

# Overview of the Methodology for the State Budget Outlook (January 2020)

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## **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**

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 Fiscal Years (FY) is equal to the projected ending balance for the previous FY.

### Revenue Forecast

The amounts for 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 6636) call for the ensuing biennium revenue (in this instance, the 2021-23 biennium) to be 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 2019 forecast projects revenue growth of less than 4.5 percent per year in the 2021-23 biennium, this Outlook uses the 4.5 percent growth rate.

### Transfers to Budget Stabilization Account

Pursuant to a constitutional amendment approved by the voters in 2007 (Article VII, section 12(1), of the Constitution), this reflects the transfer of one percent of general state revenues (GSR) for each FY to the Budget Stabilization Account (BSA). 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 GSR is based on the November 2019 revenue forecast adjusted for the estimated revenue impacts of the Governor's proposed revenue changes.

### Extraordinary Revenue Growth

Pursuant to a constitutional amendment approved by the voters in 2011 (Article VII, section 12 of the constitution), this reflects the transfer of three-quarters of extraordinary revenue growth (ERG) into the BSA. 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 amount into the BSA. The November 2019 revenue forecast does not project ERG for the 2019-21 nor 2021-23 biennia so no additional BSA transfer is assumed in this Outlook.

## Overview of the Methodology for the State Budget Outlook (January 2020)

### Enacted Fund Transfers

This category reflects all enacted NGF-O fund transfers made through the 2019 legislative session (including special sessions) after accounting for vetoes. For more information, see the 2019 Legislative Budget Notes at: <http://leap.leg.wa.gov/leap/budget/lbns/2019LBN.pdf>.

### Governor's Proposed Resource Changes

#### *Fund Transfers*

The Governor's budget proposes transfers as listed below.

<b>Transfers Proposed in the Governor's 2020 Supplemental Budget (\$'s in 1,000's)</b>		
	<b>2019-21</b>	<b>2021-23</b>
From GFS to the Sea Cucumber Dive Fishery Account*	\$(4)	
From GFS to the Urchin Dive Fishery Account*	\$(1)	
From Financial Services Regulation Account to the GFS	\$1,400	
From Department of Retirement Systems Expense Account to the GFS	\$5,000	
From Treasurer's Service Account to the GFS	\$4,000	\$8,000
<b>Total</b>	<b>\$10,395</b>	<b>\$8,000</b>

\* The GFS transfer to the Sea Cucumber Dive Fishery Acct is an amount up to \$4,000 and the GFS transfer to the Urchin Dive Fishery Acct is an amount up to \$1,000.

#### *Proposed Revenue Changes*

The Governor is proposing several pieces of legislation that affect revenues:

<b>Governor Inslee's Revenue Proposals (\$'s in 1,000's)</b>		
	<b>2019-21</b>	<b>2021-23</b>
Vapor Products – Permanent Ban (HB 2454/SB 6254)	\$(1,294)	\$(582)
Community Solar Tax Incentive (HB 2248/SB 6223)	\$0	\$(341)
Multi-Family Tax Exemption (HB 2620/SB 6411)*	\$0	\$0
<b>Total</b>	<b>\$(1,294)</b>	<b>\$(923)</b>

\* The revenue impact of HB 2620/SB 6411 is indeterminate. The requirements that may be adopted by local governments for new exemptions or extensions of existing exemptions are unknown. Exemptions or extensions granted for Tax Year 2021 will result in a loss of state revenue, while exemptions or extensions granted for 2022 and after will result in a shift of state property taxes onto taxable properties.

#### *Tobacco Arbitration Settlement Revenue*

Some tobacco companies that are part of the 1998 settlement have disputed the lack of a downward adjustment related to non-participating manufacturers and have not been fully paying the amounts they owe going back to 2003. The argument for the manufacturers is that Washington and other states are failing to diligently enforce provisions related to non-manufacturers and therefore the downward adjustment should be applied.

In 2013, Washington was one of a number of states that prevailed in an arbitration related to withheld payments for the year 2003. Washington received approximately \$15 million upon conclusion of the arbitration for with-held 2003 funds. There were a few states that were found to have failed to diligently enforce the agreement and as a result suffered significant adverse fiscal impacts from the arbitration.

## Overview of the Methodology for the State Budget Outlook (January 2020)

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The revenue forecast currently assumes an approximately \$15 million payment will be received in FY 2020. The Governor's budget assumes that an additional \$16.4 million in tobacco arbitration settlement revenue will be received in the 2021-23 biennia.

### *Budget Driven Revenue Adjustments*

Adjustments are made to reflect the difference between assumed transfers of cannabis, liquor and lottery revenue to the General Fund in the November forecast and what is estimated to be available after adjusting for the Governor's proposed spending levels.

<b>Governor Inslee's Budget Driven Revenue (\$'s in 1,000's)</b>		
	<b>2019-21</b>	<b>2021-23</b>
Liquor Control Board (Marijuana)	\$(1,192)	\$(105)
Liquor Control Board (Liquor)	\$(2,118)	\$(7,155)
Lottery	\$(15)	\$(26)
<b>Total</b>	<b>\$(3,325)</b>	<b>\$(7,286)</b>

### **Expenditures**

As the starting point for the expenditure projection, the Outlook utilizes the most recently enacted budget (the 2019-21 Enacted budget). It is based on these 2019-21 budget appropriation levels, and then reflects adjustments for the Governor's Maintenance Level (ML) estimates. For more information on the 2019-21 Budget, please see: [http://leap.leg.wa.gov/leap/budget/index\\_lbns.asp](http://leap.leg.wa.gov/leap/budget/index_lbns.asp).

### Assumed Reversions

Reversions are the estimated appropriations that will be unspent and revert to the state for re-appropriation. Consistent with prior outlooks, reversions are estimated at approximately 0.5% of GF-S appropriations. Pursuant to guidance provided by the ERFC on June 6, 2019, additional reversions are assumed in relation to K-3 enhancement funds. The total reversions assumed are \$358 million in the 2019-21 biennium and \$298 million in the 2021-23 biennium.

### Estimating Costs for the 2019-21 and 2021-23 Fiscal Biennia

Per statute, the estimated expenditures in the Outlook reflect the cost to continue current programs, entitlement program growth, and actions required by law in the subsequent fiscal biennium (i.e. the 2021-23 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.

The historical growth factors used to estimate increased costs in the subsequent fiscal biennium are updated each biennium through a joint effort by legislative and executive branch staff and ultimately adopted by the ERFC. The growth factors were adopted by the ERFC on November 6, 2018. Additional information on the calculation of the historical growth factors adopted by the ERFC for the current outlook can be found in the following document available on the ERFC website: [https://erfc.wa.gov/sites/default/files/public/documents/budget/20181106\\_MemoToERFC\\_GrowthRates.pdf](https://erfc.wa.gov/sites/default/files/public/documents/budget/20181106_MemoToERFC_GrowthRates.pdf)

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

## Overview of the Methodology for the State Budget Outlook (January 2020)

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- **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 and student transportation.
- **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 in the subsequent fiscal biennium are expected to be significantly different from the second 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 into the subsequent biennium.
- **Compensation items.** Because the Outlook statute specifically excludes any additional future costs related to collective bargaining agreements (CBAs) not approved by the Legislature, or salaries and benefits, no growth factor is applied to compensation related items. However, a custom adjustment is applied to items that are not fully implemented in the second year of the biennium to capture the full cost in the subsequent fiscal biennium.

### **Maintenance Level Revisions**

In this section, additional adjustments are made to reflect the costs of continuing to comply with current law provisions. This is often referred to as 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 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. The Governor's statewide ML estimate, by biennial period:

- ❖ 2019-21 biennial estimate: \$478 million, and
- ❖ 2021-23 biennial estimate: \$330 million.

These estimates are total impacts. These amounts are based on the Governor's budget and will change prior to the enacted FY2020 Supplemental budget. The impacts follow for reference.

### Kindergarten – Grade 12 (K-12) Education

The amounts depicted reflect the November 2019 caseload and 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 and student transportation.

- ❖ ML adjustments total \$107 million in the 2019-21 biennium and savings of \$125 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

## Overview of the Methodology for the State Budget Outlook (January 2020)

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technical correction to the state Learning Assistance Program high-poverty calculations to better align with amounts actually allocated to school districts for this purpose.

### Low-Income Health Care and Community Behavioral Health

The amounts depicted reflect the caseload and per capita cost information, as well as other mandatory maintenance level changes. Some of the major cost components include utilization, caseload, and medical inflation. The average growth factor for this grouping is 2.89 percent per FY from FY 2021 levels.

- ❖ ML adjustments total \$325 million in 2019-21 and \$451 million in 2021-23.

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, as well as other mandatory maintenance level changes. Some of the major cost components include caseload, utilization, and severity of client needs. The average growth factor for this grouping is 3.27 percent per FY from FY 2021 levels.

- ❖ ML adjustments total \$55 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 final ML 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.

### Higher Education

Higher Education adjustments are generally related to the Initiative 732 cost of living adjustments, the College Bound Scholarship program, and to maintenance, operations, and lease adjustments. The average growth factor for this grouping is 0.1 percent per FY from FY 2021 levels.

- ❖ ML adjustments total \$760,000 in the 2019-21 biennium and \$495,000 in the 2021-23 biennium.

### Corrections

The amounts depicted reflect caseload, as well as other mandatory maintenance level changes. The average growth factor for this grouping is 1.33 percent per FY from FY 2021 levels.

- ❖ ML adjustments total \$37 million in the 2019-21 biennium and \$50 million in the 2021-23 biennium.

The larger adjustments are related to capital projects operating costs, equipment replacement costs, and changes in the community supervision and female offender caseload forecasts.

### All Other

This area includes all other agencies not reflected in the preceding Outlook groups. Many are general government agencies, smaller human service agencies, the department of child youth and families (DCYF), natural resource agencies, legislative agencies, and judicial agencies. The average growth factor for this grouping is 0.42 percent per FY from FY 2021 levels.

## Overview of the Methodology for the State Budget Outlook (January 2020)

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- ❖ ML adjustments total savings of \$7 million in the 2019-21 biennium and savings of \$19 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 changes in the forecast for the Working Connections Child Care program.

### Debt Service

The amounts depicted reflect 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 total savings of \$40 million in the 2019-21 biennium and savings of \$45 million in the 2021-23 biennium.

### Employee Health and Benefits

The amounts depicted reflect the cost projected for employer health and benefits. This includes updated employer funding rates for PEEB and savings associated with the most recent actuarial projections of employer pension contribution rates by the Office of the State Actuary.

- ❖ ML adjustments total \$2 million in the 2019-21 biennium and savings of \$114 million in the 2021-23 biennium.

### Policy Level Items

In this section, referred to as Policy Level (PL), adjustments are made to reflect the policy level expenditures included in the Governor's proposed budget. PL adjustments total \$336 million in the 2019-21 biennium and \$164 million in the 2021-23 biennium.

### K-12 Education

The Governor proposes to increase funding for K-12 Schools by \$80 million in the 2019-21 biennium and by \$71 million in the 2021-23 biennium. The major components of this increase are:

- ❖ Various items related to pupil transportation;
- ❖ PERS & TRS Plan 1 Benefit Increase;
- ❖ Student Mental Health and Safety;

### School Employee Benefits Board (SEBB) Health Benefit Funding Rates

The Governor proposes savings related to SEBB funding rates. These are adjusted based on updated rates for FY 2021 to incorporate new data from SEBB open enrollment regarding plan choice and demographic information. These adjustments include \$37 million savings in the 2019-21 biennium and \$92 million savings in the 2021-23 biennium.

### Low-Income Health Care and Community Behavioral Health

The Governor proposes savings for Low Income Health Care and Community Behavioral Health of \$31 million savings in the 2019-21 biennium and \$130 million savings in the 2021-23 biennium. The major components for Low Income Health Care and Community Behavioral Health are:

- ❖ Program Integrity Savings Restoration;
- ❖ DSH Delay (savings);

## Overview of the Methodology for the State Budget Outlook (January 2020)

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- ❖ Low Income Health Care I-502 (savings);

### Social and Health Services

The Governor proposes to increase funding for DSHS programs by \$57 million in the 2019-21 biennium and by \$135 million in the 2021-23 biennium. The major components for DSHS are:

- ❖ Various items related to the Consumer Directed Employer Program;
- ❖ Various items related to nursing home rate and forecast increases;
- ❖ Hospital Safety: Direct Care Staff;
- ❖ DSH Adjustment (savings);

### Higher Education

The Governor proposes to increase funding for Higher Education by \$35 million in the 2019-21 biennium and by \$4 million in the 2021-23 biennium. The major components of this increase are:

- ❖ Workforce Education Investment Account, funds are appropriated into this account to ensure the account remains solvent in the 2019-21 biennium;
- ❖ Various items related to UW and SEIU/WFSE negotiated payments;
- ❖ University of Washington Specific Wage Increase not implemented (savings);

### Corrections

The Governor proposes to increase funding for Department of Corrections (DOC) by \$55 million in the 2019-21 biennium and by \$31 million in the 2021-23 biennium. The major components for DOC are:

- ❖ Custody Relief Factor;
- ❖ Tolling Centralization;
- ❖ Custody Staff: Health Care Delivery;
- ❖ Supervision Reforms (savings);
- ❖ Earned Time to 50 Percent (savings);

### All Other

This area includes all other agencies not reflected in the preceding Outlook groups. Many are general government agencies, smaller human service agencies, natural resource agencies, legislative agencies and judicial agencies. Other PL changes total \$177 million in the 2019-21 biennium and \$145 million in the 2021-23 biennium. The major components are:

- ❖ Juvenile Rehabilitation to age 25;
- ❖ Waiver Shortfall, which closes the five-year federal Title-IVE waiver which maintained in-home placements and reduced entry into foster care;
- ❖ Preserve Title X Program, to reduce the length of stay for youth in hospital inpatient and emergency room settings, hotels, and out-of-state placements;
- ❖ Foster Care Payment Increase;
- ❖ Program fund shift from the Model Toxics Control Account to the GFS (savings);

### Budget Stabilization Account (BSA)

The Governor proposes to appropriate \$319 million from the BSA in the 2019-21 biennium. This spending is directed towards decreasing the rate of unsheltered homelessness in Washington. Some of the major operating budget components are:

- ❖ Unmet Need Sheltering, to provide an additional 2,100 shelter beds statewide;
- ❖ Housing and Essential Needs, to provide assistance to 2,900 individuals to meet their foundational needs including securing safe and healthy homes;

## Overview of the Methodology for the State Budget Outlook (January 2020)

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- ❖ Supportive Housing, to ensure that 1,200 of the highest need, chronically homeless persons with a history of living outside will receive permanent supportive housing assistance required to obtain and maintain stable housing; and
- ❖ Homeless Encampment Waste Cleanup.