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MTF Bulletin

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The FY 2021 Surplus and Fiscal Recovery Funds

Prior to the end of formal sessions in calendar year 2021, the Legislature has two major public finance tasks before it:

- Determine how to use the fiscal year (FY) 2021 budget surplus; and
- Appropriate Fiscal Recovery Funds (FRF), provided through the American Rescue Plan, to sustain and galvanize the Commonwealth's pandemic recovery.

The availability of this level of flexible federal funds and a significant budget surplus is unprecedented in the Commonwealth's recent history. Legislators must now choose how to deploy these resources in a sustainable and impactful way; those choices will shape the state's fiscal future for years to come. This MTF Bulletin outlines the path forward for both of these tasks and previews some of the major considerations before the Legislature.

The FY 2021 Budget Surplus

Last week, as part of legislative action to close the books on FY 2021, the House and Senate set aside a budget surplus of \$1.5 billion in a temporary escrow account that they can spend in whole or part in a subsequent bill. This action prevents the budget surplus from being included in the state's end-of-year Consolidated Net Surplus (CNS), which is automatically deposited into the Stabilization Fund. Governor Baker took a different approach, electing to spend the surplus as part of his closeout supplemental budget proposal.

Calculating the initial surplus

The end-of-year surplus is a result of tax revenue collections that exceeded the benchmark by more than \$5 billion. Approximately \$3 billion of this amount was either automatically deposited into state reserves or was necessary to offset other budget assumptions as outlined in Figure 1.

Figure 1. FY 2021 Surplus Calculation

Calculating the Initial Surplus	
Taxes above benchmark	\$5,080
Statutory transfers	
Capital gains above benchmark	-\$1,220
Increased transfers to MBTA and SBA	-\$173
Tax revenue remaining	\$3,687
Other Offsets	
Elimination of planned Stabilization draw	-\$1,100
FY 2022 receipt of federal revenues	-\$409
Other spending/revenue exposures	-\$120
Estimated surplus remaining	\$2,058
<i>\$ in millions</i>	

The Stabilization Fund lays claim to about \$2.2 billion of above benchmark tax revenues, with \$1.1 billion of this being used to offset a previously planned drawdown of the fund and a further \$1.1 billion being deposited as above benchmark capital gains. Additionally, \$173 million goes directly to the MBTA and School Building Authority, while approximately \$530 million is needed to cover non-tax revenue exposures. After accounting for these adjustments, approximately \$2 billion remained for potential appropriation in the closeout supplemental budget.

Surplus after Closing the Books

This \$2 billion surplus was further reduced by the need to cover approximately \$330 million in outstanding spending needs, collective bargaining agreements and other labor costs. In addition, the Administration and Legislature agreed on approximately \$180 million in FY 2021 spending appropriations to be extended into FY 2022 that would have otherwise reverted to the General Fund. After accounting for these spending needs, a surplus of about \$1.5 billion remains.

Figure 2. Administration v. Legislature Closeout Spending

Gov v. House Closeout Proposal		
Starting Surplus	\$2,058	
	Governor	Legislature
UI trust fund	\$1,000	\$0
General deficiencies	\$7	\$7
Chapter 257 costs	\$39	\$0
Shelter rates	\$17	\$17
Residential special education schools	\$20	\$20
One-time payment to frontline workers	\$40	\$0
Substance use programming	\$7	\$5
CBA and public employee wages	\$405	\$252
Sheriff deficiencies	\$25	\$26
Supportive housing	\$5	\$5
Absorption of Becker College costs	\$3	\$3
Mass. Life Sciences	\$10	\$0
Community Preservation	\$10	\$0
PACs	\$229	\$230
Total spend	\$1,817	\$564
Approximate remaining surplus	\$241	\$1,494

\$ in millions

Governor Baker’s proposal disposed of the FY 2021 surplus by dedicating \$1 billion to improve the solvency of the state’s Unemployment Insurance Trust Fund and appropriating \$229 million for: additional public employee costs (\$103 million), rates for human service providers (\$39 million) and one-time bonuses for state employees required to work in person during the pandemic (\$40 million).

In contrast, the Legislature deferred spending decisions on the remaining surplus, while still closing the books on FY 2021. They accomplished this by depositing the surplus into a temporary escrow account that is available for future spending, thereby avoiding the statutory requirement that any unexpended surplus at the end of a fiscal year is automatically deposited into the state’s Stabilization Fund.

Lawmakers can spend the estimated \$1.5 billion surplus from this temporary fund until the end of FY 2022, when the fund expires and the remaining balance will be transferred into the Stabilization Fund. The Legislature may opt to include some level of surplus spending in a larger Fiscal Recovery Fund ARPA bill.

Fiscal Recovery Funds

The American Rescue Plan included billions in support for Massachusetts, its communities and residents, but the Fiscal Recovery Fund (FRF) program has received perhaps the most attention as it provides billions for a variety of pandemic recovery uses to Massachusetts and its cities and towns. Massachusetts as a state received \$5.3 billion in total FRF funds and it is now up to the Legislature to pass a spending plan for \$4.9 billion that remains available for appropriation.

Determining FRF Available for Appropriation

Massachusetts received its total FRF award in one payment back in May. At the time, it was not clear whether these funds would be expended directly by the Baker Administration or by legislative appropriation. Ultimately, Governor Baker signed a bill put forward by the House and Senate that makes just under \$4.9 billion of the total award subject to appropriation.

Figure 3. Breakdown of State Fiscal Recovery Fund Award

Total MA Award	\$5,286.1
Supplemental distribution to Chelsea, Everett, Methuen & Randolph	\$109.0
Administration set-aside	\$200.0
COVID paid leave set-aside	\$75.0
VaxMillions	\$10.0
Amount remaining	\$4,892.1

\$ in million

In late June, Administration and Legislative leaders agreed to expend approximately \$400 million of the FRF amount outside of the appropriation process. Governor Baker retained \$200 million to

use for immediate Coronavirus response and recovery needs, of which \$186 million has already been programmed as outlined in Figure 4.

Figure 4. Baker Administration Use of ARPA Funds to date

Administration set-aside	\$200.0
Health worker rate enhancement	\$55
Financial support for distressed hospitals	\$50
In-patient psychiatric supplemental payments	\$31
Workforce training programming	\$50
Total	\$186.0
Amount remaining	\$14

\$ in millions

Remaining FRF funds not subject to appropriation have supplemented municipal FRF awards to four communities (\$109 million), funded a COVID-19 leave program (initially budgeted at \$75 million) and covered the cost of the state’s vaccination lottery program (\$10 million).

The Process for Appropriating Remaining FRF Resources

The task before the House and Senate is to pass a spending plan for some portion or all of the remaining \$4.9 billion. Governor Baker has already filed a \$2.9 billion FRF plan and the House and Senate will likely use that bill as the legislative vehicle for their action. The bill itself is likely to look much like a standard supplemental budget, with spending appropriations and related policy sections¹. Because the bill will make appropriations, Governor Baker will have a variety of veto options when it gets to his desk, including reducing or eliminating spending, eliminating policy sections, or proposing amended language.

Legislative leaders have indicated that they plan to complete this process by the time the House and Senate conclude formal sessions for the year (November 17th), though the Legislature could act on any gubernatorial vetoes after they return to session in the New Year

Governor Baker’s FRF Plan

As with the annual budget process, the Governor released the first proposal to use FRF resources and this bill has heavily influenced subsequent spending discussions. Governor Baker proposed allocating \$2.9 billion in FRF spending among five priority areas: housing, workforce, economic development, health care and infrastructure, as detailed in Figure 5.

¹ The most likely legislative process would mirror other appropriation bills, with a bill being released by House Ways and Means, amended and engrossed in the House prior to the same process in the Senate. A conference committee may be required to resolve differences between House and Senate versions prior to enactment.

Figure 5. Governor Baker’s FRF Spending Plan

Item	Category	Amount
First-time homebuyer/homeownership support	Housing	\$300
Affordable homeownership production	Housing	\$200
Affordable rental production	Housing	\$200
Senior/veteran housing production	Housing	\$300
Housing total		\$1,000
Downtown revitalization in disproportionately impacted communities)	Economic Development	\$100
Downtown revitalization (other communities)	Economic Development	\$250
Cultural and tourism assets	Economic Development	\$100
Economic development total		\$450
Workforce and skills training	Workforce	\$240
Workforce total		\$240
Behavioral health and addiction services	Health care	\$175
Fiscally distressed hospitals	Health care	\$50
Health care total		\$225
Water and sewer infrastructure	Infrastructure	\$400
Climate and environmental infrastructure	Infrastructure	\$300
State parks and recreational facilities	Infrastructure	\$100
Broadband and internet access	Infrastructure	\$100
Marine port development	Infrastructure	\$100
Infrastructure total		\$1,000
Total		\$2,915

Considerations for the Next Spending Bill

The spending decisions made by the Legislature related to the FY 2021 surplus and FRF will set the tone for the state’s COVID recovery and fiscal outlook over the next several years. In recent bulletins, MTF has outlined some of the challenges lawmakers will face in building the necessary infrastructure to expend, oversee and evaluate the use of this large sum of money, but there are several other major considerations to keep in mind.

FRF Spending and Reporting Requirements

As outlined in ARPA and subsequent Treasury guidance, all Fiscal Recovery Fund spending must fall into one of four eligible spending listed below and ordered from most flexible to least flexible use categories:

- General government services related to revenue lost due to the Pandemic (often referred to as revenue-replacement spending);
- Public health and economic response and recovery;
- Water, sewer and broadband infrastructure; and
- Premium-pay for essential workers.

It is likely that the majority of spending in any FRF legislation will fall into the revenue-replacement or public health/economic impact categories.

Revenue-replacement spending can go toward almost any general government service, with prohibitions related to servicing debt, rebuilding reserves, or paying down long-term liabilities, but it is also subject to a calculated limit: the total amount of FRF used for revenue replacement cannot exceed a calculation of estimate revenue lost due to the pandemic. Massachusetts' initial cap for revenue-replacement is \$3.7 billion. This number could grow in future years, but given the strength of recent tax revenue growth, MTF recommends treating \$3.7 billion as a hard cap on revenue replacement for the time being.

The state also has significant flexibility in spending under the public health/economic impact category, especially for any expenditures designed to aid those disproportionately affected by the pandemic. US Treasury guidance makes clear that assistance to these communities is a priority for FRF funds, but does not set forth a specific definition of how to apply the disproportionate impact definition. The Administration and Legislature should work together to develop an applied definition for disproportionate impact that can be used for spending programs and will pass federal muster.

In addition to ensuring that spending falls within an eligible category, lawmakers must also be cognizant of the reporting and oversight requirements that go along with FRF spending. Massachusetts is responsible for complying with all reporting and oversight requirements while also ensuring that any organization that receives FRF funding through the state abides by eligible spending categories and other obligations. To date, the Executive Office of Administration and Finance (ANF) has led Massachusetts' reporting and oversight efforts related to federal COVID-19 legislation. Ongoing, strong coordination between ANF and the Legislature is critical to ensuring that the state does not run afoul of myriad federal guidelines governing FRF resources.

Interaction between FRF and the FY 2021 Surplus

A key decision before lawmakers is whether or not to combine an FRF spending bill with their plan for the FY 2021 surplus. Like FRF, the FY 2021 surplus is best treated as one-time and not to be used to support ongoing costs. Unlike FRF, the state's budget surplus is not subject to external requirements as to how it can or cannot be used. It is likely that the legislature will combine FRF and surplus resources in one bill. Combining the FRF spending with the FY21

surplus has two major benefits. First, it streamlines the legislative process and avoids two separate spending debates that would likely have a great deal of policy overlap. Second, state surplus resources could work in conjunction with FRF funds to minimize federal eligibility and oversight concerns. For example, if the state wanted to use no more than \$1 billion of its revenue-replacement cap in this bill, state surplus funds could be used to support any number of COVID recovery programs not otherwise eligible under the other three categories.

The challenge with this combined approach is in creating a transparent process to account for which resource supports which investment. Meeting federal compliance and reporting requirements for FRF must be a top priority for the state. The federal government will recoup the full amount of any ineligible FRF spending and has until the end of 2026 to notify states of spending violations. The consequences of violating the terms of these funds, and needing to repay the federal government for investments already made, could wreak havoc on future budgets. Clearly delineating the use of state and federal resources is critical.

Finally, it is important that policymakers use temporary budget surpluses to rebuild reserves and pay down future obligations, such as debt service and pension liabilities for which Fiscal Recovery Funds cannot be used. The surplus and FRF uses should complement each other, and this includes using the surplus to reach a Stabilization Fund balance of \$5 billion and address other long-term fiscal challenges.

Spending Now v. the Future

Fiscal Recovery Funds are available to be obligated through the end of 2024 and expended through the end of 2026. The purpose of these extended timelines, along with the size of the FRF award, is twofold. First, it reflects the fact that pandemic recovery will take years and policymakers must be given adequate time to implement impactful programs. Second, these funds are intended to help address future economic and public health challenges related to the pandemic, that have yet to occur. Therefore, Massachusetts must hold a share of FRF funds in reserve for future contingencies.

The Governor's FRF bill balances these two, competing, factors, by programming 60 percent of remaining FRF funds now, while leaving the balance for future appropriation. Maintaining the flexibility to adapt to changing pandemic recovery needs, and economic and fiscal circumstances, is critical to a thoughtful FRF approach and the legislature should adopt a similar method.

MTF's [recent bulletin](#) provided recommendations on developing a plan for federal funds that balances immediate impact with the need for long-term planning.

Next Steps

The spending bill the legislature is likely to take up in the coming weeks will be pivotal in charting the Commonwealth's course for recovering from the pandemic and creating a sustainable fiscal future. MTF has set forth [broad principles](#) and [specific policy recommendations](#) that can be used by policymakers to help chart that course. As the legislative process moves forward, those principles will provide a framework to guide our analysis of the coming spending plan.