January 19, 2015

The 2015 Kansas Legislative Session kicked off on Monday, January 12th. The Governor was sworn in for his second term around noon and legislative members took their oathes of office begining at 2:00 pm. The Governor and legislators face significant budget challenges this session. According to the Consensus Revenue Estimating Group, Kansas faces a $280 million shortfall for the cirrent fiscal year (FY' 2015) and more than $400 million for next year (FY' 2016).

The Governor presented his State of the State on Thursday evening and began laying out his proposals for the session. Friday morning the Governor's budget was released with more details regarding his proposals to balance the budget. His proposals released a somber reception during the joint meeting of the House APpropriations and Senate Ways and Means committees. The budget proposal did not recieve significant comment as legislative members wanted time to go through the proposal in detail. Below are some of the highlights of the Governor's program.

**K-12 Funding**. The Governor proposed sunsetting the current school finance formula at the end of this fiscal year (July 1) and go to "block grant" style funding for schools while work on a new formula begins. The Governor's proposal would combine certain portions of funding to be combined before being allocated to indivdual district. The Governor's proposal would keep the total amount of funding flat for next fiscal year. It is expected that districts will recieve the same amount of funding next year as they are this year, but that is not completely clear in the documents that have been prepared by the administration. This proposal is not expected to affect whether the courts will determine the constitutionality of the current funding amount or formula that is currently being considered.

**Medicaid**. Funding for Medicaid programs from state sources has increased by $182.0 million dollars from FY 2012 to the FY 2015 revised budget.

The Department of Health & Environment (KDHE) Division of Health Care Finance and the Department for Aging and Disability Services (KDADS) now administer the state's Medicaid program. The two agencies have successfully transitioned Kansas' program to a managed care model as an effort to provide better care coordination and better outcomes. KanCare began covering the medical, behavioral health, and long-term care services for all Medicaid consumers on January 1, 2013 with supports and services for individuals with intellectual and developmental disabilities starting on February 1, 2014.

While the implementation of KanCare over the last two years has led to slower growth in expenditures as compared to the projected baseline growth of the old fee-for-service system, it is it is time to make additional changes in order to further bend the cost curve of Medicaid. A mix of KanCare policy and contractual changes are being proposed and implemented by KDHE and KDADS that will achieve $50.0 million in State General Fund expenditure savings in the proposed FY 2016 and FY 2017 budgets.

**Bruno & Associates** 800 SW Jackson, Ste. 914 Topeka, Kansas 66612 **T** 785-354-8172 kslobby@cox.net

Managed care organizations (MCOs) in Kansas currently pay a 1.0 percent privilege fee, the proceeds of which are added to the State General Fund. In KanCare, the capitation rate paid to MCOs must cover the fee, and the payment source is a combination of state and federal funds. The Governor's proposed budget increases the privilege fee from 1.0 to 5.5 percent, which is estimated to generate a net increase in revenues of $79.9 million in FY 2016 and $82.1 million in FY 2017 to offset the increasing Medicaid caseload costs.

The budget proposal also reduces Medicaid expenditures by $26.0 million from the State General Fund in FY 2017 to reflect an improvement in the Kansas Medicaid Payment Error Rate Measurement. An Executive Reorganization Order will move Medicaid eligibility determination staff and responsibilities from the Department for Children and Families to the Department of Health and Environment's Division of Health Care Finance.

The Governor has made it a priority over the last few years to reduce the number of Kansans with disabilities on the Home and Community Based Services (HCBS) waiting lists for the Physically Disabled and Intellectual and Developmentally Disabled programs. There is $5.0 million of additional State General Fund expenditures, $10.1 million from all funding sources, in FY 2016 and FY 2017 that is proposed to be used for waiting list reduction and behavioral health access for transitional and intermediate levels of care. There is also $7.0 million of State General Fund expenditures, $15.9 million from all funding sources, allocated to the underserved waiting list of the Intellectual and Developmentally Disabled Program that was eliminated in 2014. This $7.0 million will replace the KDHE fee fund swap that was used in FY 2014.

**KPERS**. The 2012 Kansas Legislature passed a KPERS reform bill that, among other things, created a cash balance tier for new employees hired after January 1, 2015, and created greater rates of employer and employee contributions to the System.

Due to the higher employee contribution rates, there has been an increased investment of $445 million made to KPERS compared to contribution made at pre-recession levels. In current statute, the KPERS employee contribution rates would increase by $107.9 million in Fiscal Years 2016 and 2017 as the employer contribution rates continue to increase from 12.12% in FY 2015 to 13.37% in FY 2016 and 14.57% in FY 2017.

Working with the Legislature, the Governor will examine various possibilities to further reform the KPERS system. The Governor's budget for FY 2016 and FY 2017 proposes two initial policy changes to be considered among other future options: (1) issuing bonds, and (2) extending the current amortization period of payments to KPERS. Under the first proposal, total bonds of $1.5 billion would be issued. The proceeds of the bonds would be used to help reduce the future employer contribution rates of the State/School group. The second proposal would further reduce the employer contribution rates by extending the amortization period another ten years to FY 2043. The current amortization period goes to FY 2033. Based on estimates from KPERS, these reforms would reduce expenditures by $39.6 million in FY 2016 and $92.8 million in FY 2017.

**Efficiencies**. There are over $350 million of State General Fund savings in the FY 2015, FY 2016 and FY 2017 proposed budget based on a policy of running programs more efficiently and effectively. The savings come from expanding the debt set-off program with the federal government; refinancing bonds to lower rates; consolidating state information technology systems; improved utilization of the state employee health plan and improved utilization of pharmaceutical rebates in KanCare. The efficiencies also include Medicaid policy changes, Medicaid eligibility
determination system change and changes to the KPERS system.

**Spending Reductions**. Due to the State General Fund shortfall projected for FY 2015, the Governor implemented allotments for the final six months of FY 2015, which includes a 4.0 percent State General Fund expenditure reduction for select agencies. These spending reductions are being carried forward for the same agencies in the proposed FY 2016 and FY 2017 budgets. This includes most Cabinet level and elected office agencies, legislative agencies, and select agencies receiving state highway funds and/or Economic Development Initiatives Fund (EDIF) transfers to fund operations. Expenditure reductions are also proposed for the Kansas Department of Education, the Board of Regents, the Department of Corrections Central Office, and the portion of the KDOT state highway fund that funds agency operations. Agencies and appropriations not affected by the 4.0 percent reduction include Elementary and Secondary education, Medicaid appropriations to KDADS and KDHE, Department of Corrections institutions, State Hospitals, and the Higher Education system.

The total number of State employees, not including the higher education system, has decreased by 11% between Fiscal Year 2010 and Fiscal Year 2014. This downward trend will continue through Fiscal Years 2016 and 2017 as agencies continue to re-organize and become more efficient.

**State Highway Fund.** The State Highway Fund currently transfers $262.9 million to other state agencies and the State General Fund. Additional transfers of $150.7 million have been proposed in the FY 2015 budget and additional transfers of $100.0 million have been proposed in the FY 2016 and FY 2017 budgets.

The Kansas Department of Transportation (KDOT) indicates that preservation projects already announced for FY 2015 and FY 2016, as well as expansion and modernization projects announced for the course of T- WORKS, will be let as scheduled. Yet to be programmed State Highway Fund dollars will be applied to additional preservation projects at a level that allows KDOT to maintain a positive yearly ending balance in the State Highway Fund. The agency notes that estimated State Highway Fund yearly ending balances are very fluid and are shaped by a number of ever changing variables and assumptions.

Based on KDOT's most current information and assumptions, the TWORKS program can maintain a commitment to construct all of the announced expansion projects and program preservation projects at a level that achieves the performance targets for road and bridge conditions.

**Tax Policy.**

The tax proposals put forth by the Governor will likely attract significant attention, given the current budget challenges. The information below lays out what the proposal from the administration presented on Friday.

The Governor's FY 2016 and FY 2017 budget proposal has proposed modifications to the 2013 tax policy to continue tax reduction and promote further growth of the Kansas economy. The income tax rates were reduced on January 1, 2015 and currently are 4.6 percent and 2.7 percent. The lower rate would be proposed to decrease from 2.7 percent to 2.66 percent on January 1, 2016 without any further reductions in statute. Further income tax rate reductions would occur when revenues over the previous year exceeded 103.0 percent, allowing the growth of the economy to determine when reductions in the statutory rates would take place. The small business stimulus would remain in effect.

The tax proposal includes the addition of a Budget Stabilization Fund that would be set in statute and utilize growth in revenues greater than 102.0 percent and less than 103.0 percent. This fund would have statutory limitations on withdrawals and would use the 1.0 percent funding stream until it is maintained at a 5.0 percent cap on expenditures. It is estimated that these adjustments will create additional State General Fund revenue totaling $22.9 million in FY 2016 and $86.9 million in FY 2017.

The tax proposal also includes accelerating the itemized income tax deduction haircut of 50.0 percent currently set in statute to begin on January 1, 2017 to instead begin January 1, 2015. The acceleration of the 50.0 percent haircut is estimated to generate $50.3 million in FY 2016 and $21.8 million in FY 2017.

The budget proposal for FY 2016 and FY 2017 includes an increase in consumption taxes, which is consistent with the Governor's original tax policy proposal. The proposed consumption tax increase would apply to cigarettes, tobacco products and liquor enforcement. The last increase on cigarette taxes was in 2003, when it increased to 79 cents per pack. The tobacco products tax has held at 10.0 percent of wholesale price since 1972. The proposed rates would be increased to $2.29 per pack and 25.0 percent of wholesale price. The last increase in the liquor enforcement tax was in 1983 when it was increased from 4.0 percent to 8.0 percent. The liquor enforcement tax would be increased to 12.0 percent. Altogether, it is estimated that the consumption tax increases would generate revenue of $107.9 million in FY 2016 and $104.1 million in FY 2017.

The Governor also proposes a tax amnesty program for delinquent taxes due in individual, corporate, privilege, state sales and use, liquor, mineral and local sales taxes accrued from tax periods ending on or before December 31, 2013. Additional revenue of approximately $30.0 million for the State General Fund would be collected in FY 2016.

**New Session Information**
Since there was an election this past fall, no bills were carried over to this session, so the legislatutre must start from scratch on bills.  Over the coming weeks and months, many proposals will be introduced in both the House and Senate.

The first couple weeks of the session are filled with informational hearings by committees, to help educate legislators on various issues, agencies and procedures that may become items of discussion during the session.

The following dates are the anticipated deadlines for introduction and consideration of bills for the 2015 session. These dates are subject to change by adoption of new Joint Rules of the Senate and the House of Representatives after session begins.

**Monday, January 12**
First day of 2015 session; convene at 2:00 p.m.

**Monday, February 2**
Last day for member or members to submit REQUESTS to Revisor's office for bill drafts.

**Monday, February 9**
Last day for Committees, except House and Senate Federal and State Affairs, Senate Ways and Means, Senate Assessment and Taxation, House committees on Calendar and Printing, Appropriations, Taxation or select committees of either house when so authorized, to submit REQUESTS to Revisor's office for bill drafts.

**Wednesday, February 11**
Last day for Individuals to INTRODUCE bills in originating chamber.

**Friday, February 13**
Last day for Committees, except committees listed above, to INTRODUCE bills in originating chamber.

**Friday, February 27  (Turnaround Day)**

Last day to CONSIDER BILLS IN HOUSE OF ORIGIN, except by House and Senate Federal and State Affairs, Senate Ways and Means, Senate Assessment and Taxation, House committees on Calendar and Printing, Appropriations, Taxation or select committees of either house when so authorized.

**Wednesday, March 25**
Last day to CONSIDER BILLS NOT IN HOUSE OF ORIGIN, except by committees listed above.

**Friday, April 3 (Drop Dead Day)**
No bills considered after this date except BILLS VETOED BY GOVERNOR, OMNIBUS APPROPRIATIONS ACT AND OMNIBUS RECONCILIATIONS SPENDING LIMIT BILL.

**Veto session is anticipated to begin on Monday, April 27.**