

### **Introduction**

The purpose of this document is to provide an overview of the methodology used to develop the four-year budget projections pursuant to Chapter 8, Laws of 2012, 1st sp. sess. (SSB 6636). This document summarizes the major components of the projection, the overall approach, as well as the assumptions used in the State Budget Outlook (Outlook) document.

The amounts reflected in the Outlook are the sum of the state General Fund, the Education Legacy Trust Account, and the Opportunity Pathways Account.

### **Resources**

Pursuant to Chapter 8, Laws of 2012, 1st sp. sess. (SSB 6636), the amounts depicted include the actual/projected revenue and other resources. Some of the largest components include:

#### **Beginning Fund Balance**

The Outlook uses the certified fund balance in accordance with generally accepted accounting principles for the most recently closed biennium as the starting point.

The beginning fund balance for subsequent years is equal to the projected ending balance for the previous year.

#### **Revenue Forecast**

The amounts for 2015-17, 2017-19, and 2019-21 reflect the November 2016 quarterly revenue forecast by the Economic and Revenue Forecast Council (ERFC). The provisions of Chapter 8, Laws of 2012, 1st sp. sess. (SSB 6636) call for the ensuing biennium (in this instance, the 2019-21 biennium) to be balanced based on the greater of: (1) the official revenue forecast for the ensuing biennium; or (2) an assumed revenue increase of 4.5 percent per year for that ensuing biennium. Because the November 2016 forecast projects revenue growth of less than 4.5 percent per year in the 2019-21 biennium, the November 2016 Outlook uses the 4.5 percent growth rate.

#### **Transfers to Budget Stabilization Account**

Pursuant to a constitutional amendment approved by the voters in 2007, this reflects the transfer of one percent of general state revenues for each fiscal year (FY) to the Budget Stabilization Account. The estimated transfer amounts are based on the calculation of estimated general state revenues as defined in Article VIII, section 1, of the Constitution. The calculation of estimated general state revenues is based on the November 2016 revenue forecast.

#### **Extraordinary Revenue Growth**

Pursuant to a constitutional amendment approved by the voters in 2011, this reflects the transfer of three-quarters of extraordinary revenue growth into the budget stabilization account. Extraordinary revenue growth (ERG) is defined in the state Constitution as growth in general state revenues for the fiscal biennium that exceeds the average biennial percentage growth of the prior five fiscal biennia by one-third. The state Constitution also provides that the transfer only occurs to the extent that it exceeds the normal transfer

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amount into the budget stabilization account. A transfer of \$680.5 million in 2015-17 is reflected from the GF-S into the BSA, based on the November 2016 revenue forecast.

Chapter 2, Laws of 2015, 3rd sp. sess. (EHB 2286) directs the State Treasurer to transfer amounts attributable to extraordinary revenue growth that were deposited into the BSA to the GF-S. The transfer amounts were capped at \$75 million for 2015-17 and \$550 million for 2017-19. A transfer of \$75 million is projected to be deposited back to the GF-S in 2015-17. As of the November 2016 revenue forecast, there is no ERG transfer assumed in either the 2017-19 or 2019-21 biennia.

### **Enacted Fund Transfers**

This category includes all enacted fund transfers made in the 2015 and 2016 legislative sessions (including special sessions) after accounting for vetoes. For more information, see the 2015 and 2016 Legislative Budget Notes at:

- <http://leap.leg.wa.gov/leap/budget/lbns/2015operating1517.pdf>
- <http://leap.leg.wa.gov/leap/budget/lbns/2016LBNOp.pdf>

The Governor's budget proposal assumes additional transfers for the 2017-19 biennia as listed below. These include some but not all of the transfers assumed in the November 2016 Outlook. The table below provides the transfers assumed in the Governor's proposal.

<b>2017-19 Transfers in the Governor's Proposed Budget</b>		
	<b>2017-19</b>	<b>2019-21</b>
Treasurer's Service Account	\$20.0 M	0
Disaster Response Account	0.0 M	0
Criminal Justice Treatment Account	8.9 M	0
Public Works Assistance Account*		
Flood Control Account	2.0 M	0
Performance Audit of Government Account	6.5 M	0
Financial Services Regulation Account	5.0 M	0
Safe Drinking Water Account	1.0 M	0
Carbon Pollution Reduction Account	91.9 M	151.3
	<b>\$135.3 M</b>	<b>\$151.3 M</b>

\* See next page

### **Governor's Tax Package**

The Governor's proposal assumes a revenue package that includes changes to local distributions, loophole closures, a carbon tax, adding the B&O tax to services, an increase in the capital gains, and some reductions in tax incentives and credits.

The budget also calls for repayments to the Public Works Assistance Account (PWAA) to be transferred to the Education Legacy Trust Account (ELTA) starting in 2017-19 and for the various taxes going into PWAA to be deposited in ELTA and the General Fund starting in 2019-21.

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Please see tables on the next page for a detailed list of proposed revenues.

### Governor's Tax Package

\$ in millions

	2017-19 Total	2019-21 Total
<b>Local Distributions/Fees/Other</b>		
Eliminate Streamlined Sales/Use Tax Mitigation	-	45.1
Increase interest rate on assessments/reduce int. rate on refunds	16.5	29.6
Expand Trust Fund Accountability	10.3	11.7
Extend Economic Nexus to Retailing B&O Activities	12.1	22.5
<b>Loophole Closures</b>		
Limit Trade-in Exclusion to \$10,000	90.8	94.2
Refund nonresident sales tax exemption	49.2	54.6
Repeal bottled water sales tax exemption	57.1	62.3
Repeal extracted fuel (except hog fuel)	51.8	67.4
Limit REET foreclosure exemption	59.4	63.0
<b>Carbon Tax (Net Revenue) Ed Legacy Trust Account</b>		
\$25/ton plus inflation plus 3.5%	1,069.1	2,458.7
	-	-
<b>B&amp;O Tax on Services</b>		
Increase rate to 2.5% (all services)	2,276.0	2,609.0
<b>Capital Gains Tax Ed Legacy Trust Account</b>		
7.9% (\$25,000/\$50,000 threshold, exempt all residential property)	821.0	1,848.0
School Investment Fund		(48.0)
<b>Total</b>	<b>4,513.3</b>	<b>7,318.1</b>
<b>Revenue Reductions</b>		
High-Technology R&D Tax Incentives	(30.2)	(44.7)
Small Business B&O Credit and Tax Filing Threshold	(91.9)	(151.3)
	<b>(122.1)</b>	<b>(196.0)</b>
<b>Governor's Tax Package</b>	<b>4,391.2</b>	<b>7,122.2</b>

### 058 Public Works Assistance Acct Transfer of Revenue Stream and Repayments in 08A ELTA

	2017-19	2019-21
Public Utility Tax	-	43.7
REET (5.1%) & interest	-	95.2
Refuse Tax	-	92.9
PWAA Loan Repayments	252.6	190.2
	<b>252.6</b>	<b>422.0</b>

**Governor’s Other Revenue Legislation**

In other revenue legislation, there is one bill to create new dedicated account at the Department of Labor and Industries, and both spending and revenue move from the General Fund to the new account. Similarly, the existing commercial fish privilege tax moves from the General Fund to the Wildlife Account.

**Other Revenue Legislation**

Shift Commercial Fish Privilege Tax to the Wildlife Acct	(4.4)	(6.0)
New L&I Dedicated Account	(20.4)	(20.4)
Raise Cigarette Age to 21	(15.9)	(20.0)
	<u>(40.718)</u>	<u>(46.348)</u>

**Governor’s Proposal Budget Driven Revenue**

Based on slightly higher spending in the budget for the Liquor and Cannabis Board, budget than was assumed in the November 2016 revenue forecast, budget-driven revenue is a loss of about \$2 million in 2017-19.

**Other Resource Assumptions**

The Governor’s proposed budget assumes legislation that will transfer from the Budget Stabilization Account to the general fund an amount equal to the constitutionally required one percent transfer during the 2017-19 and 2019-21 biennia.

**Expenditures**

As the starting point for the expenditure projection, the Outlook utilizes the most recently enacted budget. It is based on the 2016 supplemental budget appropriation levels, and then the total for carryforward level (CFL), and a high level of the changes in the Governor’s final Maintenance and Policy levels. For more information on the 2016 supplemental Budget, please see: <http://leap.leg.wa.gov/leap/budget/lbns/2016LBNOp.pdf>

**Assumed Reversions**

The general methodology for calculating future reversions was updated during the 2016 session to be based on 0.5% of the GF-S budget. Additionally, reversions were increased across the four-year timeframe to reflect amounts agencies were directed to hold in unallotted status. Reversion assumptions for fiscal year 2016 have been updated to reflect actuals of \$122 million. In addition, an adjustment was made to the FY 2016 balance of the Budget Stabilization Account to reflect \$37 million less in spending of funds appropriated out of the BSA for fires. The Governor’s proposed budget makes slightly different assumptions than the .5%. Reversions assumed for the remainder of the outlook period are as follows:

- FY 2017: \$105 million
- FY 2017-19 biennium: \$255 million (.55%)
- FY 2019-21 biennium: \$280 million (.51%)

### **Maintenance Level Revisions**

In this section, additional adjustments are made to reflect the costs of continuing to comply with current law provisions. This is referred to as Maintenance Level (ML). Pursuant to the provisions of Chapter 8, Laws of 2012, 1st sp.s. (SSB 6636), this excludes the costs of policy enhancements, including new collective bargaining agreements not approved by the Legislature, other proposed compensation increases, and costs of any adverse court rulings within 90 days of each respective legislative session.

### **Kindergarten – Grade 12 (K-12) Schools**

The updates are based on the most recent enrollment forecast and budget driver information for required K-12 entitlement changes. The K-12 funding is adjusted each year of the ensuing biennium using the K-12 model which updates the growth and inflationary factors with each forecast. The K-12 model is also continually updated for other factors such as levy equalization, student transportation, and staff mix.

Larger adjustments in the 2017-19 ML include: K-3 class size reductions (\$485 million in 2017-19 and \$578 million in 2019-21), enrollment/workload adjustments (\$353 million in 2017-19 and \$806 million in 2019-21), MSOC inflation (\$78 million in 2017-19 and \$205 million in 2019-21), national board bonus costs (\$33 million in 2017-19 and \$81 million in 2019-21), grandfathered salary adjustments (\$17 million reduction in 2017-19 and \$19 million reduction in 2019-21), local effort assistance (\$67 million reduction in 2017-19 and \$139 million reduction in 2019-21, and staff mix adjustments (\$81 million reduction in 2017-19 and \$92 million reduction in 2019-21).

The larger adjustments in the 2017 supplemental include enrollment/workload adjustments (\$43 million), local effort assistance (\$9 million), and staff mix adjustments (-\$11 million savings).

### **Low-Income Health Care**

The larger adjustments in the 2017-19 ML are related to: utilization changes (\$181 million in 2017-19 and \$241 million in 2019-21); federal matching changes for the Affordable Care Act, Medicare Parts A, B, and D clawback, and IMD federal rule changes (\$147 million in 2017-19 and \$398 million in 2019-21); and managed care rate changes (\$105 million in 2017-19 and \$140 million in 2019-21). Other large reduction changes include (\$12 million savings in 2017-19 and \$14 million in 2019-21) a less than anticipated rate increase for dual eligible Medicare clients (\$41 million savings in 2017-19 and \$45 million savings in 2019-21).

The larger adjustments for the 2017 supplemental budget are related to: utilization changes (\$16 million); managed care rate changes (\$12 million); and caseload changes (\$41 million) savings.

**Mental Health/Long Term Care/ Developmental Disability Services**

The amounts depicted reflect the most recent caseload and per capita cost information prepared through joint effort by legislative and executive branch staff, as well as other mandatory maintenance level changes. Some of the major cost components include utilization and severity of client needs. Assumed future growth is estimated at 4.12 percent per year from FY 2019.

Larger adjustments in the 2017-19 ML include: caseload, workload, and utilization changes (\$140 million in 2017-19 and \$212million in 2019-21); loss of federal funding for Institutions of Mental Diseases and the Disproportionate Share Hospital grants (\$4 million in 2017-19 and \$69 million in 2019-21); State Hospital Overspending (\$48 million in 2017-19 and \$51 million in 2019-21); Governor's Behavioral Health Innovation Fund bowwave (\$20 million in 2015-17 and \$21.4 million in 2019-21); federal matching changes for the Affordable Care Act (\$16 million in 2017-19 and \$38 million in 2019-21); nursing home rebasing (\$18 million in 2019-21); and actuarial rate savings (\$16 in 2017-19 and \$38 million in 2019-21).

The larger adjustments for the 2017 supplemental budget related to hospital transition funding (\$23 million), and caseload and utilization changes savings (\$56 million).

**Children's/Economic Services**

The amounts depicted reflect the most recent caseload and per capita cost information prepared through joint effort by legislative and executive branch staff, as well as other mandatory maintenance level changes. Some of the major cost components include caseload and per capita cost increases and revised growth trends. Assumed future growth is estimated at 1.20 percent per year from FY 2019.

The larger adjustments in 2017-19 are related to caseload changes (\$34 million savings in 2017-19 and \$25 million savings in 2019-21).

The larger adjustments for the 2017 supplemental budget are related to caseload changes (\$21 million savings).

**Department of Corrections/ Special Commitment/ Juvenile Rehabilitation**

The amounts depicted reflect the most recent caseload and per capita cost information prepared through joint effort by legislative and executive branch staff, as well as other mandatory maintenance level changes. A major cost component is the proportion of community and institution population. Assumed future growth is estimated at 1.58 percent per year from FY 2019.

Larger adjustments in the 2017-19 ML include caseload and workload changes (\$39 million in 2017-19 and \$44 million in 2019-21), and equipment and facility maintenance (\$15 million in 2017-19 and \$3 million in 2019-21).

The larger adjustments for the 2017 supplemental budget are related to caseload changes (\$12 million).

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### **Debt Service**

The amounts depicted reflect the cost of debt service for the capital budget. Assumed future growth is estimated at 4.35 percent per year from FY 2019. The adjustments are a \$6 million savings in FY 2017, \$22 million increase in 2017-19 biennium and \$57 million increase for the 2019-21 biennium.

### **Higher Education**

Higher Education adjustments are related to the College Bound Scholarship program and to maintenance and operations and lease adjustments. Higher Education items are adjusted by 0.07 percent per year from FY 2019.

Larger adjustments in the 2017-19 ML include the Opportunity Scholarship program (\$14.7 million in 2017-19), operating costs for existing capital projects (\$9 million in 2017-19 and \$11 million for 2019-21), College Affordability Program (\$6 million in 2017-19 and \$14 million in 2019-21), and College Bound Caseload changes (\$4 million savings in 2017-19 and \$3 million increase in 2019-21).

### **Other**

This area includes all other agencies not reflected in the proceeding Outlook groups. Many are general government agencies, smaller human service agencies, natural resource agencies, and legislative and judicial agencies. Larger adjustments in the 2017-19 ML include: funding for a transfer to the local public safety enhancement account required under RCW 41.26.802 (\$50 million each in 2017-19 and in 2019-21), and adjustments related to federal Medicaid match for chemical dependency treatment programs (\$26 million in 2017-19 and \$26 million in 2019-21).

### **Special Appropriation Items (Part of Other in the Outlook)**

This category reflects the typical special appropriation items removed in the development of the CFL, but have historically been restored in the ML. See the itemized list below:

	Dollars in Millions	
	2017-19	2019-21
Governor's Emergency Fund	1.7	1.7
K-20 Telecommunications Network	16.0	16.0
County Public Health Assistance	72.8	72.8
COP Repayment	5.6	5.6
Cherberg Building COP	1.1	1.1
SERA Repayment	10.0	10.0
Common School Construction Account	1.2	1.2
NR Real Property Replacement Acct	0.6	0.6
Communication Services Reform	10.0	-
Impaired Driving	0.7	0.7
Legal Financial Obligations	1.0	0.9
Cancer Research Endowment	10.0	10.0
Local Government Distribution/I502	30.0	-
No Child Left Inside	1.0	1.0
	<b>161.7</b>	<b>121.6</b>

### **Policy Level Revisions**

In this section, adjustments are made to reflect the policy level expenditures included in the Governor's proposed budget.

#### **Kindergarten – Grade 12 (K-12) Schools**

The largest adjustment in K-12 education is an increase of \$2.95 billion in 2017-19 and \$5.55 billion in 2019-21 for providing funding for K-12 compensation pursuant to the McCleary court decision. The Governor's proposal also provides an increase of \$330 million in 2017-19 and \$631 million in 2019-21 for implementing class size reductions pursuant to Initiative 1351. The amounts noted for Initiative 1351 are in addition to the amounts shown in the maintenance level section of the Outlook. Additional items in this section include support for low-income students (\$50 million in 2017-19 and \$98 million in 2019-21) and adjustments for local effort assistance (\$54 million in 2017-19 and savings of \$158 million in 2019-21.)

#### **Low-Income Health Care**

The largest adjustment in this area includes an increase of \$61 million in 2017-19 and \$64 million in 2019-21 to restore savings that are assumed in the enacted budget related to the Healthier Washington Initiative. In addition, the Governor's proposal provides an increase of \$41 million in 2017-19 and \$45 million in 2019-21 for expanding access to treatment for Medicaid clients with Hepatitis C. Savings of \$21 million in 2017-19 and \$22 million in 2019-21 are assumed in lower Medicaid costs related to lowering the facility fee for hospital based clinics. Additional savings of \$11 million in 2017-19 and \$13 million in 2021 is realized because of a shift of spending from the General Fund to the Dedicated Marijuana Account.

The larger adjustments for the 2017 supplemental budget are for Hepatitis C and the restoration of savings assumed for Healthier Washington (\$50 million).

#### **Mental Health/Long Term Care/ Developmental Disability Services**

The largest adjustments in this area are related to the following components of the Behavioral Health Investment Plan: enhanced discharge placements in long term care and developmental disabilities settings (\$63 million in 2017-19 and \$107 million in 2019-21); state hospital compliance plan (\$53 million in 2017-19 and \$56 million in 2019-21), and creation of six new 16-bed state run psychiatric hospitals (\$3 million 2017-19, \$66 million 2019-21). In addition, a residential rate increase is provided to supported living providers (\$23 million in 2017-19 and \$24 million in 2019-21).

Components of the Mental Health program are transferred to the Health Care Authority and the Department of Health as part of the Governor's proposed Behavioral Health Investment Plan. The net impact of these changes is assumed to cost \$2 million in the 2017-19 biennium and a savings of \$13 million in the 2019-21 biennium.

The largest adjustment for the 2017 supplemental budget is funding for the state hospital compliance plan (\$21 million).

### **Children's/Economic Services**

The largest adjustments in this issue area include a one-time savings from using a Workfirst fund balance (\$34 million in 2017-19) and an adjustment to align Children's Administration funding with fiscal year 2016 expenditure levels (\$22 million in 2017-19 and 23 million in 2019-21).

The Governor also proposes that the Children and Family Services Program of DSHS and the Department of Early Learning become part of a new Child, Youth and Family Services agency. The estimated net impact of these changes is a cost of \$9 million in the 2017-19 biennium and a cost of \$18 million in the 2019-21 biennium.

The larger adjustment for the 2017 supplemental budget are for the Perez v state lawsuit settlement (\$11 million) and to meet required TANF work participation rates (\$4 million).

### **Early Childhood Education**

The largest adjustments in this area include phasing in of the ECEAP entitlement along with an ECEAP slot rate increase and pilot program (\$44 million in 2017-19 and \$127 million in 2019-21. Of the 2019-21 amounts, approximately \$57 million would be required to meet the entitlement requirement in FY 2021. In addition, there is a rate increase for childcare centers (\$14 million in 2017-19, \$15 million in 2019-21).

The agency also becomes part of the Governor's proposed new Child, Youth and Family Services agency described in the section above.

### **Department of Corrections/ Special Commitment/ Juvenile Rehabilitation**

The largest adjustment in this area is the closure of Naselle Youth Camp resulting in a savings of \$7 million in 2017-19 and \$15 million in 2019-21.

### **Debt Service**

Adjustments related to Debt service for the Governor's proposed capital budget are \$40 million in the first biennium and \$76 million in the second biennium.

### **Higher Education**

In Higher Education, larger adjustments include continuation of the current tuition freeze (\$56 million in 2017-19 and \$74 million in 2019-21) expansion of the State Need Grant (\$116 million each biennium) and \$30 million each biennium to maintain the current level of the State Need Grant.

### **Compensation**

The Governor's proposed budget funds all collective bargaining agreements, and provides the same General Wage increase to non-represented staff. This results in adjustments of \$560 million in 2017-19 and \$813 million in 2019-21.

Adjustments related to non-employee provider agreements are \$142 million in 2017-19 and \$235 million in 2019-21.

### **Other**

The largest adjustments in this area include a transfer from the general fund to the Home Security Fund which is used to provide services for the homeless (\$20 million each biennium) and funding for the Department of Health to provide grants to local health districts (\$20 million each biennium). In addition, there are savings associated with shifts in costs at the Department of Revenue to the Business License Account (\$23 million in 2017-19 and \$24 million in 2019-21) and shifts in costs at the Department of Labor and Industries to the Construction Registration Inspection Account (\$19 million in each biennium.)

The largest adjustments in the 2017 Supplemental include \$23 million to Department of Natural Resources for Fire Suppression and \$18 million to backfill the Disaster Assistance Account while the state awaits federal FEMA funding to repay for flooding, fire and mudslide disasters.