


MEMORANDUM

TO: Agency Secretaries, Commissioners, Department Heads and Business Managers
FROM: Adam Greshin 
RE: FY2021 Budget Development Guidelines and Initial Submissions
DATE: Monday, August 19, 2019

Please submit initial budget requests for FY2021 to the Governor by October 10, 2019. As always, budget submissions to the Governor must be made through the Secretary of Administration using the e-mail folder ADM.budget@vermont.gov.

Key Background

Please keep the following key facts in mind as we proceed with this process:

- **Demographic Crisis**

The simple fact is we need to increase the size of our workforce to sustain the services we have and invest in Vermont's priorities. Although we've experienced some growth in our labor force after the downward trend bottomed out in the spring of 2016, we remain significantly below the peak established in 2009. Vermont demographics was a key concern highlighted by all three credit rating agencies in their recent reviews of Vermont's credit fundamentals. The agencies pointed to weak labor force trends due to a stagnant and aging population and slow in-migration. As Governor Scott has said, improving our demographic trajectory must be at the center of our work and is the top priority for growing the economy, making Vermont more affordable for families and businesses and protecting the vulnerable. Unaddressed, these demographic trends represent an existential threat to our economy and to state government's ability to fund current and future programs and services.

- **State Government's Fiscal Fundamentals**

The July Emergency Board economic forecast confirmed the prospects for revenue collections in the next two years have improved. However, anticipated expenditures continue to significantly outpace revenues and we begin yet another budget cycle facing a budget gap

which must be closed. In addition to unfunded liabilities (see below), the State's growing debt service expenses, declining federal support for a key children's program, and the continuing effects of the opiate crisis on families and our judicial system all combine to challenge our ability to provide the same or better level of service to Vermonters within existing revenue streams. All of this is compounded by our well-established demographic trends.

- **Unfunded Liabilities Consuming Revenue Growth**

Payments to meet promises made to retired state employees and teachers will consume \$200 million General Fund dollars in FY21, up from \$185 million in FY20 and \$162 million in FY19 (see attached chart entitled *FY20 Pension/OPEB and Debt Obligations*). These payments are projected to increase every year for the next 2 decades, according to statutory guidelines, until retirement assets are more closely aligned with retirement liabilities. We have added substantial assets to our retirement plans over the last 2 years, but we still face \$4 billion of unfunded liabilities which must be paid down. A large amount of projected General Fund revenue growth will be dedicated to paying down this debt each year for the foreseeable future. This too represents a significant risk to our ability to sustain the programs and services currently provided by the State, as well as our ability to expand or add to the scope of services we provide as a government.

- **5-Year Cost vs Revenue Projections**

For all these reasons, and others, the Governor has asked departments to consider their FY2021 budget requests in the context of this summer's strategic budget exercise, which illustrates a widening gap between current law expenditures and current law revenues over the next 5 years. Preliminary work on the FY2021 budget gap does not contradict the \$65 million enterprise-wide deficit projected in the exercise and, in fact, suggests the gap is widening. With the benefit of more up-to-date numbers and analysis, individual department results may vary from the June projections. Nevertheless, we know we face a challenge getting to balance this year and in future years under current practices, current revenue projections and the current operational and organizational structure of state government. There is a persistent structural deficit that must be addressed. We must find ways to improve our operational efficiency and productivity to preserve and expand programmatic capacity.

Budget Development Process Improvements

As part of the Cabinet's focus on improving the budget development process, we have identified several key areas where agencies and departments would like clarity earlier in the process. As requested by the Cabinet, to the extent possible, we will make every effort to accelerate the delivery of more precise information in these areas.

Of particular note, assume no increase in **internal service fund (ISF)** charges for the time being. We will communicate potential changes as more information on, for example, pension obligations and insurances, becomes available. We will be working to finalize ISF budgets early in the process, which will enable ISF departments to provide allocations to field departments earlier than in

previous years. For the purpose of October 10th submissions, departments with ISFs will be required to meet the same targets as all other departments. Keep in mind, however, benefit and pension information must await actuarial analysis which may take longer. Ideally, General Fund allotments for ISFs will accompany the allocations, but the allotments could be delayed dependent on the overall General Fund outlook during the fall. (For helpful information on the ISF allocation process, please see the attached *Demystifying Internal Service Funds* document.)

Guidance

With all this background in mind, Finance & Management asks departments to begin the process by submitting level-funded budgets based on FY2020 General Fund “As Passed” appropriations. Level funding should be understood to include state-wide pressures, including annualization of FY20 Pay Act. Departments are asked to absorb expected upward pressures with offsetting reductions to arrive at FY20 “As Passed” appropriations.

Detailed information about requirements and assumptions is included in the attached *Instructions Supplement*. Here are a few key elements:

- **General Guidance** – Please include proposed expenditures, anticipated special fund revenues, and any proposals for new or increased revenue – taxes, fees, etc. – that are incorporated into your budget numbers;
- **Policy Proposals** – Include policy proposals and their related expenditures and funding (these should also be submitted as policy proposals to the Governor’s Office);
- **Position Requests** --- New position requests will be prioritized based on their relationship to the strategic priorities. New position requests must include description, cost, source of funds to support and justification. Please incorporate the full cost associated with those positions (see attached DHR document entitled *Cost to Hire an Employee*);
- **Technology Needs & Projects** -- Requests to fill technology needs through new systems or projects (these should also be submitted as part of your request for capital funds), along with an explanation of how this project has been prioritized and what the productivity gains and/or return on investment is expected to be. If no productivity gains or ROI has been calculated, please note that as well; and
- **Federal Funding** - For the purposes of your October 10th submission, in the absence of reliable information, use current federal funding levels. If your agency/department has reasonable certainty that changes in federal funding will occur, you may incorporate those changes into your presentation. Anticipated reductions in federal funding should be met by corresponding reductions, preferably in associated limited service positions and administrative expenditures.

Aligning with the State Strategic Plan

Budget submissions must be consistent with the state strategic plan (See also: <https://strategicplan.vermont.gov/>) and prioritize the key performance indicators. Initiatives consistent with the strategic plan – and savings ideas generated by the 5-year exercise that you would like to propose for FY21 – should be included in your materials and highlighted. More detailed information about requirements and assumptions is included in the attached *Instructions Supplement*.

Budget Review Meetings

Budget review meetings will begin on October 11th and conclude in early November. Meetings will begin with the ISF departments. Again, at the request of the Cabinet, we will be working to finalize ISF budgets early in the process.

Performance Measure Reporting

In last year's budget development, for the first time we included performance measure reporting with departments' legislative budget presentations. For a select group of programs with *Performance Reports*, the Legislature had direct access to performance measure results as they made their budget decisions. We will continue that initiative this year, refining and expanding the list of selected programs to align with the Governor's strategic plan (and associated program definitions, as they are finalized). In addition, for FY2021 we will revive the *Program Profile* report (aka "Form 5"), a financial report that asks departments to associate their appropriations to the programs within their department. All departments will be expected to complete this report as part of their legislative budget presentations. As the finalized list of Governor's strategy-based programs evolves, departments' Program Profile reports will evolve accordingly.

Thank You

Finance and Management is grateful for all you do to make this budget process successful. We are ready to work with agencies and departments in their budget building exercise. Please contact your budget analyst with any questions.