Revenue Update

Part 1: Tax Collections

We expect General/Education Fund revenues for FY 2010 to be below our latest estimates by $50 to $150 million based on current collection rates and economic indicators updated in June. The deficit is primarily centered on individual income tax revenue. We expect Transportation Fund revenue to be within a range of +$5 to -$10 million.

When all sources are combined the General Fund is currently below estimates with an expected range of $0 to -$50 million. Total Education Fund collections are expected to be $50 to $100 million below the February target.

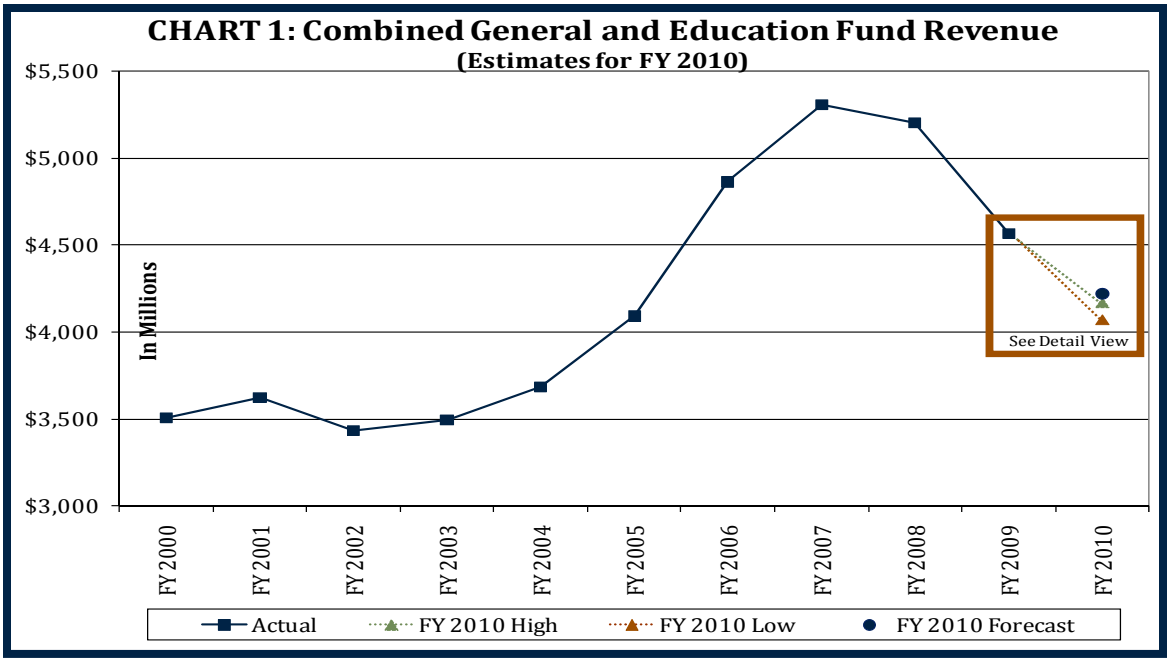
Although general economic conditions are moderating, consumers continue to struggle with wage constraints and stagnate committed expenses. We expect the abating recession to lead to below-trend growth in the coming fiscal years.

The State's economy and associated revenue collections are not likely to recover this calendar year. However, the lessening recessionary environment should moderate revenues in the coming fiscal year.

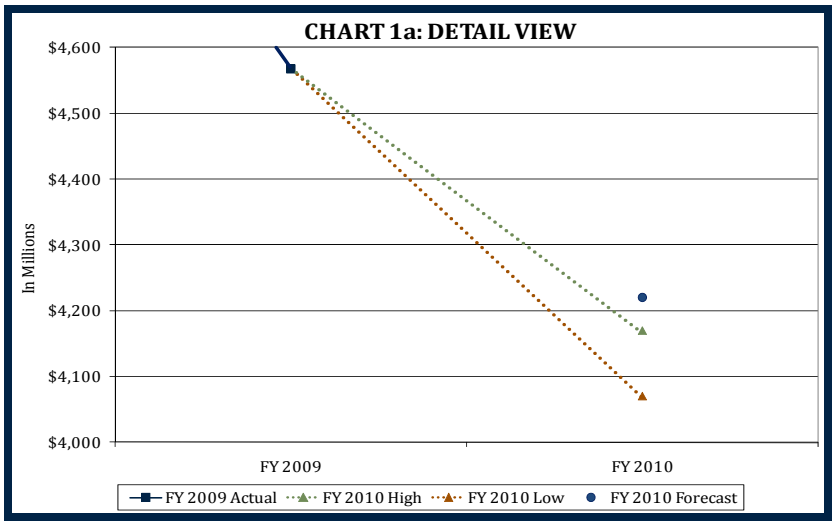
The biggest risks for the future continue to be factors which impact the consumer, i.e. the employment picture, credit availability and wage constraints. The consumer is essential for an economic recovery and any drag on income will slow potential growth.

On the up side, the housing market appears to be stabilizing, wages are showing improvement, and the labor market has reached bottom and is moving in a positive direction.

As staff we will continue to monitor income tax and corporate tax collections as we approach the end of the fiscal year. There is still some downside risk to both in the form of reduced liabilities as small businesses may not file until mid-October. Our final position within the -$50 to -$150 million range will depend greatly on corporate income tax—the most volatile of tax types.



Total General & Education Fund revenues for FY 2010 are expected to be $50 million to $150 million below the February 2010 Consensus revenue targets .



LFA
Legislative Fiscal Analyst

When all sources are combined the General Fund is currently below the February target with an expected range of $0 to -$50 million for FY 2010.

The consumer continues to act cautiously when it comes to spending. High debt levels are still being worked off and saving levels remain relatively high as compared to a couple of years ago. Continued concerns about job security and debt levels are expected to keep the consumer at bay when it comes to spending increases. As a result sales tax collections will continue to show flat to slow growth.

Sales tax collections are currently below target. Part of the reason sales tax is coming in under forecast is the inability to pay sales tax due. Historically, about 75% of sales tax due is paid on time. This year collections paid on time has dropped to 63%.

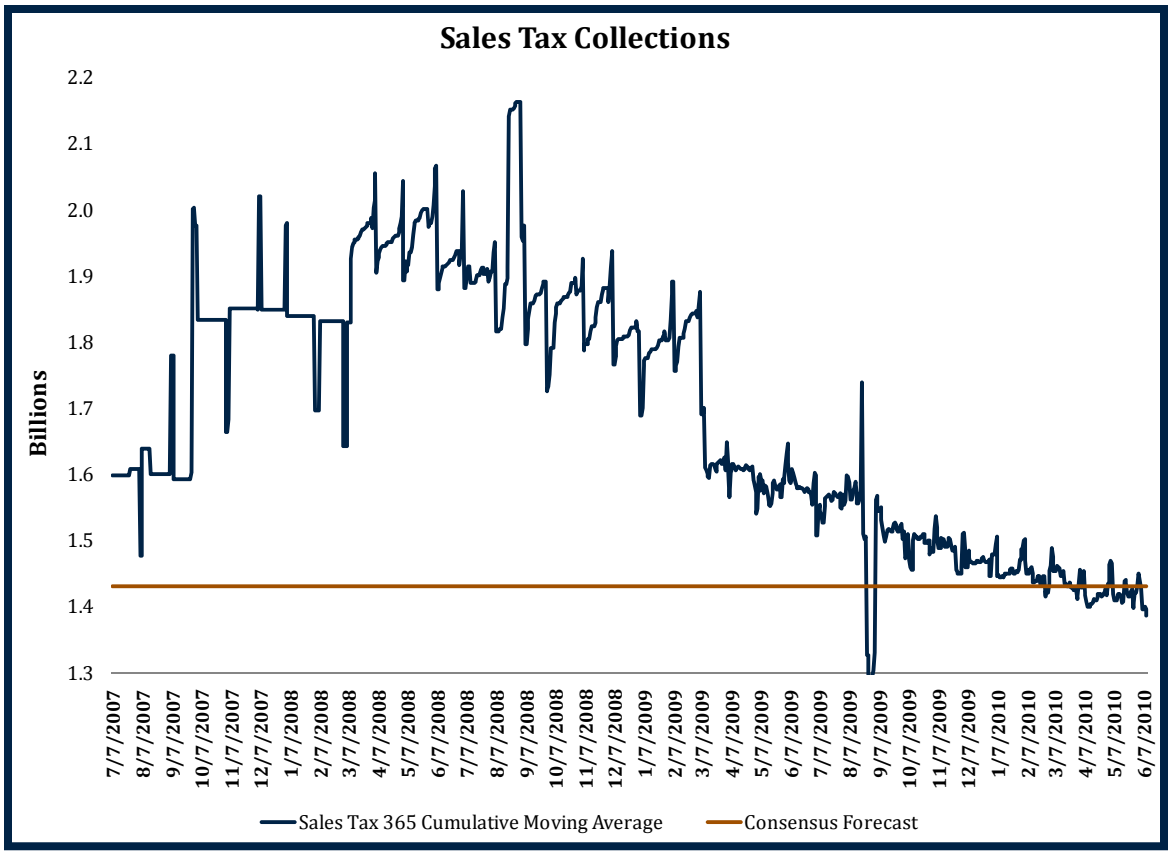
We expect a trough in sales tax collections to be reached in FY 2010, followed by below trend recovery. Taxable retail sales will remain below CY 2006 levels through CY 2011.

Inflation also impacts sales tax revenue. Prices affect sales tax revenue whenever revenue growth is linked to the price level. Prices appreciation has been the lowest in the past 46 years. The low prices have not induced consumers into non-planned consumption expenditures. As prices increase, consumers will spend less as long as constraints on income remain in place.

Insurance Premiums are coming in below targets. This is being driven by a number of factors, three of which are:

1. Self insuring on the part of firms;
2. Decreased demand by individuals;
3. Workers Compensation rate change.

Severance taxes are expected to come-in above target in FY 2010. However, they will not reach levels which would require a transfer to the trust fund.



Source: Utah State Tax Commission

Education Fund

When all sources are combined Education Fund collections are expected to be below targets by $50 to $100 million in FY 2010.

A higher than expected drop in final income tax payments is largely responsible for the Education Fund deficit.

The tax on wages represents the largest source of revenue to the Education Fund. In spite of slight growth in total wages, Income Tax collections continue to struggle. Among the factors influencing the decline in income tax liability are drops in the following:

- Sole proprietorship income
- Real estate and rental income
- Capital gains
- Bonuses

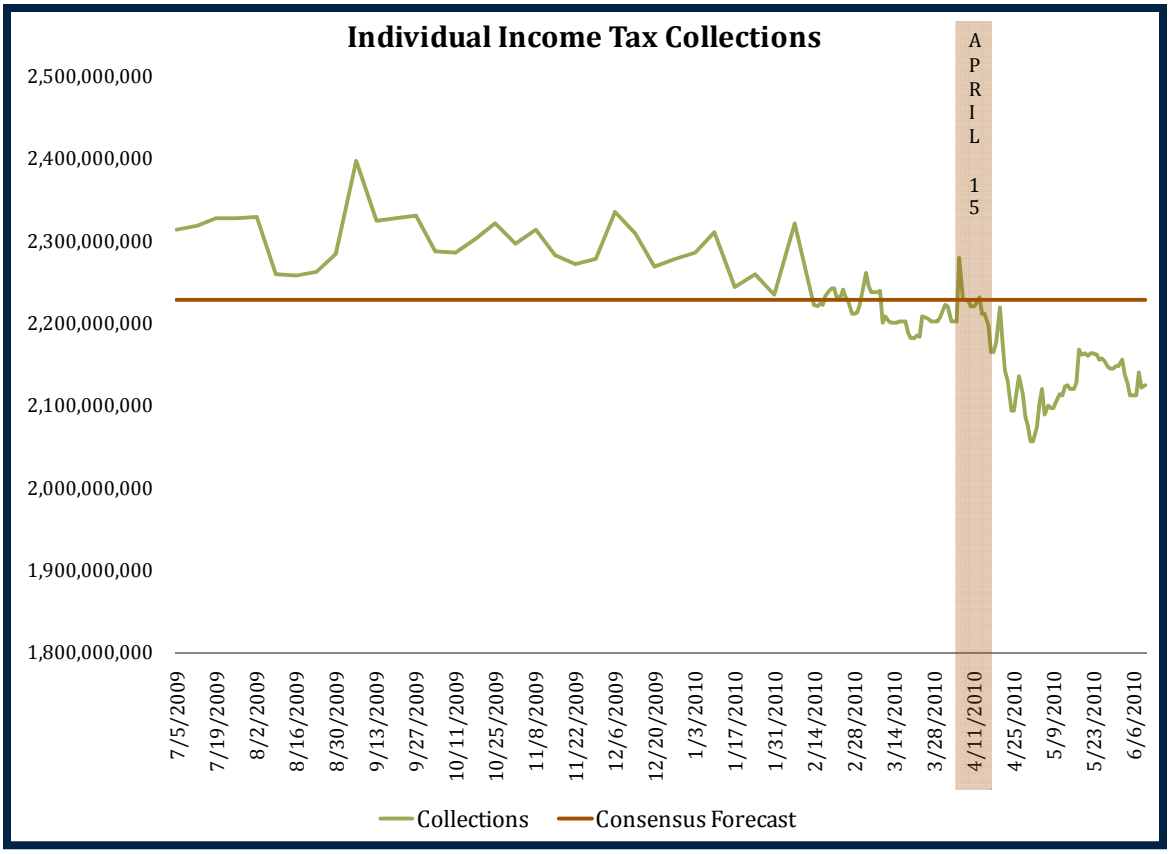
Liabilities are also being influenced by job losses, savings behavior, tuition related expenditures, depreciation, demographic changes and other federal tax changes.

Corporate income tax revenue is coming in above target. One of the key drivers for improved corporate profitability has been the reduction of labor costs. Some of the State's largest employers continue to impose hiring freezes as they remain cautious due to instability in the global markets and the banking sector.

The impact of the recession on businesses has varied by type and size of the business. The current downturn has encompassed all sizes of businesses, but it has been especially concentrated among smaller businesses. Since smaller firms are generally responsible for new job creation, the recent job declines likely mean slower job creation in the months ahead.

There is also some downside risk to corporate tax collections from small businesses due to the fact that they may have the ability to write off additional expenses and carry forward losses.

We will not know the impact on tax revenues due to these companies until October as they file annually.



Source: Utah State Tax Commission

WAGES & EMPLOYMENT

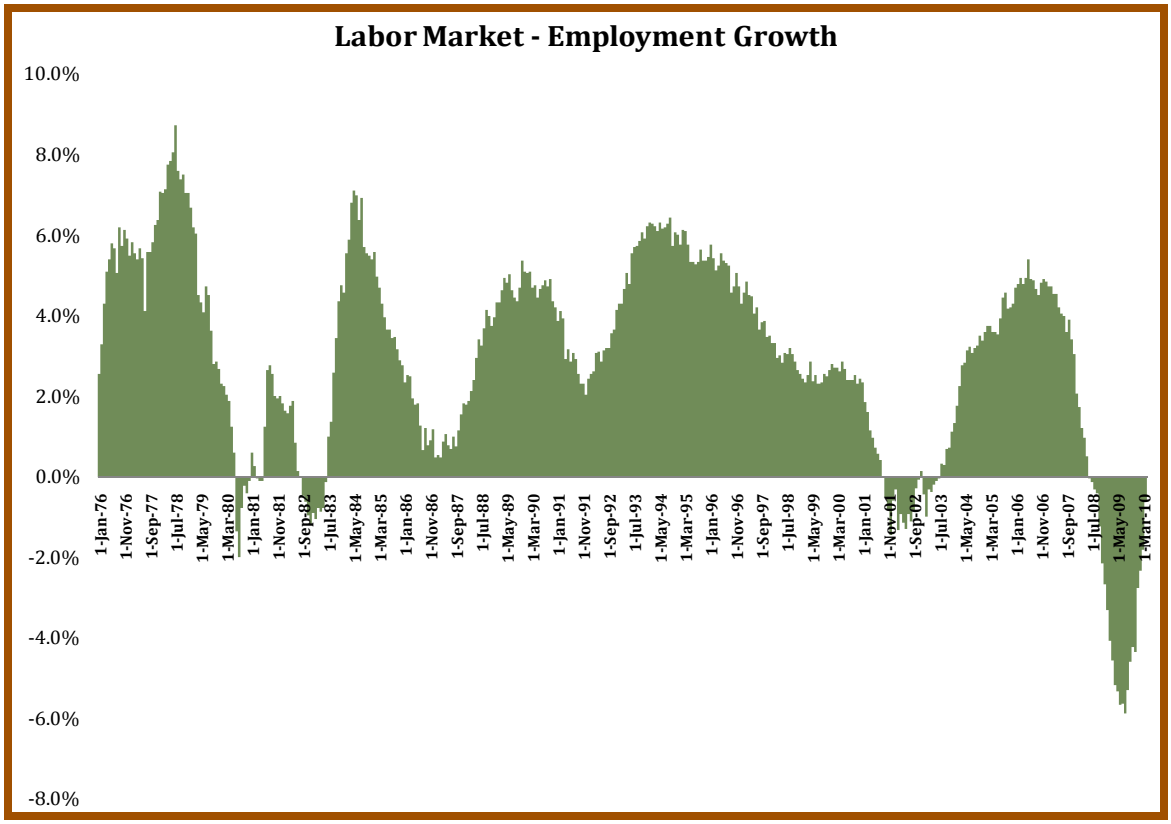
The current economic downturn in the labor cycle, began with 25 months of decreasing but positive employment growth, and followed by 23 months of consecutive negative employment growth. Of importance for revenues is that recoveries include months of negative employment growth that are subsequently followed by below trend positive employment growth. From December 2007 to February 2010 the number of seasonally adjusted jobs lost was approximately 84,300.

Total wages have declined in all industries except utilities, education services, health service, and government (federal and local). The State, in comparison with the nation, entered the wage recession later and has experienced a more severe withholding downturn than the federal government. Employment has also experienced both structural and cyclical downward pressure.

While there are signs of a modest recovery in employment, the progress is slow and U shaped. In fact, most of the job gains shown in the last national labor report were due to temporary Census workers while the private sector added fewer jobs than anticipated.

Nationally, 125,000 new jobs are needed each month to keep up with population growth and prevent the unemployment rate from rising. In the State, we estimate 2,100 monthly jobs are necessary to prevent a further eroding of the unemployment rate.

Contributing to current labor market problems is the fact that companies are currently enhancing employee productivity and profits by cutting costs and decreasing employee pay and hours. Productivity — the amount of output per hour of work — rose at a seasonally adjusted annual rate of 2.3 percent in the first quarter of CY 2010. At the same time labor costs fell at a seasonally adjusted annual rate of 1.1 percent. The productivity and unit labor cost numbers are not indicative of a typical business cycle recovery, and are correlated with continued downward labor market pressure.



Source: Utah Department of Workforce Services

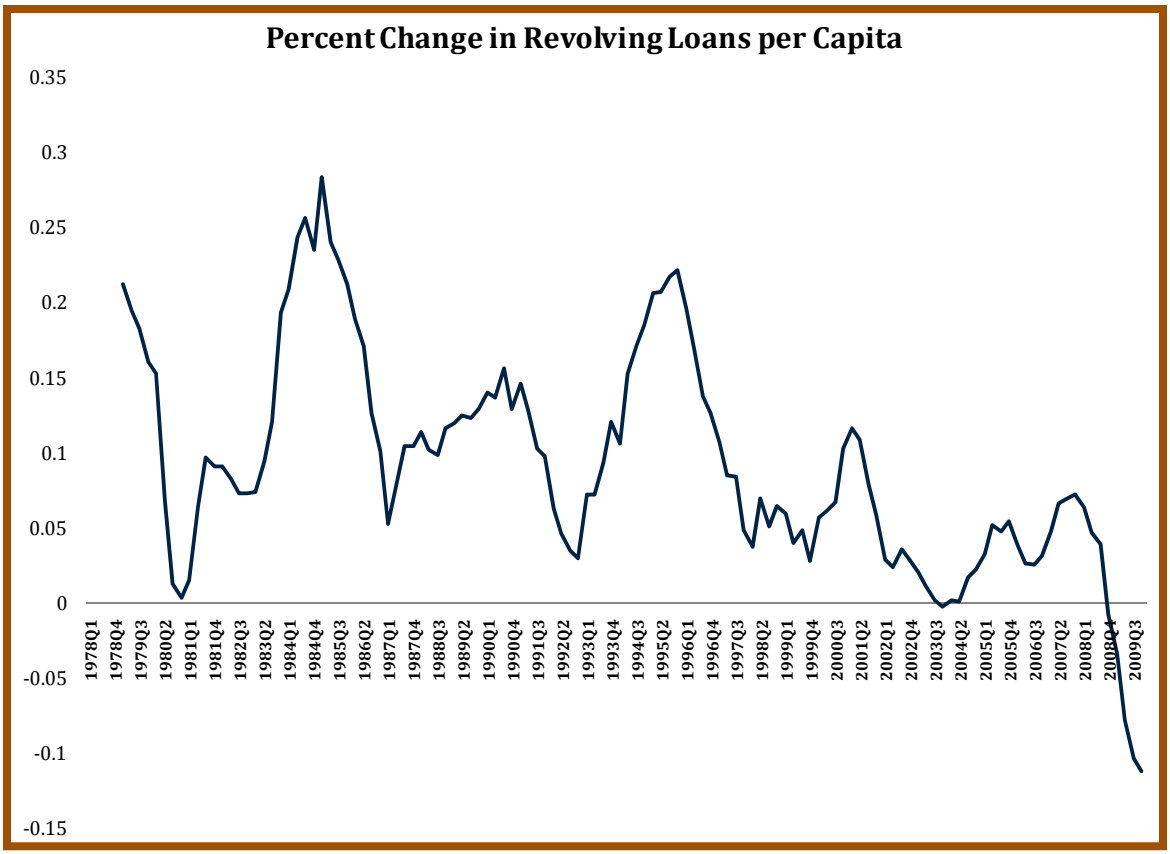
Credit Constraint: Business & Consumer

Consumers appear to be struggling with falling wages and higher living expenses. Personal incomes have declined due to lower wages and reduced working hours. Concerns about financial stability have led consumers to be cautious in their spending.

One of the key issues facing both the consumer and the business sector is the continued tightness of the credit markets. A lack of private sector credit is a key reason for employers to act cautious when it comes to hiring. The private sector credit market is the weakest since the Great Depression. Revolving debt which includes credit card borrowing has experienced 19 consecutive months of decline.

Consumer confidence has also declined. Net worth is down and, as a result, consumers are spending less and saving more. Consumer spending historically accounts for over two-thirds of U.S. economic activity. As consumers continue their reluctance to spend, the state could see a continued drag on sales tax growth.

Small businesses are particularly vulnerable to the credit crunch. Small companies do not have the access to capital markets that large corporations do. As a result, their sources of external financing are limited. As these sources shrink, small businesses are adversely affected. Without access to loans and credit lines, businesses cut back on new inventory and manufacturers cut back on production.



Source: Federal Reserve Bank, Utah Population Estimates Committee

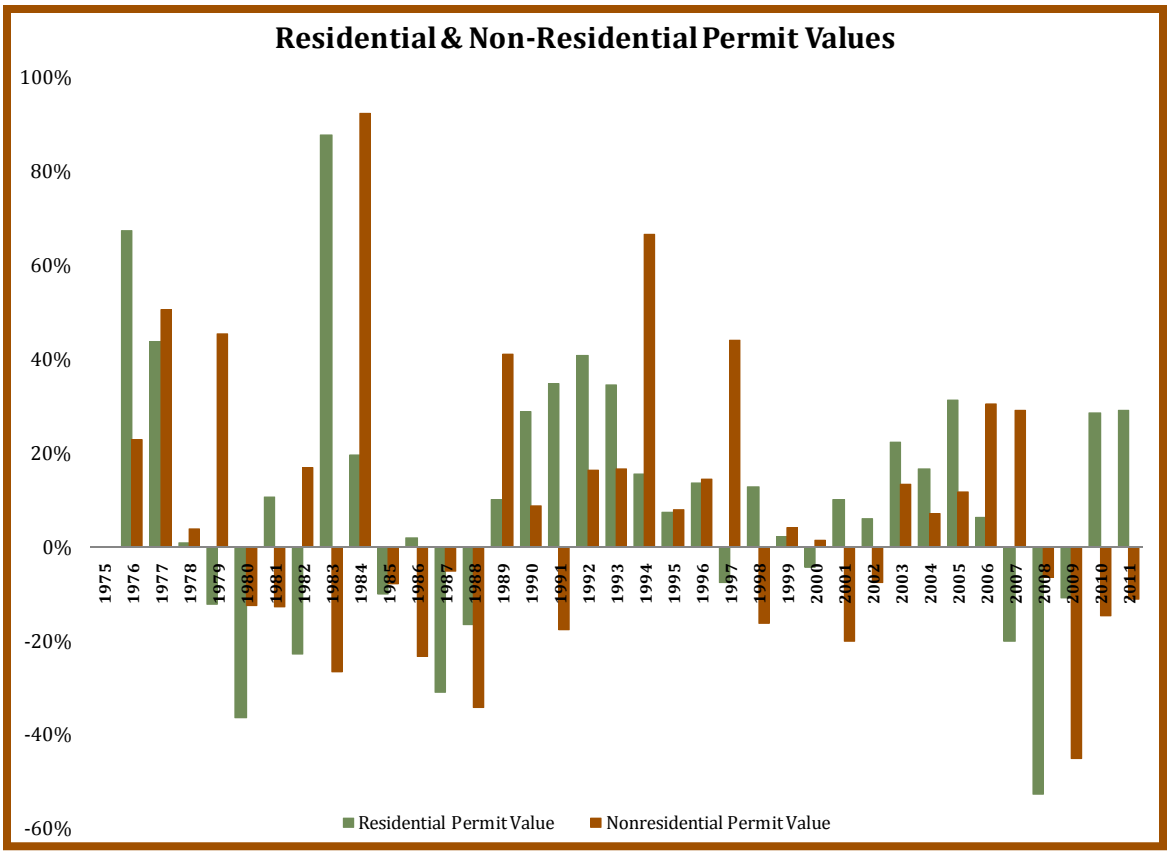
Construction

The construction sector remains under pressure. A key issue facing the commercial real estate or non-residential markets is a cycle of refinancing which will occur during the next few years. Typically, commercial real estate loans are made for a period of 5-10 years in length. Many loans which were made at the height of the real estate market's valuation are coming due in the 2010-2013 period. With valuations significantly lower and credit availability significantly tighter the ability to refinance these loans will be problematic.

Another drag on the construction sector is the difficulty builders have getting land and construction financing. Excess capacity and rising vacancy rates will probably result in further declines in non-residential construction in CY 2010. The value of permit authorized nonresidential construction will likely drop to $900 million in CY 2010 compared to the CY 2007 peak of $2.1 billion. The loss of Utah jobs in 2009 has hurt the demand for office, retail and industrial space . The rebound for nonresidential construction will likely not occur until beyond CY 2011.

Residential construction is beginning to show some growth with 12,000 new units expected in CY 2010. New housing starts still face serious pressure, but the recent drop in the number of homes for sale may be enough to maintain modest increases in residential construction spending. While new home construction has improved, the apartment and condominium construction (multifamily sector) has struggled in CY 2010.

The housing market continues to be under pressure due to the depreciation of housing prices. As a result of the housing price depreciation, an individual who owned a $250,000 home in 2007 now owns a home worth about $220,000. Additionally, 21% of homeowners have negative equity in their home. The involuntary defaults and strategic defaults of underwater homeowners remain a risk to the U.S. and Utah recovery.



Source: University of Utah Bureau of Economic and Business Research

As predicted, the state continues to be affected by national parameters of economic growth. Four issues appear to be on the forefront of concern: first, government and consumer debt and deleveraging; second, slow growth; third, income and employment rigidities; and fourth, lack of confidence and uncertainty.

On the first issue: it's fairly simple to show the towering deficits in the coming decades. The more difficult question is when and to what extent budget deficits will trigger higher interest rates and subsequently slow growth. The answer for certain European countries is now. The fiscal policy actions taken to improve the longer term outlook come at a cost of short term growth. The result is a double-dip European recession that could affect the United States. Fiscal restraint on behalf of both governments and consumers is expected in the coming years (see Debt-Stabilizing table below).

The second issue, which is closely related to the fiscal situation, is slow growth. The easiest way to improve an economy's fiscal situation is to grow one's way out of it. Unfortunately, economic growth is likely to be slow with the probability of a recession in the next six months at 23%.

The third issue is labor market slack. Currently, the probability of having another labor market recession within the next three years is higher than the probability of the economy generating enough jobs to reach a 5% unemployment rate in the next three years. There is also a long term trend towards the use of contract employment, with about 35% of the current workforce falling into this category. The shift towards contract basis employment will affect consumption and savings behavior.

The fourth issue is uncertainty and lack of confidence. The table below represents International Strategy and Investing (ISI) institutional investor survey as of June 4th. As shown, the general uncertainty suggests economic growth and markets (and thus revenue) could move in either direction. It is not expected that economic growth will retract, but the possibility and effect of the uncertainty is real. Without an improvement in the confidence level, growth is likely to remain below trend.

ISI Institutional Investor Consensus

	Average	Low	High
Los Angeles			
U.S. Unemployment Rate in December 2011	8.80%	6.50%	14.00%
U.S. GDP Growth in December 2011	2.20%	0.00%	3.50%
Euro in December 2011	1.12	1.00	1.35
S&P in December 2011	1230	1000	1300
Chicago			
S&P in December 2011	1156	887	1400
How many jobs will be created in the next 12 months?	1.3m	0m	6m
How much will home prices change in 2011?	3%	-12%	15%

Debt-Stabilizing Primary Balance or Balance Needed to Bring Debt to Benchmark Level

Nation	10yr Deficit Cut Needed as a % of GDP	5yr CDS (May 31st)
Japan	13.4	90.0
UK	12.8	80.1
Ireland	11.8	232.4
Spain	10.7	218.8
Greece	9.0	663.2
US	8.8	37.0
Portugal	6.5	305.3
France	6.1	68.6
Italy	4.8	195.5
Australia	3.7	52.6
Germany	3.4	40.0
Korea	0.1	134.6

Source: International Monetary Fund

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Revenue Collections to Date (11 Months)

Tax Revenue *(In Millions of Dollars)*	FY 2009 Final	FY 2010 Budgeted	FY 2009 11 Mo. 6/14/2009	FY 2010 11 Mo. 6/14/2010	FY 2010 Budgeted Growth Rate	FY 2010 11 Mo. Growth Rate
Sales & Use Taxes	$1,547.47	$1,430.45	$1,450.63	$1,307.30	-7.6%	-9.9%
Individual Income Tax	2,338.59	2,228.93	2,188.67	1,985.39	-4.7%	-9.3%
Corporate Franchise Tax	268.87	216.80	237.56	224.98	-19.4%	-5.3%
Beer, Cigarette & Tabacco	60.61	53.15	56.73	52.63	-12.3%	-7.2%
Insurance Premium Taxes	82.98	86.25	79.80	75.04	3.9%	-6.0%
Severance Taxes	85.57	51.80	85.57	77.27	-39.5%	-9.7%
Other Sources	176.70	152.73	67.75	53.27	-13.6%	-21.4%
Total - General & Education Funds	**$4,560.79**	**$4,220.11**	**$4,166.72**	**$3,775.88**	**-7.5%**	**-9.4%**
Motor Fuel Tax	$235.48	$238.10	$214.72	$222.20	1.1%	3.5%
Special Fuel Taxes	101.23	92.25	94.18	86.04	-8.9%	-8.6%
Other Transportation Fund	80.35	79.90	65.89	66.01	-0.6%	0.2%
Total - Transportation Fund	**$417.06**	**$410.25**	**$374.79**	**$374.25**	**-1.6%**	**-0.1%**

Source: Legislative Fiscal Analyst, Utah State Division of Finance