Three-Year General Fund Financial Outlook

FY 2021-22 to FY 2023-24

Prepared Pursuant to Act 156 of 2005

§11-11-350

South Carolina Revenue and Fiscal Affairs Office

December 2020

Three-Year General Fund Financial Outlook

FY 2021-22 to FY 2023-24

Based on Enacted FY 2019-20 Budget and FY 2020-21 Continuing Resolution

(Dollars in Millions)

	FY 2020-21 "Base Year"	Projections FY 2021-22	FY 2022-23	FY 2023-24
Resources:				
Revenue (BEA Long Range Revenue Forecast, 11/10/2020)	9,330.7	9,609.0	9,980.2	10,344.7
Adjustments				
Tax Relief Trust Fund Transfers	(629.4)	(650.0)	(665.7)	(681.7)
General Reserve Fund Transfer	(34.0)	(18.7)	17.9	(6.9)
Total Revenue/Resources	**$8,701.3**	**$8,940.3**	**$9,332.4**	**$9,656.1**
Expenditures and Reserve Fund Contributions:				
Recurring Base	**$8,750.6**	**$8,750.6**	**$8,750.6**	**$8,750.6**
Constitutional/Statutory Items:				
Reserve Funds: Capital Reserve (CRF)		7.5	0.3	8.1
Local Government Fund		5.6	15.1	24.4
Debt Service		(125.4)	(144.0)	(123.8)
Homestead Exemption Fund Shortfall (Act 388 of 2006)		(1.7)	(5.3)	(13.0)
Major Expenditure Categories (Maintenance of Effort):				
K-12 Education		46.9	76.6	107.4
Medicaid and Health*		231.5	272.8	341.9
Social Services		3.0	9.0	13.0
Higher Education Scholarship Growth (LIFE, HOPE & Palmetto Fellows)		1.9	14.0	26.5
State Employee Health Plan - Retiree Growth + Rate Increase		5.1	49.3	129.2
State Employee Compensation Changes (2 percent per year)		42.0	84.0	126.0
SCRS/PORS Contribution Increase (2 percent per one, 1 percent thereafter)		73.2	109.8	146.4
SCDMV REAL ID		0.2	0.2	0.2
Total Expenditures	**$8,750.6**	**$9,040.4**	**$9,232.3**	**$9,536.9**
Recurring Balance for Other Appropriations		($100.1)	$100.1	$119.2
Projected CRF Funds Available for Nonrecurring Expenditures		$176.1	$183.6	$176.4
Projected General Reserve Fund Balance	$406.2	$459.0	$441.1	$448.0

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

* The Department of Health and Human Services has indicated that it can cover a substantial portion of these increases using reserves in FY 2021-22. See notes section for discussion.

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 2020-21 General Fund operating budget.

The spending projections are cumulative and the estimates are based on the FY 2020-21 enacted budget and major expenditure categories contained therein. Unless noted below, future years do not include any increases over the baseline expenditures (FY 2020-21 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 10, 2020 forecast for FY 2021-22. The FY 2021-22 revenue estimate serves as the base for the long-range forecast. The plan is built upon an assumed growth rate in personal income, 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 0.97 percent;
- A sales tax growth rate of 1.4 percent;
- An individual income tax growth rate of 2.8 percent;
- Corporate income tax decreasing in FY 2021-22 and recovering in FY 2022-23 and FY 2023-24;
- Historical trends and patterns and other legislative factors affecting the remaining revenues;
- A return to pre-pandemic employment in February 2022 and slower than historical growth through the remainder of FY 2021-22;
- Slow wage growth in proportion to jobs recovered.

Due to the economic uncertainty caused by the COVID-19 pandemic, the forecast caries more caution than usual. The annual growth rates for FY 2021-22, FY 2022-23, and FY 2023-24 are 1.7 percent, 3.9 percent, and 3.7 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. Current statute earmarks these funds primarily for healthcare programs; however, specific program appropriations are at the discretion of the General Assembly. The revenues for FY 2021-22, FY 2022-23, and FY 2023-24 are estimated to be $62.0 million, $58.0 million, and $54.2 million respectively. 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 $440,237,611 million. Annual contributions for FY 2021-22 through FY 2023-24 are $18.7 million, ($17.9) million, and $6.9 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 2021-22 through FY 2023-24 are $7.5 million, ($7.2) million, and $2.8 million, respectively, with the fund maintaining 2 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 10, 2020, and assumes that the expenditure base in future years will be the prior year's available revenue. Annual increases for FY 2021-22 through FY 2023-24 are $5.6 million, $9.5 million and $9.3 million, respectively.

DEBT SERVICE

- Future Debt Service needs will decline over the forecast period based upon current projections. Incremental adjustments are ($125.4) million in FY 2021-22, ($18.6) million in FY 2022-23 and $20.2 million in FY 2023-24. 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 2020-21 base budget includes $20.4 million dedicated to offset this shortfall. Incremental adjustments for FY 2021-22, FY 2022-23, and FY 2023-24 are ($1.7) million, ($3.7) million, and ($7.7) million, respectively.

K-12 EDUCATION

- **State Aid to Classrooms –** The FY 2020-21 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 2020-21 Base Student Cost is $2,489 with a Weighted Pupil Unit (WPU) count of 1,040,872 for all districts. This forecast assumes a 0.5 percent inflation factor annually for FY 2021-22, FY 2022-23, and FY 2023-24. The WPU growth rate for the regular 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 at a growth rate of 8.8 percent. 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 2021-22
    - $2,501
    - 1,047,643
  - FY 2022-23
    - $2,514
    - 1,053,138

- FY 2023-24
  - $2,527
  - 1,059,030

The incremental adjustments for the three-year period are $46.9 million, $29.6 million, and $30.7 million, respectively.

- **Bus Replacement** – The agency has indicated that additional funds will be required to reach a 15-year replacement cycle. In order to meet this goal, additional funding of $10.0 million, $5.0 million, and $5.0 million will be required in FY 2021-22, FY 2022-23, and FY 2023-24 respectively. School buses are typically funded through non-recurring revenues. These figures are not included in the amounts listed on page 1.

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 2019-20, approximately $108.6 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.

FY 2021-22 projections assume that managed care enrollment slowly decreases to pre-COVID levels during the fiscal year. The agency also anticipates a combined increase of $8 million in pharmacy expenditures for professional dispensing fee policy change and for a new high cost array of genetic medication. For FY 2022-23 and FY 2023-24, the agency anticipates a continued increase in the managed care program. Projections assume an increase of one percent in the managed care population, while the Fee-for-Service population is expected to decrease by 0.25 percent.

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 projections made by the agency are based on the assumption that the FMAP will remain flat throughout the forecast period. Based on these assumptions, the projected General Fund growth rate for the Medicaid program is 12.6 percent for FY 2021-22, 1.6 percent for FY 2022-23 and 3.5 percent for FY 2023-24. The incremental recurring state appropriations needed to fund the Medicaid program for FY 2021-22, FY 2022-23, and FY 2023-24 are $196.7 million, $26.5 million, and $53.7 million, respectively. However, in its FY 2022 budget request the Department indicated the following:

> "If this decision package is not funded, or is funded in part, the Department will accommodate the expenditures using agency reserves and flexibility authorities currently provided through statute and proviso. The Department requests additional earmarked authority equivalent to the amount not funded but is positioned to continue funding the full program for an additional year without additional General Fund appropriations, if necessary.''

The Department did note that if no General Funds are appropriated it may temporarily cap participation the Community Long Term Care waiver and restructure some optional programs as a cost savings measure.

The total additional recurring state appropriations needed to provide sustainable funding for the current Medicaid program for FY 2021-22 thru FY 2023-24 are $276.9 million. The incremental adjustments for FY 2021-22, FY 2022-23, and FY 2023-24 are $196.7 million, $26.5 million, and $53.7 million, respectively.

- **Department of Mental Health** – The agency provided us with an explanation of several drivers for their state expenditures. The agency is mandated to operate several programs, including Forensic Services, Sexually Violent Predator Treatment Program, and four Veterans Nursing Homes. Costs to operate these programs continue to increase due to census growth and inflation. Forensics Services and the Sexually Violent Predator Program have grown at a compound annual growth rate of 7.0 and 11.1 percent respectively since FY 2015-16, while nursing home costs have grown at approximately 2.5 percent. In addition, the agency must retain and recruit a diverse workforce to continue to provide existing services. In order to reduce turnover and sustain its workforce, the agency needs to increase compensation to remain competitive with market salaries.

  To continue to cover operating costs at community mental health centers and inpatient facilities, along with growth in their mandated programs, additional funding of $34.0 million, $48.0 million, and $65.7 million will be required in FY 2021-22, FY 2022-23, and FY 2023-24 respectively. Further, funding for two new recently constructed Veterans Nursing Homes of $11.3 million is included in FY 2021-22.

SOCIAL SERVICES AND CORRECTIONAL AGENCIES

- **Child Support Enforcement Statewide Automated System Development** – The federal Family First Prevention Services Act (FFPSA) will be phased in beginning 10/1/2021. Once this begins, IV-E entitlement dollars for foster care maintenance payments will be reduced. Based on actual usage from FY2016-17 through FY 2019-20, the agency anticipates a net fiscal impact on general funds of $3 million for FY 2021-22, $6 million for FY 2022-23, and $4 million for FY 2023-24.

- **Disability and Special Needs –** DDSN reports that many of their expenditures are driven by utilization rates. The agency has experienced an average annual increase of 12 percent in their Respite Services program utilization over the last 3 years. Due to this increase, the agency is projecting annual incremental costs of $695,000 in general funds. The agency also projects an annual increase of 13 percent in utilization of their Early Intervention services. This will increase their General Fund expenditures by $755,000 each year over the forecast period.

HIGHER EDUCATION SCHOLARSHIP GROWTH

- **LIFE, HOPE & Palmetto Fellows Scholarships** – The estimated incremental costs for the three scholarship programs are $1.8 million in FY 2021-22, $12.1 million in FY 2022-23, and $12.6 million in FY 2023-24. These incremental cost estimates take into account 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. Should Lottery revenue be insufficient to cover scholarship disbursement, it becomes the obligation of the General Fund. However, since FY 2009-10, Lottery revenue growth has outpaced scholarship growth. Provided that Lottery revenues continue to grow, scholarship disbursements will be fully funded using Lottery revenues.

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 $231,000 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 $3.25 million per year through FY 2024-25. These figures are not included in the amounts listed on page 1.

  DMV reports that its IT Infrastructure components will reach end of life in the next two years, and will no longer be serviceable. These systems are used to support production operations and conduct business at HQ. The cost to replace these systems in FY 2021-22 is expected to be $3 million. This figure is 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 2021 employer base (state funds only) is $1,016,010,265;
    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 0.6 percent in January 2022, 7.0 percent in January 2023 and 7.0 percent in January 2024.
2. The projection assumes the employer pays the same proportion that is in place in January 2021 for 2022, 2023, and 2024;
3. Retiree growth for FY 2021-22 is estimated at 0.6 percent, and for FY 2022-23, and FY 2023-24 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 $5.103 million in FY 2021-22, $44.204 million in FY 2022-23, and $79.918 million in FY 2023-24.

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. Because there was no increase in the contribution rate for FY 2020-21, the state must increase the rate by 2 percent for FY 2021-22. Therefore, the cumulative impact to the General Fund will be $64.8 million for FY 2021-22, $97.2 million for FY 2022-23, and $129.60 million for FY 2023-24.