

**Revenue Estimating Conference  
Minutes  
October 13, 2015**

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

Mr. Roederer called the Revenue Estimating Conference to order at 1:00 p.m.

Mr. Roederer began by stating that the Code of Iowa establishes a three member panel. Holly Lyons represents the Legislative Branch, Dave Underwood represents the public and the citizens of the state and Mr. Roederer represents the Executive Branch. The Conference is required to meet three times per year and required to reach a consensus. Independently, projections are developed independently, using a variety of sources. The Department of Revenue provides their current activity for the state. The Governor is required to submit budget recommendations using the December estimate and the legislature is to use the lower of the December or March estimates. Today the panel will estimate the current fiscal year, which is FY16 and ends on June 30<sup>th</sup>; then estimate FY17, which begins July 1<sup>st</sup>.

**Approval of the October 13, 2015 agenda**

Mr. Roederer called for a motion to approve the October 13, 2015 agenda. 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 March 19, 2015 Minutes**

Mr. Roederer called for a motion to approve the March 19, 2015 minutes as they are written. 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.

Before discussing the economy of FY 2016 and FY 2017, Ms. Lyons noted that FY 2015 revenue came in at \$52.3 million above the March 2015 estimate made by the REC; the mark was missed by just over 7/10 of a percent on a \$6.7 billion General Fund estimate.

Looking at the remainder of FY 2016 and taking the first look at FY 2017, Ms. Lyons reviewed what has happened in the U.S. and Iowa economy since the REC meeting last March. The national economy continues to move along, growing slowly but steadily. On the other hand, the Iowa economy seems to have hit a bit of turbulence in the form of declining farm income and flat growth in sales tax revenue.

On the sheet that was handed out, it shows that the LSA has lowered the estimate for FY 2016 with the thought that there is just three months of data to review for FY 2016, and that perhaps what is happening may be just one-time events or bumps. An additional two months of data prior to the December meeting may provide more clarity when the estimates are revisited, and if this IS just a bit of turbulence, the REC can adjust the growth rates accordingly.

The U. S. economy continues to perform well. The unemployment rate is trending downward toward five percent, and the non-farm employment forecasts, while less than they were in March, are still currently positive. Wage and salary growth is coming off the highs of earlier this year, but still higher than any time in the last seven years and is chugging along at 5% growth. Federal corporate tax revenue has weakened a bit and federal income tax withholding is a little sluggish but steady. Disposable income is increasing compared to the inflation rate, in part as a result of lower fuel rates and energy prices. Initial unemployment claims - an early indicator of a recession, continues to decline, which is good.

According to Moody's Analytics, real GDP dropped in the 3rd quarter of this year, but is expected to finish the year at 2.5% growth, with growth estimated in 2016 at 3.2%. National retail sales forecasts are lower than they were in March, but still showing steady growth. Despite the large swings in the S & P stock market index in August, and the horrible third quarter for the market, the index is still expected to reflect growth of more than 6.9% this year, albeit modest compared to prior years, but still positive growth. Finally, housing starts are expected to increase significantly on a national basis.

Of course there are risks - there always are, such as the slowdown in China's economy, the continued turmoil in the Mideast, the uncertainty of the Federal Reserve's monetary policy, and the impact of the strong U.S. dollar on global markets. But overall, the U. S. economy appears to be relatively stable and growing slowly.

In Iowa, as mentioned earlier, there has been a bit of turbulence primarily in the significant reduction in farm income, and the potential it has to trickle down through the Iowa economy, specifically to durable goods manufacturing. Corn and soybean prices have dropped 47% and 32% respectively since the 2013 peak and there is no doubt that farm income is much lower than several years ago. While farm income has become a smaller portion of the overall Iowa income, thanks to a diversified economy large drops in income still have a noticeable influence. What is still unknown is how much the farm income reduction will affect machinery and other durable goods manufacturing; it is likely that there may be a pass-through effect to manufacturers, suppliers, and dealers. Both machinery and durable goods manufacturing have seen a slight downward tic recently, but nothing remarkable. There are indications of plant layoffs, but it remains to be seen how those might impact the economy.

The remainder of the Iowa Economy is doing well with employment growth still adequate. There were 26,000 jobs added between August 2014 and August 2015. The number of Iowans counted as unemployed is low and improving. As discussed at this meeting before, Iowa is running out of workers and matching skilled workers to jobs is an ongoing challenge. Initial unemployment claims, a key indicator of employment health in Iowa remains low. Claims will shoot up if the economy is in trouble, and they haven't; they continue to decline.

Of concern is the Iowa Leading Indicators Index, which has declined for the last eight months and is considered to be an indicator of the direction of the Iowa economy. However, upon

closer review of the eight components of the index, two have contributed positively: the average weekly manufacturing hours and average weekly unemployment claims.

Three indicators, building permits, index yield spread, and diesel fuel consumption, do not cause concern at this time. Three other indicators, the new orders index, the Iowa stock market index, and the Ag Profit Index, do show some cause for concern.

On the bright side the Iowa economy, like the U.S. economy, is still experiencing the benefit of low inflation and low fuel and energy prices, two related things that keep consumer sentiment positive.

While the decline in farm income is perhaps making a dent in the Iowa income stream, it is evident that revenue outflows due to economic development incentive programs have also impacted General Fund revenues. Transfers out of the General Fund to local governments with Flood Mitigation programs, along with sales and use tax rebates and the redemption of research and investment tax credits have been unusually high in the first three months of FY 2016. This has impacted the flow of revenue ....and the timing of these impacts in the future is very difficult to project.

For these reasons, the LSA has trimmed the revenue forecast to 3.2% (after transfers) for FY 2016 and established a modest growth rate estimate of 4.4% for FY 2017, with the understanding that the forecast will be revisited at the December meeting.

Mr. Underwood stated when reading one of the newsletters he receives daily, it stated that "low inflation makes it unlikely that there will be a cost of living adjustment for Social Security benefits next year." Although Iowa does not tax Social Security benefits, it does mean less disposable income for those with Social Security and it may impact sales tax a little. It also points out that Iowa is in a very low inflationary period and for many years, higher inflation levels generated a lot of additional revenue as wages grew at higher rates than they are currently growing. Three to four percent increases in withholding used to be able to be accounted for just by wage increases due to inflation, but that is not seen these days. Which makes the growth of Iowa's largest single revenue source holding flat to some degree.

The next item Mr. Underwood read was that "Federal Reserve Governor Brainard has recommended a 'Go Slow' approach to the rate policy until the downside risk of the global slowdown is better understood." Mr. Underwood is struggling with this same issue – how is the global slowdown going to impact the General Fund receipts? There are various ways that could impact Iowa. As Ms. Lyons mentioned, there is low Ag pricing on corn and soybeans and how that ripples through our economy, impacts those prices on manufacturing, and the farm supply businesses. The projections received nationally indicate a further decline in farming- over a 20% decline is expected this year. What was seen in Iowa from the individual income tax returns was over a 40% decline in reported farm incomes. There is the uncertainty of a repeat in the spring or fall of a repeat of the bird flu outbreak and what a tremendous impact that was in Iowa.

There continues to be a very strong U.S. dollar, which is impacting the manufacturing sector quite a bit. The low unemployment rate in Iowa is great, but not really great, depending upon which side of that you are sitting on. It is great because there are a lot of people working in Iowa and there are a lot of "Now Hiring" signs. But it is a slow growing workforce in the state of Iowa. Construction companies are having a difficult time finding enough construction workers, along with some of the manufacturing companies. As it is discussed where the employment growth will happen in Iowa, a lot of Iowa industries are really moderating their discussion about adding employees, many more are stating that they expect unemployment numbers to be flat or down in 2016 than those that are stating they expect an increase.

In reviewing last year's electronic returns data, 80% of Iowans' reported Adjusted Gross Income comes from wages. Until that was computed, it did not really register. But where we get our income, we get it from individual income tax and 80% of that is dependent dollar-wise, on wages. That other 20% can go up and down but not necessarily impact us that greatly. What was seen in 2014 was about 4% growth in wages when individual tax returns were compared, but a 6.5% growth in withholding on those same people. That is where a little bit of wage increase generates more withholding percentage-wise.

In looking at the federal income tax consequences on Iowa, with the Iowa deductibility, we are sitting here right now where we did a year ago. Looking at the federal income tax extenders, it is still uncertain whether that legislation is going to pass, whether it will be all or part of it, and when are they going to do it.

Mr. Roederer stated that internationally there is still focus on two areas – China as well as the Middle East. On a positive note, Europe seems to be projecting that they will have more of a modest growth than maybe they were a time before. Switching to the U.S., Mr. Underwood pointed out the uncertainty when you have tax policy at the federal level being extended year by year by year. It is so difficult to predict what they will be doing at the federal level and then projecting how Iowans will react to that in order to come up with an estimate.

As Mr. Underwood pointed out, one of the issues we do have with our low unemployment, is job skills and matching those with what employers are going to need. That is holding back some of the expansion at this time.

Ms. Lyons and Mr. Underwood both mentioned about the Ag economy. That is a big concern, because we've never been able to fully equate that if the price of corn is \$5/bushel or if it is \$3/bushel, how that ripples through the Iowa economy. As long as there are low commodity prices, caution needs to be expressed going forward.

Mr. Roederer then explained the spreadsheet handed out by LSA.

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

Mr. Underwood made a motion to accept the LSA number of \$7,039.5 for FY 2016 and Ms. Lyons seconded the motion. Mr. Underwood stated that because of all the uncertainty there is a number of assumptions that have to be made as we get a little bit further out. Withholding in the last fiscal year grew almost six percent. Yes, there has been greater employment but that is not generally where a lot of that percentage comes from. It comes from some increase in wages, manufacturing work hours and overtime hours have been pretty strong. Unless there is a real fallback in manufacturing, Mr. Underwood anticipates that will continue because everyone is reluctant in this point in time to add people. So they will use overtime to cover any uptick. Many companies are having a hard time finding good employees in the manufacturing sector so they are then forced to use overtime to match their orders. Mr. Underwood does not see that, at least in the near term, declining significantly.

The projections that the LSA and Governor's Appointee utilized are around 4.8 to 5.2 percent increase in withholding, where a 5.9% increase was seen last year. There may be just a little bit of conservatism in those estimates at this point. Mr. Underwood has not seen anything in the tax law changes that will significantly impact that. If estimates were revised one-half percent, that is really only \$16 million.

The biggest risk is in the Final Return payments where the projections are currently in approximately the 18% range for this fiscal year. With farm income continuing to decline, a lackluster stock market, and continued low interest rates, that increase might more closely follow last year's increase, which was only at 10%. So that 8% differential is about \$40 million potential impact on receipts.

Estimate payments are fairly close and appear to be quite reasonable. Taking a look at the total net number of Refunds, they are fairly similar and look okay to Mr. Underwood.

That top line, Personal Income Tax, the only one that is really concerning is the Final Pay Estimates, which might be a little bit aggressive. In trying to find that offset in the withholding, Mr. Underwood could not find much there. There was not a very significant increase in Sales Tax this last year. There was a 4.2% increase; originally it was thought it should go up 5%. Now the LSA is at 1.9% and the Governor's Appointee is at 2.9%, so that is not the kind of increase normally expected. But with all the additional Internet purchases, they are probably not getting captured in Use Tax payments. There is a \$27 million difference there in the estimates.

For FY 2016, everyone is pretty reasonable on Corporate Income Taxes, but there is a \$20 million difference. That is probably about as close as you can get to a range on that, given the nature of when corporate returns are filed. Everyone is waiting for the Quarterly Earnings Report that will be coming out this week, so it is unknown how that will impact Iowa's General Fund.

For Mr. Underwood, the big question is how to reconcile those three major items – Personal Income Tax, Sales Tax and Corporate Income Tax. He believes that LSA is closer to what he feels comfortable with at this time, but there is only a \$31 million difference in total.

Regarding Mr. Underwood's comment about Internet sales, Mr. Roederer stated that if a company has nexus or an operation in Iowa, they do pay the sales tax whether it is Internet or not. One large group, where a lot of people do purchase over the internet, does not so they do not pay sales tax. The other issue which is becoming more and more common is people using software and the expense of software. Software downloaded on the Internet is not taxed. Mr. Roederer is willing to compromise on the numbers. Ms. Lyons stated that she agrees with Mr. Underwood; the numbers could be moved around but the bottom line is they are not that far apart. She is a little reluctant to tinker with any of the line items at this time; it might mean a little more in December but not so much in October.

Mr. Underwood suggested adding \$15 million to LSA's Corporate Income Tax estimates and Ms. Lyons and Mr. Roederer agreed. Mr. Underwood amended his motion to increase LSA's Corporate Income Tax by \$15 million, to \$537.8 million and move to adopt the LSA number with that adjustment. Ms. Lyons seconded the motion. The net Receipts plus Transfers would be \$7,054.5 million, which is a 3.4% increase over FY 2015. All voted in favor and the motion was passed unanimously.

#### **Estimate Fiscal Year 2017 General Fund Estimates, Accruals, Refunds, School Infrastructure Transfer, and Lottery and Other Transfers**

Ms. Lyons stated that she would be amenable to adding \$15 million in LSA's Corporate Income Tax for FY 2017 as well. Mr. Underwood stated that one of the few numbers he struggled with was LSA's Corporate Income Tax showing a 4.8% decline next year. In reviewing Department of Revenue numbers, that was the one he struggled most with. Ms. Lyons asked Mr. Underwood if he was suggesting lowering LSA's net number from \$7,348.9 and he stated he was. To make that happen, Mr. Underwood stated there would have to be a significant improvement in the Ag economy during the first six months of FY 2017 to be able to see a significant increase/improvement in Personal Income Tax Receipts for the 2016 calendar year. He believes it will take a little longer to roll that into the General Fund even if there was some improvement next year. If the LSA Personal Income Tax for FY 2017 was lowered by \$40 million, that would be a 3.6% growth from FY 2016 to FY 2017.

Mr. Roederer agreed with Ms. Lyons that going down to 4.0% is too much. Mr. Underwood stated that if the LSA numbers are used in total, that is a 4.2% increase. Mr. Underwood made a motion to move LSA's FY 2017 numbers as presented and Ms. Lyons seconded the motion. For FY 2017, the number is \$7,348.9 million, which is a 4.2% growth. With no further discussion, all voted in favor and the motion was passed unanimously.

**Fiscal Year 2016 and 2017 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 FY 2016 and FY 2017 Gambling Revenues and Ms. Lyons seconded the motion. With no discussion, all voted in favor and the motion was carried.

**Other Business**

With no further business, Mr. Roederer called the meeting adjourned at 1:43 p.m.

Respectfully submitted,

*Tammy Winters*