

# 2010-12 Budget Outlook

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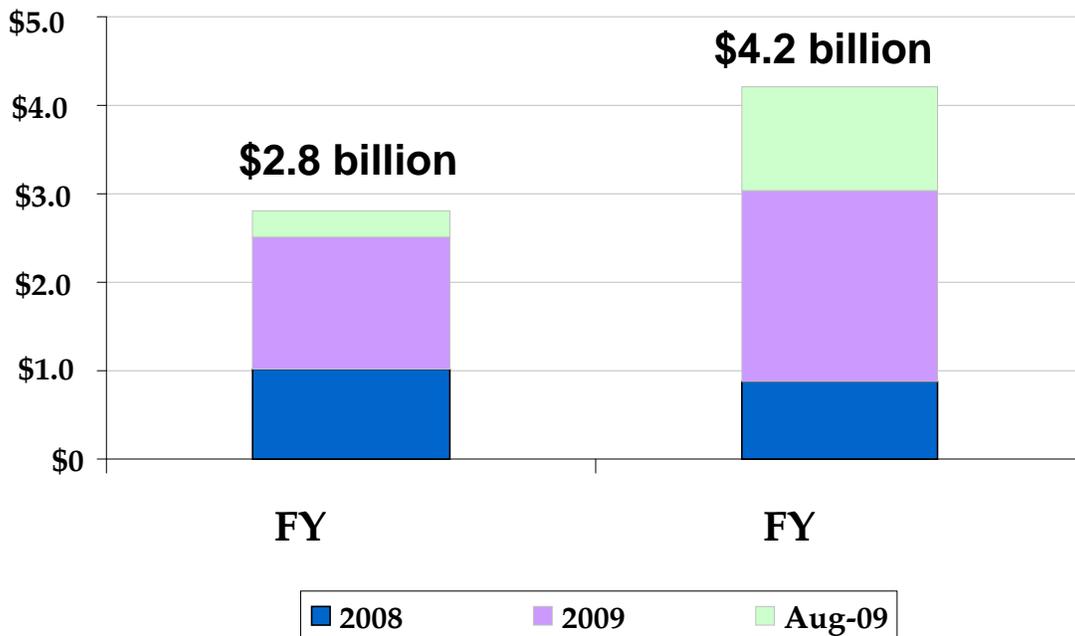
- **Based on projected revenues and budget pressures, a general fund budget shortfall of about \$3.5 billion is likely for the 2010-12 biennium.**
  - Revenues for the biennium will fall short of the amount required to support the base budget by about \$600 million.
  - Combined with spending pressures 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>
	<i>(\$ in millions)</i>	
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

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- 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.

<b>2009 Session Budget Balancing Actions</b>	
<i>(\$ in millions)</i>	
	<u><b>FY 2008-10</b></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>
<b>Budget Shortfall</b>	<b>\$4,325.4</b>

- 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

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- 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.**

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

- 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

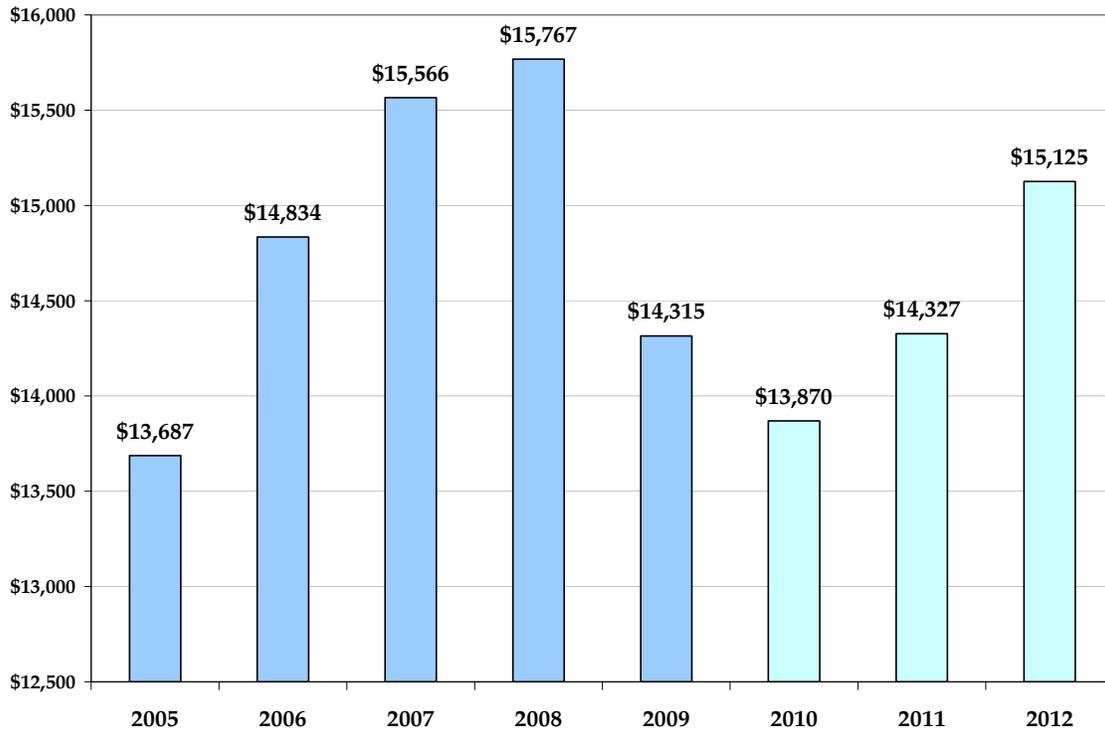
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- Virginia was among the first states to incorporate ARRA federal stimulus funds in its budget.
  - The 2009 General Assembly was able to use some of the ARRA funds to “free up” general funds and address the February, 2009 mid-session reduction in 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.

<b>ARRA Funds in 2008-10 Budget</b>			
<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>
	<b>\$478.3</b>	<b>\$1,475.8</b>	<b>\$1,954.1</b>

# 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

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## *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.

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

- 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

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*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>
<b>Total GF Revenues</b>	<b>\$14,671.3</b>	<b>\$15,480.3</b>	<b>\$30,151.6</b>
<b>GF Base Budget</b>	<b>\$15,385.6</b>	<b>\$15,385.6</b>	<b>\$30,771.2</b>
<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

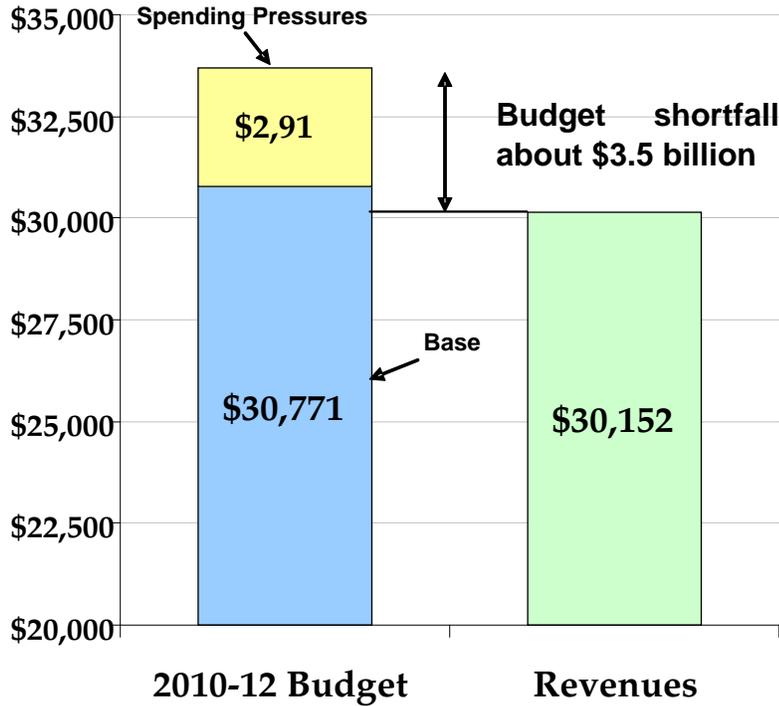
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- As ARRA funds disappear, about \$800 million in general funds would be required to replace Medicaid funds used to “manage” the 2009 mid-session revenue reforecast.
- Projected increases in Medicaid utilization, combined with increased costs for employee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

<b>Preliminary 2010-12 GF Spending Pressures</b>			
(\$ 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>
<b>Total</b>	<b>\$1,027.6</b>	<b>\$1,885.4</b>	<b>\$2,913.0</b>
<b>Other Potential Items</b>			
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>
<b>Budget Shortfall</b>	<b>(\$1,741.9)</b>	<b>(\$1,790.7)</b>	<b>(\$3,532.6)</b>

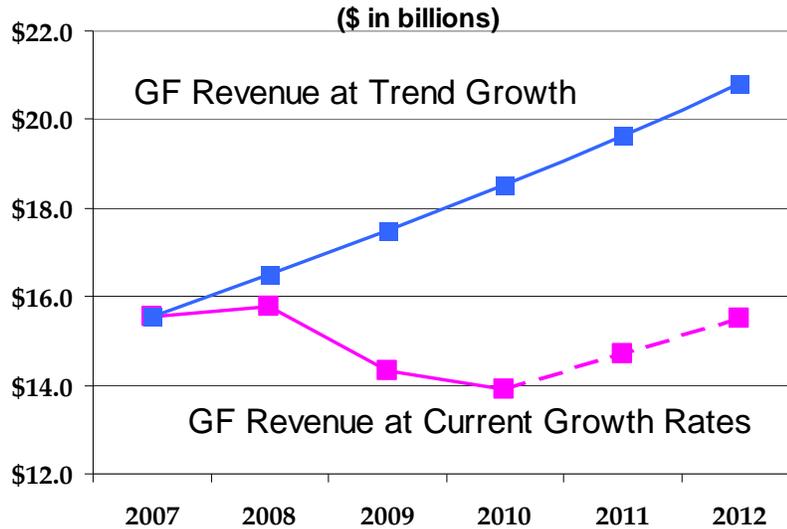
# Options for Closing the Budget Shortfall

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- **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.**

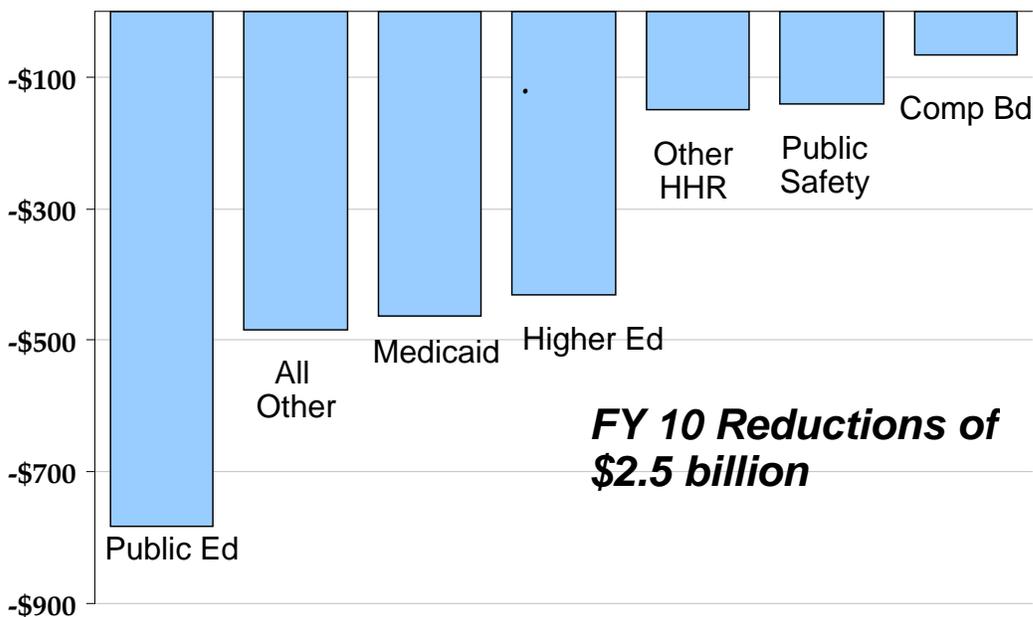
# Reduction strategies complicated by...

*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):*

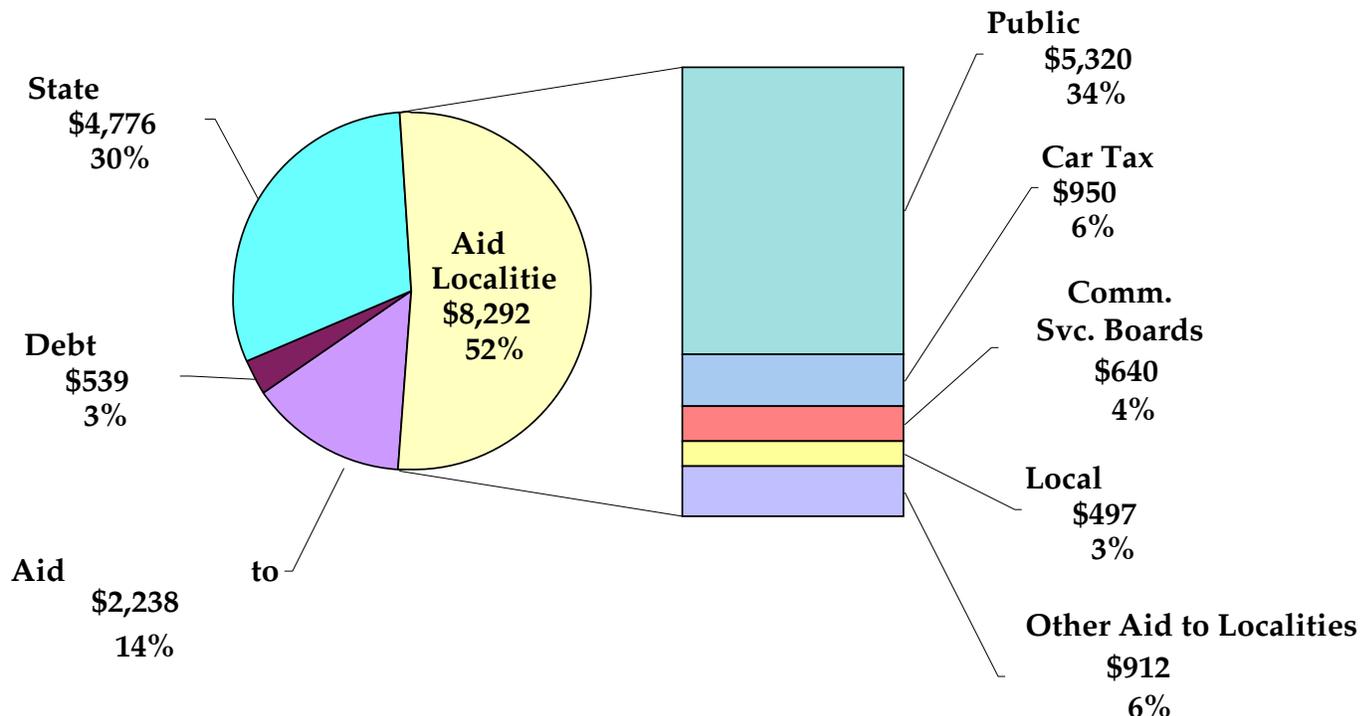
## Revised FY 2010 Budget Compared to Original FY 2010



# 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 = \$15,843.2<sup>1</sup>**  
 Chapter 781 (does not include Sept 09 Reductions)  
 (\$ in millions)

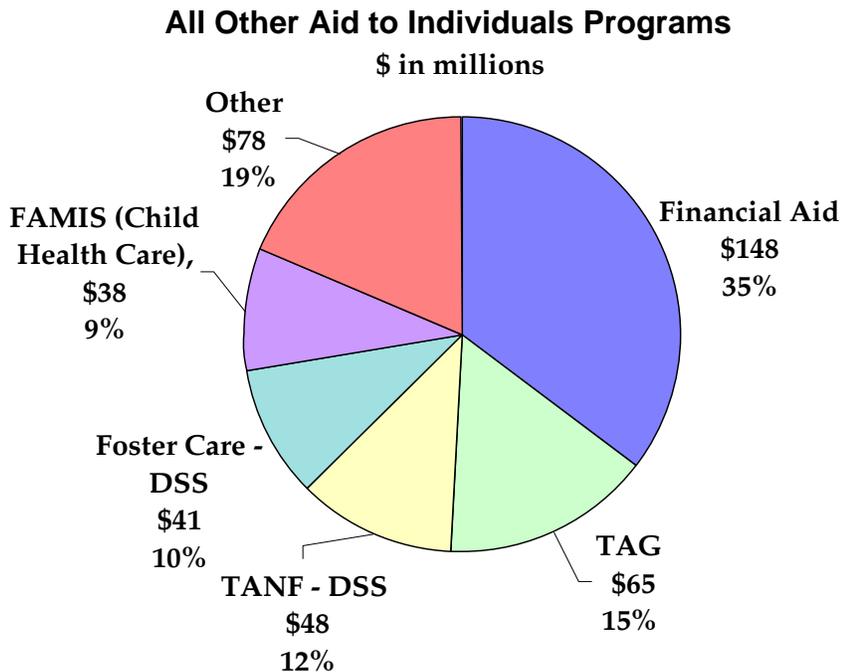
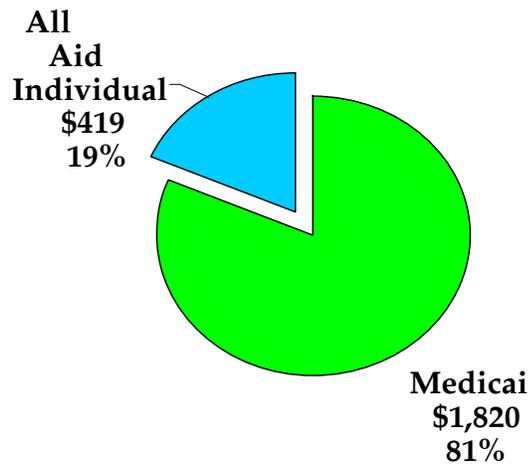


1. General Fund reductions may be partially or fully restored with federal funds available under the American Recovery and Reinvestment Act of 2009.
2. The GF budget was further reduced by \$854.3 million in September

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

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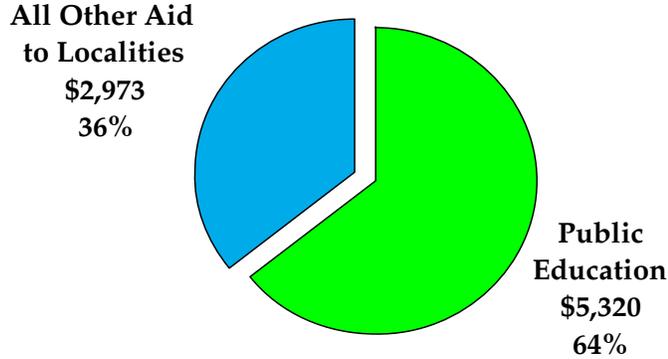
- *A ten percent reduction to general fund programs providing aid to individuals generates about \$220 million per year.*



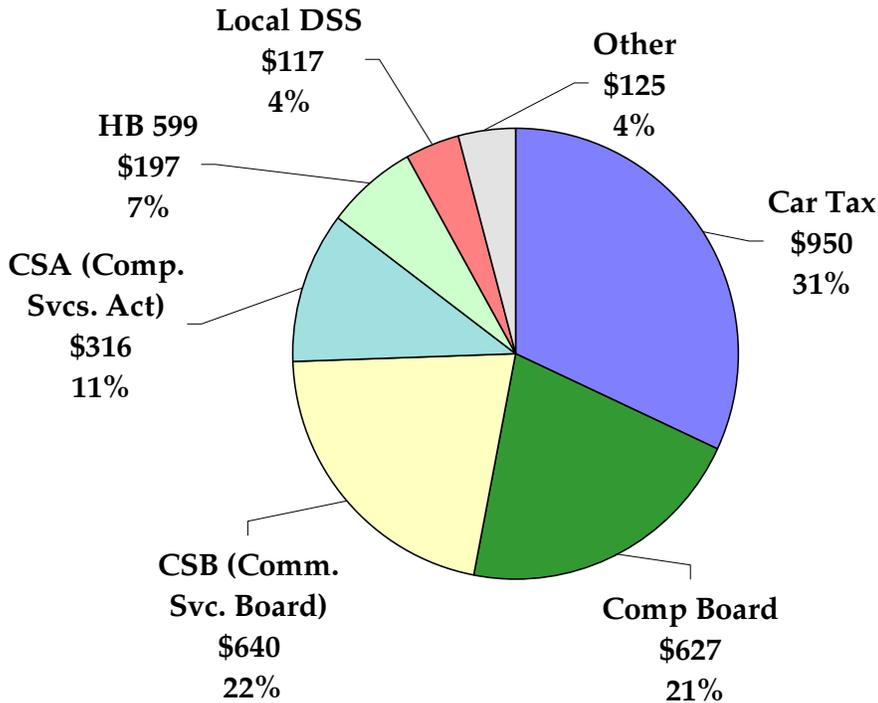
# Aid to Localities, FY 2010 - \$8.3 billion

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



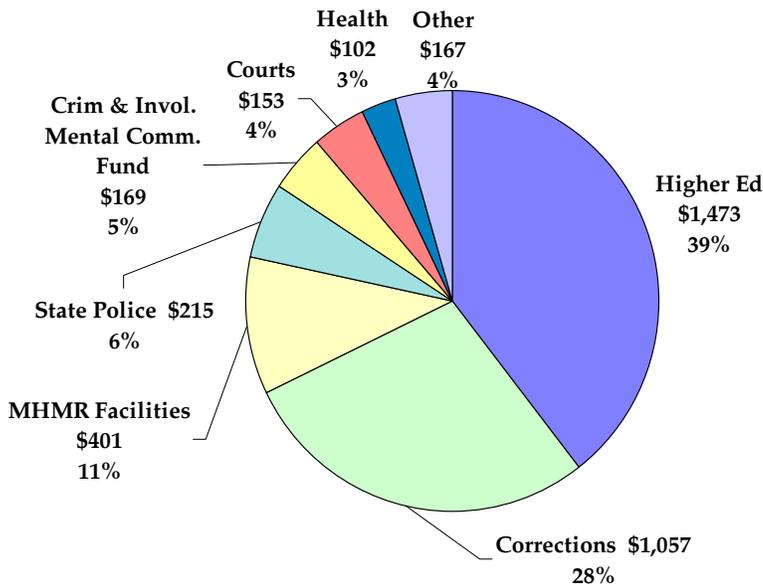
**All Other Aid to Localities Programs**  
Ch. 781, \$ in millions



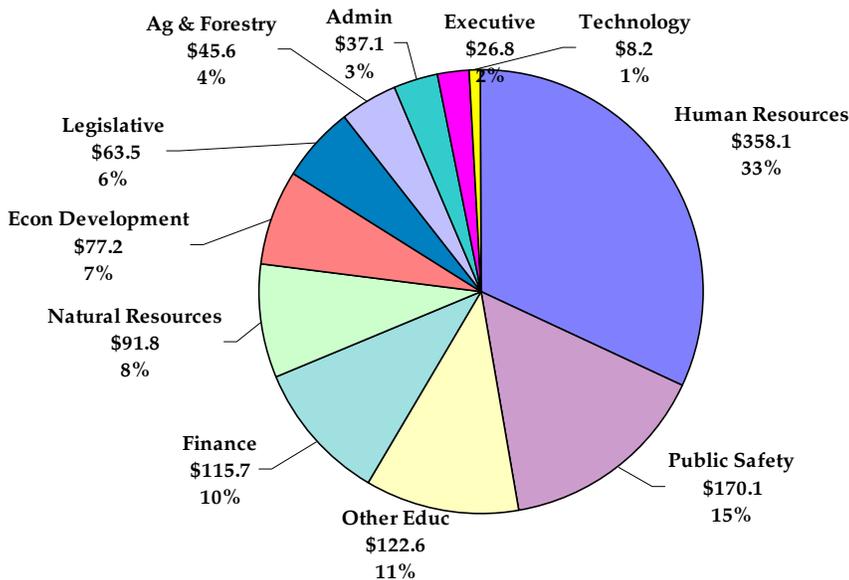
# Major State Programs and “Other” FY 2010 -- \$4.8 billion

➤ 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

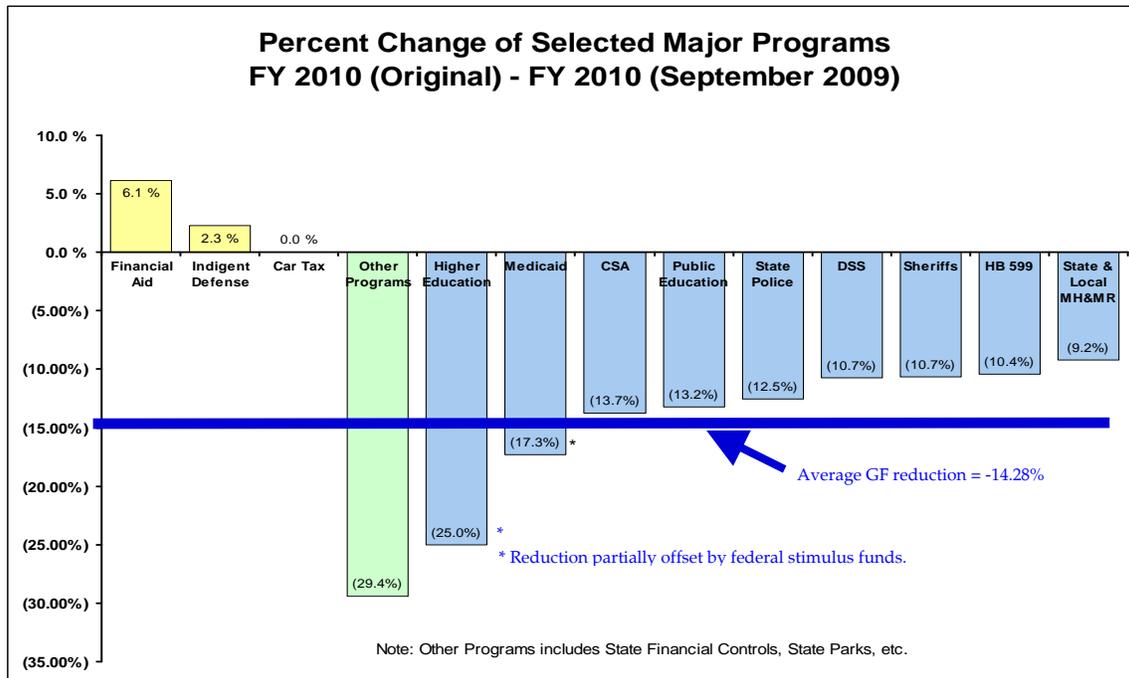


## All Other Programs/State Agencies = \$1.1 billion



# 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

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- 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

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- 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.