

2010-12 Budget Outlook

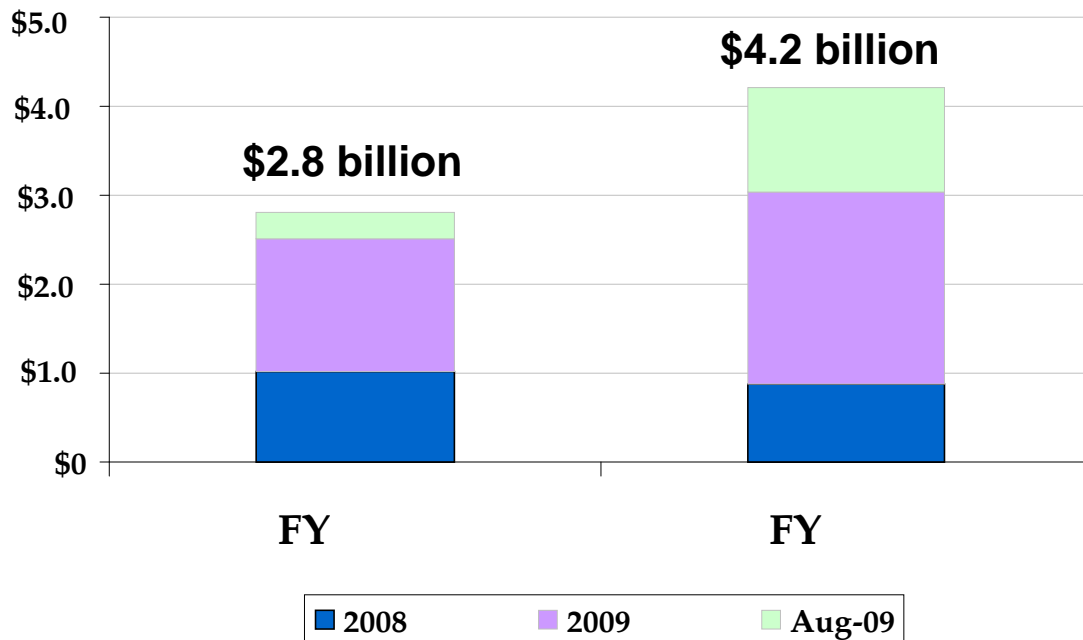
- **Based on projected revenues and budget pressures, a general fund budget shortfall of about \$3.5 billion is likely for the 2010-12 biennium.**
 - Revenues for the biennium will fall short of the amount required to support the base budget by about \$600 million.
 - Combined with spending pressures from high-priority, mandated programs of about \$2.9 billion, the budget shortfall could be close to \$3.5 billion.
- **One-time revenue sources, including ARRA federal stimulus funds and the Rainy Day Fund, are supporting the FY 2010 budget, creating “structural imbalance”.**
 - As the temporary dollars decline, decisions will need to be made about replacing the lost funding. About \$800 million of the budget problem is related to back-filling Medicaid as the ARRA enhanced match disappears.
- **Closing a \$3.5 billion budget gap will take a combination of strategies – across-the-board reductions to state agencies alone won’t be sufficient in light of reductions that have already occurred.**
 - Reductions in state aid programs to individuals or localities are likely.
 - One-time strategies have largely been exhausted; revenue sources may need to be considered.

Revenue actions through Fall, 2009

Budget cutting began two years ago...

- Since the current two-year budget was initially adopted, \$7.0 billion has been cut from the general fund revenue stream – almost \$3.0 billion last fiscal year and a little over \$4.0 billion for the current fiscal year that began in July.

Cumulative Forecast Reductions



<u>Revenue Re-forecasts</u>	<u>FY 2009</u>	<u>FY 2010</u>
	(\$ in millions)	
2008 Session (Dec/Feb)	(\$1,015.5)	(\$ 874.1)
2009 Session (Oct/Dec/Feb)	(1,495.0)	(2,160.0)
August, 2009	<u>(298.8)</u>	<u>(1,182.6)</u>
	(\$2,809.3)	(\$4,216.7)

Closing the budget gap: FY 2008-10

- The 2009 General Assembly trimmed some \$4.3 billion out of the biennial general fund budget to address the cumulative effect of the lowered revenue forecasts presented in October and December of 2008, and in February 2009.

2009 Session Budget Balancing Actions <i>(\$ in millions)</i>	
	<u>FY 2008-10</u>
Rainy Day Fund	\$ 490.0
Tax Policy/Other Revenues & Transfers	394.9
Bonded Debt for GF Capital	355.4
Enhanced ARRA Medicaid Match	995.6
Other ARRA Flexible Funds	109.5
Budget Reductions	1,925.4
Other Budget Balances	<u>54.6</u>
Budget Shortfall	\$4,325.4

- About **one-half** of the balancing actions were one-time in nature – Rainy Day fund, tax amnesty, bonded debt for cash, and ARRA funds.
- However, additional balancing actions were needed as FY 2009 actual revenues missed the forecast by \$298.0 million.
 - This shortfall was covered by eliminating a planned balance of \$138.6 million, using \$109.5 million in stimulus funds that had been set aside for FY 2011, and through cash balances.

Closing the budget gap: FY 2010

- Based on FY 2009 actual performance, the Governor convened his revenue forecasting groups, resulting in a lowered forecast presented in August, 2009.
- The Governor proposed the following actions in September, 2009 to balance FY 2010. **About two-thirds of the strategies are one-time, non-recurring savings.**

Sept. 2009 Budget Balancing Actions (<i>\$ in millions</i>)	
	<u>FY 2010</u>
Rainy Day Fund (about ½ of \$575 million balance)	\$ 283.0
VRS - No employer payment 4 th quarter	104.0
Budget Reductions	402.0
Agency Balances	142.0
Enhanced Medicaid Match	97.0
Other Targeted Reductions	<u>325.0</u>
Budget Shortfall	\$1,353.0

- Based on year-to-date revenue collections, the SFC staff forecast shows an additional FY 2010 revenue shortfall of **about \$200 million**.
 - Combined with additional Medicaid funding of about \$50 million needed in FY 2010, an additional budget shortfall of about \$250 million must be addressed in the “caboose bill”.

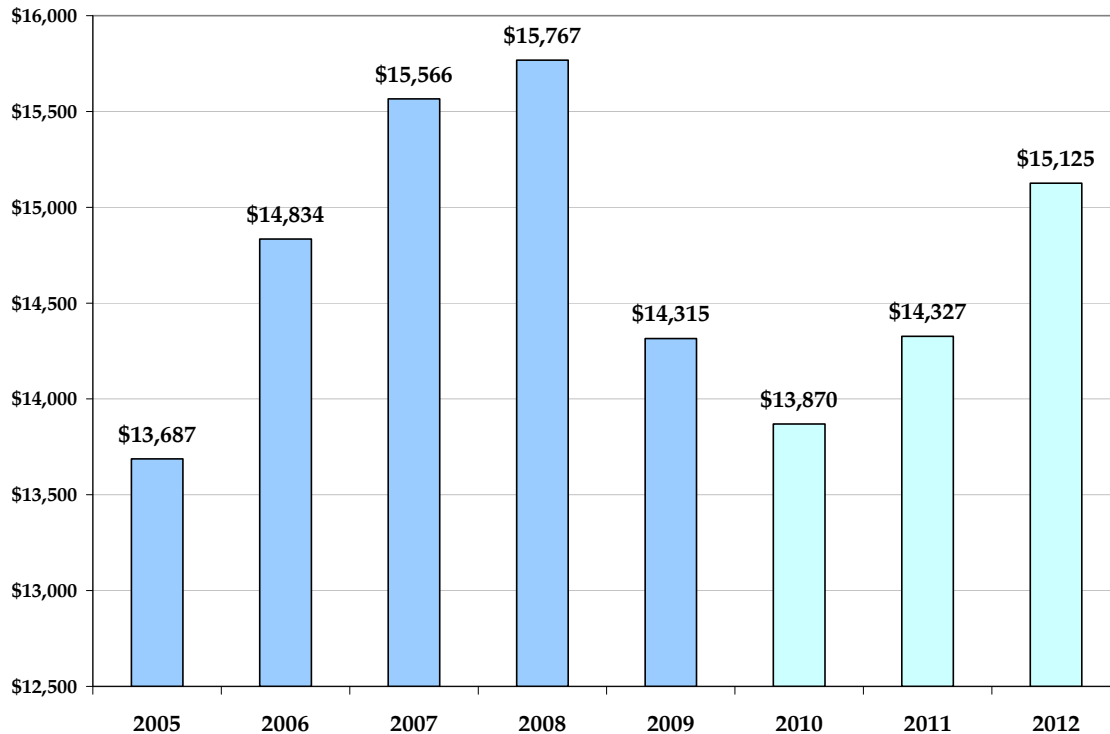
Use of ARRA Funds in the 2008-10 Budget

- Virginia was among the first states to incorporate ARRA federal stimulus funds in its budget.
 - The 2009 General Assembly was able to use some of the ARRA funds to “free up” general funds and address the February, 2009 mid-session reduction in revenues of \$825 million.
 - An enhanced Medicaid match provided \$962 million, allowing a like reduction in general funds.
- Ch. 781 as adopted appropriated \$1,696.7 million in ARRA funds. The Governor’s September, 2009 budget actions used another \$257.4 million to partially offset reductions in general fund support, bringing total ARRA funding to almost \$2.0 billion.
- Some ARRA funds remain for use in the next biennium, including \$323.0 million for education, and about \$376.0 million for Medicaid.

ARRA Funds in 2008-10 Budget			
<i>(\$ in millions)</i>			
	<u>FY 2009</u>	<u>FY 2010</u>	<u>2008-10</u>
Medicaid Enhanced Match	\$368.8	\$593.7	\$962.5
Medicaid Match – Sept. Actions	0.0	97.0	97.0
GF Supplant – Flexible Spending	109.5	109.5	219.0
K-12 Public Educ.– Restore Cuts	0.0	365.2	365.2
Higher Education – Restore Cuts	0.0	126.7	126.7
Educ. Reductions – Sept. Actions	0.0	160.4	160.4
Byrne JAG – Restore Cut to Sheriffs	<u>0.0</u>	<u>23.3</u>	<u>23.3</u>
	\$478.3	\$1,475.8	\$1,954.1

Current revenues at roughly FY 2005 level

Actual and SFC Projected GF Revenues
FY 2005 to FY 2012
(excludes transfers, \$ in millions)



- State programs and services are being operated this fiscal year on a revenue base only slightly larger than the FY 2005 base -- about \$13.9 billion.
 - In addition to budget reductions, one-time actions totaling about \$1.5 billion have “propped up” the FY 2010 budget, including Rainy Day Fund withdrawals, bonding capital projects, and capturing general fund and non-general fund balances.
 - Plus, federal stimulus funds of almost \$1.0 billion in FY 2010 have been used to temporarily support the Medicaid program and to offset reductions to education.

Looking Ahead: Developing the 2010 - 12 biennial budget

What does it cost to fund current services?

- The biennial base budget is the approximate cost of maintaining current services and caseloads.
- The operating budget for FY 2010 (from Chapter 781, 2009 Appropriation Act) is the starting point.
 - Any one-time spending items are deducted from the base.
 - The recurring savings from the September budget actions are also deducted.

2010-2012 Base Budget Calculation	
(\$ in millions)	
Ch. 781, FY 2010 GF Operating	\$15,843.2
Minus: Sept. Recurring Savings	(\$475.0)
Plus: Other Technical Adjustments	<u>\$17.4</u>
Total, Adjustments to Base	(\$457.6)
Adjusted Annual GF Base	\$15,385.6
SFC Biennial (Two-Year) Base	\$30,771.2

- Currently, the general fund base budget of \$15,385.6 million exceeds general fund revenues and transfers and is “propped up” by one-time, non-recurring sources – creating a structural imbalance.

Developing the 2010-12 Budget

How do forecast revenues compare to the cost of continuing the current base budget?

- Based on SFC staff analysis, forecast revenues for FY 2010-12 are short of the biennial “base budget” by about \$600 million.

	<u>FY 2011</u>	<u>FY 2012</u>	<u>2010-12</u>
Revenue Growth Rates	3.3%	5.6%	
SFC Staff Forecast	\$14,327.3	\$15,125.2	\$29,452.5
Transfers	<u>345.8</u>	<u>355.1</u>	<u>700.9</u>
Total GF Revenues	\$14,671.3	\$15,480.3	\$30,151.6
GF Base Budget	\$15,385.6	\$15,385.6	\$30,771.2
<i>Resources</i>			
<i>(Below)/Above Base</i>	<i>(\$714.3)</i>	<i>\$94.7</i>	<i>(\$619.6)</i>

- Most of the one-time revenue “props” can be absorbed within the FY 2010-12 projected revenue growth. However, spending pressures include:
 - “Back-filling” some of the ARRA funding.
 - Existing statutory commitments.
 - Increasing caseloads or related issues.
 - Revised costs of providing services, based on updated data (re-benchmarking or rebasing).

2010-12 Budget Pressures

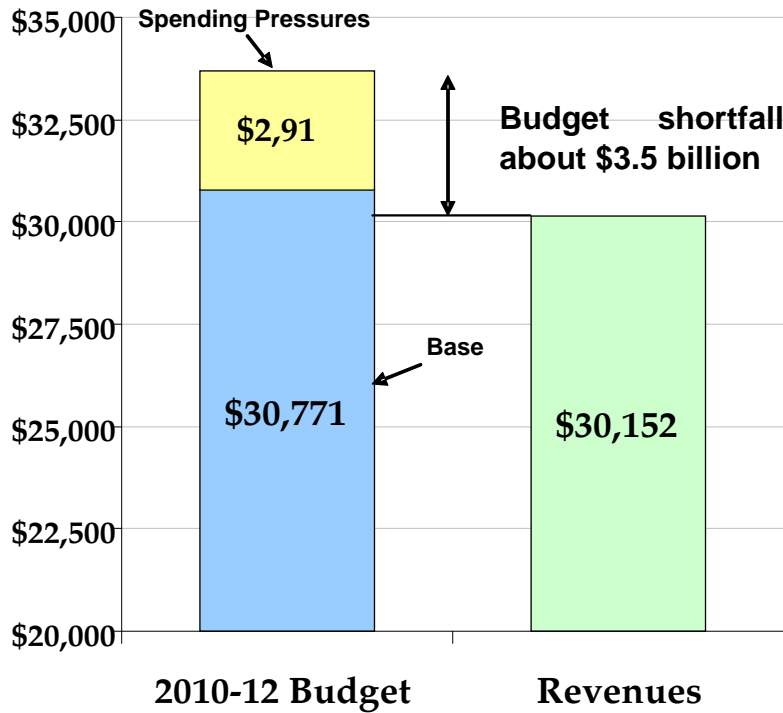
- As ARRA funds disappear, about \$800 million in general funds would be required to replace Medicaid funds used to “manage” the 2009 mid-session revenue reforecast.
- Projected increases in Medicaid utilization, combined with increased costs for employee and teacher retirement and employee health insurance also contribute to roughly \$2.9 billion in mandated or high-priority spending.

Preliminary 2010-12 GF Spending Pressures (\$ in millions)

	<u>FY 2011</u>	<u>FY 2012</u>	<u>2010-12</u>
Replace Medicaid Enhanced			
Match ARRA Funds	\$217.4	\$593.7	\$ 811.2
Medicaid Forecast	394.0	673.9	1,067.8
K-12 Rebenchmarking			
(includes Comp Index, Sales Tax)	51.8	92.8	144.6
VRS Rate Increase	56.6	56.6	113.2
VRS Rate Increase - Teachers	129.8	141.4	271.2
Employee Health Insurance	46.4	115.0	161.4
Debt Service	68.9	114.8	183.7
Other HHR: TANF, Foster Care	17.8	33.6	51.4
Other (Unemploy. Ins. Interest, Comp Board, Ec Dev Grants)	<u>44.9</u>	<u>63.6</u>	<u>108.5</u>
Total	\$1,027.6	\$1,885.4	\$2,913.0
<i>Other Potential Items</i>			
Replace K-12 and HE Funding			
Offset with ARRA	\$329.3	\$652.3	\$ 981.6
Byrne JAG ARRA Funding	23.3	23.3	46.6
Maintenance Reserve	50.0	50.0	100.0
Equipment for New Facilities	20.0	20.0	40.0

2010-12 Budget shortfall of about \$3.5 billion

Projected FY 2010-12 Budget Shortfall
(\$ in millions)



2010-2012 Budget Shortfall
(\$ in millions)

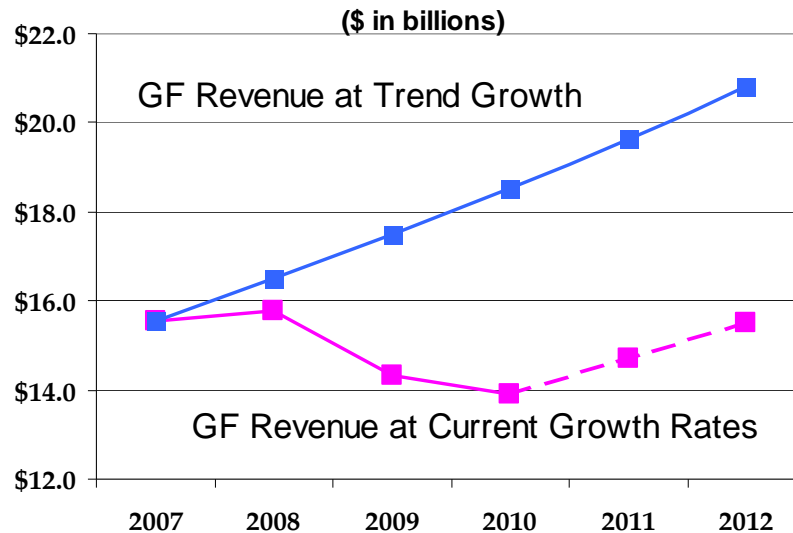
	<u>FY 2011</u>	<u>FY 2012</u>	<u>2010-12</u>
SFC Revenue Forecast	\$14,671.3	\$15,480.3	\$30,151.6
<i>Less:</i>			
GF Base Budget	\$15,385.6	\$15,385.6	\$30,771.2
Budget Pressures	<u>1,027.6</u>	<u>1,885.4</u>	<u>2,913.0</u>
Budget Shortfall	(\$1,741.9)	(\$1,790.7)	(\$3,532.6)

Options for Closing the Budget Shortfall

- **Reduce the state general fund budget.**
 - Apply further reductions to state agency budgets, either targeted or across-the-board reductions.
 - Reduce state aid programs to localities or individuals (two-thirds of the general fund budget), through targeted or across-the-board reductions.
- **Reduce cost of mandated or high-priority spending items.**
 - Redefine the cost through changes to funding methodology.
 - Postpone funding of commitments (e.g. don't pay fourth quarter VRS).
- **Shift costs to non-general fund sources or to other payers.**
 - Raise fees to cover general fund shortfalls (higher education tuition, parks fees).
 - Cost-share increases with state and local employees.
- **Generate one-time revenues or savings.**
- **Increase revenues, either permanently or temporarily.**

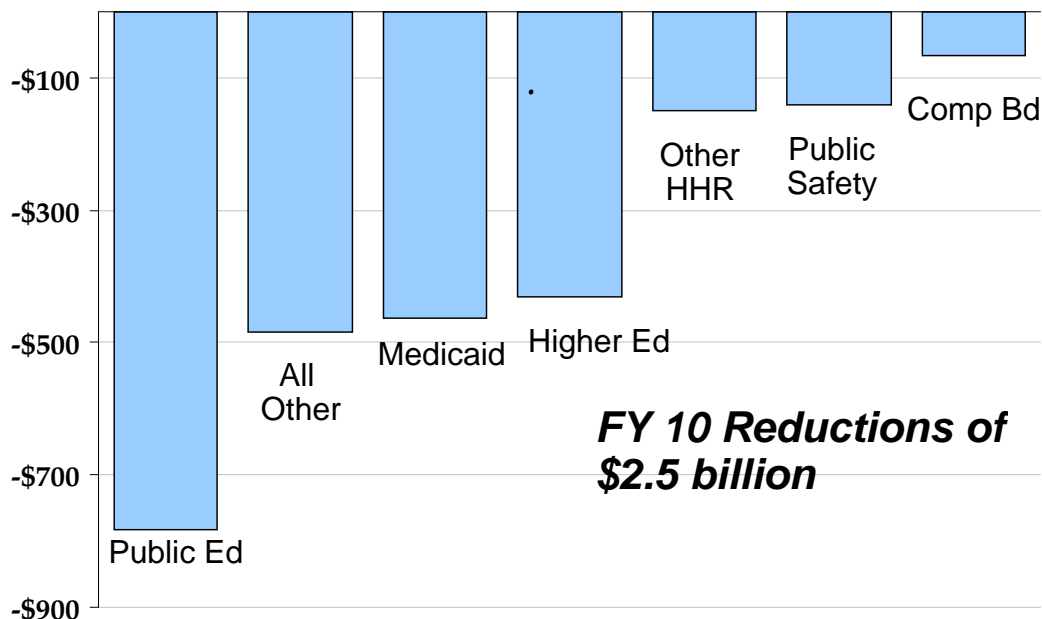
Reduction strategies complicated by...

Loss of five years of general fund revenue growth.



About \$5.0 billion in GF spending already removed from the biennial base budget (FY 2010 reductions x 2):

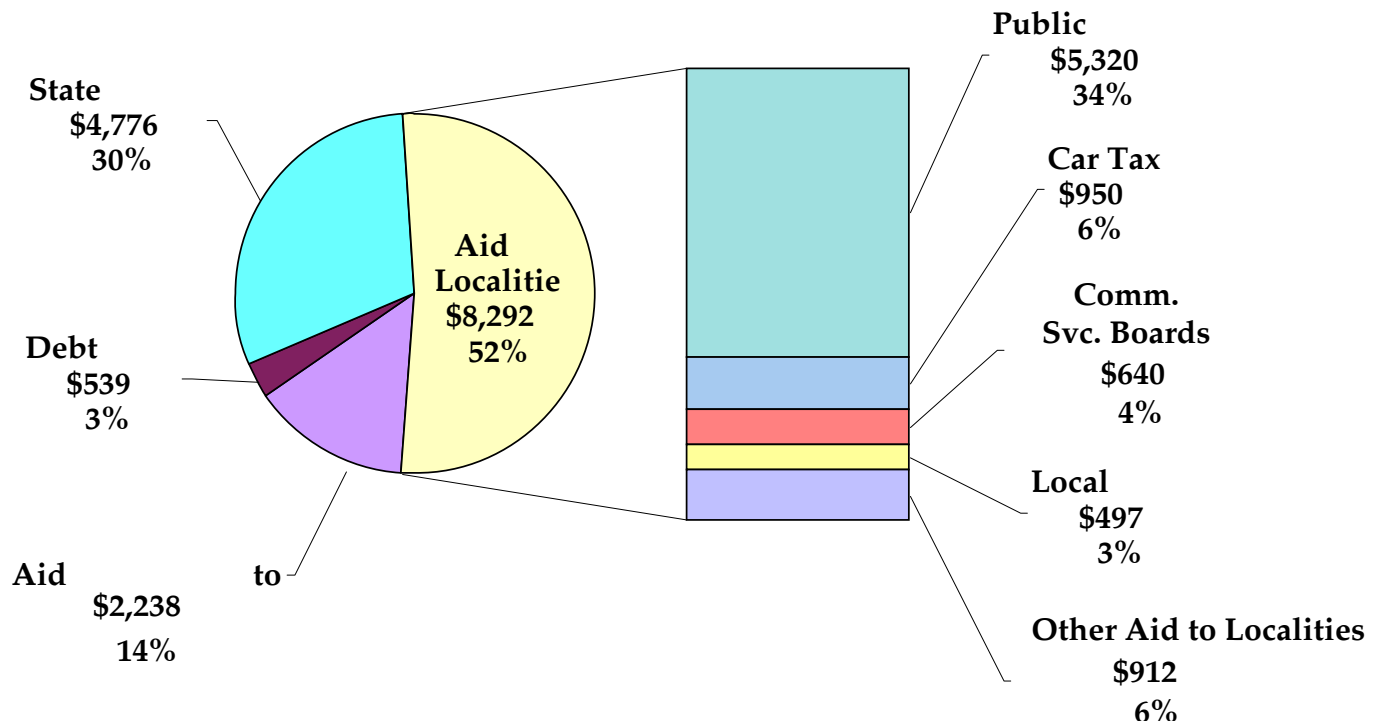
Revised FY 2010 Budget Compared to Original FY 2010



First option is to look at what can be cut: where does the money go?

- All GF programs shown below would need to be reduced by about an additional 11 to 12 percent to balance the budget through budget cuts alone.
- About half of the general fund budget is driven by several large state programs delivered at the local level, and local tax relief.

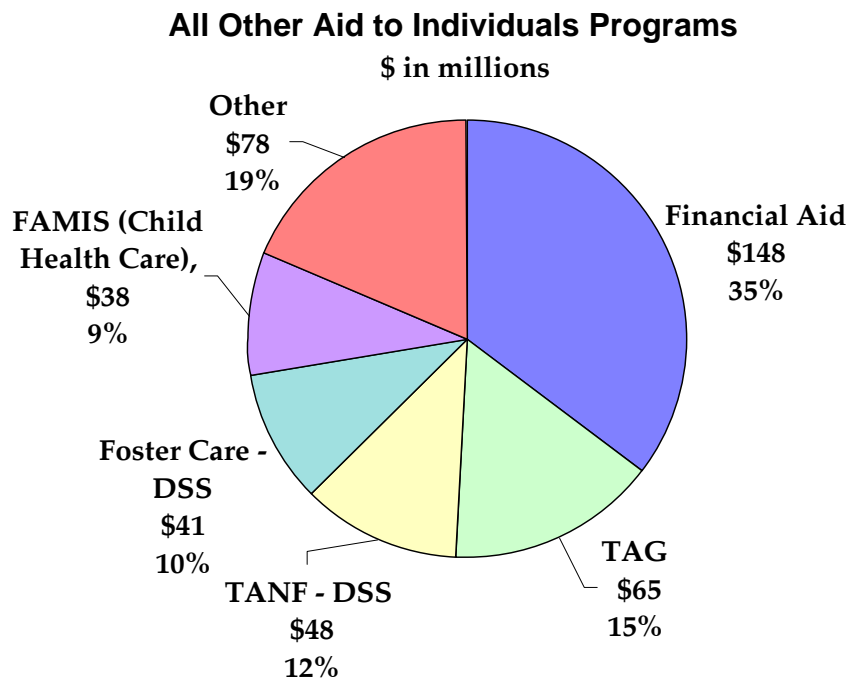
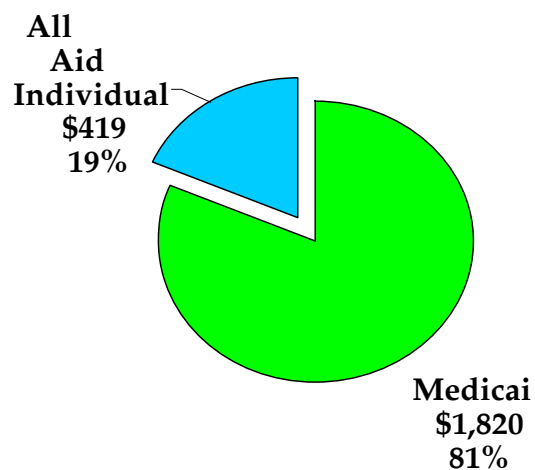
FY 2010 GF Operating Budget = \$15,843.2¹
Chapter 781 (does not include Sept 09 Reductions)
(\$ in millions)



1. General Fund reductions may be partially or fully restored with federal funds available under the American Recovery and Reinvestment Act of 2009.
2. The GF budget was further reduced by \$854.3 million in September

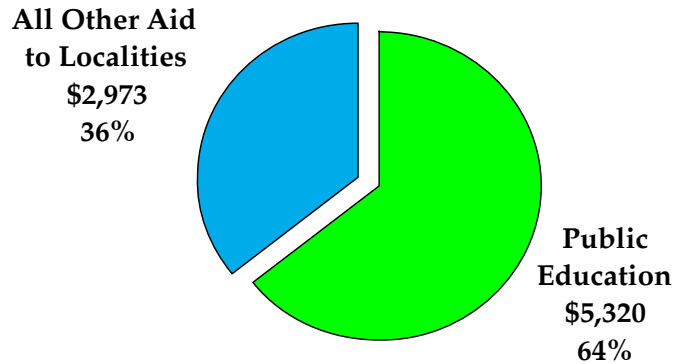
Aid to Individuals, FY 2010 -- \$2.2 billion

- *A ten percent reduction to general fund programs providing aid to individuals generates about \$220 million per year.*

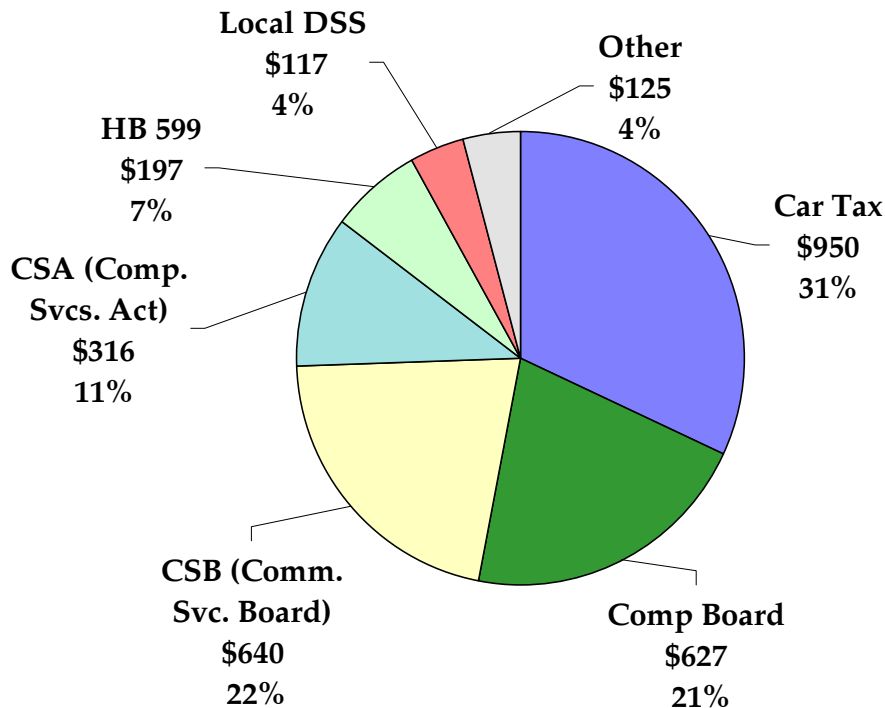


Aid to Localities, FY 2010 - \$8.3 billion

- *A ten percent reduction to all general fund local aid programs generates about \$830 million per year.*



All Other Aid to Localities Programs Ch. 781, \$ in millions

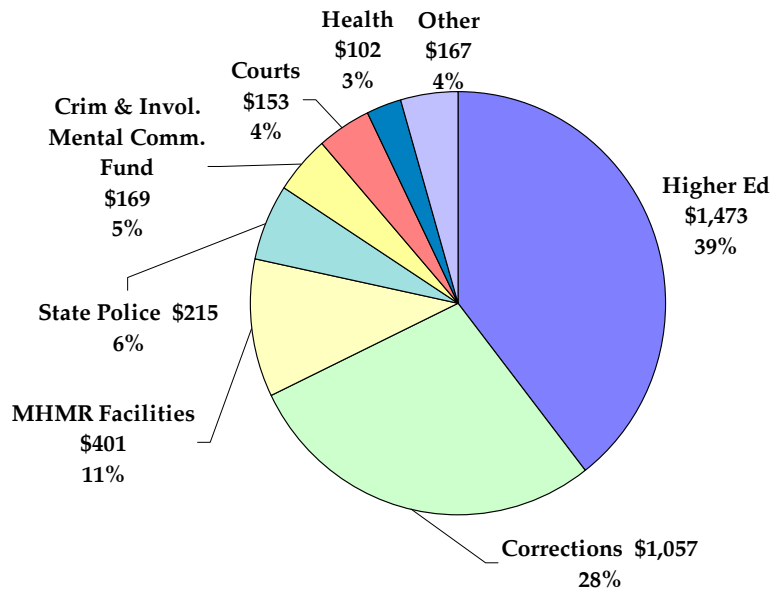


Major State Programs and “Other” FY 2010 -- \$4.8 billion

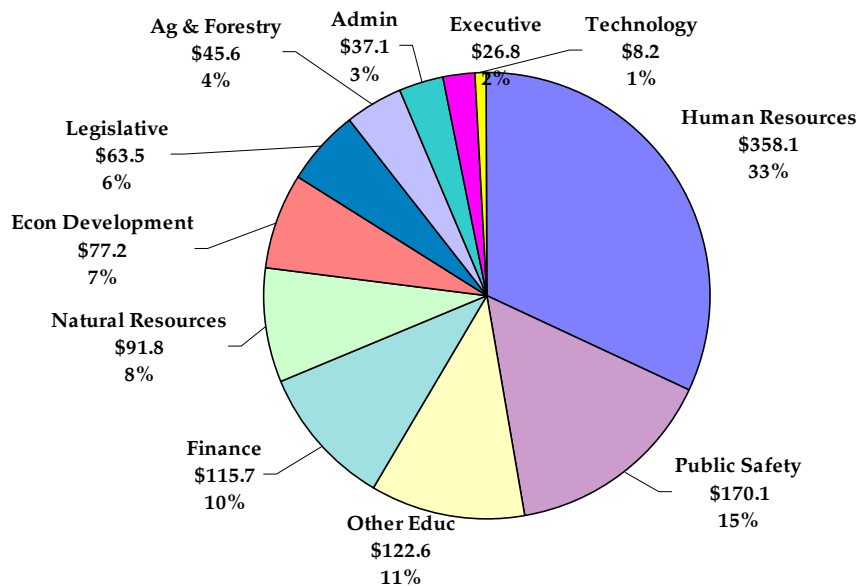
- *Looking at just state-operated programs, a ten percent reduction generates about \$480 million per year.*

Major State Programs & Systems = \$3.7 billion

Ch. 781, \$ in millions

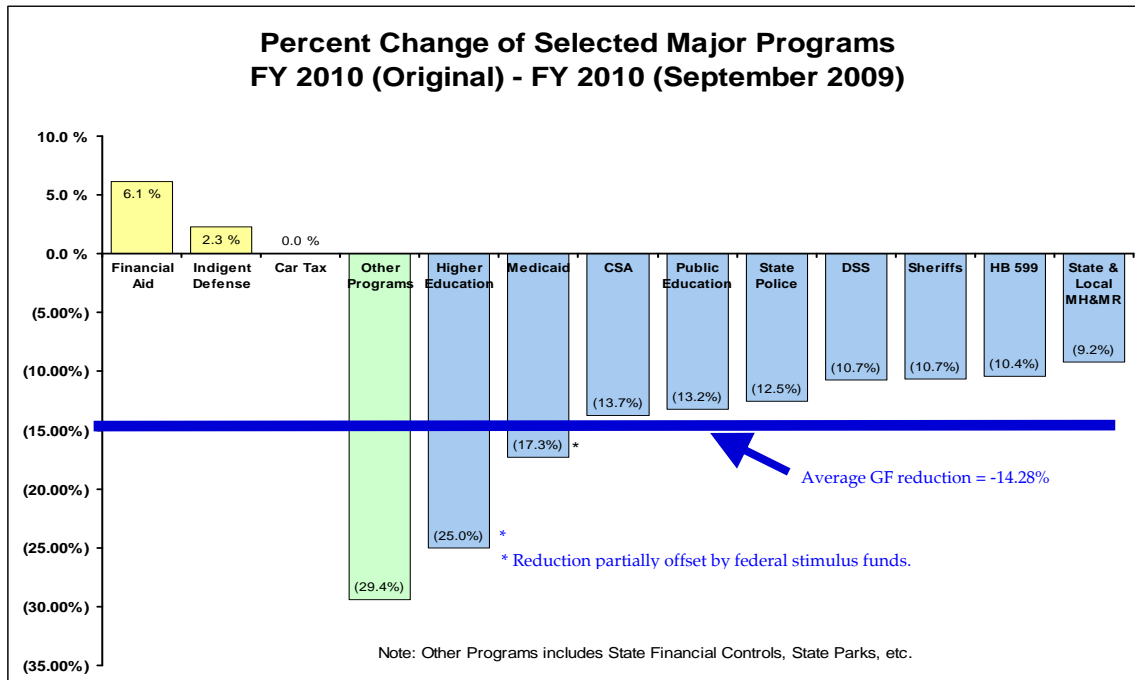


All Other Programs/State Agencies = \$1.1 billion



Budget reductions have varied across programs, agencies

- Some programs have been exempted from budget reductions or have grown slightly since the 2008-10 budget was adopted.
 - And, some programs – most notably education and Medicaid -- have received temporary assistance through federal stimulus dollars.
 - Several programs (parks, central government administrative agencies) have seen reductions of almost 30 percent.
- Completely exempting any one area of the budget from cuts – as has been done in the past -- will be increasingly difficult.



Three fundamental questions guide budget cutting decisions

1) What services should the state provide?

- Reduce the scope of services provided.
- Redefine standards or guidelines that drive funding.
- Eliminate programs or services that are not mandated or core services.
- Re-organize or consolidate agencies.

2) Who receives the services?

- Change eligibility criteria for who qualifies to receive the services.

3) Who pays?

- Shift costs to other payers: localities, increase fees for services, raise tuition, reduce reimbursements to providers.
 - Find opportunities for consolidation or regionalization of state services.
 - Provide more flexibility for local entities that deliver state programs.
- If budget cuts are viewed as “too deep”, consider the revenue side of the equation or limited use of measures that produce one-time revenues.

Challenges of the 2010 Session

- Uncertainty surrounds the national economic outlook and the revenue forecast for Virginia for the remainder of FY 2010, and, at a minimum, the next two fiscal years.
- Even with some modest revenue growth in the next two fiscal years, revenues are not sufficient to cover the current services budget.
 - Spending pressures – including almost \$2.0 billion to support the state’s Medicaid program – total about \$2.9 billion.
- As a result, the total projected budget shortfall for the 2010-2012 biennium could approach **\$3.5 billion**.
- Balancing the budget through across-the-board reductions to central state agencies and higher education will not be sufficient to close the gap.
 - Reductions to state aid programs that impact localities are likely.
- As funding reductions are being considered, efforts also should be explored for efficiencies through organizational structure, shared services, and operating flexibility.