BUDGET WATCH

Florida TaxWatch

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Volume 16, Issue 3 • August 2010

www.FloridaTaxWatch.org

Estimating Conferences Project More Money for the 2011 Legislature

Next Year's Budget Shortfall May Be Less Than Previously Estimated

This report is the third in a series of *Budget Watches* examining the results of this summer's meetings of the state's Consensus Estimating Conference and their impact on the state budget picture. The state's economists now turn their attention to producing the annual *State of Florida Long-Range Financial Outlook* report. The previous edition of this report projected that the 2011 Legislature would face a shortfall of over $5 billion in FY 2011/12. This report looks at new estimates for a number of revenue sources and what they mean for next year's budget.

General Revenue Estimating Conference

Since the last General Revenue (GR) estimates were made back in March, Florida's actual revenue collections have been exceeding expectations, and at the GR Estimating Conference held last week, state economists forecast that revenues will continue to exceed those expectations, if only modestly. Agreeing that Florida's economy is in the "early stages of a gradual recovery," the conference increased the GR estimate for the current year (FY 2010/11) by $260.1 million (1.1%) and increased the FY 2011/12 estimate by $338.8 million (1.4%). Add this to the $228.7 million by which actual revenues exceeded estimates in the fiscal year that just ended June 30, 2010 (FY 2009/10), and lawmakers will have over $800 million more to spend than previously thought when they craft the new budget next Spring.

The state's estimators are "cautiously optimist" about the future and predict the recovery will begin in earnest in Spring 2011. They warned that the potential impact of the Deepwater Horizon oil spill is still unknown. While the spill is certainly causing pain on the Gulf Coast, recent news indicates the statewide impact be not be as bad a feared. New tourism data shows that the number of Florida visitors in the second quarter of 2010 (ending June 30) was up 2.4 percent from last year. Overseas visitors, who tend to stay longer and spend more, were up 11.9 percent while Canadian visitors increased by 10.4 percent. Additionally, July job data shows that unemployment in some Panhandle counties continues to be among the lowest in the state. Statistics indicate the hospitality industry has maintained hiring levels. Beach cleanup jobs also have been added in many Panhandle counties, although those positions are now being scaled-back.

> **Sales taxes –** By far the largest GR source, the estimates for sales tax revenues increased by less than one-half of one percent in each of the years from FY 2009/10 to FY 2011/12. But due to its size, this revenue source contributed $108 million to the three year estimate increase. GR sales tax collections should grow from $16.0 billion in FY 2009/10 to $18.1 billion in FY 2011/12.
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> **Corporate income taxes** – Higher than anticipated corporate profits increased the estimate of these taxes by $528 over the three years.
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> **Medical and hospital fees –** These are reimbursements from county governments for certain services provided to county residents through Florida's Medicaid program. Due primarily to increased eligibility from the Medically Needy and MEDS AD programs continued by the Legislature, the estimate for these fees were increase by $128 million over three years, $100 million in FY 2011/12 alone,
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> **Documentary stamp and intangibles taxes –** Derived from real estate transactions, these sources were the biggest drag on the new forecast, decreasing by $102 million over three years. The tight credit market is still a concern. (See summary of Documentary Stamp Conference below.)

After an unprecedented decrease in annual GR collections for three straight years, it appears Florida has resumed the normal trend of annually increasing collections. FY 2009/10 collections grew 2.4% and growth of 6.7% and 7.4% is expected in this fiscal year and next. Still, current year revenues are $4 billion less than in FY 2005/06 and it is not forecast that collections will not exceed that that high water mark until FY 2013/14.

Lottery Estimating Conference

Stronger than expected sales in the Florida Lottery's games led to the Lottery Estimating Conference increasing it forecasted distributions into the Educational Enhancement Trust Fund (EETF) by $130.1 over the three year period from FY 2009/10 to FY 2011/12. Net revenues from the lottery (after prizes, retailer commissions and administrative costs), along with slot machine revenues, go into the EETF for the sole purpose of funding education. This has implications for the projected budget shortfall because if revenues are not sufficient to continue funding of the EEFT programs that are in the current budget, General Revenue would have to be used to maintain them.

These new estimates mean That EEFT revenues will exceed appropriations by $97.8 million in the current budget year (FY 2010/11). Rolling those reserves forward and adding the increased estimates for next year and the Legislature will have $1.496 billion in educational enhancement funds to spend. This is $195 million (15%) more than the $1.301 billion appropriated in the current budget.

Transportation Revenue Estimating Conference

This conference adopted a minor increase in its forecast of dollars flowing into the State Transportation Trust Fund (STTF) – which funds the Department of Transportation's Work Program. Estimated revenues to the STTF were increase by $37.7 million (0.2%) over the five year Work Program period ending in FY 2015/16.

The largest source of STTF revenues – fuel taxes – were hurt by reduced estimates of motor fuel consumption and tax rates. Because most of the state motor fuel tax motorists pay in Florida is indexed to inflation, reductions in CPI estimates by the earlier economic conference led to lower future tax rate estimates. While diesel consumption was up, total highway fuel tax revenues were reduced by $288.1 million (2.4%). However, increased collections from aviation fuel, the rental car surcharge, and especially motor vehicle licenses, more than offset the motor fuel tax reduction.

While important for transportation and Florida's economy, the revenues have no direct impact on General Revenue and the size of potential budget shortfall for next year.

Ad Valorem Estimating Conference

With the problems in the housing market, limited new construction, and lagging commercial and industrial real estate, the conference's consensus was that long-term taxable value will increase at a modest pace for the foreseeable future. While property taxes are a local revenue source, the tax roll has major implications for the state budget. Each year, the Legislature sets Required Local Effort (RLE) – i.e., the millage rate local school districts must levy in order to participate in the Florida Education Finance Program. If taxable value across the state falls, the Legislature must either mandate a property tax rate increase or make up the difference with General Revenue.

Interestingly, next year, while commercial and agricultural properties are expected to see a slight decline in their taxable value and non-homestead residential property will stay flat, the total taxable value of homestead property is expected to rise 2.2 percent. The Save Our Homes differential, or the different between homestead properties' just value and assessed value, will fall to $86.5 billion, the fourth straight year of decline and the lowest level since FY 2002/03.

The tax roll (school taxable value) for next year is estimated at $1.456 trillion dollars. This is slight growth of $10.6 billion (0.7%) from this year. This growth rate is forecast to begin improving – 3.7 percent in FY 2012/13, 5.5% in FY 2013/14 and 5.8% in FY 2014/15.

For RLE, the value of one mill in FY 2011/12 is $1.398 billion, up by $10 million from last year. This means if the Legislature keeps the same millage rate as the current year, $60 million in additional revenue will be raised. The same millage rate would raise $310 million more the following year and $473 million more in 2013/14.

Documentary Stamp Tax Estimating Conference

Documentary stamp taxes have been greatly affected by Florida's economic woes, since real estate transactions provide most of the revenue. While there has been a higher than expected number of sales recently, residential sales are concentrated at lower price points, thereby limiting the benefit. One-half of June 2010 sales involved distressed and foreclosed properties. The credit market, while much improved, is still very tight. All this led the conference to adopt a minor downward revision to the revenue estimate.

Doc stamp reached a peak of $4.1 billion in FY 2005/06. The forecast for this year is only $1.1 million. Even so, this is 4.5 percent growth, good news after four years of decline. Substantial growth is forecast in FY 2011/12 and FY 2012/13 (15.9% and 18.5%, respectively) as the real estate market picks up, then growth rates are expected to stabilize.

While still up from last year, the new forecast reduced estimates for 2010/11 by $60.6 million (5.1%) and only $2.9 million (0.2%). Doc stamps revenue are distributed to General Revenue and a variety of trust funds for environmental, housing and transportation programs.

Tobacco Tax and Surcharge Estimating Conference

Increased state and federal taxes on tobacco products are having the affect of cutting consumption significantly (or at least consumption of taxable cigarettes). This was anticipated but the latest tobacco forecast further reduced the expected future consumption rate. This resulted in a reduction in the revenue estimate for FY 2010/11 of $14.9 million. For subsequent fiscal years, projections were reduced in the amounts of $15.8 million (FY 2011/12), $15.7 million (FY 2012/13), and $15.1 million (FY 2013/14).

In FY 2009/10 – the year the state's new $1 tobacco surcharge took effect – the number of cigarette packs sold dropped 23.4%, from 1.25 million to 960,000. This reduced collections from the old cigarette tax by $113 million, but the new surcharge brought in $954 million. Tobacco tax collections will total $1.338 billion in FY 2011/12, down $8 million from this year. Consumption – and revenues – are expected to decline through the forecast's horizon of FY

2013/14, if only slightly. Most of the tobacco revenue goes to health care, less than one-quarter goes to General Revenue.

FMAP and Medicaid Update

On August 10, Congress passed an extension of federal Medicaid assistance to the states – known as FMAP. This increases the share of the Medicaid program that the federal government will pay. The state will also receive some additional education funding. The Medicaid Expenditure Estimating Conference met again to adjust for the money. Extending FMAP adds about $550 million in federal Medicaid dollars to the current budget. This turns a $94.4 million GR shortfall in Medicaid this year into a $461.5 million surplus.

However, next year, Medicaid expenditures are expected to increase by $1.4 billion and because federal funding will be reduced, the state will need $5.4 billion in GR, nearly $2 billion more than it is spending this year.

What Does This Mean For the Next Budget?

Before this summer's round of Revenue Estimating Conferences were complete, the state expected to have a $284 million surplus in the current budget year, which when added to estimated revenues for the next budget year (FY 2011/12), would give the Legislature $24.7 billion to spend. This was almost $2.1 billion more than the recurring General Revenue spending for FY 2010/11.

We now know they should have even more. The new GR estimates add $828 million, meaning total available GR for next year will be $25.5 billion, almost $3 billion more than the recurring General Revenue spending for FY 2010/11. The FMAP money could add another $230 million to the amount available for next year.

This brings us to the budget shortfall for next year, which has been projected at between $5 billion and $6 billion. As was discussed in the first of this *Budget Watch* series, the $5-6 billion shortfall estimate comes from last year's *State of Florida Long-Range Financial Outlook* report, released last Fall by the Florida Legislature. The *Outlook* focuses on General Revenue (GR), comparing estimated available revenue to estimated spending. Spending is estimated by starting with the recurring General Revenue expenditures in the previous budget and adding expenditures needed to meet "critical needs" (such as annualizations and increases based on estimating conferences) and "other high priority needs" (i.e., historically funded issues). The *Outlook* explains, "Critical Needs can be thought of as the absolute minimum the state must do absent significant law or structural changes, and Other High Priority Needs in combination with the Critical Needs form a highly conservative continuation budget."

In other words, estimated expenses assume most everything in the GR budget will be funded again, adjusted upward for factors such as caseload and price increases. It does not assume any potential budget cutting or cost saving measures.

The *Outlook* produced last Fall estimated the state would have $800 million (available General Revenue minus recurring GR expenditure) to fund over $2.9 billion in additional "critical" needs in FY 2011/12. Funding "high priority needs" would require another $3 billion.

The new estimate of needs for the next budget will be available the new *Outlook* is released by September 15, but the new revenues estimates show that the state should have approximately $3 billion for those additional needs.

The Estimating Conference now predicts there will be a $2 billion GR shortfall in Medicaid next year, but the 2009 *Outlook* was already estimating a $1.1 billion shortfall. So roughly, fully funding the Medicaid shortfall will leave about $1 billion for the critical and high priority needs in the other areas of the budget. Those needs in the non-Human Services sections of the budget were estimated in the last *Outlook* at $3.2 billion, with Education accounting for $2.2 billion of that amount.

The estimate for Education may not be that high. The extra lottery revenue discussed earlier will help. In addition, the same Required Local Effort Millage rate will raise $60 million additional dollars, compared to the $173 million decline estimated in the last *Outlook*.

In addition, on August 24, 2010, Florida was notified it won a $700 million grant from the federal government through the Race to the Top initiative. Of that amount, half will go to the state for statewide programs and half will go directly to school district. Florida will also be receiving some additional federal funds from the education component of the FMAP legislation passed by Congress earlier this month.

There are still questions that need to be answered and the new estimate of the FY 2011/12 budget shortfall will not be known until September 15, but the results of this summer's Estimating Conference certainly point to a smaller shortfall than previously thought.

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