

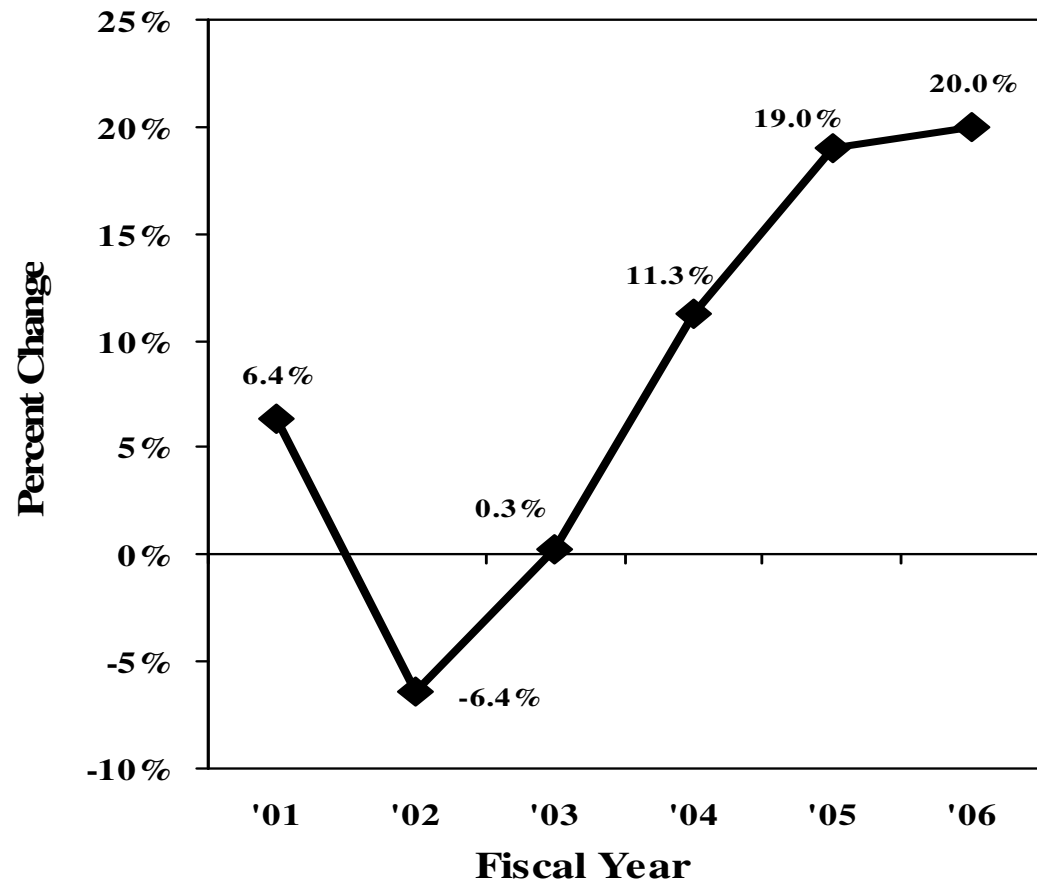
ATRA Presentation: State Budget Outlook

November 17, 2006

JLBC

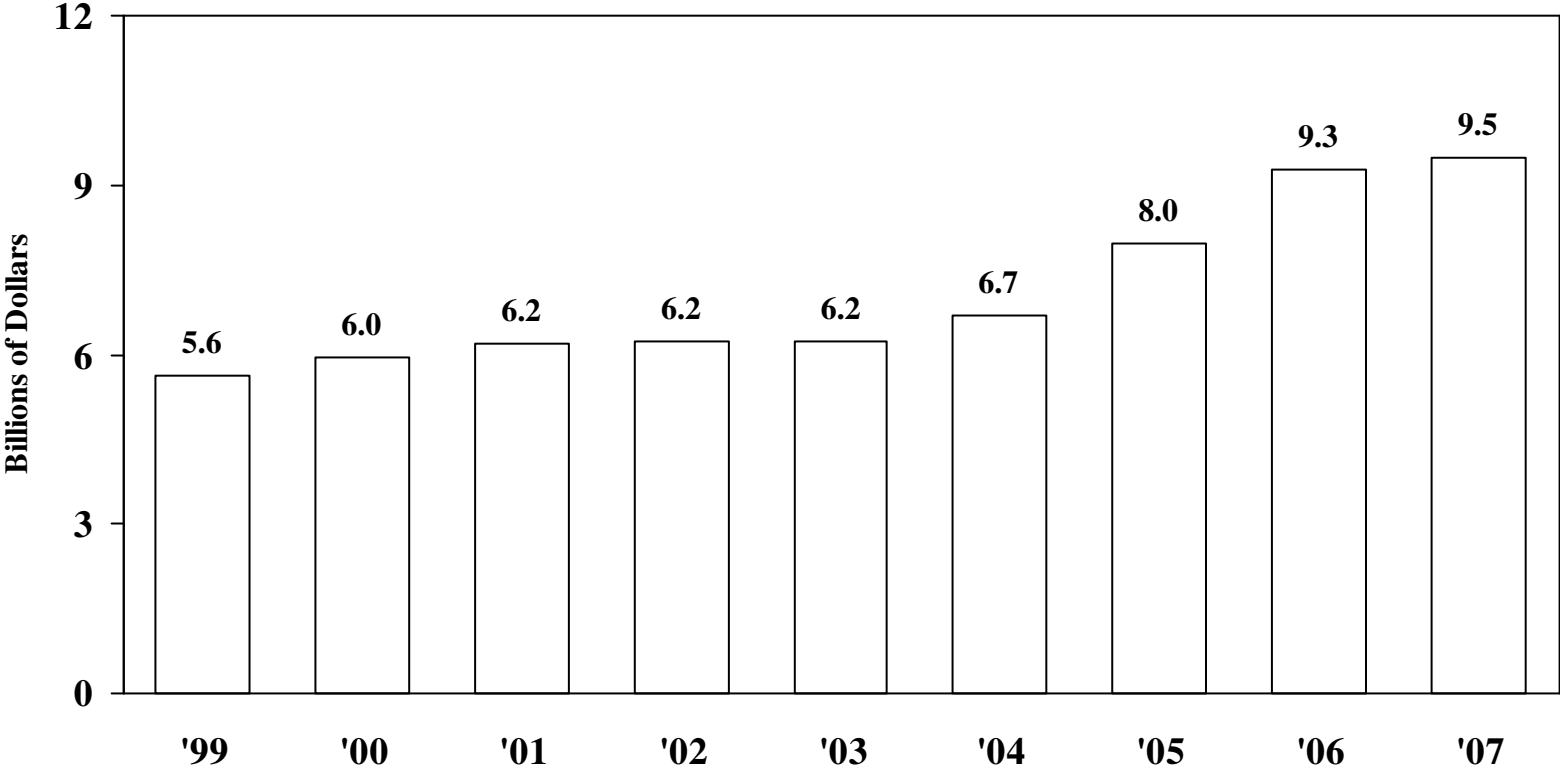
General Fund Revenues Have Grown Rapidly in the Last 2 Years

- **20% FY '06 Growth**
 - Sales Tax = 16.7%
 - Individual Income Tax = 24.1%
 - Corporate Income Tax = 24.6%
- **2-Year growth for '05 and '06 of almost 40% greatest in at least 35 years.**



General Fund Revenue Rapidly Approaching \$10 Billion

-- only \$6.2 Billion in FY 2003



How Much of Gain is Permanent?

- Maybe 50%? While revenues increased by 20% in FY 2006, Personal Income may have grown 10%.
- While 50% of the recent gain may be temporary, it may not be one-time.
- Examples of recurring one-time gains include the stock market, real estate, business profits, and employee compensation (stock options).

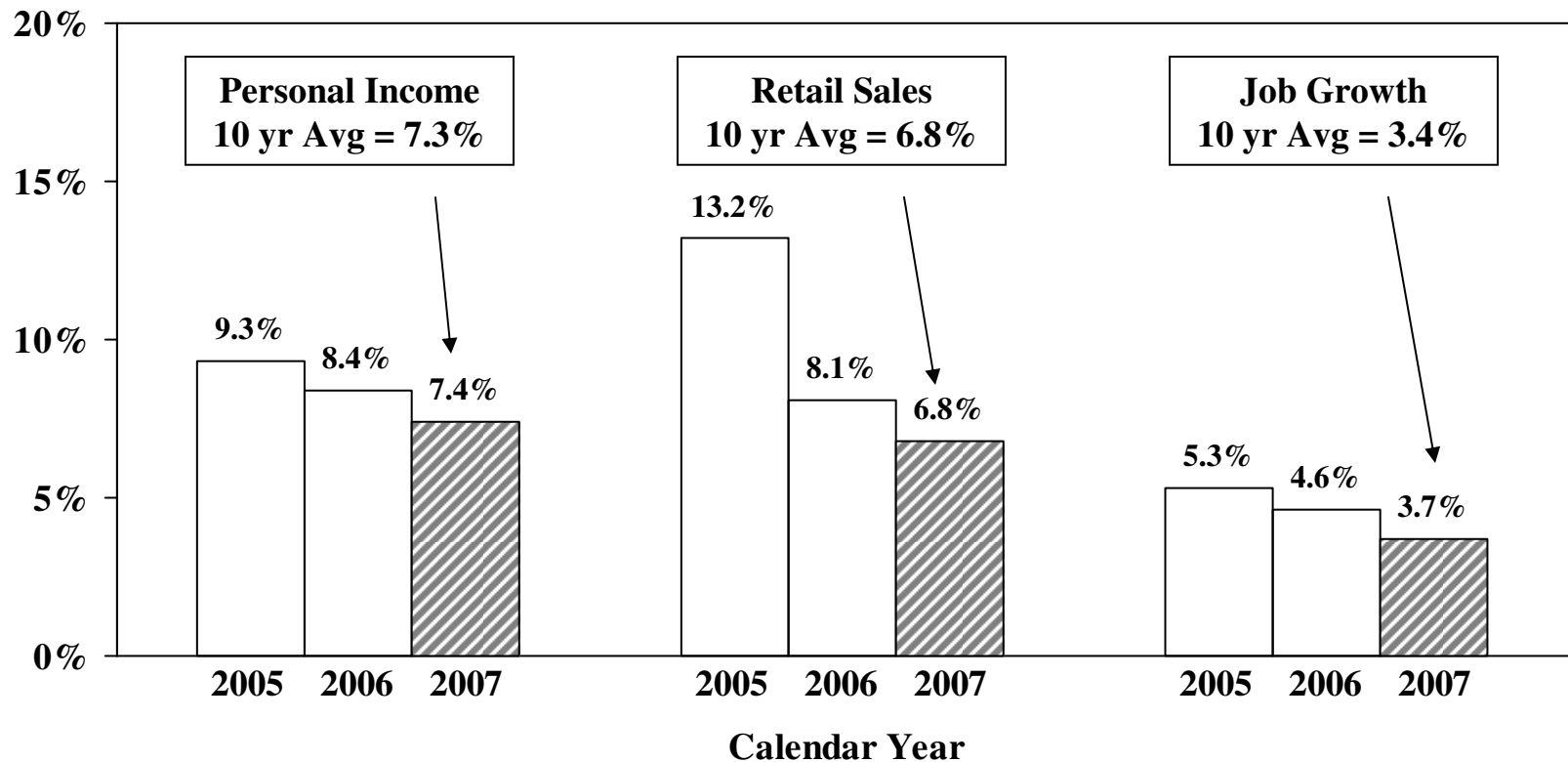
Capital Gains Alert: expect \$200 B in national distributions this year – up from \$130 B in '05 and \$14 B in '03.

Growth in 1st Trimester of FY 2007 Is Down From Last Year, But Still Double-Digit

- July-October revenues are 11% above last year.
- Sales tax is up over 10%.
- Individual income tax is up over 11%, although it is unclear how much of this increase was aided by '06 “hang-over” – some payments reflect '05 liabilities.
- Corporate income tax is up almost 23%.

Where Do We Go From Here?

- Arizona Blue Chip '07 Forecast
Remains Near Historical Averages

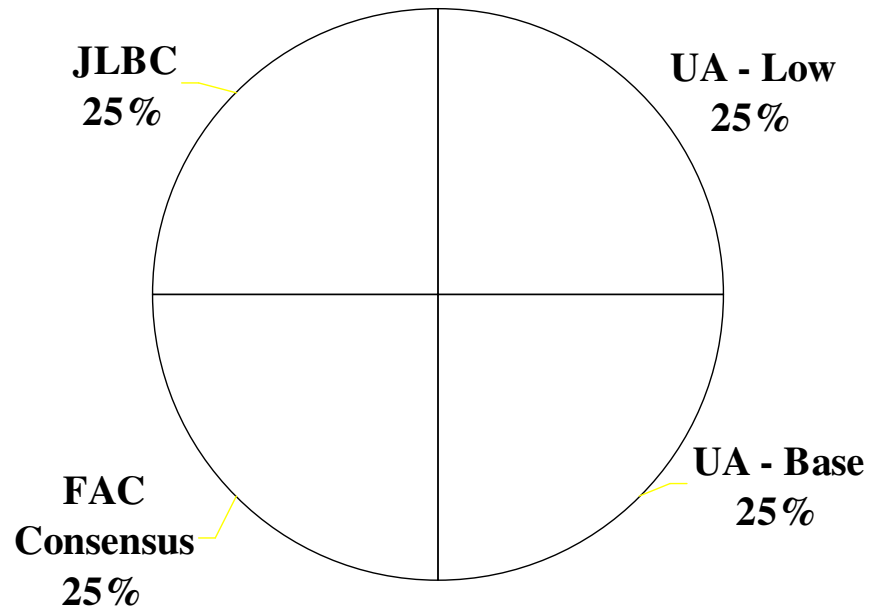


How Does JLBC Forecast Revenues?

-- A Consensus Process with 4 Inputs

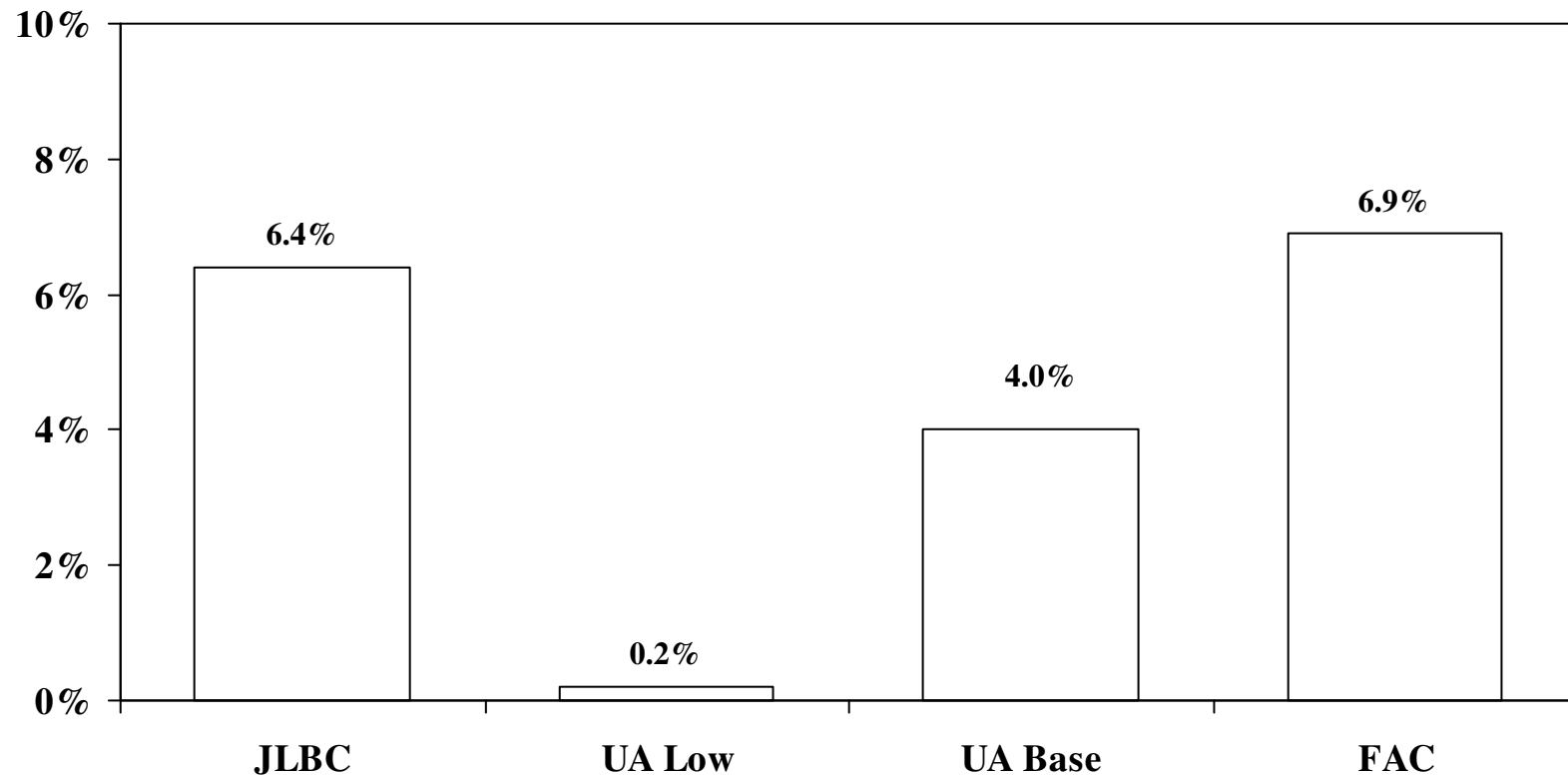
Sales and income tax forecast
equally weights:

- FAC average
- UofA model - base
- UofA model - low
- JLBC staff forecast
- Remaining revenues (5% of total) are staff forecast



FY2008 “Big 3” Forecast Growth by Input

- UA Models More Cautious Than Other 2 Inputs,
- Low UA Model Includes A Recession Scenario
- Excludes Impact of 5% Income Tax Reduction in FY 2008



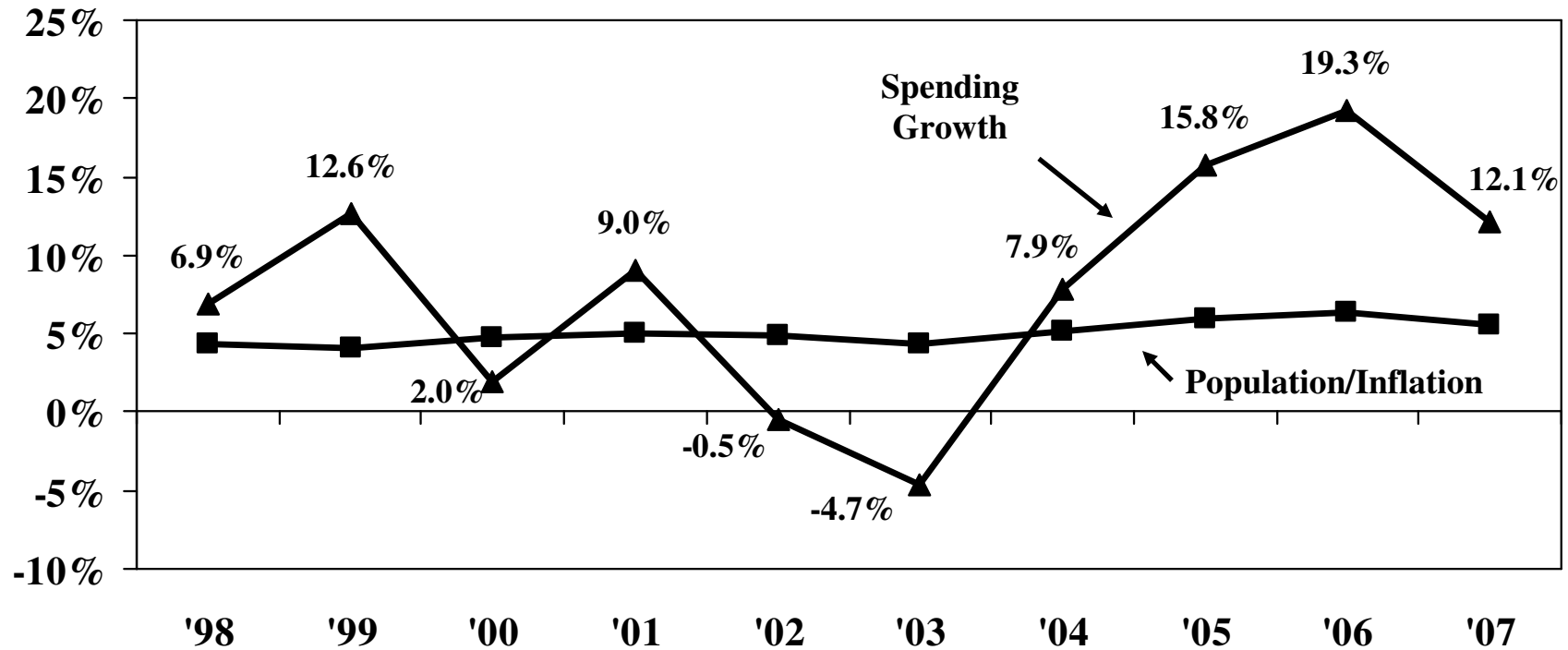
The above percentages represent the weighted average of each participant’s September forecasts for the Big 3 categories.

Evaluating the Odds of Flat Revenue Growth - How Does that Compare to the Odds of a Recession?

- National Blue Chip places the odds of a recession at 25% in the next 12 months
 - Based on responses from 55 panelists
 - 10 most optimistic place odds at average of 12.0%
 - 10 most pessimistic place odds at average of 38.4%
- Arizona Blue Chip was asked when the next recession would occur in Arizona
 - 13% said prior to 2008
 - 20% said 2008
 - 67% said 2009 or beyond

Spending Trends and Challenges

FY 2007 Will Mark 4th Consecutive Year that Spending Outpaced Population/Inflation

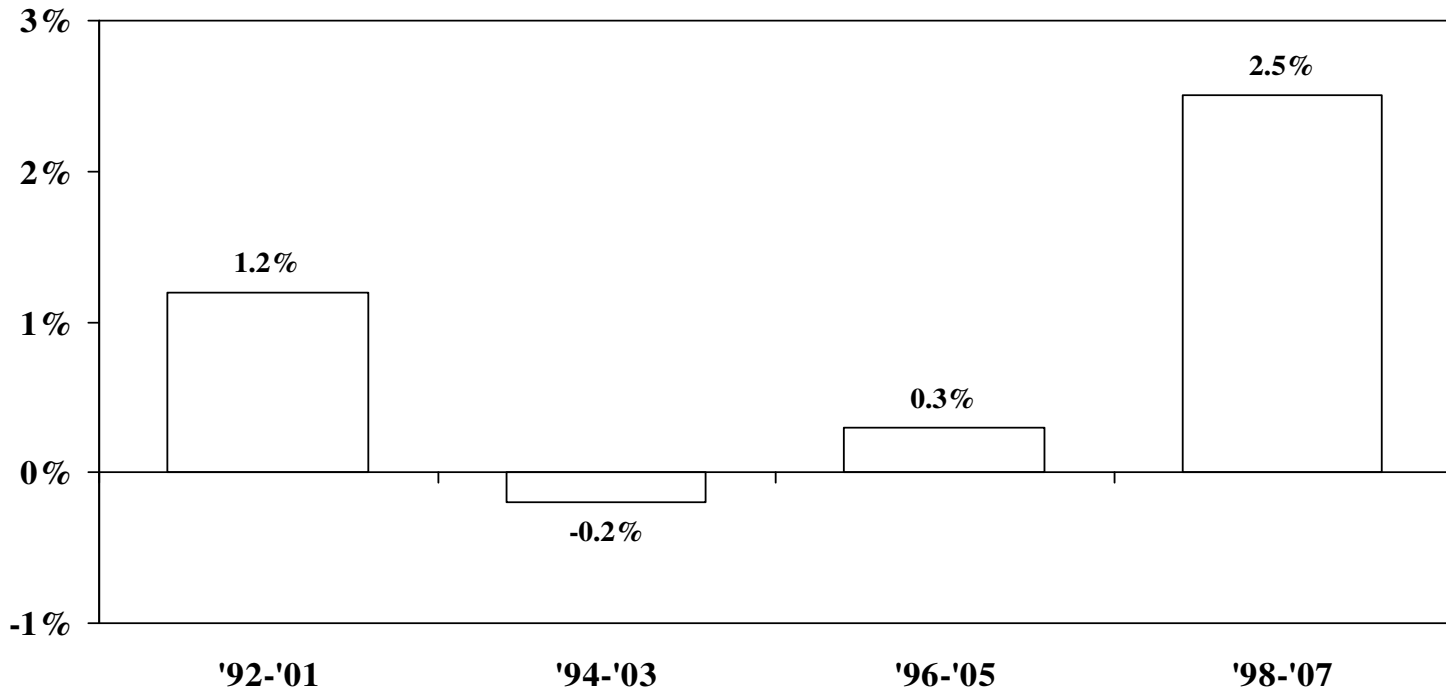


General Fund Expenditures FY 1998 - FY 2007

▲ Total Expenditures ■ Population/Inflation

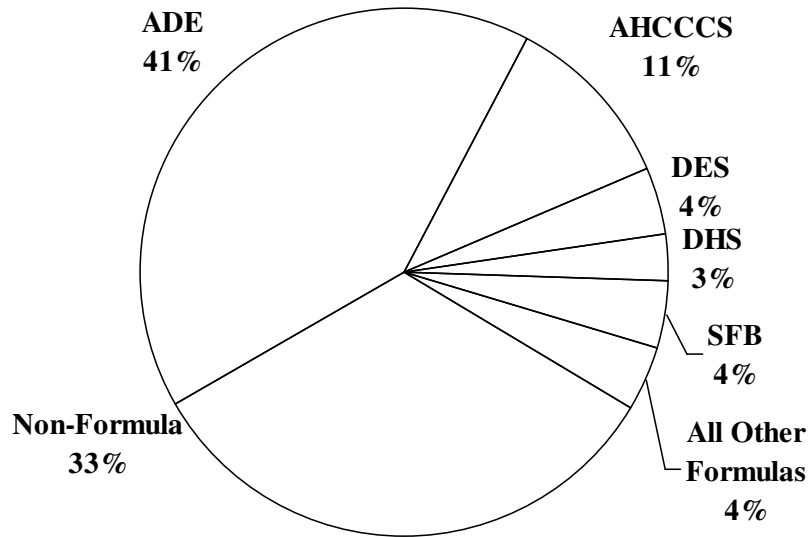
“TABOR” Differential Depends on Stage in the Economic Cycle

- TABOR Differential is 10 yr. Average of Spending vs. Population/Inflation

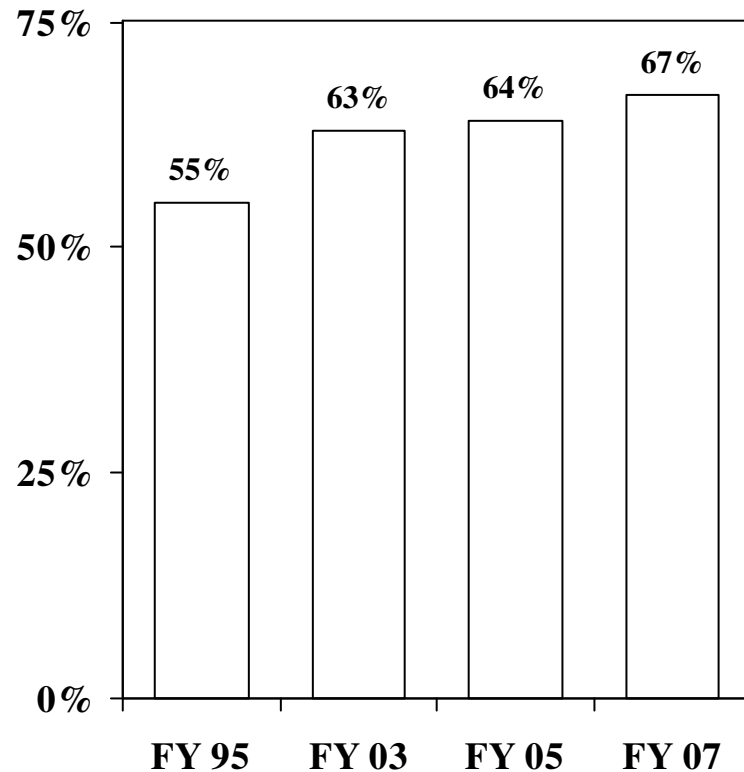


Average annual spending growth:	6.7%	5.0%	5.2%	7.6%
Average annual pop/inflation growth:	5.5%	5.2%	4.9%	5.1%

Funding Formula Spending Has Increased to 67% of the Budget



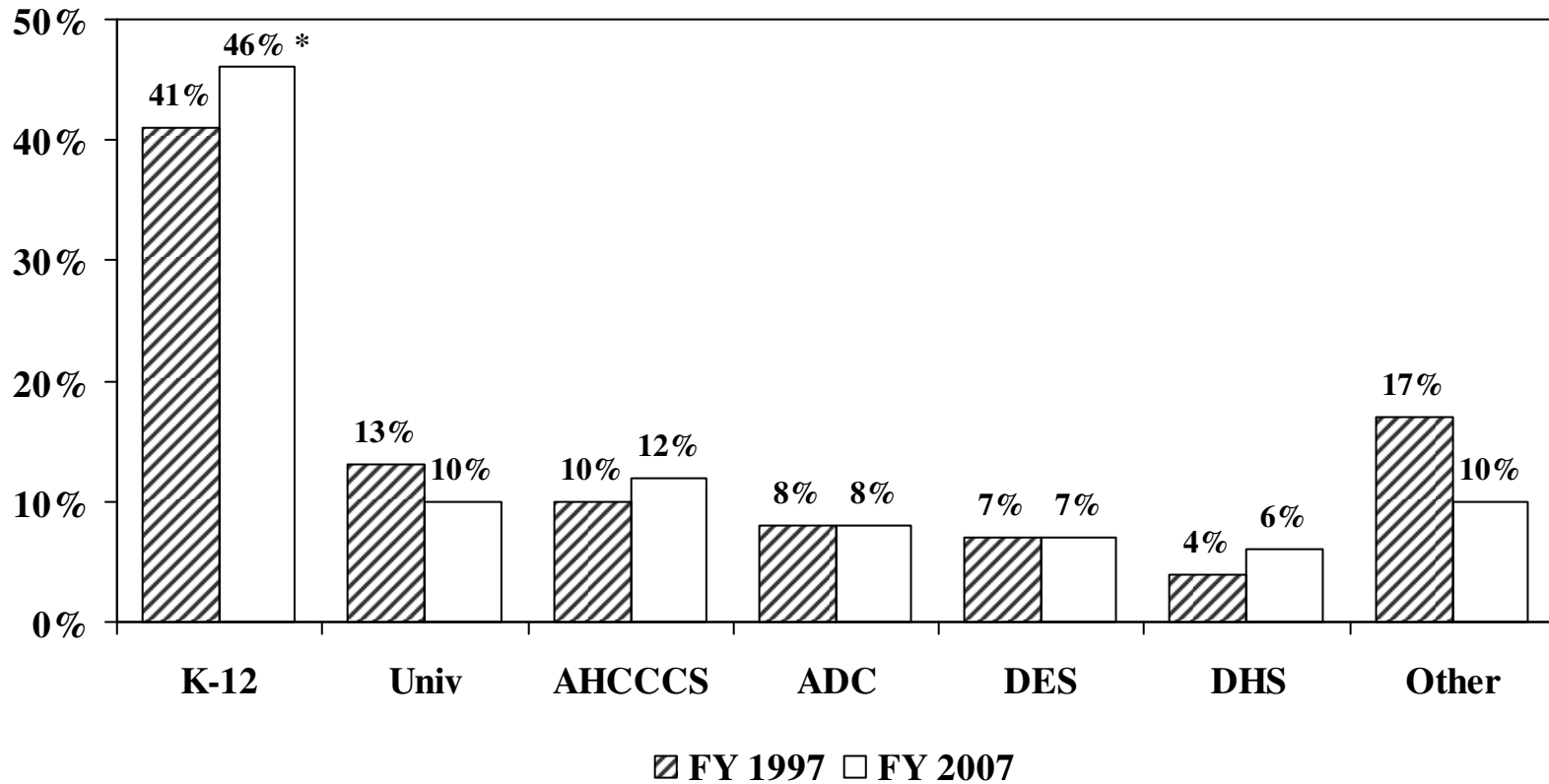
FY 2007 General Fund Spending



Funding Formulas as a Percent of General Fund

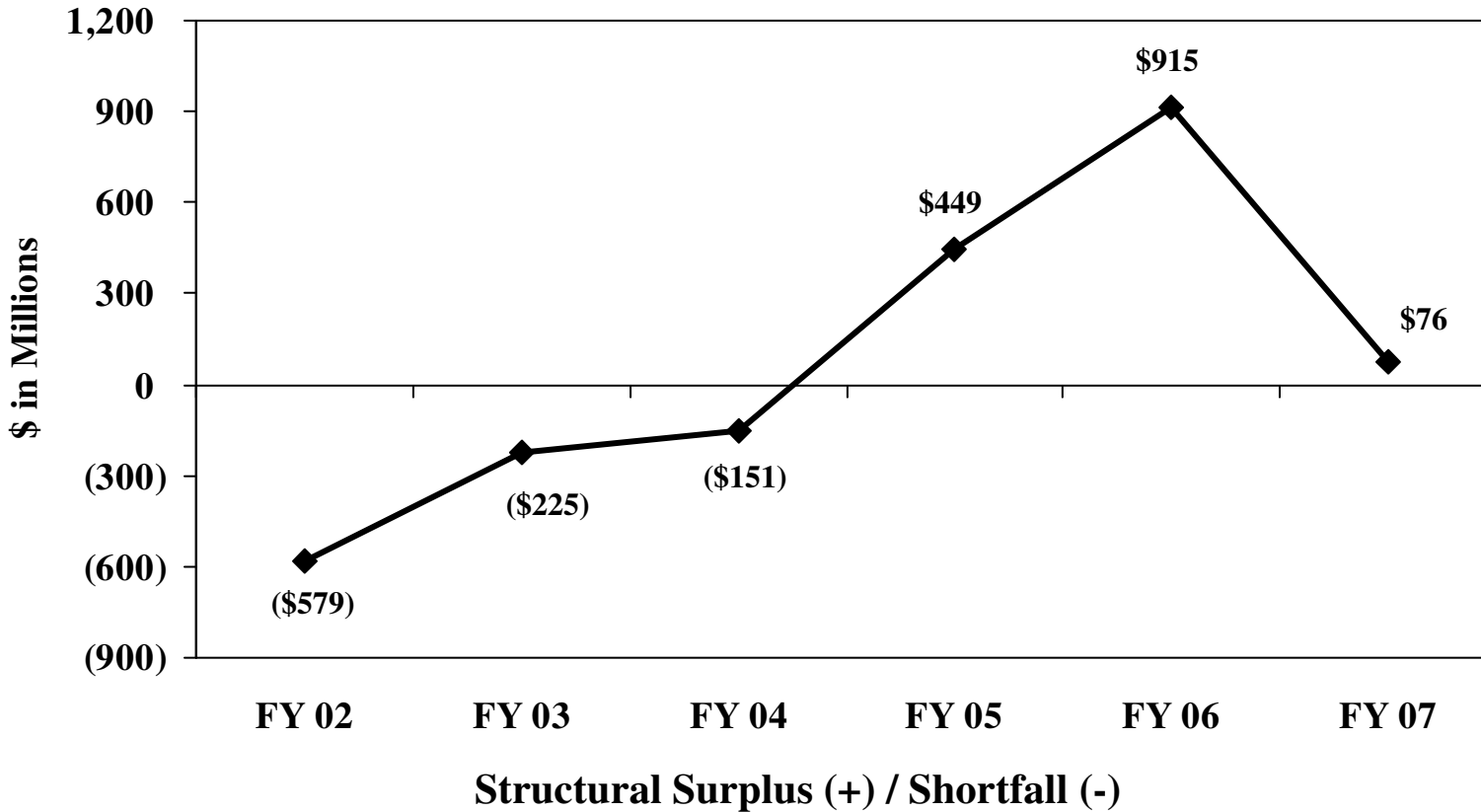
Agency Share of General Fund Over the Last Decade

- School Construction Now Consumes 4% of Budget,
Otherwise Small Shifts



* FY '07 includes School Facilities Board spending, which represents 4.3% of FY '07 General Fund expenditures.

Two-Year Revenue Growth of 39% Turned A Structural Deficit Into A \$900 Million Surplus

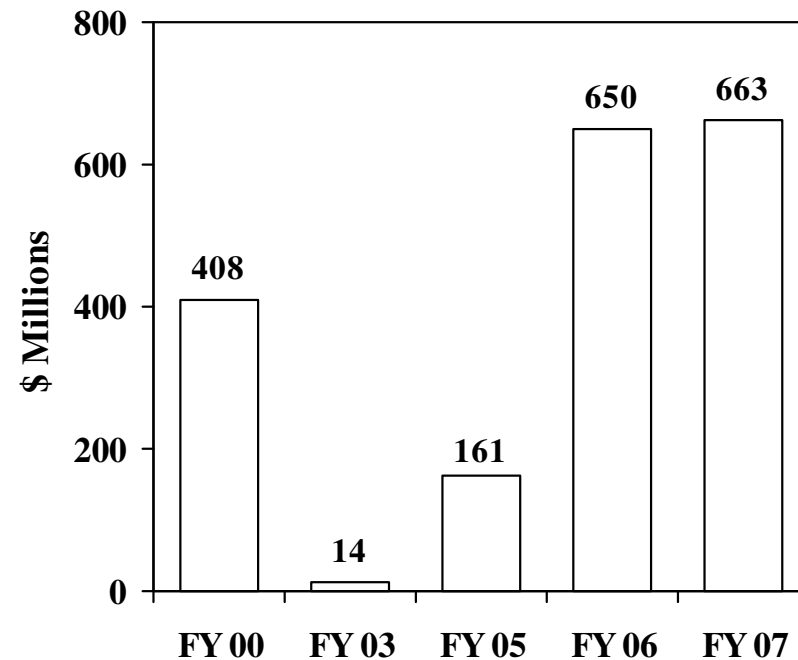


Structural Balance is the Difference in
Permanent Revenues and Permanent Spending

Budget Stabilization Fund Reached The 7% Cap in FY 2006

- \$650 M balance in FY '06.
- Fund capped at 7% of General Fund.
- \$10 M FY '07 deposit and interest earnings will keep fund at 7%.

Total Fund Balance



Challenges in the Year Ahead

**- We Have Already Committed
\$380 Million in FY 2008 Budget**

	<u>\$ in M</u>
• Complete 2-Year 10% Income Tax Cut ('06 Session)	\$ 178
• Corporate Sales Factor ('05 Session)	32
• Consolidated Corporate Returns ('94 Session)	55
• Complete Full Day Kindergarten Phase-In ('06 Session)	80
• Universities Research Facilities Debt Payment ('03 Session)	35

Potential Process Improvements

- Improve state's financial reports: one report lists the General Fund as \$9 billion, while another says \$17 billion.
- Review public-private partnerships: is legislative oversight adequate?
- Improve debt reporting.
- Expand actuarial audits: Health Care Group.
- Expand expenditure forecast modeling: TANF.