



## COLORADO FISCAL POLICY INSTITUTE

Justice and Economic Security for *all* Coloradans

### **Issue Brief** **March Revenue Projections**

#### **OVERVIEW**

On March 20, 2008, Legislative Council Chief Economist Mike Mauer presented the quarterly revenue projections for March 2008. The March revenue projections are important since they establish the amount of money appropriated through the 2008 Long Bill. The big news is a decrease in projected General Fund revenues of \$169.6 million for FY 2007-08 and \$148.6 million for FY 2008-09.<sup>1</sup>

The implications of these reduced General Fund estimates are most acute in transportation and capital construction. For transportation, the estimated SB-1 transfer for FY 2008-09 was reduced by \$52.9 million and the HB 1310 estimated transfer declined \$113 million. Total FY 2008-09 General Fund transfers to the Highway Users Tax Fund (HUTF) are now estimated to be \$232 million compared to the \$399 million projected in December 2007. For capital construction funding through HB-1310, the estimates fell from \$72.5 million to \$16 million.

**The big question is whether the revenue reductions that were reflected in the March estimates were the beginning or the end of the downward revenue adjustments. Only time and the next quarterly adjustments will tell.**

#### **ANALYSIS**

This issue brief provides analysis on the trends over the past six months in some of the major revenue areas, using the General Fund Overview as presented by Legislative Council. Revenue estimates from December 2007 are compared to the March 2008 forecast. The March numbers take into an account the economy “heading into another recession, if it is not already in one” with slower than expected growth especially in comparison with the December forecast. This slower growth translates into less than full funding for SB-1 and no excess reserve to fund HB-1310 over the last three years of this five-year projection.

Below are six sets of tables, and graphical depictions, showing forecasts for the current and following five years, for:

- Total General Fund Revenues,
- Cash Fund Revenues,

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<sup>1</sup> Unless otherwise noted all information is referenced from *Focus Colorado: Economic and Revenue, 2007-2012*, March 20, 2008.

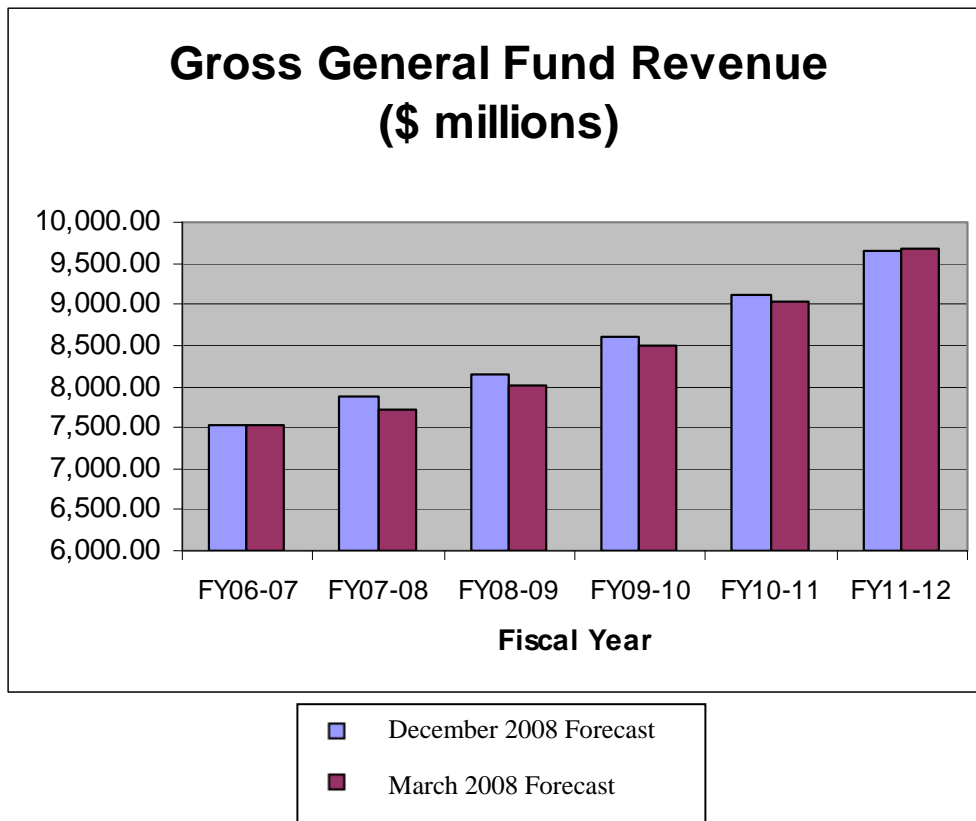
- The SB-1 Diversion to the Highway Users Tax Fund (HUTF),
- The amounts that could flow into the HUTF and Capital Funds in a 2/3–1/3 ratio as “excess General Fund Revenues”,
- General Fund Appropriations and
- Statutory Reserves.

**General Fund Revenues**

The first set of data is gross General Fund revenues. Since last December, with a slowing economy and expected reduction in state income receipts, Legislative Council decreased its five-year forecasts in March. The overall decrease in forecast-period revenues is around 1.3%, with a decrease in \$486.7 million in General Revenue for the next four years until FY 2011-2012. This exception is italicized in the table below.

Gross General Fund Revenues (\$ millions)							
Forecast	FY06-07	FY07-08	FY08-09	FY09-10	FY10-11	FY11-12	Totals
Dec. 2007	7,539.8	7,875.0	8,160.8	8,615.2	9,103.9	9,655.5	50,950.2
% Change	8.3	4.4	3.6	5.6	5.7	6.1	
Mar. 2008	7,539.8	7,705.4	8,012.2	8,507.8	9,031.9	9,666.2	50,463.3
% Change	8.3	2.2	4.0	6.2	6.2	7.0	

In this and each of the following graphs, the first bar is the December forecast and the second is the March forecast. The purpose is to compare the two forecasts.



The graph shows the effect of the slower growth over the years. Annual growth rates in revenue are anemic for this year and next, 2.2% and 4.4% respectively before rising to 6.2%, 6.2% and 7% for FY 2009-10, FY 2010-11, and FY 2011-12 respectively. Even though the revenue rises by a bigger percentage in the last three years of the March forecast versus the December forecast, the March forecast starts from a smaller base.

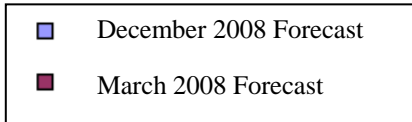
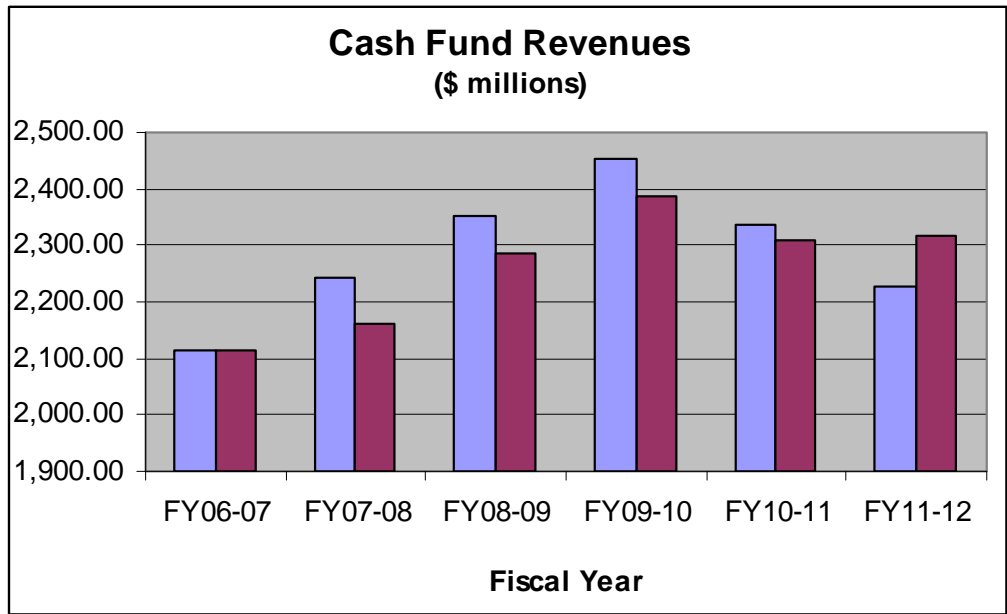
As mentioned above the decrease in revenue is attributed mainly to the lower growth of individual income taxes. After growing at double-digit rates for the last four years, they will grow by only 0.9% due to slower job growth and lower capital gains. Legislative Council expects the economy to grow a little faster, for the capital markets to stabilize, and for higher oil and gas royalty payments causing individual income taxes to increase at a more healthy rate of 5.2% in FY 2008-09.

In addition, sales tax revenue should begin to slow during the remainder of FY 2007-08 due to stagnant or falling home values and negative economic news. The federal stimulus package of rebate check will offset some of this weakness at the end of FY 2007-08 and the beginning of FY 2008-09. For FY 2008-09 a weaker job market and high food and energy costs will result in consumers buying fewer taxable goods and services.

**Cash Fund Revenue**

Cash Funds consist of transportation-related funds, unemployment insurance, employment support fund, severance tax, limited gaming fund, insurance-related funds, regulatory agencies' funds, capital construction-interest, and other cash funds. Since December, Legislative Council expects \$207.1 million less in Cash Fund Revenue for the forecast period.

<b>Cash Fund Revenues (\$ millions)</b>							
<b>Forecast</b>	<b>FY06-07</b>	<b>FY07-08</b>	<b>FY08-09</b>	<b>FY09-10</b>	<b>FY10-11</b>	<b>FY11-12</b>	<b>Totals</b>
Dec. 2007	2,113.4	2,242.9	2352.8	2451.8	2335.4	2,228.9	13,725.20
% Change	-4.7	6.1	4.9	4.2	-4.7	-2.0	
Mar. 2008	2,113.4	2,161.7	2,286.6	2,386.6	2,308.7	2,318.3	13,575.30
% Change	-4.7	2.3	5.8	4.5	-3.4	.04	



As shown in the above chart, the total cash funds forecast are smaller yet some of the annual increases are higher in the March estimate. These higher annual increases are possible because most of the downward adjustment occurs in FY 2007-08. The low growth rate in FY 2007-08 is due to expected decreases in motor fuel and workers compensation insurance premium taxes and slow growth in unemployment insurance and gaming taxes due to a weaker economy.

These decreases were partially offset by higher expected severance taxes. The forecast for FY 2007-08 was largely unchanged. The forecast for subsequent years was increased because of anticipated increases in natural gas prices and production.

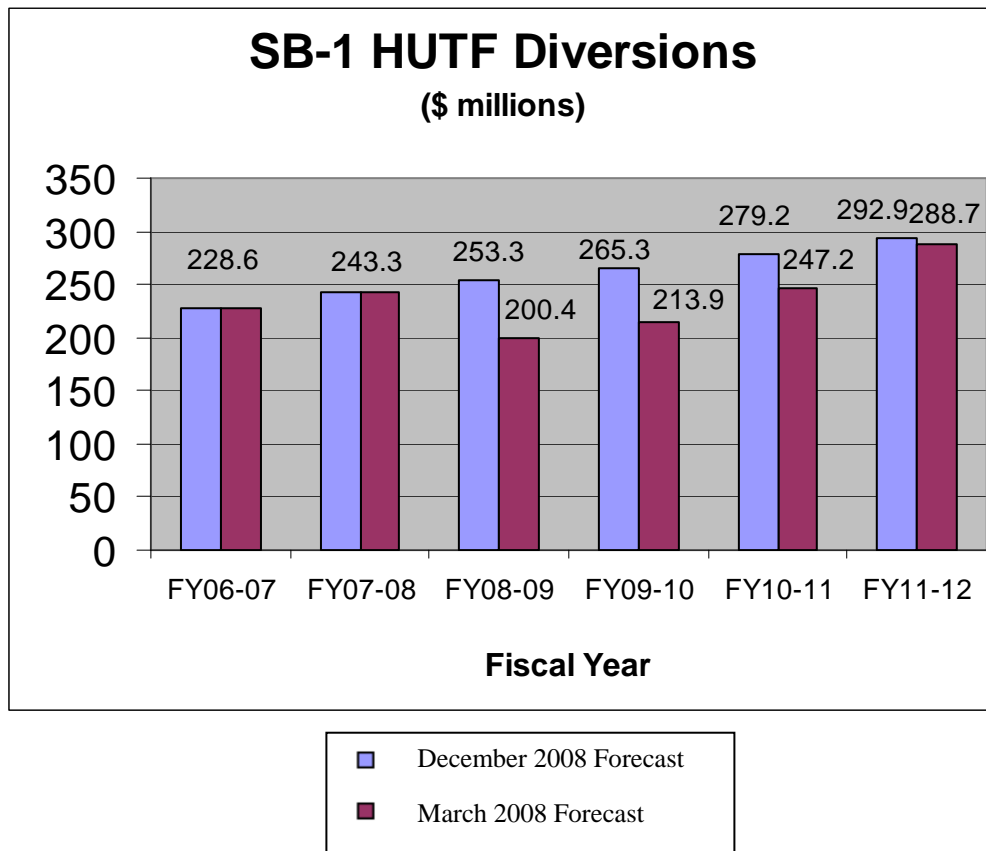
**Senate Bill 1 Highway Users Tax Fund (HUTF) Diversion**

When General fund revenue falls, one of the first areas to notice cuts is transportation through the SB-1 transfer to the HUTF. Current law requires that when General Fund revenues are sufficient to increase operating expenses by 6%, and fill the statutory reserve, an amount up to 10.335% of sales tax revenues (which for the current fiscal year is \$218.5 million) is transferred to HUTF. The table and graph below demonstrate dramatic changes to this fund. Total transfers over the forecast period dropped from \$1562.6 million to \$1422.1 million, a decrease of almost 9%. In December, the SB-1 transfer was fully funded for the forecast period. The March estimates continue to show a fully-funded transfer for this year, but then show only partial funding for the next three years until FY 2011-2012. The decrease in money is a result of the slowing economy. A result of SB-1 partial funding is the lack of spillover revenue to fund HB-1031.

This is in contrast to growth in General Fund Operating Appropriations, which change little, despite slower revenue growth. See chart in General Fund operating appropriations section below.

SB-1 HUTF Diversion (\$ millions)							
Forecast	FY06-07	FY07-08	FY08-09	FY09-10	FY10-11	FY11-12	Totals

Dec. 2007	228.6	243.3	253.3	265.3	279.2	292.9	1562.6
Mar. 2008	228.6	243.3	200.4	213.9	247.2	288.7	1422.1
Fully Funded	228.6	243.3	250.0	259.63	\$273.70	\$288.01	
% Funded	100%	100%	80%	82%	90%	100%	



**No Excess General Fund Reserve Transfer to HUTF and Capital**

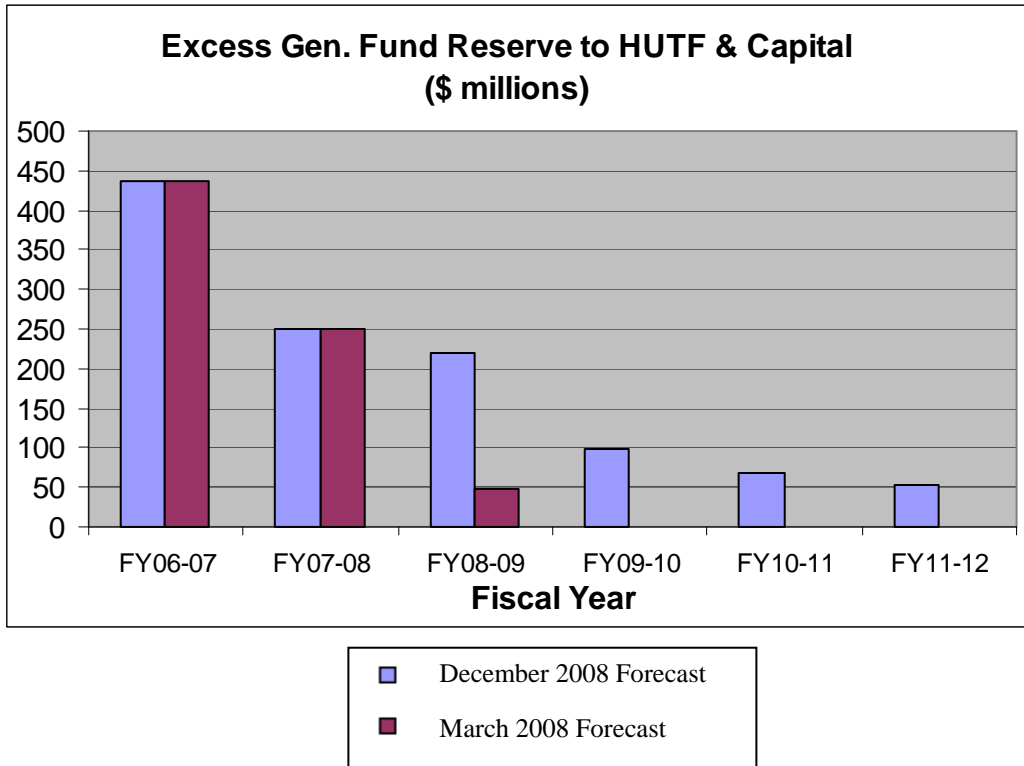
Excess general fund, general fund revenues remaining after all appropriations are made, are transferred at the close of the fiscal year 2/3 to HUTF and 1/3 to Capital Funds. As noted above, if a maximum transfer to SB-1 does not occur, no money is left for a HB-1310 transfer.

A table and graph, below, show the changes that have occurred in the forecast for this money (only the totals are shown – not each part of the HUTF-Capital split). As can be seen, FY 2008-09 shows dramatically decreased transfers to HUTF and Capital Funds as the economic picture dims. Instead of a revenue forecast-period of \$1124.4 million (December), it now stands at \$734.1 million, a decrease of 35% in just three months.

[It should be noted that Legislative Council shows the transfer in the following fiscal year, since it occurs as a residual operation after the close of the fiscal year. Thus, the FY 2006-07 excess transfer occurs in FY 2007-08.]

Since the SB-1 diversion is capped at 10.335% of sales taxes, the Excess General Fund Reserve transfer only shows up when (a) the 6% operational directive is reached, and (b) the SB-1 transfer cap is also reached. Glancing at the table and graph above, it can be seen that SB-1 only tops out in FY 2007-08; therefore the Excess General Fund transfer (below) does not occur after FY 2008-09.

Excess Gen. Fund Revenues to HUTF & Capital (\$ millions)							
Forecast	FY06-07	FY07-08	FY08-09	FY09-10	FY10-11	FY11-12	Totals
Dec. 2007	436.7	249.3	218.8	99.3	67.8	52.5	1124.4
Mar. 2008	436.8	249.3	48.0	0.0	0.0	0.0	734.1



As a side note, money does not necessarily end up in the HUTF and Capital Funds on a 2/3 – 1/3 split. The JBC and the General Assembly have the authority to appropriate this money, so long as they comply with the statutes governing the budget. If the Revenue estimates from Legislative Council are the ones that are officially adopted by the General Assembly, there are any number of places they could put this money, rather than passively allow it to revert as “excess General Fund.” They could appropriate it to specific capital projects, make additional investments toward complying with the Giardino lawsuit (fixing/replacing substandard K-12 schools), enhance the senior property tax credit, or any other use that is not prohibited under the Arveschoug-Bird directive.

In past years, these types of uses are exactly what the JBC has done with such funds that are forecast in the March revenue projections. In some years, the JBC has recommended that this money be placed into the line item for capital spending, as sort of a “placeholder” against anticipated spending needs in a subsequent year, the expectation being that it could be reprogrammed as necessary within the requirements of the law.

### **General Fund Appropriations**

Finally, General Fund appropriations for operations is governed by the Arveschoug-Bird 6% directive and are expected to grow at the full 6% allowed under it. The most striking thing to notice is that essentially nothing changes here despite the lower than previously forecast revenue from December to this March.

	<b>Allowable General Fund Appropriations (\$ millions)</b>					
Forecast	<b>FY06-07</b>	<b>FY07-08</b>	<b>FY08-09</b>	<b>FY09-10</b>	<b>FY10-11</b>	<b>FY11-12</b>
Dec. 2007	6,675.6	7,087.8	7,519.6	7,970.8	8,449.0	8,956.0
Mar. 2008	6,675.6	7,087.8	7,519.6	7,970.8	8,449.0	8,956.0

Thus, while Referendum C removed the TABOR revenue cap for a five-year period, the Arveschoug-Bird 6% directive continues to govern how much governmental operational appropriations can grow. Any desire on the part of the General Assembly to replace programs reduced or eliminated over the past five years must live within this 6% directive. Most growth and decrease in the budget is taken care of outside the 6% directive on highways and capital projects.

The March forecast indicates that the reductions in revenue will be absorbed by SB-1, HB-1310, and transfers to capital construction. The General Assembly is concerned that the revenue estimates in June and September will bring additional downward adjustments. If so, the JBC may have to consider negative supplemental budget appropriations for FY 2008-09.

### **Statutory Reserves**

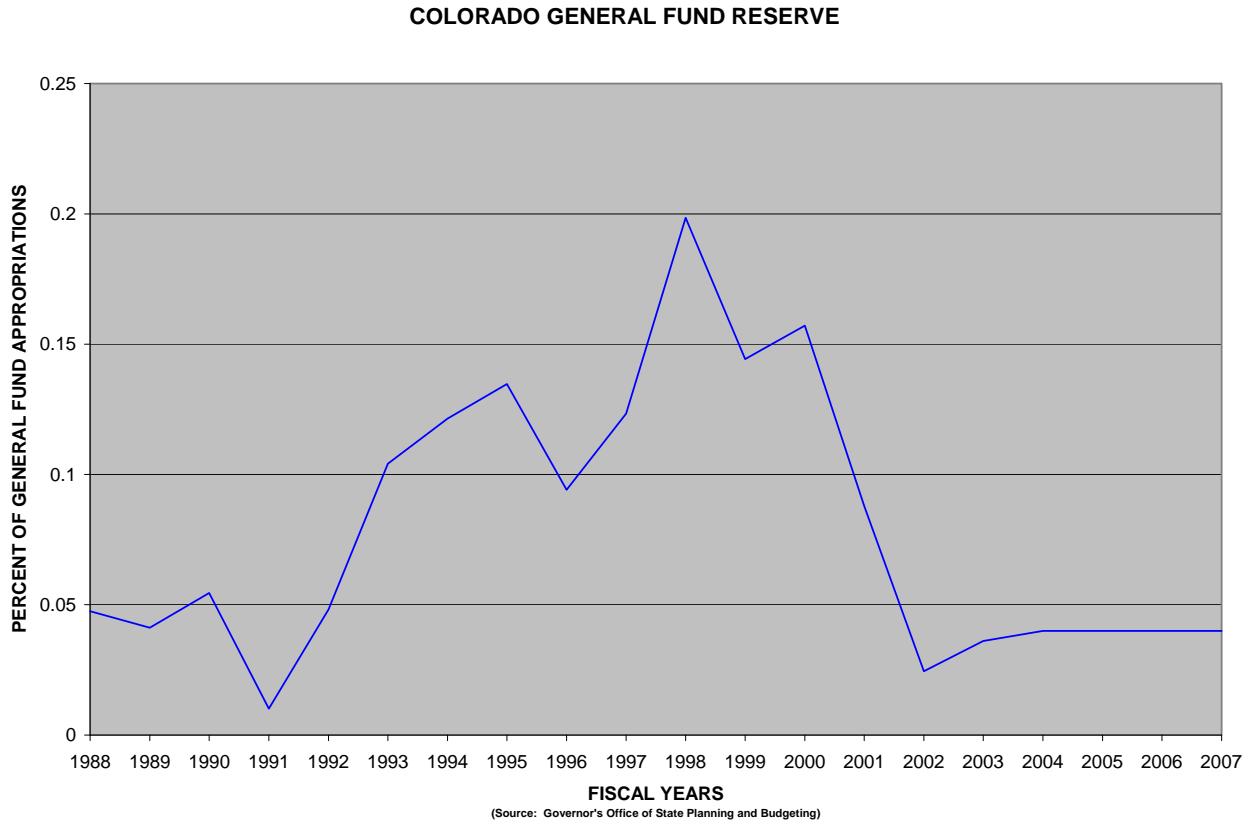
Colorado's protection against recessionary cuts comes in the form of a statutory reserve. The amount of the revenue allocated to the reserve is 4% of state general fund appropriations.

	<b>Statutory Reserve: 4% of Appropriations (\$ millions)</b>					
Forecast	<b>FY06-07</b>	<b>FY07-08</b>	<b>FY08-09</b>	<b>FY09-10</b>	<b>FY10-11</b>	<b>FY11-12</b>
Mar. 2008	267.0	283.5	300.8	318.8	338.0	358.2

During the last recession, however, the reserve was overwhelmed. State general fund revenue fell nearly 17% or \$1.505 billion, from FY 2001 to FY2003 with \$1.373 billion of the reduction coming in the first year. The statutory reserve for FY 2001, the first year of the recession was \$214 million. The woefully inadequate reserve meant severe cuts in services and raids on cash fund balances.<sup>2</sup>

<sup>2</sup> Colorado Fiscal Policy Institute, *Creating a Colorado Kind-of Rainy Day Fund*, March 1, 2007.

The chart below shows that even though the reserve has stabilized at 4%, it is still at a historic low with the exception of years 1991, 2002, and 2003, at 1.0%, 2.4, and 3.6% respectively. With a looming economic downturn and corresponding lower revenue projections, it is expected the reserve will again be inadequate to forestall cuts in services and raids on cash fund balances.



The statutory reserve remains at 4% under current law. COFPI supports the gradual increase of this reserve for use as a rainy day fund in times of economic weakness and when revenues fail to come in at a sufficient rate to fully fund the 6% General Fund Arveschoug-Bird directive.

**TABOR Rebates**

Tabor rebates affect both operations, as well as highway and capital projects. Referendum C removed the requirement to rebate roughly \$800 million per year for five years beginning in FY 2005-06. This change in the law will essentially represent a one-time increase in of the TABOR revenue limit and will modify the way the amount of rebates are calculated in the future. With the TABOR base higher after Referendum C sunsets in 2010, it is not expected that the state will generate sufficient revenue to fund TABOR rebates until after 2012.

**SUMMARY**

The Chief Legislative Economist for Colorado forecasts that the next five years will reflect a decrease in general fund revenues as compared with the December numbers. This is mostly a result of a decline in state individual income and sales taxes. There are certain long-term economic indicators, both nationally and in Colorado, that are cause for concern: the housing and

credit markets; debt levels; rising energy prices; business investment; consumer spending; and business confidence in the financial markets.

Due to the combination of constitutional rules governing the State of Colorado's budget, this slight decline will likely affect only the spillover of money into highway and Capital Funds. This is because General Fund programs under the 6% Arveschoug-Bird directive will still be fully funded with the revenue shortfall affecting the SB-1 HUTF transfer. Because SB-1 is funded at less than the maximum and leaves no spillover revenue for the HB-1310 HUTF and Capital Funds, however, this situation could cause a ripple effect throughout the budget. Programs under the Arveschoug-Bird directive could be at risk, especially Higher Education, if the legislature decides to transfer revenue to capital construction from the General Fund.

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