

August 18, 2008

Review of General Fund Revenues and the Virginia Economy for Fiscal Year 2008

*A presentation to the Senate
Finance, House Appropriations,
and House Finance Committees*



Richard D. Brown
Secretary of Finance

Overview...

Fiscal Year 2008 Year-in-Review

- Economic Performance
- Actual General Fund Collections
- Financial Results

Current Economic and Revenue Trends

Accelerated Fall Forecasting Process

The U.S. Economy Was Slightly Weaker Than Anticipated In FY08...

- Growth in the national economy was just shy of last fall's forecast, with healthy growth in employment and income.

Summary of Key U.S. Economic Indicators Percent Change Over the Prior Fiscal Year

	<u>FY08 Forecast</u>	<u>FY08 Actual</u>
Real GDP	2.5	2.4
Employment	1.0	0.7
Personal Income	5.6	5.4
Wages & Salaries	4.9	4.7

- The sharper slowdown in hiring, primarily driven by the national housing recession and continuing credit problems, put downward pressure on wages.
- Employment gains for FY08 totaled only 41,000, down substantially from the 1.9 million jobs added on average over the prior four fiscal years.

In Virginia, The Economy Weakened More Than Expected Over The Course Of FY08...

- Employment and income are tracking below the official forecast for the year.
 - Employment growth was 0.9 percent, behind the official forecast of 1.1 percent growth.
 - FY08 had an increase of 33,900 jobs, 7,600 less than forecast.
 - Both personal income and its largest component, wages and salaries, are tracking below forecast.

Summary of Key Virginia Economic Indicators

Percent Change Over the Prior Fiscal Year

	<u>FY08 Forecast</u>	<u>FY08 Actual</u>
Employment	1.1	0.9
Personal Income	5.2	4.6 *
Wages & Salaries	5.2	3.7 *

* Estimate based on three quarters of actual data and one quarter of forecast.

- The slowdown in housing and higher energy prices had a significant impact on economic growth during the second half of the fiscal year.

FY08 Revenues Finished \$15.9 Million (0.1%) Above Forecast...

Summary of FY08 Revenue Collections (millions of dollars)

<u>Major Source</u>	<u>Forecast</u>	<u>Actual</u>	<u>Variance</u>		<u>Annual Growth</u>
			<u>Dollars</u>	<u>Percent</u>	
Withholding	\$ 9,010.9	\$ 8,933.6	\$ (77.3)	(0.9) %	4.3 %
Nonwithholding	2,870.8	2,861.2	(9.6)	(0.3)	2.8
Refunds	1,710.4	1,679.9	(30.5)	(1.8)	7.7
Net Individual	10,171.3	10,114.8	(56.5)	(0.6)	3.3
Sales	3,096.4	3,075.5	(20.9)	(0.7)	0.9
Corporate	699.1	807.9	108.8	15.6	(8.2)
Wills (Recordation)	495.5	456.3	(39.2)	(7.9)	(21.7)
Insurance	418.4	396.9	(21.5)	(5.1)	3.1
All Other Revenue	870.4	915.5	45.1	5.2	3.8
Total Revenues	\$ 15,751.1	\$ 15,767.0	\$ 15.9	0.1 %	1.3 %
ABC Profits	34.3	36.1	1.8	5.2	31.0
Lottery Profits	462.2	458.2	(4.0)	(0.9)	5.4
Sales Tax (0.25%)	228.8	226.7	(2.1)	(0.9)	0.7
Transfers	96.6	91.6	(5.0)	(5.2)	(30.9)
Total Transfers	\$ 821.9	\$ 812.5	\$ (9.4)	(1.1) %	(0.9) %
Total General Fund	\$ 16,573.0	\$ 16,579.5	\$ 6.5	0.0 %	1.2 %

- A slowdown in growth for most major revenue sources during the second half of the year was offset by a large surplus in net corporate income tax receipts.
- The FY08 forecast was the second most accurate estimate of the last 25 years, trailing only the FY00 forecast.

Payroll Withholding Collections Were \$77.3 Million (0.9%) Below the Official Estimate...

- Withholding receipts increased by 4.3 percent in FY08, the weakest annual increase since FY03 (the average of last four years was 6.9 percent).

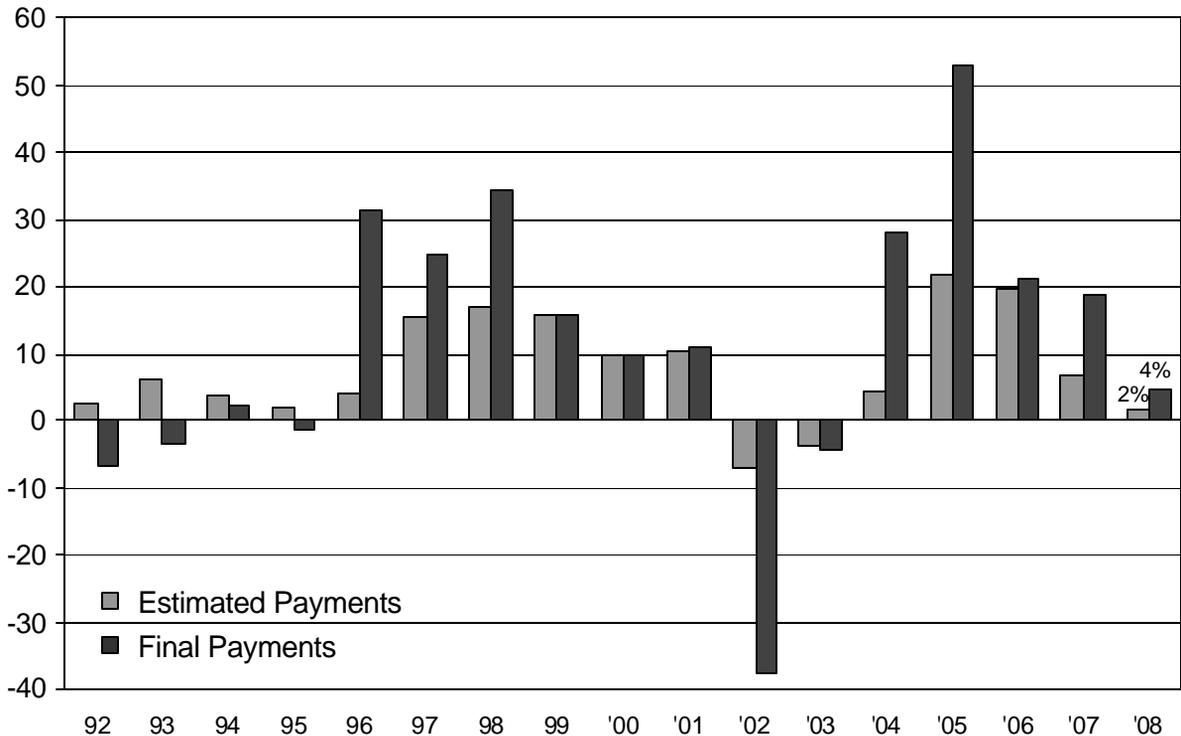
Large Withholding Payments by Sector FY07 compared with FY08 (millions of dollars)

Sector	# of Firms	FY07	FY08	% change
Public Administration	78	\$1,317.5	\$1,452.6	10.3%
Education and Health	187	632.6	698.4	10.4%
Federal Contractors	77	414.8	450.6	8.6%
Finance	81	225.9	211.5	-6.4%
Professional and Business	353	161.6	196.5	21.6%
Investment	114	117.2	132.3	12.9%
Trade	129	100.0	105.2	5.1%
Telecommunications	43	112.5	101.3	-10.0%
Transportation	31	100.8	99.2	-1.6%
Energy	27	81.6	90.8	11.3%
Housing	145	95.7	74.4	-22.3%
Other	298	272.3	277.7	2.0%
Total	1,563	\$3,632.4	\$3,890.4	7.1%

- Withholding payments from large companies – representing 44 percent of total withholding collections in FY08 – increased 7.1 percent in FY08.
 - Declines in the housing, telecommunications, and finance sectors were the exception.
- Firms paying the remaining 56 percent of withholding experienced only 2.2 percent growth in FY08.

Nonwithholding Payments Were In Line With The Annual Forecast...

Growth in Estimated and Final Payments, FY92-08
Percent Growth Over the Prior Year



- Total nonwithholding payments increased 2.8 percent in FY08, slightly below the annual forecast of 3.2 percent growth (the average of the last four years was 19.0 percent).
- Collections finished \$9.6 million below the annual estimate, with a shortfall in estimated payments partially offset by a small surplus in final payments.

Individual Income Tax Refunds Were \$30.5 Million Below The Official Estimate...

- Individual refunds increased 7.7 percent in FY08 compared with the forecast of 9.7 percent growth.

Individual Income Tax Refunds by Component (millions of dollars)

	<u>Forecast</u>	<u>Actual</u>	<u>\$ variance</u>	<u>% variance</u>
Base	1,395.9	1,423.4	27.5	2.0%
Land Preservation	220.0	155.9	-64.1	-29.1%
Low Income	94.5	100.6	6.1	6.5%
Total	1,710.4	1,679.9	-30.5	-1.8%

- The small surplus was directly attributable to lower-than-anticipated claims of the land preservation tax credit.
- Base refunds continue to reflect the weakening economy, increasing 6.6 percent in FY08.
 - Over the last two years, base refunds have increased about nine percent per year.
- The amount of land preservation tax credits not claimed in FY08 will have to be accounted for in FY09 and FY10 as the credits are still valid.

Sales Tax Collections Were \$20.9 Million (0.7%) Below the Official Estimate...

- Sales tax collections increased 0.9 percent in FY08, the weakest annual increase since FY03 (the average of last four years was 7.0 percent).

Large Sales Tax Payments by Sector FY07 compared with FY08 (millions of dollars)

Sector	# of Firms	FY07	FY08	% change
Housing	148	\$489.4	\$465.5	-4.9%
Department Stores	100	381.8	375.5	-1.7%
Warehouse Clubs/Supercenters	6	358.4	369.7	3.2%
Grocery Stores	18	275.8	288.7	4.7%
Retail Trade	86	226.3	232.6	2.8%
Restaurants	64	121.6	124.0	1.9%
Wholesale Trade	60	67.9	63.6	-6.4%
Gasoline Stations	13	50.4	48.2	-4.4%
Other	258	198.5	228.5	15.1%
Total	753	\$2,170.3	\$2,196.3	1.2%

- Housing-related taxable sales (21% of total) led the weakness in growth in FY08, declining 4.9 percent from FY07.
- Taxable sales from department stores and restaurants (23% of total), two sectors dependent on discretionary consumer spending, experienced no increase over FY07.
- Adjusted for higher food prices, sales at grocery stores, warehouse clubs, and supercenters (30% of total) were flat to negative in FY08 compared with FY07.

Corporate Income Tax Receipts Were Ahead Of Expectations In FY08, Finishing \$108.8 Million Above Forecast...

- Corporate income tax collections declined 8.2 percent in FY08 compared with the forecast of a 20.5 percent annual decline.
- The surplus in net receipts was attributable to unexpected growth in payments, specifically from companies involved with federal contracting and energy.

Large Corporate Payments by Sector FY07 compared with FY08 (millions of dollars)

Sector	# of Firms	FY07	FY08	% change
Federal Contractors	85	\$110.3	\$144.1	30.6%
Energy	59	51.1	76.0	48.9%
Tobacco	9	34.8	66.4	91.1%
Information	60	55.8	57.0	2.2%
Manufacturing	166	58.7	56.0	-4.7%
Professional and Business	184	40.0	52.2	30.7%
Telecommunications	46	87.0	49.4	-43.3%
Wholesale Trade	136	42.3	49.3	16.5%
Finance	64	62.4	42.5	-32.0%
Housing	160	85.3	39.7	-53.4%
Other	377	142.8	157.0	9.9%
Total	1,346	\$770.4	\$789.5	2.5%

- Taken together, large payments attributable to the housing and finance sectors declined 44.3 percent in FY08.

Recordation Tax Receipts Declined 21.7 Percent In FY08, Below The Official Forecast Of A 15.0 Percent Decline...

- Collections were \$39.2 million below the official forecast.
- From FY01 through FY06, recordation tax receipts increased with the boom in the housing market, growing an average of 20.6 percent per year.
- Over the last two years, the downturn in the housing market has resulted in declines in volume and prices.
 - Adjusted for increases in the average sale price, recordation tax collections finished at a level not seen since FY98.

Home Sales and Average Sale Price FY08 Percent Change over FY07

	<u>Home Sales</u>	<u>Average Sale Price</u>
U.S.	-17.0%	-5.3%
Virginia	-19.7%	-2.7%
Northern Virginia	-14.1%	-9.7%
Hampton Roads	-19.2%	1.6%
Richmond	-23.2%	-0.3%

Source: National Association of Realtors, Virginia Association of Realtors

- The average sale price in Northern Virginia is down over \$100,000 from the peak of \$525,000 reached in the third quarter of 2005.

July Revenue Collections...

Summary of FY09 Revenue Collections July

<u>Major Source</u>	As a % of Total Revenues	Percent Growth over Prior Year		
		<u>YTD Actual</u>	<u>C. 879 Estimate</u>	<u>Variance</u>
Withholding	59.1 %	15.0 %	6.4 %	8.6 %
Nonwithholding	19.0	16.8	6.9	9.9
Refunds	(11.1)	66.3	6.4	59.9
Net Individual	67.0	12.6	6.5	6.1
Sales	20.0	(4.0)	4.9	(8.9)
Corporate	4.4	(42.3)	(12.6)	(29.7)
Wills (Recordation)	2.4	(31.0)	(16.6)	(14.4)
Insurance	1.8	(100.0)	(25.7)	(74.3)
All Other Revenue	4.4	(19.7)	(22.9)	3.2
Total	100.0 %	2.9 %	2.0 %	0.9 %

- Withholding receipts included two additional deposit days accounting for about \$100 million.
- Sales tax collections fell 4.0 percent in July due to high energy prices and falling consumer confidence.
- Recordation receipts declined by over 20 percent for the ninth consecutive month.

The Current Economic Forecast Is Optimistic Given Recent Economic Developments...

Summary of Key Virginia Economic Indicators February 2008 Economic Forecast Percent Change Over the Prior Fiscal Year

	<u>FY08</u> <u>Actual</u>	<u>FY09</u> <u>Forecast</u>	<u>FY10</u> <u>Forecast</u>
Real GDP	2.4	2.0	2.9
Employment			
U.S.	0.7	0.9	1.3
Virginia	0.9	1.0	1.8
Personal Income			
U.S.	5.4	4.7	5.1
Virginia	4.6 *	5.4	6.2
Wages & Salaries			
U.S.	4.7	4.5	4.8
Virginia	3.7 *	4.8	5.9

* Estimate based on three quarters of actual data and one quarter of forecast.

- The official forecast expected a period of slower growth for the second half of FY08, with the U.S. economy avoiding a recession.
- Virginia was expected to grow near trend, with the downturn in housing a drag on growth.

The Latest Indicators Show That The U.S. Economy Is Struggling But Still Expanding....

- Recent data illustrate the weakness in the national economy:
 - Real GDP increased 0.9 percent in the first quarter and 1.9 percent in the second quarter of 2008.
 - This follows a slight contraction (-0.2 percent) in the fourth quarter of calendar year 2007.
 - Payroll employment has declined in all seven months of calendar year 2008, including losses of 51,000 in each of the last two months.
 - The national unemployment rate was 5.7 percent in July, up nearly a full percentage point from earlier in the year.
 - The ISM (manufacturing) index was 50.0 in July, consistent with an economy that is stagnant.
 - The national housing market remains depressed, interest rates are on an upward trend, and financial markets continue to decline.

In Virginia, Current Economic and Revenue Trends Do Not Support the Official Forecast....

- The three-month moving average growth rate for withholding through July is 1.6 percent, well below the 6.4 percent growth rate required to meet the annual estimate for FY09.
 - Over the last three months, employment growth in Virginia has averaged only 0.3 percent.
- Sales tax collections fell 3.1 percent during the second half of FY08, the worst 6-month performance since the 6.4 percent decline in the second half of FY91.
 - Higher sustained energy prices and interest rates are adversely affecting sales tax receipts.
- Year-to-date, the S&P 500 index is down about 12 percent. The official forecast assumed a 2.7 percent increase in the index.
- Large corporate payments from the housing, finance, and investment sectors represented 8 percent of total payments in the fourth quarter of FY08, down substantially from the 19 percent they represented in the same period last year.
- Pending home sales, a leading indicator of future closings, point to a continued slump in housing.

Based On Recent Revenue Trends, The Governor Will Accelerate The Fall Forecasting Process...

- The Governor's Advisory Board of Economists will meet in early September to review the updated economic forecast for the U.S. and Virginia.
- The Governor's Advisory Council on Revenue Estimates will meet in late September to consider revised revenue forecasts for the current and next biennium.

Key Risks for the Fiscal Year 2009-10 Forecast...

- Key factors will influence economic and revenue growth:
 - Energy costs
 - Housing market
 - Stock market volatility
 - Defense and federal procurement spending
 - International events

Appendix

Fiscal Year 2008 General Fund Collections: Actual and Forecast

December Standard and Official General Fund Forecast for Fiscal Year 2009 and Fiscal Year 2010

Growth in Total General Fund Tax Revenues, Fiscal Years 1961 to 2008

Revenue Stabilization Fund, History and Forecast

General Fund Balance Sheet, Fiscal Year 2008

June 2008 Revenue Report

July 2008 Revenue Report

Note:

The General Fund Preliminary Annual Report, August 15, 2008, is available at the Department of Accounts Web site (www.doa.virginia.gov).

This presentation is available at the Secretary of Finance Web site (www.finance.virginia.gov).