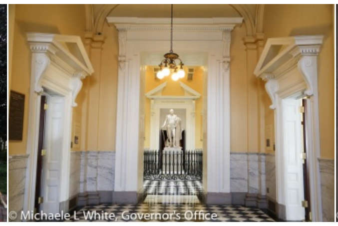
REVENUE FORECAST



The Commonwealth's total revenue consists of two types of resources: the general fund and nongeneral funds. About sixty percent 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 (or recordation charges), and taxes on insurance company premiums. Miscellaneous taxes and other revenues also contribute to the general fund.

FY 2016 revenue collections fell short of target

In FY 2016, total general fund revenues rose 1.7 percent to $18,040.1 million, with a shortfall of $268.9 million -- 1.5 percent variance from the budget forecast. All major sources except the insurance premiums tax and corporate income tax contributed to the deficit, however, collections of individual withholding and sales taxes accounted for the bulk of the shortfall in FY 2016.

Payroll withholding finished the year $195.3 million below the estimate, a -1.7 percent variance. Sales tax collections also contributed $71.9 million to the shortfall, a -2.1 percent variance. Taken together, withholding and sales tax collections, which comprise 82 percent of total revenues and are closely related to economic activity, finished with a variance of -1.8 percent from forecast. Collections in nonwithholding were $28.9 million short of the estimate, a variance of -0.9 percent. Also contributing to the shortfall, individual refunds were $43.1 million more than forecast. Wills, suits and deeds, mainly recordation taxes, missed its forecast by $13.9 million, a -3.6 percent variance.

Only two major sources exceeded expectations: corporate income taxes were $42.1 million ahead of the forecast (5.8 percent variance), and receipts of insurance premiums taxes exceeded the estimate by $16.4 million (5.1 percent variance). Collectively, the five major sources ended the year $294.6 million less than forecast (-1.5 percent variance). Collections of miscellaneous taxes and other revenues were $25.7 million ahead of the forecast in FY 2016 (3.7 percent variance).

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

The revised forecast anticipates that general fund revenues will grow by +2.9 percent for FY 2017 and +3.2 percent for FY 2018. The forecast continues the below-trend growth that appears to be the new norm for Virginia's economy.

General Fund Forecast for FY 2017 and FY 2018

	Actual 2016	Forecast 2017	Forecast 2017
Corporate income	$764.9	$794.2	$824.9
Individual income	12,555.6	12,913.8	13,380.2
Insurance premiums	339.1	344.1	364.8
State sales & uses	3,295.9	3,385.8	3,445.5
Wills, suits, deeds & contract Fees	369.1	398.6	407.9
Miscellaneous	715.5	720.9	735.2
Total revenues	**$18,040.1**	**$18,557.4**	**$19,158.5**
ABC profits	$86.5	$97.3	$101.4
Sales Tax (0.25%)	355.5	365.4	374.0
Transfers per the Appropriations Act	119.6	137.2	133.9
Total transfers	**$561.6**	**$599.9**	**$609.3**
Total general fund	**$18,601.7**	**$19,157.3**	**$19,767.8**

*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

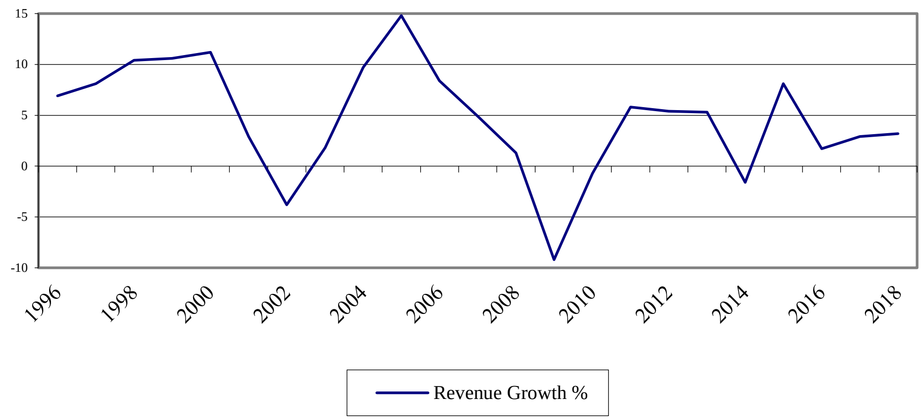
For each of the major categories of general fund revenue, the following describes the actual performance in fiscal year 2016 and the estimate over the forecast horizon.

Individual income taxes

Most of the shortfall in FY 2016 was attributable to individual income taxes. Collections of net individual income taxes (70 percent of total revenues) rose 1.8 percent in FY 2016, trailing the annual forecast of 4.0 percent growth. Receipts of $12,555.6 million were $267.4 million below the official estimate, a variance of 2.1 percent from the forecast. Both withholding and nonwithholding fell short of their estimates and refunds were higher than expected.

The outlook for net individual income taxes anticipates growth of 2.9 percent in FY 2017 to $12.9 billion. Collections in this source are projected to increase by 3.6 percent in FY 2018 reaching $13.4 billion.

General Fund Revenue Growth Remains Below-Trend



Sales and use taxes

Collections of sales and use taxes (18 percent of total revenues) were $3,295.9 million in FY 2016, $71.9 million below the forecast. Collections rose 1.9 percent for the year compared with the forecast of 4.1 percent growth. Adjusting for accelerated sales tax payments received in June, sales tax collections grew 2.2 percent in FY 2016, compared with the economic-base forecast of a 4.1 percent increase.

The sales tax revenue model is based on a direct relationship with total personal income in Virginia. The November standard forecast increases sales tax collections to $3.39 billion in FY 2017 for growth of 2.7 percent. Growth in this source is expected to be 1.8 percent in FY 2018, bringing collections to $3.45 billion.

Corporate income taxes

Corporate income tax collections (4 percent of total revenues), historically the most volatile revenue source, exceeded the forecast. Collections of $764.9 million were $42.1 million above expectations. The fiscal year decline of 8.0 percent was better than the forecast of a 13.1 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. The November standard forecast increases corporate income tax collections to $794.2 million or +3.8 percent above FY 2016 levels. Collections are expected to grow 3.9 percent in 2018 to $824.9 million.

Insurance company premiums taxes

Another major source to see a surplus, collections of taxes on the premiums of insurance companies (2 percent of total revenues) were $339.1 million in FY 2016 – $16.4 million above the annual estimate. Growth of 12.8 percent exceeded the annual estimate of 7.3 percent growth.

Collections in this source grew by 12.8 percent in FY 2016, and finished the year with a $16.4 million surplus. In the November standard forecast, insurance premiums taxes are expected to increase by 1.5 percent in FY 2017 above the FY 2016 level. For FY 2018, this source is projected to grow by 6.0 percent.

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, fell short of the forecast in FY 2016. Collections in this source were $13.9 million short of the forecast, a variance of -3.6 percent. Collections finished the year at $369.1 million, a 6.6 percent increase from FY 2015 but below the official forecast of 10.6 percent growth.

The revenue model for wills, suits, deeds and contracts is based on mortgage originations, mortgage refinancing and 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 November standard forecast for this source is 8.0 percent growth in FY 2017. For FY 2018, the estimate assumes growth of 2.3 percent.

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 2016 total transportation revenues totaled close to $3.4 billion, an increase of $218.4 million over last year. Revenue collections grew by 7.0 percent, equaling the official forecast, resulting in a forecast variance of 0.1 percent.

For FY 2017 and FY 2018, total fund revenues from state sources are expected to be over $3.4 billion in FY 2017 and close to $3.5 billion in FY 2018. Revenue collections are estimated to increase by 1.9 percent and 1.2 percent in FY 2017 and FY 2018, respectively.

Around 60 percent of state revenue is nongeneral fund

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 2.4 percent in 2016, and are expected to increase by 27.9 percent in 2017, and 1.6 percent in 2018. Nongeneral funds are almost 60 percent of total state revenue during the 2016-2018 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 2016, federal grants and other contracts increased to $9.3 billion. This source is projected to increase by 15.0 percent in 2017 and increase by 0.1 percent in 2018, resulting in projection of $10.7 billion for each year.

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. Institutional revenue collections are expected to be $7.6 billion in FY 2017 and $8.1 billion in FY 2018.

Unemployment insurance fund

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

The current unemployment estimates' decrease in FY 2017 through FY 2018, reflects improvements in the fund balance factor and decreases in the four year moving average of benefit charges overwhelming the small increase in the pool tax rate.

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 2017 and 2018, 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 2017 and $9.3 million in 2018.The Virginia Health Care Fund will receive $48.0 million in 2017, and $48.4 million in 2018.

Nongeneral Fund forecast for the 2016-2018 biennium[1]

	Actual FY 2016	Forecast FY 2017	Forecast FY 2018
Motor vehicle fuel tax	$848.3	$856.0	$865.0
Unemployment compensation payroll tax	$582.9	$468.8	$427.7
Special highway tax from sales tax[2]	$701.4	$741.6	$752.8
Motor vehicle sales tax and use tax	$919.0	$938.0	$947.3
Other taxes	$1,500.4	$1,504.3	$1523.4
Rights and privileges	$1,046.6	$1,076.9	$1,087.2
Sale of property and commodities	$1,551.2	$1,665.1	$1,640.7
Assessment & receipts for special services	$648.0	$650.3	$692.4
Institutional revenue[3]	$2,886.4	$7,674.1	$8,086.8
Interest dividends and rents	$120.8	$178.4	$190.1
Federal grants and contracts	$9,348.5	$10,746.9	$10,758.4
Master Tobacco Settlement Agreement Funds	$56.9	$127.7	$128.2
Other Revenue	$1,959.6	$1,737.5	$1,723.2
TOTAL	**$22,169.9**	**$28,365.7**	**$28,823.2**

[1]Based on December 2016 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.

[2]Represents a subset of sales use tax.

[3]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 the Cardinal financial system. However, these institutions participate in the nongeneral fund revenue estimation process.