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The Impact of the 2017 General Assembly on the Kentucky State Budget

By Pam Thomas

The just concluded 2017 legislative session was not a budget session. However, the General Assembly passed a number of bills that will have an impact on state finances including the current budget as well as future budgets and revenues.

The most significant legislation affecting the budget is discussed below. Various measures that passed will add to growing costs in the criminal justice system, expand or extend special tax breaks and subsidies for businesses, spend additional money, clarify how funding in the budget would be spent and create new expenses moving forward.

Criminal Justice Penalties Stiffened, Reentry Improved

The General Assembly enacted several criminal justice bills that increase penalties, establish new crimes or restrict the availability of probation and parole. The General Assembly also passed SB120, which originated with the Criminal Justice Policy Assessment Council (CJPAC), and which includes provisions to help ease the transition back into the community after incarceration. Although Senate Bill 120 should have a positive impact, collectively the passage of these bills will have a significant negative fiscal impact on an already overcrowded and underfunded criminal justice system.

Heroin – HB 333, which enhances penalties for trafficking in heroin or fentanyl in small amounts, will have the most significant negative fiscal impact on the criminal justice system. Due to the very broad definition of trafficking included in the bill, an addict sharing drugs with another addict (with no exchange of money) could be charged with trafficking. As a result, there will likely be more criminal charges, which will increase the burden on our court system, including prosecutors and public defenders. The correctional impact statement for a similar bill filed earlier in the session estimated the increase in correctional costs to be $30-$35 million.

Other New or Enhanced Criminal Penalties – There were other new penalties or penalty enhancements passed by the General Assembly that individually are expected to have a minimal impact, but could have a significant collective cost.

- HB 14, known as the “Blue Lives Matter” bill, includes peace officers and first responders in the hate crime statute**,** which could result in longer sentences, unavailability of community supervision or denial of probation, shock probation or conditional discharge.
- HB 38 adds public playgrounds to the locations where a registered sex offender cannot be without written permission. Violation of this provision is a Class A misdemeanor for the first offense, and a Class D felony for 2nd and subsequent offenses.
- HB 93, relating to assault of a service animal, removes the requirement the service animal be unable to return to work from the elements of enhanced sentencing, and adds levels of injury and criminal intent to the elements of the offense. Removing the requirement that the injury be so severe that the animal cannot return to work could result in additional convictions under the statute, which are Class D felonies.

- HB 222 prohibits shock probation in cases of conviction of a driving under the influence (DUI) charge in combination with Manslaughter 2nd degree, Reckless Homicide and Fetal Homicide 3rd or 4th Degree. Those committing these crimes will therefore spend more time incarcerated than they would under the current law.
- HB 329 enhances criminal penalties for securities fraud. There was no corrections impact statement prepared for this legislation so the impact is unknown.
- HB 540, relating to drones, establishes penalties for anyone who operates or allows an unmanned aircraft to operate in a manner that allows entry into prohibited areas, or in a reckless manner, which may create a risk of serious physical injury or property damage. A person engaging in such behavior could be guilty of a Class A misdemeanor or Class D felony.

Tax Breaks Expanded

Although the General Assembly did not enact any new expensive tax preferences or tax expenditures, they did pass legislation extending, expanding or broadening some existing tax breaks for specific projects.

- **Louisville Arena TIF Amendments** – Estimated revenues from taxes collected within the tax increment financing (TIF) zone established to help pay for the bonds issued to build the Louisville Arena have not materialized as projected. Because of this, the Louisville Arena Authority anticipates that it will not be able meet its debt obligations for the arena in the near future absent statutory changes that would extend the life of the TIF, allowing debt to be refinanced over a longer term. To assist in addressing this issue, HB 330 extends the period for which a pilot TIF may exist from 20 years to 45 years upon the issuance of a new bond by the Kentucky Economic Development Finance Authority, subject to specified conditions. (Note that these provisions will also apply to the Renaissance Zone TIF, located near the Louisville airport, should it meet the requirements for an extension). Although the passage of this legislation does not have a direct fiscal impact the Commonwealth, it is included here because even though the Commonwealth is not legally obligated to financially support the Louisville Arena, default on that debt would likely negatively impact future debt issued by the Commonwealth.

- **TIF Expansion** - HB 388 continues the trend established in previous sessions by expanding the TIF statutes to accommodate a project in Western Kentucky that did not meet the statutory requirements to qualify for state TIF participation. HB 388 also generally expands the mix of uses that can qualify a project as a mixed-use TIF. With regard to the Western Kentucky project, the statute is amended to include: "a mixed-use development that includes a tract of previously undeveloped land that was owned by a liberal arts educational institution within four (4) years prior to the effective date of this Act and the previously undeveloped land is bounded on one (1) side by a four (4) lane United States highway on the effective date of this Act". Because this definition is very specific, it is unlikely that any new project other than the one for which the changes were made will qualify as a TIF due to this change. The other amendment included in the bill applies a more liberal definition of what qualifies as a "mixed-use" project. This amendment will have a more significant impact as many new projects could qualify under the revised standard.

- **Fuel Sales Tax Credit** – To support an economic development package offered to Amazon to locate a facility in Northern Kentucky, HB 368 expands an existing sales tax credit on the purchase of fuel for certificated air carriers to include entities that contract with those carriers but independently purchase the fuel. The estimated fiscal impact is a loss of $3 million per year that would otherwise be deposited in the Kentucky Aviation Economic Development fund, which is used to support airports in Kentucky.

Budget Reopened and New Dollars Spent or Authorized

Several bills were enacted that direct or redirect spending of resources that differ from expenditures authorized by the 2016-18 budget or statutory language.

- **Funds for an Unnamed Economic Development Project** – In the last hours of the last day of the 2017 session, HB 482, which was “AN ACT relating to law enforcement training”, was stripped of its original language and revised to amend the 2016-2018 biennial budget. The revised language appropriates supplemental funds to the Cabinet for Economic Development “for the sole purpose of facilitating a private sector investment of not less than $1,000,000,000 in one or more locations in the Commonwealth.” The funding is provided through the issuance of a new $15 million bond for the Kentucky Economic Development Finance Authority Loan Pool, supported by an appropriation of $641,000 for debt service, or at the discretion of KEDFA, the use of $15 million in cash from the General Fund Surplus Account or the Budget Reserve Trust Fund. The authorization expires on June 30, 2018 if the private sector investment has not commenced prior to that date. Explanations provided during discussion on the House floor revealed that the project is located in Eastern Kentucky.

- **Education and Workforce Development Cabinet Office of Employment and Training** – HB 482 also directs that up to $3,500,000 of proceeds from the sale of any state–owned real property operated by the Office of Employment and Training shall be deposited in the Office of Employment Training Building Proceeds Fund, which is established in the bill, to support workforce operations. Any balance at the end of the current fiscal year are carried forward to the 2017-18 fiscal year, with any amount remaining at the close of that fiscal year to lapse to the General Fund. This is, in effect, a supplemental appropriation to the Education and Workforce Development Cabinet of funds that otherwise would be deposited in the General Fund.

- **Department of Juvenile Justice Building Sale** – SB 173 allows the Department of Juvenile Justice to use proceeds from the sale of facilities in Owensboro to service debt relating to Guaranteed Energy Savings Performance Contract loans, with the remainder to be used for a grant program operated by the department to encourage the development of community alternatives. This legislation will result in overall cost savings to the department by reducing future debt payments; however it diverts funds that would otherwise be deposited in the General Fund for another purpose.

- **Bowling Green Veteran’s Center** – HB 13 authorizes $10,500,000 in bond funds in FY 2016-17 to provide state matching funds for the Bowling Green Veteran’s Center so the project can be submitted to the United States Department of Veteran’s Affairs. The funding authorization is necessary for the project to be placed on a waiting list to receive federal funds. Debt service funding is provided from amounts already appropriated to the Finance and Administration Cabinet not needed to satisfy existing debt service obligations. The fiscal note on the bill indicates that the debt service would be $897,000 per year assuming a 5.5% interest rate and a 20 year payment on newly issued bonds. It is highly unlikely that this project will move quickly enough that the debt will be issued during the current biennium.

- **Capital Plaza and Renovation to State Occupied Buildings** – SB 238 allows the use of up to $600,000 in agency funds without additional approval of the General Assembly to renovate or retrofit a leased building that will eventually be owned by the state. This language addresses needs at a new building occupied by several state agencies, known as the “300 building,” that is a public/private partnership for which the lease cannot be modified. Any renovations or modifications undertaken as described above must be reported to the Capital Projects and Bond Oversight Committee.

  SB 238 also authorizes the Finance Cabinet to enter into a public-private partnership, build to suit, or lease purchase for the renewal of the Capital Plaza, noting that the upkeep and maintenance of the Capital Plaza as it is could be up to $800,000 per year. As such, this language does not have an immediate fiscal impact. However the language will allow the Finance Cabinet to move forward in issuing a RFP for the capital plaza in a public-private format structure that could impact future expenditures.

Bills Create Structure for Funding Provided in Budget

Three bills were enacted that establish a structure for the continuation of programs and funding provided in the 2016-2018 budget. Those programs are as follows:

- **Performance Funding for Higher Education** – The 2016-2018 budget bill transferred $42.9 million from the public university operating budgets to a newly created Postsecondary Education Performance Fund. The amount transferred to the fund is 5% of the fiscal year 2017-18 General Fund appropriations for public universities, including the Kentucky Community and Technical College System but excluding Kentucky State University. The 2016-18 budget provides that the amounts in the fund "will be distributed to postsecondary institutions, excluding Kentucky State, based on achievement of performance goals and metrics enacted by the General Assembly as recommended by the Postsecondary Education Working Group." SB 153 establishes this fund in statute, and sets forth the framework recommended by the Postsecondary Education Working Group to distribute the funds in 2017-18 and future years.

- **Dual Credit Scholarship Program** – The 2016-18 budget provides $5 million in 2016-17 and $10 million in 2017-18 to support a dual credit scholarship program for high school juniors and seniors. Legislation was enacted by the General Assembly in 2016 establishing the dual credit scholarship program, but that bill was vetoed by Governor Bevin after adjournment of the General Assembly. HB 206 represents the General Assembly's second attempt to establish the parameters for the program. HB 206 does not include the appropriation of a specific sum to support the program, so continuation of the program in the future will depend on additional appropriations by the General Assembly. HB 206 also allows KEES (college scholarship) funds to be used for costs associated with participation in apprenticeship programs. This expansion will result in more students using their KEES funds, which will increase the amount needed to fully fund KEES scholarships in future years.

- **Additional Coal Severance Funds For Coal Counties** – The General Assembly established the "Kentucky Coal Fields Endowment Fund" in the 2016-2018 budget bill, and appropriated $7.5 million from General Fund coal severance revenues in each year to the fund. In the budget bill, the Department for Local Government was to administer the fund, and amounts in the fund were to be used to diversify the economy of the coal regions of Kentucky. HB 156 creates the fund in permanent statutory language for the same purposes; appropriates $7.5 million annually from the General Fund portion of coal severance tax receipts to the fund; and establishes a board to oversee the expenditure of funds. There is no immediate fiscal impact from the passage of this bill as funds have already been appropriated for the 2016-18 biennium, but the bill will impact General Fund revenues in future years.

  HB 156 also establishes the Kentucky Mountain Regional Recreation Authority (KMRAA) "to establish, maintain, and promote a recreational trail system throughout the Kentucky Mountain Region Area to increase economic development, tourism, and outdoor recreation." The KMRAA replaces the Kentucky Recreational Trails Authority. The KMRAA s authorized to hire an executive director, which will cost an estimated $125,000 per year until the KMRAA is self-sustaining.

Other Legislation Amends the Current Budget

HB 471 makes several amendments to the 2016-2018 Budget, including the following:

- **Teacher's Retirement System –** Amended language allows the payment of a dependent subsidy for participants under the age of 65 from July 1, 2017 through June 30, 2018 similar to the dependent subsidy that Executive Branch agencies pay for their active employees who have similar coverage. The language requires reporting on the impact to the Appropriations & Revenue Committee if the KTRS Board of Trustees elects to provide the subsidy for the 2018 plan year.

- **Additional Transportation Funding For Schools** – Language regarding the use of excess SEEK funds is amended to require the funds to be used for pupil transportation under the SEEK formula, rather than transferred to KTRS to address the unfunded pension liability.
- **Charter School Funding** – Budget language addressing SEEK program funding is amended to include funding for Charter Schools. We have expressed our concern about charter school funding previously and those concerns remain. It is highly unlikely that the funding formula established in HB 471 will actually be the one used to fund charter schools because the language will expire before everything necessary for a charter school application to be submitted and reviewed can occur.
- **Use of Local District Capital Funds By Local School Districts** – The 2016-2018 budget bill as originally enacted permitted local school districts to apply to the Commissioner of Education to use capital funds for general operating expenses during the 2016-2017 school year only. The practice of allowing this diversion of funds through budget language began during the recession as one way to help school districts meet continuing and ongoing expenses. The budget language was amended to allow the practice to continue for 2017-2018, however the amount approved cannot exceed 50 percent of a local boards' trailing three-year average.
- **Volkswagen Mitigation Trust Agreement** – Language is added to the budget to prevent the expenditure of any funds received from the environmental mitigation trust established by Volkswagen without express authority of the General Assembly.
- **University of Kentucky Lease Authorization** – Language is added to authorize the lease of a building for a satellite medical facility for the University of Kentucky in Warren County.

Other Measures Will Have a Fiscal Impact

- **Tim's Law** – After several unsuccessful attempts in prior sessions, "Tim's Law", allowing court-ordered outpatient treatment for individuals meeting the statutory requirements, was passed during the 2017 session of the General Assembly, notwithstanding the Governor's veto of the measure. SB 91, the implementation of which is "contingent upon adequate funding," will cause increased workloads for prosecutors, public defenders, the courts and mental health providers in the state, and will therefore require additional resources or will require the already overburdened and underfunded agencies involved in implementation to stretch their insufficient resources even further. It is possible that one or more of the agencies required to participate in the process could refuse to do so without additional funding, since implementation is specifically contingent of adequate funding being available.

- **REAL ID** – HB 410 changes the method for issuance of instruction permits, operator's licenses and personal identification cards from a decentralized system using 142 circuit clerk locations to a centralized system operated by Transportation Cabinet. Circuit clerk offices will still accept applications, but the issuance of all documents will be from a central location. The measure increases fees and lengthens the renewal period from four to eight years after a transition period. Applicants will have the option of obtaining a voluntary travel ID document that complies with the requirements of the federal REAL ID Act of 2005, or a standard document that does not meet the requirements. This legislation increases both expenditures and revenues, with a net positive fiscal impact, although the impacts will be delayed as implementation is not expected until 2019 or 2020 according to the fiscal note accompanying the bill. Additional revenues in the first five years are expected to be \$11.4 million, with additional expenses of between \$1.95 and \$1.69 million for net positive revenue of \$9.45 to \$9.71 million annually. Both revenues and expenses are projected to decrease after the 5th year. Proceeds from the fees are distributed to several accounts with the majority going to the Road Fund.

- **Claims Commission** – HB 453 establishes the Kentucky Claims Commission and confirms an executive order. This legislation transfers the duties and responsibilities previously fulfilled by the Board of Tax Appeals and the Crime Victims Compensation Board to the Claims Commission. The legislation also amends various provisions that will impact the finances of the Commonwealth or expenses of the commission, including:

- An increase in the award cap from $200,000 to $250,000,or from $350,000 to $400,000 for multiple claims, which could result in larger awards;
- An increase in the filing limit from $100 to $250, which could result in fewer filings,
- Allowing claims under $2,500 rather than those under $1,000 to be handled internally rather than using a hearing officer, which should reduce expenses for the commission; and
- Decreasing the date by which claims must be filed from 5 years to 2 years, which could result in a decrease in the number of claims.