Revenue Estimating Conference
Minutes
October 19, 2017

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

Mr. Roederer called the Revenue Estimating Conference to order at 2:00 p.m.

Mr. Roederer reiterated that the Code of Iowa establishes a three member panel consisting of the Legislative Branch represented by Ms. Lyons, the state represented by Mr. Underwood, and himself representing the Executive Branch. The Conference is required to meet at least three times per year, where it is required to reach a consensus. Projections are developed independent of each other, using a variety of sources. The Department of Revenue is relied upon heavily. The Governor is required to submit her budget based on the December estimate of the year. The Legislature is to use the lower of the two estimates between December and March. Today has no legal requirements with it, but it does give an idea of where the economy is believed to be and to be used for making projections for revenue for the state budget. The Conference will update Fiscal Year 2018, which ends June 30, 2018, and an estimate will also be made for Fiscal Year 2019.

Approval of the March 14, 2017 minutes
Mr. Roederer called for a motion to approve the March 14, 2017 minutes.
Motion: Mr. Underwood.
Second: Ms. Lyons.

All voted in favor and the motion was carried unanimously.

Approval of the October 19, 2017 agenda
Mr. Roederer called for a motion to approve the October 19, 2017 agenda.
Motion: Mr. Underwood
Second: Ms. Lyons

All voted in favor and the motion was carried unanimously.

Ms. Lyons began with comments about the close of FY2017. FY2017 General Fund revenue, after the accrual period and tax refunds but before transfer revenue, increased $173 million, or 2.5%, to a total of $6.964 billion. This missed the March REC estimate by 0.3% or $18.0 million. Transfer revenue provided a significant boost to the final condition of total net revenue and this was due to legislative and Governor-authorized transfers to the State General Fund from Reserve Funds.

Individual income tax revenues expanded at a 2.9% growth rate, slow by historical standards, but still positive growth. There is nothing we see that indicates that revenue growth will turn negative. Iowa corporate income tax grew at a 14.6% rate, considerably more than projected and probably not sustainable in the near term. Unfortunately, this is only about 7% of gross state tax receipts.

Sales tax revenue continued to be flat, which is not unique to Iowa and occurred in the majority of states. This is partly attributed to online marketplace sales, and creative methods by stores in determining a physical presence in states. Some sources also partially attribute it to declining disposable income, demographics (such as those closer to retirement saving more) or changing consumer habits such as buying Netflix services versus buying DVDs or visiting movie theaters.

It now appears that the March estimate for FY2018 was high and needs to be adjusted downward, at least in the short term. For the last two years, state tax revenue has not grown as fast as indicators of the underlying Iowa economy would indicate. Income and sales tax refunds and credits are also forecasted to increase at a faster growth rate than revenues.

Real gross domestic product (GDP) grew at an annual rate of 3.1 percent in the second quarter of 2017. The U.S. labor market continues to expand, although at a slightly slower rate than in 2016, but unemployment is at an all-time low. Average hourly earnings are up only slightly but at the national level, wage income growth remains steady in the 3.6 to 5.0% range. The U.S. financial markets are at record highs, but there is uncertainty about the impact of tax reform, health insurance changes, the federal budget, and the federal debt limit. Oil prices remain volatile but are rising slightly, and it appears that the Federal Reserve will continue to normalize interest rates over the next three years. New factory orders are increasing and business investment is forecast to increase modestly. One indicator to keep an eye on is new residential housing units constructed – that number has flattened out after 5 years of steady increases.

The U.S. dollar has weakened since March, indicating a stronger global economy, and stronger economic growth in China and Europe. There are several worldwide geopolitical risks that have intensified since last spring, including the threat of nuclear attacks by North Korea and the uncertainty brought on by U.S. policy on trade agreements and immigration. The hurricanes and wildfires have created an uptick in initial unemployment claims, and will likely impact the housing, construction and auto industries.

The March estimate was based on modest to moderate revenue growth, but the reality, at least for the first three months of the fiscal year, is that revenue numbers reflect slow to modest growth. The good news includes the Department of Revenue forecasts Iowa wage and salary growth will range from 3.1% to 4.2% for the next two years.

The USDA estimates that net cash farm income will increase in 2017 and ISU economists suggest that farm economic conditions appear to have stabilized. One Creighton University economist, Ernie Goss, stated in September that the performance of the implement manufacturer, Deere and Co, signals recovery in the agricultural economy with two consecutive quarters of gains after 12 consecutive quarters of decline. The company is hiring back many of the workers that had been laid off three years ago. Farmland prices, while still falling, are not dropping as much.

Iowa continues to add jobs, the unemployment rate has ticked up slightly but remains low at 3.3%. Initial unemployment claims, a leading indicator, remains very low by historical standards. The Mid American Business Conditions Index increased in September with production and new orders showing the most positive index values. The Iowa Leading Indicators Index remains steady with five of the eight indicators experiencing positive changes – average manufacturing hours, new orders index, average weekly unemployment claims, diesel fuel consumption, and the agricultural futures profits index.

Moody Analytics projects the S & P Stock Index to grow 15.4% in 2017. This may impact non-wage income tax revenue, which was likely subdued last year as Iowans held on to capital gains in anticipation of federal tax changes. With these changes still pending, the effect on state revenue remains unclear.

Non-seasonally adjusted nonfarm employment increased by 10,700 jobs in FY2017 and the Department of Revenue forecasts that this rate is expected to increase slightly in FY2018, with corresponding increases in wage and salary income. At near full employment it may be more an issue of a lack of qualified employees to fill those jobs than a lack of available jobs for the economy to grow at a healthy pace.

Another component to watch are tax credit claims. The Department of Revenue indicates that several tax credit programs experienced lower claims in FY2017, and those claims have been pushed to later year forecasts. This could negatively impact the bottom line receipts number, particularly given the lower projects for tax revenue.

In summary, Iowa is experiencing slow to modest revenue growth for the first three months of the fiscal year, but there are no significant signs of an economic downturn or recession at this time. Revenues are off to a slow start in FY2018, but the LSA remains cautiously optimistic about FY2018 and FY2019. It is still early in the fiscal year and we look forward to reviewing more revenue data in the weeks ahead, prior to the December meeting.

The LSA October 2017 estimate is $7.263 billion, which reduces the REC estimate for March by $101.3 million for FY2018, but represents a 2.7% growth rate in Total Net Receipts (before transfers). The LSA has reduced the initial FY2019 estimate made last March by $108.6 million, and this represents a modest 3.6% growth rate over the new FY2018 estimate.

Mr. Underwood began by emphasizing what Ms. Lyons stated at the end of her narrative – the employment levels, the number of employees, the lack of employees out there. Just like in March, December and October of last year, Mr. Underwood continues to see Help Wanted ads/Now Hiring signs. That continues to be one of the drags on the growth percentages, when it comes to withholding in particular. The openings that are out there cannot be filled. There is certainly a lot of opportunity for anybody that wants to go to work, just whether it is in their area or not, and it is the only complaint Mr. Underwood hears from employers today – they cannot find the workers they need and employees are getting tired of overtime. That is one of the reasons the average manufacturing hours continue to be fairly strong. Until many more manufacturing employees are found, that number will stay up there. But Mr. Underwood does not see it growing too much higher because employees will only put up with a lot of overtime for a little while before they just get too tired.

Relative to the farm economy, the only thing Mr. Underwood has heard in the last couple weeks of farmers complaining is to see a moisture content of the beans and corn; having to jump from field to field to find a place that is drying enough to pick. Mr. Underwood stated there has been talk about $3.20 corn very possible in the near future. Everyone is watching Brazil and their planting process and what is going on closely with the export markets. Some people are projecting higher farm income net, but Mr. Underwood is unsure that will show up in this year's tax returns for the farmers, given their ability to adjust sales of crops and defer gains on certain items. Mr. Underwood was surprised last year on how low farm reported income was so it has a long ways to go back before it gets to a positive number. It would be helpful to the suppliers if the farmers were actually making money. Mr. Underwood still sees the farm lender's crisis teams working, spending a lot of time working with the farmers that are struggling and figure out to pay and how to finance next year's crops as well. That has not gone away, according to the lenders. There are still farmers that are in trouble – not as bad as the last time there was a collapse in the farm economy, but enough that the lenders are concerned. Fortunately the projections heard a year ago about the number of farmers that were going to have to shut down and go out of business has not happened, at least in Mr. Underwood's area in the northern part of the state.

Mr. Roederer stated that a variety of sources are reviewed when trying to decide where the numbers would come down. As have been pointed out by Iowa Leading Indicators, which are put out by the Department of Revenue, some growth is showing but it is not real robust. The Federal Reserve in our region is also projecting a modest growth. The Business Conditions Index for Iowa is also talking about a modest trend. Slow, modest, moderate, how those are defined are sometimes in the eyes of the beholder. There is not a scientific metric that will classify any of those terms in a particular area.

On the negative side the Rural Main Street Index, brought down by farm prices, is very real; and the Bureau of Economic Analysis also showed some signs, largely in the agriculture sector. Weighing that out, many positives, a couple major negatives, are probably holding back the economy from growing greater than it is.

Looking forward, we see continued positive growth. Encouraging numbers, at least initially, are coming out of the Department of Revenue, the income side is in the four percent. Although not as robust, it is still positive growth. Wage growth is at three percent, which is not terrific but not a real negative either. There is some difference of opinion between LSA and the Governor's Appointee regarding Capital Gains and the stock market. When looking at what the stock market is doing compared to what was being picked up on Capital Gains last year, Mr. Roederer believes that will show an increase this year.

Retail sales are still concerning. It appears to be returning somewhat back to what has been defined as the normal range, which is kind of in the three percent/three percent plus range. The last couple years it has been pretty anemic. When looking at Sales and Use, which are combined, the online is continuing to grow. One of the local television stations had an interview with the Postmaster in the Des Moines area for the US Postal Service and they are having a Jobs Fair. They are afraid they do not have enough workers for this holiday season. It is not because they are worried about how many Christmas cards they are going to deliver. If you look at neighborhoods, whether it be Saturday or Sunday, you see the mail trucks out there and they are delivering for the online sales coming in. That is still a major step going on in our economy and we are probably not picking up the normal sales tax on many of the companies.

The only thing Mr. Roederer is still a little concerned about on the unemployment side is while there is low unemployment, currently the construction sector has dropped down as far as the number of employment goes. Adding manufacturing employment and salaries together counts for about 30% of the wage base that comes in. Mr. Roederer believes that will start picking up. There were some major announcements recently that will require a lot of employees for probably over a one-two year period.

If tax reform occurs at the federal level, it is likely to have a positive impact on state revenues. Agriculture is holding its own concerning what the crop prices are right now. No forced sales have been seen. There has been a slight increase in land values, depending on location. In talking to individuals that buy and sell agricultural land, there has been more activity in that area. They are starting to purchase where they have not for the last couple years, indicating that they believe that land prices are probably bottomed out. As far as crops go, as Mr. Underwood pointed out, it depends on the part of the state. The reason the moisture content is so important is because obviously if you have to dry your crop, then it is costing you more money.

In summary, the state continues to grow. It is not growing at the rate projected back in March. There are a couple big question marks out there that could make a major change that would affect our projections. One is the renewable fuel standards. If that comes back lower than what it is believed it should be, that could have a big impact on the agriculture sector. Over 50% of the corn crop is going into the production of ethanol. If, in fact, the standard is such that people won't need to use as much, that is going to have an impact. The other area of concern is NAFTA and whether or not there would be any trade disruption. Canada, Mexico, China, Japan, and Germany represent 70% of Iowa's customers on exported products. So any change, or anything that would happen that would disrupt that normal flow of exports, would have an impact on the estimates. It is encouraging that, at least on NAFTA, they have agreed to extend the deadline for talking for a few months. As long as that discussion is still going on, that is probably a positive side. Another major change that could affect revenues is the federal tax reform. Since Iowa has federal deductibility, federal taxes can be deducted from state taxes.

There continues to be, at least initially, a slow to moderate growth and the workforce skills that Mr. Underwood mentioned earlier are being addressed.

Review FY2018 General Fund Estimates, Accruals, Refunds, School Infrastructure Transfer, and Lottery and Other Transfers
Motion: Made by Mr. Underwood to approve the Governor's Appointee's estimate for Fiscal Year 2018.
Second: Mr. Roederer
Discussion: Mr. Underwood stated that although his own estimate was lower than both the Governor's Appointee and the LSA, he could comfortably agree with the Governor's Appointee number, which is the $7,217.5, a -0.3% on the net receipt plus transfers. Ms. Lyons stated she would be more comfortable with the Governor's Appointee's number if $20 million were added to it. Ms. Lyons suggested adding $10 million to the Governor's Appointee's Personal Income Tax estimate and decreasing the Refunds number by $10 million.

Mr. Underwood amended his motion to approve the Governor's Appointee's numbers, with the change to Personal Income Tax and Refunds. Mr. Roederer seconded the amended motion.

All voted in favor and the motion was passed unanimously.

The new number for FY18 is $7,237.5 billion for Net Receipts plus Transfers. This would be a $2.5 million decrease from Fiscal Year 2017. Total net receipts takes out the transfers and lottery, which gives about a 2.4% increase in revenue.

Review FY2019 General Fund Estimates, Accruals, Refunds, School Infrastructure Transfer, and Lottery and Other Transfers
Motion: Ms. Lyons made a motion to move the Governor's Appointee Fiscal Year 2019 estimate, less $10 million.
Second: Mr. Underwood
Discussion: Ms. Lyons suggested adjusting the Corporate amount.

All voted in favor and the motion was passed unanimously.

The new number for Net Receipts and Transfers is $7536.3 billion, bottom line growth is 4.1%. Total Net Receipts would be 4.2% growth.

RECAP: The number for FY2018 is $7,237.5 and the number for FY2019 is $7,536.3.

Fiscal Years 2018 and 2019 Gambling Revenues Transferred to Other Funds and Interest Earned on Reserve Funds (transferred to Rebuild Iowa Infrastructure Fund)
Motion: Mr. Underwood made a motion to utilize the numbers without change.
Second: Ms. Lyons.

All voted in favor and the motion was passed unanimously.

Other Business
With no further business, Mr. Roederer called the meeting adjourned at 2:45 p.m.

These minutes were approved at the December 4, 2017 meeting.
David Underwood made a motion to approve the minutes of the October 19, 2017 meeting and the motion was seconded by Holly Lyons. All members voted in favor of the motion and the motion was carried unanimously.

Respectfully submitted,
Tammy Winters