

# Virginia's State and Local Budget Issues and Challenges

Virginia Association of Counties

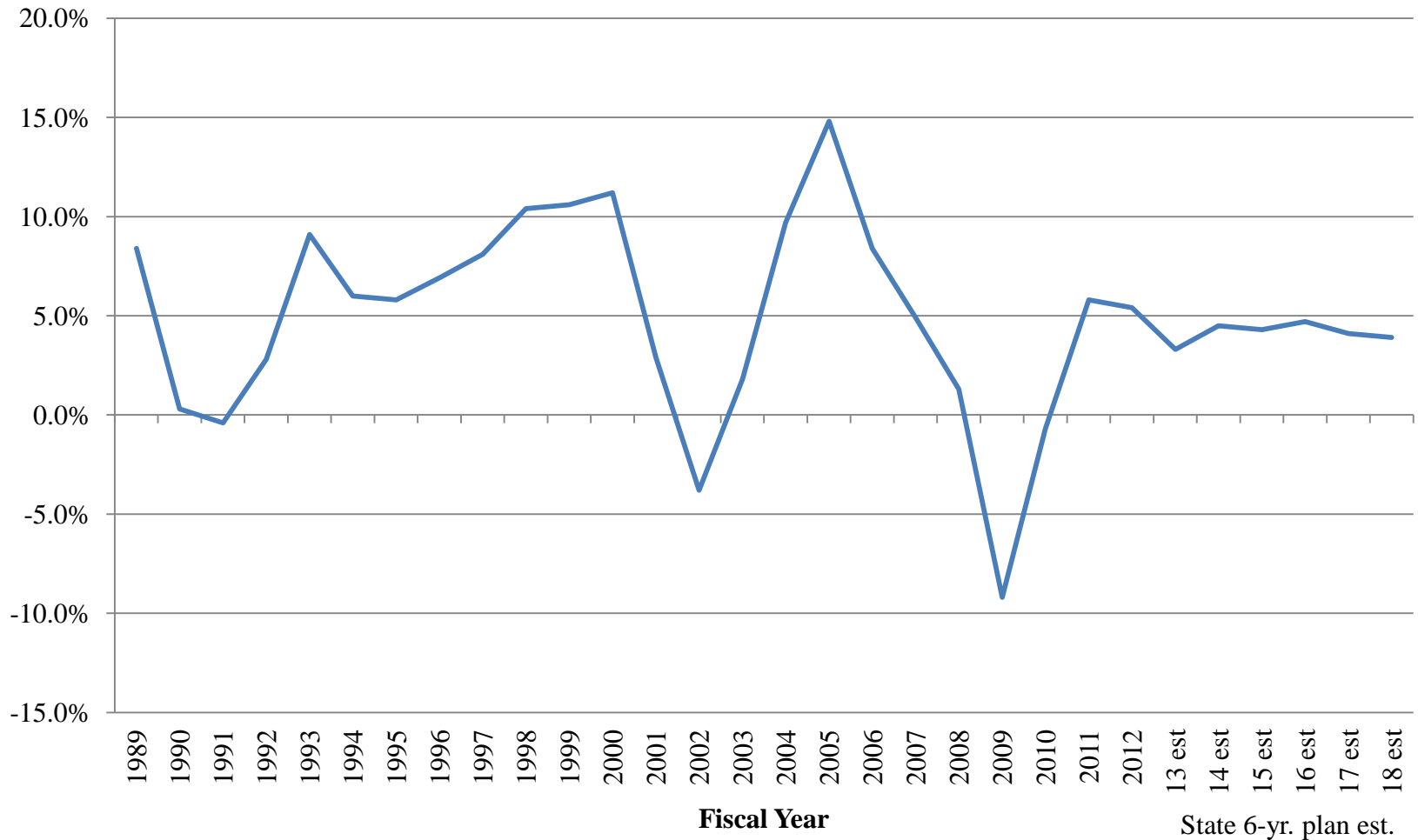
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Fiscal Analytics, Ltd.

November, 2012

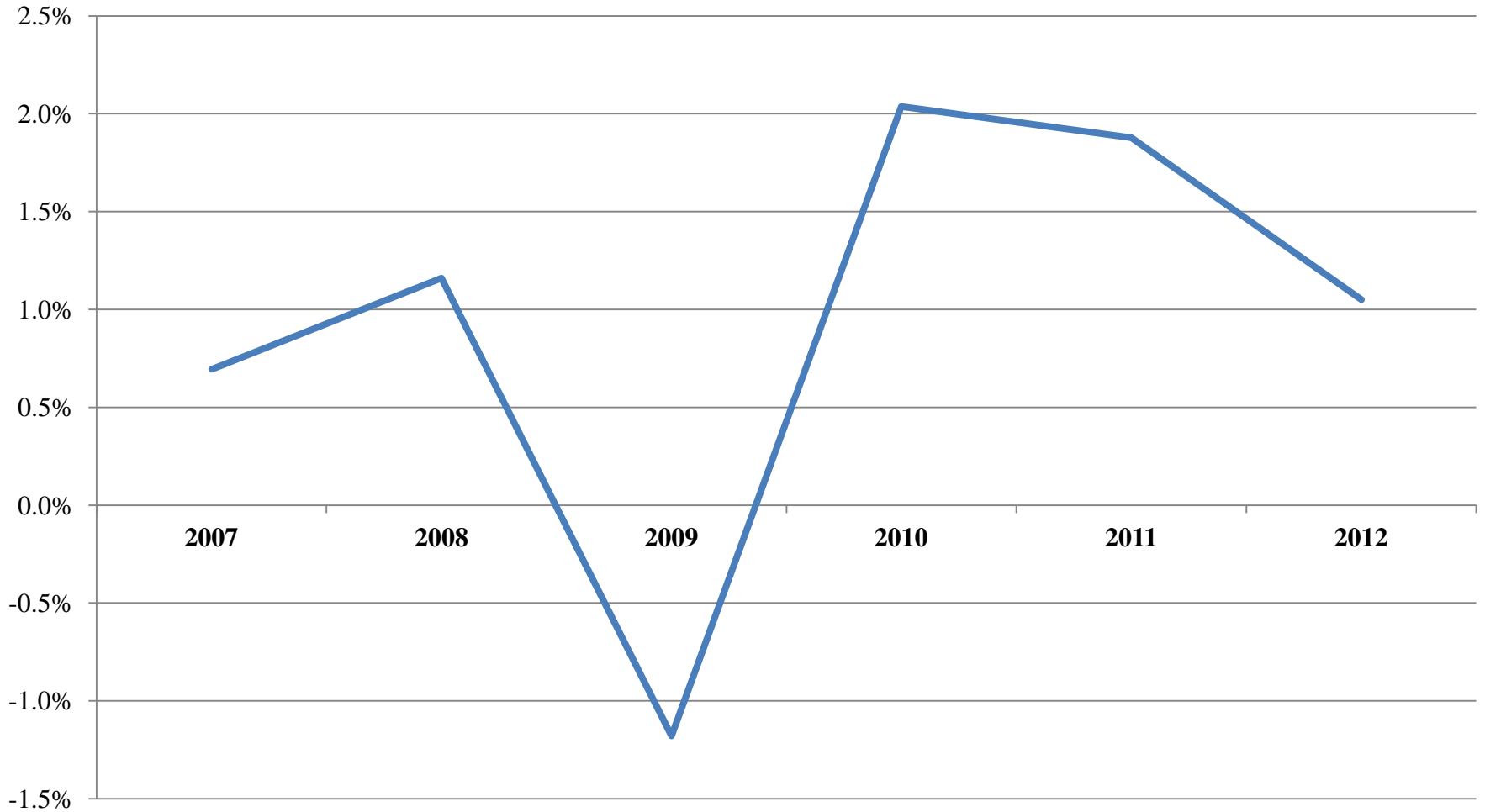
# State GF Revenues Not Rebounding as Fast After Recent Recession Compared to Previous Recessions

## Growth in Total General Fund Tax Revenues



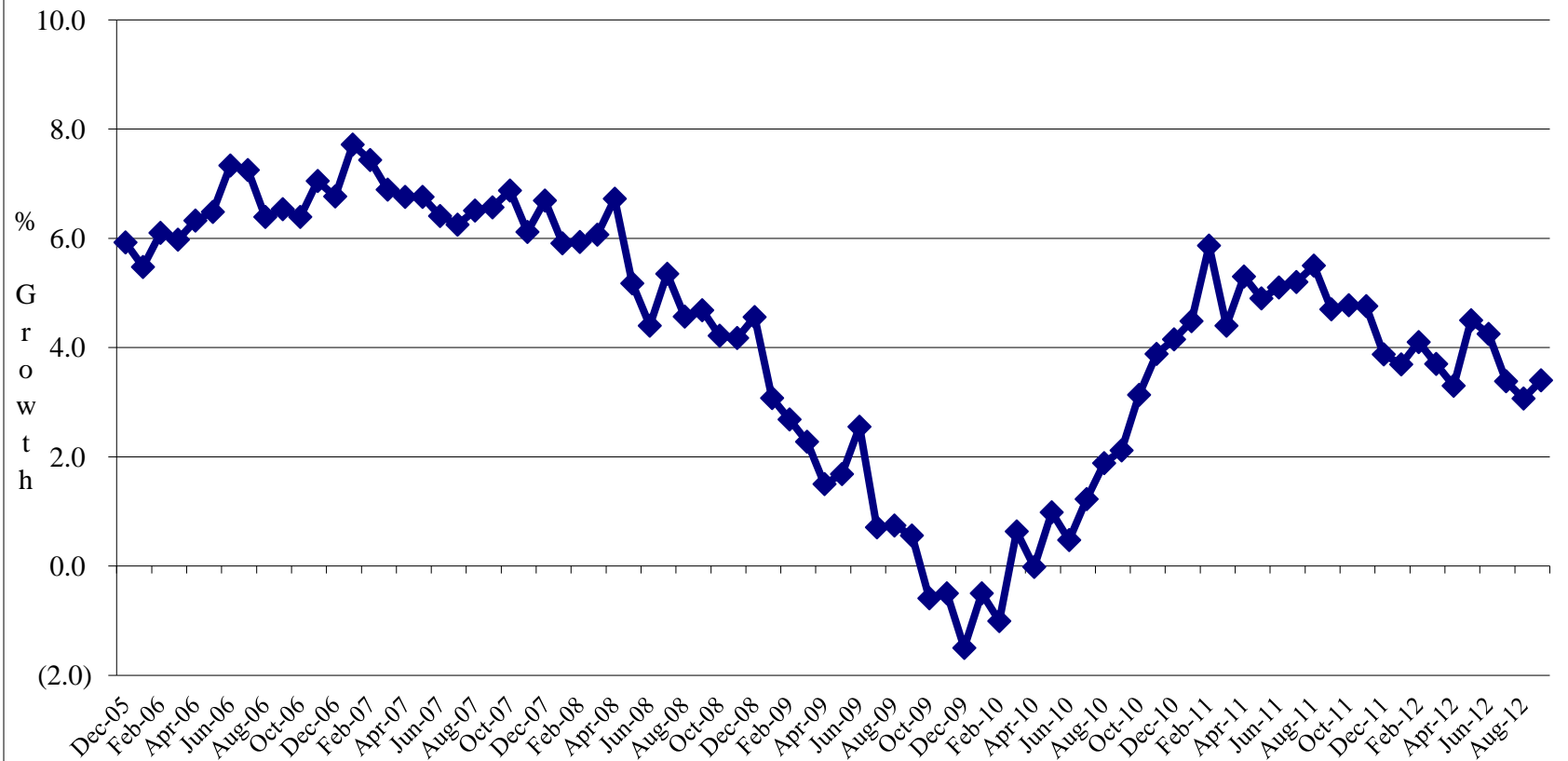
# Employment Growth is Slowing

**Year-over-Year VA September Employment Growth**



# Economic Growth Is Slowing

## Growth in VA Individual Income Tax Withholding 12 Mo. Moving Avg (% Growth)



# FY 2012 Surplus Mostly Spent

## Proposal to Spend FY 2012 GF Surplus

	<u>\$ Mil.</u>
Surplus GF Revenues	\$129.2
Unspent GF Appropriations	<u>\$319.3</u>
<b>Total FY 2011 GF Surplus Available:</b>	<b>\$448.5</b>
<b>Spending Required or Proposed by Governor:</b>	
Mandatory Re-appropriations	\$98.0
Revenue Stabilization Fund	\$78.3
State Employee Bonus	\$77.2
Virginia Health Care Fund balances	\$66.1
<b>Discretionary Re-appropriations</b>	<b>\$41.8</b>
Fact Fund Reserve	\$30.0
Accelerated Sales Tax to Transportation	\$20.9
Natural Disaster Sum Sufficient	\$17.2
Water Quality Improvement Fund	\$16.9
Other	<u>\$2.1</u>
<b>Total Required/Proposed Spending</b>	<b>\$448.5</b>

# Even With Slower Growth, the Higher Revenue Base from FY 2012 Should Provide \$100-150M in Additional GF Revenues for 2012-14 Biennium

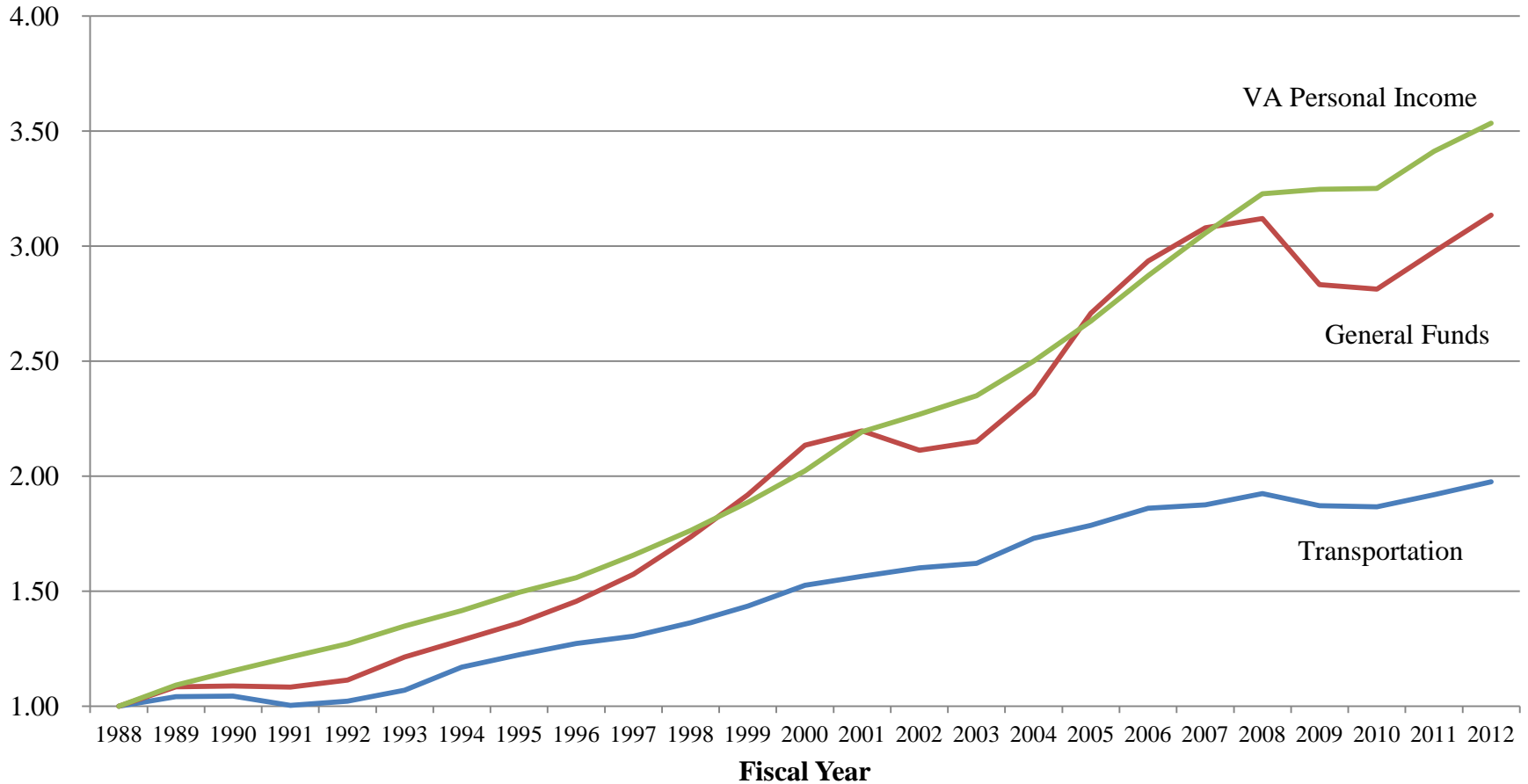
	<i>FY 2012 Actual</i>	<b>FY 2013 FA Est.</b>	<b>Est. Growth</b>	<b>Est. FY 2014 FA Est.</b>	<b>Est. Growth</b>
Individual Income	\$10,613	\$11,001	3.7%	\$11,500	4.5%
Sales Taxes	\$3,122	\$3,266	4.6%	\$3,419	4.7%
Corporate Income	\$860	\$815	-5.2%	\$860	5.5%
Insurance Premiums	\$253	\$258	2.2%	\$271	4.7%
Wills, Suits, Deeds	\$322	\$350	8.7%	\$375	7.1%
All Other GF Revenues	<u>\$678</u>	<u>\$676</u>	<u>-0.3%</u>	<u>\$701</u>	<u>3.8%</u>
<b>Total GF Revenues</b>	<b>\$15,847</b>	<b>\$16,366</b>	<b>3.3%</b>	<b>\$17,126</b>	<b>4.6%</b>
GF Transfers	<u>\$501</u>	<u>\$407</u>	<u>-18.9%</u>	<u>\$423</u>	<u>4.0%</u>
<b>Total General Fund</b>	<b>\$16,348</b>	<b>\$16,773</b>	<b>2.6%</b>	<b>\$17,549</b>	<b>4.6%</b>
<b>Amt Above Official Est.</b>	<b>\$129</b>	<b>\$62</b>		<b>\$94</b>	

# Virginia Vulnerable to Federal Spending Cutbacks

- In 2010, Federal spending (\$137 B total; \$58B DoD) contributed approximately one-third of Virginia's gross state product (\$424 B).
  - VA ranks #2 in total per capita federal spending and #1 in per capita DoD spending in 2010).
- From CY 2000-10 Virginia's gross state product grew 60% while federal spending in Virginia grew 107%. VA particularly vulnerable to cutbacks in defense spending and procurement.
- **Tax Department presented evidence at August Joint Money Committee meeting of recent slowdown in payroll withholding payments by “professional and business services” and particularly federal contractors.**
- Recent report by Stephen Fuller of GMU estimates that Virginia could lose \$10.7 billion in labor income from 136,191 lost Defense Dept. jobs and 71,380 non-Defense Dept. jobs over 10 years if automatic spending cuts are imposed.

# State Transportation Revenues Lag

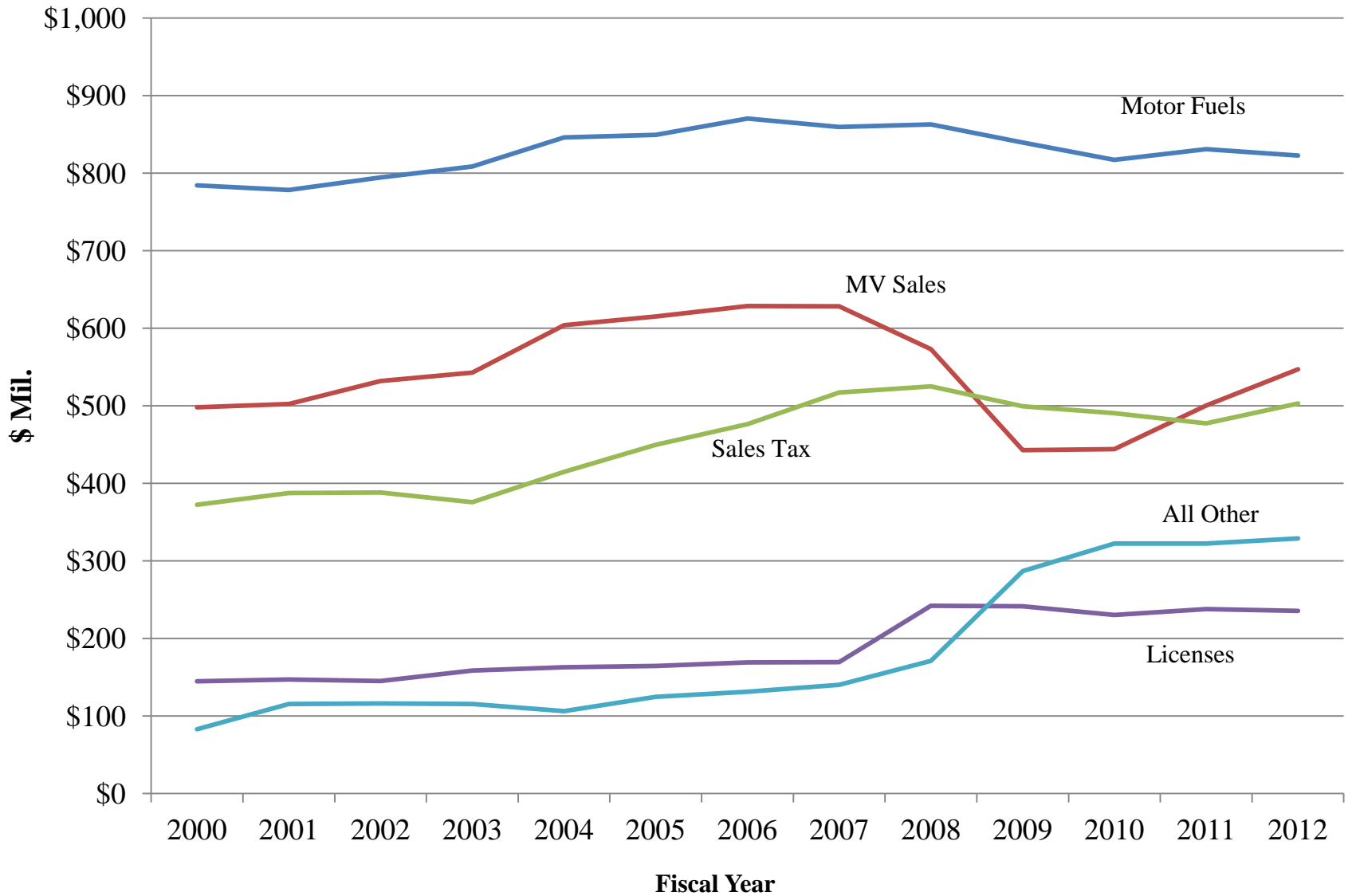
## Growth in Virginia Personal Income, General Funds and Transportation Revenues



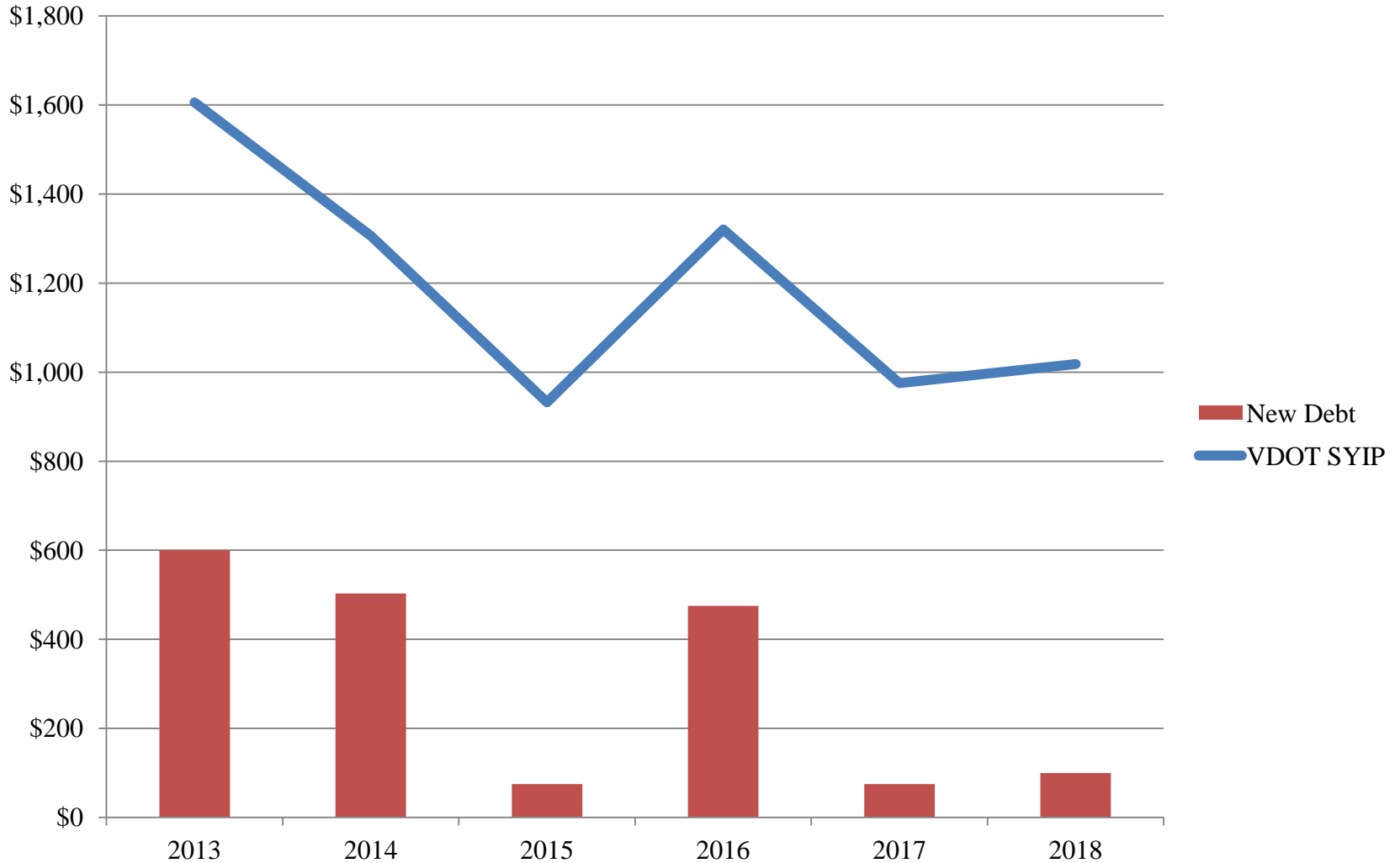
FY 2012: GF revenues increased 5.4%; CTF revenues increased 2.9%



# ... Due to Transportation Revenue Sources

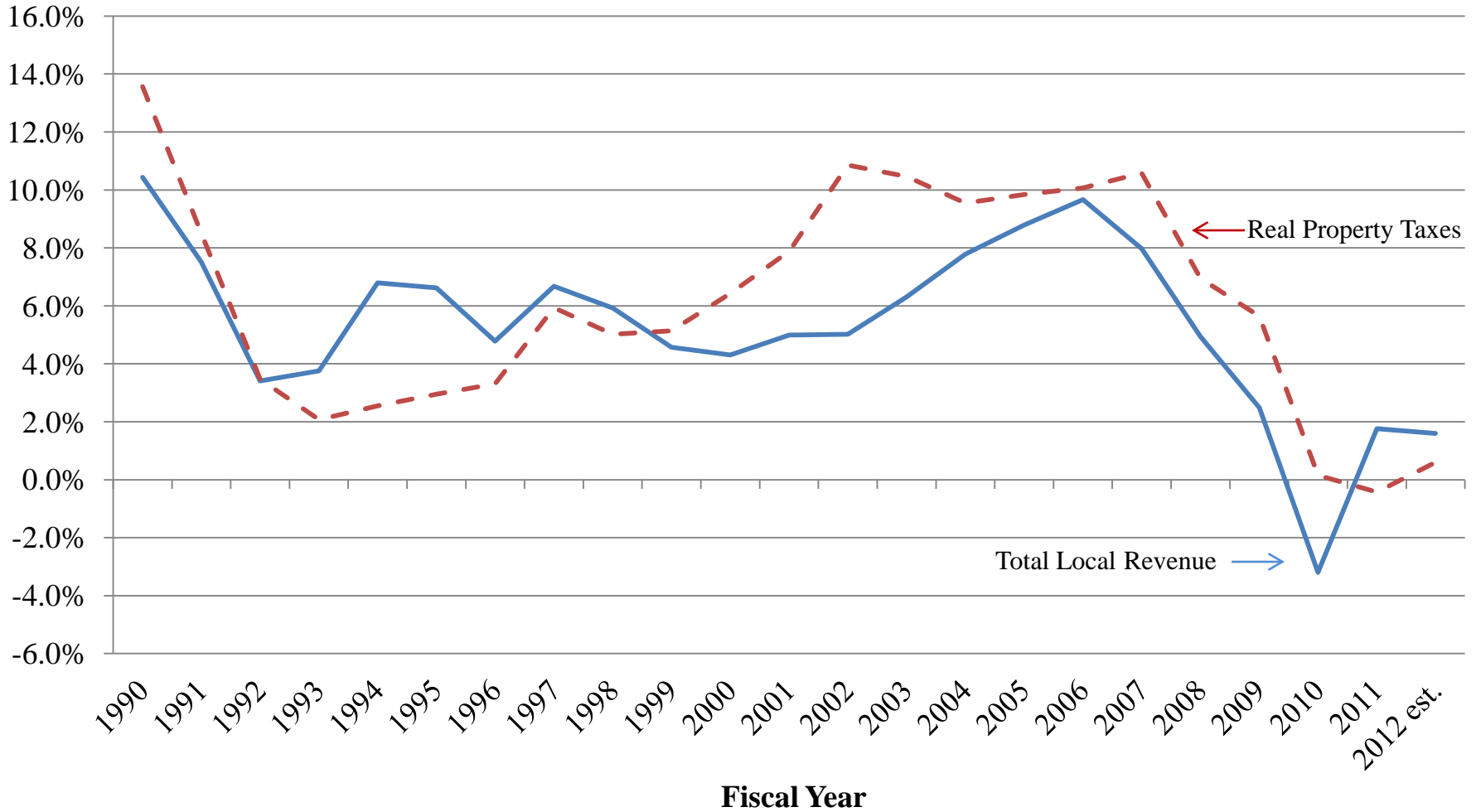


# VDOT Construction SYIP Is Primarily Federal \$ Supplemented by \$1.8B in Debt



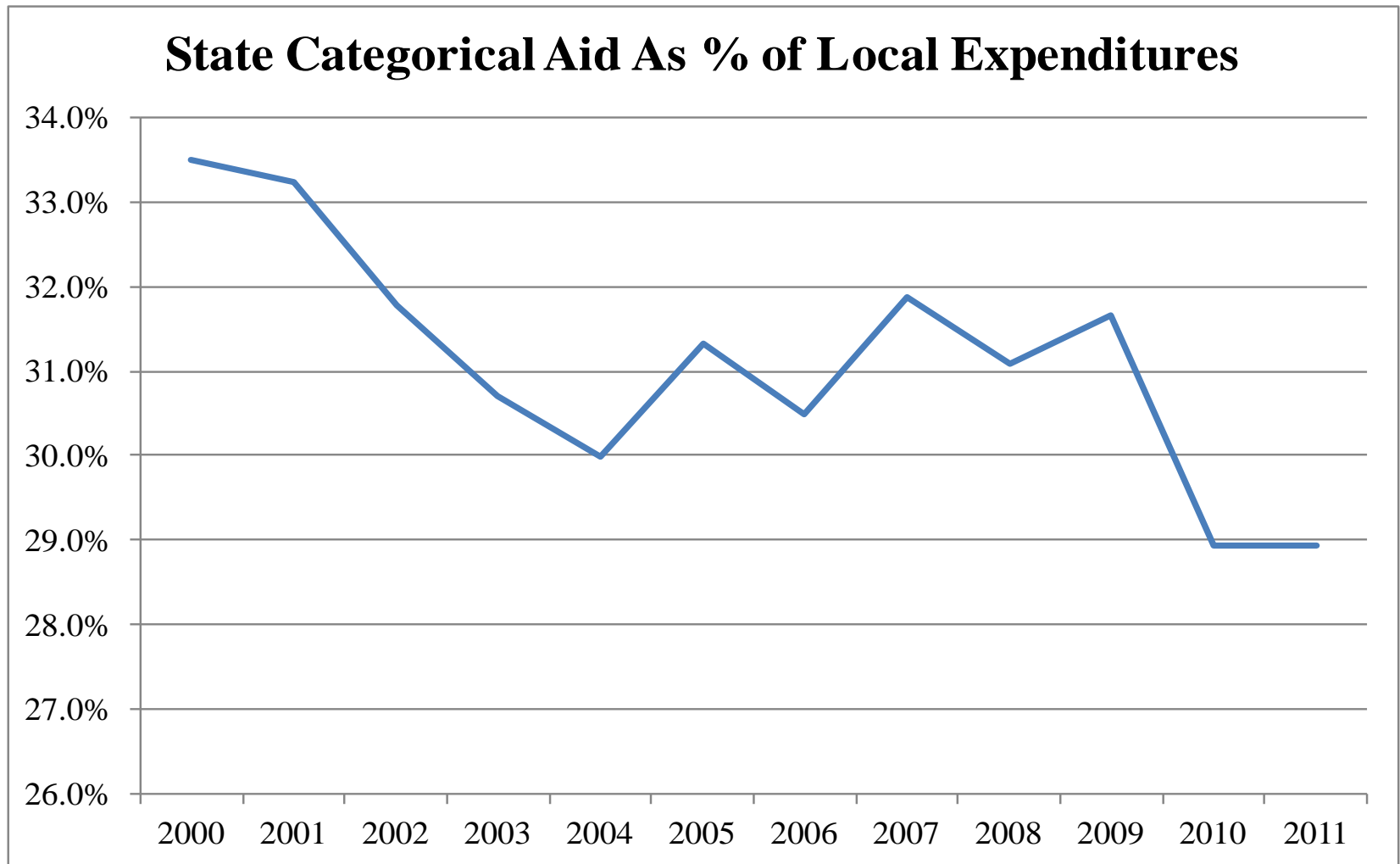
# Local Revenues Also Continue to Suffer

## % Change in Local Revenues



Source: 1990-2011, Auditor of Public Accounts  
 FY 12 estimates from VML/VACO 2011 Fiscal Survey

# State Support For Locally-Administered Programs Has Fallen



Source: APA Comparative Reports on Local Revenues and Expenditures, Fiscal Years 2000-2011

# State Assistance for Local Mandates Below Pre-Recession Levels

## Major State GF Aid for Locally-Administered Programs

	<u>FY 2009</u>	<u>FY 2010</u>	<u>FY 2011</u>	<u>FY 2012</u>	<u>FY 2013</u>	<u>FY 2014</u>
GF Direct Aid to K-12	\$5,607.6	\$4,769.8	\$4,713.3	\$4,891.2	\$5,240.6	\$5,268.3
Health and Human Services	\$888.4	\$878.7	\$816.8	\$827.2	\$846.4	\$811.8
Public Safety	\$734.3	\$556.8	\$686.0	\$667.7	\$677.8	\$678.4
<i>HB 599 (Aid-to-Police)</i>	<i>\$197.3</i>	<i>\$180.8</i>	<i>\$178.7</i>	<i>\$172.4</i>	<i>\$172.4</i>	<i>\$172.4</i>
Constitutional Officers	\$155.3	\$142.2	\$144.2	\$143.8	\$143.5	\$143.5
Car Tax	\$950.0	\$950.0	\$950.0	\$950.0	\$950.0	\$950.0
Aid-to-Locality Reduction	<u>(\$50.0)</u>	<u>(\$50.0)</u>	<u>(\$60.0)</u>	<u>(\$60.0)</u>	<u>(\$50.0)</u>	<u>(\$45.0)</u>
<b>Total Local GF Aid</b>	<b>\$8,285.6</b>	<b>\$7,247.5</b>	<b>\$7,250.3</b>	<b>\$7,419.9</b>	<b>\$7,808.3</b>	<b>\$7,807.0</b>
<b>Total GF Appropriations</b>	<b>\$15,943.0</b>	<b>\$14,787.2</b>	<b>\$15,457.4</b>	<b>\$16,556.9</b>	<b>\$17,340.7</b>	<b>\$17,502.0</b>
<b>% Local GF Aid</b>	<b>52.0%</b>	<b>49.0%</b>	<b>46.9%</b>	<b>44.8%</b>	<b>45.0%</b>	<b>44.6%</b>

# Many Localities Feel They Will Be Less Able to Meet Their Financial Needs in the Future

<b>Meet Financial Needs?</b>	<b><u>Better</u></b>	<b><u>Same</u></b>	<b><u>Less Able</u></b>
<b>All Localities (102)</b>			
FY 2013 Compared to FY 2012	16%	52%	32%
FY 2014 Compared to FY 2013	11%	44%	45%
<b>Cities (28)</b>			
FY 2013 Compared to FY 2012	32%	43%	29%
FY 2014 Compared to FY 2013	25%	32%	46%
<b>Counties (73)</b>			
FY 2013 Compared to FY 2012	10%	58%	34%
FY 2014 Compared to FY 2013	5%	51%	45%

# Falling Revenues and Reduced State Support Require Tough Choices for Local Budgets

<b>* 45 counties responding to VML/VACO survey</b>	<b>Top 3 FY 13 Local Budget Balancing Actions</b>
Increase tax rates (24*) and/or fees	28
Drawdown Reserves or Balances	19
Delay or Cancel Capital or Equipment Purchases	18
Salary or Hiring Freezes	12
Targeted Budget Cuts	11
Eliminate Vacancies or Positions	8
One-time/Other	7
Renegotiate Debt	4
Early Retirement Incentives	3
Across-the-Board Budget Cuts	3
Reduce Employee Benefits	1

\* 17 counties out of 45 increased RE tax rates at greater than equalization

Source: Preliminary results from VML/VACO 2012 fiscal survey

# Can the State Restore Program Cuts? Serious Challenges Must Be Overcome.

1. Revenues not growing as fast as usual coming out of a recession (under 5% revenue growth expected in 2012-14). Tax changes reducing revenues. Concern over potential impact of federal deficit reductions. **However, expect FY 12 revenue surplus to flow thru to 2012-14 biennium, providing \$100-150 million in additional appropriation capacity over adopted budget.**
2. Rainy Day Fund must be *constitutionally* restored – Half of any GF\* revenue growth above prior 6-yr. avg. (2% now) goes to RDF. Actual FY 2012 revenues require a \$245 million deposit to the RDF in FY 2014.
3. VRS contribution rates for teachers and state employees are being significantly increased since recession lows.
4. Medicaid spending will continue to grow faster than state revenues. 2014 impact of federal health care big unknown, but law as written would add up to 425,000 new Medicaid recipients.
5. Increased use of debt will have long-term consequences.
6. Increasing efforts to use general funds and PPTA for transportation.



# State Six-Year GF Plan (\$ Mil.)

## Expects Tight Budgets Going Forward\*

### FY 2013-18 Annual GF Appropriation Growth Expected

<b>K-12 Education</b>	<b>3.1%</b>
Higher and Other Education	4.4%
Medicaid	6.4%
Other H&HS	0.6%
Public Safety	0.6%
Other Finance and Admin.	0.1%
Judicial	0.3%
Commerce & Trade	-2.6%
Nat Res., Ag, Forestry	<u>-5.1%</u>
<b>Total Appropriations</b>	<b>3.2%</b>

\* See [http://dpb.virginia.gov/forms/20120206-1%5C2012\\_GFSix-YearPlan.pdf](http://dpb.virginia.gov/forms/20120206-1%5C2012_GFSix-YearPlan.pdf). Does not include FY2018 ending balance of \$653 million.

# General Fund Tax Changes Over Last Two Decades Swamp 2004 Tax Increase

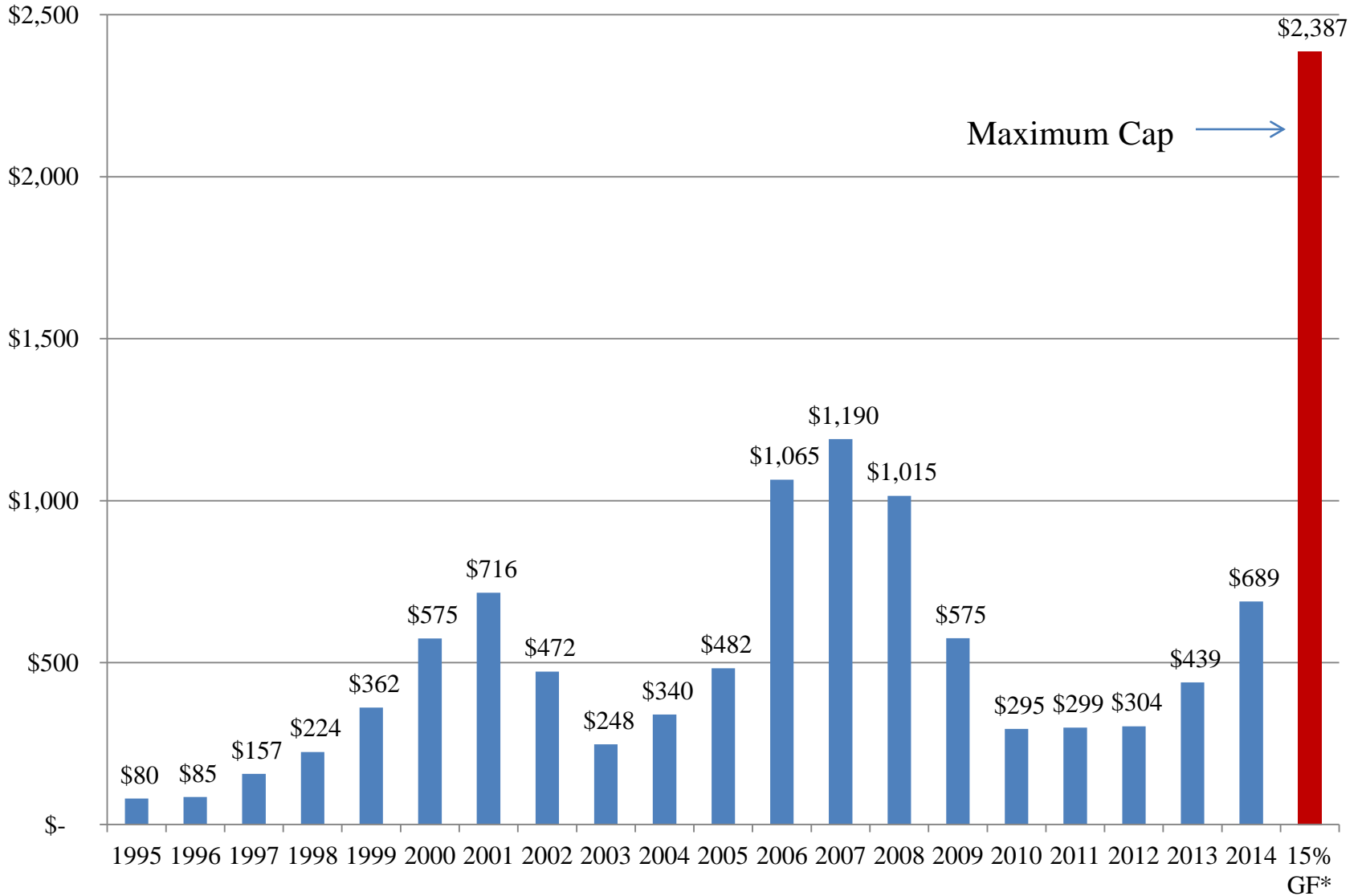
	<u>Enacted/Amended</u>	<u>2010-12 (\$ Mil.)</u>
Age Subtraction (net of 2004 means testing)	1994 and 2004	(\$555)
Subtraction for UI/Military/Gov't Empl	1999	(\$73)
Historic Rehab Tax Credit	1999	(\$92)
Coalfield Employment Tax Credits	2000	(\$89)
Low Income Tax Relief	2000, 2004, and 2007	(\$377)
Land Preservation Tax Credit	2003	(\$275)
2004 Tax Reform Increases*	2004	\$1,603
Elim. 2.5% Sales Tax on Food	2004	(\$437)
Car Tax Reimbursement	1997, 2003	(\$1,900)
Shift Insurance Premiums and Recordation from GF to Transportation	2009	(\$340)
Estate Tax Repeal	2009	(\$280)
Other Tax Changes since 1999	1999-2011	<u>(\$182)</u>
<b>Total</b>		<b>(\$2,997)</b>

\* Includes cigarette tax increase dedicated to Health Care Fund

Sources: Senate Finance Committee Retreat, Revenue Outlook, Nov. 18, 2010

Summary of Amendments to the 2010-2012 Budget, Money Committee Staff. May 2010

# Revenue Stabilization Fund History



\* RDF deposits and maximum calculated on individual and corporate income taxes and sales tax

# Retirement Rates Are Rising

	<b>2011 &amp; 2012 VRS Board Cert. Rates</b>	<b>FY 2011</b>	<b>6/25/2011- 3/24/2012</b>	<b>3/25/2012- 6/24/2012</b>	<b>FY 2012-14 VRS Board Cert. Rates *</b>	<b>FY 2012-14 Adopted Rates**</b>
<b>State</b>	8.46%	2.13%	2.08%	6.58%	13.07%	8.76%
<b>Teachers</b>	12.91%	3.93%	6.33%	6.33%	16.77%	11.66%

\* Assumes phase-in of 7.5% to 7% investment return, 2.5% COLA, and 30 year amortization

\*\* Reflects 8.0% investment return

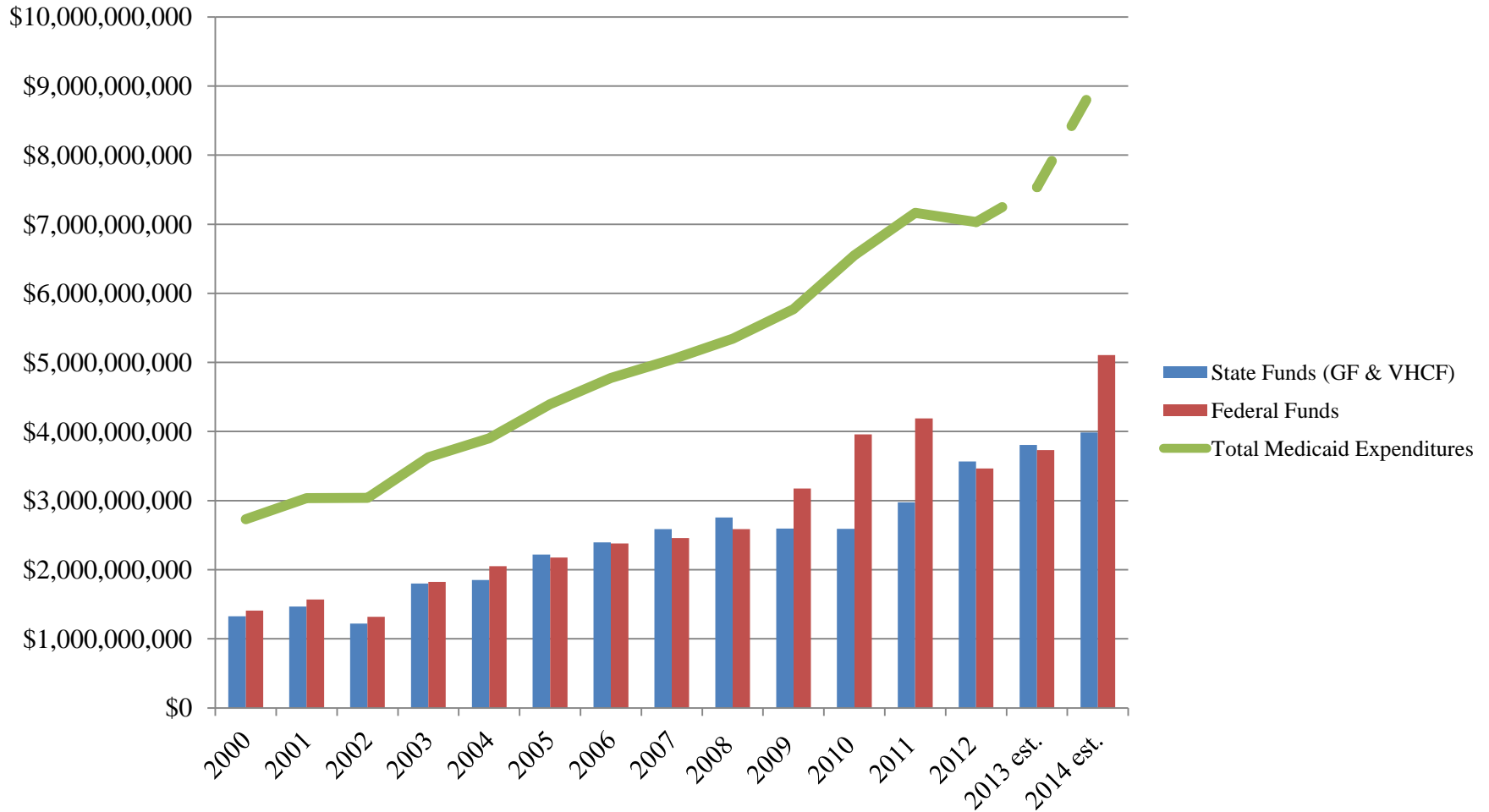
Notes: Employer rates only and do not include 5% member contribution.

Over the last 10 years ending June 30, 2011 VRS annual average total fund investment return has been 5.7%.

2012 Session adopted hybrid defined benefit/contribution plan for new state employees.

# Medicaid Expenditure Slowdown in FY 12 Will Not Last\*

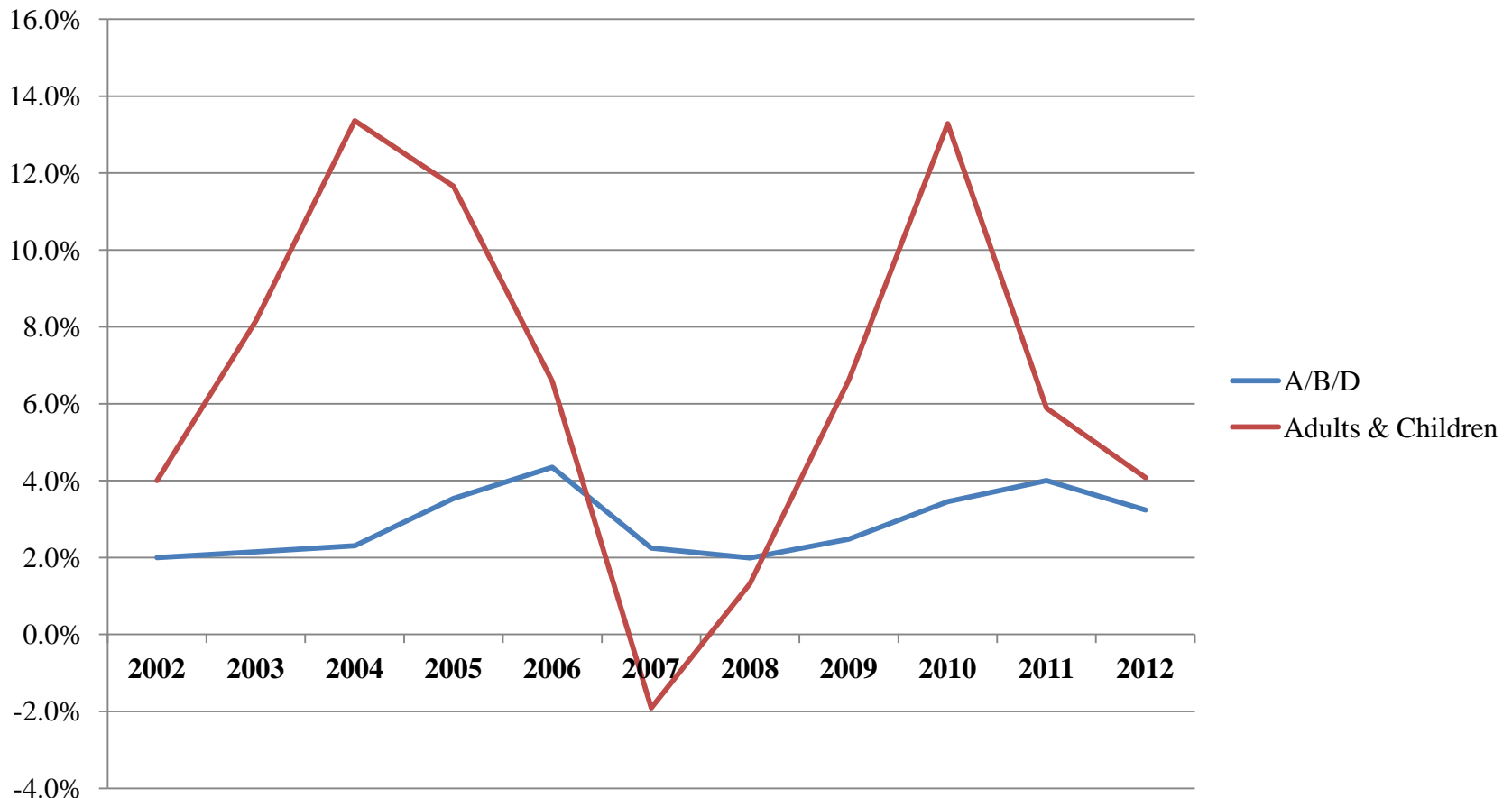
## VA State and Federal Medicaid Expenditures



\*Enrollment growth slowed, payments pushed into FY 11 and FY 13, lower rates for managed care and pharmacy, and other state policy changes such as respite care reductions

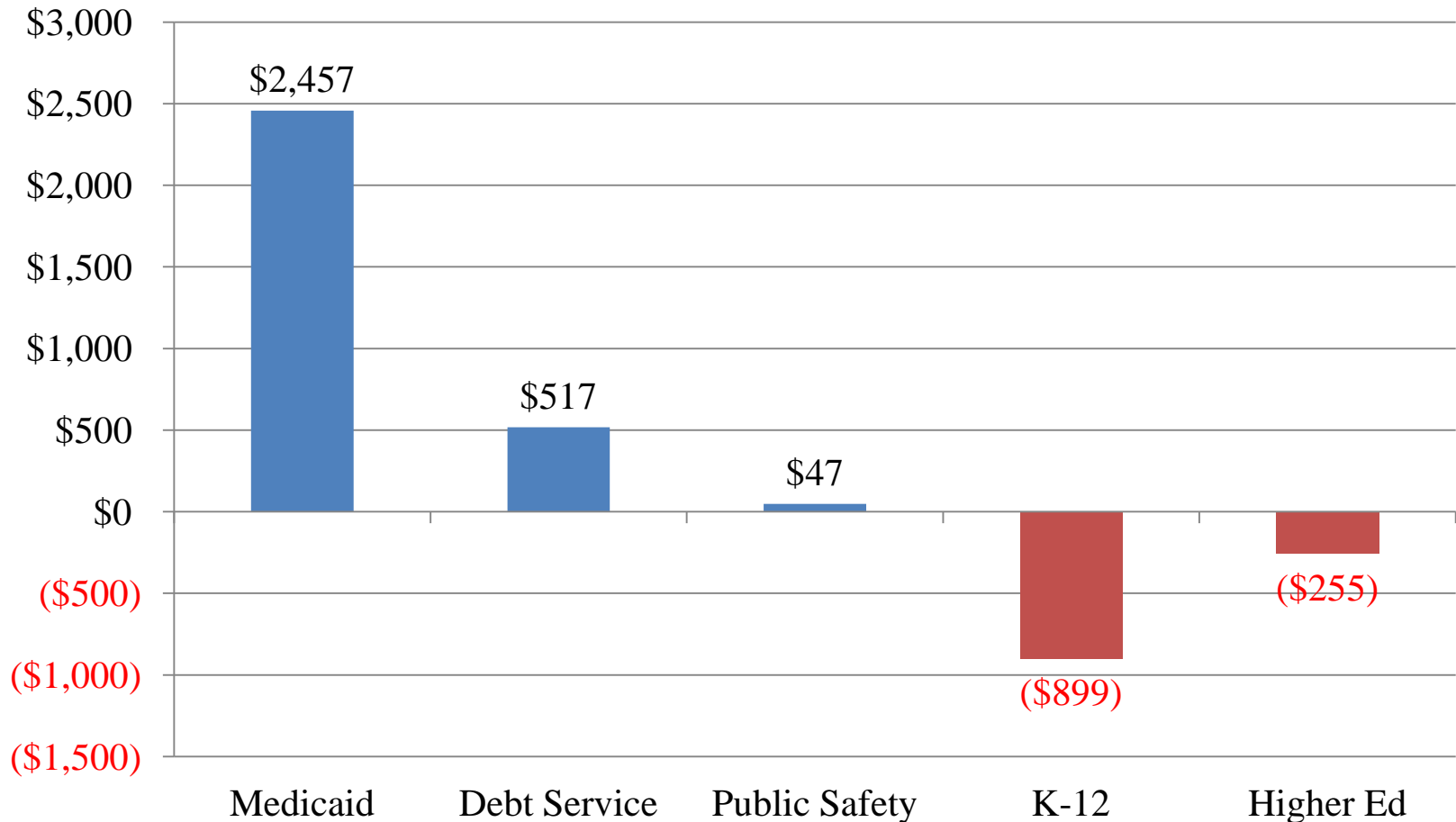
# Can Recent Slowdown in Medicaid Enrollment Continue?

## Growth in Medicaid Enrollment



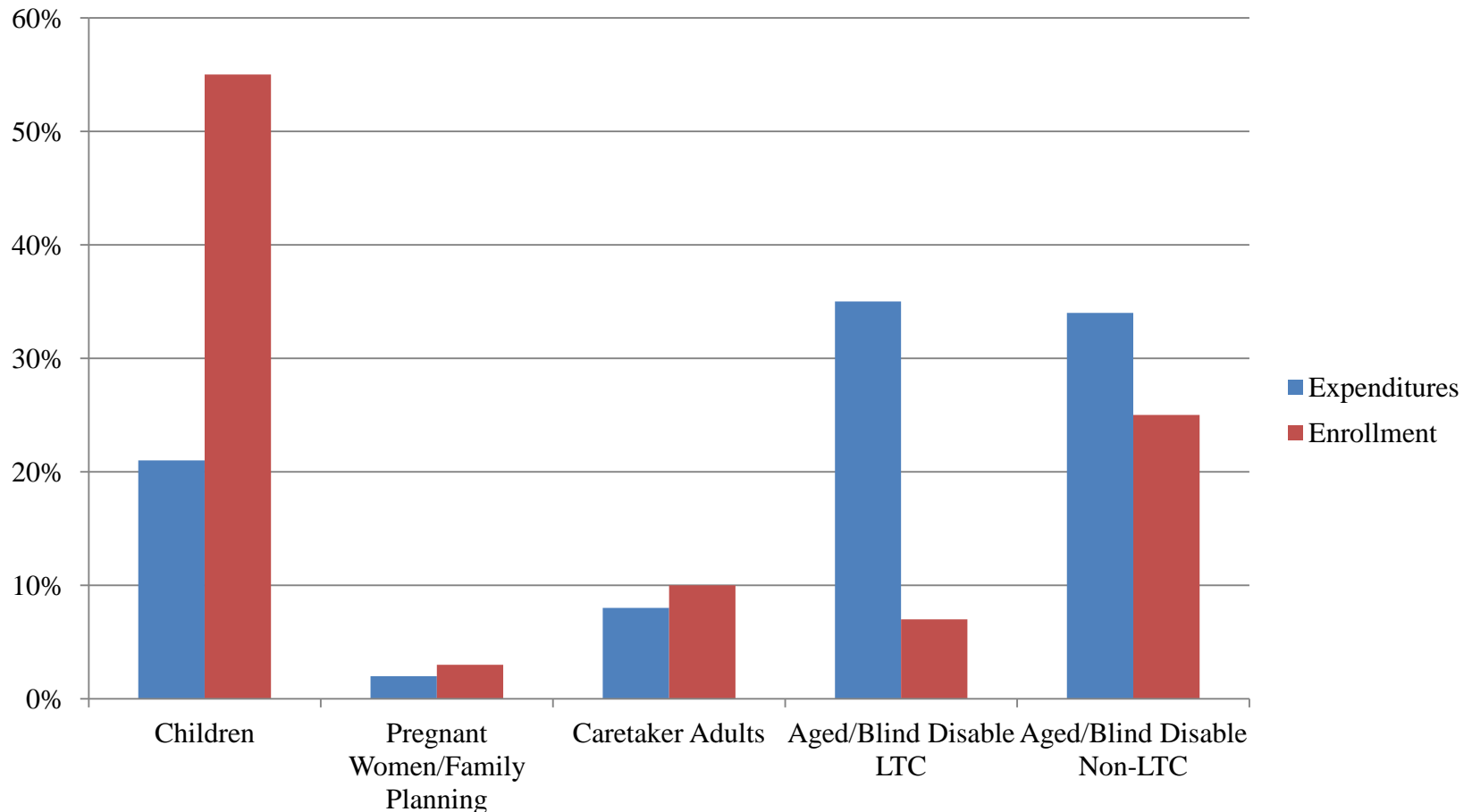
# Health Care Has Trumped Education

**2006-08 Budget Compared to 2012-14 Adopted Budget  
(Change in Appropriated GF Mil. \$)**



# Medicaid Aged/Blind Disabled 69% Expenditures / 32% Enrollment

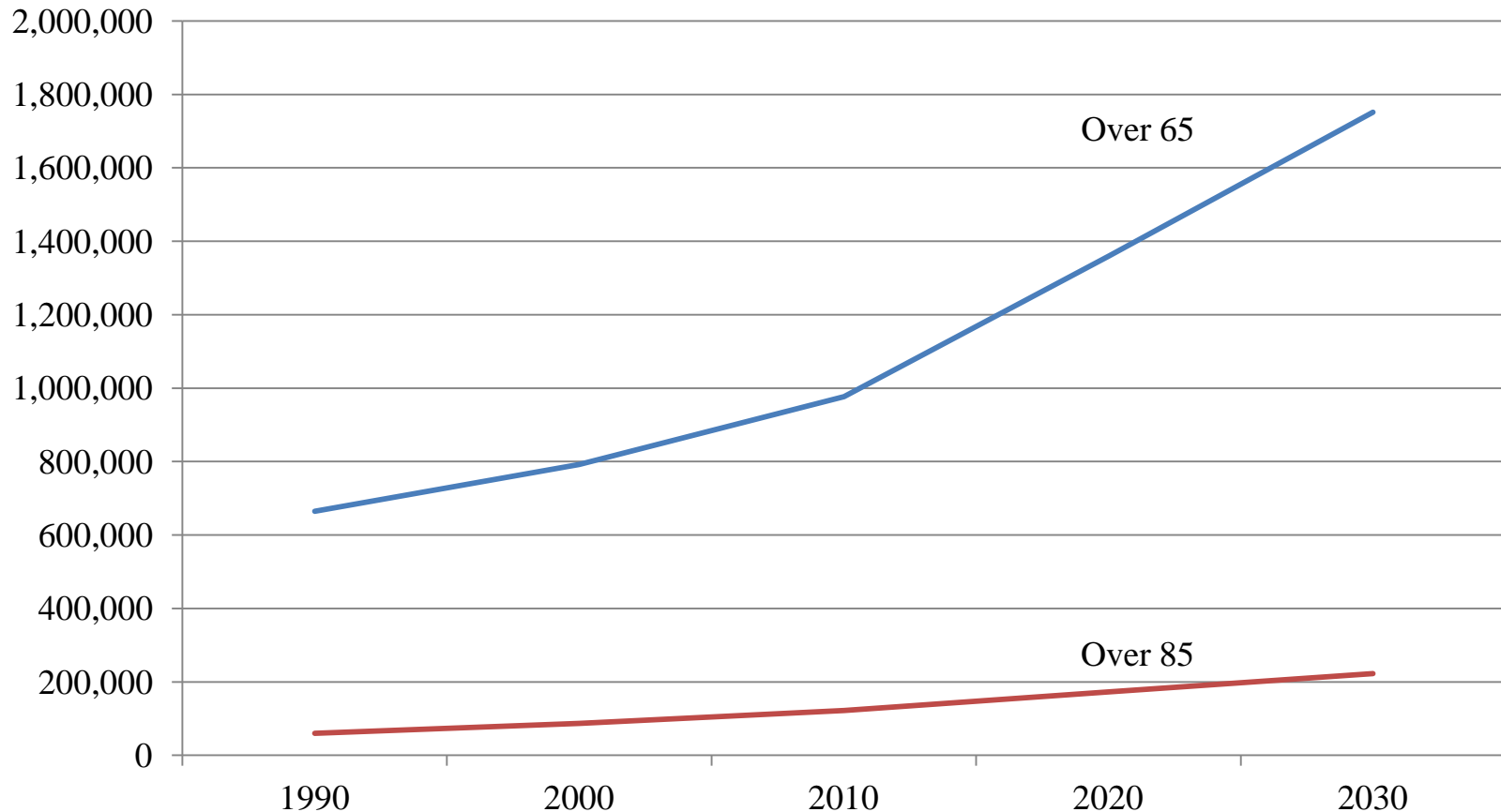
## FY 2012 Virginia Medicaid



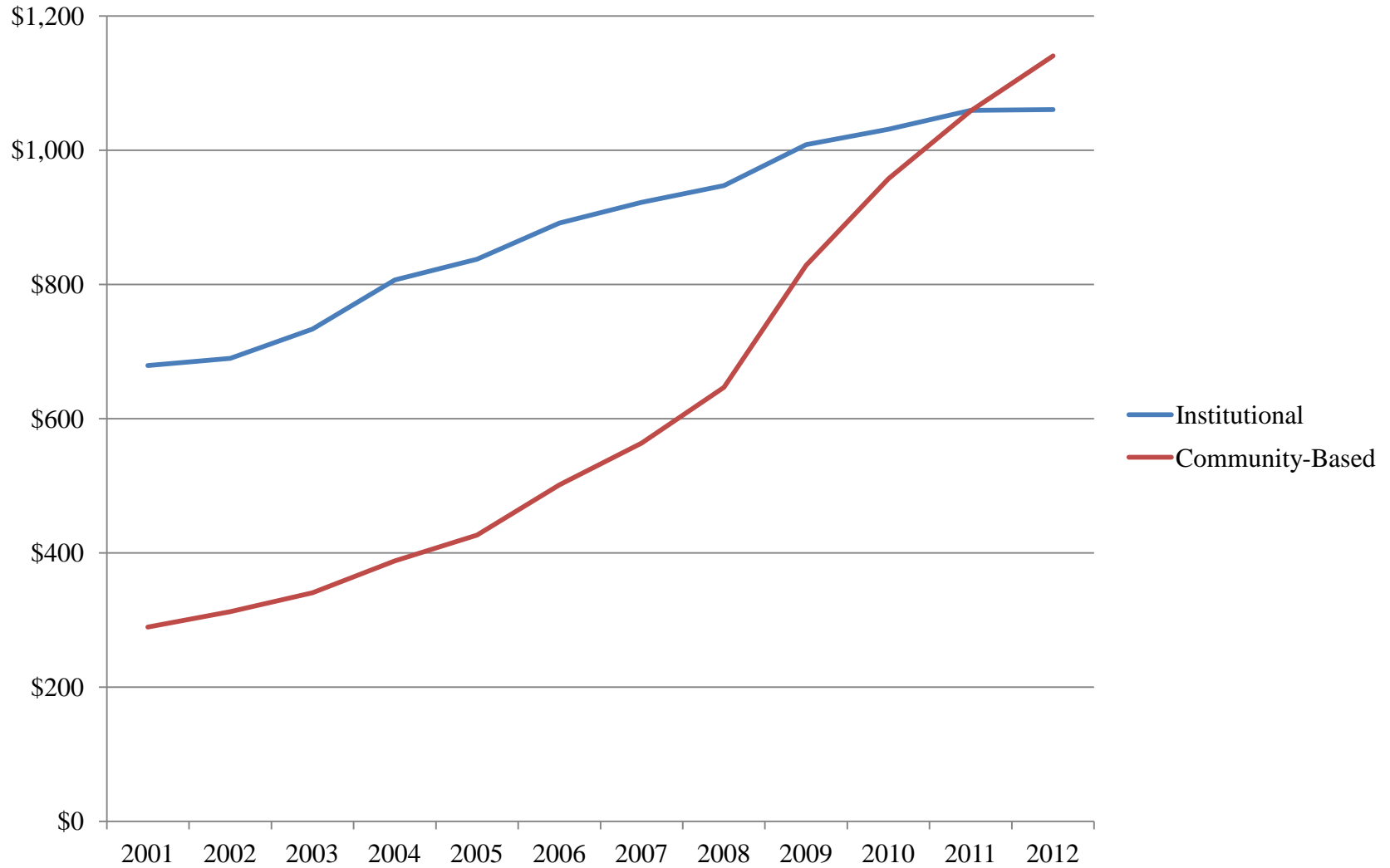


# Demographics Mean a Continued Rise in Health Care Expenditures

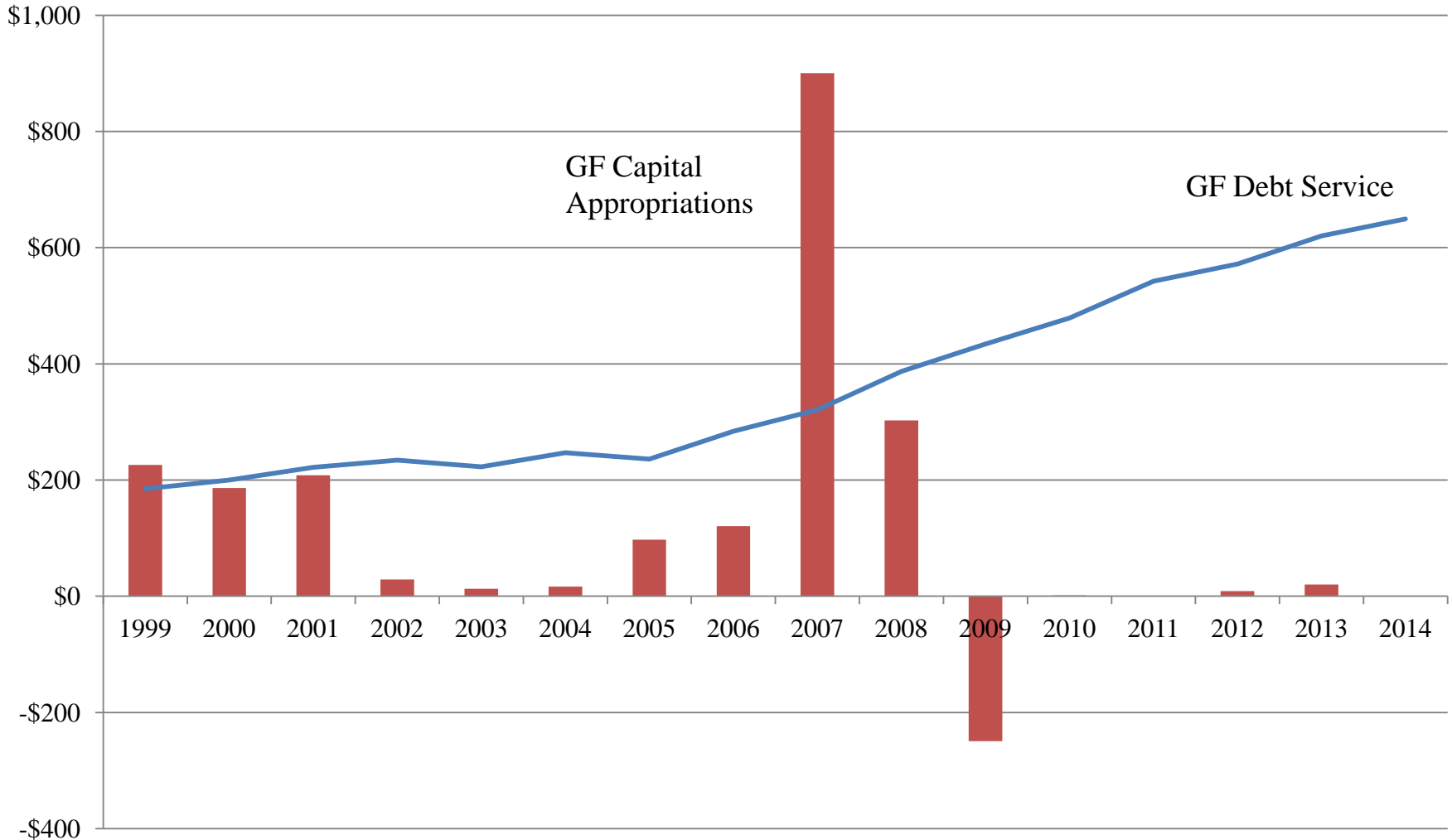
## Growth in Virginia Elderly Will Accelerate



# Medicaid Long-Term Care Expenditures (\$ Mil.)



# VA Still Using Debt Rather Than Cash to Pay for Capital Improvements (\$ Mil.)



# Only Limited New Debt Capacity Available

- Outstanding tax-supported debt of the Commonwealth increased by \$8.1 bil. or 150% from 2002 to 2011, with the largest increases occurring between 2009 and 2011.\*
- About \$340 million in new tax-supported debt authorized in 2012 Session.
- In addition, \$1.15 bil. in FRAN's issued between 2000 and 2005 and \$1.2 bil. GARVEE authorization in 2011 for transportation (not considered tax-supported debt).
- Expect about \$400 million per year in average tax-supported debt capacity to be available over the next 10 years when new Debt Capacity Advisory Committee reports in December.
  - Amount available for both general fund and transportation debt.
  - Assumes no recession over next 10 years.

\* Does not include federal revenue anticipation notes (FRAN), or similar federal grant anticipation revenue vehicle (Garvee) 28

# Expect More Local Funding for Transportation System

- Local urban street maintenance expenditures exceed state payments by 33%. State has proposed devolving secondary road maintenance.
- Local expenditures for highways exceeded \$365 million in FY 2010, not including toll revenue, and debt service for transportation bonds.\*
- State revenue sharing increasing. 55 localities with 149 projects applied for \$132 mil. in FY 13.
- Local general funds subsidizing public transit include \$265 million for operating assistance and \$58 million for capital in FY 2013.\*\*
  - SJR 297 DRPT recommendations could increase need for local transit support.

\* FY 2010 Weldon Cooper Road, Street, and Highway Finance Survey

\*\* Dept. of Rail and Public Transportation SYIP

# Transportation Relying More on Public-Private Partnerships

## Pro's:

- Potential for more innovation and timely delivery
- Private sector management skills
- Risk transfer to private sector
- Extends public dollars and avoids state debt capacity
- Easier politically to generate revenues/set toll rates

## Con's:

- Little empirical evidence to assess private sector risk premiums, particularly in cases of one proposer (Midtown Tunnel)
- Potentially higher cost of capital/tolls than purely public project
- Centralized decision-making/circumvents existing process for prioritizing public dollars
- Difficult balancing act with NEPA and alternatives evaluation
- Non-compete and fairness issues

# PPTA Case Studies

- **I-495 Express Lanes**

- Parallel facility available, free HOV-3
- Innovative design/HOT financing based on demand
- *No* non-compete clauses, only first refusal right to build new capacity
- Real private-sector risk assumption with *potential* for high returns

- **Midtown/Downtown Tunnel/MLK Extension**

- Mostly upgrading existing facilities – no alternative travel routes
- Previously tolled and now state maintained; concession includes tolling before completion, automatic escalators, long-term O&M.
- Private risk assumption mitigated further with non-compete clauses if harm proven to “baseline” finances, and automatic toll escalators
- One detailed PPTA bid. Why not state-created authority (like CBBT) or non-profit “63-20” corporation like Route 460 proposal?
- \$420 mil. state subsidy for Midtown Tunnel, potentially over \$1 bil. for Route 460. Each additional \$50 mil. Midtown subsidy would reduce toll by 10 cents.

# Fiscal Analytics PPTA Recommendations

- Strengthen the independence of the CTB and other oversight boards in statute and give these boards a direct role in approving PPTA projects. Require PPTA project state subsidies be included in the state six-year plan (SYIP) prior to initiating PPTA procurement decisions.
- Require a completed NEPA alternatives study *before* PPTA project procurement studies/evaluations are initiated.
- Require a procurement method evaluation report to be presented to the General Assembly Money Committees before initiating PPTA procurement activities.
- Require at least two bidders before procurement can be initiated through the PPTA.
- Require a public hearing disclosing all major business points at least 30 days prior to the signing of a PPTA comprehensive agreement.
- Provide statutory guidance on the use of “non-compete” or similar clauses in any PPTA agreement.
- Implement “fairness” statutes and guidelines for prioritizing state subsidies and long term O&M toll concessions.
- Consider a regulated rate of return model for long-term concessionaire projects under the PPTA – instead of negotiating risk mitigation through long-term contracts.

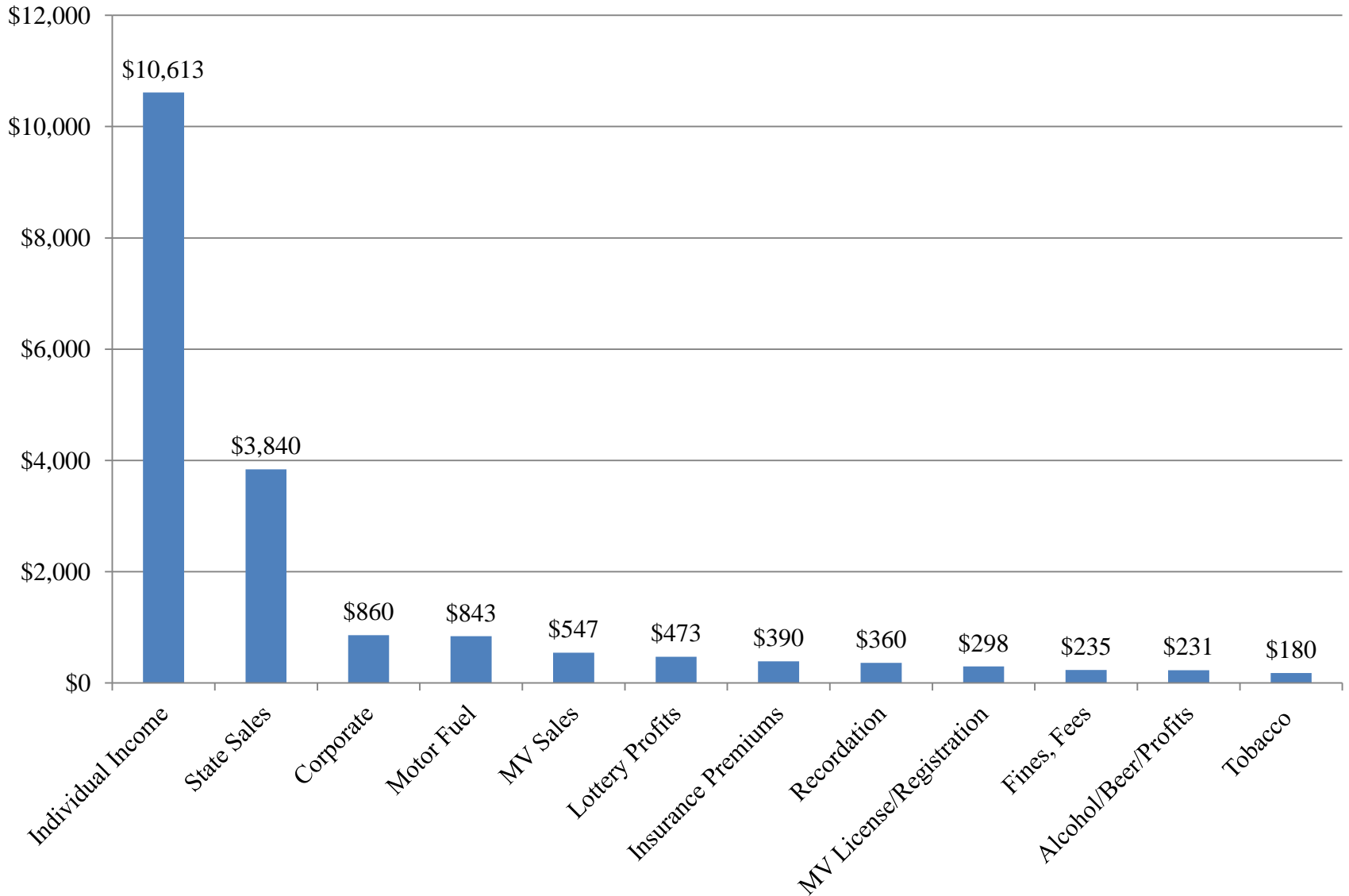


# Virginia Is a Wealthy, Low Tax State, With Higher Reliance on Local Revenues

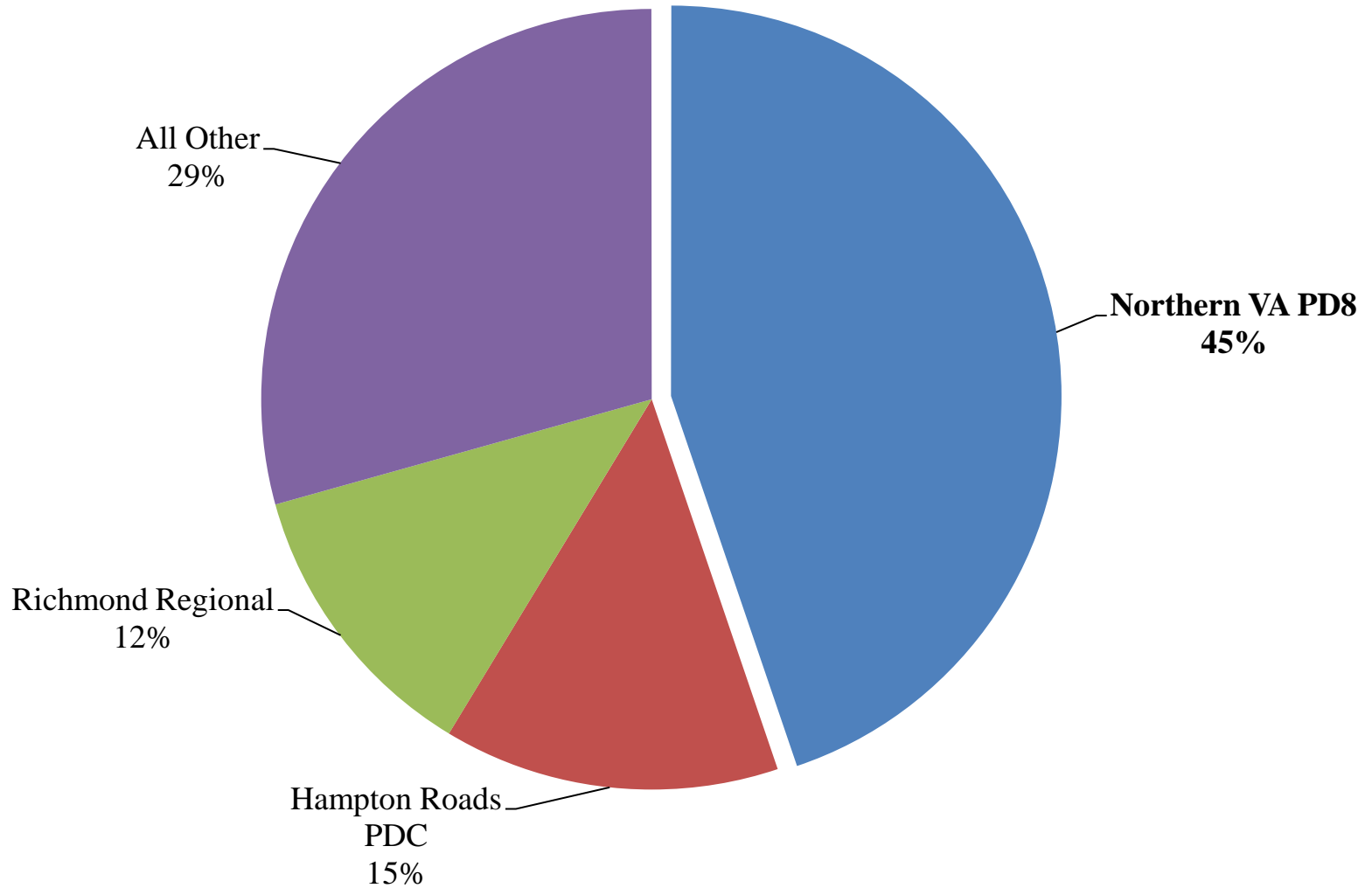
	<u>State Rank</u>
Per capita personal income	8
State and local <i>revenue</i> as a percentage of personal income	49
State and local <i>taxes</i> as a percentage of personal income	43
Per capita state taxes	34
Per capita local taxes	13
Individual income taxes as a percentage of state and local tax revenue	7
State motor fuel tax rate rank	37

Source: Virginia Compared to Other States, JLARC, 2012 Edition  
<http://jlarc.virginia.gov/reports/Rpt419.pdf>

# FY 2012 Major State Tax Sources (\$ Mil.)



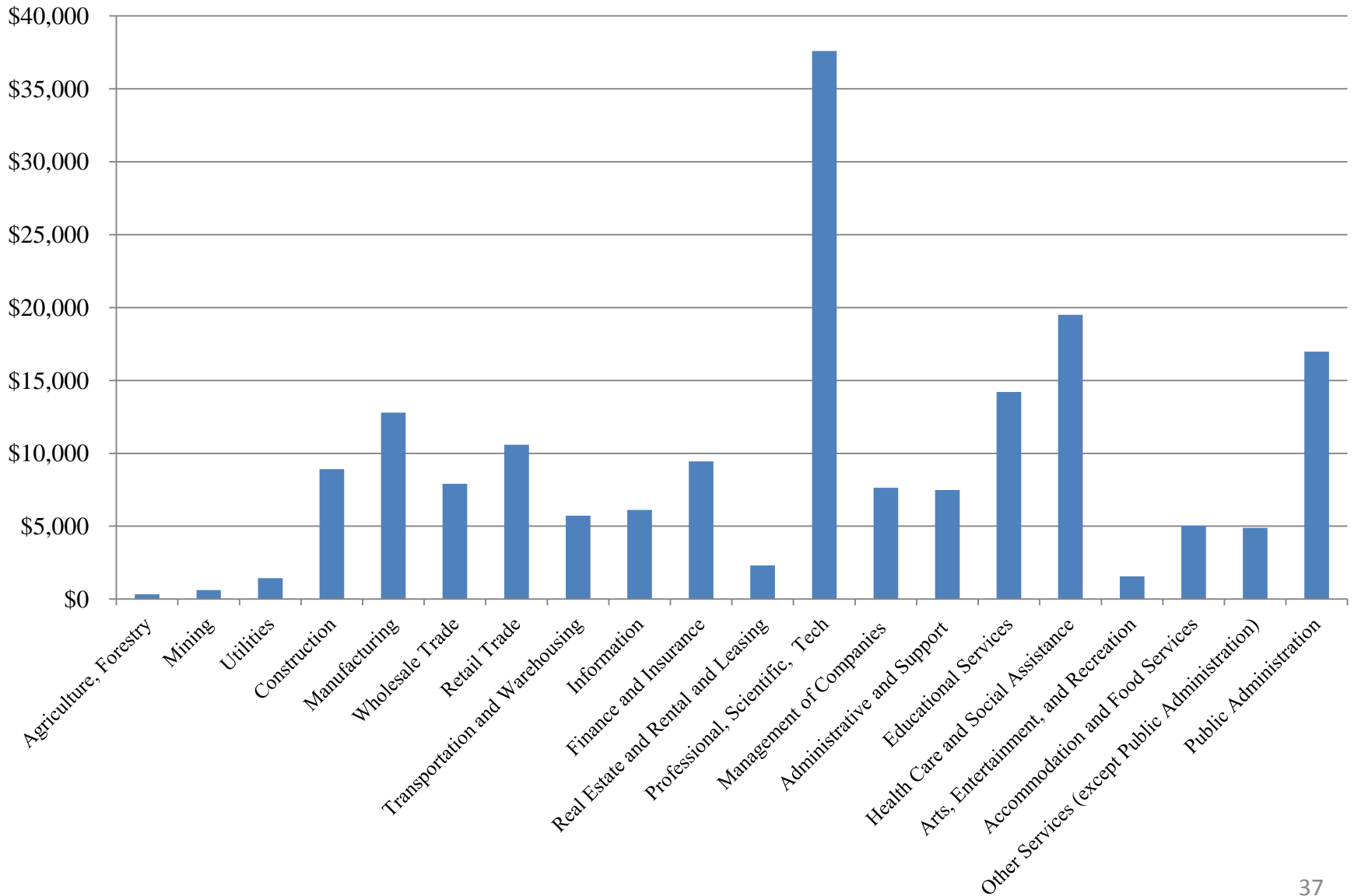
# Percent of TY 2010 State Individual Income Tax



# Options for State GF Tax Reform

- Make the individual income tax more progressive. Add a new top marginal individual income tax rate @ 6.25% above \$100,000 and raising corporate tax rates accordingly generates \$300 mil. per year.
- Limit/means test individual income tax itemized deductions or exemptions, or corporate tax benefits.
- Reduce or eliminate special tax preferences such as the Age Subtraction, Land Preservation, Historic Rehab, Coalfield Employment, or many other smaller tax credits.
- Increasing sales tax rate by 1 percent generates \$1 bil. per year.
- Apply sales taxes to selected services.
- Increase “sin” taxes. Tobacco tax: \$6 mil per penny. Double the beer and beverage tax for \$43 mil.

# 2011 Virginia Payroll Economy (\$ Mil.)



# Virginia Motor Fuel Taxes Are Low

	<b>Gas Tax</b>	<b>Diesel</b>	<b>Index</b>
New York	49.3	49.1	Yes
North Carolina	37.5	37.5	Yes
West Virginia	33.4	32.1	Yes
Pennsylvania	32.3	39.2	Yes
Kentucky	29.9	26.9	Yes
Georgia	28.6	31.8	Yes
Washington D.C.	23.5	23.5	No
Maryland	23.5	24.3	No
Massachusetts	23.5	23.5	No
Tennessee	21.4	18.4	No
<b>Virginia*</b>	<b>17.5</b>	<b>17.5</b>	<b>No</b>
South Carolina	16.8	16.8	Yes
New Jersey	14.5	17.5	No
<i>Average for All States</i>	<i>30.5</i>	<i>29.4</i>	

\* Does not include NVTD 2% sales tax

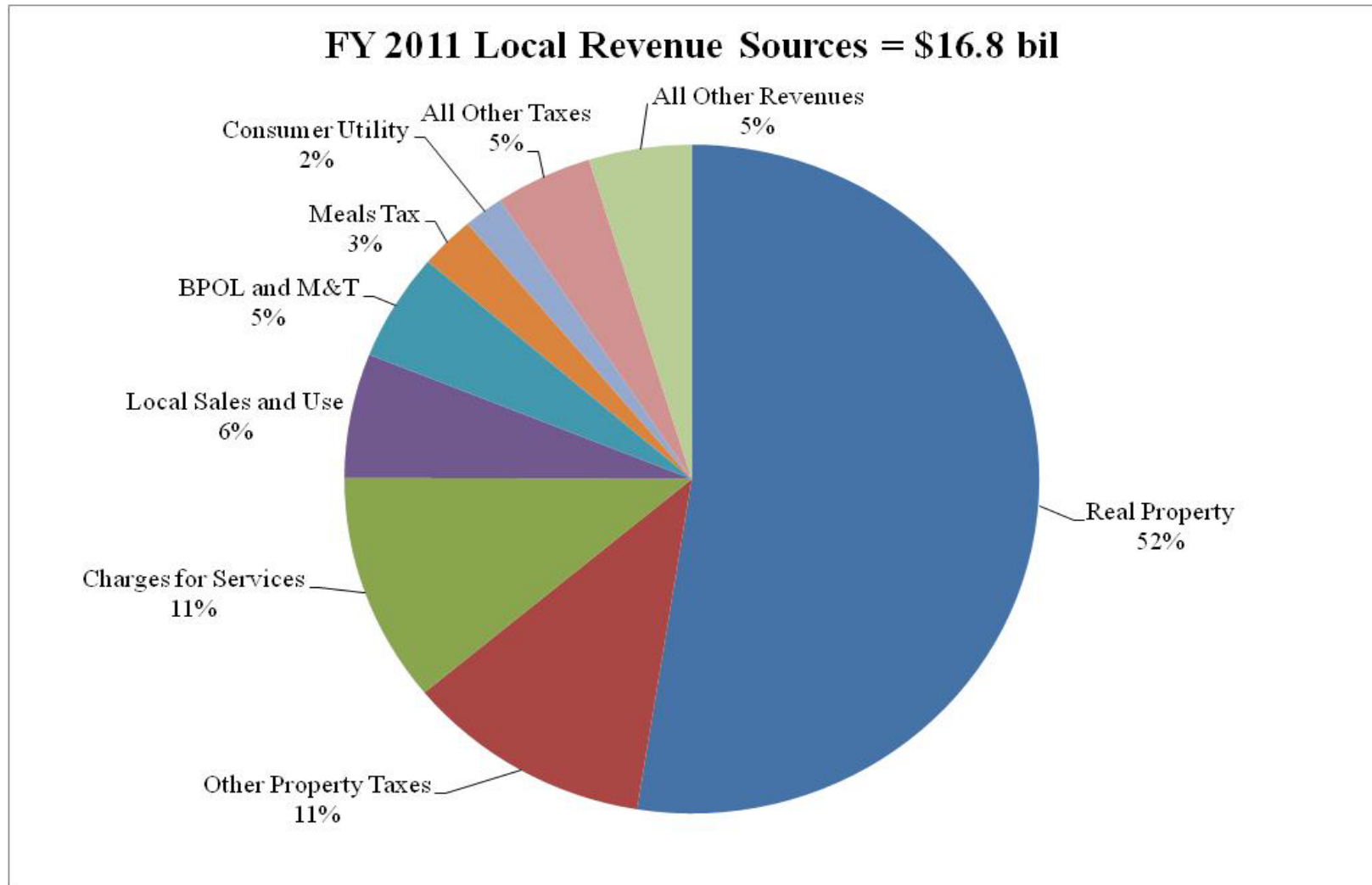
Source: American Petroleum Institute, July 2012

[http://www.api.org/Oil-and-Natural-Gas-Overview/Industry-Economics/~media/Files/Statistics/State\\_Motor\\_Fuel\\_Excise\\_Tax\\_Update.ashx](http://www.api.org/Oil-and-Natural-Gas-Overview/Industry-Economics/~media/Files/Statistics/State_Motor_Fuel_Excise_Tax_Update.ashx)

# Options for Increasing State Transportation Taxes

- Increase motor fuel taxes (\$49 mil. per penny) and index to inflation.
- Increase motor vehicle sales tax (\$185 mil. per 1%)
- Increase motor vehicle registration (\$6 mil. per \$1 increase)
- Apply 5% state and local option sales tax at the rack (wholesale) to motor fuels (\$733 mil. @ \$2.90 per gallon).
- Apply sales tax to auto repair labor (\$131 mil./yr).
- Expand NoVa regional 2% tax (\$78 mil.) to other MPO's.
- Use local car tax revenue for local road maintenance and replace “lost” revenue with 1% additional local option sales tax (\$ 1 bil./yr.).
- Implement a VMT tax. Most highways costs are the result of miles traveled (pavement damage, congestion, etc.), not fuel consumed.
- Expand use of tolls and congestion pricing as a limited means of VMT taxation.

# Local Revenues Dominated by Property Taxes



Note: "All Other Taxes" includes, transient occupancy, MV license, recordation, bank stock, tobacco, admission, severance, franchise license, other



# FY 2011 Local Tax Sources (\$ Mil.)

