

2018 Session Revenue Outlook

Annual Meeting

November 16, 2017

FY 2017 Recap: GF Revenues Beat Forecast By \$134.1 Million

- Gains in withholding and corporate income tax were partially offset by shortfalls in nonwithholding and sales tax.
- Including transfers, the surplus totaled \$136.6 million.

Fiscal Year 2017 General Fund Revenues (\$ in millions)

Major Sources	Actual	Forecast	Variance	Change (%)	
				Actual	Forecast
Withholding	\$11,895.4	\$11,713.3	\$182.1	5.2	3.6
Nonwithholding	3,018.5	3,048.5	(30.0)	(1.7)	(0.7)
Refunds	(1,861.0)	(1,848.0)	(13.0)	2.2	1.5
Net Individual	\$13,052.9	\$12,913.8	\$139.1	4.0	2.9
Sales	\$3,357.1	\$3,386.8	(\$29.7)	1.9	2.8
Corporate	827.0	794.2	32.8	8.1	3.8
Recordation	394.4	398.6	(4.2)	6.9	8.0
Insurance	340.9	344.1	(3.2)	0.5	1.5
All Other	722.9	723.5	(0.6)	1.0	1.1
Total GF Revenue	\$18,695.1	\$18,561.0	\$134.1	3.6	2.9

First Quarter Results Above the Official Forecast

- Q1 total revenue collections increased 4.1% versus the forecast of 2.7% growth.
- Strength in payroll withholding and corporate income tax collections drove the increase, while sales tax collections continue to lag the forecast.

First Quarter General Fund Revenues (\$ in millions)

Major Sources	1 st Quarter FY 2018	1 st Quarter FY 2017	Change (%)	
			Actual	Forecast
Withholding	\$2,888.1	\$2,777.0	4.0	1.8
Nonwithholding	463.8	470.8	(1.5)	7.0
Refunds	<u>(126.7)</u>	<u>(114.9)</u>	<u>10.3</u>	<u>4.4</u>
Net Individual	<u>\$3,225.1</u>	<u>\$3,132.9</u>	<u>2.9</u>	<u>2.6</u>
Sales	\$667.2	\$649.9	2.7	2.8
Corporate	252.7	197.5	27.9	1.6
Recordation	107.1	109.6	(2.3)	3.4
Insurance	-	-	-	7.0
All Other	<u>130.2</u>	<u>121.4</u>	<u>7.2</u>	<u>2.3</u>
Total GF Revenue	\$4,382.3	\$4,211.3	4.1	2.7

Revenue Outlook: The Good, the Bad, and the Unknown



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The Good

- U.S. economy is growing slowly but steadily.
- Expectations remain upbeat.
- Stock market is near an all-time high.

The Bad

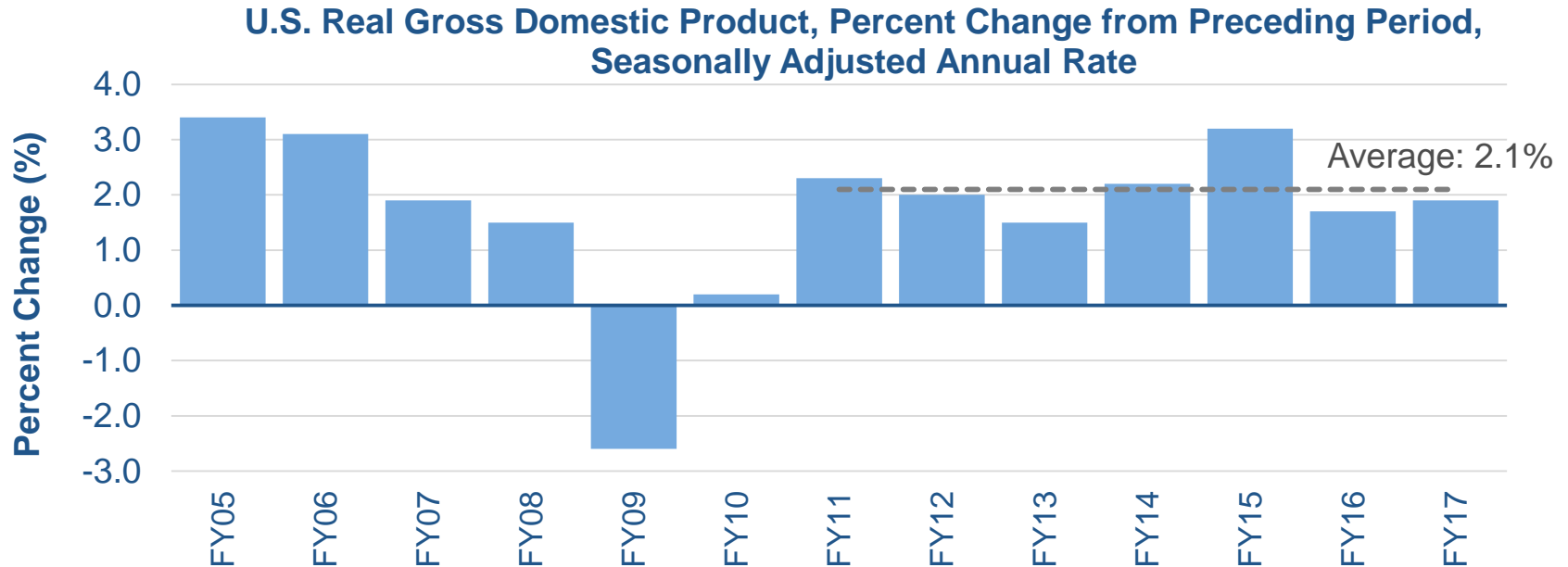
- Supply constraints (mostly labor) are holding back growth.
- Employment growth is slowing.
- State sales tax growth is among the worst in the nation.

The Unknown

- What impact will U.S. fiscal policy have on state tax collections?
- How long can the economy continue on the current path?

U.S. Economy Growing Slowly and Steadily

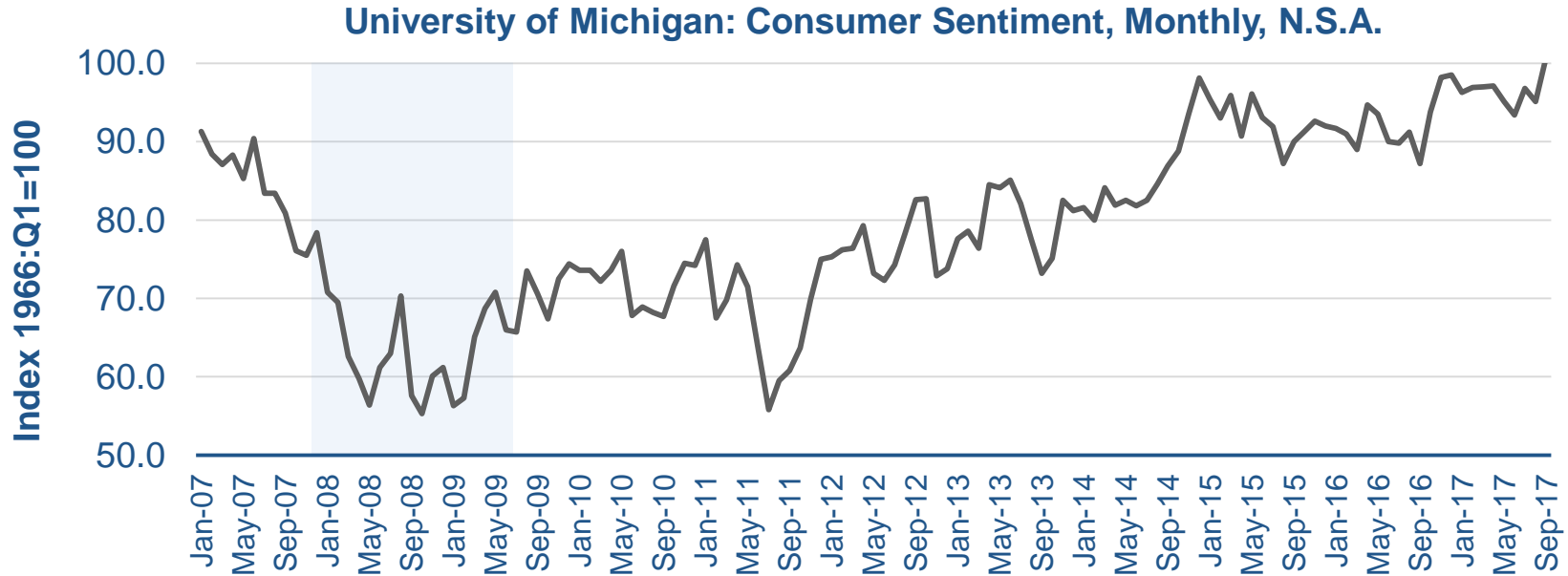
- Since the Great Recession, real GDP growth has been slow but remarkably steady, averaging 2.1%.
- U.S. GDP should improve slightly to 2.3% to 2.4% annual growth over the biennium.



Source: Virginia Department of Taxation.

Expectations are Upbeat

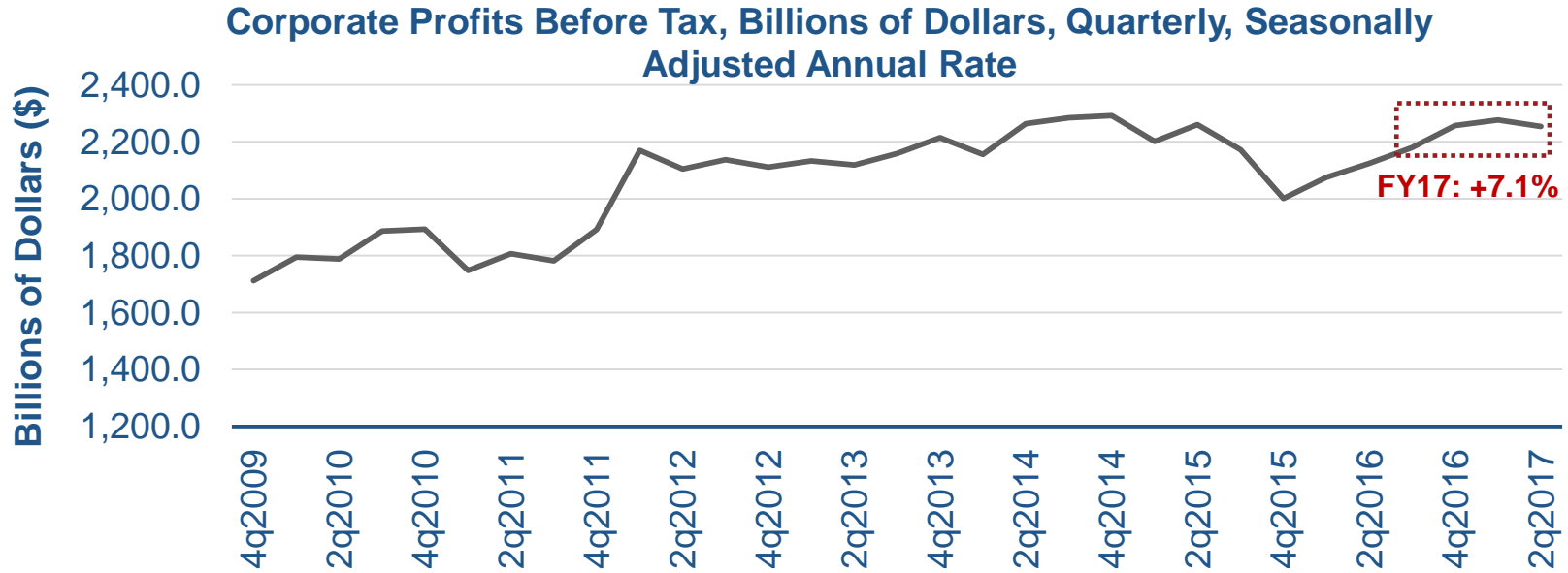
- Positive consumer sentiment reflected in multiple surveys, fueling consumer demand.
- Business sentiment also indicates continued expansion.



Source: University of Michigan: Consumer Sentiment [UMCSENT], retrieved from FRED, Federal Reserve Bank of St. Louis.

Growth in Corporate Profits Continues

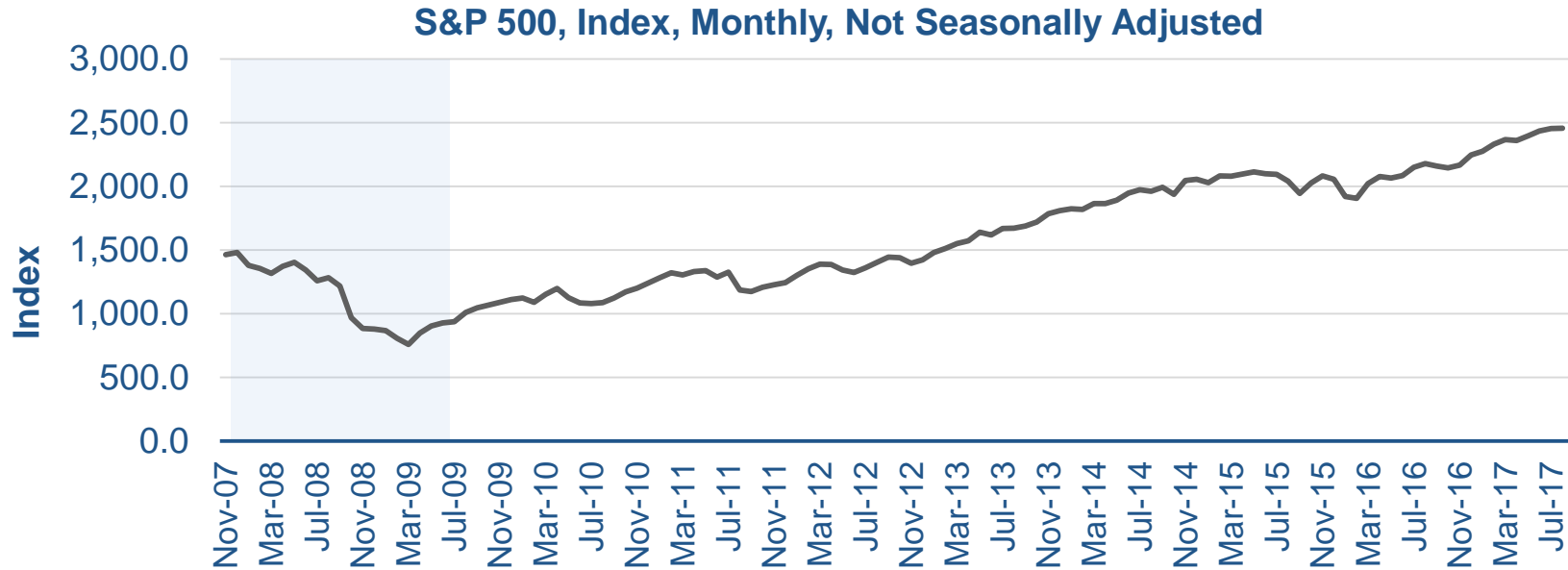
- U.S. corporate profits grew 7.1% in FY 2017. The forecast expects similar growth in FY 2018 and FY 2019.



Source: U.S. Bureau of Economic Analysis, National income: Corporate profits before tax (without IVA and CCAadj) [A053RC1Q027SBEA], retrieved from FRED, Federal Reserve Bank of St. Louis.

Stock Market Near All-time High

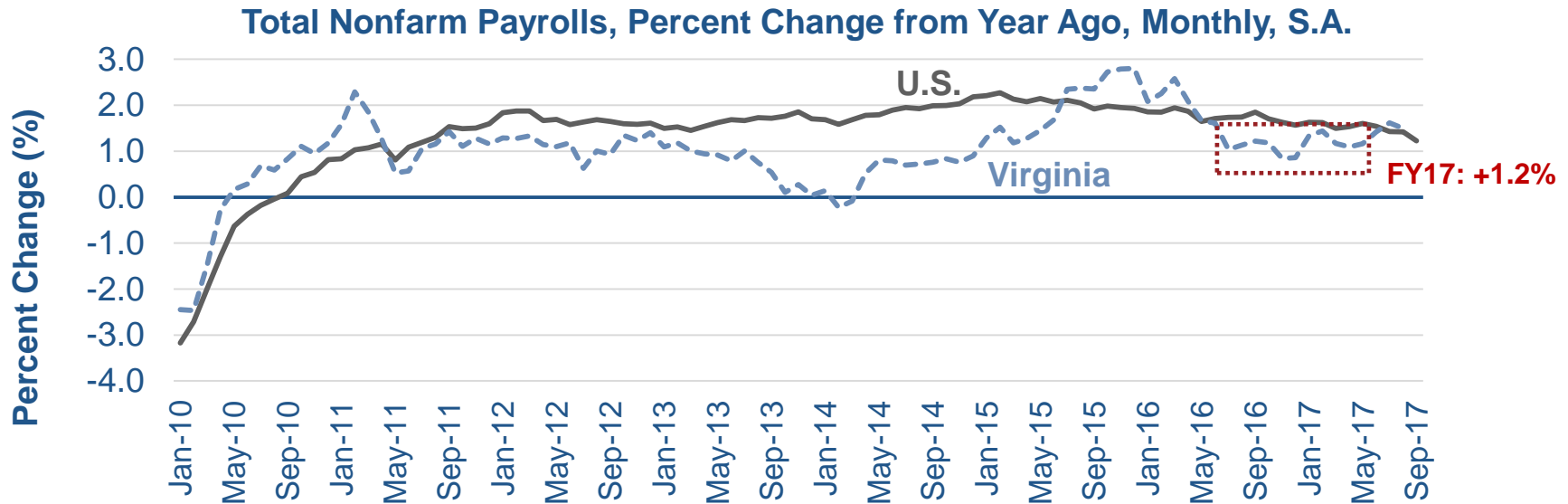
- The S&P 500 index returned more than 12% in calendar year 2016 and is up more than 15% year-to-date.
- In a normal year, market returns and nonwithholding collections are correlated.



Source: U.S. Bureau of Economic Analysis, S&P Dow Jones Indices LLC, S&P 500 [SP500], retrieved from FRED, Federal Reserve Bank of St. Louis.

Employment is Growing ... But Slowly

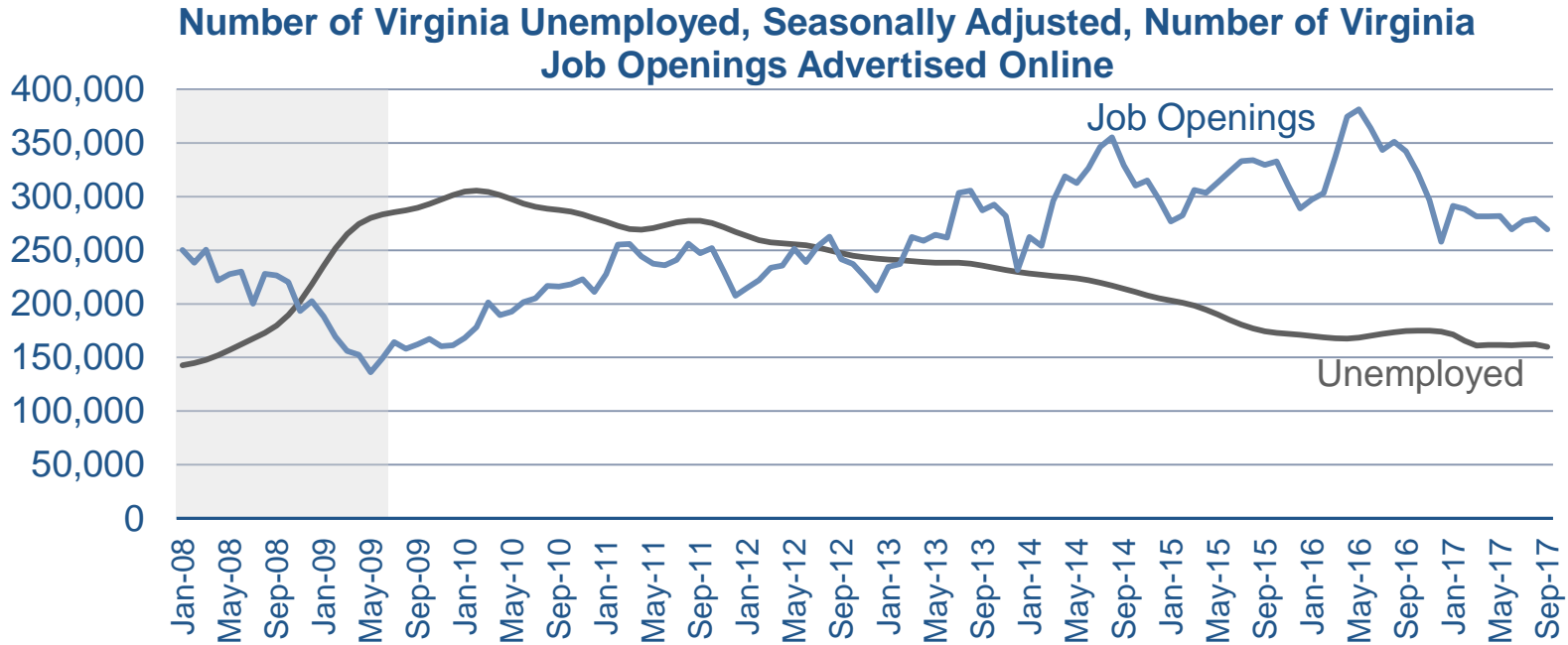
- Virginia payrolls grew 1.2% in FY 2017. Year-to-date growth is slightly better at 1.4%.
- Growth is expected to slow to 1.0% and 0.8%, in FY 2019 and 2020, respectively, as markets tighten.



Source: US. Bureau of Labor Statistics, All Employees: Total Nonfarm Payrolls [PAYEMS], and Total Nonfarm in Virginia [VANA]; retrieved from FRED, Federal Reserve Bank of St. Louis.

Labor Supply Holding Back Job Growth

- Virginia has an exceptionally low unemployment rate at 3.7% (Sept 2017).
- However, shortages of workers with in-demand skills are holding back growth.

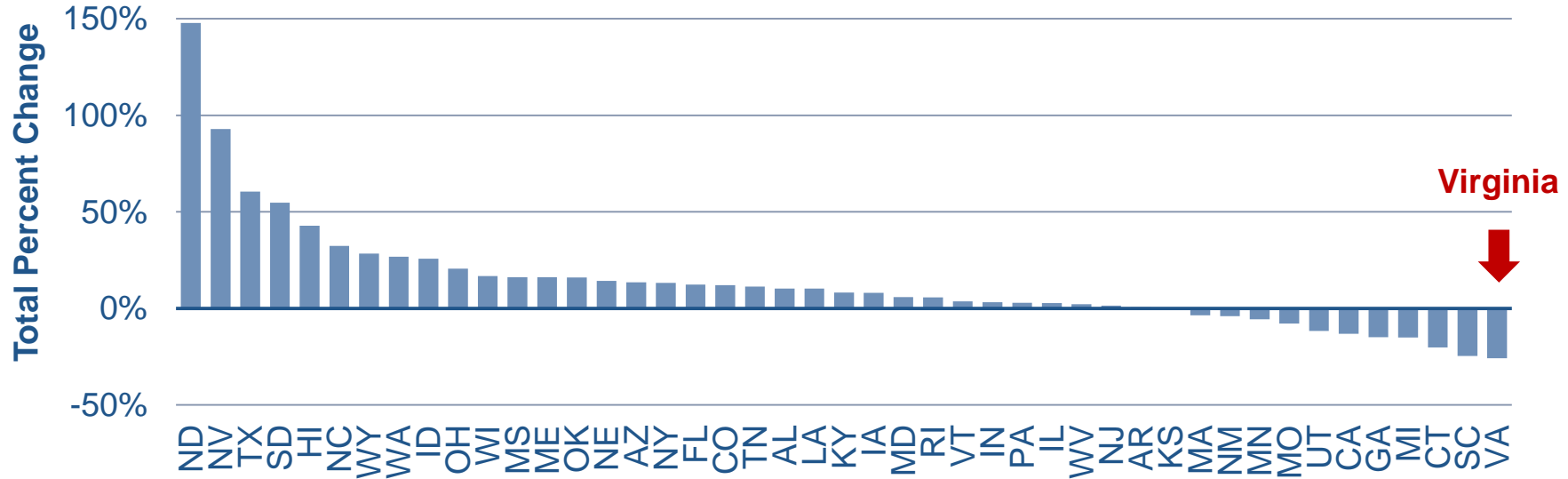


Source: Sara Dunnigan, Virginia Board of Workforce Development.

Virginia's Sales Tax Collections are Shrinking in Real Terms

- Strategic Economics Group: Adjusted for inflation and rate changes, Virginia sales tax collections fell 25% between 2000 and 2016.

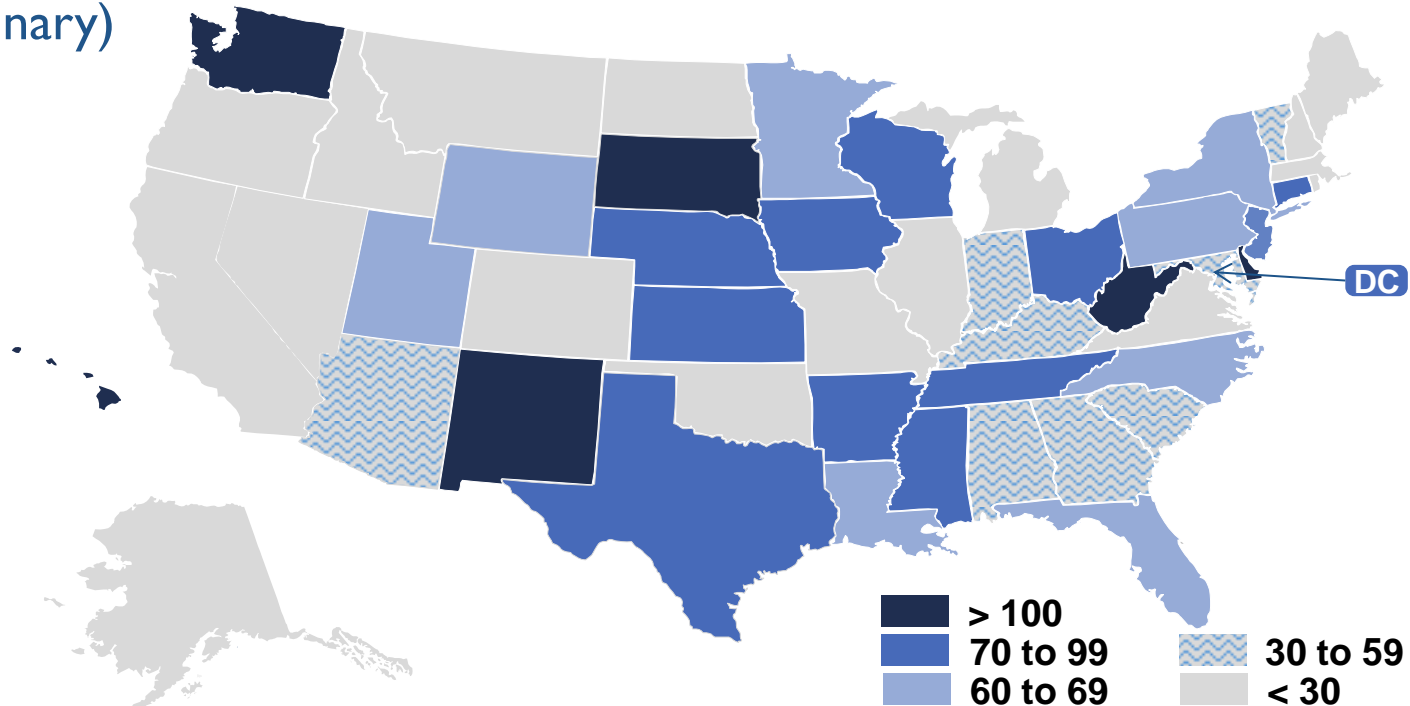
Tax Rate and Inflation Adjusted Percent Change in Sales Tax Collections, 2000 to 2016



Source: Mike Lipsman and Natalie Davila, Strategic Economics Group, Inc.

Virginia Taxes Fewer Services Than Many Other States

Number of Services Taxed – Federation of Tax Administrators, 2017 Survey (Preliminary)



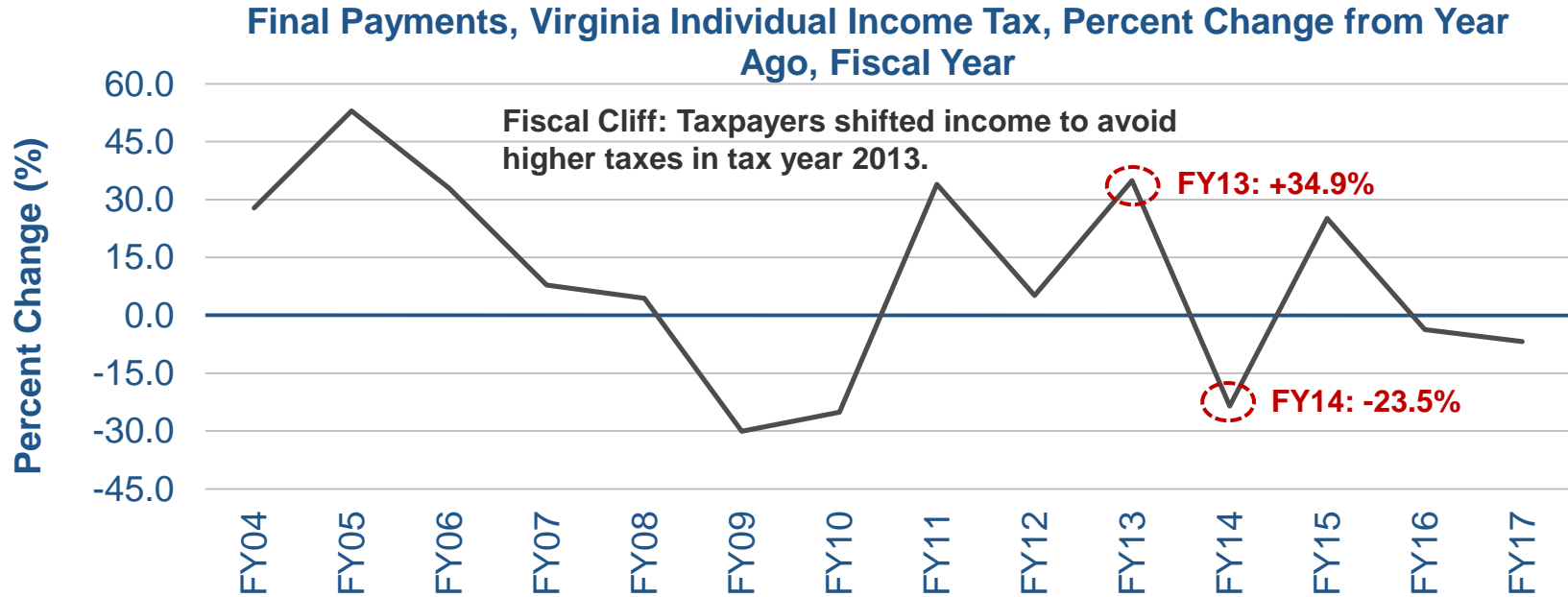
Source: Ronald Alt, Federation of Tax Administrators.

Uncertainty at the Federal Level

- Sequestration – Automatic spending cuts are likely if Congress passes a Continuing Resolution to fund the government at same levels for full-year Federal FY 2018.
 - Would disproportionately impact Northern Virginia and Hampton Roads regions with high reliance on Department of Defense spending.
- U.S. Tax Reform Proposals:
 - Some differences between House and Senate proposals, but the two are more alike than different.
 - Nearly doubles the standard deduction to \$12,200 (House) / \$12,000 (Senate).
 - House plan keeps the highest marginal rate and consolidates seven individual income tax brackets (from 10% to 39.6%) to four (12%, 25%, 35%, and 39.6%).
 - Senate plan keeps seven brackets (10%, 12%, 22.5%, 25%, 32.5% and 38.5%).
 - Eliminates personal exemption and many tax credits, deductions and exclusions.
 - Caps the individual income tax rate at 25% (House) and 33% (Senate effective rate) for pass-through entities.
 - Permanently reduces the corporate tax rate from 35% to 20% (delayed in Senate version); changes to territorial system.
 - Creates a new one-time “deemed repatriation” tax on overseas profits.
 - Estate tax exemption doubles; tax is repealed in 2024 in House plan.
- Anticipation of federal tax reform affects the timing of state income tax collections.

Final Nonwithholding Income Tax Payments Will Depend Partly on U.S. Tax Policy

- Expectations about federal tax policy affect the behavior of high-income taxpayers. Case in point: FY 2013-14.

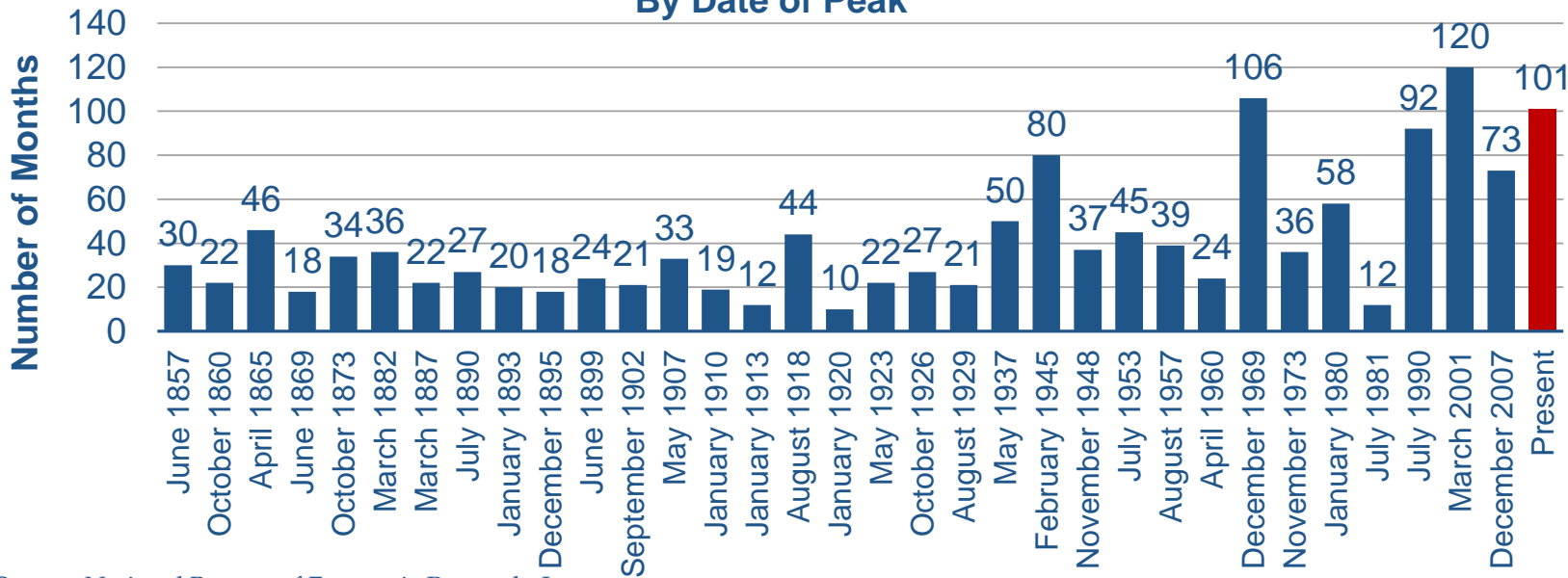


Source: Virginia Department of Taxation.

Current Economic Expansion Is More Than Eight Years Old

- Third-longest expansion. How long will it continue?
- As time goes by, there are more opportunities for policy missteps, external shocks.

Duration of Economic Expansions Since 1857
By Date of Peak



Source: National Bureau of Economic Research, Inc.

Key Economic Variables

Fiscal Years 2017-2020 Economic Variables, Percent Change Over Prior Year, Actuals and Forecast

Percent Change (%)	FY17 Actual	FY18 Forecast	FY19 Forecast	FY20 Forecast
Virginia				
Employment	1.2	1.3	1.0	0.8
Average Wage	1.5	2.2	3.4	3.1
Wages & Salaries (Empl + Avg Wage)	2.7	3.6	4.4	4.0
Personal Income	2.4	3.3	4.3	4.6
Dividends, Interest and Rent	2.2	3.2	5.3	7.2
Proprietors' Income	2.6	2.9	(0.2)	(3.7)
U.S.				
Real GDP	1.9	2.4	2.3	2.2
Employment	1.6	1.4	1.2	1.0
Corporate Profits	7.1	6.7	7.3	1.5

SFC Staff General Fund Revenue Forecast

- Employment will continue to expand slowly, but the rate of job growth will decelerate in Fiscal Years 2019 and 2020.
- Tightening labor markets, particularly in high-demand fields (information technology, healthcare, etc.) will lead to improved average wage growth.
- Payroll withholding collections will benefit from increasing wages.
- Sharp increase in corporate income tax collections will moderate, but growth continues.
- Sales tax collections have improved over last year, but growth will remain relatively weak over the biennium.
- Expectations around U.S. tax reform will continue to depress nonwithholding collections temporarily, but if passed it will likely be a net positive in FY 2019 and 2020. However, the exact timing and magnitude of the impact is difficult to estimate.
- Federal spending could have a significant impact on state income tax collections. A conservative forecast is appropriate.

SFC Staff General Fund Revenue Forecast

(\$ in millions)	FY 2018 Forecast	FY 2019 Forecast*	FY 2020 Forecast
Growth by Revenue Source			
Withholding	4.1%	4.1%	4.3%
Nonwithholding	1.9%	6.0%	4.0%
Refunds	6.7%	4.5%	4.3%
Sales & Use	3.3%	2.2%	2.7%
Corporate	16.1%	0.5%	2.0%
All Other Revenue Sources	<u>2.8%</u>	<u>1.4%</u>	<u>1.5%</u>
Total GF Revenue Growth	3.8%	3.6%	3.7%
SFC General Fund Revenue Forecast	\$19,399.0	\$20,106.9	\$20,840.9
SFC Transfer Estimate	<u>645.1</u>	<u>603.1</u>	<u>618.1</u>
SFC Total GF Resources Estimate	\$20,044.1	\$20,710.0	\$21,459.0
GF Resources Above Official Forecast	\$210.0		

* FY 2019 growth rates are adjusted for tax amnesty. Unadjusted, total GF revenue growth in FY 2019 is estimated at 4.1%