State IT budget analysis and forecast for 2015: Changes and opportunities on the horizon

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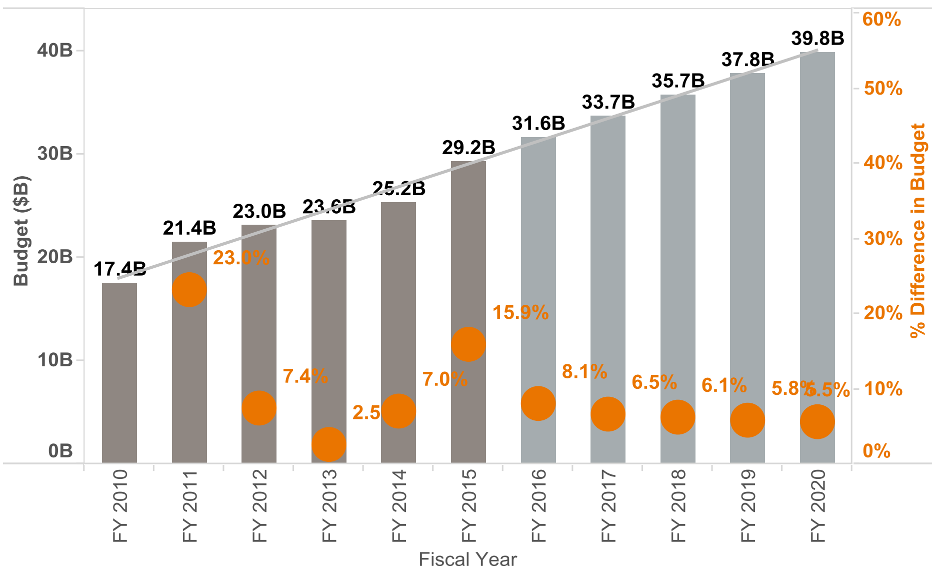
State government revenues and budgets are projected to increase in FY 2015 and beyond as states continue along their path of growth, according to the latest analysis from Deltek. With this general financial improvement, state IT budgets and related contracting opportunities are also growing.

Each year Deltek collects IT budget line items from each state's budget. This dataset is unique in the marketplace and offers invaluable insight into states' IT operations and related opportunities for interested contractors.

State all funds[1] IT budgets are experiencing accelerated growth as governments continue restoring lost funding and approving new projects. This expansion is projected to continue and should provide some contract relief to vendors challenged by federal IT spending uncertainty

Figure 1: All funds IT budget (total and YoY % change) with 5-year projection



Overall IT budgets and projections

Overall IT budgets are accelerating in growth, up from a modest increase in 2013 to almost 16 percent growth in 2015. The slowed growth in 2013 was due to federal stimulus drying up and states scurrying to right-size budgets as a result. States made efficiency-driven cuts and are now growing IT budgets again. In fact, the $4.0 B increase for 2015 is the second highest single year dollar value gain since Deltek has kept track.

Looking ahead at projection modelling shows strong future indications of positive all funds IT budget growth. Deltek's modeling (Figure 1) shows growth rates (CAGR) between 6 and 9 percent for the near future. Taking all factors into consideration, including 5 straight years of gains from 2010 to 2015, recent accelerated IT budget growth, and decreased growth in specific general budget verticals, Deltek is conservatively projecting a 6.4 percent 5-year IT budget CAGR from 2015 to 2020. All of this is great news for the GovCon IT market.

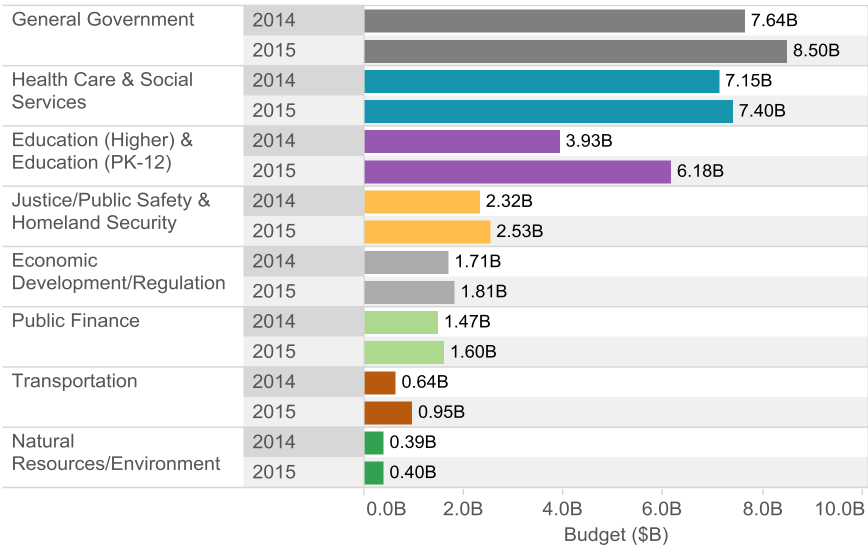
IT budget analysis by vertical

FY 2015 indicates some changes in fortune for various IT budget verticals (see Figure 2). Since the recession, this fluctuation by vertical is par for the course as states cycle IT budget areas in which they invest to maximize impact.

General government and health care and social services accounted for 57 percent of IT budgets over the last five years (30 and 27 percent respectively). Since both are so large already and continue to grow, the combined impact of IT spending in these areas is becoming more important to the states.

Growth accelerated for general government IT, up $856 million (+ 11.2 percent) to a total of $8.5 billion in 2015 (Figure 3). These increases are in large part due to states placing enterprise IT projects back on track (legacy modernization/replacement) and increased investments in infrastructure (including cloud and mobile) while adding new efficiency gaining technologies (including business intelligence/data analytics and enterprise resource planning). Look ahead for future opportunities with a five year CAGR of 3.1 percent.

Figure 2: All funds IT budget by vertical



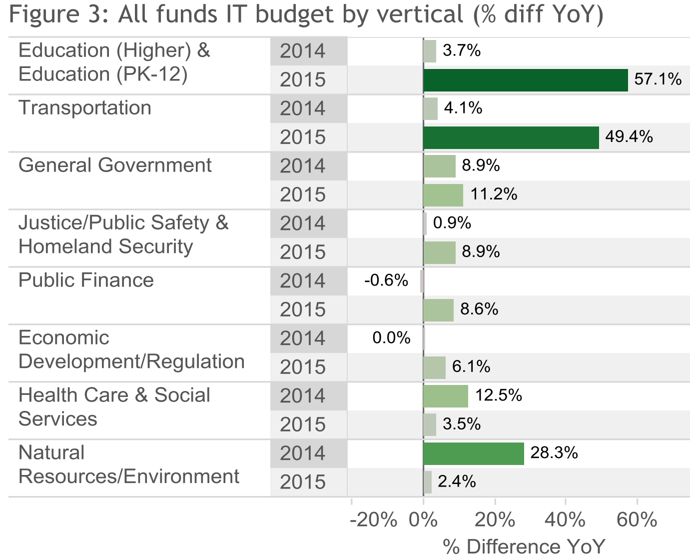
While IT spending growth has slowed a bit for health care and social services, there is still strength in the segment, moving ahead $251 million (+ 3.5 percent) to a total of $7.4 billion for 2015. Some of the slowed growth is from the ACA boom flattening out. However, there will still be substantial maintenance spending related to these new systems. Additionally, there will be spending for MMIS and integrated eligibility systems upgrades in line with recent Medicaid expansion. There may also be opportunities related to efficiency with business intelligence and data analytics. Vendors can still look ahead for robust growth in this sector with a Deltek projected 5-year IT budget CAGR of 8.5 percent.

Adding in education (both PK-12 and higher education) at about 17 percent of total and justice/public safety at 9 percent of total covers over 8 out of 10 IT dollars spent over the last 5 years.

The biggest surprise gainer of 2015 is education IT, moving up $2.3 billion, or + 57 percent to a total of $6.2 billion. While an important gain, much of the jump can be attributed to the huge new $2 billion investment by New York; nobody else even comes close in terms of new education IT investment. However, the additional $252 million in new investments by other states constitutes a solid market gain. PK-12 educational investment is geared toward technology in the classroom to improve overall educational outcomes and better prepare students for a more technical workplace. For higher education, states push consistently for new technology where it can be afforded to drive up the educational prestige of institutions through increasing the quality of applicants and bringing in new research investment. Combined, Deltek estimates a 5-year IT budget CAGR of 4.4 percent going forward.

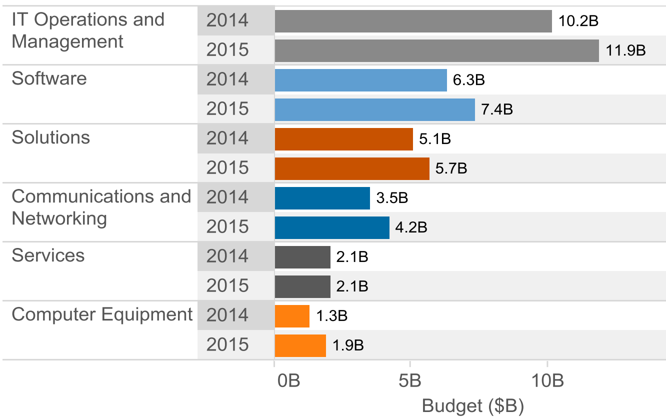
Justice and public safety IT budgets moved up at a healthy 8.9% clip, which is great news for contractors who experienced the relatively flat growth rate in the vertical since the recession. New areas of investment include officer safety/accountability technology, which will grow even more popular with this year's rash of very public and controversial officer-related incidents. Also, look for advancement of communications infrastructure (related to LTE and FirstNet) and other mobile technologies. Vendors interested in this vertical should be much happier with the improved 5-year outlook with a Deltek estimated IT budget CAGR of 6 percent.

Figure 3: All funds IT budget by vertical (% diff YoY)



While not a huge part of the overall state IT market (2.5 percent of total), transportation IT moved up an impressive 49.4 percent, or + $315 million; such movement is certainly enough for contractors to notice. This growth is more than likely a result of states not only recapturing some lost projects and funding from the recession, but also looking for ways to increase efficiency through traffic management and grow revenue through various automated technologies. Look ahead for continued growth and opportunity with a stellar 9.9 percent 5-year IT budget CAGR.

Figure 4: All funds IT budget by IT category



IT budget analysis by IT category

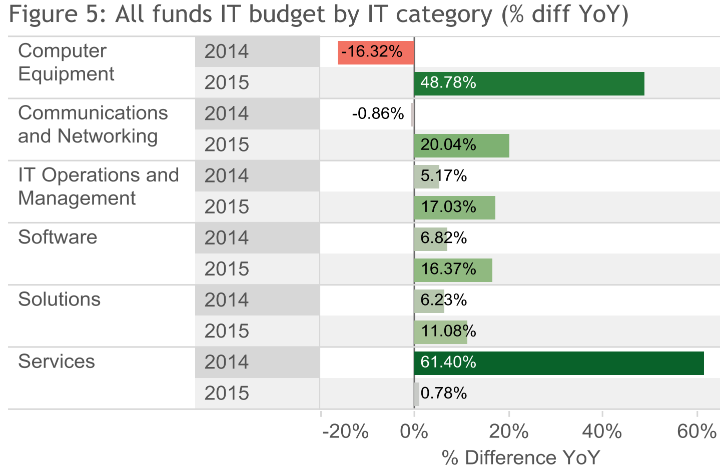
General IT operations and management occupied over 41 percent of all IT budget line items over the last five years, moving up 17 percent to a total of $11.9 billion in 2015 (Figures 3 and 4). Since this category includes personnel, facilities, general IT support, and other IT-related budget items provided by the state to other agencies, much of this growth is not likely to trickle down to vendors. On the other hand, solid growth here indicates overall state investment in centralized IT operations, which usually translates well for vendors regarding large IT projects. The forward-looking 5-year IT budget CAGR of 4.5 percent indicates continued state investment in centrally-managed IT infrastructure and talent.

Over the last five years, the four main procurement-related budget categories (software, communications and networking, professional services, and computer equipment) accounted for almost 52 percent of total IT budgets, moving up 18.3 percent to $15.6 billion for 2015. This projects well for contractors as the main IT procurement budget categories are increasing more than operations and management budgets.

Software was the largest procurement-related category over the last 5 years, accounting for over 25% of total IT budgets, moving up 16.4 percent to almost $7.4 billion in 2015. One reason software is so heavily represented in state budgets is that software systems used by states are often expensive enough that they require higher level budget approvals. These higher cost systems shouldn't skew analysis to presume that software is the largest procurement category for the states. On the other hand, these larger software systems are easily identifiable in budgets and provide significant opportunities for contractors as states look to drive efficiency through IT. Vendors can anticipate a healthy 5-year IT budget CAGR of 5.9 percent in this category.

Communications and networking was the second largest procured budget category over the last 5, years accounting for almost 15 percent of total IT budgets and growing 20 percent in 2015 to a total of $4.2 billion. This growth offers some better news for contractors after the slight contraction experienced in 2014. With many state CIOs prioritizing cloud, mobile, wireless, and networking, contractors can expect to see continued budget growth in this area as states seek to improve related infrastructure to meet future demand. Looking ahead, the Deltek projected 5-year IT budget CAGR is significant at around 7.5 percent.

Figure 5: All funds IT budget by IT category (% diff YoY)



Computer equipment showed the strongest year-over-year growth, moving up almost 49 percent to total of $1.9 billion for 2015. While not as strongly represented in state budgets as contractors might assume, there is a significant amount of computer equipment purchasing that does not rise to the level of budgetary approval. So, while vendors will see fewer large computer equipment purchases relative to software, there will still be significant smaller equipment purchases made by states for IT operations. Nevertheless, the future outlook is solid with a Deltek projected 3.5 percent 5-year IT budget CAGR.

Professional services round out the top procurement categories, taking up almost 5.9 percent of total IT budgets over the last 5 years. While one of the strongest growth areas last year, professional services budgets experienced slowed growth for 2015, moving up just 0.8 percent to $2.1 billion. Even with this dip, Deltek expects professional services budgets to pick back up, remaining one of the strongest budget growth areas with a forward-looking 5-year IT budget CAGR of around 14 percent.

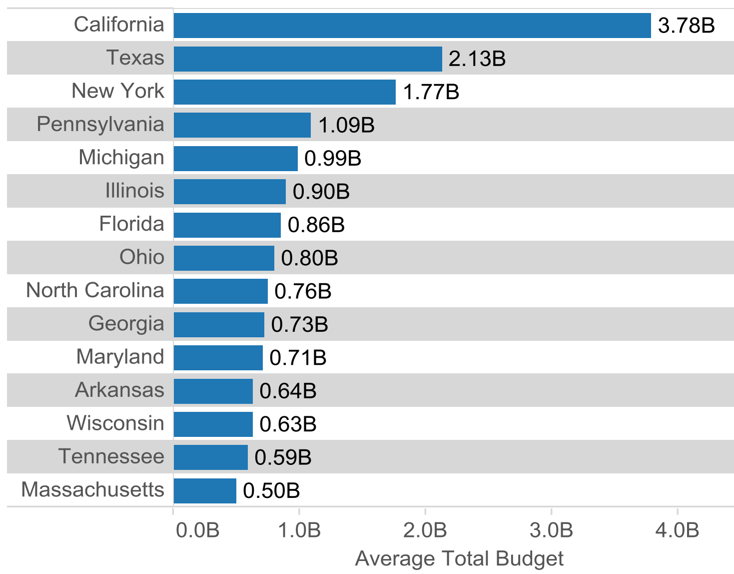
Solutions as defined by Deltek are more intricate systems that involve a combination of software, hardware, networking, and/or professional services for implementation. Over the last 5 years, IT solutions crossing multiple categories totaled over 17 percent of IT budgets. For 2015, IT solutions budgets made a big bump up, moving 11 percent to a total of $5.7 billion. This is great news for contractors, as solutions almost always result in outside procurement for successful completion. Looking ahead, Deltek projects a 5-year IT budget CAGR of around 7 percent.

Analysis of top states

Each year Deltek gathers IT budget data for each state, including line items and related departmental totals. This unique dataset offers insight into how states spend that is otherwise very difficult to obtain. While a full examination of individual state budgets is outside the scope of this report, all of this data in its rich detail is available to Deltek subscribers.

Taking a peek at state IT budgets over the last five years shows which states are budgeting the most and where contractors are likely to find potential procurement opportunities. The top 8 IT budgets are explained relative to overall budgets. However, a few of the larger IT budgets are a bit higher on the list than vendors might have anticipated. Some medium-sized states like Maryland, Tennessee, and Arkansas have significantly increased IT budgets in recent years. Georgia, North Carolina, and Wisconsin also show up a bit higher than anticipated, but have relatively stable IT budgets over the past few years.

Figure 6: Top 15 state IT budgets (5-year avg. FY 2011 - 2015)



While IT budgets generally follow regular budgets, comparing states' relative IT budgets can be tricky. Quite simply, some states are much more transparent in reporting IT budget line items than others. In layman's terms, if the legislature or governor can see a line item, they may request to have it cut. As a result, there is some deliberate opacity with regard to budget line items.

Analyst's take and recommendations

State IT budgets are growing along with regular budgets as states continue to push forward in recovery. The overall 16 percent surge in 2015 and 6.4 percent forward-looking CAGR are fantastic news for contractors. Even better, the increases for each of the last five years illustrate a relative consistency noticeably absent from the federal IT market.

Some of the best news for the broader state IT market is that the rate of health care and social services (HC&SS) IT growth has slowed. Look for this to open up more diversified IT projects for vendors interested in other verticals.

However, in 2015, the HC&SS space still has significant projected spending, especially with software and related solutions. In fact, HC&SS software and solutions are the two highest combined vertical and categorical IT budget areas across the states, coming in at about $3.8 billion and $3.5 billion, respectively. Contractors in this space should remain put, as continued opportunities are on the near horizon as states continue investment in the wake of Medicaid expansion.

Lower growth rates for general IT operations and management budgets also positively impact the overall market. Simply, as internal operations budgets stay lower relative to overall IT budgets, the potential for more outsourced projects increases. Contractors should continue watching these numbers and plan accordingly. Better yet, vendors with solutions to keep operational costs lower should be vying their wares.

For example, general government IT budgets are projecting excellent opportunities in professional services ($725 million for 2015), as states look for outside help and expertise to build and manage complex systems. One of the most important parts of these complex systems is the software that runs them, and contractors should look here for related opportunities ($823 million for 2015).

Educational IT will continue to present excellent vendor opportunity as states look to at least stay current, if not pull ahead of neighbors; a better-educated population attracts better business opportunities for all. Vendors should look for the market to strengthen, with a keen eye toward computer equipment ($1.2 billion) and software ($1.4 billion) for 2015.

For justice and public safety (JPS) vendors, the recent uptick in IT budgets will be welcome news as states continue to upgrade communications and related technology. Contractors should focus on communications and networking (around $854 million for 2015) as a particularly strong segment.

One gem not often focused on in analysis is public finance IT, particularly financial management and ERP systems. Some might classify this under general government, but the point remains the same; 2015 indicates almost $700 million in software spending for the vertical. Interested contractors should be proactive in talking with states about any systems they have to help manage enterprise finances.

As states continue clearing their recessionary backlog, larger and more complex projects continue to get budgetary approval. Specifically in 2015, vendors will want to look for larger solution-oriented opportunities in education ($393 million), general government ($395 million), JPS ($625 million), and public finance ($649 million).

The basic recommendation for all vendors is to get out ahead of the planning curve by considering the future needs of states. States have an increasing need for professional services ($2.1 billion in 2015) and desire the expertise to implement complex solutions that only the vendor side can provide.

Contractors that are not in the state market should get in now, as the market is strong and growing. For those hurting from losses in federal sales, state opportunities may spell some of that pain. Contractors already in the state market should be well-positioned for continued expansion in future opportunities.

Vendors should look closely at available budget and procurement data to find states and departments that are good matches for their products and have future business potential. While everyone loves a good bidding opportunity from an RFP that hits the street, using data to uncover opportunities before the fact is the true differentiator in building win rates. Wading through the myriad of state budgets and related procurement opportunities is admittedly no easy task and one reason why vendors are often leery when expanding to new states. However, deep data and related knowledge from Deltek makes that sort of strategic business planning possible.

Next Steps

Gain access to additional analysis and learn more about GovWin IQ by visiting Deltek.com/GovWinIQ.

[1] All funds represent the combination of all available sources of revenue for a state, including: general funds, federal funds, other state funds, and bonds. All funds budgets are capital inclusive when identified as such by individual states.