

TENNESSEE STATE FUNDING BOARD
May 27, 2020

The Tennessee State Funding Board (the "Board") met on Wednesday, May 27, 2020, at 10:00 a.m., in the Cordell Hull Building, First Floor, Senate Hearing Room I, Nashville, Tennessee. Interested members of the public were only able to observe and listen to the meeting through electronic means.

The following members were present:

The Honorable Justin Wilson, Comptroller of the Treasury
The Honorable Tre Hargett, Secretary of the State of Tennessee
The Honorable David Lillard, State Treasurer

The following members were present via electronic means:

The Honorable Bill Lee, Governor
Commissioner Butch Eley, Department of Finance and Administration

Recognizing a quorum present, Mr. Wilson called the meeting to order and stated that the meeting was called by Mr. Lee to better understand the economic impact that occurred as a result of COVID-19 (the "virus"), as well as the implications of those effects. Mr. Wilson stated that presentations and documents from the meeting would be made available on the Funding Board's website (<https://comptroller.tn.gov/boards/tennessee-state-funding-board/state-funding-board-information/meeting-minutes-and-materials/2020.html>). Mr. Wilson further stated that although members could pose questions to the presenters, there would be no decisions or deliberations made toward decisions at this special called meeting, except determinations to have further meetings to take action.

Mr. Wilson then recognized Mr. Lee who stated that the state was in a strong financial position for the unprecedented financial challenge. Mr. Lee further stated that the state and country had faced economic downturns before but never one that was so sudden and deep. Mr. Lee then stated that the challenge extended into the coming years and required being addressed with a look to the future. Mr. Lee further stated that the process to look at reductions had already begun for the coming year. Mr. Lee then stated that the economic challenge should be addressed as aggressively as the public health challenge had been addressed, to mitigate the damages, to the economy in the years ahead. Mr. Lee then stated that the meeting was about gathering insights from economists and those that have perspectives beyond the members that would inform the members as they considered the decisions to be made in the days ahead.

Mr. Wilson then recognized Ms. Laurel Graefe, Regional Executive, Federal Reserve Bank of Atlanta, Nashville Branch. Ms. Graefe presented information on the economic impact of the COVID-19 pandemic including the below findings:

- Unprecedented economic slowdown due to the virus, resulted in a very sharp contraction in Gross Domestic Product (GDP).
- The real GDP declined 4.8% in the first quarter of 2020 and was expected to decline a projected 40% in the second quarter of 2020.
- This economic recession was not the result of excessive risk-taking or the deterioration of economic fundamentals like previous recessions.
- Since February of 2020, 16% of the national workforce was shed from the economy.
- Prior to the COVID-19 outbreak, consumer spending was the primary driver of economic growth and it would be the primary driver of the recovery.

- Key issues for the outlook: Response to CARES Act support for businesses expiring, evolution of the virus' response and tracking impacting the consumer/business psyche, and future steps taken in spending and monetary policy.

Mr. Hargett asked Ms. Graefe, based on her interactions, at what point would those on temporary unemployment begin to feel that their lay-off was permanent. Ms. Graefe responded that they did not have as much experience with this situation as traditionally recessions came on slower, so by the time of job loss the unemployed person has a clearer idea at the outset if the job loss was permanent. Ms. Graefe further responded that the current downturn seemed to be a different environment where employers initially had hoped and indicated to those laid-off that it was temporary. Ms. Graefe then responded that there was not a historical precedent for the situation, and they were not sure how things would look in the future.

Mr. Hargett then asked about the possible reasons that the metropolitan areas of Jackson and Chattanooga were outliers on the analysis of employment momentum that was presented. Ms. Graefe responded that one reason could be lessened sectoral effects as sectors such as logistics and transportation had not seen the same negative impact as other sectors. Ms. Graefe further responded that there could also be a timing issue as the data was delayed. Ms. Graefe then responded that it was difficult to determine the smaller shifts when drilling down into the data in smaller Metropolitan Statistical Areas (MSAs) where the data is much more volatile.

Mr. Hargett then asked for a further explanation of why small firms were having a greater percentage decline from normal in sales levels compared to the mid-size and large firms. Ms. Graefe responded that the small firms when surveyed usually give responses that are comparable to larger firms. Ms. Graefe further responded that the results validated the policy discussions of what types of organizations are most vulnerable in this situation.

Mr. Hargett then asked if there was any policy advice for the members, to avoid any further long-term economic damage resulting from policy decisions. Ms. Graefe responded that bold and decisive action early in an economic downturn has an amplified impact on the economy. Ms. Graefe further responded that stretching and making contributions to support the fundamentals of the economy allowed for a faster recovery to the point that policy accommodations could be removed.

Mr. Wilson then recognized Dr. William Fox, Professor of Economics, Boyd Center for Business and Economic Research, University of Tennessee. Dr. Fox presented information on the economic impact of the COVID-19 pandemic including the below findings:

- The GDP declined 5.0% in the first quarter of 2020 and was expected to decline a projected 35% in the second quarter of 2020 based on an annualized growth rate, leading to a projected total decline for the year of around 7%.
- The decline in tax revenue was smaller than that of the GDP but it was unknown if that trend would continue.
- Sales tax collections declined but not to the level that was expected.
- There were job losses in every sector in April resulting in an 11% unemployment rate with an expected unemployment rate of 20% by June.
- Sales tax collections are projected to decline with a significant decline in Franchise & Excise (F&E) tax collections for the next year.
- Revenue growth for the state is projected to be 0% in 2020 followed by a slight decline 2021.

Mr. Lee then asked for further explanation of why there was an increase in sales tax revenue in April for most counties during the economic decline. Dr. Fox responded that there was a volume of destination collections in sales tax revenue from online sales, based on the Wayfair court decision, that was collected

by the counties. Dr. Fox also responded that there was also the single article cap that impacted the local government less than the state as a whole.

Mr. Hargett then asked what the projected time frame would be for the leisure and hospitality sector to return to where it had been previously. Dr. Fox responded that restaurants and other firms were going to use this as a time to "right size". Dr. Fox further responded that this "right sizing" in conjunction with some businesses never reopening would result in it being a long time to return to previous levels. Dr. Fox then responded that the geographic location of Tennessee would help in the recovery as the state is within driving distance of much of the U.S. Dr. Fox further responded that there should be significant improvement in the leisure and hospitality industry starting in June and July if there is a smooth transition into a growing economy, which was the scenario on which the forecast was built.

Mr. Hargett then asked if business travel would ever get back to what we are used to with the advent of electronic means of meeting. Dr. Fox responded that he thinks the use of these electronic means would enhance growth in the state as more people would teleworking while living in places with a better quality of life such as Tennessee.

Mr. Wilson then recognized Dr. Jon L. Smith, Director, Bureau of Business and Economic Research, East Tennessee State University. Dr. Smith presented information on the economic impact of the COVID-19 pandemic including the below findings:

- There was uncertainty in forecasting due to the lack of data that was available.
- Many retail sectors that the state relies on for sales tax generation had significant downturns.
- Most economists expected to see a U-shaped or Swoosh-shaped recovery curve for the economy marked by a sharp decline in economic activity followed by gradual return to the previous growth path.
- Total revenue collections are projected to decline 2.6% for fiscal year 2020 over fiscal year 2019 and a further decline of 5.46% in fiscal year 2021 for the state, based on a recovery similar to that of the Great Recession.
- The economy could see a further downturn due to changes in consumer behavior and the permanent loss of some businesses.

Mr. Lillard then pointed out that Dr. Smith's projections for the collection of F&E taxes were less than those presented by Dr. Fox for the current fiscal year and fiscal year 2021. Mr. Lillard then asked if Dr. Smith had any observations of particular dynamics of the F&E tax that contributed to his projections. Dr. Fox replied that he was anticipating that the state would not come back online with as much manufacturing capacity as was possible. Dr. Fox further replied that during the 2008-2009 recession there was reduction in the amount of F&E tax collections. Dr. Fox then replied that he would rather take the conservative approach in his projections.

Mr. Wilson then asked what was the possibility that the economy does not return to the traditional growth rate but enters a new normal with an extended period of no growth. Dr. Smith replied that he thought that was a very negative outlook considering the state has a growing population and a robust economy. Dr. Smith further replied that returning to the prior growth path could take a long time, as much as three to five years if taking such a negative outlook.

Mr. Hargett then asked Dr. Smith, given his conservative approach, if he felt that the three to five projected recovery time was too negative. Dr. Smith replied in the negative. Dr. Smith further replied that there had been some projections that it would take ten years to return to the previous growth rate and that he felt that was too negative. Dr. Smith further replied that it was not out of the realm of possibility for the return to the former growth rate to take ten years as it took that long for the Kingsport and Johnson City MSAs to

fully recover from the Great Recession. Dr. Smith then stated that during the Great Recession total tax collections in the state bottomed out in 2009 and did not return to the pre-recession growth rate until 2018.

Mr. Wilson then recognized Mr. Jeff Bjarke, Director of Research, Department of Revenue. Mr. Bjarke presented information on the impact of COVID-19 on revenue collections including the below findings:

- The extension of filing and payment deadlines was a major factor in the uncertainty of F&E and business tax collections. The true effect of COVID-19 would not be known for some time.
- Based on Moody's baseline forecast it was projected that it would be late 2021/early 2022 before the Gross State Product (GSP) returned to its prior level.
- The cumulative revenue collections through March were \$606 million greater than budgeted for fiscal year 2020; April collections were \$694 million less than budgeted for the month and it is unknown how much was from delayed collections compared to lost revenue.
- Retail sales was the large driver of sales tax collections and it suffered a significant negative impact.
- Total revenue collections are projected to decline 2.09% in fiscal year 2020 followed by a 3.08% projected decline in fiscal year 2021.
- General fund collections are projected to decline 1.61% in fiscal year 2020 followed by a 2.90% projected decline in fiscal year 2021.

Mr. Eley then asked how long it would take to return to the previous growth curve the state was on prior to the pandemic. Mr. Bjarke responded that the Department of Revenue's forecast relied on the Moody's baseline forecast updated that month. Mr. Bjarke further responded that it would be late calendar year 2021 to early calendar year 2022 for the state to return to its peak GSP prior to the pandemic and that it would take an additional year or two before the state would return to the same growth path.

Mr. Wilson then recognized Mr. Bojan Savic, Assistant Director, Fiscal Review Committee, State of Tennessee. Mr. Savic presented information on the economic impact of the COVID-19 pandemic including the findings below:

- Consumer and small business optimism had declined drastically.
- The unemployment rate was high at 12% but was projected to return to a normal range as it was believed most jobs would return, except in the case of automation and businesses taking the opportunity to resize.
- Total revenue collections are projected to decline 0.67% in fiscal year 2020 followed by a 0.20% projected increase in fiscal year 2021.
- General fund collections are projected to decline 0.62% in fiscal year 2020 followed by a 0.30% projected decline in fiscal year 2021.
- Non-general fund collections are projected to decline 0.91% in fiscal year 2020 followed by a 2.72% projected increase in fiscal year 2021.
- The forecast risks included a second wave of the virus, long-term business and consumer behavioral changes, additional government stimulus, strong pent-up demand, and the development of effective virus treatment.

Mr. Wilson then recognized Mr. Lee who acknowledged and thanked the presenters. Mr. Lee stated that the more input that was received, the more informed decisions could be made moving forward.

Mr. Lillard then asked if staff was going to prepare a recap summary that compared the presenters' projections. Mr. Wilson responded in the affirmative.

After requesting other business and hearing none, Mr. Wilson adjourned the meeting.

Approved on this 25th day of June 2020.

Respectfully submitted



Sandra Thompson

Assistant Secretary