The Fiscal Focus

An update for Vermont Legislators from the Joint Fiscal Office

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Budget & Revenue Outlook

FY 2005 Budget Adjustment
There are several areas that are likely to be hot spots in the budget adjustment process:

- The State Hospital remains a potential FY 2005 budget pressure as federal support continues to be in jeopardy. Vermont faces two distinct issues: First, Vermont is in the process of regaining certification for federal funds which should be completed this fall. The budget assumed October 1st as a recertification date; the budget will require an estimated $330,000 per month beyond this date. Second, federal support for independent state mental hospitals will be diminishing due to a change in federal policy direction.
- Corrections caseload and the medical services contract are anticipated to require additional funding. Also, recent Corrections Study recommendations are being considered. Corrections may require an adjustment of $2.0 million.
- Child care costs are running a projected $700,000 above estimates.
- Finally, in the Agency of Natural Resources, lagging receipts in the Forest & Parks and Fish & Wildlife special funds combined with previous year deficits indicate potential budget needs for both programs of up to a total of $1.8 million.

FY 2006 Appropriations Bill
The outlook for the coming budget year can be characterized as very tight. There is good news on the revenue side of the equation. The General Fund forecast for next year is $33 million above the FY 2005 budget as passed and may be upgraded.

The demands on the expenditure side of the equation are substantial. In addition to pressures in the Medicaid program, there are the anticipated roll-outs

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Capital Debt Outlook

The Capital Debt Affordability Committee met in September to set the FY 2006 debt limit at $45 million. This is an increase of $4 million from the prior year.

The current debt statistics are:

- Debt per capita fell from $861 to $724, changing the state ranking from 16th to 24th. Vermont is slightly above the Moody's median of $701 with 26 states having less debt per capita.
- Debt as a percentage of personal income dropped from 2.9% to 2.5%, the lowest level in recent history. The state ranking improved from 17th to 25th.
- Debt service as a percentage of revenues is currently 5.5%. It is projected to increase to 5.8% and then drop back down.

Vermont, on a composite basis, continues to be the highest rated New England state with a rating of Aa1 from Moody's, AA+ from Fitch, and an AA+ from Standard & Poor's.

While the $45 million cap is an increase over previous years, it will continue to limit the choices made during the capital bill decision-making process. ❖

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Dear Legislator,

This is the second 2004 issue of THE FISCAL FOCUS. This is a nonpartisan update prepared by the 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 abreast of local, state, and federal financial developments while the General Assembly is adjourned. This update is sent to all House and Senate members.

It is important for us to understand what topics interest you so we can incorporate them into future issues. If you have any comments or suggestions, please let us know.

Joint Fiscal Office Staff

LIHEAP Update

LIHEAP (Low Income Home Energy Assistance Program) is a federally-funded program created to provide support for heating in northern states and air conditioning in southern states. Each year, the Federal government appropriates funds to be divided among the states. During the 2003-2004 heating season, Vermont received a basic block grant of $10,478,244. In addition, Vermont received a contingency payment of $931,845, for a total federal allotment of $11,410,089. This compared to the 2002-2003 heating season basic block grant of $10,471,920 and a contingency payment of $2,128,885, totaling $12,600,805. As is usually the case at this time of year, it is very hard to predict the level of funding that Vermont will receive from the Federal government for the current heating season, 2004-2005. The Vermont Office of Home Heating Fuel Assistance is basing the projected benefit level on the assumption of a $10,478,244 basic block grant.

Vermont is experiencing an upward trend in the number of applications for fuel benefits. Last heating season, 2003-2004, the average household benefit was $695, the same benefit level as the prior year. As of October 7, 2004, the Office of Home Heating Fuel Assistance had received 19,883 applications for heating assistance which represents an increase of 975 over last year at the same time. Benefits for clients heating with wood have been mailed. The first fuel benefit for clients not heating with wood will be sent out in November. ❖

Budget & Revenue *(continued from page 1)*

of the budget adjustment items, pay act and benefit pressures, and the base increase in the General Fund support of the Education Fund, as well as all other program pressures. The tobacco settlement revenues anticipated to be collected in FY 2006 are $5.0 million less than the FY 2005 expenditure level of these funds.

Federal Funds for Vermont

The FY 2005 federal budget is not yet resolved, creating a lot of uncertainty in levels of federal funds. Section 8 housing funds may be coming in at a higher level than expected in the current year, temporarily addressing the shortfall. Another bright spot is federal elections funding. Vermont has received substantial federal Help Americans Vote Act (HAVA) funds. As of June 30, 2004, $16.6 million has been received. The money substantially exceeds the state's election funding needs and will provide a resource that can be used into the future. While there are still homeland security funds in the pipeline, future allocations to Vermont are anticipated to decrease.

FY 2005 Revenues

After one-quarter of revenue collections for FY 2005, the General Fund has received $244.6 million compared to a target of $231.8, or $12.8 million additional revenue. The major tax sources, personal income tax, sales & use, and especially corporate income tax, have all surpassed expectations. Personal income tax collections are up $3.7 million or 3.3% above targets; sales and use tax is up $3.8 million or 7.9% above targets; and corporate income tax is up $2.4 million or 20.8% above targets.

Actual Transportation Fund revenues are $2.5 million above the target of $51.8 for total collections of $54.3 million. DMV fees account for $2.3 million of additional receipts. The rest of the transportation tax sources are within $200,000 of the targets.

The Education Fund is also benefiting slightly from the strength in sales and use tax receipts, finishing the quarter up $1.9 million above targets.

While it is still early in the fiscal year, recent General Fund revenue collections could indicate the possibility of a revenue upgrade in January. ❖

Projected Deficit in the Health Access Trust Fund

According to projections by the Joint Fiscal Office, the Health Access Trust Fund (HATF) will be emptied by the end of the current fiscal year (2005) and will have a deficit of $52.7 million at the end of FY 2006. This significant change in the financial status of the fund is due to three factors: 1) the long-term imbalance between revenue and spending in the fund, 2) a sharp decline in the federal contribution to the state Medicaid program, and 3) the trust fund itself, which had a balance that paid for a projected operating shortfall of $25 million during the current fiscal year.

The Health Access Trust Fund is used to finance the state's share of Medicaid spending by the Office of Vermont Health Access (OVHA). This spending is about two-thirds of all state Medicaid spending. The balance is spent by other departments, primarily the Department of Health and the Department of Aging and Independent Living.

Spending from the fund is for many different types of health care, including hospitals, nursing homes, pharmaceuticals, physicians, and home health care. Historically, spending has grown at a rate of about 10% per year. This growth is due primarily to increases in the cost of health care (about three-quarters of spending growth), with the balance due to increases in enrollment (both program expansions and population growth) and increases in utilization.

Revenue comes from three major sources: provider taxes (taxes on hospitals, nursing homes, and home health agencies), cigarette and tobacco revenue (including both taxes and some of the funds from the national lawsuit against tobacco manufacturers), and an annual General Fund appropriation.

Of the three revenue sources, only provider tax revenue has grown over the last several years and is projected to continue to grow. The General Fund transfer has been flat for the last several years, but is slated to increase in the future at the same rate as General Fund revenue (about 3.5% per year). Cigarette and tobacco revenues have increased historically (when funds from the settlement were first received and when cigarette taxes were increased in fiscal years 2003 and 2004), but settlement funds are projected to remain flat (if not decline), while tax revenues are declining due to decreased sales (due to both decreasing smoking rates and internet sales).

Reliance on revenue sources which, taken in total, are growing much more slowly than Medicaid spending is the fundamental challenge to sustainable financing. However, two additional factors have contributed to the sudden deficit.

- In every state, Medicaid is financed by a combination of state and federal funds. The federal contribution, referred to as FMAP (federal medical assistance percentage) is established annually and is based on each state's relative per capita income. From state fiscal years 1994 through 2002, Vermont's FMAP increased from 59.6% to 62.9%. Starting in 2003, the rate has declined each year and is projected to be 58.8% in FY 2006. Each percentage point decline represents a shift of about $6 million in costs from the federal government to the state.

- In FY 2003 and FY 2004, the decline was more than offset by temporary federal fiscal assistance. Including this assistance, Vermont's FMAP in fiscal year 2004 was 65.5%. After the temporary federal assistance program ended, the rate declined from 65.5% in 2004 to 60.4% in 2005. An additional 1.6% decline is projected in 2006. This shift had the effect of increasing state spending from FY 2004 to FY 2005 by about $30 million, independent of all other influences on spending.

While the existence of the HATF as a financing mechanism does not contribute to the magnitude of the problem, the fund balance insulated the state from a projected shortfall of about $25 million in FY 2005, eliminating the need for any action this year. The existence of this balance has also let the state level fund the General Fund contribution in recent years

The projections indicate that with no changes in anticipated revenue or spending, the shortfall increases by about $16 million per year. Concern about the long-term sustainability of the program led the legislature to create a sustainable health care study. ❖

Education Fund Balance and Property Tax Rates

Act 68 base statewide property tax rates are $1.59 for nonresidential property and $1.10 for homestead property. Homestead rates are adjusted by the local level of school spending in each town. Both of these base rates may be adjusted annually depending on the health of the Education Fund. In FY 2005, the base rates were reduced to $1.54 and $1.05, respectively, because of surplus balances. Per 32 VSA § 5402b the Commissioner of Taxes is charged with marking a recommendation each fall:

"…by December 1, the commissioner of taxes shall recommend to the general assembly, after consultation with the department of education, the secretary of administration and the joint fiscal office, the following adjustments in the statewide education tax rates under subdivisions 5402(a)(1) and (2)"

There are several factors at work which have an impact on the recommendation:

- First, grand list growth continues to exceed projections. In the short term, this means additional revenue to the fund which will enable lower tax rates. In the long term, this can increase the risk of a "bubble" where property values in the future may not rise or may actually fall. This could jeopardize the Education Fund in future years.
- Second, the base education payment per pupil for FY 2006 is higher than projected, creating an additional cost for the Education Fund. The $6,800 base payment amount, set in Act 68, is anticipated to increase to $6,975 next year.
- Finally, it is unknown exactly how much towns will vote to spend in FY 2006. In FY 2005, education spending grew 6% over FY 2004. In the July forecast, spending was projected to grow at 5.5% in FY 2006 over FY 2005. Every ½ percent difference in spending has a $3 million impact on the Education Fund.

At present, due to the grand list growth, it is likely that the Education Fund could support a reduction in the tax rate to $1.05 and $1.54 as was done last session. The final recommendation by the commissioner of taxes awaits further data and analysis that will occur in the weeks ahead. ❖

JFC Meeting Notes

The Joint Fiscal Committee met on September 15th and took the following actions:

- Heard an update from Finance Commissioner Rob Hofmann on revenue and spending pressures and a presentation on FY 2006 budget instructions. For FY 2006, agencies were asked to present a budget with a 2% reduction from FY 2005 budget levels.
- Reviewed a proposal to reduce the FY 2004 General Fund surplus by $1,954,000 to cover VEDA mortgage insurance program losses, most of which occurred prior to 1993. As part of this proposal, an indemnification fund would be created for future program losses. The Committee postponed action on this due to questions on how the indemnification fund would be capitalized.
- Heard a report on the Human Services Caseload Reserve which now has a balance of $18,543,422. This is up from $17,243,422 at the end of FY 2003 due to additions approved in the 2004 legislative session. This fund is available to address unanticipated caseload increases.
- Heard an update on Vermont State Hospital funding which continues to face federal fund shortfalls. In the current year, federal funding is anticipated to be $660,000 below expectations. In future years, federal funding for stand-alone state hospitals may be in jeopardy.
- Reviewed elderly and disabled transportation program issues. The state distributed available funds based on 3-year average historical usage. The program impacts accessibility of adult day care center programs, senior meals programs, and non-Medicaid medical services (cancer, dialysis, other treatments).
- Approved the use of the Producer Price Index as the inflation index for VTRANS to assess 10-year needs for highways and street construction. This new process will help ascertain the projected balance between future resources and needs.
- Heard an update on Vermont's Hydroelectric Power Authority. Deputy Commissioner John Sayles reported that work is underway to develop a bid for Connecticut River dams currently in a bankruptcy proceeding. The process is active, and more information will be available by the November meeting.
- Set the next meeting date for November 29th. ❖

Federal Transportation Act

Federal transportation aid is governed by a multi-year, usually 6 years, authorization act. The last 6-year authorization act, TEA-21, expired in September 2003, and Congress is still struggling to enact a successor.

TEA-21 included a mechanism for increasing state apportionments in line with rising federal gasoline tax revenues, and when TEA-21 expired, Vermont's base annual apportionment was in the $126 million range. Under the various proposals on the table, Vermont's annual apportionment would have increased, certainly above $130 million and in some versions, well above $150 million.

The state FY 2005 transportation budget assumed federal aid in federal fiscal year 2005 would total $133 million. Since TEA-21 expired last year, federal transportation aid has been authorized in a series of short-term continuing resolutions at the TEA-21 level. In the latest development, Congress extended funding authority for the transportation programs for another 8 months, signaling that a new authorization act will not be passed prior to the election. In the meantime, the federal funds being received are at a lower level than what was assumed in the budget, and adjustments will likely need to be made. ❖

Sustainable Healthcare Study

As part of the FY 2005 appropriations act, the legislature created a sustainable health care study designed to generate and evaluate alternative ways to address financial issues in state-supported health care programs. The study is overseen by a special committee consisting of members of the Joint Fiscal Committee, the Chair and Vice Chair of the Health Access Oversight Committee, and the Secretaries of Administration and Human Services, and the Commissioner of Banking, Insurance, Securities, and Health Care Administration (BISHCA). The Chairs of the House and Senate Committees on Health and Welfare are also invited to participate.

The Joint Fiscal Committee received a background presentation at its July 15th meeting. The full study committee met on September 19th and received presentations from Vernon Smith, a nationally-known Medicaid expert; Steve Kappel, of the Joint Fiscal Office; Joshua Slen, Director of the Office of Vermont Health Access; and Herb Olson, General Counsel for BISHCA.

The Committee adopted a motion requesting the legislative and administration staff to develop options to address the shortfall for its November meeting. ❖

Streamlined Sales Tax: Coming to Vermont, But When?

The Streamlined Sales Tax Agreement (SSTA) is a multi-state endeavor to simplify and streamline state sales and use taxes in order to facilitate the collection of such taxes from out-of-state vendors – notably mail order and internet retailers.

Although the SSTA could be "current law" in Vermont as early as July of 2005 (affecting FY 2006 revenues), it has not been included in the current Revenue Forecast Update for several reasons. The implementation of this legislation is contingent upon a sufficient number of qualifying states participating in the SSTA. Although it is likely this threshold will be reached and that the SSTA will be finalized, the implementation date at this time is still uncertain. Even upon implementation by the states, however, out-of-state vendor payments would still be voluntary until Congress acts to overturn the Bellas Hess and Quill decisions. Legislation has been introduced to effect this (S.1736), but it is not yet current law.

The Joint Fiscal Office will be working with Administration and Tax Department economists and policy analysts to estimate the fiscal impacts of the SSTA as the potential implementation date approaches. There are many factors to take into consideration, such as voluntary compliance rates, when estimating the potential new streamlined sales and use tax revenue. The range of estimates currently circulating puts potential FY 2006 impacts for Vermont in a wide range between $20 and $70 million, to be divided between the General Fund and Education Fund. ❖

JOINT FISCAL OFFICE STAFF

CHIEF FISCAL OFFICER

Stephen Klein — sklein@leg.state.vt.us

ASSOCIATE FISCAL OFFICERS

Stephanie Barrett — sbarrett@leg.state.vt.us
Maria Belliveau — mbelliveau@leg.state.vt.us
Catherine Benham — benham@leg.state.vt.us
Steve Kappel — skappel@leg.state.vt.us

FISCAL ANALYSTS

Mark Perrault — mperrault@leg.state.vt.us
Neil Schickner — nschickner@leg.state.vt.us
Sara Teachout — steachout@leg.state.vt.us

STAFF ASSOCIATES

Rebecca Buck — rbuck@leg.state.vt.us
Virginia Catone — catone@leg.state.vt.us

BUSINESS MANAGER

Sandra Noyes — snoyes@leg.state.vt.us

Legislative Joint Fiscal Office
One Baldwin Street, Drawer 33
Montpelier, VT 05633-5701
Tel: (802) 828 - 2295
Fax: (802) - 828-2483
Website: www.leg.state.vt.us/jfo

JFO Performance Survey

The JFO received 59 responses this summer to the biennial performance survey. The response rate was 71 in 2002 and 24 in 2000. Additional responses are always welcome. Thank you to everyone who took the time to fill out the survey.

This year, the office received the highest overall evaluation results since the survey began. On a scale of 4, the responses are an average of 3.7. Two years ago, the average was 3.55, and four years ago it was 3.47. Ninety-eight percent of respondents felt the JFO was impartial between the House and Senate chambers. Ninety-four percent felt the service was equal between minority and majority parties. The concerned respondents were equally divided between democrat and republican responses with one unidentified member.

A number of written responses indicated that non-money committee members would like more interaction with the Joint Fiscal Office. As part of our response to the survey, we will implement a committee liaison system. A joint fiscal staff person would be assigned to each non-money committee to check in on needs and answer questions as they arise. It is hoped this would provide for greater information flow and improved interaction. ❖

Legislative Joint Fiscal Office
1 Baldwin Street, Drawer 33
Montpelier, VT 05633-5701