



Office of State Budget Director

284 Capitol Annex, 702 Capitol Avenue
Frankfort, Kentucky 40601

Matthew G. Bevin
Governor

(502) 564-7300
Internet: osbd.ky.gov

John E. Chilton
State Budget Director

Governor's Office for Policy and Management
Governor's Office for Economic Analysis
Governor's Office for Policy Research

December 2, 2019

John E. Chilton
502-564-1218

Memorandum

From: John Chilton, State Budget Director

To: Governor-elect Transition Team, Crit Luallen & Elizabeth Natter, All members of the House and Senate

Subject: 2020-2022 biennial budget

This memorandum addresses topics related to the 2020-2022 Biennial Budget that the General Assembly will consider during the upcoming meeting of the General Assembly, which begins on January 7, 2020.

Revenues

General Fund receipts for FY 2019 beat expectations -- revenues exceeded the budgeted amount by \$194.5 million. That generated a budget surplus, of which the budget bill allocated \$70 million to the Teachers' Retirement System's post-retirement health insurance fund and \$60 million to the Kentucky Employees Retirement System Nonhazardous fund to help with the unfunded pension liability.

The expectations for FY 2020 revenue are not as good as FY 2019. In October, the Consensus Forecasting Group issued a preliminary projection for FY 2020 receipts – actual receipts will exceed the budgeted amount by only \$26.7 million. In addition, the CFG's preliminary projection was that there will be \$227.5 new General Fund revenue in FY 2021 compared to FY 2020, and \$193.5 million new General Fund revenue compared to FY 2021.

In December, the CFG will issue their revised and final "official" estimate of FY 2020 receipts, as well as their "official" estimates for the next biennium -- FY 2021 and FY 2022. One thing is clear – revenue growth for the next biennium will be modest – perhaps in the 1.7 to 2.0 percent range.

The Budget should be "Structurally Balanced"

Good fiscal policy requires a balanced budget and one that is "structurally balanced."

A balanced budget means that expenditures do not exceed financial resources – no borrowing to fund current operations.

A structurally balanced budget is one where recurring expenditures are funded only with recurring revenue. Thus, recurring expenses should not be funded with "one-time money."

The General Fund consists of all money, not otherwise restricted, available for the general operations of state government. [KRS 48.010(15)(a).]

Restricted Funds consists of budget unit receipts restricted as to purpose by statute. [KRS 48.010(15)(f)]

Unless otherwise specified in a budget bill, unspent General Fund appropriations lapse back to the General Fund at the end of each fiscal year. Likewise, unless otherwise specified in a budget bill, unspent Restricted Funds do not lapse to the General Fund; those funds carry over to the next fiscal year where those funds can be spent according to the purpose for which they were restricted.

Sometimes the Legislature balances the biennial budget by “sweeping” restricted funds back into the General Fund. Many components of all three branches of government have restricted funds that do not lapse to the General Fund but carry over to future years. This is the case in the Executive Branch, the Judicial Branch, and the Legislative Branch and the aggregate size of those funds is quite large.

Good budgeting dictates that sweeping restricted funds to the General Fund should not be done. In order to maintain structural balance, one-time money might be used to pay one-time, non-recurring expenses or costs.

Budget pressures for the 2020-2022 biennium - Expenditures

There are significant needs in excess of a “baseline” budget that would simply continue current levels of services, taking into account inflation and increased costs. The General Assembly will consider these needs in the upcoming session of the General Assembly that starts in early January.

What are the needs that need to be addressed in the budget for the next biennium?

Here are some of the known needs of which I am aware. Please note that OSBD has not studied the budget requests recently submitted by each Cabinet and agency. Thus, the needs and the dollar amounts are subject to change and those changes could be substantial.

CFG current <u>Estimate</u> of General Fund Revenue in Excess of FY 2020 Budgeted Amount	\$ 26.7 million
---	-----------------

<u>Estimated</u> FY 2020 Additional Needs in Excess of FY 2020 Budgeted expenditures	
Additional appropriation of lottery funds so that 100% of FY 2020 lottery funds goes to education.	\$15 million
Estimated Necessary Government Expenditures (NGEs) not included in the budget	40 million
School district health insurance funding shortfall	17 million
Additional Kentucky Wired (KCNA) needs	8 million
Funding for the University of Louisville loan in connection with acquisition of Kentucky One assets	50 million
Various other needs in corrections, parks, Ky State University, Eastern Ky University, etc.	15 million
Total	\$ 145 million

Current CFG <u>Estimate</u> of Increase in General Fund Revenue	FY 2021	FY 2022
FY 2021 compared to FY 2020 baseline	\$ 227.5 million	
FY 2022 compared to FY 2020 baseline		\$420 million

<u>Very Preliminary & Estimated</u> Additional Needs Above Baseline Funding		
	FY 2021	FY 2022
Stabilize Premiums in Kentucky Employees' Health Insurance Plan	\$ 250 million	\$ 400 million
Medicaid – increased costs over FY 2020 base	55 million	173 million
Medicaid – decrease in federal contributions, increasing state costs	43 million	48 million
Medicaid – court ordered settlement of case from prior administration - DRG payments to rural hospitals – estimated payments over next 3 years	142 million	142 million
Health & Family Services – additional costs associated with other activities	<i>Unknown</i>	<i>Unknown</i>
Corrections – additional costs for Southeastern Correctional Complex	18.8 million	19.3 million
Corrections – additional costs for North region locality pay supplements	6 million	6 million
Corrections – more state inmates	<i>Unknown</i>	<i>Unknown</i>
Corrections – court ordered costs; inmate good time audit from previous administration	13 million	<i>Unknown</i>
Corrections – higher medical costs	<i>Unknown</i>	<i>Unknown</i>
Pensions – Teachers' - increased contribution to fully fund ARC	13 million	41 million
Post-retirement health benefits – Teachers' health insurance shared responsibility	80 million	87 million
Pensions – Ky employees and state police – increased contribution to fully fund ARC	55 million	60 million

Pensions - increase subsidies above \$50 million to help quasi-governmental employers with pension costs (HB 1)	<i>Unknown</i>	<i>Unknown</i>
Coal Severance Tax - dedicate 100% of declining tax revenue to coal counties, none to General fund	16 million	5 million
K-12 education – school safety funding	<i>Unknown</i>	<i>Unknown</i>
Kentucky Wired (KCNA) – service debt on new \$110 million funding	7 million	7 million
Estimated Necessary Government Expenditures (NGEs) not included in the budget	40 million	40 million
Debt service on new borrowing	<i>Unknown</i>	<i>Unknown</i>
Total – <u>not</u> including unknown amounts	\$ 738.8 million	\$ 1,028.3 million

<u>Very Preliminary & Estimated</u> Amounts Relating to Other Additional Budget Spending That Has Been Discussed		
	FY 2021	FY 2022
State employees – increase compensation by 1%	\$ 6 million	\$ 18.8 million
Restore prior year reductions to higher education institutions	255 million	255 million
Teachers' Retirement System request for funding in excess of ARC/ADC	110 million	110 million
K-12 education – increase 42,000 teachers' pay by \$2,000 each, including benefits	97 million	97 million
K-12 education – Increase in per-student SEEK amount by \$40 (1% increase)	31 million	31 million
Post-secondary education – increase funding by 1%	11 million	11 million
Post-secondary education – increase performance funding allocation	<i>Unknown</i>	<i>Unknown</i>
Total – <u>not</u> including unknown amounts	\$ 510.0 million	\$ 522.8 million