GENERAL FUND REVENUE AND BUDGET OVERVIEW

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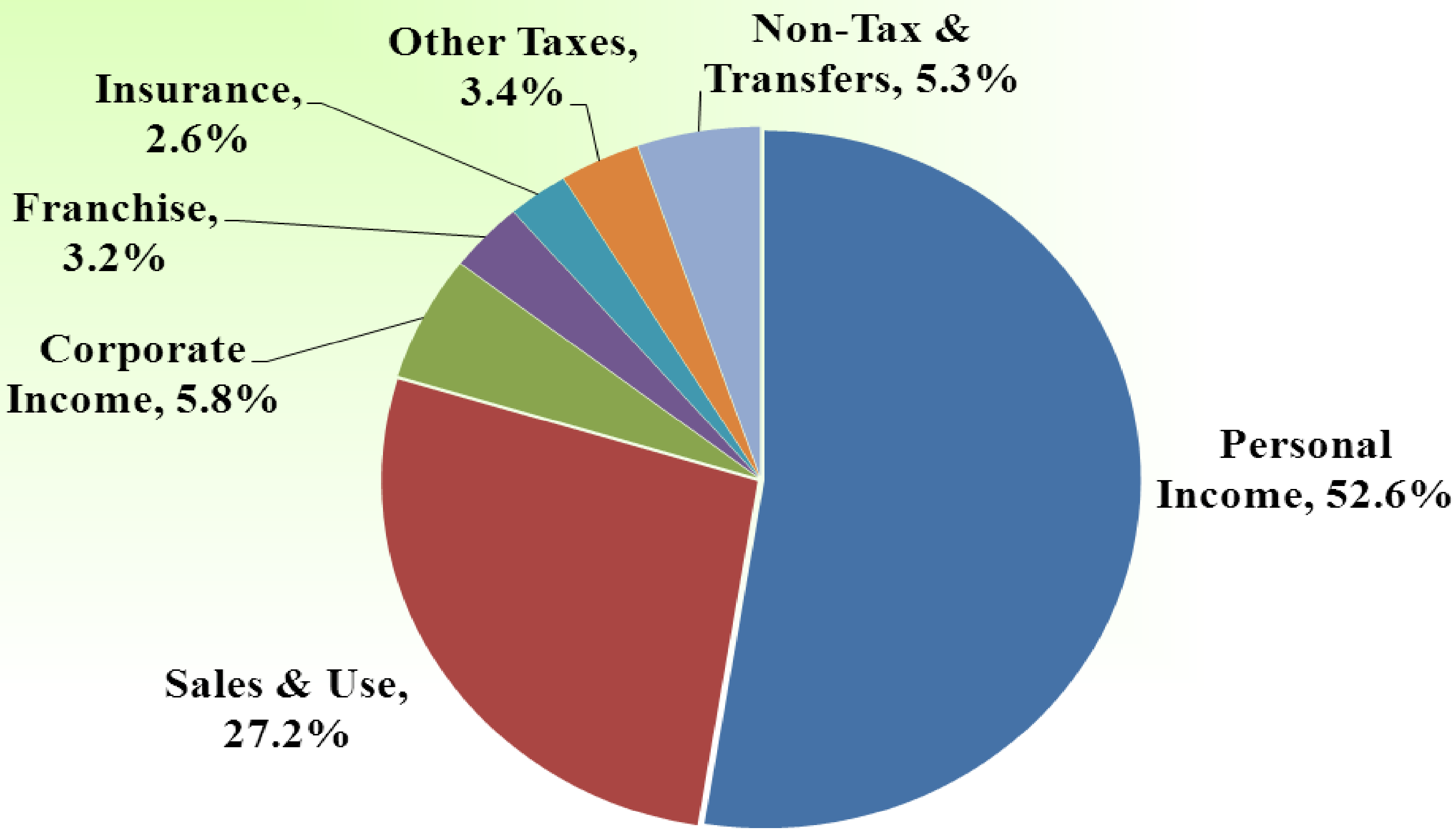
Presentation Outline

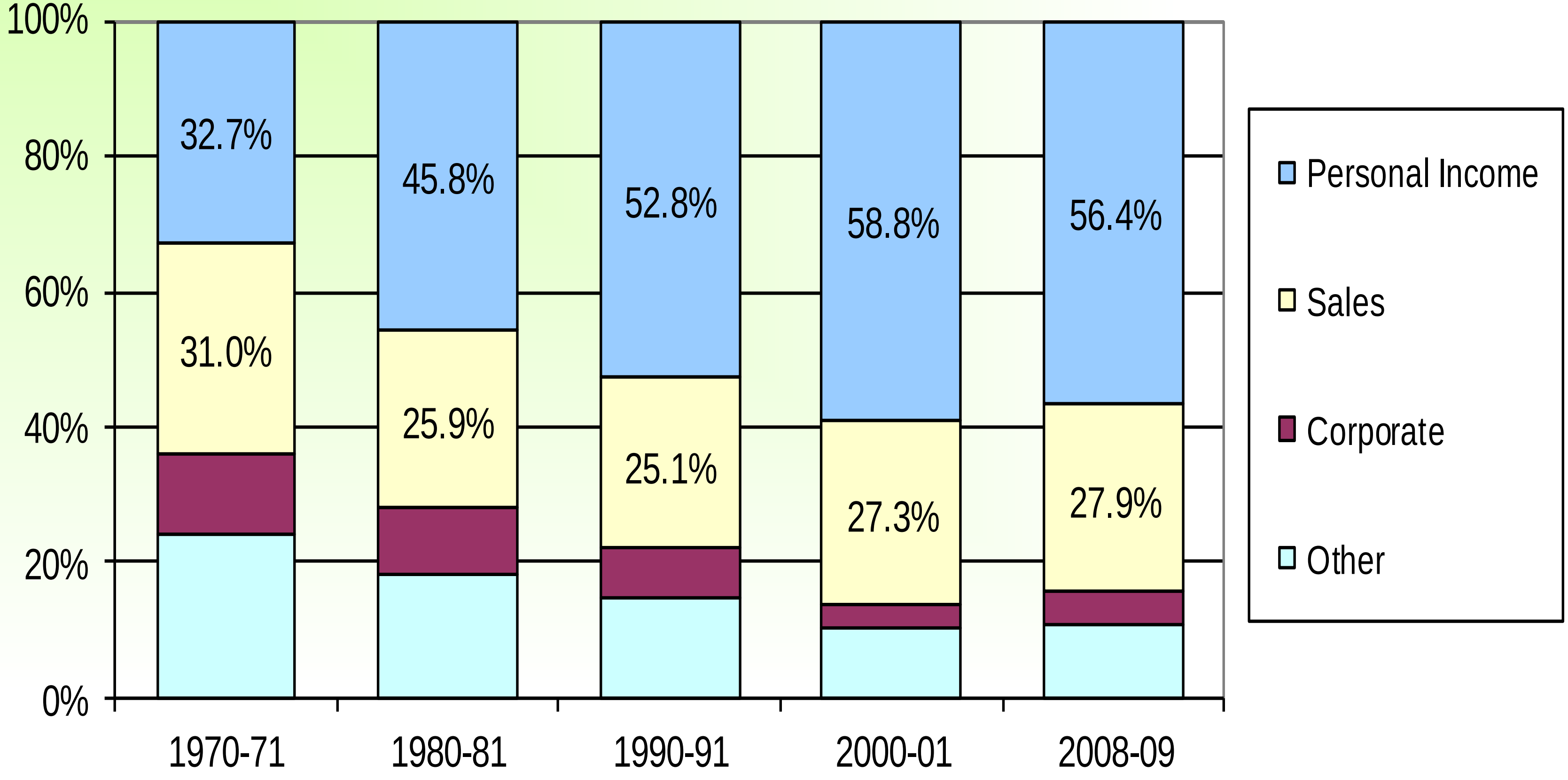
- Overview of General Fund Revenue
- Key Economic and Revenue Trends
- State Budget Overview

Overview of General Fund Revenue

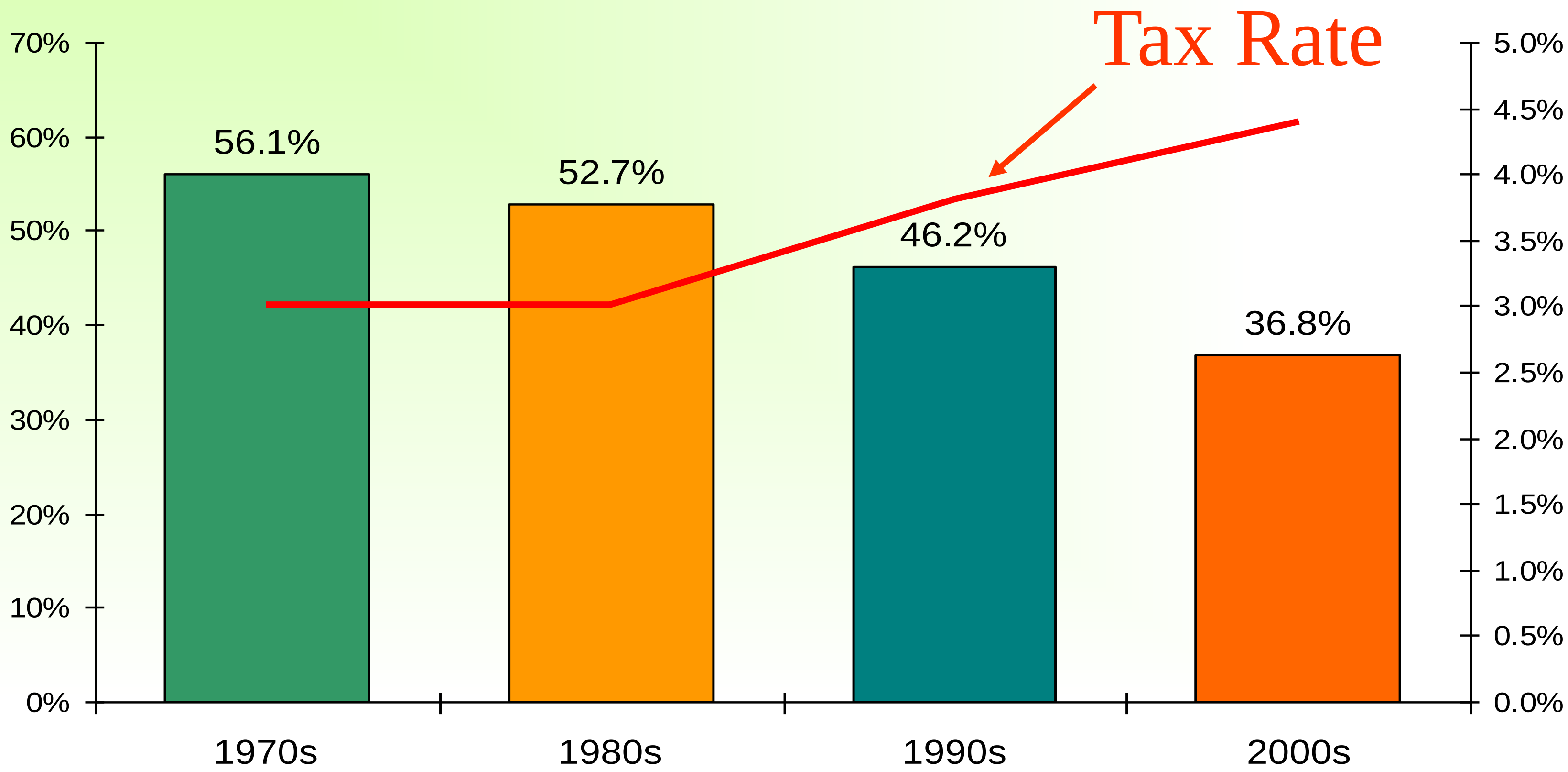
Average State General Fund, FY 2000-01 to FY 2009-10



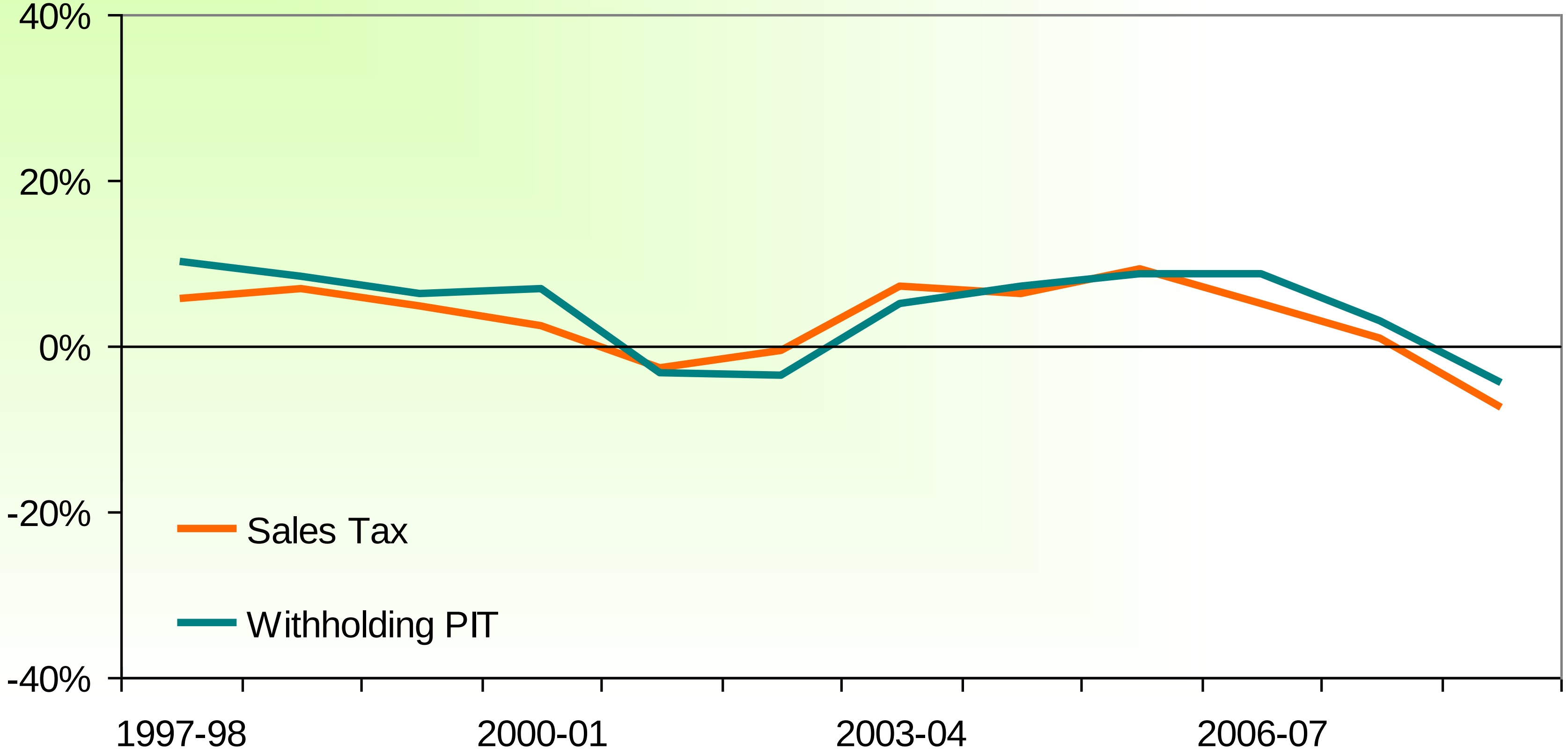
State Tax Structure



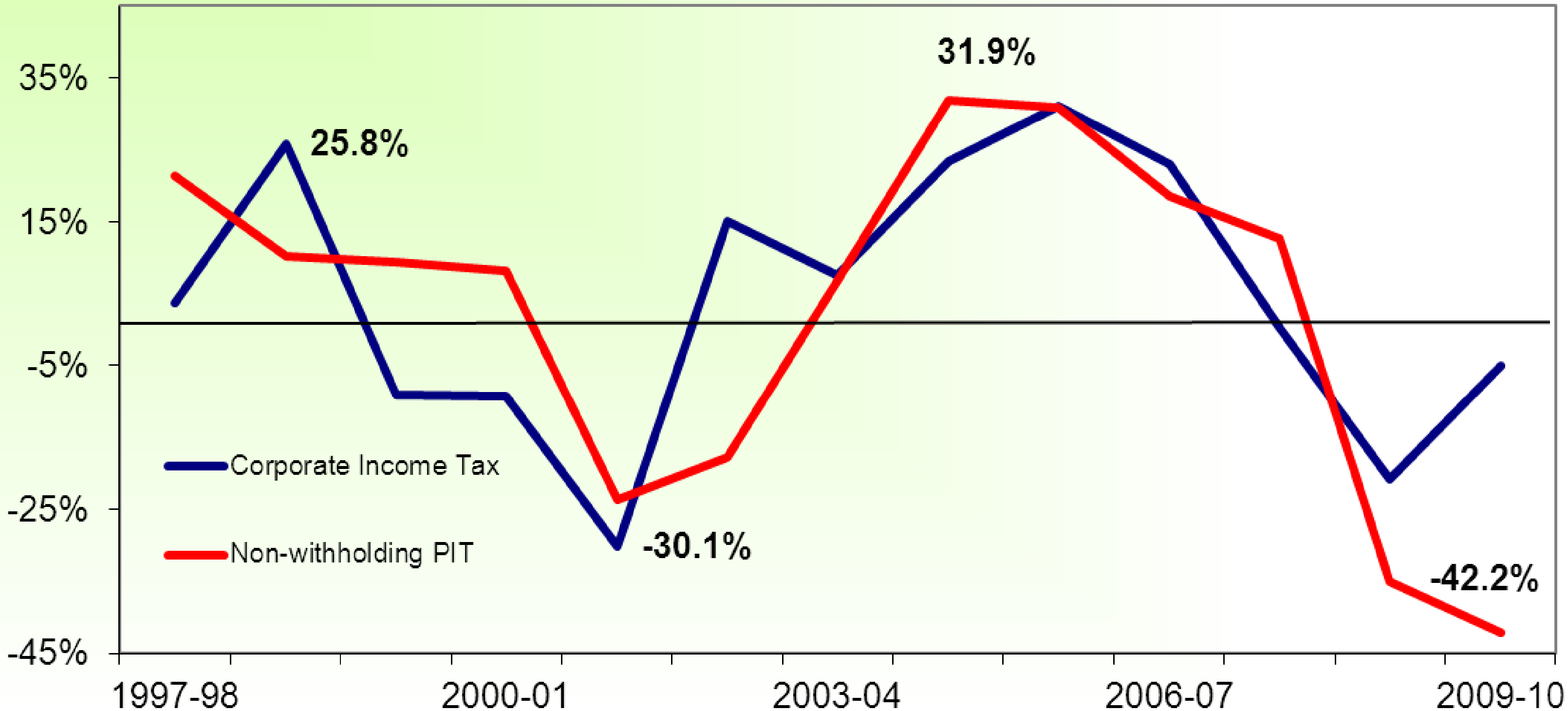
Sales Tax Base and Rate



Stable Sources of Revenue



Volatile Sources of Revenue



Consensus Revenue Process

- Statutory Guidelines do not address the budget revenue forecast
- Since the 1990s, a consensus forecast has been used
- Fiscal Research and the 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

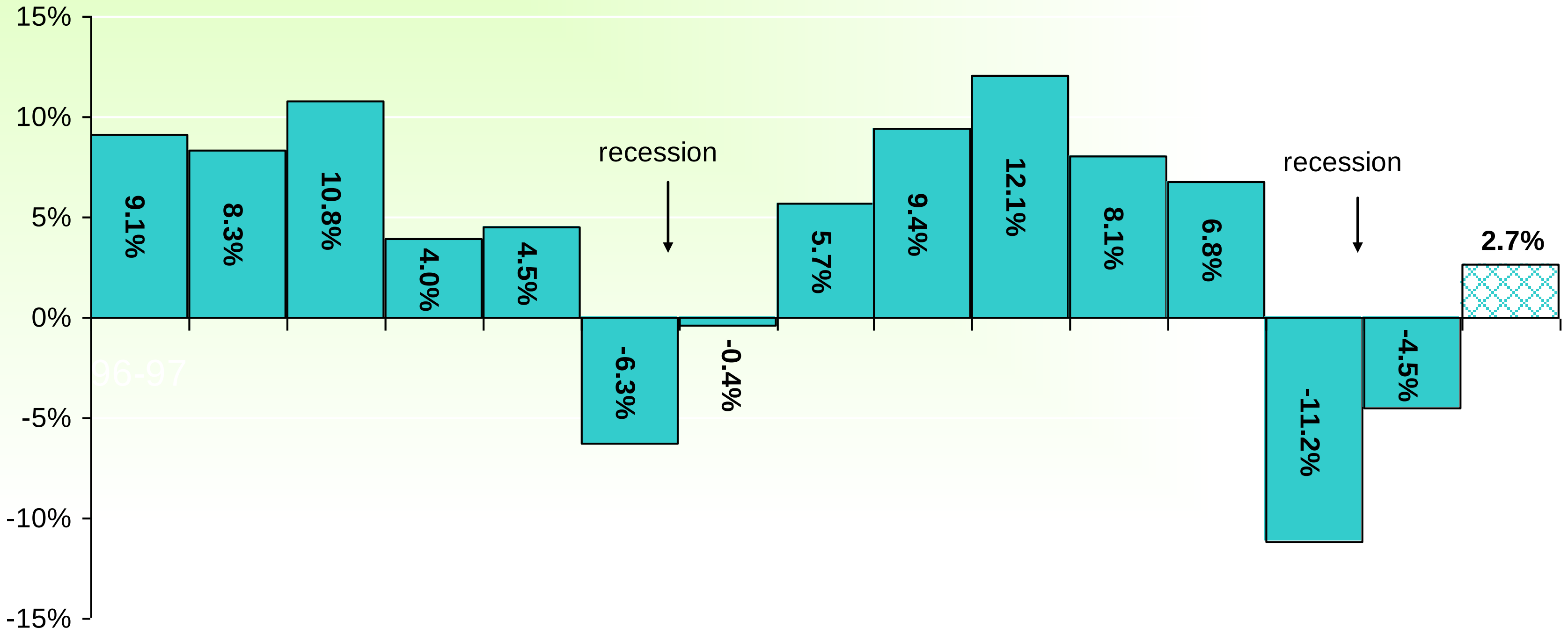
- Finally, a small informal revision may be warranted before final passage of the budget
- In even-numbered years
  - a consensus revision to the second year biennium forecast takes place in early May

Current State Revenue and Economic Trends

Current GF Revenue

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

Baseline Revenue Growth, FY 1996-97 to FY 2010-11



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

How Do 2010-11 Revenues Look So Far?

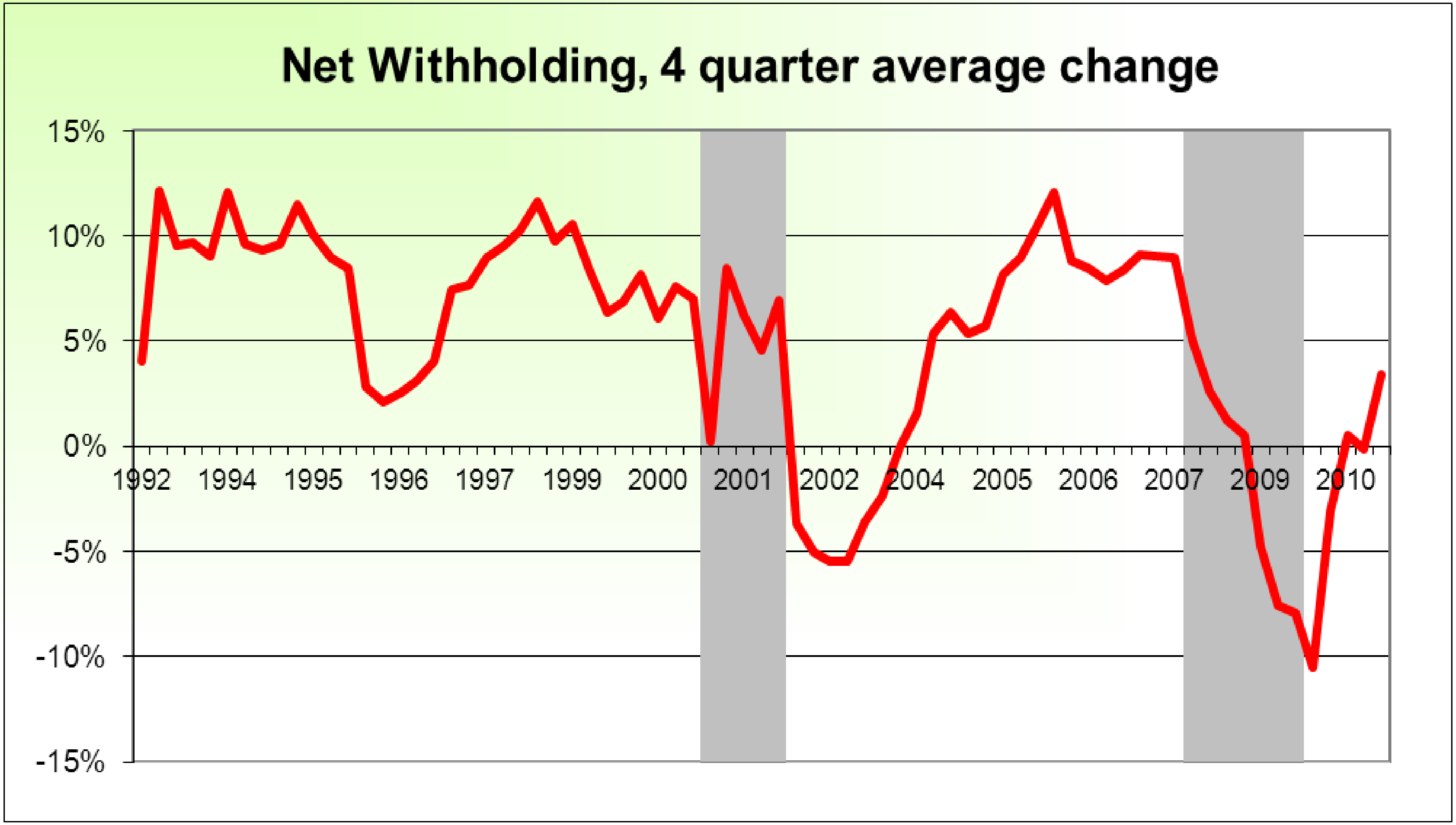
- Collections through December are meeting the $9.4 billion target.
- Key revenue sources have started to rebound.
- Caveat: Most of the forecast risk occurs in second half of the fiscal year.

How Do 2010-11 Revenues Look So Far?

- Net income tax withholdings are up 1.1%.
- Sales tax collections have improved significantly
  - December gross collections were up over last year 8.5%.
- Baseline (tax-adjusted) sales collections for the second quarter of the fiscal year were up 2.7%.
  - Still 13% below where we were December 2007.

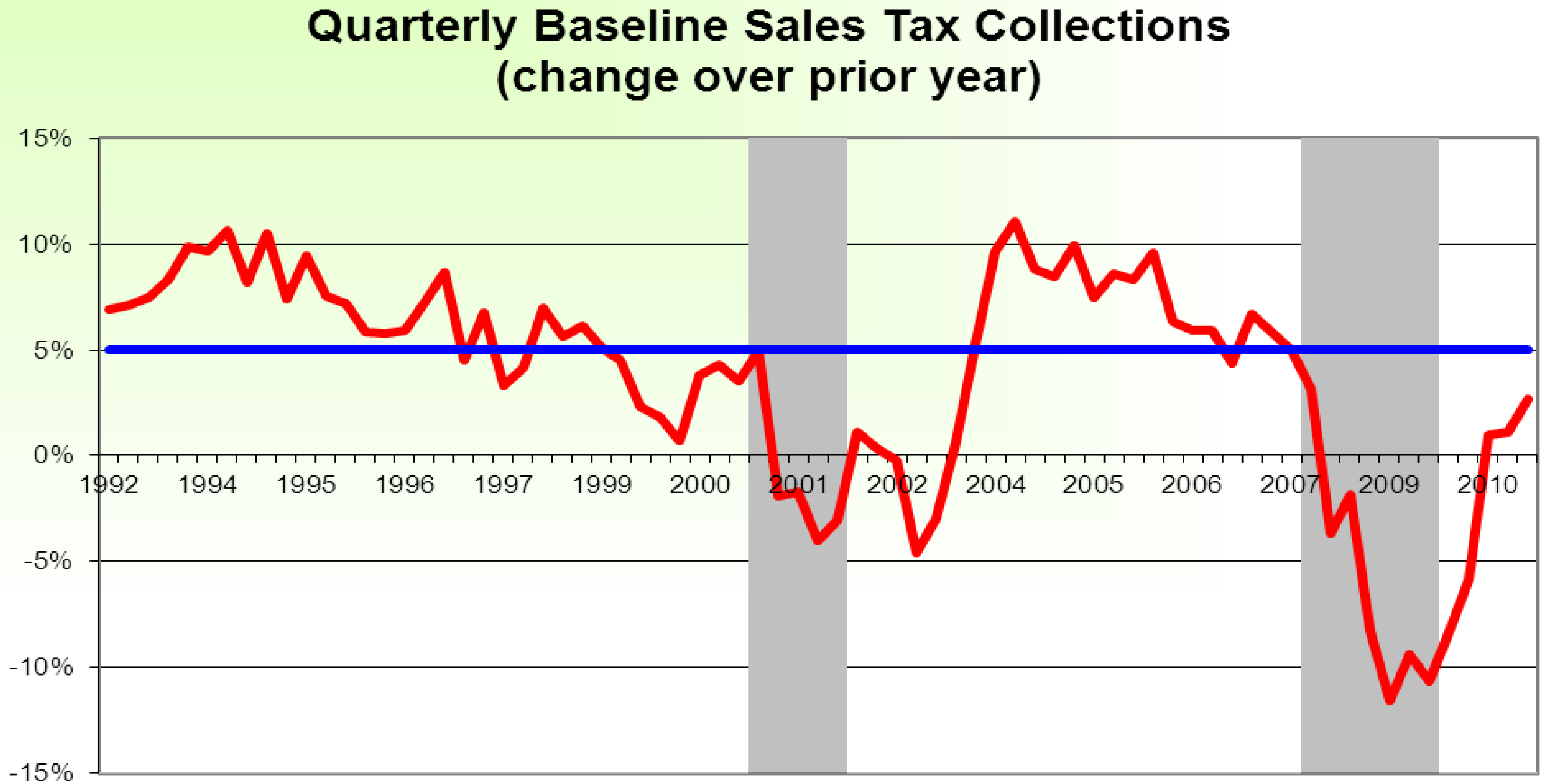
Tracking Economy-Based Collections

Personal income withholdings less refunds continue to strengthen.



Tracking Economy-Based Collections

Baseline sales tax collections have moved into positive growth territory despite weak consumer confidence and very little positive news available on the employment picture.



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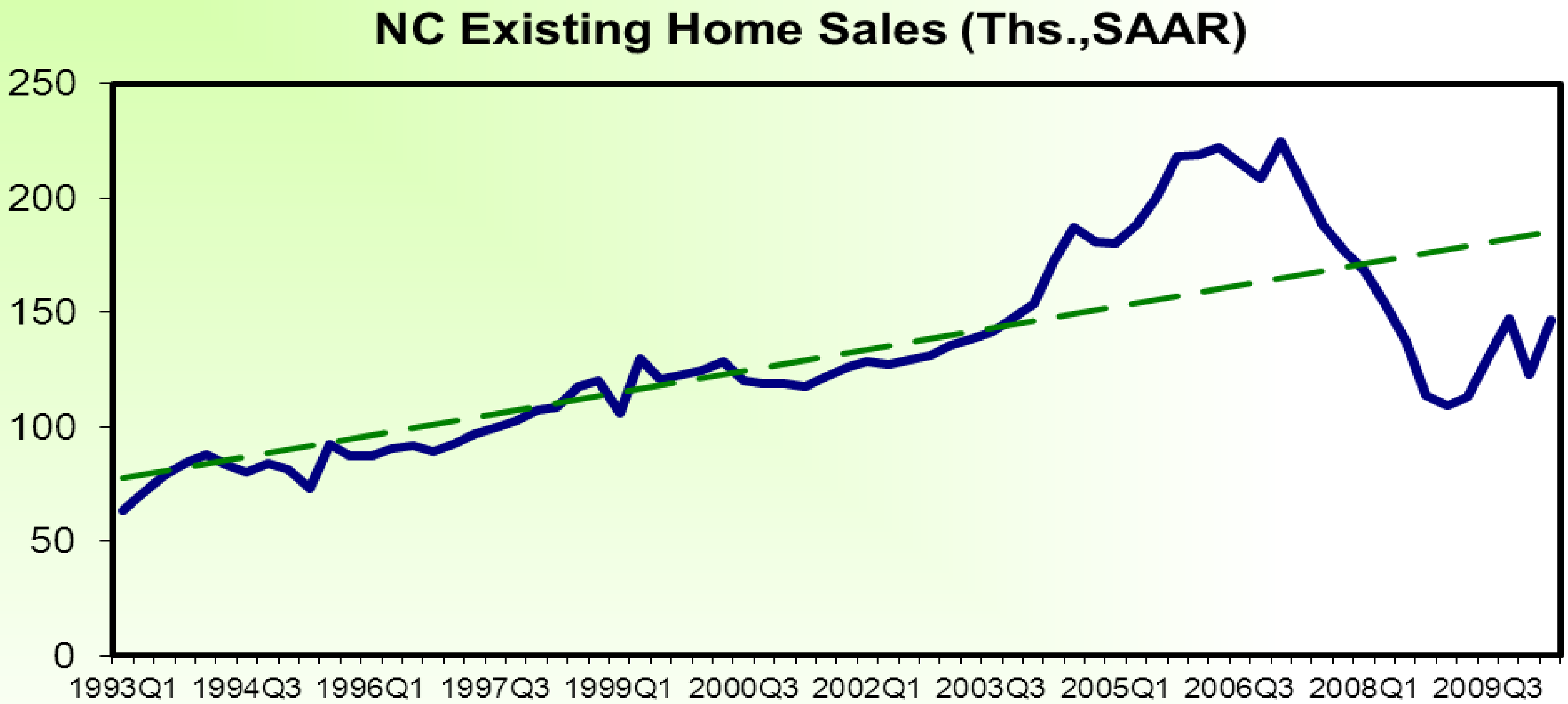
Economic Outlook

- National economic data suggests economy is beginning to accelerate.
- Most forecasters are upgrading their national economic outlook.
- Robust economy is still a year away.

State's Economic Outlook

- Economic recovery is gaining strength - headwinds from housing market's problems plus weak employment will be a drag on growth.
  - The housing market is still out of balance
  - Foreclosures will prolong the housing market's woes
  - Existing home sale prices across the State continue to fall and were down 1.9% in the third quarter of 2010
  - Since the start of the recession, the average price of an existing home sold in the State has dropped 12%.

Key Economic Trends



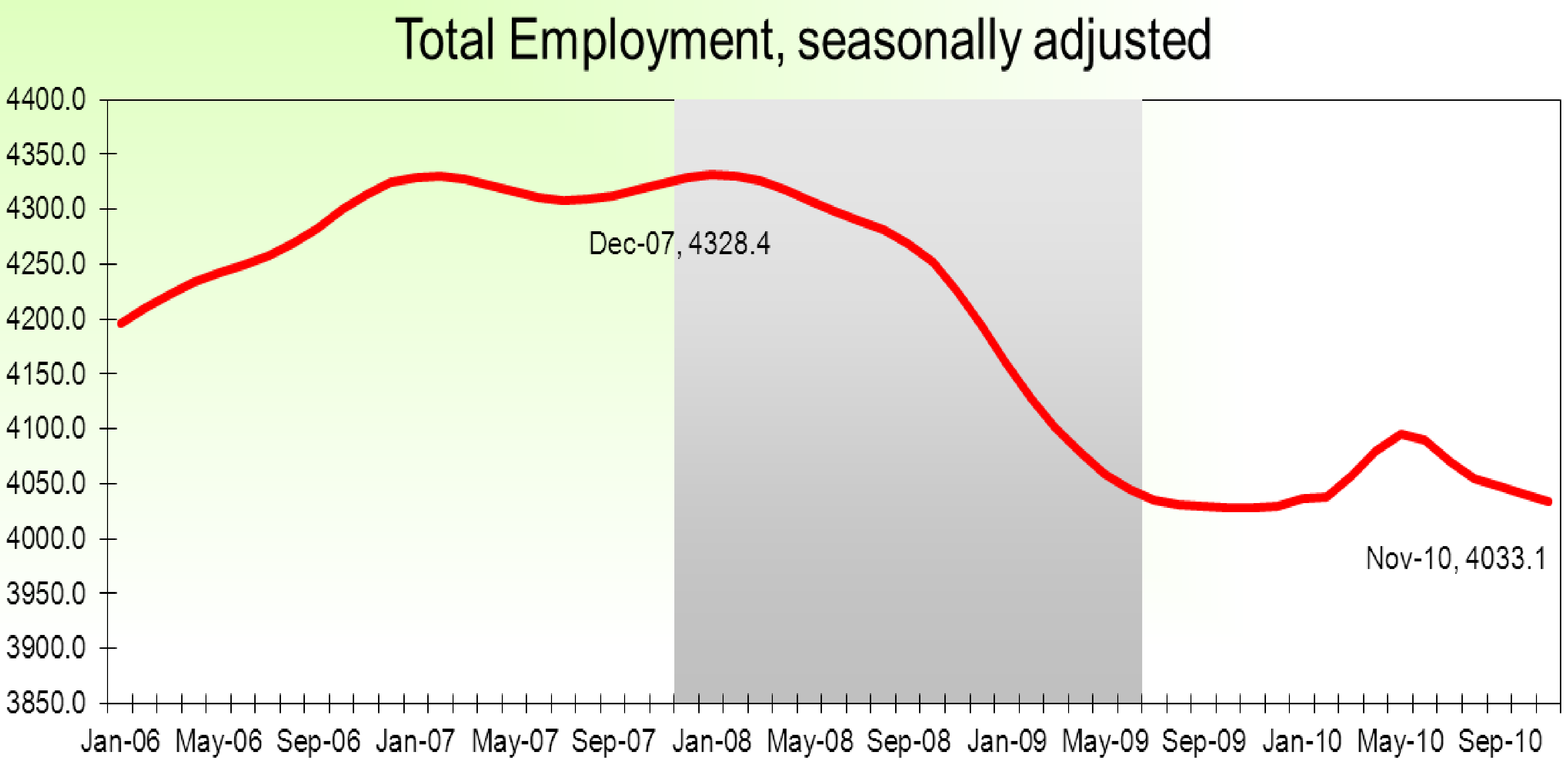
The dotted line traces the long range trends established in the 1990s. Existing home sales are expected to remain below this trend throughout 2011.

State’s Economic Outlook

- Employment in most industry sectors remain near recession levels.
  - The good news is that both wages and hours worked have started to increase. This is typically a precursor to an increase in hiring.
- Construction, Manufacturing, Trade, and Entertainment and Hospitality have experienced Y/Y losses in employment.

Key Economic Trends

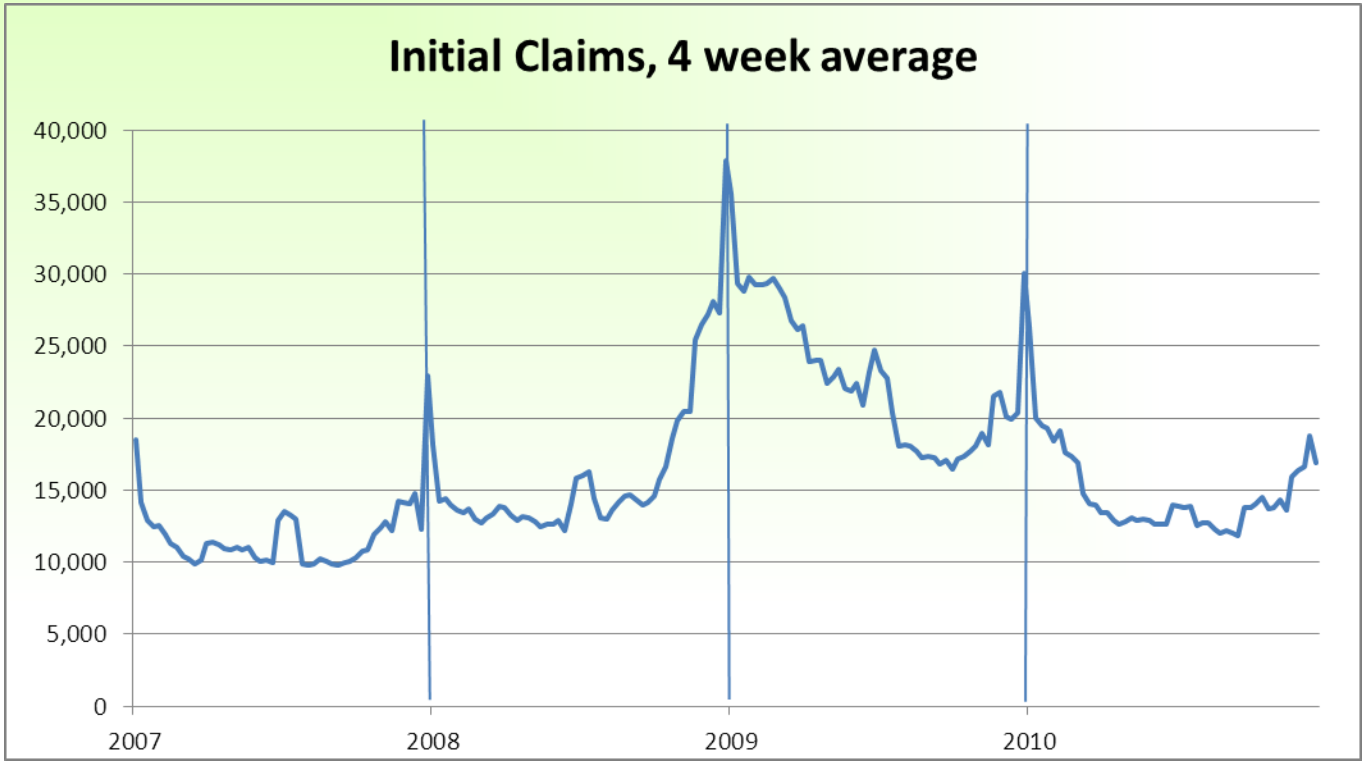
Total employment is down 290,000 jobs since start of recession.



Source: NC Employment Security Commission

Key Economic Trends

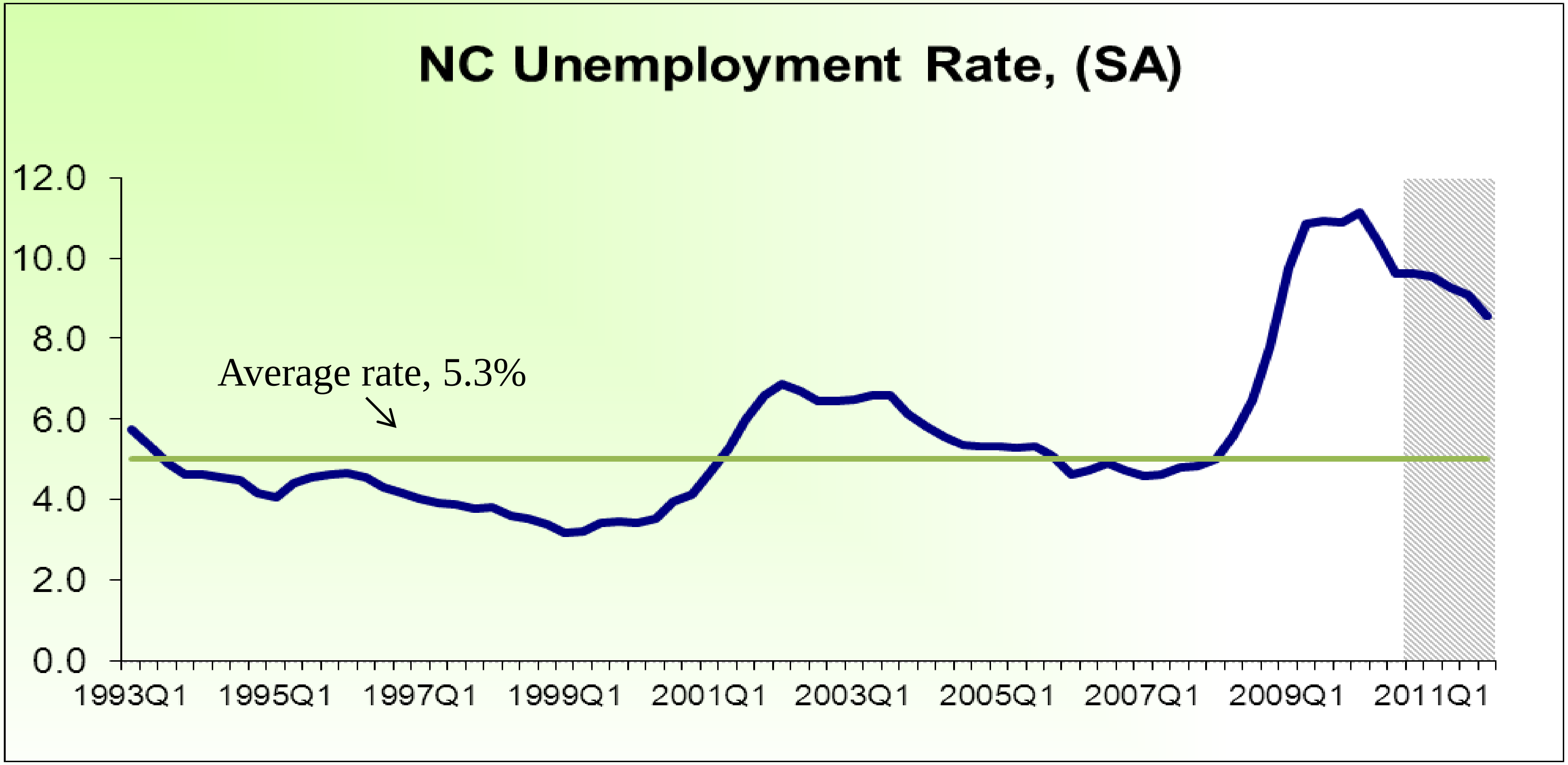
Initial claims, a measure of the number of jobless claims filed by individuals seeking to receive State jobless benefits, have dropped significantly since the onset of the recession. They are still elevated above the pre-recession levels of 2007.



State's Economic Outlook

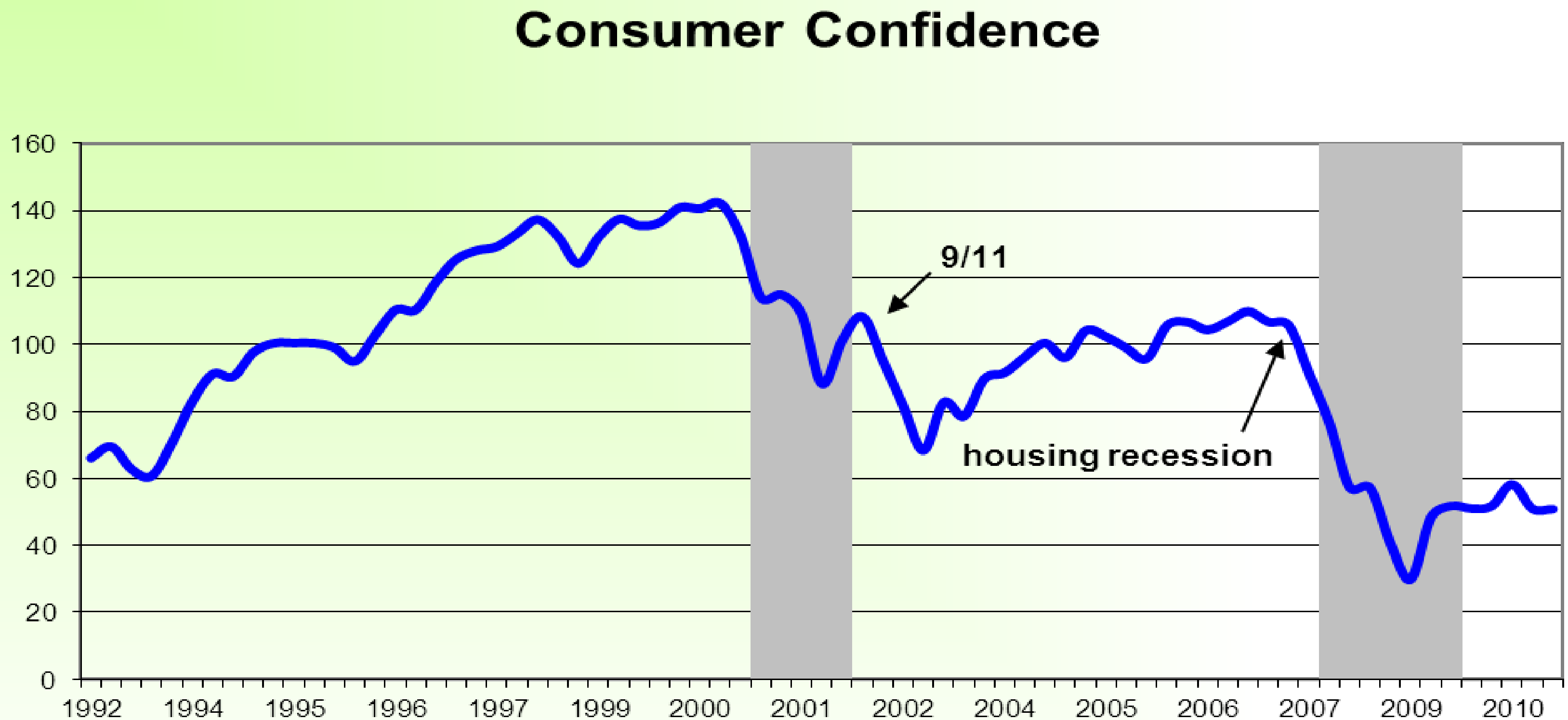
- The economy in 2011 will build on the improvements that were underway the second-half of 2010; the question is, by how much?
- State forecasters are not expecting significant changes in employment until the second half of 2011
  - The slow rate of recovery unfortunately is consistent with recessions caused by structural problems in the financial markets

Key Economic Trends



The unemployment rate (forecast shaded in gray) is expected to remain above 9% even as employment numbers improve.

Key Economic Trends



•Source: The Conference Board

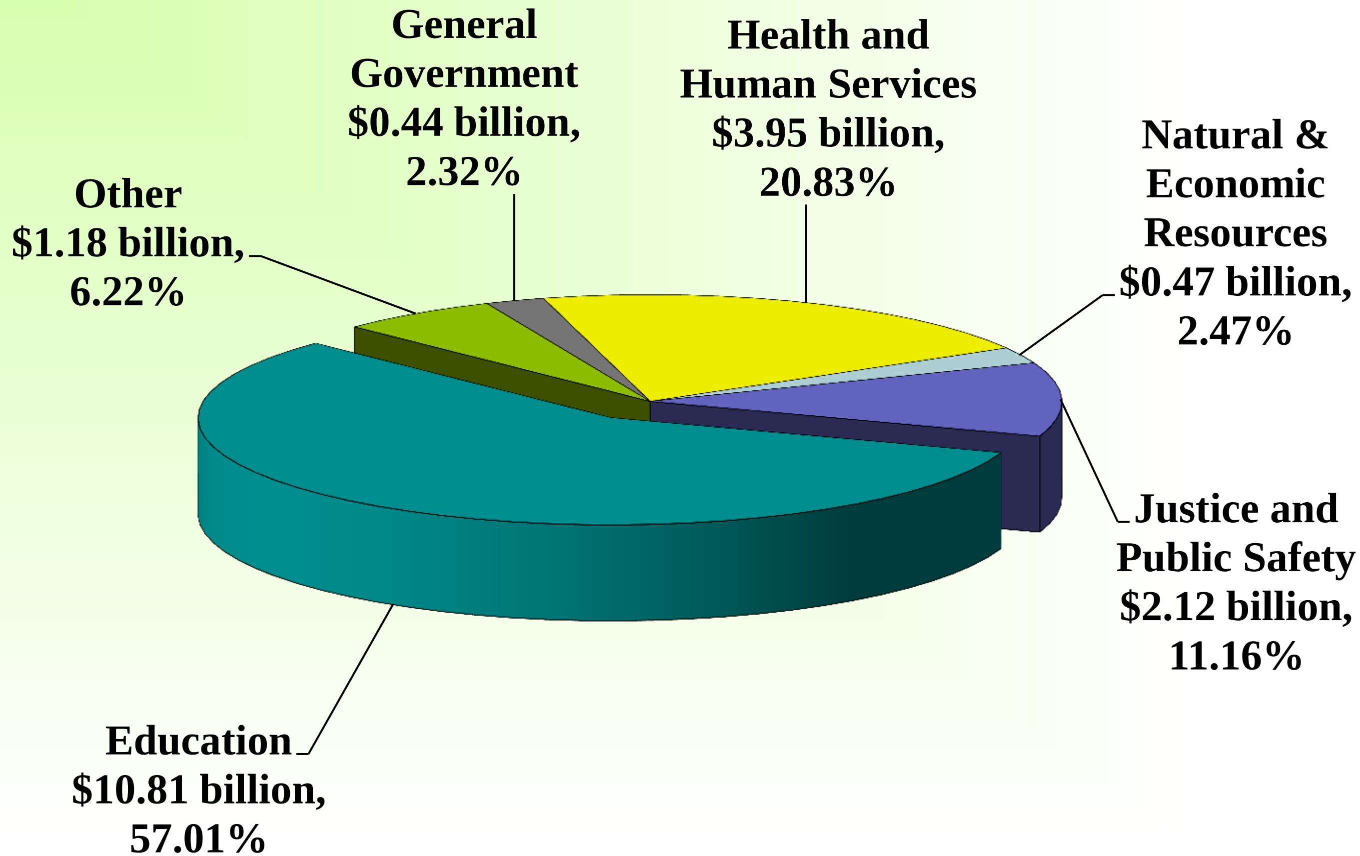
The rebound in consumer confidence has stalled-out Confidence remains affected by the weak employment news and the shaky housing market.

Key Points

- General Fund revenue is on target
- Sales tax collections and withholding income tax are slightly ahead of projections and improving
- The economic recovery is finally starting to gain solid footing
- Economic improvement to accelerate throughout 2011 - growth will remain modest

State Budget Overview

FY 2010-11 General Fund Budget



[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.

10 Year Change in General Fund Budget
($ Billions)*

	2000-01 Budget	2010-11 Budget	2010-11 Budget w/ARRA	Total Growth w/ARRA
Education	$7.58	$10.81	$11.33	49.5%
Medicaid	1.43	1.81	2.79	95.1%
All Other HHS	1.49	1.58	1.72	15.4%
JPS	1.49	2.12	2.13	43.0%
NER	0.34	0.47	0.47	38.2%
Gen. Gov.	0.35	0.44	0.44	25.7%
Debt Service	0.24	0.72	0.72	200.0%
Reserves, Other	0.91	0.46	0.46	-49.5%
Total	**$13.81**	**$18.41**	**$20.06**	**49.3%**

Sources: FRD Overview of 2000 Session and 2010 OSBM Budget Summary Chart

*The NER budget includes the Clean Water Management Trust Fund. The FY 2010-11 Medicaid budget excludes $562 million in Medicaid county swap.

Putting Budget Growth in Perspective

Consumer Price Index (CPI)

- CPI grew 26.2% from July 2000 to July 2010
- The healthcare component of the CPI grew 48% from August 2000 to August 2010

Source: U.S. Department of Labor, Bureau of Labor Statistics

Putting Budget Growth in Perspective

Population

From July 2000 to July 2009, the NC population grew:

- 10.6% for ages 5 to 17
- 19.3% for ages 17 to 24
- 22.2% for ages 65+
- 16.6% overall

Source: U.S. Census Bureau; OSBM State Data Center

Putting Budget Growth in Perspective

Workloads

- The Medicaid caseload grew 62.6% from 2000 to 2010.
- UNC system headcount increased 38.1% from FY 1999-00 to FY 2009-10.
- The Community College System FTE increased 65% from FY 1999-00 to FY 2009-10.

Source: State Agency Reports

FY 2011-12 Base General Fund Budget

Subcommittee/Area	Net Appropriation[1]	% of Total
Education	11,525,670,684	55.27%
Health & Human Services	5,062,966,609	24.28%
Justice & Public Safety	2,176,990,485	10.44%
Natural & Economic Resources	471,533,874	2.26%
General Government	442,742,632	2.12%
Debt Service	707,521,563	3.39%
Salaries & Benefits - Reserves	437,479,709	2.10%
Other Reserves	29,640,000	0.14%
TOTAL	**$20,854,545,556**	**100.00%**

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

Preliminary FY 2011-12 Budget Estimate

FY 2011-12 OSBM Preliminary Base Budget	**$20.85 billion**
State Retirement System Contribution	+ 0.30 billion
State Health Plan	+ 0.15 billion
Enrollment Growth (K-12, Community College and UNC)	+ 0.11 billion
Medicaid	+ 0.20 billion
Preliminary Estimate FY 2011-12 Budget	**$21.6 billion[1]**

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

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]
  - 38.1% 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
- 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 663,000 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% annual growth in debt service since FY 2000-01
- $3.3 billion in debt (COPs) 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 (but unissued) debt to reduce future debt service payments

Constraints for Change

- Significant backlog of needs

Spending Pressures: Other Areas

- Savings Reserve Account (Rainy Day Fund)
- Transportation
- Unemployment Debt
  - State has borrowed $2.57 billion from the federal government as of 1/21/2011
  - One of 30 states that has borrowed
  - Interest at 4.1% began accruing January 1, 2011
  - First payment due by September 30, 2011 (ESC has $90 million in reserve fund to cover this payment, if needed)

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

For Additional Information

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