MINNESOTA Management & Budget

November 2012 Forecast

HIGHLIGHTS

$1.095 Billion Budget Shortfall Forecast for 2014-15 Biennium

Minnesota's FY 2014-15 budget outlook has changed little since August's special legislative session when a $1.079 billion shortfall was projected. Revenues now are forecast to be $35.793 billion, $68 million less than earlier estimates. This small decline in revenues is partially offset by a $43 million reduction in projected spending and a net $9 million increase in reserves. Spending in FY 2014-15 is now estimated to be $36.866 billion. The projected FY 2014-15 budget shortfall has grown by $16 million.

Current Biennium's Budget Balance of $1.330 Billion Goes to Repay School Aid Shift

State general fund revenues for the 2012-13 biennium are forecast to exceed end-of-session estimates by $1.076 billion (3.2 percent), while general fund spending is projected to be $262 million below earlier estimates. State law requires that any forecast balance for the current biennium be used to reduce the $2.4 billion school aid shift outstanding. After the buyback, $1.1 billion in school shifts will remain.

Revenue Growth in FY 2012-13 Does Not Carry Forward into FY 2014-15 Biennium

Global Insight's November baseline calls for U.S. economic growth to average 2.8 percent in the 2014-15 biennium. In February, 3.1 percent growth was expected. That slight decline in the economic outlook, coupled with several one-time items that increased FY 2012-13 revenues but did not add to future revenues, left FY 2014-15 revenues almost unchanged from earlier planning estimates. Income tax revenues are now forecast to be $548 million less than end-of-session estimates. Almost half of that decline came from a weaker wage forecast. A projected shift of capital gains realizations and other portfolio income from the 2013 and 2014 tax years into tax year 2012 produced much of the remainder of the reduction.

Federal Tax and Spending Policy Concerns Add to Forecast Uncertainty

Minnesota's budget outlook for FY 2014-15 depends on more than the national economy's strength. Changes in federal law also will affect state revenues by inducing changes in individual behavior. For example, permanent tax rate increases are generally expected to encourage acceleration of taxable income and reduce it in later years. Global Insight's baseline assumes that federal policymakers resolve current fiscal cliff concerns on a timely basis and that significant tax and spending changes will be phased in beginning in 2014. Failure to reach agreement before January 1, 2013 tax year or a more aggressive fiscal policy stance in 2013 would materially reduce economic growth and state revenues in the 2014-15 biennium.

SUMMARY

$1.330 Billion Projected FY 2012-13 Balance Triggers School Shift Buyback

Minnesota's budget outlook for the current biennium has improved materially since last February's forecast. After August's special legislative session, the budget was balanced and a zero general fund balance was projected.

Forecast revenues are now expected to be $34.944 billion, up $1.076 billion from the end-of-the special session. Forecast spending is now expected to be $33.898 billion, a $262 million decline from previous projections. These forecast changes, coupled with a $8 million net increase in reserves, produce a forecast balance of $1.330 billion. But, this balance does not carry forward to the next budget period. Instead it is statutorily allocated to buying back some of the outstanding school aid payment shifts. Leaving the available balance at zero.

FY 2012-13 Forecast

($ in millions)

	November Forecast	Change
Beginning Balance	$1,289	$0
Revenues	34,944	1,076
Spending	33,898	(262)
Reserves	988	26
Stadium Reserve	17	(18)
Forecast Balance	**$1,330**	**$1,330**
School Shift Buyback		*1,324*
Residual to Reserve		*6*
Available Balance		**$0**

Over 40 percent of the forecast improvement reflects gain from closing the books for FY 2012. For the 2012-13 biennium, forecast revenues are up $1.076 billion. The forecast tax revenues, primarily the income, corporate and sales tax forecasts increased by $810 million. Non-tax revenue, transfers and other revenues increased $266 million. Of the $262 million decline in spending, human services spending accounted for $196 million. The remainder came from small savings in K-12 education, debt service and property tax aid and credit spending.

Available Balance Drops to Zero after School Shift Buyback

As in last February's forecast, current law allocates all of the projected balance to buying back K-12 education shifts enacted in the 2009, 2010 and 2011 legislative sessions. Minnesota Statutes 16A.152 requires that if a forecast during the biennium indicates a positive balance for the close of the biennium, the forecast balance must be used to repay school aid payment shifts and reverse the school property tax recognition shift.

Statutory Allocation of Forecast Balances

($ in millions)

	Feb 2012 Forecast	Nov 2012 Forecast	Total Allocated
Forecast Balance	$323	$1,330	$1,653
Statutory Allocations			
Restore Reserves	5		
K-12 Shift Buyback	313	1,324	1,642
Residual to Reserve	$5	$6	$11
Total Allocated	**$323**	**$1,330**	**$1,653**

November's forecast balance of $1.330 billion provides an additional $1.324 billion that is automatically allocated to reversing school aid payment shifts. It will be added to K-12 education aids spending in FY 2013, changing payment percentages from 64.3 percent in the current year followed by a 35.7 percent settle-up payment in the following year to an 82.5 percent, 17.5 percent payment basis.

The $1.324 billion pays back over one-half of the $2.4 billion in school shifts that remained following the February 2012 forecast. The additional funds will be paid to schools in the December 15 school aid payment. After this buyback, $1.1 billion in school aid shifts will remain. The estimated amount needed to return payment percentages to the original 90-10 payment schedule is $546 million; the amount required to fully reverse the existing 50 percent property tax recognition shift is estimated to be $555 million.

Under current law, the school payment percentage is to be adjusted to the nearest one-tenth of one percent. The remaining balance, $6 million, is directed to the budget reserve.

Budget Gap for FY 2014-15 Has Not Changed – A $1.095 Billion Shortfall

The outlook for the budget to be considered by the 2013 legislature, has not changed. At the end of the 2012 special legislative session a $1.079 billion shortfall was projected. With this forecast, the budget gap still remains just under $1.1 billion. General fund revenues for FY 2014-15 are now forecast to be $35.793 billion, an $849 million (2.4 percent) increase over the current biennium. Projected current law spending is expected to reach $36.866 billion, an increase of $1.644 billion (4.7 percent) over the spending forecast for the current biennium.

FY 2014-15 Budget Forecast

($ in millions)

	FY 2012-13	FY 2014-15	$ Change	% Change
Beginning Balance	**$1,289**	**$1,011**	**$(278)**	**(21.6)**
Revenues				
Taxes	32,107	33,778	1,671	5.2
Non-Tax Revenues	1,558	1,390	(168)	(10.8)
Transfers, Other Resources	1,279	625	(654)	(51.1)
Total Revenues	**34,944**	**35,793**	**849**	**2.4%**
Expenditures				
K-12 Education	14,446	15,241	795	5.5
K-12 Shift	781	(61)	(842)	nm
Health & Human Services	10,700	11,443	743	6.9
Debt Service	415	1,355	940	226.5
All Other	8,880	8,888	8	0.1
Total Spending	**$35,222**	**$36,866**	**$1,644**	**4.7%**
Reserves	994	994	--	--
Stadium Reserve	17	39	22	--
Budget Balance	**-0-**	**($1,095)**		

Tax revenues for the coming biennium are forecast to increase nearly $1.7 billion over the current biennium. Underlying growth in current law spending for K-12 education and health and human services will be about $1.5 billion, slightly below the growth in taxes.

However, a $1.1 billion shortfall remains largely because non-tax revenues and transfers are expected to be well below amounts projected in the current biennium and debt services costs significantly higher. This comes from the use of one-time resources to balance the FY 2012-13 budget, including one-time tobacco bond savings which artificially reduced debt service in FY 2012-13.

Slow Growth Economy Expected to Continue through Mid-2014

The recovery from the Great Recession has not gone as hoped. U.S. payroll employment remains well below its pre-recession high and the unemployment rate, while down from its peak of 10.0 percent, is still well above levels considered to be full employment. It has been 44 months since the U.S. unemployment rate was reported to be less than 7.5 percent. Real GDP growth since the recession's end simply has not been robust enough to provide the additional jobs needed to reduce the unemployment rate to its full employment level.

Unfortunately, prospects for a sizeable drop in the U.S. unemployment rate over the next two years are not good. Some positive factors are in place. The economy is growing, (albeit not as fast as it potentially could) and, the aging of the baby boom has produced an increasing number of retirements which, in turn, has created many more replacement job openings than in the recent past. Those replacement jobs are not counted as new jobs in the payroll survey's official job count, but they do bring down the unemployment rate by providing positions for those currently unemployed.

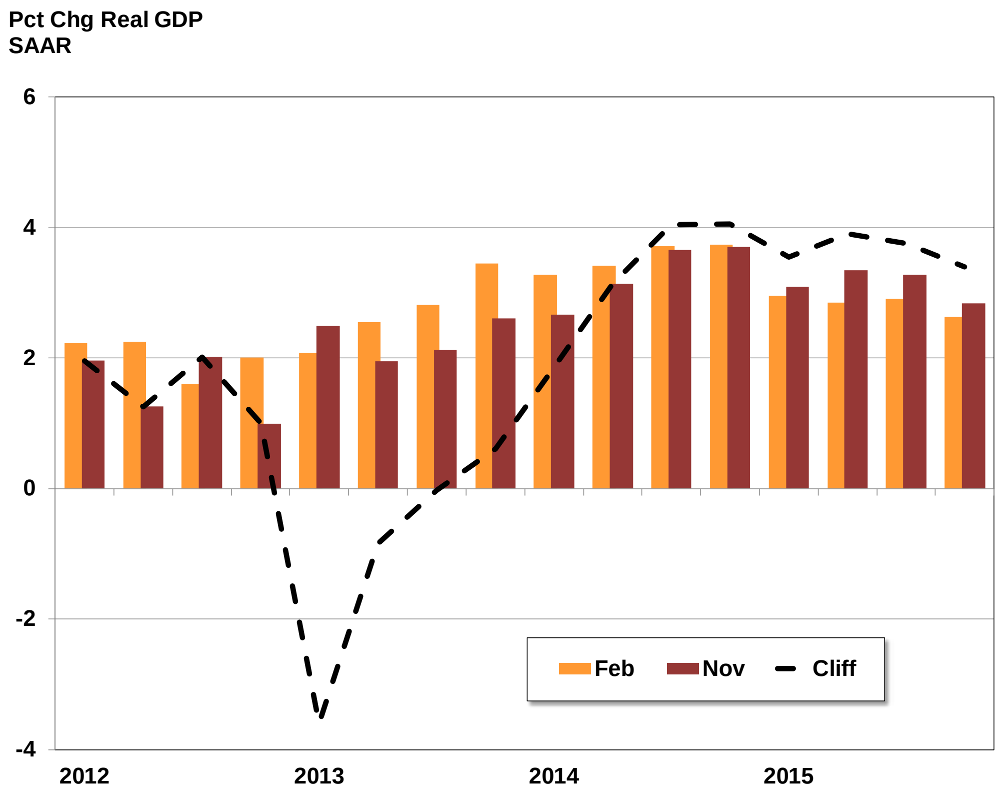
Also, growth in the number of new workers entering the labor market has slowed. That reduces the number of new jobs that must be created just to hold the unemployment rate steady. But forecasters must add discouraged workers and part-time workers who would prefer full time employment to the pool of the unemployed. Once the economics and demographics are put together most expect unemployment rates to remain above 6 percent into 2016 and possibly beyond. The only way to change that less than cheery unemployment outlook is for the U.S. economy to grow faster than currently projected. But there are no quick fixes. Were real GDP to grow 0.5 percent faster in 2013 and 2014 the unemployment rate still would be unlikely to fall below 6 percent in 2015.

Economists do not expect a booming economy in 2013, but a foundation is being put in place for an extended period of stronger growth. Interest rates are low, corporate balance sheets strong, and the housing and auto industries appear poised for a breakout, but short-term uncertainty continues to plague this recovery. The effects of the European recession, Europe's sovereign debt crisis, and China's economic slowdown on the U.S. economy are all unknown. The downside risk is so substantial that many businesses are nervous, and believe it prudent to delay investment and hiring decisions until some of the uncertainty is resolved.

And then there is the fiscal cliff. Forecasters are assuming that the perfect storm of tax increases and expenditure cuts scheduled to begin on January 1, 2013 will somehow be avoided and that the economy will escape unscathed. That may well be the case, but until federal fiscal policy is seen to be taking a less damaging course the potential impact of a domestic fiscal policy mistake adds further to the reluctance of business to add workers and purchase more equipment.

The November baseline forecast from Global Insight Inc. (GII), Minnesota's national macro-economic consultant, calls for real GDP growth rates for 2013, 2014, and 2015 that are only slightly weaker than those in their February 2012 baseline. Like almost all other forecasters GII assumes that the cliff is avoided and that a program of tax increases and spending cuts begins in 2014. Real GDP in 2013 is now expected to grow at a 1.9 percent annual rate followed by real growth rates of 2.8 percent and 3.3 percent for 2014 and 2015 respectively. In February real growth rates of 2.3 percent, 3.3 percent and 3.2 percent were projected for 2013, 2014, and 2015. Global Insight's forecast for 2013 through 2015 is slightly more optimistic than the Blue Chip Consensus. Blue Chip and GII forecasts for real growth in 2013 and 2015 are almost identical, but the Blue Chip estimate for 2014 of 2.8 percent is 0.5 percentage points below the 3.3 percent growth called for in GII's November baseline.

Slower Real GDP Growth Expected but Fiscal Cliff Could Bring a Recession



Global Insight sees the U.S. economy plunging off the fiscal cliff as a low probability event. Their pessimistic scenario (probability 20 percent) includes a U.S. recession, a very messy exit by Greece from the Eurozone and a more severe than expected European recession. In their optimistic scenario (probability 20 percent) quick resolution of the fiscal cliff coupled with stronger recovery in housing boosts real growth rates by 0.5 percent in 2013 and 2014. The baseline scenario is assigned a probability of 60 percent.

The Fiscal Cliff and Minnesota – Job Losses and Lower Revenues

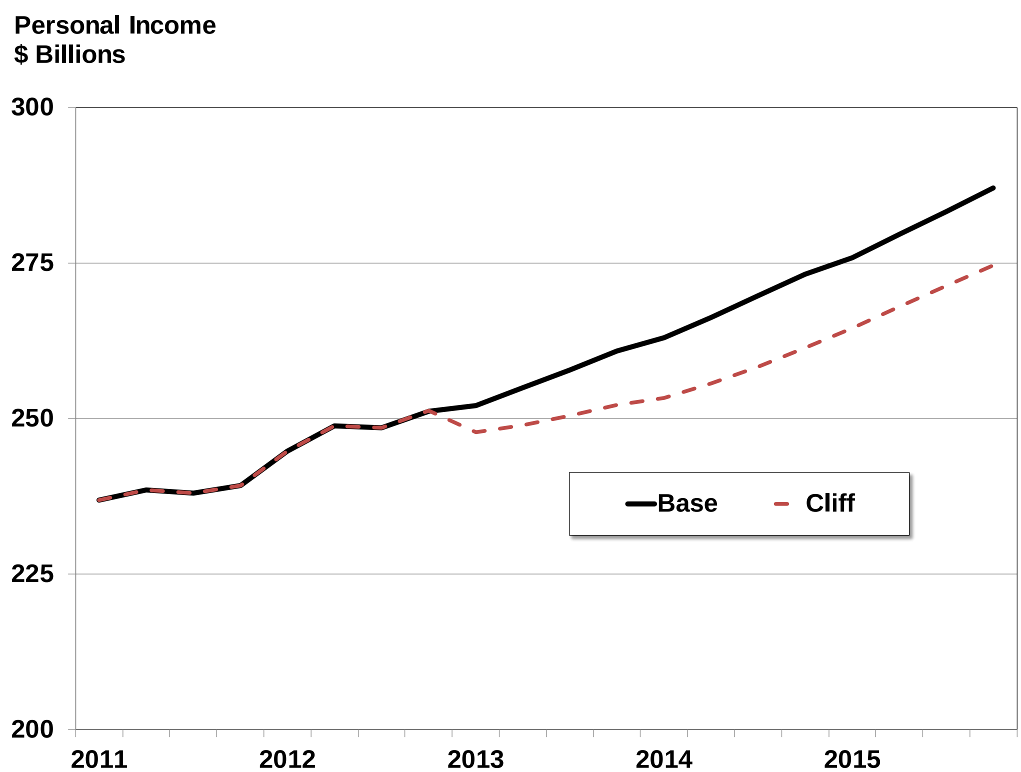
As noted in February's forecast, projections for Minnesota's economy and the state's budget for 2013, 2014, and 2015 have a much larger than usual margin of error. Significant changes in federal tax and expenditure policy are scheduled to take place beginning on January 1, 2013, but the details of those changes and their timing is still unknown, and some of the policy alternatives are of sufficient magnitude they could push the U.S. economy into a recession. In total they will most certainly affect the national economic outlook. They also will affect the performance of the Minnesota economy and the state's budget outlook.

To provide an indication of the fiscal cliff's potential impact on Minnesota's finances MMB economists constructed an alternative state forecast based on Global Insight's broad fiscal cliff scenario. This GII scenario assumes the tax increases and expenditure cuts currently scheduled for the start of 2013 are allowed to proceed as scheduled, and are not reversed by congressional action.

In Global Insight's fiscal cliff scenario real GDP falls at a 3.6 percent annual rate in the first quarter of 2013 and at a 0.9 percent annual rate in the second quarter. For all of 2013 real GDP declines by 0.5 percent. Payroll employment at the end of 2015 is roughly 3.5 million less than in the baseline scenario. The U.S. unemployment rate goes to 9.0 percent by mid-2014 and U.S. personal income falls short of baseline projections by more than one-half trillion dollars by the end of 2013.

In the fiscal cliff scenario Minnesota employment falls 60,000 below the baseline by early 2014 and is 70,000 below the baseline by mid-2015. Minnesota's unemployment rate grows to 7.1 percent by the end of 2014 and state personal income in 2015 is approximately five percent below the baseline.

Minnesota Personal Income Falls Five Percent Below Baseline in Fiscal Cliff Scenario



A weaker state economy means slower revenue growth for the 2014-15 biennium. The fiscal cliff forecast for Minnesota shows individual income tax receipts more than $250 million below current baseline projections in fiscal 2014 and at least $450 million below the 2015 baseline before taking into account the likely acceleration of capital gains and other portfolio income into tax year 2012. After the behavioral effects of the increase in the capital gains rate are taken into account individual income tax receipts in the 2014-15 biennium would likely fall more than one billion dollars below the baseline forecast. Sales tax receipts and corporate tax receipts also would be reduced. MMB economists estimate that Minnesota sales tax receipts in the 2014-15 biennium would fall by at least $350 million below the baseline and corporate tax receipts would be more than $250 million below the current forecast.

Revenues from Minnesota’s three largest revenue sources would fall at least $1.3 billion below the baseline forecast in the 2014-15 biennium before accounting for changes in the timing of receipt of income from capital gains and other investments. After those behavioral effects are taken into account, state revenues for the 2014-15 biennium could easily be more than five percent ($1.75 billion) below the current forecast.

FY 2012-13 Revenues Up $1.076 Billion from End-of-Session Estimates

Minnesota general fund revenues for the 2012-13 biennium are forecast to total $34.944 billion, $1.076 billion (3.2 percent) more than expected at the close of the August special legislative session. Almost half of the additional revenues come from fiscal 2012 when revenues closed $475 million more than anticipated. Receipts from the four major taxes were $267 million (1.8 percent) above forecast while receipts from other tax and non-tax revenues exceeded previous projections by $208 million. A one-time settle-up of the federal share of Medical Assistance costs for FY 2011 and prior years accounted for $139 million of the change in other revenues. Fiscal 2013 revenues now are forecast to be $601 million more than end-of-session estimates, with projected receipts from the four major taxes accounting for $477 million of the addition to the forecast.

FY 2012-13 General Fund Revenues
Change From End-of-Session Estimates

($ in millions)

	November Forecast	$ Change	% Change
Income Tax	$16,493	$232	1.4
Sales Tax	9,514	152	1.6
Corporate Tax	2,124	325	18.1
Statewide Levy	1,616	35	2.2
Subtotal	29,747	744	2.6
Other	5,197	332	6.8
Total Revenue	**$34,944**	**$1,076**	**3.2**

Corporate tax receipts showed the largest dollar and percentage increases, up $325 million or 18.1 percent from previous estimates for the 2012-13 biennium. Corporate profits grew more rapidly in 2012 than was projected in February and revenue collections to date have been stronger than anticipated. Actual corporate tax receipts in FY 2012 were $97 million above forecast and fiscal year-to-date corporate receipts for FY 2013 are $67 million above projections.

Much of the $232 million increase in individual income tax receipts came from increases in the forecast of portfolio income. Capital gains realizations by Minnesota taxpayers now appear to have increased by 20 percent in 2011 and they now are projected to increase by nearly 60 percent in tax year 2012 as some taxpayers realize gains this year to avoid the 3.8 percent surtax on the non-wage income of high income individuals used to help fund the Affordable Care Act beginning in 2013.

Projected Revenues for FY 2014-15 Down $68 Million from Previous Planning Estimates

Minnesota's general fund revenues for the 2014-15 biennium are forecast to total $35.793 billion, $68 million less than end-of-session estimates. Projected receipts from the individual income tax are $548 million below prior planning estimates due to slower than projected wage growth and a significant drop in tax year 2013 non-wage income. Much of the reduction was attributable to high income taxpayers accelerating portfolio income from 2013 into 2012 to take advantage of lower tax rates. Sales tax and corporate tax forecasts exceeded planning estimates by $124 million and $137 million respectively. Much of the increase in other revenues is due to a change in the treatment of tobacco settlement revenues following replacement of the bonds issued by the Tobacco Settlement Authority with general fund appropriation bonds.

FY 2014-15 General Fund Revenues
Change From End-of-Session Estimates

($ in millions)

	November Forecast	$ Change	% Change
Income Tax	$17,436	$(548)	(3.0)
Sales Tax	10,123	124	1.2
Corporate Tax	1,954	137	7.5
Statewide Levy	1,677	24	1.4
Subtotal	31,190	(263)	(0.8)
Other	4,603	195	5.7
Total Revenue	**$35,793**	**$(68)**	**(0.2)**

Projected general fund revenues for the 2014-15 biennium are $940 million more than those forecast for the 2012-13 biennium. Individual income tax receipts are $943 million (5.7 percent) more than anticipated for FY 2012-13 and sales tax receipts $610 million (6.4 percent) greater than expected in the current biennium. Corporate tax receipts fall below the forecast for the 2012-13 biennium by $171 million as corporate profits pull back from their historic highs of 2012.

Forecast Spending Down $261 Million in FY 2012-13, and $100 Million in FY 2014-15

Spending estimates have been reduced in both the 2012-13 and 2014-15 biennia. General fund spending for the current biennium is forecast to be $33.898 billion, down $262 million (0.7 percent), from end-of-session estimates before additional spending is added reflecting the K-12 shift buyback. FY 2014-15 spending is projected to be $100 million below prior estimates.

November Forecast Expenditures

($ in millions)

	November FY 2012-13	$ Change	November FY 2014-15	$ Change
K-12 Education	$13,906	($28)	$15,122	($7)
Property Tax Aids & Credits	2,804	(32)	2,729	(42)
Health & Human Services	10,700	(196)	11,443	(185)
Debt Service	415	(39)	1,355	(5)
All Other	6,073	33	6,160	139
Total Forecast Spending	**$33,898**	**($262)**	**$36,809**	**($100)**
K-12 Shift Buyback	1,324		57	
Total After Buyback	**$35,222**		**$36,866**	

Projected human services spending decreased $196 million for FY 2012-13 and $185 million in FY 2014-15, driven primarily by savings in Medical Assistance (MA) payments. The savings come from lower average cost of care in MA Families with Children, a downward trend in nursing facility caseloads in both biennia, and lower than anticipated caseload growth in the MA Long-term Waiver programs in FY 2012-13. Also fewer adults with disabilities opt into managed care in the 2012-13 biennium, and higher than anticipated pharmacy rebates in FY 2012-13 help reduce expenditures.

K-12 education estimates were reduced $28 million in 2012-13 and $7 million in 2014-15, due to a small downward revision in enrollment projections. Savings in 2014-15 were offset, in part, by increases in compensatory program costs. Lower property tax aid costs, reflecting reduced estimates for homeowner and targeted refunds were offset in part by an increase in renters' refunds. Debt service savings reflect the impact of a smaller bond sale in FY 2012 and lower interest rates in the FY 2012-13 biennium.

The changes shown in "all other" spending are largely technical. In FY 2014-15, $113 million of the increase is due to the refinancing of Tobacco Settlement Revenue Bonds with State General Fund Appropriation Refunding Bonds which caused debt service costs to be reflected as general fund spending. This change has an offsetting increase in tobacco settlement revenues.

FY 2016-17 Planning Estimates Provide Longer Term Budget Context

This report provides the first budget planning estimates for the 2016-17 biennium. These planning estimates are materially different than the short-term forecast for FY 2013-15 and carry a higher degree of uncertainty and an inherently larger range of error.

Projected revenue growth exceeds projected expenditure growth in the planning horizon, indicating small structural balances for FY 2016-17. Revenues for FY 2016-17 reflect a normal longer term trend growth rate. Spending projections are essentially flat. They assume no nominal increases in spending will occur over the four-year period beyond those incorporated in current law for education aids and human services health care programs for enrollment, caseload, and current formula driven aids.

Budget Planning Estimates

($ in millions)

	FY 2014	FY 2015	FY 2016	FY 2017
Forecast Revenues	$17,604	$18,189	$19,078	$19,624
Projected Spending	18,419	18,447	19,049	19,390
Difference	**$(815)**	**$(258)**	**$29**	**$234**
Estimated Inflation (CPI)	*$276*	*$614*	*$968*	*$1,393*

The table above shows annual revenues and expenditures, excluding beginning balances and reserves. The difference is a “structural balance”, that is, how much more is being collected than spent. The budget planning estimates are not intended to predict a balanced or unbalanced budget in the future. Their purpose is to assist in determining how well ongoing spending will match revenues based on trend projections of Minnesota’s economy and what it will cost to maintain the same programs.

The expenditure projections do not include a general adjustment for inflation or repayment of the $1.1 billion of remaining school shifts. Therefore, future increases in state spending may be significantly greater than those shown. Projected inflation based on the consumer price index is now expected to be 1.5 and 1.8 percent for FY 2014 and FY 2015; followed by rates of 1.7 and 2.0 percent for FY 2016 and FY 2017. Annual inflation pressures if recognized, compounded over the four-year period, would add roughly $300 million per year to spending.

The FY 2016-17 planning estimates provide a baseline against which the longer term impacts of 2014-15 budget proposals and decisions can be measured.

BUDGET OUTLOOK

BUDGET STATUS: FY 2012-13

$1.330 Billion Projected Budget Balance Triggers School Shift Buyback

The budget for the current biennium was based on the February 2012 forecast. Minor budget changes were made in the 2012 regular legislative session and the August 2012 special session dealing with disaster relief. Following the special session the general fund budget was balanced, with a zero available balance projected for the end of the biennium, and $962 million in the state's cash flow and budget reserves.

This forecast shows a significant improvement in the state's financial position with seven months left in the biennium. Forecast revenues are now expected to be $34.992 billion, up $1.076 billion (3.2 percent) from estimates at the end of the August special session. Biennial spending is now expected to be $33.898 billion, a $262 million (0.7 percent) decline from previous estimates. A small net $9 million increase in reserves offsets part of the improvement – leaving a bottom line of $1.330 billion.

FY 2012-13 Budget Forecast
($ in millions)

	End of Session	November Forecast	$ Change	% Change
Beginning Balance	**$1,289**	**$1,289**	**0**	
Revenues				
Taxes	31,297	32,107	810	2.6
Non-Tax Revenues	1,499	1,558	59	3.9
Transfers, Other Resources	1,072	1,279	207	19.4
Total Revenues	**33,868**	**34,944**	**1,076**	**3.2%**
Expenditures				
K-12 Education	13,934	13,906	(27)	(0.1)
Property Tax Aids	2,836	2,804	(33)	(1.2)
Health & Human Services	10,896	10,700	(196)	(1.8)
Debt Service	454	415	(39)	(0.6)
All Other	6,040	6,073	33	0.7
Total Spending	**34,160**	**33,898**	**(262)**	**(0.7)**
Reserves	962	988	26	--
Stadium Reserve	34	16	(18)	--
Balance Before Allocation	**$ -0-**	**$ 1,330**		

The entire amount of the $1.330 billion projected balance is automatically allocated by current statutes to paying back a portion the outstanding $2.4 billion in school aids accounting shifts.

FY 2012 Closing Contributed $550 Million to the Bottom Line

In August, the books were officially closed for the fiscal year that ended June 30, 2012. FY 2012 concluded with a general fund balance of $640 million, $550 million more than previously forecast. This gain, representing “money in the bank”, accounts for slightly more than 40 percent of the $1.3 billion balance for the biennium.

The remainder of the forecast improvement for the current biennium incorporates the $199 million positive revenue variance reported for July through October for the current fiscal year – as well as revised estimates for revenues and spending for the remaining eighth months of the biennium.

Final FY 2012 Revenues Were $475 Million above Estimates

Total revenues, transfers and other resources for FY 2012 were $475 million higher than previously forecast. Final non-dedicated revenues, both taxes and other non-tax revenues, were $309 million higher. This is $10 million more than previously reported in the *October Economic Update.*

Change in the forecast for other resources, including transfers from other funds and prior year adjustments, added an unanticipated $166 million to the bottom line. Transfers from other funds were $14 million higher than projected. But, prior year adjustments totaled $174 million, $152 million above the $25 million normally forecast. Prior year adjustments reflect savings occurring from cancellation of encumbrances (contracts, grants, or purchase orders) or revenues deposited attributable to *prior fiscal years* after the years have closed. Any savings are reflected as adjustments in the most recent fiscal year – in this case, FY 2012.

Of the $152 million gain from prior year adjustments, a single adjustment accounted for $139 million. That amount represents federal Medicaid funds owed to Minnesota for years *prior* to FY 2012. Minnesota draws federal money on a reimbursement basis for the federal share of Medical Assistance spending which totals about $8 billion annually (state and federal share). In the process of implementing the new statewide accounting system and revising procedures, it was recognized that federal Medicaid funds were owed to the State for previously reported activity not properly reflected by state fiscal year. The federal government has accounted for the situation as $139 million in accounts payable to Minnesota. These funds have now been drawn and a one-time “settle-up” of federal revenue has been deposited to the general fund. This is being reflected as a *prior year adjustment* in the general fund budgetary statements, as well as the state’s *FY 2012 Comprehensive Annual Financial Report*.

Lower FY 2102 Spending Added $75 Million to Projected Balance

FY 2012 spending was $222 million below end-of-session estimates. However, of that amount, $175 million of unspent appropriations were carried forward and appear as an increase in FY 2013 spending. After the carry-forward is considered, the net decrease in spending for the biennium attributable to FY 2012 close is $75 million. Lower spending in health and human services accounted for most of the savings.

General Fund Reserves Increase Slightly

At the end of the August 2012 special session general fund reserves were $962 million: $350 million in the Cash Flow Account; and, a balance of $612 million in the budget reserve after $45 million was used to fund disaster relief. The special session enacted a temporary suspension of the requirement in MS 16A.1522 that restoring the budget reserve to the $653 million ceiling be the first priority for any forecast balance for the biennium.

In this forecast other statutory provisions have directed $32 million to the budget reserve, increasing it to $644 million. Under current law (M.S. 79.251 Subd. 1) any excess surplus in the workers' compensation assigned risk plan is deposited to the general fund and directed to the budget reserve. $26 million was deposited under this provision. Additionally, provisions governing forecast balances and school shift buyback percentages direct that any excess balance, after rounding the nearest one-tenth percent, be deposited to the budget reserve. After allocating $1.324 billion to the buyback, the $6 million residual has been added to the budget reserve.

Stadium Reserve Reduced by Change in Underlying Revenue Forecast

As part of the Vikings stadium financing enacted in 2012, a small reserve was created within the state general fund. Unlike the cash flow and budget reserves, the stadium reserve is a bookkeeping account that simply reflects the balance of forecast revenue from the expanded gambling matched against forecast expenditures for stadium related costs.

For FY 2013, the projected reserve balance has been reduced from $34 to $16 million. Projected new gambling revenues from stadium legislation are expected to be $18 million (51 percent) below end-of-session estimates. For both the FY 2014-15 and FY 2016-17 biennia, estimates have been reduced $9 million (7.7 percent). The forecast reduction reflects a slower than expected implementation of electronic gaming options and reduced estimates for daily revenue per gaming device. As a result, the stadium reserve balance is now expected to be $47 million by the end of 2017, $36 million lower than end-of-session estimates.

Three Successive Positive Forecasts, but Little Change to The Bottom Line

The budget for the current biennium was enacted in July 2011 following the state shutdown. The enacted general fund budget had $16 million on the bottom line, the budget reserve was reduced to zero, and the cash flow account was drawn down to $96 million as part of the final budget solution.

Since that time, there have been three successive positive forecasts, as well as the 2012 regular and special legislative sessions. The three forecasts, November 2011, February 2012, and this forecast have added slightly over $2.5 billion to the general fund bottom line in the form of net increases in forecast revenues and decreases in forecast spending.

Statutory Allocation of Forecast Balances
($ in millions)

	Nov 2011 Forecast	Feb 2012 Forecast	Nov 2012 Forecast	Total Allocated
Forecast Balance	**$876**	**$323**	**$1,330**	**$2,529**
Statutory Allocations:				
Restore Cash Flow Acct.	255	--		255
Restore Reserves	621	5		626
K-12 Shift Buyback	--	313	1,324	1,627
Residual to Reserve	--	5	6	11
Total Allocated	**$876**	**$323**	**$1,330**	**$2,529**

Over that same period the cash flow account and budget reserves had been restored and $1.6 billion of school shifts used to balance the budget have been bought back.

BUDGET FORECAST: FY 2014-15

FY 2014-15 Budget Shortfall $781 Million Less Than Projected At the Start of Biennium

In July 2011 following a regular session budget impasse and a 21-day state government shutdown, a one-day special session resolved the state's $5 billion projected general fund budget deficit for FY 2012-13. The enacted FY 2012-13 budget left a projected shortfall for the FY 2014-15 biennium of just under $1.9 billion. Over three successive forecasts, and the 2012 legislative sessions, the budgetary shortfall has remained relatively unchanged at $1.1 billion.

FY 2014-15 Budget Forecast

($ in millions)

	July 2011 Special Session	November Forecast	Difference
Beginning Balance	**$110**	**$1,011**	**$901**
Forecast Revenues	35,296	35,793	$497
Projected Spending	37,187	36,866	($321)
Balance Before Reserve	(1,781)	(62)	$1,719
Reserves	95	994	$899
Stadium Reserve	--	39	$39
Budgetary Balance	**($1,876)**	**($1,095)**	**$781**

Since the end of the 2011 Special Session, forecast revenues have grown $497 million. Over 60 percent of that change is in tax revenues which have increased $298 million (0.9 percent). At the same time, projected spending has decreased $321 million (0.9 percent) driven by reductions in Health and Human Services ($498 million) and property tax aids and credits ($94 million).

Even though the state has seen its revenue grow and spending estimates declined since July 2011, the budgetary shortfall has remained relatively unchanged. There are three reasons for the lack of progress. First, positive forecast balances in the past three succeeding forecasts have been allocated to restoring budget reserves and reducing the school aid shifts. Second, the use of one-time budget solutions in FY 2012-13, namely one-time transfers to the general fund and the use of tobacco bond proceeds to pay general obligation debt service did not reduce the structural balance in FY 2014-15. Third, the two largest components of the state budget (K-12 Education and Health and Human Services) are expected to grow by a combined $1.5 billion in FY 2014-15.

One-Time Factors and Estimated Spending Growth Outpace Forecast Revenues

When compared to revised forecast estimates for the current biennium, FY 2014-15 revenues are projected to increase by $849 million (2.4 percent) while expenditures are projected to increase by $1.644 billion (4.7 percent).

FY 2014-15 Budget Forecast

($ in millions)

	FY 2012-13	FY 2014-15	$ Change	% Change
Beginning Balance	$1,289	$1,011		
Tax Revenues	32,107	33,778	1,671	5.2%
Non-Tax Revenues	1,558	1,390	(168)	(10.8%)
Other Resources	1,279	625	(654)	(51.1%)
Current Resources	**34,944**	**35,793**	**849**	**2.4%**
K-12 Education	14,446	15,241	795	5.5%
K-12 Payment Shift	*781*	*(61)*	*(842)*	*n/m*
Health and Human Services	10,700	11,443	743	6.9%
Debt Service	415	1,355	940	226.5%
All Other	8,880	8,888	8	0.1%
Total Expenditures	**35,222**	**36,866**	**1,644**	**4.7%**
Balance Before Reserve	**1,011**	**(62)**		
Cash and Budget Reserves	994	994		
Stadium Reserve	17	39		
Budget Balance/Shortfall	**$0**	**$(1,095)**		

General fund revenues for FY 2014-15 are forecast to total $35.793 billion, $849 million (2.4 percent) more than FY 2012-13. Individual income tax receipts are expected to be $940 million higher than FY 2012-13 and biennial growth in other major state taxes includes sales tax ($610 million), statewide property tax ($60 million) and mortgage registry tax ($97 million).

Reductions in non-tax revenues and other resources partially offset the growth in tax revenue. A large number of one-time revenues in FY 2012-13 do not continue in FY 2014-15. These include $52 million from the workers' compensation assigned risk plan, $29 million in a 1 percent cap on Health Maintenance Organization (HMO), $12 million from a HMO donation and significant one-time prior year adjustment of $139 million. Also, one-time transfers primarily from the health care access fund that were used to balance the FY 2012-13 budget do not carry into FY 2014-15 under current law.

While a fairly significant amount of FY 2012-13 revenues do not continue into FY 2014-15 one-time spending reductions used in FY 2012-13 also distort spending growth projections. General fund spending for FY 2014-15 is estimated to total $36.866 billion, $1.644 billion more than FY 2012-13. Forecast spending in health and human services is estimated to be $743 million (6.9 percent) more than FY 2012-13 while K-12 spending estimated to be $795 million higher (5.5 percent). Furthermore, the one-time use of tobacco bond proceeds to pay general obligation debt service artificially reduced spending by $646 million in FY 2012-13. In FY 2014-15 general obligation debt service is once again paid for from the general fund. The biennial growth in K-12 Education and Health and Human Services and significant one-time budget solutions explain why the FY 2014-15 budget shortfall remains at $1.095 billion.

BUDGET PLANNING ESTIMATES: FY 2016-17

This forecast provides the first planning estimates for the 2016-17 biennium. These estimates are materially different from the short-term forecast for the current and 2014-15 biennia. Projection methods are different and the longer-term projections carry a higher degree of uncertainty and an inherently larger potential range of error.

Planning estimates for FY 2016-17 are presented to help identify longer-term state finance issues. Revenues projections are based on GII's November baseline forecast for 2016 and 2017. Expenditure projections assume current funding levels and policies continue unchanged, adjusting only for caseload and enrollment changes as well as specific formula driven items.

Projected Gaps Between Revenues and Expenditures

($ in millions)

	FY 2012-13	FY 2014-15	FY 2016-17
Forecast Revenues	$34,944	$35,793	$38,702
Projected Spending	35,222	36,866	38,439
Difference (Gap)	**$(278)**	**$(1,073)**	**$263**
Inflation CPI		*$890*	*$2,361*

The table depicts forecast revenues and projected spending while excluding the impact of balances from prior years and reserves in order to highlight the structural balance or imbalance. FY 2014-15 projected spending is expected to be $1.073 billion more than forecast revenues while FY 2016-17 revenues are expected to exceed projected spending by $263 million.

Projected inflation based on the Consumer Price Index (CPI) is now expected to be 1.5 and 1.8 percent for FY 2014 and FY 2015 and 1.7 percent and 2.0 percent for FY 2016 and FY 2017. Applying the annual forecast inflation rate, compounded over the four year period, to current law projected spending base would add approximately $300 million per year to the preceding year's adjusted base.

Biennial Comparison
($ in millions)

	FY 2014-15	FY 2016-17	$ Change	% Change
Forecast Revenues	35,793	38,702	2,909	8.1%
Projected Spending	36,866	38,439	1,573	4.3%

Projected revenues for FY 2016-17 now total $38.702 billion, $2.909 billion (8.1 percent) more than FY 2014-15. Estimated spending is projected to grow $1.573 billion (4.3 percent) more than FY 2014-15. The impacts of one-time actions that typically drive large budget growth do no recur in FY 2016-17 planning estimates.

The planning estimates are not intended to predict surpluses or deficits three or more years into the future. Rather their purpose is to assist in determining how well ongoing expenditures are likely to match future revenues based on trends in Minnesota's economy, and the level of spending that is need to maintain current programs. The FY 2016-17 planning estimates provide an important baseline against which the longer-term impacts and affordability of proposed FY 2014-15 budget solutions and decisions in the 2013 legislative session can be measured.

ECONOMIC OUTLOOK

COUNCIL OF ECONOMIC ADVISORS' STATEMENT

The longest and deepest recession since World War II ended more than 41 months ago, but U.S. output and employment have yet to rebound as much as hoped. At this point in prior business cycles employment was making new highs and real output was more than 10 percent above its previous peak. This time has been different. In the third quarter of 2012, GDP exceeded its pre-recession high by just 1.7 percent. And, October's payroll employment report showed that while the economy has added 4.5 million jobs since the recession's low, there are currently 4.3 million fewer jobs than when the recession began.

The foundation for an extended period of good growth is being put in place and, as in late 2011, there are signs of better days ahead. But, most economists believe it will take a year or more for the economy to regain the momentum needed to return it to its normal growth path. Although the outlook for consumer spending, housing, and exports provides reason for longer term optimism, few forecasters expect anything other than modest growth until at least mid-2013.

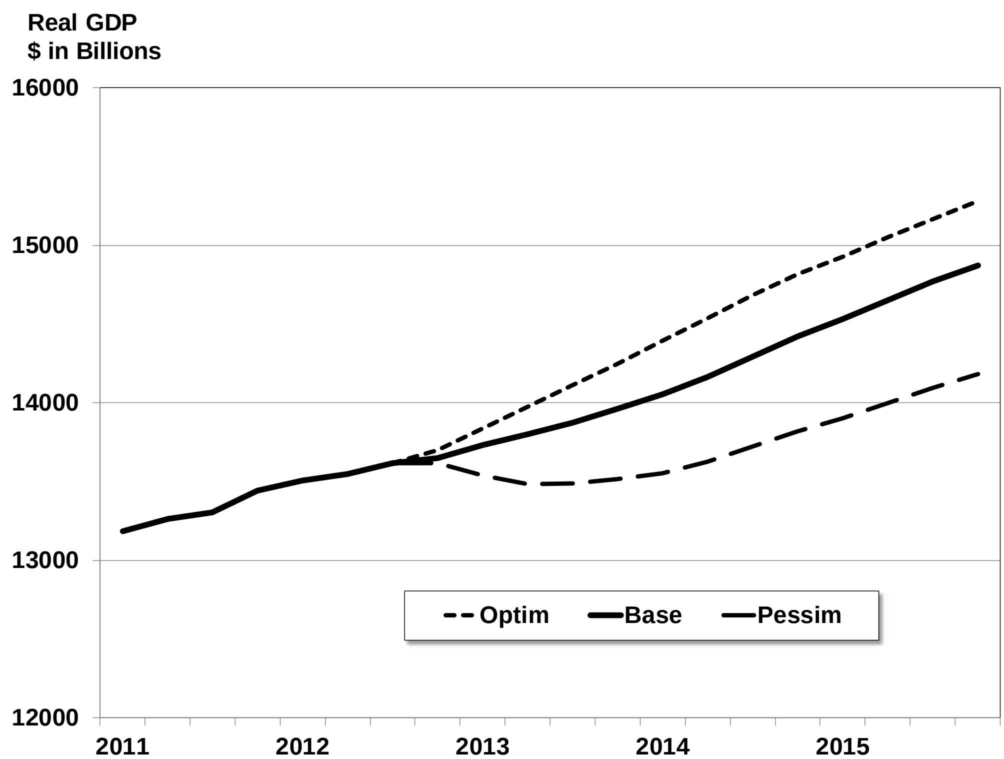
In the short term consumer spending is projected to remain subdued as households continue to face a well-known list of negatives, including high unemployment rates, slow wage growth, and high debt burdens. Still recent measures of consumer confidence and consumer sentiment provide some reason for optimism. Housing starts also appear to be accelerating and that is good news for the hard-hit construction sector where employment levels remain more than 1.9 million below those at the start of the great recession. The economic impact of housing's improvement is likely to be tempered though, since the growth in starts is coming off an extremely low base. Even if starts were to increase by 25 percent in 2013, next year's starts would be among the lowest since World War II. Similarly, export growth is expected to stall in 2013 as Europe continues to struggle to resolve its sovereign debt problems and deal with a recession. But, by 2014, a stronger global economy and a weaker dollar are expected to boost foreign demand for U.S. produced goods and services.

November's baseline forecast from Global Insight Inc. (GII), Minnesota's national macroeconomic consultant, calls for a continuation of the current slow-growth economy through the third quarter of 2013. Then, economic growth accelerates and the real GDP growth rate peaks at 3.7 percent in the third and fourth quarters of 2014. GII now expects real growth of 1.9 percent in 2013 and growth rates of 2.8 percent and 3.3 percent in 2014 and 2015. February's GII forecast anticipated slightly stronger growth - 2.3 percent in 2013, 3.3 percent in 2014 and 3.2 percent in 2015. Global Insight's baseline forecast for 2013 through 2015 is very similar to the Blue Chip Consensus. The Blue Chip forecast is for 2.0 percent real growth in 2013, followed by 2.8 percent growth in 2014 and 3.1 percent in 2015.

Inflation is not expected to be a problem over the forecast horizon, even though food prices are expected to go up in 2013. Higher food prices are expected to be offset by lower energy prices leaving core CPI inflation at 1.8 percent in 2013 and 2.0 percent in 2014 and 2015.

Global Insight assigns a probability of 60 percent to its baseline forecast. A more optimistic forecast led by much stronger growth in consumer spending and housing is assigned a 20 percent probability. A pessimistic scenario in which a recession is brought on by policy gridlock in Europe over attempts to resolve sovereign debt problems and partisan gridlock in the U.S. over attempts to avoid the fiscal cliff is also assigned a probability of 20 percent. Global Insight notes that “the fiscal cliff and its resolution are – at the same time – the biggest downside and upside risks to the economy.”

U.S. Economy Could Do Better or Worse Than The Baseline Depending on Fiscal Cliff Solution.



Members of Minnesota’s Council of Economic Advisors agreed that Global Insight’s November baseline forecast reflects the consensus outlook through 2015. While differences were generally small between Council members’ own forecasts and Global Insight’s baseline, most Council members were slightly more optimistic about 2013 than was GII, but not as optimistic about growth in 2014 and 2015. Most Council members believed that the upside potential and downside risk for the forecast were about evenly balanced, although several noted that the 60 percent probability assigned to the baseline indicated more certainty about the forecast than was warranted given its dependence on timely policy decisions. One Council member indicated he would be more comfortable if the baseline was assigned a 40 percent probability and both the optimistic and pessimistic alternatives given 30 percent probabilities. Several Council members noted that while the uncertainty surrounding federal fiscal policy widens the confidence interval around this forecast, much of the policy uncertainty associated with the fiscal cliff should disappear before February's forecast.

MMB economists are concerned that GII's November Baseline may be unduly optimistic since it assumes business-as-usual in early 2013, even though dealing with the fiscal cliff and the implementation of a credible deficit reduction plan are delayed for at least six months. In the baseline scenario fiscal policy changes are small in 2013 as the payroll tax cuts, the Bush tax cuts, AMT indexing, and most other tax provisions scheduled to expire in 2012 are eventually extended through 2013. The baseline also assumes that scheduled expenditure cuts, including those required by the sequester, are replaced by a broader set of spending cuts which also affect entitlements. Those spending cuts are phased in, beginning in 2014. Agreement between the President and Congress on a program of more aggressive spending cuts and more rapid phase-outs of tax cuts would yield lower real growth than in the Global Insight baseline.

MMB economists also noted that the additional uncertainty produced by delaying resolution of the fiscal cliff for an additional six months could also reduce hiring and business investment in early 2013. They also observed that the federal debt ceiling will need to be extended sometime in the first few months of 2013. Both Moody's and Fitch's rating services have warned that the AAA rating for U.S. Treasury bonds would be downgraded if permanent policies that lead to debt stabilization and ultimately debt reduction are not put in place. Downgrades of U.S. credits would be disruptive for financial markets and would be likely to slow growth further.

Council members, while recognizing the potential negative impact of failing to deal with the fiscal cliff on a timely basis, generally believe that the problem will be resolved without any major damage to the economy in early 2013. One Council member said "the damage from going off the fiscal cliff would be too huge for it to happen."

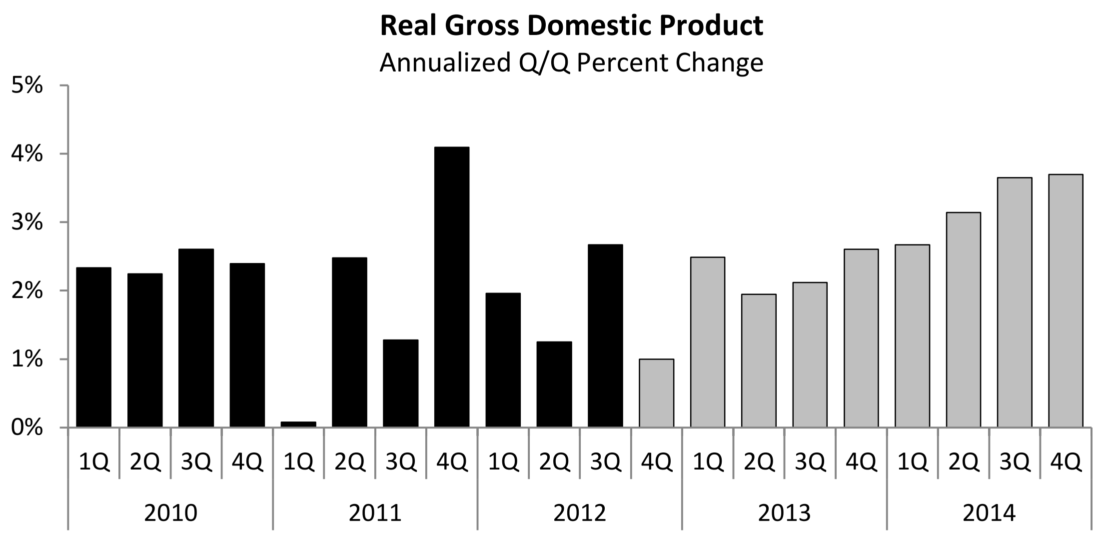
Council members agreed that the economic fallout from superstorm Sandy would be modest, reducing real GDP growth by 0.1 to 0.2 percent in the fourth quarter of 2012 and then increasing real growth by 0.2 to 0.4 percent in the first quarter of 2013. Construction employment was expected to see a boost in November and December in affected areas.

Council members continued to recommend that budget planning estimates for future biennia include an adjustment of future spending to reflect expected inflation. The current practice of including inflation in projected revenues but not in spending projections is misleading and not consistent with either sound business practice or the methods of the Congressional Budget Office. Since inflation is relatively low currently, failure to incorporate it in expenditure projections understates the projected deficit for the 2014-15 biennium by more than $1 billion. That systematic distortion will grow larger if and when inflation accelerates. The Council has made a similar recommendation in each of its written statements since the current practice was required by statute in 2003.

U.S. ECONOMIC OUTLOOK

The foundation for an extended period of stronger economic growth is being primed. Businesses balance sheets are healthy, consumers are feeling more optimistic, and household demand for traditional drivers of recovery, vehicles and housing, is beginning to climb. But growth has been modest and inconsistent, and the immediate outlook remains soft. U.S. payroll employment is still below its pre-recession high and the unemployment rate, although down from its peak of 10.0 percent in late 2009, remains well above what economists consider a normal rate. The combination of slow global growth and a deepening Eurozone crisis are creating headwinds for U.S. exports. And, capital goods orders have fallen sharply as businesses contend with political and economic uncertainty related to the so-called fiscal cliff of tax increases and spending cuts scheduled to begin in January.

Global Insight Inc. (GII), MMB's macroeconomic consultant, believes the fiscal cliff and its resolution are the biggest downside and upside risks facing the U.S. economy. And, they estimate there is roughly equal probability (20 percent) that things could get much better or much worse. On the downside, the risk of political gridlock could send the economy over the fiscal cliff in early 2013. Consumer and business confidence would suffer, spending growth and capital expenditures would freeze, and the U.S. economy would likely fall back into recession in the first part of the year. But a substantive resolution near the end of 2012 could significantly reduce the uncertainty paralyzing U.S. businesses. Hiring and capital spending could accelerate, consumers could become even more optimistic and willing to spend, while stronger growth and sharp, sustained improvements in the labor market could reignite the recovery.



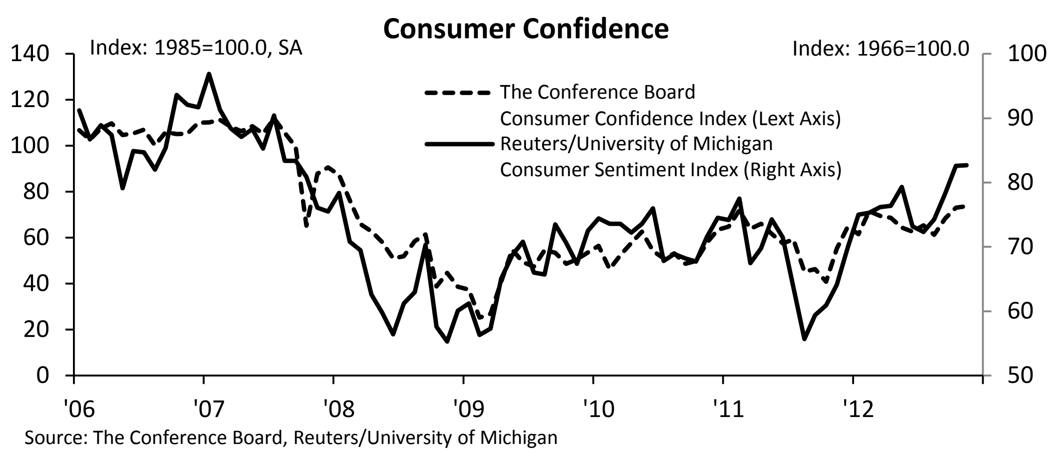
Source: U.S. Bureau of Economic Analysis (BEA), Global Insight (GII)

Real GDP growth has been modest and inconsistent, and the immediate outlook remains soft. The combination of slow global growth and a deepening Eurozone crisis are creating headwinds for U.S. exports. And, capital goods orders have fallen sharply as businesses contend with political and economic uncertainty.

The outlook for economic growth has changed only modestly since Minnesota's revenue forecast was last prepared in February. Real GDP advanced at an annual rate of 2.7 percent in the third quarter of 2012, led by faster inventory accumulation, and up from 1.3 percent in the second quarter. GII expects much slower growth of around 1 percent in the fourth quarter, held back in part by the disruptive effects from Hurricane Sandy. If federal policymakers can make substantive steps towards a credible long-term deficit reduction plan early next year, and at the same time avoid a premature tightening of fiscal policy, GII believes the combination of a continuing housing recovery and a return of business confidence should allow growth to accelerate over the course of 2013. Growth for calendar-year 2012 comes in at 2.1 percent, the same as forecast last February. GII now expects real GDP growth of 1.9 percent in 2013, with growth rates of 2.8 percent and 3.3 percent forecast for 2014 and 2015. February's GII forecast called for slightly stronger growth of 3.3 percent in 2014 and 3.2 percent in 2015.

Too Many Negatives

Confidence among U.S. consumers is as strong as it has been since before the Great Recession. The Reuters/University of Michigan Consumer Sentiment index is at its highest reading since June 2007 and the Conference Board's Consumer Confidence index is at its highest since February 2008. Positive fundamentals on the consumer front are providing momentum. First, a long-awaited housing recovery finally seems to be underway, as sales of both new and existing homes have picked up. The decline in inventory is helping push prices higher. The S&P/Case Shiller 20-city home price index rose 3.0 percent in August from a year earlier, the biggest gain since July 2010. Second, consumers are feeling more upbeat about falling gasoline prices, with the average cost of a gallon of regular gasoline at the pump down 11 percent in the past two months. Most importantly, the labor market is improving following a weak spring. Average payroll employment growth since July now stands at 173,000, more than twice the pace experienced from March to June.



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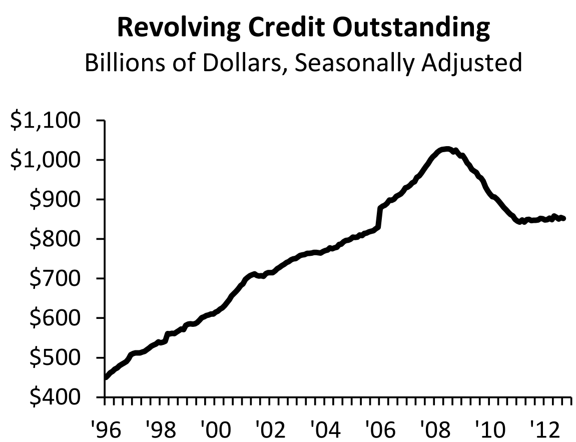
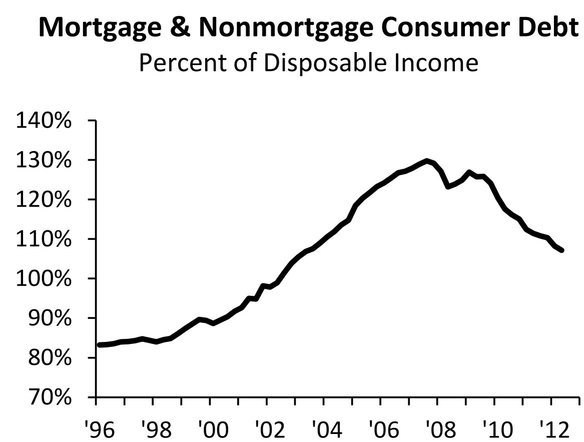
Despite the improvements, consumers still face too many negatives to allow for a robust spending recovery. High debt burdens, reduced household wealth, modest employment growth, low home values, disappointing wage growth, and looming tax increases are barriers to stronger growth in 2013. As expected, households are keeping debt at manageable levels. Consumers are now willing to take on more non-mortgage debt, mainly in the form of big-ticket items such as auto loans and student loans, but are reluctant to run up large credit card bills for smaller discretionary purchases. The Federal Reserve reports that revolving credit outstanding, mostly credit card loans, was about $852 billion in the third quarter of 2012, down $172 billion (or 17 percent) from its 2008 peak and increasing little since 2010. Deleveraging is ongoing. Mortgage and nonmortgage consumer debt has fallen to 107 percent of disposable income, the lowest since 2003, but still well above the 1990s average of near 80 percent of disposable income. GII believes more deleveraging is necessary before consumer spending makes a genuine comeback.





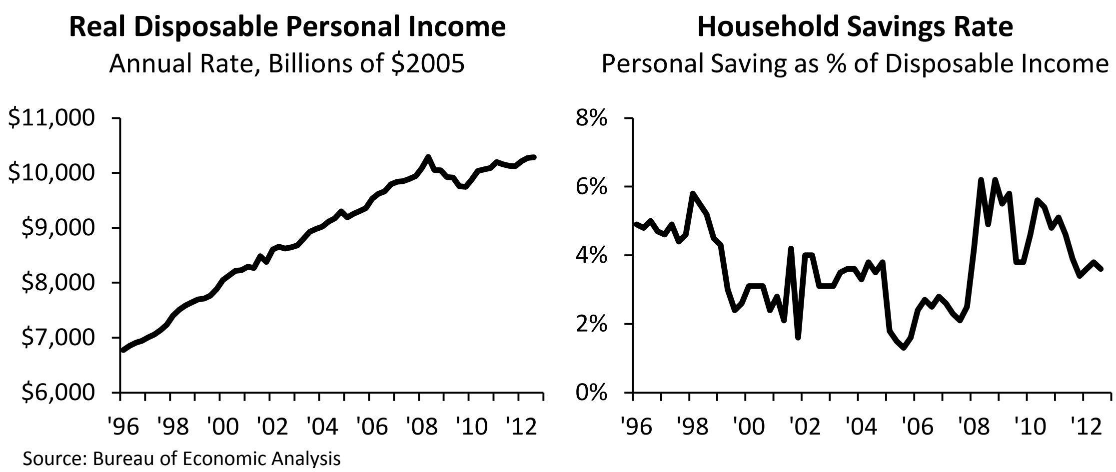
Source: Federal Reserve

Deleveraging is ongoing. The Federal Reserve reports that revolving credit outstanding, mostly credit card loans, was about $852 billion in the third quarter of 2012, down $172 billion (or 17 percent) from its 2008 peak and increasing little since 2010. Mortgage and nonmortgage consumer debt has fallen to 107 percent of disposable income, the lowest since 2003, but still well above the 1990s average of near 80 percent.

Households are beginning to make progress toward rebuilding the wealth lost during the recession. GII believes real household net worth (the value of assets like homes, bank accounts and stocks, minus debts like mortgages and credit cards) will finish 2012 up 4.8 percent from a year earlier, after falling 1.1 percent in 2011 due in part to a setback in equity prices following the debt ceiling crisis. But real net worth is still about 13 percent off its late 2006 peak, just before nationwide home prices began to unravel.

Job prospects are improving and recent housing numbers have been promising, but the U.S. jobless rate (at 7.9 percent) remains well above pre-recession levels and house prices remain very low. Lower labor-force participation, not rapid job growth, has been the primary reason unemployment has dropped from its 10 percent peak. As jobs return, labor force growth will pick up, and the decline in the unemployment rate is likely to slow down. Moreover, average house prices are still down more than 16 percent from their peak as measured by the Federal Housing Finance Agency (FHFA) purchase-only index. Consumers are expected to remain cautious until further progress is made in these areas.

In the face of those headwinds, real consumer spending, which accounts for about 70 percent of U.S. economic activity, still managed to grow at a 1.4 percent annualized rate in the third quarter of 2012, although that is the weakest growth in five quarters. Much of the gain though came from lower savings. Slower wage growth is forcing households to reduce their savings. After accounting for taxes and inflation, real disposable income rose at an annual rate of just 0.5 percent during the quarter, compared with a 3.0 percent real annualized increase during the first half of the year. The personal savings rate on the other hand ticked down to 3.6 percent, from 3.7 percent during the first half of 2012.



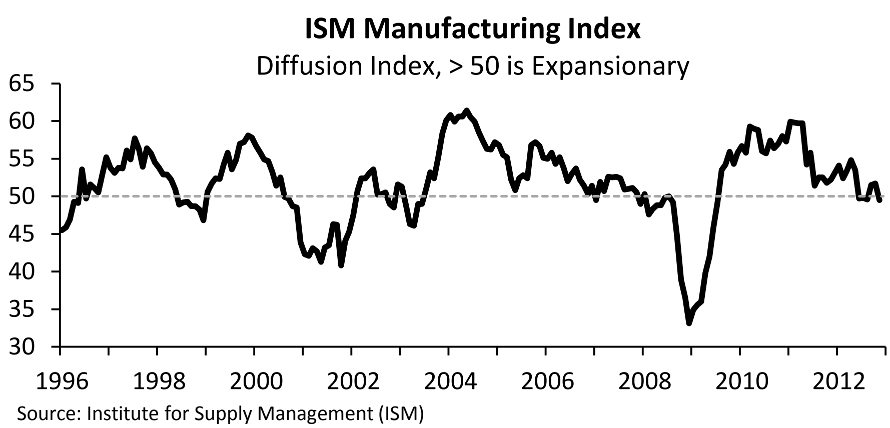
Much of the gains in real consumer spending have come from lower savings. Slow wage growth is forcing households to reduce their savings.

GII believes U.S. households remain focused on repairing finances and that it will be difficult for consumers to sustain current rates of spending without strong and sustainable increases in employment and real income. But consumer expectations have become significantly more pessimistic since the media and politicians began focusing on fiscal cliff issues. Previously, the falling saving rate was suggesting that consumers, unlike businesses, were not as concerned about possible tax increases at the end of the year, which could significantly reduce disposable income. With the election behind us, however, there are signs that concerns about the fiscal cliff are beginning to weigh more heavily on sentiments. The final November reading of the Reuters/University of Michigan consumer sentiment index, for example, was noticeably weaker than the month's preliminary reading, suggesting subsequent fallout after the election. Growing household awareness of impending fiscal tightening and its implications for household income, is likely to suppress confidence going into the holiday shopping season and hold back spending growth until 2014. GII expects some negative implications from Hurricane Sandy on real consumer spending in the fourth quarter of 2012, which grows at a 1.8

percent annualized rate, followed by growth of 2.3 percent in 2013 and 2.8 percent in 2014.

Businesses Hold Back Investment and Hiring Under Cloud of Uncertainty

Business investment and manufacturing has been an important source of economic strength during the recovery, but momentum is slowing as firms contend with cooling global demand and domestic policy uncertainty. In 2012, overall manufacturing output appears to have stalled. Excluding the estimated effects of Hurricane Sandy, the October level of the Federal Reserve's industrial production index for manufacturing is roughly where it was when the year began. The Institute for Supply Management's (ISM) manufacturing index has shown little change from a relatively stagnant position since May, with average conditions near the breakeven 50 mark compared to 53+ in the first quarter of 2012. And, the ISM export and imports indices are signaling contraction, reflecting the weakness in Europe and other global economies as well as cutbacks in capital equipment expenditures.



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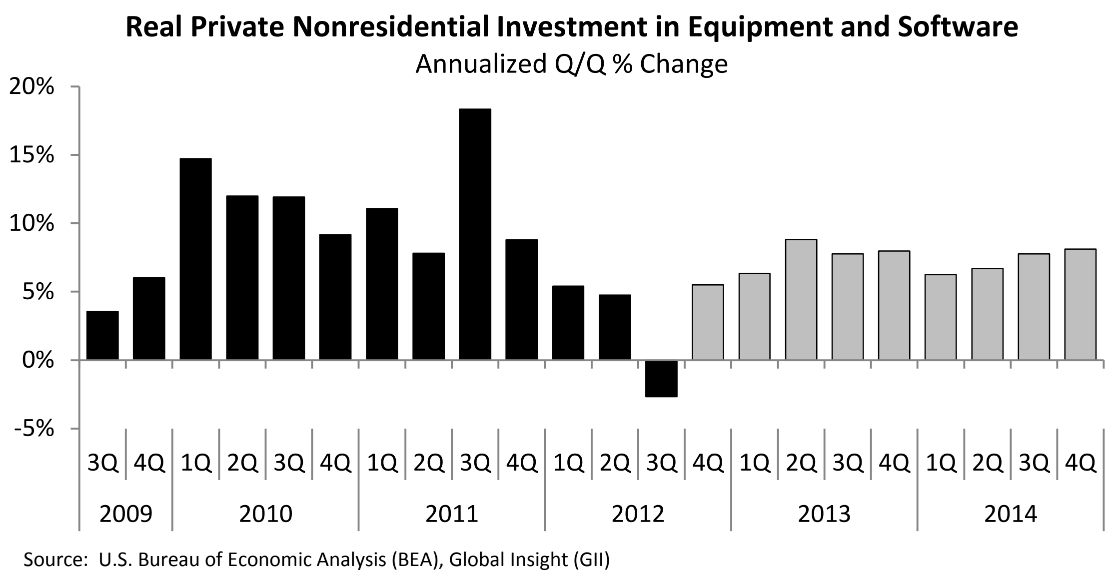
During the 2007-2009 recession, businesses responded to the sharp decline in demand by aggressively cutting back on hiring and capital expenditures. Then it was investment spending on equipment and technology that helped drive the recovery, as businesses found more ways to boost productivity rather than hire workers. Between the second half of 2009 and the first half of this year nominal business equipment and software spending increased 28.1 percent, while nominal spending on compensation of employees rose just 9.3 percent. That has helped companies pile up cash reserves, restore balance sheets to health following the financial crisis, and boost corporate profits to all-time highs.

That pattern changed in the third quarter of 2012, when business investment in equipment and software fell at a 2.7 percent annualized rate for the first time since early 2009. Although the ISM manufacturing headline index is not contracting, recent evidence also suggests firms have become more cautious in their capital investment plans. The Commerce Department reports that factory orders for core capital goods (nondefense capital goods excluding aircraft), a leading indicator for future capital expenditure growth, have deteriorated sharply, and shipments are beginning to follow. Shipments of farm machinery, computers, heavy duty trucks, and electromedical, measuring, and control instruments all declined sharply during the third quarter. Despite the inducement from accelerated depreciation allowances set to expire at the end of this year, nervous businesses appear to be delaying or cutting back construction plans amid growing concern that failure to resolve the fiscal cliff will sap consumer confidence and spending and tip the economy back into recession. Given the increased level of uncertainty over the economy's direction, GII believes companies will be cautious in deciding when to expand. Real spending on business equipment and software is expected to slow to 6.9 percent in 2012, from 11 percent in 2011, and then to 6.2 percent growth in 2013.



Business investment in equipment and software fell at a 2.7 percent annualized rate in the third quarter of 2012 for the first time since early 2009.

A pullback in business investment is also fuelling concerns that cautious employers could postpone hiring decisions until the outlook becomes clearer. But hiring continues to slowly improve. Average employment growth over the last three months now stands at a modest 170,000 and the unemployment rate has fallen to 7.9 percent from 8.5 percent at the end of 2011. If some of the uncertainties can be resolved, GII believes conditions are falling into place for accelerated job creation. Still, uncertainties are expected to ease only gradually, and the labor market is not projected to ramp up until late 2014 and 2015.

Federal Fiscal Cliff Notes

With the presidential election decided and the lame-duck Congress back for its post-election session, focus has quickly turned toward the impending fiscal cliff of federal tax increases and spending cuts. These challenges are very serious. If compromise cannot be reached to change current law, most forecasters believe the economy will be in recession by spring. But if federal policymakers can craft a fiscal policy program that is not so austere in the near-term that it trips up an already fragile economic recovery, yet positions the country well for future growth by making substantial progress toward controlling the national debt, the economy's prospects will quickly brighten. This means reaching substantive bipartisan agreement on clear and credible long-term deficit reduction plans.

The stakes are high. Unless Congress takes action, an estimated $680 billion in combined tax increases and spending cuts are scheduled to take effect in 2013, or 4.2 percent of GDP. Accounting for tax and spending multipliers, that level of fiscal tightening could reduce economic growth next year by 2.5 percent or more, undoubtedly sinking the U.S. economy back into recession in the first half of next year. GII's November baseline expects U.S. real GDP to grow 1.9 percent in 2013, and assumes the cliff is largely avoided. But GII has also provided clients with a set of economic projections that highlight the consequences of permanently going over the fiscal cliff. In GII's fiscal cliff scenario the extra fiscal tightening drives the economy into a mild (three quarter) recession and the nation's unemployment rate spikes back to near 9 percent by the end of next year. Real GDP contracts at a 3.6 percent annual rate in the first quarter of 2013 and at a 0.8 percent annual rate in the second quarter. For the entire year real GDP falls by 0.5 percent. Payroll employment falls slightly throughout 2013, but by the end of 2014 the U.S. economy has roughly 3.5 million fewer jobs than is forecast in GII's baseline scenario. U.S. personal income falls short of the baseline projection by more than one-half trillion dollars, or 3.6 percent. The loss in personal income continues, stretching to more than $700 billion (4.5 percent) in 2015.

Current Law Fiscal Policy in Calendar Year 2013

Effect on Federal Deficit if Current Law Tax and Spending Rules Expire as Scheduled

	CY2013	Percent of GDP
Policies that Affect the Federal Tax Code		
Bush Tax Cuts Expiry (< $250k income)	$198	1.2%
Bush Tax Cuts Expiry (> $250k income)	$79	0.5%
AMT Fix Not Extended	$105	0.6%
Payroll Tax Cuts Expiry	$113	0.7%
Emergency UI Expiry	$36	0.2%
Other Expiring Tax Provisions	$32	0.2%
Affordable Care Act	$24	0.1%
Policies that Affect Federal Spending		
Sequester Spending Cuts	$72	0.4%
Doc Fix Not Extended	$21	0.1%
Total	**$680**	4.2%

Source: MMB calculations based on Global Insight (GII), Congressional Budget Office (CBO), Moody's Analytics, Minnesota Management & Budget (MMB)

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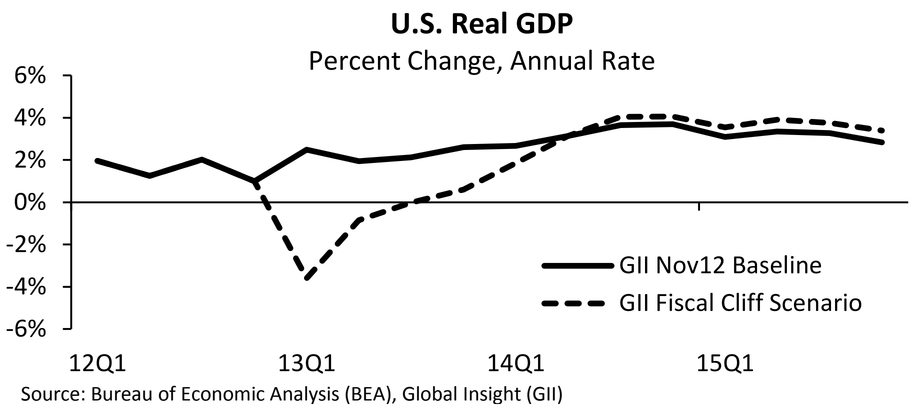
GII's estimates are very similar to both those of the nonpartisan Congressional Budget Office (CBO) and Moody's Analytics'. MMB economists also note that the risks associated with these outlooks are heavily weighted to the downside as business and household confidence is likely to slump more than the models predict.

Leaving current policy in place is not an option. Reducing the federal budget deficit too quickly and significantly restraining the near-term recovery would be a mistake, but continuing to run high annual deficits threatens our prospects for long term growth. CBO estimates that under current policies the federal budget deficit will break $1 trillion for the fifth consecutive year in 2013. During that time public debt relative to the size of the U.S. economy will have more than doubled. Without broad-based changes to fiscal policy, this ratio will continue to rise to unsustainable levels.

To this point, a broad-based bipartisan “grand bargain” on long-term deficit reduction remains elusive. The agreement to end the debt-ceiling crisis last year resulted in a down payment on spending restraint, but the special bipartisan Congressional “super committee” it created to find substantive long-term budget savings fell short. The final debt-ceiling deal contains no tax revenue or entitlement reforms and the more than $1 trillion in caps to discretionary spending is only about one-quarter (not counting the $1 trillion in automatic spending cuts known as sequestration) of the $4 trillion widely believed necessary to simply begin to stabilize the debt.

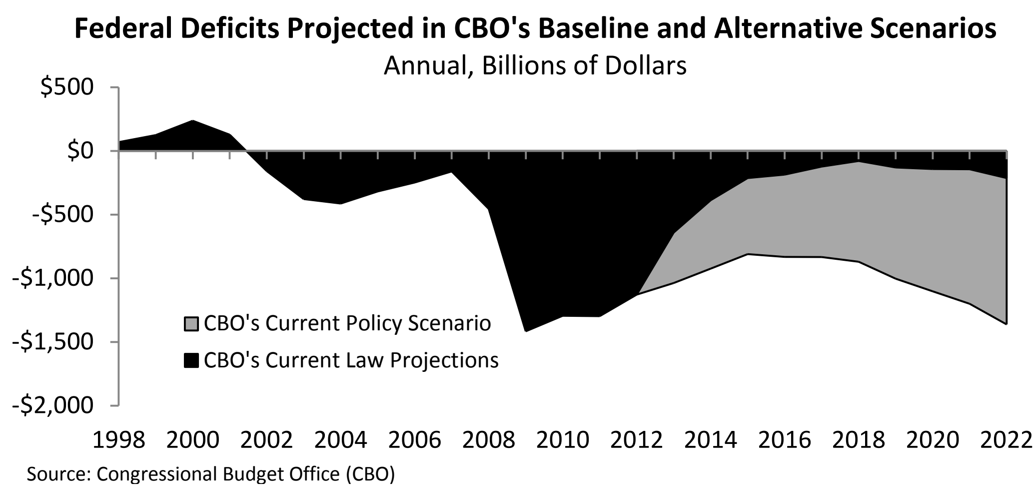


In GII’s fiscal cliff scenario the extra fiscal tightening drives the economy into a mild (three quarter) recession and the nation’s unemployment rate spikes back to near 9 percent by the end of next year.

If all the expiring tax and spending provisions go into effect this coming January, CBO estimates revenues will shoot up by more than 30 percent in the next two years, annual deficits will start to drop, and public debt will begin to retreat to more manageable levels. In reality, however, the economic cost of going over the fiscal cliff is so widespread that policymakers are likely to avoid it. CBO believes that if current tax policies are extended indefinitely this coming January and that scheduled spending cuts are waived, the economy will grow noticeably faster for a while, but there is a cost. Annual deficits will likely average more than $1 trillion a year in the coming decade, representing a substantial increase in the relative level of federal debt to the economy.

Such an increase in the debt will have significant implications for longer term growth. All else equal, larger deficits will drive interest rates higher. As the recovery progresses, those higher interest rates will crowd out private sector investment in new plant and equipment. Economies with lower capital stocks produce less goods and services for a given number of workers. The economy would adjust to a new normal of slower long term growth. Indeed, Moody's Analytics projects that a decade from now under current policies real GDP growth would be about a half a percentage point per year slower than if we went over the cliff. And, the real economy would be about 5 percent smaller a decade from now than in their baseline.

Building a consensus and passing a substantive and durable long-term deficit reduction plan that does not harm short-term economic growth will be difficult. But it is not impossible. In fact, during a speech to the Economic Club of New York in mid-November Federal Reserve Chairman Ben Bernanke reiterated that the two goals are in fact mutually reinforcing. A stronger near-term recovery will lower deficits in coming years, while a clear and credible plan that sets fiscal policy on a sustainable longer-term path will hold down borrowing costs and help improve confidence, allowing today's economy to grow faster.



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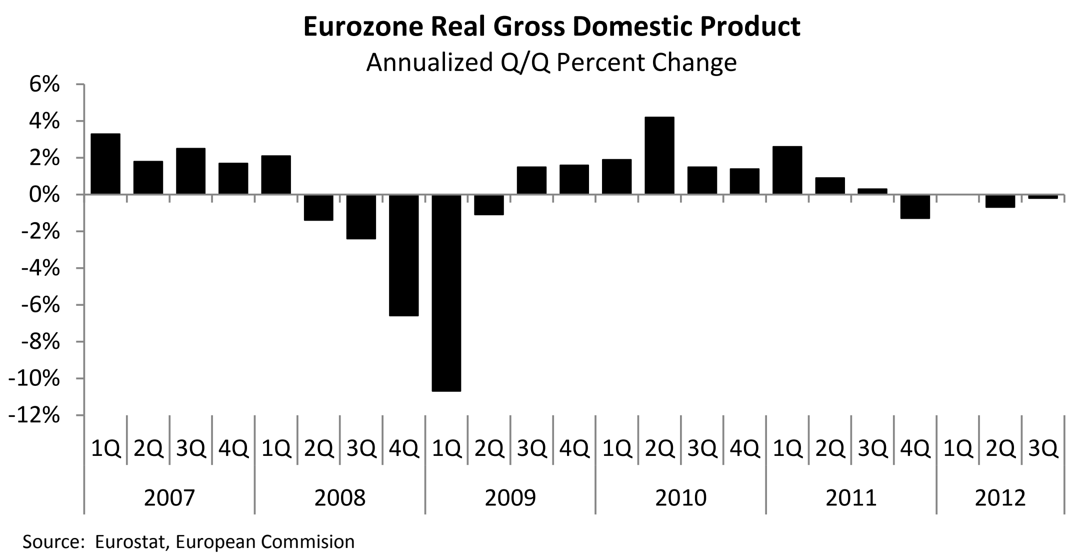
Facing a difficult set of choices that can no longer be deferred, policymakers will need to restore confidence by responding to this challenge with a tangible balance of entitlement spending savings and tax reforms, sufficient to stabilize the debt, while avoiding premature tightening. This is a basic judgment shared by all of the leading non-partisan or bipartisan proposals for comprehensive fiscal reform, including Bowles-Simpson, Domenici-Rivlin, and the Senate "Gang of Six".

GII does not expect the economy to go off the fiscal cliff, but extreme uncertainty over fiscal policy is likely to remain well into 2013. Adding to the economic threat is the fact the Treasury debt ceiling will need to be raised sometime during the first few months of the year. GII assumes the lame-duck Congress and the president layout a structural framework for comprehensive longer term deficit reduction late this year or early next, but agree to a short-term extension of all deadlines to give more time to work out the details of a plan. The debt ceiling is increased and the cliff is largely avoided, replaced by a combination of tax increases and cuts in entitlement programs and nondefense discretionary spending, sufficient in size to begin stabilizing the debt to GDP ratio starting in early 2014. The contractionary impact of going over the cliff or breaking the debt ceiling would be consequential, further unraveling consumer and business confidence and upsetting their willingness to spend and invest, undoubtedly pushing the economy back into recession.

Eurozone Threat Has Relaxed, But Remains High

Europe remains the other significant threat to the global economic recovery. Implementation of a series of negotiated bailouts, structural reforms, and deficit reduction measures have failed to contain the continent's slow-moving sovereign debt crisis. Austerity-based prescriptions intended to lower debt burdens, restore growth, stabilize investor confidence, and lower borrowing costs have become a counterproductive economic drag, making it even more difficult for struggling governments to achieve mandated deficit targets. The sovereign debt problems will not be solved by austerity alone and successful deficit reduction will clearly be difficult to achieve without economic growth. But much of the continent is now in deep recession. Real GDP in the Eurozone fell at an annual rate of 1.3 percent in the fourth quarter of 2011, stagnated in the first three months of 2012, before contracting 0.7 percent in the second quarter and 0.2 percent in the third-quarter, a sign that the debt crisis is sparing no member of the single currency union.



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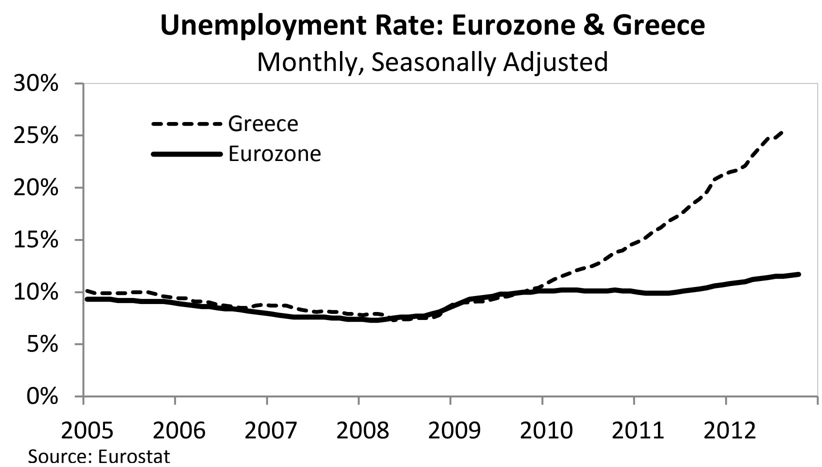
The Eurozone monetary union is structurally weak. While it is governed by a single interest rate policy, there is no common fiscal authority to naturally steer money toward ailing countries or guarantee debts. This past summer Spain became the fourth and largest country after Greece, Ireland and Portugal to accept a financial rescue package under supervision of the European Union (EU), the International Monetary Fund (IMF), and the European Central Bank (ECB), collectively known as the troika. But because these troubled countries are unable to implement expansionary monetary policies to soften the fiscal austerity demanded by creditors, widespread economic weakness and added social unrest has resulted. The ECB has taken bold actions in the past year to support troubled governments, mutualize sovereign debt, and preserve the currency union. Fiscal leaders must act to not only follow through with long-term deficit reduction, but also provide credible debt guarantees by deepening integration of fiscal policy among currency-members.

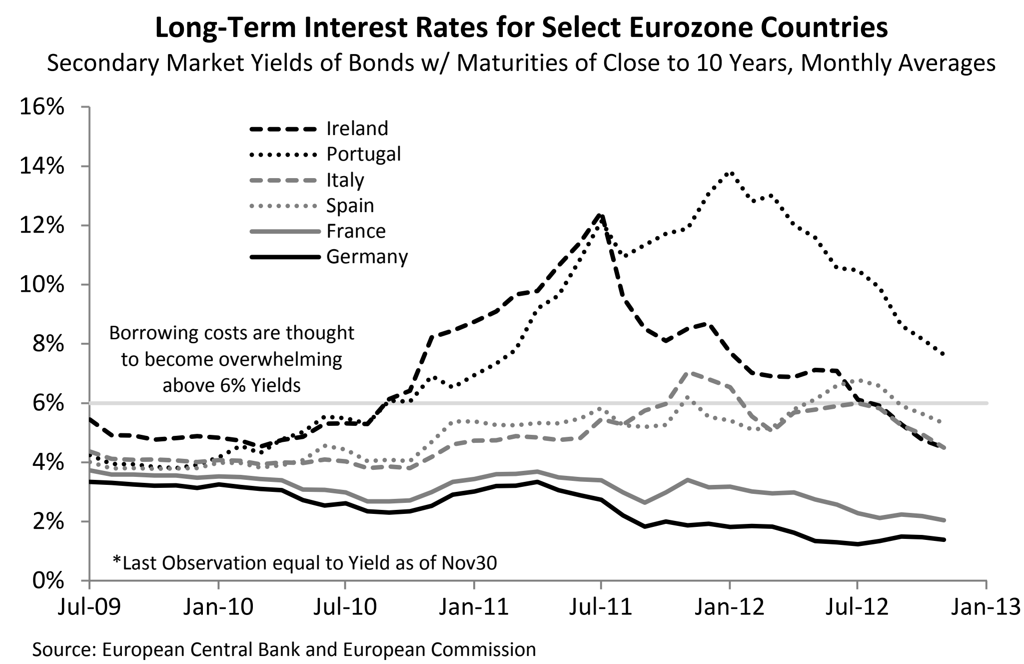
Last January, Eurozone leaders collectively outlined a treaty, known as the fiscal stability pact, calling for tighter budgetary controls with more stringent oversight and sanctions for those that violate the limits. But optimism over the Eurozone's ability to achieve far-reaching institutional reforms has eroded since the beginning of the year. Growing political, economic, and social tensions suggest that the German-led focus on strict fiscal discipline is nearing a breaking point, particularly in Greece where the economy is in its fifth year of recession and the jobless rate has climbed over 25 percent.



Growing political, economic, and social tensions have begun to suggest that the German-led focus on strict fiscal discipline is nearing a breaking point, particularly in Greece where the economy is in its fifth year of recession and the jobless rate has climbed over 25 percent.

In early May, voters in France chose to replace President Nicolas Sarkozy with Socialist challenger Francois Hollande, who campaigned on an anti-austerity platform, ending a loyal partnership with German chancellor Angela Merkel that has been at the core of recent European integration. On the same day in Greece, the two main parties that had supported bailout agreements failed to gain enough votes to form a government, so a second parliamentary election was called for mid-June. That election was widely cast as a referendum on Greece's membership in the Eurozone. Ahead of the new vote, fears that a Greek rejection could send financial markets into panic forced Spain to seek emergency assistance from Eurozone finance ministers to shore up its banks. Ultimately, however, Greek voters elected to avoid the unprecedented consequences of withdrawing from the Eurozone, at least for now, and gave a narrow victory to the pro-bailout conservative party.

The ECB stepped up its debt crisis response last December and again in February under the leadership of new chairman Mario Draghi. Previously criticized for not taking a more interventionist role, the central bank removed an imminent risk of systemic collapse by flooding European banks with cheap liquidity that many used to prop up their strained governments. But governments eased off reforms, bailout promises were broken, and markets continued to deteriorate well into the summer, with Spanish and Italian bond yields soaring above 7 percent. By late July, the situation had become so severe that Draghi intervened with a promise to do “whatever it takes” to keep the Eurozone together, including fighting unreasonably high government borrowing costs. A month later the central bank outlined a framework to effectively backstop national debts. The policy is called Outright Monetary Transactions (OMT), an unlimited bond-buying program that will purchase the sovereign debt of troubled countries in the secondary market. To mitigate the moral hazard problem, the OMT requires countries to apply for help and abide by the strict conditionality of Eurozone's bailout fund, the European Financial Stability Facility (EFSF) or its permanent successor the European Stability Mechanism (ESM). The ECB’s move has calmed markets since September, particularly liquidity pressures in Spain and Italy. It remains to be seen if either county will approach the ESM or OMT for support.

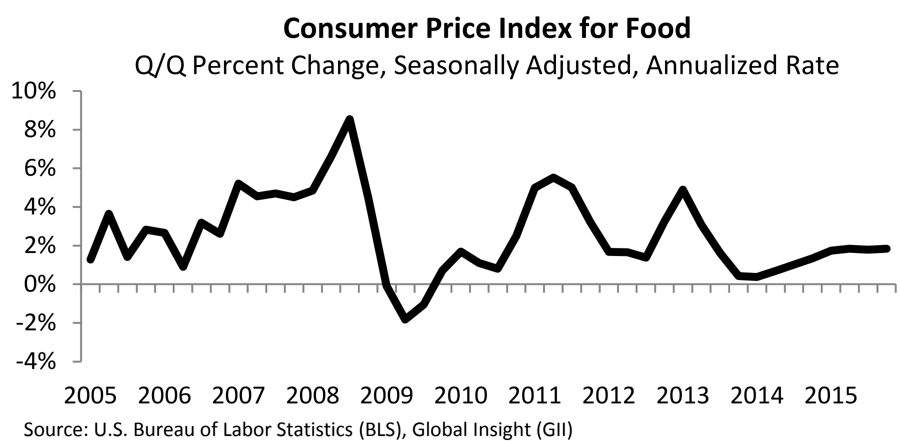


Last September, the European Central Bank (ECB) outlined a framework to effectively backstop national debts. The move has since calmed markets, particularly liquidity pressures in Spain and Italy.

The recent decision by the ECB to backstop sovereign debts significantly reduces the risk that a Greek exit and/or a Spanish bailout will spiral out of control and drag down Italy and the rest of the Eurozone. GII expects Spain to request a new rescue package from the ESM to stabilize volatile financing conditions by the end of 2012. Greece was expected to receive its next tranche of bailout loans from the Troika, as was agreed to in late November, but repeated failure to meet its fiscal targets and deliver on reforms means the country is expected to leave the Eurozone in 2013. With private-sector confidence declining, unemployment rates nearing record highs, and the manufacturing sector contracting, GII's outlook for the Eurozone is grim. The recession is deepening and is expected to last well into 2013. But the U.S. economy's and banking system's direct exposure to the downturn is relatively small. Tighter credit conditions, reduced exports to the Eurozone, lower corporate profits for foreign investors in the Euro-area, and appreciation of the dollar against the euro are estimated to subtract less than a half percentage point from U.S. growth.

Inflation Remains Subdued, but Food Prices Will Climb

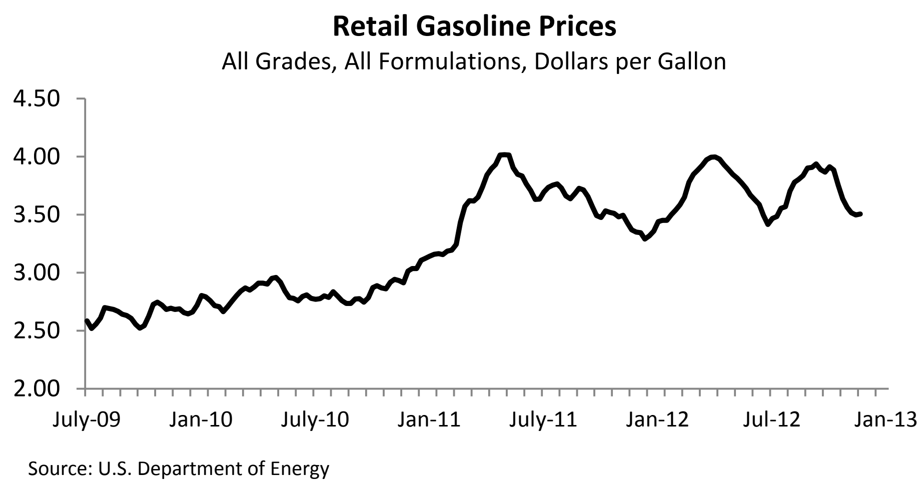
The Bureau of Labor Statistics (BLS) reports its headline inflation measure, the Consumer Price Index (CPI), grew at an annualized rate of 0.8 percent during the second quarter of 2012, largely restrained by a sharp pullback in gasoline prices earlier in the spring. But crude oil prices rallied during the latter part of the summer and gasoline prices rose, hitting record highs in places such as California, driving the headline CPI to three-year highs in August and September. Nevertheless, pump prices have stabilized since mid-October and inflation expectations remain generally subdued by a lack of broad pricing power and sluggish demand growth.



Consumer worries are now shifting from gasoline pumps to grocery store shelves. GII projects consumer food price inflation of about 4 percent during the next six months, compared to an average annual rate of just 1.6 percent the first 9 months of 2012.

Consumer worries are now shifting from gasoline pumps to grocery store shelves. U.S. corn, soybean, wheat, and other grain prices soared to record highs this summer as a result of widespread drought in the Midwest, which widely damaged crops and reduced production. Herds have been trimmed as farmers' costs to raise cattle, hogs, and chickens have climbed, and the sharp rise in grain prices is expected to pass through to the consumer in the form of higher egg, beef, and dairy prices late this year and in early 2013. Global Insight projects consumer food price inflation of about 4 percent during the next six months, compared to an average annual rate of just 1.6 percent the first 9 months of 2012.

But, aside from temporary flux in commodity prices, underlying inflation pressures continue to cool. Core CPI, which excludes more volatile prices of food and energy, eased to an annual rate of 1.5 percent in the third quarter of 2012, down from 2.1 and 2.6 percent the first two quarters of the year respectively. Services like rents and medical care services have been climbing at a stronger pace. Rents were up at an annualized rate of 2.1 during the third quarter of 2012, while medical care services were up 5.0 percent over the same period. But an easing of goods prices helped offset the aforementioned gains. The BLS index for used and new motor vehicles, for example, was down 2.0 percent during the three month period. The year-over-year increase in the core CPI rose to 2.0 percent.



Gasoline prices drifted higher last summer, hitting record highs in places such as California, and driving the headline CPI to three-year highs in August and September. Nevertheless, pump prices have stabilized since mid-October, wage growth is barely keeping up with rising prices, and inflation expectations remain generally subdued.

GII continues to believe inflation is a non-issue. Gasoline prices have begun to retreat and headline CPI is expected to drop to an annualized rate of 1.8 percent to close out 2012, down from 2.3 percent in the third quarter. Consumers will grumble about food prices rather than gasoline prices most of next year, but slower growth around the world, a stronger U.S. dollar, and lower oil prices are forecast to pull the inflation figure down to a modest 1.3 percent in 2013. Sluggish demand and stable core goods prices also restrain core CPI inflation. GII expects it to grow 1.8 percent in 2013, from 2.1 percent growth in 2012, and below the Federal Reserve's 2 percent longer run objective.

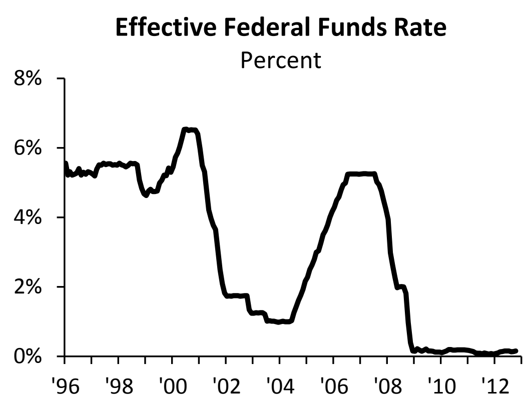
Fed Continues to Ease Amidst Weak Economic Outlook

During a speech to the Economic Club of New York in mid-November, Federal Reserve Board Chairman Ben Bernanke stated that inflation remains generally subdued despite periodic fluctuations in commodity prices. Indeed, an inflationary spiral is unlikely given that several market-based measures of longer-term inflation expectations remain stable and ongoing resource slack in labor and product markets continues to restrain wage and price increases. The five and ten-year breakeven inflation rates, for example, which project the pace of consumer price increases using the yield spreads between nominal

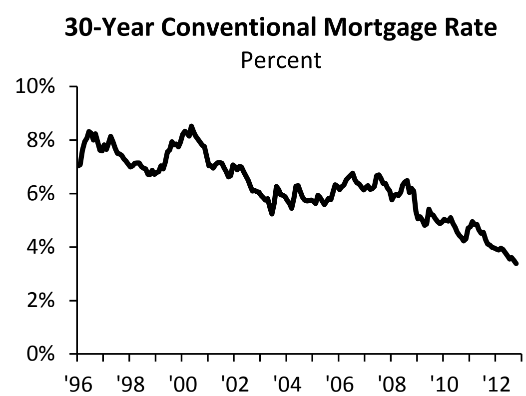
Treasury bonds and Treasury inflation-protected securities, were near 2.1 and 2.5 percent respectively at the beginning of November, slightly above the Federal Reserve's long-term objective of 2 percent but not signaling a significant inflationary threat. Likewise, long-term unemployment is at a historically high level and the jobless rate is near eight percent, well above its level prior to the onset of the recession.

The combination of low inflation and high unemployment has allowed the Fed to take several accommodative monetary policy actions this year to encourage a stronger recovery and promote maximum employment. Last January, it adopted a more explicit 2 percent inflation target and began to publish the wide-ranging views of Fed participants concerning the appropriate path of the target federal funds rate. These interest rate forecasts revealed broad agreement among members that the federal funds target should not be raised until late-2014. In June, it decided to extend a previously established measure meant to push down long term interest rates known as "Operation Twist" that involves selling short-term Treasury securities in exchange for the same amount of long-term bonds. And at its September meeting, the Fed launched an open-ended third round of large-scale asset purchases known as quantitative easing (QE), aimed at jump-starting the housing market. It also elected to push its pledge to keep interest rates "exceptionally low" into mid-2015. Bottom line, the Fed does not intend to withdraw its accommodative policy stance anytime soon, even after the economic recovery begins to strengthen.

GII believes that the Fed's policy easing has had real benefits for the economy. And, if economic growth continues to languish next year, the Fed will not hesitate to do even more. GII assumes that the Fed keeps the federal funds rate near zero through mid-2015, in line with its new guidance. GII also assumes that to supplement the QE3 program of mortgage-backed security purchases, the Fed will renew purchases of Treasury securities in 2013, after the expiration of the existing Operation Twist at year end.



Source: Federal Reserve

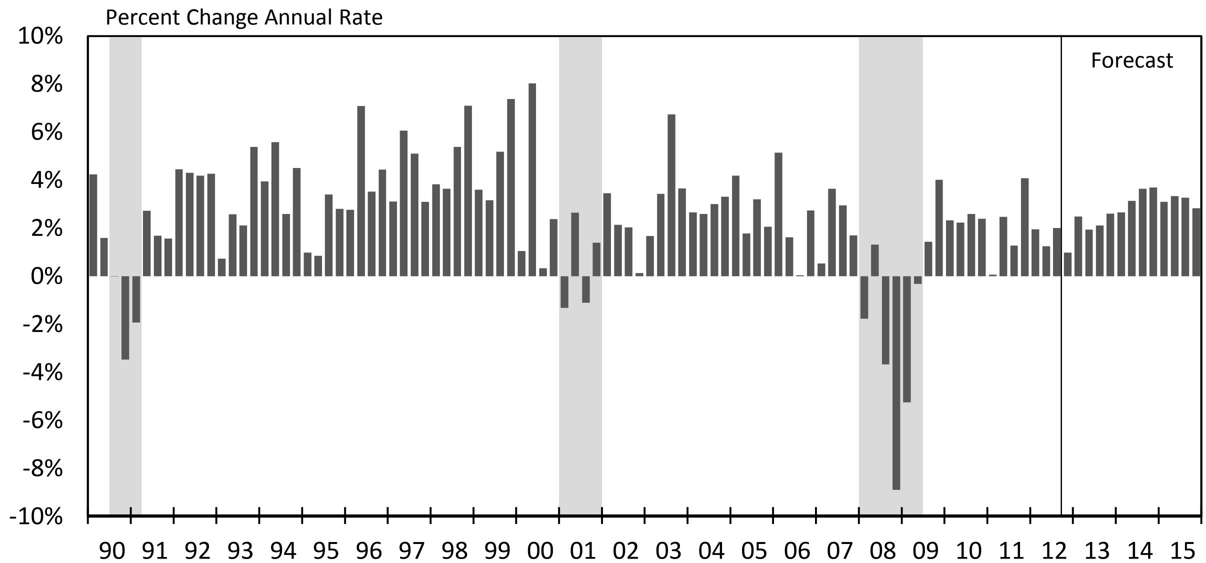


Source: Freddie Mac

At the September meeting, the FOMC elected to push its pledge to keep interest rates "exceptionally low" into mid-2015. The Fed does not intend to withdraw its accommodative policy stance anytime soon.

SELECT ECONOMIC INDICATORS

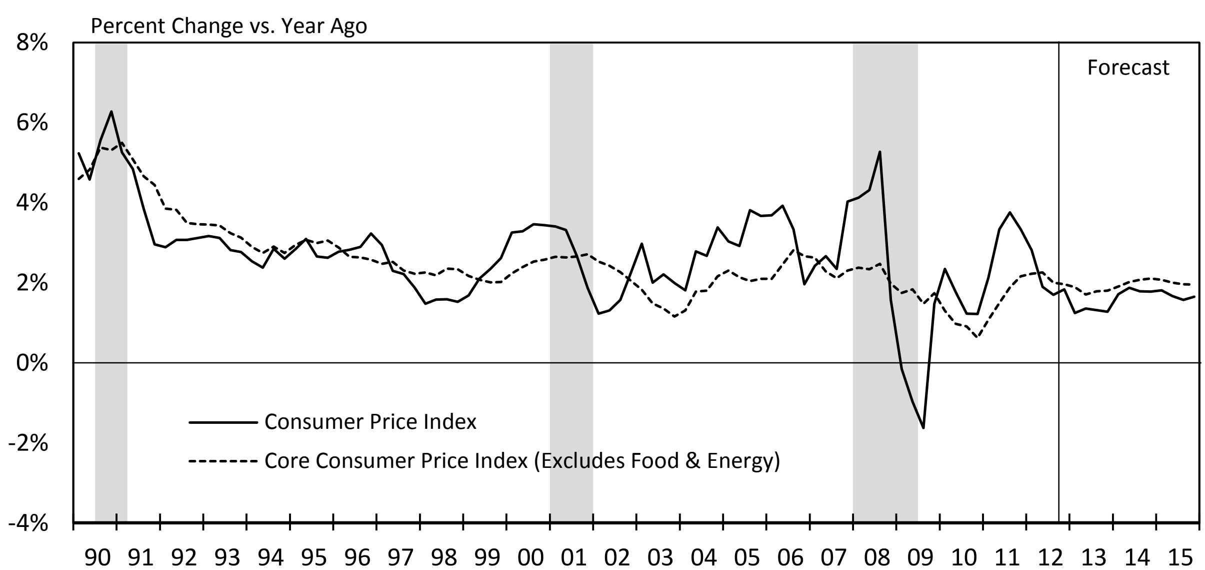
Real Gross Domestic Product



Source: Bureau of Economic Analysis, National Bureau of Economic Research, and Global Insight

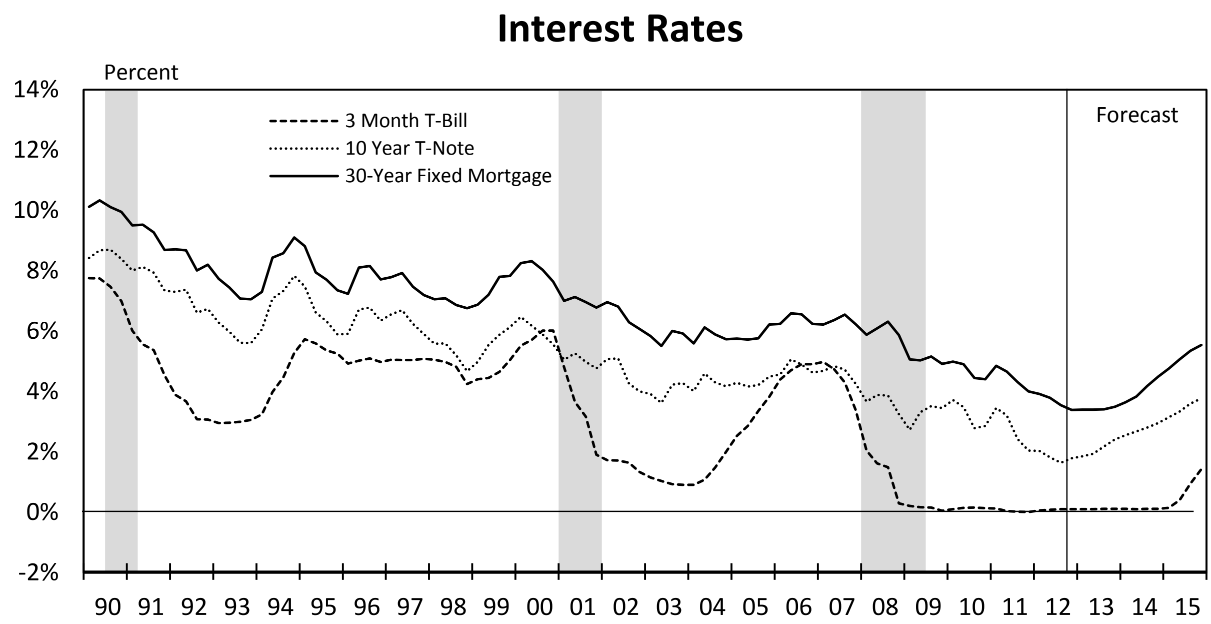
The economy is still moving forward at a slow pace, as exports and business investment have run out of steam in the face of global economic headwinds and domestic policy uncertainty. GII expects U.S. real GDP to increase 2.1 percent in 2012 and 1.9 percent in 2013.

Consumer Price Indexes



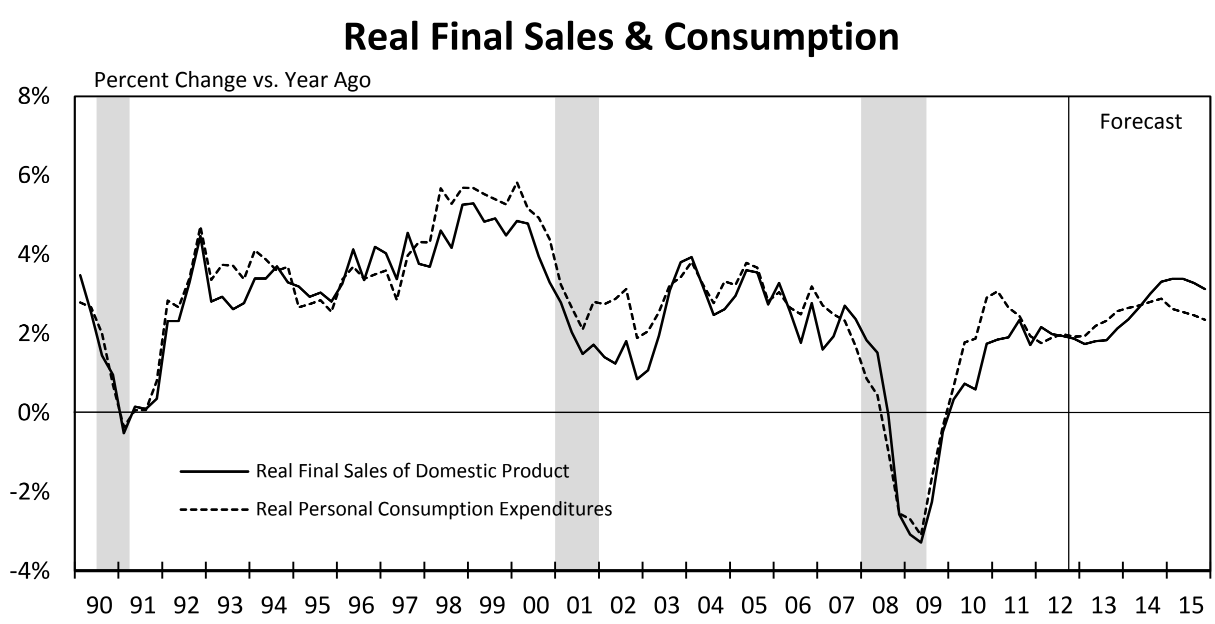
Source: Bureau of Labor Statistics, National Bureau of Economic Research, and Global Insight

Inflation remains a non-issue. Consumers will grumble about food prices rather than gasoline prices most of next year, but slower growth around the world and lower oil prices are forecast to pull headline CPI inflation down to 1.3 percent in 2013, from 2.0 percent growth in 2012.



Source: Federal Reserve Board, Freddie Mac, National Bureau of Economic Research, and Global Insight

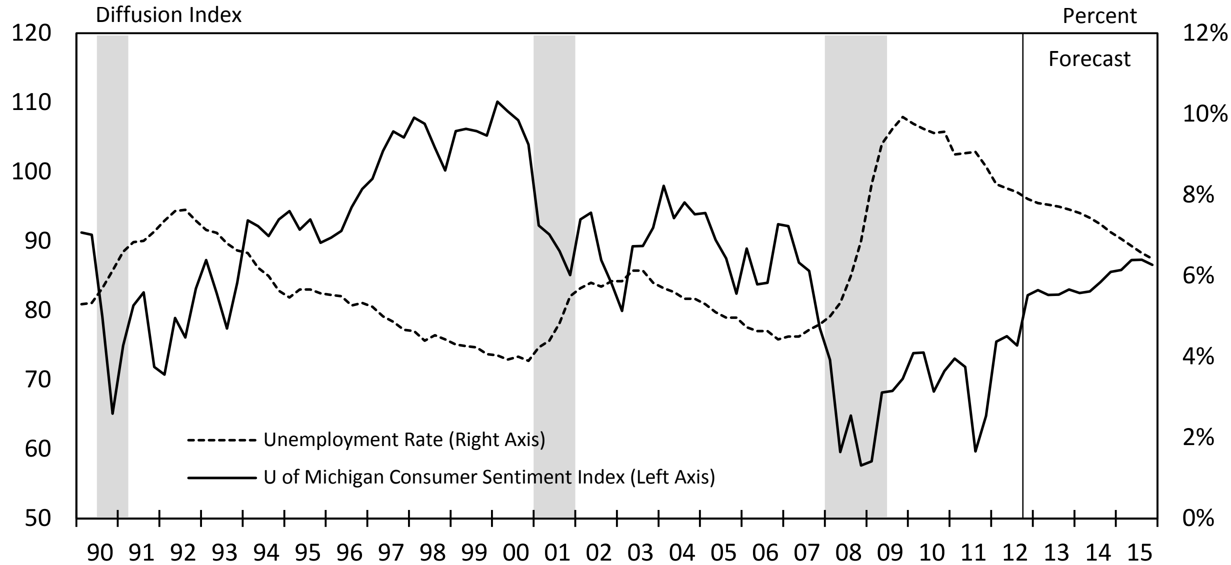
In September, the Federal Reserve launched an open-ended round of large-scale asset purchases known as quantitative easing (QE), aimed at jump-starting the housing market, and elected to push its pledge to keep interest rates "exceptionally low" into mid-2015.



Source: Bureau of Economic Analysis, National Bureau of Economic Research, and Global Insight

Households are feeling more confident, but still face too many negatives to allow a robust consumer spending recovery. GII expects real consumer spending growth of 1.9 percent in 2012, down from 2.5 percent in 2011, followed by 2.3 percent growth in 2013 and 2.8 percent in 2014.

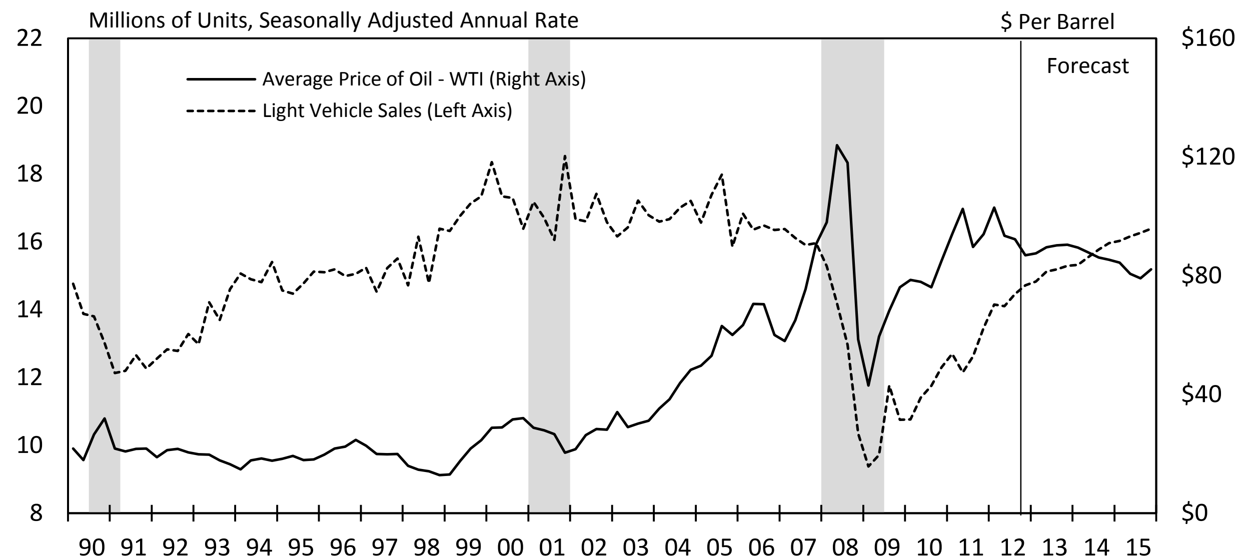
Consumer Sentiment and Unemployment Rate



Source: University of Michigan, Bureau of Labor Statistics, National Bureau of Economic Research, and Global Insight

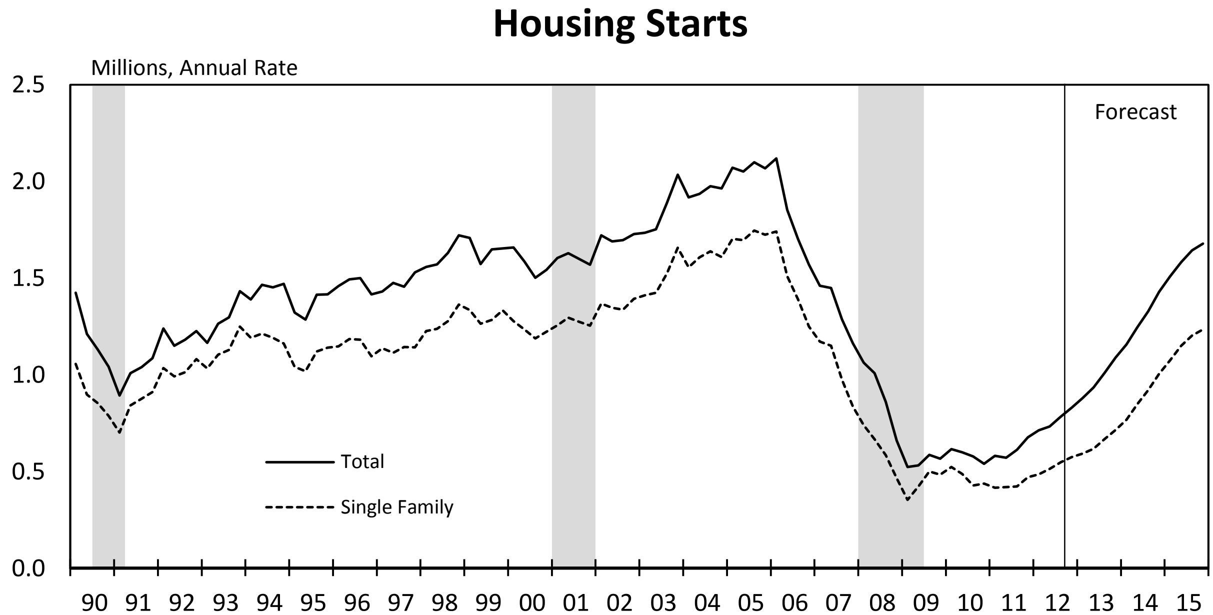
Largely unfazed by the impending fiscal cliff, confidence among consumers climbed to a five-year high in November as improvements in the labor market, cheaper gasoline, and rising home values are sparking renewed optimism.

Light Vehicle Sales and Oil Prices



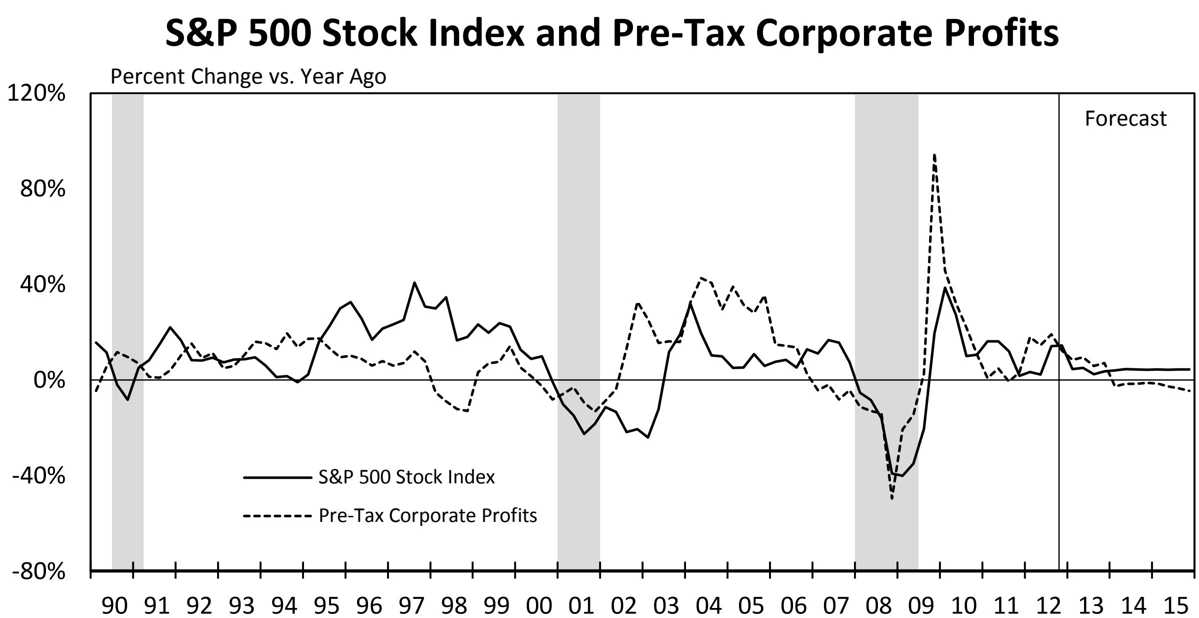
Source: Bureau of Economic Analysis, Investors' Business Daily, National Bureau of Economic Research, and Global Insight

Weak global growth is assumed to keep a lid on oil prices in 2013 and 2014. Tensions in the Middle East pose potential upside risks, but GII expects oil prices to drift lower through 2015 as Europe's recession weighs on demand and global supplies increase.



Source: U.S. Census Bureau, National Bureau of Economic Research, and Global Insight

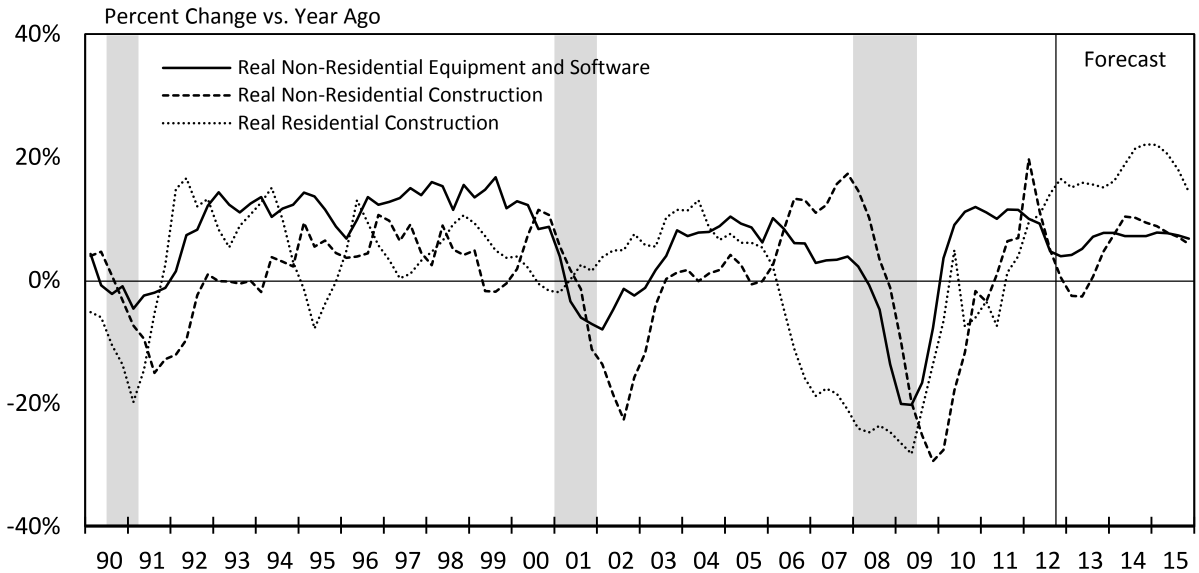
The housing recovery finally seems to be under way. Inventories of unsold homes are falling quickly, home prices are rising, and housing starts are trending upward. GII expects a modest housing recovery that lasts about three years.



Source: Standard and Poor's, National Bureau of Economic Analysis, National Bureau of Economic Research, and Global Insight

Concerns about global growth, weak demand, and the impending fiscal cliff have left many firms unwilling to extend themselves financially. Tighter cost controls have driven productivity higher and have helped businesses maintain increases in profitability.

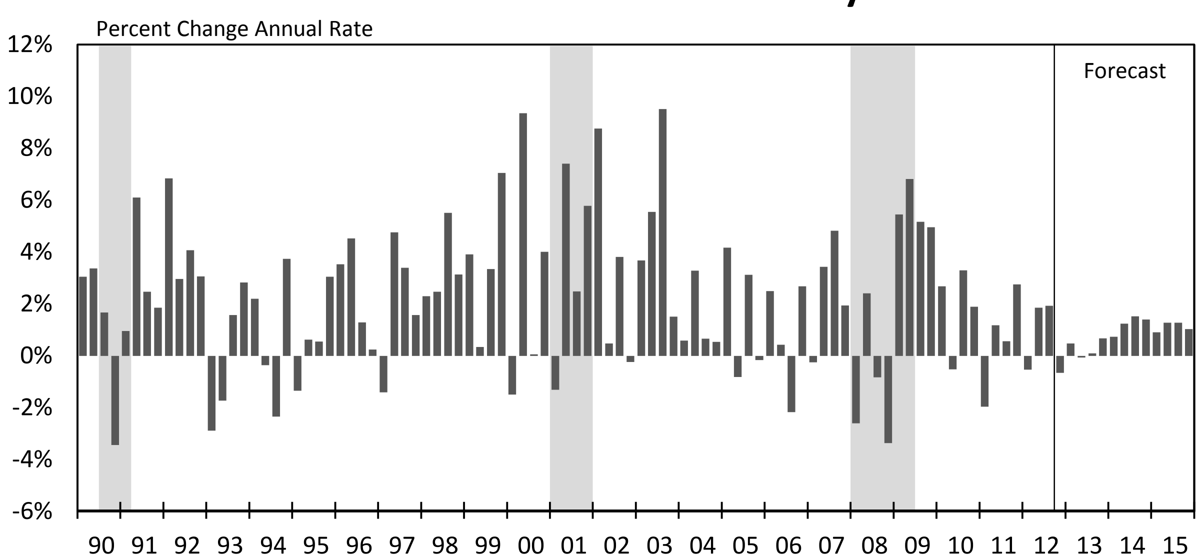
Real Private Investment



Source: Bureau of Economic Analysis, National Bureau of Economic Research, and Global Insight

Capital equipment and software investment remains an important driver of economic growth, but its momentum has slowed. GII expects business equipment and software spending growth to slow to 7.3 percent in 2012, from 11 percent in 2011, and then to 6.0 percent growth in 2013.

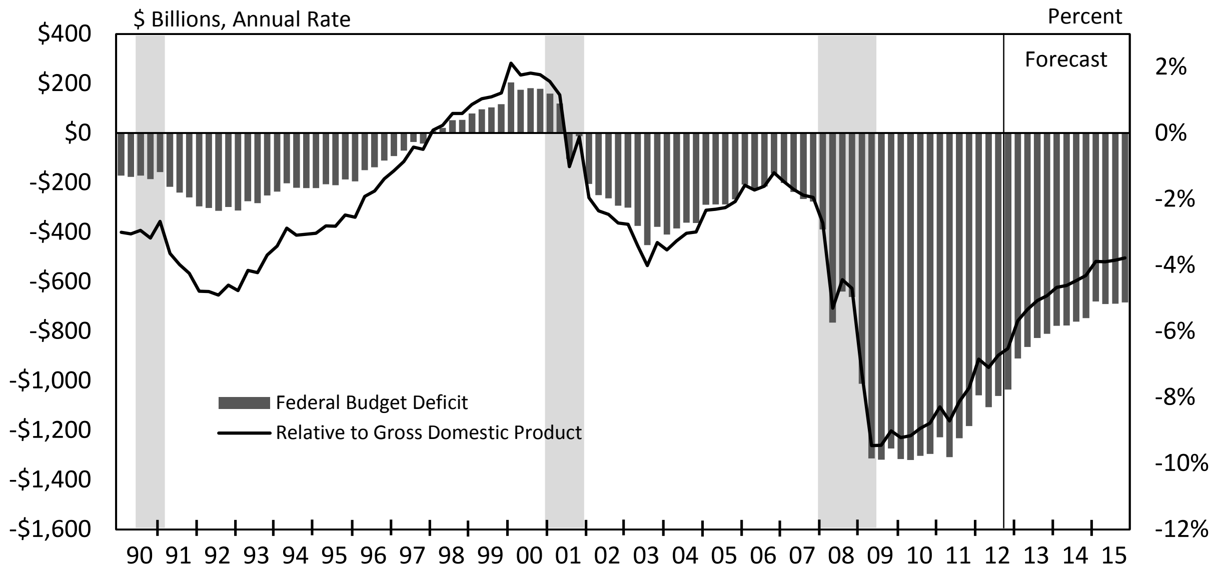
Total Non-Farm Productivity



Source: Bureau of Labor Statistics, National Bureau of Economic Research, and Global Insight

Nonfarm business productivity is expected to advance a modest 1.1 percent in 2012, as output growth once again outpaces hiring. But productivity growth should be muted next year as the labor market gains momentum. GII expects productivity to grow less than 0.5 percent in 2013.

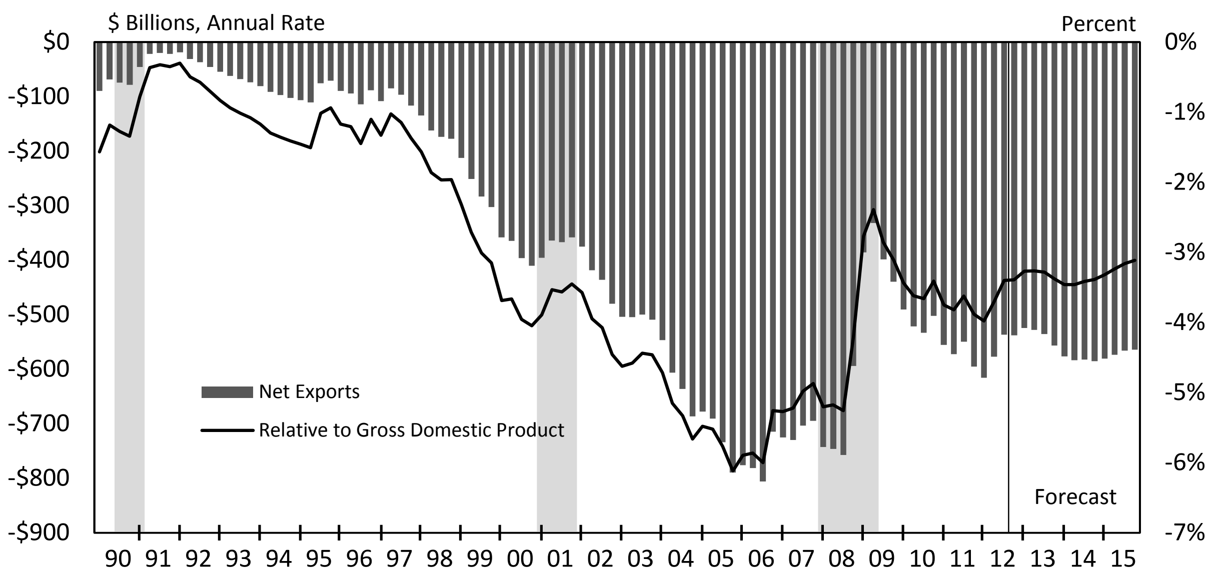
Federal Budget Deficit (NIPA Basis)



Source: Bureau of Economic Analysis, National Bureau of Economic Research, and Global Insight

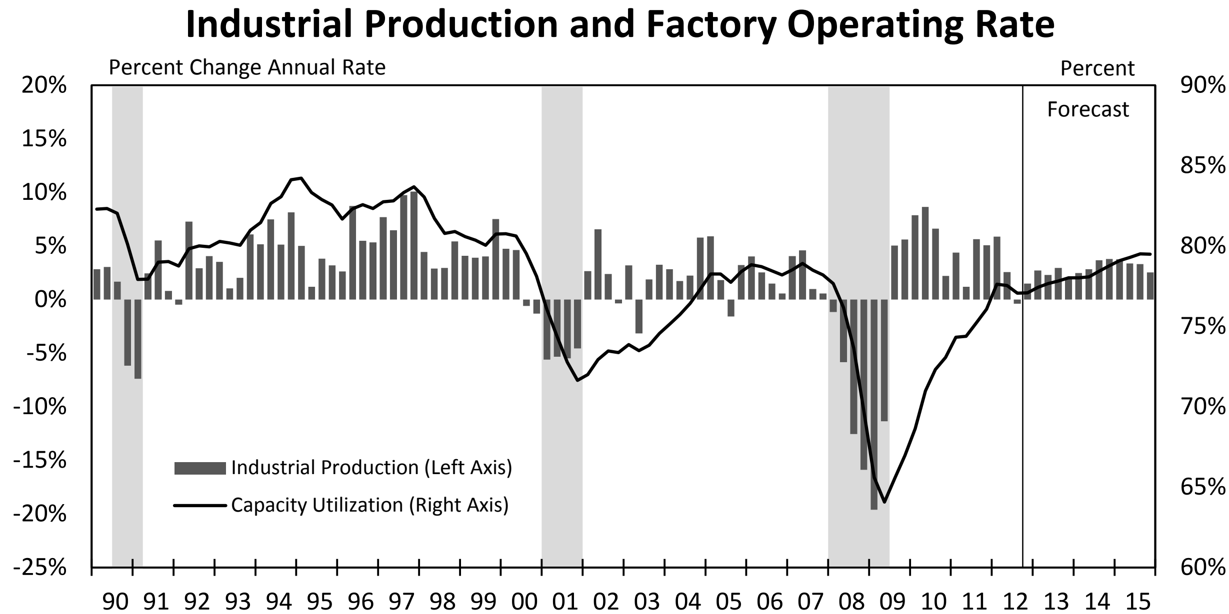
The federal budget deficit in fiscal 2012 narrowed to $1.1 trillion (7.0 percent of GDP), from about $1.3 trillion (8.7 percent of GDP) in fiscal 2011. GII expects the budget deficit to narrow again in fiscal 2013 as the economic recovery advances and lawmakers avoid the fiscal cliff.

Balance of Trade (Net Exports)



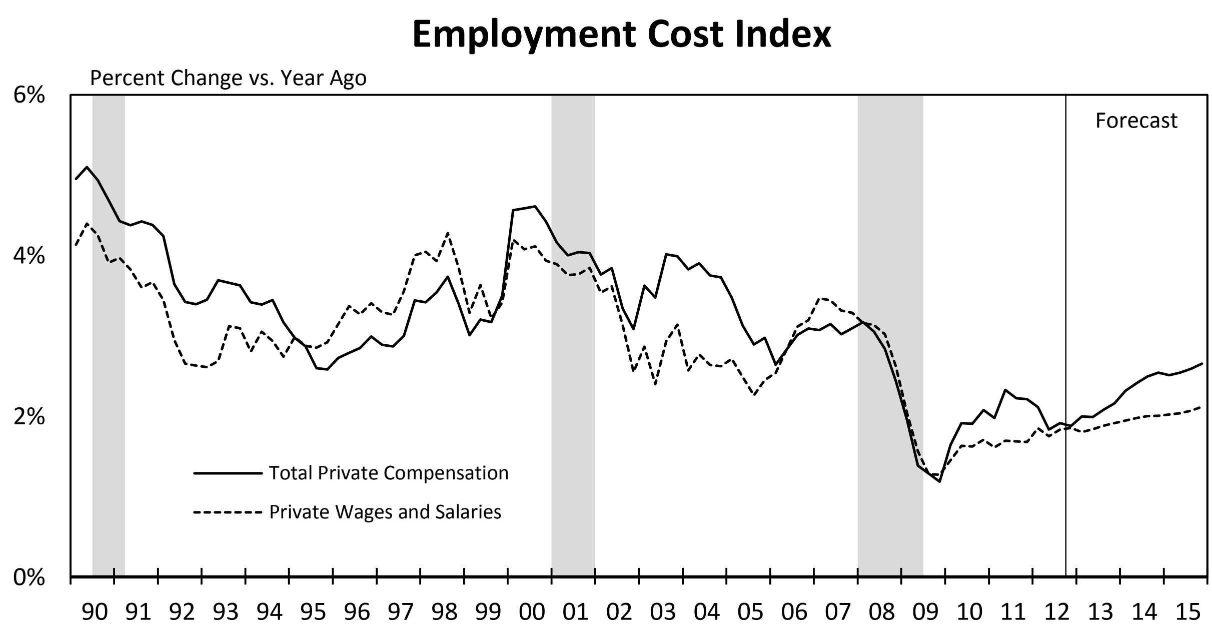
Source: Bureau of Economic Analysis, National Bureau of Economic Research, and Global Insight

China's economy is slowing and the Eurozone has fallen into recession. This combination is creating headwinds for U.S. export growth, which GII expects to decelerate from 6.7 percent growth in 2011 to 3.3 percent in 2012 and 3.1 percent in 2013.



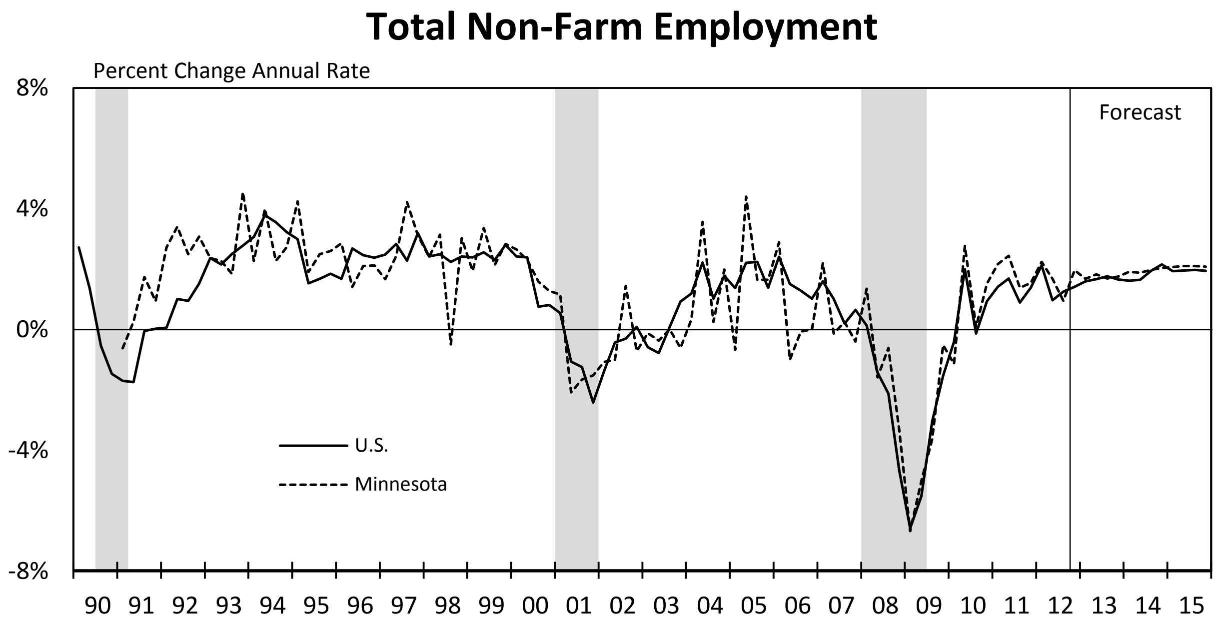
Source: Federal Reserve Board, National Bureau of Economic Research, and Global Insight

Industrial production has been slowing through much of 2012 as manufacturers contend with cooling global demand. In 2011, industrial output grew 4.1 percent. This year it is on track to increase 3.7 percent. In 2013, however, GII expects industrial production to expand only 2.0 percent.



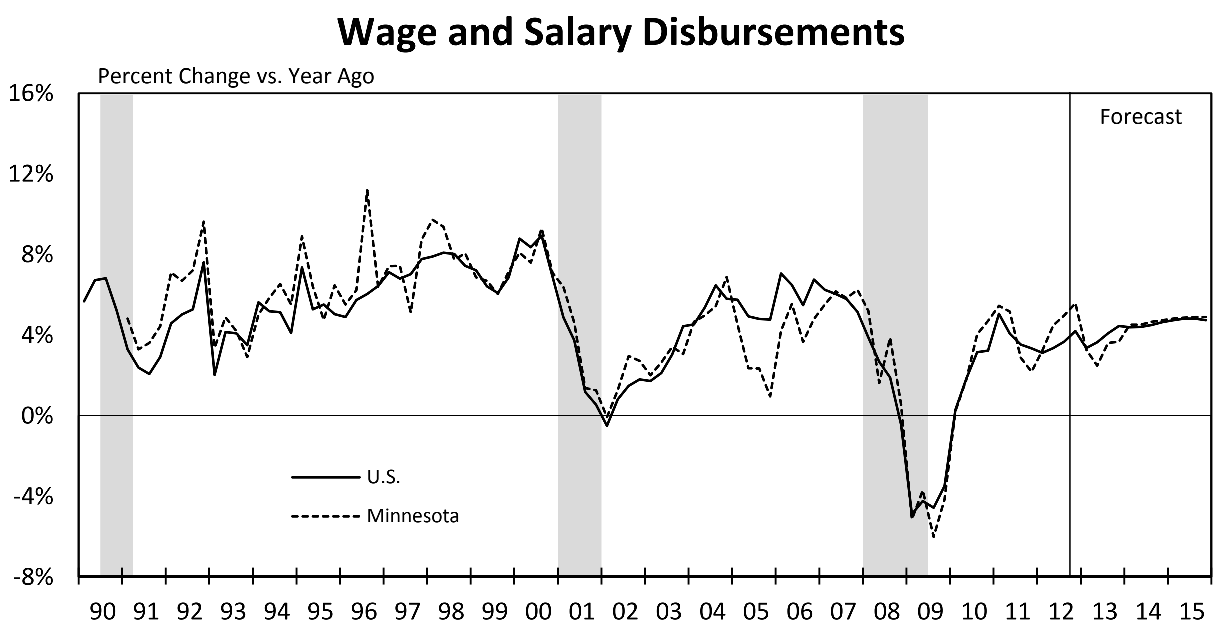
Source: Bureau of Labor Statistics, National Bureau of Economic Research, and Global Insight

Wage inflation is still not a concern. The employment cost index (ECI) continued to show very modest compensation inflation in 2012. And, GII expects employment costs to remain very much under control in 2013, as high unemployment and weak demand keep a tight grip on payrolls.



Source: Bureau of Labor Statistics, MN Management & Budget, National Bureau of Economic Research, and Global Insight

The November 2012 forecast for Minnesota's economy projects the state's employment rebound will remain modest. After declining 3.9 percent in 2009 and 0.5 percent in 2010, state employment rebounded 1.7 percent in 2011. Employment is forecast to rise 1.7 percent in 2012 and 2013.



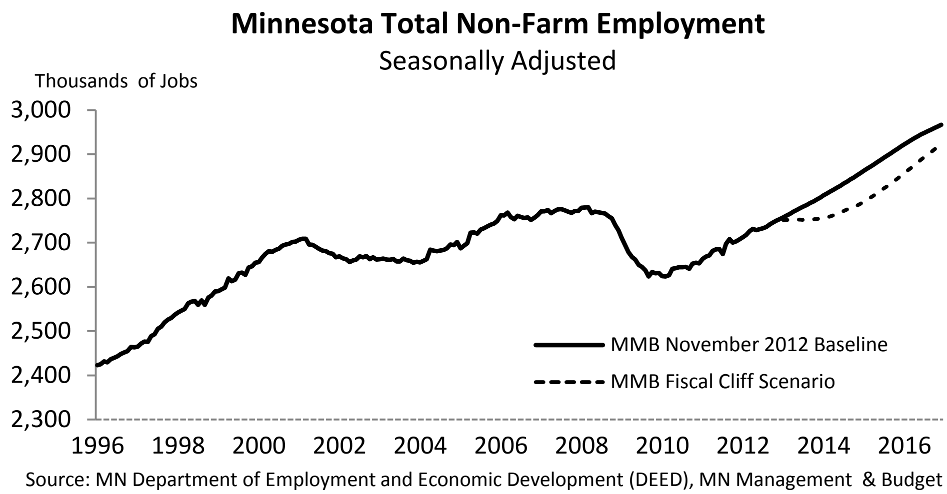
Source: Bureau of Economic Analysis, MN Management & Budget, National Bureau of Economic Research, and Global Insight

Minnesota's nominal wage and salary income grew 3.9 percent in 2011 and preliminary labor market data and income tax withholding collections suggests income climbed 4.6 percent in 2012. Nominal wages are forecast to rise 3.3 percent in 2013 and 4.6 percent in 2014.

MINNESOTA ECONOMIC OUTLOOK

Minnesota's recovery has shown modest improvement in 2012. Upcoming revisions to payroll employment estimates are expected to show employers have added more than 40,000 jobs in the past year. Wage and salary income during the first nine months of the year is up an estimated 4.3 percent relative to a year earlier and the state's jobless rate has dropped by almost a half of a percentage point over the past twelve months. Leading indicators, such as temporary help employment, average hours worked, job vacancies, and the number of unemployed all continued to improve during the year. First time claims for jobless benefits have fallen to levels not observed since early 2008, just before the peak of the financial crisis. And, the employment recovery remains broad based with professional and business services, education and health services, manufacturing, finance and insurance all signaling gains. State and local government cutbacks remain a drag on employment, but even the long-suffering construction sector is starting to turn around, as positive factors are helping revive pent-up demand for housing and construction firms are beginning to hire again. Minnesota's labor market appears to be recovering.

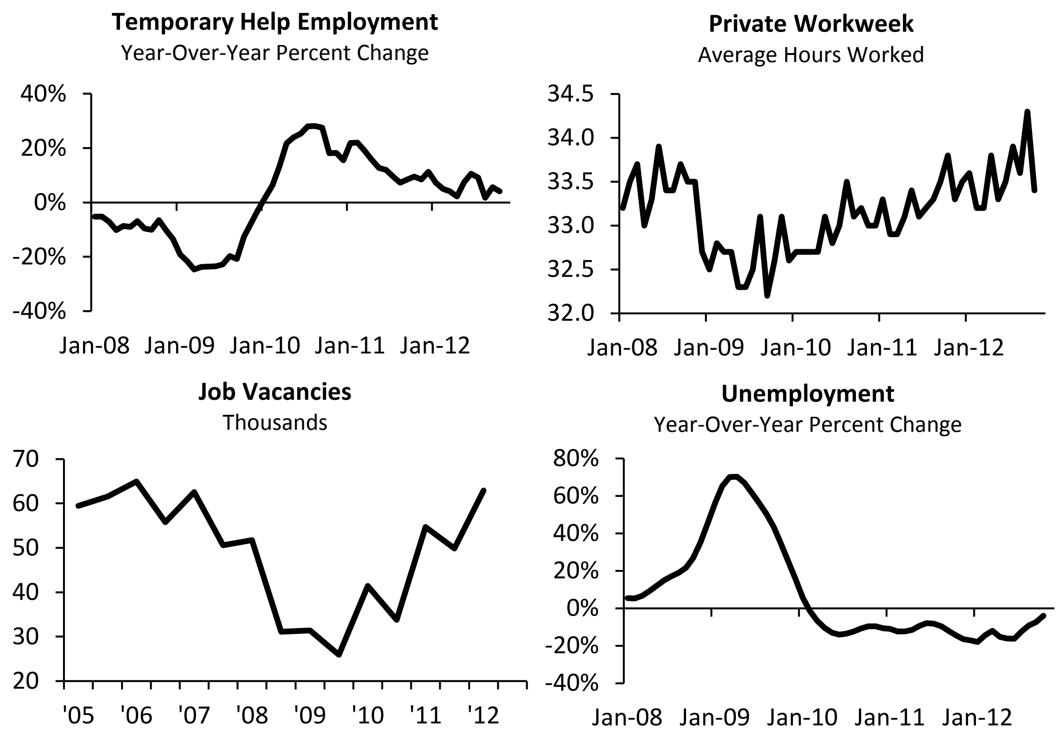
Still, while Minnesota's economic conditions have improved at a pace slightly ahead of the U.S., the state has a long way to go to recover the losses from the Great Recession. Minnesota employers have added about 110,000 jobs counting the upcoming revisions since employment bottomed three years ago, or more than 73 percent of the 150,000 jobs lost during the recession. Nationally, after the annual benchmarking adjustment, about 54 percent of the jobs lost during the recession have come back. And, there is a high degree of uncertainty surrounding fiscal policy. The fiscal cliff of Federal tax increases and Federal spending cuts scheduled for the end of the year could plunge the U.S. economy back into recession in early 2013 and cost Minnesota an estimated 70,000 jobs by the end of 2014.



MMB economists believe that implementing all the Federal spending cuts and Federal tax hikes would slam the brakes on job growth in Minnesota next year. At the end of 2014, Minnesota would have roughly 70,000 fewer jobs than is forecast in MMB's baseline scenario.

Forecasts for state employment and wages have been revised based on recent Minnesota specific information and Global Insight's (GII) November 2012 baseline. The November baseline was used to drive a newly re-estimated Minnesota Management and Budget (MMB) model of the Minnesota economy. MMB economists believe Minnesota's labor market is recovering, but will not appreciably improve on the current pace of job creation until 2014. Employment growth (measured fourth quarter to fourth quarter) of 46 thousand is expected this year, versus 50 thousand in 2011. Next year should be similar, with a 48,000 job gain, before increasing to 55 thousand in 2014 and 60 thousand in 2015. Minnesota payrolls return to pre-recession peak in the last half of 2013, a few months earlier than expected last February. And finally, as perceptions of growing job opportunities improve and previously discouraged workers are attracted back into the labor force, it is likely Minnesota's unemployment rate will remain in the 5.5 to 5.8 percent range (before the annual revisions) for much of 2013.

Minnesota Leading Indicators



Source: Minnesota Department of Employment and Economic Development (DEED)

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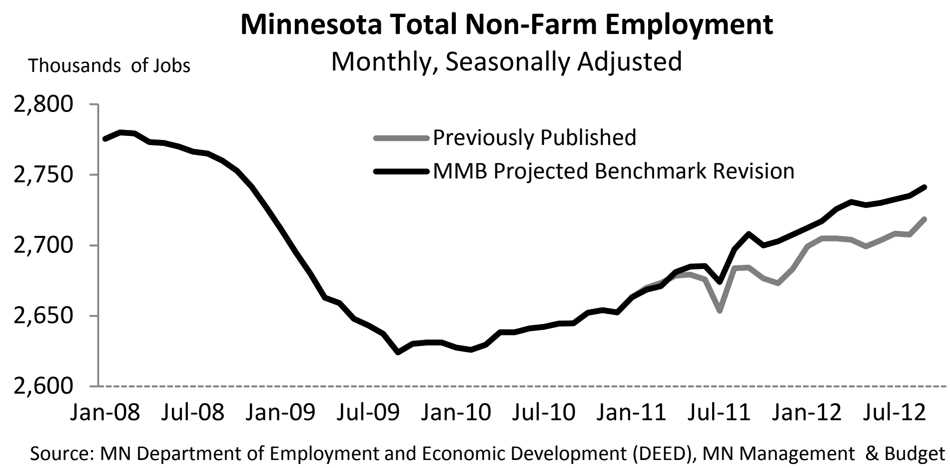
Revisions to Show Minnesota Job Conditions are Outpacing U.S.

The latest news on Minnesota's labor market remains encouraging. According to the employer survey released by the Minnesota Department of Employment and Economic Development (DEED), Minnesota non-farm employment payrolls grew 1.2 percent during the first 10 months of 2012 over the same period in 2011. That rate was slightly less than the U.S. But, each year these monthly sample-based estimates are re-aligned with state unemployment insurance (UI) tax records filed by nearly all employers. Based on UI records for first quarter 2012, MMB estimates that currently published employment data through March 2012 will be revised upward by 0.9 percent, or about 23,400 jobs, when annual benchmark revisions are released in the spring. The Bureau of Labor Statistics' (BLS) preliminary benchmark revision estimate similarly suggests an upward adjustment to March 2012 U.S. total nonfarm employment of 0.3 percent. When these likely benchmark revisions are incorporated Minnesota employment appears to have grown about 0.3 percent faster than the U.S. on an annual basis in 2011 and about 0.1 to 0.2 percent faster in 2012.



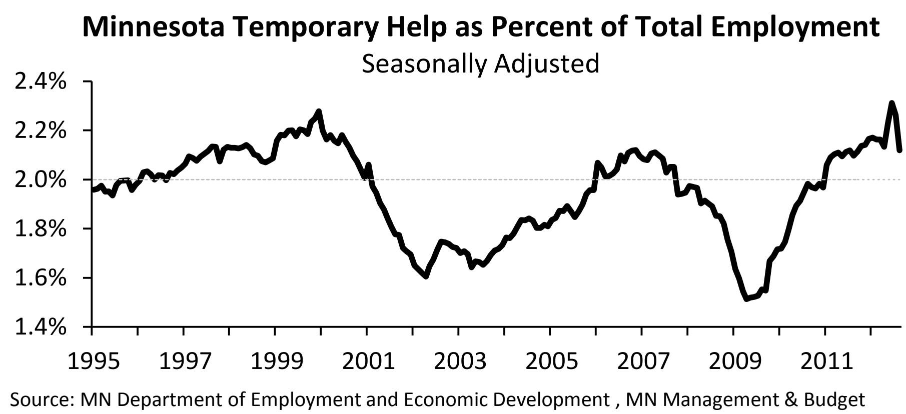
Upcoming revisions are expected to show that the state's labor market performed slightly better than previously thought in late 2011 and early 2012.

Labor market indicators from Minnesota's household survey are also outperforming the U.S. The state's seasonally adjusted unemployment rate held steady at 5.8 percent in October, down slightly from 6.1 percent a year earlier and still well below the 7.9 percent national jobless rate. Furthermore, monthly job growth has been much weaker in Minnesota's household survey than in the state's payroll survey in 2012. Households are reported to have shed an average of 900 jobs per month since the beginning of 2012, while DEED's currently published payroll survey shows average gains of 2,700 a month. The benchmark revisions to payroll employment are expected to show solid gains of 3,700 a month. The household survey has a smaller sample size and consequently tends to be more volatile, but MMB economists believe that when DEED performs its annual revisions to Minnesota's labor force and unemployment data at the end of the year the adjusted household survey employment will track more closely with the stronger payroll survey measure.

MMB's November 2012 forecast assumes labor market conditions will continue to improve into 2013, albeit at about the same modest pace as 2012. The number of jobs Minnesota employers add to their payrolls is forecast to average 3,800 a month in the first part of 2013 before picking up to over 4,500 a month by early 2014, aided by gains in construction and construction-related manufacturing. Minnesota's labor market needs to produce an estimated 2,000 jobs a month to keep pace with population growth and new people entering the workforce. Thus when combined with modest labor force growth, that outlook should be enough to noticeably bring down the state's unemployment rate beginning in late 2014 and 2015.

Leading Employment Indicators Back to Pre-Recession Peaks

Leading employment indicators, such as average hours worked, temporary help employment, and job vacancies, are all returning (or have returned) to levels not observed since before the recession. According to DEED, the average workweek in the private sector will increase in 2012 for the third consecutive year, reaching more normal, pre-recession levels. Likewise, the percentage of temporary jobs relative to total employment in the state has risen back over 2 percent, a share consistent with a healthy overall job market. Finally, in early September, DEED reported that the number of job vacancies in Minnesota rose over 15 percent in the second quarter of 2012 compared to the same period a year earlier. Employers registered 62,950 openings, the most since the second quarter of 2006. That equates to 2.6 unemployed people for each vacancy, down from 3.6 a year earlier and the lowest ratio observed since the spring quarter of 2007.



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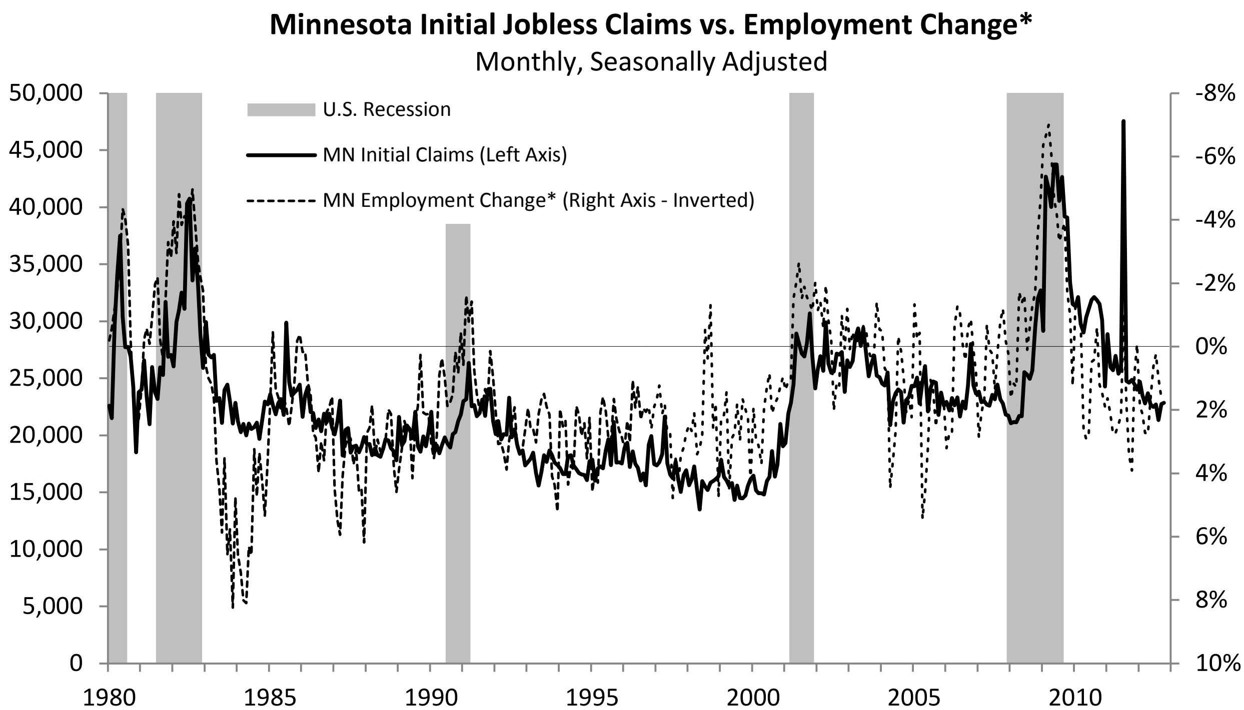
Minnesota's initial jobless claims also serve as a useful barometer of Minnesota's short-term labor market trends. According to DEED, the number of seasonally adjusted first time filers for unemployment insurance benefits has held below 23,000 for 7 of the past 8 months, down from a recessionary peak of nearly 44,000 during the summer of 2009 and back to levels not seen since just before the 2008 financial crisis.

Historical evidence suggests that following a recession once Minnesota's seasonally adjusted monthly initial claims drop to near 28,000, unemployment begins to stabilize and consistent month-to-month job losses fade. Furthermore, when this indicator falls below 25,000 for an extended period, it indicates employer confidence is improving and that hiring and investment in the state are turning up. Following the 2001 recession, for example, monthly initial jobless benefits in the state dropped below 28,000 during the early months of 2002 and month-to-month job losses faded later that spring. Initial claims, however, consistently remained over 26,000 until the fall of 2003 in part due to what was believed to be the lingering uncertainty resulting from the Iraq War. It wasn't until monthly claims fell below 25,000 at the end of the year and sank to near 23,000 by mid-2004 that meaningful job growth accelerated in Minnesota. With initial claims for unemployment insurance recently falling to levels statistically linked with better job growth, MMB economists view the health of this indicator as a strong sign of a recovering labor market.



* MN Employment Change is Annualized Percent Change of 3-Month Moving Average
Source: MN Dept of Employment and Economic Development (DEED)

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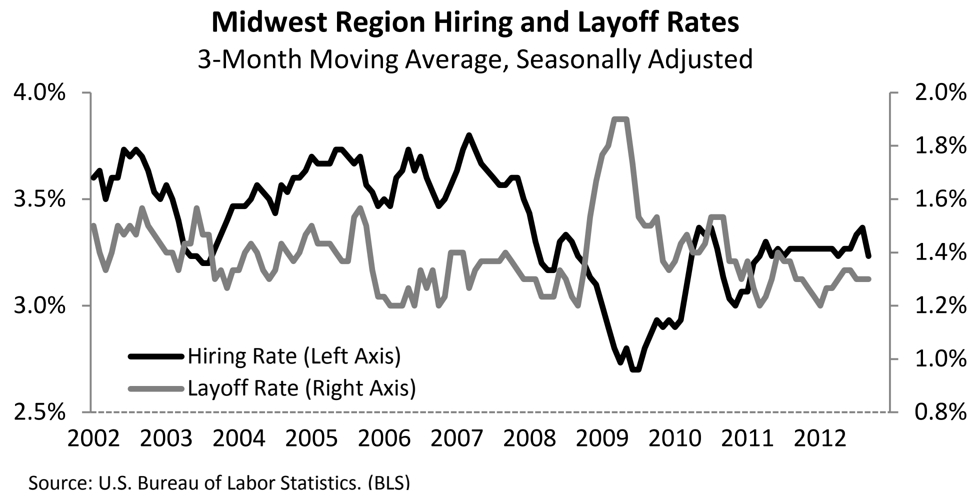
Hiring is Key to Faster Job Growth

Currently, the most significant barrier to stronger job growth is not layoffs, but reduced hiring. During the recession, Minnesota businesses responded to a sharp decline in demand by aggressively cutting back payrolls. Between the early part of 2008 and the end of 2009, for example, payroll employment in the state fell by about 150,000 jobs, or 5.4 percent. But in this new recovery, employers have remained reluctant to commit to new hiring. Uncertainty about political and economic conditions and the future of employee healthcare costs appears to be a major part of the explanation. And, without a clear and sustainable outlook for final demand, hiring plans continue to be postponed as more output is squeezed from the existing workforce by increasing hours of existing staff and turning to more affordable temporary workers. To put this into perspective, the Minnesota economy is now estimated to be producing two to three percent more than it did prior to the recession, but with about 40,000 (1.8 percent) fewer workers. The hiring shortfall is evident in the Bureau of Labor Statistics' (BLS) Job Openings and Labor Turnover Survey (JOLTS), where both the layoff and hiring rates in the Midwest remain low (Note: JOLTS data are not available at the state level). Cautious employers appear to be postponing hiring decisions until the outlook becomes clearer.



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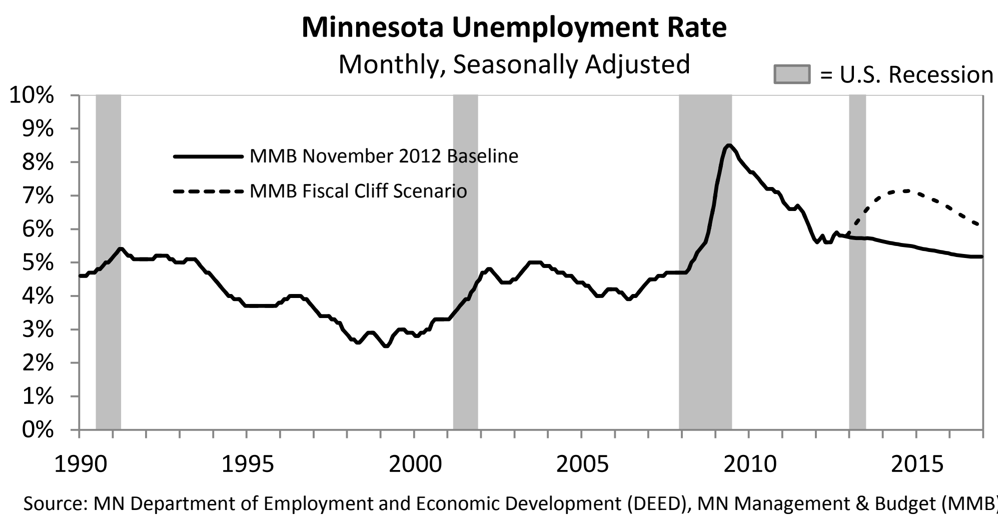
Fiscal Cliff Threatens Minnesota Recovery

The election resolved some uncertainties. The Affordable Care Act (or Obamacare) is here to stay. Questions still remain about how it will be implemented, its impact on the cost of premiums, and how many states will participate in the law's Medicaid expansion. Nevertheless, President Obama's re-election brings some measure of stability to the health reform law moving forward.

But key uncertainties over the future of fiscal policy remain, particularly the fiscal cliff of tax increases and spending cuts scheduled for the end of the year. There are two major parts. First, if federal policymakers fail to act, the tax cuts enacted in 2001 and 2003 under President George W. Bush will expire on January 1, 2013, along with the payroll tax cut and a host of other tax breaks. According to calculations by the nonpartisan Tax Policy Center, middle-income households would likely see an average tax increase of almost $2,000 next year. The second is the across-the-board spending cuts to defense and domestic programs set to take effect as well. According to calculations by the Federal Funds Information for State (FFIS) about 17 percent of federal grant dollars flowing to Minnesota would be subject to the across-the-board cuts, including funding for education programs. FFIS estimates that the state's share of sequestration would result in cuts of $129 million, or roughly 8 percent of federal nonexempt, nondefense grants to Minnesota compared with the federal fiscal year 2013 Continuing Resolution.

GII estimates that these tax hikes and spending cuts would plunge the U.S. economy back into recession in the first half of 2013. To better understand the consequences of permanently going over the fiscal cliff on Minnesota's economy, MMB economists modeled the state-level effects using a set of national economic projections made by GII. MMB forecasts that implementing all the spending cuts and tax hikes would slam the brakes on job growth in Minnesota next year. At the end of 2013, Minnesota would have roughly 45,000 fewer jobs than is forecast in MMB's baseline scenario. By the end of 2014, payroll employment drops almost 70,000 below baseline levels. MMB also estimates that failure to avoid the cliff would push the unemployment rate from 5.8 percent today to over 7 percent by the end of 2013, or 1.4 percent above the baseline estimate. Minnesota personal income falls by $3.4 billion (1.4 percent) in the first quarter of 2013 and remains below its pre-cliff high for the remainder of the year. At the end of 2015, Minnesota personal income is more than $12 billion (4.3 percent) below the level forecast in MMB's baseline.



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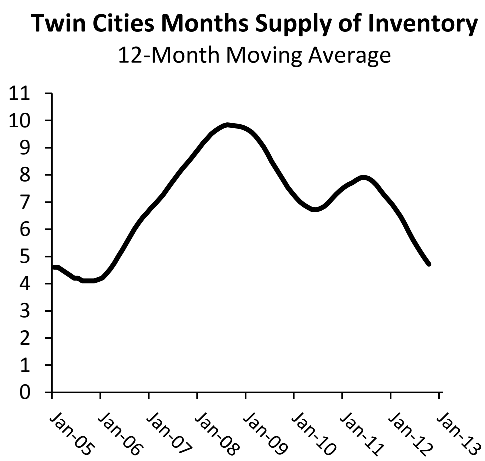
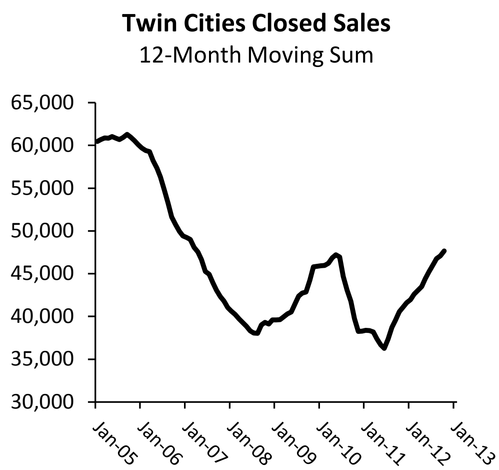
Signs of Life in Housing

Minnesota's housing market has shown widespread improvement in 2012. A pickup in household formation is beginning to release pent-up demand built up during the recession and weak recovery. These new buyers are taking advantage of near record low mortgage rates and more homes are selling. In the Twin Cities area, for example, the Minneapolis Area Association of Realtors (MAAR) reports closed sales were up 17 percent during the first 10 months of the year relative to the same period a year earlier. Combined with a five-year dearth of new home construction, stronger demand is also rapidly absorbing excess units created during the housing boom. Inventories are at or nearing record lows, which along with a falloff in distressed sales, is fuelling more competition among buyers. In the past year, sellers in the metro area have gone from receiving 91.1 percent of their asking price to 94.4 percent. While that is helping to boost selling prices, slower projected economic growth and another surge in distressed sales early next year due to processing delays could dampen home prices in the spring.

In a normal housing environment, underlying demand for new home construction is largely conditional on increases in the number of households, or formations. Between 2002 and 2005, however, low mortgage qualification requirements and growing speculation both nationally and in Minnesota fueled unsustainable levels of home construction that far outpaced demographic fundamentals. This produced a statewide excess supply of housing units going into the housing downturn in 2006 and the recession in late 2007.





Source: Minneapolis Area Assocation of Realtors (MAAR)

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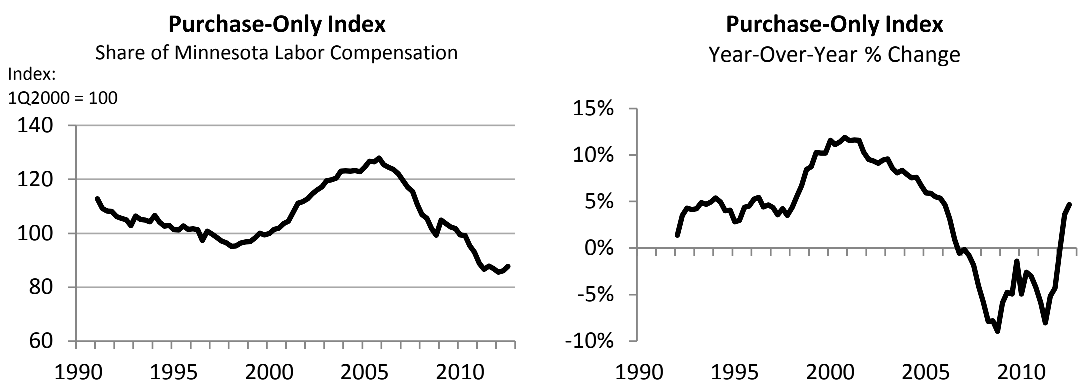
Before Minnesota's housing market can return to normal health it needs to work through the excess homes built during the housing boom. And, the only sustainable way to work through these excesses is to build new homes at a slower pace than households are being formed. Home building activity has been depressed in Minnesota for over six years. Only 9,200 building permits were authorized for new home construction in the state during 2009, just 9,600 were approved in 2010, and a record low 8,300 were issued in 2011. In 2012, the number of authorized permits are on pace to improve to 13,500, a five year high. By comparison, during normal building conditions, approximately 30,000 permits would be authorized to meet underlying demand.

Despite the sharp slowdown in home building activity in recent years, inventories remained high, mostly due to sluggish demand. This is because the recession slowed net migration and people chose to reduce housing costs by combining expenses. When more Minnesotan's "double up" on housing, there is less demand for new homes or rental units. Indeed, household formation in Minnesota fell so sharply during the recession that it has taken a prolonged period of time to absorb the excesses back into the market.

After nearly seven years of severe housing market correction, MMB economists estimate improving job growth and strengthening household formation rates will help absorb most, if not all, of the excess homes into the market by 2013. This is already playing out in data collected by MAAR, where the inventory of homes available for sale in the metro area has dropped for 21 consecutive months. In October, supply was down nearly 30 percent compared to a year earlier. The last time inventories were this low was late 2003.

Falling inventories are one reason selling prices have improved in 2012. According to the Federal Housing Finance Agency (FHFA) purchase-only index for conventional, conforming mortgages, Minnesota home values rose 4.9 percent in the third quarter from a year earlier, the first signs of over-the year gain since the housing market first began to deteriorate in mid-2006. Likewise, the S&P/Case-Shiller Home Price Index (HPI) reports that nominal home prices in the Minneapolis/St Paul area were up 8.8 percent last September from a year before.

Federal Housing Finance Agency (FHFA)
Minnesota Home Price Index



Source: Federal Housing Finance Agency (FHFA)

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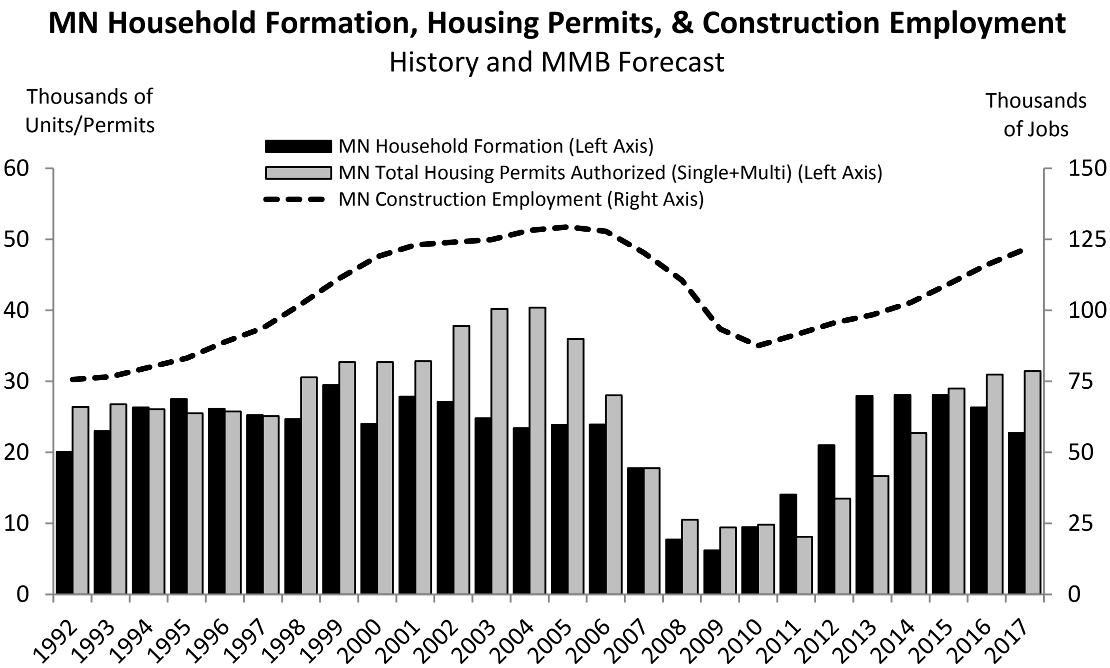
Another contributing factor to improving home prices is the falling share of distressed sales, where properties sell at a large price discount, relative to traditional listings. The median price of a foreclosure property in the Twin Cities, according to MAAR, for example, was $115,000 in the past year, significantly less than the $206,000 median price for a traditional listing. About 40 percent of the closed sales in the metro area this year have been foreclosures and short sales. Although still high, that rate is the lowest level in five years and down from about half in 2011.

Improvements in distressed markets come despite predictions by many housing experts last spring that the share of distressed sales would rise further in mid-to-late 2012. This is because the volume of recent home foreclosures had been temporarily snarled by slow processing and lengthy lawsuits, due to the nationwide "robo-signing" scandal. The disclosure prompted regulatory and legal action against the mortgage-lending industry, including a yearlong joint investigation by the state attorneys general from all 50 states and the federal government into alleged fraudulent misconduct. Last February, the coalition finalized a negotiated settlement with five large financial institutions and a private national mortgage registry. With the final settlement wrapped up, many economists expected the foreclosure processing to accelerate during the year, but another wave has not yet materialized. Another round of foreclosures in the 2013 pipeline could therefore reverse the drop in distressed inventory.



Source: MN Department of Employment and Economic Development (DEED), MN State Demographic Center, MN Management & Budget (MMB)

MMB economists estimate improving job growth and strengthening household formation rates will help absorb most, if not all, of the excesses into the market by 2013. These are principal assumptions behind the November 2012 outlook for residential building permits and construction employment.

A Revised Forecast

Forecasts for employment and wages have been revised based on recent Minnesota-specific information and GII's November 2012 baseline. The baseline was used to drive a newly re-estimated MMB model of the Minnesota economy. That model has also incorporated preliminary information on revisions to Minnesota's non-farm payroll employment provided by the Minnesota Department of Employment and Economic Development (DEED).

The November 2012 forecast for Minnesota's economy projects the state's employment recovery will remain modest. After declining 3.9 percent in 2009 from a year earlier and falling an additional 0.5 percent in 2010, Minnesota employment rebounded 1.7 percent in 2011. Employment in the state is forecast to continue to grow at that rate over the near term, growing 1.7 percent in both 2012 and 2013, before accelerating to 1.9 percent in 2014 and 2.1 percent in 2015. MMB economists estimate that it will take until the second half of 2013 before the state's employment regains the 2.770 million high reached before the recession began in late 2007.

Minnesota Outlook Compared to the U.S.

(Calendar Year Percent Change)

	2011	2012	2013	2014	2015	2016
Non-Farm Employment						
Minnesota						
November 2012	1.7	1.7	1.7	1.9	2.1	2.0
February 2012	1.6	1.5	1.6	1.7	N/A	N/A
United States						
November 2012	1.2	1.4	1.5	1.7	2.0	1.8
February 2012	1.2	1.5	1.5	1.7	1.7	1.5
Wage and Salary Income						
Minnesota						
November 2012	3.9	4.6	3.3	4.6	4.9	4.6
February 2012	4.4	4.2	4.2	4.6	N/A	N/A
United States						
November 2012	4.0	3.6	3.9	4.5	4.8	4.5
February 2012	3.6	3.6	4.1	4.6	4.8	4.4
Personal Income						
Minnesota						
November 2012	5.5	4.3	3.3	4.5	5.0	4.9
February 2012	5.7	3.3	3.9	4.9	N/A	N/A
United States						
November 2012	5.1	3.5	3.9	4.9	4.9	4.9
February 2012	4.8	3.5	4.0	4.9	4.8	4.9

N/A – Not Available

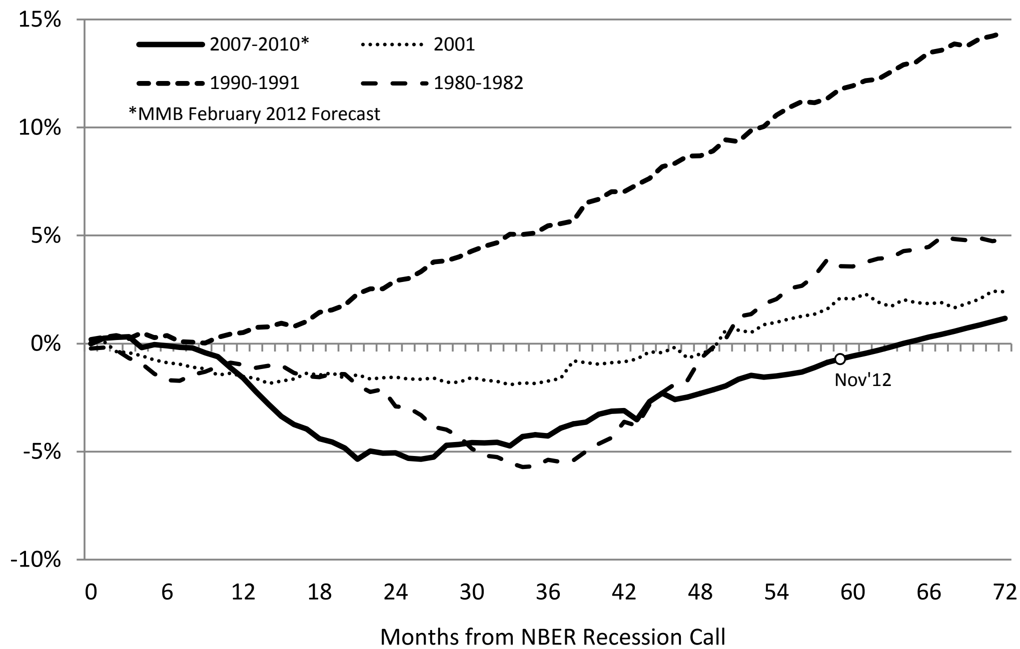
The total number of authorized monthly residential building permits in Minnesota has continued to drag along the bottom through much of 2012, but as demand for new home construction improves in early-to-mid 2013 permits will begin a modest recovery next year. Any employment rebound in construction will lag a recovery in building permits by between 6 and 9 months, thus a "catch up" period is assumed in the forecast. In the November 2012 forecast, the construction industry is forecast to add about 3,300 jobs in 2012 measured fourth quarter to fourth quarter and 3,200 jobs in 2013, before growth accelerates to 5,500 in 2014 and 7,200 in 2015. If household formation rates continue to worsen in 2013 as a result of weaker labor market conditions and the housing downturn continues to deepen later into 2013 it is unlikely that Minnesota's economy will perform as forecast.

Total nominal wage and salary disbursements in Minnesota fell 4.7 percent in 2009 from a year earlier according to the BEA, the first annual decline in this component of state personal income since the 1930s. Total nominal wages grew by 2.7 percent in 2010 and by 3.9 percent in 2011. Preliminary labor market data and income tax withholding collections suggests nominal wage income will grow 4.6 percent in 2012. In 2013, wages are forecast to rise 3.3 percent, before growth accelerates to 4.6 percent in 2014 and 4.9 percent in 2015.

The forecast assumes that GII's November 2012 baseline materializes. Any unanticipated adverse developments in the U.S. economy, however, such as a deeper Eurozone recession than GII assumes or political gridlock in Washington, will have unfavorable effects on the Minnesota economy.

Length and Depth of Minnesota Job Losses Relative to Past Recessions

Indexed Employment Change Since Month Preceding NBER Recession Call



Source: MN Department of Employment and Economic Development (DEED), MN Management & Budget (MMB)

The depth of the job declines that occurred between late 2008 and the middle of 2010 are so extensive that MMB economists estimate it will likely take until mid-2013 before Minnesota employment regains the 2.77 million peak reached before the recession began in late 2007.

REVENUE OUTLOOK

REVENUE FORECAST
FY 2012-13

Current general fund resources for the 2012-13 biennium are now forecast to total $34.944 billion, $1.076 billion (3.2 percent), more than projected at the end of the August, 2012 special legislative session. The forecast for net non-dedicated revenues increased by 2.7 percent; that for the four major taxes, by 2.6 percent. Other dedicated revenues, transfers, and prior adjustments are now expected to be 19.4 percent more than end-of-session estimates. Current resources in fiscal 2012 were $475 million above forecast and are projected to exceed earlier projections by $601 million in fiscal 2013.

Revenues FY 2012-13
($ in millions)

	FY 2010-11	FY 2012	FY 2013	FY 2012-13
Individual Income	$14,060	$7,973	$8,521	$16,493
Sales	8,581	4,678	4,836	9,514
Corporate	1,588	1,044	1,080	2,124
Statewide Levy	1,534	799	817	1,616
Four Major Taxes	25,763	14,494	15,253	29,747
Other Revenue	3,734	1,765	1,825	3,590
Tobacco	338	167	161	328
Net Non-dedicated	29,835	16,426	17,239	33,665
Other Resources	969	660	619	1,279
Current Resources	**$30,804**	**$17,086**	**$17,858**	**$34,944**

Forecast for each of the four major taxes increased over end-of-session estimates. Corporate taxes showed the largest dollar value and percentage increases. They are now expected to exceed prior estimates by 18 percent or $325 million. Percentage changes in the individual income tax and the sales tax were small, but still produced significant increases in revenue. Projected income tax receipts are up 1.4 percent, or $232 million; the sales tax, 1.6 percent or $152 million. The forecast for the state wide property tax increased by $35 million or 2.2 percent.

Total current resources are now forecast to be 13.4 percent more than in the 2010-11 biennium. After adjusting for the phased transfer of the motor vehicle sales tax to funds dedicated to transportation, fiscal 2012-13 revenues are projected to exceed similar revenues in the 2010-11 biennium by 13.0 percent.

Changes in Economic Assumptions

Global Insight's November baseline economic forecast for the 2012-13 biennium is very similar to its February 2012 baseline. Real GDP is now projected to grow by 1.94 percent over the biennium. In February biennial growth of 1.95 percent was forecast. The slightly stronger than anticipated real growth observed in fiscal 2012 is expected to be almost completely offset by slower than previously projected growth in fiscal 2013.

Global Insight's baseline forecasts for U.S. employment and wages in 2012 and 2013 also have changed little since February. Both Minnesota employment and wages are estimated to have grown more rapidly than their national counterparts in 2012 and this forecast shows Minnesota employment growth continuing to outpace the U.S. total in 2013. Minnesota wage growth however, slows to less than the national rate in 2013. Total wages in Minnesota grow at an average annual rate of 3.6 percent over the 2012-13 biennium, while U.S. wages grow at an average annual rate of 3.5 percent.

Income Tax

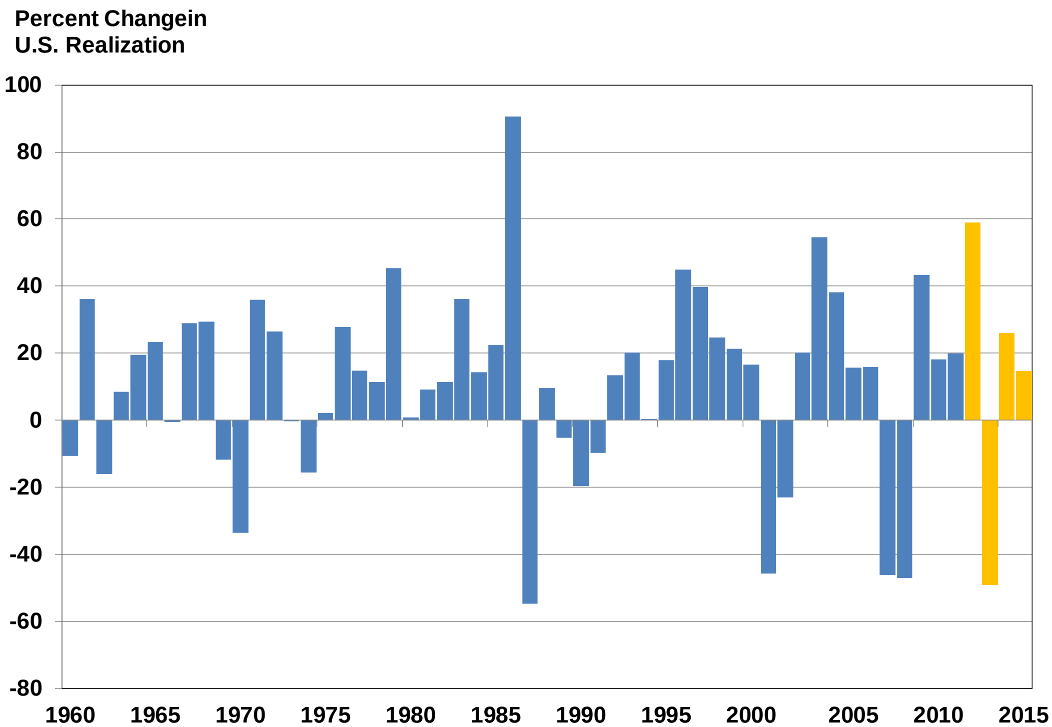
Individual income tax receipts for the 2012-13 biennium are now forecast to total $16.493 billion, $232 million (1.4 percent) more than end-of-session estimates. Actual fiscal 2012 receipts were $96 million more than prior projections, and receipts for fiscal 2013 are projected to be $136 million above earlier estimates. Through October, 2013 fiscal-year-to-date receipts were $50 million above forecast although withholding receipts were slightly below projections.

This is the first forecast made using the 2010 sample of Minnesota filers. When results from the micro-simulation were compared with tax year 2010 liability as observed by the Department of Revenue, a larger than typical gap was found. That gap was closed by making an $87.8 million off-model adjustment to final liability in each year of the 2011-17 forecast horizon. Estimated final liability for tax year 2011 was set at $7.421 billion, $36 million more than projected in February. All of the additional tax revenue for tax year 2011 appears to have come from non-wage income. Wage growth in 2011 now appears to have been slightly slower than thought in February.

Wages are believed to have grown slightly faster in 2012 than was anticipated in February. Non-wage income, however, appears to have grown substantially faster than was previously expected. Almost all of that additional growth comes from a change in the capital gains forecast. Capital gains realizations in tax year 2012 are now expected to increase by 59 percent over 2011. February's revenue forecast called for an increase of 16 percent. As in February, no behavioral changes are assumed related to the expiration of the Bush tax cuts. But, this forecast does adjust for the impact of the surtax on non-wage income for high income individuals provided for in the Affordable Care Act. That surtax implicitly raises the federal tax rate on capital gains from 15 percent in 2012 to 18.8 percent in 2013 and beyond, and is expected to lead some taxpayers to realize gains in 2012 that otherwise might have not been realized until 2013 or later. If the special capital gains rate provided for in the Bush tax cuts is not extended the top capital gains rate will rise to 23.8 percent in 2013 and a further increase in tax year 2012 realizations would be likely.

At the time this revenue forecast was prepared the President and the Congress had not reached agreement on whether or not the Bush tax cuts would be extended into 2013. A decision not to extend the current rate structure for high income filers would likely trigger significant tax avoidance activity by high income taxpayers who would be expected to accelerate incomes into 2012 and reduce them in future tax years. Those behavioral changes would add to state tax revenues in fiscal 2013, and reduce state revenues in the 2014-15 biennium. This forecast assumes current policy remains in place with respect to the Bush tax cuts. It does not make any adjustments for behavioral changes related to their expiration. Assuming that these tax cuts are not extended for high income taxpayers would add materially to fiscal 2013 revenues.

Capital Gains Forecast Up in 2012, Down in 2013



Source: CBO, MMB

A one-time increase in the number of filers was made for tax year 2012 to reflect the large increase in people age 65 which occurs this year. Technical changes included a material reduction in an off-model adjustment to better represent the impact of changes in the federal tax treatment of business equipment spending. More current estimates of the gap between economic income and taxable income for businesses indicated that the gap in taxable income associated with bonus depreciation and expensing provisions may be overstated for tax years 2012 through 2017.

Sales Tax

Net sales tax collections for the 2012-13 biennium are now expected to reach $9.514 billion, $152 million (1.6 percent) more than projected at the end of the special legislative session. The forecast for gross sales tax receipts increased by $92 million and expected sales tax refunds fell by $60 million. Gross sales tax receipts exceeded forecast by $26 million in fiscal 2012 and they are currently $18 million above forecast through the first four months of fiscal 2013. Those variances were incorporated into the current forecast. Net sales tax revenue for the 2012-13 biennium is now expected to be 10.9 percent greater than in the 2010-11 biennium.

Minnesota's sales tax base is now forecast to grow slightly faster in the 2012-13 biennium, than in February's forecast. Most of the additional growth occurs in fiscal 2013. Spending on construction materials grows by 23 percent this biennium, while spending on non-auto consumer durables is forecast to grow by 11 percent.

No changes were made to the receipts elasticity. It remains at 0.95 through 2017. The $2.5 million per month reduction to projected sales tax receipts was removed for an entire forecast horizon since the model now appears to be tracking actual revenues closely. The growth rate for e-commerce and catalog sales is estimated to have grown 14.5 percent in FY 2012 and is forecast to grow 12.7 percent in FY 2013.

Corporate Franchise Tax

Corporate tax revenues for the 2012-13 biennium are forecast to total $2.124 billion, $325 million (18.1 percent) more than previously estimated. The forecast for the current biennium is now $536 million or 33.8 percent above the level of corporate tax receipts observed in the 2010-11 biennium. Corporate tax receipts in fiscal 2012 were $97 million above forecast and to this point fiscal 2013 net corporate receipts are $67 million above projections. Both those variances were incorporated into the current forecast. The corporate income tax continues to be Minnesota's most volatile tax source.

About 60 percent of the addition to the corporate forecast comes from an increase in the forecast for corporate estimated (declaration and extension) payments. Corporate estimated payments were $55 million more than forecast in the final five months of fiscal 2012 and were $46 million above forecast during the first four months of fiscal 2013. Global Insight expects corporate profits to peak in 2013 as labor costs and capital costs associated with expanding output reduce margins. Corporate refunds in the 2012-13 biennium are now expected to be $81 million less than forecast in February, consistent with Global Insight's stronger corporate profit outlook and refund experience to date.

Other Revenues

Other tax and non-tax revenues including transfers and prior year adjustments are expected to total $5.197 billion, $333 million more than end-of-session estimates. Projected mortgage registry tax receipts were increased by $71 million reflecting stronger than previously anticipated refinancing activity. Changes in forecasts for most other taxes were small, although projections for estate tax receipts and for other dedicated revenues both were increased by more than $20 million.

Other non-dedicated revenues were increased by a $26 million transfer of the excess balance in the assigned risk plan to the general fund. State law requires that any surplus in the assigned risk plan be used to increase the budget reserve. Transfers from other funds added $56 million to 2012-13 revenue, a transfer from the Health Care Access Fund to the general fund accounted for $45 million of that increase. Prior year adjustments exceeded end-of-session estimates by $152 million. Receipt of a large payment from the federal government for claims covering multiple years accounted for $139 million of that increase. Tobacco settlement revenues are now projected to be $327 million, $6 million more than previously forecast.

REVENUE FORECAST
FY 2014-15

Total current resources available for Minnesota's general fund in the 2014-15 biennium are now forecast to total $35.793 billion, $849 million (2.4 percent) more than is forecast for the 2012-13 biennium, but $68 million less than February's planning estimates after adjusting for actions by the 2012 legislature. General fund receipts for the major taxes are expected to grow by $1.443 billion or 4.8 percent over receipts in the 2012-13 biennium.

FY 2014-15
Revenues Estimates
($ in millions)

	FY 2012-13	FY 2014	FY 2015	FY 2014-15
Individual Income	$16,493	$8,508	$8,929	$17,436
Sales	9,514	4,975	5,148	10,123
Corporate	2,124	1,012	942	1,954
Statewide Levy	1,616	831	845	1,677
Four Major Taxes	29,747	15,326	15,864	31,190
Other Revenue	3,590	1,808	1,859	3,667
Tobacco	328	157	154	311
Net Non-dedicated	33,665	17,291	17,877	35,168
Other Resources	1,279	313	312	625
Current Resources	**$34,944**	**$17,604**	**$18,189**	**$35,793**

This is the first detailed forecast of revenues for the 2014-15 biennium. Previous revenue estimates for fiscal 2014 and 2015, termed "planning estimates", were simple extrapolations of projected 2013 revenues using long-term growth trends for the U.S. economy from Global Insight's baseline forecasts. No adjustments to reflect the relative performance of the Minnesota economy were made, nor were any behavioral adjustments made to reflect changes in taxpayer behavior caused by changes in federal tax rates. In addition, for the income tax planning estimates, all elements of income and all individual itemized deductions were assumed to grow at Global Insight's projected growth rate for taxable personal income. Beginning with this forecast, and in all future forecasts of revenues for tax years 2014 and 2015, separate growth rates for each source of income and each type of deduction are incorporated into the income tax micro-simulation. The wage growth rates and growth rates used in the sales tax and corporate income tax computations also are Minnesota specific, they take into account the projected strength of Minnesota's economy, not simply national economic growth rates.

In this forecast individual income tax receipts grow by $943 million from projected 2012-13 levels, but growth is slower than previously projected in end-of-session planning estimates. Much of the slower growth anticipated is the result of behavioral assumptions made regarding the impact of the additional 3.8 percent tax on non-wage income of high income taxpayers provided for in the Affordable Care Act. That tax increase, effective in tax year 2013, is expected to lead some upper income filers to accelerate portfolio income into tax year 2012 to benefit from the lower tax rates currently in place. Projected sales tax receipts and corporate tax receipts exceed end-of-session planning estimates for the 2014-15 biennium by $124 million and $136 million respectively. But FY 2014-15 corporate tax receipts are projected to be $171 million less than in the current biennium.

Changes in Economic Assumptions

Global Insight's November baseline forecast shows real GDP growth proceeding at a slightly slower pace in the 2014-15 biennium than was expected in February. Real growth of 2.8 percent is now expected. In February the U.S. economy was expected to grow at a 3.1 percent annual rate over that period. There was also a slight change in the inflation outlook. The CPI is now expected to increase at an annual rate of 1.7 percent over the biennium. February's baseline forecast called for CPI growth of 1.9 percent. Nominal GDP is projected to grow at an average annual rate of 4.4 percent in fiscal 2014 and 2015, 0.5 percentage points less than February's estimate.

Income Tax

Individual income tax revenue for the 2014-15 biennium is forecast to total $17.436 billion, $943 million (5.7 percent) more than is now projected for the 2012-13 biennium, but $547 million less than the end-of-session planning estimate. About 43 percent of the decline in revenue is due to slower wage growth, and 43 percent to slower than anticipated growth in non-wage income. The remainder is due to technical adjustments. Because the planning estimates use the same growth rate for all income sources, prospective wage growth is often overstated and growth rates for most other sources of income slightly understated. When the transition from planning estimates to forecast occurs the greater than previously projected growth in non-wage income—particularly capital gains – typically offsets the revenue lost to slower wage growth.

In this forecast capital gains realizations in tax years 2013 and 2014 are projected to fall well below previous estimates as upper income taxpayers accelerate realizations into tax year 2012 to avoid the higher rates in 2013 and beyond. In the absence of the tax rate change in the Affordable Care Act non-wage income for tax years 2013 and 2014 would be larger than in 2012, but growth would not have been sufficient to offset the decline in wage income.

Capital gains are now assumed to fall by 49 percent in 2013 leaving realizations at approximately the level observed in 2009. Realizations decline because some tax year 2013 and 2014 gains are taken in 2012 and because the higher tax rates reduce investors propensity to sell capital assets. In 2014 realizations are forecast to increase by 26 percent. The capital gains forecast assumes that federal policy makers reach agreement to extend the Bush Tax for all taxpayers through 2013, and that the special 15 percent rate remains in place through 2015.

Technical changes included use of a revised filer growth equation which slightly reduced the impact of employment growth on the number of filers consistent with currently observed filer growth patterns.

Sales Tax

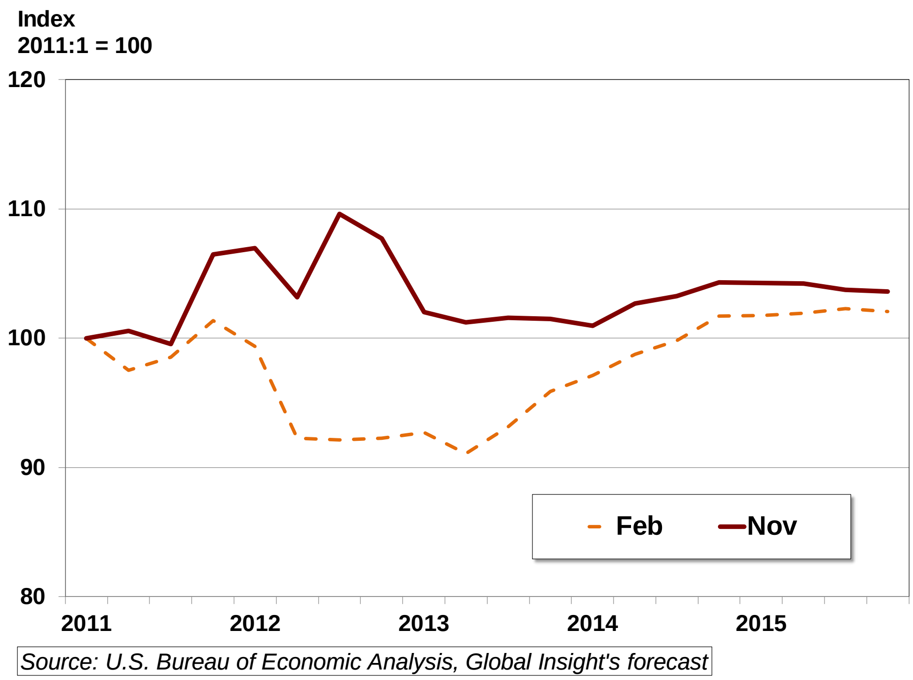
Net sales tax receipts for the 2014-15 biennium are projected to total $10.123 billion, an increase of $610 million (6.4 percent) from levels currently anticipated for the 2012-13 biennium. This sales tax forecast is $124 million greater than the end-of- session planning estimates for sales tax receipts. Expected sales tax refunds fell by $74 million reflecting the lower base level refunds observed in 2012 and a reduction in Global Insight's capital equipment forecast.

Receipts elasticities remained at 0.95 the same as was used in the forecast for fiscal 2013. Growth rates for e-commerce and catalog sales were set at 11.5 percent and 10.5 percent respectively for FY 2014 and FY 2015.

Corporate Franchise Tax

Corporate tax revenues for the 2014-15 biennium are forecast to total $1.954 billion, $171 million (8.0 percent) less than the forecast for the 2012-13 biennium. Expected corporate tax revenues are, however, $136 million more than the end-of-session planning estimates for the 2014-15 biennium. Global Insight expects domestic corporate profits to pull back modestly from 2012's historic high, falling by two percent in tax year 2013, and another one percent in tax year 2014. Slower productivity growth and lower profit margins explain the decline. Since changes in corporate tax payments follow changes in corporate profits with a lag, the reductions in the 2013 and 2014 outlook for profits affect state revenues in fiscal 2014 and 2015. Off-model adjustments for the phase in of the 100 percent sales factor for the allocation of income from corporations operating in multiple states and the historical preservation credit reduced the forecast for corporate revenues by $78 million.

U. S. Corporate Profits Expected to Decline Slightly From Current Levels



Other Revenues

Other tax and non-tax revenues, including prior year adjustments and transfers are expected to total $4.603 billion in the 2014-15 biennium, $595 million less than is expected in the 2012-13 biennium, but $195 million more than end-of-session planning estimates. Much of the increase is explained by a change in the treatment of tobacco settlement revenue. The budget agreement reached in the 2011 special legislative session included the issuance of Tobacco Settlement Revenue bonds. Debt service on these bonds was to be paid from future tobacco settlement payments received by the state and a portion of the state's tobacco settlement was dedicated to debt service on those bonds. General fund revenues were reduced to reflect that obligation. In November, 2012 the bonds issued by the Tobacco Settlement Authority were called and replaced by appropriation bonds. The debt service on these appropriation bonds is dependent on appropriations made in each biennial budget and is no longer a claim on tobacco settlement revenues. To reflect that change the tobacco revenue forecast now includes the full amount of the forecast payment not the amount after the transfer to the Tobacco Settlement Account. The debt service payment is now treated as an expenditure, not a reduction in revenues. Revenues from the mortgage registry tax were increased by $52 million over end-of-session planning estimates.

REVENUE PLANNING ESTIMATES
FY 2016-17

Total current resources for the 2016-17 biennium are estimated to be $38.702 billion, an increase of $2.909 billion (8.1 percent) over the current forecast for 2014-15 biennial revenues. This is the first estimate of revenues for the 2016-17 biennium. These revenue planning estimates assume that both the U.S. and Minnesota economies begin to grow at more normal rates in late 2013. Real growth rates then accelerate, peaking at 3.7 percent in the third and fourth quarters of 2014. Real GDP is assumed to grow at a 3.1 percent rate in fiscal 2016 and a 2.7 percent rate in fiscal 2017. Nominal GDP is assumed to grow by 4.6 percent in the 2014-15 biennium.

FY 2016-17
Revenues Estimates
($ in millions)

	FY 2014-15	FY 2016	FY 2017	FY 2016-17
Individual Income	$17,436	$9,641	$10,022	$19,663
Sales	10,123	5,295	5,433	10,727
Corporate	1,954	943	937	1,880
Statewide Levy	1,677	863	882	1,745
Four Major Taxes	31,190	16,741	17,274	34,015
Other Revenue	3,668	1,878	1,895	3,773
Tobacco	311	151	148	300
Net Non-dedicated	35,168	18,771	19,317	38,088
Other Resources	625	307	307	614
Current Resources	**$35,793**	**$19,078**	**$19,624**	**$38,702**

General fund receipts for the four major taxes are now projected to be 9.1 percent more than in the 2014-15 biennium. The individual income tax provides the largest share of additional revenues for the 2016-17 biennium. Projected income tax receipts are now expected to exceed the forecast for the 2014-15 biennium by $2.227 billion or 12.8 percent. Sales tax receipts grow by 6.0 percent over projected FY 2014-15 levels, corporate franchise tax receipts fall by 3.8 percent, and the statewide property tax increases by 4.1 percent.

No one can accurately forecast the economy's path five years into the future. The baseline revenue planning estimates presented above are not explicit forecasts; they are extrapolations of projected trends in the economy. Even small deviations from the assumed trend over five years will compound and produce sizeable changes in revenues. In addition, due to the way the estimates are constructed any change in the base level of revenues for fiscal 2013 through fiscal 2015 will change the revenue planning estimates for fiscal 2016 and 2017. Other things equal, stronger than anticipated revenue growth through fiscal 2015 will carry forward and add significantly to revenues in the 2016-17 biennium. But, should the economy grow more slowly than forecast, or should some item of portfolio income such as capital gains fall well below forecast – as it did in tax year 2000 and again in tax years 2008 and 2009--the revenue outlook for the 2016-17 biennium will deteriorate.

The revenue planning estimates are only a guide to the level of future revenues. They are not a guarantee. Normally, if the economy remains strong the planning estimates are likely to slightly understate actual receipts. But, taxpayer reaction to scheduled increases in the tax rate on capital gains could be quite different from that assumed in this forecast or the capital gains tax rate could be changed. That could lead to either a material increase in revenues in fiscal 2014, or a significant decline. Also, Minnesota's economy is assumed to grow at the national rate in 2016 and 2017. While Minnesota has typically grown at or above the national rate, there is no guarantee the state will not underperform the U.S. economy between now and the close of the 2016-17 biennium. Either outperforming or underperforming the national averages could lead to a material change in projected revenues. Actual revenues for 2016-17 could exceed or fall short of the planning estimates by $4 billion or more depending on the economy's performance.

Since November 2002 the Finance Department has based its revenue planning estimates on Global Insight's baseline forecast. February's 2016-17 revenue planning estimates again were prepared consistent with the GII baseline forecast. GII projects real GDP growth rates of 2.9 percent in calendar 2016 and 2.6 percent in 2017. GII's GDP growth rates for both 2016 and 2017 are below those assumed by the CBO in their August 2012 *Budget and Economic Outlook* update. The CBO expects real GDP to grow at an annual rate of 4.5 percent in 2016 and 3.8 percent in 2017. October's Blue Chip Consensus long term outlook is similar to GII's, with real GDP growth projected to be 2.9 percent in 2016 and 2.8 percent in 2017.

As in the past, individual income tax estimates were prepared using the House Income Tax Simulation (HITS) Model. Assumed filer growth in Minnesota was consistent with average national employment growth for the years in question. All elements of income and all individual itemized deductions were assumed to grow at the growth rate of taxable personal income – the combination of wages and salaries, proprietors' incomes, dividend, interest and rents – as projected in GII's baseline forecast.

HITS model pin files were adjusted for changes in federal tax law that will occur in 2013 when provisions initially enacted in the Economic Growth and Tax Relief Act of 2001 and the Jobs and Growth Tax Relief Reconciliation Act of 2003, including the reduction in the federal capital gains tax rate from 20 percent to its current level of 15 percent, expire. Since Minnesota taxes capital gains at the same rate as ordinary income changes in the federal tax rate on capital gains will not affect the rate at which capital gains are taxed in Minnesota. They could, however, have a significant indirect impact on Minnesota taxable income if investors adjust their behavior to maximize after tax returns on investments. MMB has not included one-time off model adjustments to tax liability in tax years 2012, 2013, 2014 and 2015 to reflect behavioral shifts by taxpayers seeking to reduce the impacts of the scheduled expiration of the Bush Tax cuts. Parameters in the

HITS model were, however, adjusted to account for behavioral shifts expected due to tax law changes in the Affordable Care Act.

The complete sales tax model was used to prepare the sales tax revenue planning estimates. Each component of the sales tax base was assumed to grow at the national average rate for that group of goods or services. Corporate tax receipts in Minnesota were estimated using a model driven by before tax corporate profits on a national income accounts basis reduced by foreign source profits. The deed and mortgage taxes were forecast based on the projected growth in the value of new and existing home sales. Planning estimates for other tax and non-tax revenues were based on extrapolation of existing trends.

SPENDING OUTLOOK

Spending estimates for FY 2012-15 are largely unchanged from prior estimates. Prior to additional spending related to the K-12 shift buyback, projected state general fund spending for FY 2012-13 is now $33.898 billion, $262 million less than end-of-session estimates. Once the additional spending is added to reflect the K-12 aid payment buyback, total general fund spending is estimated to be $35.222 billion. General fund spending for FY 2014-15 prior to the shift buyback was forecast to be $36.809 billion, $100 million less than end-of-session estimates. Once the additional spending is added to reflect the K-12 aid payment buyback, total general fund spending is estimated to be $36.866 billion. The following table shows forecast change for FY 2012-15.

November Forecast Expenditures

($ in millions)

	November FY 2012-13	$ Change	November FY 2014-15	$ Change
K-12 Education	13,906	(28)	15,122	(7)
Property Tax Aids & Credits	2,804	(32)	2,729	(42)
Health & Human Services	10,700	(196)	11,443	(185)
Debt Service	415	(39)	1,355	(5)
All Other	6,073	33	6,160	139
Total Forecast Spending	**33,898**	**(262)**	**36,809**	**(100)**
K-12 Shift Buyback	1,324		57	
Total After Buyback	**35,222**		**36,866**	

FY 2012-13 Spending Estimates Down $262 Million in 2012-13 Biennium, Down $100 Million in 2014-15 Biennium

Outside of health and human services, forecast changes in other areas of the budget were the modest. Health and human services spending is down $196 million in FY 2012-13 and $185 million in FY 2014-15. The vast majority of the savings is driven by changes in Medical Assistance (MA). Increased pharmacy rebates in FY 2012-15 for all MA eligibility categories and reduced case load and average costs of providing care amongst a number of eligibility groups account for the lower spending estimates.

K-12 education estimates were reduced by $28 million in FY 2012-13 and $7 million in FY 2014-15 to reflect a small downward revision in enrollment projections. The lower estimates in FY 2014-15 were offset, in part, by expected increases in compensatory aid, alternative teacher compensation (Q comp) and literacy aid. Property tax aids and credits estimates are down $32 million in FY 2012-13 and $42 million in FY 2014-15. The reductions in property tax aids and credits are mostly due to lower than expected spending on homeowner property tax refunds, offset slightly by increases in the renter property tax refund program. Debt service savings reflect the impact of a smaller bond sale in FY 2012 and a lower interest rate in the FY 2012-13 biennium.

All other spending is up $139 million in FY 2014-15. As mentioned previously, this relates to the debt service attributable to the refinancing of the Tobacco Settlement Revenue Bonds with General Fund State Appropriation Refunding Bonds.

FY 2014-15 Expenditure Estimates $1.644 billion Higher than FY 2012-13

After the increases in K-12 education and property tax aids and credits spending related to the school shift buyback are accounted for state general fund spending for FY 2014-15 is $36.866 billion, a 4.7 percent increase over the current biennium.

FY 2014-15 Budget Forecast
($ in millions)

	FY 2012-13	FY 2014-15	$ Change	% Change
K-12 Education	14,446	15,241	795	5.5%
K-12 Payment Shifts	781	(61)	(842)	n/m
Subtotal K-12	15,227	15,180	(47)	(0.3%)
Property Tax Aids & Credits	2,806	2,729	(77)	(2.7%)
Health & Human Services	10,700	11,443	743	6.9%
Debt Service	415	1,355	940	226.5%
All Other	6,074	6,159	85	1.4%
Total Spending	**35,222**	**36,866**	**1,644**	**4.7%**

The large majority of the biennial growth is in K-12 education and health and human services. FY 2014-15 K-12 Education spending is estimated to be $795 million (5.5 percent) more than the current biennium. After the impact of shifts is controlled for health and human services spending is projected to be $743 million (6.9 percent) more than FY 2012-13. Debt service estimates are up $940 million over FY 2012-13; however, that change is attributed to the one-time use of tobacco bond proceeds to pay general obligation debt service. In FY 2014-15 those costs will again be paid from the general fund.

After a discussion of the FY 2016-17 planning estimates, the narrative sections below explain the forecast and biennial change for major areas of the budget (K-12 education, health and human services, property tax aids and credits and debt service).

This Forecast Provides Initial Set of FY 2016-17 Long-Term Planning Estimates

The spending growth shown for FY 2016-17 planning estimates is similar to the growth seen in FY 2014-15. Total spending is projected to increase by nearly $1.644 billion, 4.3 percent over FY 2014-15.

FY 2016-17 Planning Estimates

($ in millions)

	FY 2014-15	FY 2016-17	$ Change	% Change
K-12 Education	15,241	15,818	577	3.8%
K-12 Payment Shifts	(61)	(91)	(30)	n/m
Subtotal K-12	15,180	15,727	547	3.6%
Property Tax Aids & Credits	2,729	2,802	73	2.7%
Health & Human Services	11,443	12,204	761	6.7%
Debt Service	1,355	1,504	149	11.0%
All Other	6,159	6,202	43	0.7%
Total Spending	**36,866**	**38,439**	**1,573**	**4.3%**

The growth trends for major forecast programs remain the same as described for FY 2014-15. K-12 education growth from FY 2014-15 is driven by an increase in enrollment and demographic trends which impacts the largest areas of K-12 spending including general education basic aid entitlements ($131 million) and compensatory aid ($95 million). Regular special education ($198 million) grows primarily due to an inflation factor in current law. Property tax aids and credits growth is driven by the property tax refund program ($58 million) and aid to police and fire ($10 million). The majority of growth in health and human services is in Medical Assistance (MA). Increased estimates in long term care waiver program ($362 million), elderly and disabled basic program ($144 million) and families with children program ($398 million) are offset by lower estimates for the adults without children program since the program is 100 percent federally funded for most of FY 2016-17. Debt service estimates are up $149 million reflecting slightly higher interests rate assumptions as well as increases in the size of projected bond sales.

Nearly all other areas of spending are essentially flat in FY 2016-17. These areas of spending are set by state law and are not adjusted for inflation. It is important to highlight that additional K-12 spending related to the remaining $1.1 billion in school aid payment shifts is not included in FY 2014-15 or FY 2016-17. Changes in out-year spending estimates will be largely driven by decisions made in the next legislative session to balance the budget for FY 2014-15.

Education Finance

Education Finance, the largest category of state general fund spending, consists of aid programs for general education, special education, early childhood and family education, charter schools, nonpublic pupil programs, and desegregation programs.

E-12 aids can be divided into two major funding streams: 1) general education, the primary source of basic operating funds for schools, and 2) categorical aid tied to specific activities or categories of funding.

E-12 aids are usually discussed in two ways: 1) school year aid entitlements, the state aid share of school district revenue that is promised to school districts through Minnesota's school finance formulas, and 2) state fiscal year spending, the amount paid to school districts by the state during each fiscal year, sometimes referred to as the "payment" or the "appropriation." In a typical year, a school district receives 90 percent of their current year entitlement and 10 percent of their prior year entitlement – this makes up the state fiscal year spending amount, or the payment to districts. In FY 2013, they will receive 82.5 percent of their current year entitlement and 35.7 percent of their prior year entitlement. In FY 2014 and beyond, they will receive 82.5 percent of their current year entitlement and 17.5 percent of their prior year entitlement.

Entitlement amounts change from forecast to forecast as a result of demographic and program cost changes or law changes. State fiscal year spending can be impacted by entitlement changes, and by changes in the amount the state shifts between current and prior year payments.

If the amount of a shift changes in a given year, it changes the percent of a school district's entitlement that they receive in a year, which comprises the state fiscal year spending amount. However, it does not change the underlying entitlement, which is determined by Minnesota's school finance formulas. For example, in FY 2013, school districts were expecting to receive 35.7 percent of their prior year's entitlement and 64.3 percent of their current year entitlement. As a result of the current forecast, they will still receive 35.7 percent of their prior year entitlement, but they will receive 82.5 percent of their current year entitlement, changing state spending for FY 2013, or the payments received by school districts.

E-12 Education Entitlements Down $31.5 Million for FY 2012-13 and Flat in FY 2014-15 Compared to End of Special Session - State Spending Up $1.293 Billion in FY 2012-13 After Shift Buyback

For the current biennium, E-12 spending amounts are estimated to be $15.227 billion, an increase of $1.29 billion from end-of-session estimates. This increase is due to the partial buyback of the aid payment shift as required by M.S. 16A.152. Of the total amount allocated to the aid payment shift buyback, $1.324 billion will go out to school districts in the form of increased school aids in FY 2013. Because the shift is bought back to the nearest tenth of a percent, $6 million remains and is added to the state budget reserve.

The shift buyback distorts the underlying story of forecast change. Total entitlements are now expected to be $14.93 billion in FY 2012-13 and $15.15 billion in FY 2014-15. Total entitlements for the current biennium are down $31.5 million (0.2 percent) from end of session estimates as a result of slightly slower than expected pupil growth. Entitlements for in FY 2014-15 are largely unchanged. The slightly lower than previously expected growth in pupils continues in FY 2014-15, however increases in other entitlements offset the savings from slower pupil unit growth. The result is that FY 2014-15 entitlements increase by only $474,000 since end of session estimates. The changes that comprise change in FY 2014-15 include a reduction in Basic Education Aid entitlements of 38.4 million (0.4 percent) due to the lower pupil counts, offset by increases in Compensatory aid of $22.3 million (2.3 percent), Alternative Teacher Compensation (Q Comp) aid of $13.0 million (10.9 percent), and Literacy Aid of $6.8 million (6.8 percent). Compensatory aid, based on the number of pupils eligible for free and reduced lunch, is increasing due partly to changes in student identification practices. Previously, districts have been able to manually review Department of Human Services files to enroll pupils for free and reduced lunch if they are enrolled in certain DHS programs. This file sharing has become more automated, resulting in an increased number of pupils automatically qualifying for the program. Q Comp estimates are increasing due to the Anoka-Hennepin school district joining the program starting in FY 2014 as well as an increase in growth assumptions due to recent activity with the program. Literacy Aid increases are due to FY 2012 test results that are included as a component in the formula calculation coming in higher than previously anticipated, resulting in an increase in aid for schools with more proficient pupils and pupils showing growth on their tests.

E-12 Education Entitlements Expected to Grow $759 Million from FY 2012-13 to FY 2014-15 and $546 Million from FY 2014-15 to FY 2016-17

E-12 education entitlements are projected to total $15.15 billion in FY 2014-15 and $15.70 billion in FY 2016-17, an increase of $759 million from FY 2012-13 to FY 2014-15 and an increase of $546 million from FY 2014-15 to FY 2016-17. The majority of the growth between biennia occurs in the General Education and Special Education programs, driven by an increase in total pupils, an increase in the identification of students in poverty and growth in the Special Education formula. The Basic Aid portion of General Education is growing due to an increase in the number of students. Despite the slightly lower pupil unit projections from previous estimates, pupil units are still increasing on an annual basis. Between FY 2012 and FY 2017, pupil units are expected to grow by 26,529 or approximately 3.2 percent over the six year period. The Compensatory aid portion of the General Education formula increases due to growth in the number of students in poverty and increased identification of those students. Special Education funding grows based on the number of students identified and the program growth factor, which allows for 4.6 percent growth annually.

The biennial growth between FY 2012-13 and FY 2014-15 is driven by these underlying factors and includes $196.9 million (2.0 percent) growth in General Education Basic Aid entitlements, $111.2 million (12.4 percent) growth in Compensatory aid and $187.7 million (11.1 percent) growth in Special Education (regular). The growth between these two biennia is also driven by funding changes and new programs established in the FY 2012-13 biennia that were not fully funded until the second year of the current biennium, resulting in two years of spending in FY 2014-15 compared to one year of spending in FY 2012-13. These changes include Small School Revenue, Literacy Incentive Aid and a one percent increase on the General Education formula.

The growth between FY 2014-15 and FY 2016-17 is driven by these same underlying trends continuing. An increase in pupil units generates an increase of $131.1 million (1.3 percent) in General Education Basic Aid entitlements. Compensatory aid increases by $95 million (9.4 percent) over the 2014-15 biennium and Special Education (regular) entitlements increase $198.4 million (10.5 percent) over the previous biennium.

K-12 Shifts

There are two types of shifts that have been used in tough budget times to balance the budget.

- **School Aid Payment Shift –** The typical payment schedule of 90 percent current year payments/ ten percent prior year payments is adjusted to make a smaller current year payment, generating savings on a one-time basis.
- **Property Tax Recognition Shifts –** Schools are required to recognize a portion of local property tax revenues in an earlier fiscal year in order to offset state spending on a one-time basis.

Both types of shifts were used in 2002 and 2003 to generate additional budgetary savings and help balance the budget. Forecast surplus was used to buy back the shifts starting with the November 2004 forecast, with both shifts fully restored by February 2006.

K-12 shifts were used again starting in FY 2010. The total value of K-12 shifts implemented since the beginning of FY 2010 is $2.7 billion. This forecast includes a buyback of $1.323 billion of that shift, in addition to the $313 million that was bought back in the forecast last February. $1.1 billion remains to be bought back in the future.

RECENT SCHOOL AID PAYMENT SHIFT HISTORY

Time Period	Changes in Aid Payment Percentages	(Savings)/Costs[1] $ in millions
2002 Legislative Session	90/10 to 83/17	($438.0)
2003 Legislative Session	83/17 to 80/20	($191.1)
November 2004 Forecast	80/20 to 81.9/18.1	$117.9
February 2005 Forecast	81.9/18.1 to 84.3/17.4	$150.1
November 2005 Forecast	84.3/17.4 to 90/10	$370.4
2010 Legislative Session (FY10)	90/10 to 73/27	($1,072.9)
2010 Legislative Session (FY11)	73/27 to 70/30	($311.4)
2011 Legislative Session (FY12)	70/30 to 60/40	(710.0)
February 2012 Forecast	60/40 to 64.3/35.7	$313
November 2012 Forecast	64.3/35.7 to 82.5/17.5	$1,323.8

RECENT PROPERTY TAX RECOGNITION SHIFT HISTORY

Time Period	Changes in Early Recognition Percentages	(Savings)/Costs[2] $ in millions
2003 Legislative Session	0 to 48.6	($251.5)
November 2005 Forecast	48.6 to 10.8	$330.7
February 2006 Forecast	10.8 to 0	$93.5
2010 Legislative Session (FY11)	0 to 48.6	(519.1)

[1] Savings do not equal costs because underlying funding formulas were increased beginning in FY 2006. This made the aid payment shift buy back more expensive.
[2] Savings do not equal costs because property values grew significantly while the shift was in place. This generated additional savings for the state, but also increased the cost of the property tax recognition shift buy back.

Health and Human Services

Overview

Health and human services expenditures make up one-third of the total state general fund budget, and of those expenditures, 86 percent are for forecast programs including Medical Assistance, Chemical Dependency (CD), the Minnesota Family Investment Program (MFIP), MFIP Child Care, General Assistance, Group Residential Housing, and Minnesota Supplemental Aid.

General fund forecast changes are generally driven by changes to the Medical Assistance (MA) forecast, since MA accounts for the largest portion (90 percent) of forecasted program expenditures. MA is a state-federal, means-tested entitlement program for low-income families, persons with physical or developmental disabilities, and the low-income elderly. MA costs are split between the state and federal government, though only the state share of expenditures is reflected as part of the general fund forecast.

Health and Human Services Forecast Down $195 Million in FY 2012-13 and $185 Million in FY 2014-15

Health and human services expenditures for FY 2012-13 are expected to be $10.7 billion, a decrease of $195 million (1.8 percent) from the end of the 2012 legislative session. The change is driven almost entirely by the Medical Assistance (MA) program, which is reduced by $210 million. Estimated spending in Chemical Dependency and economic assistance programs are also reduced from end of session, by $3 million and $10 million respectively. Offsetting decreases in estimated federal administrative reimbursements (recognized as a negative expenditure) net the total reduction to $195 million.

In FY 2014-15, health and human services expenditures are expected to be $11.4 billion, a decrease of $185 million (1.6 percent) from end of session. Again, lower MA spending accounts for a vast majority of the change ($194 million.) Reduced projected spending on Chemical Dependency ($6 million) constitutes the remainder of the change with non-MA changes netting to a spending increase of less than $1 million. Once again, offsetting expenditure increases in grant programs ($6.2 million) and federal reimbursements ($14 million) reduce the change in forecast to $185 million.

Health Care Programs

The forecast shows reduced expenditures in Medical Assistance between 2 and 3 percent in current and next biennium. A breakout of this change by subparts of the MA forecast is shown in the table below.

MA Eligibility Category	FY 2012-13 Change From EOS (in millions)	Change as % of EOS Expenditures	FY 2014-15 Change from EOS (in millions)	Change as % of EOS Expenditures
Pharmacy Rebates	($37)	(18%)	($77)	(39%)
Families With Children Basic Care	($55)	(2.6%)	($30)	(1.3%)
Long Term Care Facilities	($17)	(1.8%)	($24)	(2.5%)
Long Term Care Waivers	($42)	(1.8%)	($27)	(1.0%)
Elderly & Disabled Basic Care	($53)	(2.1%)	($37)	(1.2%)
Adults Without Children	($6)	(0.7%)	$1	(0.2%)
Total Medical Assistance Change	**($210)**	**(2.5%)**	**($194)**	**(2.2%)**

Although not an eligibility category, the table includes pharmacy rebates, which are increased by 39 percent in FY 2014-15. These rebates derive from MA pharmacy payments for all MA eligible — Families with Children, Adults without Children, and Elderly and Disabled. The increased rebate revenue results from two main factors. First, an Affordable Care Act (ACA) provision that provides rebates on pharmaceuticals purchased within managed care plans. Second, this forecast incorporated a higher baseline projection based on above-forecast actual rebates in FY 2012. Together, these increase anticipated pharmacy rebates by over $114 million in the current and next biennium.

Forecast expenditures for Families with Children decrease by $55 million in FY 2012-13 (2.6 percent) and $30 million (1.3 percent) in FY 2014-15 from EOS estimates due to two primary factors. First, the average cost of providing care is down by $44 million in FY 2012-13 and by $24 million in FY 2014-15, due to reduced fee-for-service payments, including lower inpatient hospital costs. The second relates the Supreme Court's 2012 ruling that made the ACA's requirement that states provide Medical Assistance to adults with income up to 133 percent of the federal poverty guideline optional. The end of session forecast assumed MA coverage of parents up to 133 percent FPG. Since state law does not currently provide MA coverage for MA parents with income above 100 percent FPG, their coverage was removed from projected spending, generating $35 million in reduced expenditures in FY 2014-15. These reduced expenditures are partially offset by a $27 million increase related to a one percent increase in forecasted enrollments in the program.

Spending estimates show reduced expenditures in MA Long-term Care Facilities of $17 million in FY 2012-13 (1.8 percent) and $24 million in FY 2014-15 (2.5 percent). Change in both biennia is largely driven by a downward trend in nursing facilities caseloads (2 percent annually), which accounts for reduced expenditures of $9 million in FY 2012-13 and $20 million in FY 2014-15. This forecast adjustment better aligns projections with actual nursing facility utilization in FY 2012.

Projected spending on MA long-term waivers is lower by $42 million in FY 2012-13 (1.8 percent) and $27 million in FY 2014-15 (1 percent). Reduced expenditures in both biennia relate to lower caseload and average costs in the Community Alternatives for Disabled Individuals (CADI) and Traumatic Brain Injury (TBI) waivers. These account for a change of $19 million in FY 2012-13 and $28.3 million in FY 2014-15. The forecast projects lower average costs in FY 2012-13 for the Developmentally Disabled (DD) waiver generating $10 million in reduced spending. Decreased spending in FY 2014-15 was partially offset by an increase of $12 million in the DD waiver, which is driven by higher projected caseloads.

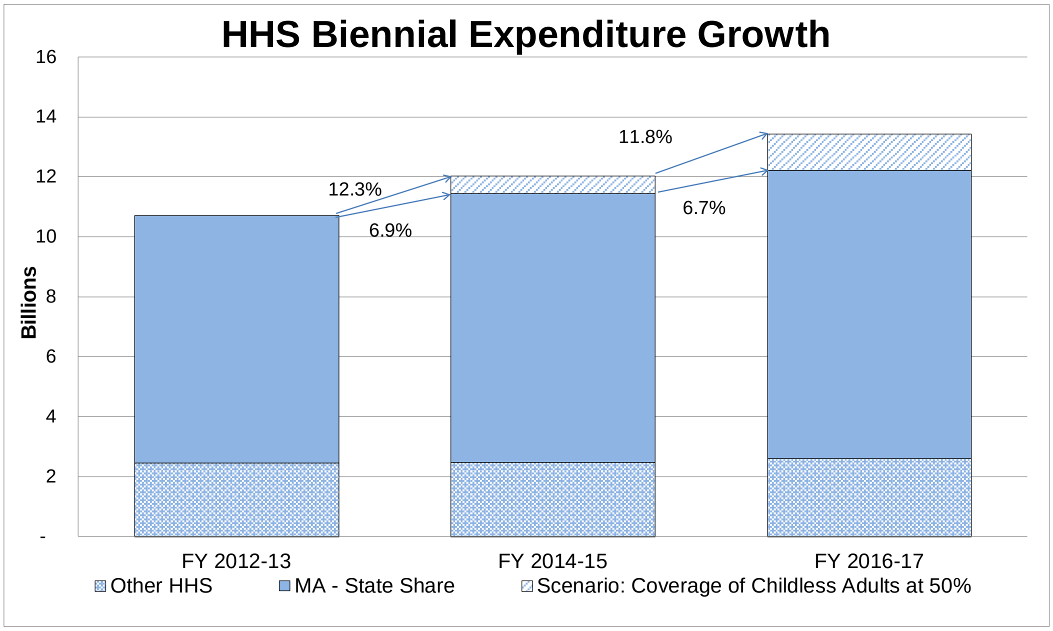
Estimated MA Elderly and Disabled Basic Care expenditures are down $53 million in FY 2012-13 (2.1 percent) and $37 million (1.2 percent) for FY 2014-15. Decreases in both biennia relate to lower caseload in the Elderly Waiver and reduced average costs for Elderly Basic Care plans. Of the FY 2012-13 change, $38 million is attributed to lower-than-expected movement of adults with disabilities into managed care from fee-for-service. This forecast adjustment reduces expenditures by $7 million in FY 2014-15. Decreased Medicare Part D Clawback payments (due to lower than expected inflation of Medicare Part D pharmacy costs) produced an additional $13 million in reduced expenditures in the FY 2014-15.

The Chemical Dependency Program (CD) is another component of health care spending although it occurs outside of MA. This forecast adjusts CD expenditures down by four percent in both the current and next biennium. This downward movement results from recognition that the fiscal benefits to the state CD program of the MA expansion for Adults without Children were greater than expected in the previous forecast.

Non-Health Care Programs
November projections show reduced expenditures in economic assistance programs of $10 million in FY 2012-13 and a slight increase of less than $1 million in FY 2014-15. The FY 2012-2013 change relates to lower-than-previously-forecasted caseload and average payment growth in Group Residential Housing (GRH). Despite these forecast reductions, caseload and average payments for GRH are projected to grow at an annual rate of 3 percent over the current and subsequent two biennia.

Health and Human Services Expenditures Grow $743 million from FY 2012-13 to FY 2014-15 and $761 million from FY 2014-15 to FY 2016-17

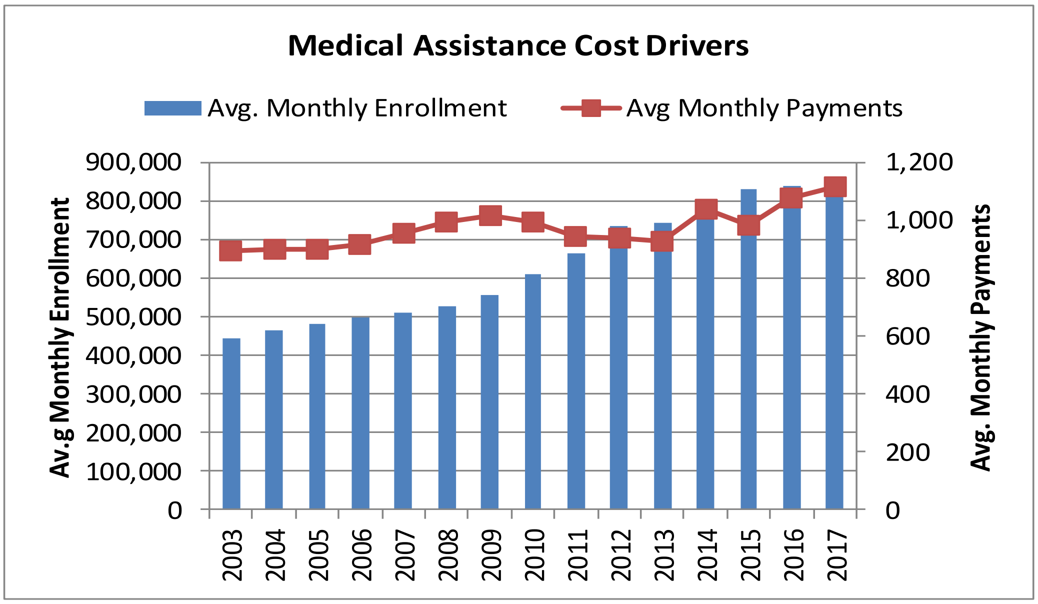
Health and human services expenditures are expected to grow $743 million (6.9 percent) from FY 2012-13 to FY 2014-15 and $761 million (6.7 percent) from FY 2014-15 to FY 2016-17.



The majority of this growth occurs in the MA program, as the state continues to see increases in MA enrollment and cost trends overall. State cost increases are somewhat moderated in the short term due to a 100 percent enhanced federal matching rate for the MA Adults Without Children population under the Affordable Care Act beginning January 1, 2014. The chart above reflects a scenario where biennial expenditure growth remained consistent at 50 percent across the biennia. Under this scenario, biennial growth is more consistent with historical projections.

In FY 2014-15, MA expenditures grow by $714 million, or 8.6 percent. The state continues to see increases in the long term care waiver program ($380 million or 16 percent) and the elderly and disabled basic program ($544 million or 22 percent), as the elderly population continues to grow and the cost of their care increases. The Families With Children program also increases by $273 million or 15 percent, 8 percent of which is due to the new federal mandate that individuals have health care coverage. These increases are somewhat offset by the decrease in the state share of costs for the Adults Without Children ($485 million), resulting from the receipt of enhanced federal match for this population under the ACA.

In FY 2016-17, these trends continue. Total MA expenditures increase by 7.2 percent or $642 million over FY 2014-15 expenditures. There are three major drivers of this increase. They include a $362 million or 13 percent increase in the Long Term Care Waiver program, as this population continues to grow and continues to need increasingly expensive services. Expenditures in the elderly and disabled basic program also increase by $144 million or 5 percent, primarily because the cost of care is increasing. In addition, the Families with Children program sees a $398 million increase (19 percent), primarily as a result of the federal individual mandate being fully annualized within the biennium. These cost increases are offset by a decrease in the Adults Without Children program, since the costs of the program are 100 percent federally funded for the majority of the FY 2016-17 biennium.



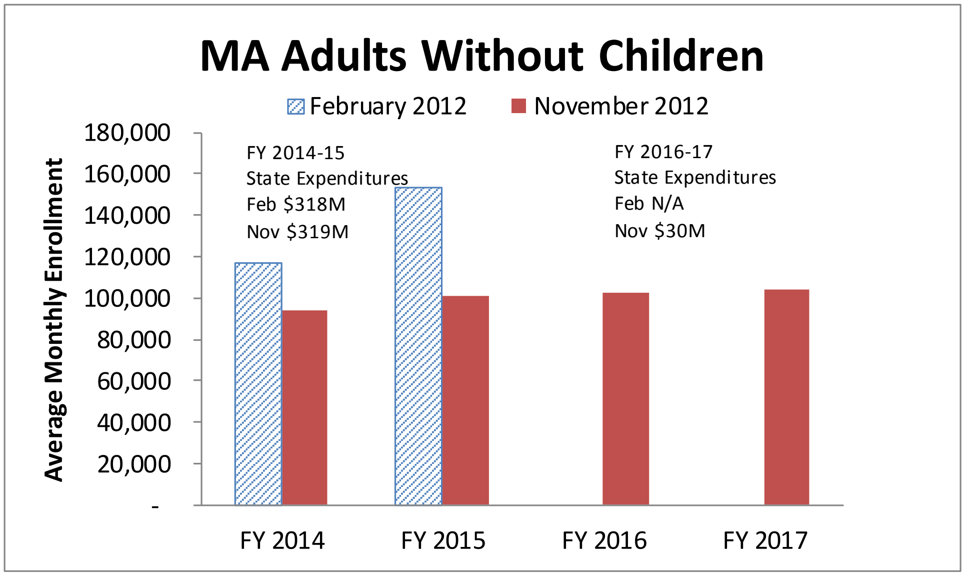
SPECIAL ANALYSIS: Forecast Impacts from the Affordable Care Act and the Supreme Court Ruling of June 2012

State economic forecasts have included certain assumptions about the implementation of the federal Affordable Care Act since its passage in April 2010. Those assumptions have been made to the extent state law or federal guidance was available, or to the extent reasonable assumptions could be made about how public health care markets would react given new eligibility parameters and incentives.

The primacy of the new federal law became somewhat more difficult to interpret when the Supreme Court of the United States ruled on its constitutionality in the National Federation of Independent Business ET AL. v. Sebelius, Secretary of Health and Human Services ET AL in June 2012. The Supreme Court made it clear that the federal government may not compel states to expand their Medicaid programs to the benchmark in the federal law, 133 percent of the federal poverty guideline (FPG). Prior to the Supreme Court decision, the forecast had assumed that Adults on MA would receive insurance coverage up to 133 percent of FPG in conformity with the federal standard beginning January 1, 2014, though state law provides coverage only to 75 percent of FPG for Adults Without Children and to 100 percent of FPG for Caretakers. Federal guidance is still developing as to how it will provide federal matching dollars under circumstances where the state and federal law do not conform, creating risk to the forecasted MA expenditures looking beyond 2014. Because the Supreme Court decision made it less clear that states would be mandated to expand coverage to 133 percent, this forecast reflects enrollment commensurate with current state law on eligibility. The effects of the enrollment change, as well as a summary of other significant impacts included in the general fund forecast as a result of the Affordable Care Act are summarized here.

MA Expansion for Adults without Children is Reduced from 133 to 75 percent of FPG Starting January 1, 2014

While enrollment for Adults Without Children substantially decreases in Medical Assistance, state expenditures on this group are virtually unchanged due to the assumption that the federal government will provide 100 percent of the funding for the expansion population from January 2014 through 2016. Adults Without Children with incomes from 75 to 133 percent of FPG are eligible for the MinnesotaCare program under current state law. For this reason, the forecast change removing this group from the MA forecast results in an increase in state expenditures in the MinnesotaCare forecast, affecting the Health Care Access Fund.



In FY 2016-17 Adults Without Children with incomes up to 75 percent of FPG will be eligible for MA coverage at a state cost of $30 million. The cost reflects reductions in the federal share from 100 percent through 2016 down to 95 percent in 2017 as specified in the Affordable Care Act. Federal matching is set to decline further to 94 percent in 2018, 93 percent in 2019, and 90 percent in 2020 and for subsequent years.

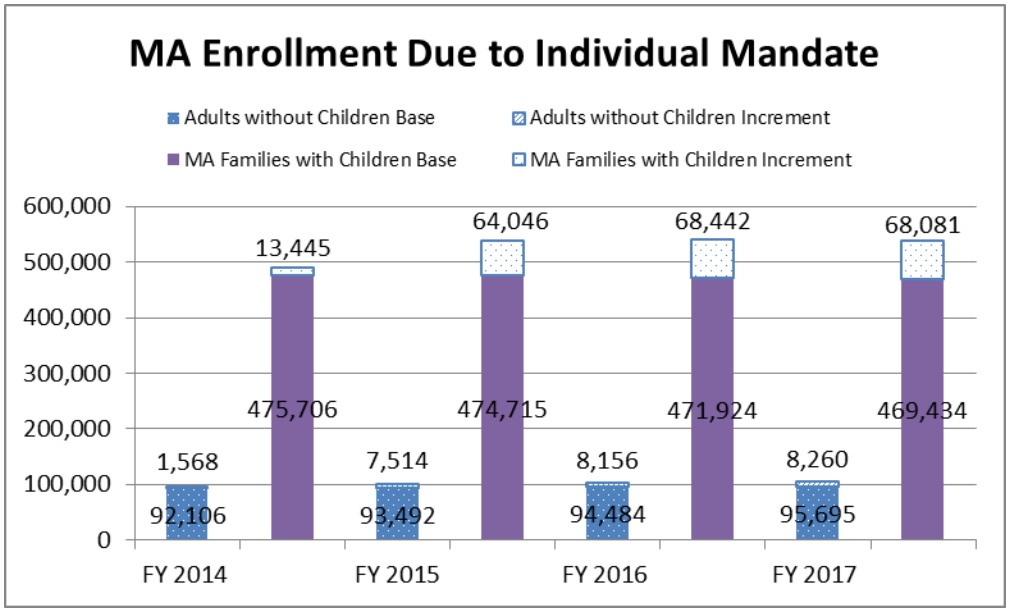
MA Expansion for Caretakers to 133 of FPG Starting January 1, 2014 is Eliminated

Commensurate with the Adults Without Children eligibility group, this forecast reduces enrollment for Caretakers to align with current state law. A previous assumption from February 2011 that MA would be expanded for Caretakers between 100 percent and 133 percent of FPG is reversed in this forecast, due to the Supreme Court ruling. The forecast now reflects MA enrollment for this group at the current state eligibility level of 100 percent of FPG. Average monthly enrollment was reduced approximately 3,700 in FY 2014 and 13,300 in FY 2015, a biennial savings to the general fund of $34.9 million as a result of this change.

Individual Mandate Impacts Continues to be Reflected in MA Enrollment

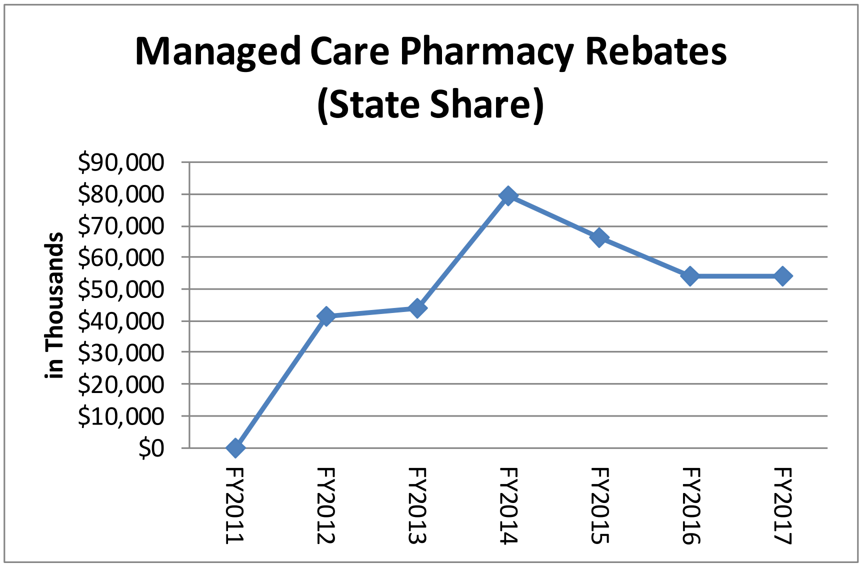
Some forecast impacts of the Affordable Care Act are not due to the Supreme Court ruling, but rather have been incorporated over time since the passage of the federal law. Beginning January 1, 2014, the federal Affordable Care Act requires that U.S. citizens and legal residents have qualifying health coverage. Those without coverage pay a tax penalty depending upon household income. Increased enrollment in Medical Assistance programs is included in the forecast to account for those individuals who previously would have qualified for Medical Assistance under state law, but were not enrolled. The forecast reflects total increased enrollment over the baseline for Families with Children and Adults Without Children of 2.6 percent in FY 2014, 11.2 percent in FY 2015, 11.9

percent in FY 2016, and 11.9 percent in FY 2017 for the individual mandate. Enrollment increases for this reason have been included in the forecast since February 2011.



Receipts Collected from Pharmacy Rebates Continue to Grow in Near Term

In addition to enrollment effects, new revenue sources have also become significant to the forecast as a result of the federal law. Beginning in November 2011, additional pharmacy rebate collections on manufacturers, authorized under the Affordable Care Act, were recognized in the forecast for individuals enrolled with Medicaid managed care organizations. These are in addition to pharmacy rebates for individuals enrolled in fee-for-service payment plans, historically recognized in the forecast. All pharmacy rebates reduce MA expenditures in the forecast. Rebate collections are expected to decrease and ultimately level off after 2014 because there will be no state share of rebates resulting from 100 percent federal expenditures for Adults Without Children.



Forecast Uncertainty Remains as Federal Guidance Post-Supreme Court Decision is Released

While the Affordable Care Act was largely upheld by the Supreme Court, federal guidance on implementation of the entirety of the law, especially as it relates to Medical Assistance eligibility and federal matching funds, is still forthcoming. Forecast risk is more significant than in the past due to uncertainty about how the Centers for Medicare and Medicaid Services (CMS) will interpret the Supreme Court ruling, especially as it relates to federal matching funds. Subsequent to the ruling, CMS has indicated that they may choose not to provide a 100 percent federal share on the MA Adults Without Children group (the expansion population), unless states enact a full expansion to the eligibility level of 133 percent of FPG. Minnesota expanded eligibility to this population early, up to 75 percent of FPG in March 2011, through Governor Dayton’s executive order 11-01 and state law enacted in the 2010 Legislative Session (Laws 2010, First Special Session, chapter 1, article 16, sections 5 to 7 and 20). This forecast assumes $1.784 billion in FY 2014-15 and $2.449 billion in FY 2016-17 in federal matching dollars to fund coverage of the expansion population, all of which may be at risk depending upon how CMS chooses to interpret the Supreme Court decision and upon what eligibility standards the state legislature chooses to implement.

Affordable Care Act Impacts Excluded from the Forecast

There are a number of requirements and state options in the Affordable Care Act that will affect state expenditures in the Medical Assistance program, though these are not included in this forecast. Such requirements include changes to eligibility as well as enrollment processes that will have a fiscal impact. In general, the expenditure forecast does not assume the effects of federal changes until the state has acted to conform state law to federal law. Federal conformity changes are expected to be included as part of the budget process.

Property Tax Aids and Credits

Property Tax Aids and Credits are paid to local governments, including cities, counties, towns, public schools, and special taxing districts. These aids and credits help offset costs of service delivery, defray costs of state mandates, and reduce local property taxes by substituting state funds for revenues that would otherwise need to be raised locally. Direct payments to individuals, like property tax refunds for homeowners and renters, are also included in this category because they reduce property tax burdens.

Aids and Credits is Down $20 Million in FY 2012-13 and $42 Million in FY 2014-15

In the current biennium tax aids and credit spending is now expected to be $2.81 billion, a decrease of $19.9 million (0.7 percent) from end of session estimates. The net decrease can primarily be attributed to lower than expected spending on homeowner property tax refunds, down $28.7 million (4.4 percent). Additionally, spending on targeted property tax refunds is $10.3 million (65.3 percent) lower than anticipated due to significantly lower program participation than previously forecasted. Partially offsetting the overall spending reduction is higher than expected spending in the renter property tax refund program (up $8.2 million, 2.2 percent). Tax refund interest spending is also up ($12.1 million, 43.7 percent) due to amended corporate tax returns that generate refund interest.

FY 2014-15 total tax aids and credits spending is forecast to be $2.73 billion, $42.2 million (1.5 percent) lower than previous estimates. Driving this change is a decrease of $38.5 million (5.2 percent) in the homeowner property tax refund program which is partially offset by growth of $8.0 million (2.1 percent) in the renter property tax refund program. These changes, in both the current biennium and FY 2014 – 15, are due to a continued overall tax value shift away from homesteads to other properties and movement away from homeownership to renting. For the homeowner property tax refund program, both program participation and average refunds are lower than previously forecasted resulting from a smaller homestead population and lower qualifying property tax amounts due to the tax shift away from homestead properties. For the renter property tax refund program the shift from owning to renting has increased program participation and average refunds are higher than anticipated due to a tight rental market. Also contributing to the overall tax aid and credit forecast reduction in FY 2014 – 15 is a $9.7 million (5.5%) decrease in aid to police and fire due to lower than projected insurance premium tax receipts, upon which aid amounts are set.

Tax Aids and Credits Expected to be $78 Million Lower in FY 2014-15 Compared to FY 12-13

Expenditures for tax aids and credits are expected to be $2.73 billion in FY 2014-15, a decrease of $77.6 million (2.74 percent) compared to spending in the current biennium. The decrease is primarily the result of the full phase out of the market value homestead credit program, which accounted for $175.9 million in spending in the current biennium. Partially offsetting this biennial decrease is growth in the homeowner property tax refund program of $74.3 million (11.9 percent). This growth is driven by legislative formula changes that increased the average refund amount by 10 percent along with assumed program participation growth and inflation indexing of refund tables. Reinstatement of the political contribution refund program, representing $12 million in spending, in FY 2014-15 also offsets a portion of the overall biennial decrease in tax aids and credits.

Tax Aids and Credits Expenditures Expected to Grow $73 Million in FY 2016-17

Tax aids and credit spending is expected to reach $2.80 billion in the FY 2016-17, an increase of $73 million (2.7 percent) over forecasted expenditures for FY 2014-15. This increase is due primarily to continued growth in the property tax refund programs which, in total, are expected to reach $1.17 billion in the planning years, an increase of $58.2 million (5.3 percent) over FY 2014-15. Additionally, aid to police and fire spending is expected to grow in FY 2016-17 with an increase of $9.7 million (5.8 percent) over the previous biennium due to forecasted growth in insurance premium tax receipts. Payment in Lieu of Taxes (PILT) (up $2.8 million, 5.5 percent), tax refund interest (up $1.2 million, 4.0 percent) and senior deferral reimbursement (up $2.8 million, 71.8 percent) are also expected to see program growth in the FY 2016-17 relative to FY 2014-15.

Debt Service Forecast down $39 Million in FY 2012-13, and $5 Million in FY 2014-15

Debt service costs for FY 2012-13 are now projected to be $415 million, down $39 million from the August 2012 end-of-session estimates. FY2014-15 costs are projected to be $1.355 billion, down only $5 million for the end of session estimate.

Minnesota Management and Budget (MMB) determines the size of each bond sale based on agency cash flow estimates for their projects. Revised cash flow estimates reduced the size of the August 2012 bond sale. A smaller bond sale lowered debt service by $13 million in FY 2012-13, and increased it by $1 million in FY 2014-15. Short-term investment earnings on bond proceeds are projected to be $10 million higher than previous estimates in FY 2012-13, and by $3 million in FY 2014-15. User-financing receipts received from various programs, including the Rural Finance Authority programs were approximately $10 million more than previous estimates in FY 2012-13 and were up by $3 million in the FY 2014-15. Finally, lower interest rates resulted in $7 million of additional premium payments received.

Debt Service Payments Grow $941 Million from FY 2012-13 to FY 2014-15, and an additional $148 Million in FY 2016-17

Forecasted debt service costs for FY 2014-15 is $1.355 billion, $941 million more than FY 2012-13 estimates. The projected increase is primarily due to the use of tobacco bond proceeds as part of the FY 2012-13 budget solution. $643 million in tobacco bond proceeds were used in FY 2012-13 to reduce general obligation and other debt payments. In FY 2014-15, general obligation debt service will again be paid from the general fund.

The forecast continues to assume future capital budgets of $775 million in each even-numbered legislative session and $225 million in each odd-numbered session.

The forecast debt service costs for FY 2016-17 is $1.504 billion, $148 million more than FY 2014-15 estimates. The estimates reflect slightly higher interest rate assumptions, a decrease of user financing receipts as well as increases in the size of projected bond sales, reflecting the continued growth of long-term financing costs based on projected legislative actions on capital budgets.

FORECAST FUNDAMENTALS:

ABOUT THE REVENUE AND EXPENDITURE FORECAST

The November forecast establishes the starting point for FY 2014-15 budget decisions. It contains revised revenue and expenditure estimates for the current biennium based on the most recent information about the national and state economic outlook, caseloads, enrollments, and cost projections. Additionally this forecast provides closing data for FY 2012 revenues and expenditures, year-to date revenue collections for FY 2013, and updated revenue and expenditure forecast for the remaining eight months of the biennium.

The revised forecast for FY 2012-13 is followed by the first complete forecast for the next budget period, FY 2014-15, and by revenue and expenditure planning estimates for FY 2016-17. The planning estimates should not be interpreted as explicit forecasts, but rather as a guide to indicate whether proposed budgetary actions are sustainable in future years.

Revenue estimates for the current year and the next biennium are based on econometric models that forecast the Minnesota economy. Those models are driven by a national economic forecast prepared by Global Insight Incorporated (GII).

The GII baseline forecast is then reviewed by Minnesota's Council of Economic Advisors. Their comments are found in the "Economic Summary." The "Economic Outlook" which follows provides a more comprehensive overview of the current outlook for the U.S. and Minnesota economies. Revenue planning estimates for FY 2016-17 are driven entirely by the longer-term national economic forecast provided by GII, no Minnesota specific forecast is used.

Expenditure estimates in most areas are shown at the level of FY 2013 appropriations plus any authorized future spending increases. Entitlement programs—such as K-12 education, property tax aids, health care, and family support are forecast based on expected changes in eligibility, enrollment, and average cost. No general adjustments for inflation were made in future spending.

The difference between the forecast and the budget process is often confused. The forecast does not reflect the Governor's budget recommendations or potential legislative action, only current law. Presentation of the current law forecast will likely be accompanied by a discussion of possible future legislative changes. The forecast presents only a current law framework for those discussions. A forecast increase in spending for any area in the current biennium or the next does not preclude the Governor or the Legislature from proposing budget changes that would lead to significantly different spending levels than are shown in this forecast.

APPENDIX TABLES

ALTERNATIVE FORECAST COMPARISON
Real GDP (Annual Rates)

	12III	12IV	13I	13II	13III	13IV	12A	13A	14A
GII Baseline (11-12)	2.0	1.0	2.5	1.9	2.1	2.6	2.1	1.9	2.8
Blue Chip (11-12)	2.0	1.7	1.6	2.2	2.6	2.9	2.2	2.0	2.8
Moody's Economy.Com (11-12)	2.0	1.8	1.2	2.5	3.4	3.6	2.2	2.1	
UBS (11-12)	2.0	1.6	2.1	2.8	3.0	3.5	2.1	2.3	3.0
Standard & Poors (11-12)	2.0	1.8	N/A	N/A	N/A	N/A	2.3	2.3	2.7
Wells Fargo (11-12)	2.0	1.4	1.0	2.1	2.2	2.2	2.1	1.6	2.2

CONSUMER PRICE INDEX (ANNUAL RATES)

	12III	12IV	13I	13II	13III	13IV	12A	13A	14A
GII Baseline (02-12)	2.3	1.8	1.1	1.2	2.1	1.7	2.1	1.3	1.8
Blue Chip (02-12)	2.3	2.5	1.8	2.0	2.3	2.2	2.1	2.2	2.3
Moody's Economy.Com (02-12)	2.2	2.4	2.0	2.4	2.5	2.4	2.1	2.2	N/A
UBS (02-12)	2.3	2.4	0.6	1.4	3.8	1.9	2.1	1.8	2.5
Standard & Poors (02-12)	2.3	1.8	N/A	N/A	N/A	N/A	2.1	1.3	1.9
Wells Fargo (11-12)	1.7	2.3	2.2	2.7	2.7	2.3	2.2	2.5	2.2

FORECAST COMPARISONS

Real Economic Growth

(Annual Percent Change in Real GDP)

	2012	2013	2014	2015	2016	2017
Nov 08 GII Baseline	3.5	3.1				
Feb 09 GII Baseline	3.3	2.9				
Nov 09 GII Baseline	3.7	2.9				
Feb 10 GII Baseline	3.7	2.9				
Nov 10 GII Baseline	2.9	2.7	3.1	3.1		
Feb 11 GII Baseline	2.9	3.1	3.3	2.9		
Nov 11 GII Baseline	1.6	2.5	3.5	3.3		
Feb 12 GII Baseline	2.1	2.3	3.3	3.2		
Nov 12 GII Baseline	2.1	1.9	2.8	3.3	2.9	2.1

Inflation

(Annual Percent Change in CPI-U)

Nov 08 GII Baseline	2.4	2.4				
Feb 09 GII Baseline	2.3	2.6				
Nov 09 GII Baseline	2.0	1.8				
Feb 10 GII Baseline	2.0	1.9				
Nov 10 GII Baseline	1.9	2.0	2.2	2.2		
Feb 11 GII Baseline	1.7	1.9	2.2	2.2		
Nov 11 GII Baseline	1.5	1.7	2.0	2.1		
Feb 12 GII Baseline	2.0	1.8	1.9	1.9		
Nov 12 GII Baseline	2.1	1.3	1.8	1.7	1.9	1.9

MINNESOTA - U.S. COMPARISON REPORT

November 2012 Baseline

(Annual Percent Changes)

	2009	2010	2011	2012	2013	2014	2015
Wage and Salary Income							
United States	-4.3	2.1	4.6	3.6	3.9	4.5	4.8
Minnesota	-4.7	2.7	3.9	4.6	3.3	4.6	4.9
Implied Annual Wage							
United States	0.1	2.9	2.8	2.1	2.3	2.7	2.8
Minnesota	-0.9	3.3	2.1	2.8	1.6	2.7	2.8
Non-Farm Employment							
United States	-4.4	-0.7	1.2	1.4	1.5	1.7	2.0
Minnesota	-3.9	-0.5	1.7	1.7	1.7	1.9	2.1
Personal Income							
United States	-4.8	3.8	5.0	3.5	3.9	4.9	4.9
Minnesota	-5.2	4.4	5.5	4.3	3.3	4.5	5.0

COMPARISON OF ACTUAL AND ESTIMATED
NON-RESTRICTED REVENUES
($ IN THOUSANDS)

	October YTD, 2012 - FY2013			October Monthly - FY 2013		
	FORECAST REVENUES	ACTUAL REVENUES	VARIANCE ACT-FCST	FORECAST REVENUES	ACTUAL REVENUES	VARIANCE ACT-FCST
Individual Income Tax						
Withholding	2,209,400	2,192,898	(16,502)	570,700	563,917	(6,783)
Declarations	291,512	320,931	29,419	15,124	22,605	7,481
Miscellaneous	125,772	148,988	23,215	56,524	65,680	9,156
Gross	2,626,685	2,662,817	36,132	642,348	652,202	9,854
Refund	79,403	65,664	(13,738)	46,968	49,150	2,182
Net	2,547,282	2,597,153	49,870	595,380	603,052	7,672
Corporate & Bank Excise						
Declarations	252,613	299,027	46,414	31,900	41,676	9,777
Miscellaneous	88,830	101,835	13,005	26,706	35,249	8,544
Gross	341,443	400,862	59,419	58,605	76,926	18,320
Refund	33,970	25,966	(8,004)	18,690	10,690	(8,000)
Net	307,473	374,896	67,423	39,915	66,235	26,320
Sales Tax						
Gross	1,500,072	1,518,180	18,107	450,862	451,378	517
Refunds	57,924	57,890	(34)	19,138	18,031	(1,107)
Net	1,442,148	1,460,289	18,141	431,723	433,347	1,624
Other Revenues:						
Estate	48,667	43,574	(5,092)	12,167	12,124	(43)
Liquor/Wine/Beer	21,985	23,510	1,525	6,517	6,822	305
Cigarette/Tobacco/Cont Sub	67,254	65,705	(1,549)	23,031	18,110	(4,922)
Deed and Mortgage	36,967	58,419	21,453	15,014	15,862	848
Insurance Gross Earnings	71,809	72,503	695	1,651	(71)	(1,722)
Lawful Gambling	9,200	9,900	700	2,228	2,012	(217)
Health Care Surcharge	77,991	65,679	(12,311)	19,483	20,684	1,200
Other Taxes	238	211	(27)	57	55	(2)
Statewide Property Tax	166,289	186,047	19,758	158,370	171,657	13,287
DHS SOS Collections	16,667	17,431	765	4,167	4,210	44
Income Tax Reciprocity	0	0	0	0	0	0
Investment Income	710	1,931	1,221	237	38	(198)
Tobacco Settlement	0	100	100		0	0
Departmental Earnings	77,445	84,505	7,059	36,023	40,992	4,969
Fines and Surcharges	22,246	17,752	(4,494)	7,716	5,640	(2,077)
Lottery Revenues	13,055	15,188	2,134	4,352	4,045	(307)
Revenues yet to be allocated	0	1,130	1,130		680	680
Residual Revenues	43,935	82,402	38,467	4,682	12,884	8,202
County Nursing Home, Pub Hosp	2,931	1,698	(1,233)	733	566	(167)
Other Subtotal	677,388	747,688	70,299	296,428	316,311	19,883
Other Refunds	10,482	16,811	6,329	4,301	5,066	765
Other Net	666,906	730,876	63,971	292,126	311,244	19,118
Total Gross	**5,145,588**	**5,329,546**	**183,958**	**1,448,242**	**1,496,816**	**48,574**
Total Refunds	**181,779**	**166,331**	**(15,447)**	**89,098**	**82,938**	**(6,160)**
Total Net	**4,963,809**	**5,163,214**	**199,405**	**1,359,144**	**1,413,878**	**54,734**

FACTORS AFFECTING THE INDIVIDUAL INCOME TAX
($ in billions)

	Calendar Year					
	2010	2011	2012	2013	2014	2015
Minnesota Non-Farm Tax Base						
November 2008 Baseline	180.893	189.211				
February 2009 Baseline	175.674	183.239				
November 2009 Baseline	171.395	178.688				
February 2010 Baseline	172.985	180.445				
November 2010 Baseline [(1)]	179.524	185.413	193.358	203.033		
February 2011 Baseline	180.193	187.398	196.463	206.145		
November 2011 Baseline	178.433	187.762	194.610	202.278		
February 2012 Baseline	178.435	187.074	194.943	203.230		
November 2012 Baseline	176.360	184.406	192.573	199.658	209.583	220.465
Minnesota Wage and Salary Income						
November 2008 Baseline	126.854	132.244				
February 2009 Baseline	123.518	128.709				
November 2009 Baseline	118.220	123.020				
February 2010 Baseline	117.355	122.365				
November 2010 Baseline [(1)]	125.707	130.640	136.453	142.848		
February 2011 Baseline	126.202	131.010	137.183	143.608		
November 2011 Baseline	125.211	131.254	136.156	141.758		
February 2012 Baseline	125.214	130.664	136.133	141.810		
November 2012 Baseline	124.789	129.676	135.623	140.065	146.545	153.708
Minnesota Property Income						
November 2008 Baseline	39.271	41.252				
February 2009 Baseline	37.993	39.363				
November 2009 Baseline	38.192	39.805				
February 2010 Baseline	40.310	41.843				
November 2010 Baseline	40.103	40.313	41.614	44.257		
February 2011 Baseline	40.312	41.875	43.817	46.363		
November 2011 Baseline	38.386	40.661	41.734	42.887		
February 2012 Baseline	38.386	40.647	42.292	43.922		
November 2012 Baseline	36.271	38.934	40.582	42.526	44.862	47.427
Minnesota Proprietors' Income						
November 2008 Baseline	14.768	15.447				
February 2009 Baseline	14.164	15.167				
November 2009 Baseline	14.983	15.862				
February 2010 Baseline	15.321	16.237				
November 2010 Baseline	13.714	14.456	15.293	15.927		
February 2011 Baseline	13.679	14.559	15.463	16.172		
November 2011 Baseline	14.835	15.846	16.723	17.635		
February 2012 Baseline	14.835	15.765	16.518	17.496		
November 2012 Baseline	15.301	15.796	16.367	17.064	18.176	19.337

[(1)] Began using Bureau of Economic Analysis Concept

FACTORS AFFECTING SALES AND CORPORATE INCOME TAX

($ in billions)

	Fiscal Year					
	2010	2011	2012	2013	2014	2015
SALES TAX						
Minnesota Synthetic Sales Tax Base						
February 2010 Baseline	69.222	71.789				
Pct.	-1.5%	3.7%				
November 2010 Baseline	66.738	70.720	73.053	75.597		
Pct.	-2.2%	6.0%	3.3%	3.5%		
February 2011 Baseline	66.659	70.862	74.606	77.027		
Pct.	-2.3%	6.3%	5.3%	3.2%		
November 2011 Baseline	66.277	70.523	74.604	76.674		
Pct.	-2.7%	6.4%	5.8%	2.8%		
February 2012 Baseline	66.213	70.456	74.383	77.000		
Pct.	-2.7%	6.4%	5.5%	3.4%		
November 2012 Baseline	66.161	69.056	72.768	75.755	78.287	81.516
Pct.	-3.2%	4.4%	5.4%	4.1%	3.3%	4.1%
Minnesota's Proxy Share of U.S. Consumer Durable Spending (Excluding Autos)						
November 2009 Baseline	12.756	12.720				
February 2010 Baseline	13.123	13.276				
November 2010 Baseline	12.818	13.468	13.829	14.118		
February 2011 Baseline	12.812	13.657	14.363	14.732		
November 2011 Baseline	12.838	13.523	14.165	14.636		
February 2012 Baseline	12.838	13.527	14.083	14.571		
November 2012 Baseline	12.771	13.313	14.011	14.756	15.215	15.636
Minnesota's Proxy Share of U.S. Capital Equipment Spending						
November 2009 Baseline	10.972	12.084				
February 2010 Baseline	11.244	12.292				
November 2010 Baseline	11.189	12.849	13.901	14.822		
February 2011 Baseline	11.179	12.833	14.372	14.936		
November 2011 Baseline	11.147	12.600	13.769	14.415		
February 2012 Baseline	11.147	12.543	13.626	14.602		
November 2012 Baseline	10.523	11.263	12.283	12.896	13.805	15.122
Minnesota's Proxy Share of U.S. Construction Spending						
November 2009 Baseline	5.292	5.364				
February 2010 Baseline	5.207	5.403				
November 2010 Baseline	4.757	4.524	4.273	5.391		
February 2011 Baseline	4.808	4.632	4.848	5.507		
November 2011 Baseline	4.734	4.705	5.148	5.414		
February 2012 Baseline	4.738	4.745	5.184	5.539		
November 2012 Baseline	4.771	4.739	5.327	5.815	6.372	7.021

FACTORS AFFECTING SALES AND CORPORATE INCOME TAX

($ in billions)

	Fiscal Year					
	2010	2011	2012	2013	2014	2015
SALES TAX (Cont.)						
Minnesota's Personal Income Excluding Farm Proprietors Income						
November 2008 Baseline	219.52	227.48				
February 2009 Baseline	215.33	223.33				
November 2009 Baseline	212.56	219.22				
February 2010 Baseline	214.25	219.93				
November 2010 Baseline (1)	221.11	229.65	237.52	247.61		
February 2011 Baseline	220.74	231.94	240.66	250.36		
November 2011 Baseline	217.97	231.18	240.10	248.62		
February 2012 Baseline	217.97	231.23	239.15	249.31		
November 2012 Baseline	216.203	229.088	237.813	246.393	257.009	269.940

	Calendar Year					
	2010	2011	2012	2013	2014	2015
CORPORATE FRANCHISE TAX						
U.S. Corporate Profits						
November 2008 Baseline	1,446.5	1,493.8				
February 2009 Baseline	1,286.7	1,480.7				
November 2009 Baseline	1,291.5	1,480.7				
February 2010 Baseline	1,273.0	1,466.8				
November 2010 Baseline	1,369.3	1,365.1	1,427.0	1,486.0		
February 2011 Baseline	1,386.5	1,401.1	1,349.3	1,426.8		
November 2011 Baseline (2)	1,385.7	1,518.5	1,492.7	1,571.1		
February 2012 Baseline	1,385.7	1,499.4	1,418.7	1,406.6		
November 2012 Baseline	1,268.0	1,374.7	1,445.1	1,373.8	1,390.2	1,405.9

(1) Began using Bureau of Economic Analysis Concept

(2) Began using Before Tax Domestic Corporate Profits with capital consumption adjustment, less profits of the Federal Reserve System.

Current Biennium Forecast Comparison
November 2012 General Fund Forecast - Before Statutory Allocations
2012-13 Biennium
($ in thousands)

	8-12 Enacted FY 2012-13	11-12 Fcst FY 2012-13	$ Difference
Actual & Estimated Resources			
Balance Forward From Prior Year	1,288,673	1,288,673	0
Current Resources:			
Tax Revenues	31,296,703	32,106,987	810,284
Non-Tax Revenues	1,499,516	1,557,881	58,365
Subtotal - Non-Dedicated Revenue	32,796,219	33,664,868	868,649
Dedicated Revenue	1,200	476	(724)
Transfers In	1,023,455	1,079,660	56,205
Prior Year Adjustments	47,031	199,254	152,223
Subtotal - Other Revenue	1,071,686	1,279,390	207,704
Subtotal-Current Resources	33,867,905	34,944,259	1,076,354
Total Resources Available	**35,156,578**	**36,232,932**	**1,076,354**
Actual & Estimated Spending			
K-12 Education	14,486,075	14,446,346	(39,729)
K-12 Ptx Rec Shift/Aid Payment Shift	(551,904)	(539,990)	11,914
Subtotal K-12 Education	13,934,171	13,906,356	(27,815)
Higher Education	2,565,974	2,568,830	2,856
Property Tax Aids & Credits	2,836,440	2,803,598	(32,842)
Health & Human Services	10,895,655	10,699,989	(195,666)
Public Safety	1,844,259	1,855,421	11,162
Transportation	126,130	126,125	(5)
Environment, Energy & Natural Resources	272,893	283,798	10,905
Agriculture	80,191	77,585	(2,606)
Economic Development	202,994	203,554	560
State Government	920,611	918,162	(2,449)
Debt Service	453,978	414,640	(39,338)
Capital Projects & Grants	45,219	45,162	(57)
Other	0	9,729	9,729
Estimated Cancellations	(20,000)	(15,000)	5,000
Subtotal Expenditures & Transfers	**34,158,515**	**33,897,949**	**(260,566)**
Dedicated Expenditures	1,527	476	(1,051)
Total Expenditures & Transfers	**34,160,042**	**33,898,425**	**(261,617)**
Balance Before Reserves	**996,536**	**2,334,507**	**1,337,971**
Cash Flow Account	350,000	350,000	0
Budget Reserve	612,236	637,954	25,718
Stadium Reserve	34,300	16,454	(17,846)
Budgetary Balance	**0**	**1,330,099**	**1,330,099**

Current Biennium Forecast Comparison
November 2012 General Fund Forecast - After Statutory Allocations
2012-13 Biennium
($ in thousands)

	8-12 Enacted FY 2012-13	11-12 Fcst FY 2012-13	$ Difference
Actual & Estimated Resources			
Balance Forward From Prior Year	1,288,673	1,288,673	0
Current Resources:			
Tax Revenues	31,296,703	32,106,987	810,284
Non-Tax Revenues	1,499,516	1,557,881	58,365
Subtotal - Non-Dedicated Revenue	32,796,219	33,664,868	868,649
Dedicated Revenue	1,200	476	(724)
Transfers In	1,023,455	1,079,660	56,205
Prior Year Adjustments	47,031	199,254	152,223
Subtotal - Other Revenue	1,071,686	1,279,390	207,704
Subtotal-Current Resources	33,867,905	34,944,259	1,076,354
Total Resources Available	**35,156,578**	**36,232,932**	**1,076,354**
Actual & Estimated Spending			
K-12 Education	14,486,075	14,446,346	(39,729)
K-12 Ptx Rec Shift/Aid Payment Shift	(551,904)	781,009	1,332,913
Subtotal K-12 Education	13,934,171	15,227,355	1,293,184
Higher Education	2,565,974	2,568,830	2,856
Property Tax Aids & Credits	2,836,440	2,806,390	(30,050)
Health & Human Services	10,895,655	10,699,989	(195,666)
Public Safety	1,844,259	1,855,421	11,162
Transportation	126,130	126,125	(5)
Environment, Energy & Natural Resources	272,893	283,798	10,905
Agriculture	80,191	77,585	(2,606)
Economic Development	202,994	203,554	560
State Government	920,611	918,162	(2,449)
Debt Service	453,978	414,640	(39,338)
Capital Projects & Grants	45,219	45,162	(57)
Other	0	9,729	9,729
Estimated Cancellations	(20,000)	(15,000)	5,000
Subtotal Expenditures & Transfers	**34,158,515**	**35,221,740**	**1,063,225**
Dedicated Expenditures	1,527	476	(1,051)
Total Expenditures & Transfers	**34,160,042**	**35,222,216**	**1,062,174**
Balance Before Reserves	**996,536**	**1,010,716**	**14,180**
Cash Flow Account	350,000	350,000	0
Budget Reserve	612,236	644,262	32,026
Stadium Reserve	34,300	16,454	(17,846)
Budgetary Balance	**0**	**0**	**0**

* $1.330 billion forecast balance for FY 2012-13 is allocated by statute: $1.324 billion to K-12 education shift buyback and $6 million to budget reserve

FY 2012-13 Current Biennium By Year

November 2012 General Fund Forecast - After Statutory Allocations

2012-13 Biennium

($ in thousands)

	Closing FY 2012	11-12 Fcst FY 2013	Biennial Total FY 2012-13
Actual & Estimated Resources			
Balance Forward From Prior Year	1,288,673	1,794,929	1,288,673
Current Resources:			
Tax Revenues	15,651,423	16,455,564	32,106,987
Non-Tax Revenues	774,392	783,489	1,557,881
Subtotal - Non-Dedicated Revenue	16,425,815	17,239,053	33,664,868
Dedicated Revenue	321	155	476
Transfers In	485,720	593,940	1,079,660
Prior Year Adjustments	174,254	25,000	199,254
Subtotal - Other Revenue	660,295	619,095	1,279,390
Subtotal-Current Resources	17,086,111	17,858,148	34,944,259
Total Resources Available	**18,374,784**	**19,653,077**	**36,232,932**
Actual & Estimated Spending			
K-12 Education	7,078,192	7,368,154	14,446,346
K-12 Ptx Rec Shift/Aid Payment Shift	(448,032)	1,229,041	781,009
Subtotal K-12 Education	6,630,160	8,597,195	15,227,355
Higher Education	1,275,446	1,293,384	2,568,830
Property Tax Aids & Credits	1,456,665	1,349,725	2,806,390
Health & Human Services	5,385,094	5,314,895	10,699,989
Public Safety	882,601	972,820	1,855,421
Transportation	62,197	63,928	126,125
Environment, Energy & Natural Resources	128,751	155,047	283,798
Agriculture	42,973	34,612	77,585
Economic Development	91,531	112,023	203,554
State Government	411,646	506,516	918,162
Debt Service	192,056	222,584	414,640
Capital Projects & Grants	20,414	24,748	45,162
Other	0	9,729	9,729
Estimated Cancellations	0	(15,000)	(15,000)
Subtotal Expenditures & Transfers	**16,579,534**	**18,642,206**	**35,221,740**
Dedicated Expenditures	321	155	476
Total Expenditures & Transfers	**16,579,855**	**18,642,361**	**35,222,216**
Balance Before Reserves	**1,794,929**	**1,010,716**	**1,010,716**
Cash Flow Account	350,000	350,000	350,000
Budget Reserve	657,618	644,262	644,262
Stadium Reserve	0	16,454	16,454
Appropriations Carried Forward	146,662	0	146,662
Budgetary Balance	**640,649**	**0**	**0**

FY 2014-15 General Fund Biennial Comparison
FY 2014-15 vs FY 2012-13
($ in thousands)

	11-12 Fcst FY 2012-13	11-12 Fcst FY 2014-15	$ Difference	% Change
Actual & Estimated Resources				
Balance Forward From Prior Year	1,288,673	1,010,716	(277,957)	(21.6%)
Current Resources:				
Tax Revenues	32,106,987	33,778,206	1,671,219	5.2%
Non-Tax Revenues	1,557,881	1,389,814	(168,067)	(10.8%)
Subtotal - Non-Dedicated Revenue	33,664,868	35,168,020	1,503,152	4.5%
Dedicated Revenue	476	190	(286)	(60.1%)
Transfers In	1,079,660	574,817	(504,843)	(46.8%)
Prior Year Adjustments	199,254	50,000	(149,254)	(74.9%)
Subtotal - Other Revenue	1,279,390	625,007	(654,383)	(51.1%)
Subtotal-Current Resources	34,944,259	35,793,027	848,768	2.4%
Total Resources Available	**36,232,932**	**36,803,743**	**570,811**	1.6%
Actual & Estimated Spending				
K-12 Education	14,446,346	15,241,152	794,806	5.5%
K-12 Ptx Rec Shift/Aid Payment Shift	781,009	(61,812)	(842,821)	n/m
Subtotal K-12 Education	15,227,355	15,179,340	(48,015)	(0.3%)
Higher Education	2,568,830	2,565,262	(3,568)	(0.1%)
Property Tax Aids & Credits	2,806,390	2,728,800	(77,590)	(2.8%)
Health & Human Services	10,699,989	11,442,841	742,852	6.9%
Public Safety	1,855,421	1,825,379	(30,042)	(1.6%)
Transportation	126,125	181,634	55,509	44.0%
Environment, Energy & Natural Resources	283,798	266,000	(17,798)	(6.3%)
Agriculture	77,585	77,560	(25)	0.0%
Economic Development	203,554	165,272	(38,282)	(18.8%)
State Government	918,162	919,422	1,260	0.1%
Debt Service	414,640	1,355,156	940,516	226.8%
Capital Projects & Grants	45,162	179,430	134,268	297.3%
Other	9,729	0	(9,729)	n/m
Estimated Cancellations	(15,000)	(20,000)	(5,000)	n/m
Subtotal Expenditures & Transfers	**35,221,740**	**36,866,096**	**1,644,356**	4.7%
Dedicated Expenditures	476	190	(286)	(60.1%)
Total Expenditures & Transfers	**35,222,216**	**36,866,286**	**1,644,070**	4.7%
Balance Before Reserves	**1,010,716**	**(62,543)**	**(1,073,259)**	
Cash Flow Account	350,000	350,000	0	
Budget Reserve	644,262	644,262	1	
Stadium Reserve	16,454	38,777	22,323	
Budgetary Balance	**0**	**(1,095,582)**	**(1,095,583)**	

FY 2014-15 General Fund Forecast Comparison
November 2012 Forecast
2014-15 Biennium
($ in thousands)

	8-12 Plng Est FY 2014-15	11-12 Fcst FY 2014-15	$ Difference	% Change
Actual & Estimated Resources				
Balance Forward From Prior Year	996,536	1,010,716	14,180	1.4%
Current Resources:				
Tax Revenues	34,003,515	33,778,206	(225,309)	(0.7%)
Non-Tax Revenues	1,241,449	1,389,814	148,365	12.0%
Subtotal - Non-Dedicated Revenue	35,244,964	35,168,020	(76,944)	(0.2%)
Dedicated Revenue	1,200	190	(1,010)	(84.2%)
Transfers In	564,723	574,817	10,094	1.8%
Prior Year Adjustments	50,000	50,000	0	0.0%
Subtotal - Other Revenue	615,923	625,007	9,084	1.5%
Subtotal-Current Resources	35,860,887	35,793,027	(67,860)	(0.2%)
Total Resources Available	**36,857,423**	**36,803,743**	**(53,680)**	(0.1%)
Actual & Estimated Spending				
K-12 Education	15,246,801	15,241,152	(5,649)	0.0%
K-12 Ptx Rec Shift/Aid Payment Shift	(118,271)	(61,812)	56,459	n/m
Subtotal K-12 Education	15,128,530	15,179,340	50,810	0.3%
Higher Education	2,565,266	2,565,262	(4)	0.0%
Property Tax Aids & Credits	2,771,029	2,728,800	(42,229)	(1.5%)
Health & Human Services	11,628,137	11,442,841	(185,296)	(1.6%)
Public Safety	1,814,094	1,825,379	11,285	0.6%
Transportation	180,060	181,634	1,574	0.9%
Environment, Energy & Natural Resources	263,748	266,000	2,252	0.9%
Agriculture	77,592	77,560	(32)	0.0%
Economic Development	165,270	165,272	2	0.0%
State Government	908,416	919,422	11,006	1.2%
Debt Service	1,360,071	1,355,156	(4,915)	(0.4%)
Capital Projects & Grants	65,468	179,430	113,962	174.1%
Estimated Cancellations	(20,000)	(20,000)	0	n/m
Subtotal Expenditures & Transfers	**36,907,681**	**36,866,096**	**(41,585)**	(0.1%)
Dedicated Expenditures	1,200	190	(1,010)	(84.2%)
Total Expenditures & Transfers	**36,908,881**	**36,866,286**	**(42,595)**	(0.1%)
Balance Before Reserves	**(51,458)**	**(62,543)**	**(11,085)**	
Cash Flow Account	350,000	350,000	0	
Budget Reserve	612,236	644,262	32,026	
Stadium Reserve	65,510	38,777	(26,733)	
Budgetary Balance	**(1,079,204)**	**(1,095,582)**	**(16,378)**	

FY 2012-17 Planning Horizon
November 2012 Forecast
($ in thousands)

	11-12 Fcst FY 2012-13	11-12 Fcst FY 2014-15	11-12 Fcst FY 2016-17
Actual & Estimated Resources			
Balance Forward From Prior Year	1,288,673	1,010,716	(62,543)
Current Resources:			
Tax Revenues	32,106,987	33,778,206	36,710,963
Non-Tax Revenues	1,557,881	1,389,814	1,377,015
Subtotal - Non-Dedicated Revenue	33,664,868	35,168,020	38,087,978
Dedicated Revenue	476	190	2
Transfers In	1,079,660	574,817	564,018
Prior Year Adjustments	199,254	50,000	50,000
Subtotal - Other Revenue	1,279,390	625,007	614,020
Budget Changes - Taxes	0	0	0
Budget Changes - Non-Taxes	0	0	0
Subtotal-Current Resources	34,944,259	35,793,027	38,701,998
Total Resources Available	**36,232,932**	**36,803,743**	**38,639,455**
Actual & Estimated Spending			
K-12 Education	14,446,346	15,241,152	15,818,220
K-12 Ptx Rec Shift/Aid Payment Shift	781,009	(61,812)	(90,623)
Subtotal K-12 Education	15,227,355	15,179,340	15,727,597
Higher Education	2,568,830	2,565,262	2,565,262
Property Tax Aids & Credits	2,806,390	2,728,800	2,801,904
Health & Human Services	10,699,989	11,442,841	12,204,115
Public Safety	1,855,421	1,825,379	1,834,981
Transportation	126,125	181,634	181,634
Environment, Energy & Natural Resources	283,798	266,000	277,986
Agriculture	77,585	77,560	77,560
Economic Development	203,554	165,272	165,272
State Government	918,162	919,422	924,461
Debt Service	414,640	1,355,156	1,503,644
Capital Projects & Grants	45,162	179,430	194,839
Deficiencies/Other	9,729	0	0
Estimated Cancellations	(15,000)	(20,000)	(20,000)
Subtotal Expenditures & Transfers	**35,221,740**	**36,866,096**	**38,439,255**
Dedicated Expenditures	476	190	2
Total Expenditures & Transfers	**35,222,216**	**36,866,286**	**38,439,257**
Balance Before Reserves	**1,010,716**	**(62,543)**	**200,198**
Cash Flow Account	350,000	350,000	350,000
Budget Reserve	644,262	644,262	644,262
Stadium Reserve	16,454	38,777	47,421
Budgetary Balance	**0**	**(1,095,582)**	**(841,485)**