Joint Fiscal Office

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MEMORANDUM

To: Representative Martha Heath, Chair
Senator Jane Kitchel, Vice Chair
Members of the Joint Fiscal Committee

From: Stephen Klein, Chief Fiscal Officer

Date: November 15, 2013

Subject: November 2013 – Fiscal Officers' Report

What follows is an update of developments, some of which will be on the agenda for the November Fiscal Committee meeting:

1. **FY 2014 Revenues Update:** Revenues – The first four months of the fiscal year are very consistent with forecasts in all funds:
    a. Through the first four months of the fiscal year, the General Fund overall is basically on target! We are up $2.3 million or 0.5% over target.
        i. The income tax is up just over 1.3% some of which could be attributable to timing of refunds;
        ii. Sales tax is on target due to a slight improvement in October;
        iii. Corporate tax is the outlier, down $2.6 million from estimates for the first four months of the fiscal year. Given the volatility of this revenue source, this is not an indicator of its ultimate direction;
        iv. Meals and Rooms is up $2 million, or 4% through October;
        v. Property Transfer and other revenue are essentially on target.
    b. The Transportation Fund (TF) ended the four month period 1% above target. Neil Schickner points out that the July consensus forecast (incorporating the new revenue initiatives) showed a substantial increase relative to the January forecast, but a $4.1 million shortfall compared to the assumptions upon which the FY14 budget was based. As required by statute, in September, AOT proposed and the Joint Fiscal Committee approved budget rescissions of $4.1 million to cover the shortfall. Through October, TF revenue is $1.0 million above the July forecast target. If this holds, it means that $1.0 million of the rescissions already made could be restored in budget adjustment. The fund's strength is in purchase and use and fees. Transportation Infrastructure Bond (TIB) fund July–October revenue is 4.9% below target. The 12 month rolling sum of TIB revenue is - 1.7% below the level one year ago. TIB revenues are being hit by a combination of both falling gasoline consumption and falling prices. The 12-month rolling total of gasoline gallons sold as of Oct. is 317.7 million gallons, down 4.5 million gallons from the level one year

ago. The TF is doing better than TIB because the new TF assessment has a minimum cent per gallon, which TIB does not.

c. The Education Fund also is just above target, up 0.8%. Purchase and use is the strongest component but all components are on or near target.

2. FY 2014 Budget Adjustment Pressures:

Commissioner Reardon released a summary sheet of FY 2014 Budget Adjustment pressures which net to an increase of $12 million from the "as passed" budget, or 1% of the General Fund. The $12 million number is largely a combination of:

i. $1.7 million in ANR increases due to post Irene rent
ii. $3 million in expenses related to the Veterans Home
iii. $1.6 million in Corrections caseload pressures
iv. $5–$9 million in Medicaid increases primarily due to Catamount costs, pharmacy, and inpatient pressures
v. $1 million in AHS rent costs transitioning from FEMA-covered costs
vi. $7 million of other AHS cost pressures with the largest components being in DMH and DCF
vii. The increases are partially offset by a $5 million reduction in health care costs due to a four pay period rate holiday for state employees. The holiday is a result of both moving the State health care plan from CIGNA to Blue Cross, as well as less utilization than expected, and a one-time healthcare balance of $1.6 million. The document which was presented on October 31 can be found at http://www.leg.state.vt.us/jfo/appropriations/fy_2015/Reardon%20-%20FY%202014%20BAA%20Topside%20overview%20-%20master%2010-15-13.pdf
viii. The numbers are still changing and will be clearer when the Budget Adjustment is presented to the House Appropriations Committee during the first week of December.

3. FY 2015 Budget GAP

a. The budget gap projection for FY 2015 remains fluid but is around $72 million. Assuming current services are covered by current forecast revenue the shortfall could be attributable to two key factors:
   i. the use of $56 million in one-time funds in FY 2014 that needs to be replaced in FY 2015.
   ii. $15.6 million in State funds that are needed to meet a reduction in the federal share of Medicaid. The FY15 "FMAP" federal percentage was reduced to 54.28%. In FY 2014, the base FMAP was 55.24%

b. The State Employee and teachers' retirement system actuarial request will increase a total of $11 million from FY 2014 to FY 2015. The funded ratio of the two funds dropped slightly in the year ending June 2013. The state employees funded ratio dropped from 77.7% to 76.8%. The teachers' system funded ratio dropped from 61.6% to 60.5%. The State employees unfunded increase is, in part driven by an increase in the number of employees. For the teachers system, a key driver remains the $26 million for current retiree health care paid from the retirement fund.

4. The Federal Context:

a. The federal fiscal context remains one of uncertainty since the FFY 2014 budget is not finalized and we continue to see operations funded by continuing resolutions. With the sequester still in place and the reduced opportunity to find State and federal offsets to the reductions after the first year, the impacts of the sequester should grow.

b. On the positive side, the Congressional Budget Office reports that the federal deficit has dropped to the lowest level since 2008 due to rising revenues and the cuts that have already taken place. The CBO indicates that:

   i. The FFY 2013 deficit was $680 billion or 4.1% of the GDP. In 2008, the deficit was $450 billion, or 3.1% of GDP.

   ii. Total federal revenue for FFY 2013 was $2.8 trillion– the first year that federal revenue receipts exceeded the previous high of FFY 2007. FFY 2013 revenues were $325 billion, or 13 percent more than revenues in 2012, and 8 percent above their previous peak in 2007.

5. Education Finance

1. Tax Rates: Much work has been done on preparation for the Administration's recommended education tax rates, which are due on December 1. Initial runs indicate that the base education amount will decline this year as the inflation index will be lower, resulting in a decline in the amount. This happens as prior years' inflation was overstated and the index is self-correcting over time. An actual decline in the base education payment is a first however. With a lower payment, the spending-adjusted homestead tax rates will grow faster than the base homestead tax rate. This occurs as school districts spend a multiple of the base education payment. If a school district spends 150% of the base education amount, and the base amount is lower, the school district's tax rate will increase, all other things being equal (even without a change in per-pupil spending). With education spending projected to increase by 3.8%, the spending-adjusted tax rates could rise substantially. Mark will present some updated charts to the committee indicating where revenue is shifting within the Education Fund.

2. July 2015 and Teachers Retirement: July 2015 takes on added importance as beginning on that date teachers are eligible to retire with spousal health care coverage. In 2010, the State and the teachers agreed on a collection of retirement change, including health care coverage for spouses of retired teachers delayed until July 2015. We do not know how many teachers are waiting until this change kicks in to retire but initial reports are that it could represent a 100 to 200 teacher addition to the usual retirement run rate. This could be an opportunity for school spending savings and to make changes to educational spending parameters. Since it will occur at the start of FY 2016, the legislative decisions of this session would be relevant to shaping how this unfolds.

6. Medicaid Spending Growth Analysis

a. The Administration, Nolan and Stephanie of our staff have been meeting to determine Medicaid spending needs. The projected spend for FY 2014 is still an area where final consensus is not yet in place. It is likely substantially above the level Jim Reardon presented to the House Appropriations Committee on October 31st. In addition, the fiscal implications of the Governor's proposal to extend Catamount and VHAP through March have yet to be determined.

b. As we indicated at the last Joint Fiscal Committee meeting, as part of our work in analyzing the health care reform finances, existing Medicaid services will abosorb revenues. With existing spending, known federal match changes, and other adjustments such as the loss of tobacco settlement strategic payments from FY 2014 as passed to FY 2018 projected, we will need an additional $113 + million in State funds beyond normal revenue growth to support Medicaid before the advent of Single Payer. This estimate will continue to evolve.

7. **LIHEAP Update**.
   a. The LIHEAP program has recently received two deposits of money. The first is a $190,000 Amerigas settlement and the second is $16.66 million allocation from the federal government representing the annual block grant. As you know, the federal budget has not been finalized so the federal funds that Vermont received are not necessarily the correct allocation. The allocation that we received was based upon level funding from last year, not taking into account the 6.1% sequester and the new allocation formula, which does not favor the cold weather states. Last year the federal budget wasn't finalized until April so it is not clear when we will receive our final and correct allocation.
   b. The LIHEAP program administrator is still anticipating a federal allocation of $16.99 million for the entire heating season. For comparison sake, if the $16.66 million that Vermont has received was ultimately determined to be the correct amount, since Vermont receives 90% of the block grant in November, the total amount for the season would be $18.25 million, after some adjustments based upon the new funding formula. However, as mentioned, that is not likely. The $190,000 settlement fund will be applied as a buffer against any unforeseen events.

8. **JFO Tax Analysis and the Tax MOU:**
   a. The Tax Department and the Joint Fiscal Office (JFO) have worked to improve the long-term capacity of State tax analysis. The present plan includes as part of the Tax Modernization Integrated Tax System, submitted by the winning bidder FAST, a software system developed by Chainbridge Associates called PolicyLinks. This income tax microsimulation software component will meet the IRS confidentiality requirements and all of the tax data will remain at the Tax Department. The JFO will prepare/develop income tax simulations and send the programs to the Tax Department. The Tax Department will "run" the simulation on the full data maintained at the Tax Department and return the results in the form of pre-determined aggregated reports. The submission by JFO and the resulting run will be encrypted so the Tax Department theoretically does not have access to the information The Tax Department's responsibility to run the data is expected to be administrative only. This system is expected to be in place by late summer 2014. Once the contracts and system development are resolved, we will work with the Department to update the MOUs as needed to fit with the new technologies and relationship.

b. An additional sales tax modeling component will also be included as part of the Chainbridge Policy Links package. This has less intensive data requirements and is expected to be operational in a much shorter time frame, optimally 2–3 months

9. The Joint Fiscal Office Budget:

a. At the meeting, we will be presenting the JFO Draft Budget for Committee review and possible approval. The budget represents an increase of $85,000 from last year. All but $10,000 of that represent the ongoing funding for the position created last session to provide increased capacity for data analysis to the revenue committees. During FY2014, that position was funded from one-time funds and now needs to be built into the budget.

b. Without that position, overall budget growth is just over 1%. With the position, the budget growth is just over 6%. Legislative budgets overall are not yet finalized but the combined growth rate is likely to be in the 2.5%–2.9% range.

10. Other Joint Fiscal Office Updates:

a. As indicated to the Committee earlier Stephen Klein will receive the Stephen D. Gold Award on Dec. 6 during the National Conference of State Legislatures' (NCSL) Fall Forum in Washington, D.C. The award is presented by NCSL in conjunction with the National Tax Association and the Association for Public Policy Analysis and Management. They will be flying him down for the event.

b. Stephen Klein has been asked by NCSL to be the NCSL Representative to the Government Accounting Standard Board (GASB) Financial Advisory Group which will involve attendance at three two-day meetings a year and some other preparatory work. Two of the meetings are in Connecticut and New York and one is an undetermined location. Generally, one meeting occurs during the session. The role will be to make sure legislative concerns are considered when the GASB takes action on Governmental accounting issues. What is curious is that the National Governors Association has asked Commissioner Jim Reardon to continue to represent them on the same Advisory Committee. While they will not always agree, the combined voice will be very useful as the organization considers requirements which could have major impacts on small states like Vermont. The Board is considering NCSL's and NGA's request for designation and both Steve and Jim expect to hear in the next month about this.

c. Catherine, Nolan, and Steve have been working on identifying the analytical tools and the capacities that currently exist for health care finance analysis. This session, the legislature will need to make decisions regarding the resources necessary to provide the legislature with expertise necessary