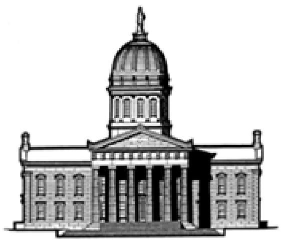

The Fiscal Focus

An update for Vermont Legislators from the Joint Fiscal Office

August 2019 **Volume 26 – No 1**

Dear Vermont Legislator,

THE FISCAL FOCUS 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

Table of Contents

FY 2020 and 2021 New Revenue Forecasts

Economic Conditions: With a relatively strong economy, the Legislative and Administration economists have forecasted continued strength for FY2020 and FY2021. This led to an upgrade in the forecast overall. The increase in all funds is approximately 1%.

Vermont's unemployment rate, at 2.1%, was the lowest of all states in June 2019. Chittenden County, at 1.9%, continues to have the lowest unemployment rate statewide. As has been the case, the weakest employment areas in the State are in Essex and Orleans Counties which have 3.2% and 4% unemployment rates respectively. With national median rate at 3.5% and nine states at or above 4.3%, even our highest rate counties compare relatively well.

The Legislative Economist's presentation pointed out that Vermont's exports in 2018 were at 8.7% of GDP which is the highest in New England and above the national average (8.1%). North America (mainly Canada) at 43% and Asia at 41% represent our two largest export destinations, with electronics being a big part of these exports. This reliance on exports means Vermont has greater exposure to the potential negative consequences of tariff-led trade wars.

General Fund (GF): The July 2019 forecast for FY2020 and 2021 presents a challenge for comparative purposes due to the recent major changes in reporting, among these are:

- Moving most of the State Health Care Resources Fund into the GF; this was subsequent to the EF and GF restructuring that occurred last session.
- Moving 6% of the rooms and meals tax revenue to the Clean Water Fund.

- Reducing the Liquor tax revenue and raising the “direct application” or transfer of profits from Liquor Control to offset the tax change in FY2020.
- Much of the FY2020 revenue increase in the 2019 session is in the form of DFR fees which are transfers to the GF and are not included in the official adopted forecast.
- A number of changes were made during the session that impact GF revenues: long term capital gains; the estate tax; deductions for medical expenses; taxes on vaping; raising the age for smoking; and reduced land gains taxes.

Compared to our projections for FY2020 and 2021 at the close of the session in May, on a budgetary basis overall the new July forecasts for GF revenues are an upgrade.

- **FY2020:** Currently there is a projected $18.4 million GF balance, just over 1%. These funds will be available for the Fiscal Year 2020 budget adjustment or for one-time allocation or expenditure in the 2020 session.
- **FY2021:** The new forecast results in a $28 million upgrade when solely compared to what was projected in January plus the FY2021 estimates related to tax changes made during the session. However, this number will be reduced as increases in DFR fees that were initially expected in FY2021 are likely to occur in FY2022 instead.

In FY2020 revenue from the personal income tax revenue is projected to stay relatively flat at the FY2019 level and growth in FY2021 is projected to be just under 2%. The corporate tax surplus was primarily due to repatriated income, this is projected to decline in FY2021 and 2022. See the close out article below for more FY2019 revenue detail.

Transportation Fund (TF): The new forecast for the TF will still show very modest growth overall for FY2020 and FY2021 with receipts in diesel; purchase and use; and motor vehicle fees being the main areas of growth while gasoline is generally flat. These are all projected to be below the amounts estimated in the January 2019 forecast.

Education Fund (EF): The FY2020 EF shows expenses met with a full stabilization reserve. However, the new forecast is a $5.6 million reduction in projected non-property tax revenues mostly related to the sales tax forecast. The sales tax is still projected to grow, but the revised online marketplace and local retail impacts combined result in a lower rate. This change in estimate is offset with prior year surplus which allows the fund to remain in balance for FY2020.

FY 2019 Closeout Summary

General Fund: The GF ended FY2019 with $51.2 million in surplus funds consistent with expectations in May. These funds were allocated according to the requirements of Act 72 which directed that 50% or $25.6 million go to Retired State Employee OPEB; $9.4 million to re-pay the AHS fund used in FY20; and $16.2 million into the GF Rainy Day reserve. Reserves in the GF now total $224.2 million in four reserves, which is 14.2% of FY2019 GF appropriations.

GF Reserves	**FY19**
Stabilization Reserve (5% of prior year appropriations)	78.18
Rainy Day Fund Reserve	31.6
Human Service Caseload reserve	100.09
27/53 reserve (dedicated use)	14.42
Total GF related reserves	**224.23**

The surplus in FY2019 was a result of personal income and corporate income tax receipts coming in 6% and nearly 10% higher than the forecast estimated in January. Corporate tax surplus was primarily due to onetime payments associated with repatriation of income held in foreign countries. These payments are projected to decline in FY2021 and 2022. Personal income tax revenue was about $50 million above target due to several factors, including significant capital gains and business income, residual impacts of federal tax reform, and faster-than-expected growth in taxable income amongst higher-income taxpayers. These collections helped offset areas where revenues such as estate, property transfer, cigarette, and hospital provider taxes came in under expectations.

Transportation Fund: Receipts came in $3.4 million below projected year-end expectations. The Agency of Transportation expects to offset this with available carryforward funds. The shortfall materialized in June and there is a sense that, in part, it was a function of timing.

Education Fund: Overall the EF met expectations, but sales tax and purchase and use taxes fell short by 0.6% and 1.8% respectively; this was offset by strength in lottery and Medicaid receipts. Property tax revenue was on target with wind generation properties adding to the fund balance.

Medicaid and related programs: Overall expenditures in FY2019 for Medicaid Global Commitment, the Children's Health Insurance Program (CHIP), and other related programs totaled $1.82 billion, an increase of 4% over FY18. In terms of gross total spending, the programs in the aggregate came in below budgeted expectation, but after accounting for Choices for Care savings there is a less than 0.1% or $600k GF program balance. Medicaid enrollment continues to decline with a 4% drop compared to FY18 average enrollment. More detail is provided in the annual Medicaid Year End Report on the JFO website.

Vermont Retirement Systems

At the close of FY2019, the Legislature provided additional retirement funding totaling $51.1 million, beyond the actuarial recommend. Coupled with funding directed during the 2018 session, over $87 million surplus GF has provided supplemental funds to our retirement systems. The FY 2019 supplemental closeout contributions included:

1. Teachers' Retirement System	$ 3.3 million
2. Retired Teachers' Post-Employment Benefits	$22.2 million (retired debt)
3. Retired State Employees' Post-Employment Benefits	$25.6 million

While the Legislature has worked to address retirement funding, this remains an area of constant and significant fiscal pressure summarized by the four areas of obligation below. The updated funded ratio and liability analysis for June 30, 2019 will be available later this fall.

1. State Teachers' Retirement (VSTRS)
   - June 30, 2018 funded ratio of 55.2%, unfunded accrued liability of $1.513 billion
   - FY 2020 funding contribution $129.5 million
2. Retired Teachers' Post-Employment Benefits (OPEB *primarily health care*)
   - June 30, 2018 unfunded accrued liability of $973.4 million
   - FY 2020 funding contribution $38.2 million

3. State Employee Retirement (VSERS)
   - June 30, 2018 funded ratio of 70.7%, unfunded accrued liability of $779.8 million
   - FY 2020 funding contribution $78.0 million (all funding sources)
4. Retired State Employees (OPEB *primarily health care*)
   - June 30, 2018 unfunded accrued liability of $1.609 billion
   - FY 2020 funding contribution $37.2 million

Education Update /Act 46 and Act 173

Consolidation: The Legislature enacted Acts 153; 156; and 46 with the specified goal of improving educational outcomes and equity by creating larger and more efficient school governance structures in response to Vermont's declining (student) populations. Act 46 has been received both optimistically and successfully by some towns and legally challenged by others. The following provides a brief update of the education system in Vermont after the implementation of the consolidations acts.

There were 146 towns that voluntarily consolidated into 38 union school districts, representing 56% of the 259 towns (including 8 gores) in Vermont. Then, as set out in statute, the Secretary of Education and the State Board of Education proposed and finalized unification plans for the remaining towns – combining another 39 towns into unified districts. The governance structure of 47 towns was left unchanged.

A number of towns subject to the State Board of Education consolidations have contested the mandatory merger process. Three unique court cases were filed, which continue to be debated in the Vermont court. No injunction was issued; therefore, on July 1, 2019, all state proposed mergers took place.

All the consolidations have resulted in a reduction of 156 school districts. In FY2013 there were 276 operational districts, and now, in FY2020 there are 120 operational districts. A district could be an entity that operates a school, a town operating an elementary school, or a larger shared high school. Often, prior to the Act 46 reconfigurations, a single town would be a member of two districts.

Due to legal challenges and resistance to consolidation, a number of towns do not yet have final education tax rates. This is a function of delayed budget votes in the newly merged districts. Tax rates will be updated by the Agency as soon as finalized information becomes available (there is a 30-day reconciliation period). On Monday, July 15, 2019, the final consolidated budget passed in the Windham Northeast Union Elementary School District: Athens, Grafton and Westminster. As of July 26, 5 towns were awaiting their final rate calculations due to budget delays and reconciliations. It is noted that another 6 towns are awaiting final rate calculations due to town reappraisals.

Special Education: Act 173 – *"an act to enhance the effectiveness, availability, and equity of services provided to all students who require additional support in Vermont's schools"*— passed in May 2018, changes the funding of special education from a reimbursement model to a census-based funding model. The Act set out a multiyear, FY21-25, transition to the new funding system, identifying time for rule making procedures, professional development, and implementation support for school Supervisory Unions (SUs). The legislation also created three new positions within the Agency of Education to help Supervisory Unions improve the delivery of special education services with the goal that federally mandated special education services may be provided at a lower cost.

In the 2019 legislative session a delay in implementation of this act was issued to provide additional time for rulemaking and implementation support for districts/SUs most in need of professional learning. The delay was passed in the 2019 budget bill – moving the entire timeline back by one year:

- Rulemaking delayed from August 1, 2019 to August 1, 2020.
- The effective date of implementation was changed from July 1, 2020 to July 1, 2021, pushing the entire program out one year with a final implementation in FY26.

SNAP Eligibility Changes

The Department of Children and Families has analyzed the impact to Vermonters that would result if proposed federal changes in rules are adopted for Supplemental Nutrition Assistance Program. These changes would result in over 5,200 households with over 4,600 children losing benefits that range on average from $24 to $280 per month. In total, this is estimated at over $7.5 million in reduced support for these families. The rule changes impact households that receive broad-based categorical eligibility making them subject to asset limits of $2,250-$3,500 and lower gross income from 185% to 130% of FPL and subsequently net income levels at 100% of FPL. If implemented, these changes will likely reduce eligibility for free and reduced lunch for these children and impact various federal funding streams for schools that are tied to free and reduced lunch enrollment.

Vermont Tax Structure Commission

The Tax Structure Commission aims to analyze Vermont's revenue system, recommend improvements and modernization, and provide a long-term vision for the tax structure. In accordance with Act 11 of 2018 Special Session, the three members - Deb Brighton, Bram Kleppner, and Stephen Trenholm – hold regular public hearings and will deliver a final report to the Legislature in January 2021. Seán Sheehan staffs the Commission with support from consultant Susan Mesner and JFO staff associate Sorsha Anderson.

The Commissioners are currently finalizing two papers, one on the impact of demographic change on Vermont's revenue system and one on nonresident withholding for owners of pass-through businesses. Both papers will be published in the coming weeks.

The Commission has also begun to dig into the topic of education finance. At their July 24 meeting, the Commissioners heard testimony about the logistical and administrative issues related to the education property tax from local town clerks and treasurers as well as staff from the Department of Taxes Division of Property Valuation and Review.

The Commissioners have reserved two hours on August 29 at 1 p.m. in the State House to hear from stakeholders about their perspectives on education financing and the education property tax. Legislators are welcome and encouraged to share perspectives from constituents as well as their own experiences with proposed bills and debates in recent years. Representatives of several organizations have also expressed a desire to speak at the meeting. Anyone who is interested in testifying is asked to email taxcommission@leg.state.vt.us by August 15; those unable to attend at that date can submit written testimony through the same address.

JFO Studies and Reports

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

- **Demographics and Revenues:** Both the Legislative Joint Fiscal Office and the Tax Structure Commission will be doing fiscal briefs/white papers on the demographic impacts on revenues. The Joint Fiscal Office report is based on IRS data on taxpayer migration and should be released in August. The Draft Tax Commission paper is available HERE. It looks at the effects of broader demographic changes on a number of Vermont revenue sources.

- **Children in State Custody - UVM Study**: The Legislature funded a research project at the University of Vermont (UVM) to identify and examine the factors contributing to Vermont's high rate of children entering the custody of the State. "*Such research shall study the preventive and upstream services and interventions provided to families and the extent to which these supports to families have demonstrated effectiveness in allowing children to remain with their families."* A legislative working group has been meeting with UVM to finalize the contract and study details. Aspects of the timing of this project may entail a language change in the budget adjustment process.

- **Review Minimum Wage Changes on Medicaid Contracts:** We are in the process of building our capacity to estimate the impacts on health care providers of changes in the minimum wage. This estimating work will need to be done by sampling as there are over 2300 vendors in the Medicaid program. Due to the close-out process taking much of the AHS staff's time, this work has been slow.

- **Corrections Population**: The Legislature appropriated $25,000 for Conference of State Government (CSG) consulting work on Vermont's incarcerated population. The CSG has indicated that they may be able to do this without funding, so we are holding the monies pending a legislative determination as to future use.

Joint Fiscal Committee – July 29, 2019

The JFC met on July 29, 2019 and took the following actions:

- Reviewed FY 2019 preliminary closeout for the major funds, and a summary of Medicaid and related programs. Details of the FY 2019 closeout are in an article above in this newsletter.

- Reviewed the revised FY2020 and 2021 revenue forecasts from Tom Kavet, Economist for the Legislature. A summary article is above and a copy of Tom Kavet's Revenue Report is available on the JFO website.

- Approved the release of $1.5 million of funding and the plan for an electronic medical/health records system for the State's Designated Agencies. Approval included the request that the DAs continue to work with the AHS and JFO to allow continued project review, updates in estimates/true costs and a single point of overall project accountability.

- Heard from State Treasurer Beth Pearce regarding Fitch's bond rating for Vermont.

- Heard testimony from State Auditor Doug Hoffer regarding the cost effectiveness of Lake Champlain Cleanup Efforts and concerns related to TIF financing policy interpretations which resulted in a letter from the JFC to Vermont Economic Progress Council expressing the JFC's subsequent concerns and request for delay of action by VEPC in this area.

- Discussed the effort to assess cost and needs for a new correctional facility and tabled the issue until the September meeting of the JFC.

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