



NC 2016 Legislative Session Budget and Fiscal Policy Highlights

Budget Brief

August 15, 2016

Introduction

During the 2016 session, the General Assembly enacted a FY 2016-17 General Fund budget that provides \$22.3 billion in net appropriations, a 2.8% increase over the enacted budget for FY 2015-16. The budget provides salary increases for educators and State employees, a one-time cost-of-living supplement for retirees, additional funds for the Savings Reserve and Repairs and Renovations Reserve, a significant reduction from the projected FY 2016-17 budget for Medicaid, and an increase in the standard deduction under the Individual Income Tax. More specifically, the major components of S.L. 2016-94, 2016 Appropriations Act of 2016 (the Appropriations Act) are:

- \$192 million for salary and experienced-based step increases for educators, and \$15 million for pilot programs to provide bonuses to teachers who meet certain requirements.
- \$158 million for salary increases and \$122 million for bonuses for most State-funded employees.
- \$48 million nonrecurring for a 1.6% one-time cost-of-living supplement for State retirees.
- \$474 million for the Savings Reserve and \$81 million for the Repairs and Renovations Reserve from the General Fund unreserved fund balance, leaving a beginning unreserved fund balance of \$371 million for other purposes in FY 2016-17.
- A reduction of \$319 million to the Medicaid budget as a result of lower enrollment and lower projections for utilization and costs.
- An increase from \$15,500 to \$17,500 over the next two years in the standard deduction amount for married couples jointly filing Individual Income Tax returns; this change will result in a decrease of \$145 million in revenue for FY 2016-17 and \$200 million annually when fully implemented.

The General Assembly made additional commitments to reduce revenues and increase expenditures in future fiscal years and amended the State Budget Act to provide the Governor with ongoing budget authority in the event that a budget is not enacted before the next biennium begins.

General Fund Availability, Revenue, and Tax Changes

Total funding available for the General Fund in FY 2016-17, excluding State agency receipts, is \$22.3 billion. This \$22.3 billion in availability comes from three sources: the beginning unreserved fund balance, forecasted General Fund revenues, and tax law changes.

Beginning Unreserved General Fund Balance

The fund balance at the end of FY 2015-16 was projected to be \$926 million:

- \$175 million in unappropriated funds from the FY 2015-16 budget,
- \$421 million in reversions (appropriated but unexpended funds), and
- \$330 million in over collected revenue.



From this balance, \$474 million is earmarked to the Savings Reserve, bringing the total amount to just under \$1.6 billion, or about 7.5% of the prior year General Fund operating budget. The General Assembly also earmarked \$81 million for repairs and renovations, leaving a beginning unreserved fund balance of \$371 million in funds available for other purposes in FY 2016-17.

General Fund Revenue

The single largest source of General Fund availability is revenue, which the Fiscal Research Division (FRD) and the Office of State Budget and Management (OSBM) estimate jointly through a consensus revenue forecasting process. The final FY 2016-17 consensus forecast, produced after April tax collections were tabulated, projected increased General Fund revenue of \$250 million for a total of \$22.2 billion. This increase was primarily the result of stronger than expected Individual Income Tax collections. Despite the continued expectation of solid economic growth, State revenue in FY 2016-17 is projected to grow by only 0.8% due to tax law changes enacted in previous sessions, which are estimated to reduce revenue by approximately \$780 million over last fiscal year.

Tax Law Changes

The Appropriations Act includes adjustments to the Individual Income Tax, the Sales and Use Tax, and the Mill Machinery tax.

Individual Income Tax. The Standard Deduction is increased by \$1,000 each year for the next two years, going from \$15,500 in tax year 2016 to \$17,500 in 2018 for taxpayers who are married, filing jointly, and by lesser amounts for taxpayers with other filing statuses. Once fully implemented, the change in the standard deduction will reduce General Fund revenue by approximately \$200 million annually. For FY 2016-17, the standard deduction increase is expected to reduce revenue by \$145.0 million.

Sales and Use Tax. Several modifications and clarifications are made to the sales tax on services enacted in Section 32.18 of S.L. 2015-241, 2015 Appropriations Act, including amending tax law to treat similar transactions the same, regardless of who provides the service. S.L. 2016-94 exempts multiple services from the tax, including:

1. self-service car washes,
2. alteration and repair of clothing,
3. pest control services,
4. cleaning of real property,
5. moving services,
6. removal of waste from tangible personal property, except that removal of waste from portable toilets is taxable,
7. repairs and maintenance to real property by real property contractors within 12 months of new structure being occupied for the first time,
8. landscaping,
9. services performed for a related member,
10. home inspections,
11. government-imposed inspection fees, and
12. services performed to roads, driveways, sidewalks, and parking lots.

The Appropriations Act also limits the tax on airplane and boat repair and maintenance to the first \$25,000 of repair and maintenance work performed and applies a “capital improvements test” to help determine whether various repair, installation, and maintenance services are subject to tax. These combined changes increase both State and local government sales tax revenue. The revenue increase projected for local governments is sufficient to offset the General



Assembly's repeal of G.S. 105-524.(e), which was enacted in the 2015 session and which would have required the State to redirect \$17.6 million of its sales tax revenue annually to local governments, beginning in FY 2016-17, via the local option sales tax distribution formulas. The net impact of these changes on FY 2016-17 State revenues is estimated to be a \$30.9 million increase.

Mill Machinery Tax. The list of items eligible for preferential tax treatment under the mill machinery tax, a 1% tax capped at \$80 per item, is expanded to apply to the following items, formerly subject to sales and use taxes:

1. Attachments, accessories and repair parts for a company located at a ports facility for waterborne commerce,
2. Secondary metals recyclers and precious metals recyclers, and
3. Metal fabricators that have gross receipts from fabrication of metal work in excess of \$8 million.

The fiscal impact of these changes is included in the Sales and Use Tax estimate above.

General Fund Appropriations and Budgetary Actions

The General Fund budget enacted by the General Assembly provides for \$22.3 billion in net appropriations in FY 2016-17, a 2.8% increase over the enacted budget for FY 2015-16. S.L. 2016-94 includes salary increases and benefit changes for State employees and educators, adjustments to State agency budgets, including a reduction to the Medicaid base budget, future year changes to tax laws and statutory appropriations, and policy changes related to the Governor's budget authority.

Salary and Benefit Changes

Salary Increases for Most State-funded Employees. The Appropriations Act includes nearly \$5.7 billion in net appropriations to support the salaries of more than 150,000 full-time equivalent (FTE) positions in the legislative, judicial, and executive branches of State government, including those employed by the University of North Carolina (UNC) system, as well as State-funded employees of the State's 58 community colleges and non-educator employees of the State's 115 public school districts. Compensation increases include four major components:

1. \$158 million recurring for salary increases, including:
 - a. 1.5% for most State employees,
 - b. 4.5% for judicial branch employees,
 - c. A step increase for employees paid in accordance with experience-based salary plans, and
 - d. Continued implementation of custody-based pay for correctional officers.
2. \$35 million nonrecurring for a 0.5% one-time bonus.
3. \$70 million nonrecurring for merit-based bonuses.
4. \$17 million nonrecurring for Community College employee bonuses.

Salary Increases for Educators. The Appropriations Act includes over \$4.4 billion in net appropriations to support the salaries of approximately 95,000 educators, including teachers and instructional support personnel employed by public school districts (LEAs) and State agencies. S.L. 2016-94 provides over \$192 million for recurring salary and experienced-based step increases for these educators. The salaries of educators not paid on the salary schedule (i.e., those subject to the hold harmless established in FY 2014-15) were not increased.

The revised teacher salary schedule for FY 2016-17 (see Appendix A) provides a monthly minimum salary of \$3,500 for teachers with no years of experience to \$5,100 for teachers with 25 years of experience or more. For educators with 15 or fewer years of experience, the schedule returns to annual steps; these educators will no longer be



compensated on the basis of the tier system established in FY 2014-15. Educators with 16 years of experience or more will continue to be compensated on the basis of tiers, which cover multiple years of experience.

The budget also includes \$15 million for pilot programs providing one-time bonuses to teachers who meet the following requirements:

- Third grade reading teachers whose students' Education Value-Added Assessment System (EVAAS) reading growth scores are in the top 25% statewide or within their LEA. Section 9.7 of S.L. 2016-94 provides additional details on this bonus.
- Teachers whose students successfully complete an advanced placement (AP) exam, an international baccalaureate (IB) exam, or receive a career technical or industry certification. Bonuses are calculated per student, and capped at \$2,000 per teacher. Details of these bonus programs can be found in Sections 8.8 and 8.9 of S.L. 2016-94.

Retirement Systems. The Appropriations Act funds each of the State-supported retirement systems at the actuarially determined contribution (ADC) or higher. The contribution rate for the Teachers and State Employees' Retirement System (TSERS), the largest of these retirement systems, is increased to 9.98% of pay; the amount of this increase (\$79 million from the General Fund and \$2 million from the Highway Fund), reflects all impacts of 2016 legislation. TSERS has 310,000 contributing members, 190,000 beneficiaries, and pays retirement benefits of \$4.1 billion annually to retirees of State agencies, departments, institutions, universities, local public schools, and community colleges.

The 2016 Appropriations Act also provides a 1.6% one-time cost-of-living supplement to retirees of TSERS, the Consolidated Judicial Retirement System, and the Legislative Retirement System at a cost of \$48 million. The supplement is nonrecurring and does not increase the ongoing monthly benefit.

State Health Plan (SHP). The SHP administers health benefit coverage for 700,000 active State agency, department, institution, university, local public school, and community college employees; eligible retired employees; certain dependents of active and retired employees; active and retired employees of selected local governments; and certain fire and rescue squad and National Guard members. Total requirements for FY 2016-17 are projected to be roughly \$3.1 billion. 2016 premiums for the SHP are shown in Appendix B.

The 2016 Appropriations Act does not provide additional funds for SHP employer premium increases. However, Section 36.24 of the Act authorizes the Director of the Budget to use \$70 million in funds reserved under S.L. 2015-241, 2015 Appropriations Act, to increase FY 2016-17 employer contributions to the SHP if the Director determines that cost-controlling measures adopted by the SHP Board of Trustees and the State Treasurer are sufficient to reduce employer premium increases in the 2017-2019 fiscal biennium to 4% or less. If allocated, the additional \$70 million would flow into the general cash reserves of the SHP and would represent an increase of 3.4% for FY 2016-17. The employer-paid premium for each active SHP member would increase from \$5,471 to \$5,659.

Budget Adjustments by Appropriations Committee Area

The chart on the next page shows the enacted budget for each appropriations committee as well as the budgetary changes between FY 2015-16 and FY 2016-17.



**Year Over Year Budget Comparison by Appropriations Committee
FY 2015-16 vs. 2016-17 (\$ millions)**

Committee/Area	FY 2015-16 Enacted	FY 2016-17 Enacted	% Change
Education	12,332.4	12,681.6	2.8%
Health and Human Services	5,130.5	5,020.9	(2.1%)
Justice and Public Safety	2,502.9	2,601.7	3.9%
Agriculture and Natural and Economic Resources	465.9	536.3	15.1%
General Government	391.7	427.5	9.1%
Debt Service, Reserves, IT and Capital	911.3	1,073.4	17.8%
Total General Fund Net Appropriations	\$21,734.7	\$22,341.4	2.8%

Education. The major budget changes in Education include:

- Increases in salaries and benefits discussed in the previous section,
- Increases in funds for enrollment growth in public schools (\$47 million), and universities (\$31 million), and
- Establishment of a nonrecurring reserve of \$35 million to shift the Opportunity Scholarship grant program to forward funding.

A more detailed summary of budget actions in Education can be found [here](#).

Health and Human Services (HHS). The most significant HHS action is a \$319 million reduction to the Medicaid base budget. During the 2015 session the General Assembly budgeted \$3.9 billion in net appropriations to Medicaid for FY 2016-17. During the 2016 Session, the General Assembly reduced that amount to \$3.6 billion (about 7.9%) due to a Division of Medical Assistance forecast which was based on lower Medicaid enrollment and smaller increases in utilization and costs than what had been projected. More details on the HHS budget can be found [here](#).

Agriculture and Natural and Economic Resources (ANER) and General Government. As shown in the table above, ANER and General Government had the largest percentage increases in their budgets. Some of the major legislative actions include:

- Additional nonrecurring funding for water infrastructure grants and projects (\$30 million).
- A nonrecurring increase for downtown revitalization grants (\$5.7 million).
- A nonrecurring increase for the Clean Water Management Trust Fund (\$8.6 million).
- Nonrecurring funding for a career and technical education center in Onslow County (\$5 million).
- Nonrecurring funding for two challenge grants at UNC-Chapel Hill, one for the Policy Collaboratory, and another for applied physical sciences (\$7.5 million).
- Additional nonrecurring funding for the Workforce Housing Loan Program (\$5 million).



More details on ANER, General Government and other sections of the budget can be found at the following links or at www.ncleg.net/fiscalresearch/fiscal_briefs/fiscal_briefs.html:

- [Education](#)
- [Health and Human Services](#)
- [Agriculture and Natural and Economic Resources](#)
- [Justice and Public Safety](#)
- [General Government](#)
- [Transportation](#)
- [Information Technology](#)

Laws Impacting Later Years

For FY 2016-17 recurring obligations are funded entirely from recurring sources rather than from one-time funding sources. However, beyond FY 2016-17 the General Assembly has passed laws that reduce future tax revenues or increase future appropriations in the following ways:

- Future tax revenues will be reduced from ongoing changes to the individual and corporate income taxes as enacted in S.L. 2013-316, Tax Simplification and Reduction Act, S.L. 2015-241, 2015 Appropriations Act, and S.L. 2016-94, 2016 Appropriations Act. Those changes are projected to reduce revenues for FY 2017-18 by \$405 million relative to what is projected for FY 2016-17. These changes will reduce revenues by an estimated \$662 million by FY 2021-22.
- Section 11.4 of S.L. 2016-94 commits \$40 million in recurring appropriations for the NC Promise Tuition Plan at UNC beginning in FY 2018-19.
- Section 11A.4 of S.L. 2016-94 establishes a statutory appropriation requiring annual increases for the Opportunity Scholarship Grant Fund Reserve starting in FY 2017-18 and ending in FY 2026-27. The budget for this scholarship would increase by \$10 million each year for ten years for a cumulative increase of \$100 million by FY 2026-27.
- Section 9.1 of S.L. 2016-94 states the intention of the General Assembly to revise the teacher salary schedule upward for FY 2018-19. Following through on the commitment would require an estimated \$360 million.

Ongoing Budget Authority for the Governor

Section 6.3 of S.L. 2016-94 amends the State Budget Act (Chapter 143C) to authorize the Director of the Budget to continue funding State government beyond the end of the biennium in situations where an appropriations act has not become law. In the past, when an appropriations act has not been enacted by the end of a biennium, the General Assembly has enacted temporary budget measures to continue State government operations until the main appropriations act can be enacted. These temporary budget measures are known as continuing resolutions. Section 6.3 would obviate the need for continuing resolutions in the future. If no appropriations act is passed by June 30, 2017, for example, the State Budget Act would allow the Director of the Budget to continue to allocate funds for expenditure at a level not to exceed FY 2016-17 levels.



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Appendices

Appendix A: FY 2016-17 “A” Monthly Teacher Salary Schedule

Years of Experience	Monthly Salary
0	\$3,500
1	\$3,575
2	\$3,600
3	\$3,625
4	\$3,675
5	\$3,725
6	\$3,800
7	\$3,850
8	\$3,900
9	\$3,950
10	\$4,025
11	\$4,100
12	\$4,175
13	\$4,250
14	\$4,325
15 - 19	\$4,525
20 - 24	\$4,800
25	\$5,100

Appendix B: Employee/Retiree Monthly Premiums Effective January 1, 2016¹

Coverage Type	Traditional 70/30 Plan	Enhanced 80/20 Plan ²	Consumer Directed ²
Non-Medicare Active Employee/Retiree			
Employee/Retiree Only	\$0.00	\$14.20	\$0.00
Employee/Retiree + Child(ren)	\$210.92	\$294.72	\$189.82
Employee/Retiree + Spouse	\$543.46	\$660.52	\$489.14
Employee/Retiree + Family	\$578.86	\$699.42	\$520.96
Medicare Primary for Both			
Employee/Retiree and Dependent(s)	Traditional 70/30 Plan	Base Medicare Advantage	
Employee/Retiree Only	\$0.00	\$0.00	
Employee/Retiree + Child(ren)	\$150.06	\$132.00	
Employee/Retiree + Spouse	\$394.56	\$132.00	
Employee/Retiree + Family	\$429.92	\$264.00	

¹ Employer premium is \$463.68 per month (\$360.24 for Medicare Primary).

² Premiums for Enhanced 80/20 and Consumer Directed Health Plan (CDHP) assume member completes three wellness activities: smoking attestation; primary care physician selection and Patient Centered Medical Home video viewing; and a health assessment.