

Three-Year General Fund Financial Outlook

FY 2024-25 to FY 2026-27

Prepared Pursuant to Act 156 of 2005

§11-11-350

South Carolina Revenue and Fiscal Affairs Office

December 2023



Three-Year General Fund Financial Outlook

FY 2024-25 to FY 2026-27

**Based on Enacted FY 2023-24 Budget
(Dollars in Millions)**

	FY 2023-24	FY 2024-25	FY 2025-26	FY 2026-27
	"Base Year"			
<u>Resources:</u>				
Revenue	12,885.5	13,214.2	13,628.3	14,272.5
Tax Relief Trust Fund Transfers	(795.9)	(800.8)	(814.9)	(825.1)
General Reserve Fund Transfer	(140.0)	(24.3)	(46.3)	(83.1)
Income Tax Rate Reduction	(5.0)	(99.8)	(99.8)	(99.8)
Total Budgetary Revenue/Resources	\$11,944.6	\$12,289.2	\$12,667.3	\$13,264.5
Recurring Base	\$11,636.5	\$11,636.5	\$11,636.5	\$11,636.5
<u>Recurring Expenditures (Adjustments to Base Year):</u>				
Constitutional/Statutory Items:				
Capital Reserve		(20.3)	(27.4)	(17.7)
Local Government Fund		13.9	23.3	38.1
Debt Service		(95.3)	(122.1)	(122.1)
Homestead Exemption Fund Shortfall		0.0	0.0	0.0
Major Expenditure Categories (Maintenance of Effort):				
Public Education		38.6	77.3	116.0
Health and Social Services		119.7	208.0	294.4
Higher Education		8.6	17.3	25.9
Correctional		14.5	29.4	44.5
Public Safety		6.9	9.9	12.9
Transportation		0.0	0.0	0.0
State Employee Health Plan (Retiree Growth + Rate Increase)		94.1	208.1	312.8
State Employee Compensation Changes (2 percent per year)		58.1	120.4	186.9
Total Cumulative Expenditures	\$11,636.5	\$11,875.4	\$12,180.5	\$12,528.2
Increase over the Base Year		\$238.9	\$544.0	\$891.7
Recurring Balance for Other Appropriations		\$413.9	\$486.8	\$736.3
Projected Reserve Funds		\$1,109.4	\$1,148.5	\$1,241.3
Capital Reserve		\$369.8	\$362.7	\$372.4
General Reserve		\$739.6	\$785.8	\$868.9

*The Notes and Assumptions are an integral part of this Financial Outlook.
Revenue is based on the BEA Long Range Revenue Forecast, 11/16/2023*

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Introduction

The Three-Year General Fund Financial Outlook is prepared by the South Carolina Revenue and Fiscal Affairs Office in accordance with Section 11-11-350 of the S. C. Code of Laws, 1976. The Outlook is a three-year revenue and spending projection based on the enacted FY 2024 General Fund operating budget and revenue assumptions by the S.C Board of Economic Advisors.

Agencies receiving more than one percent of total general fund appropriations for FY 2024 were surveyed regarding their fiscal outlook and this report serves to summarize their responses. The agencies were asked to evaluate their existing programs and estimate the future funding needed to maintain these programs and to implement any mandatory federal or state programs. In addition, agencies were asked to identify factors that are driving these increases. The table on page one shows the anticipated increase over the base year required for maintenance of effort. Maintenance of effort is a subjective term and actual needs will vary depending on economic conditions, agency policies, and legislative changes. The pages following provide a brief explanation for the increases.

If the projected balance is negative in any year, a budget gap exists. A budget gap reflects a structural imbalance between projected revenue growth and expenditure increases based on the adjusted enacted budget.

This document is intended to be used for illustrative purposes only. The outlook should not be viewed as required funding, nor should it be viewed as an agency's future budget requests. The Outlook does not attempt to capture every agency's needs or budget requests. This document is preliminary and is subject to revision.

Key Points

- ✦ South Carolina's fiscal outlook remains positive as the state's population growth is among the nation's highest due to net in-migration, especially with retirees.
- ✦ Economic Development is also contributing to the state's growth.
- ✦ Employment and personal income are expected to return to long term growth rates experienced prior to the pandemic years, resulting in growth in general fund revenues.
- ✦ The State continues to increase its reserves to safeguard against an unexpected downturn in the economy. By FY 2027, total reserve funds will total approximately 10 percent of cumulated expenditures.
- ✦ In FY 2027, expected budgetary revenues are \$1.63 billion (or 14.0 percent) above the FY 2024 base expenditures.
- ✦ The major items listed in this report as maintenance of effort are estimated to increase \$0.89 billion, leaving a residual of \$0.74 billion. This conclusion, however, is highly dependent on actual budget and revenue actions over the next two years.

Assumptions About Resources and Revenues

Economic Forecast

The economic forecast is based on the Board of Economic Advisors (BEA) long-range General Fund revenue forecast as of November 16, 2023. In November, the forecast for FY 2024 was updated and the initial estimate for FY 2025 was introduced. The Board also adopted the long-range forecast for FY 2026 and FY 2027. While the state's economy and revenues are expected to continue to perform better than the nation, we anticipate slower than normal growth over the next two fiscal years in FY 2024 and FY 2025. However, expectations for FY 2026 and FY 2027 reflect a return to historical levels of revenue growth.

Updated FY 2024 Forecast

The FY 2024 budget was based on the May 2023 forecasted budgetary revenue¹ of \$11,636.5 million, net of legislative changes. As of November 2023, the BEA increased the budgetary revenue estimate for FY 2024 to \$12,084.6 million. Recurring general fund appropriations for FY 2024 total \$11,636.5 million. If revenues continue to perform as anticipated, the year could end with a surplus of approximately \$448.1 million dollars.

Assumptions and Methodologies for FY 2025

The FY 2025 revenue estimate developed in November 2023 serves as the base for the long-range forecast. Overall, gross general fund revenue is expected to increase by 2.6 percent in FY 2025.

The forecast for FY 2025 includes the following assumptions:

- ✦ Personal income will grow 4.3 percent for FY 2024 and 3.8 percent for FY 2025.
- ✦ Employment remains above pre-pandemic levels and slows to an average growth pattern through the remainder of FY 2024 followed by a slowdown to below average employment growth in FY 2025.
- ✦ Sales tax will increase by 1.7 percent in FY 2025 as collections return closer to historical levels and consumer spending behavior shifts back towards a more historical mix of services and goods.
- ✦ Forecasted individual income tax revenue will increase 2.7 percent, driven by growth in withholdings of 3.8 percent; however, actual revenue collections and the budget will be impacted by the additional tax rate reduction from 6.4 percent to 6.3 percent as required by the Comprehensive Tax Cut Act of 2022 (Act 228).
- ✦ Corporate income tax will decrease by 2.6 percent as corporate profits are expected to moderate from their peak in 2022.

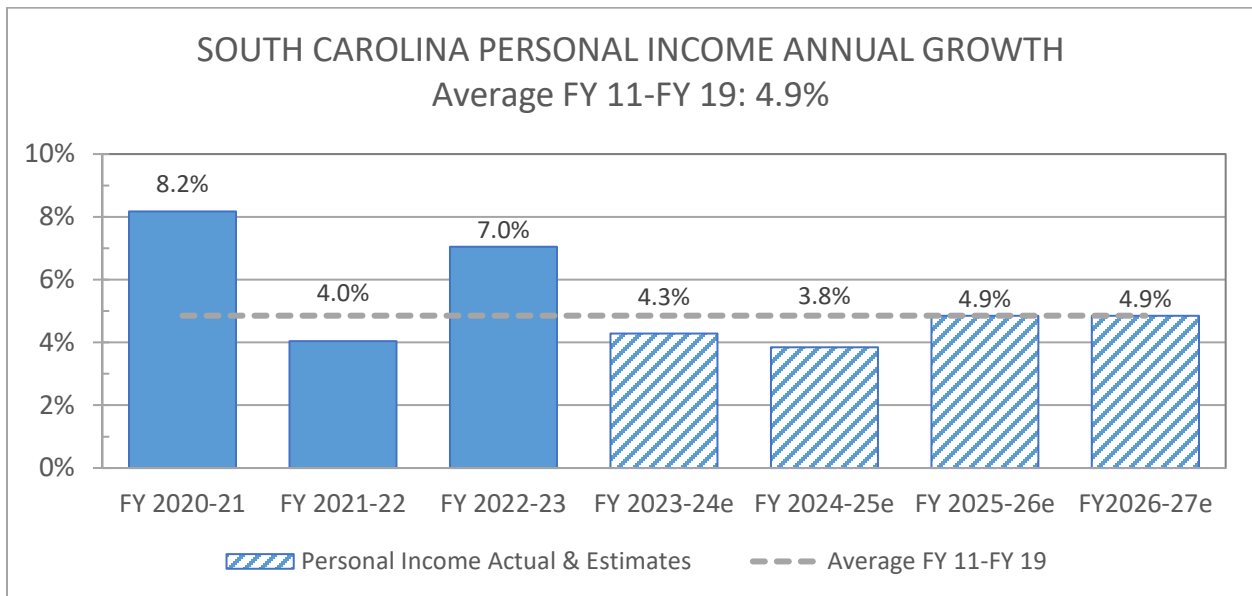
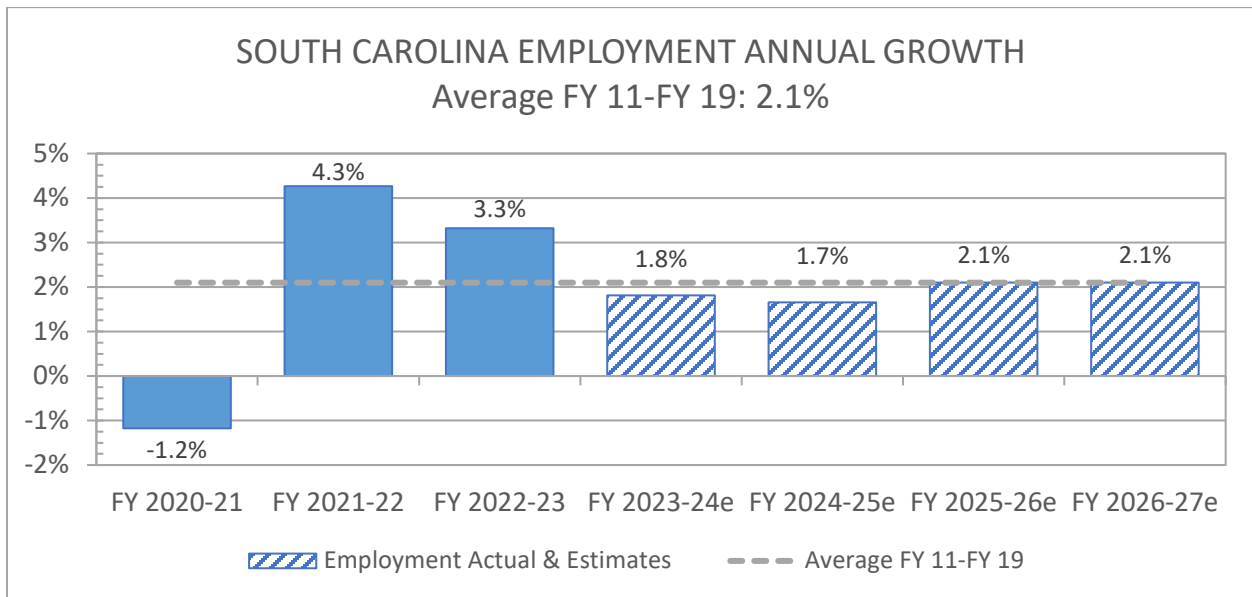
Anticipated reductions in consumer spending and continued high interest rates are expected to slow economic and wage growth during the next two fiscal years. The modest growth of 2.6

¹ Budgetary revenue is equal to gross general fund revenue less allocations to the Tax Relief Trust Fund.

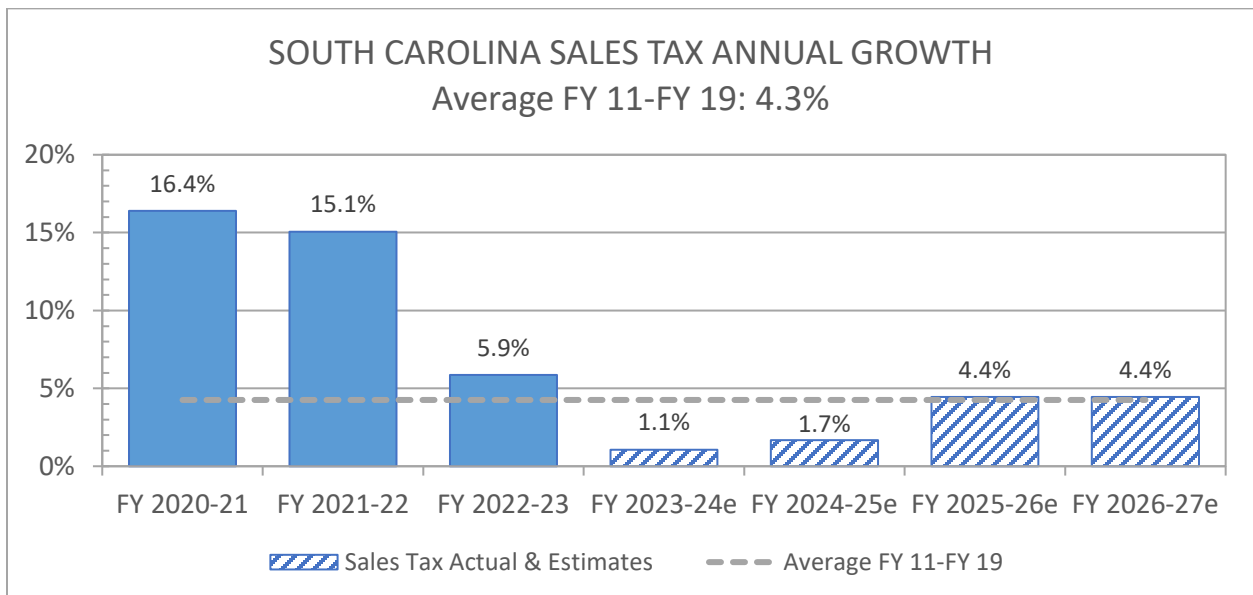
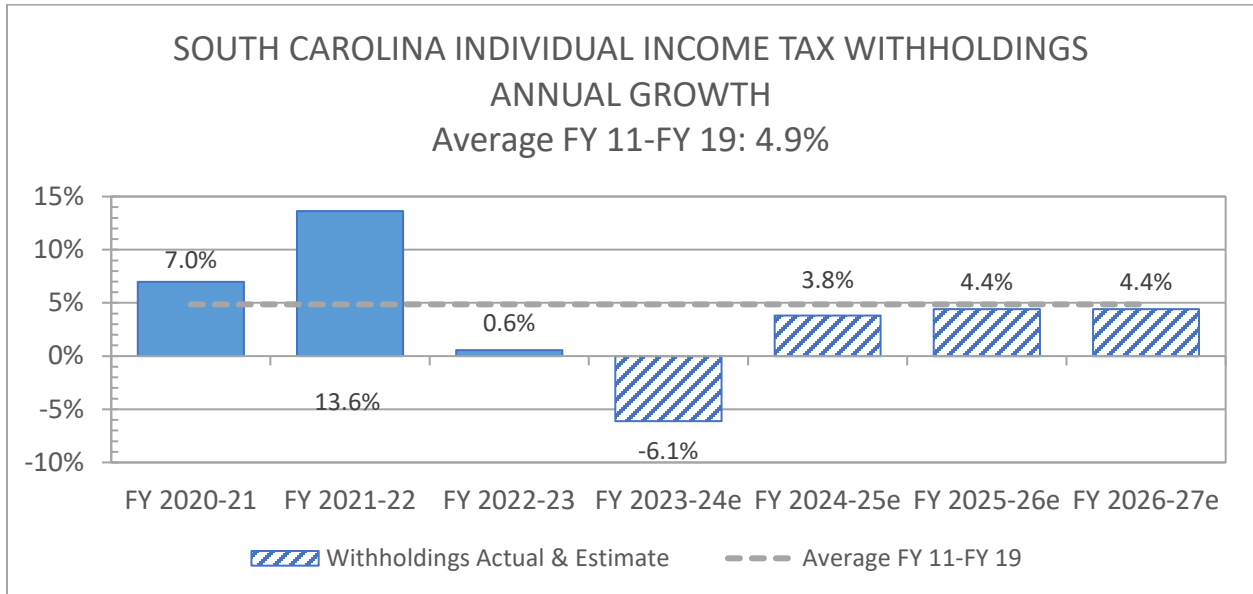
percent reflects expectations for slower-than-normal growth in income and employment growth and, consequentially, slower growth in revenue. Growth in the major revenue categories is expected to remain below historical averages. In addition to challenges from higher borrowing costs and changing consumer behavior, concerns about the global economy with wars in Ukraine and the Middle East are a significant factor in the expectations for a slowdown in economic growth.

Long-Range Forecast

The plan is built upon a return to historical average growth in personal income and historical growth rates or patterns in the revenue sources. Over the years from FY 2011 to FY 2019 following the great recession, personal income and employment have grown 4.9 and 2.1 percent respectively as shown below.



Gross General Fund revenue is expected to increase in FY 2026 and FY 2027 at rates of 3.1 and 4.7 percent, respectively. A return to historical levels of growth is anticipated in sales tax, individual income tax, and corporate income tax. Individual income tax withholdings are expected to grow by 4.4 percent, compared to 4.9% historically from FY 2011 to FY 2019. Sales tax is expected to grow 4.4%, compared to 4.3% historically. (See Appendix B).



Distribution of Recurring Appropriations

After allocations for insurance, employer contributions for retirement systems, and base pay increases, 14 agencies received one percent or more of the general fund recurring appropriations for FY 2024 (see Appendix A). Appropriations for these “one percent” agencies totaled \$8.9 billion, or 76.1 percent of all general fund recurring appropriations. Figure 1 below shows the breakout of these funds, the majority of which are appropriated for public education and health and social services. Other appropriations greater than one percent went to Aid to Subdivisions, Capital Reserve Fund, and Debt Service, which accounted for 2.7, 1.3, and 3.4 percent, respectively. The remaining 16.5 percent, or \$1.9 billion, was distributed among the other agencies.

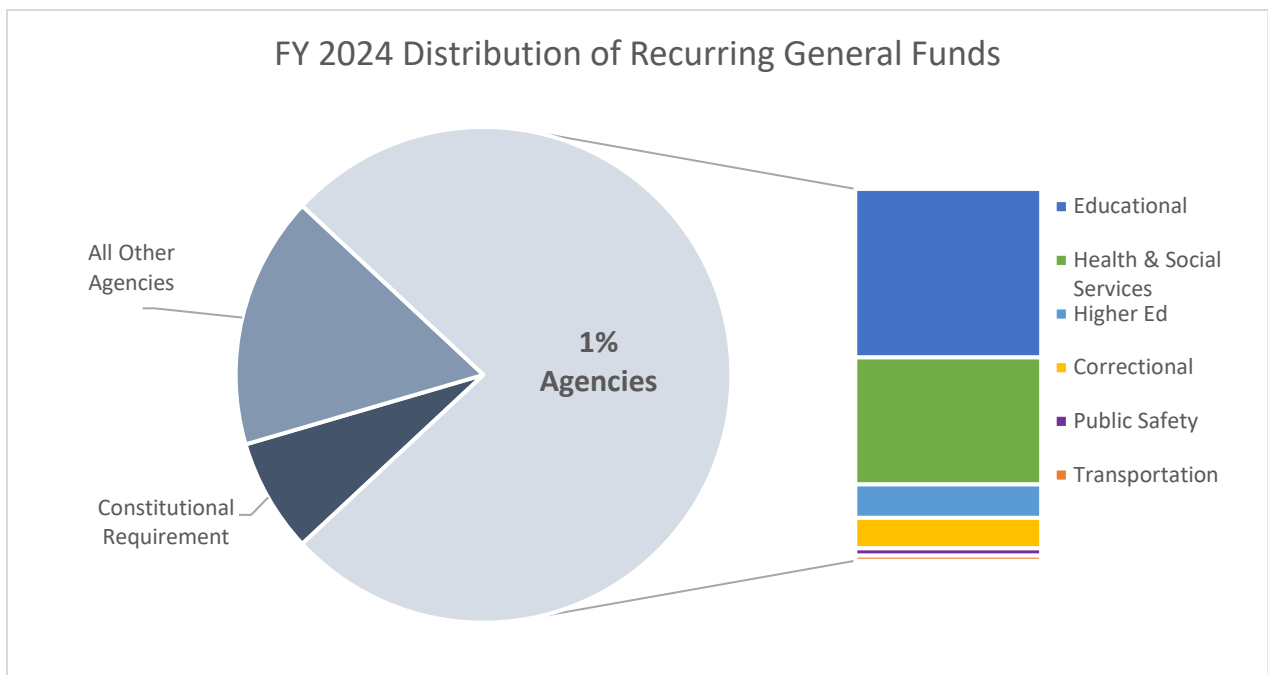


Figure 1: Distribution of recurring general fund appropriations for FY 2024.

Reserve Funds

The State maintains two main reserve funds, the General Reserve Fund and the Capital Reserve Fund, to safeguard against unexpected budget shortfalls. The balances required for these two funds are determined by statute and are dependent upon the actual general fund budgetary revenue collected during the previously completed fiscal year. Due to the ongoing economic uncertainty, the BEA continues to be cautious in its forecasting. Should revenue performance differ significantly from current projections, the contribution requirements to the reserve funds will likewise change.

Table 1 displays the balance required to fully fund the reserves, the budgetary revenues used to determine that balance, and the necessary incremental contribution needed to make the fund whole for each fiscal year.

General Reserve Fund

The General Reserve Fund serves as a savings account which may only be used to cover operating deficits of state government. The reserve was originally funded at 3 percent of budgetary revenue. This requirement was increased to 5 percent beginning FY 2015. With the passage of Act 238 of 2022, the General Assembly voted to increase the reserve funding requirement to 7 percent, which was later approved by public referendum. The applicable rate increased to 5.5 percent for FY 2024 and will increase one-half of one percent until the rate reaches 7 percent in FY 2027. This analysis assumes that the General Reserve Fund is not needed to cover any year-end deficit during the forecast period.

Often, the increase to the General Reserve Fund is funded using nonrecurring sources. However, this would be an obligation on recurring funds if nonrecurring sources are not available.

Capital Reserve Fund

The Capital Reserve Fund (CRF) is a budgetary account used to offset budget deficits and to replenish, when needed, the required amount in the General Reserve Fund. If not used for either purpose, the CRF may be appropriated for the following: (1) to finance in cash previously authorized capital improvement bond projects, (2) to retire the interest or principal on bonds previously issued, or (3) for capital improvements or other nonrecurring purposes. Act 238 of 2022 also increased the funding requirement for the CRF from 2 percent to 3 percent of budgetary revenue beginning FY 2024.

Because budgetary general fund revenues decreased in FY 2023 are anticipated to decrease further in FY 2024, funding requirements will decrease by \$20.3 million in FY 2025, and \$7.1 million in FY 2026. As the CRF is renewed in full each fiscal year, it is possible that the annual appropriation may be reduced.

Table 1 Reserve Requirements

	FY 2022	FY 2023	FY 2024e.	FY 2025e.
General Fund Budgetary Revenue	13,004.4	12,326.1	12,089.5	12,413.4
	FY 2024	FY 2025e.	FY 2026e.	FY 2027e.
General Reserve Fund Required Balance	715.2	739.6	785.8	868.9
Annual Appropriation	140.0	24.3	46.3	83.1
Capital Reserve Fund Required Balance	390.1	369.8	362.7	372.4
Incremental Adjustment	180.9	(20.3)	(7.1)	9.7
Total Reserve Balance	1,105.4	1,109.4	1,148.5	1,241.3
Total Incremental Adjustment	320.9	4.0	39.2	92.8

Statewide Expenditures

Local Government Fund

The Local Government Fund (LGF) is a statutorily defined appropriation of funds to counties and municipalities from the general fund of the state. Act 84 of 2019 amended the formula used to calculate the annual appropriation. Under the new formula, the annual appropriation is determined by the growth in the BEA General Fund revenue projection for the planning year over the current fiscal year’s appropriation base. The current LGF is to be increased by the same growth rate, up to a maximum of 5 percent. The formula change was to take affect beginning in the FY 2021 budget. However, the pandemic hindered the budget development process in the spring of 2020, and the state operated under a Continuing Resolution that extended funding levels for state government into FY 2021. Therefore, the new funding formula was not incorporated until the FY 2022 budget. Figure 2 shows the actual funding of the LGF in relation to the balance that would have been required per statute.

The LGF is distributed to counties and municipalities based on decennial Census population. Counties receive 83.278 percent of the fund, and municipalities receive the remaining 16.722 percent. Fifty cents per capita is withheld from the portion of the LGF allotted to counties per §44-6-146 for Medicaid services.

The growth rate for revenues over appropriations for FY 2025 is 6.68 percent, so the increase to the LGF is capped at 5 percent. Growth in state revenue is expected to be slower over the next two years, and the increase to the LGF is expected to be 3.22 percent for FY 2026 and 4.95 percent for FY 2027. Annual increases for FY 2025, FY 2026, and FY 2027 are \$13.9 million, \$9.4 million, and \$14.9 million, respectively.

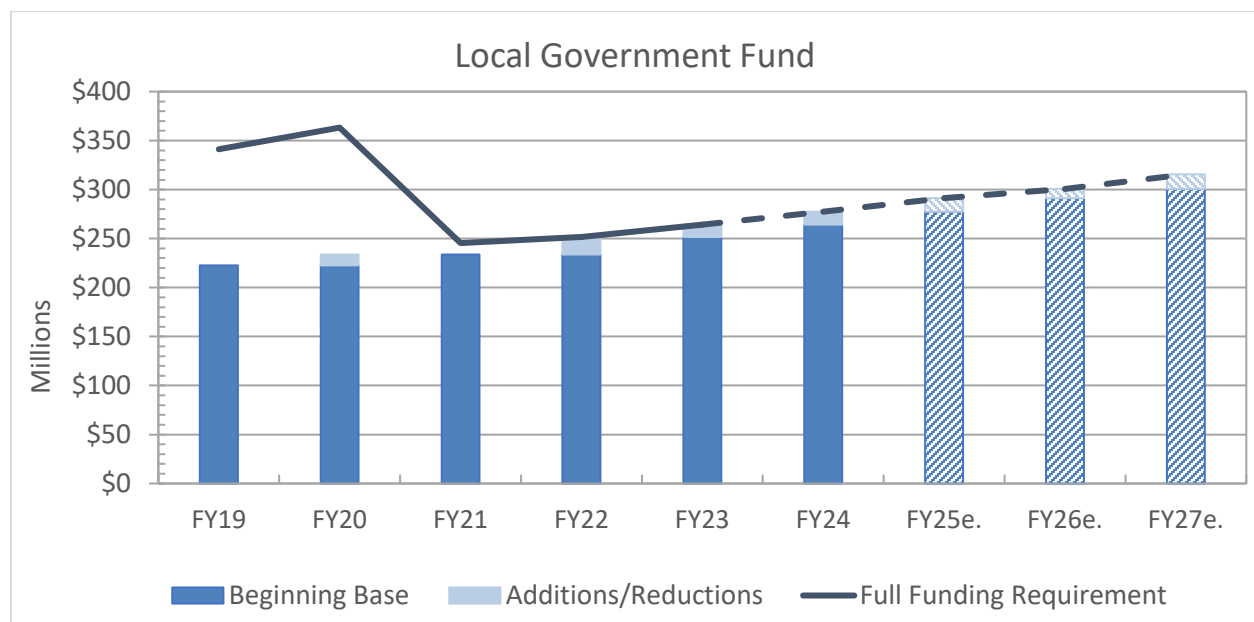


Figure 2 Local Government Fund appropriations vs. formula funding.

Debt Service

Future Debt Service needs will decline over the forecast period based upon current projections and obligations. This analysis assumes that Debt Service will continue to be funded at the current level of \$153.9 million. This estimate reflects existing law and does not include the potential impact of proposed legislation. Figure 3 displays the funds required for Debt Service each year along with the anticipated amount above current obligations. Debt service appropriated above obligations is often used to fund nonrecurring items, however, the anticipated excess for FY 2024 was not appropriated. The Debt Service obligation for FY 2024 is \$66.2 million. The State Treasurer's Office (STO) intends to use \$91 million of the appropriation above current obligation to pay down general obligation bond debt. STO is authorized to take this action per Proviso 112.2 of the FY 2024 Appropriations Act. FY 2024 includes \$8.5 million carried forward from the previous year.

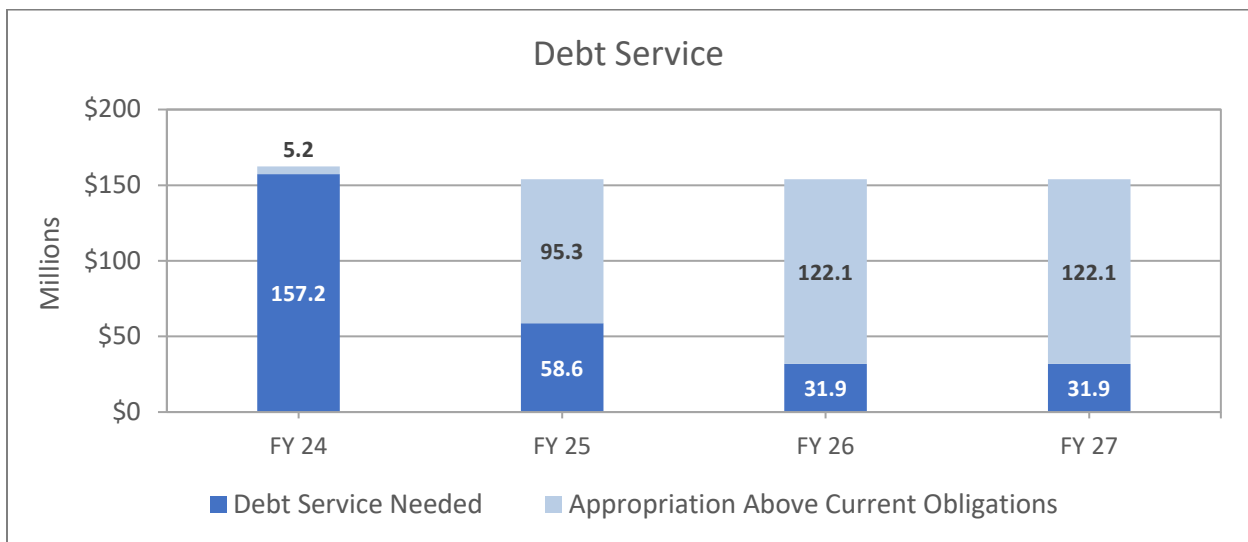


Figure 3 Debt Service Requirements

Homestead Exemption Fund

The Property Tax Reform Act, Act 388 of 2006, eliminated all school operating taxes on owner-occupied homes and implemented a one-cent state sales tax to replace the reduced property tax revenue stream. The new revenue from the one-cent sales tax increase is earmarked for the Homestead Exemption Fund, which replaces the local school district property tax revenue. The funding formula requirement is based on inflation plus a population growth factor. The Act provides that, should there be a shortfall of revenue in the Homestead Exemption Fund, the deficit will be funded using general fund revenue.

Currently, the Homestead Exemption Fund is forecasted to be fully funded from the one-cent sales tax revenue. However, if the state experiences an economic downturn, it may become necessary to appropriate general funds. Figure 4 illustrates the estimated revenues and expenditures for the Homestead Exemption Fund for the forecast period.

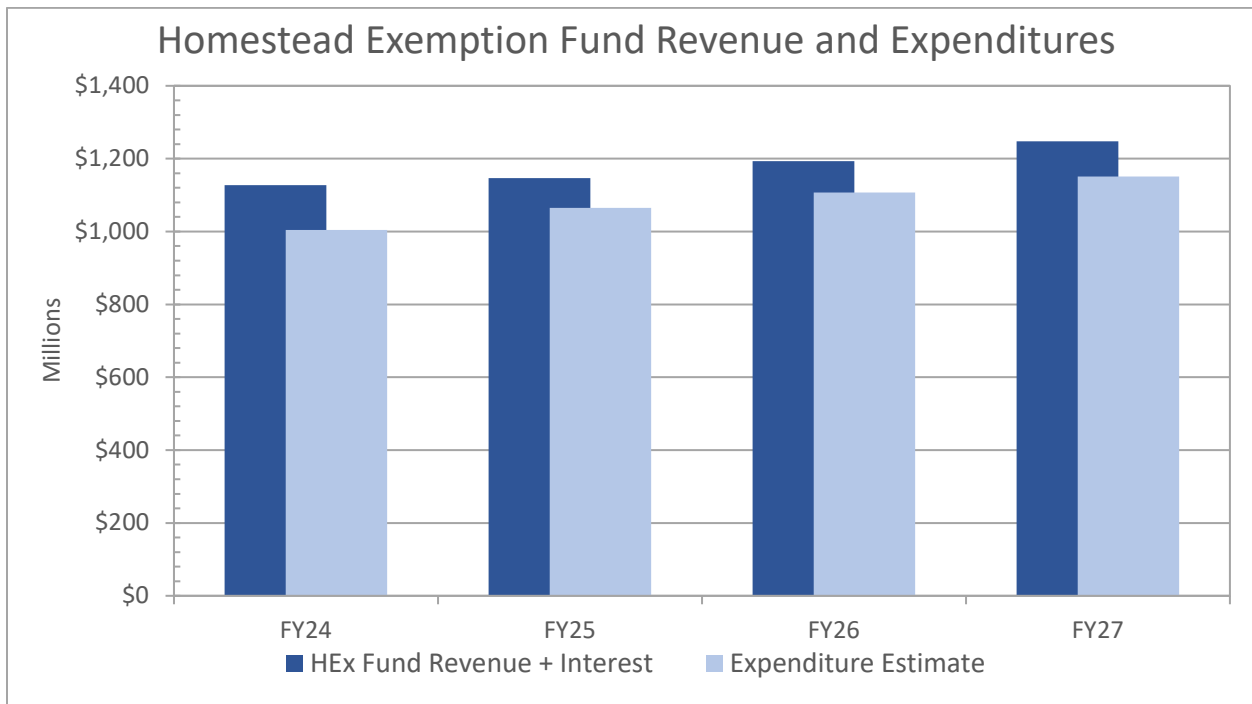


Figure 4 Homestead Exemption Fund forecasted values.

Public Education

State Aid to Classrooms

The General Assembly adopted education funding reform for the FY 2023 budget and implemented a new funding formula for State Aid to Classrooms to replace the Education Finance Act. The new State Aid to Classrooms formula provides funding for the cost of salary and fringe benefits for one teacher for every 11.2 students. The state funds 75 percent of the total cost of the formula for regular school districts and 100 percent for statewide charter districts. Funding is distributed to districts based on the district's percentage of weighted pupils and ability to pay as measured by the Index of Taxpaying Ability (proportion of statewide taxable property value).

The total student count, as measured by the Average Daily Membership for the regular districts and the charter districts, is estimated to be 764,700 in FY 2024. Based upon population projections for school age students (ages 5 to 17), we anticipate 0.39 percent growth in the number of students in the regular districts each year and an average of 7.80 percent growth for students in the charter districts for FY 2025, FY 2026, and FY 2027 (see Table 2).

Table 2 Projected Student Count - Average Daily Membership

Average Daily Membership			
Fiscal Year	Regular Districts	Charter Districts	Total
FY23	716,765	41,312	758,077
FY24	719,586	45,114	764,700
FY25	722,408	48,916	771,324
FY26	725,241	52,718	777,959
FY27	728,085	56,520	784,605

The State Aid to Classrooms formula for FY 2024 is based on the statewide minimum salary for a teacher with a master's degree and twelve years of experience, which is \$55,104, and a fringe rate of 32.56 percent, for a total of \$73,046 (see Table 3). The fringe rate for FY 2025 is expected to remain flat, although the actual fringe rate may vary. Because the new funding formula depends greatly on legislative decision making in setting the salary and student/teacher ratio, projected future needs for State Aid to Classrooms is limited the impact of student growth.

Table 3 Projected State Aid to Classrooms Incremental Formula Funding

State Aid to Classrooms					
Fiscal Year	Student/Teacher Ratio	Salary	Fringe	Total Cost of a Teacher	Incremental State Formula Funding (in millions)
FY23	11.2	\$52,604	\$16,549	\$69,153	n/a
FY24	11.2	\$55,104	\$17,942	\$73,046	\$239.8
FY25	11.2	\$55,104	\$17,942	\$73,046	\$38.6
FY26	11.2	\$55,104	\$17,942	\$73,046	\$38.7
FY27	11.2	\$55,104	\$17,942	\$73,046	\$38.7

Bus Replacement

The State Department of Education (SDE) has indicated that additional funds will be required to reach a 15-year replacement cycle and address growth in districts with increased ridership. In order

to meet this goal, additional funding of \$28 million will be required over the next three years. Since FY 2018, SDE has received \$5.0 million annually in general fund appropriations for bus purchases, and \$3.0 million annually for bus leases.

School bus purchases over the base appropriations have been funded through nonrecurring revenues from the SC Education Lottery, Capital Reserve Fund, and surplus general funds. Over the last five years, SDE has received an average of \$21.0 million annually in nonrecurring funds and have purchased a total of 1,195 buses. Because this is typically funded with nonrecurring revenues, these figures are not included in the amounts listed on page 1.

Reading Coaches

SDE has indicated an increase in the number of schools qualifying for reading/literacy coaches as determined by Proviso 1.51 of the FY 2024 Appropriations Act. Providing support to all schools that qualify would require an additional \$3.3 million in FY 2025. Because funding for this type of support is not open-ended, but dependent upon appropriations, these figures are not included in the amounts listed on page 1.

Health and Social Services

Medicaid Program

The Medicaid program is administered by the Department of Health and Human Services (DHHS). The cost for providing Medicaid services is driven by four main components: enrollment, program utilization, reimbursement rates, and services required by the Centers for Medicare and Medicaid Services (CMS). Medicaid projections reflect additional State funds needed to maintain current service levels based on enrollment and cost per member projections. Based on the assumptions described below, total state funding for the Medicaid program is expected to increase by 13.7 percent by FY 2027. This equates to an additional \$226.7 million in FY 2027 (see Figure 4).

Enrollment

The state experienced an economic downturn during the COVID-19 pandemic, which began early in 2020. More people became eligible for Medicaid due to lost wages/jobs, and the state experienced an increase in enrollment. The federal Families First Coronavirus Response Act (FFCRA) became effective April 1, 2020. This act requires states to freeze disenrollment for Medicaid recipients while the country is under a declared public health emergency (PHE). A PHE was declared in January 2020, which ended April 2023. Medicaid enrollment remained elevated during this time despite the economic recovery seen in the state. The disenrollment freeze continued until July 2023, when DHHS could begin to gradually remove members who no longer qualify for Medicaid. This disenrollment phase is expected to last for approximately one year. Projections for FY 2025 are based on these changes, and further assume that managed care enrollment will slowly decrease to pre-COVID levels during the fiscal year.

The DHHS continues to see an increase in enrollment in the Community Long-term Care (CLTC) waiver program which provides nursing facility-level care in a patient's home. The department anticipates normal growth rate of 1 percent in managed care and fee-for-service enrollment in FY 2026 and FY 2027.

Utilization

Service utilization refers to the number of services received by Medicaid beneficiaries. This can be influenced by enrollment, but also by the quantity of services members use. The DHHS is anticipating an increase in utilization of certain services, particularly the school-based mental health services. The number of recipients of Medicaid services has increased significantly since FY 2021, driving costs higher (see Figure 5).

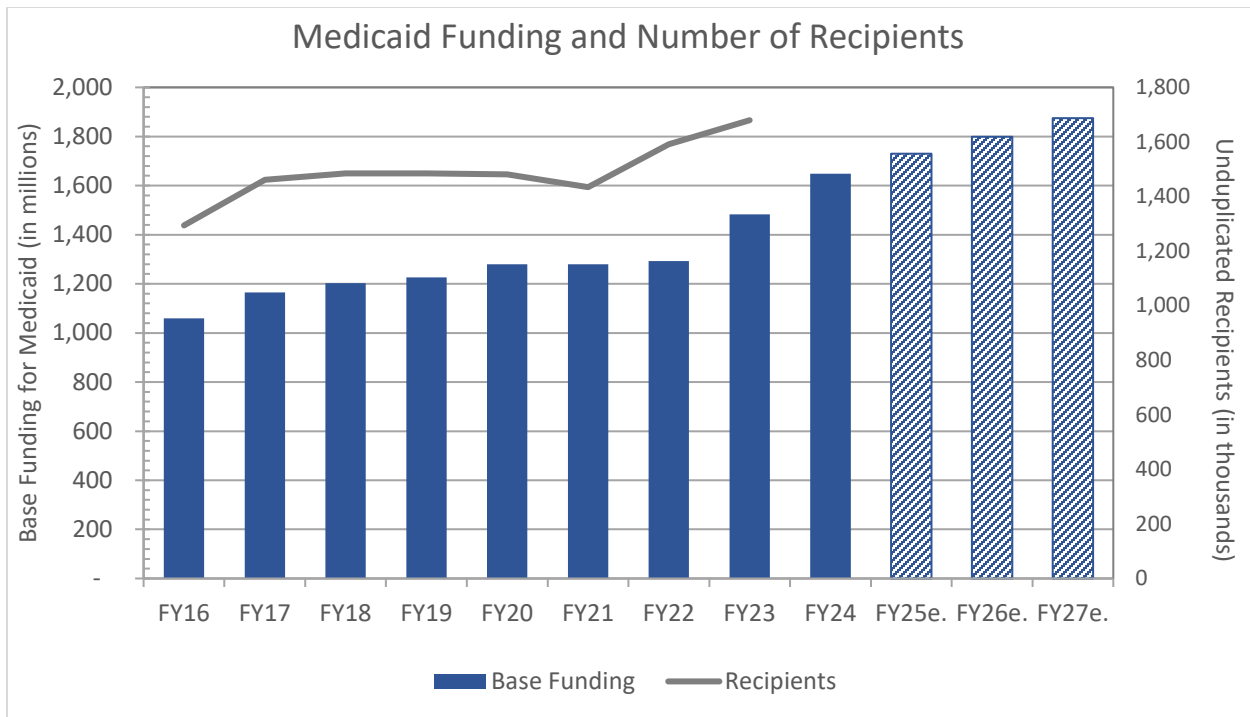


Figure 5 Annual general fund appropriations for Medicaid along with the number of people receiving Medicaid services.

Reimbursement

The Medicaid program is jointly funded by the federal government and the states. The federal government’s share is referred to as the federal medical assistance percentage (FMAP), and this rate is used to reimburse states for the federal share of expenditures. The FMAP, which is updated annually, is determined by a formula that considers the average per capita income for each state relative to the national average. The federal government pays a larger portion of Medicaid costs in states with a lower per capita income. As South Carolina’s economy has improved over the last several years, our FMAP has declined, resulting in a need for additional state funds to make up for the loss of federal reimbursements. The state’s FMAP has declined 2.05 percentage points since 2018, as seen in Figure 6. The greatest single year decline of 1.5 percentage points occurred during 2023, which represented a shift of approximately \$68 million from federal to state funding for FY 2024. The FMAP will tick upwards slightly in 2025. The projections made by the DHHS for FY 2026 and FY 2027 are based on the assumption that the FMAP will remain flat throughout the forecast period. However, if the FMAP continues to drop, this will result in the need for additional state funding.

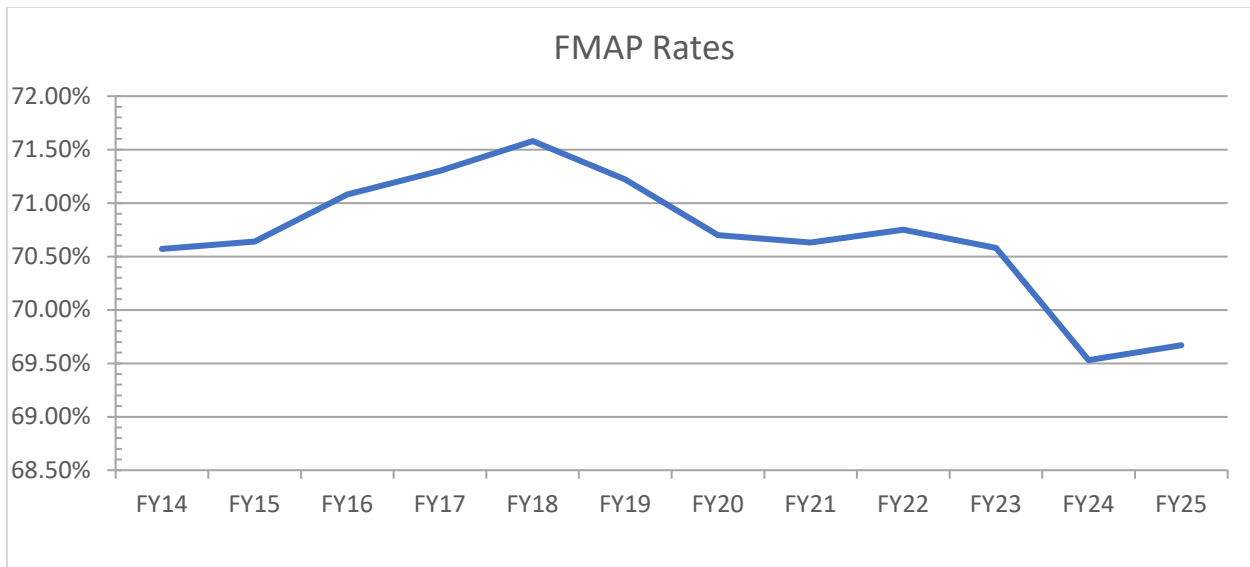


Figure 6 South Carolina's FMAP.

The department is also anticipating the need to increase the reimbursement rates paid to providers for services currently offered. This increase is intended to match inflationary wage increases and bring Medicaid reimbursement rates closer to the industry standard.

Service Package Array

The CMS is part of the federal Department of Health and Human Services and provides regulation for Medicare and Medicaid programs at the state level. Certain Medicaid programs are mandated by CMS. This analysis assumes that no new programs will be mandated throughout the planning period.

Mental Health

The Department of Mental Health (DMH) is mandated by statute to operate several programs, including Forensic Services, the Sexually Violent Predator Treatment Program (SVPTP), and Seriously Mentally Ill (SMI) youth. Costs to operate these programs continue to increase due to census growth and inflation.

The DMH reports that the demand for forensic services continues to increase year over year, however, bed capacity has remained the same. Current capacity is 199 beds, while functional bed capacity is 213. The DMH has utilized nonrecurring funding to meet as much demand as possible.

Pursuant to state law and policy, youth who have been committed to the Department of Juvenile Justice (DJJ) but who are determined to have a serious mental illness are to be transferred to the DMH to meet their treatment needs. In order to meet the psychiatric inpatient hospital treatment needs of these youths, the DMH is renovating one of its existing facilities to best serve these patients. This will require approximately \$6.4 million in FY 2025.

The demands for the SVPTP evaluation and treatment continue to increase year over year. Their average daily census is expected to increase by 7 percent in FY 2025 and continue to grow throughout the remainder of the forecast period. Their contracted service agreements require the DMH to seek an annual rate increase based on the most recent South Regional Medical Services Consumer Price Index. The SVPTP program costs are expected to increase by \$1.5 million in FY 2025, and approximately \$500,000 each year the following two years.

Maintenance of effort funding increases for the DMH are primarily driven by program utilization and inflationary costs. In addition, the DMH cites needs for enhanced information technology. In total, the DMH anticipates additional funding needs of \$61.3 million over the next three years.

Disability and Special Needs

The Department of Disabilities and Special Needs (DDSN) reports that many of their expenditures are driven by utilization rates and service rates. Their analysis assumes the FMAP will return to historical levels. However, should the State's economy continue to perform above the national average, the agency will need additional funds for maintenance of effort.

The DHHS amended the South Carolina Title XIX State Plan by updating the Intermediate Care Facilities for Individuals with Intellectual Disabilities (ICF/IID) Medicaid prospective payment rates effective July 1, 2023. The new cost-based rate is estimated to require an additional \$1.5 million for FY 2025, and \$2.0 million each year for FY 2026 and FY 2027 to maintain current utilization levels.

The DDSN maintains a multi-tiered career progression program for Direct Support Professionals that allows the opportunity for on-the-job training and advancement. The existence of this program is necessary to remain in compliance with CMS. The agency anticipates a future need of \$3.3 million each year beginning FY 2025 to maintain this program. These general funds will allow the DDSN to draw down additional federal funds.

Social Services

The Department of Social Services (DSS) is required to meet the USDA guidelines for the cost of raising a child in the southeast region when determining compensation to foster care providers. The agency is also experiencing rate increases for congregate care facilities, therapeutic foster care and medical therapeutic foster care, qualified residential treatment providers, and child placing agency support. The agency anticipates an increase of \$20.6 million over the next three years in order to meet these requirements.

For Title IV-E eligible foster care placements, the FMAP rate is used to compute the amount of uncapped federal IV-E dollars that can be drawn down for foster care maintenance and is adjusted by the federal government annually. As previously stated, the State's FMAP continues to decline.

Reductions in foster care placements, reductions in average duration of foster care episodes, and continued shifts to family-like settings for foster care such as kinship foster care, could partially offset the increases in state costs associated with FMAP decreases. To the extent that reductions in placement costs do not offset a reduction in the State's FMAP adjustment, additional general funds may be required in the future.

Higher Education

Scholarships

The South Carolina Education Lottery Act² mandates the use of lottery funds. Among other beneficiaries, lottery funds must be used to provide Palmetto Fellows, LIFE, and HOPE scholarships for higher education. Palmetto Fellows and LIFE scholarships must be awarded to all eligible applicants.

Of the funds appropriated to the Commission on Higher Education for Education Endowment, \$12.0 million is allocated to fund Palmetto Fellows scholarships. The remaining funding for Palmetto Fellows, as well as the entire funding for LIFE and HOPE scholarships, is currently provided through the South Carolina Education Lottery. Should Lottery revenue be insufficient to cover scholarship disbursement, additional funding for the LIFE and Palmetto Fellows scholarships becomes an obligation of the General Fund. However, since FY 2010, Lottery revenue growth has outpaced scholarship growth, as shown in Figure 7. Over the past five years, total disbursements for LIFE and Palmettos Fellows scholarships have averaged 63 percent of the State’s earnings from the Lottery. Provided that Lottery revenues and scholarship expenditures continue to grow at their current rates, scholarship disbursements will be fully funded using Lottery revenues. Scholarship distribution has decreased slightly over the past three years due to enrollment disruptions caused by the pandemic. Scholarship distributions are expected to return to historical trends over the next few years.

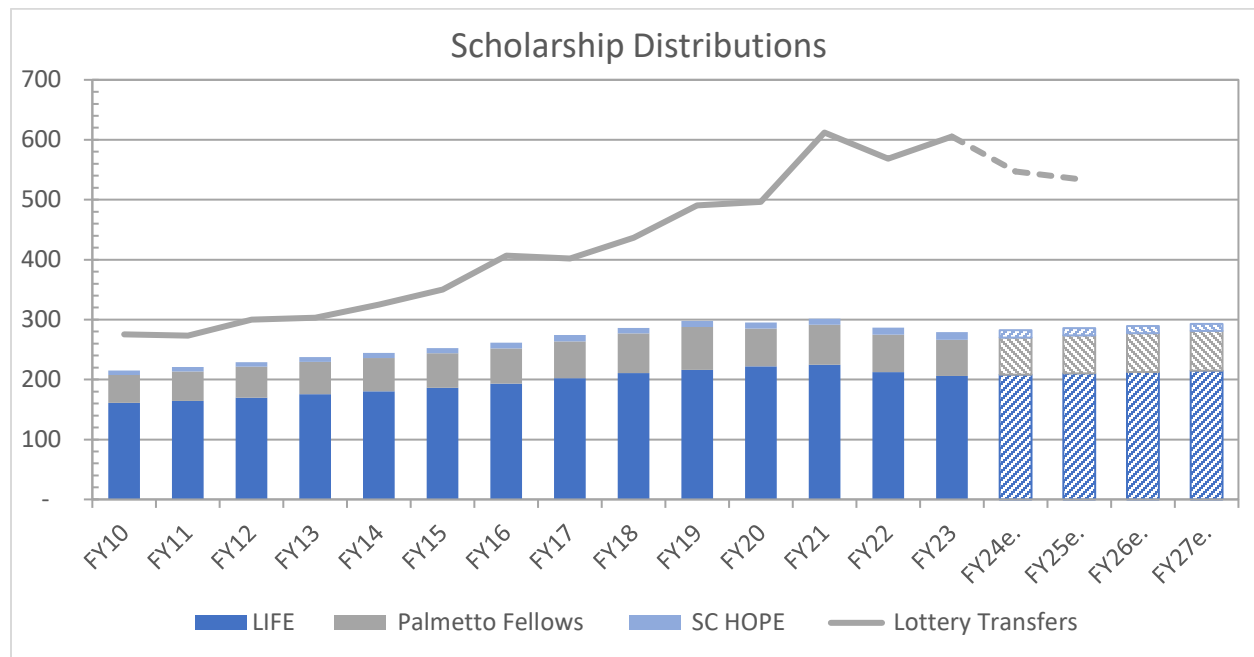


Figure 7 Distributions for LIFE, HOPE, and Palmetto Fellows scholarships, along with transfers to the education lottery account.

² SC Code of Laws: Chapter 150, Title 59

Higher Education Funding

Since 2000, inflationary costs for higher education have outpaced inflation in other spending areas. The Higher Education Price Index (HEPI) published annually by the Commonfund Institute is an inflation index that measures the average relative level in the price of a fixed market basket of goods and services purchased each year by institutions of higher learning (IHLs). Beginning in FY 2009, Commonfund expanded its HEPI service to include calculations of HEPI for the nine standard census divisions of the United States. Since FY 2010, the HEPI for the South Atlantic division, of which South Carolina is a part, has increased at an average annual rate of 2.66 percent, outpacing the Consumer Price Index for all goods, which averaged 2.43 percent annually over the same period.

For this report, we surveyed the state’s three research institutions and the Technical College System. When asked what is driving their costs, institutions cited inflation, mandated benefit changes, and increases in risk management and compliance costs. Insurance, cybersecurity, and excess liability premiums have also risen substantially over the past few years.

In FY 2013, the State began increasing funding to public IHLs for education and general operating expenses. Since FY 2017, the General Assembly has appropriated recurring funds to the state’s public IHLs to help mitigate the cost of tuition, with the condition that the institutions limit their increase in in-state tuition. State-wide, general funds account for 16.5 percent of total IHL budgets.³ On average, general fund appropriations to IHLs have grown 11.9 percent over the past five years, while federal and other funds (in aggregate) have grown 3.4 percent. Figure 8 shows the total funds appropriated for higher education compared to the HEPI index for the South Atlantic region for the last six years.

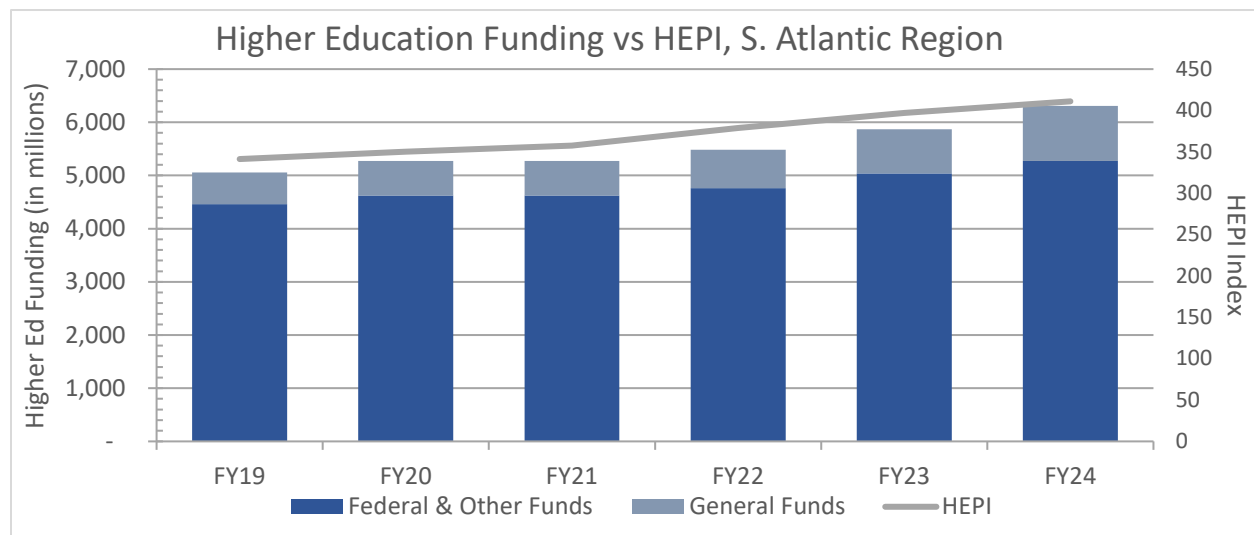


Figure 8 Funding for higher education compared to HEPI growth.

³ Agency budget refers to the published appropriations act and does not include agency enterprise funds for athletics, housing, etc.

Correctional

Department of Corrections

The Department of Corrections (Corrections) operates 21 prisons serving about 16,000 inmates. Corrections continues to experience increased costs for workers' compensation, insurance reserve fund, care services (inpatient hospital, emergency, clinics, etc.), food, medical and dental supplies and equipment, and maintenance supply costs. These increases are driven by increased premiums as well as inflation.

Department of Juvenile Justice

The Department of Juvenile Justice (DJJ) is responsible for providing custodial care and rehabilitation for the state's children who are incarcerated, on probation or parole, or in community placement for a criminal or status offense, and operates its own accredited school district. The DJJ continues to experience increases in intake, probation, and parole services for youth. In addition, the number of youth and families involved with multiple state agencies has increased, requiring interagency specialists to facilitate coordination.

The DJJ is statutorily required to produce a comprehensive psychological evaluation to Family Court before a youth's dispositional hearing, which must be completed by a psychologist. Since the implementation of Raise the Age legislation, the number of these evaluations have increased fourfold. In addition, the DJJ is serving older youth and for a longer period of time, increasing the need to case workers and staff.

The DJJ is also experiencing continued increases in costs for tort insurance, workers' compensation, vehicle rotation, housing for youths, and supplies. The department is working with the Department of Administration to address the needs of their aging IT systems. Upgrades are required to address cybersecurity, network strength, database, and information sharing platform requirements.

Department of Public Safety

The Department of Public Safety (DPS) includes the State Highway Patrol, State Transport Police, Bureau of Protective Service, Office of Highway Safety and Justice Programs, and the South Carolina Law Enforcement Officers Hall of Fame. Fleet vehicles are a significant part of the DPS budget and the department has indicated a need for recurring funds in order to address vehicle maintenance and upfitting costs. These costs have historically been covered using fines and fee revenue, however, due to increased costs and expenses caused by supply chain issues and labor shortages, this funding is no longer sufficient.

The DPS is also responsible for the state's School Resource Office (SRO) program. The number of state funded SROs has increased 38.6 percent in one year (FY 2024 over FY 2023). The DPS anticipates increasing the number of SROs by another 5.0 percent in FY 2024 and an additional 12 percent in FY 2025.

Department of Transportation

The Department of Transportation (DOT) operates on federal funds and other funds. The DOT received \$122.0 million in recurring general funds as part of the FY 2024 budget. However, these funds are to be used as state match funds and not for agency operations. These funds will allow the DOT to draw down additional federal funds as part of the federal Infrastructure Investment and Jobs Act. These funds will be part of the recurring budget for a limited number of years. No increase is anticipated over the forecast period.

The DOT also notes the current trend in the purchase and use of electric vehicles (EVs) and the impact this could have on tax revenue. While EVs comprise a very small portion of the State's registered vehicles, EV use has grown by 366% over the past 3 years. The average annual gas tax paid by internal combustion engine vehicles is approximately \$338 while the current electric vehicle fee is \$120 biannually (\$60 annually). This translates to an 85 percent decrease in revenue per vehicle. SC was an early adopter of electric vehicle fees, but now has the lowest rate in the Southeast, which averages approximately \$200 per year. While EV fees capture residents who will charge at home, visitors passing through the state pay neither this nor the traditional gas tax.

State Employee Benefits and Compensation

Health Plan

The South Carolina Public Employee Benefit Authority (PEBA) maintains the State’s health and retirement programs. The PEBA evaluates health care premiums each year and makes adjustments as necessary. The general fund portion of the employer base for calendar year 2024 is \$1,283.3 million. General fund appropriations for insurance premiums are annualized each year. The first six months of FY 2025 (July through December 2024) are funded per the January 2024 rate. January 2025 through June 2025 will be funded per the new rate effective January 2025. Table 4 displays the incremental increases to general fund appropriations for the forecast period.

Table 4 Estimated increases for State Health Plan expenditures.

	Annualization of Previous CY Rate increase (July-Dec)	Upcoming CY Rate Increase (Jan-June)	FY Retiree Enrollment Growth (July-June)	Total Additional General Fund Appropriations
FY 2025	\$28,206,715	\$62,240,377	\$3,678,132	\$94,125,224
FY 2026	\$62,240,377	\$49,401,297	\$2,349,232	\$113,990,906
FY 2027	\$49,401,297	\$52,941,622	\$2,361,280	\$104,704,199

These projections are based on the following assumptions:

- ✦ Continuation of current covered services and patient cost sharing; and
- ✦ Employer pays share of rate increase proportionate to employer/enrollee contributions in force January 2024; and
- ✦ Rate increase effective January 2025 equals 9.7 percent; January 2026 increase equals 7.0 percent; January 2027 increase equals 7.0 percent; and
- ✦ Retiree enrollment growth equals 0.8 percent for FY2025, and 0.5 percent each year for FY 2026 and FY2027.

The recently enacted federal Inflation Reduction Act (IRA) includes a re-structuring of the Medicare Part D (pharmacy) benefit. The State Health Plan operates a group Part D plan for its Medicare membership, and accordingly receives federal subsidies related to its Medicare pharmacy spend. These dollars go into the State Health Plan’s general operating fund and now represent about 6 percent of total Health Plan revenue. At this time, it is unclear as to how the IRA’s Part D restructure will affect group Part D subsidies. Current estimates indicate no significant change in the total amount of subsidies in the upcoming year. However, with 6 percent of Plan revenue derived from Part D subsidies, if a significant amount of subsidies are lost, additional contribution increases above those provided in this projection may become necessary.

Retirement System

Required employer contributions to the state employee, school district, and police retirement systems (SCRS and PORS) were increased 2 percent in 2017 with the passage of Act 13. The Act also increased employer contributions 1 percent per year beginning in FY 2018, with the final increase scheduled for FY 2023. The 1 percent increase was suspended for FY 2021 as part of the Continuing Resolution passed in May of 2020. The final employer contribution rate increase was completed as part of the FY 2024 Appropriations Act. At this time, there are no scheduled increases beyond FY 2024.

Act 13 of 2017 was passed in order to address unfunded liabilities accrued within SCRS and PORS. Since 2017, both funds have outperformed expectations. Figure 9 shows the funded ratios for SCRS and PORS up through FY 2022. The dotted blue lines indicate the estimated funded ratio at the time the act was passed. The solid blue line shows the actual funded ratio for FY 2017 through FY 2023. As of the end of FY 2022, both retirement systems have exceeded the ratios estimated for FY 2028.

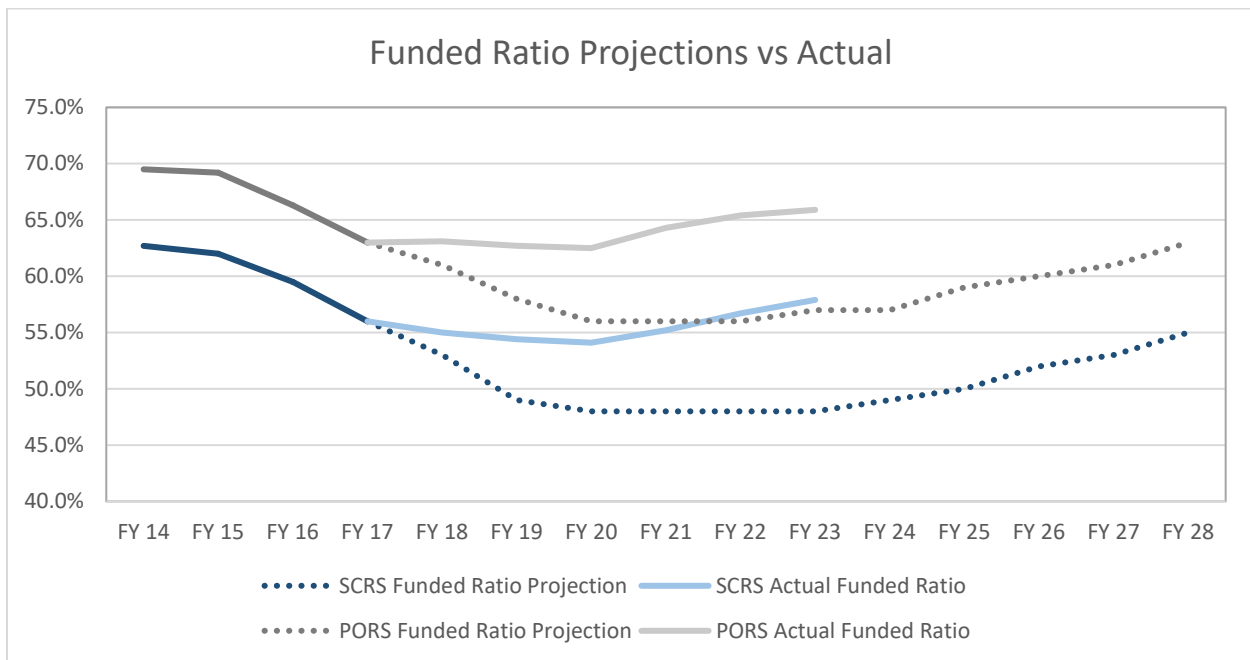


Figure 4 Actual Funded Ratio compared to the funded ratio projections made in 2017.

Employee Compensation

This report provides an estimate of the cost to increase base pay salaries by 2 percent each year. This increase is not statutorily required and is included in this report as a reference to cost-of-living increases. The estimate is based on base salary for state employees in all pay bands, with the exception of exempted groups (agency heads, members of the legislature, and constitutional officers). Included in the estimate are other groups (local health care providers, county auditors and treasurers, and school bus drivers) whose salaries are provided entirely or in part through the general funds. A base pay increase of 2 percent for all applicable state employees would increase general fund expenditures by approximately \$58.1 million in FY 2025, \$62.3 million in FY 2026, and \$66.5 million in FY 2027. This estimate includes all applicable fringe benefits.

In addition to targeted salary increases for specific workforce industries over the last few years, the General Assembly approved a pay increase for FY 2024 of at least 5 percent for all state employees. The percent increase was greater for those earners in the lower pay bands. Several agencies have reported that this increase has significantly enhanced their ability to hire for certain vacancies. Other agencies have noted an increase in the number of applications they have received as well as noticeable increases in agency retention and rehire rates. Concerns still linger over hiring for positions within lower pay bands. Agencies also note that competition from private sector employers who can offer more flexibility in telework scheduling is an additional challenge to their hiring process. Wages among private sector jobs continue to exceed state and local government salaries (see Figure 10).

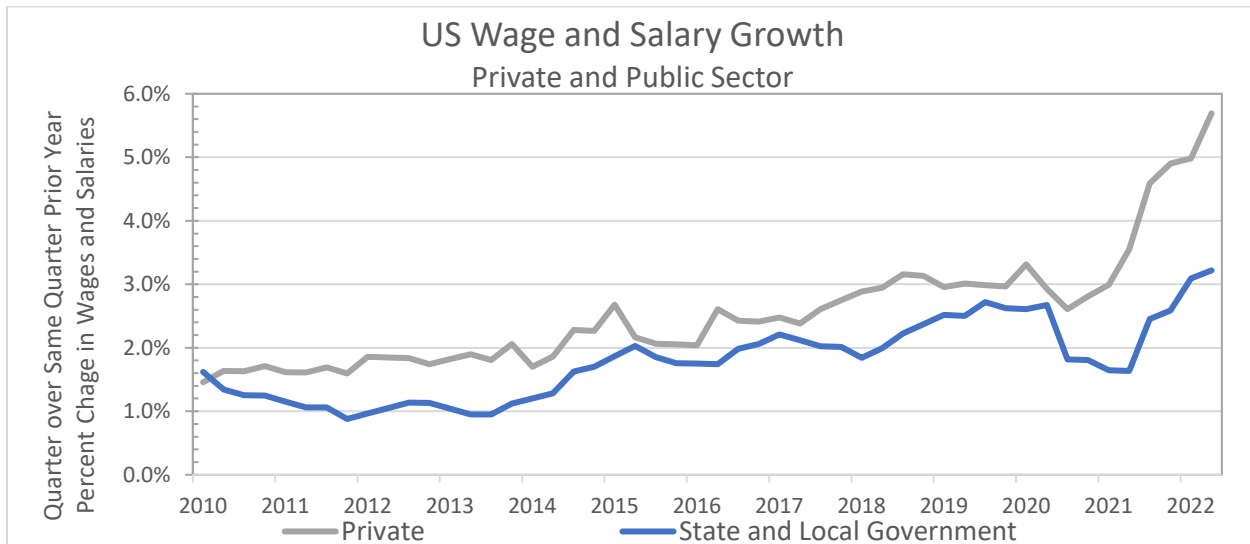


Figure 10 Comparison of wages in the private sector to wages in the public sector. (Source: U.S. Bureau of Labor Statistics, Employment Cost Index: Wages and Salaries: Private Industry Workers, Government Workers)

Other Considerations

Maintenance and Renovation

Each year many agencies submit requests for maintenance, renovation, repair, and replacement for buildings and equipment. Over the last five years, these requests have averaged \$567.8 million. Because these requests are typically funded using nonrecurring funds, these expenditures have not been included in the calculations on page 1 and are included here for informational purposes only.

Tobacco Master Settlement Agreement

The State’s “tobacco bonds,” securitized by its Tobacco Master Settlement Agreement (MSA) payments, were retired June 1, 2012. By statute, future MSA receipts are available for appropriation. Historically, these funds have been appropriated in their entirety per proviso and are not counted with general fund revenue. While current statute earmarks these funds primarily for healthcare programs⁴, specific program appropriations are at the discretion of the General Assembly. For the last several years, a specified amount has been appropriated for the diligent enforcement of the tobacco MSA with the remainder used for Medicaid maintenance of effort (see Figure 11).

Estimates for MSA annual distributions are provided by the Center for Tobacco and Public Health (Center) at the National Association of Attorneys General. The Center has projected receipts of \$77.0 million and \$74.0 million for FY 2024 and FY 2025, respectively. Based on current trends, receipts for FY 2026 and FY 2027 are expected to be \$76.0 million and \$75.0 million, respectively.

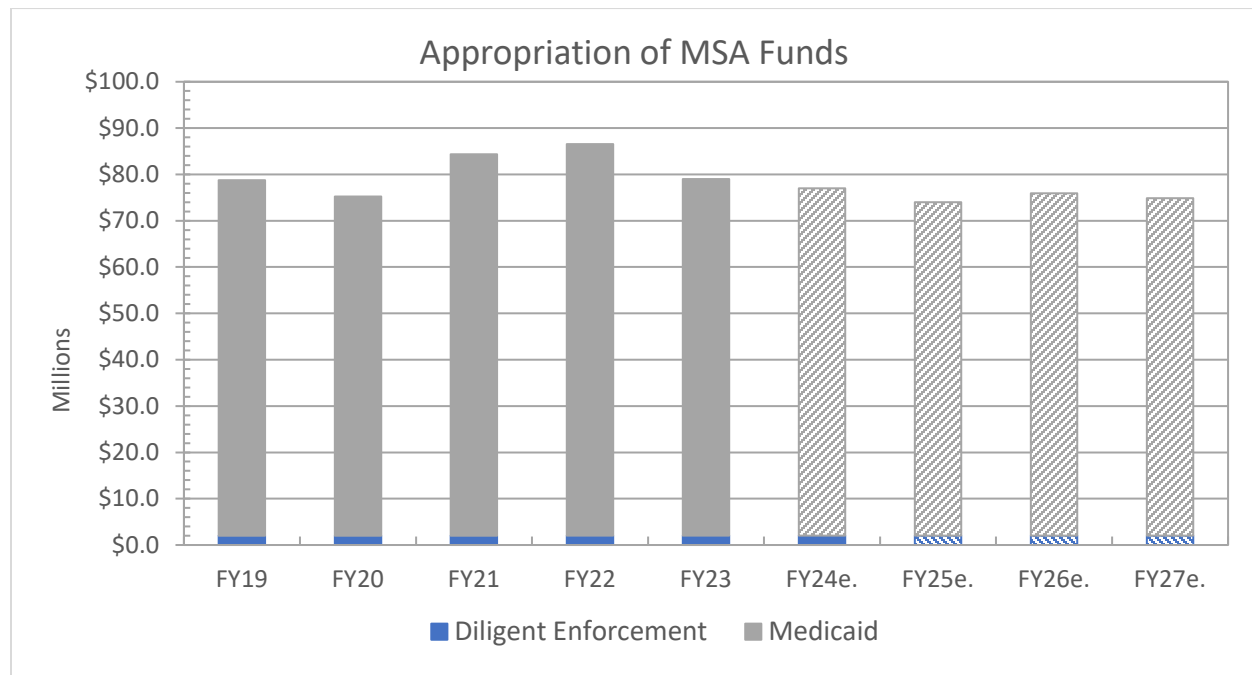


Figure 11 Distribution history of funds received from the Master Settlement Agreement.

⁴ Section 11-11-170 of the S. C. Code of Laws, 1976, outlines allowable uses for Tobacco MSA funds.

APPENDIX

Appendix A: Recurring General Fund Distribution for FY 2023

TOTAL APPROPRIATIONS	11,636,468,009	% of Total
<i>"1%" Agencies</i>		
Public Education		
State Department of Education	4,014,072,140	34.50%
Health & Social Services		
Department of Health and Human Services	2,070,137,254	17.79%
Department of Health and Environmental Control	183,404,612	1.58%
Department of Mental Health	333,167,387	2.86%
Department of Disabilities and Special Needs	131,500,076	1.13%
Department of Social Services	307,463,305	2.64%
Higher Education		
Clemson University	172,656,734	1.48%
University of South Carolina - Columbia	262,854,227	2.26%
Medical University of South Carolina - MUSC	128,043,318	1.10%
State Board for Technical and Comprehensive Education	232,522,776	2.00%
Correctional		
Department of Corrections	573,646,916	4.93%
Department of Juvenile Justice	152,938,470	1.31%
Public Safety		
Department of Public Safety	172,489,638	1.48%
Transportation		
Department of Transportation	122,057,270	1.05%
<i>Subtotal</i>	<i>8,856,954,123</i>	<i>76.11%</i>
<i>Constitutional Requirements</i>		
Aid to Subdivisions - State Treasurer	318,890,380	2.74%
Debt Service	153,914,766	1.32%
Capital Reserve Fund	390,131,763	3.35%
<i>Subtotal</i>	<i>862,936,909</i>	<i>7.42%</i>
<i>Other Agency Appropriation</i>		
<i>Subtotal</i>	<i>1,916,576,977</i>	<i>16.47%</i>

Appendix B: Long-Range General Fund Revenue Forecast

General Fund Revenue Estimate				
Revenue Category (\$ Millions)	FY 2024	FY 2025	FY 2026	FY 2027
Sales and Use Tax	4,709.9	4,788.5	5,001.4	5,223.8
Individual Income Tax	6,029.3	6,192.7	6,496.1	6,813.9
Corporation Income Tax	782.1	762.1	762.1	762.1
Other GF Revenue Sources	1,364.2	1,470.8	1,368.7	1,472.7
Gross General Fund Revenue	12,885.5	13,214.2	13,628.3	14,272.5

Percent Change in Revenue				
Revenue Category	FY 2024	FY 2025	FY 2026	FY 2027
Sales and Use Tax	1.1	1.7	4.4	4.4
Individual Income Tax	4.7	2.7	4.9	4.9
Corporation Income Tax	-38.0	-2.6	0.0	0.0
Other GF Revenue Sources	-3.5	7.8	-6.9	7.6
Gross General Fund Revenue	-1.6	2.6	3.1	4.7

The table above does not include adjustments for legislative tax reform pursuant to Act 228 of 2022, Comprehensive Tax Cut Act of 2022. Gross general fund revenue includes Individual Income tax revenue that is transferred to the Property Tax Relief Trust Fund pursuant to §11-11-150.

(Source: South Carolina Board of Economic Advisors/BEA/11/16/2023)