Summary of Current Budget Status

- The Baseline compares the 4-sector consensus revenue forecast with cost of current funding formulas through ‘18

- Prior to the K-12 litigation, the current year (FY ‘15) baseline shortfall is $(148) M, followed by $(678) M in ‘16

- The K-12 inflation “reset” ruling would increase the shortfall to $(480) M in ‘15 and $(1.02) B in ‘16

- The cash balance estimates exclude the $464 M available in the Budget Stabilization Fund
## Restatement of Potential Ending Balances
- Does Not Reflect Impact if Litigation Back Payments Are Awarded

<table>
<thead>
<tr>
<th>After:</th>
<th>FY ’15</th>
<th>FY ’16</th>
</tr>
</thead>
<tbody>
<tr>
<td>January FAC</td>
<td>$(148)</td>
<td>$ (678)</td>
</tr>
<tr>
<td>January FAC + K-12 Reset</td>
<td>(480)</td>
<td>(1,015)</td>
</tr>
</tbody>
</table>

- Estimates assume that ‘15 shortfall is resolved with 1-time solutions prior to ’16
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
‘15 Improved Over Slow ‘14 Due to Corporate Collections
- Otherwise Weak Growth

<table>
<thead>
<tr>
<th></th>
<th>‘14 Budgeted</th>
<th>‘14 Actual</th>
<th>’15 1st Half</th>
</tr>
</thead>
<tbody>
<tr>
<td>Sales</td>
<td>5.7%</td>
<td>5.5%</td>
<td>3.4%</td>
</tr>
<tr>
<td>Individual Income</td>
<td>3.7%</td>
<td>1.9%</td>
<td>3.2%</td>
</tr>
<tr>
<td>Corporate Income</td>
<td>(3.5)%</td>
<td>(13.1)%</td>
<td>21.4%</td>
</tr>
<tr>
<td>Overall</td>
<td>3.9%</td>
<td>2.7%</td>
<td>4.6%</td>
</tr>
</tbody>
</table>

- 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

<table>
<thead>
<tr>
<th></th>
<th>Historical</th>
<th>Current</th>
</tr>
</thead>
<tbody>
<tr>
<td>Overall Job Growth</td>
<td>3.9%</td>
<td>2.6%</td>
</tr>
<tr>
<td>Construction Employment</td>
<td>5.7%</td>
<td>(3.5)%</td>
</tr>
<tr>
<td>Population Growth</td>
<td>3.1%</td>
<td>1.5%</td>
</tr>
<tr>
<td>Building Permits</td>
<td>38K</td>
<td>17K</td>
</tr>
</tbody>
</table>

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%

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

* Adjusted for corporate YTD collections
Sales Tax
- Projected Growth of 3.7% in ’15 and 3.6% in ’16

- 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

“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

Estimated one-time collections = $56 M
Corporate Income Tax
- Projected Growth of 15.0% in ’15 and 0.1% in ’16

- 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

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

<table>
<thead>
<tr>
<th>Description</th>
<th>‘16</th>
<th>‘17</th>
<th>‘18</th>
</tr>
</thead>
<tbody>
<tr>
<td>Corporate Rate Reduction/Sales Factor</td>
<td>(68)</td>
<td>(61)</td>
<td>(60)</td>
</tr>
<tr>
<td>25% Capital Gains Reduction</td>
<td>(11)</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td>1-time Income Tax Indexing</td>
<td>(6)</td>
<td>6</td>
<td>0</td>
</tr>
<tr>
<td>Corporate School Tuition Indexing</td>
<td>(9)</td>
<td>(10)</td>
<td>(12)</td>
</tr>
<tr>
<td>Other</td>
<td>(18)</td>
<td>(13)</td>
<td>(5)</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>(112)</strong></td>
<td><strong>(78)</strong></td>
<td><strong>(77)</strong></td>
</tr>
</tbody>
</table>

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%

<table>
<thead>
<tr>
<th></th>
<th>’16</th>
<th>’17</th>
<th>’18</th>
</tr>
</thead>
<tbody>
<tr>
<td>Base Revenue Growth (3.3%/4.4%/5.1%)</td>
<td>300</td>
<td>413</td>
<td>495</td>
</tr>
<tr>
<td>Elimination of Fund Transfers</td>
<td>(54)</td>
<td>--</td>
<td>--</td>
</tr>
<tr>
<td>Previously Enacted Tax Legislation</td>
<td>(112)</td>
<td>(78)</td>
<td>(77)</td>
</tr>
<tr>
<td>Urban Revenue Sharing</td>
<td>3</td>
<td>(10)</td>
<td>(5)</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td>137</td>
<td>325</td>
<td>413</td>
</tr>
<tr>
<td><strong>% Change</strong></td>
<td>1.6%</td>
<td>3.7%</td>
<td>4.5%</td>
</tr>
</tbody>
</table>
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
FY 2015 Total Spending is $32 Billion
- General and Non-General Fund

<table>
<thead>
<tr>
<th>Budget Unit</th>
<th>$ in Millions</th>
</tr>
</thead>
<tbody>
<tr>
<td>AHCCCS</td>
<td>$ 8,188.9</td>
</tr>
<tr>
<td>Education (K-12)</td>
<td>5,516.8</td>
</tr>
<tr>
<td>Universities</td>
<td>4,708.6</td>
</tr>
<tr>
<td>Economic Security</td>
<td>2,365.9</td>
</tr>
<tr>
<td>Health Services</td>
<td>2,345.5</td>
</tr>
<tr>
<td>Administration</td>
<td>1,192.7</td>
</tr>
<tr>
<td>Corrections</td>
<td>1,095.4</td>
</tr>
<tr>
<td>Child Safety</td>
<td>873.9</td>
</tr>
<tr>
<td>Other Agencies</td>
<td>3,988.0</td>
</tr>
<tr>
<td>Capital</td>
<td>1,515.7</td>
</tr>
<tr>
<td><strong>TOTAL</strong></td>
<td><strong>$ 31,791.4</strong></td>
</tr>
</tbody>
</table>

[Circle chart showing budget distribution]
The $9.3 B General Fund Share is 29% of Total Funds
- GF Share Down from 43% in FY ’02

<table>
<thead>
<tr>
<th>FY ’15 Enacted</th>
<th>$ in Millions</th>
</tr>
</thead>
<tbody>
<tr>
<td>General Fund</td>
<td>$ 9,336.0</td>
</tr>
<tr>
<td>Other Appropriated Funds</td>
<td>3,377.1</td>
</tr>
<tr>
<td>Non-Appropriated Funds</td>
<td>7,671.8</td>
</tr>
<tr>
<td>Federal Funds</td>
<td>11,406.5</td>
</tr>
<tr>
<td>TOTAL</td>
<td><strong>$ 31,791.4</strong></td>
</tr>
</tbody>
</table>
The 3 Main Drivers of General Fund Spending: Education, Health, and Prisons
- Represents 82% of ‘15 On-Going General Fund Budget

<table>
<thead>
<tr>
<th>Category</th>
<th>$ in Millions</th>
</tr>
</thead>
<tbody>
<tr>
<td>K-12 Education</td>
<td>$3,808.4</td>
</tr>
<tr>
<td>Medicaid</td>
<td>$1,989.8</td>
</tr>
<tr>
<td>Prisons</td>
<td>$1,021.2</td>
</tr>
<tr>
<td>Higher Education</td>
<td>$843.3</td>
</tr>
<tr>
<td>Other State Workers</td>
<td>$408.6</td>
</tr>
<tr>
<td>Child Safety</td>
<td>$386.0</td>
</tr>
<tr>
<td>Debt Service</td>
<td>$326.7</td>
</tr>
<tr>
<td>Other</td>
<td>$552.0</td>
</tr>
<tr>
<td><strong>TOTAL</strong></td>
<td><strong>$9,336.0</strong></td>
</tr>
</tbody>
</table>
Updated ‘16 – ‘18 Spending Projections

- Baseline reflects cost of **active** statutory funding formulas
- Continues annual suspension of $375 M of **inactive** formulas - mostly ADE funding
- Continues $1.2 B in “rollover” payments
- Assumes no discretionary spending increases over 3 years – highly unlikely based on past practice
# Projected Baseline Spending Changes

<table>
<thead>
<tr>
<th>$ in M Above Prior Year</th>
<th>'16</th>
<th>'17</th>
<th>'18</th>
</tr>
</thead>
<tbody>
<tr>
<td>K-12 Formula</td>
<td>181</td>
<td>210</td>
<td>164</td>
</tr>
<tr>
<td>Medicaid Formula</td>
<td>29</td>
<td>121</td>
<td>137</td>
</tr>
<tr>
<td>DCS 1-Time Backlog</td>
<td>(16)</td>
<td>(8)</td>
<td>0</td>
</tr>
<tr>
<td>ADC Operating</td>
<td>8</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td>Capital</td>
<td>(42)</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td>HURF Shift ($30 M to $60 M)</td>
<td>0</td>
<td>30</td>
<td>0</td>
</tr>
<tr>
<td>One-Time/Other</td>
<td>(70)</td>
<td>(16)</td>
<td>2</td>
</tr>
<tr>
<td><strong>Additional Spending</strong></td>
<td><strong>90</strong></td>
<td><strong>337</strong></td>
<td><strong>303</strong></td>
</tr>
<tr>
<td><strong>Total Spending</strong></td>
<td><strong>$9,447</strong></td>
<td><strong>$9,784</strong></td>
<td><strong>$10,087</strong></td>
</tr>
<tr>
<td>% Growth</td>
<td>1.0%</td>
<td>3.6%</td>
<td>3.1%</td>
</tr>
<tr>
<td>K-12 Inflation Reset</td>
<td><strong>$337</strong></td>
<td><strong>$341</strong></td>
<td><strong>$346</strong></td>
</tr>
<tr>
<td>Revised Total</td>
<td><strong>$9,784</strong></td>
<td><strong>$10,125</strong></td>
<td><strong>$10,433</strong></td>
</tr>
</tbody>
</table>
Main Caseload Assumptions

- Before “reset”, K-12 would grow by $181 M
  - 1.6% inflation/1.4% student growth/property tax cut
- Medicaid ‘16 spending grows 1.2%
  - 2.0% caseload, 3.0% capitation, and better federal match rates
- DCS funding adjusted consistent with May 2014 plan
- ADC reflects annualized cost for opening 1,000 new beds
FY ’16 General Fund Baseline by Agency

<table>
<thead>
<tr>
<th>Budget Unit</th>
<th>$ in Millions</th>
</tr>
</thead>
<tbody>
<tr>
<td>Education (K-12)</td>
<td>$ 3,989.6</td>
</tr>
<tr>
<td>AHCCCS</td>
<td>1,272.3</td>
</tr>
<tr>
<td>Corrections</td>
<td>1,004.4</td>
</tr>
<tr>
<td>Universities</td>
<td>765.9</td>
</tr>
<tr>
<td>Health Services</td>
<td>622.3</td>
</tr>
<tr>
<td>Economic Security</td>
<td>501.6</td>
</tr>
<tr>
<td>Child Safety</td>
<td>351.1</td>
</tr>
<tr>
<td>Other Agencies</td>
<td>964.4</td>
</tr>
<tr>
<td><strong>Total Operating Budget</strong></td>
<td><strong>$ 9,471.6</strong></td>
</tr>
</tbody>
</table>

*Litigation inflation reset would add $337 M
# K-12 Baseline Spending Change

<table>
<thead>
<tr>
<th>Component</th>
<th>'16 (GF $ in M Above Prior Year)</th>
<th>'17</th>
<th>'18</th>
</tr>
</thead>
<tbody>
<tr>
<td>'15 Shortfall</td>
<td>24</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td>Student Growth (1.4% for all years)</td>
<td>82</td>
<td>83</td>
<td>84</td>
</tr>
<tr>
<td>Higher Average Cost Per Pupil</td>
<td>23</td>
<td>23</td>
<td>23</td>
</tr>
<tr>
<td>Charter Conversions</td>
<td>(25)</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td>Full Inflation (1.6%, 1.9%, 1.8%)</td>
<td>87</td>
<td>103</td>
<td>101</td>
</tr>
<tr>
<td>Property Taxes from New Construction</td>
<td>(37)</td>
<td>(44)</td>
<td>(44)</td>
</tr>
<tr>
<td>Property Tax Assessment Ratio Reduction</td>
<td>26</td>
<td>45</td>
<td>0</td>
</tr>
<tr>
<td>Other</td>
<td>1</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td><strong>Total Additional Spending</strong>*</td>
<td><strong>181</strong></td>
<td><strong>210</strong></td>
<td><strong>164</strong></td>
</tr>
<tr>
<td>% Growth</td>
<td>4.8%</td>
<td>5.3%</td>
<td>3.9%</td>
</tr>
</tbody>
</table>

*Litigation inflation reset would add $337 M in ’16, $341 M in ’17, and $346 M in ‘18
Status of K-12 Inflation Litigation

- In ‘09 – ‘13, State did not fully inflate K-12 formula
- AZ Supreme Court has ruled that full inflation is required
- In response, State fully inflated in ‘14 and ‘15, but made no retroactive adjustments
- Case returned to Superior Court to determine whether other adjustments are required
What Is Potential Cost of K-12 Litigation?

- Superior Court concurred with plaintiffs’ request to reset the formula for foregone inflation
  - “Reset” would cost $337 M in ‘16

- The Superior Court is now considering back payments
  - Back payments could cost $250 M annually for 5 years

- Resolution could take a year – depends on appeals
University Restoration by Campus

- University GF reduced by $435 M through ‘12; $88 M restored
- ASU/NAU gain due to parity
- UA due to student population increase at Phoenix Biomedical
- Only minor ‘16 Baseline adjustments
University GF Reduction Since ‘08 Offset by Tuition Increases

- Avg ‘08-’15 tuition grew from $4.8 K to $10.4 K
- Total tuition increased from $816 M to $1.8 B
- Total GF + Tuition grew from $1.9 B to $2.6 B
- ‘08-’15 GF/Tuition per student $ grew from $17.0 K to $17.7 K
Medicaid Agencies Baseline Spending Changes

<table>
<thead>
<tr>
<th>GF $ in M Above Prior Year</th>
<th>’16</th>
<th>’17</th>
<th>’18</th>
</tr>
</thead>
<tbody>
<tr>
<td>AHCCCS</td>
<td>(2)</td>
<td>67</td>
<td>75</td>
</tr>
<tr>
<td>DHS</td>
<td>9</td>
<td>26</td>
<td>31</td>
</tr>
<tr>
<td>DES</td>
<td>22</td>
<td>28</td>
<td>31</td>
</tr>
<tr>
<td>Total</td>
<td>29</td>
<td>121</td>
<td>137</td>
</tr>
</tbody>
</table>

% Growth: 1.2%, 5.1%, 5.4%

- Savings from increasing the federal match rate from 68.2% to 68.8%
- 3% cap rate adjustment
- AHCCCS/DHS Base enrollment growth of 2%; DD growth of 4.5%
# AHCCCS Caseloads

- Enrollment Increased By 337 K to 1.6 M in CY ‘14

<table>
<thead>
<tr>
<th>Population</th>
<th>December 2013</th>
<th>January 2015</th>
<th>Change</th>
</tr>
</thead>
<tbody>
<tr>
<td>Traditional</td>
<td>880</td>
<td>962</td>
<td>82</td>
</tr>
<tr>
<td>Childless Adults</td>
<td>68</td>
<td>279</td>
<td>211</td>
</tr>
<tr>
<td>Adult Expansion</td>
<td>-</td>
<td>36</td>
<td>36</td>
</tr>
<tr>
<td>All Others</td>
<td>310</td>
<td>317</td>
<td>7</td>
</tr>
<tr>
<td><strong>TOTAL</strong></td>
<td><strong>1,258</strong></td>
<td><strong>1,594</strong></td>
<td><strong>337</strong></td>
</tr>
</tbody>
</table>

Enrollment (Thousands)
# DCS Baseline Spending Estimates

<table>
<thead>
<tr>
<th>GF in $ in M Above Prior Year</th>
<th>’16</th>
<th>’17</th>
<th>’18</th>
</tr>
</thead>
<tbody>
<tr>
<td>One-Time Backlog</td>
<td>(11)</td>
<td>(12)</td>
<td>0</td>
</tr>
<tr>
<td>Preventive Services</td>
<td>4</td>
<td>4</td>
<td>0</td>
</tr>
<tr>
<td>Automation Replacement</td>
<td>(5)</td>
<td>5</td>
<td>0</td>
</tr>
<tr>
<td>Other</td>
<td>(4)</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td><strong>Total Additional Spending</strong></td>
<td>(16)</td>
<td>(3)</td>
<td>0</td>
</tr>
</tbody>
</table>

- ‘16 & ’17 estimates consistent with May Special Session plan
- Automation Replacement funding deferred to ’17, consistent with procurement timetable
- Baseline also deletes $25 M in one-time transition funding to ADOA
Department of Corrections Baseline Spending Changes

GF $ in M Above Prior Year

<table>
<thead>
<tr>
<th></th>
<th>’16</th>
</tr>
</thead>
<tbody>
<tr>
<td>Annualize 500 Medium Security Beds</td>
<td>7.3</td>
</tr>
<tr>
<td>Annualize 500 Maximum Security Beds</td>
<td>0.3</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>7.6</strong></td>
</tr>
</tbody>
</table>

- Annualizes 500 private beds opened in ‘15
- Annualizes 500 maximum security public beds that just opened
- Excludes cost related to settlement of inmate health care litigation – may add up to $25 M
- Excludes cost of employee retirement rate increase - $2 M or $15 M depending on phase in
ADC Bed Surplus/Shortfall
- Possible Total Bed Shortfall in ‘16

<table>
<thead>
<tr>
<th>Classification</th>
<th>Level</th>
<th>June 15</th>
<th>June 16</th>
</tr>
</thead>
<tbody>
<tr>
<td>Minimum</td>
<td>82</td>
<td>(136)</td>
<td></td>
</tr>
<tr>
<td>Medium</td>
<td>(5)</td>
<td>(559)</td>
<td></td>
</tr>
<tr>
<td>Close</td>
<td>(42)</td>
<td>(59)</td>
<td></td>
</tr>
<tr>
<td>Maximum</td>
<td>528</td>
<td>477</td>
<td></td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>563</strong></td>
<td><strong>(277)</strong></td>
<td></td>
</tr>
</tbody>
</table>

- Prison population projected to grow by 840 male inmates in ‘16
- Includes more than 5,400 temporary beds
General Fund Debt Service Cost $364 M
- Represents 7th Largest Budget Unit

Annual Payments

- Capital Facilities/Uses $ 72 M
- School Facilities Board $ 169 M
- Operating $ 123 M

‘16 Baseline Spending Change

- Only minor adjustments

’15 General Fund = $364 M
Includes $38 M Lottery Bonds
State Employer Retirement Impacts
- ’15 General Fund Cost is $166 M; Total State = $458 M

- ASRS employer rate will decrease from 11.60% in ’15 to 11.47% in ’16
- AZ Supreme Court Ruling on permanent benefit increases raises employer rate in other systems
- Baseline excludes cost of rate increase, which depends on whether higher rate is phased in

<table>
<thead>
<tr>
<th></th>
<th>Phase In</th>
<th>Full Rate</th>
</tr>
</thead>
<tbody>
<tr>
<td>PSPRS</td>
<td>$ 0.9</td>
<td>$ 4.4</td>
</tr>
<tr>
<td>CORP</td>
<td>2.1</td>
<td>15.7</td>
</tr>
<tr>
<td>EORP</td>
<td>0</td>
<td>1.4*</td>
</tr>
<tr>
<td>GF Total Increase</td>
<td>$ 3.0</td>
<td>$ 21.5</td>
</tr>
</tbody>
</table>

*If fixed rate changed
Projected Ending Balance Estimates
### Updated ’15 – ’18 Ending Balance Projections
- January FAC Revenue With Projected Spending

<table>
<thead>
<tr>
<th>Baseline</th>
<th>’15</th>
<th>’16</th>
<th>’17</th>
<th>’18</th>
</tr>
</thead>
<tbody>
<tr>
<td>Balance Forward</td>
<td>$577 M</td>
<td>--</td>
<td>--</td>
<td>--</td>
</tr>
<tr>
<td>Revenues</td>
<td>$8.63 B</td>
<td>$8.77 B</td>
<td>$9.09 B</td>
<td>$9.51 B</td>
</tr>
<tr>
<td>Spending</td>
<td>$9.36 B</td>
<td>$9.45 B</td>
<td>$9.78 B</td>
<td>$10.09 B</td>
</tr>
<tr>
<td><strong>Ending Balance</strong></td>
<td>$(148) M</td>
<td>$(678) M</td>
<td>$(690) M</td>
<td>$(581) M</td>
</tr>
<tr>
<td>K-12 Reset</td>
<td>$332 M</td>
<td>$337 M</td>
<td>$341 M</td>
<td>$346 M</td>
</tr>
<tr>
<td><strong>Revised Balance</strong></td>
<td>$(480) M</td>
<td>$(1.02) B</td>
<td>$(1.03) B</td>
<td>$(928) M</td>
</tr>
</tbody>
</table>

- 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
The Ongoing Structural Shortfall Part of Current Problem

- Structural balance compares ongoing revenue and spending
- 1-cent sales tax and carryforward kept ‘12-’14 balanced
The Structural Gap Details

<table>
<thead>
<tr>
<th>Year</th>
<th>Rev</th>
<th>Exp</th>
<th>Revenue</th>
<th>Expenses</th>
</tr>
</thead>
<tbody>
<tr>
<td>'12</td>
<td>$9.07 B</td>
<td>$8.67 B</td>
<td>$9.07 B</td>
<td>$8.67 B</td>
</tr>
<tr>
<td>'13</td>
<td>$9.56 B</td>
<td>$8.66 B</td>
<td>$9.56 B</td>
<td>$8.66 B</td>
</tr>
<tr>
<td>'14</td>
<td>$9.37 B</td>
<td>$8.80 B</td>
<td>$9.37 B</td>
<td>$8.80 B</td>
</tr>
<tr>
<td>'15</td>
<td>$9.21 B</td>
<td>$9.32 B</td>
<td>$9.21 B</td>
<td>$9.32 B</td>
</tr>
<tr>
<td>'16</td>
<td>$8.77 B</td>
<td>$9.43 B</td>
<td>$8.77 B</td>
<td>$9.43 B</td>
</tr>
</tbody>
</table>

Shortfall

- Cash/Structural
- With K-12 Reset

<table>
<thead>
<tr>
<th>Year</th>
<th>Shortfall</th>
</tr>
</thead>
<tbody>
<tr>
<td>'12</td>
<td>$397/(410) M</td>
</tr>
<tr>
<td>'13</td>
<td>$895/(364) M</td>
</tr>
<tr>
<td>'14</td>
<td>$577/(406) M</td>
</tr>
<tr>
<td>'15</td>
<td>$(148)/(738) M</td>
</tr>
<tr>
<td>'16</td>
<td>$(678)/(672) M</td>
</tr>
</tbody>
</table>

Base  | One-Time  | 1- Sales Tax | Beginning Balance | K-12 Reset
Suggestions to Improve Fiscal Policy
- Currently 4th Worst Credit Rating Among States

- Align ongoing revenues and spending – develop multi-year targets
- Reduce reliance on 1-time solutions over time
- Set aside 1-time revenues into a separate fund
  - Excess ending balances
  - Excess capital gains
  - Windfalls (retail gain with gas price plunge)
- Dedicate 1-time $ for 1-time purposes
  - Rebates/Operating debt buyback/Infrastructure/IT Modernization
California Initiative Addresses Volatility

- Voter approved in November 2014
- 1.5% of annual General Fund revenue will be deposited into Rainy Day Fund
- Excess capital gains income tax collections will be deposited into the fund as well
- 50% of fund will be used to buy down state debts, including unfunded retirement and operating loans
- Rainy Day Fund capped at 10% of GF revenue; excess dedicated to infrastructure
- Emergency provisions allow deposit requirements to be suspended
Other Suggested Fiscal Policy Improvements

- Enhance current tax analysis and administration
  - Increase timeliness of tax credit reporting
  - Would improve our understanding of revenue changes
- Increase transparency of retirement expenses which are not delineated separately in budget
  - JLBC Baseline Book begins this process
- Evaluate accountability measures as we consider consolidating acute and behavioral health services
  - Retain ability to measure behavioral health effort in light of Arnold litigation settlement
## Appendix A: January 2015 4-Sector Forecast

<table>
<thead>
<tr>
<th></th>
<th>2015</th>
<th>2016</th>
<th>2017</th>
<th>2018</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Sales Tax</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>JLBC Forecast</td>
<td>4.0%</td>
<td>4.4%</td>
<td>4.8%</td>
<td>5.0%</td>
</tr>
<tr>
<td>UA – Low</td>
<td>2.5%</td>
<td>1.1%</td>
<td>3.3%</td>
<td>5.4%</td>
</tr>
<tr>
<td>UA – Base</td>
<td>4.0%</td>
<td>4.4%</td>
<td>5.8%</td>
<td>6.6%</td>
</tr>
<tr>
<td>FAC</td>
<td>4.5%</td>
<td>4.4%</td>
<td>5.0%</td>
<td>5.2%</td>
</tr>
<tr>
<td>Average:</td>
<td>3.7%</td>
<td>3.6%</td>
<td>4.7%</td>
<td>5.6%</td>
</tr>
<tr>
<td><strong>Individual Income Tax</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>JLBC Forecast</td>
<td>3.6%</td>
<td>5.4%</td>
<td>5.9%</td>
<td>5.9%</td>
</tr>
<tr>
<td>UA – Low</td>
<td>1.8%</td>
<td>1.0%</td>
<td>3.0%</td>
<td>4.7%</td>
</tr>
<tr>
<td>UA – Base</td>
<td>3.0%</td>
<td>3.8%</td>
<td>5.0%</td>
<td>6.0%</td>
</tr>
<tr>
<td>FAC</td>
<td>3.7%</td>
<td>4.4%</td>
<td>5.0%</td>
<td>5.1%</td>
</tr>
<tr>
<td>Average:</td>
<td>3.0%</td>
<td>3.7%</td>
<td>4.8%</td>
<td>5.4%</td>
</tr>
<tr>
<td><strong>Corporate Income Tax</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>JLBC Forecast</td>
<td>15.0%</td>
<td>3.1%</td>
<td>3.5%</td>
<td>4.5%</td>
</tr>
<tr>
<td>UA – Low</td>
<td>(2.0)%</td>
<td>(6.6)%</td>
<td>(8.8)%</td>
<td>(11.7)%</td>
</tr>
<tr>
<td>UA – Base</td>
<td>(1.2)%</td>
<td>0.7%</td>
<td>(0.2)%</td>
<td>(7.2)%</td>
</tr>
<tr>
<td>FAC</td>
<td>2.9%</td>
<td>3.1%</td>
<td>5.1%</td>
<td>7.3%</td>
</tr>
<tr>
<td>Average:</td>
<td>3.7%</td>
<td>0.1%</td>
<td>0.2%</td>
<td>(0.9)%</td>
</tr>
</tbody>
</table>

### JLBC Weighted Average

<table>
<thead>
<tr>
<th></th>
<th>2015</th>
<th>2016</th>
<th>2017</th>
<th>2018</th>
</tr>
</thead>
<tbody>
<tr>
<td>JLBC Weighted Average</td>
<td>4.6%</td>
<td>4.7%</td>
<td>5.2%</td>
<td>5.4%</td>
</tr>
<tr>
<td>UA Low Weighted Average</td>
<td>1.9%</td>
<td>0.5%</td>
<td>2.5%</td>
<td>4.4%</td>
</tr>
<tr>
<td>UA Base Weighted Average</td>
<td>3.2%</td>
<td>3.9%</td>
<td>5.1%</td>
<td>5.7%</td>
</tr>
<tr>
<td>FAC Consensus Weighted Average</td>
<td>4.0%</td>
<td>4.3%</td>
<td>5.0%</td>
<td>5.3%</td>
</tr>
<tr>
<td>“Big-3” Weighted Average*</td>
<td>4.2%</td>
<td>3.4%</td>
<td>4.5%</td>
<td>5.2%</td>
</tr>
<tr>
<td>Consensus Weighted Average**</td>
<td>4.3%</td>
<td>3.3%</td>
<td>4.4%</td>
<td>5.1%</td>
</tr>
<tr>
<td>Adjusted Consensus Weighted Average***</td>
<td>3.0%</td>
<td>2.1%</td>
<td>3.6%</td>
<td>4.3%</td>
</tr>
</tbody>
</table>

* ‘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
STAFF OF THE
JOINT LEGISLATIVE BUDGET COMMITTEE

• Director ................................................................. Richard Stavneak
• Office Manager ......................................................... Linda Monsanto
• Deputy Directors ...................................................... Steve Schimpp
............................................................................... Stefan Shepherd
• Assistant Director .................................................. Jack Brown
• Principal Economist ................................................. Tim Everill
• Chief Economist ..................................................... Hans Olofsson
• Principal Fiscal Analysts ......................................... Eric Billings
........................................................................ Bob Hull
........................................................................ Andrew Smith
........................................................................ Art Smith
• Senior Fiscal Analysts ............................................. Ben Beutler
........................................................................ Steve Grunig
........................................................................ Jon Stall
• Fiscal Analysts ......................................................... Henry Furtick
........................................................................ Matt Gress
........................................................................ Jeremy Gunderson
........................................................................ Josh Hope
........................................................................ Micaela Larkin
........................................................................ Krista MacGahan
........................................................................ Rebecca Perrera
........................................................................ Tom Ritland
• Administrative Assistant/JLBC & JCCR Clerk ............ Kristy Paddack