VERMONT

State of Vermont
Agency of Administration
Department of Finance & Management
Pavilion Office Building
109 State Street, 5th Floor
Montpelier, VT 05609-0201
www.finance.vermont.gov

[phone] 802-828-2376

Adam Greshin, Commissioner

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

FROM: Adam Greshin Adam Greshin Digitally signed by Adam Greshin Date: 2023.08.31 17:10:59 -04'00'

RE: FY2025 Budget Development Guidelines and Initial Submissions

DATE: August 31, 2023

Introduction

On the heels of pandemic recovery, the FY25 state budget will continue our work to rebuild and strengthen communities after severe flooding that ravaged many parts of the state. Community revitalization - achieved from growing our labor force, improving the quality and supply of housing, bringing downtowns back to life, and ensuring all people living in Vermont have access to quality, affordable, services like health care, public safety, broadband and cell service, and the best PK–12 education - must be the north star of all proposed investments. These core priorities, and how we measure our progress, are reflected in the Administration's Strategic Plan.

However, while the scope of our challenges grows, federal and state funding streams may be diminishing. Vermont's three major funds ended FY24 with mixed results. The General Fund had a small surplus, that is largely already obligated, while the Transportation Fund and the Education Fund ended with small deficits relative to projected revenues. The FY25 revenue forecast reflects a more nuanced macroeconomic picture. The global economy is no longer firing on all cylinders, although Vermont's economy has remained remarkably resilient considering the decline in federal funding and the sharp hike in borrowing rates. The long-term impact of the July floods on our revenues remains to be seen, but the Administration will make sure that throughout the fall those likely to visit Vermont know we are open for business.

Given our financial outlook, and the historic thirteen percent increase in base spending the Legislature imposed in FY24 coupled with broad based taxes and fees, the Governor is particularly focused on moderating the growth in base spending in FY25. Even without the uncertainty of the state's financial liability for flood recovery, prudence dictates long term growth in spending should not outpace expected growth in revenue. With this in mind, Agencies and Departments are asked to submit budgets that increase base spending no greater than three percent based on FY24 "As Passed" appropriations and adhering to guidelines described below for statewide allocated costs. Anticipating wage and benefit pressures, and growing program costs, Agencies and Departments should prioritize investments that can be numerically demonstrated to move us towards the priorities outlined in the Strategic Plan in one to two years, while maintaining front line services for Vermonters.

The Administration is aware how difficult budget development will be for many Agencies and Departments, particularly with the expanded scope of our challenges. Nonetheless, our revenue outlook requires a return to more prudent budgeting and in this regard, evaluating the impact of three percent General Fund growth is a valuable and necessary exercise. As always, Finance & Management and the Governor's team are ready to work with Agencies and Departments to help meet their target.

Context

Budget development begins with the July Emergency Board (E-Board) revenue forecast. The updated forecast, while more optimistic than the January forecast, still predicts a 5.5 percent decline in General Fund revenue in FY24 relative to actual results in FY23, and virtually no increase in FY25. The E-Board upgraded the available FY24 revenue by $78 million, which will be one-time money to invest in BAA, and the FY25 budget will begin with a base that is $78 million higher than last year. However, given targets outlined below, this will still be a challenging budget build.

- **Vermont's Fundamentals**

  The economic impact of the July flood will not be known for months, however if we use Irene as a guidepost, the *aggregate* financial impact will be minimal. Keeping this in mind and taking a more granular look at what is driving our revenues, personal income taxes, our largest state revenue source and over half the available General Fund revenue, declined 4.6 percent from last year. That hole was filled by booming interest earnings (see below) and by a large increase in corporate income tax collections, which is primarily due to the statutory change to "market-based sourcing" as opposed to vastly improved corporate earnings. Consumption taxes, which help power both the Education Fund and the Transportation Fund, advanced over last year, but signs point to slower progress ahead as the Federal government works to moderate demand and avoid a recession. At best, we can anticipate a return to slow, plodding economic growth as inflation and the job market normalize.

- **The Return of Interest Income**

  We find ourselves in a unique situation this year. For the past two decades or more, interest income was practically non-existent. With little or no inflation to combat, the Federal Reserve kept the Fed Funds rate close to zero. That was great for borrowers, but not so great for interest earning savings accounts. Things began to change in March 2022 when the Fed initiated the first of eleven rate hikes that would bring the Federal Funds rate from .25% to 5.5% in July 2023. The sharp increase in short-term interest rates coincided with an equally sharp increase in the State's average daily cash balance, from $300-400 million to over $2 billion. This was driven by the COVID-induced federal stimulus program and the ancillary economic benefits of increased public spending. The State's interest earnings in the General Fund skyrocketed from $2.3 million in FY22 to $51.2

million in FY23. The E-Board forecast assumes interest earnings in the General Fund will reach $60 million in FY24 and then recede to $45 million in FY25. Without these earnings, the revenue outlook would be far more somber, but this is not a reliable source of revenue. As inflation subsides, so will interest rates, and as the state spends down the federal funds comprising most of this cash balance, earnings will decline commensurately.

- **Cost Pressures**

  Last year we wrote extensively on managing costs in an inflationary environment. While headline inflation has subsided, the tight labor market, rising cost of health care, enhanced retirement contributions, significant increase in property insurance premiums and technology upgrades mean state government faces similar cost pressures this year. In the prior two years, Departments were allotted additional General Fund, above their target increase, to absorb these pressures. This year we are reverting to the historical norm by asking Departments to absorb internal service fund and other pressures within their three percent budget target. This will not be a change for Departments funded partially or fully by special funds. Internal service funded Departments will be held to the same budget target as other departments. As you all know, the State is exposed to many embedded costs like insurance and retirement premiums and health care benefits, which are driven by market dynamics that we have limited ability to control. These costs typically are allocated to Departments based on head count, which underscores the importance of managing positions.

Acknowledging the cost pressures we face and considering the flat revenue stream in the July E-Board forecast, FY25 budget development will be challenging. 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 even in challenging economic times.

Budget Development Process and Timeline

Initial FY25 budget proposals, FY24 budget adjustment proposals, and FY24 capital bill adjustment proposals are due electronically to the Department of Finance & Management by Tuesday, October 17th. Budget meetings will begin the following week and continue into mid-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. Despite the tighter revenue environment and notwithstanding the higher fees and new taxes incorporated in last year's budget, 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. You may have already submitted these initiatives to the Governor's Policy Office and should resubmit them with your budget documents as well.

- **FY24 Base Spending** – Please confirm with your budget analyst your Department's FY24 As-Passed base appropriation. This will be the starting point for measuring changes to spending.

- **Statewide Allocated Costs** - For the purposes of the three percent General Fund increase target for initial budget submissions, assume Internal Service Funds (ISF) are held to the same three percent increase and Health Benefits allocations to be up fifteen percent from FY24 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 updates as soon as ISF budgets, insurance, and retirement rates are finalized and known. Agencies and departments must be prepared to absorb these updates within their three percent target as part of the FY25 budget exercise.

- **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 and 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, your budget analyst, 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. Please keep in mind the future costs of additional positions on your Agency/Department Internal Service Fund and insurance charges as these costs will need to be absorbed within future budget targets.

- **Boards & Commissions, Per Diems** – 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. Act 134 also imposes reporting requirements which are described in more detail in the *Instructions Supplement.*

- **Technology Needs & Projects** – Budget requests for new IT projects should include an IT ABC Form and a Legislative Initiative form for review by the Governor's Office. All technology requests will be provided to ADS for review and feedback 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. Do not assume State funding will be available to supplant reduced or eliminated Federal funds.

- **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.

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 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 Monday, October 23rd and conclude early to mid-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 programmatic performance is transparent and can be used within the budget decision-making process.

For FY25, we are following the same process as we did last year which is to **not** require 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. These high-level financials will be linked with the program-level performance data captured in Attachment A-2. For ease of reporting, we are pre-populating Attachment A-2's with data from prior submissions. You may download your agency's pre-populated template at https://vermontgov.sharepoint.com/sites/SOV-ContinuousImprovement/PPMB/. You will need to confirm the information present on all tabs, adjust information as necessary, and add new data values. If you do not see a template for your agency or department, please reach out to 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.

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, however, the ideal scenario is that you report on whatever number of programs is necessary to cover most of the work being done under an appropriation. Additional information about filling out Attachment A-2, as well as available resources, can be found in the *Instructions 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.

Budget Submissions

Please submit initial budget proposals for FY25 to the Governor by Tuesday, October 17th, 2023. Budget submissions to the Governor are made via the Secretary of Administration, by the exempt head of your Agency or Department, using the email 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.