Maryland Bureau of Revenue Estimates

Analysis of December 15, 2014 General Fund Estimate

Fiscal Years Ending June 30, 2015 and June 30, 2016

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Peter Franchot
Comptroller

Andrew M. Schaufele
Director
Bureau of Revenue Estimates

December 15, 2014

Although the official revenue revisions carry the support of the Board of Revenue Estimates, the report and analysis provided belong to Andrew M. Schaufele, the Director of the Bureau of Revenue Estimates and Executive Secretary of the Board. It is provided solely to aid objective analysis of Maryland's economic and fiscal condition. Additional information was weighed when formulating the final revisions.

Included in this report is a statement from the Board of Revenue Estimates commending the Revenue Monitoring Committee for their superb work in crafting the revenue revisions.

I hope you find this report informative. If you should have any questions or concerns regarding this report, please do not hesitate to contact me at 410-260-7450.

Sincerely,

Andrew M. Schaufele

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Executive Summary

The Board of Revenue Estimates submitted revised general fund revenue estimates of $15.692 billion for fiscal year 2015 and $16.245 billion for fiscal year 2016. This report expresses the related analysis of Andrew Schaufele, Executive Secretary to the Board. The fiscal year 2015 estimate represents a decrease of $123.2 million while the fiscal year 2016 estimate represents a decrease of $147.9 million, or $271.1 million across both years. Growth of 3.9% is expected for fiscal year 2015 and 3.5% for fiscal year 2016. Those rates are somewhat distortive as they include varying statutory transfer tax amounts; excluding those amounts growth is 3.5% for fiscal year 2015 and 4.0% for fiscal year 2016. It should be noted that these rates of growth are generally sluggish with respect to historical pre-Great Recession general fund collections, though consistent with Maryland's current and near-term economic climate.

These downward revisions reflect the Board's continued effort to align revenues with the new economic landscape in Maryland. Maryland is in the midst of a structural change as its economic competitive advantage, federal government spending growth has been displaced and is no longer expected to provide the strong growth it had between 2000 and 2011. For perspective, Maryland's civilian federal government economic output (a component of gross domestic product) increased at an inflation adjusted annual rate of 2.8% during that time frame compared to just 0.6% nationally. Growth slowed to just 0.6% for Maryland in 2012 and, though yet unreported, will almost certainly have finished negative for 2013. Furthermore, the significant federal economic presence in Maryland supports various other industries directly and indirectly, and many of these positions generate incomes well above State and national averages. While these developments are not new, the extent of the continued weakness from these related economic sectors has proven greater than our prior limited expectations.

The national economy is not immune from federal spending reductions, though they are more acute to Maryland. In fact, inflation adjusted national civilian federal government economic output (real gross domestic product attributable to federal spending) actually declined 1.2% in 2012, worse than in Maryland. However, such output represents only 2.4% of all output nationally compared to 9.8% in Maryland. Although the federal budget sequestration limits in conjunction with continued federal budget policy uncertainty will continue to restrain aggregate economic growth potential, the national economy is recently seeing somewhat increased economic growth. Unfortunately the growth has been in the durable goods intensive industries which do not have a strong presence in Maryland. These advancements nationally coupled with stalled federal spending will keep Maryland economic growth subdued relative to national for at least the near-term.

Driving the revenue reduction is a decreased outlook for aggregate wage growth and therefore income tax withholding. Relative to our September outlook, the revised economic forecast calls for reduced aggregate wage growth throughout the forecast; therefore it is not surprising that we have reduced the fiscal year 2015 and fiscal year 2016 estimated growth rates for withholding to 3.7% and 4.5%, respectively. This reduced outlook to the State's largest revenue component unsurprisingly creates the greatest decrease in the general fund forecast, -$53.7 million for fiscal year 2015 and -$89.9 million for fiscal year 2016. Other, less potent components of the income tax are also revised slightly downwards. It is also important to note that a portion of the revenue reduction is attributable to a technical adjustment to the local income tax reserve account that reduces general fund income tax collections by $45.0 million for fiscal year 2015.

The sales tax is revised up by $15.1 million for fiscal year 2015 and $5.2 million for fiscal year 2016. The upwards revision is generally attributable to stronger than expected year-to-date performance as well as expected taxable spending gains from lower oil prices. While recent collection activity is promising, with the last seven months seeing growth greater than 3.5%, it remains difficult to reconcile this growth with the continued sluggish income growth. This disparity may be related to pent-up demand from reduced spending for the last seven years or attributable to stronger consumer confidence from those less affected by the aforementioned economic realignment. It is early to conclude that recent collection growth will prove sustainable, though it is nonetheless encouraging.

Many of the other revenue sources are revised for year-to-date activity in conjunction with the new outlook. The corporate income tax, the second largest reduction, is reduced moderately based on lesser than expected corporate profits, with the bulk of the reduction related to a timing correction for Maryland State film tax credits. It had been thought that more of these were taken in fiscal year 2014, when in fact they were taken for fiscal year 2015.

In conclusion, as the national recovery begins to heat up, it is evident that Maryland's economic trajectory has not and will not keep pace. Federal budget sequestration and continued federal budget policy uncertainty in general continue to drive a wedge between Maryland and the nation as a whole. Risks to the forecast are numerous. It seems that the most recent pending federal shutdown has been averted, though only through a continuing resolution; federal budget uncertainty will be an ongoing issue. There is also considerable risk that while the national recovery proceeds at a slow and lethargic pace, the recession may have engendered a structural change to the national and regional labor markets that has reduced overall employment capacity. Global concerns remain significant, both in the form of geopolitical volatility and economic growth; many European countries remain at risk for recession and several developing countries, particularly China, have seen slowing economic growth.

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The Maryland Economy

Introduction

The principal descriptive element of Maryland's recent economic trajectory has been the divergence between its growth and that of the nation as a whole. That is not to say that the State and national economic trajectories are normally synchronized, the difference is that generally, since the dot-com bubble, the pre-2012 divergence had been favorable to Maryland. Largely the recent relative successes of the national economy can be attributed to the strength and recovery of tangible goods producing industries, generally industries where Maryland does not have a significant footprint. Further impacting the divergent paths is the relative concentration of federal government expenditures in Maryland; sequestration and the lingering uncertainty continue to reduce economic output in the State. As a result of these elements, the current near-term outlook points towards lesser growth for Maryland relative to the nation.

History – Gross Domestic Product

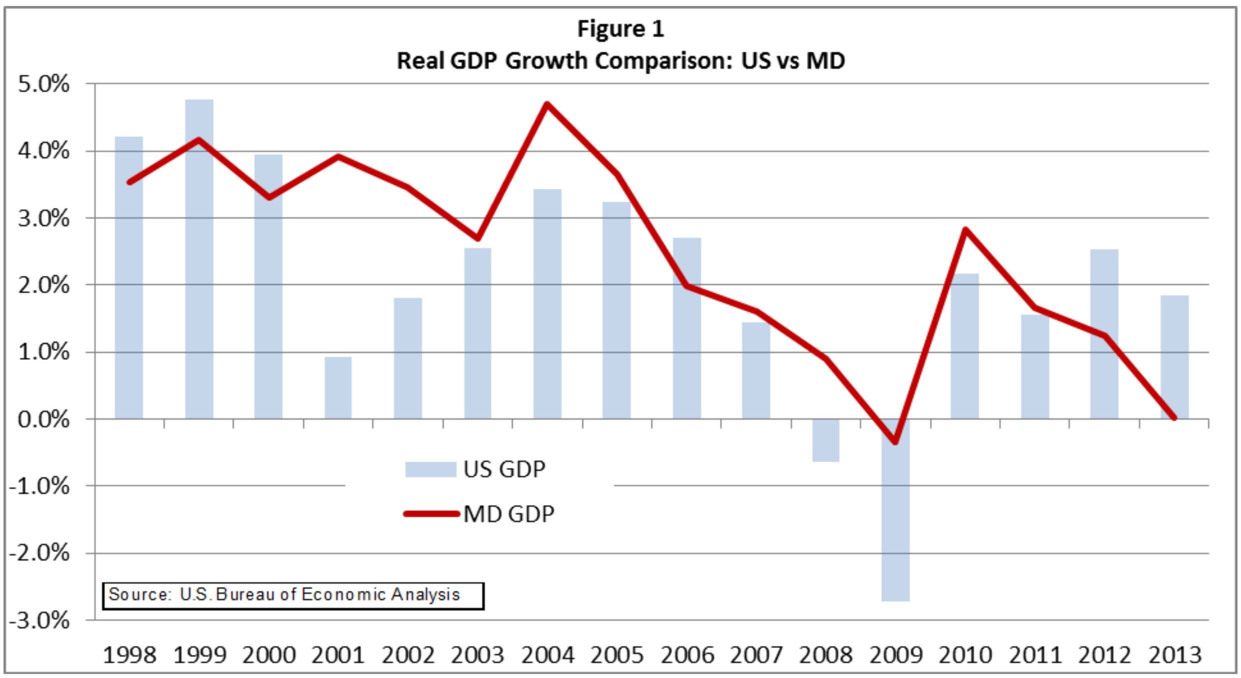
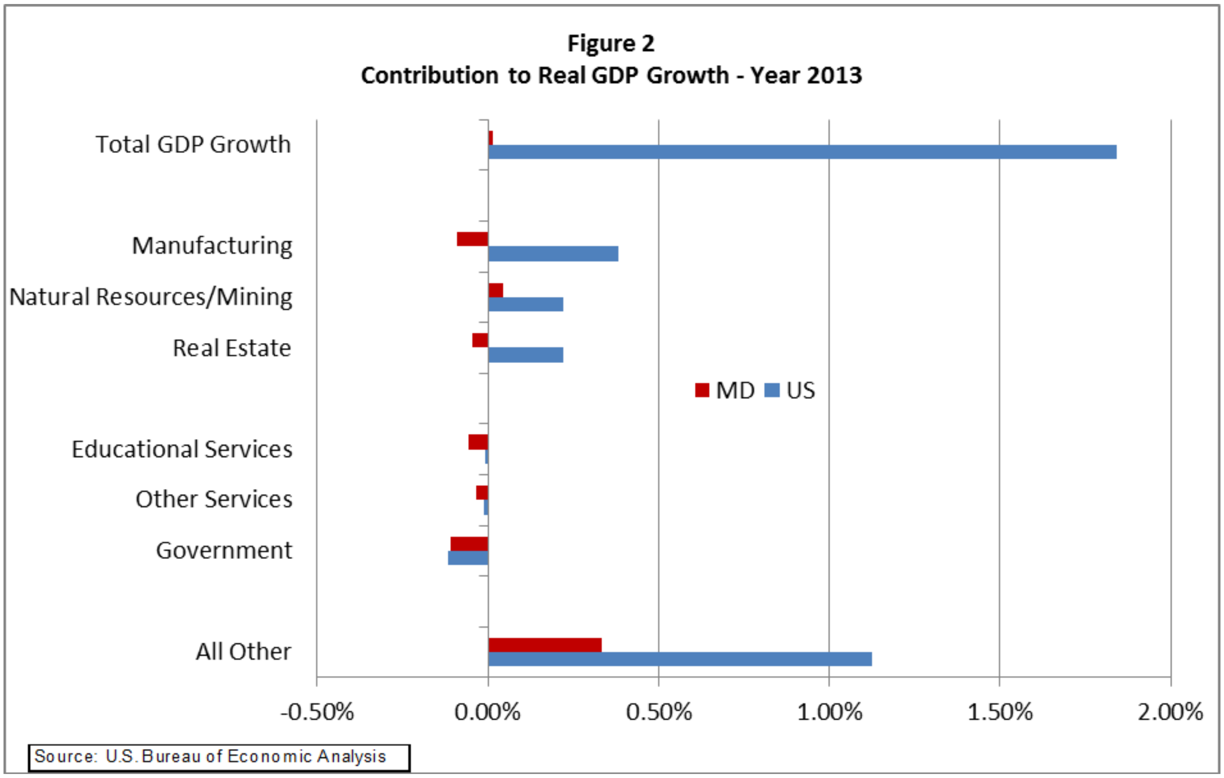


Figure 1
Real GDP Growth Comparison: US vs MD

Whereas Maryland's economic growth had eclipsed national growth, as measured by real gross domestic product (GDP), in every year with one exception between 2001 and 2011, the differences in 2012 and 2013 are substantial (see Figure 1). Notably, GDP growth in Maryland was stagnant in 2013 (0.0% growth). Driving growth nationally in 2013 (see Figure 2) were the manufacturing, natural resources and mining, and real estate, rental, and leasing industries. Figure 2 displays total real GDP growth for Maryland and the nation, as well as the top and bottom three industries ranked according to their contribution to U.S. real GDP growth; contribution is a function of growth and the industry's relative size.



Manufacturing has seen somewhat of a renaissance in the United States as foreign capital has grown older and shipping and labor costs have increased internationally. The natural resources and mining industry has benefited from high commodity prices as well as gas exploration and extraction; those benefits are generally concentrated in the Midwest. Interestingly, growth in this category was actually stronger in Maryland, up 12.3% versus 6.7% nationally; however, the share of the total economy is so small in Maryland, only 0.4% of total output versus 3.3% nationally, that the impact is very small for Maryland in the aggregate. Nationally, the real estate, rental, and leasing industry has seen relatively strong growth since 2009, though Maryland has not been as fortunate.

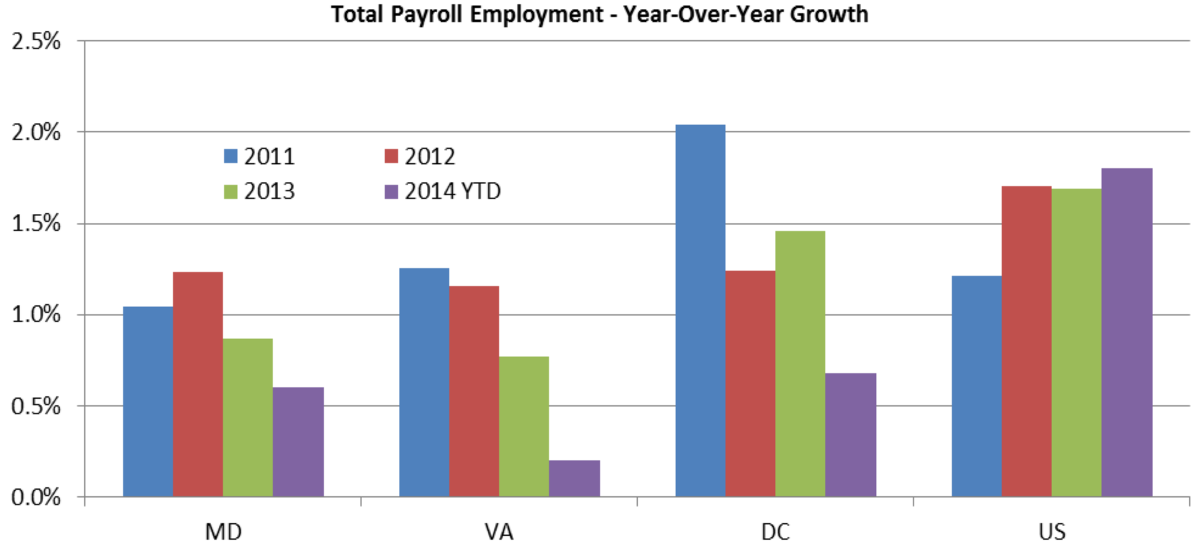
Government output, including federal as well as State and local, was the greatest detractor from growth for both the nation and Maryland. Government output only decreased 0.5% in Maryland while it decreased 0.9% nationally, though the industries size in Maryland increases the impact; total government accounted for 20.8% of Maryland's economic output while only 12.6% nationally. A breakdown between levels of government is not yet available, though it seems very reasonable to assume that the federal government contracted and State and local governments' growth rates remained sluggish or declined moderately. The "All Other" component of Figure 2 shows that the industries between the top three and bottom three contributors outperformed nationally; in fact, all thirteen other industries contributed positively to growth nationally compared to only seven in Maryland.

Of course, as Figure 1 illustrates, Maryland did not realize as substantial an economic contraction during the Great Recession as the nation as a whole. Paradoxically, a significant reason for the less substantial decline in 2009 was the manufacturing industry; manufacturing actually expanded in Maryland in 2009, growing 3.8%, versus a decline of 7.8% nationwide. In 2009, Maryland also benefited from strong growth in federal government output, presumably largely related to the 2005 Base Realignment and Closure (BRAC) process which shifted many defense positions to Maryland installations, with positions actually beginning to transfer in 2009 and reaching conclusion in 2011. Relatedly, it should be noted that relative to prior peak GDP (2007 for the United States and 2008 for Maryland), through 2013 Maryland's economy has increased by 5.5% whereas the national economy has increased only 4.7%.

History – Employment

The employment situation, as one would expect, is very similar to that of GDP, Maryland's employment growth in recent years has not kept pace with national employment growth. Of course, the timing may differ somewhat as employment decisions may precede or lag economic circumstances. Also, as was touched on earlier, the federal budget issues that have been depressing Maryland's growth relative to national growth are regionally acute; therefore, it is not surprising that since 2011 Maryland, Virginia, and the District of Columbia have all lagged national growth (see Figure 3).

Figure 3
Total Payroll Employment - Year-Over-Year Growth



Beginning mid-2011 – in unison with the beginning of the federal sequestration discussions –Maryland's total employment growth began to look substantially different from the national rate. It now seems evident that private companies began adjusting payrolls for the eventual reduction in federal government outlays prior to the passage of the first sequestration bill, the Budget Control Act of 2011 (Figure 4). Furthermore, even as we are now more than one year removed from the onset of sequestration, it seems the effects continue to weigh on private sector job growth. This may be related to a lack of transparency from federal agencies regarding the manner in which they reached their reduced budget targets. Continued uncertainty may plague private federal contractors.

Figure 4
Private Payroll Employment Growth

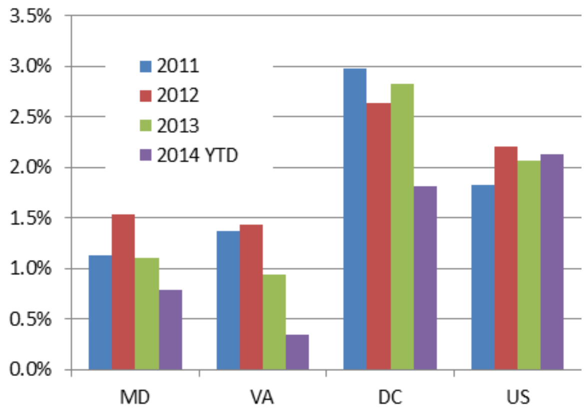
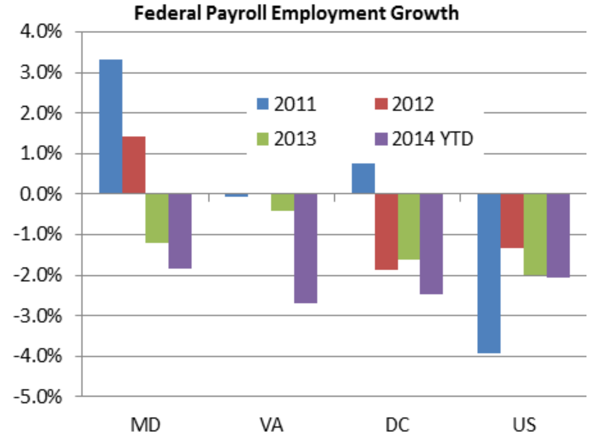


Figure 5
Federal Payroll Employment Growth

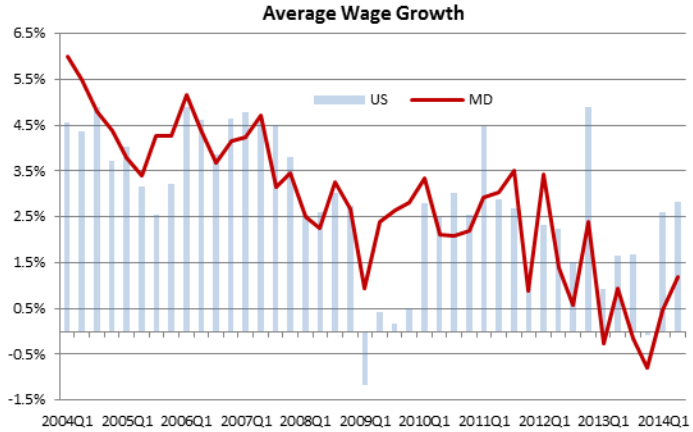


Direct federal job losses would come later as sequestration's actual commencement date neared. Interestingly, as Figure 5 shows, federal jobs have decreased at a greater rate nationally than in Maryland. While there is no way to be certain, it seems likely that the federal job losses are occurring at a greater rate in field offices, relatively benefiting Maryland. However, the impact to Maryland's labor market is greater than that of the nation because of the share of the federal government employment here; in 2013 federal employment directly accounted for 5.6% of payroll jobs in Maryland versus 2.0% nationwide.

History – Income

While employment in Maryland has increased, albeit at a less than desirable pace, income growth has been frustratingly slow. Suppressing growth has been extraordinarily weak growth in the average wage for the last several years (see Figure 6). In fact, between the first quarter of 2012 and the second quarter of 2014, the average wage in Maryland has increased more than 2.0% (the general barometer for inflation) only twice. This is indicative of lost purchasing power for the average wage earner. The fact that wages compose approximately 47.0% of total personal income in Maryland, along with other factors which served to restrain growth in 2013, lead a total Maryland personal income increase of only 1.1% in 2013.

Figure 6
Average Wage Growth



Possibly most notable of these other factors was the fiscal cliff: a general term used to define the expiration of many preferential tax rates that were set to expire at the end of 2012. An agreement was reached in the early days of 2013 that ameliorated the impact for taxpayers, though the uncertainty leading up to that period triggered a wave of income recognition. The effect was income that might have been recognized in 2013 was recognized in 2012. For example, companies paid dividends to shareholders in 2012 that would have normally been paid as the first quarterly dividend distribution for 2013. Many other types of income were affected, including capital gains, wages, and proprietor income. It seems likely that future years will also have depressed income as a result of this wave of income recognition; however, the extent of the effect on future years is unknown given current data.

Outlook

The official economic forecast is as follows. It should be noted that the forecasted growth rates are lower than those of Moody's Analytics and Global Insight:

Calendar Year	Employment	Personal Income	Wages & Salaries
2014	0.7%	3.3%	3.5%
2015	1.1%	3.8%	4.0%
2016	1.3%	4.1%	4.2%

Regional issues and slowing global growth will restrain Maryland employment growth in the near-term. Growth will receive a boost as the rate of federal government job losses is reduced, or at least flat lines, in the near future. Further employment growth is derived from continued improvement for the broader, national economy. An improving job market is expected to reduce labor market slack; thereby, increasing employer job competition and placing upward pressure on wages. However, average wage growth remains subdued relative to non-recessionary periods. Aggregate income growth benefits from increased employment as well as a moderate rebounding from the specific fiscal cliff issues that distorted growth in 2012 and 2013.

Negative risks persist and should not be ignored. The current federal government spending bill expires on December 11; failure to pass a budget or a continuing resolution could create another federal government shutdown. The global economic situation remains desperate in some areas (Europe) and is slowing in developing countries (the BRICS countries). Further negative developments, particularly in Europe, could slow national and Maryland economic growth. Additionally, the perennial risks remain: unrest in the Middle East; other geopolitical unrest (Russia in particular); Federal Reserve actions (possible "unwinding" of quantitative easing and raising interest rates); demographic shifts.

On the positive side, a broader long term budget agreement, one that does not further cut discretionary spending, could provide just the type of certainty that Maryland's federal contractors need to jump start labor and capital planning decisions. Recent developments in the price of sweet crude oil (less than $70 per barrel in first few days of December) are encouraging.

Reduced oil prices should provide significant savings for consumers, encouraging consumer spending, as well as reduce inflation for many goods over time. In turn, the reduced inflation expectations may support continued near-term Federal Reserve support for the economy. Additionally, the Panama Canal expansion project should complete in early 2016; the Port of Baltimore and surrounding areas could benefit tremendously, particularly if the bottlenecking at the Baltimore and Potomac railroad tunnel is alleviated.

Table 1

Forecast of the Maryland Economy

CALENDAR YEAR	2010	2011	2012	2013	2014	2015	2016
Total Non-Agricultural Employment (thousands)	2,517	2,543	2,575	2,597	2,616	2,645	2,679
	-0.2%	*1.0%*	*1.2%*	*0.9%*	*0.7%*	*1.1%*	*1.3%*
Existing Median Home Price	295,057	283,526	289,227	307,500	313,828	316,506	322,798
	-3.7%	*-3.9%*	*2.0%*	*6.3%*	*2.1%*	*0.9%*	*2.0%*
Existing Single Family Home Sales (thousands)	62.7	65.8	73.3	82.2	80.7	94.3	101.8
	3.7%	*4.9%*	*11.4%*	*12.1%*	*-1.8%*	*16.8%*	*8.0%*
Total Private Housing Starts (thousands)	12.0	11.6	14.4	17.0	17.0	18.3	20.0
	20.4%	*-2.7%*	*23.5%*	*18.4%*	*-0.1%*	*7.6%*	*9.3%*
Total Personal Income ($ in millions)	289,560	304,808	315,776	319,125	329,708	342,249	356,428
	2.5%	*5.3%*	*3.6%*	*1.1%*	*3.3%*	*3.8%*	*4.1%*
Wages and Salaries ($ in millions)	139,343	144,427	149,038	150,219	155,474	161,763	168,554
	2.2%	*3.6%*	*3.2%*	*0.8%*	*3.5%*	*4.0%*	*4.2%*
Dividends, Interest and Rent ($ in millions)	51,407	55,808	59,814	61,625	63,966	67,078	71,662
	0.0%	*8.6%*	*7.2%*	*3.0%*	*3.8%*	*4.9%*	*6.8%*
Capital Gains ($ millions)	4,406	5,582	7,877	7,090	7,444	7,891	8,364
	18.2%	*26.7%*	*41.1%*	*-10.0%*	*5.0%*	*6.0%*	*6.0%*
Unemployment Rate (%)	7.8	7.3	6.9	6.6	5.9	5.5	5.5

Source: Board of Revenue Estimates and Global Insight (December 2014 Forecast)

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General Fund Revenues

In preparing these estimates, all of the State’s revenue collecting agencies were consulted. In addition, the Board of Revenue Estimates continued to rely on the Revenue Monitoring Committee, comprised of key State staff with revenue estimating knowledge or collection responsibility. The committee compared and considered alternative economic forecasts from national economic consulting firm Moody’s Analytics and Global Insight, and local economists at Sage Policy Group.

Table 2 shows detail on general fund and selected special fund revenue sources for fiscal years 2014 through 2016. Table 3 provides additional detail on general fund revenues. The sections which follow these tables provide more information on each of the state’s general fund revenue sources.

Table 2
Selected Revenues
Fiscal Years 2014 - 2016

	GENERAL FUND			SPECIAL FUND			TOTAL		
$ Thousands	Fiscal Year 2014 Actual	Fiscal Year 2015 Revised Estimate	Fiscal Year 2016 Estimate	Fiscal Year 2014 Actual	Fiscal Year 2015 Revised Estimate	Fiscal Year 2016 Estimate	Fiscal Year 2014 Actual	Fiscal Year 2015 Revised Estimate	Fiscal Year 2016 Estimate
INCOME TAXES									
Individual	7,773,773	8,168,396	8,628,707				7,773,773	8,168,396	8,628,707
Corporations	761,208	767,581	822,141	221,576	223,431	239,313	982,784	991,012	1,061,454
Total	8,534,982	8,935,977	9,450,848	221,576	223,431	239,313	8,756,558	9,159,408	9,690,160
SALES AND USE TAXES	4,143,174	4,334,793	4,529,455	52,822	60,802	72,853	4,195,996	4,395,595	4,602,308
STATE LOTTERY RECEIPTS									
Lottery Games	501,107	500,010	476,021	77,186	76,521	97,660	578,293	576,531	573,681
Casinos				427,658	550,517	507,103	427,658	550,517	507,103
Total	501,107	500,010	476,021	504,845	627,038	604,764	1,005,951	1,127,049	1,080,784
TRANSPORTATION REVENUES									
Motor Vehicle Fuel Tax	5,000	5,000	4,625	806,381	870,894	1,016,320	811,381	875,894	1,020,945
Motor Vehicle Licenses, Fees				743,740	758,383	760,227	743,740	758,383	760,227
Motor Vehicle Titling Tax				740,835	786,000	805,700	740,835	786,000	805,700
Maryland Transit Fees				139,821	143,000	169,000	139,821	143,000	169,000
Maryland Port Fees				52,841	47,000	47,000	52,841	47,000	47,000
Maryland Aviation Fees				217,290	217,000	213,000	217,290	217,000	213,000
Total	5,000	5,000	4,625	2,700,907	2,822,277	3,011,247	2,705,907	2,827,277	3,015,872
OTHER REVENUES									
State Real and Personal Property Tax				717,524	742,295	734,873	717,524	742,295	734,873
Property Transfer Tax	89,199	144,189	77,654	61,695	16,827	96,887	150,894	161,016	174,541
Business Franchises and Filing Fees	228,389	230,277	233,623				228,389	230,277	233,623
State Tobacco Tax	402,418	393,221	391,595				402,418	393,221	391,595
Tax on Insurance Companies	334,807	312,863	301,478				334,807	312,863	301,478
Alcoholic Beverages Excises	31,144	31,624	31,750				31,144	31,624	31,750
Estate & Inheritance Taxes	213,785	239,366	216,271				213,785	239,366	216,271
Clerks of the Court	35,352	36,607	35,390				35,352	36,607	35,390
District Courts	77,670	78,524	78,859				77,670	78,524	78,859
Hospital Patient Recoveries	63,039	63,288	63,265				63,039	63,288	63,265
Interest on Investments	21,392	20,361	31,199					--- See Notes ---	
Miscellaneous Fees, Other Receipts	424,724	365,790	323,167						
Total	1,921,919	1,916,111	1,784,251						
Total Current Revenues	15,106,181	15,691,892	16,245,199					--- See Notes ---	
Extraordinary Revenues[1]									
GRAND TOTAL	15,106,181	15,691,892	16,245,199		--- See Notes ---				

Notes: Includes all general fund revenues, all Transportation revenues and selected special fund taxes. In conjunction with Appendix B of the Fiscal Year 2015 Budget Book, this table will comprise the official estimate of total state revenues.

Table 3
Maryland General Fund Revenues
Fiscal Years 2014 - 2016

$ Thousands	FY 2014 Actual	FY 2015 September Estimate	FY 2015 December Estimate	FY 2015 Difference	FY 2015 Growth	FY 2016 September Estimate	FY 2016 December Estimate	FY 2016 Difference	FY 2016 Growth
INCOME TAXES:									
Individual	7,773,773	8,284,949	8,168,396	(116,553)	5.1%	8,743,375	8,628,707	(114,668)	5.6%
Corporation	761,208	787,272	767,581	(19,691)	0.8%	837,131	822,141	(14,990)	7.1%
Total	8,534,982	9,072,221	8,935,977	(136,244)	4.7%	9,580,506	9,450,848	(129,658)	5.8%
SALES AND USE TAXES	4,143,174	4,319,650	4,334,793	15,143	4.6%	4,524,223	4,529,455	5,232	4.5%
STATE LOTTERY	501,107	503,467	500,010	(3,457)	-0.2%	486,043	476,021	(10,022)	-4.8%
OTHER REVENUES									
Business Franchise Taxes	228,389	230,277	230,277	0	0.8%	233,623	233,623	0	1.5%
Tax on Insurance Companies	334,807	319,913	312,863	(7,050)	-6.6%	308,745	301,478	(7,267)	-3.6%
Estate and Inheritance Taxes	213,785	235,608	239,366	3,758	12.0%	211,492	216,271	4,779	-9.6%
Tobacco Tax	402,418	401,557	393,221	(8,336)	-2.3%	400,065	391,595	(8,470)	-0.4%
Alcoholic Beverages Excise Tax	31,144	31,537	31,624	87	1.5%	31,989	31,750	(239)	0.4%
Motor Vehicle Fuel Tax	5,000	5,000	5,000	0	0.0%	4,625	4,625	0	-7.5%
District Courts	77,670	77,897	78,524	627	1.1%	77,659	78,859	1,200	0.4%
Clerks of the Court	35,352	36,015	36,607	592	3.6%	37,032	35,390	(1,642)	-3.3%
Hospital Patient Recoveries	63,039	57,416	63,288	5,872	0.4%	50,076	63,265	13,189	0.0%
Interest on Investments	21,392	20,361	20,361	0	-4.8%	31,199	31,199	0	53.2%
Miscellaneous	424,724	359,952	365,790	5,838	-13.9%	338,183	323,167	(15,016)	-11.7%
Total	1,837,720	1,775,533	1,776,922	1,389	-3.3%	1,724,688	1,711,222	(13,466)	-3.7%
Total Current Revenues	15,016,983	15,670,871	15,547,703	(123,169)	3.5%	16,315,460	16,167,545	(147,915)	4.0%
Transfer Tax Revenues[1]	89,199	144,189	144,189	0		77,654	77,654	0	-46.1%
GRAND TOTAL	15,106,181	15,815,060	15,691,892	(123,169)	3.9%	16,393,114	16,245,199	(147,915)	3.5%

[1] Chapter 425 of the 2013 Legislative Session and Chapter 464 of 2014 Legislative Session direct a portion of transfer tax revenues to the general fund: $89.2 million in fiscal year 2014, $144.2 million in fiscal year 2015, and $77.7 million in fiscal year 2016 .

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Individual Income Tax

Coming on the heels of 8.1% growth for fiscal year 2013, general fund income tax growth slowed remarkably to 1.1% for fiscal year 2014. This slowing is explained by changes to State and federal tax codes as well as continued sluggish economic growth throughout. As withholding growth actually accelerated in fiscal year 2014, albeit at a muted pace, estimated payments decelerated significantly and payments with final returns (final payments) declined. Estimated and final payments are generally regarded as tax payments from taxpayers with non-wage income who also tend to have higher average aggregate incomes. Non-wage income was the source of income most likely to be affected by the fiscal cliff.

The fiscal cliff is the term used to define the expiration of many preferential federal tax code treatments as well as the need to raise the federal debt ceiling; all of which, in the absence of congressional action, were set to occur at the end of calendar year 2012. While an inability to raise the debt ceiling could have had immensely dire macroeconomic consequences, it was the tax policy uncertainty that created the recent extraordinary tax volatility which will continue to play a role for years to come.

Several preferential tax treatments for a broad range of taxpayers were set to expire, though the volatility is likely attributable to those policies affecting high income or high wealth taxpayers. The general capital gains tax rate for high income taxpayers was set to increase to 20.0% from 15.0% and would also include a new 3.8% surcharge arising from the Affordable Care Act; the forthcoming total capital gains rate of 23.8% was a tax increase of 58.7%. Dividend income faced a greater tax rate increase; dividends had been taxed at the preferential capital gains rate of 15% since 2003, the expiration of the preferential rate meant dividend income would be taxed as ordinary income with rates as high as 39.6%. The fiscal cliff also included the expiration of preferential tax brackets that benefited all taxpayers, though higher income wage earners to a greater degree.

Although a deal was reached that ameliorated the coming impact, including an agreement to increase the debt ceiling, the deal was not reached and signed by the President until January 2, 2013. With such a late deal and the American public's general pessimism with regard to federal lawmakers' ability to accomplish any policy changes throughout 2012, taxpayers recognized income throughout the second half of tax year 2012 that would have most likely been recognized at later dates, thereby essentially pulling income forward.

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Tax Year	Total Income	Wage Income	Capital Gains	Dividend Income	Partnership Income
2012	4.8%	2.1%	41.1%	32.7%	14.3%

Growth Rates for Selected Federal Adjusted Gross Income Components

Source: Internal Revenue Service, Statistics of Income

As the above table illustrates, the resulting impact to tax year 2012 was significant. Not only was non-wage income growth remarkable, in its absence aggregate income growth would have likely been sub 3.0% and more demonstrable of the underlying economic conditions throughout 2012. The impact to Maryland tax was further magnified by the retroactive Maryland tax changes passed during the first special session of the 2012 General Assembly. Maryland income tax rates were increased for all taxpayers earning more than $150,000 in taxable income. As income is generally more volatile at higher income levels, general volatility will be more significant, but was extreme for tax year 2012.

The impact carried into tax year 2013 as it is estimated that the aforementioned types of income either slowed significantly, or decreased. Tax return data for income components are not yet available, but wage and salary income growth, as reported by the U.S. Bureau of Economic Analysis (BEA), increased only 0.8%. To illustrate the relationship, the correlation between the BEA measure of wages and taxable wage income is 99.9%. Our estimates for capital gains growth in tax year 2013 is -10.0%.

Carrying the preceding events forward and incorporating our macroeconomic forecast results in relatively slow growth for the income tax. As gains in employment are made, albeit at a slow pace, wages increase at a generally slower pace than Maryland's pre-recession average growth rates (see "Maryland Economy" section). Capital gains income growth is slowed relative to the pre-2012 outlook as gains were undoubtedly pulled forward, not from tax year 2013 alone, but from years to come; the extent to which this has occurred, we will never know. Nonetheless, non-wage income, including capital gains, does grow faster than aggregate income throughout the forecast, meaning the graduated tax brackets will cause Maryland tax to increase at a faster rate than general income growth.

Additionally, it should be noted that to support a technical GAAP (Generally Accepted Accounting Principles) adjustment an additional $99.5 million was distributed to the local income tax reserve fund in fiscal year 2014 and another $45.0 million is planned for fiscal year 2015. In the absence of those non-economic adjustments, general fund growth for fiscal year 2014 would have been 2.4% and growth for fiscal year 2015 would have been an estimated 4.3%. Furthermore, it should be noted that the local share has increased as a function of tax year 2013's final local share. Local governments should be aware that this is likely due to the recent extraordinary decrease in income at the high levels. Because of the graduated tax brackets, in non-extraordinary tax years where high incomes grow faster than average incomes, the local share should generally decrease annually.

Table 4
Individual Income Tax Revenues
Fiscal Years 2013-2016
($ in thousands)

	2013 Actual	2014 Actual	2015 Estimate	2016 Estimate
Gross Receipts (State & Local)				
Withholding	11,345,394	11,723,541	12,155,432	12,699,265
Estimated Payments	1,710,633	1,730,157	1,910,123	2,041,768
Payments with Final Returns	1,625,182	1,518,157	1,547,874	1,640,681
Fiduciary	93,978	108,882	122,619	137,009
Gross Receipts	14,775,188	15,080,737	15,736,048	16,518,721
Refunds	(2,370,213)	(2,403,369)	(2,475,867)	(2,585,869)
Net Receipts (State & Local)	12,404,975	12,667,368	13,260,181	13,932,852
Local Reserve Account	(4,712,106)	(4,902,005)	(5,089,785)	(5,302,146)
Income Tax Check-offs	(1,488)	(1,585)	(2,000)	(2,000)
Net General Fund	7,691,381	7,773,777	8,168,396	8,628,707

Figures may not sum to totals due to rounding.

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Transportation Revenues

Table 5
Transportation Revenues
Fiscal Years 2013-2016
($ in thousands)

	2013 Actual	2014 Actual	2015 Estimate	2016 Estimate
Department of Transportation				
Registrations	362,324	367,310	371,400	371,000
Licenses	46,845	50,795	52,600	52,500
Med-Evac Surcharge	52,594	69,683	71,077	71,000
Trauma Physician Services Surcharge	11,609	11,957	12,090	12,077
Miscellaneous Motor Vehicle Fees	177,956	178,535	185,449	187,213
Vehicle Emission Inspection Fees	31,650	32,822	32,867	33,037
Security Interest Filing Fees- Special Funds	10,658	11,176	11,900	12,100
Hauling Fees	10,352	9,806	9,400	9,500
Special License Tags – Special Funds	5,276	5,123	5,100	5,200
Titling Tax	684,655	740,835	786,000	805,700
Sales Tax on-Rental Vehicles	25,462	30,311	31,523	32,784
Special Distribution from Sales Tax	-	-	-	-
Subtotal	1,419,381	1,508,353	1,569,406	1,592,111
Motor Vehicle Fuel Tax	739,387	693,580	708,200	805,700
Road Tax	4,526	6,357	6,500	6,600
Decals & Permits	134	176	-	-
Sales Tax Equivalent	1,298	99,720	138,366	265,628
Indexing	211	13,081	24,328	39,692
Subtotal	745,556	812,914	877,394	1,022,920
Total	2,164,937	2,321,267	2,446,800	2,615,031

Casino Revenues

In 2008, Maryland voters approved the installation of video lottery terminals (VLTs) at five casino locations. In 2012, Maryland voters expanded gambling by legalizing table games at Maryland casinos. Additionally, the legislation also approved a sixth casino location. To start fiscal year 2014, four casinos; Hollywood Casino, Ocean Downs Racetrack, Maryland Live, and Rocky Gap were all operational. The Horseshoe Casino in Baltimore opened in the last week of August 2014. The sixth location, MGM National Harbor, is expected to open July 2016 in Prince George's County.

In fiscal year 2013 four casinos had VLTs operational. Additionally, fiscal year 2013 was Maryland Live's, Maryland's largest casino, first full operational year as well as the first few months of Rocky Gap's operations. Casino revenue from VLTs increased 188% in fiscal year 2013 totaling $560.3 million. Although no new facility opened in fiscal 2014, VLT revenues increased only 3.2% to $578.4 million. The softening in growth relative to initial expectations is largely explained by tremendous growth in table games, a share of which comes at the cost of VLTs. Fiscal years 2015 and 2016 are strongly impacted by the Horseshoe Casino. Through November 2014, the Horseshoe has underperformed relative to expectations; however, total revenue has increased. Additionally, the Horseshoe has not cannibalized other casino's revenues relative to prior expectations.

Operating in four casinos, table games in Maryland have surpassed expectations since legalization in 2012. Initially activated in three casinos for part of fiscal year 2013 and then operational year-round at the same facilities for fiscal year 2014, Maryland casino gamblers have shown strong interest. In fact, while VLT revenue has been revised down several times, table games have been revised up several times. The direct net result of table games' popularity is generally negative for State revenues as casino operators receive a greater share from table games.

As gambling continues to expand, state revenues from both video lottery terminals and table games are expected to increase, growing 26.7% for fiscal year 2015 and then slowing to 5.8% in fiscal year 2016 (excluding miscellaneous). Miscellaneous revenues are just that, but include significant licensing revenues for fiscal year 2015. Including miscellaneous revenues, total education trust fund revenues are forecast to reach $437.9 million for fiscal year 2015 and $394.0 million for fiscal year 2016.

Table 6

Casino Revenues

Fiscal Years 2013 - 2016

($ in millions)

	Video Lottery Terminals			
	FY 2013	FY 2014	FY 2015E	FY 2016E
Education Trust Fund	274.7	277.1	320.5	315.9
Casino Operators	185.4	202.1	256.2	297.8
Local Impact Grants	30.7	30.8	36.8	38.9
Small, Minority, and Women-owned Businesses	8.4	8.4	10.0	10.6
Purse Dedication	39.1	38.9	46.5	49.1
Race Tracks Facility Renewal Account	10.8	9.5	7.2	6.9
State Lottery Agency	11.2	11.6	12.1	7.7
Total	**560.3**	**578.4**	**689.4**	**726.8**

	Table Games			
	FY 2013	FY 2014	FY 2015E	FY 2016E
Education Trust Fund	9.6	51.0	73.2	78.1
Casino Operators	38.4	203.9	292.9	312.3
Total	**48.0**	**254.9**	**366.1**	**390.4**

	Miscellaneous - Education Trust Fund			
	FY 2013	FY 2014	FY 2015E	FY 2016E
Total	**1.6**	**0.3**	**44.1**	**-**

	Total			
	FY 2013	FY 2014	FY 2015E	FY 2016E
Education Trust Fund	286.0	328.4	437.9	394.0
Casino Operators	223.8	406.0	549.1	610.1
Local Impact Grants	30.7	30.8	36.8	38.9
Small, Minority, and Women-owned Businesses	8.4	8.4	10.0	10.6
Purse Dedication	39.1	38.9	46.5	49.1
Race Tracks Facility Renewal Account	10.8	9.5	7.2	6.9
State Lottery Agency	11.2	11.6	12.1	7.7
Total	**610.0**	**833.6**	**1,099.6**	**1,117.2**

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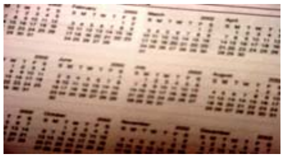

Five Year Forecast

These estimates are based on current economic outlooks for the U.S. and Maryland economies and incorporate recent legislative changes. The horizon does not include a single year where general fund revenues exceed 4.0% growth. To put that in perspective, annual ongoing general fund revenue growth averaged 4.6% throughout the 1990s and 5.4% between 2000 and 2007. In general, the economic forces that provided the catalyst for such strong economic and revenue growth historically have matured.

Federal spending has been reduced and will remain low due to sequestration caps. The expansion of federal spending in Maryland that followed the 2001 terrorist attacks may have peaked. There may be upside to this forecast in that Maryland's defense industry is more knowledge based, particularly with regard to cyber-security; therefore, the military may continue to shift resources from traditional defense toward areas where Maryland has an advantage. The technology boom that has provided extraordinary economic growth globally for the last three decades seems to have matured. Demographic issues, most notably slowing population growth and the aging of the population, may also serve as an impediment, likely not in the near-term, but beginning in the later years of this forecast.

The United States Economy has traversed through a whirlwind of economic revolutions since the industrial revolution, including large immigration waves in the early 1900s, the G.I. Bill that educated an extraordinarily productive generation following world war two, women entering the workforce and desegregation during the 1960s, and the aforementioned technological advances. While it is impossible to anticipate forthcoming major economic advances, history dictates that another productivity booster will be on the horizon. The issue is that we may be in a period of economic lull. Until real productivity gains materialize in a manner exclusive of a boom-bust cycle, a reduced economic and revenue forecast seems prudent.

Notable revenue items include the pace of growth for the sales tax, which accelerates strongly in fiscal year 2015 and fiscal year 2016, before reducing to levels more related to the economic forecast. Fiscal years 2015 and 2016 benefit from Amazon creating nexus in the third quarter of 2014 as well as the satisfaction of pent-up demand (housing and non-housing). State lottery receipts decline somewhat in 2015 as competition from casinos continues to cannibalize sales. The opening of the casino in Prince George's county will take another significant piece of lottery sales in fiscal year 2016 before growth slowly improves as the casino market matures. The Franchise, Excise, License, Fee grouping declines as those sources are generally slow-growing in nature; however, they also strongly affected by tax changes, largely the phased-in increased exemption for the estate tax.

Table 7

Long Term Economic Forecast

Primary Indicators

Calendar Year	2012	2013	2014	2015	2016	2017	2018
US Real GDP ($ billion, chained)	15,369	15,710	16,055	16,467	16,924	17,435	17,884
	2.3%	*2.2%*	*2.2%*	*2.6%*	*2.8%*	*3.0%*	*2.6%*
US Total Non-Farm Employment (thousands)	134,098	136,363	138,838	141,411	143,464	145,299	146,562
	1.7%	*1.7%*	*1.8%*	*1.9%*	*1.5%*	*1.3%*	*0.9%*
US Personal Income ($ billion)	13,888	14,167	14,766	15,404	16,170	17,079	17,943
	5.2%	*2.0%*	*4.2%*	*4.3%*	*5.0%*	*5.6%*	*5.1%*
Consumer Price Index (% Δ)	*2.1%*	*1.5%*	*1.7%*	*1.0%*	*1.6%*	*2.2%*	*2.2%*
US 10-Year Treasury Bond Yield	1.8%	2.4%	2.6%	3.1%	3.6%	4.2%	4.4%
MD Total Non-Farm Employment (thousands)	2,575	2,597	2,616	2,645	2,679	2,706	2,719
	1.2%	*0.9%*	*0.7%*	*1.1%*	*1.3%*	*1.0%*	*0.5%*
MD Total Personal Income ($ million)	315,776	319,125	329,708	342,249	356,428	373,230	388,931
	3.6%	*1.1%*	*3.3%*	*3.8%*	*4.1%*	*4.7%*	*4.2%*

Source: Board of Revenue Estimates and Global Insight (December 2014 Forecast)

Table 8

Maryland General Fund Revenues

Fiscal Years 2014- 2020

($ in thousands)

	2014 Actual	2015 Estimate	2016 Estimate	2017 Estimate	2018 Estimate	2019 Estimate	2020 Estimate
Income Taxes							
Individual	7,773,773	8,168,396	8,628,707	9,052,573	9,474,423	9,878,151	10,299,084
Corporation	761,208	767,581	822,141	881,683	911,758	942,115	979,360
TOTAL	8,534,982	8,935,977	9,450,848	9,934,256	10,386,181	10,820,266	11,278,443
Sales and Use Taxes	4,143,174	4,334,793	4,529,455	4,698,165	4,852,734	5,017,158	5,189,411
State Lottery	501,107	500,010	476,021	478,970	487,738	499,779	512,581
Franchise, Excise, License, Fee	1,837,720	1,776,922	1,711,222	1,695,033	1,702,506	1,713,961	1,752,234
ONGOING GENERAL FUND REVENUES	15,016,983	15,547,703	16,167,545	16,806,424	17,429,160	18,051,164	18,732,670
Transfer Tax GF Share	89,199	144,189	77,654	82,771	86,028		
TOTAL GENERAL FUND REVENUES	15,106,181	15,691,892	16,245,199	16,889,195	17,515,188	18,051,164	18,732,670

Notes:

Totals do not include extraordinary revenues.