COMPTROLLER of MARYLAND
Serving the People

Peter Franchot
Comptroller

Sandra L. Zinck, CPA
Director
General Accounting Division

August 30, 2018

The Honorable Peter Franchot
Comptroller of Maryland
Comptroller's Office
80 Calvert Street
Annapolis, Maryland 21404

Dear Comptroller Franchot:

Enclosed you will find the statement of General Fund Balance for the year ended June 30, 2018. In addition, you will find a schedule of General Fund revenues and an analysis of the variances between the 2018 estimated and actual revenues prepared by the Bureau of Revenue Estimates.

The State closed the fiscal year ended June 30, 2018 with a fund balance of $589.6 million in the General Fund. Of this amount $85.8 million was assigned by the 2018 General Assembly for fiscal year 2019 operations leaving an unassigned fund balance of $503.8 million.

Please advise me if you have any questions or would like additional information.

Sincerely,

Sandra L. Zinck
Director

SZ:ma

Enclosure

cc: The Honorable David Brinkley
The Honorable Nancy Kopp
Ms. Victoria Gruber
Mr. Len Foxwell
Ms. Sharonne Bonardi
Mr. Andrew Schaufele

General Fund Balance
June 30, 2018

General Fund Balance, June 30, 2017		$	258,549,955
Add:			
2018 Estimated Revenues (Board of Revenue Estimates March 2018)			17,019,138,819
Adjustments to Revenues (See detail)			14,014,857
Reimbursement from reserve for Tax Credits			21,761,071
Other adjustments to revenue - 2018 Session:			
Transfer from other funds (See detail)			9,000,000
Transfer from Revenue Stabilization Account			
Deduct:			
2018 General Fund Appropriations			
Appropriated by 2017 General Assembly	$ 17,240,318,114		
Board of Public Works reductions	(60,978,555)		
Deficiency appropriations	46,615,069		
Legislative reductions	(5,471,673)		
Specific reversions (See detail)	(54,612,704)		
Estimated agency reversions	(35,000,000)		
Net appropriations			(17,130,870,251)
Estimated 2018 General Fund Balance			191,594,451
Add:			
Excess of Actual Revenues over estimates	339,337,935		
Excess of Actual Transfers over estimates	4,097,524		
			343,435,459
Add:			
Excess of Actual Reversions over estimates			54,560,386
Total General Fund Balance			589,590,296
Deduct:			
General Fund Balance Reserved for 2019 Operations	191,594,450		
Minus 2019 Estimated Surplus	(105,840,167)		
			85,754,283
2018 Unassigned General Fund Balance		$	503,836,013

EXHIBIT A
GENERAL FUND BUDGET SUMMARY
Detail – Fiscal Year 2018

Adjustments to Revenues – Other	
Volkswagen Settlement	$22,000,000
Central Collection Unit Savings	600,000
Lottery Revenue Adjustment	(2,833,333)
Settlement Revenue Lower than Expected	(5,677,810)
Chapter 479 of 2018 – DLLR Nondepository Special Fund	(74,000)
Total	$14,014,857

Transfers from Other Funds	
University System of Maryland Fund Balance (2018 Session)	$9,000,000

Specific Reversions	
MDH – Medicaid Prior Year Accrual	$(43,000,000)
MHEC – College Savings Plan Match	(4,546,250)
MSDE – Quality Teacher Stipends	(1,500,000)
DGS – Deferred Revenues	(1,321,454)
DJS – Residential Per Diems	(1,250,000)
MSDE – Teacher Induction, Retention, and Advancement Program	(1,145,000)
MSDE – Anne Arundel Teacher Pilot Program	(950,000)
MSDE – Juvenile Service Education	(700,000)
MSDE – Out of County Placements	(200,000)
Total	$(54,612,704)

STATE OF MARYLAND
State Reserve Fund
June 30, 2018
(In Dollars)

	Revenue Stabilization Account (Rainy Day) A0101 (fund 0201)	Dedicated Purpose Account A0201 (fund 0202)	Economic Development Opportunity (Sunny Day) A0301 (fund 0203)	Catastrophic Event Account A0401 (fund 0204)	Total
Beginning Balance - July 1, 2017	$ 832,492,382.92	$ 500.00	$ 21,733,614.35	$ 7,229,411.11	$ 861,455,908.38
Investment Earnings	13,399,580.06				13,399,580.06
Replenishment	10,000,000.00		-		10,000,000.00
Distributions/Transfers	950,191.84	-	-	(2,243,781.83)	(1,293,589.99)
Ending Balance - June 30, 2018	$ 856,842,154.82	$ 500.00	$ 21,733,614.35	$ 4,985,629.28	$ 883,561,898.45

COMPTROLLER of MARYLAND
Serving the People

Peter Franchot
Comptroller

Andrew Schaufele
Director
Bureau of Revenue Estimates

August 30, 2018

To: Honorable Peter Franchot
Honorable Nancy K. Kopp
Secretary David R. Brinkley

From: Andrew Schaufele
Director, Bureau of Revenue Estimates

Subject: Fiscal Year 2018 Revenues

General fund revenues in fiscal year 2018 were $17.4 billion, an increase of 4.0% over fiscal year 2017, and 2.0% or $339.3 million above estimate. The ongoing growth rate for the general fund was 4.4%.

Key Variances
($ in Millions)

Item	Dollar Variance	$ Variance Rank	Percent Variance	% Variance Rank
Total General Fund	$339.3	NA	2.0%	NA
Personal Income Tax	$218.7	1	2.4%	6
Insurance Premium Tax	$60.1	2	18.4%	1
Sales Tax	$34.1	3	0.7%	12

- Large capital gains realizations likely caused much of the income tax variance
    - In this era of extraordinary volatility, we have estimated no growth in capital gains to deter large negative variances, opting for the lesser of two evils
- Tax policy uncertainty may have impacted the income tax as well
    - After the 2016 elections, taxpayers shifted income into 2017; we estimated $1.6B shifted
    - No reform for 2017, reform passes for 2018; we estimate another $2.3B shifts to 2018
    - Actual magnitudes will never be known
- Employment growth slows in back-end of fiscal year, but average wage improves, countering employment slowdown
- Sales tax growth weak for the year, growing 2.3%, but improved in second half
    - First half increased just 0.9%, second half increased 3.4%
    - Buoyed by: (1) 1st year Trump headwinds behind; (2) federal tax cut; (3) inflation
- Premium tax extraordinarily strong, 2nd year in a row; cause remains under analysis

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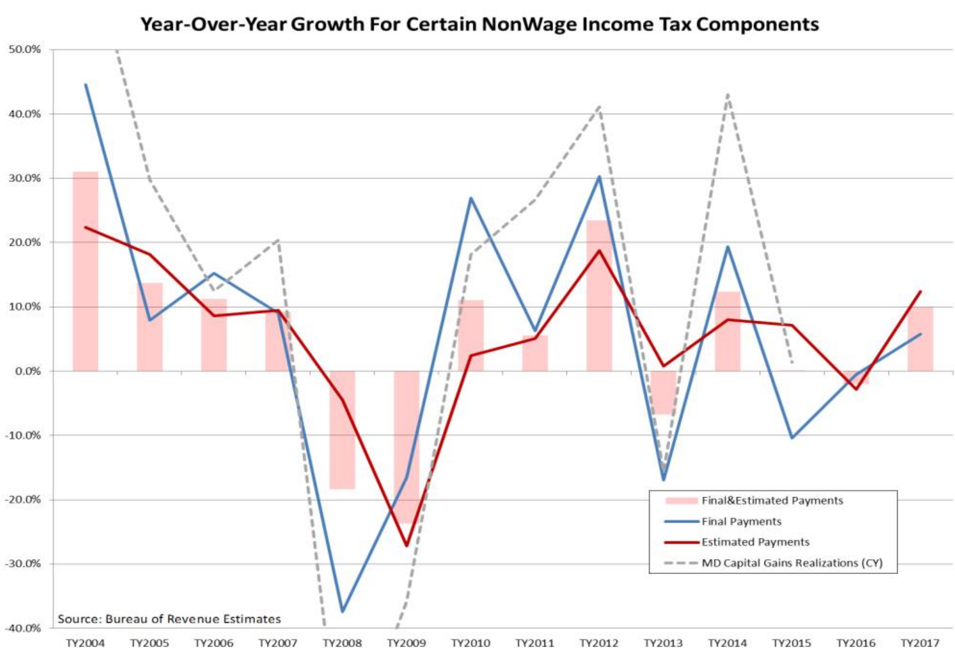
Income Tax

First, it should be noted that recent economic and withholding data indicate that average wage growth, for two consecutive quarters, has finally surpassed 3.0%. While this rate remains low relative to prior economic expansions at or near full employment, it remains a significant milestone for this expansion following the Great Recession. Moreover, as wage withholding is two-thirds of the income tax and roughly one-third of the total general fund, and is thus the most critical aspect of our estimate, this growth holds significance for the State's revenue outlook, as well. Although it does not disproportionately relate to our variance, it does, at least temporarily, support our outlook for such growth. The boost in average wage proved critical as employment growth slowed significantly in the fourth quarter of 2017 and into the first quarter of 2018. However, as a note of caution, though this slowdown was expected to occur as the labor market began to operate near full employment, direct federal employment actually began to contract in that time frame, as federal contracts expired and agencies slowed their rate of hiring.

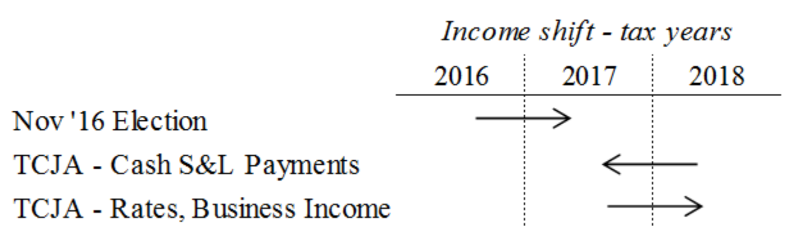
Regarding the variance, the approximately $218.7 million surplus in individual income tax revenues is almost certainly a result of a significant amount of capital gains realizations. Our most recent capital gains data shows an increase of just 1.4% in 2015. As illustrated below, capital gains routinely factor into large swings in nonwage income; the lack of nonwage payments and the late 2016 speculation for tax reform point toward low realizations for 2016, as well. By the end of 2017, the S&P 500 and Nasdaq were up 30% and 47%, respectively, relative to their 2014 closes. The lack of gains in such a strong bull market is indicative of strong unrealized capital gains and also lends credibility to our assumption that capital profit taking bolstered this variance.



Capital gains tax realizations are volatile and often short-term in nature. Historically, the market has fluctuated significantly with business cycles, and more importantly, to a much greater degree than any other aspect of the economy. While market fundamentals and the prospect for still unrealized gains remain strong, surely in the future there will be an unpredictable correction that will reverse these good fortunes.

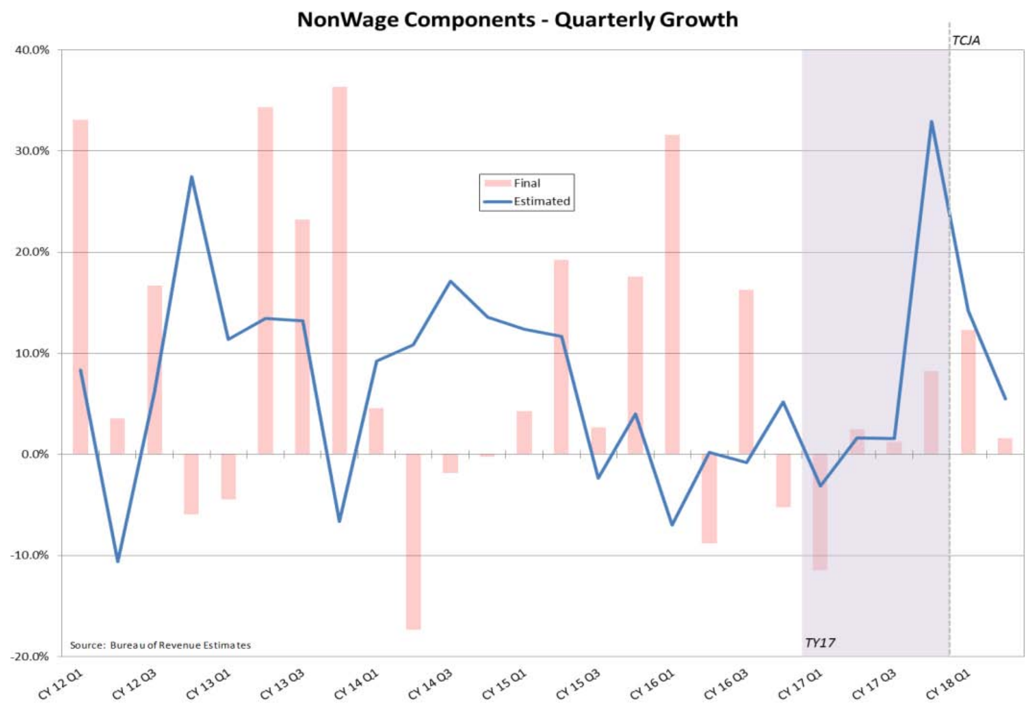
It should be noted that, as mentioned, the Board/Revenue Monitoring Committee has adopted a policy of estimating 0% capital gains growth in order to minimize the effects of this volatility. The revenue volatility cap, which will come into effect in fiscal year 2020, will help alleviate some of volatility by capping estimates of non-withholding revenues and pledging certain amounts that exceed the capped estimate toward one-time uses and preparation for future down-turns, notably paygo capital and a reserve account. We believe this to be a prudent approach.

Although likely to a lesser extent, the shifting of income between tax years that occurred in anticipation of federal tax reform may have also created variance. The chart below illustrates likely taxpayer behavior related to federal tax policy.



There were two anticipatory periods: one following the 2016 federal elections in which President Trump was elected and Republicans retained a majority in Congress, and one through the winter of 2017/2018 as momentum built and the Tax Cuts and Jobs Act (TCJA) passed. The first period incentivized taxpayers to pull expenses into tax year 2016 and push income into tax year 2017 as the elections brought the general possibility of tax reform, but no specifics. In the second period, the specifics of the bill were available to taxpayers, including a lack of reform for capital gains and a large broad based tax cut, but also the federal $10,000 cap on the deduction for State and local taxes paid. We estimated $1.6 billion of taxable income ($80.0 million in General Fund revenues) to have shifted from tax year 2016 into 2017, and another $2.3 billion ($112.5 million GF) to have shifted from 2017 into 2018, all in the form of nonwage income. The exact magnitude of those shifts will never be known, but the fact that they were accounted for likely minimizes their direct impact on the estimate variance.

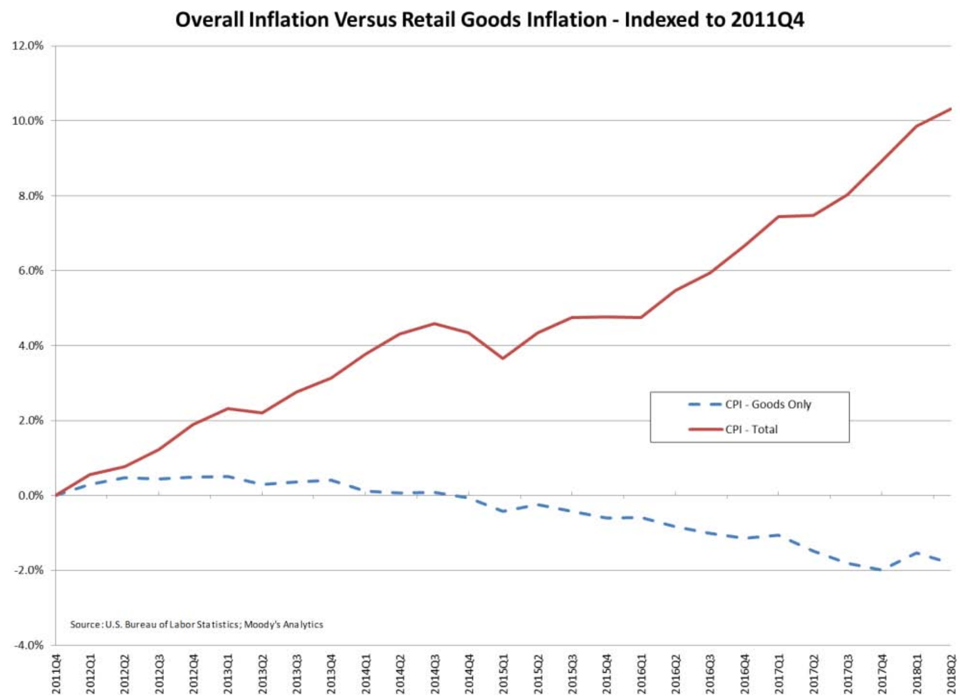
The $10,000 cap on state and local taxes paid likely had little impact on the shifting of income between fiscal years, but it almost certainly had an impact on how and when taxpayers paid their 2017 taxes. That deduction is cash-based rather than tax year-based, and thus the cap on the deduction incentivized itemizers to pay as much of their 2017 taxes in 2017 in order to avoid an April 2018 extension or final payment in which their deduction would be limited. The chart below illustrates the extraordinary fourth quarter estimated payment for tax year 2017, which supports this theory. The fact that we still had growth (not strong, but growth at all) in April payments likely signifies the strength of capital gains. It is worth noting that some taxpayers may have wanted to pay all of their 2018 taxes in 2017; however, the IRS released regulations prohibiting that act.



Sales Tax

While sales tax revenues came in at a sluggish 2.3%, they appear markedly improved in the second half of the fiscal year (3.4%) relative to the first half (0.9%), primarily for two reasons. First, February marked one year of the Trump Administration. Spending in the first half of calendar year 2017 was restrained (revenues grew only 1.7% over the prior year), as the new Administration brought along the potential for spending cuts and federal hiring freezes. Revenues from the first half of calendar year 2018 are thus measured against weak sales tax numbers from the first half of calendar year 2017; the 3.4% growth rate reflects the return to an apples-to-apples comparison, while the 0.9% growth rate reflects a pre-Trump vs. post-Trump comparison. Second, federal tax reform has, in fact, put money back into consumer pockets, and presumably some has made its way into the economy in the form of taxable spending.

Inflation generally, and certainly in the near-term, supports stronger sales tax collections. Inflation, as measured by the consumer price index (CPI), increased 2.2% in fiscal year 2018, the measure's strongest growth since fiscal year 2012. However, since at least 2014, there has been a divorce between the broader measure of inflation and inflation related to goods. Goods tend to relate closer to the types of items that are taxable in Maryland. Goods prices have generally decreased since 2014. More recently, it appears that the decrease has stalled and perhaps prices have even increased modestly. This also may help explain the second half improvement in sales tax.



Other significant factors for the sales tax include:

- the Supreme Court's Wayfair decision, not yet materially impacting sales tax revenues, is set to boost collections from remote sellers
- digital goods – streaming music, digital subscriptions, and digital downloads – continue to increase in popularity but remain untaxable
- services continue to grow as a share of consumer spending but most remain untaxable
- age demographic shifts – younger consumers preferences for generally non-taxable goods as well as the baby-boomers shift to services
- more broadly, the rate of savings throughout this expansion has been at levels not seen since the early 1990s

Insurance Tax Premiums

Insurance tax premiums grew 17.6% over the prior year, were 18.4% above the fiscal year 2018 estimate, and accounted for 17.7%, or $60.1 million, of the general fund variance. Growth in fiscal year 2017 was also unusually strong at 14.4%. The explanation provided by the Maryland Insurance Administration (MIA) for the extraordinary growth is that additional carriers have entered the market.

The notion that revenues could increase at these rates statewide as a result of the addition of new carriers is difficult to reconcile with the reality of an insurance market dominated by a small number of players. Furthermore, it would also intimate that prior to two years ago, Maryland insurance consumers were lacking an extraordinary amount of coverage that they apparently needed or wanted. Surely an increase in carriers is good for the State; however, increased competition generally drives prices down. Competition also invites innovation, thus perhaps new lines of insurance have been introduced; however, those would have to be significant coverages that were hitherto missing in order to drive such increases. As such, we do not believe that we have a complete understanding of what constitutes the historical data or the current monthly data that we receive. Given our lack of understanding, we are thankful for the General Assembly's statutory language requiring MIA to report additional information to my office. We plan to use the statistics to greatly reduce the variance from the estimate in the future.

Actual and Estimated General Fund Revenue
Fiscal Year 2018

	Fiscal Year 2018				Fiscal Year 2017		
			Difference from Estimate			Growth FY 17 - FY 18	
	Actual	Estimated [1]	$	%	Actual	$	%
INCOME TAXES							
Individual	9,507,776,217	9,289,072,375	218,703,842	2.4%	9,019,277,722	488,498,496	5.4%
Corporation	820,401,157	815,083,215	5,317,942	0.7%	795,593,546	24,807,611	3.1%
Total	10,328,177,374	10,104,155,590	224,021,784	2.2%	9,814,871,268	513,306,106	5.2%
SALES AND USE TAXES	4,645,755,937	4,611,658,477	34,097,460	0.7%	4,539,320,011	106,435,925	2.3%
STATE LOTTERY RECEIPTS	534,598,098	518,374,063	16,224,034	3.1%	484,332,421	50,265,677	10.4%
OTHER REVENUES							
Business Franchise Taxes	245,945,748	234,067,487	11,878,261	5.1%	228,436,706	17,509,042	7.7%
Tax on Insurance Companies	386,427,178	326,340,707	60,086,472	18.4%	328,733,917	57,693,261	17.6%
Estate and Inheritance Taxes	214,383,030	216,364,690	(1,981,661)	-0.9%	227,946,637	(13,563,607)	-6.0%
Tobacco Tax	372,735,070	381,556,023	(8,820,953)	-2.3%	386,976,488	(14,241,418)	-3.7%
Alcoholic Beverages Excises	32,031,841	31,856,325	175,516	0.6%	32,489,553	(457,713)	-1.4%
District Courts	62,990,048	62,095,339	894,708	1.4%	69,302,834	(6,312,786)	-9.1%
Clerks of Court	31,764,976	34,354,275	(2,589,299)	-7.5%	36,145,515	(4,380,539)	-12.1%
Hospital Patient Recoveries	69,802,699	68,258,242	1,544,457	2.3%	62,180,339	7,622,360	12.3%
Interest on Investments	32,001,272	35,000,000	(2,998,728)	-8.6%	22,491,751	9,509,521	42.3%
Miscellaneous	354,513,396	348,225,450	6,287,946	1.8%	355,277,244	(763,848)	-0.2%
Total	1,802,595,258	1,738,118,537	64,476,721	3.7%	1,749,980,985	52,614,273	3.0%
TOTAL CURRENT REVENUES	17,311,126,667	16,972,306,667	338,820,000	2.0%	16,588,504,685	722,621,982	4.4%
Extraordinary Revenues [2]	15,336,944	14,819,008	517,936	3.5%	47,431,726	(32,094,782)	-67.7%
Transfer Tax Revenues [3]	46,028,000	46,028,000	-	0.0%	62,771,000	(16,743,000)	-26.7%
GRAND TOTAL	17,372,491,611	17,033,153,676	339,337,935	2.0%	16,698,707,411	673,784,200	4.0%

[1] The 2018 Legislative Session resulted in an additional $14.015 million in estimated revenues beyond the March 2018 official estimate; this table has been adjusted accordingly
[2] The 2017 BRFA diverted VLT revenue dedicated to the SMWOB Account to the General Fund for FY 2018. In FY 2019 and 2020, that money will be distributed to the Education Trust Fund
[3] The Tax Property Article §13-209 has been altered across several legislative sessions so as to provide various distributions to the general fund