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

FY 2014 revenue collections decline

In FY 2014, total general fund revenues fell 1.6 percent to $16,411.4 million, falling short of the official forecast (1.0 percent growth) by $438.0 million. This marks the first time that revenues have declined outside of a national recession. Adjusting for the accelerated sales tax program, total revenues fell 0.6 percent, trailing the economic-base forecast of 2.1 percent growth.

All major sources except the insurance premiums tax and individual income tax refunds contributed to the deficit, however, collections of individual nonwithholding accounted for most of the shortfall in FY 2014. Collections in this source were $401.1 million below the estimate, a variance of -13.7 percent. Payroll withholding and sales tax collections, 83 percent of total revenues and closely related to economic activity, finished a combined 0.6 percent below forecast. Taken together, the two sources were $78.9 million behind the forecast. Two major sources contributed positively to collections. Individual refunds were $51.3 million lower than forecast, a net positive for the Commonwealth, and insurance premiums taxes finished the year with a $31.0 million surplus. Collectively, the five major sources ended the year $476.8 million below the forecast (2.9 percent variance). Also, collections of miscellaneous taxes and other revenues were $38.8 million ahead of the forecast in FY 2014 (5.8 percent variance).

General fund revenues expected to show below-trend growth over the forecast horizon

The general fund revenue forecast for FY 2014 through FY 2016 includes slightly below-trend growth that appears to be the new norm for Virginia's economy. In particular, the slow rate of job growth over the next two years and federal sequestration are expected to constrain growth in general fund revenue collections.

Growth of total general fund revenues (excluding transfers) of 3.1 percent in FY 2015 reflects the aforementioned sluggish job growth. Revenue growth of 3.1 percent for FY 2016, illustrates the lack of robust growth in this economic recovery.

General Fund Forecast for FY 2015 and FY 2016*

	Actual FY 2014	Forecast FY 2015	Forecast FY 2016
Corporate income	$757.5	$757.9	$771.6
Individual income	11,253.3	11,645.3	12,036.1
Insurance premiums	320.4	334.5	326.8
State sales & uses	3,066.5	3,197.8	3,292.0
Wills, suits, deeds & contract fees	310.8	318.3	318.3
Miscellaneous	702.9	673.6	714.5
Total revenues	**$16,411.4**	**$16,927.4**	**$17,459.3**
ABC profits	$72.2	$77.3	$80.2
Sales Tax (0.25%)	334.0	348.1	359.3
Transfers per the Appropriations Act	131.5	208.1	124.6
Total transfers	**$537.7**	**$633.5**	**$564.1**
Total general fund	**$16,949.1**	**$17,560.9**	**$18,023.4**

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

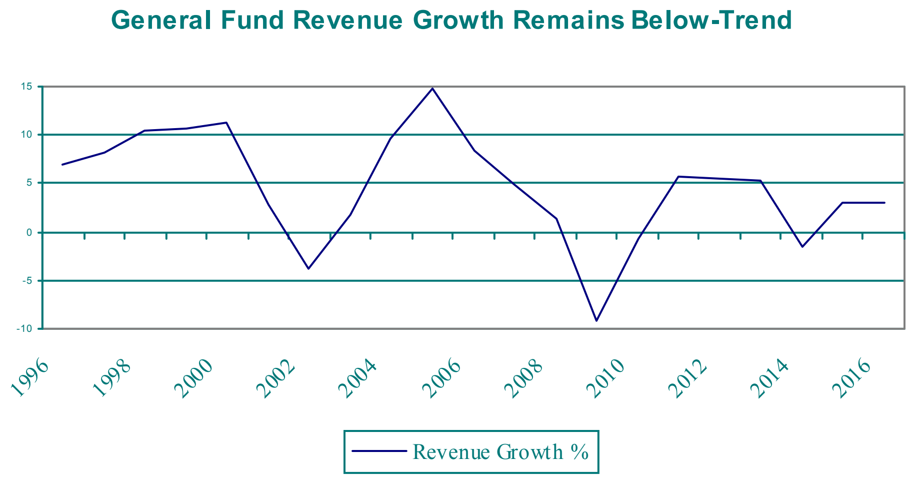
Forecast for the Major General Fund Revenue Sources

For each of the major categories of general fund revenue, the following describes the actual performance in FY 2014 and the estimate over the forecast horizon.

Individual income taxes

Collections of net individual income taxes (69 percent of total revenues) fell 0.8 percent in FY 2014, trailing the annual forecast of 2.9 percent growth. Receipts of $11,253.3 million were $415.8 million below the official estimate, a variance of 3.6 percent from the forecast. Although refunds were lower than expected, both withholding and nonwithholding fell short of their estimates, with nonwithholding accounting for the bulk of the shortfall.

Individual income tax collections are expected to post moderate gains over the next two fiscal years, growing by 3.5 percent and 3.4 percent, respectively.



Sales and use taxes

Collections of sales and use taxes (19 percent of total revenues) were $3,066.5 million in FY 2014, $12.9 million below the forecast, a forecast variance of 0.4 percent. Collections fell 4.8 percent for the year compared with the forecast of a 4.4 percent decline. Adjusting for accelerated sales tax payments received in June, sales tax collections grew 0.8 percent in FY 2014, compared with the economic-base forecast of a 1.6 percent increase. Monthly growth rates were below the annual forecast in six out of the 12 months as Virginia consumers have shown restraint in the face of federal government layoffs and spending cuts.

Growth in sales tax collections are expected to increase by 4.3 percent and 2.9 percent in fiscal years 2015 and 2016, respectively.

Corporate income taxes

Corporate income tax collections (5 percent of total revenues), historically the most volatile revenue source, fell short of the forecast. Collections of $757.5 million were $12.4 million below expectations, a forecast variance of 1.6 percent. The fiscal year decrease of 4.9 percent trailed the forecast of a 3.4 percent decline.

The corporate revenue model considers gross payments and refunds separately. Gross payments are modeled as a function of Virginia specific pre-tax corporate profits and the S&P 500 index. Refunds are driven by the historic ratio of gross payments to refund activity. In FY 2015 and FY 2016, collections are expected to increase by 0.1 percent and 1.8 percent, respectively.

Insurance company premiums taxes

One major source to see a surplus, collections of taxes on the premiums of insurance companies (2 percent of total revenues) were $320.4 million in FY 2014 - $31.0 million above the annual estimate. Growth in the commercial real estate market and improving home values led to a rebound in insurance premiums tax collections.

The forecast for insurance premiums is for growth of 4.4 percent and -2.3 percent, respectively over the next two fiscal years.

Wills, suits, deeds & contract fees

Wills, suits, deeds, and contract fees (2 percent of total revenues), of which the primary component is the recordation tax, were well behind the forecast in fiscal year 2014. The sluggish recovery of the housing market slowed recordation receipts and caused a deficit in this source of $66.7 million, a variance of -17.7 percent. Collections finished the year at $310.8 million, a 17.7 percent drop from FY 2013 and far below the official forecast of 0.0 percent growth.

The revenue model for wills, suits, deeds and contracts is based on mortgage originations and median home prices in Virginia, along with the yield on 30-year treasury bonds. The outlook for recordation taxes drives the other components of this source. The JABE pessimistic forecast for collections in this source is 2.4 percent growth, an upward revision of $3.8 million.

Tax Preference Items Included in the General Fund Revenue Forecast

The general fund revenue forecast for FY2015 and FY2016 also includes $114.3 million in additional collections related to limiting or eliminating some tax preference items. These include:

1. Limiting the amount of Coalfield Enhancement Tax Credit that may be claimed at $500,000 per return and limiting the amount of the Virginia Coal Employment & Production Incentive Tax Credit to $2 per ton and limit the amount the credit can be redeemed to $500,000. Together, these two actions save the Commonwealth almost $20 million in FY 2016.

2. Reducing the deduction for long-term health care insurance from 100% to 50% of the amount of premiums paid annually resulting in a positive revenue impact of $9.4 million in FY 2016

3. Limiting the amount of the Land Preservation Tax Credit that may be claimed to $20,000 per taxpayer, and $40,000 for joint returns, resulting in $22.4 million in savings in FY 2016

4. Combining all sales tax holidays into a single three day holiday in August saving $1.6 million in FY 2015 and $1 million in FY 2016

5. Reducing the Accelerated Sales Tax (AST) threshold, which would result in increasing general fund revenues by $39.2 million in FY 2015 and $18.6 million in FY 2016.

6. Imposing the sales tax on online travel companies resulting in $1.7 million in general fund savings in FY 2016, and

7. Repealing the subtraction for the sale of land for open space use, resulting in $500,000 in increased revenues in FY 2016.

60.7 PERCENT 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 consists of nongeneral funds that are earmarked by law for specific purposes. Nongeneral fund revenue collections increased by 10.0 percent in 2014, and are expected to increase by 18.8 percent in 2015, and 2.1 percent in 2016. Nongeneral funds are 60.7 percent of total state revenue during the 2014-2016 biennium.

Federal grants and other contracts

Federal grants are the largest single source of nongeneral fund revenue, about 37 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 2014, federal grants and other contracts decreased to $9.2 billion. This source is projected to increase by five percent to $9.7 billion in 2015 and 1.9 percent in 2016 to $9.9 billion. The decline in 2014 is due to the uncertainty surrounding the federal budget and future federal domestic spending.

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 2015, institutional revenue collections are expected to be $7.2 billion or about 27.2 percent of all nongeneral fund revenue. Institutional revenues are projected to grow to $7.4 billion in 2016. Overall institutional revenues are projected to be 28.4 percent of all nongeneral fund revenues over the 2014-2016 biennium. 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.

The 2014 revenue collections increased by 25.4 percent. Total fund revenues from state sources are expected to be $3.0 billion in 2015 and $3.2 billion in 2016.

During the 2007 session of the General Assembly, legislation was passed that provided new revenues into the Commonwealth Transportation Fund. Motor Vehicle license fees, motor fuels taxes and miscellaneous revenues reflect these adjustments. Beginning in FY 2009, one third of the insurance premiums tax and three cents of the twenty five cent recordation tax is deposited to the Commonwealth Transportation Fund. The 2013 Session of the General Assembly passed House Bill 2313 (Chapter 766) which provided a considerable influx of new revenues into the Commonwealth Transportation Fund. Included in the bill was the elimination of the $0.175 per gallon tax on motor fuels, and replaces it with a percentage-based tax of 3.5 percent for gasoline and a 6 percent tax on diesel fuel. The bill also raised the state sales and use tax from 4 percent to 4.3 percent the increased revenue dedicated to the Transportation Fund. The bill also increased the share of the existing general sales and use tax revenues used for transportation from 0.5 percent to 0.675 percent phased in over four years. Finally the bill amended the tax on the sale of motor vehicles (the "titling tax"). The new rate of 4.15 percent is being phased in over four years.

Unemployment insurance fund

Unemployment insurance tax collections rise and fall with trends in the economy.

Unemployment tax collections are expected to decrease to $696.7 million in 2015 and $673.7 million in 2016. These projected collections reflect the decreases in the four-year moving average of benefit charges overwhelming the fluctuations in the pool tax rate. The current estimate anticipates increases in the pool taxes of 0.19 percent and 0.24 percent for calendar years 2015-2016, respectively. A fund building tax is imposed in calendar years 2015-2018.

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 8.5 percent of the MSA allocation for the purposes of preventing tobacco use by minors and reducing childhood obesity. Programs targeted at minors include but are not limited educational and awareness programs. The final portion of the allocation (41.5 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 2015 and 2016, it is anticipated that the Tobacco Indemnification and Community Revitalization Fund may expend up to 10.0 percent of the endowment, an amount estimated at $70.3 million each year. The Foundation for Healthy Youth is anticipated to take in $9.4 million in 2015 and $9.3 million in 2016.

The Virginia Health Care Fund will receive $48.2 million in 2015, and $47.7 million in 2016.

Nongeneral fund forecast for the 2014-2016 biennium*

	Actual FY 2014	Forecast FY 2015	Forecast FY 2016
Motor vehicle fuel tax	$697.1	$760.8	$889.6
Unemployment compensation payroll tax	735.2	696.7	673.7
Special highway tax from sales tax	571.1	886.2	916.0
Motor vehicle sales tax and use tax	788.6	814.2	840.0
Other taxes	1,986.7	1,370.0	1,378.4
Rights and privileges	1,002.2	1,087.4	1,080.6
Sale of property and commodities	1,836.5	1,482.1	1,466.7
Assessment & receipts for special services	227.1	226.7	234.2
Institutional revenue**	2,787.5	7,157.1	7,373.3
Interest dividends and rents	401.0	149.0	164.2
Federal grants and contracts	9,224.7	9,690.0	9,872.9
Master Tobacco Settlement Agreement Funds	58.1	128.0	127.4
Other Revenue	1,694.2	1,846.2	1,699.7
Total	**$22,009.8**	**$26,294.4**	**$26,716.8**

*Based on December 2014 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.

**Per the Management Agreement between the tier 3 schools and the Commonwealth as set forth in Chapters 933 and 943 of the 2006 Acts of Assembly, the tier 3 schools are not required to report actual revenue collections in CARS.