GENERAL FUND REVENUE

FY 2011

FY 2011 General Fund Baseline revenues are projected to be $7.91 billion. As indicated in *Table 1*, the revised FY 2011 revenue estimate is $(648.7) million lower than the estimate from the FY 2011 budget enacted March 2010.

Table 1

FY 2011 Revenue Forecast ($ in Millions)

Adopted FY 2011 Revenue Estimate	$8,558.8
Revised Revenue Forecast	$(648.7)
Revised FY 2011 Revenue Estimate	$7,910.1

Table 2 below outlines the major components of the $(648.7) million revenue forecast revision.

Table 2

Components of FY 2011 Revenue Forecast Revision ($ in Millions)

Loss of Prop 301 & Prop 302 Funds	$(508.5)
Reduced Revenue Estimate	(80.0)
Reduced Ending Balance Estimate	(54.1)
Other	(6.1)
Total – Revenue Forecast Revision	**$(648.7)**

As shown in the table above, $(508.5) million of the total forecast revision is due to voters' rejection of Propositions 301 and 302 at the November 2010 General Election. If the measures had been approved, a total of $448.5 million would have been transferred to the General Fund from the State Parks Board's Land Conservation Fund and the Early Childhood Development and Health Board in FY 2011. Additionally, the repeal of the Early Childhood Development and Health Board and its regional councils (also known as "First Things First") under Proposition 302 would have redirected the 80¢ tobacco tax to the General Fund with an estimated revenue gain of $60 million beginning in FY 2011.

The actual net value of the revenue loss under Propositions 301 and 302 is $(468.5) million since $40 million of the fund transfers would have been appropriated to the Department of Economic Security (DES) as additional spending.

A total of $(80.0) million of the FY 2011 forecast revision is due to updated revenue estimates. Under the adopted budget, the temporary 1-cent sales tax was estimated to raise additional revenue of $918.0 million in FY 2011. Under the revised forecast, however, this figure is now estimated to be $814.8 million, or $(103.2) million less than first assumed. This loss, however, is expected to be offset by a $23.2 million gain in ongoing revenues under the revised forecast, for a net revenue impact of $(80.0) million. (The $23.2 million revenue increase relative to the adopted forecast reflects a base growth rate of 5.2%, which is described in more detail below.)

Under the budget adopted in March 2010, the FY 2011 beginning balance was estimated to be $48.3 million. The actual FY 2011 beginning balance has since been determined to be a shortfall of $(5.7) million. This means that $(54.1) million of the total forecast revision is due to reduced estimates of the FY 2011 beginning balance.

The remaining $(6.1) million of the FY 2011 revenue forecast revision is due to lower-than-expected collections of abandoned vehicle fees under Laws 2010, 7th Special Session, Chapter 12.

As described in the FY 2012 section below, the JLBC Staff uses a consensus forecasting process to develop its General Fund revenue estimates. *Table 3* shows the projected FY 2011 growth rates for the "Big 3" General Fund revenue sources (sales tax, individual and corporate income tax) provided by each of the components comprising the 4-sector consensus forecast. These estimates reflect ongoing revenue prior to tax law changes.

Table 3

FY 2011 4-Sector Forecast Percentages

	FAC	UA Low	UA Base	JLBC	Avg
Sales	0.8%	(2.8)%	0.0%	2.0%	0.0%
Individual Income	5.1%	3.1%	13.4%	5.0%	6.6%
Corporate Income	21.9%	(6.0)%	3.8%	39.6%	14.8%
Weighted Average [1/]	3.9%	(0.7)%	5.5%	5.7%	3.7%

1/ Once adjusted for tax law changes and minor revenue categories, the 4-Sector FY 2011 growth rate of 3.7% would be 3.3%. The JLBC growth rate of 5.7% would become 5.2%.

Based on the weighted average of the components of the 4-sector consensus forecast, "Big 3" General Fund revenue would grow by 3.7% in FY 2011. After adjusting for tax law changes and small revenue categories, the base revenue increase would be 3.3%.

Based on preliminary December data, year-to-date ongoing revenues are 7.4% above the same period in FY 2010 and total General Fund revenues are $(18) million below forecast. To reach the FY 2011 consensus forecast of 3.3%, base revenue would have to decrease by (1.0)% over the remaining 6 months of the current fiscal year. (Tax law changes with an ongoing revenue impact in FY 2011 are assumed to occur in the second half of the fiscal year.) Since revenue collections have been trending up for most of FY 2011, a (1.0)% decline appears unlikely. As a result, the Baseline uses the JLBC Staff forecast of a 5.2% General Fund revenue increase in FY 2011.

Under the 5.2% forecast, base revenue would have to grow by 2.9% in the second half of FY 2011. The 7.4% revenue gain in the first 6 months of FY 2011 is not expected to be maintained throughout the fiscal year. First, the 115% growth in corporate tax collections through December is most likely unsustainable. Second, a portion of the year-to-date individual income tax increase of 9.7% is believed to be attributable to over-withholding. Anecdotal information suggests that the larger-than-expected growth in net collections thus far is the result of a change in the state's withholding rates at the start of FY 2011 as opposed to underlying economic forces. The strong growth in withholding collections through December does not appear to be supported by underlying job and wage growth. This will result in larger-than-expected refunds in the second half of FY 2011 when tax returns are filed.

The individual revenue detail for FY 2011 is found in *Table 8* at the end of this section.

Once adjusted for tax law changes, minor revenues, and Urban Revenue Sharing, the revised FY 2011 estimate is 5.2% above FY 2010.

The FY 2011 General Fund total resource estimate of $7.91 billion includes permanent revenues of $6.91 billion net of Urban Revenue Sharing, temporary sales tax revenues of $814.8 million, and one-time revenues of $187.7 million. FY 2011 one-time revenues include a negative balance forward from FY 2010 of $(5.7) million, budget legislation of $(2.0) million related to the acceleration of unclaimed property and teacher certification loans, and $195.3 million in fund transfers. *(See Revenue Adjustments section below for more information.)*

FY 2012

Projected FY 2012 General Fund Baseline resources are $8.31 billion. This amount includes $886.0 million in temporary sales tax revenues, $(16.2) million in prior year enacted budget legislation, and $84.5 million in ongoing fund transfers. Prior to tax law and budget legislation changes, ongoing revenues are expected to increase by 5.4% over FY 2011 collections (excluding Urban Revenue Sharing). After accounting for the temporary 1-cent sales tax, budget legislation changes, Urban Revenue Sharing, and one-time revenues, total projected resources are 5.0% above FY 2011.

The FY 2012 Baseline estimated growth rates for the "Big 3" ongoing revenue categories were developed through a consensus process. The Baseline revenue estimate is based on averaging the results of the following 4 forecasts:

- Finance Advisory Committee panel forecast of January 2011. This independent panel consists of 15 public and private sector economists that meets 3 times a year to provide the Legislature with guidance on the status of the Arizona economy.
- The University of Arizona Economic and Business Research (EBR) General Fund Baseline model. The model is a simultaneous-equation model consisting of more than 100 equations which are updated on a regular basis to reflect changes in the economy. The model uses more than 200 variables related to Arizona's economy and is updated quarterly.
- EBR's conservative forecast model, and
- JLBC Staff projections.

The growth rates from each sector of the forecast are detailed in *Table 4*.

Table 4

FY 2012 4-Sector Forecast Percentages

	FAC	UA Low	UA Base	JLBC	Avg
Sales	4.0%	3.1%	7.6%	5.0%	4.9%
Individual Income	6.6%	(1.1)%	5.8%	6.4%	4.4%
Corporate Income	17.1%	17.4%	33.1%	2.3%	17.5%
Weighted Average [1/]	6.1%	2.3%	8.5%	5.3%	5.6%

1/ Once adjusted for minor revenue categories, the FY 2012 increase is 5.4%.

In FY 2012, sales tax revenue (excluding the temporary 1-cent tax) is projected to increase by 4.9%. Individual and corporate income tax collections are forecast to grow by 4.4% and 17.5%, respectively.

Revenue Adjustments

Table 5 provides an overview of base revenue growth rates for FY 2011 and FY 2012 with budget legislation changes (which include a number of tax law changes and revenue adjustments described in more detail in *Table 6*) and one-time financing sources. The table shows the base and adjusted revenue growth rates based on the enacted FY 2011 budget.

Table 5

General Fund Revenue Growth Rates
Based on Enacted FY 2011 and Projected FY 2012 Budget
($ in Millions)

	FY 2011	%	FY 2012	%
Base Revenue	$7,381.7 [1/]	5.2%	$7,778.8	5.4%
Prior Budget Legislation	N/A		(16.2)	
Temporary 1¢ TPT Increase	814.8		886.0	
Urban Revenue Sharing	(474.0)		(424.4)	
One-Time Financing				
Balance Forward	(5.7)		0.0	
Budget Legislation	193.4		84.5	
Adjusted Revenue	**$7,910.1**	**0.8%**	**$8,308.7**	**5.0%**

1/ The FY 2011 Base Revenue of $7.38 billion includes $94.6 million in ongoing tax law and revenue changes. The FY 2011 increase of 5.2% excludes these changes.

Table 6

FY 2011 Budget Legislation Changes
With Ongoing Revenue Impact
($ in Millions)

Prior Year Changes (Year Enacted)	
Phoenix Convention Center (03)	$ (5.0)
Contributions to Charities (09)	(0.9)
Solar Tax Credit (09)	(5.0)
BRITS Shift (09)	2.0
Treasurer's Management Fees (09)	(2.5)
Subtotal	$ (11.4)
2010 Tax Law Changes	
Out-of-State Proportionality	$ 22.0
STO Inflation Adjustments	(0.6)
STO Deadline Extension	(2.5)
Refundable R&D Credit	(5.0)
IRS Conformity	-- [1/]
Subtotal	$ 13.9
Other Revenue Changes	
DOR Auditors/Collectors	$ 7.7
DOR Revenue Generating Programs	15.3
Lottery Decrease (Debt Service)	(21.6)
Lottery Distribution Change	49.6
Abandoned Vehicle Fees	6.0
Property Tax – Class 3 Reform	0.5
County Contributions	34.6
Subtotal	$ 92.1
Total – FY 2011 Revenue Impact	**$ 94.6**

1/ The already enacted legislation has a minimal impact.

Prior Budget Legislation

Each year there are statutory tax law and other revenue changes that impact the state's revenue collection base. These may include tax rate or tax exemption changes, conformity to federal tax law changes, or the implementation of programs that affect revenue collections.

FY 2011

For FY 2011, ongoing budget legislation is expected to provide additional General Fund revenues of $94.6 million. *Table 6* provides a summary of budget legislation changes with ongoing revenue impacts in FY 2011. As noted above, the FY 2011 base revenue growth of 5.2% excludes these changes. Further details on these changes can be found on page 386 of the *FY 2011 Appropriations Report*.

The FY 2011 adjustments remain the same with 2 exceptions. Abandoned vehicle fees, which under the enacted budget were estimated to bring in additional revenue of $12.1 million in FY 2011, are now expected to result in a revenue gain of $6.0 million. The Arizona Department of Transportation (ADOT) has not yet implemented the fee increases. In addition, the $34.6 million in county contributions to the General Fund are now assumed to be ongoing rather than one-time.

FY 2012

Several tax law changes enacted in prior years will either take effect or be further phased-in during FY 2012. As shown in *Table 5*, ongoing budget legislation is expected to result in a total net revenue loss of $(16.2) million in FY 2012. Below is a description of the ongoing revenue changes.

- Phoenix Convention Center – Laws 2003, Chapter 266 requires the state to contribute to the expansion and renovation of the Phoenix Convention Center. The state's obligation for this project is to pay the debt service on $300 million of construction bonds, beginning with $5 million the first year after construction is completed. This obligation increases over a period of years to a maximum of $30 million per year. The first $(5.0) million payment occurred in FY 2010. The incremental debt service cost in FY 2012 is $(5.0) million, for a total payment of $(15.0) million.

- TPT Business License Fee – Laws 2010, 7th Special Session, Chapter 12 allows the Department of Revenue (DOR) to set a one-time fee for new and renewed Transaction Privilege Tax (TPT) business licenses in FY 2011. The temporary fee is expected to generate a total of $5.4 million in General Fund revenue in FY 2011. Since the TPT business license fee will not be imposed in FY 2012, there will be a one-time revenue offset of $(5.4) million in FY 2012.

- Renewable Energy Production Credit – Laws 2010, Chapter 312 provides a tax credit for the production of electricity using renewable energy. The new credit allows a qualified producer of renewable energy to receive an individual or corporate income tax credit of up to $2 million per year, beginning in FY 2012. Total credits are capped at $20 million annually. The revenue loss in FY 2012, the first year the credit is available to businesses, is estimated to be $(10.0) million.

- Land Fees – Laws 2010, Chapter 243 changed the State Land Department's fee structure. Previously, fee revenue was deposited into the General Fund, but under Chapter 243 such revenue will be deposited in the Trust Land Management Fund instead. However, in FY 2011 only, Chapter 243 deposits the first $2.1 million of fees into the General Fund, an amount comparable to such General Fund deposits in prior years. As a result, this statutory change is cost neutral in FY 2011. Beginning in FY 2012, however, Chapter 243 will result in a revenue loss of $(2.1) million since Land Department fees will no longer be deposited in the General Fund. The deposit of these fees in the Trust Land Management Fund will permit the Land Department's General Fund appropriation to be reduced by a corresponding $(2.1) million.

- QSCB Revenue – The budget authorized the School Facilities Board (SFB) to enter into a maximum of $100 million worth of lease-purchase transactions through the end of FY 2011, to be financed through a federal bonding program known as Qualified School Construction Bonds (QSCB). The program provides a direct federal interest subsidy based on a rate determined by the U.S. Department of Treasury. SFB issued $91.3 million worth of QSCBs at an annual interest rate of 6.0%, with a federal subsidy of 4.86%. The FY 2012 QSCB revenue of $6.2 million reflects the federal subsidy for interest due for the FY 2012 debt service payment.

Prior year legislative changes with ongoing revenue impact in FY 2012 are summarized in *Table 7* below.

Table 7

Prior Year Budget Legislation With Ongoing Revenue Impact in FY 2012 ($ in Millions)

Phoenix Convention Center	$(5.0)
TPT Business License Fee	(5.4)
Renewable Energy Production Credit	(10.0)
Land Fees	(2.1)
QSCB Revenue	6.2
Total – FY 2012 Revenue Impact	**$(16.2)**

Temporary 1-Cent TPT Increase

At the May 2010 Special Election, voters approved a 1-cent increase of the TPT (sales tax) for 3 years. As shown in *Table 5*, the temporary TPT increase is estimated to generate additional General Fund revenues of $814.8 million in FY 2011 and $886.0 million in FY 2012.

Urban Revenue Sharing

The Urban Revenue Sharing (URS) program provides that a percentage of state income tax revenues (including both individual and corporate income tax) be shared with incorporated cities and town within the state. The amount that is currently distributed to cities and towns is 15% of net income tax collections from 2 years prior. As indicated in *Table 5*, total URS distributions will decline from $474.0 million in FY 2011 to $424.4 million in FY 2012. These amounts are significantly below the URS distribution of $628.6 million in FY 2010.

One-Time Financing

As shown in *Table 5*, one-time financing sources have been used to help provide a balanced budget. Following is a discussion of one-time financing sources included in the budget for FY 2011 and FY 2012.

FY 2011

The $193.4 million in one-time financing sources for FY 2011 includes:

<u>Balance Forward</u> – The FY 2011 General Fund balance forward is estimated to have a deficit of $(5.7) million.

<u>Budget Legislation</u> – One-time net revenues of $(2.0) million, which include:

- Unclaimed Property Acceleration – Laws 2009, 4th Special Session, Chapter 3, accelerated the timeframe for unclaimed traveler's checks from 15 years to 3 years. Laws 2010, Chapter 119 reverted the presumption of abandonment schedule for such unclaimed property back to 15 years, which is expected to result in a revenue reduction of $(2.4) million in FY 2011.

- Teacher Certification Repayment – Laws 2010, Chapter 306 established a new Teacher Certification Fund and appropriated $429,700 to it from the General Fund as a temporary intra-year loan in order to fund expenses incurred during the early part of the year (since the fund will have no beginning balance going into FY 2011). The Arizona Department of Education will transfer the fees paid by teachers and other certification applicants back to the General Fund by June 30, 2011. These certification fees will result in net new General Fund revenues of $429,700 in FY 2011. (There will be no net impact on the General Fund, however, since the appropriation will be paid for by the fees collected during FY 2011.)

<u>Fund Transfers</u> – Laws 2010, 7th Special Session, Chapter 1, provides for a total of $195.3 million in fund transfers in FY 2011 *(for more detail, see the FY 2011 Appropriations Report, General Provisions section).*

FY 2012

The $84.5 million in one-time financing sources for FY 2012 includes:

<u>Fund Transfers</u> – The Baseline continues $84.5 million in fund transfers in FY 2012 from the prior fiscal year. Non-General Fund agencies had their spending authority reduced in FY 2011 and the savings were transferred to the General Fund (otherwise known as Fund Reduction and Transfer – FRAT). The $84.5 million in reductions and the related General Fund transfers are continued in FY 2012. *(See page S-19 in "General Fund – Detailed List of FY 2012 Changes" in the Summary Section.)*

Table 8

GENERAL FUND REVENUE - FY 2011-FY 2012

FORECAST REVENUE GROWTH

($ in Thousands)

	ACTUAL FY 2010	% CHANGE PRIOR YR	FORECAST FY 2011	% CHANGE PRIOR YR	$ CHANGE PRIOR YR	FORECAST FY 2012	% CHANGE PRIOR YR	$ CHANGE PRIOR YR
Taxes:								
Sales and Use	3,377,528.5	-10.1%	3,454,812.3	2.3%	77,283.8	3,624,098.1	4.9%	169,285.8
Income -Individual	2,416,296.3	-5.9%	2,558,853.9	5.9%	142,557.6	2,671,443.4	4.4%	112,589.5
-Corporate	413,193.3	-30.2%	573,453.4	38.8%	160,260.1	673,807.8	17.5%	100,354.4
Property	20,269.6	11.1%	20,000.0	-1.3%	(269.6)	20,000.0	0.0%	0.0
Luxury -Tobacco	25,810.4	-13.4%	25,881.0	0.3%	70.6	25,881.0	0.0%	0.0
-Liquor	29,541.8	2.4%	28,994.9	-1.9%	(546.9)	28,994.9	0.0%	0.0
Insurance Premium	405,616.6	-1.4%	412,600.0	1.7%	6,983.4	420,000.0	1.8%	7,400.0
Estate	363.8	72.9%	500.0	37.5%	136.2	0.0	-100.0%	(500.0)
Other Taxes	1,447.9	24.2%	1,500.0	3.6%	52.1	1,500.0	0.0%	0.0
Sub-Total - Taxes	6,690,068.2	-9.7%	7,076,595.5	5.8%	386,527.3	7,465,725.2	5.5%	389,129.7
Other Non-Tax Revenues:								
Lottery	69,751.4	125.0%	77,900.9	11.7%	8,149.5	82,009.6	5.3%	4,108.7
Licenses, Fees and Permits	27,022.9	-21.7%	25,000.0	-7.5%	(2,022.9)	25,000.0	0.0%	0.0
Interest	211.4	-98.9%	4,000.0	1792.1%	3,788.6	6,000.0	50.0%	2,000.0
Sales and Services	34,451.7	-28.6%	24,507.6	-28.9%	(9,944.1)	27,000.0	10.2%	2,492.4
Other Miscellaneous	53,276.9	-0.8%	42,500.0	-20.2%	(10,776.9)	45,000.0	5.9%	2,500.0
Transfers and Reimbursements	34,330.3	1.7%	69,600.0	102.7%	35,269.7	75,600.0	8.6%	6,000.0
Disproportionate Share Revenue	18,722.0	-72.3%	61,592.3	229.0%	42,870.3	52,489.0	-14.8%	(9,103.3)
Sub-Total - Other Non-Tax	237,766.6	-17.6%	305,100.8	28.3%	67,334.2	313,098.6	2.6%	7,997.8
Subtotal On-Going Revenue	**6,927,834.8**	**-10.0%** [1/]	**7,381,696.3**	**6.6%** [2/]	**453,861.5**	**7,778,823.8**	**5.4%**	**397,127.5**
Temporary 1-cent Sales Tax Increase	0.0	N/A	814,756.3	N/A	814,756.3	886,024.5	8.7%	71,268.2
Budget Legislation	0.0	N/A	0.0	N/A	0.0	(16,230.2)	N/A	(16,230.2)
Subtotal w/Tax Law Changes	**6,927,834.8**	**-10.0%**	**8,196,452.6**	**18.3%**	**1,268,617.8**	**8,648,618.1**	**5.5%**	**452,165.5**
Urban Revenue Sharing (URS)	(628,644.6)	-13.6%	(474,006.5)	-24.6%	154,638.1	(424,423.4)	-10.5%	49,583.1
Subtotal w/Tax Law Changes/URS	**6,299,190.2**	**-9.6%**	**7,722,446.1**	**22.6%**	**1,423,255.9**	**8,224,194.7**	**6.5%**	**501,748.6**
One-Time Financing Sources:								
Budget Legislation	154,720.0	30.1%	(1,956.0)	-101.3%	(156,676.0)	0.0	-100.0%	1,956.0
Fund Transfers	387,085.5	-42.0%	195,342.9	-49.5%	(191,742.6)	84,548.7	-56.7%	(110,794.2)
State Asset Leaseback/Lottery	1,485,419.3	N/A	0.0	-100.0%	(1,485,419.3)	0.0	N/A	0.0
Sub-Total - One-Time Financing Sources	2,027,224.8	58.3%	193,386.9	-90.5%	(1,833,837.9)	84,548.7	-56.3%	(108,838.2)
Subtotal - Revenues	**8,326,415.0**	**1.0%**	**7,915,833.0**	**-4.9%**	**(410,582.0)**	**8,308,743.4**	**5.0%**	**392,910.4**
Balance Forward	(480,713.0)	N/A	(5,723.0)	N/A	474,990.0	0.0	-100.0%	5,723.0
Total - Resources	**7,845,702.0**	**-4.9%**	**7,910,110.0**	**0.8%**	**64,408.0**	**8,308,743.4**	**5.0%**	**398,633.4**

1/ The (10.0)% FY 10 decline includes $21.5 million in tax law and other revenue changes. Adjusting for these changes, the base FY '10 decline is (10.3)%.

2/ The 6.6% FY 11 increase includes $94.6 million in tax law and other revenue changes. Adjusting for these changes, the base FY '11 increase is 5.2%.