December 2018 Quarterly Revenue Forecast

Overview of Economic Outlook

Today the Legislative Council Staff (LCS) and the Office of State Planning and Budgeting (OSPB) gave their December forecasts. Sen.-Elect Lee, Sen. Court, Rep. Kraft-Tharp, Rep. McKean, Rep.-Elect Bird, Rep. Hooton attended along with the Joint Budget Committee for the December 2018 Revenue Forecast. OSPB saw more uncertainty since September, but not enough to make a large revision to the forecast. The largest difference between the two forecasts is that LCS expects a larger slow down in growth in the future years.

Growth in the third quarter was strong, but restrained by federal tariffs. The unemployment rate in Colorado has averaged 2.9% which still lower than the national rate. Employment grew by 2.7% however, it is expected to slow to 1% by 2020. Almost all industries have added jobs this quarter. As the expansion continued, the Federal Reserve has ratcheted up interest rates and it is expected that rate hikes will slow in 2019. Higher mortgage rates have cooled off the housing market. Construction costs have risen this year primarily due to tariffs on lumber. With softening demand for real estate, houses are staying on the market longer. Home values continue to rise, but at a slower pace. There has been a slow down in the growth rate of new jobs in the metro area, but growth remains strong. With this slow down in job growth, there has been an increase in wages as employers have sought to attract and retain workers. Wage growth is at the highest level during the expansion.

SHORT TERM

- Continued growth above September forecast
- Cooling housing market
- Agriculture market hardest hit by tariffs.

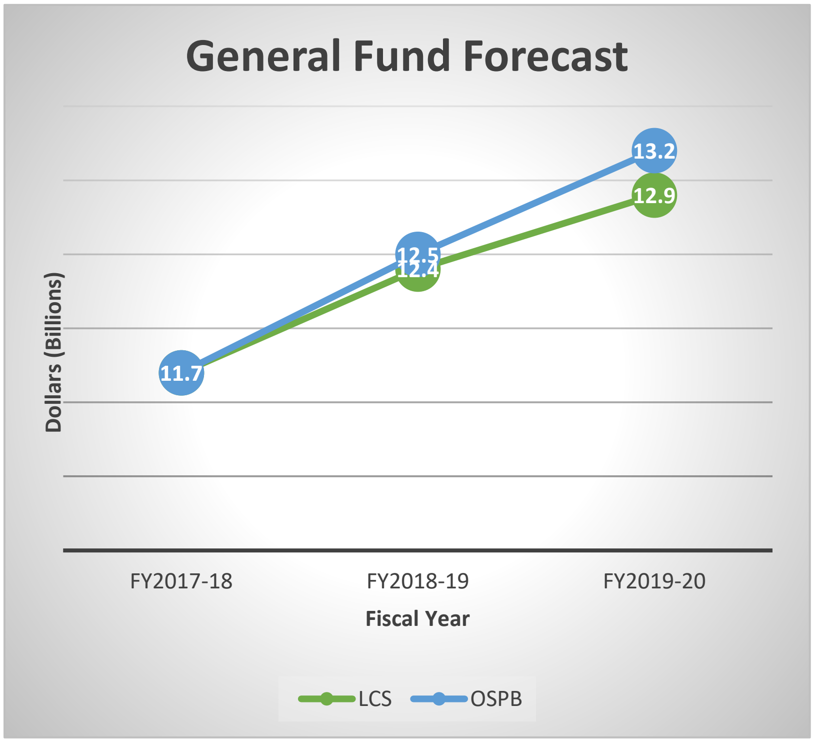
Trade activity has remained elevated and imports and exports have grown. Imports have grown by 5.9% and exports have grown by 5.4% from the previous year. Trade activity is expected to slow in 2019. Negotiations with China are ongoing and an agreement has been reached in North America, but the tariffs are expected to remain in effect. The agricultural market has been hit the hardest from the new tariffs. Many countries can provide the same exports and there has been a shift in supply from the United States to other producing similar agricultural products. China has looked to South America for some agricultural exports rather than the United States. Farm income in Colorado has been dropping due to decades of low prices on a number of key commodities. Tariffs have created a stockpiling of certain items such as soybeans. This glut of soybeans will potentially affect corn and wheat prices into the next year.

Oil prices have dropped almost 40% since October, despite Organization of the Petroleum Exporting Countries' (OPEC) intention to cut production. US production is at an all time high. The volatility in the oil market is expected to continue.

LONG TERM

- Slower economic growth
- $3 million decrease in State aid for school finance in FY2019-20
- 2019 RAR projected at 6.78% for 2019

Growth will continue, but at a slower pace. Lower unemployment, a cooling housing market, higher interest rates and higher construction costs will all contribute to a slower growth rate.



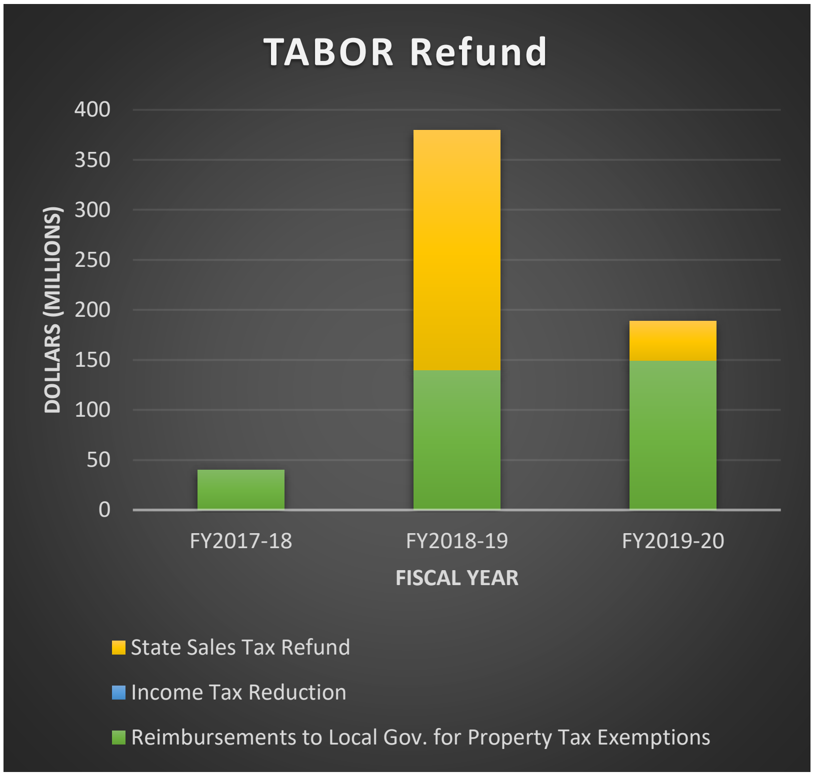
General Fund Forecast
LCS increased their General Fund forecast by $151 million compared to their September Forecast. In FY2017-18 there was double digit 14% growth in the General Fund due to a number of one time anomalies that are not expected to continue. This year revenue is expected to grow at 6.2% from the previous year. Since the September Forecast OSPB has also seen more revenue come in. OSPB forecast for FY2018-19 is higher by $93 million compared to the September forecast. Most states which recently updated their revenue forecasts have projected higher revenues. OSPB forecasts that FY2018-19 General Fund revenue will total $12.5 million while LCS projects $12.9 million.

The Wayfair Decision, which requires online out of state retailers to begin to collect and remit sales and sue taxes, was incorporated into the forecast for December. This change in tax collection contributed to an additional $20 million in revenue and next year it is forecasted to cause a $90 million increase in revenue.

In September, LCS expected revenue to come in $600 million above the statutory reserve for FY2017-18. The December Forecast predicts the revenue for FY2017-18 above the statutory reserve to total $691 million for a year end total reserve of $1.3 billion. In September the expected excess reserve above the statutory reserve for FY2018-19 was predicted to be $230 million. Now LCS expects the reserve surplus to be $296 million for FY2018-19. Because of the revenue levels, these increases in revenue impact the TABOR refunds.

TABOR Refunds

The December 2018 Revenue Forecast from LCS predicts a $380.4 million TABOR refund for FY2018-19. FY2019-20 is predicted to have a lower TABOR refund at $188.9 million and FY2020-21 is predicted not to trigger a TABOR refund. OSPB predicts higher TABOR a higher surplus of $394.4 million in FY2018-19 and $525.8 million in FY2019-20.



There are three TABOR Refund mechanisms. Based on calculations of what is likely to be collected by local governments, the first $140 or $150 million of TABOR refunds goes to reimburse local governments for revenue lost from property tax exemptions. A TABOR surplus of roughly $400 million is enough to trigger an income tax rate reduction. While this forecast does not predict an income tax reduction TABOR refund mechanism, the forecasted $380 million is very close and within the margin of error. If there is not sufficient revenue for an income tax rate reduction, overages go to the 6 tier sales tax refunds. In March the data will begin to show how taxpayers closed out the year and there will be one month of data for individual filers and how that revenue is tracking. There will be more confidence in March about the federal tax changes and the implications for the state revenue.

There is room for error in the forecast that could drive increased revenue collection due to increased economic activity, federal tax policy distortions, and out of state collections. These factors could lead to a higher TABOR refund because any additional revenue subject to TABOR restrictions will contribute to the TABOR surplus. In the longer term outlook for the TABOR , slower growth will lead to a lower TABOR revenue outlook.

Assessed Valuation Forecast

Under the Gallagher Amendment, the residential assessment rate (RAR) is reset every two years to keep the assessed value ratio between residential property and non-residential property at 45:55.

$1.22 Billion Additional Revenue

It is estimated in FY2019-20 that lawmakers will have an additional $1.22 billion compared with the previous year to spend, save, or refund to taxpayers.

Changes in the value of residential and non-residential property drives the change in the residential assessment rate. 2019 is a reassessment year. All types of residential and non-residential property will be re-assessed. Actual values are expected to go up for residential property and non-residential values are also expected to increase. Non-residential assessed value is expected to increase 10.5% in 2019 and residential assessed value is expected to increase 9.5%. The increase in non-residential assessed value is largely attributable to booming oil and gas production in 2018. The 16% growth in residential property actual values compared to the 10% growth in non-residential property will lead to a lower RAR this cycle.

LCS is predicting a 6.78% RAR for 2019 and 2020. This is a 67 basis point reduction form the current 7.2% rate. The RAR was previously predicted to drop to 6.11%. Part of this difference in the forecast is due to oil and gas production. Oil production is up by 33%. Last December, oil and gas growth was expected to be only about 5%. Looking forward, the Division of Property Taxation will give a report in January with a more formal report on the expected RAR and they update the report in April which has in the past been used to set the RAR.

The RAR is used to calculate local property taxes which fund schools, local governments, and special districts. 12 school districts will see a reduction in assessed value and 65 school districts will grow their assessed value less than 2%. The largest decreases in assessed values are in Clear Creek because of a declining molybdenum mine in the Clear Creek County School District.

School Finance and Enrollment Outlook

Each December, Legislative Council Staff (LCS) reports on the K-12 enrollment forecast for the upcoming years. In FY2018-19 there are just over 500 more students from the previous year for a total of 838,079 students. Lower birth rates and delayed household construction has depressed enrollment. Northern, and Colorado Springs has seen the highest growth in enrollment, while the metro Denver area saw a 0.3% decrease. However, these growth rates for Northern Colorado and Colorado Springs are still modest, hovering around 1%. For the upcoming FY2019-20 enrollment trends are expected to remain flat adding 900 students roughly or a 0.1% increase.

For FY2018-19 there has been a reduction in the overall funded per pupil count of 1,000 and the funded at risk per pupil count decreasing by 10,000 which saves the state $22 million in total program requirements. At the same time, the local share has increased by $57 million relative to expected forecasts last spring. This leads to a reduction in the state required aid of $79 million for FY2018-19. The General Assembly has several options including reducing the state aid portion of school finance and buying down the budget stabilization factor to $593 million. For FY2019-20 the local share of K-12 school finance is expected to rise $252 million and the state aid requirement is expected to decrease $3 million. This leaves more budgetary flexibility.

Corrections Population Forecast

These are published annually for the adult prison population and the adult parole program. Last year, LCS anticipated increase in the prison population. How we have data for year end prison population for FY2017-18 and this actual number was 174 inmates higher than last year's forecast. This is a relatively small change. This forecast is difficult because it involves human inputs including individual offenders, the parole boards, and judges. The rate of prison population growth is lower than previously forecasted. The forecast predicts there will be 20,432 adult inmates in June 30, 2019. This projection is lower than what was projected in the December 2017 forecast. The forecast focuses on new court commitments, parole violations, and conviction of parolees. The most important determinate of the forecast is because of new court commitments which shows an increase. The primary reason for new court commitments is because more felony cases are filed. Felony case filings have grown at a higher rate than state population since FY2015-16. They have adjusted the forecast trend slightly downward because the felony case filings are slowing. The other side of the corrections population are releases. Trends in releases are primarily driven by policy changes related to early release and parole changes. LCS anticipates higher rates of discretionary parole releases in the future. Also, new court commitments are expected to increase. Also parole population will increase, but not enough to offset the new court commitments. The forecast does not take capacity into consideration. There are three populations in Division of Youth Services (DYS), the commitment population that is in for longer terms, parole population after commitment, and detention a much shorter sentence about 2 or 3 weeks. These populations have decreased across the past decade. The forecast anticipates the populations to decline. The population for commitments shows a declining trend from 647 to 609 average daily population. This is a reduction of 38 youths over three years, it is not a major decrease. Reductions for parole and detention populations are also expected to decrease.