

State Senate Briefing

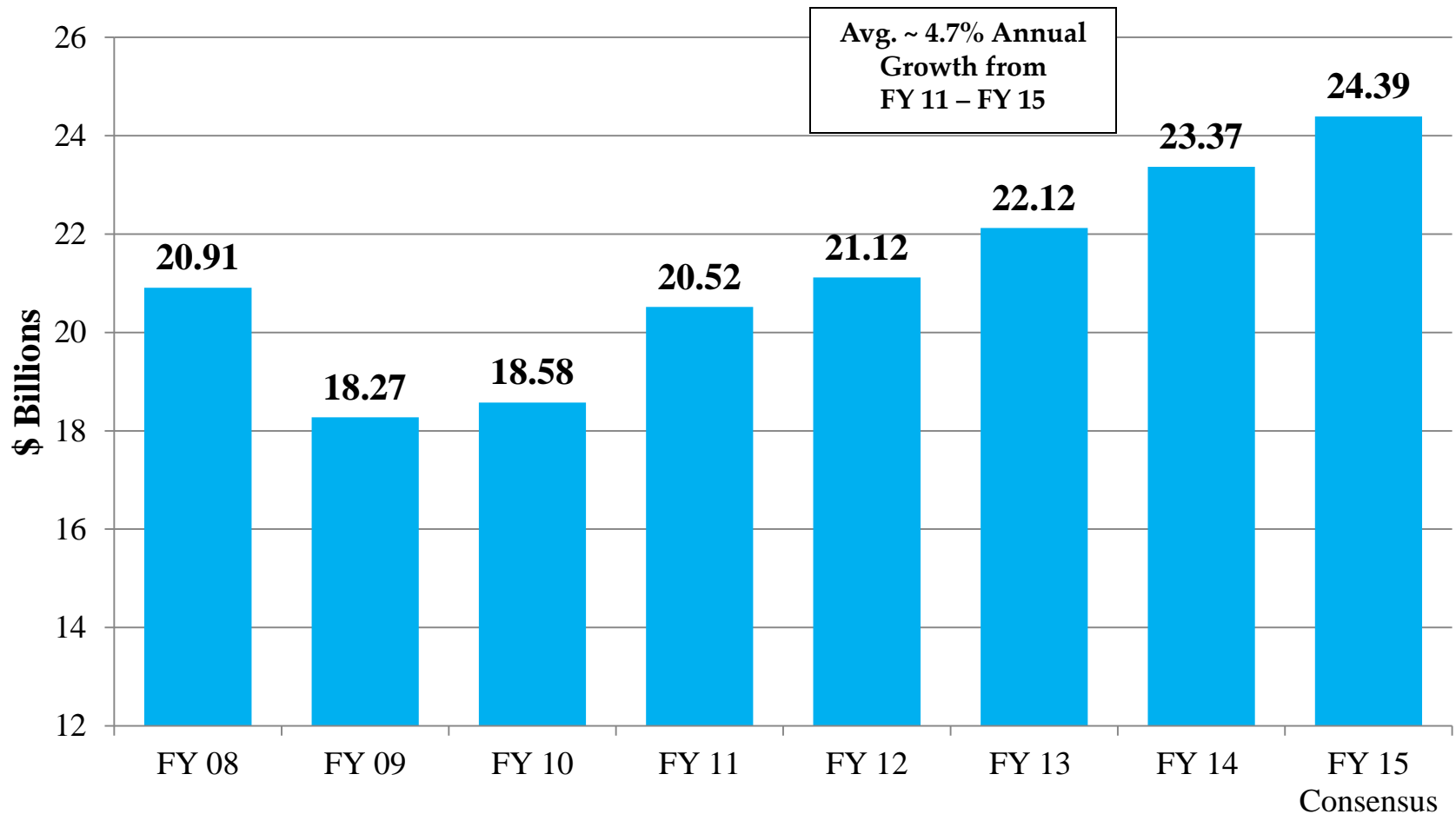
Michael J. Widmer, President
Massachusetts Taxpayers Foundation
December 4, 2014



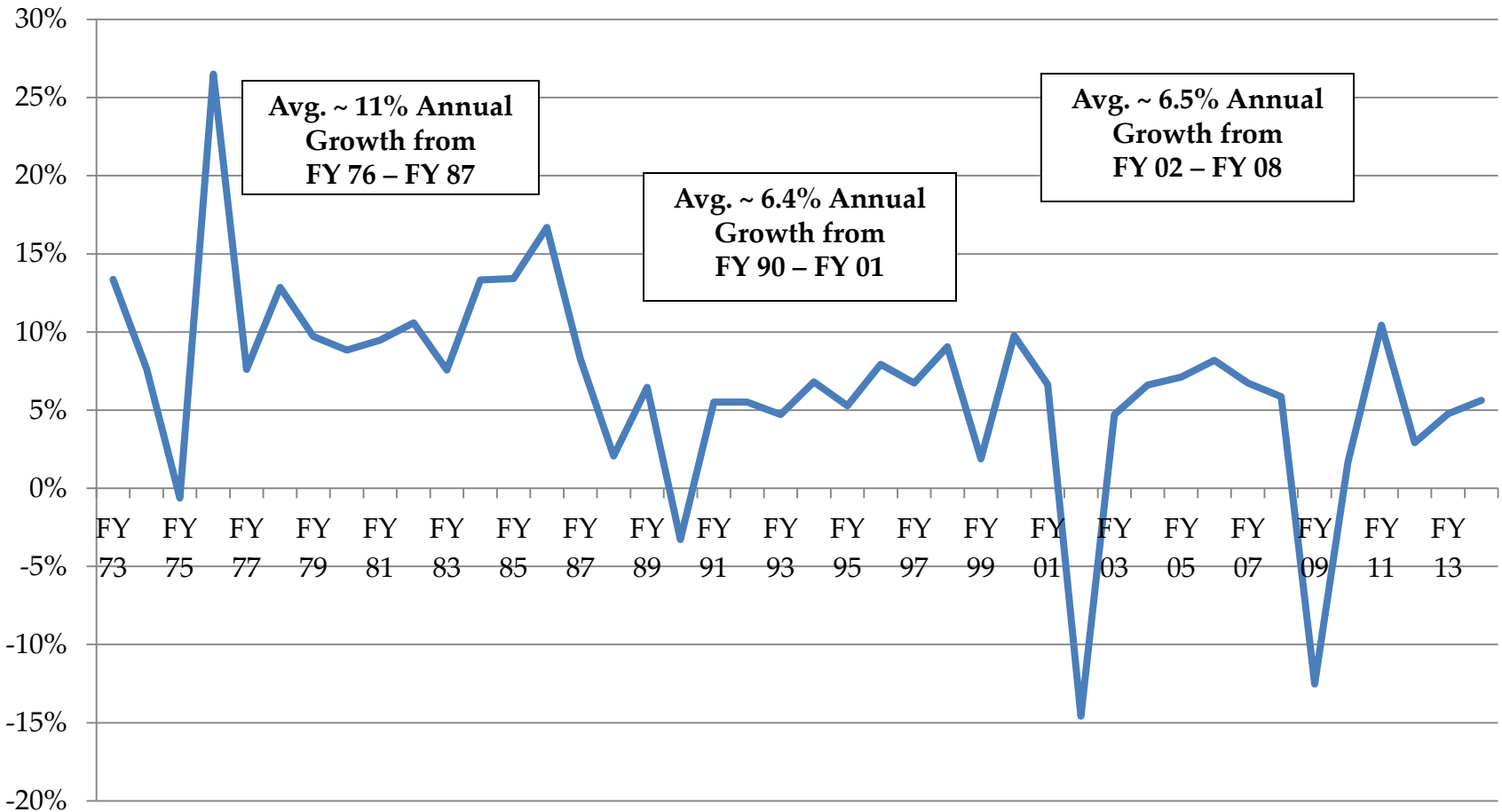
State Finances



Slow Recovery in State Tax Revenues Since Recession

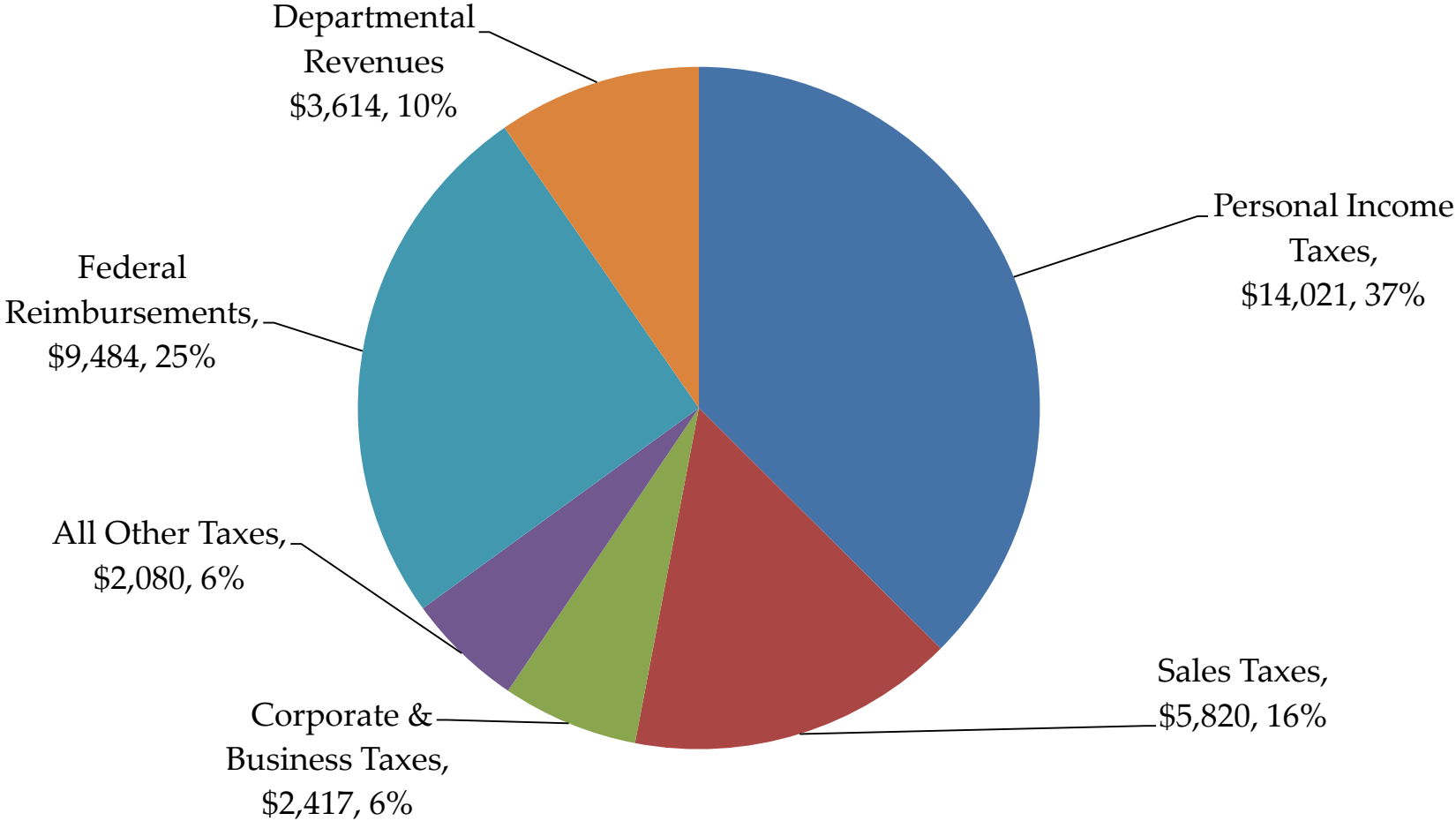


Previous Recoveries Have Seen Stronger Revenue Growth

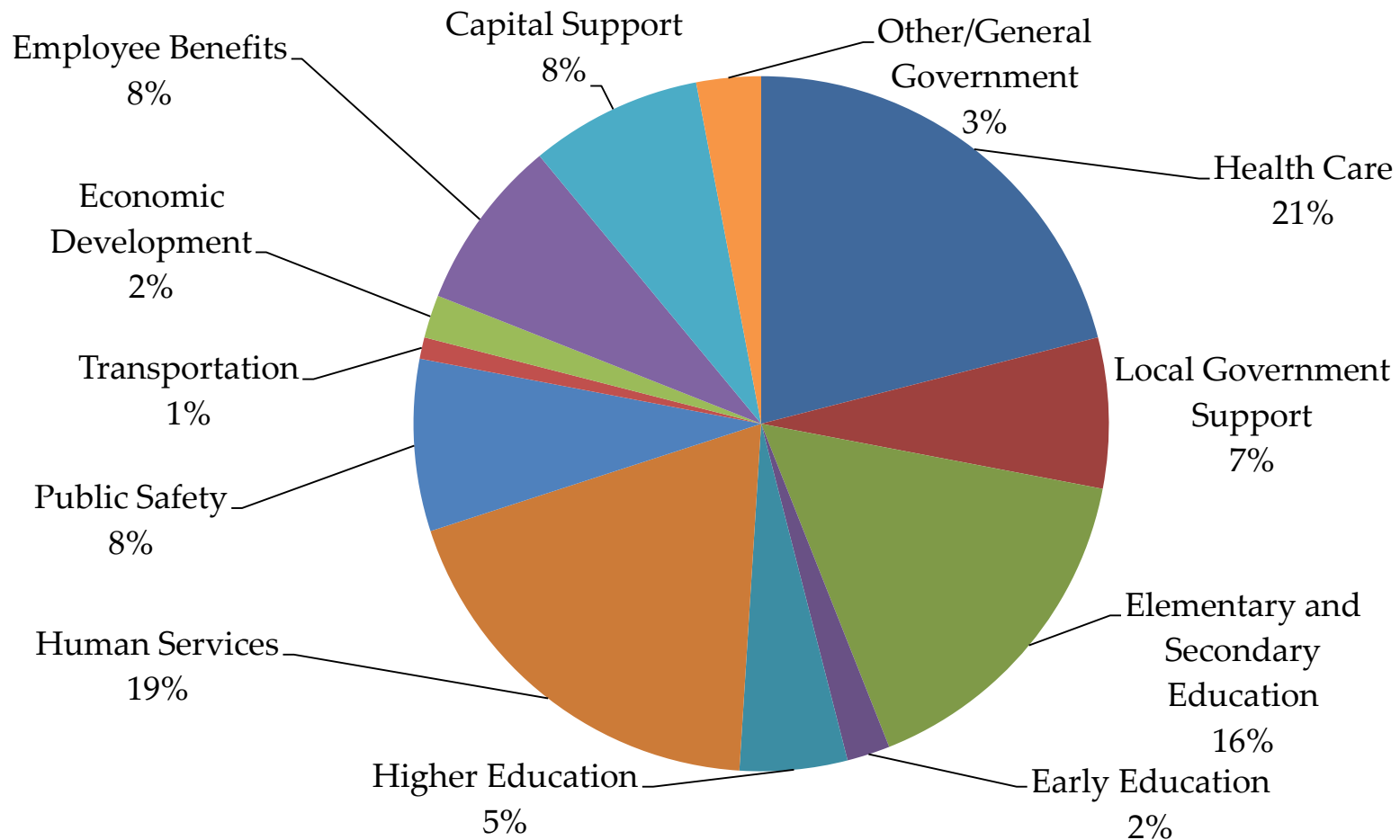


State Budget Revenue Sources – FY 2015

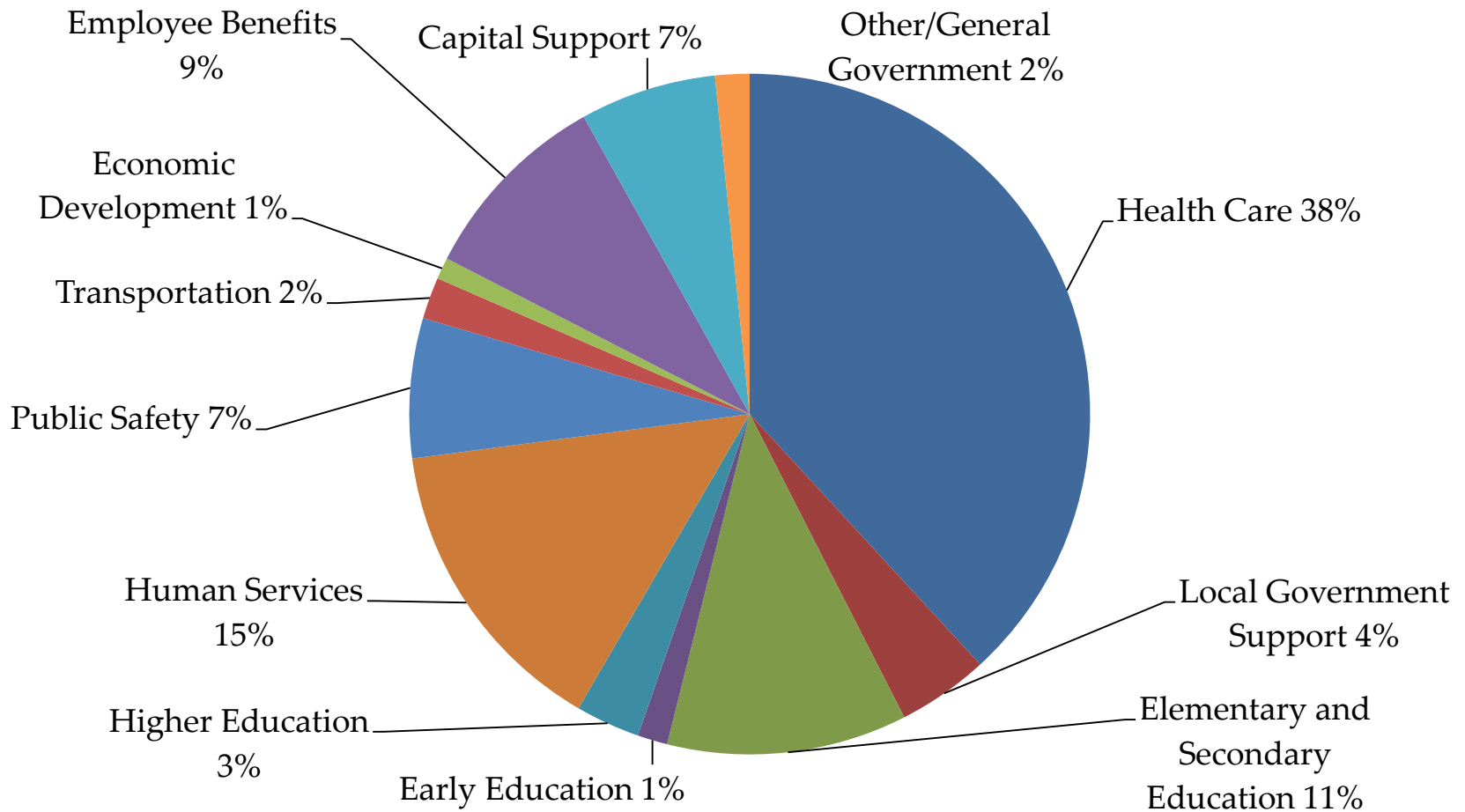
(\$ Millions)



FY 2000 State Spending



FY 2015 State Spending

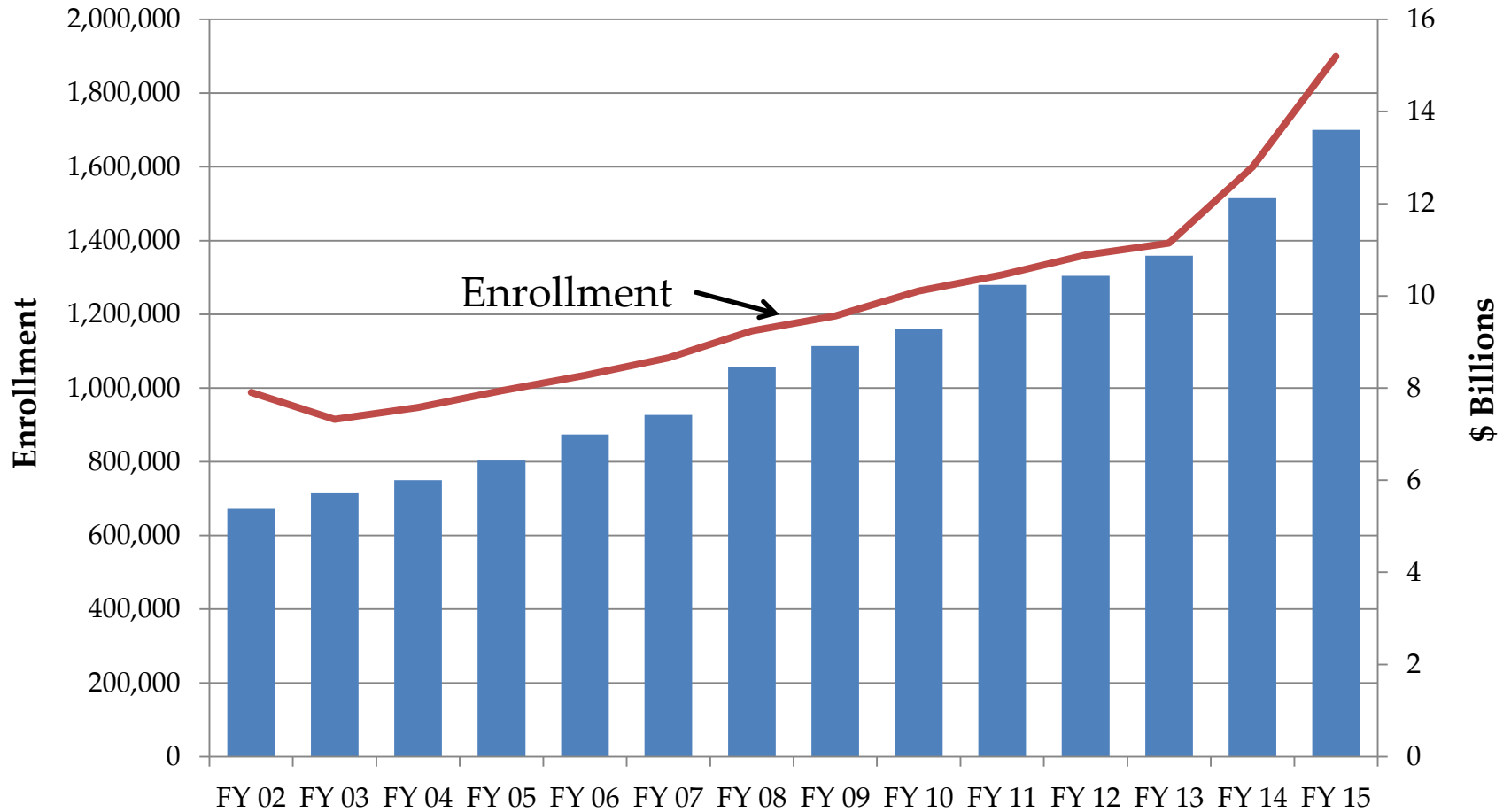


FY 15 State Budget

	FY 12 Final	FY 13 Final	FY 14 GAA	FY 14 Projected	FY 15 GAA		FY 12 Final	FY 13 Final	FY 14 GAA	FY 14 Projected	FY 15 GAA
Health Care	12,102	12,599	13,414	13,615	14,735	Public Safety	2,351	2,430	2,455	2,523	2,563
MassHealth	10,435	10,874	12,105	12,121	13,602	Corrections	569	579	584	591	602
Connector	823	905	600	600	268	Sheriffs	505	529	531	542	553
Trust Funds ¹	581	580	487	661	622	Judiciary	761	794	787	828	824
Other Health Care	262	240	222	232	242	Police	285	293	309	310	319
Local Government Support	5,641	5,765	5,904	5,920	6,080	District Attorneys	99	102	102	103	108
Chapter 70 Education Aid	4,108	4,186	4,303	4,303	4,404	Attorney General	40	40	43	43	44
Other K-12 Education Aid	517	571	589	602	633	Other Public Protection	93	93	98	106	113
Unrestricted Local Aid	927	927	948	948	973	Transportation	367	408	618	627	764
Other Local Aid	90	82	65	68	70	MassDOT/ Other	183	165	267	275	418
Other Education	1,457	1,507	1,607	1,629	1,731	Highways	0	56	0	0	0
Early Education	507	499	501	524	550	Regional Transit	15	19	68	68	40
Higher Education	950	1,008	1,106	1,105	1,181	Registry	9	9	9	9	9
Human Services	4,957	5,095	5,274	5,404	5,610	MBTA	160	160	275	275	297
Developmental Services	1,402	1,441	1,534	1,553	1,720	Economic Development	363	358	396	410	396
Family Services	902	911	944	977	1,025	Business and Labor	143	163	182	193	163
Cash Assistance	787	786	790	794	743	Environment and Energy	220	196	214	217	233
Mental Health	651	659	704	708	736	Employee Benefits	3,107	3,144	3,378	3,395	3,609
Public Health	517	522	556	560	590	GIC ²	1,214	1,177	1,328	1,345	1,396
Housing Support	337	406	356	420	379	State Retiree Benefits (OPEB)	414	415	420	420	420
Senior Support	240	240	251	253	272	Pensions	1,478	1,552	1,630	1,630	1,793
Veteran Services	121	130	139	140	145	Capital Support	2,253	2,362	2,423	2,429	2,498
						Debt Service	1,970	2,068	2,118	2,125	2,219
						Contract Assistance	283	294	304	304	279
						Other/General Government	560	568	529	711	630
						Sub-Total	33,156	34,236	35,997	36,662	38,616

Relentless Growth in Medicaid Enrollment and Expenditures

(FY 2002 – 2015)



FY 15 Projects 4.9 Percent Tax Revenue Growth

(\$ Millions)

	FY 14 Actual	FY 15 MTF	FY 15 Consensus	Change \$ Over FY 14	Change % Over FY 14
Income	13,211	14,169	14,021	810	6.1%
Sales	5,501	5,584	5,820	319	5.8%
Corporate	2,418	2,420	2,384	-34	-1.4%
All Other	2,070	2,201	2,112	42	2.0%
Total	23,200	24,374	24,337	1,137	4.9%



Revenues Falling Below Estimates

- Tax revenues are \$43 million below benchmark through November
- Non-tax revenues are \$179 million less than projected through November
- The state's income tax rate will decline from 5.2 percent to 5.15 percent on January 1, 2015
 - State revenue loss of ~ \$70 million in FY 15
- There have been only \$25 million in one-time corporate tax settlements in excess of \$10 million through November, well short of the \$240 million in the FY 15 budget



~ \$300 Million In FY 15 Budget Deficiencies Already Identified (Excluding Medicaid and Connector)

(\$ Millions)

Group Insurance Commission	75
State Retirement Benefits Trust Fund	75
Community Residential Support for Developmentally Disabled	43
Economic Development Legislation	82
Economic Independence Legislation	5
Water Infrastructure Legislation	16
FY 15 Budget Deficiencies	295



Administration Acknowledges \$329 Million Shortfall in FY 15

(\$ Millions)

Non-Tax Revenues	179
Reduction in Income Tax Rate	70
Economic Development Legislation	80
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FY 15 Shortfall	329



Administration Proposes 9C Cuts to Close \$329 Million Shortfall

9C Reductions

Health Care	75
MassHealth	55
Local Government Support	44
Early Education	1
Higher Education	6
Human Services	44
Public Safety	10
Economic Development	27
General Government	24
Hinton Drug Labs	9
Municipal Extreme Weather Reserve	5
Other	12
FMAP Loss Due to 9Cs	(35)
Net 9C Reductions	198

Non-9C Reductions

Unrestricted Local Aid	25.5
MassDOT	10
Non-Executive Agencies	22
Quasi-Public Agency Foregone	29
Funding from Economic Dev. Bill	
Total Proposed Non-9C Reductions	86.5
New Federal and Dept. Revenues	44.5
Total New Revenues	44.5
Total Solutions	329



Health Costs Pose Major Budget Risks (Connector)

- Because of the Connector Exchange problems, ~ 90,000 enrollees have not been transferred to the new ACA-compliant Connector Care plan costing the state \$10 million per month in foregone federal reimbursements (\$60 million for six months of FY 15), while another 317,000 were transferred into Temporary Medicaid coverage
- The administration will spend an additional \$20 million to contact and process the applications of these 407,000
- State responsible for an additional \$26 million in development costs for contractor Optum; CMS approved request to reimburse remaining ~ \$80 million

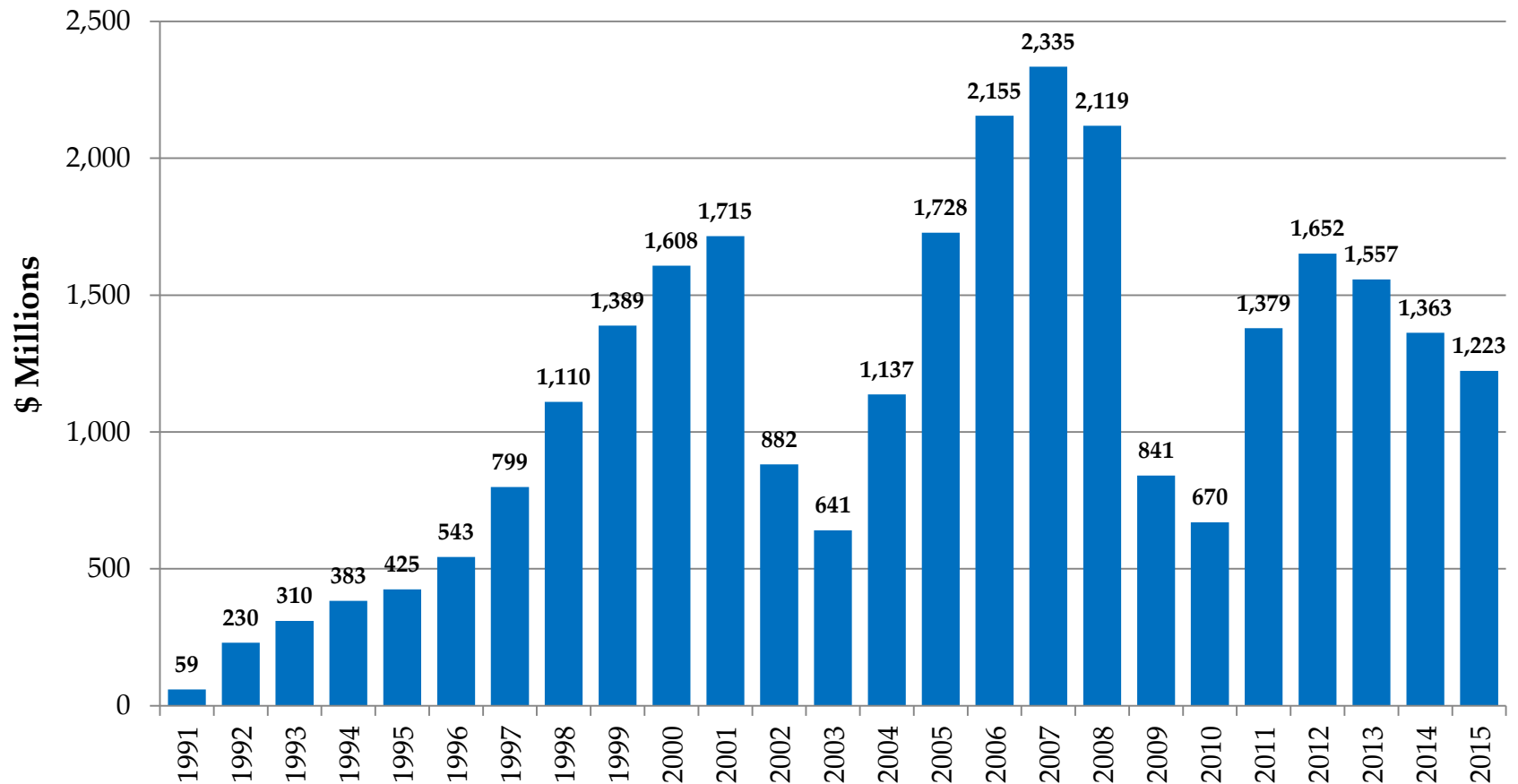
Health Costs Pose Major Budget Risks (Medicaid)

- Although federal reimbursements are uncertain, it is expected that a significant portion of the 317,000 may be ineligible for Medicaid coverage with the state bearing the full costs of their insurance
- Representative Fred Upton, Chairman, Committee on Energy and Commerce, and Senator Orin Hatch, Ranking Member of the Senate Finance Committee, have sent a joint letter to CMS questioning the legal authority and precedent for the U.S. Secretary of Health and Human Services' decision to allow temporary Medicaid coverage in Massachusetts
- Underfunding of Medicaid managed care organizations (MCOs) due to enrollment of an older and sicker population and the use of expensive specialty drugs like Sovaldi

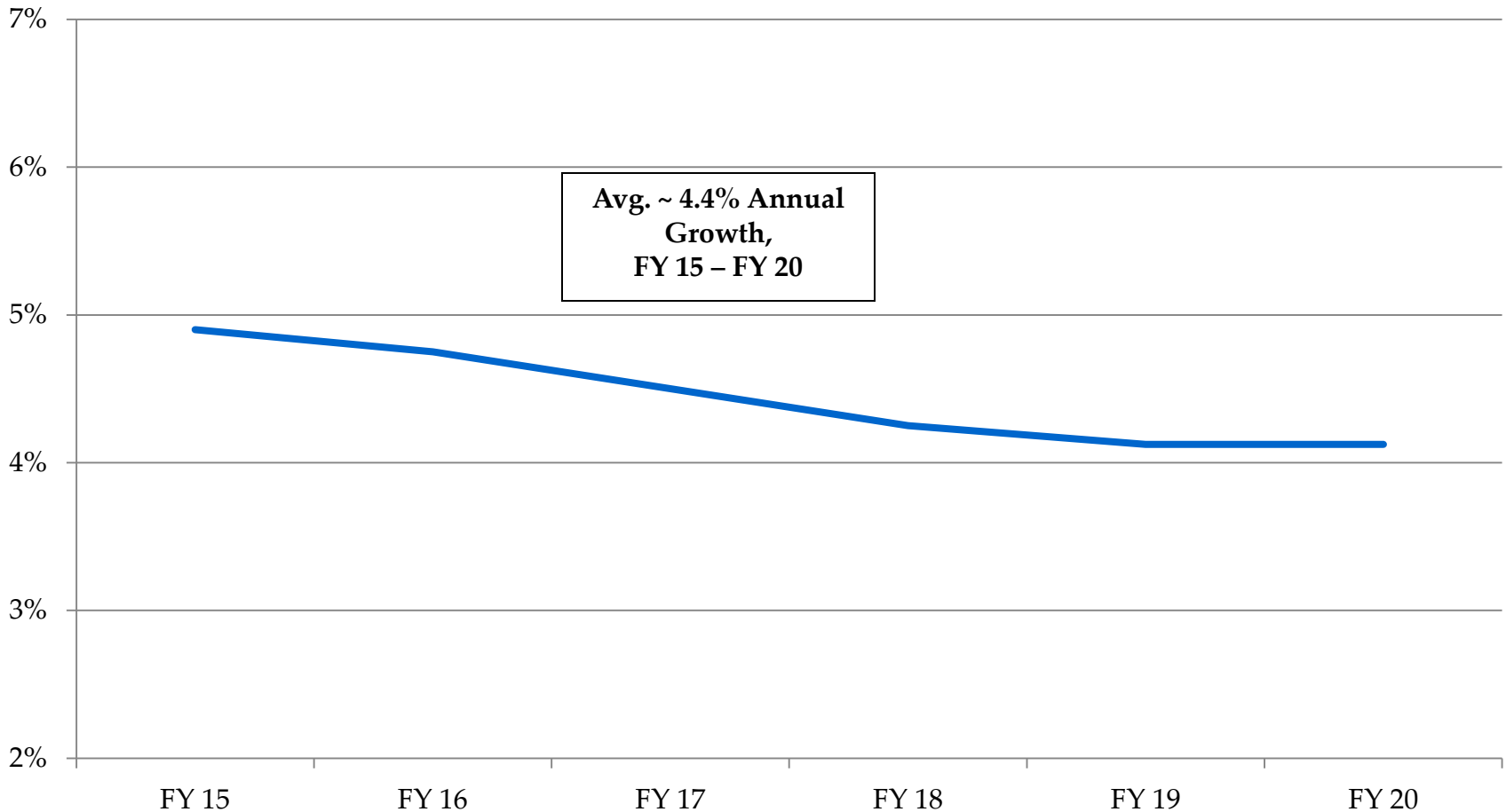
Health Costs Pose Major Budget Risks (Medicaid)

- FY 15 budget assumed MassHealth enrollment of ~ 1.67 million
- MassHealth enrollment was 1.88 million in July 2014 and now stands at ~ 1.93 million or 260,000 more than projected in FY 15 budget
- Costs of 260,000 additional enrollees could add several hundred million dollars to FY 15 budget
- Office of Inspector General of U.S. Department of Health and Human Services issued September 2014 report seeking repayment of \$105 million from the state for Medicaid overbilling

Steady Decline in Stabilization Fund During Economic Recovery



Long-Term Revenue Growth Falls Below Previous Recoveries



Transportation



~ \$25 Billion in Available Funds for Transportation Investments over 10 Years

\$ Millions

	5 Year Total	10 Year Total
State Capital Investment Plan	9,586	17,101
State Bond Cap	5,015	10,030
Federal Highway Funds	2,500	5,000
Accelerated Bridge Program	1,248	1,248
Special Obligation Transit Bonds	823	823
Other Funding Sources	4,974	8,452
Toll Revenues	1,050	2,100
MBTA CIP		
MBTA Revenue Bonds	650	1,300
Federal Transit Funds	2,400	4,800
Federal Transit and Federal Railroad Grants	628	1,256
Green Line Extension - FTA New Starts Funding	996	996
Repeal of Gas Tax Indexing	-750	-2,000
Total Available Funds	14,560	25,553



Current Commitments Consume Virtually All Available Funds

\$ Millions

Transportation Spending Commitments	
Road and Bridge Program	10,000
Accelerated Bridge Program	1,248
Chapter 90	2,000
MBTA SGR	6,100
Red & Orange Line Cars & Tracks	1,500
Green Line Extension	2,300
Total Committed	23,148



No Funds Available for Administration's Way Forward Plan

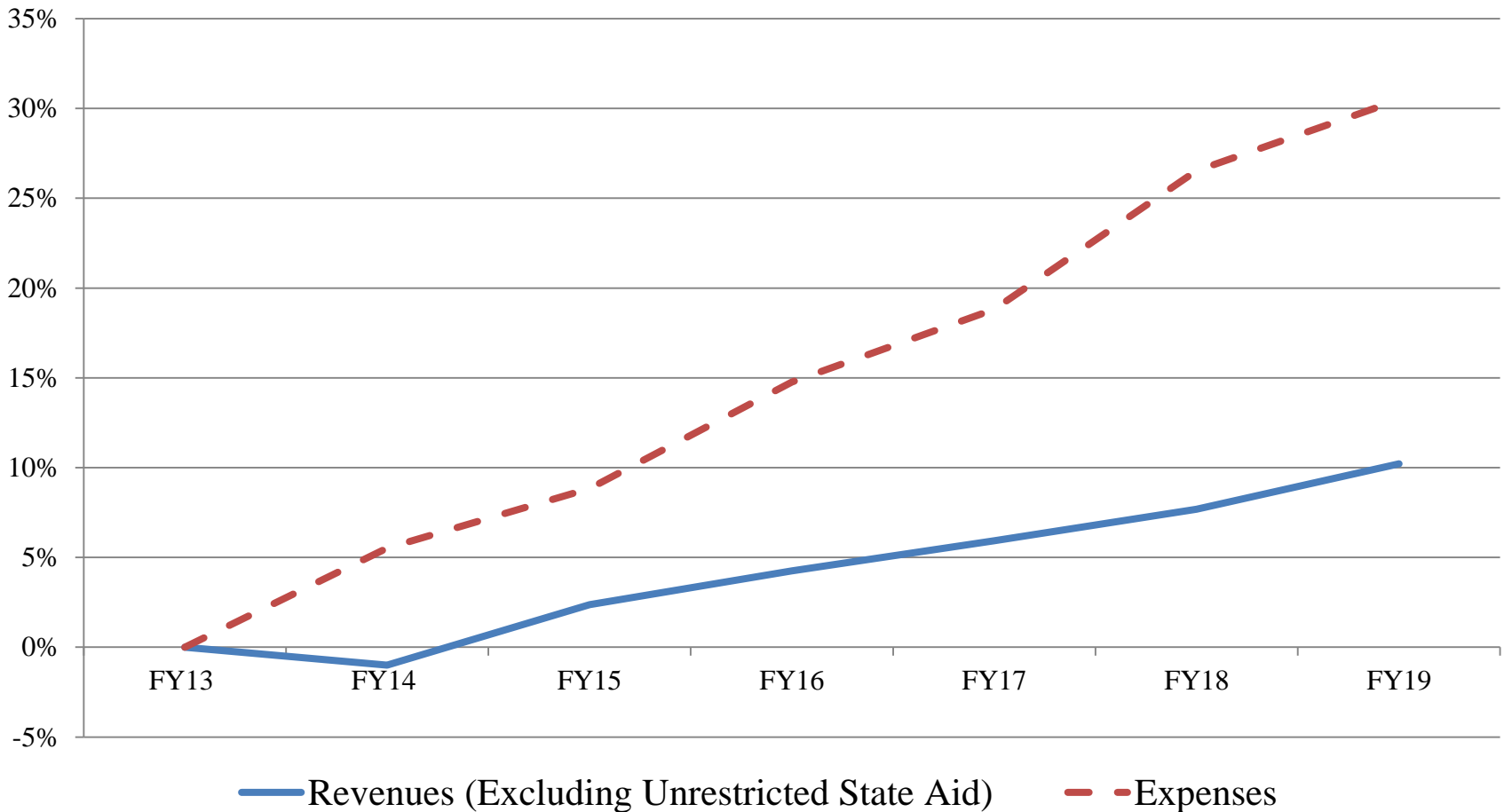
21st. Century Transportation Plan	
Road, Bridge and Multi-Use SGR Priorities	5,184,755,000
Bridge Program	1,175,000,000
Multimodal Highway Program	1,250,000,000
Regional Priority Projects	930,000,000
Bicycle & Pedestrian Facilities	429,755,000
Highway Preservation Facilities & Systems	400,000,000
Chapter 90	1,000,000,000
Regional Transit Authority State of Good Repair Priorities	
RTA Vehicles	400,000,000
MBTA State of Good Repair Priorities	1,882,000,000
Green Line Cars	732,000,000
MBTA Buses	450,000,000
Red Line #3 Overhaul	200,000,000
MBTA Power, Facilities and Operations	300,000,000
Modernization Pilot projects	200,000,000
MassDOT/Commonwealth State of Good Repair Priorities	
Aeronautics Program	125,000,000
RMV Capital	150,000,000
Unlocking Economic Growth in the Commonwealth	3,797,000,000
South Coast Rail	2,300,000,000
South Station Expansion	1,000,000,000
Inland Route	362,400,000
Berkshires to NYC	113,800,000
Rail to Cape Cod	20,800,000
Total - 21st Century	11,538,755,000
Additional Proposed Spending	
Additional MBTA SGR Needed	2,000,000,000
North-South Rail Link	3,000,000,000
Total Proposed	5,000,000,000
Total	16,538,755,000



The MBTA



The Dilemma – T Expenses are Projected to Grow More Than Twice as Fast as Revenues (Excluding Unrestricted State Aid from 2013 Legislation)



Operating Expenses Increased by 7.2 Percent Per Year Since Forward Funding, More Than Double the 3 Percent Plan

	\$ Millions		Total	Annual
	FY 2001	FY 2014	Change \$	Change %
Wages and Payroll Taxes	313.5	467.2	154	3.8%
Fringe Benefits	99.4	192.0	93	7.2%
Materials/Service	66.3	147.8	82	9.5%
Energy	44.3	76.1	32	5.5%
Commuter Rail	172.5	387.6	215	9.6%
The Ride	29.0	130.3	101	26.9%
Other	11.7	21.7	10	6.5%
Total	736.8	1,422.7	686	7.2%

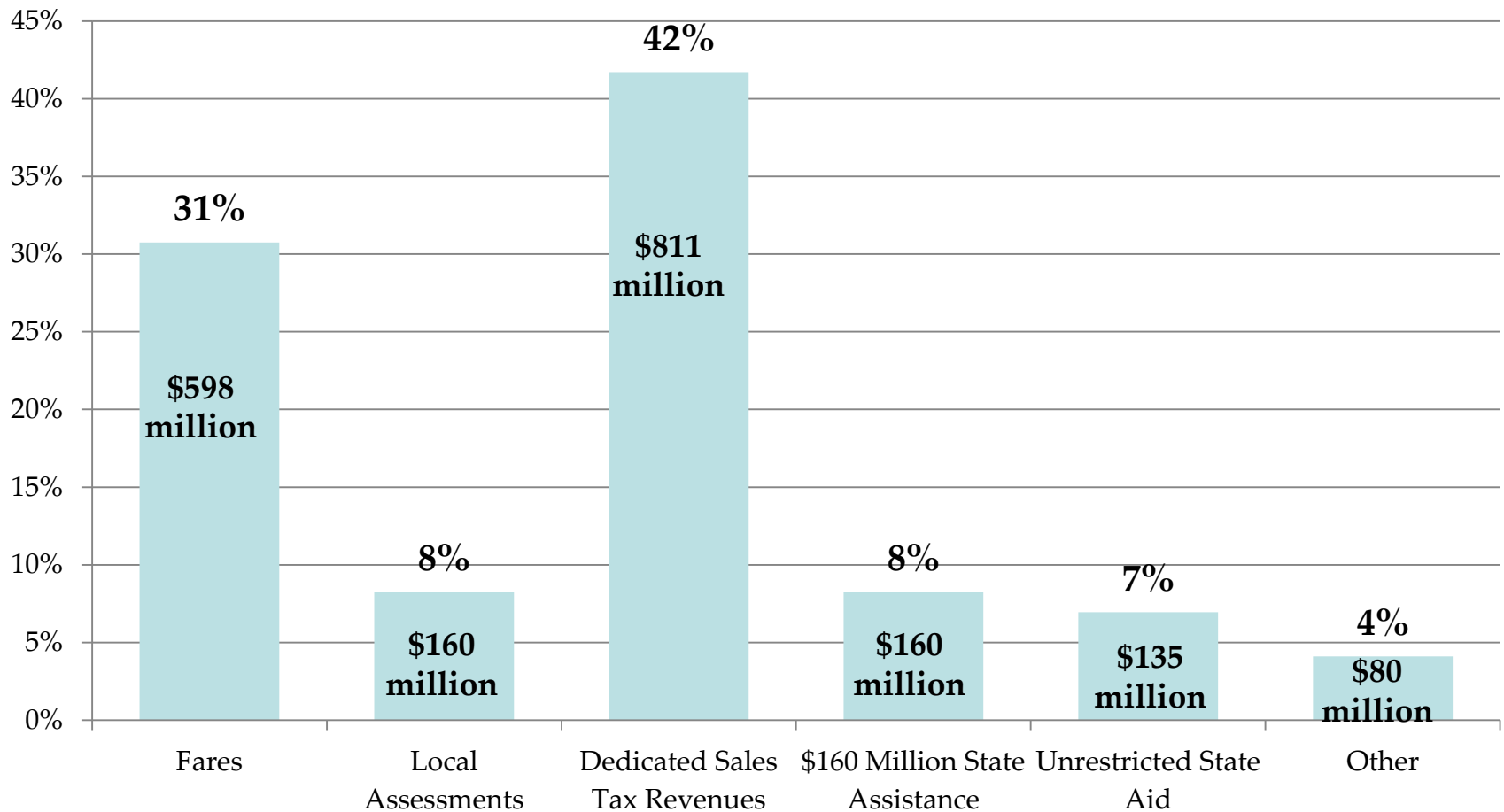
Operating Expenses Projected to Increase by 5 Percent Per Year from FY 2015 - 2019, More Than Double Revenue Growth (Excluding Unrestricted State Aid)

	\$ Millions		Total Change \$	Annual Change %
	FY 2015	FY 2019		
Wages and Payroll Taxes	532.5	655.7	123	5.8%
Fringe Benefits	209.5	234.1	25	2.9%
Materials/Service	166.5	217.0	51	7.6%
Energy	71.4	81.9	11	3.7%
Commuter Rail	384.3	438.1	54	3.5%
The Ride	122.1	159.6	37	7.7%
Other	22.6	25.7	3	3.5%
Total	1,508.9	1,812.2	303	5.0%

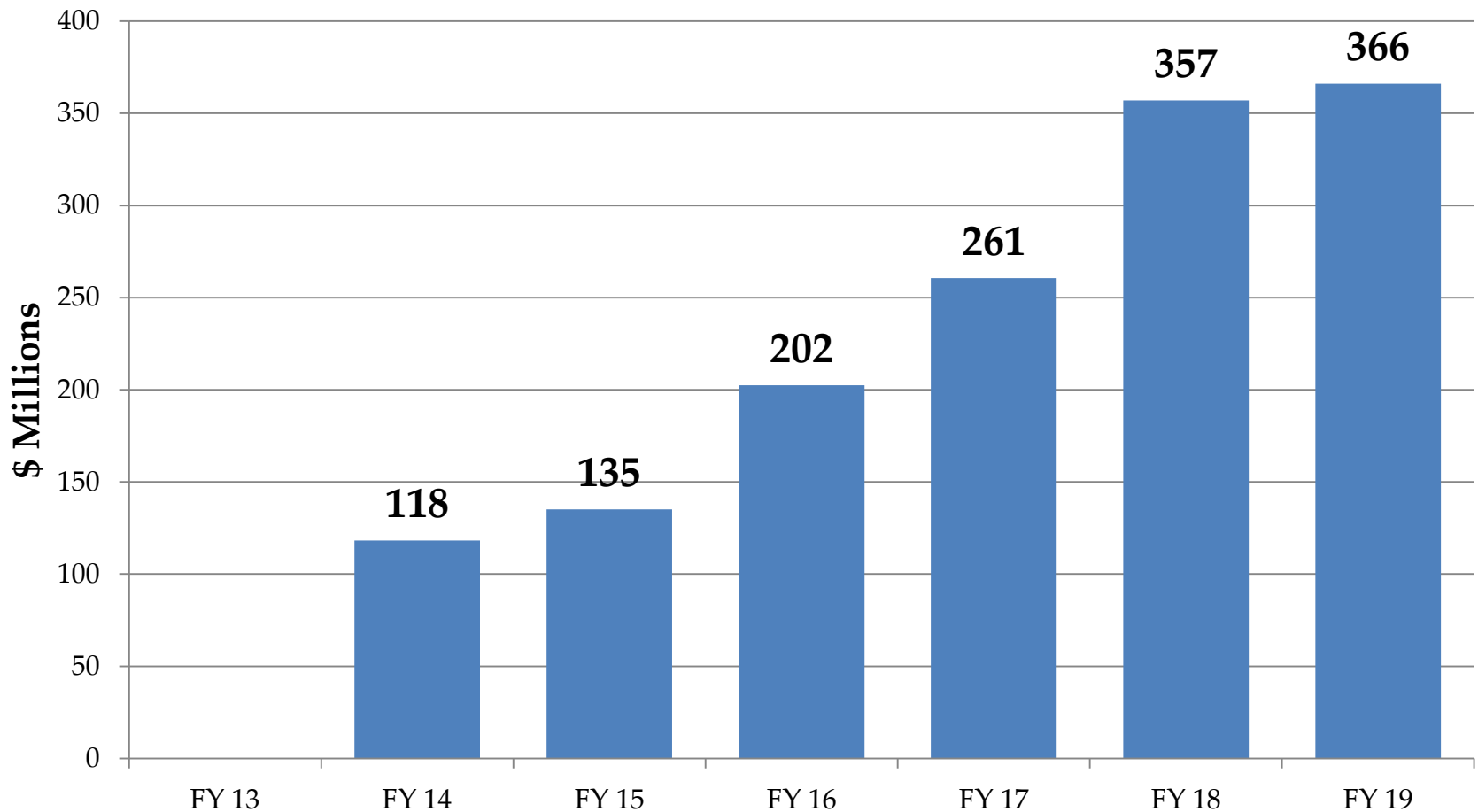
All Major Revenue Sources are Capped Except for Unrestricted State Aid

- Fares are capped at 5 percent increase every two years beginning in FY 15
- Local assessments are capped at the lesser of 2.5 percent or inflation
 - 10 major transit systems receive on average ~ 25 percent of revenues from local governments, the T receives 8 percent
- Dedicated sales tax revenues are capped at 3 percent; growth has been closer to 1 percent since FY 01
- \$160 million in state aid level funded since FY 10

State Already Contributes 57 Percent of MBTA Revenues in FY 15



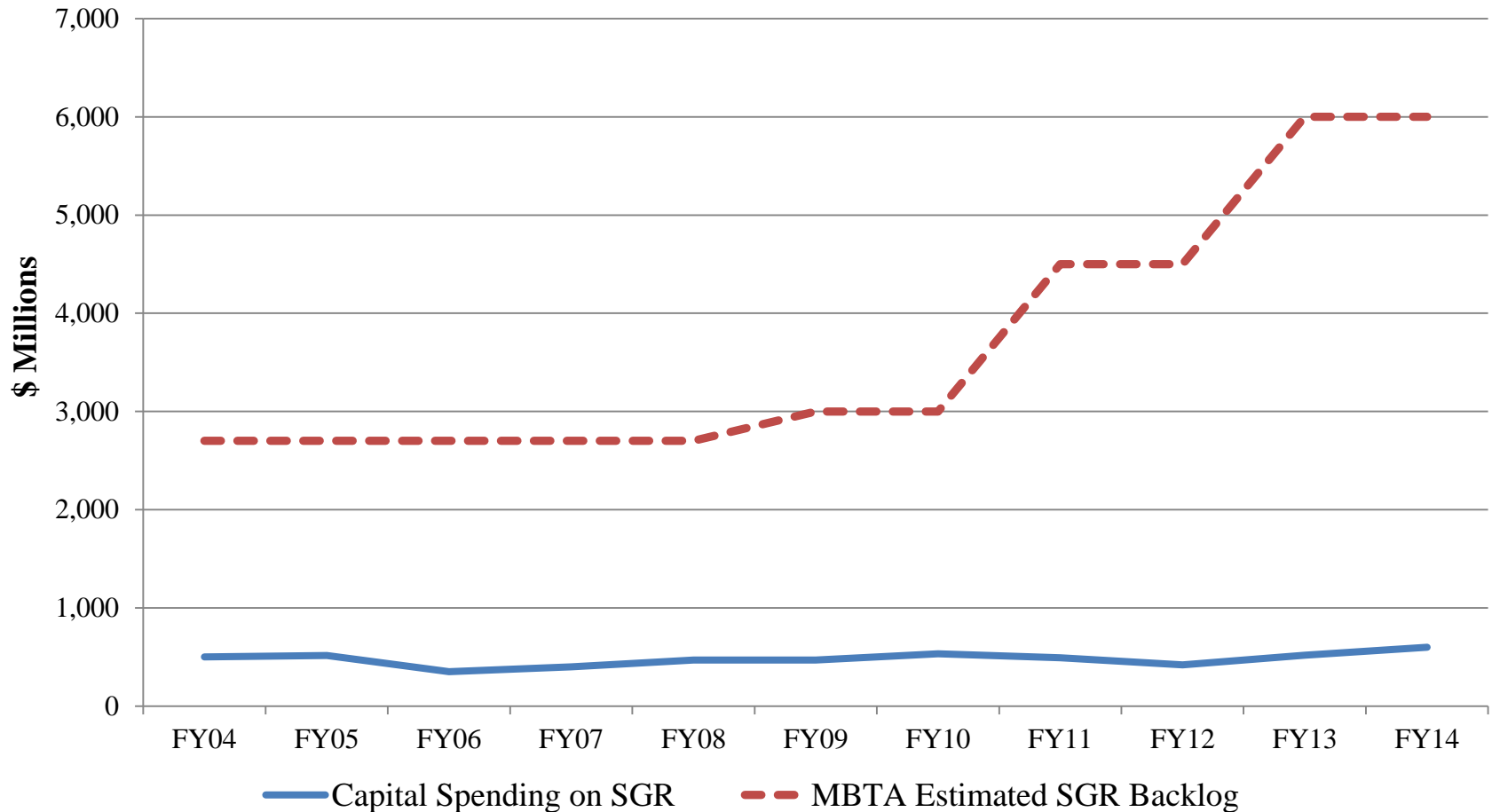
Open Ended State Aid Required to Close Ever Growing MBTA Budget Shortfalls



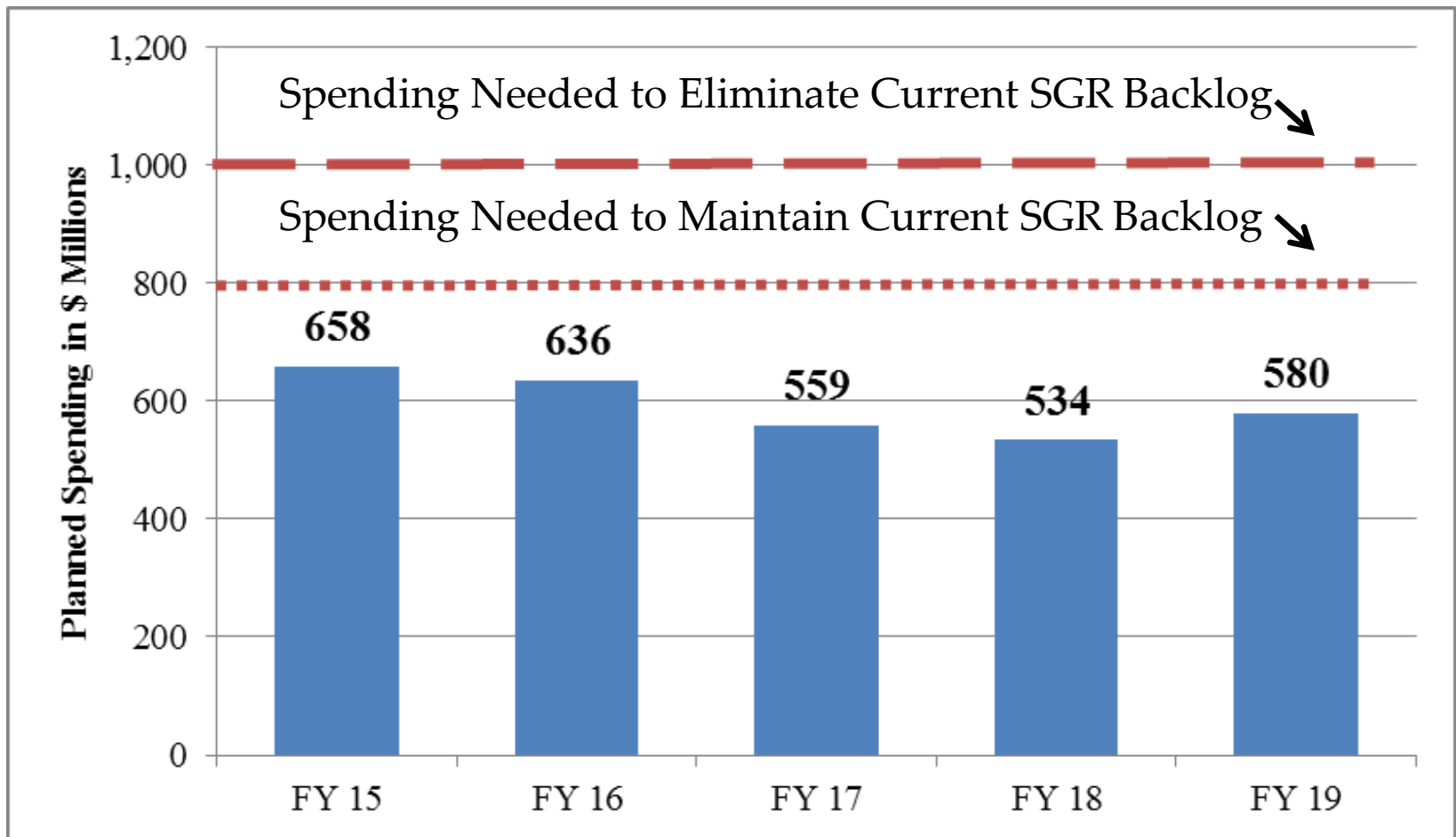
Source: MBTA FY 15 – 19 Pro Forma



The MBTA System Has Deteriorated Substantially; State of Good Repair Backlog Jumps to \$6+ Billion While Annual Spending Remains Constant



The T's Capital Plan Ensures Continued Decline in System

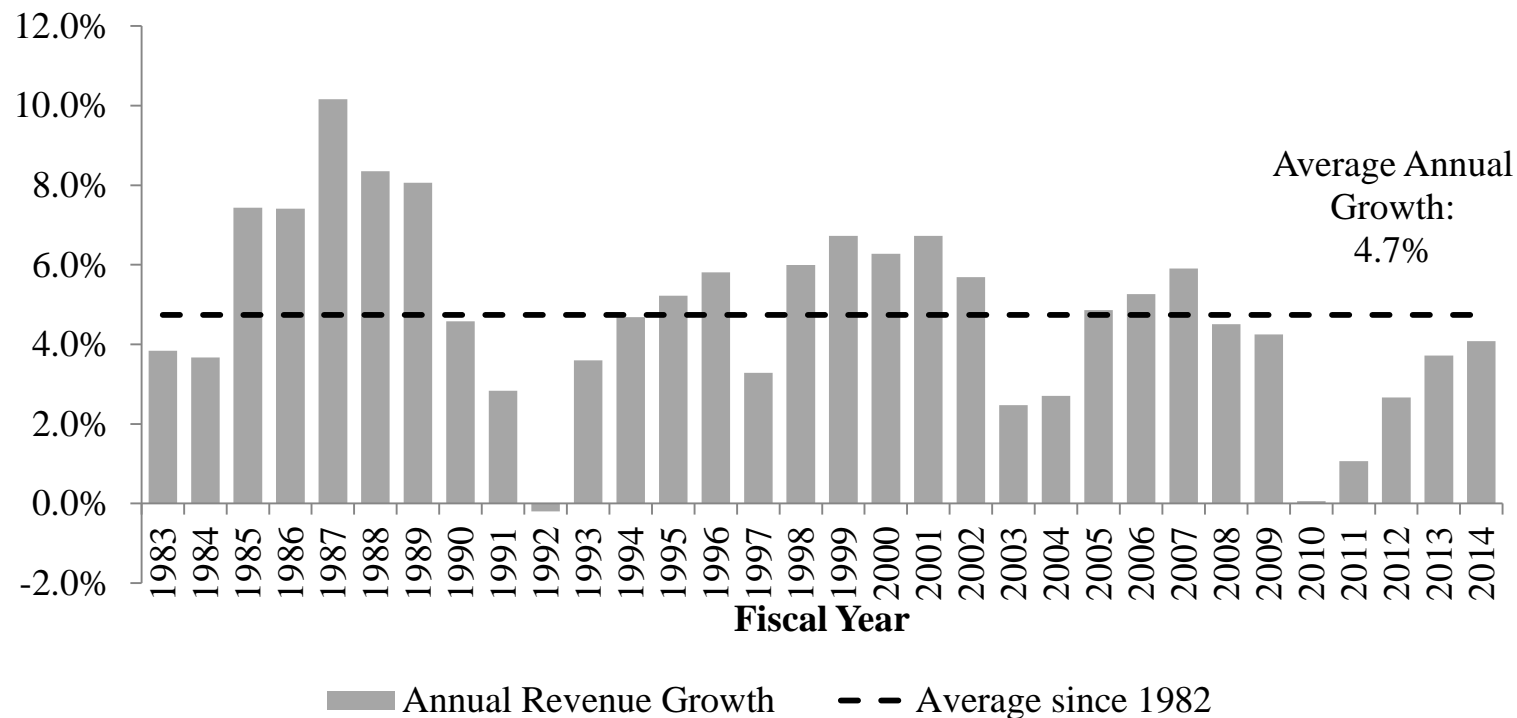


Municipal Finances



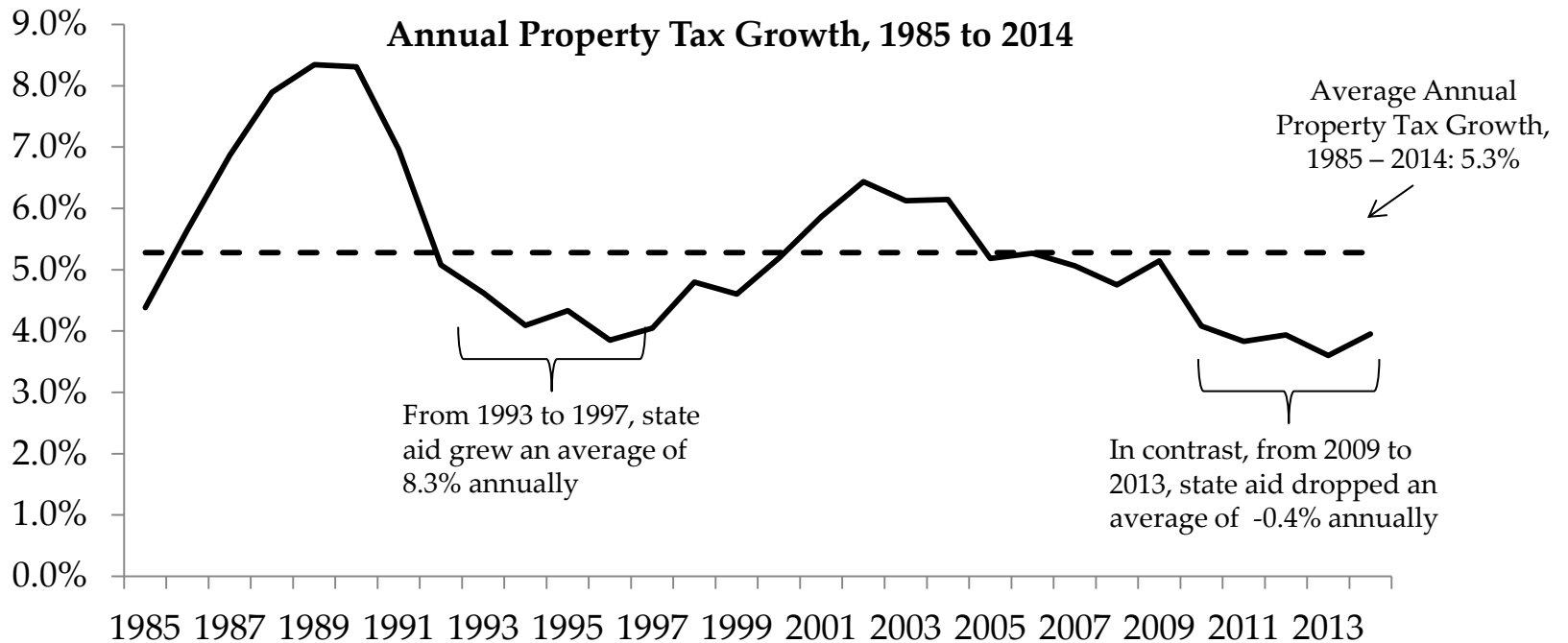
Municipalities in Longest Period of Slow Growth in Prop 2 ½ Era

**Annual Municipal Revenue Growth
(all sources)**



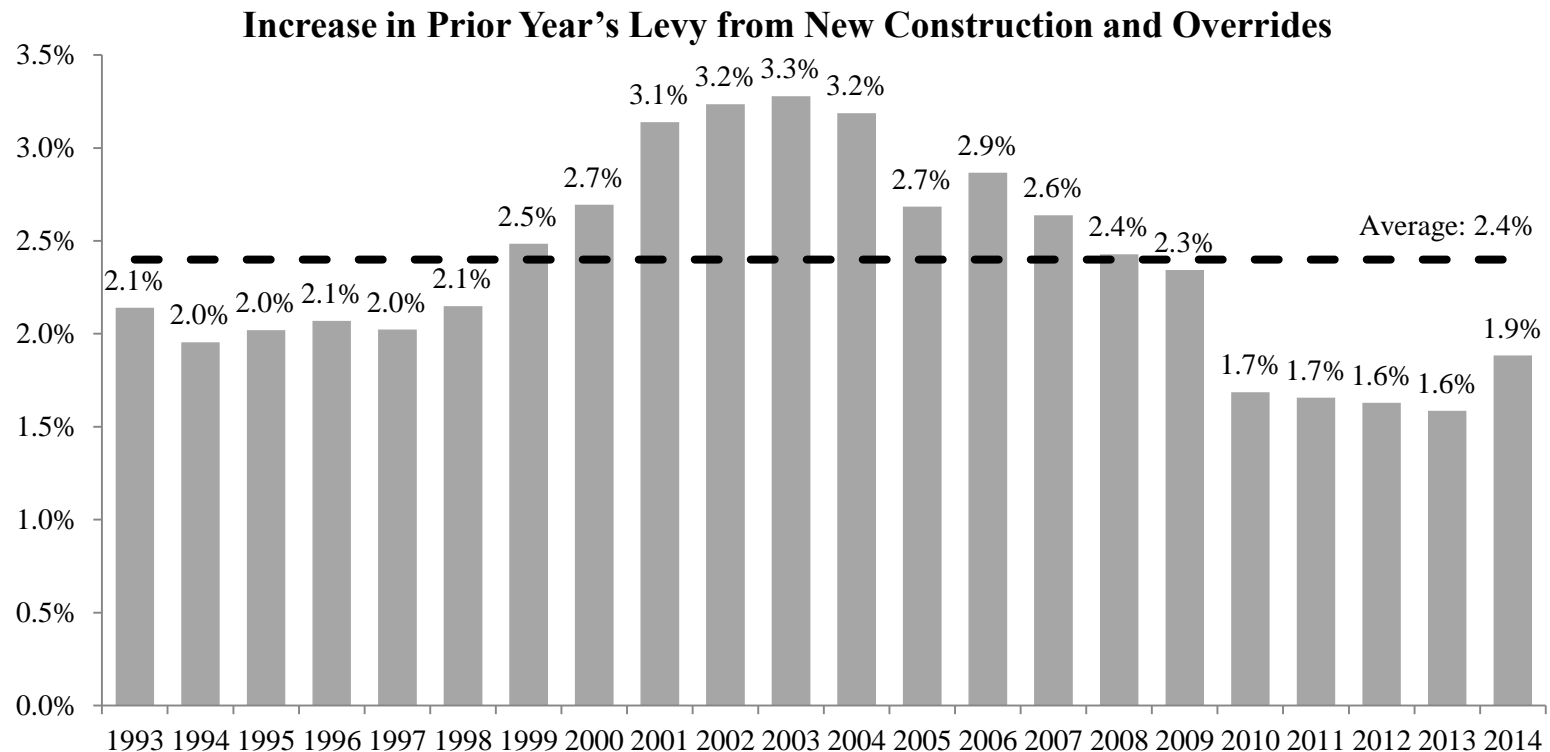
Property Taxes Growing at Slowest Rate Since 1985

- Property taxes account for half of all municipal revenues and increased by 4.0 percent in 2014, from \$13.4 billion to \$14 billion.



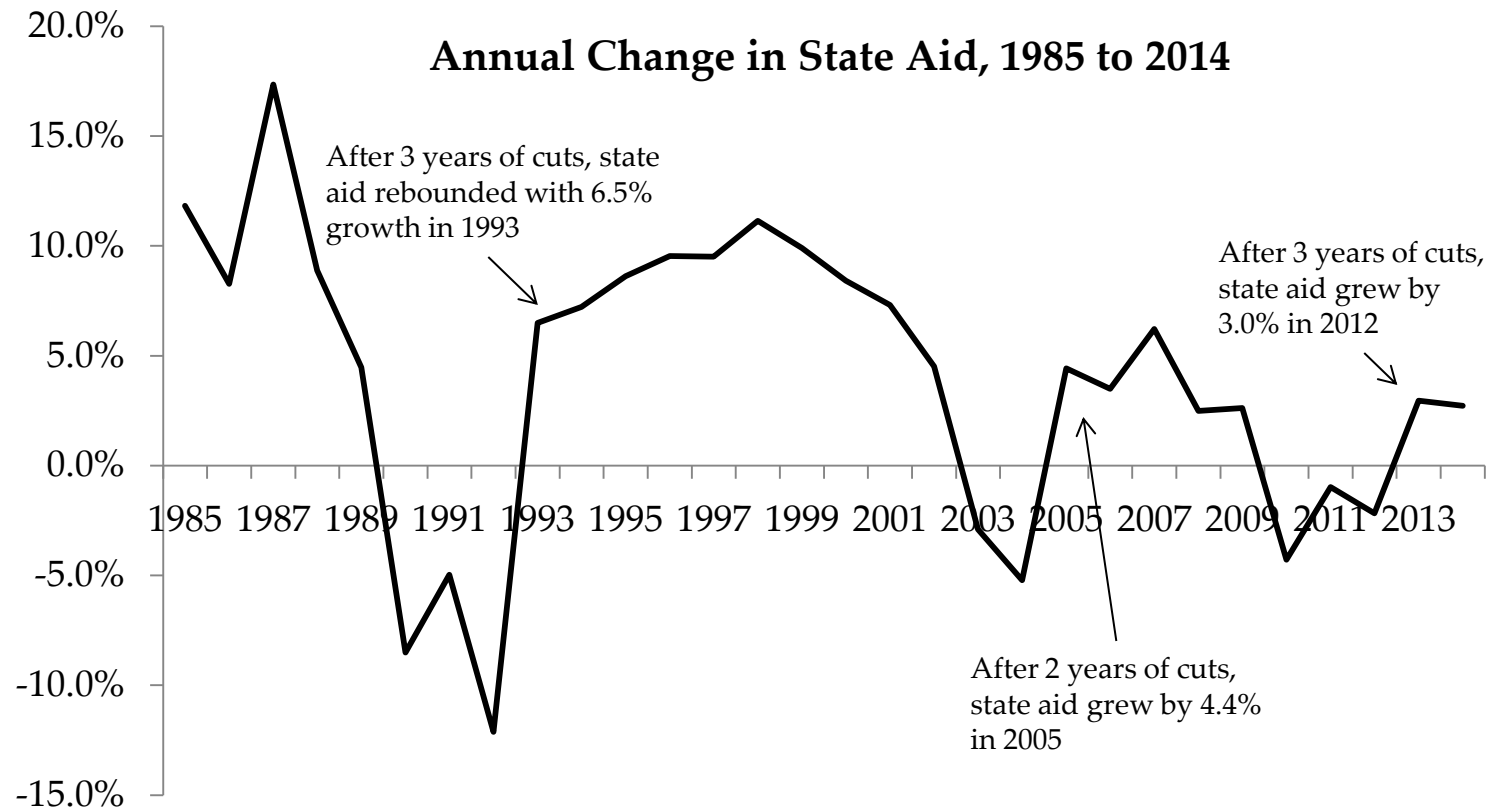
New Construction and Overrides Contributing Less To Property Taxes

- New construction and overrides, the only way for most communities to raise property taxes above the annual 2.5 percent increase, added 1.9 percent to the prior year's tax levy in 2014.



Slow Recovery Is Limiting Increases in State Aid

- After years of cuts, the rebound in state aid lags that of other economic recoveries.



Municipalities Face Enormous Unfunded Retiree Liabilities

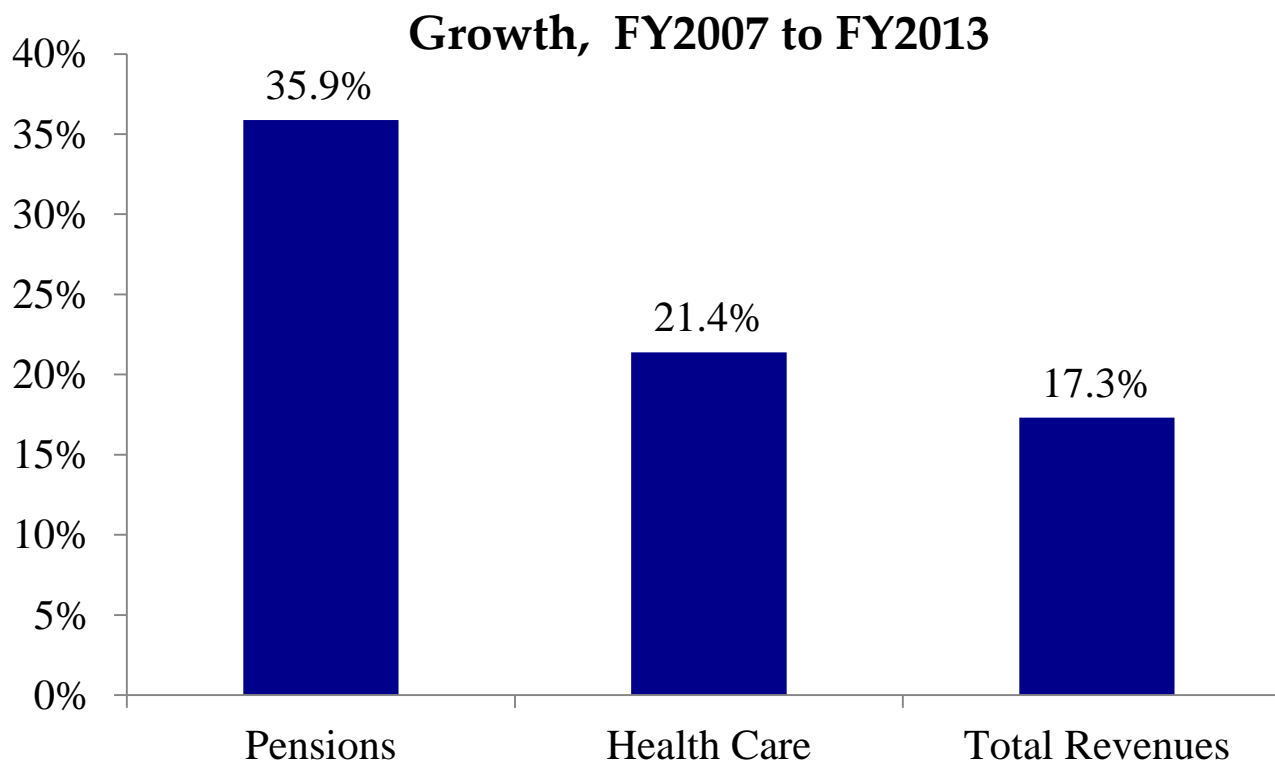
	2013 Unfunded Liability (\$ billions)	2013 Total Liability (\$ billions)	Funded Ratio
Municipal Pensions	\$14.2	\$33.0	57%
Municipal Retiree Health Care	\$30.0	\$30.0	<1.0%
Total, Retiree Benefits	\$44.2	\$63.0	30.3%

Note: In Massachusetts, the state is responsible for teacher pensions so they are not included in the table. However, municipalities must fund teachers' retiree health care, which is accounted for in the table.



Benefits Costs Are Crowding Out Basic Municipal Services

- Municipal spending on pensions and health care is rising much faster than revenues, cutting into funding for other local services.



Despite Billions in Contributions, Little Progress in Funding Pensions

- In 2013, the state's 99 local pension systems had approximately \$14.2 billion in unfunded liabilities, compared to \$8.2 billion in 2006.
- Municipal pensions were just 57 percent funded in 2013. Of the 99 systems, 96 are below 80 percent funded and 26 are less than 50 percent funded.
- The lack of progress can be attributed to several factors:
 - Benefit enhancements
 - Weak investment returns
 - Extending funding schedules (78 systems will not be funded until 2030 or later)
 - More realistic investment return assumptions, although more than half of all systems still use 8% or greater

Source: PERAC 2013 Annual Report



Massachusetts Taxpayers Foundation

The Retiree Health Care Challenge

- Municipalities have \$30 billion in retiree health care liabilities—99 percent of that unfunded.
- Rather than paying down liabilities as they are doing with pensions, municipalities have opted to pay-as-you-go.
 - Cities and towns spent an estimated \$834 million on retiree health care benefits in fiscal 2013, more than 90 percent of unrestricted (general government) aid.
 - Without change, spending is expected to grow to \$1.5 billion in 10 years.



Poorest Municipalities Under Pressure from Rising Retiree Health Care Costs

- In these municipalities, retiree health care grew by a total of \$17 million — from \$71.8 million to \$88.8 million — between fiscal 2009 and fiscal 2013, consuming 26 percent of the growth in property tax revenues.
- By contrast, the total budgets in these cities and towns grew by only two percent and wages and salaries rose by only one percent. (These municipalities had 1,000 fewer full-time employees in fiscal 2013 than in fiscal 2009.)



Eligibility Requirements and Benefits Are Exceedingly Generous

- Employees are eligible to receive full benefits beginning at age 55.
- Employees are eligible for full benefits after just 10 years of service, including part-time service in most municipalities.
- Municipalities must contribute at least 50 percent to the cost of premiums.* There is no cap on the year-to-year growth of municipal contributions.

*A small number of communities—fewer than a dozen out of 351 statewide—have not adopted this provision. Retirees are permitted to enroll in the municipal health plans but must pay 100 percent of the premium.



MTF Reform Proposal

- Raise minimum eligibility to Medicare-eligible age for all pension group classifications. Health insurance coverage for retirees who are not yet eligible for Medicare is one of the largest drivers of costs and OPEB liabilities.
- Raise minimum years of service requirement from 10 years to 20 years so employees spend half of their careers in public service in order to receive a lifetime benefit.
- Pro-rate benefits based on years of service.
- Pro-rate benefits for part-time employees.
- Changes would not apply to:
 - existing retirees;
 - current employees age 60 or older with at least nine years of service; or
 - current employees within five years of their maximum pension benefit and with at least 20 years of service.



The Need for Urgent Action

- The longer that retiree health care obligations go unaddressed, the more severe the consequences for retirees.
- Even with changes in eligibility and benefits, retirees would still receive a very generous benefit.

