

**Revenue Estimating Conference
Minutes
October 10, 2013**

Members Present: Dave Roederer, Holly Lyons, David Underwood.

Mr. Roederer called the Revenue Estimating Conference to order at 10:00 am.

Approval of March 23, 2013 Minutes

Mr. Roederer called for a motion to approve the March 23, 2013 minutes as they are written. Ms. Lyons made the motion to approve the minutes and Mr. Underwood seconded the motion. All voted in favor and the motion was carried unanimously.

Mr. Roederer began with a brief overview of the Revenue Estimating Conference. It is made up of the Legislative Branch, the Executive Branch and a mutually agreed upon individual. These meetings are required to be held three times per year. The numbers that we come up with for the October meeting are not required to be used by anyone. When we get to December, that is the number the Governor must utilize when he puts his budget together. In March, the legislature needs to use the lower of the two, whether it is December or March.

Ms. Lyons stated that every year is different and every year has its own oddities and the just completed fiscal year 2013 and the current fiscal year, 2014, are no exception. This is primarily due to the federal tax debate and the resulting tax changes. The national economy is chugging along, growing albeit slowly. Growth is very modest. On the national level, nominal GDP is expected to increase 3.2% in calendar year 2013, which is a lower than the average annual growth of 3.6% for the prior eight years. It is possible that the concern and confusion over the fiscal policy in Washington that began in earnest at this time last year and continues today has constrained the economy a bit. There seems to be consensus among the economists that if the federal shutdown were to last just a few days there would be no significant damage to the economy. But if it should extend three or four weeks, and we are well into the second week now, there could be some significant damage to the GDP. Some economists are saying it could lower GDP by as much as a percentage point or a point and a half. On the national level, businesses seem reluctant to hire or to invest in physical capital an infrastructure. Businesses aren't laying off workers, but they aren't hiring at significant levels either. The U.S. economy still hasn't reached pre-recession employment levels of 2008/2009 and is not likely to for another 18 months. The good news is that unemployment numbers have leveled off and until today, initial unemployment claims have declined. Consumer confidence ratings also fell to a five month low in September. Indicators such as wage and salary income and housing starts are coming in above average for 2013 and the estimates for 2014 and 2015 are optimistic.

There are, of course, global worries, they are everywhere. This time around, the most dominant concerns are Syria's chemical weapons and the military coup in Egypt. Then there's Washington. The debt ceiling debate and the shutdown issue, as well as the potential tapering

of monetary policy stimulus efforts by the Federal Reserve and the impact any or all of that may have on the economy- the national economy and the Iowa economy.

The Iowa leading indicators index reported a positive change of 0.4% in August, up slightly from three months of 0.2% increases. This is the largest increase since February of 2011. Not great, but not bad either. The two most positive indicators were diesel fuels consumption and manufacturing hours. Both the Iowa Business Council Economic Outlook Survey Index and the Iowa Business Conditions Index decreased slightly in the last quarter, something to keep our eye on. Employment growth continues at a steady pace and is expected to be positive through the holiday season. Iowa should return to pre-recession employment peaks within the next three months and Moody's estimates that Iowa will have continued employment growth of 0.9 to 1.7%, which is below the national estimate for calendar year 2014, but still not a cause for alarm.

Fiscal year 2013 ended with \$458 million in general fund net revenue growth, which was \$132 million above our March REC projections. That amounts to 2% above the projections. Much of that \$458 million growth can be attributed to the federal tax debate and tax changes and the impact on Iowa. The majority of the Iowa revenue growth came from higher estimate payments, payments with tax returns and income tax refunds. That is very unusual; usually the dollar growth is within holding payments and that drives the overall income tax growth. The number of payments remained steady but the size of the payments increased substantially. Exactly how much is due to law changes and how much is due to normal annual income growth is currently unknown and we won't have a better idea until analysis can be done on returns next year. The federal tax changes caused Iowa taxpayers to sell appreciated assets in calendar year 2012 in order to avoid paying higher federal taxes in the future. So this would be considered one-time money for tax year 2013. The tax law changes also caused taxpayers to sell assets and/or receive compensation in 2012 that they otherwise would have sold or received in 2013. Again, one-time money for 2013 but it will have a negative impact on growth numbers for 2014 since the base will be artificially high. There were state law changes that occurred after the REC met last March that will affect fiscal year 2014, and helps explain why the LSA estimate for fiscal year 2014 is less than the March REC estimate. Four major things- \$66 million of gambling revenue that used to be deposited in the general fund will now be deposited into the Skilled Worker Job Creation fund; \$120 million in cigarette and tobacco tax formerly deposited in the general fund will now be deposited to the healthcare trust fund; the Earned Income Tax Credit was increased from 7% to 14% with an estimated negative impact to the general fund of \$30 million; and there was expansion of certain existing tax credits and the addition of two new tax credits. Currently all sources of revenue remain positive, but nearly as positive as the first nine months of fiscal year 2013, or as positive as the same three months last fiscal year. The first three months of the fiscal year indicate solid growth in net receipts of about 3.5%. Our estimate for fiscal year 2014 is 1.5% below fiscal year 2013-actual receipts, primarily because 2013 revenues were artificially high due to what I just explained- the significant one-time occurrences caused by federal tax law changes and state law changes that occurred after the last REC meeting. The LSA estimate for fiscal year 2015 is cautiously

optimistic for a steady 4.2% growth, but we will look forward to the next two months of data and will re-visit that estimate in December.

Mr. Underwood stated that it was interesting how the estimates did come in. Basically, other than the legislative changes and their impact, the net result basically is a very similar type of forecast. Maybe a little change in mixes to withholding versus estimates versus final return payments, but on the biggest chunk is the personal income tax and that really comes out to a very similar forecast as to growth in Iowa as we had before. Sales tax as well, the forecast there has not substantially changed since March, but what we are faced with now is a showdown in D.C. as to what impact that may or may not have on Iowa. It puts that lack of certainty into our forecasting again this year and I think that also explains a lot why one minute it's a little bit sluggish; how do you plan in business when you've got all of these things hanging out there that you just can't really make a decision based upon any certainty at all. The other thing in Iowa is that continued lack of the employees to fill the positions. In the last couple weeks, I've read a lot of information from businesses within Iowa and the associations' businesses within Iowa where people are really struggling to find employees that they need to fill their slots. I've been working with one business in north Iowa trying to fill a position and it's difficult trying to find anybody in place that can fill those positions, particularly the high-skilled jobs. The other thing is the farm situation. We've certainly come off of three wonderful, wonderful years for Iowa farmers. I haven't been around the southern part of Iowa, I know that you have a lot of the drought in this area and we certainly did have some issues in northern Iowa. Talking with the farmers that are just now starting to combine the corn, yields have definitely taken a hit. Not only because of spotty areas within the fields, but also our lack of rain during that final maturity period. Farmers are just having good crops, but not great crops, this year. The soybeans yields also took a little bit of hit with the lack of rain in our part of the state. I was really pleasantly surprised with the income tax reporting from farms for the last calendar year. They are the size of numbers that we've never ever seen in Iowa before. It appears that is going to finally drop back a little bit. Capital gains were another significant item last year and Holly explained that a little bit, people selling things a little early. Capital gains report in Iowa were up in the neighborhood of 25%, which again a growth of that size is hardly anything you would expect and certainly not going to continue to see that kind of growth. We could see a decline in reported capital gains for this current calendar year. So that's going to have a major impact, along with some of the other numbers I've seen coming in. The profit growth isn't out there this year and I don't see us struggling from the standpoint of proper declines, but definitely not any significant increases. I was glad to see these estimates came in at pretty much the same level as March, as far as the assumptions are concerned, both numbers are relatively close so I think we've got something we can work with here and come to a compromise and set a good tone for Washington D.C.

Mr. Roederer started with the International scene. Holly referred to the Middle East and I concur, but I see things a little differently. I now consider that the norm instead of the abnormal, so I think that has pretty much been factored in on most deliberations. The U.S. is moving slowly, but in the right direction. I think we will maintain the modest job pace; I think the government shutdown will, I'm calculating by the end of next week, probably be over based

on conversations in the fact that both sides seem to be backing off some of their hard line positions. I would agree that if it went on much beyond 30 days I think that may have an impact on our Gross Domestic Product. I think that will be resolved by then. We are still seeing a slight increase in housing; gasoline prices, some were projecting we would be up to \$5 by now, but that's not quite happening. I think that the consumer business sentiment is still fragile. Iowa, as it's been pointed out, we out-performed our estimates in FY13 and as we did in 2012. So far in 2014, we're still increasing but maybe not at a gigantic pace. Our leading indicators are still positive and growing somewhat. I believe that corporate is strong, and I think it's going to remain strong, and I base it on having visited and made presentations to both large and small businesses throughout the state and they were all positive and were comparing notes as to what type of pay raises they were giving, which is quite a change from what it's had in the last few years when I've been visiting with them. I think we need to be cautious, I think that housing is up-ticking a little bit and it kind of ebbs and flows, but contractors I've been visiting with, some of them depending on what type they're in, they have more work booked that they'll be able to get done. A lot of that was because of the wet weather at the beginning and couldn't get in to do some of the work they're doing, so that is going to go over the winter a period of time. Agriculture banks are pretty healthy, have gotten healthier. Those that were on the banking watch list, it is down significantly from where it was a year ago. On the agriculture sector, it varies. I talked to some areas of the state and they say they're going to be even stronger this year than they were even last year; other areas not so much; it just depends on where you live. Ethanol has always maintained a fairly high level of demand, so I think that is also going to impact the price of corn. I think this is only the second time we've met since I've had the honor of being on this conference that I'm the optimist of the group.

As Ms. Lyons pointed out, it's a little more complex because of changes that were made that she talked about, primarily those which do not come directly into the General Fund. Which I think raises a question we may need to give some thought to, maybe we need to be showing other numbers in the future as some things get moved out of the General Fund that are still significant. The whole idea is to make sure that the public fully understands how much money comes into government, how much money goes out, and where that money is spent. When everything got started at one point in time, about everything went through the General Fund. Now with federal funds, we have some diversion of the funds. I'm not being critical of that, I'm just staying that it is more complex to follow, especially when people are trying to follow from year to year to year. We have to figure out a way that our computers can footnote it. Once you make the adjustment in FY 13/14, then we'll be good until that gets changed.

Review Fiscal Year 2014 General Fund Estimates, Accruals, Refunds, School Infrastructure Transfer, and Lottery and Other Transfers

Mr. Roederer stated the big differences here are the Governor's appointee was more optimistic on the income side. I don't disagree with what has been said, but we believe that companies are doing well, they are going to continue to do well and that those incomes are going to be increasing. I was a little less optimistic on the sales tax, primarily because of national surveys. Also, the Des Moines Register had a poll and people still don't feel we've quite gotten out of this recession, and rightfully so. I think that if you're employed and you're getting paid, your income is going to be a little more predictable. On the sales tax, if you're not feeling real confident about the future than you are less likely to be buying things. There was a difference in the corporate, but I do believe the corporations are doing well in the state.

Ms. Lyons stated that the LSA's rationale is just cautious. Still the impact of the federal changes and how that might affect FY14 could potentially increase refunds because, as you know, federal taxes are deductible from Iowa taxes. It is less than a percentage point difference in a six billion dollar budget, so it really isn't worth fighting over.

Mr. Underwood stated either number is very acceptable at this point. The only thing I saw is the refund accrual basis; there is a substantial difference there as to where we might end up and that's always a tough one to judge. So if I was going to make any adjustments, that is where I would propose the adjustment be made at this point.

Mr. Underwood made a motion to increase the Governor's appointee's refund number by \$20 million. Ms. Lyons seconded the motion. All voted in favor and the motion was carried unanimously. The net receipts plus transfers number is now 6695.3, or -1.1% growth. Mr. Roederer stated that because of the way things were moved off, that is actually an increase in the amount of revenue - \$38.8 million is the increase from the adjustment REC estimate after the law changes were effective.

Estimate Fiscal Year 2015 General Fund Estimates, Accruals, Refunds, School Infrastructure Transfer, and Lottery and Other Transfers

Mr. Underwood made the motion to increase the Governor's appointee's refund estimate by \$20 million. Ms. Lyons seconded the motion. All voted in favor and the motion was carried unanimously. The net receipts plus transfers number is now 6976.6, or 4.2% growth.

Fiscal Year 2014 and 2015 Gambling Revenues Transferred to Other Funds and Interest Earned on Reserve Funds (transferred to Rebuild Iowa Infrastructure Fund)

Ms. Lyons made a comment that it's perhaps something we should keep an eye on. Especially if consumer confidence is shrinking, disposable income are shrinking, that could be an issue. In some of Revenue's documents the gambling receipts are actually down at many of the casinos. Ms. Lyons made a motion to move these numbers. Mr. Underwood seconded the motion. All voted in favor and the motion was carried unanimously.

Fiscal Year 2014 and 2015 Gambling Revenues Transferred to Other funds and Interest Earned on Reserve Funds (transferred to Rebuild Iowa Infrastructure Fund)

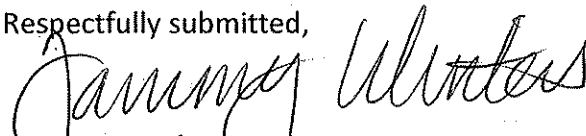
Mr. Underwood made a motion to move these numbers. Ms. Lyons seconded the motion. All voted in favor and the motion was carried unanimously.

Other Business

The next meeting has been scheduled for December 12, 2013, at 2pm at a location to be determined.

With no further business, Mr. Underwood made a motion to adjourn the meeting. Ms. Lyons seconded the motion. All voted in favor and the motion passed unanimously. Mr. Roederer called the meeting adjourned.

Respectfully submitted,


Tammy Winters