Financial Outlook Report
Interim Joint Committee on Appropriations and Revenue

June 27, 2013
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Greg Harkenrider, Deputy Exec. Director,
Governor’s Office of Economic Analysis
Overview

- Introduction
- Current 2012-14 Status
- Next Biennium Outlook
- Planning for next Biennial Budget Process
- Q & A
Current 2012-14 Status

- Tight fiscal conditions lie ahead
- General Fund Receipts have been flat or declining for three of the last four months
- On watch list:
  - Sales and Use Tax
    - Likely to end FY13 lower than FY12
    - Only 3 such nominal declines since 1980
  - Severance Taxes
    - Coal production and demand declining
    - Natural Gas prices remain subdued
That Stubborn Economy

- When will “next year” finally get here?
  - We are now approaching the fifth year of a recovery but aggregate nominal growth rates have yet to hit robust levels
- The newest explanation for tepid growth:
  - Expiration of payroll tax cut
  - Federal government sequestration
According to the Survey of Fiscal Conditions issued earlier this month our environment is consistent with a number of states:

- State budgets are not growing fast enough to make up for recession impacts and inflation.
- States continue to be challenged with providing resources in critical areas despite “fiscal distress” beginning to subside.
- One-third of states expect FY13 General Fund spending growth to be less than 2%. 

Modest Revenue Growth Predicted
(per cent change from prior fiscal year)

- FY 05: 9.6%
- FY 06: 9.6%
- FY 07: 2.4%
- FY 08: 1.1%
- FY 09: -2.7%
- FY 10: -2.4%
- FY 11: 6.5%
- FY 12: 3.8%
- FY 13: 2.4%
- FY 14: 2.3%

Official Estimates
General Fund Update

- The latest completed quarter of revenue data showed revenues flattening to 0.2 percent growth (comparing the 3rd quarter of FY13 to the 3rd quarter of FY12).

- Statutorily-required internal projections from OSBD predicted that FY13 would close $23.4 million short of the enacted estimates, an error of 0.2% compared to budgeted estimates.
Since the Last Quarterly Report...

- General Fund receipts fell 2.0 percent in April
  - April and June are typically the largest GF receipt months of the year
  - The fourth quarter of the fiscal year is always heavily weighted due to timing on income taxes
- Receipts climbed 8.3 percent in May
- June collections need to equal $917.2 million to hit the enacted revenue estimates
June Receipts, Previous Years
(Comparing Needs for FY13 to Prior Year Actual Collections)

2007: $874.1
2008: $872.9
2009: $765.2
2010: $800.0
2011: $838.4
2012: $918.5
2013: $917.2
Road Fund Update

- The latest completed quarter of Road Fund data showed flattening to 3.4 percent growth (comparing the 3rd quarter of FY13 to the 3rd quarter of FY12).

- Statutorily-required internal projections from OSBD predicted that FY13 would close $36.5 million short of the enacted estimates (compared to a total Road Fund base of $1.5 billion).
Since the Last Quarterly Report …

- Road Fund receipts soared 18.3 percent in April.
- Road Fund receipts were flat in May due to timing, but fuels taxes grew sharply.
- Both Motor Vehicle Usage and Motor Fuels taxes have shown considerable growth in the 4th quarter.
- Road Fund will need to grow 5.2 percent in June to equal the official estimate.
Road Fund Revenue Trends

- Positive
  - Starting in July, motor fuels taxes will benefit from the statutory adjustment to the average wholesale price of fuel

- Areas of Concern
  - Falling fuel prices could destabilize Road Fund
    - AWP floor is $1.786 (16.1 cents per gallon)
    - Current AWP is $2.878 (25.9 cents per gallon). The statutory AWP of $2.878 has now caught the market price of $2.884
    - Current state total fuels rate on gasoline is 32.3 cents per gallon
      - Federal rate is an additional 18.4 cents per gallon on gasoline and 24.4 cents per gallon on diesel fuel
# Budget Balancing Measures During Beshear Administration

<table>
<thead>
<tr>
<th>Fiscal Year</th>
<th>Description</th>
<th>Amount (millions)</th>
<th>Most Common Cut</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>2008 Budget Reduction</td>
<td>$76</td>
<td>3.0%</td>
</tr>
<tr>
<td>2</td>
<td>2009 Enacted Reduction</td>
<td>$176</td>
<td>12.0%</td>
</tr>
<tr>
<td>3</td>
<td>Mandated Budget Gap</td>
<td>$180</td>
<td>4.5%</td>
</tr>
<tr>
<td>4</td>
<td>2010 Budget Reduction - Round 1</td>
<td>$273</td>
<td>4.0%</td>
</tr>
<tr>
<td>5</td>
<td>Budget Reduction - Round 2</td>
<td>$49</td>
<td>3.0%</td>
</tr>
<tr>
<td>6</td>
<td>2011 Enacted Reduction</td>
<td>$61</td>
<td>3.5%</td>
</tr>
<tr>
<td>7</td>
<td>Mandated Budget Gap</td>
<td>$131</td>
<td>1.5%</td>
</tr>
<tr>
<td>8</td>
<td>2012 Enacted Reduction</td>
<td>$81</td>
<td>1.0%</td>
</tr>
<tr>
<td>9</td>
<td>Mandated Budget Gap</td>
<td>$169</td>
<td>2.0%</td>
</tr>
<tr>
<td>10</td>
<td>2013 Enacted Reduction</td>
<td>$140</td>
<td>8.4%</td>
</tr>
<tr>
<td>11</td>
<td>Mandated Budget Gap</td>
<td>$40</td>
<td>TBD</td>
</tr>
<tr>
<td>12</td>
<td>2014 Enacted Reduction</td>
<td>$6</td>
<td>NA</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td></td>
<td><strong>$1.6 billion</strong></td>
<td><strong>38.4%</strong></td>
</tr>
</tbody>
</table>
Most State Agencies Cut 8.4%

- 8.4% Cuts to Most State Agencies in FY 13 and no increases to that in FY 14
- 6.4% Cuts to Universities and KCTCS
- 4.2% Cuts to Education and Workforce agencies
- 2.2% Cuts to most Justice and Public Safety agencies

Critical Areas Exempt from Cuts
- SEEK and Preschool;
- Medicaid;
- Corrections;
- Debt Service;
- Health Insurance and Retirement;
- Teacher’s Retirement;
- Student Financial Aid;
- Coal Severance Funds;
- Community Based Services;
- Behavioral Health;
- Public Advocacy;
- Revenue Operations;
- Tourism-Fair Board, Horse Park;
- Mine Permitting, Reclamation & Enforcement;
- Veterans’ Affairs.
Subsequent Events

- **Pension** - Full Funding for ARC
- **Corrections** - Higher Inmate Population than Budgeted
- **Sequestration** - Current impact estimated approximately 5% ($62 million) total in cuts to Nondefense discretionary programs
- **Settlements** - Online gambling suit
- **Medicaid** - Woodwork Effect
- **Marketplace Fairness Act (MFA)** - Internet sales tax bill is stalled in the House Judiciary Committee of Congress
- **Lottery** - KENO
Necessary Government Expense (millions)

**FY 13 Estimate**

$53.6

$7.9 million more than the FY 12 General Fund Surplus

**Notes on Largest Amounts:**

- Corrections $25.0
- Guardian Ad Litem $9.2
- Military Affairs-Disasters and Planned Events $6.5
- Forest Fire Suppression $5.0
- County Costs-Example: Courthouse Security $3.7
What to do if short?

- **General Fund:** If actual General Fund receipts are short by the estimated $23 million from the April Quarterly Report: Actual expenditures less than appropriated will be sufficient to cover the $23 million revenue shortfall.

- **Road Fund:** For a revenue shortfall at the end of the fiscal year, unexpended Road Fund appropriations in the areas of debt service and personnel/operating areas are first used to balance.
What to do if surplus?

- **General Fund**: Surplus Expenditure Plan places Necessary Government Expenses as the first call. The second use is a deposit into the Rainy Day Fund.

- **Road Fund**: Surplus funds go to the State Construction Account for the 2012-14 Biennial Hwy Construction program.
LGEAF and LGEDF

<table>
<thead>
<tr>
<th>Fund</th>
<th>FY 13 Enacted</th>
<th>FY 13 Actual</th>
<th>FY 13 Variance</th>
</tr>
</thead>
<tbody>
<tr>
<td>Local Government Economic Assistance Fund</td>
<td>$73.8</td>
<td>$55.1</td>
<td>($18.7)</td>
</tr>
<tr>
<td>Local Government Economic Development Fund</td>
<td>$75.3</td>
<td>$43.0</td>
<td>($32.3)</td>
</tr>
<tr>
<td>Single County Funds</td>
<td>$50.2</td>
<td>$28.7</td>
<td>($21.5)</td>
</tr>
<tr>
<td>Multi-County Funds</td>
<td>$25.1</td>
<td>$14.3</td>
<td>($10.8)</td>
</tr>
</tbody>
</table>
What Does the Future Hold?

Short Term and Long Term Budget Challenges

- Need to increase funding for education
- Demand for government services goes up when the economy is down; the effects of the recession continue to elevate demand for services
- Adequately fund pension obligations
- Address infrastructure needs – education, water & sewer, parks, other
- Impact of Federal budget cuts on K-12 Schools
- Need to increase the Rainy Day Fund
- Health care and justice system costs continue to increase faster than revenues
- Aging population will require additional services
### Structural Imbalance of 2012-14 General Fund Budget

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>FY 14 Beginning Balance</td>
<td>$52.1</td>
</tr>
<tr>
<td>Use of Rainy Day Fund</td>
<td>$49.0</td>
</tr>
<tr>
<td>Fund Transfers in excess of $40 million</td>
<td>$56.3</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>$157.5</strong></td>
</tr>
</tbody>
</table>

- **FY 14 Percent of General Fund Revenue:** 1.6%
- **FY 12 Percent of General Fund Revenue:** 4.6%
Early Look at Next Biennial Budget (con’t)

<table>
<thead>
<tr>
<th>FY 15</th>
<th>(millions)</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Revenues</strong></td>
<td></td>
</tr>
<tr>
<td>Revenue Growth of 2.5% to 3%</td>
<td>$238 - $286</td>
</tr>
<tr>
<td>Funding Plan for SB2</td>
<td>$100</td>
</tr>
<tr>
<td><strong>Budgetary Requirements</strong></td>
<td></td>
</tr>
<tr>
<td>Fund Recurring Expenses Supported by One-time Money</td>
<td>$157</td>
</tr>
<tr>
<td>Pension Contributions for Teachers and State Employees- Under Current Schedule</td>
<td>$28</td>
</tr>
<tr>
<td>Full Funding for the ARC for Kentucky Retirement Systems</td>
<td>$100-$120</td>
</tr>
<tr>
<td>Medical Inflation in Medicaid (5%)</td>
<td>$75</td>
</tr>
<tr>
<td>Medical Inflation in Health Insurance for Teachers and Public Employees (5%)</td>
<td>$40</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>$400 - $420</strong></td>
</tr>
</tbody>
</table>
## Early Look at Next Biennial Budget (con’t)

### Other Critical Needs

<table>
<thead>
<tr>
<th>Description</th>
<th>FY 15 (millions)</th>
</tr>
</thead>
<tbody>
<tr>
<td>SEEK Funding (every 1% increase)</td>
<td>$29</td>
</tr>
<tr>
<td>Teacher Raises (every 1%)</td>
<td>$23</td>
</tr>
<tr>
<td>Restore Cuts to K-12 Programs like Textbooks, Professional Dev.</td>
<td>$64</td>
</tr>
<tr>
<td>Increase Funding for School Safety</td>
<td>?</td>
</tr>
<tr>
<td>Increase Postsecondary Education Funding (every 1% increase)</td>
<td>$9</td>
</tr>
<tr>
<td>Restore Cuts for DCBS - Protective Services, Child Care Assistance</td>
<td>$87</td>
</tr>
<tr>
<td>Debt Service for Any New Capital Projects</td>
<td>?</td>
</tr>
<tr>
<td>Salary Increment for State Employees (every 1% increase)</td>
<td>$8</td>
</tr>
<tr>
<td>Relieve Caseload levels for Public Advocates and Prosecutors</td>
<td>?</td>
</tr>
<tr>
<td>Other Priorities</td>
<td>?</td>
</tr>
</tbody>
</table>
Planning for next Biennial Budget Process

- Budget Instructions
- Capital Planning
- Budget Requests
Pursuant to KRS 48.120, economic and revenue forecasts will be prepared in the upcoming months:
- August 15th – Planning Estimates
- October 15th – Preliminary Estimates
- Dec/Jan – Official Estimates
Questions
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