

# **A Look Back at the 2014 Session and Thoughts About 2015**

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## **Presentation to Virginia Association of Counties**

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# Overview of Presentation

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- A Review of Budget Actions During the 2014 Session
- 2014 Fiscal Year-end and Revenue Reforecasting
- Looking ahead to 2015 – Budget Challenges and Pressures
- Other Challenges and Local Government

# A Tale of Two Sessions

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- At the beginning of the 2014 Session, the General Assembly was trying to decide how to allocate \$1.7 billion in net new revenues.
  - Governor McDonnell's proposed budget included \$2.7 billion in proposed new GF spending offset by \$939.6 million in spending reductions.
- While most new general fund revenue was allocated for mandatory spending items, large discretionary funding initiatives were directed towards higher education and mental health funding.
- When the budget was finally passed in the waning days of fiscal year 2014, a steep decline in projected revenue forced legislators to remove \$1.6 million in funding for FY 2015 and FY 2016.

# Proposed Spending

## (Governor McDonnell's 2014-16 Budget)

### Major GF Spending Proposals (\$ in millions)

Medicaid Utilization and Inflation	\$674.4
Rebenchmarking Costs for K-12 Standards of Quality	584.1
Constitutionally-required Rainy Day Fund Deposits	303.0
Debt Service for Capital Projects and Equipment	196.7
Higher education funding	184.5
Fund updated costs for State Employee Retirement Rates	97.6
State employee health insurance premiums	83.9
All other GF Spending	552.3
<b>TOTAL, Proposed GF Spending</b>	<b>\$2,676.6</b>

# Proposed Spending Reductions (Governor McDonnell's 2014-16 Budget)

Major GF Savings Proposals (\$ in millions)	
DOJ: Reduce Funding for State Training Centers	(\$84.7)
Remove Non-Personal Inflation Adjustments from the cost of Rebenchmarking the Standards of Quality	(76.4)
Supplant GF with Enhanced federal Medicaid Funds from ACA	(55.7)
Reduce Virginia Preschool Initiative for Nonparticipation	(48.5)
Withhold Medicaid Hospital Inflation Adjustment in FY 2015	(35.3)
Continue Medicaid Reduction for State Teaching Hospitals	(24.4)
Eliminate K-12 COCA Support Positions	(20.7)
All other Proposed GF Spending Reductions	(634.8)
<b>TOTAL, Proposed GF Spending Reductions</b>	<b>(\$939.6)</b>

# Goals of the Senate's Budget

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- Prior to the announcement of the revenue shortfall, the Senate's budget was designed to:
  - Promote and sustain investment in Virginia through support for public education, higher education, and workforce training.
  - Support funding for critical mental health services, and for victims of abuse and domestic violence.
  - Create a mechanism for providing health care coverage to roughly 250,000 uninsured Virginians.
  - Address employee compensation for teachers, state employees, faculty, and state-supported local employees.
  - Maintain commitment to fully funding our obligations to the VRS.
  - Maintain a structurally balanced budget, with a conservative revenue forecast.

# In May, Revenues Hit the Skids

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- Based on May year-to-date collections, revenues for FY 2014 looked to be about \$350 million below the forecast, largely from estimated payments.
- Chapter 1 (Caboose Bill) assumed a FY 2014 year-end balance of \$478.6 million.
  - Ripple effect of the shortfall in FY 2014 thought to be about \$600 million in FY 2015, and \$600 million in FY 2016.
- For planning purposes and development of the budget, the potential budget shortfall to be addressed was estimated to be:
  - FY 2015 = \$950 million; FY 2016 = \$600 million.

# Addressing the Shortfall

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- ❑ Final biennial budget was adopted on June 12, 2014 in the 2014 Special Session I.
- ❑ Incorporated strategies to deal with a potential cumulative biennial budget shortfall of \$1,550.0 million:
  - Anticipated withdrawals from the Rainy Day Fund totaling **\$707.5 million**.
  - Created a **reserve fund of \$842.5 million GF** from spending cuts and one-time resources to close the gap.
- ❑ Dropped language creating Marketplace Virginia; no related spending or savings amendments.



# Strategies to Address the Budget Shortfall

## *Problem of about \$1,550 million*

- Identified spending reductions and resources of about **\$842.5 million**.
  - Reduced new, discretionary spending (both spending in the budget as introduced plus Senate initiatives):

Spending Reductions (\$ in millions)	
Higher Education	\$183.9
K-12 Public Education	166.6
Health and Human Resources	80.1
Commerce and Trade	39.0
Public Safety/Veterans Affairs	27.0
Compensation/Other	168.3

- Additional balances and revenue adjustments of about **\$177.7 million**, including delaying \$30 million of sales tax to HMOF in FY 2015, with payback in FY 2016.
- Accelerated Sales Tax: delays \$29.9 million “unwinding” in FY 2016; \$20.8 million by requiring early payment in FY 2015 for retailers between \$26 and \$48.5 million.

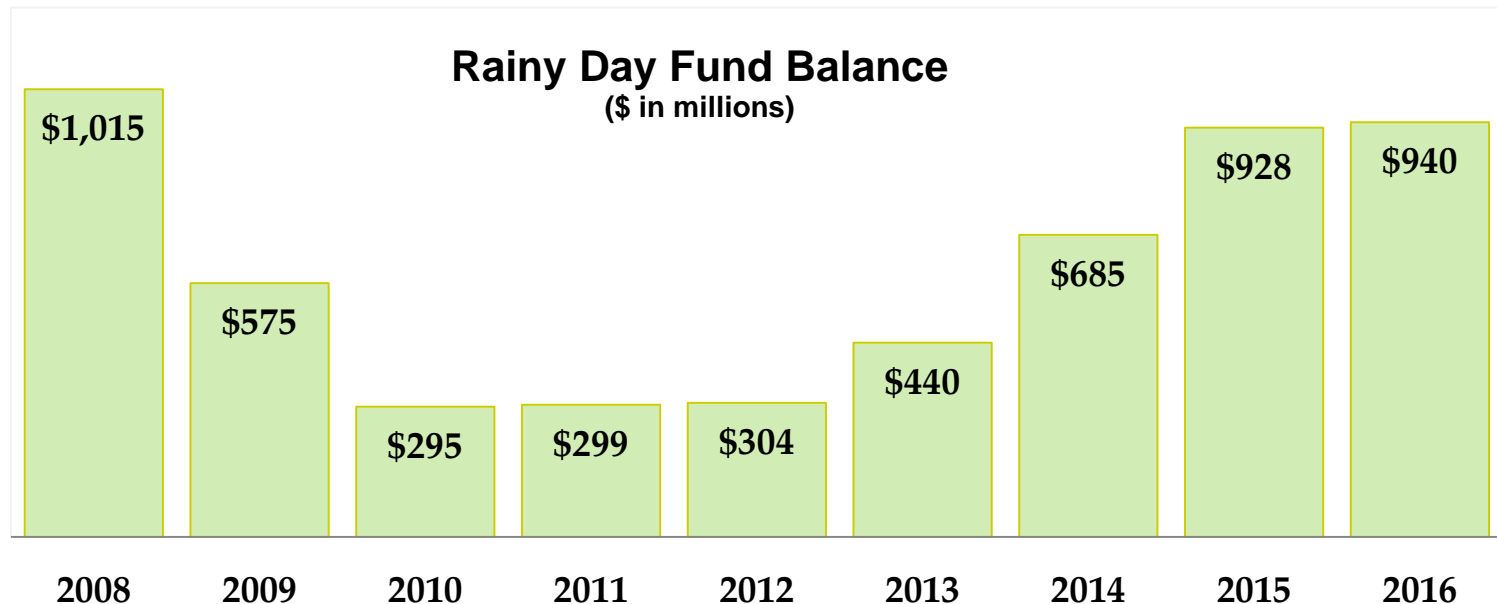
# Key Funding for Core Services Preserved

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- ❑ Funding for SOQ Rebenchmarking.
- ❑ Funding for Medicaid Utilization (less inflation).
- ❑ Commitment to repayment of VRS short funding from 2010-12 biennium.
- ❑ Commitment to fully-fund the phase-in to VRS board approved rates.
- ❑ Debt service payments.
- ❑ Required Rainy Day Fund deposit in FY 2015 (based on FY 2013 revenue performance).
- ❑ *Minimized direct impact of cuts on local governments.*

# Accessing the Rainy Day Fund

- If the difference between the *revised* forecast and the general fund appropriation in the *adopted* budget exceeds 2 percent of prior year collections, then the Rainy Day Fund may be tapped.
  - For FY 2015, **max withdrawal of one-half** of the fund is about **\$470 million**, leaving about **\$237.5 million** available in FY 2016.



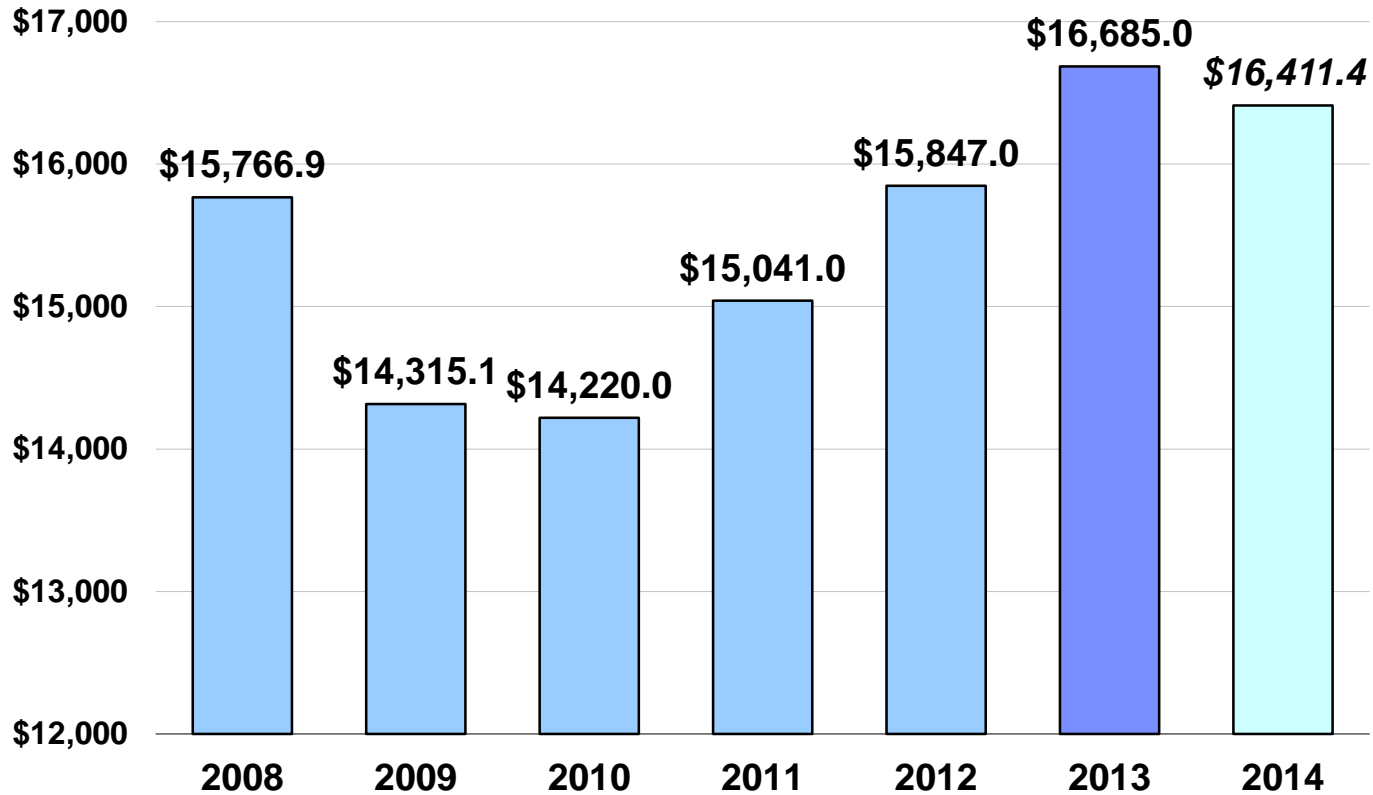
# Revenue Re-forecasting Process

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- If FY 14 revenue collections fell one percent or more below the forecast (as certified by the State Comptroller), the Governor must prepare a re-estimate of general fund revenues by September 1<sup>st</sup>.
- Governor convened Joint Advisory Board of Economists (JABE) and Governor's Advisory Council on Revenue Estimates (GACRE).
- Joint Money Committees will meet **August 15<sup>th</sup>** to receive the official year-end report, and to learn about the Governor's revised forecast.
  - Will likely share interventions to control/reduce spending in FY 2015.
  - Changes to FY 2016 will be presented during the 2015 Session.

# FY 2014 Revenues Decline 1.6%

**General Fund Revenue Collections**  
(\$ in millions)



# What's Next?

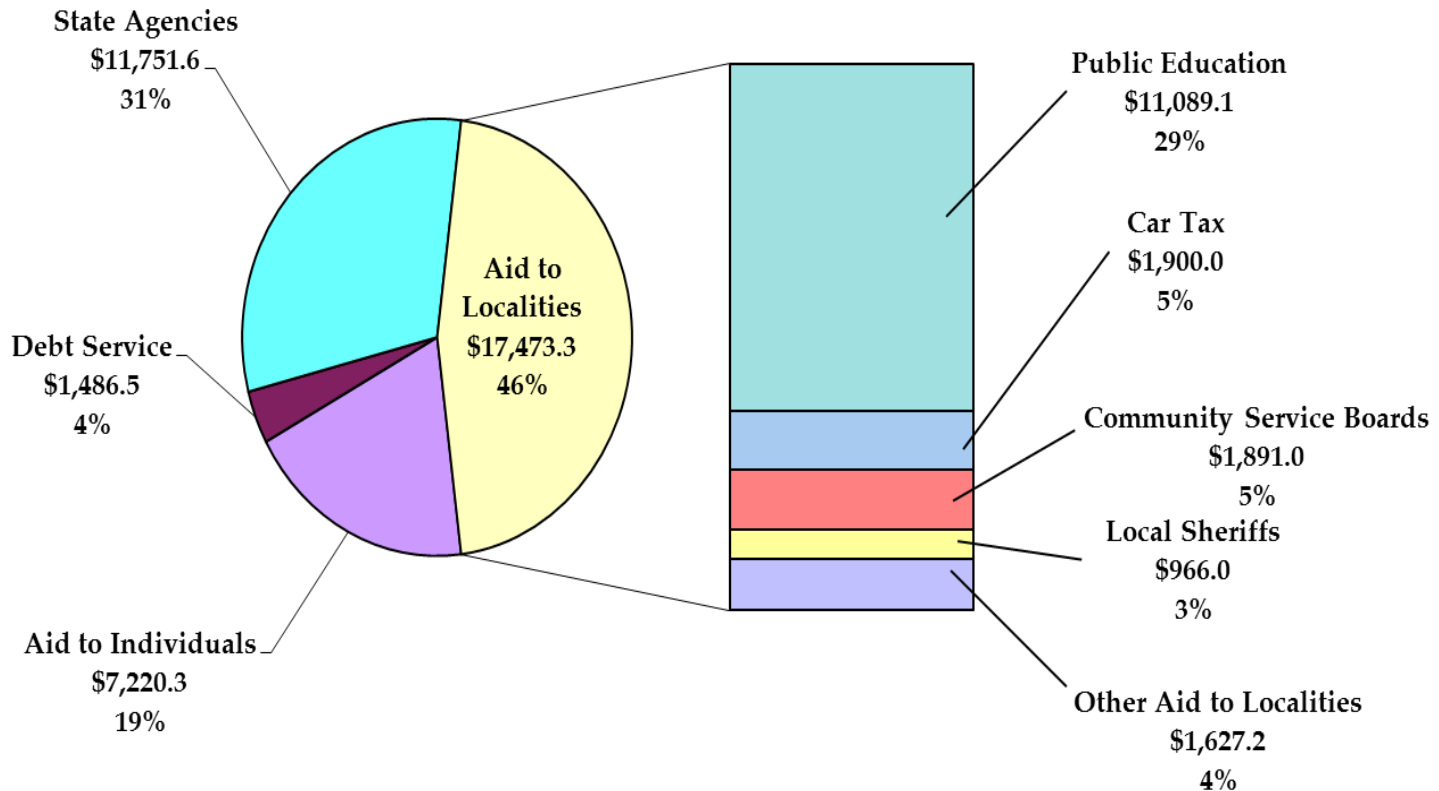
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- Even though the 2014 General Assembly expected revenues to be down in FY 2014, actual collections were short some \$438.5 million.
- Most policy makers expect projected revenues to be less than budgeted in FY 2015 and FY 2016, probably by several hundred million.
- Additional budget cuts will be required.
  - About 46 percent of the general fund budget flows to local governments.
  - Some of the remaining 54 percent may be “off the table” - debt service, aid to individuals (i.e., Medicaid, mental health and social services).
  - Efforts will be made to **avoid** cuts to core services, but reductions are very likely.

# General Fund Budget Drivers

FY 2014-2016 GF Operating Budget = \$37,931.6

Chapter 2  
(\$ in millions)



# Spending Pressures, Other Challenges

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- Weak revenue outlook may be with us for several years.
  - Won't see much use of one-time "gimmicks" to balance the budget; efforts will be made to keep the budget structurally balanced.
  - Anything short of fully-funding the VRS will not be an option.
- Pressure to address teacher and state employee salaries.
- K-12 Education has not regained funding lost during recession; little to no flexibility for innovation or new initiatives.
- Higher Education had made some progress in recent years; will likely lose that ground with additional cuts.
  - Pressure to limit tuition increases will grow.
- Gas taxes are likely to rise on January 1, 2015 due to inaction by Congress on Marketplace Fairness Act.



# Other Challenges: Closing the Coverage Gap

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- For the second year in a row, the Senate took the lead on ways to expand health care services in the Commonwealth.
- Rather than simply expanding Medicaid, Senate leaders came up with Marketplace Virginia, a common sense solution that was designed to:
  - Return more than \$1.6 billion annually to local communities;
  - Engage cost-effective private providers to deliver care;
  - Require personal responsibility from new enrollees; and
  - Free up more than \$200 million in state funding that is currently subsidizing care provided by hospitals, CSBs and DOC facilities.
- For localities, it means:
  - Shoring up the fragile finances of local hospitals;
  - Improving access to comprehensive health care for residents; and
  - Infusing the mental health system with more than \$200 million each year to address primary care and community-based treatment.



# Other Challenges:

## Behavioral Health and DOJ Settlement

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- The 2014 General Assembly continued to make necessary investments in state facility and community-based care including:
  - Funding to ensure treatment beds are available at state facilities;
  - Increased access to care for children and youth services;
  - More resources for therapeutic assessment or “drop off” centers; and
  - Investments in Programs of Assertive Community Treatment.
- Additional funding was also provided for implementation of the Department of Justice (DOJ) Settlement Agreement.
  - Funding has been set aside to transition individuals from state training centers into the community; but
  - Localities are also stepping up to ensure placements are available in the community.

# Role of Local Government in Addressing Social Services and Health Care

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- During the Great Recession, local Departments of Social Services (DSS) have been on the front lines as applications and caseloads increased dramatically for food stamps, social services and health care;
- Local DSS operations successfully managed caseload growth even as state support fell;
- At the same time, the Commonwealth has embarked upon a years-long overhaul of our outdated information technology systems in order to more effectively and efficiently handle social service caseloads;
  - In spite of some initial stumbles, DSS Central Office has made improvement and enhanced training on the new system.
- Finally, local governments have experienced a surge in Medicaid applications even though no decision on coverage has been made.
  - Re-processing these applications should be easier when/if a decision is made to move forward with closing the coverage gap.

# Conclusion

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- In hindsight, the 2014 Session of the General Assembly was two sessions in one.
  - At the beginning, it was thought that policy makers could begin to start patching up holes created since 2008 and make investments in areas like higher education.
  - A deteriorating revenue picture identified in the Spring wiped out most discretionary spending even though funding was retained for much-needed mental health services.
- There will be no shortage of budgetary challenges for lawmakers to consider at the next session.
- Additional budget reductions will likely be needed during the 2015 Session even though lawmakers anticipated less revenue when a budget was enacted in June.
  - Core services may be on the list of proposed budget reductions.