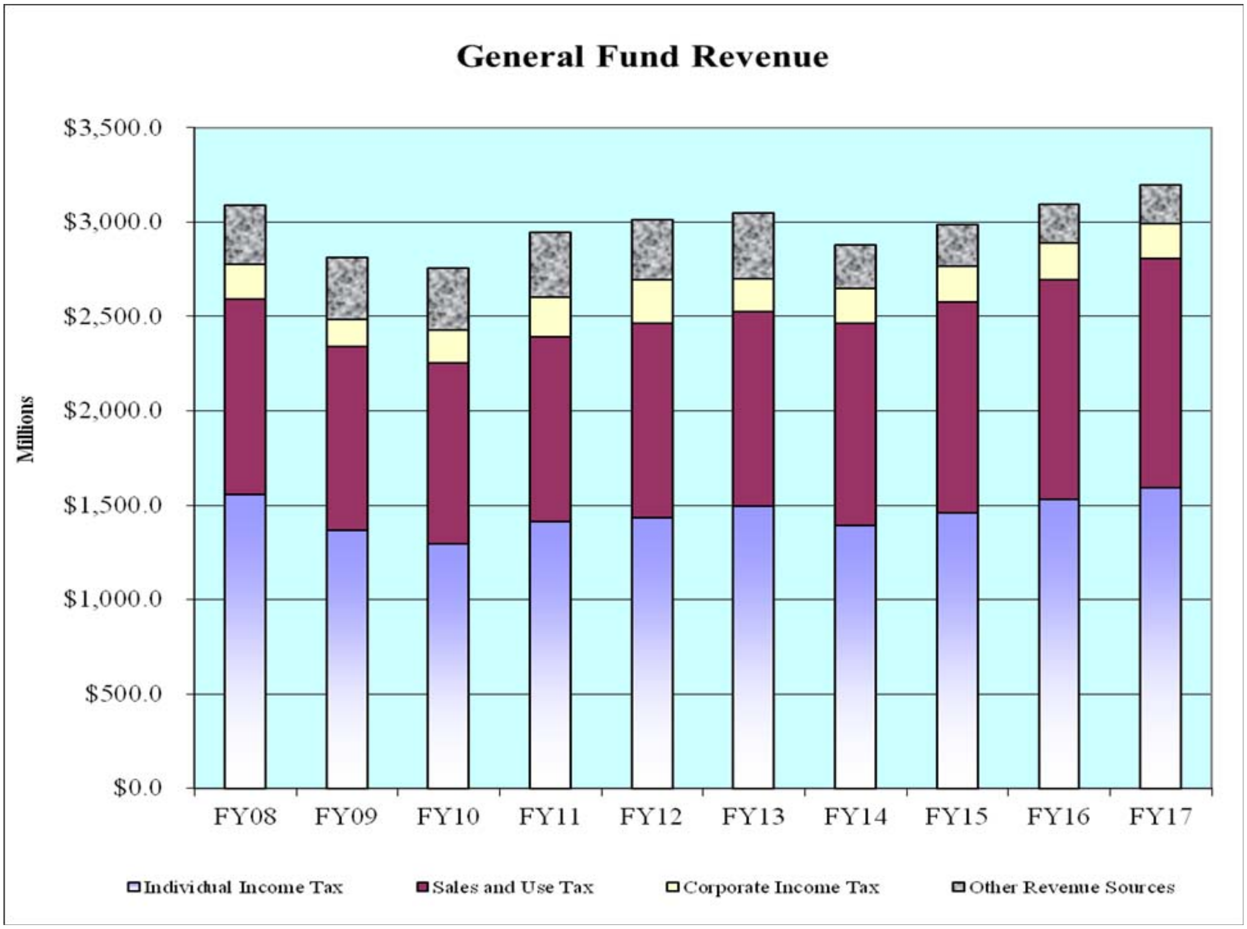
REPORT OF THE MAINE STATE REVENUE FORECASTING COMMITTEE

May 2013



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May 2013 Forecast

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Introduction

The Revenue Forecasting Committee (RFC) met on April 26, 2013 to review and update the current revenue forecast to comply with this year's statutory reporting date of May 1st. The RFC revised its revenue projections through the fiscal year ending June 30, 2017 based on the revised economic forecast updated by the Consensus Economic Forecasting Commission for its April 1st reporting date and a review of recent experience. The RFC updated its forecasts for the General Fund, Highway Fund, Fund for a Healthy Maine and Medicaid Dedicated Revenue Taxes.

Economic Forecast

This update of the revenue forecast began with a review and update of the economic forecast statutorily due this year by April 1st, five months after the last update. The economic forecast was updated by the Consensus Economic Forecasting Commission (CEFC) at its meeting on March 26 with a brief follow-up on March 28 to review the newly released 2012 personal income figures. All CEFC seats were subject to reappointment with the convening of the new Legislature. Four of the members remain the same with one new member. Overall, the CEFC made relatively modest changes to its previous forecast.

National and state economic indicators suggested a continued lack of improvement in economic conditions since the CEFC met in October 2012. Nationwide, consumer sentiment and small business optimism were down over year-ago levels. The Consumer Price Index was 2.0% higher in February 2013 than it was in February 2012. The price of crude oil declined 4.5% in the fourth quarter of 2012 to $88 per barrel. Home sales in Maine were up 21% in January 2013 compared to January 2012. The median home price in the Portland Metropolitan Statistical Area increased 4.6% year-over-year in the fourth quarter of 2012. Mortgage delinquency rates remained well above pre-recession levels but below peak crisis levels. The foreclosure rate in Maine increased in the third quarter of 2012 and remained well above pre-recession levels.

State personal income data for 2012 was released by BEA on March 27, after the initial meeting of the CEFC. A brief follow-up was held to review the new data, which was lower than expected across most components, with total personal income growth at 3.2% for 2012.

Actual wage and salary employment data for 2011 and 2012 were stronger than previously forecasted, resulting in higher growth rates for those two years. The 2013-2017 employment forecast was left unchanged. Personal income growth was revised downwards for 2012 following the release of actual estimates from the U.S. Bureau of Economic Analysis. Personal income was also revised down for 2013 in part to reflect a partial shift in bonuses and dividends from 2013 to 2012 to take advantage of lower tax rates. 2014 and 2017 were revised upwards while 2016 was revised slightly downwards and 2015 was left unchanged. Inflation, as measured by the Consumer Price Index (CPI), was revised upwards for 2012 and 2013 and slightly downwards for 2014-2017.

While Congress and the president succeeded in coming to agreement on many of the "fiscal cliff" issues, the automatic spending cuts known as "budget sequestration" took effect as originally scheduled on March 1, 2013. The CEFC assumed that, while some of the economic effects of these spending cuts will certainly be felt in Maine, Congress and the president will reach a solution that prevents extensive deterioration of economic conditions. Given the negative impact to the economy if a solution is not successfully reached, the CEFC will reevaluate their forecast in the third quarter of calendar year 2013 in response to actual policy decisions at the federal level.

A copy of the April 2013 report of the CEFC and other economic information providing the basis for this revenue forecast is included in Appendix E.

Summary of Revenue Forecast

The economic variables in the CEFC forecast play an important role in the revenue forecast. Maine Revenue Services' tax models use the CEFC economic variables to help project revenue from the major taxes. While the CEFC's changes particularly the short-term reductions to assumed growth of Personal Income might normally have resulted in more significant reductions in FY13 and FY14, these effects were offset by taxpayer behavior affecting the income tax and once again significant technical adjustments based on recent performance and updated federal income tax data. Data related to non-tax revenue lines were provided by a number of different state agencies and reviewed by staff in the Office of Fiscal and Program Review and the Bureau of the Budget to come up with consensus recommendations. The RFC reviewed Maine Revenue Services' and other staff recommendations at its meeting on April 26th and accepted those recommendations. The following tables and narratives highlight the final changes to each of the major funds and revenue sources accepted by the RFC as part of its May 2013 update to the revenue forecast. More detail on each of the funds and revenue sources is provided in the various appendices.

General Fund Summary

	FY12	FY13	FY14	FY15	FY16	FY17
Current Forecast	$3,015,538,222	$3,007,782,255	$2,914,309,263	$3,011,564,672	$3,119,091,267	$3,222,544,770
Annual % Growth	2.4%	-0.3%	-3.1%	3.3%	3.6%	3.3%
Net Increase (Decrease)		$43,522,802	($33,790,020)	($24,329,748)	($26,444,715)	($24,806,908)
Revised Forecast	$3,015,538,222	$3,051,305,057	$2,880,519,243	$2,987,234,924	$3,092,646,552	$3,197,737,862
Annual % Growth	2.4%	1.2%	-5.6%	3.7%	3.5%	3.4%

General Fund revenue estimates were revised upward by $43.5 million in FY13, but were revised downward $33.8 in FY14 and $24.3 million in FY15 ($58.1 million over the 2014-2015 biennium). A significant upward revision for Individual Income Tax in FY13 outweighed downward revisions to the sales and use, service provider and corporate income taxes.

Individual Income Tax revenues were increased in this forecast by $81.1 million in FY13 and $28.7 million in the 2014-2015 biennium. There are numerous reasons for the changes made on the individual income tax line. A large portion of the changes are technical in nature, reflecting the improvements to the new database underlying the tax forecasting and estimating models used by Maine Revenue Services' Office of Tax Policy, and additional analysis of Internal Revenue Service (IRS) tax filings by Maine residents for the 2010 and 2011 tax years. Data from the IRS shows that there has been a significant drop in the mortgage interest deduction in recent years because of historically low interest rates. Adjustments to our models to account for this lower level of itemized deductions and other calibrations of the model to state and federal data are the reasons for the on-going higher level of individual income tax receipts.

As the RFC in its December report, because of assumptions made by the CEFC in their November forecast we did not try to estimate behavior by Maine households making end-of-year financial decisions to avoid potential tax increases at the federal level as a result of the expiration of the Bush tax cuts and other tax stimulus programs enacted in 2009, 2010, and 2011 and tax increases included in the Affordable Care Act that began in 2013. It's now clear that there was significant shifting of income from calendar year 2013 and beyond into 2012 to avoid these increases. The large one-time revenue adjustment to FY13 reflects this taxpayer behavior.

The RFC is now projecting that Sales and Use Tax receipts will be $22.1 million less in FY13 than previously forecasted and $44.5 million lower in the 2014-2015 biennium. The holiday shopping season and the first quarter of CY13 have seen very weak sales tax growth as households react to a struggling economic recovery, the expiration of the federal payroll tax holiday, rising energy prices during first two months of the quarter, and continued uncertainty regarding the resolution of domestic and European fiscal policy challenges.

The Service Provider Tax for the purposes of Maine Revenue Services' tax models is included with the sales and use tax forecast and manually separated out. The Service Provider Tax was reduced consistent with the sales and use tax reductions by $4.8 million in FY13 and $11.6 million for the 2014-2015 biennium.

Year-over-year quarterly taxable sales growth has slowed from approximately 5% during late 2011 and early 2012, to only 2% during the third quarter of 2012 and negative to flat growth over the two most recent quarters. The new revenue forecast assumes that the recent fallback in energy prices and adjustment to the higher payroll tax by households will result in taxable sales growth closer to 4% during the next biennium.

The RFC has also reduced the forecast of Corporate Income Tax receipts by $15 million in FY13 and $46.2 million in the 2014-2015 biennium. Corporate receipts are down approximately 23% during the first nine months of FY13 when compared to the same period last fiscal year. The RFC continues to believe much of this recent weakness is a timing issue reflecting the recognition by corporations of the impact of the Maine Capital Investment Credit on their Maine tax liability. Based on a much different forecast of corporate profitability provided by the CEFC we expect weaker corporate tax receipts for the upcoming biennium.

Going forward, the expiration of the investment credit and enhanced Sec. 179 expensing, the ability to use net operating loss (NOL) carry forward again at the state level now that the disallowance of NOL carry forwards for 2009, 2010 and 2011 has ended and the recapture of previous bonus depreciation to which the State did not conform creates a high level of uncertainty for corporate income tax forecast for the next biennium. It's certainly possible that corporate income tax receipts will perform better than this conservative approach the committee has taken for its corporate income tax forecast for the 2014-2015 biennium.

Revisions to the Transfers for Municipal Revenue Sharing are calculated based on 5% of the total collections for the income and sales taxes and as a result of the changes described above, the forecast for these transfers from the General Fund were increased (a decrease in General Fund revenue) in FY13 by $2.0 million, but were lowered for the 2014-2015 biennium by $4.2 million. The forecast for these transfers are based on current law and do not reflect proposed changes in tax law or the Governor's biennial budget proposal to suspend these transfers.

Of note in this revenue sharing forecast is the recognition of an accounting change designed to eliminate the monthly distortion to August revenue caused by the offset for the accrual of the major taxes at the close of each fiscal year. Beginning in FY16, the accounting entry to offset the accrual at the end of the previous fiscal year will not reduce August revenue for the major taxes, but instead will be netted against the accrual for the next fiscal year at the close of the fiscal year. Due to the lag in the timing of the Municipal Revenue Sharing transfers, this will result in a one-time reduction to the deferred transfers creating a one-time reduction of General Fund revenue in FY16.

Another significant positive adjustment in the General Fund forecast was in the Estate Tax, which was increased in FY13 by $5.4 million. The FY13 adjustment is over and above the $7.0 million recognized as budgeted revenue as part of the recently enacted supplemental budget bill and a substantial increase in FY13 in this category in the December 2012 revenue forecast. FY13 Estate Tax collections are projected to be 56.5% higher than FY12. This category was also revised upward by $5.1 million for the 2014-2015 biennium as a result of higher projections of net worth in the economic forecast.

This forecast also recognizes an annual increase in revenue from the Lottery as a result of a pending rebidding of the Lottery contract of $3.2 million annually beginning in FY14. This revenue was also recognized in the Governor's biennial budget proposals and will need to be excluded from the Governor's proposals to avoid double-counting the revenue.

The General Fund forecast included many adjustments to revenue from various other sources that net to slightly less than $1 million of increases over FY13 and the 2014-2015 biennium combined. More detail on the other revenue categories can be found in Appendix A and other background materials in Appendix F.

Highway Fund Summary

	FY12	**FY13**	**FY14**	**FY15**	**FY16**	**FY17**
Current Forecast	$317,202,409	$318,865,765	$311,655,251	$309,740,019	$309,366,380	$308,875,824
Annual % Growth	1.9%	0.5%	-2.3%	-0.6%	-0.1%	-0.2%
Net Increase (Decrease)		($3,460,153)	($3,877,242)	($3,966,383)	($3,960,311)	($3,849,327)
Revised Forecast	$317,202,409	$315,405,612	$307,778,009	$305,773,636	$305,406,069	$305,026,497
Annual % Growth	1.9%	-0.6%	-2.4%	-0.7%	-0.1%	-0.1%

Highway Fund revenue estimates were revised downward by $3.5 million in FY13 and $7.8 million for the 2014-2015 biennium resulting primarily from downward revisions for fuel tax collections.

Fuel tax collections have continued to decline and have fallen well below budget. The tax models have been unable to capture the recent performance. As a result, Highway Fund fuel tax estimates were manually adjusted downward by $3.6 million each fiscal year to account for the recent experience.

Unusual activity related to title fees that resulted in some significant one-time revenue in the December 2012 forecast appears to have had some additional effect on title fee collections that again is recognized in this forecast as a one-time increase of $0.9 million additional revenue in FY13.

There were several other less significant, on-going adjustments to the Highway Fund revenue forecast that are detailed in Appendices B and F.

Fund for a Healthy Maine Summary

	FY12	FY13	FY14	FY15	FY16	FY17
Current Forecast	$55,516,906	$49,479,652	$53,899,312	$53,434,830	$52,974,942	$52,515,005
Annual % Growth	2.1%	-10.9%	8.9%	-0.9%	-0.9%	-0.9%
Net Increase (Decrease)		$1,512,073	($474,118)	($381,995)	($383,918)	($383,752)
Revised Forecast	$55,516,906	$50,991,725	$53,425,194	$53,052,835	$52,591,024	$52,131,253
Annual % Growth	2.1%	-8.2%	4.8%	-0.7%	-0.9%	-0.9%

The Fund for a Healthy Maine (FHM) revenue forecast was adjusted upward by $1.5 million in FY13, but downward by $0.9 million for the 2014-2015 biennium. Tobacco settlement payments in April were $1.5 million above budgeted amounts, but detail was not available by the deadline for this forecast to make a determination of the causes of the positive variance to project it out for future years. There remains a good deal of uncertainty surrounding certain legal proceedings under the Master Settlement Agreement. The RFC may have better information on the current variance and these legal proceeding as for the fall forecast.

The FHM, which receives a percentage of the revenue from slot machines at Hollywood Casino in Bangor, has been adversely affected by the addition of table games at the facility and the opening of the Oxford Casino, resulting in a decrease of $0.9 million to budgeted FHM revenue for the 2014-2015 biennium. FHM budgeted revenue was also modestly reduced by some interest earning assumptions (see details in Appendix C and F).

Medicaid/MaineCare Dedicated Revenue Taxes Summary

	FY12	FY13	FY14	FY15	FY16	FY17
Current Forecast	$151,925,600	$154,373,049	$154,373,049	$154,373,049	$154,373,049	$154,373,049
Annual % Growth	2.6%	1.6%	0.0%	0.0%	0.0%	0.0%
Net Increase (Decrease)		($1,098,071)	($1,098,071)	($1,098,071)	($1,098,071)	($1,098,071)
Revised Forecast	$151,925,600	$153,274,978	$153,274,978	$153,274,978	$153,274,978	$153,274,978
Annual % Growth	2.6%	0.9%	0.0%	0.0%	0.0%	0.0%

The forecast of Medicaid/MaineCare Dedicated Revenue Taxes revenue was adjusted downward based on recent experience. The current year's experience, projects out to a $1.1 million downward revision for each year of the forecast (see Appendix D and F for more detailed information).

Conclusion

Once again the CEFC and the RFC have provided forecasts in a highly uncertain economic environment. Similar to previous years, an economy that appeared to be gaining momentum has stalled, forcing economists to extend the starting date when the US economy will exhibit sustained economic growth of 3% or more. The likelihood that economic growth of that level and consistency can be achieved will depend on how the on-going budget challenges in Washington and the recession in Europe are resolved

The CEFC and RFC have agreed to watch these events carefully, as well as the reaction of businesses and households to them. If the federal budget discussions and/or the economic data deviate significantly from the key assumptions underlying the economic and revenue forecasts both committees are committed to meeting prior to the regularly scheduled forecast meeting dates to review their respective forecasts.