REVENUE FORECAST

The Commonwealth's total revenue consists of two types of resources: the general fund and nongeneral funds. About half of state revenues are "nongeneral funds," or funds earmarked by law for specific purposes. For example: motor vehicle sales and motor fuel taxes are earmarked by law for transportation programs; students' tuition and other fees support higher education, and federal grants are designated for specific activities.

General fund revenues are derived from general taxes paid by citizens and businesses in Virginia. Since general fund revenue is not dedicated to any particular purpose and can be used for a variety of government programs, these are the funds that the Governor and the General Assembly have the most discretion to spend.

General fund revenues are derived primarily from five major revenue sources. The two largest sources are the individual income tax and the sales and use tax. Other major revenue sources are wills, suits, deeds and contract fees, corporate income taxes, and taxes on insurance company premiums. Miscellaneous taxes and other revenues also contribute to the general fund.

<u>Growth in fiscal year 2007 revenue collections slow</u>

In fiscal year 2007, total general fund revenues rose by 4.9 percent to $15,565.8 million, falling short of the official forecast (6.5 percent growth) by $234.4 million. Adjusted for the end of the Accelerated Sales Tax program in fiscal

year 2006, total general fund revenues increased 3.8 percent for the year, behind the adjusted annual estimate of 5.4 percent.

Withholding and sales tax collections (75 percent of total general fund revenues), the two revenue sources most closely tied to economic activity in the Commonwealth, finished a combined 0.1 percent above forecast. The three most volatile revenue sources -- individual nonwithholding, corporate income tax, and wills, suits, deeds, and contracts (primarily recordation tax receipts) finished a combined $68.7 above forecast. The major driver of the fiscal year 2007 revenue shortfall was unexpected growth in individual refunds. Individual refunds exceeded the annual estimate by $222.7 million.

Collections of miscellaneous taxes and other revenues were $96.2 million below the estimate in fiscal year 2007. A significant shortfall in interest income drove the large forecast variance.

<u>Below trend growth in general fund revenues over the forecast horizon reflects the slowing economy and the implementation of tax policies</u>

The general fund revenue forecast for fiscal years 2008 and 2009 illustrates the impact on tax collections from the housing sector slump and recent tax policy provisions, particularly the repeal of the estate tax and the stipulations contained in the transportation package approved during the 2007 General Assembly session.

General fund revenue growth in fiscal year 2008 is expected to be 3.3 percent. However, this is slightly understated due to the repeal of the estate tax effective July 1, 2007. Underlying revenue growth for fiscal year 2008 is 3.6 percent, following underlying growth of 3.8 percent in fiscal year 2007. Growth in fiscal year 2009 is 3.3 percent, however, this is again understated due to the repeal of the estate tax and the impact of Chapter 896 (HB 3202), requiring the comptroller to transfer one-third of prior-year insurance company premiums and three cents of recordation tax to various transportation funds beginning in fiscal year 2009. Underlying revenue growth for fiscal year 2009 is 5.1 percent, slightly behind the interim forecast. Total general fund revenues are projected to increase 6.7 percent in fiscal year 2010.

The general fund forecast for fiscal years 2008 through 2010

	Actual 2007	Forecast 2008	Forecast 2009	Forecast 2010
Major tax sources				
Corporate income	$889.9	$747.9	$743.7	$783.9
Individual income	9,857.0	10,421.1	11,086.0	11,890.4
Insurance premiums	384.9	403.4	284.2	305.9
State sales & uses	3,049.1	3,136.0	3,300.9	3,488.7
Wills, suits, deeds & contract Fees	582.9	520.3	449.4	489.8
Miscellaneous	801.9	858.6	746.5	766.0
Total revenues	**$15,565.8**	**$16,087.3**	**$16,610.8**	**$17,724.7**
Transfers				
ABC profits	$27.6	$34.3	$34.6	$34.5
Lottery profits	434.9	453.2	450.0	450.0
Transfers per the Appropriations Act	357. 8	318.8	335.9	338.1
Total transfers	**$820.3**	**$806.3**	**$820.5**	**$822.6**
Total general fund	**$16,386.1**	**$16,893.6**	**$17,431.3**	**$18,547.3**

*Dollars in millions. Excludes balances available for appropriation. Figures may not add due to rounding. Source: Virginia Department of Taxation

Forecast for the major general fund revenue sources

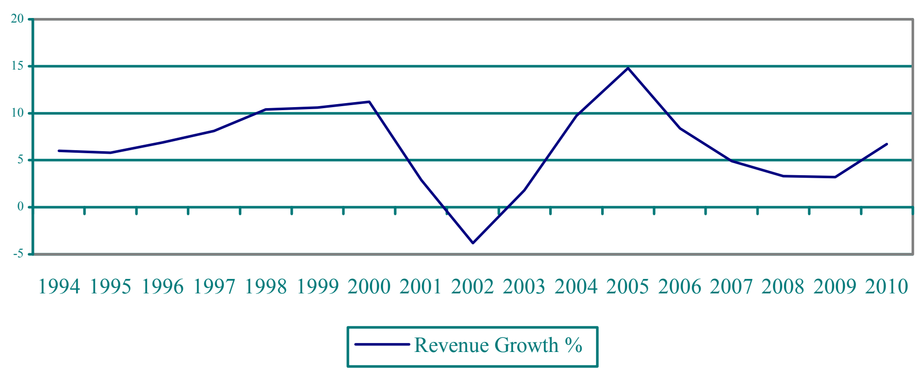
For each of the major categories of general fund revenue, the following describes the actual performance in fiscal year 2007 and the estimate over the forecast horizon:

Individual income taxes

Collections of net individual income taxes grew 5.9 percent in fiscal year 2007, below the annual estimate of 7.1 percent growth. Annual collections were $111.8 million below the official forecast. The significant slowdown in growth between fiscal year 2006 and fiscal year 2007 was attributable to double-digit growth in individual refunds.

The forecast for net individual income taxes was revised upward over the forecast horizon. The bulk of the increase is attributable to the revised outlook for nonwithholding and individual refunds. Growth in individual taxes is expected to be: 6.5 percent in fiscal year 2008; 6.4 percent in fiscal year 2009; and 7.3 percent in fiscal year 2010.

General Fund Revenue Growth Decelerating
Percent Change Over Previous Year



Sales and use taxes

Collections of sales and use taxes grew 8.4 percent in fiscal year 2007, 1.6 percentage points below the annual estimate, a $43.8 million shortfall. Growth is overstated due to the end of the Accelerated Sales Tax program in fiscal year 2006. Adjusting for this program, economic-based sales tax collections increased 2.7 percent for the year, below the adjusted annual estimate of a 4.2 percent increase.

The forecast for sales tax collections are unchanged for fiscal year 2008, with growth of 2.8 percent over fiscal year 2007. Collections have been revised down by $1.2 million in fiscal year 2009, growth of 5.3 percent, the same as the interim forecast. Fiscal year 2010 has been revised up by $4.9 million, growth of 5.7 percent, slightly ahead of the interim forecast of 5.5 percent growth.

Corporate income taxes

Corporate income tax receipts were slightly weaker than expected in fiscal year 2007, finishing $11.5 million below the annual estimate with 2.1 percent growth. Gross payments increased 5.0 percent from the prior year, compared with the forecast of 4.5 percent growth. The shortfall in net receipts was attributable to stronger-than-expected refund activity. Corporate refunds totaled $150.7 million, an increase of 25.9 percent over fiscal year 2006 and $16.0 million ahead of the annual estimate.

In the December standard revenue forecast, corporate income tax has been increased by $21.7 million in fiscal year 2008, a decline of 15.0 percent from fiscal year 2007 compared with the interim forecast of an 18.4 percent decline. Collections have been revised down by $21.7 million in fiscal year 2009, a decline of 0.6 percent compared with the interim forecast of 5.4 percent growth. Fiscal year 2010 has been revised down by $12.1 million, growth of 5.4 percent, slightly ahead of the interim forecast of 4.0 percent growth.

Insurance company premiums taxes

Collections of taxes on the premiums of insurance companies were $384.9 million in fiscal year 2007 -- $0.3 million above the forecast. Net receipts grew by 3.0 percent, compared with the forecasted growth rate of 2.9 percent.

The insurance premiums tax forecast has been revised up slightly over the next three years. The December standard revenue forecast for fiscal year 2008 is $7.3 million above the interim forecast. For the fiscal year 2008-2010 biennium, insurance premiums tax collections have been revised up to a combined $8.9 million.

The significant decline in collections in fiscal year 2009 is due to the impact of Chapter 896 (HB 3202), requiring the comptroller to deposit one-third of insurance company premiums tax collected in the most recently ended fiscal year to the Priority Transportation Fund. Underlying growth for fiscal year 2009 is 3.8 percent. Collections in fiscal year 2010 are expected to increase 6.4 percent after adjusting for the projected transfer amount.

Wills, suits, deeds & contract fees

Collections in wills, suits, deeds, and contracts (primarily recordation tax receipts) declined 16.1 percent in fiscal year 2007, slightly better than the forecast of a 20.2 percent decline. From fiscal year 2001 to fiscal year 2006, recordation tax receipts increased with the boom in the housing market, growing an average of 20.6 percent per year. The downturn in the housing market has resulted in declines in volume and a significant deceleration in price growth, increasing the drag on recordation tax collections in fiscal year 2007.

In the December standard revenue forecast, wills has been reduced $10.2 million in fiscal year 2008, a decline of 10.7 percent from fiscal year 2007. Collections have been revised up by $3.2 million in fiscal year 2009, a decline of 13.6 percent compared with the interim forecast of a 15.9 percent decline. However, this is overstated due to the impact of Chapter 896 (HB 3202), requiring the comptroller to deposit the revenues collected from three cents of the recordation tax to various transportation funds beginning in fiscal year 2009. Adjusted for this transfer, collections for fiscal year 2009 are projected to decline 3.3 percent. Fiscal year 2010 has been revised up by $3.5 million, a growth of 9.0 percent, matching the interim forecast.

Over half (53%) of state revenue is nongeneral fund revenue

Although most public attention is focused on general fund revenue, over one-half of all revenue in the state budget is nongeneral funds that are earmarked by law for specific purposes.

Nongeneral fund revenue is expected to increase by 11.9 percent in 2008, by 5.6 percent is 2009, and by 1.9 percent in 2010. Nongeneral funds will comprise about 52.7 percent of total state revenue during the 2006-2008 biennium.

Federal grants and other contracts

Federal grants are the largest source of nongeneral fund revenue, almost 40 percent of the total. Frequently these grants do not come to the state as simple cash transfers. The federal government mandates many program requirements as conditions of the grants and, often, states must provide matching funds. The Medicaid program for indigent health care is an example of a federal entitlement program that requires a state contribution.

In 2007, federal grants and other contracts totaled $6.5 billion. This source is projected to increase by 20.5 percent to $7.8 billion in 2008, by 3.8 percent in 2009 to $8.1 billion, before leveling off in 2010 at $8.1 billion. This pattern is caused by the uncertainty surrounding the federal budget and federal domestic spending in the future.

Institutional revenue

The second largest class of nongeneral fund revenue is institutional revenue. The principle sources of this revenue are patient fees at teaching hospitals and mental health institutions as well as tuition and fees paid by students at institutions of higher education. In 2007, institutional revenue collections were $4.1 billion, about 24.4 percent of all nongeneral fund revenue. Institutional revenues are projected to grow by 8.5 percent to $4.5 billion in 2008, by 7.0 percent in 2009 and by 5.9 percent in 2010. These growth rates reflect the higher cost of services provided by these institutions.

Transportation Fund

State transportation revenue comes from several sources including the motor vehicle fuels tax, the motor vehicle sales and use tax, road taxes, vehicle license fees, state sales tax, interest earnings, and other miscellaneous taxes and fees. Money in this fund is used to support highway construction and maintenance and operating costs. Federal, local, and toll revenues are also used to finance transportation programs.

Fiscal year 2007 growth of 0.8 percent in Commonwealth Transportation Fund (CTF) revenues was the lowest increase since fiscal year 1991 and was well below the long-run growth rate of 3.7 percent. However, CTF revenue collections were $12.0 million above the official forecast. The fiscal year 2007 revenue surplus can be attributed to stronger than expected growth in the transportation fund portion of the state sales and use tax, the motor vehicle sales tax, and interest earnings. Most of the other major revenue sources performed close to expectations.

For fiscal years 2008 through 2010, total fund revenues from state sources are expected to be about $2.4 billion in fiscal year 2008, $2.7 billion in fiscal year 2009, and $2.8 billion in fiscal year 2010. These amounts are equal to annual growth of 5.1 percent, 12.7 percent, and 3.4 percent respectively. This pattern reflects the anticipated collection of additional taxes and fees added to the Fund by the 2007 General Assembly.

Unemployment insurance fund

Unemployment insurance tax collections rise and fall with trends in the economy. Projected collections are expected to be lower in fiscal years 2008 and 2009, reflecting a decline in benefit charges and the pool tax rate charged to employers. The increase in fiscal year 2010 is the result of an increase in benefits and an increase in the fund balance factor (solvency level) that governs the tax schedules or formula used to make collections for the Unemployment Insurance Trust Fund. For 2008, unemployment tax collections are expected to decline to $366.9 million, from actual collections of $437.5 million in 2007. For 2009, revenues are anticipated to decline further to $353.0 million before rising to $361.1 million in fiscal year 2010.

Master Tobacco Settlement Agreement Funds

The Master Settlement Agreement (MSA) was signed between the major participating cigarette manufacturers and 45 states, the District of Columbia, and five United States' territories on November 23, 1998. The settlement agreement releases participating manufacturers from past, present, and future smoking-related claims of the states in return for an annual cash payment to the states in perpetuity. These payments are to be adjusted over time for several factors, including inflation and changes in volume of domestic cigarette shipments.

The Commonwealth's plan for the use of MSA funds has three elements. First, legislation passed by the 1999 General Assembly (Chapter 880, 1999 Acts of Assembly) earmarked 60 percent of the allocation in two separate trust funds. The Tobacco Indemnification and Community Revitalization Fund receives 50 percent of the MSA allocation. This share is used to compensate tobacco growers and tobacco quota holders for the economic loss resulting from quota loss or elimination and to promote economic growth and development in tobacco-dependent communities in the Southside and Southwest regions of the state. Recently, the annual amount received by this Fund was securitized and turned into an endowment. Thus, the Fund now receives earnings on this endowment.

The Virginia Tobacco Settlement Fund receives the next 10 percent of the MSA allocation for the purposes of discouraging, eliminating, or preventing the use of tobacco products by minors and for health care. Programs targeted at minors include but are not limited to educational and awareness programs on the health effects of tobacco and on laws restricting the distribution of tobacco products to minors.

The final portion of the allocation (40 percent) goes to the Virginia Health Care Fund. This Fund can be used to pay for various health care costs faced by the Commonwealth, including the Medicaid program for indigent health care.

For fiscal years 2008, 2009 and 2010, it is anticipated that the Tobacco Indemnification and Community Revitalization Fund will receive $68.8 million, $77.0 million, and $77.0 million, respectively. The Virginia Tobacco Settlement Fund will take in $13.2 million, $14.4 million, and $14.6 million over the same period. The Virginia Health Care Fund will receive $53.4 million, $55.1 million and $55.1 million during this three year period.

*nongeneral fund forecast detail on proceeding page

Nongeneral fund forecast for the 2006-2008 biennium*

	Actual 2007	Forecast 2008	Forecast 2009	Forecast 2010
Motor vehicle fuel tax	$921.1	$962.6	$967.2	$979.6
Unemployment compensation payroll tax	437.5	366.9	353.0	363.1
Special highway tax from sales tax	517.3	586.6	655.8	689.0
Motor vehicle sales tax and use tax	597.6	618.8	649.0	679.7
Other taxes	302.9	320.6	559.4	573.2
Rights and Privileges	777.2	893.7	910.7	925.1
Sale of property and commodities	755.9	787.1	805.0	824.2
Institutional revenue	4,110.5	4,461.0	4,772.8	5,053.1
Interest dividends and rents	184.3	158.7	146.8	142.9
Federal grants and contracts	6,502.9	7,837.2	8,138.6	8,075.3
Master Tobacco Settlement Agreement Funds	95.7	135.4	146.5	146.7
Other revenue	1,629.5	1,705.8	1,778.7	1,814.2
Total	**$16,832.5**	**$18,834.3**	**$19,883.6**	**$20,266.2**

*Based on December 2008 forecast. Dollars in millions. Figures may not add due to rounding. Total excludes balances and bond proceeds available for appropriation, as well as Literary Fund transactions, and internal service funds. Source: Department of Planning and Budget, based on data submitted by agencies.