

Budget Watch



SEPTEMBER 2014

BUDGET OUTLOOK BECOMING CLEARER:

*AN ANALYSIS OF THE SUMMER 2014 REVENUE, CASELOAD,
AND EXPENDITURE ESTIMATING CONFERENCES*

Last month's *Budget Watch* from Florida TaxWatch examined the results of the latest General Revenue Estimating Conference and their impact on the next state budget. This report looks at the other estimates produced by this summer's cycle of conferences, including those that affect trust fund receipts and estimate appropriations drivers, such as school enrollment and Medicaid caseloads.

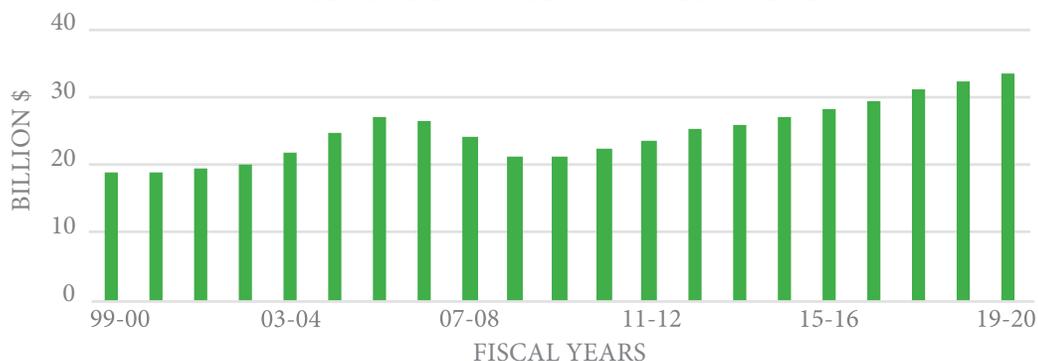
To recap the new General Revenue (GR) estimates, the results of the August conference were mixed. In total, legislators will have \$141.6 million less for next year's (FY2015-16) budget than was anticipated based on the last estimates made in March.

Actual collections for FY2013-14 came in \$106.7 million below the previous (March) estimate. The estimates for the current year (FY2014-15) were slightly increased by \$49.2 million (0.2 percent) but the FY2015-16 estimate was reduced by \$84.1 million (0.3 percent). Despite this downward revision, revenues have now recovered from the plunge brought on by the recession and steady growth is forecast for the next few years.

GR is the money for which legislators have the most discretion, it can be spent on most anything in the state budget. GR is a major source of revenue for education, human services, and public safety and corrections. When you hear discussion of a state budget shortfall or surplus, it is generally GR that is being considered.

Trust fund revenues are important for the programs they fund (such as transportation), and they can also affect the need for GR spending as changes in those revenue streams can ease or apply additional pressure on GR funding.

General Revenue Collections



Revenue Estimating Conferences

In addition to General Revenue, there are estimating conferences to forecast collections from other revenue sources. Some of these are included in the GR estimates, others are trust fund revenues for specific budget areas and programs, and some fund both GR and trust funds.

The following is a summary of several important conferences that, while dealing mostly with trust funds, can have an impact on the need for general revenue spending.

Lottery and Slot Machine Estimating Conferences

Net revenues from the lottery (after prizes, retailer commissions and administrative costs), along with slot machine revenues, go into the Educational Enhancement Trust Fund (EETF) for the sole purpose of funding education. This can have implications for GR spending because if revenues are not sufficient to continue funding of the EETF programs that are in the current budget, GR would have to be used to maintain them. Conversely, growing EETF revenues can take some of the pressure off GR to fund education.

The latest lottery conference reduced the overall forecast from the last one adopted in February. Estimates of total lottery distributions to EETF were reduced by \$22.2 million in FY2013-14, \$25.6 million in FY2014-15 and \$31.3 million in FY2015-16. This is a 1.7 percent decrease in the estimate over the three years. The growth rates vary across games, but most of the decline in the estimate is due to lower projections for Powerball and Lotto ticket sales.

Overall, total distributions to EETF are still expected to increase from year to year. The Lottery is expected to bring in \$1.460 billion for education in the next budget year, \$22.4 million more than the current year. Estimates of slot machines revenues were also reduced in every year of the forecast, although annual revenues should still increase year to year.

The estimates were decreased by \$13.1 million (2.4 percent) over the three-year period from FY2013-14 to FY2015-16. Slot machine tax collections are now pegged at \$185.4 million for the next budget year.

Examining the outlook for the EETF, the 2015 Legislature will have less revenue available in the fund than it spent this year. Recurring EETF revenues of \$1.704 billion are \$41.1 million less than current recurring expenditures. When non-recurring revenue and expenditures are included, the deficit increases to \$153.2 million. Last session, the Legislature shifted \$136.2 million (non-recurring) from the EETF to the Public Education Capital Outlay (PECO) Trust Fund.

Ad Valorem Estimating Conference

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), which is the amount of property taxes that local school districts must levy in order to participate in the Florida Education Finance Program (FEFP). If taxable value across the state falls, the Legislature must either mandate a property tax rate increase or make up the difference with GR. If values increase, the same millage rate will bring in additional local dollars for the FEFP, or the Legislature could avoid a tax increase by rolling back the RLE millage rate.

The tax roll (school taxable value) for next year is estimated at \$1.592 trillion. This is an increase of 1.7 percent from the last estimate and results in annual growth of 4.8 percent. 2015 will be the third straight year of positive growth following four straight years of decline. The housing industry shows signs of progress but the state forecasters are concerned that new residential construction has showed recent signs of weakening, indicating that the recent spike in new construction may not be sustained. Also, home ownership rates are continuing to decline, and the bulk of foreclosed homes are yet to come on the market.

For RLE, the value of one mill in 2015 is \$1.528 billion, up by \$69.5 million from this year. The new estimate is \$8.4 million more than the one made last December. This means if the Legislature keeps the same millage rate as the current year, \$393 million more local revenue for schools will be raised than in the current year. The Legislature could decide to roll back the millage rate, but the desire of the Governor and legislators to significantly increase education funding next year makes this less likely.

Transportation Revenue Estimating Conference

This conference adopted a small 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 increased by \$177.6 million (0.9 percent) over the five year Work Program period ending in FY2019-20. Annual revenues are still expected to increase. Total STTF revenues are expected to grow by \$103.0 million, reaching \$3.230 billion, in FY2015-16.

All sources of STTF revenues (fuel taxes, motor vehicle licenses and fees, and the rental car surcharge) are expected to show steady, modest growth over the work program period. While important for transportation and Florida's economy, these revenues have no direct impact on GR or the size of a potential budget surplus for next year. However, the legislature often "sweeps" revenue from the STTF to shore up GR.

Tobacco Tax and Surcharge Estimating Conference

Tobacco taxes have been a declining revenue source for several years, as cigarette consumption is down. The latest conference reduced these estimates again. Most of the tobacco tax revenues go to GR, but the tobacco surcharge (enacted in 2009) goes to the Health Care Trust Fund (HCTF) which helps fund Medicaid. The last two conferences have reduced estimated revenues going into the HCTF by a total of \$75.9 million over the three-year period ending in FY 2105-16, which all impact the next state budget.

PECO Revenue Estimating Conference

The Public Education Capital Outlay (PECO) program is funded by the gross receipts tax on utilities, and funds the construction and maintenance of educational facilities in Florida. In 2006-07, a high of \$1.854 billion was appropriated for PECO projects; however, gross receipts revenues began declining in FY2008-09 and the PECO Trust Fund has been strapped since then. Because PECO funds are used for bonding, debt service has taken up most of the revenue, and there has been no bonding since FY2010-11. Over the last three years, the Legislature has transferred \$635 million from GR and \$266 million in lottery funds to PECO to provide for some construction projects (largely university and college). Last year, the Legislature addressed PECO funding on a recurring basis by changing the tax on commercial electricity by reducing the sales tax rate (which goes to GR) by 2.65 percent and increasing the gross receipts tax rate by 2.6 percent. The effect was a small tax cut for businesses and a shifting of funds from GR to PECO, ranging from \$152.4 to \$184.1 million for fiscal years 2014-15 through 2018-19. These changes, coupled with the fact that gross receipts tax revenues are increasing again, have restored bonding capacity to PECO.

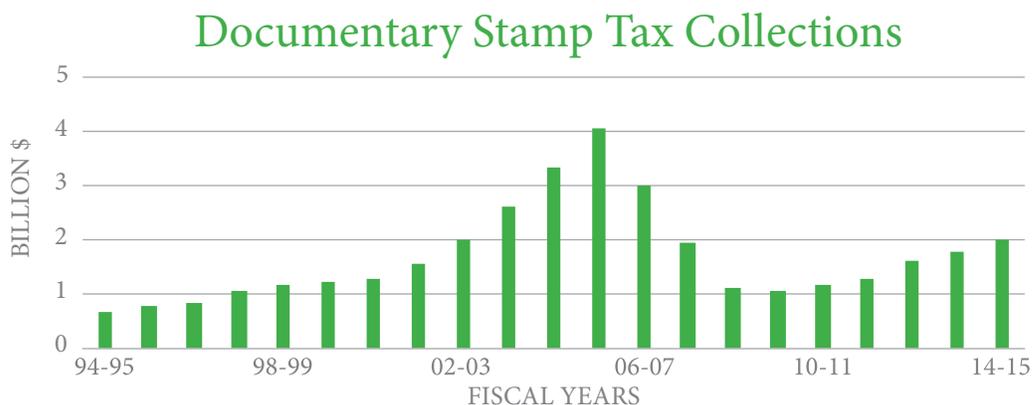
The latest PECO conference produced estimates under two scenarios: no bonding, and maximum bonding. Under the bonding scenario, the Legislature will have \$2.2 billion in bonding capacity and \$214.9 million in cash available for appropriation in FY2015-16. If all capacity is used, there would be \$116 million in bonds available the next year. With no bonding, there would be \$351 million in cash available next year, growing to \$423 million in FY 2108-19. Even with the Governor's and some legislators' support for reducing total state bonding, the 2015 Legislature should not have to use general revenue to shore up PECO.

Documentary Stamp Tax Estimating Conference

The Documentary Stamp Tax (doc stamp) is probably the most widely distributed revenue source in the state. Through a complex formula, GR receives about one-third of total collections. The rest goes to a variety of trust funds to fund programs including debt service on Florida Forever and Everglades Restoration bonds, transportation, economic development, state and local housing programs, state and water management land programs, lake restoration, water quality assurance, invasive plant control, and oyster management and restoration.

As discussed in last month's *Budget Watch* on GR estimates, the new doc stamp forecast asserts that the construction and housing market in Florida are improving. Construction activity, real estate prices, and transaction volume are all expected to grow at a moderately strong pace. Doc stamp revenues are expected to grow by 9.4 percent this year and 9.0 percent next year; however, these estimates are down slightly from the last ones made in March. The previously discussed concerns about slowing new residential construction, foreclosures, declining homeownership rates, and a still large inventory of unsold properties have dampened the recovery a bit. The state estimators still expect "the turnaround in Florida housing will be led by low home prices that attract buyers and clear the inventory, coupled with the long-run sustainable demand caused by continued population growth and household formation that has been pent-up."

Total documentary stamp tax collections are estimated to total \$1.98 billion this year. This amount is still less than half of the housing bubble peak of \$4.06 billion in FY2005-06. After that peak, four straight years of decline brought collections down to \$1.08 billion in FY2009-10.



Caseload and Expenditure Conferences

Criminal Justice Estimating Conference

Surprisingly, despite decreases in crime rates, arrests, and felony filings, Florida's prison population continues to grow. Driving that growth are increasing technical commitments (i.e. probation violations), "year and a day" commitments, and sentence lengths. The "year and a day" commitments are important because when a sentence exceeds one year, the inmate goes to state prison, as opposed to local jails.

The latest estimates provide some good news, as the projected growth was scaled back. There will now be an estimated 101,107 inmates in Florida's correctional system at the end of the current fiscal year (on June 30, 2015). This is up 0.2 percent from the population at the end of the last fiscal year, and growth of 0.4 percent is expected in FY2015-16. While there is still annual growth, the population estimates were reduced by 1,497 (1.5 percent) for this fiscal year and 1,863 (1.8 percent) for next fiscal year.

With a new prison bed costing just under \$61,000 and annual operating costs of \$18,000 per inmate, increasing populations can have a significant impact on the state budget. The population increase that was funded in the current budget was not as large as estimated, so that may help to mitigate the cost for next year.

Voluntary Prekindergarten Estimating Conference

Overall, the estimates of the number of children enrolled in Florida's Pre-K system was revised slightly downward; however, enrollment is still expected to grow each year through the forecast period, ending in FY2017-18. This growth reverses a trend that saw enrollment drop in both FY2012-13 and FY2013-14. Actual enrollment for FY2013-14 was reported at 155,339 students, which was 527 FTEs below the last estimate, made in March 2014, prior to the end of the fiscal year. Due to this slightly smaller than expected class roll, along with a slight reduction in the population estimate of four-year olds, the current fiscal year estimate was reduced by 384 and next fiscal year's was reduced by 546. For the next budget, the Pre-K rolls are still expected to increase by 1,725 children. Annual growth of approximately 1 percent is expected through the forecast horizon.

Florida has the second highest participation rate in the nation, with 77 percent of four-year olds in Pre-K. The national average is 28 percent.

Public Schools Education Estimating Conference

Estimates of public school enrollment were increased throughout the new forecast (through FY2018-19). For the next budget year (FY2015-16) the estimate was increased by 5,491 students, bringing total enrollment to 2,735,359. This is a 13,224 student (0.5 percent) increase over the number of students that were funded in the current budget.

The estimates for future years were increased by a larger amount in each successive year (compared to the April 2014 estimates), reaching an increase of 23,389 (0.9 percent) in FY2018-19.

Factors in the revised estimates include changes to the Florida Tax Credit Scholarship Program that will decrease the number of public school students going into the program, and the growth of charter schools that will draw private and home-schooled students into public charter schools.

To put this increase in perspective, the 13,224 additional students for next year would cost \$91.7 million just to keep per student funding level. Using the current state/local funding split, this would be \$51.7 million in additional funding for the state.

Enrollment growth varies from district (county) to district. Comparing FY2015-16 estimates to the enrollment used in the current budget, the five fastest growing are Hamilton (4.3 percent), Taylor (3.9 percent), Holmes (2.7 percent), Franklin (2.2 percent), and Osceola (2.0 percent). The five districts with the largest decline are Washington (-2.9 percent), Jefferson (-2.5 percent), Madison (-2.3 percent), Gulf (-2.1 percent), and Gadsden (-1.7 percent). Most of the large counties are expected to have minor, if any, growth.

Due to a law change that requires Full Time Equivalent (FTEs) students to be calculated differently beginning in FY2013-14, state estimators say that the new estimates are not directly comparable to pre-FY2013-14 enrollment numbers, and that the new method increases uncertainty in the forecast.

Social Services Estimating Conference

There are three separate conferences to estimate both caseloads and expenditures for the state's Medicaid, Kidcare, and Temporary Assistance for Needy Families (TANF) programs.

Medicaid – The current environment makes estimating Medicaid caseloads and costs difficult, fluid, and incomplete. Changes related to the Patient Protection and Affordable Care Act (PPACA) had a significant impact on the caseload forecast as Medicaid enrollees are being moved from one eligibility category to another. Further, new entrants into Medicaid from the federal health insurance exchange and the impact of “woodworking” (those eligible but not yet enrolled) also resulted in adjustments to the forecast. There are also yet to be quantified impacts of changes such as a new basis for eligibility.

On the expenditure side, the Florida's transition to Statewide Medicaid Managed Care, and its unknown fiscal implications, cloud the forecast. The current budget included expenditure realignment for the long-term care component of managed care, and the new forecast for the first-time attempts to estimate the fiscal implications of the phase-in of the managed medical assistance component. The expenditure estimates included some of the impacts of PPACA, both some are still not known.

The conference increased FY2014-15 Medicaid caseloads by 117,530 (3.2 percent) to 3,743,700 total beneficiaries. Growth of another 50,003 (1.3 percent) is estimated for next year. Estimated expenditures for FY2014-15 were revised downward to \$23.316 billion dollars. This is \$246.0 million less than was appropriated, meaning there should be a surplus at the end of the year, including \$86.0 million in unspent GR. For FY2015-16, total Medicaid expenditures are expected to decrease to \$21.707 billion (-6.9 percent). However, the reduction is mostly in federal dollars - the state's GR expenditures are expected to increase \$181.4 million (5.1 percent). The federal reduction is largely due to the expected expiration of the Low Income Pool (LIP) hospital funding program.

Kidcare – New caseload projections under the new forecast for the Kidcare Program are lower than the estimates made in February 2014 for each of four components: Florida Healthy Kids, Medikids, Children's Health Services, and Behavioral Health. Only the FY2013-14 estimate for Medikids was increased slightly, all other estimates through the FY 2017-18 forecast horizon were reduced. Total average monthly caseloads for Kidcare are expected to fall by nearly 10 percent in FY2014-15, as some kids transition to Medicaid, which results in reduced spending. For FY2014-15, the program should end with a GR surplus of \$9.61 million, and a surplus of \$3.27 million the next year (based on a continuation budget). Annual growth begins again in FY2015-16 through FY2017-18. Total expenditures for FY2015-16 are estimated at \$496.0 million, of which \$67.8 million is state funds, and the rest comes from the federal government.

Temporary Assistance for Needy Families (TANF) – The conference also reduced caseloads and expenditure estimates for the financial assistance payments under the TANF program. State estimators believe declining near-term caseloads are resulting from an improving economy and new employment opportunities, but warned that “volatility in the recent data suggests that this assumption bears careful watching over the next several months.” Expenditures are expected to decline each year of the forecast, dropping from the \$175.4 million appropriated in FY2013-14 to \$159.4 million in FY2017-18.

Conclusion

The latest round of revenue estimating conferences provide further evidence that the economy is still improving, but the recovery is slow. General Revenue collections are back above the pre-recession high and most revenue sources are growing again, if only modestly; but most conferences scaled back their projections of revenue growth.

The 2015 Legislature will have \$29.934 billion available for the next budget (including unspent reserves carried forward.) If budget writers want to keep the same level of reserves that exists now (\$1.589 billion), there will be only \$43.4 million more GR available than was spent this year. This compares with \$403.3 more that was available last session, along with \$2.2 billion in reserves that were carried forward. Recurring GR for next year does exceed recurring appropriations from this year by \$1.3 billion.

All these estimates will be revised two more times before the Legislature puts together the next state budget. The state's economists now turn their attention to Long Range Financial Outlook report that will be released in Fall. The Outlook analyzes projected revenues against the increasing cost of a continuation budget to attempt to quantify a surplus or shortfall for the next budget year.

The Legislature should have a general revenue surplus (revenue available after funding a continuation budget) heading into session, but it may not be go very far. There are expected to be more than 13,000 additional students in Florida's public schools next year. The Governor has stated that, if re-elected, he will recommend increasing per student spending to its highest level ever, which would cost more than \$700 million. Growth in property values could help bring in more school ad valorem taxes to increase the local share of education funding. General Revenue Medicaid expenses are expected to increase by \$181 million and there are more inmates expected in Florida prisons. There will also certainly be competition over dollars to fund new initiatives, member projects and tax cuts.



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Kurt Wenner, Vice President for Tax Research, is a mainstay on the Tallahassee state budget watchdog scene and is the second-longest serving staff member of Florida TaxWatch.

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