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 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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Major Fund Revenue Through November 2017

Through the first five months of the fiscal year, overall, revenues are tracking expectations. Although it is early in the fiscal year, so far we are not seeing any major revenue issues of concern.

The General Fund is 1% or $5.2 million over estimates. Personal income taxes are 1.3% over targets. We have seen strength in withholding and lower refunding in the past month. November's collections have made up the weak October result in personal income. Sales Tax is on target with Meals and Rooms Tax exceeding targets by 1.7%. Corporate Tax has been below expectations with more refunds still expected and receipts are down 20% from targets over the first five months.

The Transportation Fund is $1.5 million or 1.3% above target through November. The Diesel Tax and Purchase and Use provide strength to the fund receipts.

The Education Fund nonproperty tax revenue is $900,000 or 1% over the five-month projection. The Lottery and the Purchase and Use Tax have been areas of strength.

The next official forecast revision will occur in January and will need to take into account the impact of the federal tax changes on revenues this year and in FY 2019. We expect considerable changes as federal action continues to unfold.

Education Tax Rates For FY 2019

On December 1, the Commissioner of Taxes released the letter with a projected property yield, income yield, and a nonresidential property tax rate for next year. The yields indicate how much per-pupil spending can be supported with the base tax rate on homestead property set at $1.00 and the base tax rate on household income set at 2%.

If the Commissioner's projections were to be adopted by the Legislature, preliminary estimates indicate that the average tax rate on homestead property will increase from $1.500 to $1.594, the uniform tax rate on nonresidential property will increase from $1.535 to $1.629, and the average tax rate on household income will increase from 2.55% to 2.65%. At these tax rates, the median tax bill for each class of taxpayer would increase by about 7% next year.

The most important factor determining education tax rates and median tax bills is statewide education spending, which is projected to grow by 3.52% or about $46 million over FY 2018. However, actual statewide education spending next year, which is determined collectively by voters in each school district, may be higher or lower. Board-approved school budgets are generally reported to the Agency of Education prior to town meeting week in March.

These estimated education tax rates include the cost of the incentives provided to qualified school districts that have completed mergers pursuant to Act 46. The Agency of Education website provides several reports and visualizations on provisions and activity related to Act 46 and indicates that over 50% of towns in Vermont will be members of unified school districts. The statewide cost of the Act 46 tax incentives is projected to be about $14.1 million in FY 2019.

Teachers and State Employees Retirement Systems

Pension funding continues to be an area of concern, particularly the Teachers' Retirement system. The funded ratios (the actuarial value of the system's assets divided by the system's liabilities) were 54.3% and 71.4% for the Teachers and State Employees systems in FY 2017, respectively. Both ratios are below the FY 2016 ratios of 58.3% and 74.6%. These actuarial valuations include a practice of smoothing market performance over a multi-year period to offset market volatility. Generally, a well-funded system should be funded over 80%. The funded levels using Government Accounting Standards Board 67 standardized accounting measures for FY 2017 for the teachers fund and the State employees fund would be 53.98% and 71.99%

Market values at the close of FY 2017 are still a bit lower than the smoothed actuarial values of the Funds. Even though FY 2017 was a positive year for the markets, the Funds were making up for the systems' under performance in the market for FY 2016.

In the case of the Teachers' Retirement system, the Legislature has been fully funding the actuarially recommended contribution, or ARC, since 2007. The Legislature began separately funding the retired teachers' healthcare obligation in FY15, removing some significant pressure on the Fund.

This year a major factor for the lower funded levels was a decision to lower the assumed investment rate of return for future years from 7.9% to 7.5%. This, coupled with actuarial table changes i.e. increased assumed life expectancy, create pressure on the funded ratio. Both changes are important, good-practice revisions reflecting the investment climate and participant experience.

In 2015, the Legislature, at the request of the Treasurer, put in place a system of faster amortization of the unfunded liabilities to begin in FY 2020. These changes will require a higher level of annual State appropriation, which, over time, should help bring the funded levels up.

Separately, the State's obligation for retiree health care remains a liability that will need to be addressed over time. This will be an increasing cost in the coming years and is known in the retirement analysis community as an OPEB obligation (Other Post-Employment Benefits). For both the retired Teachers and State employees we are essentially paying as we go with a large obligation as these retirees continue to age and grow in number.

Budget Reserves

Several members and fiscal staff attended an NCSL/PEW sponsored fiscal leaders meeting in late November. Aspects of the meeting focused on state bond ratings, debt and pension obligations, but among the strong presentations was one addressing states' preparedness for the next dip in the business cycle which many economists believe likely in the near term.

While Vermont has been consistently building up its reserves, its overall reserve funding is still likely to be short of levels appropriate for the volatility of the specific mix of Vermont revenue sources. Moody's Analytics gave a presentation which focused on the range of reserves needed to address the next recession from moderate or severe. Aside from Medicaid, it does not address the other potential budgetary needs that would also likely arise or account for changes in federal funding - a further area of vulnerability for the State given that 35% of our budget is paid for with federal funds. The Moody's Analytics analysis places the Vermont fiscal reserve need at 13.3% or ($200m) of the annual GF fund budget for a moderate recession and 18.3% ($277m) for a severe recession.

Reserve levels are one part of a continuum of responses states have in managing in an economic downturn. Vermont's current reserve may be at or near sufficiency to 'manage the pain' of what could come into play in the event of moderate recession scenario. The current FY17 actual and FY18 projected major fund reserves are:

Reserves	FY17	FY18 proj
General Fund		
Stabilization Reserve	74.10	77.00
27/53 Reserve	5.29	8.99
Human Service Caseload Reserve	10.00	22.00
Rainy Day Fund Reserve	17.2	7.3
General Fund Reserve Total	**106.6**	**115.3**
Global Commitment Fund Balance	**81.5**	**79.8**
Transportation Fund Stablization Reserve	**13.3**	**13.5**
Education Fund Stabilization Reserve	**33.5**	**24.7**
	234.9	**233.3**

A severe recession would of course present greater challenges both in terms of length and depth of the downturn and subsequent impacts on State revenue levels and program demands. The potential of a recession, coupled with possible reductions in federal revenue and the uncertainty of any federal fiscal assistance to states during the next recession underscore the importance of a strong reserve position.

DVHA Medicaid Update

While the entirety of the Medicaid budget is consolidated in the AHS central office, the majority (60% or $1+ billion) of the state's Medicaid expenditures run through DVHA. These expenses in the aggregate are tracked on a weekly basis in a report known as the "52 points." This reporting has been made more robust by DVHA this year with additional data for greater understanding of specific costs centers included with the weekly comparison to budget.

The "52 Points" analysis takes the entire DVHA Medicaid budget and distributes the expenditures over the 52 weeks of the year for comparison to actual expenditures out the door each week. This distribution is estimated based on past years' experience and well-established payment patterns for certain expenses, in this regard it is similar to the estimated monthly expectations used in tracking GF revenue. This tracking is based on gross expenditures so it reflects both State and federal share. In order to understand the State share of this analysis, the various match rates need to be appropriately applied.

Since the beginning of the fiscal year, this tracking system has consistently been showing good news with a positive position (i.e. expenditures coming in less than expected) and this position has been typically growing week to week. To date, drug rebates have come in $11 million higher than expected making net Rx lower. This appears to be roughly half one-time in nature (collections on older outstanding issues) and half reflecting a trend due to higher rebate percentages for specialty drugs. Expenditure for claims has been coming in below expectation particularly in inpatient, outpatient, and physician services. As of Dec.1, the range of claims coming in under expenditure is a low of $1 million to a high of $18.2 million in total State and federal funds with the current median at $15.6 million and current mean at $13.9 million under budget. The claims position fluctuates a bit more widely week to week (the low end has been negative i.e. overspent) but has remained significantly positive on average.

The staff working group on caseload and program cost estimates (AHS, DVHA, F&M, JFO) met in early October and again in late November to update program projections. They are likely to reconvene in December to update and finalize FY 2018 updates and FY 2019 estimates for presentation and action at the January meeting of the Emergency Board.

At this point, the SFY18 gross total projection remains near the current rescission-based level and the SFY19 gross total shows very minimal (<0.5%) growth. However, this does not mean that the General Fund need in the program will remain static. The State share and specifically the GF portion of that State is dependent on several issues. First, the position of the State Health Care Resources Fund is yet to be updated, but we know current cigarette collections are off target. Second, the shrinking proportion of expenditure from the high match New Adults category puts more pressure on State funding, and finally, the uncertainty on CHIP funding at the federal level remain an issue.

November 9 Joint Fiscal Committee Actions

The Joint Fiscal Committee met on November 9, 2017 and heard testimony on several issues and took actions. Their work included:

- Administration provided updates on the Budget adjustment process and made a commitment to present to the House Appropriations Committee on Monday, December 18.
- Approval of a technical change in the rescission plan which reallocated $10,000 in the Secretary of State's Special Fund.
- Review of the Administration's Management Savings Report required under B.1102 of Act 85 of 2017. Hearing a presentation on the Tax Computer Modernization Fund which has been used to fund the Tax Department's VTax system. The Department will be requesting approval to continue to use this fund to finish system financing in the next two years.
- Review of DVHAs open enrollment which has been proceeding well. Also heard reports on Medicaid tracking, Seasonal warming shelters and Designated Agency funding. Approval of a $3,987,558 grant from the U.S. Dept. of Health and Human Services to the VT Department of Mental Health to develop integration in clinical practices for pediatric care and mental health care. One (1) limited–service position is associated with this request.
- Hearing a presentation from Marcia Howard, Executive Director, Federal Funds Information States; on federal budget developments. She opined that the budget process is unfolding slowly and current year reductions have not developed to the extent anticipated.
- Review of the Fiscal Officer's report, the Fiscal Office budget for FY 2019 and initial work on development of the December 2017 Education Fund Tax letter by the Administration.

Grants and Limited-Service Positions Update

The following grants and/or limited-service positions were approved by the Joint Fiscal Committee in the second quarter of State fiscal year 2018 (10/1–12/31/2017 – *as of 12/8/2017*):

Grant # JFO	Agency/Dept.	Grantor	Amount	Description
2889	Dept. of Fish & Wildlife	Safari Club Int'l Foundation	$50,000.00	Funding to study the impacts of tick infestations on VT moose populations during winter conditions.
2890	Agency of Education	U.S. Dept. of Education	$1,940,000.00	Funding to provide student support and academic achievement (SSAE) sub-grants to local education agencies.
2891	Agency of Education	Council of Chief State School Officers	$10,000.00	Funding to help build teacher capacity to support historically marginalized students and support equity in VT school systems.
2892	Dept. of Public Safety	Federal Emergency	$2,562,253.00	Funding for pre-disaster mitigation projects in four VT communities.

		Man. Agency		
2893	Dept. of Public Safety	Federal Emergency Man. Agency	$5,170,254.00	Funding for public assistance to communities impacted by severe storms on June 30 and July 1, 2017. Grant amount is based on initial damage estimates and may change.
2894	Dept. of State's Attorneys and Sheriffs			One (1) limited-service position titled Traffic Safety Resource Prosecutor to help the Dept. meet increasing demands for these duties.
2895	Military Department			One (1) limited-service position titled Financial Specialist II to replace a temporary position. 100% federally funded.
2896	Dept. of Fish and Wildlife	VT Housing and Conservation Board	$198,000.00	To Facilitate the purchase of a 50-acre parcel of land in the town of Benson and adjacent to the Pond Woods Wildlife Management Area.
2897	Dept. of Fish and Wildlife	VT Housing and Conservation Board	$50,000.00	To Facilitate the purchase of a 281.4-acre parcel of land in the town of Fair Haven and adjacent to the Green Mountain Conservation Camp.
2898	Dept. of Forests, Parks and Recreation	U.S. Forest Service	$41,550.00	To hire one (1) limited-service position to fulfill increasing land management demands in Southern VT. A 50% State cost-share is required for this grant.
2899	Dept. of Environmental Conservation	U.S. Geological Survey and U.S. Environmental Protection Agency	$190,000.00	To hire one (1) limited-service position to improve the collection and interpretation of water use data to aid in future water delivery infrastructure replacement.
2900	Agency of Education	U.S. Dept. of Education	$241,888.00	To offer sub-grants to rural school districts to support academic achievement.
2901	Dept. of Mental Health	U.S. Dept. of Health and Human Services	$3,987,558.00	To develop integration in clinical practices for pediatric care and mental health care. One (1) limited-service position is associated with this request.
2902	Military Department			Four (4) limited-service positions within the VT Military Dept. titled Security Guard and funded by ongoing FF.
2903	Military Department			One (1) limited-service position within the VT Military Dept. titled Military Property Man. Specialist and funded by ongoing FF.
2904	Military Department			Two (2) limited-service positions within the VT Military Dept. titled

				Custodian II and funded 75% by ongoing FF and 25% by State GF.

Each grant/limited-service position request, and its supporting documentation, is listed on the Joint Fiscal Office website. http://www.leg.state.vt.us/jfo/grants/default.html

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