Revenue Update

Part 1: Tax Collections

As predicted in February, declining economic activity continues to put downward pressure on state revenues. However, based on current collection rates we expect General Fund/Education Fund revenues to be within +/- $40 million of February estimates. Most of the downside risk in revenues is in the Education Fund as a result of Corporate Tax volatility.

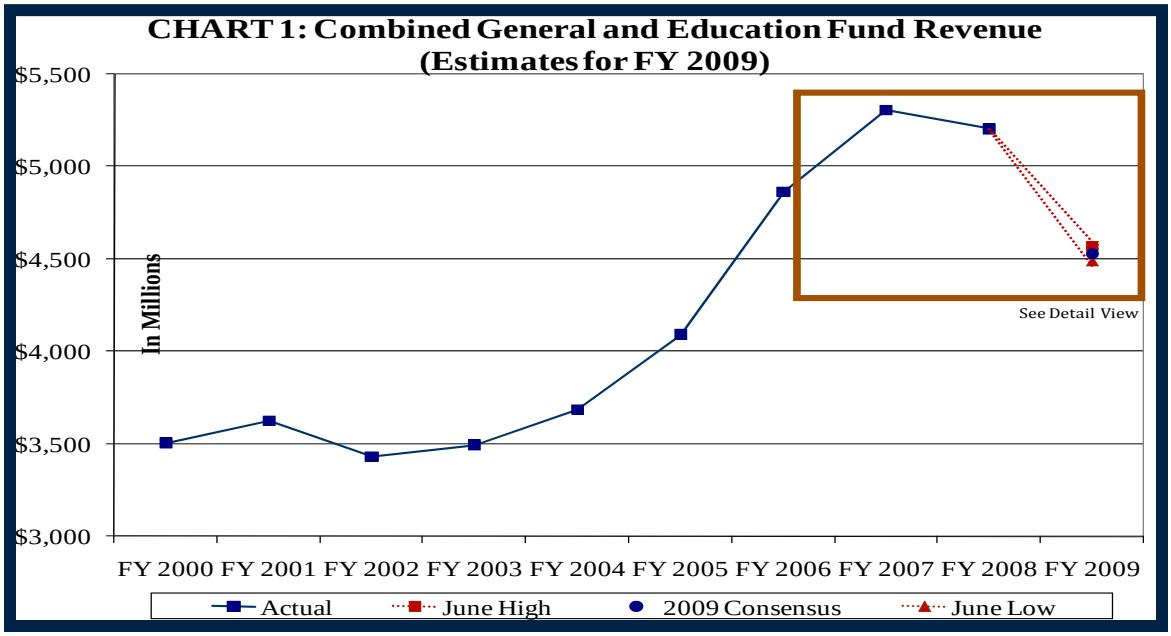
When all sources are combined the General Fund is currently on target with an expected range of +/- $10 million. When all sources are combined Education Fund collections are expected to be within a range of +/- $30 million. The largest risk is in the Corporate Tax. Based on collections to date Transportation Fund revenues appear to be coming in on target for FY 2009.

The national recession began in December 2007 following the onset of problems generated in the financial system and housing price depreciation. The state appears to have followed suit, entering recession territory in March 2008.

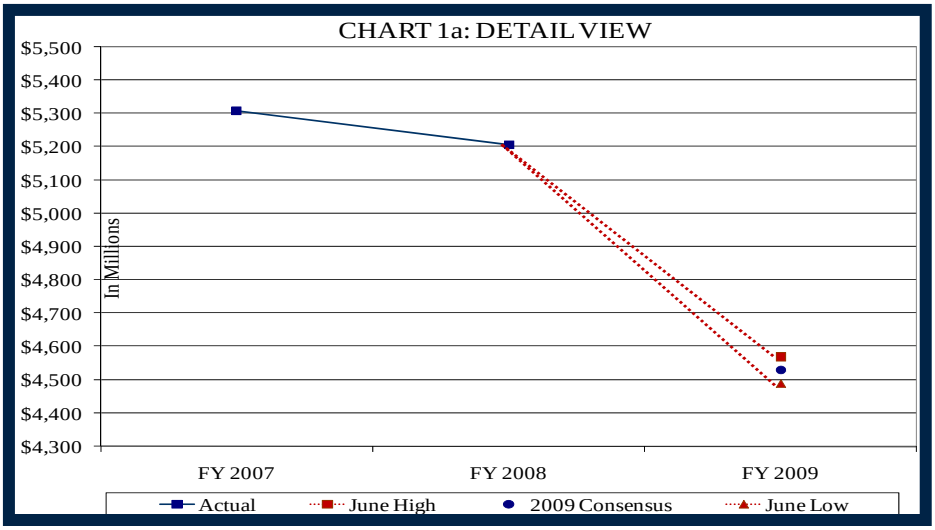
This recent downturn in unique in that the economic decline materialized in the labor and financial markets suddenly. Because of the immediacy of the effects and due to the nature of the individuals and industries affected, this recession appears to be set for a longer duration and subsequent slower growth once the downturn is over. We expect the abating recession to lead to below trend growth in the coming fiscal years.

In spite of this, the recession should moderate over the next several months – with some positive indicators being forecast for 2010 (i.e. some growth in retail sales, moderating personal income and slightly higher non-agricultural wages). Going forward, some of the factors above (i.e. carry forward losses) will weigh on individual income and corporate franchise tax revenues.

The economy and revenues are not likely to recover this year. However, the lessening recessionary environment should lead to slower deceleration in the coming fiscal year.



Total General & Education Fund revenues are expected to be +/- $40 million in relation to the February 2009 Consensus revenue target.



LFA
Legislative Fiscal Analyst

Higher Savings rates continue to depress sales tax collections.

One of the factors currently weighing on sales and use collections is the higher savings rate of consumers. Consumers, burdened with many years of accumulated debt are being forced to re-trench and save in order to reduce their debt load. As a result Sales and Use tax collections are expected to continue to drop.

For the past several years U.S. consumers have consistently saved less and less and spent more and more of their disposable income. Easy credit combined with appreciating asset values (homes, stocks, etc.) led to spending habits beyond wage resources for many consumers. In fact, by 2005 the personal savings rate as a percentage of disposable income fell below 0.

Sales Tax growth is no longer being created by the financial and housing markets.

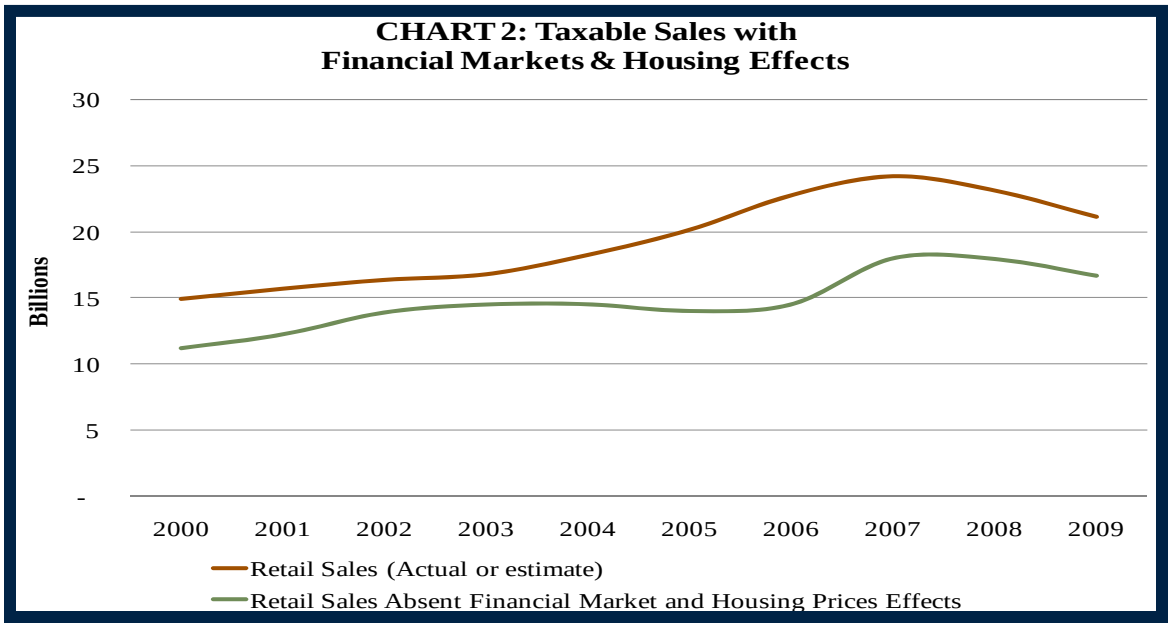
As the recession hit and credit dried up and asset values plummeted consumers were faced with the reality that they could no longer spend more than they made. As a result there has been a dramatic increase since late 2008 in the personal savings rate. As the consumer is forced to save – pay down their debt - and as a result spend less – sales and use tax collections will be lower.

Conversely, severance taxes are currently coming in above targets. However, collections accruing to the General Fund will remain at target as a result of caps passed in a previous legislative session. (Current General Fund earmarks from all sources are shown in Table 1.) Interest earnings and the Cable and Satellite Tax are also coming in above target.

If the household deleveraging effect continues, and saving rates continue to grow, then consumer spending recovery will likely be dampened. The dampening effect is the current risk for sales tax revenues in the short term.

When all sources are combined the General Fund is currently on target with an expected range of +/- $10 million.

TABLE 1: General Fund Earmarks	FY 08 Prelim.	FY 09 Prelim.
Dedicated Credits:		
Admin. Allowance Service Charge	$7,648,497	$7,148,036
DNR Watershed Rehab/Cloud Seeding	650,000	650,000
DNR Plants/Animal Protect.: Sales	2,450,000	2,450,000
Water & Wastewater - DWR	580,010	528,569
General Fund Restricted:		
Water & Wastewater Projects	20,997,288	20,264,441
Transportation Fund Restricted:		
Transportation Projects	27,856,138	27,100,471
Public Transit Systems Highway	27,053,027	23,744,239
Motor Vehicle Rental Tax - restricted	4,637,252	3,447,892
Cent. Hwy Vehicle Rel. Products - 8.3%	3,094,668	154,084,775
Centennial Hwy 1/64 Sales Tax & Transfers	153,660,387	(14,995,479)
Critical Need Highway Fund	82,903,144	57,720,850
State Sales & Use Tax - Earmarked	**$331,530,411**	**$282,143,794**
Oil & Gas Severance Tax		
Permanent State Trust Fund	-	22,000,000
Navajo & Uintah Basin Revital. Funds	7,986,442	9,000,000
Total Earmarks	**339,516,853**	**313,143,794**



Education Fund

Total wages represent the largest source of revenue to the Education Fund. As a result Income Tax continues to struggle. Currently total wages are expected to be down by 3.4 percent for CY 2009. Given the weak employment and wage outlook over the next several months, we can see Utah personal income potentially dropping 3% o 5% in calendar year 2009 . It appears that individual income tax revenue for FY2009 will decline approximately 11% from FY2008 levels.

The second largest source of Education Fund revenue, corporate profits continue to be under pressure. Business conditions now affect future revenue through a variety of factors but especially through capital losses. Of mention is the finance and insurance industry, which, up until recently accounted for a small portion of capital losses. The taxable income from this sector will likely continue to be under pressure and accrue capital losses for future years. As a result corporate taxes will continue to be a volatile source of revenue.

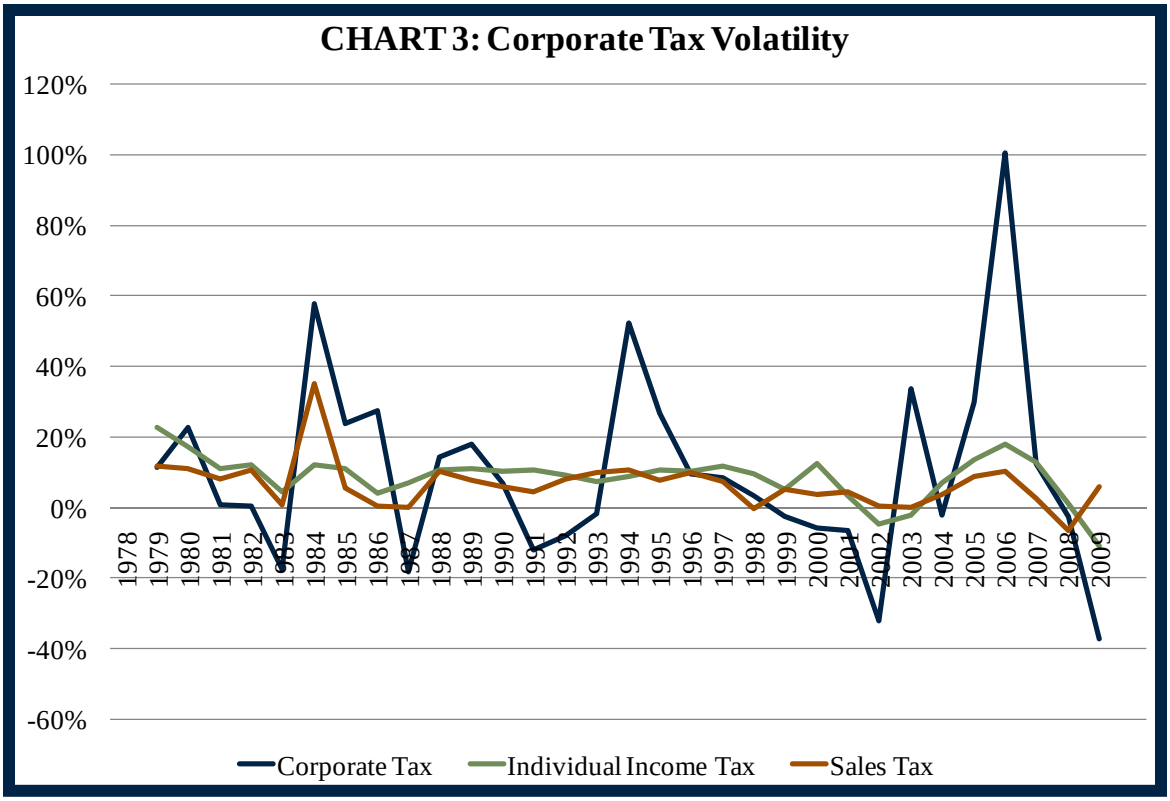
Part of the explanation for the state's corporate income tax performance is the structure of industries that pay the tax. Industries that account for a larger portion of corporate income tax paid in the state tend to be those industries that are under less pressure. Those that have large losses will most likely pay the minimum tax.

The impact of the massive capital market losses over the past 18 to 24 months will likely offset potential future capital gains for the next several years which in turn will dampen income tax and corporate franchise tax collections into the future. The volatility of the corporate tax is shown in the chart below.

When all sources are combined the Education Fund collections are expected to be within a range of +/- $30 million. The largest risk is in the Corporate Tax.

Employment Declines and Wage Slowdown Impact Education Fund Revenues

Corporate Tax Collections are Below Expectations in FY 2009



Corporate Taxes remain particularly volatile in the short term.

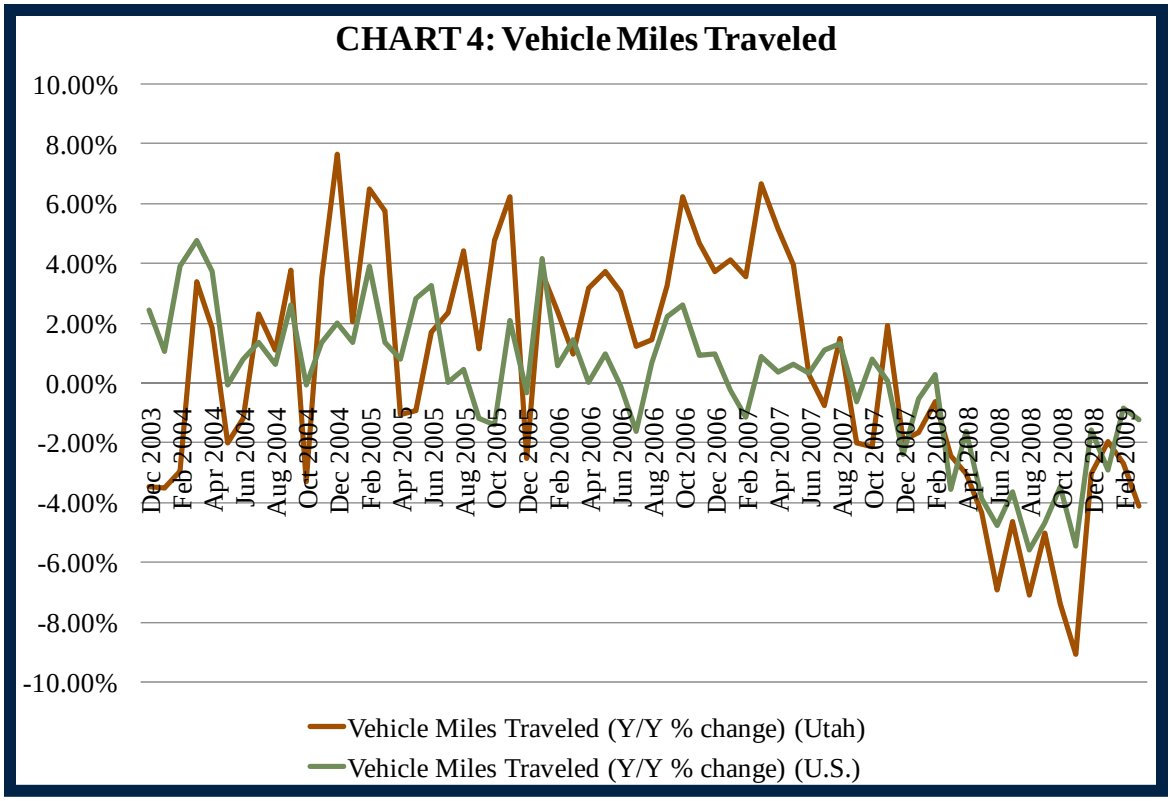
Vehicle efficiencies have shifted the transportation fund base lower.

Total Vehicle Miles Traveled continue to decline.

In the past, speculation, exchange rates, domestic and international demand, and interest rates had mostly a transitory effect on transportation fund revenue – leaving the built-in expectation that revenue would continue to follow a business cycle pattern once these factors changed course. It appears that these historically transitory impacts have caused a structural shift – at least for the moment. Individuals have shifted to more fuel efficient vehicles – with the switch largely due to the impact speculation had on the price of oil. The structural shift does not eliminate the cycle – but rather shifts *base* transportation fund revenue lower. An initial analysis of automobile data indicates that the aggregate fuel economy of automobiles purchased in the state has increased from 24.65 mpg to 26.8 mpg (see table below). The differential aggregate increase means that the same miles can be traveled with 78.9 million fewer gallons of gasoline purchased representing $19.8 million in fuel tax revenue.

The decrease in vehicle miles traveled cannot be entirely attributed to the price of oil and the impact of more fuel efficient vehicles. Individuals also appear to be traveling less due to other business cycle factors – such as pressure on employment and wages.

Based on collections to date Transportation Fund revenues appear to be coming in on target for FY 2009.



WAGES & EMPLOYMENT

Unemployed individuals now represent about 2.5 percent of the population (71,000 individuals). These individuals may be unemployed because of, among other possibilities, fluctuations in the business cycle, lack of employment in a specific specialization area, or incentives offered to the unemployed. Either due to the three aforementioned factors or due to discouragement based upon the low hiring rate, about 44,800 individuals have dropped out of the labor force (thus not counted as unemployed). Because of the drop in the labor force, the unemployment rate probably does not represent the most accurate picture of the economic situation.

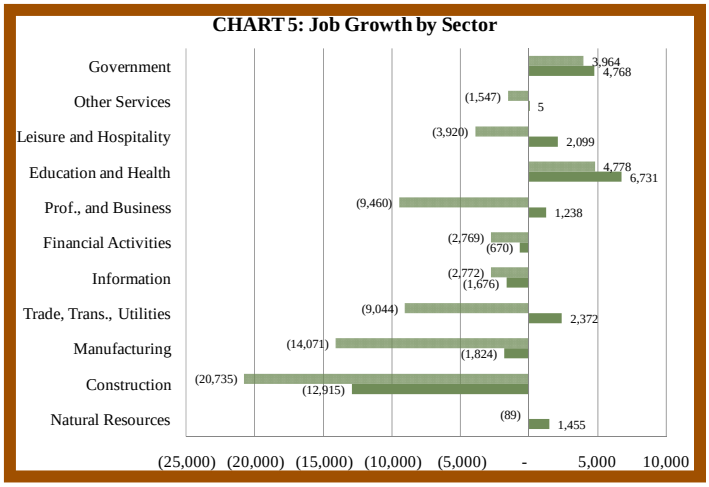
For the first few months of the downturn, the employment effect was only evident in the financial activities and construction sectors. Now, every sector except for natural resources, education, and government has experienced workforce reduction, ranging from a low of 1,547 to a high of 20,735.

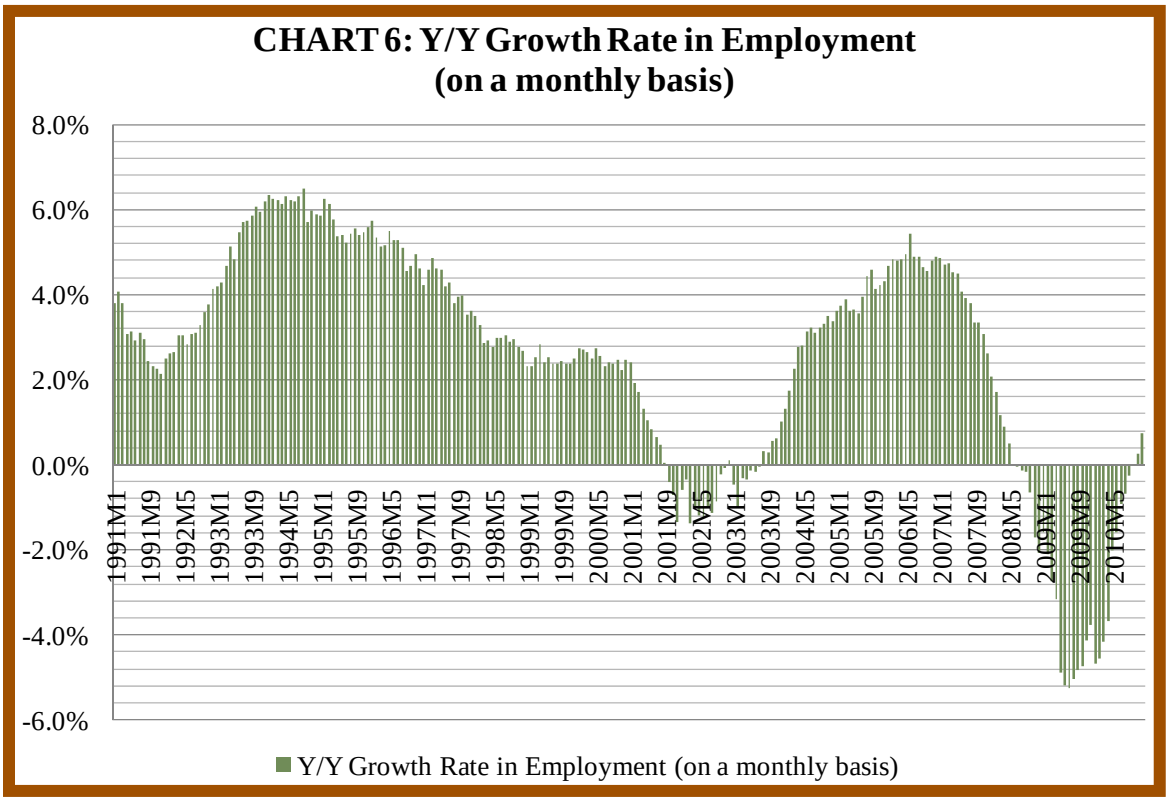
As is noted in Chart 6 – Utah has experienced negative year over year job growth since July 2008 – and the rate of job losses has accelerated through April 2009. It is anticipated that job losses will begin to moderate throughout the second half of calendar 2009 – but that positive year over year job growth will likely not resume until late 2010.

Wage growth also remains slow. Most of the gains occurring in recent quarterly reports are the result of severance payments and bonuses. Ongoing wage growth remains flat.

Job Growth Forecast at (4.3) Percent in 2009

Job Growth in Utah Continues to Decelerate—Especially in the Construction & Financial Activity Sectors





Severe contractions in financial markets continues to impact stocks, pensions and borrowing.

Starting with the collapse of financial giant Bear Stearns in early 2008 followed by the Lehman Brothers failure later in the year, the U.S. financial sector and the economy as a whole have been left reeling. Capital destruction has been massive from large stock market declines to large real estate devaluations.

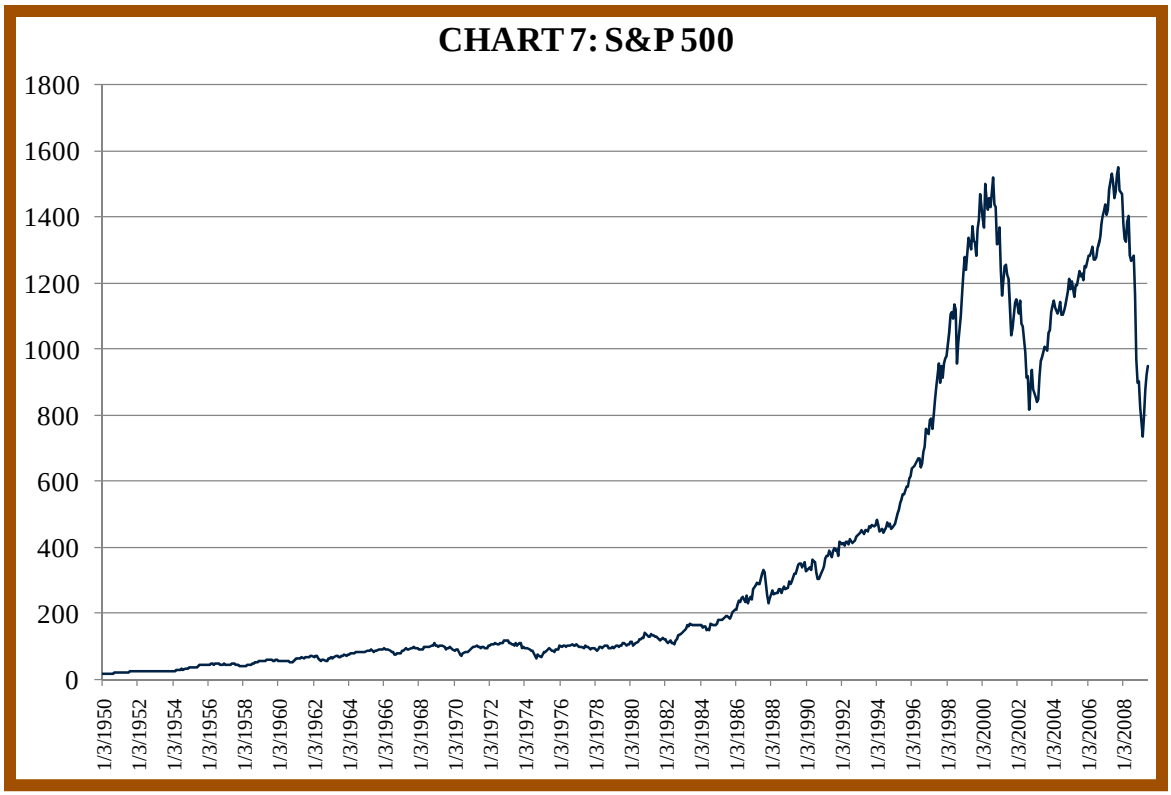
Large bank losses from high risk loans (subprime) have led to the failure or near failure of many financial institutions. Credit markets have dried up. Even the most well qualified borrowers have found it difficult to borrow since the fall of 2008.

Both individual and institutional investors have suffered severe losses – realized and unrealized. The S&P 500 fell more than 50% from its October 2007 highs to March 2009 lows (see Chart 7). Financial sector stocks (not long ago one of the leading sectors in the equity and capital markets) are in many cases worth just a fraction today of their highs from just a few years ago.

Federal Tax Changes Impact State Revenues.

As a result, the federal government has pumped trillions of dollars into the banking sector - and throughout the economy - in an attempt to stave off an economic depression. Part of the federal stimulus programs relate to taxes. Some of these changes will impact state revenues. The following items could reduce income tax collections:

- Temporary suspension of unemployment benefits will reduce AGI and as a result will impact individual income tax.
- Extension of bonus depreciation, carry-back of net operating losses, and the extension of small business expensing will likely impact both individual and corporate tax revenues.



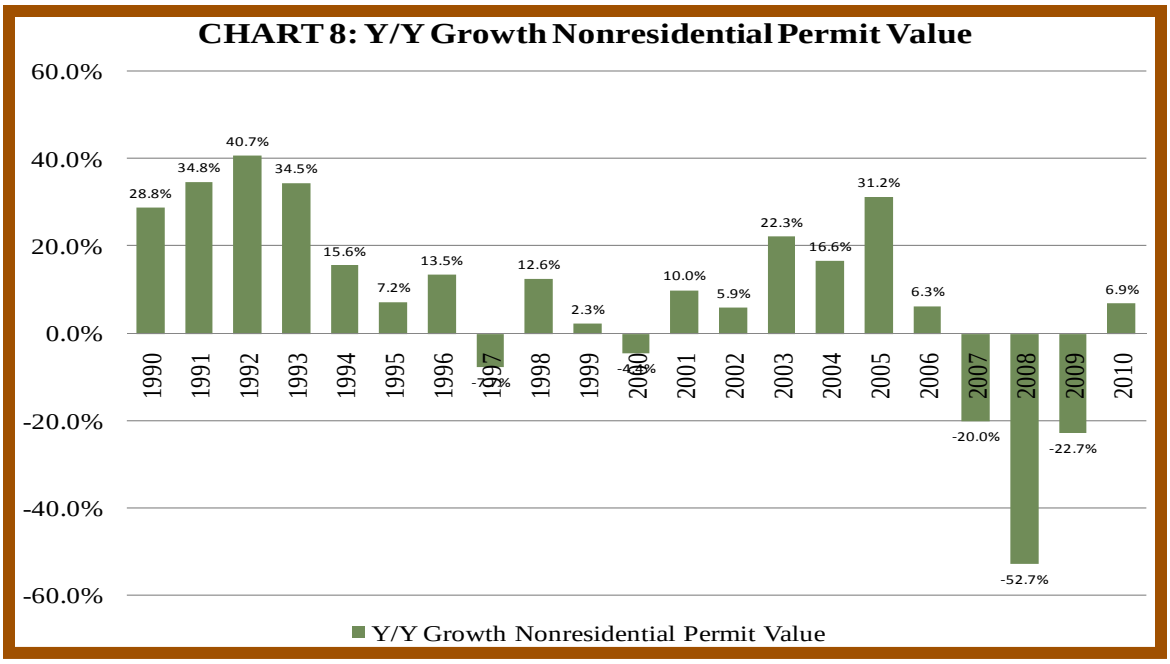
Construction

Non-residential construction will continue its decline because of excess supply and declines in production. Non residential permit values are expected to drop from 1.9 billion to 1.4 billion in 2009.

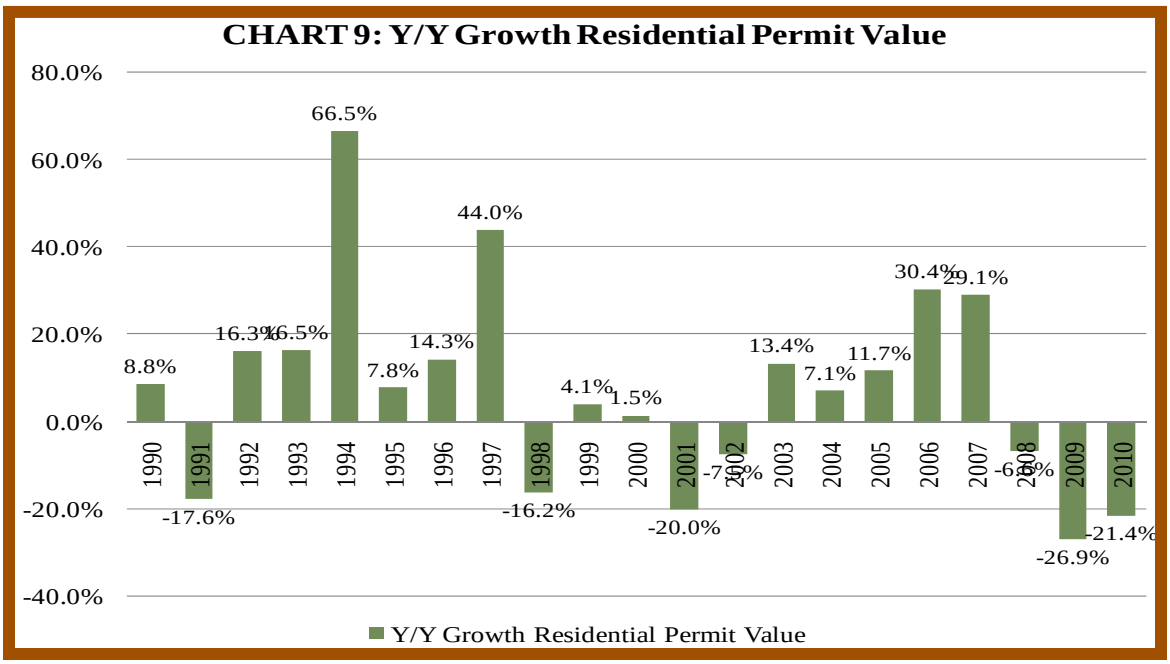
Since peaking in 2006, the rate of growth in the Utah construction sector has steadily deteriorated. By December 2007 the rate of growth fell below zero and the decline has accelerated throughout 2008 and into 2009.

Low fixed rate mortgages, combined with low short term interest rates are helping stabilize the Utah housing market. Buyers are also taking advantage of federal and state tax credits for the purchase of moderate priced homes. Excess supply of existing homes has been reduced. However, new home construction remains constrained mainly as a result of credit restrictions still in place.

The good news is that real estate inventory is going down. Moving forward the housing market should derive strength from strong population growth and some pent up demand.



Non-residential construction continues to decline.



Utah Dwelling Unit Permits to be 8,500 in 2008—Lowest Level of Home Building Documented History

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Revenue Collections to Date (11 Months)

Major Tax Sources *(In Millions of Dollars)*	FY 2008 Final	FY 2009 February Consensus (2/12/2009)	FY 2009 February Growth Rate	FY 2008 Year-to-Date (6/7/2008)	FY 2008 Year-to-Date (6/7/2009)	FY 2009 Year-to-Date Growth Rate
Sales & Use Taxes	$1,739.38	$1,544.19	-11.2%	$1,616.02	$1,448.52	-10.4%
Individual Income Tax	2,602.70	2,323.00	-10.7%	2,457.75	2,185.07	-11.1%
Corporate Franchise Tax	418.32	281.25	-32.8%	350.27	233.79	-33.3%
Beer, Cigarette & Tabacco	62.84	60.47	-3.8%	59.58	56.60	-5.0%
Insurance Premium Taxes	77.20	81.26	5.3%	76.76	77.41	0.8%
Severance Taxes	92.06	86.32	-6.2%	100.27	116.19	15.9%
Total - General & Education Funds	**$4,992.50**	**$4,376.49**	**-12.3%**	**$4,660.65**	**$4,117.58**	**-11.7%**
Motor Fuel Tax	$244.68	$223.48	-8.7%	229.18	211.03	-7.9%
Special Fuel Taxes	116.92	104.57	-10.6%	107.54	94.11	-12.5%
Motor Vehicle Registration Fees	35.37	35.30	-0.2%	32.67	31.96	-2.2%
Total - Transportation Fund	**$396.97**	**$363.35**	**-8.5%**	**$369.39**	**$337.10**	**-8.7%**

Source: Utah State Tax Commission, TC-23 Report, June 2009.