

SENATE OF VIRGINIA

Senate Finance Committee

2015 Session Budget Outlook

November 20, 2014



SENATE FINANCE COMMITTEE

Outlook for the 2015 Session

- Addressing a \$2.4 billion budget shortfall has been the focus of 2014.
 - Action to balance the budget occurred over the summer and fall.
 - What remains is fine-tuning of the current two-year budget, including addressing remaining reversion account of \$272 million in FY 2016.
- Virginia's economy will continue to **underperform** the nation's.
 - General fund growth rates will lag historical growth rates.
 - SFC staff forecast \$150 million of revenue above Interim Forecast.
- Limited budget pressure from mandated spending items.
 - But, will need to identify cuts to fill the **remaining** reversion accounts.
 - No funding available for high priority items such as higher education, public education, mental health, or salaries.
- Little opportunity to make investments in key areas, unless funded through spending reallocations or identification of other resources.



Recap of 2014:

How did we get here?

- **December, 2013:** Gov. McDonnell's biennial budget, SB 30 as introduced, included \$1.8 billion in additional revenues.
 - A conservative forecast, but sufficient to cover mandated and high priority spending when combined with targeted reductions.
 - Additional resources for investment in higher education and to honor VRS rates and payback.
- **February, 2014:** First hint of trouble – revenues for FY 2014 reduced by \$125 million in the Caboose Bill, and \$15 million in FY 2015 in SB 30 (as passed by the Senate).
 - Managed this adjustment through reduced requirement for FY 2016 Rainy Day Fund deposit and by lowering the FY 2014 planned carry-forward.
- **March, 2014:** Adjourned *sine die* without passing a biennial budget.



Recap of 2014:

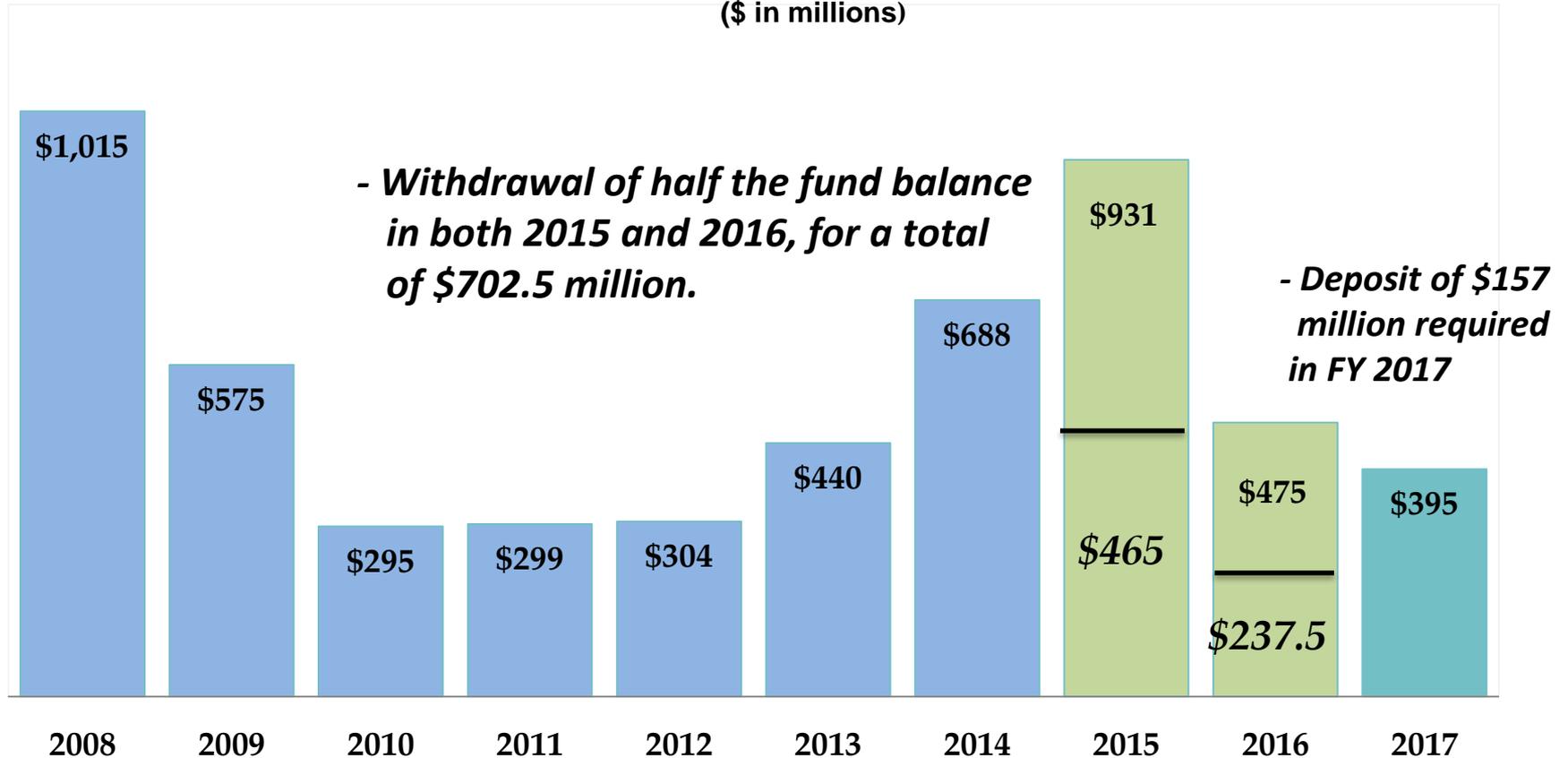
Passage of Chapter 2 – Biennial Budget

- *June, 2014:* Chapter 2 of Special Session I, the 2014-16 biennial budget bill, addressed an *anticipated* budget shortfall of about **\$1.55 billion**.
 - Assumed FY 2014 collections would fall short by \$350 million, due to taxpayer behavior on non-withholding/final payments.
 - Assumed negative impact on revenues of \$600 million in both FY 2015 and FY 2016.
 - Two key strategies to close the shortfall:
 - Set-aside budget reversion accounts totaling \$842.5 million (mostly from reducing new spending in budget).
 - Anticipated withdrawals from the Rainy Day Fund totaling \$705.0 million.



Use of the Rainy Day Fund

Rainy Day Fund Balance
(\$ in millions)



Recap of 2014:

Fiscal Year Ends with a Revenue Shortfall

- *July, 2014:* FY 2014 revenues fell short by \$437.8 million (more than the \$350 million anticipated), triggering the revenue reforecasting process.
 - Major tax sources (corporate, withholding, non-withholding, sales) fell short by \$559.1 million, offset by \$120.6 million more from minor sources (refunds, insurance, interest).
- *August, 2014:* Governor McAuliffe presented a revised revenue forecast to the Joint Money Committees.
 - Forecast based on the recommendations of the JABE and GACRE forecasting groups.
 - Reflected impact of FY 2014 shortfall, and continued sluggish job and wage/salary growth, especially in Northern Virginia.



Recap of 2014: HB 5010 Supplemental Budget Bill

- *September, 2014:* SB 5005/HB 5010 were introduced to amend Chapter 2, the budget adopted in June.
 - Updated revenues to reflect the downward revisions to the forecast as presented by the Governor in August.
 - Appropriated transfers from the Rainy Day Fund of \$470.0 million in FY 2015 and \$235.0 million in FY 2016.
 - Included actions to close the *remaining* budget shortfall of \$345.5 million in FY 2015 and \$536.0 million in FY 2016.
 - Reversion clearing accounts allowed Governor to provide guidance to state agencies, local governments, and colleges on the actual reduction strategies employed for FY 2015.



Calculating the Shortfall

<i>(\$ in millions)</i>	FY 2015	FY 2016	Total
Chapter 2 Official Revenues	\$17,721.9	\$18,448.6	\$36,170.5
<i>August Revenue Forecast</i>	<u>16,862.4</u>	<u>17,313.3</u>	<u>34,175.7</u>
Variance	(\$859.5)	(\$1,135.3)	(\$1,994.8)
FY 2014 Revenue Shortfall	<u>(437.8)</u>	<u>0</u>	<u>(437.8)</u>
Total Shortfall	(\$1,297.3)	(\$1,135.3)	(\$2,432.6)
<i>Strategies to Close Gap:</i>			
Ch. 2 Revenue Reserve Fund	\$481.8	\$364.3	\$846.1
Rainy Day Fund Withdrawal	<u>\$470.0</u>	<u>\$235.0</u>	<u>\$705.0</u>
Remaining Shortfall	(\$345.5)	(\$536.0)	(\$881.5)



Recap of 2014: Budget bill finalized

- *November, 2014:* The General Assembly met to **reverse** one of the planned strategies to close the budget gap employed in HB 5010.
 - One-year deferral of the FY 2015 increase in the existing sales tax revenue dedicated to the Highway Maintenance and Operating Fund, estimated to be **\$49.8 million**.
 - Phased increase from .50 to .675 was established in HB 2313 (2013), the landmark transportation funding bill.
 - Strategy replaced with additional general fund agency balances; unclear as to how this will be addressed in the amended budget.
- **Chapter 3:** Governor signed HB 5010 on November 14th.



Chapter 3: Closing the Budget Gap

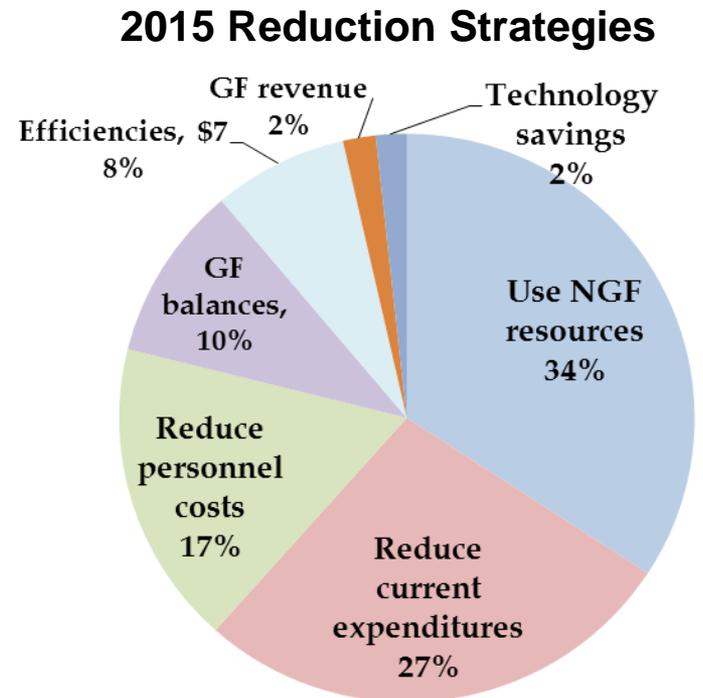
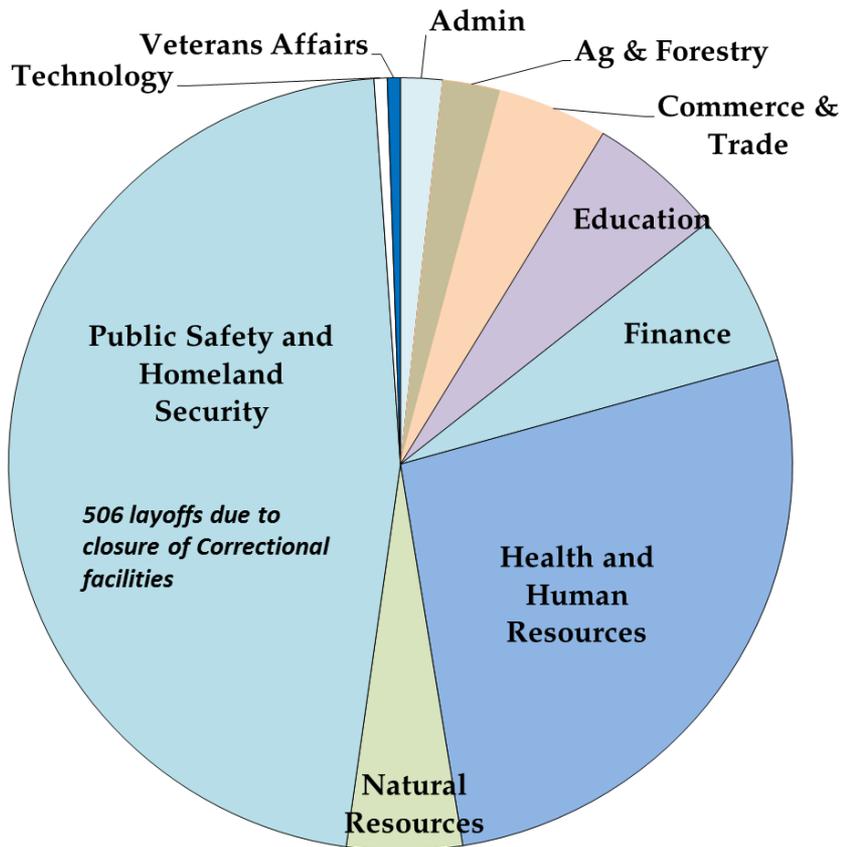
- To close the remaining shortfall of \$881.5 million, a combination of resource actions and spending cuts were adopted.
 - As adopted and *amended*, Chapter 3 includes \$267.1 million in agency balances and transfers.
 - Four reversion accounts totaling \$614.4 million provide parameters for budget cuts to be identified by the Governor.

(GF \$ in millions)	<u>FY 2015</u>	<u>FY 2016</u>
Balances/Transfers/Other	\$219.1	\$ 48.0
Reversion Accounts:		
State Agencies	\$ 92.4	\$100.0
Higher Education	45.0	45.0
Aid to Localities (no K-12)	30.0	30.0
<i>Miscellaneous/Other Actions</i>	<u>0.0</u>	<u>272.0</u>
Total	\$386.5	\$495.0



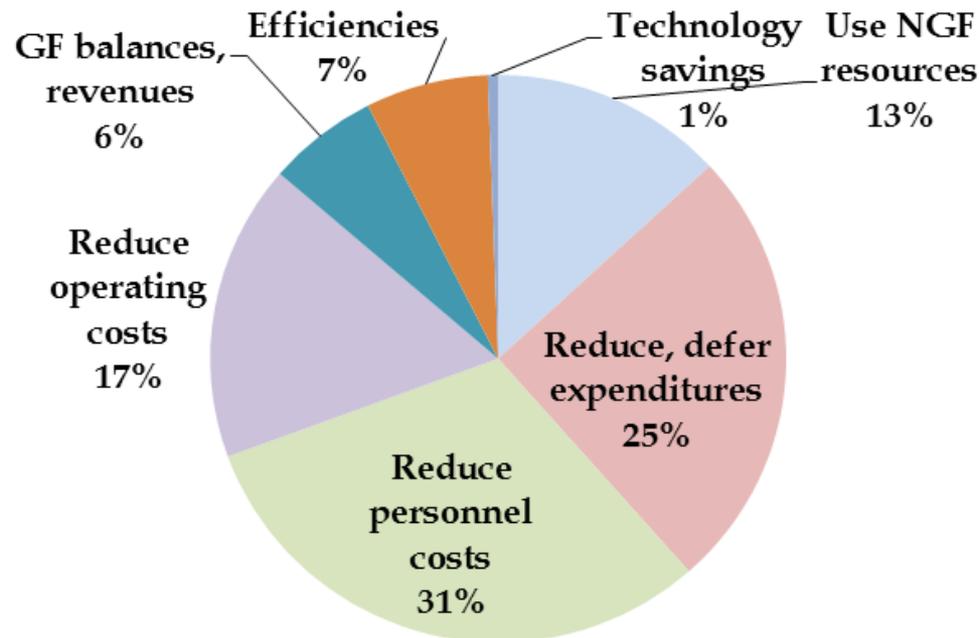
FY 2015 State Agency Reductions

- State agencies have received approval for \$92.4 million in reduction strategies for FY 2015; slightly less than half appear to be one-time.



FY 2015 Reductions to Higher Education

- Higher education reductions of \$45.0 million each year. Targets based on each institution's in-state/out-of-state mix and revenue capacity; actual cuts range from 0.9 to 6.6 percent.
 - About half of the strategies for FY 2015 rely on NGF and one-time sources.
 - Tuition increase offsets were discouraged as a strategy in FY 2015.



Reductions to Local Aid

- Savings from reductions in state aid to local governments of \$30.0 million each year.
 - Targets have been established by the Department of Planning and Budget and communicated to localities last week.
 - Targets were distributed among localities based on a *pro rata* share of total local aid received.
- K-12 and car tax reimbursement are **excluded** from the targets.
 - With those exclusions, \$30.0 million is about 0.3 percent of total local aid funding.
- Localities have the option of either designating programs for targeted reductions or submitting payment to the Commonwealth.
 - Localities have until January 9 to make arrangements, or rolling stock and recordation tax distributions will be withheld by the Comptroller.



Budget Pressures for 2015 Session

- Few incremental spending pressures anticipated for the amended 2014-16 biennial budget.
 - Medical costs for inmates and jail per diem payments are the major incremental high priority, mandated spending items.
- While typically an area with an upward funding adjustment in the short session, the Medicaid program will see savings over the current forecast, even after spending required by the Governor's initiative.
- No discretionary funding for high priority programs such as public and higher education, mental health, or salary adjustments.
- **Strategies to cover the Miscellaneous Reversion of \$272.0 million in FY 2016 will be addressed by the Governor in December in his proposed amendments to the budget.**



Public Safety

- Department of Corrections: \$44.4 million GF for increased inmate medical costs for the 2014-16 biennium. Three components:
 - New contract with Armor for inmate medical care at 17 sites as of 10/1.
 - Old contract with Corizon terminated because vendor could not deliver required services at the cost which they bid two years ago.
 - \$10.0 million in FY 2015 and \$21.6 million in FY 2016.
 - Increased system-wide costs for off-site medical care (inpatient and outpatient).
 - \$2.7 million in FY 2015 and \$5.7 million in FY 2016.
 - Increased costs for Hepatitis-C drugs.
 - \$1.7 million in FY 2015 and \$2.7 million in FY 2016.
- Compensation Board, Jail Per Diems: \$29 million GF.
 - Approximately \$13 million in FY 2015 and \$16 million in FY 2016.
 - Reflects increased backlog of state prisoners in jail due to prison closures, as well as the previously projected increase in the local-responsible offender population.



Medicaid Forecast

- Medicaid spending will see a **net reduction** of \$194.3 million for the biennium, on a current biennial base of \$8.5 billion.
 - FY 2014 expenditures fell \$137.0 million below forecast due to pharmacy rebates, less indigent care (reached DSH limits), and lower enrollment in dental care for children.
 - Expected growth of about 4.0 percent in FY 2015 against the 6.6 percent rate assumed in the current budget due to slower growth in enrollments and lower payments to Medicaid managed care organizations.
- Savings offset by \$10 million more for the new program for “dual eligibles”, and inclusion of the Governor’s Healthy Virginia initiative, which totals about \$123 million.

(GF \$ in millions)	FY 2015	FY 2016	2014-16
Comm. Coordinated Care	\$11.7	(\$1.8)	\$ 9.9
Governor’s Access Plan (GAP)	13.5	78.3	91.8
Outreach to Children	1.7	17.0	18.7
Dental Coverage for Pregnant Women	0.3	1.6	1.9
Cover State Emp. Children	0.1	2.3	2.4
Behavioral Health Homes	0	8.6	8.6



2014-16: Spending and Savings Items

<i>(GF \$ in millions)</i>	<u>FY 2015</u>	<u>FY 2016</u>	<u>2014-16</u>
Medicaid Forecast Adjustment (net)	(\$127.8)	(\$66.5)	(\$194.3)
FAMIS, MCHIP	0.0	5.0	5.0
Health Care Fund: Offset Tobacco Taxes	10.0	10.0	20.0
DBHDS: Geriatric Fac. Loss of Funding	11.1	26.6	37.7
Other HHR (e.g. admin IT systems)	0.6	16.9	17.5
DOC: Inmate Medical Expenses	14.4	30.0	44.4
Comp Board: Jail per diems	13.0	16.0	29.0
Criminal Fund	9.0	8.0	17.0
HE: Financial Aid – at current level	0.0	26.0	26.0
HE: New Facilities On-Line	0.0	13.2	13.2
DSS: Foster Care to Age 21	0.0	5.7	5.7
Other (SBE, STARS, Medevac)	4.5	6.4	10.9
K-12: Lower ADM, Sales Tax, Tech	(8.8)	(9.5)	(18.3)
Additional Lottery Proceeds	<u>(4.5)</u>	<u>(21.7)</u>	<u>(26.2)</u>
Total	(\$78.5)	\$66.1	(\$12.4)



Budget Outlook 2015 Session

- Additional revenues and net budget savings generate available resources of about \$170 million.
 - First call may be either reducing reversions, or putting aside dollars for FY 2017 Rainy Day Fund deposit of \$157 million.

2014-16 Amended Budget			
(GF \$ in millions)			
	<u>FY 2015</u>	<u>FY 2016</u>	<u>2014-16</u>
Chapter 3 (2014)	\$17,462.5	\$17,872.4	\$35,334.9
Revenue Adjustment	\$ 56.9	\$110.5	\$ 167.4
Transfers	(4.9)	(5.2)	(10.1)
Total, Add'l. Resources	\$ 52.0	\$105.3	\$157.3
Budget Pressures	(78.5)	66.1	(12.4)
Net Available Resources	\$130.5	\$ 39.2	\$169.7
Undesignated Reversions	\$ 49.8	\$272.0	\$321.8



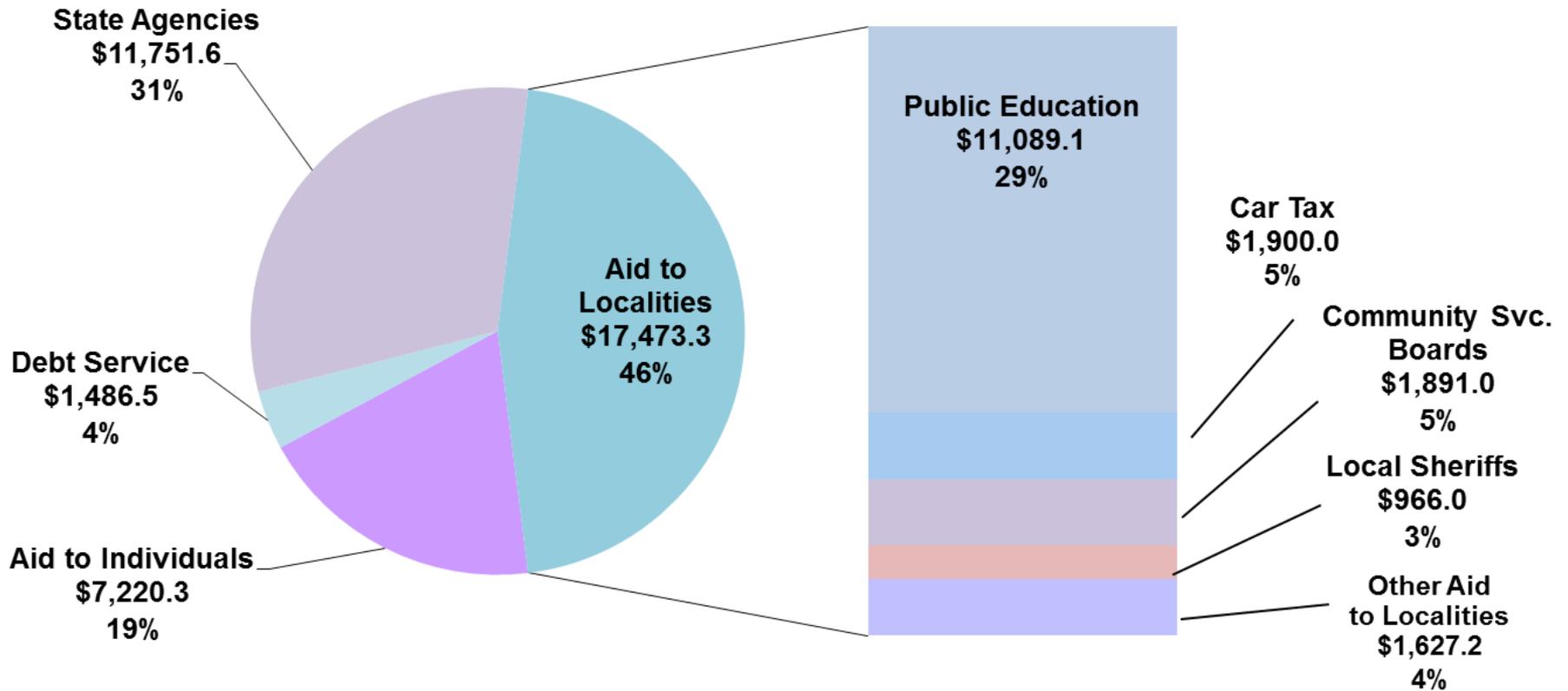
Options to Address Remaining Cuts

- Increase designated reductions in reversion clearing accounts for state agencies, higher education, and local government in FY 2016.
- Make targeted reductions to those programs that were not included in the reversions, namely K-12 public education and Medicaid.
- Identify additional resources:
 - Fees, tuition increases, shift GF to NGF sources.
 - Revisit tax policy choices.
- Some options are off the table – transportation, VRS.
- Think ahead to development of the NEXT biennial budget:
 - Avoid using one-time resources or savings to balance budget.
 - First additional dollar next biennium will go toward:
 - Replacing \$237.5 million in Rainy Day Funds propping up FY 2016.
 - Deposit of about \$157 million to the Rainy Day Fund required in FY 2017.



General Fund Budget Drivers

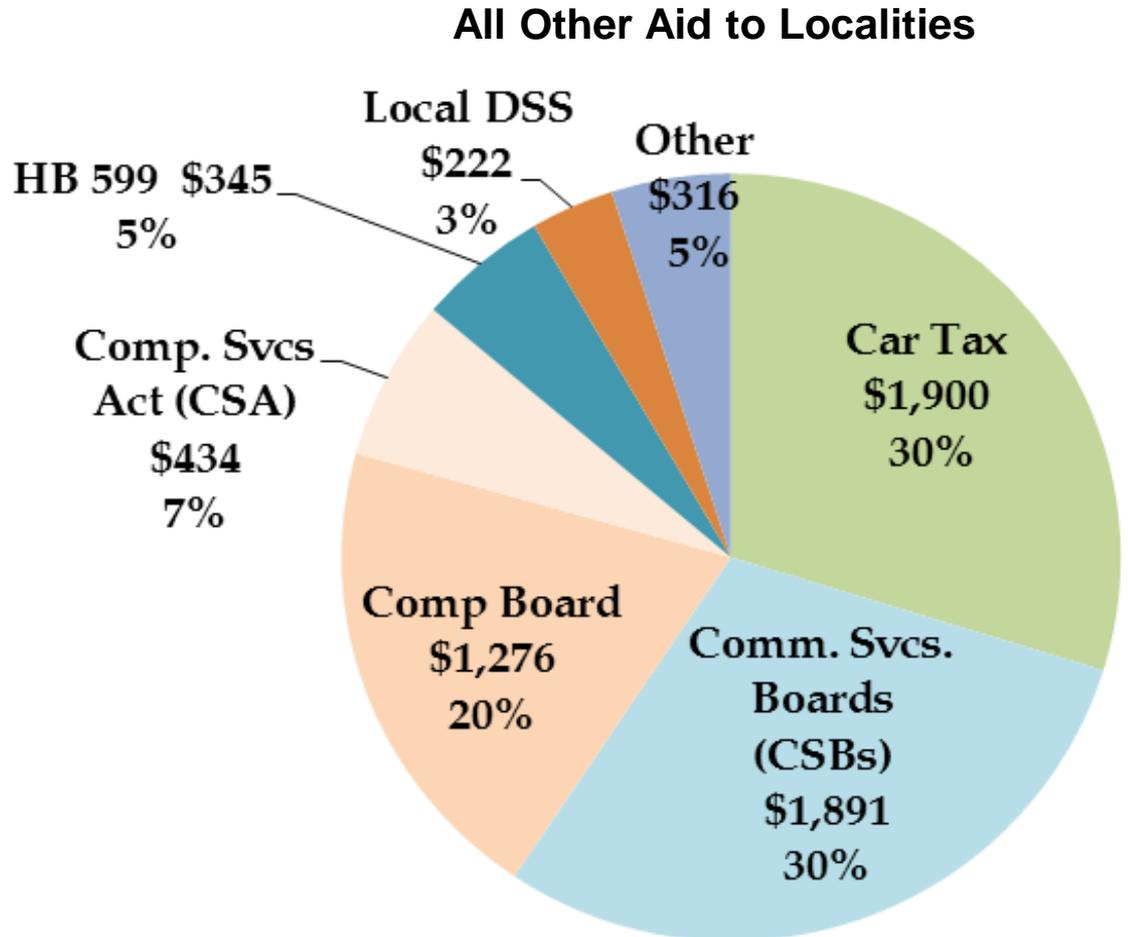
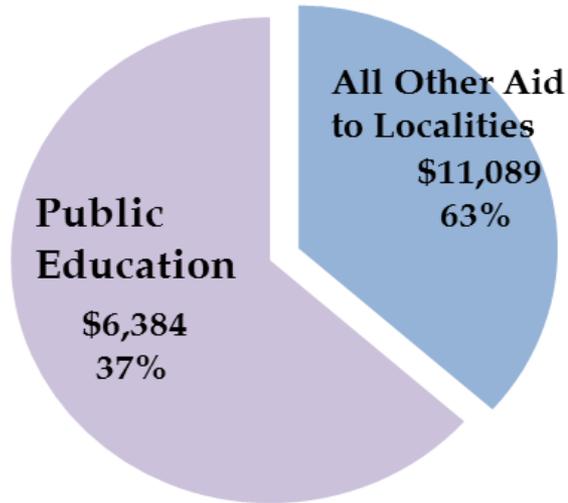
2014-16 GF Operating Budget = \$37.9 billion
Chapter 2 (\$ in millions)



Aid to Localities

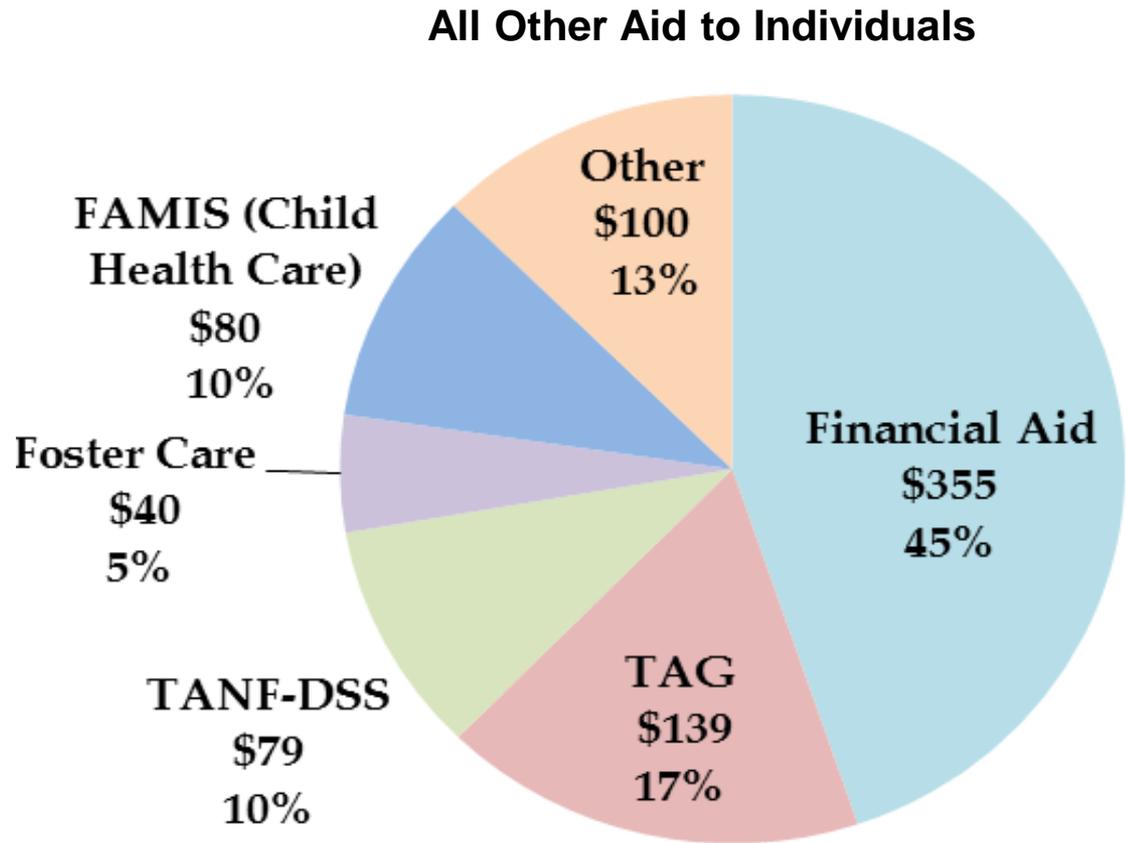
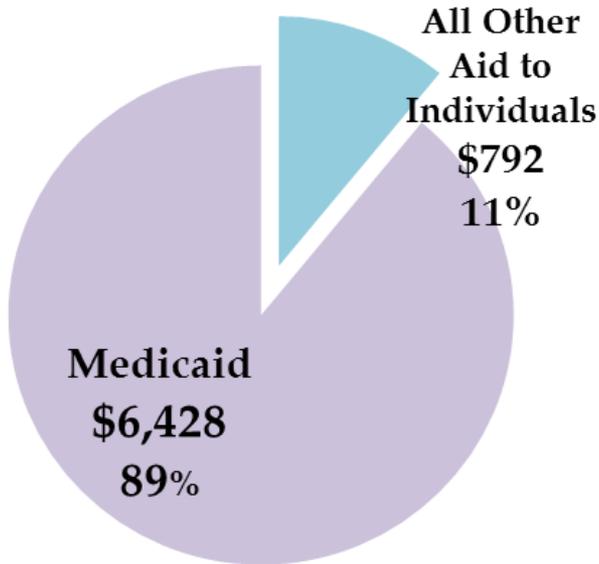
2014-16 = \$17.5 billion

Ch. 2, GF \$ in millions



Aid to Individuals 2014-16 = \$7.2 billion

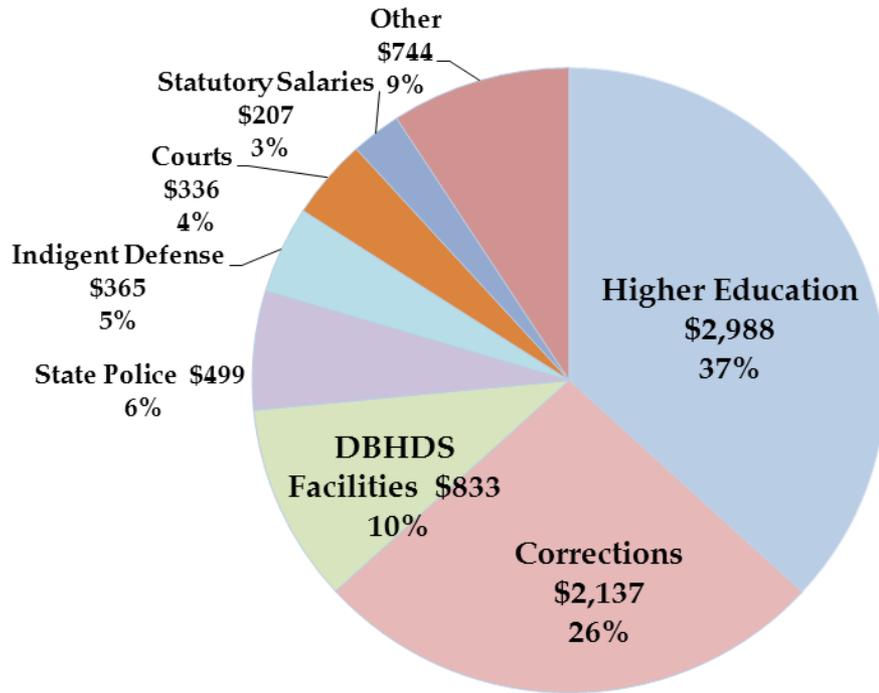
Ch. 2, GF \$ in millions



Major Systems & Other State Programs 2014-16 = \$10.6 billion

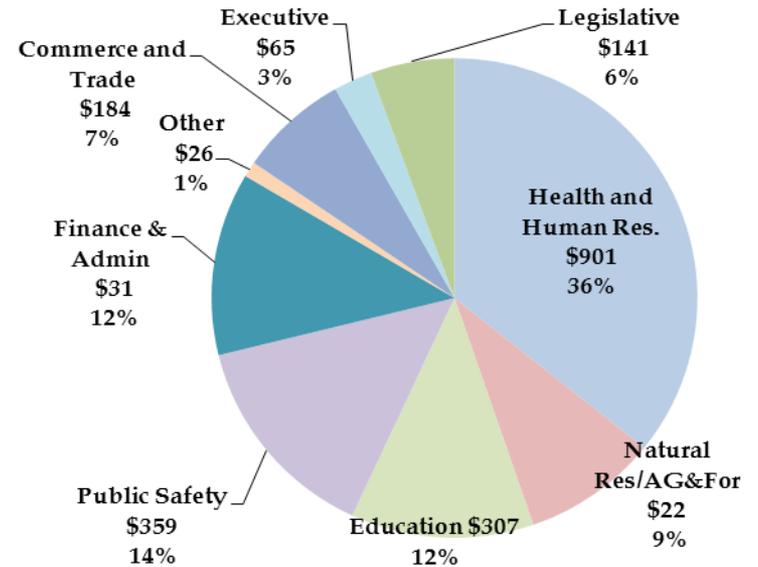
Major State Programs & Systems = \$8.1 billion

(Ch. 2, GF \$ in millions)



All Other Programs = \$2.5 billion

(Ch. 2, GF \$ in millions)



Next Steps

- Governor's Advisory Council on Revenue Estimates (GACRE) meets next week to react to economists' recommendations.
 - Despite interim forecast, Governor required to reconvene economic advisory groups.
- Joint Money Committees meet December 17th to hear Governor's budget recommendations.
 - Chapter 3 (supplemental budget bill) will be incorporated into the amended Chapter 2, 2014-16 biennial budget.
 - Governor may modify any and all aspects of the budget, as can the General Assembly.
 - Changes to FY 2015 more difficult to make than FY 2016.
- Revenues will be monitored throughout the session, with a potential mid-session re-forecast in early February.



Not Business as Usual: Challenges of the 2015 Session, and Beyond

- The foundations of Virginia's economy are shifting. To adapt will require the Commonwealth to:
 - Improve educational preparation and attainment to create a competitive workforce.
 - Provide post-secondary education, training, and credentials to further develop the workforce.
 - Maintain a “best for business” environment; encourage entrepreneurship and small firm formation.
- With limited incremental revenue growth, making new investments to foster economic growth will be a challenge. Strategies include:
 - Scrutinizing current spending to better align with priorities of an evolving economy.
 - Evaluate core functions and services of state government with an examination of alternate providers (private sector or local government).
 - Identify new resources; update tax policies to better meet current needs.

