
Finance Advisory Committee

Revenue and Budget Update

January 22, 2015

JLBC

Summary of JLBC Baseline Shortfall Status

- Compares Cost of Consensus Revenue vs Funding Formulas

	\$ in M	
<u>Ending Balance</u>	<u>FY '15</u>	<u>FY '16</u>
• January FAC	\$(148)	\$ (678)
• January FAC + K-12 Reset	(480)	(1,015)

- Excludes \$464 M available in Budget Stabilization Fund
- Estimates assume that '15 shortfall is resolved with 1-time solutions prior to '16
- Does not reflect impact if litigation back payments are awarded

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

JLBC

'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

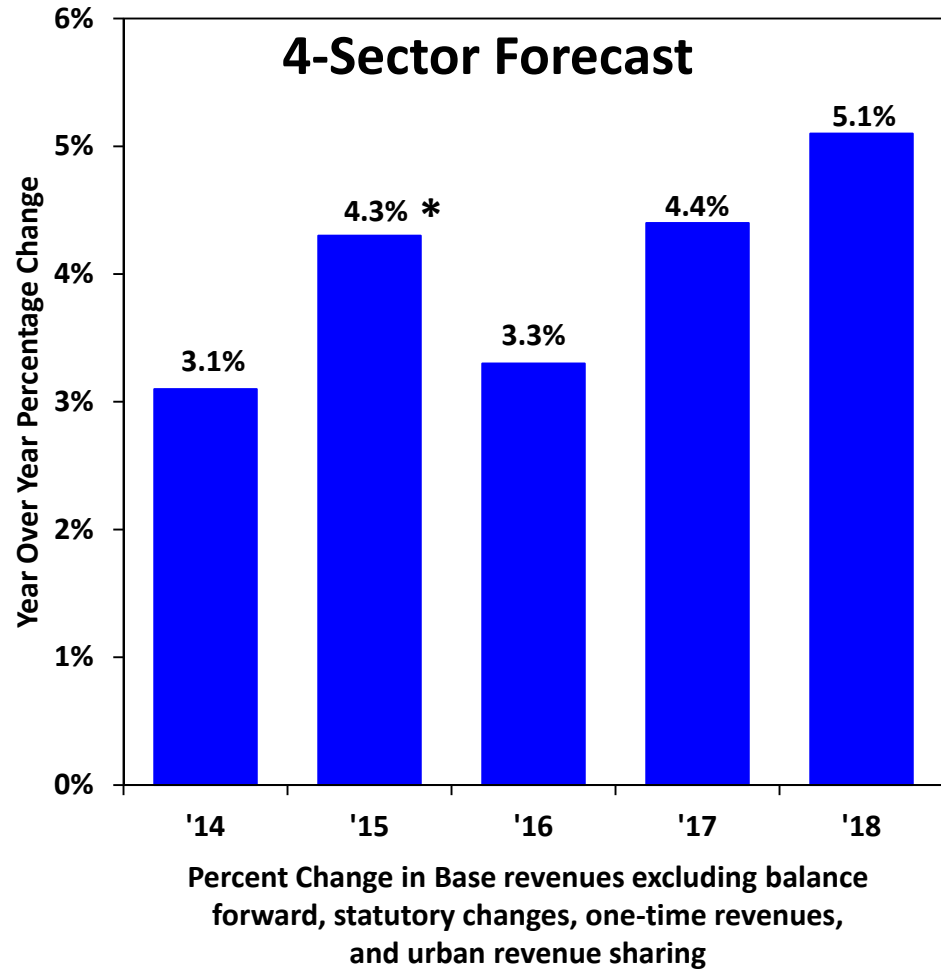
- ☐ Finance Advisory Committee
- ☐ UA base model
- ☐ UA lower model
- ☐ JLBC Staff

Chance of Exceeding Forecast

- ☐ 60%

Long Run Average Growth

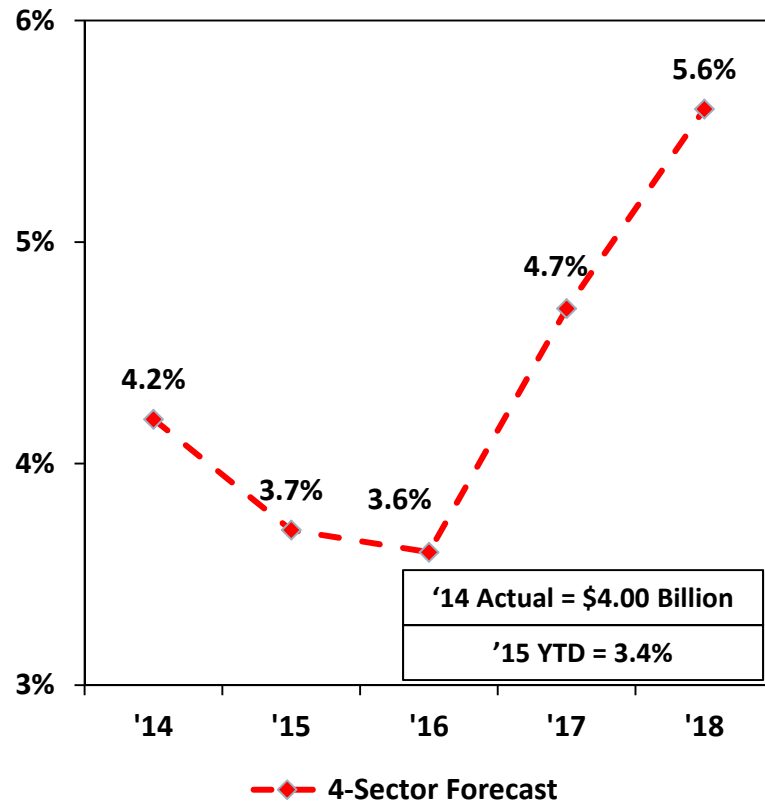
- ☐ 4.75%



* Adjusted for corporate YTD collections

Sales Tax

- Projected Growth of 3.7% in '15 and 3.6% in '16



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

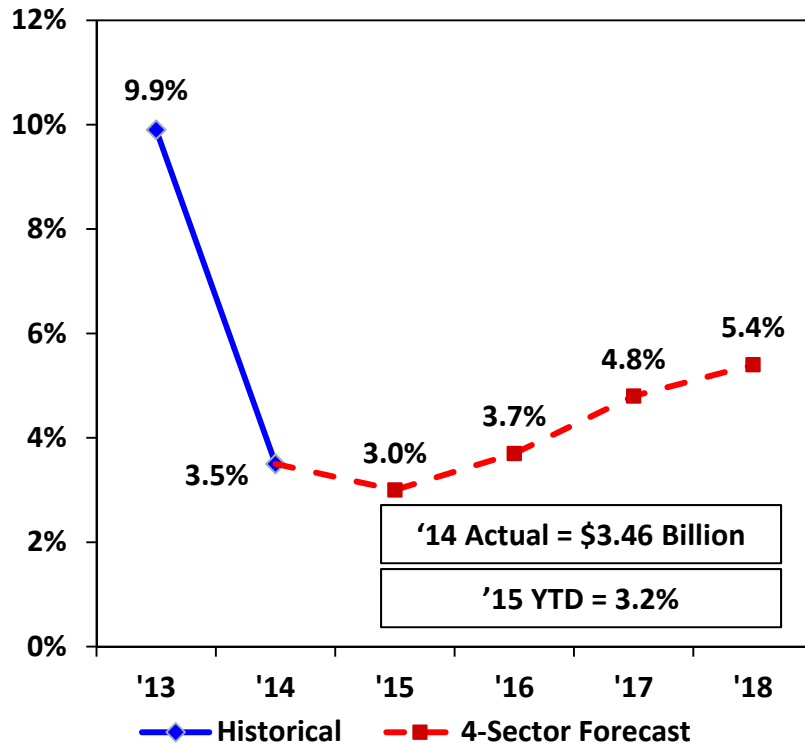
- ❑ Retail sector of sales up 7.8% in '14; 4.5% so far in '15
- ❑ Contracting up 11.2% in '14; near flat in '15 YTD
- ❑ Overall, 3.4% growth through first half of fiscal year
- ❑ Will Jan '15 contracting law have an impact?
- ❑ How much will drop in gas prices spur taxable sales?

Potential 1-Time Windfall from Gas Prices

- ❑ Dramatic decline in gas prices will increase disposable income
- ❑ General Fund revenue impact will depend on:
 - Duration of oil price decline
 - Propensity to save vs. spend
 - Taxable nature of spending
- ❑ Given uncertainty of all factors, this 1-time windfall could be between \$10M -\$40M
- ❑ Potential gain not reflected in 4-sector forecast

Individual Income Tax

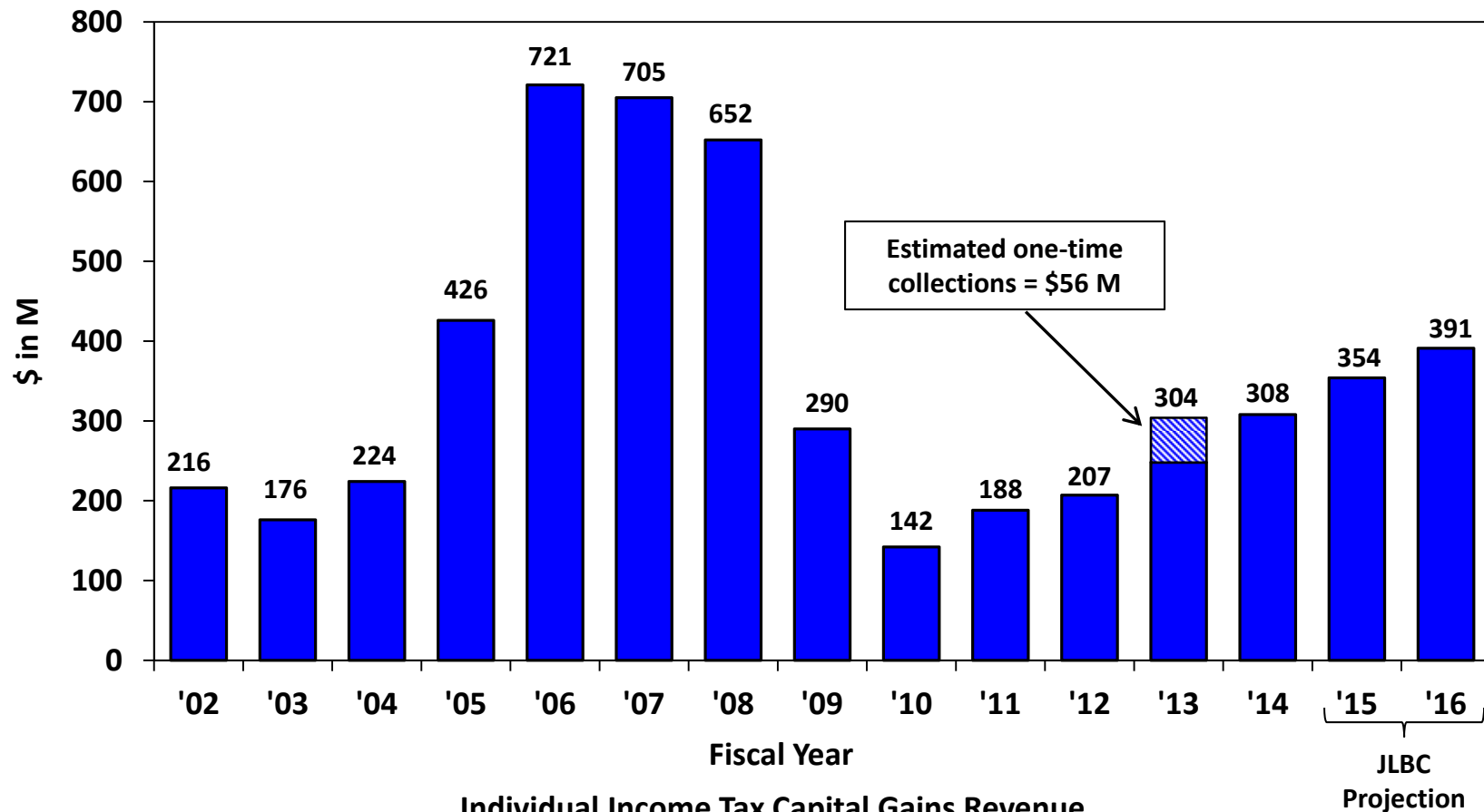
- Projected Growth of 3.0% in '15 and 3.7% in '16



Percent Change in Base Revenue Excluding Statutory Changes and One-Time Changes

- ❑ “Fiscal cliff” fueled ‘13 growth
- ❑ Acceleration of gains primarily lowered ‘14 collections
 - Plus some ‘15 & ‘16 impact
- ❑ Weak job and salary growth led to 3.4% withholding gain in ‘14
- ❑ 1st half ‘15 withholding growth was 2.8%
- ❑ Projected 15% capital gains growth; April filing will verify

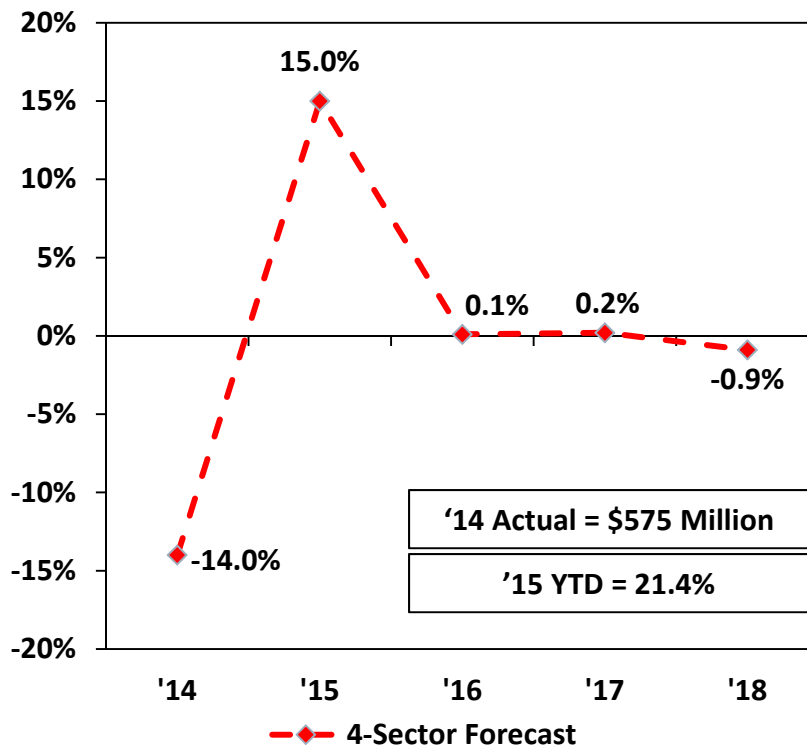
Volatility of Capital Gains Complicate Forecasting



Individual Income Tax Capital Gains Revenue
'14 through '16 Not Adjusted for Tax Law Changes

Corporate Income Tax

- Projected Growth of 15.0% in '15 and 0.1% in '16

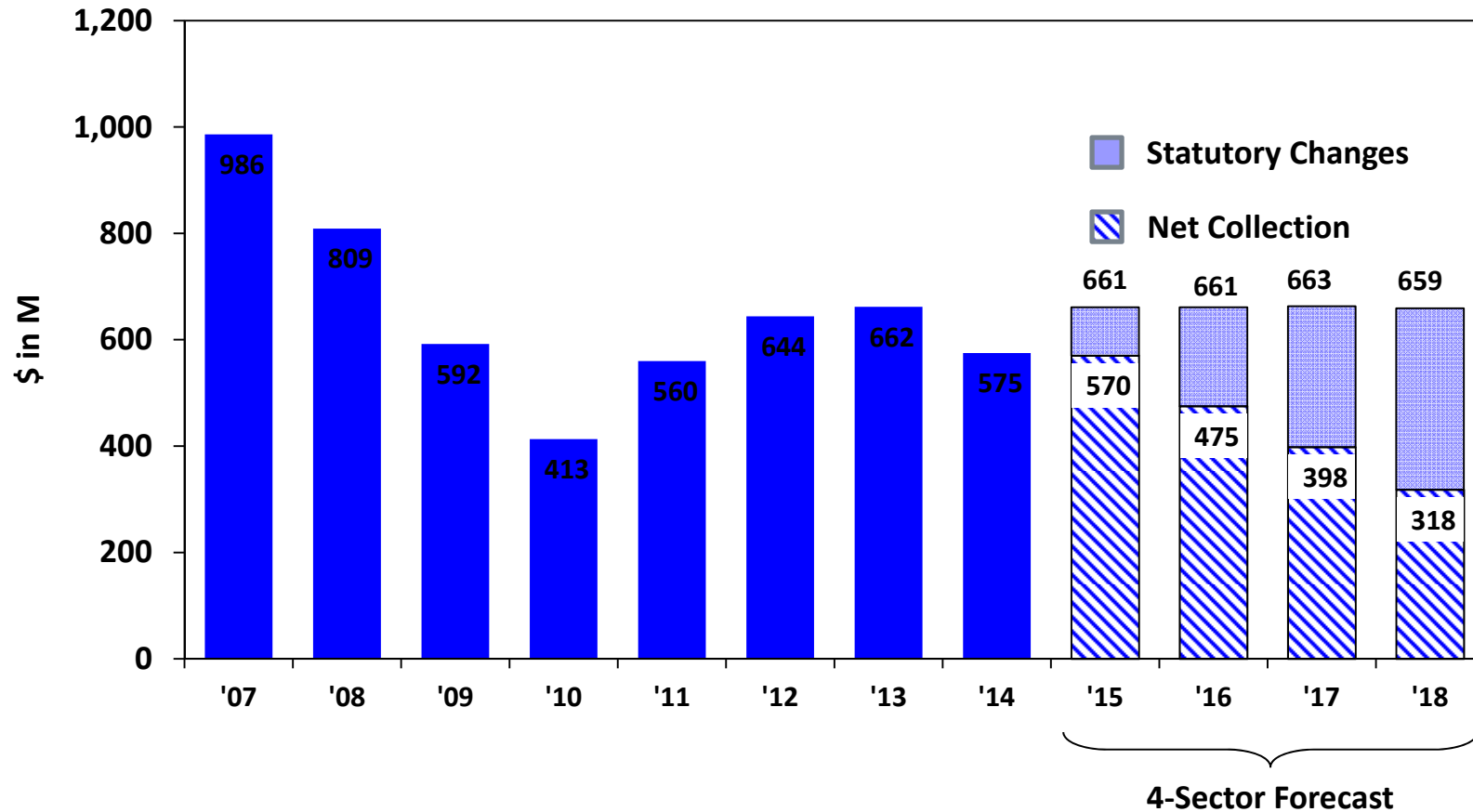


Percent Change in Base Revenue Excluding
Statutory Changes and One-Time Changes

- ❑ After '14 decline, '15 YTD growth is 21.4%
- ❑ 4-sector '15 growth is 3.7% - would require (10)% 2nd half decline
- ❑ '15 adjusted to 15% annual growth – 10% 2nd half growth
- ❑ Filing extension may delay the impact of rate cuts

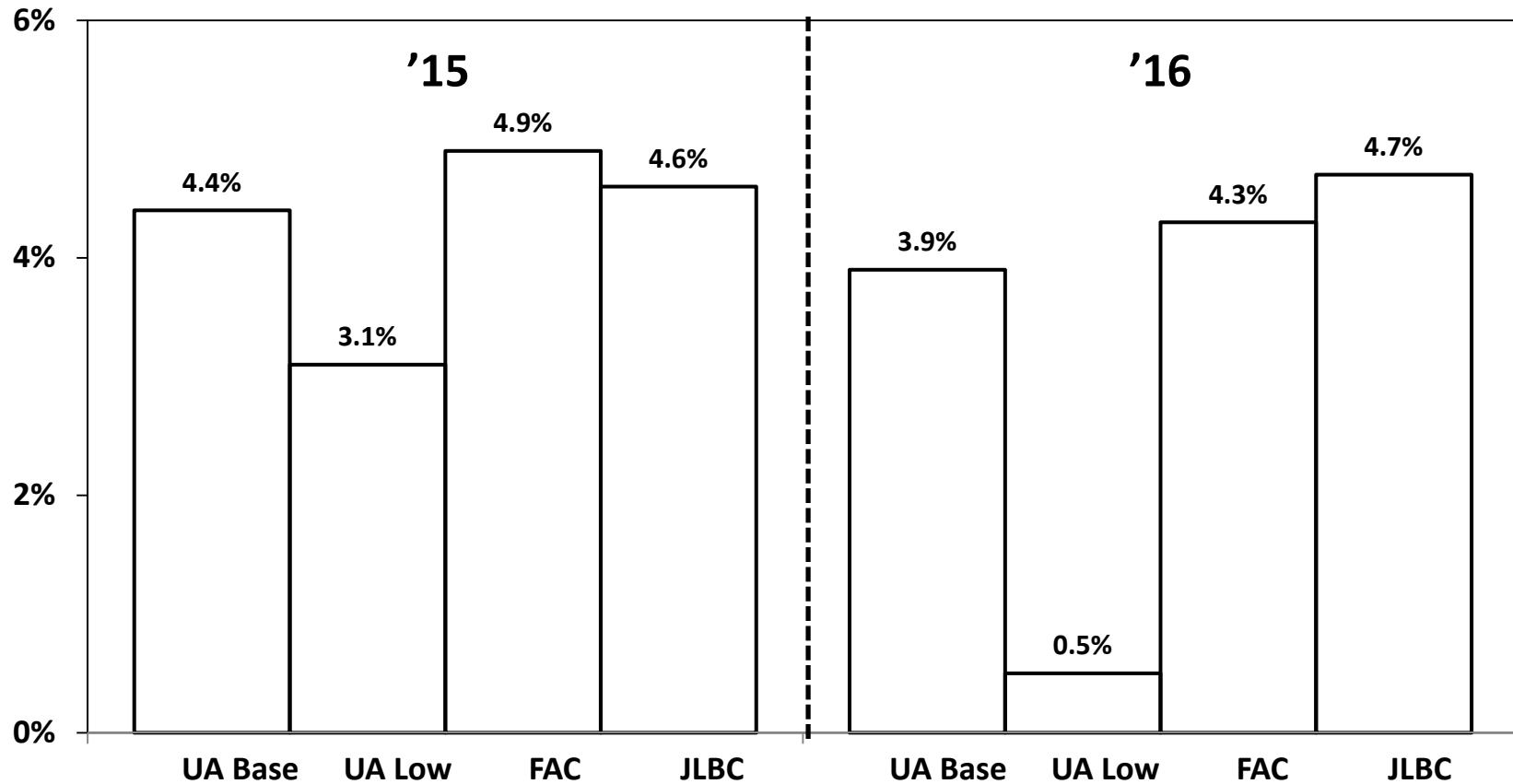
'18 CIT Projected to be \$318 M

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



Consensus Growth Rate is 4.3% in '15 and 3.3% in '16

- Prior to Corporate Adjustment, '15 Growth More Comparable to '16 ^{1/}



Details in Appendix A

1/ Prior to adjustment for corporate collections, the '15 growth rate is 3.6%



Phase-In of \$267 M of Enacted Tax Reductions

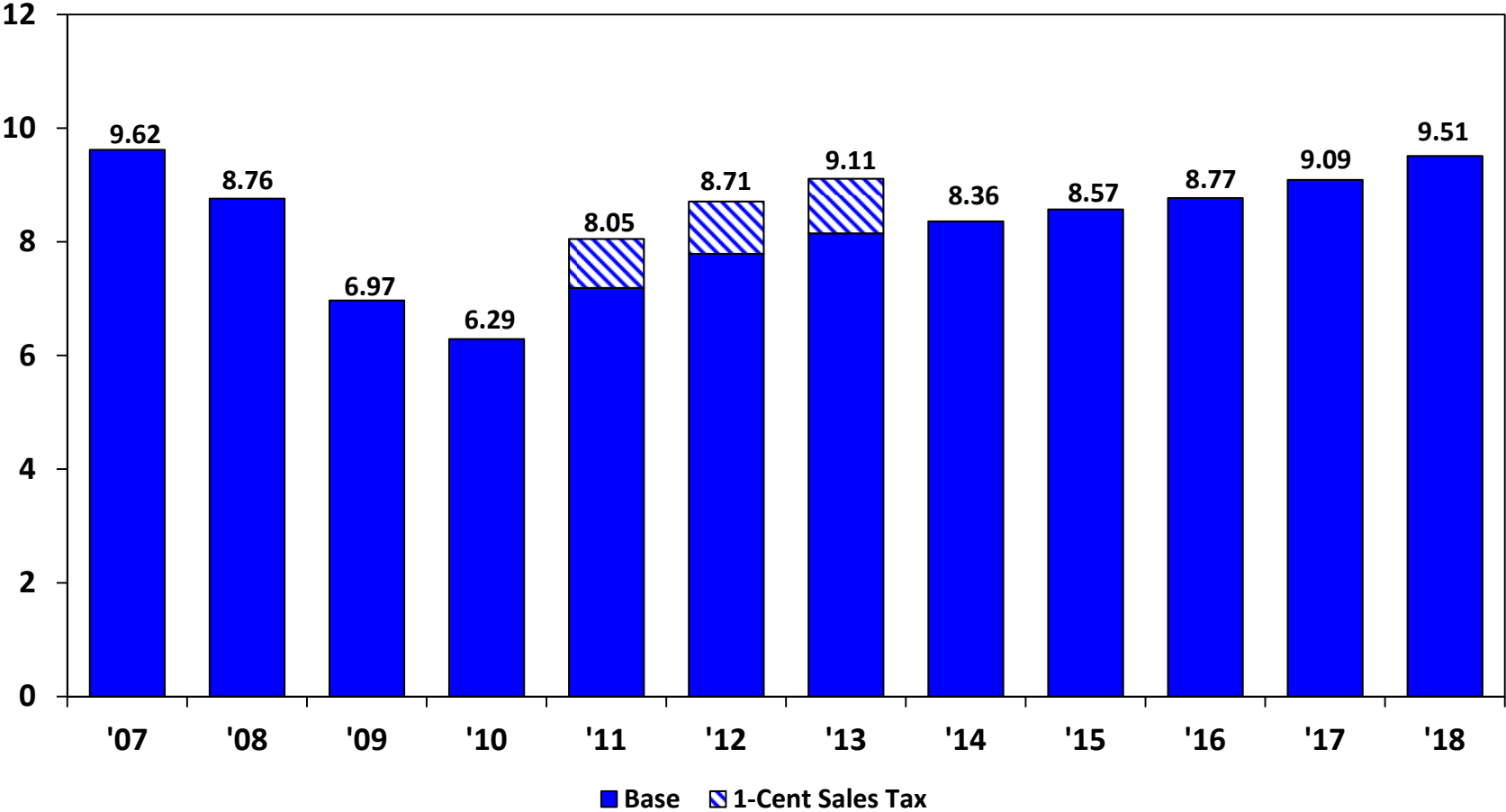
	\$ in M		
	<u>'16</u>	<u>'17</u>	<u>'18</u>
<input type="checkbox"/> Corporate Rate Reduction/Sales Factor	(68)	(61)	(60)
<input type="checkbox"/> 25% Capital Gains Reduction	(11)	0	0
<input type="checkbox"/> 1-time Income Tax Indexing	(6)	6	0
<input type="checkbox"/> Corporate School Tuition Indexing	(9)	(10)	(12)
<input type="checkbox"/> Other	(18)	(13)	(5)
Total	<u>(112)</u>	<u>(78)</u>	<u>(77)</u>

By '18, revenue base is forecast to be a total of \$267 M lower than if no enacted changes

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%

The Last Decade of General Fund Revenues



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



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

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
Ending Balance	<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
Revised Balance	<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

Executive Comparisons

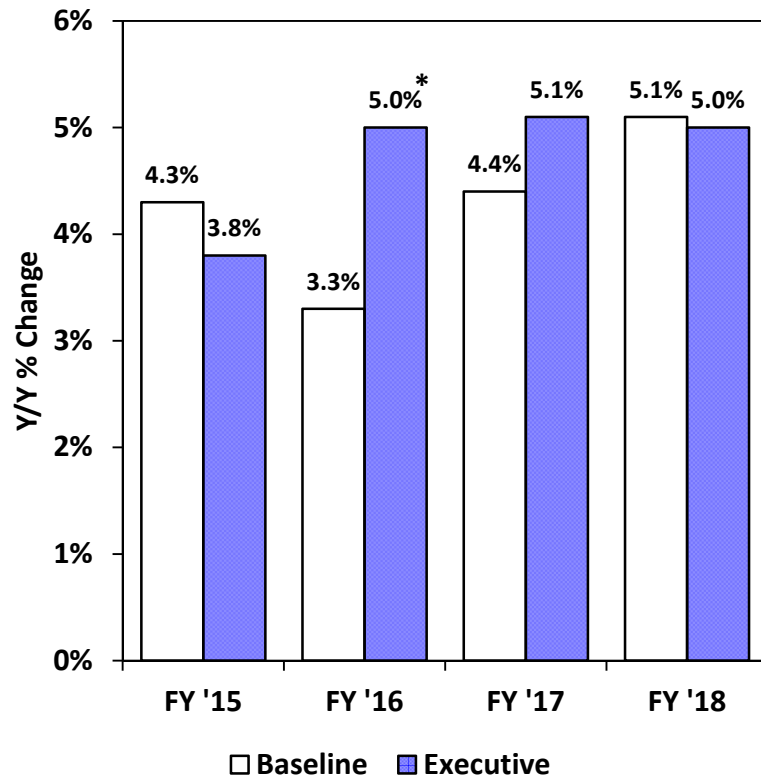
'16: How JLBC \$(678) M Shortfall Becomes Executive \$137 M Balance

<u>\$ in M</u>	
\$(678)	Baseline '16 shortfall (without K-12 litigation)
140	Lower Executive K-12 and Medicaid technical caseload
106	Higher Executive base revenues
	<u>Policy Issues</u>
62	Revenue increases
303	Fund transfers
(201)	Spending increases
388	Spending reductions
17	Other
\$137	Executive '16 Ending Balance

'16 Executive Revenue \$106 M Higher

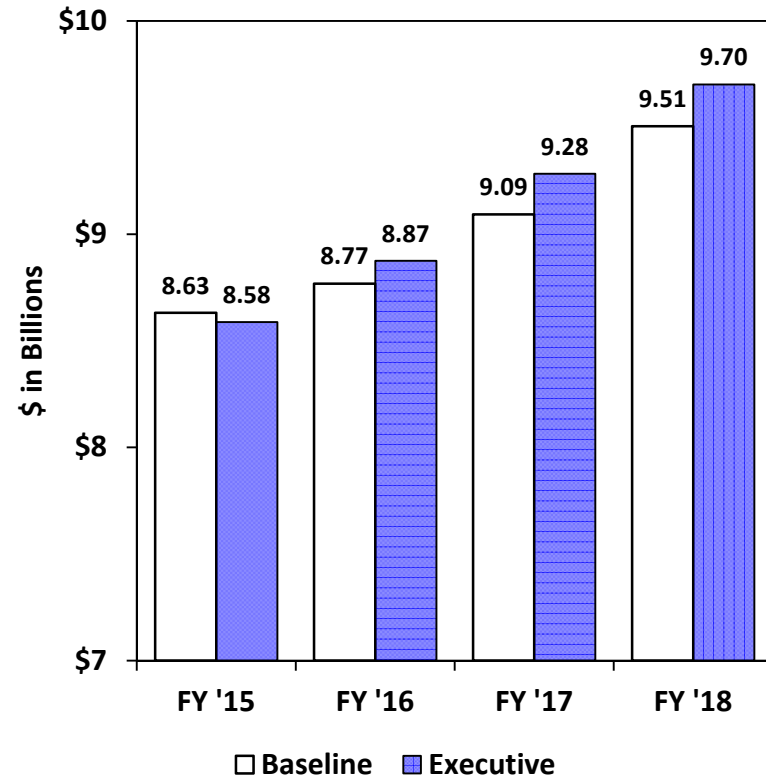
- But JLBC Higher by \$54 M in '15

Base Growth Rate



* 4.3% when compared to JLBC '15 base

Total Revenue*



* Excluding Balance Forward and Executive proposals



Executive Structural Balance with JLBC “Technicals”

- JLBC Revenue and ADE/Medicaid Caseload

\$ in M

<u>Fiscal Year</u>	<u>Executive Nominal</u>	<u>Executive W/JLBC</u>	<u>Exec W/ JLBC & "Reset"</u>
2016	(184)	(414)	(677)
2017	4	(338)	(605)
2018	155	(180)	(452)

- ❑ Structural balance represents difference between on-going revenues and spending
- ❑ Reset reflects full funding of Superior Court ruling on K-12 inflation reset, but no back payments

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				