
FY 2016 JLBC Baseline

Summary Version

January 16, 2015

JLBC

Summary of Current Budget Status

- ❑ The Baseline compares the 4-sector consensus revenue forecast with cost of current funding formulas through '18
- ❑ Prior to the K-12 litigation, the current year (FY '15) baseline shortfall is \$(148) M, followed by \$(678) M in '16
- ❑ The K-12 inflation “reset” ruling would increase the shortfall to \$(480) M in '15 and \$(1.02) B in '16
- ❑ The cash balance estimates exclude the \$464 M available in the Budget Stabilization Fund

Forecast Risks

- 1% Variance Yields \$575 M Over 3 Years

Potential Gains

- National economic recovery may provide upside gain, in part, by generating more in-state migration
- Gas price windfall will also help stimulate retail sales, but is likely temporary

Potential Losses

- Uncertainty of international events
- Litigation – prison health, retirement, hospital assessment

Revenue Overview

'15 Improved Over Slow '14 Due to Corporate Collections

- Otherwise Weak Growth

	<u>'14 Budgeted</u>	<u>'14 Actual</u>	<u>'15 1st Half</u>
Sales	5.7%	5.5%	3.4%
Individual Income	3.7%	1.9%	3.2%
Corporate Income	(3.5)%	(13.1)%	21.4%
Overall	3.9%	2.7%	4.6%

- ❑ Without corporate income tax collections, year-to-date overall increase would be 3.6%
- ❑ December is first month that revenues have been above forecast since March 2014
- ❑ Through December, year-to-date revenues \$(60) M below forecast

AZ Economy is Growing, But Slower than Average

- Given Our Size, Historical Norm May Not be Realistic

Main Factors Behind Slow Growth

	<u>Historical</u>	<u>Current</u>
Overall Job Growth	3.9%	2.6%
Construction Employment	5.7%	(3.5)%
Population Growth	3.1%	1.5%
Building Permits	38K	17K

Other Factors

- Great Recession “hangover” may be hampering investment
- Tougher loan standards and declining household formation have hurt housing demand
- Flat wages have limited consumer purchases
- Reduced Federal defense contracts in Arizona

4-Sector Forecast Has Slow Growth Until '18

Components of 4-Sector

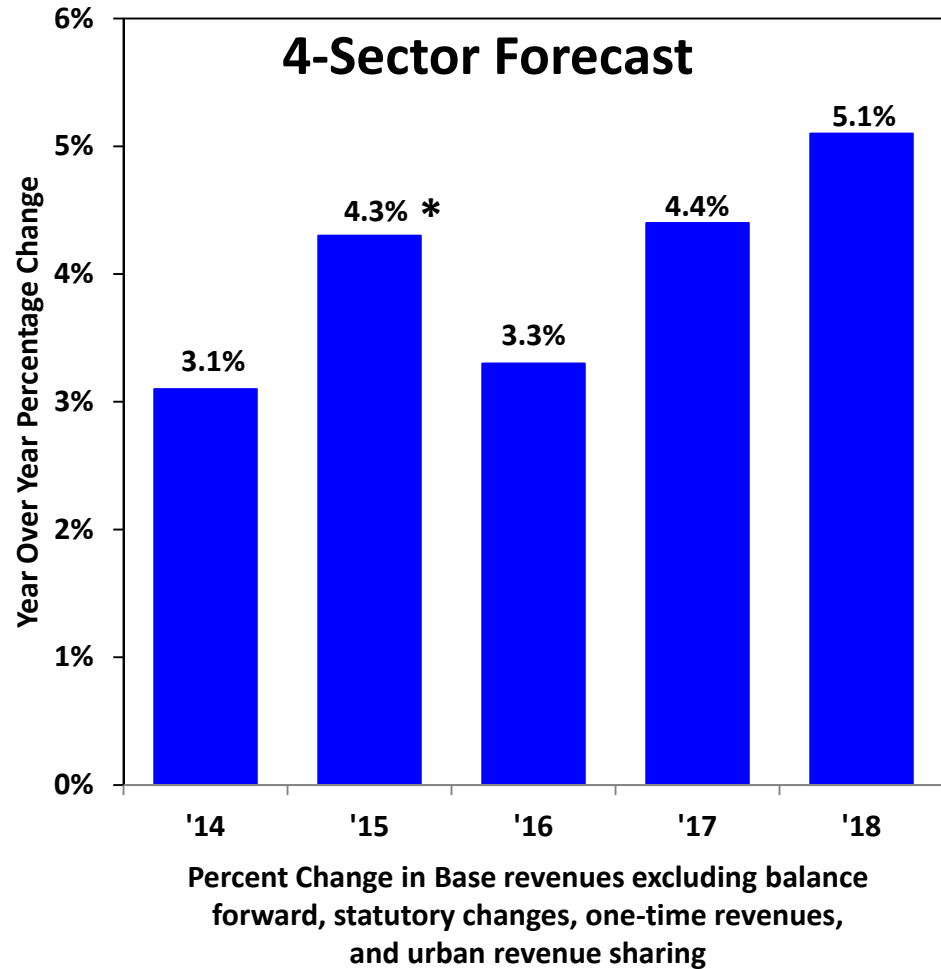
- Finance Advisory Committee
- UA base model
- UA lower model
- JLBC Staff

Chance of Exceeding Forecast

- 60%

Long Run Average Growth

- 4.75%



* Adjusted for corporate YTD collections

Tax Law Phase-In Reduces '16 Growth Rate to 1.6%

	\$ in M Above Prior Year		
	<u>'16</u>	<u>'17</u>	<u>'18</u>
Base Revenue Growth (3.3%/4.4%/5.1%)	300	413	495
Elimination of Fund Transfers	(54)	--	--
Previously Enacted Tax Legislation	(112)	(78)	(77)
Urban Revenue Sharing	<u>3</u>	<u>(10)</u>	<u>(5)</u>
Total	137	325	413
% Change	1.6 %	3.7%	4.5%

Spending Overview

Projected Baseline Spending Changes

	\$ in M Above Prior Year		
	'16	'17	'18
K-12 Formula	181	210	164
Medicaid Formula	29	121	137
DCS 1-Time Backlog	(16)	(8)	0
ADC Operating	8	0	0
Capital	(42)	0	0
HURF Shift (\$30 M to \$60 M)	0	30	0
One-Time/Other	(70)	(16)	2
Additional Spending	90	337	303
Total Spending	\$9,447	\$9,784	\$10,087
% Growth	1.0%	3.6%	3.1%
K-12 Inflation Reset	\$337	\$341	\$346
Revised Total	\$9,784	\$10,125	\$10,433

Main Caseload Assumptions

- ❑ Before “reset”, K-12 would grow by \$181 M
 - 1.6% inflation/1.4% student growth/property tax cut
- ❑ Medicaid ‘16 spending grows 1.2%
 - 2.0% caseload, 3.0% capitation, and better federal match rates
- ❑ DCS funding adjusted consistent with May 2014 plan
- ❑ ADC reflects annualized cost for opening 1,000 new beds

Projected Ending Balance Estimates

Updated '15 – '18 Ending Balance Projections

- January FAC Revenue With Projected Spending

Baseline	'15	'16	'17	'18
Balance Forward	\$577 M	--	--	--
Revenues	\$8.63 B	\$8.77 B	\$9.09 B	\$9.51 B
Spending	\$9.36 B	\$9.45 B	\$9.78 B	\$10.09 B
<i>Ending Balance</i>	<i>\$(148) M</i>	<i>\$(678) M</i>	<i>\$(690) M</i>	<i>\$(581) M</i>
K-12 Reset	\$332 M	\$337 M	\$341 M	\$346 M
<i>Revised Balance</i>	<i>\$(480) M</i>	<i>\$(1.02) B</i>	<i>\$(1.03) B</i>	<i>\$(928) M</i>

Does not include \$464 M Rainy Day Fund

The Path from a \$900 M Surplus to a Large Shortfall

- ❑ Current shortfall is not unexpected -- '15 budget projected shortfalls of \$(237) M in '16 and \$(490) M in '17
- ❑ The state had an underlying structural shortfall in past several years
- ❑ When the \$900 M 1-cent sales tax ended in '13, we replaced it with a \$900 M 1-time carryforward in '14
- ❑ Lower than expected revenue growth
- ❑ Phase-in of tax law changes enacted in '11 and '12
- ❑ K-12 inflation litigation

Suggestions to Improve Fiscal Policy

- Currently 4th Worst Credit Rating Among States

- ❑ Align ongoing revenues and spending – develop multi-year targets
- ❑ Reduce reliance on 1-time solutions over time
- ❑ Set aside 1-time revenues into a separate fund
 - Excess ending balances
 - Excess capital gains
 - Windfalls (retail gain with gas price plunge)
- ❑ Dedicate 1-time \$ for 1-time purposes
 - Rebates/Operating debt buyback/Infrastructure/IT Modernization

California Initiative Addresses Volatility

- Voter approved in November 2014
- 1.5% of annual General Fund revenue will be deposited into Rainy Day Fund
- Excess capital gains income tax collections will be deposited into the fund as well
- 50% of fund will be used to buy down state debts, including unfunded retirement and operating loans
- Rainy Day Fund capped at 10% of GF revenue; excess dedicated to infrastructure
- Emergency provisions allow deposit requirements to be suspended

Appendix A: January 2015 4-Sector Forecast

	<u>2015</u>	<u>2016</u>	<u>2017</u>	<u>2018</u>
Sales Tax				
JLBC Forecast	4.0%	4.4%	4.8%	5.0%
UA – Low	2.5%	1.1%	3.3%	5.4%
UA – Base	4.0%	4.4%	5.8%	6.6%
FAC	4.5%	4.4%	5.0%	5.2%
Average:	3.7%	3.6%	4.7%	5.6%
Individual Income Tax				
JLBC Forecast	3.6%	5.4%	5.9%	5.9%
UA – Low	1.8%	1.0%	3.0%	4.7%
UA – Base	3.0%	3.8%	5.0%	6.0%
FAC	3.7%	4.4%	5.0%	5.1%
Average:	3.0%	3.7%	4.8%	5.4%
Corporate Income Tax				
JLBC Forecast	15.0%	3.1%	3.5%	4.5%
UA – Low	(2.0)%	(6.6)%	(8.8)%	(11.7)%
UA – Base	(1.2)%	0.7%	(0.2)%	(7.2)%
FAC	2.9%	3.1%	5.1%	7.3%
Average:	3.7%	0.1%	0.2%	(0.9)%
JLBC Weighted Average	4.6%	4.7%	5.2%	5.4%
UA Low Weighted Average	1.9%	0.5%	2.5%	4.4%
UA Base Weighted Average	3.2%	3.9%	5.1%	5.7%
FAC Consensus Weighted Average	4.0%	4.3%	5.0%	5.3%
“Big-3” Weighted Average*	4.2%	3.4%	4.5%	5.2%
Consensus Weighted Average**	4.3%	3.3%	4.4%	5.1%
Adjusted Consensus Weighted Average***	3.0%	2.1%	3.6%	4.3%
* '15 Adjusted for corporate year-to-date collections				
** Represents on-going revenue adjusted for small revenue categories				
*** Represents on-going revenue adjusted for tax law changes; excludes Urban Revenue Sharing				

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