COMMONWEALTH OF VIRGINIA

HOUSE OF DELEGATES

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September 12, 2008

MEMORANDUM

TO: Members, House Appropriations Committee

FROM: Robert P. Vaughn, Staff Director

SUBJECT: Update on Status of FY 09 Revenue Collections and Anticipated Reforecast

As a follow-up to last Tuesday's presentation by Secretary Brown, I wanted to provide you some additional detail on the status of year-to-date revenues and the potential scope of the revenue reforecast to be issued in October.

The September revenue report being released today – which contains collections for July and August – reflects year-to-date revenue collections of negative 1.9 percent compared to a forecast of +2.0 percent. In addition to the perennially volatile sources (nonwithholding and corporate income), of particular concern are collections in our two largest sources, payroll withholding and sales tax.

As you will recall, withholding tax collections were about 1% below the FY 08 estimate. As a result of the reduced base, a revised growth rate of 6.4% is required to meet the FY 09 payroll forecast. Yet for the past 6 months, the average growth in withholding taxes has been only 2.8%. We have seen some recent improvement in that source, and collections for the first two months of the fiscal year have averaged 5.1%. However, Global Insight projects a slight decline in national employment over the 2nd and 3rd quarters of the current fiscal year, making it likely the growth rates will decline over the coming months. Payroll taxes are the single largest general fund revenue source and make up almost 60% of our revenue collections. As a result, every 1% drop in the payroll forecast will result in a revenue reduction of almost $100 million per year.

Even more dramatic has been the weakness in our general sale tax collections. Like withholding taxes, sales tax revenues failed to meet the FY 08 forecast. With the resulting base adjustments, sales tax collections would have to grow 4.9% to meet the FY 2009 forecast. In contrast, year-to-date sales tax collections have fallen 1.1%, a level we have not seen since the early 1990s. It is anticipated that consumer spending will continue to be a major drag on our economy in the coming months. While somewhat stabilized, dramatic increases in fuel prices, as well as increased costs of food and the continued weakness in the credit markets, make it unlikely this source will improve substantially in the short term. If the revised sales tax forecast assumes no growth, this would result in a revenue reduction of about $150 million in FY 2009 alone.

In addition to these two sources, we face continued declines in our more volatile revenue sources. With the housing market continuing to search for the bottom, recordation tax collections are currently below the 16.6% reduction assumed for the current fiscal year. Year-to-date, revenues from this source are running 34% below last year. We are hearing some mixed signals on housing, with those in Northern Virginia beginning to see a slight diminishment in listings and an increase in housing permits over the historic lows. So while there is hope that the bottom has been reached in that region, signs indicate that the other regions of the state are 12 months behind, and housing industry experts anticipate it will be another year before pricing and sales begin to recover. If current revenue trends continue, the net result could be a reduction in excess of $50 million for this source in FY 2009 alone.

Furthermore, the slowdown in the economy continues to negatively impact our nonwithholding and corporate tax collections. As you may recall, while corporate tax revenues declined by 8.2% in FY 2008 they still exceeded the forecast significantly and it was the one source that enabled us to meet the overall forecast. However, year-to-date, corporate tax revenues have declined 19 percent compared to a forecasted reduction of 12.6%. Based on these initial collections, an additional forecast adjustment may be necessary.

More importantly, nonwithholding collections, which make up close to 20% of our revenues, appear unlikely to meet the forecast. The quarterly nature of nonwithholding payments make it difficult to make educated estimates of the final outcome until final September data is analyzed. However, the last quarterly estimated payments which were received in June showed an increase of 2.5% compared to the forecast of 6.9% growth. Worse, because final payments (about 40% of total nonwithholding payments) tend to reflect stock market performance, calendar year-to-date declines of about 12% in the S & P do not bode well for final payments. If nonwithholding tax collections are assumed to fall about 5% below FY 2008 levels, that would result in a reduction of about $350 million in FY 2009.

In conclusion, recent trends suggest the scope of the shortfall continues to increase and could be much larger than previously indicated. The Governor has stated that under the expedited GABE/GACRE schedule, a reforecast will be released in early October. However, the acceleration of this process means the October reforecast – which will be made without the benefit of quarterly nonwithholding and corporate payments made in September and October – is likely to be revisited prior to the release of the Budget Bill in December.

As I learn additional information I will keep you apprised.

cc: Chairman Lacey E. Putney
Speaker William J. Howell
Secretary Richard D. Brown