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# **Revenue and Budget Update**

## **Arizona Tax Research Association**

**November 20, 2015**

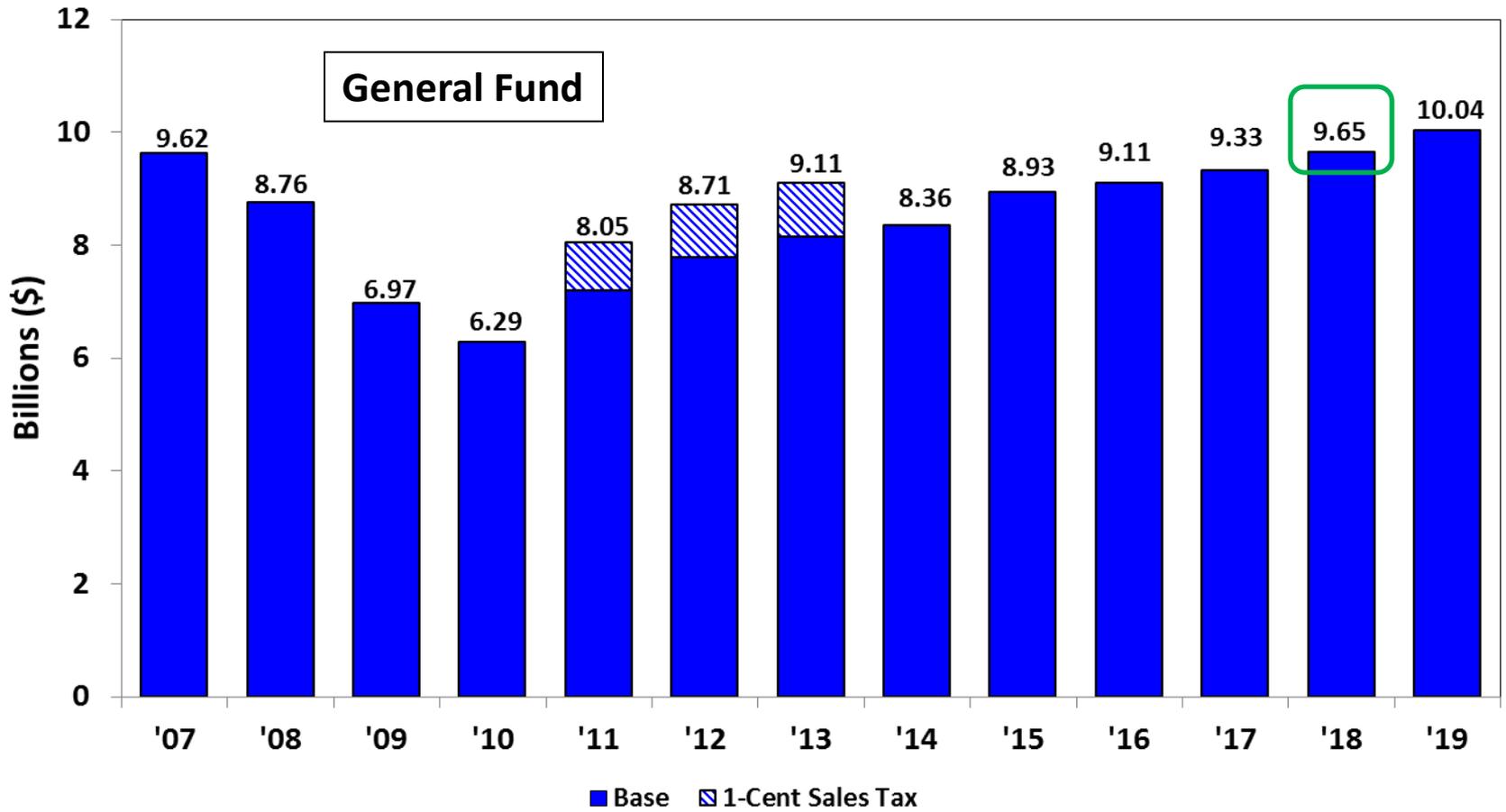
**JLBC**

# Summary of Current Budget Status

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- ❑ JLBC Baseline reflects revenue and statutory funding formula growth
- ❑ The projected '17 one-time cash balance is \$555M
- ❑ Up to \$218M available for permanent initiatives without re-creating a long-run structural gap
- ❑ Remember lessons learned from the '08 budget

# Revenue Will Reach Pre-Recession Level in '18



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

# Forecast Risks

- 1% Variance Yields \$600 M Over 3 Years

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## Potential Gains

- National recovery creating more interstate migration

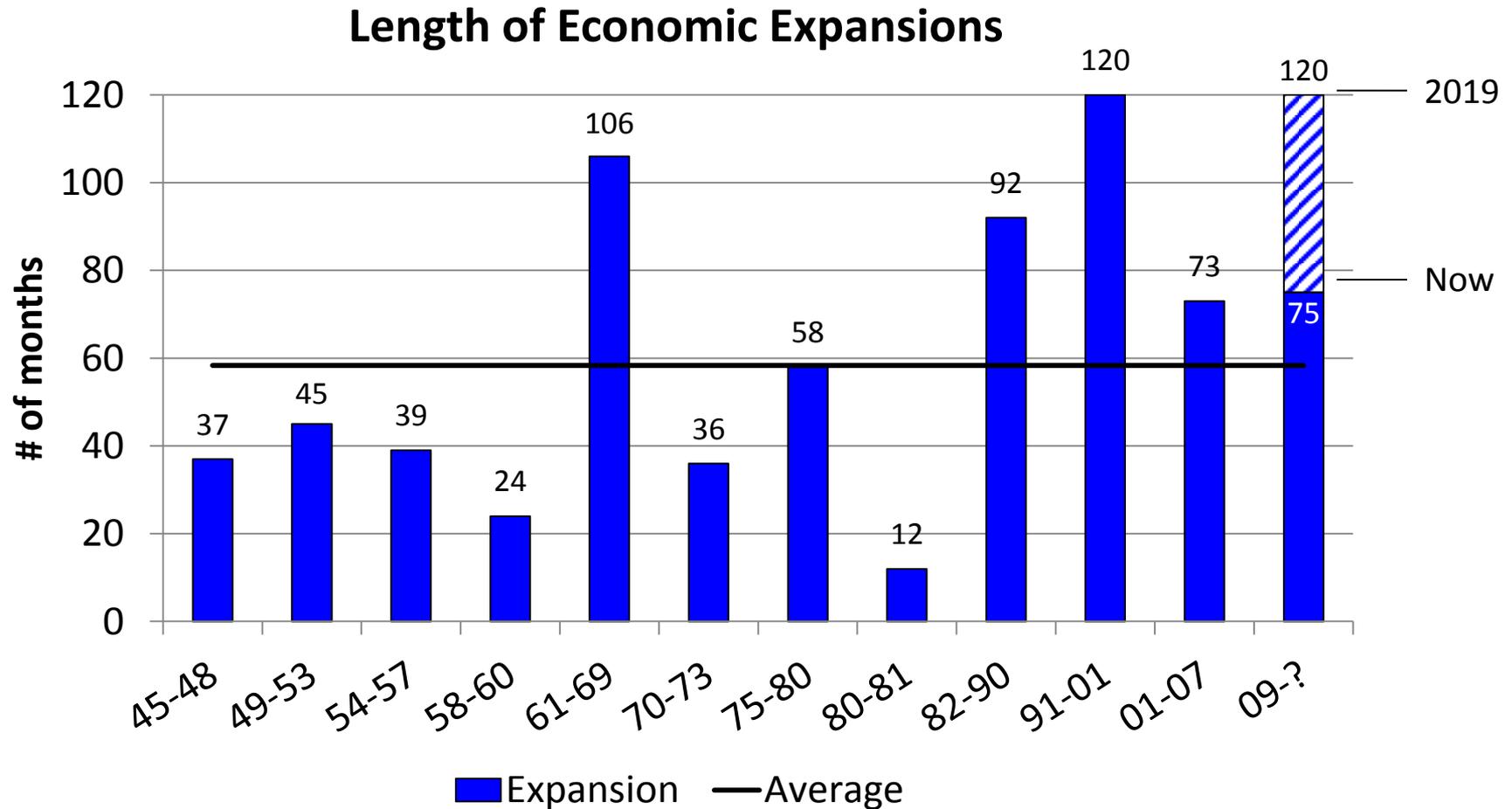
## Potential Gain or Loss

- Estimate of ongoing '15 gains

## Potential Losses

- If historical average holds true, recession likely in this forecast cycle

# Current Expansion Exceeds Historical Average



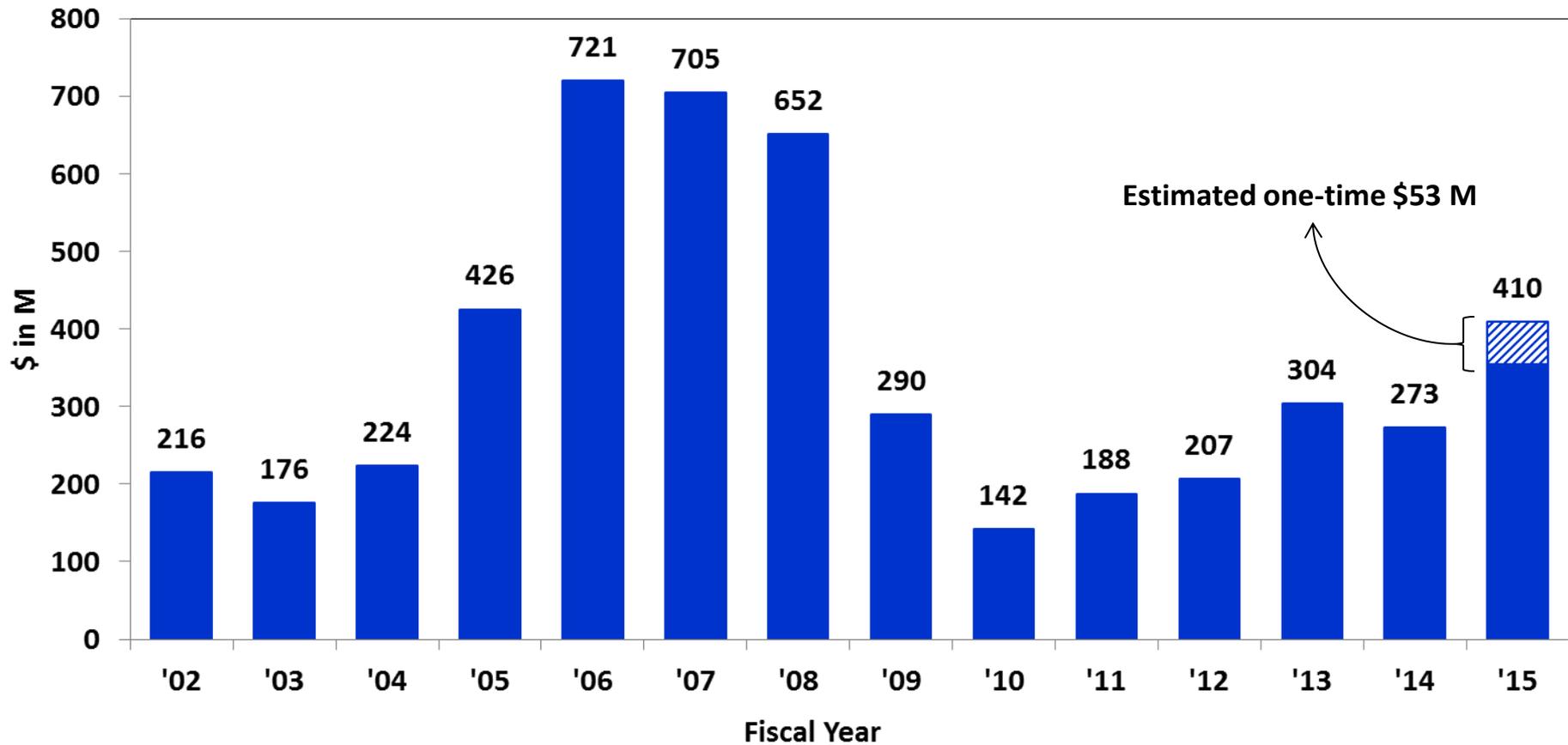
# 1<sup>st</sup> Trimester Net Revenue Growth Slowed Significantly

## - '15 Driven by Capital Gains and Corporate Taxes

	'15 Above '14	Thru Oct. Above '15	
Sales	4.7%	2.5%	❑ 1 <sup>st</sup> trimester includes \$46 M in tax amnesty collections, \$31 M more than expected
Individual Income	8.6%	5.3%	❑ Without amnesty, 1 <sup>st</sup> trimester is \$90 M above forecast
Corporate Income	15.3%	(4.7%)	
Other	(14.5%)	3.2%	❑ “Core” revenue growth remains disappointing --2.5% for sales, 1.2% for withholding
<b>Total</b>	<b>6.1%</b>	<b>3.3%</b>	

# Volatility of Capital Gains Complicate Forecasting

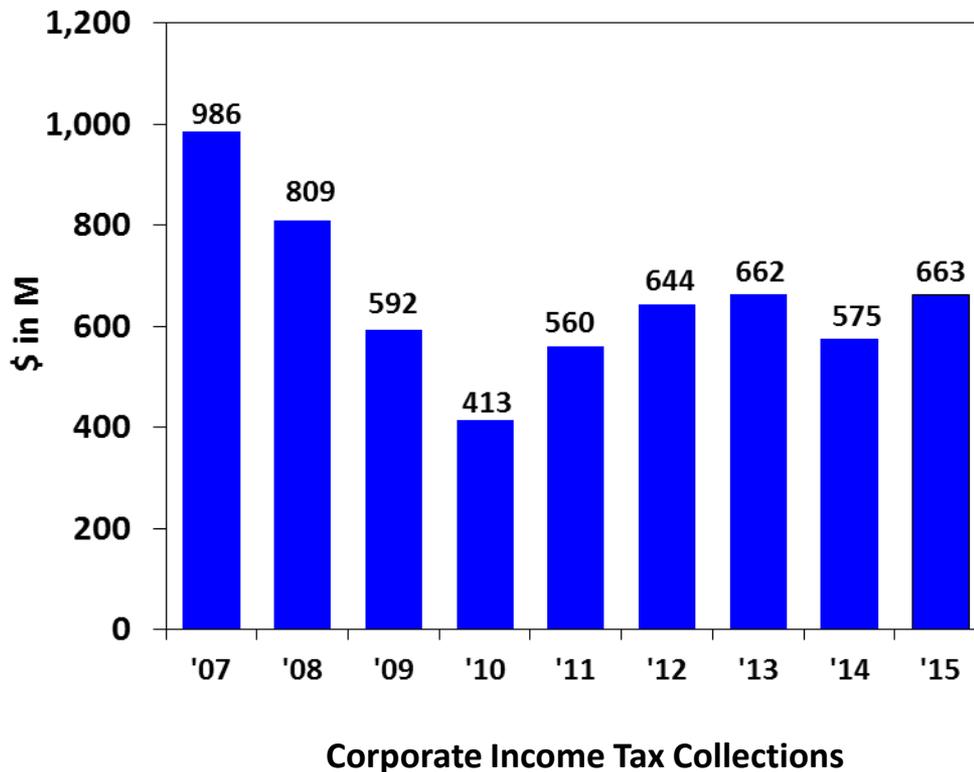
- Final '15 Capital Gain Receipts to be Determined



Individual Income Tax Capital Gains Revenue

# Corporate Gains May Not Be Sustainable

## - Past History of Significant Revenue Shifts



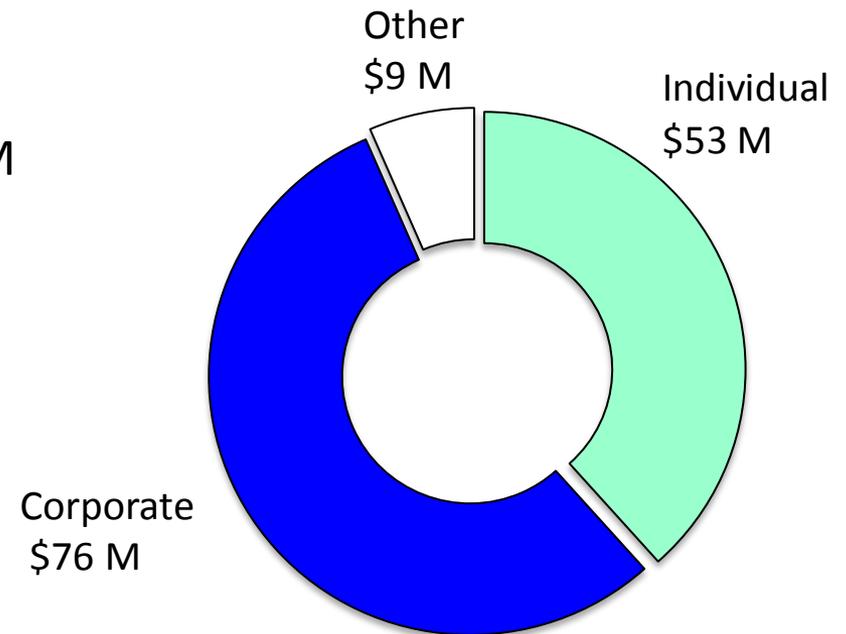
- In 22 of last 28 years, annual change has been > +/- 10%
- '14 & '15 results inexplicable
- 4-year tax cut was to begin in '15, likely delayed to '16
- YTD '16, however, only declined by \$(8) M

# '15 Base Adjusted for One-Time Collections

- Net '16 Growth with Adjustment is 2.6%

- ❑ Some '15 corporate and capital gains appear one-time
- ❑ As a result, a portion of the \$378 M '15 revenue gain is one-time
- ❑ FAC Panel average:
  - \$240 M ongoing
  - \$138 M one-time

## One-Time '15 Gains



# Revenue Growth Accelerates Slightly in '18 & '19

## October Consensus Forecast

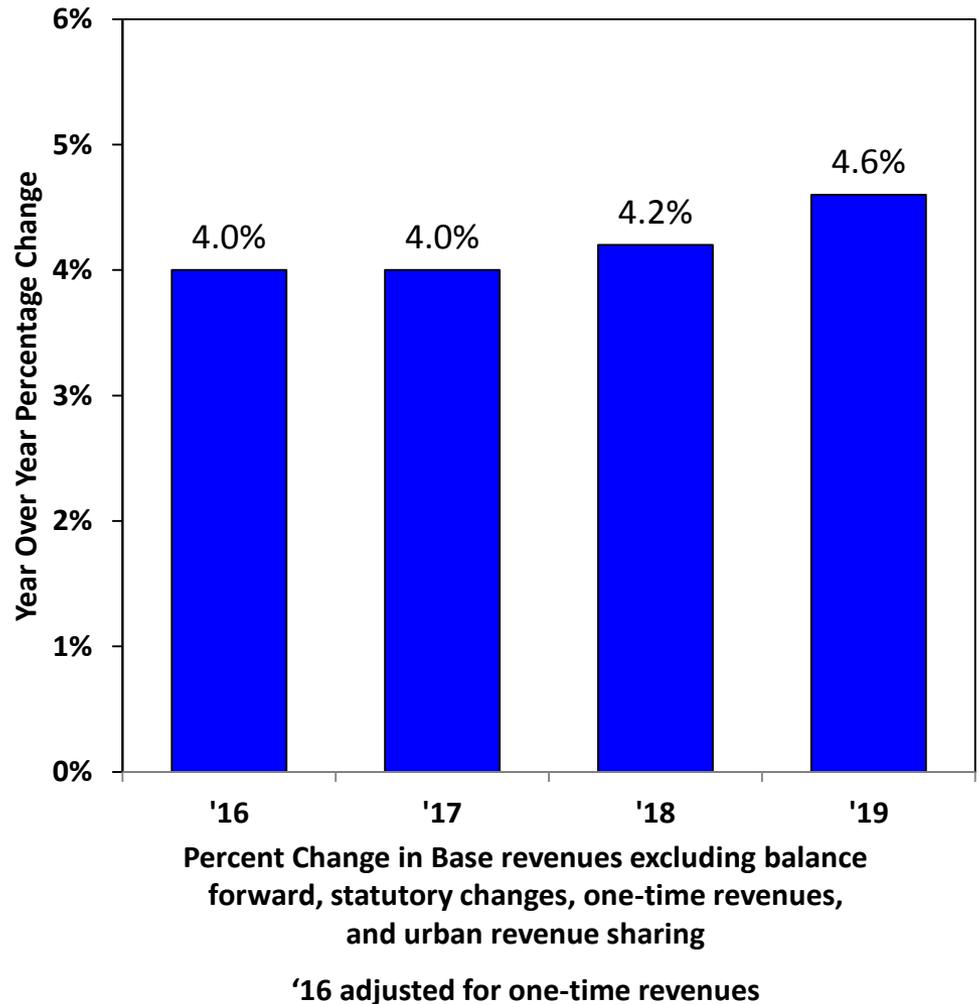
4 inputs

## Chance of Exceeding Forecast

65%

## Long Run Average Growth

4.75%



# Components of the Revenue Forecast

- Excludes Change in Beginning Balance

	\$ in M			
	<u>'16</u>	<u>'17</u>	<u>'18</u>	<u>'19</u>
Base Revenue Growth (4.0%/4.0%/4.2%/4.6%)	379	388	422	469
Previously Enacted Tax Legislation	(98)	(97)	(90)	(73)
Other Adjustments	57	(206)	(106)	(12)
<b>Total</b>	<b>338</b>	<b>85</b>	<b>226</b>	<b>384</b>
<b>% Change</b>	<b>3.7%</b>	<b>0.9%</b>	<b>2.4%</b>	<b>4.0%</b>

# Projected Baseline Spending Changes

## - Including Special Session

	\$ in M Above Prior Year		
	'17	'18	'19
K-12	65	157	142
AHCCCS	81	79	100
DCS	(8)	0	0
DES	15	25	30
Corrections	25	7	0
Universities	12	4	0
Hiring Freeze / Consolidations	(21)	0	0
Employee Health Insurance	(16)	0	0
Land Dept. Self-Fund	0	(13)	0
Other	(14)	(5)	(31)
<b>Total Operating Budget Changes</b>	<b>140</b>	<b>254</b>	<b>241</b>
<b>Total Spending</b>	<b>\$9,322</b>	<b>\$9,576</b>	<b>\$9,818</b>
<b>% Change</b>	<b>1.4%</b>	<b>2.7%</b>	<b>2.5%</b>

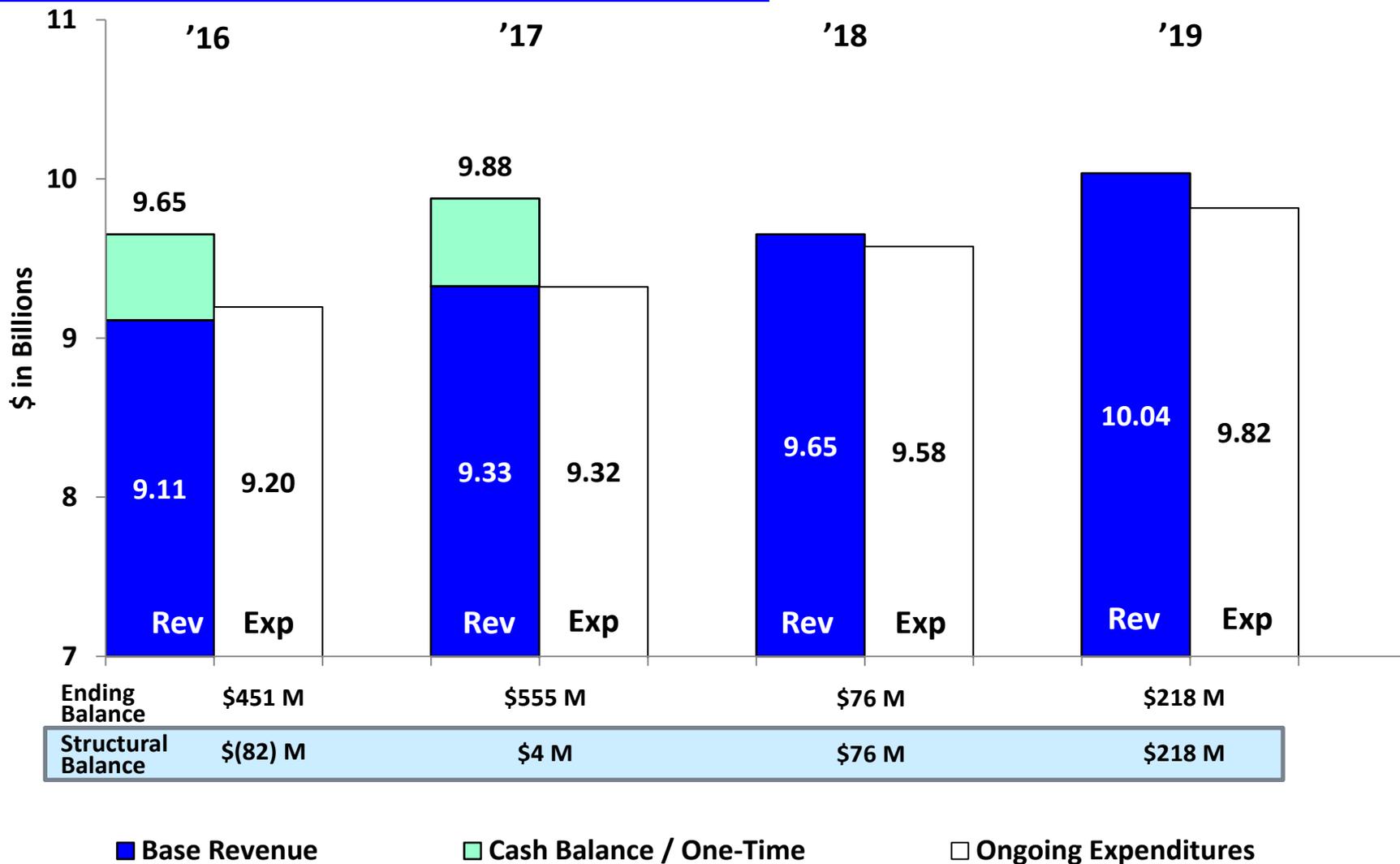
# '17: Large Cash Balance, But only Small Structural Balance

- ❑ '17 would be first structurally balanced budget since '06
- ❑ Using \$555M cash balance for ongoing initiatives re-creates structural gap
- ❑ Excludes \$460M Rainy Day Fund Balance

## FY 2017 Baseline Projection

	\$ in M
Balance Forward / Other	
One-time Revenues	\$ 551
Ongoing Revenues	9,326
<b>Ongoing Spending</b>	<b>(9,322)</b>
<b>Cash Balance</b>	<b>\$ 555</b>

# Projected General Fund Revenues & Expenditures - With K-12 Special Session Funding



FY 2017 projected ending balance assumed to be allocated as part of the budget process.

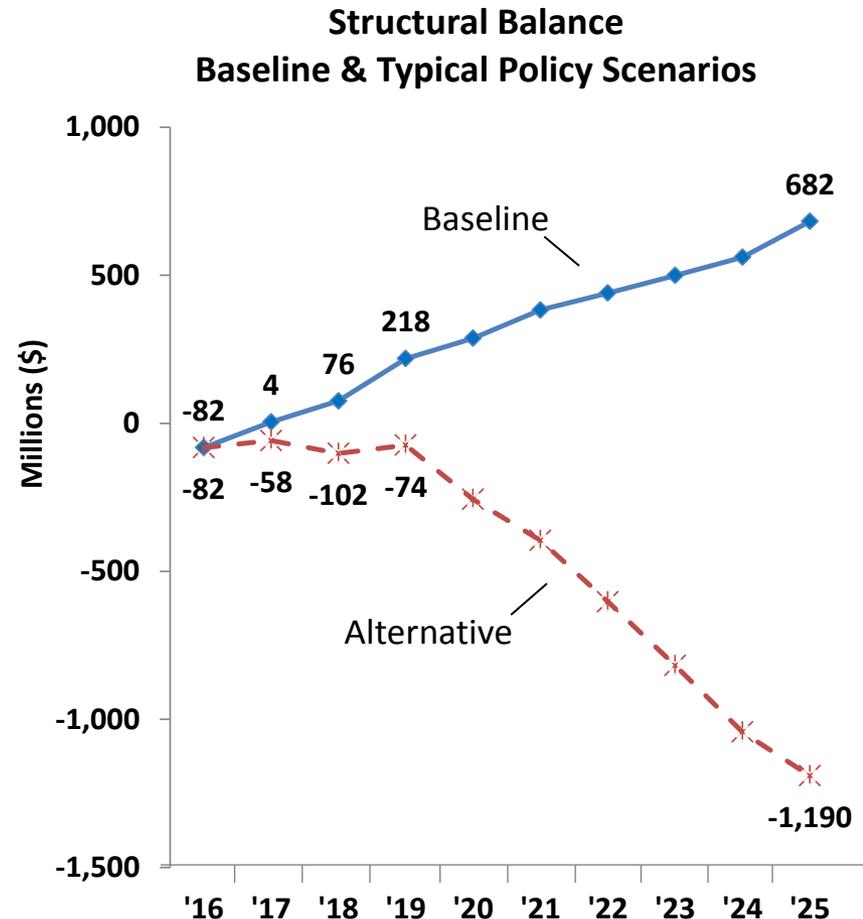
# Agency Budget Requests

	\$ in M	
	'16	'17
DCS	65	106
ADC	-	67
DES (Non-Medicaid)	8	56
SFB	15	27
Universities	24	170

- ❑ '16 represents supplemental to existing budget
- ❑ '17 represents change to enacted '16 budget

# By '25, \$680 M Structural Balance Under Baseline, \$(1.2) B Shortfall Under Alternative Scenario

- Are 10 year forecasts useful?
- Baseline tends to overstate balances
- Alternative: adds discretionary spending + 10 year average tax cut



# Reviewing JLBC's November 2014 Fiscal Policy Goals

- Discussed at Last Year's ATRA Meeting

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- ❑ Eliminate structural shortfall
- ❑ Develop multi-year solution with targets - Reduce reliance on 1-time solutions over time
- ❑ Long term goal: set aside 1-time revenues
  - Excess ending balances
  - Excess capital gains
- ❑ Dedicate 1-time \$ for 1-time purposes
  - Rebates
  - Operating debt buyback - \$84 M annual debt payment
  - Infrastructure
  - IT Modernization