

# **Governor Kaine's Proposed 2008-2010 Budget**

## **Economic Outlook & Revenue Forecast**

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

December 17, 2007



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## *Outline...*

- Fiscal Year 2007 Year-end Revenue Results
- August Interim Revenue Forecast
- November Revenue Collections
- U.S. and Virginia Economic Outlook
- December Revenue Forecast
- Key Risks to the Outlook
- Proposed Budget Actions

# **Fiscal Year 2007 Year-end Revenue Results**

## ***Fiscal Year 2007 Revenues Finished \$234.4 Million (1.5%) Below Forecast...***

### **Summary of Fiscal Year 2007 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	\$ 8,517.5	\$ 8,565.5	\$ 48.0	0.6 %	6.4 %
Nonwithholding	2,788.4	2,782.0	(6.4)	(0.2)	11.6
Refunds	<u>(1,337.1)</u>	<u>(1,559.8)</u>	<u>(222.7)</u>	<u>16.7</u>	<u>21.6</u>
Net Individual	9,968.8	9,787.6	(181.2)	(1.8)	5.6
Sales *	3,092.9	3,049.1	(43.8)	(1.4)	8.4
Corporate	901.4	879.6	(21.8)	(2.4)	1.4
Wills (Recordation)	554.4	582.9	28.5	5.1	(16.1)
Insurance	384.6	384.9	0.3	0.1	3.0
All Other Revenue	<u>898.1</u>	<u>881.7</u>	<u>(16.4)</u>	<u>(1.8)</u>	<u>7.4</u>
<b>Total Revenues *</b>	<b>\$ 15,800.2</b>	<b>\$ 15,565.8</b>	<b>\$ (234.4)</b>	<b>(1.5) %</b>	<b>4.9 %</b>
ABC Profits	27.3	27.6	0.3	0.9	(8.3)
Lottery Profits	406.3	434.9	28.6	7.0	(4.2)
Transfers	<u>360.8</u>	<u>357.8</u>	<u>(3.0)</u>	<u>(0.8)</u>	<u>(6.2)</u>
<b>Total General Fund</b>	<b>\$ 16,594.6</b>	<b>\$ 16,386.1</b>	<b>\$ (208.5)</b>	<b>(1.3) %</b>	<b>4.4 %</b>

\* Not adjusted for the Accelerated Sales Tax (AST) program. Adjusted sales tax growth was 2.7 percent compared to a forecast of 4.2 percent. Adjusted total revenue growth was 3.8 percent compared to a forecast of 5.4 percent.

# **August Interim Revenue Forecast**

## ***The Interim Forecast Was Based On A Complete Revenue Forecasting Process Review...***

- The August 2007 interim revenue forecast was based on the updated economic outlook for Virginia as approved by the Governor's Advisory Board of Economists (GABE).
  - ♦ GABE was presented with the May 2007 standard economic outlook for Virginia, which was based on the May 2007 Global Insight standard forecast for the U.S.
    - A majority of the Board supported slight upward revisions to employment and income growth.
- The interim forecast also incorporated input from leaders in the residential housing industry and was reviewed by the Governor's Advisory Council on Revenue Estimates (GACRE).

***The Combined Shortfall In Fiscal Year 2007 Of \$234.4 Million With The Fiscal Year 2008 Forecast Reduction Of \$406.7 Million Presented An Estimated Biennial Shortfall Of \$641.1 Million...***

**August Interim Revenue Forecast – Difference from Official**  
(millions of dollars)

<b>August Forecast</b>	<b>FY08</b>	<b>FY09</b>	<b>FY10</b>
Withholding	34.7	31.2	68.9
Nonwithholding	125.7	139.7	155.9
Refunds	-282.0	-302.7	-256.0
Sales	-119.1	-133.3	-137.1
Corporate	-68.7	-99.0	-102.1
Wills	-24.4	-89.0	-75.7
Insurance	-15.0	-11.0	-11.2
<u>All Other</u>	<u>-57.8</u>	<u>-18.4</u>	<u>-9.4</u>
<b>Total GF Revenue</b>	<b>-406.7</b>	<b>-482.4</b>	<b>-366.7</b>
% of Official Forecast	-2.5%	-2.8%	-2.0%

<i>Annual % Change</i>	<u>FY08</u>	<u>FY09</u>	<u>FY10</u>
Revenue Base	3.0%	3.7%	6.5%
Economic Base	3.1%	5.7%	6.5%

Note: Economic base growth rates adjust for the repeal of the estate tax and the transfer of one-third of prior year insurance company premiums and \$0.03 of recordation tax to transportation beginning in FY09.

# **November Revenue Collections**

## *Year-to-date Revenue Collections Through November Are Running Very Close To The Interim Forecast...*

### **Summary of Fiscal Year 2008 Revenue Collections July through November**

<u>Major Source</u>	As a % of Total <u>Revenues</u>	Percent Growth over Prior Year		
		<u>YTD Actual</u>	<u>August 2007 Estimate</u>	<u>Variance</u>
Withholding	56.7 %	5.0 %	6.1 %	(1.1) %
Nonwithholding	18.9	13.4	8.8	4.6
Refunds	<u>(10.8)</u>	<u>(7.5)</u>	<u>10.5</u>	<u>(18.0)</u>
Net Individual	64.9	6.8	6.2	0.6
Sales	19.6	2.8	2.8	0.0
Corporate	4.5	(26.7)	(17.4)	(9.3)
Wills (Recordation)	3.3	(15.3)	(9.0)	(6.3)
Insurance	2.5	5.8	2.9	2.9
All Other Revenue (a)	5.3	5.1	(4.4)	9.5
<b>Total (a)</b>	<b>100.0 %</b>	<b>3.2 %</b>	<b>3.0 %</b>	<b>0.2 %</b>

(a) Adjusted for nongeneral funds interest earnings for October and November that will be transferred in January. Not adjusted for the transfer, all other revenue growth is 11.7 percent and total general fund revenue growth is 3.6 percent.

# **U.S. and Virginia Economic Outlook**

## ***Over The Forecast Horizon, The October U.S. Forecast Is For Slower Growth Than Projected In The Interim Forecast...***

- Tight credit conditions are expected to result in a deeper downturn in housing and more cautious consumers.

### **Key U.S. Economic Indicators** Interim vs. October Standard Forecast (annual percent change)

	Fiscal Year				
	06	07	08	09	10
Real GDP					
Interim (May '07)	3.4	2.5	2.3	3.2	3.2
Standard (Oct '07)	3.2	2.1	2.1	2.5	2.9
Consumer Spending					
Interim (May '07)	3.3	3.2	2.8	2.9	3.1
Standard (Oct '07)	3.1	3.0	2.6	2.4	2.8
Employment					
Interim (May '07)	1.9	1.6	1.0	1.3	1.5
Standard (Oct '07)	1.9	1.6	0.9	1.0	1.3
Personal Income					
Interim (May '07)	5.7	5.8	5.5	5.6	6.0
Standard (Oct '07)	6.2	6.4	5.8	4.7	5.3

Source: Global Insight

## *The October Standard Forecast For Virginia Mirrored The Interim Forecast...*

- Virginia is expected to outperform the nation over the forecast horizon.

### **Key Virginia Economic Indicators** Interim vs. October Standard Forecast (annual percent change)

	Fiscal Year				
	06	07	08	09	10
<b>Employment</b>					
Interim (May '07)	2.1	1.4	1.3	1.6	1.8
Standard (Oct '07)	2.1	1.4	1.1	1.5	1.8
<b>Personal Income</b>					
Interim (May '07)	5.9	5.3	5.6	6.0	6.2
Standard (Oct '07)	6.4	5.2	5.6	5.9	6.2
<b>Wages &amp; Salaries</b>					
Interim (May '07)	6.4	5.2	5.5	5.7	6.2
Standard (Oct '07)	6.2	5.4	5.5	5.2	6.0
<b>Average Wage</b>					
Interim (May '07)	4.2	3.7	4.1	4.1	4.3
Standard (Oct '07)	4.0	3.9	4.4	3.7	4.1

# **December Revenue Forecast**

## ***The December Revenue Forecast Reflects The Updated Economic Outlook And First Quarter Collections For Fiscal Year 2008...***

- Over the next three fiscal years, the interim forecast for total general fund revenues has been revised up by 0.1 percent from the interim forecast.
  - ♦ Withholding and sales tax collections (75 percent of total revenues) -- revenue sources most closely tied to Virginia economic activity -- are marginally adjusted.
  - ♦ The revised forecast for the three most volatile revenue sources -- nonwithholding, corporate, and recordation -- is only 0.5 percent above the interim estimate for fiscal year 2008 through fiscal year 2010.

## ***Withholding Has Been Revised Down From The Interim Forecast...***

- The withholding revenue model is based on a relationship to wages and salaries in Virginia.

	Wage & Salary Growth	Withholding Growth
FY07 actual	5.4%	6.4%
FY08 forecast	5.5%	5.6%
FY09 forecast	5.2%	6.2%
FY10 forecast	6.0%	6.0%

- Given that year-to-date collections through November are trailing the annual estimate, the withholding forecast has been revised downward slightly.
- Revision: FY08 -\$49.1 million, FY09 -\$35.1 million, FY10 -\$56.6 million

## *The Outlook For Sales Tax Collections Is Essentially Unchanged Over The Forecast Horizon...*

- The sales revenue model is based on a relationship to personal income in Virginia.

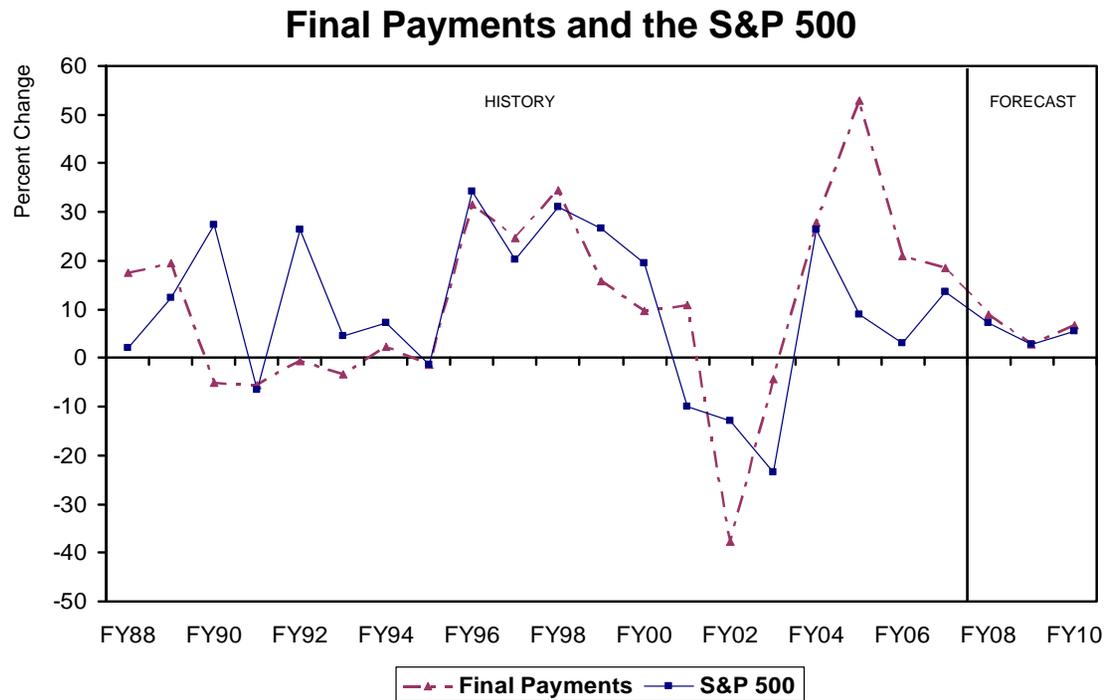
	Personal Income Growth	Sales Tax Growth *
FY07 actual	5.2%	2.7%
FY08 forecast	5.6%	2.8%
FY09 forecast	5.9%	5.3%
FY10 forecast	6.2%	5.7%

\* FY07 adjusted for the end of the Accelerated Sales Tax Program in FY06.

- Growth in personal income is near the interim forecast.
- Actual growth for the first quarter of FY08 was 3.1%. The negative wealth effect from the downturn in housing and higher energy prices have hurt consumer confidence, leading to persistent weakness in collections.
- Revision: FY08 +\$0.0 million, FY09 -\$1.2 million, FY10 +\$4.9 million

## Individual Nonwithholding Has Been Revised Upward From The Interim Forecast...

- Healthy growth in first quarter collections and slightly stronger growth in financial markets and non-wage income result in upward revisions over the next three years.
- Revision: FY08 +\$33.0 million, FY09 +\$10.6 million, FY10 +\$43.9 million



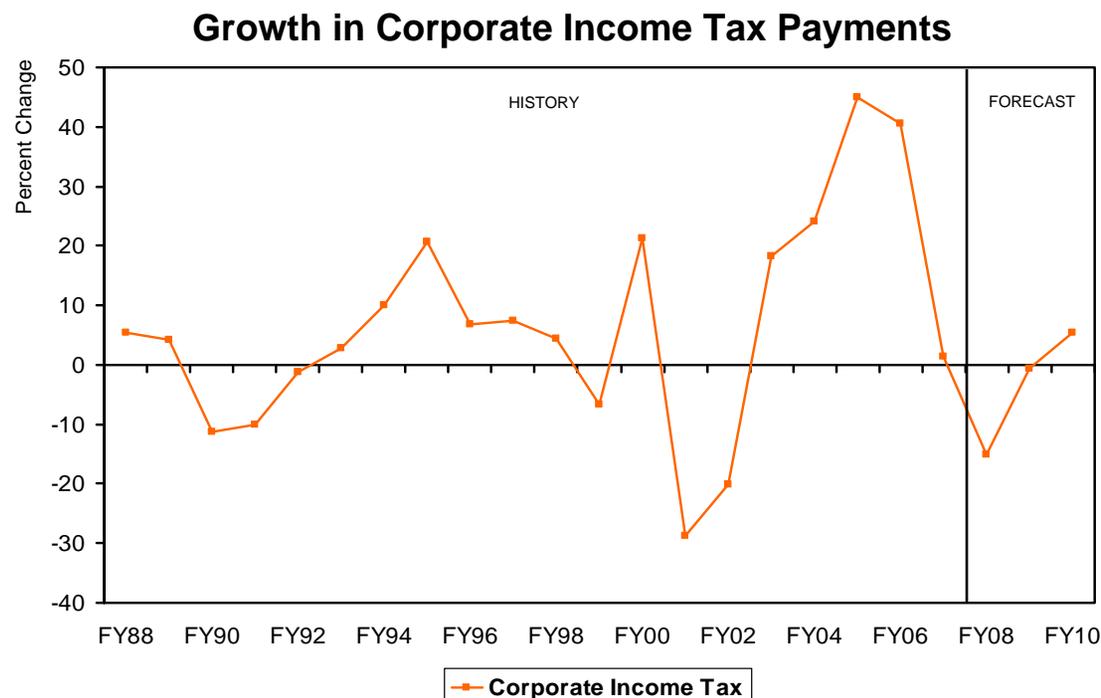
\*S&P 500 growth is for the prior calendar year, i.e., FY07 is CY06.

## ***The Forecast For Individual Refunds Has Been Revised Down Slightly Over The Forecast Horizon...***

- In the interim revenue forecast, individual refunds were adjusted to reflect:
  - ♦ The higher refund base due to overpayment of estimated income taxes by individuals who are not adjusting payments as their incomes fall.
  - ♦ The increasing cost of the land preservation tax credit.
- A double-digit decline in the first quarter of fiscal year 2008 and updated withholding tax estimates suggest a downward revision over the forecast horizon, resulting in an increase in revenues.
  - ♦ The outlook for the land preservation credit is unchanged from the interim forecast.
    - As expected, about one in every three dollars refunded through November is attributable to land preservation credit.
- Revision: FY08 -\$43.4 million, FY09 -\$43.8 million, FY10 -\$44.1 million

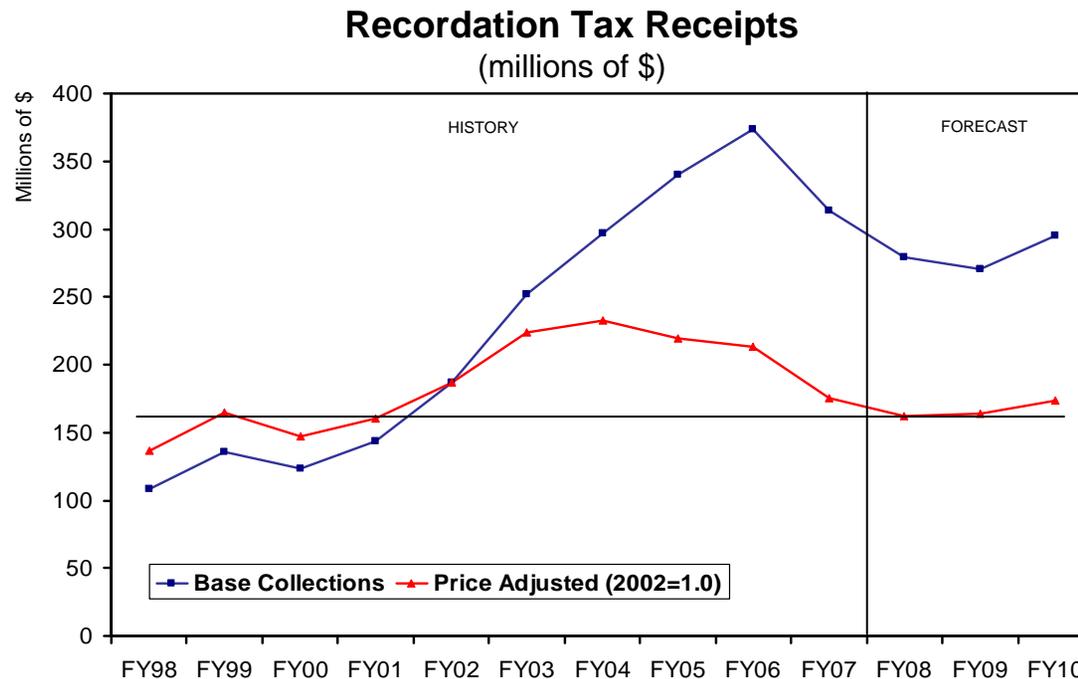
## *The Outlook For Corporate Income Tax Collections Has Been Revised Upward In Fiscal Year 2008 And Down In Fiscal Year 2009 And Fiscal Year 2010...*

- Similar to the interim estimate, the November forecast relies on the U.S. low-growth scenario to better capture the projected downturn in corporate income tax receipts from the slowdown in housing.
- Revision: FY08 +\$21.7 million, FY09 -\$21.7 million, FY10 -\$12.1 million



## Recordation Tax Receipts Are Expected To Decline Further...

- The revenue model supports the interim revenue forecast for fiscal year 2008; however, due to weaker collections for the first quarter of the year, model results are adjusted down.
- Revision: FY08 -\$10.2 million, FY09 +\$3.2 million, FY10 +\$3.5 million



## *The December Forecast Is Essentially Unchanged From The August Interim Revenue Forecast...*

### Summary of the December 2007 Revenue Forecast (millions of dollars)

Major Source	As a % of Total Revenues	Fiscal Year 2008		Fiscal Year 2009		Fiscal Year 2010	
		\$ Amount	\$ Change	\$ Amount	\$ Change	\$ Amount	\$ Change
Withholding	56.2 %	\$ 9,042.3	\$ (49.1)	\$ 9,601.8	\$ (35.1)	\$ 10,177.8	\$ (56.6)
Nonwithholding	19.0	3,059.4	33.0	3,279.5	10.6	3,545.8	43.9
Refunds	(10.4)	(1,680.6)	(43.4)	(1,795.3)	(43.8)	(1,833.2)	(44.1)
Net Individual	64.8 %	\$ 10,421.1	\$ 27.4	\$ 11,086.0	\$ 19.3	\$ 11,890.4	\$ 31.4
Sales	19.5 %	\$ 3,136.0	\$ 0.0	\$ 3,300.9	\$ (1.2)	\$ 3,488.7	\$ 4.9
Corporate	4.6	747.9	21.7	743.7	(21.7)	783.9	(12.1)
Wills (Recordation)	3.2	520.3	(10.2)	449.4	3.2	489.8	3.5
Insurance	2.5	403.4	7.3	284.2	(0.0)	305.9	8.9
All Other Revenue	5.3	858.6	15.3	746.5	(12.6)	766.0	(11.8)
<b>Total</b>	<b>100.0 %</b>	<b>\$ 16,087.3</b>	<b>\$ 61.6</b>	<b>\$ 16,610.8</b>	<b>\$ (13.0)</b>	<b>\$ 17,724.7</b>	<b>\$ 24.8</b>

## *The December Forecast Is Essentially Unchanged From The August Interim Revenue Forecast (continued)...*

### Summary of the December 2007 Revenue Forecast (millions of dollars)

Major Source	As a % of Total Revenues	Fiscal Year 2008 (a)		Fiscal Year 2009 (b)		Fiscal Year 2010	
		\$ Amount	% Growth	\$ Amount	% Growth	\$ Amount	% Growth
Withholding	56.2 %	\$ 9,042.3	5.6 %	\$ 9,601.8	6.2 %	\$ 10,177.8	6.0 %
Nonwithholding	19.0	3,059.4	10.0	3,279.5	7.2	3,545.8	8.1
Refunds	(10.4)	(1,680.6)	7.7	(1,795.3)	6.8	(1,833.2)	2.1
Net Individual	64.8 %	\$ 10,421.1	6.5 %	\$ 11,086.0	6.4 %	\$ 11,890.4	7.3 %
Sales	19.5 %	\$ 3,136.0	2.8 %	\$ 3,300.9	5.3 %	\$ 3,488.7	5.7 %
Corporate	4.6	747.9	(15.0)	743.7	(0.6)	783.9	5.4
Wills (Recordation)	3.2	520.3	(10.7)	449.4	(13.6)	489.8	9.0
Insurance	2.5	403.4	4.8	284.2	(29.5)	305.9	7.6
All Other Revenue	5.3	858.6	(2.6)	746.5	(13.1)	766.0	2.6
<b>Total</b>	<b>100.0 %</b>	<b>\$ 16,087.3</b>	<b>3.3 %</b>	<b>\$ 16,610.8</b>	<b>3.3 %</b>	<b>\$ 17,724.7</b>	<b>6.7 %</b>

Notes:

a) Adjusted for the Estate Tax repeal, underlying growth is 3.6% for fiscal year 2008.

b) Adjusted for the Estate Tax repeal and HB 3202 (Transportation Plan), underlying growth is 5.2% for fiscal year 2009.

## ***The December Revenue Forecast Reflects An Economy That Continues To Expand Over The Forecast Horizon...***

- Economic-based revenue growth is expected to improve over the next biennium.

### **Total General Fund Revenues** (annual percent change)

	<u>FY08</u>	<u>FY09</u>	<u>FY10</u>
Revenue Base	3.3%	3.3%	6.7%
Economic Base	3.6%	5.2%	6.7%

## *Tax Policy Reductions That Reduce Or Reallocate General Fund Revenues Are Affecting Revenue Resources...*

### **Tax Policy Changes Affecting General Fund Revenues** (millions of dollars)

<b>December Forecast</b>	FY08	FY09	FY10
Increase Filing Threshold/Personal Exemption	-13.5	-27.1	-26.9
Sales Tax Holiday -- Hurricane/Energy Efficient	-1.6	-1.7	-1.8
Estate Tax Repeal	-42.2	-140.0	-140.0
1/3 Insurance Premiums to Transportation	0.0	-134.5	-139.6
\$0.03 Recordation Tax to Transportation	<u>0.0</u>	<u>-53.9</u>	<u>-58.8</u>
<b>Total</b>	<b>-57.3</b>	<b>-357.2</b>	<b>-367.1</b>

- Tax policy changes remove \$724.3 million from General Fund Revenue in the 2008-2010 biennial budget.

## *Year-to-date Revenue Collections Through November Are Running Very Close To The December Forecast...*

### Summary of Fiscal Year 2008 Revenue Collections July through November

<u>Major Source</u>	As a % of Total <u>Revenues</u>	Percent Growth over Prior Year		
		YTD <u>Actual</u>	December 2007 <u>Estimate</u>	<u>Variance</u>
Withholding	56.2 %	5.0 %	5.6 %	(0.6) %
Nonwithholding	19.0	13.4	10.0	3.4
Refunds	(10.4)	(7.5)	7.7	(15.2)
Net Individual	64.8	6.8	6.5	0.3
Sales	19.5	2.8	2.8	0.0
Corporate	4.6	(26.7)	(15.0)	(11.7)
Wills (Recordation)	3.2	(15.3)	(10.7)	(4.6)
Insurance	2.5	5.8	4.8	1.0
All Other Revenue (a)	5.3	5.1	(2.6)	7.7
<b>Total (a)</b>	<b>100.0 %</b>	<b>3.2 %</b>	<b>3.3 %</b>	<b>(0.1) %</b>

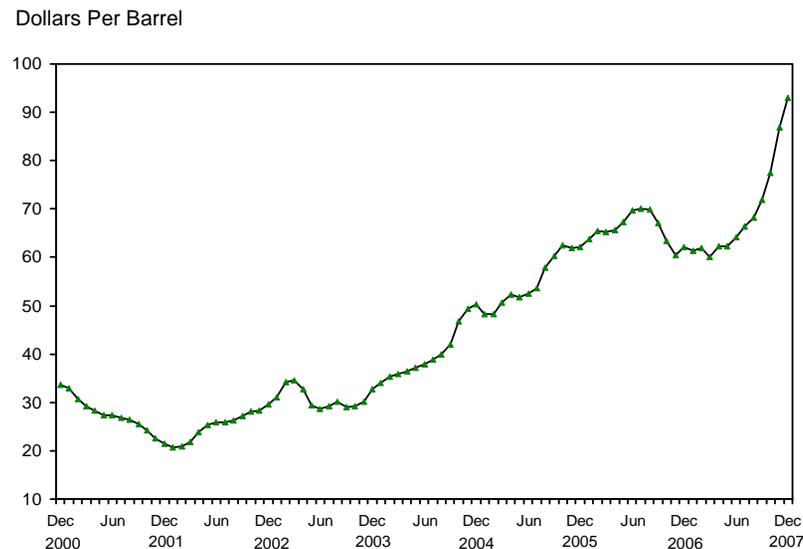
(a) Adjusted for nongeneral funds interest earnings for October and November that will be transferred in January. Not adjusted for the transfer, all other revenue growth is 11.7 percent and total general fund revenue growth is 3.6 percent.

## **Key Risks to the Outlook**

## ***The National And Virginia Economies Face Significant Risks...***

- There are downside risks that members of the Governor's Advisory Board of Economists (GABE) and Governor's Advisory Council on Revenue Estimates (GACRE) highlighted:
  - ◆ Housing Market – not expected to recover until early calendar 2009
  - ◆ Energy Prices – oil prices over \$90 per barrel could stall the economy
  - ◆ Federal Government Spending – future spending priorities unknown

**Price of West Texas Intermediate Crude**  
Seasonally-adjusted 3-month moving average



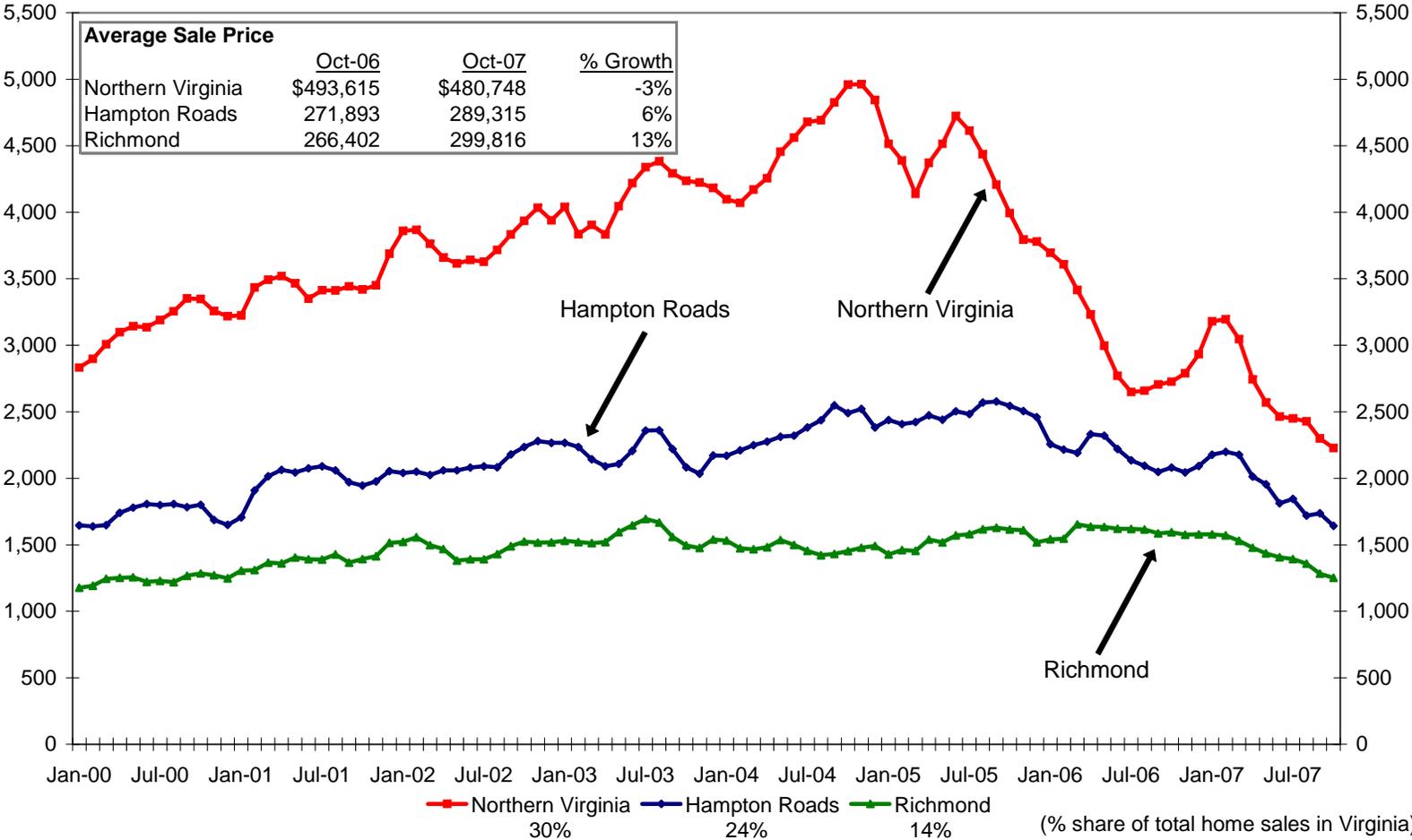
## ***One Key Risk To Economic Growth Is From The Slowdown In The Housing Market...***

- Recent data reveal a significant slowdown in housing-related economic activity.
  - ♦ The seasonally-adjusted, three-month moving average of home sales fell 22% in October. Pending home sales in Northern Virginia were down 18%.
    - Sales volume in Northern Virginia is 56% below the October 2004 level.
  - ♦ The average sale price declined 2.8% in October, the third consecutive monthly year-over-year decline.
    - The average sale price has declined in 4 out of the last 6 months. Over the last 10 years, it has declined in only 8 months.

# Pending Home Sales, A Leading Indicator Of Future Closings, Illustrate The Weakness In Housing...

Pending Home Sales in Northern Virginia, Hampton Roads, and Richmond Levels

Seasonally-adjusted 3-month moving average



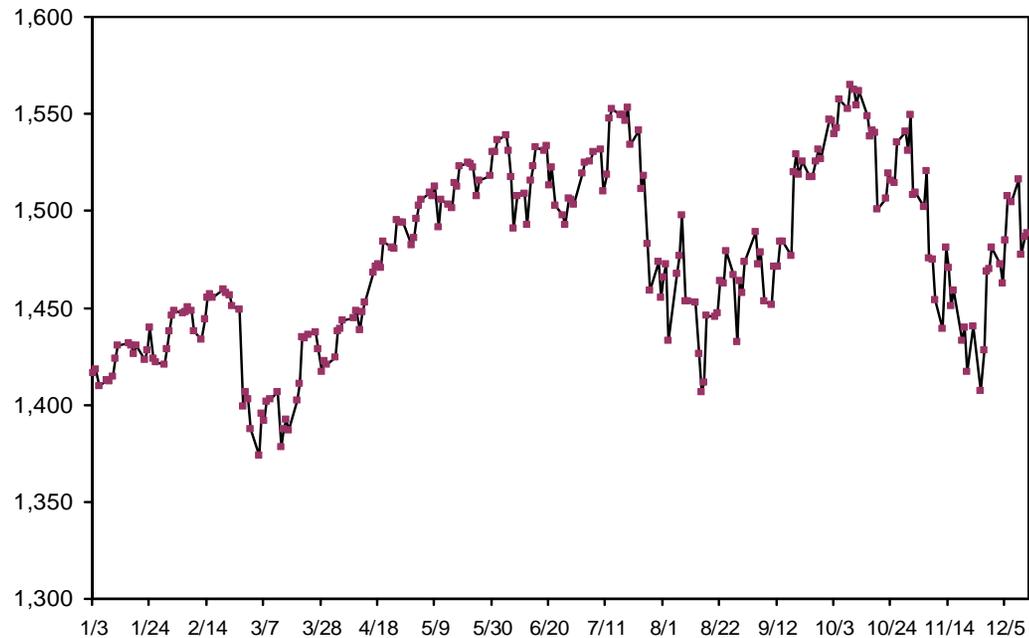
## ***The Risk From The Slowdown In The Housing Market Is That It Could Spread To The Overall Economy...***

- The general slowdown in housing and the subprime mortgage meltdown broaden risks to overall economic growth.
  - ♦ Tighter credit requirements for consumers and businesses.
  - ♦ Negatively impacts consumer spending.
  - ♦ Weakens related sectors of the economy.

## *Other Key Risks For The Fiscal Year 2008-10 Forecast...*

- Other factors will influence economic and revenue growth:
  - ♦ Stock market volatility

**S&P 500 Index – Calendar Year 2007**



- ♦ Defense and federal procurement spending
- ♦ International instability

## ***The December Global Insight National Economic Outlook Is Signaling Caution...***

- The latest monthly forecast put probability of recession at 40%.
  - The October probability was 30%.
  - A recession would delay the recovery well into fiscal year 2009.
- Moody's Economy.com puts the probability of recession at 48%.

## **Proposed Budget Actions**

## ***Steps Taken To Close The Fiscal Year 2008 Budget Shortfall...***

- Agency-based budget reductions contained in the Governor's Budget Reduction Plan released October 1, 2007.
- Carryforward of unexpended appropriations from fiscal year 2007.
- Transfer funds from the Revenue Stabilization Fund.

## ***What Can We Use The Revenue Stabilization Fund For?***

- |   |     |
|---|-----|
| 1. A shortfall in current enacted budget                                      | YES |
| 2. A projected severe downturn in economy<br>in next biennium                 | NO  |
| 3. An emergency spending event<br>(i.e. natural disaster or terrorist attack) | NO  |

## ***How Much Can Be Withdrawn From The Revenue Stabilization Fund?***

A Withdrawal From The Revenue Stabilization Fund May Be Possible In  
The Event Of A Revenue Shortfall  
(\$ in millions)

**Rule #1** – The General Assembly may appropriate a withdrawal from the Revenue Stabilization Fund if there is a revenue shortfall of 2 percent or greater in certified tax revenue (\$278.8 million for FY2007).

FY2008 calculation – uses data from FY2007

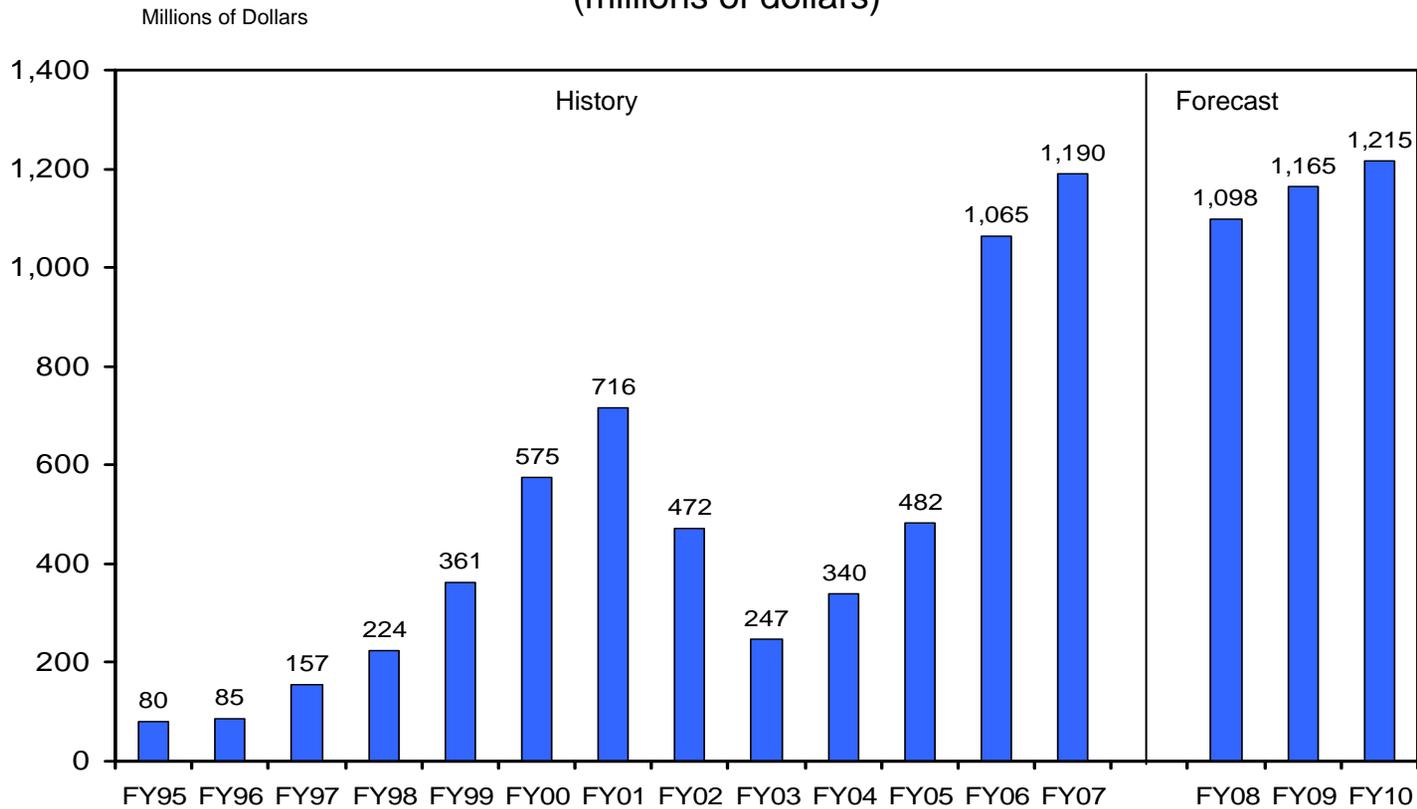
$$\begin{array}{rcccccc} \textbf{Individual Income} & + & \textbf{Corporate Income} & + & \textbf{Sales Tax} & = & \textbf{Total} & \times & \textbf{2\% Shortfall} \\ \$9,787.8 & & \$879.6 & & \$3,274.3 & & \$13,941.6 & & \$278.8 \end{array}$$

**Rule #2** – The withdrawal cannot exceed ½ of the revenue shortfall (\$522.3 million).

$$\begin{array}{rcccc} \textbf{Shortfall} & & & & \textbf{Potential Withdrawal} \\ \$522.3 & & \div 2 & = & \$261.1 \end{array}$$

# The Governor Is Proposing A \$261.1 Million Withdrawal From The Revenue Stabilization Fund In Fiscal Year 2008...

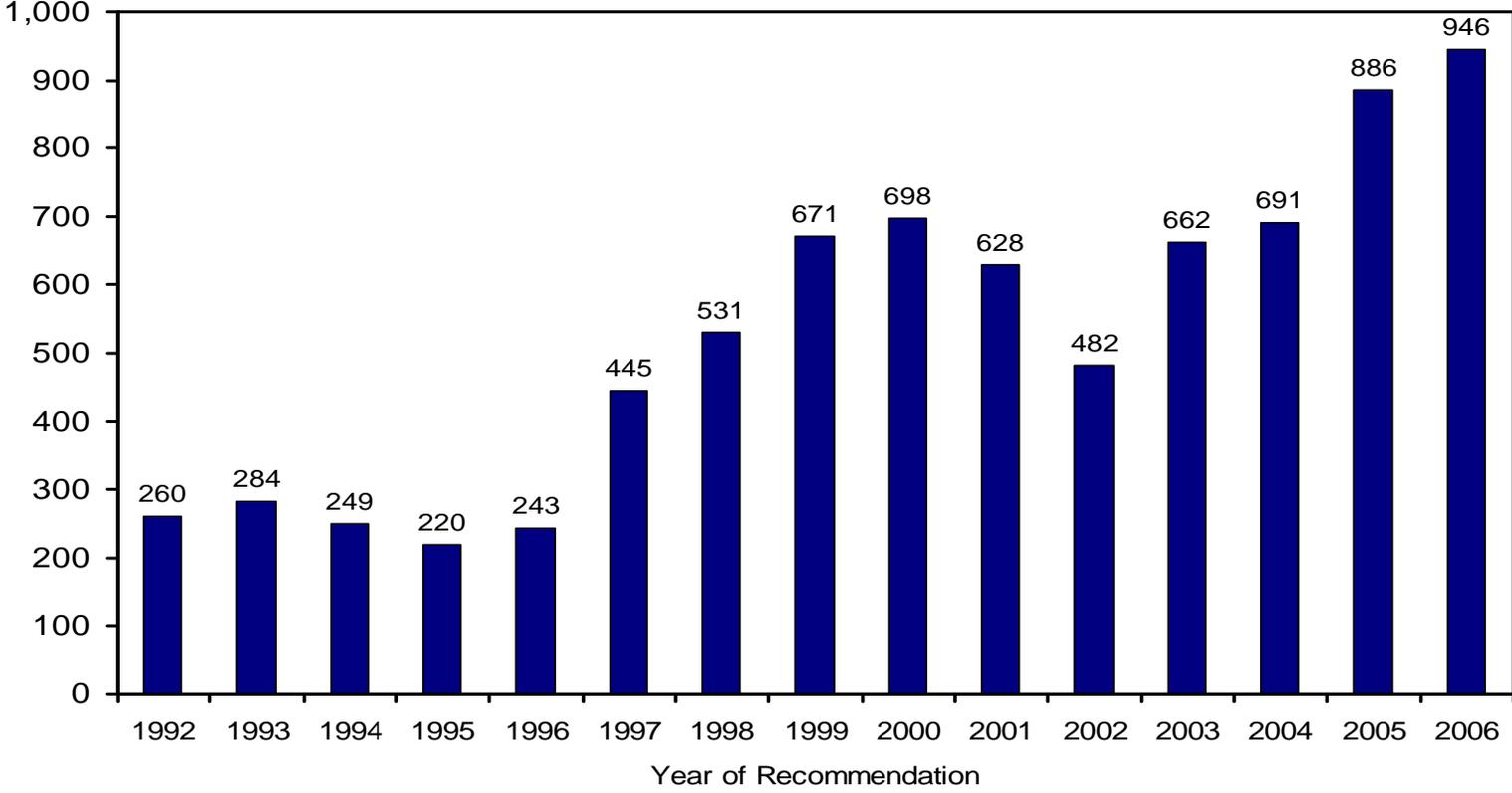
**Revenue Stabilization Fund -- June 30 Balance**  
 FY 1995-07 Actual and FY 2008-10 Forecast  
 (millions of dollars)



**The Governor is Proposing a General Obligation  
Bond to Address Construction of Higher Education  
Buildings**

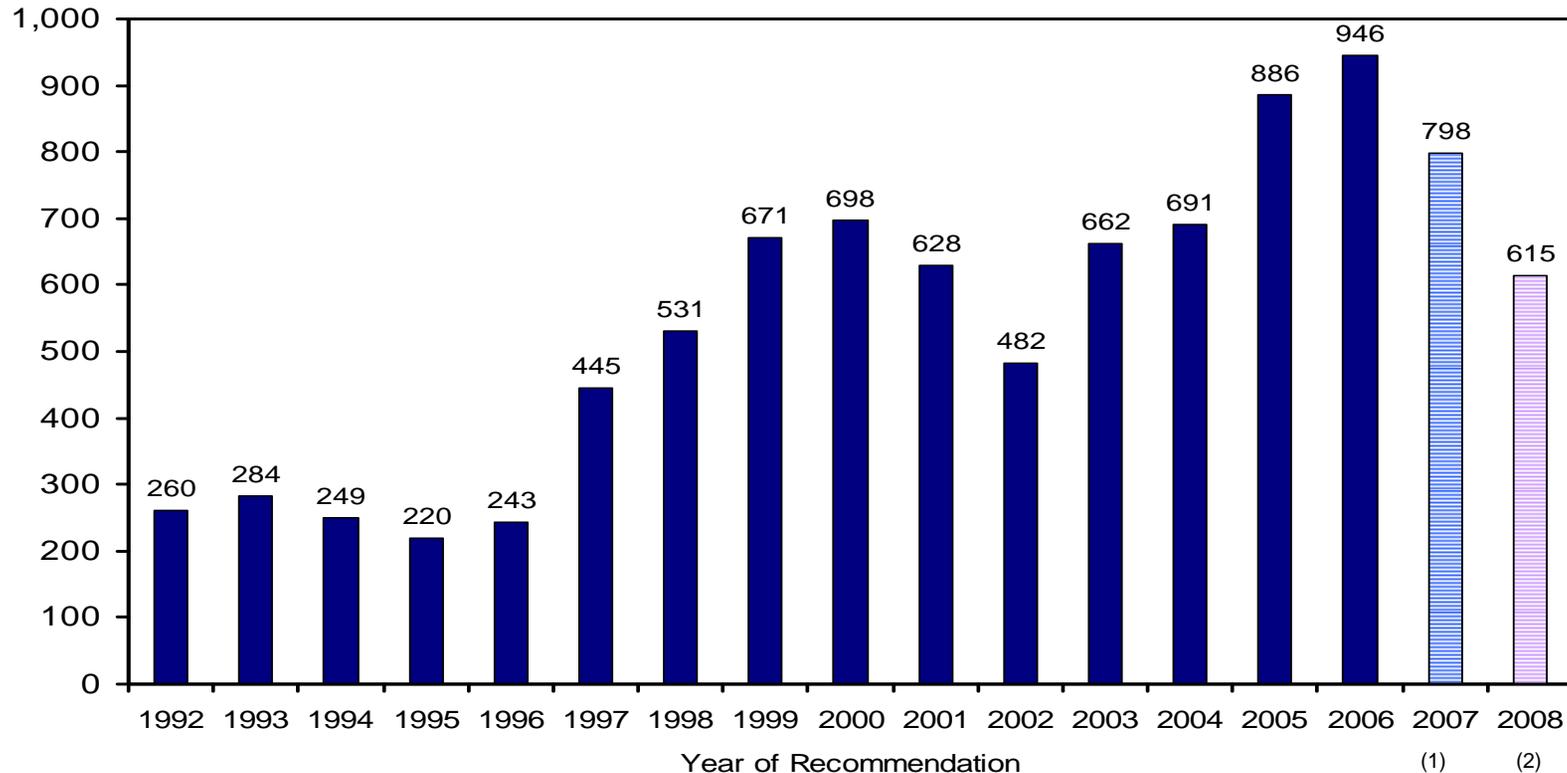
# Virginia's Fiscal Health And Financial Management Practices Are Reflected In Our "AAA" Bond Rating...

**Historic Debt Capacity**  
(millions of dollars)



# The Governor's Proposal For Higher Education Improvements Will Still Leave Virginia With Debt Capacity...

**Historic Debt Capacity Plus New and Potential Authorization**  
(millions of dollars)

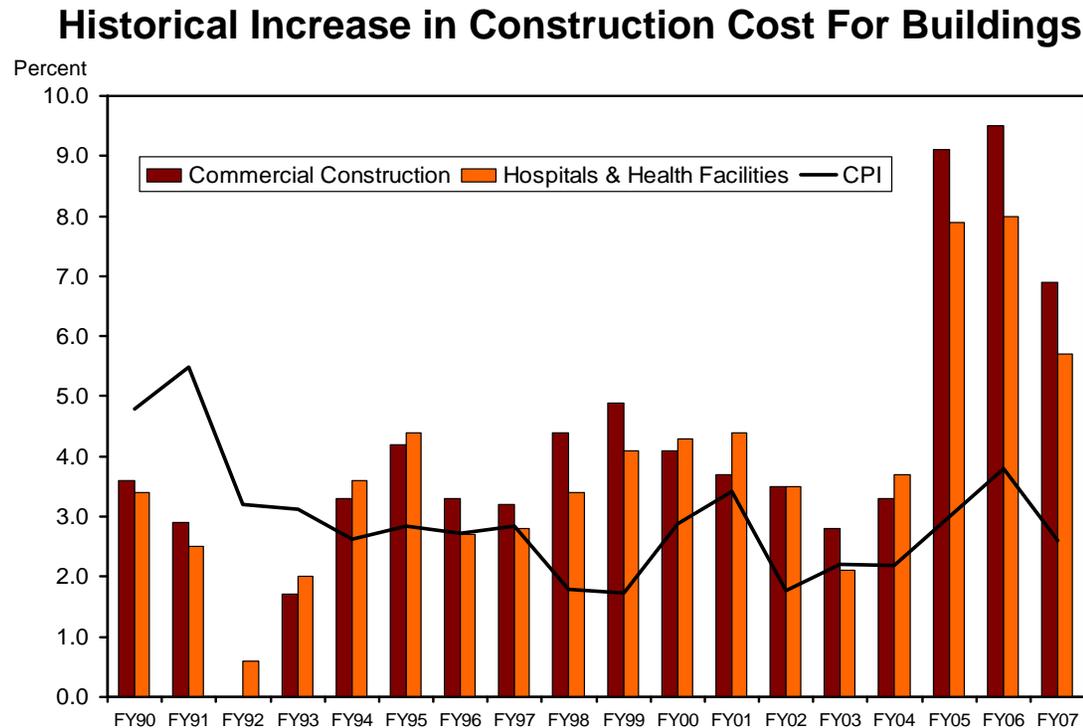


Notes:

- (1) Represents 2006 Base Capacity plus debt authorized during 2007 Session.
- (2) Represents 2006 Base Capacity plus 2007 authorization plus potential 2008 Proposed Authorization (\$1.5 Billion of General Obligation Bonds and \$700 Million of VCBA/VPBA Bonds)

## Constructing The Higher Education Buildings Now Will Save Money Over The Long Term...

- Construction costs have historically outpaced inflation.



- Breakout of type of building:
  - ♦ \$728.3 million is related to the sciences/technology
  - ♦ \$896.2 million to classroom and administrative space
  - ♦ \$27.5 million is infrastructure

# Appendix

U.S. Economic Indicators

Virginia Economic Indicators

General Fund Forecast for FY 2008 through FY 2014

Growth in General Fund Revenues, FY 1961 through FY 2010

Nongeneral Fund Forecast for FY 2008 through FY 2014

November 2007 Revenue Report