Prepared Statement of

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Before the

Committee on Finance

of the

Thirty First Legislature of the United States Virgin Islands

Overview of the Fiscal Year 2017 Executive Budget

Government of the United States Virgin Islands

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Earle B. Ottley Legislative Hall

9:00 A.M.

Good Morning Honorable Chairman Clifford F. Graham and other members of the Committee on Finance, other Senators of the 31st Legislature, and to the listening and viewing audience. I am Nellon Bowry, Director of the Office of Management and Budget (OMB).

I am accompanied by the following members of the Government's Financial Team: Mr. Marvin Pickering, Director of the Bureau of Internal Revenue (BIR); Ms. Clarina Modeste-Elliot, Executive Assistant Commissioner of the Department of Finance; Mr. Delbert Hewitt, Chief of Staff, Office of the Lieutenant Governor; Mr. Ira R. Mills, Tax Assessor, Office of the Lieutenant Governor; Ms. Bernadette Melendez, Director of the Bureau of Economic Research and Attorney Natalie Tang-How, Chief Negotiator of the Office of Collective Bargaining.

We are here, at your invitation, to present an overview of the Fiscal Year 2017 Budget of the Government of the U. S. Virgin Islands (the "FY2017 Budget"), which was submitted by the Governor to the Legislature on May 27, 2016. I will be the lead presenter; the other members of the team will be available to answer your specific questions. Your invitation asked us to be prepared to discuss the revenue assumptions and proposed appropriations that make up the FY 2017 Budget. However, before we delve into the specifics, I request your indulgence for a moment to provide some context.

United States President Obama once observed, insightfully; **"[A] budget is more than simply numbers on a page. It is a measure of how well we are living up to our obligations to ourselves and one another."[1]** That keen insight is embodied in the theme for the Governor's FY2017 Budget; "Creating Opportunities, Building Hope." Accordingly, notwithstanding the persisting economic and fiscal challenges, which will be amplified later, the proposed FY2017 spending plan makes meaningful attempts for our government to begin to live up to its obligations to the people of the Virgin Islands; particularly the most vulnerable among us.

[1] Remarks by the President at the presentation of the Fiscal Year 2010 Budget of the U.S. Government, February 26, 2009.

That is why, in addition to fully funding the salary increases recently granted to GVI employees, the Budget funds approximately 885 vacant and new full-time equivalent positions to address staffing shortages in critical areas in the Government, including: 134 positions to the Department of Education, of which 79 are for elementary and secondary education teachers; 191 positions to the VI Police Department and the Bureau of Corrections combined, including 31 correction officers and 80 police officers; 215 positions for the Departments of Health and Human Services combined; and 74 positions to the Department of Public Works to support an aggressive road maintenance program throughout the Territory. Other noteworthy inclusions are as follows:

- $1.9 million to the University of the Virgin Islands, mostly to fund faculty salary increases;
- $1.0 million to Bureau of Corrections for off-island inmate housing;
- $6.0 million for local match for Federal MAP funding;
- $2.7 million to the Department of Health for Court-ordered placement of patients at off-island behavioral health facilities.
- $37.4 million for contribution to retirees Health Insurance premium cost;
- $7.6 million for insurance for Government buildings and properties; and
- $4.9 million to support the work of 94 non-profit, community organizations

As you delve into the details of the budget, you will find a consistent effort to allocate our admittedly scarce resources to areas of concern in our community: education, healthcare, crime and public safety, and road conditions. It is also important to note that the initiatives included in this operating spending plan (and others in subsequent fiscal years), will be supplemented and complemented by a major capital projects program to be funded from $147.0 million in available balances from prior year bond issues, and $260.0 million from a planned 2016 bond issuance.

Budget Overview

In summary, the grand total of the FY 2017 Budget of the Government of the U.S. Virgin Islands (the “FY2017 Budget”) is $1.35 billion in current year expenditure and debt service. This is funded from $1.16 billion of local Funds and $193.5 million from Federal grant Funds. The local Funds portion is composed of expenditure and debt service totaling $844.9 million from the

General Fund, $112.8 million from Other Local Funds and $203.4 million from Funds not subject to annual appropriations[2].

Table 1: FY2017 Revenue & Expense Budget Basis

(In $Millions)	Gen. Fund Operation	Gen. Fund Debt Svce	Other Local	Non Approp	All Local Funds	Federal Grants	Grand Total
Revenues -Base Estimate	623.5	68.5	157.2	203.4	1,052.6	193.5	1,246.1
Fund Transfers	44.4	0	-44.4		0		0
Total Revenue & Grants	667.9	68.5	112.8	203.4	1,052.6	193.5	1,246.1
Expenditure & Debt Service	-776.4	-68.5	-112.8	-203.4	-1,161.1	-193.5	-1,354.6
Revenue Excess (Deficiency)	-108.5	0.0	0.0	0	-108.5	0	-108.5
Debt Financing	110.0			0	110.0	0	110.0

The $844.9 million General Fund expenditure budget – the main operating budget of the GVI – includes proposed expenditure of $715.5 million for Executive departments and agencies, $60.9 million for the Legislature and the Judiciary combined, and $68.5 million for long term (Gross Receipt Tax Bonds) debt service.

I will now briefly summarize the economic fiscal condition and outlook of the Virgin Islands and the Government, as a context for the assumptions and estimates that shaped the FY2017 Budget. Then, I will briefly summarize the assumptions that drive the revenue projections; and third, I will present a summary of the expenditure side of the Budget.

Economic Review and Outlook

The Virgin Islands Bureau of Economic Research (BER) reports that the contraction of the Virgin Islands economy, which was triggered by the global recession of 2008 and perpetuated by the closure of the HOVENSA refinery in 2012, has continued; but at a much slower rate. During

[2] These include the following Funds: Tourism Revolving, Indirect Cost, Union Arbitration, Government Insurance, PSC Revolving, Government Insurance, Business & Commercial Properties, St. John CIP, Anti-Litter & Beautification, Sewer, Health Revolving and the Territorial Park.

the slide period, 2007- 2015 the Virgin Islands economy, as measured by real GDP adjusted for inflation, contracted by approximately 30% and lost 8,000 jobs – primarily well-paying jobs in the manufacturing, construction and industrial sectors.

Recent economic indicators show mixed results. For the first two quarters of the current fiscal year, hotel room tax collections were up by 17% and trade and excise tax revenues were up 8%. On the other hand, collection from individual income, corporate income and gross receipts taxes were down, by 1.7%, 25.5% and 1.5%, respectively. Nonagricultural jobs declined, albeit minimally (less than 1%) however, employment in the tourism and hospitality sector held steady. Air visitor arrivals were up 1.4%, while cruise passenger arrivals were down 3.9%. The number of homes sold remained unchanged, but the average sale price decreased; except that average condominium sales prices increased by 6.5%.

The economy is expected to benefit, in the near term, from several significant multi-million dollar public sector projects, which are already funded and shovel-ready. These include: two multi-purpose sports and recreation complexes on St. Croix, $60.0 million of road development projects on St. Croix; and $40.0 million waterfront road development on St. Thomas.

The VI economy is likely to get an additional lift from a steadily rising US economy. The BER summarizes the near term outlook as follows: "Fiscal and employment challenges will persist in 2017. The tourism sector is expected to continue to improve due to strong marketing by the Department of Tourism. The losses of jobs in various sectors may linger in 2017, but the many public sector initiatives will mitigate any significant job loss. **Growth, therefore, may continue to remain slow and uneven at about 1% to 2%."**

Liquidity Position

The Department of Finance reports a current liquidity position of approximately thirty-three (33) days operating cash on hand. However, this is after making significant progress in paying off obligations. Notably, in the current fiscal year, the Government has repaid a $60 million working capital line of credit as well as a $40 million property tax revenue anticipation note; has repaid $11 million to WAPA against an outstanding street lighting bill; has paid over $50 million in tax refunds; and has so far funded approximately $4.9 million in salary increases to Government employees.

Revenue Estimates

The FY 2017 revenue estimates, on which the budget is based, assume some increase in direct and indirect taxes from a combination of increased employment in the industrial and government sectors, expiring EDC tax benefits, and more aggressive collections by a strengthened IRB staff. The General Fund will also benefit from proposed legislation accompanying the Budget, which will redirect resources that are currently being siphoned off to other Funds.

FY2017 General Fund revenues and transfers, net of $60.0 million set aside for tax refunds and credits, and $68.5 million set aside for debt service on Gross Receipts Tax Bonds, are estimated at $667.8 million. This total is composed of $425.8 million from net direct taxes,[3] $152.0 million from indirect taxes,[4] and $90.0 million from other revenues and transfers. The ***direct tax*** component is composed as follows: $351.5 million from individual income taxes, $74.3 million from corporate income taxes and $60 million from real property taxes, for a gross amount of $485.8 million. The net amount available, after offsetting $60.0 million for tax refunds and credits, is $425.8 million.

The ***indirect tax*** component is composed as follows: $24.9 million from trade and excise taxes, $184.2 million from gross receipts taxes and $11.5 million from other taxes; for a gross amount of $220.6 million. A mandatory set aside of $68.5 million for Gross Receipts Bonds debt service leaves a net available amount of $152.0 million.

The ***other revenues and transfers*** component consists of: $33.9 million from various duties, fees and charges, $45.0 million in net transfers from other local Funds, and $11.7 million from miscellaneous other sources. The primary transfers are from: the Matching Fund - $8.5 million; the Transportation Trust Fund - $15.8 million and the Insurance Guaranty Fund - $12.0 million.

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[3] Individual income, corporate income and property taxes.
[4] Primarily gross-receipts and taxes

The structural imbalance in the General Fund, which was temporarily alleviated in FY2016 by the one-time infusion of $200 million from the Limetree transaction, persists in Fiscal Year 2017. The estimated net revenues available in FY 2017 from these recurring sources are insufficient, by $110 million, to cover the estimated expenditure required to pay for government operations in the fiscal year. This difference is to be made up by proposed ***debt financing and restructuring***, as follows: $55.0 million in budgetary savings resulting from a proposed long term debt restructuring and $55.0 million from working capital financing.

With respect to the debt restructuring, financial analysis indicates that an opportunity exists, in today's municipal bond market environment, to restructure outstanding Matching Fund and Gross Receipts Tax Bonds to produce aggregate ***budgetary***[5] savings of approximately $220.0 million through Fiscal Year 2020; an annual average of $55.0 million. Within this month, the Administration will submit to the 31st Legislature, proposed legislation to authorize the issuance of Series 2016 Bonds, as a part of a long term debt restructuring program, which will, among other things, provide budgetary savings and debt relief. This will be a component of a five-year, financial recovery plan for the Government of the Virgin Islands.

Expenditure Estimates

General Fund

The FY2017 expenditure budget reflects the constraints imposed by the revenue estimates. Accordingly, in the aggregate, amounts budgeted are minimally above recent levels. Accordingly, the total FY 2017 General Fund expenditure budget, excluding $68.5 million for long term debt service, is estimated at $776.4 million. This total is $25.9 million or 3.5% more than the current level of FY 2016 appropriations. Approximately $715.5 million is allocated to the Executive Branch and $60.9 million is allocated to the Legislative and Judicial Branches combined.

The Executive Branch amount is composed as follows: $427.3 million (59.7%) for personnel services cost (salaries, employee benefits and payroll taxes); $155.6 million (21.7%) for supplies,

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[5] As distinct from present value savings, budgetary savings lower annual debt service payments by, in effect, extending the loans maturities.

services and charges; $26.0 million (3.6%) for utilities cost; $2.0 million in routine capital additions; $104.6 million (14.6%) for contributions to semi-autonomous agencies, boards and commissions. The semi-autonomous agencies include the University of the Virgin Islands, VI Waste Management Authority and both district hospitals. Other entities funded under the Executive Branch include the Election System (including the Board), the VI Inspector General and the Board of Education (including Career and Technical), PERB and the Labor Management Council.

Other (Appropriated) Local Funds

In addition to the General Fund, there is a total of $112.8 million budgeted from ***Other Local Funds***. The source of funding is a collection of about a dozen special purpose Funds[6] established by the Legislature. In summary, the budgeted uses are as follows: $86.5 million in debt service for Matching Fund Bonds; $29.2 million in appropriations to the several agencies responsible for carrying out the purposes for which the Funds were established; and $42.0 million transferred to the General Fund.

Other (Non-Appropriated) Local Funds

In addition to appropriated amounts, some GVI departments and agencies (including semi-autonomous agencies) are expected to have access to an estimated $203.4 million in local government revenues that are not subject to annual appropriations. For the most part, the sources of revenues for this ***Non-Appropriated*** expenditure are primarily fees and charges for business activity services provided by governmental entities[7].

The Schneider Regional Medical Center and the Governor Juan F. Luis Hospital & Medical Center together will have access to $138.4 million (68%) of the total, from fees and charges for medical care they provide. The two other significant amounts in this category are: $12.0 million available to the Department of Finance from the V.I. Insurance Guaranty Fund; and $24.0 million available to the Department of Tourism from the Tourism Advertising Revolving Fund.

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[6] See Footnote 3.

[7] The notable exceptions are the revenues deposited in the Insurance Guaranty Fund and Tourism Revolving Fund. These revenues are generated from taxes: the Insurance Premium Tax and the Hotel Occupancy Tax, respectively.

Each Fund is to be administered for the purposes for which it was established. The balance of $29.0 million is spread among Funds in different agencies.

Federal Funds

In addition to local funds, the FY 2017 Budget is supplemented by $193.5 million in ***Federal grants funding***. This amount compares to $210.0 million in FY 2016 and $181.8 million in FY 2015. Four VI Government departments are expected to receive $145.6 million (75.2%) of these grant funds, as follows: the Department of Human Services $68.7 million; the Department of Education $38.1 million; the Department of Health $19.2 million; and the Department of Public Works $19.6 million.

Federal grants to the Department of Human Services are intended to fund the following major programs: State Administrative Matching Grants for the Supplemental Nutrition Assistance Program, Rehabilitation Services-Vocational Rehabilitation Grants to States, Temporary Assistance for Needy Families (TANF), the Head Start Program and Medical Assistance Program.

Grants to the Department of Education are intended to fund the following major programs: National School Lunch Program, Consolidated Grant to the Outlying Areas and Special Education Grant.

Major programs grant funded under the Department of Health are: Special Supplemental Nutrition Program for Women, Infants and Children (WIC), Hospital Preparedness and Public Health Emergency Preparedness Aligned Cooperative Agreement, and Immunization Cooperative Agreements Project.

Major programs grant funded under the Department of Public Works are: Economic, Social and Political Development of the Territories, and Highway Planning and Construction Projects.

Conclusion

Within the context of our challenged economic and fiscal realities, the FY 2017 Executive Budget begins to address some of the major service-level deficiencies, particularly in the areas of workforce compensation, education, health (especially mental health), public safety and road maintenance. As such it represents an effort to create opportunities and build hope in our community.

Mr. Chairman; that concludes our prepared statement. We are available to answer your questions.