

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 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 2009 revenue collections slump

In FY 2009, total general fund revenues fell by 9.2 percent to \$14,315.1 million, falling short of the official forecast (7.3 percent decline) by \$298.8 million. Adjusted for the repeal of the estate tax and transfers to transportation from insurance and recordation taxes per HB 3202 of the 2007 Session of the General Assembly, FY 2009 collections declined 7.3 percent compared with the forecast of a 5.3 percent decline. Total general fund revenues finished the year at the lowest level since FY 2005.

Withholding and sales tax collections (83 percent of total general fund revenues), the two revenue sources most closely tied to



economic activity in the Commonwealth, finished a combined 0.6 percent below 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 \$58.7 million below forecast. A major driver of the FY 2009 revenue shortfall was unexpected growth in individual refunds. Individual refunds exceeded the annual estimate by \$162.4 million.

Collections of miscellaneous taxes and other revenues were \$1.9 million below the estimate in FY 2009.

Below trend growth in general fund revenues over the forecast horizon reflects the continuing effects of the severe economic recession

The general fund revenue forecast for FY 2010 through FY 2012 illustrates the sluggish nature of the economic recovery. In particular, the slow rate of job growth over the next three years is expected to constrain growth in general fund revenue collections.

General fund revenues are expected to decline by 2.7 percent in FY 2010. Below-trend growth in FY 2011 and FY 2012 of 3.8 percent and 5.1 percent, respectively, illustrates the modest recovery in revenue growth over the forecast horizon.

The general fund forecast for FY 2010 through FY 2012

	Actual 2009	Forecast 2010	Forecast 2011	Forecast 2012
Major tax sources				
Corporate income	\$648.0	\$705.2	\$737.4	\$813.3
Individual income	9,481.1	8,947.3	9,543.4	10,081.6
Insurance premiums	255.0	255.5	274.4	292.2
State sales & uses	2,903.4	3,021.9	2,890.2	2,986.0
Wills, suits, deeds & contract Fees	314.3	284.0	299.0	299.0
Miscellaneous	713.2	707.9	707.0	709.3
Total revenues	\$14,315.1	\$13,921.8	\$14,451.4	\$15,181.4
Transfers				
ABC profits	\$44.1	\$42.2	\$44.9	\$45.4
Sales Tax (0.25%)	213.4	204.5	208.9	215.8
Transfers per the Appropriations Act	149.0	301.2	152.9	144.6
Total transfers	\$406.5	\$547.9	\$406.7	\$405.8
Total general fund	\$14,721.6	\$14,469.7	\$14,858.1	\$15,587.2

*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 2009 and the estimate over the forecast horizon:

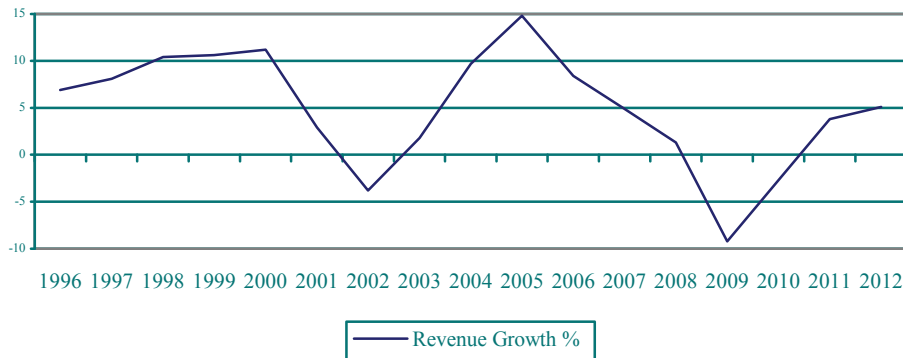
Individual income taxes

Collections of net individual income taxes fell by 6.3 percent in FY 2009, below the annual estimate of a 4.1 percent decline. Annual

collections were \$216.2 million below the official forecast. The significant slowdown in growth in FY 2009 was attributable to double-digit growth in individual refunds.

Individual income tax collections are expected to fall by 5.6 percent in FY 2010, then rebound in FY 2011 and FY 2012, growing by 6.7 and 5.6 percent, respectively.

General Fund Revenue Shows Lingering Effects of Great Recession



Sales and use taxes

Collections of sales and use taxes declined by 5.6 percent in FY 2009, 1.9 percentage points below the annual estimate, a \$57.5 million shortfall.

The FY 2010 forecast for sales tax collections is for 4.1 percent growth, mostly attributable to the implementation of accelerated sales tax collections. Sales tax revenues are expected to decline by 4.4 percent in FY 2011 and grow by 3.3 percent in FY 2012.

Corporate income taxes

Corporate income tax receipts were slightly weaker than expected in FY 2009, finishing \$37.0 million below the annual estimate with a 19.8 percent decline.

In the December standard revenue forecast, corporate income tax collections are expected to increase by 8.8 percent in FY 2010, with all the growth attributable to the tax amnesty program. FY 2011 and FY 2012 show solid growth as the economy recovers, increasing by 4.6 and 10.3 percent, respectively.

Insurance company premiums taxes

Collections of taxes on the premiums of insurance companies were \$255.0 million in FY 2009 -- \$2.5 million below the forecast. Net receipts fell by 35.7 percent, mainly due 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.

The FY 2010 forecast for insurance premiums taxes is for a marginal increase, growing by 0.2 percent. Collections are expected to grow by 7.4 and 6.5 percent, respectively, in FY 2011 and FY 2012.

Wills, suits, deeds & contract fees

Collections in wills, suits, deeds, and contracts (primarily recordation tax receipts) declined 31.1 percent in FY 2009, slightly better than the forecast of a 34.7 percent decline. However, the decline in collections 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 FY 2009.

The FY 2010 forecast for wills, suits, deeds & contract fees is for slightly less than another double-digit decline. Collections are expected to increase by 5.3 percent in FY 2011 as the housing market shows signs of stabilizing.

Over half, 60.1 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 is nongeneral funds that are earmarked by law for specific purposes.

Nongeneral fund revenue is expected to increase by 39.1 percent in 2010, decrease by 4.2 percent in 2011, and increase by 1.9 percent in 2012. Nongeneral funds will comprise about 60.1 percent of total state revenue during the 2010-2012 biennium.

Federal grants and other contracts

Federal grants are the largest single source of nongeneral fund revenue, about 40.7 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 2009, federal grants and other contracts totaled \$7.6 billion. This source is projected to increase by 45.8 percent to \$10.9 billion in 2010, decrease by 14.2 percent in 2011 decrease to \$9.4 billion, continuing to decline \$9.3 billion in 2013 before increasing back to \$9.4 billion in 2014 and continuing to grow to over \$10.0 billion in 2015 and 2016. This pattern is caused by temporary nature of the federal stimulus funding received from the American Recovery and Reinvestment Act (ARRA) in FY 2009 the stimulus funds peak in FY 2010 and declines through FY 2011 and FY 2012, this is in addition normal 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 2010, institutional revenue is estimated to be \$5.2 billion or about 21.8 percent of all nongeneral fund revenue. Institutional revenues are projected to grow by 4.2 percent to \$5.4 billion in 2011, and by 7.0 percent in 2012. 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.

FY 2009 revenue collections fell by 2.7 percent as compared to the official forecast of a 1.5 percent decline. The deficit in fiscal year 2009 collections can be attributed to a record-low year in motor vehicle sales and the slump in retail sales due to the ongoing economic recession. After adjustments to the Commonwealth Transportation fund from insurance premiums and recordation taxes resulting from 2007 legislation, annual collections declined 9.8 percent. The adjusted FY 2009 collections were equivalent to the FY 2004 level of revenue collections. During the 2007 session of the General Assembly legislation was passed that provided a considerable influx of new revenues into the Commonwealth Transportation fund. Motor Vehicle license fees, motor fuels taxes and miscellaneous revenues reflect these adjustments. In addition, one third of the insurance premiums tax and three cents of the twenty-five cent recordation tax is now deposited to the Commonwealth Transportation Fund beginning in FY 2009. Total state taxes and fees are -3.0 percent

from actual collections in FY 2009. FY 2010 revenue collections are estimated to decline 2.8 percent, marking the first time that the Commonwealth Transportation Fund revenues are expected to decline for two consecutive years.

For FY 2010 through FY 2012, total fund revenues from state sources are expected to be about \$2.2 billion in FY 2010, \$2.3 billion in FY 2011, and \$2.4 billion in FY 2012. These amounts are equal to annual growth of -3.0 percent, 3.0 percent, and 2.5 percent, respectively. This pattern reflects the anticipated sluggish recovery starting in FY 2011.

Unemployment insurance fund

Unemployment insurance tax collections rise and fall with trends in the economy. Projected collections are expected to be lower in FY 2010 and increasing in FY 2011 and, FY 2012 reflecting an increase in tax revenue. The current estimate anticipates increase in the pool taxes of 0.43 percent, 0.75 percent and 0.91 percent for calendar years 2010-2012 respectively. A fund building tax is imposed in calendar years 2010-2012. The decline in interest revenues estimates to zero is the result of the trust fund being depleted. The increase in FY 2010-2012 are 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 2010, unemployment tax collections are expected to increase to \$497.6 million, from actual collections of \$309.3 million in 2009. For 2011, revenues are anticipated to increase \$746.1 million to \$921.8 million in FY 2012.

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. In addition, the 2009 General Assembly allowed moneys from the Fund to be used to support programs aimed at reducing childhood obesity

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.

The introduced budget revises estimated Virginia Tobacco Settlement Fund payments to reflect updated MSA revenues and the diversion of 1.5 percent of MSA funds (approximately \$2.0 million each year) to cover the cost of health insurance for lower income children. This action would lower the Settlement Fund's MSA payment to 8.5 percent (a 15 percent reduction) and subsequently increase revenue dedicated to the Virginia Health Care Fund (to 41.5

percent). For FY 2010, 2011 and 2012, 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 \$77.0 million each year. The Virginia Tobacco Settlement Fund will take in \$13.2 million, \$11.2 million, and \$11.3 million over the same period. The Virginia Health Care Fund will receive \$55.2 million, \$57.8 million and \$58.6 million during this three year period.

Nongeneral fund forecast for the 2010-2012 biennium*

	Actual 2009	Forecast 2010	Forecast 2011	Forecast 2012
Motor vehicle fuel tax	\$897.2	\$896.6	\$914.9	\$925.1
Unemployment compensation payroll tax	309.3	497.6	746.1	921.8
Special highway tax from sales tax	499.4	486.1	496.6	512.7
Motor vehicle sales tax and use tax	413.2	392.8	422.0	446.3
Other taxes	374.5	387.5	432.04	455.7
Rights and Privileges	887.5	1,058.5	1,069.3	1,076.3
Sale of property and commodities	1,462.1	1,468.5	1,496.8	1,536.8
Institutional revenue ¹	2511.9	5,174.0	5,389.4	5,613.4
Interest dividends and rents	72.7	44.9	45.4	44.9
Federal grants and contracts	7,670.8	11,181.3	9,588.0	9,512.0
Master Tobacco Settlement Agreement Funds	72.9	68.4	69.0	69.9
Other revenue	1,326.9	1,467.2	1,457.9	1,456.6
Total	\$17,098.2	\$23,785.2	\$22,822.6	23,288.2

*Based on December 2010 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.

¹ 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 type 3 schools are required to report actual revenue collections in CARS.