Three-Year General Fund Financial Outlook

FY 2020-21 to FY 2022-23

Prepared Pursuant to Act 156 of 2005

§11-11-350

South Carolina Revenue and Fiscal Affairs Office

December 2019

Three-Year General Fund Financial Outlook
FY 2020-21 to FY 2022-23
Based on Enacted FY 2019-20 Budget
(Dollars in Millions)

	FY 2019-20 "Base Year"	Projections FY 2020-21	Projections FY 2021-22	Projections FY 2022-3
Resources:				
Revenue (BEA Long Range Revenue Forecast, 12/11/2018)	9,330.7	10,229.1	10,638.5	11,129.2
Adjustments				
Tax Relief Trust Fund Transfers	(614.2)	(629.4)	(644.3)	(659.5)
General Reserve Fund Transfer		(34.0)	(21.0)	(18.8)
Total Revenue/Resources	**$8,716.5**	**$9,565.7**	**$9,973.3**	**$10,450.9**
Expenditures and Reserve Fund Contributions:				
Recurring Base	**$8,737.0**	**$8,737.0**	**$8,737.0**	**$8,737.0**
Constitutional/Statutory Items:				
Reserve Funds: Capital Reserve (CRF)		13.6	22.0	29.5
Local Government Fund		11.7	21.8	33.9
Debt Service		(119.7)	(124.8)	(143.4)
Homestead Exemption Fund Shortfall (Act 388 of 2006)		(17.1)	(27.4)	(38.9)
Major Expenditure Categories (Maintenance of Effort):				
K-12 Education		51.7	98.4	148.0
Medicaid and Health		132.3	201.8	255.0
Social Services (Child Support Enforcement) (See Notes)		3.9	3.9	3.9
Higher Education Scholarship Growth (LIFE, HOPE & Palmetto Fellows)		9.4	21.8	34.8
State Employee Health Plan - Retiree Growth + Rate Increase		24.6	81.8	152.8
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		0.2	0.2	0.2
Total Expenditures	**$8,737.0**	**$8,926.3**	**$9,193.7**	**$9,448.6**
Recurring Balance for Other Appropriations		$639.4	$779.6	$1,002.3
Projected CRF Funds Available for Nonrecurring Expenditures		$162.5	$176.1	$184.5
Projected General Reserve Fund Balance	$406.2	$440.2	$461.2	$480.0

The Notes and Assumptions are an integral part of this Financial Outlook.

Notes

The three-year General Fund Outlook is prepared by the South Carolina Revenue and Fiscal Affairs Office 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 2019-20 enacted budget and major expenditure categories contained therein. Unless noted below, future years do not include any increases over the baseline expenditures (FY 2019-20 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, 2019 forecast for FY 2020-21. The FY 2020-21 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 4.50 percent;
- A sales tax growth rate of 4.50 percent based on a historical elasticity of 1.0;
- An individual income tax growth rate of 4.95 percent based on a historical elasticity of 1.1;
- Corporate income tax decreasing throughout the forecast period; and
- Historical trends and patterns and other legislative factors affecting the remaining revenues.

The annual growth rates for FY 2020-21, FY 2021-22, and FY 2022-23 are 4.0 percent, 4.0 percent, and 4.6 percent, respectively.

❖ **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 2020-21 through FY 2022-23, $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 $406,213,261 million. Annual contributions for FY 2020-21 through FY 2022-23 are $34.0 million, $21.0 million, and $18.8 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 2020-21 through FY 2022-23 are $13.6 million, $8.4 million, and $7.5 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. Act 84 of 2019 changed the required funding formula. Under the new formula beginning in FY 2020-21, the annual appropriation must be increased by the growth in the Board of Economic Advisors' General Fund revenue projection over the current fiscal year's appropriation base, up to a maximum of 5 percent. This report assumes funding based upon the General Fund projections as of November 8, 2019 and assumes that the expenditure base in future years will be the prior year's available revenue. Annual increases for FY 2020-21 through FY 2022-23 are $11.7 million, $10.1 million and $12.2 million, respectively.

DEBT SERVICE

- Future Debt Service needs will decline over the forecast period based upon current projections. Incremental adjustments are $(119.7) million in FY 2019-20, $(5.2) million in FY 2020-21 and $(18.6) 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. Current revenue projections indicate that this General Fund appropriation will not be necessary beginning in FY 2019-20. The projections for incremental revenue assume that this appropriation will be suspended in FY 2020-21 and only include the projected Homestead Exemption one-cent sales tax revenue. Incremental adjustments for FY 2020-21, FY 2021-22, and FY 2022-23 are $(17.1), $(10.3), and $(11.5) million, respectively.

K-12 EDUCATION

- **State Aid to Classrooms –** The FY 2019-20 budget provides State Aid to Classrooms of $3,889 per pupil. Funding is distributed as follows: 65.56 percent to the Education Finance Act (EFA), 28.72 percent to Education Finance Act employer contributions, and 5.68 percent to increase the State Minimum Teacher Salary Schedule. The projections for increases in State Aid to Classrooms are based upon calculated inflationary growth in the EFA as outlined below.

  Education Finance Act (EFA) – The FY 2019-20 Base Student Cost is $2,489 with a Weighted Pupil Unit (WPU) count of 1,036,491 for all districts. This forecast assumes a 1.8 percent inflation factor annually for FY 2020-21, FY 2021-22, and FY 2022-23. The WPU growth rate for school districts is 0.1 percent over the forecast period. During the forecast period, growth in the two statewide charter school districts is estimated to outpace the overall growth rate in regular school district WPUs. This expectation is due to enrollment growth in existing and new charter schools and the addition of new grade levels in existing charter schools.

The estimated Base Student Cost and Weighted Pupil Units for the projected period are:

- FY 2020-21
  - $2,534
  - 1,043,631
- FY 2021-22
  - $2,579
  - 1,049,001
- FY 2022-23
  - $2,626
  - 1,054,771

The incremental adjustments for the three-year period are $51.7 million, $46.6 million, and $49.6 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 continued growth in the Community Long Term Care waiver program, which provides nursing facility level care in a patient's home. Growth over the last 5 years has reached 50 percent. 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) previously 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 of $17.9 million in FY 2020-21. For FY 2021-22 and FY 2022-23, the FMAP is expected to remain flat. The change in the FMAP rate is also impacting the CHIP program for an expected impact of approximately $33.7 million in FY 2020-21 and an additional $5.5 million in FY 2021-22. Based on these assumptions, the projected General Fund growth rate for the Medicaid program is 3.0 percent for FY 2020-21, 3.0 percent for FY 2021-22 and 3.2 percent for FY 2022-23.

The total additional recurring state appropriations needed to provide sustainable funding for the current Medicaid program for FY 2020-21 thru FY 2022-23 are $223.15 million. The incremental adjustments for FY 2020-21, FY 2021-22, and FY 2022-23 are $127.2 million, $45.7 million, and $50.2 million, respectively.

- **Department of Mental Health** – To continue to cover operating costs at community mental health centers and inpatient facilities, along with glrowth in the forensic inpatient services and the sexually violent predators programs, additional funding of will be required in each year for FY 2020-21 through FY 2022-23. Further, funding for two new recently constructed Veterans Nursing Homes of $12.3 million is included beginning in FY 2021-22.

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. The estimated cost is $3.9 million in FY 2020-21.

HIGHER EDUCATION SCHOLARSHIP GROWTH

- **LIFE, HOPE & Palmetto Fellows Scholarships** – The estimated incremental costs for the three scholarship programs are $9.3 million in FY 2020-21, $12.5 million in FY 2021-22, and $13.0 million in FY 2022-23. These incremental cost estimates take into account both the anticipated costs of changes to the Uniform Grading Policy and continued growth at the long-term average growth rate since FY 2009-10 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

- **REAL ID and Phoenix System–** Continued implementation of the federal REAL ID Act of 2005 will require State to State Verification Service. The estimated annual cost per state fee and per driver fee for the State of South Carolina is $227,821 per year for the forecast period.

  DMV also reports that the Phoenix system used for driver's licenses and vehicle registrations is nearing end-of-life. DMV noted that they expect replacement of the Phoenix system will cost $4 million for FY 2020-21, $5.1 million for FY 2021-22 and FY 2022-23 with additional annual costs through FY 2024-25. These figures are not included in the amounts listed on page 1.

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 2020 employer base (state funds only) is $1,019,635,688;
    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 3.9 percent in January 2021, 6.0 percent in January 2022 and 6.0 percent in January 2023.
2. The projection assumes the employer pays the same proportion that is in place in January 2020 for 2021, 2022, and 2023;
3. Retiree growth for FY 2020-21 is estimated at 1.2 percent, and for FY 2021-22, and FY 2022-23 retiree growth is estimated at 1.5 percent per year.
4. The estimated amount of additional general fund dollars for the State Health Plan is $24.6 million in FY 2020-21, $57.1 million in FY 2021-22, and $71.0 million in FY 2022-23.

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.

This document was revised after the initial release to correct a typographical error in the year references on page 7.