VERMONT

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Adam Greshin, Commissioner

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

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

RE: FY2026 Budget Development Guidelines and Initial Submissions

DATE: August 23, 2024

Adam Greshin Digitally signed by Adam Greshin Date: 2024.08.23 11:29:09 -04'00'

Introduction

The Administration's FY26 state budget will prioritize revitalizing and strengthening communities that have experienced the most negative demographic trends and damage from floods. This will be achieved through continued focus on the fundamentals: Growing the labor force by supporting private sector job creation and improving the quality, supply and affordability of housing; helping families keep more of what they earn; improving public safety and holding criminals accountable; providing a top-quality education to our children in a financially sustainable system; following through on once-in-a-century infrastructure investments; and adapting to and reversing climate change.

Budget proposals will be viewed – and prioritized -- through this lens.

The state's three major funds ended FY24 in good financial shape. Revenue came in slightly above forecast in the Transportation Fund and the Education Fund. The General Fund ended the year substantially above forecast, which allowed unbudgeted contributions to the General Fund Balance Reserve and the two public pension plans. And FY25 begins with $180 million of additional one-time General Fund revenue and much smaller amounts of additional one-time revenue in the Transportation and Education Funds.

It is important to note, however, that taxes and fees have been increasing substantially – over the Administration's objections and the Governor's vetoes – and households continue to feel policy-driven cost pressures in electricity prices, healthcare and soon home heating.

The revenue outlook for FY26 is a mixed picture. The Transportation Fund and the Education Fund – both dependent on consumption taxes -- face a difficult environment with the economy showing signs of fatigue and households continuing to tighten their belts due to inflation and policy-driven cost increases. But for the elimination of the sales tax exemption on cloud software and the hike in the short-term rental tax, non-property tax receipts in the Education Fund (which make up over 35% of Ed Fund revenue) would have declined slightly. And while projected revenue in the General Fund was upgraded substantially, most of the revenue upgrade came from rebasing personal income tax receipts to a 3% growth rate, as opposed to previous forecasts that predicted a decline. While this is welcome news to government budgeters, a 3% trend growth in a major tax component is more in line with historical norms than a cause for celebration. General Fund revenue is also supported by higher-than-expected interest income, a temporary benefit from the interaction of higher interest rates, which are already declining, and the state's large cash balance, which is slowly receding as appropriations are spent down to meet federal timeline requirements.

Given the mixed financial outlook, and the ongoing flood recovery effort, the Governor is focused on aligning base spending growth with revenue in ways that prioritize affordability for Vermonters.

The fact is, the large increase in General Fund revenue since COVID has been met by an even larger increase in base spending imposed by the Legislature, so large in fact that they've had to raise millions more in new taxes and fees on working Vermonters to balance their budgets. This is unhealthy and unsustainable.

In this context, agencies and departments are asked to submit budgets that **increase base spending no greater than 3% based on FY25 "As Passed" appropriations** and adhering to guidelines described below for statewide allocated costs. With wage and benefit pressures, and increases in program costs, departments will need to think strategically and ensure critical, effective services and priority initiatives remain adequately funded.

Context

The primary driver of budget development is the July Emergency Board (E-Board) revenue forecast which predicts a 1.1% increase in General Fund revenue in FY25 relative to actual results in FY24 (in January this was forecasted to be a 1% *decrease*), and a 2.4% increase in FY26. The E-Board upgraded available FY25 General Fund revenue by $182 million, which will be one-time money to invest in the FY25 budget adjustment. The FY26 budget will begin with a base that is $240 million higher than last year, however, given targets outlined above and below, this will be a challenging budget build.

- **Subdued Macroeconomy**
  Signs of an economic slowdown - or at least a normalization after years of heady growth driven largely by historic federal stimulus – are piling up. The job market is cooling, inflation is receding, and discretionary consumption appears to be flattening as households adjust spending based on rising costs. Looming above it all is a $2 trillion (and growing) annual federal deficit. Forecasters predict the Federal Reserve will initiate a round of rate cuts at its September meeting. The large General Fund revenue upgrade resulting from July's E-Board meeting may, therefore, seem counterintuitive. In reality, we are experiencing the full effects of federal COVID-recovery and infrastructure stimulus. An acknowledgement that we may be at a "new normal" with personal income tax receipts, as opposed to a COVID-inspired anomaly, led to the upward revision. Personal income taxes account for over half of General Fund

revenue, and a small forecast change in this one component has an outsized impact on available base revenue.

- **Vermont's Fundamentals**
  The country's three major credit rating agencies – Moody's, Standard & Poor's, and Fitch – recently reaffirmed Vermont's AA+ credit rating. However, each agency cited our aging population and limited labor supply as major impediments to further growth in the economy. We have a homegrown demographic challenge, highlighted by the rating agencies, which requires a determined effort to reverse.

- **The Decline of Interest Income**
  Last year we trumpeted the *return* of interest income which resulted from the interaction of historically high interest rates and the state's abnormally high cash balance primarily from massive amounts of post-COVID federal spending. As noted, forecasters are predicting the Fed will move short-term interest rates lower, and the state's cash balance is also slowly decreasing as money moves into contracted projects, some of which had long lead times. We can still expect to earn interest income – short term rates are unlikely to return to near zero, which is where they were for almost 20 years prior to 2022 – but the state's cash balance will steadily decline from its peak of almost $2.5 billion in 2023. While it may take a few years to return to its historic average of $300-$400 million, the trend has clearly started. The consensus revenue forecast calls for $70 million net interest in FY25 declining to $50 million in FY26.

Budget Development Process and Timeline
Initial FY26 budget proposals, FY25 budget adjustment proposals, and FY26-27 capital bill proposals are **due electronically to the Department of Finance & Management by Tuesday, October 15th.** 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. The Governor is not inviting 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.

- **FY25 Base Spending** – Please confirm with your budget analyst your Department's FY25 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) charges, and employee benefit rates (including health, dental, life, disability, and EAP) to be equal to FY25 As-Passed levels. Assume employer contribution rates for the Defined Benefit (DB) and Defined Contribution (DC) retirement plans to be equal to the levels currently in effect as of July 1, 2024 (26.7% for DB and 11.75% for DC). Finance & Management will communicate potential updates as soon as ISF budgets, insurance, and retirement rates are finalized and known.

- **One-Time Expenditures** – One-time expenditures should not be included in base budget proposals.

- **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 the Director of Policy Development and Legislative Affairs, Kendal Smith, to your budget analyst, and to 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 must 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 and what specific and measurable outcomes this position is expected to achieve. Please keep in mind the future costs of additional positions on your Agency/Department ISF 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, for consideration 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 must include feedback from ADS 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 FY26-27 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 clearly defined and measurable outcomes for Vermonters, as well as advancing equity. Delivering efficient, effective, and equitable services requires agencies to define the problems they are trying to solve and the 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.

An Impact Assessment form must be completed for all new initiatives and *any* substantive changes in service delivery. This ensures each proposal goes through a robust development process by posing questions in several key areas: problem definition, approach, impacted parties, delivery, and performance measurement and improvement. By incorporating this multi-faceted tool into our regular practice, we ensure programs are built efficiently, effectively, and with an equity lens.

Earlier this year, the Chief Performance Office and the Office of Racial Equity revised the Impact Assessment tool and the questions therein. A 45-minute informational webinar scheduled for Tuesday, September 10 at 11am will cover the changes that were made as well as some of the reasoning behind them. Registration is available at this link.

Budget Review Meetings
Budget review meetings will begin on Monday, October 21 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.

Programmatic 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 FY26, each agency must use the following process for reporting performance measures with their budget submission. Additional details on each step can be found in the technical supplement and at Annual Performance Measure Reporting (sharepoint.com). Note that a 45-minute informational webinar covering the history of PPMB, best practices for reporting on programs and their performance, what the expectations are for this budget cycle, and how to fill out Attachment A-2 is scheduled for Friday, September 6 at 1pm. Registration is available at this link. Entities without a Vermont.gov address should reach out to Justin.Kenney@vermont.gov to receive the invite.

1. Identify all operational programs within each appropriation. All appropriation level department IDs (aside from one-time appropriations and select appropriations that are not programmatic in nature) should be accounted for and have at least one program with associated performance measures being reported. A program is defined as a set of services or activities aligned and resourced to accomplish a stated outcome or result. All operational programs are expected to be included in reporting as a means of showcasing the variety and breadth of work being done under an appropriation.

2. Define and collect performance measure data for each operational program. Each program should report at least 3-5 performance measures. You are encouraged to include at least one of each of the following types of measures: quantity, quality, and result.

3. Compile data into the Attachment A-2 template. For ease of reporting, we have pre-populated each agency's Attachment A-2 with programmatic and performance measure data from prior submissions. Agency specific templates should be downloaded from SOV - Continuous Improvement - PPMB (sharepoint.com). The information within will need to be confirmed and updated accordingly, with new programs and measures being added as necessary. Entities without access to the SharePoint site noted above may request their templates directly from ADM.ContinuousImprovementTeam@vermont.gov. The Agency of Human Services may continue submitting data through Clear Impact Scorecard so long as the information contained therein includes similar elements to those found in Attachment A-2.

4. Agency/department leaders review data.

5. Submit Attachment A-2 Templates by October 15, 2024. Performance measure data are due at the same time as budget request submissions but should be sent as a separate email to ADM.Budget@vermont.gov and ADM.ContinuousImprovementTeam@vermont.gov. Please include PPMB in the email header so the Chief Performance Office and Department of Finance and Management can easily locate your submissions.

6. Edit submission (if needed). Following submission, programs may receive feedback on their performance measures from the Chief Performance Office which may result in refinements and revisions.

7. Agency/leaders discuss performance during budget meetings.

8. Annual performance measure reporting should be continuously improved by each agency every year. The process can become more beneficial to leaders and programs over time when they continue to add programs and measures and improve data quality. It is also important for programs and agencies to establish ongoing mechanisms for reviewing and updating data on a regular basis in between the budget process.

Budget Submissions

Please submit initial budget proposals for FY26 to the Governor by Tuesday, October 15, 2024. 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.