
Finance Advisory Committee

Revenue and Budget Update

October 4, 2013

JLBC

Summary of Current Budget Status

- ❑ FY '13 ending balance was \$200 M more than expected
- ❑ Annual base revenue is projected to grow by only 3.5% in FY '14 due to a decline in capital gain taxes – will be reevaluated throughout the year
- ❑ FY '15 – FY '17 annual revenues would increase by over 5%
- ❑ On-going spending above projected revenues – carry forward keeps budget balanced in FY '14 and FY '15
- ❑ Projected annual shortfalls of \$(200) M in FY '16 and \$(300) M in FY '17

Revenue Overview

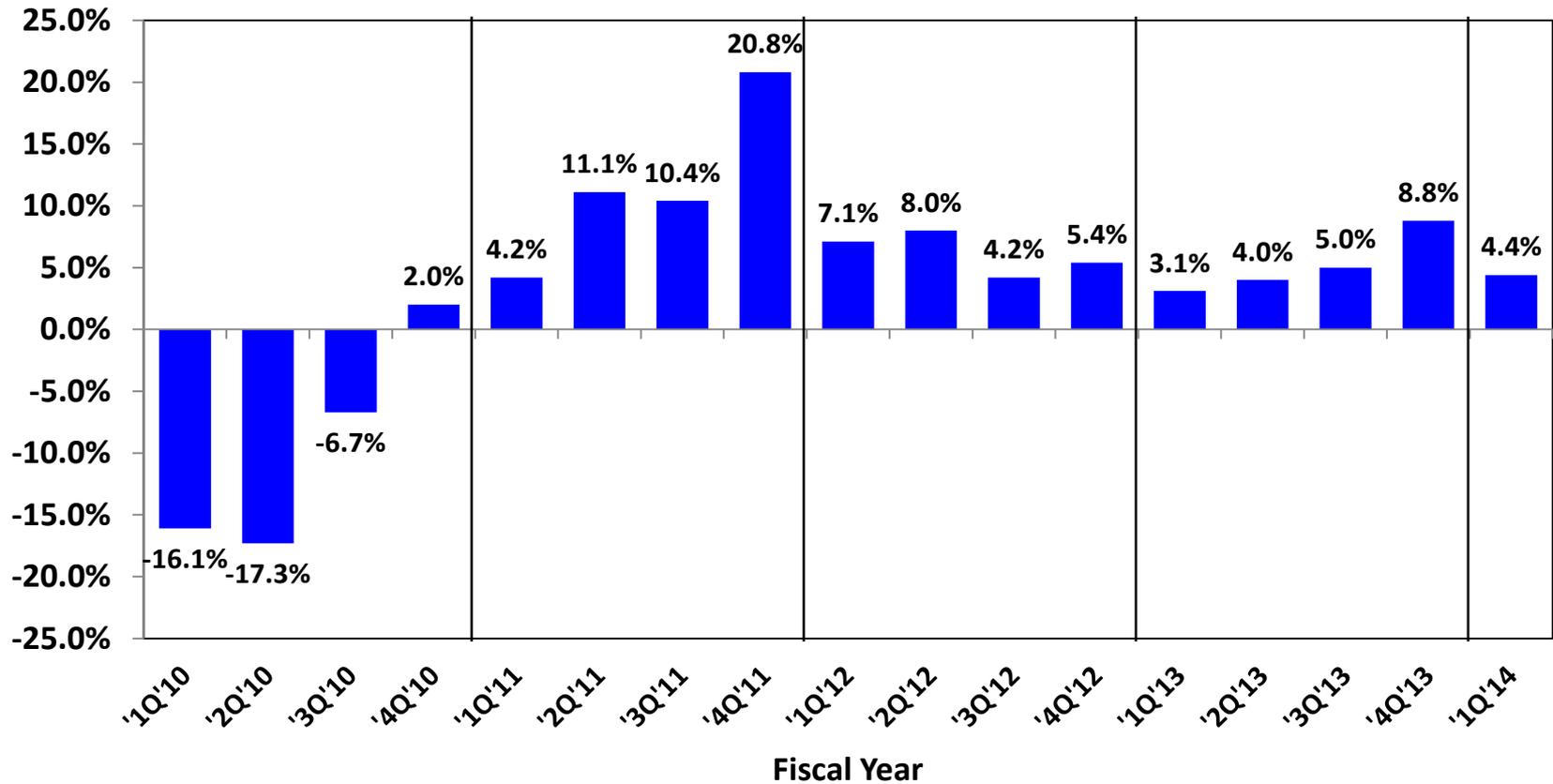
FY '13 Capital Gains Acceleration Pushed Overall Base Growth to 6.4%

	<u>FY '13 Over FY '12</u>	
	<u>Budgeted</u>	<u>Actual</u>
Sales *	3.5%	4.9%
Individual Income	5.8%	10.1%
Corporate Income	1.4%	2.8%

* Includes 1-cent, and excludes impact of change in estimated payment threshold

4th Quarter FY '13 Growth Strongest in 2 Years

- April Tax Filings Lifted Quarterly Growth Rate



1st Quarter FY '14 Growth Rate 4.4% *

- \$(12.6) M Below Forecast

	<u>% Change over Prior Year *</u>
Sales Tax (without 1-cent)	6.6%
Individual Income Tax	6.6%
Corporate Income Tax	(24.2)%

- First quarter growth (0.6)% below budgeted growth rate

* Based on preliminary September numbers

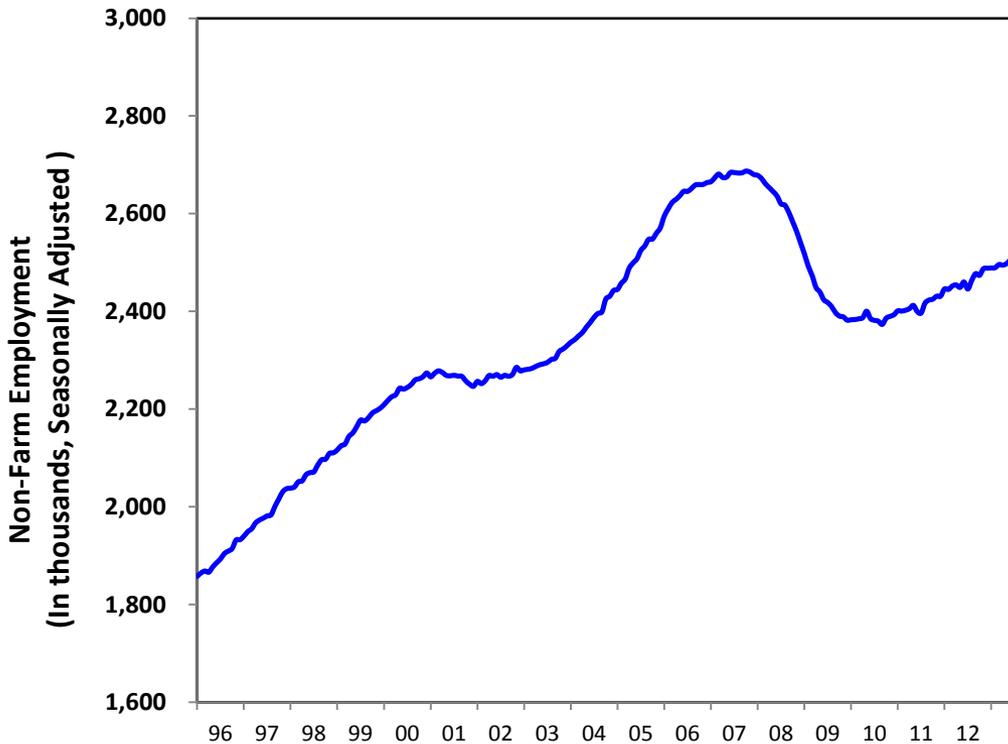
Key Economic Measures

- Current Arizona Status Compared to Last Year

	August '12	August '13
Withholding Growth 3 Month Average Compared to Prior Year	2.2%	5.7%
Retail Sales Tax Growth 3 Month Average Compared to Prior Year	3.2%	9.1%
Pending Maricopa Foreclosures Normal = 3,000	16,400	6,900
Arizona Annual Single Family Permits Normal = 40,000	14,600	17,300
Arizona Underwater Mortgages	31%	25%

Arizona Non-Farm Employment Grew 8.6%

- June 2003 to June 2013



- Since start of recession, state had 2nd lowest job growth
- But does not account for higher pre-recession job growth
- AZ had 12th highest percent growth since 2003

Arizona Forecasters Are Optimistic Compared to Other Western States

Blue Chip Forecast - % Personal Income Growth

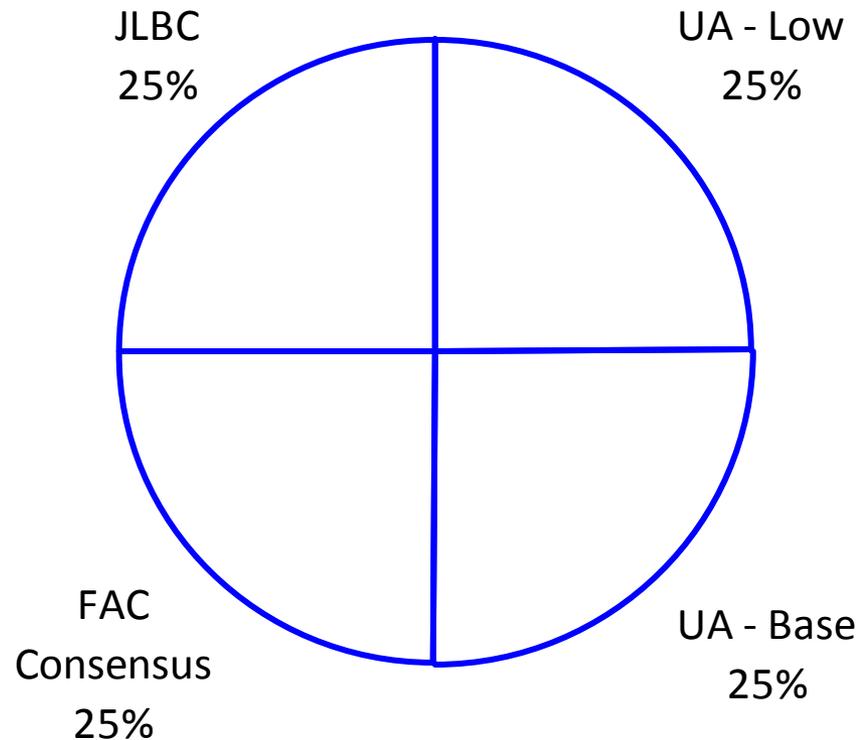
<u>CY 2013</u>		<u>CY 2014</u>	
Texas	5.8%	Texas	5.9%
Arizona	4.9%	Arizona	5.7%
Colorado	4.2%	Utah	5.6%
Utah	4.2%	Washington	5.6%
Washington	4.1%	California	5.3%
Montana	3.7%	Colorado	5.1%
Oregon	3.6%	Oregon	5.0%
California	3.5%	Montana	4.5%
New Mexico	3.1%	Idaho	4.4%
Idaho	2.9%	New Mexico	4.2%
Wyoming	2.9%	Nevada	2.7%
Nevada	2.5%	Wyoming	N/A

Where Are We Headed Over the Next Few Years?

- Four-Sector Consensus Forecast Incorporates Different Economic Views, Including the FAC

4-sector forecast equally weights:

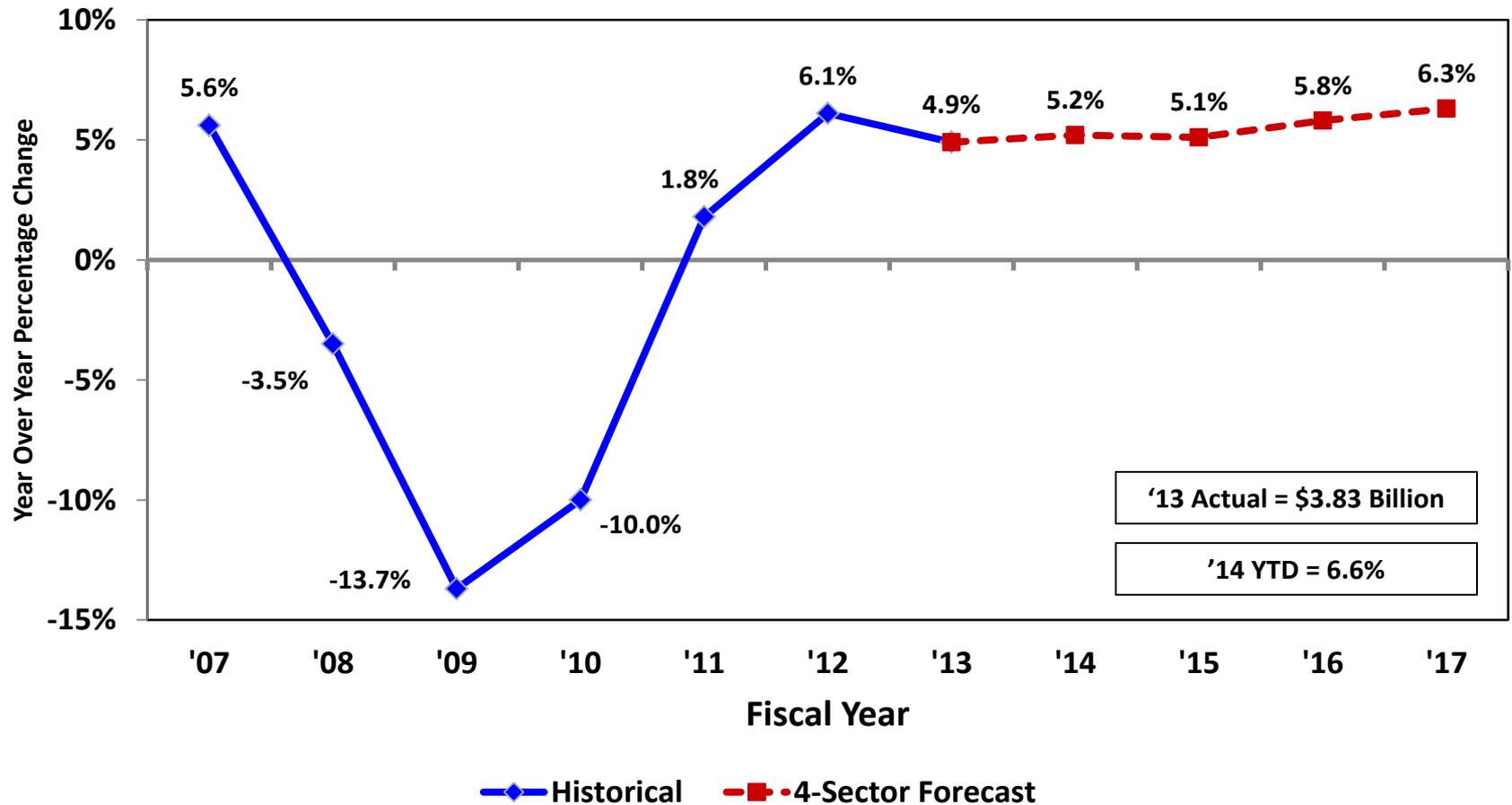
- FAC average
- UofA model – base
- UofA model – low
- JLBC Staff forecast
- Remaining revenues (10% of total) are staff forecast



* Includes Big 3 categories of sales tax, individual income and corporate income taxes

Sales Tax

- Projected Growth of 5.2% in FY '14 and 5.1% in FY '15

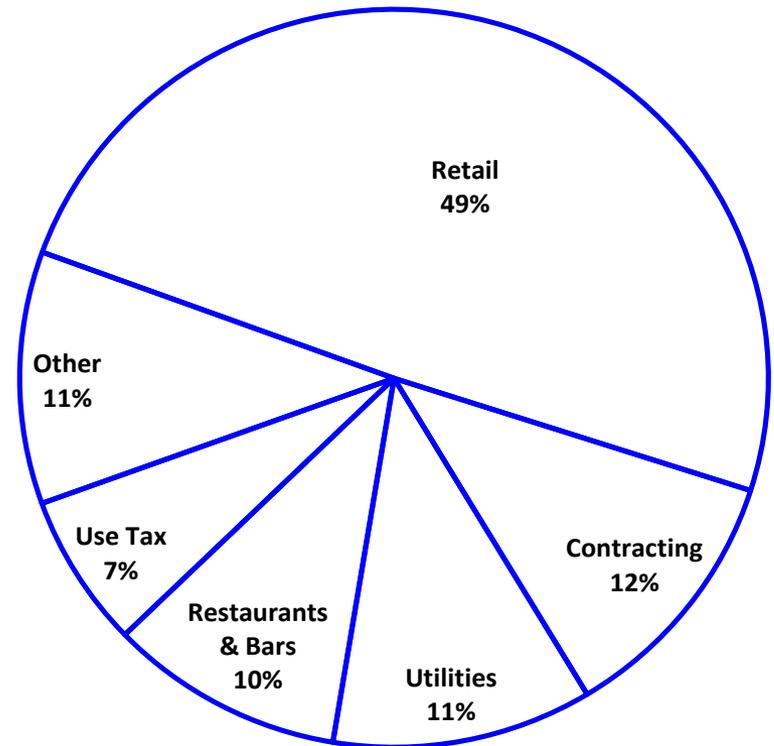


Percent Change in Base Revenue Excluding Tax Law Changes and 1-Cent Sales Tax

FY '13 Total Sales Tax Collections = \$3.83 B

- Collections by Major Category

<u>Category</u>	<u>FY '13 Base (Millions)</u>	<u>'14 YTD %* Increase</u>
Retail	\$1,891.0	8.5%
Contracting	438.6	18.1%
Utilities	430.6	2.7%
Restaurants & Bars	389.1	2.3%
Use Tax	257.9	5.0%
Other	<u>423.7</u>	<u>1.3%</u>
TOTAL	\$ 3,830.9	7.2%



* Through August

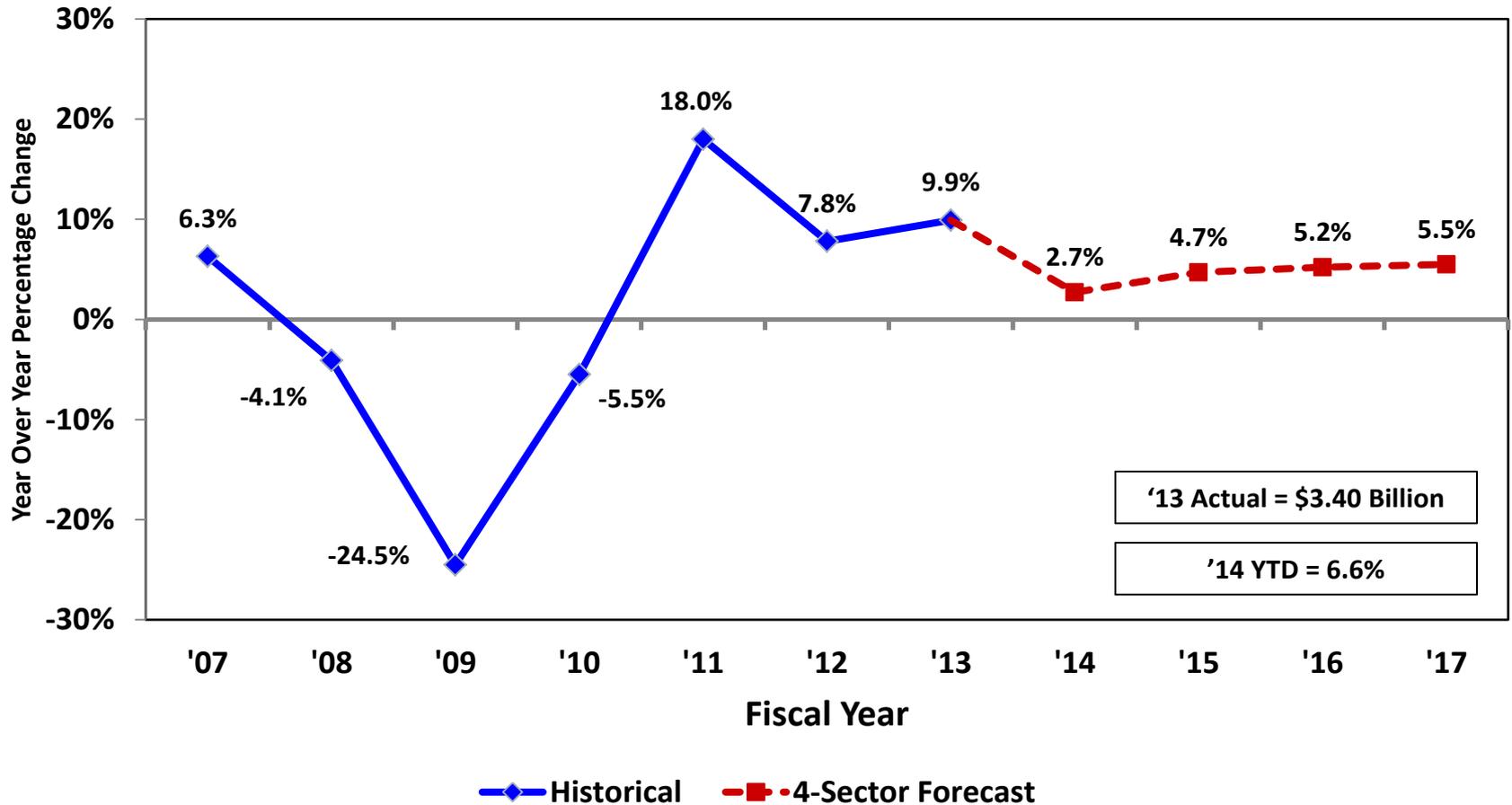
'14 YTD Sales Tax Growth Driven by 2 Categories

- Retail up by 8.5% - Contracting by 18.1%

- ❑ Auto sales are up by 13.2% (included in the retail category)
- ❑ Pent up demand and end of 1% sales tax may have boosted car sales
- ❑ Strong growth in contracting driven by both residential and nonresidential construction – up 20% and 27% respectively

Individual Income Tax

- Projected Growth of 2.7% in FY '14 and 4.7% in FY '15



Percent Change in Base Revenue Excluding Tax Law Changes and One-Time Changes

Components of Individual Income Tax Growth

- FY '13 and First Quarter of FY 14

	<u>FY '13</u>	<u>FY '14 Projected</u>	<u>1st Qtr Prelim Actual</u>
Withholding	3.5%	4.0%	5.7%
Payments	16.3%	(1.0)%	16.2%
Refunds	<u>(2.5)%</u>	<u>2.9%</u>	<u>20.1%</u>
Net	10.1%	2.7%	6.6%

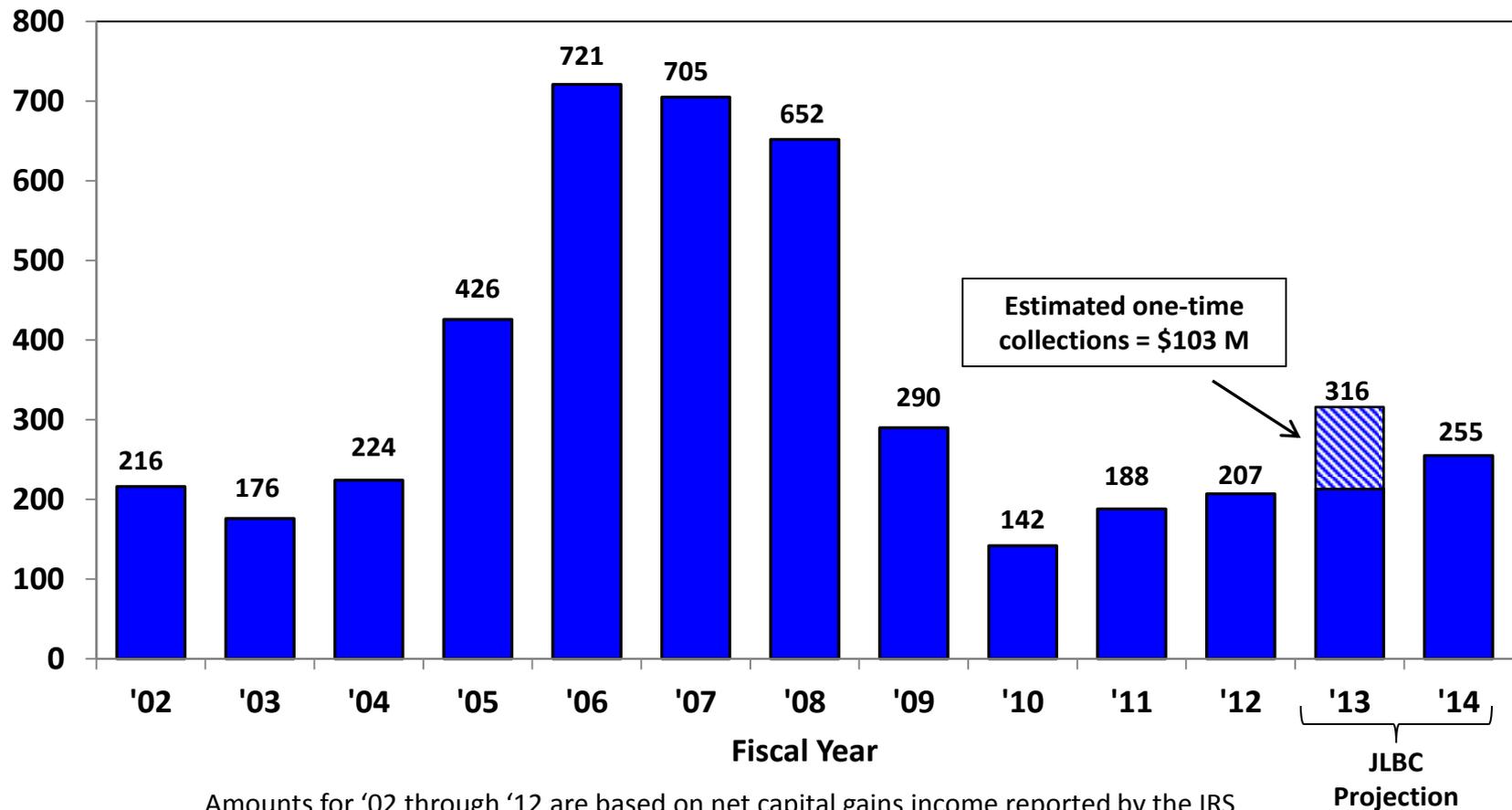
- ❑ FY '13 withholding growth below job and wage growth
- ❑ FY '13 payment increase partly due to accelerated capital gains
- ❑ Can we sustain double digit payment growth in FY '14?
- ❑ Will reevaluate FY '14 growth with more data

FY '13 Tax Acceleration Likely One-Time

- ❑ Possible and actual federal policy changes incentivized companies to issue dividends and stockholders to take capital gains
- ❑ Collections were accelerated into FY '13, likely reducing collections in future years
- ❑ JLBC projections include a \$103 M acceleration of collections in FY '13 and a \$(103) M reduction in FY '14
- ❑ Strong stock market performance in TY '13 is projected to provide a \$42 M offset to the loss of one-time investment income

Estimated Collections from Capital Gains

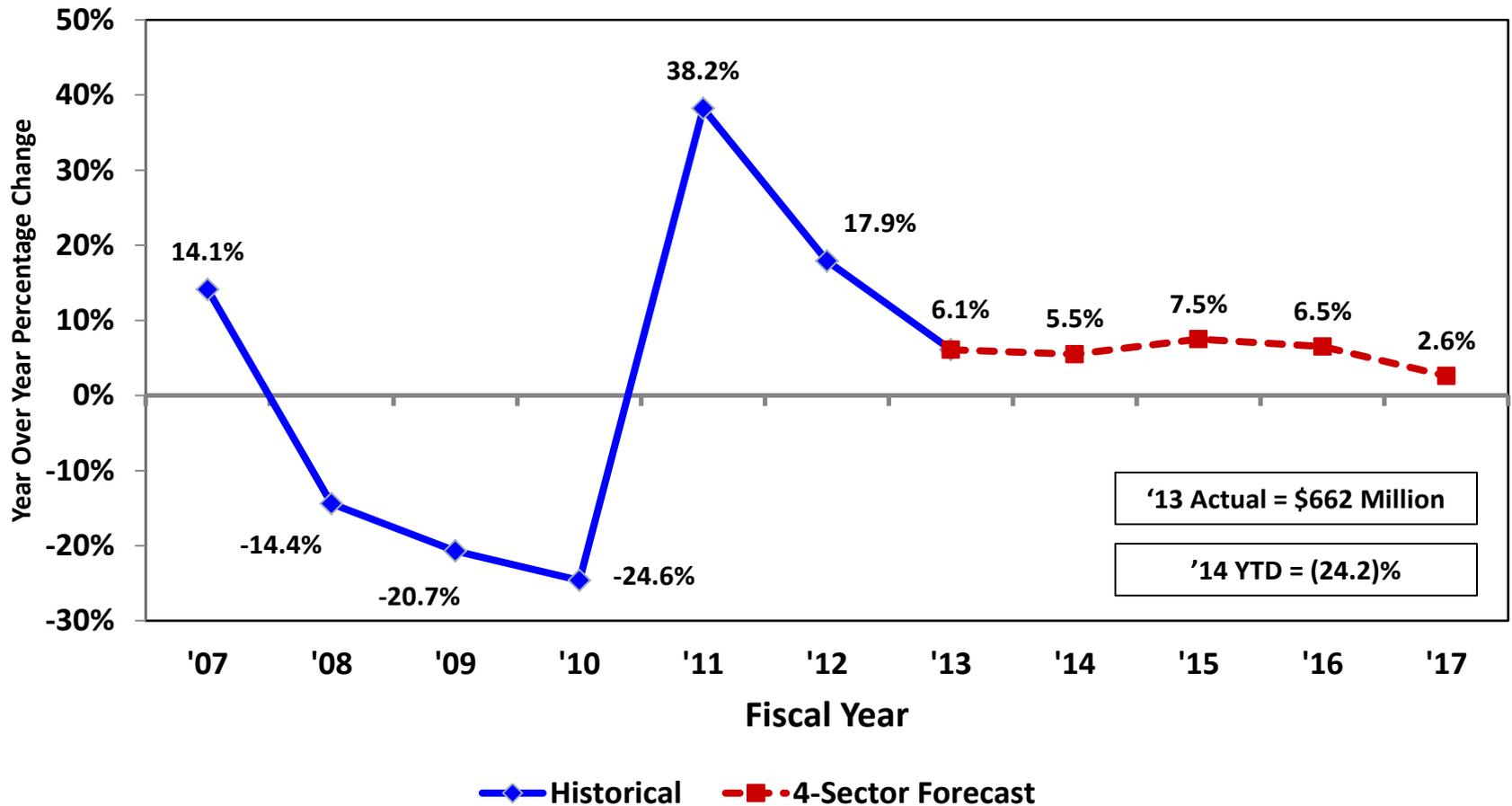
- Historically Volatile Component of Revenue



Amounts for '02 through '12 are based on net capital gains income reported by the IRS

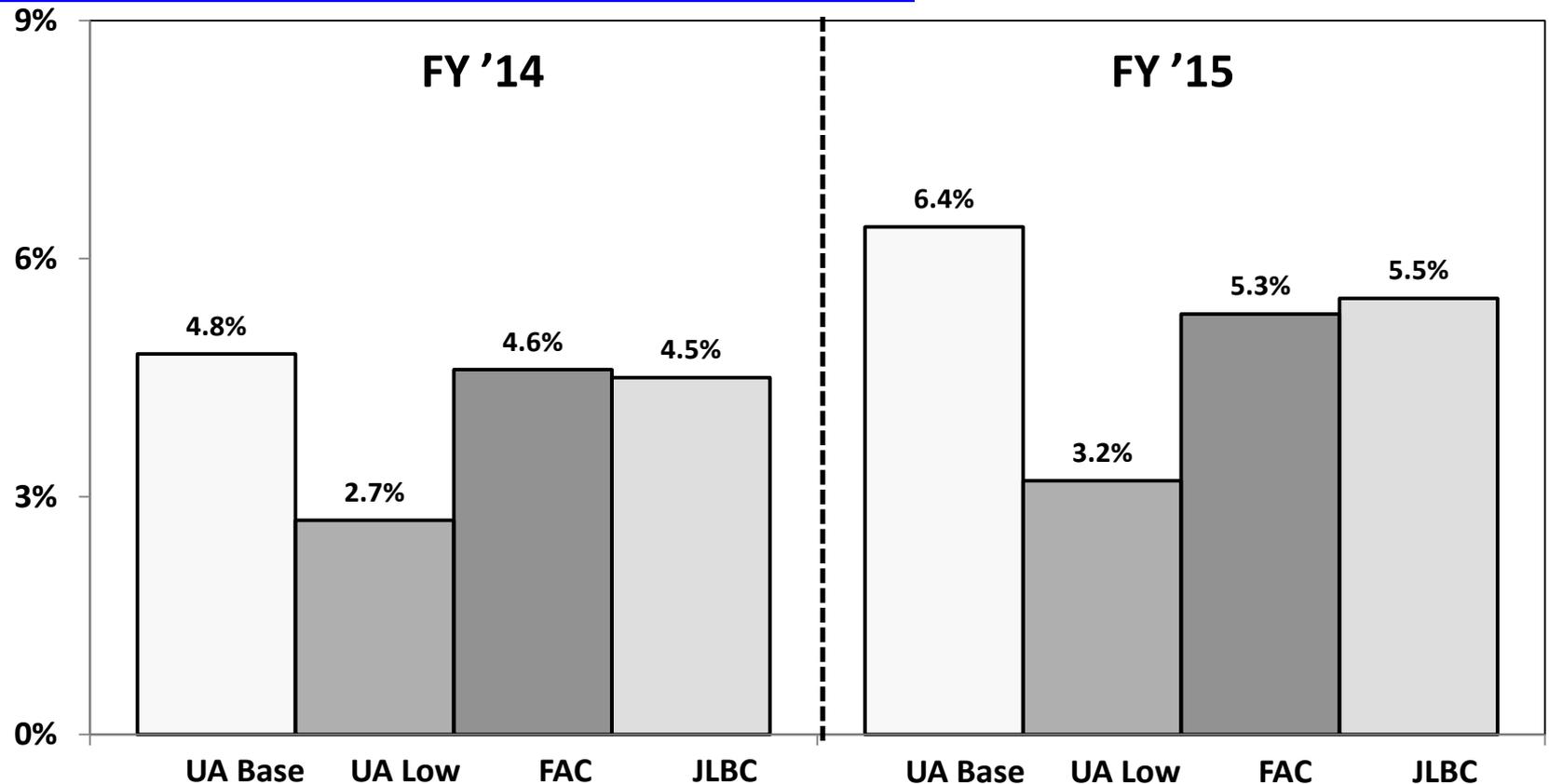
Corporate Income Tax

- Projected Growth of 5.5% in FY '14 and 7.5% in FY '15
- (24)% 1st Quarter Decline May Suggest Forecast is Too High



Consensus Predicts Base Growth Rate of 3.5% in FY '14 and 5.3% in FY '15*

- FY '14 Growth Rate Would Be 4.7% Absent Capital Gains Adjustment



Details in Appendix A

* After adjusting for small tax categories, the base growth rate is 3.5% in FY '14 and 5.3% in FY '15

Is 3.5% FY '14 Growth Reasonable?

- ❑ Without the adjustment for accelerated capital gains, projected growth would be 4.7%
- ❑ Without UofA Low growth scenario, adjusted revenue gain would be 5.2%
- ❑ But Global Insight places odds of “stalled recovery” at 20% - UofA Low not significantly overweighted

What Are Risks in Forecast?

- ❑ Standard caveats like unknown events and international economics
- ❑ Continuation of 0% interest rate economy
- ❑ Ongoing federal budget battles create uncertainty and hamper growth
- ❑ 1% change in annual growth over 3 years has a \$500 M impact on balance sheet

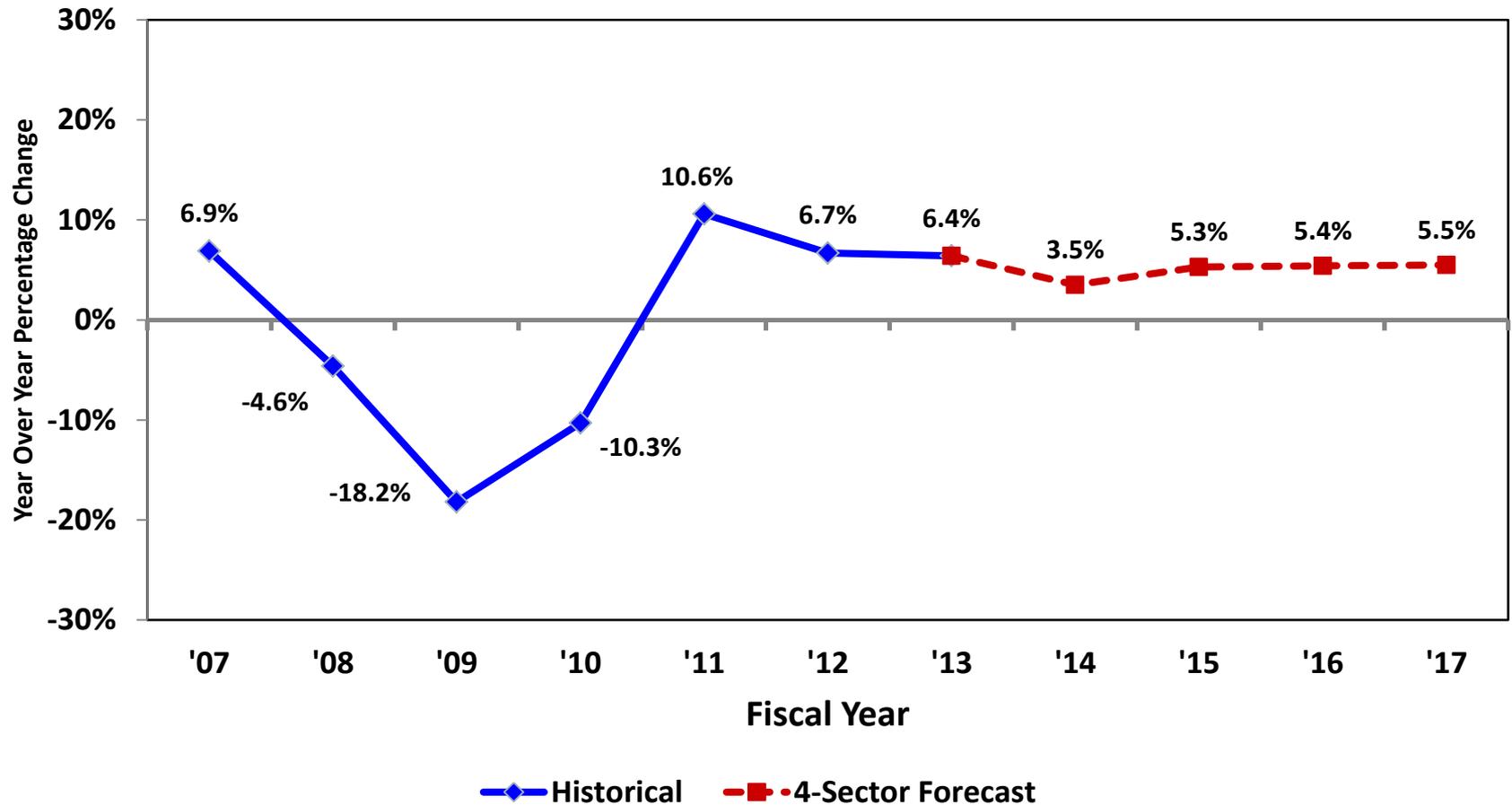
Arizona Impact of Partial Federal Shutdown

- ❑ Dynamics of shutdown constantly changing – hard to assess
- ❑ Tourism – Arizona’s National Parks
 - Average of 27,000 people visit daily
 - Visitors spend \$2.0 million per day
- ❑ Arizona employment
 - Arizona has 37,000 federal civilian employees – maybe 15,000 furloughed?

National Impact of Federal Budget Problems

- ❑ Depends on length of shutdown
- ❑ In short term, furlough of 800,000 federal employees is disruptive to those households – not much national impact
- ❑ Upcoming October 17th debt ceiling deadline has much greater potential for disruption
- ❑ Financial markets along with consumer and business confidence would be adversely affected

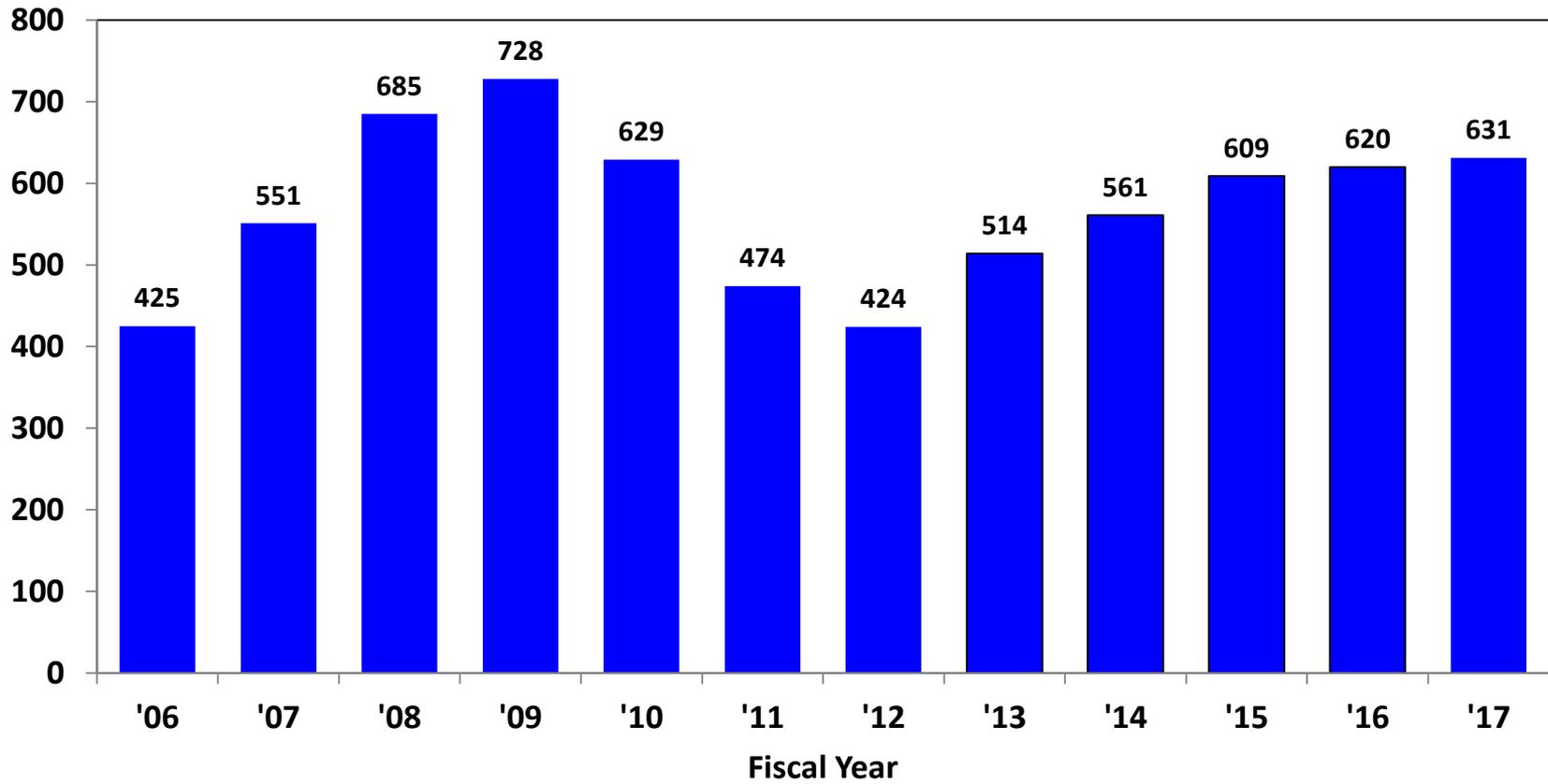
Consensus Forecasts Continuing Moderate Growth Rates Through FY '17



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

State Shared Income Tax Will Increase by \$48 M in FY '15

– City Share Linked to Income Tax 2 Years Prior



Detail of FY '15 – FY '17 Revenue Changes

- Excludes Change in Beginning Balance

\$ in Millions

4 Sector Consensus	FY '15 Above	FY '16 Above	FY '17 Above
	<u>FY '14</u>	<u>FY '15</u>	<u>FY '16</u>
Base Revenue Growth (5.3%/5.4%/5.5%)	469	501	532
Elimination of Fund Transfers	(134)	--	--
Previously Enacted Tax Legislation	(139)	(114)	(95)
Urban Revenue Sharing	<u>(48)</u>	<u>(11)</u>	<u>(11)</u>
Total	148	376	426

Spending Overview

The JLBC Staff Has Also Updated Its FY '15 – FY '17 Baseline Spending Estimates

- ❑ Enacted budget figures have been updated to reflect latest estimated changes to currently active statutory and other funding formulas
- ❑ Spending estimates assume the continued annual suspension of \$300 M of inactive formulas – mostly ADE funding
- ❑ Assumes continuation of \$1.2 B in “rollover” payments

FY '15 – FY '17 Projected Spending Changes

	General Fund - \$ in Millions		
	<u>FY '15 Above '14</u>	<u>FY '16 Above '15</u>	<u>FY '17 Above '16</u>
K-12 Formula	181	204	251
Medicaid Formula	6	88	86
DES Caseload	47	30	32
Comm. Colleges Formula	(3)	2	2
Universities	15	10	0
ADC Operating	28	10	3
Capital	(50)	0	0
Other	5	(9)	(10)
Additional Spending	<u>229</u>	<u>335</u>	<u>364</u>
Total Spending	\$9,055 M	\$9,390 M	\$9,754 M

Projected Ending Balance Estimates

Updated FY '14 – '17 Budget Projections

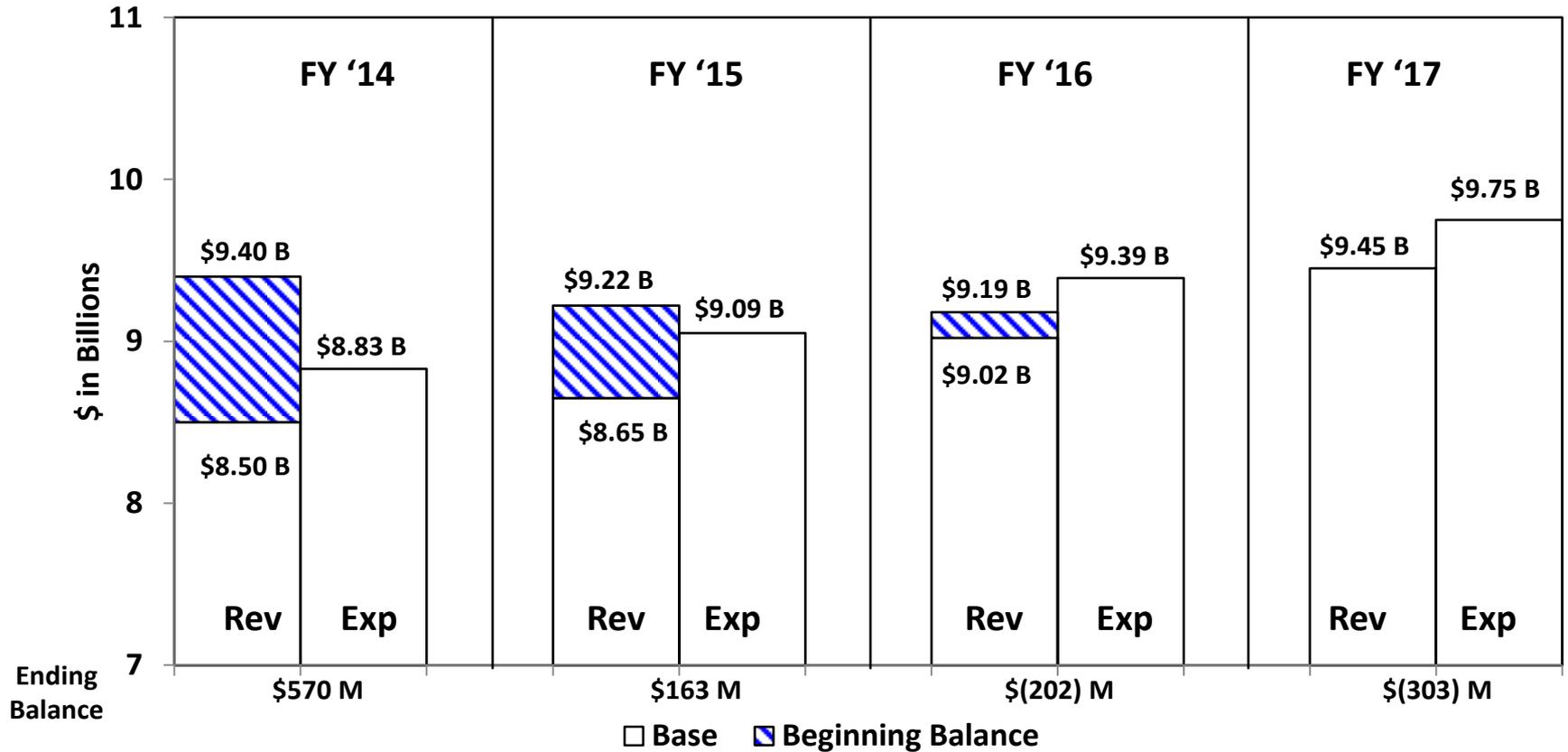
- October FAC Revenue Estimate With Updated Agency Caseload Estimates

Baseline	<u>FY '14</u>	<u>FY '15</u>	<u>FY '16</u>	<u>FY '17</u>	
Balance Forward	\$895 M	\$570 M	\$163 M	\$0	\$(202) M
Revenues	\$8.50 B	\$8.65 B	\$9.02 B	\$9.45 B	
Spending	\$8.83 B	\$9.05 B	\$9.39 B	\$9.75 B	
Ending Balance	\$570 M	\$163 M	\$(202) M	\$(303) M	\$(505) M

- ❑ On-going spending above projected revenues – carry forward keeps budget balanced in FY '14 and FY '15
- ❑ \$450 M Rainy Day Fund available to offset shortfalls
- ❑ Does not include any impact of potential mandatory repayment of operating financing issued during FY 2010

JLBC Baseline Revenues Compared to Expenditures

- If No Discretionary Spending – \$(303) M FY '16 Shortfall



Appendix A: October 2013 4-Sector Forecast

	<u>FY 2014</u>	<u>FY 2015</u>	<u>FY 2016</u>	<u>FY 2017</u>
Sales Tax				
JLBC Forecast	5.9%	5.6%	6.1%	6.2%
UA – Low	3.5%	3.0%	4.9%	6.3%
UA – Base	5.7%	6.6%	6.7%	6.9%
FAC	5.5%	5.0%	5.5%	5.3%
Average:	5.2%	5.1%	5.8%	6.3%
Individual Income Tax				
JLBC Forecast	3.2%	5.7%	5.6%	5.6%
UA – Low	0.7%	2.6%	3.9%	5.1%
UA – Base	2.8%	4.6%	6.2%	5.9%
FAC	4.0%	5.7%	5.1%	5.4%
Average:	2.7%	4.7%	5.2%	5.5%
Corporate Income Tax				
JLBC Forecast	2.5%	3.7%	4.2%	5.6%
UA – Low	8.1%	6.7%	6.2%	(2.5)%
UA – Base	9.7%	14.3%	10.7%	2.0%
FAC	1.8%	5.0%	4.0%	6.4%
Average:	5.5%	7.5%	6.5%	2.6%
JLBC Weighted Average	4.5%	5.5%	5.8%	5.9%
UA Low Weighted Average	2.7%	3.2%	4.6%	5.3%
UA Base Weighted Average	4.8%	6.4%	6.8%	6.2%
FAC Consensus Weighted Average	4.6%	5.3%	5.2%	5.5%
“Big-3” Weighted Average	4.1%	5.1%	5.6%	5.7%
Consensus Weighted Average*	3.5%	5.3%	5.4%	5.5%
Adjusted Consensus Weighted Average**	2.8%	3.6%	4.1%	5.4%
* Adjusted for small revenue categories				
** Adjusted for tax law changes				