
Finance Advisory Committee

Revenue and Budget Update

January 19, 2017

JLBC

'18 JLBC Baseline is Nominally Balanced

- But Competing Demands Far Outstrip Available \$

- ❑ Baseline compares revenues with funding formula requirements to provide a guideline of available resources
- ❑ The '18 structural balance is \$46 M with a cash reserve of \$159 M
- ❑ The balance is insufficient to address:
 - Proposition 206 minimum wage requirement
 - Continuation of “ongoing” one-time initiatives
 - Affordable Care Act repeal and other fiscal challenges
 - **Revenue forecast uncertainties**
 - \$289 M in Executive spending and tax initiatives

Revenue Overview

Arizona's Budget Picture Better than Most

- Numerous States Have Budget Problems

	<u># of States</u>
<input type="checkbox"/> Reduced the Enacted Budget Mid-Year	17
<input type="checkbox"/> Revenues Below Budgeted Forecast	25
<input type="checkbox"/> Balance Less than 5%	14
<input type="checkbox"/> Declining Balances	28*

*Arizona was only in the “Declining Balances” category

Arizona Ranks 14th in Economic Momentum

- State Policy Reports – Joint NGA/NCSL Project

	<u>AZ Rate</u>	<u>AZ Rank</u>
<input type="checkbox"/> Change in Personal Income (Sept)	3.8%	18
<input type="checkbox"/> Change in Population (July)	1.7%	8
<input type="checkbox"/> Change in Employment (Nov)	1.1%	29
<input type="checkbox"/> Unemployment Rate (Nov)	5.0%	32

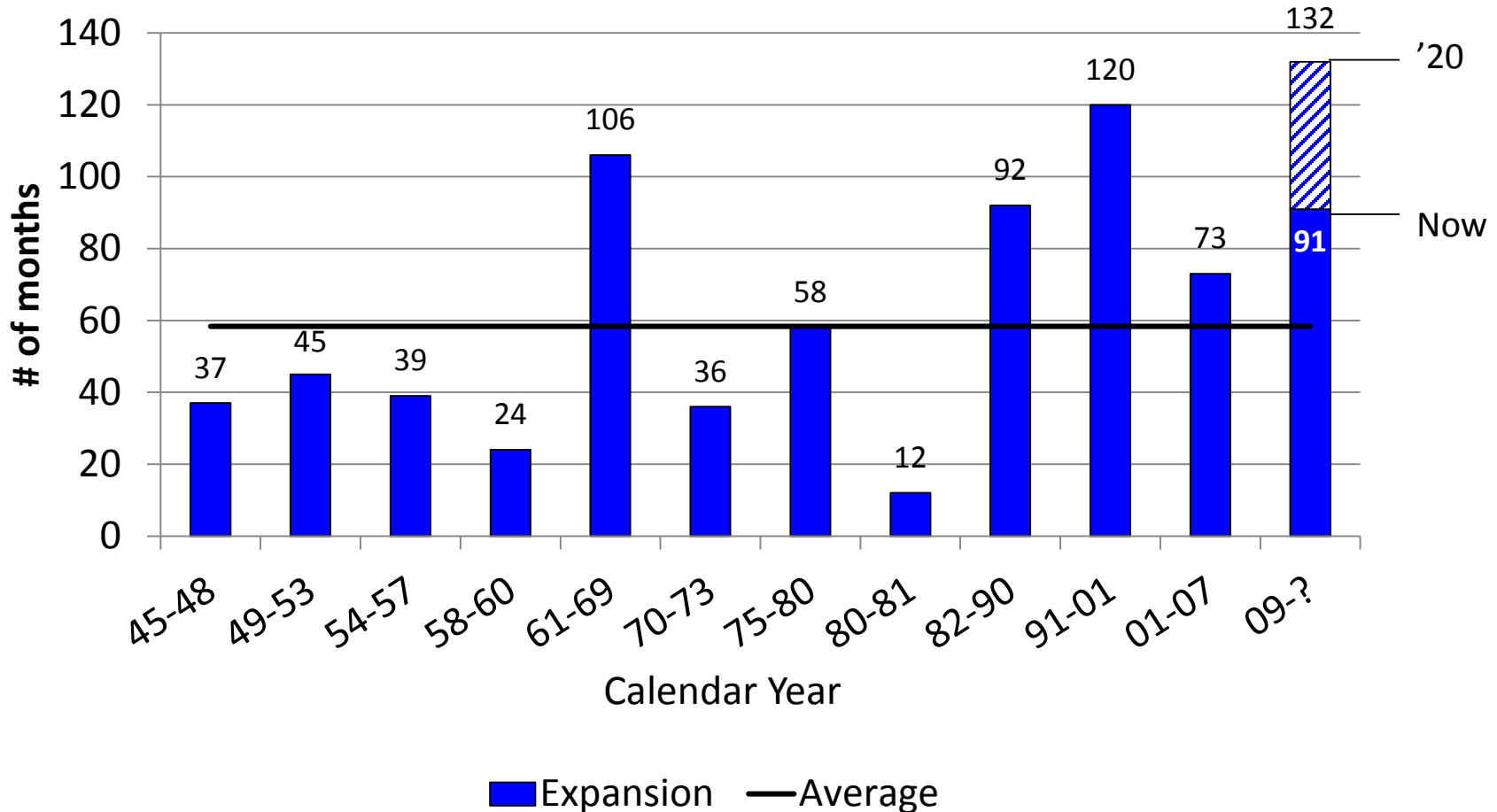
Revenue Forecast Uncertainties

- Department of Revenue Staffing
 - Unknown impact of 1/3rd reduction in DOR collections/audit staff
 - Forecast has not been specifically adjusted, but staff reduction may have affected FAC panelists' estimates
 - DOR hopes to offset loss of staff with greater e-filing, but impact unlikely to be immediate

- Federal Fiscal and Monetary Policy
 - New tax reductions and infrastructure spending likely to stimulate the economy
 - If federal deficit grows, interest rates could rise and offset the fiscal policy stimulus
 - Federal Reserve will need to chart a course on interest rates as events unfold

Current Expansion Reaching Record Length

Length of US Economic Expansions



'17 YTD Continues Slow '16 Revenue Growth

	<u>'16 Actual</u>	<u>'17 YTD</u>
Sales	2.9%	3.1%
Individual Income	5.5%	3.6%
Corporate Income	(13.9)%	(24.0)%
Insurance Premium	9.1%	28.2%
Other	12.2%	16.5%
Overall	<u>3.5%</u>	<u>3.0%</u>

- Includes preliminary December estimates
- Revenues exclude fund transfers and urban revenue sharing
- Through December, year-to-date revenues \$37 M above forecast

How Does JLBC Forecast Revenues?

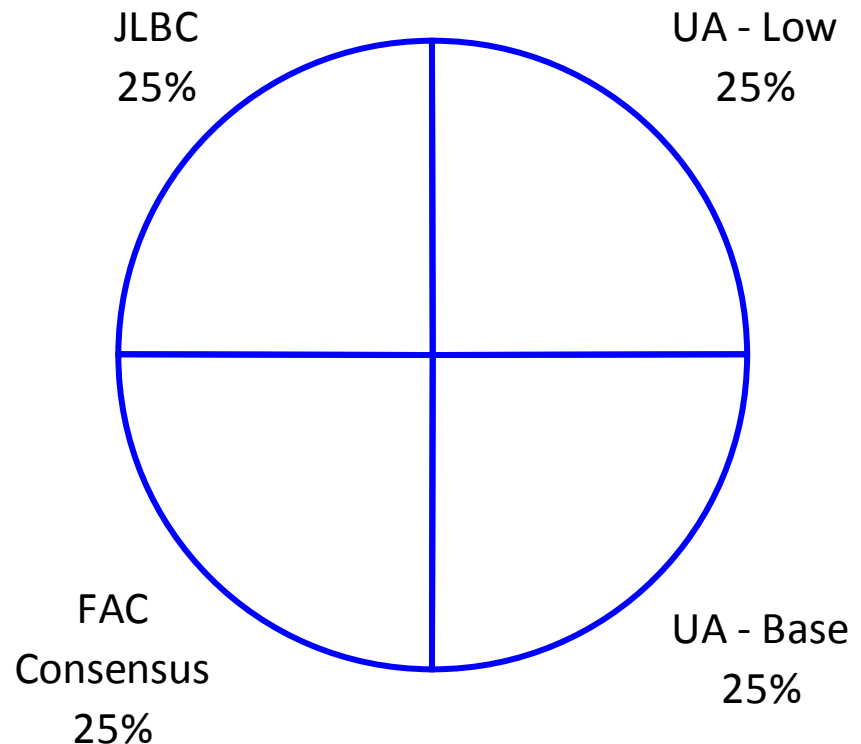
- Four-Sector Consensus Forecast

4-sector forecast equally weights:

- FAC average
- UofA model – base
- UofA model – low
- JLBC Staff forecast

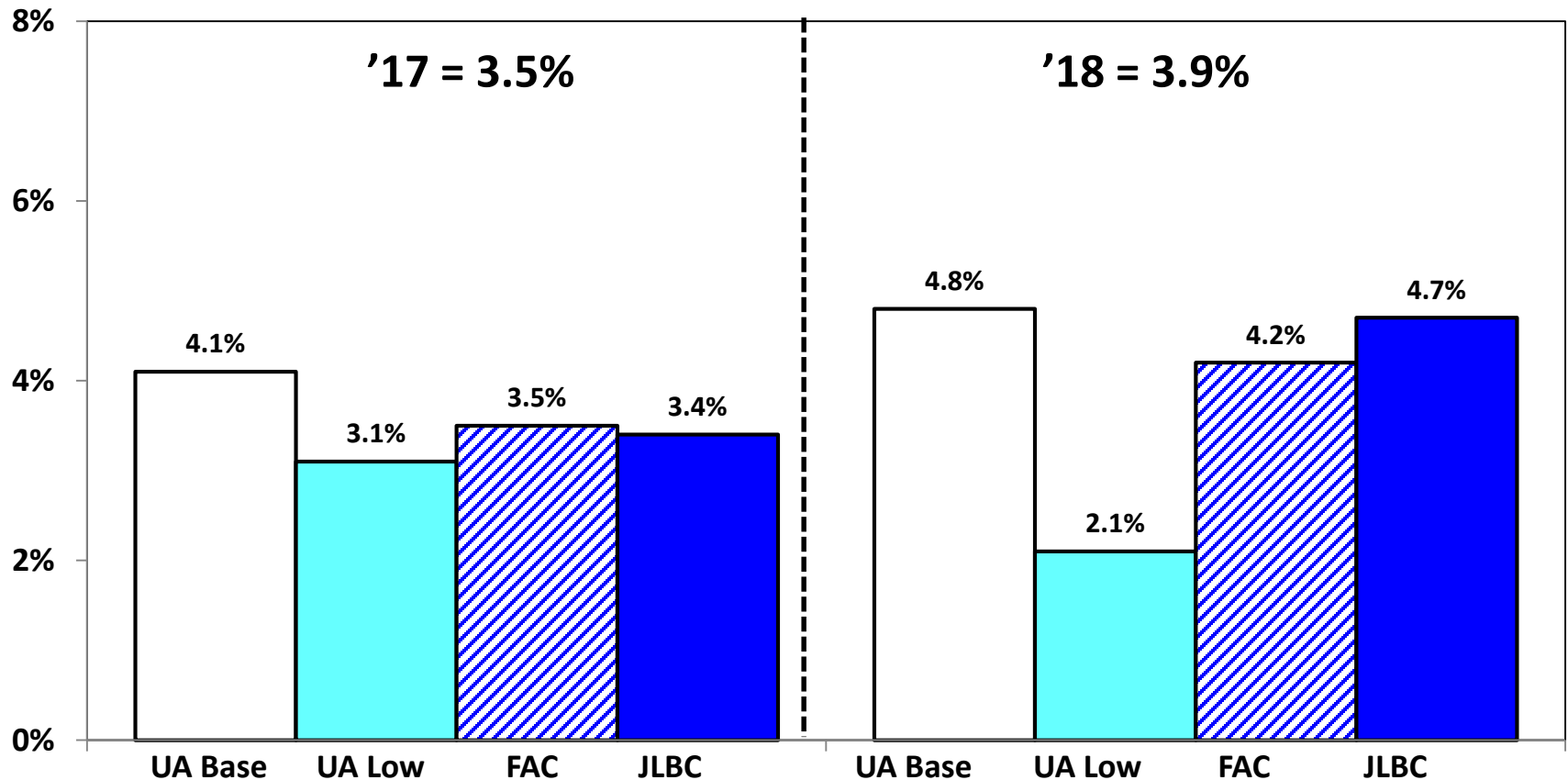
Model Includes:

- Sales Tax
- Individual Income Tax
- Corporate Income Tax
- Insurance Premium Tax
- Remaining revenues (5% of total) are staff forecast



* The Finance Advisory Committee is a 14-member panel of public and private sector economists that publicly meets 3 times a year to advise the Legislature on the state of the Arizona economy.

4-Sector Base Growth is 3.5% in '17 & 3.9% in '18

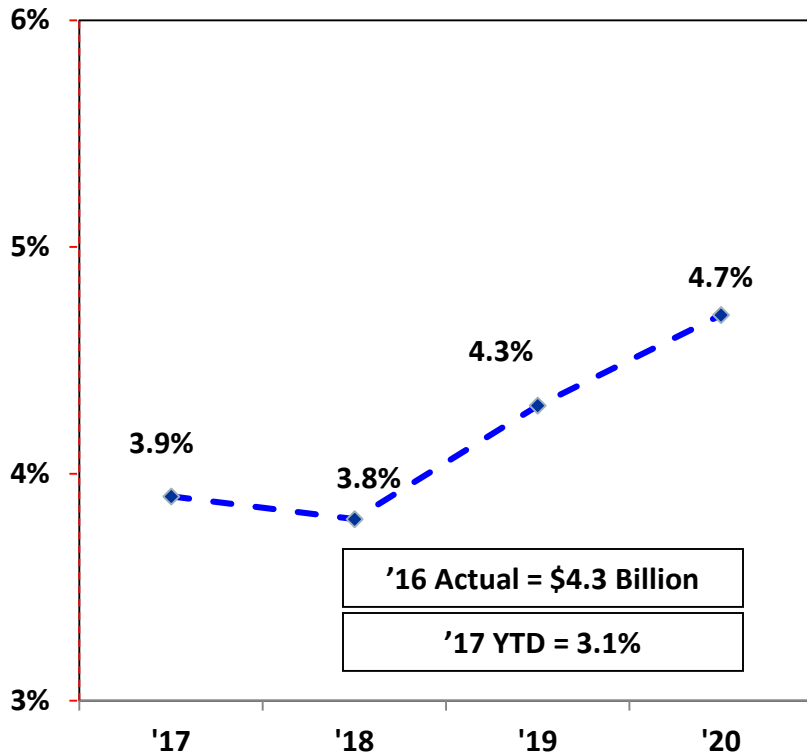


Details in Appendix A

Prior to adjusting for small tax categories, the Big 4 base growth rate is 3.6% in '17 and 4.0% in '18

Sales Tax

- Projected Growth of 3.9% in '17 and 3.8% in '18



—◆— 4-Sector Forecast

Percent Change in Base Revenue Excluding Statutory Changes

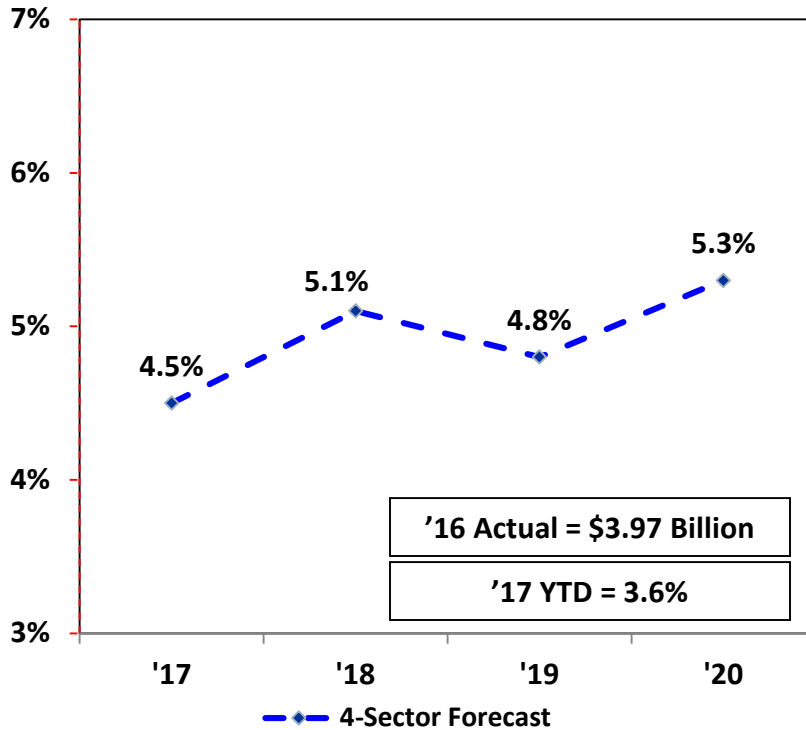
Consumers are more cautious after the Great Recession:

Sales Tax Growth

	<u>AZ</u>	<u>US</u>
Pre-Recession	7.5%	4.8%
Post-Recession	3.0%	3.4%

Individual Income Tax

- Projected Growth of 4.5% in '17 and 5.1% in '18



Percent Change in Base Revenue Excluding Statutory Changes

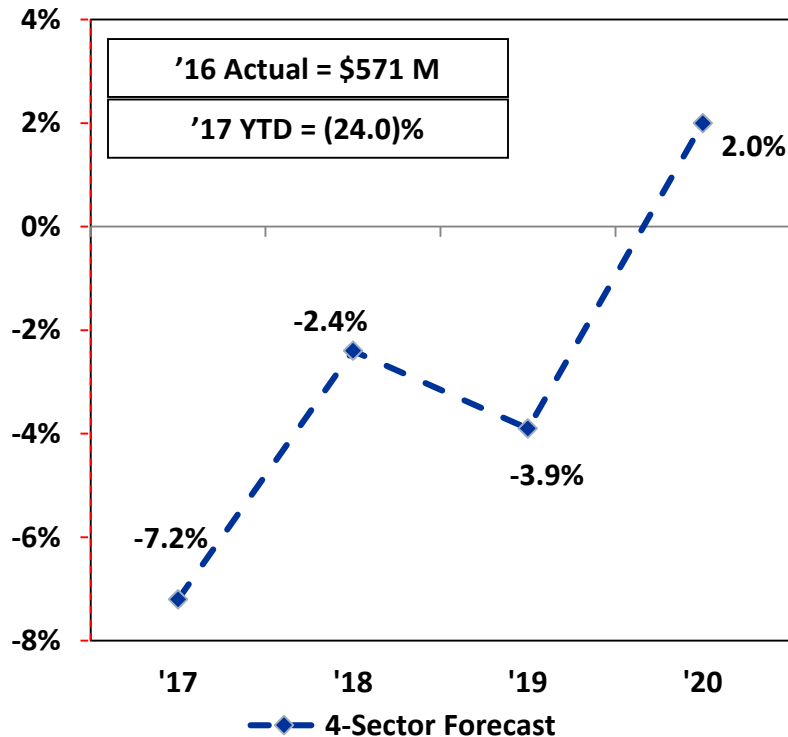
Percent Gain Above Prior Year

	'16	YTD '17
Withholding	4.0%	6.0%
Payments	8.9%	(5.7)%
Refunds	4.6%	8.6%
Total	5.5%	3.6%

- ❑ After technical change, '17 withholding growing 4.7%—highest since '11
- ❑ Since employment only up 2.1%, withholding may reflect wage increases

Corporate Income Tax

- Projected Decline of (7.2)% in '17 and (2.4)% in '18

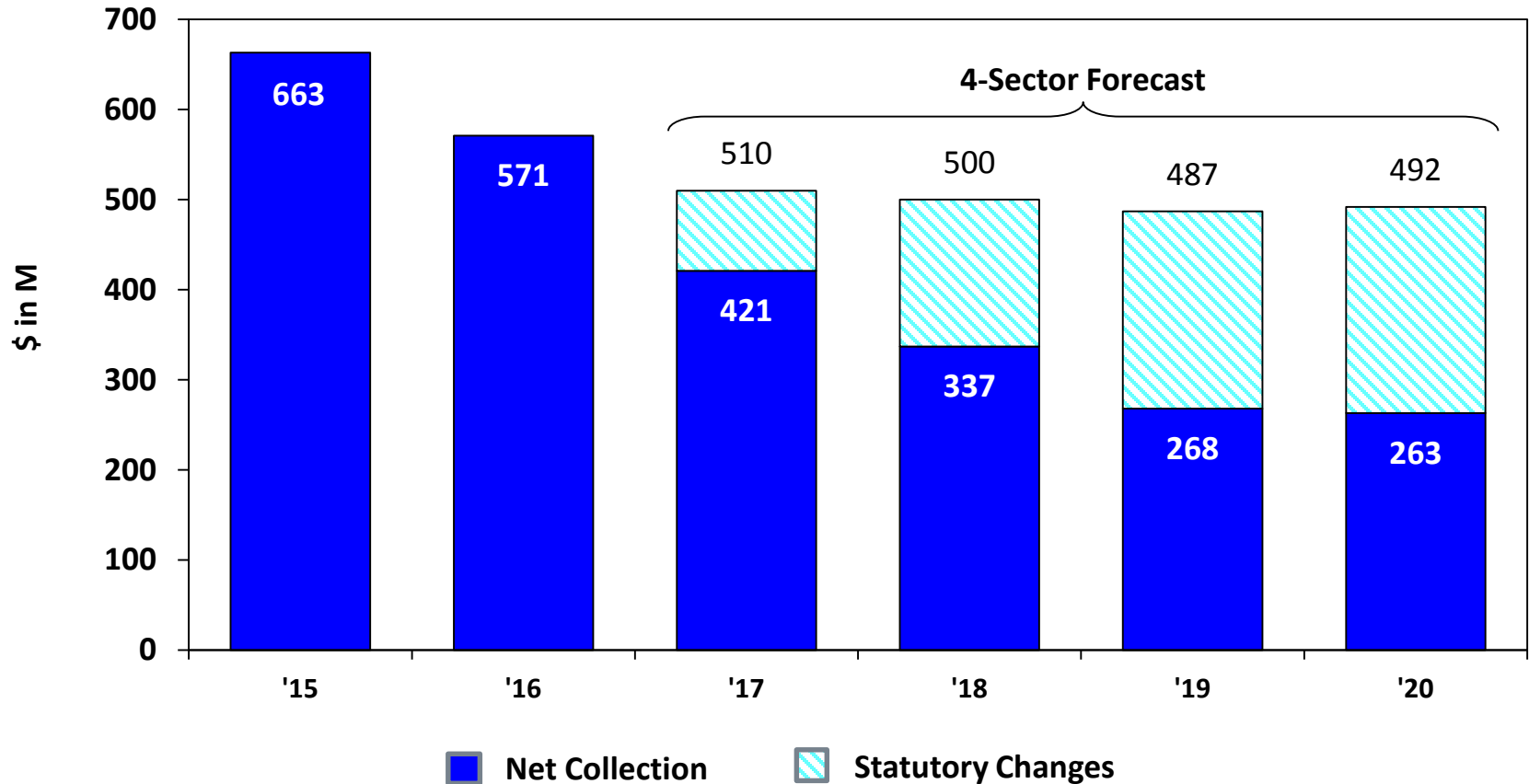


Percent Change in Base Revenue Excluding Statutory Changes

- Base Revenue is to reflect corporate collections prior to tax reductions
- 3-year decline of (14)% seems pessimistic
- Panelists may be pricing in impact of fewer DOR auditors

'20 CIT Projected to be \$263 M

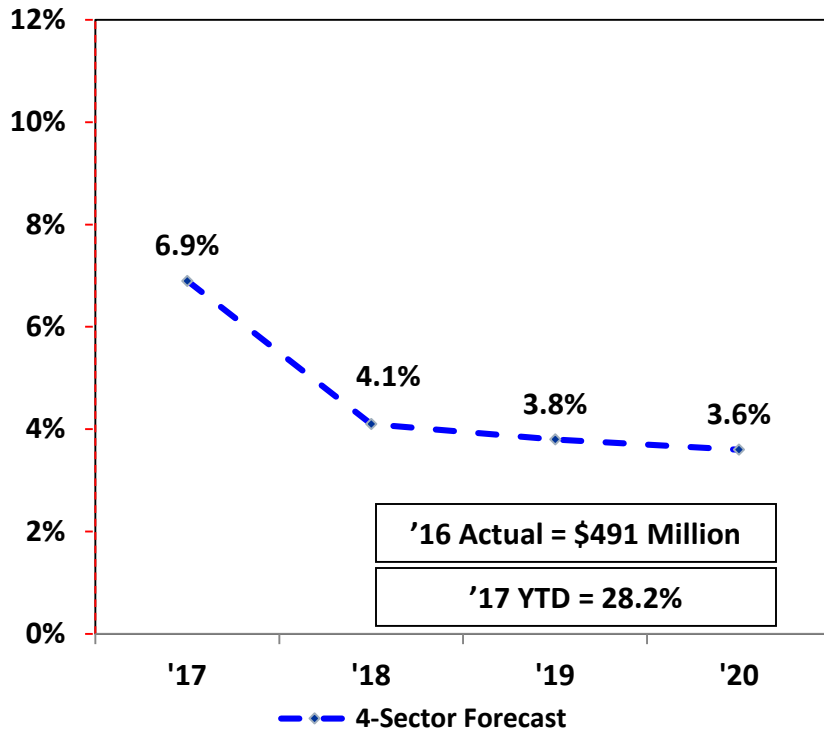
- Primary Reductions are 2% Rate Cut and 100% Sales Factor



Given taxpayer confidentiality, timing of tax reductions highly uncertain

Insurance Premium Tax

- Projected Growth of 6.9% in '17 and 4.1% in '18



Percent Change in Base Revenue Excluding Statutory Changes

- ❑ IPT (\$516 M) expected to exceed CIT (\$421 M) in '17
- ❑ As a result, IPT is now included in FAC and UA forecasts
- ❑ 27% growth in last 3 years — aided by AHCCCS expansion
- ❑ 28.2% YTD growth impacted by timing issues
- ❑ Changing the Affordable Care Act could impact collections

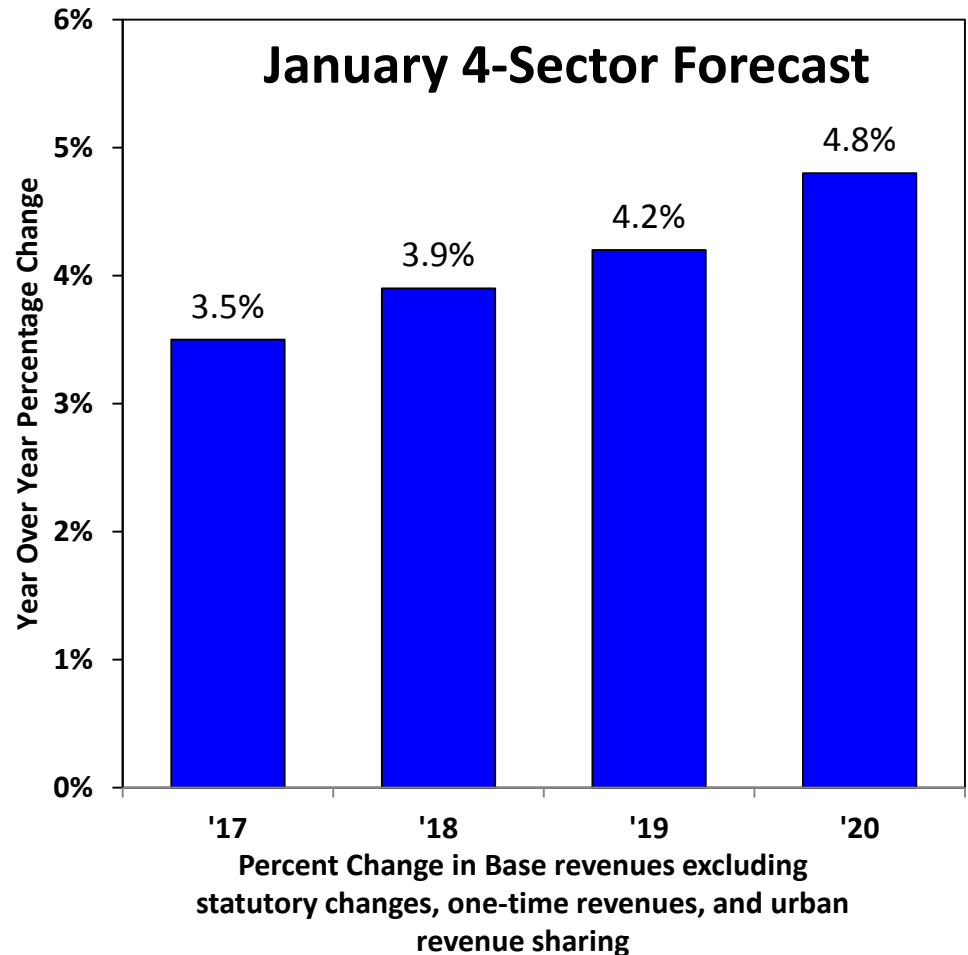
Growth Accelerates Through '20

Chance of Exceeding Forecast

60%

Long Run Average Growth

4.6%



Details in Appendix A

Phase-In of \$196 M of Enacted Tax Reductions

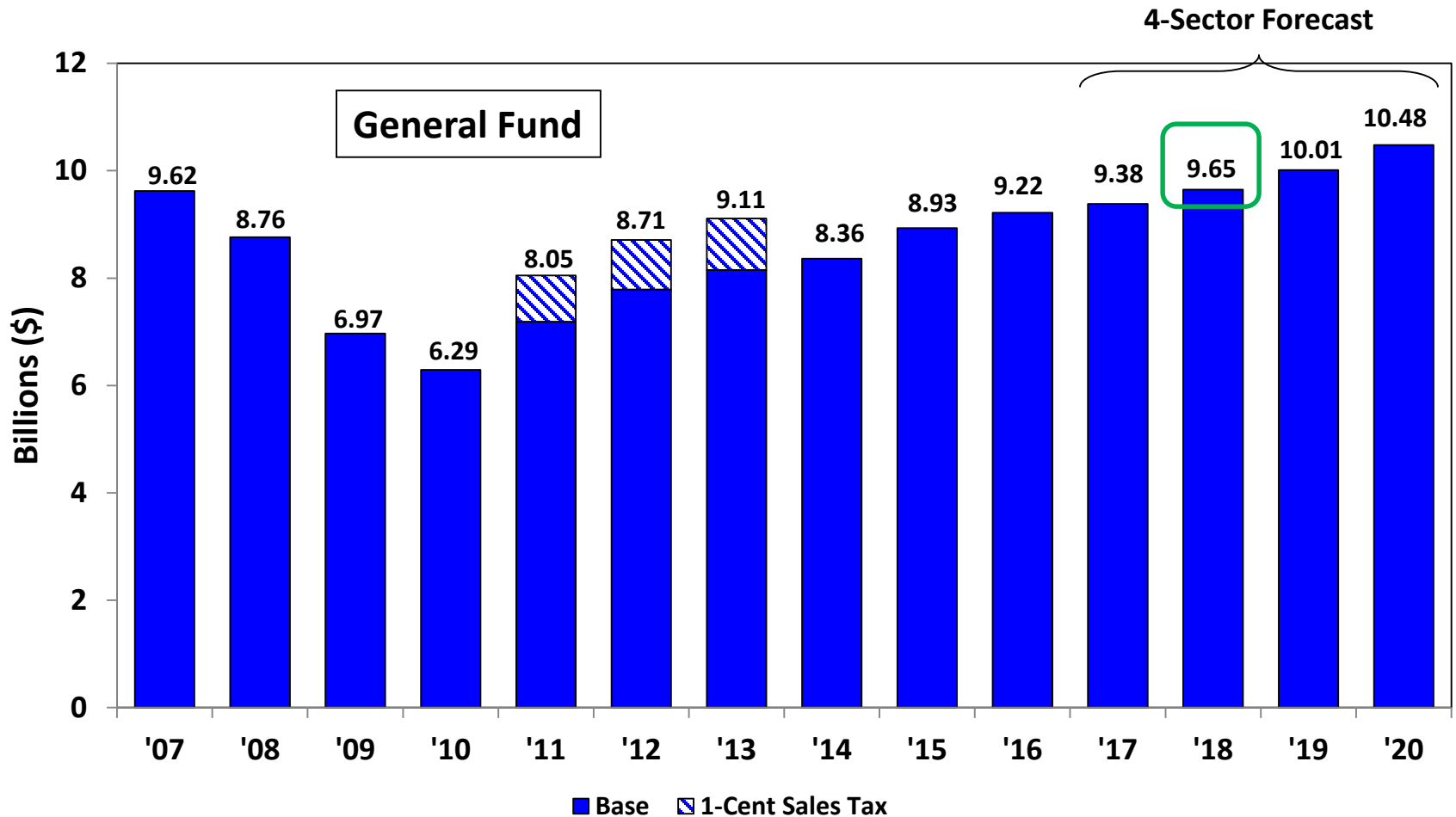
	\$ in M*		
	<u>'18</u>	<u>'19</u>	<u>'20</u>
Corporate Rate Reduction/Sales Factor	(62)	(43)	(0)
Corporate/IPT School Tuition Indexing	(12)	(15)	(18)
Bonus Depreciation Full Conformity	(8)	(0)	(0)
Expiring R&D Credit Enhancement	0	3	8
Manufacturing Electricity Exemption	(12)	(0)	(0)
Other	<u>(13)</u>	<u>(11)</u>	<u>(13)</u>
Total	(107)	(66)	(23)

*By '20, revenue base is \$(196) M lower than in '17

Adjustments Reduce Growth Rate to 0.2% in '18

	\$ in M		
	<u>'18</u>	<u>'19</u>	<u>'20</u>
Base Revenue Growth (3.9%/4.2%/4.8%)	394	430	508
One-Time Fund Transfers	(79)	0	0
Previously Enacted Tax Legislation	(107)	(66)	(23)
Urban Revenue Sharing	(17)	(0)	(18)
Beginning Balance Reduction	(170)	(114)	0
Total Revenue Changes	21	250	467
Total Revenue	\$9,761	\$10,011	\$10,478
% Change	0.2%	2.6%	4.7%

Forecast Reaches Pre-Recession Level in '18



Excludes balance forward and other one-time revenues. Includes tax law changes and urban revenue sharing.

Spending Overview

Projected Baseline Spending Changes

- '18 Statutory Spending Offset By Elimination Of 1-Times

Spending Above Prior Year

	\$ in M
	<u>'18</u>
ADE – K12 Formula	79
AHCCCS – Medicaid Formula	44
DES – Medicaid Formula	18
Corrections — Annualize Bed Cost	7
DCS	<u>0</u>
Total	148

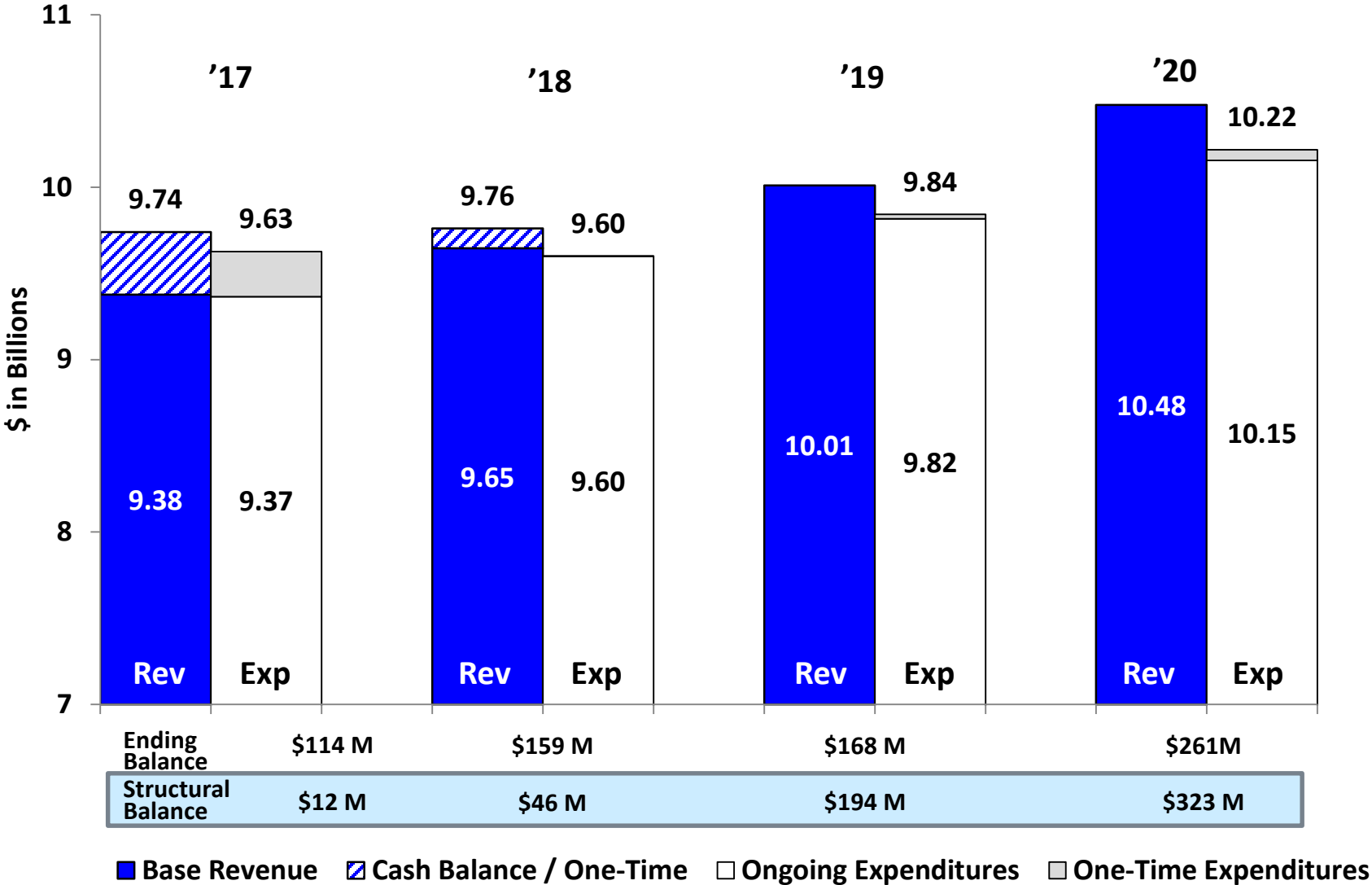
Spending Below Prior Year

	\$ in M
	<u>'18</u>
Capital – ADOT Highway Projects	(57)
Counties – Cost Sharing Offset / HURF	(38)
Capital - \$8 M ADOA/\$10 M Vets Home	(18)
SFB — Building Renewal	(16)
Universities — Eliminate 1-Time \$	(15)
DPS – Border Task Force Equipment	(15)
Other	<u>(14)</u>
Total	(173)

Total Spending Changes	\$(25) M
Total Spending	\$9,602
% Change	-0.3%

Cash and Structural Balance Forecast

Baseline Balances Improves Over Time, But...



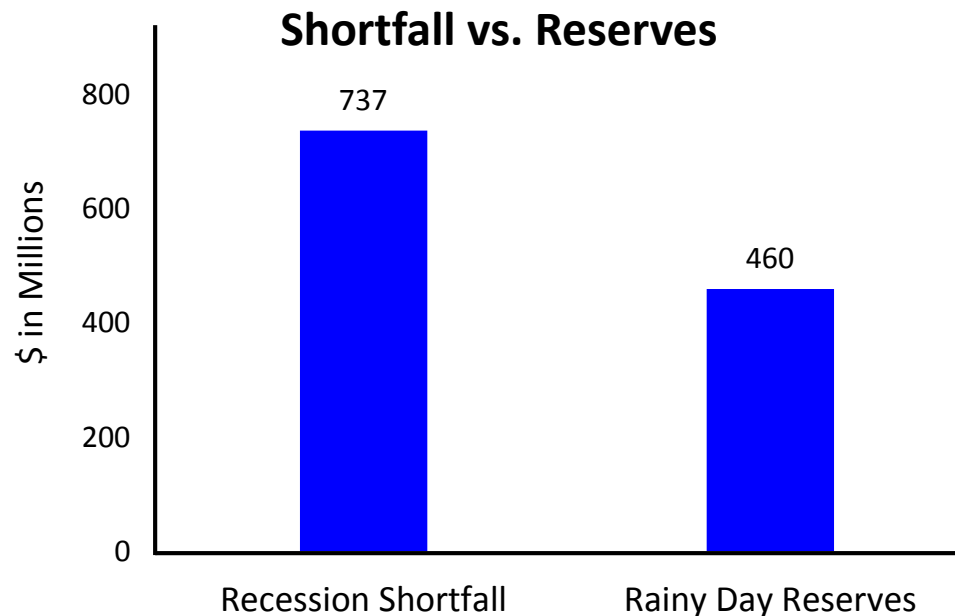
Projected ending balances assumed to be allocated as part of the budget process



How Would a Recession Affect the Budget?

- “Stress Test” Evaluates Level of Reserves in a Recession

- Compared to base revenue growth of 3.9% in '18, stress test revenues decline (5)%, or \$(896) M
- \$(737) M shortfall under stress test



Executive Comparisons

Comparing the Executive Budget and JLBC Baseline

- ❑ Executive spends down most of balance
- ❑ Higher revenue and lower caseloads also allow more Executive spending

\$ in M

\$159	JLBC Baseline '18 Ending Balance
37	Higher Exec Ongoing Revenues
38	1-Time Behavioral Health Transfer/Other
67	Lower Exec Caseload/Baseline
5	Higher Exec Carryforward

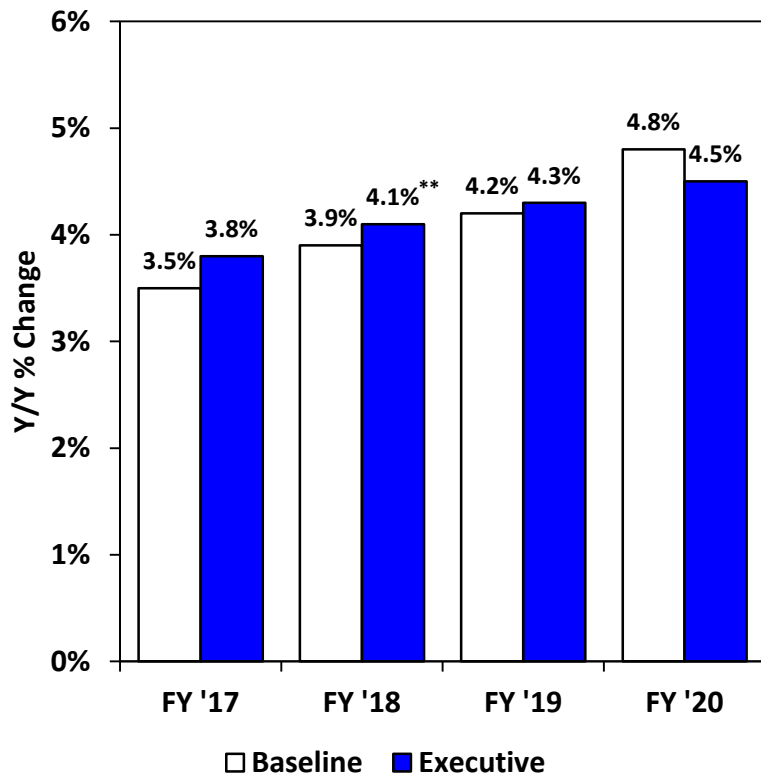
Policy Issues

(251)	Net Spending Increases
(38)	Revenue Reductions

\$17 **Executive '18 Ending Balance**

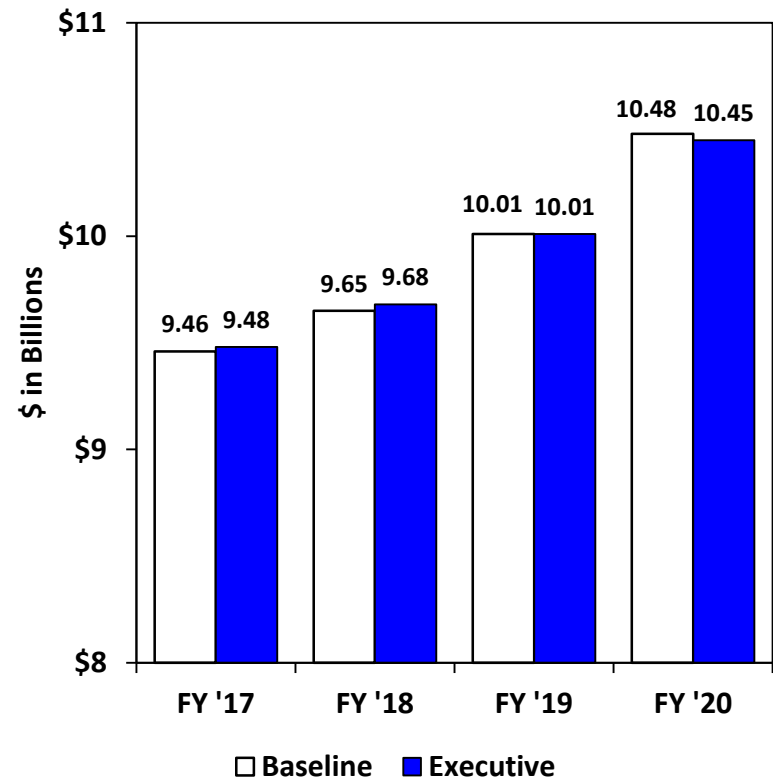
'18 Executive Base Revenue \$37 M Higher - Plus \$38 M Behavioral Health Transfer/Other

Base Growth Rate*



*Excludes tax law changes and one-time revenue
**4.3% when compared to JLBC '17 base

Total Revenue***



*** Excluding Balance Forward and Including Executive Fund Transfers of \$38 M in '18

\$38 M in Executive Revenue Reductions

	<u>\$ in M</u>
<input type="checkbox"/> Allow Universities to Retain TPT	\$30.3
▪ Universities also retain \$6.5 M local share	
▪ May increase university bonding capacity	
▪ Universities would provide matching funds	
<input type="checkbox"/> Index Personal Exemption	\$2.9
<input type="checkbox"/> Other (Reduce Judiciary Transfers, Revenue Shift)	<u>\$5.2</u>
Total	\$38.4

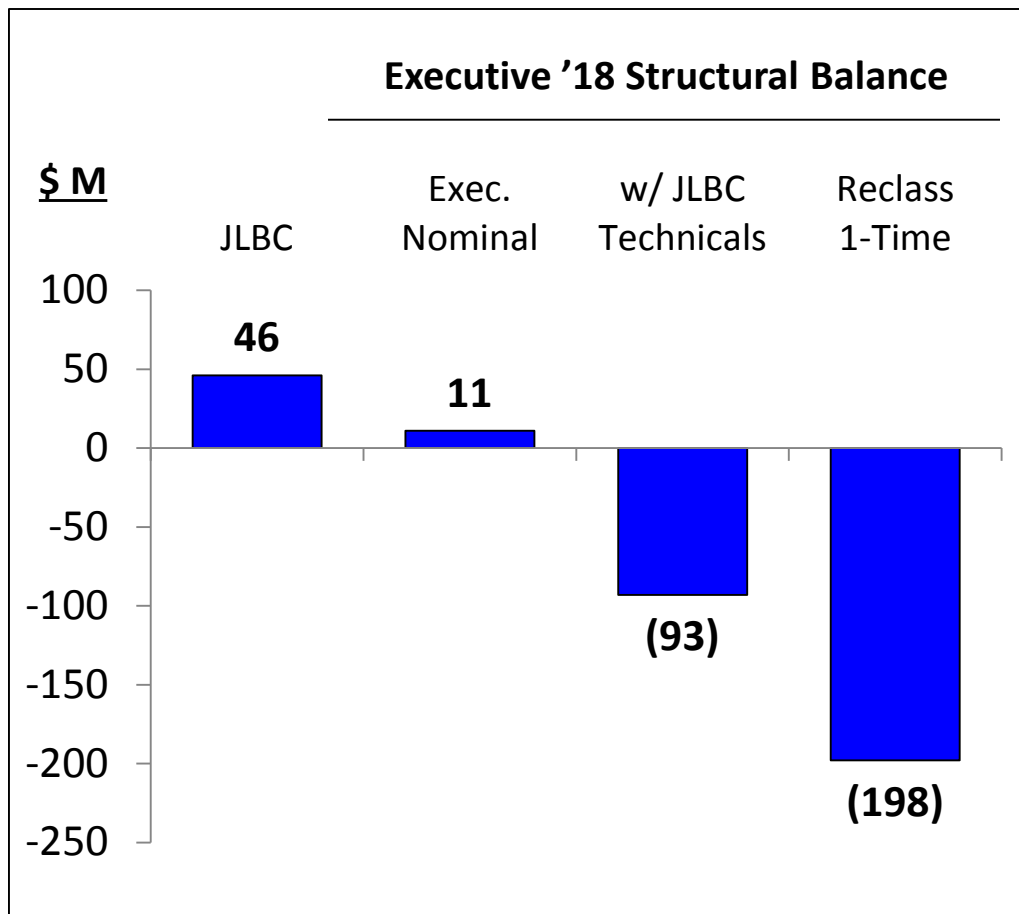
Who Pays the Transaction Privilege Tax?

- Most Other States have a Buyer-Based Sales Tax

- ❑ AZ has a TPT on sales of goods that is the legal responsibility of the seller
 - Seller likely shifts this cost to the buyer
- ❑ As a result, Arizona can effectively tax government purchases. “True” sales tax states usually exempt government purchases
- ❑ Executive would exempt sellers from paying TPT on any purchases by the universities
- ❑ AZ may be 1 of 6 states that effectively taxes university purchases—but there is some link to having a seller-based system

How Different Assumptions Affect Structural Balance

- Difference Between Ongoing Revenues and Spending



- JLBC technicals \$(104) M less
 - Less Revenue / Higher Baseline Spending

- Reclassify \$105 M 1-Time as Ongoing:

	<u>\$ in M</u>
SFB Building Renewal	17
SFB New Construction	23
ADE 2% Hold Harmless	20
Universities	15
Health Insurance Shortfall	30
Total	105

Appendix A: January 2017 4-Sector Forecast

	<u>2017</u>	<u>2018</u>	<u>2019</u>	<u>2020</u>
Sales Tax				
JLBC Forecast	4.0%	4.1%	4.1%	4.0%
UA – Low	3.2%	2.0%	3.7%	5.6%
UA – Base	4.1%	5.0%	5.6%	5.3%
FAC	4.1%	4.0%	3.9%	4.0%
Average:	3.9%	3.8%	4.3%	4.7%
Individual Income Tax				
JLBC Forecast	4.0%	5.8%	4.9%	4.9%
UA – Low	3.9%	3.7%	3.9%	5.9%
UA – Base	4.8%	6.1%	5.6%	5.5%
FAC	5.1%	4.9%	4.7%	4.8%
Average:	4.5%	5.1%	4.8%	5.3%
Corporate Income Tax				
JLBC Forecast	-7.0%	4.7%	3.1%	-0.1%
UA – Low	-5.8%	-12.1%	-17.7%	13.5%
UA – Base	-2.0%	-3.3%	-6.3%	-3.4%
FAC	-14.1%	1.9%	3.8%	2.0%
Average:	-7.2%	-2.4%	-3.9%	2.0%
Insurance Premium Tax				
JLBC Forecast	6.4%	4.5%	5.1%	4.7%
UA – Low	7.4%	3.2%	2.6%	2.0%
UA – Base	7.4%	3.2%	2.4%	2.4%
FAC	6.4%	5.5%	4.9%	5.2%
Average:	6.9%	4.1%	3.8%	3.6%

JLBC Weighted Average	3.5%	4.9%	4.5%	4.3%
UA Low Weighted Average	3.2%	2.2%	3.1%	5.7%
UA Base Weighted Average	4.2%	5.0%	5.0%	5.0%
FAC Consensus Weighted Average	3.6%	4.4%	4.3%	4.4%
“Big-4” Weighted Average	3.6%	4.0%	4.1%	4.7%
Consensus Weighted Average*	3.5%	3.9%	4.2%	4.8%
Adjusted Consensus Weighted Average**	2.2%	2.9%	3.5%	4.5%

* Represents ongoing revenue adjusted for small revenue categories.

** Represents ongoing revenue adjusted for tax law changes; excludes urban revenue sharing.