UTAH LEGISLATURE OCTOBER 15, 2013

REVENUE UPDATE

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PART A: TAX COLLECTIONS

Utah ended FY 2013 with a $242 million General and Education Fund revenue surplus. After expenditure adjustments and transfers to the Education Rainy Day Fund, the budget surplus is $122 million, all of which is in the Education Fund. The surplus was driven largely by federal tax increases such as the increase in personal income tax rates for certain individuals and higher capital gains tax rates. Because these tax changes shifted revenue from later years into FY 2013, the revenue surplus should be considered one-time going forward.

Given consensus economic indicators developed by the Revenue Assumptions Working Group, we anticipate FY 2014 General and Education Fund revenues will be in the range of $130 million below to $70 million above the May EAC targets. The Transportation Fund is expected to be $5 million below to $5 million above May targets.

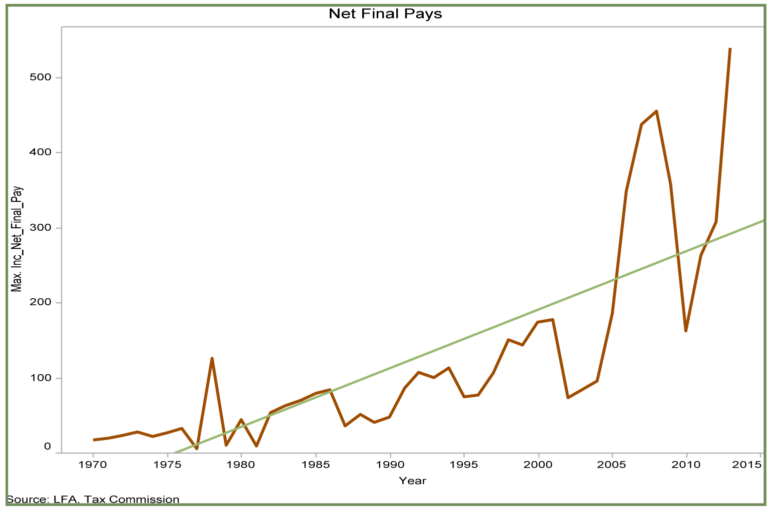
The greatest downside risk is in the General Fund, and is due to lower than projected FY 2013 collections and flagging consumer confidence. The FY 2013 $15.6 million General Fund revenue deficit was lessened by unused earmarks ($6.1 million), excess account balances ($6.6 million), and lapsed spending authority ($2.9 million), putting the final FY 2013 General Fund budget position at about $0.3 million short. No new money went into the General Fund Rainy Day Fund, the Disaster Recovery Fund, or the Industrial Assistance Fund.

In most cases, economic indicators have been revised down from May estimates. This is due to a variety of factors including federal policy uncertainty and rising interest rates.

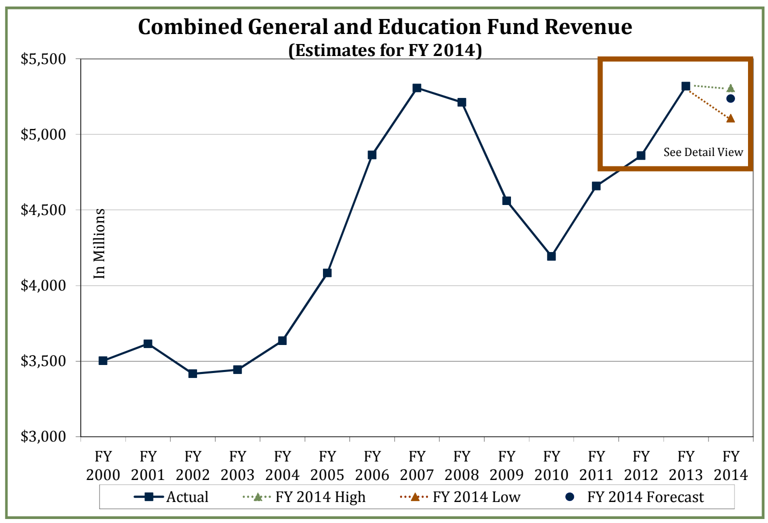
The rise in interest rates that began in May 2013 has created a cautionary tone in specific segments of the economy, particularly housing in recent months. Due to talk about federal tapering, the 10-year treasury note rose to nearly 3 percent in mid to late summer. As a result, both 15 and 30-year mortgage rates have risen from lows of 2.7 percent and 3.5 percent respectively in late 2012 to 3.5 percent and 4.5 percent respectively as of the end of September 2013. We believe if the 10-year treasury note yield moves above 3 percent and the 30-year mortgage rate moves above 5 percent that this could negatively affect housing and other sectors of the economy.

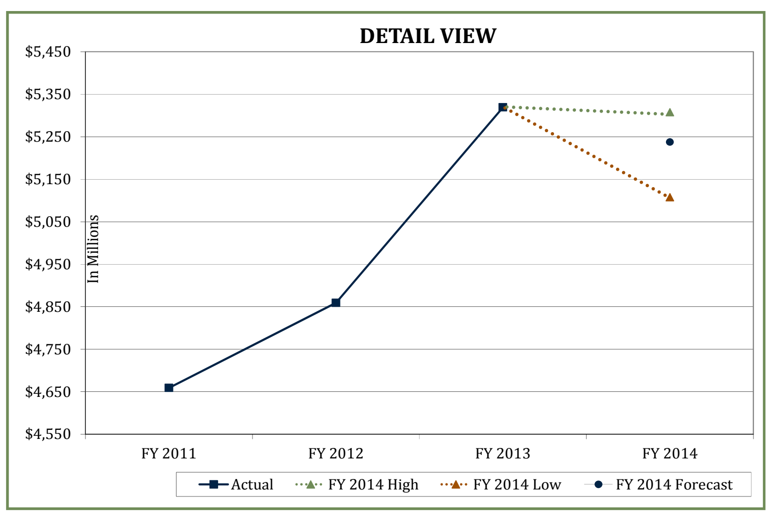
The economic impact on the private sector from the Affordable Care Act also poses a potentially significant negative risk. Uncertainty is causing employers to be cautious as they manage costs associated with new hiring as well as benefits to existing employees. Reduction in work week hours and higher costs associated with healthcare and other benefits may subdue wage growth and the number of full-time jobs created.

Overall, downside risk is greater than upside risk right now.



Source: LFA, Tax Commission

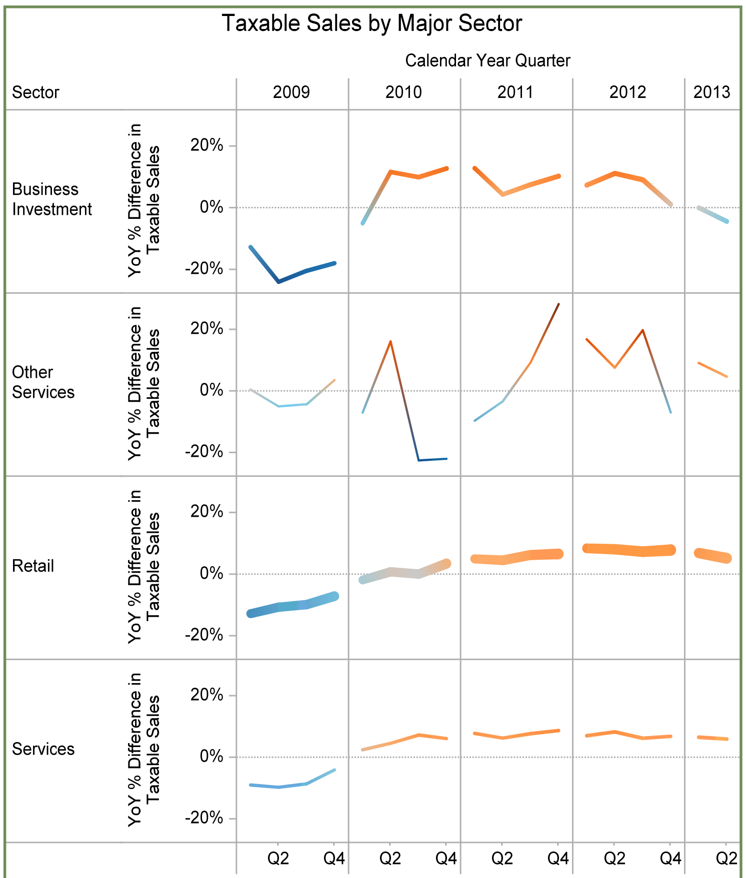




A1 General Fund

The General Fund ended FY 2013 with a revenue deficit of $15 million. The largest factors behind the FY 2013 revenue deficit were sales tax, severance taxes, cable/satellite tax, and other taxes and fees, the sum of which came in $28 million below target. On the upside, liquor profits, insurance premiums, investment income, and certain other taxes came in about $13 million above target. Looking forward, we expect the General Fund to end FY 2014 within a range of $60 million below to $10 million above May targets.

Through the first quarter of FY 2014, total revenue is coming in above targets. Because first quarter performance is only slightly related to year-end revenues, at this point the most important factors in evaluating revenue potential are the economic indicators. Overall, indicators related to the General Fund are showing moderate growth, including retail sales, new truck and auto sales, natural gas and oil prices, population growth, construction, and disposable household income, although most of these indicators have been revised down from May.



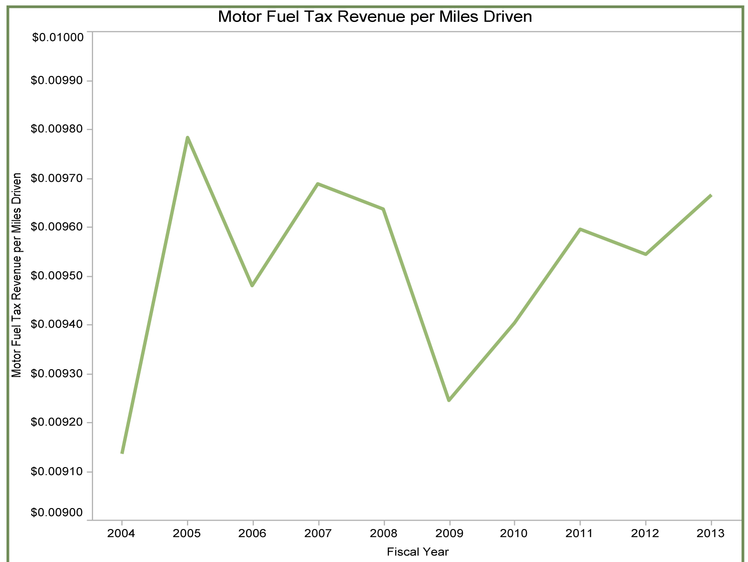
Notes: the size of the line represents how big the taxable base is, while the color represents how strong or weak the taxable sales base is doing in a given quarter.
Source: Tax Commission, LFA

A2 Transportation Fund

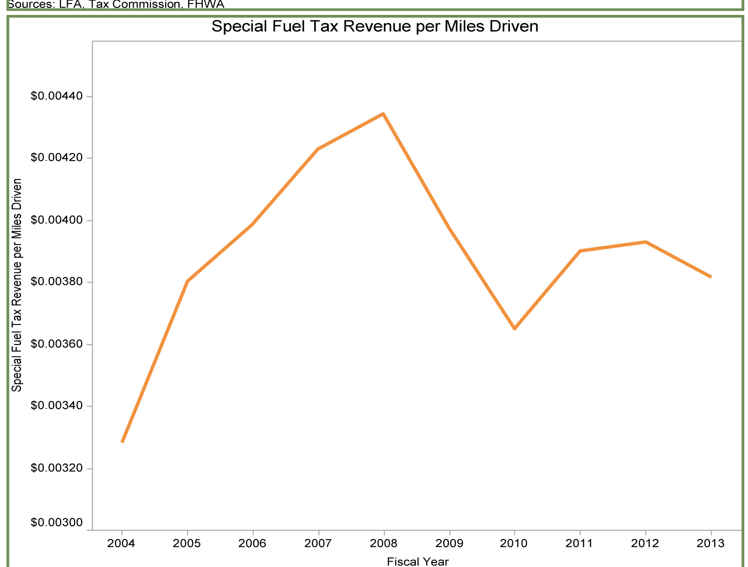
The Transportation Fund ended FY 2013 $7 million above what was expected during the legislative session. Looking forward to FY 2014, we anticipate revenue to the Transportation Fund to come in between $5 million below and $5 million above the current FY 2014 target.

The largest drivers behind Transportation Fund revenue are the gas tax and special fuel taxes, both of which came in above target in FY 2013. The motor fuel tax ended FY 2013 about $6 million above target, while the special fuel tax ended the prior fiscal year about $2 million above target.

The better-than-expected performance of motor fuel tax was the result of three factors: fuel efficiency came in lower than expected (meaning individuals are purchasing larger cars), the price of oil had less of an adverse consumption effect than what historically would have been the case, and individuals drove about 0.3 percent more miles than they did in FY 2012. We anticipate motor fuel tax revenue per mile driven to continue to increase through FY 2014.



Sources: LFA, Tax Commission, FHWA



Sources: LFA, Tax Commission, FHWA

A3 Education Fund

At the end of FY 2013, state accountants calculated an Education Fund revenue surplus of $242 million. Looking forward, when combining all sources, revenue to the Education Fund is expected to end FY 2014 in the range of $70 million below to $60 million above May estimates.

The Education Fund revenue surplus is mainly due to federal tax increases, which encouraged individuals to accelerate capital gains into an earlier fiscal year. Among the tax increases that caused the shift are: higher tax rates for individuals with income above $400,000 (single) or $450,000 (married filing jointly), which caused bonuses to be realized earlier, and higher capital gains tax rates, which shifted capital gains realization into FY 2013 instead of a later fiscal year.

In the outlook, current economic indicators related to Education Fund revenue are all showing growth, with employment, wages, personal income, and corporate profits all expected to show growth through 2014.

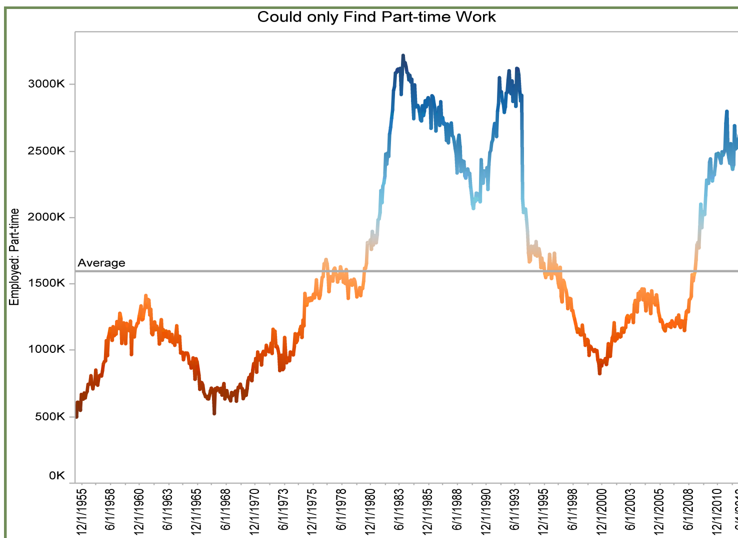
The largest driver of Education Fund revenue is personal income, which is comprised of wages and salary disbursements, other labor income, proprietors income, rental income, dividend income, interest income, transfer payments, and contributions to government social insurance programs. Although personal income is expected to be up 51 percent from 2005 to 2014, the makeup of that growth has changed over the years.

The change in the makeup of personal income is partly the reason behind the slow economic recovery. The highest growing major component is rental income, which is expected to be up 212 percent from 2005, followed by transfer payments at 91 percent, and dividend income at 55 percent. Conversely, interest income is expected to have grown only 9 percent since 2005, followed by proprietors income at 40 percent, contributions to government social insurance at 46 percent, other labor income at 46 percent, and wages and salary disbursements at 48 percent. In essence, more individuals are making their income from passive sources—rents, transfer payments (unemployment compensation, welfare, disability payments, Social Security), and dividends—than earned sources—proprietorships and salaries.

This makeup shift matters for revenue growth in that a shift towards more passive income is generally associated with a less productive economy, which could shift long-term revenue growth lower.

In addition to the personal income indications on future revenue growth, the makeup of the labor market is also changing, with more individuals accepting part-time employment and contracting-type work instead of full-time, benefitted employment. This shift, which historically would have been considered as being driven by the economic cycle (i.e. part-time employment goes up during a recession and goes down when the economy is in a boom), is looking more and more as though part-time employment isn't just a business cycle issue, but rather something inherently to do with a new labor market structure. This impacts revenue growth because part-time employment is generally not associated with as much income as full-time employment, even though a part-time employee counts as the same type of employee as a full-time employee when unemployment rate statistics are calculated.

Overall, the short-term outlook for the Education Fund is quiet optimism, with downside risks associated with uncertainty related to the Affordable Care Act, shifting income sources, federal budgeting decisions, and the fragile nature of the current recovery outweighing potential upside risks from improving household and corporate balance sheets.



Legend: Orange indicates low part-time employment, while blue is indicative of high part-time employment. High part-time employment is generally associated with poor labor market conditions.
Source: Current Employment Survey, BLS

Personal Income Components

	Calendar Year					Growth			
	2005	2008	2012	2013	2014	2005-2008	2005-2012	2005-2013	2005-2014
PI: Wage & Salary Disbursements	40,934.3	50,748.8	54,847.8	57,480.4	60,526.9	24.0%	34.0%	40.4%	47.9%
PI: Other Labor Income	10,377.0	12,383.8	14,149.0	14,614.6	15,192.5	19.3%	36.3%	40.8%	46.4%
PI: Transfer Payments	7,936.8	10,304.0	13,902.0	14,330.6	15,123.3	29.8%	75.2%	80.6%	90.5%
PI: Proprietors Income	6,760.3	7,682.3	8,380.3	8,847.9	9,472.9	13.6%	24.0%	30.9%	40.1%
PI: Interest Income	6,872.8	10,027.2	7,054.9	7,080.5	7,478.1	45.9%	2.7%	3.0%	8.8%
PI: Dividend Income	3,864.7	5,684.0	5,380.8	5,533.0	5,992.6	47.1%	39.2%	43.2%	55.1%
PI: Rental Income	1,241.0	1,680.6	3,288.3	3,679.3	3,865.8	35.4%	165.0%	196.5%	211.5%
PI: Gov. Soc. Ins.	-6,457.0	-7,900.3	-7,862.8	-8,995.9	-9,440.2	22.4%	21.8%	39.3%	46.2%

Part B: Economic Indicators

B1 Review of the Economic Indicators

Nonagricultural Employment

Employment is growing, although at a slower pace than originally anticipated. Indicators were revised down from May estimates by 0.1 percent for 2013 and by 0.6 percent for 2014 with growth now expected to be 3.3 percent and 3.0 percent respectively.

Nonagricultural Wages

The average annual wage in the State was $40,651 in 2012, an increase of 2.4 percent over the prior year. Growth is expected to slow in 2013 with an estimated 1.4 percent growth rate anticipated. This translates to an average annual wage increase of $532 in 2013. The estimated 2.2 percent increase in 2014 translates to a $905 increase in wages.

Retail Sales & Total Taxable Sales

Retail sales grew by 8.1 percent in 2012 as consumption accelerated ahead of recent federal tax changes. The growth is expected to moderate in 2013 to 4.6 percent and 4.5 percent in 2014. The universe of taxable transactions (all taxable sales) grew by 7.8 percent in 2012 and is expected to grow by 4.0 percent and 4.2 percent in 2013 and 2014. The projected 2013 and 2014 retail sales and all taxable sales growth rates are below the 1980-2012 yearly average growth rates of 5.4 percent for retail sales and 6.4 percent for total taxable sales.

New Automobiles and Truck Sales

Sales of new automobiles and trucks ended 2012 at an 18.4 percent year over year growth rate as the market continued to rebound from the deep contraction. The market is anticipated to continue growing, with 9.5 percent and 4.9 percent annual growth rates anticipated for 2013 and 2014.

Home Prices

Housing prices continue to improve with expected growth for 2013 and 2014 at 7.3 percent and 5.7 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 slower than expected.

Dwelling Unit Permits

Dwelling unit permits ended 2012 at 13,500 units, an increase of about 34 percent over the 10,000 authorized in 2012. Residential permits are anticipated to continue to grow, but at slower rates than anticipated in May with 13,000 anticipated in 2013 and 14,000 in 2014. The net decrease from May estimates for 2013 and 2014 is 6,500 units.

Residential Permit Value

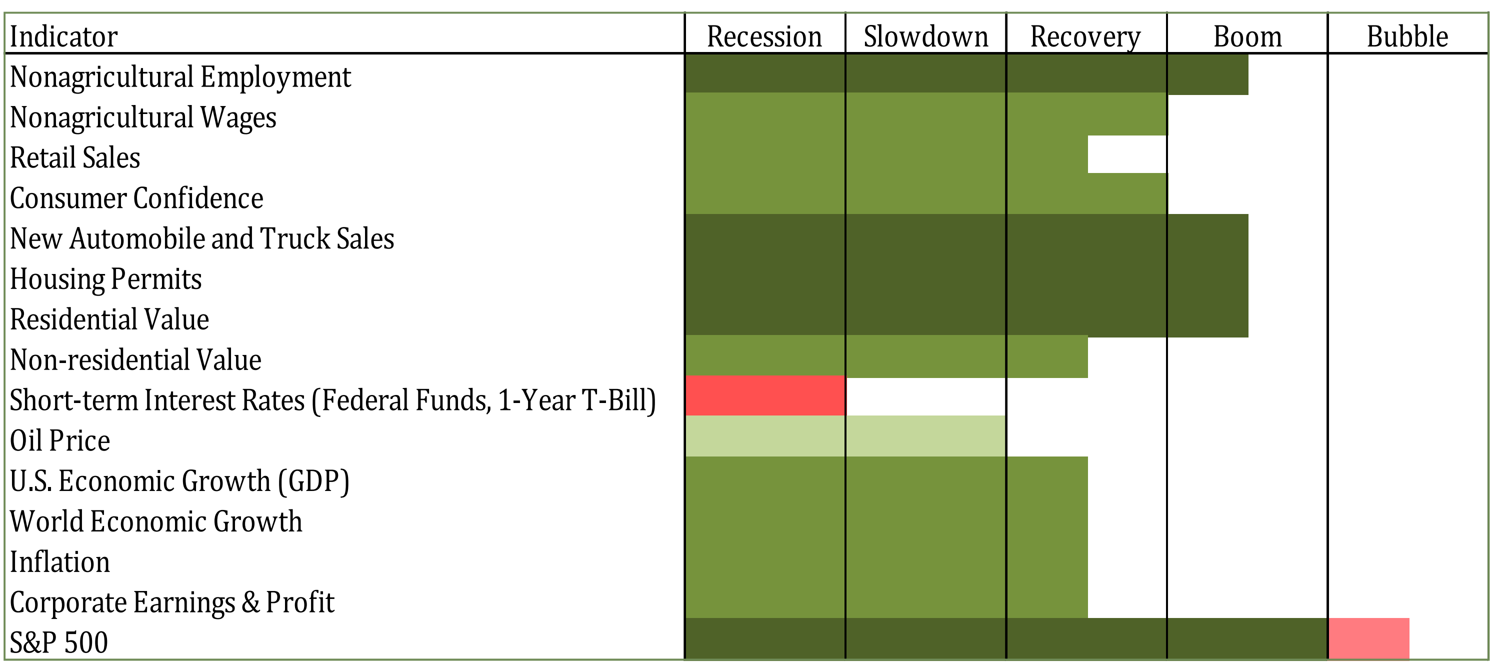
Correlated with dwelling unit permits is residential permit value. Total residential permit value bottomed out at $1.7 billion in 2010. Since then, permit values have grown quickly, with total permit value expected to reach $3.3 billion in 2014.

Nonresidential Permit Value

Nonresidential construction is expected to decline further in 2013 to $900 million from $1.1 billion in 2012 because of current commercial real estate market conditions. The 2013 estimates are down $100 million from May indicators. Nonresidential construction is anticipated to grow to $1.1 billion in 2014, down $200 million from May estimates.

U.S. Macroeconomic Indicators

Among the relevant macroeconomic indicators that influence state revenue are equity markets, oil and natural gas prices, gross domestic product (GDP), U.S. interest rates, and U.S. employment. Overall, the baseline case for these indicators is consistent with moderately positive economic growth, with GDP expected to grow by 2.6 percent in 2014, U.S. employment expected to add 2.3 million workers (1.7 percent), and interest rates expected to increase to 2.9 percent and 4.6 percent respectively (10-year, 30 year mortgage).



LABOR FORCE PARTICIPATION

Since the beginning of the 2008 recession, the U.S. labor force participation rate has dropped from an average of approximately 66 percent to a current low participation rate of around 63 percent.

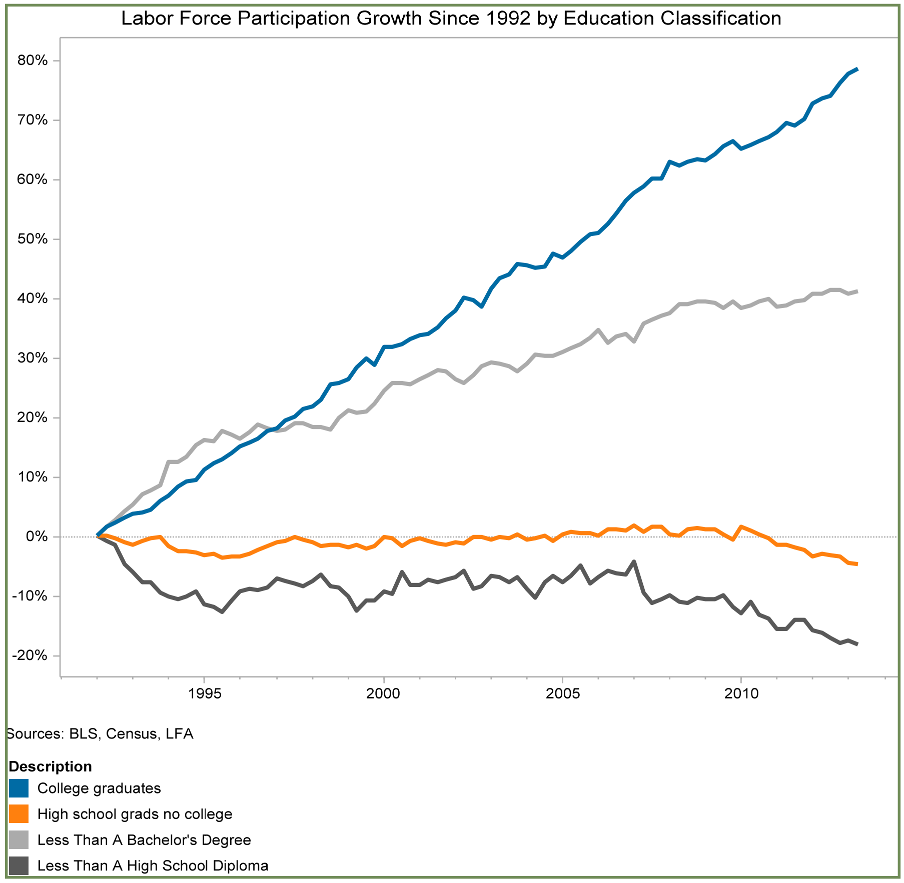
Participation rates for states with larger populations of young people, as well as those with populations near retirement typically fluctuate more. Utah's participation rate declined significantly since the start of the recession, primarily due to its population of young workers who were hit hard during the recession. Younger workers tend to have a more difficult time finding jobs and many have stayed in school during the recession. For example, Utah's annual labor force participation rate was 54.7 percent for those ages 16-19 in 2007. By the end of 2011, that rate had fallen to 42.4 percent. As of August 2013, the Utah labor force participation rate stands at 68.0 percent - down from 72.6 percent in January 2007.

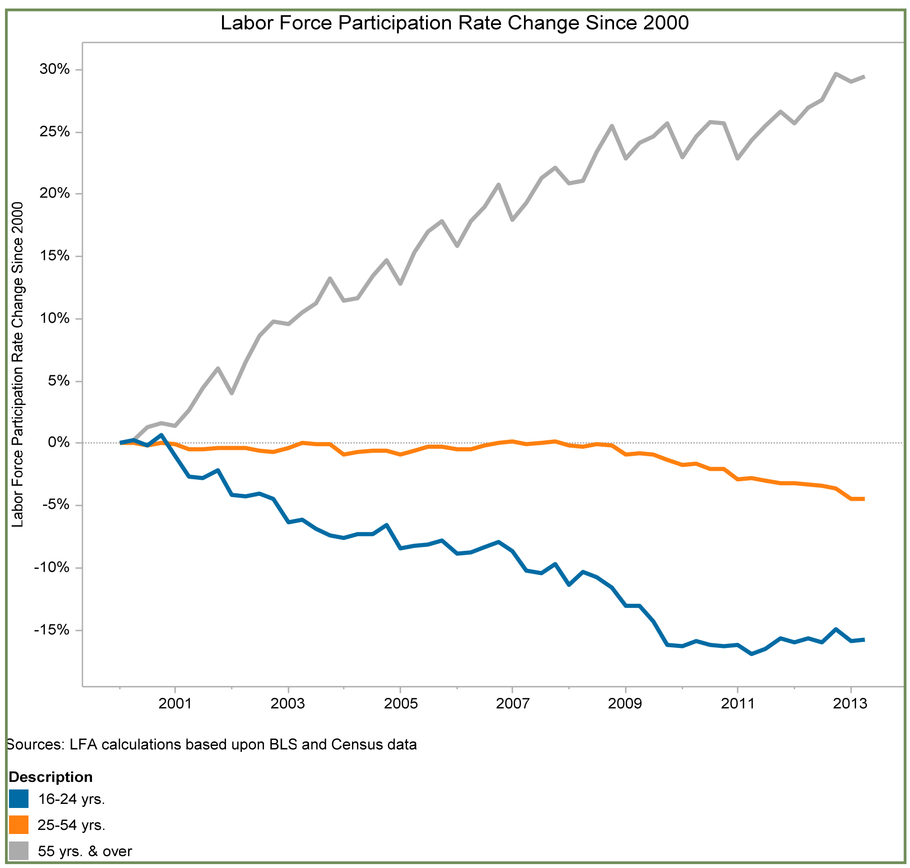
Labor force participation is divided into three groups: 1) the young, ages 16-24; 2) prime, ages 25-54; and 3) older, ages 55 and above. Several factors influence the labor force participation rate including discouraged worker status, the decision to participate in higher education, and changing demographics.

Nationally, three factors have affected labor force participation: 1) the proportion of individuals attending school is up 0.9 percent; 2) the proportion of individual collecting disability insurance is up 0.7 percent; and 3) the proportion of retirees is up 0.8 percent.

Another factor affecting labor force participation rates is the discouraged worker effect. The federal government only counts individuals looking for work as unemployed. The drop in labor force participation nationally due to the discouraged worker effect accounts for most of the net drop in unemployment over the past three years, with discouraged workers aged 16-24 increasing by 4.5 percent during the recession while discouraged workers over 55 decreased by 1.9 percent.

In terms of the make-up of the labor force, a greater portion is now made up of older workers than in 2000 (bottom right chart). Additionally, the labor market has developed an education bias, with individuals with higher college education growing more quickly than any other education classification. This comes at a time when the return to a college education is being competed away by an increased supply of college educated workers.





Labor Market Comparisons Across Geographic Boundaries

The labor market is becoming more mobile, with evidence showing up in employment growth by state by industry. The maps to the right represent employment growth by industry by state from 2010 to 2013. In most cases, the maps show that businesses in Utah are generally outperforming businesses located in other states.

In the Financial Activities sector, businesses located in Utah are up 7 percent, or an employment growth rank of 9th.

In the Education and Health Services sector, businesses are up almost 8 percent, putting this sector's employment growth in Utah in 9th place nationally.

In the Government Services arena, government employment is up almost 1 percent. Utah is one of only 12 states that have seen positive growth in government since 2010.

In the Information Technology sector, businesses in Utah are in first place, with employment in this industry up 16 percent since 2010.

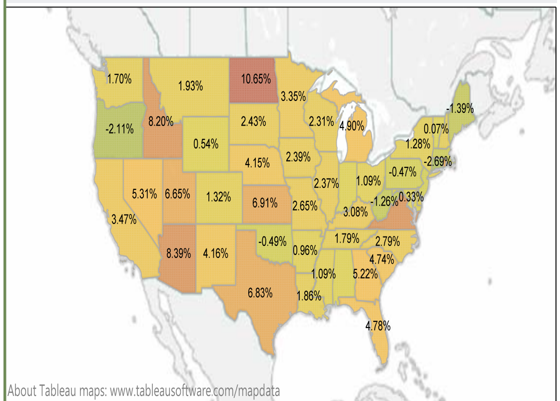
In the Leisure and Hospitality industry, businesses are in second place behind North Dakota, with employment growth at almost 13 percent.

In the Natural Resources sector, businesses come in in 6th place, with employment growth at about 13 percent.

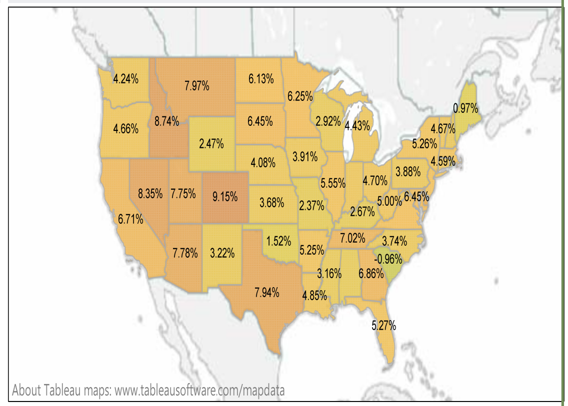
In the Professional and Business Services sector, businesses have added the 6th most jobs, or about 14 percent.

In the Trade, Transportation, and Utilities industry, employment is up 9 percent, placing businesses in Utah in 2nd place.

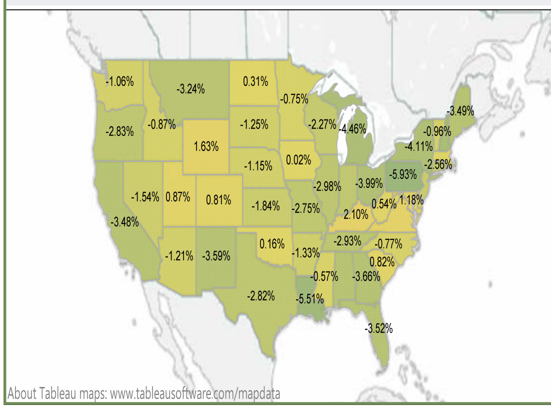
Financial Activities Employment, 2010 to 2013



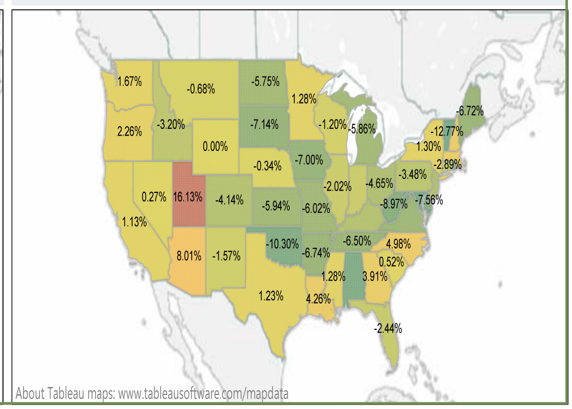
Education & Health Svcs. Employment, 2010 to 2013



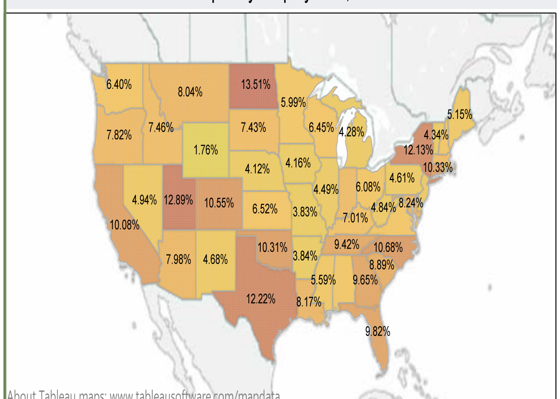
Government Employment, 2010 to 2013



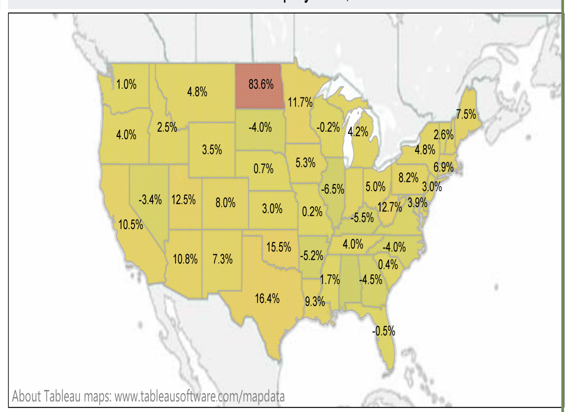
Information Employment, 2010 to 2013



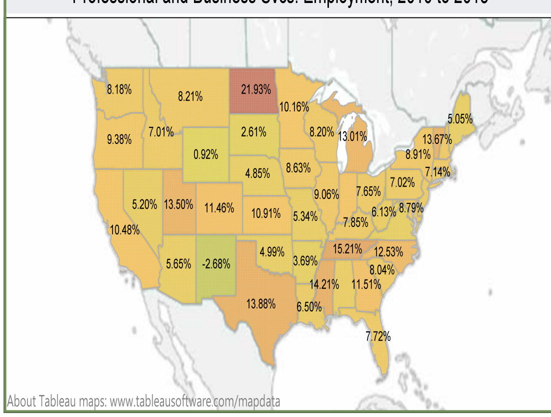
Leisure & Hospitality Employment, 2010 to 2013



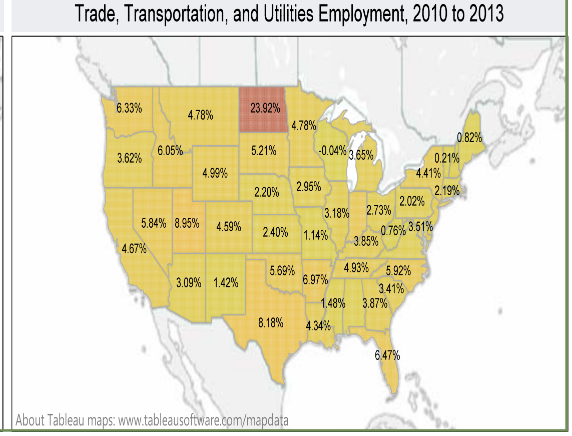
Natural Resources Employment, 2010 to 2013



Professional and Business Svcs. Employment, 2010 to 2013



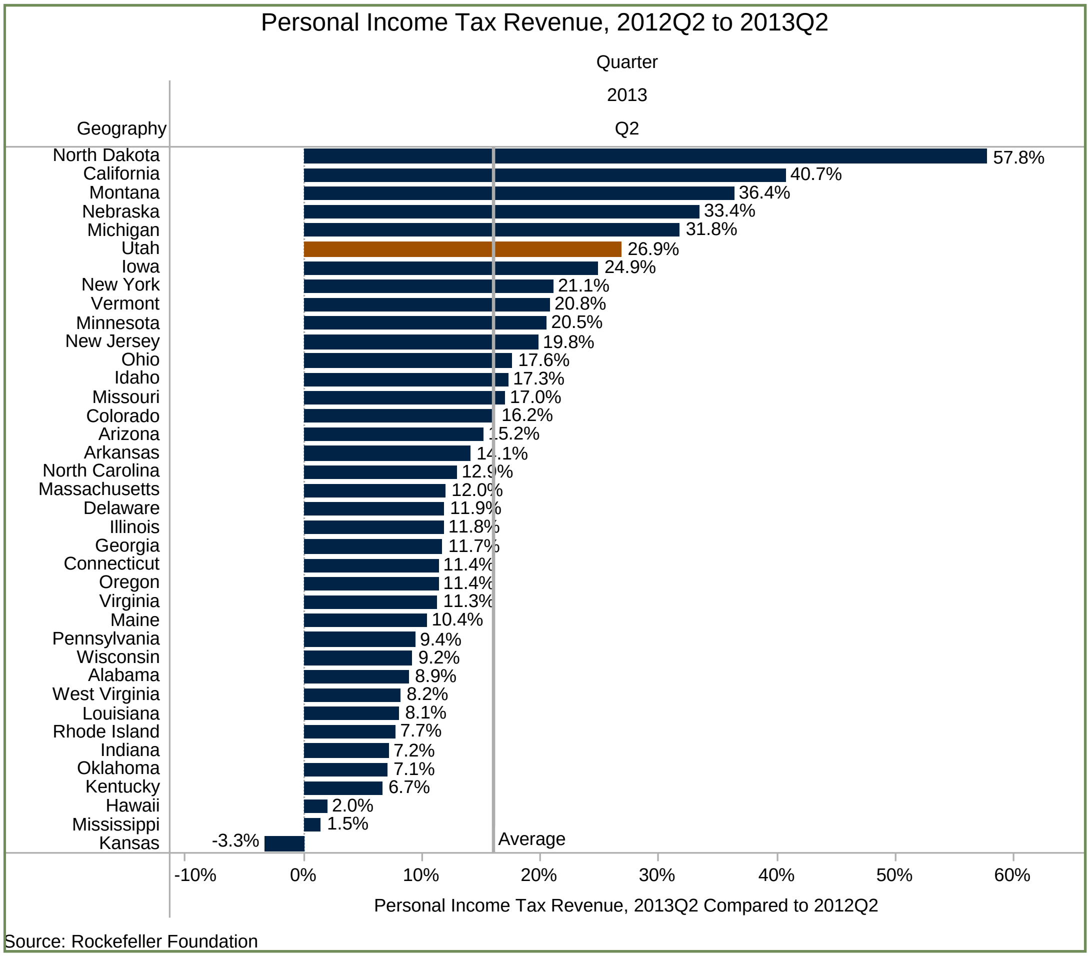
Trade, Transportation, and Utilities Employment, 2010 to 2013



B4 Interstate Comparisons of Net Final Pays (Tax Induced Changes)

Almost the entire FY 2013 revenue surplus is due to net final payments coming in higher than expected at $500 million, or about $250 million above 2012. When comparing personal income tax revenue through Q2 of 2013 to Q2 of 2012, Utah has the sixth highest growth rate at 26.9 percent. The states with higher personal income tax revenue are North Dakota at 57.8 percent, California at 40.7 percent, Montana at 35.4 percent, Nebraska at 33.4 percent, and Michigan at 31.8 percent. The approximately 20 percent total growth rate across states is higher than the historical 7.5 percent the Rockefeller Institute has.

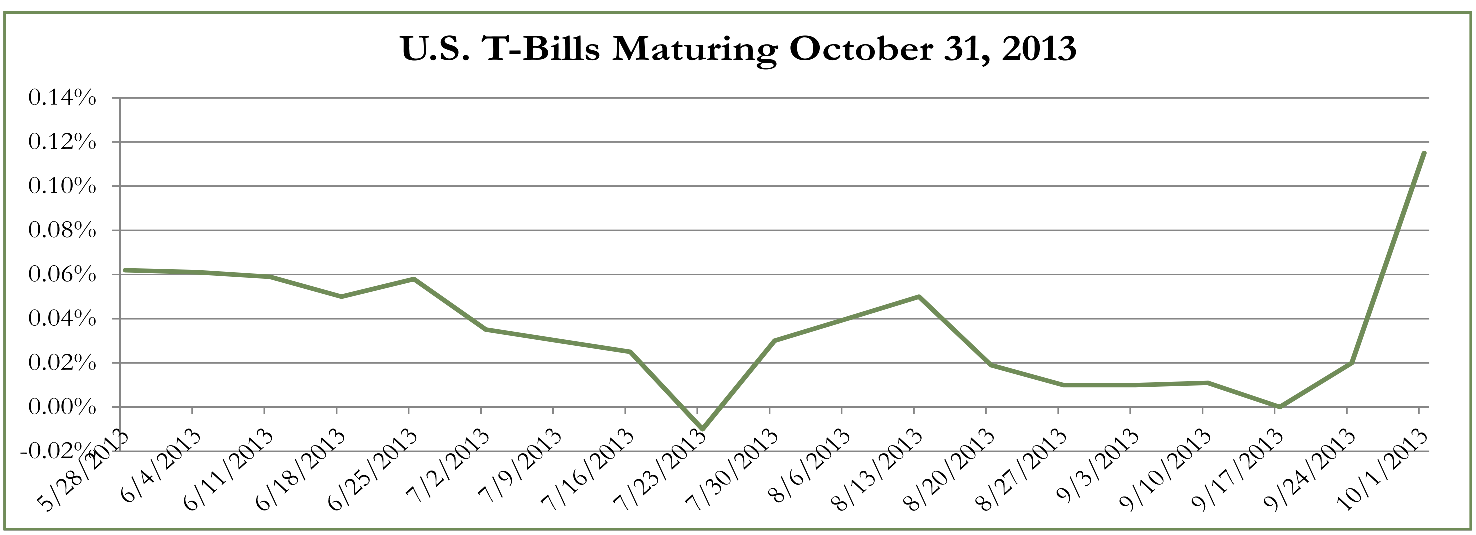
What is behind the spike in revenue? More than likely, most of the personal income tax growth is due to federal and (some) state income tax increases from 2012 to 2013, causing individuals to shift capital gains realization in 2012 rather than pay the higher 2013 tax rates.



Source: Rockefeller Foundation

B5 Risks to Revenue Forecasts

The baseline revenue forecast includes various downside risks to non-materialization. Some of the major macroeconomic risks include an emerging market or Chinese slowdown, a situation where inflation becomes a problem, the stock market enters a bear market, higher interest rates stymy the housing market recovery, a Middle East crisis creates oil price spikes that last for some time, federal debt induces a panic, and consumers and businesses lose confidence in their economic outlook.



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Part C: Revenue Collections

Tax Revenue *(In Millions of Dollars)*	FY 2013 Final	FY 2014 Consensus	FY 2014 Consensus Growth Rate	FY 2013 Year-to-Date (9/30/2012)	FY 2014 Year-to-Date (9/30/2013)	FY 2014 Year-to-Date Growth Rate
Sales & Use Taxes	$1,616.19	$1,683.23	4.1%	$427.51	$435.38	1.8%
Individual Income Tax	2,852.02	2,748.71	-3.6%	591.97	610.65	3.2%
Corporate Franchise Tax	338.20	285.45	-15.6%	71.54	57.27	-19.9%
Beer, Cigarette & Tobacco	120.86	119.06	-1.5%	23.90	24.34	1.9%
Insurance Premium Taxes	89.59	92.60	3.4%	20.84	25.37	21.8%
Severance Taxes	70.11	89.35	27.5%	16.44	22.01	33.9%
Other Sources	232.34	219.25	-5.6%	25.78	21.23	-17.7%
Total - General & Education Funds	**$5,319.31**	**$5,237.65**	**-1.5%**	**$1,177.98**	**$1,196.27**	**1.6%**
Motor Fuel Tax	$256.87	$250.70	-2.4%	62.79	55.56	-11.5%
Special Fuel Taxes	101.36	99.50	-1.8%	20.49	17.98	-12.3%
Other Transportation Fund	81.18	82.30	1.4%	18.66	19.20	2.9%
Total - Transportation Fund	**$439.41**	**$432.50**	**-1.6%**	**$101.94**	**$92.73**	**-9.0%**

Source: LFA, USTC, DOF