



REVENUE UPDATE

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PART A: TAX COLLECTIONS

Utah ended FY 2014 with a \$166.0 million General and Education Fund revenue surplus. The revenue surplus was due to better-than-expected growth in the Education Fund from above target gross final payments and stronger than expected corporate balance sheets.

After expenditure adjustments and transfers to the General and Education Rainy Day Funds, the Disaster Recovery Fund, the Medicaid Rainy Day Fund, and the Industrial Assistance Fund, the FY 2014 budget surplus is \$112.0 million, \$7.0 million in General Fund and \$105.0 million in Education Fund.

Given consensus economic indicators developed by the Revenue Assumptions Working Group, we anticipate FY 2015 General and Education Fund revenues will be in the range of \$70.0 million to \$200.0 million above May Executive Appropriations Committee targets. We expect the Transportation Fund will be \$10.0 million below to \$10.0 million above May targets.

Our current forecast for the Utah economy assumes that it will continue to move forward at a moderate pace; improving in key areas such as labor and housing markets.

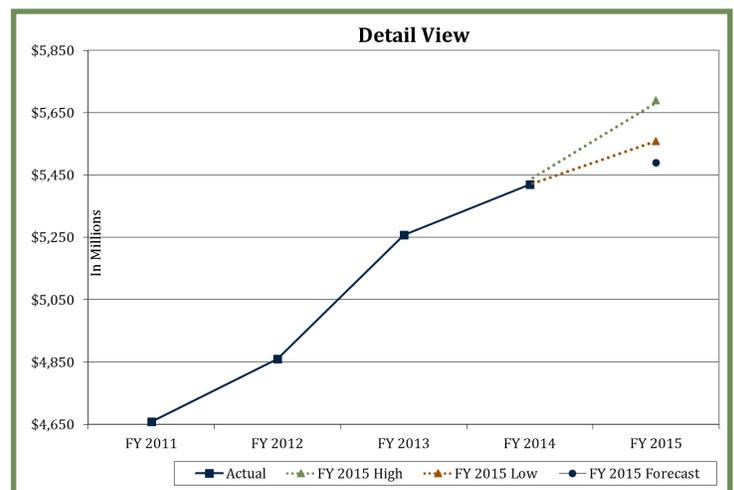
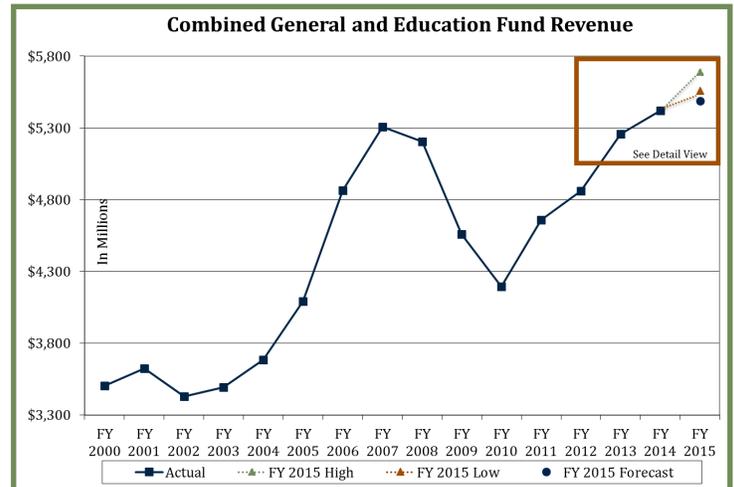
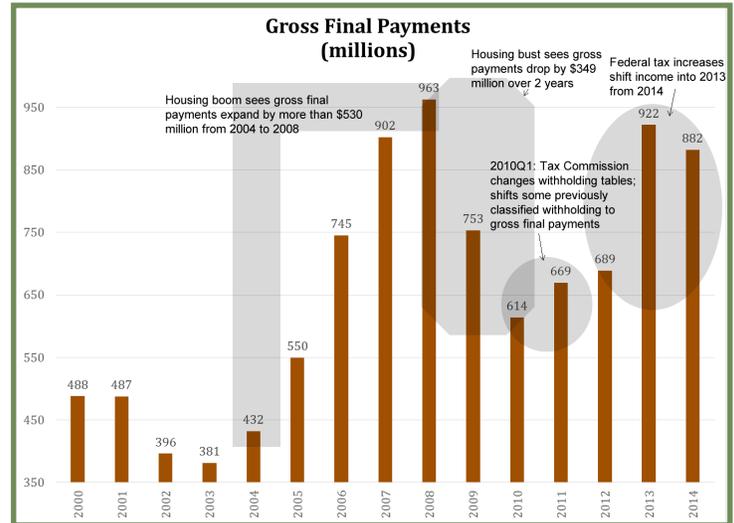
There is upside potential in a couple of areas.

- 1) Corporations have accumulated high balances which they could choose to invest in the economy resulting in stronger economic growth.
- 2) Productivity could rise faster than expected resulting in expanded output.

However, there are risks that could disrupt growth.

- 1) Monetary policy changes could potentially lead to higher interest rates, which could impact the housing market recovery, the stock market, and other measures of wealth.
- 2) Geopolitical risk could potentially impact consumer and investor confidence.
- 3) Equity markets are at all time highs. If they collapse, wealth induced investment and consumption could decrease.

We remain optimistic that the Utah and U.S. economy will continue to grow modestly over the next 12 to 18 months. In particular, we expect Utah to remain a growth leader nationally.



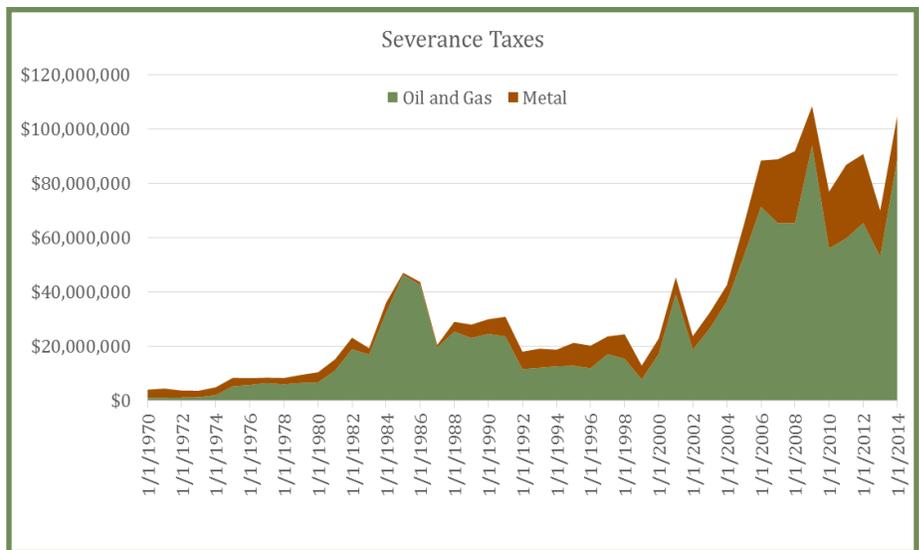
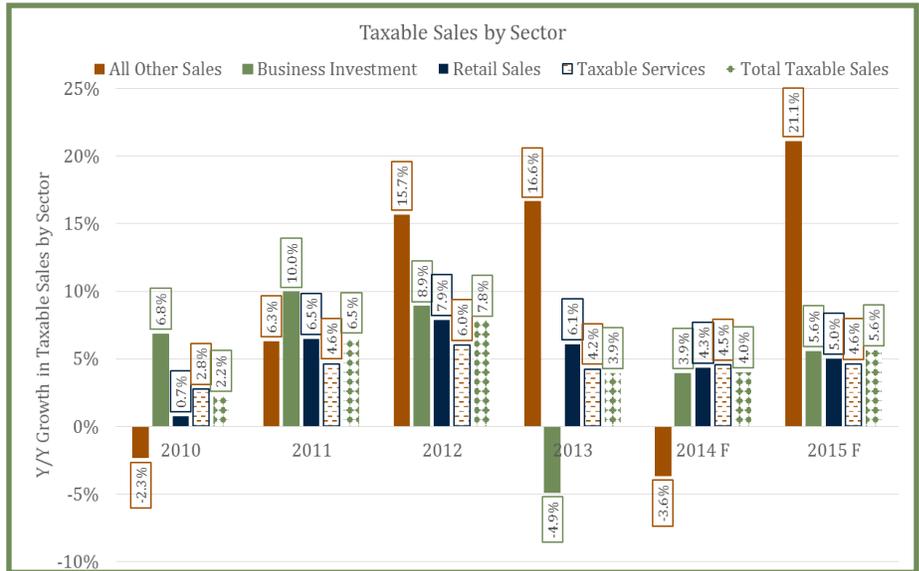
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GENERAL FUND

The General Fund ended FY 2014 with a revenue surplus of \$35.0 million. The largest factors behind the FY 2014 revenue surplus were sales tax, (\$5.3 million), oil and gas severance taxes (\$20.7 million), cable/satellite tax (\$0.3 million), investment income (\$1.3 million), liquor profits (\$1.7 million) and other taxes and fees (\$8.3 million). A portion of the surplus (\$12.1million) was the result of a statutory change which eliminated the cap on severance tax accruing to the General Fund until FY 2017. Insurance premiums (\$3.7 million), beer, cigarette and tobacco (\$3.4 million), and metal severance (\$1.1 million) all came in below targets.

Looking forward, we expect the General Fund to end FY 2015 \$30.0 million below to \$50.0 million above the May targets.

As mentioned earlier, oil and gas severance taxes represent the largest better-than-expected surprise. Behind the rise in oil and gas revenue is the rapid increase in the price of oil and natural gas since 2002, as well as a more than doubling in natural gas production and a more than tripling in oil production (2002-2014). Current indicators through 2015 have oil and natural gas prices staying about where they were in 2013, with natural gas production marginally weaker and oil production expanding.



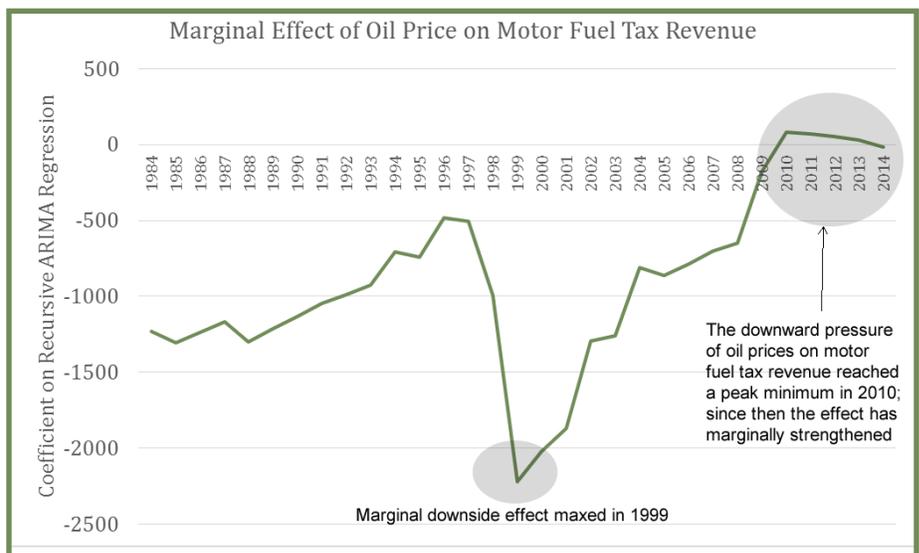
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TRANSPORTATION FUND

The Transportation Fund ended FY 2014 \$4.1 million above May targets. In FY 2015, we anticipate revenue to the Transportation Fund to come in between \$10.0 million below and \$10.0 million above the current FY 2015 target.

Economic activity, the price of oil, and fuel efficiency are major factors behind changes in Transportation Fund revenue. In terms of the latter two factors, consumers have become less sensitive to higher oil prices, while fuel efficiency continues to stay on an upward trajectory.

The decreasing sensitivity of motor vehicle tax to the price of oil is shown in the chart to the right. The downward pressure from oil prices maxed in 1999. Since then the effect has continuously weakened, with the effect reaching a “peak minimum” in 2010. The effect has only marginally strengthened since then, which explains why motor fuel tax continues to grow in the face of historically high gasoline prices.



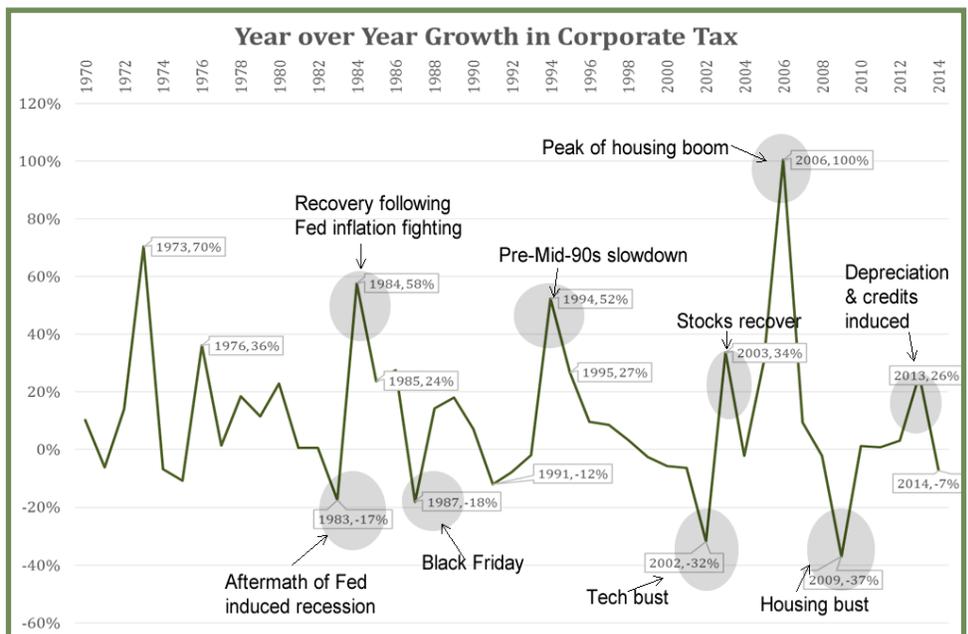
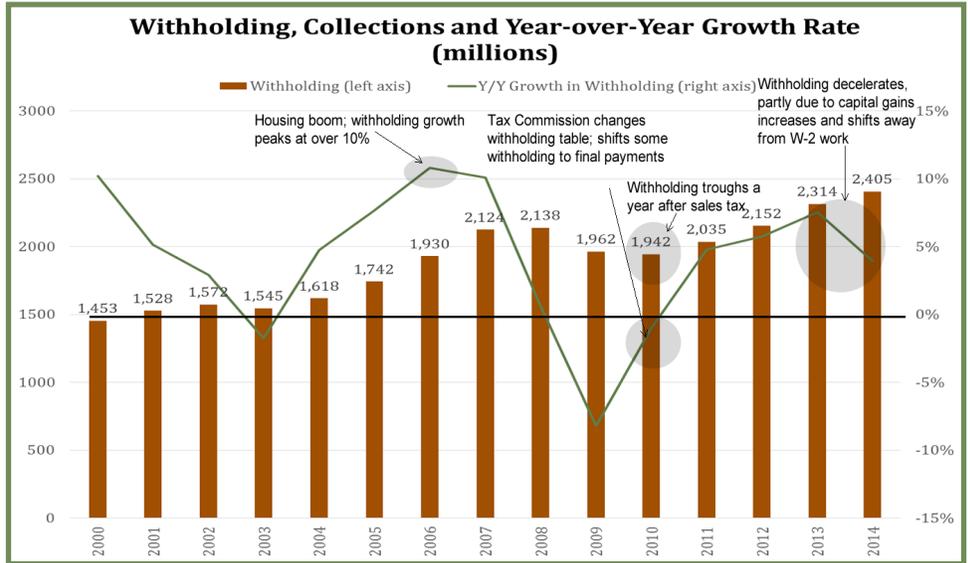
At the end of FY 2014, state accountants calculated an Education Fund revenue surplus of \$131.0 million. Looking forward, when combining all sources, revenue to the Education Fund is expected to end FY 2015 in the range of \$100.0 million to \$150.0 million above May estimates.

Behind the better-than-expected growth in Education Fund revenue are gross final payments associated with income tax liability and stronger corporate balance sheets.

In terms of the corporate situation, corporate income tax declined by 7.0 percent from 26.0 percent in 2013, largely due to corporations shifting some what-would-have-been 2014 taxable income into 2013. Behind the shift were the elimination of bonus depreciation and other tax credits.

On gross final payments, individuals' year-end checks to the state were about 4.0 percent lower than in 2013. A major driver behind the 4.0 percent drop is the federal tax increases implemented in January 2013.

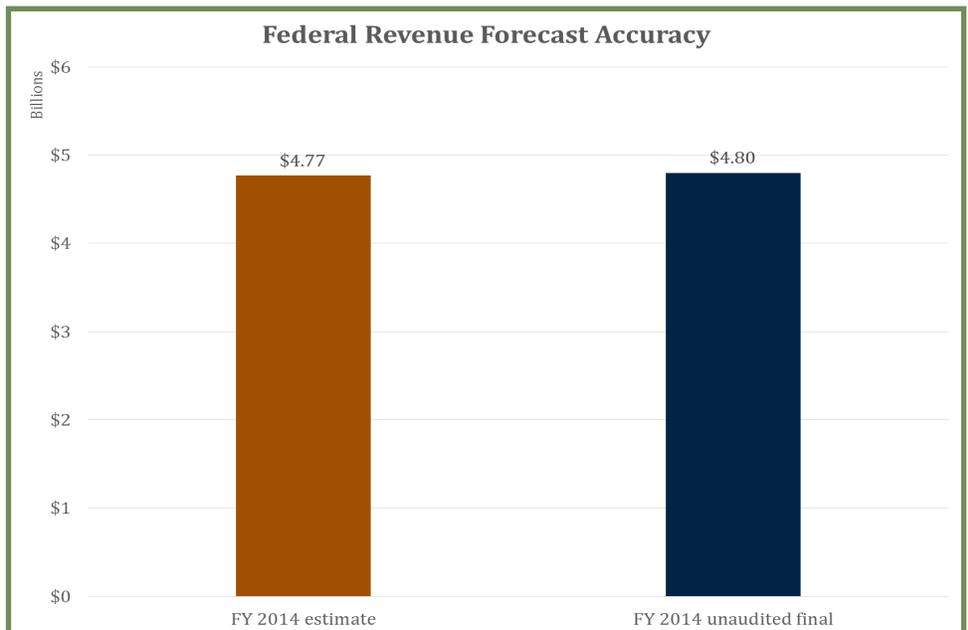
Lastly, the largest source of revenue — withholding — decelerated from 2013 (7.5 percent) to 2014 (3.9 percent). The deceleration is an indication that some individuals, particularly the young, are moving away from W-2 work (which requires withholding) and moving towards 1099-type work (which shows up in final payments). The weakness also stems from the 2013 federal tax increase and an economy that generally grew slower in 2013 than it did in 2012.



Beginning with FY 2014, we now also project federal funds in addition to revenues to the General Fund, Education Fund, Transportation Fund, and Mineral Lease revenue.

As of writing, unaudited, on-book federal revenue came in \$33.0 million above the February forecast at \$3.509 billion.

On off-budget revenue, we are waiting on the single statewide audit to compare actual revenue with the \$1.291 billion projected in February.



PART B: ECONOMIC INDICATORS

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REVIEW OF THE ECONOMIC INDICATORS

Nonagricultural Employment

Employment is growing, although at a slower pace than originally anticipated for 2015. Indicators were revised down from May estimates by 0.4 percent for 2015 with growth now expected to be 3.0 percent in 2014 and 2.5 percent in 2015.

Nonagricultural Wages

The average annual wage in the State was \$41,063 in 2013, an increase of 1.0 percent over the prior year. Growth is expected to be 3.6 percent in 2014. This translates to an average annual wage increase of \$1,466 in 2014. The 1.9 percent increase expected in 2015 translates to a \$827 increase in wages.

Retail Sales and Total Taxable Sales

Retail sales grew by 6.1 percent in 2013. The growth is expected to moderate in 2014 to 4.3 percent and increase to 5.0 percent in 2015. The universe of taxable transactions (all taxable sales) grew by 3.9 percent in 2013 and is expected to grow by 4.0 percent and 5.6 percent in 2014 and 2015.

New Automobiles and Truck Sales

Sales of new automobiles and trucks ended 2013 at an 11.1 percent year over year growth rate as the market continued to rebound from the deep contraction. The market is anticipated to continue growing, by 5.5 percent and 4.1 percent in 2014 and 2015.

Home Prices

Housing prices continue to improve with expected growth for 2014 and 2015 at 7.1 percent and 5.3 percent respectively. The housing prices forecasts are sensitive to interest rates and income expectations. Should interest rates rise faster than expected, housing prices could come in lower than expected.

Dwelling Unit Permits

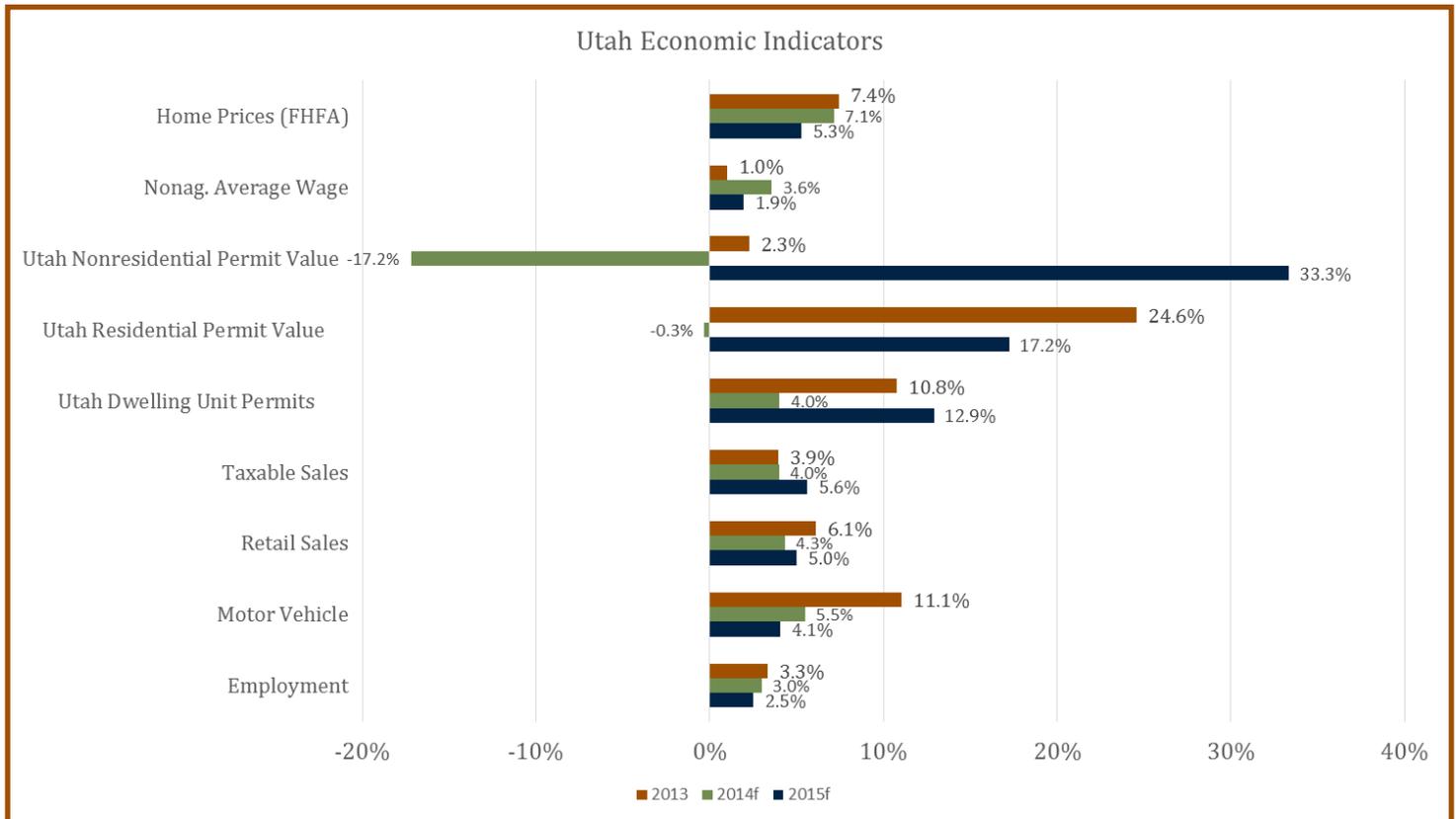
Dwelling unit permits ended 2013 at 14,900 units, an increase of about 10.4 percent over the 13,500 authorized in 2012. Residential permits are anticipated to continue to grow with 15,500 anticipated in 2014 and 17,500 in 2015.

Residential Permit Value

Dwelling unit permits are correlated with residential permit value. Total residential permit value bottomed out at \$1.7 billion in 2010. Since then, permit values have grown quickly, with total permit value expected to reach \$3.8 billion in 2015.

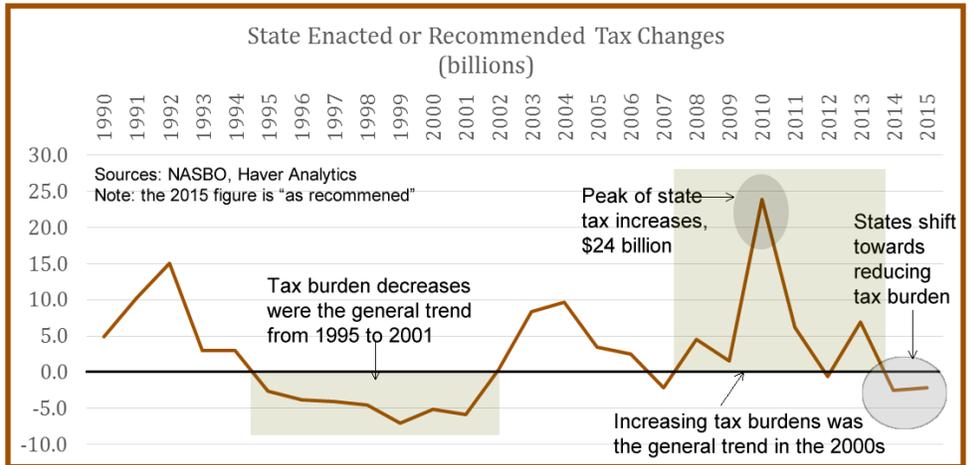
Nonresidential Permit Value

Nonresidential construction is expected to decline further in 2014 to \$900.0 million because of current commercial real estate market conditions. The 2015 estimates are up \$300.0 million for an anticipated \$1.2 billion in nonresidential construction.

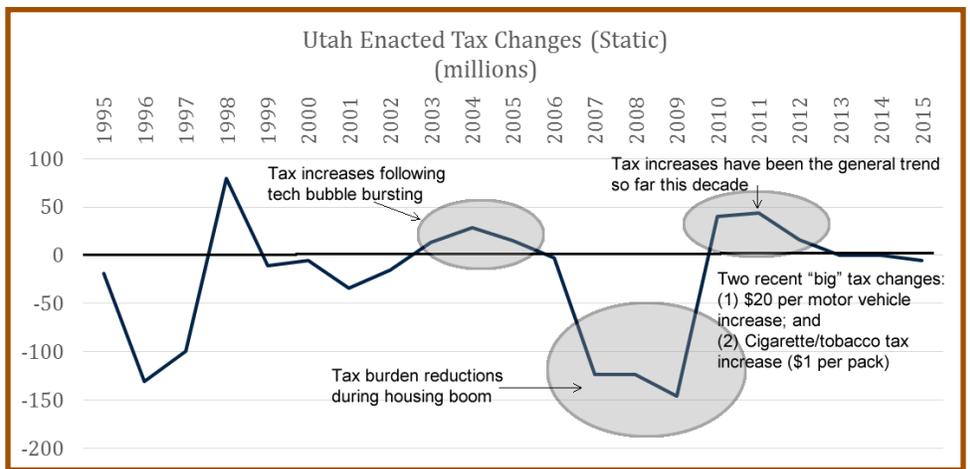


INTERSTATE TAX CHANGE COMPARISONS

We track tax increases and decreases in other states to see whether state revenue will be affected. The following graphic is a look at enacted or recommended tax changes across the nation from 1990 to 2015 as recommended, according to the National Association of State Budget Officers (NASBO). Presuming the 2015 changes were implemented as recommended by the executive branch, the chart shows that for the second year in a row the overall tax burden declined across states, something that has not happened consecutively since 2001.



Utah's experience with tax increases and decreases is similar to that of the nation. The last two "big" tax changes in the State were the cigarette and tobacco tax increases in 2010 (budgeted at \$44.0 million when enacted) and the motor vehicle registration fee increase of \$20 per vehicle (budgeted at \$53.0 million in 2009). A chart of enacted tax changes in Utah is given following the chart for the nation.



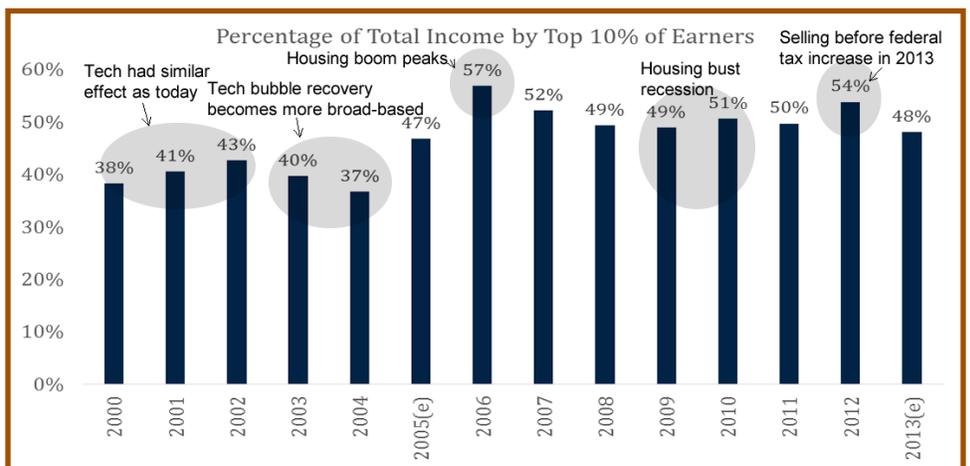
Overall, the issue matters for revenue in that tax decreases in other states put downward pressure on state revenue because the state becomes relatively less competitive. Similarly, tax increases in other states put upward pressure on state revenue.

THE WEALTH OF THE RECOVERY

Every economic downturn, subsequent recovery, and boom consists of distinct effects on various individuals. One often mentioned aspect of the current economic recovery is that it has been much stronger for wealthier individuals. The following is a look at the estimated share of income tax paid by individuals in the top 10 percentile from 2000 to 2013. The chart shows that the share of income tax paid to the state from this group of individuals expanded from 52.0 percent in 2007 (before the downturn) to 54.0 percent in 2012, and is estimated to have declined to 48.0 percent in 2013.

A similar business cycle trend was present following the bursting of the technology bubble in March 2000, where the share of total income tax paid from individuals in the top 10 percentile went from 38.0 percent in 2000 to 43.0 percent in 2002. The trend reversed itself when the economy recovered in 2003 and 2004.

Presuming the 2013 estimate is correct, the drop would indicate that the economy is on better footing when measured by depth and durability.



THE CHANGING DEMOGRAPHICS OF EXPECTED INCOME

The two recent recessions and subsequent recoveries continue to affect expected lifetime income by age groups differently, particularly the younger generation. This can be seen in the early 2000s, when the technology bubble burst, and the housing market collapsed in the late 2000s.

The top two charts on the right show the median income by age of householder for the NASDAQ bust (top right) and the housing bust (middle right) for the United States.

The older generation (55 years of age and older) did the best compared to the other age groups after the technology bubble burst, while the younger generation (ages 15-34) did the worst comparatively speaking. By 2005, the 55 years of age and older age group saw their median income increase by over 1.5 percent since 2000, the only group to be in positive territory over the four years following the technology bubble.

In contrast to the older generation's experience, the younger generation (15-34 age group) saw their median household income drop by about 8.0 percent through 2004. The group saw a small rebound, seeing their median household income appreciate by around 0.5 percent in 2005.

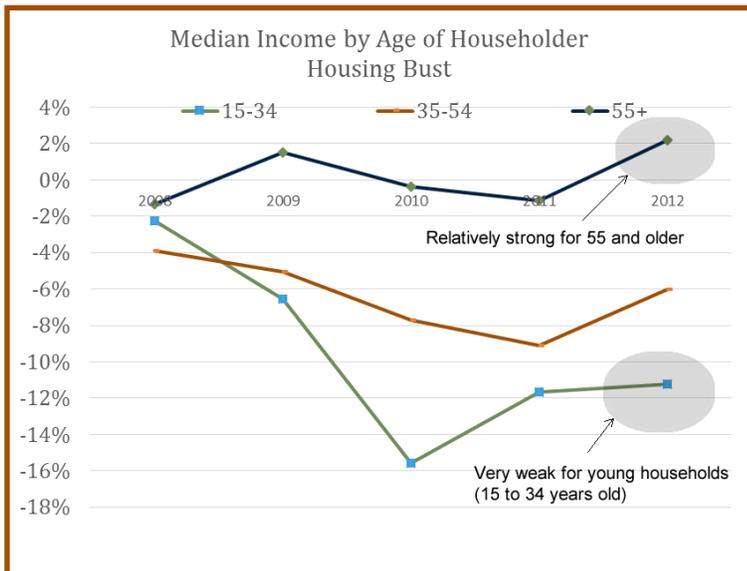
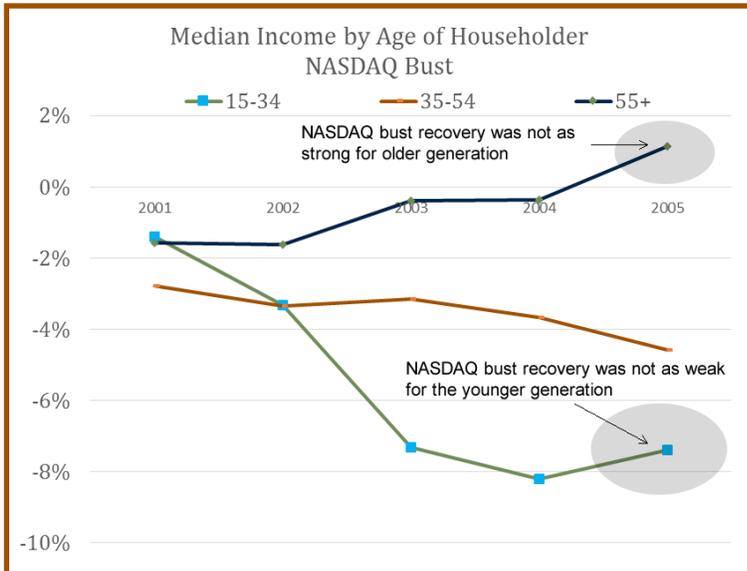
A similar story can be seen for the recent housing bust recovery. In 2008, the median income of the older generation (55 years of age) was positive by 2012 at about 2.0 percent. Over the same time frame, the younger generation's (15-34 age group) median household income was about 11 percent below where it was in 2008. The younger generation's income drop peaked in 2010 at close to 15.0 percent below where it was before the housing market deteriorated.

The past decade's experience for the younger working age population is something that will likely last with them throughout their life, with lower overall expected income through their entire working career.

Not only have these individuals been hit harder, but the effects are lasting longer. Due to this, younger generations have a higher likelihood of renting instead of owning their own home, living with their parents, marrying later, waiting to have children and having fewer children, staying in school longer, and decreasing consumer spending, etc.

Among other issues, these economic issues distinguish this generation's youth from their parents' and grandparents' generations.

The American experience is not unique. The chart to the bottom right has the experience of the younger generations in two semi-similar economies: Portugal and Spain. As shown, youth in these countries have also seen their wages shrink. In Portugal, the drop has been over 20.0 percent (15-34 age group), while in Spain the drop is about 9.0 percent for the same age group.



The following scatterplot is a matrix of the revenue risks. On the horizontal axis is the chance that an event will occur based upon historical occurrences and the vertical axis is the estimated revenue at risk should the event occur in a certain way. Events farther to the right are more likely to occur, while events either higher or lower on the y-axis comprise a greater magnitude of revenue risk.

Downside Risks

Included in all forecasts are risks of non-materialization, including the following scenarios:

China

Growth in China has been decelerating for the past three years. Should growth in China weaken to 4.0 percent or 5.0 percent, global growth would likely weaken.

Terrorist Induced Fear

Consumers respond to economic fear. Should consumer confidence deteriorate, economic growth would likely suffer.

Europe Weakens Further

Economic conditions in Europe are relatively weak at the moment, partially due to relations with Russia. The current forecast presumes Europe marginally improves over the coming year. If a different situation materializes, U.S. economic growth — and indirectly Utah economic growth — may weaken.

Interest Rates Rise Faster Than Expected

Financial markets generally think the Federal Reserve will raise its short-term interest rate in early summer 2015, which would end an historically long eight year “loose” cycle (loose means the Fed is printing money and/or keeping interest rates low). Should

more reasonable short-term interest rates spook businesses or reduce financing for projects, growth may be restrained.

Stock Market Collapses

Equity markets are floating at all-time highs. Should markets collapse, wealth induced investment and consumption may weaken.

Upside Risks

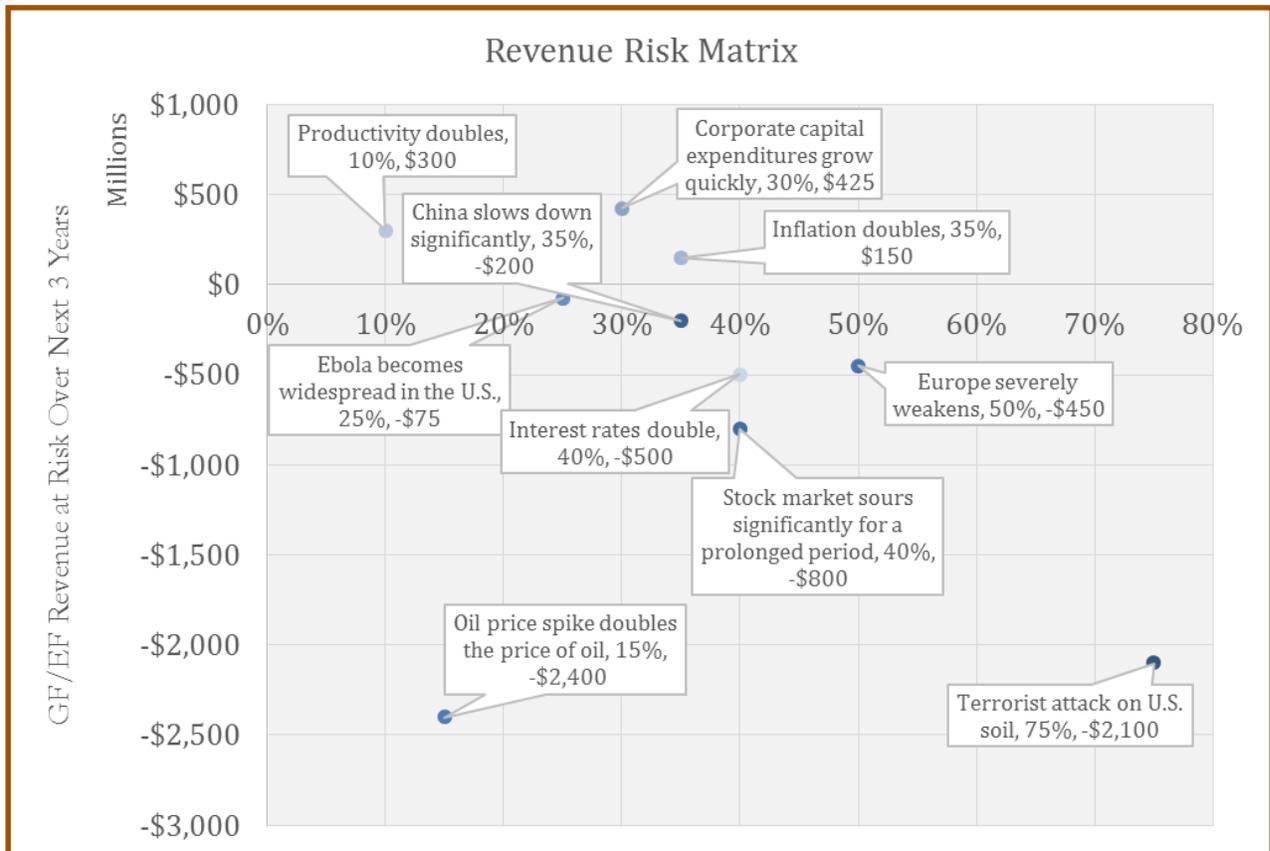
In addition to downside risks, the current revenue forecast includes scenarios where revenue could come in above target. These include:

Investment

Large corporations have accumulated historically high cash balances. Up till now that cash has been used for stock buy-back, mergers and acquisitions, and other non-investment related expenditures. Should corporations gain greater confidence in the pace of growth or durability of the economy, investment would likely follow suit, which may boost economic growth more than what is currently anticipated.

Productivity Rises Faster Than Expected

A key driver of economic growth is productivity, defined as output per unit of input. In looking at the American worker productivity compared to international workers, the American worker is about average, which explains why wage growth in the U.S. has been relatively weak by historical standards but about average by international standards. Should Utah workers become more productive relative to workers in other states and around the globe, economic growth may strengthen more than expected.





RETURN SERVICE REQUESTED

PART C: REVENUE COLLECTIONS

Tax Revenue (In Millions of Dollars)	FY 2014 Final	FY 2015 Consensus	FY 2015 Consensus Growth Rate	FY 2014 Year-to-Date (10/5/2013)	FY 2015 Year-to-Date (10/5/2014)	FY 2015 Year-to-Date Growth Rate
Sales & Use Taxes	\$1,656.81	\$1,708.61	3.1%	\$433.13	\$450.26	4.0%
Individual Income Tax	2,889.79	2,913.05	0.8%	606.31	571.24	-5.8%
Corporate Franchise Tax	313.54	319.46	1.9%	58.96	91.63	55.4%
Beer, Cigarette & Tobacco	113.13	114.86	1.5%	24.02	31.11	29.5%
Insurance Premium Taxes	91.21	98.73	8.2%	25.03	24.94	-0.3%
Severance Taxes	105.01	92.35	-12.1%	22.01	31.52	43.2%
Other Sources	249.80	242.37	-3.0%	21.76	26.70	22.7%
Total - General & Education Funds	\$5,419.28	\$5,489.42	1.3%	\$1,191.23	\$1,227.41	3.0%
Motor Fuel Tax	\$256.76	\$255.73	-0.4%	54.80	48.69	-11.1%
Special Fuel Taxes	101.71	100.14	-1.5%	18.01	15.72	-12.8%
Other Transportation Fund	82.05	85.47	4.2%	18.87	18.98	0.6%
Total - Transportation Fund	\$440.51	\$441.34	0.2%	\$91.69	\$83.39	-9.0%

Source: LFA, USTC, DOF