MINUTES of the
DELAWARE ECONOMIC & FINANCIAL ADVISORY COUNCIL

Buena Vista – March 18, 2019

Attendance:

Member	Present
N. Batta	Yes
C. Bo	Yes
C. Bonini	Yes
J. Bullock	Yes
L. Davis Burnham	Yes
R. Byrd	Yes
J. Casey	No
J. Cohan	No
N. Cook	Yes
C. Davis	Yes
F. Dixon	No
K. Dwyer	Yes
B. Fasy	Yes
R. Geisenberger	Yes
R. Glen	Yes
G. Hindes	Yes

Member	Present
J. Horty	No
M. Houghton	Yes
M. Jackson	Yes
Q. Johnson	Yes
K. Lewis	Yes
A. Lubin	Yes
G. Marcozzi	Yes
I. McConnel	Yes
C. Morgan	No
M. Morton	Yes
E. Ratledge	Yes
T. Shopa	No
D. Short	Yes
D. Sokola	Yes
D. Swayze	Yes
K. Walker	Yes

Members in Attendance: 26
Members Absent: 6

Others Present: A. Aka, T. Dailey, C. Engelsiepen, S. Gahs, R. Goldsmith, C. Haas, C. Heiks, A. Jenkins, J. Johnstone, K. Knight, M. Magarik, M. Marlin, M. McConnell, B. Motyl, J. Nauman, A. Penney, N. Polite, D. Roose, D. Scholl, S. Scola, S. Stewart, J. Vaughan and members of the press.

Opening Business: Mr. Houghton called the meeting to order at 1:30 p.m.

Mr. Houghton welcomed Representative Quinton Johnson and Senators Colin Bonini and David Sokola as new members of DEFAC.

The minutes from the December meeting were approved as submitted.

Expenditure Forecasts:

Mr. Ratledge and Mr. Jackson presented the General Fund Expenditure forecasts.

General Fund Expenditures - Fiscal Year 2019:

Mr. Ratledge noted that FY 2019 spending authority amounts to $4,745.2 million. In his review of the Balance Sheet method he mentioned that the Encumbered estimate remains unchanged in March while Continuing and Reversions estimates have been raised to $253.6 million and $18.0 million, respectively.

Mr. Jackson said the March Expenditure estimate for FY 2019 is approximately $21.0 million lower than the December estimate, and attributed the decrease to two factors: first, $10.0 million which were appropriated in the budget for capital projects will not be spent this year. As a result overall spending has been reduced while the continuing estimate has been increased. In addition the Medicaid spending has also been reduced by $15.0 million, with half of the reduction placed into Reversions and the other half into Continuing. Mr. Jackson had previously indicated during the Subcommittee meeting that the number of individuals eligible for Medicaid was 236,000 while the newly eligible figure stood at 11,062.

Mr. Ratledge also reviewed the Functional method. He noted that Salaries are up 5.1% or $72.1 million from FY 2018. Mr. Jackson explained that the growth in the expenditure category can be attributed to pay policy in the budget, a one-time bonus paid in November to State employees, required step increases for specific compensation plans, and school growth.

Mr. Ratledge mentioned that the Fringe Benefits estimate is also expected to be moderately higher during FY 2019. Mr. Jackson attributed most of the increase to the increased number of positions in the budget, which are driven by school enrollment and the number of teachers.

Mr. Ratledge noted that Pension is expected to be up by $46.3 million in the ongoing fiscal year. Mr. Jackson explained that more than $10.0 million of the increase can be attributed to one-time pension bonuses for retirees paid in November.

Mr. Ratledge mentioned that the estimates for Grants, Capital Outlay, Supplies and Materials, and Contractual Services are higher than in FY 2018 by $85.1 million, $9.6 million, $10.3 million and $75.9 million, respectively. Mr. Jackson explained that $190.0 million worth of General Fund revenue supporting capital projects, as well as one-time increases included in the Grant-in-aid act are driving the increases for these expenditure categories.

Mr. Ratledge noted the small $2.8 million increase in the Medicaid estimate. Mr. Jackson

explained that the December estimate was based on assumptions about enrollment growth and prices associated with managed care contracts, which turned out to have been aggressive. (See Table 1a, Table 1b and Table 1c for complete details).

A motion was made, seconded and approved to accept $4,428.6 million as the Expenditure estimate for FY 2019. The estimate represents an increase of $310.5 million from FY 2018 and a decrease of $20.7 million from the December estimate.

General Fund Expenditures - Fiscal Year 2020:

Mr. Ratledge mentioned the new, two-year expenditure forecasts required by Executive Order 26. Mr. Jackson explained that the FY 2020 estimates are carrying forward of current year's estimates adjusted by figures proposed in the Governor's Recommended Budget.

Mr. Jackson said the estimates for Salaries, Fringe Benefits and Pension take account of pay policy and salary step increases. He mentioned that the Medicaid estimate balances the number of eligible individuals for Medicaid and the increased costs. He indicated that estimates for Grants, Contractual Services, Supplies and Materials, and Capital Outlay reflect adjustments in the operating budget.

Mr. Batta asked whether the health care spending benchmark is built into the assumptions used to derive the FY 2020 estimates. Mr. Jackson replied that the Health Care estimate represents the amount the State contributes toward employee health care premium, while the benchmark is designed to minimize that amount over time. (See Table 1d for complete details).

A motion was made, seconded and approved to accept $4,465.1 million as the Expenditure estimate for FY 2020. The estimate represents an increase of $36.5 million from FY 2019.

<u>Revenue Forecasts:</u>

Mr. Lewis, Mr Glen, Mr. Knight and Mr. Roose presented the General Fund Revenue forecasts.

Economic Outlook

Mr. Aka presented economic forecasts for the U.S. (produced by IHS Markit ("IHS")) and Delaware (developed by the Department of Finance). He mentioned that the outlook for the nation's economy has not changed much over the past 3 months. IHS continues to

expect the U.S. economy to begin to slow in 2019, as the fiscal stimulus from the Tax Cuts and Jobs Act fades, monetary policy becomes slightly more restrictive, and global growth weakens. Overall real GDP growth is expected to decelerate from 2.8% in FY 2019 to 2.2% next fiscal year and 1.9% in FY 2021.

Mr. Aka added that the outlook of U.S. Wages and Salaries was broadly unchanged from December. He said that Delaware's moderate economic performance continues and that forecasts for Employment as well as Wages and Salaries were almost unchanged from December.

Ms. Davis Burnham asked whether the lower Wages and Salaries growth for Delaware is due to the fact that some of the job growth stems from lower earning workers. Mr. Aka replied this could be the case and added that the employment data received by the Department of Finance cannot be split into lower versus higher wage workers. When asked by Mr. Lewis what Mr. Dixon would have said if in attendance, Mr. Aka said the latter would have probably disagreed with the U.S. GDP forecast which seems optimistic and above consensus for CY 2020.

Ms. Bo asked how changes in the Expenditure estimates tie into the national economic slowdown expected by IHS. Mr. Jackson answered that the proposed budget satisfies the expenditure benchmark of 3.8% that was adopted by DEFAC in December. He added that the Executive branch is recommending a level of appropriation of 96% rather than 98%, which would set aside $92.0 million worth of funding that could otherwise be appropriated. Mr. Jackson also noted a control of personnel costs by his Office, and the role played by the Government Efficiency and Accountability Review (GEAR) in increasing efficiency across the State. Mr. Geisenberger added that should an economic downturn occur, it will be reflected in the benchmark measure though lower personal income and State and Local government purchase index forecasts.

Ms. Bo asked whether current rules of the Budget Stabilization Fund allow legislators to access funds put aside in a downturn. Mr. Jackson answered affirmatively. Mr. Houghton asked about the total amount of funds set aside in the Governor's proposal. Mr. Jackson said the Rainy Day Fund totals about $240.0 million and the amount set aside is $92.0 million, for a total of about $330.0 million.

Mr. Swayze asked about voting requirements needed to access the Rainy Day Fund (RDF) under a constitutional amendment. Mr. Geisenberger answered that accessing 2.0% to 5.0% of the RDF can be done with a simple majority. Accessing funds when the RFD is at the floor of 3% of estimated revenues needed a three-fifths supermajority rule. Finally Mr. Ratledge described ongoing structural constraints (e.g., demographics) facing both local and national labor markets.

General Fund Revenues - Fiscal Year 2019:

The Revenue Subcommittee recommended the following updates to December's estimates:

Revenue Category	Dec-18	Mar-19	Change
Personal Income Tax	1,724.8	1,699.9	(24.9)
Franchise Tax	864.0	886.0	22.0
PIT Refunds	(229.0)	(210.0)	19.0
Unclaimed Property Refunds	(100.0)	(110.0)	(10.0)
Dividends and Interest	13.3	20.7	7.4
Insurance Taxes	78.7	84.2	5.5
Bank Franchise Tax	90.5	94.3	3.8
Franchise Tax Refunds	(10.0)	(12.0)	(2.0)
Other Refunds	(22.9)	(23.6)	(0.7)
Hospital Board and Treatment	36.8	36.3	(0.5)

For a complete listing of FY 2019 estimates, see Table 2.

Discussion of FY 2019 Estimates:

PIT Less Refunds: Mr. Roose recommended a decrease in the estimate by $5.9 million.

Mr. Roose said Withholding is currently on track to hit the December estimate. He added there could be an upside by the next DEFAC meeting since some bonuses seem to have been delayed. Mr. Roose also said that Estimated payments have been reduced by $25.0 million, as the decline in the revenue category during the fourth quarter of CY 2018 was much larger-than-anticipated. He mentioned that there are very few economic factors from the past year that would indicate a problem with CY 2018 net liabilities. Mr. Roose indicated that most of the decline in Estimated payments will be partially offset through the filing season by lower Refunds or higher Final payments.

Mr. Roose pointed out the uncertainty stemming from the Tax Cut and Job Act (TCJA). He added that having a complete understanding of the effects of the TCJA will require analyzing CY 2018 tax returns (currently being received by the Finance Department), high-income Delaware returns (expected in November 2018) and Federal returns (expected in November 2019).

Net Franchise Tax & LP/LLC: Mr. Knight recommended an increase in the estimate by $20.0 million.

Mr. Knight said refunds are expected to increase by $2.0 million and gross collections by $22.0 million, of which $10.0 million are the result of more robust compliance procedures and $12.0 million are due to more corporations using

the authorized shares method.

Unclaimed Property Less refunds: Mr. Roose recommended a decrease in the estimate by $10.0 million.

Mr. Roose said claims have been increased by $10.0 million based on year-to-date total and the expected number of claims that will be processed by the end of the fiscal year.

Bank Franchise Tax: Mr. Glen recommended an increase in the estimate by $3.8 million.

Mr. Glen attributed the increase to higher final payments received on March 1st for Tax Year (TY) 2018 as well as higher estimated payments for TY 2019.

Insurance Tax and Fees: Mr. Roose recommended an increase in the estimate by $5.5 million.

Ms. Vaughan has previously said during the Subcommittee meeting that the increase can be traced to fee increases and bi-annual nonresident taxes.

Hospital Board and Treatment: Mr. Roose recommended a decrease in the estimate by $0.5 million.

Mr. Roose explained the decrease by lower census and lower Federal reimbursement rate.

Dividends and Interest: Mr. Roose recommended an increase in the estimate by $7.4 million.

Mr. Roose attributed the increase to higher cash balances and better market conditions.

Other Refunds: Mr. Roose recommended an increase in the estimate by $0.7 million.

Mr. Roose attributed the change to applications for the first-time home buyer refund that are in the door.

FY 2019 Estimate Adopted:

A motion was made, seconded and approved to accept $4,489.1 million as the revenue estimate for FY 2019. The estimate represents an increase of $19.6 million from the December estimate.

In response to a question from Mr. Sokola, Mr. Bullock said that concession payments from the Port operator (Gulftainer) will be used initially to pay down debts. Later they will be posted under Other "Other" Revenues.

General Fund Revenues - Fiscal Year 2020:

The Revenue Subcommittee recommended the following updates to December's estimates:

Revenue Category	Dec-18	Mar-19	Change
Personal Income Tax	1,816.7	1,790.7	(26.0)
PIT Refunds	(232.4)	(212.5)	19.9
Unclaimed Property	510.0	525.0	15.0
CIT Refunds	(57.0)	(70.0)	(13.0)
Unclaimed Property Refunds	(100.0)	(110.0)	(10.0)
Franchise Tax	865.5	874.5	9.0
Dividends and Interest	20.9	25.3	4.4
Bank Franchise Tax	95.8	98.8	3.0
Insurance Taxes	72.1	74.0	1.9
Other Refunds	(18.9)	(17.8)	1.1
Hospital Board and Treatment	36.2	35.7	(0.5)

For a complete listing of FY 2020 estimates, see Table 2.

Discussion of FY 2020 Estimates:

Net Franchise Tax & LP/LLC: Mr. Knight recommended an increase in the estimate by $9.0 million.

Mr. Knight said $3.0 million of the increase represent a carrying forward of the FY 2019 increase linked to more robust compliance procedures, and $6.0 million are due to the authorized share method.

Unclaimed Property Less Refunds: Mr. Roose recommended an increase in the estimate by $5.0 million.

Mr. Roose explained that slow audits are pushing collections into next year, while annual filings have been strong this year. As a result, gross collections are unchanged this year but higher next year.

Corporate Income Tax (CIT) Less Refunds: Mr. Roose recommended a decrease in the estimate by $13.0 million.

Mr. Roose said the CIT Refunds estimate is $13.0 million higher than in December on the back of newly refundable Research and Development credit.

FY 2020 Estimate Adopted:

A motion was made, seconded and approved to accept $4,568.3 million as the revenue estimate for FY 2020. The estimate represents an increase of $4.8 million from the December estimate.

Mr. McConnel asked whether the model used by the Department of Finance has been updated since the last time it was presented to DEFAC members. Mr. Roose said the model has been reviewed and evaluated several times over the years. He added that the discussion at that time included the forecasting service used (IHS), which like many other forecasting firms, has a certain bias. Mr. Roose said the bias is taken into account when developing the Delaware economic forecasts.

Mr. Houghton said perhaps it is time to consider alternatives to the current model. Mr. Roose said his office will investigate what other states are using as models and make a presentation in June. When asked whether the model's results have been compared to the actuals, Mr. Aka said that the model performs well for revenue categories such as the personal income tax and in the aggregate but fares less well for other series such as the estate tax. Mr. Houghton said he would like to be provided with a historical perspective and suggestions for model enhancement in June.

Balance and Appropriations Worksheet: Mr. Roose presented the Balance and Appropriations worksheet. The result of this exercise is attached as Table 3.

Mr. Roose added that the Budget Stabilization Fund is up $24.6 million to $177.2 million. Mr. Geisenberger noted the figure is for budget purposes only.

<u>Transportation Trust Fund (TTF)</u>

TTF -- Expenditures: Mr. Motyl presented the Transportation Trust Fund's expenditure forecast.

State Operations Expenditure: There was no change from the December estimate of $347.3 million.

State Capital Expenditure: Increased from $270.0 million in December to $290.0 million.

Mr. Motyl attributed the increase to strong fiscal year-to-date spending.

Federal Capital Expenditure: Decreased from $275.0 million in December to $245.0 million.

Mr. Motyl attributed the decrease to the Federal shutdown, which has delayed some projects into the next fiscal year.

U.S. 301 Capital Expenditure: Decreased from $127.7 million in December to $117.7 million.

A motion was made, seconded, and approved to accept $1,000.0 million as the FY 2019 TTF expenditure estimate. The estimate represents a decrease of $20.0 million from December (See Table 4.)

TTF -- Revenues: Mr. Motyl presented the Transportation Trust Fund's revenue forecast.

The following changes were made from the December estimates.

FY 2019 Estimates:

Toll Road Revenues: There was no change from the December estimate of $208.9 million.

Motor Fuel Tax Administration: Increased from $139.4 million in December to $142.4 million.

Mr. Motyl attributed the increase to strong gasoline and diesel oil consumption, as well as relatively lower gas tax than in some neighboring states.

Division of Motor Vehicles: There was no change from the December estimate of $218.0 million.

Other Transportation Revenues: Increased from $15.6 million in December to $16.6 million.

Mr. Motyl attributed the increase to stronger-than-expected cash flows and account balances.

U.S. 301 Capital Expenditure: There was no change from the December estimate of $7.9 million.

A motion was made, seconded, and approved to accept $593.8 million as the FY 2019 TTF revenue estimate. The estimate represents an increase of $4.0 million from the December estimate.

FY 2020 Estimates:

The following changes were made from the December estimates.

Toll Road Revenues: There was no change from the December estimate of $211.4 million.

Motor Fuel Tax Administration: Increased from $140.8 million in December to $143.8 million.

Division of Motor Vehicles: There was no change from the December estimate of $221.2 million.

Other Transportation Revenues: Increased from $16.1 million in December to $16.6 million.

U.S. 301 Revenues: There was no change from the December estimate of $17.8 million.

A motion was made, seconded, and approved to accept $610.8 million as the FY 2020 TTF revenue estimate. The estimate represents an increase of $3.5 million from the December estimate (See Table 5.)

Other Business:

Mr. Houghton announced the next scheduled DEFAC meeting dates:

- April 22, 2019
- May 20, 2019

There being no further business, Mr. Houghton adjourned the meeting at 2:33 p.m.

Respectfully submitted,

Arsene Aka