



Bulletin

January 27, 2016



MTF's Initial Analysis of the Governor's Budget

Key Takeaways

There are many positive elements of Governor Baker's FY 2017 budget proposal:

- Limiting line-item spending growth to 3.19% over FY 2016 estimated spending – a rate of growth that is significantly less than expected tax revenue growth (4.31%)
- Reducing the use of one-time solutions substantially compared to FY 2016
 - House 2 relies on \$266.5 million in one-time solves compared to \$629 million in FY 2016
- Budgeting on an assumed Stabilization Fund deposit of \$206 million, which will increase our reserves to approximately \$1.47 billion by the end of FY 2017
- Providing substantial funding increases to support reform efforts and new initiatives in substance abuse and child welfare
- Reducing the likelihood of midyear budget shortfalls by fully funding obligations for GIC and family homelessness programs

However, there are also several areas of concern:

- Continuing the practice of diverting a portion of above-benchmark capital gains revenues from the Stabilization Fund by using \$150 million of this revenue to pay operating expenses
- Using \$266.5 million in one-time solves which, though reduced from previous years, builds in a budget gap for FY 2018
- Amending a requirement to dedicate a portion of Tobacco Settlement revenues to long-term liabilities, by reducing the amount of the commitment from \$120 million to \$72 million in FY 2017 and relying on reversions to cover the obligation

Today, Governor Baker released his FY 2017 budget recommendations. His House 2 proposal recommends \$39.55 billion in line item spending (see Table 1), an increase of \$1.22 billion (3.2%) over FY 2016 projected spending. Of this \$1.22 billion increase, \$739.3 million goes to support increases in MassHealth and \$132.2 million is required for debt service obligations. House 2 also assumes \$4.31 billion in pre-budget transfers and other off-budget spending. This increase of 6.91% over FY 2016 is largely driven by a scheduled 10% increase in the annual contribution to the state's pension fund.

This spending plan uses \$266.5 million in one-time solutions to balance the budget, compared to \$629 million in FY 2016. It also assumes a net Stabilization Fund deposit of \$206 million in FY 2017 for an estimated end of year balance of \$1.47 billion. While this is a positive step, this amount falls short of the deposit of one percent of tax revenues or \$268 million recommended recently by the Foundation. House 2 does propose to dedicate the majority of any licensing revenue from the Southeastern Massachusetts casino to the Stabilization Fund. This deposit would be in addition to the \$206 million assumed in House 2's financial documents.

Table 1. House 2 Spending

	FY 2016 Projected	H2	\$ Change	% Change
Line Item Spending	\$38,329.7	\$39,553.4	\$1,223.8	3.19%
Pre-Budget Transfer	\$3,823.4	\$4,087.6	\$264.2	6.91%
Off-budget	\$229.4	\$226.9	-\$2.5	-1.09%
Total	\$42,382.5	\$43,867.9	\$1,485.4	3.50%

Closing the Budget Gap

Budget makers are faced with a structural budget deficit ranging from \$700 to \$900 million in FY 2017. While there are many moving pieces that contribute to closing the gap, the major strategies contained in House 2 are outlined in Table 2.

Table 2. Notable House 2 Budget Gap Solutions

Initial Budget Gap of Between \$700 - \$900 million	
<i>Notable Gap Solves</i>	
Supporting OPEB payment through reversions	\$120
Cap Gains Diversion	\$150
Other One-Timers	\$117
One Time Tax Settlements	\$115
CommCare Trust Fund Payment	\$110
Other Revenue Enhancements	\$106
GIC Premium Increase	\$33
Increased Lottery Revenues	\$24
Reduced TAFDC Payments	\$43
Reduced MassDot Transfer	\$31
Identified Solutions	\$849

Of these solutions, \$266.5 million are considered one-time and therefore will contribute to the state's structural deficit in FY 2018. While not one-time, revenues from tax settlements and transfers from the Commonwealth Care Trust fund may not be sustainable going forward either.

Budget spending

House 2 recommends \$39.55 billion in line-item spending as well as \$4.31 billion in pre-budget transfers

and other spending. This total spending figure of \$43.87 billion represents an increase of \$1.49 billion (3.5%) over the FY 2016 estimated spending.

Notable spending areas include:

MassHealth

MassHealth spending totals \$15.47 billion, an increase of \$739.3 million (5.0%) over the current fiscal year and more than half of all new spending in FY 2017. However, this gross spending increase is offset by an increase of \$463.6 million in federal revenues. Once these increased revenues are accounted for, net MassHealth spending in House 2 increases by \$275.4 million.

What is a pre-budget transfer?

Pre-budget transfers are 4 annual spending requirements that are established by prior agreement and not subject to budget negotiation:

- Annual pension contribution (\$2.198B in FY2017)
- MBTA transfer (\$1.001B in FY 2017)
- School Building Assistance transfer (\$867.1M in FY 2017)
- Workforce Training transfer (\$21.4M in FY 2017)

Local Aid

Making good on a promise to municipalities, the Baker Administration increases unrestricted local aid funding by \$42.1 million, or 4.31%, the same rate as tax revenue growth.

Table 3. Unrestricted Local Aid (UGGA), FY 2013 – FY 2017

	FY 2013	FY 2014	FY 2015	FY 2016	FY 2017 H2
UGGA	\$899	\$920	\$946	\$980	\$1,022
Increase over prior year	\$0	\$21	\$26	\$34	\$42

Chapter 70 and Education Aid

Chapter 70 education aid is funded at \$4.584 billion, an increase of \$72.1 million (1.6%) over the FY 2016 spending level. This funding amount ensures that all districts meet the minimum Foundation Budget level while continuing to phase in local spending requirement reforms based on ability to pay.

Table 4. Chapter 70 Aid, FY 2013 – FY 2017

	FY 2013	FY 2014	FY 2015	FY 2016	FY 2017 H2
Chapter 70 funding	\$4,171	\$4,301	\$4,401	\$4,512	\$4,584
Increase over prior year	\$180	\$130	\$100	\$111	\$72

House 2 includes a total of \$432 million in funding for the other three largest K-12 education reimbursement programs:

- \$272.6 million for special education reimbursements, level funded with FY 2016 estimated spending;
- \$101.0 million for charter school tuition reimbursements to schools districts, a \$20 million increase over FY 2016 estimated spending. In addition to this funding increase, House 2 also amends the charter school reimbursement formula. An analysis of this proposed change is included later in this brief.
- \$59.0 million for regional school transportation reimbursements, funding at the FY 2016 level

Table 5. Major Education Reimbursement Programs, FY 2013 – FY 2017

	FY 2013	FY 2014	FY 2015	FY 2016	FY 2017 H2
SPED Reimbursements	\$242	\$252	\$253	\$272	\$272
Charter School Reimbursements	\$78	\$103	\$77	\$81	\$101
Regional School Transportation Reimbursements	\$46	\$52	\$57	\$59	\$59
Total	\$365	\$407	\$387	\$411	\$432

Transportation

In addition to the automatic pre-budget transfer of \$1.001 billion, House 2 includes \$604.3 million in transfers to transportation agencies as outlined below in Table 6.

Table 6. Transportation Transfers in House 2

	FY 2016 GAA	FY 2016 Estimated	FY 2017 H2	\$ Change from FY 16 Estimated	% Change
MassDot	\$365	\$359	\$328	-\$31	-8.61%
MBTA	\$187	\$187	\$187	\$0	0.00%
Regional Transit Authorities	\$82	\$82	\$80	-\$2	-2.44%
Merit Rating Board	\$10	\$10	\$10	\$0	1.49%
Total	\$644	\$637	\$604	-\$33	-5.14%

Child Welfare

Funding for the Department of Children and Families (DCF) and other family services totals \$1.162 billion, an increase of \$21 million over estimated FY 2016 spending. However, because House 2 proposes moving \$24 million in domestic violence services from DCF to the Department of Public Health (DPH), the actual DCF and family service increase proposed in House 2 is \$45 million (3.9%). Funding increases include:

- \$223.5 million for social workers, an increase of \$19.6 (9.6%) million over FY 2016 spending;
- \$263.9 million for group care services, an increase of \$13.5 million (5.4%) over FY 2016 spending; and
- \$10 million for DCF Family Resource Centers, an increase of \$2.6 million (34.9%) over FY 2016 spending.

Substance Abuse

Substance abuse services receive an increase of \$24.5 million over FY 2016 estimate spending. This 21.9% increase is among the largest in the Governor’s proposed spending plan and reflects the high priority he places on addressing the opioid addiction crisis. This substantial increase is provided to the Bureau of Substance Abuse Services primary account, as opposed to smaller substance abuse items for discrete programs. Presumably this increase in spending is intended to support enhanced and additional services expected through substance abuse legislation.

Housing and Homelessness

House 2 includes \$459.3 million for homelessness and low-income housing support. While this total funding level is a decrease of \$6 million from expected FY 2016 spending, it marks an increase of \$32.1 million over the FY 2016 GAA. Also notable is that House 2 appears to fully fund the state's Emergency Assistance program at \$191.9 million. Typically, the Emergency Assistance program is underfunded in the budget and requires a sizable supplemental appropriation later in the year. By fully funding the account, the state may also avoid a mid-year gap later in FY 2017.

Budget Revenues

House 2 is built on the FY 2017 Consensus Tax Revenue number of \$26.860 billion. In addition, the Governor projects \$16.98 billion in departmental, federal and other forms of revenue (see Table 7). While not all of House 2's revenue assumptions are known at this point, there are several items to note:

- Departmental revenue equals \$3.83 billion, which is a reduction of more than \$100 million from FY 2016 estimates
- Medicaid revenue amount to \$8.66 billion, an increase of \$463.6 million over estimated FY 2016 revenues
- Lottery revenues are expected to be \$1.09 billion, an increase of \$24.6 million over estimated FY 2016 revenues

Table 7. House 2 Revenue Sources

	FY 2016 Projected	H2	Difference
Consensus Tax Revenues	\$25,752.0	\$26,860.0	\$1,108.0
<i>Less transfers</i>	\$21,949.9	\$22,772.3	\$822.4
<i>Less cap gains transfer</i>	\$21,949.9	\$22,566.3	\$616.4
Tax Settlements	\$125.0	\$115.0	-\$10.0
Tax changes not in consensus	\$0.0	\$49.0	\$49.0
Departmental Revenues	\$3,943.5	\$3,826.6	-\$116.9
Federal Reimbursements	\$10,749.2	\$10,784.3	\$35.1
Other Revenues	\$2,029.4	\$2,203.9	\$174.5
<i>Revenues for budget</i>	<i>\$38,797.0</i>	<i>\$39,545.1</i>	<i>\$748.1</i>

One-time solutions

House 2 proposes the use of \$266.5 million in one-time solutions to balance the FY 2017 budget compared to \$629 million assumed in the FY 2016 budget (see figure 4).

Table 8. One-Time Solutions in House 2

	FY 2016 GAA	H2	Difference
Cap. Gains Diversion	\$300	\$150	-\$150
Tax Amnesty	\$100	\$0	-\$100
Land Sales	\$30	\$30	\$0
MassHealth Cash Management	\$116	\$0	-\$116
MassHealth One Time Revenue	\$0	\$74	\$74
EOHHS Trust Sweep	\$0	\$13	\$13
Other	\$83	\$0	-\$83
Total	\$629	\$267	-\$362
Note: Land sales which were expected in FY 2016 have been delayed and revenue associated with those sales is now assumed in FY 2017			

Notable policy changes

Included within H2 are 43 policy sections. Generally, these sections are necessary complements to spending and revenue assumptions in House 2, but several policy changes are included as well:

- ***Charter School Tuition***

The charter school tuition formula is amended in two ways. The reimbursement percentages received by sending school districts are changed and the receipt of tuition reimbursements after the first year are limited to low-performing districts that devote more than 9% of total spending to charter school tuition.

Table 9. Charter School Reimbursement Proposal in House 2

	Current System	H2 Proposal
1st year reimbursement	100%	100%
2nd year reimbursement	25%	50%
3rd year reimbursement	25%	25%
Additional years of reimbursement	Yes, 3 at 25%	No
1st year reimbursement eligibility	All districts with increased tuition	All districts with increased tuition
Reimbursement eligibility after 1st year	All districts with increased tuition	Low-performing districts spending more than 9% on charter school tuition

- ***GIC Premiums***

All state employees are required to pay 25% of health insurance premiums under the Governor's proposal. Currently, employees who began in state service before a certain date contribute 20% while more recent hires contribute 25%. This change, which was proposed but not adopted in the FY 2016 budget, would generate approximately \$33 million in savings to the state.

- ***Delivery Reform System Trust Fund***

A new trust fund is created to be used to make Medicaid payments and provide quality incentives under the Federal Waiver. The fund will be largely supported by additional federal reimbursement generated by provider assessments.

- ***Region C Licensing Revenue***

Any new licensing revenue from the approval of a casino in Southeastern Massachusetts will go to community mitigation (\$8.5 million) with the balance deposited into the Stabilization Fund (estimated by the Administration at \$76.5 million).

- ***Consolidated Net Surplus***

The first \$20 million of any FY 2016 surplus is divided between the Community Preservation Act and the Life Sciences Center. Any surplus over \$20 million would be deposited into the Stabilization Fund.

Conclusion

The Governor's budget is a fiscally responsible spending plan that keeps the rate of spending growth less than tax revenue growth; reduces by half the reliance on one-time solutions; and assumes a Stabilization Fund deposit of more than \$206 million. The budget also makes targeted new investments in local aid, substance abuse services, child welfare and other Baker Administration priorities. As the first step in the budget process, House 2 is directionally correct and sets a tone of fiscal restraint.

At the same time, there are elements of the Governor's budget that are concerning. Most notable is the continued practice of diverting above-benchmark capital gains revenues from the Rainy Day Fund, which leaves the state ill-prepared to face the next fiscal crisis by limiting our reserves. MTF will continue to advocate for a more aggressive approach to replenishing the Stabilization Fund.

In addition, House 2 once again slows the schedule for increasing payments to pay down our unfunded retiree health benefit liability and uses an uncertain source of revenues (debt service reversions) to meet the requirement. Originally, this policy was intended to ultimately dedicate all Tobacco Settlement Revenues to this long-term liability. By amending the policy to save \$120 million now, we increase our long-term fiscal exposure.

Massachusetts Taxpayers Foundation - Fiscal 2017 Budget Summary

	FY 12 Final	FY 13 Final	FY 14 Final	FY 15 Final	FY 16 GAA	FY 16 Projected	FY 17 H2
Health Care	11,894	12,619	13,615	14,787	15,876	15,865	16,626
MassHealth	10,400	10,874	12,121	13,583	14,740	14,730	15,469
Connector	864	905	600	268	229	229	227
Trust Funds ¹	394	580	661	701	651	651	668
Other Health Care	236	260	232	235	256	255	262
Local Government Support	5,601	5,765	5,919	6,023	6,213	6,209	6,333
Chapter 70 Education Aid	4,108	4,186	4,303	4,402	4,514	4,514	4,584
Other K-12 Education Aid	508	571	602	585	622	621	638
Unrestricted Local Aid	927	927	948	973	1,007	1,007	1,049
Other Local Aid	59	81	67	63	70	67	62
Other Education	1,440	1,490	1,612	1,710	1,750	1,749	1,732
Early Education	507	499	524	544	567	566	573
Higher Education	933	990	1,088	1,167	1,184	1,183	1,159
Human Services	4,906	5,105	5,404	5,665	5,833	5,889	6,008
Developmental Services	1,391	1,441	1,553	1,715	1,847	1,847	1,897
Family Services	884	921	977	1,077	1,126	1,141	1,162
Cash Assistance	776	786	794	716	707	710	689
Mental Health	651	659	708	719	740	740	761
Public Health	506	522	560	601	549	549	595
Housing Support	337	406	420	422	427	466	459
Senior Support	240	240	253	271	283	283	286
Veteran Services	121	130	140	143	152	152	158
Public Safety	2,252	2,430	2,523	2,632	2,617	2,693	2,701
Corrections	550	579	591	607	608	612	611
Sheriffs	477	529	542	582	560	588	588
Judiciary	723	794	828	863	849	893	882
Police	280	293	310	308	326	323	339
District Attorneys	99	102	103	108	113	113	119
Attorney General	39	40	43	44	45	45	48
Other Public Protection	85	93	106	120	116	119	113
Transportation	1,142	1,191	1,423	1,774	1,629	1,623	1,605
MassDOT	180	162	272	471	365	359	328
Highways	0	56	0	0	0	0	0
Regional Transit	15	19	68	40	82	82	80
Registry	8	9	9	9	10	10	10
MBTA	939	947	1,074	1,254	1,172	1,173	1,188
Sales Tax Revenues	779	787	799	971	985	986	1,001
Discretionary Assistance	160	160	275	283	187	187	187
Economic Development	312	346	417	341	421	415	391
Business and Labor	122	147	197	114	179	174	164
Environment and Energy	191	199	220	227	241	241	227
Employee Benefits	3,128	3,207	3,445	3,897	4,152	4,152	4,391
GIC ²	1,236	1,240	1,395	1,683	1,726	1,726	1,743
State Retiree Benefits (OPEB)	414	415	420	420	425	425	450
Pensions	1,478	1,552	1,630	1,793	2,001	2,001	2,198
Capital Support	2,261	2,362	2,423	2,498	2,518	2,518	2,645
Debt Service	1,980	2,068	2,118	2,219	2,240	2,240	2,372
Contract Assistance	281	294	304	279	278	278	272
MA School Building Authority	678	669	729	772	804	815	867
Other/General Government	482	554	707	617	304	455	570
Total (Including Pre-Budget Transfers)	34,096	35,738	38,216	40,715	42,116	42,382	43,868

¹ Includes the Medical Assistance Trust Fund and the Delivery System Transformation Initiatives Trust Fund

² Includes health care costs for municipalities and authorities that reimburse the state