Overview of the Methodology for the State Budget Outlook (November 2019)

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 (GF-S), the Education Legacy Trust Account (ELTA), and the Opportunity Pathways Account. These funds are sometimes referred to as the Near General Fund Outlook (NGF-O) funds.

Resources
The amounts depicted include the actual/projected revenue and other resources. Some of the largest components include:

<u>Beginning Fund Balance</u>
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 Fiscal Years (FY) is equal to the projected ending balance for the previous FY.

<u>Revenue Forecast</u>
Current revenues for the 2019-21, and 2021-23 biennia reflect the November 2019 quarterly revenue forecast by the Economic and Revenue Forecast Council (ERFC). The provisions of Chapter 8, laws of 2012, 1st sp. sess (SSB 6336) call for the ensuing biennium, in this instance, the 2021-23 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 FY.

Because the November 2019 forecast projects revenue growth of less than 4.5 percent per FY in the 2021-23 biennium, the November 2019 Outlook assumes the 4.5 percent growth rate for the 2021-23 biennium.

<u>Transfers to the Budget Stabilization Account</u>
Pursuant to Article VII, section 12(1) of the Constitution, one percent of General State Revenues (GSR) for each FY are transferred to the Budget Stabilization Account (BSA). The transfer amounts are estimates based on the calculation of estimated GSR as defined in Article VIII, section 1(c) of the Constitution. The calculation of estimated GSR based on the November 2019 revenue forecast is not yet complete and therefore this Outlook uses GSR calculations from the September 2019 revenue forecast.

<u>Extraordinary Revenue Growth</u>
Pursuant to Article VII, section 12 of the Constitution, three-quarters of extraordinary revenue growth (ERG) is transferred to the BSA. ERG is 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 transfer only occurs to the extent that it exceeds the normal one percent transfer mentioned above. The November 2019 revenue forecast does not project ERG for the 2019-21 nor 2021-23 biennium so no additional BSA transfer is assumed in this Outlook.

Enacted Fund Transfers
This category reflects the NGF-O impact of previously enacted fund transfers made in the 2019 session after accounting for vetoes. For more information, see the 2019 Legislative Budget Notes at: http://leap.leg.wa.gov/leap/budget/lbns/2019LBN.pdf

Transfers for the 2021-23 biennium are included to the extent they are either statutorily required or there is enacted language directing that the legislature intends to maintain the transfer in the 2021-23 biennium.

Expenditures

Estimating Costs for the 2019-21 and 2021-23 Fiscal Biennia
Estimated NGF-O expenditures for the 2019-21 biennium are based on the enacted budget as well as appropriations made in other legislation. Estimated expenditures for the 2021-23 biennium in the Outlook reflect the cost to continue current programs, entitlement program growth, and actions required by law in the subsequent fiscal biennium. The general approach to estimating the cost to continue current programs and growth in entitlement programs is by applying a historical growth factor to the FY cost or savings associated with a budget item. Information on the growth factors used for this Outlook can be found on the ERFC website at: https://erfc.wa.gov/sites/default/files/public/documents/budget/20181106_MemoToERFC_GrowthRates.pdf

There are some cases in which simply applying the growth factor to the cost or savings of a budget item is not used to estimate costs. These include the following situations.

- **K-12 Education.** K-12 Outlook calculations are derived from the K-12 model, which is updated quarterly based on the caseload forecast for growth and inflationary factors. The K-12 model is periodically updated for other factors such as levy equalization, student transportation, and staff mix.
- **Debt Service.** Debt service calculations are derived from the debt service model. The Outlook statute specifies that "estimates of ensuing biennium expenditures must exclude policy items including, but not limited to, legislation not yet enacted by the legislature." Pursuant to ERFC guidance on June 6, 2019, the model used for the Outlook assumes enactment of a 2021-23 biennium bond bill and capital budget.
- **Custom adjustments.** Custom adjustments are used when the estimated annual costs are expected to be significantly different from the 2nd FY of the current biennium. This occurs primarily when a policy is being phased in during the second FY of a biennium or may be delayed until the subsequent fiscal biennium. In most cases, the growth factor is applied after a custom adjustment is made to reflect the phase in for the policy item. In a small number of cases, the custom adjustment already accounts for the types of growth captured by the growth factor and so the growth factor is not applied.

- One-Time costs. Certain items in the budget are one-time for the current biennium and therefore the related costs or savings are not carried forward.
- Compensation items. The Outlook statute directs that costs related to future collective bargaining agreements (CBA) not yet approved by the Legislature be excluded as well as future biennia costs for salary and benefit increases unless otherwise directed by statute.

Initial Starting Point

As the starting point for the expenditure projection, the Outlook utilizes the most recently enacted budget. It is based on the appropriation levels for the 2019-21 biennium. For more information, please see: http://leap.leg.wa.gov/leap/budget/lbns/2019LBN.pdf. The Outlook is then adjusted for the preliminary estimates of the FY 2020 supplemental operating budget provided by the Office of Financial Management (OFM) on November 7, 2019.

Maintenance Level Revisions

In this section, additional adjustments are made to reflect the NGF-O costs of continuing to comply with current law provisions. This is often 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 legislation not enacted by the Legislature, including new CBAs not approved by the Legislature, other proposed compensation increases, and costs of any adverse court rulings within 90 days of each respective legislative session. OFM's statewide preliminary ML estimate, by biennial period, follows:

- 2019-21 biennial estimate: $517 million, and
- 2021-23 biennial estimate: $386 million.

Kindergarten – Grade 12 (K-12 Education)

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 periodically updated for other factors such as levy equalization, student transportation, and staff mix.

K-12 education ML adjustments include $138 million in the 2019-21 biennium and savings of $67 million in the 2021-23 biennium. The larger increases are related primarily to enrollment, workload and transportation funding adjustments. The largest savings in this category are related primarily to the most recent actuarial projections of employer pension contributions rates by state actuaries and reductions in the estimated costs for local effort assistance payments. In addition, there is a budget savings associated with a technical correction to the state Learning Assistance Program (LAP) high-poverty calculations to better align with amounts actually allocated to school districts for this purpose.

Low-Income Health Care & Community Behavioral Health

The amounts depicted reflect caseload and per capita cost information prepared through joint effort by legislative and executive branch staff, as well as other mandatory ML changes. Some of the major cost components include utilization, caseload, and medical inflation. The growth factor for the 2021-23 biennium is estimated at 2.89 percent per year from FY 2021 levels.

ML adjustments include $287 million in the 2019-21 biennium and $420 million in the 2021-23 biennium. The larger state costs are related primarily to increases in physical and behavioral health managed care rates, which are required under federal law to be actuarially sound and required increases in hold harmless payments for Certified Public Expenditure hospitals. Larger state savings are related to declining Medicaid caseloads and reductions in medical utilization across some populations.

Social and Health Services

The amounts depicted reflect caseload and per capita cost information prepared through joint effort by legislative and executive branch staff, as well as other mandatory ML changes. Some of the major cost components include caseload, utilization and severity of client needs. The growth factor for the 2021-23 biennium is estimated at 3.27 percent per year from FY 2021 levels.

ML adjustments include $54 million in the 2019-21 biennium and $131 million in the 2021-23 biennium. The larger increases are related to state hospital operations, and an estimated loss of federal revenues used to support the state hospitals. The larger savings include forecasted reductions in caseloads and utilization. The preliminary maintenance level submitted by the OFM does not assume further delays in the reduction in federal Disproportionate Share Hospital (DSH) grants beyond the 2021-23 biennium as was assumed in the enacted Outlook.

Department of Corrections

The amounts depicted reflect caseload and per capita cost information prepared through joint effort by legislative and executive branch staff, as well as other mandatory ML changes. A major cost component is the community supervision and institution populations. The growth factor for the 2021-23 biennium is estimated at 1.33 percent per year from FY 2021 levels.

ML adjustments include $39 million in the 2019-21 biennium and $70 million in the 2021-23 biennium. The larger adjustments are related to capital projects operating costs and changes in the community supervision and community violator caseloads.

Higher Education

Higher Education adjustments are generally related to Initiative 732 cost of living adjustments, the College Bound Scholarship program, and to maintenance, operations and lease adjustments. The growth factor for the 2021-23 biennium is estimated at 0.1 percent per year from FY 2021 levels.

ML adjustments include $2 million in the 2019-21 biennium and $2 million in the 2021-23 biennium.

Debt Service
The amounts depicted reflect estimated savings on the cost of the debt on all capital budget bonds that were authorized through the 2019 session using the bond model to calculate estimated costs for the 2021-23 biennium. In accordance with direction from the ERFC, this includes estimated costs of adopting a capital budget in the 2021-23 biennium.

ML adjustments include savings of $40 million in the 2019-21 biennium and savings of $45 million in the 2021-23 biennium.

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, legislative agencies and judicial agencies. The growth factor for the 2021-23 biennium is estimated at 0.42 percent per year from FY 2021 levels.

ML adjustments include savings of $2 million in the 2019-21 biennium and savings of $124 million in the 2021-23 biennium. The larger increases are related to forecasted increases for early learning tiered reimbursement and some child welfare programs. The larger savings are related to the most recent actuarial projections of employer pension contributions rates by state actuaries and changes in the forecast for the Working Connections Child Care program.

Other Outlook Items

2019 Fire Suppression Costs
This adjustment reflects the November 4th, 2019 ERFC decision to include the estimated costs of the 2019 fire season, which exceeds the amount built into agency base budgets for fire suppression.

ML adjustments include $38 million for FY 2020.