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# How the 2015 General Assembly Affects the Kentucky State Budget

The 2015 General Assembly was not a budget session but the legislature made a number of decisions that impact the current budget and that of future years. These include action or lack thereof on some of the session's biggest issues— shrinking the unfunded liability in the teachers' pension system, stabilizing the Road Fund and stemming the tide of the state's growing heroin epidemic.

On the spending side, the General Assembly reopened the 2014-2016 budget to make appropriations for several initiatives. They also made choices that affect future spending in areas like debt and corrections.

**UK Medical Research Facility.** Despite its unconventional introduction in a non-budget session, HB 298 was met with little resistance to become the second bill passed in the session, authorizing debt service in support of state bonds for the construction of a new medical research facility at the University of Kentucky. Beginning in budget year 2016, $5.5 million will be appropriated from the General Fund for debt service on $132.5 million in state bonds—half the cost of the facility. Typically, state schools compete for a limited amount of funding for capital projects through the appropriations process in a budget session.

**Support Education Excellence in Kentucky (SEEK).** HB 510 authorizes up to $10 million in appropriations from end-of-year surpluses or the Rainy Day fund for SEEK, the main funding formula for P-12 schools, to take into account actual school attendance numbers exceeding what was budgeted.

**Tobacco Settlement Agreement Fund.** HB 510 also deals with how Kentucky will spend Master Settlement Agreement revenue. At the time the 2014-2016 budget was created, it was unclear how much money Kentucky would receive pending the resolution of claims that the state had not adequately monitored non-participating tobacco manufacturers over the previous decade. A settlement announced in June 2014 resulted in $159.4 million in payments coming to the Commonwealth. Of those funds, $90.8 million was appropriated for fiscal year 2014, a portion of which helped restore prior cuts in areas like lung cancer research, county agriculture funds, and early childhood oral and mental health assistance.

Following a veto by Governor Beshear, the remaining funds are available to address an expected shortfall in MSA funding in budget year 2015 for initiatives in agriculture, early childhood and health care. The governor reports that the expected shortfall may be about $37.8 million. HB 510 also allocates additional monies to restore funds that were cut for 2016, including $21 million for agricultural development initiatives such as the environmental stewardship fund and county agricultural accounts; and $2.5 million for health initiatives including lung cancer research and smoking cessation.

**Heroin.** The compromise legislators reached over heroin, SB 192, provides new money for treatment, creates the option for localities to establish needle exchanges and includes a Good Samaritan clause that protects those who seek help for overdose victims from prosecution. It appropriates $10 million of new money for substance abuse treatment in 2016, but there are also costs associated with harsher sentencing and time served requirements. Under the law:

- Those charged with Class C trafficking felonies and above (a minimum sentence of five years) must serve 50 percent of their sentence, as opposed to the previous 20 percent.
- Class D felony trafficking charges for less than two grams of heroin but accompanied by evidence of dealing (possession of paraphernalia) also require that 50 percent of the sentence is served.

- Trafficking 100 grams or more of heroin changes from a Class C (5-10 years) to a Class B felony (10-20 year sentence).
- Those who bring any amount of heroin into the state will now receive a new Class C felony charge for "importing."

**Enhanced Penalty Costs:** As with the heroin bill, a few other laws passed this session create new or increase existing penalties, although their costs are expected to be small. Both of the following now carry a Class D felony sentence with minimal estimated costs to the state (incarcerating one Class D felon costs between $12,000 and $60,000): the dating violence bill makes it a crime to fail to use a court ordered GPS tracking device and SB 28 makes it illegal for businesses to promote internet gambling with electronic devices. SB 102 expands the charge of Class B felony manslaughter in the first degree (one Class B felon costs the state $220,000 to $441,000 to incarcerate) to the perpetrators of intentional abuse which causes death, as well as to custodians who "knowingly permit" abuse of those younger than twelve or otherwise helpless.

**Miscellaneous New Expenditures.** SB 75 adds testing for Krabbe disease to the newborn screening panel—a typically fatal degenerative disorder which responds to treatment better early in its course. The new law will cost $740,000 in budget year 2016 including for new screening equipment, and $240,000 annually thereafter.

And at an indeterminable cost, HB 268 includes the Cambridge Advanced International Certificate of Education Diploma as one of the programs which qualify students who are eligible for free or reduced price lunches to earn supplemental KEES awards.

**KTRS Inaction.** HB 4 would have authorized $116.8 million in budget year 2016 for debt service on a $3.3 billion pension obligation bond (POB) to start digging the Kentucky Teachers Retirement System out of its $14 billion unfunded liability—a hole created by inadequate payments from the state to the system since 2009. In addition to the bond, HB 4 would have required the state to phase in to full annual payments to the retirement system starting with $44 million in 2017 and climbing to nearly $400 million by 2025. As a result of legislators' decision not to act on the bill, KTRS estimates it will liquidate $3 billion in assets over the next four years to meet its obligations, deepening the system's liability over time. Without a bond issue, the state will need to come up with $511 million more in the first year of the next two-year budget to make the full annual payments, and $470 million the second year.

On the revenue side of the fiscal equation, the General Assembly also made a number of decisions affecting the resources the state has to do its work.

**Road Fund.** Two drops in the gas tax during budget year 2015 have hurt the Road Fund. An additional 5.1 cent drop—to the state's previous statutory gas tax floor of 22.5 cents per gallon —was scheduled to take place on April 1 and would have cost the state and especially local governments in excess of $250 million over the budget period. But with HB 299, the legislature lifted the floor of the gas tax to 26 cents per gallon and in doing so prevented losses totaling more than $100 million. The new law also changes the gas tax adjustment from a quarterly to an annual process and prevents the gas tax from falling more than 10 percent per year; previously, while growth was capped at 10 percent annually, there was no such protection from sharp declines other than the floor.

**Tax Expenditures.** Tax breaks, credits, exemptions and other subsidies work just like spending in that they cost money. Unlike appropriations, however, tax expenditures are not reexamined in the two-year budget process. This session, legislators made the following decisions about tax expenditures:

- HB 340 expands Kentucky's film tax credits. The price tag on this expansion is estimated at $5.5 million, but the fiscal note to the bill says that it "could have a significant and serious detrimental fiscal impact" if the state was "successful in attracting new film production."
- HB 134, the Breeder's Cup bill, excludes the event from the excise tax on pari-mutuel wagering and will cost an estimated $800,000 in budget year 2016.

- HB 202 extends the sunset for the Metropolitan College Tax Credit from 2017 to 2027, at about $4 million in cost per year.
- Instead of extending energy efficiency tax credits as HB 349 would have done, legislators will allow them to expire on January 1, 2016. These credits currently cost the state $13 million a year.

**Fund Transfers.** To deal with originally unbudgeted costs during the remainder of the biennial budget period, legislators included in HB 510 a $63.5 million transfer from the Public Employee Health Trust Fund in 2016 to the Budget Reserve Trust or "rainy day fund." This comes on top of a $93 million transfer from this fund to the state's General Fund in budget year 2015, and $50 million in 2009. The money exists because, on balance, less has been paid out in claims and other expenses over the last decade than employees and the state have contributed to the fund. Cost sharing with public employees has grown in recent years, with employees contributing 48 percent more out of pocket in 2014 than they contributed in 2008.

The additional transfer to the rainy day fund will increase its balance. The fund was at $122 million going into fiscal year 2014, but because monies were used to plug holes in the budget and help close the June 30, 2014 shortfall, its balance had been reduced to $77 million. It was set to decline further to $63 million at the end of 2016 prior to the HB 510 transfer.

Both the additional SEEK funding and the $10 million in heroin appropriations for 2016 described above are termed by legislation as necessary government expenses, and are thus eligible for rainy day funds.

HB 510 also transfers $3 million from the underground storage tank fund in 2015 to the General Fund to help support $7.8 million total in revenue sharing with county and municipal road aid funds. In 2014, lawmakers transferred more than $15 million from this fund to help balance the budget.