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# **Finance Advisory Committee**

## **Revenue and Budget Update**

**January 24, 2013**

**JLBC**

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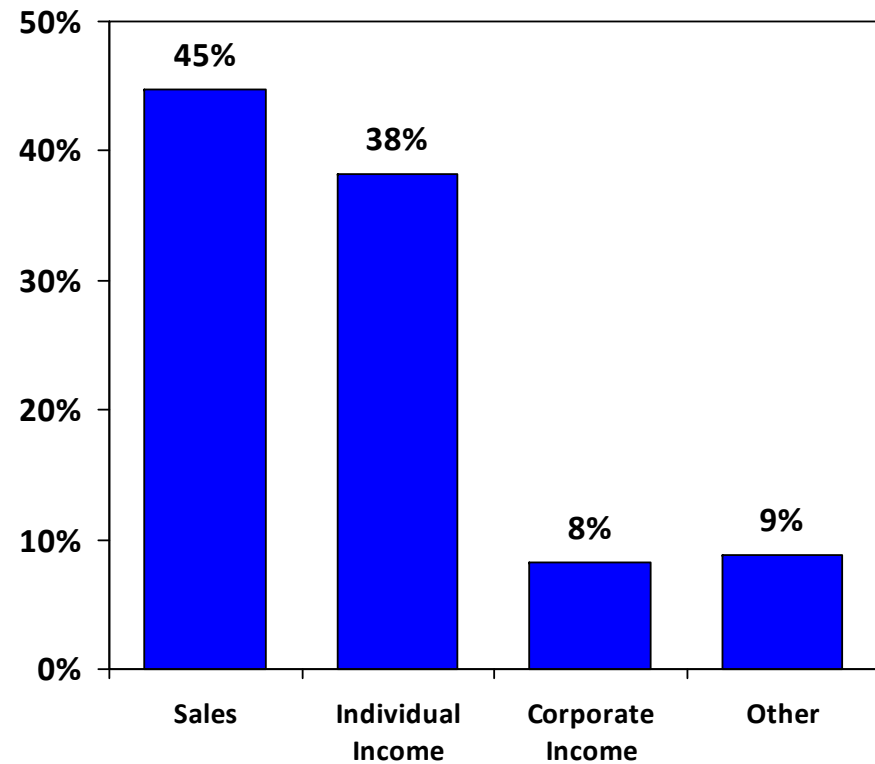
# Revenue Overview

**JLBC**

# FY 2014 General Fund Revenue

- 91% Generated by 3 Taxes

<u>Source</u>	<u>Millions</u>
Sales and Use Tax	\$ 3,997.1
Individual Income Tax	3,396.9
Corporate Income Tax	703.7
Other	<u>790.0</u>
<b>SUBTOTAL</b>	<b>\$ 8,887.7</b>
Urban Revenue Sharing	<u>(559.5)</u>
<b>TOTAL REVENUE</b>	<b>\$ 8,328.2 <sup>1/</sup></b>



<sup>1/</sup> January 2013 estimate. Excludes beginning balance



# 1<sup>st</sup> Half Growth Rate 3.6% \*

- \$32.3 M Above Forecast

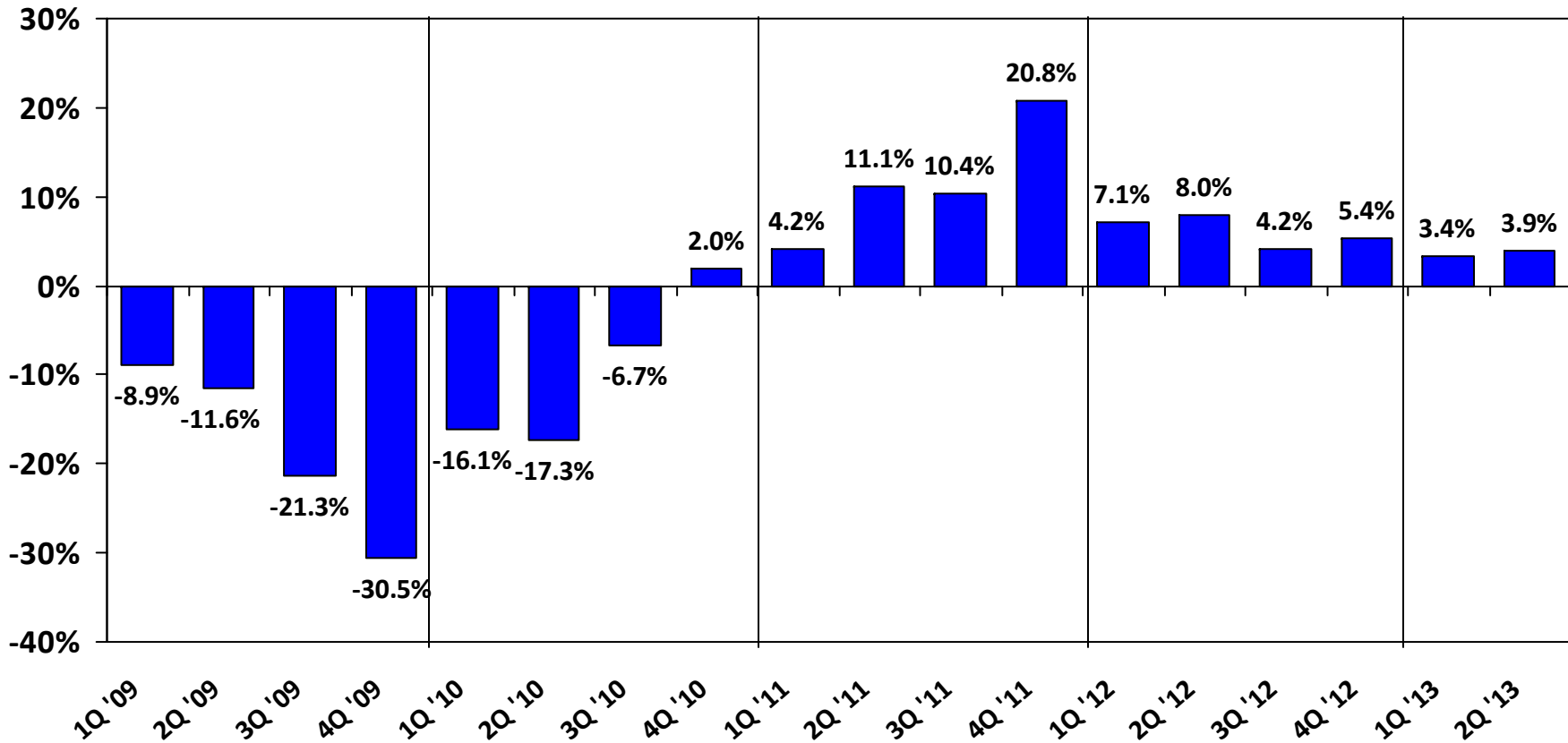
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	% Change over Prior Year *
Sales Tax (without 1-cent)	4.3%
Individual Income Tax	7.6%
Corporate Income Tax	(8.3)%

- ❑ First half growth 0.7% above forecasted growth
- ❑ Sales tax at forecast, individual income tax above forecast, and corporate income tax below forecast

\* Based on preliminary December numbers

# FY '13 Quarterly Growth Rates Have Tapered Off From Growth Rates of FY '12



Percent Change in Adjusted Revenues Excluding  
1-Cent Sales Tax



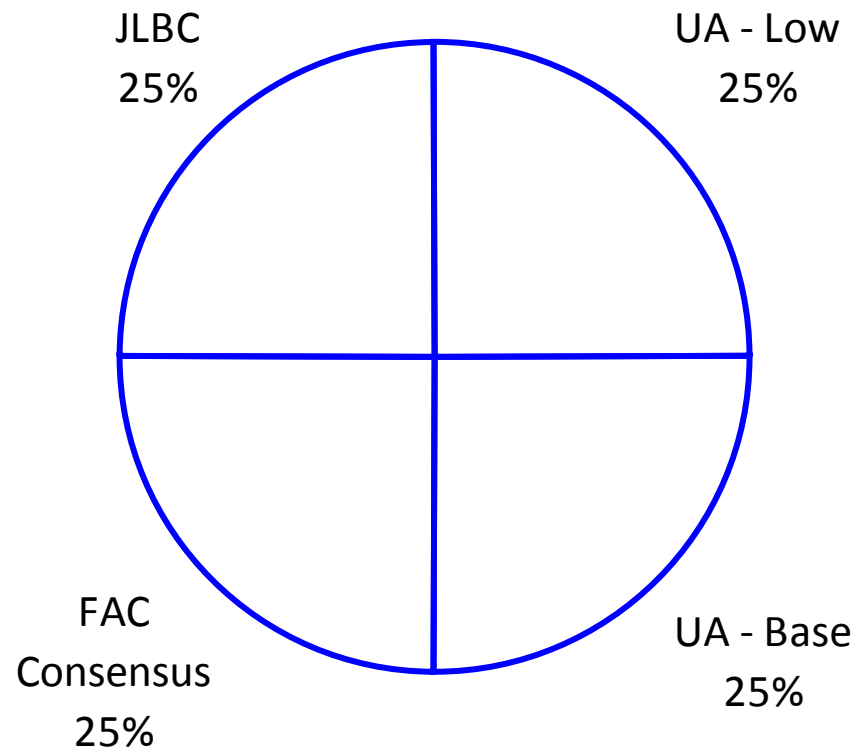
# Where Are We Headed Over the Next Few Years?

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

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4-sector forecast equally weights:

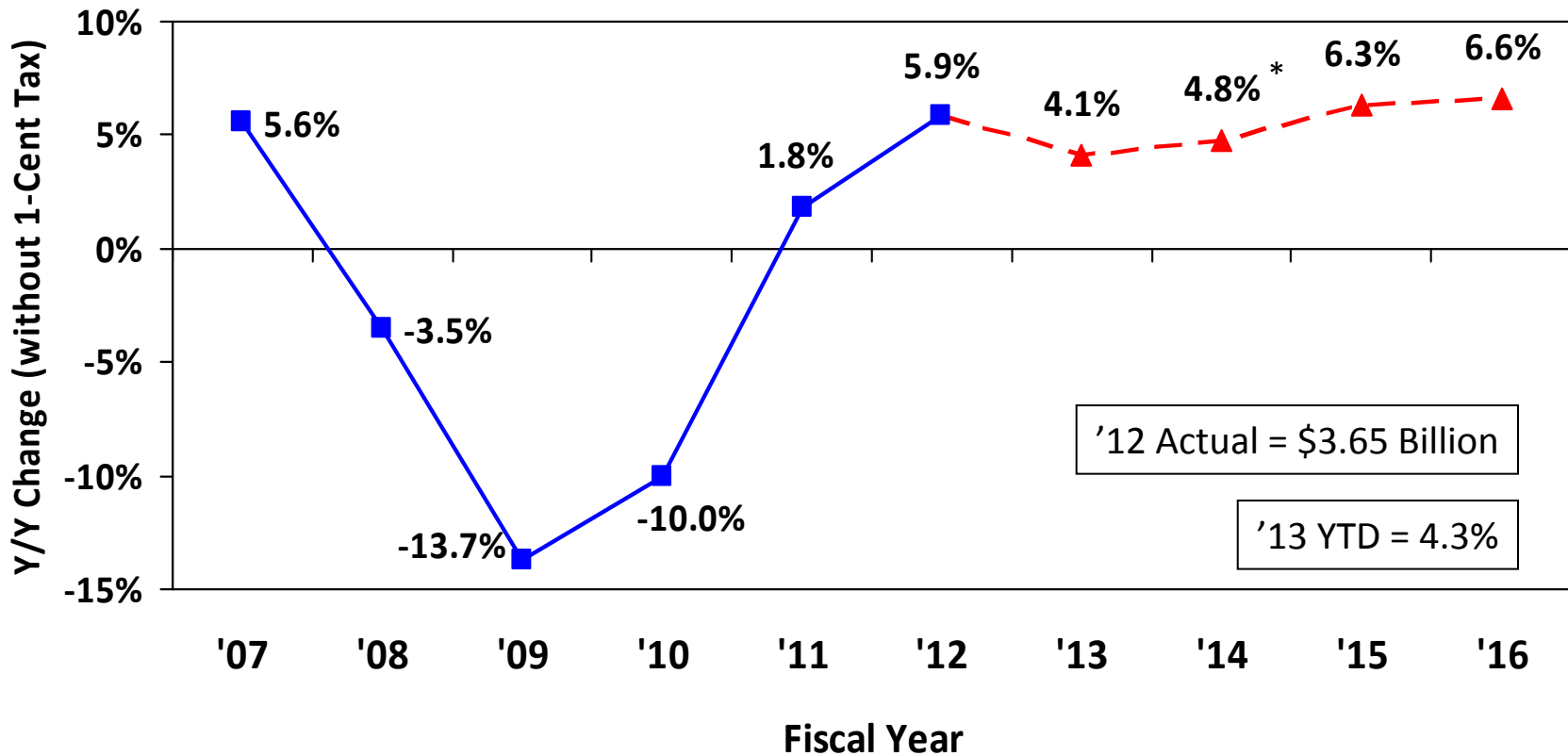
- FAC average
- UofA model – base
- UofA model – low
- JLBC Staff forecast
- Remaining revenues (9% of total) are staff forecast



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

# Sales Tax

- The Consensus Forecasts Growth of 4.1% in FY '13 and 4.8%\* in FY '14



'12 Actual = \$3.65 Billion

'13 YTD = 4.3%

—■— Historical    -▲- 4-Sector Forecast

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

\* Prior to the estimated impact of Amazon sales tax collections. Baseline adjusts for this factor, which revises FY '14 growth to 5.1%.



# Amazon Sales Taxes Expected to Add \$15 M in '14

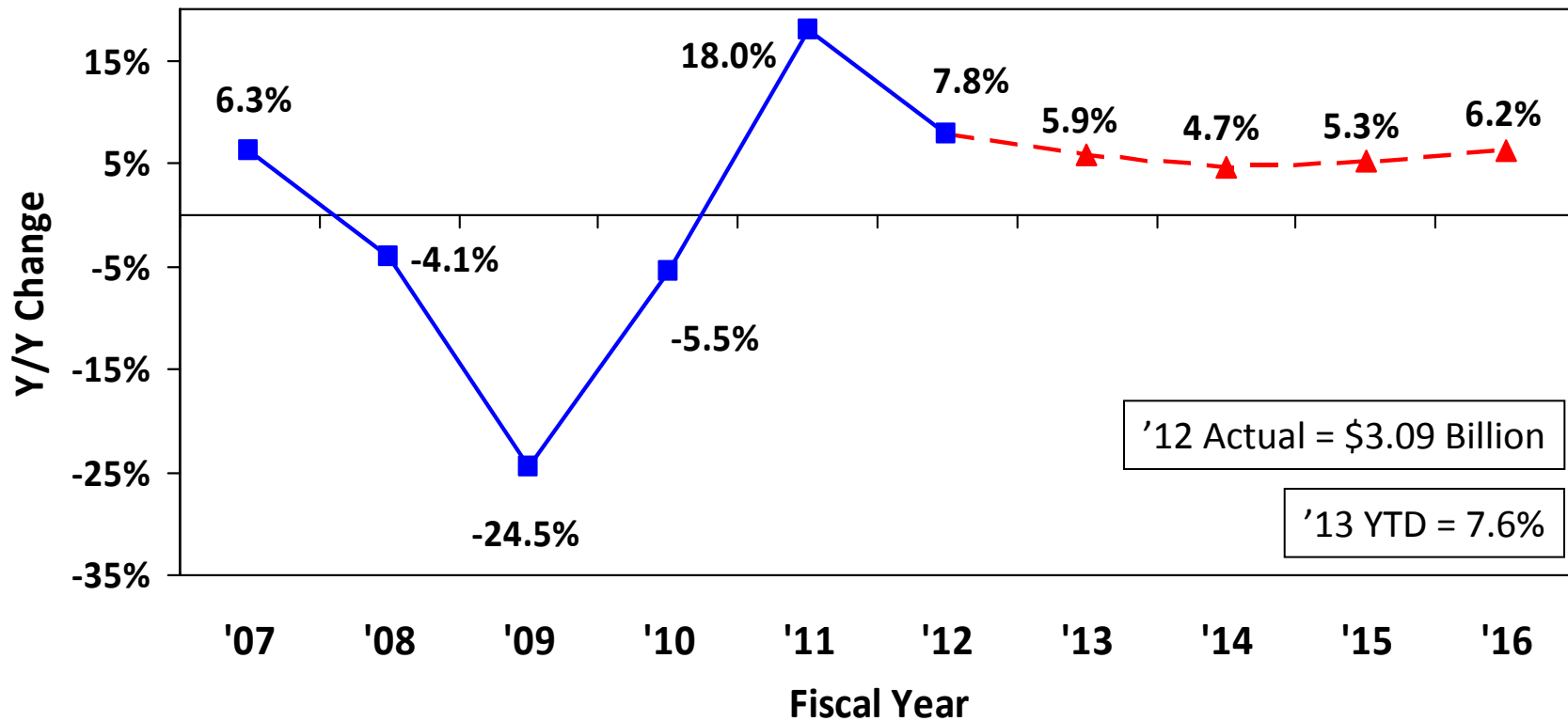
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- ❑ Online purchases not subject to sales tax if company has no physical presence in the state
- ❑ Amazon has agreed to begin taxing sales
  - Fully phased in by FY '14
  - Baseline revenue incorporates this increase
- ❑ Non-Amazon online tax potential is overstated
  - Study has suggested state could collect several hundred million – only possible if “business to business” is taxed



# Individual Income Tax

- The Consensus Forecasts Growth of 5.9% in FY '13 and 4.7% in FY '14



—■— Historical    -▲- 4-Sector Forecast

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



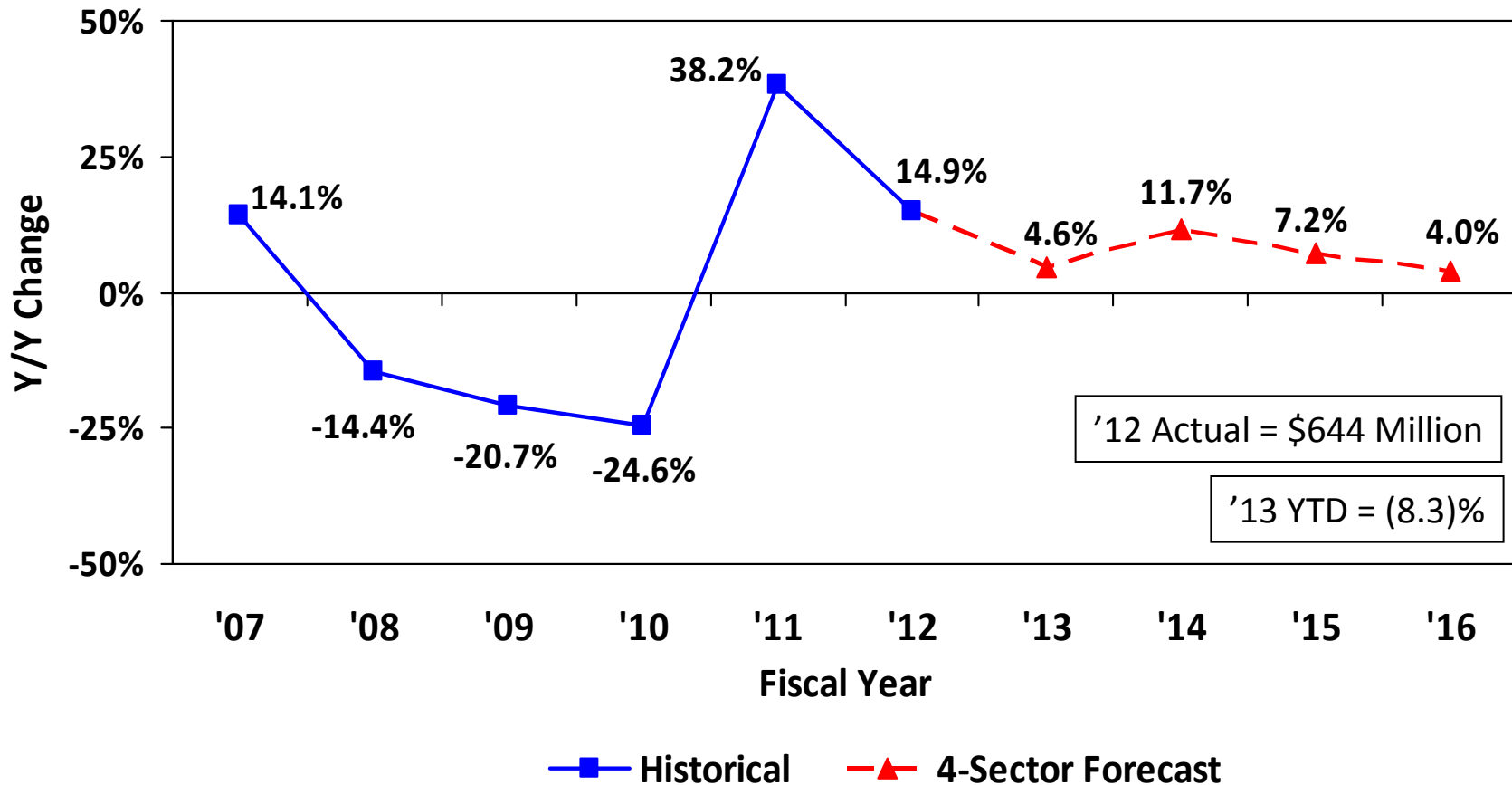
# Potential One-Time FY '13 Tax Shift

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- ❑ Federal fiscal cliff threat incentivized companies to issue dividends and stockholders to take capital gains
  - 4<sup>th</sup> quarter dividends 4 times higher than a year ago
  - May only accelerate, not increase, investment income
- ❑ Creates potential to shift future year collections into FY '13 – and reduce FY '14 by a corresponding amount
  - Very difficult to determine magnitude in advance – Baseline does not incorporate
- ❑ Legislature may consider setting aside potential FY '13 individual income tax “windfall” above Baseline
  - Approach would help prevent repeating the mistake of counting all FY '06/'07 bubble as permanent revenue
  - Set aside should first be dedicated to offset FY '14 drop-off

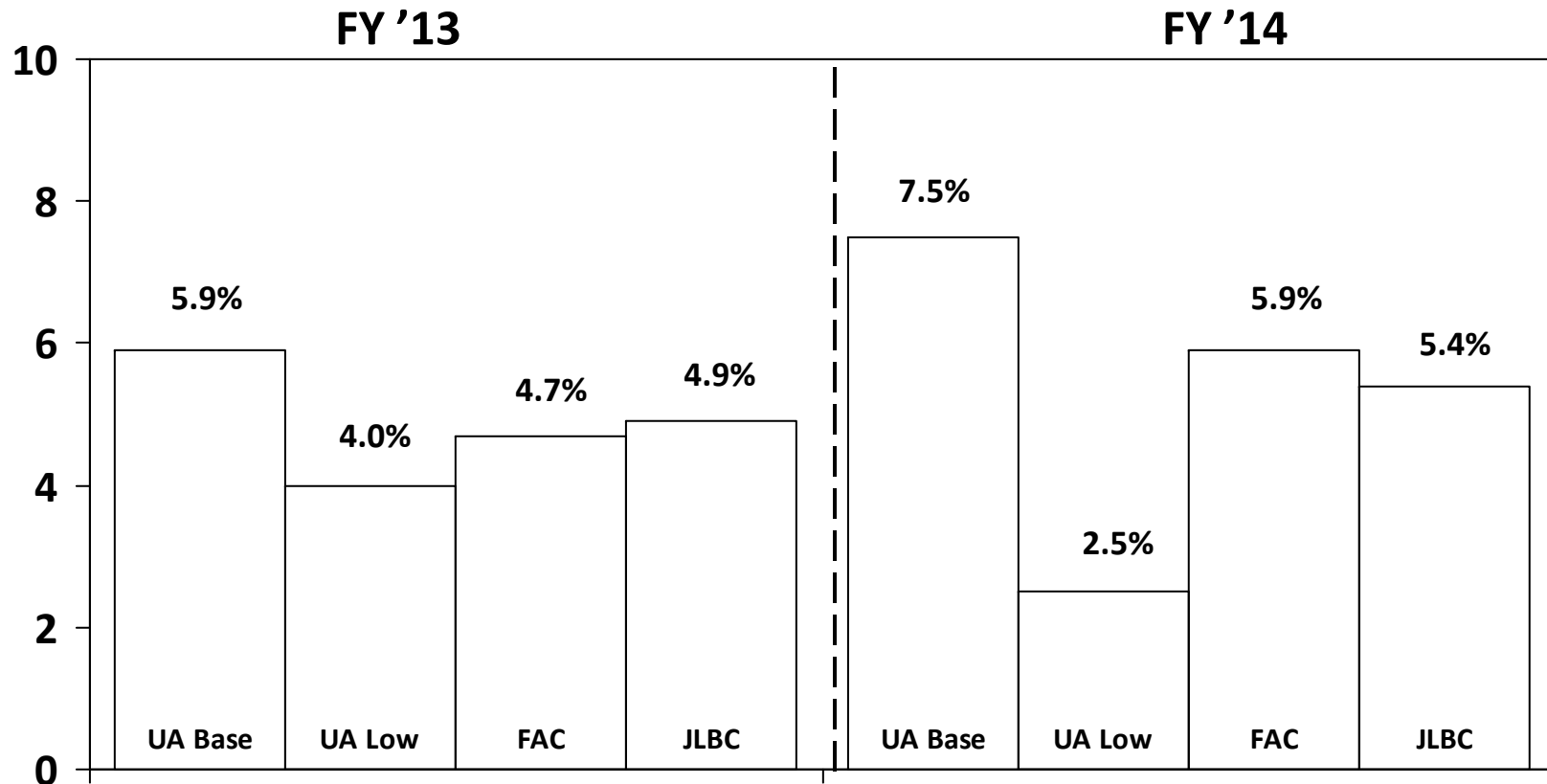
# Corporate Income Tax

- The Consensus Forecasts Growth of 4.6% in FY '13 and 11.7% in FY '14



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

# Consensus Predicts Base Growth Rate of 4.0% in FY '13 and 4.9% in FY '14\*



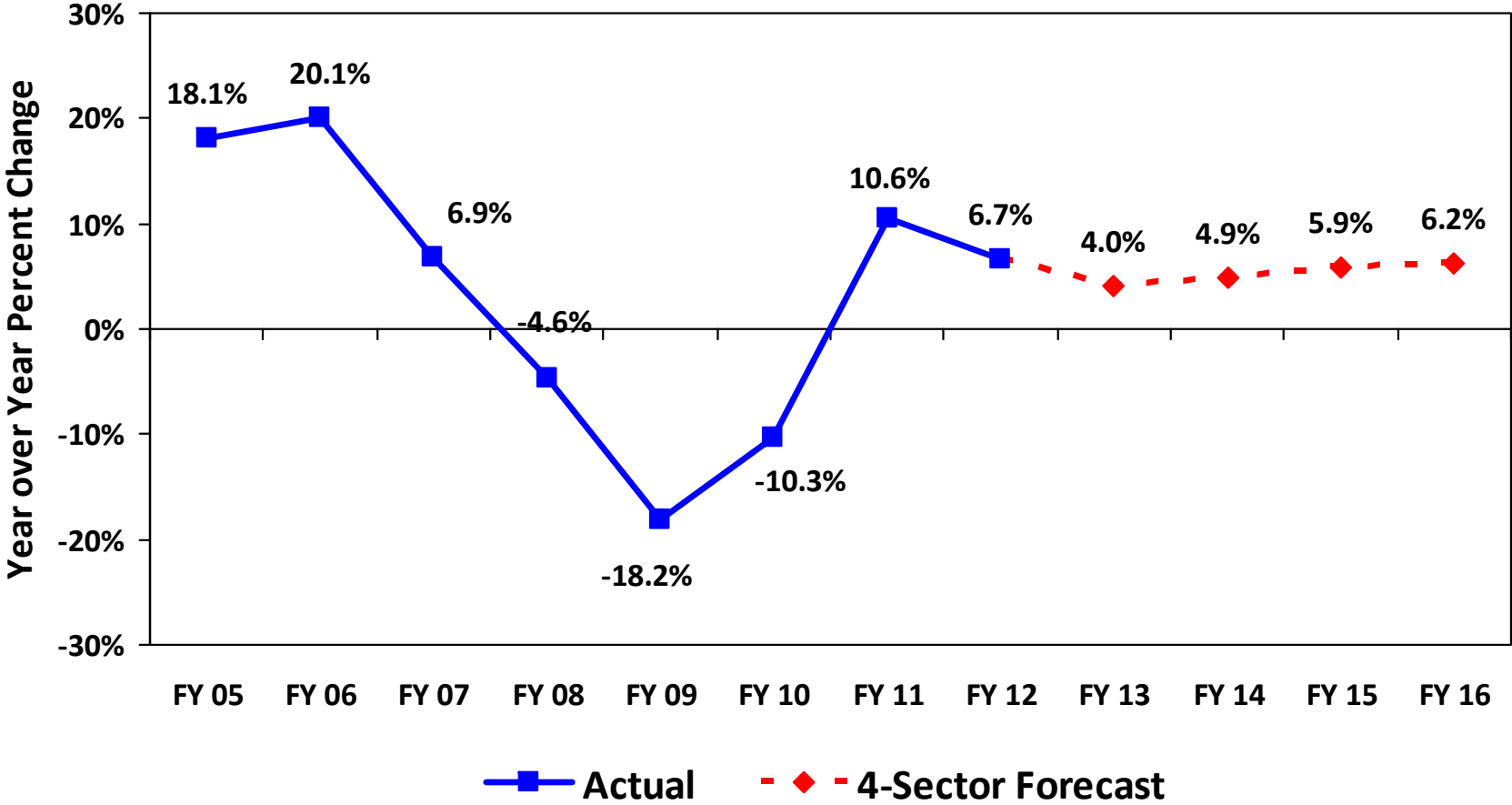
Details in Appendix A

\* Weighted Big 3 average growth prior to 1-Cent sales tax is 4.9% in FY '13 and 5.5% in FY '14. After adjusting for small tax categories, the base growth rate is 4.0% in FY '13 and 4.9% in FY '14.



# Consensus Accelerates Growth Through FY '16

- FY '14 – '16 Average Annual Base Growth = 5.7%

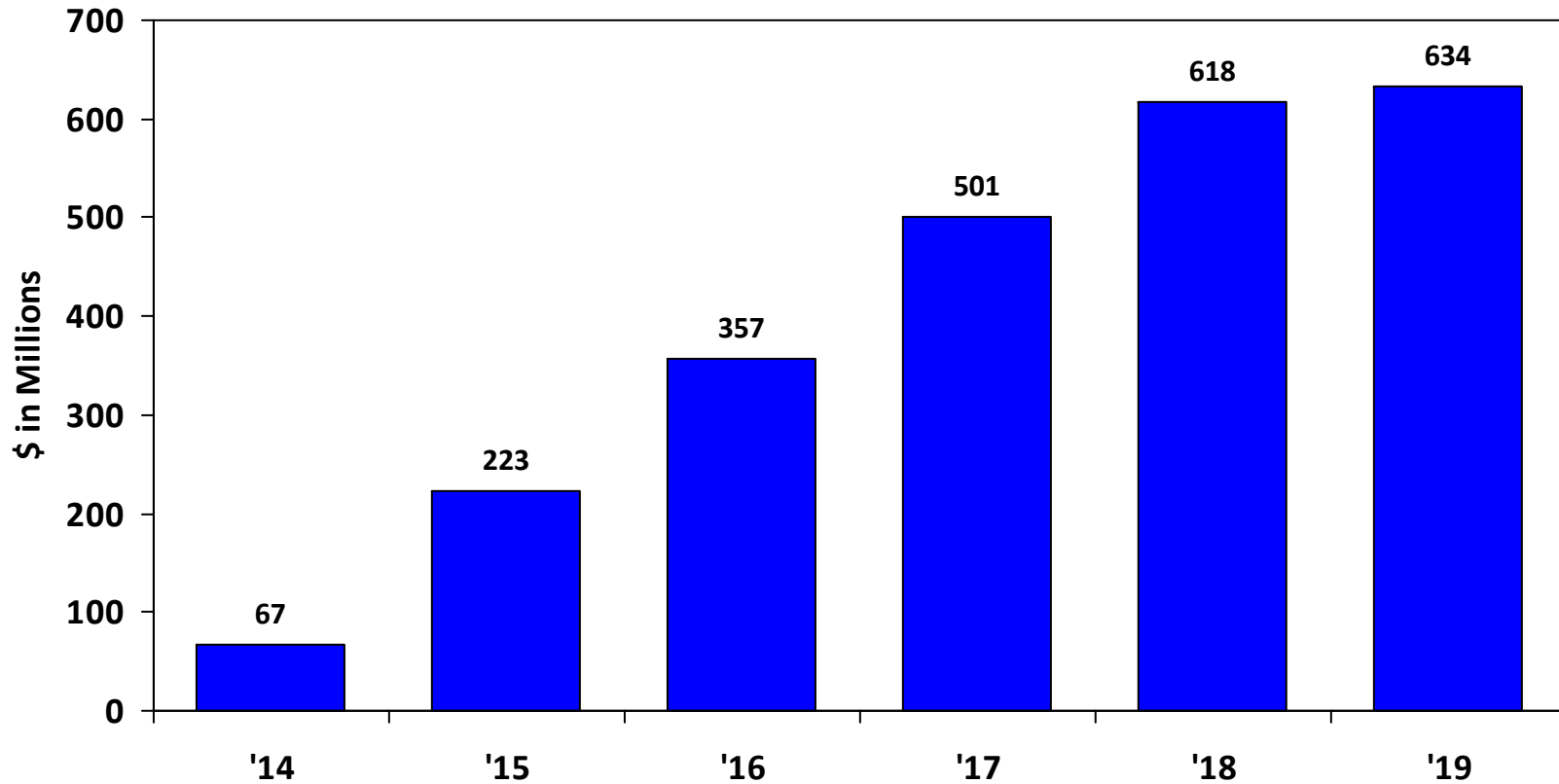


Percent Change in Base revenues excluding balance forward, tax law changes, one-time revenues, and urban revenue sharing



# Fiscal Impacts of Enacted Tax Laws

- Includes Property Tax Change Impact on K-12 Budget



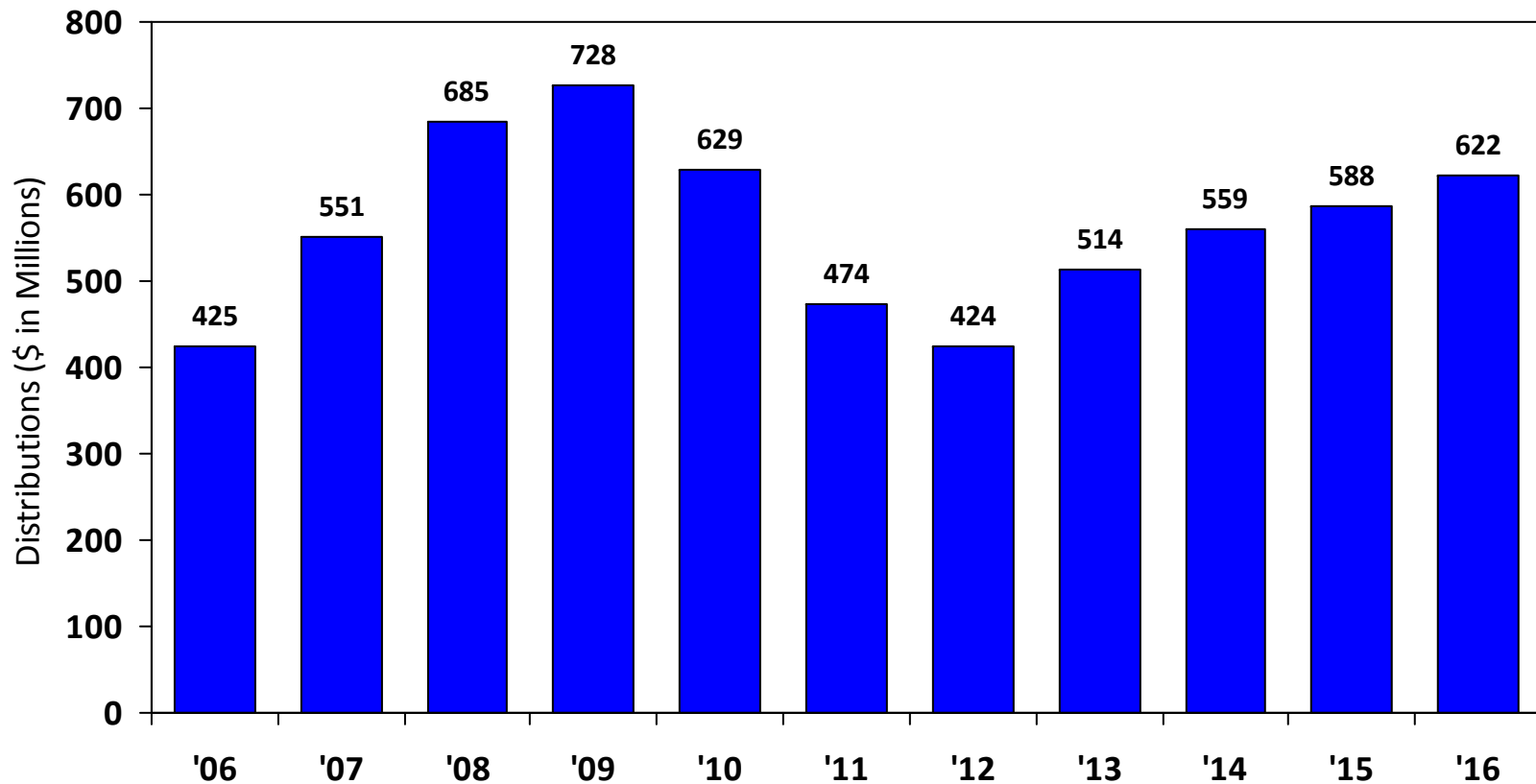
Revenue Loss/Spending Increase Relative to Enacted FY 2013 Budget

# Major Tax Provisions Affecting General Fund

Provisions	(\$ in Millions)		
	FY '14	FY '15	FY '16
Business Property Taxes / Homeowner Rebate	19	41	67
Corporate Rate Phase Down (FY '15 – FY '18)	0	54	116
Corporate Sales Factor Phase In (FY '15 – FY '18)	0	25	47
New Employee Tax Credit	18	38	45
Capital Gains Reduction	18	52	69

# State's Distribution to Urban Revenue Sharing Will Increase by \$45 M in '14

– Amount Linked to Income Tax Collections 2 Years Prior





# FY '14 – FY '16 Baseline Revenue Changes

General Fund - \$ in Millions

	FY '14 <u>Above '13</u>	FY '15 <u>Above '14</u>	FY '16 <u>Above '15</u>
Base Revenue Growth (4.9%/5.9%/6.2%)	416	526	575
TPT 1 ¢ Expires	(924)	--	--
Elimination of Fund Transfers	(90)	(6)	--
One-Time FY '13 Revenue Loss <sup>1/</sup>	52	--	--
Previously Enacted Tax Legislation	(47)	(134)	(108)
Urban Revenue Sharing	(45)	(28)	(35)
Change In Beginning Balance <sup>2/</sup>	<u>254</u>	<u>(341)</u>	<u>(285)</u>
<b>Additional Revenues</b>	<b>(384)</b>	<b>17</b>	<b>147</b>
<b>Total Resources</b>	<b>8,979</b>	<b>8,996</b>	<b>9,143</b>

<sup>1/</sup> TPT early payment threshold

<sup>2/</sup> Beginning balances: FY '13, \$397 M; FY '14, \$651 M; FY '15, \$310 M; FY '16, \$25 M

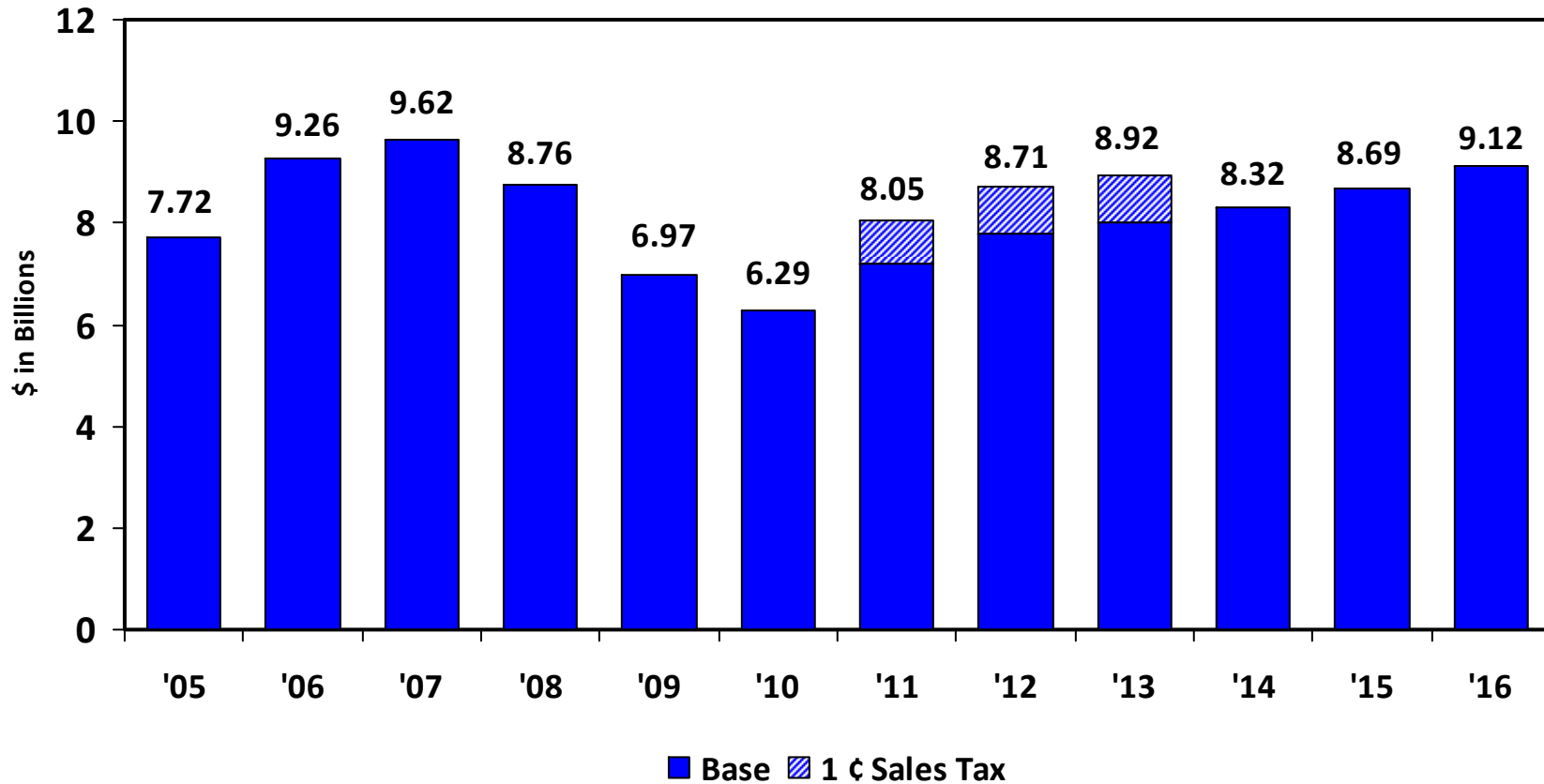


# Revenue Changes Between FY '13 and FY '16

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	<u>\$ in Millions</u>
<b>FY '13 Total Revenue</b>	<b>\$9,364</b>
Base Revenue Increase	1,517
Loss of 1 cent Sales Tax	(924)
Beginning Balance Reduction	(372)
Enacted Tax Reductions	(289)
Increased Urban Revenue Sharing	(108)
Other	(44)
<b>FY '16 Total Revenue</b>	<b>\$9,143</b>

# Consensus Forecasts Remains Below FY '07 High



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

# Risks to the Economic Forecast – Fiscal Cliff 2

## - Impact of Federal Spending Reductions

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- ❑ As part of the January 1 budget agreement, Congress deferred mandated spending reductions to March
- ❑ At that time, 9% reduction to domestic and defense expenditures would occur absent other action
- ❑ Defense cuts may disproportionately focus on procurement
  - Studies have estimated AZ defense industry generates \$71 M in business taxes and \$52 M in individual income taxes
- ❑ Domestic reductions would affect state grants such as education and job training – but excludes Medicaid, TANF and SNAP

# Beyond the “Cliff”, Other Risks to the Economic Forecast

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- ❑ Unforeseen natural disasters and political events have economic consequences
  - Since the October FAC meeting, Superstorm Sandy is an example
- ❑ International economics increasingly has domestic repercussions – Europe’s debt crisis and the slowing of the Chinese boom
- ❑ 4-sector Baseline has accelerating revenue growth in FY ’16
  - Long term forecasts usually get more cautious

# Given Unknowns, How Do We Evaluate Likelihood of Forecast?

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- ❑ Since no one forecast is likely to be correct, a “probability” percent clarifies the risk
- ❑ Probability percent of meeting or exceeding FY '14 Baseline forecast is 65%
- ❑ Derived from consensus input

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# Spending Overview

# FY '14 – FY '16 Baseline Spending Changes

	General Fund - \$ in Millions		
	<u>FY '14</u> <u>Above '13</u>	<u>FY '15</u> <u>Above '14</u>	<u>FY '16</u> <u>Above '15</u>
K-12 Formula	55	54	82
Medicaid Formula (prior to expansion)	(97)	115	128
Medicaid Mandatory Expansion	74	140	22
One-Time FY '13 Caseload Savings	76	--	--
ADC Operating – phase-in approved beds	9	19	7
Debt Service	20	--	--
Land Department Fund Source	11	--	--
Other	9	(26)	3
<b>Additional Spending</b>	<b>157</b>	<b>302</b>	<b>242</b>
<b>Total Spending</b>	<b>8,669</b>	<b>8,971</b>	<b>9,214</b>



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# Projected Ending Balance Estimates

JLBC

# FY '14 – '16 Baseline Projections

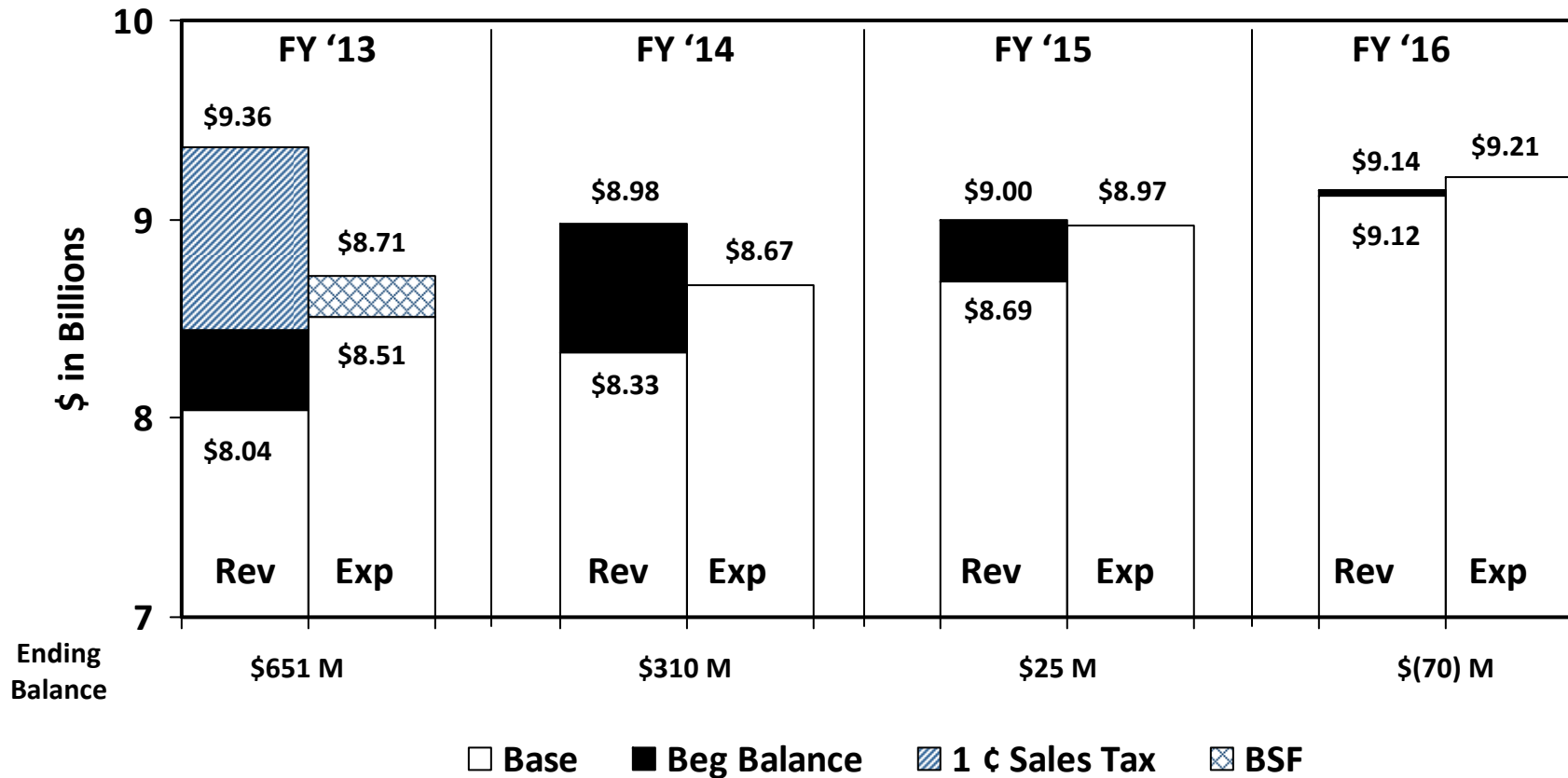
Baseline	'13	'14	'15	'16
Balance Forward	\$397 M	\$651 M	\$310 M	\$25 M
Revenues	\$9.0 B	\$8.3 B	\$8.7 B	\$9.1 B
Spending	\$8.7 B <sup>1/</sup>	\$8.7 B	\$9.0 B	\$9.2 B
<b>Ending Balance</b>	<b>\$651 M</b>	<b>\$310 M</b>	<b>\$25 M</b>	<b>\$(70) M</b>

- ❑ After statutory spending, effectively no money remains for discretionary spending without increasing out-year shortfall
- ❑ Excludes impact of K-12 inflation court ruling – would add a new \$80 M+ to budget each year. If funded, would result in \$(223) M FY '15 shortfall and \$(346) M FY '16 shortfall
- ❑ \$450 M Rainy Day Fund available to offset shortfalls

<sup>1/</sup> \$8.5 billion after adjusting for Rainy Day Fund deposit

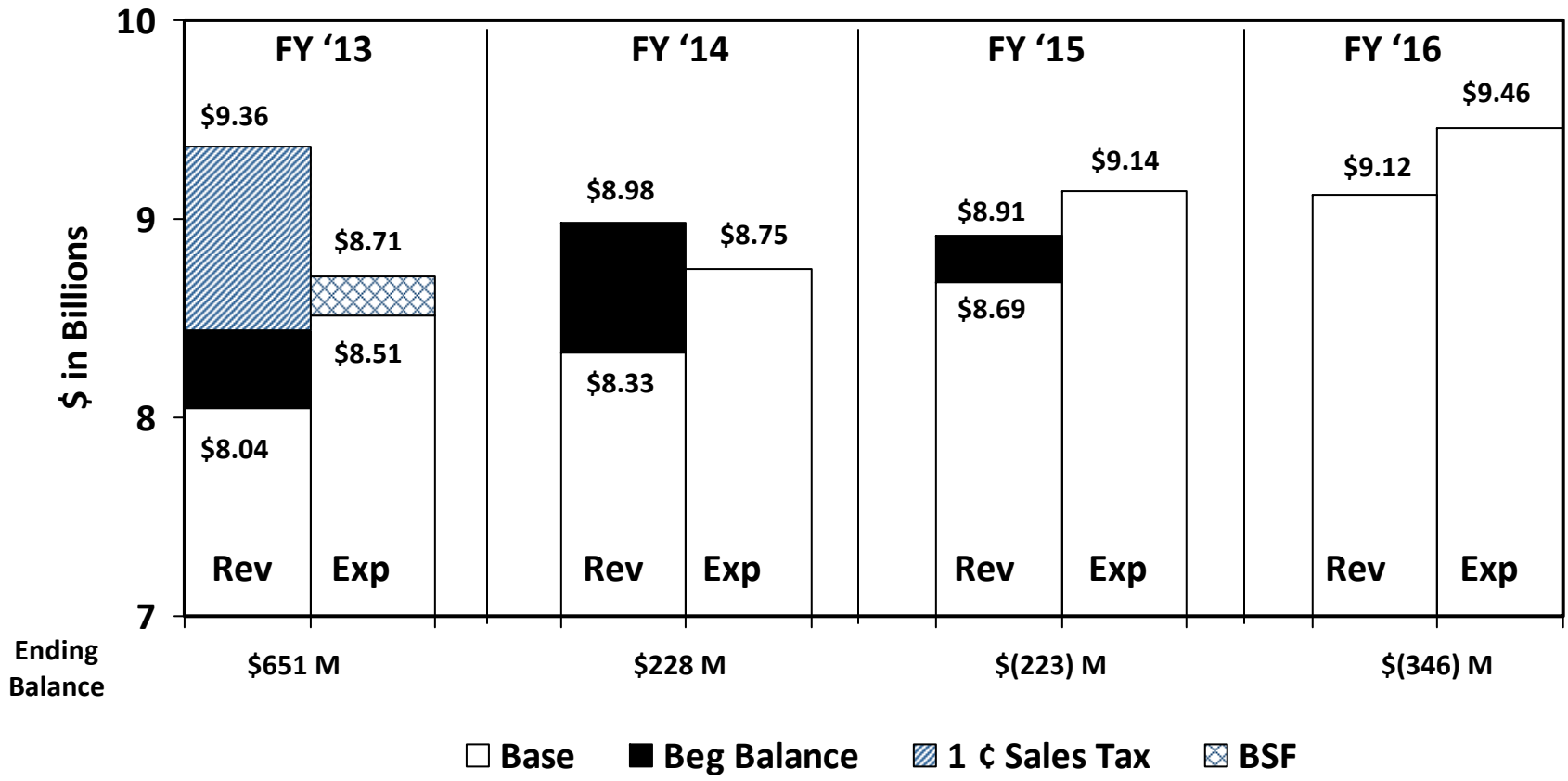
# JLBC Baseline Revenues Compared to Expenditures

## - If No Discretionary Spending – Small FY '16 Shortfall



# JLBC Baseline Adjusted for K-12 Inflation Ruling

- Every Extra \$1 Spent in '14 Increases '16 Shortfall by \$3



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# Executive Budget Comparison

## 2 Factors Influencing Budget Outlook through '16

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- How much revenue forecast risk in an uncertain economic environment?
- How much discretionary spending above the Baseline?

# Executive Has \$261 M More in Higher Revenue Than JLBC Baseline in FY '14

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## General Fund Revenue

- FY '13 - \$84 M
- FY '14- \$261 M
  - \$74 M: higher Beginning Balance
  - \$125 M: higher revenue growth rates
  - \$62 M: employee Health Insurance Fund transfer
  - \$7 M: insurance premium
  - \$(7) M: new lottery distributions – counties/parks

# Besides \$261 M in Higher Revenue, Executive has \$258 M in Higher Spending

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## General Fund Spending

- FY '13 - \$15 M (CPS supplemental)
- FY '14 - \$258 M



# What Is The Margin For Error?

## - Ending Balance Projections

	<b>\$ in Millions</b>			
	<u>FY '13</u>	<u>FY '14</u>	<u>FY '15</u>	<u>FY '16</u>
JLBC Baseline	651	310	25	(70)
Executive	725	313	122	139
Executive – Modified*	725	123	(322)	(263)

\* Modified to include JLBC's FY '14 – '16 base revenue forecast and ADE statutory formula estimate

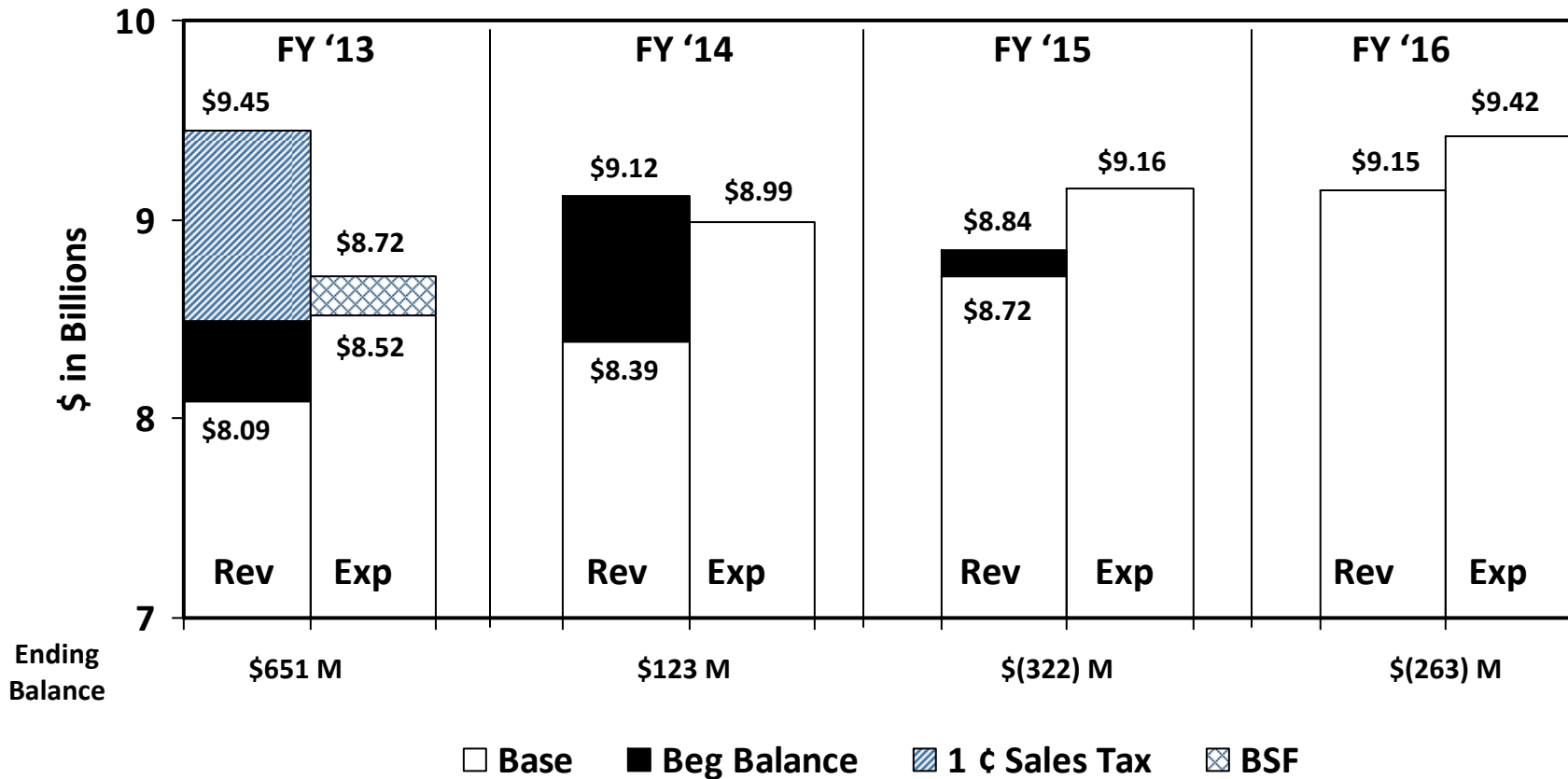
# How Different Assumptions Affect Executive's FY '15 Estimate

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<u>\$ in M</u>	<u>Changes to Ending Balance</u>
\$313	'14 Executive ending balance
(65)	'14 JLBC higher ADE formula costs
<u>(125)</u>	'14 JLBC lower revenue
\$123	'14 revised Executive ending balance
(190)	'15 lower beginning balance (\$122 M rather than \$313 M)
(85)	'15 JLBC higher ADE formula costs
<u>(170)</u>	'15 JLBC lower revenue
\$ <u>(322)</u>	'15 revised Executive ending balance

# Executive Revenues Compared to Expenditures

## - As Adjusted for JLBC Revenues and ADE Formula



# Appendix A: January 2013 4-Sector Forecast

	<u>FY 2013</u>	<u>FY 2014</u>	<u>FY 2015</u>	<u>FY 2016</u>
<b>Sales Tax</b>				
JLBC Forecast	4.6%	5.5%	5.6%	5.7%
UA – Low	2.8%	1.8%	5.8%	7.5%
UA – Base	4.7%	6.1%	7.9%	7.9%
FAC	4.2%	5.8%	5.7%	5.2%
Average:	<b>4.1%</b>	<b>4.8% *</b>	<b>6.3%</b>	<b>6.6%</b>
<b>Individual Income Tax</b>				
JLBC Forecast	5.5%	5.9%	6.5%	6.5%
UA – Low	5.2%	1.0%	2.2%	4.8%
UA – Base	7.6%	6.2%	6.3%	7.3%
FAC	5.2%	5.7%	5.8%	5.9%
Average:	<b>5.9%</b>	<b>4.7%</b>	<b>5.3%</b>	<b>6.2%</b>
<b>Corporate Income Tax</b>				
JLBC Forecast	3.3%	2.8%	4.1%	6.1%
UA – Low	4.7%	14.0%	6.5%	0.8%
UA – Base	5.1%	22.5%	10.2%	2.4%
FAC	5.3%	7.3%	7.5%	7.6%
Average:	<b>4.6%</b>	<b>11.7%</b>	<b>7.2%</b>	<b>4.0%</b>
JLBC Weighted Average	<b>4.9%</b>	<b>5.4%</b>	<b>5.9%</b>	<b>6.1%</b>
UA Low Weighted Average	<b>4.0%</b>	<b>2.5%</b>	<b>4.4%</b>	<b>5.8%</b>
UA Base Weighted Average	<b>5.9%</b>	<b>7.5%</b>	<b>7.4%</b>	<b>7.2%</b>
FAC Weighted Average	<b>4.7%</b>	<b>5.9%</b>	<b>5.9%</b>	<b>5.7%</b>
“Big-3” Weighted Average **	<b>4.9%</b>	<b>5.5%</b>	<b>5.9%</b>	<b>6.2%</b>
Consensus Weighted Average***	<b>4.0%</b>	<b>4.9%</b>	<b>5.9%</b>	<b>6.2%</b>
Adjusted Consensus Weighted Average***	<b>3.6%</b>	<b>4.3%</b>	<b>4.4%</b>	<b>5.0%</b>
* Does not include the estimated impact of Amazon sales tax collections – with Amazon, estimate is 5.1%				
** Adjusted for Amazon and small revenue categories				
*** Adjusted for Amazon and tax law changes				

