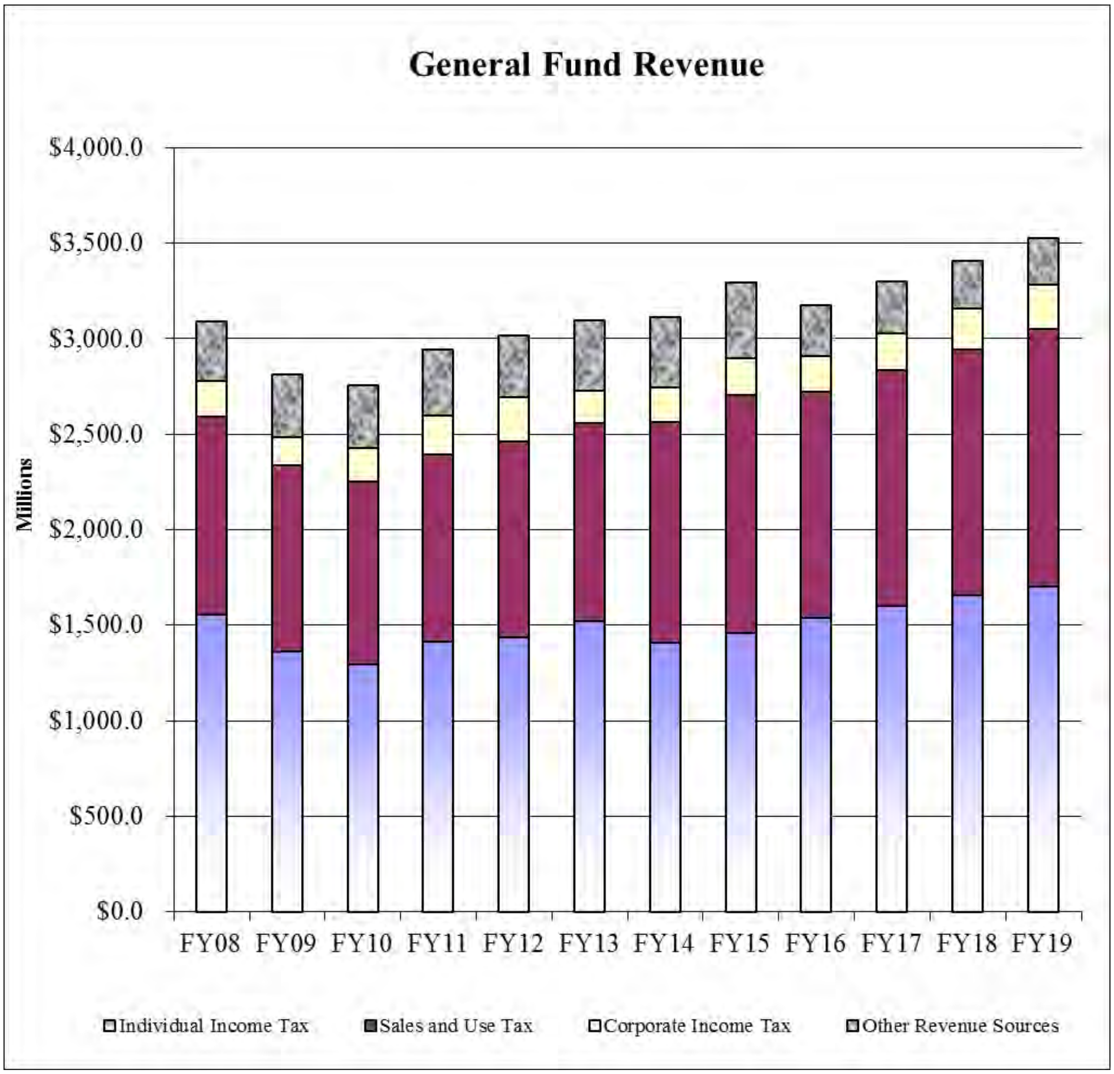
REPORT OF THE MAINE STATE REVENUE FORECASTING COMMITTEE

December 2014



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December 2014 Forecast

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Introduction

The Revenue Forecasting Committee (RFC) met on November 21, 2014 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 and as the Legislature begins a new biennium extends the forecast period through the fiscal year ending June 30, 2019 for the General Fund, Highway Fund, Fund for a Healthy Maine and Medicaid/MaineCare Dedicated Revenue Taxes.

Economic Forecast

The Consensus Economic Forecasting Commission met on October 24, 2014, to update their forecast through 2017 and additionally forecast through 2019. The Commission began with their annual fall information gathering session, where they invite a number of Maine industry associations to share with them on-the-ground observations about Maine's current and future economy. This fall they heard from seven different associations representing a broad array of Maine businesses whose perspectives helped confirm to the Commission that Maine's economy is continuing to see slow growth with the aging population and lack of population growth posing substantial challenges. The Commission also received information on recent economic indicators from the Office of Policy and Management (OPM) and heard presentations by Glenn Mills of the Maine Department of Labor and Michael Allen of the Department of Administrative and Financial Services.

During the forecasting meeting, the Commission considered three different scenarios in comparison with their previous forecast from February 1, 2014. These scenarios included baseline forecasts from Moody's Analytics and IHS Economics as well as an alternative scenario developed by OPM. This alternative scenario was structured to take into account the Commission's assumption that Maine's likely population growth is considerably lower than that used by the Moody's and IHS baselines, leading to constraints on the state's employment growth.

The alternative scenario was based on the Moody's Analytics baseline with two major adjustments. The total population forecast was adjusted downward according to recent U.S. Census Bureau estimates and OPM's *Population Outlook to 2030*. In addition, industry sector employment was adjusted to bring the employment forecast closer to the Maine Department of Labor's Job Outlook to 2022 with considerations for likely revisions to existing employment data. The Commission felt that this alternative scenario fit most closely with their current views of the economy and largely adopted this forecast with an additional adjustment to employment growth in 2014.

The Commission's November 1, 2014, forecast targets an employment level of around 607,000 for 2014, based on current data and an assumption that year-to-date figures will be revised downward during the March 2015 benchmarking process. This results in a forecast of 1.0% employment growth in 2014, up from 0.7% growth in the February 1 forecast. Employment growth is then forecast at 0.9% in 2015, 0.6% in 2016, 0.4% in 2017, and 0.1% for 2018 and 2019. This results in an employment level of 620,600 in 2019 and returns Maine to pre-recession employment levels in 2017.

Since the Commission last met, the U.S. Bureau of Economic Analysis released a revision of personal income data back to 2001, which contributed to the Commission's adjustments of personal income growth forecasts. Wage and salary income growth was revised downward for 2014, from 3.4% to 2.9%, and upward for 2015-2017 (to 3.9% in 2015, 4.0% in 2016, and 3.6% in 2017). 2018 was forecast at 3.4% and 2019 at 3.0%. Total personal income growth was revised downward for 2014-2017, to 3.3% in 2014, 3.5% in 2015, 3.7% in 2016, and 3.9% in 2017. 2018 was forecast at 3.4% and 2019 at 3.1%.

Inflation, as measured by the Consumer Price Index, was adjusted upward for 2014-2017, largely because the Commission had previously adopted the IHS forecast, which assumes lower energy price growth in the future than the Moody's forecast that was adopted this time. The Consumer Price Index is forecast to see growth of 1.8% in 2014, 2.1% in 2015, 2.4% in 2016, 2.8% in 2017, 2.9% in 2018, and 2.6% in 2019.

Overall, while the Commission continues to forecast slow growth for Maine's economy, the demographic situation in the state is of great concern, as the aging population and lack of population growth will limit employment growth and income growth going forward.

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. 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 21st and agreed 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 2014 update to the revenue forecast. More detail on each of the funds and revenue sources is provided in the various appendices.

General Fund Summary

	FY14 Actual	FY15	FY16	FY17	FY18	FY19
Current Forecast	$3,113,496,933	$3,247,324,775	$3,146,346,603	$3,261,611,293		
Annual % Growth	0.6%	4.3%	-3.1%	3.7%		
Net Increase (Decrease)		$45,533,260	$28,372,942	$39,175,130	$3,409,226,783	$3,524,001,898
Revised Forecast	$3,113,496,933	$3,292,858,035	$3,174,719,545	$3,300,786,423	$3,409,226,783	$3,524,001,898
Annual % Growth	0.6%	5.8%	-3.6%	4.0%	3.3%	3.4%

General Fund revenue estimates were revised upward by $45.5 million in the current fiscal year, by $28.4 million in FY16 and $39.1 million in FY17 ($67.5 million over the 2016-2017 biennium).

The revised forecast increases sales tax revenue by $6.3 million in FY15 and $14.2 in the 2016-2017 biennium. The reduction in the CEFC personal saving rate forecast from 4.9% in 2013 to 1.4% in 2019 had a significant impact on the forecast. Sales and use tax revenue was $4 million under budget through October of the fiscal year. Year-over-year taxable sales were up 2.5% for the 12 months ending in September. The general merchandise sectors have been especially weak over the past year. Lower energy prices and an improving labor market should help improve this line in the months ahead.

Individual income tax revenue was over budget by $25.4 million in FY14, mostly due to higher than anticipated tax liability for tax year 2013. The December RFC forecast recommends an increase in revenues of $6.2 million, $15.6 million, and $16.7 million for FY15 through FY17. This revenue forecast can be thought of as the product of FY 2014 revenue and the cumulative revenue growth rate after FY14. The upward revision in the December forecast is entirely due to upward revision of FY14 revenue; cumulative revenue growth after FY14 is actually lower in the December forecast compared to the previous forecast. FY15 revenue growth declined from 5.4% to 4.0%, a result that is consistent with both fiscal year-to-date payments and the income tax model results that incorporate new tax data and a new economic forecast. Cumulative revenue growth in FY16 and FY7 declined about .9 percentage points.

The December revenue forecast continues to rely on the income tax model estimates of the Property Tax Fairness credit although the model overstated the tax year 2013 credit by about $13 million. This conservative approach recognizes the possibility that credit takeup among credit-eligible families could increase after the first year of the credit and that the significant changes to the 2014 credit could affect the forecast error. We will closely monitor the 2014 credit when the 2014 filing season begins and revise our estimates appropriately.

Corporate Income tax receipts were over budget in FY14 by $13.2 million and are $5.7 million over budget through the first four months of FY15. The RFC increased the forecast of Corporate Income tax revenue by $12.6 million in FY15 and $8.1 million for the 2016-2017 biennium. The new forecast reflects changes to the economic forecast for pre-tax corporate profits. Corporate profits are now estimated to grow slightly slower in calendar year 2014, but significantly stronger in calendar years 2015 and 2016. The forecast also accounts for several temporary state level tax law changes that will continue to have an impact on corporate income tax revenues in next two biennia.

Estate tax revenues were $13.1 million over budget through the first four months of FY15. A number of moderately large estates accounted for the year-to-date surplus. The RFC increased the FY15 projection for estate tax receipts by $11.4 million to account for the strong performance through October. A new forecast of household net-worth contributed to an increase of $2.8 million in the FY16/17 biennium. Final data on 2013 estate tax returns and initial information on 2014 returns will be available for the May 1st forecast and they will provide a better indicator of estate tax performance post-2011 tax changes.

Other notable adjustments to General Fund revenue lines include:

- Other Taxes and Fees/Milk Handling Fee – The forecast was adjusted for all years based on predicted milk prices (see Appendix F for more detail).
- Other Taxes and Fees/Finance Industry Fees – The FY15 forecast for Securities fee revenue was increased $1.0 million, based on both historical and current year performance and adjusted upward by $.5 million in each fiscal year of the next two biennia. Despite the projected forecast increases, total revenues in each fiscal year result in a decline over FY14 Securities fee actual revenue received of $25.3 million, consistent with the projected trend towards exchange traded funds.
- Other Revenue/State Cost Allocation Program (STACAP) – The FY15 forecast was increased primarily based on current year performance, through the first four months, and the forecast for the next two biennia increased consistent with final FY14 STACAP budgeted revenue, of $18.3 million.
- Other Revenue/Liquor Sales and Operations. The FY15 forecast was increased to account for the final contract payment from the contract that ended June 30, 2014 and a one-time transfer of unclaimed bottle deposit funds resulting from a change in contractors.

Highway Fund Summary

	FY14 Actual	FY15	FY16	FY17	FY18	FY19
Current Forecast	$317,076,966	$308,576,740	$308,222,674	$307,829,602		
Annual % Growth	-0.5%	-2.7%	-0.1%	-0.1%		
Net Increase (Decrease)		$7,397,587	$10,801,835	$14,741,506	$325,653,401	$328,748,328
Revised Forecast	$317,076,966	$315,974,327	$319,024,509	$322,571,108	$325,653,401	$328,748,328
Annual % Growth	-0.5%	-0.3%	1.0%	1.1%	1.0%	1.0%

Highway Fund revenue estimates were revised upward by $7.4 million in the current fiscal year, by $10.8 million in FY16 and by $14.7 million in FY17 ($25.5 million over the 2016-2017 biennium). The changes in the Highway Fund projections are largely driven by total motor fuel tax revenue (gasoline and special fuel) which was $6.2 million over budget in FY14. Based on a Moody's Analytics forecast of motor fuel gallons sold, the revenue projection for total motor fuel tax revenue was increased by $7.4 million in FY15. This represents flat growth over FY14. Also on the basis of Moody's Analytics, the projection for the 2016-2017 biennium was increased by $27.7 million which represents a growth rate of 1.5% per year.

Fund for a Healthy Maine Summary

	FY14 Actual	FY15	FY16	FY17	FY18	FY19
Current Forecast	$60,558,934	$60,684,531	$54,694,606	$54,274,770		
Annual % Growth	18.8%	0.2%	-9.9%	-0.8%		
Net Increase (Decrease)		($7,429,240)	($800,598)	($1,361,113)	$48,531,611	$47,647,398
Revised Forecast	$60,558,934	$53,255,291	$53,894,008	$52,913,657	$48,531,611	$47,647,398
Annual % Growth	18.8%	-12.1%	1.2%	-1.8%	-8.3%	-1.8%

As discussed in the March 14 forecast, Maine prevailed in its legal challenge related to the NPM (non-participating manufacturer) adjustment for 2003 calendar year sales. The release of Maine's share of these disputed payments for that sales year of $5.6 million in FY14 instead of FY15 as was assumed in the March 2014 forecast, resulted in an increase in FY14 actual payments and a decrease in estimated FY 15 payments by the $5.6 million disputed payment amount. In addition, confusion at the national level regarding the distribution of funds included in the April 2014 payments may have resulted in an overpayment to Maine of approximately $1.36 million in FY14. The forecast assumes this $1.36 million FY14 overpayment will be offset against Maine's April 2015 resulting in a further one-time reduction in the FY15 forecast. Tobacco Settlement Payments forecast for FY16 and FY17 reflect the latest estimates from the National Association of Attorneys General (NAAG).

Payments forecast for FY18 and FY19 reflect a continuation of the NAAG forecast trend with modifications made in the forecast Strategic Contribution Payments (SCPs) scheduled to occur after the ten year life of the SCPs. Beginning in FY18, SCP payments will end but nationally, the funding provided for SCP payments will be reallocated to base payments. Because Maine's allocable share of the SCP is roughly twice that of our allocable share of the base payment, the effective result is that beginning in 2018, our SCF payment goes away, but our base payment will increase by about half what our SCF payment would have been.

Medicaid/MaineCare Dedicated Revenue Taxes Summary

	FY14 Actual	FY15	FY16	FY17	FY18	FY19
Current Forecast	$168,609,944	$169,437,676	$169,437,676	$169,437,676		
Annual % Growth	10.0%	0.5%	0.0%	0.0%		
Net Increase (Decrease)		$2,073,039	$2,500,251	$2,500,251	$171,937,927	$171,937,927
Revised Forecast	$168,609,944	$171,510,715	$171,937,927	$171,937,927	$171,937,927	$171,937,927
Annual % Growth	10.0%	1.7%	0.2%	0.0%	0.0%	0.0%

The forecast of Medicaid/MaineCare Dedicated Revenue Taxes revenue was revised upward by $2.1 million for FY15 and by $2.5 million for FY16 and FY17 based on updated information. The increase includes an assumed increase in Nursing Facility Tax payments as a result of increased MaineCare Nursing Facility payments, an increase in Service Provider tax payments to reflect recent payment trends and a one-time FY15 Hospital Tax payment reflecting an adjusted payment schedule from a hospital provider.

Conclusion

Once again the Revenue Forecasting Committee's adjustments to its previous forecast have been relatively small, reflecting the slow but steady growth of Maine's recovery from the Great Recession. In their November 1st economic forecast, the Consensus Economic Forecasting Commission (CEFC) assumes the economy will grow at a slightly more robust pace over the next five years relative to recent experience. Consistent with that forecast the new RFC projections are for stronger revenue growth in the 2016-2017 and the 2018-2019 biennia after adjusting for the expiration of the temporary sales tax increase at the end of FY15.

While the short-term outlook is generally positive, both the RFC and the CEFC remain concerned about Maine's demographic situation. With an aging population and little to no population growth, employment and income growth will be restrained going forward. In this year's forecast exercise the CEFC began the process of incorporating population and employment assumptions that are consistent with population projections by the Office of Policy and Management and the implications of those projections on employment growth guided by the Maine Department of Labor. Both the RFC and the CEFC are committed to refining this process and to better understanding how Maine's demographic trends will affect its future economic and revenue potential.