

Joint Fiscal Office

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MEMORANDUM

To: Senator Ann Cummings, Chair; Representative Martha Heath,
Vice Chair; and Members of the Joint Fiscal Committee

From: Stephen Klein, Chief Fiscal Officer

Date: November 1, 2011

Subject: November 2011 – Fiscal Officers’ Report

What follows is an update of Fall developments – some of which will be part of the November Fiscal Committee meeting.

1. **FY 2012 Revenues.** After the first four months of the fiscal year, revenue collections in the General Fund have remained above forecast. Through October, the General Fund was up 2.5% or \$10 million with most of this due to strength in the corporate income tax. Some of this may be activity coupled with subsequent refunding. Meals and rooms revenues continue to exceed targets with sales and use tax just below targets. Income tax revenues continue tracking just above target with October seeing a weakening in withholding tax.

The Transportation Fund revenues are below forecast at \$1 million or 1.3%, which is primarily due to weakness in the purchase and use tax. The Education Fund revenues are below forecast at \$1.2 million or 2.3% - also due to purchase and use tax receipts being lower and lottery revenues not yet showing strength. However, this may change with the high prize levels which may boost sales.

Tom Kavet reviewed the November revenues and indicated that most of the corporate revenue “lead” will disappear in November, due to refund timing. For this reason he reads General Fund revenues through October should be considered as “up about \$2 million (not up \$10 million)” which is essentially right on target. He classifies the Transportation Fund and Education Fund as also essentially on target. Finally, he added “I am pleased that meals and rooms taxes stayed on or slightly above target, given the potential Hurricane losses to tourism, but weakness in consumption taxes such as motor vehicle purchase and use tax and sales and use tax bear close watching, given the negative economic externals right now.”

2. **Gap analysis.** In October we completed a consensus GAP analysis http://www.leg.state.vt.us/JFO/appropriations/fy_2013/FY13_Gap_Oct_Consensus.pdf with the Administration. We estimated a shortfall between expected revenues and actual projected expenditure pressures at \$74.5 million or 6 percent of our FY 2012 Budget. The estimate is a point of time in that numbers continue to change

and will change up through January; while we will not be changing the gap the changes on the spending side have been problematical. Several are:

- a. The transfer from the General Fund to the Education Fund has been recalculated based on new state and local price index estimates and has risen to \$6.1 million from \$1.6 assumed in the gap sheet.
- b. The actuary's recommendation for state teachers' retirement and the estimates for teacher retiree health care were higher than anticipated. We will have the Treasurer at the meeting to talk about the pressures in this area.
- c. The annual cost of Irene flood-related building rentals is estimated at \$3.2 million, up from the estimate we used of \$2.5 million.
- d. On the other hand, the state is able to collect some Medicaid match with the closure of the state hospital and the alternative placements being Medicaid-eligible. This money is offsetting some of the transition cost.

Where no increases are mentioned in the gap analysis, it is assumed that the budgets will be level year over year. There is no trend growth in this analysis. Also, with the flood damage raising expenditure needs and possibly impacting revenues, and the uncertainty of federal participation and federal resources, this gap analysis is just a guide.

Some states have resolved their FY 2013 issues through their two-year budgets while other states have not made projections. In August, NCSL published a survey of states with total budget gap projections for FY 2012 of \$89 billion and for FY 2013 of \$32 billion. Of the 21 states reporting budget gaps for FY 2013, Vermont's estimate was the fourth lowest.

The Gap analysis also outlines the key FY 2012 budget adjustment pressures.

3. **Education Finance Study.** Larry Picus and Associates have made their first two visits to Vermont and have carried out three school case study visits. Two more are being scheduled at this time. The additional case studies are White River elementary and Bethel's Whitcomb High School. Allen Odden is the primary person in the case study work. The second of the public hearings is scheduled for November 15th and as with the previous one, it will involve school-based hearings in the afternoon at 7-10 sites and then a VIT hearing in the evening.
4. **Education Tax Rate Projection.** On December 1, the Commissioner of Taxes will release a projected tax rate for FY 2013. A number of changes in the Education Fund balance have helped reduce the potential increase of the tax rate. Based data at this point, the increase may be from \$.01 - \$.02. If the base on education payment does not rise as much as required by current law, a zero increase may be obtainable. Mark will go over this at the meeting.
5. **The tax abatement proposal.** The department of taxes has proposed a methodology for abatement of state education tax due to flood-related damage. The abatement would be targeted at individuals who had more than 50% loss of use for a period of three months. Details are available at

<http://www.leg.state.vt.us/JFO/education/Irene%20Abatement%20Info%20Sheet.pdf>
 The House Committee on Ways and Means has taken a committee vote to allow the commissioner to put such an approach in place, and it will come before the legislature during the upcoming session.

6. **LIHEAP Funding.** We remain uncertain about the LIHEAP funding level. As of 10/3, The House funding would have brought an average full-season fuel oil benefit of \$711, the Senate \$765. Both are below last year's average full-season benefit of \$866. The estimates are that prices this heating season will be about 8% above last year.
7. **Vermont State Hospital Planning.** The administration appears to be moving forward with some medium term actions on the Vermont state hospital. Under consideration is an expansion of the capacity of the Brattleboro Retreat to a 14-bed facility. It has not signed a contract, but would like to reach an agreement relatively soon. To that end, it is trying to determine the role of the General Assembly and the Emergency Board in this process. There would be some capital costs involved, but FEMA funds might help to pay for these. It is also looking for interim secure residential units and is examining other options around the state.

Act 48 Health Cost Study. Act 48, the health care bill, requires BISHCA and the Legislative Joint Fiscal Office to issue a second report on cost estimates of the health care reform initiative in November. The report was issued as required on November 1 and is available on the Joint Fiscal Office Website. The report describes a health care base cost growth trend averaging 7.1% through 2020 with potential savings from that trend of up to 18.3%. The report is built with an analytical model we hope to make available on the web at some point. The report outlines the issues and estimate savings within ranges. Much of the actual savings amounts will depend on state and federal health care actions as the work on Act 48 progresses.

8. **Retirement costs.** Both the state teachers' and state employees' retirement systems made a number of changes this year which will have the impact of increasing payment obligations to the funds. First, mortality rates were updated to reflect the longer lives that participants are benefitting from. Second, the investment return assumptions were reduced to an average return of just below 8%. These changes were, in part, offset by strong market returns but in total they have dramatically increased the state's payment obligation. The teachers' fund will experience a \$9.1 million increase in the actuary's year over year request and a \$3 million increase in the need to pay in additional retiree health care costs. The state employee increases are less but still represent an upward pressure. The funded ratio in the teachers' system has reached the lowest point in over 15 years at 63.6% funded. The state employees' system is just above FY 2009 levels at 79.6%. The practice of taking the retired teacher health care costs out of the annual payment to the system serves to retard the funding level. The Treasurer will be at the meeting to give the committee an update on this.

9. **Transportation Infrastructure Bond (TIB) capacity.** Based on lower interest rates for bond issuance and higher receipts and projections of the TIB funds, it is likely that there is an additional \$83.5 million in capacity for bond issuance from this source. This could prove a useful element of meeting the flood-related funding needs.
10. **November 10th legislative briefing.** As you are aware, there will be an all-legislature briefing on November 10th. The briefing will cover flood-related responses, the budget gap projection and budget building process, and updates on health care and energy-related issues. The briefing agenda is available at <http://www.leg.state.vt.us/JFO/misc/Legislative%20Briefing%20Preliminary%20Agenda.pdf>
11. **The PEW Foundation evidenced-base budgeting initiative.** The staff of the Joint Fiscal Office, some members of the administration, and members of the committees on appropriations has been meeting with the PEW foundation to potentially participate in the use of its evidence-based budgeting model initiative. Pew is developing a model, based on the work of the Washington State Institute for Public Policy to help state's estimate the effectiveness of programs and initiatives as part of the budget process. The appropriations committee chairs and key members are exploring the use of this system initially in the criminal justice area. The Pew team is scheduled to meet with the Committee on Government Accountability on November 7th. The administration does have a concern that it not interfere with what it perceives is a difficult year in that staff are dealing with the budget gap and the flood recovery. Assuming this project moves forward, we would most likely hire a consultant to help with this project and use existing Joint Fiscal Office carry-forward to do so. We expect to have more information available on this initiative shortly.
12. **Joint Fiscal Office Updates:**
 - a. Jeremy Fonte is back from Medical leave.
 - b. Maria, Stephanie, and Nathan of our staff continue to work with the fifth floor staff on the development of the new budget system. The hope is that we can integrate budget documents for both branches and have it be more useful to departments. We are also developing a program budget format for the Joint Fiscal Office as a test case to provide a sense of what a program-based budget should look like. A draft should be ready by the end of November.