



2017 Budget Overview: Closing a Budget Gap in a Growing Economy

In what might be seen as the opening campaign for his budget plan, Gov. Terry McAuliffe greeted with handshakes and smiles the members of the House Appropriations, House Finance and Senate Finance Committees.

His task on that chilly December 16 morning was twofold: 1) to show that Virginia's economy is pulling out of the economic development "slow lane" and 2) to persuade the legislators that the "hundreds of hours of meetings with the outstanding staff at Finance and Planning and Budget, with stakeholders and community leaders and with members of the General Assembly" produced the right product to traverse an uncertain fiscal terrain.

To that end, McAuliffe touted the state's low unemployment rate, "the second lowest unemployment rate of any major state in America." He also hyped his administration's efforts to build a new Virginia economy, resulting in the creation of 182,100 net new jobs and a record \$14.22 billion in capital investment. He pledged to the money committees to "continue the substantive work we have undertaken together to build a stronger new Virginia economy." And, he proclaimed as his top goal to provide every Virginia family the opportunity to thrive.

The governor's spending themes are consistent with past priorities, including investments in opportunities to grow a new economy, protecting core services from new cuts, adequately funding core health and human resource services, and supporting important needs in public safety and for veterans.

FY 2016 Tax Collections Go Up But Not Enough To Meet Approved Spending

Virginia's budget stumble in fiscal year 2016 came about even as the state posted its strongest gain in employment growth in eleven years. An official revenue forecast of 3.2 percent growth turned into a disappointing increase of 1.7 percent. Almost the entire shortfall can be attributed to the underperformance of individual income tax withholding and sales tax collections. McAuliffe blamed the slowdown in withholding money from the loss of high-paying jobs in Northern Virginia due to sequestration and the retirements of "Baby Boomers." This combination upset the state's employment mix resulting in an increase in the Virginia economy of lower-paying jobs.

By mid-May the disappointing FY2016 revenue collections had become apparent to the governor and General Assembly. Gov. McAuliffe issued instructions to conduct a reforecast of the FY17 and FY18 revenues. This interim revenue forecast was released in August, reducing revenues by \$1.2 billion for fiscal years 2017 and 2018 from the official forecast adopted just three months earlier. When combined with the fiscal year 2016 revenue shortfall, the budget shortfall totaled \$1.5 billion.



Governor Fills Out A Rainy Day Withdrawal Slip

As the August Interim Revenue Forecast was released, the governor directed state agencies to begin preparing budget reduction plans. By mid-October a strategy to close the budget gap in FY17 had been put together using withdrawals from the Rainy Day Fund (\$392.3 million); cancelling scheduled pay increases for state employees and state-supported local employees (\$125.1 million); grabbing cash balances and unexpended appropriations, substituting non-general fund money for general fund spending, and accelerating sales tax collections (\$249.3); and other spending cuts (\$108.5). All told, the spending cuts, cash swaps and Rainy Day Funds exceeded the anticipated \$861.4 million shortfall in FY 2017.

Governor’s December Budget Plan Adapts to Changing Conditions

As the Joint Advisory Board of Economists (JABE) and the Governor’s Advisory Council on Revenue Estimates (GACRE) crunched numbers and hunches in November, a pleasant surprise was unfolding through the first five months of FY 2017. Total general fund revenue collections were running 5.4 percent ahead of the August interim forecast of 1.7 percent growth.

As a result, the \$1.5 billion shortfall was knocked down by \$233.0 million. Here are the other major “close the gap” strategies in the McAuliffe budget amendments.

Rainy Day Fund: The proposed budget ([HB 1500](#) and [SB 900](#)) calls for withdrawals of \$294.7 million in fiscal year 2017 and \$272.5 million in fiscal year 2018. It is interesting to note that as these withdrawals take place, a mandatory deposit of \$605.6 million will be made in FY 2017. These are monies from FY 2015 collections. After the deposit and two withdrawals are made, the Revenue Stabilization Fund will have an ending balance in FY18 of \$281.7 million.

The projected increase in revenue collections in FY 17 (2.7%) and FY 18 (2.9%) are not enough to cover the state’s expenses. In his address to the three money committees, McAuliffe said he’d recommend certain policy adjustments concerning taxes and fees that will add \$35.7 million in general fund revenues for 2017 and another \$102.9 million in 2018.

The table below details these proposed tax changes. Most of the amendments to effectuate the changes are in the Budget Bill. (See pages 531-532.)

Proposed Tax Revisions	FY17	FY18	Biennium
	(\$s in millions)		
Tax Amnesty	\$ -	\$ 58.2	\$ 58.2



Expand Accelerated Sales Tax collections	\$35.1	\$ 12.8	\$ 47.9
Limit Historic Rehab Tax Credit payouts	\$ -	\$ 9.9	\$ 9.9
Limit Land Preservation Tax Credit (LPTC) payouts	\$ -	\$ 6.1	\$ 6.1
Prevent double dipping of credits and deductions	\$ -	\$ 2.0	\$ 2.0
Increase LPTC transfer fee to 3%	\$ -	\$ 1.0	\$ 1.0
Tighten sales tax nexus	\$ -	\$ 11.1	\$ 11.1
Telework tax credit sunset	\$ -	\$ 0.1	\$ 0.1
License fees for adult services	\$ 0.1	\$ 0.2	\$ 0.3
Dam Safety Fund clawbacks	\$ 0.5	\$ -	\$ 0.5
VOSH Civil Penalties	\$ -	\$ 0.7	\$ 0.7
Notification of payroll system breaches	\$ -	\$ 0.8	\$ 0.8
Totals	\$35.7	\$102.9	\$ 138.6

The most important budget strategy in terms of dollar magnitude are the spending reductions -- \$806.5 million for the biennium.

	FY 2017	FY 2018	Biennium
	(\$s in millions)		
Savings Actions			
October Plan – state agency savings	(\$54.9)	(\$18.1)	(\$72.9)
October Plan – other savings actions	(\$237.6)	(\$290.0)	(\$527.6)
Additional state agency savings	\$0.0	(\$26.4)	(\$26.4)
Higher Education – 5% reductions	\$0.0	(\$76.1)	(\$761)
Targeted reductions	(\$39.5)	(\$63.9)	(\$103.4)
TOTALS	(\$332.0)	(\$474.5)	(\$806.5)

The “other savings” category includes the elimination of the pay increases (\$347.2 million for biennium), additional lottery revenue available for swapping out general fund



dollars (\$52.3 million), K-12 net savings from sales tax collections not meeting official forecasts (\$29.7 million), additional Literary Fund revenue available to offset general fund support for teacher retirement costs (\$50.0 million), and other measures (\$48.4 million).

The additional state agency savings in FY 2018 do not affect direct payments to local governments.

Here are the top ten “targeted savings” that make up more than 90.0 percent of the \$103.4 million biennial reductions.

	FY 2017	FY 2018	Biennium
	(\$s in millions)		
Savings Actions			
Delay opening Culpeper Correctional Center	\$0.0	(\$21.7)	(\$21.7)
Refinance debt service funding	(\$12.8)	(\$1.0)	(\$13.8)
GO Virginia	(\$4.6)	(\$10.4)	(\$15.0)
Support for aerospace engine facility	(\$8.5)	(\$3.7)	(\$12.2)
Support for Virginia Research Investment Fund	(\$4.0)	(\$6.0)	(\$10.0)
Incentive Grants	(\$1.0)	(\$5.9)	(\$6.8)
Jamestown-Yorktown Commemorations	(\$0.2)	(\$5.2)	(\$5.4)
INOVA Global Genomics & Bioinformatics	(\$4.0)	\$0.0	(\$4.0)
K-12 Driver Education (swap with DMV money)	(\$1.5)	(\$1.6)	(\$3.1)
Unobligated Funding at State Training Centers	\$0.0	(\$2.5)	(\$2.5)
TOTALS	(\$36.6)	(\$58.0)	(\$94.6)

In terms of absolute dollars, the largest spending cuts fall in the program areas of Medicaid and K-12 education. In Direct Aid to Public Education, there are cuts of \$34.6 million for the biennium based on revised student enrollment projections, \$13.2 million resulting from an update of sales tax revenues for public education, \$6.3 million to update program participation for Remedial Summer School and ESL, and \$5.1 million to update costs of Lottery programs. For Medicaid, there are proposed cuts of \$44.0 million for the biennium in the Health Care Fund appropriation and \$25.5 million to account for revised Medicare premiums.

Notwithstanding the budget cuts, the budget amendments boost spending by a net increase of \$508.0 million for the biennium. The table below identifies the top ten spending items, which account for 80.0 of the total increased spending.

	FY 2017	FY 2018	Biennium
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	(\$s in millions)		
New Spending Actions			
Medicaid utilization and inflation	\$84.3	\$196.3	\$280.6
Children’s Services Act (caseloads & service cost increases)	\$41.2	\$44.5	\$85.7
Bonus for state employees & state-supported local employees	\$0.0	\$60.0	\$60.0
K-12 Education – bonus for SOQ positions	\$0.0	\$55.5	\$55.5
State inmate medical costs	\$11.4	\$7.2	\$18.6
Community behavioral health service gaps	\$0.0	\$9.4	\$9.4
Compensation Board – salary compression	\$0.0	\$8.7	\$8.7
DSS – computer system costs	\$4.0	\$4.6	\$8.6
Medicaid – overtime pay for up to 56 hours for consumer-directed attendants	\$0.0	\$8.5	\$8.5
Establish Virginia International Trade Corporation	\$0.0	\$7.2	\$7.2
TOTALS	\$140.9	\$401.9	\$542.8

Gov. McAuliffe’s salary actions for state constitutional officers go beyond the \$8.7 million to address salary compression issues for Sheriffs offices and local and regional jails. Under the proposed budget bill, career development funding is restored for all qualified constitutional officers. Also, the \$2.5 million in compensation adjustments for district court clerks and deputy clerks are restored along with \$4.0 million in salary adjustments for the Department of State Police.

The governor is also proposing \$31.7 million to begin the transformation of the state mental health system and to provide ongoing care for individuals who are in need of services.

Politics

As has been the case for most of his administration, Gov. McAuliffe will face a General Assembly that is controlled by the Republicans. HB 1500 and SB 900 are the last budget bills that reflect McAuliffe’s priorities and that he is responsible to shepherd through the General Assembly.

To further complicate the political situation, the voters next year will decide on three statewide elected offices (governor, lieutenant governor and attorney general) as well as all 100 seats in the House of Delegates. Legislative attention on budget matters and other items of local interest will compete with “brochure” issues that will set the stage for next November’s fun and games.

Stay tuned.

Links to budget resources:



- Governor's speech to the money committees:
<https://governor.virginia.gov/newsroom/newsarticle?articleId=18552>
- Secretary of Finance Ric Brown's revenue and budget outlook presentation:
http://www.dpb.virginia.gov/budget/buddoc17/SOF_Presentation12-16-2016.pdf
- Department of Planning and Budget Director Dan Timberlake's presentation on the budget amendments:
<http://www.dpb.virginia.gov/budget/buddoc17/BudgetDirectorsPresentation12-16-2016.pdf>
- 2017 Budget Document:
https://solutions.virginia.gov/pbreports/rdPage.aspx?rdReport=BDOC2017_FrontPage
- Superintendent of Public Instruction describing the changes proposed in the budget amendments:
http://www.doe.virginia.gov/administrators/superintendents_memos/2016/312-16.shtml