

SENATE OF VIRGINIA

Senate Finance Committee

2017 Session Revenue and Budget Outlook *Presentation to the 2017 VML and VACO Finance Forum*

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Outlook for the 2017 Session

- Recap of revenue shortfall and implications for the remainder of the biennium
- Highlights of the Governor's budget – actions to close the budget shortfall and proposed spending
- Issues/opportunities/challenges for the 2017 Session



Recap of 2016:

Key Dates in the Revenue/Budget Shortfall

- **December 2015:** Governor McAuliffe's biennial budget included \$3.4 billion in additional resources above the base budget.
 - Resources sufficient to cover mandated, high-priority budget items.
 - Additional resources available to address employee compensation, and make new investments in public and higher education, research, and economic development.
- **February 2016:** First hint of trouble - downward adjustment to sales and corporate income tax, offset by positive adjustments to refunds, recordation and insurance for FY 2016, and for FY 2017 and FY 2018.
- **May/June 2016:** Based on collections through April, agencies directed to slow spending. In June, Governor indicated intention to reforecast revenues based on May year-to-date collections.



Recap of 2016:

Key Dates in the Revenue/Budget Shortfall

- **July 2016:** FY 2016 GF collections fell short by \$279.3 million, officially triggering the revenue reforecasting process.
 - GF revenues fell short \$268.9 million, driven mainly by withholding and sales tax; transfers off by \$10.4 million.
 - GF revenues grew 1.7%, instead of the forecast rate of 3.2%.
 - Reflected that job growth is primarily in lower paying occupations.
- **August 2016:** Governor McAuliffe presented an **interim revenue forecast** to the Joint Money Committees, based on the recommendations of the JABE and GACRE forecasting groups.
 - Growth rate lowered from 3.2% to 1.7% in FY 2017; from 3.9% to 3.6% in FY 2018.
 - Biennial revenues lowered by **\$1.2 billion** from the official forecast; total problem of **\$1.5 billion**, when FY 16 shortfall included.
 - State agencies directed to develop budget reduction strategies.



FY 2016 Recap: GF Revenues Fell Short \$268.9 Million

- GF revenues missed the forecast by 1.5 percent, driven by lower than expected payroll withholding and sales tax.
- Including transfers, the shortfall totaled \$279.3 million.

Fiscal Year 2016 General Fund Revenues (\$ in Millions)

Major Sources	Forecast	Actual	Variance	Change (%)	
				Forecast	Actual
Withholding	\$11,501.6	\$11,306.3	(\$195.3)	4.1	2.4
Nonwithholding	3,099.0	3,070.1	(28.9)	1.9	0.9
Refunds	<u>(1,777.6)</u>	<u>(1,820.7)</u>	<u>(43.1)</u>	<u>1.2</u>	<u>3.6</u>
Net Individual	\$12,823.0	\$12,555.6	(\$267.4)	4.0	1.8
Sales	\$3,367.7	\$3,295.9	(\$71.9)	4.1	1.9
Corporate	722.8	764.9	42.1	(13.1)	(8.0)
Recordation	383.0	369.1	(13.9)	10.6	6.6
Insurance	322.7	339.1	16.4	7.3	12.8
All Other	<u>689.8</u>	<u>715.5</u>	<u>25.7</u>	<u>(0.4)</u>	<u>3.3</u>
Total GF Revenue	\$18,309.0	\$18,040.1	(\$268.9)	3.2	1.7



Calculating the Revenue Shortfall

(\$ in millions)	FY 2016 Ch. 732	FY 2017 Ch. 780	FY 2018 Ch. 780
Official Revenue Forecast	\$18,309.0	\$18,902.4	\$19,633.1
Actual / Interim Forecast	<u>18,040.1</u>	<u>18,338.0</u>	<u>19,000.4</u>
Revenue Variance	(\$268.9)	(\$564.4)	(\$632.7)
Transfers	<u>(10.4)</u>	<u>(17.7)</u>	<u>(21.6)</u>
Subtotal	(\$279.3)	(\$582.1)	(\$654.3)
* FY 2016 Balance Forward		<u>(\$279.3)</u>	<u>0.0</u>
Total		(\$861.4)	(\$654.3)
Total Shortfall			(\$1,515.7)

**FY 2017 budget assumed a balance forward from FY 2016 of \$265.3 million.*



Recap of 2016:

Key Dates in the Revenue/Budget Shortfall

- **October 2016:** Governor presented plan that identified about \$875 million in savings in FY 2017.
 - \$125.1 million from removing December pay actions, including 2% increase for teachers and state-supported local employees.
 - Withdrawal from the Rainy Day Fund.
 - **K-12, aid to localities, higher education, and most “safety net” services were exempt.**
- **October/November 2016:** Economists and GACRE meet again to discuss revenues; slightly more optimistic than in July.
 - Based on GACRE recommendations, combined with “money in the bank”, Governor’s budget includes about \$233.0 million in revenues above the interim revised forecast.
- **December 2016:** Governor’s budget reflects net revenue reduction of \$303.6 million, and net spending reduction of \$298.5 million, compared to budget adopted last year (Ch. 780).



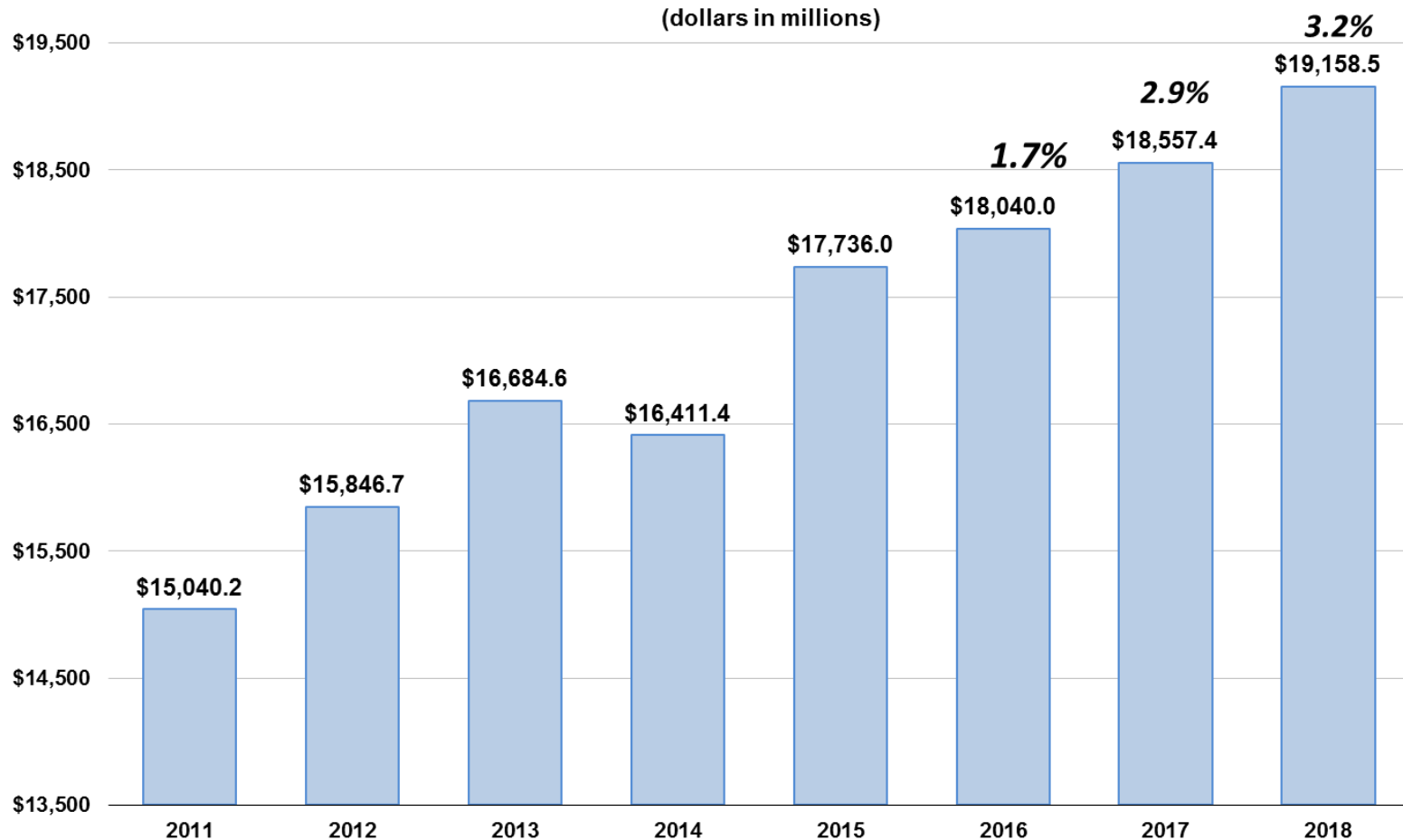
Virginia's Economic Outlook: Slowly Growing Economy, Modest Revenue Growth

- On pace for growth of less than 2 percent in U.S. GDP for calendar year 2016, slower than the 2.4 percent growth in 2014 and 2015 (alho up to 3.2 percent in Q3 of 2016).
- Nationally, job growth has been good but slowing gradually. Gains are expected to slow further.
- Statewide employment growth slowed the last three quarters. Expected to slow to 1.5 percent and 1.0 percent in fiscal years 2017 and 2018.
- Despite the low unemployment rate, there is slack in the labor market which may dampen wage growth and hurt payroll withholding.
- Shifting patterns of consumer spending means continued weakness in sales tax growth.
- Housing market continues to rebound.
- Sequestration is still a concern. The Bipartisan Budget Act of 2015 increased caps by \$50 billion in FY 2016 and \$30 billion in 2017. Without federal action, caps will be lowered after September 2017.



Slow, but Steady, Revenue Growth Projected

Va. General Fund Revenue Collections



Highlights of Governor's Budget

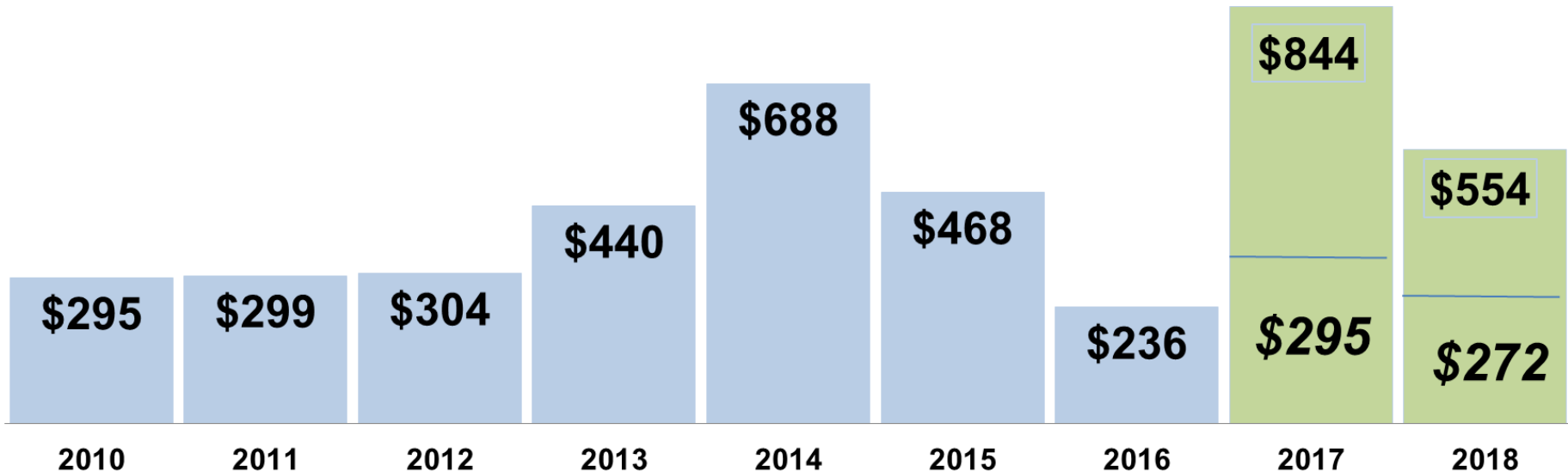
- Uses Chapter 780, enacted in April 2016, as the starting point.
- **Resources:** Reflects a downward adjustment of \$1.2 billion in GF revenues.
 - Adds \$233.0 million based on GACRE, plus \$144.5 million of technical and tax policy actions.
 - Includes \$58.2 million from Tax Amnesty; about \$13.3 million to transportation and localities.
 - Assumes withdrawals from the Rainy Day Fund of \$567.2 million.
- **Spending:** Includes a **net** reduction of \$298.5 million, with:
 - \$359 million of **new** spending to address high priority, mandated items (Medicaid, CSA, inmate medical costs).
 - Provides discretionary spending of about \$130 million for bonus for teachers, state employees & state-supported locals; compression pay; & career development for constitutional officers.
 - Funding of \$31.7 million to address the state's mental health system.



Rainy Day Fund covers about \$567 million of two-year shortfall

Rainy Day Fund Balance
(\$ in millions)

- Deposit of \$605.6 million required in FY 2017.
- Withdrawal of \$295 million to help close FY 2017 gap, and \$272 million in FY 2018.



Major Proposed Spending

Spending Item	FY 2016-18 GF, \$ in millions
Medicaid Forecast	\$255.1
Children's Services Act – Caseload Growth	85.7
SOQ Teachers & Support 1.5% Bonus (Dec. '17)	55.5
State Employee 1.5% Bonus (Dec. '17)	42.2
Corrections – Inmate Medical Costs	18.5
SS Local Employees 1.5% Bonus (Dec. '17)	13.8
Salary Compression for Sheriffs, Local & Reg. Jails	8.7
Career Development for Constitutional Officers	3.9
District Court Clerks & Deputy Clerks Salary Adj.	2.5

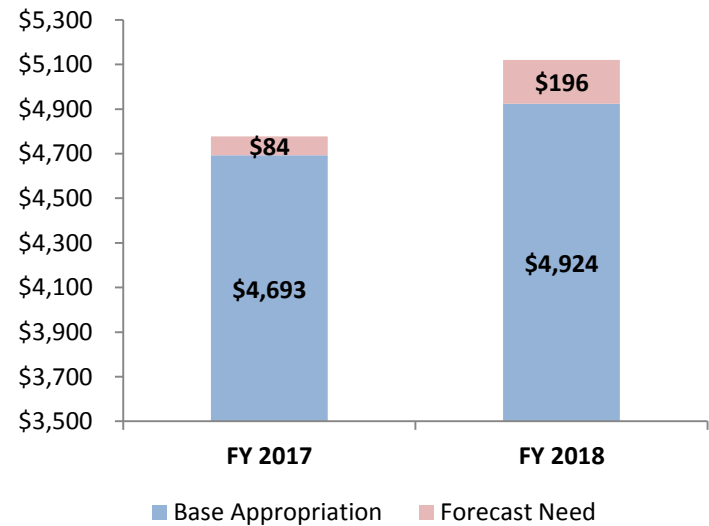


Medicaid Forecast

- Additional funding of **\$281 million GF** for fiscal years 2017 and 2018 is required to address caseload and cost growth. Spending is projected to increase by 7.4% in FY 2017 and 4.3% in FY 2018. Last year's forecast projected growth of 3.8% and 2.9%, respectively.
 - Federal increases in Medicare Premiums account for \$89 million GF of the growth.
 - Increasing utilization of community behavioral health services accounts for \$86 million GF.
 - In FY 2016, enrollment growth was 2.6%. Year-to-date enrollment growth is up 1.6%. (Full benefit Medicaid enrollees).
 - Fee-for-service acute care and early intervention services reflect higher utilization.
 - Non-waiver long-term care and pharmacy rebates provide offsetting savings.

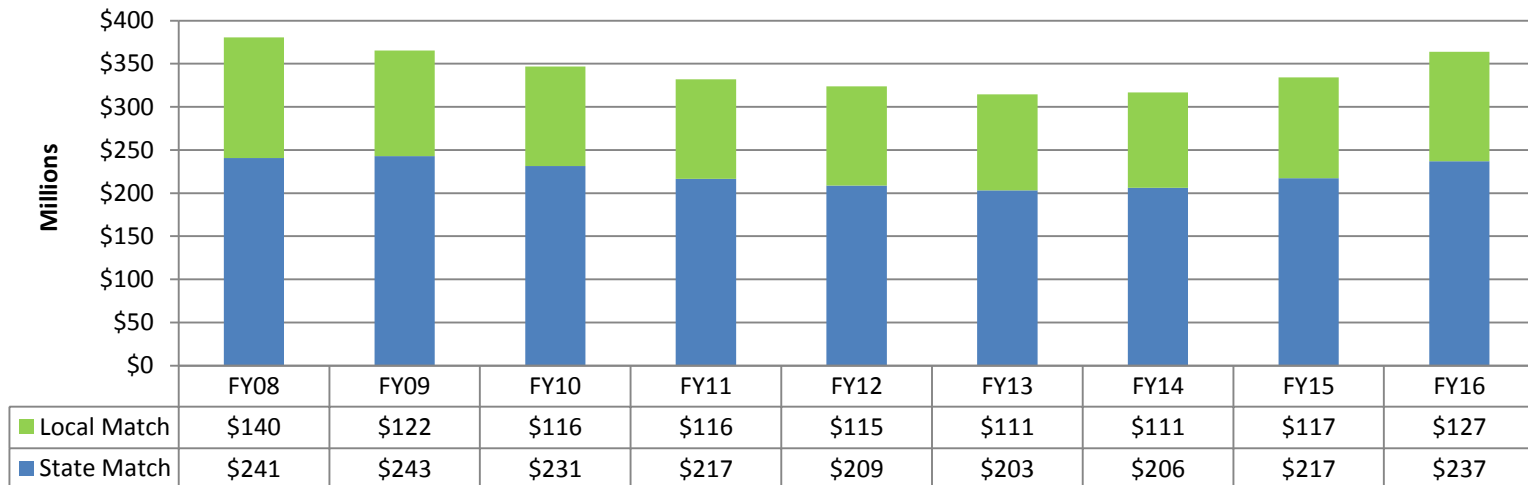
November 2016 Medicaid Forecast

(GF Dollars in Millions)



Children's Services Act

- After a few years of declining spending, growth returned in FY 2014.
- FY 2015 growth was over 5% and in FY 2016 over 9%.
- The majority of this growth is due to **private day placements** through special education in public schools.
- Projected GF need in FY 2017 is **\$23.8 million** and in FY 2018 is **\$34.9 million**.



Major Budget Reduction Strategies

Reduction Strategy	FY 2016-18 GF, \$ in millions
Remove Dec. 2016 Pay Increases	\$346.3
Across-the-Board Agency Savings	99.4
Higher Education 5% Reduction in Year 2	76.1
Additional Lottery Proceeds for K-12	52.3
Supplant K-12 GF with Literary Fund	50.0
Medicaid Offset from Health Care Fund	43.9
Recover HE NGF Share of VRS Savings	40.4
K-12 Update Net Sales Tax	38.1
K-12 Student Enrollment Projections	34.6



Proposed Amended 2016-18 GF Budget

(GF, \$ in millions)

	<u>FY 2017</u>	<u>FY 2018</u>	<u>2016-18</u>
GF Resources, Ch. 780	\$20,426.4	\$20,229.4	\$40,655.8
Net Resource Adjustments	<u>(242.6)</u>	<u>(61.0)</u>	<u>(303.6)</u>
Available Resources	\$20,183.8	\$20,168.4	\$40,352.2
GF Appropriations, Ch. 789	\$20,349.5	\$20,285.0	\$40,634.6
Net Spending Adjustments	<u>(248.6)</u>	<u>(49.9)</u>	<u>(298.5)</u>
Total Appropriations	\$20,100.9	\$20,235.1	\$40,336.1
Unappropriated Balance	\$82.9	(\$66.8)	\$16.1



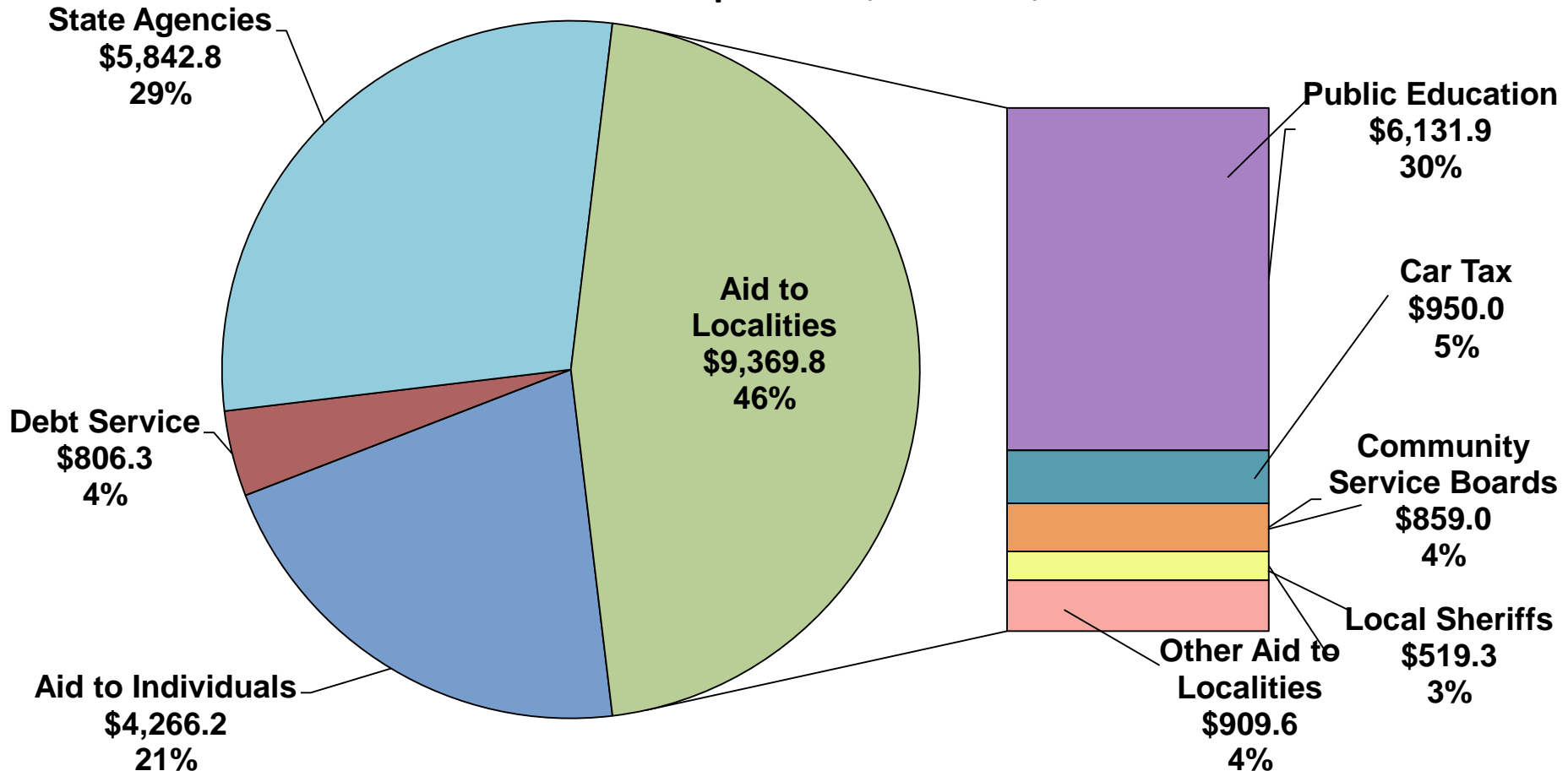
Potential Budget Issues

- Governor's proposed bonus may not satisfy members' stated intention to RESTORE scheduled pay increase.
- GA may wish to restore some of the targeted cuts, such as to the GO Virginia initiative (reduced from \$35.5 million to \$20.6 million).
- Any additional spending or restoration of cuts will require cuts in other areas.
 - Either deeper cuts to across-the-board reductions, or
 - Cuts to areas that have been exempted in the Governor's budget.
- Will need to avoid using “budget gimmicks” that will have to be back-filled this time next year when the biennial budget is developed.
 - Keep resources and expenditures in balance.
 - Big ticket savings items, such as deferring VRS (as in 2010), have become the “third rail” – not likely to see efforts to walk away from reforms, advance repayments, etc.
 - Underfunded program makes it vulnerable to modifications/elimination.



General Fund Budget Drivers

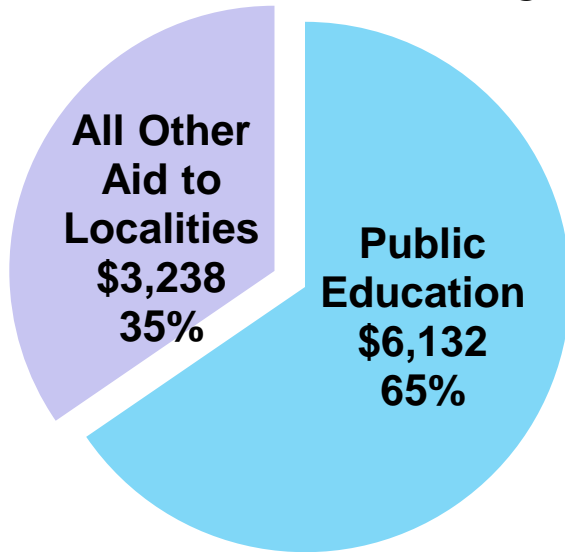
FY 2018 GF Operating Budget = \$20,285.0
Chapter 780 (\$ in millions)



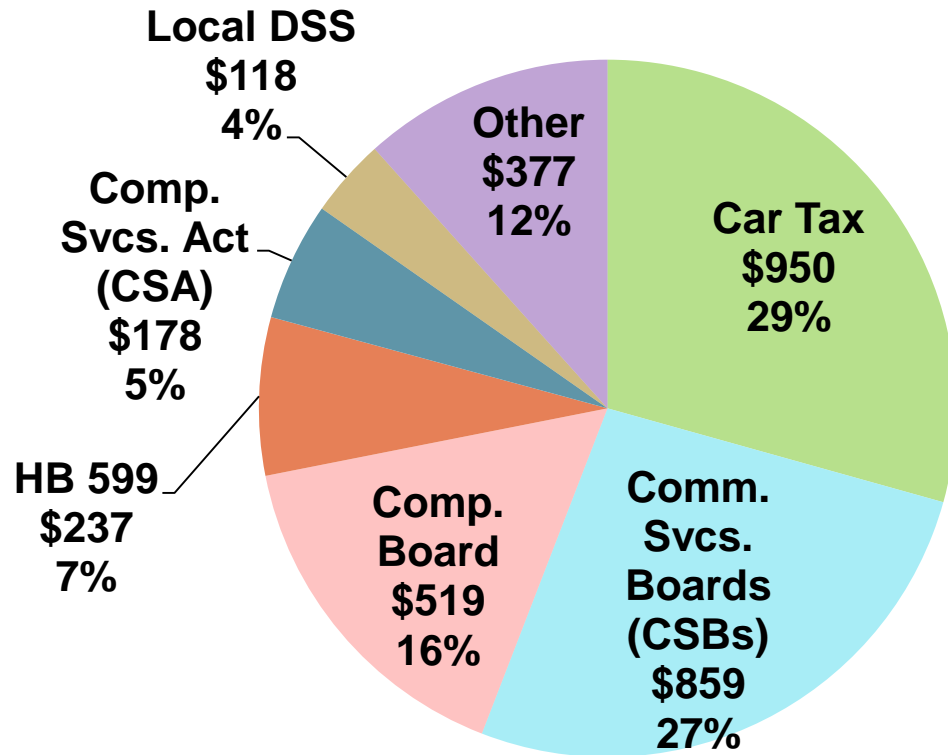
Aid to Localities

FY 2018 = \$9.4 billion

Ch. 780, GF \$ in millions



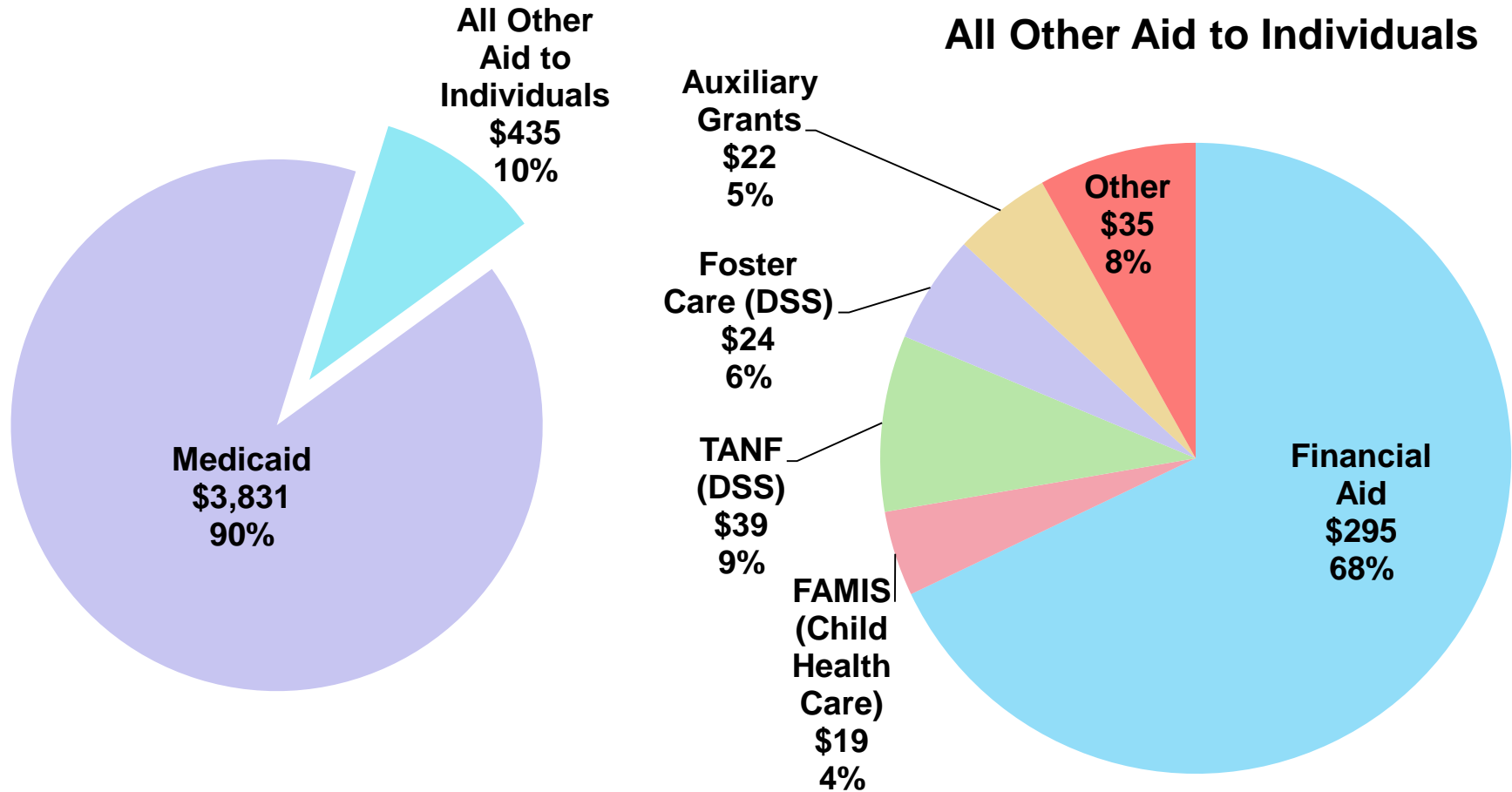
All Other Aid to Localities



Aid to Individuals

FY 2018 = \$4.3 billion

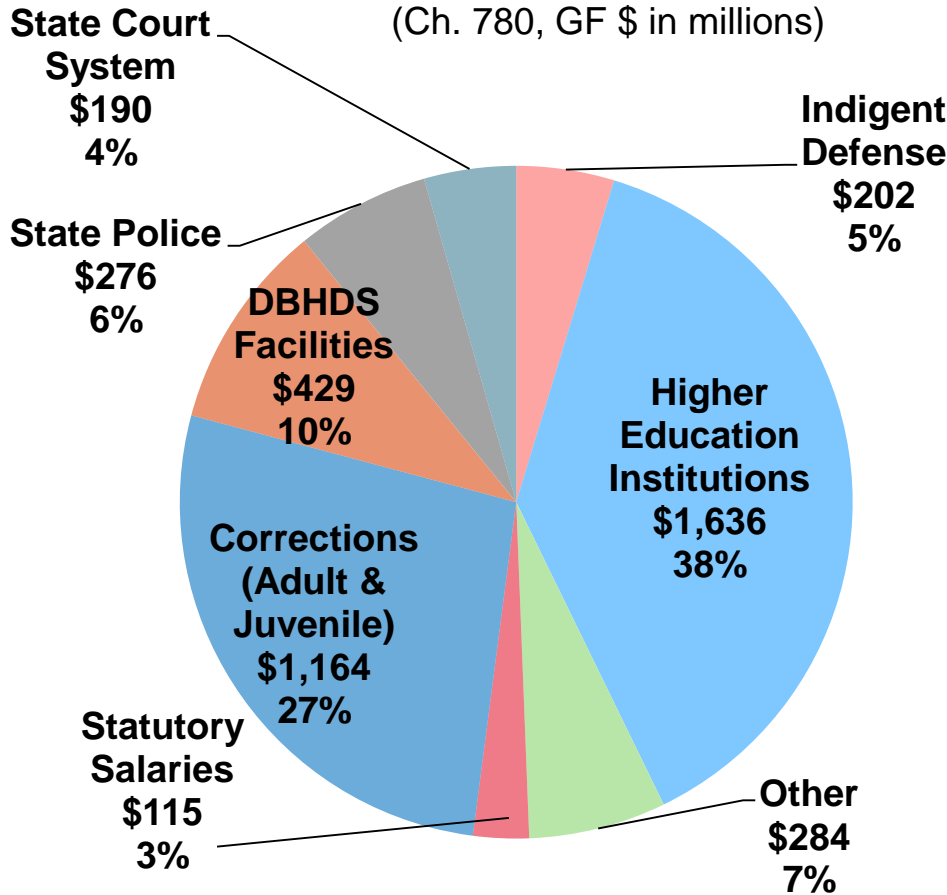
Ch. 780, GF \$ in millions



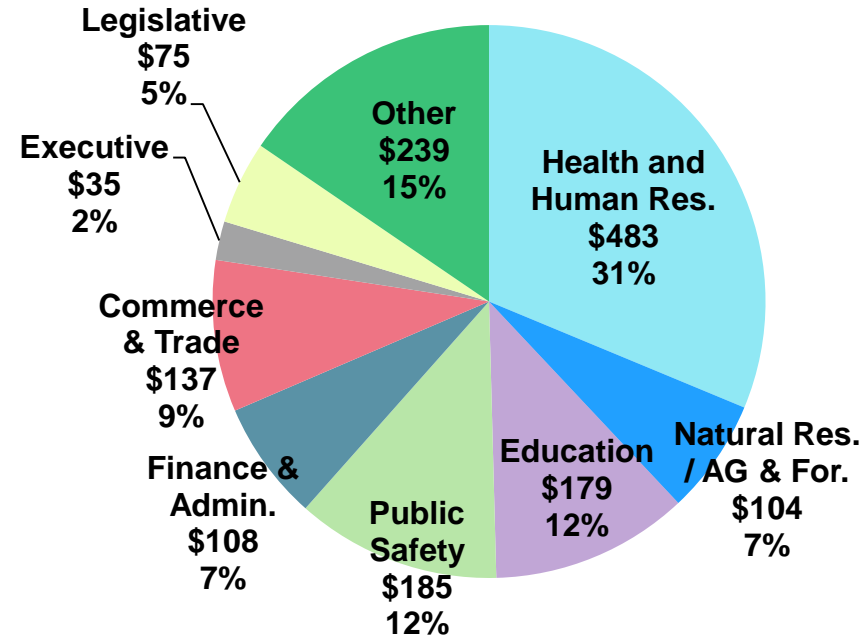
Major Systems & Other State Programs

FY 2018 = \$5.8 billion

Major Programs/Systems = \$4.3 billion
(Ch. 780, GF \$ in millions)



Other State Operations = \$1.5 billion
(Ch. 780, GF \$ in millions)



Potential Issues for 2017 (and beyond)

- Assessing local fiscal stress.
 - What role should the Commonwealth play when a locality exhibits fiscal stress?
 - Intervention limited to “technical assistance”; bankruptcy not an option.
 - No early warning/monitoring systems in place (in contrast to many other states).
 - Interest on the part of Senate and House to address this issue.
- Policy for short-term rentals (AirBNB).
- Tax Reform?
 - May be some interest among members to take a comprehensive look at current tax provisions.
 - Rates, credits, exemptions, what is subject to taxation (e.g. services).
 - Need to look at both state and local taxes.



Potential Issues for 2017 (and beyond)

- Employee Retirement Security and Pension Reform Commission – several recommendations after first year of work.
 - Compensation:
 - GA should prioritize funding for the previously scheduled state employee pay raises, including state-supported local employees and teachers.

Ch. 780

Full year 3% state, faculty; 2% teachers, state supported

State Employees	\$70.5
Faculty	\$27.9
State -Supported Local Employees	\$18.7
Teachers	\$85.5
Total GF Cost	\$202.6

- Modify Hybrid Retirement Plan to Improve Default Retirement Savings Levels.
- GA should consider creating an optional Defined Contribution (DC) retirement plan.

