
Finance Advisory Committee

Revenue and Budget Update

January 19, 2012

JLBC

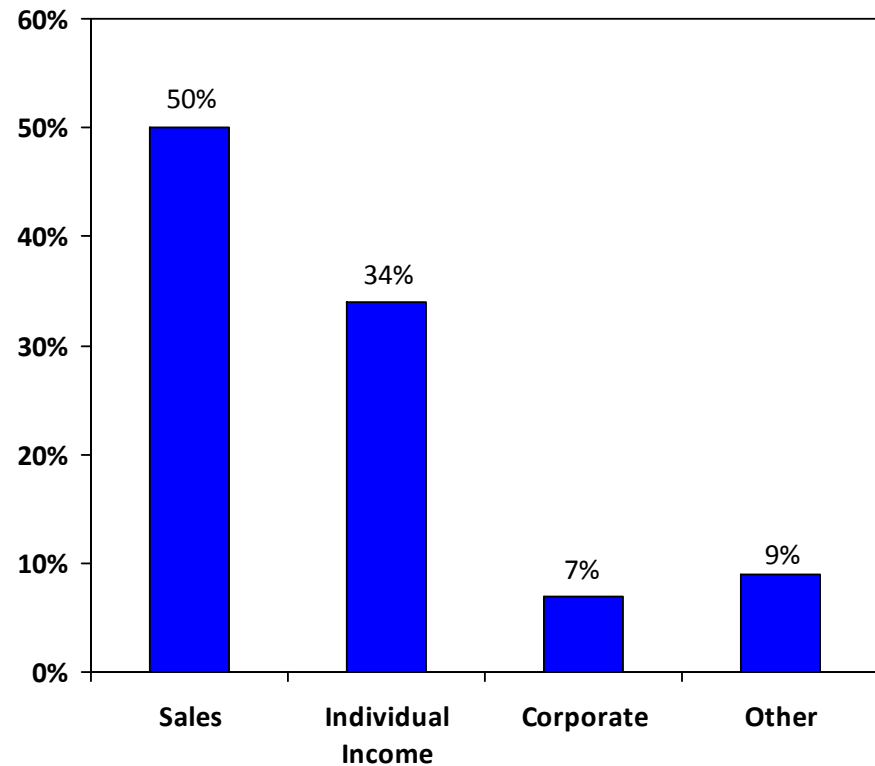
Revenue Overview

JLBC

FY 2012 General Fund Revenue

- 91% Generated by 3 Taxes

<u>Source</u>	<u>(Millions)</u>
Sales and Use Tax	\$ 4,508.2
Individual Income Tax	3,058.3
Corporate Income Tax	617.7
Other	<u>775.4</u>
TOTAL REVENUE	\$ 8,959.6 ^{1/}



^{1/} January 2012 estimate. Excludes beginning balance, urban revenue sharing, and one-time revenue adjustments.

In FY '11, 10.1% Revenue Growth Eliminated FY '11 Shortfall of \$(332) Million

- Followed by 7.4% Year to Date Growth in FY '12

<u>Tax Category</u>	<u>'11 Over 10</u>	<u>'12 YTD Over 11</u>
Sales*	2%	5%
Individual Income	18%	8%
Corporate Income	36%	34%

*without 1 cent

Key Economic Measures

- Comparing Current Arizona Status to a Healthy Economy

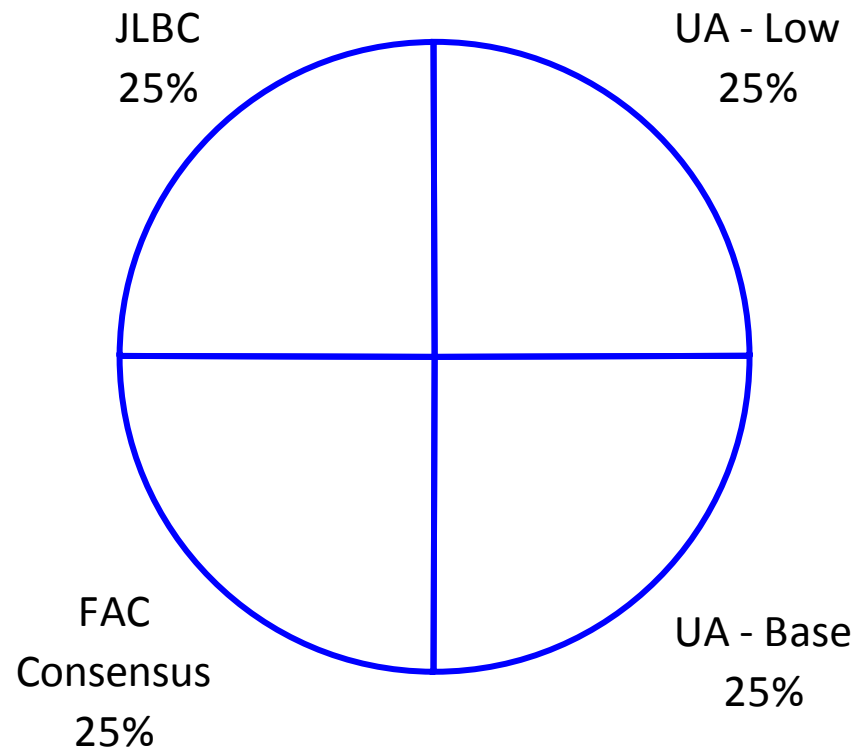
	Healthy Economy	Current AZ Economy
Annual Job Growth	3%	2.1%
New Weekly Unemployment Claims	15,000	25,000
Pending Maricopa Foreclosures	5,000	20,000
Single Family Permits	45,000	10,000
Mortgages Underwater	5%	47%

Where Are We Headed Over the Next Few Years?

- Four-Sector Consensus Forecast Incorporates Different Economic Views, Including the FAC

4-sector forecast equally weights:

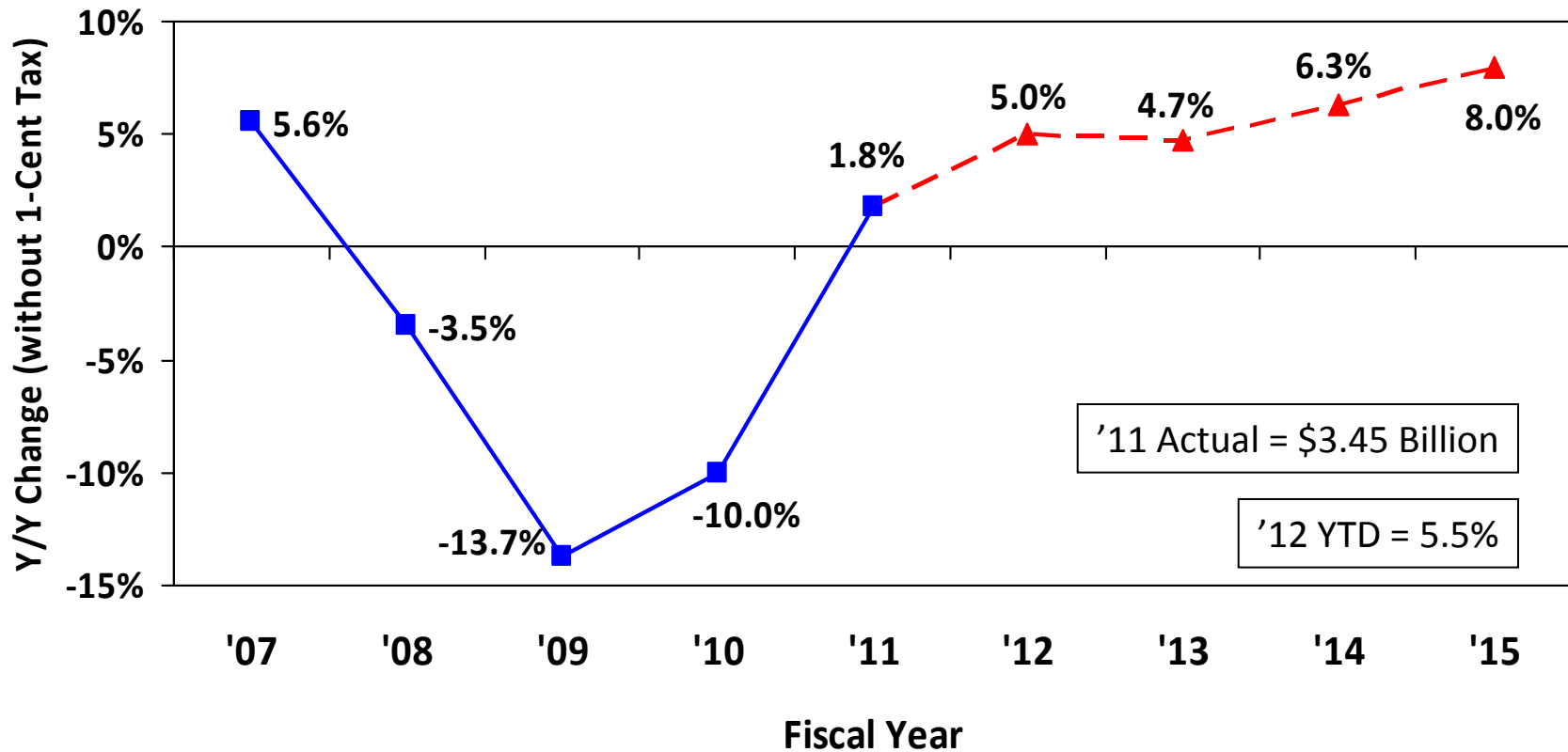
- FAC average
- UofA model – base
- UofA model – low
- JLBC Staff forecast
- Remaining revenues (10% of total) are staff forecast



* Includes Big 3 categories of sales tax, individual income and corporate income taxes

Sales Tax

- The Consensus Forecasts Growth of 5.0% in FY '12 and 4.7% in FY '13



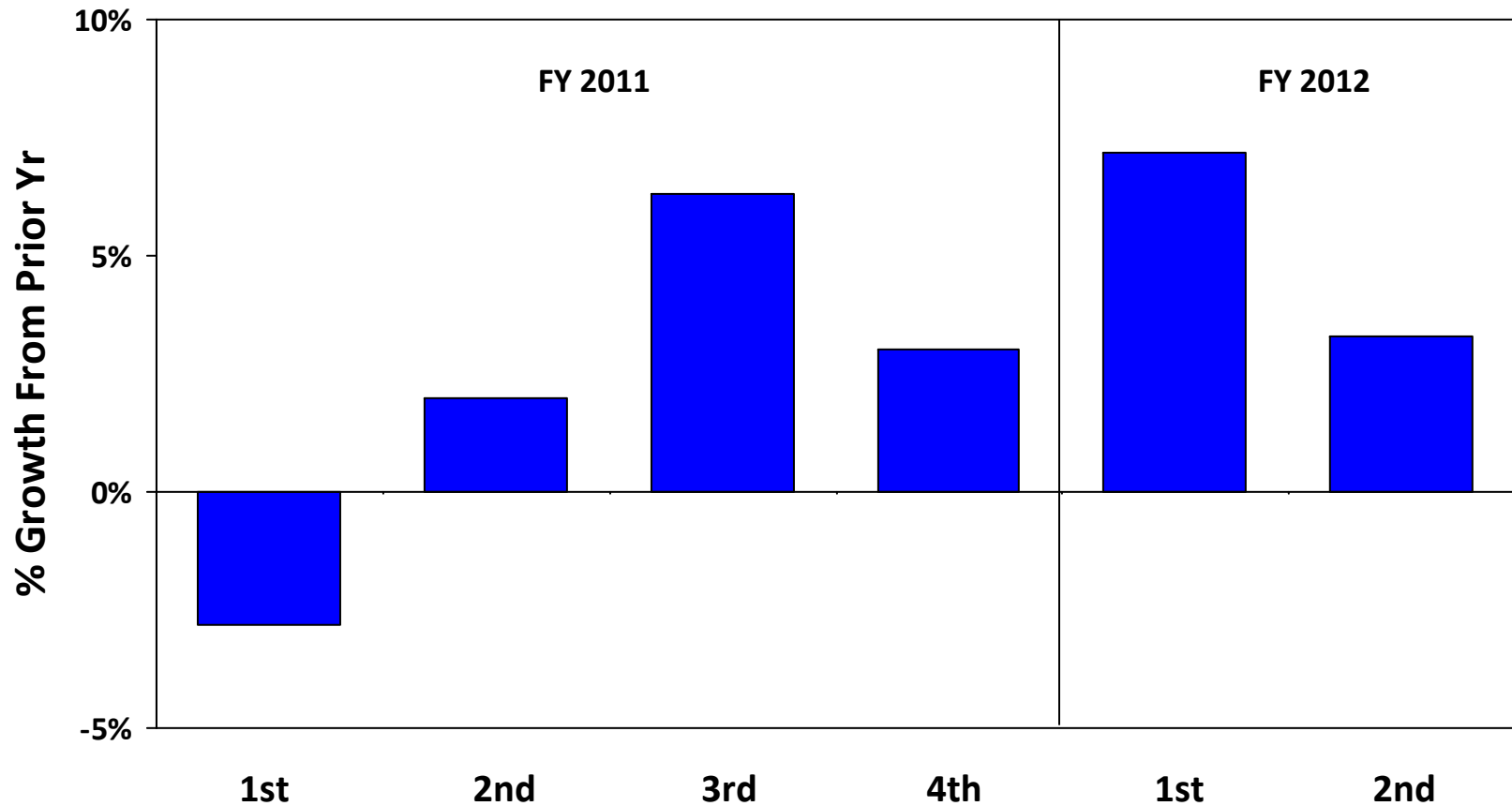
—■— Historical -▲- 4-Sector Forecast

Percent Change in Base Revenue Excluding
Tax Law Changes and 1-Cent Sales Tax



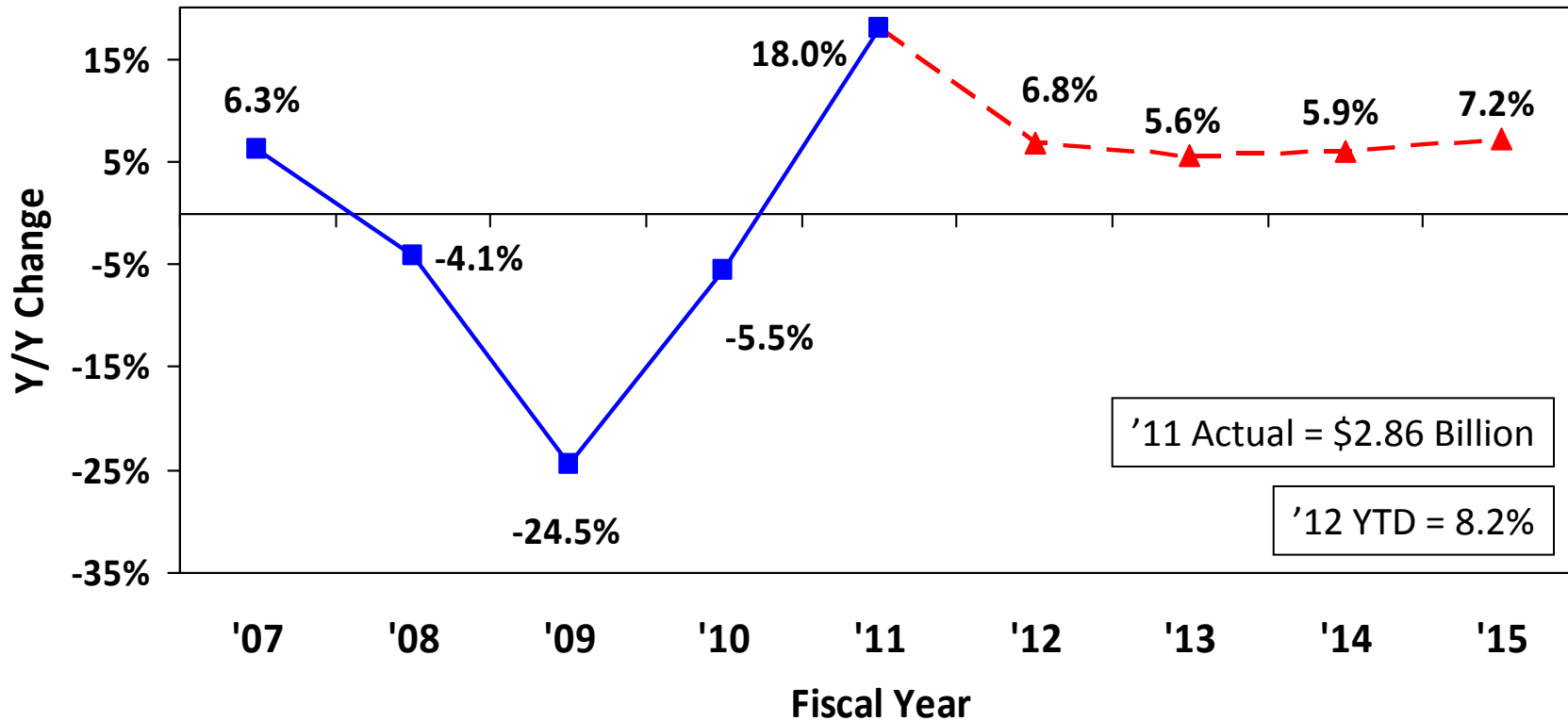
Sales Tax Growth Rate Likely To Slow in 2nd Half

- 5% Growth in 1st Half of '12 Compared To A Low FY '11 Base
- Sales Tax Recovery Began in 2nd Half of FY '11



Individual Income Tax

- The Consensus Forecasts Growth of 6.8% in FY '12 and 5.6% in FY '13



'11 Actual = \$2.86 Billion

'12 YTD = 8.2%

—■— Historical -▲- 4-Sector Forecast

Percent Change in Base Revenue Excluding Tax Law and One-Time Changes



Components of Individual Income Tax Growth

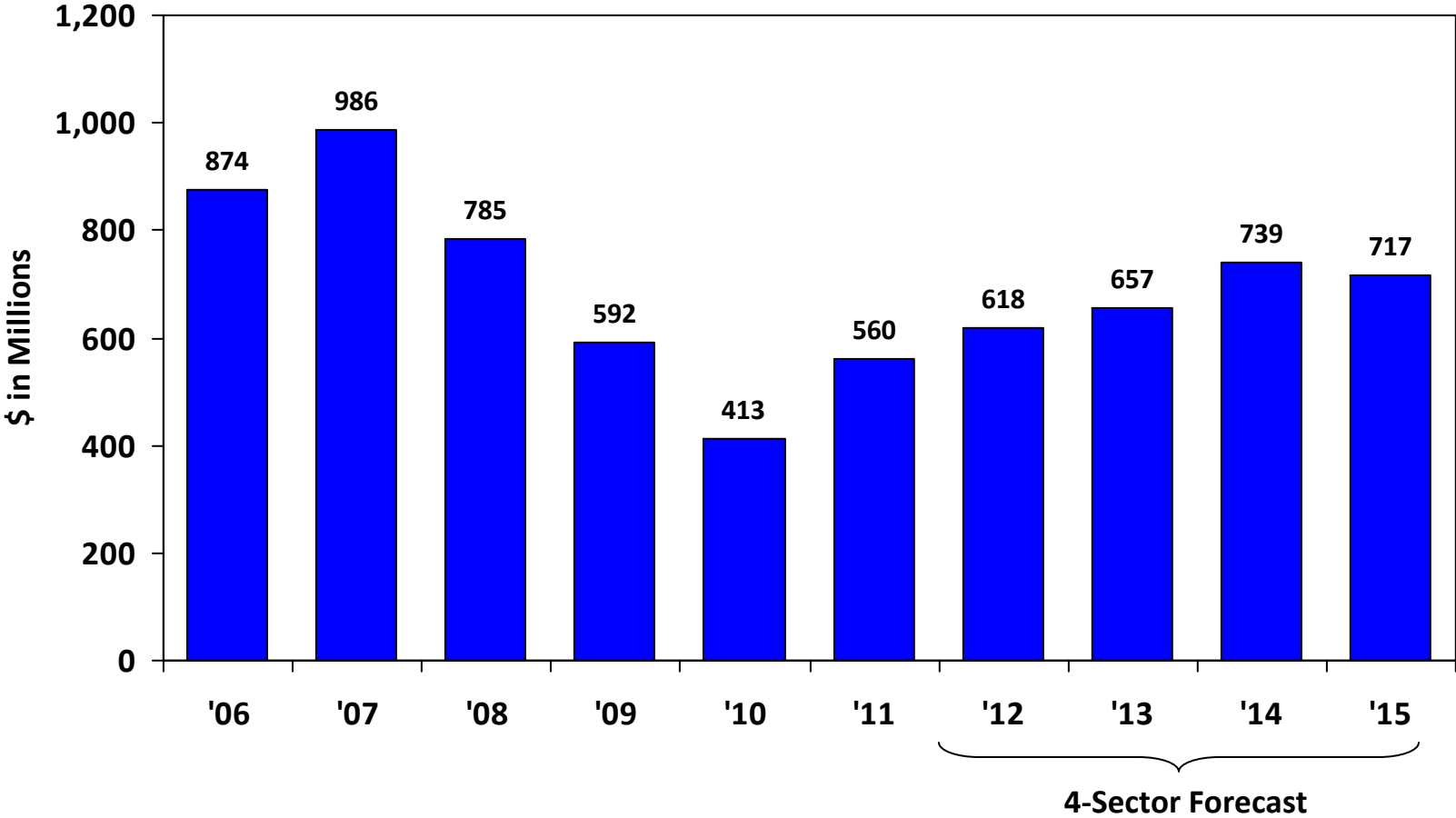
- First Half of of FY '12

Withholding	3.4%
Payments	15.6%
<u>Refunds</u>	<u>(25.3)%</u>
Net	8.2%

- ❑ 3.4% Withholding increase is consistent with current 2% job growth and low wage inflation
- ❑ Payment increase/refund decline is likely a holdover of TY 2010's 18% liability growth

Corporate Income Tax

- Forecast Remains Substantially Below FY '07 High Point



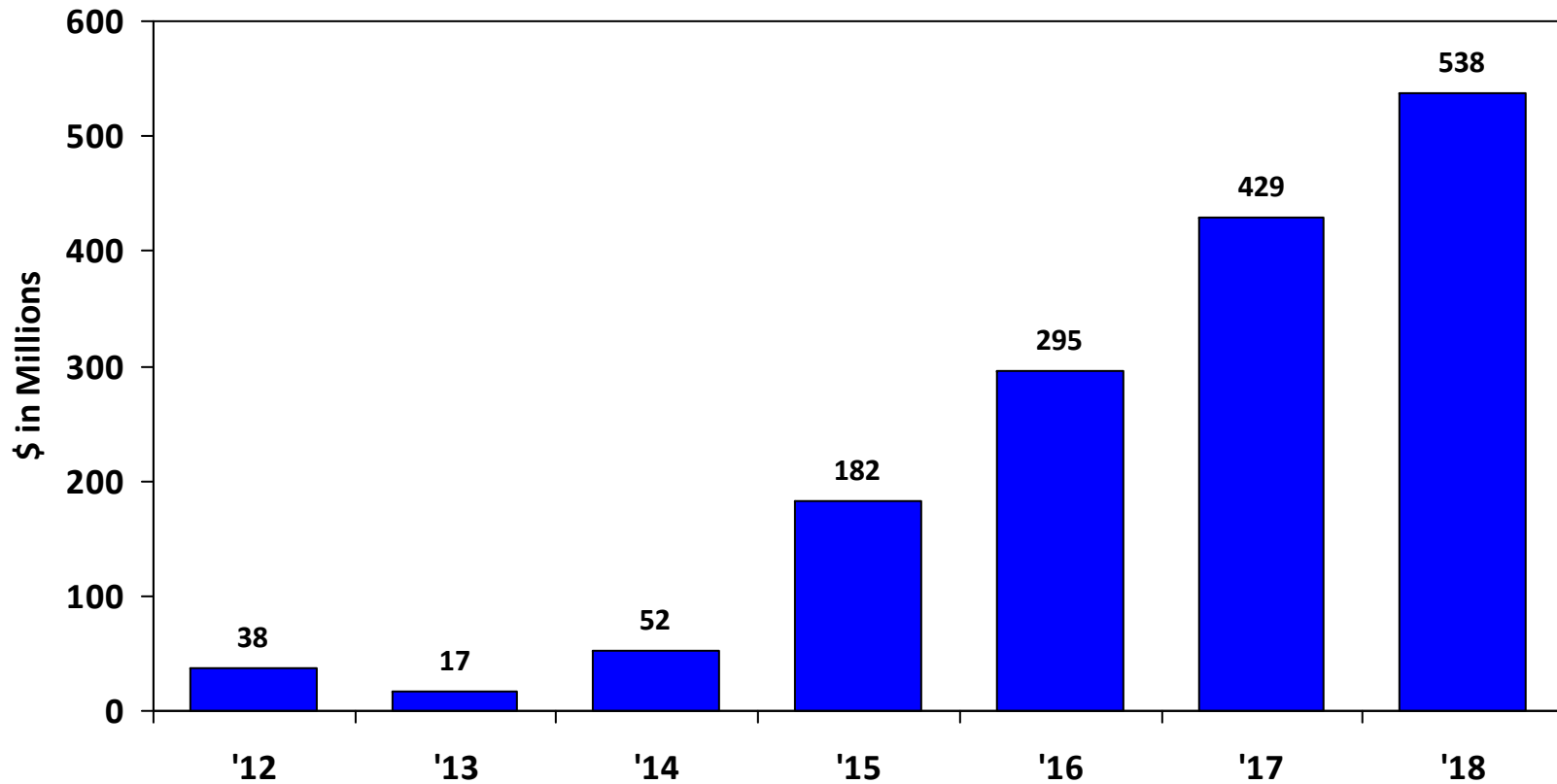
Includes enacted tax law changes and one-time adjustments.



Previously Enacted Tax Law Changes Will Reduce Revenue by \$(91) M in '13

	<u>\$ in M</u>
<input type="checkbox"/> Fewer businesses will make early sales tax payments in June	\$(52)
<input type="checkbox"/> Lottery Bond Debt Service Increase	(17)
<input type="checkbox"/> Jobs Bill/Depreciation and \$3,000 tax credit	(10)
<input type="checkbox"/> Other	<u>(12)</u>
Total	\$(91)

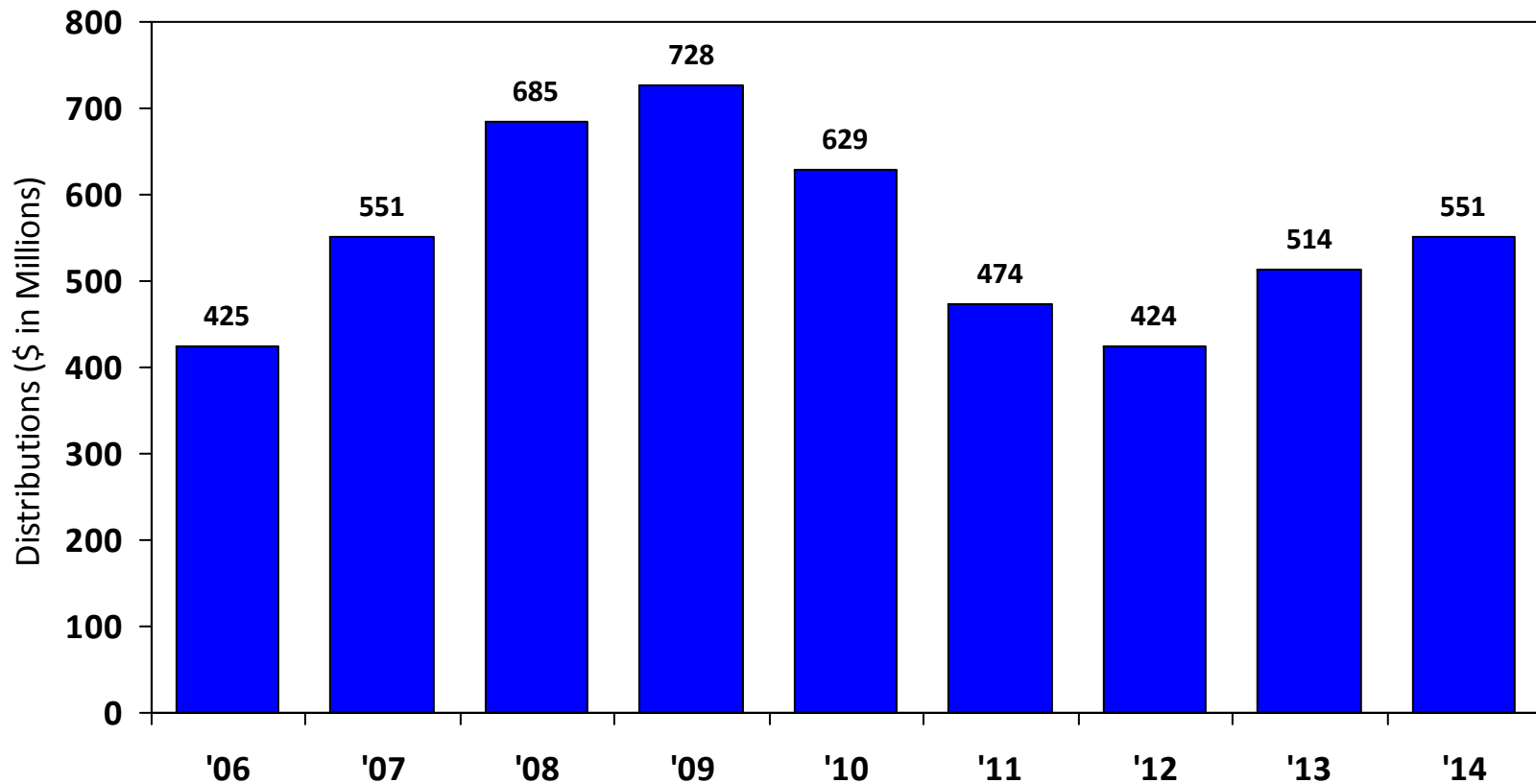
Enacted AZ Jobs Bill Will Not Have Major Fiscal Impacts Until FY 2015



Revenue Loss/Spending Increase Relative to Original FY 2012 Baseline Forecast

State's Distribution to Urban Revenue Sharing Will Increase by \$89 M in '13

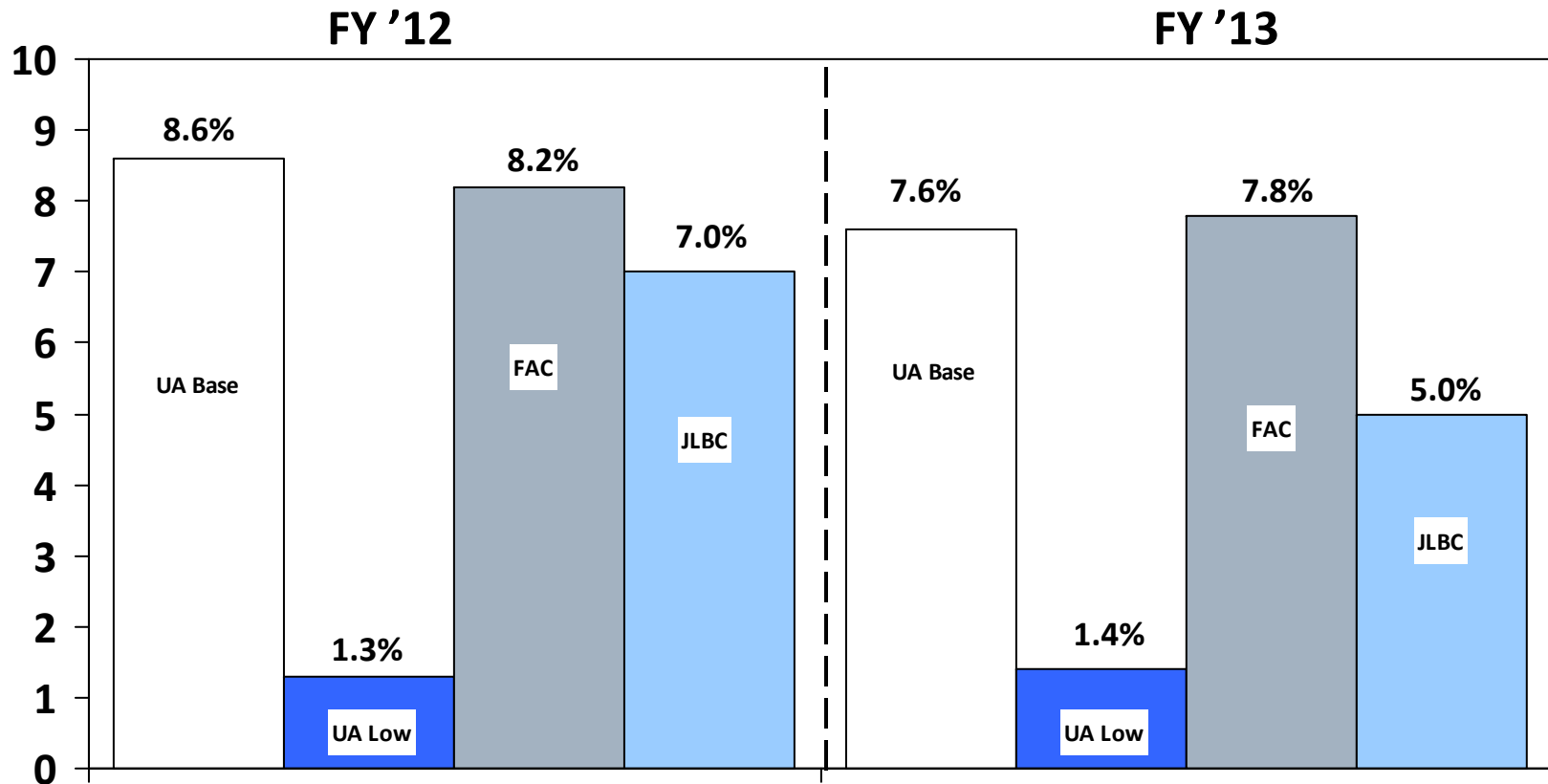
– Amount Linked to Income Tax Collections 2 Years Prior



Baseline Discontinues Fund Transfers and County Cash Payments in FY '13

- ❑ Results in the loss of \$(357) M in revenue, including \$(328) M in fund transfers and \$(39) M in county cash payments
- ❑ Continuing some fund transfers may be re-evaluated during session, especially for internal state funds
 - State employee health insurance fund has \$250M balance
- ❑ While fund transfers have been eliminated, there has been no adjustment in appropriation level of appropriated funds

Consensus Predicts Base Growth Rate of 5.3% in FY '12 and 5.1% in FY '13*

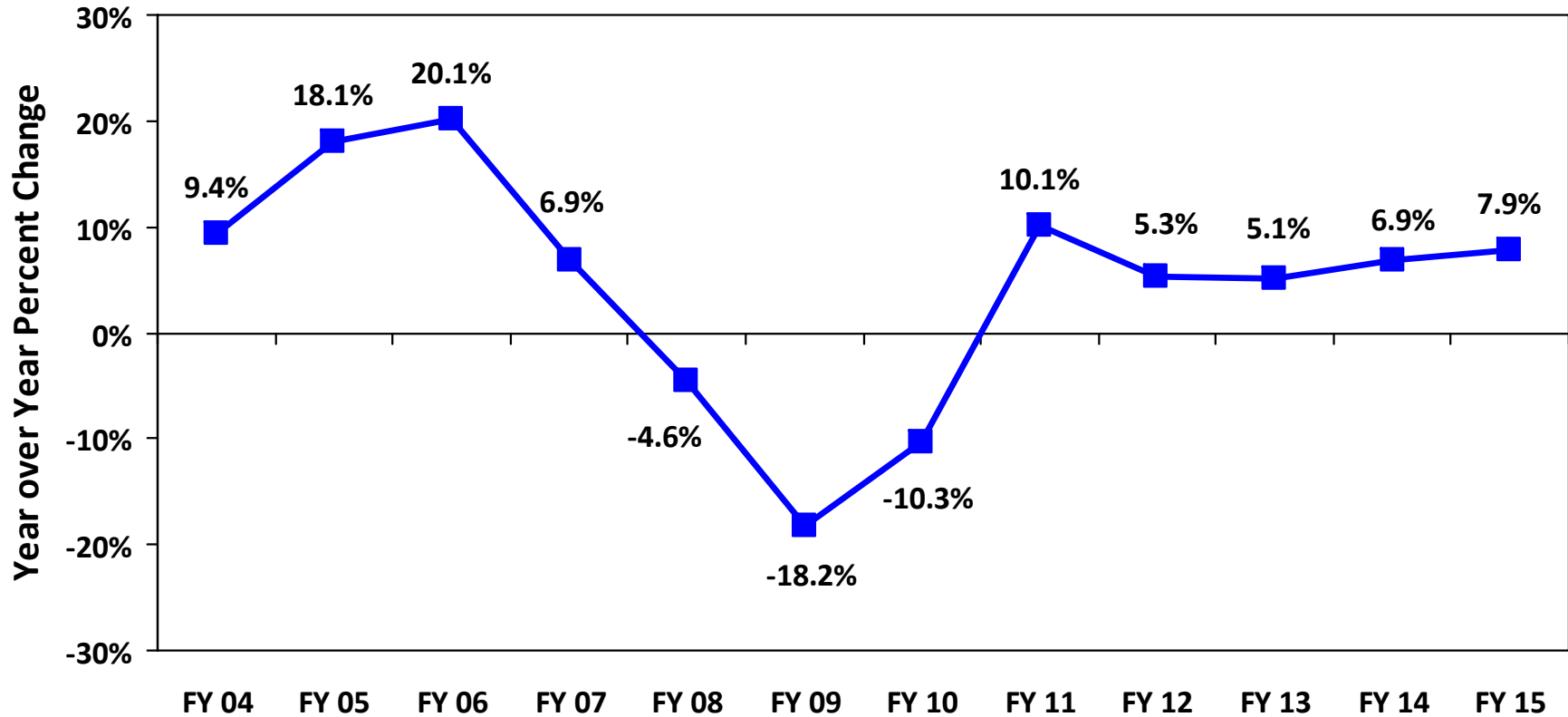


Details in Appendix A

* Weighted Big 3 average growth prior to 1-Cent sales tax is 6.3% in FY '12 and 5.5% in FY '13. After adjusting for small tax categories, the base growth rate is 5.3% in FY '12 and 5.1% in FY '13.



Consensus Forecasts Steadily Rising Revenue Growth Rate Through FY '15



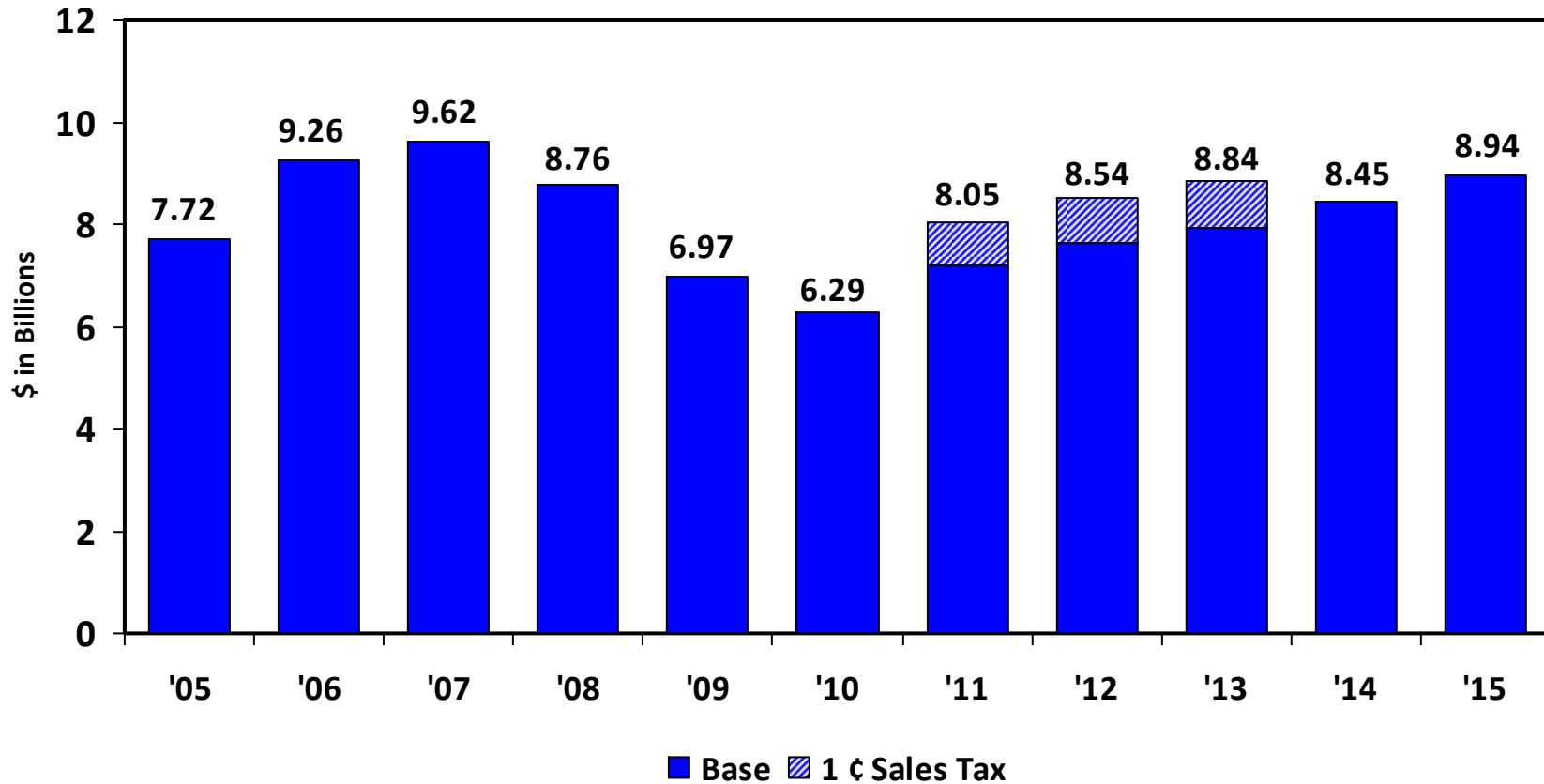
Percent Change in Base revenues excluding balance forward, tax law changes, one-time revenues, and urban revenue sharing



Detail of FY '13 and '14 Revenue Changes

	\$ in Millions	
	<u>FY '13 Above FY '12</u>	<u>FY '14 Above FY '13</u>
Base Revenue Growth (5.1%/6.9%)	415	541
Previously Enacted Legislation	(91)	75
Elimination of One-Time Revenues - Fund Sweeps/County Cash Payments	(357)	--
Urban Revenue Sharing	(89)	(38)
1¢ Sales Tax Expires	--	(913)
Total	(121)	(335)

Consensus Forecasts Remains Below FY '07 High



Excludes balance forward and other one-time revenues. Includes tax law changes and Urban Revenue Sharing.

Risks to the Economic Forecasts

- ❑ Consequences of the European Debt Crisis on the U.S. Economy
 - Difficult to predict outcome, leading some national forecasters to place recession risk at 30%
- ❑ Cannot predict natural disasters or political events ahead of time
 - What will be the Japanese earthquake or Arab Spring of 2012?
- ❑ Consensus forecast assumes above average long-run growth
 - Projections usually become more cautious in the outyears
- ❑ To address these concerns:
 - Develop an alternative revenue scenario with rates 2% below Consensus
 - Cap long term growth rates at 7%

Spending Overview

Detail of the FY '13 and '14 General Fund Baseline Spending Adjustments

	\$ in M	
	<u>FY '13 Above FY '12</u>	<u>FY '14 Above FY '13</u>
K-12 Formula – Enrollment decline in '13, followed by gain in '14	(28)	39
Medicaid caseload, no inflation, \$40 M in '14 for Federal health care requirement	99	206
Debt Service	50	20
Extra Pay Period – One time savings	(79)	0
Other	(12)	3
Total	30	268

* Baseline supports an FTE ceiling of 52,100 positions. Recommend ceiling reduction since 8,600 of those positions are vacant.

JLBC Baseline Summary

JLBC

FY '12 – '14 JLBC Baseline Projections

- ❑ Given the current revenue forecast and active funding formulas, the General Fund is expected to generate a \$583 M balance in FY '12 and \$431 M in FY '13.
- ❑ With the expiration of the 1-cent sales tax in FY '14, State is forecasted to have relatively small shortfall of \$(172) M.

	<u>'12</u>	<u>'13</u>	<u>'14</u>
Revenues	\$8.9 B	\$8.8 B	\$8.5 B
Spending	\$8.3 B	\$8.4 B	\$8.6 B
Balance	\$583 M	\$431 M*	\$(172) M*

*Excludes estimated prior year balance

The Caveats

- ❑ New permanent initiatives would reduce the '13 balance and increase the '14 shortfall
- ❑ A 3-Year budget forecast is inherently unreliable
 - A 2% error could change revenues by \$500 M in the 3rd year
- ❑ Serious federal deficit reduction could increase state costs
- ❑ Pending “budget” lawsuits could cost over \$475 M if plaintiffs are successful

What if Projections Are Not Accurate?

- Short Term Balances Disappear & \$(1) B FY '14 Shortfall

Alternative Assumptions:

- 2% Slower Revenue Growth
- Plaintiffs Prevail in Budget Lawsuits

Projected Balance (+)/Shortfall (-)			
(\$ in M)			
	<u>'12</u>	<u>'13</u>	<u>'14</u>
Baseline	583	431	(172)
Alternative	325	(367)	(1,072)

Legislative Considerations

- ❑ Given the loss of the 1¢ sales tax in FY '14, Staff recommends that we track the impact of '13 decisions on '14 bottom line throughout the budget process
- ❑ The lack of budget reserves leaves little margin for error and hampers our credit rating
 - Pre-recession Rainy Day Fund exceeded \$600 M
 - Arizona has one of the worst state credit ratings
- ❑ The state annually suspends \$700 M in formula spending
 - If funded, the state would no longer have any balances
- ❑ Legislative budget oversight continues to decline
 - The General Fund represents only 31% of the budget, down from 44% in 2000.

Executive Has Higher Revenue and Spending Estimates Than JLBC Baseline

- \$375 M in Revenue and \$802 M in Spending

Revenue

- FY '12: \$4 M
- FY '13: \$371 M

Spending

- FY '12: \$195 M
- FY '13: \$607 M
- Since FY '13 Executive Caseload estimates are \$(99) M below JLBC, all other '13 non-caseload differences exceed \$700 M

What Is The Margin For Error?

- As Measured By Cumulative Unallocated Resources

\$ in Millions			
	<u>FY '12</u>	<u>FY '13*</u>	<u>FY '14**</u>
JLBC Baseline	\$583	\$1,014	\$842
Executive	392	588	330
Executive w/ JLBC Revenue and No Fund Sweeps	388	213	296

* Cumulative Across '12 - '13 ** Cumulative Across '12 - '14

Appendix A: January 2012 4-Sector Forecast

	FY 2012	FY 2013	FY 2014	FY 2015
Sales Tax				
JLBC Forecast	5.1%	5.0%	7.1%	7.3%
UA – Low	2.1%	1.2%	4.9%	9.3%
UA – Base	5.8%	5.8%	6.6%	9.5%
FAC	6.9%	6.8%	6.5%	6.2%
Average:	5.0%	4.7%	6.3%	8.0%
Individual Income Tax				
JLBC Forecast	8.8%	5.0%	6.9%	7.5%
UA – Low	0.2%	1.6%	3.9%	6.9%
UA – Base	10.1%	7.9%	5.5%	7.4%
FAC	8.2%	7.7%	7.0%	7.0%
Average:	6.8%	5.6%	5.9%	7.2%
Corporate Income Tax				
JLBC Forecast	10.0%	4.9%	7.1%	2.4%
UA – Low	2.0%	2.2%	21.7%	17.0%
UA – Base	17.8%	16.1%	21.9%	12.8%
FAC	15.9%	14.2%	9.8%	7.0%
Average:	11.4%	9.7%	15.1%	10.0%
JLBC Weighted Average:	7.0%	5.0%	7.0%	7.0%
UA Low Weighted Average	1.3%	1.4%	5.8%	9.0%
UA Base Weighted Average	8.6%	7.6%	7.5%	9.0%
FAC Weighted Average:	8.2%	7.8%	7.0%	6.6%
“Big-3” Weighted Average	6.3%	5.5%	6.9%	7.9%
Consensus Weighted Average:*	5.3%	5.1%	6.9%	7.9%
Adjusted Consensus Weighted Average:**	5.2%	4.7%	6.7%	6.7%
* Consensus Big-3 Categories adjusted for small revenue categories				
** Consensus Weighted Average adjusted for tax law changes				

