

Convergence

A Presentation to the South Carolina School Boards Association

DECEMBER 2, 2017

CHARLESTON, SOUTH CAROLINA

SENATE FINANCE COMMITTEE,

SENATOR HUGH K. LEATHERMAN, SR., CHAIRMAN

STAFF PRESENTATION BY MIKE SHEALY

Outline

- Economic Outlook
- Budget Outlook
- H. 3726, Pension Reform and Funding
- H. 3516, Transportation Funding
- Conclusion

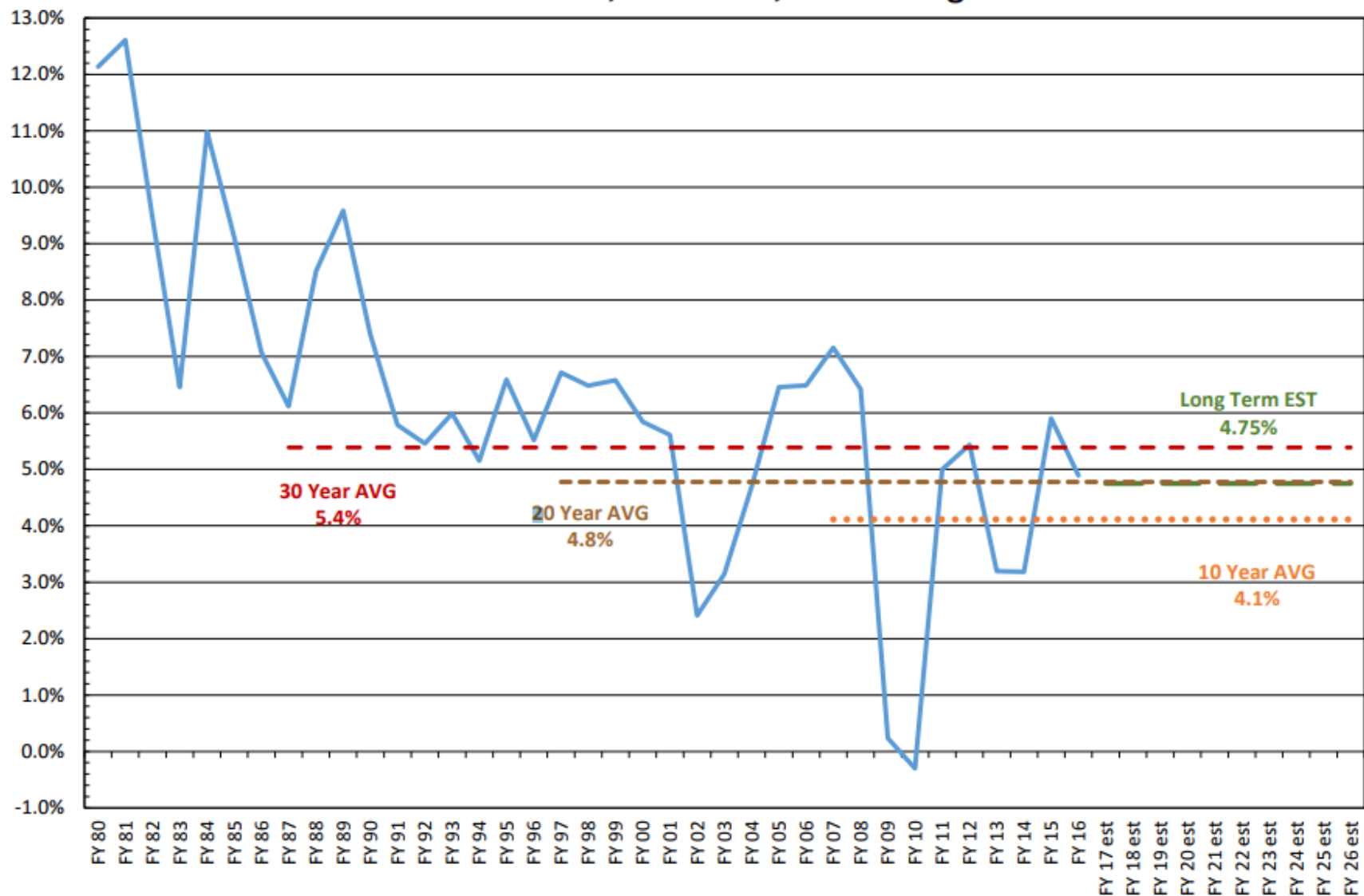
Economic Outlook

Let's take a look at the state's income growth, employment growth and population growth...



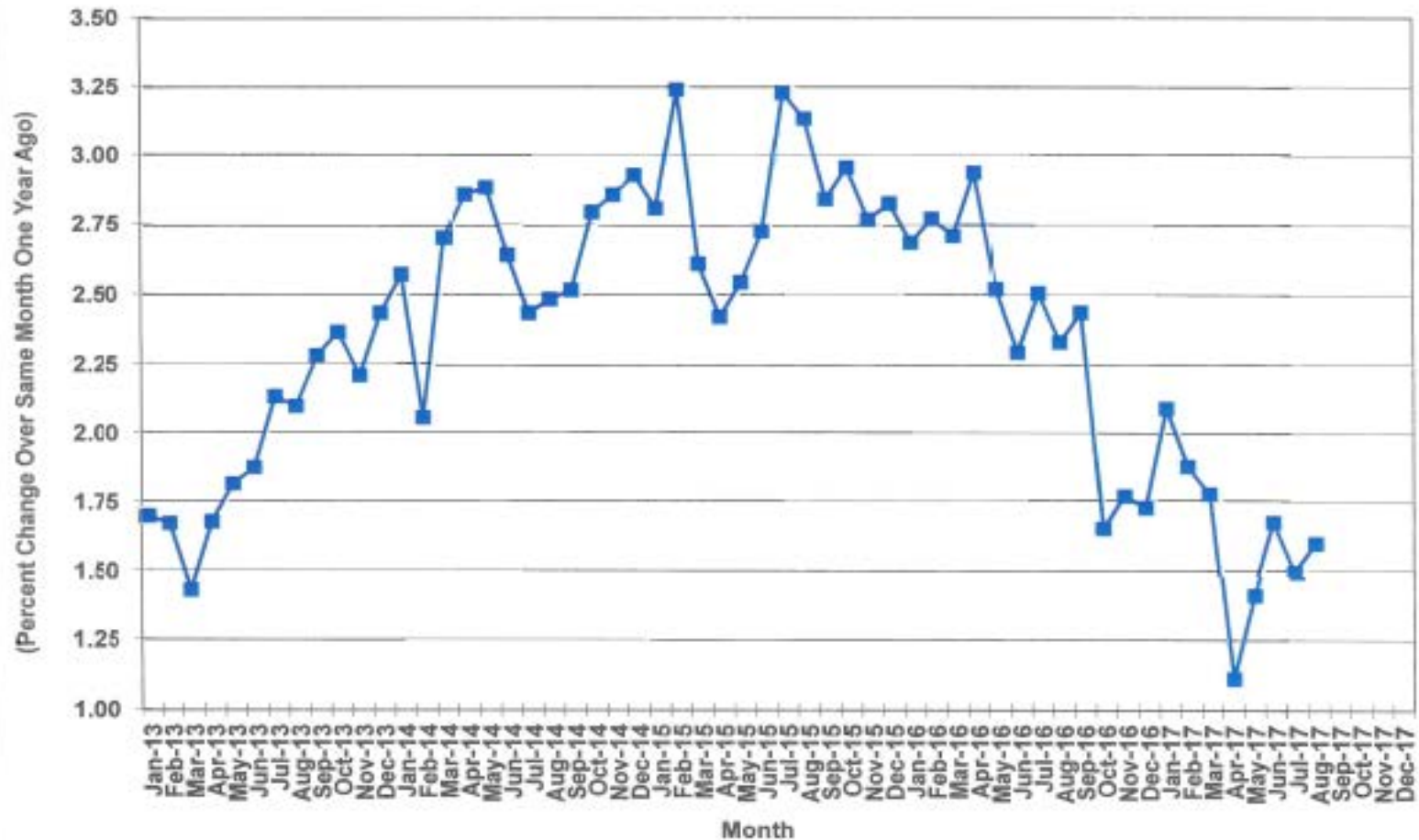
SC PERSONAL INCOME FY GROWTH RATES

Actuals, Estimates, and Averages



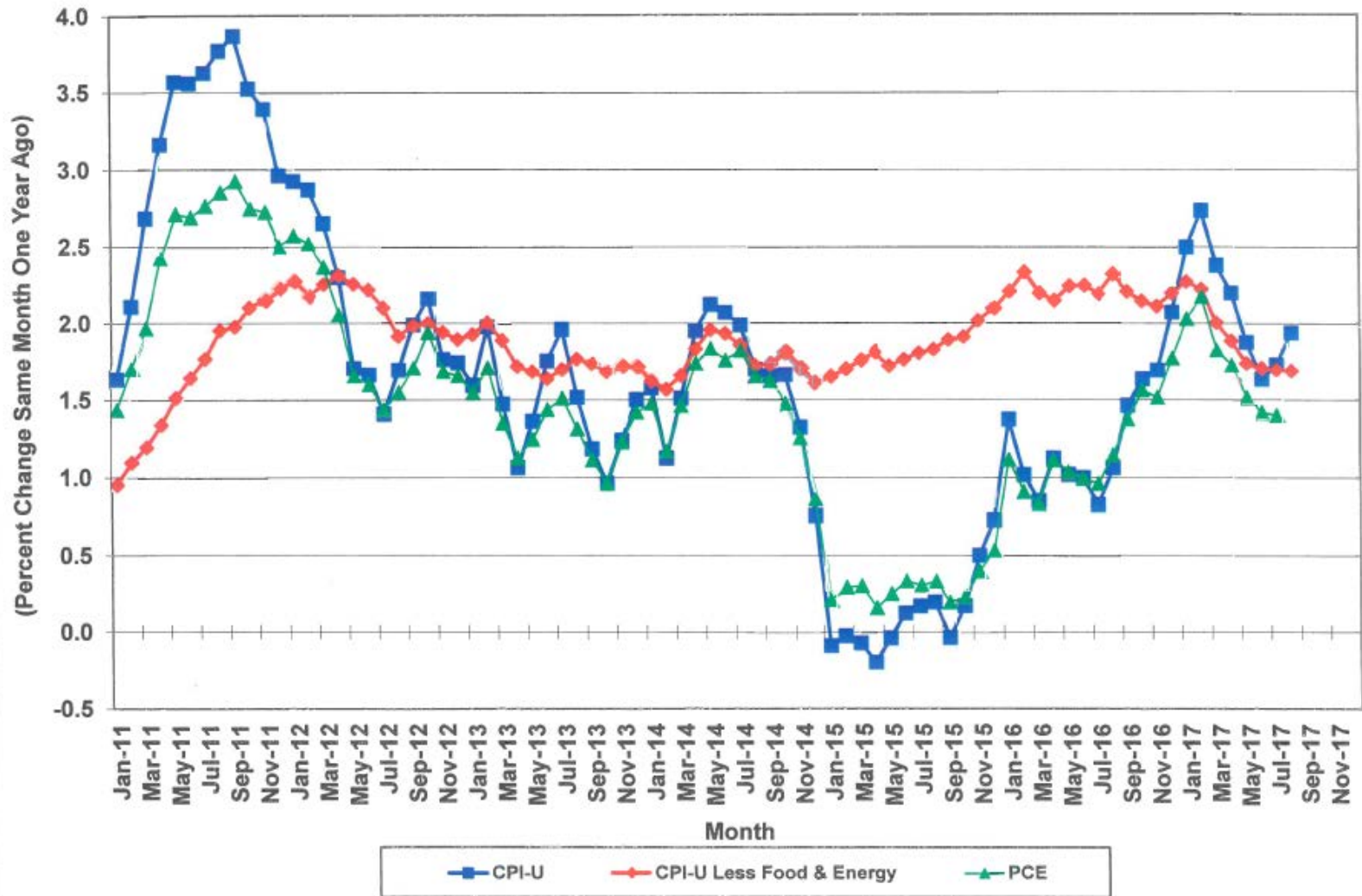
Source: US Department of Commerce, Bureau of Economic Analysis RFA – 173/lj/11/10/16

Total Nonfarm Employment Growth in South Carolina



Source: U.S. Department of Labor, Bureau of Labor Statistics
SCBEA/RWM/09/21/17

Inflation in the United States



Source: U.S. Department of Labor, Bureau of Labor Statistics

S.C. Board of Economic Advisors

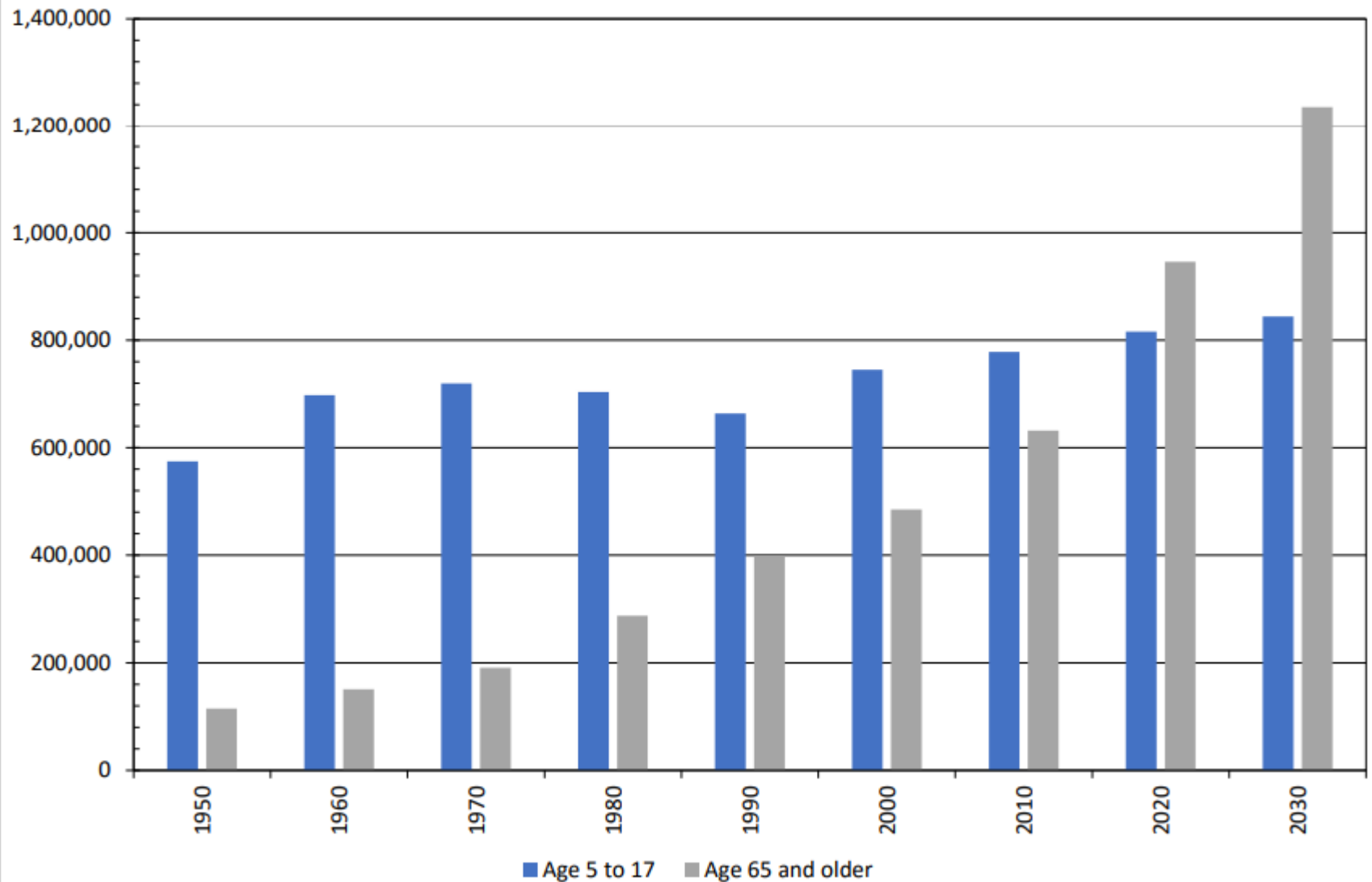
Palmetto State Population Growth 1960-2016



Population AGR Linear (Population)

SOUTH CAROLINA POPULATION TRENDS

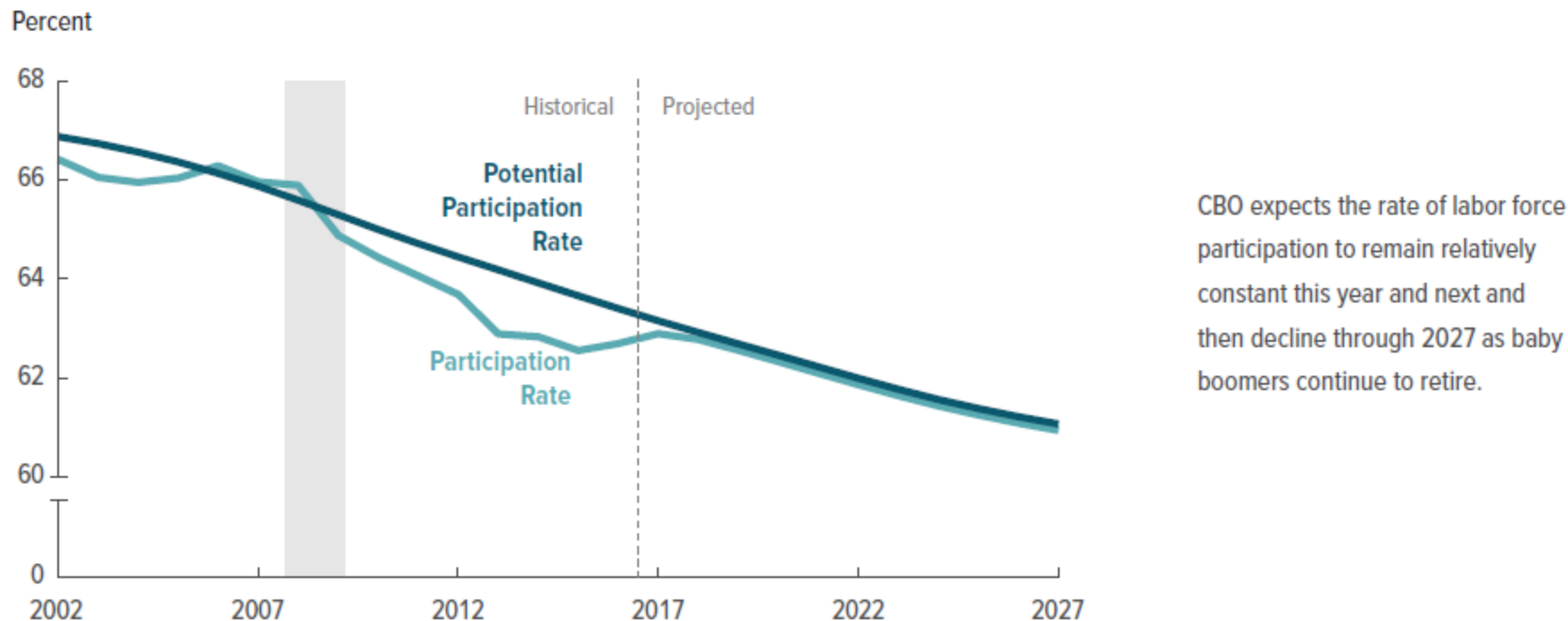
Age 5 to 17 and Age 65 and Older



Source: Revenue and Fiscal Affairs Office: LPW

Supplemental Figure 3.

Labor Force Participation Rates



Sources: Congressional Budget Office; Bureau of Labor Statistics.

The vertical bar indicates the duration of a recession, which extends from the peak of a business cycle to its trough.

The participation rate is the percentage of people in the civilian noninstitutionalized population who are at least 16 years old and in the labor force. The labor force consists of people who are employed and people who are unemployed but who are available for work and are actively seeking jobs. The potential participation rate is CBO's estimate of what the participation rate would be without the effects of the business cycle.

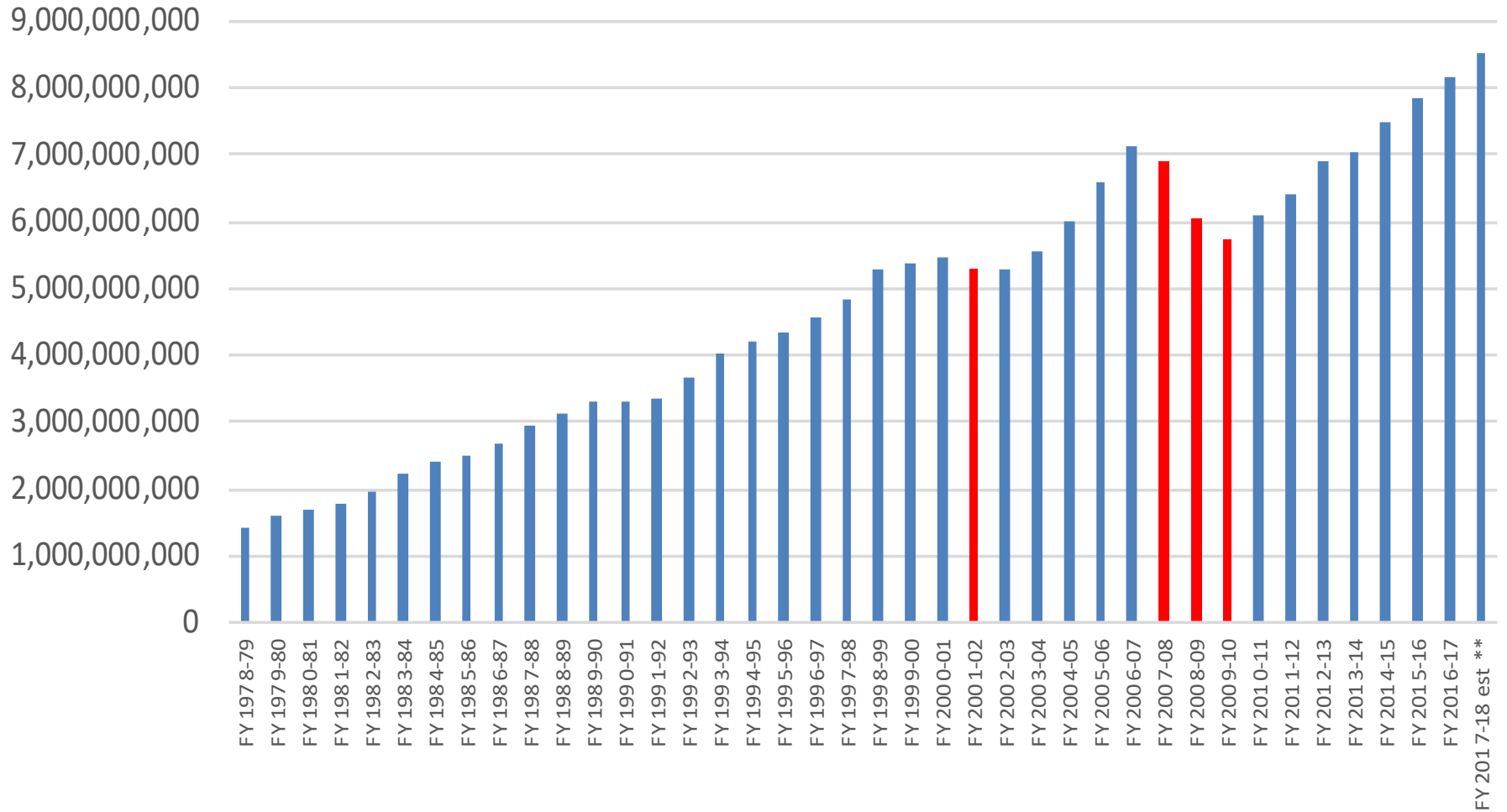
Data are fourth-quarter values.

Budget and Revenues

FY 17-18
Recap
and FY
18-19
Forecast.



Total General Fund Revenue



Where is the State Money Spent?

Pre- and Post-Great Recession

	FY07-08	FY17-18	Difference
K-12 Education	\$2,467,599,084	\$3,046,997,096	\$579,398,012
Health and Social	\$1,685,415,369	\$2,138,683,647	\$453,268,278
Higher Education - College Operations & Other	\$839,703,577	\$614,817,055	(\$224,886,522)
Higher Education - Scholarships & Grants	\$299,490,939	\$425,472,350	\$125,981,411
Correctional and Public Safety	\$593,358,615	\$709,943,818	\$116,585,203
Transportation (SCDOT)	\$186,590	\$137,861,654	\$137,675,064
All Other	\$1,129,360,663	\$1,293,728,566	\$164,367,903
Total	\$7,015,114,837	\$8,367,504,186	\$1,352,389,349

**Note: "State Money" includes recurring Part 1A "General Funds" and Lottery. Excludes EIA, CRF and other non-recurring appropriations.*

Source: Executive Budget Office

FY 2017-18 Recurring Appropriation Revenue Sources

General Fund (Gross)	\$8,533,988,000
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<i>Less Tax Relief Trust Fund</i>	<i>(\$583,649,169)</i>
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<i>Less Homestead Exemption Shortfall</i>	<i>(\$25,735,247)</i>
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General Fund (Net Available)	\$7,924,603,584
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Federal Funds	\$8,623,469,730
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Other Funds	<u>\$10,855,586,746</u>
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Total	\$27,429,395,307*
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**SC Total Personal Income in 2016 is \$192.6 Billion. So, the State Budget represents about 14% of economic activity in SC.

FY 2017-18 General Fund, EIA and Capital Reserve Appropriations

(incremental increases)

“New Money”

Recurring	\$417 Million
One-time	\$ 95 Million
CRF	<u>\$ 139 Million</u>
Total:	<i>\$651 Million</i>

Statewide Appropriations:

Pension Stabilization	\$118 Million
Employee Pay/Health/Dental/Pension	\$ 58 Million
Hurricane Matthew and Pinnacle Mountain	\$ 69 Million
Reserve Funds	\$ 22 Million
Local Govt. Fund	<u>\$ 10 Million</u>
Subtotal:	\$277 Million

State Agency Appropriations:

K-12 Education	\$ 80 Million
Health & Environment	\$ 149 Million
Higher Education	\$ 26 Million
Econ. Develop, Tourism & Natural Resources	\$ 83 Million
All Other	<u>\$ 36 Million</u>
Subtotal:	\$ 374 Million



Tracking General Fund Revenues

Are we at an inflection point?



Board of Economic Advisors General Fund Revenue Monitor

Revenues vs. BEA 02/15/17 Estimate of \$8,186.0 Million in FY 2016-17 1/

	JULY - 13th MONTH FY 2016-17			Revenue Growth Rates (%)	
	(\$ in Millions)			Estimate Full Fiscal Yr.	Actual Yr. to Date
	Actual Revenues	Expected Revenues	Excess / (Shortfall)		
Total General Fund Revenue	8,158.5	8,186.0	(27.5)	4.4	4.1
Sales Tax	2,896.3	2,903.3	(7.0)	3.0	2.8
Individual Income Tax	4,107.6	4,097.4	10.3	6.9	7.2
Corporate Income Tax	320.4	322.4	(2.0)	(21.6)	(22.1)
Other Revenue Sources	834.1	863.0	(28.8)	11.0	7.3
Select Tax Revenues, Sub-Total	685.5	720.7	(35.2)	12.5	6.9
Admissions Tax - Total	31.5	29.6	1.9	(4.0)	0.9
Alcoholic Liquors Tax	76.7	76.9	(0.1)	4.5	4.3
Bank Tax	53.4	40.0	13.4	35.9	81.3
Beer and Wine Tax	109.6	111.0	(1.4)	3.5	2.2
Corporation License Tax	68.2	115.2	(47.0)	29.9	(23.1)
Documentary Tax	51.7	46.5	5.2	0.7	12.0
Earnings on Investments	30.8	24.0	6.8	(4.7)	22.3
Insurance Tax	237.7	249.7	(12.0)	17.7	12.0
Tobacco Tax	26.4	27.8	(1.4)	(1.3)	(6.1)
Residual Revenue, Sub-Total 2/	148.7	142.3	6.4	4.6	9.3

1/: BEA format - includes certified adjustments and excludes non-recurring cash transfers and certain "other source" revenues, where applicable.

2/: Refer to p. 15, Residual Revenue, for list of components in this subcategory.

Note: Detail may not sum to total due to rounding.



Board of Economic Advisors General Fund Revenue Monitor

Revenues vs. 07/01/17 Adj. Appropriation Act of \$8,534.4 Million in FY 2017-18 1/

	JULY - OCTOBER FY 2017-18			Revenue Growth Rates (%)	
	(\$ in Millions)			Estimate Full Fiscal Yr.	Actual Yr. to Date
	Actual Revenues	Expected Revenues	Excess / (Shortfall)		
Total General Fund Revenue	2,751.9	2,780.8	(29.0)	4.6	2.5
Sales Tax	743.8	750.9	(7.1)	5.0	4.0
Individual Income Tax	1,726.7	1,755.6	(28.8)	4.6	2.3
Corporate Income Tax	67.4	87.1	(19.7)	7.5	23.3
Other Revenue Sources	214.0	187.3	26.7	2.3	(6.0)
Select Tax Revenues, Sub-Total	186.5	208.7	(22.1)	3.8	(7.2)
Admissions Tax - Total	1.2	1.9	(0.7)	(4.2)	(51.9)
Alcoholic Liquors Tax	17.2	18.1	(0.9)	4.7	(0.8)
Bank Tax	9.9	6.2	3.6	(40.9)	(6.6)
Beer and Wine Tax	27.7	30.7	(3.0)	4.8	(5.4)
Corporation License Tax	37.7	11.6	26.1	36.4	11.5
Documentary Tax	20.9	17.5	3.4	31.4	56.5
Earnings on Investments	5.6	5.4	0.2	(22.1)	(39.7)
Insurance Tax	59.7	63.9	(4.3)	1.8	(24.2)
Tobacco Tax	6.9	6.7	0.2	3.9	6.9

1/: BEA format - includes certified adjustments and excludes non-recurring cash transfers and certain "other source" revenues, where applicable.

Note: Detail may not sum to total due to rounding.

FY 2018-19 Budget Revenue Outlook

Recurring

*Projected FY 18-19 “New” Revenue (3.7% Change)	\$292.3 Million
DOT “Transfer Back”	\$50.0 Million
Net “New Money”	\$342.3 Million

Non-Recurring

FY 2017 Surplus:	\$0
Capital Reserve Fund:	<u>\$145.4 Million</u>
Net “Non-Recurring”:	\$145.4 Million
TOTAL Recurring and Non-Recurring	\$487.7 Million

FY 17-18 amount was \$651 M or \$172 M greater.

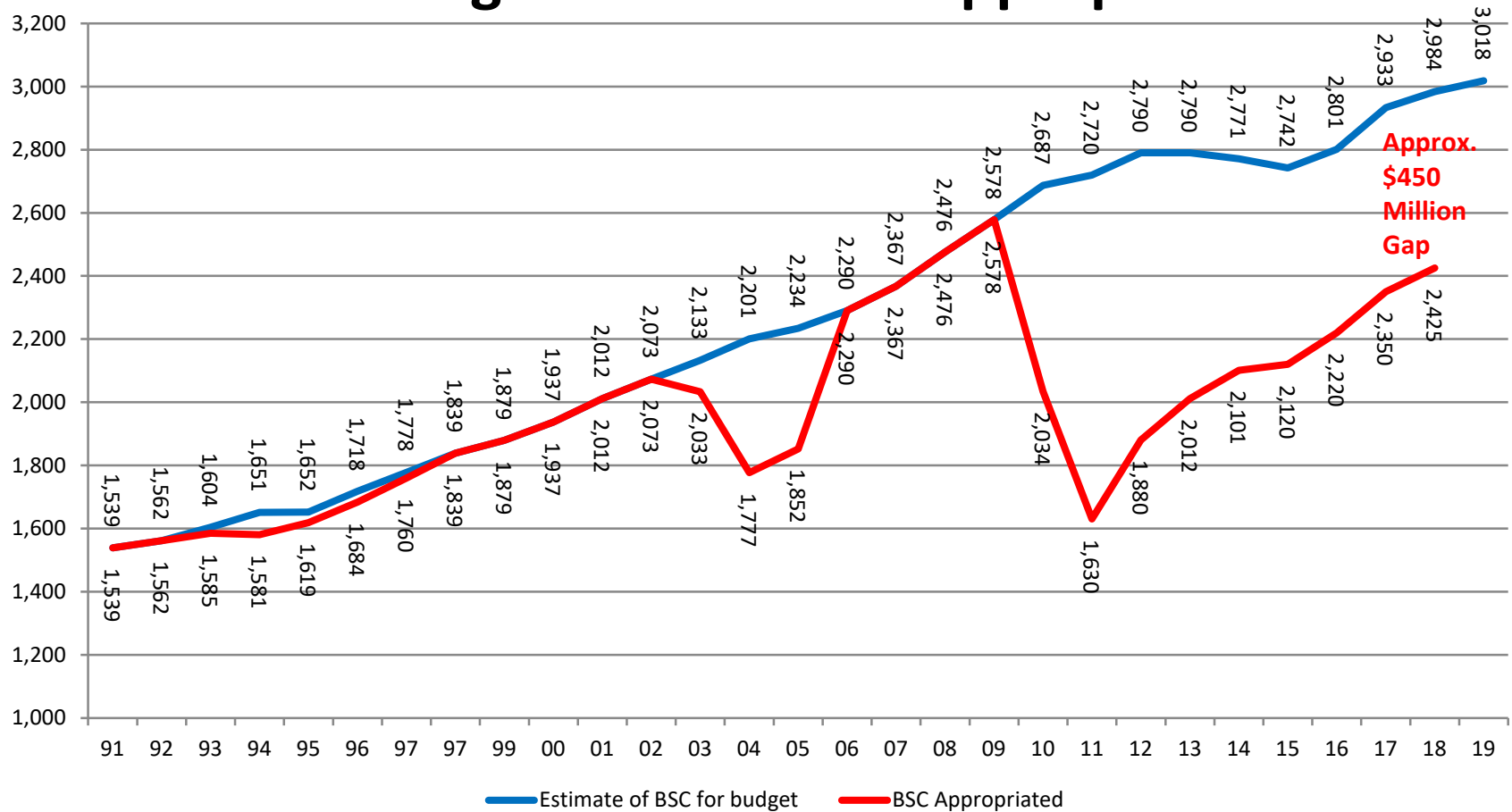
*Road Bill Tax Cuts (Year 1): (\$36 Million)

Source: BEA estimate 11/9/2017

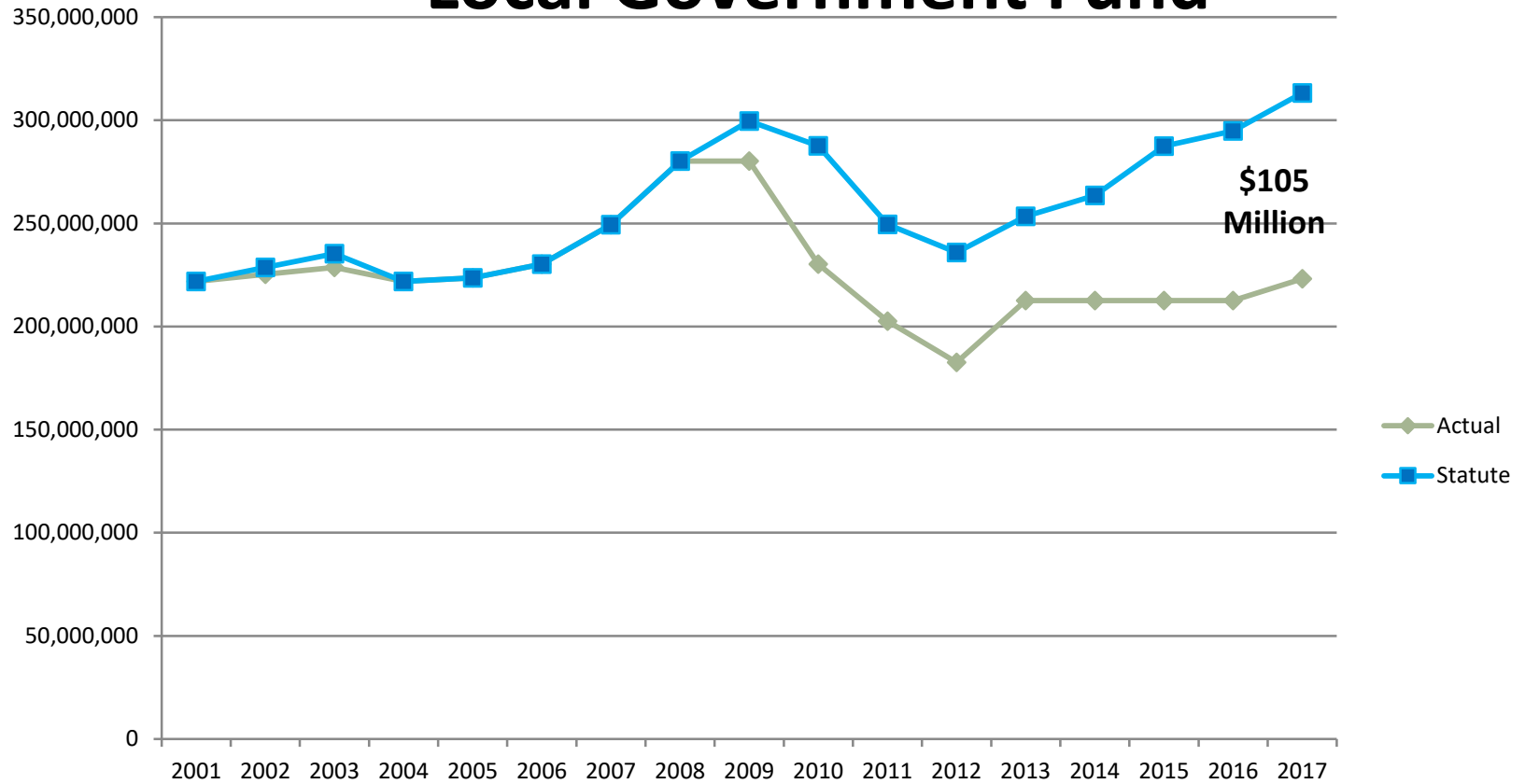
Question: What are the demands for the “new” dollars?

ANSWER: THE SAME DEMANDS AS LAST YEAR, WITH ONE NOTABLE EXCEPTION.

Base Student Cost Estimate Provided for the Budget and the BSC Appropriated



Local Government Fund



State Health Plan Budget Requirements for FY 2019

State-appropriated funds only

	Percent	EE only	ER and EE share proportionally		ER only
		EE+/month	State \$ (M) ¹	EE+/month	State \$ (M) ¹
Stay Grandfathered Current Plan	8.2%	\$56.04	\$60.6	\$12.38	\$71.2
Stay Grandfathered Current Plan (plus adult well visit)	9.6%	\$65.62	\$67.0	\$14.48	\$79.4
Stay Grandfathered Current Plan (with increase in patient liability ²)	6.5%	\$44.44	\$52.7	\$9.82	\$61.1
Stay Grandfathered Current Plan (plus adult well visit and increase in patient liability ²)	7.9%	\$54.00	\$59.2	\$11.92	\$69.4
Not Grandfathered Current Plan (plus annual adult well visit and other ACA-required benefits)	10.8%	\$73.82	\$72.5	\$16.30	\$86.5

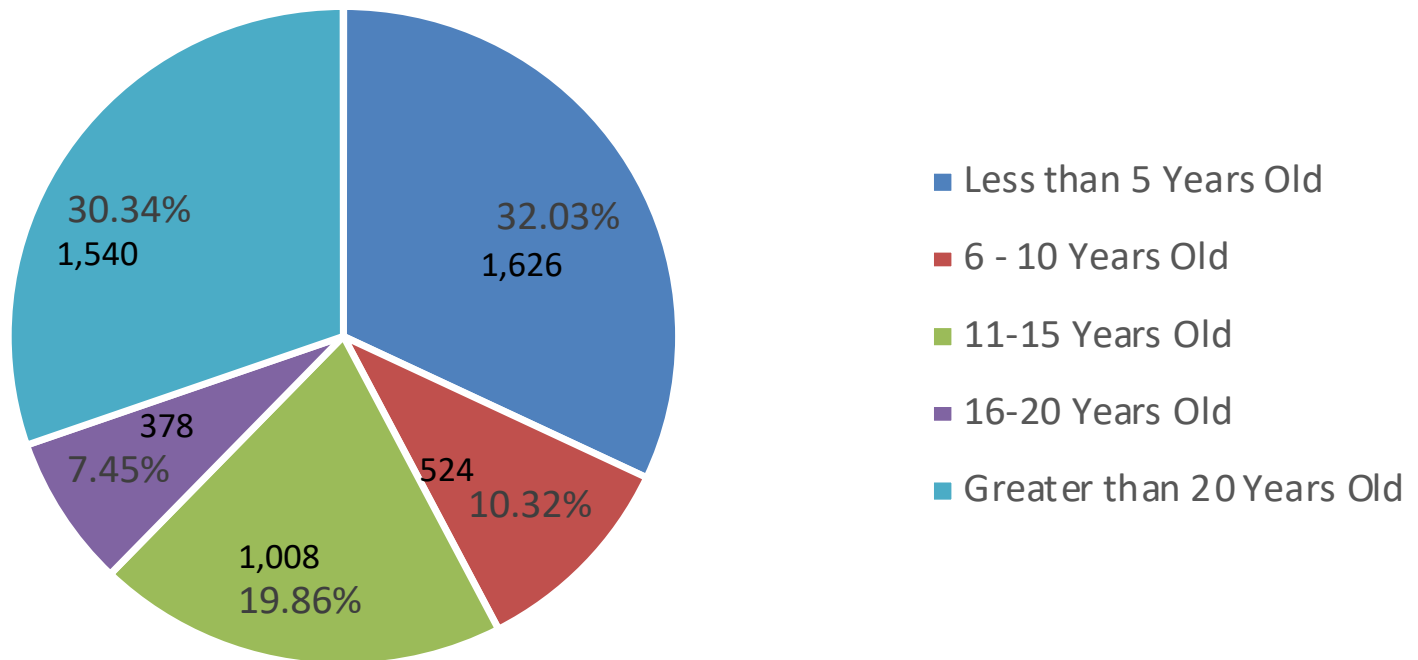
¹State \$ includes amounts for 2019 rate increase for January-June 2019, annualization of 2018 rate increase for July-December 2018 (\$14.1 million) and estimated retiree enrollment growth (\$9.1 million).

²Projected permissible changes in patient liability available on Slide 4.

School Bus Funding

Route District School Buses by Age

Total Number of Route Buses is 5,076



Source: SCDE School Bus Fleet Data 2017, data as of June 30, 2017.

Biggest Risk Not Discussed: Federal Tax Cuts

This issue is very important to the SCSBA because the individual income tax is about 50% of General Fund Revenues. So, budgeting will be based on estimates of very significant federal tax law changes ... and estimates can be inaccurate.



Elements of Federal Tax Reform

Corporate Tax Rate Reduction from 35% to 20%.

Individual Income Tax

Decrease top marginal rate.

Double standard deduction to \$24 K.

Eliminate Personal Exemptions

Limit other deductions primarily to charitable contributions and mortgage interest; no deductibility for state and local taxes.

*SC State Personal Income Taxes:
Starting Point for Calculating Taxes Due...
it Matters (a lot)*

South Carolina?

Gross Income

No

↓
Federal Adjusted Gross (AGI) Income **No**

(30 States = “Yes”, including GA and NC)

↓
Federal (Net) Taxable Income

Yes!

Impact of Federal Tax Reform... On SC Income Tax... and Taxpayers?

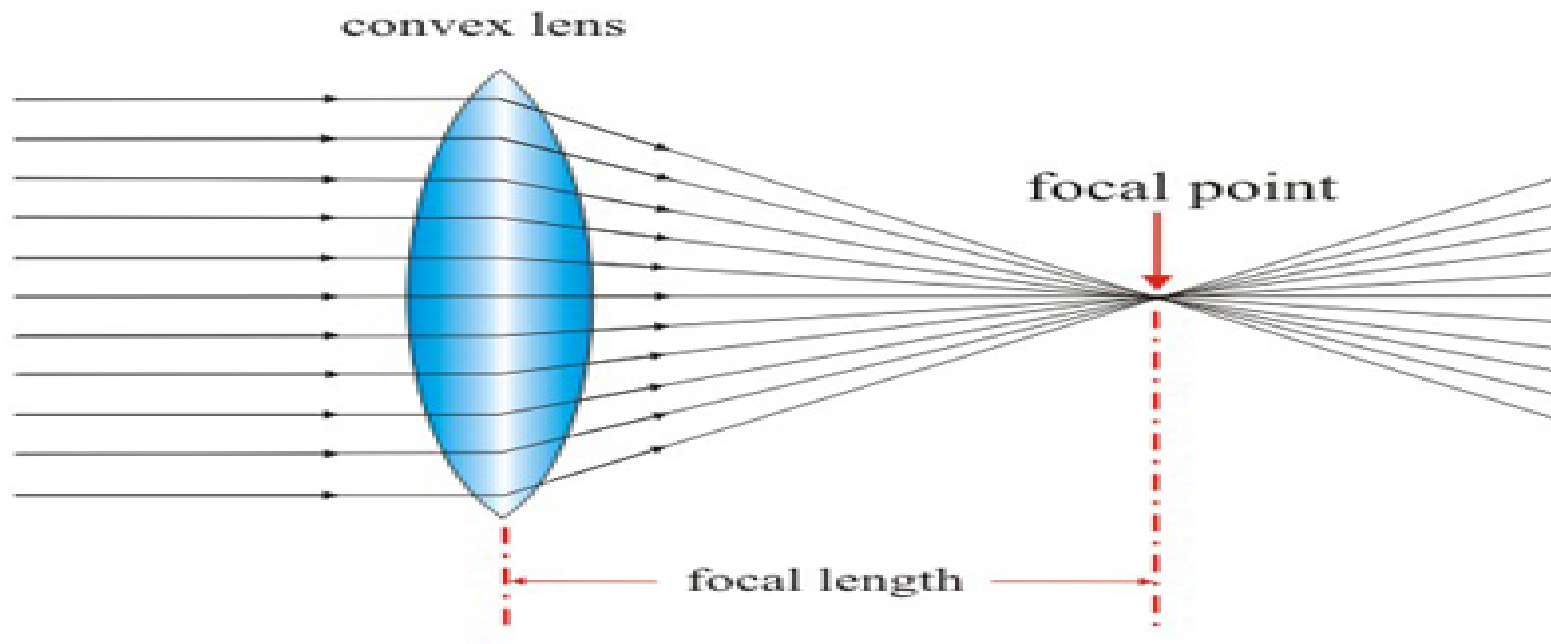
As a result of the changes, state taxable income is increased, and without any change to the state income tax brackets and rates, state individual income tax liability for South Carolina taxpayers will increase overall. The net increase in state individual income tax liability is estimated at \$492,466,000 for tax year 2018. This would increase General Fund income tax revenue by approximately \$25,854,000 in FY 2017-18 and \$440,758,000 in FY 2018-19, assuming South Carolina taxpayers adjust declarations to reflect the increased tax liability.

Based upon this analysis:

- 19.0% of returns will have a lower tax liability
 - New standard deduction is higher for these taxpayers
- 39.4% of returns will have a higher liability
 - 22.5% of returns due to the change to allowable itemized deductions
 - 16.9% of returns due to the change to the standard deduction and personal exemptions
- 41.5% of returns will be unchanged
 - The majority have zero tax liability under the current and proposed tax structure
- 41.9% of returns will have zero tax liability
 - This is a slight decrease from our current tax structure

Why “Convergence?”

Retirement Funding Reform and Transportation Funding Reform



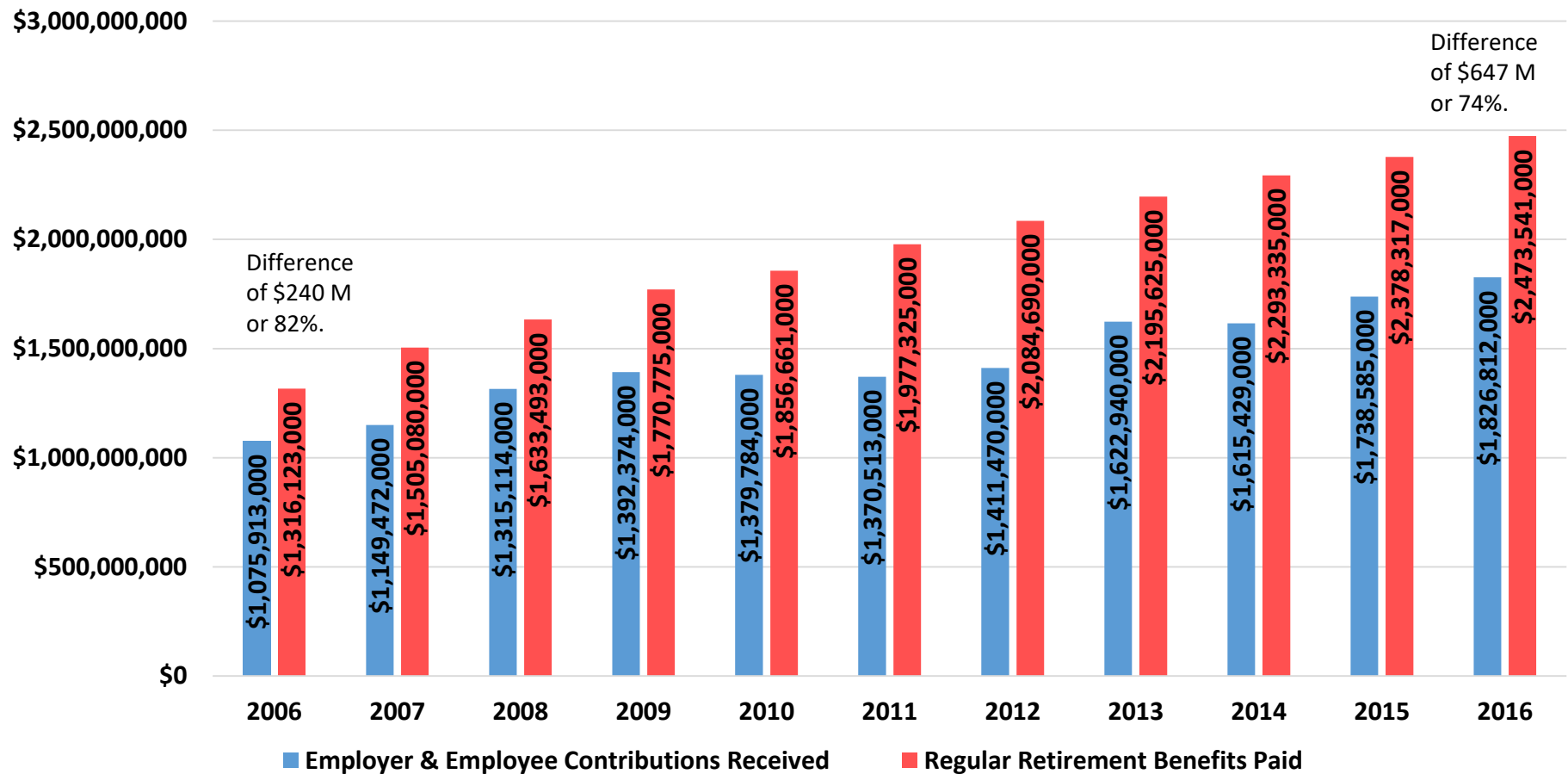
Both bills were the culmination of years of work in the legislative arena.



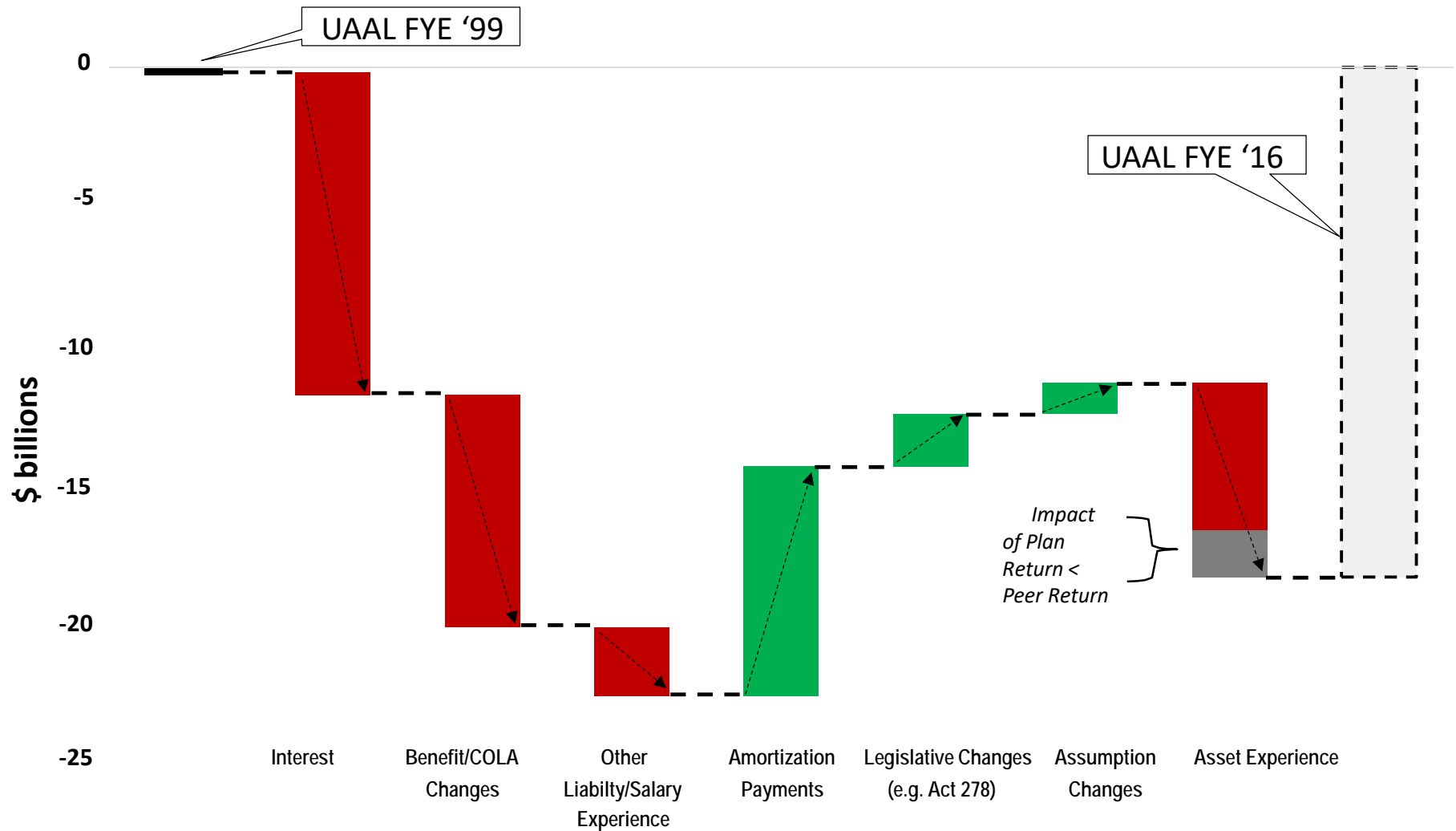
H. 3726, Pension Reform and Funding

SCRS Trust Fund

Comparison of Payroll Contributions Received and Regular Benefits Paid



SCRS Unfunded Actuarial Assumed Liability (“UAAL”) Reconciliation: FY ‘99 – FY ‘16



Pension Reform Act 278 of 2012

Return to Work (earnings limitation).

TERI Program Closed (6/30/18).

Retiree COLAs (1% up to \$500 annually).

Employee and Employer Contributions Rate linked (2.9% difference).

Lowered Assumed Rate of Return (8% to 7.5%).

Class III Membership (Rule of 90).

Note: Actuarial scenarios provided at that time predicted that employer contributions would peak around 19% of payroll in a 10 year time horizon to properly fund the System.

Act 13 of 2017

SCRS & PORS FUNDING IMPACT

- Expected new cash flow into SCRS and PORS from employers as a result of contribution increases required by Act 13 is \$73.6 million for FY 2017-18, and an additional \$36.8 million for each of the next 5 years.

EMPLOYER IMPACT						
July 1	Employer Rate Increase	General Fund	Local Government	Federal /Other Funds	Total All Funding Sources	Cumulative Total
2017	2.00%	\$73.6	\$67.4	\$95.4	\$236.4	\$236.2
2018	1.00%	\$36.8	\$33.7	\$47.7	\$118.2	\$354.6
2019	1.00%	\$36.8	\$33.7	\$47.7	\$118.2	\$472.8
2020	1.00%	\$36.8	\$33.7	\$47.7	\$118.2	\$591.0
2021	1.00%	\$36.8	\$33.7	\$47.7	\$118.2	\$709.2
2022	1.00%	\$36.8	\$33.7	\$47.7	\$118.2	\$827.4
				Total Additional Funds to System over 6 years		\$3,191.4

(\$ in millions)

PENSION FUNDING IN THE FY 2017-18 GENERAL APPROPRIATIONS ACT

The General Assembly allocated \$154.8 million funding to cover a portion (if not all) of the 2% employer contribution rate increases in FY 2017-18 for every employer that participates in SCRS or PORS as follows:

- The full 2% for:
 1. General-funded state and school district employees
 2. EIA-funded employees (teachers & other school employees funded through the EIA)
- 1% for:
 1. Federal-funded employees (including state agencies & colleges)
 2. Other-funded state and school district employees (also includes colleges)
 3. Local entities (counties, municipalities, associations, hospitals, special purpose districts)

South Carolina Retirement System (SCRS)

Projection Based on July 1, 2016 Actuarial Valuation

Investment Return Assumption is 7.50% for 2016, 7.25% for 2017 Through 2018, and 7.00% for 2019 and Thereafter

Assumes Emerging Investment Experience is 4.00% Per Year for FY 2017 - 2021 and 7.00% Each Year Thereafter

Maintain Current 5-Year Asset Smoothing Method

2.00% Increase in the Employer Contribution Rate at July 1, 2017, and 1.00% Increase at each July 1, 2018 through 2022 (Member Rate Capped at 9.00%)

(\$ in Millions)

July 1,	Employer	Member	Change in Employer Rate	Amount from General Fund (\$ millions)	Unfunded Liability	Funded Ratio AVA/AAL	Funding Period (years)	Interest on Unfunded Liability Column 4 x Int Rate	Amortization Payment	Positive (Negative) Interest Payment Column 8 – Column 7
2016	11.56%	8.66%			\$ 18,566	60%	23	\$ 1,392	\$ 1,111	\$ (281)
2017	13.56%	9.00%	2.00%	\$66.8	21,372	56%	25	1,549	1,357	(193)
2018	14.56%	9.00%	1.00%	33.4	22,976	53%	24	1,666	1,438	(228)
2019	15.56%	9.00%	1.00%	33.4	26,105	49%	26	1,827	1,540	(288)
2020	16.56%	9.00%	1.00%	33.4	27,441	48%	24	1,921	1,701	(220)
2021	17.56%	9.00%	1.00%	33.4	28,417	48%	22	1,989	1,869	(121)
2022	18.56%	9.00%	1.00%	33.4	29,116	48%	21	2,038	2,045	7
2023	18.56%	9.00%	0.00%	0.0	29,617	48%	21	2,073	2,100	26
2024	18.56%	9.00%	0.00%	0.0	29,782	49%	20	2,085	2,154	69
2025	18.56%	9.00%	0.00%	0.0	29,737	50%	19	2,082	2,211	129
2026	18.56%	9.00%	0.00%	0.0	29,475	52%	18	2,063	2,269	205
2027	18.56%	9.00%	0.00%	0.0	29,129	53%	17	2,039	2,339	300

Amount from General Fund estimated based on information from RFA in January 2017 indicating a .50% increase results in a \$16.7 million increase in general fund requirements.

Projection based on the July 1, 2016 actuarial valuation.



H. 3516, Transportation Funding

2.) General Fund Redirections to Roads, a Quick Summation

Year	One-Time	Recurring
2013	\$50 M – SCDOT bridges	\$109 M – ½ sales tax on cars, ACT 98 SIB funds
2014	\$13.5 M – CTCs	\$110 M – ½ sales tax on cars, ACT 98 SIB funds
2015	\$216 M – CTCs \$70 M – Volvo \$10 M – CTCs (from Aid to Counties)	\$110 M – ½ sales tax on cars, ACT 98 SIB funds
2016	\$50 M – backfill of NFAHF from ACT 275 redirect \$49 M – FEMA flood match \$50 M – ACT 92 (2015) SIB funds to CTCs	\$116 M – ½ sales tax on cars, ACT 98 SIB funds \$66 M – ½ (remainder) sales tax on cars from ACT 275 \$85 M – backfill of DMV fees and fines
TOTAL	\$508.5 M	\$596 M

\$1104.5 B from the General Fund since 2013.

\$216 M permanent (2016-onward) recurring reduction from the General Fund.

2.) Road Funding... and Tax Cuts

	FY2018-19 (year 2)	FY22-23 (year 6, full implementation)
New Road Funding	\$281 M	\$622 M
- REBATE*	-\$40 M	-\$114 M
- Earned Income Tax Credit (nr)	-\$20 M	-\$40 M
- Enhanced Two Wage Earner Credit (nr)	-\$3 M	-\$16 M
- Enhanced College Tuition Tax Credit (nr)	-\$6 M	-\$7 M
- Manufacturing Property Tax Exemption	-\$6 M	-\$30 M
Total Tax Relief	\$75 M	\$207 M

*rebate sunsets in FY 2023 unless reauthorized by the General Assembly. Rebate is paid for by the SCDOT first using the revenues generated from the maintenance fee imposed on out-of-state motorists and then by other unrestricted revenues available to the department. **indicates from General Fund.*

Lawsuits pending:

Act 275 of 2016 – Sloan v. SC Senate, et. al., filed 1/27/2017: plaintiff alleges that the act violates the one-subject provision in the SC Constitution.

Act 40 of 2017 – Folks v. SC Senate, et. al., filed 8/11/2017: plaintiff alleges that the act violates the one-subject provision in the SC Constitution.

Act 40 has a direct impact on the Annual Budget Process:

Leading up to 2017, transportation “cut the line” and redirected General Fund Revenues to a function usually underwritten by transaction fees.

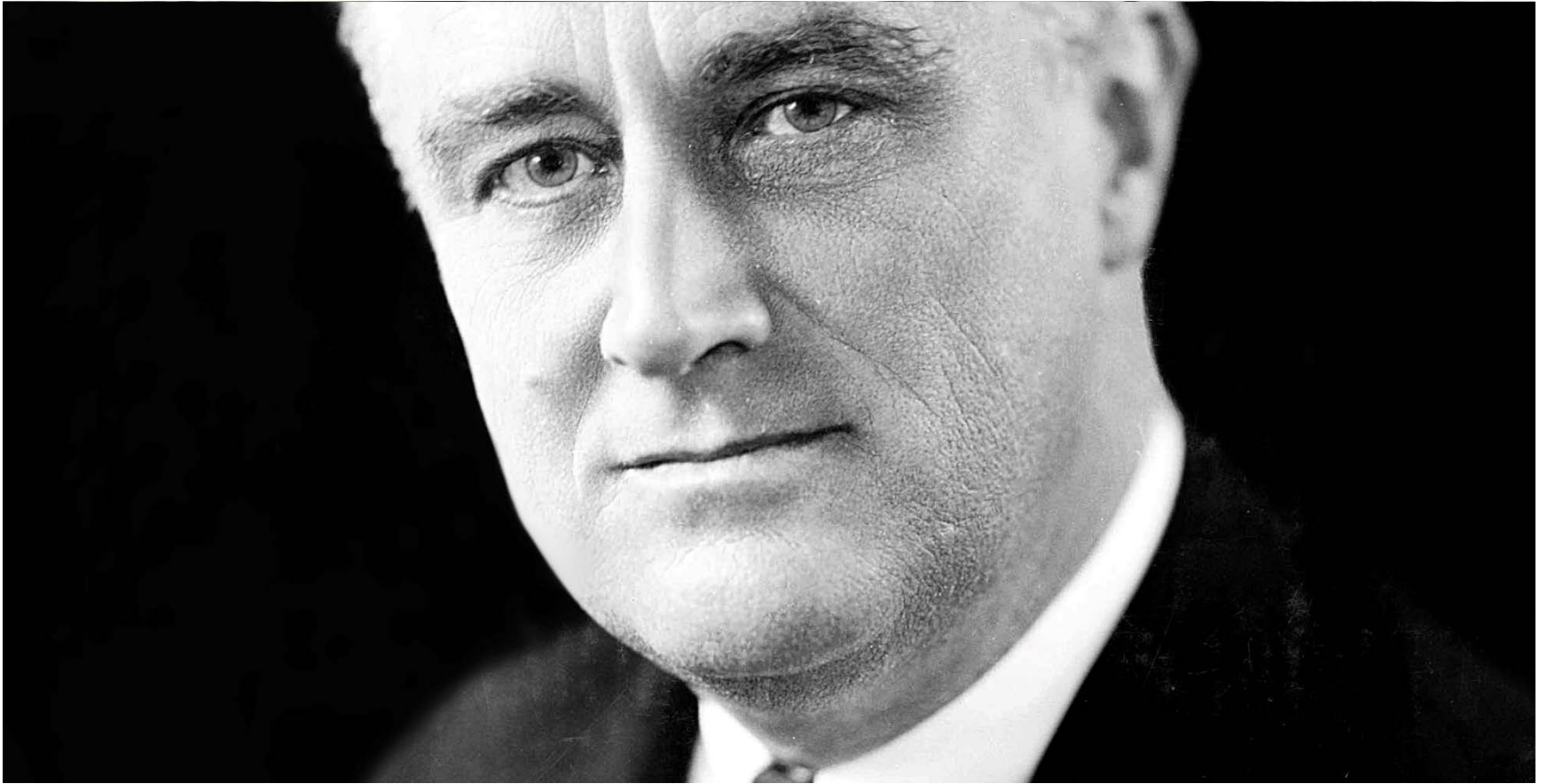


The Take Away

- This budget cycle will be similar to the past several years, but recurring revenue growth will be slightly muted and non-recurring revenues will be scarce. A modest mid-year cut is possible.
- The costs for pensions will increase over the next five years essentially to pay for benefit increases that have already been granted.
- For the short term and intermediate term, transportation funding has been addressed. However, in the short run, Act 40 of 2017 must withstand a court challenge. In the longer run, inflation and lower gasoline usage will undermine the fix.

Thank you for
your service to
our communities.

MIKESHEALY@SCSENATE.GOV



Franklin Delano Roosevelt

“Democracy cannot succeed unless those who express their choice are prepared to choose wisely. The real safeguard for democracy, therefore, is education.”