

**Revenue Estimating Conference
Minutes
October 9, 2014**

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

Mr. Roederer called the Revenue Estimating Conference to order at 11:00 a.m.

Mr. Roederer began by stating that the task is to reach a consensus for FY15 and FY16 estimates. The Governor's budget is submitted based on the December estimate and the legislature uses either the December or March number, whichever is lower.

Approval of March 20, 2014 Minutes

Mr. Roederer called for a motion to approve the March 20, 2014 minutes as they are written. Mr. Underwood made the motion to approve the minutes and Ms. Lyons seconded the motion. All voted in favor and the motion was carried unanimously.

Ms. Lyons stated that the national economy continues to improve, and has even accelerated in several areas. Real GDP increased by 2.2% in 2013, well above the 1.5% annual average for the prior nine-year period. Moody's has forecasted real GDP growth to be stable at 2.2% in 2014, and grow to 3.5% in 2015 – all indicative of a stable, growing economy. The U.S. workforce economy continues to expand in the number of workers and in wage growth. Housing prices are rebounding, stock values continue to be strong and business confidence and investment is increasing. Retail sales forecasts are strong heading into the holiday season.

In Iowa, most economic indicators remain positive, pointing to solid but perhaps slower economic gains in the near term. Nothing is indicating anything but a growing economy at this time. Agricultural commodity prices and the demographics of the Iowa workforce are worth watching – both could have an impact on tax revenue in future years.

The Iowa Business Council's recent Overall Economic Outlook Survey remains very positive with 86% of the surveyed executives expecting steady to increased sales over the next six months. Of the executives surveyed, 95% expect steady or increased capital spending and 90% expect hiring levels to remain steady or increase.

Another index, the Iowa Business Conditions index produced by Creighton University fell in September, but still indicates expansion; albeit projected slower economic gains over the next three months. The significant decline in farm commodity prices will mean lower farm income in 2015 and a potential pullback in the economy for businesses linked to the agricultural industry.

Employment and wage growth national and in Iowa has recently picked up. Since Iowa is much closer to normal employment levels than the country as a whole, the wage growth may be a little faster than nationally. However, due to demographics, including an aging workforce, Iowa

may find it harder to sustain employment growth numbers over the next two years and growth may need to come from wage increases rather than employment increases.

With overall wage and salary growth continuing in Iowa over the next two years, Iowans should continue to have more disposable income to spend, and that should support sales/use tax growth, the other key component to General Fund revenue. Another factor contributing to increased disposable income are steady or declining gasoline prices.

State and federal tax law changes over the most recent two fiscal years created much volatility in Iowa revenue, particularly for individual income tax, but those changes are fully implemented now, hopefully making it easier to estimate future revenues.

Corporate tax revenue was down a bit in FY2014, but nothing alarming, and is up for the first three months of this fiscal year. Again, weakness in the agricultural economy may hold down corporate tax growth in the future and is worth watching.

While the Iowa economy is expanding and remains solid, recently it has not been expanding as fast as the rest of the country. This could be partially due to the lower farm commodity prices and partially due to the lack of qualified but still unemployed workers. There is still some uncertainty in business that slows investment – concern about the overall economy, costs associated with the Affordable Care Act, and various global issues. Additional investment in plant and equipment would create jobs. More jobs create more income tax revenue and generate sales tax revenue.

As always with the October REC estimate, we look forward to the next two months' data, knowing that we will likely revise the estimate in December. However, at this time withholding receipts and sales and use tax receipts are all up over 6% for this cash fiscal year, so the LSA estimate for FY2015 is for a steady 5.6% growth in General Fund revenue after transfers, and for our first look at Fiscal Year 2016, the estimate is for 4.5% growth in General Fund revenue after transfers.

Mr. Underwood stated that when it comes to FY2015, there haven't been many changes since the March meeting. The legislative changes after the last meeting was a net reduction of \$19.6 million, which is reflected adequately in the new estimates for FY2015. The big unknown seems to be the farm economy and the timing of the impact on state general fund revenues, particularly personal income tax. In speaking with tax return preparers that have been working with the farmers, as well as some of the lenders out there, the tax return preparers commented on how this was going to impact some of the farmers. Earlier this year, there were some estimates that approximately 10% of the farmers would really be at risk in the next year or two. Following up with the tax return preparers, one stated that estimate might be on the low side of the farmers that are going to be very negatively impacted as far as being able to continue in business as a farmer. The bankers thought the estimate might be a little high. The bankers will take a very hard look at all the people they are lending money to as soon as they can get them in or out of the crop fields. They are working very closely with their farmers that have significant

debt due to the lower prices of the corn and soybeans; they've seen some significant reductions in farmers' net worth. One example is a farmer who had not covered himself on grain very well and has already seen his net worth decrease by 50%. One loan officer indicated is they are going to pay a lot closer attention this year to the tax liabilities of the farmers because there is so much deferred income and the ability of the farmer to pre-pay and take those deductions this year, when they have to go to the bank to borrow the money, the lenders have to pay close attention to that tax liability and decide whether or not to loan for pre-pays for next year. It is a game changer situation for row crop farmers. Those farmers that not only row crop, but also have cattle and hogs, the banks are not too concerned about those farmers. The offset to some of that is the ethanol industry which, according to some of the reports out of the ethanol plants, is doing very well right now with lower grain prices, but is also having a hard time getting grain in. The ethanol plant in Hanlontown, Iowa, is increasing their bids trying to get enough grain in to keep operating. One of the concerns for Fiscal Year 2016 is the Schedule E income from cash rents. Talking with some of the people that have been working with farmers on how much rent they are going to be willing to pay next year, there have been indications that some farmers are just walking away because the landlord won't lower the rents enough. The rents that have been negotiated are 25-40% lower. A number of discussions have been held on new leases that instead of just cash rent, it will be crop share or an adjustable amount based upon yield and price. There is a significant impact there, as to how much impact that could actually have on the landlord's reported income for Fiscal Year 2016. It would be nice to have a better handle on this because the rent aspect of it will be quite significant because there is a tremendous amount of farmland in Iowa that is rented.

The other aspect is equipment purchases. The bankers indicated that they are not going to loan for equipment unless there is a tremendous need for it. Combine prices have already started to fall and just in recent months a new combine costs \$40,000 less than it did two months ago. That will have a ripple effect throughout the economy because farmers are not going to have the kind of funds that they had to spend on discretionary spending, let alone equipment, and the bankers indicated that they are talking to all their farmers about going through their equipment inventory and if they don't absolutely need it, they should sell it now because used farm equipment prices will start to fall as well.

The farm economy helped Iowa's General Fund considerably during the last recession and as we came out of that recession, now it is their turn to take a breather in providing growth in general revenues. The rest of the economy in Iowa seems to be doing very well. As Ms. Lyons alluded, companies cannot find enough workers to fill the available positions. There are many entry level, as well as advanced, jobs available.

Mr. Roederer stated that internationally, there are always trouble spots. Right now there seem to be more trouble spots than there has been in some time- Russia, Ukraine, Iraq, Iran, Syria, the Koreas, Hong Kong, China, Israel, Egypt, and a new player called Isis. So far that doesn't appear to be affecting the world economy that much. An eye should be kept on it though, to see if that starts a ripple effect in the world economy. In the U.S., it seems to be moving in the right direction, economy wise. The consumer and business sentiment is still very fragile. The

dis-functionality in Washington is impacting our ability to forecast what is going to happen with the Iowa economy. Tax changes that are enacted in Washington have a big impact on behavior and how that is going to impact what individuals do and what the tax revenues will be in the state. Passing of laws that are going to impact taxes, and then putting sunsets on them only to say they may or may not be extended, makes it difficult to predict what Iowa taxpayers are going to do. Currently, the Bonus Depreciation and the amount of expenses that one can deduct for major equipment needs to be extended or modified. Congress is talking about doing that in the lame duck session. The U.S. economy is very resilient and once the rules are known, things can be adjusted. But it's the changing of the rules or having the question marks up there is what creates a little bit of angst. The lack of action on the renewable fuel standards ties in quite a bit with what Ms. Lyons and Mr. Underwood both said on the corn prices. One of the challenges right now in the Agriculture economy is there is an over-supply for demand. By all accounts, records seem to point that there will either be record crops, or pretty close to it. As a result, those prices are probably going to stay subdued for some time. Compared to one year ago, corn prices are down 40% and soybeans are down 23%. The challenge we always have is 'What is the impact?', 'What is the connection if commodity prices lower?' Mr. Underwood spoke about the cash rent – what impact is that going to have and if that is lowered, then what happens to other people when they decide what kind of other goods and services they are going to buy. Ms. Lyons summed it up when she said "We always want two more months". All in all, Iowa economy is doing well, but don't mix up the difference between the economy doing well and the amount of revenue coming into the state. Generally they are pretty closely tied, but not necessarily. In speaking with Tax Preparers, there was a mixed response.

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

Ms. Lyons made a motion to accept LSA's Fiscal Year 2015 numbers and Mr. Underwood seconded the motion. Mr. Underwood stated since there is a \$20.5 million difference, primarily in accruals, which is a \$37 million variance. This is very difficult to estimate because it is all based on when people write their checks. Mr. Underwood could go with either number and Mr. Roederer concurred. All voted in favor and the motion was carried.

Estimate Fiscal Year 2016 General Fund Estimates, Accruals, Refunds, School Infrastructure Transfer, and Lottery and Other Transfers

Mr. Underwood made a motion to accept LSA's Fiscal Year 2016 numbers and Ms. Lyons seconded this motion. The difference is \$43.7 million, with the Governor's appointee being more optimistic than LSA. The number is further apart than in FY2015. Mr. Underwood stated that the numbers are not significantly different in most areas; they just spread out a little bit here and there. Given his pessimism on cash rents, LSA is close enough for a first look and the farm situation can be watched closely. Mr. Roederer stated he would feel differently if the Fiscal Year 2015 number had not just been increased. After some discussion, the motion was amended to reduce the LSA number for refunds on the accrual basis from \$-956 million to \$-936 million. All voted in favor and the motion was carried. The Fiscal Year 2015 number will be – total next receipts 6.7% growth, net receipts plus transfers 5.6% growth. For Fiscal Year 2016, the total net receipts growth line would be 5.2% growth, \$352.2 million above the just accepted

Fiscal Year 2015 estimate. For Fiscal Year 2016 net receipts plus transfers, it is a 4.8% growth over Fiscal Year 2015 or \$328.2 million.

Fiscal Year 2015 and 2016 Gambling Revenues Transferred to Other Funds and Interest Earned on Reserve Funds (transferred to Rebuild Iowa Infrastructure Fund)

Mr. Underwood made a motion to carry the numbers as presented for Fiscal Year 2015 and 2016 Gambling Revenues and Ms. Lyons seconded the motion. All voted in favor and the motion was carried.

Mr. Underwood made a motion to carry the numbers as presented for Fiscal Year 2015 and 2016 Interest Earned and Ms. Lyons seconded the motion. All voted in favor and the motion was carried.

Other Business

With no further business, Mr. Roederer called the meeting adjourned at 11:35 a.m.

Respectfully submitted,



Tammy Winters

