
Finance Advisory Committee

Revenue and Budget Update

January 21, 2016

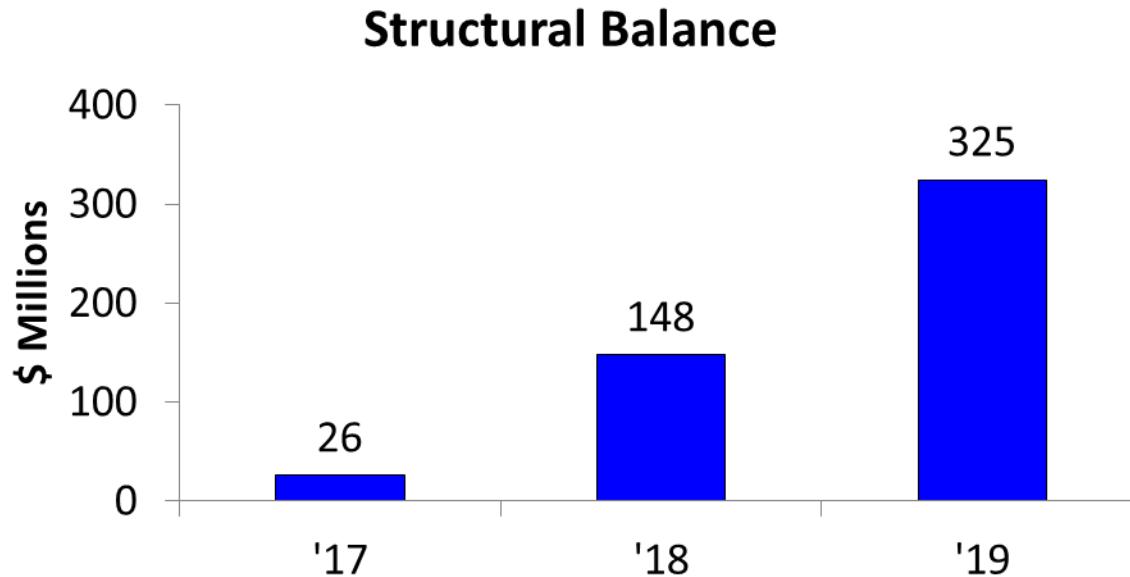
JLBC

'17 Challenge: Avoid Re-creating a Structural Gap

- ❑ '17: large cash balance, small structural balance
- ❑ Using cash balance for ongoing initiatives re-creates structural gap in '18
- ❑ Excludes \$460 M Rainy Day Fund Balance

FY 2017 Baseline Projection	
	\$ in M
Balance Forward / Other	\$ 599
One-time Revenues	
Ongoing Revenues	9,397
Ongoing Spending	(9,371)
Cash Balance	\$ 625

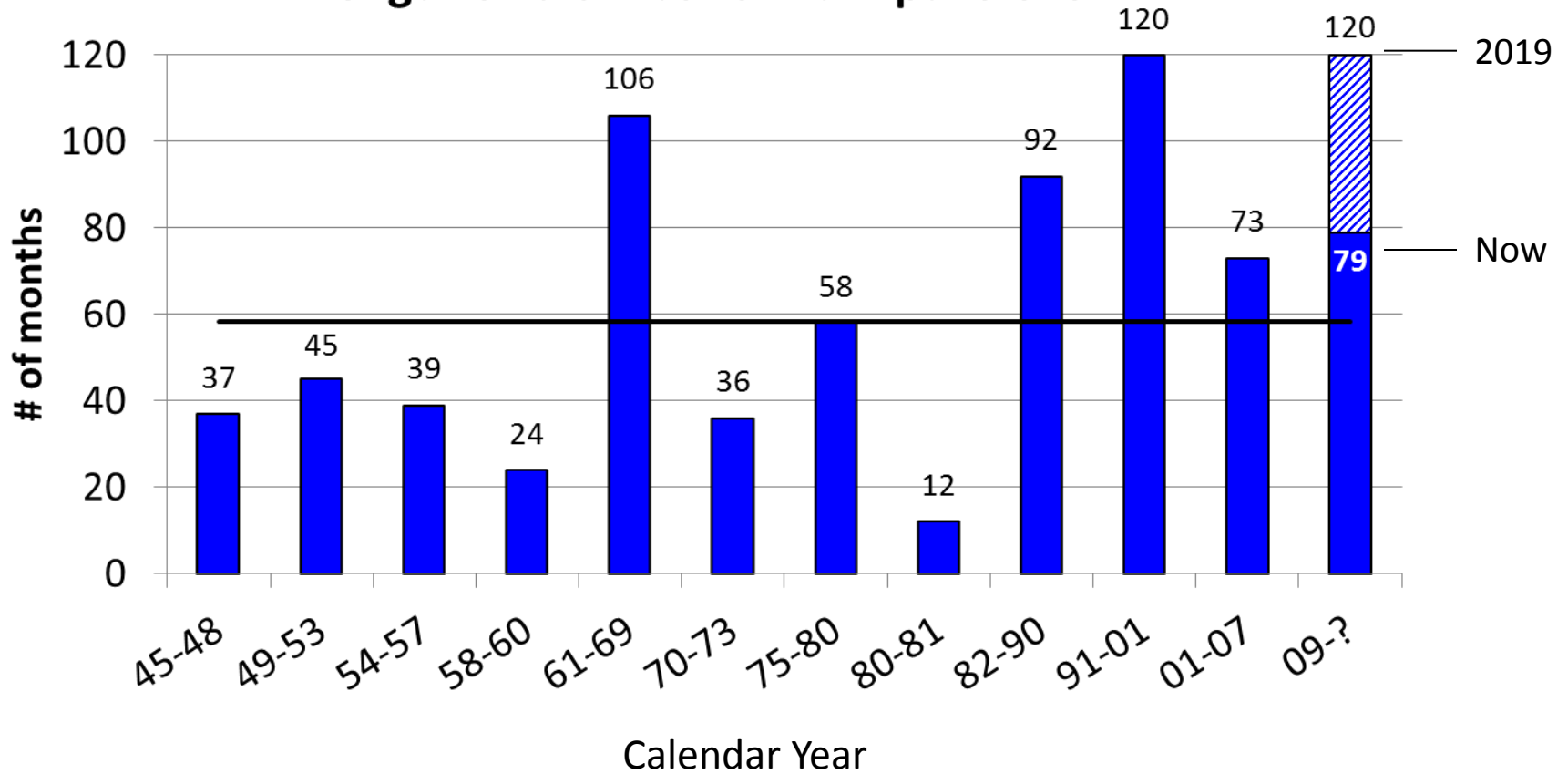
Baseline Structural Balance Improves Through '19



- ❑ Improving balances could provide more flexibility, but...
- ❑ Based on highly unlikely assumption of no discretionary changes in next 3 years

Forecast Risk: Current Expansion Exceeds Historical Average

Length of U.S. Economic Expansions



Forecast Risks II

- 1% Variance Yields \$625 M Over 3 Years

Potential Gains

- National recovery creating more interstate migration

Potential Gain or Loss

- Estimate of ongoing '15 Capital Gains and Corporate collections

Potential Litigation Losses

- Ongoing retirement litigation
- Hospital assessment
- Rental car surcharge
- Foster care lawsuit in U.S. District Court

Revenue Overview

AZ Economy is Growing, But Slower than Average

- Given Our Size, Historical Norm May Not be Realistic

Key Indicators

	<u>Historical</u>	<u>Current</u>
Overall Job Growth	3.9%	2.5%
Construction Employment	5.7%	5.5%
Population Growth	3.1%	1.5%
Single Family Residential Building Permits	38K	22K

- ❑ Overall job and population growth remain significantly below historical standard
- ❑ Construction employment has picked up but still remains 115,000 workers behind the 250,000 (June 2006) peak
- ❑ Number of annual building permits has grown substantially—from 17k last year to 22k now

Revenue Growth Improves Slightly Over Time

January Consensus Forecast

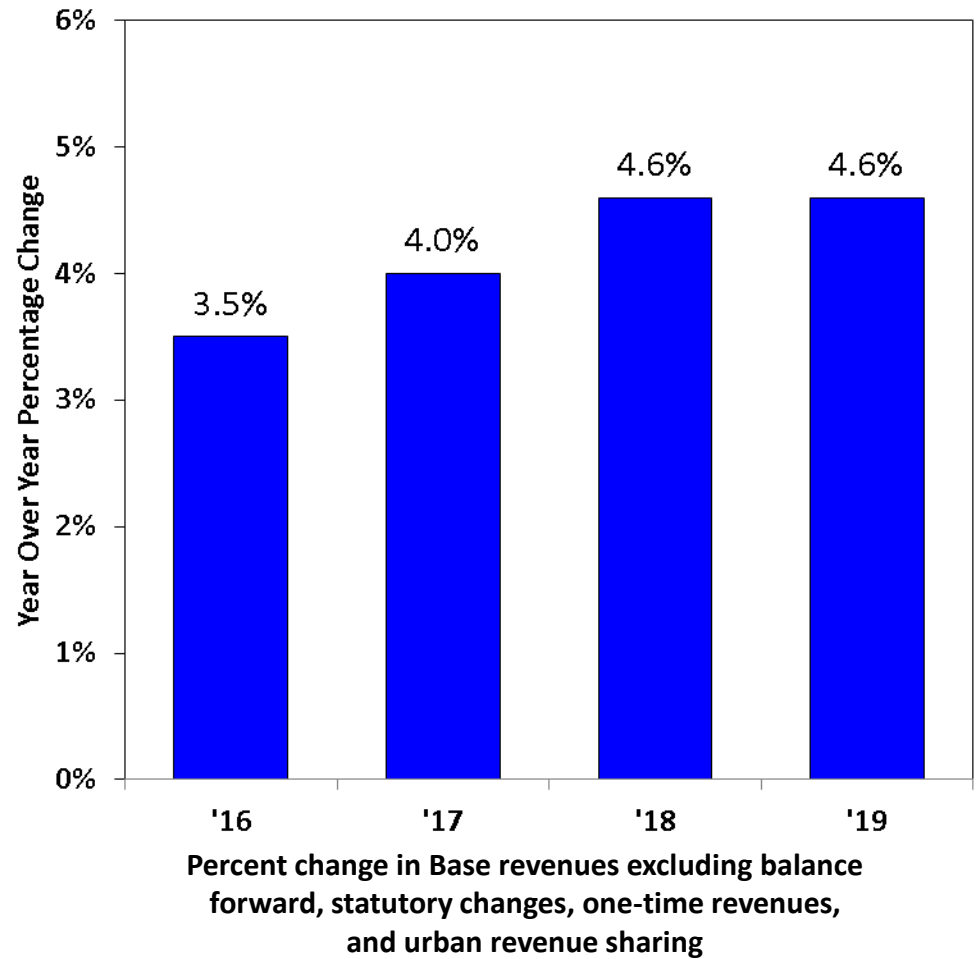
- Finance Advisory Committee
- UA model – base
- UA model – low
- JLBC Staff

Chance of Exceeding Forecast

- 66%

Long Run Average Growth

- 4.7%



Is the FY '16 Growth Rate Reasonable?

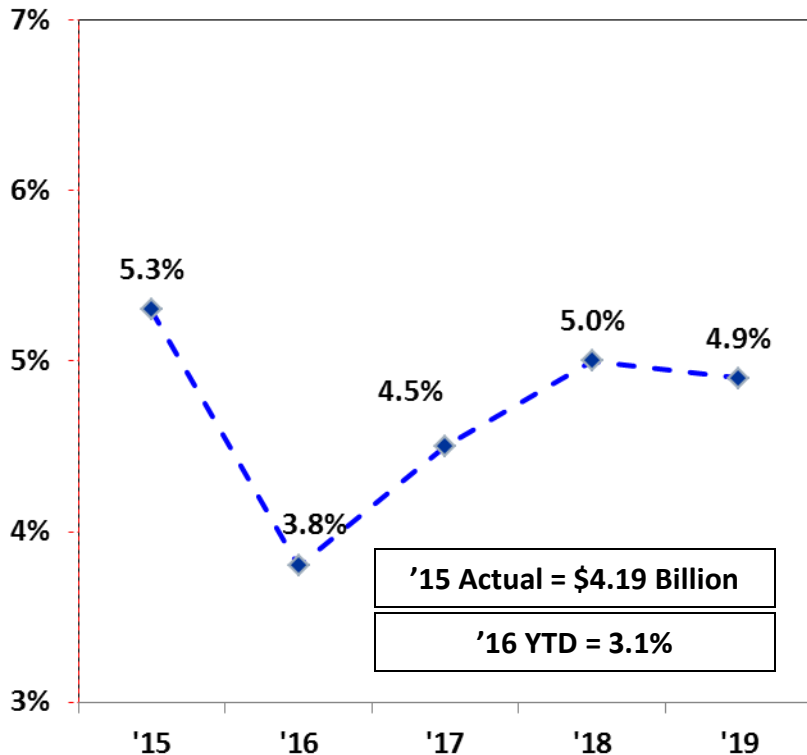
- ❑ After adjusting for tax laws and one-time funds, the projected '16 growth rate is 3.0%
 - The comparable preliminary growth rate through December is also 2.9%
 - “Core” Revenues are lagging– sales tax (2.3%) and withholding (2.8%)

- ❑ The Baseline would increase the forecast of ongoing revenues by \$341 M above the enacted budget
 - Through December, '16 revenues are \$210 M above budget
 - Individual income tax payments and Corporate income tax accounts for \$140 M of \$210 M

- ❑ The 2nd half forecast gain is expected to slow due to the higher collection level in the 2nd half of '15
 - Capital gains and Corporate collections may not be sustainable

Sales Tax

- Projected Growth of 3.8% in '16 and 4.5% in '17



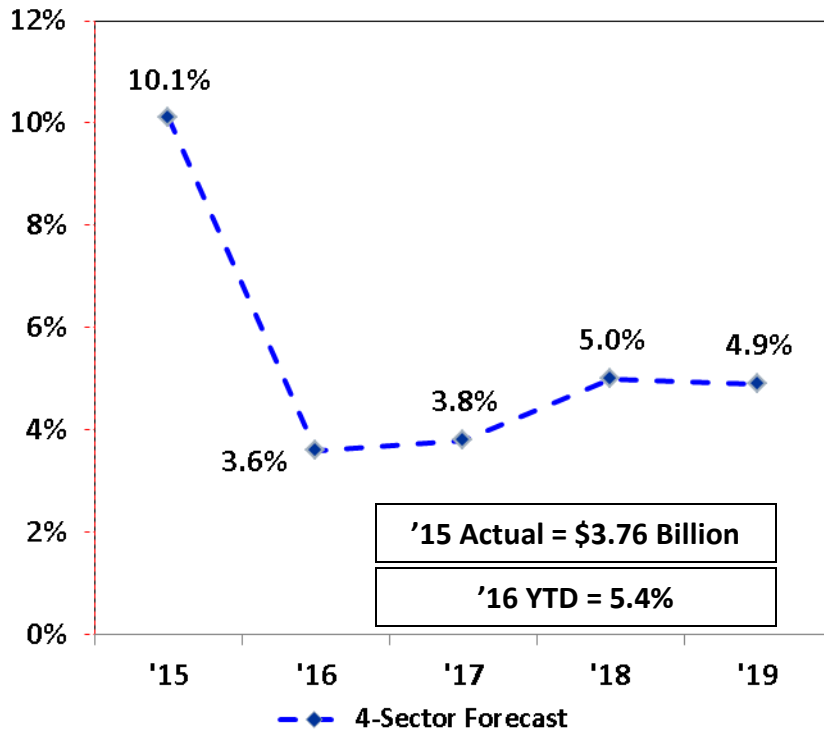
—◆— 4-Sector Forecast

Percent Change in Base Revenue Excluding Statutory Changes

- Since 1/15, retail is up 10%; contracting is down (17)%
- Trends likely related to Jan. '15 contracting law
- \$15 M in '16 amnesty collections
- Overall, 2.3% 1st Half was weak (adjusted for amnesty)

Individual Income Tax

- Projected Growth of 3.6% in '16 and 3.8% in '17



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

- ❑ '15: low withholding growth offset by capital gains
- ❑ That trend persists in 1st half of '16
- ❑ Capital gains are volatile and may not be sustainable
- ❑ 4.9% 1st Half growth (excluding \$11 M in '16 amnesty)

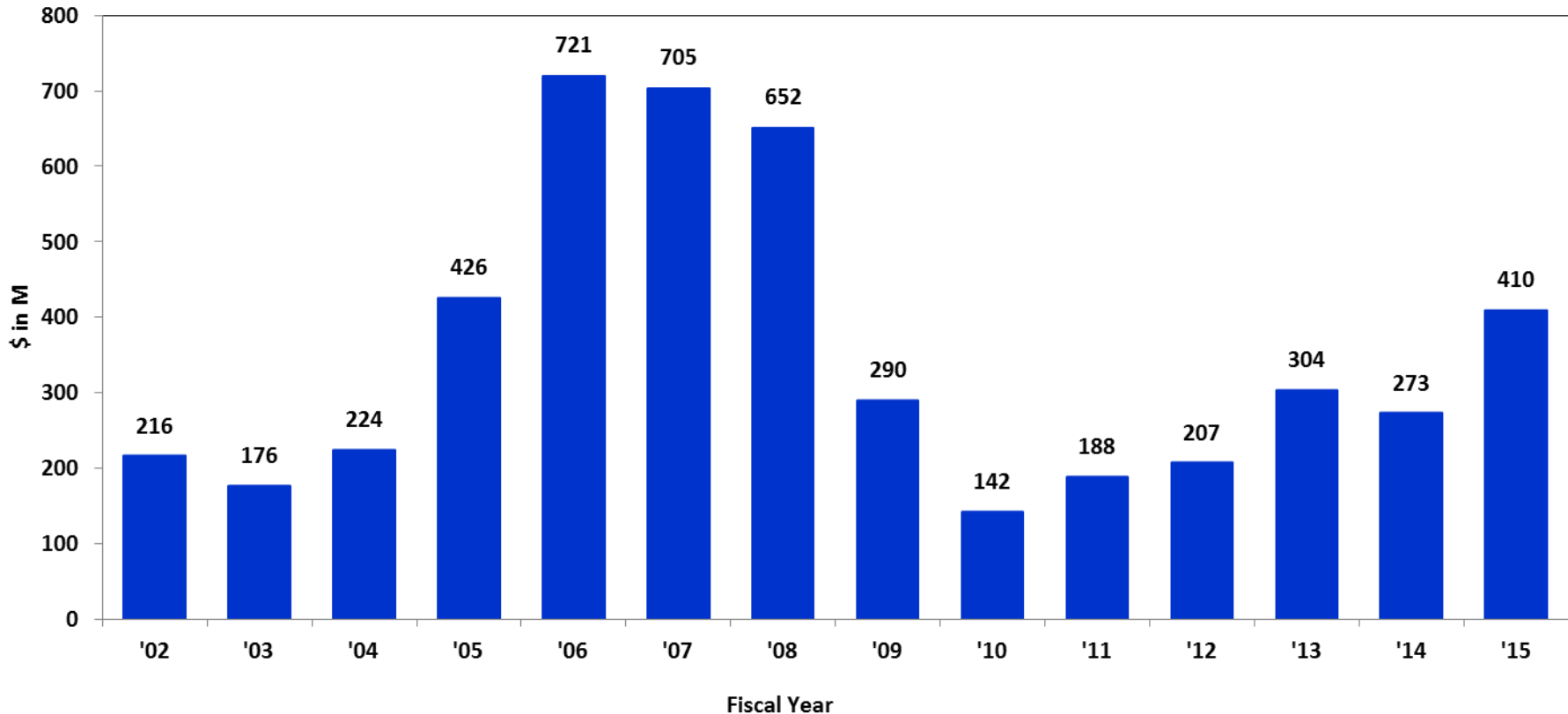
'16 So Far Continues Slow Withholding/High Payments

Percent Gain Above Prior Year		
	<u>'15</u>	<u>1st Half '16</u>
Withholding	3.4%	2.8%
Payments	14.8%	19.3%
Refunds	(0.8)%	11.1%
Net	<u>8.6%</u>	<u>4.9%</u>

- ❑ Withholding growth in the 1st Half is sluggish at 2.8%
- ❑ Annual withholding growth has not been above 3.5% since '11
- ❑ Payments up 19.3% in 1st Half of '16 – carryover impact of TY '15 filings
- ❑ Little refund activity occurs until tax season

Volatility of Capital Gains Complicate Forecasting

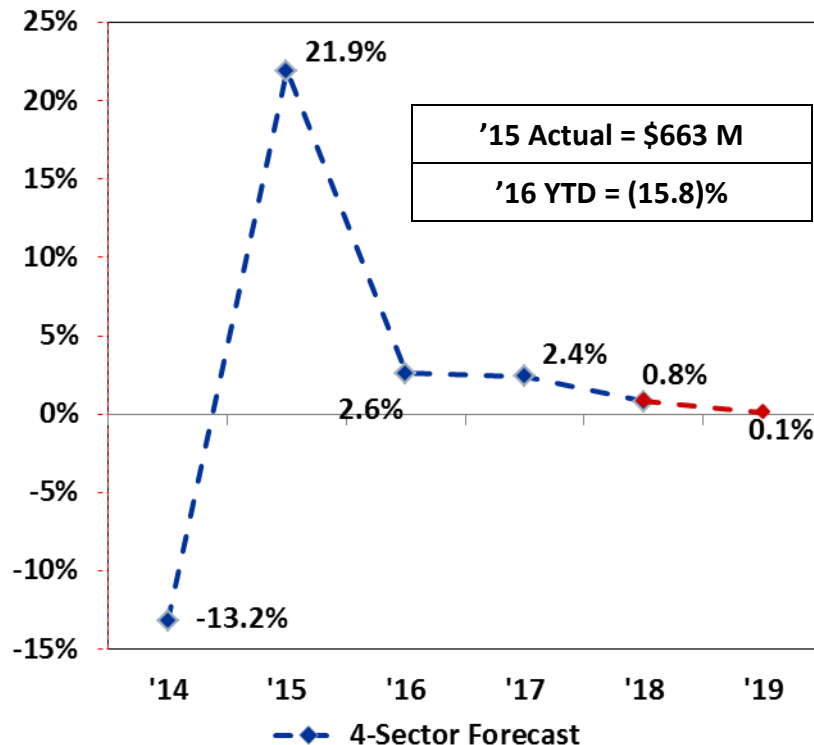
- Final '15 Capital Gain Receipts to be Determined



Individual Income Tax Capital Gains Revenue

Corporate Income Tax

- Projected Growth of 2.6% in '16 and 2.4% in '17

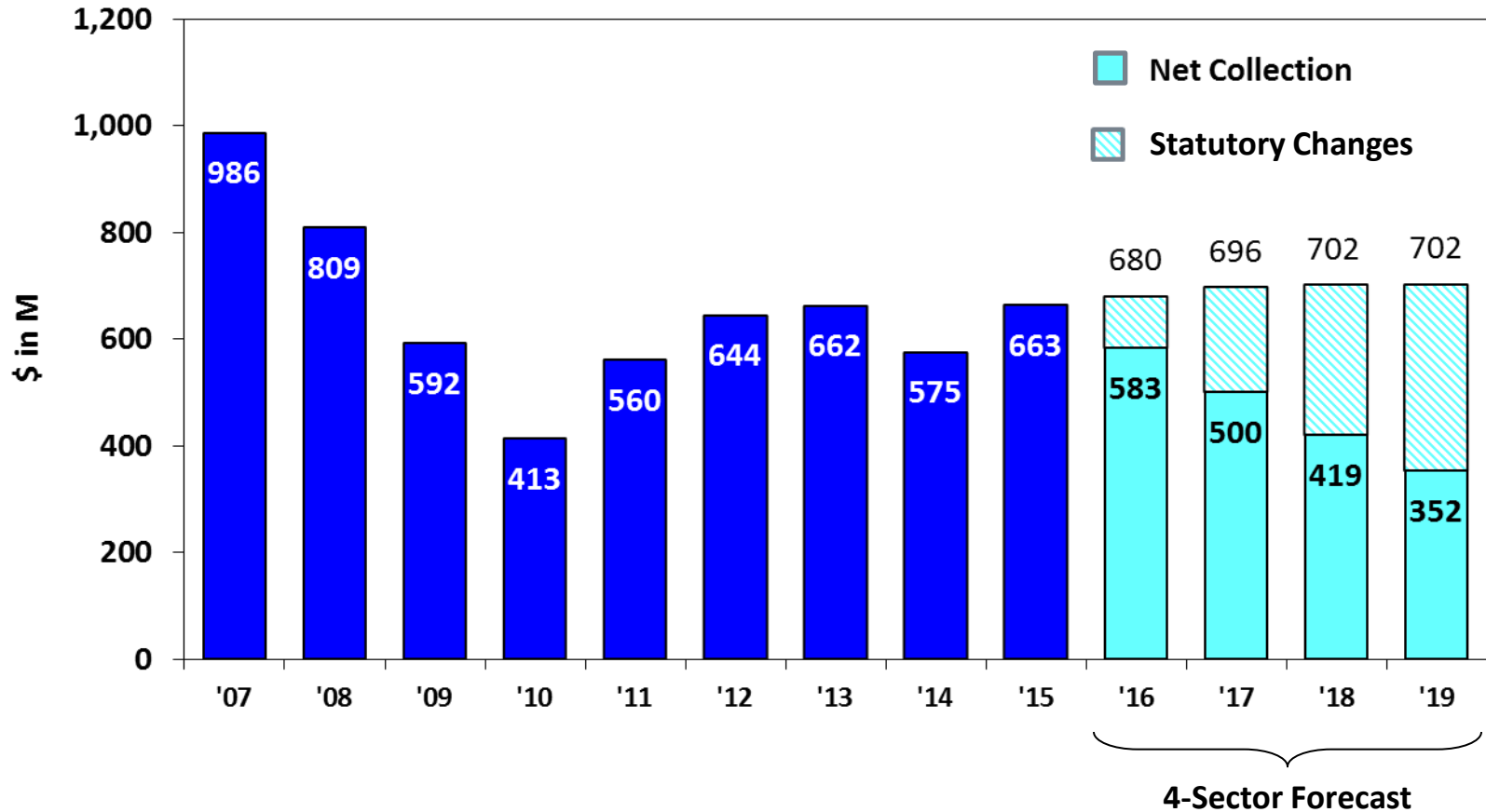


Percent Change in Base Revenue Excluding
Statutory Changes and One-Time Changes

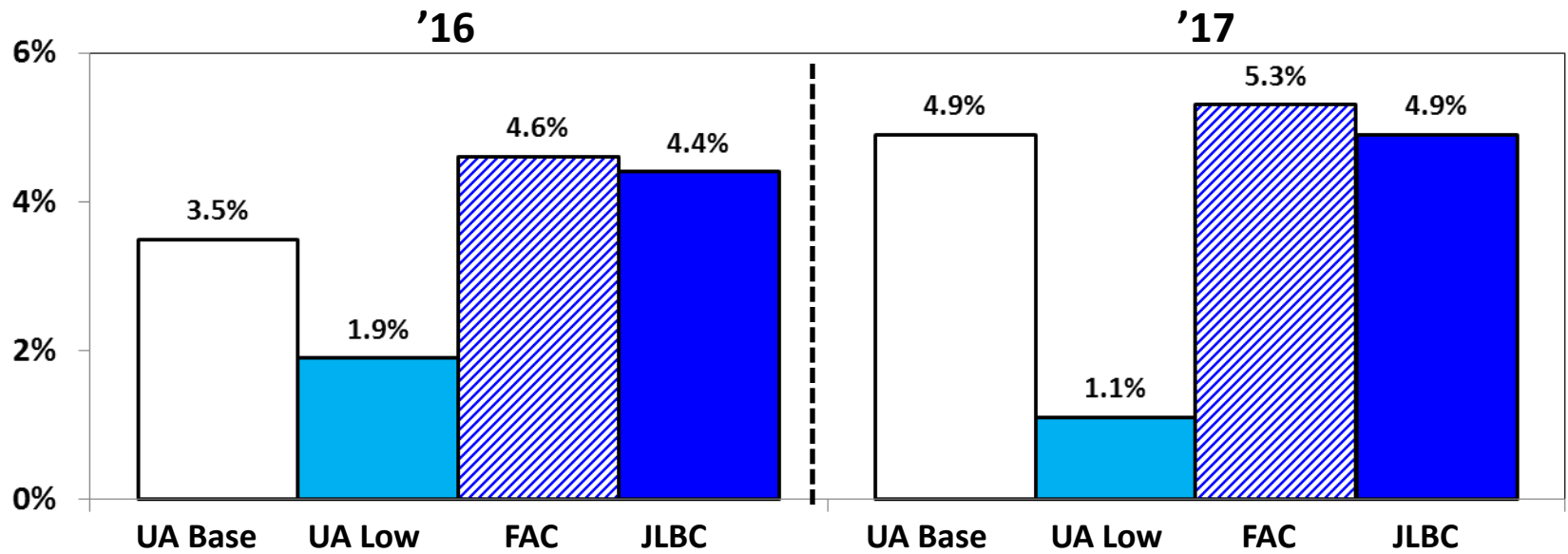
- In 22 of last 28 years, annual change has been > +/- 10%
- '14 & '15 results inexplicable
- 4-year tax cut was to begin in '15, likely delayed to '16
- (22.7)% 1st Half decline (excluding \$21 M in '16 amnesty)

'19 CIT Projected to be \$352 M

- Primary Reductions are 2% Rate Cut and 100% Sales Factor



4-Sector Base Growth is 3.5% in '16 & 4.0% in '17



- ❑ With exception of UA Low, 3 other sectors have comparable growth rates
- ❑ Recessions rarely predicted in advance
- ❑ Especially given current length of expansion, an economic slowdown remains possible

Details in Appendix A

Phase-In of \$261 M of Enacted Tax Reductions

	\$ in M*		
	<u>'17</u>	<u>'18</u>	<u>'19</u>
<input type="checkbox"/> Corporate Rate Reduction/Sales Factor	(77)	(74)	(52)
<input type="checkbox"/> Corporate School Tuition Indexing	(10)	(12)	(15)
<input type="checkbox"/> Other	(11)	(4)	(6)
Total	<u>(98)</u>	<u>(90)</u>	<u>(73)</u>

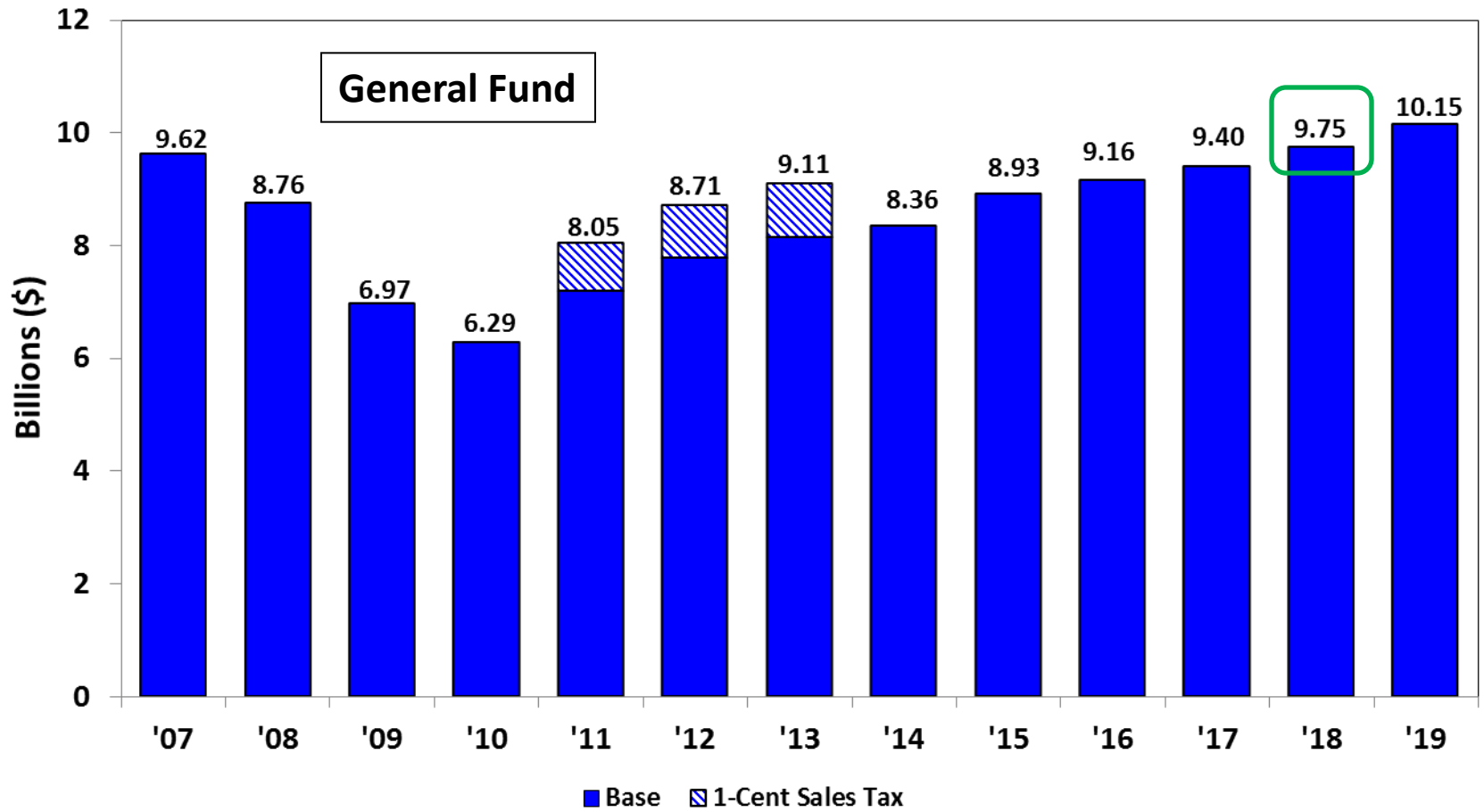
* Represents changes to prior year. By '19, revenue base is \$(261) M lower than in '16.

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 (3.5%/4.0%/4.6%/4.6%)	333	389	461	475
One-Time Fund Transfers	139	(117)	(100)	0
One-Time Amnesty Collections	47	(47)	0	0
Previously Enacted Tax Legislation	(98)	(98)	(90)	(73)
Urban Revenue Sharing	3	(58)	(13)	(6)
Total	424	69	258	396
% Change	4.7%	0.7%	2.7%	4.1%

Revenue Will Reach Pre-Recession Level in '18



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

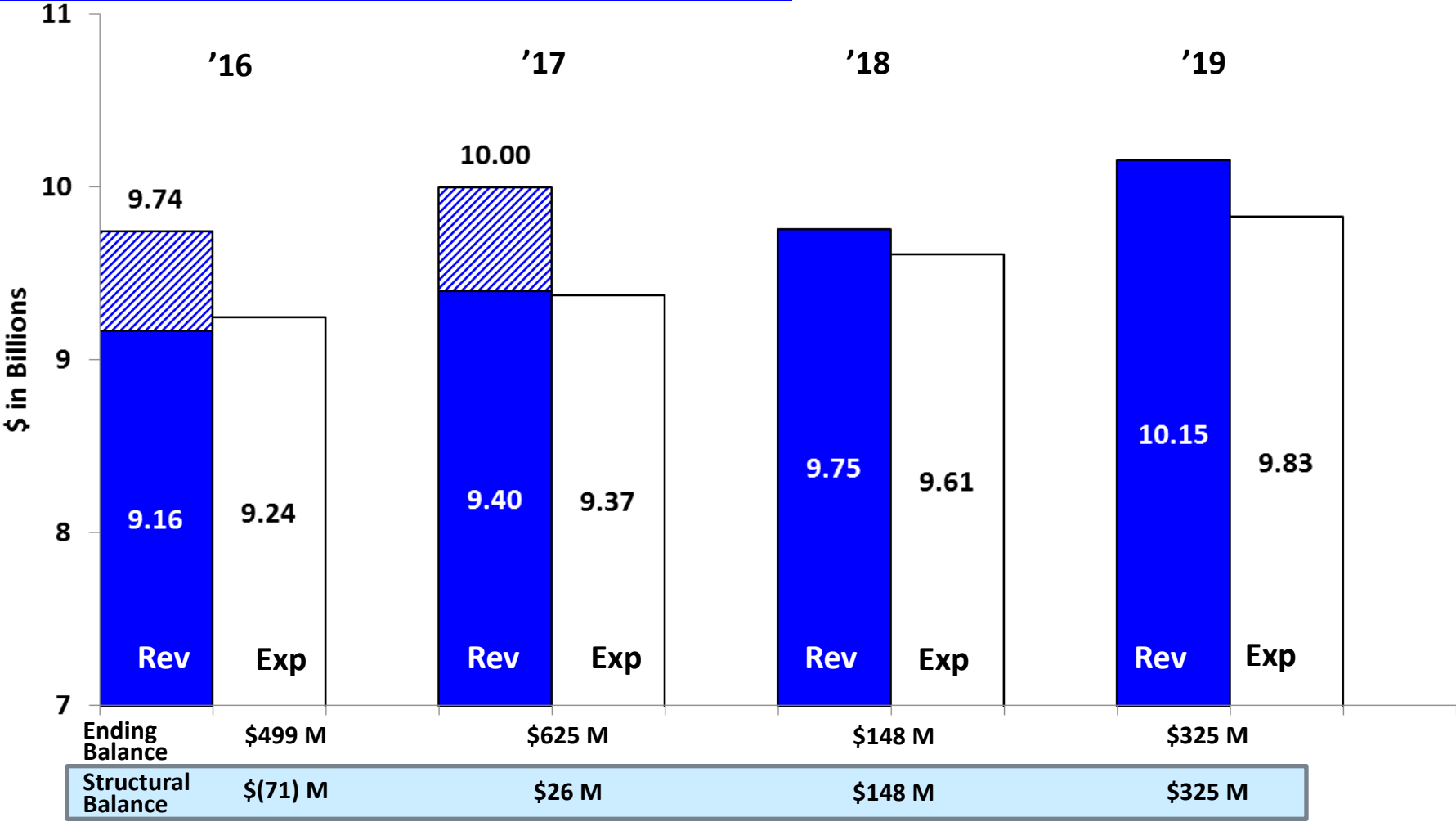
Spending Overview

Projected Baseline Spending Changes

	GF \$ in M Above Prior Year		
	'17	'18	'19
K-12	84	138	124
AHCCCS	79	77	98
DCS	(9)	0	0
DES	24	25	29
Corrections	23	7	0
Universities	12	4	0
Employee Health Insurance	(8)	0	0
Land Dept. Self-Fund	0	(13)	0
Other	(24)	(2)	(32)
Total Operating Budget Changes	181	236	219
Total Spending	\$9,371	\$9,607	\$9,826
% Change	1.4%	2.5%	2.3%

Projected Ending Balance Estimates

Projected General Fund Revenues & Expenditures



■ Base Revenue

▨ Cash Balance / One-Time

□ Ongoing Expenditures

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



Executive Comparisons

Comparing the Executive Budget and JLBC Baseline

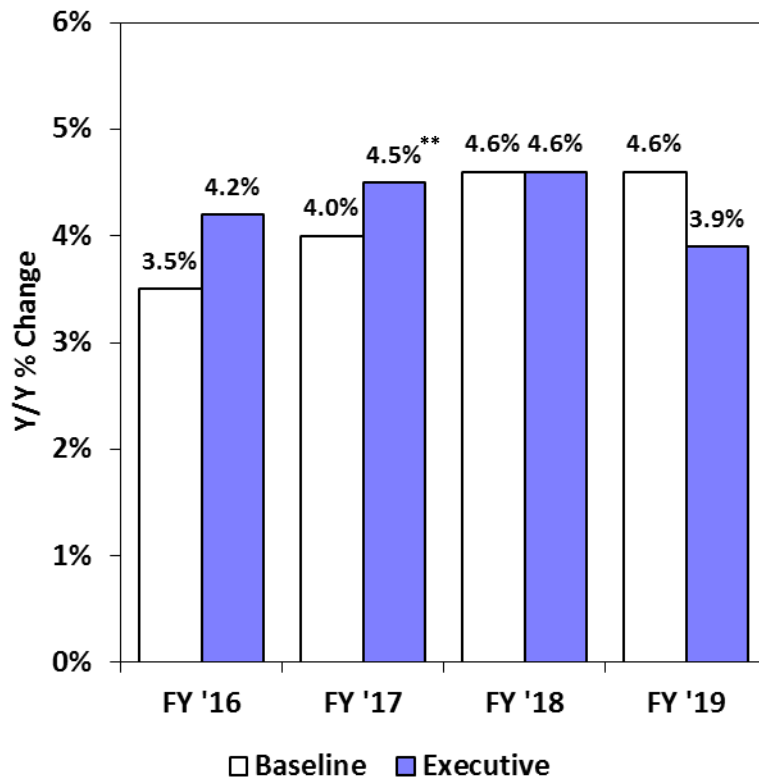
- ❑ Similar cash balances, but very different assumptions
- ❑ Higher revenue and lower caseloads allow Executive to fund more spending
- ❑ Analysis of Executive budget incomplete without tax proposal

<u>\$ in M</u>	
\$625	JLBC Baseline '17 Ending Balance
81	Lower Exec K-12 / Medicaid caseload
120	Higher Exec revenues
(15)	Lower Exec Carryforward
	<u>Policy Issues</u>
(269)	Spending increases
79	Spending reductions
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\$621	Executive '17 Ending Balance
?	Tax Package
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?	Revised Exec '17 Ending Balance

'17 Executive Revenue \$120 M Higher

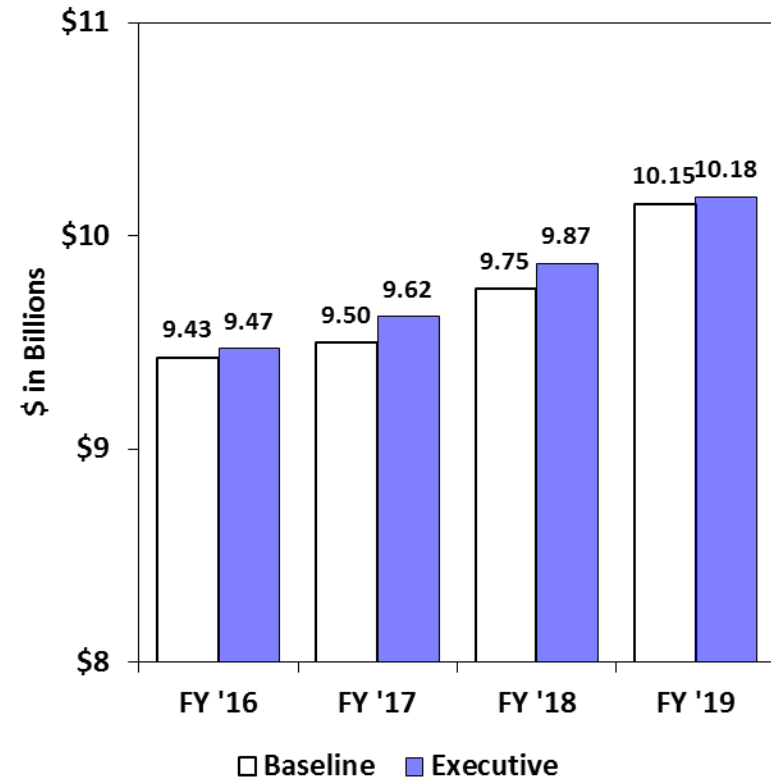
- Executive Higher by \$45 M in '16

Base Growth Rate*



*Excludes tax law changes and one-time revenue
 **5.2% when compared to JLBC '16 base

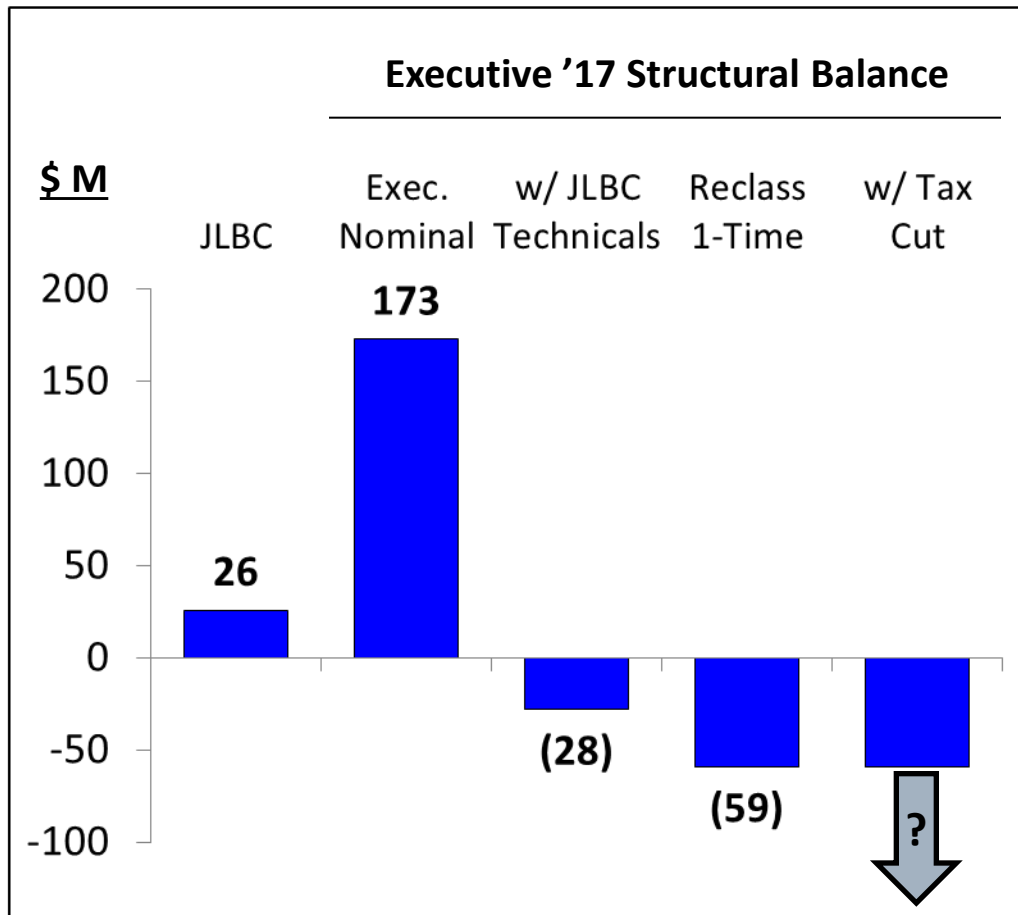
Total Revenue***



*** Excluding Balance Forward

How Different Assumptions Affect Structural Balance

- Difference Between Ongoing Revenues and Spending



- We evaluate Exec. proposal using JLBC revenue and caseloads
 - \$173 M structural balance becomes a \$(28) M shortfall
- Reclassifying certain Exec. 1-time \$ as ongoing further increases shortfall to \$(59) M
 - \$10 M JTED, \$6 M College Prep, \$15 M SFB
- Permanent Tax Cut increases shortfall beyond \$(59) M

**STAFF OF THE
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.....	Matt Gress
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.....	Krista MacGahan
.....	Tom Ritland
.....	Jon Stall
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.....	Jeremy Gunderson
.....	Josh Hope
.....	Patrick Moran
.....	Rebecca Perrera
Administrative Assistant / JLBC & JCCR Clerk.....	Kristy Paddack

Appendix

Appendix: January 2016 4-Sector Forecast

	<u>2016</u>	<u>2017</u>	<u>2018</u>	<u>2019</u>
Sales Tax				
JLBC Forecast	4.0%	4.6%	4.5%	4.3%
UA – Low	3.0%	2.6%	4.7%	4.9%
UA – Base	4.0%	5.6%	6.0%	6.0%
FAC	4.1%	5.2%	4.8%	4.3%
Average:	3.8%	4.5%	5.0%	4.9%
Individual Income Tax				
JLBC Forecast	4.6%	5.3%	4.5%	4.5%
UA – Low	1.9%	-0.1%	4.6%	5.2%
UA – Base	2.5%	4.6%	5.5%	5.7%
FAC	5.2%	5.4%	5.2%	4.4%
Average:	3.6%	3.8%	5.0%	4.9%
Corporate Income Tax				
JLBC Forecast	5.4%	4.4%	4.2%	4.0%
UA – Low	-4.6%	-2.8%	-5.5%	-4.1%
UA – Base	5.4%	1.9%	-1.7%	-5.5%
FAC	4.1%	5.5%	4.8%	3.9%
Average:	2.6%	2.4%	0.8%	0.1%

JLBC Weighted Average	4.4%	4.9%	4.5%	4.4%
UA Low Weighted Average	1.9%	1.1%	4.2%	4.7%
UA Base Weighted Average	3.5%	4.9%	5.3%	5.4%
FAC Consensus Weighted Average	4.6%	5.3%	5.0%	4.3%
“Big-3” Weighted Average	3.6%	4.1%	4.7%	4.7%
Consensus Weighted Average*	3.5%	4.0%	4.6%	4.6%
Adjusted Consensus Weighted Average**	2.5%	3.0%	3.7%	3.9%

* Represents on-going revenue adjusted for small revenue categories.

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