

PROJECTED BUDGET SURPLUS OF \$635 MILLION IS NOT AS LARGE AS IT SEEMS

It is estimated that the 2016 Florida Legislature will have a budget surplus for FY2016-17, meaning major budget cuts should not be needed and there should be some money left over for new initiatives. After funding a continuation budget, including expected cost increases in current programs and other historically funded items, it is anticipated that there will be \$635.4 million (including an allowance for \$1 billion in cash reserves) in General Revenue (GR) left over. While this is surely better than the string of multi-billion dollar deficits from FY2008-09 to FY2011-12, the Legislature can only spend a portion of that surplus without creating a deficit in two years.

Highlights

- Legislators will have an estimated GR budget surplus of \$635.4 million when they develop the state budget for FY2016-17. This is the amount remaining after funding what could be considered a continuation budget. There is a surplus in each of the three years covered by the *Long Range Financial Outlook*.
- However, if more than \$74.0 million of the FY2016-17 surplus is spent on recurring appropriations, an estimated deficit would occur in the third year (FY2018-19).
- For the first time, the *Outlook* assumes there will be tax cuts (\$262.6 million) and trust fund sweeps (\$237.3 million) in each of the three years. These two items largely offset each other in the first year, but the compound effect of the tax cuts results in a \$494.3 million reduction in year three.
- “Critical needs” will require an additional \$664.8 million over the recurring GR base budget in FY2016-17 and “high priority needs” will require an additional \$934.2 million. In total, an additional \$1.6 billion is needed to fund a continuation budget.
- Medicaid is the largest budget driver, making up 37.1 percent of all critical and high priority needs.
- It is assumed the Required Local Effort school property tax millage rate will stay the same. This would produce \$428 million from rising property values. This tax increase on local taxpayers would provide 81 percent of the amount need to fund the almost 26,000 new public school students.
- The *Outlook* further assumes a 2.4 percent increase in per student funding.
- The *Outlook* assumes a GR reserve of only \$1 billion. The Legislature has left a larger reserve than that in each of the last five years, ranging from \$1.2 billion to \$1.6 billion. Any reserve larger than \$1 billion would reduce the surplus.

Surpluses/Shortfalls Projected by the Long Range Financial Outlook (\$ millions)	
2008-09	(\$2,334.5)
2009-10	(\$3,306.3)
2010-11	(\$2,654.4)
2011-12	(\$2,510.7)
2012-13	\$273.8
2013-14	\$71.3
2014-15	\$845.7
2015-16	\$336.2
2016-17	\$635.4
2017-18	\$583.7
2018-19	\$222.2

These new estimates are contained in the constitutionally-required *Long-Range Financial Outlook* that was recently adopted by the Legislative Budget Commission. This summer’s round of state estimating conferences for revenue and expenditure needs was the basis for the *Outlook*, which is produced annually by the legislative Office of Economic and Demographic Research and the House and Senate Appropriations Committees. The *Outlook* focuses specifically on GR. These are the funds that can be spent by the Legislature on anything and that are major source of funding for education, human services and criminal justice. The *Outlook* also considers trust funds that can affect the need for GR spending in certain areas of the budget.

This valuable budget planning tool looks ahead three years. There is no projected shortfall through the three-year horizon of the *Outlook*. This analysis focuses on the upcoming budget year.

The *Outlook* first projects the amount of GR that will be available for the budget. That amount is then compared to the base budget (recurring appropriations in the current budget) plus an estimate of increased spending needed for a “continuation budget.” The difference in projected revenues and expenditures is the projected surplus or shortfall.

The forecasted growth in expenditures is made up of two categories. **Critical Needs** are mandatory increases (based on estimating conferences and other essential items), representing the minimum cost to fund the budget without significant programmatic changes. New initiatives and funding increases above what is required are not included. For example, the cost of funding additional students is included but an increase to per student funding is not. Increased Medicaid costs comprise 89.3 percent of these new “critical needs.”

High Priority Needs are historically funded issues that are typically viewed as “must fund” in normal budget years. These can include the continued funding of programs paid for with non-recurring revenues, as well as non-mandatory increases for recurring programs. These are usually calculated by using the three-year average appropriations for that program. For example, while Critical Needs include only the cost of maintaining per-student funding, this year’s High Priority Needs include a 2.4 percent increase in per-student funding (the average increase of the last three years).

Adding these two categories to the recurring expenditures in the current budget comprises what can be thought of as a continuation budget.

REVENUE ADJUSTMENTS

This year's *Outlook* has a new feature. For the first time, it assumes that the Legislature will cut taxes (reducing GR) and sweep trust funds¹ (increasing GR). In the past, the size of any estimated surplus was used by some as a gauge of the likelihood that there would be tax reductions. Now, tax cuts are built in, assuming the Legislature will enact \$262.6 million² in net tax and fee reductions in each of the three years. This is the average of the last three years' worth of revenue reductions. This includes \$191.4 million in recurring cuts (such as permanent tax rate decreases or new exemptions), and \$71.2 million of non-recurring cuts (one-time reductions such as sales tax holidays).

In the short-term, this reduction is largely offset by the new inclusion of trust fund sweeps, which are estimated at \$237.3 million each year. This leaves a negative impact on available GR for next year of \$25.3 million; however, over the next two years of the *Outlook's* horizon, the net impact of these two factors increases significantly. This is because it is assumed \$262.6 million in new tax cuts will be passed each year. The recurring portion of the cuts compounds each year, resulting in a net reduction from tax cuts and trust fund sweeps of \$494.3 million in FY2018-19.

IMPACT ON THE 2ND AND 3RD YEARS OF THE OUTLOOK

The *Outlook* assumes that any surplus is carried over into the next budget year (in addition to \$1 billion in GR reserves.) This helps produce an estimated surplus in each of the three years. However, if any of the surplus is spent on recurring appropriations, there is a compounding effect on future years because less money is carried forward into the next and the recurring budget base is larger. Along with the effects of the revenue adjustments discussed above, this puts a strain on future budgets.

So, while the estimated surplus for next year is \$635.4 million, the Legislature can only spend \$74.0 million of that on recurring programs without creating a deficit in the third year.

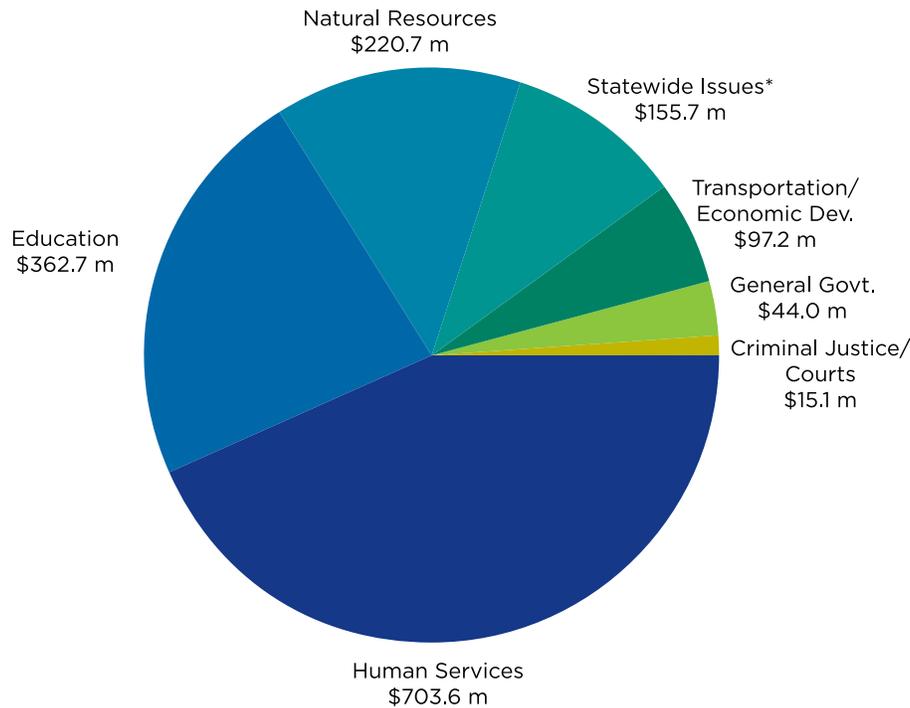
BUDGET OUTLOOK - FY2016-17			
<i>General Revenue - \$ in millions</i>			
	RECURRING	NON-RECURRING	TOTAL
2015-16 Base Budget	\$29,880.6	-	\$29,880.6
Transfer - Budget Stabilization Fund	-	\$30.4	\$30.4
Increase - Critical Needs	\$615.8	\$49.0	\$664.8
Increase - High Priority Needs	\$566.7	\$367.5	\$934.2
Cash Reserves	-	\$1,000.0	\$1,000.0
Total Needed for Continuation Budget	\$29,437.5	\$1,446.9	\$30,884.4
Available General Revenue	\$29,880.6	\$1,664.5	\$31,545.1
Tax Cuts & Trust Fund Sweeps	-\$234.5	\$209.2	-\$25.3
Balance	\$208.6	\$426.8	\$635.4

Source: TaxWatch analysis of the 2015 Long-Range Financial Outlook

¹ The Legislature often transfers money from trust funds, which has specified uses, to GR, which may be used for anything. For more information see Florida TaxWatch, Putting the Trust Back in Trust Funds, March 2014.

² This is the first year impact of the tax cut. Because recurring tax cuts usually have delayed effective dates, the first year impact is less than the annualized amount. The annualized amount (plus the non-recurring cuts) is \$305.6 million.

What Are the \$1.6 Billion in Estimated Increased Needs?



* Includes state employee salary and benefit increases, capital improvements, statewide technology issues, etc.

Source: Florida TaxWatch from data in the 2015 Long Range Financial Outlook

There will be \$31.545 billion in GR available in FY2016-17, which is only \$500 million (1.6 percent) more than last year. This is because there will be \$1.7 billion in non-recurring funds carried forward (unspent GR) from the current budget year. While this is a healthy reserve, there was \$2.4 billion carried forward for the current budget. There will be \$29.6 billion in recurring GR available for the next budget, \$1 billion (3.3 percent) more than this year.

The recurring GR base budget totals \$28.253 billion. There will be a required transfer to the Budget Stabilization Fund of \$34 million and it is assumed the 2016 Legislature with leave reserves of \$1 billion. The estimated critical and high priority needs of \$1.599 billion means that \$30.884 billion is needed to fund a continuation budget.

After adjusting for the estimated tax cuts and trust fund sweeps, a surplus of \$635.4 million remains.

CRITICAL NEEDS

Pre K- 12 Education – Maintaining per-student funding next year with an additional 25,887 students in Florida’s public schools will cost \$530.1 million; however, it is assumed that only \$0.2 million in GR will be needed. Increased lottery revenues in the Educational Enhancement Trust Fund (EEFT) and the State School Trust Fund will provide \$101.8 million. And since the Outlook assumes the same property tax millage rate for Required Local Effort school taxes, increasing property values will bring in another \$428.1 million. In fact, over the three year period covered by the Outlook, it is estimated that property taxes will provide \$1.51 billion (91 percent) of the \$1.66 billion needed to cover new students. Based on the Outlook’s projections, the local share of the Florida Education Finance Program (FEFP) will increase from 44.5 percent to 47.8 percent in three years. The other critical need in the Pre K–12 area is the Voluntary Pre-K program. Another \$1.3 million is needed to meet that enrollment increase, bringing the total GR needed to only \$1.5 million.

Higher Education – The increased revenue estimates for the EEFT also impact higher education, reducing the amount of GR needed to maintain current spending. This added revenue, along with reduction in the number of students eligible for Bright Futures scholarships, means that \$46.5 million less in GR will be needed for the critical needs in higher education.

Health & Human Services – The biggest budget driver is Medicaid, and its growth creates the largest addition in funding a continuation budget. Caseloads are expected to increase by 6.6 percent next year, adding nearly 250,000 persons to the program. Growth is expected to slow in the next two years of the *Outlook*, increasing by 4.2 percent and 3.0 percent. Total Medicaid enrollees are expected to top four million. Total expenditures (federal and state) for Florida’s Medicaid program are expected to grow by \$1.4 billion (5.7 percent) next year, reaching \$24.9 billion. The state share of the increase is \$755.9 million, \$593.4 million of which is GR. Despite a 2 percent rise in Kidcare caseloads, and increase in the share paid by the federal government will decrease the amount of state money needed.

Transportation and Economic Development – The Department of Transportation’s work program is not funded with GR, so transportation system needs are not reflected here. One critical needs item is included: \$23.6 million for the state match for federal FEMA disaster funding.

Criminal Justice – The *Outlook* does not project any added funding required for Criminal Justice critical needs. While there is a small estimated increase in the prison population, there is a current surplus of prison beds and there are less inmates in the current year than were anticipated when the current budget was passed.

General Government – Critical needs in this area will require \$24.5 million, due to state law requiring the Legislature to provide money to fiscally constrained counties to offset property tax reductions arising from two constitutional amendments. Non-Florida Retirement System pension and benefit programs (such as those for the Florida National Guard and disabled justices and judges) will cost \$0.5 million less in the next budget.

Administered Funds (Statewide Issues) – State contributions for state employee benefits are expected to increase by \$101.9 million next year, of which \$60.8 million will be funded with GR. A small amount of GR (\$1.4 million) will be needed for increase administrative hearing costs and the transition to the People First human resources information system.

HIGH PRIORITY NEEDS

Pre K-12 Education – In addition to maintaining per student funding as discussed above, the *Outlook* includes an increase in per student funding equal to the average of the last four years. This would be a 2.4 percent increase for the Florida Education Finance Program (FEFP), costing \$126.1 million next year. There is \$18.3 million provided for the Florida Personal Learning Scholarship Accounts Program, which allows parents to personalize the education of their children with unique abilities by enabling them to use the funds for a combination of services and programs. The additional funds are the three-year average increase of appropriations for these scholarships. Increases are also included for VPK (\$2.4 million) and the Florida School for the Deaf and Blind (\$1.3 million).

Higher Education - Increased funding based on the three-year average appropriations increase is provided for universities (\$182.9 million), colleges (\$43.2 million) and financial aid programs (\$19.3 million). An increase of \$5.2 million is also provided for the new Florida National Merit Scholar Incentive Program. Another \$8.9 million is provided for operational costs for newly constructed facilities already authorized by the Legislature.

Health & Human Services - \$16.7 million is included for additional Medicaid waiver slots for the elderly and individuals with brain and spinal cord injuries. Increases for the following agency programs are also provided for the following departments:

- *Children and Families* (\$44.7 million) – Community Action Teams, adoption subsidies, community based care, Healthy Families, child abuse investigations, sheriff grants, homeless coalitions, and mental health and substance abuse initiatives, as well as the restoration of some nonrecurring funding.
- *Health* (\$21.9 million) – Early Steps, cancer and biomedical research and child protection teams.
- *Persons with Disabilities* (\$14.2 million) – reducing the waitlist for developmental disability waiver, supported employee and intern programs and adult day training.
- *Elder Affairs* (\$5.9) – reducing the Community Care for the elderly waitlist, and Alzheimer’s disease respite services.

Criminal Justice and Courts – Funding is provided for an anticipated 4 percent increase in due process costs (\$1.4 million), juvenile justice prevention and intervention programs (\$6.2 million), replacement of vehicles (\$1.1 million) a revenue shortfall in the State Courts Trust Fund (\$3.3 million) and the renovation and repair of small county courthouses (\$3.1 million).

Transportation and Economic Development – An increase of \$3.2 million in GR is included for economic development and workforce programs (in addition to \$75.7 in trust fund spending). Funding for National Guard armories and other military affairs priorities (\$12.0 million) and the Department of State’s library, cultural, historical, and election priorities (\$58.4 million) is also included.

Natural Resources – Although there are no additional critical needs identified in Natural Resources in the *Outlook*, funding of \$378.5 (\$210.7 million in GR) is included for a myriad of environmental and agricultural high priority needs, including Everglades restoration, environmental land acquisition and restoration, beach restoration, water projects, and springs protection. Funding is based on the average of the last three years of appropriations.

General Government - \$17.4 million is included for general repair and maintenance of the state building pool and \$2.8 million is provided for other general government activities.

Administered Funds (Statewide Issues) - GR of \$64.3 million is provided for state employee bonuses and competitive, merit, and retention pay adjustments. \$29.2 million is provided for capital improvements for state buildings.

CONCLUSION

For the fifth year in a row, the Legislature heads into the General Session with an estimated budget surplus. This is good news, but the \$635.4 million surplus needs to be put into context. It is 2.1 percent of projected General Revenue spending.

The inclusion of estimated tax cuts and trust fund sweeps reduces some of the uncertainty about those two factors—it is assumed there will be significant tax cuts. However, in the short-term, trust fund sweeps largely offset the assumed cuts. The compound effect of tax cuts will put increased strain on future budgets.

The *Outlook* also provides for only a \$1 billion GR (cash) reserve; however, recent Legislatures have left larger reserves. Last year, the budget left \$1.2 billion in GR reserves, and reserves in the prior two years both exceeded \$1.6 billion.³ A reserve of more than \$1 billion will reduce the surplus. Spending the surplus also has a compounding effect on future budget. If the Legislature was to spend more than \$74 million of the surplus on recurring programs, an estimated deficit would be created in two years. This may be another incentive for legislators to leave some of the FY2016-17 surplus in reserve.

The *Outlook* also assumes that the millage rate for Required Local Effort school property taxes will stay the same. This is an understandable assumption, as this has been what the Legislature has chosen to do recently. Due to rising property values, the same millage rate will bring in \$428 million in additional taxes, 81 percent of the \$530 needed to fund the anticipated additional public school students. Although it is seldom characterized this way, most of that \$428 million should be considered a tax increase.

³ These are planned reserves, or the amount left after appropriations. A number of things can change the level of reserves from what the Legislature had anticipated when it passed the budget. For example, vetoes can add the reserves and changes in revenue estimates can increase or decrease reserves. The current year reserves have risen from \$1.2 billion to \$1.7 billion, due to improved GR estimates after the budget was passed.

Some legislators have already questioned this additional revenue,⁴ so a reduction in the RLE millage rate may be considered, which would increase the amount of state funds needed.

There will also be additional new spending initiatives advanced by legislators, including member projects. But the Legislature does not have to fund all of the \$934.2 million in High Priority Needs identified in the *Outlook*. Those programs will compete with other new initiatives and possibly tax cuts in excess of the amount assumed in the *Outlook*.

It should also be remembered that these are still estimates. *The Outlook* anticipated no shortfall for FY2012-13, but subsequent reductions in revenue estimates led to a \$1.2 billion shortfall for the Legislature to deal with. The state's estimators will meet again before the 2016 Session is over and while revenues appear to have stabilized, estimates do change. There are risks to the estimates, including the risk of a global recession and stock market losses.

Senate Appropriations Chair Tom Lee has announced the Senate will be undertaking a thorough review of the budget base, and searching for efficiencies and unnecessary spending.⁵ Florida TaxWatch commends this effort and reiterates its recommendations that the Legislature consider this another tight budget year and continue to look for ways to reduce the cost of the current budget, such as the cost-savings recommendations published by Florida TaxWatch.

⁴ Miami Herald, "Historic' school funding hike relies on higher property taxes," September 17, 2015.

⁵ Senate Appropriations Committee meeting, September 17, 2015. Video at flsenate.gov/Committees/Show/AP/.

ABOUT FLORIDA TAXWATCH

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106 N. Bronough St., Tallahassee, FL 32301 o: 850.222.5052 f: 850.222.7476
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