



COLORADO FISCAL POLICY INSTITUTE

Justice and Economic Security for all Coloradans

Issue Brief June 2008 Revenue Projections

OVERVIEW

On June 23, 2008, Legislative Council presented the June 2008 quarterly revenue projections. The June revenue forecast reviews not only the current conditions but also the impact of recent legislation on future revenue. In addition, it sets the amount for next year's HB-1310 transfer. The big news was a projected increase in the five-year forecast of total revenue subject to TABOR by \$718.4 million over the March forecast. Short-term projected General Fund revenues, however, are now expected to stay the same for FY 2007-08, but fall \$66.1 million for FY 2008-09.¹

The implications of these reduced General Fund estimates are most acute in SB-1 and HB-1310 transfers with transportation suffering the brunt of the impact. Both suffered additional reductions since March. For transportation, the estimated SB-1 transfer for FY 2008-09 was reduced by another \$100.1 million and HB-1310 by \$39.8 million. Total FY 2008-09 General Fund transfers to the Highway Users Tax Fund (HUTF) are now estimated to be \$105.8 million compared to the \$232.4 million projected in March 2007. For capital construction funding through HB-1310, the estimates fell from \$16 million to \$2.7 million. Most of the decrease in the HUTF-1310 for FY2008-09 went to increase the Capital Construction Transfer in FY2007-08 from \$45.9 to \$93.7.

In March, we asked whether the revenue reductions that were noticed were the beginning or the end of the downward revenue adjustments. The June forecast provides a mixed answer. The forecast projects short-term downward movement but long-term positive movement.

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 March 2008 are compared to the June 2008 forecast. The June numbers show a Colorado economy struggling with corrections in the housing and financial markets, but growth in the energy market due to the oil and gas boom.

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

¹ Unless otherwise noted all information is referenced from *Focus Colorado: Economic and Revenue, 2007-2012*, June 20, 2008.

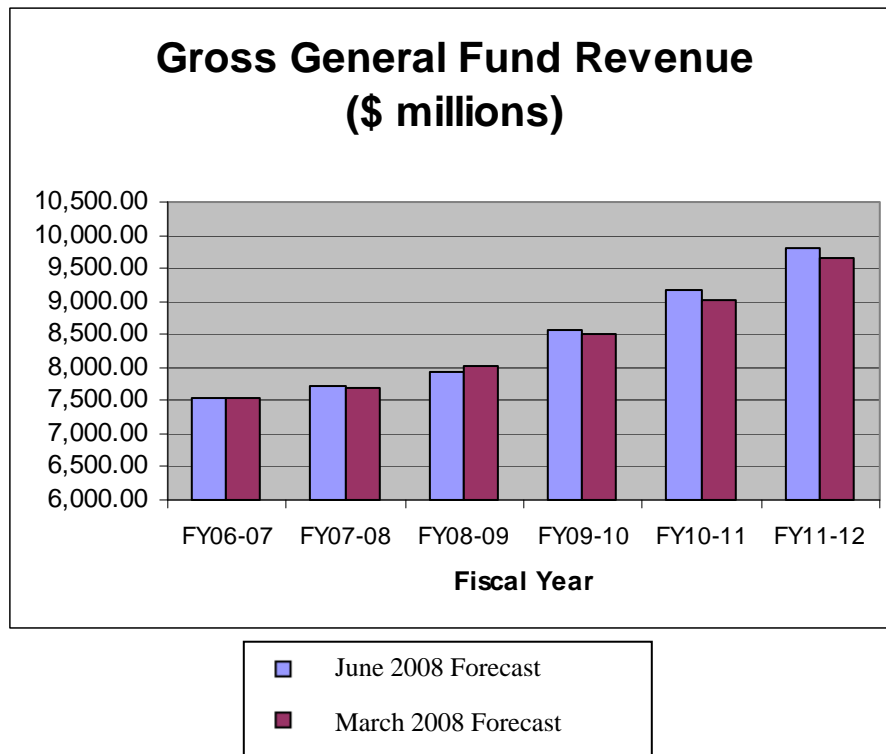
- Total General Fund Revenues,
- Cash Fund Revenues,
- The SB-1 Diversion to the Highway Users Tax Fund (HUTF),
- The amounts that could flow into the HUTF and Capital in a 2/3–1/3 ratio as “excess General Fund Revenues”,
- General Fund Appropriations and
- Statutory Reserves.

General Fund Revenues

The first set of data is gross General Fund revenues. Since March, the higher than expected state income receipts and increased severance taxes due to higher energy prices led Legislative Council to increase its five-year forecast in June. The overall increase in the revenue forecast is around 1.3%, with an increase in \$291.0 million in General Revenue. The only reduction relative to the March forecast comes in FY 2008-09 highlighted in italics.

Gross General Fund Revenues (\$ millions)							
Forecast	FY06-07	FY07-08	FY08-09	FY09-10	FY10-11	FY11-12	Totals
March 2008	7,539.80	7,705.40	8,012.20	8,507.80	9,031.90	9,666.20	50,463.30
% Change	8.3	2.2	4.0	6.2	6.2	7.0	
June 2008	7,539.80	7,709.20	<i>7,946.00</i>	8,575.7	9,166.60	9,817.0	50,754.30
% Change	8.3	2.2	3.1	7.9	6.9	7.1	

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



The graph shows the effect of slight growth over the years. Annual growth rates in revenue are anemic for this year and next, 2.2% and 3.1% respectively before rising to 7.9%, 6.29% and 7.1% for FY 2009-10, FY 2010-11, and FY 2011-12 respectively.

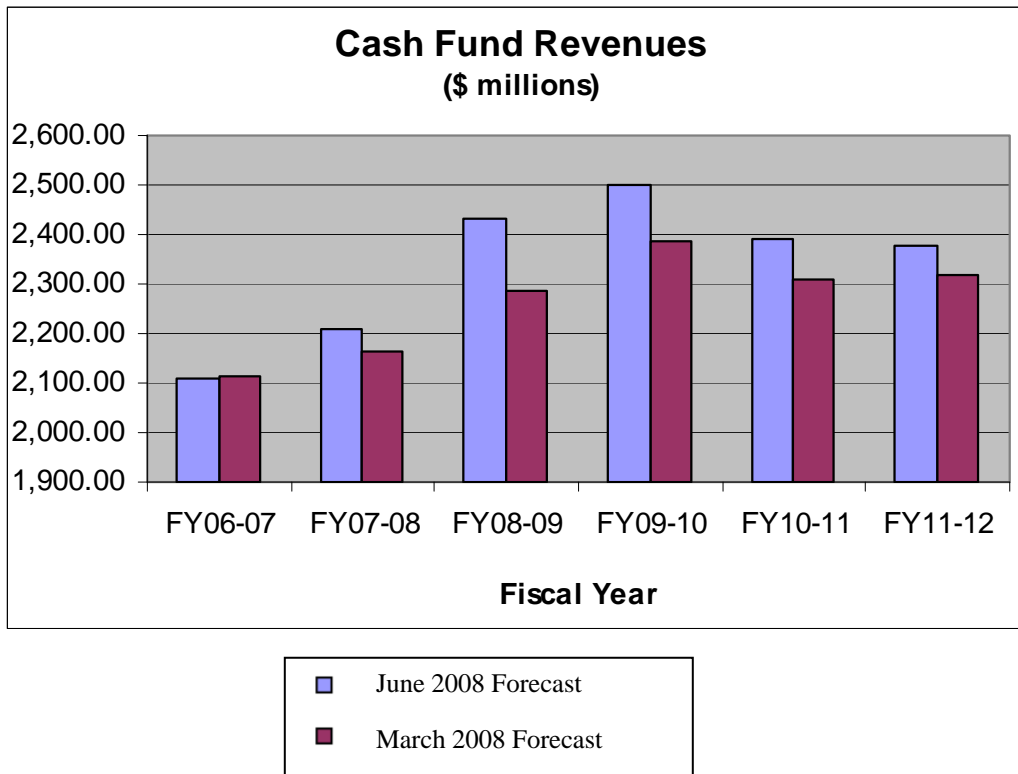
As mentioned above, the increase in revenue is attributed mainly to the slight growth in individual income tax revenue. The increase is also due to recovery from slower growth, stabilized capital markets, and higher severance tax royalties. Four recently passed tax credit and deduction bills will reduce projections by \$21.4 million a year.

In addition, state sales tax revenue is expected to continue to slow over the next two years. Food and gasoline prices have significantly increased causing state sales taxes to fall for two reasons. Food and gasoline are not subject to the state sales tax and purchases on those items are crowding out taxable goods and services. The federal stimulus rebate checks will produce a temporary, yet modest, boost during the summer causing sales tax to increase by 4.8 percent in FY 2007-08 and slow to 2.6 percent in FY 2008-09. Six bills positively impact sales and use tax revenue by about \$3 million a year.

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 March, Legislative Council expects \$427.4 million more in Cash Fund Revenue for the forecast period driven by rising energy prices.

	Cash Fund Revenues (\$ millions)						
Forecast	FY06-07	FY07-08	FY08-09	FY09-10	FY10-11	FY11-12	Totals
March 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	6.1	4.9	4.2	-4.7	-2.0	
June 2008	2,109.90	2,207.40	2430.30	2501.80	2392.10	2,375.30	14,016.80
% Change	-4.9	4.6	10.1	2.9	-4.4	-0.7	



In the above chart, the total cash funds forecasted show a sharp increase from the March estimate. Increases in severance and unemployment tax were partially offset by decreased expectations for motor fuel taxes, vehicle registration fees and gaming taxes. Severance tax and unemployment insurance revenue will be expected to increase by \$300 and \$99.3 million respectively over the forecast period. In addition, 62 bills passed in the recent session will contribute new revenue of \$227.5 million over that time.

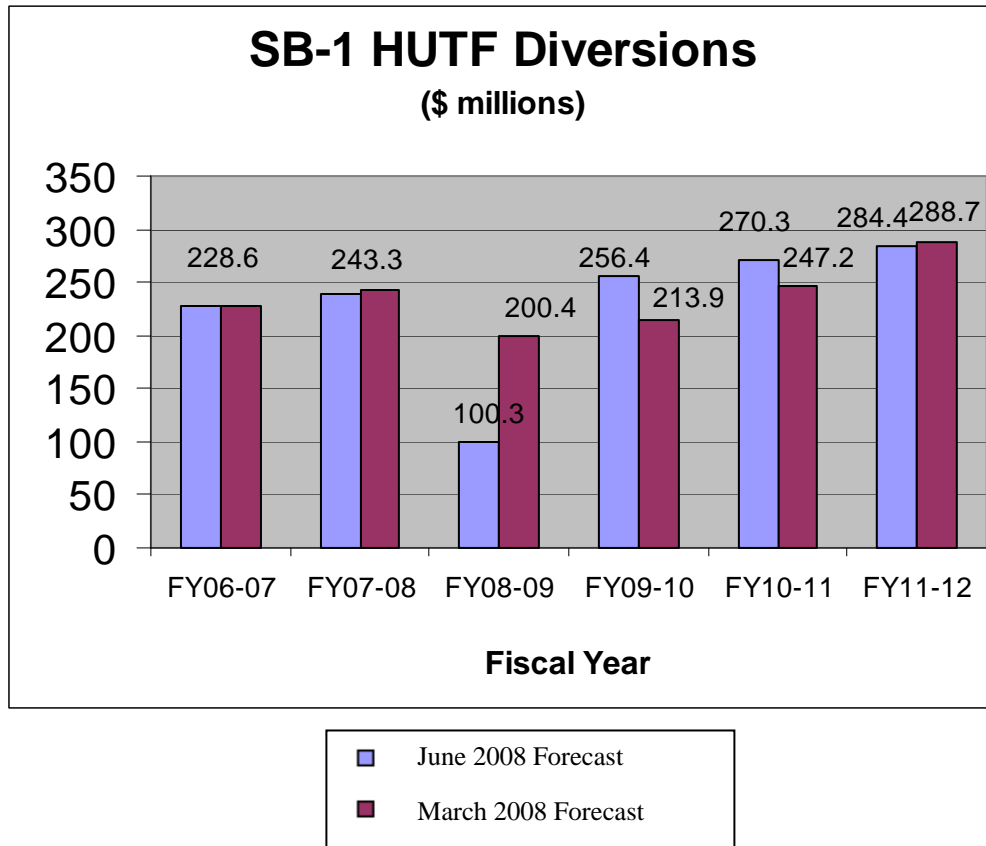
Senate Bill 1 Highway Users Tax Fund (HUTF) Diversion

General Fund revenue uncertainty leads to high volatility in transportation funding 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 is transferred to HUTF.

The table and graph below demonstrate full funding for the transfer except for the sharp reduction of funding during FY 2008-09. The FY 2008-09 transfer, only at 41 percent of full funding, is responsible for a majority of the difference between the March and current forecast, \$1422.1 million to \$1379.8 respectively, over the five-year period.

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

SB-1 HUTF Diversion (\$ millions)							
Forecast	FY06-07	FY07-08	FY08-09	FY09-10	FY10-11	FY11-12	Totals
March 2008	228.6	243.3	200.4	213.9	247.2	288.7	1422.1
June 2008	228.6	239.8	100.3	256.4	270.3	284.4	1379.8
Fully Funded	228.3	239.3	245.0	255.8	269.7	283.8	
% Funded	100%	100%	41%	100%	100%	100%	



No Excess General Fund Reserve Transfer to HUTF and Capital Construction

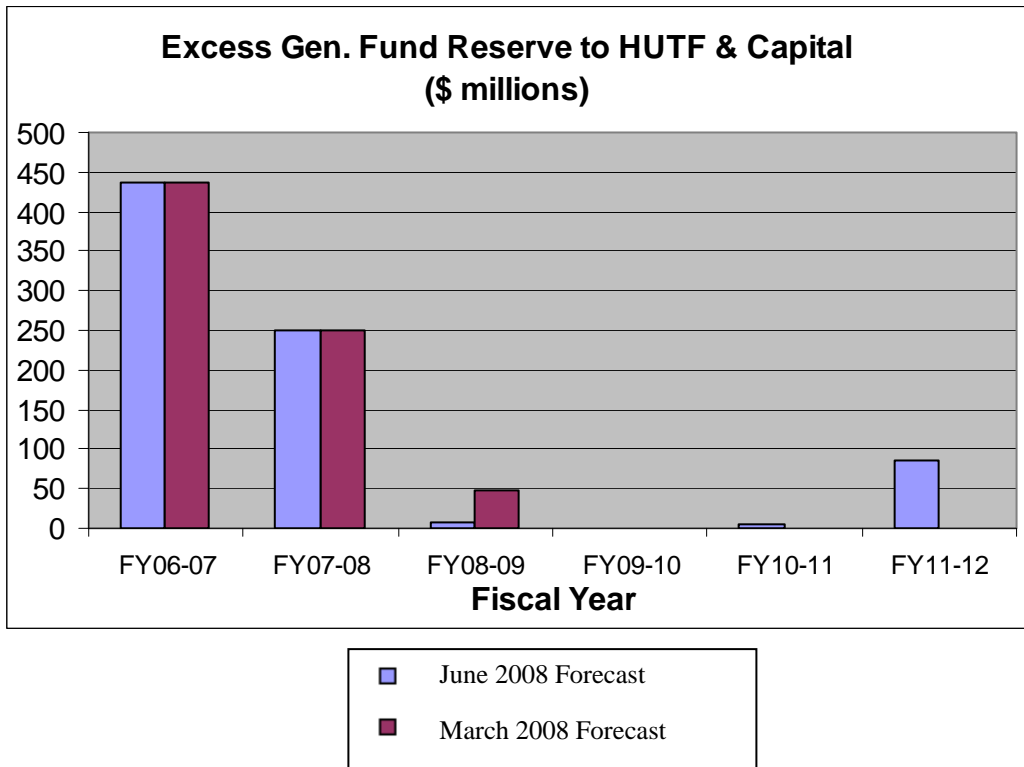
Excess General Fund revenues remaining after all appropriations are made are transferred at the close of the fiscal year - 2/3 to HUTF and 1/3 to Capital Construction. As noted above, if a maximum transfer to SB-1 does not occur, no money is left for a HB-1310 transfer.

A table and graph show the changes that have occurred in the forecast for this money (only the totals are shown – not each part of the HUTF-Capital Construction split). Both forecasts show about equal transfers over the forecast period, but a shift in when the reductions are felt. As can be seen, FY 2007-08 shows dramatically decreased transfers to HUTF and Capital Construction due to dimming economic conditions. Because the June forecast sets the HB-1310 transfer for the next year, funding for the FY 2008-09 transfer will practically be non-existent.

[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, a significant spillover after the SB-1 transfer does not occur until FY 2010-11 for a Excess General Fund transfer (below) in FY 2011-12.

Excess Gen. Fund Revenues to HUTF & Capital (\$ millions)							
Forecast	FY06-07	FY07-08	FY08-09	FY09-10	FY10-11	FY11-12	Totals
March 2007	436.8	249.3	48.0	0.0	0.0	0.0	734.1
June 2008	436.7	249.3	8.2	0	4.2	86.7	785.1



Note that the HB-1310 transfer does not automatically occur. 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. They did this in FY 2007-08 through HB08-1376 by appropriating \$45 million to the Capital Construction Fund thereby reducing the HB-1310 transfer.

General Fund Appropriations

Finally, General Fund appropriations for operations are governed by the Arveschoug-Bird 6% directive and are expected to grow at the full 6% allowed under it. Nothing essentially changes despite the differing revenue figures between March to June.

	Allowable General Fund Appropriations (\$ millions)					
Forecast	FY06-07	FY07-08	FY08-09	FY09-10	FY10-11	FY11-12
Mar. 2008	6,675.6	7,087.8	7,519.6	7,970.8	8,449.0	8,956.0
June 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 or decline in the budget is taken care of outside the 6% directive on transportation and capital projects.

The June forecast indicates that the revenue reductions will be absorbed by SB-1, HB-1310, and transfers to capital construction. Because of the volatility in the forecasts the JBC may have to consider negative supplemental budget appropriations for FY 2007-08.

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.

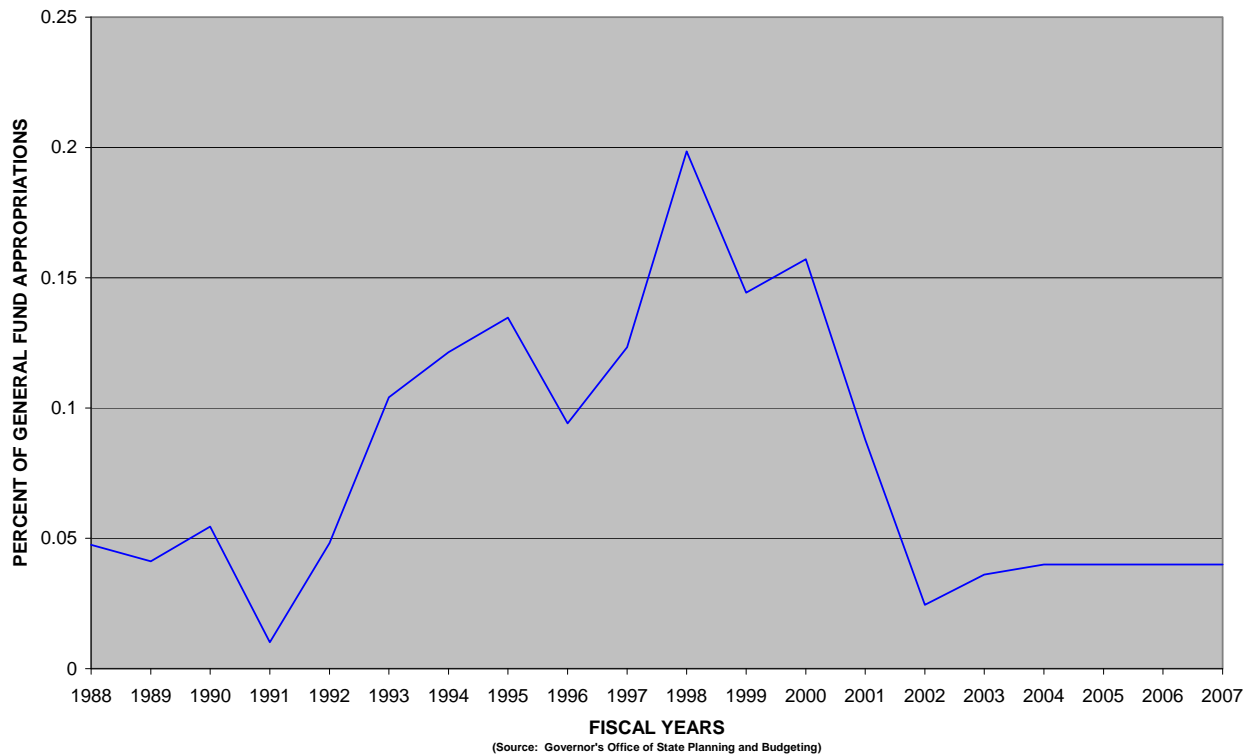
	Statutory Reserve: 4% of Appropriations (\$ millions)					
Forecast	FY06-07	FY07-08	FY08-09	FY09-10	FY10-11	FY11-12
June 2008	267.0	283.5	300.8	318.8	338.0	358.2

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.²

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.

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

COLORADO GENERAL FUND RESERVE



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 \$1.2 billion per year for five years beginning in FY 2005-06 through FY 2009-10. This change in the law will essentially represent a one-time increase in the TABOR revenue limit and will modify the way the amount of rebates are calculated in the future. Even though the revenues are expected to grow faster than inflation plus population, the Unemployment Insurance solvency tax will take a hiatus during 2011 leading to lower overall revenues. The higher base plus the expected decline in overall revenue will not trigger TABOR rebates until after 2012.

SUMMARY

The June forecast reflects an increase in both General and Cash fund revenues as compared with the March numbers. This is mostly a result of an increase in state individual income tax revenue and an increase in tax revenue resulting from rising energy prices. 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. Colorado is struggling with these, but is in better shape than the national economy. FY 2008-09 will bear the brunt of the economic downturn over

this forecast. It will suffer a reduction of \$66.1 million of General Revenue and \$39.8 million in the HB-1310 transfer.

Due to the combination of constitutional rules governing the State of Colorado's budget, declines will only affect the spillover of money into transportation and capital construction. The General Fund programs under the 6% Arveschoug-Bird directive as well as the SB-1 HUTF transfer, with the exception of one year, will still be fully funded. Little, however, will be left for the HB-1310 transfer until FY 2010-11.

The lack of spillover revenue for the HB-1310 HUTF and Capital Construction during the next three years could cause a ripple effect throughout the budget. Both transportation and capital construction will face a severely constrained funding environment. Programs under the Arveschoug-Bird directive could be at risk, especially Higher Education, if the legislature decides to transfer revenue to fund Capital Construction from the General Fund.

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