Finance Advisory Committee

Revenue and Budget Update

April 9, 2015

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Summary of April Forecast Update

- The Legislature enacted a ’16 budget in March with a $450K balance. The 3-year plan had an ’18 balance of $33 M
- The April FAC revision includes an updated revenue forecast and reflects enacted 2015 legislation
- The April forecast is more optimistic than the January Baseline for ’15 and ’16, but more cautious in ’17 and ‘18
- The April revisions have generally small impacts on the ending balance projections
- The ‘16 ending balance is currently projected to be $33 M, or $3 M if the tax conformity bill is signed*

**4/10 Note: Tax conformity was subsequently signed into law*

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March Budget As Enacted – Prior to April FAC

March Budget	’15	’16	’17	’18
Balance Forward	$577 M	$12 M	$450 K	$0 M
Revenues	$8.77 B	$9.11 B	$9.27 B	$9.55 B
Spending	$9.34 B	$9.13 B	$9.28 B	$9.52 B
Ending Balance	***$12 M***	***$450 K***	***$(16) M***	***$33 M***

Base Revenue Growth	4.3%	3.8%	4.4%	5.1%
Spending Growth		(2.2)%	1.7%	2.5%

- The enacted budget transfers monies as needed from the Rainy Day Fund to generate a $12 M ‘15 ending balance
- In March, this provision was estimated to use $113 M of the $464 M Rainy Day Fund to balance ‘15

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How April Forecast Affects Ending Balance

Ending Balance	$ in M '15	'16
• Enacted Budget	$ 12	$ 0
• Adjusted for April FAC	12	33
• April FAC + Tax Conformity	12	3
• April FAC + Tax Conformity + K-12 Reset	12	(260)

- April forecast would require $70 M Rainy Day Fund transfer, rather than $113 M
- K-12 Reset of $337 M occurs if Superior Court ruling is upheld

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Forecast Risks

- 1% Variance Yields $575 M Over 3 Years

Potential Gains

- National economic recovery may provide upside gain, in part, by generating more interstate migration
- Gas price windfall will also help stimulate retail sales, but is likely temporary
- Business filing behavior may delay impact of ‘15 corporate income tax reductions until ‘16

Potential Gain or Loss

- Impact of January 1, 2015 TPT changes

Potential Losses

- Uncertainty of international events and the Fed rate hike
- Litigation – K-12, hospital assessment
- Internal Revenue Code conformity legislation

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Revenue Overview

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‘15 Revenue Growth Rate Improved Over Slow ‘14
- Led by Corporate Recovery

	‘14 Actual	‘15 YTD
Sales	5.5%	4.2%
Individual Income	1.9%	5.9%
Corporate Income	(13.1)%	11.3%
Overall	2.7%	4.9%

- Through March, year-to-date revenues $87 M above forecast
- Difficult to interpret YTD in middle of tax filing season

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4-Sector Forecast Displays Gradual Improvement

Components of 4-Sector

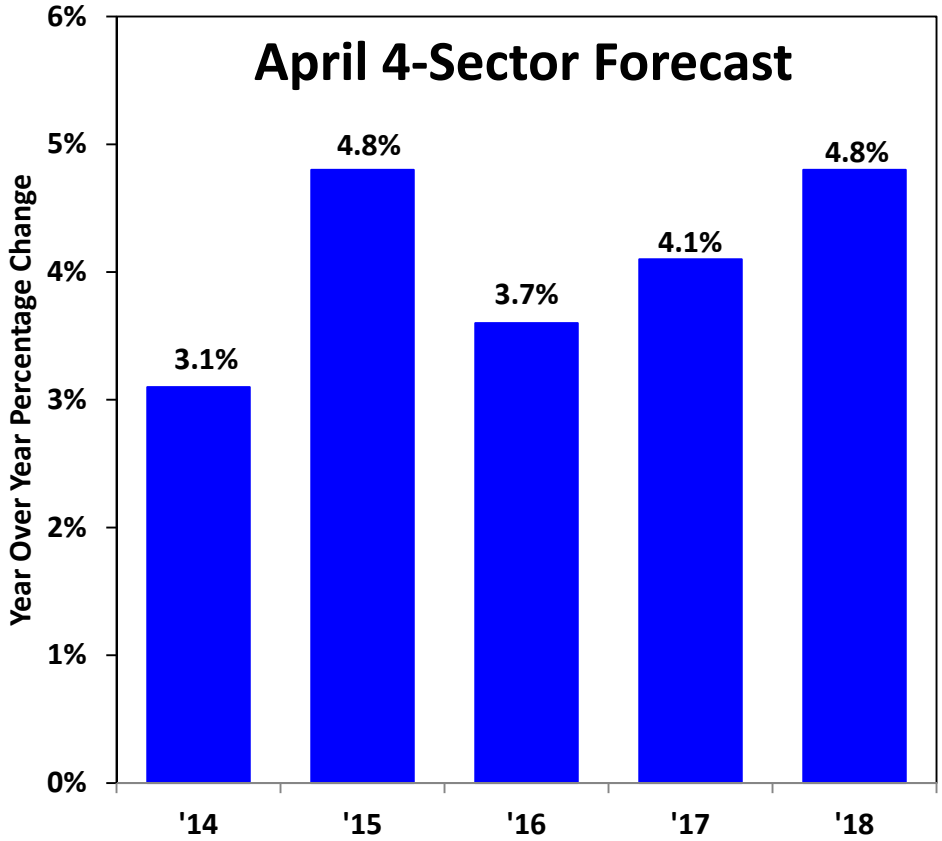
- Finance Advisory Committee
- UA base model
- UA lower model
- JLBC Staff

Chance of Exceeding Forecast

- 65%

Long Run Average Growth

- 4.75%



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

Details in Appendix A

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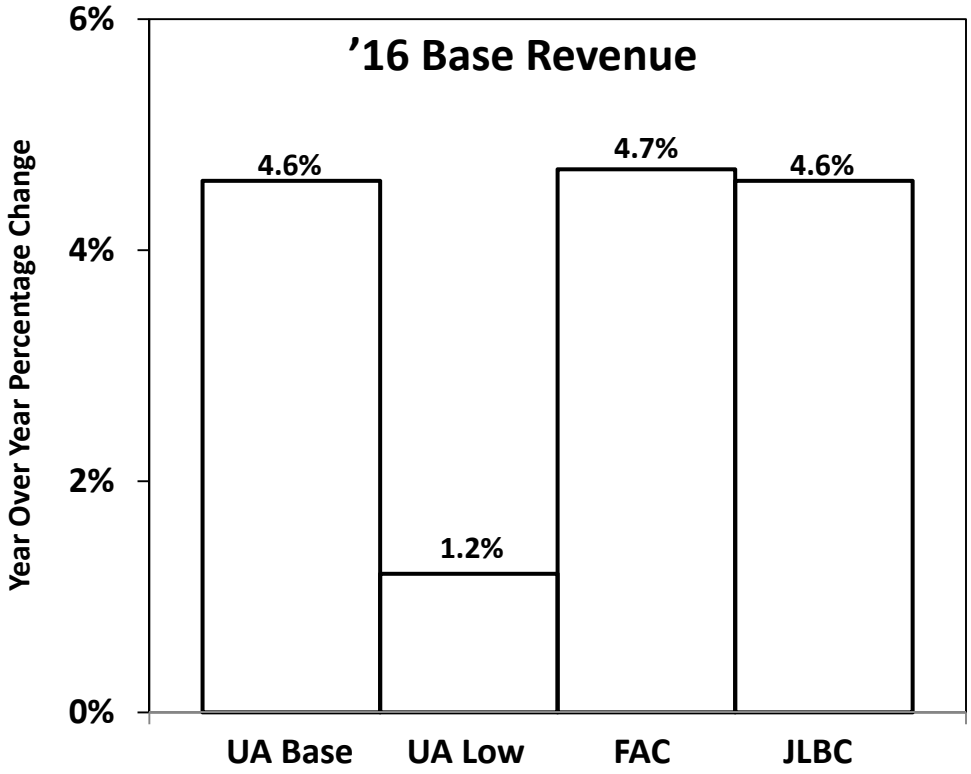
Why Is '16 Projected to Grow More Slowly Than '15?



- Without UA Low, '16 rate is near '15
- UA Low represents a "Stalled Recovery" scenario
- Global Insight places odds of this scenario at 15%
- Lower growth if household formation weak

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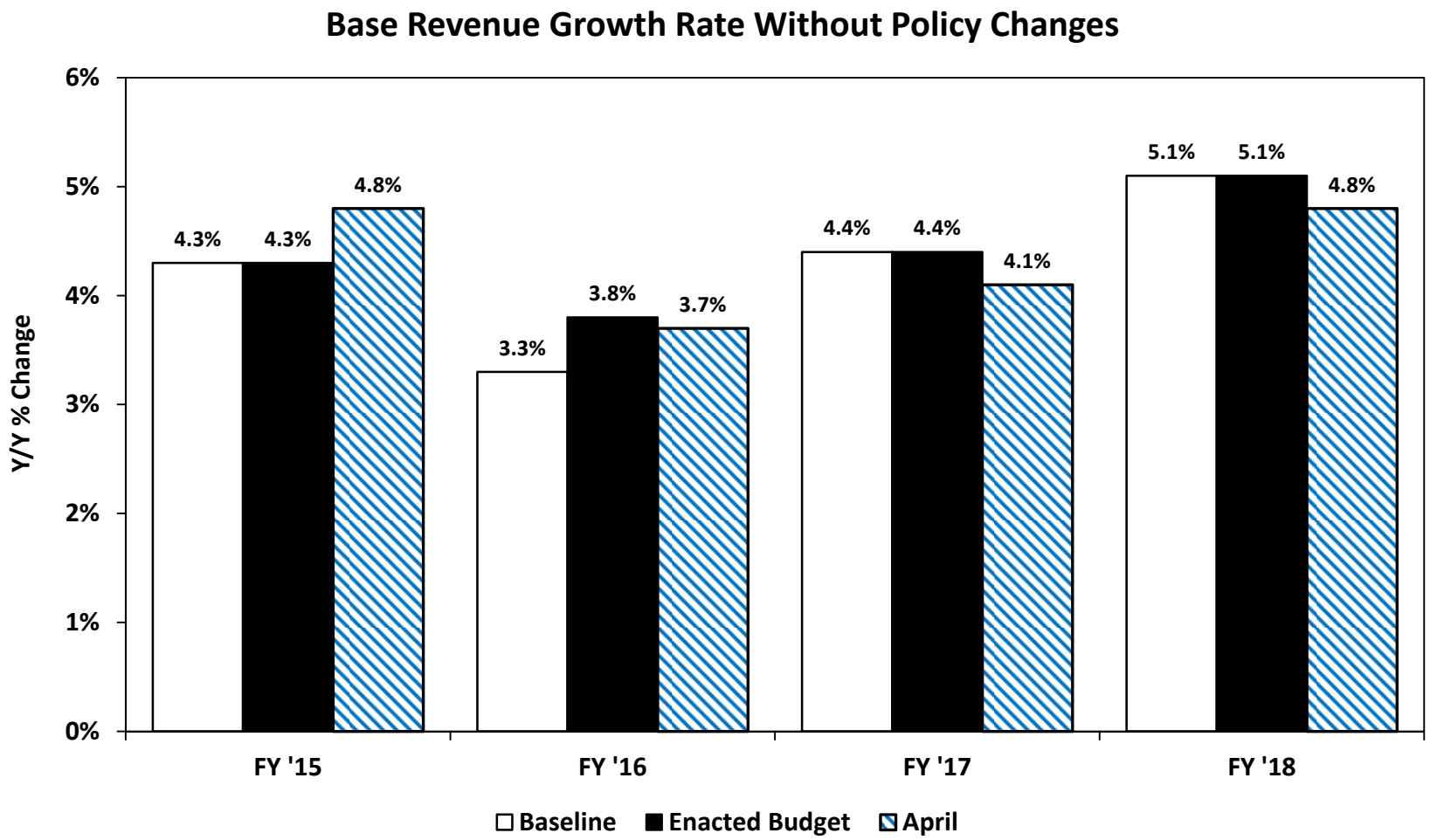
March Budget Versus April Forecast



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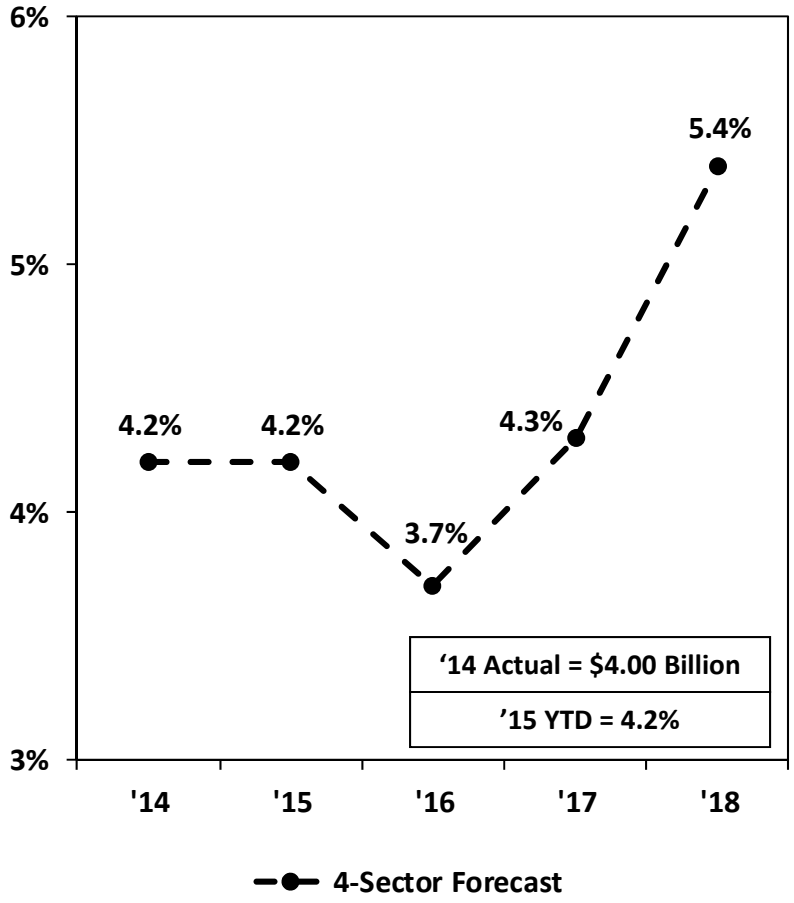
Sales Tax

- Projected Growth of 4.2% in ’15 and 3.7% in ‘16



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

- Retail sector of sales up 7.8% in ‘14; 3.5% so far in ’15
- After technical fix, retail ’15 YTD would be 5.7%
- Contracting up 11.2% in ‘14; down (0.8)% in ’15 YTD
- Effects of Jan ‘15 contracting law and reduced gas prices need to be monitored

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Potential 1-Time Windfall from Gas Prices

- Gas price decline has increased consumer disposable income – but recent price hike tempers enthusiasm
- General Fund revenue impact depends on duration and how much of savings are spent on taxable goods
- Recent survey indicates that gas savings are going primarily to groceries and paying off debt
- General Fund revenue impact may be smaller than original $10 M - $40 M estimate
- Windfall not reflected in enacted or April estimates

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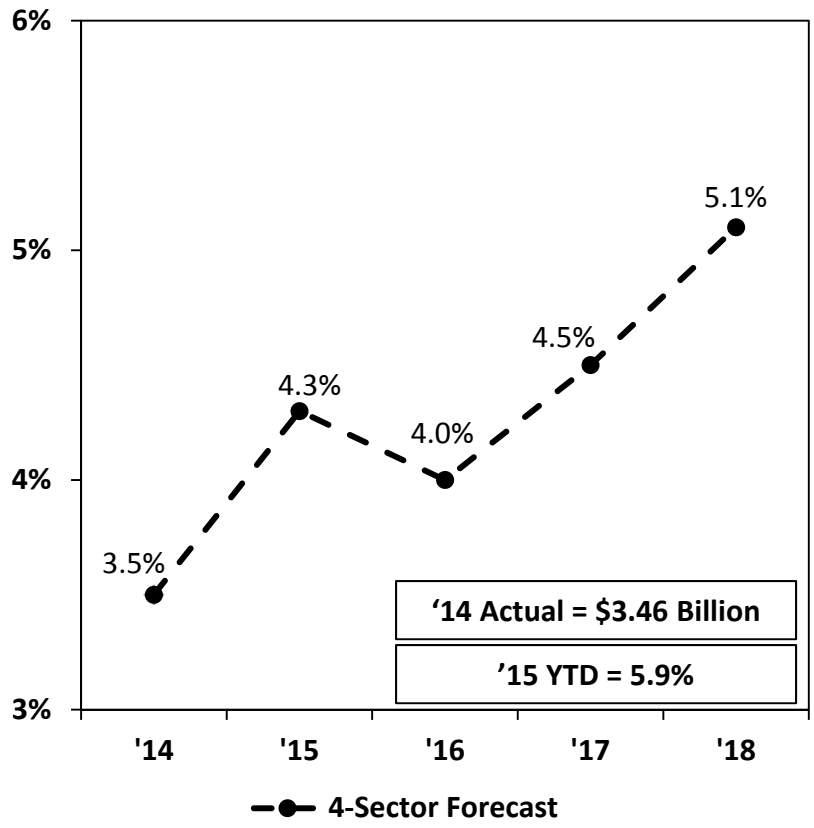
Impact of Recent Changes to Contracting Tax

- Effective January 2015, legislation changed tax base for certain materials from prime contracting to retail
- JLBC estimated shift would cause revenue loss, but other provisions would keep bill revenue neutral
- Collections from January contracting activity declined (17.4)% from prior year – impact of the bill?
- Some of January's strong 8.9% retail growth may be related to Super Bowl and contracting shift
- Shift likely to make TPT category collections volatile this year; difficult to measure actual impact

Individual Income Tax
- Projected Growth of 4.3% in ’15 and 4.0% in ‘16



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

- Difficult to interpret IIT results in middle of tax filing
- Payments subside after April, refunds go through May
- April/May results can alter forecast significantly

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Components of Individual Income Tax Growth

	'14	'15 YTD
Withholding	3.4%	3.0%
Payments	(3.4)	6.5%
Refunds	1.1%	(4.2)%
Net	1.9%	5.9%

- Withholding growth remains sluggish
- Annual withholding growth has not been above 3.5% since '11
- April/May payment growth forecast at 6.2% in Update
- Based on December/January filings, payment potential is greater

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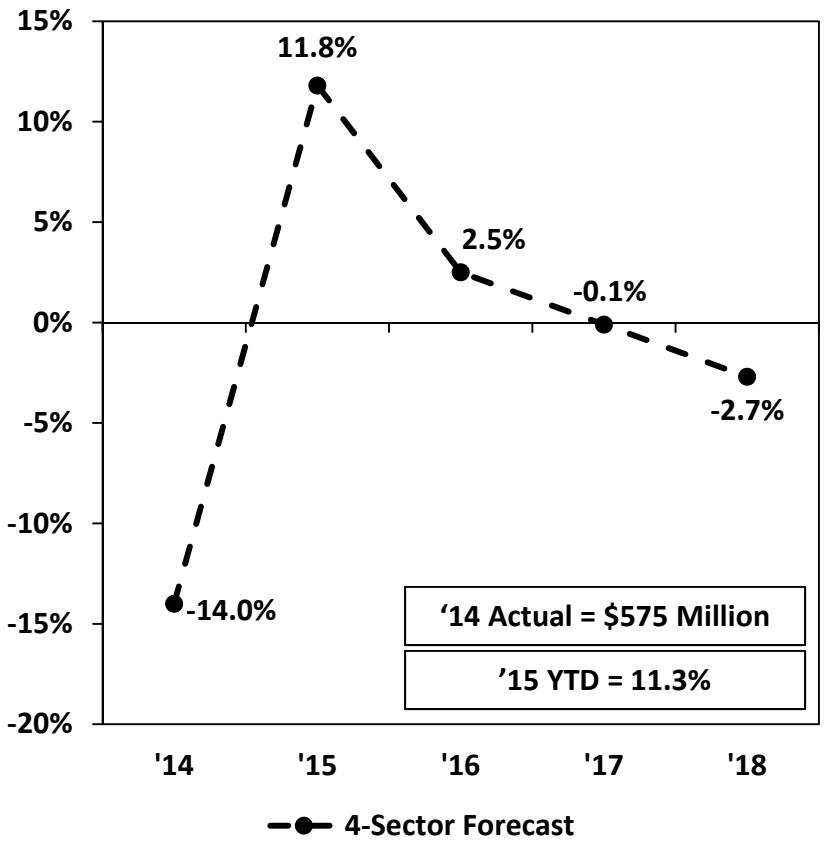
Corporate Income Tax
- Projected Growth of 11.8% in ’15 and 2.5% in ’16



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

- ‘15 growth offsets ‘14 drop
- ‘17/18 base revenue declines exclude tax cuts
- These declines due to UA models
- Filing extension may delay the impact of tax cuts

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Phase-In of Previously Enacted Tax Reductions
- By '18, Revenue Base is $283 M Lower

Pre-2015 Session Changes	'16	'17	'18
		$ in M	
❑ Corporate Rate Reduction/Sales Factor	(68)	(60)	(59)
❑ 25% Capital Gains Reduction	(11)	0	0
❑ Income Tax Indexing	(6)	(9)	(9)
❑ Corporate School Tuition Indexing	(9)	(10)	(12)
❑ Other	(18)	(8)	(4)
Total	**(112)**	**(87)**	**(84)**

- ❑ Corporate reduction adjusted to reflect April base
- ❑ Income tax indexing made permanent this session

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Corporate Filing Pattern May Delay Impact of Reduction

- The 4-year phase in of corporate tax reductions began with Tax Year 2014 at estimated ‘15 cost of $70 M
- If a company’s tax year began in January 2014, it would file taxes in April 2015
- Based on further research, however, many large corporations file a 6-month extension (October 2015)
- As a result, the primary impact of the initial corporate reductions may be delayed until ‘16
- ‘15 Net corporate collections likely higher than forecast

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Additional Revenue Changes Approved in 2015 Session*

Budgeted	**'15**	**'16**	**'17**	**'18**
Fraud Detection and Prevention	0	42	(14)	(13)
Tax Amnesty	0	15	(15)	0
Retain Federal Dispro Share	11	5	(8)	(8)
Fund Transfers	15	205	(120)	(100)
Rainy Day Fund Transfer	70	(70)	0	0
Outside Budget - Signed				
TPT Exemption – Int'l Operations	0	0	(1)	0
Insurance Retaliatory Taxes	0	(2)	(0)	(0)
Insurance 11-Year Rate Cut	0	0	(1)	(0)
Outside Budget - Unsigned				
IRS Conformity	(31)	0	0	0

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*Changes relative to prior year

Impact of IRS Conformity Bill

- Two years ago, AZ conformed to the $500K small business equipment deduction in Tax Year '13
- Last year, Governor vetoed a permanent $500K deduction, thereby freeing up funds for DCS Special Session
- As a result of the veto's redirection of funds, the January Baseline excluded funding for this provision
- As transmitted to the Governor, SB 1188 would once again conform to the $500K federal level
- Relative to the Baseline, the bill has an on-going cost of $31 M beginning in '15

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All Adjustments Result in '16 Growth Rate of 4.3%

	$ in M Above Prior Year		
	'16	'17	'18
Base Revenue Growth (3.7%/4.1%/4.8%)	344	388	474
Previously Enacted Tax Legislation	(112)	(87)	(84)
Newly Enacted Revenue	61	(39)	(22)
Elimination of Prior Year Transfers	(54)	--	--
New Fund Transfers	205	(120)	(100)
One-time '15 Rainy Day Fund Transfer	(70)	0	0
Urban Revenue Sharing	3	(20)	(9)
Total	**377**	**122**	**259**
% Change	**4.3%***	**1.3%**	**2.8%**

*Excludes net loss of $565 M beginning balance. After that adjustment, total '16 revenues decline (2.0)%

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Projected Ending Balance Estimates

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Enacted Budget Adjusted for April FAC Forecast

April FAC	’15	’16	’17	’18
Balance Forward	$577 M	$12 M	$0 M	$0 M
Revenues	$8.77 B	$9.15 B	$9.27 B	$9.53 B
Spending	$9.34 B	$9.13 B	$9.28 B	$9.52 B
Ending Balance	***$12 M***	***$33 M***	***$(15) M***	***$12 M***

Base Revenue Growth	4.8%	3.7%	4.1%	4.8%
Spending Growth		(2.2)%	1.7%	2.5%

- Uses $70 M of $464 M Rainy Day Fund to balance ’15
- $33 M ‘16 balance would be reduced with enactment of IRS conformity bill

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Projected Ending Balance

- Impact of April Forecast on Enacted Budget

	’15	’16	‘17	‘18
March Budget	$12 M	$450 K	$(16) M	$33 M
April Forecast	$12 M	$33 M	$(15) M	$12 M
April Forecast w/ Conformity	$12 M	$3 M	$(46) M	$(18) M
April/Conformity/ K-12 Reset	$12 M	$(260) M	$(313) M	$(290) M

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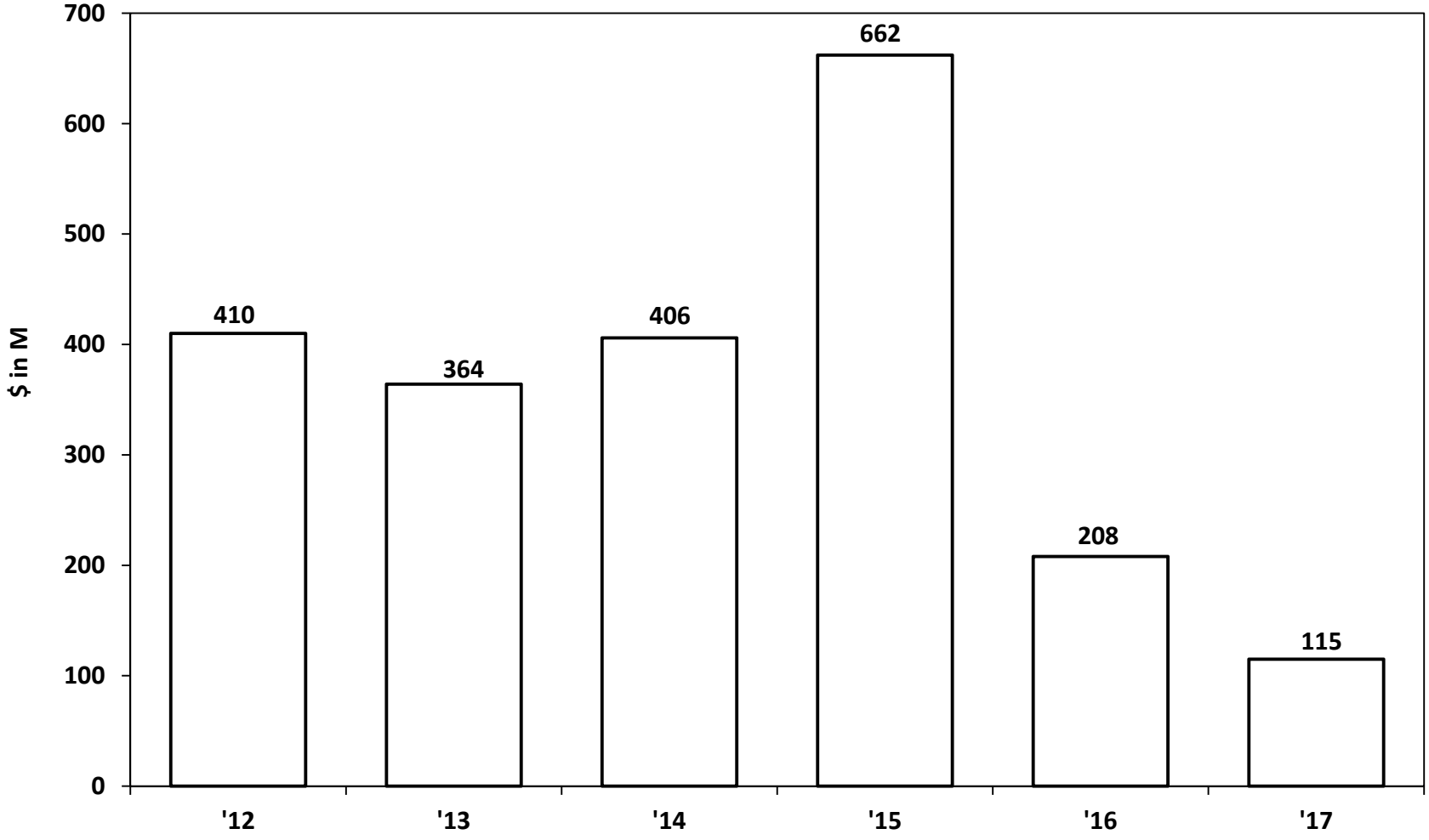
Structural Shortfall – Ongoing Revenues Vs. Spending

- '18 Has Projected $12 M Structural Balance using April Forecast



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Appendix A: April 2015 4-Sector Forecast

	2015	2016	2017	2018
Sales Tax				
JLBC Forecast	4.3%	4.5%	4.8%	5.0%
UA – Low	3.7%	1.1%	2.2%	4.6%
UA – Base	4.3%	4.6%	5.2%	5.9%
FAC	4.3%	4.6%	4.9%	4.8%
Average:	**4.2%**	**3.7%**	**4.3%**	**5.4%**
Individual Income Tax				
JLBC Forecast	5.4%	5.2%	5.3%	5.3%
UA – Low	2.9%	1.5%	2.6%	4.3%
UA – Base	3.7%	4.4%	4.8%	5.5%
FAC	5.2%	5.0%	5.1%	5.4%
Average:	**4.3%**	**4.0%**	**4.5%**	**5.1%**
Corporate Income Tax				
JLBC Forecast	15.0%	1.2%	3.1%	3.9%
UA – Low	11.2%	0.1%	(9.1)%	(14.2)%
UA – Base	11.2%	5.5%	(0.8)%	(9.2)%
FAC	9.8%	3.3%	6.0%	6.4%
Average:	**11.8%**	**2.5%**	**(0.1)%**	**(2.7)%**
JLBC Weighted Average	**5.5%**	**4.6%**	**4.9%**	**5.1%**
UA Low Weighted Average	**3.9%**	**1.2%**	**1.8%**	**4.0%**
UA Base Weighted Average	**4.5%**	**4.6%**	**4.7%**	**5.3%**
FAC Consensus Weighted Average	**5.1%**	**4.7%**	**5.0%**	**5.4%**
"Big-3" Weighted Average	**4.8%**	**3.8%**	**4.1%**	**4.9%**
Consensus Weighted Average*	**4.8%**	**3.7%**	**4.1%**	**4.8%**
Adjusted Consensus Weighted Average**	**3.6%**	**3.0%**	**2.9%**	**3.8%**

* Represents on-going revenue adjusted for small revenue categories
** Represents on-going revenue adjusted for tax law changes; excludes Urban Revenue Sharing

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