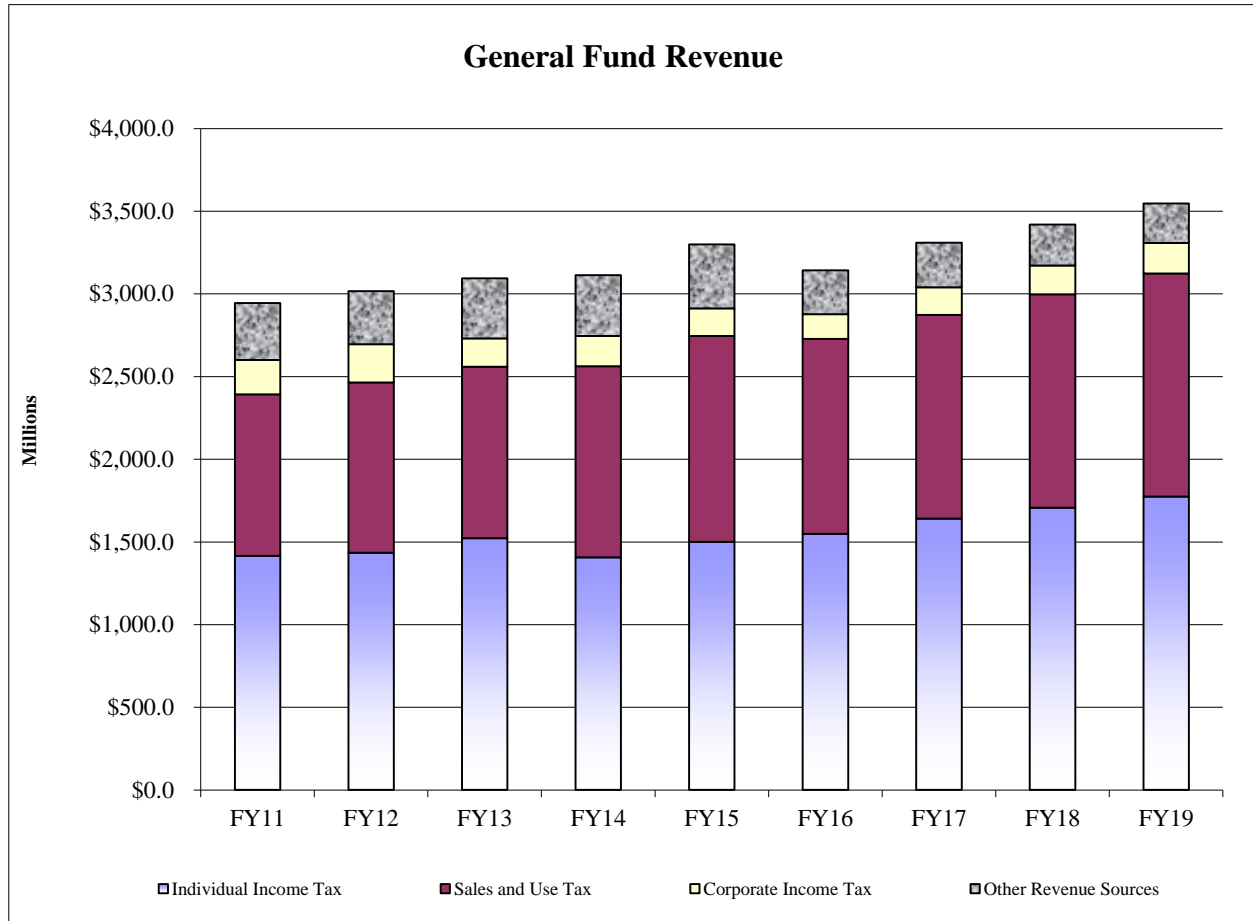


REPORT OF THE MAINE STATE REVENUE FORECASTING COMMITTEE

May 2015



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Report of the Maine State Revenue Forecasting Committee May 2015 Forecast

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Introduction

The Revenue Forecasting Committee (RFC) met on April 29, 2015 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, 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 (CEFC) met on March 30, 2015 to review and update their economic forecast through 2019. The first part of the meeting consisted of presentations on labor market conditions from the Maine Department of Labor and on current revenues from the Maine Department of Administrative and Financial Services. The Commission then considered and came to agreement on changes to its November 2014 forecast for inclusion in its April 2015 report.

The Maine and national economies continued to show signs of improvement since the CEFC met in October of 2014. Historical employment revisions and new 2014 data for employment, income, the Consumer Price Index (CPI), and corporate profits have been released since the Commission's last meeting. These revisions and new data contributed to adjustments in the forecast. Additionally, the Commission continued to largely follow an alternative scenario ("LowPop") created by the Office of Policy and Management, which provides staff support to the CEFC. This alternative scenario is based on the Moody's Analytics baseline with adjustments that lowered the population and employment growth forecasts. These adjustments are a result of the consensus that the national level 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.

There were three key factors identified during the CEFC's discussion as impacts on the forecast: Maine's demographic outlook, the recent steep decline in oil prices, and the strengthening U.S. dollar. Employment growth will likely be held back by the limited availability of workers in the next few years resulting from Maine's lack of growth in the working age population. This was a consideration in the previous CEFC forecast as well, so did not result in any significant changes to this forecast. The drop in oil prices and the surge in the dollar have both occurred since the previous forecast, and so contributed to changes in the forecast for the CPI, personal income and corporate profits.

Overall, the employment forecast saw only minor modifications to the growth rates, although the lower 2014 base results in employment levels that are lower than previously forecast. The 2019 employment level is nearly the same as the 2007 pre-recession peak. The largest change to CPI is in 2015: a significant downward revision resulting from the decline in oil prices. The remaining years were each revised slightly downward. Total personal income was also revised downward in 2015, resulting from a downward revision to wage and salary income linked to lower inflation. 2016-2019 wage and salary income and total personal income were revised upward. While many of the forecast indicators were taken from the "LowPop" scenario, some adjustments were made to specific years and in some cases, the IHS forecast seemed to be more realistic and so was used instead.

A copy of the April 2015 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' (MRS) 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 April 29th 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 May 2015 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	\$3,276,843,885	\$3,174,826,695	\$3,305,362,573	\$3,413,888,433	\$3,527,505,498
Annual % Growth	0.6%	5.2%	-3.1%	4.1%	3.3%	3.3%
Net Increase (Decrease)		\$22,078,705	(\$32,307,756)	\$3,083,541	\$5,631,218	\$19,040,617
Revised Forecast	\$3,113,496,933	\$3,298,922,590	\$3,142,518,939	\$3,308,446,114	\$3,419,519,651	\$3,546,546,115
Annual % Growth	0.6%	6.0%	-4.7%	5.3%	3.4%	3.7%

General Fund revenue estimates were revised upward by \$22.1 million in the current fiscal year, downward by \$32.3 million in FY16 and upward by \$3.1 million in FY17 (downward by \$7.1 million for the three year period).

The new economic forecast from the CEFC resulted in the revenue forecasting model used by the MRS Office of Tax Policy (OTP) to project significantly lower sales and use tax revenue for all the fiscal years in the current budget window. Based on sales and use tax receipts through March, and preliminary data through late April, there is no indication that the December 1st forecast should be adjusted at this time. Taxable sales surged during the final quarter of 2014 as energy prices plunged. While taxable sales slowed throughout the nation in the first quarter of 2015, the Maine sales and use tax forecast remained close to budget and is expected to continue to track the December forecast through the remainder of the fiscal year. With expectations that energy prices will remain relatively low and the economic recovery will continue, the RFC decided to accept the Office of Tax Policy recommendation that the sales and use tax forecast from December go unchanged.

The individual income tax forecast is one of the few revenue lines that the RFC adjusted in the May forecast. The Office of Tax Policy recommended an increase in the FY15 projection of \$51.3 million, \$6.6 million in FY16 and \$33 million in FY17. The change in the 2018-2019 biennium is an increase of \$119.7 million. While the new economic forecast generally resulted in relatively minor downward adjustments to the forecast, there were two technical changes that accounted for most of the net upward reprojected. First, in the original revenue estimate, and subsequent revenue forecasts, OTP assumed the New Markets Tax Credit (NMTC) would be claimed by owners of pass-through entities and therefore impact individual income tax revenues. Based on updated information we now know that corporations and financial institutions will be claiming the credit. Recognition of this information merely shifts the revenue impact from the individual income tax to the corporate income tax, with the timing of the revenue impact being the only change to the General Fund forecast. Second, with the April 15 processing complete, it's clear the Property Tax Fairness Credit (PTFC) will be less than previously projected. OTP now estimates the cost of the PTFC will be \$16.5 million, roughly half of the amount forecasted in December. Preliminary analysis of 2014 tax returns shows that a combination of

overestimating eligibility for the PTFC and imperfect credit take-up among eligible taxpayers are the reasons for the lower cost.

In addition to the two technical changes above, the new individual income tax forecast recognizes the strong performance of April final and estimated payments. Final payments increased by a healthy 10.5% over last April and the first estimated payment of 2015 was up 37%. The percentage increase in the first estimated payment is well above any other in the last 15 years and is not easily explainable. Information from other states indicates that Maine is one of a handful of states that experienced an increase in the April estimated payment of this magnitude. Given the lack of information at this time, the RFC has assumed the April surplus on estimated payments is a timing issue that will be reversed through lower estimated payments later in the calendar year. As a result of this cautious assumption, FY16 individual income tax receipts are essentially unchanged in the May forecast.

Corporate income tax revenue is the other revenue line the RFC made significant adjustments to during the latest meeting. The committee reduced corporate income tax receipts by \$19 million in FY15, \$65 million in the 2016-2017 biennium and \$88 million in the 2018-2019 biennium. As explained in the previous section on the individual income tax, the shift of the New Markets Tax Credit from the individual income tax to the corporate income tax is the cause of some of the reduction in the corporate forecast. Final information on the 2013 tax year shows that corporate liability was \$23 million below the December forecast. The 2013 tax year is the jumping-off point for this revenue forecast. In addition, approximately \$15 million of refunds associated with the 2012 tax year are expected to be settled by MRS and corporate taxpayers early in FY16. Finally, a slightly less optimistic forecast by the CEFC of corporate profits explains a portion of the out year downward adjustments.

Estate tax revenues were \$5 million under budget through the first 10 months of FY15. The RFC decreased the FY15 projection for estate tax receipts by \$3 million to account for the lagging performance since December. A new forecast of household net-worth contributed to an increase of \$3.7 million in the 2016-2017 biennium and \$2.9 million in the 2018-2019 biennium.

Other notable adjustments to General Fund revenue lines include:

- Transfer from Lottery Commission – the forecast was revised downward (negative impact on General Fund) in all years as a result of “sluggish” sales for draw games not offset by “healthy” instant game sales.
- Other Taxes and Fees/Finance Industry Fees – The forecast for security issuer registration fee revenue was increased to \$25 million for all years based on historical and current year performance.
- Other Revenue/Transfer to Maine Milk Pool – The forecast for the transfer to the milk pool was adjusted upward (negative impact on General Fund) for all years based on the latest estimates of milk prices (see Appendix F for more detail). The significant increase in the FY 16 transfer reflects both the change in the current milk price estimate and a change not included in the December 2014 RFC forecast.

Highway Fund Summary

	FY14 Actual	FY15	FY16	FY17	FY18	FY19
Current 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%
Net Increase (Decrease)		\$646,935	\$447,284	\$494,643	\$494,643	\$494,643
Revised Forecast	\$317,076,966	\$316,621,262	\$319,471,793	\$323,065,751	\$326,148,044	\$329,242,971
Annual % Growth	-0.5%	-0.1%	0.9%	1.1%	1.0%	0.9%

Highway Fund revenue estimates were revised upward by \$646.9 thousand in the current fiscal year, by \$447.3 thousand in FY16 and by \$494.6 thousand in FY17 (\$941.9 thousand over the 2016-2017 biennium). With no estimated change in total motor fuel tax revenue (gasoline and special fuel), the changes in the Highway Fund projections are largely driven by an estimated increase in long-term trailer registration fees. Overall growth in Highway Fund revenue is estimated to be approximately 1% per year for the next four years.

Fund for a Healthy Maine Summary

	FY14 Actual	FY15	FY16	FY17	FY18	FY19
Current 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%
Net Increase (Decrease)		(\$134,967)	\$66,055	\$64,497	\$65,079	\$65,668
Revised Forecast	\$60,558,934	\$53,120,324	\$53,960,063	\$52,978,154	\$48,596,690	\$47,713,066
Annual % Growth	18.8%	-12.3%	1.6%	-1.8%	-8.3%	-1.8%

Fund for a Healthy Maine revenue estimates were revised downward by \$134.9 thousand in the current fiscal year and upward by \$66.1 thousand in FY16 and by \$64.5 thousand (see Appendix C for more detailed information).

After some uncertainty over the last few weeks, Maine's Tobacco Settlement Payments (TSPs) for the current year ended up only slightly below budgeted levels. The continued lack of detailed information about Maine's TSPs for FY14 and FY15, led the RFC to leave the TSP forecast for the next four years at the levels assumed in the December 2014 forecast. Additional information about the FY14 and FY15 payments will be reviewed for the December 2015 forecast. In addition to the small current year TSP adjustment, a one-time negative adjustment in Hollywood Casino Bangor revenue also reduced current year Fund for a Healthy Maine revenue.

Medicaid/MaineCare Dedicated Revenue Taxes Summary

	FY14 Actual	FY15	FY16	FY17	FY18	FY19
Current 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%
Net Increase (Decrease)		(\$265,546)	(\$265,546)	(\$265,546)	(\$265,546)	(\$265,546)
Revised Forecast	\$168,609,944	\$171,245,169	\$171,672,381	\$171,672,381	\$171,672,381	\$171,672,381
Annual % Growth	10.0%	1.6%	0.2%	0.0%	0.0%	0.0%

The forecast of Medicaid/MaineCare Dedicated Revenue Taxes revenue was adjusted downward based on recent experience. The experience for the current year projects out to a \$265.5 thousand downward revision for each year of the forecast (see Appendix D for more detailed information).

Conclusion

The Revenue Forecasting Committee's adjustments to its previous forecast have been relatively small, reflecting the slow but steady growth of the current economic expansion. In their April 1st economic forecast, the Consensus Economic Forecasting Commission (CEFC) assumed the economy will grow at a slightly slower pace over the next five years relative to their previous forecast. Consistent with that

forecast the new RFC projections are for moderate 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.

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 forecast exercise the CEFC continued 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.