VERMONT GENERAL ASSEMBLY

THE FISCAL FOCUS

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An Update from the Joint Fiscal Office

In This Issue:

The Fiscal Focus is a nonpartisan update prepared by the Joint Fiscal Office staff to keep legislators current 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.

Most Major Revenues Remained Strong in Fiscal Year 2022, Leading to Positive Year-End Fund Balances

Vermont tax revenues have continued to benefit from unprecedented levels of economic stimulus in response to the COVID-19 pandemic, with most major revenue sources ending fiscal year 2022 above forecast. The Transportation Fund was an exception—revenues fell $8.3 million short of the forecast, due primarily to weak purchase and use tax and Department of Motor Vehicle fees as a result of limited inventory of vehicles for sale. All three major funds, however, ended the year with positive fund balances to carry forward into fiscal year 2023.

General Fund (GF)

Vermont's GF ended fiscal year 2022 with an unallocated available fund balance of $91 million. These funds are carried forward into fiscal year 2023 and will be available for allocation in the next budget cycle. In future years, any end-of-year surplus will follow the new construct established in Act 114 (Pension and OPEB bill) which directs 25% each to the teachers' and State employees' pension systems respectively. Forecasted tax revenues came in $231.7 million over the consensus estimate adopted in January; additional funds also flowed into the GF from the Department of Financial Regulation special funds and the property transfer tax, bringing the fiscal year 2022 GF extra resources to $249 million. Surplus contingent appropriations, transfers, and reserves authorized in Sec. C.102 and Sec. C.107.2(b) of Act 185 (the Big Bill) allocated $158 million of this total.

The contingent uses of fiscal year 2022 GF surplus included $52.25 million for IT systems investments, $25 million to seed the new capital expenditure cash fund, $20 million for early bond redemption, $15 million for a reserve for emergency housing subsidies, $12.15 million for various internal fund needs, and over $35 million of programmatic funding, including housing investments through the Vermont Housing Conservation Board, Medicaid caseload, judicial reopening, and child care workforce incentives.

Transportation Fund (TF)

The TF ended fiscal year 2022 with a $15.3 million unallocated balance, $4.7 million below the forecasted level of $20 million. Revenues fell $8.3 million (-2.8%) short of the forecast for the year, due primarily to weaker purchase and use tax and Department of Motor Vehicle fee revenues as a result of vehicle inventory constraints. This revenue decrease was partially offset by a $3.1 million increase in federal indirect cost reimbursements, plus $0.5 million of prior year refunds of expenditures.

Education Fund (EF)

In addition to the setting of the yields and nonhomestead rate, Act 178 created an additional reserve for polychlorinated biphenyls (PCBs) of $22 million. This fund was created with a provision that if, at the close of fiscal year 2022, there were remaining unreserved and undesignated funds, the first $10 million shall remain as unreserved/unallocated, the next $10 million shall go to PCB reserve, and any remaining funds shall remain as unreserved/unallocated.

After updating sources to reflect the actuals at the close of fiscal year 2022, and after accounting for appropriations and designations for fiscal year 2022 funds, at the close of fiscal year 2022 there remains $23 million undesignated and unreserved. This means the PCB reserve is filled to $32 million. Established in Act 178, no funds shall be expended from this reserve for purposes of remediation, removal, or other required responses to the presence of PCBs in schools until the General Assembly has adopted legislation implementing or approving the plan of the process for the disbursement of funds from the reserve.

Summary of Reserves of the Major Funds

(in millions)	FY19	FY20	FY21	FY22
General Fund				
Unallocated Fund Balance	0.0	0.0	3.6	91.5
Stabilization Reserve	78.2	79.8	81.9	87.1
Rainy Day Fund Reserve	31.6	31.6	80.4	80.4
Human Service Caseload Reserve	100.1	98.2	97.7	97.7
Subtotal Main GF Reserves/Bal.	209.8	209.6	263.6	356.7
27/53 Payment Reserve	14.4	18.4	20.3	0.0
Pension/OPEB Reserve	0.0	0.0	150.0	0.0
Specified Use GF Reserves	14.4	18.4	170.3	0.0
TOTAL GF	**224.2**	**228.1**	**433.9**	**356.7**
Education Fund				
Unallocated Fund Balance	19.4	0.0	28.7	12.9
Stabilization Reserve	37.0	33.0	38.2	39.3
Subtotal Main EF Reserves/Bal.	56.4	33.0	66.9	52.2
PCB Reserve	0.0	0.0	0.0	32.0
Pension/OPEB Reserve	0.0	0.0	14.0	0.0
Specified Use EF Reserves	0.0	0.0	14.0	32.0
TOTAL EF	**56.4**	**33.0**	**80.9**	**84.2**
Transportation Fund				
Unallocated Fund Balance	0.0	24.2	28.6	15.3
Stabilization Reserve	13.8	14.1	11.9	13.9
TOTAL TF	**13.8**	**38.3**	**40.5**	**29.3**

State Tax Revenues Upgraded in Latest Forecast, Although Slowdowns Predicted in Fiscal Year 2023 and Fiscal Year 2024

At the July 28, 2022 Emergency Board meeting, the Legislative and Administration economists released their latest revenue forecast. Overall, this forecast updates fiscal year 2023 and fiscal year 2024 by $146.4 million and $44.8 million respectively across all funds. Despite these upgrades, the forecast predicts a gradual slowing of revenues over the next three fiscal years across all three funds and places strong emphasis on the highly uncertain macroeconomic environment that will impact State revenues in years to come.

Across the three funds, the greatest beneficiary of the forecast upgrade for fiscal year 2023 and fiscal year 2024 was the General Fund which is expected to have an additional $138.2 million in revenues in fiscal year 2023 and $31.9 million more in fiscal year 2024 relative to the January 2022 forecast. This upgrade reflects surging personal and corporate income tax receipts observed since the beginning of the pandemic, but particularly in fiscal year 2022.

Non-property tax revenues in the Education Fund are also expected to benefit from an additional $11.4 million in fiscal year 2023 and $14 million in fiscal year 2024 as compared to the January 2022 forecast. This upgrade was largely due to a modest upgrade in sales tax revenue but also in meals and rooms tax revenues which were surprisingly strong in fiscal year 2022.

Transportation revenues overall were slightly upgraded relative to their January 2022 forecast. The Transportation Fund (TF) was modestly downgraded relative to its January 2022 forecast by $3.2 million in fiscal year 2023 and $1.1 million in fiscal year 2024. This slight downgrade reflects flagging gasoline and diesel tax receipts and DMV fee revenues in fiscal year 2022. The forecast also predicts continued vehicle inventory constraints, which will likely hamper growth in purchase and use tax. However, the forecast for the Transportation Infrastructure Bond (TIB) Fund was upgraded by $6.1 million in fiscal year 2023 and $4.1 million in fiscal year 2024 as a result of higher recent gasoline prices leading to higher quarterly per-gallon assessment rates. The combined impact of the TF downgrade and TIB Fund upgrade is a net increase in total state transportation revenues of $2.9 million in fiscal year 2023 and $3.0 million in fiscal year 2024.

Going forward, the forecast itself predicts a softening of revenues overall in fiscal year 2023 and fiscal year 2024 as compared to the January 2022 forecast.

- Available General Fund receipts were $2.13 billion in fiscal year 2022 but are now expected to decline to $2.06 billion in fiscal year 2023 and $1.98 billion in fiscal year 2024. Revenue streams such as the personal income tax, corporate income tax, and property transfer tax are expected to normalize somewhat in response to a slowing macroeconomic climate, although not to pre-pandemic levels.
- Growth in Transportation Fund revenues is expected to increase over 4% in fiscal year 2023 but then stay relatively level in fiscal year 2024. This is due to the backward-looking calculation for the taxes on motor fuels, which will lead to higher revenues in fiscal year 2023, but a decline in fiscal year 2024 as fuel prices are expected to recede from recent highs.
- Growth in non-property tax Education Fund revenues is expected to slow in the next two fiscal years from the sky-high growth they experienced in fiscal year 2021 and fiscal year 2022. Sales tax revenues, which saw record growth during the pandemic as a result of consumers using higher disposable incomes on taxable goods, are expected to cool as consumers increasingly spend money on nontaxable services relative to goods. With this forecast, an estimated $16.8 million is unreserved and unallocated for fiscal year 2023 in the Education Fund.

Like all forecasts during the pandemic, this forecast was made during a highly uncertain macroeconomic environment. While the health impacts of the pandemic have become less salient over the past few months, the economic impacts of unprecedented fiscal stimulus, shifting consumer preferences, supply chain disruptions, and reduced labor force participation will create volatility and unpredictability in revenue performance for several fiscal years to come.

Average Education Property Tax Bills Decrease by 3.5%

In Act 178 of 2022 (H.737), the General Assembly set fiscal year 2023's education homestead property yield, income yield, and uniform nonhomestead rate based on voter-approved spending, January revenue forecasts, and a projected surplus of approximately $96 million. Under this scenario, the General Assembly decreased the average education property tax bill for fiscal year 2023 across all three classes by approximately 3.5%:

	FY22	FY23	Average rate change	Average bill change
Average homestead property tax rate	$1.523	$1.385	-$0.138	-3.5%
Uniform non-homestead property tax rate	$1.612	$1.466	-$0.146	-3.5%
Average tax rate on household income	2.50%	2.32%	-0.18%	-3.5%

These projected decreases in education property tax bills are despite an increase in locally voted education spending and a decrease in equalized pupils as compared to the previous year:

	FY22	FY23	Change
Total locally voted education spending	$1,502.0 million	$1,572.5 million	+$70.5 million
Total equalized pupil count	86,944	85,606	-1,338

Significant Changes Made to Vermont's Education Financing System

The General Assembly passed Act 127 of 2022 (S.287), which made substantial changes to Vermont's education financing system by adjusting and/or adding differing pupil weights for grade levels, students from economically deprived backgrounds, English learners, low population density districts, and small schools, beginning in fiscal year 2025. With the adjustment of pupil weights, school districts are expected to be impacted because the change in the weights will affect their per pupil spending, which in turn affects their tax rate. By changing the weights, this Act will change tax capacity for most school districts and towns. This means that assuming all education spending remains constant, some districts will have higher tax rates (those that have fewer pupils with the new weights than they had from the prior weights), and some districts will have lower tax rates (those that have more pupils with the new weights). This will likely have an effect on the Education Fund, including the property and income yields, but will ultimately depend on local spending decisions since total education spending is determined by local votes.

Act 127 of 2022 also established a number of other changes to the education financing system in Vermont, including the provision of categorical aid of $25,000 for each school district with one to five English Learning (EL) students enrolled and categorical aid of $50,000 for school districts with six to twenty five EL students enrolled.

Because changes implemented by Act 127 of 2022 will impact schools' tax rates differently, there is a transition provision that limits a district's tax rate annual increase to 5% over a maximum of five years.

Pension Systems Face Economic Challenges in Fiscal Year 2023

Pension systems nationwide have felt the impact of volatile investment markets in recent months. In fiscal year 2021, Vermont's combined pension investments experienced a gain of 24.6% - the strongest performance since the early 1980s. However, more recent global economic challenges adversely impacted the portfolio in fiscal year 2022, leading to a preliminary return of -7.7% for the year (excluding final private investment valuations). The median preliminary return for the year among nationwide public pension funds surveyed by Callan was -9.35%.

Returns significantly short of the long-term assumption of 7% are concerning, but the immediate-term impact to the pension systems will be mitigated by the prior year's strong performance. To reduce year-to-year volatility for budgeting purposes, the pension systems "smooth" the impact of investment gains and losses over a five-year period. Therefore, only 20% of last year's losses will be included in the funding calculations for next year. Additionally, the Vermont State Employees' Retirement System (VSERS) and the Vermont State Teachers' Retirement System (VSTRS) entered fiscal year 2022 with a total of $439.8 million of deferred investment gains from the strong performance in fiscal year 2021. As these deferred gains are smoothed into the actuarial funding calculations, they will offset some of last year's losses.

Above-average inflation poses risks to the pension systems. The cost-of-living adjustment (COLA) formula is tied to the Consumer Price Index, so current retirees and beneficiaries will see higher adjustments to their benefits when inflation is higher. To compensate for higher costs in a tight labor market, the wage scale for active members may also increase at an above-average rate, which may lead to larger future benefit payments when members retire. Each of these factors would be expected to increase the liabilities of the pension systems, and investment returns may not keep pace.

Above-average inflation also poses obvious risks to the health of the overall economy, with implications for investment performance and actuarial assumptions going forward. Pension systems set their assumed rate of return and discount rate based on forecasts of the global investment markets. Many systems, including Vermont's, have lowered their assumed rates of return significantly since the Great Recession. According to NASRA, as of July, Vermont's 7% assumed rate of return is equal to the median of nationwide public pension plans, and the national average has declined to 6.94%. Should economic conditions warrant further reductions in Vermont's assumed rate of return, or changes to other inflation-influenced assumptions like higher COLA or salary growth rates, the liabilities of the pension systems would increase.

The collective impact of these factors (combined with other demographic and economic experience factors) on the funded ratios and future costs of the pension systems during fiscal year 2022 will be detailed in the annual actuarial valuations in the fall.

Medicaid Spending Increased in Fiscal Year 2022 at Lower Rate than Expected

The Medicaid Fiscal Year 2022 Year-End Report was submitted at the Emergency Board and Joint Fiscal Committee meetings held on July 28, 2022. Below is a summary of some of the primary take-away points from the report:

- Overall, Medicaid and Medicaid-related all funds' expenditures totaled $1.99 billion. While this is 2%, or $40 million, below the all funds' budgeted amount through budget adjustment, it is still a 10% increase in total spending over fiscal year 2021.

Medicaid Spending Increased in Fiscal Year 2022 at Lower Rate than Expected *(continued)*

- Caseloads generally came in very close to projections. However, there are two areas worth noting. First, the continued suspension of annual eligibility redeterminations under the federal Public Health Emergency (PHE) continues to impact the beneficiaries in the three nondisabled adult eligibility groups. These groups generally experience significant churn both off and on the program related to income and employment changes. Under the PHE people can still be enrolled into Medicaid programs but cannot be disenrolled. As such, enrollment numbers have continued to grow. Other eligibility categories are less impacted by the PHE suspension because the income limit is higher or tied to a specific disability status, so the churn is traditionally much lower. Second, the number of people receiving Vermont Premium Assistance (for Vermont Health Connect plans) unexpectedly dropped by 20%, while those receiving state cost sharing reduction (CSR) subsidies remained flat. This represented a $1.1 million reduction in gross spending.
- Vermont continued to receive the temporary increase in Federal Medical Assistance Percentage (FMAP) through the Families First Coronavirus Response Act passed in March 2020. FMAP is a federally set rate for each state reflecting the share of costs the federal government will pay for eligible Medicaid expenses. In fiscal year 2022, a full year of draw has resulted in approximately $88 million in General Fund budget savings. At this time, we know the enhancement will extend at least through the December quarter, which is expected to result in $45 million in General Fund savings available for fiscal year 2023 Budget Adjustment or the fiscal year 2024 budget.
- The Choices for Care (CFC) program, which provides nursing home or home- and community -based services for Vermonters who are eligible came in below budget. The resulting underspending of $7.7 million is available for reinvestment in the program.
- Global Commitment Waiver investments came in below expectations mostly driven by the phasedown and cap on investments for the Institutes for Mental Disease (IMD). This phase down will continue to be a State fiscal pressure in the future, for while it will gradually reduce Medicaid expenditures, it will increase state funding needs outside the waiver to make up for the loss of federal matching dollars.

New Global Commitment Medicaid Waiver Approved

In late June, the Scott Administration announced the approval of a new agreement with the Centers for Medicare and Medicaid Services (CMS) to extend the Global Commitment to Health 1115 demonstration project (often referred to as the Global Commitment Waiver). The approval is effective July 1, 2022, through December 31, 2027. Some initial highlights of the agreement include:

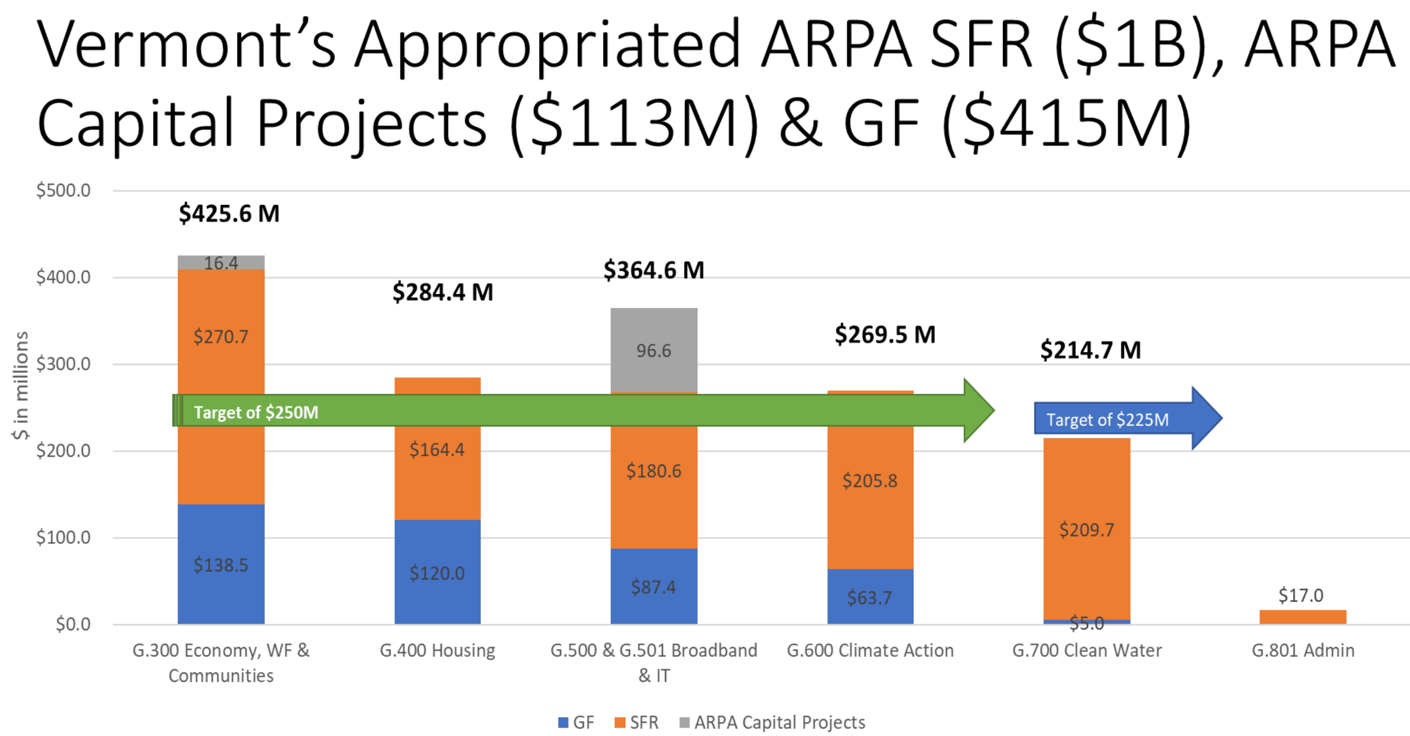
- Providing flexibility to adjust provider payment rates without negatively impacting the waiver's spending cap;
- Including authority to continue to pay for services and fund programs normally outside of Medicaid, known as investments, that improve public health, reduce the rate of uninsured and/or underinsured, increase access to care, and support the health care delivery system;
- Allowing for the use of Medicaid funding to expand access to substance use disorder treatment services.; and
- Allowing a new pilot program that will help people covered by Medicaid to secure and maintain housing.

More information and documents related to the Global Commitment waiver, including the recently approved agreement between Vermont and CMS, as well as a new issue brief providing a high-level overview of Global Commitment called "Global Commitment to Health: A Primer," can be found here.

With Federal Funds and Strong Revenues, General Assembly Continues to Make Investments in Vermont's Future

ARPA-Coronavirus State Fiscal Recovery Fund (SFR) and Capital Projects Fund: During the 2022 session, the General Assembly finished appropriating over $1 billion in ARPA SFR and Capital Projects funds, investing in Vermont's recovery and long-term future by supporting Vermonters' health and well-being and by strengthening Vermont's communities, businesses, environment, and climate. All but roughly $1 million of available SFR funds has been appropriated. To date, $1,048,210,957 has been appropriated.

Act 74 of 2021 provided funding targets for these investments by key area – including economy, workforce and communities; housing; broadband and information technology; climate action and clean water. With the exception of Clean Water, Vermont has met those funding targets through the 2022 session (including GF, ARPA SFR, and capital projects). Below is a summary of the targets and the funds appropriated to date. This does not include IIJA.



Joint Fiscal Committee

The Joint Fiscal Committee met on **July 28** and took the following actions:

- **Received fiscal updates from the Administration:**
  - ◊ Fiscal year 2022 preliminary close-out for the General, Education, and Transportation Funds
  - ◊ Fund transfers, reversions and reserves (unencumbered balances) report

- **Received Global Commitment and Medicaid updates from the Agency of Human Services and the Joint Fiscal Office:**
  - ◊ Global Commitment and Medicaid close-out
  - ◊ Medicaid Year-End Report
  - ◊ Global Commitment Waiver

- **Received additional updates on the following:**
    - ◊ VEDA's Short-Term Forgivable Loan Program
    - ◊ Joint Fiscal Office – the Chief Fiscal Officer's Report

- **Approved 13 grants that are listed individually in the agenda and in the motions. Grants of note include:**
    - ◊ JFO #3111 – is an updated application and full acceptance request of the action taken at the Committee's November 17, 2021, meeting that allowed approved participation in applying for grant JFO #3074 – $57,947,977.00 awarded for State Small Business Credit initiative (SSBCI) by the Agency of Commerce and Community Development.
    - ◊ JFO #3102 – included thirty-one (31) limited-service positions to the Department of Environmental Conservation within ANR, funded through the Investment Infrastructure and Jobs Act (llJA), for existing programs.
    - ◊ JFO #3107 – included twenty-six (26) limited-service positions to the VT Agency of Transportation funded through the Investment Infrastructure and Jobs Act (llJA). The expectation is to increase the Department's workload by 30–50% over the next five years.

JFO Studies and Reports

The staff of the Joint Fiscal Office is actively working on several studies and reports. A sampling includes:

- **Global Warming Solutions Act —** in response to the charge from the Global Warming Solutions Act, and in follow-up to JFO's earlier report, the JFO is currently preparing a report on the economic, budgetary, and fiscal implications of potential policies that would enable Vermont to meet its climate goals. The report focuses particularly on policies aimed at promoting low- and middle-income household adoption of electric vehicles, heat pumps, and weatherization.

- **Child Care System Funding —** the JFO has contracted with the Rand Corporation to evaluate the economic impacts of and potential funding mechanisms for Vermont's child care system. The report is due on January 15, 2023.

- **Funding and Governance Structures of Career Technical Education (CTE) —** the JFO issued a request for proposals (RFP) for a systematic examination of the funding structures of CTE in Vermont and how they promote workforce development goals. The JFO will work in collaboration with the Agency of Education and other relevant stakeholders. The report is due on March 1, 2023.

- **Income-based Education Tax Study Committee** – the JFO, in collaboration with the Agency of Education, Department of Taxes, Legislative Counsel and Legislative Operations, will assist the legislative committee in its study of the creation and implementation of an income-based tax system. The report is due on December 30, 2022.

Staff Updates

Emily Byrne has been hired to fill the upcoming vacancy as an Associate Fiscal Officer. Emily has 10 years of experience in Vermont State government including at the Department of Finance & Management and Agencies of Education and Natural Resources. She most recently worked at Burlington Electric.

Graham Campbell is leaving to take a job in New Zealand. Graham has been an invaluable asset as he mastered revenues, economic analyses, and the legislative process. We will miss him and his excellent work and wish him the best.

Chrissy Gilhuly is transitioning to the Office of the Secretary of the Senate as the Operations Manager/ Journal Clerk. In her time at the JFO, Chrissy has made significant contributions in drafting the budget and budget adjustment bills and staffing the Senate Appropriations Committee. Her positive attitude, attention to detail and strong work ethic will be missed, but we are happy that she is still part of the Legislative team.

Caroline Ro is interning with the JFO this summer working on the report related to the Global Warming Solutions Act. Caroline is a senior at Williams College majoring in Economics and Mathematics and recently returned from a semester in mathematics in Budapest. She is a great addition to the team!

The Fiscal Analyst position is still vacant; we will continue to recruit.

Notable Dates

Joint Fiscal Committee Meetings

- *September 21, 2022*
- *November 9, 2022*