The Fiscal Focus

An update for Vermont Legislators from the Joint Fiscal Office

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Dear Vermont Legislator,

<u>THE FISCAL FOCUS</u> is a nonpartisan update prepared by the Joint Fiscal Office staff to keep legislators informed of events during the off-season. As your staff, we believe it is important for a citizen legislature to be kept informed of local, State, and federal financial developments while the General Assembly is adjourned. It is important for us to hear what topics interest you for future issues. If you have any comments or suggestions, please let us know.

Sincerely, The Joint Fiscal Office

All Legislative Briefing to be held on December 3, 2020 via videoconference

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FY 2021 Revenue Update

September revenues continued to be strong. We are now through the first quarter of the year, and the strength overall reflects the impact of unprecedented federal fiscal stimulus working its way through the economy. There remains considerable uncertainty regarding durability of this strength and whether the above-forecast personal income and corporate income tax revenues at the beginning of the year will lead to large refunds in the Spring 2021 filing season.

General Fund

Overall, the General Fund finished the month $31.6 million above its September target (+24%) and sits nearly $50 million above target for the first three months of the fiscal year (+9.4%). Much of this is due to very strong personal and corporate income tax receipts in September:

- Personal income tax receipts were $22.9 million above target for the month (+29%) and are now $29.5 million above target year-to-date (+7.65%). The strong month was due to greater-than-expected estimated payments but also continued resilience in withholding payments.
- Corporate income tax revenues were $8.9 million above target for the month (+59%) and are $9.8 million above target year-to-date (+85%). Quarterly corporate estimate payments, like with personal income taxes, were very strong this month. Through October 26th we have seen a substantial amount of corporate refunds, so after October, some of this overage may be gone.

For both revenue sources, most taxpayers are paying estimated payments for this tax year based upon last year's income. Considering the uncertainty due to COVID, this presents a risk that some of this revenue could be refunded in the Spring filing season. January revenues (when the next estimated personal income tax payments are due) should give an important early indication as to whether the strength is real or the result of taxpayers overpaying early in the year.

General Fund property transfer tax revenues are confirming widespread anecdotal realtor reports of a hot housing market. September revenues were $800,000 above target for the month (+66%) and total revenues are now up $1.4 million (+39%) year-to-date. Initial property transfer tax data show the volume of sales to be close to normal, but the properties sold to be higher priced. Early October revenue data also indicate that this strength has continued. The only large General Fund revenue laggard was the meals and rooms tax, which finished the month $400,000 below target (-4%) and is down $1 million (-3.7%) year-to-date despite a forecast that was already more than 30% below last year.

Transportation Fund

The Transportation Fund finished $3.6 million above target for the month of September (+15%) and is now $2 million (+3%) above target year-to-date. Most of this strength is due to August revenues spilling over into September due to processing issues.

- Gasoline taxes were +$800,000 for the month (+12%), erasing a slow month in August and putting overall revenues up $400,000 year-to-date (+2%)
- Purchase and use tax revenues were +$2.7 million for the month (+42%) and are now $1.9 million above target year-to-date (+10.8%) - echoing other consumption tax strength.
- DMV fees were +$500,000 for the month (+7%) and are slightly above target now year-to-date.

Education Fund

The Education Fund had another strong month, finishing $6 million above target (+14%) and is now $13.3 million above target year-to-date (+10%). Almost all of this is due to continued strength in consumption taxes. After another strong month in September (+4.5 million above target or +14%), the sales tax is now $12.5 million (+11.2%) above target for the first three months of the fiscal year and based upon early October revenue data, has continued to outpace its monthly targets. Meals and rooms, as noted above, is lagging modestly below target, but is 33% lower than the first quarter of last year. Purchase and use tax revenues also had a strong month.

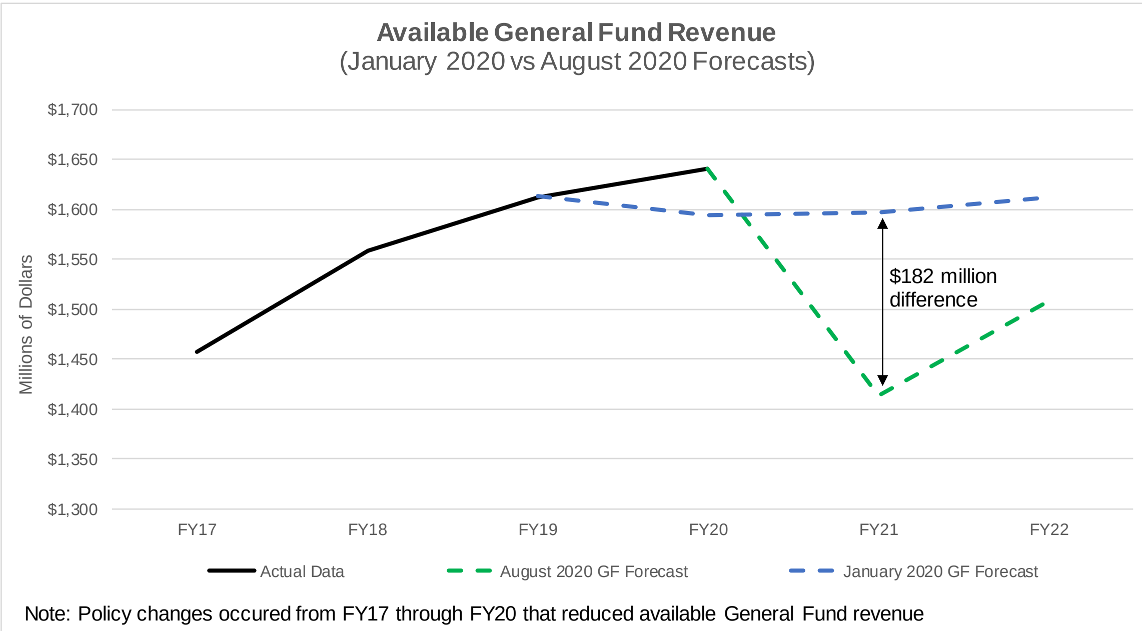
FY 2021 Revenues Going Forward

While the strength of revenues in the first quarter is encouraging, much uncertainty remains as to whether it will continue:

- Personal and corporate income taxpayers may have been overpaying in the first half of the year which could lead to greater refunding during the April tax filing season.
- In the absence of additional Federal fiscal stimulus, the money from the CARES Act drains out of the economy at some point by the end of the year, which could cause consumers and businesses to restrain growth and spending in the second half of the year.

- The trajectory of the COVID-19 pandemic will impact consumer behavior, which will impact consumption-based taxes.

At the same, as the chart below shows, the August 2020 forecast, upon which the FY 2021 budget was built, forecasted revenues for FY 2021 and FY 2022 well below what were expected pre-COVID. In FY 2021, the difference was $182 million for the General Fund. Revenues are expected to continue to be well-below pre-COVID expectations for at least three fiscal years.



FY 2021 Budget Adjustment & FY 2022 Budget Instructions

FY 2021 Budget Adjustment

At this time, there is very little indication of specific budget adjustment items for the current year, this is expected given the atypical later passage of the full budget this year. We anticipate there will be some items that will be identified in December and January. We do not expect a budget adjustment proposal from the administration until January. Act 154 established a process for reallocation of Coronavirus Relief Funds (CRF) through the fall (see the article below on this topic).

FY 2022 Budget Instructions and Areas of Pressure

On October 19, the Administration sent out their FY 2022 budget instructions to departments and agencies. The document acknowledges the high level of uncertainty around both revenue and expenditure estimates as well as the unsettled dynamics at the federal level on additional pandemic relief legislation. The document and its supplement present the Administration's general guidance on policy proposals, positions, technology projects and federal funds and the desire for alignment with their Long Term Recovery Task Forces and State Strategic Plan. There will be a new tool available to all departments to provide an equity lens to assist budget and policy staff in their assessments of new initiatives. This assessment tool is to help policymakers at the decision-making phase to give due consideration to the needs of marginalized or underserved communities by asking questions related to geographic equity, demographic equity, language access, and other factors. The administration is asking departments to prepare level-funded budgets as well as scenarios of up to 3% increase.

The budget instruction memo references an initial FY 2022 General Fund budget gap projection of $180 million before offsets. This initial analysis considers the current FY 2022 revenue forecast and estimates likely or known pressures to be faced in FY 2022. Key pressures include obligations for reserve requirements $6–7 million, debt service $9 million, and retirement $35–$45 million, this includes a reduction in the return assumption to 7%. Next are personnel pressures of $20–$25 million, which includes pay act roll out, reclassifications, and the second year of pay act. The Agency of Human Services has a variety of pressures and offsets that net in the range of $65 million. This is mostly driven by restoring $46 million to the base, which was reduced in FY 2021 due to the 6.2% temporary increase in federal matching rate (FMAP), and up to $20 million of increased costs related to continued investment phasedowns under the current Global Commitment Waiver. Other Agency of Human Services costs include the usual pressures in Developmental Services, General assistance, emergency housing, Department of Corrections and Medicaid caseload, as well as several other smaller pressures. These Agency of Human Services pressures will continue to be refined and updated over the next two months. Finally, there is likely to be $6–7 million in pressures in other departments and programs including higher general liability insurance.

General Fund offsets to these pressures will continue to be refined and identified. They include revised General Fund revenue forecast and potential onetime funds that could become available in FY 2021 and carried forward for FY 2022. There is the potential that the FMAP bump of 6.2% could extend further then currently by several quarters. Reallocation of CRF resources this fall could also create estimated onetime capacity to help FY 2022. Finally, Vermont has a very strong reserve position coming into FY 2022.

Federal Relief Status

Summaries of the total CRF funding appropriated or allocated by the legislature are available on the JFO website in our CRF tracking database or by broad spending category or by function and department. As of Oct. 22, 2020, based on information from the Department of Financial Operations approximately $670 million has been disbursed from the State treasury to individuals, businesses, providers, and community organizations as well as vendors and contractors. Significant funds remain to be dispersed from the appropriations and allocations of this $1.25 billon CRF total.

Given the existing tight federal constraints requiring actual expenditure by December 30, 2020, in combination with the dynamics or unknowns of several newly created programs, the Legislature acknowledged the need to provide some ways to reallocate funds. Act 154 (FY 2021 Budget), Sec. B.1108 sets out the parameters for reallocation of CRF funds. The Commissioner of Financial and Management is charged with identifying the CRF funds that are not likely to be expendable and authorized to reallocate funds upon approval of the Joint Fiscal Committee. Reports are to be submitted to the Joint Fiscal Committee by November 5 and December 7. All reports will be posted on the Joint Fiscal Office website and shared with the Legislature as required by this section.

Sec. B.1102.2 of Act 154 also required the Commissioner to identify and reallocate $15,000,000 of funds from the combined $225,000,000 initial May 5 Joint Fiscal Committee grant approval items to support the $76.7 million increase in economic relief grants for businesses and individuals. Commissioner Greshin reported to the Joint Fiscal Committee on October 22, 2020 that $11.5 million has been identified as either unspent or expenditures have been covered by other sources. The remainder should be identified in the weeks ahead.

LIHEAP Benefit Update

LIHEAP (Low Income Home Energy Assistance Program) is a federally funded program that provides a benefit to income-eligible clients to assist with their heating costs. Federal funding for LIHEAP is made up of an anticipated $20.9 million block grant as well as $5.1 million CARES funds.

Starting in FY 2016, the Vermont Legislature allowed that up to 15% of the federal block grant could be swapped with State funds in the Home Weatherization fund to address the eligible population between 151% and 185% of the federal poverty level and some administrative costs. The State funds for this heating season include a fund swap from the Home Weatherization program of an estimated $3.1 million.

The Administration has projected that this season's eligible fuel liability caseload will be approximately 20,000, which is higher than last year's caseload of approximately 19,000 households. The Department for Children and Families has estimated that the full-season fuel benefit will be an average of approximately $912 this heating season. This benefit will pay an estimated 55% of the average household's seasonal fuel oil bill.

Heating Season		Ave. Oil Benefit	Purchase Power	Federal Funds	State Funds
2020/21	*	**912**	**55%**	**$22.4M**	**3.1M**
2019/20	*	846	38%	$17.3M	3.1M
2018/19	*	715	36%	$17.3M	3.1M
2017/18	*	849	42%	$16.1M	2.9M
2016/17	*	831	50%	$16.2M	3.8M
2015/16	*	699	43%	$14.6M	2.9M
2014/15		783	36%	$18.9M	5.0M
2013/14		792	29%	$19.1M	8.1M
2012/13		898	31%	$18.4M	9.7M
2011/12		900	33%	$19.5M	6.1M

* State Funds includes 15% "swap" from Home Weatherization Fund

FY 2022 FMAP Increase & Federal Relief

FMAP (Federal Medical Assistance Percentage) is the share of state Medicaid benefit costs paid by the federal government. FMAP is calculated by the federal government based on a three-year average of state per capital personal income compared to the national average. Vermont's current base FMAP for most of the Medicaid program for the state FY 2021 is 54.39%. Additionally, Vermont has been receiving a temporary additional 6.2% as part of the federal Families First Coronavirus Response Act and will continue receiving this enhancement for every calendar quarter in which the federal public health emergency is in effect. This has translated to approximately $22 million in additional federal relief per quarter (over $44 million to date) and will likely continue for many more quarters providing continued fiscal relief to the state.

Further, according to Federal Funds Information for States (FFIS), Vermont could see an estimated increase of 1.9% in its base federal FY 2022 FMAP, which would be one of the largest increases in the State's base FMAP in at least 30 years or more. This increase would translate to an additional $20 million of federal participation in the State's Medicaid program for state FY 2022. This base FMAP increase, coupled with the additional 6.2% enhancement, will provide much-needed fiscal relief in a year where the State's finances continue to feel significant pressure as result of the COVID-19 public health emergency. The FMAP rates should be finalized by the federal government sometime in the early part of calendar year 2021 at which time we will have a better understanding of its impact on the State budget.

Note: The State also receives an enhanced FMAP for the Children's Health Insurance Program (CHIP) and the New Adult population, which was an expansion population under the Affordable Care Act, but most Medicaid programs that receive federal match get the regular FMAP.

JFO Studies and Reports

The staff of the Joint Fiscal Office is actively working on several studies and reports including:

- Select Committee on the Future of Public Higher Education in Vermont – This committee is meeting regularly. The first interim report is due December 20, 2020.

  - Agendas and meeting schedules are available here: Higher Ed web page
  - YouTube link for watching (also on each agenda): Video Links to meetings

- Basic Needs Budget and Livable Wage Report – This biennial report is underway and will be delivered in January 2021.

- Tax Expenditure – The biennial Tax Expenditure Report is focusing on estimating foregone revenues to the State from tax credits, exemptions, and carve outs. The report will also include evaluations of tax expenditures related to housing and community development, including a full review of the Downtown and Village Center tax credit program. It will be delivered in January 2021.

Joint Fiscal Committee – October 22, 2020

The Joint Fiscal Committee met on October 22 and took the following actions:

- Approved a reallocation of $860,000 in health care provider stabilization grant funds to provide for administration of the second round of the grants. The first round allocated $87 million in funds. There is up to $150 million left to allocate.

- Received a report from the Deputy Auditor on adverse findings and repeat negative findings in the State's single audit. With the advent of the pandemic and the large influx of federal funds, maintaining this level of performance will be challenging. The report is available at: FY 2019 single audit handbook.

- Reviewed Medicaid spending trends, which have been positive through the first quarter of the fiscal year. Much of this is due to timing of receipts from drug rebates and lower spending in health care claims. It is too early to know the long-term implications of this initial trend.

- Discussed the CRF fund expenditures to date. While almost all the funds are appropriated, as discussed above, expenditures trail appropriations. Considerably more has been encumbered and expended amounts are expected to increase dramatically in the coming weeks.

The next meeting of the Committee will be on November 5, 2020.

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