

**Revenue Estimating Conference
Minutes
October 11, 2012**

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

Mr. Roederer called the Revenue Estimating Conference to order at 10:00 am by explaining the purpose of the Revenue Estimating Conference. The Revenue Estimating Conference makes the projections of what the revenues are going to be for the state. The committee meets three times per year – October, December and March. The December estimate is utilized by the Governor in preparing his budget and the legislature utilizes either the December estimate or the March estimate, whichever is lower of the two. Mr. Roederer introduced Holly Lyons, who is the representative of the Legislative Branch, David Underwood who is the consensus representative and himself, the appointee of the Governor for the Executive Branch. The Governor is planning to submit a two-year budget; however, the law provides that one year projections are done. This meeting will review the current year, FY13, and the upcoming year, FY14. All members are present.

Approval of October 11, 2012 Agenda

Mr. Roederer called for a motion to approve the October 11, 2012 agenda as it is written. Mr. Underwood made the motion to approve the agenda and Ms. Lyons seconded the motion. All voted in favor and the motion was carried unanimously.

Approval of minutes from the March 23, 2012 meeting

Mr. Roederer called for a motion to approve the minutes of the March 23, 2012 meeting. 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.

Ms. Lyons remarked about the National Economy by stating that after a period of slow growth, it is possible that the U.S. economy has stalled, but it is not yet declining. The economy had a 1.65% growth pace in the first half of the calendar year and is now tracking at about 1.5% growth pace. Not exactly robust growth, but it is growth. Consumer spending has slowed down, but the National Retail Federation estimates that holiday sales will increase 4.1% this year. Business spending appears to be slowing, as evidenced by a slow-down in new orders, and business investment has also declined. The national unemployment rate has appeared to stabilize at 7.8% and the housing market is recovering. Clearly, the upcoming elections and the variety of possible outcomes is a concern and will impact the economy. The U.S. government faces a fiscal cliff. Existing federal tax cuts, also known as the Bush Era Tax Cuts, are set to expire in January. The federal Budget Control Act passed in 2011 also requires huge federal spending reductions in the form of sequestering; that is, the government will reduce payments to the states. This is scheduled to begin this January 1st. Whether tax cuts will expire and sequestering will actually occur remains to be seen. Congress, either lame duck or newly-elected and/or a new administration, could act to delay or modify the existing law. The current

consensus view of economists is that regardless of the November election results, Washington is likely to take the path of least resistance and kick the proverbial can down the road. Meanwhile, however, the threat of the looming cliff is considered to be dragging on the national economy.

The world economy is a concern, as it has been for previous meetings. The most recent concerns are the recession in Europe and the slowdown in China. Both of these effect U.S. factory production. But there is always something in the global economy that concerns economists, be it the European monetary policy, nuclear arms in Iran, tsunamis, demand in China, oil crisis and so on. In Iowa, it continues to be a long slow climb out of the recession, but in the last half of fiscal year 2012, the Iowa economy seemed to accelerate, ending the year with 7% growth, or \$412 million, well above the 2.6% growth predicted last March. An explanation for the increase is that there were better than expected gross tax receipts combined with lower than expected tax refunds. Iowa was not unique. Many other states missed their forecast with revenues coming in higher than originally predicted. For the first quarter of fiscal year 2013, contrary to what is happening in the U.S. economy and despite one of the worst droughts in the state's history, revenues are strong. Gross receipts are coming in at 8.7% and net receipts, that is receipts adjusted for refunds, are coming in at a remarkable 11.3%. This is not saying that the drought won't have an impact, but so far revenues have not been impacted in Iowa. This could change come next spring or next year. The Iowa leading indicators index increased for the fourth consecutive month and suggest that Iowa's current gains in employment should continue into November and December. Building permits issued during the last twelve months were at the highest level in four years, indicating that the Iowa housing market finally appears to be in recovery. We're keeping a close eye on employment; Iowa employment growth remains at the July level, but weekly manufacturing hours have declined slightly. Unemployment claims are slightly elevated, but are not of significant concern at this time. Employment growth is moderate. During the great recession, Iowa lost 59,000 jobs and is still down 39,000 jobs. All this could change in the next two months prior to the next REC meeting in December, but for now the LSA revenue projection is optimistic for the remainder of fiscal year 2013. We've already experienced significant growth in 2013 of more than \$130 million. Even if the growth would stall for the remainder of the fiscal year, we believe that we should reach our projections of \$221.4 million, or 3.5% growth. For our first look at FY2014, we're estimating a 3.7% growth rate, and are hopeful that the next two months will provide more information to re-evaluate both fiscal year 2013 and 2014.

Mr. Underwood discussed what has changed since March. The drought is a significant change since the last meeting. Speaking with farmers recently, they all say they're going to be okay. They either had a fairly decent crop or their crop insurance will step in, but certainly not the kind of year that they had the previous year. It is hard to know when that is actually going to impact the growth fund receipts, just because we don't know what year they will sell those crops and when they will actually receive their insurance checks. Those kinds of things put some uncertainty there. Mr. Underwood doesn't see the farm economy growth that we've seen over the past three years. Mr. Underwood believes that will stabilize a little bit and will hold back a little bit when it comes to personal income taxes in Iowa. However, farm land is

still selling at very high rates, so will probably see significant capital gains from that, as well as rent rates still being pretty high so those Schedule E reports will probably continue to be pretty healthy. The Schedule F reports and some of the farm corporation should show a little bit of a reduction sometime in the next two years. Speaking with manufacturers as to what happened and why it was so good the past six months, many of them said they didn't know. They've been working hard to sell and fortunately, a lot of the manufacturers have had good success in penetrating their markets deeper, developing new products, and putting the efforts in. This has resulted in hiring requirements. The only disturbing thing is that the one message every single company had was it is very difficult to find workers to fill their slots when they need it. So that remains a challenge in Iowa. As we continue this very slow recovery, it will be a continuing challenge to find the workers we need in the right spot at the right time as we continue to grow. We've added some people and it would be great if we could get all 59,000 jobs back, but the struggle there is to find the people to fill those new jobs that are out there today. We continue to have the uncertainty on the federal tax issue. The Department of Revenue has made some estimates as to whether they don't do anything or if they extend everything, what that impact is. That is probably potentially the largest impact on our numbers. It is over a 300 million dollar swing, as I understand it. We don't know what's going to happen and hopefully by the time we meet in December we will have a pretty good idea as to what that is because that will be significant to our estimates at that time.

Mr. Roederer stated that at the meeting in March, he expressed real concern about the European Union. There was some discussion as to the long-term viability and what would happen. That seems to be much more firm now than it was before. Europe has been taking measures in order to shore up the euro and when there was some discussion at that time whether the euro was going to collapse, that does not seem to be the case. Even though it is definitely under stress. As Ms. Lyons pointed out with international issues, you can always look to find risk and areas to be concerned about. China and Brazil do seem to continue to move along and continue to grow. Obviously not at quite the strength that they were at one time, but still seems to be pretty stable. Middle East remains the Middle East, and trying to project what will occur there is not a very happy thought. It is still encouraging that Saudi Arabia continues to show flexibility on their production. While gas prices are high, especially on the west coast, they seem to be fluctuating their production and it seems to be keeping at least the price down somewhat. In the U.S., nationwide I would echo what Ms. Lyons and Mr. Underwood said. We are seeing some positive signs, we've got modest job growth, housing is increasing slightly nationwide, but the consumer and business sentiment is still very fragile, or possibly nervous. The federal sequestration is out there and it has frozen everything. It has frozen business so that though their profits seem to be up and they do have money, they don't know what to do. The reason for that, of course, is when you look at the combination of tax increases and the amount of cuts that are supposed to take place, that totals 700 billion dollars. Seven hundred billion dollars into a U.S. economy can make a world of difference, depending on which way it goes. So I echo what Mr. Underwood and Ms. Lyons have said on that. What makes it difficult is how to predict. How do you predict what is going to happen, because depending on who you want to listen to, it could have a great swing one way or the other. It appears that Congress has about four options:

- 1) They could let everything go into effect the way it is. Some people are predicting that will throw us into a recession and double digit unemployment.
- 2) They could also, as Ms. Lyons pointed out, postpone everything. This seems to be the consensus of many of the economists. That still doesn't solve the problem and that will have a very dampening impact again on our economy because businesses and individuals aren't going to know which direction to go by that.
- 3) Another option is to not raise the debt ceiling. Debt ceiling is projected to be hit sometime in the upcoming January. If that happens, we will go through a lot of the cuts and maybe not be as severe, but we'll still be going through that.
- 4) The other option is that they all get together and make a good decision. That hasn't been able to happen for the last four years and now maybe there will be something that is going to take place that will change that.

The only reason I point that out is that I hope you can kind of understand the dilemma we are in where we are trying to give our best estimate of what the impact is going to be on the state. Looking solely at Iowa, as Ms. Lyons and Mr. Underwood pointed out, our economy out-performed our estimates in fiscal year 2012, which we just completed. So far in the first quarter in fiscal year 2013, it's out-performing what our projections are there as well. Corporate earnings seem to be strong, which is a very good sign, but corporate is a little more difficult to get a good estimate on because corporations have about 18 months to make decisions as to what they are going to do there. Hiring has slowed somewhat in the state, as David pointed out that when many jobs do become available, it's a challenge to make sure we have the right skill set in order to meet those whenever this takes off. I really do believe that the sequestration issue is what is really holding back many companies right now. I think that they are ready to move forward, but they want to know what the impact is going to be. Housing is increasing at a rate that we're almost ready to say we're kind of on a good path and let's hope that continues. Mr. Underwood pointed out about the drought. For those of you who are unfamiliar with the new program, 90% of our agriculture producers have crop insurance, which pays 70-75%, of their base production (over a 6-7 year period), and that number is based on what the price of the commodity is by the close of business on the Chicago Stock Exchange on, I believe, November 1st. There doesn't seem to be anything out there that would indicate that the price would be falling through the floor here in the next 30 days or so. Unfortunately, that's not the best news necessarily for the livestock producers because that means their inputs are much more expensive. The reason that I think that we're pointing out about the drought is because we don't know when that's going to end. As Mr. Underwood pointed out, the producers feel that they are going to be okay but even with crop insurance, if we go through another year of a drought, that is going to be extremely difficult. So at least from my perspective, when we were putting together our projections, we did factor in certain things that Congress has traditionally always done regardless of what the situation has been and we also factored in what Ms. Lyons referred to when she discussed the tax cuts, we are calculating that those are going to expire. If they don't expire and they're modified then the state would have more revenue than what we are projecting.

Review Fiscal Year 2013 General Fund Estimates, Accruals, Refunds, School Infrastructure Transfer, and Lottery and Other Transfers

Mr. Underwood believes there are only about three numbers to spend any time on – personal income tax, corporate income tax and the refunds which primarily relate to those two numbers (personal income tax and corporate income tax). That makes up about \$60 million of the difference in fiscal year 2013. Mr. Underwood asked Ms. Lyons what approach she took with personal income tax growth to get to 5.3%. Ms. Lyons responded that they were looking at current receipts and the rate at which they are coming in. To date there is already \$70 million in personal income basically in the bank. To reach the estimate, 8.3% would be needed. Looking at a very strong first quarter, it may not continue at that rate but she believes there is some wiggle room for the rest of the year to meet that estimate. Mr. Underwood asked if any speculation relative to what Congress might do between now and next was factored in. Ms. Lyons stated they assumed the fiscal cliff in terms of the expiration of the tax cuts and sequestering. They did not try to estimate any kind of economic impact on that. Corporate income tax is a little bit more aggressive number at 21.2%, in particular since the Department of Revenue was in the \$560 million range. Winnebago did just report they had a record quarter in comparison to anything since the recession started, but that's just one small piece of it. In response to that, Ms. Lyons asked Mr. Roederer – there is already \$42 million of revenue, the Governor's estimate for corporate income tax is \$42 million. So basically my interpretation of that is that you are assuming there will be no more revenue coming in? Or refunds would balance that? Mr. Roederer responded that that was a tricky one. Last year was so strong and usually we start seeing that impact the following year because we have federal deductibilities so the more federal taxes that people pay, the less that the state will have and although the corporations are at 50% of that, Mr. Roederer feels he could go various directions on these because of the number that is out there and what the impact of the sequestration may have. It depends on how you want to look at what may be happening nationally and what might happen in Congress. It came in so strong last year, it was difficult to be confident that it could be maintained.

Mr. Underwood stated with the \$33 million difference between the Mr. Roederer's and Ms. Lyons' numbers, either could be correct. Mr. Underwood struggles a little more with the corporate income tax. After having a 32% increase last year, which was an extraordinary increase, to come back with a 21% increase this year that's probably not likely. Mr. Underwood would like to see that closer to the \$560 million range, which agrees with what the Iowa Department of Revenue was projecting, based upon the trend numbers and what they are seeing in corporate returns. A lot of those returns haven't shown up for the current fiscal year, so it is still speculative in nature and would require strong estimate payments to get to that \$631 million number. Mr. Underwood requested that if Ms. Lyons would agree to reduce corporate income tax, he could go along with the rest of her numbers. Mr. Underwood is requesting a \$50 million reduction. Ms. Lyons said she could agree to the \$50 million reduction. She believes there will still be corporate revenue coming in, not at the 32% growth rate of last year, but higher than the 8% Mr. Roederer estimated. Ms. Lyons would agree to lower that \$50 million, which would take it to \$580.9 million. Mr. Underwood made a motion to reduce the corporate income tax to \$580.9 million and accept the other numbers as projected by the

Legislative Services Agency. Ms. Lyons seconded the motion. With no further discussion, Mr. Roederer called for a vote. All voted in favor and the motion was carried.

Because of this vote, this will change the percentages and that will effect fiscal year 2014. Bottom line for fiscal year 2013 – net receipts plus transfers with that adjustment is now \$6,482.5 million, a 2.7% increase over actual of fiscal year 2012.

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

Mr. Underwood would feel comfortable starting at \$50 million lower on the corporate. There again, significant growth is showing and that runs the risk of taking it back too far. Mr. Underwood is comfortable with the rest of the numbers if \$50 million is taken out of corporate. Ms. Lyons complies. Bottom line numbers, going with \$600 million in corporate income tax, you'll get a 3.3% growth for corporate. Bottom line you'll have \$6,723.6 million revenue for fiscal year 2014, which is a 3.7% growth over the approved estimate for fiscal year 2013.

Mr. Underwood made a motion, and Ms. Lyons seconded, to reduce the corporate estimate by LSA to \$600 million and accept the rest of the LSA projected numbers. With no further discussion, Mr. Roederer called for a vote. All voted in favor and the motion was carried.

Fiscal Year 2013 and 2014 Gambling Revenues Transferred to Other Funds and Interest Earned on Reserve Funds (transferred to Rebuild Iowa Infrastructure Fund)

Mr. Underwood asked if anyone could explain why the numbers are going down instead of up. Joel Lunde from the Department of Management explained that the legislature last year made an adjustment to the revenue that goes to the General Fund – from \$66 million to \$40 million and that is picked up in the fiscal year 2013 numbers. But that is a one-time diversion so next year the numbers go back to \$66 million.


Ms. Lyons made a motion to accept FY 2013 and 2014 gambling revenues to other funds, as estimated by LSA and the Department of Management. Mr. Underwood seconded the motion. With no further comment, Mr. Roederer called for a vote. All voted in favor, motion carried.

Mr. Underwood made a motion, and Ms. Lyons seconded, to accept the interest earned on Reserve Funds. With no further comment, Mr. Roederer called for a vote. All voted in favor, motion carried.

Other Business

With no further business, Mr. Roederer called the meeting adjourned.

Respectfully submitted,


Tammy Winters