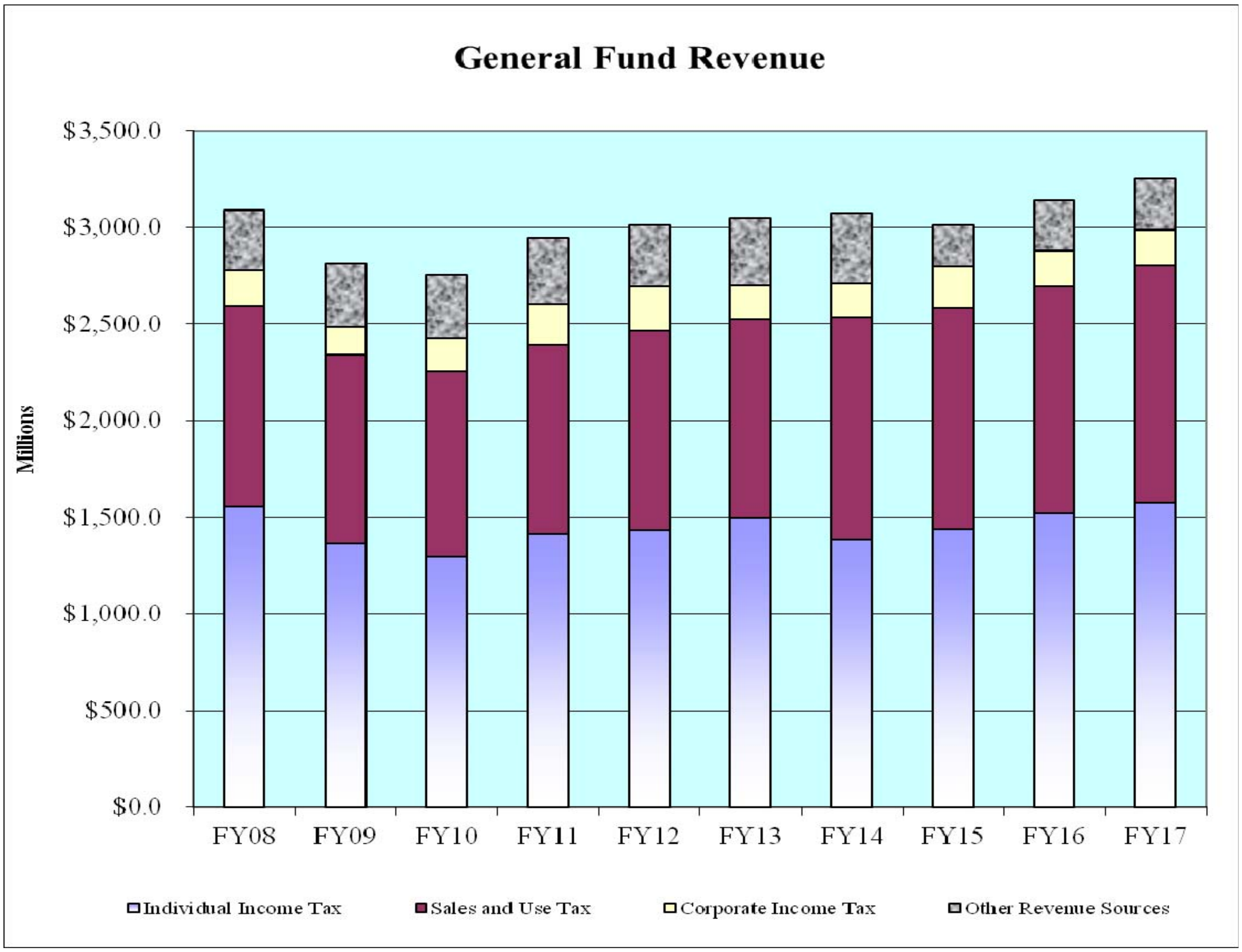
REPORT OF THE MAINE STATE REVENUE FORECASTING COMMITTEE

December 2013



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December 2013 Forecast

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Introduction

The Revenue Forecasting Committee (RFC) met on November 21, 2013 to review and update the current revenue forecast to comply with this year's statutory reporting date of December 1st. The RFC revised its revenue projections through the fiscal year ending June 30, 2017 based on the new economic forecast by the Consensus Economic Forecasting Commission for its November 1st reporting date, updated tax data and a review of recent experience. The RFC updated its forecasts for the General Fund, Highway Fund, Fund for a Healthy Maine and Medicaid/MaineCare Dedicated Revenue Taxes.

Summary of Economic Forecast

This update of the revenue forecast included a review of the economic forecast statutorily due by November 1st, seven months after the last revision. The economic forecast was developed by the Consensus Economic Forecasting Commission (CEFC) at its meeting on October 25.

The Maine and U.S. economies continued on a slow and bumpy road to recovery since the CEFC last met in March 2013, with Maine's economy continuing to grow more slowly than the nation as a whole. Maine's Gross Domestic Product for 2012 was slightly higher than 2011, with all of the growth coming from private industry, but total GDP growth for the state was below the national rate of growth. Personal income in Maine grew 2.3% year-over-year in the first half of 2013, while wage and salary income, which makes up about half of total personal income, grew 2.1% over the same period. The debt-to-income level for Maine businesses and households continued its recent slow rise to 22.4%. The Consumer Price Index was 1.5% higher in August 2013 than it was in August 2012, driven largely by increases in fuels and utilities.

Nationwide, consumer sentiment declined 5.6% month-over-month in September due to the then-looming government shutdown, while small business optimism remained relatively stable over the month and was up over the previous year's level.

The price of crude oil increased 6.3% in the third quarter of 2013 to around $110 per barrel. Heating oil and gasoline prices remained relatively steady. The number of new automobile titles issued by the Maine Bureau of Motor Vehicles increased in FY 2012 compared to FY 2011, although the number of used auto titles decreased.

Existing single-family home sales in Maine were up 20% in August 2013 compared to August 2012 and housing permits for the September 2012-August 2013 year were 13% higher than the previous September-August period. The median home price in the Portland Metropolitan Statistical Area (York, Cumberland, and Sagadahoc Counties) increased 3.3% year-over-year in the second quarter of 2013. Mortgage delinquency rates remain well above pre-recession levels but below peak crisis levels. The foreclosure rate in Maine increased in the second quarter of 2013 and remains well above pre-recession levels.

The major revisions to the forecast were to wage and salary employment, wage and salary income, supplements to wages and salaries, and total personal income. These changes were made based on a consensus that Moody's Analytics and Global Insight forecasts are based on overly optimistic population projections for the state of Maine, causing employment forecasts, among other things, to grow at an unattainable rate. For this reason, employment and the components of income most closely correlated with employment levels were revised downwards.

The 2013 wage and salary employment forecast was revised downwards 0.2 percentage points, from 0.7% to 0.5%, while the 2014-2017 employment forecast was revised downwards 0.3 percentage points each year (to 0.7% for 2014-2016 and 0.5% for 2017). Wage and salary income growth was revised downwards for 2014-2017 based on the lower employment growth. Total personal income was also revised downwards for 2013-2015, reflecting the lower wage and salary income growth. Personal income for 2016 was revised upwards by 0.1 percentage point and 2017 was left unchanged. Inflation, as measured by the Consumer Price Index (CPI), was revised downwards by 0.1 percentage point for 2013 and 2014 and upwards by 0.1 percentage point for 2015, 2016 and 2017.

The federal government experienced a 16-day shutdown earlier in October, ending shortly before the debt ceiling deadline was reached as Congress and the President came to agreement on a short-term solution. While there are certainly negative economic effects from the shutdown, not least of which is an erosion of consumer confidence, the relatively short length of the shutdown averted any severe economic consequences. However, the next budget and debt ceiling debate will occur soon, with the next deadlines in January and February 2014. If a similar scenario were to play out, economic conditions may deteriorate further, posing a risk to the forecast in the near term. The CEFC will review and revise the forecast by February 1, 2014, and will consider the impacts of actual policy decisions at the federal level at that time. It is important to note that the national forecasts that were considered by the CEFC (IHS Global Insight and Moody's Analytics) were produced before the federal government shutdown had run its course and are based on more optimistic scenarios than actually occurred.

A copy of the November 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. As with the May 2013 revenue forecast, the underlying economic forecast lowered the growth assumptions for income and employment, which would in the absence of other factors lower the forecasts of the major taxes produced by the tax models. The strength of recent revenue performance, updated federal tax data and other technical adjustments were once again enough to offset the slower economic growth assumptions to produce net positive revisions to revenue for the major taxes.

Recent performance and data related to non-tax revenue lines were reviewed with a number of different state agencies and 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 November 21st and accepted those recommendations. The following tables and narratives highlight the final changes to each of the major funds and revenue sources projected by the RFC as part of this revenue forecast. More detail on each of the funds and revenue sources is provided in the various appendices.

General Fund Summary

	FY12 Actual	FY13 Actual	FY14	FY15	FY16	FY17
Current Forecast	$3,015,538,222	$3,094,383,842	$3,061,688,898	$3,267,890,598	$3,137,396,936	$3,249,712,446
Annual % Growth		2.6%	-1.1%	6.7%	-4.0%	3.6%
Net Increase (Decrease)			$12,688,716	$7,922,560	$3,976,064	$4,821,630
Revised Forecast	$3,015,538,222	$3,094,383,842	$3,074,377,614	$3,275,813,158	$3,141,373,000	$3,254,534,076
Annual % Growth		2.6%	-0.6%	6.6%	-4.1%	3.6%

General Fund revenue estimates were revised upward by $12.7 million in FY14 and $7.9 million in FY15 ($20.6 million over the 2014-2015 biennium). Upward revisions to the Sales and Use Tax and the Individual Income Tax offset a downward adjustment to the Corporate Income Tax to account for more than 90% of the net changes to the General Fund revenue forecast.

Individual Income Tax revenues were increased in this forecast by $11.1 million in FY14 and $12.1 million in FY 15. Updated tax data from the 2012 tax year and various technical adjustments resulted in a higher base that resulted in the upward revisions and offset the lower income assumptions in the economic forecast through FY16. In FY17, the slower growth assumptions lower the forecast for this category downward by $1.5 million.

The review of updated tax data helped the RFC better refine its estimates of 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. In particular, capital gains grew by roughly 50% in the 2012 tax year, which is less than the 60% growth assumed in the May forecast. The growth of non-resident income tax liability and other business-related income were among several adjustments that contributed to the upward revisions. Wage growth in 2012 was also revised upward from 1.4% to 2%.

A crucial question going forward is what will happen to the income sources that experienced unusually large gains in 2012 (capital gains, dividends, business income, and nonresident income sourced to Maine). The forecast assumes that the excess growth in these items in 2012 reflects a timing response to federal policy changes and that these income sources will return to normal levels in 2013. If, instead, more of the 2012 growth reflects persistent factors that should be incorporated into the forecast base, then the forecast will be excessively conservative. The strong growth in the 3rd quarter of 2013 estimated income tax payment raises the possibility that tax year 2013 revenue will be above forecast. But because estimated payment growth in the first two quarters of 2013 was nowhere near as strong, the RFC did not want to put excessive weight on one estimated payment. The final estimated payment for 2013, which is due in January 2014, will provide important guidance for the next revenue forecast.

After significantly reducing the forecast for Sales and Use Tax receipts as part of the May 2013 forecast, the RFC reversed some of that downward revision with upward revisions of $10.2 million in FY14 and $8.5 million in FY15 for this revenue category. Improved fuel price forecasts and higher projections for automobile sales contributed to this increase. Updated information regarding the effect of the recent repeal of the sales tax exemption for publications also contributed roughly $2 million annually to this upward revision. Taxable sales growth for the last quarter has been substantially above projections led by growth in the automobile and building supply sectors. This forecast does not assume that growth will continue. It assumes taxable sales growth will be lower in future months and that the holiday shopping season will be lackluster.

For the purposes of Maine Revenue Services' tax models, the Service Provider Tax is included with the sales and use tax forecast and must be manually separated out. The Service Provider Tax was reduced by $1.3 million and $2.4 million in FY14 and FY15, respectively, to reflect recent trends.

The RFC reduced the forecast of Corporate Income Tax receipts by $10.4 million in FY14 and $8.4 million in FY15 ($18.8 million for the 2014-2015 biennium). While corporate receipts have been tracking only modestly below budget through October, Maine Revenue Services is currently reviewing a sizeable batch of pending refunds that will be paid out in future months. This indicates that the 2012 tax liability was lower than previously projected. This and other adjustments more than offset an improved national corporate profit picture in the economic forecast.

As a result of the changes to the sales and income taxes described above, Transfers for Municipal Revenue Sharing were revised to reflect a transfer equal to 5% of these taxes. These transfers are lagged one month and as a result of the significant change in the monthly distribution for FY14, largely due to the sales tax rate change, the normal inverse relationship between revisions to the taxes and revenue sharing transfers is distorted on a one-time basis for that fiscal year. General Fund revenue related to these transfers was decreased by $0.8 million for the 2014-2015 biennium.

Some other sizeable downward adjustments include fine revenue (revised downward by $2.0 million for the biennium), telecommunications excise tax ($2.8 million for the biennium) and milk-related transfers and taxes ($1.8 million net).

These downward adjustments were more than offset by upward revisions to securities fee revenue ($1.5 million upward for the biennium), beer and wine excise taxes ($0.9 million) and corporation filing fee revenue ($0.9 million). The revenue transferred to the General Fund through the State Cost Allocation Program (STA-CAP) was increased by $3.3 million in FY14 only.

More detail on the other revenue categories can be found in Appendix A and other background materials in Appendix F.

Highway Fund Summary

	FY12 Actual	FY13 Actual	FY14	FY15	FY16	FY17
Current Forecast	$317,202,409	$318,825,700	$307,858,009	$305,853,636	$305,486,069	$305,106,497
Annual % Growth		0.5%	-3.4%	-0.7%	-0.1%	-0.1%
Net Increase (Decrease)			$717,854	$936,130	$936,130	$936,130
Revised Forecast	$317,202,409	$318,825,700	$308,575,863	$306,789,766	$306,422,199	$306,042,627
Annual % Growth		0.5%	-3.2%	-0.6%	-0.1%	-0.1%

Highway Fund revenue estimates (also refer to Appendix B) were revised upward by $0.7 million in FY14 and $0.9 million in FY15 ($1.6 million for the 2014-2015 biennium). These revisions result primarily from upward revisions for motor vehicle registrations and title fees. The RFC made no adjustments to the forecast for fuel taxes. The tax models forecasts for fuel taxes have been ineffective in adequately forecasting these tax receipts in the last couple of forecasts. These taxes are running modestly ahead of projections through recent years.

The broader category of Motor Vehicle Registrations and Fees was increased by $1.0 million annually in each year of the forecast based on recent performance. Revenue from motor vehicle registrations was 5.3% over budget through the first quarter of FY14. These fees were adjusted upward by $0.9 million in each year of the forecast period. Title fee revenue was 15% over budget through the first quarter of FY14. This combined with Global Insight's projected increase of automobile sales resulted in the RFC revising title fee revenue upward by $0.4 million in each year of the forecast period. A portion of the revenue from these fees is transferred to the Transcap Trust Fund. These upward revisions from these fees is reduced or offset by $0.3 million annually to account for these transfers..

In FY14 only, reimbursement to the Highway Fund for State Cost Allocation program expenditures was adjusted downward by $0.2 million.

Fund for a Healthy Maine Summary

	FY12 Actual	FY13 Actual	FY14	FY15	FY16	FY17
Current Forecast	$55,516,906	$50,992,315	$53,425,194	$53,052,835	$52,591,025	$52,131,253
Annual % Growth		-8.1%	4.8%	-0.7%	-0.9%	-0.9%
Net Increase (Decrease)			$1,280,588	$1,288,147	$1,270,426	$1,252,855
Revised Forecast	$55,516,906	$50,992,315	$54,705,782	$54,340,982	$53,861,451	$53,384,108
Annual % Growth		-8.1%	7.3%	-0.7%	-0.9%	-0.9%

The Fund for a Healthy Maine (FHM) revenue forecast was adjusted upward by $2.6 million for the 2014-2015 biennium. The increase was primarily the result of trending tobacco settlement payments off of higher FY13 payments that were $1.5 million above budgeted amounts. There remains a good deal of uncertainty surrounding certain legal proceedings under the Master Settlement Agreement. While Maine prevailed in the legal challenge related to the NPM (non-participating manufacturer) adjustment for 2003 calendar year sales, the release of Maine's share of the disputed payments for that sales year, roughly $5.6 million, is being challenged and held up by certain states that were not successful in these proceedings. The RFC may have better information on these legal proceeding for the March 2014 forecast. There is a potential for Maine's share of these disputed payments to be included in the April 2014 payment, but the RFC was not comfortable assuming that for this forecast.

The FHM, which receives a percentage of the revenue from slot machines at Hollywood Casino in Bangor, is once again being revised downward by $0.4 million for the 2014-2015 biennium to reflect recent performance. The newer Oxford Casino has been performing better than anticipated, but at the expense of Hollywood Casino in Bangor. FHM budgeted revenue was also modestly increased by interest earning assumptions for FY14 (see details in Appendix C and F).

Medicaid/MaineCare Dedicated Revenue Taxes Summary

	FY12 Actual	FY13 Actual	FY14	FY15	FY16	FY17
Current Forecast	$151,925,600	$153,241,054	$171,805,470	$171,805,470	$171,805,470	$171,805,470
Annual % Growth		0.9%	12.1%	0.0%	0.0%	0.0%
Net Increase (Decrease)			$216,047	$216,047	$216,047	$216,047
Revised Forecast	$151,925,600	$153,241,054	$172,021,517	$172,021,517	$172,021,517	$172,021,517
Annual % Growth		0.9%	12.3%	0.0%	0.0%	0.0%

The forecast of Medicaid/MaineCare Dedicated Revenue Taxes revenue was adjusted upward based on recent experience. The current years' experience projects out to a $0.2 million upward revision for each year of the forecast (see Appendix D and F for more detailed information). The significant increase in revenue from FY13 to FY14 is primarily the result of legislation (PL 2013, c. 368) modifying the hospital tax base year from hospital fiscal years ending during calendar year 2008 to hospital fiscal years ending during calendar year 2012 beginning in FY 14.

Conclusions

The timing of this forecast was such that the national economic forecasts were updated prior to the conclusion of the negotiations over the federal debt ceiling and the federal shutdown and were more optimistic in their assumptions than the actual events. The short-term nature of the solutions to the federal negotiations means that the CEFC and the RFC will potentially be dealing with a similar situation and uncertainty when they convene for the winter updates in January and February.

The economic and revenue forecasts have settled into a less volatile pattern of more modest changes in the last few forecasts, which contrasts with the significant swings we experienced during the recession. However, the relative stability of these forecasts, projecting a slow, steady recovery, could change if federal negotiations result in another shutdown or fail to address the debt ceiling in January and February, respectively. A second federal government shutdown, following so closely after the October shutdown, could have a significant negative impact on business and consumer confidence, posing a downside risk to the economic forecast.