

**The 2016-18 State GF Budget**  
**Where Does Local Government Go From Here?**

Fiscal Analytics, Ltd.

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# What are General Fund Prospects?

- The good news: GF revenues are improving, and budget *policy* changes to close the budget gap did not target local government - other than salary changes.
- 3.0% FY17 and 3.2% FY18 introduced budget GF revenue growth forecast.
  - New forecast - about \$600 mil. - incl. transfers - above the August interim forecast, but still \$667 mil. below last year's adopted budget.
  - Partially relies on policy changes, including tax amnesty, AST renewal, sales tax nexus, and limiting historic rehab and land preservation credits.
- Use of Rainy Day funds, tax amnesty, and nongeneral fund transfers for operating expenses leaves a hole to fund 2018-20 biennium needs.

# GF Revenue Growth is Historically Low

<u>Fiscal Years</u>	<u>Avg. Annual GF Growth*</u>
1990-1999	5.9%
2000-2008	5.7%
2009-2010	-5.0%
2011-2016	4.1%
<i>2017 Forecast</i>	<i>3.0%</i>
<i>2018 Forecast</i>	<i>3.2%</i>

\* Does not include GF transfers

# Will Lower Paying Job Mix Continue?

	<u>2nd Q 2016</u>	<u>5-Yr Change</u>	<u>Avg Weekly Wage</u>
Total, All Industries	3,808,034	5.9%	\$1,011
Management of Companies	72,785	-0.5%	\$2,017
Professional, Scientific, and Technical	414,770	4.5%	\$1,846
Information	73,091	-8.0%	\$1,673
Finance and Insurance	134,995	9.7%	\$1,569
Utilities	18,561	-0.2%	\$1,510
Wholesale Trade	110,457	-1.5%	\$1,404
Public Administration	248,037	3.1%	\$1,366
Mining, Quarrying, and Oil and Gas	5,622	-37.3%	\$1,263
Manufacturing	241,367	1.1%	\$1,074
Construction	198,049	5.1%	\$978
Transportation and Warehousing	136,164	13.0%	\$951
Real Estate and Rental and Leasing	53,217	3.6%	\$950
Health Care and Social Assistance	483,298	10.7%	\$917
Educational Services	366,291	-0.2%	\$821
Other Services	140,132	6.7%	\$784
Administrative and Support	233,796	12.8%	\$748
Retail Trade	422,743	4.0%	\$542
Arts, Entertainment, and Recreation	75,956	8.2%	\$466
Accommodation and Food Services	348,863	13.3%	\$353

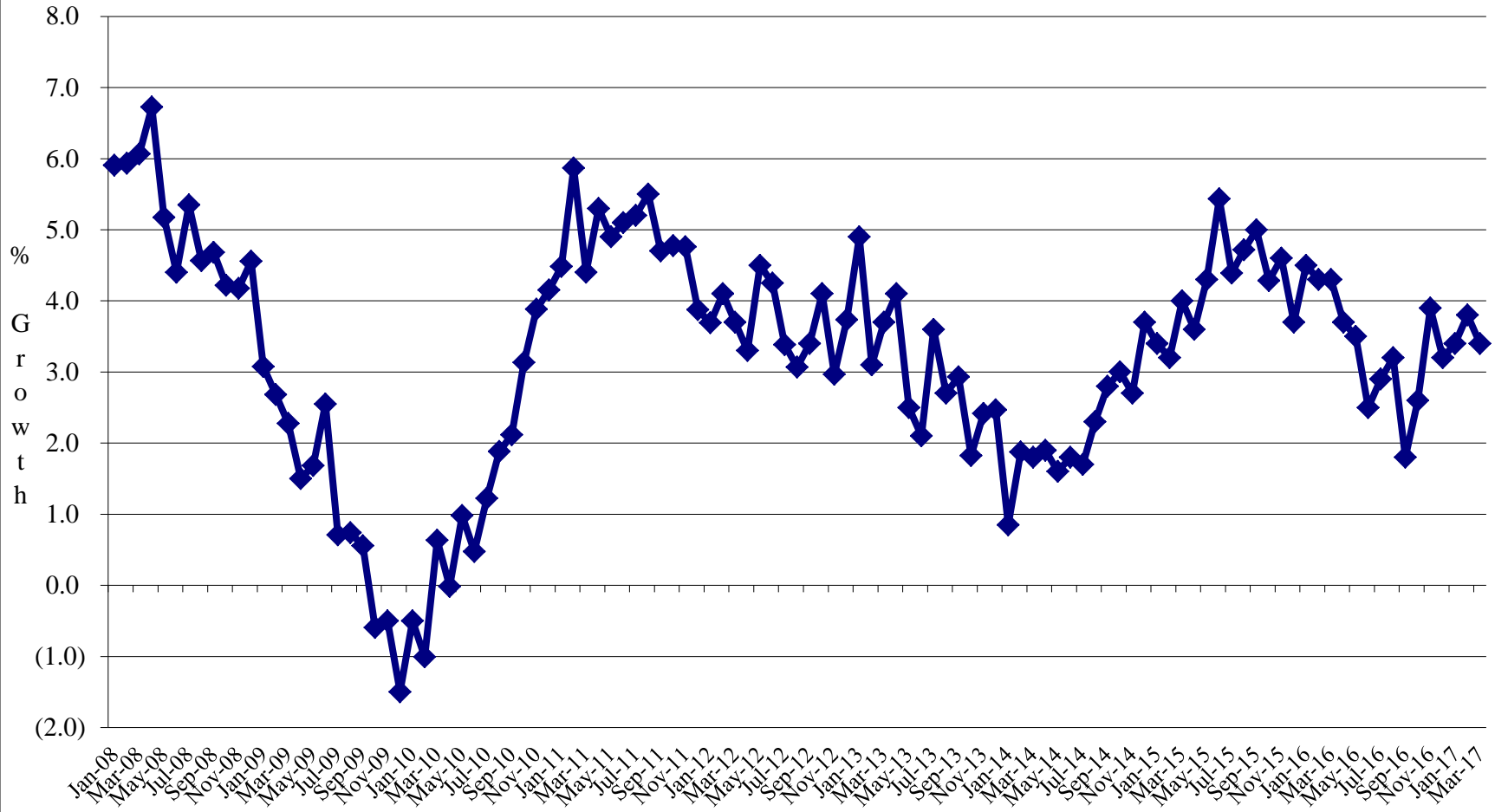
# 9 Months GF Revenue Collections Better Than Forecast

## *Adopted Budget Reserves Half of Any Unobligated Year-End Surplus to RDF*

<u>GF Revenue Sources</u>	<u>9 Mo. Collections</u>	<u>FY 2017 Forecast</u>
Individual Income Tax (70% of GF)	5.6%	2.9%
<i>Withholding</i>	5.3%	3.6%
<i>Non-Withholding</i>	2.9%	-0.7%
<i>Refunds</i>	-0.4%	1.5%
Sales Tax (18% of GF)*	1.5%	2.7%
Corporate Income Tax (4% of GF)	2.5%	3.8%
<b>Total GF</b>	<b>4.6%</b>	<b>2.9%</b>
* Adjusted for the accelerated sales tax program in June		

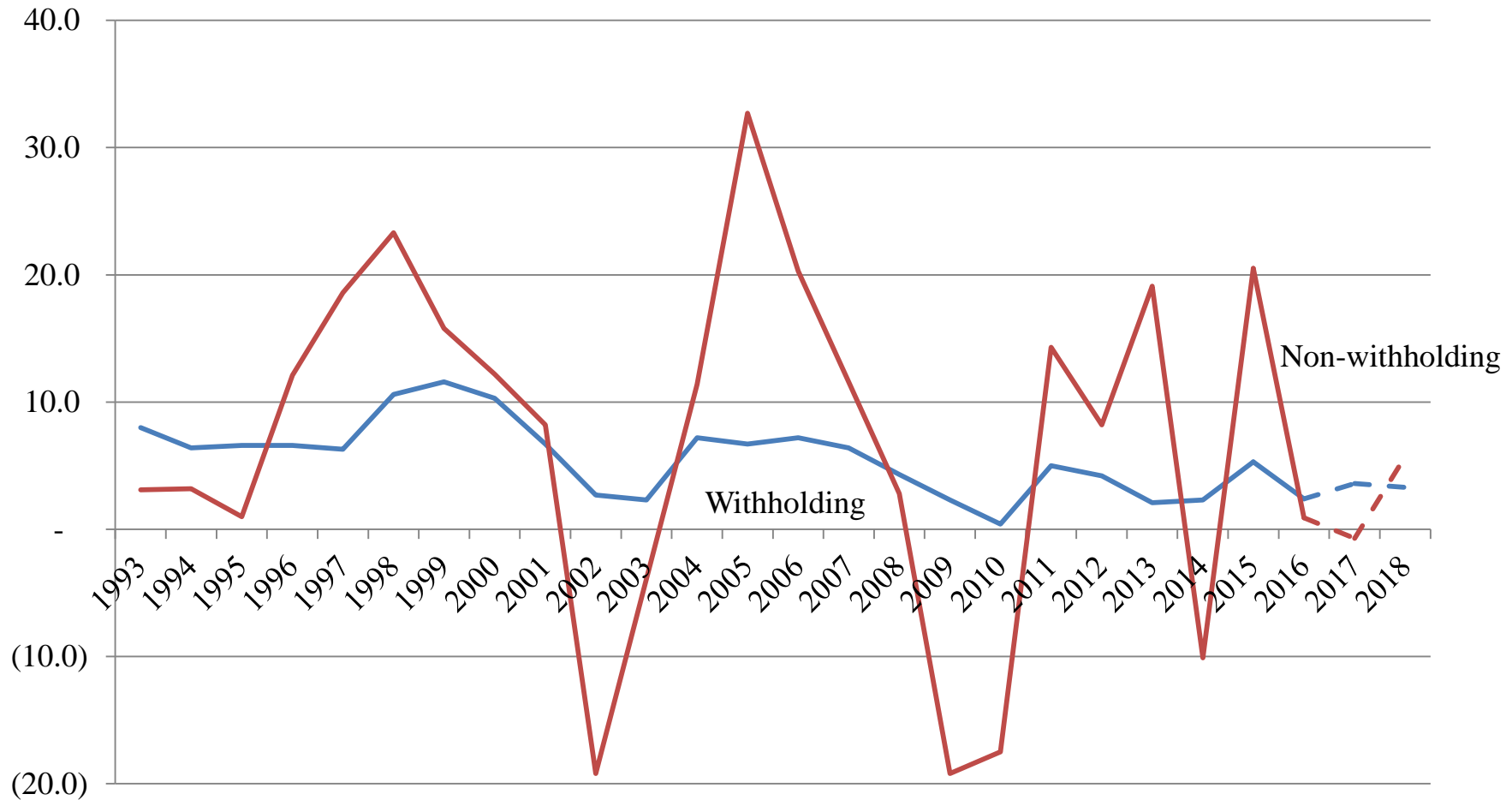
# Income Tax Withholding Growth Is the Driver of GF Revenues

## 12 Mo. Moving Avg (% Growth)



# Income Tax Non-Withholding Revenues Are More Volatile, Amplifying Economic Changes and Making Revenue Forecasting Difficult

## Annual % Growth in Income Tax Withholding and Non-Withholding Collections



*Note: Non-W % of total GF revenues: 15.4% in FY 14; 17.1% in FY 15, 17.0% in FY 16  
Non-W 16.1% forecast “collar” reduces 2016-18 revenues by \$379 mil.*

# Policy Adjustments Raise Revenues

	<u>Biennium Mil. \$</u>
<b>Major Revenue Policy Adjustment Proposals</b>	
Tax Amnesty (Senate budget increased amount by \$31 mil.)	\$89.5
Accelerated Sales Tax Renewal	\$47.9
Tighten Sales Tax Nexus	\$11.1
\$5 mil. per Return Historic Rehab Tax Credit	\$9.9
Retain \$20,000 Limit on LPTC for FY 17	\$6.1
<b>Total GF Revenue Policy Adjustments</b>	



# How Did the Adopted Budget Balance the \$1.5 Bil. GF Budget Shortfall?

## **Major Revenue Changes and Spending Reductions:**

- \$567.2 mil. Rainy Day Funds
- About \$400 mil. in increased revenues (incl. policy changes) and \$150 mil. in transfers
- \$150 mil. unspent agency appropriations
- \$128 mil. in captured capital balances
- \$146 mil. in additional lottery (\$52.4m), Literary (\$50m), and Virginia Health Care (\$44.5m) funds to offset GF.
- \$347.2 mil. eliminated contingent salary increases (\$134m for teachers)
- Targeted reductions including: higher education (\$56m), “technical” reductions in K-12 aid from lower sales tax (\$40m) and ADM (\$35m), reductions in economic development incentives (\$53m), and delayed women’s prison open (\$21m).

## **Major Increases :**

- \$247 mil. in Medicaid cost increases
- \$161 mil. in FY 2018 compensation adjustments (\$32m for teachers)
- \$86 mil. in Children Services Act sum sufficient funding
- \$32 mil. in new mental health funding

	<b>GF Budget Accounting</b>					
		<u>2016 Session</u>		<u>2017 Session</u>		Biennial
	<u>FY 16</u>	<u>2017</u>	<u>2018</u>	<u>2017</u>	<u>2018</u>	<u>Change</u>
Legislative and Executive	107.7	115.5	115.5	115.7	119.4	4.1
Judicial Dept.	456.0	484.5	485.2	482.9	485.6	(1.2)
Administration/Comp Board	691.7	711.8	718.7	705.2	715.4	(9.9)
Treasury Board Debt Service	675.0	734.9	766.3	722.1	763.7	(15.4)
Other Finance/Technology	181.6	191.6	188.6	189.1	186.0	(5.1)
Rainy Day Fund	-	605.6	-	605.6	-	-
Car Tax Reimbursement	950.0	950.0	950.0	950.0	950.0	-
Commerce and Trade	197.0	203.8	217.3	188.3	205.6	(27.2)
Agriculture / Nat. Resources	174.7	237.7	172.2	234.2	163.7	(12.1)
K-12 Education/Central Office	5,576.0	5,900.0	6,190.6	5,735.6	6,088.5	(266.5)
Higher & Other Education	1,865.5	2,046.6	2,081.1	2,040.0	2,015.2	(72.5)
DMAS Medicaid	4,159.5	4,293.9	4,421.0	4,332.8	4,605.7	223.6
Other Health & Human Services	1,682.6	1,759.3	1,764.8	1,799.9	1,831.6	107.4
Public Safety & Veterans/HS	1,837.5	1,921.8	1,949.4	1,907.1	1,932.9	(31.2)
Transportation	69.1	41.0	41.0	41.0	41.0	-
Central Appropriations	334.8	139.5	223.0	63.5	214.9	(84.0)
Cash Reserve	-	-	-	-	35.0	35.0
Independent Agencies/Capital	143.2	12.0	0.3	2.2	0.3	(9.8)
Total GF Appropriations	19,102.0	20,349.5	20,285.0	20,115.2	20,354.6	(164.7)
GF Revenues/Transfers	19,119.3	19,481.2	20,230.3	19,210.6	19,835.4	(665.5)
Rainy Day Fund Withdrawal				294.7	272.5	567.2
Balances	932.1	946.2	(0.5)	736.3	128.2	(81.2)
Unreserved Balance	265.3	77.9	22.6	126.4	7.9	

# Medicaid Spending Forecast Increasing by \$255 Mil. in 2016-18

<u>Fiscal Years</u>	<u>Avg. Annual Growth</u>	
2000-2009	8.8%	
2010-2015	6.2%	
2016	9.3%	
<i>2017 Forecast</i>	<del>3.8%</del>	7.4%
<i>2018 Forecast</i>	<del>2.9%</del>	4.1%

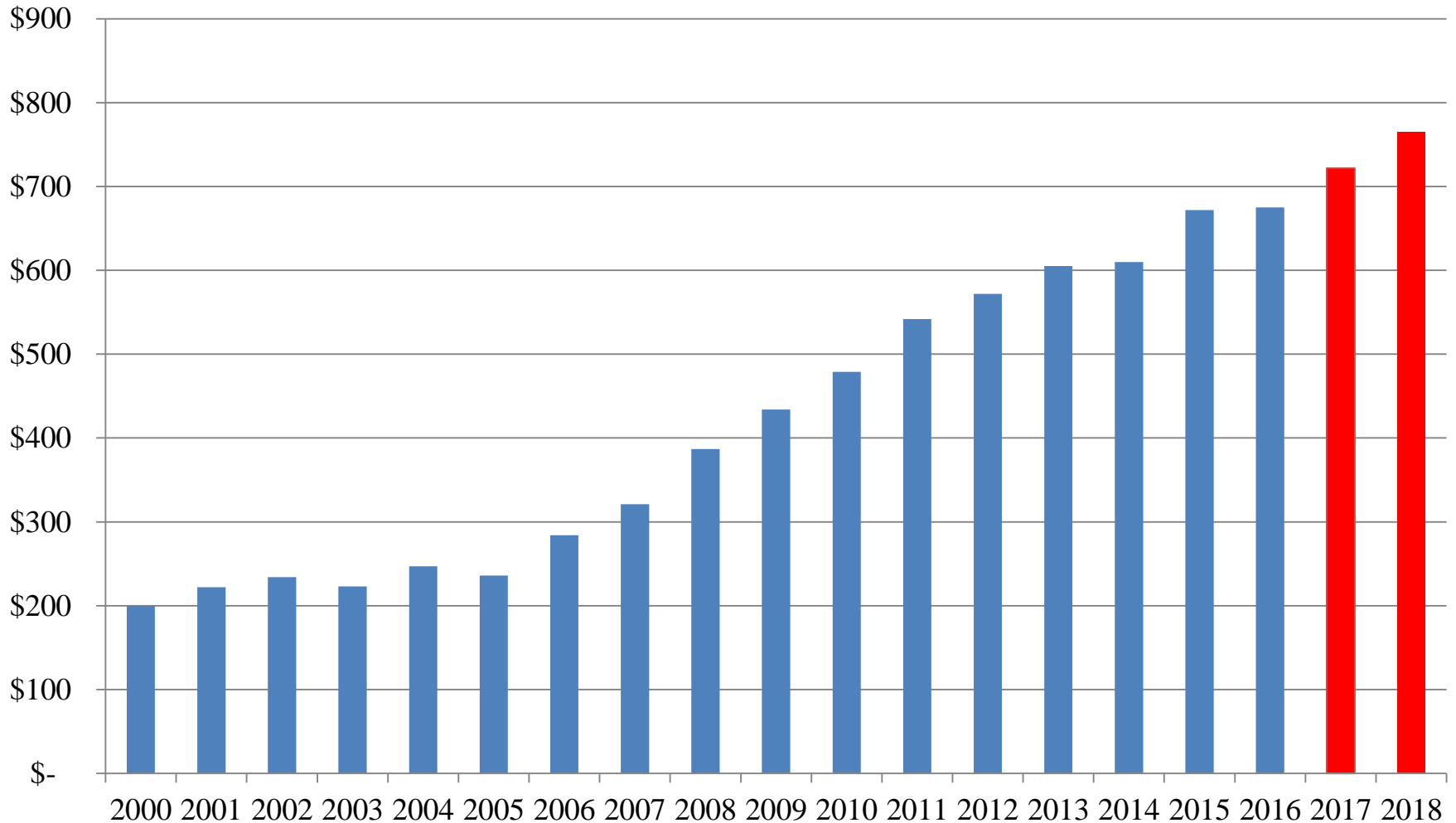
Major forecast spending changes were in:

- 1) Behavioral adult rehabilitation services and intensive in-home services for children
- 2) Medicare Part A, B and Part D premium increases
- 3) Medicaid fee-for-service expenditures

# Will Steadily Rising Elderly Population Spur Continued Growth in Medicaid?

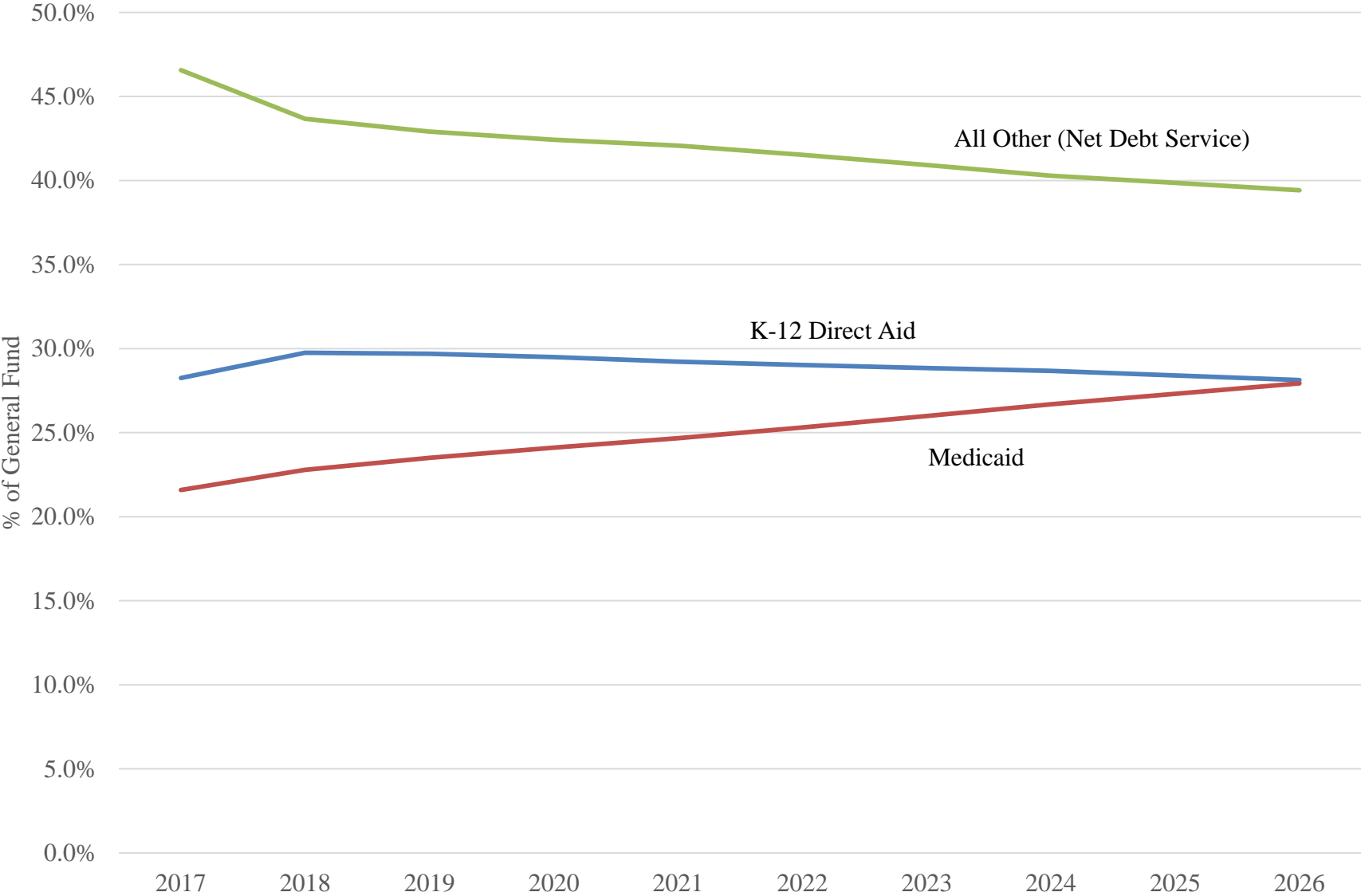
	Total Projected VA Population	Pop. 65 years and over	% of Total Pop. Age 65 and Over	Pop. 85 years and over	% of Total Pop. Age 85 and Over
2010	8,001,024	976,937	12.2%	122,403	1.5%
2020	8,744,273	1,392,849	15.9%	149,399	1.7%
2030	9,546,958	1,803,403	18.9%	194,658	2.0%
2040	10,201,530	1,925,149	18.9%	283,507	2.8%

# Continued Growth in GF Debt Service (\$ Mil.)



*Note: Over \$3 bil. in new GF tax supported debt (VPBA, VCBA) already planned from 2017-2022*

# Ominous Trajectories for GF Spending



# How Did Localities Fare in the Revised 2016-18 Budget Proposal?

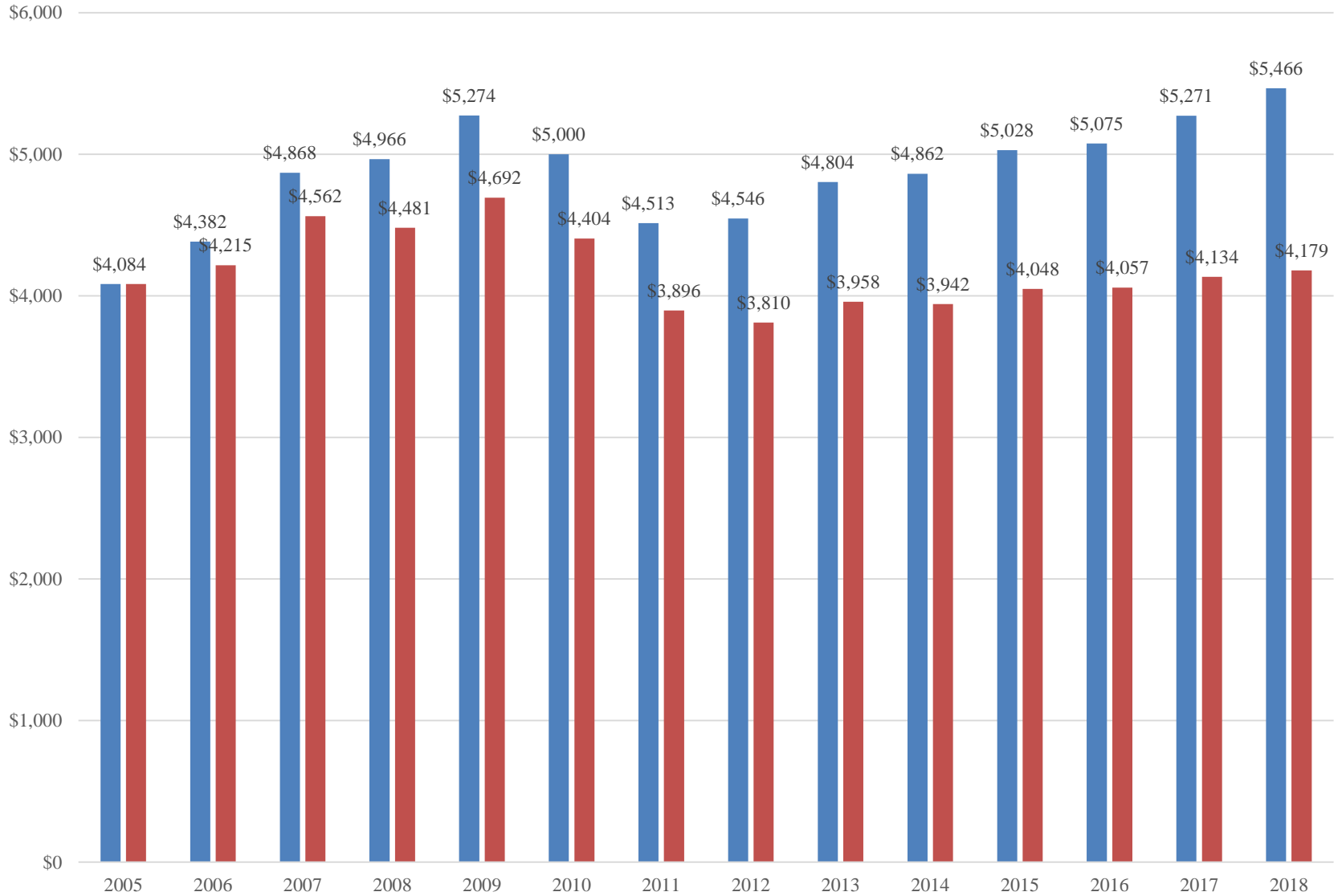
- Net \$167 mil. biennial reduction in K-12 direct aid after Lottery and Literary fund offsets, primarily from lost salary contingency funding (net of \$55 mil. 1.5% bonus plan) and reduced ADM projections and lower sales tax revenue forecasts.
  - Only small changes to overall K-12 funding in GA budget, primarily re-working Gov. bonus funding into salary and lottery funding changes.
- Economic development funding reductions. General Assembly restored: half of the Governor's "GO Virginia" reduction to \$7.5 million; \$1.0 mil. to the \$1.8 mil. reduction to the Virginia Enterprise Zone Program; and most of the reduction in the Brownfields Rehabilitation program.
- Child Services Act sum sufficient est. funding increased by \$86 mil. GF due to higher caseloads. Localities required to provide an approximately one-third match.
- \$28 mil. in new mental health funding provides for additional "same-day-access" intake and evaluation staff at 25 CSBs; supportive housing; community supports to aid in discharging and diverting individuals into community settings; and increased access to opioid addiction treatment.
- Localities receive \$32 mil. based on teachers receiving a 2.0% salary increase effective 2/15/18. State-supported locals receive a 2.0% salary increase effective Aug. 1, 2017 (\$15.6 mil.). Career development funding for all qualified Constitutional Officers, and targeted pay incentives for district court clerks and deputy sheriffs.

## GF State Aid to Localities (\$ Mil.)

	<u>FY 2009</u>	<u>FY 2014</u>	<u>FY 2016</u>	<u>FY 2017</u>	<u>FY 2018</u>
<b>Direct Aid to K-12</b>	<b>\$5,607.6</b>	<b>\$5,240.3</b>	<b>\$5,520.9</b>	<b>\$5,675.3</b>	<b>\$6,030.0</b>
<b>K-12 % of Total GF Appropriations</b>	<b>35.2%</b>	<b>29.6%</b>	<b>28.9%</b>	<b>28.2%</b>	<b>29.6%</b>
<b>Health and Human Services</b>	<b>888.4</b>	<b>791.7</b>	<b>867.5</b>	<b>926.0</b>	<b>951.5</b>
<i>CSA</i>	299.7	217.2	237.2	278.9	279.5
<i>Community MH/MR Services</i>	249.4	269.3	318.0	330.8	351.6
<i>Local Social Services Staff</i>	117.4	115.3	114.4	117.5	122.1
<i>Community Health Programs</i>	117.6	107.2	115.1	117.7	117.6
<i>Welfare Services and Programs</i>	104.3	82.7	82.8	81.1	80.7
<b>Public Safety</b>	<b>734.3</b>	<b>687.9</b>	<b>715.5</b>	<b>732.1</b>	<b>743.4</b>
<i>Local Sheriffs Offices</i>	406.1	411.3	436.0	447.2	457.0
<i>Local Police Depts HB 599</i>	197.3	172.4	172.4	178.0	178.0
<i>Local Jail Per diem</i>	80.1	59.4	61.4	60.6	61.3
<i>Assistance for Juvenile Justice</i>	50.8	44.8	45.7	46.3	47.1
<b>Constitutional Officers</b>	<b>155.3</b>	<b>145.8</b>	<b>152.5</b>	<b>156.7</b>	<b>158.0</b>
<b>Dept. of Accounts Transfers</b>	<b>49.3</b>	<b>49.3</b>	<b>49.5</b>	<b>49.6</b>	<b>49.6</b>
<b>Car Tax</b>	<b>950.0</b>	<b>950.0</b>	<b>950.0</b>	<b>950.0</b>	<b>950.0</b>
<b>Aid-to-Locality Reduction</b>	<b>(50.0)</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>
<b>Total Local GF Aid</b>	<b>\$8,334.9</b>	<b>\$7,865.0</b>	<b>\$8,255.9</b>	<b>\$8,489.7</b>	<b>\$8,882.5</b>
<b>Total GF Appropriations</b>	<b>\$15,943.0</b>	<b>\$17,705.2</b>	<b>\$19,102.0</b>	<b>\$20,115.2</b>	<b>\$20,354.6</b>
<b>Local Aid % of Total GF</b>	<b>52.0%</b>	<b>44.1%</b>	<b>43.2%</b>	<b>42.2%</b>	<b>43.6%</b>



# 2017 Session State Per Pupil K-12 Direct Aid Funding Nominal and Inflation-Adjusted (CPI \$2005)



# Virginia Board of Education Recommends \$600 Million in Standards of Quality Upgrades

- First BOE recommended SOQ funding changes since the early 2000's. Examined where local practices exceed state recognized staffing practices.
  - **Statewide about 136,000 out of 200,000 K-12 positions are funded by the SOQ.**
- The Board of Education recommends the following changes to the SOQ:
  - Restoring the funding of support positions using prevailing practices rather than the 2009 enacted support position cap (1 support per 4.17 SOQ funded teachers).
  - A staffing ratio of 1 to 400 students for assistant principals.
  - One full-time principal in each elementary school. 12 percent of schools have under 299 students and are only provided funding for a part-time principal.
  - Staffing ratios for school counselors (1 to 250); school psychologists (1 to 1,000); school nurses (1 to 1,000); and school social workers (1 to 1,000).

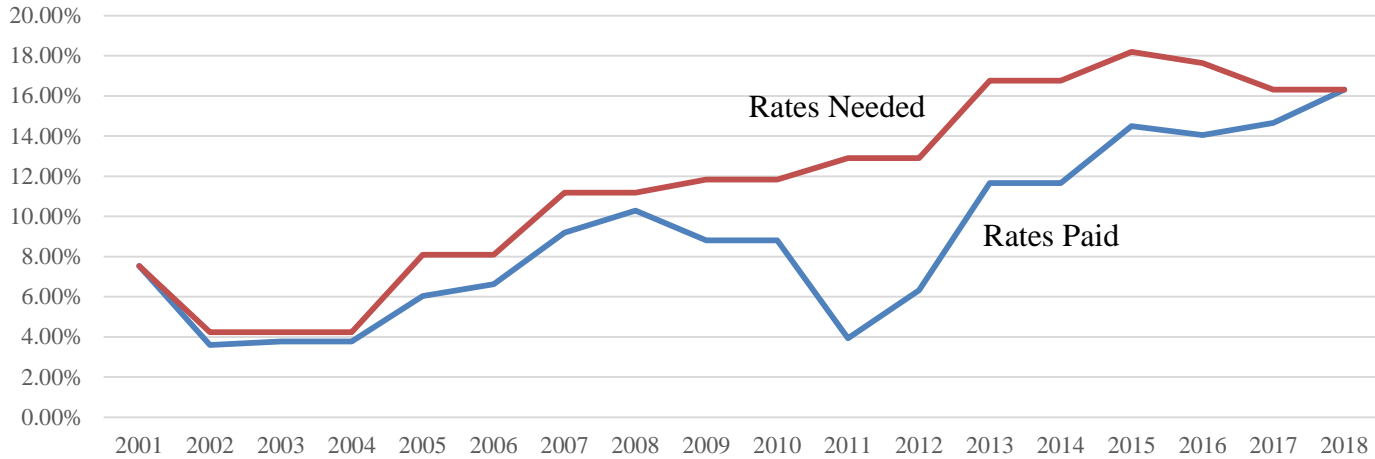
# State Standards of Quality Do Not Reflect True Costs for Local K-12 Divisions

- Only 68 percent of K-12 positions employed by local school divisions are recognized by the SOQ, including many support positions; other support costs de-funded after 2009; the “linear weighted average” methodology underfunds 85% of teacher’s salaries (in 2/3 of school divisions); real-time costs not reflected in re-benchmarking.
  - Just raising teacher salaries to the national average and funding prevailing support costs requires an additional \$750 million GF/year.
- Localities on average spend about double, or \$3.6 bil. beyond state requirements to meet SOL and SOA requirements. All 134 local school divisions exceeded Required Local Effort (RLE) in FY 15.

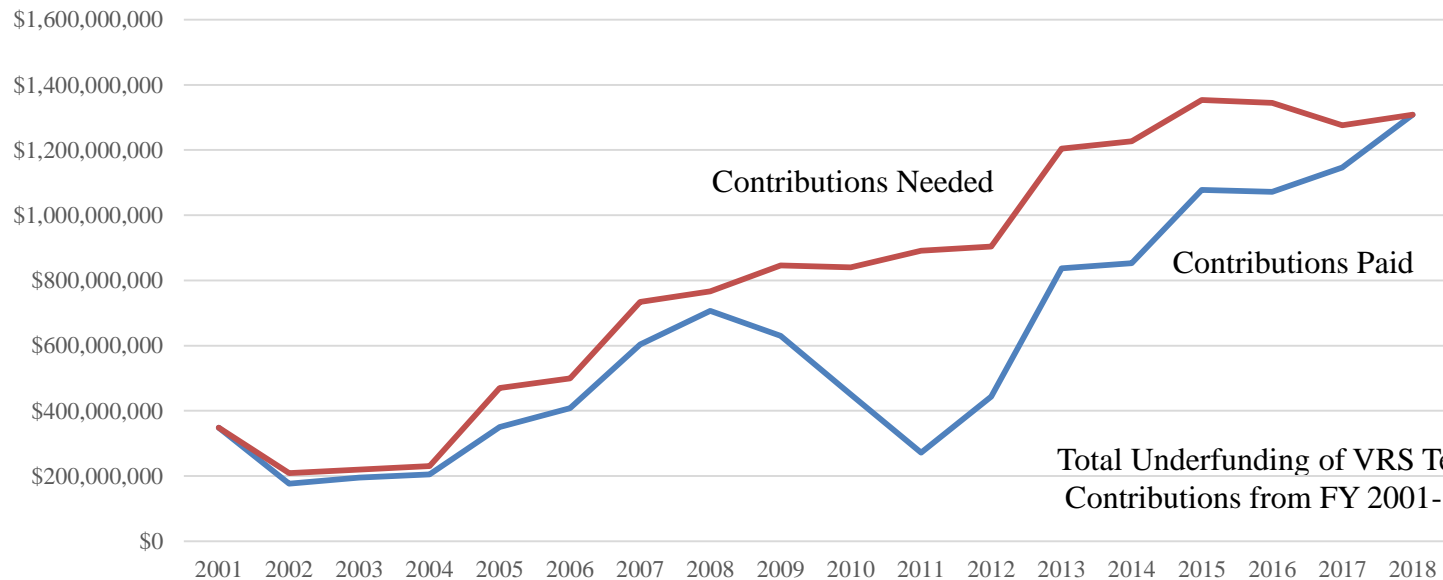
Divisions up to 25% Above RLE	16
Divisions Exceeding 25% to 75%	50
Divisions Exceeding 76% to 100%	31
Divisions Exceeding 100% RLE	37

# FY 2018 Is the First Time in Many Years VRS Rates Will Be Fully Funded

## VRS Teacher Rates Needed Vs. Paid



## VRS Teacher Contributions Needed Vs. Paid (\$ Mil.)



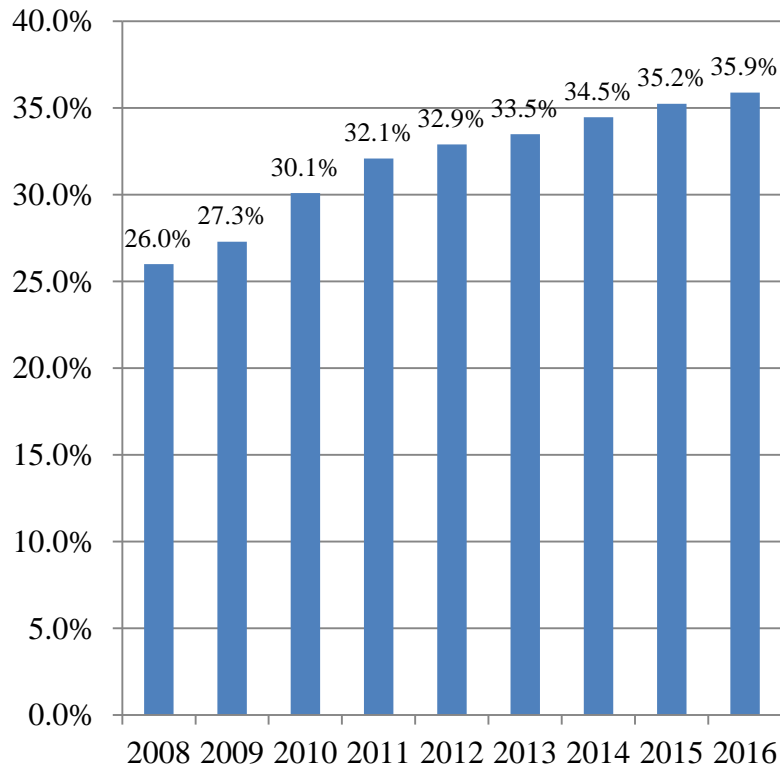
Total Underfunding of VRS Teacher Contributions from FY 2001-17 = \$3.6B

# More Difficult and Diverse Student Population to Educate

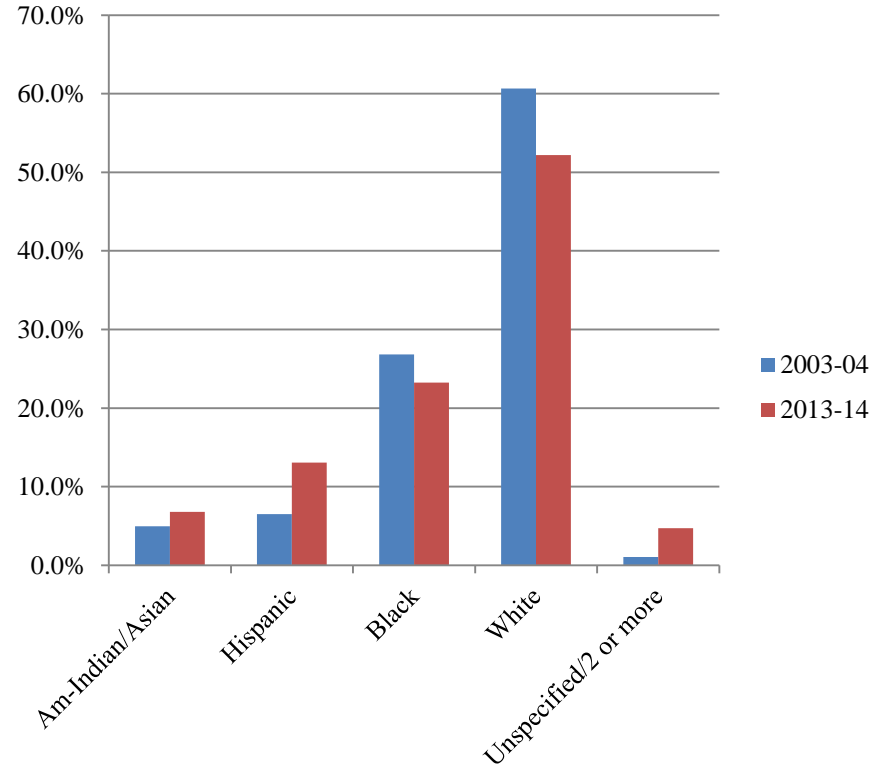
- 163,000 Special Ed Students (13% )

- Changing Demographics – ESL increased 63% over last 10 years

**% Free Lunch Students Growing**



**VA Public K-12 Student Population by Race**



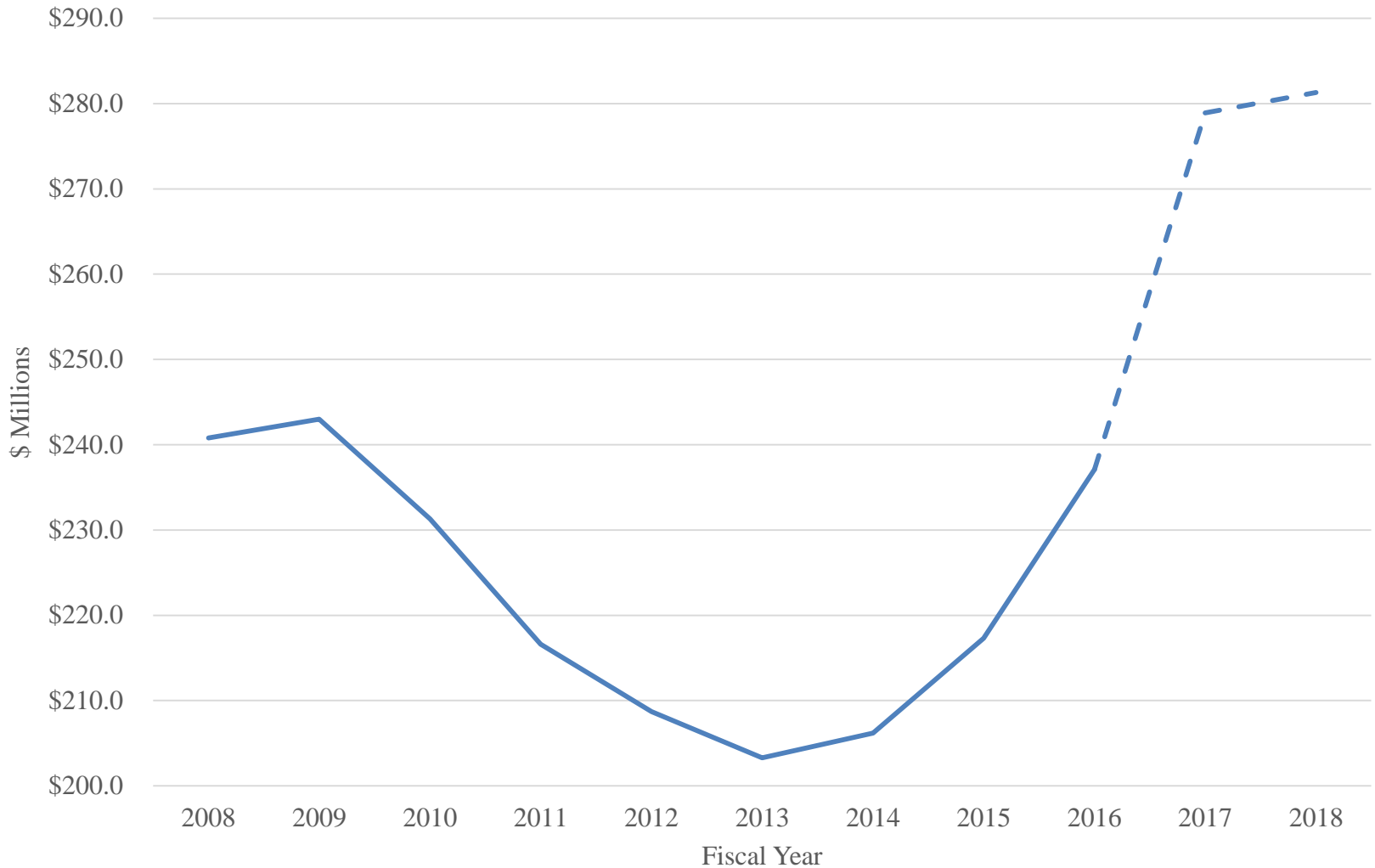
# The Achievement Gap Persists

## Over 20 Percent of All Schools Not Fully Accredited (2015-16)

Fully Accredited	1414
Conditionally Accredited (New)	9
Partially Accredited - Improving	123
Partially Accredited - Warned	215
Accreditation Denied	13
To Be Determined	49

<b>SOL Pass Rates (2015-16)</b>			
	<u>English</u>	<u>Math</u>	
Asian	91	93	
White	86	86	
Hispanic	71	72	
Black	66	67	
Economically Disadvantaged	66	69	
Limited English Proficiency	61	66	

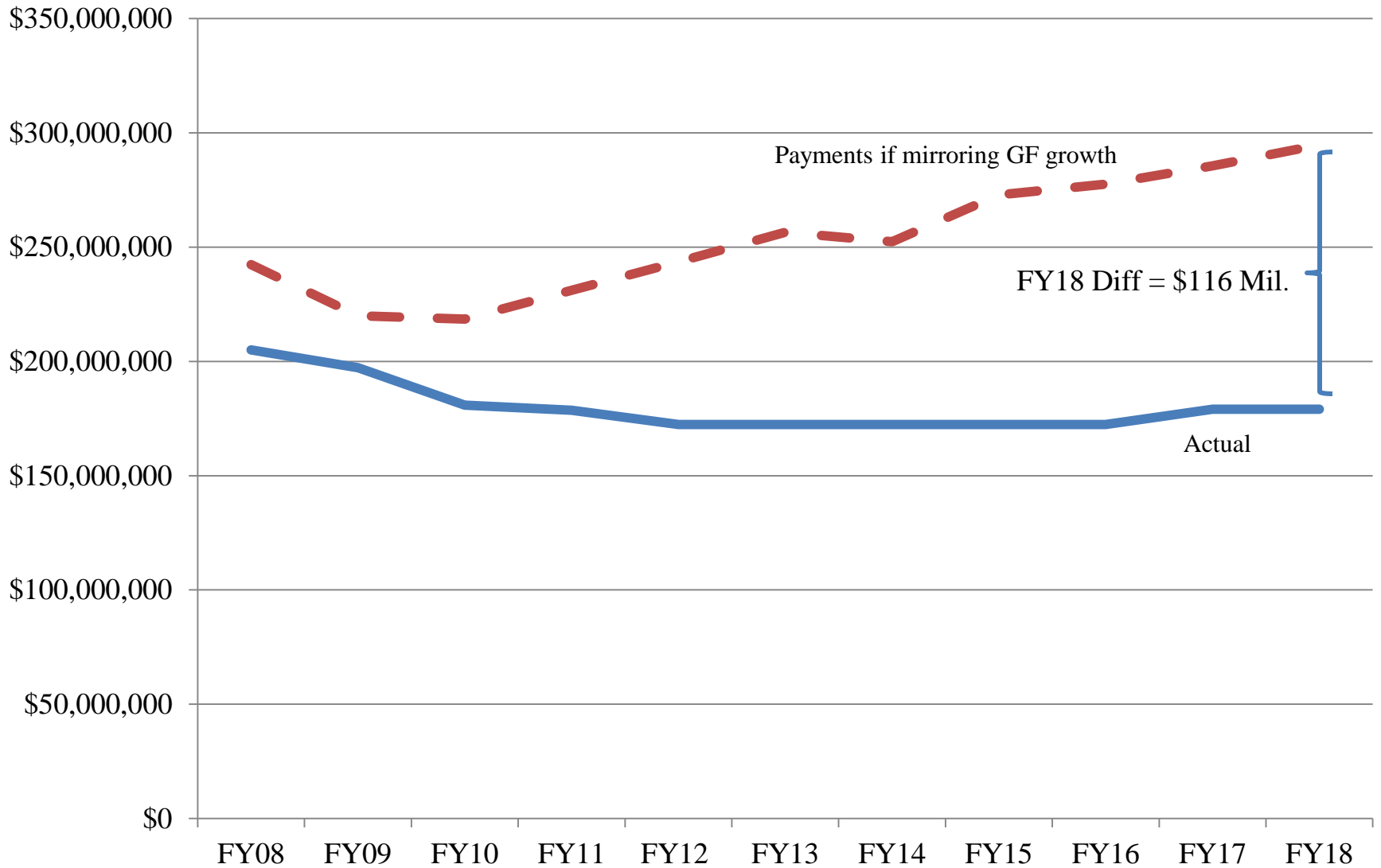
# State CSA GF Expenditures Rising Again



Note: From FY 2014-16, out of \$46 mil. increase in total CSA expenditures, \$28 mil. has been for SPED private day placements. 220 percent increase in autism diagnosis over last 10 years.

# HB 599 Aid to Police

## Actual vs Growth in GF Revenues Since FY 2000 (Statute)





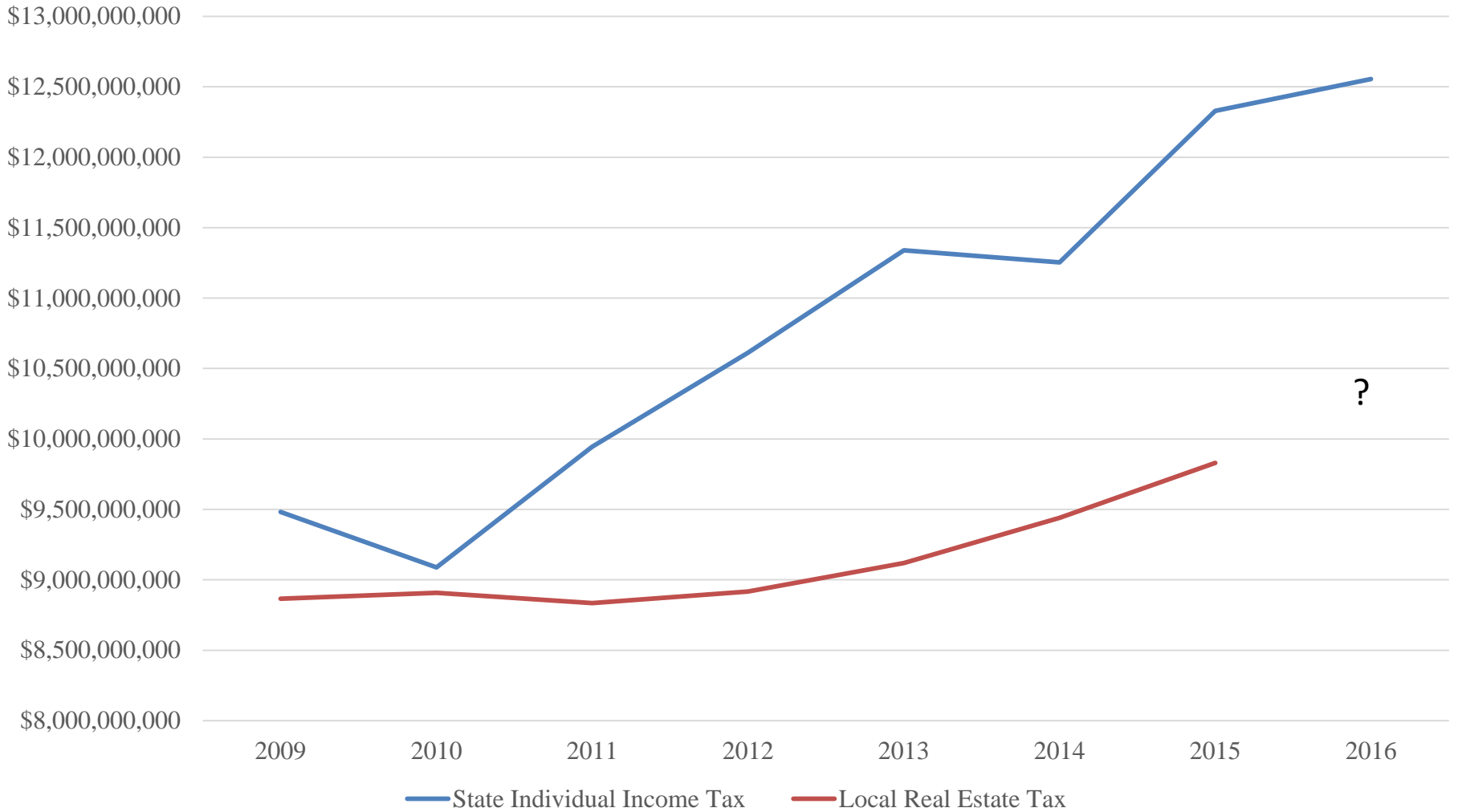
# Since Recession, Locality Resources Have Not Kept Pace with Inflation/Population Growth

	<b>FY 2009 - FY 2015 Growth Comparison</b>				
	<b>Locally-Generated Revenue</b>	<b>State/Federal Revenue</b>	<b>All Revenue</b>	<b>Population</b>	<b>Population/ Inflation</b>
VA Cities	7.7%	0.6%	4.6%	4.5%	15.1%
VA Counties	14.3%	9.5%	12.5%	6.1%	16.7%

Note: Consumer Price Index from fiscal years 2009-15 = 10.6%

Sources: Virginia Auditor of Public Accounts Comparative Revenue and Expenditure Reports,  
U.S. Bureau of Labor Statistics

## Slow State Income Tax Growth Has Still Significantly Exceeded Local Real Estate Tax Growth Since Recession



# Even Slow Real Property Revenue Growth Has Required Sharply Rising Rates

## Median Real Estate Tax Rates in Virginia Localities\*

	<u>CY 2009</u>	<u>CY 2016</u>	<u>Change</u>
<b>Cities</b>	<b>0.90</b>	<b>1.07</b>	<b>0.17</b>
<b>Counties</b>	<b>0.55</b>	<b>0.66</b>	<b>0.11</b>
<b>Towns</b>	<b>0.18</b>	<b>0.18</b>	<b>-</b>

\* Nominal rates per \$100 of assessed value. Source: Weldon Cooper Center, "Virginia Local Tax Rates"

# Conclusion

- The state is significantly underfunding state-mandated locally-administered programs, particularly the largest -- K-12 education. The K-12 budget for FY 2017 is no higher in nominal dollars than 2009 and is almost \$600 per pupil less in inflation-adjusted terms.
  - Most other locally-mandated programs for health, welfare, public safety, etc., have been level funded or reduced since FY2009.
  - The state continues to shift funding responsibilities to locals.
- Low growth in GF revenues and continued higher growth in Medicaid and debt service mean a continued degradation in state support for locally-administered mandated programs. **The state cannot adequately shoulder its responsibilities due to a systematic reduction in the general fund tax base.**
- Local revenues -- already straining to provide the state's critical services -- are under continual threat from redefinition, exemption, and elimination.
- The state should either shoulder more funding responsibility or provide localities with much greater revenue generating capacity.

# Previous Tax Changes Annually Reduce GF Revenues by \$2 Bil.

	<u>Enacted/Amended</u>	<u>FY 2016</u>
Car Tax Reimbursement	1997, 2003	\$950
Impose lower 2.5% Sales Tax on Food	2004	\$556
Age Subtraction (net of 2004 means testing)	1994 and 2004	\$292
Low Income Tax Relief, increase filing thresholds, exemptions, etc.	2000, 2004, and 2007	\$203
1/3 Insurance Premiums to Transportation	2007	\$150
Estate Tax Repeal	2009	\$140
0.1% sales tax diversion to transportation	2013	\$101
Land Preservation Tax Credit	2003	\$100
Historic Rehab Tax Credit	1999	\$76
Corp. double weighting sales and single sales factor	1999, 2009	\$74
Sales tax exemption for data centers	2010/2011	\$51
Sales tax exemption for non-prescription drugs	1990	\$39
Subtraction for military wages and unemployment benefits	1999	\$37
Coalfield Employment Tax Credits	2000	\$34
All Other Tax Reductions Since 1999	1990-2014	<u>\$121</u>
<b>State GF Tax Reductions since 1994</b>		<b>(\$2,924)</b>
Add 1/2 percent sales tax on non-food items	2004	\$500
Recordation Tax Increase (net of 3 cents to transp.)	2004/2007	\$150
Tobacco Tax Increase (Va Health Care Fund)	2004	\$146
Close 2 Corp. Tax Loopholes/Eliminate ST Exem for Pub. Svc. Co.	2004	\$143
Sales Tax Presence in Virginia Amazon	2012	\$22
Sales tax on satellite TV equipment	2014	<u>\$10</u>
<b>State Tax Increases since 1994</b>		<b>\$971</b>
<b>Net State Tax Change Since 1994</b>		<b>(\$1,953)</b>

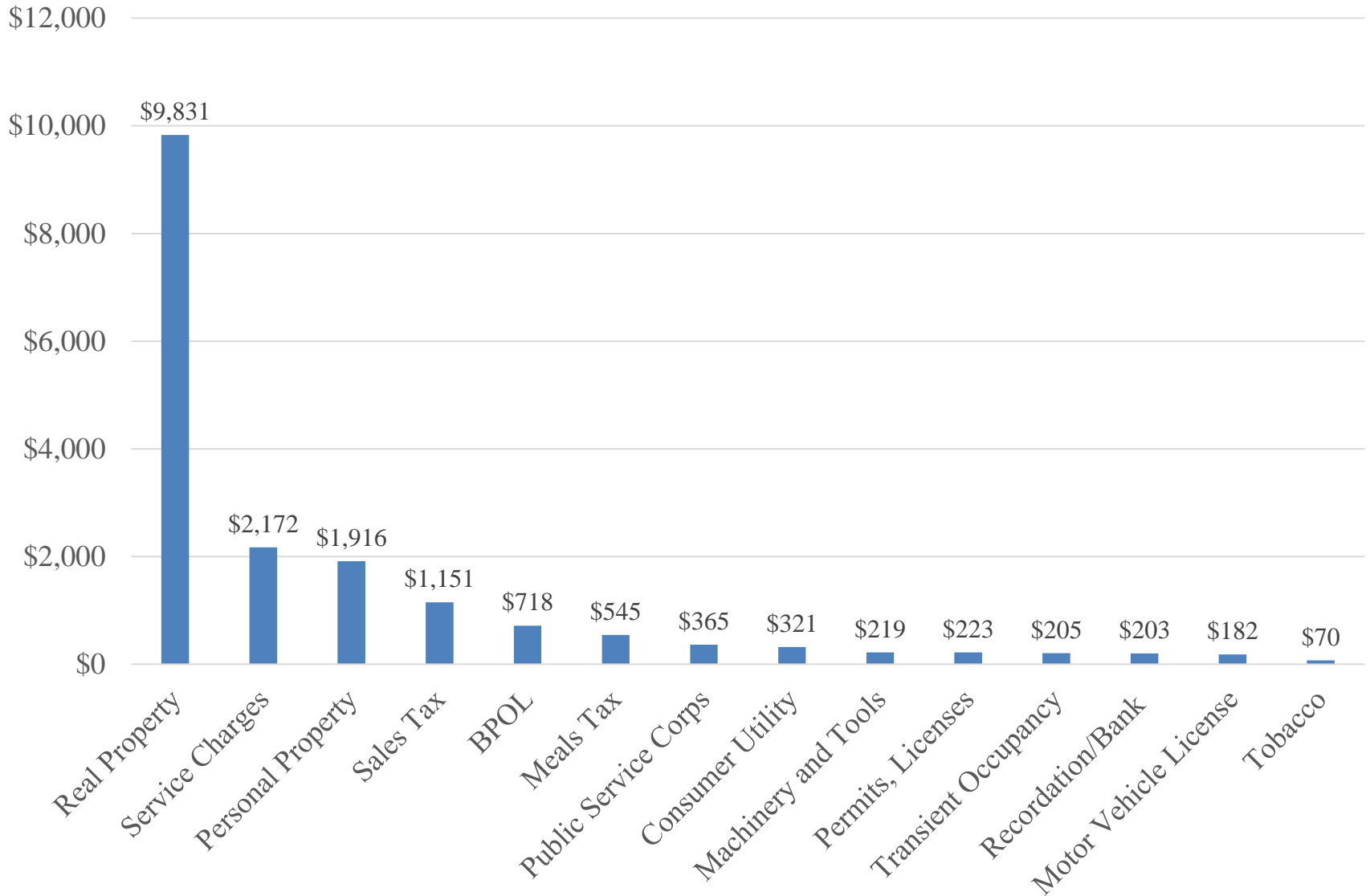
Source: Senate Finance Committee Retreat, Revenue Outlook, Nov. 19, 2015

# Options for Strengthening/Diversifying the State/Local Tax Base

- Structural individual/corporate income tax reform, including reform of tax credits/subtractions (e.g., grandfather reduced age subtraction)
- Apply sales taxes to selected personal and repair services (auto) and reduce exemptions (e.g., data center replacement equipment, nonprofit hospitals).
- Return to GF insurance premium, recordation tax, and sales tax diversion to transportation. Expand the 0.7 percent regional sales tax for transportation to the rest of the state.
- Require internet sellers not collecting sales tax to inform the purchaser and Tax Department for use tax payment purposes.
- Increase tobacco taxes for the Virginia Health Care Fund.
- Broaden the local communications sales tax for audio and video streaming services and prepaid calling services and raise rate to 5.3%.
- Allow counties the same taxing authority *by ordinance* as cities for meals and transient occupancy taxes.
- Put a price floor under the regional gas taxes. Expand the differential commercial/industrial property tax rate currently used in Northern Virginia (and available in Hampton Roads).
- Phase down or eliminate the car tax reimbursement over several biennia.

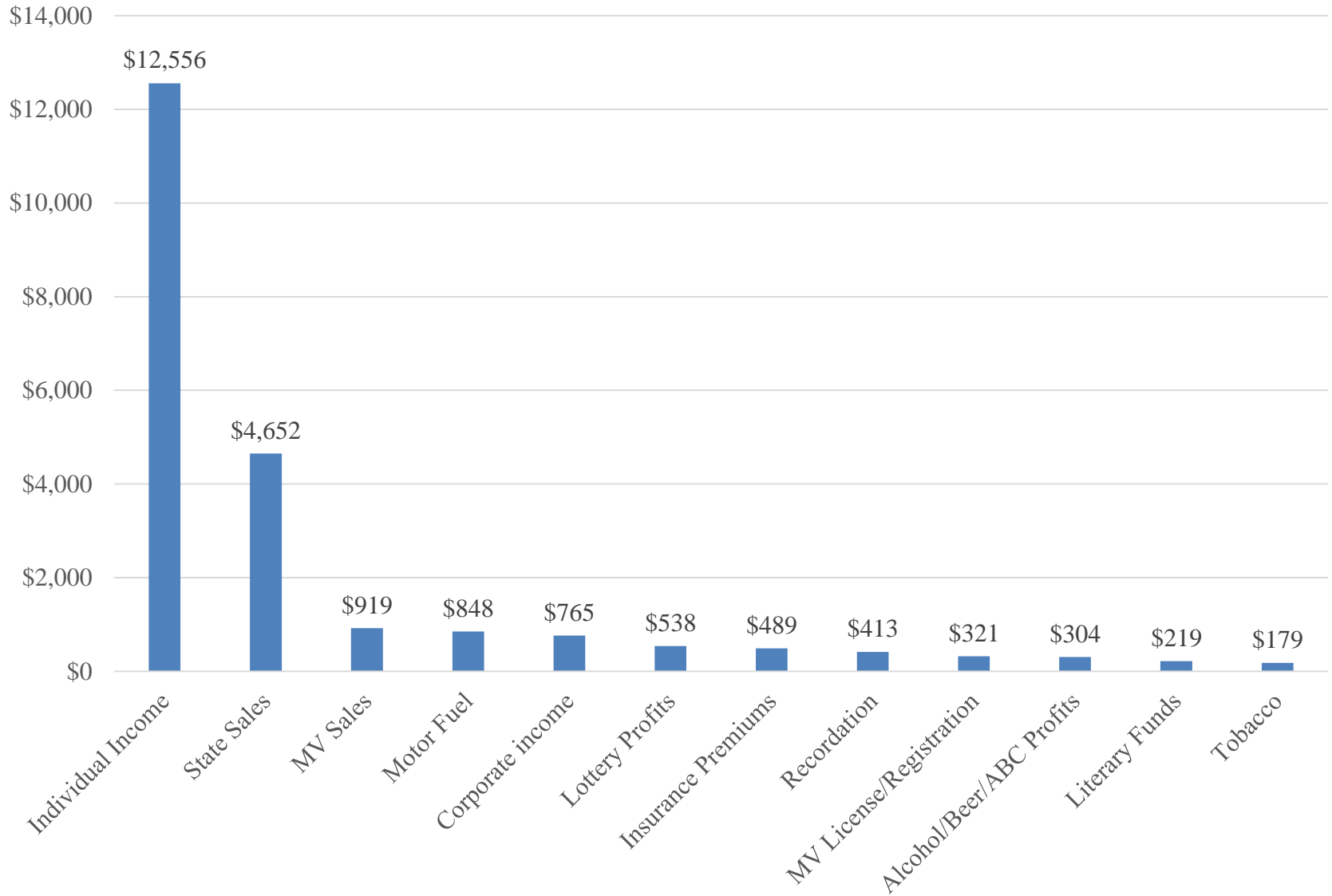
# Appendices

# FY 2015 Major Local Revenue Sources (\$ Mil.)





# FY 2016 Major State Revenue Sources (\$ Mil.)



# Sales Tax Rates In Surrounding States

	<u>State</u>	<u>Lowest Local</u>	<u>Highest Local</u>	<u>Highest Combined</u>
Washington D.C.	5.75			5.75
<b>Virginia</b>	<b>4.30</b>	<b>1.00</b>	<b>1.70</b>	<b>6.00</b>
Kentucky	6.00	No Local	No Local	6.00
Maryland	6.00	No Local	No Local	6.00
North Carolina	4.75	2.00	2.75	7.50
Tennessee	7.00	1.50	2.75	9.75

# Individual Income Taxes in Surrounding States

	<u>State Rates</u>	<u>Local Rates</u>	<u>Single-Filer Brackets</u>	<u>Standard Deduction</u>	<u>Personal Exemption</u>
Virginia	2.00	N/A	\$0	\$3,000	\$930
	3.00		\$3,000		
	5.00		\$5,000		
	5.75		\$17,000		
Kentucky	2.00	0-2.25%	\$0		
	3.00		\$3,000		
	4.00		\$4,000		
	5.00		\$5,000		
	5.80		\$8,000		
	6.00		\$75,000		
Maryland	2.00%	1.25-3.20%	\$0	\$2,000	\$3,200
	3.00		\$1,000		
	4.00		\$2,000		
	4.75		\$3,000		
	5.00		\$100,000		
	5.25		\$125,000		
	5.50		\$150,000		
	5.75		\$250,000		
North Carolina	5.75	N/A	\$0	\$7,500	N/A
Tennessee	6.00% on Interest/Dividend Income Only				\$1,250
Washington D.C.	4.00	N/A	\$0	\$2,000	\$1,675
	6.00		\$10,000		
	8.50		\$40,000		
	8.95		\$350,000		