



The Fiscal Focus

An update for Vermont Legislators from the Joint Fiscal Office

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Dear Vermont Legislator,

THE FISCAL FOCUS is a nonpartisan update prepared by the Joint Fiscal Office (JFO) 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

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Strong Fiscal Year 2021 Tax Revenues Expected to Continue in Near-Term

State tax revenues closed for fiscal year 2021 at the end of June. Overall, it was a banner year for State tax receipts. This appears to be in line with what many states are seeing, although Vermont’s reliance on income taxes made it one of the country’s top revenue performers over the past 12 months. Across all three major funds:

- General Fund tax receipts came in \$194 million above their January 2021 forecast¹ or 11%.
- Transportation Fund revenues exceeded their January 2021 forecast by \$7.7 million or 3%.
- Non property tax revenues in the Education Fund beat their January 2021 forecast by \$31.1 million or 5%.

¹ Net of a \$3.5 million transfer to the Higher Education Trust Fund.

This strong revenue performance served as the base for a new Consensus forecast which was released July 29, 2021. It can be found [here](#) and included a major upgrade to the January 2021 forecast.

Fiscal year 2022 forecast upgrades across all three funds exceeded \$240 million:

- General Fund was upgraded by \$190.2 million.
- Education Fund was upgraded by \$13.3 million.
- Transportation Fund was upgraded by \$39 million.

Within the **General Fund**, it is expected that the extraordinary amount of fiscal stimulus will provide continued strength in the personal and Corporate Income Tax. Record-high savings levels are driving consumer demand, leading to strong pass-through business income, but also asset prices, boosting capital gains. Within the Corporate Income Tax, record low interest rates, high consumer demand and pricing power for many firms are expected to enhance corporate profitability. Finally, Property Transfer Tax revenues, coming off a record year in fiscal year 2021, are expected to remain high, as a result of low interest rates and Federal stimulus driving soaring asset price growth in the property market.

Revenues within the **Transportation Fund**, whose fiscal year 2021 levels were below their pre-pandemic levels, are expected to rebound in fiscal year 2022. Federal stimulus is forecasted to continue driving significant Purchase and Use Tax revenues, but also, as Gasoline and Diesel Tax revenues are expected to normalize in fiscal year 2022.

Finally, in the **Education Fund**, the consumption-based taxes all received upgrades for fiscal year 2022. Stronger-than-expected consumer demand, driven by direct Federal stimulus payments led to record high revenues in the Sales and Use Tax and Purchase and Use Tax in fiscal year 2021. Many consumers saved these payments, and it is expected that some of this will be used on taxable goods purchases in fiscal year 2022 and fiscal year 2023. Meals and rooms taxes are expected to recover, albeit slowly, as vaccination rates in Vermont and the northeast lead to a recovery in eating away from home and traveling.

While the revenue upgrade is positive news, it is worth noting that after fiscal year 2023, revenue growth is expected to return to more historical levels. In the General Fund, annual revenue growth beyond fiscal year 2023 averages just over 2%, while in the Education Fund, it is just under 2%. Transportation Fund revenues from fiscal year 2023 through fiscal year 2026 are expected to grow less than 0.5%, as fiscal stimulus and consumer savings propping up the Purchase and Use Tax fades.

As always, JFO will track actual receipts compared to forecast and post tracking on our website. Actual revenues for the month of July were received in early August. Across all three funds, revenues came in largely close to forecast.

Fiscal Year 2021 Closeout Summary

General Fund:

Vermont ended fiscal year 2021 with unallocated General Fund (GF) revenue collections of \$197.5 million. In addition to the \$197.5 million unallocated funds, there were GF revenue changes related to the Property Transfer Tax, increased reversions, and direct applications that added another \$4.81 million to the \$197.5 million, for a total of \$202.4 million. Finally, there was an estimated \$8.5 million of fiscal year 2021 unallocated general funds on the bottom line when the Legislature adjourned in May, resulting in a total of \$210.9 million to be allocated at the close of the fiscal year.

There are several moving pieces regarding the allocation of the \$210.9 million GF that are summarized below.

First, Sec. C.111 of Act 74, the fiscal year 2022 budget, directs that the first \$100 million of remaining unreserved and undesignated funds at the end of fiscal year 2021 shall remain in the GF and be carried forward to fiscal year 2022. In fiscal year 2022, the Commissioner of the Department of Finance and Management is authorized to replace ARPA funds with these General Funds in specific appropriations listed in Sec. C.111.

Second, there were two required transfers at the close of the fiscal year, the Higher Education Trust Fund (HETF) that received a transfer of \$3.5 million pursuant to 16 V.S.A. § 2885(a)(2), and the Human Services Caseload Reserve (HSCR) that received a transfer of \$2.5 million pursuant to Sec. B.1123.1(a)(1) of Act 154 of 2020, the fiscal year 2021 Appropriations bill.

Third, existing statute determines the allocation of the remaining funds.

- Of the remaining unallocated balance, according to 32 V.S.A. § 308c(a), 50% is transferred to the State employees OPEB fund, or \$52.4M. Additionally, up to 50% is transferred to the GF Balance Reserve (Rainy Day Fund). Since the full 50% would exceed 5% of the prior year's GF appropriations, only \$48.8 million is transferred to the GF Balance Reserve.

Finally, since the Rainy Day Fund reached its 5% statutory cap, an unallocated general fund balance of \$3.6 million brought forward for allocation in fiscal year 2022.

FY21 Available Unallocated Year End GF Revenue (\$ millions)	210.9
Years End Allocations	
Sec. C.111 (for ARPA replacement)	100.0
Transfers – HETF (\$3.5M), HSCR (\$2.5M)	6.0
State Employees OPEB	52.4
Rainy Day Fund (to 5% level)	48.8
Total Allocated	207.3
GF Unallocated carried forward	3.6

Transportation Fund:

The Transportation Fund (T-Fund) ended fiscal year 2021 with a \$28.6 million unallocated balance. This surplus is in addition to \$11.9 million in a full stabilization reserve.

The T-Fund entered fiscal year 2021 with a \$24.2 million balance carried forward from fiscal year 2020 due to a \$44.6 million appropriation reduction at the end of fiscal year 2020 in response to the impacts the pandemic had on construction activity, travel demand, and forecasted collections. Collections exceeded targets by \$7.7 million (2.8%) for FY2021, as well.

Stronger than forecasted Purchase and Use (P&U) Tax collections drove T-Fund revenues \$18.6 million (7.0%) above fiscal year 2020 levels. Federal stimulus dollars have boosted demand for new and used vehicles, which led to high P&U collections that were 11.3% above target for the year. However, the increase in funds from vehicle sales and fees offset relatively weak motor fuel collections as travel remains below pre-pandemic levels.

The T-Fund balance was further boosted by a \$4.9 million year-end appropriation reduction in fiscal year 2021, which represents expenses that were charged to federal COVID relief funds instead of the T-Fund.

As a result of the July revenue upgrade, plus the carry-forward of the \$28.6 million fiscal year 2021 balance, the T-Fund is projected to end fiscal year 2022 with a \$23.3 million unallocated balance and full stabilization reserves of \$13.9 million.

In future years, it is likely that this surplus will be needed to draw down additional federal transportation dollars that are expected from the surface transportation reauthorization and a potential broader infrastructure bill, both of which are currently under consideration by Congress.

Education Fund:

Actual fiscal year 2021 non property tax revenue dedicated to the Education Fund (EF) finished \$31.2 million higher than the January forecast. Dedicated non property tax revenues – the sales & use tax, the purchase & use tax, and the meals & rooms taxes all benefited from federal transfer payment flows to individuals and businesses. As a result, the EF closed the year with a \$28.7 million surplus in addition to a full stabilization reserve and an additional \$14 million contingent reserve that the Legislature will consider using to cover the normal cost of teachers’ other post-employment benefits during the 2022 session.

Education Update

In Act 73 of 2021 (H.436), the Legislature set fiscal year 2022 education property tax rates based on voter-approved spending, January revenue targets, and a small projected surplus. Under this scenario, the Legislature was able to decrease average homestead and non-homestead property tax rates by 1.5 and 1.6 cents, respectively:

	<u>FY2021</u>	<u>FY2022</u>	<u>Change</u>
Average homestead property tax rate:	\$1.538	\$1.523	-\$0.015
Uniform non-homestead property tax rate:	\$1.628	\$1.612	-\$0.016
Average tax rate on household income:	2.50%	2.50%	0.00%

Although education property tax rates decreased, because property values grew total education property tax revenues are projected to grow by almost \$17 million in fiscal year 2022.

Since education property tax rates were set in May, non-property tax revenues dedicated to the Education Fund (EF) have consistently exceeded targets. This growth has been supported by federal transfer payments to individuals and business in response to the pandemic-related economic downturn.

- Actual fiscal year 2021 non-property tax revenues dedicated to the EF exceeded January revenue targets by \$31.2 million.
- Projected fiscal year 2022 non-property tax revenues dedicated to the EF now exceed the January revenue targets by an additional \$39.0 million.

As a result of the July revenue update, the EF is now projected to close fiscal year 2022 with a surplus of nearly \$67 million. This surplus is in addition to a full stabilization reserve and a \$14 million contingent reserve that the Legislature will consider using to cover the normal cost of teachers’ other post-employment benefits during the 2022 session.

Major Fund Balances and Reserves Positions

Major State Funds: The reserves in each of the major funds of the State at the close of fiscal year 2021 and projected for fiscal year 2022 are at the highest levels ever. This is as a result of the positive impact on State revenues primarily from the unprecedented federal fiscal response to the pandemic (see revenue forecast article). Below is a summary of the unallocated major fund balances and reserve levels from fiscal year 2018 through the current projected level in fiscal year 2022. The application of the reserves for Pension/OPEB related funds will be determined in the next legislative cycle pending task force recommendations. The use of unallocated fund balance amounts highlighted in yellow below will be determined in the fiscal year 2022 budget adjustment and fiscal year 2023 budget processes. It will be particularly important to understand the one-time versus ongoing nature of these balances as expenditure decisions are made. Alignment of state funding with remaining ARPA allocations and the yet to be specified amounts for Vermont from federal infrastructure and budget actions will also be a significant aspect of the next budget cycle.

	FY18	FY19	FY20	FY21	FY22(P)
General Fund					
Unallocated Fund Balance	0.0	0.0	0.0	3.6	198.1
Stabilization Reserve	77.0	78.2	79.8	81.9	87.1
Rainy Day Fund Reserve	12.5	31.6	31.6	80.4	80.4
Human Service Caseload Reserve	22.0	100.1	98.2	97.7	97.7
27/53 Week Reserve	10.8	14.4	18.4	20.3	0.0
Pension/OPEB Reserve	0.0	0.0	0.0	150.0	150.0
GF Balance and Reserve Total	122.3	224.2	228.1	433.9	613.3

Education Fund					
Unallocated Fund Balance	21.2	19.4	0.0	28.7	66.7
Stabilization Reserve	34.6	37.0	33.0	38.2	39.3
Pension/OPEB Reserve	0.0	0.0	0.0	14.0	14.0
EF Balance and Reserve Total	55.8	56.4	33.0	80.9	120.0
Transportation Fund					
Unallocated Fund Balance	1.5	0.0	24.2	28.6	23.3
Stabilization Reserve	13.5	13.8	14.1	11.9	13.9
TF Balance and Reserve Total	14.9	13.8	38.2	40.5	37.2

Investments for Vermont’s Future

ARPA- Coronavirus State Fiscal Recovery Fund (CSFRF): The availability of over \$1 billion to Vermont in this fund, along with other potential federal funding and onetime General Fund provides the opportunity to invest 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. The aspirational funding target levels for these investments are established in Sec. G.100 of Act 74. Below is a summary of the targets and the funds appropriated to date.

Investments in Vermont's Future ARPA -CSFRF and GF (in millions)	G.100 targets	ARPA	GF	Other FF
Funds Appropriated to Date				
Wellbeing & Economy - G.300	250.0	72.4	86.3	
Housing - G.400	250.0	69.0	70.0	49.0
Broadband & IT - G.500	250.0	178.8	37.2	
Climate - G.600	250.0	40.0	14.5	
Clean Water - G.700	225.0	115.0	10.0	
Administration - G.800	n/a	6.5	n/a	
Act 9 of the 2021 session	n/a	39.5	43.6	9.0
	1,225.0	521.2	261.6	58.0
ARPA- CSFRF to be allocated		528.1		
Vermont's Total ARPA - CSFRF		1,049.3		

Medicaid Fiscal Year 2021 Report

The Emergency Board receives a high-level fiscal year report each July. The [Medicaid Fiscal Year 2021 Year End Report](#) was submitted at the Joint Fiscal Committee meeting on July 30, 2021. The report provides more details, but the primary take-away points for fiscal year 2021 are:

- Spending across the various programs under the State Medicaid Global Commitment waiver was mixed. Overall, total spending came in below budget primarily due to the pandemic impacts or due to offsets from onetime federal pandemic related funds. However, the main claims program in Department of Vermont Health Access (DVHA) came in over budget and was only able to close in balance for the year due to transfers from other underspent areas. This increasing claim experience is a pressure to be addressed both in the fiscal year 2022 budget adjustment and the fiscal year 2023 budget cycle.
- Caseload overall came in over expectation. Most of the caseload categories were on target, but the three largest adult enrollment categories were significantly over the January 2021 adopted target for the year. This is a function of two factors: 1) the impact of the pandemic on employment and income for these Vermonters, and 2) the suspension of annual eligibility redeterminations. This suspension is a federal requirement for states to draw the pandemic enhanced federal match for the program.
- It is yet to be determined how much of this increasing trend in the main DVHA health care claims driven program is due to the higher caseload and how much is due to the changing utilization trends. That analytic work will be done through the fall.
- The Choices for Care program, which provides nursing home or home-and-community based care for Vermonters who are eligible, came in below budget. The resulting underspending of over \$6 million is available for reinvestment in the program.

Pensions Post Strong Investment Gains, But Impact Not Yet Known

Vermont's pension investments earned strong gains as markets continued to rebound from the economic impacts of COVID-19 in early 2020. For fiscal year 2021, the preliminary return estimate for the combined portfolio of the State's pension systems through June 2021 was 24.6% – the highest return percentage since the 1980s – significantly exceeding the 7.0% assumption. This translates to a gain of over \$1.1 billion, net of benefit payments and administrative expenses. Investment gains are credited to the pension systems in proportion to the size of their assets in the portfolio.

While this is positive news, it is unlikely to translate to large-scale, immediate improvement in the funded ratios of the state employee (VSERS) or teacher (VSTRS) pension systems. 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 gains will be included in the pension funding calculations for next year. Additionally, both pension systems entered fiscal year 2021 with a total of \$180 million of deferred investment losses from previous

years that had not yet been included in the funding calculations. Although these deferred losses are relatively small compared to the gains earned in fiscal year 2021, they will offset some of the positive impact of last year's performance. It is also likely that high recent inflation trends will cause higher than expected cost-of-living adjustments to be paid to retirees. The collective impact of these factors to the funded ratios of the pension systems will be detailed in the annual actuarial valuations in the fall.

The Pension Benefits, Design, and Funding Task Force created by Act 75 of 2021 continues to meet throughout the summer to evaluate a range of issues pertaining to the VSERS and VSTRS pension systems. The Task Force, which is composed of legislators, labor representatives, and State government leaders, is charged with issuing an interim report in October and a final report in December with recommendations to ensure Vermont's retirement benefits are on a sustainable financial path.

Future of Public Higher Education in Vermont

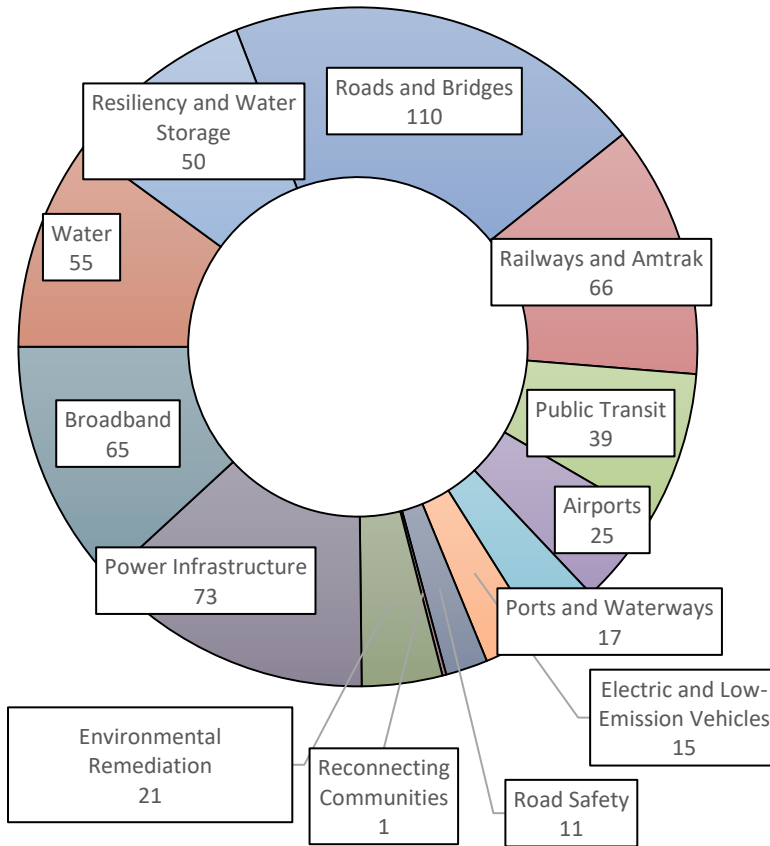
Following the [Final Report](#) of the Select Committee on the Future of Public Higher Education in Vermont, released in April this year, [Act 74](#) (the Big Bill) appropriated funding of \$101 million for higher education in fiscal year 2022. That total is up from \$94 million in fiscal year 2021, and the increased amounts primarily cover \$5 million in "transformational" funding for the Vermont State College System and \$3 million in additional funds for the Vermont Student Assistance Corporation. In addition, federal funding through the Higher Education Emergency Relief Fund (HEERF I, II, and III) in response to the COVID-19 pandemic amounted to almost \$28 million for the Vermont State College System and about \$36 million for the University of Vermont. HEERF dollars are generally targeted to replacing lost revenue, covering expenses directly related to the pandemic, and providing financial aid to students affected by the pandemic.

Federal Infrastructure Legislation

The staff of the JFO continue to monitor the progress on the bipartisan infrastructure bill and accompanying budget reconciliation legislation under consideration by Congress.

On August 10, the U.S. Senate approved an historic \$1.2 trillion infrastructure bill on a bipartisan 69-30 vote. This bill reauthorizes the nation's surface transportation programs, which are set to expire on September 30 and includes provisions from the Drinking Water and Wastewater Infrastructure Act and Energy Infrastructure Act that are also pending in Congress. The legislation includes approximately \$550 billion in new spending "above the baseline," including \$284 billion for transportation infrastructure, \$243 billion for utility infrastructure and climate resilience, and \$21 billion for remediation of abandoned mines, wells, and other contaminated sites. Funds would be distributed through both formulas and competitive grants.

Major Above-Base Highlights of the Bipartisan Infrastructure Framework (as passed by Senate)
\$ billion



Source: [White House, 7/28/21](https://www.whitehouse.gov/briefing-room/statements-releases/2021/07/28/)

Although this legislation passed the Senate, its ultimate fate remains uncertain. Congressional leadership has indicated its intent to advance the infrastructure bill in conjunction with a broader “human infrastructure” budget bill through the reconciliation process. At this time, it is not clear what form either of these bills will ultimately take, whether the two-track strategy will result in successful passage of either or both bills, or what the state-by-state funding allocations will be.

JFO Studies and Reports

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

- Affordable, Accessible Health Care Task Force – This group has just started meeting. JFO is in the process of hiring a consultant to assist with this work. <https://legislature.vermont.gov/committee/detail/2022/368>

- Implementation of the Pupil Weighting Factors Report Task Force – This task force is meeting through the summer and the fall with a report due in December
<https://ljfo.vermont.gov/committees-and-studies/task-force-on-the-implementation-of-the-pupil-weighting-factors>
- Pension Benefits, Design and Funding Task Force – This task force has been meeting with an interim report due in October and a final report due in December.
<https://legislature.vermont.gov/committee/detail/2022/367>
- Unemployment Insurance Study Committee – This committee will have a total of three meetings with the first one in September.
<https://legislature.vermont.gov/committee/detail/2022/370>

Joint Fiscal Committee – July 30, 2021

The Joint Fiscal Committee met on July 30 and took the following actions:

- Received a briefing on the new revenue forecast from Tom Kavet, Economist for the Legislature. A summary article is above, and a copy of the revenue report is available [here](#).
- Reviewed fiscal year 2021 preliminary closeout for the major funds and a summary of the Medicaid and related programs. Details of the fiscal year 2021 closeout are in an article on pages 1 and 2 in this newsletter.
- Received updates on a variety of issues including the Brattleboro Retreat, Mental Health/Workforce Issues, and the status of General Assistance Housing.
- Received an update on the Homeowner Assistance Fund grant which was approved in June.
- Approved eight limited-service positions for the Office of the Defender General.
- Approved one limited service position within the Vermont Military Department.
- Thanked Stephen Klein for his service to the Vermont Legislature. For 29 years he has led the Joint Fiscal Office with professionalism, remarkable wisdom, unrelenting energy and talent.
- Appointed Catherine Benham to be the Chief Fiscal Officer.

JFO Staff Updates

On Wednesday, August 11, on the portico of the State House, a large gathering of staff, legislators, family and friends thanked **Stephen Klein** for his 29 years of service as Chief Fiscal Officer and congratulated him on his well-deserved retirement.

We are pleased to announce the appointment of **Catherine Benham** as the JFO's new Chief Fiscal Officer. Catherine has served the JFO with distinction for over 20 years, most recently as Associate Fiscal Officer/Chief Operating Office. We look forward to the next chapter under her leadership.

Breanna Parker will be departing the JFO in October and will be relocating to Colorado. It has been our pleasure to work with Breanna; her energy and expertise will be missed.



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