State Budget Outlook

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Colorado School Finance Project
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State Budget Outlook

• Why is the near-term budget outlook so strong?
• Why are the risks to the forecast so high?
• What is the longer-term outlook?
Economic Summary

The near-term outlook is bright
• Wages are rising as the labor market tightens
• Stronger global demand is contributing to inflationary pressures
• Business investment and profits are elevated
• Consumer spending continues to rise

Risks remain elevated
• Risk of overheating in the late stages of expansion
• Rising interest rates will shift investor behavior
• Geopolitical risk and policy uncertainty cloud the outlook

Sales tax and income tax collections have accelerated in FY 2017-18.

Year-over-Year Percent Change in State Tax Collections

Source: Colorado Office of the State Controller. Data are seasonally adjusted by Legislative Council Staff and shown as three-month moving averages to further smooth calendar effects and unusual collections patterns.
Risk #1: TCJA-related distortions are difficult to disentangle from underlying economic growth.

Change in General Fund Revenue by Major source
July 2017 through February 2018 (First 8 Months) over the same period last year
Dollars in Millions

<table>
<thead>
<tr>
<th>Source</th>
<th>Change Relative to Last Year</th>
</tr>
</thead>
<tbody>
<tr>
<td>Withholding</td>
<td>$305.1 +8.3%</td>
</tr>
<tr>
<td>Estimated Payments</td>
<td>$213.0 +29.0%</td>
</tr>
<tr>
<td>Refunds</td>
<td>$47.6 +11.7%</td>
</tr>
<tr>
<td>Cash with Returns</td>
<td>$32.3 +13.0%</td>
</tr>
<tr>
<td>Corporate Income</td>
<td>$77.3 +32.6%</td>
</tr>
<tr>
<td>Sales</td>
<td>$128.3 +7.0%</td>
</tr>
<tr>
<td>Use</td>
<td>$30.3 +17.8%</td>
</tr>
</tbody>
</table>

Source: Colorado Office of the State Controller.
February 2018 data are preliminary and provided by the Department of Revenue.

Partially attributable to pre-paying state income tax; May also reflect higher capital gains.

The LCS revenue forecast was revised upward significantly on stronger collections to date and a stronger economic outlook.

Gross General Fund Revenue
Billions of Dollars

Change Relative to December

Source: Colorado Office of the State Controller and Legislative Council Staff March 2018 forecast.
Amounts include estimated impacts of the federal Tax Cuts and Jobs Act.
OSPB and LCS General Fund revenue forecasts differ, yet budget outlooks converge in FY 2018-19.

Risk #2: State revenue impacts of the federal Tax Cuts and Jobs Act remain uncertain.

New revenue will flow to both the General Fund and State Education Fund.
Tax Bill Provisions with the Largest Colorado Impacts

The federal tax bill broadens the tax base and lowers federal tax rates. For the state of Colorado, the bill broadens the tax base, while rates remain constant.

Individual Income Tax
- Roughly doubles the standard deduction
- Modifies several itemized deductions
- Repeals the deduction for personal exemptions

Businesses Income Tax
- Allows a 20% deduction for pass-through entities
- Allows immediate expensing for depreciation of property
- Limits interest and net operating loss deductions

The federal tax bill broadens the tax base and lowers federal tax rates.

For the state of Colorado, the bill broadens the tax base, while rates remain constant.

How Are Individual Income Taxes Calculated?

At the federal level, the federal tax bill broadens the tax base and lowers tax rates. On net, these changes lower taxes owed by most taxpayers and lower federal tax revenue.
How Are Individual Income Taxes Calculated?

**Federal**

\[
\text{Federal Taxable Income} = \text{Federal Taxable Income} - \text{State Subtractions} + \text{State Additions} - \text{State Tax Credits} \times \text{State Tax Rate} \]

\[
\text{Net Federal Taxes Owed} = \text{Federal Taxable Income} - \text{State Tax Credits} \times \text{State Tax Rate} \]

**Colorado**

\[
\text{Colorado Taxable Income} = \text{Federal Taxable Income} \times 4.63\% \]

\[
\text{Net Colorado Taxes Owed} = \text{Colorado Taxable Income} - \text{State Tax Credits} \times \text{State Tax Rate} \]

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**FY 2017-18 General Fund Reserve**

**Millions of Dollars**

<table>
<thead>
<tr>
<th>December 2017 Expectations</th>
<th>March 2018 Expectations</th>
</tr>
</thead>
<tbody>
<tr>
<td>$900</td>
<td>$171.8M Above Required Reserve 8.1% Reserve</td>
</tr>
<tr>
<td>$800</td>
<td>$681.7M</td>
</tr>
<tr>
<td>$700</td>
<td>$675.4M 6.5% Reserve Requirement</td>
</tr>
<tr>
<td>$600</td>
<td>$34.7M Above 6.8% Reserve</td>
</tr>
<tr>
<td>$500</td>
<td></td>
</tr>
<tr>
<td>$400</td>
<td></td>
</tr>
<tr>
<td>$300</td>
<td></td>
</tr>
<tr>
<td>$200</td>
<td></td>
</tr>
<tr>
<td>$100</td>
<td></td>
</tr>
<tr>
<td>$0</td>
<td></td>
</tr>
</tbody>
</table>

Source: Legislative Council Staff forecasts based on current law.
Amounts include estimated impacts of the federal Tax Cuts and Jobs Act.
FY 2018-19 Budget Outlook
General Funds available above FY 2017-18 appropriations to spend, save, or return to taxpayers
Millions of Dollars

December 2017 Expectations

March 2018 Expectations

$962.7 million

$1,291.6 million

Increased revenue expectations and FY 2017-18 budget decisions

Source: Legislative Council Staff forecasts based on current law. Amounts include estimated impacts of the federal Tax Cuts and Jobs Act.

March 2018 TABOR Outlook
Revenue Subject to TABOR
Dollars in Billions

Source: Colorado Office of the State Controller and Legislative Council Staff March 2018 forecast.
TABOR Refund Budget Impacts

General Fund

Set-Asides... …go toward reimbursements to local governments for property tax exemptions in the next fiscal year*

<table>
<thead>
<tr>
<th>Fiscal Year</th>
<th>FY 2018-19</th>
<th>FY 2019-20</th>
</tr>
</thead>
<tbody>
<tr>
<td>Amount</td>
<td>$8.4 million</td>
<td>$8.4 million FY 2018-19 surplus +$21.8 million FY 2014-15 remaining surplus $30.3 million toward reimbursements</td>
</tr>
</tbody>
</table>

FY 2019-20

<table>
<thead>
<tr>
<th>Amount</th>
<th>$156.4 million</th>
</tr>
</thead>
</table>

FY 2020-21

<table>
<thead>
<tr>
<th>Amount</th>
<th>$156.4 million toward reimbursements</th>
</tr>
</thead>
</table>

*Pursuant to SB17-267, the TABOR refund is first allocated toward reimbursements to local governments for the senior homestead and disabled veteran property tax exemption. Local government reimbursements are not reduced. Instead, TABOR surplus revenue is set aside to pay for these reimbursements in the following budget year.

Risks to the revenue forecast are elevated

1. Unusual shifts in taxpayer behavior in recent months
2. Federal Tax Cuts and Jobs Act impacts remain uncertain
3. Late stages of the economic expansion, more susceptible to shocks
While the near-term budget situation is relatively rosy, budgetary pressures will persist over the long term.

* **Aging population** = lower per capita income and sales tax

* **State tax structure constraints**
  - Shifts from brick and mortar to online, from goods to services
  - Erosion of gas tax revenue with higher fuel efficiency
  - TABOR Amendment limits revenue the state may spend or save
  - Gallagher Amendment requires the residential assessment rate to fall

* **Demand for services outpacing revenue growth**
  - Amendment 23 K-12 funding requirements
  - Aging infrastructure
  - Population growth

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Risk #3: How long can the expansion last?

**Unemployment Rate**

- **US:** 4.1%
- **CO:** 3.0%

**Nonfarm Employment Growth, Year-over-Year Change**

- **CO:** 2.6%
- **US:** 1.5%

**Labor Force Participation Rate**

- **CO:** 68.5%
- **US:** 63.0%
Oil prices are increasing...
Price per Barrel of Oil Received by Colorado Producers

...leading to more production.

Value of Colorado Oil and Gas Production


Assessed values under current assessment rates.

Actual Values × Assessment Rate = Assessed Values

Source: Division of Property Taxation and Legislative Council Staff December 2017 forecast.
Assessed values under forecast assessment rates. 
Actual Values × Assessment Rate = Assessed Values

Non-Residential
29% assessment rate

Residential

Source: Division of Property Taxation and Legislative Council Staff December 2017 forecast.

Change in Residential Assessed Values by County
2016 to 2017

Source: Department of Local Affairs, Division of Property Taxation.
Change in Total Assessed Values by County
2016 to 2017

Source: Department of Local Affairs, Division of Property Taxation.