Three-Year General Fund Financial Outlook

FY 2019-20 to FY 2021-22

Preliminary

Prepared Pursuant to Act 156 of 2005

§11-11-350

South Carolina Revenue and Fiscal Affairs Office

December 2018

Three-Year General Fund Financial Outlook
FY 2019-20 to FY 2021-22
Based on Enacted FY 2018-19 Budget
(Dollars in Millions)

	FY 2018-19 "Base Year"	Projections FY 2019-20	FY 2020-21	FY 2021-22
Resources:				
Revenue (BEA Long Range Revenue Forecast, 12/11/2018)	8,836.0	9,330.6	9,670.0	9,987.1
Adjustments				
Tax Relief Trust Fund Transfers	(599.4)	(614.1)	(629.2)	(644.5)
General Reserve Fund Transfer		(27.1)	(5.6)	(24.0)
Total Revenue/Resources	**$8,236.6**	**$8,689.4**	**$9,035.2**	**$9,318.6**
Expenditures and Reserve Fund Contributions:				
Recurring Base	**$8,218.8**	**$8,218.8**	**$8,218.8**	**$8,218.8**
Constitutional/Statutory Items:				
Reserve Funds: Capital Reserve (CRF)		10.8	23.9	46.6
Debt Service		(128.9)	(128.9)	(124.8)
Homestead Exemption Fund Shortfall (Act 388 of 2006)		2.3	(0.8)	(3.8)
Major Expenditure Categories (Maintenance of Effort):				
K-12 Education		70.0	149.7	222.6
Medicaid and Health		74.3	149.4	198.5
Social Services (Child Support Enforcement & Michelle H Consent Agreement) (See Notes)		74.0	86.9	117.6
Higher Education Scholarship Growth (LIFE, HOPE & Palmetto Fellows)		15.5	28.2	39.6
State Employee Health Plan - Retiree Growth + Rate Increase		49.7	86.9	153.8
State Employee Compensation Changes (2 percent per year)		42.0	84.0	126.0
SCRS/PORS Contribution Increase (1 percent per year)		36.6	73.2	109.8
SCDMV REAL ID and Roads Bill Implementation		5.1	0.0	4.2
Total Expenditures	**$8,218.8**	**$8,470.2**	**$8,771.3**	**$9,108.7**
Recurring Balance for Other Appropriations		$219.2	$263.9	$209.9
Projected CRF Funds Available for Nonrecurring Expenditures		$151.7	$162.5	$164.7
Projected General Reserve Fund Balance	$379.1	$406.2	$411.8	$435.8

The Notes and Assumptions are an integral part of this Financial Outlook. FY 2018-19 Base Year reflects Appropriations Act forecast.

Notes

The three-year General Fund Outlook is prepared by the South Carolina Revenue and Fiscal Affairs Office in consultation with the Board of Economic Advisors in accordance with Section 11-11-350 of the S. C. Code of Laws, 1976. The Outlook is a three-year revenue and spending projection based on the enacted FY 2018-19 General Fund operating budget.

The spending projections are cumulative and the estimates are based on the FY 2018-19 enacted budget and major expenditure categories contained therein. Unless noted below, future years do not include any increases over the baseline expenditures (FY 2018-19 enacted recurring budget). If the projected balance is negative in any year, a budget gap exists. A budget gap reflects a structural imbalance between projected revenue growth and expenditure increases based on the adjusted enacted budget.

This document is intended to be used for planning purposes only and should not be viewed as requiring the General Assembly to fund the major expenditure items listed. The Outlook does not attempt to capture every agency's needs or budget requests. This document is preliminary and is subject to revision.

Resource/Revenue Assumptions

- **Board of Economic Advisors Forecast** – The Board of Economic Advisors (BEA) long-range General Fund revenue forecast is based upon its November 8, 2018 forecast for FY 2019-20. The FY 2019-20 revenue estimate serves as the base for the long-range forecast. The plan is built upon an assumed growth rate in personal income, historical elasticities for the major revenue components (sales and individual income taxes), and historical growth rates or patterns in the remaining revenue sources.

The assumptions and methodologies for this long range forecast include:

- An annual personal income growth rate of 4.25 percent;
- A sales tax growth rate of 4.25 percent based on a historical elasticity of 1.0;
- An individual income tax growth rate of 4.675 percent based on a historical elasticity of 1.1;
- Corporate income tax increasing throughout the forecast period; and
- Historical trends and patterns and other legislative factors affecting the remaining revenues.

The annual growth rates for FY 2019-20, FY 2020-21, and FY 2021-22 are 3.0 percent, 3.6 percent, and 3.3 percent, respectively. The detailed three-year General Fund revenue forecast by revenue category is included as an attachment to this document.

❖ **Tobacco Master Settlement Agreement** – The state's "tobacco bonds," securitized by its Tobacco Master Settlement Agreement (MSA) payments, were retired June 1, 2012. By statute, future MSA receipts are available for appropriation. The revenue expected, based on historical MSA payments to the state and settlement credits, is estimated at $70.0 million annually. Current statute earmarks these funds primarily for healthcare programs; however, specific program appropriations is at the discretion of the General Assembly. For FY 2019-20 through FY 2021-22, $70.0 million is estimated to be available for appropriation annually. This amount is not shown as additional revenue in the Outlook because it was appropriated in the base year for Medicaid maintenance of effort and diligent enforcement of the tobacco MSA.

RESERVE FUNDS

- **General Reserve Fund –** On November 2, 2010, a constitutional amendment was adopted increasing the General Reserve Fund from 3 percent to 5 percent of the previously completed fiscal year's General Fund revenue. Currently, the General Reserve Fund is fully funded at $379,123,483 million. Annual contributions for FY 2019-20 through FY 2021-22 are $27.1 million, $5.6 million, and $24.0 million, respectively, with the fund maintaining 5 percent funding for all years.

- **Capital Reserve Fund –** The Capital Reserve Fund (CRF) is a budgetary account funded at 2 percent of the previously completed fiscal year's General Fund revenue. It is used to offset year-end deficits and to replenish, when needed, the required amount in the General Reserve Fund. If not needed to offset a year-end deficit or to replenish the General Reserve Fund, the CRF may be appropriated for the following purposes: (1) to finance in cash previously authorized capital improvement bond projects, (2) to retire the interest or principal on bonds previously issued, or (3) for capital improvements or other non-recurring purposes. Incremental contributions for FY 2019-20 through FY 2021-22 are $10.8 million, $2.2 million, and $9.6 million, respectively, with the fund maintaining 5 percent funding for all years.

Expenditure Assumptions

LOCAL GOVERNMENT FUND

- The Local Government Fund is a statutorily defined transfer of funds to counties and municipalities equal to 4.5 percent of the previously completed fiscal year's General Fund revenue. For the last eight years, the requirement to fund this account at the statutorily prescribed level has been suspended. This report assumes continued funding at FY 2018-19 levels. Annual increases for FY 2019-20 through FY 2021-22 are $0.0 million, $0.0 million and $0.0 million, respectively. However, if funding were returned to statutorily mandated levels in FY 2019-20, it would require an additional $143.0 million.

DEBT SERVICE

- Future Debt Service needs will decline over the forecast period. Incremental adjustments are $(128.9) million in FY 2019-20, $(0) million in FY 2020-21 and $4.0 million in FY 2021-22. This estimate reflects existing law and does not include the potential impact of proposed legislation.

HOMESTEAD EXEMPTION FUND

- The Property Tax Reform Act, Act No. 388 of 2006, eliminated all school operating taxes on owner-occupied homes and increased the state sales tax by one cent to replace the reduced property tax revenue stream. The new revenue from the one-cent sales tax increase is earmarked for the Homestead Exemption Fund, which replaces lost property tax revenue as of FY 2007-08. Funding to school districts in the first year was based on what would have been collected under the old system. For subsequent years, the school district funding requirement is based on inflation plus population growth factors. The Act provides that should there be a shortfall of revenue in the Homestead Exemption Fund then the General Fund will make up the difference.

- The FY 2019-20 base budget includes $20.4 million dedicated to offset this shortfall. Incremental adjustments for FY 2019-20, FY 2020-21, and FY 2021-22 are $2.3, $(0.8), and $(3.8) million, respectively.

K-12 EDUCATION

- **Education Finance Act (EFA)** – The FY 2018-19 Base Student Cost is $2,486 with a Weighted Pupil Unit (WPU) count of 992,431. This forecast assumes a 2.0 percent inflation factor annually for FY 2019-20, FY 2020-21, and FY 2021-22. The WPU growth rate for school districts is 0.4 percent over the forecast period. This growth is primarily attributable to an increase in students qualifying for add-on weights for academic assistance and dual enrollment. During the forecast period, growth in the South Carolina Public Charter School district is estimated to outpace the overall growth rate in school district WPUs. This is due to enrollment growth in existing and new charter schools and the addition of new grade levels in existing charter schools. The Base Student Cost and Weighted Pupil Units for the projected period are:
  - FY 2019-20
    - $2,536
    - 1,036,181
  - FY 2019-20
    - $2,586
    - 1,048,785
  - FY 2020-21
    - $2,638
    - 1,056,571

  The incremental adjustments for the three-year period are $70 million, $79.7 million, and $72.9 million, respectively.

MEDICAID AND HEALTH

- **Medicaid Program** – In 2010, the General Assembly increased the state's cigarette tax by fifty cents. The annual revenue from the increase is dedicated to the Medicaid program. During FY 2018-19, approximately $118 million of cigarette tax revenue was estimated to be used to support the Medicaid program. The Medicaid expenditure estimates on Page 1 are adjusted to reflect this dedicated source of revenue.

  The Medicaid projections reflect additional state funds needed to maintain current service levels based on enrollment and cost per member projections. These increases are primarily attributable to growth in existing programs, as well as increases in federally mandated Medicare premium assistance programs such as Medicare premiums for Part A, B, and D.

  The South Carolina Department of Health and Human Services also anticipates continued growth in the Community Long Term Care waiver program, which provides nursing facility level care in a patient's home. This avoids or delays the need for placement in a nursing home. As the economy has improved, South Carolina's Federal Medical Assistance Percentage (FMAP) has declined. FMAP is computed from a formula that takes into account the average per capita income for each state relative to the national average. FMAP affects the rate at which the federal government matches state dollars spent on Medicaid. The agency reports that this decrease in FMAP will result in an increased need for state appropriations in excess of $30 million in FY 2019-20. The change in FMAP rate is also impacting the CHIP program. Based on these assumptions, the projected General Fund growth rate for the Medicaid program is 5.4 percent for FY 2019-20, 5.1 percent for FY 2020-21 and 3.0 percent for FY 2021-22.

  The total additional recurring state appropriations needed to provide sustainable funding for the current Medicaid program for FY 2019-20 thru FY 2021-22 is $178.95 million. The incremental adjustments for FY 2019-20, FY 2020-21, and FY 2021-22 are $67.83 million, $68.61 million, and $42.5 million, respectively.

- **Department of Mental Health** – To continue to cover operating costs at community mental health centers and inpatient facilities, along with growth in the forensic inpatient services and the sexually violent predators programs, additional funding of will be required in each year for FY 2019-20 through FY 2021-22. However, the total amount of funding required in is heavily dependent on the outcome of a pending capital project to construct three additional nursing homes for veterans. The environmental studies have been completed, and the project is pending final approval. For the purpose of this outlook, increased recurring appropriations of $6.5 million per year have been assumed based on historical submissions.

SOCIAL SERVICES AND CORRECTIONAL AGENCIES

- **Child Support Enforcement Statewide Automated System Development** – Funding is required for the continued development and implementation of a federally mandated statewide automated system for child support enforcement, as well as to pay for penalties currently imposed on the state by the federal government. The estimated cost is $28.6 million in FY 2019-20.
- **Michelle H Consent Agreement** – Per a settlement agreement approved by a federal court on October 4, 2016, the Department of Social Services reports that it is required to meet several benchmarks to reform the child welfare system. Those benchmarks include achieving and maintaining a caseload standard that must be approved by the court, increasing the size and improving the quality of the foster care placement array, and developing a foster care health care system that is tailored to meet the needs of children in the foster care system. DSS reports that the agency's work with federal court monitors and consultants has resulted in an estimate of $44.5 million in targeted areas for FY 2019-20. The agency also reports that additional recurring state appropriations in FY 2020-21 and FY 2021-22 will also be necessary in the amounts of $42.4 million and $30.7 million, respectively. However, there is still a substantial degree of uncertainty in these estimates as a final plan has not yet been approved. If additional information becomes available, this estimate may be revised.

HIGHER EDUCATION SCHOLARSHIP GROWTH

- **LIFE, HOPE & Palmetto Fellows Scholarships** – The estimated incremental costs for the three scholarship programs are $15.5 million in FY 2019-20, $12.7 million in FY 2020-21, and $11.4 million in FY 2021-22. These incremental cost estimates take into account both the anticipated costs of changes to the Uniform Grading Policy and continued growth at the five-year average rate for each scholarship program. Most scholarship funding has been moved from the General Fund to the South Carolina Education Lottery. However, as lottery revenues begin to plateau, there may be a need for General Fund appropriations to make up incremental increases in scholarship awards.

DEPARTMENT OF MOTOR VEHICLES

- **Roads Bill Implementation** – Act 6 of 2017 requires that the State of South Carolina come into compliance with the federal REAL ID Act of 2005. To comply with this federal mandate the state must issue new licenses or ID cards to all citizens who wish to have a REAL ID compliant credential. SCDMV will need $5.1 million in FY 2019-20 to implement REAL ID. The agency has sufficient Other Funds for this initiative; however, since the passage of Act 40 of 2017, which changed the agency's primary funding source from Other Funds to General Funds, the agency has been expending a carried forward Other Fund balance to supplement its operations. These carried forward funds will be exhausted in FY 2021-22, and the agency indicates that General Fund appropriations totaling $4.2 million will be required beginning in FY 2021-22 to maintain its operations. Use of the current Other Funds balance for other proposed projects, such as REAL ID, could accelerate the timing of this transition.

STATE EMPLOYEE HEALTH PLAN

- Retiree Growth and Rate Increase – The South Carolina Public Employee Benefit Authority (PEBA) estimates the General Fund amounts needed for the operation of the State Health Plan for retiree growth and health plan increases are as follows:

1. Retiree Growth and Rate Increase
    a. Calendar Year 2019 employer base (state funds only) is $991,540,582;
    b. Annualization involves funding the final six months (Jul-Dec) of an increase that is effective the prior January;
    c. The employer rate increase involves funding the first six months (Jan-Jun) of an increase that is effective January of the fiscal year; and
    d. The projected annual premium growth rate effective each year equals 0.0 percent in January 2020, 6.0 percent in January 2021 and 6.0 percent in January 2022.
2. The projection assumes the employer pays the same proportion that is in place in January 2019 for 2020, 2021, and 2022;
3. Retiree growth for FY 2019-20 is estimated at 4.7 percent, and for FY 2020-21, and FY 2021-22 retiree growth is estimated at 2.0 percent per year.
4. The estimated amount of additional general fund dollars for the State Health Plan is $49.7 million in FY 2019-20, $37.2 million in FY 2020-21, and $66.9 million in FY 2021-22.

STATE EMPLOYEE COMPENSATION

❖ The estimate is based on total state employee salary, with the exception of exempted groups (agency heads, members of the legislature, and constitutional officers), plus other included groups (local health care providers, county auditors and treasurers, and school bus drivers). The cost for a 2 percent increase equals approximately $42 million per year to include all applicable fringe benefits.

STATE EMPLOYEE RETIREMENT SYSTEM

❖ Required contributions to the state employee, school district, and police retirement systems (SCRS and PORS) were raised 2.0 percent on the employer in 2017 with the passage of Act 13. The Act also increased employer contributions 1.0 percent per year for the next five years in order to address unfunded liabilities accrued within SCRS and PORS. For every 1.0 percent increase in employer contributions (100 basis points), the impact on the General Fund's portion of the increase is estimated at $32.4 million. Additionally, each 1.0 percent employer contribution increase requires an increase of $4.2 million for Education Improvement Act employer contributions.