

TAX RATE REVIEW COMMITTEE
July 23, 2010

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The Tax Rate Review Committee met at 11:30 a.m. on Friday, July 23, 2010, in Room 1003 of the State Capitol, Lincoln, Nebraska, for the purpose of conducting a meeting. Members present: Senator John Wightman, Chairperson; Senator Abbie Cornett; Tax Commissioner Doug Ewald; Senator Mike Flood; and Senator Lavon Heidemann. Members absent: None. Also present: Legislative Fiscal Analyst Mike Calvert.

SENATOR WIGHTMAN: Good morning, everybody. It's almost past morning. So I'll call on Mike Calvert, as our Fiscal Analyst, to present the report prepared for the committee's review. And I think all of you have a copy of that.

MIKE CALVERT: (Exhibits 1 and 2) If you forgot your report, I've got an extra copy. Anybody need one? Looks like we're okay. This report, dated July 23, incorporates year-end results for the fiscal year ending June 30, 2010. So subsequently, because revenues under performed estimates, the sine die financial status changes and I'll walk you through a short description of that. The statute dictating the purpose of this committee is inside the front cover, it is covered in (2). Page 2 of the report there is a summary. And I'll walk through most of the items there. Actual receipts, as was reported by the Department of Revenue for fiscal '09-10, were \$76.7 million below the forecast used at the sine die of the 2010 Session. That was based on a February forecast with some adjustments due to legislation passed. Recalculation of revenue growth for the fiscal year ending '09-10 based on actual receipts is a -4.8 percent, adjusted for rates and bases and compared to the prior year. Originally, the February forecast by our calculation amounted to about a 2.4 percent growth, negative growth over the prior fiscal year. So obviously, revenue performance was worse than what was expected. The 4.8 percent follow...negative growth 4.8 percent follows the prior years' growth rate which is also a -4.4 percent. In combination, the two of them represent...probably represent the lowest growth rate over the last 29 years for which we've calculated growth rates. Cumulative growth for the two years works out about -9.2 percent if you just compare it to a simple average of what we would believe to be about 5.2 percent growth year over year over the long run, on average. There is a very significant difference to this two-year period in terms of -9.2 versus a positive 10. That 19 percent swing amounts to about \$646 million of a "structural imbalance" on the revenue side, if you would. The results, when we plug in the revised...the actual results for the fiscal year, there are other calculations involved making adjustments for some transfers and whatnot. But the ending balance is projected now for the current fiscal year at \$71.3 million below the minimum reserve that we originally were very close to balance at sine die. Notwithstanding the status, however, there are some positives in terms of the relative soundness of the General Fund, particularly considering the current state of the economy. Primarily one of the things we look to is how adequate for the foreseeable future is the General Fund balance through the remainder of the fiscal year. Do we have enough money to meet obligations? I had handed out a graph that is a simplification of

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a larger table where there are estimates developed on a day-by-day basis. And this is a projection for fiscal '10-11. It incorporates the actual balance that we started with. In other words, the shortfall of \$70-some million that we endured this last fiscal year is part of the calculation here. And you can see month by month the table just simply lays out graphically and tabulated amounts of high, low, and ending balance throughout the time period. And as is typical, our low point in terms of a General Fund balance occurs in April of 2011, high balance during the month is projected at \$164.2 million, low balance \$25 million, ending balance \$139.5 million. And if we follow true to form in terms of exactly hitting revenue estimates and expenditure projections, the balance in May and June will begin to ratchet up, as you can see by the values that are shown there. This tabulation is literally updated daily. So I check and verify what the projections look like based on actual receipts on a day-to-day basis, based on actual expenditures on a day-to-day basis and periodic adjustments to the future schedule of revenues and expenditures. And again, this is based on the official forecast, current appropriations as we know it, the financial status that you have before you. Now \$25 million is definitely a low point. It represents probably about two and a half days' cash on hand. On the other hand, we have our normal backstop of the Cash Reserve Fund. Unobligated balance of the Cash Reserve Fund is \$320 million. In April, that would be before scheduled transfers, we'll actually have in excess of \$400 million in the Cash Reserve. So as a backstop, in case we run into a liquidity problem, by law that is already there and it's an automatic transaction of transfer in. And then once you hit into May and June, where General Fund assets are sufficient to pay bills, then you pay...it's automatically paid back by law. So we have that extra security blanket in terms of General Fund cash flow. As I mentioned, Cash Reserve balance is projected at \$321.7 million unobligated after we clear all of the transfers that are currently scheduled for this fiscal year. The projected status of this report is on page 3. And just would simply point out that when we were at sine die we were at approximately a \$420,000 positive balance above the minimum reserve for the current '09-10. If you look at line 24, due to revenue results and other year-end adjustments, we are now \$71.3 million below the minimum reserve. However, line 22 shows you that the unobligated balance is still positive. It's \$134.5 million. So overall, liquidity looks to be okay, at least for the foreseeable future. The other thing I would point out on the status, on line 29, actual '08-09 revenue growth, on line 30 actually, as I pointed out is -4.4 percent. Our recalculation for '09-10 was a -4.8 percent because of the current year base dropping. And there has been no revision to fiscal '10-11 revenue estimates. Since that number doesn't change, the implied growth rate now spikes up to about 7.5 percent for the current fiscal year in terms of year over year growth for revenue. Okay? Originally, when we sine died, using that same number but a higher current year base for '09-10, that growth rate was about 5.2 percent. Okay, the adjustments that we went through to calculate the revised financial status are detailed on line 4. Primarily again, it is the net receipt results. We also recalculate the long-term projection for FY '11-12 based on our assumptions in terms of revenue growth rates and expenditure assumptions. So you can see those elements that went into the recalculation to arrive at a shortfall to the 3 percent reserve for the current fiscal year of

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\$71.2 million. The rest of it is some detail to backup the revenue picture, starting on page 6 and 7. There is a graphic representation starting on page 8 in terms of revenue history. And in part, we do this in order to kind of put some context in terms of those future revenue growth rates. We have seen, in terms of historical and cyclical patterns, where we fall below the long run average in terms of growth year over year. In subsequent years it's not unusual to see growth rates that are higher and sometimes substantially higher. I'll readily admit this recession, this revenue pattern related to this recession is a different breed of cat compared to past recessions. They're all different. There's been a lot of discussion in terms of the slowness of a recovery and the likely consequence of a slower recovery with respect to state revenues. I wish my crystal ball was clearer in that regard.

SENATOR WIGHTMAN: The chairman of the Federal Reserve Board, the day before yesterday, didn't give an exactly glowing report on what was expected.

MIKE CALVERT: I read that, right, yes. And in fact, the pattern in terms of revenue growth actually, excuse me, revenue forecast is actually a second criteria that we look at. On page 10 there is a history in terms of the error terms with respect to forecasts. Error terms have gotten larger in recent years. A less stable economy, a less predictable economy leads to more difficult problems in terms of revenue forecasting. If you go back to the '91 through '96 time period, the error terms in terms of variance, a lot smaller. It was a lot more benign economy at the time.

SENATOR WIGHTMAN: Mike, it appears in watching the receipts come in, and perhaps Mr. Ewald can comment on that as well, but the quarter...the months that are ending of quarters and the income tax estimates are due in seem to be the ones that we're taking a big beating in. April is big, which doubled up, of course, with the final tax returns for 2009 plus the estimate. Then June was the next estimate month and was way off target again. I'm assuming September is very likely to be similar to June. Some of the receipts, I think, were, as I understood it, were a lot of refunds that were made under Nebraska Advantage and LB775. Is that...was there quite a factor there in June?

DOUG EWALD: We had some...

SENATOR WIGHTMAN: Fairly big refunds.

DOUG EWALD: We had some fairly big refunds that were paid out up and above the estimate for the month that would have been normally paid out at some other time.

SENATOR WIGHTMAN: But still the biggest factor seemed to be the income tax receipts for the quarterly estimates. I think the die is kind of cast once you get to April and people report less income, then it follows through that their estimates are going to be lower on the estimate months for the forthcoming year.

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MIKE CALVERT: One thing to keep in mind, however, for the fiscal year that we just closed out, the vast majority, and correct me if I'm wrong, Mr. Tax Commissioner, but the vast majority of individual income tax receipts actually relate to the prior calendar year, that particular tax year. So, I mean, there's something of a lag effect. What you're saying is estimated payments have some influence on this. And, yes, they do. But...

SENATOR WIGHTMAN: And tend to follow the previous year's tax figures to some extent.

MIKE CALVERT: Well, they may or may not. There might be an impact with respect to the expiration of federal preferential treatment on capital gains that expires the end of this year.

SENATOR WIGHTMAN: And that could be a factor.

MIKE CALVERT: We have speculated to some extent that we might see a bunching of estimated or...estimated tax payments in December. Senator.

SENATOR CORNETT: Mike, I'm looking at the line 30 on page 3, current year, 2011 projected adjusted growth is 7.5 percent.

MIKE CALVERT: Correct.

SENATOR CORNETT: Do you think that that is an accurate number? And is that what the deficit in the out biennium is being based on?

MIKE CALVERT: The calculation is the result of using the currently official forecast for this fiscal year.

SENATOR CORNETT: And...

MIKE CALVERT: The conundrum is, is 7.5 percent realistic or not given the current environment?

SENATOR CORNETT: In your past experience, because you have been with the state a long time...

MIKE CALVERT: Sure.

SENATOR CORNETT: ...and I really respect your opinion, what do you feel is a realistic adjusted growth for this year?

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MIKE CALVERT: Our internally generated forecasts in our own office are a little bit lower but not dramatically so. Now if you look at past cycles, I'd say that that might be a plausible estimate, a plausible growth rate. But as I pointed out, every recession, every...

SENATOR CORNETT: Is different.

MIKE CALVERT: ...is different. And this one has really shaped up to be different. To what extent the recovery occurs on a timely basis, to what extent that recovery translates to tax receipts, because an economic recovery and a "recovery" in terms of tax receipts...

SENATOR CORNETT: Are two different things.

MIKE CALVERT: ...can be two different things.

SENATOR CORNETT: And I don't mean to put you on the spot and I don't expect this...I'm not taking this as carved in stone...

MIKE CALVERT: Sure, sure.

SENATOR CORNETT: Because things have been different over the last couple of years. What adjusted growth rate is your office projecting?

MIKE CALVERT: Well, internally I would say...

SENATOR CORNETT: Internally.

MIKE CALVERT: ...internally we are probably no more than a half a percent off.

SENATOR CORNETT: Okay, thank you.

MIKE CALVERT: But they change.

SENATOR CORNETT: But they change.

MIKE CALVERT: You know, we update our forecasts regularly, literally almost monthly. And it's a function of not only how revenues perform on a month-to-month basis, because we recycle that into a forecast, but it's also the economic outlook that's published by Global Insight and then we use that. So as those things change and their outlooks change and as results change, it's always a moving number.

SENATOR CORNETT: What does a half a percent equate to in regards to...dollar

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amount in regards to deficit?

MIKE CALVERT: Well, it's probably...you know, if you just look at annual revenue, roughly about \$3.5 billion, then you're talking about maybe half of that, about \$15 million,...

SENATOR CORNETT: I'm sorry?

MIKE CALVERT: ...\$15 to \$17 million, thereabouts.

SENATOR CORNETT: Fifteen to 17 million?

MIKE CALVERT: Yes.

SENATOR CORNETT: Okay, thank you very much.

MIKE CALVERT: But I mean, it's...I mean, what we're doing is we're moistening a finger and putting it up in the air.

SENATOR CORNETT: Trust me, I understand that.

MIKE CALVERT: Very good.

SENATOR WIGHTMAN: Senator Flood.

SENATOR FLOOD: Mr. Calvert, it's your opinion the state is cash flowing just fine?

MIKE CALVERT: Yes, sir.

SENATOR FLOOD: And in your opinion we're going to continue to cash flow just fine?

MIKE CALVERT: Based on the estimates that we have right now. The only thing that's going to cause me to change my opinion is if month-to-month revenue performance underperforms estimates.

SENATOR FLOOD: And to key months for that as we get into, you know, one of the questions we have to answer today, is there going to be a special session or should we suggest that a special session be called? And my opinion at this time is that, no, it is not an appropriate situation for a special session. However, the first financial fiscal quarter, you know, getting us through the end of September, this is a very critical time. Is that your opinion?

MIKE CALVERT: Yes, sir. Yes.

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SENATOR FLOOD: Okay. Because by the time you get to November and if you're looking at November numbers, you might as well wait until we go into session in January. But...

MIKE CALVERT: Yeah. And if you look at that graph again, just for a moment, if you look at the high balances for...

SENATOR FLOOD: Yeah.

MIKE CALVERT: ...July through December, that tends to be your high point in terms of overall cash flow.

SENATOR FLOOD: And that's got to be our priority consideration as it relates to the duty that we're asked to perform today.

MIKE CALVERT: Right, I think that's...

SENATOR FLOOD: The state can meet its obligations.

MIKE CALVERT: I think that's an important consideration. Yes, sir.

SENATOR WIGHTMAN: Senator Heidemann. Oh, excuse me.

SENATOR FLOOD: And I guess it's safe to say that we're all concerned about the situation. But the more I sit at this point, it's not necessary, at this time.

SENATOR WIGHTMAN: Senator Heidemann.

SENATOR HEIDEMANN: Just throwing this out, can we accelerate those transfers from the Cash Reserve to the General Fund to help our bottom line? Would that be advantageous or we just go ahead and let it sit in case we need it, it's going to happen by law anyway?

MIKE CALVERT: Well, generally, the way...the philosophy that we've used in terms of crafting a bill for the Appropriations Committee to introduce is we tend to put the scheduled transfers and set a date usually in June, towards the end of the year. Okay? Gives you the discretion in the next legislative session to change the timing of that. But the way the transfers that are scheduled for this fiscal year are worded, it's "on or before" a date. So that gives us some flexibility in terms of working with the administration, if need be, to maybe rethink the timing. I don't think you really have to prospectively legislate a different date.

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SENATOR HEIDEMANN: Okay.

MIKE CALVERT: I think we're fine.

SENATOR WIGHTMAN: Mike, the Forecasting Board will meet the last Friday in October, is that correct?

MIKE CALVERT: Yes, sir.

SENATOR WIGHTMAN: And then our meeting for November has not been set yet, I think,...

MIKE CALVERT: That's correct.

SENATOR WIGHTMAN: ...as far as the date.

MIKE CALVERT: It's always between the 15th and 25th, by statute, of November.

SENATOR WIGHTMAN: Other questions?

SENATOR FLOOD: I'd make a motion. My motion is that we not recommend a special session and that we not recommend increasing tax rates in the state of Nebraska.

SENATOR HEIDEMANN: Second.

SENATOR WIGHTMAN: Okay. The motion and second. Call the roll.

JESSICA SHELBURN: Senator Wightman.

SENATOR WIGHTMAN: Yes.

JESSICA SHELBURN: Senator Cornett.

SENATOR CORNETT: Yes.

JESSICA SHELBURN: Commissioner Ewald.

DOUG EWALD: Yes.

JESSICA SHELBURN: Senator Flood.

SENATOR FLOOD: Yes.

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JESSICA SHELburn: Senator Heidemann.

SENATOR HEIDEMANN: Yes.

JESSICA SHELburn: Motion carried.

SENATOR WIGHTMAN: Motion carried. I don't think there's any other business, so we'll be adjourned.