GENERAL FUND REVENUE AND BUDGET OUTLOOK
FY 2011-12

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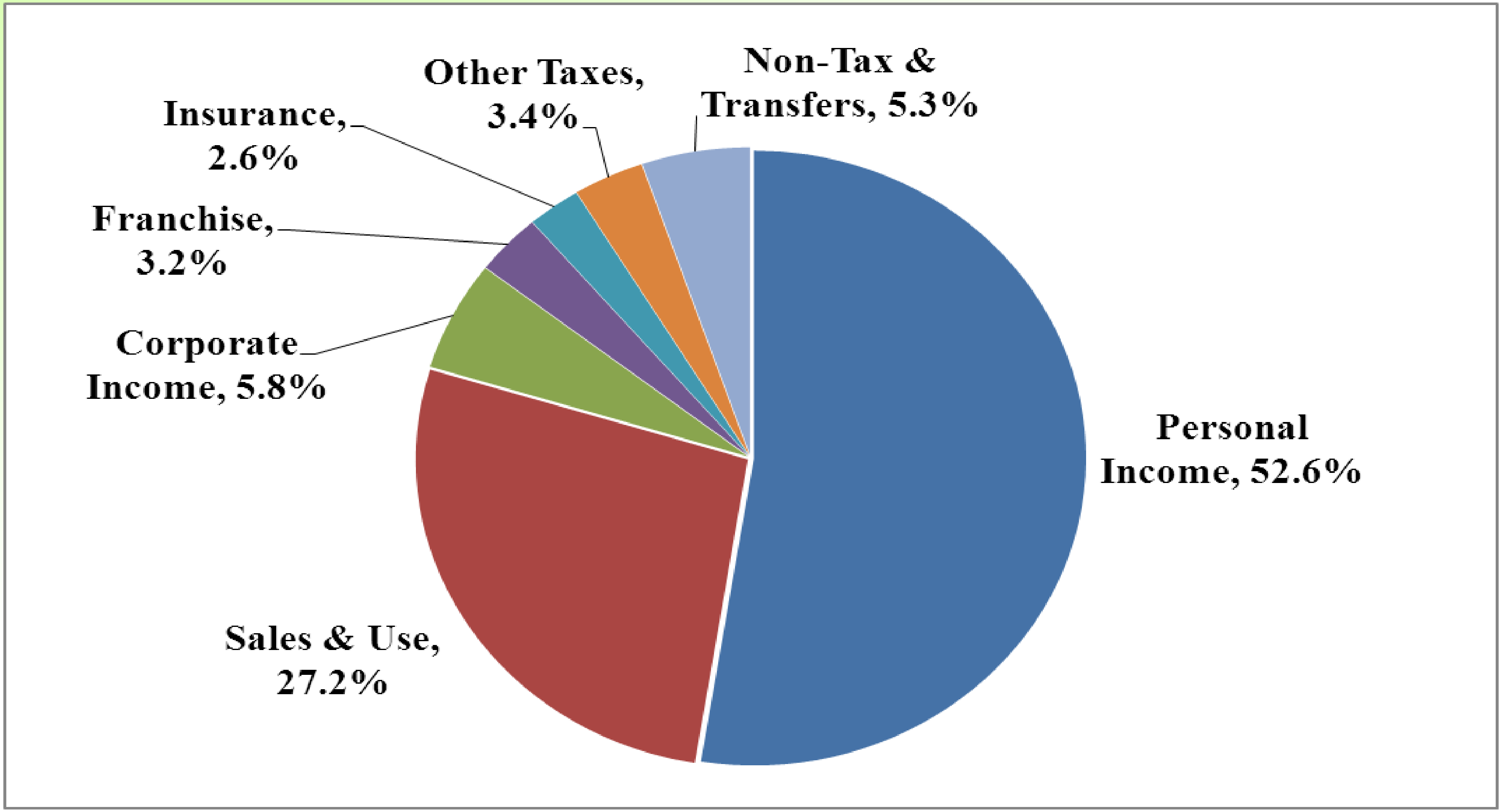
Presentation Outline

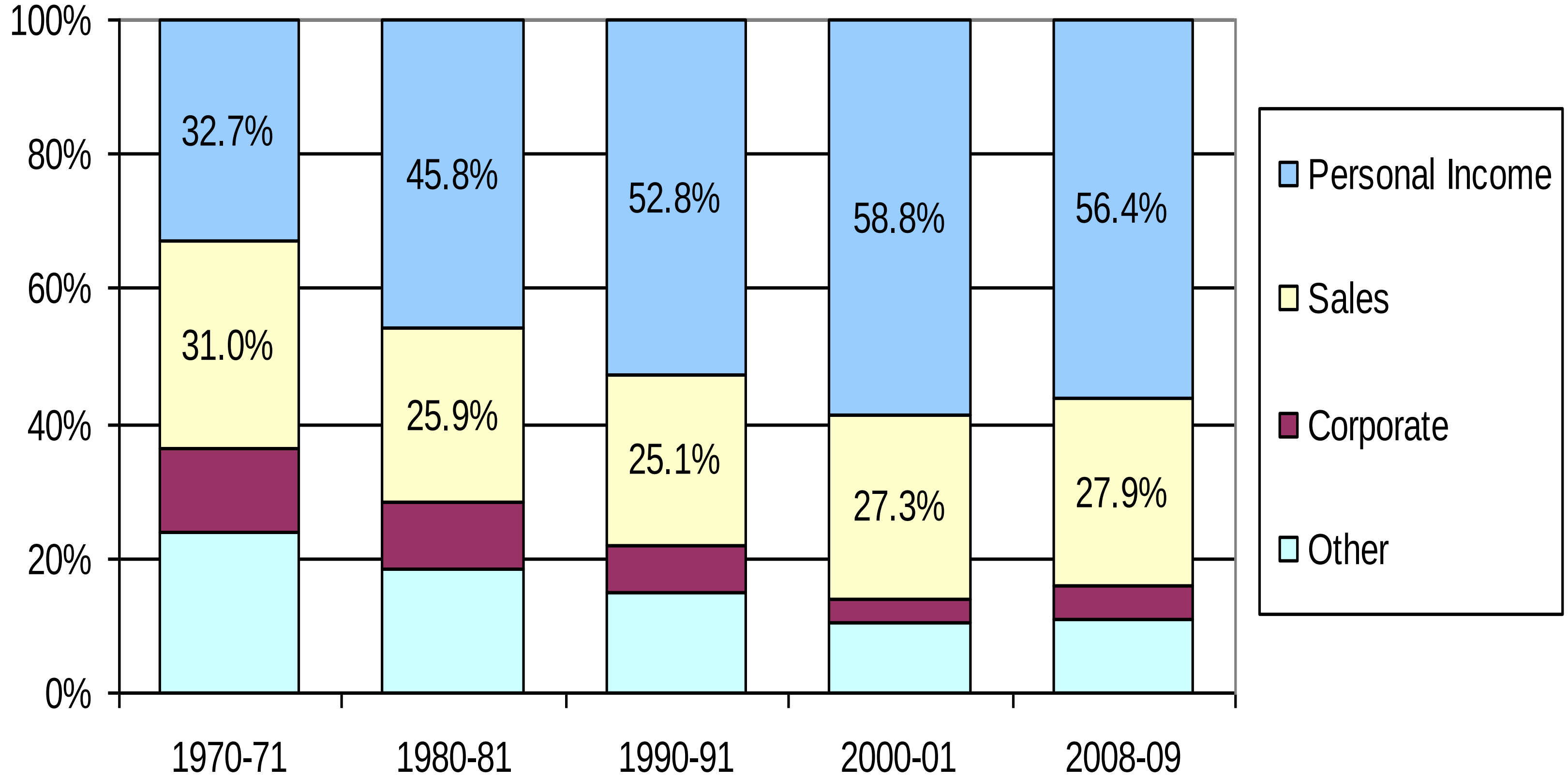
- General Fund Revenue Overview
- Economic Conditions and Forecast Risks
- Key Economic and Revenue Trends
- State Budget Overview
- National and NC Perspective
- Preliminary FY 2011-12 Budget Gap Estimate

General Fund Revenue Overview
and
Economic Conditions &
Forecast Risks

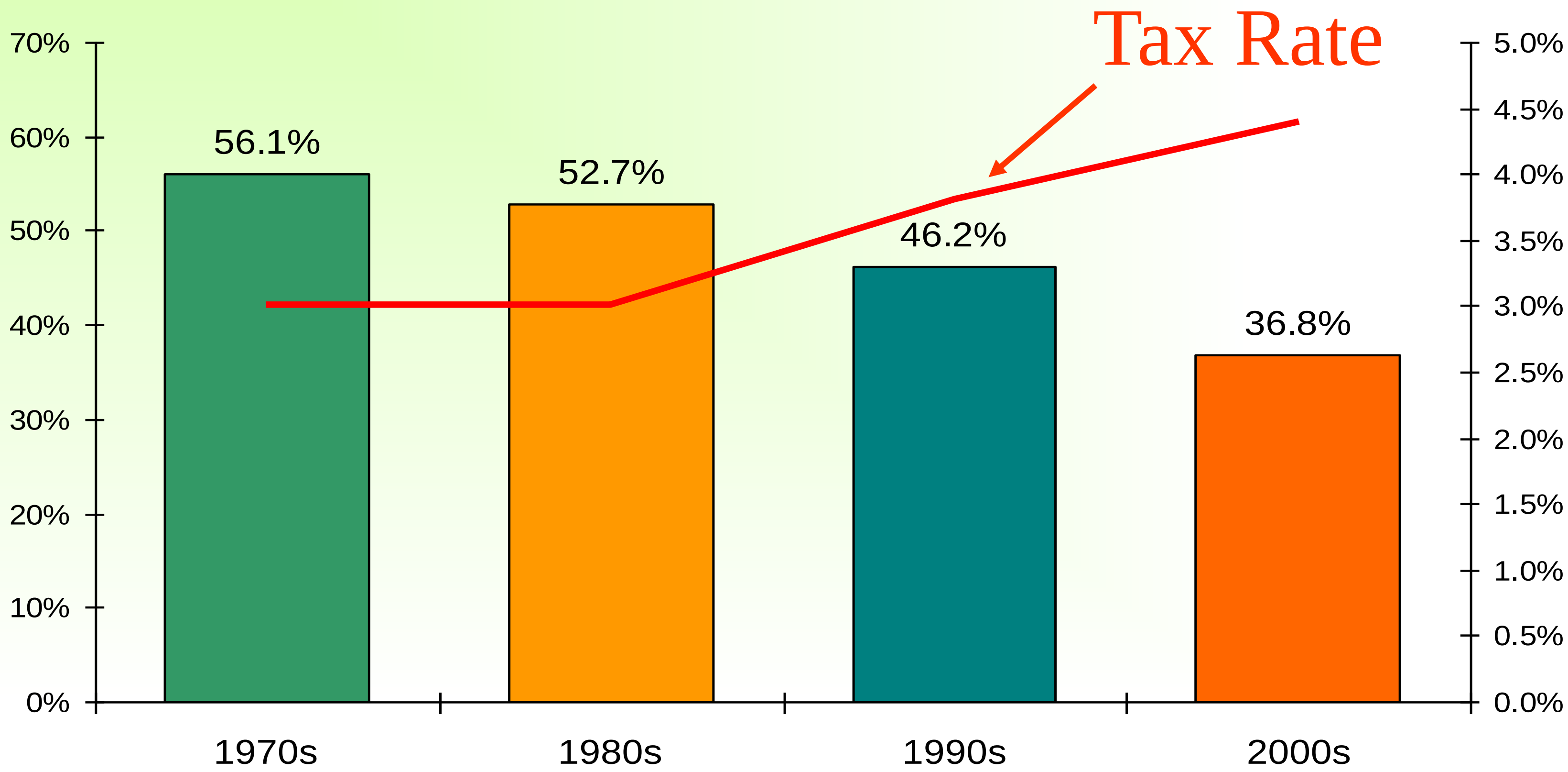
Average State General Fund,
FY 2000-01 to FY 2009-10



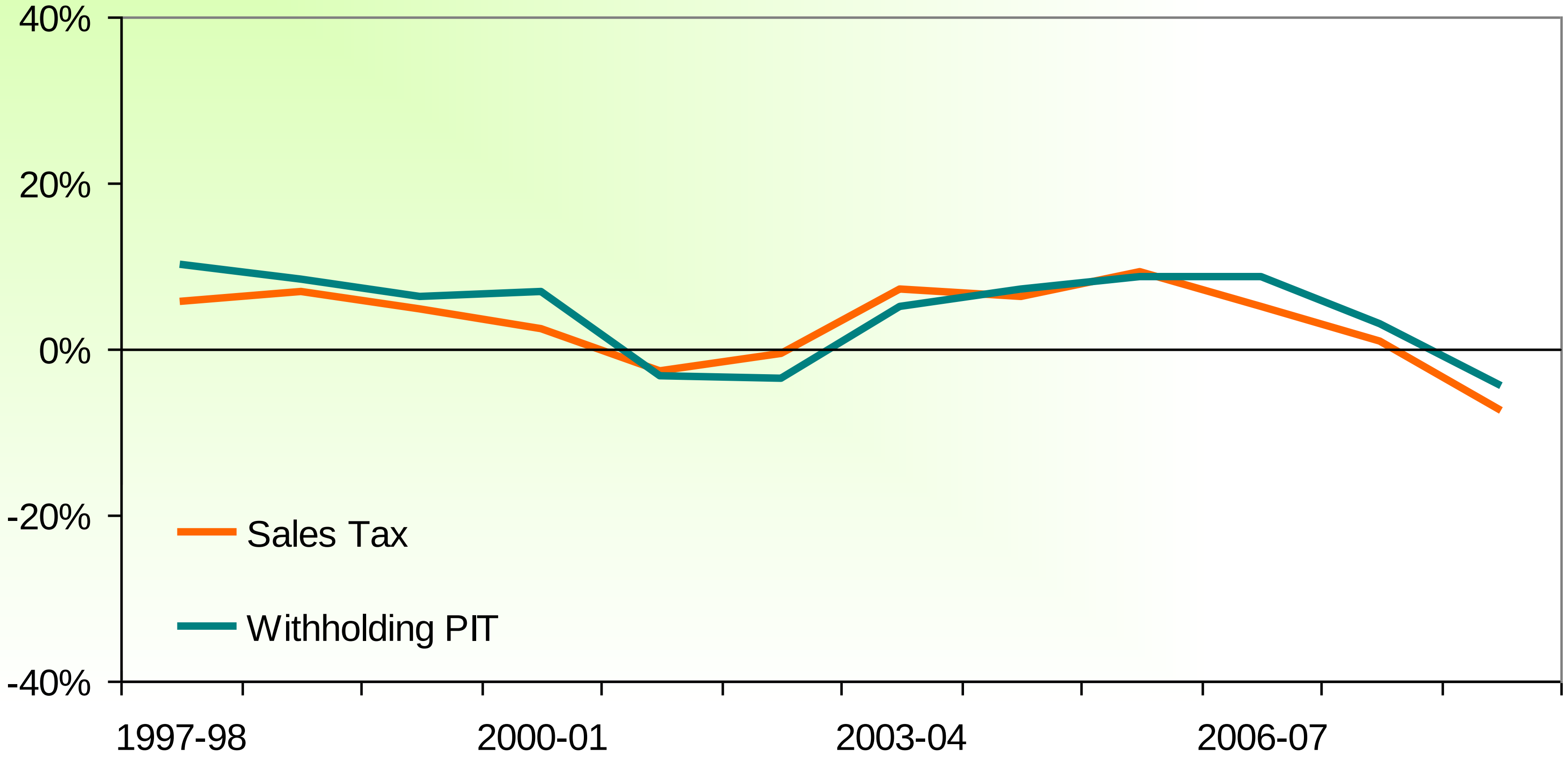
State Tax Structure



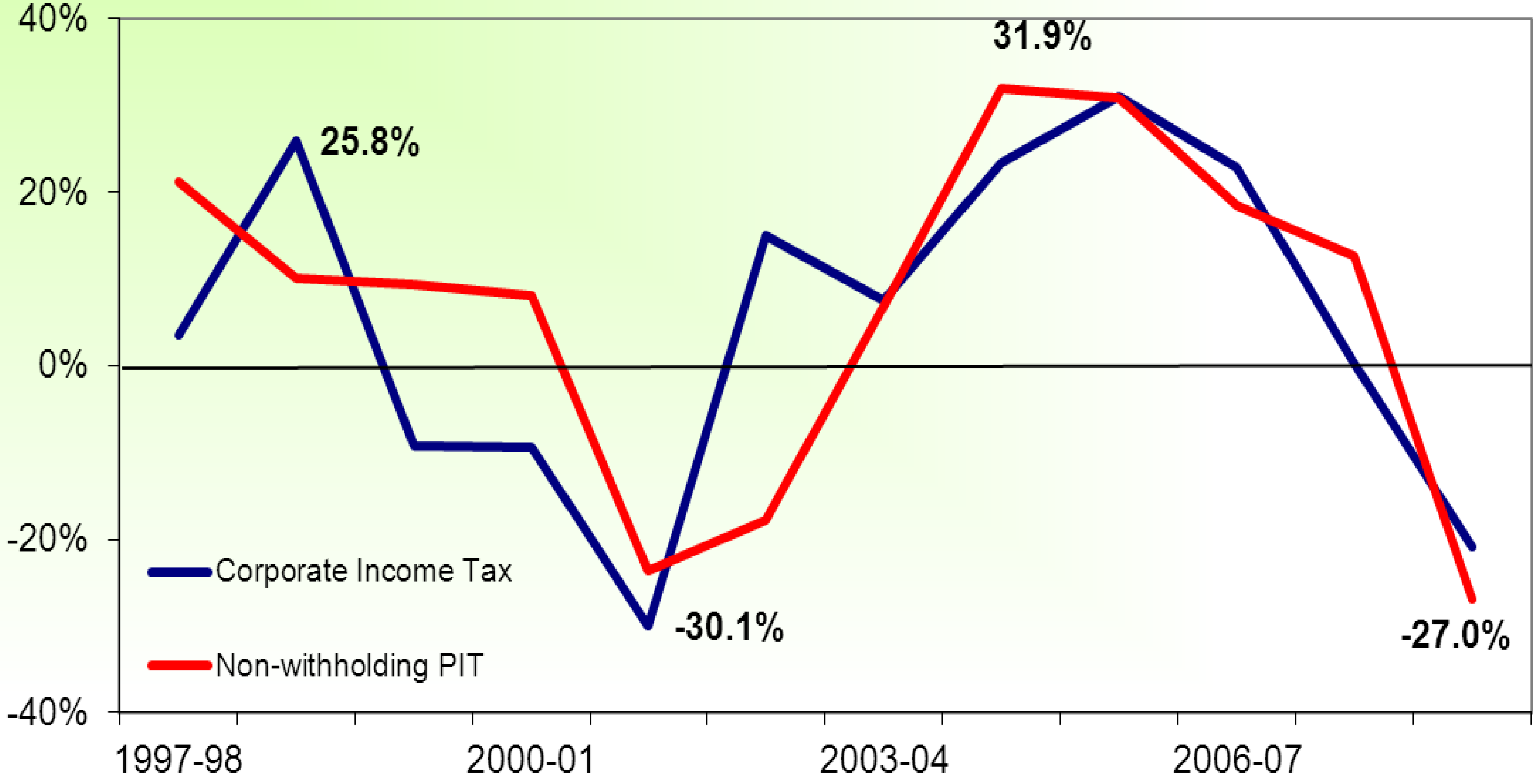
Sales Tax Base and Rate



Stable Sources of Revenue



Volatile Sources of Revenue



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Consensus Revenue Process

- Statutory Guidelines do not address the budget revenue forecast
- Since the 1990s, a consensus forecast has been used
- Fiscal Research and Office of State Budget and Management develop independent forecasts

Consensus Revenue Process

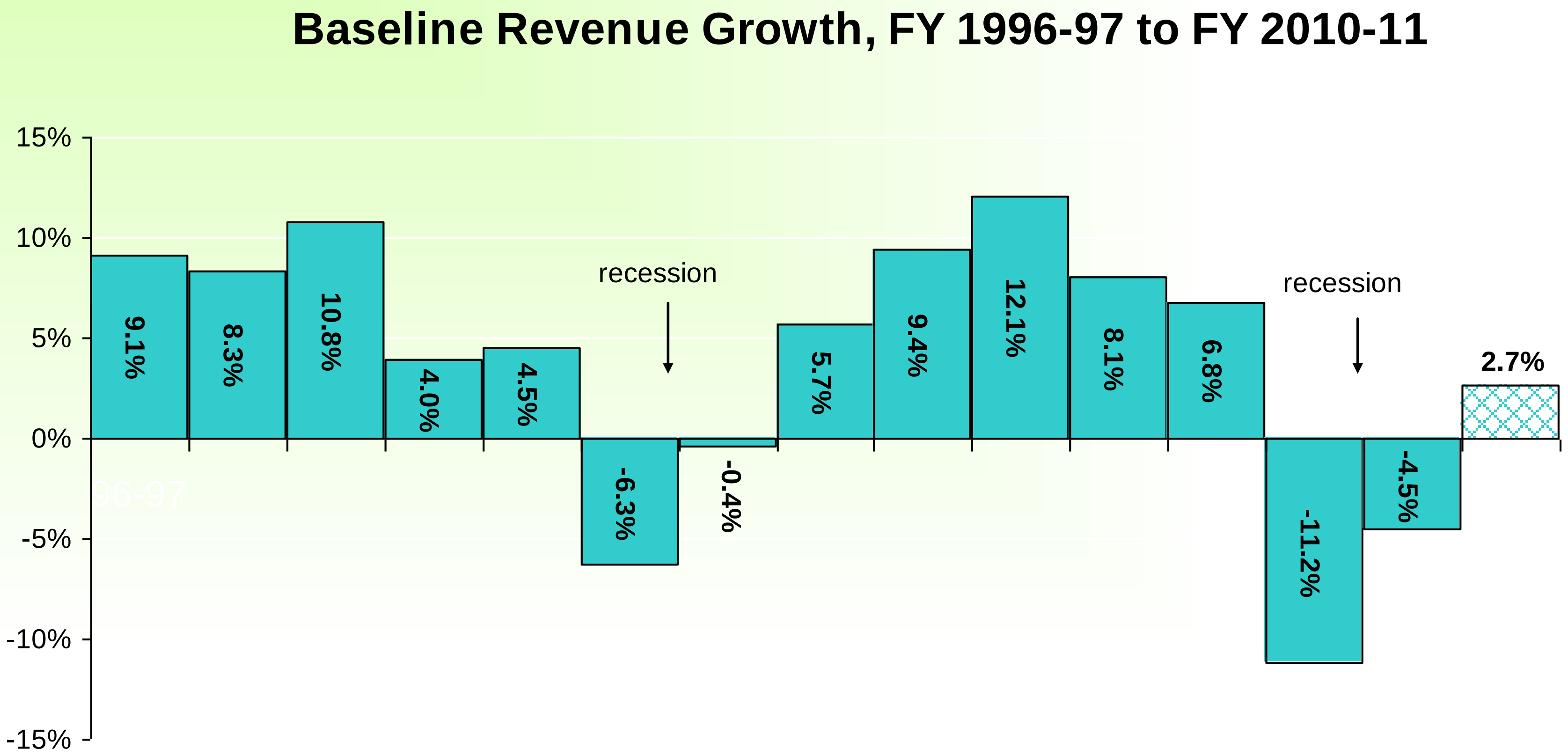
- Prior to release of Governor's biennial budget, forecasters meet to develop a consensus forecast
- In early May, after April receipts have been recorded, the legislature and/or the Governor can request a revised consensus forecast

Consensus Revenue Process

- Finally, a small informal revision may be warranted before final passage of the budget
- In even-numbered years
  - a consensus revision to the second year biennium forecast takes place in early May

Current GF Revenue

The Great Recession's impact on State revenues can be clearly seen from the economy-based growth rates.



Note: The last column represents the current forecast baseline estimate.

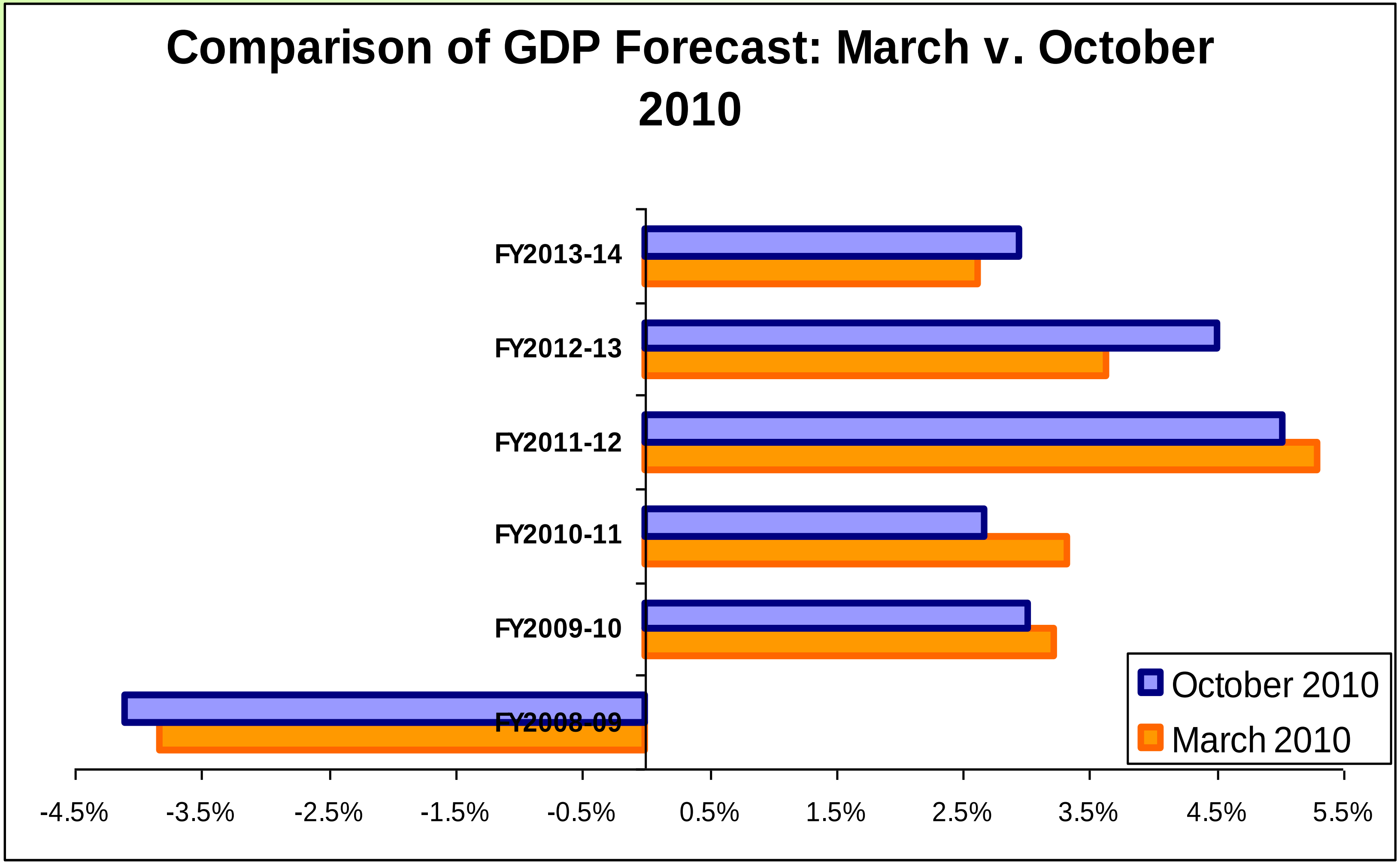
Current GF Revenue

- Collections through November are meeting the $7.5 billion target
- Key sources of tax revenue have bottomed out and are beginning to show signs of growth
- Too early to claim sustainable growth.

Revenue: Things to Watch

- April 2010 consensus revenue forecast envisioned a gradual improvement in the State's economic conditions
- Economic forecasts at the time expected growth to be slightly above 3% by the end of 2010
- Economic forecasts have been downgraded to below normal growth closer to 2 to 2.5%

Economic Forecast Downgraded



Revenue Estimates Take Cautious Approach

- The forecasted baseline growth rates of key revenue components, which represent 87% of the General Fund, are:
  - Personal Income Tax 3.0%
  - Sales Tax 1.5%
  - Corporate Income Tax 3.6%

Revenue: Things to Watch

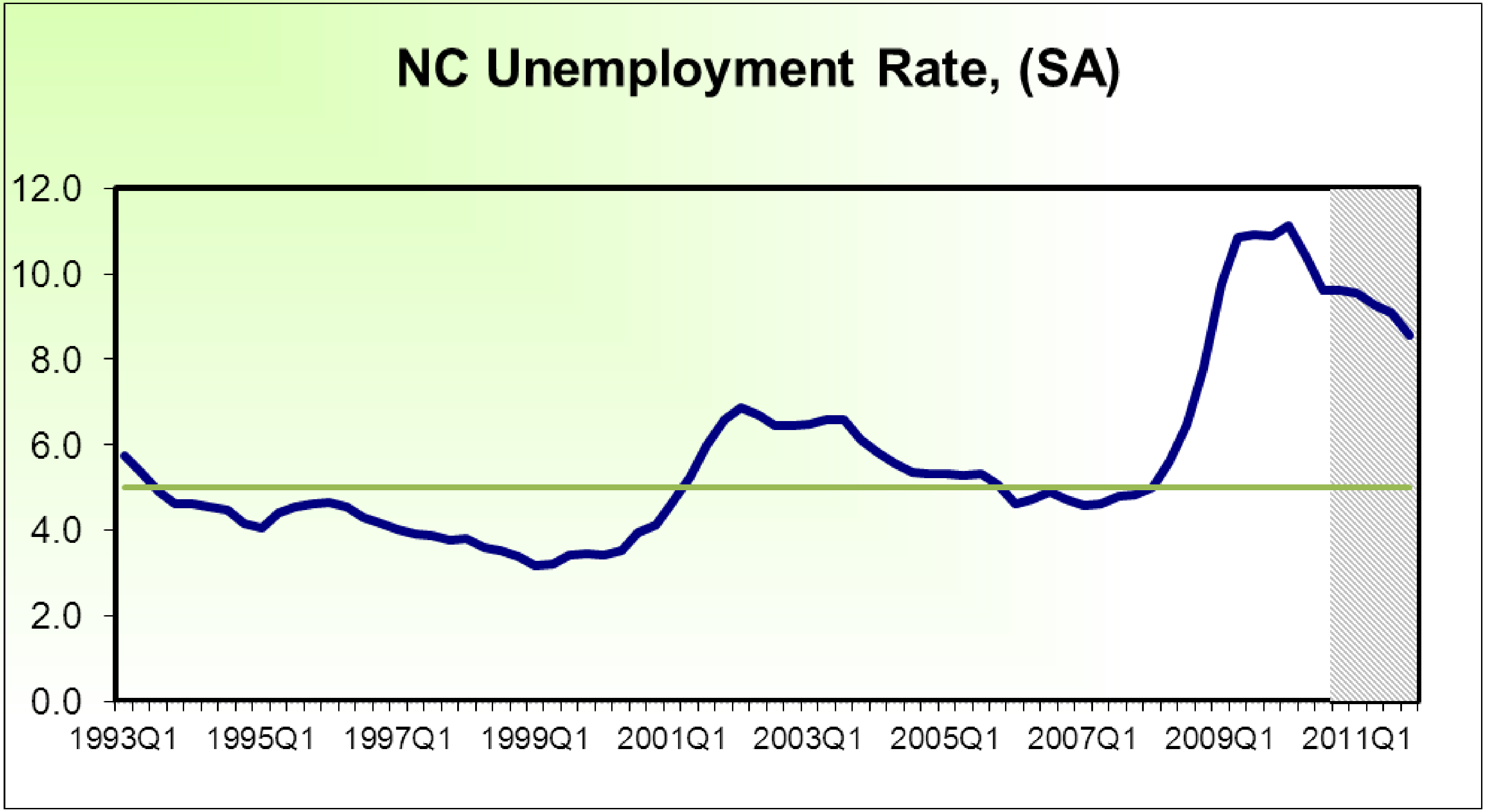
- The April consensus forecast was necessarily cautious
- Forecasters used a more pessimistic growth outlook than most were anticipating
- **The cautious revenue forecast is now aligning with economic forecast revisions**

Key Economic and Revenue Trends

Economic Outlook: Choppy Waters Ahead

- Recent "Good" News
  - Unemployment claims on the decline
  - Consumer confidence more up than down
  - Chain-store sales increase in September
  - Private hours worked are on the increase
  - Pending house sales increased
- Recent "Bad" News
  - Total labor force is declining as more drop out
  - BLS employment index drops to near recession levels
  - Consumer Sentiment weakens
  - Unemployment Rate increases

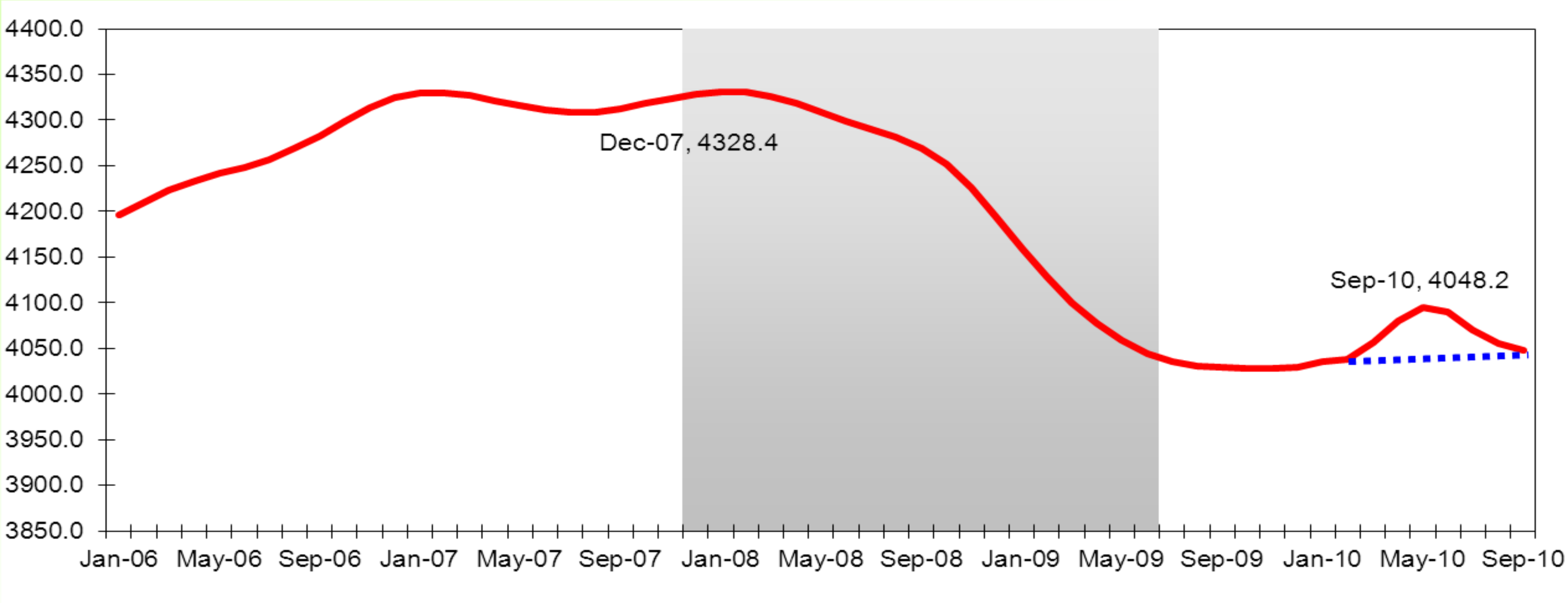
Key Economic Trends



Forecast shaded in gray.

Key Economic Trends

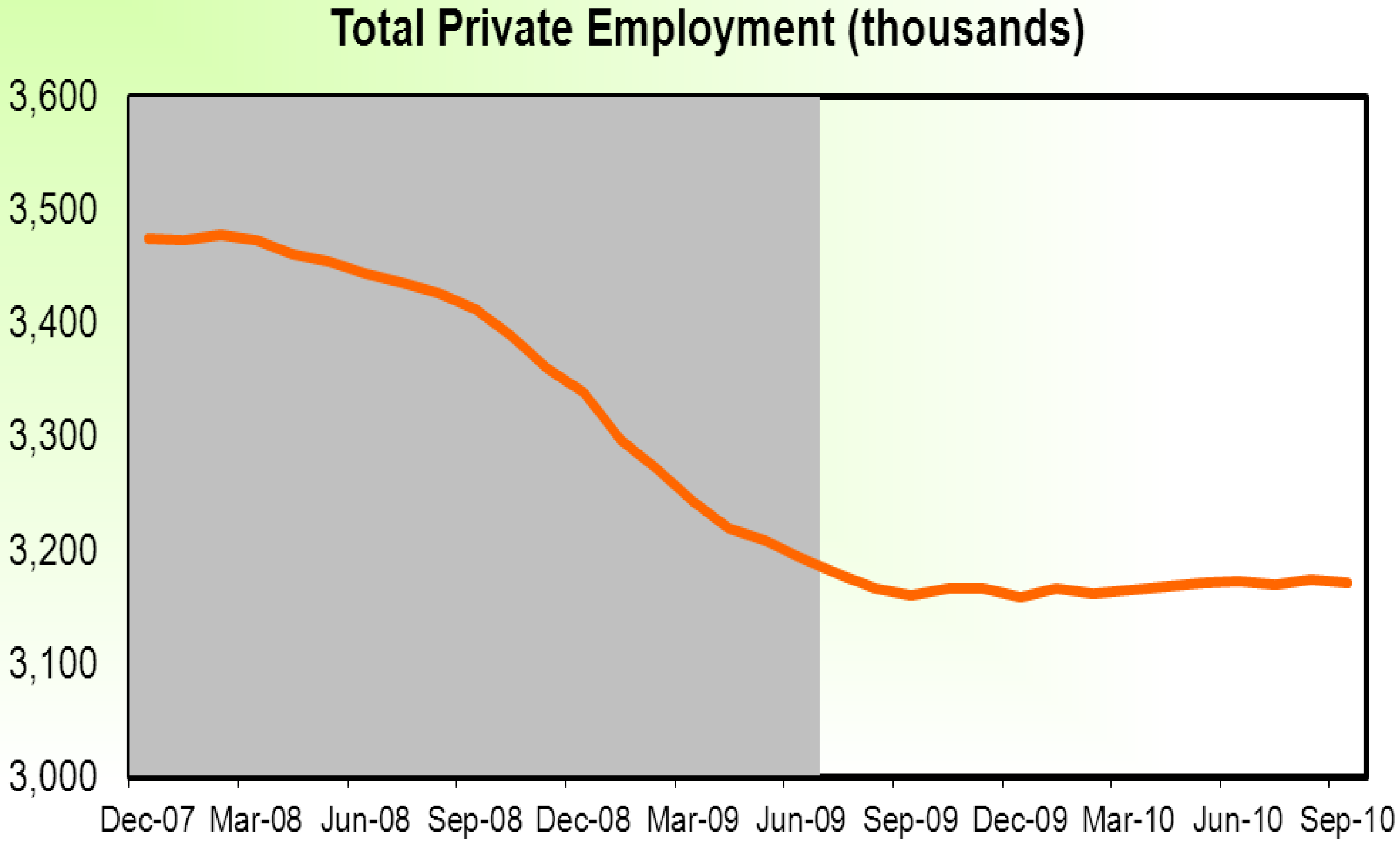
Total Employment (thousands)



The trend of monthly net job losses has ended, but there has been little rebound in employment. The temporary uptick from Census jobs can be seen in the early summer (the dotted blue line is an FRD estimate of total employment without the census uptick).

Source: North Carolina Employment Security Commission

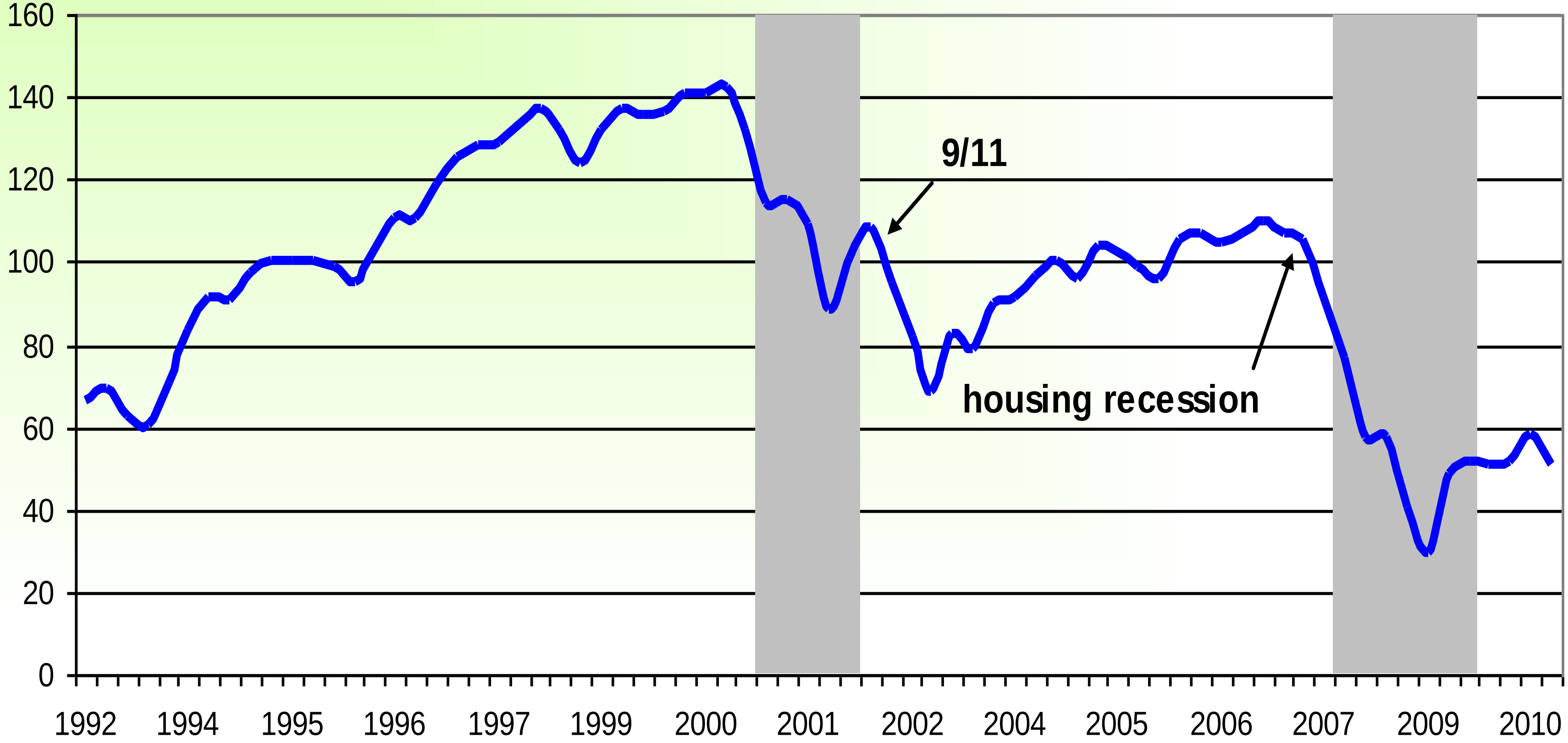
Key Economic Trends



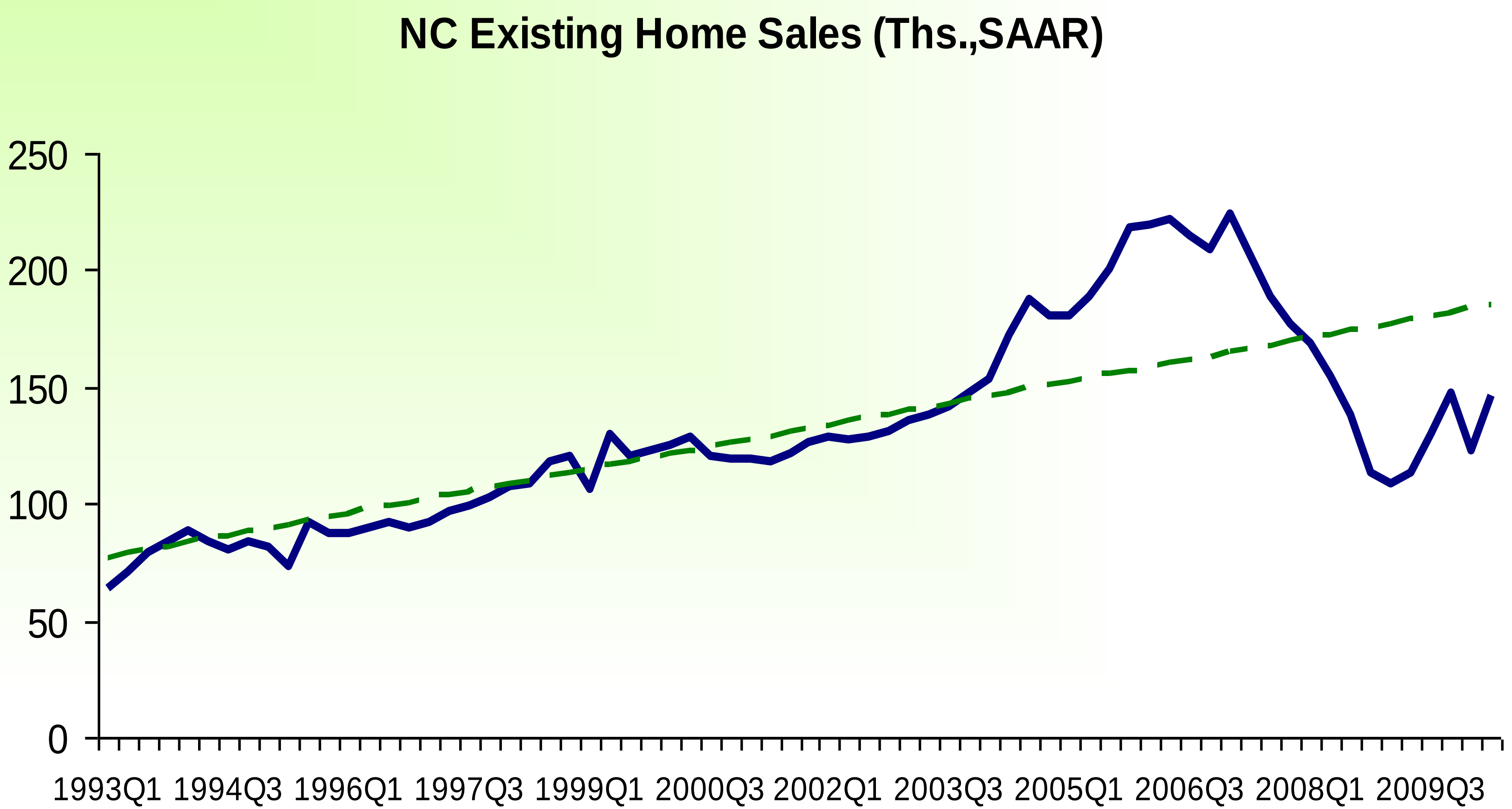
Source: North Carolina Employment Security Commission

Key Economic Trends

Consumer Confidence



Key Economic Trends



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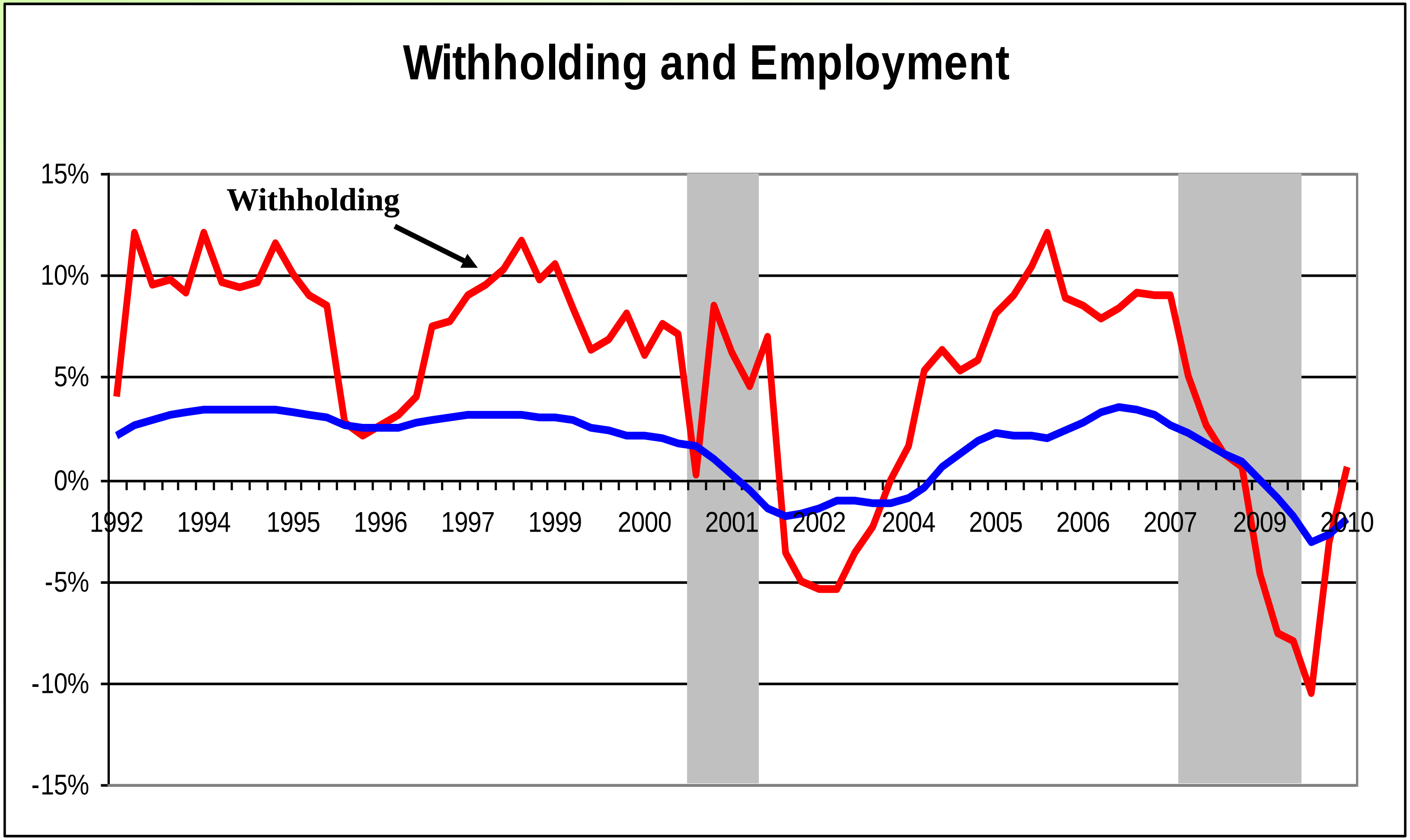
Key Revenue Collection Trends



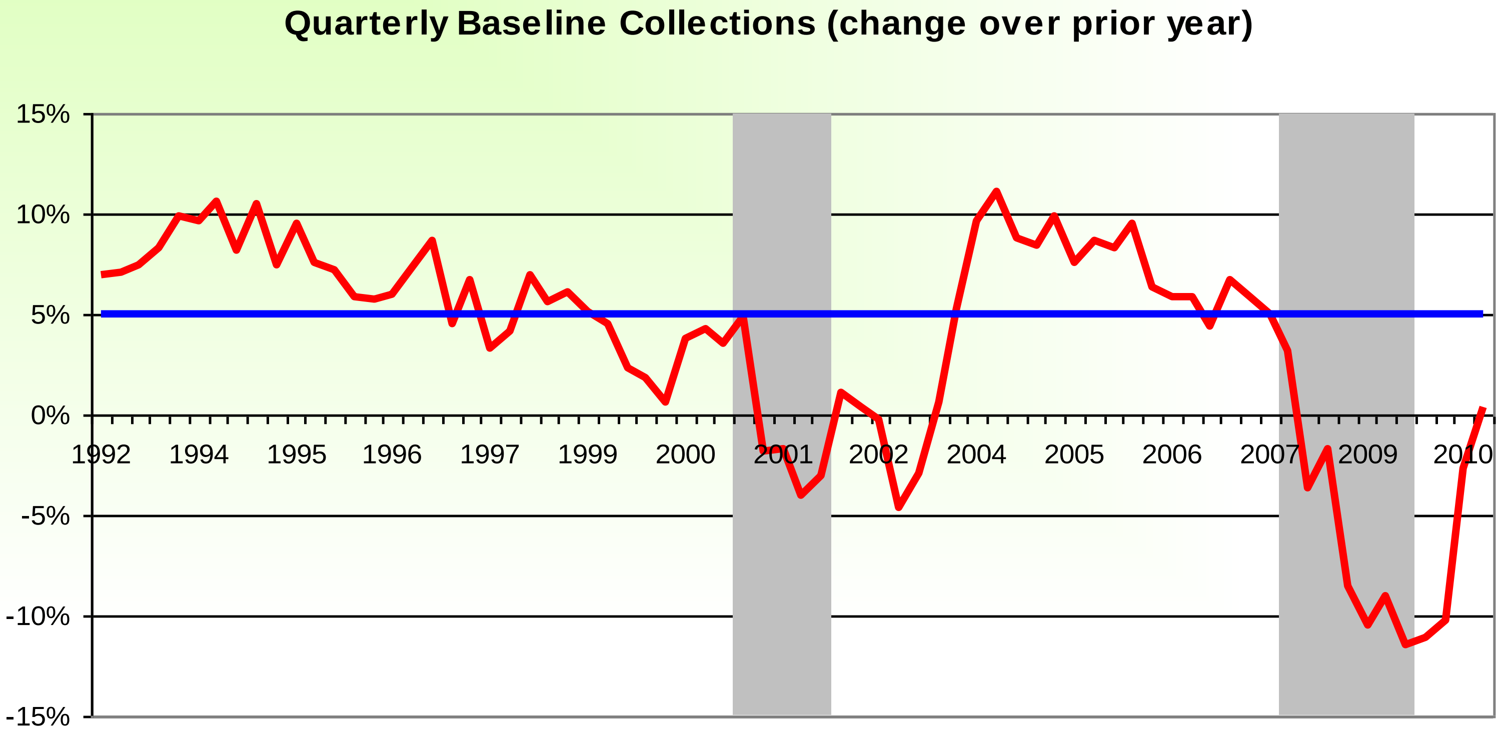
Withholding and Employment are 4 month moving averages

Key Revenue Collection Trends

- A glimmer of hope for a key revenue source (40% of total General Fund revenue)
- Net withholding is up 1% over last year
- Total personal income is up 0.8%. This time last year, it was down 2.8%.
  - Collections increased 1.2% in September, 3.8% in October, and 4.8% in November

Key Revenue Collection Trends

Sales and Use Tax Collections (adjusted for tax law changes)



Key Revenue Collection Trends

- Double-digit, year-over-year losses have ended
  - Baseline collection growth at 1.2% (long term average is 5%)
- Modest growth is encouraging, but baseline numbers are **12.4% below** the first five months of FY 2007-08
  - On par with collections of FY 2005-06

FY 2011-12 Economic Conditions

- Overall economic activity continues to improve
  - National GDP between 3% and 3.5%
- Modest economic improvement means employment picture remains weak
  - As much as 3 years to recover employment losses
- Weak wage and employment growth keeps GF revenue growth below long-run trend of 5% to 6%

State Budget Overview and Preliminary Estimate of FY 2011-12 Budget Gap

National Budget Conditions

National Perspective

- States are facing their 3rd or 4th consecutive year of budget gaps[1]
- National recession officially ended June 2009[2]
- "ARRA cliff" finally arrived - $37.9 billion in federal stimulus funds[3] are almost gone
- 35 states project budget gaps for FY 2011-12[1]
- 21 states project gaps $\geq$ 10%, including NC[1]

[1]National Conference of State Legislatures, State Budget Update: November 2010
[2]Business Cycle Dating Committee, National Bureau of Economic Research http://www.nber.org/cycles/sept2010.html
[3]Federal Funds Information for States

National Perspective

States have used various solutions to address budget gaps:

- Federal ARRA funds
- Other cash balances
- Borrowing
- Accounting changes
- Budget reductions
- Revenue adjustments
- Rainy Day Funds

National Perspective

2009 Budget Actions:

- 30 states enacted tax increases[1]
- 35 states cut higher education[2]
- 26 states cut prison funding, including seven that closed prisons[2]
- 17 states instituted furloughs or unpaid leave[2]
- 14 states instituted or increased Medicaid provider assessments[3]
- At least 8 states cut optional Medicaid services and at least 4 states increased co-pays[2]

[1]National Conference of State Legislatures, State Budget Update: November 2010
[2] The Pew Center for the States, 2009 Legislative Review
[3]National Conference of State Legislatures, October 2010

National Perspective

2010 Budget Actions:

- 15 states have new budget gaps since beginning of FY 2010-11[1]
- 43 states cut higher education[2]
- 34 states reduced spending in K-12 education[2]
- 29 states cut services to the elderly and disabled[2]
- 11 instituted or increased Medicaid provider assessments

[1]National Conference of State Legislatures, State Budget Update: November 2010
[2]Center on Budget and Policy Priorities, An Update on State Budget Cuts, November 2010

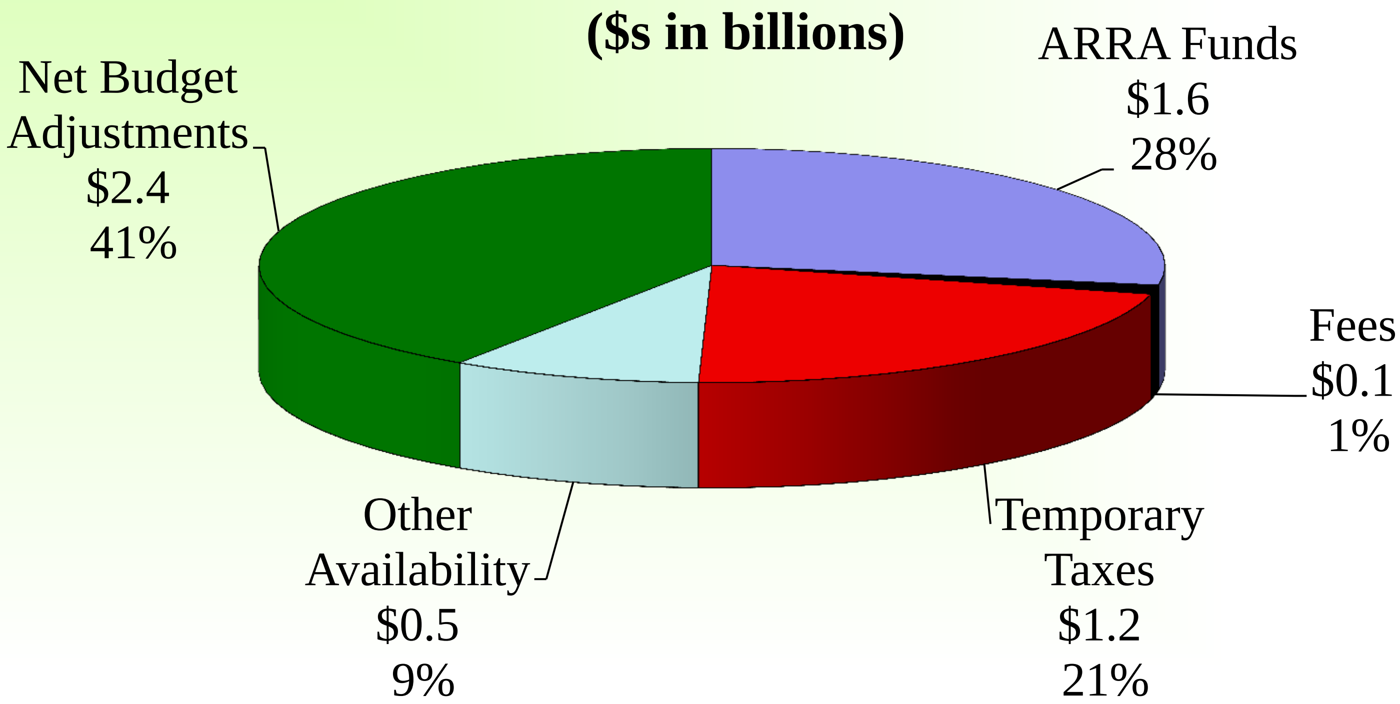
North Carolina Budget Conditions

State Budget Gap

- 2011 marks NC's 3rd consecutive budget gap
- General Assembly closed the following budget gaps:[1]
    - $4.6 billion in FY 2009-10
    - $5.8 billion in FY 2010-11

[1]Budget gap is based on Governor's Recommended Continuation Budget plus legislative adjustments.

Legislative Strategies to Close NC's 2010-11 $5.8 billion Budget Gap



Estimating a Budget Gap

Legislative Budget Process usually begins with:

- Governor's recommended continuation budget[1]
- Consensus revenue estimate
- Mandated spending items
- Other spending pressures

[1]NC Constitution, Article III, Section 5(3)

Preliminary FY 2011-12 Availability Estimate

FY 2010-11 Budgeted Availability	**$19.0 billion**
Expiration of 1% Sales Tax	-1.1 billion
Expiration of Corporate and Personal Income Surtaxes	-0.2 billion
Other One-time Availability	-0.2 billion
Preliminary Estimate of Revenue Growth (midpoint of $0.5 billion and $0.9 billion range)	+0.7 billion
Preliminary Availability Estimate for FY 2011-12	**$18.2 billion[1]**

[1]Does not include unreserved fund balance (estimates of over-realized revenues or reversions).

FY 2010-11 Budget Adjusted for Nonrecurring Items

FY 2010-11 Certified Budget	**$19.0 billion**
State Funds Needed to Replace Federal ARRA Funding	+1.6 billion
Other One-time Budget Adjustments	+ 0.4 billion
FY 2010-11 Budget Adjusted for NR Items	**$21.0 billion**

Preliminary FY 2010-11 Budget Estimate

FY 2010-11 Budget Adjusted for NR Items	**$21.0 billion**
State Retirement System Contribution	+ 0.3 billion
State Health Plan	+ 0.2 billion
Enrollment Growth (K-12, Community College and UNC)	+ 0.2 billion
Medicaid	+ 0.2 billion
Preliminary Estimate FY 2011-12 Budget	**$21.9 billion**[1]

[1]Does not include estimates for inflation (other than Medicaid), prison population growth, debt service, capital or repairs and renovations.

Preliminary FY 2011-12 Budget Gap Estimate

Revenue Availability Estimate	$18.2 billion
Budget Estimate	$21.9 billion
Preliminary Budget Gap Estimate	-$ 3.7 billion

Preliminary FY 2011-12 Budget Gap Estimate

FY 2010-11 Revenue Availability	**$19.0 billion**
Expiration of 1% Sales Tax	- 1.1 billion
Expiration of Corporate and Personal Income Surtaxes	- 0.2 billion
Other One-Time Revenue Adjustments	- 0.2 billion
Preliminary Estimate of Revenue Growth	+ 0.7 billion
Preliminary Availability Estimate for FY 2011-12	**$18.2 billion**
FY 2010-11 Certified Budget	**$19.0 billion**
State Funds Needed to Replace Federal ARRA Funds	+ 1.6 billion
Other One-time Budget Adjustments	+ 0.4 billion
Retirement System Contribution	+ 0.3 billion
State Health Plan	+ 0.2 billion
K-12 and Higher Education Enrollment	+ 0.2 billion
Medicaid	+ 0.2 billion
Preliminary Estimate of FY 2011-12 Budget	**$21.9 billion**
Preliminary Estimate of Budget Gap	**-$ 3.7 billion**

FY 2010-11 State General Fund Budget

Subcommittee/Area	Net Appropriation[1]	% of Total
Education	10,807,660,079	57.00%
Health & Human Services	3,949,918,671	20.83%
Justice & Public Safety	2,115,263,447	11.16%
Natural & Economic Resources	467,727,028	2.47%
General Government	439,210,275	2.32%
Capital & Debt Service	718,695,003	3.79%
Salaries & Benefits - Reserves	437,479,709	2.31%
Other Reserves	23,040,000	0.12%
TOTAL	**$18,958,994,212**	**100.00%**

Note: [1]Includes general purpose revenue such as income and sales tax; does not include agency receipts.

FY 2010-11 State Budget Overview

- $18.96 billion General Fund budget[1]
- State appropriations grew 31% since FY 2000-01; 42% when adjusting for ARRA funds
- Average annual growth[2] is 3%, 4% adjusting for ARRA funds

[1]Includes general purpose revenue such as income and sales tax; does not include agency receipts.
[2]From FY 2000-01 through FY 2010-11.

NC's Major Budget Categories
FY 2010-11

Major Budget Category	Net G.F. Appropriations	% of total
Public Schools	7,085,588,912	37%
Higher Education[1]	3,722,071,167	20%
Medicaid	2,368,365,829	12%
Correction	1,285,252,983	7%
Mental Health	705,476,614	4%
Natural & Econ. Resources	467,727,028	2%
Courts[2]	566,019,508	3%
Capital and Debt	718,695,003	4%
Other	2,039,797,168	11%
TOTAL	**$18,958,994,212**	**100%**

[1]Includes universities and community colleges.
[2]Includes courts and indigent defense.

State Mandated Spending: Public Schools

Fiscal Facts

- $7.1 billion operating budget; 37.4% of General Fund[1]
- Average annual growth:
  - 2.0% budget[2]
  - 1.4% enrollment[3]
- Funding to local education agencies constitutes over 99% of agency budget

Recent Legislative Actions

- Increased LEA flexibility
  - Eliminated grades 4-12 class size requirements
  - Use of funds/allotments
  - $305 million in flexible cuts
- Funded $10 million for Governor's diagnostic initiative

[1]Includes general purpose revenue such as income and sales tax; does not include agency receipts.
[2]From FY 2000-01 through FY 2010-11.
[3]From FY 1999-00 through FY 2009-10.

State Mandated Spending: Public Schools

Opportunities for Budget Changes

- Adjust class sizes
- Eliminate optional spending (salary supplements and capital)
- Review role & number of non-instructional staff

Constraints for Change

- State must provide uniform system of public schools.[1]

[1]NC Constitution, Article IX, Section 2.

Spending Pressures: Higher Education

Fiscal Facts

Universities

- $2.7 billion budget; 14.1% of General Fund[1]
- Average annual growth:
  - 4% budget[2]
  - 3.3% enrollment[3]
- Growth in past 10 years:
  - 48% budget[2]
  - 38% enrollment[3]

Community Colleges

- $1.1 billion budget; 5.6% of General Fund[1]
- Average annual growth:
  - 5.1% budget[2]
  - 5.1% enrollment[3]
- Growth in past 10 years:
  - 64% budget[2]
  - 65% enrollment [3]

[1]Includes general purpose revenue such as income and sales tax; does not include agency receipts.
[2]From FY 2000-01 through FY 2010-11.
[3]From FY 1999-00 through FY 2009-10.

Spending Pressures: Higher Education
Recent Legislative Actions

Universities

- Cut $170 million via management flexibility cuts
  - Allowed campuses to increase tuition up to $750/year to meet cut
- Eliminated resident tuition for nonresident athletes
- Increased financial aid by $47 million

Community Colleges

- Funded $180 million in enrollment growth
- Cut $29 million via management flexibility cuts
- Increased tuition costs to NC students by $14.50/credit hour

Spending Pressures: Higher Education

Opportunities for Budget Change

- Increase tuition
- Reduce per student funding
- Eliminate or reduce specific degree or non-degree programs or functions
- Incentivize course offerings in high employability areas
- Pursue performance-based funding

Constraints for Change

- State is mandated to provide system of higher education as free as practicable.[1]
- Accreditation
- Maintenance of effort is required for certain federal funds

[1] NC Constitution, Article IX, Section 8.

State Mandated Spending: Medicaid

Fiscal Facts

- $2.4 billion operating budget; 12% of General Fund[1]
- Average annual growth[2]
  - 5.4% budget
  - 4.4% enrollment
- Payments to providers constitute 98% of Division's budget

Recent Legislative Actions

- Assumed county share of costs, $562 million
- Reduced selected provider rates
- Reformed & reduced costs in certain services
  - Community support
  - In-home personal care

[1]Includes general purpose revenue such as income and sales tax; does not include agency receipts.
[2]From FY 2000-01 through FY 2010-11.

State Mandated Spending: Medicaid

Opportunities for Budget Change

- Eliminate, restructure and/or reduce $1.1 billion in optional services
  - Prescription drugs
  - Non-physician services
  - Nursing facilities
  - Dental
- Institute new payment & performance strategies

Constraints for Change

- Federal-state partnership – legal entitlement
- Almost impossible to reduce eligibility
- Federal healthcare reform
- Counter-cyclical program (demand increases when economy slows)

Spending Pressures: Correction

Fiscal Facts

- $1.3 billion operating budget; 7% of General Fund[1]
- 3.9% average annual budget growth[2]
- Prison personnel comprise 66% of budget

Recent Legislative Actions

- Closed 7 prisons
- Eliminated 1,033 positions (FTEs)
- Reduced inmate medical costs
- Expanded in-house inmate medical capacity

[1]Includes general purpose revenue such as income and sales tax; does not include agency receipts.
[2]From FY 2000-01 through FY 2010-11

Spending Pressures: Correction

Opportunities for Budget Change

- Reform sentencing policies & laws
  - Misdemeanants
  - Habitual felons
- Reform probation policies/procedures
  - Reduce revocations

Constraints for Change

- Current & projected shortage of prison beds
- Costs for use of local jail beds are mounting

Spending Pressures: Employee Compensation & Benefits

Fiscal Facts

- General Fund supported payroll exceeds $11 billion annually - Education employment comprises 81% of that annual amount
- Teachers' and State Employees' Retirement System has 317,000 active members and 164,000 retirees receiving benefits of $3.3 billion annually

Fiscal Facts

- State Health Plan enrolls 666,000 employees, retired employees and their respective covered dependents and has total annual paid claims of over $2.5 billion

Spending Pressures: Employee Compensation & Benefits

Opportunities for Budget Change

- Evaluate minimum benefit eligibility requirements for post employment benefits

- Evaluate alternative benefit plan designs

Constraints For Change

- Growth in health benefit costs largely outside of State control – Costs driven by medical price inflation and demand consumption

- Savings associated with changes may not be immediate and likely will accrue over time

Spending Pressures: Capital/Debt Service

Fiscal Facts

- $707 million for debt service (FY 2010-11); 3.8% of current net General Fund appropriations
- 12% growth in debt service since FY 2000-01
- $3.3 billion in debt authorized since 2004
- Last GO bonds[1] authorized in 2000 ($3.1 billion)

Legislative Actions

- Authorized $688 million in special indebtedness during 2009 & 2010 Sessions

[1]The bonds authorized in 2000 were the last GO Bonds authorized by a vote of the people. However, in FY 2010, the Legislature authorized $487.7 of GO Bonds known as "Two-Thirds Bonds."

Spending Pressures: Capital/Debt Service

Opportunities for Change

- Examine current $1.5 billion authorized to reduce future debt service payments

Constraints for Change

- Significant backlog of needs

Spending Pressures: Other Areas

- Economic Development
- Savings Reserve Account (Rainy Day Fund)
- Unemployment Debt
  - State has borrowed $2.35 billion from the federal government as of 11/25/2010
  - One of 32 states that has borrowed
  - Without federal action, interest will begin January 2011 and repayment September 30, 2011
- Transportation

For Additional Information

- Fiscal Research Division Contacts (733-4910)
  - Barry Boardman, Economist
  - Karen Hammonds-Blanks, House Budget
  - Richard Bostic, House Budget
  - Evan Rodewald, Senate Budget
  - Susan Morgan, Senate Budget