2018 Session
Budget Outlook

November 16, 2017

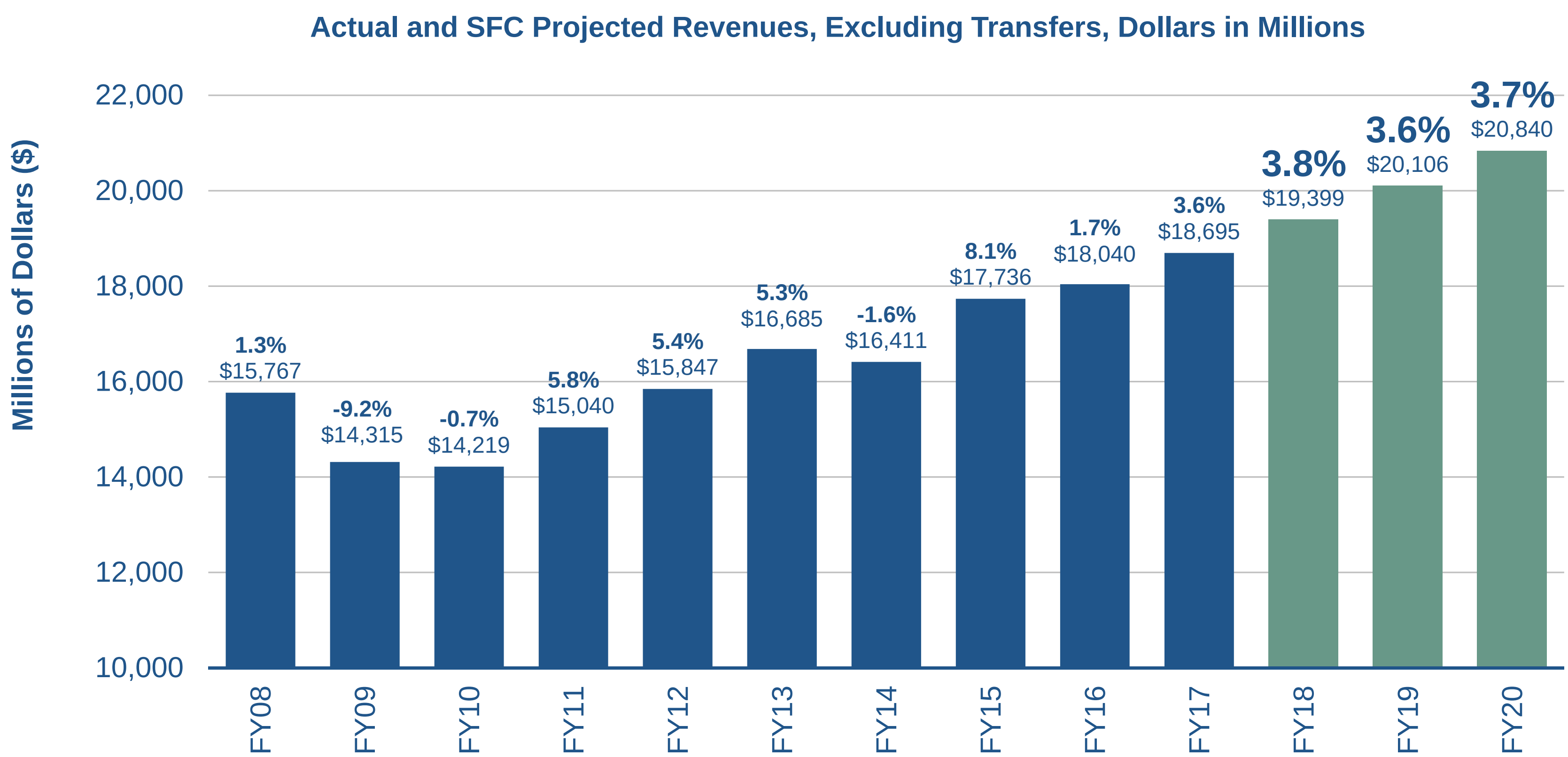
Outlook for the 2018 Session – Key Takeaways

- Bottom line: Resources for the 2018-20 biennium are projected to be adequate to cover growth in major budget drivers (Medicaid, K12 re-benchmarking).
- Little will remain for other spending priorities.
- Rebuilding the Rainy Day Fund (RDF), or a back-up cash reserve, will be a priority.
  - RDF balance will be $282 million at the end of the 2016-18 biennium.

Topics:

- GF Revenue Outlook
- Recap of 2016-18 Biennium
- 2018-20 Budget Pressures

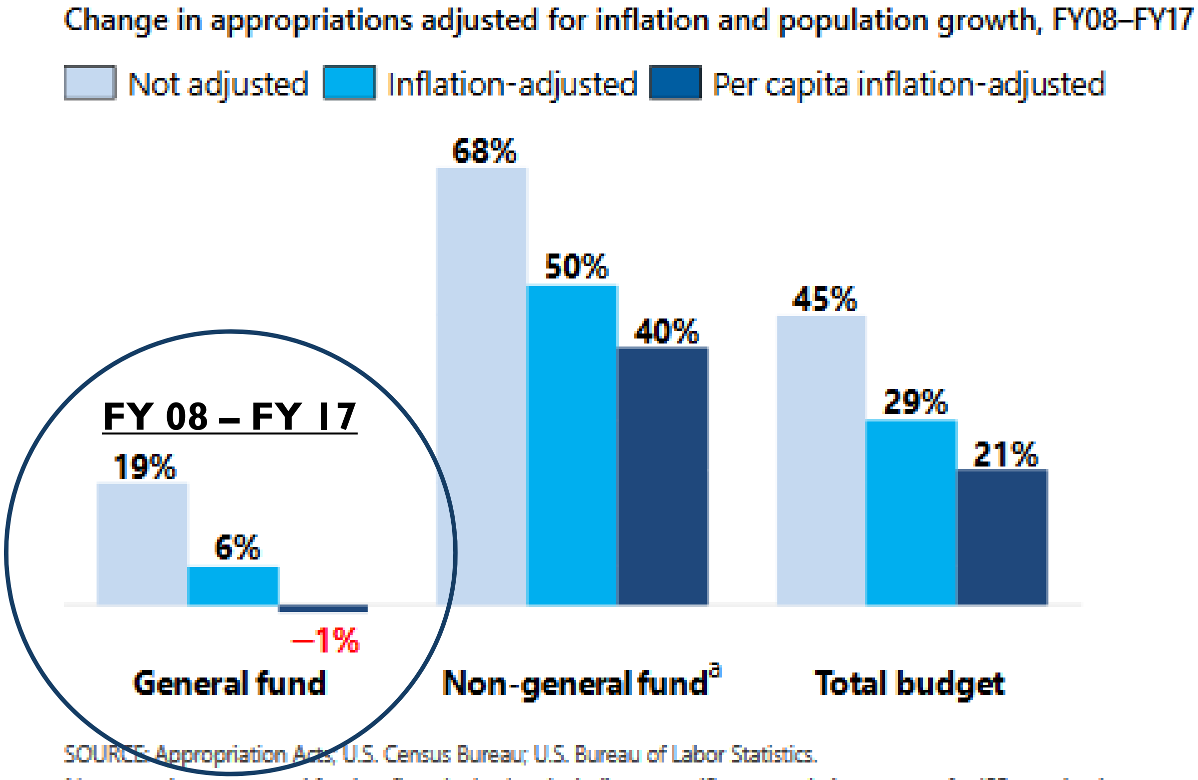
Modest Revenue Growth Expected



*FY 2019 growth rates are adjusted for Tax Amnesty. Unadjusted, total GF revenue growth in FY 2019 is estimated at 4.1%.

After a Decade of Modest GF Growth

GF Average Annual Growth of 2%; Negative if Adjust for Inflation and Population Growth



SOURCE: Appropriation Acts; U.S. Census Bureau; U.S. Bureau of Labor Statistics.
[a] Increases in non-general funds reflect the budget including a specific appropriation amount for ISFs starting in FY15.

Source: JLARC, 2017 State Spending Report

Recap of the Current Biennium (2016-18 Biennium)

Tale of Two Sessions
Sound 2016 Budget Actions Mitigated Impact of FY 16 Shortfall

- ***2016 Session.*** *Adjourned in March 2016 with an adopted Conference Report for HB 30 that provided $3.4 billion above the base budget -- to cover growth in major budget drivers and allow for new investments in economic development and research, along with a renewed emphasis on structural balance (VRS obligations).*

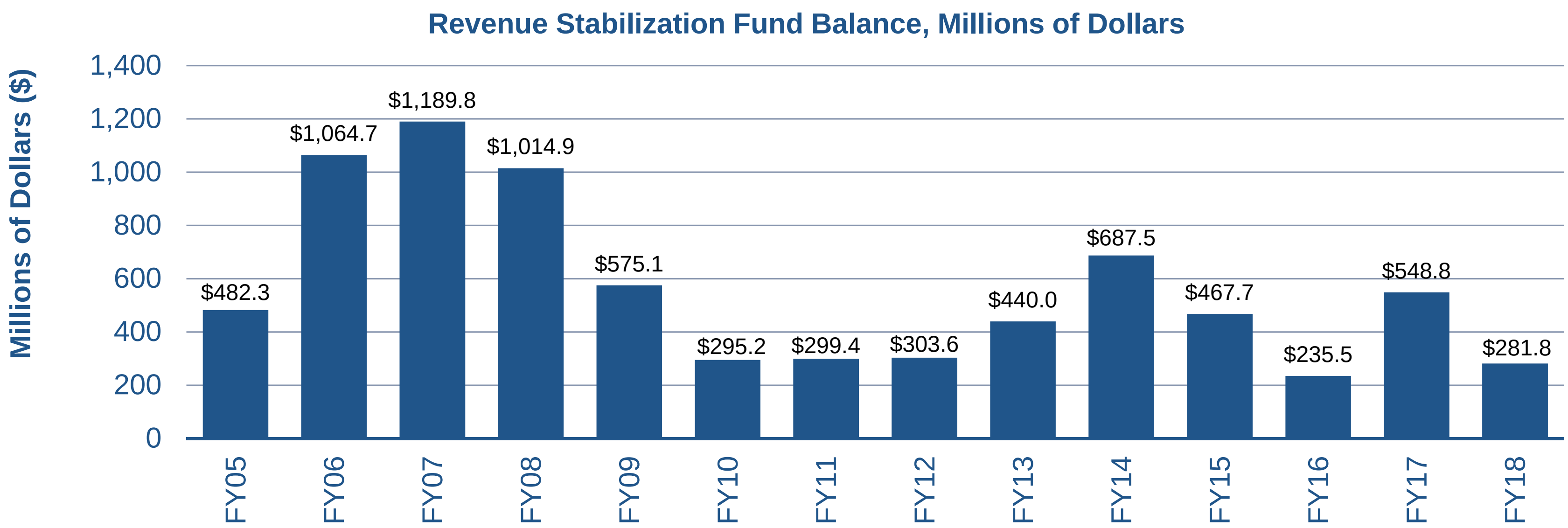
- ***2017 Session.*** *Opened in January 2017 with introduced budget nearly $1 billion less in forecast revenue.*
  - Revenue growth did not improve in the final quarter of FY 2016, resulting in $279.3 million shortfall that led to the ripple effect in FY 2017 and FY 2018.

Strategies to Close the 2016-18 Budget Gap

- *Many actions were included in October 2016 budget reduction plans for FY 2017 and then extended into FY 2018 in the amended budget:*
  - ***$567.2 million withdrawal from the Revenue Stabilization Fund.***
  - ***$347.2 million by eliminating Dec. 2016 contingent salary actions (in effect they were delayed until FY 2018).***
  - ***$175.5 million in across-the-board reductions to state agencies and institutions of higher education.***
  - ***$89.5 million from a Tax Amnesty program.***
  - *$58.0 million Literary Fund/GF Offset to Teacher Retirement.*
  - *$52.3 million in additional Lottery revenue.*
  - *$47.9 million by slowing the elimination of the Accelerated Sales Tax (AST).*
  - *$43.5 million to recover Higher Education NGF share of VRS savings.*

Use of Rainy Day Fund to Help Close the Budget Gap

- There was a required deposit of $605.6 million in FY 2017, based on FY 2015 revenue growth.
- **Budgeted withdrawals of $294.7 million in FY 2017 and $272.5 million in FY 2018.**
- APA certifies no mandatory deposit in FY 2019, but FY 2018 balance is well short of the $1 billion withdrawals that were utilized in the 2002, 2008, and 2015-2017 rounds of withdrawals.



- In April 2017, S&P issued a "negative" outlook (from "stable") for Virginia's AAA rating, citing concerns about the budgeted withdrawals from the Revenue Stabilization Fund.

Other Budget Actions in 2017 Session

- *In addition to eliminating the shortfall, the General Assembly:*
  - *Restored in the second year of the budget, the delayed across-the-board compensation increase as well as targeted initiatives.*
  - *Maintained commitment to annual full funding of VRS contributions.*
  - *Advanced the GO Virginia initiative to enhance regional cooperation in economic development.*
  - *Initiated an early warning system to identify localities that may be experiencing financial distress and established a Joint Subcommittee on Local Fiscal Stress.*
  - ***Created a Revenue Cash Reserve of $35 million, and directed that half of any FY 2017 revenue surplus be set aside to increase the cash reserve.***

FY 2017 Ended with $134.1 million Revenue Surplus

- Chapter 836 called for at least 50 percent of any FY 2017 revenue surplus, not required for the Rainy Day Fund or the Water Quality Improvement Fund ($13.4 million), to be placed in a Cash Reserve to help address revenue shortfalls or federal budget actions = **$60.4 million.**
  - Continued use of the "collar" on the nonwithholding forecast mitigates volatility risk and contributed to the surplus.
- Remaining surplus is reserved by the Comptroller for a Capital Projects Reserve (one-time spending) = **$60.4 million.**
  - If this amount were added to the FY 2018 Reserve and the other FY 2017 surplus set-asides, the Cash Reserve would be $156+ million.

FY 2018 Will Increase From Ripple Effect of FY 2017 Surplus

- SFC Staff estimates additional FY 2018 resources of $210.0 million.

- After addressing anticipated budget pressures in FY 2018, a net balance of $159.0 million is projected as the starting point for 2018-20 biennium.

Turning to the Next Biennium
2018-20 Budget Pressures

Calculating the Base Budget

- **Base budget** = cost of maintaining **current** services and caseloads (FY 2018 appropriation).
- **One-time** spending items are **deducted** from the base year budget (e.g cash reserve, transition costs).
- On-going items that are **not fully funded** in FY 2018 are **added** to the base (e.g. partial-year salary increase).

2018-20 GF Base Budget Calculation ($ in millions)	
Ch. 836, FY 2018 GF Approp. X 2	**$40,709.2**
Minus: One-time Spending	(90.5)
Plus: Technical Adjustments	26.9
Total, Adjustments to Base	**(63.6)**
Biennial (Two-Year) GF Base	**$40,645.6**

Two Budget Bills

- In even-numbered sessions, action is taken to amend the current year budget (FY 2018) and to adopt a budget for the biennium that starts July 1, 2018.
  - **SB 29 ("Caboose Bill")** – Amends the CURRENT budget (Ch. 836) to reflect revised revenue estimate, required spending, and any savings in FY 2018.
    - Goes into effect when signed by the Governor.
  - **SB 30** – the proposed biennial budget for the next two fiscal years, FY 2019 and FY 2020.
    - Goes into effect on July 1, 2018.

Developing the 2018-20 Budget

Comparing projected resources to the current base budget.

($ in millions)	FY 2019	FY 2020	2018-20
Revenue Growth Rates	3.6%	3.7%	
Total SFC GF Resources	$20,710.0	$21,459.0	$42,169.0
GF Base Budget	$20,322.8	$20,322.8	$40,645.6
Resources Above Base	$387.2	$1,136.2	$1,523.4
Balance Forward from FY 2018[1]	159.0	0.0	159.0
Available Resources	$546.2	$1,136.2	$1,682.4

[1]FY 2018 additional $210 million revenue net of required spending.

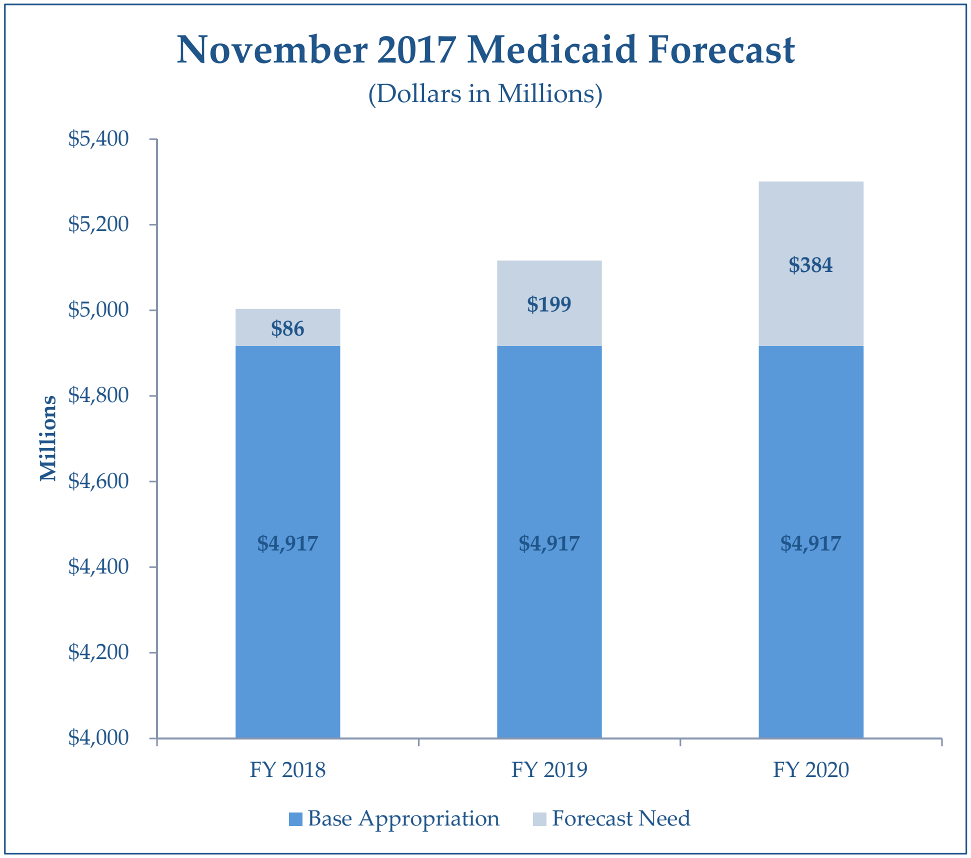
2018-20 Budget Pressures

Agencies Have Submitted Almost $2.5 Billion in Total Requests to the Department of Planning and Budget

($ in millions)		FY 2018	FY 2019	FY 2020	Biennial
Available Resources:			***$ 546.2***	***$ 1,136.2***	***$ 1,682.4***
HHR	DMAS: Medicaid Utilization & Inflation	86.7	199.5	384.4	583.9
	DMAS: Children's Health Ins. (CHIP)	0.9	2.2	61.9	64.1
	Children's Services Act (CSA)	1.4	21.6	43.4	65.0
	DOJ Required Slots		17.2	36.3	53.5
	Implementation of STEP-VA		14.6	14.6	29.2
K-12	SOQ Rebenchmarking	(5.8)	235.0	256.8	491.8
	SOQ - VRS Rates		(21.2)	(21.2)	(42.4)
	Lottery Forecast	(52.0)	(40.2)	(40.2)	(80.4)
	SOQ - Other	0.7	7.1	20.1	27.2
	Literary Fund		35.0	35.0	70.0
General Government	VRS Rates		(6.5)	(6.5)	(13.0)
	Employee Health Care		33.7	84.6	118.3
	Dept. of Elections		3.5	3.5	7.0
	VEAP Debt Retirement	2.3			
Public Safety	DOC Medical Costs	16.8	20.3	25.2	45.5
Total, Budget Pressures		**$ 51.0**	**$ 521.8**	**$ 897.9**	**$ 1,419.7**
Difference Between Resources/Pressures			***$ 24.4***	***$ 238.3***	***$ 262.7***

Medicaid Forecast

- FY 2018 requires additional funding of **$86 million GF**
- The 2018-20 Biennial GF Need is **$583 million GF**
- Official forecast anticipates GF spending increases:
  - 6.5% in FY 2018
  - 2.3% in FY 2019
  - 3.4% in FY 2020

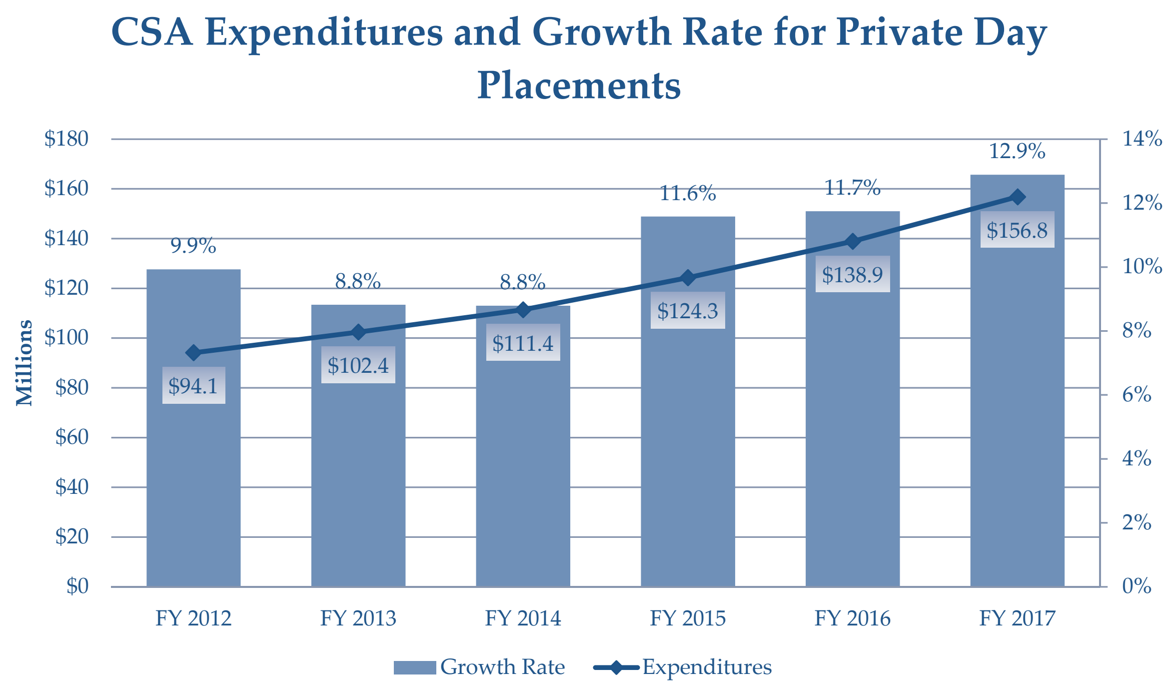


Medicaid Forecast Drivers

- Enrollment Growth is stable at around 2.0%
- Managed Care rate increases:
  - 2.5% in FY 2019 and 3.8% in FY 2020 for the Medallion program (existing managed care program)
  - 2.4% in FY 2020 and 3.5% in FY 2020 for CCC Plus (new managed care program)
- Hospital Inflation – 2.8% in FY 2019 and 3.0% in FY 2020
- Nursing Home Inflation – 2.9% in FY 2019 and 3.0% in FY 2020
- Behavioral Health Services Continue to Grow
- Medicare Premiums
  - Part D increase is 1.22% for 2018, 5% assumed in out-years for Parts A, B and D

Children's Services Act

- The majority of growth is due to **private day placements** through special education in public schools.
- Projected GF need in FY 2019 is **$21.6 million** and in FY 2020 is **$43.4 million**.



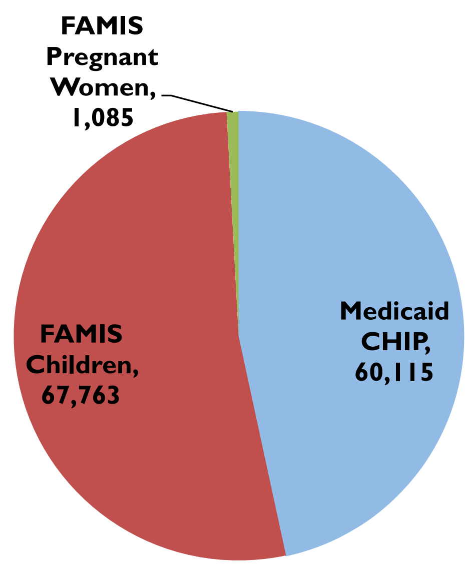
Summary of HHR Budget Pressures

Budget Item	FY 2018	FY 2019	FY 2020
Medicaid Forecast	$86.7	$199.5	$384.4
Children's Health Ins. Program	0.9	2.2	61.9*
Children's Services Act	1.4	21.6	43.4
Required DOJ Waiver Slots	-	17.2	36.3
Implementation of STEP-VA	-	14.6	14.6
Totals	**$89.0**	**$255.1**	**$540.6**

* The enhanced federal match rate of 88 percent, provided in the Affordable Care Act, expires September 30, 2019. The normal match rate is 65 percent.

Reauthorization of CHIP: Impact of Inaction

- Children's Health Insurance Program expired September 30;
- Congress has not reauthorized the program;
- Program has funding through January;
- Children aged 6 – 19 with family income of 109 to 143% of poverty must be covered under Medicaid, so will be covered regardless of reauthorization.



November 2017 Enrollment

Fiscal Impact on State

FY 2018	FY 2019	FY 2020
$34.7m	$79.0m	$81.6m

K-12 Re-benchmarking

- Re-benchmarking is the formula-driven ("technical") cost adjustment to meet the SOQ minimum staffing requirements and related support services (updates from FY 2014 to FY 2016 base year actual data).

($ in millions)		Preliminary Estimate (September)	Other Updates To-Date	Revised Total	Percent Change Over Prior Year
FY 2018 Base Budget	$6,761.5				
FY 2019		235.0	(54.4)	180.6	**2.7%**
FY 2020		256.8	(41.4)	215.4	**0.5%**
Biennial		**$491.8**	**($95.8)**	**$395.9**	

K-12 Re-benchmarking

- Additional funding of about $395.9 million for the biennium.
  - Partial estimate for re-benchmarking (as presented to SFC on October 19) of $235.0 million in FY 2019 and $256.8 million in FY 2020 reflects teacher salaries, health insurance, inflation, and textbooks.
  - Preliminary savings for updated Composite Index and Average Daily Membership enrollment.
  - Offset by about $21.2 million in savings in FY 2019 and in FY 2020 for VRS and Retiree Health Care Credit rates.
  - $40.2 million per year in additional NGF Lottery Proceeds available to fund education programs.
- Other adjustments will likely include annual assumed savings from Virginia Preschool Initiative slots.

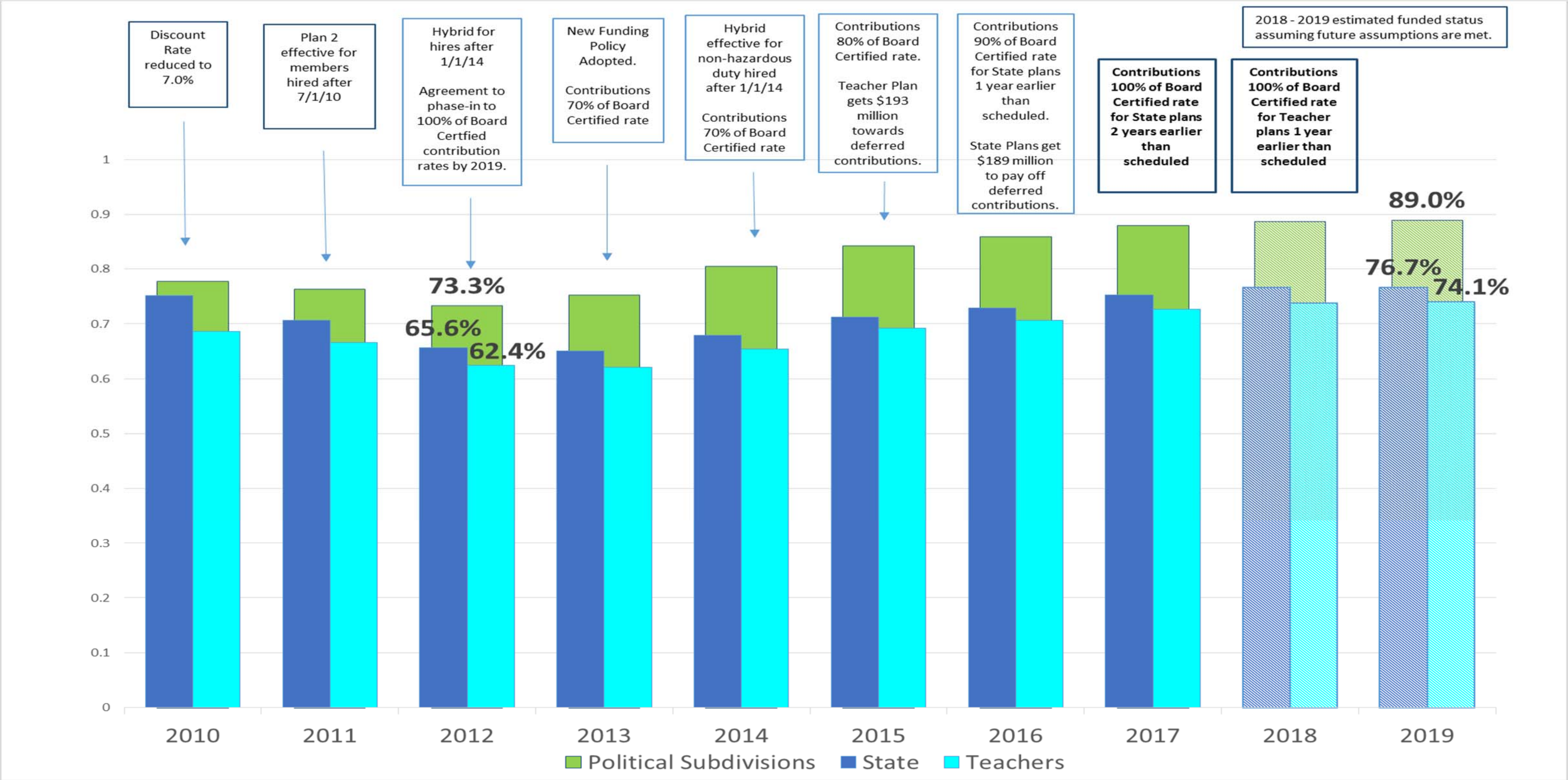
Some Relief on Retirement (VRS) Contribution Rates

- Three factors – strong investment returns of 11.7 percent for FY 2017, full payment of annual employer contributions, and reduced plan costs from pension reform – have contributed to significant improvement in the retirement plans' funded status and budgetary relief on rate changes.

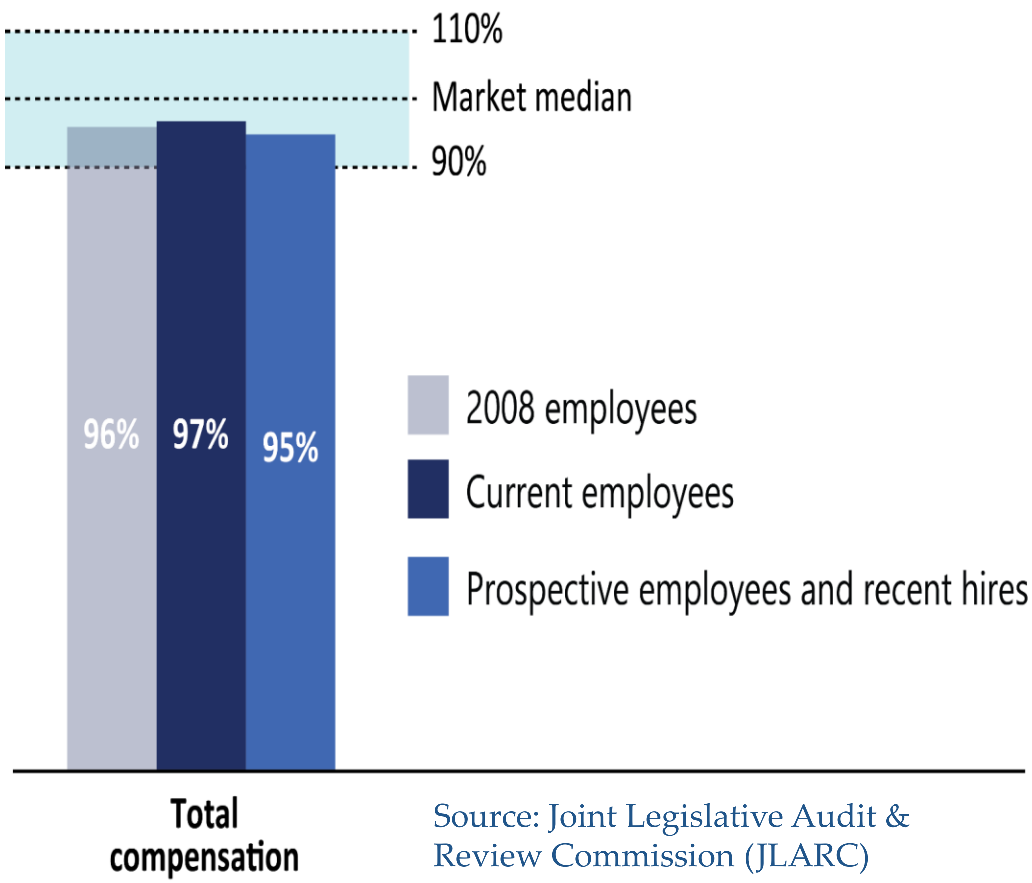
	General Assembly Approved Rate (FY 2018)	VRS Board Approved Rates (2018-20 Biennium)	Change	Annual Cost/ (Savings)
Teachers	16.32%	15.68%	**(0.64%)**	**($21.4M)**
State	13.49%	13.52%	**0.03%**	
VaLORS	21.05%	21.61%	**0.56%**	
SPORS	28.54%	24.88%	**(3.66%)**	**($6.5M)**
Judicial	41.97%	34.39%	**(7.58%)**	

* Approximately 2/3 of the employer rates are due to amortizing the unfunded liability.

VRS Funded Status Steadily Moving Up



Total Compensation Should Continue to Be Addressed Strategically



Source: Joint Legislative Audit & Review Commission (JLARC)

2017 JLARC Report Key Findings:

- Combination of salary and benefits is comparable to other Virginia employers on average.
- Salaries are slightly below market median, while benefits are above market median.
- Competitive starting salaries are key for recruitment, and regular salary growth improves retention.
- State could strategically spend funds on targeted salary increases for jobs with greatest recruitment and retention challenges.

Other Potential Funding Items

- **Salary Increase –** 1 percent increase for classified state employees/state-supported locals = $34.1 million per year.
- **Teacher Salary Increase –** 1 percent increase = approximately $40 million per year.
- **Faculty Salary Increase –** 1 percent increase = $9.6 million GF per year.
- **Public Safety –** High turnover DOC positions; Culpeper opening; State Police tactical team; IT security.
- **Higher Education –** SCHEV recommendations = $241.1 million GF over the biennium.
- **Capital Outlay –** $800 million in projects in the planning stage; additional needs.
- **Economic Development –** GO Virginia and Economic Development Incentives funding requests.
- **Education Initiatives –** State Board SOQ revisions for counselors, social workers, nurses.

Recap

Comparing projected resources to spending needs.

($ in millions)	FY 2019	FY 2020	2018-20
SFC Total GF Resources	**$20,710.0**	**$21,459.0**	**$42,169.0**
GF Base Budget	$20,322.8	$20,322.8	$40,645.6
Resources Above Base	$387.2	$1,136.2	$1,523.4
Plus: FY 2018 Balance Forward*	159.0	0.0	159.0
Available Resources	**$546.2**	**$1,136.2**	**$1,682.4**
Less:			
Budget Pressures	**$521.8**	**$897.9**	**$1,419.7**
Available Resources for All Other Items	**$24.4**	**$238.3**	**$262.7**

*FY 2018 additional revenue net of required spending.

Next Steps

- Governor's Advisory Committee on Revenue Estimates (GACRE) meets next week to react to economists' recommendations.
- Joint Money Committees meet on Monday, December 18th to hear Governor McAuliffe's budget recommendations.
- Revenues will be monitored throughout the session, with a potential mid-session re-forecast in mid-February.

Challenges of the 2018 Session

- Although resources should be adequate to cover major budget drivers, not much left for other items.
- FY 2019 will be a bigger challenge than FY 2020.
- Rebuilding the Rainy Day Fund, or a less restrictive cash reserve, and continuing to improve structural balance, becomes increasingly important as the recovery goes beyond 10 years and federal actions play out.
- On-going actions to address challenges:
  - Scrutinize current spending and weigh core functions and services of state/local government.
  - Assess the shift in sales tax collections; examine tax preferences that narrow the tax base.
  - Continue to foster economic growth through education/economic development.

Appendix

Where The Money Goes