MINNESOTA Management & Budget

November 2008

HIGHLIGHTS

$426 Million Deficit in FY 2008-09 - $4.847 Billion Shortfall Expected for FY 2010-11

The U.S. economy has weakened significantly since February. A longer and deeper recession than previously anticipated is now underway. Revenues are expected to fall $412 million (1.3 percent) below prior estimates. When combined with small increases in spending the result is a $426 million deficit for the current biennium.

FY 2010-11 revenues are now forecast to fall 9.4 percent below previous estimates, reducing projected revenues by $3.321 billion. That revenue reduction, combined with projected spending increases of $580 million, increase the expected budget deficit for the coming biennium to $4.847 billion. At the close of the 2008 legislative session a $946 million shortfall was projected.

U.S. Economic Outlook Has Deteriorated Significantly

As projected in February a recession started in late 2007, however, the problems facing the U.S. economy have proven to be much more difficult to remedy than anticipated. Global Insight's November baseline scenario includes a 1.0 percent reduction in real GDP in 2009 and slightly over 1.5 percent growth in 2010. It is not until the start of 2011 that the economy begins to grow at its trend (3 percent) growth rate. This downturn has already lasted longer than either of the two most recent recessions and most forecasters believe the economic decline will intensify between now and early summer.

Falling Revenues and Higher Spending Drive Budget Outlook

FY 2010-11 revenues will be 1.8 percent, or $579 million, below levels forecast for the 2008-09 biennium, while current law spending is expected to grow by 6.1 percent over FY 2008-09 levels. About 40 percent of the $579 million decline in revenues from the 2008-09 biennium is due to the economic slump. The remainder is caused by revenue reductions already in end-of-session estimates. Projected expenditure increases are concentrated in health care programs.

400 CENTENNIAL BUILDING ♦ 658 CEDAR STREET ♦ ST. PAUL, MINNESOTA 55155 ♦ (651) 201-8000

November Forecast

BUDGET SUMMARY

Weakening U.S. Economy Creates State Budget Deficit in Current Biennium – Projected Shortfall Grows Substantially in 2010-11 Biennium

The problems facing the U.S. economy are no longer limited to those of financial institutions and the housing sector. Consumer spending is falling, setting up a vicious, self-reinforcing cycle in which declining consumer spending produces a reduction in the demand for workers, which in turn causes consumer spending to decline further. The result has been the start of a recession that is expected to be more severe than average. As always, state government revenues will be a casualty of the economic downturn.

The recession reduces revenues and adds slightly to expenditures in the current biennium. State budget problems will compound in the 2010-11 biennium as revenues fall further below estimates and expenditure projections increase. Compared to budget projections made at the end of the 2008 legislative session, the forecast for the current biennium has deteriorated by $432 million, leaving an expected deficit of $426 million. The outlook for the 2010-11 biennium is now much worse. Balancing the budget for the current biennium will eliminate $426 million of the total $5.273 billion budgetary shortfall projected for this next biennium, leaving a $4.847 billion prospective shortfall.

Budget Forecast, FY 2008-11

($ in Millions)

	FY 2008-09	FY 2010-11
Beginning Balance	**$2,245**	**$79**
Revenues	32,445	31,866
Spending	34,611	36,713
Budget Reserve	155	155
Cash Flow Account	350	350
Budget Balance	**($426)**	($5,273)
Shortfall (excluding FY2008-09)	**- - -**	**($4,847)**

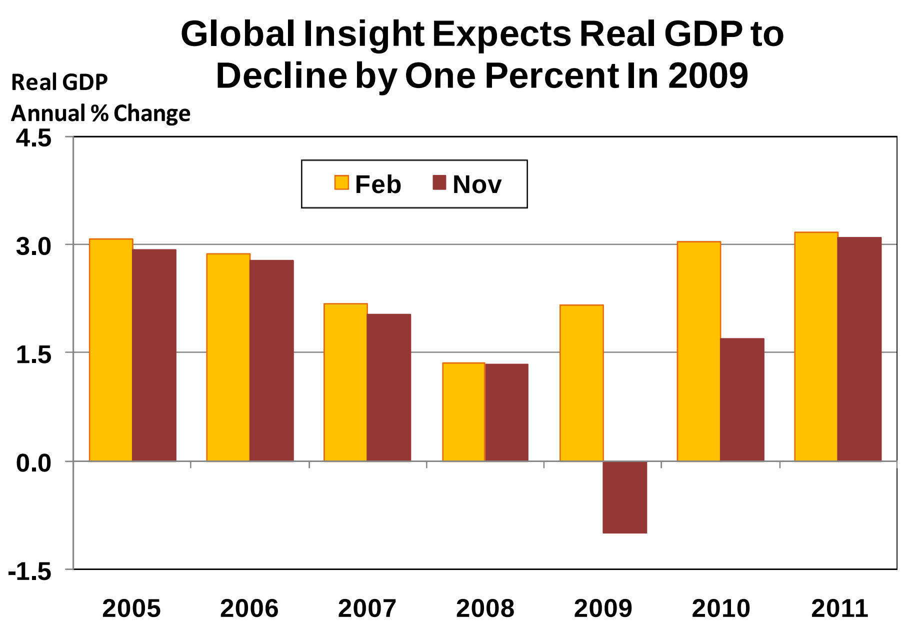
Action Required to Re-balance FY 2008-09 Budget

Because Minnesota's Constitution prohibits borrowing for operating purposes beyond the end of the biennium, options for dealing with the projected deficit for the current biennium deficit are limited. Minnesota's budget reserve, currently $155 million, is available for use, but it is not sufficient to solve the entire problem. The Governor also has authority to unallot expenditures after the budget reserve has been depleted. The state's cash flow account, used to smooth timing differences between the receipt of revenues and expenditure cash outlays within the fiscal year, is currently $350 million.

Economic Outlook Has Deteriorated Since February, 2008 Forecast

There is no longer any debate over whether the U.S. economy was in a recession when the February revenue forecast was prepared. The National Bureau of Economic Research (NBER) has declared that a recession began in December, 2007. The 2008 federal stimulus package provided some relief from the shocks to spending created by the ongoing credit squeeze and rapidly increasing oil prices, but the stimulus checks did not provide a permanent solution to all the problems facing the U.S. economy. By late summer the scope of the problems facing economic policy makers suddenly widened as a seemingly unending flow of bad economic news led consumers to increase savings and cut back spending. Consumer spending, which accounts for more than 70 percent of U.S. economic activity, fell by 3.7 percent during the third quarter. Preliminary data indicate it is extremely likely that consumption will decline again in the current quarter.

The November baseline forecast from Global Insight (GII), Minnesota's national macroeconomic consultant, assumes that real GDP will grow at an annual rate of 1.3 percent during calendar 2008, and then fall by 1.0 percent in 2009. Economic growth begins again in 2010, although at a rate much slower than normal. It is not until 2011 that real GDP growth returns to its trend rate of near 3 percent. February's GII baseline also contained a recession, but that recession was relatively mild and confined to the first two quarters of 2008. The recession in the November baseline is deeper, lasts longer, and has a slower, more extended recovery path than that in February's baseline. The Blue Chip Consensus outlook for 2009 also contains a recession, but it is slightly milder than the one expected by GII. The Blue Chip Consensus forecast calls for real GDP to decline by 0.4 percent in 2009.



The weaker economy has put inflation concerns on hold. GII now projects the Consumer Price Index (CPI) to fall by 0.9 percent in 2009. In 2010 and 2011 CPI growth rates of 2.4 percent and 3.0 percent are now anticipated. When converted to fiscal years, CPI inflation rates of 0.2 percent and 3.1 are projected for FY 2010 and 2011 respectively. Oil prices are expected to remain in the $50 range through 2009, then gradually move to the $80 range by 2011.

Global Insight assigns a probability of 60 percent to their November baseline forecast. A more pessimistic forecast which contains a longer and significantly deeper recession is assigned a probability of 25 percent. Their optimistic scenario, assigned a 15 percent probability, also contains a recession but economic growth returns to the trend rate more rapidly than in the baseline.

Budget Deficit of $426 Million Projected for June 30, 2009

The current U.S. economic recession has produced a major revision in Minnesota's budget outlook for the current biennium. General fund revenues are now forecast to be $32.445 billion, down $412 million (1.3 percent) from end-of-session estimates. State general fund expenditures for this biennium are now expected to be $34.611 billion, $18 million (0.1 percent) more than prior estimates. As required by current law, an Assigned Risk Plan surplus of $2 million was transferred to the general fund reserve in FY 2008, increasing the reserve to $155 million. The combined impact of the revenue, expenditure and reserve changes leaves a projected general fund deficit of $426 million on June 30, 2009.

FY 2008-09 Forecast

($ in millions)

	End of Session	November Forecast	Change
Beginning Balance	**$2,245**	**$2,245**	**$0**
Revenues	**32,857**	**32,445**	**(412)**
Expenditures	**34,593**	**34,611**	**18**
Budget Reserve	153	155	2
Cash Flow Account	350	350	0
Available Balance	**$6**	**($426)**	**($432)**

FY 2008-09 Revenues Fall by $412 Million

Minnesota's general fund revenues are now forecast to total $32.445 billion in the 2008-09 biennium, $412 million (1.3 percent) less than end-of-session estimates. Though small in percentage terms, this is a large change for a biennium that is almost complete. Actual receipts for FY 2008 were $398 million (2.4 percent) more than forecast, but receipts for FY 2009 are now expected to fall $810 million (4.9 percent) below earlier projections. Receipts from the individual income tax, sales tax, and the corporate income tax all are projected to decline by substantial amounts.

FY 2008-09 General Fund Revenues
Change from End-of-Session Estimates
($ in Millions)

Revenues	$ Change	% Change
Income Tax	($291)	(1.9%)
Sales Tax	(145)	(1.6)
Corporate Tax	(57)	(3.1)
Motor Vehicle	(1)	(0.4)
Subtotal	**($493)**	**(1.9%)**
Other	81	1.3
Total	**($412)**	**(1.3%)**

The forecast for individual income tax receipts has been reduced by $291 million or 1.9 percent. Projected wage growth during the 2008-09 biennium is now greater than expected in February. The additional revenue generated by the improvement in the wage outlook, however, was more than offset by reductions in forecasts for portfolio incomes, particularly capital gains, interest, and dividends. Net capital gains realizations in tax year 2008 are now projected to decline by 30 percent from tax year 2007 levels.

Sales tax receipts have been reduced $145 million (1.6 percent) from the last forecast. The projected economic slump will reduce the level of taxable sales in Minnesota in FY 2009 to a level below that observed in FY 2008. Both consumer durable spending and business equipment spending, the two largest portions of Minnesota's sales tax base, are forecast to fall more than 5 percent in FY 2009.

The corporate tax receipts forecast was reduced by 3.1 percent ($57 million), the largest percentage decline for any of the major revenues. General fund motor vehicle sales tax receipts were also reduced from February's estimates, but by only $1 million. The declines in the major revenue sources were partially offset by increases to all other revenues, which are now expected to exceed February's forecast by $81 million. Increases in insurance gross premiums receipts and fee revenues were sufficient to offset declines in other tax and non-tax revenues.

FY 2010-11 Budget Outlook Shows Projected $4.847 Billion Shortfall

General fund revenues for FY 2010-11 are now forecast to be $31.866 billion. This is a $579 million (1.8 percent) decline from the amount of revenue expected to be collected in the current biennium. Projected spending, based on current laws, is expected to reach $36.713 billion, an increase of $2.102 billion (6.1 percent) over the spending forecast for the current biennium.

At the end of the 2008 legislative session a $946 million shortfall was projected for the 2010-11 biennium. With this forecast, that shortfall has increased to $4.847 billion. When compared to the planning estimates used to prepare the end-of-session estimates, general fund revenues have been reduced by $3.321 billion (9.4 percent), while the expenditure forecast increased $580 million (1.6 percent).

FY 2010-11 Budget Forecast

($ in millions)

	FY 2008-09	FY 2010-11	$ Change	% Change
Beginning Balance	$2,245	$79	($2,166)	
Tax Revenues	29,917	29,589	(328)	
Non-Tax Revenues	1,584	1,481	(103)	
Other Resources	944	796	(148)	
Total Revenues	32,445	31,866	(579)	(1.8%)
Expenditures	34,611	36,713	2,102	6.1%
Budget Reserve	155	155		
Cash Flow Account	350	350		
Budget Balance	**($426)**	($5,273)		
Shortfall (excluding FY08-09)	**- - -**	**($4,847)**		

Revenues for the 2010-11 biennium from the sales tax and the corporate income tax are below amounts expected in the current biennium. General fund receipts from the motor vehicle sales tax are also expected to be well below amounts received in the 2008-09 biennium, mainly due to the phasing in of full dedication of motor vehicle sales tax collections to transportation funding. In addition transfers from other funds are projected to fall by $150 million from FY 2008-09 levels. If this forecast holds, this will be the first time revenues for the next biennium will be below collections for the current budget period since the 1986-87 biennium.

Nearly $1.8 billion of the growth in forecast spending occurs in health care and human services programs which are projected to increase 18.9 percent over the current biennium. Much of the change comes as additional adults, families and children become eligible for health care services due to the weaker economy. Most other areas of the budget show little growth. Expenditure estimates are based on current law adjusted only for enrollment, caseload changes, and specific formula requirements.

No adjustment is included for estimated inflation. The CPI is currently forecast to increase by 0.2 percent in FY 2010, and 3.1 percent in FY 2011. If expenditures were uniformly adjusted for estimated inflation, it would add approximately $650 million in spending and increase the projected shortfall by a like amount.

Forecast for FY 2010-11 Revenues Down $3.321 Billion from End-of-Session Estimates

Minnesota general fund revenues for the 2010-11 biennium are forecast to be $31.866 billion, $3.321 billion (9.4 percent) less than projected in end-of-session planning estimates. This is the first official forecast of FY 2010-11 revenues using complete models and detailed assumptions. While the transition from planning estimates to forecast often changes the revenue outlook, the new economic assumptions used in this forecast have produced a drop in revenues substantially larger than past experience. The reduction in the individual income tax alone exceeds the total change in forecast revenues in November, 2002, a forecast which occurred at a comparable point in the budget cycle.

FY 2010-11 General Fund Revenues
Change from End-of-Session Estimates
($ in Millions)

Revenues	$ Change	% Change
Income Tax	($1,748)	(10.1%)
Sales Tax	(826)	(8.7)
Corporate Tax	(640)	(31.3)
Motor Vehicle	(10)	(9.0)
Subtotal	**($3,224)**	**(11.1%)**
Other Revenues	(97)	(1.5)
Total	**($3,321)**	**(9.4%)**

Individual income tax receipts are expected to fall by the largest amount, $1.7 billion. While growth recovers in tax year 2010, the 0.2 percent growth rate forecast for tax year 2009 leaves total wage growth for the biennium well below that previously anticipated. Portfolio income also declines further in tax year 2009 but recovers in 2010. For tax year 2010 Minnesota taxable income is about 6.5 percent greater than in tax year 2008.

In the 2010-11 biennium both sales tax receipts and corporate income tax receipts are projected to fall below expected collections in the 2008-09 biennium. Corporate tax receipts show the largest percentage decline from end-of-session estimates, down 31 percent or $640 million. Much of that decline is due to a recession related reduction in corporate profits. Recent merger and acquisition activity in Minnesota was also incorporated into the corporate revenue estimates. Sales tax receipts are now forecast to fall $826 million (8.7 percent) below end-of-session estimates and $345 million below the level projected for the 2008-09 biennium. Cutbacks in consumer spending, business equipment spending, and purchases of building materials reduce the Minnesota's sales tax base. The sales tax base is likely to remain below its 2007 level until FY 2011.

Forecast for FY 2010-11 Expenditures Up $580 Million from End-of-session Estimates

Projected spending in FY 2010-11 is $580 million higher than end-of-session estimates. A $498 million increase in estimated health and human services spending is the primary driver of this change. Higher than expected health care enrollment caused by the weakening economy accounts for over three-quarters of this forecast increase.

Other forecast increases include debt service ($45 million) and property tax aids and credits ($28 million). Higher interest rates on new bond issues and lower investment earnings on bond-related balances result in higher debt service costs. Increases in property tax refund and credit programs are partially offset by downward revisions to estimates of police and fire pension aid.

K-12 education spending declined $22 million from previous estimates, due primarily to lower pupil unit projections and a reduction in the general education forecast. An $18 million reduction in Department of Corrections costs reflects a lower than anticipated prison population growth rate in the public safety area.

FY 2010-11 Expenditures - Forecast Changes

($ in millions)

	End of Session	November Forecast	$ Difference
K-12 Education	$13,925	$13,903	($22)
Higher Education	3,158	3,158	0
Property Tax Aids & Credits	3,391	3,419	28
Health & Human Services	10,908	11,406	498
Public Safety	1,715	1,697	(18)
Debt Service	1,022	1,067	45
All Other	1,931	1,933	(2)
Subtotal	**$36,050**	**$36,583**	**$533**
Dedicated Expenditures	83	130	47
Total	**$36,133**	**$36,713**	**$580**

Planning Estimates Outlook

Most states currently are facing sizeable budget problems and many national observers of state finances suggest that states are unlikely to see improvements in their fiscal positions for four to five years. Historically, state revenues and fiscal stability lag economic recovery. For this reason, a longer term outlook is a useful measure when formulating state budget plans.

This report provides the first revenue and expenditure planning estimates for the 2012-13 biennium. The planning estimates provide a necessary framework against which the potential impact of FY 2010-11 budget decisions can be judged. Projected revenues for FY 2012-13 are based on long-term trends of economic growth not a specific short-term forecast.

Expenditure planning estimates do not include any tax or spending changes beyond those in current law. Current law spending estimates have been adjusted only to reflect enrollment and caseload growth in entitlement programs and areas where specific statutory formulae exist. Expenditure estimates are not adjusted for inflation. Since the impact of inflation is not included in the expenditure projections, it is important to recognize that inflation and historical growth trends in state spending may create spending pressures in addition to those reflected in the planning estimates.

FY 2012-13 Long Term Planning Estimates
($ in millions)

	FY 2008-09	FY 2010-11	FY 2012-13
Revenues	$32,445	$31,866	$34,558
Spending	34,611	36,713	39,162
Difference	**($2,166)**	**($4,847)**	**($4,604)**
Inflation (estimate)		*$650*	*$1,500*

The planning estimates shown above display projected revenues compared to projected spending. Balances or deficits from prior years, as well as any reserves, are excluded. For example, FY 2008-09 began with a $2.245 billion balance that offsets a significant portion of the revenue-expenditure gap in the biennium. The differences shown by biennium highlight the "structural" gap – how much more is being spent than collected.

These expenditure and revenue planning estimates make no assumptions about any actions taken in the 2009 legislative session to balance the FY 2009 deficit, or to resolve the FY 2010-11 budget gap. The FY 2012-13 planning estimates are simply a benchmark for assessing whether ongoing spending exceeds revenues. Changes in the economic outlook, as well as changes to the budget, will materially affect the planning estimates for the 2012-13 biennium.

Spending projections for FY 2010-11 and FY 2012-13 do not include estimated inflation. Inflation, based on the CPI, is forecast to be 0.2 and 3.1 percent for FY 2010 and FY 2011 respectively. At these levels, the cost of inflation would be $650 million in the next biennium.

For FY 2012-13 inflation is expected to average 2.5 percent per year. Simply applying forecast inflation to current law projected spending would add about $1.5 billion to FY 2012-13 spending.

A complete version of this forecast can be found at the Minnesota Management & Budget's World Wide Web site at http://www.mmb.state.mn.us/. This document is available in alternate format.

FORECAST FUNDAMENTALS
About the Revenue and Expenditure Forecast

The November forecast establishes the starting point for FY 2010-11 budget considerations. 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 balances for FY 2008 and compares how actual revenue collections and expenditures in that year compare to end-of-session estimates.

The revised forecast for the 2008-09 biennium is followed by the first complete forecast for the next budget period, FY 2010-11, and by revenue and expenditure planning estimates for FY 2012-13. 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 2012-13 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 2009 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 clearly defined, but 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 for various areas 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 biennium 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.

ECONOMIC SUMMARY

The U.S. economy is in a recession. In early December, 2008 the National Bureau of Economic Research (NBER) officially established that we entered a recession in December, 2007. There really was no doubt that the current economic slump would meet the NBER's criteria for a recession. Indeed, most forecasters believe this downturn will be more severe than either of the two most recent recessions. It has already been longer, and most believe it has at least a half year to go.

The economy's health had been in question for more than a year as problems facing global financial institutions compounded. Then, in early October, credit market conditions deteriorated so much that they posed a substantial threat to the global economy. To reduce the risk of a short-term collapse, the President requested and Congress approved emergency legislation granting wide ranging authority to the U.S. Treasury, the Federal Reserve, and the FDIC to deal with financial problems faced by private financial firms. The spillover effects of the financial industry problems that came to a head in early October have been far greater than policy makers expected, and have left a weakened global economy. Although there are now signs that credit is beginning to flow once again, key credit spreads remain well out of their typical ranges and it is too early to declare that global financial markets are back to normal.

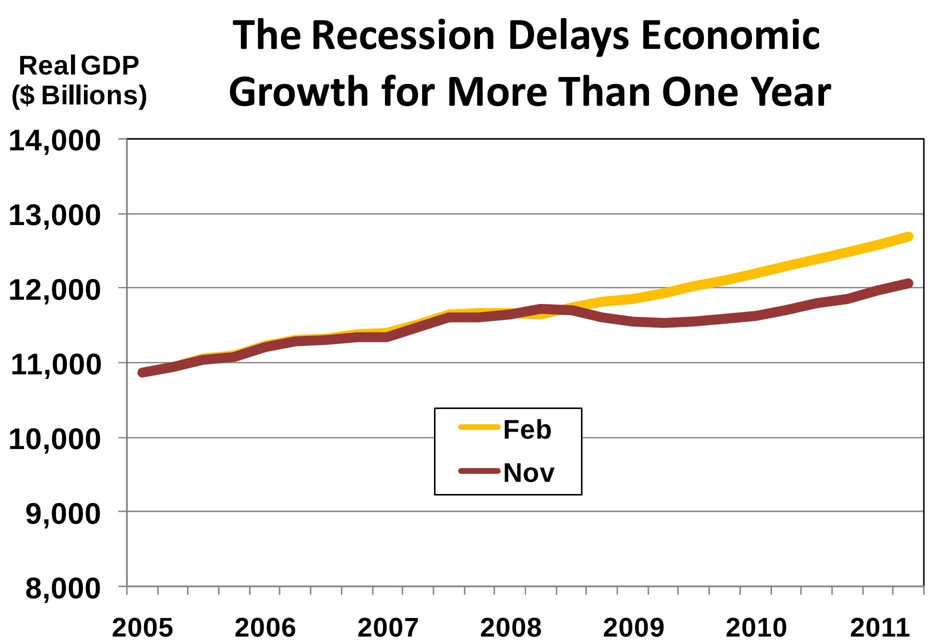
Sometime in late summer the credit crunch and the perceived weakness of the financial sector also began to affect the real economy. The weakening was most evident in the consumer sector where real spending fell at an annual rate of 3.7 percent in the third quarter, the weakest quarter since 1980. Capital equipment spending has also been affected by tighter credit conditions. And, economies elsewhere in the world recently have begun to show further signs of weakening, thus reducing the potential for future growth in U.S. exports. When taken together with recent news, including October's payroll employment report, which showed a current month decline of 240,000 and additional reductions of 179,000 to previously reported declines in August and September the outlook for the next half year, and particularly the fourth quarter of 2008, becomes grim. Most forecasters now expect real GDP to decline at an annual rate of at least 2.5 percent during the current quarter. Many expect substantially greater declines.

The November baseline forecast from Global Insight Inc. (GII), Minnesota's national economic consultant, reflects the recent rapid deterioration in the short-term economic outlook. They now expect real GDP to decline through early summer of 2009, then grow at a rate well below trend (3 percent) until the summer of 2010. Their November forecast shows a 1 percent decline in real GDP in 2009 and growth of just 1.7 percent in 2010. February's GII baseline forecast called for growth rates of 2.2 percent and 3.0 percent in 2009 and 2010 respectively. In the baseline scenario U.S. unemployment rates reach 8.3 percent in mid 2010.

Inflation is not a problem. GII believes that the weaker global economy is removing inflationary pressures on energy and other core commodities. The November baseline shows the consumer price index falling by 0.9 percent in 2009 and then growing by 2.4 percent in 2010. Much of the good inflation news comes from a further decline in energy prices. GII now expects oil prices to fall to the $50 per barrel level in the second quarter of 2009. Oil prices are expected to average $53 per barrel in 2009 and then increase only moderately to an average of $63 per barrel in 2010, February's baseline projected oil prices in the mid $70 range for both 2009 and 2010.

Global Insight assigns a probability of 60 percent to their baseline forecast. They assign a probability of 15 percent to a more optimistic scenario and a probability of 25 percent to one that is more pessimistic. The more optimistic scenario, however, still contains three quarters of declining real GDP and slow growth through the end of 2009. The pessimistic scenario calls for 6 consecutive quarters of declining GDP.

Members of Minnesota's Council of Economic Advisors believe that Global Insight's November Baseline forecast reflects the consensus short-term outlook in early November when that forecast was made. While individual forecasts of some members were for a slightly shorter downturn, all agreed that the Global Insight November baseline provided a reasonable starting point for the state revenue forecast. No Council member expected that the U.S. economy would escape a recession, and all expected this recession to be more severe than either the 1990-91 recession or the 2001 recession.



Minnesota Management & Budget (MMB) economists noted that year-to-date revenues had exceeded February's forecast, consistent with the slightly stronger than projected economic growth observed during the first half of 2008. That additional revenue can be thought of as a supplement to the state's budget reserve, which was drawn down to $153 million during the last legislative session. They also cautioned that negative variances in final payments and refunds for the individual income tax could exceed $350 million in this fiscal year.

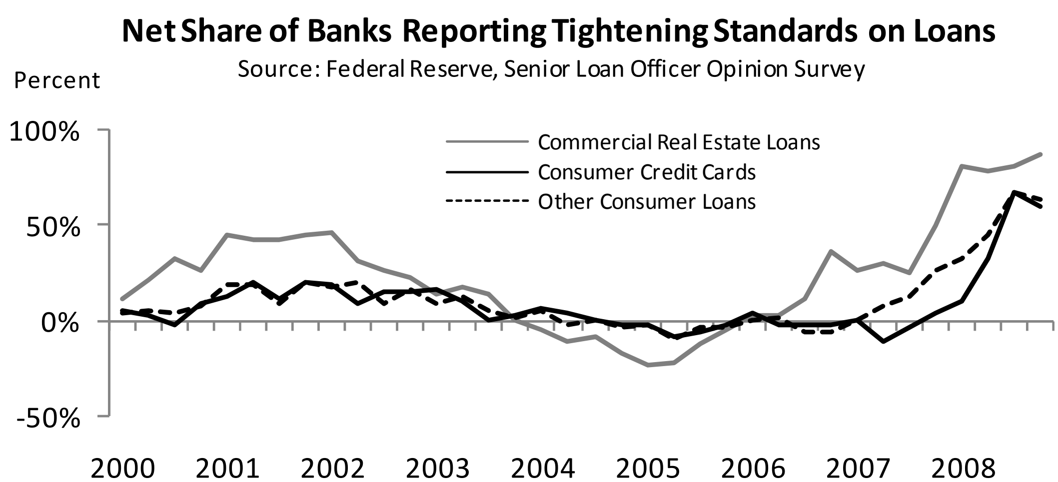
MMB economists also noted that demographic trends may slow future growth in consumer spending more than is currently expected by many forecasters. Because the baby-boom cohort is approaching retirement, additional income is likely to be disproportionately directed toward re-building depleted retirement savings accounts, not go for the purchase of additional household goods.

The Council again noted that projecting future expenditures without making allowance for inflation except where required under current law understates the severity of financial problems faced by the state.

ECONOMIC OUTLOOK

The National Bureau of Economic Research (NBER) has determined that the U.S. recession began in December 2007. The litany of disappointing economic news is sobering. Negative impacts from a national housing downturn coupled with the most serious financial market crisis since 1929 and declining consumption are reinforcing each other. Job losses are accelerating and the national unemployment rate is approaching 7 percent. Declining home prices and lower stock market values have dramatically reduced household wealth. Consumers have lost confidence and are aggressively tightening their belts just before what retailers anticipate will be the worst Christmas season in more than two decades. Prospects for a short, mild recession with a sharp rebound have vanished. Global Insight's November baseline scenario calls for the worst recession since 1982 with four consecutive quarterly declines in real GDP beginning in third quarter 2008.

The economy's problems started in the housing sector more than a year ago. Mortgage loan defaults have surged, the financial system is in crisis, and credit availability has tightened dramatically over the past 18 months. First, two well known hedge funds failed. Then home equity loans and cash-out mortgage refinancing dried up, eliminating an important source of funding for consumer spending. By the end of last year, key indicators used by the NBER to mark the beginning of a recession had peaked. January, for example, marked the beginning of 10 consecutive months of job losses. Last summer's spike in gasoline and food prices absorbed much of the fiscal stimulus payments. Meanwhile, home values continued to fall, driving mortgage defaults and foreclosures higher. Battered by job losses, tight credit, and declining household wealth, consumers began to cut back on spending. By early fall, consumers were already reeling when several key financial institutions failed, banks tightened lending standards further, and the stock market plunged.



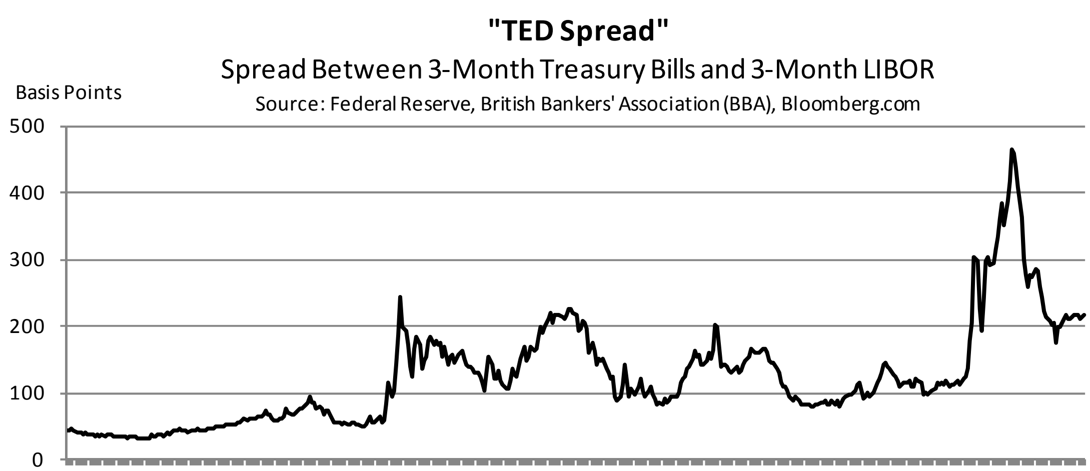
Credit availability has tightened dramatically over the past 18 months despite sharp reductions in the federal funds rate and large cash infusions into financial institutions.

Policy response to the financial crisis has been unprecedented. The Federal Reserve and Treasury have in effect backed the financial system with the full resources of the U.S. government. Sharp reductions in the federal funds rate and huge cash infusions into financial institutions, however, have not yet restored normal lending volume. Instead, Federal Reserve data suggests banks have tightened standards on consumer and commercial loans. Money market trading has languished as investors shun riskier investments in favor of risk-free Treasury bonds, greatly increasing borrowing costs.

Even if normal bank lending and money market trading can be restored, stimulating a sinking economy with lower interest rates will be problematic. The Fed has little room to further reduce the 1 percent federal funds target rate. Any further cut would mark the lowest level for federal funds in its 53-year history. Global Insight expects a largely symbolic 50 basis point reduction at this month's Federal Open Market Committee (FOMC) meeting, but its November outlook depends heavily on a new $200 billion fiscal stimulus in 2009 to help turn the economy around. A recent statement by Global Insight's chief economist, however, suggests the economy is now sinking so fast that $200 billion may not be enough.

So What Happened to the Financial System?

The financial market's fear of credit risk continues to be fueled by declining home prices and related write-downs of mortgage-related investments originated during the housing boom. As a result, credit is not flowing at normal volumes. While there has been some improvement in interbank lending, trading has stopped or is minimal for most private sector debt instruments. The result is restricted access to funding and higher interest rates for business firms, consumers, and state and local governments. Credit spreads, meaning the extra yield investors require to be compensated for risk, have fallen but remain abnormally wide.



Federal Reserve and Treasury actions have improved interbank lending, but the TED Spread, or the spread between 3-month Treasury Bills and the 3-month LIBOR, remains abnormally wide.

All of this is reaction to the realization that once obscure mortgage-related securities originated late in the housing boom were riskier than once thought. That discovery had broad implications since it meant that many financial institutions were highly over-leveraged. During the boom lenders originated risky subprime mortgage loans and sold them to investment banks to be packaged into securities. Risks associated with these securities were diversified by drawing on mortgages from local housing markets throughout the U.S. The bundled securities were then graded by rating agencies based on information provided by the investment banks before being sold to global investors, largely financial institutions, as a higher yield alternative to more traditional investments such as government bonds.

This financing model worked for a while. Home prices surged as the Fed held interest rates low during the first half of the decade to boost a slow economic recovery. At the same time, lenders made ever more risky loans to meet both the growing demand for homes and investors' desire for higher returns in a low interest environment. By the spring of 2006, however, serious weaknesses in lending practices started to surface and a nationwide over-supply of houses started to undermine prices. That forced more and more mortgages underwater, leaving many homeowners unable to refinance at rates they could afford. The decline in home prices then accelerated and financial institutions began tightening credit standards, making refinancing even more difficult. Waves of defaults and foreclosures spread across the nation, further increasing downward pressure on home values. According to RealtyTrac, total foreclosure filings on U.S. residential properties had swollen to more than 2.2 million by 2007, up 75 percent from a year earlier and 150 percent from 2005. Prices fell unlike any time since the 1930s. National home values have now declined back to 2004 levels and still continue to fall.

Commercial paper is a financial instrument sold by large banks and corporations to raise money to meet short term obligations. Money market trading in commercial paper has languished as investors shun riskier investments in favor of risk-free Treasury bonds. The volume of commercial paper outstanding in November was 13 percent less than a year earlier.

Surprised by soaring defaults and foreclosures, investors concluded that the risks inherent in mortgage-related securities had been underestimated. Financial institutions reacted by retreating from markets, re-pricing nearly all categories of risk, and writing-down massive amounts of mortgage related securities on their balance sheets. These capital write-downs reduce ability to meet obligations and to get temporary loans from other banks as needed to extend credit to customers. They also threaten solvency. By September, multiple nearly insolvent institutions were taken over by regulators. Failures included the two government-sponsored enterprises Fannie Mae and Freddie Mac, mortgage originator Countrywide Financial, and commercial bank Washington Mutual. There were emergency fire-sales for investment bank Merrill-Lynch, which went to Bank of America, and for commercial bank Wachovia, which was purchased by Wells Fargo. Financial services giant Citigroup received a Treasury bailout loan as did mortgage bond insurer American International Group. Much respected investment bank Lehman Brothers was allowed to declare bankruptcy and was liquidated. This failure marked the largest bankruptcy in U.S. history.

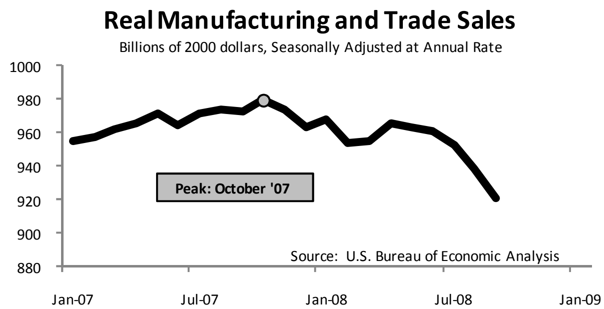
These developments, particularly the Lehman bankruptcy, sent frightened investors off on a massive flight to risk-free U.S. Treasury securities, and brought the entire global financial system to the brink of collapse. By October, the panic had spread to the stock market which plunged and turned extraordinarily volatile. Short selling stock of financial firms was temporarily banned and credit spreads exploded, greatly increasing borrowing costs to consumers, businesses, and state and local governments. Similar developments occurred globally.

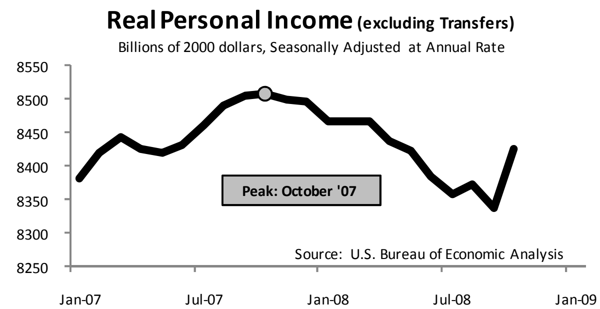
An Aggressive Response

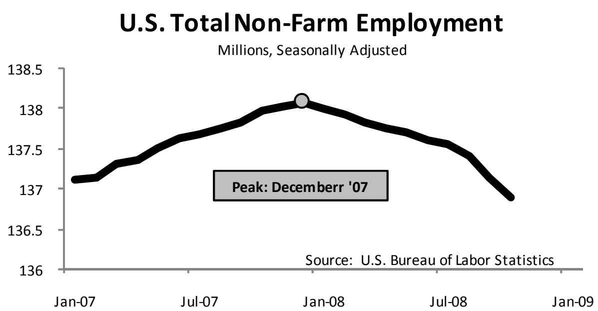
Since mid-September, the Federal Reserve and the Treasury have moved aggressively to reverse investor's flight from credit risk without noteworthy success. Much of that effort has been focused toward getting banks to lend again in hopes of limiting damage to the broader economy. The federal funds rate has been lowered, but the primary strategy has been massive cash infusions onto the balance sheets of floundering financial institutions. A variety of methods have been implemented, including Treasury loans, expanded discount window-like emergency loans, and purchases of senior nonvoting preferred stock. More recently, there has been a focus on getting money markets working again with a program to buy securities related to consumer debt, including credit cards, auto loans, and student loans. According to the *Wall Street Journal*, more than $4 trillion has been committed in one way or another beginning in September.

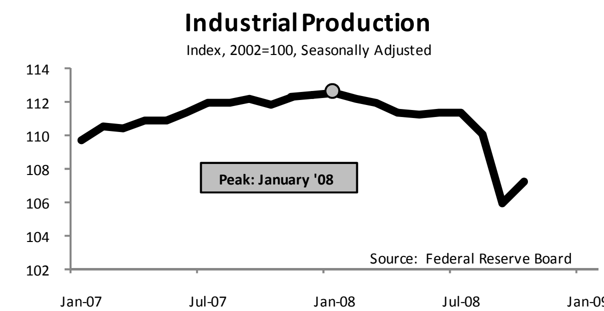
A Severe Recession

The NBER has determined that the economy began to deteriorate near the end of last year when four key indicators used by the committee to define a recession peaked. Over the summer, the economy's slide accelerated, led by declining consumer spending. The sudden financial panic this fall put an even greater strain on the economy. Negative impacts from the financial markets as well as job losses and household wealth deterioration are now reinforcing each other.









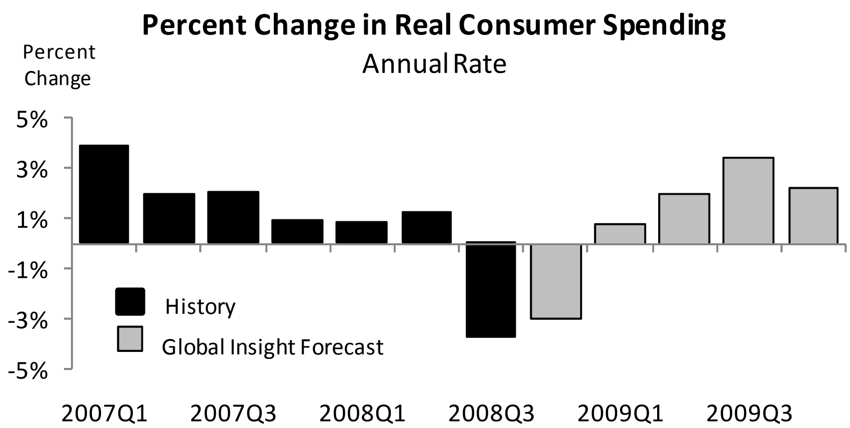
The National Bureau of Economic Research (NBER) has determined that the U.S. recession began in December 2007. This fall's sudden financial panic put even greater pressure on an economy already declining.

Most observers believe this recession is unlikely to end before the housing market hits bottom, easing pressure on the financial system. The latest S&P Case-Shiller report shows home prices are still sinking in the country's 20 largest metropolitan areas. A recent Congressional Budget Office (CBO) report indicates the big unknown is how long foreclosures continue to rise. According to RealtyTrac, foreclosures are now up some 70 percent from a year ago and represent about a third of all properties for sale. Most of these are being offered at deep discounts, driving down the value of neighboring homes. Global Insight has the housing market nearing bottom in late 2009, but admits this is just an assumption since there appears to be no conclusive end in sight.

Global Insight's November baseline assumes that a new $200 billion stimulus package and $50 dollar oil will help ensure that a recovery begins in late 2009 or early 2010, but the recession will be the worst since 1982. The $500 billion two-year stimulus package now being considered by President-elect Obama would help moderate a more severe recession than the November baseline, but any new program will be too late to prevent the severe downturn expected for this winter. A two-year package, however, could help a recovery made tepid by the relatively frugal spending habits of an aging population.

Consumption

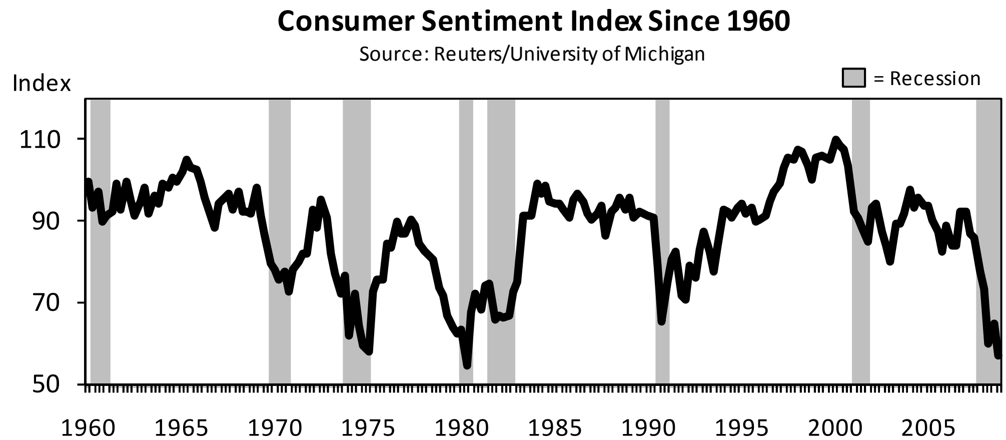
Fallout from job losses, tight credit, declining household wealth, and negative home equity are weighing heavily on consumers. The *Wall Street Journal* recently reported that nearly 1 in 5 households in the U.S. owe more on their mortgage than their home is worth. The toxic combination of negative home equity and a weakening labor market is igniting yet another wave of foreclosures, putting increased downward pressure on home values. Declining house prices and a sinking stock market have already reduced household wealth by some $7 trillion nationally since mid-2007. In reaction, consumers are retrenching sharply. Third quarter real spending contracted 3.7 percent at an annual rate, the largest decline since 1980. Global Insight's November baseline expects a similar drop in the fourth quarter.



Real consumer spending in the third quarter contracted at an annual rate of 3.7 percent. This was the largest decline since 1980. Global Insight's November baseline expects a similar drop in the fourth quarter.

Unlike the 2001 recession when robust light vehicle sales supported household outlays, auto sales have fallen to their lowest level since early 1980's on an annualized basis and the outlook is poor. In addition to the downturn in the economy, auto sales have been hurt by a shift in preferences toward more fuel efficient cars following last summer's $4 gas shock. Manufacturers also are cutting back sharply on leasing, leaving more consumers in search of loans which have become much harder to obtain as automakers cut back on their financing programs due to the credit crunch. In Global Insight's November baseline light vehicle sales reach a 26 year low in 2009.

In addition to autos, most categories of non-auto durables and nondurable goods spending are also declining. Only spending for services is rising. Retail sales are unlikely to revive until the housing market stabilizes, consumer sentiment improves, and real income begins to grow steadily again.

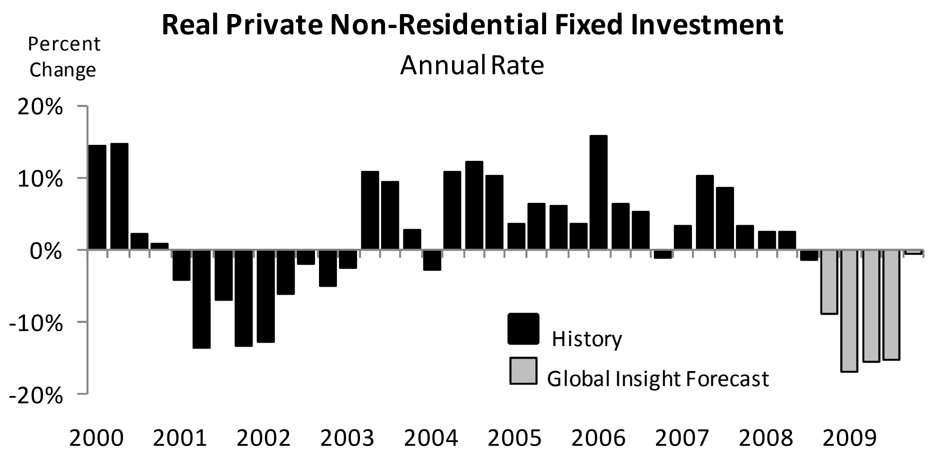


The Reuters/University of Michigan's Index of Consumer Sentiment fell 2.3 points in November, to 55.3, its lowest level since May 1980. Consumers have lost confidence and are aggressively tightening their belts just before what retailers anticipate will be the worst Christmas season in more than two decades.

Investment

During the past year non-residential business investment helped offset plunging residential construction outlays. This changed abruptly in early fall. Data from the U.S. Bureau of Economic Analysis (BEA) indicates real nonresidential investment declined at a 1.5 percent annual rate in the third quarter, down from 2.5 percent growth in the previous quarter. Equipment and software outlays dropped at a 5.7 percent annual rate, following a 5.0 percent decline in the second quarter. Spending growth for structures slowed from a positive 18.5 percent annual rate in the second quarter to 6.6 percent in the third quarter. Spending for structures is forecast to drop 5.6 percent in the current quarter.

Much of the downturn in business investment is expected to be commercial construction related. Financing for commercial construction projects has become much more difficult to obtain. Early indications suggest a weakening is already underway. The demand for commercial space, for example, has abated as national job losses accelerated. In the November baseline, Global Insight does not expect non-residential investment to begin recovery until the end of 2009. Likewise, residential investment is forecast to continue its slide through the end of 2009. Housing starts are down 59 percent from their previous peak in first quarter 2006. In Global Insight's November baseline, they decline another 25 percent to average 715,000 in 2009, the lowest level since 1945.



Data from the U.S. Bureau of Economic Analysis (BEA) indicates real nonresidential investment declined at a 1.5 percent annual rate in the third quarter, down from 2.5 percent growth in the previous quarter. Global Insight does not expect non-residential investment to begin recovering until the end of 2009.

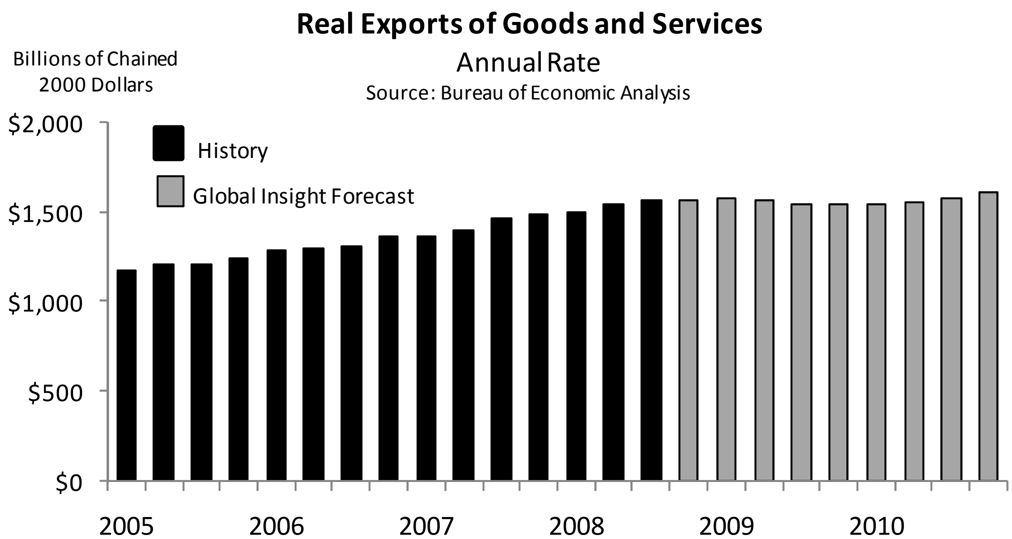
Government

In October, Congress passed the $700 billion Troubled Asset Relief Program (TARP) giving the U.S. Treasury broad authority to intervene in the financial markets. Among other things, TARP authorizes new capital infusions into the banking system in return for senior preferred stock. Those exchanges have begun. Under the program the Treasury has required the nine largest banks to sell it preferred shares amounting to some $125 billion. This requirement was needed to avoid revealing which prominent banks really needed the money. The shares will pay a 5 percent dividend for the first 3 years and 9 percent after that if no repurchase occurs. Smaller banks' participation is voluntary. Another $125 billion is available for those institutions. Some have already drawn on TARP funds.

Just before Thanksgiving, the Federal Reserve and Treasury jointly announced a new $800 billion program to infuse cash directly into credit markets rather than onto bank balance sheets. The Fed will buy up to $600 billion in Fannie Mae, Freddie Mac, and Federal Home Loan Bank securities. There will also be up to $200 billion in financing available for investors buying securities backed by auto loans, student loans, credit card debt, and small business loans. The Treasury will use TARP funds to provide $20 billion of the $200 billion. According to the *Wall Street Journal*, some $330 billion of TARP's initial $350 billion appropriation is now committed.

International

Last February, forecasts of economic weakness were largely confined to the U.S. The summer spike in energy prices, the global spread of financial panic, and declining U.S. demand for foreign products, however, have changed the outlook overseas. Now the European Union and Japan are in recession and many other economies around the world are weakening. The International Monetary Fund (IMF) is predicting that some 30 developed economies including Western Europe, Japan, and the U.S. will contract as a group in 2009 producing the first global recession since World War II. A global recession means exports will no longer prop up the U.S. economy as they have in recent quarters. In Global Insight's November baseline, exports are forecast to begin deteriorating in early 2009.



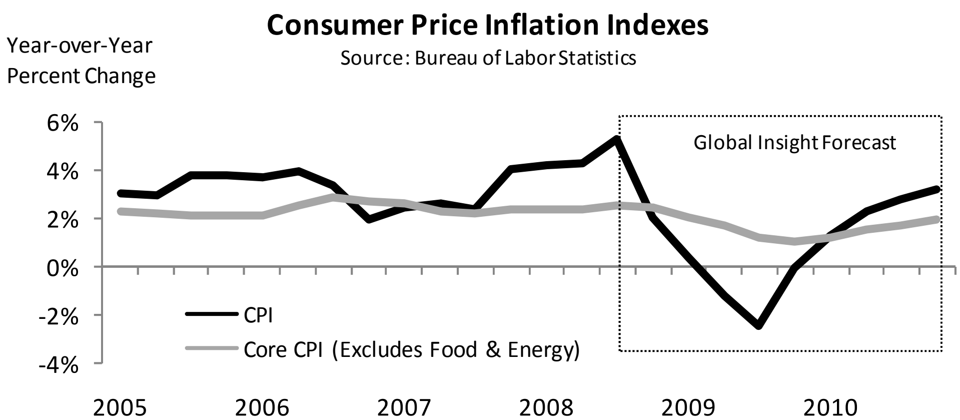
A global recession means exports will no longer prop up the U.S. economy as they have in the past several quarters. In Global Insight's November baseline, exports are forecast to begin deteriorating in early 2009.

Inflation

In July, headline consumer inflation peaked at 5.6 percent year-over-year. Since then, retreating oil and commodity prices, declining home values, and a weakening labor market have virtually eliminated near term prospects for accelerating inflation. Global Insight expects the consumer price index to decline 0.9 percent in 2009, down from a 3.9 percent increase in 2008, primarily because of lower oil prices. If this occurs, the 2009 annual decline in headline CPI will be the first since 1955. Meanwhile, core inflation is forecast to rise 1.3 percent, down from 2.4 percent in 2008. West Texas Intermediate crude is forecast to average $53 per barrel in 2009, down from $101 in 2008.

Global Insight's forecast for a modest, short-lived decline in consumer prices next year is certainly not the disastrous, persistent deflation experienced by the U.S. during the 1930's and by Japan in the 1990's. The FOMC noted, though, a growing risk of deflation in the minutes of its October 29 meeting. Currently, consumer prices for food, energy, clothing, transportation, including autos, and housing of course have all begun to decline. Prices for non-energy services, however, are still rising.

While inflation is no longer an immediate concern, it remains a long term issue. The Federal Reserve and its overseas peers have chosen to deal with tumult in the global financial system and growing prospects for a deep worldwide recession by infusing massive, unprecedented amounts of cash onto balance sheets and into credit markets. As a result, money supply indicators in the U.S. and elsewhere have spiked upward dramatically. Since inflation is a case of too much money chasing too few goods and services, it seems that recent central bank actions could greatly increase the longer term risk of runaway inflation. Many economists wonder whether there is a viable plan to withdraw all the cash without adverse effects once the world economy improves.



Retreating oil and commodity prices, declining home values, and a weakening labor market have virtually eliminated near term prospects for accelerating inflation. Global Insight expects the consumer price index to decline 0.9 percent in 2009, down from a 3.9 percent increase in 2008.

Monetary Policy

Federal agencies have intervened in the financial markets in the past, but, with the possible exception of the 1930s, not on as massive a scale, nor with such potential for permanent changes as in recent months. Since last summer, the Federal Reserve and the Treasury have greatly expanded their roles in managing the economy. By one means or another, the Fed can now lend to almost any financial institution without limit, accept any collateral, and buy whatever assets it pleases. The Treasury's purchase of non-voting preferred shares in banks under the TARP program arguably amounts to a partial nationalization of the banking system. Similarly, Treasury's takeover of Fannie Mae and Freddie Mac amounts to nationalization of the nation's residential mortgage financing.

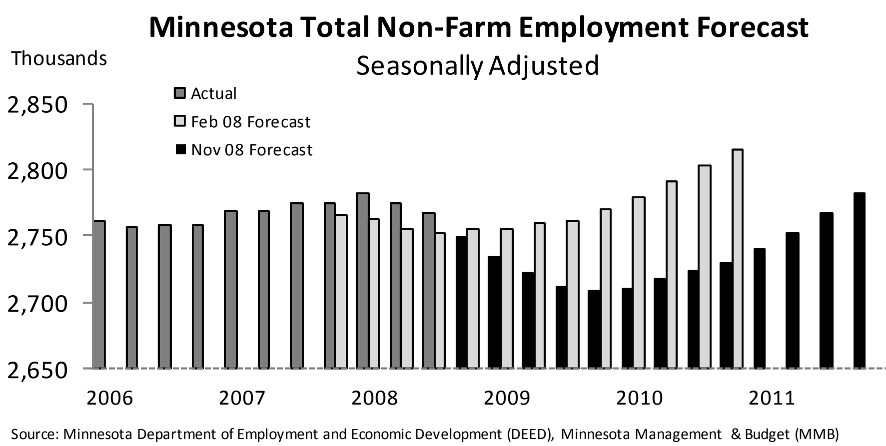
The *Wall Street Journal* indicates that some federal officials are privately expressing concern that the Federal Reserve and Treasury will not be able to wind down their intervention in financial markets once the crisis ends without inadvertently creating new problems. That makes it seem unlikely the Fed and Treasury will back completely out of their new roles. In addition, the unexpected onset and speed with which the financial problems emerged beginning in September almost certainly means there will be a need to monitor operations of global financial markets and major institutions much more closely than previously thought.

Globalization of the U.S. financial crisis has changed the Fed's relationship with its overseas peers. A precedent for coordinated action was established when it became clear that uncoordinated single-country solutions to global financial problems were not working. On October 8, the Federal Funds rate was cut by 50 basis points in a move coordinated with all the G-7 central banks plus the Bank of China. A further 50 point cut in October was coordinated with Norway and China. These joint actions seem to mean the Fed realizes globalization has reduced its room for independent, unilateral action.

MINNESOTA OUTLOOK

The economic downturn in Minnesota continues to deepen. Instead of gathering strength in the second half of 2008 as forecast last February, problems stemming from the housing downturn began to expand into the rest of the economy over the summer. During October, negative pressure on household wealth intensified following the stock market's plunge. Home prices are tumbling throughout the state, foreclosures and bankruptcy filings are still on the rise, credit conditions for both consumers and business firms have tightened, and job losses are occurring in most industry sectors. Since March, the state has lost over 26,000 jobs on a seasonally adjusted basis, pushing monthly employment below levels first reached in early 2006. Minnesota's unemployment rate has climbed from 4.7 percent to 6.0 percent.

Although the full impacts of the global financial crisis and national economic recession have not yet materialized, some effects are recognizable throughout Minnesota. News articles indicate that Small Business Administration (SBA) loans are down 20 percent from a year ago, the pipeline for new construction projects is drying up, and lenders are turning down almost a third of hopeful car buyers with quality credit. St. Paul's Ford plant will be idled in December because two major fleet customers could not get short term financing, auto dealerships have closed as sales plummet and manufacturers pull back financing, and at least one major health provider is laying off employees to cut expenses after it was unable to refinance short-term debt. In northern Minnesota, a major Duluth manufacturer has furloughed production until January to clear out built up inventory, most oriented-strand board plants remain closed indefinitely, and a number of taconite mining facilities have idled production and notified workers that layoffs may occur because of softening demand for steel in North America and Europe.



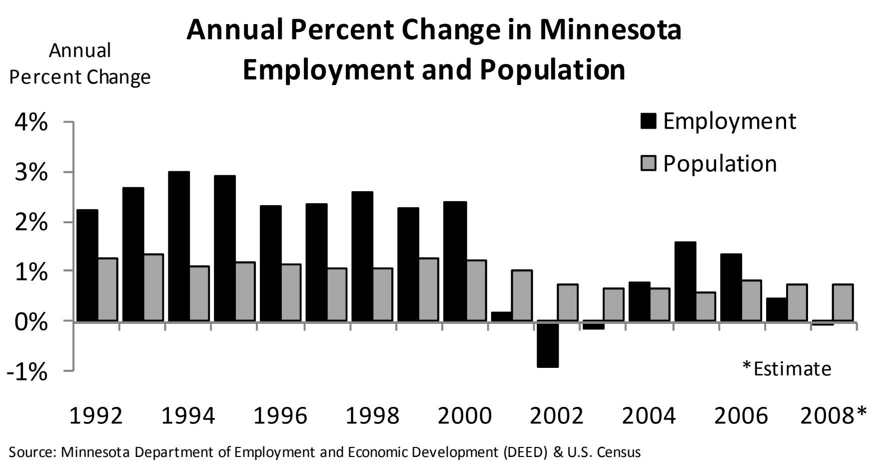
Measured on a quarterly seasonally adjusted basis, the November forecast calls for Minnesota to lose an additional 50,000 jobs by the end of 2009. This implies a total loss of nearly 80,000 jobs peak-to-trough between the first quarter of 2008 and the fourth quarter of 2009.

Job growth normally lags an economic recovery. Assuming the national economy begins improving next summer as the Global Insight baseline scenario suggests, Minnesota should not expect to see meaningful job growth until early 2010. Meanwhile, the forecast calls for additional job losses of up to 50,000 by the end of 2009. By then the state's unemployment rate could top 8 percent. Measured on a quarterly seasonally adjusted basis, the state will have lost nearly 80,000 jobs peak-to-trough since first quarter 2008.

Soft Economic Momentum

The vibrant "dot-com boom" economy of the late 1990's left Minnesota with strong momentum moving into the 2001 recession. This arguably helped dampen the severity of the downturn. The recovery to follow, however, was dubbed "jobless" as both Minnesota's population and employment growth slowed significantly relative to the experience of the 1990's. By 2004, both indicators had begun to significantly lag national growth for the first time in at least a decade. A satisfactory explanation for this phenomenon has yet to be offered, but Minnesota Management & Budget (MMB) economists believe this increases downside risk in the Minnesota outlook for both recession and recovery.

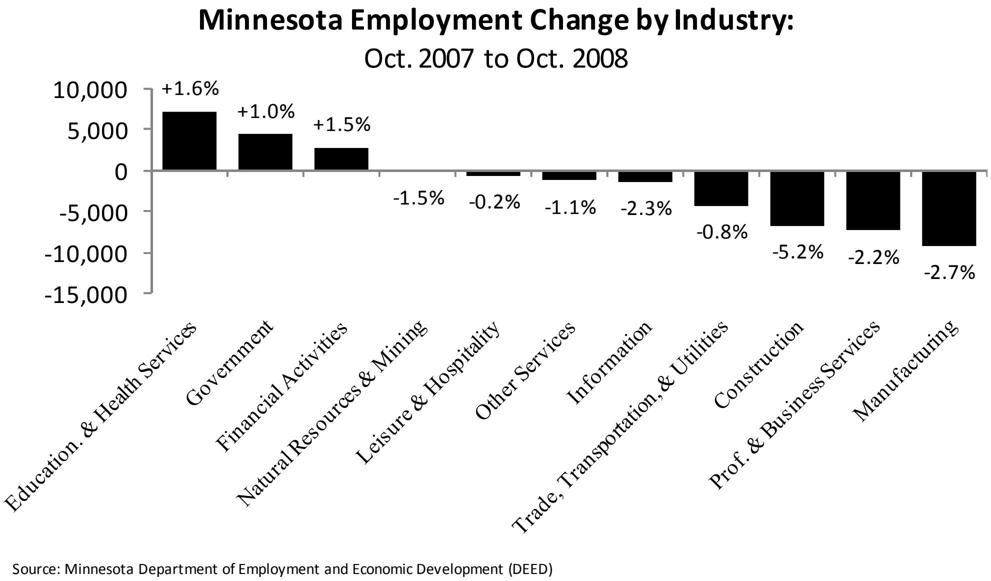
Moving into this recession, Minnesota's economy did not boast the same momentum as in 2000. There are additional factors that could weigh more heavily on the State's economy than on its national counterpart. Those include the housing slump, abnormal financial market conditions, the sharp decline in spending for automobiles and household durables, and the frugal spending habits of an aging population.



Following the 2001 recession, Minnesota's population and employment growth slowed significantly relative to the experience of the 1990's. Moving into this recession, Minnesota's economy did not boast the same momentum as in 2000.

Widespread Job Losses

Recent Minnesota employment data is sobering. Year-over-year total job loss through October totals 16,500 jobs. The job losses have been spread across 8 of 11 major industrial sectors. Spillover from the state's housing market implosion continues to depress job growth in the construction industry. It has also weakened job growth in wood-product manufacturing, real estate, home improvement stores, and the banking industry. Since the housing downturn and the national recession began to overflow into the rest of the State economy last summer, professional and business services, transportation, warehousing and utilities, wholesale trade, and information have also shed thousands of jobs. More recently, the drop in household wealth, resulting from falling home prices, a lower stock market, and fewer jobs, has caused consumers to retrench, placing further strain on retail trade and leisure and hospitality.



Year-over-year employment change through October is negative in 8 of 11 major industrial sectors.

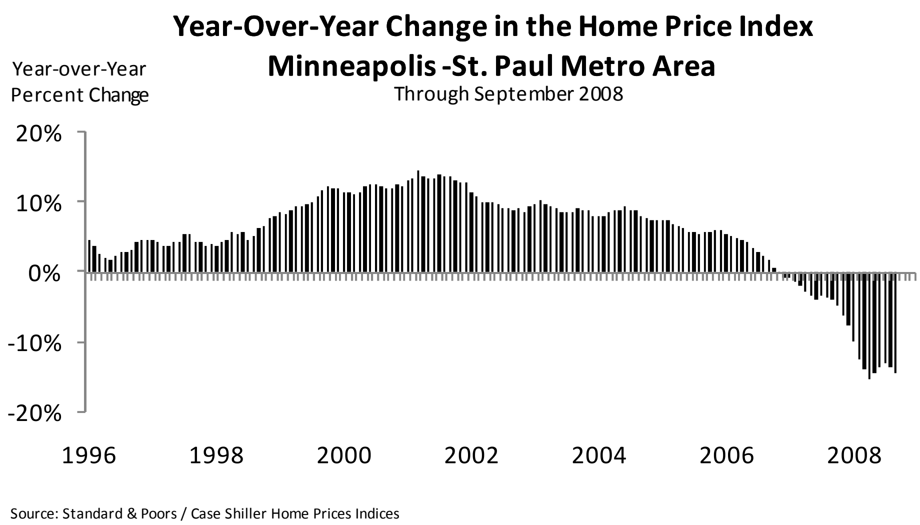
Widespread declines have left Minnesota employment more concentrated in the health services and social assistance sector. Recent news suggests, however, that even healthcare is not recession proof. In the past few months, at least three Twin Cities' medical facilities have announced job cuts related to the financial pressures of uncompensated care and less demand for elective treatment. Both are signs of growing economic stress. The forecast calls for slower employment growth in this sector for the duration of the recession.

Recent unemployment data are also disconcerting. In August, Minnesota's unemployment rate rose to 6.0 percent, the highest recorded since 1986. In the spring of 2007, Minnesota's rate exceeded the nation for the first time on record dating back to 1976. While unemployment retreated to levels just below the nation for a short period thereafter, it inched back above the national rate again in July and August of this year and stood at 6.0 percent in October. MMB economists estimate that the state's unemployment rate could exceed 8 percent by the end of 2009.

There is some encouraging news. Minnesota is the principal location for several strong and conservative financial institutions that are expected to successfully navigate this period of rising mortgage defaults and financial volatility. Through the middle of September, the State's financial sector showed consistent monthly job growth despite national events. Recent reports, however, suggest the industry may be losing some of its recent employment momentum.

Housing Slump Continues

As foreclosures soar and home values fall, Minnesota's housing market continues to implode. In November, the *Minneapolis Star Tribune* reported that falling home values have left nearly 12 percent of Minnesota's mortgaged properties "underwater", meaning that homeowner's debt is greater than the estimated value of their property. Minneapolis Association of Realtors data for the third quarter indicates that Twin Cities' lender mediated properties and homes already foreclosed upon constitute some 35 percent of total sales, up from 9 percent a year ago. Meanwhile, home prices continue to tumble. Median home prices in the Twin Cities are down almost 16 percent compared to a year ago. Similarly, according to the S&P/Case-Shiller Home Price Index Minneapolis-St. Paul average metro area home prices in September were down 14.4 percent from a year earlier and 17.9 percent from two years prior. Much of the price decline is the direct result of sales of mediated properties and foreclosures. The median price of a lender mediated house, for example, is about $150,000, significantly less than the $226,000 median price for a home not in default or foreclosure.



According to the S&P/Case-Shiller Home Price Index Minneapolis-St. Paul metro area home prices in September were down 14.4 percent from a year earlier and 17.9 percent from two years prior.

The good news is that buyers may have begun taking advantage of lower prices. Twin Cities' area sales were up 35 percent in September from a year ago and the inventory of unsold homes on the market appears to be slowly retreating. The increase in sales marks the first year-over-year monthly increase in sales since March 2006 and the month's supply of inventory has been down from the previous year for three consecutive months. It also appears that the long slide in Minnesota authorized housing permits may be approaching a floor as they have stabilized the past three quarters. MMB economists suggest, however, that it will take at least a few more months of such news to justify believing the housing market has reached bottom.

A Revised Forecast

Forecasts for employment and wages have been revised based on recent Minnesota-specific information and Global Insight's November 2008 baseline. The baseline was used to drive a newly re-estimated MMB model of the Minnesota economy.

Total annual non-farm employment is now forecast to decline -0.1 percent in 2008 and another -1.8 percent in 2009. This reflects Global Insight's outlook for the national recession and a weaker than previously projected Minnesota housing market. The November forecast for Minnesota's economy has seasonally adjusted employment declining through the fourth quarter of 2009. Very modest growth is projected for most of 2010. In 2011 Minnesota job growth is forecast to slightly exceed its U.S. counterpart.

Minnesota Outlook Compared to the U.S.

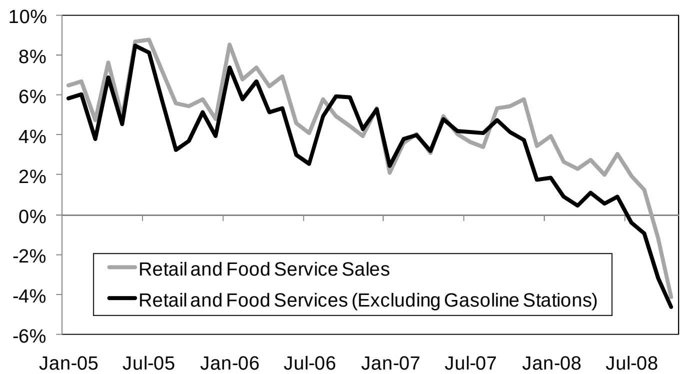
(Calendar Year Percent Change)

	2007	2008	2009	2010	2011
Non-Farm Employment					
Minnesota					
February 2008	0.5	-0.5	0.2	1.3	NA
November 2008	0.5	-0.1	-1.8	0.0	1.5
United States					
February 2008	1.1	0.3	0.7	1.3	NA
November 2008	1.1	-0.1	-1.5	0.1	1.4
Wage and Salary Income					
Minnesota					
February 2008	5.5	2.5	3.2	3.9	NA
November 2008	5.6	3.4	0.2	2.4	4.2
United States					
February 2008	5.8	3.6	4.1	4.8	NA
November 2008	5.6	3.5	1.2	2.4	4.1

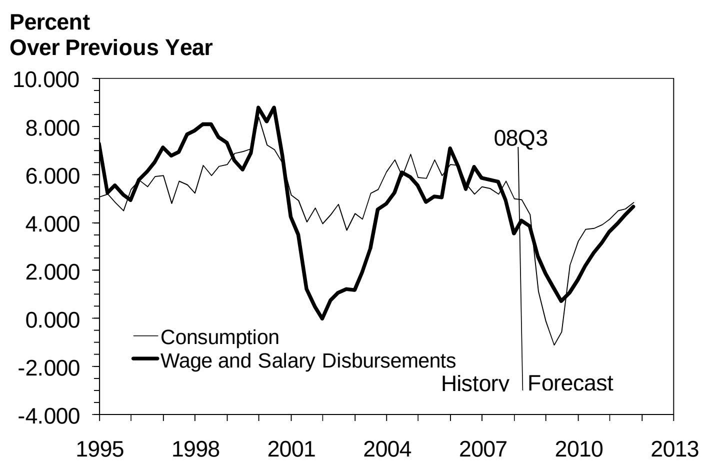
Housing remains critical to the Minnesota outlook. Construction is expected to lose about 6600 jobs in 2008 and another 7000 in 2009. The forecast assumes authorized housing permits will establish a floor next summer before beginning a slow recovery in early 2010. There are two assumptions behind this outlook. First, from experience in 2007 and 2008 it appears that job losses in construction lag the decline in building permits up to 3 months. Therefore, a “catch up” period is anticipated in the forecast. If the housing slump continues to deepen, however, it is unlikely that Minnesota’s economy will perform as expected. The forecast also assumes the Global Insight baseline forecast materializes. Recent news reports suggest, however, that downside risk to the baseline is increasing. Any unanticipated adverse developments in the U.S. economy, such as further deterioration in the financial markets, will have unfavorable effects on Minnesota.

SELECTED NATIONAL ECONOMIC INDICATORS

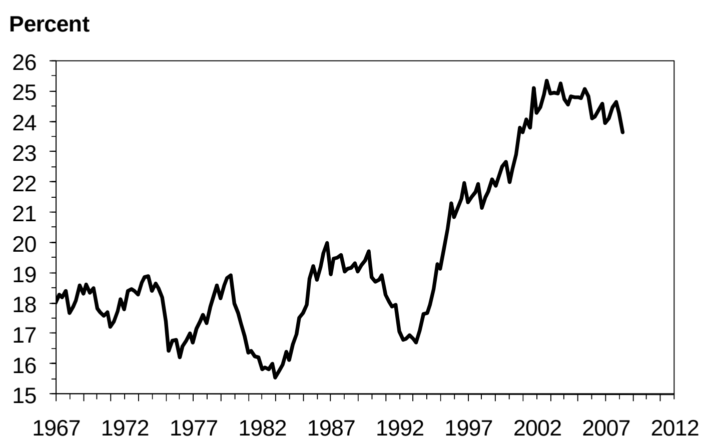
Year-Over-Year Percent Change in Retail and Food Service Sales



Consumption and Wages

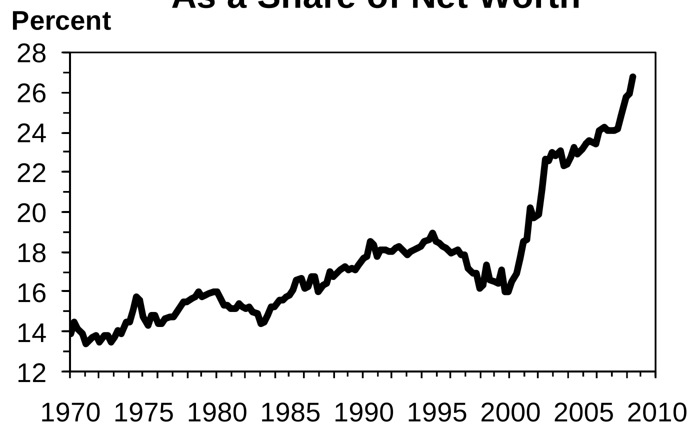


Installment Credit Outstanding As a Percent of Disposable Income

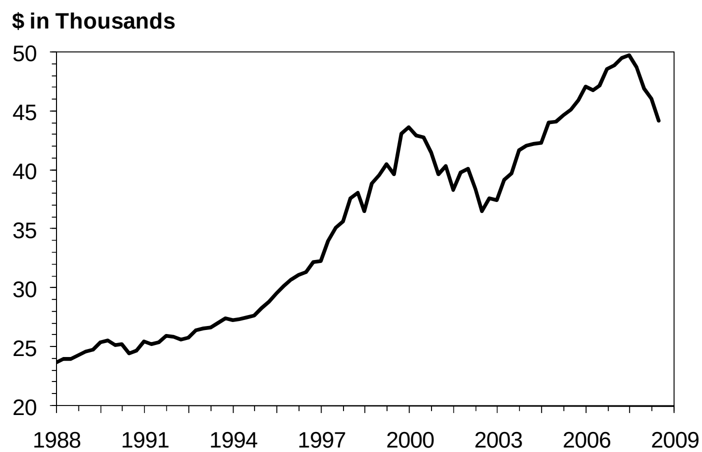


SELECTED NATIONAL ECONOMIC INDICATORS

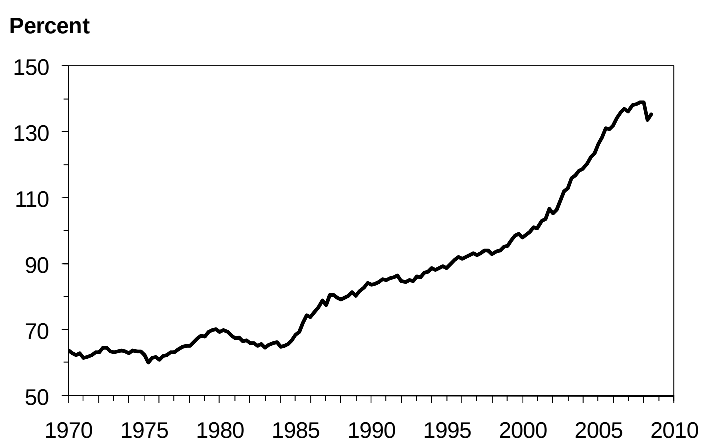
Household Financial Liabilities As a Share of Net Worth



Real Household Net Worth ($ 1996)



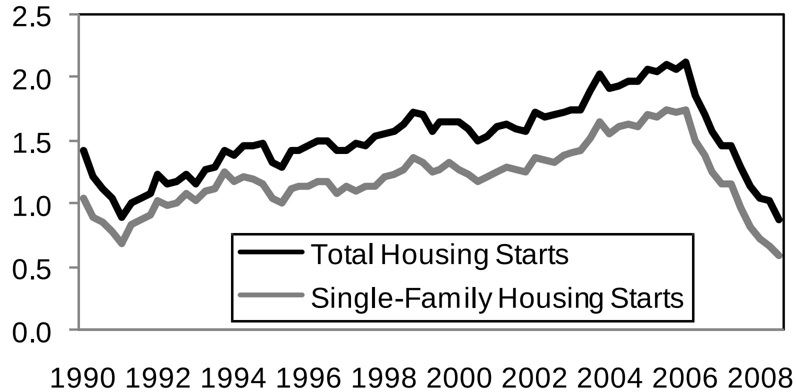
Household Financial Liabilities As a Share of Disposable Income



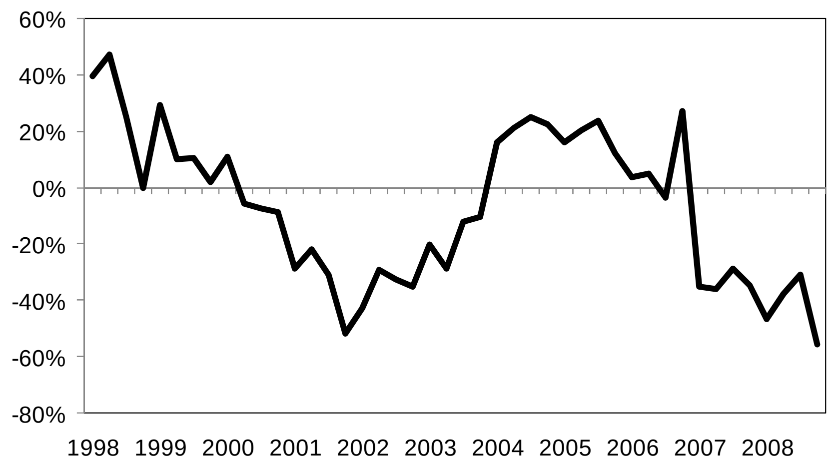
SELECTED NATIONAL ECONOMIC INDICATORS

U.S. Housing Starts

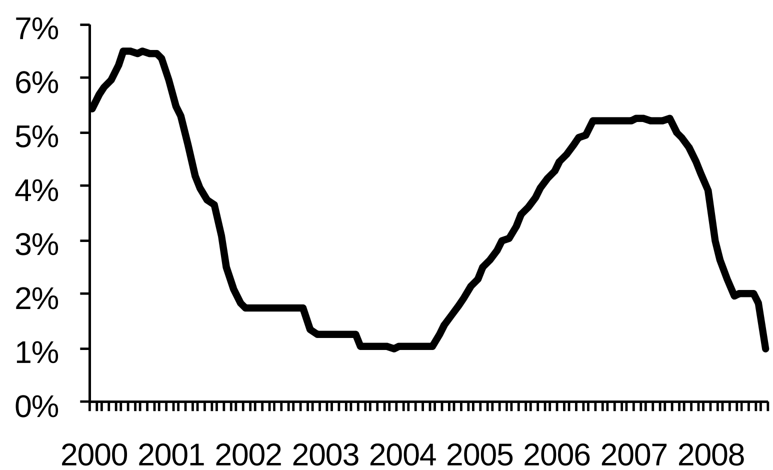
Millions of Units, Seasonally Adjusted Annual Rates



Net Share of Banks Reporting Stronger Demand for Commercial Real Estate Loans

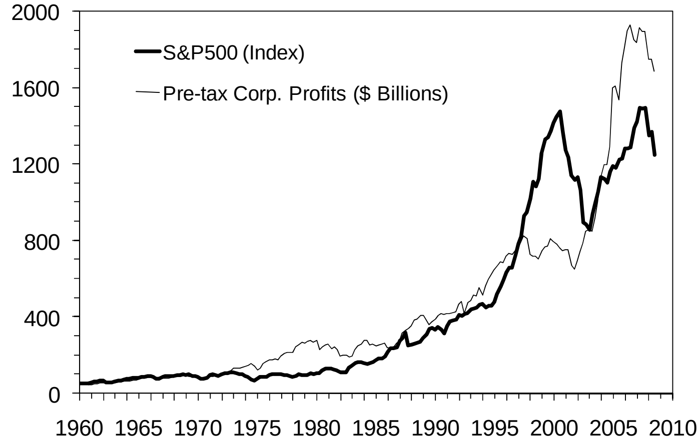


Effective Federal Funds Rate

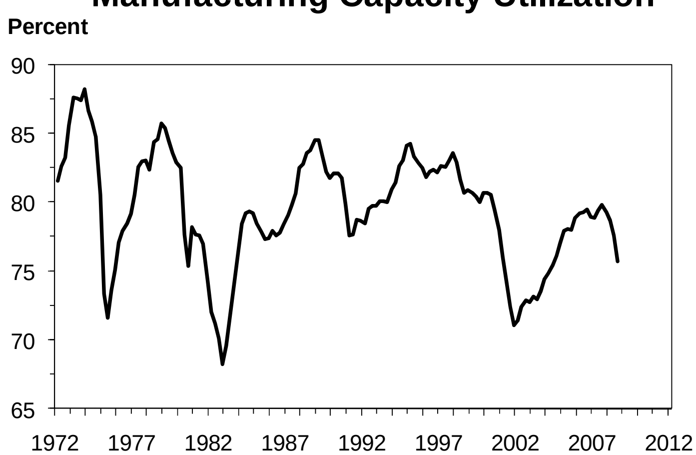


SELECTED NATIONAL ECONOMIC INDICATORS

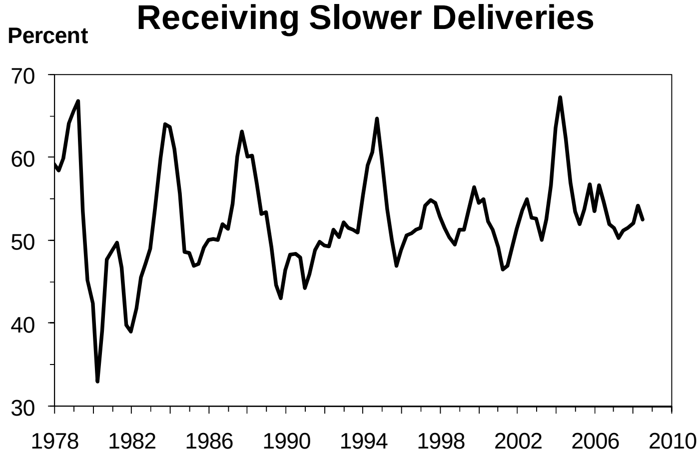
Corporate Profits and the Stock Market



Manufacturing Capacity Utilization



Proportion of Companies Receiving Slower Deliveries



FY 2008-09 BUDGET STATUS

The 2008 Legislature eliminated the $935 million general fund shortfall for the current biennium projected in the February 2008 forecast. The budget changes enacted left $153 million in the budget reserve, a $350 million cash flow account for FY 2009, and a projected $6 million budget balance.

The November forecast shows a significant change in the state's financial picture. Revenues are now forecast to be $32.445 billion, a decrease of $412 million (1.3 percent) from end-of-session estimates. General fund spending for FY 2008-09 is now expected to be $34.611 billion, $18 million (0.1 percent) more than prior estimates. These changes leave a projected deficit of $426 million for June 30, 2009.

The $426 million deficit represents about 2 percent of total spending for FY 2009. However, with less than seven months remaining in the fiscal year, the actual percentage more than doubles when compared to remaining unspent funds.

FY 2008-09 Forecast

($ in millions)

	End of Session	November Forecast	Change
Beginning Balance	**$2,245**	**$2,245**	**$0**
Revenues	31,936	31,501	(435)
Other Resources	921	944	23
Total Resources	32,857	32,445	(412)
Expenditures	**34,593**	**34,611**	**18**
Cash Flow Account	350	350	0
Budget Reserve	153	155	2
Available Balance	**$6**	**($426)**	**($432)**

Budget Reserve Account Increases by $2 Million

At the end of the 2008 legislative session, $153 million was projected for the budget reserve. In accordance with current law, an Assigned Risk Plan surplus of $2 million was transferred to the budget reserve at the end of FY 2008, increasing the reserve to $155 million. The budget reserve is available to offset part of the deficit for FY 2009, or part of the projected shortfall for FY 2010-11.

Action Is Required Before June 30, 2009 to Re-balance the FY 2009 Budget

Because Minnesota's Constitution prohibits borrowing for operating purposes beyond the end of the biennium, options for dealing with the projected deficit for the current biennium deficit are limited. State statutes (16A.152) governing the use of the budget reserve and the governor's authority to unallot to reduce spending provide broad authority to balance state revenues and expenditures to resolve a projected deficit.

REVENUE FORECAST
FY 2008-09

Current general fund resources for the 2008-09 biennium are now forecast to total $32.445 billion, $412 million (1.3 percent) less than end-of-session estimates. The forecast for net non-dedicated revenues has been reduced by $436 million or, 1.4 percent to $31.500 billion. Revenues in FY 2008 were $390 million more than projected, but a drop in forecast revenue forecast for fiscal 2009 of $826 million reduces biennial revenues. While declining individual income tax revenues account for more than one-half of the projected revenue decline, sales tax receipts and corporate tax collections also fall substantially. In FY 2009 net corporate tax collections are expected to drop by more than 18 percent.

Revenues FY 2008-09
($ in millions)

	FY 2006-07	FY 2008	FY 2009	FY 2008-09
Individual Income	$14,094	$7,759	$7,300	$15,059
Sales	8,970	4,571	4,461	9,032
Corporate	2,233	1,020	792	1,812
Motor Vehicle Sales	497	186	106	292
Statewide Levy	1,297	704	743	1,447
Five Major Taxes	27,091	14,240	13,402	27,642
Other Revenue	3,963	1,812	1,681	3,497
Tobacco	365	184	181	361
Net Non-dedicated	31,419	16,236	15,264	31,500
Other Resources	923	444	501	945
Current Resources	**$32,341**	**$16,680**	**$15,765**	**$32,445**

Revenues for the current biennium from the five major taxes are expected to fall short of end-of-session estimates by $488 million or 1.7 percent. Individual income tax revenues are forecast to be $291 million (1.9 percent) less than the previous forecast, sales taxes fall by $145 million (1.6 percent), and corporate taxes by $57 million (3.1 percent). Receipts from the statewide property levy are now expected to exceed end-of-session estimates by $6 million and the general fund share of motor vehicle sales tax receipts is now projected to be $1 million less than previously forecast.

Almost all of the reduction to the individual income tax forecast comes from declines in portfolio or non-wage income. Through early November withholding receipts were slightly above forecast. Capital gains and dividend and interest incomes for the 2008 and 2009 tax years are now projected to be well below levels forecast in February. Expected revenues for almost all taxes were less than end-of–session estimates, consistent with the weaker near term economic outlook. For the 2008-09 biennium total current resources are now forecast to be 0.3 percent more than total collections in the 2006-07 biennium.

Changes in Economic Assumptions

Global Insight's November baseline is markedly different from its February forecast. Both had recessions, but the November baseline calls for a deeper and longer slump than was anticipated nine months ago. Tight credit markets, the on-going housing sector slump, and higher oil prices led consumers to cut back their spending in late summer. The result has been the first consumer led recession in more than 25 years.

GII expects the economy to contract through all of FY 2009. The economic weakness lasts for four consecutive quarters and is widespread. Employment falls and purchases of consumer goods and business equipment decline as well. Because the economic slump extends well beyond America's borders U.S. exports also plateau removing a major source of recent economic stimulus.

In calendar 2009 employment is forecast to shrink more rapidly in Minnesota than elsewhere in the nation, consistent with growth patterns observed since 2005. Wage and salary income in Minnesota also grows more slowly than the national average reflecting the weaker job growth. The 2009 fiscal year ends with Minnesota payroll employment 55,000 jobs below that at the end of FY 2008. Growth in average wage per job also falls below the U.S. average.

Individual Income Tax

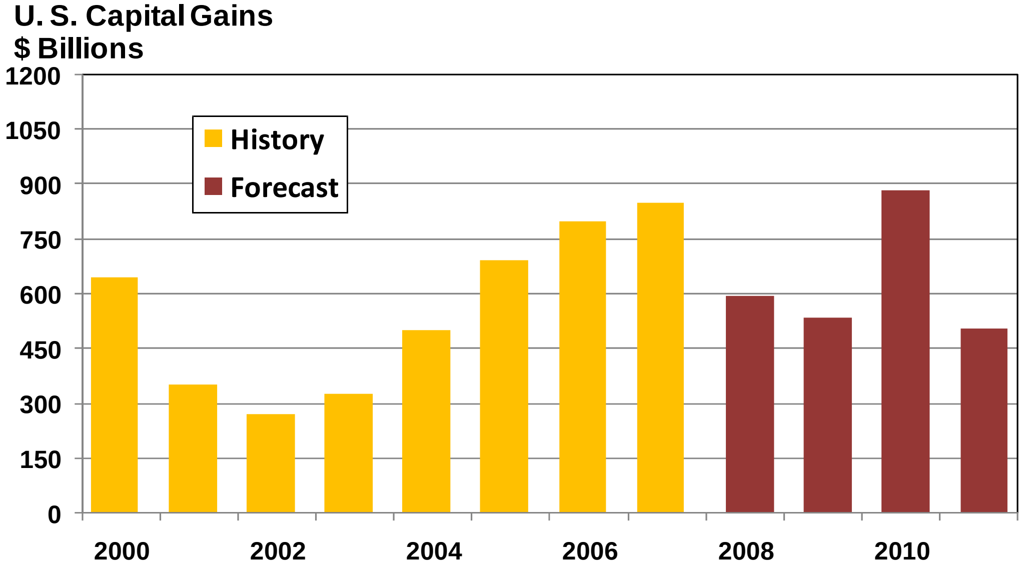
Individual income tax receipts for the 2008-09 biennium are now forecast to total $15.059 billion, $291 million (1.9 percent) less than end of session estimates. Actual receipts in fiscal 2008 were $176 million more than forecast, but receipts for FY 2009 are now expected to fall $467 million below forecast. Through October fiscal-year-to-date receipts were $15 million above forecast.

Other things equal about one half of the higher income tax variance observed in fiscal 2008 would be added to tax year 2007 liability. However, transfers of refunds to estimated taxes exceeded the forecast by about $40 million. That, coupled with summary liability information from a processing report for early November, reduced the estimated increase in tax year 2007 income tax liability to $32 million. Higher than projected withholding accounted for $74 million of the $176 million 2008 fiscal year variance. That increase in withholding is consistent with the slightly stronger than expected economic growth observed in Minnesota and elsewhere in the nation.

Wages in tax year 2008 are now projected to be 0.4 percent above levels forecast in February. Other things equal that would increase expected revenues for the biennium. That increase is offset by a drop in the projected wage growth rate in tax year 2009 and by large declines in the expected level of non-wage income in both the 2008 and 2009 tax years. Receipts from partnerships, S corps, and fiduciaries also fall by a combined $45 million in FY 2009.

Net realizations of capital gains are assumed to decline by 30 percent in tax year 2008 and by an additional 10 percent in 2009. February's forecast assumed realizations would decline by 5 percent in 2008, but then grow by 10 percent in 2009. The capital gains assumptions explain more the 75 percent of the expected decline in tax year 2008 liability. When combined with assumed reductions in interest and dividend income more than 90 percent of decline in tax year 2008 income tax liability is explained. The assumed decline in capital gains is large, but not beyond historical experience. During the last recession net U.S. capital gains realizations fell by 46 percent in 2001 and an additional 27 percent in 2002.

Capital Gains Realizations Forecast to Fall 30 Percent in 2008 Tax Year and an Additional 10 Percent in 2009

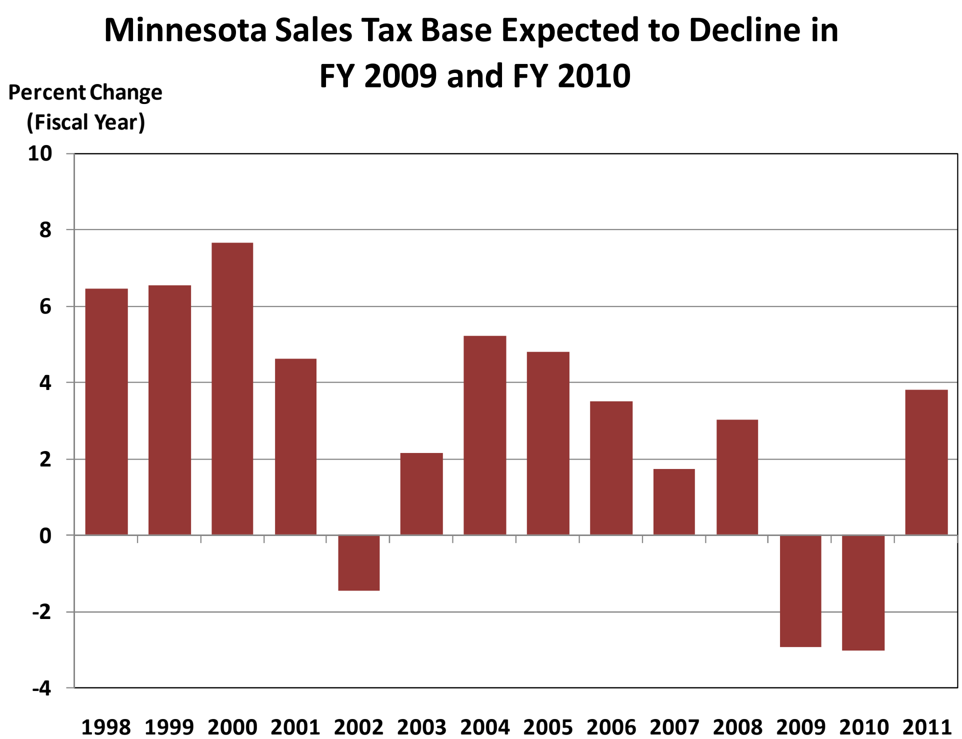


Revised estimates of Minnesota's working family credit on dependent care credit reduced tax year 2008 liability by $16 million. The accounts receivable forecast was reduced by $14 million to reflect experience since February. The estimated excess withholding was reduced by $13 million in FY 2009 to be consistent with recent experiences and the outlook for a slower economy.

Sales Tax

Net sales tax collections for the 2008-09 biennium are now expected to reach $9.032 billion, $145 million (1.6 percent) less than end-of-session estimates. The forecast for gross sales tax receipts fell by $140 million and expected sales tax refunds increased by $5 million. The 2009 fiscal year to date negative variance of $29 million was incorporated into this forecast. The state also closed FY 2008 with a negative variance of $20 million in net sales tax receipts. Net sales tax revenue for the biennium is now expected to be just 0.7 percent greater than in the 2006-07 biennium.

Minnesota's sales tax collections depend greatly on consumer purchases of consumer durable goods such as furniture and electronics, business investment spending, and purchases of construction materials. The current GII baseline forecast calls for further slowing in each of those types of sales in the current fiscal year. In February Minnesota's sales tax base was forecast to decline 0.3 percent in FY 2009. The current forecast calls for a drop of 2.9 percent in the states estimated sales tax base. Sales tax receipts in the current fiscal year are now expected to fall back to levels observed in FY 2006.



No changes were made to the receipts elasticity. It remains at .95. The rate at which sales tax losses to e-commerce and catalog sales occur is now assumed to be 6.5 percent.

Corporate Franchise Tax

Corporate tax revenues for the 2008-09 biennium are forecast to total $1.812 billion, $57.4 million (3.1 percent) less than end-of-session estimates. The forecast for the current biennium is $421 million (18.8 percent) below the level of corporate tax receipts actually received during the 2006-07 biennium. Corporate profits would be expected to decline when economic growth disappears. Global Insight's November baseline forecast shows a reduction in corporate profits from the levels assumed in February. U.S. corporate profits are now assumed to fall by 15 percent during FY 2009.

While the current forecast incorporates an expected change in the tax treatment of foreign operating corporations approved in the 2008 legislative session, the estimate of the revenue that law change produces has been reduced by 16 million (18 percent) to reflect changes in economic conditions since the fiscal note for the law change was prepared. Refunds associated with the Hutchinson Technology decision in FY 2009 are now projected to total $13 million. The remaining $15 million are expected to be paid in the 2010-11 biennium. Corporate tax receipts in FY 2008 were $22 million more than forecast and receipts during the first four months of FY 2009 were an additional $15 million above projection. Both positive variances were incorporated into the forecast. The model used to estimate corporate miscellaneous payments has been revised. A four period lag in domestic corporate profits is now the primary driving variable. The tax effects of recent merger and acquisition activity by corporations with a substantial presence in Minnesota has also been incorporated into this forecast.

Motor Vehicle Tax Receipts

Minnesota's sales tax on motor vehicles is now projected to yield $292 million in the current biennium, $1 million (0.3 percent) less than end-of-session estimates. The forecast for the current biennium is $205 million less than the general fund received during the 2006-07 biennium. While the outlook for motor vehicle sales has dropped dramatically since FY 2006-07, a constitutional amendment that phases in the full dedication of the motor vehicle sales tax to transportation funding is the principal source of the decline in general fund receipts between biennia.

Other Revenues

Other tax and non-tax revenues, including the statewide property tax levy, are expected to total $5.305 billion, $58 million (1.1 percent), more than previously forecast. Large increases in insurance gross premiums tax receipts, fees and dedicated revenues more than offset small declines in most other revenues. Expected cigarette and tobacco tax revenue was reduced by $19 million and expected investment income fell by $18 million. The deed and mortgage tax forecast was reduced by a combined total of $6 million.

EXPENDITURE FORECAST
FY 2008-09 BIENNIUM

Forecast expenditures for the 2008-09 biennium now total $34.611 billion, $18 million more than estimated at the end of the 2008 legislative session. This change reflects a 0.1 percent increase over previous estimates.

FY 2008-09 Expenditures
($ in millions)

	End of Session	November Forecast	Difference
K-12 Education	$13,830	$13,789	($41)
Higher Education	3,139	3,140	1
Property Tax Aids & Credits	3,153	3,172	19
Health & Human Services	9,531	9,594	63
Public Safety	1,687	1,687	0
Transportation	449	452	3
Environment, Energy & Natural Res.	436	429	(7)
Agriculture & Veterans	277	271	(6)
Economic Development	394	399	5
State Government	701	707	6
Debt Service	870	862	(8)
Other	35	33	(2)
Est. Cancellations	(21)	(24)	(3)
Subtotal	**$34,481**	**$34,511**	**$30**
Dedicated Expenditures	112	100	(12)
Total	**$34,593**	**$34,611**	**$18**

Total estimated spending for the current biennium is virtually unchanged. Higher projected spending in health and human services ($63 million) and property tax aids and credits ($19 million) is largely offset by lower projected spending in K-12 education ($41 million), reduced debt service estimates ($8 million), and a net reduction in all other spending areas ($16 million).

Health and human services spending is 0.7 percent higher than end-of-session estimates, predominantly due to worsening economic conditions and higher health care enrollment projections. This forecast includes a 3.2 percent increase in caseloads of families and children within Medical Assistance, and a 4.8 percent increase in caseloads within General Assistance Medical Care. Caseload and average costs for long term care waivers within the Medical Assistance program are lower than previous estimates, mitigating the health care enrollment impact somewhat.

The net increase in property tax aids and credits over previous estimates can be attributed to a $20 million transfer from the Department of Natural Resources to the Department of Revenue for Payments in Lieu of Taxes (PILT) to counties for state-owned land. Other than this change—which has no net impact on the general fund—modest increases in Renters and Homeowners Property Tax Refund and Market Value Homestead Credit programs are largely offset by downward adjustments to the forecast for police and fire pension aids.

Lower K-12 education estimates are driven primarily by lower pupil unit projections which result in a small reduction in basic aid of $25 million (0.3 percent). The FY 2009 forecast for Q-Comp is also down by $12 million due to fewer schools entering the program than previously anticipated. Total estimated debt service costs for the current biennium are $8 million below end-of-session estimates do to delay of the bond sale originally scheduled for October 2008 reflecting the difficult conditions in the municipal bond market.

While minor changes in estimates are shown for other areas within the budget, none of these represent significant adjustments to the forecast. End-of-session estimates are based on appropriations. This forecast, in the second year of the biennium, incorporates actual spending for FY 2008. Unspent operating appropriations have been carried forward into FY 2009. Differences shown from prior forecasts for individual agencies largely reflect movement of money between categories, transfers of funds between agencies, and changes in dedicated revenue estimates and related dedicated spending – not underlying forecast changes.

County Maintenance of Effort and Matching Requirements

For many programs, counties must either maintain fixed levels of local funding ("maintenance of effort") or provide a local share ("match") in order to receive state or federal funds. The 2008 tax bill contained language that suspended county maintenance of effort (MOE) and matching requirements during the three year period that levy limits are in place (January 1, 2009 through December 31, 2011).

Within the health and human services area, several state programs that rely on county MOE or match – for example, chemical dependency treatment and nursing facility services – are entitlement services. If counties choose to discontinue their former contributions toward entitlement services, the services must continue to be provided by the state at a potential general fund cost of about $200 million during FY 2009-11. The language would also allow counties to reduce up to $300 million in other local services during the same time period that would not have a direct general fund impact.

Governor Pawlenty and legislative leaders agreed to repeal this language early in the 2009 legislative session. As a result of their agreement and the uncertainty surrounding the actions of 87 separate counties, the potential state costs identified above have not been included in the expenditure forecast for the upcoming biennium.

FY 2010-13 BUDGET OUTLOOK

FY 2010-2011 Budget Forecast

The economic downturn has produced a significantly lower revenue forecast and higher projected state spending. The expected budget shortfall has grown from the $946 million projected at the end of the 2008 session to $4.847 billion. When compared to those for the 2008-09 biennium, FY 2010-11 revenues are projected to decline by $579 million (1.8 percent) while expenditures are projected to increase by $2.102 billion (6.1 percent).

Unlike the $426 million FY 2009 deficit, the $4.847 billion projected shortfall shown for FY 2010-11 is not an actual budget deficit. It is the difference between forecast revenues and "base level", current law, expenditures. This shortfall estimate provides the framework for developing the budget for the next two years.

FY 2010-11 Budget Forecast
($ in millions)

	FY 2008-09	FY 2010-11	$ Change	% Change
Beginning Balance	$2,245	$79	($2,166)	
Tax Revenues	29,917	29,589	(328)	
Non-Tax Revenues	1,584	1,481	(103)	
Other Resources	944	796	(148)	
Total Revenues	32,445	31,866	(579)	(1.8%)
Expenditures	34,611	36,713	2,102	6.1%
Reserves	505	505		
Budget Balance	**($426)**	($5,273)		
Shortfall (excluding FY08-09)	**- - -**	**($4,847)**		

Revenues decline from FY 2008-09 to FY 2010-11, the first time since 1986-87 that this has occurred. When combined with expenditure growth of 6.1 percent, this presents a very difficult financial management challenge. In an economic downturn, state tax revenues weaken, and sometimes even decline, but health care entitlement spending grows at an even higher rate than in good times as additional adults, families, and children become eligible for services.

FY 2010-11 revenues are estimated with the same detailed, complete models used to estimate FY 2009 revenues. Inflation is included in these revenue estimates. Expenditure estimates are based on current law adjusted only for enrollment, caseload changes, and specific formula requirements. No adjustment is included for estimated inflation. If expenditures were uniformly adjusted for estimated inflation, it would add approximately $650 million to spending and increase the forecast deficit by that amount.

Forecast Provides Initial Set of FY 2012-13 Long-term Planning Estimates

This forecast also provides the first planning estimates for the 2012-13 biennium. These estimates are materially different from the short-term forecasts for the current and 2010-11 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 2012-13 are presented to help identify longer-term state finance issues. Revenue projections are based on the GII November baseline forecast for 2012 and 2013. Expenditure projections assume current funding level and policies continue unchanged, adjusting only for caseload and enrollment changes as well as specific formula-driven items.

As with estimates for 2010-11, spending projections for 2012-13 do not include estimated inflation. Inflation, based on the CPI, is forecast to be 0.2 and 3.0 percent for FY 2010 and FY 2011 respectively. For 2012-13, CPI inflation is forecast by GII to average about 2.5 percent annually. At these levels, the cost of inflation would be $650 million in the next biennium.

For FY 2012-13 inflation is expected to average 2.5 percent per year. Simply applying forecast inflation to current law projected spending would add about $1.5 billion to FY 2012-13 spending.

FY 2012-13 Long Term Planning Estimates

($ in millions)

	FY 10-11	FY 12-13	$ Change	% Change
Current Resources				
Revenues	$31,070	$33,792	$2,722	8.8%
Transfers, Other	796	766	(30)	(3.8%)
Total	31,866	34,558	2,692	8.4%
Projected Spending	36,713	39,162	2,449	6.7%
Difference	**($4,847)**	**($4,604)**	**$243**	
Estimated Inflation (CPI)	*$650*	*$1,500*		

The table with the FY 2012-13 planning estimates shows current resources and projected spending. It excludes any projected balances for FY 2009-11. The term "current resources" refers to revenues and transfers received *within* a fiscal year or biennium. When compared with projected spending, the difference highlights the "structural" gap – how much more is being spent than collected.

Long Term Planning Estimates Highlight Likely Future Budget Problems

For FY 2012-13 current resources are projected to reach $34.558 billion, an increase of $2.692 billion (8.4 percent) over the forecast for FY 2010-11. Current law expenditures are projected to be $39.162 billion, an increase of $2.449 billion (6.7 percent) over forecast spending levels for FY 2010-11.

Revenue growth exceeds expenditure growth, but not enough to meaningfully impact projected future budget shortfalls. This is despite the fact that spending projections assume no general inflation or increases in spending in FY 2010-11 or FY 2012-13 beyond those already incorporated in current law (i.e., enrollment, caseloads, and formula-driven aids.)

The planning estimates are not intended to predict surpluses or deficits that far into the future. Rather their purpose is to assist in determining how well ongoing expenditures will likely match revenues based on trends in Minnesota's economy, and what it will cost to maintain current programs. The FY 2012-13 planning estimates provide one baseline against which the longer-term impacts and affordability of budget proposals and decisions in the 2009 legislative session can be measured.

Clean Waters, Wildlife, Cultural Heritage, and Natural Areas Amendment

On November 4, 2008, Minnesota voters approved the Clean Waters, Wildlife, Cultural Heritage, and Natural Areas constitutional amendment. The amendment increases the state sales tax rate by 3/8 of 1 percent (to 6.875 percent). The new sales tax rate becomes effective July 1, 2009 and remains in effect for 25 years. Unlike the existing state sales tax, the new revenue does not go to the general fund. Rather, the amendment created four funds. It directs 33 percent of receipts to the new Outdoor Heritage fund, 33 percent to the new Clean Water fund, 14.25 percent to the new Parks and Trails fund and 19.75 percent to an Arts and Cultural Heritage fund.

The amendment produces $242 million dollars in FY 2010 and $252 million in FY 2011 in additional revenues. The revenues are forecast using the same methodology as current state sales tax revenues. While the amendment identifies general purposes for the spending in each new fund, it also specifies that the new money must be appropriated through the normal legislative process.

REVENUE ESTIMATES FY 2010-11

Total current resources for Minnesota's general fund in the 2010-11 biennium are forecast to total $31.866 billion, $3.322 billion (9.4 percent) less than end-of-session revenue planning estimates. Current resources for Minnesota's general fund are forecast to be $579 million (1.8 percent) below the level of receipts currently expected for the 2008-09 biennium. General fund receipts for the five major taxes are expected to shrink by $282 million between the 2008-09 biennium and the 2010-11 biennium. While about 60 percent of that that decline is due to an increase in the percentage of state motor vehicle tax receipts transferred to the highway users fund and the transit fund in accordance with the phase in of the constitutional amendment dedicating all motor vehicle sales collections to highways and transit in 2012, expected sales tax and corporate income tax collections are also below levels anticipated in the current biennium.

Revenues FY 2010-11

($ in millions)

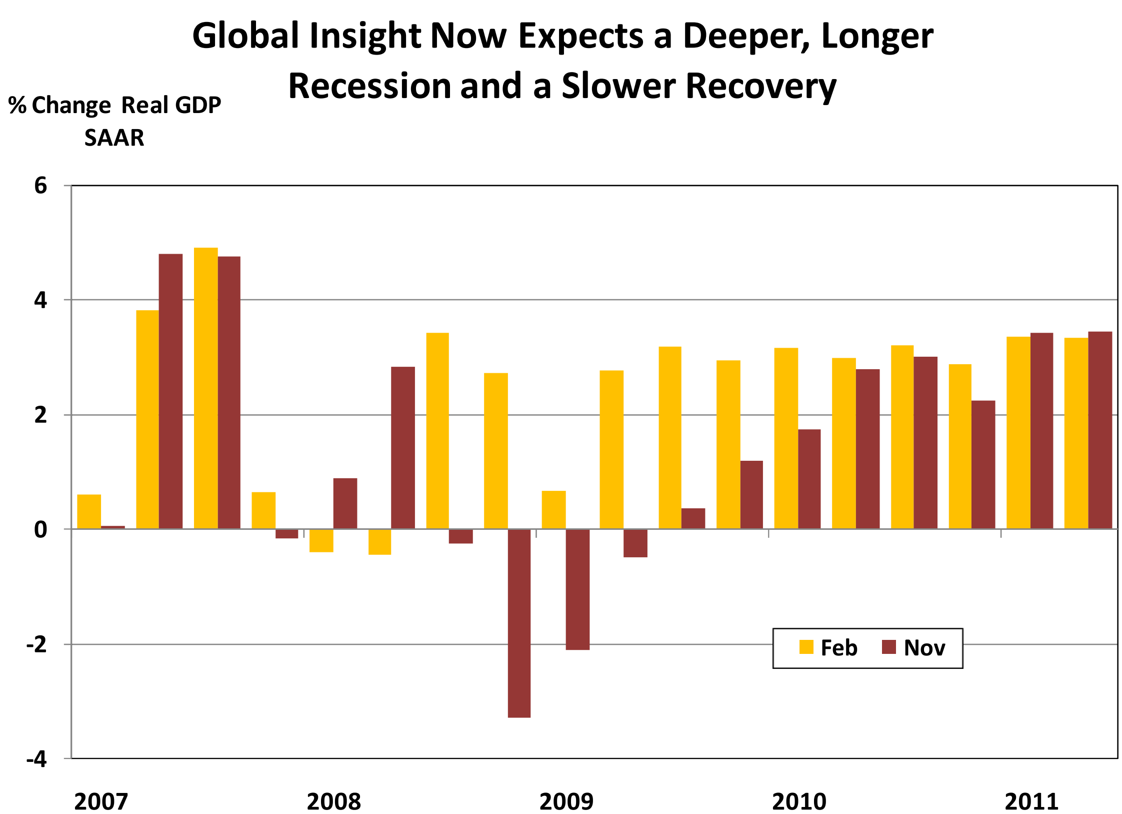
	FY 2008-09	FY 2010	FY 2011	FY 2010-11
Individual Income	$15,059	$7,498	$8,113	$15,611
Sales	9,032	4,280	4,407	8,687
Corporate	1,812	597	809	1,406
Motor Vehicle Sales	292	69	29	98
Statewide Levy	1,447	773	787	1,560
Five Major Taxes	27,642	13,217	14,145	27,362
Other Revenue	3,497	1,655	1,695	3,350
Tobacco	361	180	180	360
Net Non-dedicated	31,500	15,052	16,020	31,072
Other Resources	945	403	393	796
Current Resources	**$32,445**	**$15,454**	**$16,413**	**$31,868**

The individual income tax grows by $552 million between the 2008-09 and 2010-11 biennia, but projected receipts from this tax also show the largest decline from prior estimates. State individual income tax receipts are now forecast to be $15.611 billion, $1.748 billion (10.1 percent) less than end-of-session revenue planning estimates. Forecasts for sales tax receipts and corporate income tax receipts also are substantially below end-of-session estimates. Projected sales tax receipts are down $826 million, (8.7 percent); anticipated corporate tax receipts are down, $640 million or 31.3 percent. The statewide property tax was the only major tax where forecast revenues exceeded prior planning estimates. Minnesota statutes require that the total levy for that tax increases each year at the rate of inflation.

This is the first detailed forecast of revenues for the 2010-11 biennium. Previous revenue estimates for the biennium were simple extrapolations of projected 2009 revenues using long term growth trends. Large changes between end-of-session planning estimates and the first detailed forecast for a biennium are not unusual. The changes in this forecast, however, are outside the bounds of normal experience and greatly exceed previous changes. The expected length and depth of the current economic slump has produced much larger reductions in 2010-11 revenue than would have been expected as recently as late summer.

Changes in Economic Assumptions

Global Insight's November baseline shows the 2007-09 recession ending just as the 2010-11 biennium begins. Then, following the six-quarter long economic downturn, the economy grows more slowly than previously forecast for another one and one half years. In the November baseline real GDP growth does not return to its trend (3 percent) growth rate until early in calendar year 2011. The combination of slower growth and growing from a lower base leaves real GDP at the end of the 2011 fiscal year 4.8 percent below the level projected in February's baseline. After incorporating a reduction in the inflation outlook over the 2009-11 forecast horizon, GII's November baseline shows nominal or current dollar GDP falling 5.8 percent below February's baseline projections.



Income Tax

Individual income tax revenues in the 2010-11 biennium are forecast to total $15.610 billion, $552 million (3.7 percent) more than is now expected for the 2008-09 biennium but $1.748 billion less than end-of-session planning estimates. Adjusted gross income in Minnesota falls in tax year 2009, and Minnesota taxable income falls in both the 2008 and 2009 tax years. While taxable income in 2010 now grows more rapidly than anticipated in February that growth comes from a materially lower starting point. At the end of tax year 2011 the Minnesota resident taxable income is expected to be 13 percent below expectations at the end of the 2008 legislative session.

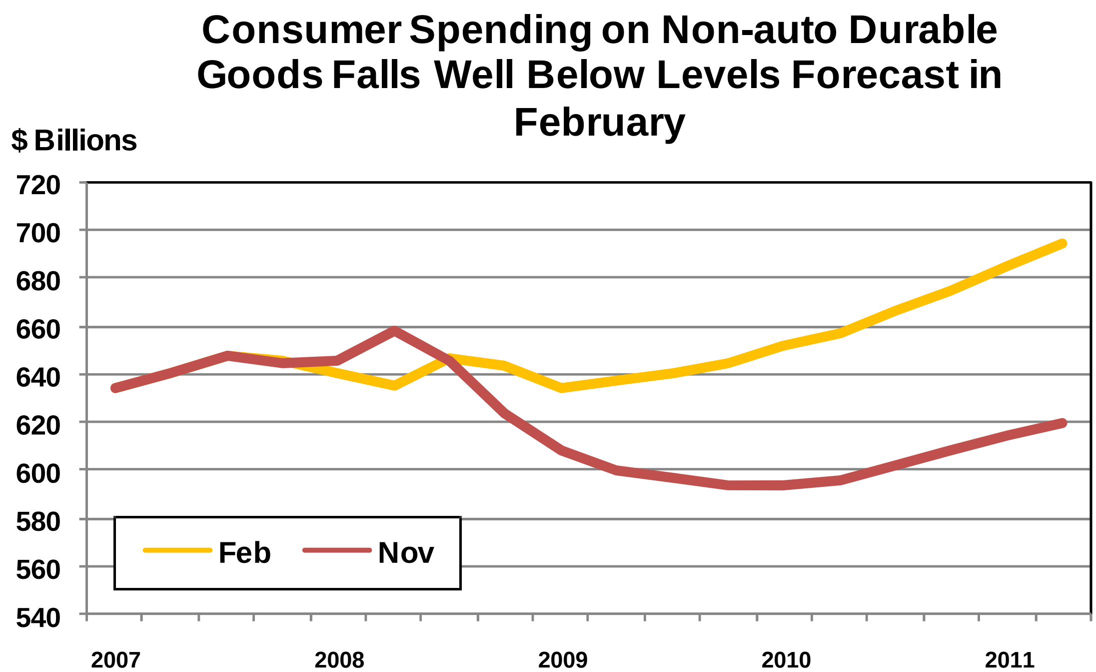
Unlike the situation in tax year 2008, expected wage growth in tax years 2009, 2010, and 2011 is lower in the current forecast. By tax year 2011 wages are 7 percent less than forecast in February. However, declines in non-wage income, particularly capital gains, still account for more than one half of the change in Minnesota's income tax base from February's baseline even though wages represent nearly 75 percent of the state adjusted gross income.

Capital gains realizations are assumed to fall by 30 percent in tax year 2008 and then by an additional 10 percent in tax year 2009. In tax year 2010, the last year before federal capital gains tax rates are scheduled to return to the 20 percent level, realizations are projected to increase by 64 percent as individuals accelerate sales of capital assets to take advantage of the more favorable tax treatment. Tax year 2011 realizations fall by 42 percent from 2010 levels, reflecting both the elimination of the one-time acceleration in realizations in 2010 and the fact that much of the 2010 acceleration comes from transactions that would otherwise have been made in 2011.

Changes in projected levels of Minnesota's working family credit and dependent care credit reduced revenues by $52 million, and changes in expected receipts from partnerships, S-corps, and fiduciaries reduced expected revenues by an additional $91 million. Changes in excess withholding and accounts receivables made for FY 2009 were carried forward into FY 2010 and FY 2011, reducing income tax revenue by $62 million. An additional payday for workers paid on Friday added more than $40 million to FY 2010 receipts.

Sales

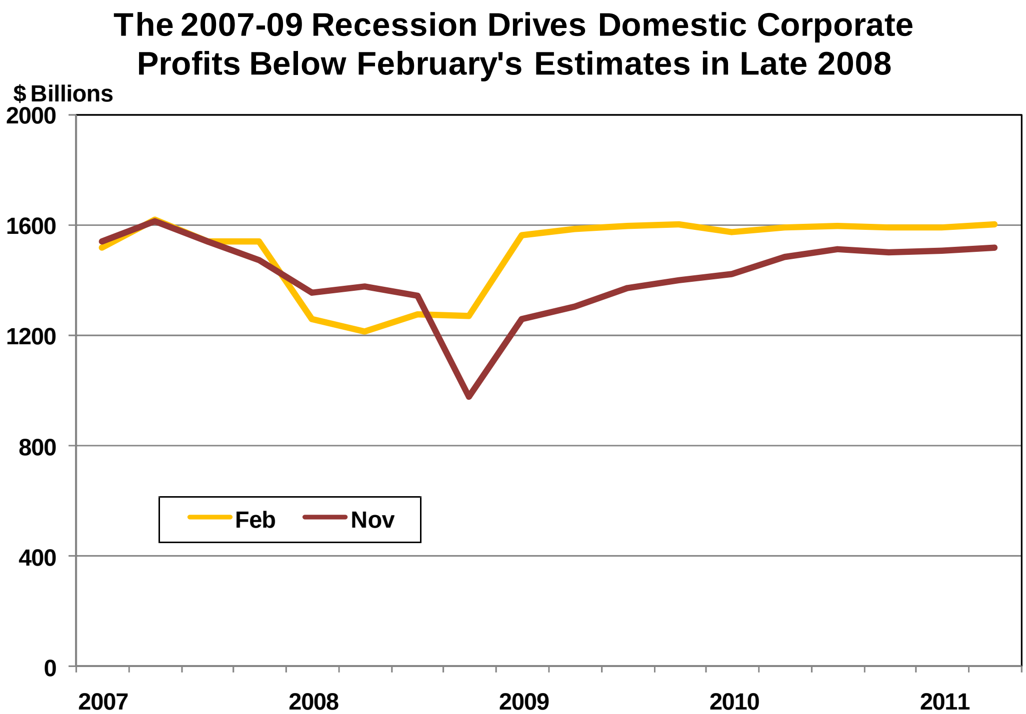
Net sales tax receipts for the 2010-11 biennium are projected to total $8.687 billion, a decline of $345 million (3.8 percent) from levels currently anticipated for FY2008-09. This sales tax forecast is $826 million (8.7 percent) less than the revenue planning estimates following the 2008 legislative session. Consumer durable spending, capital equipment spending, and construction spending are all forecast to remain weak through 2011. The sales tax base continues to be below its fiscal year 2007 level until fiscal 2011. Construction material sales in fiscal 2011 are now projected to be at the level observed in fiscal 2004.



Receipts elasticities were unchanged from those used in February's forecast. There were no changes in the percentage of sales estimated to be lost to e-commerce and catalog sales from those used for 2008 and 2009.

Corporate Franchise Tax

Corporate tax revenues for the 2010-11 biennium are forecast to total $1.405 billion, $408 million (22.5 percent) less than forecast for the 2008-09 biennium. Expected corporate tax revenues are also $640 million (31.3 percent) less than end-of-session planning estimates. The reduction in expected revenues comes from Global Insight's reduction in corporate profits due to the 2008-09 recession. The tax effects of recent merger and acquisition activity by corporations with a substantial presence in Minnesota has also been incorporated into this forecast. The corporate income tax remains the most volatile of Minnesota's major taxes.



Motor Vehicle Sales Tax

Minnesota's sales tax on motor vehicles is now projected to yield $98.6 million in FY2010-11, the last two years before the tax is fully transferred to dedicated funds for transportation and transit. General fund receipts from this tax for the current biennium are now expected to be $194 million less than in the 2008-09 biennium. However, $184 million of that decline is due to transfers to the transportation and transit funds. When compared to end of session planning estimates the decline in revenue is more modest. Forecast revenues for the 2010-2011 biennium are $10 million, 9.0 percent, below February's estimate.

Other Revenues

Other tax and non-tax revenues, including the statewide property tax levy are expected to total $5.269 billion during fiscal 2010-11, $36 million less than receipts in the 2008-09 biennium and $125 million below end-of session estimates. Projected receipts from the insurance gross premiums tax and departmental earnings both increased by more than $40 million from prior estimates, but those gains were more than offset by reductions in the forecast from other tax and non-tax sources. Forecasts for the deed and mortgage taxes were reduced by $38 million and $47 million respectively, while investment income for the 2010-11 biennium was cut by $55 million.

REVENUE PLANNING ESTIMATES FY 2012-13

Total current resources for the 2012-13 biennium are estimated to be $34.558 billion, a $2.692 billion (8.4 percent) increase from the amount now forecast for the 2008-09 biennium. This is the first estimate of the revenue planning estimates for the 2012-2013 biennium. Projected revenues are $629 million less than February's planning estimate for revisions in the 2010-11 biennium. General fund receipts for the five major taxes are now projected to be 9.2 percent more than in the previous biennium. This reflects the complete elimination of motor vehicle sales tax revenues from the general fund as required by the constitutional amendment dedicating of those revenues to transportation funding. While the U.S. and Minnesota economies are assumed to return to a normal growth path beginning in early 2011, that growth comes from a substantially lower base level and revenues continue to fall below the level that would have been expected absent the 2008-09 recession far into the future.

Revenues FY 2012-13
($ in millions)

	FY 2010-11	FY 2012	FY 2013	FY 2012-13
Individual Income	$15,611	$8,300	$8,762	$17,062
Sales	8,687	4,614	4,386	9,450
Corporate	1,406	858	902	1,760
Motor Vehicle Sales	98	0	0	0
Statewide Levy	1,560	799	816	1,615
Five Major Taxes	27,362	14,571	15,316	29,887
Other Revenue	3,350	1,752	1,794	3,546
Tobacco	360	180	178	358
Net Non-dedicated	31,072	16,503	17,288	33,791
Other Resources	796	385	382	767
Current Resources	**$31,866**	**$16,888**	**$17,670**	**$34,558**

The individual income tax is the major source of growth, up 9.3 percent from levels forecast for the 2010-11 biennium. Projected growth in income tax receipts would have been even stronger in the absence of the reduction in tax year 2011 capital gains realizations caused by a scheduled increase in the federal capital gains tax rate effective in 2011. The tax rate increase will produce a one-time jump in revenues in 2010 as taxpayers accelerate their realization of gains to take advantage of the lower tax rate. Those additional realizations will borrow from future realizations in the 2012-13 biennium, leaving tax year 2011 income tax liabilities and fiscal year 2012 payments well below prior year levels.

Sales tax receipts are projected to grow by 8.8 percent, the statewide property tax is expected to increase by 3.5 percent and the corporate franchise tax by 25.2 percent. Receipts from the motor vehicle sales tax are no longer a source of revenue for the state general fund.

No one can forecast the path of the economy 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 FY 2011 will change the revenue planning estimates for FY 2012-13. Other things equal, stronger than anticipated revenue growth through fiscal 2011 will carry forward and add significantly to revenues in the 2012-13 biennium. But, should the economy grow more slowly than forecast during the next thirty-one months, as it has in the last nine months, or should some item of portfolio income such as capital gains fall well below forecast – as it did in tax year 2001 and is forecast to do in 2008 and 2009 — the revenue outlook for the 2012-13 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 the scheduled increase in the tax rate on capital gains could be quite different from that forecast. That could lead to either a material increase in revenues in FY 2012, or a significant decline. Also, Minnesota is assumed to grow at the national rate in 2012 and 2013. While Minnesota has typically grown at or above the national rate, the state has underperformed the U.S. economy in recent years. Either outperforming or underperforming the national averages would lead to a material change in projected revenues. Actual revenues for the 2012-13 biennium could exceed or fall short of the planning estimates by $4 billion or more depending on the economy's performance.

Since November 2002 Minnesota Management & Budget has based its revenue planning estimates on Global Insight's baseline forecast. These revenue planning estimates again were prepared consistent with the GII baseline forecast. GII projects real GDP growth rates of 3.5 percent and 3.1 percent for calendar 2012 and 2013 and nominal GDP growth of 5.4 percent in 2012 and 5.1 percent in 2011. The Blue Chip Consensus expects slightly weaker real growth rates of 2.9 percent and 2.8 percent, but similar nominal GDP growth. GII's real GDP growth rate is also slightly above that assumed by the CBO in their August budget update. GII now expects the CPI to increase at an annual rate of 2.4 percent in both 2012 and 2013. Those rates are almost identical to those of the Blue Chip Consensus and those used by CBO.

As in the past, the 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 by GII in their baseline forecast. Calendar year income tax liabilities were converted into fiscal year revenues using the same proportions as forecast for 2011.

HITS model pin files were adjusted for changes in federal tax law that will occur in 2011 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 expire. Among those changes is the return of the federal capital gains tax rate to 20 percent from its current level of 15 percent. Since Minnesota taxes capital gains at the same rate as ordinary income that change in the federal code will not affect the rate at which capital gains are taxed in Minnesota. It is likely, however, to have a large indirect impact on Minnesota taxable income as investors seeking to maximize after tax returns on investment accelerate realizations into 2010. Since that additional capital gains activity would not be part of taxable personal income as defined for the national income accounts, Minnesota Management & Budget has included off-model adjustments to tax liability in tax year 2012 and 2013, where liabilities was increased by $243 million, and $253 million respectively.

As in recent years the complete sales tax model was used to prepare 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 the same revised model based on before tax corporate profits on a national income accounts basis reduced for foreign source profits. The general fund's share of Minnesota's motor vehicle sales tax collections falls dramatically due to the phase in of the constitutional dedication of these receipts to transportation funds. Total motor vehicle sales tax collections are expected to grow at the GII baseline growth rate for national consumption of motor vehicles and parts. The deed and mortgage tax was 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.

EXPENDITURE FORECAST
FY 2010-2013

FY 2010-11 Biennial Budget Expenditure Estimates

Projected state general fund spending for FY 2010-11 is now $36.713 billion, a 6.1 percent increase over the current biennium.

FY 2010-11 Expenditure Estimates
($ in millions)

	FY2008-09	FY2010-11	$ Difference	% Change
K-12 Education	$13,789	$13,903	$114	0.8%
Higher Education	3,140	3,158	18	0.6
Property Tax Aids & Credits	3,172	3,419	247	7.8
Health & Human Services	9,594	11,406	1,812	18.9
Public Safety	1,687	1,697	10	0.6
Transportation	452	390	(62)	(13.7)
Environment, Energy & Natural Res.	429	370	(59)	(13.8)
Agriculture & Veterans	271	259	(12)	(4.4)
Economic Development	399	280	(119)	(29.8)
State Government	707	624	(83)	(11.7)
Debt Service	862	1,067	205	23.8
Other	33	30	(3)	(9.1)
Estimated Cancellations	(24)	(20)	4	(16.7)
Subtotal	**$34,511**	**$36,583**	**$2,072**	**6.0%**
Dedicated Expenditures	100	130	30	30.0
Total	**$34,611**	**$36,713**	**$2,102**	**6.1%**

Health and human services spending and K-12 education finance costs represent over two-thirds of Minnesota's general fund budget. Health and human services' spending continues to be the most significant contributor to forecast spending growth. Spending in health and human services programs is now projected to grow $1.812 billion (18.9 percent) over FY 2008-09 levels. Within K-12 education programs, a legislative increase in the formula per pupil and a rising number of enrolled pupils, offset by one-time payments made in FY 2008-09 that do not continue, leaves spending growth of less than one percent in the next biennium.

Other growing categories include property tax aids and credits and debt service. Expenditures for property tax aids and credits are projected to increase 7.8 percent in FY 2010-11, primarily due to formula increases to Local Government Aid (LGA) of $95 million and County Program Aid (CPA) of $49 million enacted in the 2008 legislative session. Debt service payments are expected to grow by 23.8 percent, in part because of higher interest rates for new bond issues and lower investment earnings on bond-related balances.

Apart from these major areas, net spending in all other categories is actually projected to remain flat or decline. This largely reflects FY 2009 appropriations carried forward and reductions for a variety of one-time appropriations made in FY 2008-09. The FY 2008 general fund appropriation for the I-35W Victim's Compensation Fund in the state government spending category is one example of this.

Projected Spending in FY 2010-11 Is Up $580 Million from Prior Estimates

Projected spending in FY 2010-11 is $580 million higher than comparable estimates at the end of the 2008 legislative session. A $498 million increase in estimated health and human services spending is the primary driver of this change. Other forecast growth areas include debt service ($45 million) and property tax aids and credits ($28 million). K-12 education and public safety spending declined slightly from previous estimates.

FY 2010-11 Expenditures - Forecast Changes

($ in millions)

	End of Session	November Forecast	$ Difference
K-12 Education	$13,925	$13,903	($22)
Higher Education	3,158	3,158	0
Property Tax Aids & Credits	3,391	3,419	28
Health & Human Services	10,908	11,406	498
Public Safety	1,715	1,697	(18)
Transportation	390	390	0
Environment, Energy & Natural Res.	367	370	3
Agriculture & Veterans	259	259	0
Economic Development	280	280	0
State Government	625	624	(1)
Debt Service	1,022	1,067	45
Other	30	30	0
Estimated Cancellations	(20)	(20)	0
Subtotal	**$36,050**	**$36,583**	**$533**
Dedicated Expenditures	83	130	47
Total	**$36,133**	**$36,713**	**$580**

Health and human services' spending is 4.6 percent higher than end-of-session estimates. Higher expected health care enrollment due to the worsening economic outlook accounts for over three-quarters of this forecast increase. For FY 2010-11, projected caseloads for families and children on the MA have increased 13.6 percent over prior estimates; projected caseloads for adults on GAMC have increased 20 percent. Other significant health care changes include a federally mandated change to the Minnesota health care programs application form that will trigger increased MA eligibility determination and have the effect of shifting enrollment from MinnesotaCare to MA.

Forecast debt service costs for FY 2010-11 are up 4.4 percent from prior estimates. Higher interest rates on long-term tax-exempt bond issues result in higher debt service costs for new state bond issues. At the same time, lower short-term interest rates on balances in the bond proceeds and debt service funds result in lower investment earnings. In this forecast, the assumed size of the future capital budget also increased from $645 to $725 million based on the average size of capital bonding bills over the last ten years.

Slower than anticipated growth in personal income and declining real estate values also result in a small increase (less than one percent) in the forecast for property tax aids and credits spending when compared to end-of-session. Increases in Renters and Homeowners Property Tax Refund and Market Value Homestead Credit programs are offset somewhat by downward revisions to police and fire pension aid estimates.

Lower K-12 education estimates are driven primarily by lower pupil unit projections and a basic aid reduction of $48 million (0.5 percent) compared to end-of-session estimates. The FY 2010-11 forecast for Q-Comp is $18 million lower due to revised estimates of the number of schools that will apply for the program. A higher number of students expected to qualify for free and reduced price lunch increases compensatory education estimates in the next biennium by 4 percent, partially offsetting savings in other areas.

Finally, within the public safety area, a reduction in Department of Corrections costs of $18 million from prior estimates reflects a lower than anticipated growth rate in the prison population. The average adult population for FY 2009 is now projected to be 9,040, down more than 300 from what was anticipated when the current budget was enacted. The projected number of release violators returning to prison has declined; this has been partially offset by growth in new commitments.

Current Law is Starting Point for Budget Planning

FY 2010-11 current law expenditure projections set the context for decisions on the next budget. The expenditure estimates represent the cost of major forecast items adjusted only for enrollment, caseload, or cost increases specifically built into current law or formula. Estimates for other grant programs and operating budgets largely represent FY 2009 appropriations carried forward at the same level. The estimates do not include agency requests or other budget proposals.

The current law expenditure estimates are not automatically adjusted for inflation. Except for a small portion of health care programs where rising prices are an integral part of forecast costs, the estimated impact of inflation on salaries and benefits, goods, or services is *not* generally included in the forecast.

Spending Growth is Limited Under Current Law Estimates

Even without general inflation, there is some growth in current law spending from one biennium to the next. Legislative appropriations increase from the first to the second year of the *current* biennium – and the second year is carried forward as the "base" for the next two-year period. There also are "fiscal tails" – costs reflected for only a single year or part of the current biennium that are fully reflected in each of the next two years.

The 6.1 percent current law expenditure increase projected for FY 2010-11 is higher than actual increases in spending over the last decade. Health and human services accounts for $1.8 billion of the total increase of $2.1 billion. After factoring out health and human services growth, a small increase in K-12 education spending, and 2008 formula increases for LGA and CPA, biennial growth for all other spending areas is negligible.

FY 2012-13 Expenditure Projections are Higher – 6.7 Percent Growth

The spending growth shown for FY 2012-13 planning estimates is slightly higher than that for shown for FY 2010-11. Total spending is projected to increase $2.449 billion, 6.7 percent over FY 2010-11. The growth trend for major forecast programs remains the same as described for FY 2010-11. Health and human services projections account for most of the growth. K-12 education, property tax aids and credits, and debt service projections contribute to biennial spending growth, though to a lesser extent. Estimates for the other major spending areas remain essentially flat.

FY 2012-13 Planning Estimates

($ in millions)

	FY 2010-11	FY 2012-13	$ Difference	% Change
K-12 Education	$13,903	$14,346	$443	3.2%
Higher Education	3,158	3,145	(13)	(0.4%)
Property Tax Aids & Credits	3,419	3,543	124	3.6%
Health & Human Services	11,406	13,182	1,776	15.6%
Public Safety	1,697	1,712	15	0.9%
Transportation	390	389	(1)	(0.3%)
Environment, Energy & Natural Res.	370	377	7	1.9%
Agriculture & Veterans	259	257	(2)	(0.8%)
Economic Development	280	280	0	0.0%
State Government	624	624	0	0.0%
Debt Service	1,067	1,166	99	9.3%
Other	30	45	15	50.0%
Estimated Cancellations	(20)	(20)	0	0.0%
Subtotal	**$36,583**	**$39,046**	**$2,463**	**6.7%**
Dedicated Expenditures	130	116	(14)	(10.8%)
Total	**$36,713**	**$39,162**	**$2,449**	**6.7%**

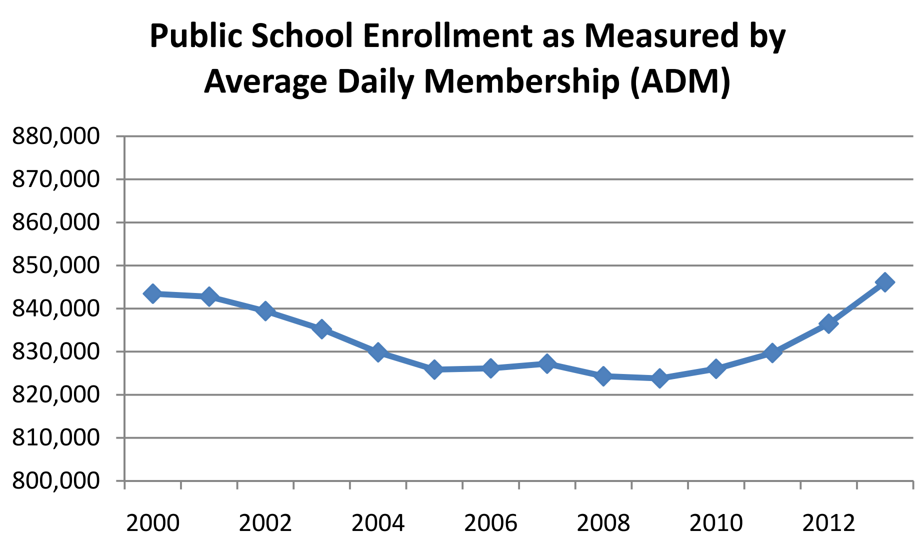
Education Finance, FY 2010-13

Education Finance, the largest category of state general fund spending, consists of aid programs for K-12 education, early childhood and family education, and adult education. K-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. The number and characteristics of students receiving educational services drive most K-12 education funding.

Education Finance Expected to Grow $114 Million in FY 2010-11

General Education
A large portion of the biennial increase in FY 2010-11 is due to General Education funding which is forecast to grow by $92.8 million (0.8 percent) between FY 2008-09 and FY 2010-11.

Basic Education Aid entitlements are expected to increase by $47.8 million (0.5 percent) over the previous biennium. This increase is due to a legislative increase in the formula allowance per pupil between FY 2008 and FY 2009, and increases in the total number of enrolled pupils, with the legislative change accounting for the majority of the increase. Pupil counts are expected to increase in the 2010-11 biennium, reversing the recent trend of declining pupil counts in Minnesota public schools; however the weighting system applied to pupils for purposes of Basic Education Aid balances out much of the potential aid increase. This is because enrollment growth is concentrated among lower weighted students in grades K-5 while higher weighted students in upper grades continue to decline.



In addition to growth in the Basic Education Aid entitlements, Compensatory Aid entitlements are expected to increase by $65.8 million (9.7 percent) over the previous biennium due to an increasing number of pupils qualifying for free and reduced price lunch, the poverty measure for this aid and an increase in the concentration of these pupils. There is also a $56 million increase in General Education funding over the previous biennium due to the elimination of the Permanent School Fund subtraction from the General Education formula.

These increases are partially offset by reductions in other portions of the General Education formula. There is a $48.5 million decrease relative to FY 2009 due to a one-time $51 per pupil payment made in FY 2009 that does not continue into the subsequent biennium. Additionally, entitlements for Referendum Equalization Aid, Operating Capital Aid, and Equity Aid are decreasing relative to the previous biennium due to continued growth in local property tax bases, which increase the school district property tax levy share of these programs. With the real estate market declining, estimates for growth in local property tax bases are lower than previous estimates, but the forecast still includes positive growth for local property tax bases overall. Entitlements for Referendum Equalization Aid are down $51.8 million (27 percent), Operating Capital Equalization Aid entitlements are down $18 million (11.6 percent) and Equity Aid is down $11.4 million (25 percent) compared to the previous biennium.

Categorical Aids
Charter School Lease Aid appropriations are projected to grow by $16.5 million (24 percent) over current levels, reflecting a rising number of students in charter schools and a slight increase in per pupil lease costs. In addition, Integration Revenue is expected to increase by $11.2 million (9.3 percent) and Interdistrict Desegregation Transportation Aid is expected to increase by $10.5 million (44 percent). The Integration Revenue growth is a result of increased participation in the program, including more pupil units in qualifying districts and additional districts qualifying for aid. The growth of Interdistrict Desegregation Transportation Aid is primarily due to more districts and students participating in integration programming, leading to more students transported and higher costs.

Special Education Aid is the largest area of categorical increase and is expected to grow by $121 million (8.7 percent) in FY 2010-11 compared to FY 2008-09. This increase is due to growth that was built into the special education formula in the 2007 legislative session and growth in total pupils.

In addition to the above growth, there are also some offsetting decreases. Debt Service Equalization Aid appropriations are estimated to decrease by $8 million (33.7 percent), primarily due to increases in Adjusted Net Tax Capacity (ANTC). Debt Service Equalization Aid as a percentage of total debt service revenue is expected to be less than 1% in FY 2010-11. Much of the remaining decrease between the biennia is due to the discontinuation of some one-time categorical programs from the 2008-09 biennium totaling $122 million.

Education Finance Expected to Grow $443 Million in FY 2012-13

Education Finance appropriations will total $14.3 billion in FY 2012-13, an increase of $443.2 million (3.2 percent) over the 2010-11 biennium. The vast majority of this growth occurs in the General Education and Special Education programs.

General Education

General Education funding is anticipated to increase by $205.7 million (1.8 percent) over the previous biennium. This change is primarily due to growth in the total number of pupils in the state. Basic Education Aid is anticipated to increase by $133.6 million (1.4 percent). In addition, Compensatory Aid entitlements are expected to increase by $60 million (8 percent) over the previous biennium due to continued increases in the number of pupils qualifying for free and reduced lunch and a continued increase in the concentration of qualifying students. Q-Comp entitlements are expected to increase by $23.5 million (19.5 percent) relative to the previous biennium due to continued growth in the number of districts participating in the program.

Categorical Aids

Outside of the General Education program, the bulk of the growth between biennia occurs in the Special Education program. Total Special Education aid is anticipated to grow $191.5 million (11 percent) from FY 2010-11 to FY 2012-13. This growth is due to an automatic statutory increase in special education funding combined with growth in the total number of pupils in the state.

Beyond special education, the most significant area of growth in categorical programming is in Charter School Lease Aid. Charter School Lease Aid is expected to grow by $18.4 million (21.4 percent) in FY 2012-13 over the previous biennium due to an anticipated 21 percent increase in the number of students enrolling in charter schools.

Property Tax Aids and Credits, FY 2010-13

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.

Tax Aids and Credits Expected to Grow $247 million in FY 2010-11

Expenditures for tax aids and credits are projected to reach $3.418 billion in FY 2010-11, an increase of $247 million (7.8 percent) over spending for the previous biennium. This increase is primarily the result of legislative changes enacted in the 2008 session. The most significant changes were increases to Local Government Aid (LGA) and County Program Aid (CPA) formulas. LGA and CPA funding was increased by 2 percent for aids payable in 2010 and an additional 4 percent for aids payable in 2011. As a result, FY

2010-11 LGA expenditures increase by $100 million (10.3 percent) and CPA increases by $49 million (11.9 percent) compared to FY 2008-09 spending.

Another legislative change driving increased expenditures is the expansion of the Homeowners Property Tax Refund (PTR) program. The maximum refund was increased and the income threshold was lowered in order to increase the number and size of refunds. This change accounts for $35.5 million (4.2 percent) in biennial growth. Additional growth totaling $92.2 million (10.9 percent) occurs in the Renters and Homeowners PTR Programs due to higher numbers of PTR refund filings and slower than anticipated growth in personal income.

The Market Value Homestead Credit (MVHC) is driven by real estate values. Although the housing market has experienced significant turmoil in recent months and many residential valuations have been lowered, the overall trend of rising property values continues for all classes at a modest pace. This results in a MVHC decrease of $22.7 million (4.2 percent) in FY 2010-11 when compared to the previous biennium.

Tax Aids and Credits Expenditures Expected to Grow $124 million in FY 2012-13

Tax aids and credits spending is expected to reach $3.543 billion in FY 2012-13, a $124 million (3.6 percent) increase over FY 2010-11 forecast expenditures. A significant portion of this change results from the Local Government Aid (LGA) and County Program Aid (CPA) increases that were enacted during the 2008 legislative session. In FY 2012-13, LGA spending is expected to increase by $54.2 million (5.1 percent) and CPA is anticipated rise by $23.1 million (5.0 percent) compared to FY 2010-11.

The growth trend in the Renters and Homeowners Property Tax Refund (PTR) Programs continues in the planning years, although at a more modest pace. Increased filings and slower personal income growth result in an increase of $57.7 million (5.9 percent) over FY 2010-11 spending.

These increases are partially offset by a decrease in Market Value Homestead Credit (MVHC) expenditures. Spending is this area is forecast to be down $24.9 million (4.8 percent) compared to FY 2010-11. This results from modest anticipated growth in real estate values.

Health and Human Services, FY 2010-2013

Health and human services includes state payments for direct health care services, such as hospital and physician visits, nursing home services, home care, and other medical and long-term care services. Approximately two-thirds of the spending in this area occurs in the state's Medicaid program, Medical Assistance (MA). MA is a federal entitlement program for low-income families, persons with physical or developmental disabilities, and the frail elderly. In Minnesota, MA costs are split between the state and federal government. The costs described here are the state share only.

This area of the state's budget also includes a wide range of non-health care programs and services, many of which are means-tested. These programs include cash assistance, child care, and grants to counties for child protection, child support enforcement, and other services.

Health and Human Services Expected to Grow $1.8 Billion in FY 2010-11

Spending in the Health and Human Services budget is now expected to be $11.4 billion in FY 2010-11, $1.8 billion (18.9 percent) more than the current biennium. The bulk of the growth is within the MA program, as enrollment and average payments continue to increase each year. Additional MA enrollment is expected in FY 2010-11 due to worsening economic conditions.

Health Care
Basic Health Care includes state assistance for acute care such as hospitalization and physician services that are covered under MA Children and Families Basic Care, MA Elderly and Disabled Basic Care, and General Assistance Medical Care (GAMC). Overall, Basic Health Care is forecast to reach $5.5 billion in FY 2010-11, up $1.2 billion (28.8 percent) from FY 2008-09.

Public health programs face many similar cost pressures to the private health care market, including medical inflation and increased utilization of health care services. Public health programs must also accommodate higher enrollment during economic downturns.

MA Families and Children Basic Care costs in FY 2010-11 are expected to be $2.2 billion, an increase of $545.5 million (32.6 percent) over FY 2008-09. Projections include increases in both enrollment and average costs. Enrollment growth in this segment is larger than in previous forecasts due to worsening economic conditions and a federally mandated change to the Minnesota health programs application form. The change is expected to shift some enrollees from MinnesotaCare to MA. Monthly average enrollment is expected to increase by about 67,400 enrollees (17.6 percent) from FY 2008-09 to FY 2010-11. Monthly average payments are expected to increase by 14.4 percent from FY 2008-09 to FY 2010-11. The majority of this population participates in managed care and the per person cost of this purchasing strategy increases by varying amounts each year.

MA Elderly and Disabled Basic Care costs are projected to reach $2.5 billion, an increase of $513.4 million (25.0 percent) from FY 2008-09 to FY 2010-11. Monthly average enrollment is expected to increase by about 8,500 enrollees (5.3 percent) from FY 2008-09 to FY 2010-11. Monthly average payments are expected to increase by 19.9 percent from FY 2008-09 to FY 2010-11.

Costs for GAMC are projected to increase $176.4 million (31.8 percent) from FY 2008-09 to FY 2010-11. Total costs for GAMC in FY 2010-11 are $731.5 million. Monthly average enrollment is expected to increase by about 4,400 enrollees (15.2 percent) from FY 2008-09 to FY 2010-11. Average monthly costs per enrollee are expected to increase 14.5 percent form FY 2008-09 to FY 2010-11.

Continuing Care

Continuing Care Grants provide ongoing support for chronically ill and disabled individuals in institutions or in home and community-based settings. Spending across all Continuing Care Grants in FY 2010-11 is expected to be $3.97 billion, an increase of $550.5 million (16.1 percent) from FY 2008-09. Total expenditures for MA waiver services are expected to reach $2.4 billion in FY 2010-11, an increase of $448.5 million (23.3 percent) from FY 2008-09. The following details by waiver program explain most of the increase:

- Developmentally Disabled (DD) expenditures account for nearly one-half of total waiver spending, and are projected to increase $144.8 million (15.1 percent) over the current biennium. Approximately 1,600 recipients will added to the program in FY 2010-11 compared to the previous biennium. The average cost per recipient rises as well, increasing by just over $2,900 (9.2 percent) per recipient.

- Community Alternative for Disabled Individuals (CADI) expenditures are estimated to reach $497.1 million in FY 2010-11, a 52.1 percent increase from the current biennium. Current law limits CADI growth in the current and upcoming biennium. Even with limits, it is estimated that 7,500 more CADI recipients will receive services in FY 2010-11. The average cost per recipient increases 22.3 percent (approximately $2,200) over the previous biennium. Caseload projections in FY 2010-11 were expected to be higher, due to one year without enrollment caps, but were never realized.

- Traumatic Brain Injury (TBI) spending is estimated to increase $26.9 million (29.4 percent) over the previous biennium, totaling $118.4 million in FY 2010-11. The estimated number of TBI recipients is expected to exceed the previous biennium by 17 percent, or approximately 532 recipients. Like CADI, enrollment projections linked with limits on growth turned out to be less than estimated.

- Elderly Waiver (EW) is the one area where expenditures are lower than the previous biennium. EW spending is $27.8 million below FY 2008-09 (39.3 percent). EW services are provided both on a fee for service basis and under managed care. Expenditures for fee for service recipients are reflected in this activity while expenditures for managed care recipients are accounted for under Elderly and Disabled Basic Care. Approximately 5,400 fewer recipients will receive EW services in this activity than did in the previous biennium. Those recipients that remained were more expensive than those in FY 2008-09, average cost increased 12 percent.

Chronically ill and disabled individuals also receive services outside waiver programs, as part of this activity. The bulk of this spending is for personal care assistant (PCA) and private duty nurse (PDN) services. PCA/PDN expenditures are projected to reach $531.1 million in FY 2010, a 21.7 percent increase over the current biennium. In the past, limits on the growth in the waiver programs resulted in significantly higher PCA/PDN use, especially within the disabled population.

The MA LTC Facilities expenditures are expected to total $1.0 billion in FY 2010-11, a 3.2 percent increase from the current biennium. The bulk of this activity is payments for nursing facilities, but also includes services for those with mental illness served in intermediate care facilities for the mentally retarded (ICF/MRs) and day training and rehabilitation services (DT&H). Payments for nursing home services total $838.7 million, $30.3 million higher than FY 2008-09. The average monthly caseload is expected to be approximately 1,000 lower in FY 2010-11 compared to the previous biennium. While the number served is declining, the average monthly cost per recipient is projected to be higher, a 6.6 percent increase.

Children and Economic Assistance Grants

Children and Economic Assistance Grants include an array of programs for families and individuals, many of which are means tested. Expenditure estimates in this area are projected to total $1.1 billion in FY 2010-11, up $71.3 million (7.2 percent) from FY 2008-09.

General fund spending on MFIP/Diversionary Work Program grants is expected to be $144.9 million in FY 2010-11, an increase of $49.3 million (51.7 percent) from FY 2008-09. Part of this change is explained by changes in the 2008 legislative session that replaced general fund expenditures with TANF funds to achieve a one-time savings in FY 2008-09. At the same time, monthly caseload increases 17.5 percent, driven by worsening economic conditions. Also, the Work Participation Cash Benefit program begins in FY 2010, adding $5.7 million of spending. This provides a monthly benefit to MFIP recipients who meet certain work requirements. Spending for MFIP Child Care Assistance is also higher than FY 2008-09, up $19.4 million, due to higher monthly caseload projections and slightly higher average costs.

Spending for other forecast grant programs in this area are all higher in FY 2010-11 than the current biennium: General Assistance grows by $11.6 million (13.6 percent), Minnesota Supplemental Aid grows by $4.1 million (6.6 percent), and Group Residential Housing (GRH) is $39.2 million higher (25.1 percent). All of these programs serve more recipients than in the previous biennium. Only GRH’s average costs are significantly higher, with average monthly payments increasing 10.4 percent.

Health and Human Services Grows $1.8 billion in FY 2012-13

Basic Health Care spending is projected to grow another $1.2 billion (21.6 percent) in FY 2012-13 to an estimated $6.7 billion. MA Families and Children expenditures are expected to be $2.7 billion in FY 2012-13, an increase of $451.2 million (20.3 percent) from FY 2010-11. Average monthly enrollment is expected to increase by about 10,200 (2.3 percent), and average monthly payments are expected to increase by 16.4 percent between the two biennia. MA Elderly and Disabled Basic Care costs are projected to grow $577.8 million (22.5 percent) from FY 2010-11 to FY 2012-13 and reach $3.1 billion in FY 2012-13. Average monthly enrollment is projected to grow by approximately 7,800 (4.7 percent) from FY 2010-2011 to FY 2012-13, while average monthly payments are estimated to increase by 18.0 percent. General Assistance Medical Care costs are projected to raise $164.9 million (22.5 percent) from FY 2010-11 to FY 2012-13 and reach $896.3 million in FY 2012-13. Average enrollment is expected to increase by 2.4 percent between the two biennia, and monthly average costs per enrollee are expected to increase by 19.7 percent.

Continuing Care Grants spending is now projected to reach almost $4.5 billion in FY 2012-13, an increase of $513.9 million (12.9 percent) over FY 2010-11 costs. Growth is primarily attributable to increases in projected average monthly caseload in MA Long Term Care Waivers, which is projected to add approximately 13,400 recipients over the previous biennium. Spending for MA Long Term Care facilities is relatively flat.

Children and Economic Assistance Grants estimates for FY 2012-13 total over $1.1 billion, $66.9 million (6.3 percent) above FY 2010-11 estimates. Rising caseloads account for the bulk of this increase, reflected by higher spending for Group Residential Housing and the Minnesota Family Investment program.

ALTERNATIVE FORECAST COMPARISON
REAL GDP (ANNUAL RATES)

	08III	08IV	09I	09II	09III	09IV	08A	09A	10A
GII Baseline (11-08)	-0.3	-3.3	-2.1	-0.5	0.4	1.2	1.3	-1.0	1.7
Blue Chip (11-08)	-0.3	-2.8	-1.5	0.2	1.5	2.1	1.4	-0.4	NA
Moody's Economy.Com (11-08)	-0.3	-2.2	-1.6	0.6	2.2	NA	1.4	0.0	NA
Ameriprise (11-08)	-0.3	-3.1	-2.0	-0.4	2.7	3.4	1.3	-0.5	NA
UBS (11-08)	0.3	-3.5	-1.5	0.0	1.5	2.0	1.3	-0.6	2.2
Standard & Poors (11-08)	-0.3	-3.0	NA	NA	NA	NA	1.4	-0.5	2.4

Consumer Price Index (Annual Rates)

	08III	08IV	09I	09II	09III	09IV	08A	09A	10A
GII Baseline (11-08)	6.7	-7.5	-2.3	-1.4	1.4	2.0	3.9	-0.9	2.4
Blue Chip (11-08)	6.7	-2.1	0.8	1.6	2.2	2.1	4.2	1.5	NA
Moody's Economy.Com (11-08)	6.7	-1.8	0.7	2.2	2.5	NA	4.3	1.8	NA
Ameriprise (11-08)	6.7	-3.7	2.7	2.3	1.9	2.5	3.0	2.2	NA
UBS (11-08)	6.7	-7.6	-1.4	3.9	6.0	-0.2	3.9	0.7	2.4
Standard & Poors (11-08)	6.7	-6.9	NA	NA	NA	NA	4.0	-0.3	0.5

FORECAST COMPARISONS

Real Economic Growth

(Annual Percent Change in Real GDP)

	2008	2009	2010	2011	2012	2013
Nov 04 GII Baseline	3.1	3.2				
Feb 05 GII Baseline	3.1	3.3				
Nov 05 GII Baseline	3.4	3.1				
Feb 06 GII Baseline	2.9	3.2				
Nov 06 GII Baseline	3.1	3.3	3.3	2.9		
Feb 07 GII Baseline	3.0	3.2	3.1	2.7		
Nov 07 GII Baseline	1.9	2.9	2.9	2.8		
Feb 08 GII Baseline	1.4	2.2	3.0	3.2		
Nov 08 GII Baseline	1.3	-1.0	1.7	3.1	3.5	3.1

Inflation
(Annual Percent Change in CPI-U)

Nov 04 GII Baseline	1.9	2.1				
Feb 05 GII Baseline	2.1	2.2				
Nov 05 GII Baseline	2.0	2.2				
Feb 06 GII Baseline	2.0	1.9				
Nov 06 GII Baseline	1.9	1.8	1.8	1.7		
Feb 07 GII Baseline	2.3	2.1	1.9	2.0		
Nov 07 GII Baseline	2.0	1.6	1.9	1.8		
Feb 08 GII Baseline	2.5	1.6	1.9	1.8		
Nov 08 GII Baseline	3.9	-0.9	2.4	3.0	2.4	2.4

MINNESOTA - U.S. COMPARISON REPORT

November 2008 Baseline

(Annual Percent Changes)

	2005	2006	2007	2008	2009	2010	2011
Wage and Salary Income							
United States	5.1	6.3	5.6	3.5	1.2	2.4	4.1
Minnesota	2.7	5.0	5.6	3.4	0.2	2.4	4.2
Implied Annual Wage							
United States	3.3	4.4	4.5	3.6	2.6	2.3	2.7
Minnesota	1.1	3.7	5.2	3.9	2.0	2.4	2.7
Non-Farm Employment							
United States	1.7	1.8	1.1	-0.1	-1.5	0.1	1.4
Minnesota	1.6	1.3	0.5	-0.1	-1.8	0.0	1.5
Personal Income							
United States	5.6	7.1	6.1	4.2	2.1	2.4	4.6
Minnesota	3.8	5.4	6.2	4.6	1.1	2.2	4.6

COMPARISON OF ACTUAL AND ESTIMATED

NON-RESTRICTED REVENUES

($ IN THOUSANDS)

	October YTD , 2008 -FY2009			October 2008 -FY2009		
	FORECAST REVENUES	ACTUAL REVENUES	VARIANCE ACT-FCST	FORECAST REVENUES	ACTUAL REVENUES	VARIANCE ACT-FCST
Individual Income Tax						
Withholding	2,005,467	2,022,564	17,097	564,017	539,237	(24,780)
Declarations	338,342	353,378	15,037	15,549	19,621	4,072
Miscellaneous	129,705	128,080	(1,625)	57,444	56,326	(1,118)
Gross	2,473,514	2,504,022	30,508	637,010	615,184	(21,826)
Refund	58,016	73,616	15,600	23,354	38,424	15,070
Net	2,415,498	2,430,407	14,908	613,656	576,760	(36,895)
Corporate & Bank Excise						
Declarations	245,172	253,445	8,273	34,719	73,875	39,156
Miscellaneous	51,096	67,610	16,514	21,918	(21,130)	(43,048)
Gross	296,268	321,055	24,787	56,637	52,745	(3,892)
Refund	44,100	53,506	9,406	15,040	18,568	3,528
Net	252,168	267,549	15,381	41,597	34,177	(7,421)
Sales Tax						
Gross	1,489,291	1,482,438	(6,853)	427,847	428,784	937
Refunds	67,049	89,070	22,021	17,584	27,294	9,710
Net	1,422,242	1,393,368	(28,874)	410,263	401,491	(8,773)
Motor Vehicle Sales Tax	41,156	44,038	2,882	10,318	9,774	(544)
Other Revenues:						
Estate	41,000	51,519	10,519	10,250	15,069	4,819
Liquor/Wine/Beer	20,656	21,439	783	5,805	6,440	635
Cigarette/Tobacco/Cont Sub	63,296	68,069	4,773	17,667	17,681	14
Deed and Mortgage	47,108	46,870	(238)	12,997	12,972	(26)
Insurance Gross Earnings	62,728	69,983	7,254	1,712	547	(1,165)
Lawful Gambling	13,329	11,712	(1,617)	2,943	2,902	(41)
Health Care Surcharge	72,022	71,109	(913)	18,004	18,221	217
Other Taxes	271	236	(35)	52	63	12
Statewide Property Tax	104	707	603	0	682	682
DHS SOS Collections	24,013	11,473	(12,540)	6,003	3,829	(2,174)
Income Tax Reciprocity	0	0	0		0	0
Investment Income	17,615	16,334	(1,281)	1,794	4,562	2,768
Tobacco Settlement	0	100	100		0	0
Departmental Earnings	81,953	93,941	11,988	33,107	44,423	11,317
Fines and Surcharges	25,097	23,981	(1,116)	8,225	7,965	(260)
Lottery Revenues	11,003	13,506	2,504	3,668	8,818	5,150
Revenues yet to be allocated	0	2,714	2,714	0	1,672	1,672
Residual Revenues	25,946	22,154	(3,793)	5,722	4,393	(1,329)
Sales Tax Rebates (all years)	0	0	0	0	0	0
County Nursing Home, Pub Hosp IGT	1,499	2,264	765	375	566	191
Other Subtotal	507,640	528,112	20,472	128,324	150,806	22,482
Other Refunds	13,950	11,886	(2,064)	5,206	5,435	229
Other Net	493,689	516,225	22,536	123,118	145,371	22,253
Total Gross	**4,807,869**	**4,879,666**	**71,797**	**1,260,136**	**1,257,293**	**(2,844)**
Total Refunds	**183,115**	**228,078**	**44,963**	**61,184**	**89,721**	**28,537**
Total Net	**4,624,754**	**4,651,587**	**26,834**	**1,198,952**	**1,167,572**	**(31,380)**

FACTORS AFFECTING THE INDIVIDUAL INCOME TAX

($ in billions)

	Calendar Year					
	2006	2007	2008	2009	2010	2011
Minnesota Non-Farm Tax Base						
November 2004 Baseline	163.506	171.373				
February 2005 Baseline	163.983	172.200				
November 2005 Baseline	161.799	170.983				
February 2006 Baseline	161.561	170.274				
November 2006 Baseline	161.271	169.111	177.669	187.572		
February 2007 Baseline	160.564	169.026	178.408	189.146		
November 2007 Baseline	162.525	171.000	176.126	182.836		
February 2008 Baseline	162.284	171.215	176.042	182.122		
November 2008 Baseline	162.407	172.180	178.014	178.017	180.893	189.211
Minnesota Wage and Salary Income						
November 2004 Baseline	114.465	120.202				
February 2005 Baseline	114.473	120.360				
November 2005 Baseline	114.328	119.824				
February 2006 Baseline	113.713	118.957				
November 2006 Baseline	113.827	119.133	124.673	130.636		
February 2007 Baseline	113.045	118.579	124.034	130.567		
November 2007 Baseline	113.369	119.589	122.871	127.595		
February 2008 Baseline	112.953	119.173	122.189	126.100		
November 2008 Baseline	113.072	119.459	123.530	123.834	126.854	132.244
Minnesota Property Income						
November 2004 Baseline	34.760	36.088				
February 2005 Baseline	35.200	36.744				
November 2005 Baseline	33.432	36.204				
February 2006 Baseline	33.754	36.367				
November 2006 Baseline	34.633	36.654	38.739	41.925		
February 2007 Baseline	34.659	37.168	40.223	43.666		
November 2007 Baseline	36.063	38.161	39.560	40.713		
February 2008 Baseline	36.251	38.852	40.162	41.289		
November 2008 Baseline	36.253	39.071	40.622	39.994	39.271	41.252
Minnesota Proprietors' Income						
November 2004 Baseline	14.281	12.083				
February 2005 Baseline	14.309	15.156				
November 2005 Baseline	14.037	14.956				
February 2006 Baseline	14.093	14.950				
November 2006 Baseline	12.811	13.324	14.256	15.017		
February 2007 Baseline	12.861	13.279	14.150	14.912		
November 2007 Baseline	13.093	13.251	13.694	14.529		
February 2008 Baseline	13.080	13.192	13.691	14.733		
November 2008 Baseline	13.081	13.650	13.861	14.188	14.768	15.447

FACTORS AFFECTING SALES TAX, CORPORATE INCOME TAX, AND SALES TAX ON MOTOR VEHICLES

($ in billions)

	Fiscal Year					
	2006	2007	2008	2009	2010	2011
SALES TAX						
Minnesota Synthetic Sales Tax Base						
February 2006 Baseline	74.807	77.366				
Pct	6.0%	3.4%				
November 2006 Baseline	74.170	76.219	78.115	81.901		
Pct	4.63%	2.76%	2.49%	4.85%		
*February 2007 Baseline	70.497	72.139	73.905	77.157		
Pct	4.3%	2.3%	2.4%	4.4%		
*November 2007 Baseline	68.299	69.405	70.381	70.572		
Pct	3.3%	1.6%	1.4%	0.3%		
*February 2008 Baseline	68.299	69.342	70.593	70.388		
Pct	3.3%	1.5%	1.8%	-0.3%		
November 2008 Baseline	68.104	69.284	71.375	69.278	67.178	69.730
Pct	3.5%	1.7%	3.8%	-2.9%	-3.0%	3.8%
Minnesota's Proxy Share of U.S. Consumer Durable Spending (Excluding Autos)						
February 2006 Baseline	12.993	13.247				
November 2006 Baseline	13.229	13.606	13.697	14.291		
February 2007 Baseline	13.232	13.788	14.055	14.552		
November 2007 Baseline	12.885	13.289	13.525	13.229		
February 2008 Baseline	12.885	13.287	13.560	13.451		
November 2008 Baseline	12.715	13.163	13.567	12.869	12.257	12.549
Minnesota's Proxy Share of U.S. Capital Equipment Spending						
February 2006 Baseline	12.610	13.841				
November 2006 Baseline	11.616	12.443	13.204	13.778		
February 2007 Baseline	11.619	12.179	12.834	13.419		
November 2007 Baseline	11.698	11.822	12.227	12.404		
February 2008 Baseline	11.698	11.820	12.199	12.078		
November 2008 Baseline	11.640	11.922	12.316	11.760	10.854	11.711
Minnesota's Proxy Share of U.S. Construction Spending						
February 2006 Baseline	11.714	11.729				
November 2006 Baseline	12.135	11.775	11.622	12.398		
**February 2007 Baseline	8.510	8.031	7.509	7.829		
***November 2007 Baseline	7.276	7.067	6.304	5.812		
February 2008 Baseline	7.290	6.784	6.267	5.421		
November 2008 Baseline	7.248	6.716	6.401	5.966	5.445	6.180

* Series revised
** New Series
*** New Series

FACTORS AFFECTING SALES, CORPORATE INCOME AND SALES TAX ON MOTOR VEHICLES

($ in billions)

	Fiscal Year					
	2006	2007	2008	2009	2010	2011
SALES TAX (Cont.)						
Minnesota's Personal Income Excluding Farm Proprietors Income*						
November 2004 Baseline	194.41	204.46				
February 2005 Baseline	194.76	204.77				
November 2005 Baseline	196.70	207.71				
February 2006 Baseline	195.47	206.78				
November 2006 Baseline	195.19	205.96	216.03	227.93		
February 2007 Baseline	195.42	205.82	216.81	229.20		
November 2007 Baseline	190.95	200.20	207.70	215.85		
February 2008 Baseline	190.84	200.00	209.19	216.12		
November 2008 Baseline	190.82	200.36	210.61	216.41	219.52	227.48
SALES TAX ON MOTOR VEHICLES						
Minnesota's Proxy Share of U.S. Consumption of Motor Vehicles and Parts						
November 2004 Baseline	9.132	9.594				
February 2005 Baseline	9.140	9.495				
November 2005 Baseline	8.925	9.340				
February 2006 Baseline	8.919	9.258				
November 2006 Baseline	9.018	9.061	8.993	9.292		
February 2007 Baseline	8.963	8.951	9.159	9.597		
November 2007 Baseline	8.869	8.892	8.681	8.852		
February 2008 Baseline	8.873	8.872	8.569	8.506		
November 2008 Baseline	8.846	8.862	8.571	6.895	7.977	8.380
CORPORATE FRANCHISE TAX		Calendar Year				
U.S. Corporate Profits						
November 2004 Baseline	1,019.7	1,010.9				
February 2005 Baseline	971.8	965.8				
November 2005 Baseline	1,137.8	1,299.8				
February 2006 Baseline	1,137.8	1,329.9				
November 2006 Baseline	1,237.4	1,460.7	1,481.5	1,382.8		
February 2007 Baseline	1,237.4	1,460.7	1,617.8	1,463.6		
November 2007 Baseline**	1,368.6	1,392.4	1,302.8	1,355.1		
February 2008 Baseline**	1,368.6	1,373.7	1,310.7	1,326.7		
November 2008 Baseline**	1,557.8	1,510.5	1,402.8	1,286.4	1,446.5	1,493.8

* Bureau of Economic Analysis Concept

** MMB Estimate of Domestic Corporate Profits & Adjusted to net effects of the Federal Tax Acts of 2002, 2003, and 2008.

FY 2008-09 General Fund Budget - Current Biennium
November 2008 Forecast
($ in thousands)

	Actual FY 2008	11-08 Fcst FY 2009	11-08 Fcst FY 2008-09
Actual & Estimated Resources			
Balance Forward From Prior Year	2,244,935	1,920,021	2,244,935
Current Resources:			
Tax Revenues	15,411,900	14,504,888	29,916,788
Non-Tax Revenues	824,255	759,583	1,583,838
Subtotal - Non-Dedicated Revenue	16,236,155	15,264,471	31,500,626
Dedicated Revenue	74,439	88,457	162,896
Transfers In	344,549	387,214	731,763
Prior Year Adjustments	24,951	25,000	49,951
Subtotal - Other Revenue	443,939	500,671	944,610
Subtotal-Current Resources	16,680,094	15,765,142	32,445,236
Total Resources Available	**18,925,029**	**17,685,163**	**34,690,171**
Actual & Estimated Spending			
K-12 Education	6,833,702	6,966,196	13,799,898
K-12 Shift Buyback	(11,058)	533	(10,525)
Subtotal K-12 Education	6,822,644	6,966,729	13,789,373
Higher Education	1,563,413	1,576,446	3,139,859
Property Tax Aids & Credits	1,581,087	1,591,090	3,172,177
Health & Human Services	4,630,471	4,963,782	9,594,253
Public Safety	817,020	869,809	1,686,829
Transportation	236,552	215,658	452,210
Environment, Energy & Natural Resources	199,969	228,993	428,962
Agriculture & Veterans	126,936	144,001	270,937
Economic Development	249,994	148,921	398,915
State Government	314,652	392,124	706,776
Debt Service	409,296	452,762	862,058
Capital Projects	10,247	10,248	20,495
Deficiencies/Other	7,322	4,818	12,140
Estimated Cancellations	0	(23,700)	(23,700)
Subtotal Expenditures & Transfers	**16,969,603**	**17,541,681**	**34,511,284**
Dedicated Expenditures	35,405	64,857	100,262
Total Expenditures & Transfers	**17,005,008**	**17,606,538**	**34,611,546**
Balance Before Reserves	**1,920,021**	**78,625**	**78,625**
Cash Flow Account	350,000	350,000	350,000
Budget Reserve	654,922	154,922	154,922
Appropriations Carried Forward	217,207	0	0
Budgetary Balance	**697,892**	**(426,297)**	**(426,297)**

FY 2008-09 General Fund Budget - Current Biennium Comparison
November 2008 Forecast vs End of Session
($ in thousands)

	5-08 Enacted FY 2008-09	11-08 Fcst FY 2008-09	Fcst Vs Enacted FY 2008-09
Actual & Estimated Resources			
Balance Forward From Prior Year	2,244,935	2,244,935	0
Current Resources:			
Tax Revenues	30,378,391	29,916,788	(461,603)
Non-Tax Revenues	1,557,786	1,583,838	26,052
Subtotal - Non-Dedicated Revenue	31,936,177	31,500,626	(435,551)
Dedicated Revenue	145,498	162,896	17,398
Transfers In	725,643	731,763	6,120
Prior Year Adjustments	50,000	49,951	(49)
Subtotal - Other Revenue	921,141	944,610	23,469
Subtotal-Current Resources	32,857,318	32,445,236	(412,082)
Total Resources Available	**35,102,253**	**34,690,171**	**(412,082)**
Actual & Estimated Spending			
K-12 Education	13,840,842	13,799,898	(40,944)
K-12 Shift Buyback	(10,525)	(10,525)	0
Subtotal K-12 Education	13,830,317	13,789,373	(40,944)
Higher Education	3,138,791	3,139,859	1,068
Property Tax Aids & Credits	3,153,411	3,172,177	18,766
Health & Human Services	9,530,912	9,594,253	63,341
Public Safety	1,687,397	1,686,829	(568)
Transportation	448,959	452,210	3,251
Environment, Energy & Natural Resources	435,486	428,962	(6,524)
Agriculture & Veterans	277,064	270,937	(6,127)
Economic Development	393,507	398,915	5,408
State Government	701,348	706,776	5,428
Debt Service	870,498	862,058	(8,440)
Capital Projects	34,932	20,495	(14,437)
Deficiencies/Other	0	12,140	12,140
Estimated Cancellations	(21,164)	(23,700)	(2,536)
Subtotal Expenditures & Transfers	**34,481,458**	**34,511,284**	**29,826**
Dedicated Expenditures	111,710	100,262	(11,448)
Total Expenditures & Transfers	**34,593,168**	**34,611,546**	**18,378**
Balance Before Reserves	**509,085**	**78,625**	**(430,460)**
Cash Flow Account	350,000	350,000	0
Budget Reserve	153,000	154,922	1,922
Budgetary Balance	**6,085**	**(426,297)**	**(432,382)**

Biennial Comparison
FY 2010-11 vs FY 2008-09
($ in thousands)

	11-08 Fcst FY 2008-09	11-08 Fcst FY 2010-11	$ Change	% Change
Actual & Estimated Resources				
Balance Forward From Prior Year	2,244,935	78,625	(2,166,310)	-96.5%
Current Resources:				
Tax Revenues	29,916,788	29,589,108	(327,680)	-1.1%
Non-Tax Revenues	1,583,838	1,480,987	(102,851)	-6.5%
Subtotal - Non-Dedicated Revenue	31,500,626	31,070,095	(430,531)	-1.4%
Dedicated Revenue	162,896	164,514	1,618	1.0%
Transfers In	731,763	581,281	(150,482)	-20.6%
Prior Year Adjustments	49,951	50,000	49	0.1%
Subtotal - Other Revenue	944,610	795,795	(148,815)	-15.8%
Subtotal-Current Resources	32,445,236	31,865,890	(579,346)	-1.8%
Total Resources Available	**34,690,171**	**31,944,515**	**(2,745,656)**	**-7.9%**
Actual & Estimated Spending				
K-12 Education	13,799,898	13,903,227	103,329	0.7%
K-12 Shift Buyback	(10,525)	0	10,525	-100.0%
Subtotal K-12 Education	13,789,373	13,903,227	113,854	0.8%
Higher Education	3,139,859	3,157,824	17,965	0.6%
Property Tax Aids & Credits	3,172,177	3,418,955	246,778	7.8%
Health & Human Services	9,594,253	11,406,553	1,812,300	18.9%
Public Safety	1,686,829	1,696,831	10,002	0.6%
Transportation	452,210	389,888	(62,322)	-13.8%
Environment, Energy & Natural Resources	428,962	369,661	(59,301)	-13.8%
Agriculture & Veterans	270,937	259,006	(11,931)	-4.4%
Economic Development	398,915	280,078	(118,837)	-29.8%
State Government	706,776	624,302	(82,474)	-11.7%
Debt Service	862,058	1,067,310	205,252	23.8%
Capital Projects	20,495	29,800	9,305	45.4%
Deficiencies/Other	12,140	0	(12,140)	-100.0%
Estimated Cancellations	(23,700)	(20,000)	3,700	-15.6%
Subtotal Expenditures & Transfers	**34,511,284**	**36,583,435**	**2,072,151**	**6.0%**
Dedicated Expenditures	100,262	129,714	29,452	29.4%
Total Expenditures & Transfers	**34,611,546**	**36,713,149**	**2,101,603**	**6.1%**
Balance Before Reserves	**78,625**	**(4,768,634)**	**(4,847,259)**	
Cash Flow Account	350,000	350,000	0	
Budget Reserve	154,922	154,922	0	
Budgetary Balance	**(426,297)**	**(5,273,556)**	**(4,847,259)**	

FY 2010-11 Biennial Comparison - General Fund
November 2008 Forecast vs End of Session
($ in thousands)

	5-08 Plng Est FY 2010-11	11-08 Fcst FY 2010-11	Fcst vs Enacted FY 2010-11
Actual & Estimated Resources			
Balance Forward From Prior Year	509,085	78,625	(430,460)
Current Resources:			
Tax Revenues	32,912,582	29,589,108	(3,323,474)
Non-Tax Revenues	1,505,553	1,480,987	(24,566)
Subtotal - Non-Dedicated Revenue	34,418,135	31,070,095	(3,348,040)
Dedicated Revenue	117,626	164,514	46,888
Transfers In	601,558	581,281	(20,277)
Prior Year Adjustments	50,000	50,000	0
Subtotal - Other Revenue	769,184	795,795	26,611
Subtotal-Current Resources	35,187,319	31,865,890	(3,321,429)
Total Resources Available	**35,696,404**	**31,944,515**	**(3,751,889)**
Actual & Estimated Spending			
K-12 Education	13,924,992	13,903,227	(21,765)
Higher Education	3,157,668	3,157,824	156
Property Tax Aids & Credits	3,391,575	3,418,955	27,380
Health & Human Services	10,908,543	11,406,553	498,010
Public Safety	1,715,108	1,696,831	(18,277)
Transportation	389,510	389,888	378
Environment, Energy & Natural Resources	366,528	369,661	3,133
Agriculture & Veterans	259,376	259,006	(370)
Economic Development	280,154	280,078	(76)
State Government	624,949	624,302	(647)
Debt Service	1,021,935	1,067,310	45,375
Capital Projects	29,800	29,800	0
Estimated Cancellations	(20,000)	(20,000)	0
Subtotal Expenditures & Transfers	**36,050,138**	**36,583,435**	**533,297**
Dedicated Expenditures	82,826	129,714	46,888
Total Expenditures & Transfers	**36,132,964**	**36,713,149**	**580,185**
Balance Before Reserves	**(436,560)**	**(4,768,634)**	**(4,332,074)**
Cash Flow Account	350,000	350,000	0
Budget Reserve	153,000	154,922	1,922
Budgetary Balance	**(939,560)**	**(5,273,556)**	**(4,333,996)**

FY 2008-13 Planning Horizon
November 2008 General Fund Forecast
($ in thousands)

	11-08 Fcst FY 2008-09	11-08 Fcst FY 2010-11	11-08 Plng Est FY 2012-13
Actual & Estimated Resources			
Balance Forward From Prior Year	2,244,935	78,625	(4,768,634)
Current Resources:			
Tax Revenues	29,916,788	29,589,108	32,290,180
Non-Tax Revenues	1,583,838	1,480,987	1,501,371
Subtotal - Non-Dedicated Revenue	31,500,626	31,070,095	33,791,551
Dedicated Revenue	162,896	164,514	150,514
Transfers In	731,763	581,281	565,874
Prior Year Adjustments	49,951	50,000	50,000
Subtotal - Other Revenue	944,610	795,795	766,388
Subtotal-Current Resources	32,445,236	31,865,890	34,557,939
Total Resources Available	**34,690,171**	**31,944,515**	**29,789,305**
Actual & Estimated Spending			
K-12 Education	13,799,898	13,903,227	14,346,463
K-12 Shift Buyback	(10,525)	0	0
Subtotal K-12 Education	13,789,373	13,903,227	14,346,463
Higher Education	3,139,859	3,157,824	3,144,594
Property Tax Aids & Credits	3,172,177	3,418,955	3,543,221
Health & Human Services	9,594,253	11,406,553	13,181,651
Public Safety	1,686,829	1,696,831	1,711,437
Transportation	452,210	389,888	389,440
Environment, Energy & Natural Resources	428,962	369,661	376,761
Agriculture & Veterans	270,937	259,006	256,806
Economic Development	398,915	280,078	280,078
State Government	706,776	624,302	624,506
Debt Service	862,058	1,067,310	1,166,404
Capital Projects	20,495	29,800	45,219
Deficiencies/Other	12,140	0	0
Estimated Cancellations	(23,700)	(20,000)	(20,000)
Subtotal Expenditures & Transfers	**34,511,284**	**36,583,435**	**39,046,580**
Dedicated Expenditures	100,262	129,714	115,714
Total Expenditures & Transfers	**34,611,546**	**36,713,149**	**39,162,294**
Balance Before Reserves	**78,625**	**(4,768,634)**	**(9,372,989)**
Cash Flow Account	350,000	350,000	350,000
Budget Reserve	154,922	154,922	154,922
Budgetary Balance	**(426,297)**	**(5,273,556)**	**(9,877,911)**
Structural Balance	***(2,166,310)***	***(4,847,259)***	***(4,604,355)***

Historical and Projected Revenue Growth

General Fund, November 2008 Forecast

($ in millions)	Actual FY 2006	Actual FY 2007	Actual FY 2008	Estimated FY 2009	Estimated FY 2010	Estimated FY 2011	Average Annual
Individual Income Tax	$6,863	$7,231	$7,759	$7,300	$7,498	$8,113	
$ change		368	528	(459)	198	615	
% change		**5.4%**	**7.3%**	**-5.9%**	**2.7%**	**8.2%**	**3.4%**
Sales Tax	4,464	4,506	4,571	4,461	4,280	4,407	
$ change		42	65	(110)	(181)	127	
% change		**0.9%**	**1.4%**	**-2.4%**	**-4.1%**	**3.0%**	**-0.3%**
Corporate Tax	1,062	1,171	1,020	792	597	809	
$ change		109	(151)	(228)	(195)	212	
% change		**10.3%**	**-12.9%**	**-22.4%**	**-24.6%**	**35.5%**	**-5.3%**
Statewide Property Tax	631	666	704	743	773	787	
$ change		34	38	39	30	14	
% change		**5.5%**	**5.7%**	**5.5%**	**4.0%**	**1.8%**	**4.5%**
Motor Vehicle Sales	250	247	186	106	69	29	
$ change		(2)	(61)	(80)	(37)	(40)	
% change		**-1.0%**	**-24.7%**	**-43.0%**	**-34.9%**	**-58.0%**	**-35.0%**
Other Tax Revenue	1,380	1,211	1,172	1,103	1,099	1,128	
$ change		(169)	(39)	(69)	(4)	29	
% change		**-12.2%**	**-3.2%**	**-5.9%**	**-0.4%**	**2.6%**	**-4.0%**
Total Tax Revenue	$14,649	$15,032	$15,412	$14,505	$14,316	$15,273	
$ change		383	380	(907)	(189)	957	
% change		**2.6%**	**2.5%**	**-5.9%**	**-1.3%**	**6.7%**	**0.8%**
Non-Tax Revenues	861	876	824	759	735	746	
$ change		15	(52)	(65)	(24)	11	
% change		**1.7%**	**-6.0%**	**-7.9%**	**-3.2%**	**1.5%**	**-2.8%**
Dedicated, Transfers, Other	452	471	444	501	403	393	
$ change		19	(27)	57	(98)	(10)	
% change		**4.1%**	**-5.7%**	**12.8%**	**-19.6%**	**-2.5%**	**-2.8%**
Total Current Resources	$15,962	$16,379	$16,680	$15,765	$15,454	$16,412	
$ change		417	301	(915)	(311)	958	
% change		**2.6%**	**1.8%**	**-5.5%**	**-2.0%**	**6.2%**	**0.6%**

Historical and Projected Spending Growth

General Fund, November 2008 Forecast

($ in millions)	Actual FY 2006	Actual FY 2007	Actual FY 2008	Estimated FY 2009	Estimated FY 2010	Estimated FY 2011	Average Annual
K-12 Education	$6,301	$6,438	$6,822	$6,967	$6,908	$6,995	
$ change		138	384	145	(59)	87	
% change		**2.2%**	**6.0%**	**2.1%**	**-0.8%**	**1.3%**	**2.1%**
Higher Education	1,348	1,414	1,563	1,577	1,579	1,579	
$ change		66	149	14	2	0	
% change		**4.9%**	**10.6%**	**0.9%**	**0.1%**	**0.0%**	**3.2%**
Prop. Tax Aids & Credits	1,464	1,559	1,581	1,591	1,687	1,732	
$ change		96	22	10	96	45	
% change		**6.5%**	**1.4%**	**0.6%**	**6.0%**	**2.7%**	**3.4%**
Health & Human Services	3,910	4,311	4,630	4,964	5,481	5,925	
$ change		401	319	334	517	444	
% change		**10.3%**	**7.4%**	**7.2%**	**10.4%**	**8.1%**	**8.7%**
Public Safety	812	895	817	870	847	850	
$ change		83	(78)	53	(23)	3	
% change		**10.3%**	**-8.7%**	**6.5%**	**-2.6%**	**0.4%**	**0.9%**
Debt Service	352	400	409	453	533	534	
$ change		47	9	44	80	1	
% change		**13.4%**	**2.3%**	**10.8%**	**17.7%**	**0.2%**	**8.7%**
All Other	1,356	931	1,183	1,184	1,035	1,028	
$ change		(426)	252	1	(149)	(7)	
% change		**-31.4%**	**27.1%**	**0.1%**	**-12.6%**	**-0.7%**	**-5.4%**
Total Spending	$15,542	$15,947	$17,005	$17,606	$18,070	$18,643	
$ change		405	1,058	601	464	573	
% change		**2.6%**	**6.6%**	**3.5%**	**2.6%**	**3.2%**	**3.7%**