BUDGET WATCH

Florida TaxWatch

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Volume 12, Issue 1 • January 2006

This report was initially released electronically before being printed in hardcopy format

2006-07 State Budget Outlook
With Florida Coffers Flush, the Legislature Should Balance Smart Tax Relief With a Significant Investment in Paying Down State Debt and Investing in Infrastructure

As the 2006 Legislature crafts the new state budget for 2006-07, it will have to make decisions on what to do with a large pot of taxpayer money that will be available even after current programs are funded, including cost increases for the new year.

Florida's tax system has been producing revenue much faster than previously anticipated. The last General Revenue Estimating Conference provided the Legislature with an additional $3.2 billion for the next budget. **The state now has $5.6 billion more in general revenue for 2006-07 than it is spending this year on recurring programs.** The current property tax millage rate the Legislature requires school districts to levy (Required Local Effort) could free up an **additional $1 billion** for other uses.

This additional general revenue does not include robust growth in many state trust funds (*see summary of other revenue sources in back of this report*).

There will be much debate over what to do with the non-recurring portion of this money, which totals $3.76 billion. There has already been talk of providing tax relief to Floridians. Florida TaxWatch applauds this bi-partisan commitment and supports smart tax relief but also recommends that a large portion of this non-recurring revenue be used to pay down the state debt or avoid issuing new debt. This will strengthen the long-term fiscal position of Florida by reducing future debt service requirements.

Assuming that a 10% reduction in outstanding tax-supported debt translates into a 10% deduction in debt service payments, **if the Legislature uses $1.75 billion of the available non-recurring funds to pay down the debt, approximately $160 million in annual debt service payments would be avoided. If the state forgoes a new bond issue, savings could continue for 30 years. Based on the projected interest payments**

for bonds authorized in 2005-06, the $1.75 billion would avoid nearly $3.5 billion in debt service over 30 years ($1.75 billion in principal and $1.7 billion in interest.)

General Revenue Estimates Added $3.2 Billion to State Coffers

The state's Consensus Estimating Conference met in November 2005 to revise its projections for Florida's General Revenue Fund. Florida's economy and its tax structure are continuing to perform well. The estimate for the current year's (FY 05-06) collections was increased by $1.7 billion (7%), and the estimate for FY 2006-07 was raised by $1.5 billion (6%). As a result, lawmakers will have $3.2 billion more than previously anticipated when they begin crafting the new state budget for FY 2006-07.

Housing has been a key to Florida's recent revenue generating performance. Collections of documentary stamp taxes, intangibles taxes on mortgages, and sales taxes have increased greatly and continue to produce above estimates.

In addition to housing, sales tax collections were boosted by hurricane reconstruction efforts as well as evacuees from other states spending money in Florida. In addition, estimated growth of 26.7% in the corporate income tax reflects Florida's economic strength and robust corporate profits.

Economy Expected to Slow

This good news is tempered by the fact that the new forecasts show an economic slow down beginning. Although Florida's economy continues to fare better than most of the rest of the nation, it is expected that economic activity will moderate. This is due to the belief that the real estate boom is cresting. In addition, higher energy prices and interest rates will divert spending from other transactions, reducing sales tax collections. Corporate profits are also expected to slow, as insurance companies face hurricane claims and increased costs hit other corporations.

Following annual growth in general revenue collections of 9.2% in FY 2003-04 and 14.4% in FY 2004-05, the state is expected to bring in 5.8% more in FY 2005-06. However, that growth slows to 1.2% next year.

The 2006-07 Budget

The new estimates predict that the Florida Legislature will have $30.5 billion in general revenue available for the 2006-07 budget. This is $3.7 billion (13.8%) more than the $26.8 billion in general revenue spending during the current year. Of the $30.5 billion, $26.7 billion is recurring revenue and $3.8 billion is non-recurring.

General Revenue Financial Outlook for Next Year

The current 2005-06 state budget is now expected to have a $3.531 billion surplus in general revenue. This means that more than $3.5 billion of current year revenue will not be spent and will be available for the 2006-07 budget.

The summarized financial outlook statement below illustrates the fiscal condition of the state heading into next year's budget negotiations. There is expected to be $26.706 billion in recurring general revenue to fund $24.819 billion in recurring spending during 2006-07. There will also be $3.76 billion in non-recurring general revenue available.

Combined General Revenue and Working Capital Funds
Financial Outlook Statements
(millions $)

	Recurring	Non-Recurring	Total
Funds Available 2005-06			
Balance Forward from 04-05	0.0	3,570.6	3,570.6
Estimate Revenues	25,859.5	546.2	26,405.7
Transfers from Trust Funds	0.0	17.2	17.2
Reversions	0.0	227.0	227.0
Other Adjustments	(4.3)	85.7	(81.4)
	25,855.2	4,446.7	30,301.9
Appropriations 2005-06			
Operations	12,192.3	1,288.9	13,481.2
Aid to Local Governments	12,606.1	115.0	12,721.1
Fixed Capital Outlay	20.1	240.2	173.3
Other Adjustments	0.6	297.2	297.8
Total Effective Appropriations	24,819.1	1,951.3	26,770.4
Ending Balance/Working Capital Fund	1,036.1	2,495.4	3,531.5
Funds Available 2006-07			
Balance Forward from 05-06	0.0	3,531.5	3,531.5
Estimated Revenues	26,710.7	6.4	26,717.1
Other Adjustments	(4.3)	221.7	217.4
Total 2006-07 Funds Available	26,706.4	3,759.6	30,466.0

Source: Florida Legislature, Office of Economic and Demographic Research.

This means there is $26.706 billion to fund a continuation general revenue budget of $24.819 billion, before workload, caseload and price increases, as well as any new spending. This leaves about $1.9 billion to pay for these items.

Below are some estimates of additional recurring general revenue spending (above the current year base) needed for the upcoming budget.

Program	***Additional Recurring Expenses (million $)***
Medicaid Increase	$596
Other Social Services	100
Class Size Amendment	560
New K-12 Students	235
Universities	165
Community Colleges	90
Criminal Justice	150
Salaries Increases and Annualizations	100
Total	$1.996 billion

The above numbers are the amount needed over and above what is in the current budget. For example, the Medicaid increase is the general revenue portion of the latest projection of the total increase in Medicaid expenditures for next year from the October 2005 Social Services Estimating Conference. The Medicaid budget is expected to climb to almost $16 billion, an increase of 6.2%. The general revenue share of this is expected to be just over $5 billion, a 14.5% increase over last year. So, based on current estimates, the state will spend $596 million more in general revenue next year than it will this year.

Although these estimates would deplete the $1.9 billion in additional general revenue available, it should be noted that lower than anticipated K-12 enrollment may reduce the education costs by $150 million. Similarly, lower than expected enrollment in the state's Pre-Kindergarten program means that there is more than enough money in the base to fund next year's Pre-K expenditures, if the rate the state pays stays the same. The state could, and perhaps should, work to increase enrollment, or even increase rates. But if not, Pre-K will not need as much money as appropriated last year.

The biggest adjustment to this budget outlook is the Required Local Effort (RLE) millage rate. This is the rate local school districts must levy in order to participate in the Florida Education Finance Program (FEFP), the state's basic school funding program. The RLE for 2005-06 was set by the Legislature at $6.3 billion, resulting in a millage rate at 5.239. Due to skyrocketing property values, the value of the current rate will increase dramatically next year. For next year, a RLE of 5.239 mills would be worth $7.8 billion. A requirement in law that ensures that no school district's revenue from required local effort will produce more than 90% of the district's total FEFP calculation means that the RLE would not actually produce all that revenue. However, it is anticipated that it would produce approximately $1 billion more than last year. Unless the Legislature changes the RLE, school districts will be providing $1 billion more next year, meaning the state would need $1 billion less in general revenue to fund the base budget.

The numbers below approximate the amount of general revenue the Legislature will have to decide what to do with after they fund a continuation budget adjusted for major cost increases:

	Recurring	Non-Recurring	Total
General Revenue Funds Available	$26,706	$3,760	$30,466
Less Current Year Recurring Appropriations	(24,819)		(24,819)
Increased Funds Available 2006-07	**1,887**	**3,760**	**5,647**
Increased RLE (current millage)	1,000		1,000
Less Additional Costs (see above)	(1,996)		(1,996)
Funds Remaining	**$891**	**$3,760**	**$4,651**

It appears the Legislature will have over $4 billion to fund new projects or programs, enhance existing programs, provide tax relief, and, as Florida TaxWatch has recommended, pay down the state debt.

Most of the money is non-recurring. Some necessary non-recurring expenses will certainly arise, but the state will have a significant amount of one-time revenue available for this upcoming budget. We must repeat our long-standing caution against using non-recurring revenue for recurring expenses. Because there does not appear to be a recurring general revenue crunch, the temptation may not be as great to use the non-recurring money in this way.

Tax Relief Proposals

There will be a lot of support for tax relief in this session. Both the House Republicans and House Democrats have already unveiled their plans for tax cuts. The Republicans offered a one-week sales tax holiday on virtually all taxable items, limited to the first $5,000 of the sales price of any item. It is intended for individuals, so business purchases would not be exempt. The sales tax holiday is proposed for July 31 through August 6. The sales tax holiday would cost the state $460 million and local governments $40 million. Local option sales taxes would still be in effect, but locals would lose some money from revenue sharing of the state sales tax.

House Democrats countered with a plan to send a $100 check to homeowners. The tax refunds would only go to owners of homestead property and is expected to cost $427 million. This idea has the benefit of returning tax money to homeowners who paid a large portion of the additional taxes from real estate transactions, housing prices, and hurricane rebuilding.

Another way of providing relief to homeowners (and all property owners) would be to reduce the Required Local Effort.

The Governor will certainly unveil his plan for tax relief when he releases his budget recommendations. Florida TaxWatch continues to support eliminating taxes that discourage job creation, economic growth, and diversification. This includes tax exemptions for equipment for research and development and manufacturing expansion. Florida TaxWatch also continues to urge the Legislature to eliminate the last phase of the antiquated Intangibles Tax and the last third of the impractical Alcoholic Beverage Surcharge.

There is enough money available to provide significant tax relief and still pay off a good portion of the state's long-term debt.

The Time is Right for Debt Reduction

Florida TaxWatch recommends that the state use a large portion of this non-recurring revenue to pay off some of the $22.5 billion in state debt or avoid issuing new debt. This is a smart way to improve the long-term fiscal health of the state and cuts debt service costs, in effect providing annual additional general revenue dollars that can be used for other things.

Using less than half of the available non-recurring money for debt reduction would yield considerable savings. Of the $22.5 billion in outstanding state debt, $17.5 billion is tax-supported debt (the rest is self-supported debt, such as toll roads). The state is currently paying approximately $1.6 billion a year in debt service on that debt. That amount will stay relatively stable until 2014 when the Preservation 2000 bonds mature. Assuming that a 10% reduction in outstanding tax-supported debt translates into a 10% deduction in debt service payments, **if the Legislature uses $1.75 billion of the available non-recurring funds to pay down the debt, approximately $160 million in annual debt service payments would be avoided. If the state forgoes a new bond issue, savings could continue for up to 30 years. Based on the projected interest payments for the bonds authorized in 2005-06, the $1.75 billion would avoid nearly $3.5 billion in debt service over 30 years ($1.75 billion in principal and $1.72 billion in interest).**

Florida TaxWatch also supports increased investment in needed infrastructure. The Legislature made a big commitment last year when it pledged $750 million a year for local infrastructure needs. Investing in critical infrastructure not only helps meet critical growth management demands to improve Florida's quality of life, it also helps grow and sustain the foundation/catalyst of a healthy and diversified Florida economy.

Let the tax cut discussion begin. Tax cuts are certainly an appropriate use of surplus funds but let's not forget about the long-term debt. There should be an equal or greater emphasis on cutting the debt. By reducing long-term debt, the state gives taxpayers a gift that keeps on giving by saving hundreds of millions of dollars in debt service payments. Debt reduction would not produce ribbon-cuttings or bill-signing ceremonies, but it is a true fiscally conservative response to all of this available revenue. With the positive financial outlook the state finds itself in today, and the uncertainty of the future, now is the perfect time to take these steps to focus on the long-term fiscal health and stewardship of our state.

Other Revenue Estimates

The following summarizes the results from the State's Revenue Estimating Conference latest meetings to forecast other state revenue sources.

Documentary Stamp Tax

In November, the latest forecast reflected a strong real estate market, with rapidly increasing prices and a high number of transactions. Rebuilding from the hurricanes also contributed to increased revenue. Although total collections are projected to drop in FY 2006-07 by almost half-a-billion dollars as real estate prices slow, the state will still bring in more than $700 million more from this source than previously forecast.

Doc stamp revenues are distributed for several uses, including general revenue, debt service, land acquisition and affordable housing. Last year, the Legislature committed $750 million of this revenue annually for local infrastructure/growth management needs.

The $3.2 billion in total doc stamp collections will go to general revenue ($865 million), local infrastructure ($750 million), and debt service and other trust funds ($1.6 billion). It should be noted that a new law caps annual distributions to other trust funds beginning in FY 2007-08. This will add $571 million to general revenue in 2007-08, and that amount is expected to grow to almost $1 billion annually by 2015.

Gross Receipts Tax

This tax on electricity, natural and manufactured gas, and telecommunications, is now expected to raise $971 million in 2007-08. This is $70 million more than previously forecast but only $25 million (2.7%) more than last year. While collections from electricity increased 10%, collections from gas and telecommunications fell.

These funds go to PECO (Public Education Capital Outlay), the state's school building program.

Lottery

Despite reductions in projected sales of lottery tickets, the estimate of the amount of money transferred to the Education Enhancement Trust Fund (EETF) for schools was increased by $156 million over two years, including $77 million in 2006-07. This is due to a change in the way that the Lottery transfers proceeds to the EETF. The department is now transferring each month any amount above its appropriated expenses, instead of being transferred in the subsequent fiscal year. This results in more revenue being transferred within the fiscal year.

The EETF is now expected to have $1.431 billion available in 2006-07, compared to the estimated $1.138 billion that will be spent in the current year.

Transportation Revenue

The Transportation Revenue Estimating Conference also increased its estimate of revenues for the State Transportation Trust Fund. The conference raised the revenue estimate for the current Department of Transportation work program period (2005-06 through 2010-11) by $449.9 million, or 2.5%. The forecast was increased for all but one revenue source. Gasoline consumption was higher than anticipated and collections from both the rental car surcharge collections and the aviation fuel tax are showing improvement after a long slow-down following the terrorist attacks of 9/11.

Transportation revenues are expected to total $2.884 billion in 2006-07, up $162 million (5.9%) from the current year.

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