

# **The State Budget “The Train Derailed”**

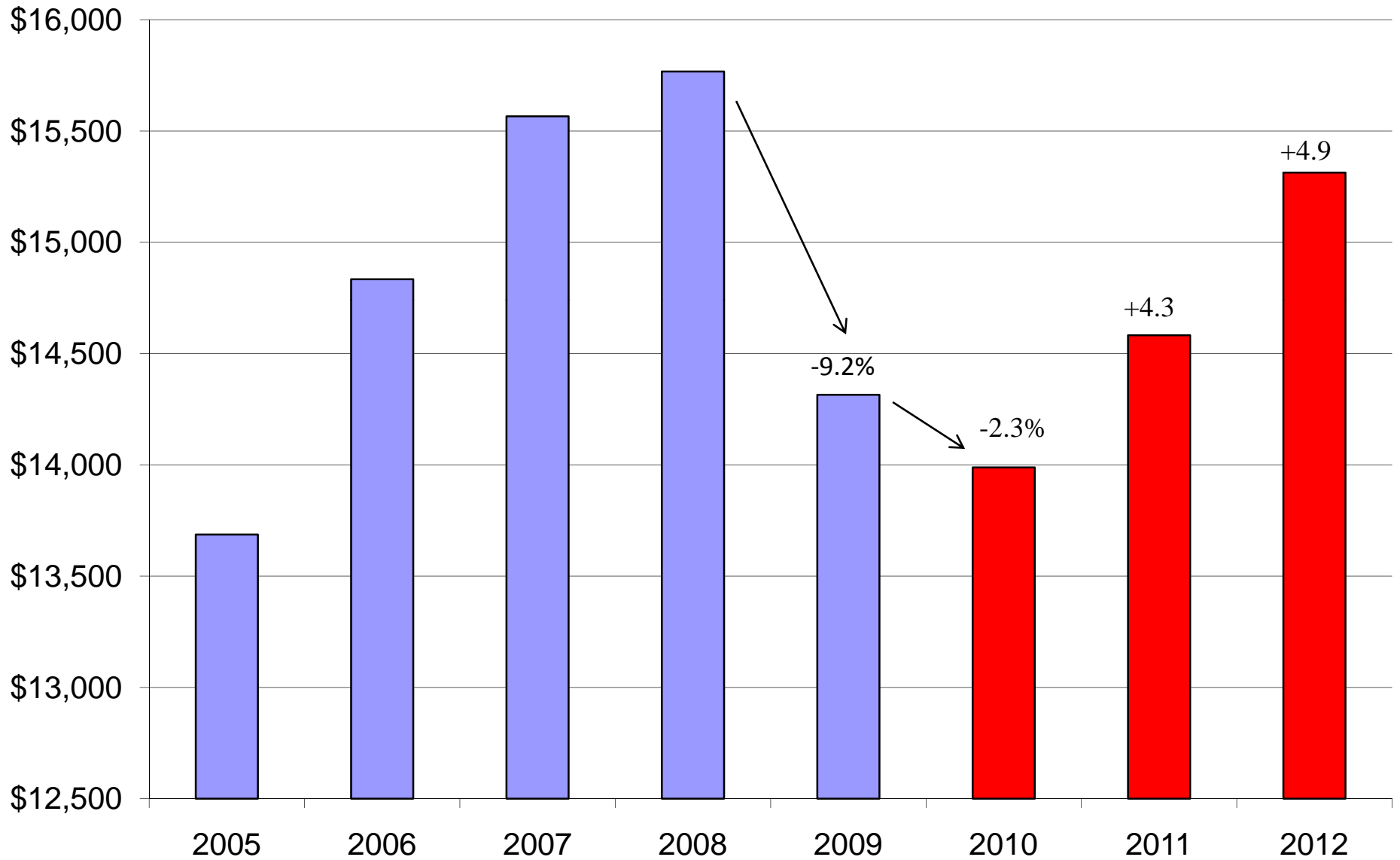


Prepared for the  
Virginia Government Finance Officers Association  
May 2010

# The \$4.5 Bil. 2010-12 Budget Gap was Primarily Due to:

- Dramatic revenue slowdown
- Previous use of one-time budget reductions
  - Rainy Day Fund, debt for cash, balances
- Expiring federal stimulus funding
- Additional spending pressures, particularly for the Medicaid program.

# 2010 Session Adopted General Fund Revenues in FY 2012 Less Than FY 2007



## Fiscal Year 2010 GF Revenue Changes

	\$ Mil.
<b>Original Forecast 2008 Session</b>	<b>\$17,190.1</b>
December 2008 Reforecast	(\$1,744.6)
February 2009 Reforecast	(\$418.3)
August 2009 Reforecast	(\$1,182.6)
December 2009 Reforecast	(\$340.0)
February 2010 Reforecast	\$82.5
All Policy Changes	\$401.5
<i>Accelerated sales tax</i>	<i>\$241.8</i>
<i>Tax Amnesty</i>	<i>\$102.1</i>
<i>Reduce LPTC Max Claim</i>	<i>\$50.0</i>
<b>Current 2010 Session Estimate</b>	<b>\$13,988.6</b>

## **Major "One Times" More Than Half of Strategies to Close the 2008-10 Budget Gap**

	<u>GF Millions \$</u>
Rainy Day Fund Withdrawal	\$783
Sales Tax Acceleration/LPC Adjust/Tax Amnesty	\$394
Bonded Debt for GF Capital	\$355
Delay 4th Q VRS Retirement/Benefit Payments	\$135
State Employee Furlough	\$16
Transfer Fire Programs Fund to GF	\$26
Enhanced ARRA SFSF Medicaid Match	\$1,059
ARRA SFSF - Flexible Funds	\$219
ARRA SFSF - K12 & Hi Ed Education	\$805
<b>Total Major "One-time" Budget Strategies</b>	<b>\$3,792</b>

# Governor Kaine Strategy To Close 2010-12 Budget Gap

- Eliminate the \$1.9 bil. car tax reimbursement program\*
- Proposed \$360 mil. in tax policy and fee increases
- \$716 mil. in targeted and across-the-board agency reductions from 9/09 plan
  - Significant reductions to higher education, health and human services, public safety, and constitutional officers
- \$1.5 bil. in additional savings in budget as introduced, including K-12:
  - FY 2011 base budget included \$376 mil. K-12 support position reduction from FY 2010.
  - \$269 million in K-12 health care premium support reductions
  - \$174 mil. for K-12 payments for accrued annual/sick leave for terminated employees and excluding capital expenditures
  - \$126 million in remaining K-12 federal stimulus funds

\* *Proposed income tax surcharge was separate from the appropriation act.*

# How Did the General Assembly Restore the \$1.9 Bil. Car Tax Reimbursement?

- \$321 mil. revenue re-forecast (mid-session + GA interest & less refunds)
- \$122 mil. in other revenues, fees, other transfers, and balances
- \$504 million reduction in VRS state employee retirement/benefit contributions.
- \$346 million reduction in VRS teacher retirement/benefit contributions.
- \$614 mil. in other net GF spending budget reductions, including:
  - \$253 mil reduction in public education program funding
  - \$360 mil reduction in HH&S (mitigated by FMAP extension)
  - \$120 mil in “flexible” local reductions
  - Approx. \$90 million other net program reductions
  - \$207 mil. increase to partially restore sheriffs, constitutional officers, and HB 599 Aid to Police funding

## Introduced/Adopted Budget Comparison (GF \$ mil.)

	<b>FY 2010 (2009)</b>	<b>FY 2010 Adopted</b>	<b>FY 2011 (Introduced)</b>	<b>FY 2011 Adopted</b>	<b>FY 2012 (Introduced)</b>	<b>FY 2012 Adopted</b>
Legislative, Judicial, Executive	\$503	\$501	\$500	\$496	\$499	\$496
Public Safety, Comp Board	\$2,386	\$2,160	\$2,151	\$2,256	\$2,131	\$2,207
Treasury Board (Debt)	\$507	\$479	\$566	\$558	\$614	\$606
Admin., Finance & Technology	\$228	\$202	\$184	\$184	\$248	\$198
Commerce and Trade, NR, Ag	\$258	\$258	\$274	\$271	\$277	\$242
<b>Direct Aid to K-12</b>	<b>\$5,320</b>	<b>\$4,770</b>	<b>\$5,030</b>	<b>\$4,742</b>	<b>\$5,217</b>	<b>\$4,906</b>
Higher & Other Education	\$1,832	\$1,773	\$1,753	\$1,747	\$1,598	\$1,588
<b>DMAS &amp; Medicaid</b>	<b>\$2,338</b>	<b>\$2,417</b>	<b>\$2,969</b>	<b>\$2,821</b>	<b>\$3,574</b>	<b>\$3,390</b>
Other Health & Human Serv.	\$1,474	\$1,413	\$1,392	\$1,381	\$1,375	\$1,359
Car Tax	\$950	\$950	\$0	\$950	\$0	\$950
Other (Transp., Central Appr., Ind. Agen., Non-S, Capital)	<u>(\$85)</u>	<u>(\$144)</u>	<u>\$26</u>	<u>(\$42)</u>	<u>\$83</u>	<u>\$52</u>
<b>Total GF Appropriations</b>	<b>\$15,711</b>	<b>\$14,776</b>	<b>\$14,846</b>	<b>\$15,364</b>	<b>\$15,616</b>	<b>\$15,994</b>

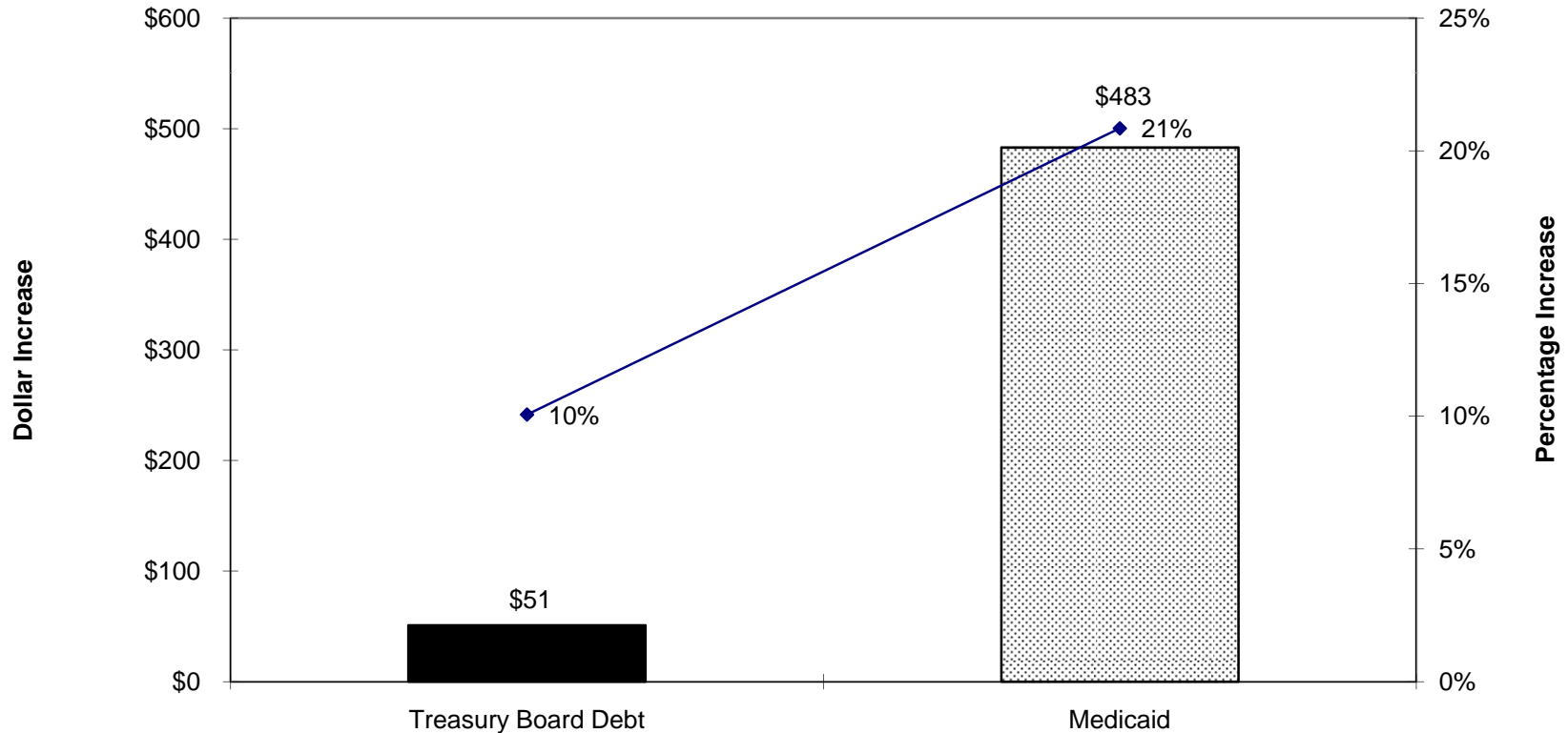
## Adopted General Fund Appropriations

	<u>FY 2009</u>	<u>FY 2010</u>	<u>FY 2011</u>	<u>FY 2012</u>
K-12 Direct Aid	35.2%	32.3%	30.8%	30.7%
Higher & Other ED	12.2%	12.0%	11.6%	9.9%
Other HH&S	9.2%	9.6%	9.0%	8.5%
DMAS (Medicaid)	14.7%	16.3%	18.3%	21.2%
Public Safety/Comp Board	15.3%	14.6%	14.7%	13.8%
Car Tax	6.0%	6.4%	6.2%	5.9%
Debt Service	2.8%	3.2%	3.7%	3.8%
All Other	4.6%	5.6%	5.7%	6.2%

# “Winners and Losers”

## Shifting State Priorities FY10 (2009) to FY11

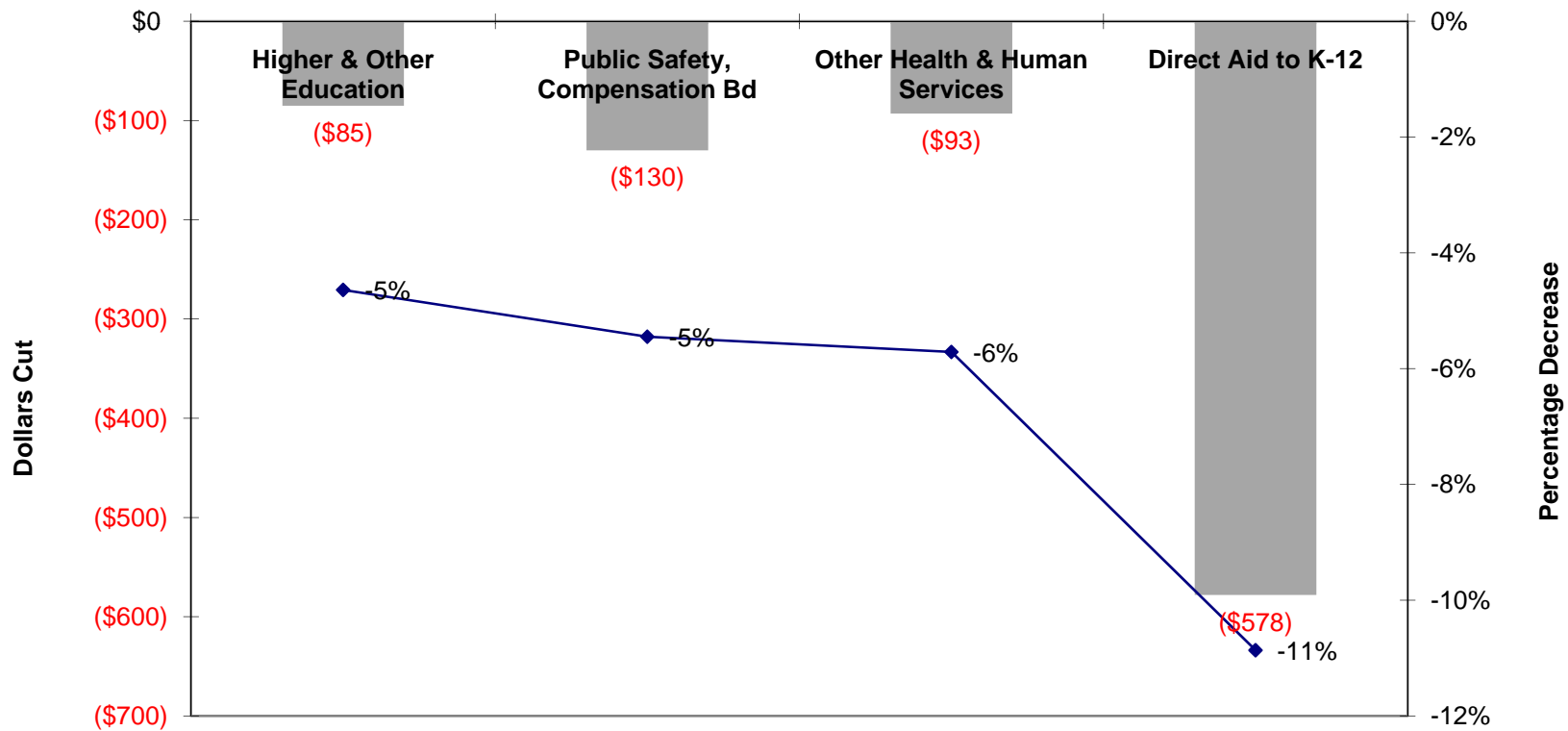
### Growth in Medicaid and Debt Service (GF in \$ millions)



# “Winners and Losers”

## Shifting State Priorities FY10 (2009) to FY11

### Decline in General Fund Support GF in \$ millions



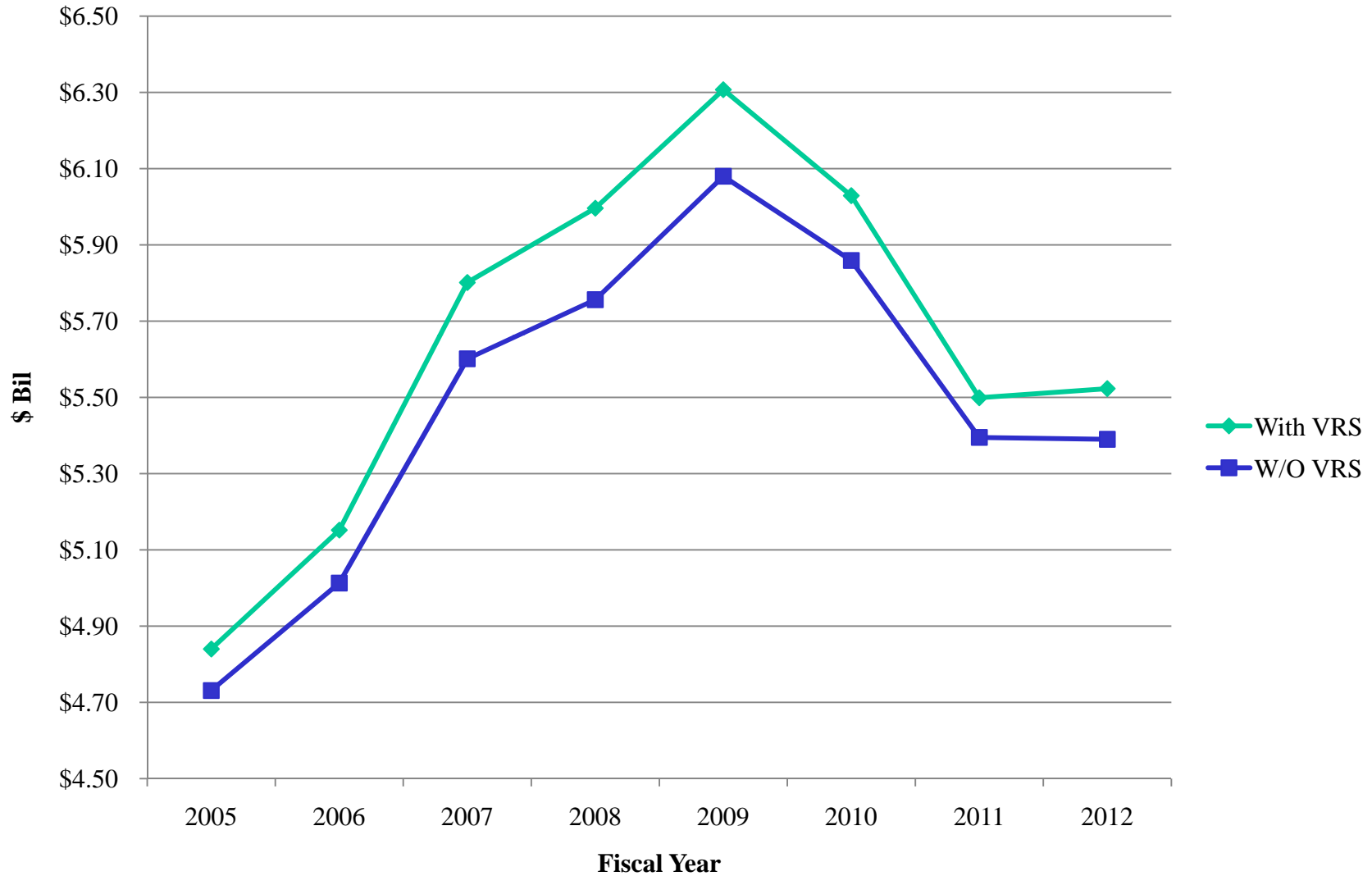
# K-12 Funding is Greatest Concern to Localities

- Adopted FY 2010 K-12 state distributions from all funding sources are nearly \$300 million lower than actual FY 2009, even with \$584 mil. in federal stimulus funds.
- Adopted FY 2011 K-12 state distributions from all funding sources (including \$189 million less VRS contributions) are: 1) \$773 million lower than last year's planned FY 2010 distributions and 2) \$512 million lower than this year's adopted FY 2010 distributions.
- Localities are already holding the K-12 education system together to meet SOA and SOL standards by spending **\$3 billion or 82% more per year than required** to match state \$. Local excess is 22 percent of total K-12 spending in state.
- Adopted budget endorsed last year's decision to reduce state support position funding by one-third (\$376 mil. in FY 11).

# Permanent K-12 Policy Changes Adopted in the 2010 Session

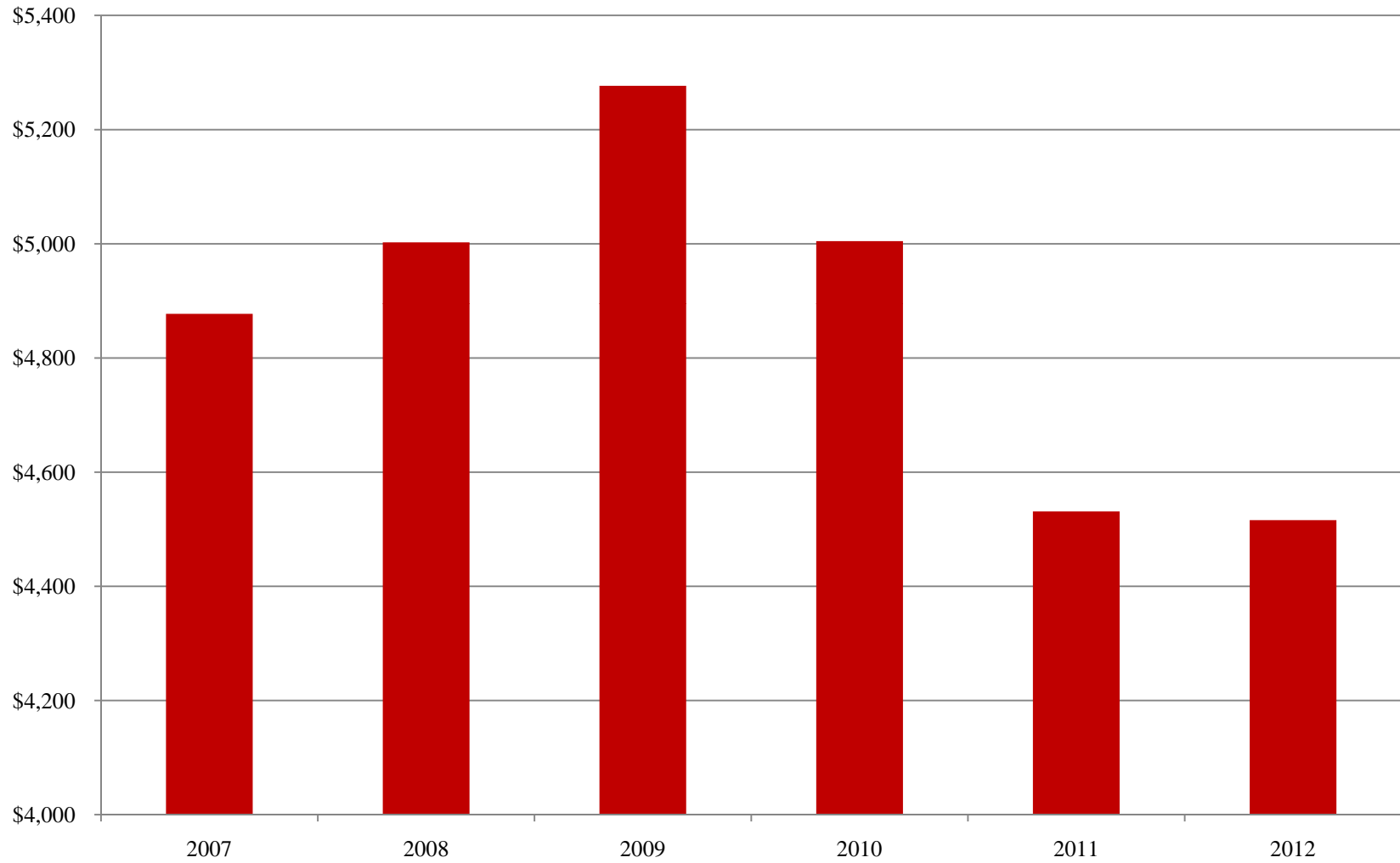
- Introduced 2010-12 Budget:
  - Fund health care premium at prevailing participation (\$134 mil./yr.)
  - Eliminate annual/sick leave payments for personnel who terminate employment, capital outlay replacement and a “miscellaneous” category (\$87 mil./yr.)
  - Eliminate non-personal inflation (\$4.7 mil/yr)
- Additional Support Function Reductions in Adopted Budget (\$100 mil/yr )
  - Include \$0 in division LWA for non-personal support (\$39 mil/yr)
  - Extend school bus replacement cycle from 12 to 15 years (\$10 mil/yr)
  - Eliminate staff travel, leases/rentals, and facilities from recognized non-personal support funding (\$35 mil/yr)
  - Increase the federal revenue deduct from 29% to 38% (\$17 mil/yr)
- Lottery Funding Changes Net \$165 mil. (biennial) GF Savings
  - Transfers remedial summer school, ESL, and 2/3 of textbook funding to lottery
  - Eliminates enrollment loss and add'l support for construction and operating costs
  - Limits participation in the K-3 Class Size Reduction Program to schools with free lunch higher than 30 percent

## Actual and Projected State Aid to K-12\*



\* Includes all state fund sources and appropriated federal stimulus \$

# State K-12 Spending per Pupil \*



\* Includes all state fund sources and appropriated federal stimulus \$

## **“Standards of Quality” Already Push Localities to Pay \$3 Bil. More for Education Than Required**

- State does not pay for all Board of Education approved standards, even though the Standards of Quality do not adequately reflect the costs of meeting the Standards of Learning and the Standards of Accreditation.
- The state methodology (LWA) overemphasizes the generally lower values in the more numerous/smaller school divisions in calculating prevailing costs for teacher and support positions.
- FY ‘08 base year for 2010-12 re-benchmarking does not reflect real-time salary costs: No state teacher compensation supplements since FY 2008.
- Most localities go beyond state mandates, especially for at-risk student funding, including lowering class sizes to help meet SOL and SOA requirements.

# Board of Education Standards Not Funded by the General Assembly = (\$185 mil/yr.)

- A full-time principal for each elementary school
- A full-time assistant principal for every 400 students in the school
- A reduction in speech-language pathologists caseloads from 68 to 60
- One reading specialist for every 1,000 students in K-12
- One mathematics specialist for every 1,000 students in K-8
- A data manager-test coordinator for every 1,000 students in K-12
- Instructional positions for students who are blind or vision impaired

# Likely Examples of School Division Budget Reductions in FY 2011

- Larger class sizes with fewer teachers.
- Administrative, security, and technical support staff reductions.
- Pay and benefit reductions for employees.
- Less capital outlay, maintenance, and equipment replacement
- Reductions in summer school, pre-school and tutoring programs.
- Reducing and charging for sports and other extra-curricular programs.
- Fewer special and alternative education and other specialty programs (e.g. gifted and AP offerings).
- Elimination of teacher training programs.
- Increase in “no transportation” zones and policies.

# Other Budget Pressures on Localities

- Medicaid cost increases are contributing to reductions in other health and human service expenditures by the state (e.g. CSA, social services, CSB's, health dept's) and will pressure localities to spend additional local funds.
- State constitutional officer support continuing to decline.
- Detrimental jail inmate policies and reduced per diems.
- Future VRS retirement/benefit contribution increases will be needed
- "Flexible" local reduction increased to \$60 mil/yr
- Local transportation spending pressures

# Increases in State Aid to Localities Will Be Limited for Some Time

- General funds needed to backfill expiring federal stimulus funds
- Constitutional requirement to fill Rainy Day Fund.
  - Requires deposit of half of growth above previous six-year GF revenue growth
- VRS contributions for both teachers and state employees will have to be restored
- Additional Medicaid commitments – growth in cost & utilization, plus new policy requirements
- Continued growth in debt service requirements
- No appetite for tax increases and revenue pressures for transportation
- Local revenue pressures continuing for some time due to housing downturn, commercial real estate losses, and lagging assessments.

# Significant Additional General Funds Are Necessary to Maintain Current Services When Federal Stimulus Ends

<b>ARRA Stimulus Funding (\$ Mil.)</b>					
	<b>FY 10 <u>ARRA*</u></b>	<b>FY 11 <u>ARRA*</u></b>	<b>FY 11 GF <u>Backfill</u></b>	<b>FY 12 <u>ARRA</u></b>	<b>FY 12 GF <u>Backfill</u></b>
<b>Medicaid **</b>	\$720	\$777	-\$57	\$0	\$777
<b>K-12 Public Education</b>	\$586	\$126	\$460	\$0	\$586
<b>Higher Education</b>	\$219	\$36	\$183	\$0	\$219
<b>Sheriffs (Bryne Justice)</b>	\$23	\$0	\$23	\$0	\$23
<b>SFSF General</b>	<u>\$109</u>	<u>\$0</u>	<u>\$109</u>	<u>\$0</u>	<u>\$109</u>
<b>Total</b>	\$1,657	\$939	<b>\$718</b>	\$0	<b>\$1,714</b>

\*Federal ARRA stimulus funds used by Virginia to offset general fund cuts

\*\* DMAS forecast presented to Senate Finance Committee 10/22/09

Note: Assumes full FY 2011 FMAP Medicaid extension

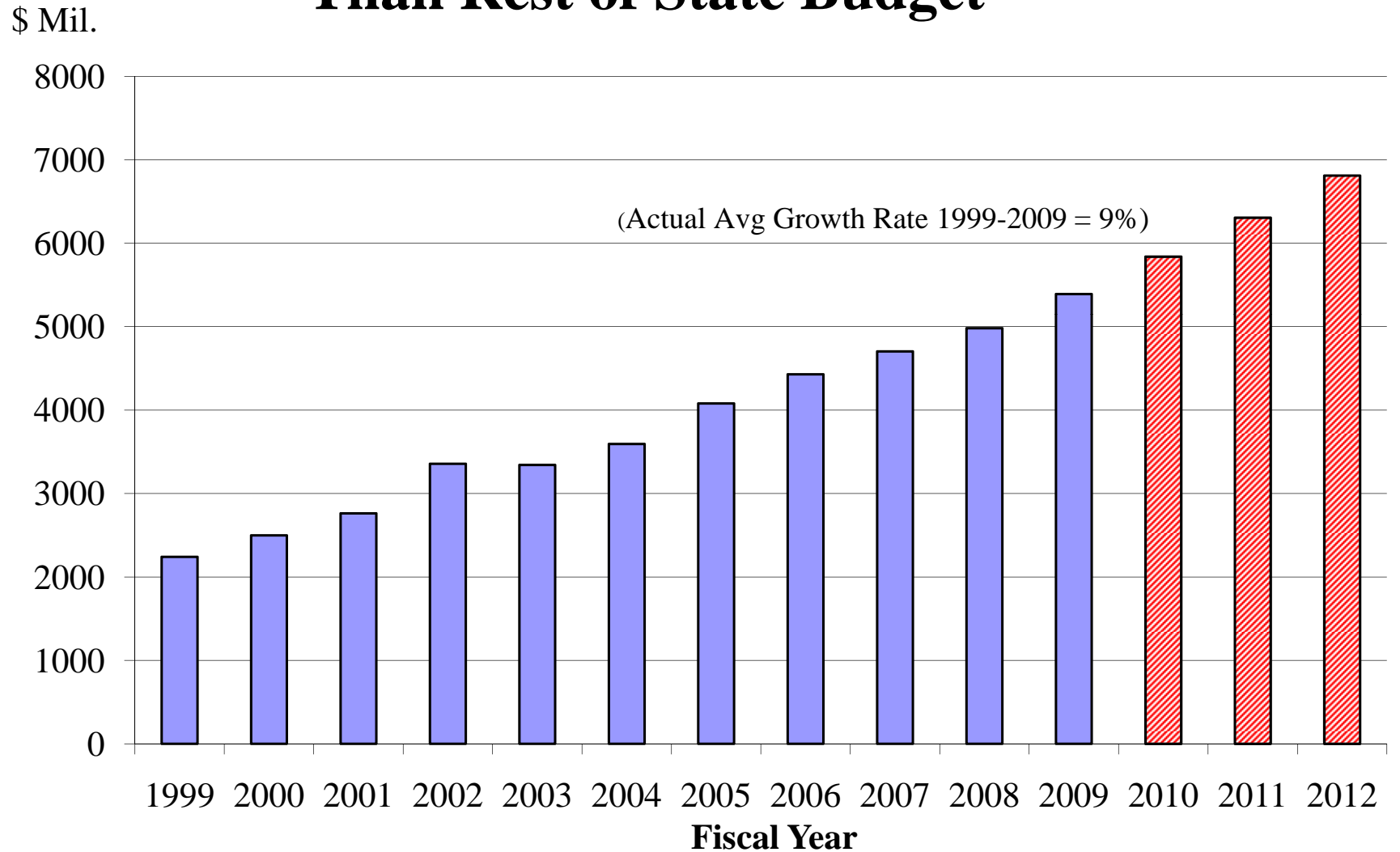
# 2010-12 Teacher VRS Rates Will Be Raised in Future Biennia

<u>VRS Board Certified Employer Rates</u>	<u>VRS Adopted Budget Employer Rates</u>
Retirement* = 12.91%	Retirement* = FY 11: 3.93%; FY 12: 5.16%
Retiree Health Care Credit = 1.08%	Retiree Health Care Credit = 0.60%
Group Life = 1.11%	Group Life = 0.28%
VSDP = 0.66%	VSDP = 0.00%
* Does not include 5% member contribution	

## 2012-2014:

**“In setting the employer retirement contribution rates in subsequent biennia, the Board shall calculate a separate, supplemental employer contribution rate that will amortize the FY 2011 and 2012 contribution shortfalls over a 10-year period using the Board's assumed long-term rate of return. The Governor shall include funds to support payment of such Board-approved, supplemental employer contribution rates in the budget submitted to the General Assembly.”**

# Medicaid Expenditures Growing Faster Than Rest of State Budget\*



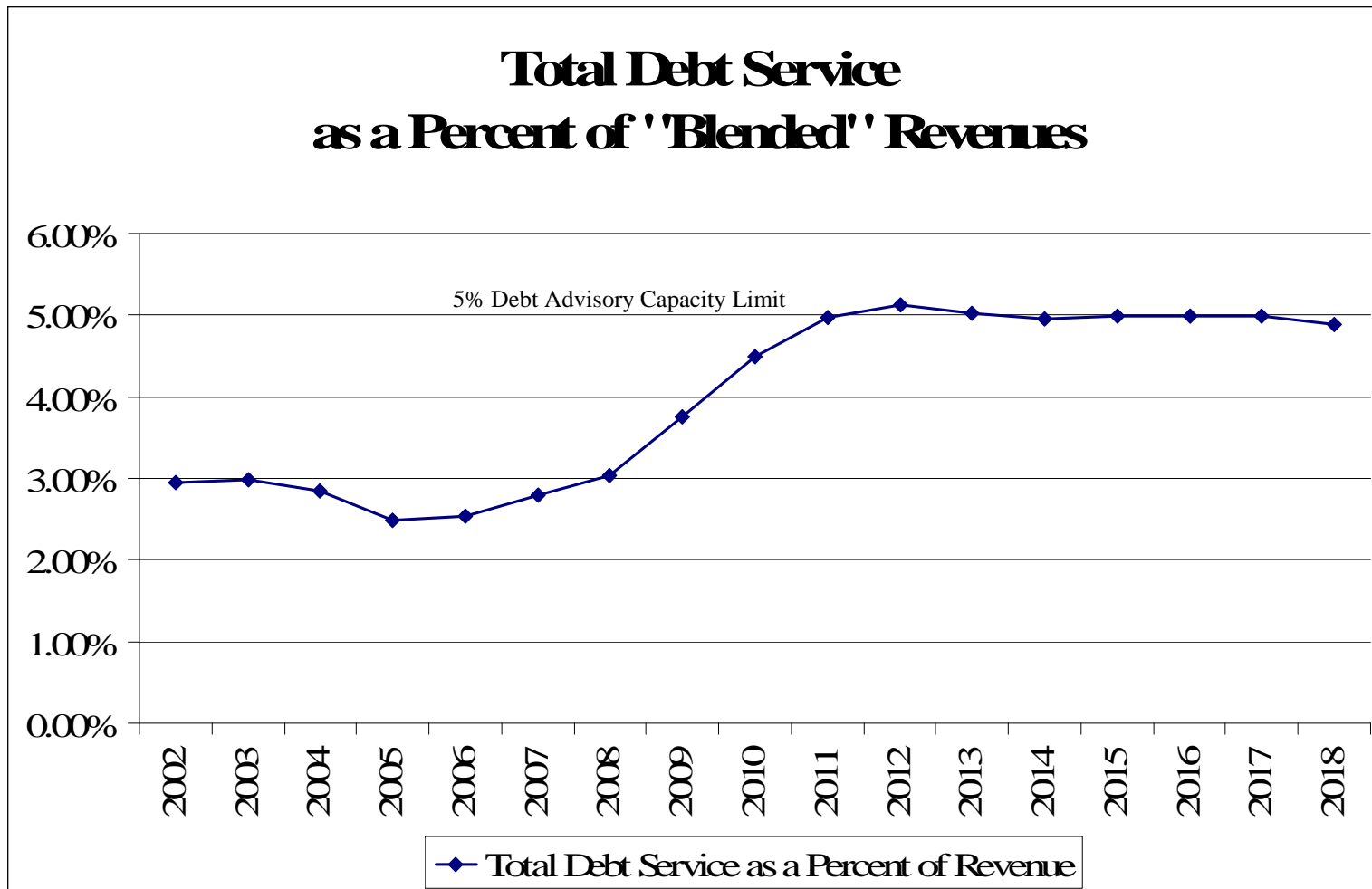
\* DMAS forecasted - does not include Medicaid expenditures for MH&MR facilities and CSA = \$361mil. in FY 2008

# Virginia Already Spends Significantly Less on Medicaid Than Other States

	Enrollment % of Population - 2006	Medicaid Expenditures - Per Capita FY 07
United States	20%	\$1,061
<b>Virginia</b>	<b>11%</b>	<b>\$639</b>
Colorado	12%	\$605
Georgia	19%	\$736
Indiana	16%	\$808
Maryland	14%	\$967
Massachusetts	19%	\$1,592
North Carolina	19%	\$1,087
Tennessee	25%	\$1,159
Washington	19%	\$898
Wisconsin	18%	\$882

# New Debt Capacity Is Limited...

## If Virginia Wants to Keep its AAA Rating



Note: "Blended" revenues include GF and transportation revenues

Source: Debt Capacity Advisory Committee, Dec. 19, 2009 <http://www.trsvirginia.gov/Documents/Debt/DCAC/DCAC2009.pdf>

## Recent Major General Fund Tax Changes Have Neutralized 2004 Tax Increase

	<u>FY Implemented</u>	<u>2008-10 (\$ Mil.)</u>
Historic Rehab Tax Credit	1999	(\$92)
Low Income Tax Relief	2000 and 2007	(\$150)
Land Preservation Tax Credit	2003	(\$300)
2004 Tax Reforms	2005	\$1,600
Add'l Reduced Sales Tax on Food	2006	(\$380)
Shift Insurance Premiums and Recordation from GF to Transportation	2009	(\$340)
Estate Tax Repeal	2009	(\$300)
Total		\$38

# Revenue Pressures Increase for Transportation

- \$5.5 billion in reductions for 2010-15 program since spring of 2008.
- Construction blueprint now primarily a federal match program that eliminates state formula distributions for unpaved roads, primary, secondary and urban systems.
- Surface Transportation Program federal formula funding will no longer be distributed by locality in FY 11: CTB to do the programming.
- If all federal funds are to be matched, adequate maintenance funding particularly for secondary roads no longer available.
- First \$492 mil. tranche of \$3.18 bil. in authorized HB 3202 (2007) debt delayed from summer 2007 until summer 2010 due to insufficient insurance premiums – current FRAN debt has first call. Now expected to take until 2028 to let full HB 3202 authority.
  - Over last 10 years, debt service has increased from 3% to 7% of total transportation expenditures.

## Local General Fund Revenue Annual Growth Rate\*



\* Source: APA Comparative Report FY 1990 to FY 2009; VML/VACO survey results for FY 2010

# The Case for Optimism

Housing and large federal deficits remain serious problems.

But America's competitive advantages still remain:

- 1) Ability to swiftly react to issues compared to other countries
- 2) A willingness to write off bad debts, restructure, and embrace efficiency
- 3) America still leads the world at understanding failure, at latching on to new innovations, and building them to scale quickly and profitably.

Compare 1st Q 2009 GDP of -6.4%  
to 4<sup>th</sup> Q 2009 GDP of + 5.6%

*Daniel Gross, NEWSWEEK Magazine*

“So what will our new economy look like once the smoke finally clears? There will likely be fewer McMansions with four-car garages and more well-insulated homes, fewer Hummers and more Chevy Volts, less proprietary trading and more productivity-enhancing software, less debt and more capital, more exported goods and less imported energy. Most significant, there will be new commercial infrastructures and industrial ecosystems that incubate and propel growth—much as the Internet did in the 1990s.”

# Where Will New Jobs Come From?

10 Year Changes in Virginia Employment by Industry Category				
	<u>3rd Q 1999</u>	<u>3rd Q 2009</u>	<u>Change</u>	<u>Percent Chg</u>
Total, All Industries	3,337,683	3,525,410	187,727	5.6%
Construction	215,165	202,069	(13,096)	-6.1%
Manufacturing	371,830	243,939	(127,891)	-34.4%
Wholesale & Retail Trade	518,743	513,935	(4,808)	-0.9%
Transportation and Warehousing	136,358	120,370	(15,988)	-11.7%
Information	110,620	85,368	(25,252)	-22.8%
Finance and Insurance, Real Estate	173,644	177,002	3,358	1.9%
Professional, Technical, Management	341,928	457,988	116,060	33.9%
Administrative Support Services	210,462	196,933	(13,529)	-6.4%
Educational Services	244,763	316,739	71,976	29.4%
Health Care and Social Assistance	320,041	422,273	102,232	31.9%
Arts, Entertainment, and Recreation	64,261	76,448	12,187	19.0%
Accommodation and Food Services	255,108	302,433	47,325	18.6%
Utilities & Other Services	138,997	149,324	10,327	7.4%
Public Administration	206,147	236,394	30,247	14.7%

# **Governor McDonnell Initiatives**

## **Executive Order No. 1 (2010): Establishing the Chief Job Creation Officer and the Governor's Economic Development and Job Creation Commission**

“The Commission shall have the following responsibilities ... Make recommendations on new investments and changes to the tax and regulatory environment in the Commonwealth to maintain and increase the Commonwealth's standing as the best place to do business in the United State of America; ...”

## **Executive Order No. 2 (2010) : Establishing the Governor's Commission on Government Reform and Restructuring**

The Commission will conduct a thorough review of Virginia state government:

Identify opportunities for creating efficiencies in state government, including streamlining, consolidating, or eliminating redundant and unnecessary agency services, governing bodies, regulations and programs;  
Explore innovative ways to deliver state services at the lowest cost and best value to Virginia taxpayers;  
Seek out means to more effectively and efficiently perform core state functions, including potential privatization of government operations where appropriate, and restore focus on core mission oriented service;  
and  
Examine ways for state government to be more transparent, user friendly and accountable to the citizens of the Commonwealth.

## **Transportation Funding and Special Session: ?**