

Virginia Economic and Budget Trends  
What a Difference a Year Makes!  
...Now Localities Need Help

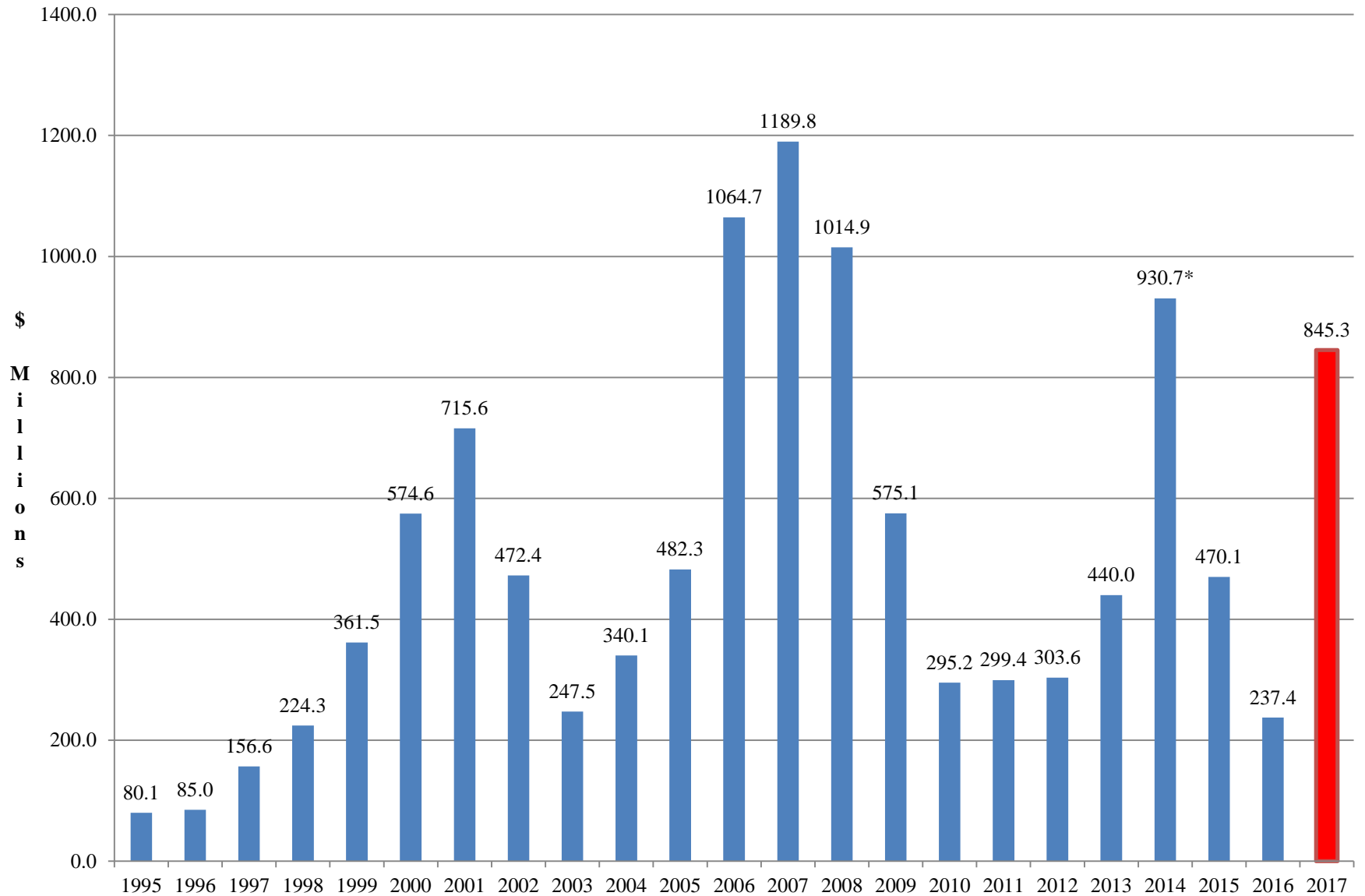
Presentation to  
Virginia Association of Counties  
Fiscal Analytics, Ltd.  
November 9, 2015

# **The Good News: Additional 2016-18 Revenues Likely - Even With FY15 Surplus Consumed by Rainy Day Fund**

<b>Fiscal Year</b>	<b>Official Growth</b>	<b>Official GF Revenues</b>	<b>Adj. Est. Growth</b>	<b>Adjusted GF Revenues</b>	<b>Difference</b>
2014	-1.6%	\$16,411	-1.6%	\$16,411	\$0
2015	<b>4.7%</b>	\$17,186	<b>8.1%*</b>	\$17,736*	\$550
2016	3.1%	\$17,721	3.1%	\$18,289	\$568
2017	2.1%	\$18,092	2.1%	\$18,673	\$581
2018	3.7%	\$18,755	3.7%	\$19,364	\$609

\* Preliminary Actual, FY 2015 surplus consumed by Rainy Day Fund constitutional deposit requirements

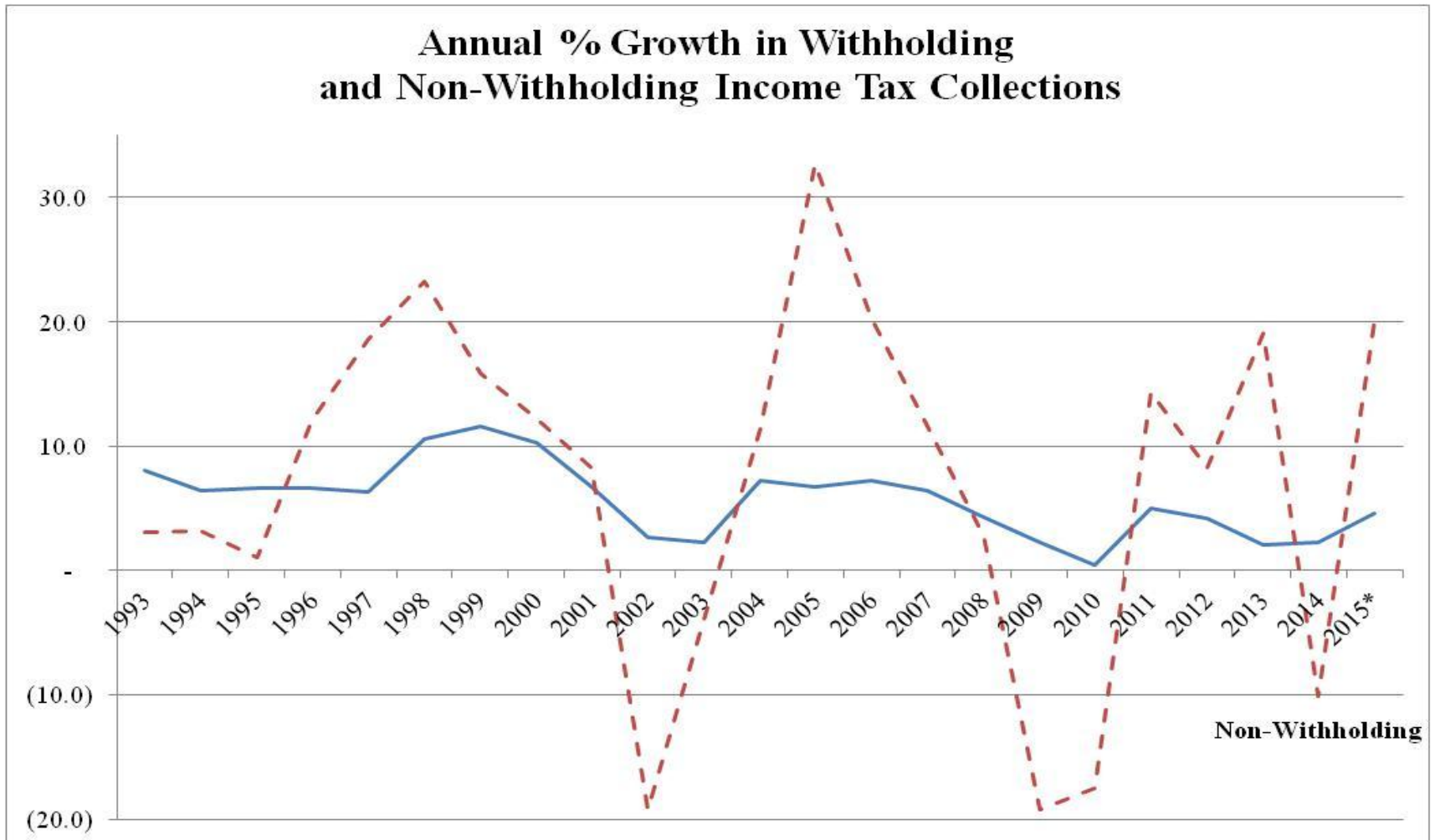
# Revenue Stabilization Fund Year-End Balances



# Will General Fund Growth Rates Perform Better than Expected?

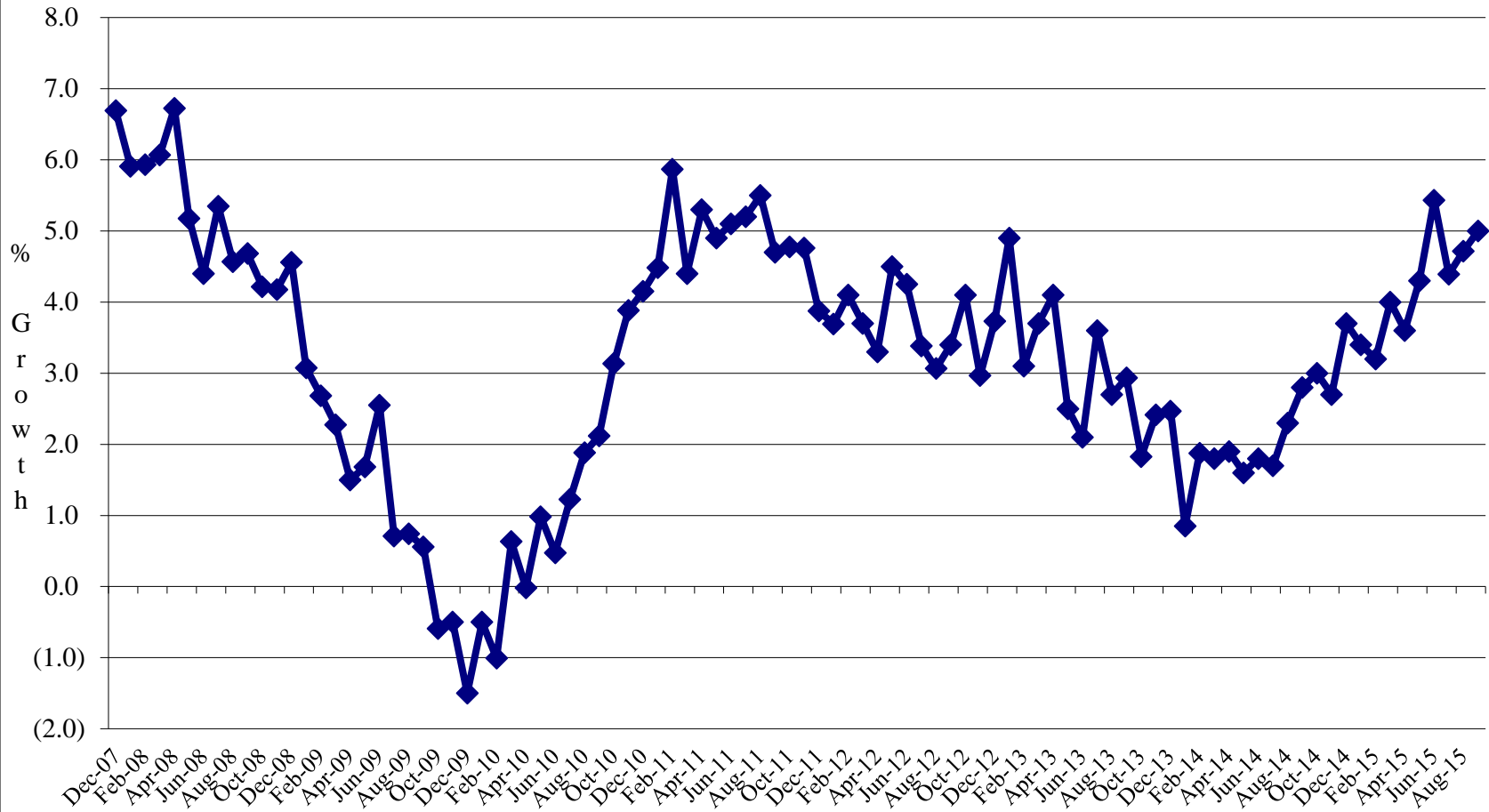
- Revenue forecasting has proven to be especially difficult in recent years.
  - Non-withholding income taxes (16% of GF) hard to forecast.  
(i.e., higher 2013 federal tax rates amid strong stock market gains).
- Virginia economy seems to be improving, even though still underperforming overall U.S. employment and income growth.
  - Income tax withholding (64% of GF) currently growing 4-5%.
  - Recent 2-year federal budget deal with defense spending increases helps Virginia.
  - NoVa employment growth is bouncing back (2.4% yr over yr August growth, stronger professional/business services).

# Non-Withholding Income Tax Is a Volatile Revenue Source\*

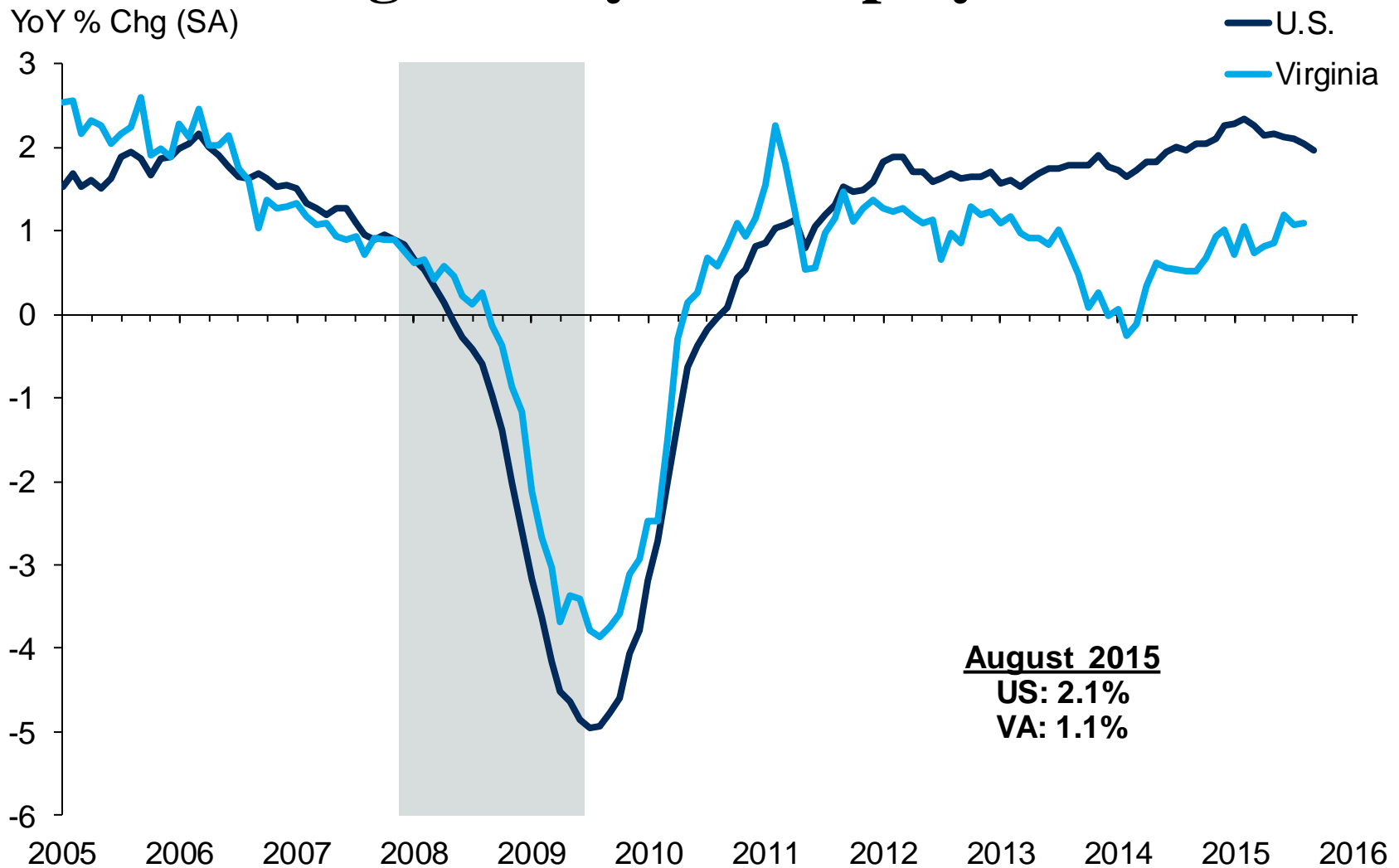


\* Note: % of total GF revenues: 15.4% in FY 14; 17.1% in FY 15

## Improving Growth in Individual Income Tax Withholding (62% of GF; 12 Mo. Moving Avg % Growth Thru Sept.)

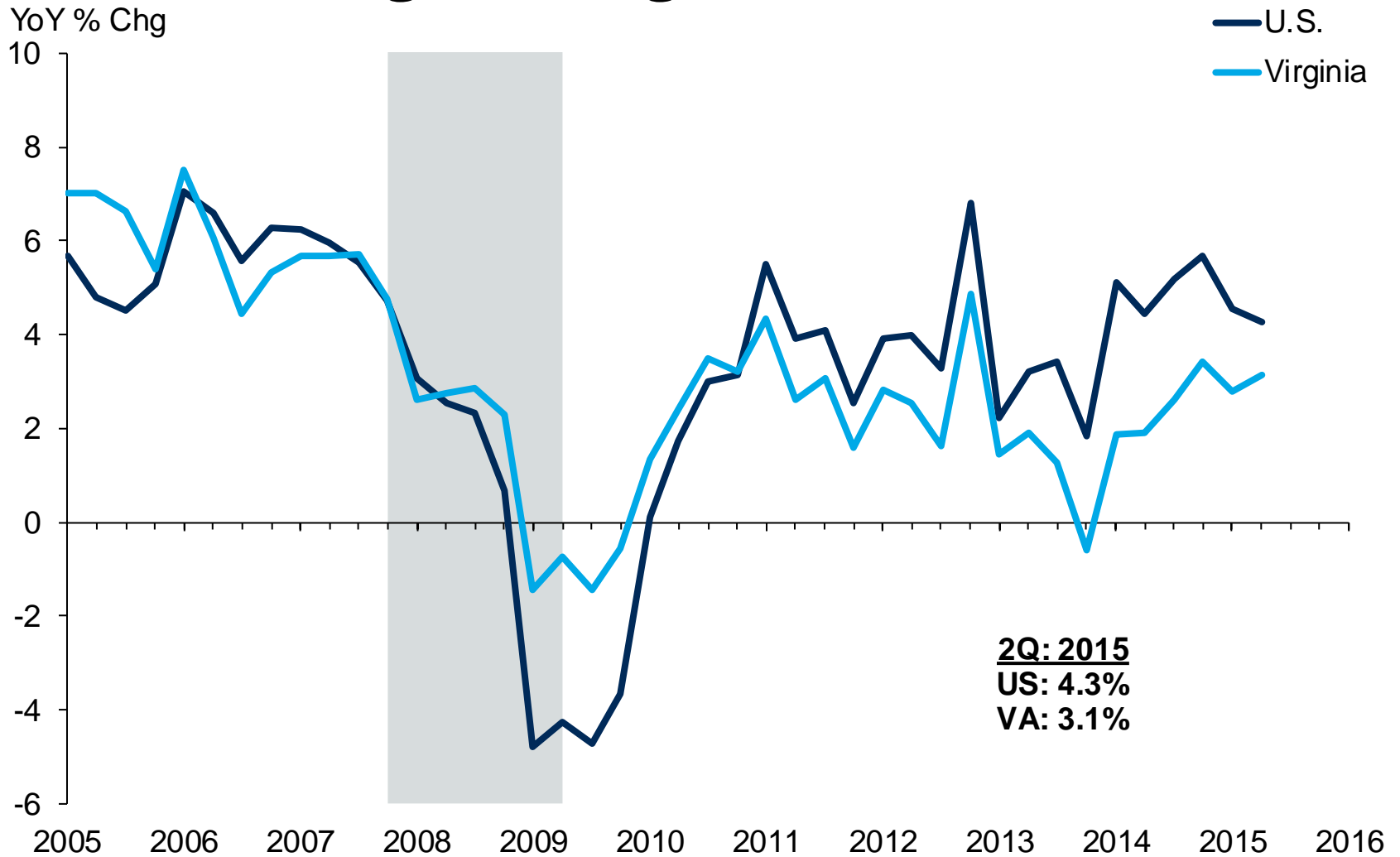


# Continued Improvement? Virginia Payroll Employment



Source: Bureau of Labor Statistics/Haver Analytics

# Continued Improvement? Virginia Wages and Salaries

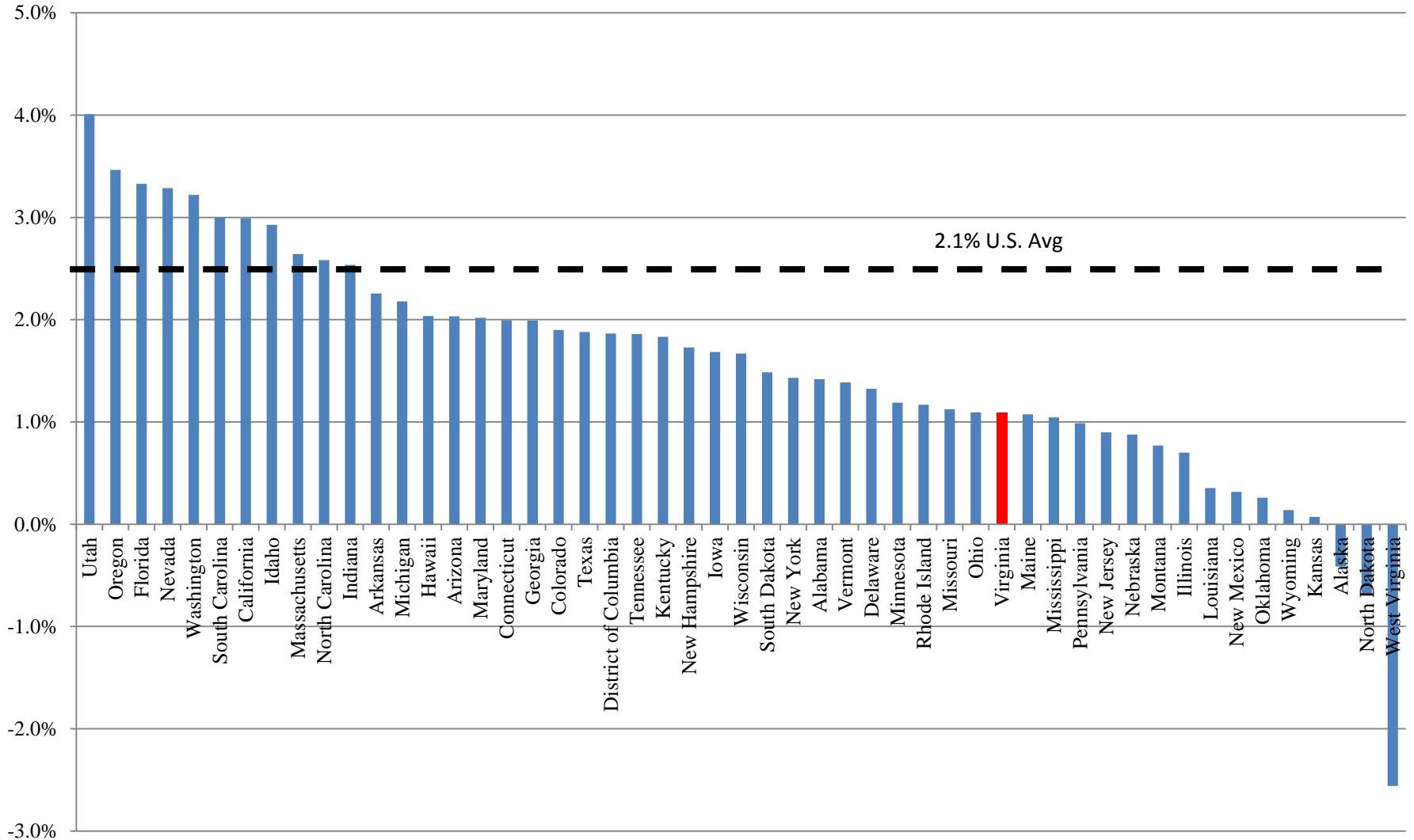


Source: Bureau of Economic Analysis/Haver Analytics



# Will VA Return to At-Least National Avg Growth?

## August 2015 States' Year-over-Year Employment Growth



## Current 2014-16 General Fund Appropriations: \$1.6 Bil. Above its FY 14 Base

	<u>2015 Session Adopted Budget</u>			<u>FY14-16 over FY14 x 2</u>
	FY 2014 Budget	FY 2015 Budget	FY 2016 Budget	
Legislative and Executive Dept's	103.2	109.0	107.7	10.3
Judicial Dept.	425.2	452.6	455.4	57.6
Administration/Comp Board	654.1	689.6	680.5	61.8
Treasury Board GF Debt Service	608.5	672.1	683.7	138.7
Other Finance/Technology	171.8	179.8	181.5	17.5
Rainy Day Fund	339.6	372.7	-	(306.5)
Car Tax Reimbursement	950.0	950.0	950.0	-
Commerce and Trade	183.3	181.9	197.0	12.3
Agriculture / Nat. Resources	144.0	184.3	174.4	70.7
K-12 Education/Central Office	5,292.7	5,456.5	5,615.3	486.5
Higher & Other Education	1,782.1	1,813.6	1,865.5	114.9
DMAS Medicaid	3,519.8	3,694.4	3,987.2	642.0
Other Health & Human Services	1,541.5	1,646.1	1,658.1	221.1
Public Safety & Veterans/HS	1,699.0	1,802.8	1,836.1	240.8
Transportation	42.0	13.2	69.1	(1.7)
Central Appropriations	247.2	20.4	160.2	(313.8)
Independent Agencies/Capital	<u>1.2</u>	<u>1.4</u>	<u>142.6</u>	<u>141.6</u>
<b>Total GF Appropriations</b>	<b>\$ 17,705.2</b>	<b>\$ 18,240.2</b>	<b>\$ 18,764.2</b>	<b>1,593.9</b>
<b>GF Resources</b>	<b>\$ 17,304.1</b>	<b>\$ 18,301.0</b>	<b>\$ 18,767.3</b>	
<b>Balances</b>		<b>\$ 186.4</b>	<b>\$ 1.9</b>	
<b>Unspent Balance</b>		<b>\$ 247.2</b>	<b>\$ 5.1</b>	

# Improving Revenues Will Provide Budget Flexibility in the 2016-18 Biennium

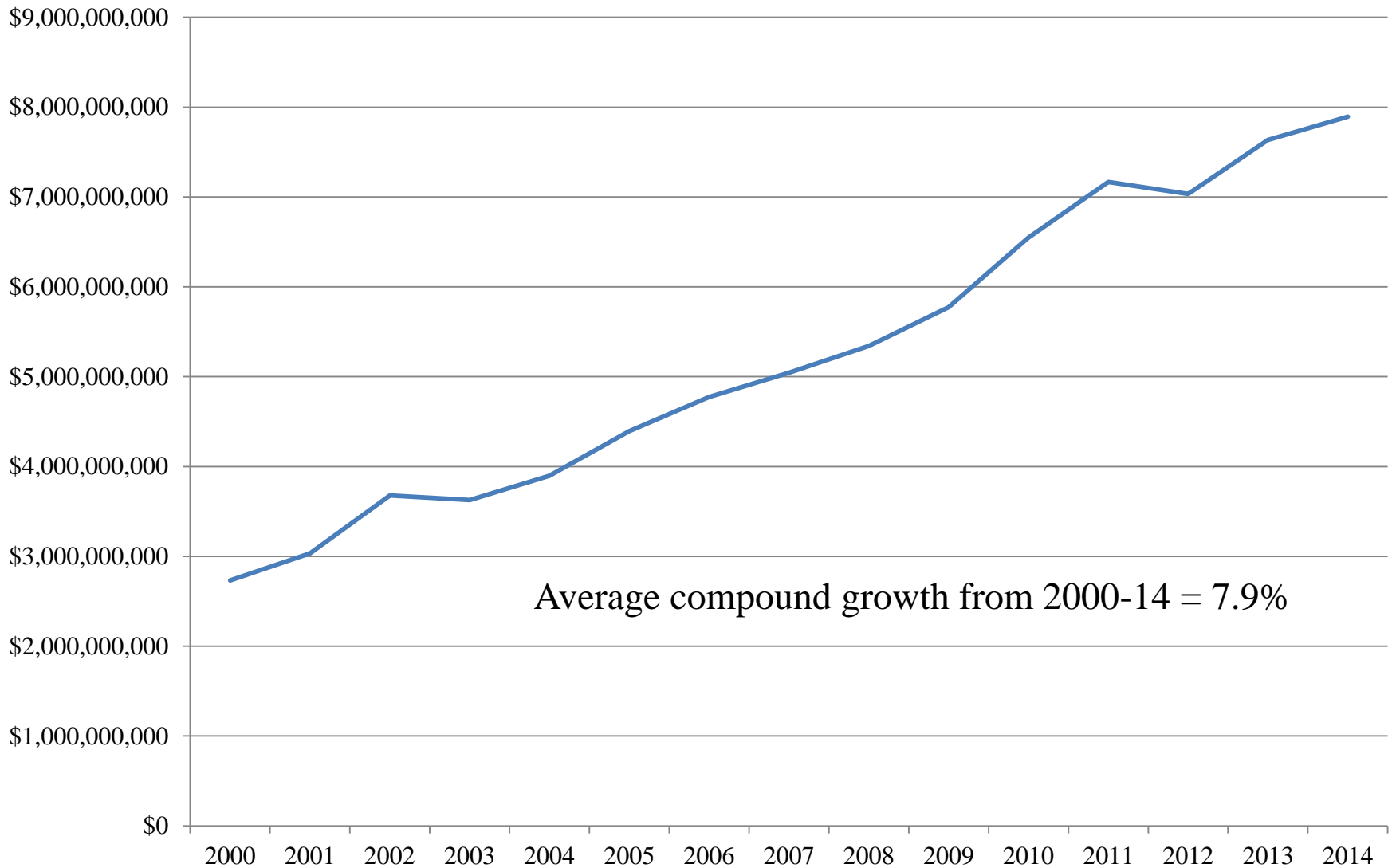
- 2016-18 biennial GF base budget about \$37.5 billion. Available GF resources (balances, revenues, transfers) of about \$40.0 billion assuming current forecasted growth rates (i.e., \$2.5 bil. above base budget). Additions to the base budget could include:
  - Initial K-12 rebenchmark (\$341 million – net of \$47 mil. VPI non-participation); Final update includes changes to: LCI, enrollment, VRS, lottery and sales tax revenues.
  - Medicaid inflation and utilization (5% growth=\$600 mil; 7% growth=\$850 mil)
  - Enhanced funding for locally mandated programs, such as K-12 public education.
  - Higher education base funding increases, more student aid, other initiatives.
  - Other health & human service increases: e.g., CSA, behavioral/mental health.
  - Additional debt service for already authorized debt. New debt capacity \$550 mil./yr. Cash for capital spending?
  - Increase state employee and faculty salaries and benefits, including health care costs. Restore selected agency cuts?
  - Accelerate full funding of VRS? Current projected 2016-18 teacher rate of 14.66% represents 90% of full contribution rate needed. One-time cash infusion?
  - New initiatives, such as “GO Virginia”?
  - Tax policy changes such as repealing the accelerated sales tax payment (\$200mil.); or new/expanded economic development incentives?

# What Has Held Back State Aid to Localities?

## Slower State GF Revenue Growth

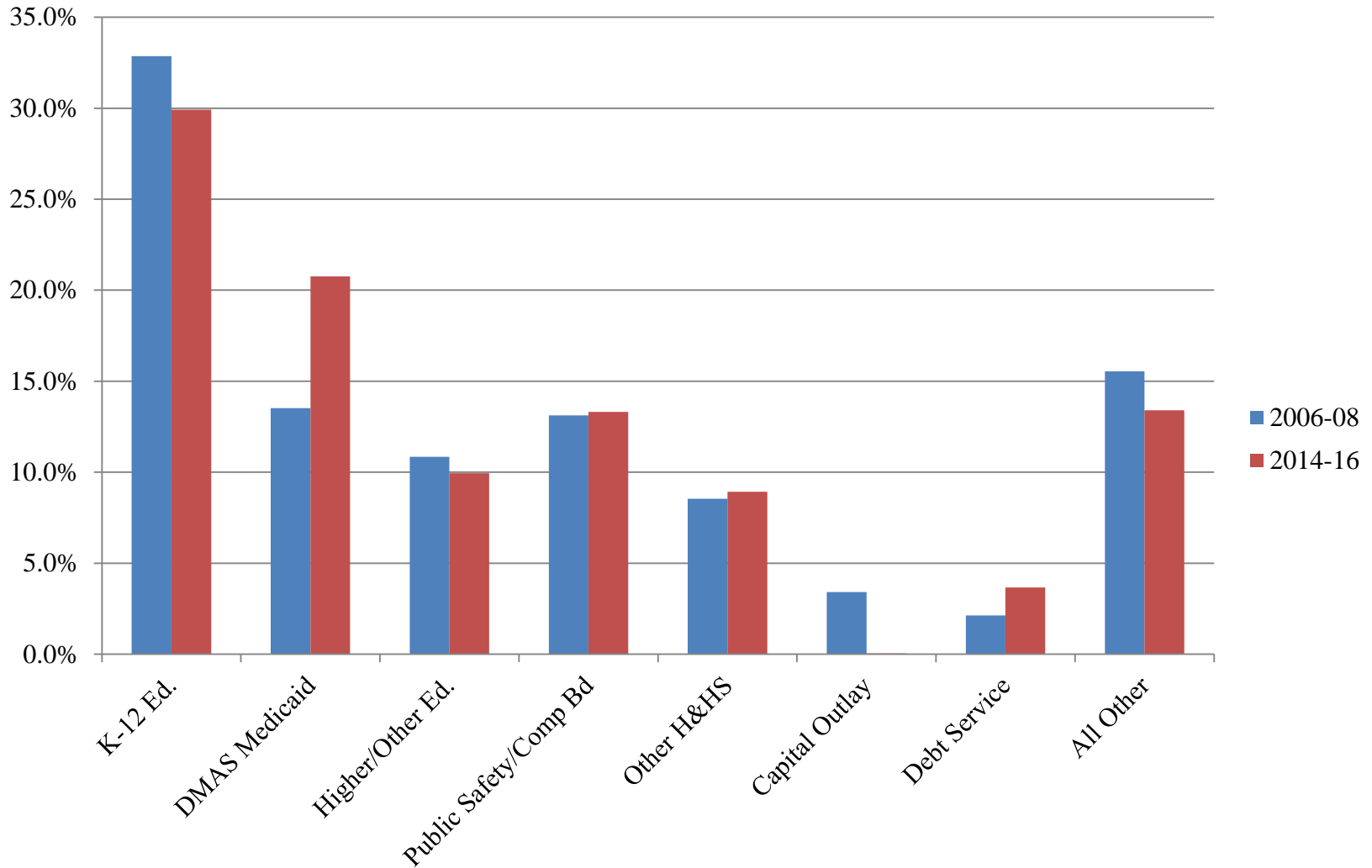
<u>Years</u>	<u>Avg. GF Revenue Growth</u>
1990-1999	5.9%
2000-2008	5.7%
2009-2015	1.9%

# Total Medicaid Expenditures as Recorded in the Commonwealth Accounting and Reporting System (CARS)

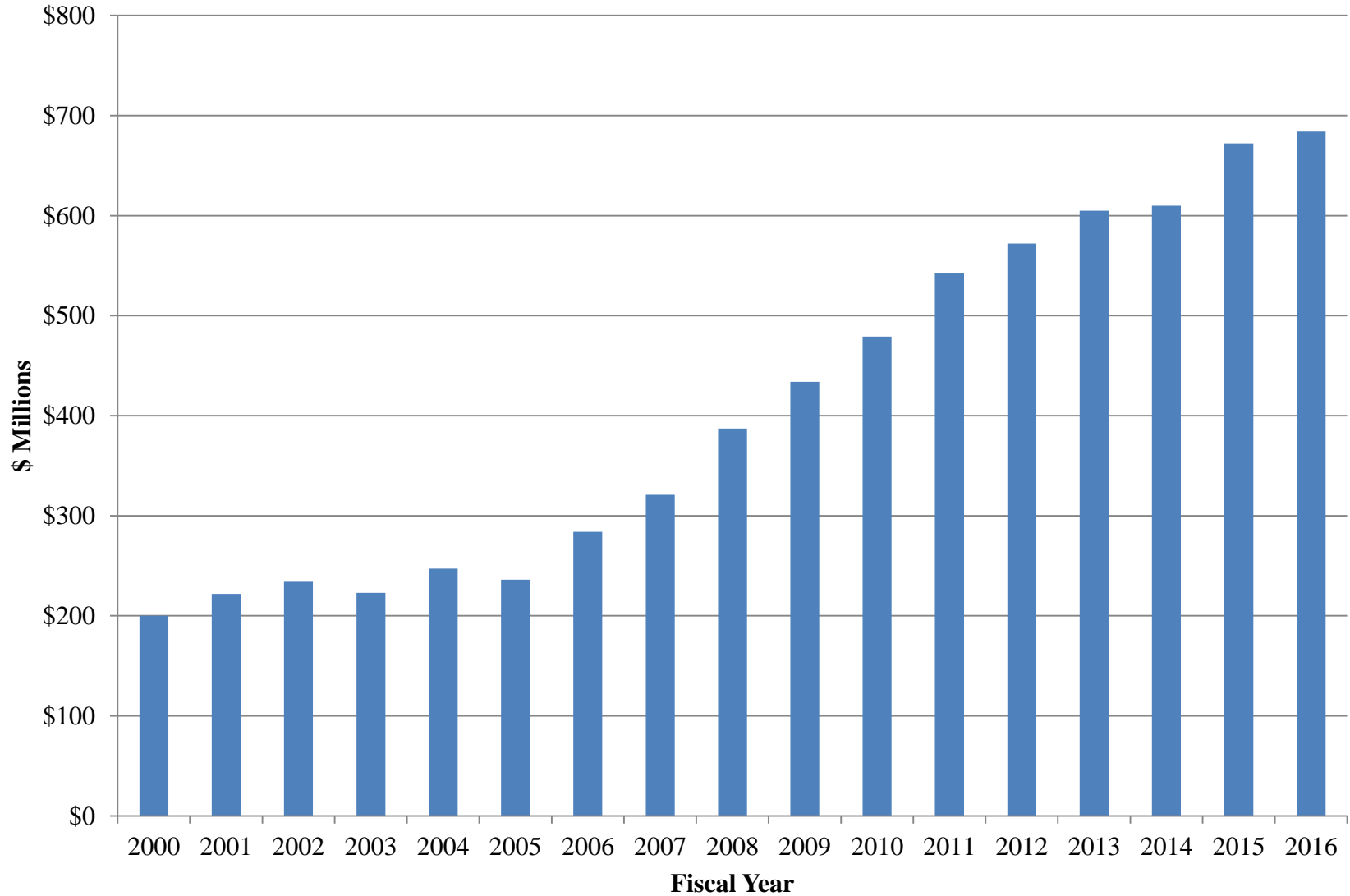


# Medicaid Spending Outstripping GF Growth

## Change in Share of State General Fund Appropriations 2006-08 to 2014-16 Bienniums



# Growing State GF Debt Service



# Tax Changes Reducing Biennial State GF Revenues by \$3.1 Bil.

	<u>Enacted/Amended</u>	<u>Biennial (\$ Mil.)</u>
Age Subtraction (net of 2004 means testing)	1994 and 2004	(\$581)
Car Tax Reimbursement	1997, 2003	(\$1,900)
Subtraction for UI/Military/Gov't Empl	1999	(\$74)
Historic Rehab Tax Credit	1999	(\$152)
Coalfield Employment Tax Credits	2000	(\$68)
Low Income Tax Relief	2000, 2004, and 2007	(\$412)
Land Preservation Tax Credit	2003	(\$200)
Impose 2.5% Sales Tax on Food	2004	(\$1,094)
Estate Tax Repeal	2009	(\$280)
Other Tax Changes since 1999	1999-2014	(\$182)
<b>State Tax Reductions since 1994</b>		<b>(\$4,942)</b>
Sales Tax Presence in Virginia Amazon	2012	\$41
Sales tax on satellite TV equipment	2014	\$19
Add 1/2 percent sales tax on non-food items	2004	\$986
Recordation Tax Increase (net of 3 cents to transp.)	2004/2007	\$210
Tobacco Tax Increase	2004	\$285
Close 2 Corp. Tax Loopholes/Eliminate ST Exem for Pub. Svc. Co.	2004	\$286
<b>State Tax Increases since 1994</b>		<b>\$1,827</b>
<b>Net State Tax Change Since 1994</b>		<b>(\$3,115)</b>

*Source: Senate Finance Committee Retreat, Revenue Outlook, Nov. 20, 2014*



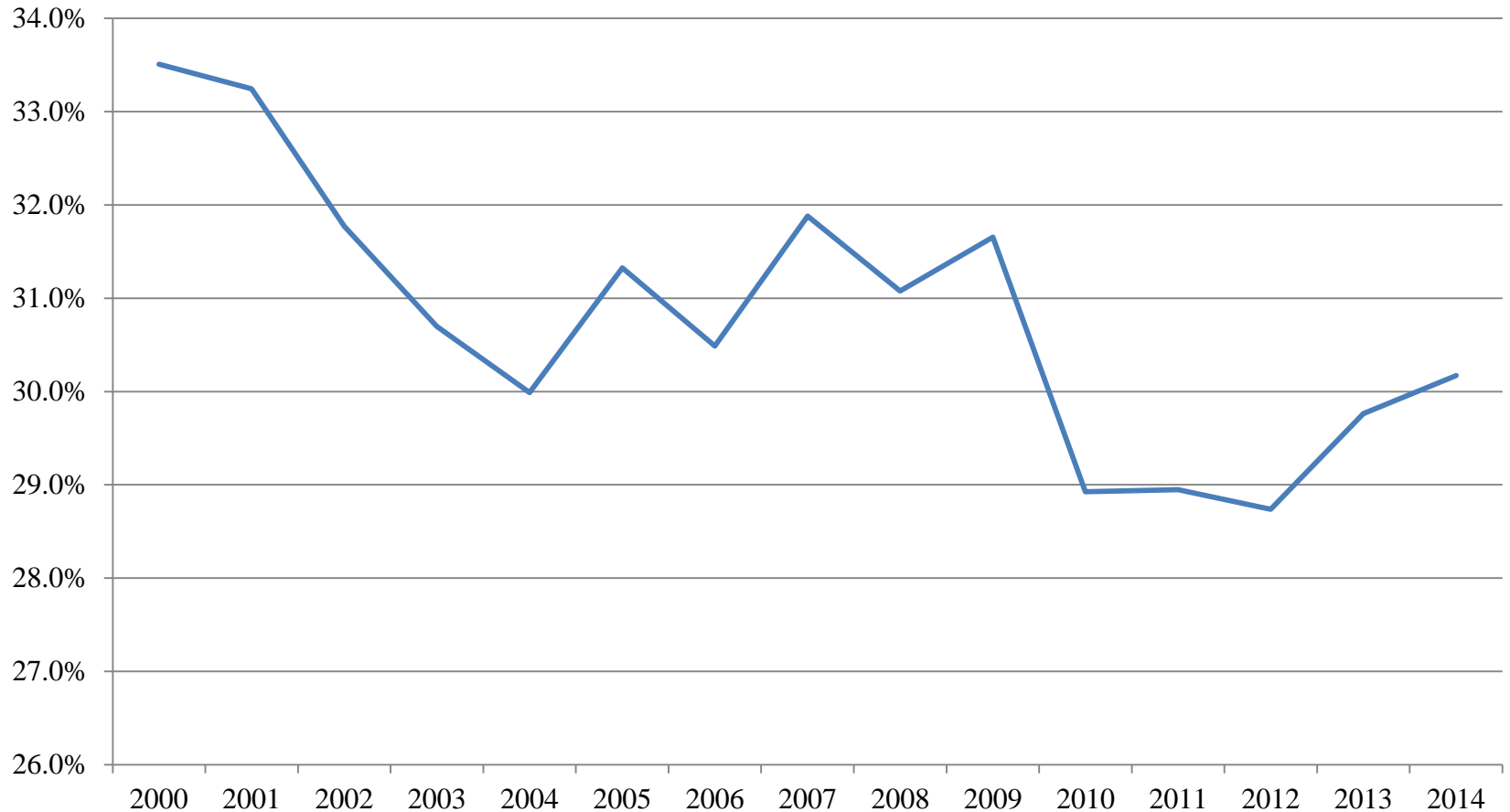
# Leads to Declining State Aid to Localities as a Percent of the GF Budget

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

	<u>FY 2009</u>	<u>FY 2012</u>	<u>FY 2014</u>	<u>FY 2015</u>	<u>FY 2016</u>
<b>Direct Aid to K-12</b>	<b>\$5,607.6</b>	<b>\$4,903.1</b>	<b>\$5,240.3</b>	<b>\$5,405.4</b>	<b>\$5,560.3</b>
<b>Health and Human Services</b>	<b>888.4</b>	<b>822.7</b>	<b>791.7</b>	<b>810.1</b>	<b>846.8</b>
<i>CSA</i>	299.7	245.2	217.2	217.4	217.4
<i>Community MH/MR Services</i>	249.4	269.0	269.3	287.3	317.1
<i>Local Social Services Staff</i>	117.4	111.4	115.3	112.1	114.4
<i>Community Health Programs</i>	117.6	109.3	107.2	110.6	115.1
<i>Welfare Services and Programs</i>	104.3	87.8	82.7	82.7	82.8
<b>Public Safety</b>	<b>734.3</b>	<b>670.0</b>	<b>687.9</b>	<b>713.2</b>	<b>704.2</b>
<i>Local Sheriffs Offices</i>	406.1	396.9	411.3	431.2	436.0
<i>Local Police Depts HB 599</i>	197.3	172.4	172.4	172.4	172.4
<i>Local Jail Per diem</i>	80.1	54.5	59.4	63.9	50.1
<i>Assistance for Juvenile Justice</i>	50.8	46.2	44.8	45.7	45.7
<b>Constitutional Officers</b>	<b>\$155.3</b>	<b>\$143.8</b>	<b>\$145.8</b>	<b>\$152.4</b>	<b>\$152.5</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><u>(50.0)</u></b>	<b><u>(60.0)</u></b>	<b><u>0.0</u></b>	<b><u>(30.0)</u></b>	<b><u>0.0</u></b>
<b>Total Local GF Aid</b>	<b>\$8,285.6</b>	<b>\$7,429.6</b>	<b>\$7,815.7</b>	<b>\$8,001.1</b>	<b>\$8,213.7</b>
<b>Total GF Appropriations</b>	<b>\$15,943.0</b>	<b>\$16,556.9</b>	<b>\$17,705.2</b>	<b>\$18,240.2</b>	<b>\$18,764.2</b>
	<b>52.0%</b>	<b>44.8%</b>	<b>44.1%</b>	<b>43.9%</b>	<b>43.8%</b>

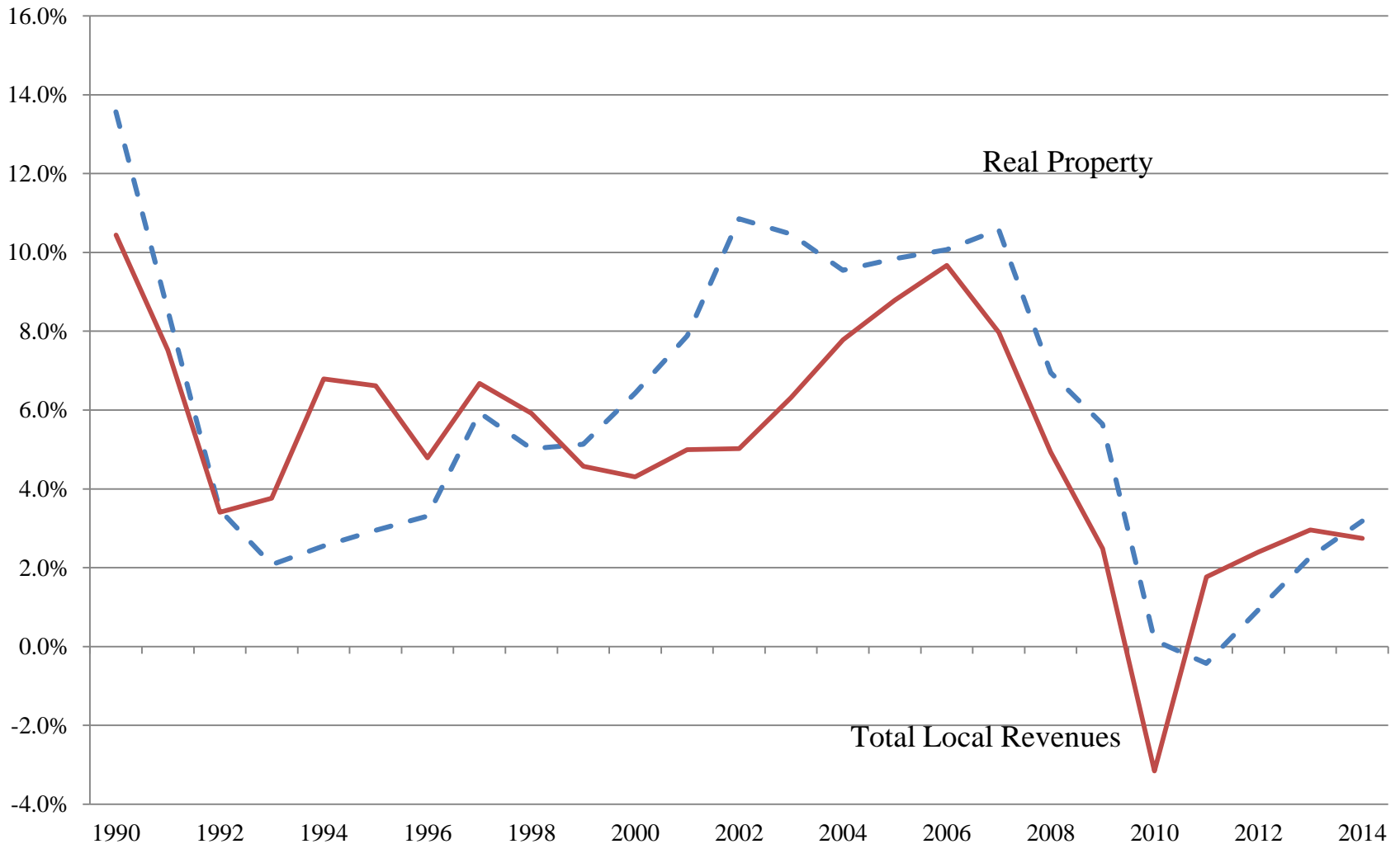
# State Support For Locally-Administered Programs Has Fallen Over Time

**State Categorical Aid as % of Local Expenditures**



Source: APA Comparative Reports on Local Revenues and Expenditures, Fiscal Years 2000-2014

# Localities Only Beginning to Recover from Real Estate Recession



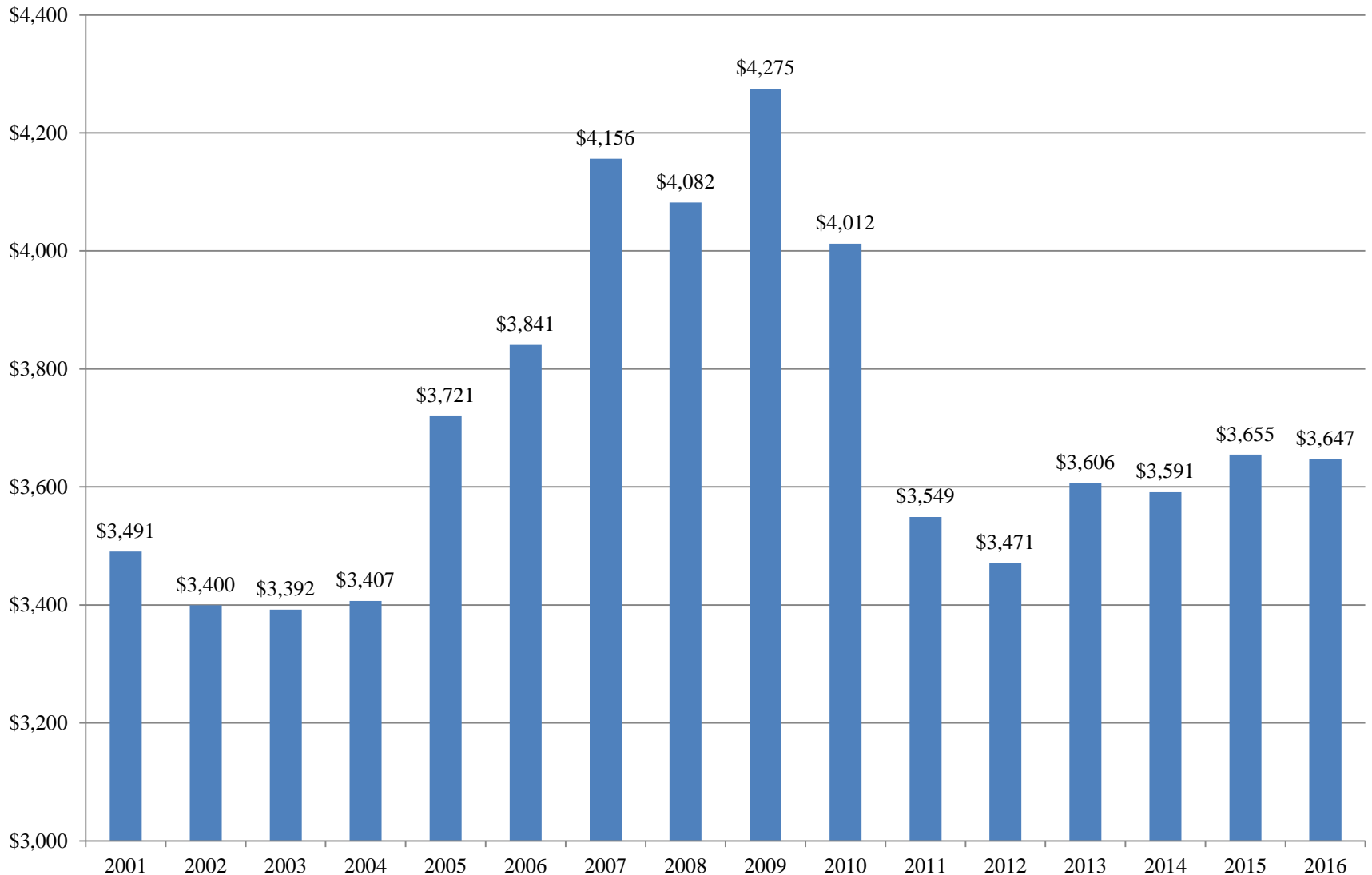
Note: real property tax rate changes from FY 13-15: 20 cities increased, 2 decreased; 57 counties increased, 7 decreased . 19

# Since Recession, Local Revenues & Expenditures Have Not Kept Pace with Inflation\* / Population Growth

<b>FY 2009 - FY 2014 Growth Comparison</b>						
	<b>Locally-Generated Revenue</b>	<b>State/Federal Revenue for Localities</b>	<b>All Revenue for Localities</b>	<b>O&amp;M Expenditures</b>	<b>Population</b>	<b>Population/Inflation*</b>
<b>VA Cities</b>	<b>3.9%</b>	<b>-1.4%</b>	<b>1.7%</b>	<b>0.1%</b>	<b>3.7%</b>	<b>14.2%</b>
<b>VA Counties</b>	<b>9.0%</b>	<b>6.8%</b>	<b>8.2%</b>	<b>8.3%</b>	<b>5.3%</b>	<b>15.8%</b>

\* Inflation as measured by the CPI grew 10.5% from FY 2009-14

# Real Inflation-Adjusted State K-12 Funding is Below 2005 (FY 2001 \$ Per Pupil - All State Appropriated Funds)



# Recent JLARC Report on State K-12 Education Agrees With Funding Assessment

- Virginia spends less to educate each student than a decade ago
  - 7% less per student adjusted for inflation (FY 2005-14).
  - Non-instructional spending was reduced the most.
  - Health insurance spending increased 66%.
- More than 80% of divisions reported challenges in recruitment and retention. High turnover may reduce instructional effectiveness.
- Teacher support services declining
- Divisions spent 30% less to operate and maintain facilities since 2005.

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

- State does not pay for all Board of Education approved current practices and standards; “linear weighted average” methodology understates true prevailing costs; real-time costs not reflected in re-benchmarking; no longer pays prevailing support costs.
  - Raising SOQ teacher salaries to the national average and funding prevailing support costs requires an additional \$750 million GF/year (\$625 per pupil).
- Localities have to spend \$3.6 bil. beyond minimal state funding requirements to meet SOL and SOA requirements. All school divisions exceeded Required Local Effort (RLE) in FY 14.

Divisions up to 25% Above RLE	10
Divisions Exceeding 25% to 75%	54
Divisions Exceeding 76% to 100%	26
Divisions Exceeding 100% RLE	45

# State Policy Changes Adopted to Reduce K-12 Funding

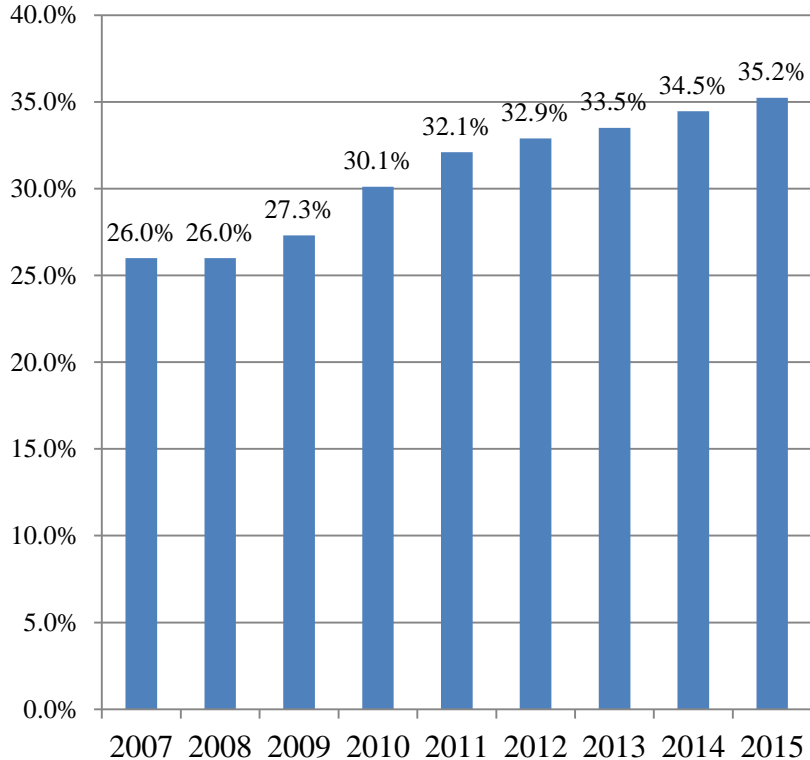
<u>Major K-12 Funding Policy Changes Since 2008 Session</u>	<u>Session</u>	<u>Biennial \$ in Mil.</u>
Cap Funding for Support Positions	2009	(\$754)
Eliminate School Construction Grants	2009	(\$55)
Adjust Health Care Participation Rates	2010	(\$269)
Eliminate Equipment, Travel, Misc. Expenses From SOQ Calculation	2010	(\$244)
Include \$0 Values in Linear Weighted Avg Calculation	2010	(\$79)
Eliminate Lottery Support for School Construction	2010	(\$67)
Drop Lowest Tier From K-3 Class Size Calculation	2010	(\$36)
Extend School Bus Replacement Cycle From 12 to 15 Yrs	2010	(\$19)
Eliminate Enrollment Loss Assistance	2010	(\$16)
Eliminate Non-personal Inflation Update (not originally intended as permanent, <i>partially offset in 2012-14 biennium</i> )	2012	(\$109)
Eliminate COCA for support positions in NoVa	2012/14	(\$50)
Use Kindergarten as Proxy for 4-yr-old Pre-K Count	2012	<u>(\$27)</u>
<b>Total Major Policy Changes Since 2008</b>		<b>(\$1,725)</b>



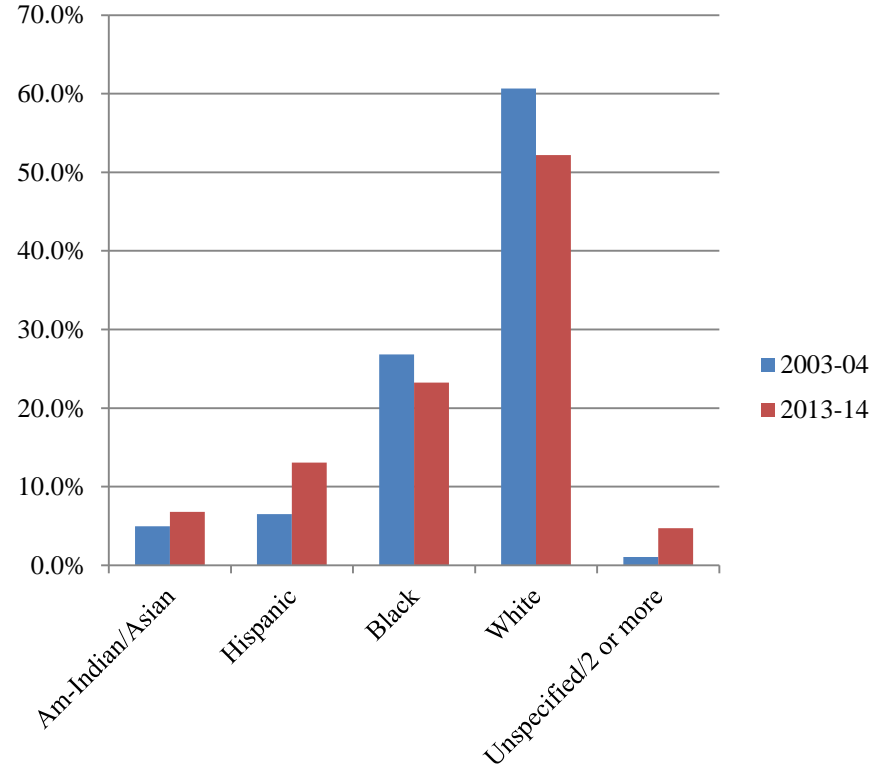
# More Difficult and Diverse Student Population to Educate

- More At-Risk Students
- Changing Student Demographics

Percentage of Free Lunch Students in VA



VA Public K-12 Student Population by Race



# The Achievement Gap Persists

## 32 Percent of All Schools Are Not Fully Accredited (2014-15)

Fully Accredited	1249
Provisionally/Conditionally Accredited	23
Accredited with Warning	541
Accreditation Denied	13

## 2014-15 SOL Pass Rates

	<u>English</u>	<u>Math</u>
Asian	90	93
White	86	85
Hispanic	71	73
Black	65	67
Economically Disadvantaged	66	68
Limited English Proficiency	61	67

# VASS Spring 2015 Superintendent Survey

## “Great Recession” Cuts Have Impacted School Divisions

**92 percent of school divisions responded. Key findings included:**

- 10,180 FTE reduced, including 5,138 teachers.
- 87% of respondents who reduced staff have added duties to the remaining staff
- 77% of respondents believe that teachers have left their division due to their salary.
- 20% have reduced compensation and 44.5% of divisions have reduced employees' benefits since FY 2009.
- 71% of divisions have increased class sizes since FY 2009.
- 23% of divisions closed schools for financial reasons.
- 52% of divisions reduced curricular programs.
- 29% of have reduced co-curricular programs.

# **As State Revenues Recover, Locally-Administered Programs Need High Priority**

- K-12 Public Education:
  - Basic Aid and support costs
  - Career and technical education
  - Teacher salaries
  - At-risk student programs
  - School infrastructure
- Public Safety/Compensation Board:
  - HB 599 Aid to Police Departments
  - Jail per diem payments
  - Sheriff and Constitutional Officers
- Health and Human Services:
  - CSA local match requirements and education costs for Medicaid children.
  - Local social services staffing
  - CSB behavioral health treatment capacity
- Other:
  - Water quality, LODA, economic development initiatives

# 2016-18 State Agency Funding Requests of Particular Interest to Localities

- **Compensation Board:**
  - \$21.5 mil. for jail per diems to support the increased cost of housing local responsible and state responsible inmates in local and regional jail facilities.
  - \$10.3 mil. for corrections officers for local and regional jails with overcrowding rates.
  - \$20.2 mil. to meet 25% of the Commonwealth's responsibility for staffing needs for constitutional officers.
  - \$14.6 mil. to meet the 1:1,500 law enforcement deputy ratio
- **Dept. of Elections:** \$11.4 mil. to return the reimbursement rate of the General Registrar to 100%.
- **Dept. of Housing and Community Development:**
  - \$32 million for the Housing Trust Fund
  - \$4 mil. for the VA Enterprise Zone Program.
  - \$4 mil. for the Industrial Revitalization (Derelict Structures) Fund.
  - \$10.3 mil. to fund up to 9 Broadband Planning grants and 9 to 12 implementation projects throughout the state.
- **CSA:**
  - \$32.8 mil. GF in 2016-18 biennium to cover CSA enrollment growth and savings that did not materialize from a new waste, fraud, abuse analytical system.
  - \$20.6 mil. GF to eliminate the local match responsibility for residential TFC Case Management Services.
  - \$21.5 mil. GF to cover costs of education for students placed in Medicaid-eligible residential treatment facilities that bypassed the CSA process.
  - \$21.0 mil. to eliminate the local match for non-mandated children and serve as an incentive for localities to utilize all their non-mandated funding.
- **CSB'S:** Various proposed grants to localities to address community mental health needs.
- **Direct Aid to Public Education:**
  - \$2.2 mil. per year for the Extended School Year Program.
  - \$2 mil. for the Virginia Tiered Systems of Support program to help decrease student disciplinary actions.
- **Dept. of Conservation and Recreation:**
  - \$10 million to increase livestock stream exclusion best management practices.
  - \$14.4 mil. for administration, operations costs and technical assistance to soil and water conservation districts
- **DOC:** \$1.2 mil. to cover increased costs for the Community Residential Re-entry Program.

# Virginia Is a Wealthy, Low Tax State, With Higher Reliance on Locality Taxes

	<u>2012 JLARC Ranking</u>	<u>2015 JLARC Ranking</u>
Per capita personal income	8	10
State and local <i>revenue</i> as a percentage of personal income	49	49
State and local <i>taxes</i> as a percentage of personal income	43	45
Per capita state taxes	34	36
Per capita local taxes	13	15
Individual income taxes as a percentage of state and local tax revenue	7	6
State motor fuel tax rate rank	37	46

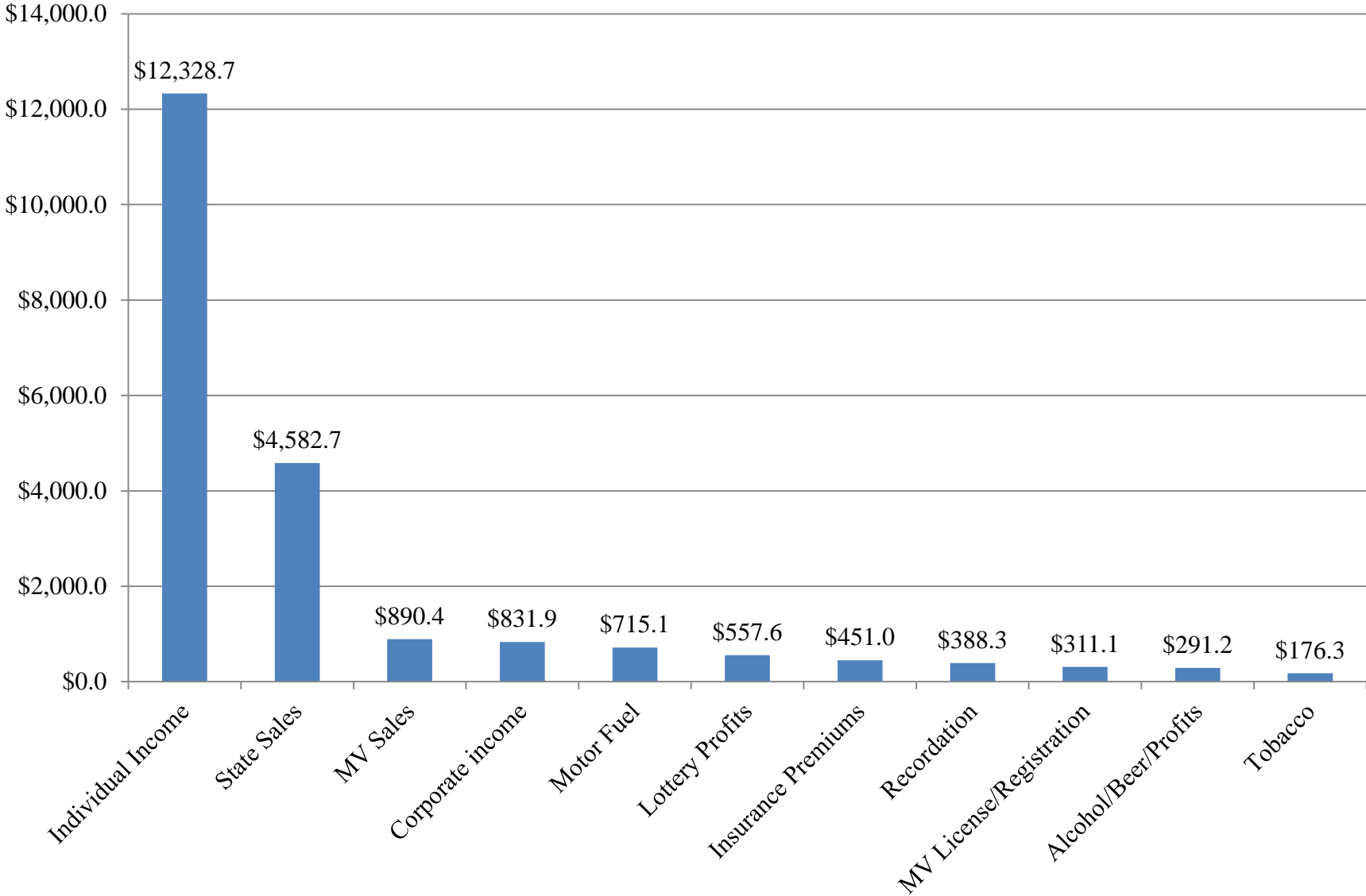
Source: *Virginia Compared to Other States, JLARC, 2012, 2015 Editions*

# Virginia Ranks Well Below the National Average in Spending Despite Its Wealth

	<u>2012 State Rank</u>	<u>2015 State Rank</u>
Per Capita Personal Income	8	10
Per Capita State Expenditures	32	27
State Per Pupil Funding	35	41
State and Local Per Pupil Funding	17	26
Average Salary of Public School Teachers	28	35
Per Capita State and Local Road Expenditures	38	28
Per Capita Medicaid Expenditures	47	48
Average Annual In-State Tuition and Fees at Public 4-Year Institutions	12	11

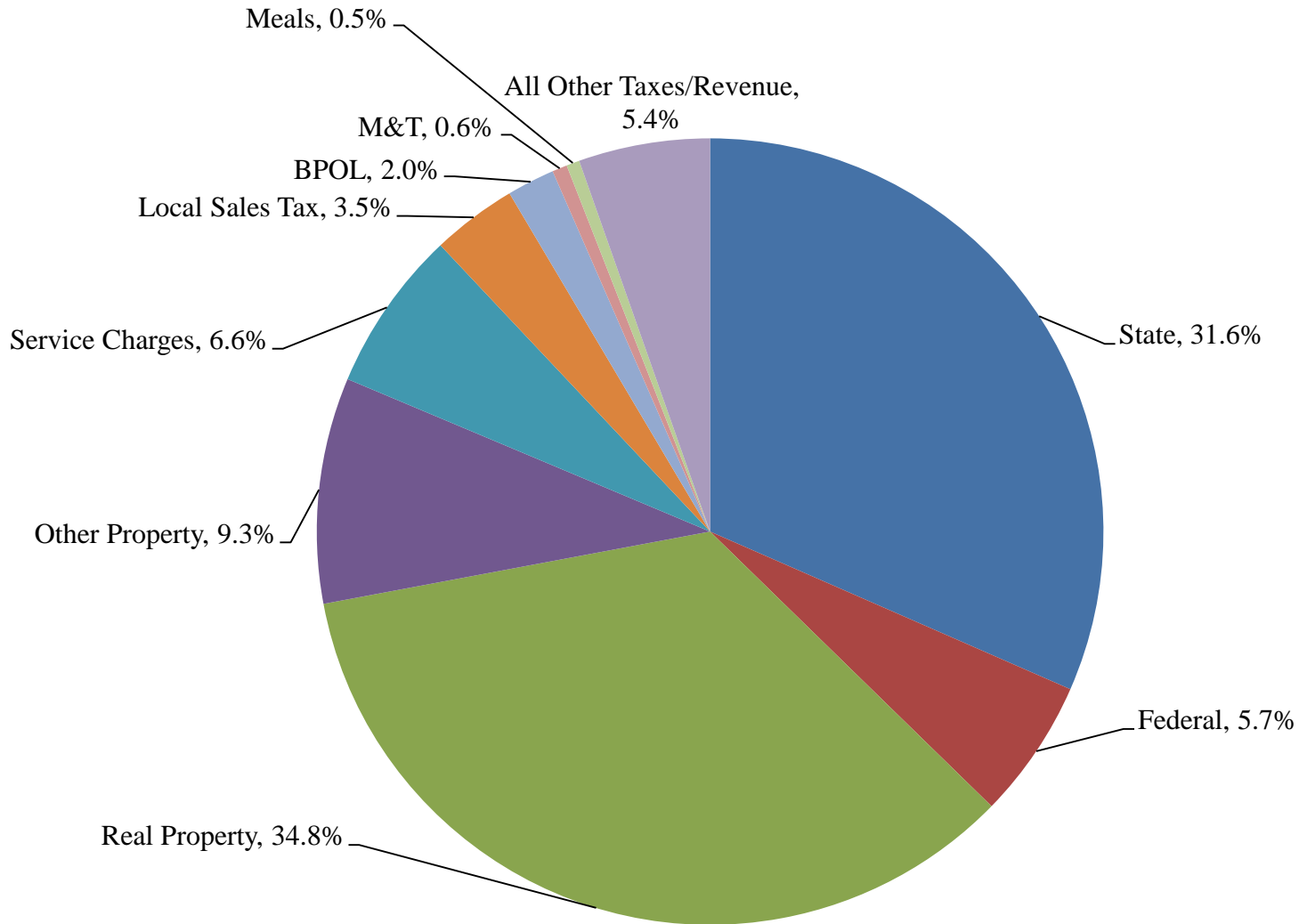
*Source: Virginia Compared to Other States, JLARC, 2012, 2015 Editions*

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





# FY 2014 Sources of Revenue for VA Counties - \$19.5B



Note: "All Other Taxes/Revenue" includes, licenses/permits, fines/fees, rental/sales, and other taxes incl. transient occupancy, MV license, recordation, bank stock, tobacco, admission, severance, franchise license, other

Source: Auditor of Public Accounts Comparative Report of Revenues and Expenditures

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

- Make the state income tax more progressive? A tax rate of 6.0% above \$50,000 and 6.25% above \$100,000 in taxable income would raise about \$700 mil. per year.
- Reduce tax preferences, such as itemized deductions (e.g., mortgage interest, age subtraction), or special tax preferences (e.g., land preservation, historic rehabilitation, coal mining), or corporate tax benefits (e.g., single sales factor for allocating corporate income)?
- Increase the sales tax rate? Each additional statewide 1% raises \$1 bil.
- Apply sales taxes to services, such as selected personal and repair services?
- Increase “sin” taxes. Tobacco tax: \$6 mil per penny. Double the beer and beverage tax for \$43 mil.
- Allow counties same taxing authority *by ordinance* as cities for meals and transient occupancy taxes.
- Adopt additional regional taxing strategies?
- Expand the differential commercial/industrial property tax rate currently used in Northern Virginia (and available in Hampton Roads)?