

2019 Session Revenue and Budget Outlook

Annual Meeting
November 15, 2018

Topics:



Recap of 2018 Special Session Actions

GF Revenue Outlook

2018-20 Budget Pressures & 2019 Session Outlook

Recap of the 2018 Special Session

2018 Session Recap

- FY 2017 ended with a revenue surplus, setting up a good starting point for the adjustments to FY 2018 and the development of the 2018-20 budget in the 2018 Session.
- Major spending in Chapter 2:
 - \$534 million for increased Medicaid utilization and inflation costs;
 - \$481 million for state's share of re-benchmarking the Standards of Quality for public schools;
 - \$256 million for salary increases for state employees and state-supported local employees;
 - \$91 million additional appropriation to the Revenue Cash Reserve (plus 100% of FY18 surplus); and
 - \$1.0 billion in tax-supported bonds for Capital Outlay projects.
- In June, S&P Global Ratings affirmed Virginia's AAA bond rating and upgraded the Commonwealth's financial outlook to stable.

2018 Session Recap

Medicaid Expansion with a Hospital Provider Assessment

ACA Expansion: (GF \$ in millions)	FY 2019	FY 2020
Estimated Medicaid Expansion Costs (paid by the provider assessment)	\$80.8	\$226.1
Estimated Savings of ACA Expansion (estimated GF savings)	(\$101.3)	(\$269.7)

Hospital Provider Assessments: (NGF \$ in millions)	FY 2019	FY 2020
Coverage Assessment (assessment % x net patient service revenue)	~0.5%	~1.4 %
Rate Enhancement for Private Acute Care Hospitals	~1.2%	~1.9%
Total Projected Assessment \$	\$295.3	\$575.4

Source: Chapter 2 amounts.

- **Coverage:** All adults up to 138% of the federal poverty level.
- **Delivery System:** Enrollment in private Medicaid managed care plans or employer sponsored plans.
- **Benefits Package:** ACA essential benefits and current Medicaid mental health and addiction recovery/treatment services.
- **Premiums:** Adults with incomes between 100-138% of poverty pay monthly premiums.
- **Coverage Effective Date:** Effective first month following receipt of premiums payment.
- **Co-Payments:** Existing cost-sharing arrangements for those up to 100% of poverty; co-payments for those between 100-138% of poverty.
- **Health & Wellness Accounts:** Premiums deposited into these accounts to fund premiums and out-of-pocket expenses.
- **Training, Education, & Employment Requirement:** Able-bodied adults must participate to receive coverage. There are exceptions, and participation escalates from 20-80 hours per month after an initial grace-period. Waiver of the requirement in areas of high unemployment.

FY 2018 Ended with \$555.5 Million Above the Forecast

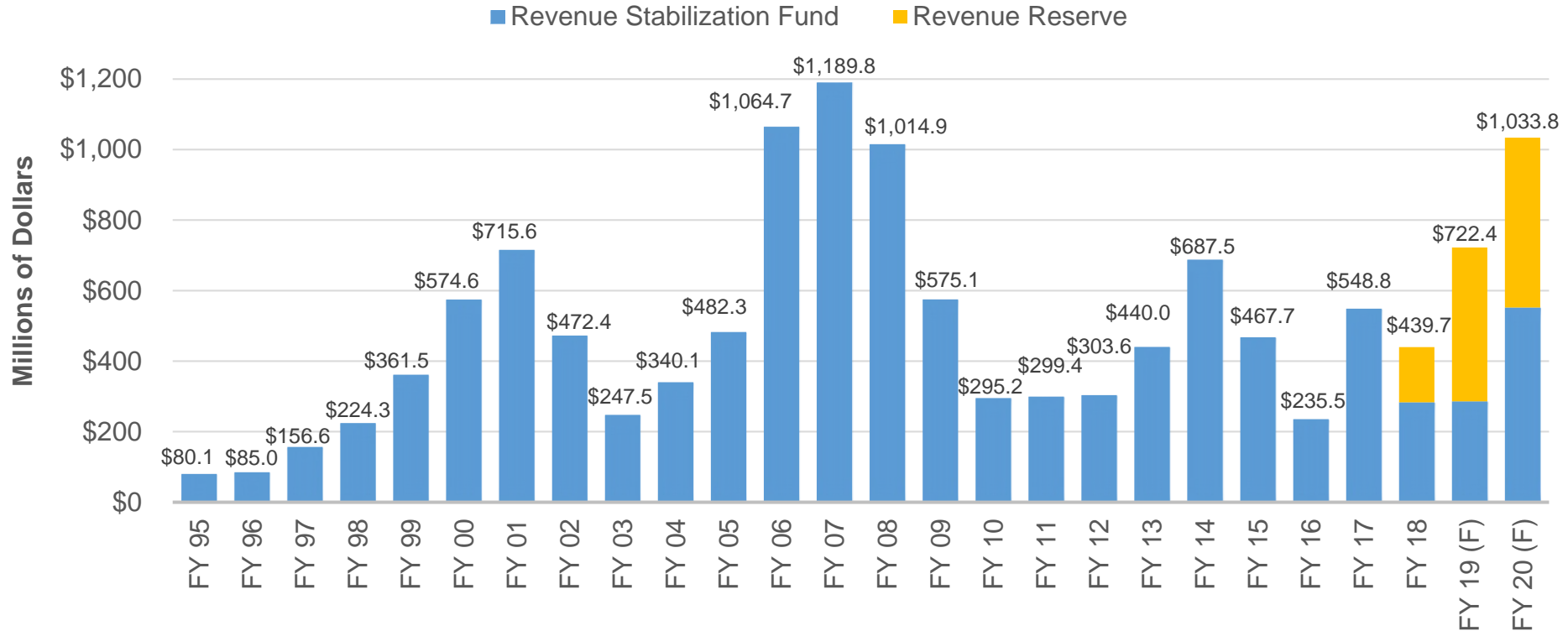
- General Fund resources grew 6.0 percent, 2.8 percent above forecast, due to payroll withholding and non-withholding collections and sales tax.
- Language directed 100 percent of FY 2018 surplus revenues, less any necessary, statutory deposits to the Revenue Stabilization Fund and the Water Quality Improvement Fund, to the Revenue Cash Reserve.
 - Water Quality Improvement Fund Part A and Part B = **\$73.8 million**
 - Revenue Stabilization Fund Deposit in FY 2020 = **\$262.9 million**
 - Revenue Cash Reserve in FY 2019 = **\$234.4 million**

Combined Reserves are Expected to Exceed \$1.0 Billion by the End of FY 2020

- The Administration and General Assembly prioritized preserving Virginia's AAA debt rating by increasing reserves in order to provide for greater liquidity and resiliency.
 - A portion of the surplus was due to one-time non-withholding income tax revenues.
 - 2018-20 budget already assumes \$60 million per year additional withholding revenue, limiting upward revenue adjustments.
 - Virginia is currently benefitting from an improving economy and increased federal spending, particularly in the area of defense.

Combined Reserves are Expected to Exceed \$1.0 Billion by the End of FY 2020

Total Reserve Fund Balances



GF Revenue Outlook

SFC Staff General Fund Revenue Outlook

Two Considerations:



Revenue growth driven by economic conditions



Impact of the federal Tax Cuts and Jobs Act

SFC Staff General Fund Revenue Outlook

Economic Conditions

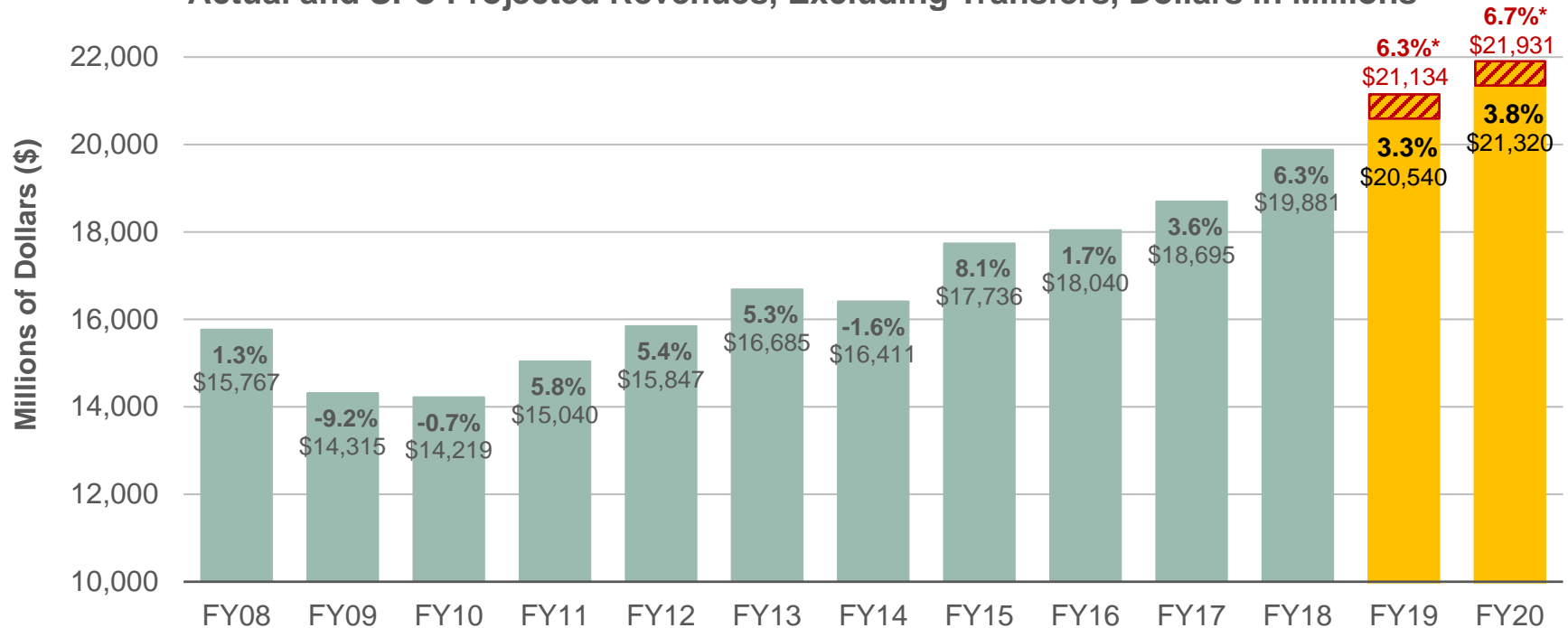
- Better than expected revenue growth in FY 2018; first four months of FY 2019 above forecast.
- Consensus among members of Joint Advisory Board of Economists that economic conditions continue to look positive over the 2018-20 biennium. However, a slowdown is possible after FY 2020.
- Strong labor market, higher wages driving growth in income tax collections.
- Improved growth in sales tax collections; partly attributable to e-commerce (expanded nexus laws and voluntary participation by online retailers).
- More weakness in recordation tax revenues as interest rates climb.
- Based on economics and actual YTD collections, staff expect overall GF revenue growth of 3.3 percent (with the nonwithholding “collar”) in the current fiscal year, slightly better growth in FY 2020.

Tax Cuts and Jobs Act

- Federal tax reform adds approximately 3.0 percent to annual revenue growth.
- However, most individual provisions are temporary and will expire after taxable year 2025.

Moderate Revenue Growth Projected – Enhanced By Expected TCJA Impacts

Actual and SFC Projected Revenues, Excluding Transfers, Dollars in Millions

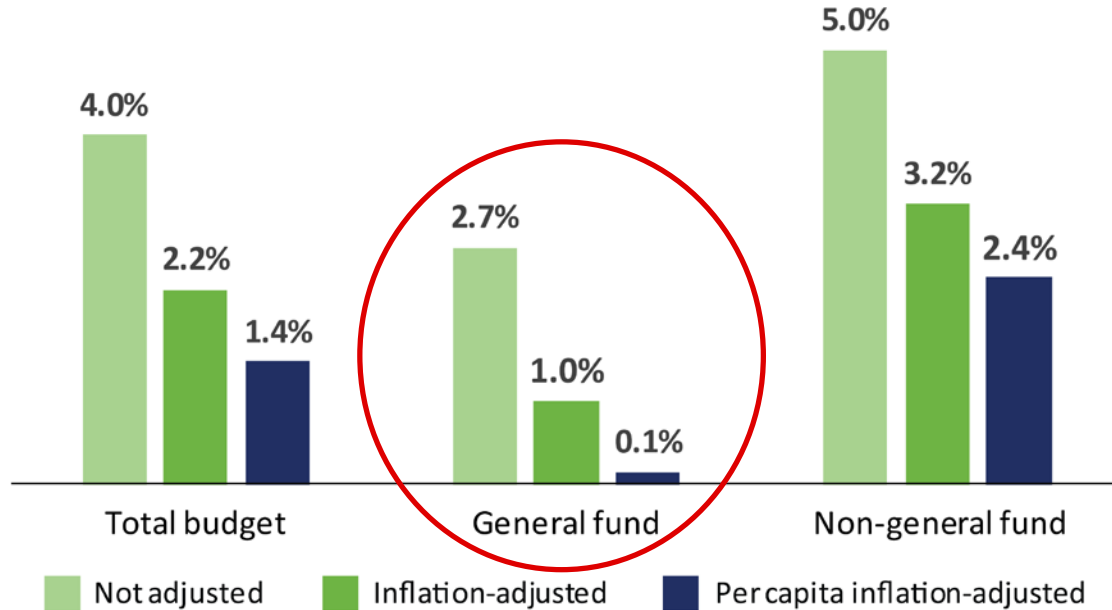


* Includes impact of the Tax Cuts and Jobs Act (TCJA). Excluding TCJA, staff project growth of 3.3% in FY19 and 3.8% in FY20.

After a Decade of Modest GF Growth

GF Average Annual Growth of 2.7%; Flat When Adjusted for Inflation and Population Growth

Change in appropriations adjusted for inflation and population growth, FY09-FY18



AVERAGE ANNUAL CHANGE

Source: JLARC, 2018 State Spending Report.

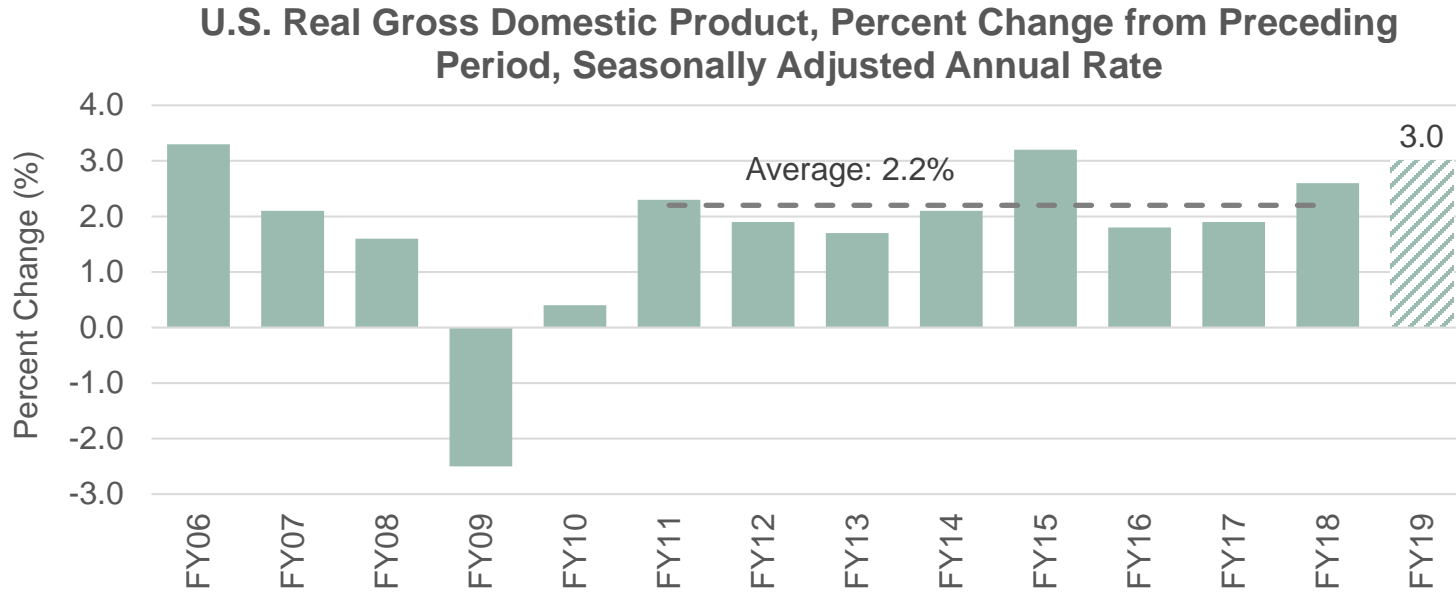
FY 2019 To-Date: Revenues Above Forecast

Major Sources	Jul - Oct FY 2019	Jul - Oct FY 2018	Change (%)	
			Actual	Req by Est
Withholding	\$4,036.8	\$3,877.3	4.1	2.6
Nonwithholding	663.2	574.2	15.5	(3.0)
Refunds	(221.3)	(207.6)	6.6	7.7
Net Individual	<u>\$4,479.7</u>	<u>\$4,243.9</u>	<u>5.5</u>	<u>0.6</u>
Sales	\$1,007.4	\$962.5	4.7	2.5
Corporate	239.6	269.0	(10.9)	5.8
Recordation	130.7	141.1	(7.4)	3.1
Insurance	-	-	-	11.4
All Other	<u>174.5</u>	<u>153.7</u>	<u>13.5</u>	<u>3.9</u>
Total GF Revenue	\$6,031.9	\$5,770.2	4.5	1.5

- FYTD total revenue collections increased 4.5 percent versus 1.5 percent required by the official forecast assumed in Chapter 2.
- Gains in individual withholding, estimated payments and sales taxes drove the increase. Withholding was impacted by the timing of collections around the July 4th holiday.

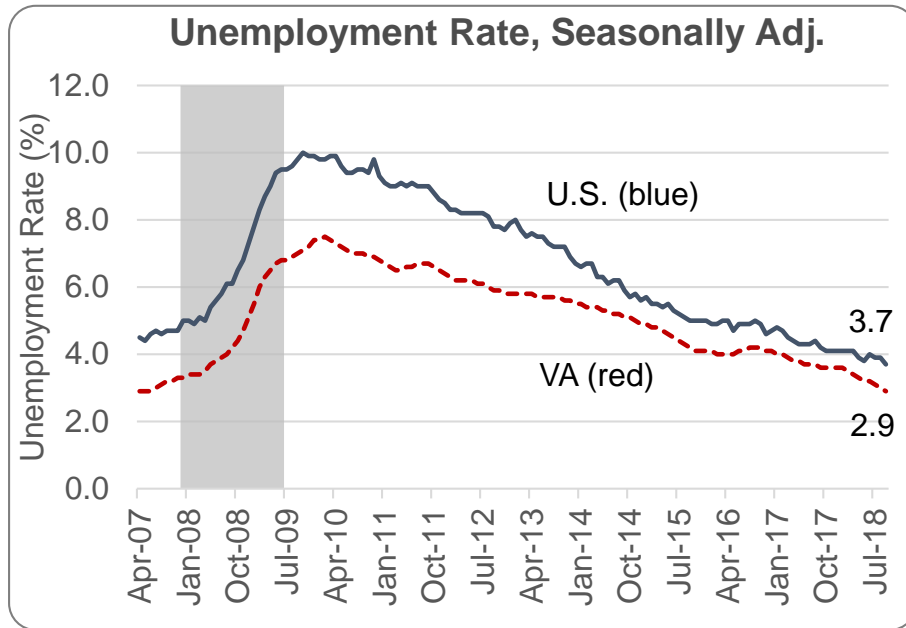
Economic Growth Accelerating in the Near Term

- Growth in U.S. GDP is expected to accelerate to 3.0 percent in FY 2019; will slow in FY 2020 and FY 2021 but remain above recent trend for the current biennium.



Source: Virginia Department of Taxation.

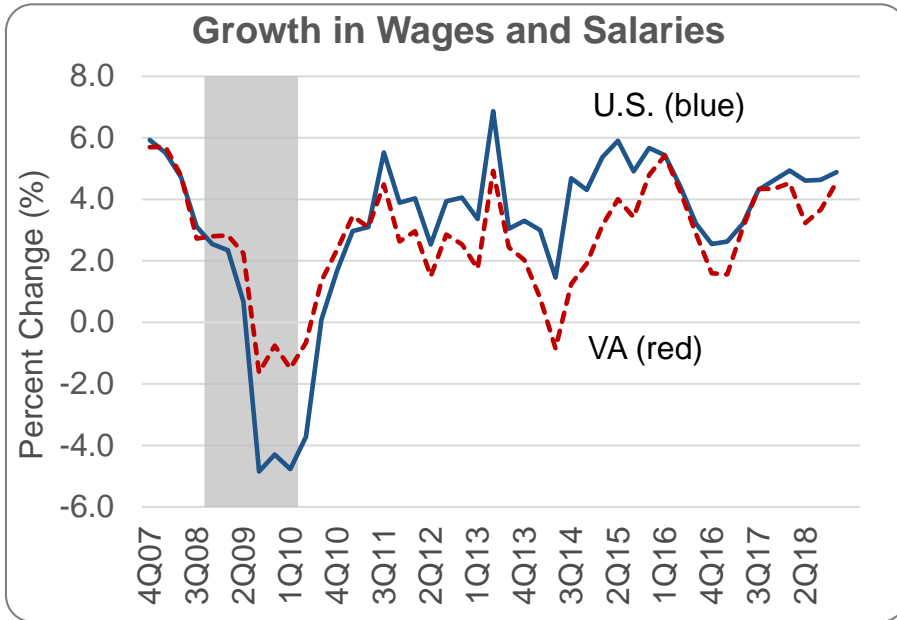
Unemployment Near Historic Lows



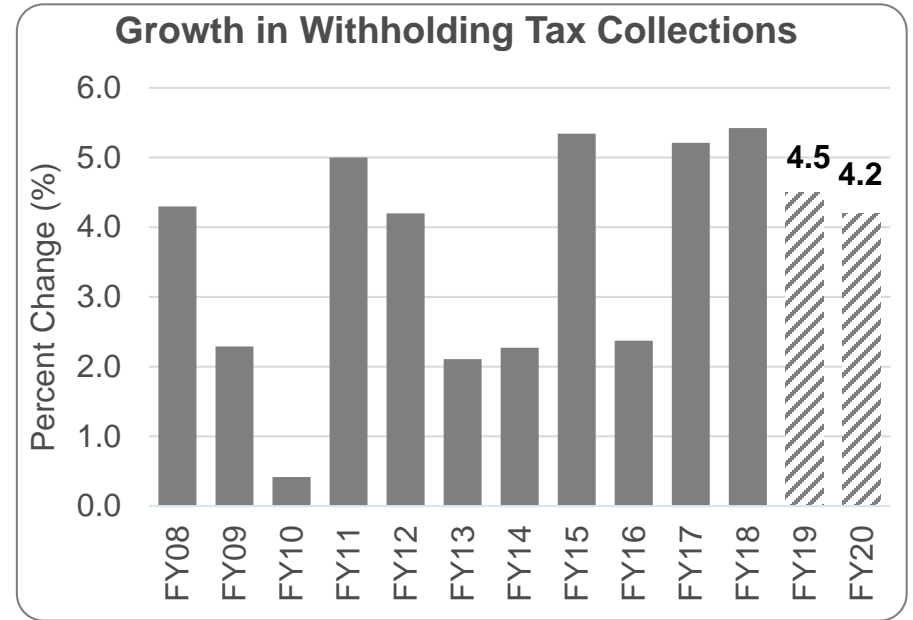
Source: U.S. Bureau of Labor Statistics.

- Lowest U.S. unemployment rate since 1969.
- Virginia unemployment rate equal to pre-recession trough.
- Labor market conditions are strong; near-term outlook is positive.
- Adding jobs steadily; U.S. averaging 200,000+ new payrolls each month; Virginia adding 4,000+ each month.

Wage Growth Drives Higher Withholding Tax Collections



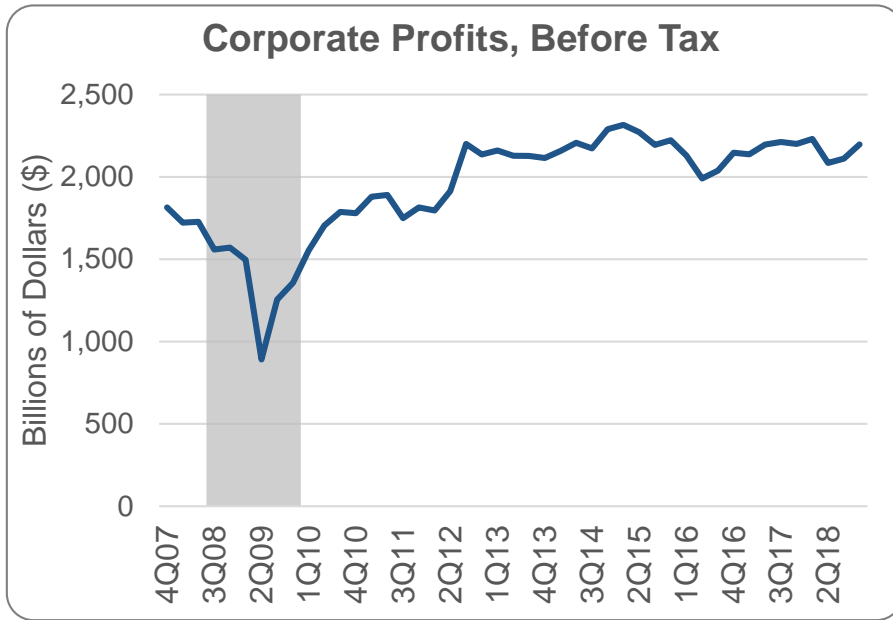
Source: Federal Reserve Bank of St. Louis and U.S. Bureau of Economic Analysis.



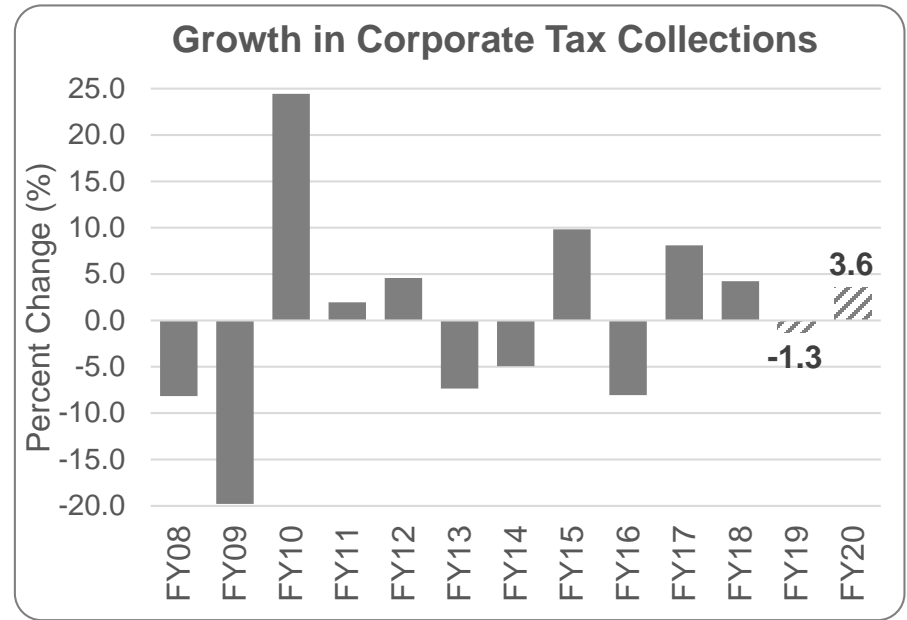
Source: VA Department of Taxation; SFC Staff estimates.

- Continued growth in wages and salaries will drive withholding tax collections.
- Timing of payments related to July 4th holiday inflated FY 2018 collections.

Modest Rebound in Corporate Income Tax Revenues Expected



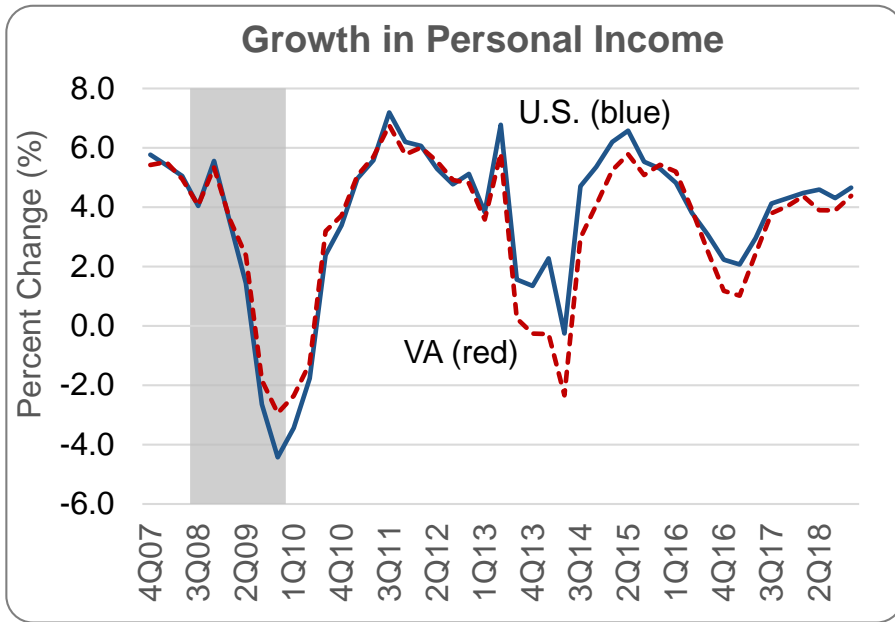
Source: U.S. Bureau of Economic Analysis.



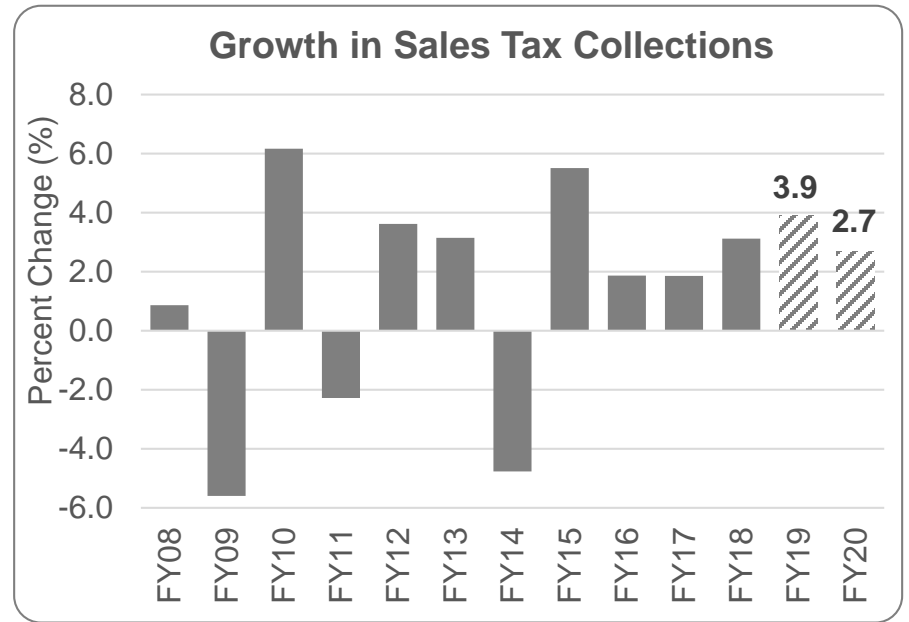
Source: VA Department of Taxation; SFC Staff estimates.

- Despite YTD decline in collections, positive outlook for corporate profits should drive rebound in corporate income tax revenue in FY 2020.

Rising Incomes Boost Sales Tax Revenues



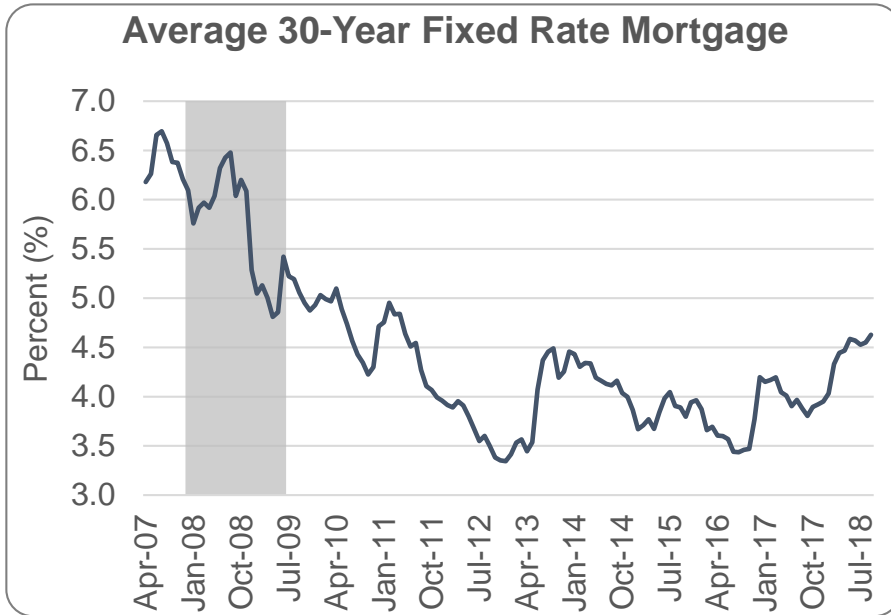
Source: U.S. Bureau of Economic Analysis.



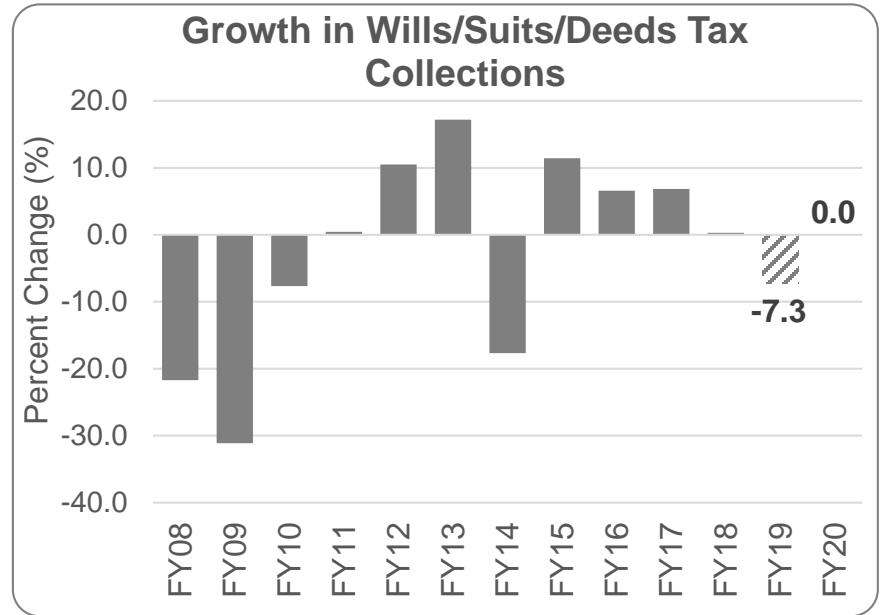
Source: VA Department of Taxation; SFC Staff estimates.

- Improved sales tax growth in current fiscal year is partly attributable to additional online sales tax collections (up 28% YTD); expecting moderate growth in FY 2020.

Recordation Tax Revenues Are Declining



Source: U.S. Bureau of Economic Analysis.



Source: VA Department of Taxation; SFC Staff estimates.

- Rising interest rates and softening housing market means continued weakness in recordation tax revenues.

Impact of the Tax Cuts and Jobs Act

The TCJA adds \$1.2 billion in additional revenue in FY19-20.

(\$ in millions)	FY 2019	FY 2020	Biennium
Individual Impact of the Individual Provisions	\$532.1	\$443.8	\$976.0
Individual Impact of the Business Provisions	(127.3)	(35.0)	(162.3)
Individual Impact of the International Provisions	<u>25.5</u>	<u>47.3</u>	<u>72.8</u>
Total Individual Income	\$430.3	\$456.2	\$886.5
Corporate Impact of the Business Provisions	156.8	149.5	306.3
Corporate Impact of the International Provisions	<u>7.1</u>	<u>5.4</u>	<u>12.5</u>
Total Corporate Income	<u>\$163.9</u>	<u>\$154.9</u>	<u>\$318.8</u>
Total, All Provisions	\$594.2	\$611.1	\$1,205.3

Source: VA Department of Taxation.

- Federal tax reform adds \$1.2 billion in additional expected GF revenues over the current biennium; about three-quarters of the revenue will be in individual income tax collections.
 - Adds 2.9 to 3.0 percentage points to GF revenue growth in FY 2019 and FY 2020.

Impact of the Tax Cuts and Jobs Act

The TCJA may trigger deposits to the Rainy Day Fund.

- Additional revenue growth resulting from the Tax Cuts and Jobs Act will likely trigger additional mandatory deposits to the Rainy Day Fund in the 2020-2022 biennium.
- Constitutionally mandated deposits to the Rainy Day Fund are required when the growth rate of individual, corporate income, and sales tax collections exceeds the prior six-year average growth rate.
- Staff estimates of the required deposits are:
 - Approximately \$240 million in FY 2021, and
 - Approximately \$275 million in FY 2022.

SFC Staff General Fund Revenue Forecast

(\$ in millions)	SFC Staff Estimate		Impact of TCJA		Combined Estimate	
	FY 2019	FY 2020	FY 2019	FY 2020	FY 2019	FY 2020
Growth by Revenue Source						
Individual Income	3.5%	4.3%	3.1%	3.0%	6.6%	7.3%
Sales & Use	3.9%	2.7%	-	-	3.9%	2.7%
Corporate	-1.3%	3.6%	19.0%	14.6%	17.7%	18.4%
All Other Revenue Sources	<u>2.7%</u>	<u>1.9%</u>	___-	___-	<u>2.7%</u>	<u>1.9%</u>
Total GF Revenue Growth	3.3%	3.8%	3.0%	2.9%	6.3%	6.7%
General Fund Revenues	\$20,540.1	\$21,320.1	\$594.2	\$611.1	\$21,134.3	\$21,931.2
Transfer Estimate	<u>629.5</u>	<u>640.0</u>	___-	___-	<u>629.5</u>	<u>640.0</u>
Total GF Resources	\$21,169.6	\$21,960.1	\$594.2	\$611.1	\$21,768.8	\$22,571.2
GF Resources Above Official Forecast	\$374.9	\$352.9	\$594.2	\$611.1	\$969.1	\$964.0

Next Steps

2018 Revenue Forecasting Schedule

- **October 11.** Joint Advisory Board of Economists (JABE) reviews outlook for the current and next biennium (FY19 – FY22).
- **November 19.** Governor's Advisory Council on Revenue Estimates (GACRE) reviews economic and revenue outlook for current and next biennium (FY19 – FY22).
- **November 21.** General Fund Agencies' Final Adjustments to Revenues and Transfers are due to the Department of Taxation.
- **December 18.** Governor releases revised forecast and budget actions for 2018 – 2020 biennium, along with a long-term revenue forecast to FY26.

2018-20 Budget Pressures & 2019 Session Outlook

2019 Session: *Amending the Adopted Budget*

- In odd-numbered sessions, action is taken to amend the previously adopted biennial budget for the current and next fiscal years.
 - Current budget (Chapter 2, 2018 Special Session I) covers July 1, 2018 through June 30, 2020 (i.e. FY 2019 and FY 2020).
 - *FY 2020 will be the base year for developing the 2020-22 biennial budget.*

Agency Requests Total \$1.2 billion; Some Items Already Well-Funded

Secretarial Area (\$ in millions)	FY19	FY20
Administration	\$ 4.0	\$ 31.7
Agriculture & Forestry	-	2.6
Commerce & Trade	10.4	128.2
Public Education	-	128.9
Higher Education	10.8	175.3
Other Education	0.5	3.4
Finance	-	1.9
Health & Human Resources	133.8	164.3
Judicial	0.4	6.7
Natural Resources	0.7	94.5
Public Safety & Homeland Security	28.6	236.9
Veterans & Defense Affairs	-	3.5
Grand Total	\$ 189.3	\$ 977.9

- Agency requests total more than \$1.2 billion for the biennium.
- Chapter 2 contains a number of items that are already well-funded.
 - Budgeted salary increases.
 - Higher education operating and financial aid funding.
 - STEP-VA at the CSBs.
 - K-12 Rebenchmarking.

2019 Possible Funding Commitments/Risks

Commitment/Need	Cost (GF \$ in millions)
Medicaid Forecast	\$462.5
Medicaid Administrative Disallowances	40.0
Children's Health Insurance Forecast (FAMIS/CHIP)	18.0
Piedmont/Catawba Operations	13.0
Major Employment and Investment Project Obligations	50.0
Inmate Healthcare (increases in offender medical costs and Fluvanna)	36.5
Census and Staffing at State Mental Health Hospitals	21.7
Hurricane Florence (amount that will not be reimbursed)	10.8
Forensic Science Caseload (fill budget hole created by transfer from FY 2020 to FY 2019)	3.3
State Police Communications – STARS (operating, \$132.4 M bond request)	TBD
Other Items	TBD
TOTAL (FY 2019 & FY 2020)	\$655.9

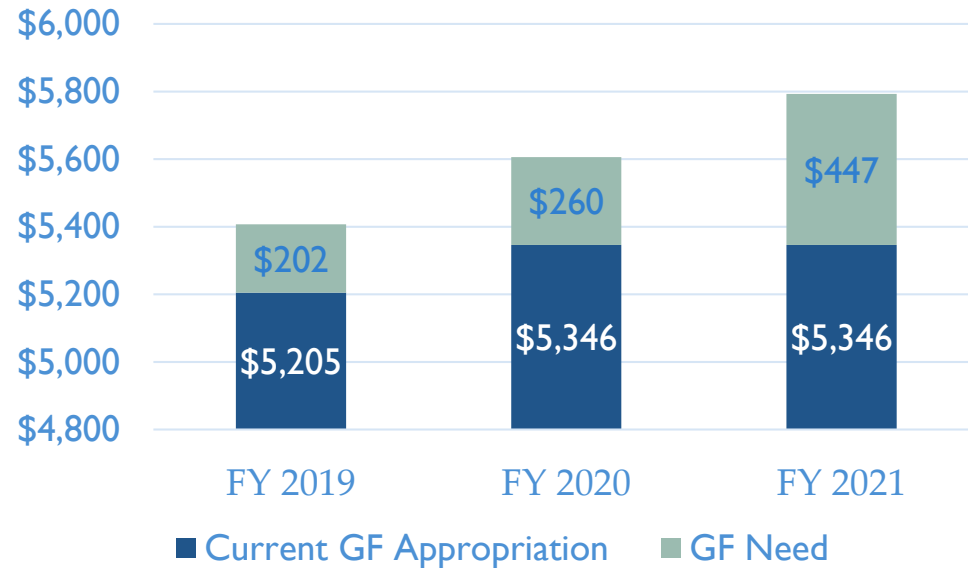
2019 Possible Funding Commitments/Risks

Commitment/Possible Need	Cost (GF \$ in millions)
Other Commitment Needs Total	\$655.9
SAVINGS/OFFSETS:	
Health Care Fund Revenue Offset	(16.7)
FY 18 ADM actuals lower than projected	(9.1)
Lottery Forecast	(7.5)
TOTAL (with savings incorporated)	\$622.6
Rainy Day Fund/Revenue Reserves (for the next biennium)	TBD
Human Resource System Replacement	TBD
Broadband (agency request \$25 million; other requests may be larger)	TBD
Deferred Maintenance	TBD
Previously Planned Capital Outlay Projects	TBD
VITA/Northrop Grumman Settlement/Transition (\$100M+)	TBD
TOTAL (FY 2019 & FY 2020)	\$+

Medicaid Forecast

- The latest forecast for the 2018-20 Biennium is an additional GF need of **\$462.5 million**.
- Last year's forecast required **\$576 million GF** for the 2018-20 biennium.
- Official forecast anticipates GF spending increases:
 - **6.2% in FY 2019**
 - **2.6% in FY 2020**
 - **3.5% in FY 2021**

November 2018 Medicaid Forecast (\$ in millions)



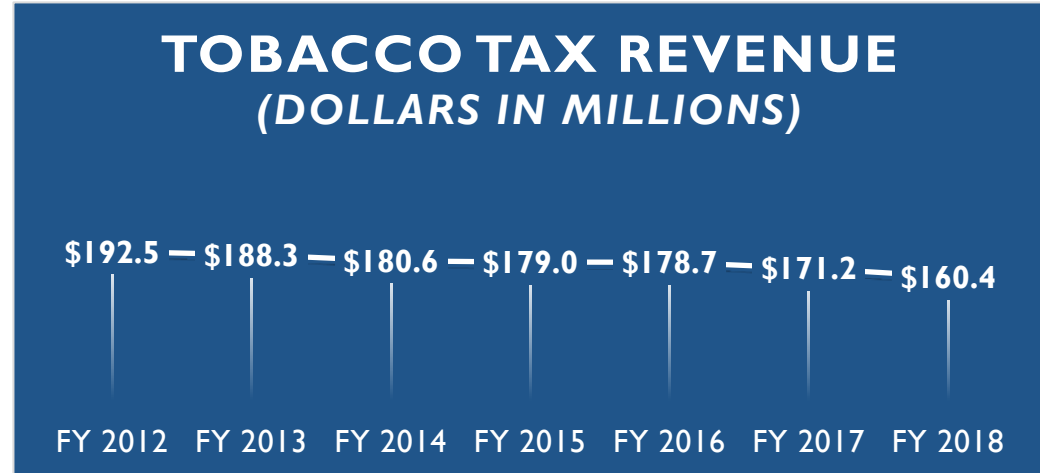
Medicaid Forecast Drivers

- Enrollment Growth was 2.5% in FY 2018 and is expected to slow for the base population.
 - The trend in enrollment of children is higher than last year's forecast.
- Managed Care rate increases:
 - Medallion 4.0 (traditional managed care program) - Last year's assumed rate increase of 3.8% for FY 2020 increased to 4.1%.
 - Commonwealth Coordinated Care Plus (new managed care program) - Last year's assumed rate increase of 2.4% for 2019 increased to 5.4% and for 2020 increased from 3.5% to 4.8%.
- Hospital Fee-For-Service claims are higher than previously projected.
 - The number of individuals that transitioned to the new CCC Plus managed care program was lower than projected resulting in an increase in hospital costs in fee-for-service.
- Federal repayment of Medicaid funding for Piedmont Geriatric and Catawba Hospitals:
 - Federal government has requested repayment due to their determination the two hospitals did not meet all the requirements for Medicaid reimbursement.

Health Care Fund Balances are Limited

- Used as state match for Medicaid program.
- Revenue sources include:
 - **Tobacco taxes**
 - **41.5% of Master Settlement Agreement with Tobacco Manufacturers**
 - **Medicaid Recoveries / Pharmacy Rebates**
 - **Smoking Civil Penalties**
- Tobacco taxes continue to be a declining revenue source.
- FY 2018 year-end cash balance will offset the decline.

Revenue Changes	FY 2019	FY 2020
Prior Year Cash Balance	\$47.7 million	\$0
Tobacco Taxes	-\$12.9 million	-\$18.1 million
Net Impact	\$34.8 million	-\$18.1 million



Additional Possible Funding Commitments

- Other traditional budget drivers or funding items are being evaluated over the next several months:
 - Rainy Day Fund Deposits likely required in the next biennium.
 - Amazon HQ2 may require higher education GF support in this biennium; and may wish to consider pre-funding related to economic development post-performance incentives.
 - Medicaid: additional adjustments and provider rates.
 - Other HHR issues: mental health, reinsurance program, etc.
 - K-12: pre-K, safety initiatives, grants, and other support.
 - Higher education/workforce: New Economy Workforce Credential Grant, internships, adult completion, financial aid, operations, and Tuition Assistance Grant (TAG) awards.
 - Public safety: conversion of inmate beds, probation recovery support, and staffing issues.

Budget Outlook 2019 Session

- Available resources from the economic forecast (excluding TCJA) are sufficient to cover major budget pressures. However, there are many other items that would typically be considered.

2018-20 Budget Outlook

(\$ in millions)	FY 2019	FY 2020	2018-20
Ch. 2 GF Resources	\$21,028.8	\$21,606.7	\$42,635.5
FY18 Surplus (less commitments)	3.0	-	3.0
SFC Revenue Estimate	<u>374.9</u>	<u>352.9</u>	<u>727.8</u>
Total Additional Resources*	\$377.9	\$352.9	\$730.8
Major Budget Pressures	(\$229.3)	(\$393.3)	(\$622.6)
Net Available Resources	\$148.6	(\$40.4)	\$108.2

* Excludes the potential impact of the federal Tax Cuts and Jobs Act.

Debt and Capital Outlay

- Outstanding Tax-Supported Debt of the Commonwealth.
 - Tax-Supported 9(b), 9(c), and 9(d) Debt - \$11.1 billion.
 - 12% (\$1.3 billion) is General Obligation debt.
 - 88% (\$9.8 billion) is appropriation-backed 9(d).
 - Moral Obligation Debt - \$927.8 million.
- Many requests are anticipated for new projects during the 2019 Session.
 - Multiple projects that cost more than \$100 million.
 - The bond package in 2016 had 21 detailed planning projects with estimated total costs of approximately \$925 million from all sources (2 projects have already been funded for construction).
 - An additional seven detailed projects have been approved during the 2017 and 2018 Sessions with costs totaling more than \$560 million (one project has been funded for construction).

Outlook & Challenges - 2019 Session

- Additional revenue of approximately \$728 million will be available (with further possible revenue of \$1.2 billion from TCJA) above what is assumed in Chapter 2.
- There are some already known expensive funding commitments and/or risks (Medicaid forecast, other HHR pressures, MEI, etc).
- Budget needs, commitments, and other high-priority funding items are significant.
- As usual, structural balance in the second year will be important to setting the stage for the 2020-22 biennium.
- May want to consider setting aside funding for reserves.

Outlook & Challenges - 2019 Session

- With “windfall” revenues from the federal tax changes, resources may be available to cover some unanticipated expenses. With tax changes for individuals expiring in 2025, this “windfall” is mostly temporary.
- An initial decision point will be whether to adopt tax “conformity” with federal definitions.
- Assessing and responding to Virginia revenue impacts of federal tax reform (Tax Cuts and Jobs Act of 2017) and the Supreme Court’s *South Dakota v. Wayfair* decision (internet sales) will likely dominate.

Appendix

FY 2018 Recap: GF Collections Exceed Forecast By \$555.5 Million

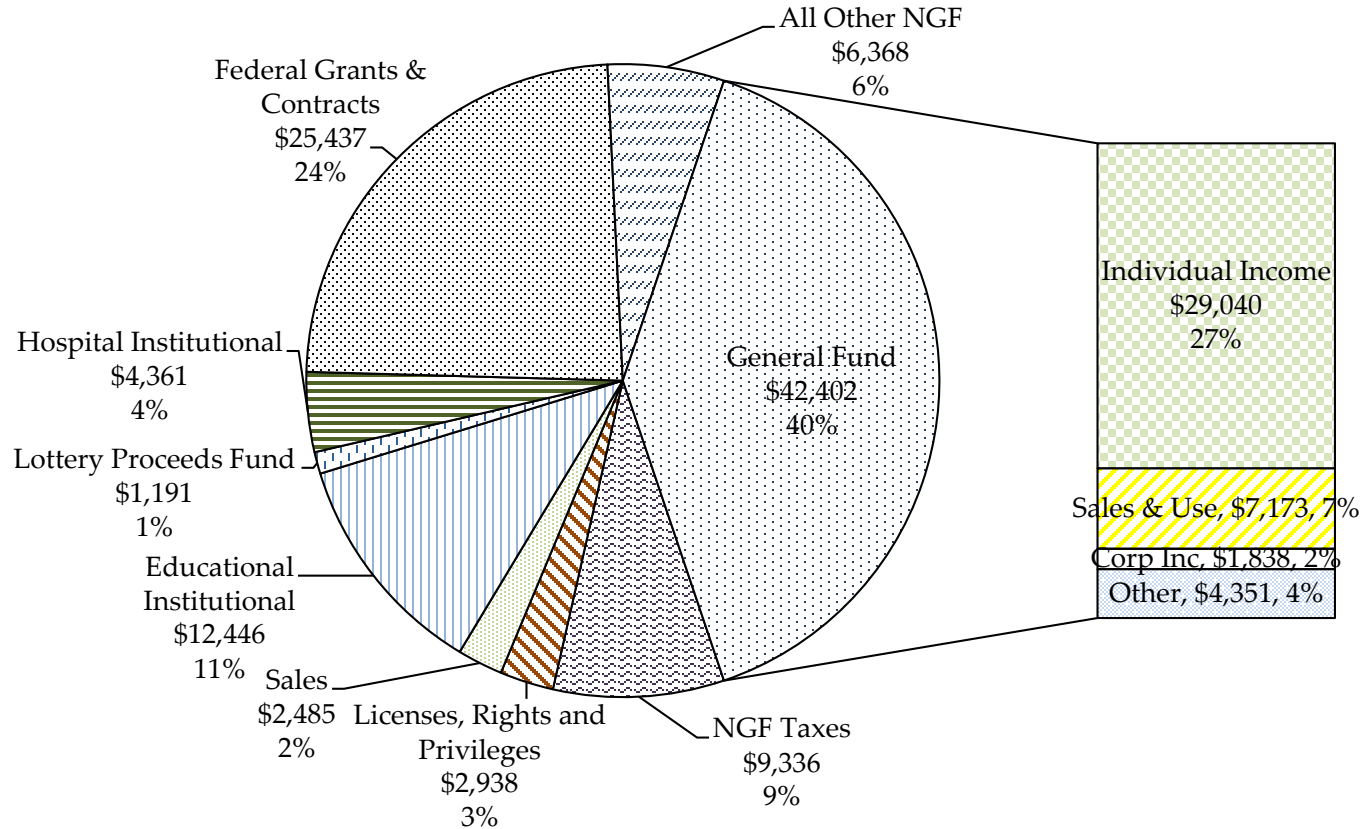
Major Sources	Actual	Forecast	Variance	Change (%)	
				Actual	Forecast
Withholding	\$12,540.5	\$12,313.3	\$227.2	5.4	3.5
Nonwithholding	3,472.9	3,147.3	325.6	15.1	4.3
Refunds	<u>(1,907.6)</u>	<u>(1,968.7)</u>	<u>61.1</u>	<u>2.5</u>	<u>5.8</u>
Net Individual	<u>\$14,105.8</u>	<u>\$13,491.9</u>	<u>\$613.9</u>	<u>8.1</u>	<u>3.4</u>
Sales	\$3,461.8	\$3,458.2	3.6	3.1	3.0
Corporate	861.9	874.0	(12.1)	5.7	4.2
Recordation	394.9	407.2	(12.3)	0.1	3.3
Insurance	337.9	362.1	(24.2)	(0.9)	6.2
All Other	<u>718.5</u>	<u>734.8</u>	<u>(16.3)</u>	<u>(0.6)</u>	<u>1.6</u>
Total GF Revenue	\$19,880.8	\$19,628.2	\$552.6	6.3	3.4
Transfers	<u>\$628.3</u>	<u>\$625.3</u>	<u>3.0</u>	<u>(3.8)</u>	<u>(4.3)</u>
TOTAL GENERAL FUND	\$20,509.0	\$19,953.5	\$555.5	6.0	3.1

- All FY 2018 surplus GF revenues are committed to the Water Quality Fund, Revenue Stabilization Fund, or the Revenue Cash Reserve.)

FY 2018-20 Total Revenues = \$107.0 billion

Chapter 2 (HB 5002, as Adopted)

(\$ in millions)



FY 2018-20 GF Operating Budget = \$42.6 Billion

Chapter 2, (HB 5002, as Adopted)

(\$ in millions)

