

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

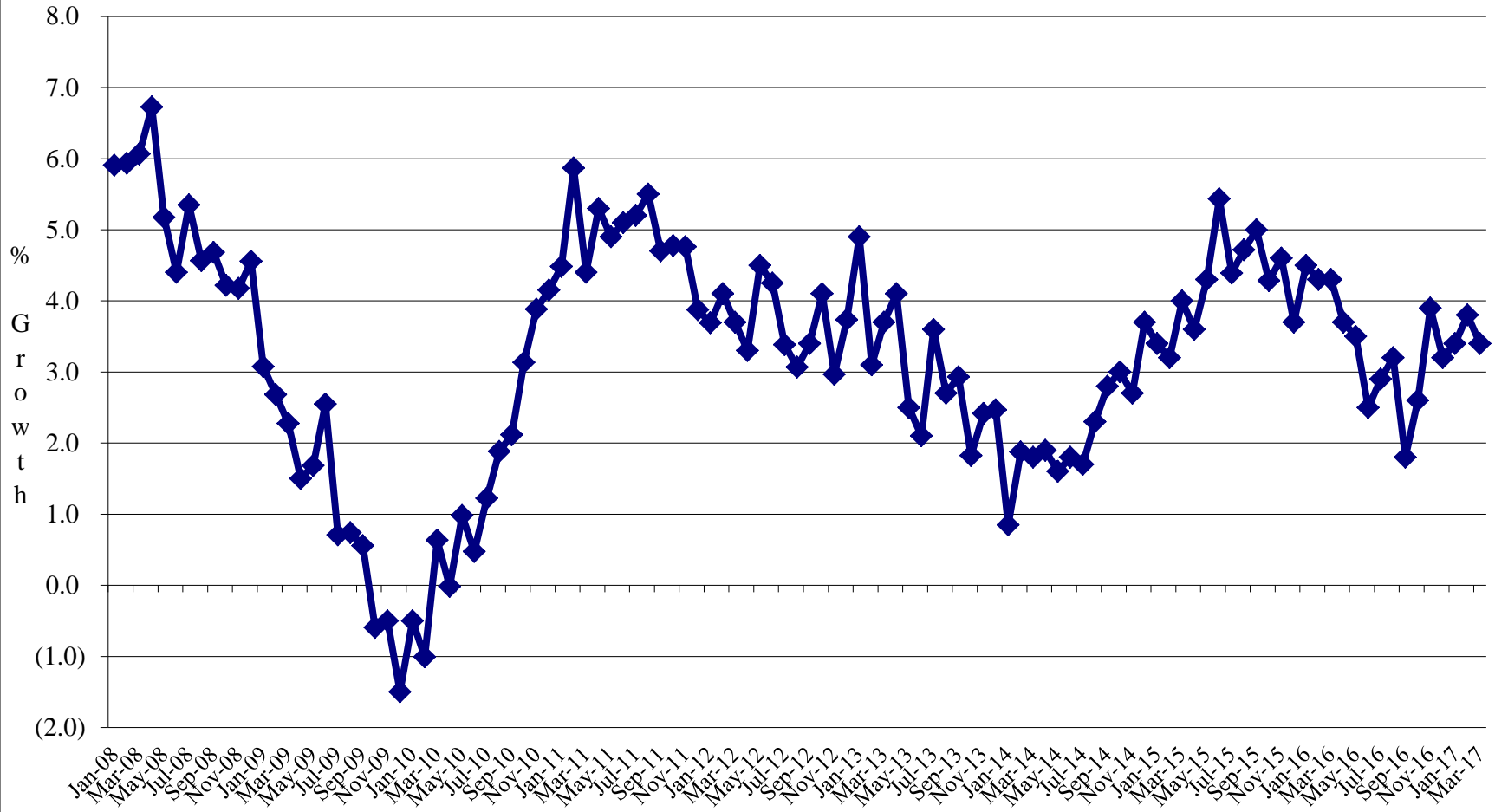
9 Months GF Revenue Collections Better Than Forecast

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%
Total GF	4.6%	2.9%
* Adjusted for the accelerated sales tax program in June		

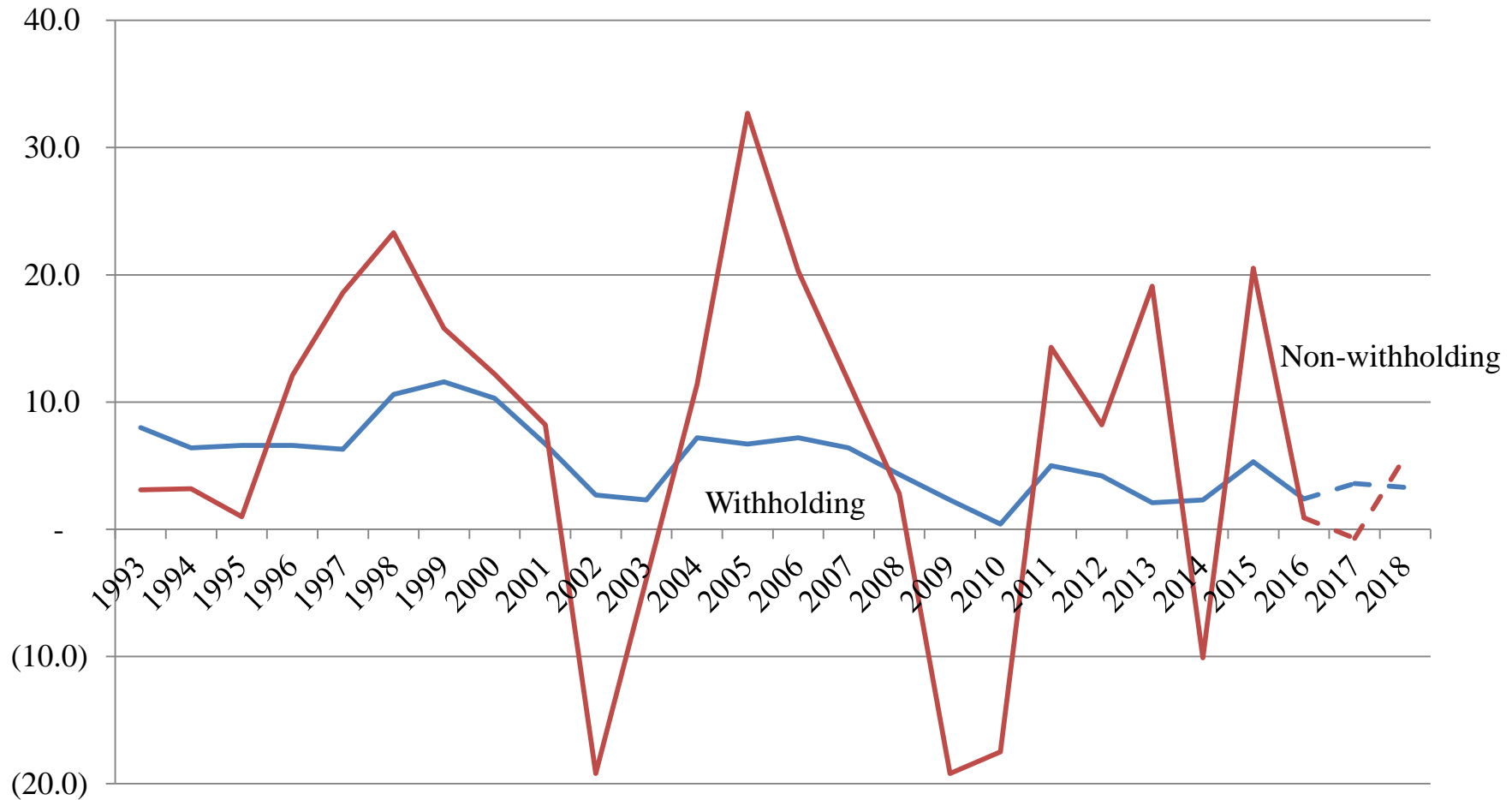
Income Tax Withholding Growth Is the Driver of GF Revenues

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>
Major Revenue Policy Adjustment Proposals	
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
Total GF Revenue Policy Adjustments	

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

	GF Budget Accounting					
		<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>	3.8%	7.4%
<i>2018 Forecast</i>	2.9%	4.1%

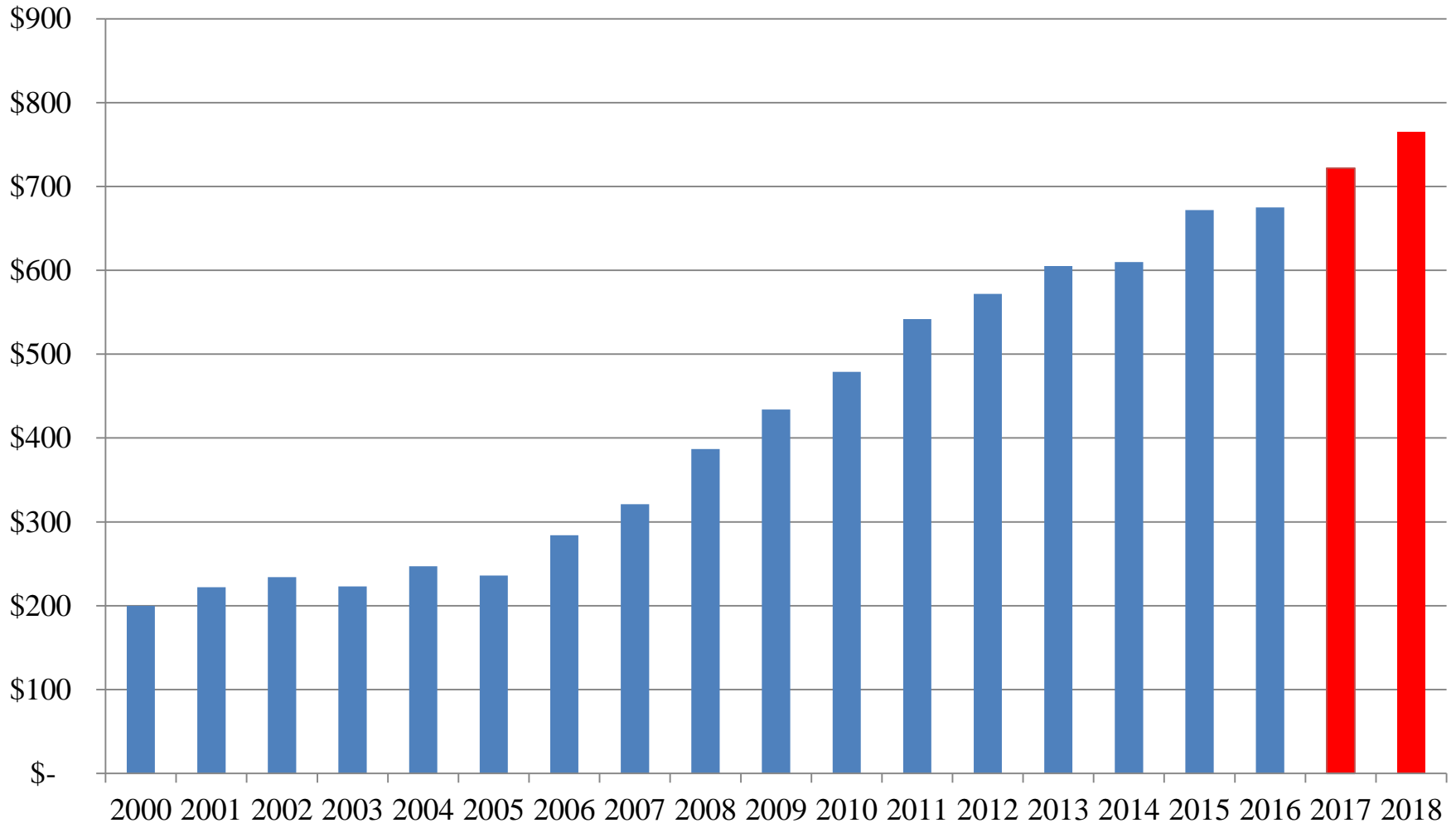
Major forecast spending changes were in:

- 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?

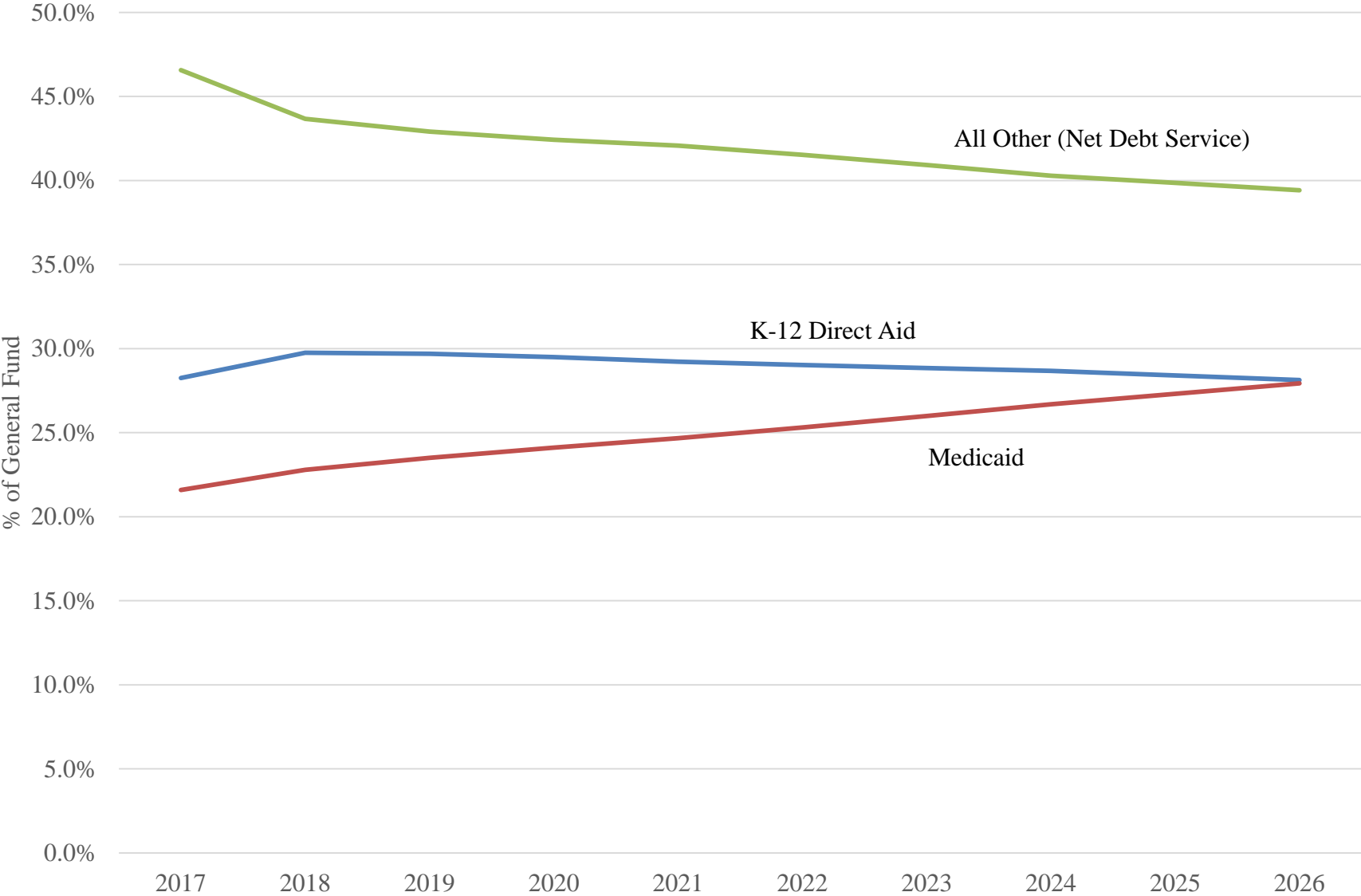
	Total Projected VA Population	Pop. 65 years and over	% of Total Pop. Age 65 and Over	Pop. 85 years and over	% of Total Pop. Age 85 and Over
2010	8,001,024	976,937	12.2%	122,403	1.5%
2020	8,744,273	1,392,849	15.9%	149,399	1.7%
2030	9,546,958	1,803,403	18.9%	194,658	2.0%
2040	10,201,530	1,925,149	18.9%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



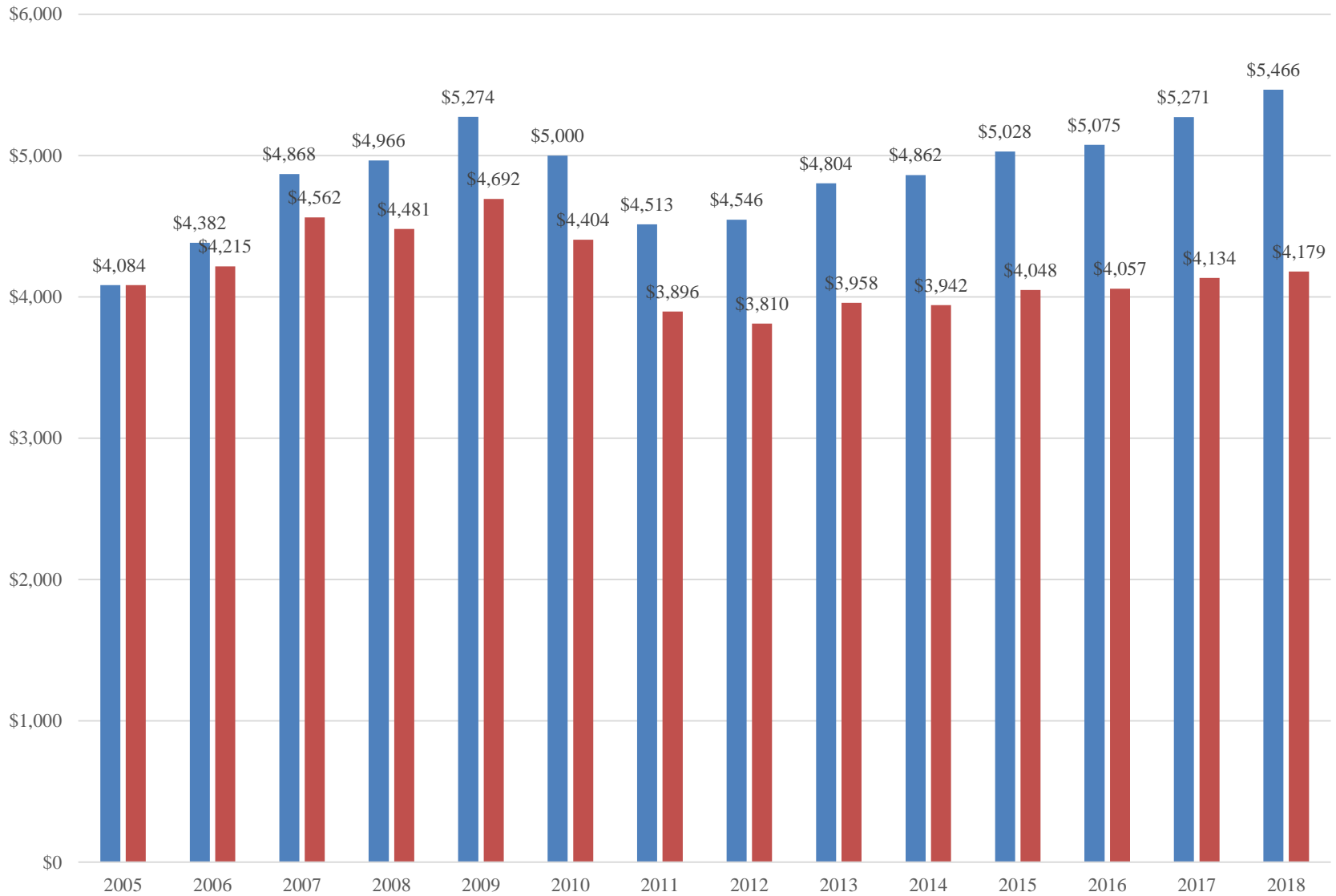
How Did Localities Fare in the Revised 2016-18 Budget Proposal?

- 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>
Direct Aid to K-12	\$5,607.6	\$5,240.3	\$5,520.9	\$5,675.3	\$6,030.0
K-12 % of Total GF Appropriations	35.2%	29.6%	28.9%	28.2%	29.6%
Health and Human Services	888.4	791.7	867.5	926.0	951.5
<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
Public Safety	734.3	687.9	715.5	732.1	743.4
<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
Constitutional Officers	155.3	145.8	152.5	156.7	158.0
Dept. of Accounts Transfers	49.3	49.3	49.5	49.6	49.6
Car Tax	950.0	950.0	950.0	950.0	950.0
Aid-to-Locality Reduction	(50.0)	-	-	-	-
Total Local GF Aid	\$8,334.9	\$7,865.0	\$8,255.9	\$8,489.7	\$8,882.5
Total GF Appropriations	\$15,943.0	\$17,705.2	\$19,102.0	\$20,115.2	\$20,354.6
Local Aid % of Total GF	52.0%	44.1%	43.2%	42.2%	43.6%

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).

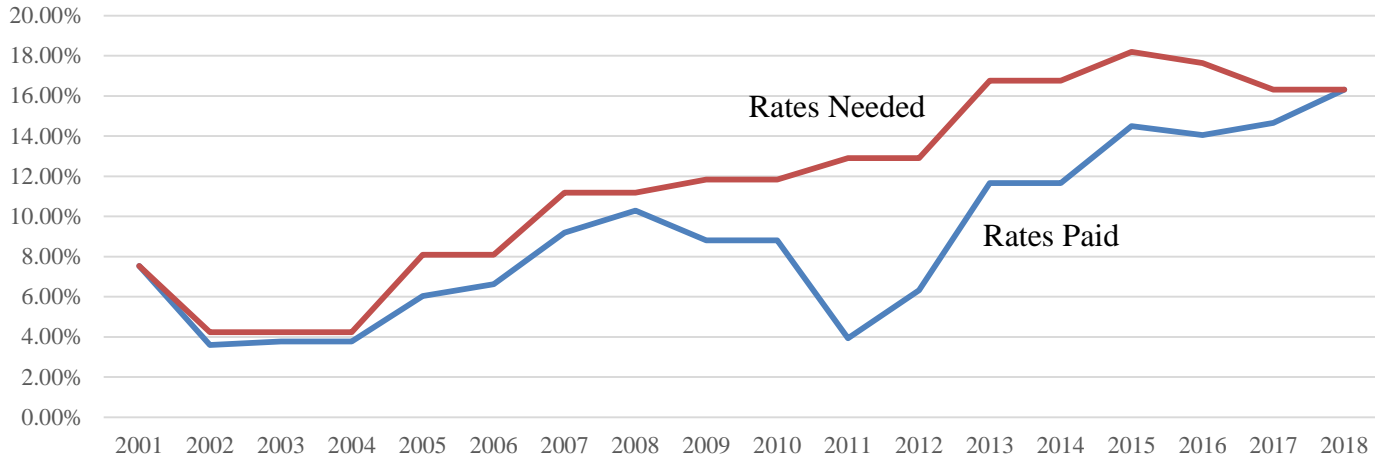
State Standards of Quality Do Not Reflect True Costs for Local K-12 Divisions

- 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.

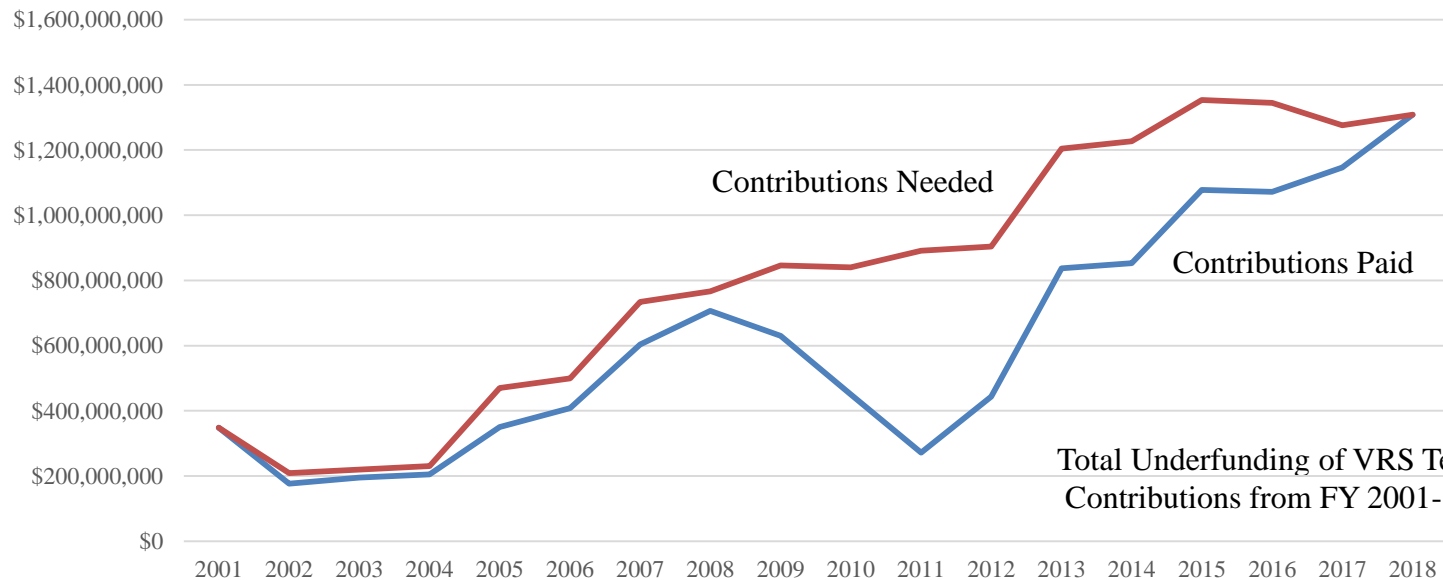
Divisions up to 25% Above RLE	16
Divisions Exceeding 25% to 75%	50
Divisions Exceeding 76% to 100%	31
Divisions Exceeding 100% RLE	37

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.)



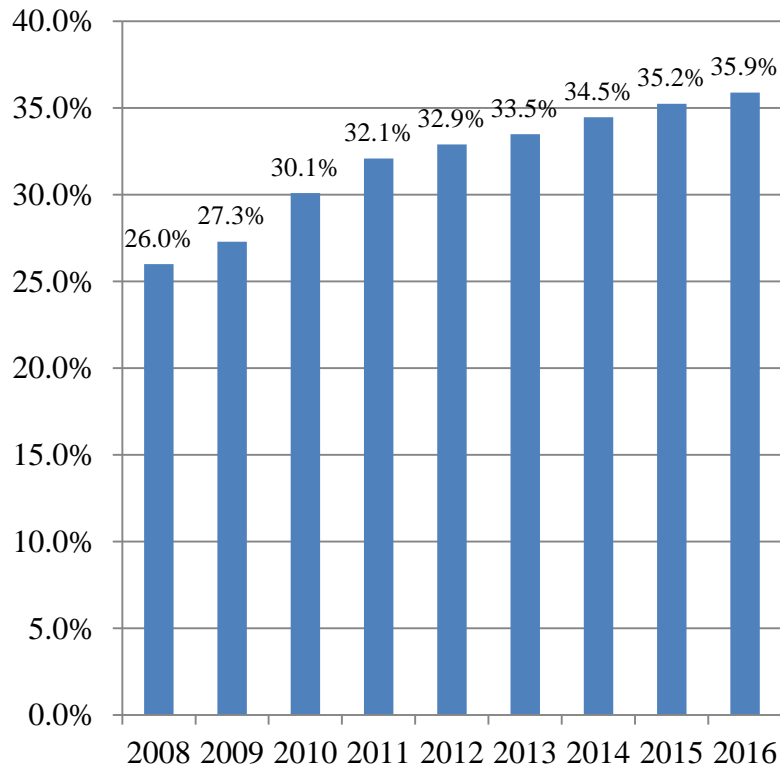
Total Underfunding of VRS Teacher Contributions from FY 2001-17 = \$3.6B

More Difficult and Diverse Student Population to Educate

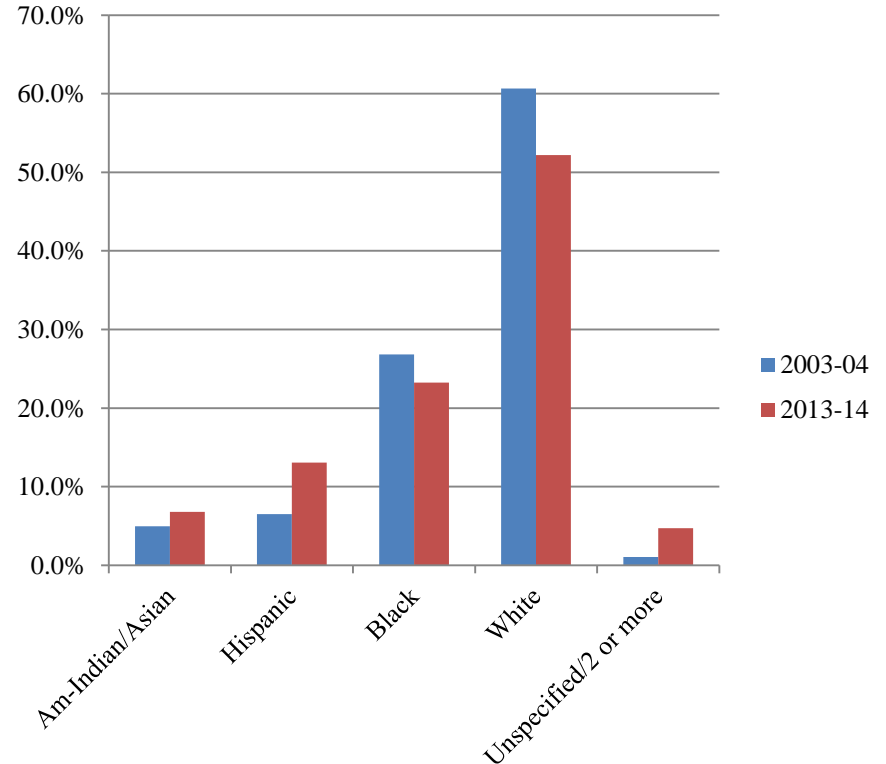
- 163,000 Special Ed Students (13%)

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

% Free Lunch Students Growing



VA Public K-12 Student Population by Race



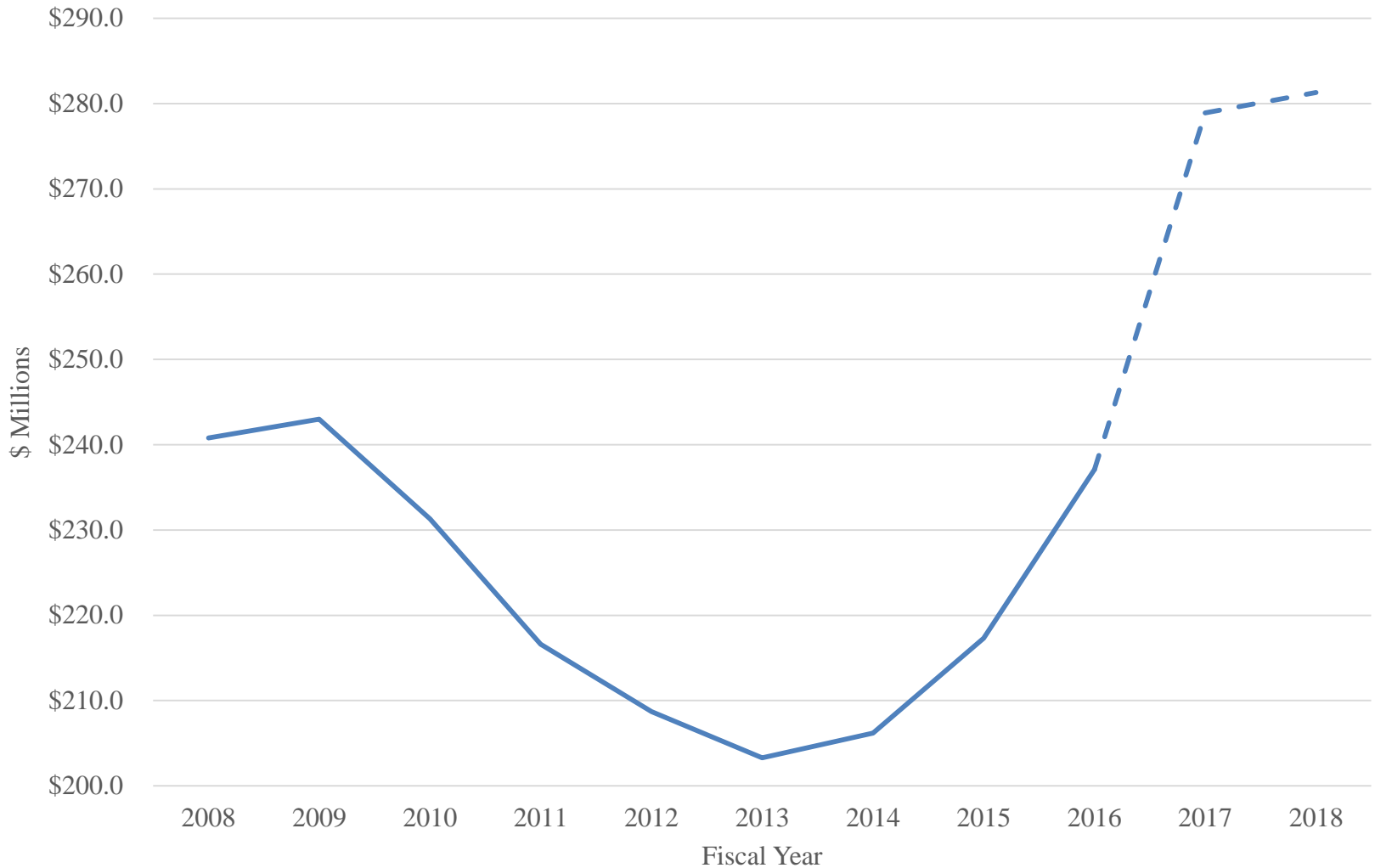
The Achievement Gap Persists

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

SOL Pass Rates (2015-16)			
	<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	

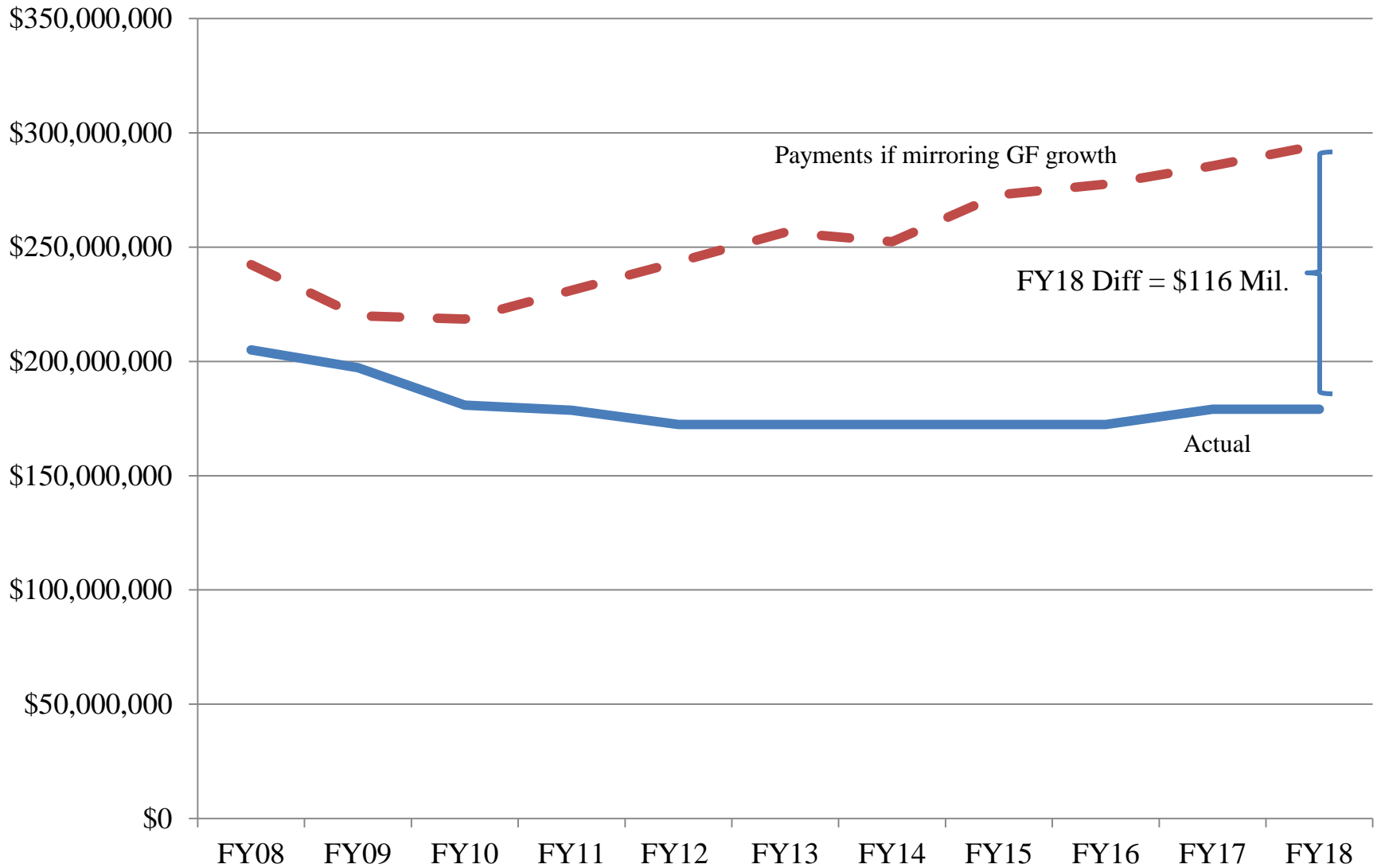
State CSA GF Expenditures Rising Again



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)



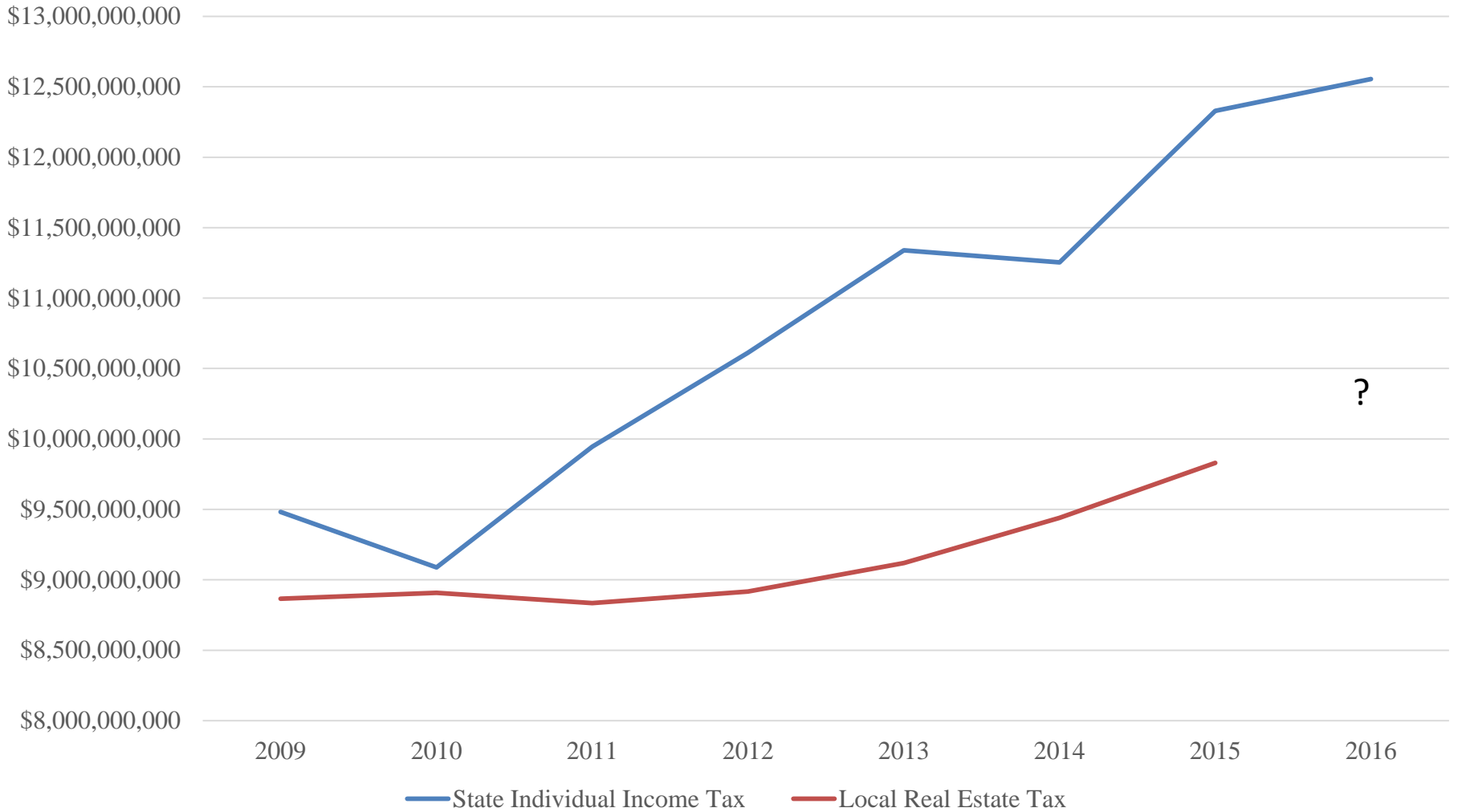
Since Recession, Locality Resources Have Not Kept Pace with Inflation/Population Growth

	FY 2009 - FY 2015 Growth Comparison				
	Locally-Generated Revenue	State/Federal Revenue	All Revenue	Population	Population/Inflation
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>
Cities	0.90	1.07	0.17
Counties	0.55	0.66	0.11
Towns	0.18	0.18	-

* 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>
State GF Tax Reductions since 1994		(\$2,924)
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>
State Tax Increases since 1994		\$971
Net State Tax Change Since 1994		(\$1,953)

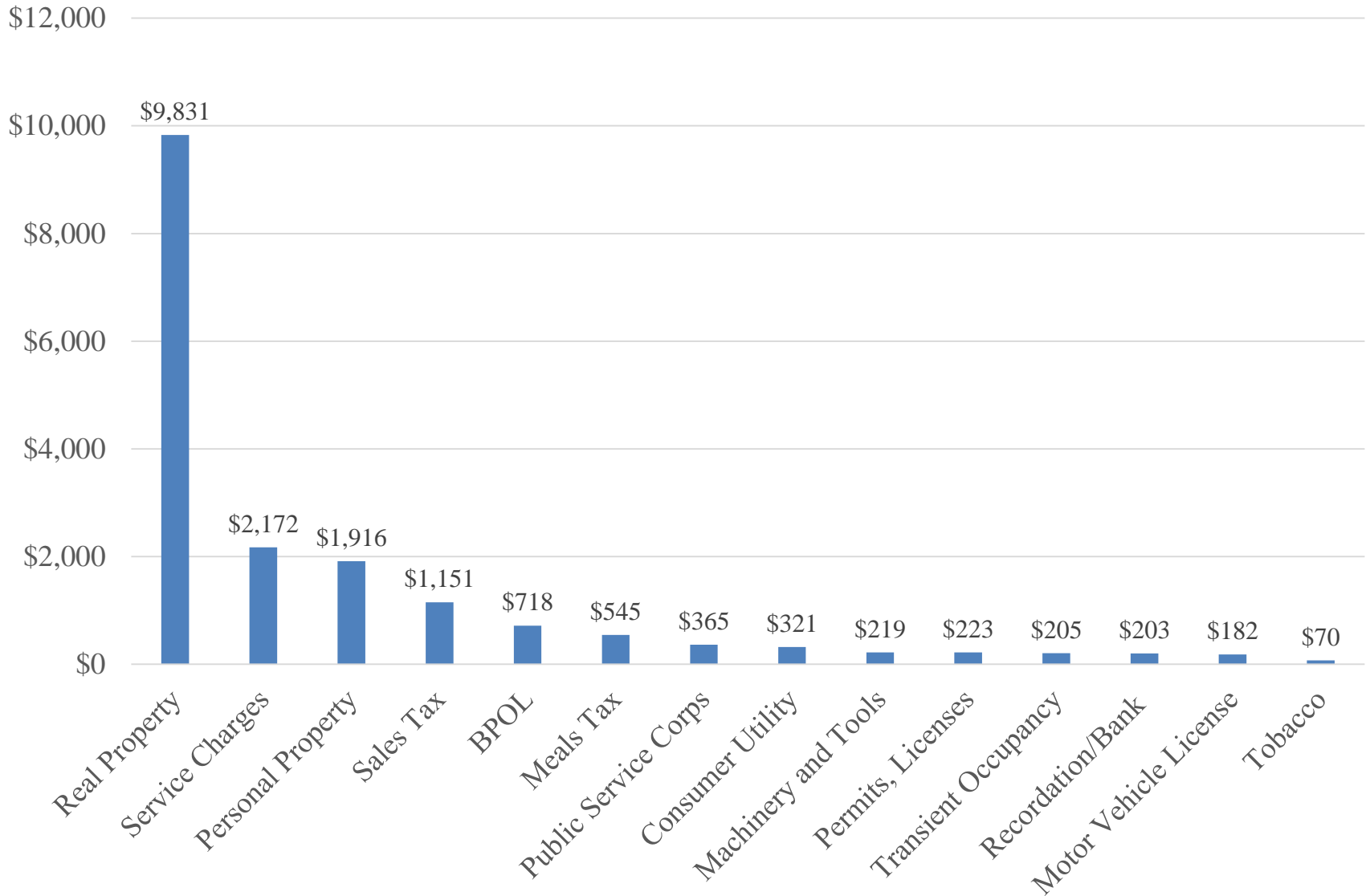
Source: Senate Finance Committee Retreat, Revenue Outlook, Nov. 19, 2015

Options for Strengthening/Diversifying the State/Local Tax Base

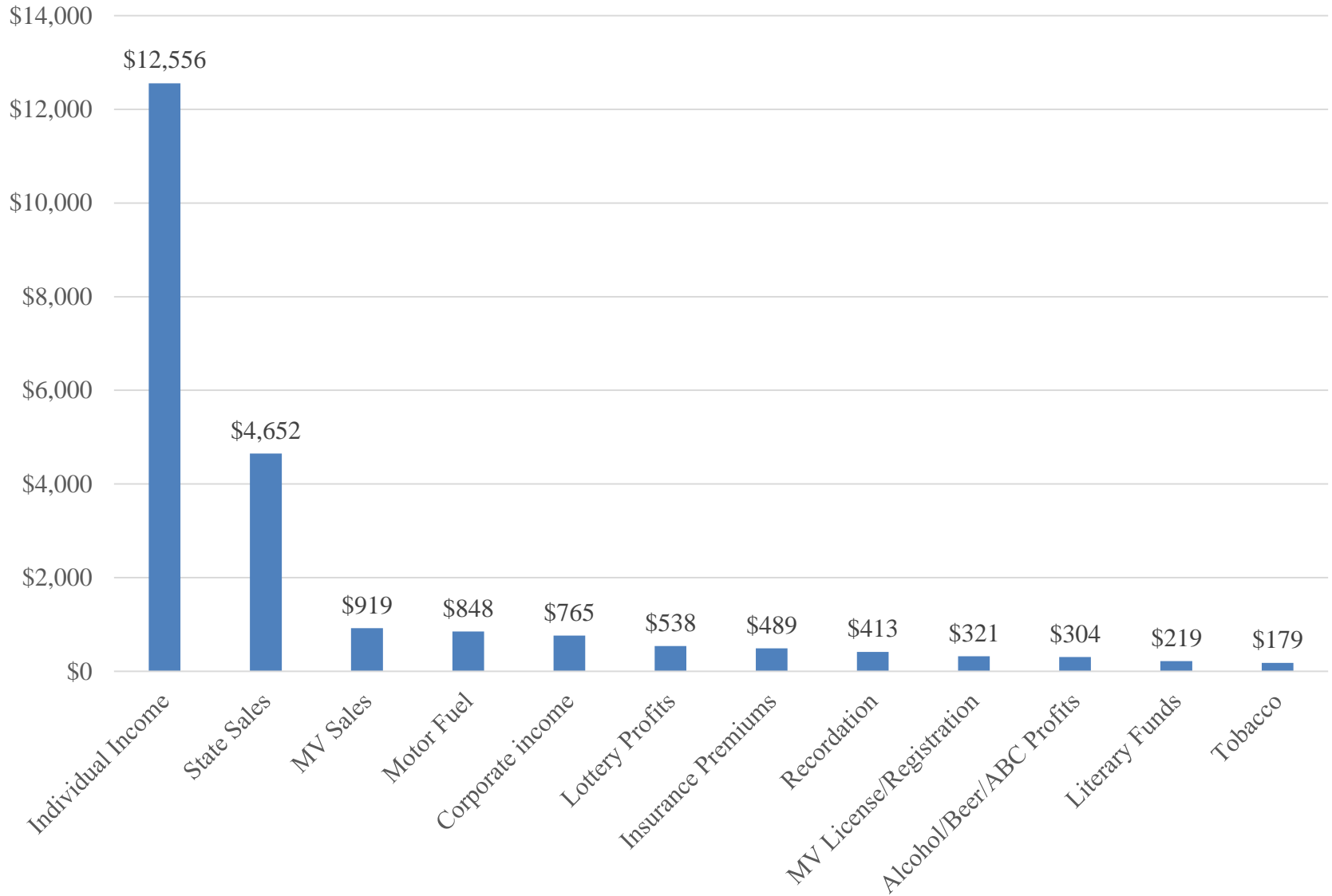
- Structural individual/corporate income tax reform, including reform of tax credits/subtractions (e.g., grandfather reduced age subtraction)
- Apply sales taxes to selected personal and repair services (auto) and reduce exemptions (e.g., data center replacement equipment, nonprofit hospitals).
- Return 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
Virginia	4.30	1.00	1.70	6.00
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		