Revenue Estimating Conference
Minutes
December 12, 2016

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

Mr. Roederer called the Revenue Estimating Conference to order at 3:00 p.m.

Mr. Roederer reiterated that the Code of Iowa establishes a three member panel consisting of the Legislative Branch represented by Ms. Holly Lyons, the state represented by Mr. Underwood, and himself representing the Executive Branch. The Board is required to meet three times per year, where a consensus is to be reached. Projections are developed independent of each other, using a variety of sources. The Department of Revenue is relied upon heavily. The significance of this estimate is that the Governor is required to submit a budget based on the estimate made today, and the Legislature must also use that estimate unless the March estimate is lower. If the March estimate is lower, they are required to use that. Today the projections for FY2017, the current fiscal year, as well as FY2018, will be updated

Approval of the October 13, 2016 minutes
Mr. Roederer called for a motion to approve the October 13, 2016 minutes. 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.

Approval of the December 12, 2016 agenda
Mr. Roederer called for a motion to approve the December 12, 2016 agenda. Ms. Lyons made the motion to approve the agenda and Mr. Underwood seconded the motion. All voted in favor and the motion was carried unanimously.

Mr. Underwood stated that things are changing a little bit and it has all of a sudden become a lot more difficult to feel confidence in the numbers. So it definitely required a lot more research in this situation that we have before. As we come into this, versus the October meeting, we ask if the feds are going to raise interest rates. The consensus is yes. It is early in the national political transition to incorporate any potential fiscal policy changes, in changing forecasts, or to anticipate economic impact from changing trade proposals that a lot of people have been talking about. There are the federal infrastructure upgrade spending and tax cut discussions. They seem to be all too preliminary in design to forecast impact directly on Iowa's General Fund Revenue, in particular for FY2017 or 2018. What can be seen is that industrial sales, which are a big part of Iowa's economy, continue to be weak, in particular as they relate to exports. Iowa has many exporting industries and they all are bearing the brunt of a continued strong dollar and subdued, or flat, global growth. However, Iowa employment remains strong and it appears that wage increases will be slightly better than in the prior few years. That is great for General Fund Revenues but it does not necessarily support significant growth percentages. It appears that the impact of individual income tax decline of Iowa's farmers will be lessened as farm income near breaks even in 2015. As far as the farm returns that will be filed in early 2017, any declines there are small enough in net numbers so that any negative impact on the General Fund Revenues should be softened a little from what was seen the prior two years, probably even with the large percentage increase of decline. As bad as that is for farmers, that is good news for the General Fund.

Through November, about 35% of anticipated total personal income tax receipts have been received by the state. With that 35%, we are only looking at an increase of 3.2% versus last year's to date numbers. The total increase last year for personal income tax was only 3.5% for the full fiscal year and associated with that is a reduced rate of growth in Withholding Receipts through November – only 4.5% this year to date, versus 5.4% last year. Mr. Underwood was anticipating that number through November should have been pretty close, or actually beat last year's increase. The only direct factor Mr. Underwood could find that accounts for this reduction in increase is a moderation of the average weekly manufacturing hours. That has a very direct impact on Growth Withholding Rates, which is all in spite of higher employment, higher wages, and higher wage increases in Iowa. All these various statistics indicate to MR. Underwood that Personal Income Tax growth rate significantly above 3.5% of last year is going to be difficult to forecast for FY2017. There is some room in several of the income categories such as Capital Gains, Interest, Schedule C, Schedule E Income to see some increase above the prior years, but he is struggling with increases much above 5.0%.

Turning to Sales Tax, they continue to be lagging in growth from would normally be anticipated given the current economic climate, but in reviewing something from the Iowa Department of Revenue recently that indicates that this is really not isolated to Iowa, it is really becoming a national trend and newly identified trends need to be reflected in our Sales Tax changes as well. That has been recognized somewhat in the Revenue Estimate before the committee today. The rest of the numbers, particularly for FY2017 appear to be very reasonable and quite consistent with October.

Ms. Lyons began with what is new since the October meeting. There are two more months of revenue collection data and economic indicators to review; there has been a presidential election that surprised many, including economists. Nationally the economy is experiencing moderate growth. Iowa continues to experience revenue growth but even slower than predicted in October, at least for the current fiscal year, FY2017. In terms of the estimate, the LSA estimate calls for a downward adjustment, again to the FY2017 projection. This one is a little more significant. The important thing to note is that growth is anticipated in FY2017, just very slow growth. It is a deceleration, or flattening. The Iowa economy is growing, just not at the pace we'd like to see, or the pace experienced in the last few years. Revenues are not negative; there is nothing that indicates they will turn negative. As job numbers show that Iowa job growth is good, unemployment is down and but for the Ag sector, economic conditions would seem to be able to produce better growth than what is being experienced. The LSA estimate for FY2018, the upcoming budget year, is a bit more optimistic but has also been adjusted for slower growth. The US economic outlook has weakened slightly with the uncertainty brought on by the Presidential election. Forecasts in national economic indicators changed only very slightly since October. The other issues identified nine weeks ago also still exist, factors affecting both the national and the Iowa economy, including the choices facing the Federal Reserve regarding interest rates and lower forecasts for consumer spending and business capital investment. Oil prices, Brexit, the impact of Populism in Europe, China's declining economy, and the subsequent impact of any of these factors on the global economy are all issues to keep an eye on.

Slow growth rates of the world economy continue to impact the Ag industry, particularly in Iowa and other Midwest states. The strong US dollar means that some countries may turn to other sources for agricultural products and machinery, and this further depresses an already weak agriculture sector. A new concern for the Ag economy is potential changes in foreign trade policy.

In other revenue categories, corporate profits continue to decline and most states are experiencing slowing growth in sales tax revenue. The underlying strength in the economy continues as more people are working and/or the people working are receiving raises. Unemployment claims are at the lowest number in decades and show no signs of increasing. We are now in the ninetieth month of recovery from the Great Recession.

Growth continues, just slower than previous levels. In Iowa, economic indicators are mixed. Ag commodity prices are up slightly since October and there was a record harvest. As noted in October, the USDA predicts that the farm income will drop again in Calendar Year 2016. It isn't expected to drop as much as it did in 2015. This is in part due to lower input prices in production expenses and the realized record harvest. Before the election, Moody Analytics the S & P 500 stock index would grow 6.2% in 2017. There are some indications that this may be adjusted downward. The good news is that the recent surge in the financial markets may positively impact Iowa non-wage income tax revenue for the current fiscal year. The Iowa Leading Indicators Index increased in October, with five of the indicators experiencing positive changes. Those included Residential Building Permits, Average Weekly Employment Claims, Agricultural Future Profits Index, Diesel Fuel Consumption and the National Yield Spread.

Another positive sign in Iowa is that withholding tax receipts are currently supported with 1% growth in employment. Non-seasonally adjusted non-farm employment is increasing by nearly 18,000 jobs per year and that is expected to continue with corresponding increases in wage and salary income. Initial unemployment insurance claims, an early sign of a recession, remain low, suggesting that that Iowa economy is strong and in most instances just indicates a lack of qualified employees as a bigger issue than the lack of available jobs.

The Iowa Business Council Economic Outlook Survey was positive in December. Ninety percent of business executives surveyed said that they expect sales to increase over the next six months. Some other indicators to watch, the Business Conditions Index for Iowa remains at 48, after reaching 53 last May. The Index has been below the growth neutral value of 50 for five straight months, much of it attributed to a decline in exports of manufactured machinery.

Another component to watch – tax credit claims are projected to increase. The Department of Revenue indicates that there may be a 17.9% increase in tax credit claims in FY2017 and 5.6% in 2018. This is one of the components of the refund line item when looking at revenue estimates. As refunds increase, revenues decrease.

Finally, any potential federal tax changes are likely to impact Iowa revenue due to Iowa's federal deductibility status. A reduction in federal taxes paid will increase state tax revenue since federal taxes are deductible on Iowa returns. Revenues are definitely off to a slow start this fiscal year and are up 1.5% through last Friday, compared to 1.0% at this time last year The LSA is cautious about FY2017, reducing the October REC estimate by $125.2 million, but projecting stable revenue growth of 4.3%. The LSA is cautiously optimistic for FY2018, but is suggesting lowering the October REC estimate by $76 million.

Mr. Roederer started by stating the manufacturing sector is very much tied to the agriculture sector, so the two are pretty well coupled. So when there is a downturn in agriculture, there is generally a downturn in manufacturing as well. On the positive side, the stock market is going just the opposite direction that all the economists were predicting after the election. It is continuing and appears that it will continue for some time, based primarily on the changes and the repealing of regulations that will be forthcoming in January. Also, Iowa is still hampered somewhat as a state that Ms. Lyons mentioned with qualified workers with work skills. That is an issue that is going to need to continue to be worked on. Mr. Roederer agrees with Ms. Lyons statement about the tax credits, but also keep in mind that you don't get tax credits unless there has been an investment made, so there is that side of the coin as well. The numbers indicate that there should be a lowering of what was recommended in October, the question is how much. LSA is recommending a lowering of roughly $125 million and the Governor's appointee is recommending a lowering of about $73 million and a little less so in 2018.

Review FY2017 General Fund Estimates, Accruals, Refunds, School Infrastructure Transfer, and Lottery and Other Transfers

Mr. Roederer began by explaining the spreadsheet. After reviewing the numbers and all the input, plus the Department of Revenue input, Mr. Underwood stated the only current estimate he could really support is the LSA and he fears the personal income tax may be a little high at 5.8%. His preference would be to take $20-$25 million out of the personal income tax and he could support those numbers in total. Mr. Roederer stated he could not go along with that. Ms. Lyons stated she likes the LSA numbers, but is willing to listen to some arguments. Mr. Roederer stated that the Sales Tax numbers do include the Amazon numbers as well. Mr. Roederer stated he could come up some with the Governor's Appointee's numbers, but couldn't go as high as Mr. Underwood suggested. Ms. Lyons stated she agrees with Mr. Underwood. When LSA looked at this, they were pretty optimistic about FY2017, which is why she would be reluctant to go any higher on Personal Income Tax for sure, but there may be some wiggle room with Sales Tax. Fingers crossed that sales tax picks up, but there is a nationwide concern that the growth isn't there for Sales Tax for a number of reasons. Mr. Underwood suggested splitting the difference on the Sales Tax. Ms. Lyons stated she could support that and asked Mr. Robinson what the increase would be if $26 million were added to Sales Tax. Mr. Robinson responded that the percentage increase would go to 2.9%. Mr. Underwood asked what that would do to the Net Receipts plus Transfers and Mr. Robinson responded 4.2%. Mr. Robinson also stated the $26 million increase revenue on the current estimate would be a reduction from $125 million to $99.2 million. Ms. Lyons asked about ramifications if the October estimate comes in too high and then the March revenues aren't showing and the estimate is lower, would the Governor have to resubmit a new budget based on that new estimate? Mr. Roederer responded it depends where it's at, but generally that is how it is. Mr. Underwood suggested the $26 million increase to the LSA estimate doesn't have to come out of Sales Tax; it could be a reduction in refunds. There is a $59 million dollar difference in estimates in refunds. Ms. Lyons asked if keeping the October REC estimate for refunds would help. Mr. Underwood stated it is a $29 million difference and he is flexible on the $4 million either way if that kind of adjustment is made. Ms. Lyons made a motion to take the refund number from the October estimate and move that to the LSA number. That would put the bottom line number for 2017 of $7,211.9 million, a 4.2% increase compared to last year, and trim $96.2 million from the current estimate, which still leaves the LSA and Governor's Appointee's numbers quite a ways apart. Mr. Underwood seconded the motion. All voted in favor and the motion was carried. The FY2017 number for October REC was $7,308.1 million and that number would become $7,211.9 million. The increase from close of 2016 would be $290.8 million, an increase of 4.2%.

Review FY2018 General Fund Estimates, Accruals, Refunds, School Infrastructure Transfer, and Lottery and Other Transfers

Mr. Robinson stated the LSA's estimate would be $76 million less than the current estimate and the Department of Management's estimate was $30 million less from the current estimate. In October the estimate was $7,607.3 million. LSA's recommendation is to lower the October estimate by $76 million to $7,531.3 million and Governor's Appointee is lowering the October estimate by $30 million to $7,577.3 million.

All are more optimistic about FY2018. Mr. Underwood made a motion to take LSA's numbers for FY2018, with the exception of the refunds, and take that negative $1,043 million to a negative $1,018 million. That would be a $25 million reduction of LSA's estimate to $7,556.3, 4.8% growth and $51 million less than the current estimate for FY2018. The motion was seconded by Ms. Lyons. All voted in favor and the motion was carried.

Fiscal Years 2017 and 2018 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 the estimated Gambling Revenues for FY2017 and FY2018, and the motion was seconded by Ms. Lyons. All voted in favor and the motion was carried.

Mr. Underwood made a motion to move the Interest Earned on Reserve Funds for both FY2017 and FY2018 and Ms. Lyons seconded the motion. All voted in favor and the motion was carried.

RECAP:
From FY2016 actual, $290.8 million increase, a 4.2% increase for FY2017.
From the October 2017 estimate for FY2018, there was a reduction by $51 million, but a 4.8% increase.

Other Business
With no further business, Mr. Roederer called the meeting adjourned at 3:50 p.m.

These minutes have not been approved.

Respectfully submitted,
Tammy Winters

These minutes were approved at the March 14, 2017 REC meeting.