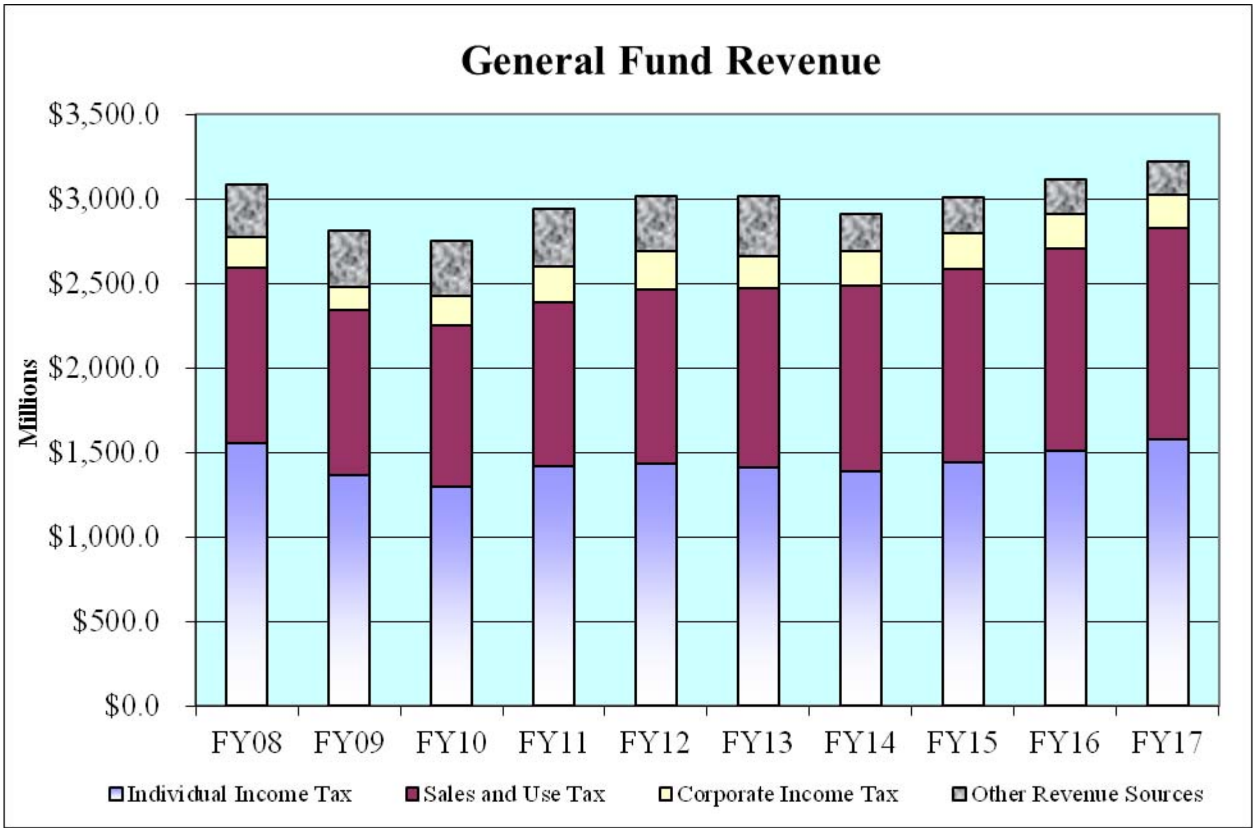
REPORT OF THE MAINE STATE REVENUE FORECASTING COMMITTEE

December 2012



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December 2012 Forecast

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Introduction

The Revenue Forecasting Committee (RFC) met on November 28, 2012 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, 2015 and as the Legislature begins a new biennium extends the forecast period through the fiscal year ending June 30, 2017 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 November 1st. That economic forecast was developed by the Consensus Economic Forecasting Commission (CEFC) at its meetings on October 25 and 29, 2012. At the invitation of the CEFC, leaders of several Maine business and industry groups shared economic data and industry-specific information to give the Commission a real world perspective beyond the numbers. Overall, these business perspectives helped confirm the CEFC's subsequent findings that Maine should not expect significant economic growth in the short run.

National and state economic indicators suggest little improvement in economic conditions since the CEFC met in February 2012. Maine's coincident economic activity index was unchanged in the three months ending in August and remains below pre-recession levels. Nationwide, consumer sentiment and small business optimism are up over year-ago levels. Personal income in Maine grew 3.0% year-over-year in the first half of 2012, while wage and salary income grew 1.3% over the same period. The Consumer Price Index was 2.0% higher in September 2012 than it was in September 2011.

The price of crude oil remained fairly steady in the third quarter of 2012 around $92 per barrel. Home sales in Maine increased in six of the seven months after January 2012. Month-over-month, housing permits in Maine grew 33% in August. 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 2012 and remains well above pre-recession levels.

The CEFC revised its forecast of wage and salary employment growth upward slightly for 2012 and downward slightly for 2013 through 2015 to reflect more robust current-year employment growth and longer-term structural workforce challenges, respectively. Personal income growth was revised upward for 2012 in part to reflect the stronger employment growth and in 2013 to reflect increased dividends, interest and rent income, while 2014 and 2015 were revised downward. Inflation was revised upward for 2012, primarily the result of drought induced food price increases, and downward for 2013 through 2015.

The CEFC felt that uncertainty over the so-called "fiscal cliff" (the elimination of several federal tax reductions and automatic federal budget cuts) has continued to restrain economic growth. Failure to resolve this at the federal level could impact GDP by an estimated 3% nationally. In its forecast the CEFC assumed a positive resolution to the "fiscal cliff" by the new Congress and the President. If a timely solution is not forthcoming, the CEFC will revisit the economic forecast in the first quarter of calendar year 2013. The other principal risks to the forecast are the depths and longevity of the continuing economic crisis in Europe, prospects for global economic growth and uncertainty in energy markets.

A copy of the November 2012 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 did make some adjustments to the projections of the growth rates of the major economic variables, the forecast was heavily influenced by the year-to-date performances of major tax lines and other "technical adjustments" made by Maine Revenue Services. As was the case in the March 2012 revenue forecast, these adjustments to the tax models established a lower base to which growth rates were applied, resulting in lower projections for the major taxes throughout the forecast. 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 November 28th and made some adjustments to 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 December 2012 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 Actual	FY13	FY14	FY15	FY16	FY17
Current Forecast	$3,015,538,222	$3,056,234,628	$2,972,636,157	$3,078,473,951		
Annual % Growth	2.4%	1.3%	-2.7%	3.6%		
Net Increase (Decrease)		($35,452,373)	($58,326,894)	($66,909,279)	$3,119,091,267	$3,222,544,770
Revised Forecast	$3,015,538,222	$3,020,782,255	$2,914,309,263	$3,011,564,672	$3,119,091,267	$3,222,544,770
Annual % Growth	2.4%	0.2%	-3.5%	3.3%	3.6%	3.3%

General Fund revenue estimates were revised downward by $35.5 million in FY13, $58.3 million in FY14 and $66.9 million in FY15 ($125.2 million over the 2014-2015 biennium). Most of the decline came from the top three tax lines: Sales and Use, Individual Income and Corporate Income taxes.

Sales and use tax receipts will be $8.9 million less in FY13 than previously forecasted and $21.1 million lower in the 2014-2015 biennium. Year-over-year quarterly sales tax growth has slowed from approximately 5% during late 2011 and early 2012 to only 2% during the second half of 2012 as consumers and households reacted to a weak economic recovery, rising energy prices during late summer and early fall and uncertainty regarding resolution of US and European fiscal policy challenges. The new forecast assumes that the recent fallback in energy prices and an orderly resolution of the national and international fiscal issues will result in taxable sales growth closer to 4% during the second half of FY13 and into the next biennium.

Individual income tax revenue is lowered in this forecast by $23.2 million in FY13 and $8 million in the 2014-2015 biennium. These changes reflect a combination of technical changes to Maine Revenue Services' individual tax microsimulation model and the application of the updated economic forecast to the new model. The technical changes included the incorporation of 2010 and preliminary 2011 federal income tax data and 2011 Maine income tax data into the tax model and updating the database used by the tax model from 2000 to 2008. After these changes, the model prediction for income tax in 2011 closely matches actual liability for that year, unlike the prior version of the model, which overstated liability for 2011. This does provide some assurance that the predictive quality of the new model will be better than the old. Due primarily to the lower 2011 base and the technical changes, the estimate for income tax liability in subsequent years has fallen as well. The lowered estimate for FY13 from the model is also consistent with the low withholding growth through November. The new estimate for FY13 assumes no income shift into calendar 2012 due to the scheduled expiration of federal tax cuts and the new Medicare tax components of the Affordable Care Act which go into effect beginning in January, 2013. Any timing behavior would likely increase fiscal year 2013 tax revenue at the expense of future revenue.

The tax line with the most significant negative adjustment was the Corporate Income Tax. The RFC has reduced the forecast for this category by $18.2 million in FY13 and $92.6 million in the 2014-2015 biennium. Corporate income tax receipts are down approximately 35% during the first five months of FY13 compared to the same five month period last year. With little tax data to go on, the RFC believes much of the recent weakness is a timing issue reflecting the recognition by corporations of the impact of the Maine Capital Investment Credit on their 2011 Maine Tax Liability. Based on the forecast of corporate profitability provided by the CEFC and the fact that the investment credit is cut in half in 2012 we expect a rebound in corporate final and estimated payments later this year. Going forward, the expiration of the investment credit and enhanced Sec. 179 expensing, the ability to use net operating loss carryforwards again at the state level now that the disallowance of carryforwards for 2009, 2010 and 2011 has ended and the recapture of previous bonus depreciation the state did not conform to create such a high level of uncertainty that the RFC believes it is prudent to significantly scale back its corporate income tax forecast for the next biennium. Similar to the individual income tax, there is a high probability that corporate income tax receipts will perform better than this conservative approach taken for the 2014-2015 biennium.

There were other adjustments to revenue lines, both positive and negative. The largest positive variance that helped keep the revenue reduction from being worse was in the Estate Tax, which was increased in FY13 by $15.1 million. There was one very large unanticipated collection in FY13 that could not have been predicted and the base assumption for net worth is slightly higher. 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	FY14	FY15	FY16	FY17
Current Forecast	$317,202,409	$316,679,543	$319,761,131	$321,955,253		
Annual % Growth	1.9%	-0.2%	1.0%	0.7%		
Net Increase (Decrease)		$2,186,222	($8,105,880)	($12,215,234)	$309,366,380	$308,875,824
Revised 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%

Highway Fund revenue estimates were revised upward by $2.2 million in FY13 and downward by $8.1 million in FY14 and $12.2 million in FY15. The downward revisions to projections for the 2014-2015 biennium net to $20.3 million. (Also see Appendices B and F).

The biggest reductions in Highway Fund revenue were in the Fuel Taxes category, which dropped $2.8 million in FY13, $9.0 million in FY14 and $13.1 million in FY15. The high volatility of the Fuel Taxes category from month to month compared to budget has made it difficult to ascertain a general trend and the changes made were determined primarily by targeting the model to actual revenue received through October.

An unusual one-time payment of title fees from a trucking company having to re-title roughly 179,000 trailers in Maine because of a change in lienholder resulted in a significant positive variance in October. The RFC recognized this one-time revenue and increased net title fees by $4.1 million in FY13, more than offsetting the negative adjustments in Fuel Taxes in that year.

Fund for a Healthy Maine Summary

	FY12 Actual	FY13	FY14	FY15	FY16	FY17
Current Forecast	$55,516,906	$49,478,341	$54,170,115	$53,755,459		
Annual % Growth	2.1%	-10.9%	9.5%	8.6%		
Net Increase (Decrease)		$1,311	($270,803)	($320,629)	$52,974,942	$52,515,005
Revised 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%	8.0%	7.1%	-2.6%

The reduction in the 2014-2015 biennium in Fund for a Healthy Maine (FHM) revenue was attributable to adjustments made to the Hollywood Casino Bangor forecast. For FY 13 only, no revenue from this source accrues to the FHM and instead accrues to the General Fund. The FY 13 modest increase comes from earnings on investments. The biggest contributor to FHM revenue, Tobacco Settlement Payments, remained unchanged in this forecast because no updated national projections for tobacco settlements are available. The current trend of an annual decline in payments for FY 14 and FY 15 is continued through FY 17. While remaining confident in the legal case Maine presented that it has diligently enforced the provisions of the Master Settlement Agreement, given the uncertainty of this unprecedented arbitration and that surrounding the timing of the resolution of these pending legal proceedings, the forecast does not yet assume recovery of withheld disputed payments.

Medicaid/MaineCare Dedicated Revenue Taxes Summary

	FY12 Actual	FY13	FY14	FY15	FY16	FY17
Current Forecast	$151,925,600	$154,373,049	$154,373,049	$154,373,049		
Annual % Growth	2.6%	1.6%	0.0%	0.0%		
Net Increase (Decrease)		$0	$0	$0	$154,373,049	$154,373,049
Revised 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%

No adjustments have been made to the previous forecast of Medicaid/MaineCare Dedicated Revenue Taxes revenue. The forecast continues to assume these revenue sources will remain flat during the forecast period.

Conclusion

It has become a custom in recent years for the RFC to alert the Governor and the Legislature of potential risks to the new forecast. While the volatility of national and state economic forecasts has significantly lessened and settled on a forecast of slow recovery, these forecasts contain a critical assumption that the

President and Congress will constructively address the looming “fiscal cliff” and avoid sending the nation back into recession. As of this time, the outcome of the negotiations remains uncertain. That uncertainty has been a contributing factor to the lackluster economic recovery as businesses are reluctant to invest given the extent of pending tax changes of the “fiscal cliff” and even after the negotiations conclude. Given this uncertainty and the potentially significant effects of taxpayer behavior, the RFC took a very conservative approach in this forecast. Therefore, assuming an outcome to the negotiations in Washington produce a substantive budget resolution that strikes the right balance between a fiscally sustainable budget and economic growth, there is reason to believe that for the first time since the recession began there may be some upside risk to this forecast. The CEFC and the RFC will be watching these negotiations carefully, as well as the reaction of businesses and households to that process. If the federal negotiations 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 next scheduled meeting dates to consider providing updated forecasts.