VERMONT

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Adam Greshin, Commissioner

TO: Agency Secretaries, Commissioners, Department Heads and Business Managers

FROM: Adam Greshin, Commissioner, Department of Finance & Management

RE: FY2024 Budget Development Guidelines and Initial Submissions

DATE: August 23, 2022

Adam Greshin Digitally signed by Adam Greshin Date: 2022.08.22 17:47:37 -04'00'

The Governor's goals for the FY24 budget are aligned with the State Strategic Plan – which prioritizes strategies that measurably grow the economy, make Vermont more affordable, build the safest and healthiest communities, and improve efficiency and accessibility of state government. The breakthrough indicators outlined in the plan – and your updated agency or department goals and metrics - will continue to be primary measures of our progress in these areas. Budget proposals will be viewed primarily through this lens.

While the COVID-19 state of emergency ended over a year ago, the federal health emergency declaration remains in place and federal stimulus dollars continue temporarily to inflate state revenues. The General Fund, the Education Fund and the Transportation Fund all ended the year with a surplus. The General Fund surplus in FY22 was over $90 million and the revised revenue forecast at the July Emergency Board meeting added another $138 million in anticipated revenue into the General Fund in FY23. Other forecast revisions were more modest – the T-Fund had a slight downward revision, which we can expect to continue as more people transition to hybrid and electric vehicles and fuel prices curb travel. Signaling the beginning of the post-pandemic economic correction and the recessionary impacts of efforts to address escalating inflation, the state's economists predict a small decline in available General Fund revenue in FY24.

Facing this unsettled and historically unprecedented macroeconomic environment, the Governor is committed to maintaining moderate growth in base spending. This is essential to ensure we are not creating future funding cliffs that cannot be sustained when the economy normalizes. For this reason, agencies and departments are asked to submit budgets that grow base spending no greater than 3% based on FY23 General Fund "As Passed" appropriations and using the assumptions described herein for statewide allocated costs. With wage pressures and increases in program costs, departments may need to think strategically and ensure critical, effective services and impactful initiatives remain a priority.

The Governor is acutely aware of the inflationary pressures facing every household, and virtually every part of state government. We acknowledge this is not an easy environment for moderate state spending growth – which makes it even more important for households who are seeing their costs rise substantially faster than growth in paychecks. Finance & Management is ready to work with you to achieve the budget target. We are aware exceptions to the 3% target may be necessary on a case-by-case basis, and we do not expect to require position reductions to achieve the goal.

Context

As always, the primary driver of budget development is the July Emergency Board revenue forecast for FY24. Again, the consensus forecast predicts a 4% decline in revenue in FY24 from the inflated levels of the previous year, and then a return to moderate growth in the following three years – provided inflation abates and there is not a prolonged recession. It is important to understand, with all the crosscurrents buffeting our economy, the adopted forecast faces an unusually high degree of uncertainty. This fact contributes to the need for cautious budgeting.

- **Federal Policy Jumble**

  With one foot on the accelerator and another on the brake, the federal government is generating lots of smoke and noise with no discernible policy direction. In a classic, and highly unusual, battle of policy levers, the national economy faces strongly contractionary monetary policy and highly expansionary and stimulative fiscal policy. In March, to combat a surge in inflation, the Federal Reserve embarked on a series of interest rate hikes and ramped up its efforts to reduce its COVID-swollen balance sheet. The net effect has been a substantial increase in the cost of money. At the same time, ARPA dollars are flowing, states are preparing for multi-year tranches of Infrastructure Investment and Jobs Act money, and a slimmed-down version of Build Back Better – recast as The Inflation Reduction Act (IRA) of 2022 – became law in mid-August. There is also funding for Vermont available via the bipartisan Safer Communities Act. Many states, Vermont included, are struggling to deploy unprecedented sums of money in the pipeline from Washington given all these factors. The opposing forces of inflationary costs, expensive money and ample fiscal stimulus – plus ongoing supply chain constraints and workforce shortages – create a very volatile macroeconomic environment and a heightened level of anxiety.

- **Vermont's Fundamentals**

  Amidst this backdrop, and despite these headwinds, Vermont's economy shows signs of continued growth. Jobs are plentiful, but as we all know, new workers are scarce. Real estate prices remain elevated, retail is back, and resorts are full. Tax receipts – sales, meals & rooms, liquor, property transfer – all reflect broad-based strength in the retail and hospitality sectors. Receipts in personal and corporate income taxes confirm the improvement in household balance sheets, but inflation is rapidly consuming those gains.

  Vermont's economy reflects the national trend, yet our local, homegrown challenges persist. According to a recently released Moody's report, "Slow population growth and a generally aging population are two factors likely contributing to the state's below average economic performance and could continue to be a drag on the state's long-term growth." <u>Moody's notes Vermont's working age population is experiencing the highest rate of decline among all 50 states and the District of Columbia.</u> Aggregate economic growth numbers hide the uneven distribution of that growth as population centers thrive, particularly in northwestern Vermont, widening the disparity with other areas of our state, and widening disparities between demographic groups as well. And notwithstanding the deep pipeline of funding for housing, and substantial investments in childcare, it is still a struggle to find affordable middle income homes.

- **State Government's Cost Pressures**

Our single biggest budgetary challenge is managing costs in an inflationary environment. Employee costs are substantially higher, not just due to wage gains but also due to the rising cost of health care and greater contributions to our retirement accounts. Virtually every program we run has an inflation premium. On the one hand, as payrolls rise, so do payroll taxes. On the other hand, budgeting with an inflation premium rarely ends well because when revenues disappear, the response is typically layoffs (which happened in 2009) and program cuts that adversely impact Vermonters and the state's ability to fight back against recessionary forces. We must take steps to mitigate those two outcomes, by focusing on what's most important and by making the case for prioritizing resources where they have the most measurable impact on reversing our negative demographic trends and making Vermont more affordable for families and job creators. The long-term payoff for disciplined prioritization today is a more stable work environment and a state government that is best positioned to continue critical services, and invest in priorities, even in challenging economic times.

While we must continue to exercise fiscal discipline and manage growth to a sustainable level, we must also acknowledge fiscal reality. In the budget development context, General Fund budgets have been enjoying more insulation from inflationary pressures than those funded by Special Funds. For example, in the FY23 budget, the actual Internal Service Fund increase was about 11%, but General Fund budgets were only required to build a 3% increase into their budget targets. While our inflationary environment has resulted in ample General Fund surplus revenue, revenue for many Special Funds has not enjoyed the same rate of increase, and in some cases has gone in the opposite direction. Considering this reality, the Agency of Administration is open to helping you manage these pressures so we can make the most strategic recommendations possible to the Governor.

- **ARPA/IIJA/IRA and Base Budgeting**

The rapid increase in federal money has inspired an equally rapid rise in requests for positions to administer the programs and services tied to the federal funds. This is both predictable and understandable. As the Governor has regularly noted to the Executive Cabinet, however, agencies and departments may not use persistent vacancies as reason to delay deployment of these transformative resources. From a budget perspective, our intent is to align positions with funding streams. While this is standard practice with limited-service positions, the magnitude and the speed of the build out has made this more important than ever. While we anticipate an ebb and flow of new positions over the next several years as programs ramp up and wind down, the Governor will not support building a stimulus-based workforce as a permanent part of government. Do not propose to do so. We have already heard similar feedback from the Legislature regarding the recent number of position requests. The primary focus of budgeting has been and will be the base cost of delivering ongoing programs and services to Vermonters. The Agency of Administration will make every effort to track and account for stimulus spending and positions separately, and we ask for agencies' and departments' assistance and cooperation to do so.

Budget Development Process and Timeline
Initial FY24 budget proposals, FY23 budget adjustment proposals and FY24 capital bill proposals are due electronically to the Department of Finance & Management by Tuesday, October 11th. Budget meetings will begin later that week and continue into early November.

Guidance
Detailed information about requirements and assumptions is included in the attached *Instructions Supplement*. Here are a few key elements:

- **General Guidance** – Please include proposed expenditures, anticipated special fund revenues, and any proposals for new or increased revenue – taxes, fees, etc. – that are incorporated into your budget. Given the enhanced revenue environment and substantial federal stimulus funds, the Governor is not inviting and does not expect to receive proposals for higher taxes or fees. Alternatively, tax and fee relief proposals, and other policies, that measurably improve economic growth and affordability metrics in the State Strategic Plan are strongly encouraged.

- **FY23 Base Spending** – *Please confirm with your budget analyst your department's FY23 As Passed base appropriation*. This will be the starting point for measuring changes to spending.

- **Statewide Allocated Costs** - For the purposes of the 3% General Fund increase target for initial budget submissions, assume Internal Service Fund (ISF) and Health Benefits allocations to be flat with FY23 As Passed levels. Assume Employer Contribution Rates for the Defined Benefit (DB) and Defined Contribution (DC) retirement plans to be flat with the levels currently in effect as of July 1, 2023 (26.7% for DB and 11.75% for DC). Finance & Management will communicate any potential changes as soon as ISF budgets, insurance, and retirement rates are finalized. If rate changes are required, additional General Fund allotments will be provided to General Fund departments as needed.

- **One-Time Expenditures** – One-time expenditures should not be included in base budget proposals. Proposed amendments, if any, to ARPA appropriations will be considered one-time expenditures. These proposals should be raised during budget development sessions but will be evaluated separately.

- **Policy Proposals** – Include a legislative initiative template and a Policy Impact Assessment form for any policy proposal with a budgetary impact (e.g. costs money to implement or will reduce available revenue). These should also be submitted to Director Smith and your Governor's Office liaison in accordance with the policy development timeline.

- **Position Requests** – New position requests will be evaluated based on their relationship to strategic priorities and available funds. When making a position request, reclassification of a vacant position should be considered first. New position requests must include position description, cost and source of funds. Please incorporate the full cost associated with a new position.

- **Boards & Commissions, Per Diems** – *New this year*, per Act 134 of 2022, agencies or departments that administer funds for a board or commission may submit to the Governor, to be included in his budget, requests to increase per diems for that board or commission. Any request must include a detailed justification that will form the basis for a review by the Governor's Office.

- **Technology Needs & Projects** – Budget requests for new IT projects should include an IT ABC Form and a Legislative Initiative Template for review by the Governor's Office. All technology requests will be provided to ADS for review prior to presentation to the Governor.

- **Federal Funding** – For the purposes of your submission, in the absence of reliable information, use current federal funding levels. If your agency/department has reasonable certainty that changes in federal funding will occur, you may incorporate those changes into your presentation along with potential federal match requirements. Anticipated reductions in federal funding should be met by corresponding reductions, preferably in associated limited-service positions and administrative expenditures.

- **Capital Budgeting** – For specific details on your FY24 Capital Budget submission, please refer to the Capital Budget instruction memo sent under separate cover from the Secretary of Administration. Agencies and departments that submit capital budget requests are strongly encouraged to submit those requests with their operating budget. Any operating cost impacts resulting from your capital budget request should be included and clearly identified in your operating budget submission.

Aligning with the State Strategic Plan

Again, budget submissions must align with the State's Strategic Plan. We are currently in the process of finishing an update to the plan, and you can get a copy of your agency's plan from your leadership. Please highlight whether your budget initiatives are consistent with achieving the key performance measures in your portion of the plan and, where applicable, what measurable impact budget initiatives will have on the topline Breakthrough Indicators. More detailed information about requirements and assumptions is included in the attached *Instructions Supplement*.

Impact Assessments

The State of Vermont is committed to ensuring state dollars are spent on programs that will achieve the desired outcomes for Vermonters, as well as advancing equity for all those who live, work, play, and learn here. Delivering efficient, effective, and equitable services requires agencies to fully understand the problems they are trying to solve and the potential impacts of their proposals. Equity and inclusion are not "add-ons" to our budget processes—rather, they are necessary to address the demographic, workforce, and social challenges facing our state.
The Policy Impact Assessment form must be completed for all new initiatives and any substantive changes in service delivery. The thought process invoked with this form ensures each proposal goes through a robust development process by posing questions in several key areas: connections to strategic priorities, problem definition, identification of stakeholders and potential impacts, resource needs, and measurement and monitoring. By incorporating this multi-faceted tool into our regular practice, we will ensure our programs are built efficiently, effectively, and with an equity lens.

Budget Review Meetings

Budget review meetings will begin on October 17th and conclude early November. Meetings will begin with the ISF departments to finalize ISF budgets as early as possible. Meetings will include your Governor's Office liaison and Policy Director Smith to the extent possible.

Performance Measure Reporting

Programmatic performance measures are reported along with the budget, as required by 32 V.S.A. §307 (c)(2), to ensure that the programmatic performance is transparent and can be used within the budget decision-making process.

For FY24, we are making some changes to the performance measure reporting process to ease the reporting burden, ensure accurate financials, and create opportunities for the development of higher quality measures. In a shift from the past few budget cycles, we will not be requiring the submittal of a program profile report (Attachment A-1). Instead, we will pull financial information at the appropriation level directly from Vantage once budgets are finalized (roughly December). These high-level financials will be linked with the program level performance data captured in Attachment A-2 which is still required. For ease of reporting, we are prepopulating Attachment A-2's with data from prior submissions. You may access your agency's pre-populated template at https://vermontgov.sharepoint.com/sites/SOV ContinuousImprovement/PPMB/. You will need to confirm the information present and add/adjust information as necessary.

All programs listed should be associated with an appropriation level department ID and multiple programs can have the same ID if they are considered subprograms within an appropriation. Our expectation is that agencies and departments will continue to report on programs from previous cycles and are strongly encouraged to refine their existing measures and add additional programs where relevant. All appropriation level department IDs should have at least one program with associated measures being reported. Please note that the requirements for the Program

Description field have changed to better capture program purpose/context, and there are two additional fields to capture program services provided and a link to the program website. Additional information about filling out Attachment A-2 can be found in the Budget Instructions Technical Supplement.
Attachment A-2 should be submitted with initial budget proposals to allow time for review and refinement in consultation with the Chief Performance Office. Should you need assistance in defining and developing program performance measures, please reach out to Justin Kenney, Chief Performance Officer – Justin.Kenney@Vermont.gov. As in previous years, the Agency of Human Services may continue to utilize Clear Impact Scorecard for their Performance Measure Reporting.

Budget Submissions

Please submit initial budget proposals for FY24 to the Governor by Tuesday, October 11th, 2022. Budget submissions to the Governor are made via the Secretary of Administration using the e-mail folder ADM.budget@vermont.gov.

Thank You

Finance and Management is grateful for your efforts to develop and support the Governor's Recommended Budget and we look forward to working with agencies and departments in this process. Please contact your budget analyst with questions or requests.