewardship is necessary for maintaining Arizona's natural beauty and for enhancing the state's economic development.

Water. Arizona's drought condition will not be alleviated by one rainy winter. Because Arizona is largely desert and drought cycles will continue, State Government must provide clear leadership in the wise use of water, both to sustain life and to support our long-term economic objectives. The Executive Recommendation provides:

- \$1.5 million to the University System for drought and water management research and activities; and
- \$5 million to restore funding cuts imposed on the Department of Water Resources in FYs 2002 and 2003, and to help Arizona simultaneously achieve its water resource and economic goals.

Forest fires. The drought has been a contributing factor in the forest fires that ravaged parts of the state, especially during 2003. One response to those fires was to use crews of properly supervised inmates to help with brush-clearing activities. The FY 2005 budget increased to 12 the number of crews, and this year's Executive Recommendation provides \$800,000 for three additional crews.

Trust lands. Finally, a direct link can be drawn between the activities of the Land Department and the beneficiaries of the State Land Trust, particularly as it pertains to K-12 education. To maximize the earnings from the sale and lease of State lands, the Land Department needs sufficient resources for planning and other preparatory work.

The Executive Recommendation provides \$7.2 million for the Land Department to carry out this mission.

ECONOMIC DEVELOPMENT

While all of the issues mentioned above contribute to Arizona's economic prosperity, the Executive Recommendation also contains targeted initiatives designed to help move the state's economy forward. Specifically:

- There will be additional cooperation between the Department of Commerce and the Office of Tourism to enhance rural economic development.
- Targeted tax credits for expenditures on technology and on research and development at the universities will be proposed, to take effect in the 2007 tax year.
- In a change that will especially benefit small business owners, the Executive Recommendation assumes a reduction, from 25% to 1%, in the assessment ratio on business personal property between \$56,298 (the amount of business personal property that is exempt from taxation) and \$100,000.
- For manufacturers, the business personal property tax assessment ratio will drop from 25% to 13%, to make Arizona's manufacturing industry more competitive with other states.

PUBLIC SAFETY

In our post-9/11 world, public safety in Arizona has taken on unprecedented importance. With the increasing demand for public safety personnel nationwide, it is important that Arizona maintain an experienced corps of law enforcement professionals and support staff. The Executive Recommendation provides targeted salary increases for these personnel, including:

- \$14.5 million for Correctional Officers;
- \$3 million for second-year funding of a Pay Plan for Department of Public Safety officers;

- \$1.3 million for Assistant Attorneys General;
- \$1 million for the Department of Juvenile Corrections; and
- \$1.5 million in State Highway Fund monies for Maintenance workers at the Department of Transportation.

STATE EMPLOYEES

Without question, State employees impact Arizona's citizens every hour of every day. Without their dedication and commitment, our highways would not be safe, our natural resources would be neglected, our roads would not be built and maintained, and our neediest citizens would not receive essential services and care.

The Executive Recommendation recognizes State employees' crucial role and provides adequate funding to offset increase in both retirement and health insurance costs.

FISCAL MANAGEMENT AND ACCOUNTABILITY

In the final analysis, a budget reflects the State's fiscal plan. The Executive Recommendation for FY 2006 contemplates measures to ensure proper collection and accounting of funds, such as:

- the generation of an expected \$11.4 million through enhanced enforcement efforts by the Department of Revenue;
- providing \$500,000 in additional funding to the General Accounting Office for pay parity to ensure that funds are properly expended; and
- saving \$4 million by making Health Care Group self-supporting.

CONCLUSION

Initiatives such those discussed above clearly illustrate the dynamic impact that can occur when State Government optimizes its existing resources for the benefit of the people it serves and makes the most prudent investments in its infrastructure. ●



The Budget Summary

STATE OF ARIZONA
SOURCES AND USES OF FUNDS
GENERAL FUND
(In Thousands)

	FY2004 Actuals	FY2005 Executive Recommendation	FY2006 Executive Recommendation
SOURCES OF FUNDS			
Balance Forward	192,185.0	360,388.9	143,819.4
Base Revenues	6,827,599.8	7,698,019.4	8,078,740.0
<i>Urban Revenue Sharing</i>	(365,065.0)	(373,074.2)	(417,315.3)
Adjusted Revenues	6,462,534.8	7,324,945.2	7,661,424.7
Enacted Fund Transfers	54,500.0	35,234.5	0.0
Qwest Settlement	9,047.0	0.0	0.0
Tax Amnesty Revenues	65,253.1	0.0	0.0
Federal Cash Assistance	87,265.9	0.0	0.0
Judicial Collections	5,389.3	2,106.7	0.0
VLT Transfer		118,000.0	0.0
Proposed Fund Transfers			25,000.0
DOR Revenue Generating Program			11,398.3
Lottery Revenues Distribution Change			3,000.0
TOTAL SOURCES OF FUNDS	6,876,175.1	7,840,675.3	7,844,642.4
USES OF FUNDS			
Operating Budgets	6,537,900.9	7,208,016.8	7,795,559.3
Operating Budget Supplementals		91,728.0	0.0
Voluntary Full Day Kindergarten		0.0	16,900.0
Ladewig Settlement	/1	134,280.4	0.0
Deficiency Corrections		100,000.0	0.0
School Building Maintenance & Renovation	/2	70,000.0	0.0
Military Base Preservation		5,000.0	5,000.0
Employer Related Expense Increases		0.0	30,758.5
Employee Health Insurance		0.0	18,045.6
Transfer to Budget Stabilization Fund		165,000.0	0.0
Employee Retirement Adjustment		0.0	24,155.9
Federal Revenue Maximization	0.0	(16,100.0)	(25,000.0)
Total Operating Budgets	6,537,900.9	7,757,925.2	7,865,419.3
Capital Outlay Appropriations	0.0	0.0	0.0
Administrative Adjustments	38,692.7	23,000.0	23,000.0
Revertments	(60,807.4)	(84,069.3)	(51,169.3)
USES OF FUNDS	6,515,786.2	7,696,855.9	7,837,250.0
ENDING BALANCE	360,388.9	143,819.4	7,392.4
TOTAL USES OF FUNDS	6,876,175.1	7,840,675.3	7,844,642.4

/1 The FY2006 Executive Recommendation presumes the financing of the FY2006 Ladewig payment.

/2 The FY2006 Executive proposes establishing conditional appropriations of \$70.7million for School Building Maintenance & Renovation, and \$22.0 million for funding provided by Maricopa County for adult probation.

**STATE OF ARIZONA
GENERAL FUND
REVENUE SUMMARY
FY 2004 THROUGH FY 2006
(in thousands)**

<u>TAXES</u>	Actual FY 2004	Estimate FY 2005	Estimate FY 2006
Corporate Income Tax	475,959.0	670,000.0	630,000.0
Individual Income Tax	2,306,142.7	2,656,000.0	2,834,000.0
Property Taxes	40,922.6	28,100.0	27,700.0
Sales and Use	3,294,788.3	3,589,000.0	3,865,000.0
Luxury Taxes	61,113.7	65,000.0	60,000.0
Insurance Premium Taxes	307,211.6	347,042.7	362,600.0
Estate Taxes	38,818.4	40,000.0	0.0
Other Taxes	1,446.6	1,400.0	600.0
TOTAL TAXES	6,526,402.8	7,396,542.7	7,779,900.0
<u>OTHER REVENUES</u>			
Licenses, Fees & Permits/Misc.	113,226.9	111,929.3	126,000.0
Interest Earnings	12,237.6	22,200.0	25,000.0
Lottery	31,659.9	31,000.0	31,000.0
Transfers & Reimbursements	10,857.6	24,900.0	25,000.0
Disproportionate Share	133,215.0	111,447.4	91,840.0
TOTAL OTHER REVENUES	301,197.0	301,476.7	298,840.0
TOTAL REVENUE	6,827,599.8	7,698,019.4	8,078,740.0
<u>ADJUSTMENTS</u>			
Urban Revenue Sharing	(365,065.0)	(373,074.2)	(417,315.3)
B.S.F. Deposit	0.0	0.0	0.0
GRAND TOTAL REVENUES	6,462,534.8	7,324,945.2	7,661,424.7

General Fund Operating Budgets Summary

	FY 2004 Actual	FY 2005 Approp	FY 2006 Exec Rec	'06 Exec - '05 App.	FY 06 Growth	FY 2007 Exec Rec	'07 Exec - '05 App.	FY 07 Growth
<u>General Government</u>								
Arizona Department of Administration	151,710.3	24,134.8	24,924.6	789.8	3.3%	N/A	N/A	N/A
Office of Administrative Hearings	1,078.5	1,104.2	1,106.1	1.9	0.2%	1,106.1	1.9	0.2%
Attorney General - Department of Law	23,341.9	23,448.5	25,303.6	1,855.1	7.9%	26,320.1	2,871.6	12.2%
Auditor General	10,681.2	11,747.5	11,747.5	0.0	0.0%	11,747.5	0.0	0.0%
Department of Commerce	3,185.2	8,864.5	8,571.6	(292.9)	-3.3%	8,571.6	(292.9)	-3.3%
Governor's Office for Equal Opportunity	212.4	220.9	221.4	0.5	0.2%	221.4	0.5	0.2%
State Board of Equalization	544.7	556.7	617.9	61.2	11.0%	985.1	428.4	77.0%
Office of the Governor	7,145.3	6,127.7	6,188.1	60.4	1.0%	6,188.1	60.4	1.0%
House of Representatives	10,557.5	11,955.5	11,955.5	0.0	0.0%	11,955.5	0.0	0.0%
Arizona Commission of Indian Affairs	197.5	205.1	205.2	0.1	0.0%	205.2	0.1	0.0%
Joint Legislative Budget Committee	620.4	2,201.1	2,201.1	0.0	0.0%	2,201.1	0.0	0.0%
Judiciary	112,231.8	114,302.6	114,302.6	0.0	0.0%	N/A	N/A	N/A
Legislative Council	3,739.4	4,628.4	4,628.4	0.0	0.0%	4,628.4	0.0	0.0%
Arizona State Library, Archives & Public Records	6,307.5	6,724.1	6,724.1	0.0	0.0%	6,724.1	0.0	0.0%
Personnel Board	268.5	338.3	338.3	0.0	0.0%	338.3	0.0	0.0%
Arizona Rangers' Pension	12.3	12.6	12.8	0.2	1.6%	13.0	0.4	3.2%
Arizona State Retirement System	488.4	0.0	0.0	0.0	0.0%	0.0	0.0	0.0%
Department of Revenue	59,858.3	62,846.5	63,823.8	977.3	1.6%	63,815.9	969.4	1.5%
Department of State - Secretary of State	4,751.5	7,149.9	3,027.6	(4,122.3)	-57.7%	6,427.6	(722.3)	-10.1%
Senate	6,093.2	6,841.5	6,841.5	0.0	0.0%	6,841.5	0.0	0.0%
Governor's Office of Strategic Planning and Budgeting	1,680.6	1,721.4	1,925.8	204.4	11.9%	1,925.8	204.4	11.9%
State Board of Tax Appeals	238.2	278.7	278.8	0.1	0.0%	279.6	0.9	0.3%
Arizona Office of Tourism	9,000.0	11,609.2	12,952.3	1,343.1	11.6%	13,822.7	2,213.5	19.1%
State Treasurer	7,482.7	5,411.2	5,262.3	(148.9)	-2.8%	5,112.3	(298.9)	-5.5%
Commission on Uniform State Laws	43.2	52.3	52.6	0.3	0.6%	52.8	0.5	1.0%
General Government Total	421,470.5	312,483.2	313,213.5	730.3	0.2%	179,483.7	5,437.9	3.1%
<u>Health and Welfare</u>								
Department of Economic Security	474,841.4	606,123.8	696,131.8	90,008.0	14.8% *	N/A	N/A	N/A
Department of Environmental Quality	22,858.5	23,142.1	23,310.9	168.8	0.7%	23,310.9	168.8	0.7%
Arizona Health Care Cost Containment System	676,024.7	860,921.3	994,121.8	133,200.5	15.5% *	N/A	N/A	N/A
Department of Health Services	319,809.8	367,491.9	482,010.9	114,519.0	31.2% *	N/A	N/A	N/A
Arizona Pioneers' Home	3,643.1	3,197.8	0.0	(3,197.8)	-100.0%	0.0	(3,197.8)	-100.0%
Department of Veterans' Services	2,164.4	2,261.7	2,265.1	3.4	0.2%	2,265.7	4.0	0.2%
Health and Welfare Total	1,499,341.9	1,863,138.6	2,197,840.5	334,701.9	18.0%	25,576.6	(3,025.0)	-10.6%
<u>Inspection and Regulation</u>								
Arizona Department of Agriculture	9,979.4	10,337.6	10,514.1	176.5	1.7%	10,501.8	164.2	1.6%
State Banking Department	2,721.5	2,891.7	3,167.8	276.1	9.5%	3,213.1	321.4	11.1%
Department of Building and Fire Safety	2,806.3	3,278.4	3,294.3	15.9	0.5%	3,300.6	22.2	0.7%
Corporation Commission	4,766.9	4,953.4	4,971.6	18.2	0.4%	4,972.6	19.2	0.4%
Department of Insurance	6,069.2	6,393.6	6,433.4	39.8	0.6%	6,433.7	40.1	0.6%
Department of Liquor Licenses and Control	2,448.9	2,813.7	2,827.3	13.6	0.5%	2,827.3	13.6	0.5%
State Mine Inspector	1,085.1	1,116.2	1,136.5	20.3	1.8%	1,136.5	20.3	1.8%
State Board of Nursing	134.9	136.4	161.4	25.0	18.3%	161.4	25.0	18.3%
OSHA Review Board	0.3	4.8	4.8	0.0	0.0%	4.8	0.0	0.0%
Arizona Department of Racing	2,291.6	2,504.8	2,531.4	26.6	1.1%	2,534.0	29.2	1.2%
Radiation Regulatory Agency	1,496.6	1,557.2	1,616.9	59.7	3.8%	1,606.1	48.9	3.1%
Department of Real Estate	3,112.4	3,208.4	3,483.0	274.6	8.6%	3,483.0	274.6	8.6%
Department of Weights and Measures	1,292.8	1,466.9	1,652.4	185.5	12.6%	1,566.2	99.3	6.8%

	FY 2004 Actual	FY 2005 Approp	FY 2006 Exec Rec	'06 Exec - '05 App.	FY 06 Growth	FY 2007 Exec Rec	'07 Exec - '05 App.	FY 07 Growth
Inspection & Regulation Total	38,205.9	40,663.1	41,795.0	1,131.9	2.8%	41,741.1	1,078.0	2.7%
<u>Education</u>								
Arizona State University - East Campus	12,449.5	13,040.2	13,040.2	0.0	0.0%	N/A	N/A	N/A
Arizona State University - Main Campus	263,779.4	282,510.5	294,478.8	11,968.3	4.2%	N/A	N/A	N/A
Arizona State University - West Campus	37,214.0	40,323.1	40,323.1	0.0	0.0%	N/A	N/A	N/A
Arizona Commission on the Arts	1,801.1	3,818.2	4,338.1	519.9	13.6%	4,319.1	500.9	13.1%
State Board for Charter Schools	594.3	702.7	1,027.9	325.2	46.3%	714.1	11.4	1.6%
Arizona Community Colleges	128,308.7	143,940.0	152,325.7	8,385.7	5.8%	N/A	N/A	N/A
Arizona State Schools for the Deaf and the Blind	12,947.6	14,636.2	15,266.2	630.0	4.3%	15,320.4	684.2	4.7%
Department of Education	2,957,037.0	3,184,039.5	3,315,465.2	131,425.7	4.1%	N/A	N/A	N/A
Arizona Historical Society	3,373.9	3,462.1	3,506.0	43.9	1.3%	3,506.0	43.9	1.3%
Northern Arizona University	110,274.0	117,440.5	122,535.1	5,094.6	4.3%	N/A	N/A	N/A
Commission for Postsecondary Education	1,391.3	1,391.3	1,391.3	0.0	0.0%	1,391.3	0.0	0.0%
Prescott Historical Society of Arizona	612.5	639.1	646.8	7.7	1.2%	646.8	7.7	1.2%
Arizona Board of Regents	6,674.9	7,611.0	10,492.2	2,881.2	37.9%	N/A	N/A	N/A
School Facilities Board	21,378.1	218,616.1	76,354.5	(142,261.6)	-65.1%	N/A	N/A	N/A
University of Arizona - Health Sciences Center	52,871.3	54,849.1	54,849.1	0.0	0.0%	N/A	N/A	N/A
University of Arizona - Main Campus	264,308.0	278,843.0	287,592.1	8,749.1	3.1%	N/A	N/A	N/A
Education Total	3,875,015.6	4,365,862.6	4,393,632.3	27,769.7	0.6%	25,897.7	1,248.1	5.1%
<u>Protection and Safety</u>								
Department of Corrections	604,686.5	629,113.9	691,518.3	62,404.4	9.9%	N/A	N/A	N/A
Arizona Criminal Justice Commission	1,052.2	1,302.0	1,302.0	0.0	0.0%	1,302.0	0.0	0.0%
Department of Emergency Services and Military Affairs	7,746.3	12,015.0	12,605.5	590.5	4.9%	12,605.5	590.5	4.9%
Board of Executive Clemency	857.6	913.3	1,025.7	112.4	12.3%	1,043.6	130.3	14.3%
Department of Juvenile Corrections	63,943.1	69,092.0	68,502.8	(589.2)	-0.9%	N/A	N/A	N/A
Law Enforcement Merit System Council	56.5	58.3	69.2	10.9	18.7%	66.5	8.2	14.1%
Department of Public Safety	29,638.5	31,839.0	28,173.8	(3,665.2)	-11.5%	31,080.6	(758.4)	-2.4%
Protection and Safety Total	707,980.7	744,333.5	803,197.3	58,863.8	7.9%	46,098.2	(29.4)	-0.1%
<u>Transportation</u>								
Department of Transportation	68.1	71.7	71.7	0.0	0.0%	N/A	N/A	N/A
Transportation Total	68.1	71.7	71.7	0.0	0.0%	0.0	0.0	0.0%
<u>Natural Resources</u>								
Arizona Geological Survey	778.8	796.7	796.7	0.0	0.0%	796.7	0.0	0.0%
State Land Department	16,540.5	17,600.1	25,262.8	7,662.7	43.5%	23,335.2	5,735.1	32.6%
Department of Mines and Mineral Resources	611.5	658.4	780.4	122.0	18.5%	780.4	122.0	18.5%
Arizona Navigable Stream Adjudication Commission	130.8	160.7	160.7	0.0	0.0%	0.0	(160.7)	-100.0%
State Parks Board	22,203.4	22,380.5	22,389.5	9.0	0.0%	22,389.5	9.0	0.0%
Department of Water Resources	13,212.9	14,198.9	18,318.9	4,120.0	29.0%	18,318.9	4,120.0	29.0%
Natural Resources Total	53,477.9	55,795.3	67,709.0	11,913.7	21.4%	65,620.7	9,825.4	17.6%
General Fund Operating Total	6,595,560.6	7,382,348.0	7,817,459.3	435,111.3	5.9%	384,418.0	14,535.0	3.9%

* Note: For FY 2006 the Executive has recommended technical adjustments to the AHCCCS, DES and DHS budgets. The first adjustment is a transfer of \$46.8 million General Fund from AHCCCS to DHS in exchange for tobacco settlement dollars, the second is a funding transfer of \$35.3 million General Fund from AHCCCS to DES so appropriations for eligibility workers will reside within the DES budget as opposed to the AHCCCS budget. If not for these two adjustments the AHCCCS FY 2006 growth would be 28.0%, the DES FY 2006 growth would be 7.1% and the DHS FY 2006 growth would be 20.6%.

**STATE OF ARIZONA
OTHER APPROPRIATED FUNDS
REVENUE SUMMARY
FY 2004 THROUGH FY 2006
(in thousands)**

	Actual FY 2004	Estimate FY 2005	Estimate FY 2006
<u>TAXES</u>			
Motor Fuel Taxes	716,778.2	689,480.4	682,919.9
Property Taxes	18,392.7	16,066.0	16,153.0
Sales and Use	114,206.0	71,713.3	71,341.3
Luxury Taxes	260,503.9	271,520.1	282,885.0
Insurance Premium Taxes	30,945.6	32,776.5	29,150.0
Motor Carrier License Tax	16508.66327	18887.6	18418.79744
Vehicle License Taxes	304746.0929	205699	332985.9551
Other Taxes	34,285.2	33,714.6	31,762.6
TOTAL TAXES	1,496,366.3	1,339,857.5	1,465,616.6
<u>OTHER REVENUES</u>			
Licenses, Fees and Permits	275,565.5	295,789.5	302,964.2
Charges for Services	1,079,232.0	1,181,792.5	1,185,083.2
Interest Earnings	53,801.8	46,899.4	48,305.0
Lottery	366,514.5	335,024.4	357,440.3
Miscellaneous Revenues	326,714.3	373,143.8	379,036.8
TOTAL OTHER REVENUES	2,101,828.1	2,232,649.6	2,272,829.5
<u>OTHER FINANCING SOURCES</u>			
Transfers & Reimbursements	2,651,462.8	2,694,776.5	2,989,786.2
GRAND TOTAL REVENUES	7,604,454.7	7,744,865.5	8,216,279.7

*Other Appropriated Funds Revenues include all revenues for funds which may only be partially subject to statutory or legislative appropriation. The expenditures shown in the "Other Funds Budget Summary" are for the appropriated portion of these funds only and may represent only a small portion of the funds' total expenditures. There are several funds where a General Fund appropriation is deposited into an "Other Appropriated Fund" and these deposits are reflected in the figures above.

Other Appropriated Funds Operating Budgets Summary

	FY 2004 Actual	FY 2005 Approp	FY 2006 Exec Rec	'06 Exec - '05 App.	FY 06 Growth	FY 2007 Exec Rec	'07 Exec - '05 App.	FY 07 Growth
<u>General Government</u>								
Arizona Department of Administration	143,375.8	176,855.9	179,606.1	2,750.2	1.6%	N/A	N/A	N/A
Office of Administrative Hearings	13.9	13.9	13.9	0.0	0.0%	13.9	0.0	0.0%
Attorney General - Department of Law	24,798.9	28,633.5	29,235.8	602.3	2.1%	28,497.9	(135.6)	-0.5%
Department of Commerce	2,926.2	3,481.7	3,656.7	175.0	5.0%	3,656.7	175.0	5.0%
Arizona Exposition & State Fair	10,934.9	15,147.6	15,101.6	(46.0)	-0.3%	15,101.6	(46.0)	-0.3%
Government Information Technology Agency	2,162.3	2,545.9	2,551.2	5.3	0.2%	2,553.8	7.9	0.3%
Arizona Department of Housing	432.2	442.5	446.5	4.0	0.9%	446.5	4.0	0.9%
Judiciary	25,384.7	35,707.9	35,707.9	0.0	0.0%	N/A	N/A	N/A
Arizona State Library, Archives & Public Records	426.1	672.2	672.2	0.0	0.0%	672.2	0.0	0.0%
Arizona State Lottery Commission	60,720.4	49,550.1	49,774.7	224.6	0.5%	49,639.4	89.3	0.2%
Arizona State Retirement System	17,052.1	23,828.4	21,287.9	(2,540.5)	-10.7%	18,197.5	(5,630.9)	-23.6%
Department of Revenue	2,178.2	2,319.2	2,724.5	405.3	17.5%	2,656.1	336.9	14.5%
Department of State - Secretary of State	3,768.0	27,000.0	10,916.4	(16,083.6)	-59.6%	116.3	(26,883.7)	-99.6%
State Boards Office	256.0	287.6	172.1	(115.5)	-40.2%	172.1	(115.5)	-40.2%
State Treasurer	0.0	150.0	0.0	(150.0)	-100.0%	0.0	(150.0)	-100.0%
General Government Total	294,429.7	366,636.4	351,867.5	(14,768.9)	-4.0%	121,724.0	(32,348.6)	-21.0%
<u>Health and Welfare</u>								
Commission for the Deaf and the Hard of Hearing	4,859.3	5,951.6	5,204.5	(747.1)	-12.6%	5,204.5	(747.1)	-12.6%
Department of Economic Security	410,462.5	435,090.2	448,261.7	13,171.5	3.0%	N/A	N/A	N/A
Department of Environmental Quality	53,093.0	66,527.4	69,553.6	3,026.2	4.5%	68,756.1	2,228.7	3.4%
Arizona Health Care Cost Containment System	111,246.3	119,413.6	136,308.3	16,894.7	14.1%	N/A	N/A	N/A
Department of Health Services	60,775.3	62,957.6	65,811.3	2,853.7	4.5%	N/A	N/A	N/A
Arizona Pioneers' Home	1,563.4	2,433.8	5,611.3	3,177.5	130.6%	5,611.3	3,177.5	130.6%
Department of Veterans' Services	11,512.0	12,404.5	12,407.0	2.5	0.0%	12,384.4	(20.1)	-0.2%
Health and Welfare Total	653,511.8	704,778.7	743,157.7	38,379.0	5.4%	91,956.3	4,639.0	5.3%
<u>Inspection and Regulation</u>								
State Board of Accountancy	1,650.6	2,150.5	2,152.2	1.7	0.1%	2,154.6	4.1	0.2%
Acupuncture Board of Examiners	51.8	86.2	99.3	13.1	15.2%	99.3	13.1	15.2%
Arizona Department of Agriculture	2,193.3	3,111.3	2,728.3	(383.0)	-12.3%	2,728.3	(383.0)	-12.3%
State Board of Appraisal	446.5	491.2	590.0	98.8	20.1%	545.3	54.1	11.0%
Board of Barber Examiners	203.4	234.4	234.4	0.0	0.0%	234.4	0.0	0.0%
Board of Behavioral Health Examiners	785.8	840.4	1,363.7	523.3	62.3%	1,258.1	417.7	49.7%
State Board of Chiropractic Examiners	393.0	464.2	464.0	(0.2)	0.0%	465.8	1.6	0.3%
Corporation Commission	18,045.6	18,116.7	17,617.7	(499.0)	-2.8%	17,617.7	(499.0)	-2.8%
Board of Cosmetology	1,415.4	1,570.1	1,479.3	(90.8)	-5.8%	1,486.7	(83.4)	-5.3%
State Board of Dental Examiners	872.0	923.8	1,026.9	103.1	11.2%	946.0	22.2	2.4%
State Board of Dispensing Opticians	93.0	106.7	92.9	(13.8)	-12.9%	N/A	N/A	N/A
State Board of Funeral Directors & Embalmers	269.4	285.3	293.0	7.7	2.7%	293.0	7.7	2.7%
Department of Gaming	7,326.6	11,407.3	11,253.8	(153.5)	-1.3%	11,150.7	(256.6)	-2.2%
Board of Homeopathic Medical Examiners	62.1	77.3	78.4	1.1	1.4%	78.4	1.1	1.4%
Industrial Commission of Arizona	15,157.7	16,949.9	17,170.4	220.5	1.3%	17,162.3	212.4	1.3%
Arizona Medical Board	4,546.3	4,933.6	5,111.5	177.9	3.6%	5,132.6	199.0	4.0%
Naturopathic Physicians Board of Medical Examiners	295.5	414.9	472.4	57.5	13.9%	425.5	10.6	2.6%
State Board of Nursing	3,256.9	2,909.7	3,075.2	165.5	5.7%	3,044.4	134.7	4.6%
Nursing Care Ins. Admin. Examiners	348.0	370.0	370.3	0.3	0.1%	370.3	0.3	0.1%
Board of Occupational Therapy Examiners	181.6	219.3	219.5	0.2	0.1%	219.5	0.2	0.1%
State Board of Optometry	169.1	176.0	176.4	0.4	0.2%	176.9	0.9	0.5%
Arizona Board of Osteopathic Examiners	422.1	496.5	644.9	148.4	29.9%	601.1	104.6	21.1%
Arizona State Board of Pharmacy	1,259.7	1,378.8	1,500.6	121.8	8.8%	1,416.2	37.4	2.7%

	FY 2004 Actual	FY 2005 Approp	FY 2006 Exec Rec	'06 Exec - '05 App.	FY 06 Growth	FY 2007 Exec Rec	'07 Exec - '05 App.	FY 07 Growth
Board of Physical Therapy Examiners	230.1	264.6	264.9	0.3	0.1%	264.9	0.3	0.1%
State Board of Podiatry Examiners	90.6	107.0	110.3	3.3	3.1%	110.3	3.3	3.1%
State Board for Private Postsecondary Education	248.5	263.5	279.7	16.2	6.1%	288.3	24.8	9.4%
State Board of Psychologist Examiners	268.4	326.1	343.5	17.4	5.3%	348.5	22.4	6.9%
Arizona Department of Racing	352.9	448.6	345.0	(103.6)	-23.1%	345.0	(103.6)	-23.1%
Radiation Regulatory Agency	206.8	247.7	248.0	0.3	0.1%	248.0	0.3	0.1%
Registrar of Contractors	9,527.1	9,547.1	10,490.4	943.3	9.9%	9,663.6	116.5	1.2%
Residential Utility Consumer Office	1,012.9	1,168.2	1,171.2	3.0	0.3%	1,173.6	5.4	0.5%
Board of Respiratory Care Examiners	170.4	203.5	203.8	0.3	0.1%	203.8	0.3	0.1%
Structural Pest Control Commission	1,874.0	1,931.1	1,935.6	4.5	0.2%	1,935.6	4.5	0.2%
State Board of Technical Registration	1,276.1	1,370.0	1,383.6	13.6	1.0%	1,389.4	19.4	1.4%
State Veterinary Medical Examining Board	366.2	400.9	401.6	0.7	0.2%	401.6	0.7	0.2%
Department of Weights and Measures	1,154.0	1,280.1	1,351.9	71.8	5.6%	1,351.9	71.8	5.6%
Inspection & Regulation Total	76,223.3	85,272.5	86,744.5	1,472.0	1.7%	85,331.7	165.9	0.2%
<u>Education</u>								
Arizona State University - East Campus	10,298.2	12,352.8	12,352.8	0.0	0.0%	N/A	N/A	N/A
Arizona State University - Main Campus	140,000.3	167,563.1	167,563.1	0.0	0.0%	N/A	N/A	N/A
Arizona State University - West Campus	13,358.6	17,458.8	17,458.8	0.0	0.0%	N/A	N/A	N/A
Arizona State Schools for the Deaf and the Blind	12,900.2	15,240.7	14,475.2	(765.5)	-5.0%	14,879.3	(361.4)	-2.4%
Department of Education	70,962.3	58,399.4	54,118.7	(4,280.7)	-7.3%	N/A	N/A	N/A
Arizona Historical Society	0.0	193.7	659.0	465.3	240.2%	661.1	467.4	241.3%
Board of Medical Student Loans	330.6	296.6	336.6	40.0	13.5%	353.4	56.8	19.2%
Northern Arizona University	33,641.1	35,861.4	35,861.4	0.0	0.0%	N/A	N/A	N/A
Commission for Postsecondary Education	2,117.1	2,864.0	2,865.8	1.8	0.1%	2,866.0	2.0	0.1%
University of Arizona - Health Sciences Center	14,053.9	12,160.3	12,160.3	0.0	0.0%	N/A	N/A	N/A
University of Arizona - Main Campus	94,708.7	106,862.6	106,862.6	0.0	0.0%	N/A	N/A	N/A
Education Total	392,371.0	429,253.4	424,714.3	(4,539.1)	-1.1%	18,759.8	164.8	0.9%
<u>Protection and Safety</u>								
Automobile Theft Authority	4,016.5	4,550.1	4,828.5	278.4	6.1%	4,821.8	271.7	6.0%
Department of Corrections	39,374.0	42,354.6	46,736.4	4,381.8	10.3%	N/A	N/A	N/A
Arizona Criminal Justice Commission	5,760.3	5,834.1	6,131.8	297.7	5.1%	6,106.8	272.7	4.7%
Arizona Drug and Gang Prevention Resource Center	461.0	1,504.6	554.6	(950.0)	-63.1%	554.6	(950.0)	-63.1%
Department of Emergency Services and Military Affairs	132.7	132.7	132.7	0.0	0.0%	132.7	0.0	0.0%
Department of Juvenile Corrections	3,835.5	3,681.9	6,538.8	2,856.9	77.6%	N/A	N/A	N/A
Department of Public Safety	114,861.8	131,493.9	137,524.1	6,030.2	4.6%	141,333.3	9,839.4	7.5%
Protection and Safety Total	168,441.8	189,551.9	202,446.9	12,895.0	6.8%	152,949.2	9,433.8	6.6%
<u>Transportation</u>								
Department of Transportation	363,938.0	389,769.9	394,450.0	4,680.1	1.2%	N/A	N/A	N/A
Transportation Total	363,938.0	389,769.9	394,450.0	4,680.1	1.2%	0.0	0.0	0.0%
<u>Natural Resources</u>								
Arizona Game & Fish Department	22,260.4	26,326.0	26,100.8	(225.2)	-0.9%	26,322.9	(3.1)	0.0%
State Land Department	488.5	1,520.0	250.0	(1,270.0)	-83.6%	250.0	(1,270.0)	-83.6%
State Parks Board	11,240.0	11,907.5	11,913.5	6.0	0.1%	11,913.5	6.0	0.1%
Natural Resources Total	33,988.9	39,753.5	38,264.3	(1,489.2)	-3.7%	38,486.4	(1,267.1)	-3.2%
Other Appropriated Funds Operating Total	1,982,904.4	2,205,016.3	2,241,645.2	36,628.9	1.7%	509,207.4	(19,212.2)	-3.6%

FY 2006 Executive Recommendation: Expenditure Growth Breakdown

<i>Agency</i>	<i>FY 2005 Appropriation</i>	<i>Standard Adjustments</i>	<i>FY 2005 Appropriation Net of Standard Adjustments</i>	<i>Population, Enrollment, or Caseload Requirements</i>	<i>Statutory, Court, Other Mandated Obligations</i>	<i>Good Business</i>	<i>Employee Retirement Adjustment</i>	<i>Executive Initiatives</i>	<i>FY 2006 Executive Recommendation</i>
Dept. of Education	3,184,039,500	(18,307,200)	3,165,732,300	125,026,100	472,400	334,400	-	23,900,000	3,315,465,200
AHCCCS	860,921,300	(113,123,200)	747,798,100	242,353,900	-	-	-	3,969,800	994,121,800
Dept. of Corrections	629,113,900	(11,795,600)	617,318,300	54,108,700	-	-	-	20,091,300	691,518,300
Dept. of Economic Security	606,123,800	38,768,200	644,892,000	24,323,200	-	259,500	-	26,657,100	696,131,800
Dept. of Health Services	367,491,900	47,348,900	414,840,800	65,403,800	-	444,800	-	1,321,500	482,010,900
Arizona State Univ.-Main Campus	282,510,500	(298,700)	282,211,800	10,767,000	-	-	-	1,500,000	294,478,800
Univ. of Arizona-Main Campus	278,843,000	1,116,100	279,959,100	1,133,000	-	-	-	6,500,000	287,592,100
School Facilities Board	218,616,100	(170,007,000)	48,609,100	-	27,745,400	-	-	-	76,354,500
Community Colleges	143,940,000	(325,000)	143,615,000	8,710,700	-	-	-	-	152,325,700
Northern Arizona Univ.	117,440,500	976,600	118,417,100	618,000	3,000,000	-	-	500,000	122,535,100
Dept. of Juvenile Corrections	69,092,000	(5,218,700)	63,873,300	(3,021,300)	6,674,800	-	-	976,000	68,502,800
Dept. of Revenue	62,846,500	837,000	63,683,500	-	-	140,300	-	(11,398,300)	52,425,500
Dept. of Administration	24,134,800	(33,800)	24,101,000	-	-	268,100	-	555,500	24,924,600
Attorney General - Dept. of Law	23,448,500	(32,000)	23,416,500	-	-	540,700	-	1,346,400	25,303,600
State Land Department	17,600,100	(78,200)	17,521,900	-	-	-	-	7,740,900	25,262,800
Dept. of Water Resources	14,198,900	154,700	14,353,600	-	-	-	-	3,965,300	18,318,900
Board of Regents	7,611,000	14,100	7,625,100	-	-	615,900	-	2,251,200	10,492,200
Arts	3,818,200	19,900	3,838,100	-	-	-	-	500,000	4,338,100
All Other Agencies	471,226,300	20,285,400	491,511,700	0	1,876,800	1,997,000	-	(0)	495,385,500
All Agency Impact	-	18,045,600	18,045,600	-	-	-	24,155,900	-	42,201,500
	7,383,016,800	(191,652,900)	7,191,363,900	529,423,100	39,769,400	4,600,700	24,155,900	90,376,700	7,879,689,700
Percent of growth over base				7.4%	0.6%	0.1%	0.3%	1.3%	9.6%



The Budget Message

Economic Rebound: Slow but Steady

Despite the negative influence of the national economy, Arizona continues to outperform all but a handful of states on job and aggregate income growth

THE NATIONAL AND local economies should continue to improve in Fiscal Years 2005 and 2006. On most fronts, Arizona has clearly outperformed the nation as a whole; however, we continue to fall short of expectations, in part because relatively weak national and international economic behavior is acting as a drag on the state's economy.

NATIONAL OUTLOOK

While the economic growth rate has slowed throughout 2004, each of the first three quarters was above the long-term trend for the economy, and the fourth quarter will be either at or above trend as well. Annual real GDP growth for 2004 should be above 4%, which is quite good. The outlook for 2005 is for a more modest, yet respectable, 3.5% growth.

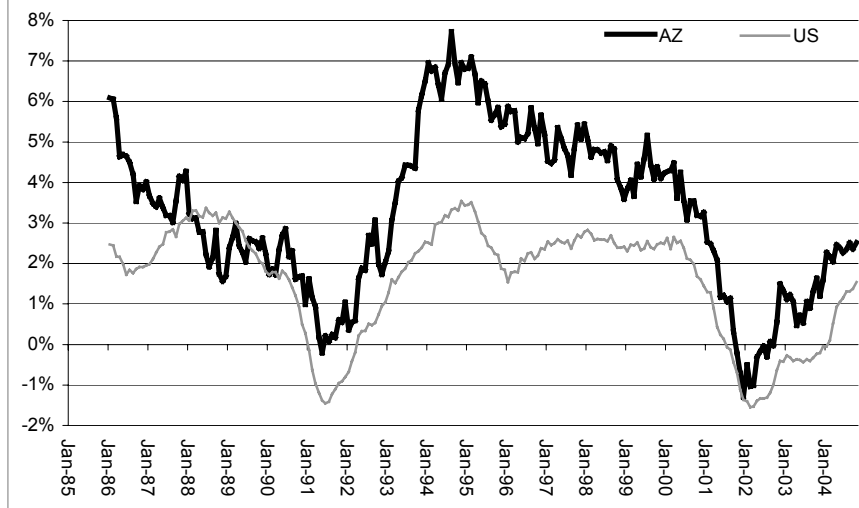
Employment. Employment is finally posting over-the-year gains, but the growth rate, while positive, is still lackluster. The disappointing rate of job growth can be attributed to a number of factors, including:

- increased efficiency and worker productivity, meaning that employers do not have to hire new workers at nearly the rate as in past cycles;
- high employee benefit costs; and
- lingering uncertainty about the economy.

Another consideration is the trend toward more service-oriented jobs, which continues to fuel debate over the quality of job creation, both nationally and locally.

Consumer spending. Consumers continue to spend but at a somewhat

Employment Growth: Arizona and the U.S., 1985-2004



lower rate than last year. Higher interest rates will be a further drag on consumer spending because consumer debt levels, while starting to decline, remain high, and growth in household income is relatively modest.

Interest rates. Short-term interest rates are clearly on the way up as the Federal Reserve raises the Federal funds rate¹ will likely climb to between 3% and 4% before the Fed considers monetary policy to be neutral. While that strategy may seem counter-intuitive to some, raising short-term rates should keep long-term rates from rising very far. Long-term interest rates are very sensitive to the market's inflationary expectations, and the recent

Fed moves to raise short-term rates are reassuring markets that the Fed is serious about keeping inflation at bay. Consequently, no substantial increases in rates at the long end of the term structure have occurred. Nonetheless, mortgage rates could rise to between 7% and 8%, which will have a modest impact on demand by individuals but perhaps a significant impact on investor demand for houses.

Business spending. If economic growth is to continue at a rate above 3%, business spending will have to increase. While the overall mood of firms remains cautious, and no unusual catalyst is in place to fuel excessive growth, companies seem to be loosening their purse strings somewhat. Much of the increase in business spending so far has been for computers and software to replace aging Y2K-era equipment and systems, and that trend will continue (see chart next page). Spending on plant or new facilities will lag at least until

¹ The *federal funds rate* is the interest rate that banks with excess reserves at a Federal Reserve district bank charge other banks that need overnight loans. It often points to the direction of U.S. interest rates. It is the most sensitive indicator of the direction of interest rates, since it is set daily by the market, unlike the prime rate and the discount rate

capacity utilization returns to normal levels.

The dollar. Many economists are welcoming the slow decline in dollar value, but it is difficult to predict its impact on business spending. The good news: U.S. exports are becoming cheaper, which should lead to increased demand for our goods and services. However, America's economy has been the strongest of the major western economies over the last several years, and the drop in our import spending could weaken our trading partners enough to blunt their demand for our exports. The one area where the impact of the falling dollar can already be seen is a surge in the number of foreign tourists visiting the U.S.

Risks. One of the biggest barriers to increased business spending during most of the recovery has been uncertainty about terrorism. Another large-scale terrorist attack in the U.S. or elsewhere could cause companies to reconsider any stepped-up spending plans.

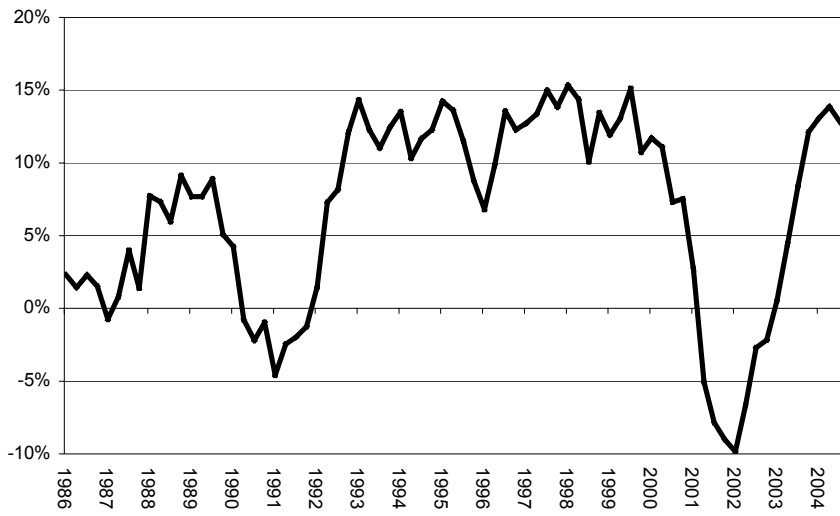
Tourism and travel in general would also be severely impacted and might not recover as quickly as in the aftermath of the September 11, 2001, attacks.

ARIZONA OUTLOOK

Healthier economic performance for the nation as a whole will further stimulate Arizona's economy, much of which is tied to national and international factors. The consensus economic forecast for the state is generally optimistic, as reflected in the predictions for growth in employment, personal income, and population.

Employment growth has continued to improve but not at the pace anticipated in early 2004. While it should return to normal in 2005, some weak areas – such as manufacturing and telecommunications – will continue to struggle. Those two industries lost jobs in 2004, and the prospects for 2005 are for modest improvement as the year progresses.

Business Investment in Computer Equipment and Software, 1986-2004



Many of the state's export industries – i.e., industries that cause dollars to flow into the state – are tied to business spending, and Arizona will benefit greatly as business spending at the national level continues to improve. One of the state's top export industries, tourism, will also receive a boost from the influx of foreign visitors taking advantage of the weak dollar.

Personal income growth is expected to benefit from the improving employment picture, because of more people working and because of wage increases for current employees. Personal income growth will be critical to maintaining consumer spending and, by extension, sales and income tax revenues.

Population growth, primarily a result of demographic and economic factors, has been somewhat stronger than in past cycles, suggesting that the recent recession was relatively mild. Arizona enjoyed a significant level of population inflows and experienced below-normal population outflow, as the state avoided the usual exodus of construction workers. However, if Arizona is to maintain its current rate of population growth, it will have to strengthen its employment growth.

Residential real estate. While single-family housing in 2004 is poised to set another building permit record (*see*

chart next page), the picture for 2005 is clouded by falling affordability and the uncertain role of investors in the market.

Affordability boils down to the monthly mortgage payment and how much of it homeowners can afford. Affordability has been improved greatly over the last several years because of low interest rates. While rates are expected to rise only modestly in 2005, they will impact affordability.

The rapid rise in home values is another factor in affordability. Investors seem to be the driving force behind much of the appreciation and have been propping up the permit numbers as well.

As for the multi-family market, it has been hurt by the strength of the single-family market, and that seems unlikely to change in 2005 even if the single-family market cools as expected.

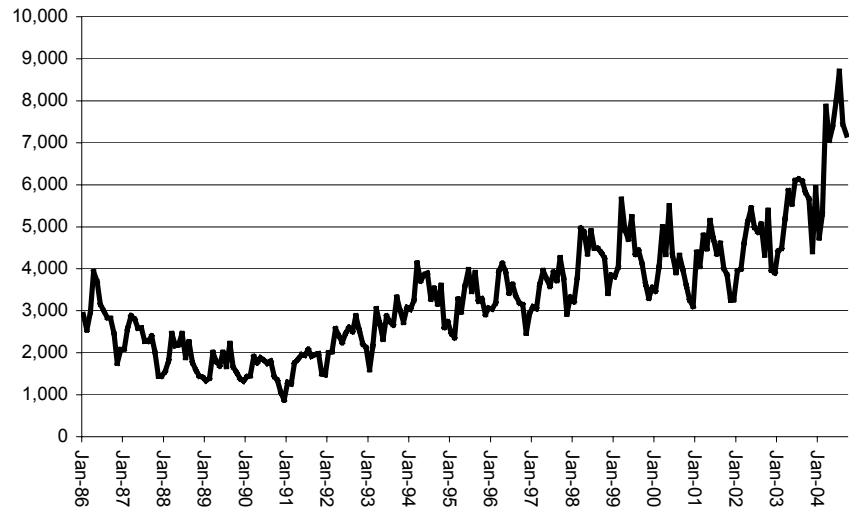
Commercial and industrial real estate. The commercial and industrial markets actually declined as a result of the recent recession and finally seem poised to take off. The acceleration in these markets should help blunt the impact of the expected slowdown in the single-family market.

Risks. The biggest risk for the Arizona economy is that the U.S. economy will not grow as rapidly as expected.

Another risk stems from Arizona's vulnerability to the same risks as the nation at large with respect to foreign trade and export demand. Fortunately, a relatively high share of Arizona exports head to Asia, and that region has enjoyed solid economic performance. (How the disastrous December 2004 earthquake and tsunami may affect Southeast Asia's economic picture and its demand for foreign goods is not reflected in this economic forecast.) Further, many of our Asian exports are assembled into products that are then imported into the U.S, where consumer demand is generally higher than in most countries.

Arizona could also be sensitive to the rise in interest rates that is expected in 2004 and 2005. As was discussed earlier, higher rates will undoubtedly have some negative impact on the sin-

Arizona Single-Family Construction Permits, 1986-2004



gle-family housing market, and that in turn will affect the construction industry. To achieve sustained growth, the Arizona economy must look to non-

construction industries as the explosive real estate sector calms to more moderate levels. ●

GUIDELINES FOR EVALUATING TAX REDUCTIONS

THE LEGISLATURE SHOULD NOT ENACT new tax exemptions, deductions, subtractions, credits, rate changes or any other form of reduction in tax liabilities without fully and formally considering the impact of the proposed actions on critical State services and the well being of Arizona citizens. Legislation requiring a comprehensive analysis using specific criteria to evaluate tax reductions in whatever form should be enacted. The criteria should include at least the following:

- The benefit from the tax change should be quantitatively established as exceeding the value of any lost revenue.
- A limited-period tax rebate should be offered where appropriate, in lieu of a permanent reduction in revenues, particularly if the benefit cannot be proven to exceed the value or cost of the tax reduction.
- Any tax reduction should be broadly based rather than targeted at individual taxpayers, so that like taxpayers are treated equally. The proposal should have an analysis as to which individuals, businesses or industries benefit, and it should also identify the intended specific benefits prior to passage.
- Any tax reduction should not be regressive, i.e., it should not impose a disproportionately greater tax burden on low-income persons or small businesses. An analysis should be provided of how the tax cut directly or indirectly affects these taxpayers by a shift in the tax burden, reduction in services or programs, or other impacts.
- If the benefits of any tax reduction cannot be proven to exceed the reduction in revenues, an analysis should be conducted to identify specific services or programs that are reduced or eliminated, or identify where offsetting revenues will be received.
- Tax reductions should be implemented completely and not phased in.
- Any tax reductions should be automatically sunsetted to ensure a thorough reassessment of whether the benefits promised were actually received and whether the tax reduction is still appropriate.
- When appropriate, certification or verification of eligibility should be required for the tax reduction or exemption benefit, with tax administrators and certifying entities having the right to fully exchange information.
- The enactment should note the costs, if any, of implementation.
- A tax reduction should be specific, clear and narrowly defined to ensure that all parties understand the intended parameters.
- Tax reductions should not be retroactive.
- A recapture provision should be included so that if the nature or use of the equipment or property for which the benefit was allowed is converted or changed to a non-qualifying use within the useful life of the asset, the benefit is prorated and recaptured.
- When appropriate, if an income tax reduction is allowed based on special treatment of certain property, then any associated expenses should be disallowed to prevent doubling the tax benefits.
- Any tax credit should be non-refundable, except where it is necessary to provide property tax or sales tax relief through the income taxation for low-income persons.
- A credit should be limited to some percentage of the tax liability.
- Public release of the names of credit recipients and the value of the credit should be provided, except in instances where it would reveal the amount of tax liability.
- The total cost of any tax credit not subject to certification should not be restricted to limited numbers of claimants, nor should it force allocation among multiple claimants.
- Carry-forwards of unused tax credits should be limited to no more than five years, to reduce the administrative burden and complexity of claiming and monitoring the credit.

Better Performance through Efficiency Review

The Efficiency Review process promotes good government by targeting sensible ways to cut costs and achieve more responsive service

THE INITIAL PHASE of the Efficiency Review process was completed in 2003 for the FY 2004 and 2005 budgets. Identifying areas of savings, eliminating bureaucratic redundancy, and improving customer services through operational efficiencies are integral components of an overall review of agency spending. The initial process was a two-pronged approach that identified both agency-specific savings and Statewide strategic initiatives to reduce costs.

The second phase of the Efficiency Review process was initiated in 2004, featuring:

- a continuation of agency spending reviews and operational efficiencies for FY 2006 and future years;
- implementing Statewide initiatives; and
- establishing agency accountability through monthly Efficiency Review Steering Committee meetings and budget integration.

These three processes form a base for ongoing improvements to management and operations that promote smarter, better government.

AGENCY-SPECIFIC SAVINGS

Agency-specific savings were approximately \$78.2 million for FY 2005 and are projected to be \$118 million for FY 2006. The two following tables, *FY 2006 Efficiency Review Initiatives* and *Efficiency Review Initiatives – Five-Year Summary*, identify savings for both fiscal years.

Agencies reduced and avoided costs through a variety of measures,

including measures that were identified in the Governor's Executive Order 2003-14, such as:

- reducing unnecessary travel costs,
- reducing the number of agency fleet vehicles,
- increased use of electronic communications,
- making more effective and conservative use of outside consultants, and
- consolidating training for State employees.

Some agencies identified other cost reductions through review of their operational processes.

Electronic communications. A number of agencies improved customer service and reduced expenditures through improved use of electronic communications and the Internet. For example, the Office of Tourism will save between \$400,000 and \$500,000 a year by directing people who seek information on Arizona to Tourism's improved website. Savings result from decreased mailing and printing costs as well as a reduction in call center staffing.

Prudent purchasing. Agencies identified new ways to reduce costs through more prudent purchasing. For example, AHCCCS has phased in a fee schedule for outpatient facility services. Establishing this fee schedule will save the State over \$60 million in total funds expenditures in FY 2006. AHCCCS will also purchase blood factor products for hemophiliacs more efficiently, which will save over \$1 million dollars in FY 2006.

Professional and outside services. The Department of Economic Security (DES) has reduced its current use of consultants by requiring that all new contracts and contract amendments be reviewed by the Chief Procurement Officer. DES has also directed that all new contracts and contract amendments include a transfer of knowledge requirement so that DES may become less dependent on consultants. DES savings in FY 2006 are projected to total \$2.7 million.

STATEWIDE STRATEGIC INITIATIVES

The Department of Administration began implementation of several Statewide strategic initiatives in 2005 that are hallmarks of good government practices. All of the initiatives that result in the largest savings involve improving the purchasing of goods and services as well as monitoring payments for accuracy and timeliness.

Value in Procurement. The Department of Administration is implementing the Value in Procurement (VIP) program in the purchasing of goods and services for State Government – the first major reform of procurement operations in 20 years. VIP will use a variety of innovations, including aggressive use of market forces and purchasing techniques to get the best prices and maximum value. The first contract, awarded in December 2004 for office supplies, will save the State at least \$10 million over the next five years. When fully implemented within the next year, VIP will save the State over \$45 million annually.

Self-insured health benefits. On October 1, 2004, Arizona moved from a fully insured health benefits program to a self-insured model. The self-insured model for purchasing health care services will save the State \$25 million in FY 2006. Not only will the self-insured model significantly reduce costs, but it will also improve the health status of State employees through disease management programs that target high-risk health conditions such as diabetes and obesity.

Overpayment recoveries. In December 2004 the Department of Administration awarded a contract for a review of agency overpayments on invoices. This program has the potential of bringing in millions of dollars to the State by identifying inadvertent overpayments by State agencies. An overpayment recovery process will be incorporated into VIP when an enterprise procurement system is developed in 2007.

REVENUE MAXIMIZATION

In 2004, the Governor's Office initiated the Revenue Maximization (RevMax) program, the primary purpose of which is to identify federal funding sources to supplement State funding. The Department of Administration awarded six contracts to vendors to identify RevMax opportunities. During the first half of FY 2005, \$16 million in new federal revenues were identified through one-time retroclaims for AHCCCS eligibility, increased Title IV-E funding, and the settlement of a court case that requires the federal government to provide matching funds for dialysis treatments provided to undocumented persons.

There are several FY 2006 and 2007 projects underway that are targeted to bring in additional federal revenues or avoid costs in federal/State programs. They include a review of the Juvenile Justice system's funding streams, a pilot program to reduce AHCCCS eligibility error rates, and a fresh look at disability eligibility for children age five and under. If successful, each of these initiatives has the potential of bringing in several million dollar in federal funding and of avoiding millions in Medicaid spending.

AGENCY ACCOUNTABILITY

Agency accountability is the critical third component of a successful good government program. An Efficiency Review process will not become part and parcel of operational thinking unless accountability is built into the system. In the second year of Efficiency Review, accountability was achieved through two steps: (a) the establishment of an oversight Steering Committee and (b) budget integration.

Efficiency Review Steering Committee. The Governor's Office established an oversight Steering Committee that meets monthly, and agencies are required to report to the Committee on a regular basis regarding the progress of ongoing initiatives. Monthly updates of the meeting are given to the Cabinet in order to share best practices among agency Directors.

Budget integration. OSPB created the Consolidated Efficiency Review Tracking System (CERTS) for State agencies to document their cost savings and to integrate those savings into their budgets. This information is detailed in the Executive Budget for

each agency in order to communicate what the budget request would have been in the absence of those savings.

Redeployment of Efficiency Review savings. Finding more efficient ways of doing business allows agencies to either mitigate future budget requests or redeploy any savings. Redeployment of resources can take the form of:

- upgrading information technology,
- offsetting supplemental budget requests,
- covering the portion of the agency's 2005 health care costs and pension contributions that were not appropriated by the Legislature, and
- increasing the State's General Fund at the close of the fiscal year.

On an annual basis, agencies are required to submit to OSPB a plan for redeploying Efficiency Review savings. Agencies are also required to maintain records that document appropriate budgetary and financial information for the redeployment of funds as well as quantifiable performance measures (targeted and actual) for any of the redeployment options that have been communicated.

These accountability measures will ensure that Efficiency Review will become institutionalized into agencies' operational thinking and become second nature when agencies make decisions that have a fiscal impact. Smarter and more efficient government will grow as a result, and become the standard rather than an exception. ●

FY 2006 Efficiency Review Initiatives

ALL FUNDS

All figures in thousands of dollars

*Efficiency
Initiative
Savings*

STATEWIDE INITIATIVES

Energy Conservation	714.0
Fleet Consolidation	6,381.4
Leasing/Space Utilization.....	1,543.0
Statewide E-Procurement.....	45,000.0
Employee Benefits	25,000.0
<i>Total for Statewide Initiatives</i>	78,638.4

*Agency Request
Prior to Efficiency
Initiatives*

*Agency Request
Post Efficiency
Initiatives*

*Efficiency
Initiative
Savings*

AGENCY INITIATIVES

Arizona Department of Administration.....	749,439.2	749,414.3	24.9
Arizona Department of Agriculture	24,352.2	24,148.9	203.3
Automobile Theft Authority.....	4,582.1	4,550.1	32.0
Board of Behavioral Health Examiners	1,374.3	1,373.3	1.0
Department of Commerce.....	38,013.6	37,963.5	50.1
Department of Corrections.....	910,297.9	900,453.0	9,844.9
Department of Economic Security	3,199,924.3	3,181,640.6	18,283.7
Department of Emergency Services and Military Affairs.....	77,549.1	77,541.1	8.0
Governor's Office for Equal Opportunity	295.0	288.9	6.1
Arizona Game & Fish Department.....	71,569.0	70,387.7	1,181.3
Department of Gaming.....	69,814.0	69,742.2	71.8
Arizona Health Care Cost Containment System	6,946,457.5	6,868,171.8	78,285.7
Department of Health Services	1,620,374.3	1,613,972.1	6,402.2
Arizona Department of Housing.....	92,656.0	92,548.7	107.3
Department of Insurance	26,355.4	26,328.0	27.4
Department of Juvenile Corrections	84,590.8	84,228.7	362.1
State Land Department	35,259.5	35,222.5	37.0
Department of Liquor Licenses and Control.....	3,590.3	3,576.5	13.8
Arizona State Lottery Commission	451,568.1	451,561.1	7.0
Department of Public Safety.....	228,548.6	228,300.2	248.4
Arizona Department of Racing	4,967.2	4,841.1	126.1
Department of Real Estate	3,599.8	3,599.3	0.5
Registrar of Contractors	15,274.5	15,194.2	80.3
Residential Utility Consumer Office.....	1,178.8	1,168.2	10.6
Department of Revenue	68,346.3	67,623.3	723.0
School Facilities Board.....	748,092.0	747,950.6	141.4
Office of Tourism	31,942.3	31,503.2	439.1
Department of Transportation	2,631,156.7	2,629,892.3	1,264.4
Department of Veterans' Services.....	15,150.2	15,143.0	7.2
Department of Water Resources	36,457.0	36,456.5	0.5
Department of Weights and Measures.....	2,874.0	2,808.1	65.9
<i>Total for Agency Initiatives</i>	18,195,650.0	18,077,593.0	118,057.0
<i>Total for FY 2006 - All Initiatives for All Agencies and Statewide</i>			196,695.4

Efficiency Review Initiatives - Five-Year Summary

ALL FUNDS

All figures in thousands of dollars

	<i>2004 Actual</i>	<i>2005 Est.</i>	<i>2006 Est.</i>	<i>2007 Est.</i>	<i>2008 Est.</i>	<i>Total</i>
STATEWIDE INITIATIVES						
Energy Conservation.....	224.2	365.0	714.0	714.0	714.0	2,731.2
Fleet Consolidation.....	0.0	0.0	6,381.4	4,324.6	4,324.6	15,030.6
Leasing/Space Utilization.....	0.0	1,543.0	1,543.0	1,743.0	1,743.0	6,572.0
Statewide E-Procurement.....	0.0	1,200.0	45,000.0	45,000.0	45,000.0	136,200.0
Employee Benefits	0.0	0.0	25,000.0	48,000.0	59,000.0	132,000.0
Total for Statewide Initiatives	224.2	3,108.0	78,638.4	99,781.6	110,781.6	292,533.8
Total for Agency-Specific Initiatives	34,553.8	78,175.5	118,057.0	143,282.3	174,360.6	548,429.2
Total for All Initiatives	34,778.0	81,283.5	196,695.4	243,063.9	285,142.2	840,963.0

Investing in Arizona's Future

State government prepares Arizona's next generation to meet the technological demands of the new economy

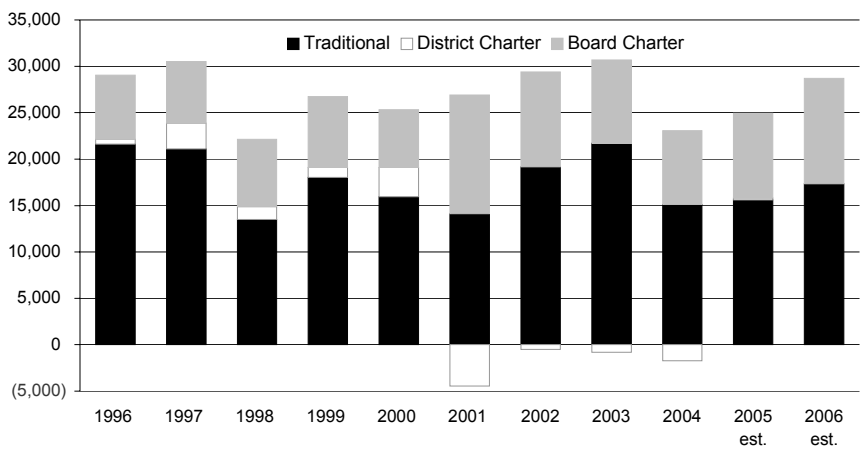
THE 21ST CENTURY has heralded a modern technological society that is driven by knowledge and therefore demands a more educated workforce. Governor Napolitano recognizes that preparing our students requires a possible transition of public education from the traditional K-12 system to a "P-20" system, i.e., preschool through post-graduate higher education. The latter would promote a broadening of the education continuum and allow students to strive beyond a high school diploma to assuming a more productive role in Arizona's economy.

The Governor continues to emphasize individual opportunity and economic development as education goals, in conjunction with an alignment of expectations and necessary resources. Her basic tenets for a successful education system rest in three major goals:

- Every Arizona child must enter first grade in a safe environment, in good health, and ready to succeed academically.
- As children advance through school, they must obtain the skills they will need to succeed in the new economy.
- After they graduate from high school, they must have access to technical and vocational training, to community colleges and to universities.

These goals are advanced through the Governor's ongoing commitment to enhancing P-20 education programs, with emphasis on early education and care, expansion and innovative learning opportunities in elementary and secondary schools, and financial accessibility and opportunity in higher education.

Growth in Average Daily Membership, 1996-2006 (est.)
Traditional, District Charter, and Board Charter Schools



To accomplish these goals, the Governor recognizes that public schools must be given the necessary fiscal resources. In addition to fully funding all of the State's K-12 formula programs, the Governor recommends additional monies for the State Land Department to assist in the land management of State Trust Lands. The most prominent beneficiaries of State Trust lands are Arizona's public schools.

The passage of Proposition 301 in November 2000 assured that public schools would benefit directly from the sale and lease of State Trust Lands. In recent years, the volume of State Trust Land transactions has increased due to a large inventory of land in high-demand areas in and around Phoenix. With additional funding, the State Land Department will be better able to prepare for the sale and lease of these lands, thereby increasing the revenues available to public schools.

VOLUNTARY FULL DAY KINDERGARTEN

Fiscal Year 2005 marked the first year of Governor Napolitano's Voluntary Full Day Kindergarten initiative. In FY 2005, 136 of the State's most needy schools received full funding, and approximately 10,000 of the neediest students were given the opportunity to attend voluntary full day kindergarten with no cost to their parents.

In response to the November 2004 recommendation of the Joint Legislative Study Committee that funding for voluntary full day kindergarten be phased in over five years, the Governor's second year phase-in plan includes continuation of the existing first-year commitment of \$21 million for schools in which 90% or more of the students participate in free and reduced-cost lunch programs. In the second year, approximately 9,880 pupils in 128 public schools with free and reduced lunch participation of 80%-90% or more will be phased in at a cost of

\$20.9 million.² That funding commitment ensures that the most needy and at-risk students will continue to receive the opportunity to attend voluntary full-day kindergarten.

To prepare for the culmination of a five-year phase-in of voluntary full-day kindergarten, the governor recommends full participation of kindergarten students in the STUDENTS FIRST new school construction program.

Additionally, funding will be provided to the Arizona Department of Education to administer the program and to ensure compliance with statutes, professional development, and fiscal management of funds.

BASIC STATE AID

The largest formula funding program for K-12 education, Basic State Aid, provides financial assistance to school districts and charter schools for their maintenance and operations needs.

For FY 2006, the Governor's recommendation of \$119.5 million fully funds student growth in traditional and charter schools. The overall school district student growth is expected to rise by 17,355 – to 888,139 – and combined board- and district-sponsored charters are projected to increase by 11,364, to 96,709. The Governor's recommendation for this program is based on the following growth assumptions for FY 2006:

- 3% total growth in new students (2% growth in traditional students and 13% growth in charter students),
- a 9% increase in net assessed valuation, and
- 2% inflationary growth.

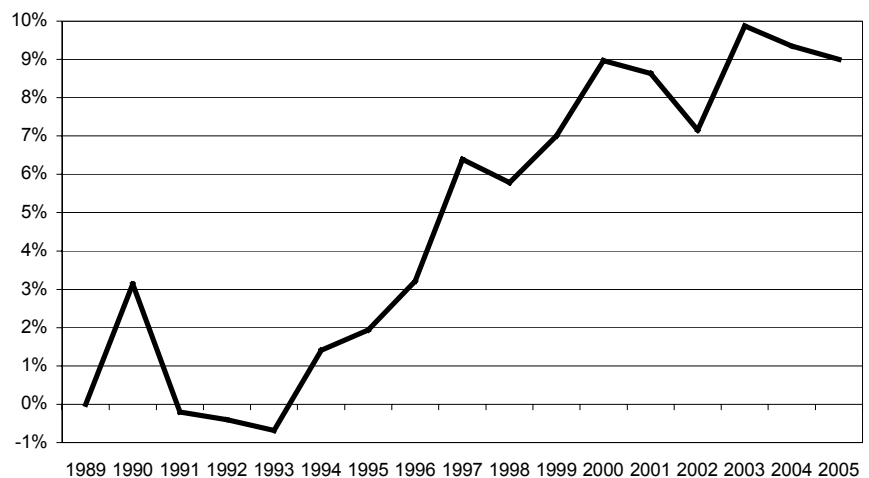
OTHER STATUTORY PROGRAMS

The Additional State Aid program provides a 35% subsidy for residential property owners toward the local obligation of funding public schools. The Executive Recommendation provides

² This estimated total is based on data available as of March 2004.

Historical Growth in Net Assessed Valuation

Tax Years 1989-2005



New Construction as of January 3, 2005

	Number	Students/ Capacity	Square Footage	Cost
Design	53	40,257	3,968,963	439,267,800
Under Construction	23	9,990	1,194,218	126,690,008
Completed	163	112,366	11,241,473	1,142,396,396
Total	239	162,613	16,404,654	\$1,708,354,204
K-6	74	43,051	3,904,748	381,473,513
K-8	92	56,762	5,388,684	528,859,559
Middle Schools	34	21,688	1,952,999	191,948,287
High Schools	39	41,112	5,158,223	606,072,844
Total	239	162,613	16,404,654	\$1,708,354,204

Notes: Only new capacity is listed. Replacement schools count as zero capacity. There are two K-12 schools in the "High Schools" row.

\$18.9 million for Additional State Aid, with an extra \$3.5 million earmarked for special education programs in permanent and residential educational institutions.

AIMS TEST PREPARATION

In FY 2005, the Governor approved \$10 million in grants for one-on-one tutoring for high school juniors who need such assistance to pass the AIMS (Arizona Instrument to Measure Standards) test, which is a prerequisite for graduation starting with the class of 2006.

In FY 2006, the Executive continues this program by making available \$5 million to school districts and charter schools to assist in preparing juniors and seniors who have not met one or more of the AIMS standards.

FUNDING FOR ENGLISH LEARNERS

In response to the Court's ruling in *Flores v. State of Arizona*, the Joint Legislative Committee on School Maintenance and Operations Funding was required to submit a final report by December 1, 2004, outlining a funding recommendation plan for English Language Learners. The final report and the December 1 deadline were contingent on the results of a cost study contract awarded to the National Council of State Legislatures with a completion deadline of August 1, 2004.

While an executive summary of the cost study has been released, a full version is still being developed. Due to this delay, the Joint Legislative Committee was not able to meet the dead-

line of December 1 for its final report to the Governor, the President of the Senate, and the Speaker of the House. The Governor has appealed to the Legislature to complete its work on this issue as quickly as possible so that any legislation or budget priorities can be addressed in the 2005 legislative session.

NEW CONSTRUCTION

For FY 2006, the Executive recommends \$300.7 million for the New Construction program. The \$300.7 million is expected to fund approximately 32 new schools and/or build-outs of existing schools, including 25 elementary or combined elementary and middle schools, as well as seven high schools.

Since repayment of lease-to-own transactions usually begins in the year after which these transactions occur, no FY 2006 General Fund appropriation is required for payments on the FY 2006 \$300.7 million issuance.

For payments on existing obligations for FY 2006, the Executive recommends an additional \$7.7 million to the existing \$43 million appropriation, for a total of \$50.7 million in General Fund for lease payments. Currently, the total FY 2006 lease payment amount is \$72.9 million, but due to the proposed debt refinancing of approximately \$379.9 million of the outstanding \$852.1 million in lease-to-own transactions, debt service in FY 2006 will, under current market conditions, decrease to \$50.7 million. Therefore, the increase in debt service for FY 2006 above FY 2005 levels is \$7.7 million. The long-term impact of this refinancing is revenue neutral.

DEFICIENCIES CORRECTIONS

The STUDENTS FIRST program required the School Facilities Board (SFB) to establish minimum facility guidelines for Arizona school districts and to address any known deficiencies by June 30, 2004. This timeline was extended to June 30, 2005, for 306 de-

ferred projects in three school districts: Mesa Unified, Tucson Unified and Glendale Union.

It is expected that, by the end of the Deficiencies Corrections program, the Board will have:

- identified and corrected 5,547 construction projects,
- completed an additional 1,410 networking projects and 1,235 electrical projects,
- provided \$50.8 million in equipment, and
- funded a five-year Application Service Provider program.

All of this will be completed with less than 6% in construction change orders and within 1.6% of the November 2002 estimate.

In November 2002, the School Facilities Board projected that the total cost of the Deficiencies Corrections program would be \$1.294 billion. At that time, only 26% of the identified projects had reached completion, 34% were in construction/design, and 40% had not yet commenced. Currently, based on 99.3% completion of non-deferred projects and with 55% of deferred projects in construction and 45% in design, the SFB has revised its estimate for the program to \$1.314 billion. Therefore, the Executive recommendation provides an additional \$20 million to conclude the Deficiencies Corrections program.

SCHOOL BUILDING MAINTENANCE AND RENOVATION

For FY 2006, the Executive proposes that the current Building Renewal program, created in 1998 through the STUDENTS FIRST legislation, be eliminated in favor of a new "School Building Maintenance and Renovation" program. The SFB estimates the total cost of the new program to be \$70.7 million in FY 2006. The Executive recommends that these monies be "conditionally appropriated" contingent upon excess FY 2005 revenues.

The new program is intended to refine the various aspects of the existing Building Renewal Program. Those problems include the following: The formula treats all districts the same despite geographical differences; there is no specific tie to actual costs; monies are not distributed on a need-based system; and there is no focus on preventive maintenance.

The proposed \$50.7 million preventive maintenance component will provide districts with new funding to perform the work necessary to lengthen the useful life and efficiencies of school building systems. For the Building Renewal portion, the School Facilities Board has recommended a funding level of \$20 million. School districts will apply for these monies through projects identified in their five-year Building Renewal plans that are currently submitted to the School Facilities Board. The awards will be made on actual project costs.

To distribute these monies in the most efficient and equitable manner, school districts will be required to utilize any existing Building Renewal balances from prior-year distributions before receiving these new funds.

COMMUNITY COLLEGES

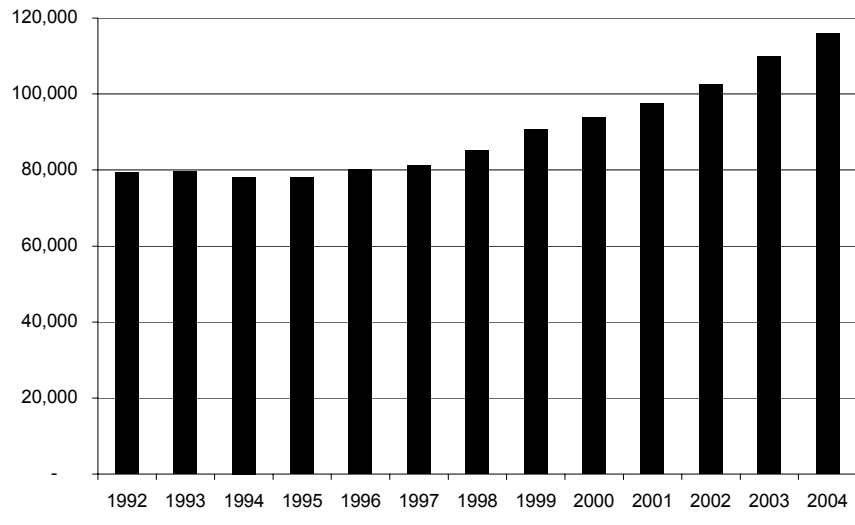
In Arizona, community colleges have become higher education opportunity centers that welcome all students wishing to learn new skills and enhance existing skills, regardless of previous academic experience.

Between FY 2003 and FY 2004, community college student enrollment increased by 5.3% increase (*see chart next page*). The Executive recommends fully funding the growth with an additional \$8.7 million for formula programs, to include:

- \$5.9 million for Operating State Aid,
- \$800 thousand for Capital Outlay, and
- \$2 million for Equalization Aid.

The 5.5% growth rate represents 6,069 new full-time equivalent students

Community College FTSE Growth, 1992-2004



(FTSE) from FY 2003 to FY 2004. The largest FTSE growth occurred in Cochise County (39%), owing to a successful partnership with Fort Huachuca, that county's largest employer. Following Cochise County are:

- Pinal County (8% growth rate and 272 new FTSE),
- Coconino County (7.7% growth rate and 130 FTSE),
- Maricopa County (5.8% growth rate and 3,786 new FTSE), and
- Graham County (5.15% growth rate and 291 new FTSE).

Four districts – Mohave, Navajo, Pima, and Yuma/La Paz – experienced declining enrollment. For Pima, the decreased enrollment was due to a change in which Gila County FTSE, due to its provisional status, is now reported independently of Pima County.

UNIVERSITIES

The state's three universities – Arizona State University (ASU), the University of Arizona (UofA) and Northern Arizona University (NAU) – are essential tools in creating new and high value economic opportunity for Arizona individuals, families and corporations. The Executive Recommendation reflects a commitment to expanding the scope of higher education in Arizona and in opening new doors for educational opportunity and participation.

Medical school. Phoenix is the largest U.S. city without a medical school. To eliminate that distinction, the Executive recommends \$6 million for UofA to provide the foundation for a medical school class in downtown Phoenix in July 2006.

The new medical school involves cooperation among the UofA, ASU, the City of Phoenix, and the medical community. The recommended funding will contribute toward hiring 12 to 15 full-time faculty positions for the Phoenix-based medical school. The recommended funding will also provide resources in the areas of diabetes, neurology, quantitative biology, and molecular medicine. These areas of specialization align with other private medical centers in the Phoenix area that will leverage the new medical school's resources.

The Executive is further recommending \$1 million for the initial startup of the Department of Bioinformatics at ASU to serve as the organizational focal point for medical research data.

Future funding. The Arizona Commission on Medical Education and Research is studying long-term funding for the new medical school. In the interim, the Executive recommends establishing a separate medical school savings account in the Budget Stabili-

zation Fund, consisting of \$20 million of the existing fund balance to be set aside for the future costs of developing the medical school.

Financial aid. Tuition costs at the State's three public universities have risen by 56% in the last three years. To offset these increases, the Governor is doubling – to approximately \$4.6 million – the funds under the Arizona Financial Aid Trust to provide additional student assistance.

In FY 2006, the Executive also makes available \$613,000 for the continuation of student financial assistance through the WICHE³ program.

Additionally, in December 2004 the Governor issued Executive Order 2004-31, which established the Arizona Higher Education Loan Authority, a non-profit entity tasked with generating additional funds for student loans through a new student loan origination and purchase program.

Enrollment growth. Transitional funding for enrollment growth at the three State universities provides one faculty member and support staff for every 22 additional students. In FY 2006, the Governor funds enrollment growth and a 2% inflation adjustment through the "22:1" formula by providing an average of \$103,000 for each additional 22 students. For FY 2006, the funds distribution would be made as follows:

- ASU, with expected growth of 2,431 students at all campuses, for a total of 58,584, will receive \$10.8 million.
- UofA, with expected growth of 242 students at all campuses, for a total of 34,626, will receive \$1.1 million.
- NAU, with expected growth of 132 students, for a total of 18,635, will receive \$618,000.

Faculty retention. In response to a recent study indicating that NAU faculty salaries were in the bottom

³ Western Interstate Commission for Higher Education.

range of salaries paid at similar institutions, the Executive recommends \$3 million to assist in retaining critical faculty members, especially those who attract research grants for the University.

Water research. For FY 2006 the Governor proposes additional funding for, and greater collaboration among, all three State universities in the area of water research.

While each university will have independent research goals, the ultimate objective is to coordinate the efforts of all water experts in the state so that information can be readily available to the public and other researchers. The Executive recommendation includes \$500,000 for each university for the following purposes:

- ASU will concentrate on improving the state's climate and drought models and linking the supply, as determined by climate

and hydrological systems, with the demands of a growing and changing population.

- UofA will focus on water sustainability, quality, policy, and water in high technology manufacturing.
- NAU will study the state's rapid growth and the demand for water supply as it relates to Northern Arizona and the Colorado Plateau.

New facilities. The Governor provides for the operations and care of new buildings at UofA and NAU.

At UofA, \$1.4 million is recommended for five new buildings: the Meinel Optical Learning Center, Roy Drachman Hall, Phase I of the Agriculture Research Center Shell Space, the Poetry Center, and the Architecture Expansion.

New funding is also provided to NAU for four new buildings costing \$800,000: the School of Communications Building, Phase II of the Swing Space, a new College of Business Building, and the College of Engineering Building.

Digital media. The Executive recommends further exploration of a University proposal that would use the technology of digital media to provide a more cost-effective mode of education delivery. While no additional funding has been provided for this issue, the Executive recommends that the State universities study the impact of using digital media as a replacement for current large lecture hall formats, as well as how wider access through electronic delivery would affect future enrollment growth funding. ●

Making the Case for Kids

Caring for and enhancing the health of children are key initiatives for Fiscal Year 2006

EVERY DAY, THOUSANDS of Arizona children awaken to nightmarish living conditions and health and safety threats that many would associate with Third World nations or scenes from a Charles Dickens novel. When the economy declines, vulnerable children are often the first to suffer, and as prosperity returns, they may be the last to benefit, but often after irreparable damage to their bodies, souls and futures has already been inflicted.

As the economic health of our state and nation improves, State Government must continue to take the lead in protecting and enhancing the futures of Arizona's needy children. The Executive Budget Recommendation marshals the ever-scarce but growing resources of three key State agencies – the Department of Economic Security, AHCCCS, and the Department of Health Services – for the benefit of one of the segments of our population whose members are least able to care for themselves.

Childcare. Low-income working parents need to be able to go to their jobs knowing that their young children are in safe hands. Childcare subsidies have proven to be important tools in providing effective child supervision for working parents and freeing those parents from welfare to become regular members of Arizona's workforce.

For FY 2006, the Executive recommends an increase of \$21 million from the General Fund and \$1.6 million from the federal Childcare and Development Fund for this program. Subsidies are available to:

- individuals attempting to achieve independence from the Cash Assistance (CA) program,

- individuals transitioning off of CA,
- families referred by Child Protective Services,
- foster parents, and
- low-income working families.

The total recommendation would provide subsidies for an average of 48,440 children per month and preclude the need for a waiting list in FY 2006.

Child Protective Services. Over the past year, State government has made important strides towards ensuring that Child Protective Services (CPS) has the resources necessary to protect Arizona's vulnerable children. During the 2003 Special Session and the 2004 Regular Session, the Department of Economic Security (DES) received additional funding to enable CPS to investigate 100% of the reports received and to begin easing case managers' overwhelming caseloads.

The Executive recommendation aims to reaffirm this commitment by providing \$5.7 from the General Fund and \$6 million from the Temporary Assistance for Needy Families Block Grant to fund 184.5 new case manager positions, so that caseloads are 5% greater than the national standards established by the Child Welfare League of America.

Children Services. It is critical that DES have the resources to protect the health and safety of children in the CPS system. The Executive's \$10.8 million General Fund recommendation underscores the commitment to providing in-home support to families so that children can be safe within their homes. As a result of this focus, the Executive Budget assumes a 5.4% re-

duction in out-of-home placements in FY 2006. The recommended funding is necessary to provide the in-home services that will reduce the need for out-of-home care and to address existing shortfalls in the program.

KidsCare outreach. There are approximately 177,000 Arizona children who live in households at or below 200% of the federal poverty level and who are not covered by health insurance. The KidsCare Children's Health Care Program (CHIP) is designed to provide coverage for these children.

In FY 2004, CHIP premiums were increased. Since the implementation of the new premium levels, CHIP enrollment has been virtually flat at approximately 49,000 children. For FY 2006 the Executive proposes that \$4 million General Fund be used to:

- return premiums to prior levels,
- initiate a media outreach program to enroll more of Arizona's uninsured children, and
- provide funds to pay for the projected increase in enrollment.

The additional funds represent an investment in Arizona's present and future. Keeping children healthy puts them in a better position to learn and become contributors to Arizona's economic future. And providing health coverage helps parents focus on their jobs and improve their skills so that they can become free of State assistance programs.

Healthy Families. Audits of the nationally recognized Healthy Families program have demonstrated a number of positive outcomes, including a greater likelihood of child immunization, improved safety precautions, and decreased parental stress.

The Executive recommends \$3.3 million from the Temporary Assistance for Needy Families Block Grant to continue the expansion of the program from 48 to 73 sites throughout the state.

Adoption Services. Adoption provides a permanent placement for a child and is less costly to the State than out-of-home placements. Of far greater importance, adoption offers parentless children their best opportunity to enjoy the safety and support of a loving family. The Executive recommendation includes a \$5.6 million General Fund increase to cover unfunded caseload growth in FY 2005, new caseload growth in FY 2006, and rate growth associated with the increase in foster care rates. The program is anticipated to provide maintenance payments to the adoptive parents of an average of 8,221 children each month.

Permanent guardianship. At times, adoption may not be possible for a child in the CPS system. In these instances, DES seeks to place the child in a permanent guardianship that, while not severing the legal rights of the parents, provides a more permanent placement for the child.

The Executive recommends \$1.2 million from the General Fund to cover unfunded caseload growth in FY 2005 and new caseload growth in FY 2006.

Childcare facilities. The Executive proposes a \$521,500 General Fund increase for the Childcare Facility Licensure program. FY 2006 would be the first year of a three-year phase-in to provide a 50-to-1 staffing ratio of childcare facilities to surveyors, which represents a significant improvement to the current 71-to-1 ratio. At the end of the three-year phase-in, the program will have 27.0 additional FTE dedicated to surveying childcare facilities.

Children's Rehabilitative Services. Continuing a tradition that dates to 1927, the "State-only" CRS program, administered by the Department of Health Services (DHS) Office for

Children with Special Health Care Needs, provides specialty rehabilitative services to Arizona children who are afflicted with crippling disorders and who are not eligible for Title XIX (Medicaid) or Title XXI (KidsCare). Services include medical treatment, rehabilitation, and support services and case management. To be eligible for services, the child or youth must be an Arizona resident under 21 years of age and have an identified physical disability, chronic illness, or medical condition that is potentially disabling.

Services are provided through four contracted regional clinics in Phoenix, Tucson, Flagstaff and Yuma. Early referral is encouraged to assure the most successful results. Anyone, including doctors, nurses, teachers, patients or friends, may refer a child to CRS.

The "State-only" program has not received an increase for membership or for medical inflation since FY 2002. The Executive Recommendation would provide \$879,000 General Fund for an overall increase of 7.2% in membership and a 15.6% increase for medical inflation.

The Title XIX Children's Rehabilitative Services (CRS) Program provides services under a monthly capitated rate basis. The Title XIX program requires that capitation rates paid to CRS contractors are actuarially sound and developed in compliance with federal regulations. The \$1.79 million General Fund increase will fund an expected 8.9% medical acuity increase and a 2.5% client growth rate for FY 2006. The Program expects to provide services to 13,919 Title XIX-eligible children in FY 2006.

SERVICES FOR FAMILIES AND ADULTS

The Executive's emphasis on funding to benefit children should by no means be construed as a lessening of commitment to other needy people. State Government must continue to strive for excellence in this area as well, and the Executive Recommendation in-

cludes funding for several programs that provide vital services to Arizona's families and adults.

KidsCare Parents. The KidsCare Parents program provides health insurance to approximately 12,000 parents of children enrolled in the KidsCare program. By providing coverage for this population, Arizona can utilize enhanced federal participation to pay for a selected population within AHCCCS. This provides direct savings for the General Fund.

The KidsCare parents program is legislated to end on June 30, 2005; consequently, the Executive recommendation provides \$8.3 million General Fund to fund the KidsCare Parents program through FY 2006. By continuing this program, the State will qualify to receive enhanced federal funds, saving the State \$6.7 million General Fund. In essence, this allows approximately 12,000 parents to receive health care coverage at a net cost to the State of \$1.7 million General Fund, or \$142 per parent per year.

Developmentally disabled. The Executive recommendation includes \$18.7 million from the General Fund in response to estimated 8% caseload growth in the Title XIX developmentally disabled population and a 3.5% capitation rate increase. These funds will allow the State to provide services to developmentally disabled individuals, consistent with federal law.

Domestic violence. The Executive recommendation includes \$1.5 million from the Temporary Assistance for Needy Families Block Grant to begin addressing the large unmet need for emergency shelter beds for domestic violence victims. In FY 2004 there were over 14,000 unmet requests, 60% of the total, for emergency shelter. The recommendation does not eliminate the unmet need; however, it will fund an additional 75 beds that will shelter 1,100 victims of domestic violence.

Senior citizens. The federal Older Americans Act provides funding to the states to provide a variety of non-

medical home and community-based services to older individuals. Services include case management, adult day care, respite care, home-delivered meals, legal services, transportation, and preventive health services. The Executive recommends \$259,500 from the General Fund to match an additional \$4 million available under the Act. This funding would be sufficient to provide services to 2,788 individuals each month.

Cash benefits. The Executive recommendation includes a \$12 million General Fund reduction to the Temporary Assistance for Needy Families Cash Benefits line item as a result of declining caseloads.

Caseloads peaked in the fall of 2003 and have been declining since. The DES redesign of the Job Opportunity and Basic Skills (JOBS) program is a significant contributing factor to falling caseloads, though improving economic conditions in Arizona have also had an impact. Changes to the program have included:

- reducing the waiting time, from four months to less than one month, before clients receive services;
- ensuring that clients receive targeted training tailored to their needs, and
- more quickly identifying clients that are job-referral ready.

As DES continues implementation of its Service Integration initiative, it should continue to produce positive outcomes in this and other programs.

HEALTH CARE

Demand for health care for low-income individuals continues to grow nationwide, particularly in rapidly growing states such as Arizona.

Like other state governments, Arizona spends more on Medicaid (through the Arizona Health Care Cost Containment System, or AHCCCS) than on any other program except education. Over one million Arizonans – roughly 18% of the state's population –

receive AHCCCS benefits, and as the number of people depending on the State for their health care needs grows, the State must address its competing responsibilities of providing adequate services while containing costs.

During the first half of the current fiscal year, AHCCCS enrollment grew by approximately 8%. That rate is expected to climb to 9.5% by the time FY 2005 comes to a close.

In FY 2006, the AHCCCS growth rate should return to about 3.8%, which more closely resembles Arizona's population growth rate as a whole.

In addition to the projected enrollment increase, a capitation rate increase of 6% is anticipated for FY 2006.⁴

The rapid growth of persons enrolled in AHCCCS has resulted in the Executive's FY 2005 supplemental recommendation of \$52 million dollars General Fund. For FY 2006, the Executive recommends an additional \$215 million General Fund above the 2005 appropriation.

Rural hospital reimbursement. Rural hospitals are a crucial part of Arizona's health care community, but smaller patient populations and a scarcity of physicians, nurses and other medical personnel make providing quality health care in the rural counties more costly than in urban areas. A 2002 survey of in-patient hospital reimbursements revealed that AHCCCS covers 94% of hospitals' costs for serving AHCCCS members. However, hospitals with fewer than 75 beds were reimbursed for only 57% of their costs.

To help close the reimbursement gap, the Executive recommends \$2.5 million General Fund in FY 2006 to provide enhanced reimbursements for 18 rural Arizona hospitals with 100 beds or less.

MENTAL HEALTH

Arizona's public behavioral health system provides behavioral health treatment, rehabilitation, psychiatric, crisis intervention, in-patient, residential and prevention services to individuals of all age groups. In the past year, DHS has served 37,927 children and their families. It is worth noting that:

- Approximately 6% of these children – 2,248 – are younger than age five, and the remainder are school-aged.
- About 62% of the children are male; as the age increases, the male-to-female ratio evens out, so that the overall enrollment for adults and children in the public system is about 50-50.
- The most prevalent diagnosis among children served is attention deficit hyperactivity disorder (ADHS).
- About 12% of the children are in State custody for child welfare and/or juvenile justice purposes.

DHS also provided services to 27,000 adults with a serious mental illness, i.e., emotional or behavioral functioning that is so impaired that it interferes with their capacity to remain in the community without supportive treatment. The mental impairment may result in a limitation of their ability to engage in daily living, interpersonal relationships, homemaking, self-care, employment or recreation.

After three years of steady growth that started in 2000, enrollment of individuals who are eligible for care pursuant to Title XIX (i.e., financial need based on household income) appeared to have reached its peak in September 2003 at 1,192,614 enrollees. The Title XIX caseload declined through May 2004, when it reached 1,151,503 enrollees.

However, in June 2004 the caseload reversed its earlier trend and grew continuously through November 2004, when it peaked at 1,291,219 enrollees.

⁴ The capitation rate is comprised of medical inflation, program changes, and utilization.

In December 2004, the caseload again began to decline.

While such fluctuations make it difficult to forecast the caseload for the remainder of Fiscal Year 2005 and for FY 2006, the Executive expects FY 2006 Title XIX Behavioral Health Services caseloads to grow by 3.8% over estimated FY 2005 levels. The Executive Recommendation reflects estimated increased costs of \$62.5 million to the General Fund and \$8.9 million to the non-appropriated Tobacco Tax and Health Care Fund. The Executive Recommendation also includes a FY 2005 supplemental appropriation of \$23 million from the General Fund and \$700,000 from the non-appropriated Tobacco Tax and Health Care Fund.

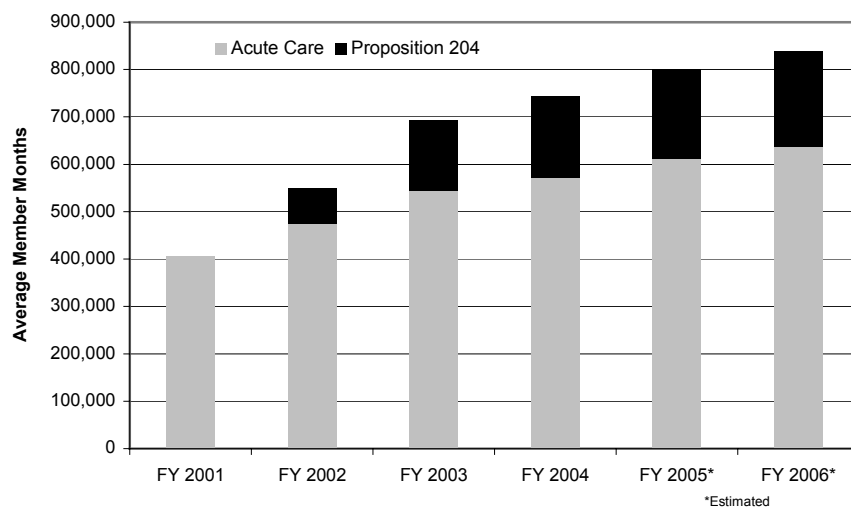
Proposition 204, which provides care for individuals up to 100% of the Federal Poverty Level, continues to be the fastest growing component of the Title XIX Behavioral Health Services caseload. The Proposition 204 caseload is expected to grow at an annualized rate of 15.3% during FY 2005, compared to 9.2% growth for the remaining Title XIX (non-Proposition 204) caseload.

The Executive Recommendation assumes varying rates of capitation rate inflation for FY 2006:

- 10% for Children's Behavioral Health, General Mental Health, and Substance Abuse Services;
- 6% for Behavioral Health services provided for Developmentally Disabled individuals; and
- 20% for Seriously Mentally Ill individuals.

With respect to the third bullet point above, the higher rate adjustment is needed to provide additional resources to the Department of Health Services to comply with a corrective action plan to complete the agreement between the State of Arizona and plaintiffs in the *Arnold v. Sarn* lawsuit. The Executive recommendation brings

Member Months: Acute Care & Proposition 204



the State of Arizona into compliance with the funding level for seriously mentally ill individuals in Maricopa County that was recommended by the Leff Report in *Arnold v. Sarn* and agreed to by the parties and ordered by the Superior Court in that case. More than 17,000 people with serious mental illness will benefit from this historic agreement.

In-patient care. To qualify for Medicare and Medicaid reimbursements, the Arizona State Hospital must be Medicare certified. Two recent Medicare surveys found areas of non-compliance that could jeopardize the facility's ability to maintain its certification. The Executive recommends \$1.28 million in Other Appropriated Funds in FY 2005 and \$3.56 million in FY 2006 to implement and fully fund a corrective action plan to correct deficiencies at the Arizona State Hospital. Nearly 40% of the proposed increase will be used to fill current Registered Nurse vacancies or to fund counter-offers to current nursing staff who receive job offers from private hospitals.

The proposal will also:

- restore seven clinical therapist positions,
- provide four new social workers for ward-level treatment,

- restore maintenance and environmental contracts reduced during recent budget cutbacks, and
- provide additional funding to cover the increased cost of atypical drugs used in the treatment of the facility's patients.

OTHER SERVICES

Family and Public Health Services. The Executive recommendation provides \$203,000 General Fund to fund the continued growth of the Breast and Cervical Cancer Treatment program. This program was created to provide Medicaid coverage to women diagnosed by the Department of Health Services' Well Woman Health Check program as having breast or cervical cancer and to enable them to get treatment.

This program has seen substantial growth since its implementation in 2002, when it provided services to 37 women. The enrollment grew to 573 in FY 2004 and is expected to reach 1,487 women by FY 2006 (a 40% increase over FY 2005 expected enrollment). The Recommendation would add 1.5 additional FTE and provide funding for diagnostic services.

Continued next page

A 2001 enactment requires the Department of Health Services to establish a program for distributing folic acid supplements and counseling on these supplements through local health departments for women of child-bearing age. Current funding for this program has been through a one-time, FY 2001 payment of Tobacco Settlement monies. Tobacco Settlement monies are no longer available because of demands for other healthcare programs placed on that funding source by the Proposition 204 medical services program. The Executive recommendation of \$800,000 from the General Fund will ensure the continued operation of the valuable program.

Health facilities. The Executive Recommendation also proposes an increase in health facility licensure staffing. The proposal would increase staffing for the:

- Office of Assisted Living Licensing (4.0 FTE),
- Office of Medical Facilities (3.0 FTE),
- Office of Behavioral Health Licensing (2.0 FTE),
- Office of Long-term Care (2.0 FTE), and
- the Office of Architectural Review (1.0 FTE).

The additional surveyors will help eliminate backlogs for license renewals, ensure that mandatory surveys are conducted in a timely manner, and reduce refunds to facilities whenever statutory timelines for renewals are not met. In FY 2004, General Fund licensure revenue was reduced by \$114,000 because statutory timelines were not met. ●

PUBLIC SAFETY

Keeping Arizona Citizens Safe and Secure

The Executive Recommendation provides substantial investment in attracting and retaining top law enforcement and corrections professionals

PROTECTING OUR CITIZENS is one of State Government's fundamental responsibilities. The Executive recommends moderate, needed funding increases in a variety of areas to meet the security needs of Arizona citizens and, in isolated cases, to respond to the findings and recommendations of investigative bodies.

PUBLIC SAFETY

As one would expect in a rapidly growing state, from FY 1995 to FY 2004 Arizona experienced a:

- 51% increase in metropolitan highway miles,
- 66% increase in daily vehicle miles traveled,
- 71% increase in the number of collisions on Arizona highways, and a
- 75% increase in registered vehicles.

However, during that same period, the number of Highway Patrol officers grew by only 38%. To help close the gap, the Executive recommends the addition of four Highway Patrol squads over the biennium, two in FY 2006 and two in FY 2007.

Though the need for additional officers is significantly higher, the Department of Public Safety (DPS) reports that hiring new officers has been a challenge, due in part to DPS's non-competitive pay levels. When comparing the salaries of DPS officers with other comparable public safety agencies, DPS ranks 13th out of the 15 Arizona jurisdictions that have 100 or more officers.

As a continuation of the multi-year effort to bring officer pay more in line with market salary levels, the Executive recommends \$3 million in FY 2006 and \$6 million in FY 2007 for sworn officer salary increases. If competing agencies continue to increase pay by an average of 3.5% per year, the recommended funding will bring DPS to within 9.5% of the level of their direct competitors. If officer pay remains unchanged, by FY 2007 DPS will have fallen behind by an average of 16.5%.

Additionally, the Recommendation includes funding for the promotion of the 58 officers hired in FY 2003 under Laws 2001, Chapter 1 to the next step in the DPS three-tiered pay-step system.

Fuel and equipment. The recent spike in gasoline prices caused a significant DPS budget problem. Because its budget is based on a price level of \$1.18 per gallon, and fuel prices have been well above that level for many months, DPS has had to forego major expenditures – \$638,700 in FY 2004 and an estimated \$973,300 in FY 2005 – in its base budget.

The Executive recommends an additional \$1 million from the Highway User Revenue Fund to be placed, along with the base fuel appropriation, in a \$2.7 million Fuel Cost special line item.

The Executive also recommends \$250,000 in FY 2006 and in FY 2007 to add 50 video cameras in each year to the fleet of DPS vehicles patrolling identified “drug corridors.” These cameras will provide valuable evidence in court cases and will increase public trust in the efforts of Highway Patrol officers.

CORRECTIONS

The Executive Recommendation for the Department of Corrections (ADC) focuses on:

- improving pay competitiveness for Correctional Officers and
- providing more effective working conditions for staff at the prisons in general and at the Lewis Prison Complex in particular.

Compensation. Prominent among the recommendations of the Blue Ribbon Panel that investigated the January 2004 inmate escape attempt and hostage taking at the Lewis Complex was increased funding for Correctional Officers compensation. Non-competitive pay results in high turnover, inexperience, and increased risk to the public.

Pay increases of \$1,170 per year are included for all Correctional Officers. In addition, a geographic stipend of an additional \$2,600 per year is proposed for officers at the Lewis Prison. These increases are in addition to all existing geographic stipends and bonuses, which are expected to continue.

Equipment. Also in response to the Blue Ribbon Panel’s findings, the Executive recommends \$4.2 million for improvements in communications and security equipment.

Currently, there are four different types of radios in use, none of which offers panic buttons for officers in trouble. There are also many areas of the prisons where radio transmissions will not work. These problems will be solved by the new radios provided by the Executive recommendation, which also includes funding for:

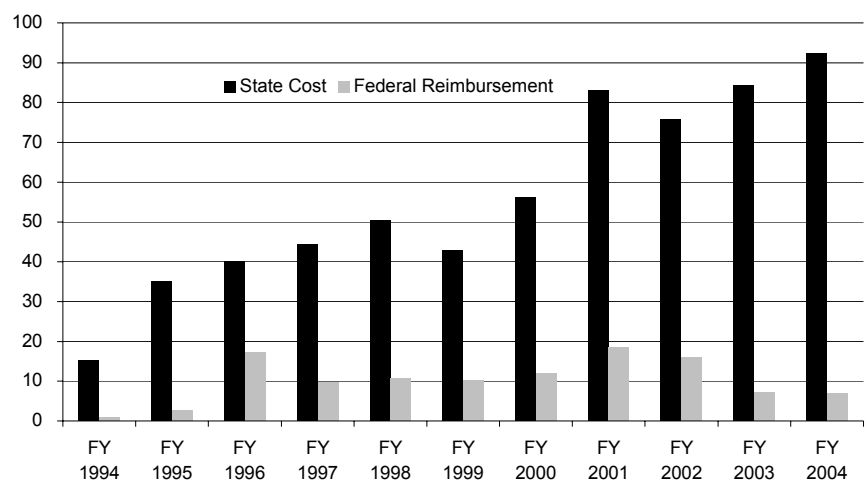
- kitchen cameras at the Lewis Prison as a pilot project to determine if they should be used at all prisons;
- two new contraband squads to reduce the amount of contraband in the prisons; and
- the renovation and expansion of the van pools used by staff at large prisons located away from population centers.

Federal SCAAP Reimbursements

	Eligible Inmates	State Cost (millions)	Federal Reimbursement (millions)	Unpaid Shortage (millions)
FY 1994	950	15.2	1.0	14.2
FY 1995	2,152	35.2	2.7	32.4
FY 1996	2,408	40.2	17.1	23.1
FY 1997	2,521	44.4	9.8	34.6
FY 1998	2,748	50.4	10.7	39.7
FY 1999	2,220	42.8	10.3	32.4
FY 2000	2,709	56.1	12.0	44.1
FY 2001	3,887	83.0	18.5	64.6
FY 2002	3,885	75.8	15.9	59.9
FY 2003	4,321	84.3	7.2	77.1
FY 2004	4,743	92.5	6.8	85.7
Totals		619.9	112.0	507.8

Federal SCAAP Reimbursements

In millions of dollars



Beds. All of the beds originally authorized during FY 2004 and FY 2005 will be open by the end of FY 2006. The Executive Recommendation provides funding for these additional beds.

The cost of the growing number of prison beds could be mitigated if the federal government would follow its own law requiring that it reimburse the states for the cost of incarceration of criminal illegal aliens. However, the aggregate amount reimbursed to the State by the Federal State Criminal Alien Assistance Program (SCAAP) since the program started in 1994 is \$112 million, \$508 million short of the \$620 million that should have been reimbursed (*see table and chart, right*).

Fire crews. As is discussed further in the *Natural Resources* section of the Budget Message, the number of 20-man inmate fire crews would be increased by three in the Executive Budget. The inmate fire crews are cooperative ventures between ADC and the Land Department.

Continued next page

JUVENILE CORRECTIONS

Addressing the findings of the U.S. Justice Department investigation into Civil Rights of Institutionalized Person Act violations by the Department of Juvenile Corrections (DJC) continues in the second year of the two-year plan.

The Executive proposes the expenditure of \$6.7 million in FY 2006 in an attempt to conclude the matter. Funding will:

- complete suicide prevention renovations,
- increase the line staffing at housing units,
- provide continuous nursing coverage at all secure-care schools,
- increase staff training, and
- increase special education and behavioral health staffing.

To improve pay competitiveness at DJC, a \$1,000 pay increase is recommended for each Youth Correctional Officer, at an approximate cost of \$976,000.

It should be noted that DJC is in its sixth year of declining population, which is expected to save the State about \$3.6 million in FY 2006.

EMERGENCY AND MILITARY AFFAIRS

In an effort to maintain readiness by recruiting and retaining trained National Guardsmen, the Executive is recommending a 50%, \$300,000 increase for tuition assistance. Currently, only about half of qualified Guardsmen are receiving tuition reimbursement.

The Executive also recommends \$362,700 for the State share of maintenance of National Guard facilities. The State share appropriation has remained unchanged for ten years, failing to keep pace with the increased number of Guard Units and Guardsmen. ●

NATURAL RESOURCES

Managing Our Land, Water and Environment

Staying ahead of the state's enduring drought dominates the Executive's natural resources plan

AN APPROPRIATE BALANCE must be maintained between achieving growth-driven economic prosperity and preserving Arizona's natural beauty, and the Governor has made preserving and protecting water resources a top priority since taking office. The Governor's leadership on, and commitment to, such issues as drought management and water conservation are clearly demonstrated in the budget recommendations for the Department of Water Resources (ADWR), the Land Department, and the Department of Environmental Quality (ADEQ).

WATER

Challenges to providing a sustainable water supply are numerous, diverse and complex. Competition for water throughout the Southwest continues to increase as Arizona and its neighboring states experience rapid growth. It is essential that the State continues to play a prominent role in Colorado River negotiations and remain vigilant to protect its water rights.

Drought Task Force. On March 20, 2003, Governor Napolitano signed Executive Order 2003-12 to establish the Arizona Drought Task Force. Its mission: to develop the State's first plan to deal with drought management and water conservation.

The Task Force was directed to develop a sustainable drought planning process for Arizona, to include:

- reliable monitoring of drought and water supply conditions in the state and an assessment of the drought's impact;
- an assessment of the vulnerability of key sectors, regions and population groups in the state and potential actions to mitigate those impacts; and
- assisting stakeholders in preparing for and responding to drought impacts, including development of a statewide water conservation strategy and public awareness program.

The Governor also instructed ADWR to provide statewide leadership in this effort, with an emphasis on assisting rural communities regarding their potable water supply needs.

Recommendations. The Task Force's recommendations, presented to the Governor in October 2004, provided the critical first measures toward long-term management of Arizona's water for drought preparation and water conservation. For FY 2006, the Executive Budget endorses key recommendations and provides funding to:

- \$1.5 million and 17.0 FTE positions to establish an agency to focus on statewide conservation, drought mitigation and rural studies.
- \$1.7 million to restore funding for ADWR to carry out its mission and protect Arizona water.

- \$877,600 to provide technical and engineering support in the hydrology and water management programs; and
- a \$700,000 increase for rural water studies, including data collection and analysis of surface and groundwater systems in rural areas.

The Executive also supports creating a fee-based revenue stream of about \$1.7 million over the biennium for the Assured and Adequate Water Supply Program and the Recharge and Recovery Program. This budgetary mechanism is designed to provide a more stable source of funding support and reduce reliance on General Fund appropriations.

Revitalizing the funding for ADWR is crucial to the success of this vision. Despite its important mission, the Department has faced significant funding challenges that have threatened and limited water management and its other core functions. While during the last decade the state's population has risen by 45% and statutory mandates have continued to increase, the Department's staffing level has declined by 30%, to its lowest level since it was created. With essential funding restored, ADWR will be better able to carry out the Governor's mandate to help rural water providers and local governments modernize their water-usage plans, establish basin-by-basin solutions, and identify resources to stretch existing water supplies and formulate innovative solutions.

The initiative for protecting and preserving water will yield building blocks for statewide strategies to encourage Arizona communities to adopt long-term plans to ensure that the water needs of families and businesses are met.

STATE LAND

Over the last several years, the volume of Land Trust leases and sales has grown rapidly, due largely to the location of large and prime Trust Land parcels in the Phoenix and Tucson areas. The Land Department is becoming an active land manager and seller, selecting prime parcels and preparing them for sale or lease to an assortment of competitive buyers.

Staff increase. The Department has a small staff of planners, scientists and managers to oversee the planning, engineering and disposition of lands for sale or lease. At that staffing level, the Department cannot keep up with demand; consequently, if the land is not sold or leased in a timely manner, its value to the Trust is severely diminished. The Executive recommends adding 17.0 FTE positions to maintain the value of the Trust and increase its contributions to schools in Arizona. Without this additional funding, the estimated loss in land sales over the next three years will be \$240 million.

Dam maintenance. There are 20 large dams and over 4,000 small dams on State Trust Land. The Executive Recommendation funds, for the first time, the monitoring and

oversight of those dams. While the dam owners are responsible for operation and maintenance, the dams should be monitored as tenants on State Land. Further, some of the private dams have been abandoned. As part of the recommendation, the Executive proposes approximately \$800,000 for maintenance of abandoned dams on State Trust Land.

Fire fighting. Because of the increasing danger of wildland fires, the Executive recommends five positions and \$302,700 to coordinate the fighting of wild fires. In addition, three more inmate fire crews are proposed, bringing the total number of crews to 15, consisting of 300 inmates.

ENVIRONMENTAL QUALITY

A key component of the Governor's water management initiative is the role of the Arizona Department of Environmental Quality (ADEQ), whose mission is to protect and enhance public health and the environment by ensuring safe drinking water and reducing the impact of pollutants discharged to surface and groundwater.

Water quality. For FY 2006, the Executive Budget provides \$1.3 million and 15 positions for the Water Quality Program. These resources will allow ADEQ to:

- help ensure that Arizona's public water systems deliver safe drinking water;
- monitor and assess the quality of surface water and groundwater; and
- identify water pollution problems and establish solutions for them.

E-Government. Preserving Arizona's natural resources and protecting the environment depends in part on good customer relations. The Executive Recommendation for ADEQ includes funding to strengthen the Department's efforts to improve customer service through automation and reduction in paper-based compliance requirements. Specifically, the Recommendation provides \$2.3 million in non-General Fund monies to enhance technology utilization and create efficiencies to offset the projected annual growth in permit applications and compliance reports.

The Department will implement electronic services to offer customers 24-hour convenience, lessen compliance costs for regulated entities, reduce paper filings, and eliminate office appointments. The funding also will help create an enterprise portal to link and align three key business components: permitting and licensing, billing and financial system, and recording and information management.

The recommended funding will provide the resources needed to meet the projected 8% growth in customer service transactions during FY 2006. ●

Infrastructure Vital to Economic Growth

The Executive Recommendation places a strong focus on transportation safety, mobility, employee retention and environmental stewardship

THE ARIZONA ECONOMY'S ability to outperform most of the nation in 2004 is attributable in part to the quality of the state's physical infrastructure. Maintaining a strategic vision for transportation is essential to sustaining our economy, responding to the opportunities and challenges of a rapidly growing state, and meeting the high expectations for rapid, safe movement of people and products.

State government must respond to the certainties of growth and transportation complexity with strategic expansion of our system capacity and more effective solutions, including public transit, to address our growing mobility and transportation needs. Such challenges cannot be relieved without substantial investment in transportation infrastructure.

The Executive Recommendation for FY 2006 reflects an integrated and coherent plan to enhance highway safety and mobility, reduce congestion, and further stimulate our economy. Highlights of the plan include:

- an additional \$3.5 million in the Department of Transportation budget to improve roadway conditions and highway safety;
- an additional \$360,700 to increase engineering staff to improve bridge inspections, maintenance and safety throughout the state;
- \$1.9 million to address salary needs of workers in the Maintenance Program and enhance employee retention, improve morale and reduce turnover costs;
- \$804,100 and nine positions to establish an Environmental Compliance Program to meet

FY 2006 ADOT Financial Plan Dollars in millions

S O U R C E S		
HURF	\$600	37%
Federal Funds	\$423	26%
RARF	\$272	17%
Other	\$143	9%
Bonds	\$125	8%
HELP Fund	\$60	3%
U S E S		
Capital Budget	\$968	61%
Debt Service	\$258	16%
Highways	\$115	7%
Maintenance	\$110	7%
MVD	\$87	5%
Administration	\$40	3%
Magazine	\$10	1%
Aeronautics	\$2	0%

regulatory requirements and balance safe and efficient transportation with environmental quality;

- an additional \$500,000 to enhance business systems and continue improvements of e-government and customer services; and
- \$386,600 and additional revenue auditors and driver license fraud investigators to ensure compliance with the laws, enhance safety, and protect the State's assets.

ADOT FY 2006 BUDGET

The FY 2006 Executive Budget increases transportation funding by \$7.5 million and adds 24 positions for mission-critical operating programs, raising ADOT's operating budget to \$394.5 million and its workforce to 4,650 positions. The recommendation will enable the Department of Transportation to carry out its \$3.6 billion, five-year

Transportation Facilities Construction Program for the fiscal years 2005 through 2009 and complete the Maricopa Regional Freeway System by the accelerated date of December 31, 2007.

Funding sources. The Department's operating and construction budgets are primarily funded from the federal highway trust fund, the State Highway User Revenue Fund (HURF), bond proceeds, and the Maricopa County Transportation Excise Tax, which is deposited into the Regional Area Revolving Fund (RARF). In FY 2006, the excise tax is expected to generate \$327.4 million, an increase of 7.3% over FY 2005. Since the excise tax applies only to taxable transactions in Maricopa County, RARF monies are exclusively dedicated to the Maricopa Regional Transportation System.

Just over half (50.5%) of the monies flowing into the HURF are shared with cities and counties, while the balance remains with the State. In FY 2006, the HURF is projected to receive \$1.26 billion, a 2.2% increase over FY 2005. ●

Recommended FTE Increases

The net increase of 938.1 FTE is comprised of two components: technical changes to the appropriations base and newly funded positions

THE EXECUTIVE BUDGET is divided into one- and two-year budget recommendations. One-year recommendations are made for 17 selected agencies. In the following analysis of full-time equivalent positions (FTE), the FY 2006 recommendation includes all State agencies. In contrast, the FY 2007 recommendation includes only those agencies that qualify for two-year reviews.

As reported in the FY 2005-2006 budget detail that follows, the net increase between the appropriated FTE levels in FY 2005 and the recommended FTE levels in FY 2006 is 912.1 FTE and is comprised of two components – technical adjustments and newly received FTE:

- a net of 0.0 FTE through technical changes to the appropriation base
- a net increase of 912.1 FTE resulting from newly funded or eliminated programs

FY 2006: FTE TECHNICAL CHANGES

Dept. of Economic Security..... 813.9 FTE
810.9 FTE from eligibility worker transfer from AHCCCS
3.0 FTE for foster care licensing from DHS

Dept of Health Services(3.0)
Transfers (3.0) FTE to DES for foster care licensing

AHCCCS(810.9)
Transfers (810.9) FTE to DES

FY 2006 NEW FTE POSITIONS

FTE totals were adjusted to reflect programs that were newly funded in FY 2006. The specific adjustments are detailed below, by agency.

The Executive Budget provides an aggregate increase of 912.1 FTE in FY

2006 for all budget units, the majority concentrated in specific, high-priority programs of State government. The increases are necessary to:

- ensure that Child Protective Services has the personnel necessary to protect Arizona's children;
- respond to the growth in motorists on Arizona's highways; and
- ensure that Capital Police has the personnel necessary to protect the Capital.

Following is an itemized listing, by agency, of the Executive's recommendation for increased FTE positions in FY 2006:

Dept. of Economic Security..... 274.5 FTE
8.1 FTE for child support enforcement in Santa Cruz and Yavapai
232.8 FTE for CPS staffing
33.6 FTE for the Development Disabilities division

Dept. of Corrections 261.0
240.0 FTE to annualize new beds appropriated in FY 2005
12.0 FTE for Blue Ribbon Panel Recommendations
9.0 FTE for inmate fire crews

Arizona State University..... 192.5
120.8 FTE at Arizona State University
38.2 FTE at the University of Arizona
33.5 FTE at Northern Arizona University

Retirement 30.0
30.0 FTE for workload increases

Dept. of Public Safety 29.0
16.0 FTE for highway patrol officers
9.0 FTE for the Public Safety Communications Commission
4.0 FTE for the crime lab

Land Department 25.0
9.0 FTE for preparing land for lease or sale

5.0 FTE for IT specialist, dispatcher, and procurement specialists
3.0 FTE for inmate fire crews
3.0 FTE for an auditor, marketing manager and land administrator
2.0 FTE for Geologists
2.0 FTE for streambed research
1.0 FTE for dam safety

AHCCCS..... 24.3
13.0 FTE for Health Care Group
11.3 FTE for lease purchase/oversight and infrastructure

Dept. of Transportation 24.0
9.0 FTE for environmental compliance
4.0 FTE for maintenance
4.0 FTE for bridge inspection
3.0 FTE for Loop 303 maintenance
2.0 FTE for driver license fraud investigation
2.0 FTE for audit staff

Department of Health Service..... 21.4
9.0 FTE for child care licensure
6.9 FTE for new surveyors
4.0 FTE for AZ State Hospital corrective action plan
1.5 FTE for breast and cervical cancer program

Dept. of Environmental Quality 19.0
15.0 FTE for water quality
2.0 FTE for air quality enforcement
1.0 FTE for customer service enhancement
1.0 FTE for hazardous air pollutant

Department of Administration 16.0
12.0 FTE for the Capital Police
3.0 FTE for Attorney General legal services
1.0 FTE for the small and disadvantaged business program

Dept. of Revenue..... 10.0
7.0 FTE for the unclaimed property division
3.0 FTE for taxpayer information and assistance

Dept. of Education.....7.0
*4.0 FTE for Student Accountability Information
 System Implementation & Training*
2.0 FTE for Voluntary Full Day Kindergarten
1.0 FTE for Teacher Certification

Dept. of Banking.....5.0
5.0 FTE to handle workload increases

Attorney General.....5.0
5.0 FTE to handle workload increases

Water Resources5.0
*17.0 FTE for the Statewide Drought and
 Conservation Office*
*Reduction of (12.0) FTE because of a funding
 shift*

Department of Gaming.....4.0
4.0 FTE to handle workload increases

Weights and Measures3.5
2.0 FTE for Taxicab Registration
1.5 FTE to improve inspection cycle

Industrial Commission.....3.0
3.0 FTE to handle workload increases

Board of Accountancy3.0
*3.0 FTE to handle additional
 administrative tasks*

Registrar of Contractors3.0
*3.0 FTE to handle additional
 administrative tasks*

Secretary of State2.0
2.0 FTE for business services

Behavioral Health Examiners.....2.0
1.0 FTE for a lead investigator
1.0 FTE for a chief investigator

Department of Equalization.....1.0
1.0 FTE for a data entry clerk

Comm. for Postsecondary Education.....1.0
*1.0 FTE for Arizona College Savings
 Plan*

Automobile Theft.....1.0
1.0 FTE for business services

Dept. of Insurance.....1.0
1.0 FTE for professional services licensing

Board of Nursing1.0
1.0 FTE for professional services licensing

FTE Change From Prior Year by Area of Government

FY 2005 - FY 2006
ALL APPROPRIATED FUNDS
 ALL BUDGET UNITS

Area of Government	FY 2005 FTE Budgeted	FY 2006 FTE Recommended	FY 2006 FTE Change
General Government	4,496.3	4,552.3	56.0
Health and Welfare	8,023.9	8,363.1	339.2
Inspection and Regulation	1,832.0	1,859.0	27.0
Education	16,998.1	17,198.6	200.5
Protection and Safety	13,613.2	13,848.6	235.4
Transportation	4,626.0	4,650.0	24.0
Natural Resources	919.2	949.2	30.0
Total	50,508.7	51,420.8	912.1

FTE Change From Prior Year by Area of Government

FY 2005 - FY 2006
GENERAL FUNDS
 ALL BUDGET UNITS

Area of Government	FY 2005 FTE Budgeted	FY 2006 FTE Recommended	FY 2006 FTE Change
General Government	2,788.5	2,791.5	3.0
Health and Welfare	5,831.7	6,042.5	210.8
Inspection and Regulation	728.3	737.3	9.0
Education	16,621.2	16,819.7	198.5
Protection and Safety	12,060.1	12,301.0	240.9
Transportation	2.0	2.0	0.0
Natural Resources	428.4	458.4	30.0
Total	38,460.2	39,152.4	692.2

FTE Change From Prior Year by Area of Government

FY 2005 - FY 2006
OTHER APPROPRIATED FUNDS
 ALL BUDGET UNITS

Area of Government	FY 2005 FTE Budgeted	FY 2006 FTE Recommended	FY 2006 FTE Change
General Government	1,707.8	1,760.8	53.0
Health and Welfare	2,192.2	2,320.6	128.4
Inspection and Regulation	1,103.7	1,121.7	18.0
Education	376.9	378.9	2.0
Protection and Safety	1,553.1	1,547.6	(5.5)
Transportation	4,624.0	4,648.0	24.0
Natural Resources	490.8	490.8	0.0
Total	12,048.5	12,268.4	219.9

Executive Clemency1.0
1.0 FTE for professional services licensing

Dept of Agriculture1.0
1.0 FTE for professional services licensing

Board of Appraisal0.5
*0.5 FTE for the addition of a part-time
 accountant*

State Boards Office.....(2.0)
*Elimination of (2.0) positions due to
 reorganization of the State Boards Office*

Dept of Commerce.....(6.0)
*Reduction of (6.0) FTE because funding
 is being shifted*

Drug and Gang Prevention(13.5)
*Reduction of (13.5) FTE to reflect a
 reduction in revenues*

Dept. of Juvenile Corrections.....(43.1)
*Reduction of (43.1) FTE due to bed
 closure*

FY 2007 FTE POSITIONS

The FY 2007 Executive Budget provides for the addition of 938.1 FTE over FY 2005, or an additional 26 FTE over the FY 2006 budget for various State agency programs. The new FTE are distributed in the following manner:

Public Safety	21.0
<i>20.0 FTE for highway patrol officers</i>	
<i>1.0 FTE for records management</i>	
Land Department	6.0
<i>6.0 FTE for preparing lands for lease</i>	
<i>sales and fire management</i>	
State Treasurer	(2.0)
<i>Reduction of (2.0) FTE for new</i>	
<i>investment pools</i>	
Dept of Equalization	1.0
<i>1.0 FTE for a property appraiser</i>	

FTE Change From Prior Year by Area of Government

FY 2005 - FY 2007
ALL APPROPRIATED FUNDS
BIENNIAL BUDGET UNITS

Area of Government	FY 2005 FTE Budgeted	FY 2007 FTE Recommended	FY 2007 FTE Change
General Government	4,496.3	4,551.3	55.0
Health and Welfare	8,023.9	8,363.1	338.2
Inspection and Regulation	1,832.0	1,859.0	27.0
Education	16,998.1	17,198.6	200.5
Protection and Safety	13,613.2	13,869.6	256.4
Transportation	4,626.0	4,650.0	24.0
Natural Resources	919.2	955.2	36.0
Total	50,508.7	51,446.8	938.1

FTE Change From Prior Year by Area of Government

FY 2005 - FY 2007
GENERAL FUNDS
BIENNIAL BUDGET UNITS

Area of Government	FY 2005 FTE Budgeted	FY 2007 FTE Recommended	FY 2007 FTE Change
General Government	2,788.5	2,790.5	2.0
Health and Welfare	5,831.7	6,042.5	210.8
Inspection and Regulation	728.3	737.3	9.0
Education	16,621.2	16,819.7	198.5
Protection and Safety	12,060.1	12,302.0	241.9
Transportation	2.0	2.0	0.0
Natural Resources	428.4	464.4	36.0
Total	38,460.2	39,158.4	698.2

FTE Change From Prior Year by Area of Government

FY 2005 - FY 2007
OTHER APPROPRIATED FUNDS
BIENNIAL BUDGET UNITS

Area of Government	FY 2005 FTE Budgeted	FY 2006 FTE Recommended	FY 2006 FTE Change
General Government	1,707.8	1,760.8	53.0
Health and Welfare	2,192.2	2,320.6	130.4
Inspection and Regulation	1,103.7	1,121.7	18.0
Education	376.9	378.9	2.0
Protection and Safety	1,553.1	1,567.6	14.5
Transportation	4,624.0	4,648.0	24.0
Natural Resources	490.8	490.8	0.0
Total	12,048.5	12,288.4	239.9

Proposed Legislative Changes

The following changes are necessary to implement the Executive Budget recommendation

Arizona Department of Administration

Personnel Division Fund (A.R.S. § 41-764[C])

For the Personnel Division Fund, under current law, only monies in excess of \$500,000 revert to the General Fund at the end of each fiscal year. The Executive recommends changing the \$500,000 limit to \$1 million. The additional funds would give the Department of Administration additional cash flow to manage expenditures from this Fund.

Attorney General - Department of Law

Collection Enforcement Revolving Fund (A.R.S. § 41-191.03)

For FY 2006 and FY 2007, the Executive recommends continuing language that began with Laws 2003, Chapter 263, Sec. 90 and was extended by Laws 2004, Chapter 281, Sec. 11, which includes a session law provision allowing the Attorney General to use Collection Enforcement Revolving Fund monies for operating expenses. The Executive further recommends that A.R.S. § 41-191.03 be modified to allow the Attorney General's Office to keep a fund balance of \$400,000 instead of \$100,000 to help manage cash flow in the early part the fiscal year.

Automobile Theft Authority

Use of Gift Proceeds (A.R.S. § 41-3451)

The Executive recommends that A.R.S. § 41-3451 be amended to allow revenues collected from the solicitation of grants to be expended as approved by the AATA Board of Directors and that the gift proceeds be continuously appropriated by the Legislature.

State Board for Charter Schools

State Board of Education; charter school sponsorship (New Session Law replaces Laws 2004, Chapter 278, Section 8.)

The Executive recommends that responsibility for charter school sponsorship, transferred from the State Board of Education (SBE) in FY 2004, remain with the State Board for Charter Schools (SBCS) in FY 2006. Statutory language must be added to allow the moratorium on SBE charter school sponsorship to continue into FY 2006, as well as to allow the SBE to contract with the SBCS for oversight of the charters that were transferred from SBE to SBCS in FY 2004.

Arizona Criminal Justice Commission

Drug and Gang Survey (A.R.S. § 41-2416)

Even though A.R.S. § 41-2416 requires an annual survey, during the last ten years the survey has been conducted every two years. The Executive recommendation continues this practice.

Arizona State Schools for the Deaf and the Blind

Excess Voucher Funds (General Appropriations Act footnote)

The Executive recommends that the General Appropriations Act footnote that allows the Arizona School for the Deaf and Blind to expend endowment and voucher earnings in excess of its appropriation for the Arizona Schools for the Deaf and Blind Fund be updated to reflect FY 2006 projected amounts.

Arizona Drug and Gang Prevention Resource Center

Authority to Expend Additional Revenue (General Appropriations Act Footnote)

The Executive recommendation continues the existing footnote that allows the Center to expend to the Fund any additional revenue the Center may receive.

Department of Economic Security

Cash Assistance (Remove General Appropriations Act)

The Executive recommends the removal of the following footnote in the General Appropriations Act: "Notwithstanding section 35-173, subsection C, Arizona Revised Statutes, any transfer to or from the \$156,233,800 appropriated for Temporary Assistance for Needy Families cash benefits requires review by the Joint Legislative Budget Committee." Eliminating this footnote will provide the Department of Economic Security with the flexibility to reinvest the savings it generates by reducing the Cash Assistance caseload into its Service Integration initiative, to improve outcomes for clients through improved investments. In addition to reducing the

number of families on Cash Assistance by increasing self-sufficiency, Service Integration aims to reduce the risk of abuse and neglect for children and to reduce the use of restrictive and institutional placements for children in the child protection system.

Department of Economic Security

Spinal and Head Injuries Trust Fund (General Appropriations Act footnote)

The amount in the following footnote needs to be updated to \$2,492,000: “All Spinal and Head Injuries Trust Fund receipts received by the Department of Economic Security in excess of \$2,391,200 are appropriated to the Independent Living Rehabilitation Services special line item. Before the expenditure of any Spinal and Head Injuries Trust Fund receipts in excess of \$2,391,200, the Department of Economic Security shall submit the intended use of the monies for review by the Joint Legislative Budget Committee.”

Department of Economic Security

Workforce Investment Act - Local Government funds (General Appropriations Act footnote)

The amount in the following footnote needs to be updated to \$47,445,700: “All federal Workforce Investment Act funds for local governments that are received by the State in excess of \$45,088,100 are appropriated to the Workforce Investment Act - Local Governments special line item. Excess monies may not be spent until a proposed expenditure plan for the excess monies has been reviewed by the Joint Legislative Budget Committee.”

Department of Economic Security

Workforce Investment Act - Set-Aside funds (General Appropriations Act footnote)

The amount in the following footnote needs to be updated to \$3,900,600: “All federal Workforce Investment Act funds that are received by the State in excess of \$3,266,600 are appropriated to the Workforce Investment Act - Discretionary special line item. Excess monies may not be spent until a proposed expenditure plan for the excess monies has been reviewed by the Joint Legislative Budget Committee.”

Department of Education

2% Inflation Increase (A.R.S. §§ 15-185[B][4], 15-901, 15-945)

For FY 2006, the Executive recommends that amounts currently specified in statute for base level (including additional school day), transportation route mile funding, and additional assistance for charter schools be adjusted to reflect the 2% inflation increase approved by voters in Proposition 301.

Department of Education

Basic State Aid: Reduction in Trust Land Earnings (General Appropriations Act Footnote)

The Executive projects that FY 2006 income generated from the Permanent State School Fund will be \$45.2 million, \$1.3 million less than the FY 2005 appropriated levels. The decrease is due mainly to the existence of monies reserved to pay debt service on \$247.1 million in Deficiencies Correction revenue bonds issued by the School Facilities Board in FY 2004. A footnote that specifies the amount derived from the Fund for State aid to school districts must be updated to reflect the new FY 2006 appropriation.

Department of Education

Desegregation “soft cap” extension (New Session Law replaces Laws 2004, Chapter 278, Section 16)

The Executive recommends extending into FY 2006 the desegregation “soft cap” pursuant to Laws 2004, Chapter 278, Section 16. The “soft cap” allows school districts to increase their desegregation budgets for increased enrollment and inflation.

Department of Education

Expansion of Full Day Kindergarten - Year Two (A.R.S. § 15-901.02)

The Executive recommends that the phase-in of Year Two of the Voluntary Full Day Kindergarten program include 80%-and-above schools.

Department of Education

Joint Technological Education District Cap (Laws 2004, Chapter 341)

The Executive recommends extending into FY 2006 the Joint Technological Education Districts (JTED) moratorium, pursuant to Laws 2004, Chapter 341.

Department of Education

K-12 rollover (New Session Law)

The Executive Recommendation for FY 2006 to extend the existing \$191 million K-12 rollover requires the following: (a) A.R.S. § 15-973 to be notwithstanding; (b) defer \$191 million from the June 15, 2006, State Aid payment until July 1, 2006; (c) advance appropriate \$191 million for the July 1 payments in FY 2007; and (d) allow for districts to recoup interest charges related to issuing warrants.

Department of Education

School Accountability Fund (A.R.S. § 15-241)

The Executive proposes that the School Accountability Fund be established permanently in statute to avoid end-of-year reconciliation issues caused by the Fund's status as a sub-account of the General Fund.

Department of Education

Teacher Certification Fund (A.R.S. § 15-531.)

The Executive proposes that the Teacher Certification Fund be established permanently in statute to avoid end-of-year fund reconciliation issues that are caused by the Fund's status as a sub-account of the General Fund.

Department of Environmental Quality

WQARF Transfer from Corporate Income Tax (A.R.S. § 49-282)

This action would suspend A.R.S. § 49-282 to limit to \$10 million the transfer from the corporate income tax, instead of \$15 million as provided in current law. The same action was taken for FY 2005.

Arizona Health Care Cost Containment System

County Acute Care Contribution (Laws 2004, Chapter 279, Sec. 7 & 8)

Two session laws pertain to county contributions totaling \$73.1 million for Acute Care services within AHCCCS. The Executive recommendation continues the Acute Care county contribution at this level.

Arizona Health Care Cost Containment System

County Expenditure Limitation; Disproportionate Share; Fiscal Year 2005-2006 Adjustment Formula (Session Law)

This change provides for the decrease of the base limit of each county that receives Disproportionate Share Hospital (DSH) payments to a county-operated hospital when calculating the county expenditure limit during FY 2005-2006. This is necessary to hold Maricopa County harmless to the pass-through of DSH intergovernmental transfer monies to the General Fund.

Arizona Health Care Cost Containment System

County Expenditure Limitation; Disproportionate Share; Fiscal Year 2006-2007 Adjustment Formula (Session Law)

This change provides for the increase of the base limit of each county that receives DSH payments to a county-operated hospital when calculating the county expenditure limit during FY 2006. This is necessary to hold Maricopa County harmless to the pass-through of DSH intergovernmental transfer monies to the General Fund.

Arizona Health Care Cost Containment System

KidsCare Parents Program Continuation (Laws 2004, Chapter 279, Section 13)

This program is legislated to end June 30, 2005. The Executive Recommendation would continue it through FY 2006 and beyond.

Arizona Health Care Cost Containment System

Withholding State Share Revenues for FY 2005 (DSH) (Session Law)

The Executive recommends that the FY 2006 Transaction Privilege Tax withholdings, authorized under the DSH Payments Program, be \$63,366,600.

Department of Health Services

Restoration to Competency - City Cost Sharing (Notwithstanding A.R.S. § 13-4512.)

Provides, as session law, that counties and cities pay 86% of the cost of restoration of competency treatment provided at the Arizona State Hospital.

Department of Health Services

Suspend Suicide Prevention Program in FY 2006. (Notwithstanding A.R.S. § 36-3415.)

This proposed change notwithstanding A.R.S. § 36-3415 to suspend the Suicide Prevention Program in FY 2006.

Department of Insurance

Suspend 95% to 110% Fee Range (A.R.S. §§ 20-167[F] and 20-466 [J])

Current law requires DOI to adjust fees so that fee revenue (which is deposited into the General Fund) is no more than 110% and no less than 95% of the Department's appropriated budget. Current estimates are that FY 2006 fees will be \$9,599,100, which is approximately 146% of the Executive recommendation. Enforcing the statute would require a revenue loss through a fee reduction totaling approximately \$2.7 million.

Arizona State Lottery Commission

Distribution of Lottery Proceeds (A.R.S. § 5-522)

The Executive recommends changing the process for the distribution of Lottery proceeds to the benefiting programs. The new process will streamline the statutes and create a precise hierarchical structure for the

State Parks Board

Off-Highway Vehicle Recreation Fund; Use (A.R.S. § 28-1176)

This proposed change notwithstanding A.R.S. § 28-1176 to authorize the Arizona State Parks Board to spend up to \$692,100 from the Arizona State Parks portion of the Off-Highway Vehicle Fund in FY 2006 and FY 2007.

State Parks Board

State Parks Enhancement Fund (A.R.S. § 41-511.11)

This proposed change would suspend A.R.S. § 41-511.11 to specify that all monies except those necessary for the lease-purchase of the Tonto Natural Bridge State Park are available for the operating of State parks in FY 2006 and FY 2007.

Department of Public Safety

CJEF Distribution to General Fund Redirected to Crime Lab Assessment Fund (A.R.S. §§ 41-2401[D][11] and 41-2415[C])

This recommendation continues the policy from previous years of redirecting to the Crime Laboratory Assessment Fund the 9% Criminal Justice Enhancement Fund (CJEF) distribution to the General Fund.

Department of Public Safety

Highway User Revenue Fund (HURF)/Highway Fund DPS Expenditure Limits (A.R.S. §§ 28-6537 and 28-6993)

In order to appropriate amounts recommended in the Executive Budget, these two sections should be deferred for the biennium or repealed.

Department of Real Estate

Fee Recovery (A.R.S. § 32-2103[B])

The Executive recommends continuing the provision of Laws 2004, Chapter 286 that notwithstands section A.R.S. § 32-2103(B) so that the Real Estate Commissioner cannot revise fees in FYs 2006 and 2007 for the purposes of meeting the requirement to recover at least 95% but not more than 110% of the State Real Estate Department's appropriated budget.

School Facilities Board

Building Maintenance and Renovation Program (A.R.S. § 15-2031; New statute)

In FY 2006, the Executive recommends the creation of a new Building Maintenance and Renovation program to provide funding to school districts on a formula basis for preventive maintenance, and on an as-needed basis for building system renovation and repair. This program will replace the existing Building Renewal program.

School Facilities Board

Deficiencies Corrections deadline extension (A.R.S. § 15-2011)

In FY 2006, the Executive recommends the elimination of the repeal provision in Laws 2003, 1st Special Session, Chapter 2, Section 9 that would eliminate the Deficiencies Corrections program (and the Deficiencies Corrections Fund) by July 1, 2005. In addition, the Executive Recommendation modifies Laws 2003, 1st Special Session, Chapter 2, Section 22 to extend to June 30, 2006 (from June 30, 2005) the deadline for deferred projects for Mesa Unified, Glendale Union, and Tucson Unified school districts.

School Facilities Board

Kindergarten as full Average Daily Membership (ADM) for new construction purposes (A.R.S. § 15-2011)

Current statute requires the School Facilities Board (SFB) to view a kindergarten student as a half ADM for new school construction purposes. Although the Voluntary Full Day Kindergarten program will be phased in over the next five years, counting the students as full ADM now will give the districts time to develop the facilities necessary to accommodate the full-day kindergarten program.

School Facilities Board

New Construction Lease to Own Authority (A.R.S. § 15-2006)

In FY 2006, the Executive recommends an additional \$101 million in lease-to-own authority for the SFB for new school construction. Since current statute limits the SFB to \$200 million annually, a notwithstanding provision is needed to allow for the additional authority.

State Treasurer

JP salaries at 38.5% (A.R.S. § 22-117)

Statute requires that the State pay 40% of the compensation and ERE of Justices of the Peace, with the counties paying the rest. Since Laws 2002, Chapter 238, the State has notwithstood this statute and paid only 38.5%, which the Executive recommends for FY 2006 and FY 2007.

University of Arizona - Main Campus

Medical School in Phoenix (A.R.S. § 35-144)

Notwithstanding A.R.S. § 35-144, \$20 million of the FY 2005 ending balance of the Budget Stabilization Fund established by A.R.S. § 35-144 shall be deposited into a medical school savings account on July 1, 2005. The purpose of the account shall be for expenditures after FY 2006 associated with the development of a medical school in Phoenix. Expenditures from this account are subject to Legislative appropriation.

Department of Water Resources

Water Protection Fund (A.R.S. § 45-2112)

Notwithstanding A.R.S. § 45-2112 to provide that the annual appropriation from the State General Fund to the Water Protection Fund for FY 2006 and FY 2007 shall be specified in the General Appropriation Act.

ELECTED OFFICIALS' SALARIES

IN 1970, THE Arizona Legislature established the Commission on Salaries for Elective State Officers. The Commission is required to conduct a biennial salary review and make recommendations to the Governor regarding salaries for elected State officers, justices, judges of courts of record, the clerks of the Superior Court and others.

The Commission makes recommendations during even-numbered years.

After receiving the recommendations, the Governor is required to include in the next budget transmitted to the Legislature the Governor's recommendations for exact rates of pay.

Elective State officers have not received a salary increase since 1999, and

judges have not received an increase since January 2001, when salaries were increased approximately by 6.5%. The 6.5% increase was far below the approximate 17% average increase in comparable states.

Arizona is one of only seven states that have not increased their judges' compensation since January 2001. As a consequence of the other 43 states' increases, the salary of only one category of Arizona judges – Superior Court judges (\$120,750) at number 10 – ranks in the top 10 of the 50 states. Other rankings:

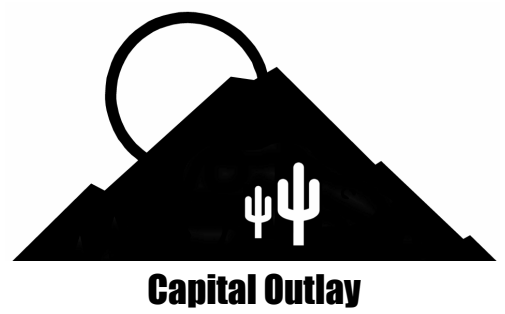
- Court of Appeals judges: \$123,900 (14 of 39);
- Supreme Court associate justices: \$126,525 (14 of 50);
- Supreme Court chief justice: \$129,150 (18 of 50).

There is some concern that Arizona may not continue to have a nationally recognized judiciary if the most qualified lawyers do not desire to become judges. As the gap between public and private sector salaries grows, the most capable lawyers will be more reluctant to leave private practice, and sitting judges will be more inclined to leave for a more lucrative position at a law firm or elsewhere.

The table below summarizes the positions for which the Executive has recommended a salary adjustment for FY 2006. The salaries identified under "Executive Proposed Salary" will become effective unless the House or Senate takes action in 90 days. ●

Judges	Salary Effective January 1, 2005	Commission Proposed Salary	Commission Proposed Effective Date	Executive Proposed Salary	Executive Proposed Effective Date
Supreme Court, Chief Justice	129,150	160,000	January 1, 2007	160,000	January 1, 2007
Supreme Court, Associate Justices	126,525	155,000	January 1, 2007	155,000	January 1, 2007
Appellate Judges, Division I	123,900	150,000	January 1, 2007	150,000	January 1, 2007
Appellate Judges, Division II	123,900	150,000	January 1, 2007	150,000	January 1, 2007
Superior Court Judges	120,750	145,000	January 1, 2007	145,000	January 1, 2007

Elected Officials	Current Salary	Commission Proposed Salary	Commission Proposed Effective Date	Executive Proposed Salary	Executive Proposed Effective Date
Governor	95,000	160,000	January 1, 2007	95,000	n/a
Secretary of State	70,000	110,000	January 1, 2007	70,000	n/a
Attorney General	90,000	135,000	January 1, 2007	90,000	n/a
State Treasurer	70,000	105,000	January 1, 2007	70,000	n/a
Superintendent	85,000	125,000	January 1, 2007	85,000	n/a
Mine Inspector	50,000	73,500	January 1, 2007	50,000	n/a
Clerk of the Courts: Maricopa & Pima Counties	67,800	100,000	January 1, 2007	67,800	n/a
Other Counties	56,500	80,000	January 1, 2007	56,500	n/a
Corporation Commission	79,500	95,000	January 1, 2007	79,500	n/a
Legislators	24,000	36,000	January 8, 2007	n/a	n/a



Preserving State Infrastructure

The FY 2006 Executive Budget provides for a number of capital projects throughout Arizona

THE EXECUTIVE RECOMMENDATION acknowledges the importance and impact of capital projects throughout Arizona by including funding to build highways, repair existing buildings, and implement new safety features to protect employees.

AGENCY REQUESTS

State agency requests for Capital Outlay funding in FY 2006 totaled \$484.8 million. The total included \$353.7 million in General Fund requests and \$131.1 million in Other Appropriated Funds. Agency capital requests from the General Fund include:

- \$134.5 million from the Department of Corrections (ADC);
- \$68.5 million from the Department of Administration (ADOA);
- \$81.9 million from ADOA and the Universities' Building Renewal;
- \$14.7 million from the Department of Juvenile Corrections (DJC); and
- \$58.1 million from, cumulatively, the Department of Public Safety (DPS), Department of Economic Security (DES), Department of Health Services (DHS), Arizona School for the Deaf and the Blind, and the Courts.

Other Fund requests consisted of:

- \$119.5 million from the Department of Transportation
- \$6 million from ADOA;
- \$630,000 from the Department of Game and Fish; and
- \$5.6 million from various funds for Building Renewal.

BUILDING RENEWAL

The FY 2006 Executive Budget provides \$8.9 million for Building Renewal, as outlined in Table I. Though no General Fund monies are recommended, the Executive proposes appropriating \$4 million from the Capital Outlay Stabilization Fund for ADOA Building Renewal.

Additionally, the Executive recommends \$3 million for Building Renewal for the ADOT Building System from the State Highway Fund. The Executive recommends 100% of

Building Renewal formula funding for "Other Fund" agencies, including Game and Fish and the Lottery.

OTHER FUNDS

As is detailed in Table I, two Game and Fish Department projects are recommended as part of the FY 2006 Executive Capital Outlay Budget. This agency has a dedicated source of funds that can be used solely for projects that support its mission.

Several projects have been recommended for the Department of Transportation. Of the total recommended ADOT funding, the majority is for its highway construction program. The State Transportation Board has specific responsibility for establishing project priorities. Historically, the Legislature has provided a lump-sum appropriation for the statewide highway construction program.

Game and Fish Capital Improvement Fund

Black Canyon Lake Dam Modifications.....\$500,000

The Executive recommends \$500,000 to modify dam and spillway design of Black Canyon. The modifications are needed to compensate for the downstream development that has elevated the hazard classification of this dam. The dam/reservoir capacity has to be increased to comply with safety design standards.

Statewide Facility Recurrent Maintenance\$30,000

The Executive recommends \$30,000 for recurring maintenance of Game and Fish Facilities.

State Highway Fund

ADOT BUILDING SYSTEM

Surprise Customer Services Center Remodel..... \$3,128,600

The Executive recommends \$3,128,600 to remodel the MVD Customer Service Center at Surprise. The facility needs to be expanded in order to meet the area's service needs and comply with safety codes.

Payson Equipment Service Shop Replacement..... \$1,563,500

The Executive recommends \$1,563,500 to build a larger pre-engineered full-service maintenance and repair facility. The new facility will provide the Department with space that can accommodate larger equipment and bring employee areas in line with current safety codes.

Vehicle Wash/Rack System, Statewide Program.....\$825,800

The Executive recommends \$825,800 to install 11 vehicle wash systems that meet EPA and ADEQ regulations regarding controlled water distribution.

Automatic Sprinkler and Fire Alarm Systems.....\$1,265,000

The Executive recommends \$1,265,000 to install automatic sprinkler and fire alarm systems to meet existing code requirements in multiple locations throughout the state.

De-Icing Materials Storage Buildings.....\$1,089,000

The Executive recommends \$1,089,000 to build storage facilities to house bulk sand, cinders and materials used during the winter months for highway de-icing operations. Some of these materials are being stored outside, exposed to moisture and freezing temperatures, making their use difficult.

Vertical Oil Storage Tanks & Basins.....\$980,700

The Executive recommends \$980,700 to replace six 10,000-gallon oil storage tanks that are rusting and subject to leakage.

Highway Construction.....\$38,510,000

The FY 2006 Executive Budget includes \$38.5 million for Highway Construction from the State Highway Fund.

Highway Construction, Controlled-Access.....\$90,826,000

The Highway User Revenue Fund (HURF) formula earmarks a specific percentage of funds for the construction of controlled access roads in Maricopa and Pima counties. The Executive recommends that the estimate of available monies be utilized for this purpose.

Debt Service.....\$69,006,000

The Executive recommends \$69 million for debt service.

State Aviation Fund

ADOT BUILDING SYSTEM

Airport Planning and Development.....\$21,283,000

The FY 2006 Executive Budget includes \$21.3 million for development and construction of State and local airports

DEBT SERVICE

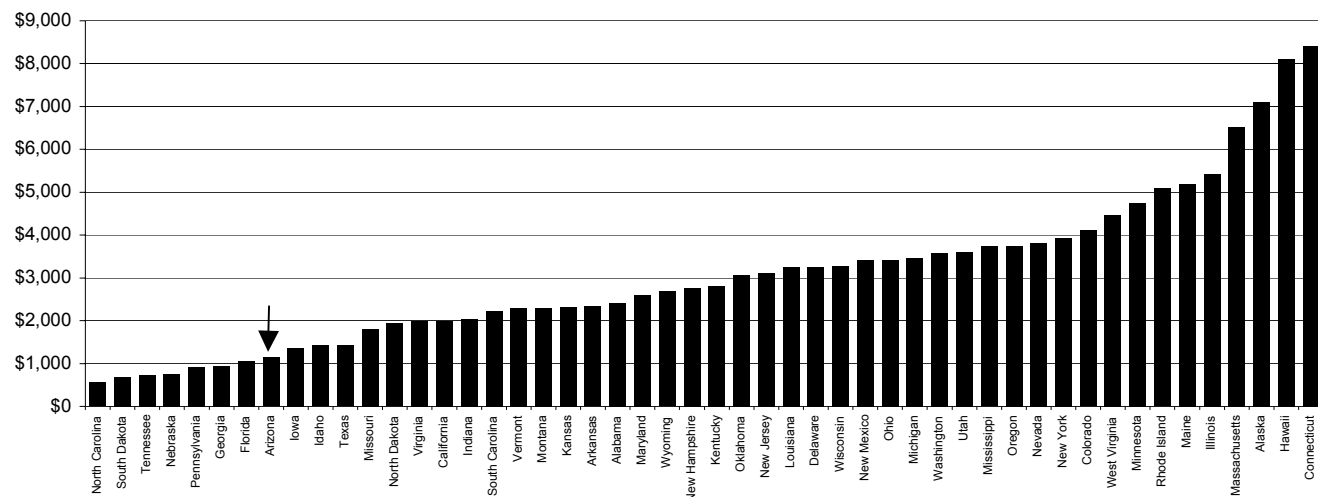
The Arizona Constitution places a \$350,000 ceiling on the level of General Obligation debt that the State may incur. However, State government has relied on COPs and revenue bonds to fund numerous construction projects. Table II provides a summary of the projects that have been funded through debt instruments.

ADOT has the authority to issue up to \$1.3 billion in bonds against the Highway User Revenue Fund (HURF). The bond payments are enforceable only from HURF.

While many states have struggled to maintain reasonable debt levels, responsible use of debt continues as a priority in Arizona. In Moody's 2004 *State Debt Medians* report, Arizona carried a per capita tax-supported debt amount of \$591, which compares favorably to the national average of \$944. When typically underfunded State pension plans are incorporated into the measure, Arizona's conservative use of debt is even more evident. As shown in the table, Arizona ranks 8th among states with a per capita amount of \$1,143 as compared to the national average of \$3,067.

2004 Gross Tax-Supported Debt Per Capita

Including Pension Liabilities



This graphical representation was produced from information from Moody's Investors Service (one of three national rating agencies) for Gross Tax-Supported Debt exclusive of pension liability information. Using pension liability information provided by Wilshire Associates (an investment advisory firm), the graph includes a combination of pension liability and debt. In states where there is not a pension liability but an asset, the dollar amount of the pension asset is not netted against the Gross Tax-Supported Debt.

Table I

OTHER FUND CAPITAL OUTLAY**FY 2006 Recommendation**

Building Renewal		<i>Fund</i>	<i>Executive Recommendation</i>
	ADOA	COSF	\$ 4,000,000
	ADOT-Highway Fund	State Highway	3,000,000
	ADOT-Aviation	Aviation	75,800
	State Fair Board	Enterprise	1,386,800
	Game & Fish	Game and Fish	388,900
	Lottery	Lottery	<u>47,600</u>
<i>Subtotal Building Renewal:</i>			<u>\$ 8,899,100</u>
Capital Projects			
Game & Fish	Black Canyon Dam Modifications	Capital Improvement Fund	\$ 500,000
Game & Fish	Statewide Facility Recurrent Maintenance	Facility Improvements	30,000
ADOT	Surprise Customer Services Center Remodel	State Highway	3,128,600
ADOT	Payson Equipment Service Shop Replacement	State Highway	1,563,500
ADOT	Vehicle Wash/Rack System, Statewide Program	State Highway	825,800
ADOT	Statewide Automatic Sprinkler and Fire Alarm Systems	State Highway	1,265,000
ADOT	De-Icing Materials Storage Buildings, Statewide Program	State Highway	1,089,000
ADOT	Vertical Oil Storage Tanks and Basins, Statewide Program	State Highway	980,700
ADOT	Highway Construction	State Highway	38,510,000
ADOT	Controlled-Access Highways	State Highway	90,826,000
ADOT	Debt Service	State Highway	69,006,000
ADOT	Airport Planning and Development	State Aviation	21,283,000
<i>Subtotal Capital Projects:</i>			<u>207,724,600</u>
Total FY 2004 Other Funds:			<u>\$ 216,623,700</u>

Table II

COPs AND REVENUE BONDS

Systems with General Fund Involvement	<i>Original Issue</i>	<i>FY 2006 Payment</i>	<i>7-1-06 Balance</i>
ADOA BUILDING SYSTEM COPs			
2000 (PLTO)	89,775,000	5,491,400	85,615,000
2001 (PLTO)	29,895,000	1,660,100	29,385,000
2001 A&B	57,930,000	9,135,500	34,700,000
2002 A	63,270,000	5,151,900	52,655,000
2002 B	75,295,000	11,633,700	62,765,000
2004 A	16,725,000	2,508,800	13,620,000
2004 B	<u>31,965,000</u>	<u>3,183,700</u>	<u>30,260,000</u>
<i>Subtotal</i>	364,855,000	38,765,100	309,000,000
BOR-University Research Infrastructure	367,200,000	-	367,200,000
SFB SCHOOL CONSTRUCTION			
Lease-to-Own	852,125,000	72,945,200	803,715,000
Bonds	<u>1,067,100,000</u>	<u>92,844,800</u>	<u>879,366,539</u>
<i>Subtotal</i>	1,919,225,000	165,790,000	1,683,081,539
General Fund Subtotal	1,466,698,800	102,411,300	1,372,608,500
Systems Entirely Other Fund	<i>Original Issue</i>	<i>FY 2006 Payment</i>	<i>6-30-04 Balance</i>
BOARD OF REGENTS LEASE PURCHASE			
University of Arizona - Various	560,635,000	34,035,000	527,634,000
Arizona State University - Various	<u>208,330,000</u>	<u>15,581,000</u>	<u>179,003,000</u>
<i>Subtotal</i>	768,965,000	49,616,000	706,637,000
BOARD OF REGENTS REVENUE BONDS			
University of Arizona - Various	272,725,000	23,777,000	232,420,000
Arizona State University - Various	418,241,000	28,763,000	401,651,000
Northern Arizona University - Various	<u>143,270,000</u>	<u>23,102,000</u>	<u>122,710,000</u>
<i>Subtotal</i>	834,236,000	75,642,000	756,781,000
DEPARTMENT OF TRANSPORTATION			
Board Funding Obligations (BFOs)	200,000,000	-	200,000,000
Grant Anticipation Notes (GANs)	342,845,000	49,894,000	308,585,000
HURF Bonds	<u>1,409,905,000</u>	<u>105,167,000</u>	<u>1,017,360,000</u>
<i>Subtotal</i>	1,952,750,000	155,061,000	1,525,945,000
General Fund	1,466,698,800	102,411,300	1,372,608,500
Other Funds	4,393,977,400	332,347,100	3,663,886,000
Federal Funds	<u>346,554,800</u>	<u>50,115,700</u>	<u>312,150,000</u>
Total	<u>6,207,231,000</u>	<u>484,874,100</u>	<u>5,348,644,500</u>

Acknowledgement

Governor Napolitano wishes to acknowledge, with gratitude, the skilled and dedicated efforts of the staff of the Governor's Office of Strategic Planning and Budgeting.

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