

Governor Kaine's Proposed Amendments to the 2008-2010 Budget

Economic Outlook & Revenue Forecast

*A Briefing for the Senate Finance,
House Finance, and House Appropriations
Committees*

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Outline...

- FY 2008 Year-in-Review
- October Revenue Forecast
- U.S. and Virginia Economic Outlook
- December Revenue Forecast
- November Revenue Collections
- Next Steps

FY 2008 General Fund Revenues Finished \$15.9 Million (0.1%) Above Forecast...

- 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 FY 2008 forecast was the second most accurate estimate of the last 25 years, trailing only the FY 2000 forecast.
 - The 25-year average forecast variance is ± 1.5 percent

Summary of FY 2008 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 %

Both the U.S. And Virginia Economies Weakened More Than Expected Over the Second Half of FY 2008...

- U.S. employment declined every month, shedding 461,000 jobs from January to June, compared with the forecast for slower growth.
- Oil prices spiked near \$140 barrel in late-June/early-July, 67 percent higher in the second quarter of 2008 than the forecast of \$70 per barrel.
 - Consumer confidence declined to recession levels.
- Financial markets declined instead of stabilizing.
- Unemployment claims increased dramatically from expectations.
 - 320,000 in January, 400,000 by July, 450,000 as of August
- The housing industry collapsed as delinquencies increased, driving down home prices.

Based On the Deteriorating Economic and Revenue Trends, The Governor Accelerated The Fall Forecasting Process...

- The October revenue forecast was the outcome of a major consensus process that included industry experts, academic economists, business leaders, and members of the General Assembly:
 - A meeting of housing industry experts – August 21
 - A meeting of consumer spending/auto industry experts – September 5
 - Governor’s Advisory Board of Economists (GABE) – September 10
 - Governor’s Advisory Council on Revenue Estimates (GACRE) – September 23
- The GABE unanimously approved the August standard outlook for fiscal year 2009 and the majority approved fiscal year 2010.
- However, business members of GACRE were split on the forecasts, with four supporting the standard outlook, four supporting the alternative lower growth scenario, and one choosing “standard minus”.
- Based on all comments, the October revenue forecast incorporated elements of both the standard and alternative economic forecasts. It indicated a revenue shortfall of \$2.5 billion.

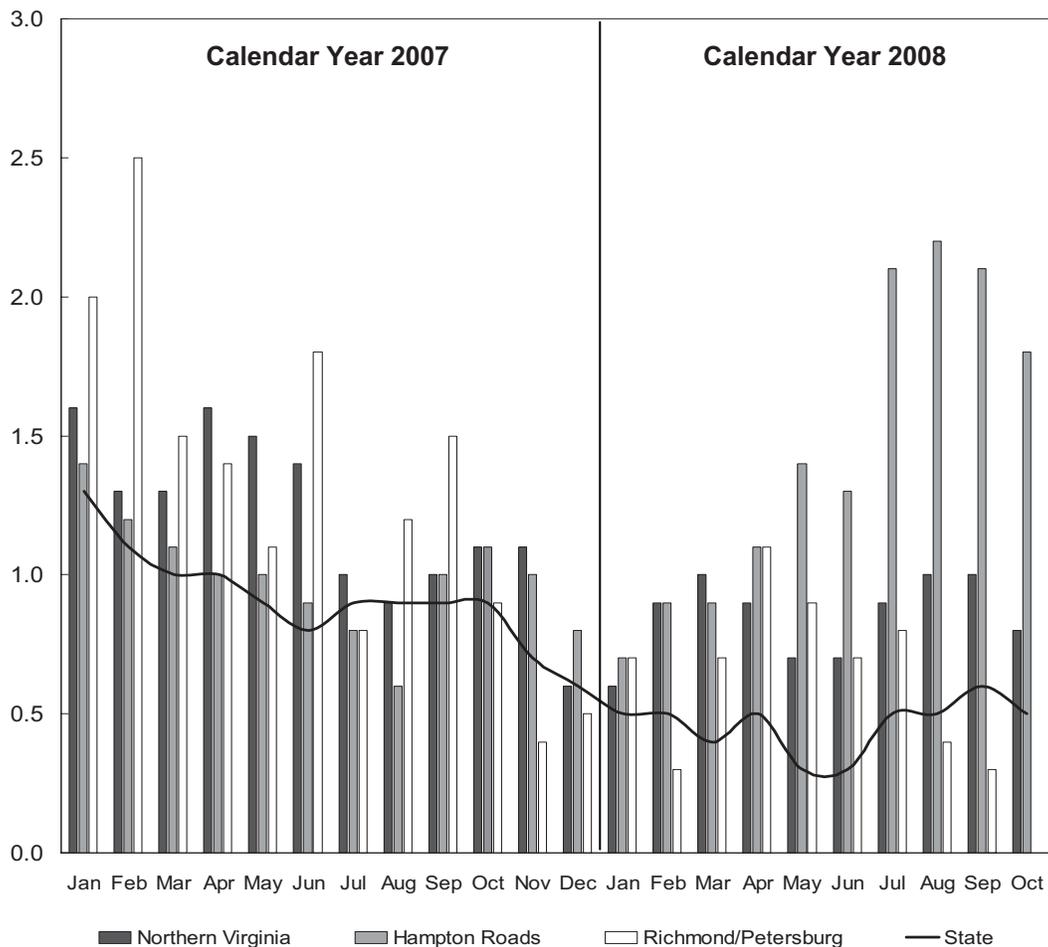
In Addition To The Ongoing Financial Crisis, The U.S. Economy Has Weakened Considerably Since August...

- Real GDP fell at an annualized rate of 0.5 percent in the third quarter, with real personal consumption expenditures falling 3.7 percent, the largest drop in consumer spending since 1980;
- Payroll employment declined by 533,000 jobs in November, the largest one-month drop since December 1974, bringing total job losses for the calendar year to 1.9 million;
- Initial claims for unemployment insurance are at their highest point since 1982, suggesting a severe weakening in the labor market;
- The ISM manufacturing index for November fell to 36.2, its lowest level since the early 1980s (anything lower than 50.0 is considered recessionary);
- November retail sales declined 1.8 percent from October and 7.4 percent from November 2007, the largest year-ago decline in sales on record back to the 1960's;
- New home sales in October fell 40.1 percent from the prior year;
- November auto sales were the lowest since the recession of the early 1980's; and
- Over the last two months, consumer confidence is at its lowest level on record.

Unlike The National Economy, Employment Growth In Virginia Remains Positive...

- Declines in housing-related employment – construction and financial activities – continue to be a major drag on growth, especially in Northern Virginia.
- However, the weakness in housing has thus far been offset by continued gains in professional and business and education and health services.

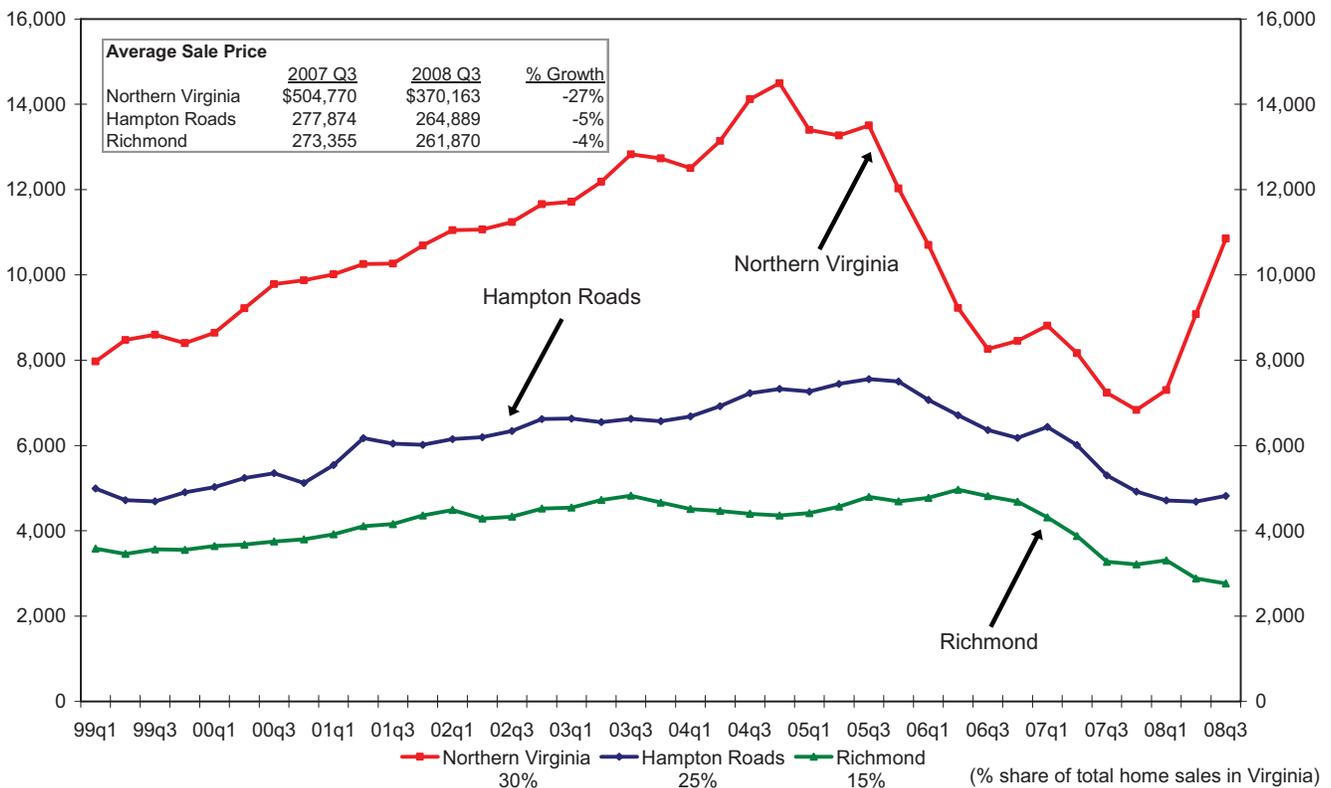
Monthly Employment Growth
(annual percent change)



Data From The Virginia Association Of Realtors Through The Third Quarter Of 2008 Suggest That The Housing Downturn In Virginia Appears To Be Near A Bottom...

- The stabilization is entirely related to a significant increase in sales activity in Northern Virginia, primarily Prince William County.
 - The increased sales activity has been fueled by a near 25 percent decline in the average sale price over the last six months.
 - Recent trends are in line with expectations of housing industry experts.

Pending Home Sales in Northern Virginia, Hampton Roads, and Richmond Levels
Seasonally-adjusted 2-quarter moving average



Global Insight's November Forecast For The National Economy Is More Pessimistic...

- In the Global Insight November standard economic outlook, real GDP is projected to decline for four consecutive quarters (2008Q3-2009Q2).

Key U.S. Economic Indicators

November and August Forecasts
Annual Percent Change

	Fiscal Year			
	07	08	09	10
Real GDP				
November Standard	2.0	2.4	(0.4)	0.1
August Standard			0.8	2.0
August Alternative			(0.7)	0.5
Consumer Spending				
November Standard	3.0	1.9	(0.7)	1.7
August Standard		2.0	0.3	1.6
August Alternative			(0.8)	(0.1)
Employment				
November Standard	1.4	0.7	(1.0)	(0.9)
August Standard			(0.4)	0.5
August Alternative			(1.0)	(0.3)
Personal Income				
November Standard	6.5	5.3	3.1	1.7
August Standard		5.4	3.3	4.1
August Alternative			2.8	3.2

Also, Global Insight's November Forecast For The Virginia Economy Is More Pessimistic...

- As a result, the Global Insight outlook for Virginia is reduced from the August standard forecast, with the outlook for employment and income growth falling at or below the August alternative outlook.

Key Virginia Economic Indicators

November and August Forecasts

Annual Percent Change

	Fiscal Year			
	07	08	09	10
Employment				
November Standard	1.2	0.9	(0.6)	(0.2)
August Standard			(0.1)	0.8
August Alternative			(0.6)	(0.0)
Personal Income				
November Standard	5.5	4.4	2.1	2.3
August Standard	4.9	4.8	3.2	3.7
August Alternative			2.6	3.0
Wages & Salaries				
November Standard	5.0	4.3	2.6	3.2
August Standard	4.9	4.4	3.3	4.4
August Alternative			2.8	3.6
Average Wage				
November Standard	3.8	3.4	3.2	3.4
August Standard	3.6	3.4	3.4	3.6
August Alternative			3.4	3.6

Due To Continued Economic Contraction In October And November, A Reassessment Of The October Revenue Forecast Was Done...

- The process utilized for the December forecast was similar to the General Assembly mid-session forecast and analyzed the most recent national and state economic data and revenue collections. The following meetings of the Governor's advisory groups were held:
 - Governor's Advisory Board of Economists (GABE) – November 14
 - Governor's Advisory Council on Revenue Estimates (GACRE) – December 2
- The baseline economic outlook presented to the GABE and GACRE was based on the Global Insight November 2008 standard U.S. forecast.
 - The November standard outlook anticipated a four-quarter national recession ending in June 2009.
 - This economic scenario was similar to the August alternative low-growth outlook that was the foundation of most revenue source estimates in the October revenue forecast.
 - The GABE unanimously approved the adoption of this outlook, with some members noting that the outlook could be somewhat optimistic.
- The November economic outlook and associated revenue forecast was then presented to GACRE.
 - A majority of the GACRE members supported moving to the November forecast update, with a few cautioning that there could be further weakness in the economy.
- The December revenue forecast reflects the consensus that further reductions are warranted to the revenue estimates released in October given that economic conditions have deteriorated.

The Weaker Economic Outlook Impacts The Major Sources Of Revenue In The Revised December Revenue Forecast...

- Withholding – Incorporates the November standard economic outlook for two years of negative employment growth.
- Nonwithholding –Expected to be an additional 5.0 percent lower than the October forecast due to continued declines in the financial markets in FY 2010.
- Sales Tax – Updated to include the first five months of collections and, based on GACRE input, an expected decline of 3.0 percent in sales for the holiday shopping season.
- Corporate – Unchanged from the October forecast (based on the August alternative outlook) as year-to-date collections support the current forecast.
- Recordation – Updated to include the first five months of collections and the weaker outlook for housing contained in the November standard economic outlook.

The December General Fund Revenue Forecast Reflects The Revised Economic Outlook As Well As Proposed Tax Policy Changes...

General Fund Revenue Adjustments

\$ in Millions

	<u>FY2009</u>	<u>FY2010</u>	<u>Total</u>
October Revenue Reforecast	\$ (956.4)	\$ (1,515.0)	\$ (2,471.4)
November Revenue Reforecast	(138.6)	(229.6)	(368.2)
Technical Changes	3.0	8.1	11.1
Transfers:			
ABC Profits	1.4	1.9	3.3
Sales Tax 1/4 cent	(21.8)	(29.2)	(51.0)
Other	(25.5)	0.3	(25.2)
Subtotal	\$ (45.9)	\$ (27.0)	\$ (72.9)
Total December (Baseline) Shortfall	\$ (1,137.9)	\$ (1,763.5)	\$ (2,901.4)
 Budget Reduction Plans/Balancing Actions:			
Federal (Title IV E Refund)	16.8	-	16.8
Enhanced Compliance Effort	1.2	21.7	22.9
Other Revenue	8.3	3.8	12.1
Transfers	63.2	67.9	131.1
Subtotal	89.5	93.4	182.9
 Proposed Tax Policy Changes:			
2/3's of Excess Fees	-	6.0	6.0
Dealer Discount on Sales Tax	-	64.3	64.3
Captive REIT legislation	-	10.0	10.0
Advance Fixed Date Conformity	(2.8)	10.5	7.7
Adjust Land Preservation Tax Credit	-	50.0	50.0
Sales Tax on Cigarettes	-	2.0	2.0
Energy Tax Credit	-	(2.0)	(2.0)
Energy Sales Tax Exemption	-	(0.2)	(0.2)
Subtotal	(2.8)	140.6	137.8
 Net Shortfall	\$ (1,051.2)	\$ (1,529.5)	\$ (2,580.7)

The December General Fund Revenue Forecast Reflects The Revised Economic Outlook As Well As Proposed Tax Policy Changes (continued)...

Summary of the December General Fund Revenue Forecast Fiscal Years 2009 and 2010 (millions of dollars)

Major Source	Fiscal Year 2009			Fiscal Year 2010		
	Official *	December	\$ Change	Official *	December	\$ Change
Withholding	\$ 9,506.5	\$ 9,239.8	\$ (266.7)	\$ 10,105.4	\$ 9,563.2	\$ (542.2)
Nonwithholding	3,057.2	2,621.2	(436.0)	3,315.6	2,622.0	(693.6)
Refunds	1,786.8	1,815.6	28.8	1,827.5	1,797.4	(30.1)
Net Individual	\$ 10,776.9	\$ 10,045.4	\$ (731.5)	\$ 11,593.5	\$ 10,387.8	\$ (1,205.7)
Sales	\$ 3,225.7	\$ 3,010.9	\$ (214.8)	\$ 3,391.2	\$ 3,166.6	\$ (224.6)
Corporate	706.0	685.0	(21.0)	728.2	729.0	0.8
Wills (Recordation)	380.8	298.1	(82.7)	415.1	298.1	(117.0)
Insurance	294.8	257.5	(37.3)	317.3	283.1	(34.2)
All Other Revenue	705.7	718.4	12.7	744.8	757.4	12.6
Total Revenues	\$ 16,089.9	\$ 15,015.3	\$ (1,074.6)	\$ 17,190.1	\$ 15,622.0	\$ (1,568.1)
ABC Profits	\$ 35.2	\$ 36.6	\$ 1.4	\$ 34.5	\$ 37.0	\$ 2.5
Lottery Profits	0.0	0.0	0.0	0.0	0.0	0.0
Sales Tax (0.25%)	243.9	222.1	(21.8)	257.7	228.5	(29.2)
Transfers	105.7	145.2	39.5	95.3	162.8	67.5
Total Transfers	\$ 384.8	\$ 403.9	\$ 19.1	\$ 387.5	\$ 428.3	\$ 40.8
Total General Fund	\$ 16,474.7	\$ 15,419.2	\$ (1,055.5)	\$ 17,577.6	\$ 16,050.3	\$ (1,527.3)
Percent Change for FY	(0.6) %	(7.0) %		6.7 %	4.1 %	

2008-10 Biennium	<u>Official *</u>	<u>December</u>	<u>\$ Change</u>
Total Revenues	\$ 33,280.0	\$ 30,637.3	\$ (2,642.7)
Total Transfers	772.3	832.2	59.9
Total General Fund	\$ 34,052.3	\$ 31,469.5	\$ (2,582.8)

* Chapter 879 Forecast

Fiscal Year 2009 Year-to-Date Revenue Collections Are Running Ahead Of The Forecasts...

November Year-to-Date Collections and FY 2009 Forecasts (annual percent change)

<u>Major Source</u>	As a % of Total <u>Revenues</u>	Percent Growth over Prior Year		
		<u>October Estimate</u>	<u>YTD Actual</u>	<u>December Estimate</u>
Withholding	61.0 %	3.3 %	4.3 %	3.4 %
Nonwithholding	17.4	(7.9)	(1.5)	(8.4)
Refunds	(11.9)	6.8	13.9	8.1
Net Individual	66.6	(0.4)	3.1	(0.7)
Sales	20.3	0.0	(2.8)	(2.1)
Corporate	4.5	(15.2)	(17.4)	(15.2)
Wills (Recordation)	2.3	(23.9)	(34.9)	(34.7)
Insurance	1.7	(35.1)	(100.0)	(35.1)
All Other Revenue	4.6	(24.0)	(30.5)	(21.5)
Total	100.0 %	(4.0) %	(3.7) %	(4.8) %

Note: Adjusted for the repeal of the estate tax and transfers to transportation from insurance and recordation per HB 3202, year-to-date collections have increased 0.2 percent compared with the October forecast of a 2.0 percent decline.

- Through November, year-to-date revenue growth is ahead of forecast.
 - However, the December forecast includes a significant decline in revenue growth in the fourth quarter of FY 2009.

The Governor Proposes A Withdrawal Of \$490 Million From The Revenue Stabilization Fund As Part Of His Recommended Actions To Address The FY 2009 General Fund Shortfall...

- The revenue stabilization fund balance on June 30, 2008 was \$1,014.9 million.
 - A \$21.3 million deposit required by Chapter 879 on or before June 30, 2009.
 - Interest credited to the fund quarterly.

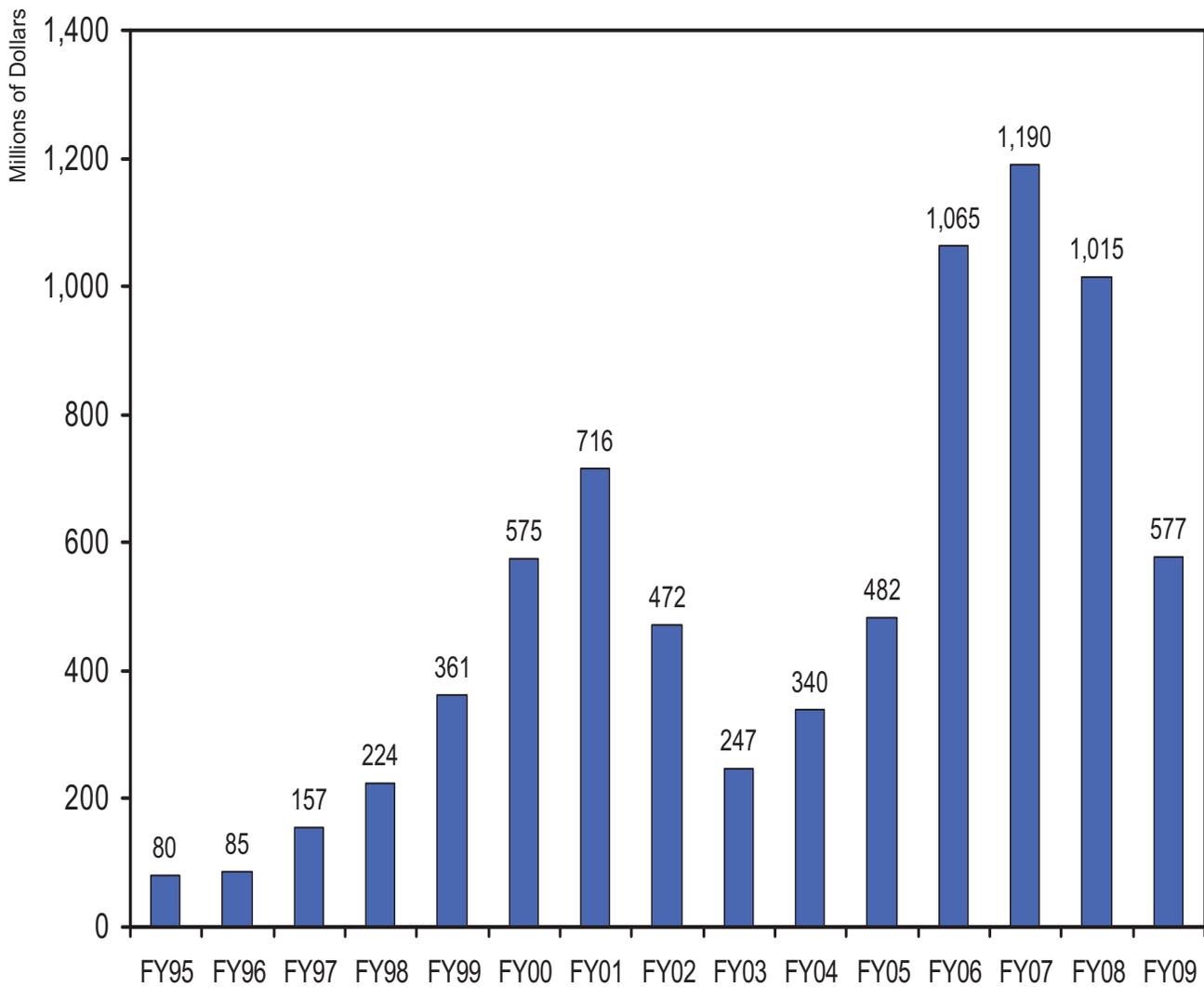
- Proceeds from the Revenue Stabilization Fund are available to meet a revenue shortfall in the currently enacted budget under proscribed conditions.
 - General Assembly may appropriate a withdrawal from the Fund if there is a revenue shortfall of 2 percent or greater in certified tax revenue (\$284.5 million) for FY 2008.
 - The withdrawal cannot exceed one-half of the revenue shortfall (\$493.3 million).

- The balance in the Revenue Stabilization Fund after withdrawing the \$490 million proposed by the Governor will be in excess of \$575 million after the required FY 2009 deposit and accrual of interest through June 30, 2009.

Revenue Stabilization Fund Activity June 30, 2008 – June 30, 2009	
Balance June 30, 2008	\$1,014,870,245
FY 2009 Deposit	\$21,320,527
Estimated FY 2009 Interest	\$30,456,700
FY 2009 Withdrawal	-\$490,000,000
Estimated June 30, 2009 Balance	\$576,647,472

The Balance In The Revenue Stabilization Fund Will Exceed \$575 Million After The Proposed Withdrawal Of \$490 Million...

Revenue Stabilization Fund -- June 30 Balance
FY 1995-08 Actual and FY 2009 Forecast
(millions of dollars)



Note: FY 2009 balance is estimated.

A Proposed Tobacco Tax Increase Will Be Earmarked For The Virginia Health Care Fund And Defray Cost Of Smoking-Related Illness In The Medicaid Program...

Summary of the Virginia Health Care Fund Revenue Forecast

Fiscal Year 2008 Actual and Fiscal Years 2009 and 2010 Forecast
(millions of dollars)

	Actual	Forecast	
	FY2008	FY2009	FY2010
Tobacco Taxes:			
Base	14.0	13.9	13.9
Cigarette User Fees (9/1/04)	154.0	153.0	153.0
Rate Increase (2009 Session)	<u>0.0</u>	<u>0.0</u>	<u>154.1</u>
Total Cigarette Taxes	168.0	166.9	321.0
10% Other Tobacco Products (3/1/05)	15.9	15.2	15.2
10% OTP to \$0.25 per oz. (2009)	<u>0.0</u>	<u>0.0</u>	<u>0.8</u>
Total Tobacco Taxes	183.9	182.1	337.0
Tobacco Settlement Funds:			
Master Settlement	53.7	55.7	55.7
NPM Escrow	0.0	0.0	0.0
Other Revenue:			
Medicaid Recoveries	<u>61.3</u>	<u>61.4</u>	<u>66.0</u>
TOTAL FUND	\$ 298.9	\$ 299.2	\$ 458.7

- The increased revenues will go directly to Medicaid.
- The CDC's estimated cost of smoking-related illness for the Virginia Medicaid Program was \$401 million in 2004.

Cigarette Tax Rates

Virginia and Surrounding States

State	Tax Rate (\$ per pack)	U.S. Rank
Virginia	0.30	47
Kentucky	0.30	47
North Carolina	0.35	45
West Virginia	0.55	40
Tennessee	0.62	36
Washington, D.C.	1.00	26
Maryland	2.00	4
U.S. Median	1.00	
U.S. Average	1.11	

Next Steps In The Revenue Forecasting Process...

- The mid-session review will incorporate the latest economic and revenue data.
 - Global Insight January U.S. economic outlook.
 - Impact of federal legislation and bailout plans.
 - Retail holiday sales.
 - Key additional revenue data will be available.
 - December 15: Due date for the fourth quarter corporate estimated income tax payment.
 - January 15: Due date for the fourth quarter individual estimated income tax payment.
 - Retail sales tax collections reflecting the main holiday shopping season.

The December General Fund Revenue Forecast And The Proposed Revenue Stabilization Fund Withdrawal Leave A Shortfall Of \$2,090.7 Million To Be Addressed By Spending Adjustments...

General Fund Revenue Adjustments

\$ in Millions

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Sales Tax on Cigarettes	-	2.0	2.0
Energy Tax Credit	-	(2.0)	(2.0)
Energy Sales Tax Exemption	-	(0.2)	(0.2)
Subtotal	(2.8)	140.6	137.8
Net Shortfall	\$ (1,051.2)	\$ (1,529.5)	\$ (2,580.7)
Revenue Stabilization Fund Withdrawal	490.0	-	490.0
Remaining Shortfall	\$ (561.2)	\$ (1,529.5)	\$ (2,090.7)

APPENDIX

This presentation and the appendix data listed below are available at the Secretary of Finance Web site (www.finance.virginia.gov).

U.S. Economic Indicators

Virginia Economic Indicators

General Fund Forecast for FY 2009 through FY 2016

Growth in General Fund Revenues, FY 1961 through FY 2009

Nongeneral Fund Forecast for FY 2009 through FY 2014

November 2008 Revenue Report

Revenue Stabilization Fund FY 2009 Withdrawal Calculation