

**SENATE FISCAL AGENCY
MEMORANDUM**



DATE: January 16, 2015

TO: Members of the Senate

FROM: David Zin, Chief Economist
Kathryn Summers, Associate Director

RE: Consensus Revenue Estimates for FY 2014-15, FY 2015-16, and FY 2016-17 and School Aid Foundation Allowance Index Estimate for FY 2015-16

The Senate Fiscal Agency, House Fiscal Agency, and Treasury Department held a Consensus Revenue Estimating Conference on January 16, 2015, and unanimously adopted revised revenue estimates for fiscal year (FY) 2014-15 and FY 2015-16, initial estimates for FY 2016-17, and an estimate of the School Aid Foundation Allowance Index for FY 2015-16. The new consensus revenue estimates for General Fund/General Purpose (GF/GP) and School Aid Fund (SAF) revenue are summarized below and in [Tables 1, 2](#) and [3](#). The School Aid Foundation Allowance Index estimate is also discussed below.

General Fund/General Purpose

The revised consensus estimate for GF/GP revenue from ongoing revenue sources for FY 2014-15 is \$9,501.4 million, which is up 5.4% or \$482.9 million from preliminary FY 2013-14 final revenue. The relatively strong growth in GF/GP revenue primarily reflects steady economic growth combined with three noneconomic factors: 1) an increase in insurance tax revenue due to the revenue impact of the Blue Cross Blue Shield demutualization, 2) a reduction in the number and amount of credits claimed under the Michigan Business Tax (MBT) by businesses with certificated credits (although the revised estimate expects an increase in credits relative to the prior FY 2014-15 estimate), and 3) a decline in refunds, largely due to accounting rules affecting accruals, under the individual income tax. Compared with the May 2014 consensus revenue estimate, this revised estimate is \$324.6 million lower. In FY 2015-16, GF/GP revenue will total an estimated \$9,713.2 million, which is up 2.2% or \$211.8 million from the revised estimate for FY 2014-15. Compared with the May 2014 consensus revenue estimate, the revised estimate for FY 2015-16 is down \$532.1 million. This decrease in FY 2015-16 GF/GP revenue is largely attributable to increases from an improving economy being more than offset by an increase in MBT credits and other tax changes that reduce revenue. The initial estimate for FY 2016-17 GF/GP revenue is \$10,000.6 million, an increase of 3.0% or \$287.4 million from the revised FY 2015-16 estimate. The growth in FY 2016-17 GF/GP revenue reflects relative stability in both tax policy and tax credits, combined with a slightly better economy.

School Aid Fund

School Aid Fund earmarked tax and lottery revenue will total an estimated \$11,889.1 million in FY 2014-15, which is up 3.2% or \$368.6 million from the preliminary final revenue level for FY 2013-14. Compared with the May 2014 consensus revenue estimate, this revised estimate is up \$35.8 million. In FY 2015-16, SAF revenue will total an estimated \$12,263.7 million, which is up 3.2% or \$374.6 million from the revised estimate for FY 2014-15, and \$5.6 million above the May 2014 forecast. The initial estimate for SAF revenue in FY 2016-17 is \$12,640.9 million, an increase of 3.1% or \$377.2 million from the revised estimate for FY 2015-16.

Total General Fund/General Purpose and School Aid Fund Revenue

Total GF/GP and SAF revenue will amount to an estimated \$21,390.5 million in FY 2014-15, up 4.1% or \$851.6 million from the preliminary final revenue level for FY 2013-14, but \$288.8 million below the May 2014 consensus revenue estimate. For FY 2015-16, GF/GP and SAF revenue will total an estimated \$21,976.9 million, an increase of 2.7% or \$586.4 million from the revised estimate for FY 2014-15. The initial estimate of FY 2016-17 combined GF/GP and SAF revenue totals \$22,641.5 million, an increase of 3.0% or \$664.6 million from the revised estimate for FY 2015-16.



Table 1

| FY 2014-15 REVENUE ESTIMATE COMPARISON & CONSENSUS AGREEMENT | | | | | | | | |
|---|--------------------|----------------------|----------------------------------|-------------------|-------------------|---------------------|------------------|-----------------|
| General Fund/General Purpose (GF/GP) and School Aid Fund (SAF) | | | | | | | | |
| January 16, 2015, Consensus Revenue Estimating Conference | | | | | | | | |
| (Millions of Dollars) | | | | | | | | |
| | FY 2014-15 | | | | | FY 2014-15 | \$ Change | % Change |
| | FY 2013-14 | Previous | Revised Revenue Estimates | | | | | |
| | Preliminary | FY 2014-15 | Treasury | House | Senate | Consensus | from May | from |
| | Final | Consensus | Department | Fiscal | Fiscal | Est. 1/16/15 | 2014 | FY |
| | | Est. May 2014 | | Agency | Agency | | Consensus | 2013-14 |
| Net GF/GP Revenue | \$9,018.5 | \$9,826.0 | \$9,551.2 | \$9,445.6 | \$9,617.3 | \$9,501.4 | (\$324.6) | 5.4% |
| Net SAF Revenue | \$11,520.5 | \$11,853.3 | \$11,876.2 | \$11,872.2 | \$11,849.7 | \$11,889.1 | \$35.8 | 3.2% |
| Net GF/GP & SAF Revenue | \$20,538.9 | \$21,679.3 | \$21,427.4 | \$21,317.8 | \$21,467.0 | \$21,390.5 | (\$288.8) | 4.1% |

Table 2

| FY 2015-16 REVENUE ESTIMATE COMPARISON & CONSENSUS AGREEMENT | | | | | | | | |
|---|---------------------|----------------------|----------------------------------|-------------------|-------------------|---------------------|------------------|-----------------|
| General Fund/General Purpose (GF/GP) and School Aid Fund (SAF) | | | | | | | | |
| January 16, 2015, Consensus Revenue Estimating Conference | | | | | | | | |
| (Millions of Dollars) | | | | | | | | |
| | FY 2015-16 | | | | | FY 2015-16 | \$ Change | % Change |
| | FY 2014-15 | Previous | Revised Revenue Estimates | | | | | |
| | Revised | FY 2015-16 | Treasury | House | Senate | Consensus | from | from |
| | Consensus | Consensus | Department | Fiscal | Fiscal | Est. 1/16/15 | May 2014 | FY |
| | Est. 1/16/15 | Est. May 2014 | | Agency | Agency | | Consensus | 2014-15 |
| Net GF/GP Revenue | \$9,501.4 | \$10,245.3 | \$9,773.5 | \$9,801.3 | \$9,903.5 | \$9,713.2 | (\$532.1) | 2.2% |
| Net SAF Revenue | \$11,889.1 | \$12,258.1 | \$12,280.1 | \$12,194.4 | \$12,227.3 | \$12,263.7 | \$5.6 | 3.2% |
| Net GF/GP & SAF Revenue | \$21,390.5 | \$22,503.3 | \$22,053.6 | \$21,995.7 | \$22,130.8 | \$21,976.9 | (\$526.4) | 2.7% |

Table 3

| FY 2016-17 REVENUE ESTIMATE COMPARISON & CONSENSUS AGREEMENT | | | | | | | | |
|---|---------------------|-------------------|----------------------------------|-------------------|-------------------|---------------------|------------------|-----------------|
| General Fund/General Purpose (GF/GP) and School Aid Fund (SAF) | | | | | | | | |
| January 16, 2015, Consensus Revenue Estimating Conference | | | | | | | | |
| (Millions of Dollars) | | | | | | | | |
| | FY 2016-17 | | | | | FY 2016-17 | \$ Change | % Change |
| | FY 2015-16 | Previous | Initial Revenue Estimates | | | | | |
| | Revised | FY 2016-17 | Treasury | House | Senate | Consensus | from FY | from |
| | Consensus | Consensus | Department | Fiscal | Fiscal | Est. 1/16/15 | 2015-16 | FY |
| | Est. 1/16/15 | Estimate | | Agency | Agency | | Consensus | 2015-16 |
| Net GF/GP Revenue | \$9,713.2 | N/A | \$10,045.8 | \$10,019.6 | \$10,001.0 | \$10,000.6 | \$2877.4 | 3.0% |
| Net SAF Revenue | \$12,263.7 | N/A | \$12,703.5 | \$12,557.5 | \$12,555.3 | \$12,640.9 | \$377.2 | 3.1% |
| Net GF/GP & SAF Revenue | \$21,976.9 | N/A | \$22,749.3 | \$22,577.1 | \$22,556.3 | \$22,641.5 | \$664.6 | 3.0% |

Revenue Limit

In FY 2012-13, revenue subject to the constitutional revenue limit was \$6.5 billion or 19.3% below the limit. In FY 2013-14 through FY 2016-17, revenue is expected to continue to fall well below the revenue limit. In FY 2013-14, revenue will fall short of the revenue limit by an estimated \$8.7 billion or 24.3%. In FY 2014-15, revenue subject to the limit will fall below the limit by an estimated \$8.5 billion or 23.2%, reflecting the dynamics of a projected 3.6% increase in revenue subject to the limit and relatively modest income growth in 2013 that increased the FY 2014-15 limit by only \$761.9 million. Revenue is estimated to fall short of the limit by \$9.4 billion or 24.5% in FY 2015-16, and by \$10.2 billion or 25.7% in FY 2016-17. The magnitude by which revenue falls below the limit reflects the growth in personal income used to calculate the limit in those years exceeding the growth in revenue.

Budget Stabilization Fund

Based on the consensus economic forecast, it is estimated that the statutory budget stabilization formula (based on the change in real Michigan personal income less transfer payments) will not trigger a suggested withdrawal from or deposit in the Budget Stabilization Fund in FY 2013-14, FY 2014-15, or FY 2015-16. However, the current FY 2014-15 budget provides for a \$111.5 million deposit into the Fund, which exceeds the calculated pay-in of \$81.2 million. The consensus forecast also indicates a formula-triggered pay-in of \$95.0 million in FY 2015-16 and another suggested pay-in of \$68.0 million in FY 2016-17. These formula-triggered transfers do not occur automatically, but must be appropriated by the Legislature.

School Aid Foundation Allowance Index

The pupil estimates presented at the January 2015 Consensus Revenue Estimating Conference (CREC) for the current year, FY 2014-15, show a decrease in the total number of pupils from those estimated at the May 2014 Revenue Estimating Conference. The FY 2014-15 pupil memberships (weighted 90.0% on the September 2014 count plus 10.0% on the upcoming February 2015 count) are now estimated at 1,508,000, which is 4,000 pupil memberships lower than the May 2014 consensus estimate, representing an error rate on the total blend of 0.3%. Compared with the previous year, FY 2013-14, the number of pupils is estimated to have declined more than 14,600. The overestimation of 4,000 memberships will result in State savings of roughly \$30.0 million. The figures used for the current year have not yet been audited and the February 2015 count has yet to occur, which means that some fluctuations will be seen in the current-year blend when pupils are again estimated in May 2015.

Pupil estimates for FY 2015-16 (which had earlier been estimated at the May 2014 conference) also were presented at the January 2015 conference. The pupil estimate of 1,495,000 memberships presented for FY 2015-16 represents a decline of 0.9%, or 13,000 pupils, from the current fiscal year. The primary reason for the estimated drop in pupil memberships from one year to the next is declining birth rates, which are slightly offset by increases predicted due to the expansion of cyber schools and other methods of school choice, including additional charter schools. However, the expected growth in these areas has been tempered below earlier estimates. The year-to-year overall declines in pupil memberships, while costing the State fewer dollars, mean, at a minimum, \$7,126 less for each pupil lost at the local school level.

Pupil estimates for FY 2016-17 also were presented (for the first time) at the January 2015 CREC. The initial estimates for planning purposes show another drop of 14,000 pupil memberships compared to the estimate for FY 2015-16. Again, strict declines in population would indicate a steeper drop than 14,000, but the estimate reflects continued moderate expansion of cyber schools and other charter schools, drawing in school population currently not in the public system.

If the expansion of cyber schools, charter schools, and other flexible choice provisions do not result in students currently outside the public education system enrolling in the public system, then it is likely that future pupil estimates will show fewer pupils in membership than estimated currently. Again, population declines (birth rate declines) continue to occur and mean that entering kindergarten classes are significantly smaller than outgoing senior classes. The estimates presented at the January 2015 CREC recognize

those population declines, but mitigate them somewhat due to an anticipated influx of students from outside the current public system; this is where the risk lies in the pupil forecast. However, this forecast assumes much slower new growth from outside the system than in the prior forecast; if the system begins to enroll large numbers of students who currently are not in public schools, there could be an uptick in total pupil memberships compared to the estimates.

The School Aid Act requires the minimum foundation allowance for a year to be at least an amount equal to the prior year's minimum, multiplied by the foundation allowance index determined at the Consensus Revenue Estimating Conference, unless an exception is written into the Act to waive this requirement for a given fiscal year. Under current law, the foundation allowance index is equal to the revenue adjustment factor multiplied by the pupil membership adjustment factor. Using the consensus estimates for pupils and revenue, the pupil membership adjustment factor is 1.0087 and the revenue adjustment factor is 1.0328. Multiplying these two factors together yields 1.0418 as the FY 2015-16 foundation allowance index. This means that under current law calculations, the FY 2015-16 minimum foundation allowance required should increase by 4.2% of \$7,126, or \$299. The new minimum foundation allowance would have to be at least \$7,425, as required under statute.

/kjh

c: Ellen Jeffries, Director