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# **Finance Advisory Committee**

## **Revenue and Budget Update**

**April 12, 2012**

**JLBC**

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# Revenue Overview

JLBC

# Key Economic Measures

## - Current Arizona Status

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Withholding Growth 3 Month Average Compared to Prior Year	2.6%
Retail Sales Tax Growth 3 Month Average Compared to Prior Year	5.1%
Pending Maricopa Foreclosures	17,800
Arizona Single Family Permits	11,400
Arizona Underwater Mortgages	48%

# Arizona Forecasters Are Optimistic Compared to Other Western States

## Blue Chip Forecast - % Personal Income Growth

<u>CY 2012</u>		<u>CY 2013</u>	
Texas	5.1%	<b>Arizona</b>	<b>5.8%</b>
<b>Arizona</b>	<b>4.9%</b>	Utah	5.8%
Utah	4.8%	Texas	5.4%
Washington	4.5%	Washington	5.2%
Wyoming	4.5%	Colorado	4.7%
Colorado	4.4%	Oregon	4.4%
Oregon	4.4%	California	4.1%
California	4.0%	Idaho	3.8%
New Mexico	3.3%	Nevada	3.2%
Idaho	2.8%	New Mexico	3.4%
Nevada	2.4%	Wyoming	N/A

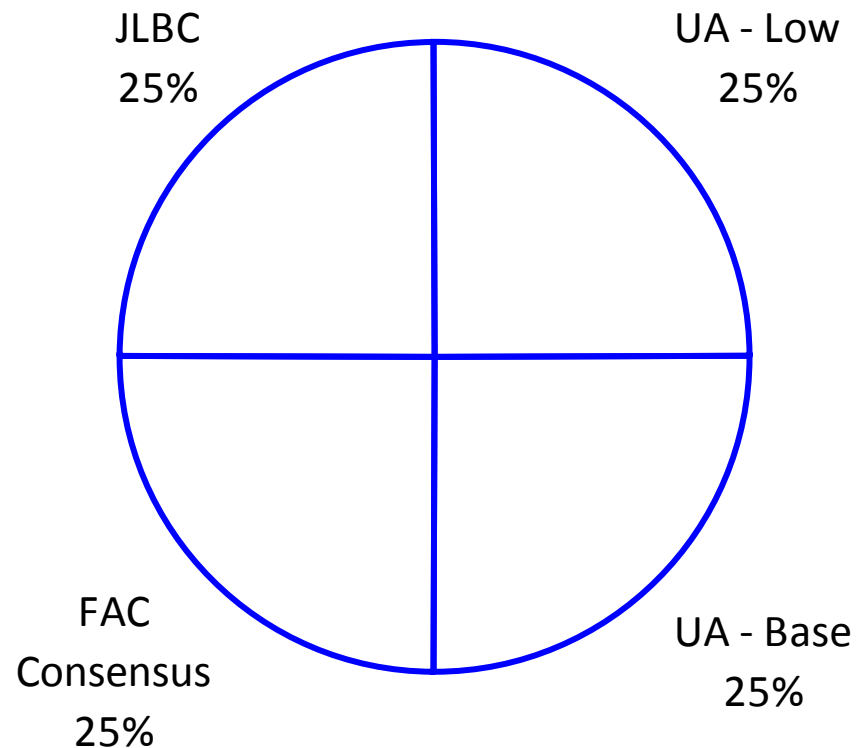
# Where Are We Headed Over the Next Few Years?

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

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4-sector forecast equally weights:

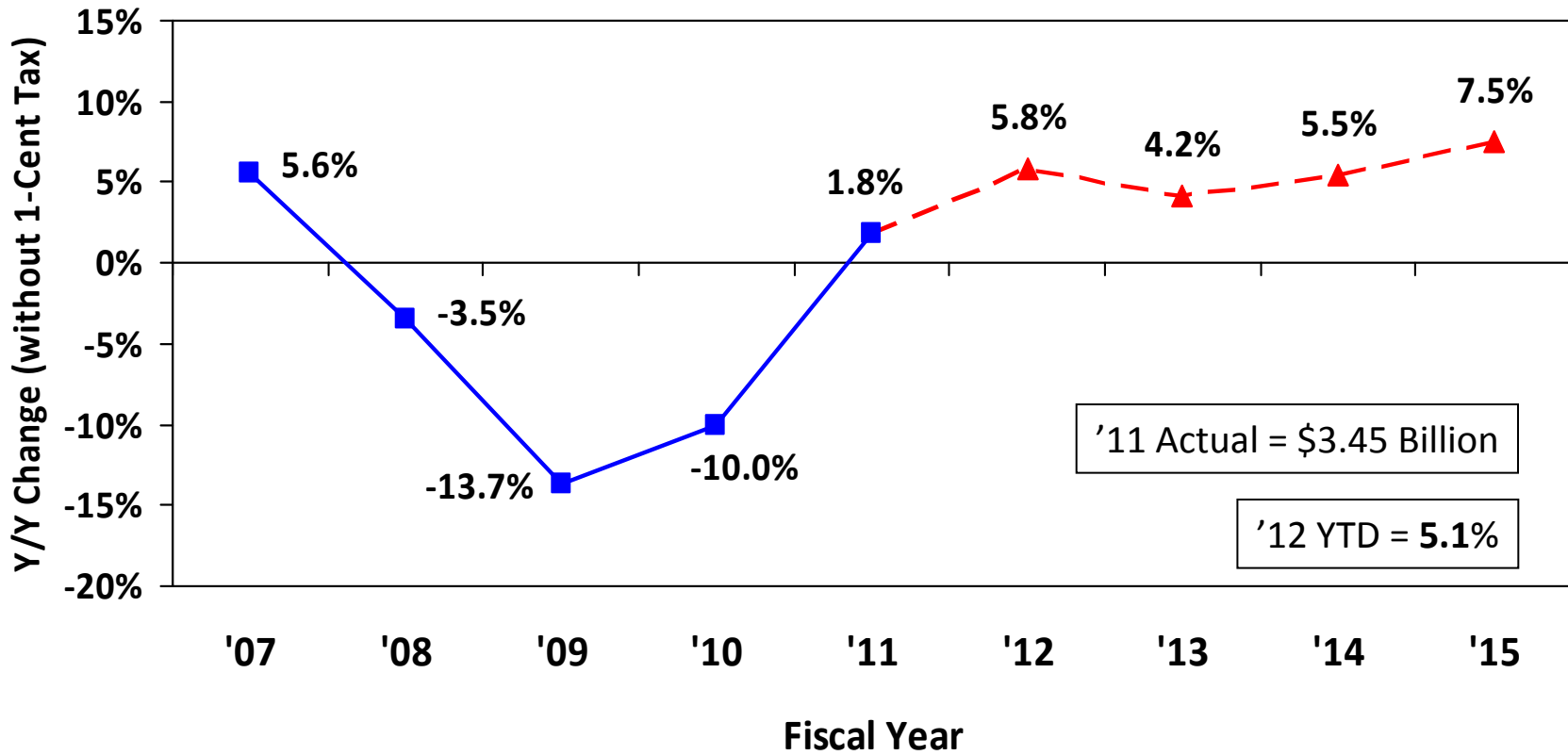
- FAC average
- UofA model – base
- UofA model – low
- JLBC Staff forecast
- Remaining revenues (10% of total) are staff forecast



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

# Sales Tax

- The Consensus Forecasts Growth of 5.8% in FY '12 and 4.2% in FY '13



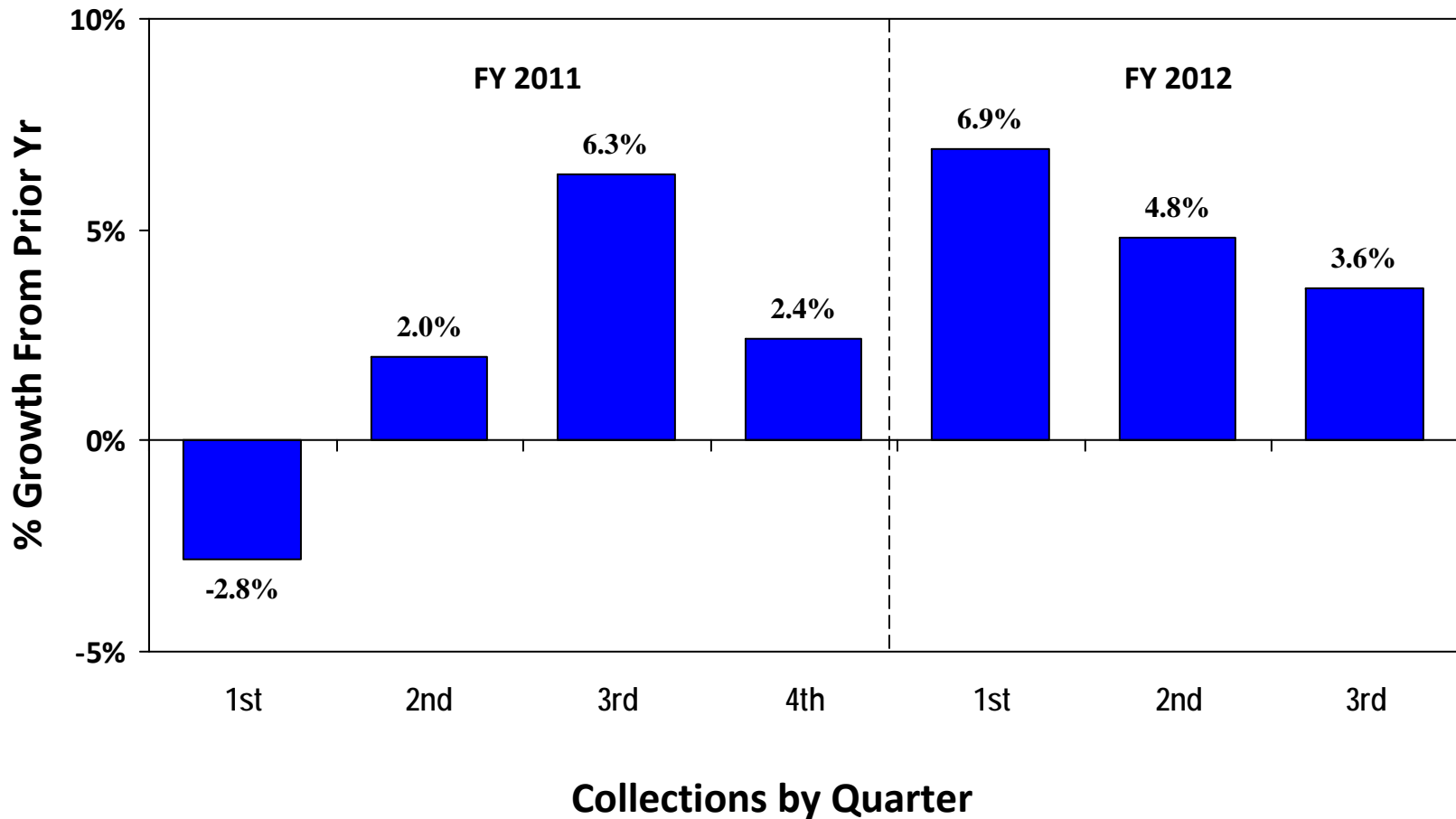
—■— Historical    -▲- 4-Sector Forecast

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



# Sales Tax Growth Rate Has Slowed Throughout Year

- Comparison to FY '11 Helps Explain FY '12 Path



# June 2013 TPT Estimated Payment

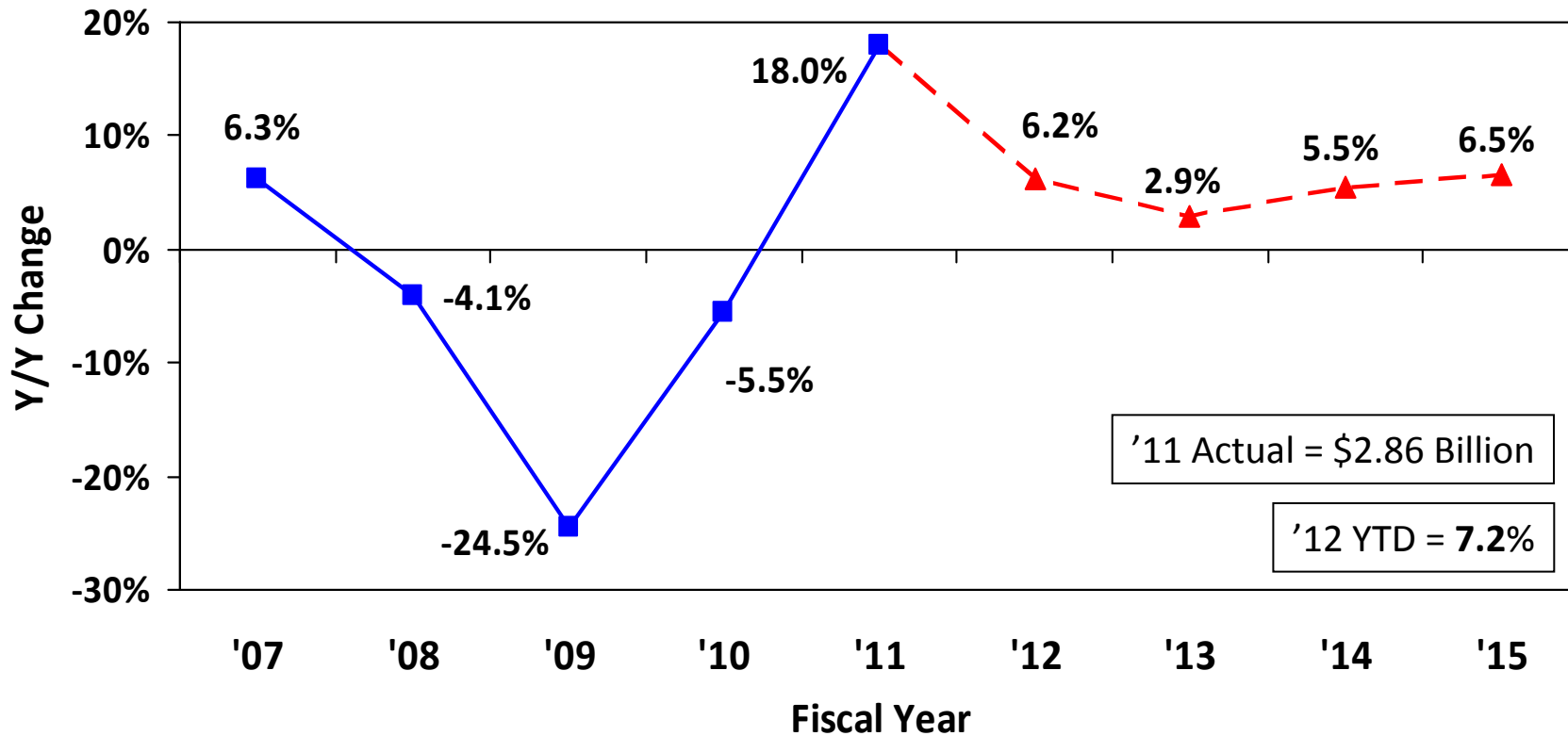
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- ❑ Businesses with an annual sales tax liability above a certain threshold are required make a single estimated advance payment in June of each year
- ❑ Legislature lowered liability threshold for estimated payment from \$1 million to \$100,000 for FY '10 thru FY '12
- ❑ The reduced liability threshold generated a one-time revenue gain of \$48 million in FY '10
- ❑ When threshold reverts to \$1 million in FY '13, state will incur an estimated one-time revenue loss of \$(52) million



# Individual Income Tax

- The Consensus Forecasts Growth of 6.2% in FY '12  
 Dropping to 2.9% in FY '13



—■— Historical    -▲- 4-Sector Forecast

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



# Components of Individual Income Tax Growth

## - First Three Quarters of FY '12

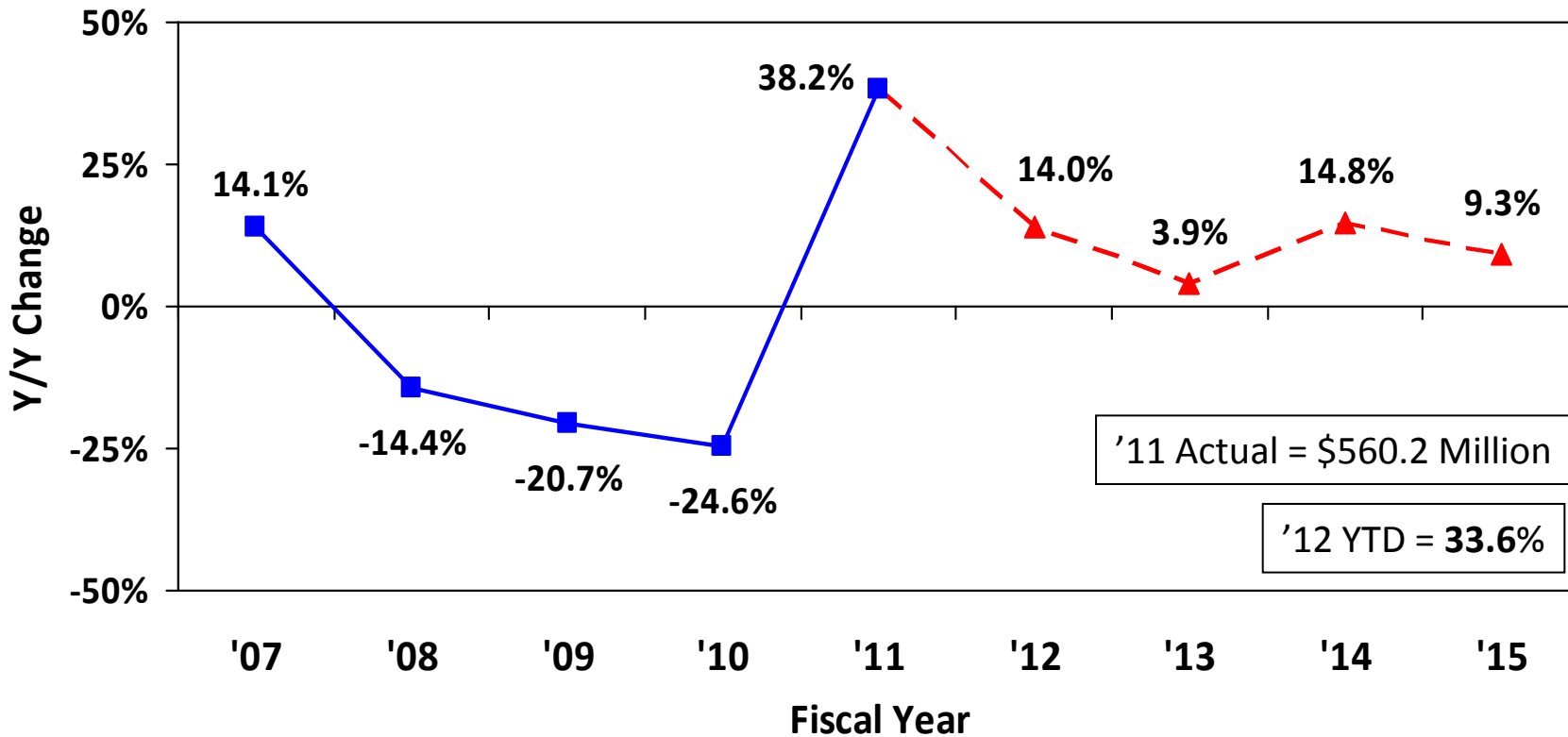
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Withholding	3.1%
Payments	29.5%
<u>Refunds</u>	<u>4.5%</u>
Net	7.2%

- ❑ Growth appears to be in line with job and wage growth
- ❑ Payment increase overstated due to large one-time payment in January – absent this payment, growth would be 12.3%
- ❑ Refunds appear to be on track for first increase since FY '09

# Corporate Income Tax

- The Consensus Forecasts Growth of 14.0% in FY '12  
 Dropping to 3.9% in FY '13



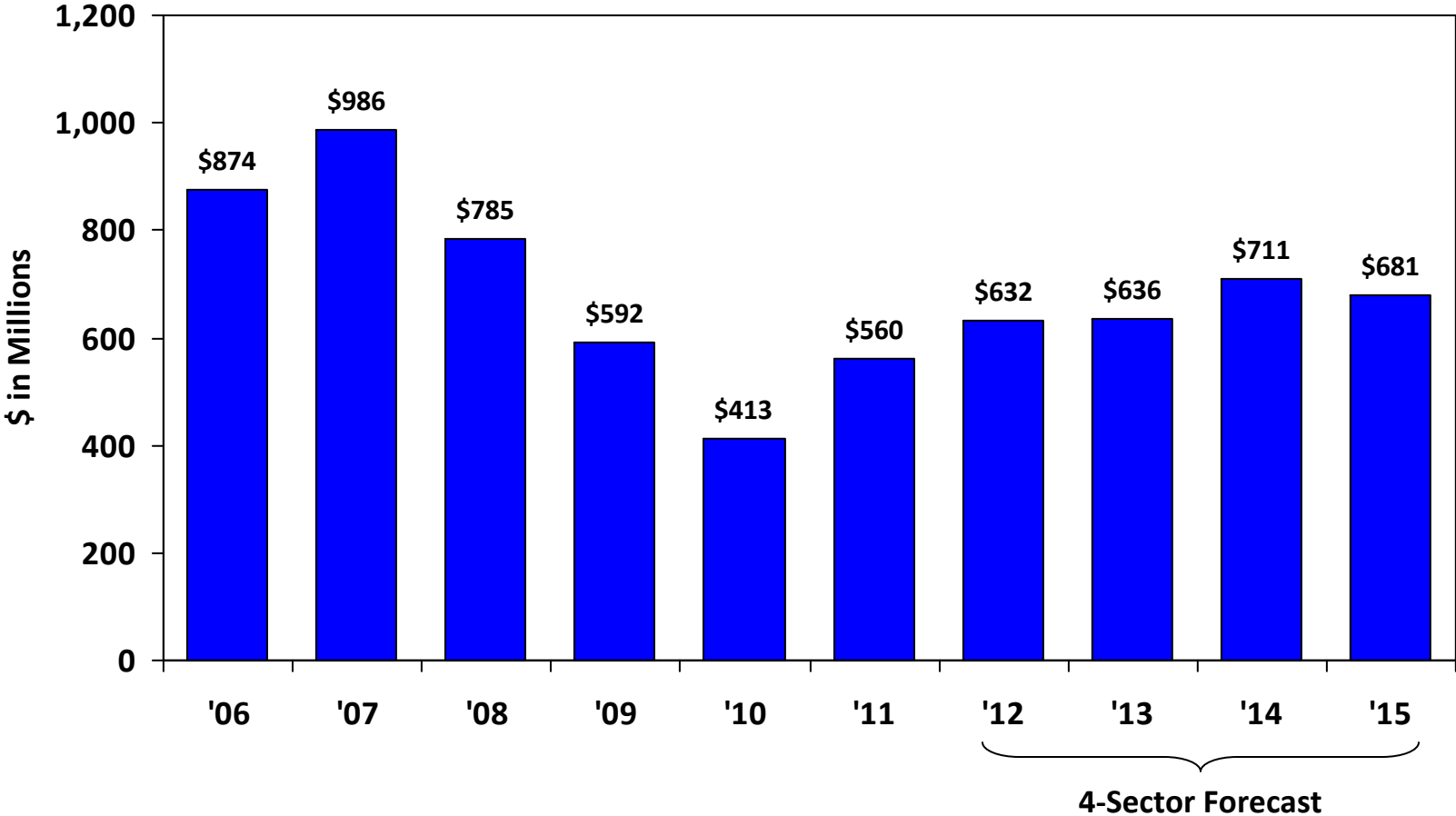
—■— Historical    -▲- 4-Sector Forecast

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



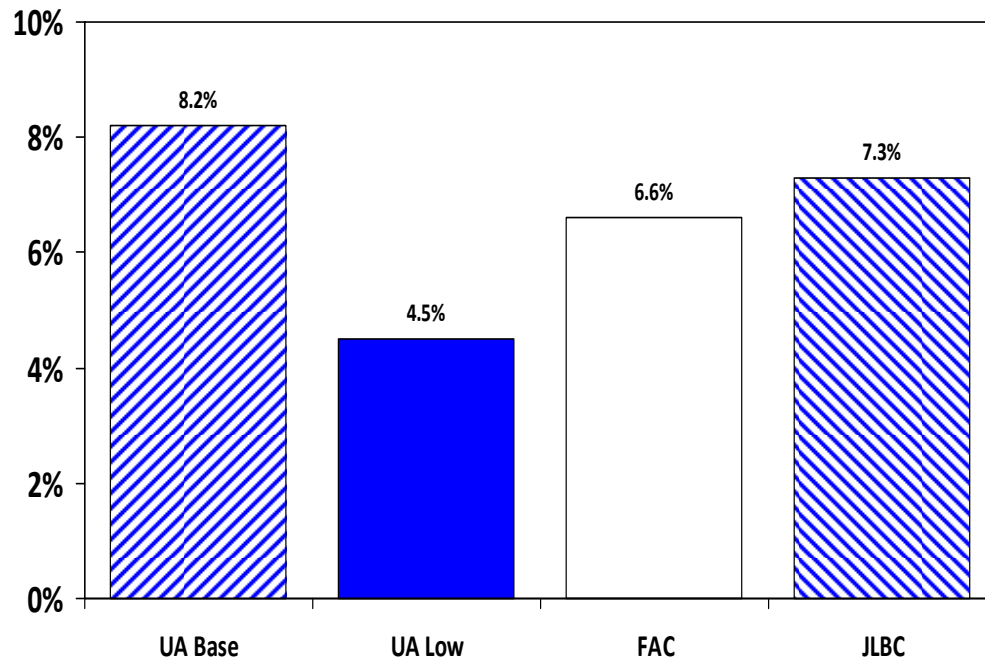
# Corporate Income Tax

- Forecast Remains Substantially Below FY '07 High Point



Total dollar collections include enacted tax law changes and one-time adjustments.

# Consensus Predicts Base Growth Rate of 5.6% in FY '12 \*



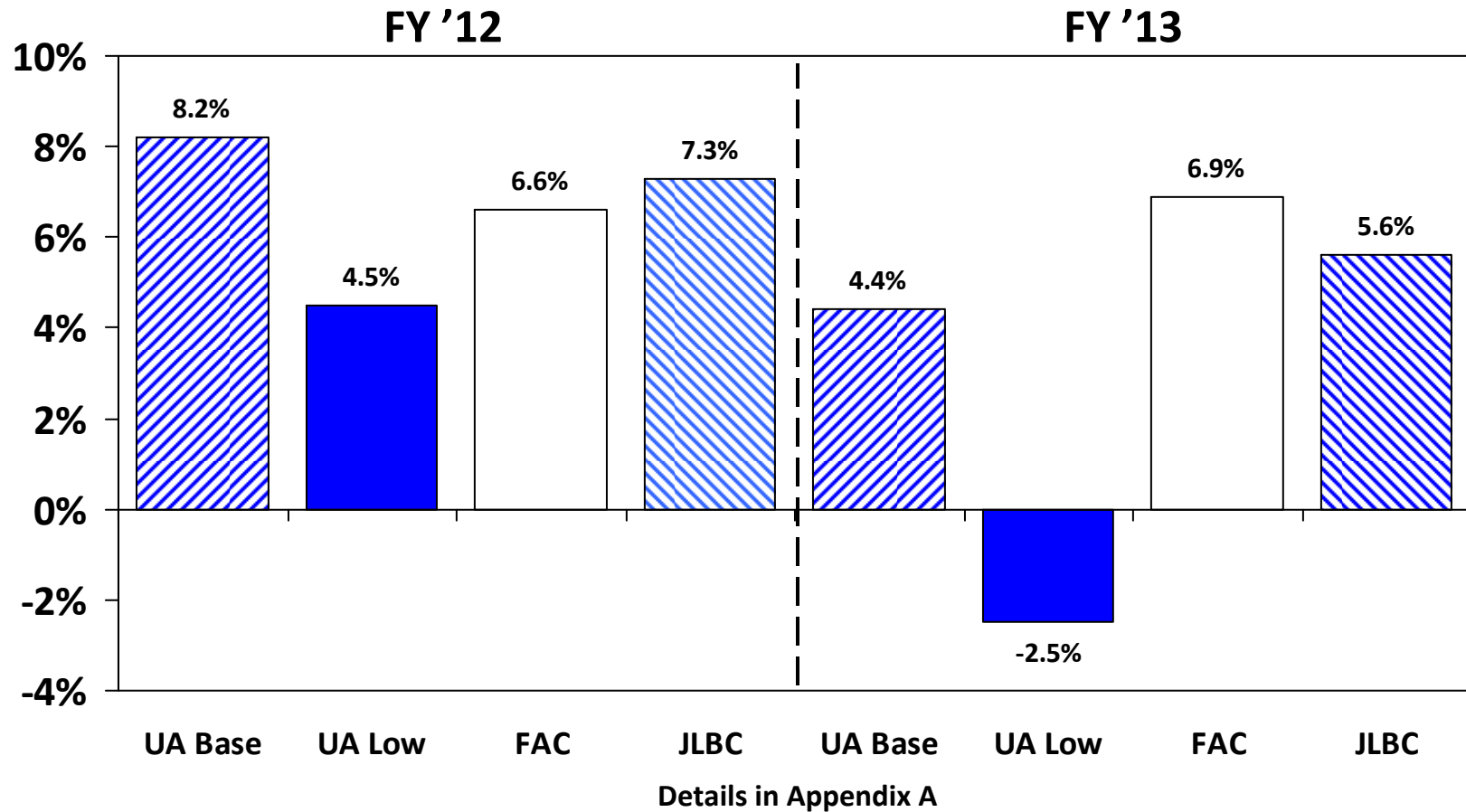
## □ FY '12 YTD collections:

- 6.7% greater than FY '11 collections
- \$17 million or 0.3% over the January Baseline forecast

Details in Appendix A

\* Weighted Big 3 average growth prior to 1-Cent sales tax is 6.6% in FY '12 . After adjusting for small tax categories, the base growth rate is 5.6% in FY '12.

# Consensus Predicts Base Growth Rate Declining from 5.6% in FY '12 to 3.4% in FY '13\*

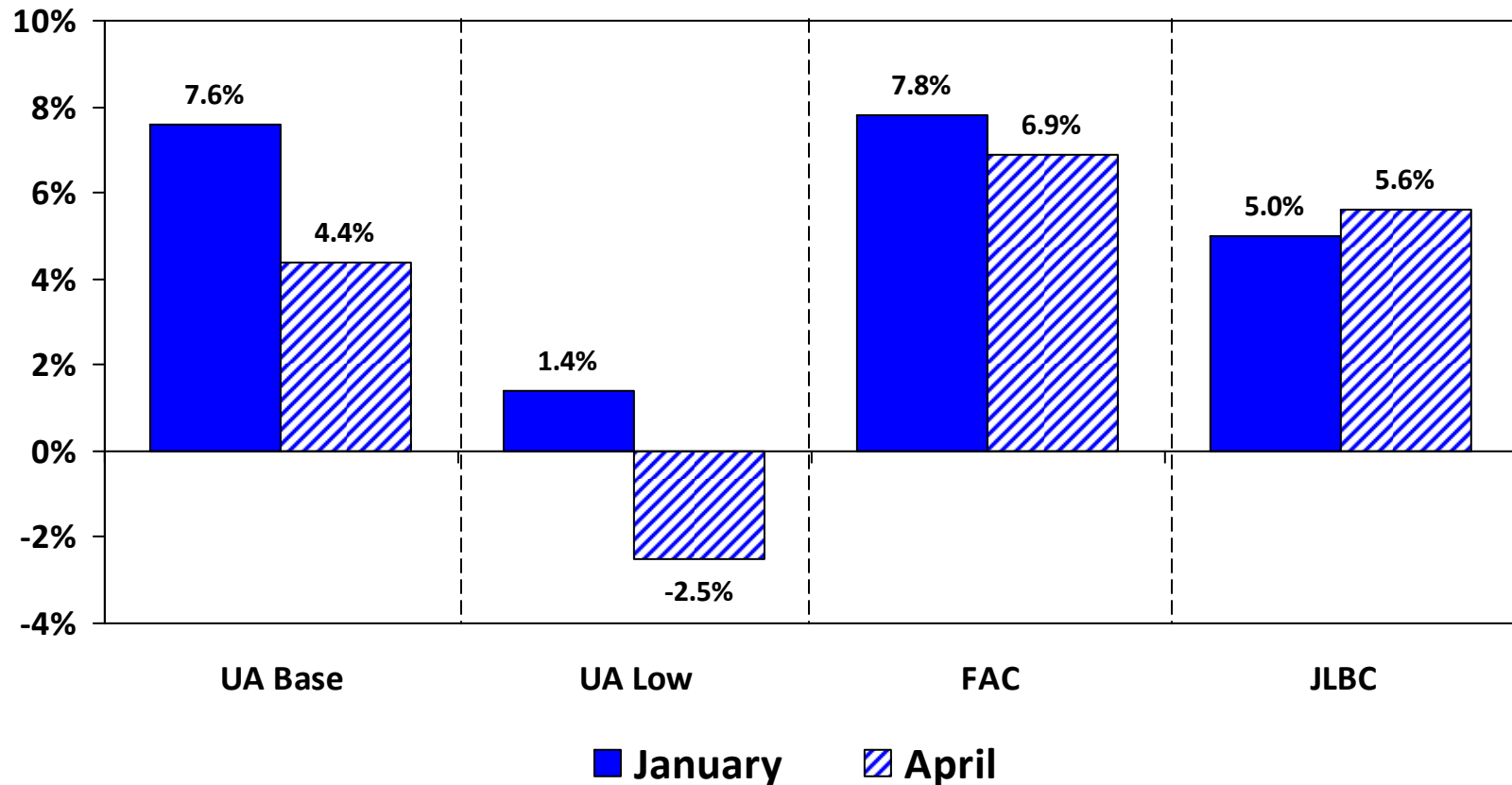


\* Weighted Big 3 average growth prior to 1-Cent sales tax is 6.6% in FY '12 and 3.6% in FY '13. After adjusting for small tax categories, the base growth rate is 5.6% in FY '12 and 3.4% in FY '13.

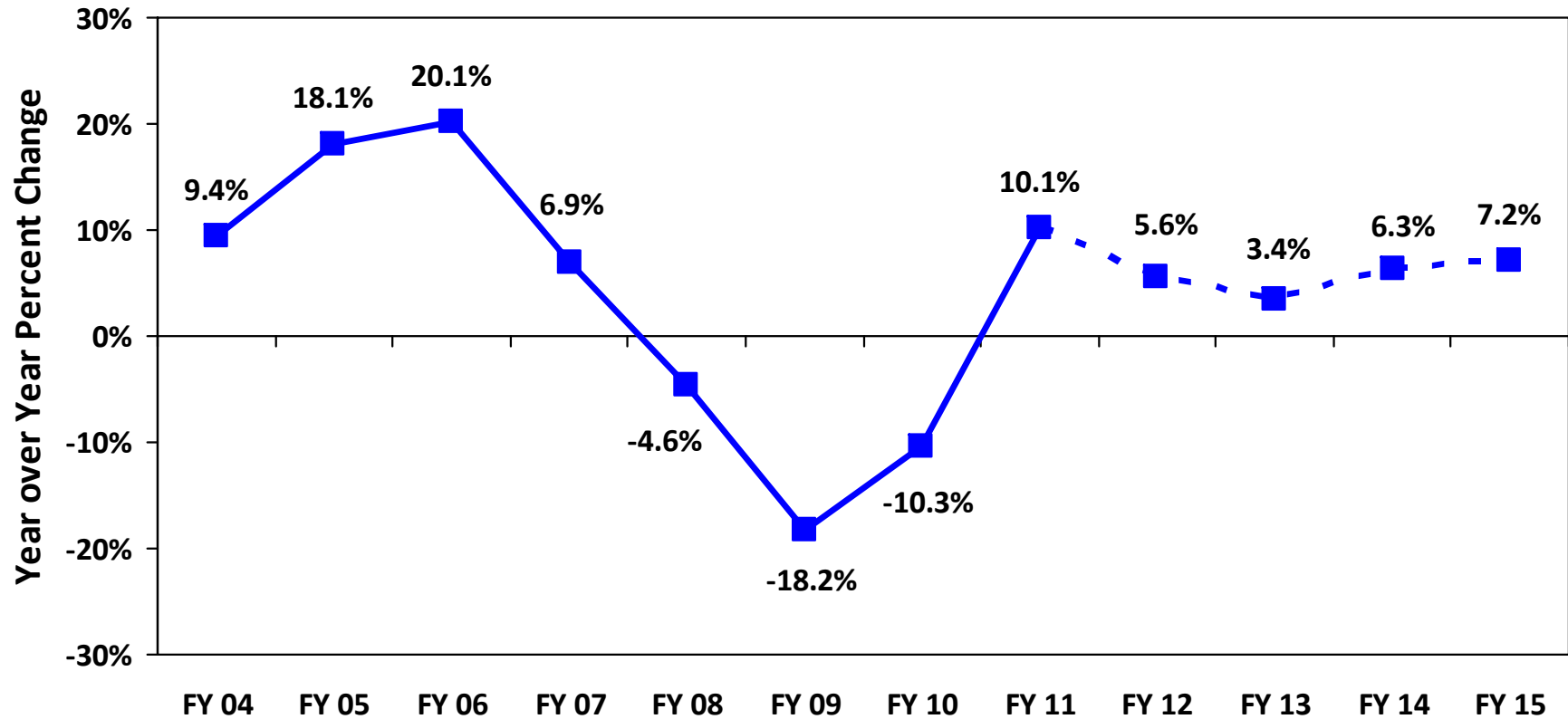


# FY '13 4-Sector Forecast

## - April Components Compared to January



# Consensus Forecasts Steadily Rising Revenue Growth Rate Through FY '15



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





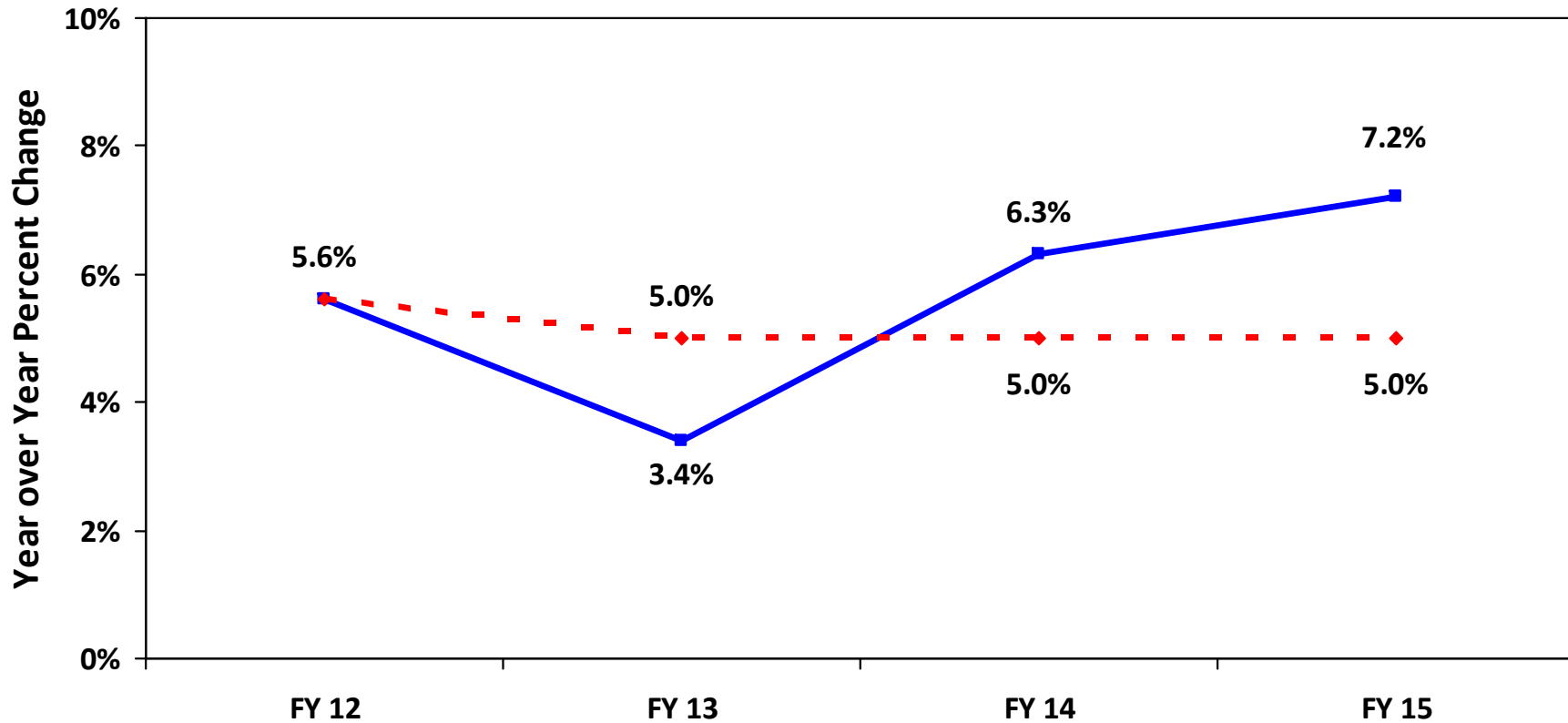
# Two Potential Issues With 4-Sector

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- 1) 3.4% FY '13 projection reflects slower average growth than many general economic projections
- 2) 4-Sector growth rates accelerate in out-years – budget forecasts usually become more cautious in the long run

# An Alternate Scenario Assumes 5% Annual Growth through FY '15

- In the FY '12-'15 Cycle, Produces Total Revenue Comparable to 4-Sector



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

# Comparison of Revenue Forecasts

## - Base General Fund Percentage Revenue Growth

	<u>FY '12</u>	<u>FY '13</u>	<u>FY '14</u>	<u>FY '15</u>
January 4-Sector	5.3%	5.1%	6.9%	7.9%
April 4-Sector	5.6%	3.4%	6.3%	7.2%
April – Alternate	5.6%	5.0%	5.0%	5.0%
Executive <u>1/</u>	5.3%	6.5%	7.3%	6.4%

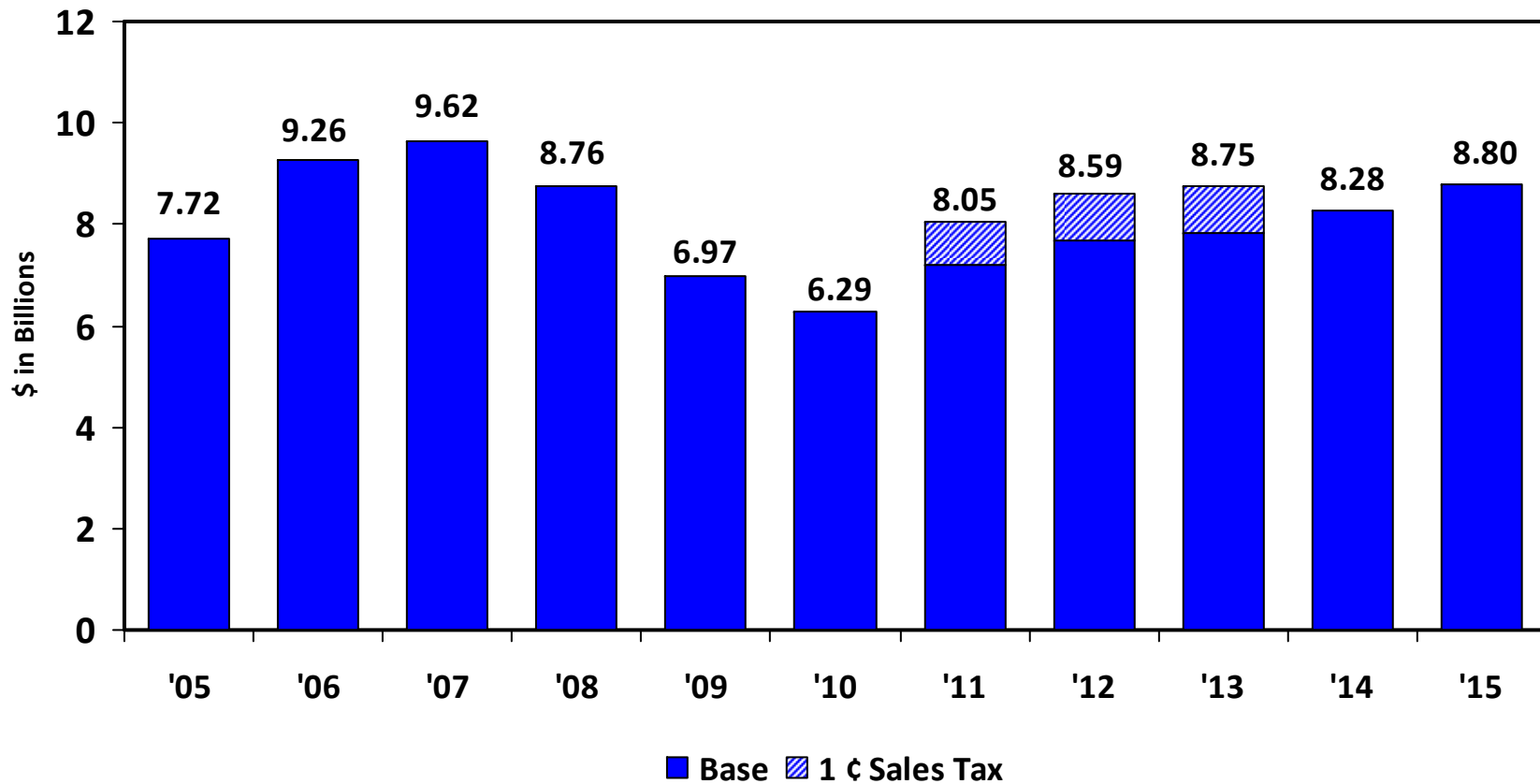
-The April estimate has slow FY '13 growth, followed by accelerating economy in FY '14 and FY '15.

-- The FY '13 4-sector may be too low and out-year budgets are not usually based on accelerating growth.

-- The Alternative scenario produces a comparable amount of revenue to the April 4-sector.

1/ Stated relative to January FAC prior year estimate for comparability.

# Consensus Forecast 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 Forecasts

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- ❑ Impact of international economy uncertain
  - Difficult to predict outcome, leading some national forecasters to place recession risk at 20%
- ❑ Cannot predict natural disasters or political events ahead of time
  - Iran and Israel
  - Gasoline prices
- ❑ Effect of future federal tax and spending decisions

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# Spending Overview

# Baseline Revision in Long Term Spending Estimates

## - Relative to Appropriation Committee Estimates

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- ❑ Federal Health Care cost has been re-estimated from \$421 M to \$210 M in FY '15
  - Reflects further analysis of Executive's \$421 M estimate
  - Assumes childless adult enrollment returns to pre-freeze levels plus 50% participation of currently eligible but not participating individuals
- ❑ FY '15 New School construction costs projections have declined from \$150 M to \$56 M
  - Reflects reduction in SFB's projection of new school openings
- ❑ See Attachment B for more details

# FY '12 – '15 Projections

- ❑ The projections include the April 4-sector revenue estimates and the spending plan approved by the Appropriations Committee in February
- ❑ The ending balance estimates are affected by whether the prior year budget has a surplus or shortfall

	<u>'12</u>	<u>'13</u>	<u>'14</u>	<u>'15</u>
Revenues	\$8.7 B	\$8.5 B	\$8.3 B	\$8.8 B
Spending	\$8.5 B	\$8.5 B	\$8.7 B	\$9.2 B
<b>Balance (W/O Carryforward)</b>	<b>\$187 M</b>	<b>\$ 80 M</b>	<b>\$(402) M</b>	<b>\$(410) M</b>
<b>Balance (W/Carryforward)</b>	<b>\$187 M</b>	<b>\$267 M</b>	<b>\$(134) M</b>	<b>\$(545) M</b>



# Change in Ending Balance Projections

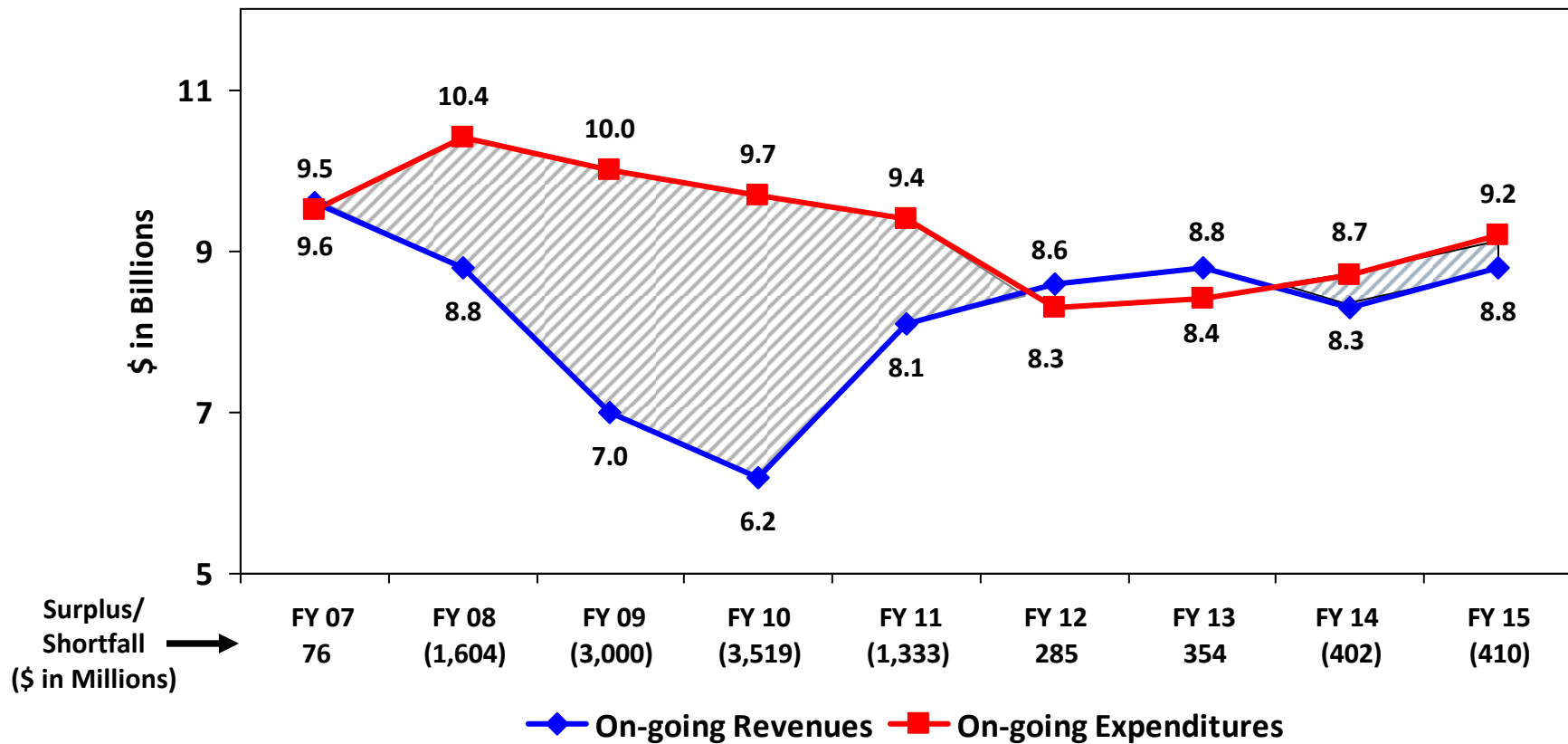
- The lower April 4-sector revenue estimates would lower the projected FY '13 ending balance and increase the FY '15 shortfall

	<u>'12</u>	<u>'13</u>	<u>'14</u>	<u>'15</u>
Balance with January Revenue	\$137 M	\$303 M	\$ 69 M	\$(380) M
Balance with April Revenue	\$187 M	\$267 M	\$(134) M	\$(545) M

Includes carryforward from prior year

# Structural Balance – April Revenue Estimate vs Appropriation Committee Spending

## - Strong FY '13 Position Helps State



Counts 1 ¢ TPT as on-going in FY '11 – FY '13



# The Caveats

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- ❑ New permanent initiatives would reduce the FY '13 balance and increase the FY '14 and FY '15 shortfalls
- ❑ A 3-Year budget forecast is inherently unreliable
  - A 2% error could change revenues by \$500 M in the 3<sup>rd</sup> year
- ❑ Serious federal deficit reduction could increase state costs
- ❑ Pending Supreme Court decision on federal health care and other state “budget” lawsuits could affect long term costs

# Appendix A: April 2012 4-Sector Forecast

	FY 2012	FY 2013	FY 2014	FY 2015
<b>Sales Tax</b>				
JLBC Forecast	5.7%	5.2%	6.8%	7.2%
UA – Low	5.2%	0.2%	3.7%	8.1%
UA – Base	7.0%	4.5%	6.3%	8.7%
FAC	5.4%	6.7%	5.1%	6.1%
Average:	<b>5.8%</b>	<b>4.2%</b>	<b>5.5%</b>	<b>7.5%</b>
<b>Individual Income Tax</b>				
JLBC Forecast	5.8%	6.4%	7.0%	7.0%
UA – Low	4.2%	-4.9%	3.9%	6.0%
UA – Base	9.6%	3.9%	5.6%	6.8%
FAC	5.1%	6.2%	5.2%	5.9%
Average:	<b>6.2%</b>	<b>2.9%</b>	<b>5.5%</b>	<b>6.5%</b>
<b>Corporate Income Tax</b>				
JLBC Forecast	25.0%	3.7%	4.8%	3.0%
UA – Low	1.2%	-7.4%	22.5%	15.9%
UA – Base	8.5%	6.8%	24.5%	13.5%
FAC	21.1%	11.0%	10.8%	6.0%
Average:	<b>14.0%</b>	<b>3.9%</b>	<b>14.8%</b>	<b>9.3%</b>
JLBC Weighted Average:	<b>7.3%</b>	<b>5.6%</b>	<b>6.7%</b>	<b>6.8%</b>
UA Low Weighted Average	<b>4.5%</b>	<b>-2.5%</b>	<b>5.1%</b>	<b>7.9%</b>
UA Base Weighted Average	<b>8.2%</b>	<b>4.4%</b>	<b>7.5%</b>	<b>8.3%</b>
FAC Weighted Average:	<b>6.6%</b>	<b>6.9%</b>	<b>5.7%</b>	<b>6.0%</b>
“Big-3” Weighted Average	<b>6.6%</b>	<b>3.6%</b>	<b>6.3%</b>	<b>7.2%</b>
Consensus Weighted Average:*	<b>5.6%</b>	<b>3.4%</b>	<b>6.3%</b>	<b>7.2%</b>
Adjusted Consensus Weighted Average:**	<b>5.6%</b>	<b>2.9%</b>	<b>6.0%</b>	<b>6.0%</b>
* Consensus Big-3 Categories adjusted for small revenue categories				
** Consensus Weighted Average adjusted for tax law changes				



## **Appendix B: Summary of Baseline Spending Adjustments**

The budget proposal heard in the House and Senate Appropriations Committees originally assumed an FY 2015 shortfall of \$(675) million. This shortfall estimate included \$421 million for costs associated with federal healthcare requirements and \$150 for School Facilities Board new construction costs.

Based on further analysis of these issues, the estimate of federal healthcare requirement costs has been reduced to \$210 million, while the SFB cost projection has been reduced to \$56 million.

The following summary provides further detail of these estimates.

### **AHCCCS**

#### **FY 14 Federal Health Care Projection - \$40M**

- Program starts in January 2014.
- New enrollees include:
  - Newly eligible – Any person with income from 100 to 133% FPL.
  - Currently eligible – Any person with income from 0 to 100% FPL, who is not a childless adult. Publicity of federal health care is expected to encourage some of these already eligible people to enroll.
  - Previously eligible childless adults – An adult without children 18 years and younger who has income from 0 to 100% FPL.
- 165,000 new enrollees in Medicaid in FY 14 as a result of federal health care changes, about half of the total expected to ultimately enroll.
  - 40,000 (35%) of the newly eligible.
  - 65,000 (25%) of the currently eligible.
  - 60,000 (50%) of the previously eligible childless adults from 0 to 100%.

The federal government covers 100% of costs for the newly eligible, 65% for the currently eligible, and 82% for restored childless adults.

## Appendix B (continued)

- A partially offsetting savings is realized from the enhanced federal match of 82% (up from 65%) for 120,000 still enrolled childless adults.
- Capitation rates increase 5% in FY 14.

### **FY 15 Federal Health Care Projection - \$210M**

- First full year of implementation.
- The remaining portion of expected enrollees comes onto Medicaid, resulting in a total of 325,000 new enrollees from federal health care changes.
  - 75,000 (70%) of the newly eligible.
  - 135,000 (50%) of the currently eligible.
  - 115,000 (100%) of the previously eligible childless adults from 0 to 100% FPL.
- The federal match for previously eligible childless adults increases from 82 to 85% of costs.
- A partially offsetting savings is realized from the enhanced federal match of 85% for 120,000 still enrolled childless adults.
- Capitation rates increase 5% in FY 15.

### **School Facilities Board**

#### **FY 15 New School Construction Projection - \$56 M**

- Estimate based on projects requested by the School Facilities Board in FY 2013 budget request.
- Eliminates projects which have been cancelled due to lower than expected enrollment forecasts.
- Cost estimate incorporates all new construction projects scheduled to open through FY 16. Assumes entire funding amount is appropriated in FY 15.