



Preliminary Thoughts on the 2014-16 Biennial Revenue & Budget Outlook

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House Appropriations Committee

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2014 Session Economic and Budget Outlook

- Economic Outlook for the Nation and Virginia
- Fiscal Year 2013 Performance
- Revenue Outlook for FYs 2014, 2015, and 2016
- Building the FY 2014-16 Biennial budget
- Budget Issues by Secretarial Area

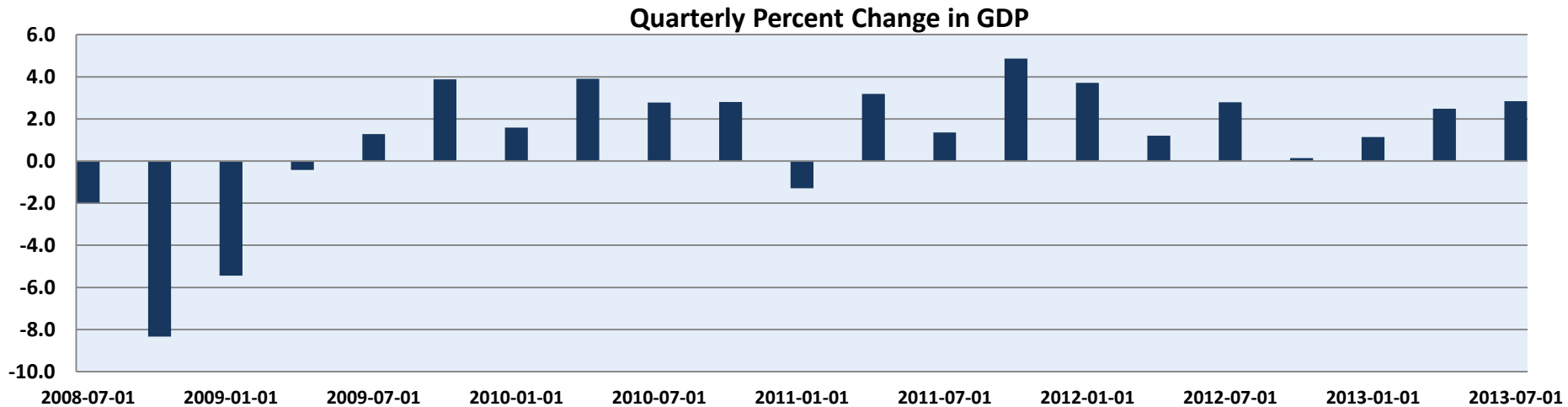
Sluggish Growth Continues

- The U.S. economy is growing, but continues to struggle with slow job growth and fragile consumer spending. Nationally, unemployment remains elevated at 7.3% in August, down 0.9% from a year ago
- Companies continue to report record profits and stock prices. Both have come at the expense of jobs and wage increases
- Companies continue hoarding cash because of the uncertain economic recovery and tax policies in Washington. Business investment is one-third below the average of previous recoveries
- Manufacturing output remains above 50, but has weakened, as exports orders have slowed, and uncertainty with federal fiscal policy
- Consumers remain cautious, spending primarily on replacement items, such as autos
- While the housing sector may celebrate small victories such as rising sales and an increase in housing starts, the recent rise in mortgage rates has curtailed refinancing and is expected to dampen the purchase of homes next year

How Has Gross Domestic Product Performed Since The “Official” End of The Recession?

- The St. Louis Federal Reserve has tracked economic recoveries from 1949 through the present
- They measure key economic indicators and compare the current recovery to average, best and slowest economic recoveries
- Since the “Great Recession” real GDP growth has been subpar overall
 - Real personal consumption (durable and non-durable goods and services) has performed amongst the worst compared to previous recoveries
 - Exports have been the one bright light for GDP
- Growth has remained slow because both employment and personal income growth have lagged typical recoveries

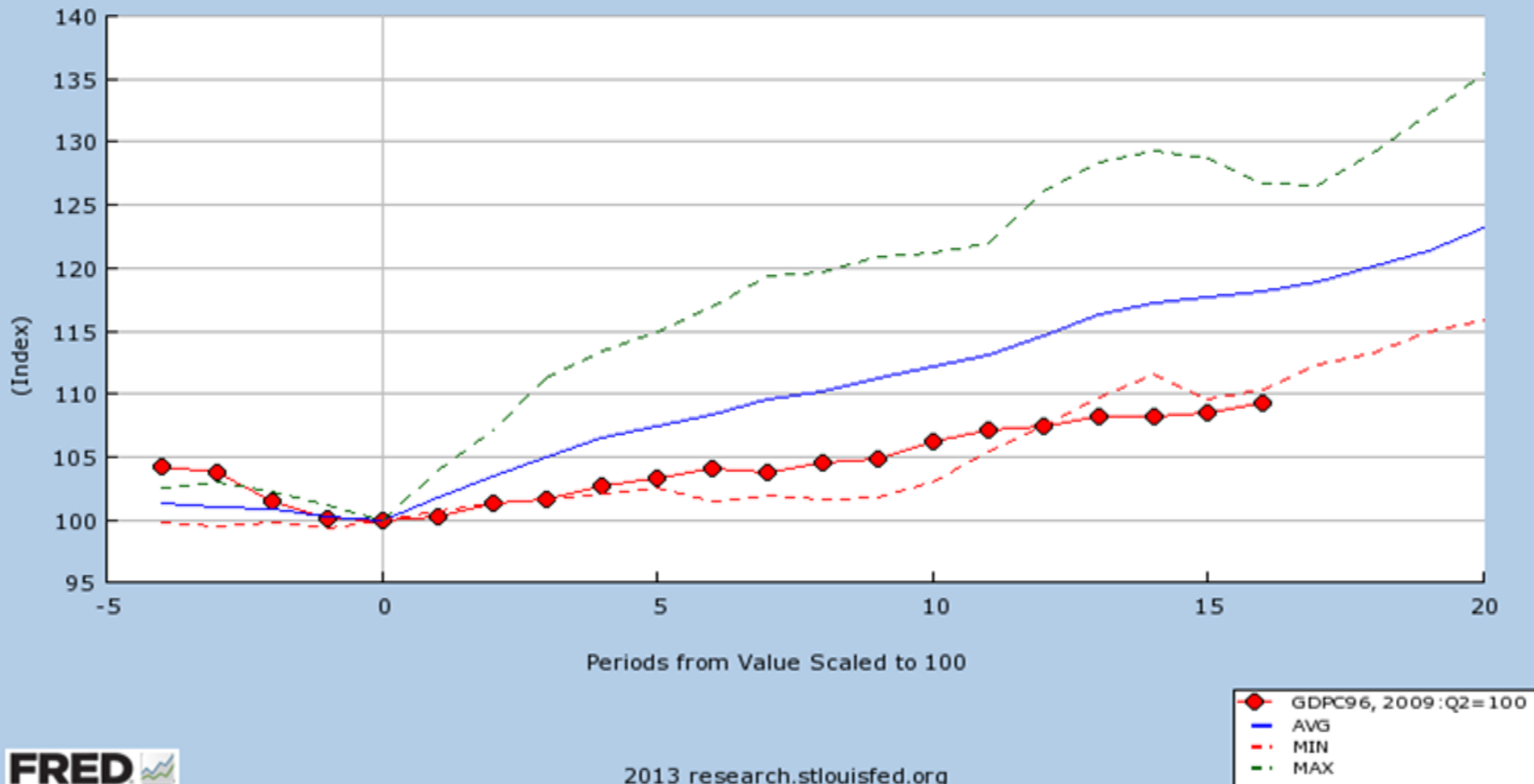
Third Quarter 2013 GDP Advanced Estimate Stronger Than Anticipated, But Does Not Reflect The Shutdown



- The level of activity in Q3, though somewhat faster, still shows an economy growing at painfully slow clip compared to prior recoveries. The U.S. has been expanding around 2% in the past few years and has been unable to generate enough thrust to breakout of its low-growth orbit
- Positive contributions from personal consumption expenditures (PCE), private inventory investment, exports, residential fixed investment, nonresidential fixed investment, and state and local government were partly offset by a negative contribution from federal government spending
- Consumer spending (the largest component) rose 1.5%, but that was less than the 1.8% rate in the second quarter
- Exports slowed to 4.5% in the Q3, compared to 8% in Q2
- In the business world, companies reduced investment in things like software, buildings and equipment. The increase in fixed investment slowed to 4.1% from 6.5%

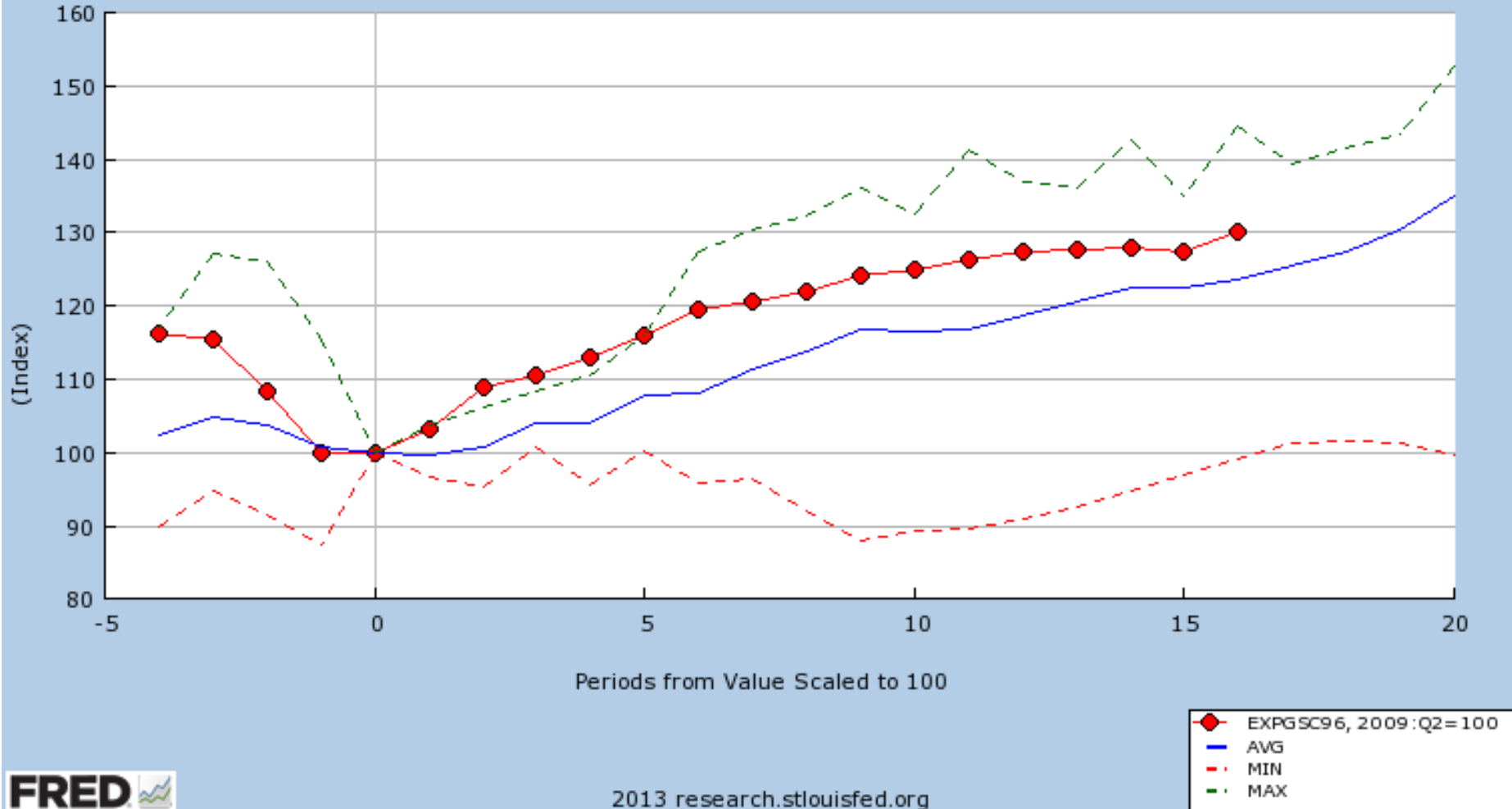
Real GDP On Par With The Worst Economic Recovery

Real Gross Domestic Product, 3 Decimal (GDPC96)
Source: U.S. Department of Commerce: Bureau of Economic Analysis



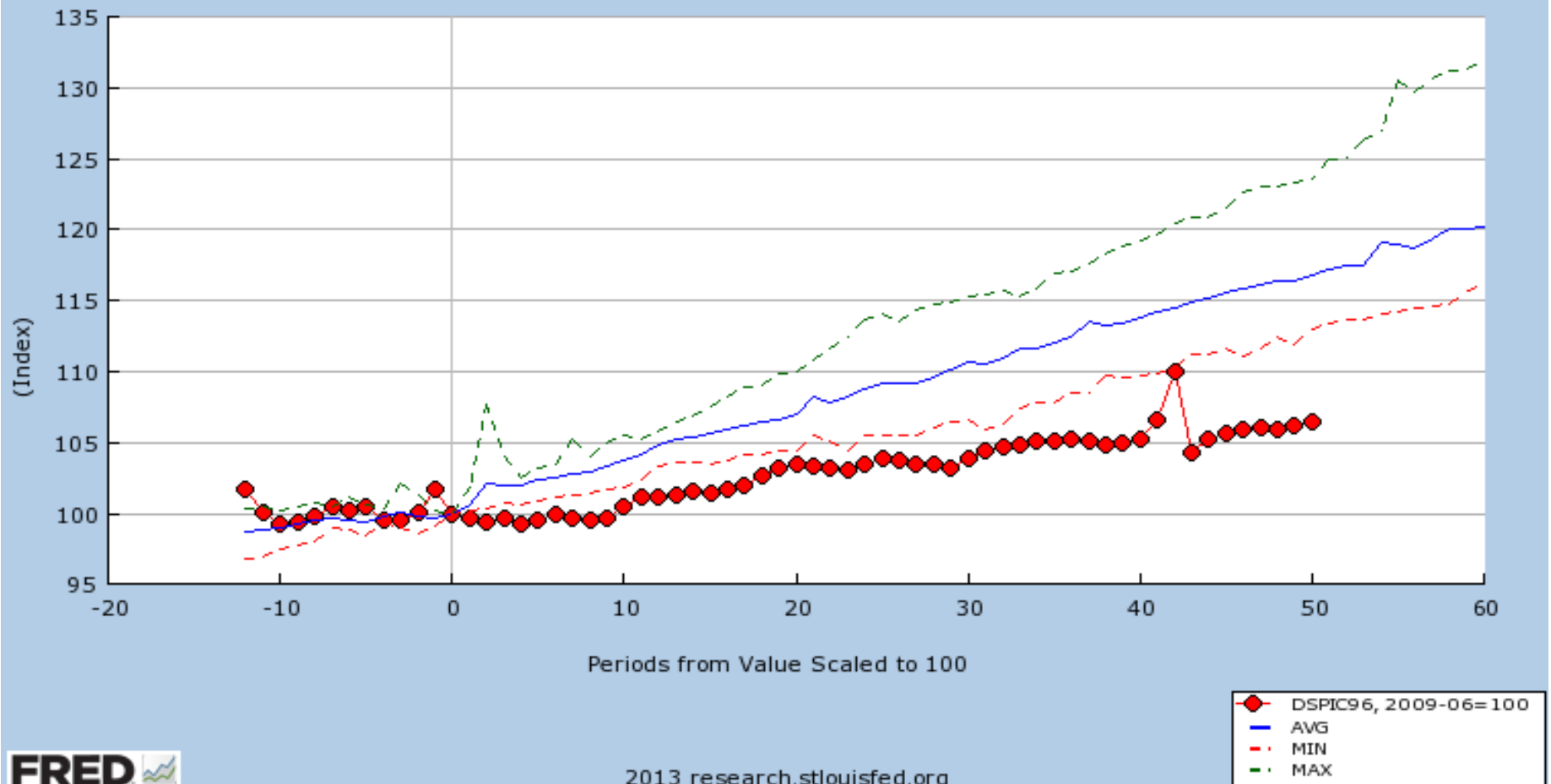
Real Exports Have Fueled GDP

Real Exports of Goods & Services (EXPGSC96)
Source: U.S. Department of Commerce: Bureau of Economic Analysis



Real Personal Disposal Income Is Performing Below All Previous Recoveries

Real Disposable Personal Income (DSPIC96)
Source: U.S. Department of Commerce: Bureau of Economic Analysis



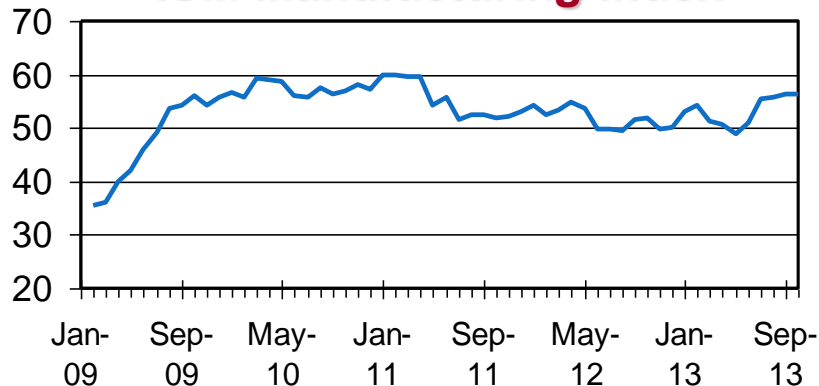
National Employment and Why Virginia Is Underperforming The Nation

What Are Other Key Indicators Showing?

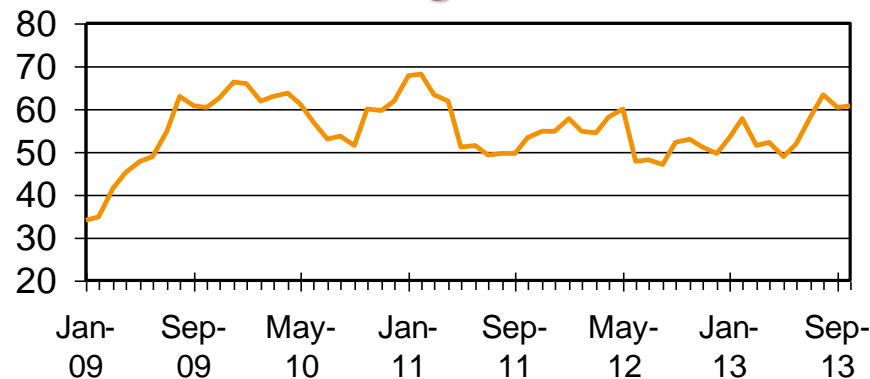
- ISM's *Report On Business* shows the manufacturing sector expanded in October following a slight contraction in the 2nd quarter, and the overall economy grew for the 53rd consecutive month
- Although the Production and Employment Index has been slowing over the last 5 months
- Manpower's 2013 Q4 survey of 18,000 firms reveals 18% of employers expect to add workers, 8% expect to contract, and 72% of the firms plan no change in hiring
 - All four U.S. regions surveyed report a positive Net Employment Outlook, with the South reporting an employment outlook of +13%
- Initial unemployment claims has fallen below 350,000

14 of 18 Manufacturing Industries Reported Growth in October Although Production and Employment Have Slipped

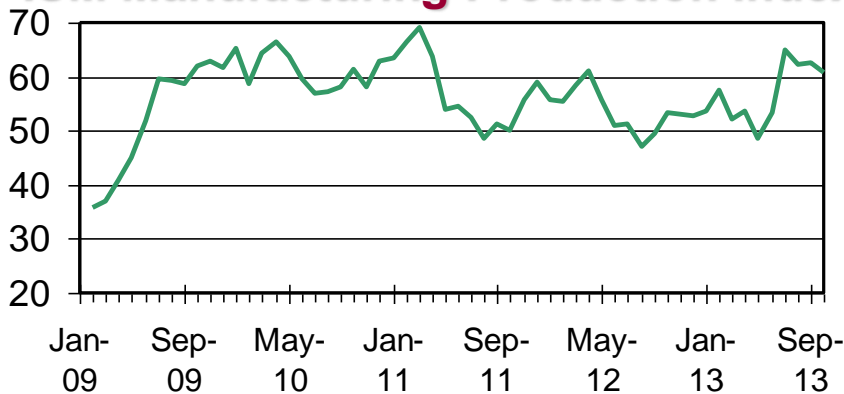
ISM Manufacturing Index



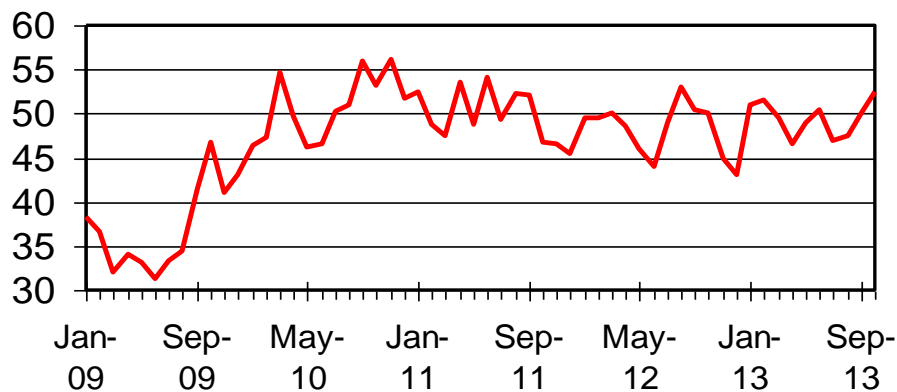
ISM Manufacturing New Orders Index



ISM Manufacturing Production Index



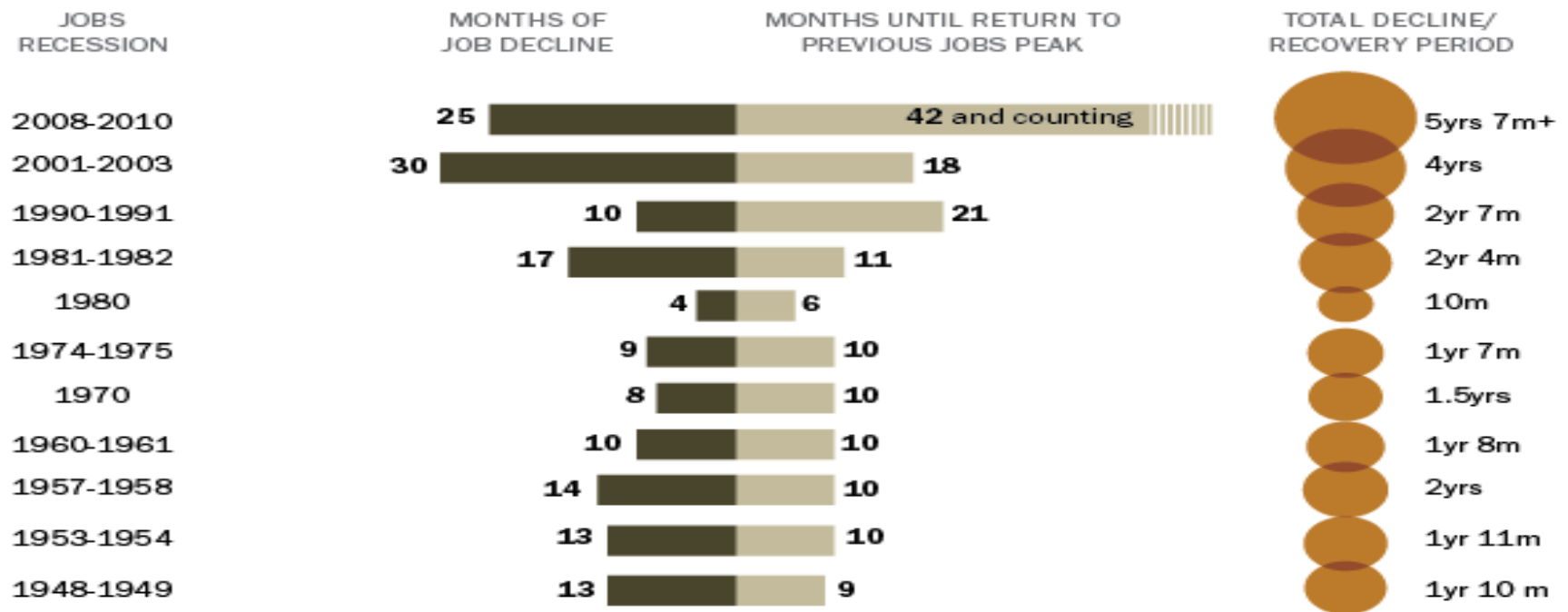
ISM Manufacturing Inventories Index



All indicators are diffusion indexes

At 42 Months and Counting, Current Job “Recovery” is Slowest Since Truman Was President

Job Decline and Recovery Throughout U.S. Recessions



TIMES OF US RECESSION, DECLINE AND RECOVERY



Source: Pew Research Center analysis of Bureau of Labor Statistics data

PEW RESEARCH CENTER

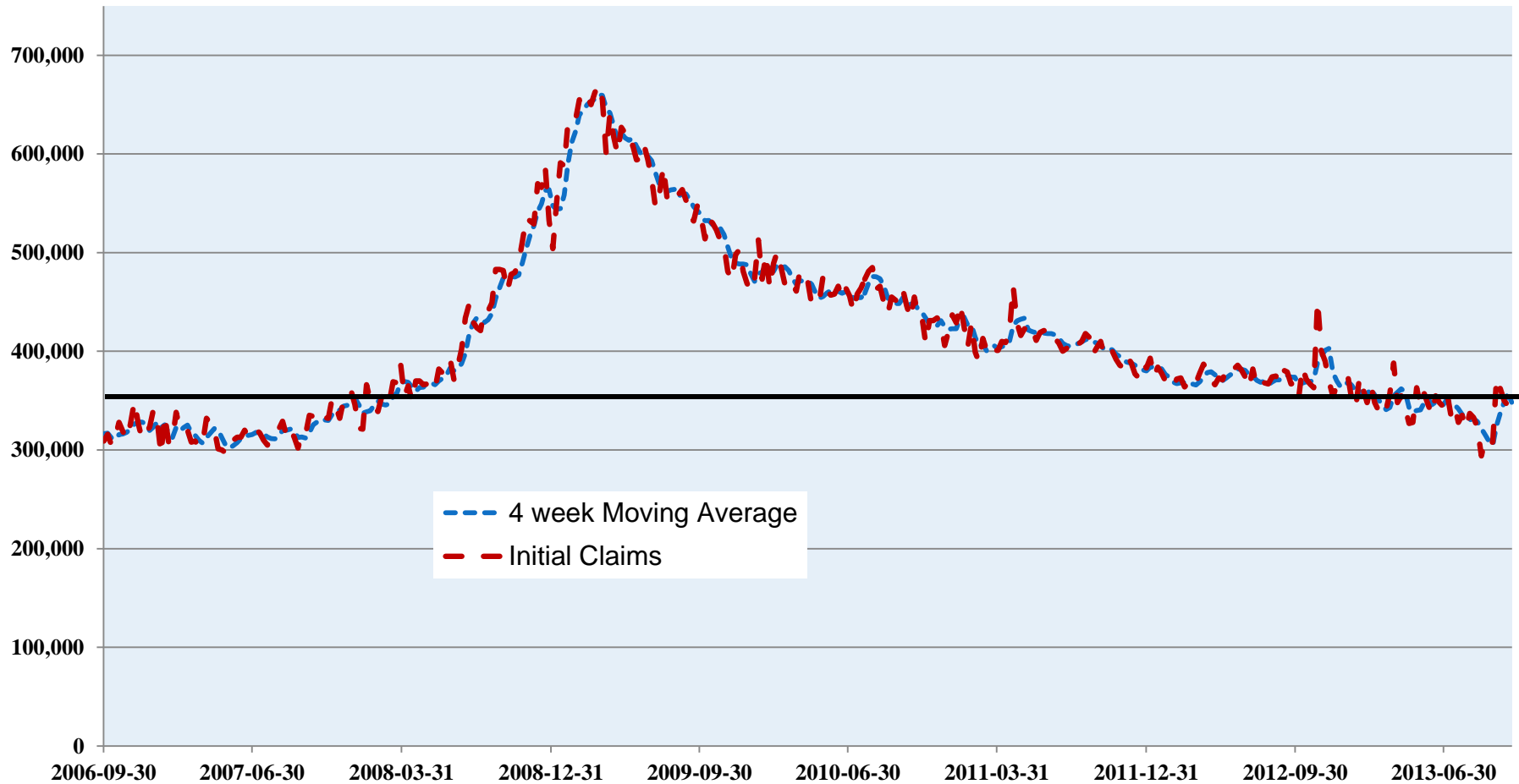
Private Sector Employment -- The Silver Lining

Monthly Job Growth (in thousands)

- A total of 8.7 million jobs were lost during the recession. To date, 6.8 million have been recovered
 - Average of 158,000 per month since trough
- Over the last 12 months average job growth has been 207,000, but has slowed over the last 6 months to about 160,000 per month
 - 125,000 jobs per month required just to absorb new entrants to the labor market. At the current rate, it will take approximately 3 years to recover remaining jobs lost
- U.S. private sector employment gains have occurred for 42 consecutive months – Added 7.4 million jobs over that period of time -- average about 177,000 per month

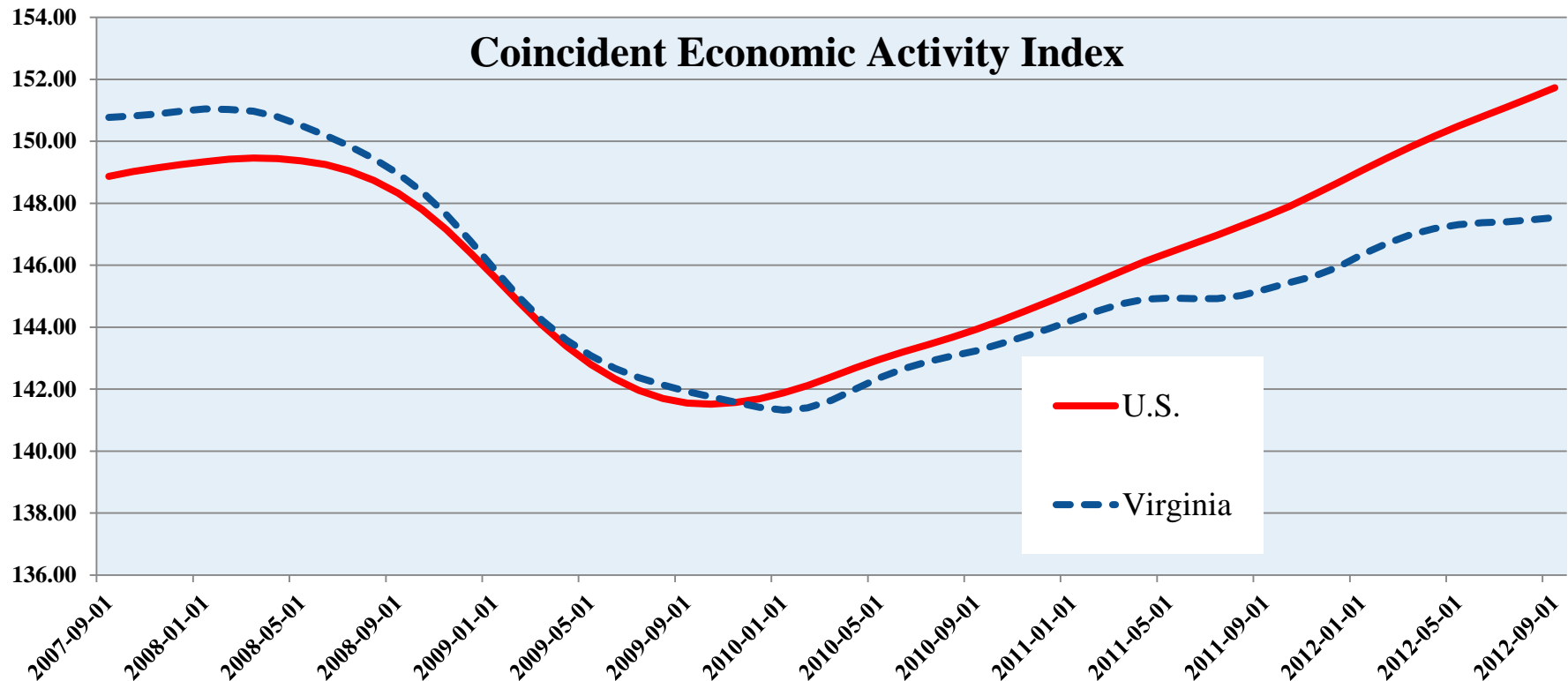


Initial Unemployment Claims Finally Below 350,000



Key Indicators Reflect Virginia Is Growing Slower Than The Nation

Based on Leading Indicators, Virginia, Which Typically Out Performs the Nation, Began to Slow Down in 2010

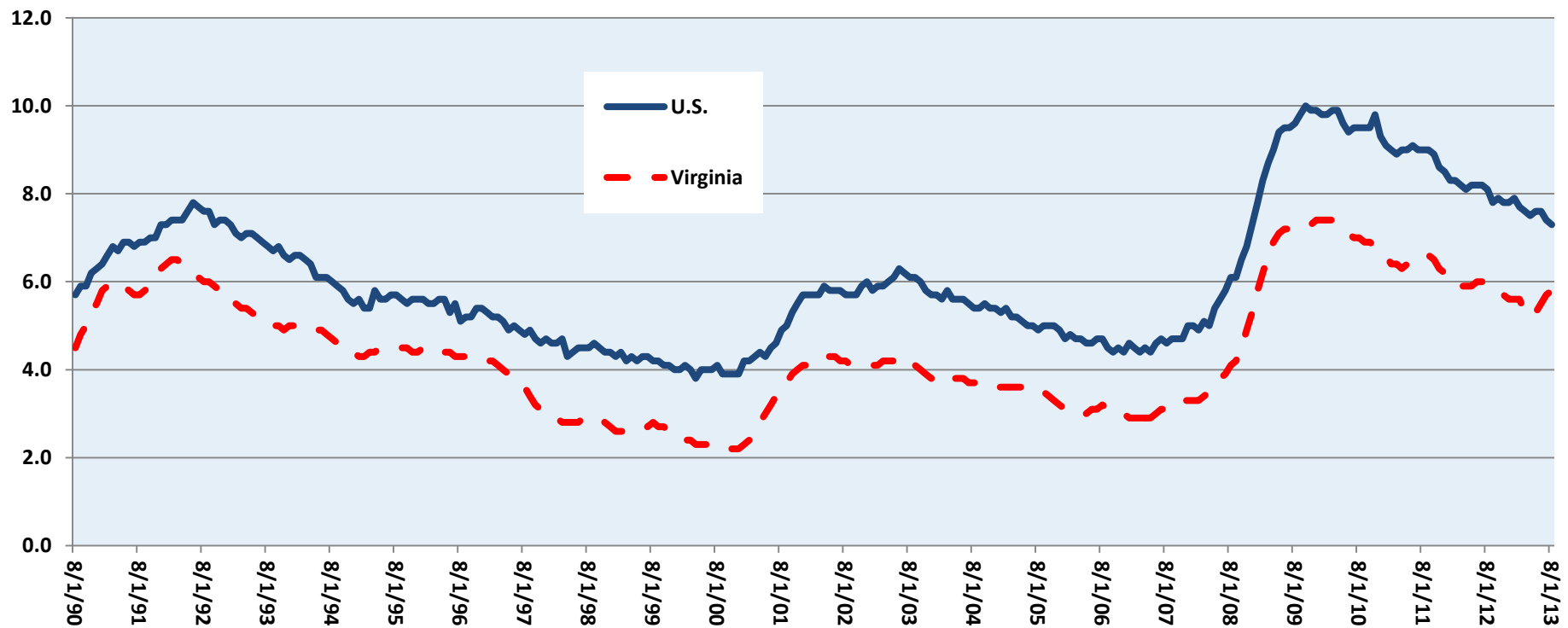


The Coincident Economic Activity Index includes four indicators: nonfarm payroll employment, the unemployment rate, average hours worked in manufacturing, and wages and salaries.

Source: Federal Reserve Bank of Philadelphia.

Virginia's Unemployment Rate in Perspective

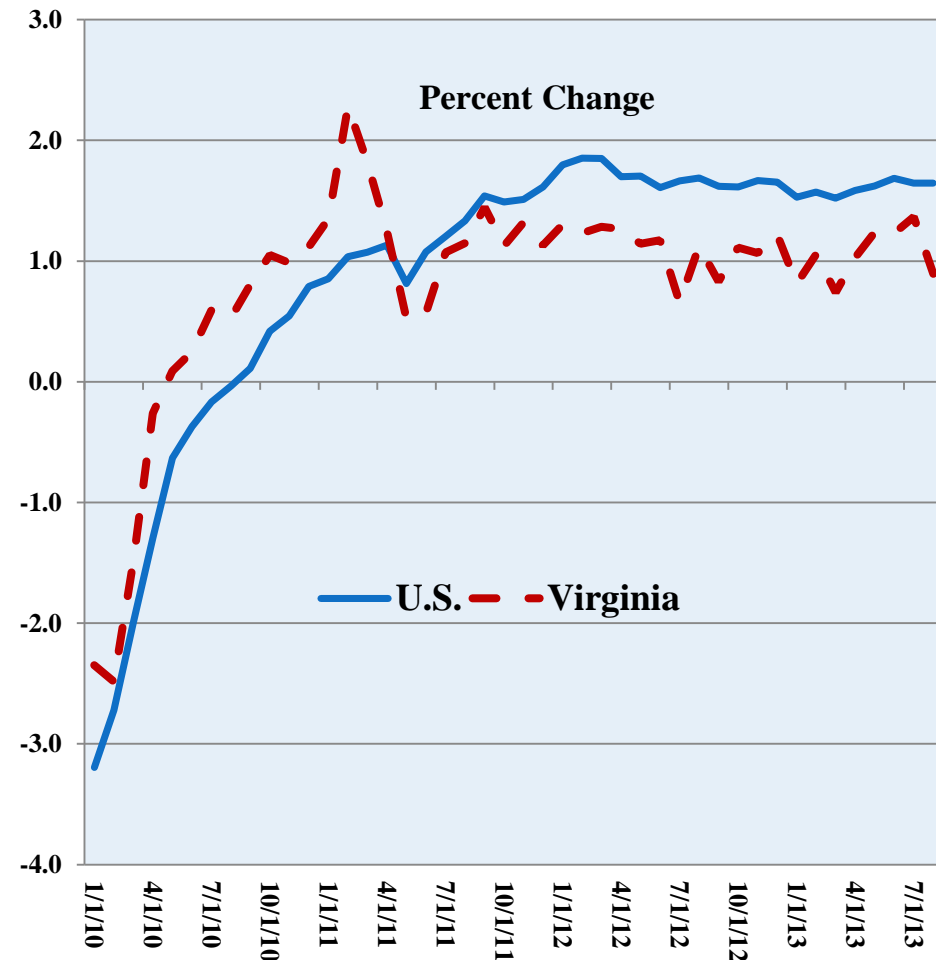
- At 5.8 %, Virginia's unemployment rate is 20% lower than the national unemployment rate of 7.3%
- While the nation's rate has fallen 2.7% from its peak of 10% in October 2009, Virginia's rate has fallen 1.6% from its peak of 7.3% in January 2010



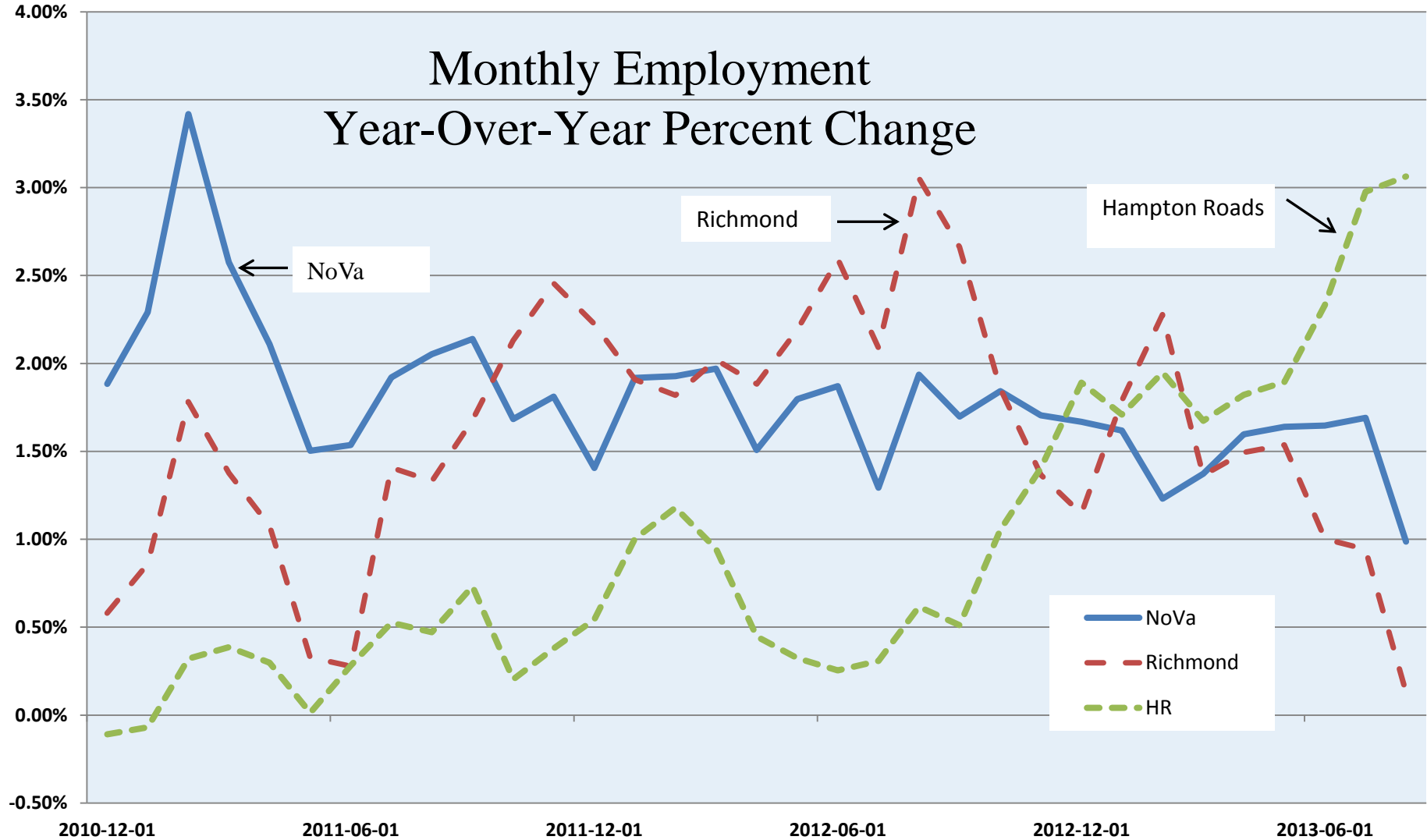
Source: Bureau of Labor Statistics.

Virginia's Job Growth Has Under Performed The Nation Since May 2011 – Why?

- Virginia's job losses were not as severe as the nation as a whole -- Virginia's job loss equaled about 5.0% of total employment versus 6.3% nationally
- Initially after the recession, Virginia's economy out-performed the U.S. However, since May 2011, Virginia's rate of job growth has been below the U.S. by one-half percent
- Nationally, since August 2013, 78% of jobs have been recovered versus 88% in Virginia -- by comparison, 16 months after reaching the trough, the U.S. recovered 25% of the job loss while Virginia recovered 42%
- Virginia's job growth rate was 1.0% for FY 2013 -- below the "official" forecast of 1.2%
- For the first two months of FY 2014, jobs grew 1.1% -- 0.3% below the current "official" forecast of 1.4%

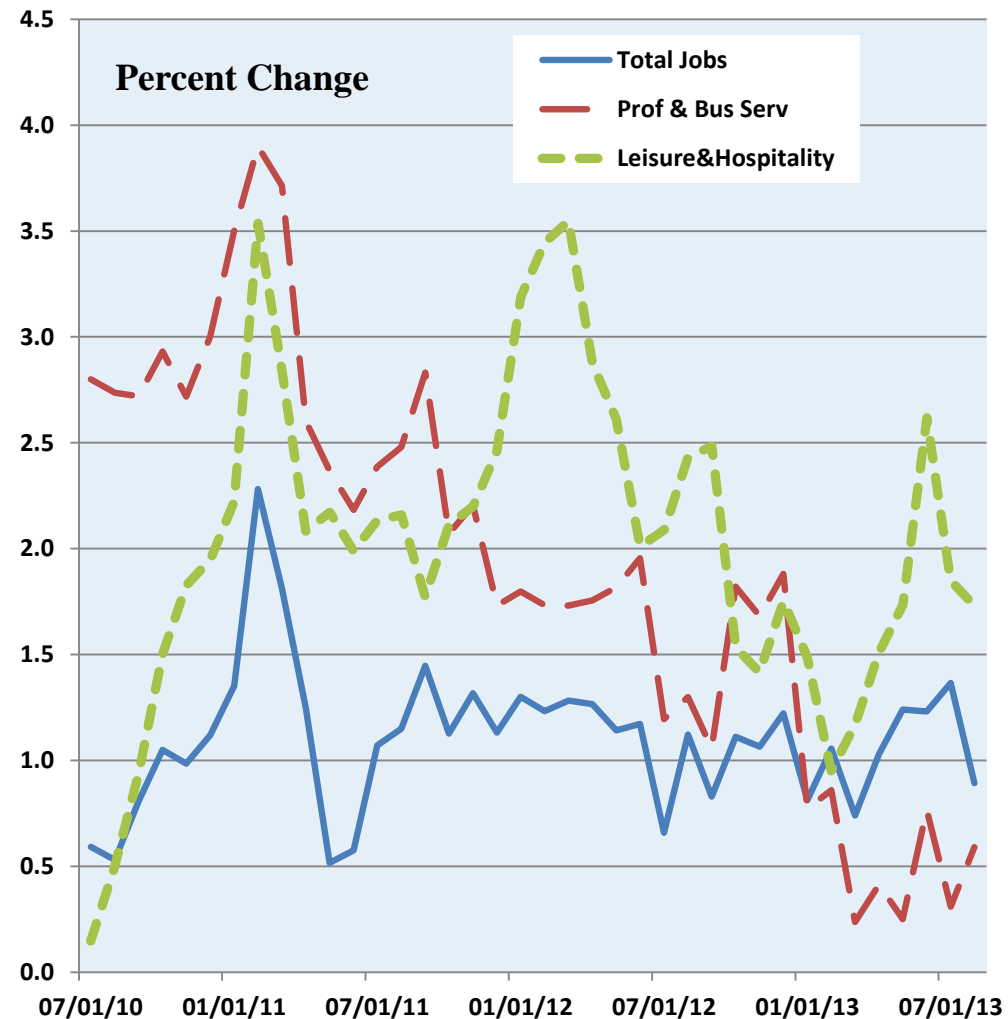


Northern Virginia: No Longer the Job Engine

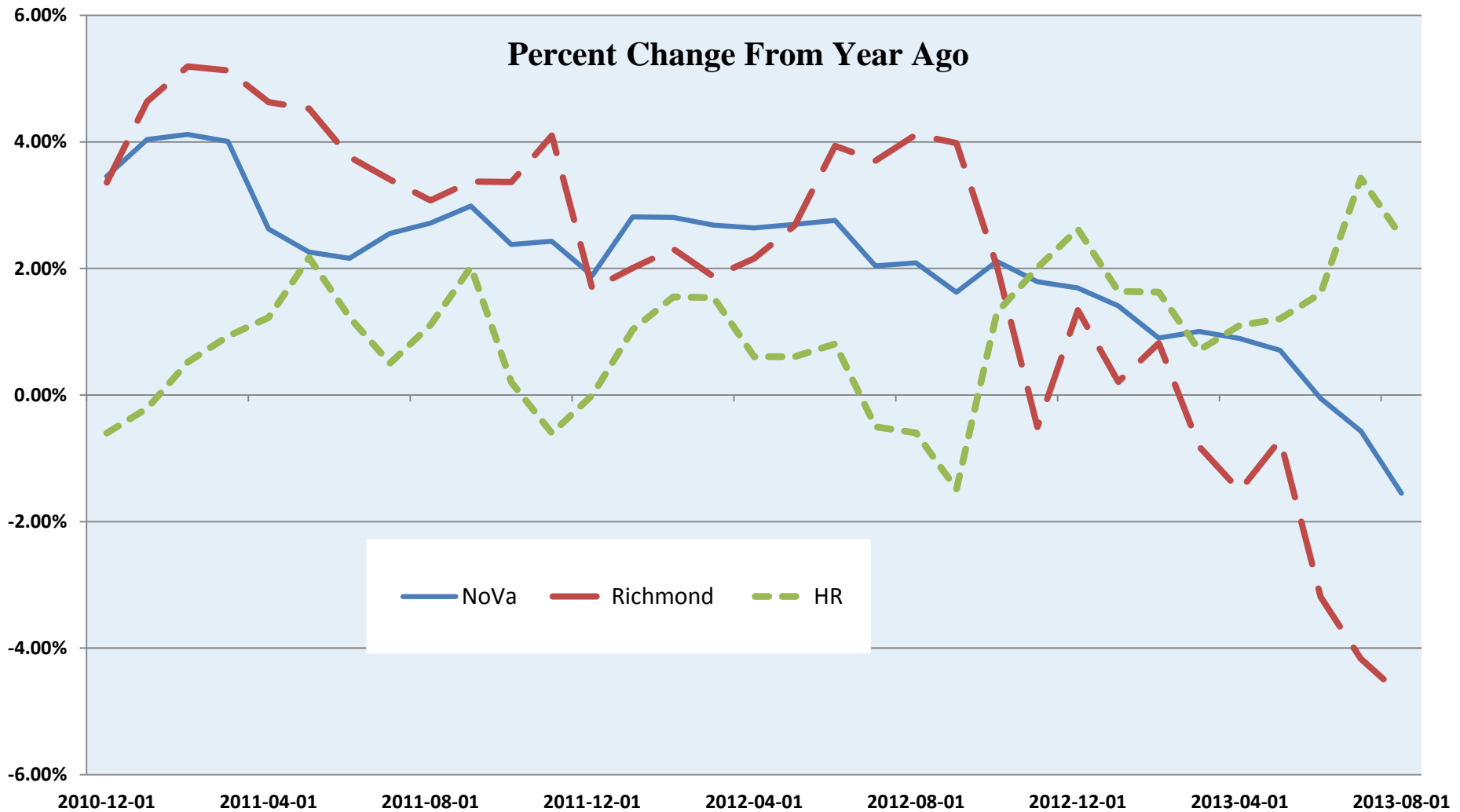


Leisure and Hospitality Driving Job Growth – What Happened To Professional & Business Services?

- Professional and Business Services account for 18% of Virginia’s jobs & since the recession have driven most of Virginia’s employment gains, however growth subsiding
 - P&BS accounted for 68% of Virginia’s total job gains in FY 2011, 31% FY 2012, but only 11% in FY 2013
- Federal spending represents nearly 40% of NoVa and Hampton Roads economies
 - Growth in P&BS jobs accounted for much of the job gains in these regions
 - Uncertainty about federal spending has had a “chilling” effect with employers



Employment Growth In Professional & Business Services Has Been Significantly Impacted in Richmond and Northern Virginia



Comparison of Virginia's Employment to Other States

- Virginia's unemployment rate of 5.8% is the 13th lowest and 8th lowest among states with over 1 million in population
- However, Virginia is ranked 41st in terms of job growth for the August over August period compared to 34th a year ago
 - Virginia rate of growth was 1.0% compared to a national rate of 1.6% growth
- Washington/Northern Virginia had one of the smallest annual percentage job gains of any major MSA over 1 million population in August compared to the previous August
 - Currently ranked 20th out of 26 MSA's based on 12-month moving average

NOVA/Washington Metro Area Ranked 22 Out of 26 in Job Gains

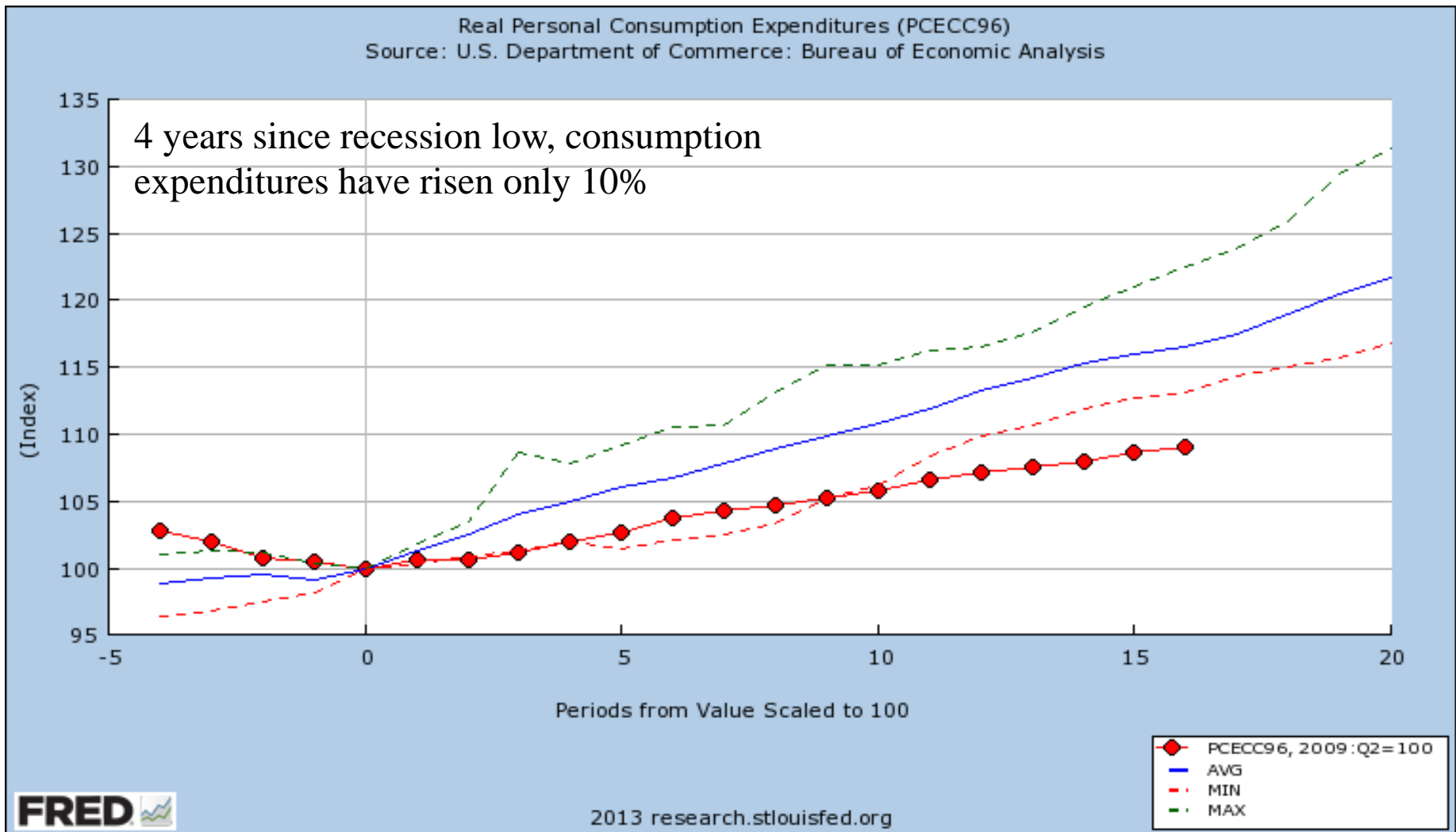
(000's)

Total Job Growth : August 2012 - August 2013



Consumer Sentiment Reveals Continued Drag From a Dysfunctional Washington

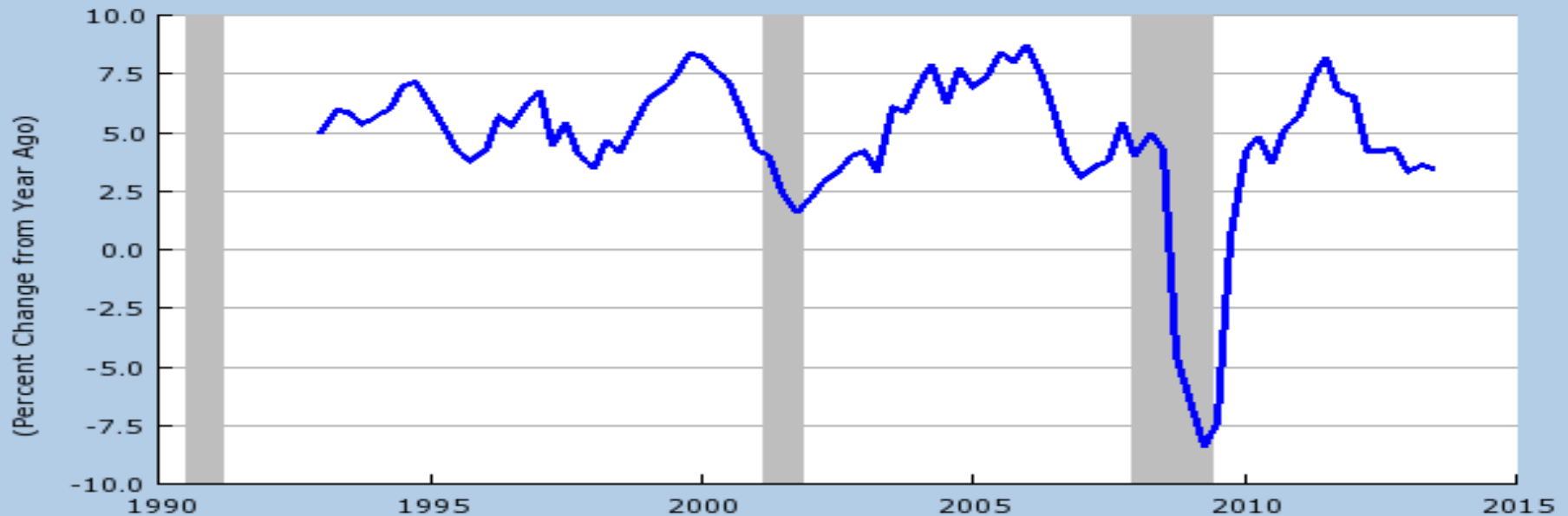
We Never Saw a Bump in Real Personal Consumption and Growth Has Slowed



Retail Sales Remain Tepid

- On a monthly basis, retail sales declined 0.1% from August to September (seasonally adjusted), and sales were up 3.2% on a year-over-year basis from September 2012
- After rebounding strongly in 2010-11, year-over-year sales growth has diminished each year since then

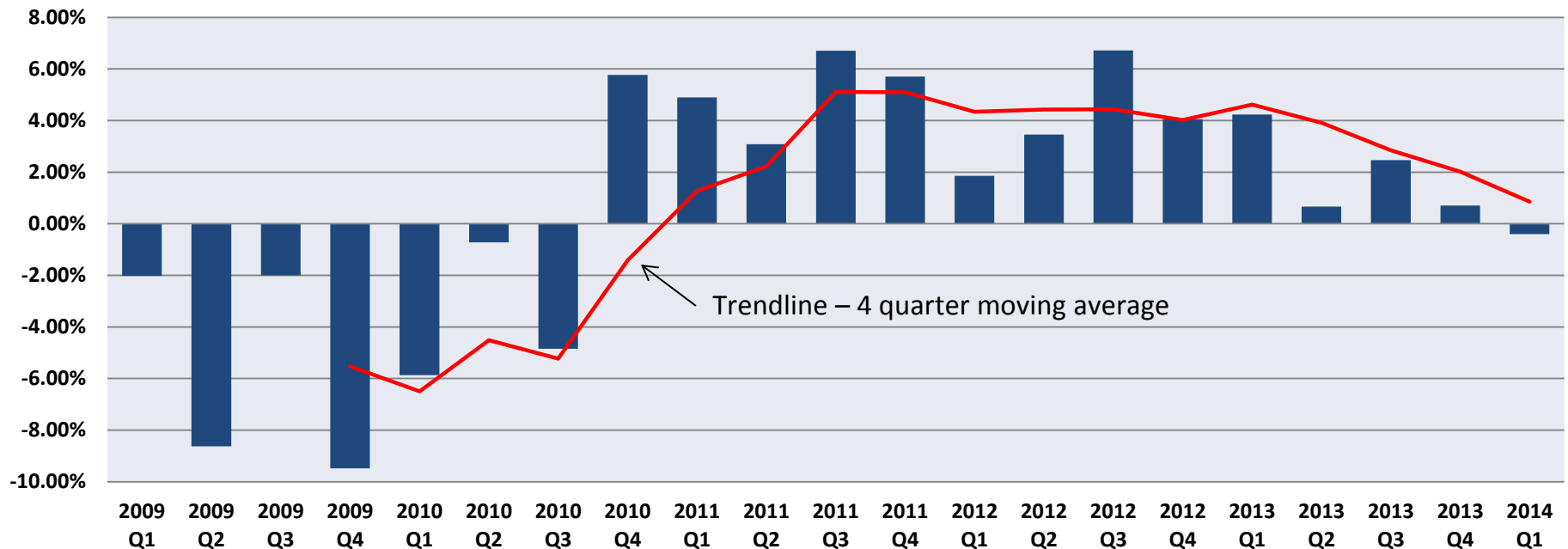
Retail Sales and Food Services Excluding Motor Vehicles and Parts Dealers (RSFSXMV)
Source: U.S. Department of Commerce: Census Bureau



...Especially in Virginia

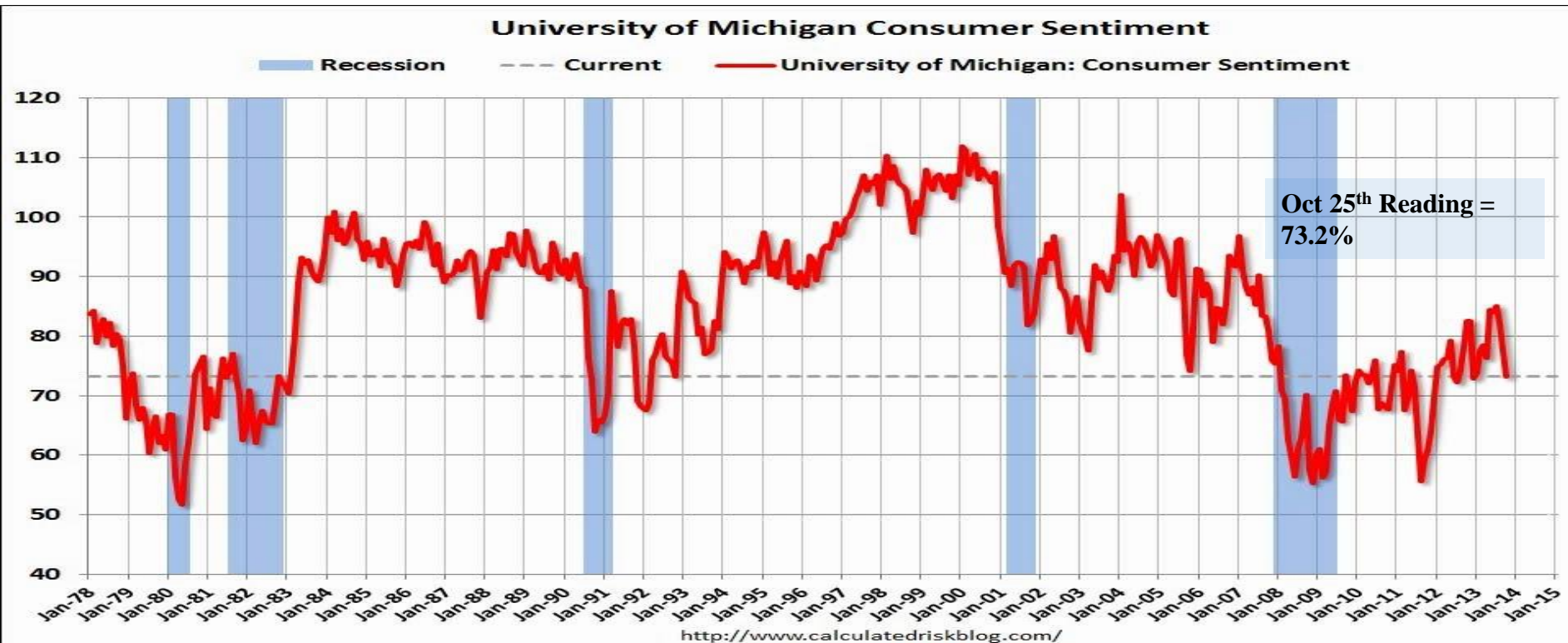
- In Virginia, sales tax growth was 5.1% in FY 2011, and 4.0% in FY 2012 but fell to 2.0% (economic basis) in FY 2013, and has been below 1% in 3 of the last 4 quarters
- Virginia consumers have shown restraint in the face of sequestration and government shutdowns
 - Unresolved nature of federal stand-off limits purchases to replacement items

Year-Over-Year Quarterly Change in Sales Tax Revenue FY 2009-2014



Consumer Confidence Hovers at Levels Typically Seen During a Recession

- The October consumer sentiment report pegged confidence at its lowest level for 9 months as the federal government shutdown undermined Americans' outlook on the economy
- While it has improved since the recession, confidence readings remain at levels typically seen in a recession – not in a recovery
- Need a reading of at least 90 for consumers to be considered in “comfort zone”



What's Required to Increase Consumer Spending?

- There are more positive factors at play than negative ones right now
 - Core factors driving ability to spend are improving
 - More ephemeral security issues have been slower to recover
- As a result, don't expect a strong holiday shopping season which makes up 20% of all retail sales
 - ShopperTrak's 2013 forecast calls for retail sales in November and December to rise by 2.4% from a year earlier, less than the 3% increase in 2012 and 4% gains in 2011 and 2010
 - National Retail Federation survey indicates average shopper to reduce holiday spending by 2%

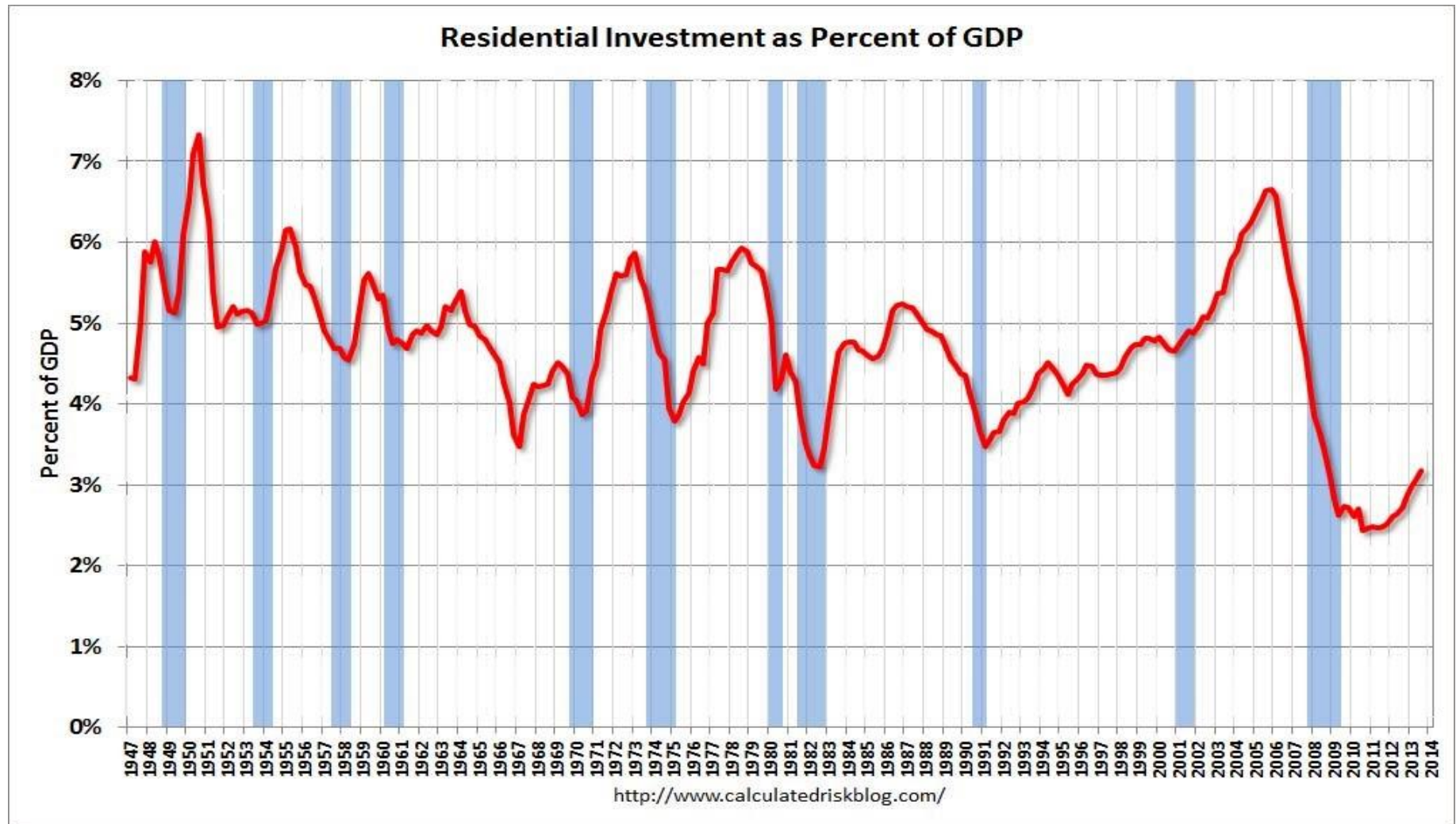
Positive Forces	Negative Forces
Rising employment	Uncertainty about federal government
Rising stock market	Rising interest rates
Rebounding home prices	Potential federal tax increases
Easing credit conditions	Low housing equity
Reduced debt burdens – lowest in 30 years	Low wage growth
Gas prices – down \$0.40 from a year ago	

Housing Market Mirrors Muddle-Along Economy

Housing: A Contributor to Growth

- U.S. Census Bureau data indicates new sale volumes increased 12.6% on a year-over-year basis in August
- The 3rd quarter 2013 GDP report shows that residential investment's share of GDP has increased at a seasonally adjusted annual rate of 14.6%, after growing 12.9% in 2012
- Housing inventory levels remain at healthy levels – 5 months supply although inventories are expected to increase over the next year
- Case Shiller average pricing increased 12.8% on a year over year basis for the summer quarter but pace of growth is expected to decline as interest rates increase
 - Price index still off 22% from the peak but up 17.3% from the post-bubble low in January 2012
- In Virginia, recordation tax receipts reflect this, having grown 11.9% in FY 2012, and 17.7% in FY 2013 due to improving markets and low interest rates
 - Expect flat collections in FY 2014

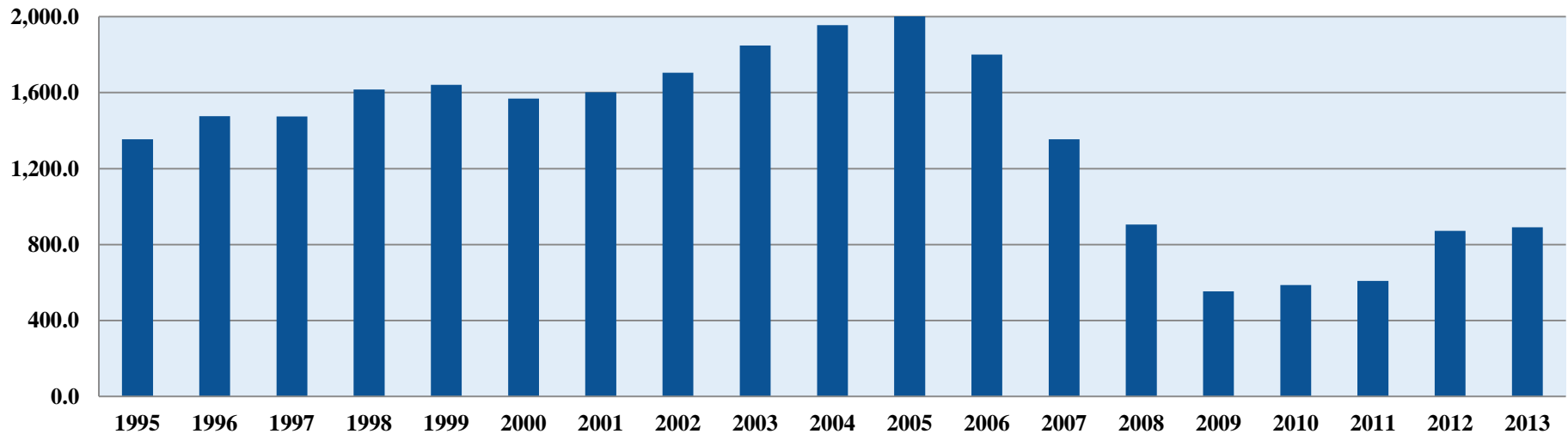
Residential Investment Is Improving but Against Record Drops



- Source: Bureau of Economic Analysis.

Homebuilding Trends Leveled

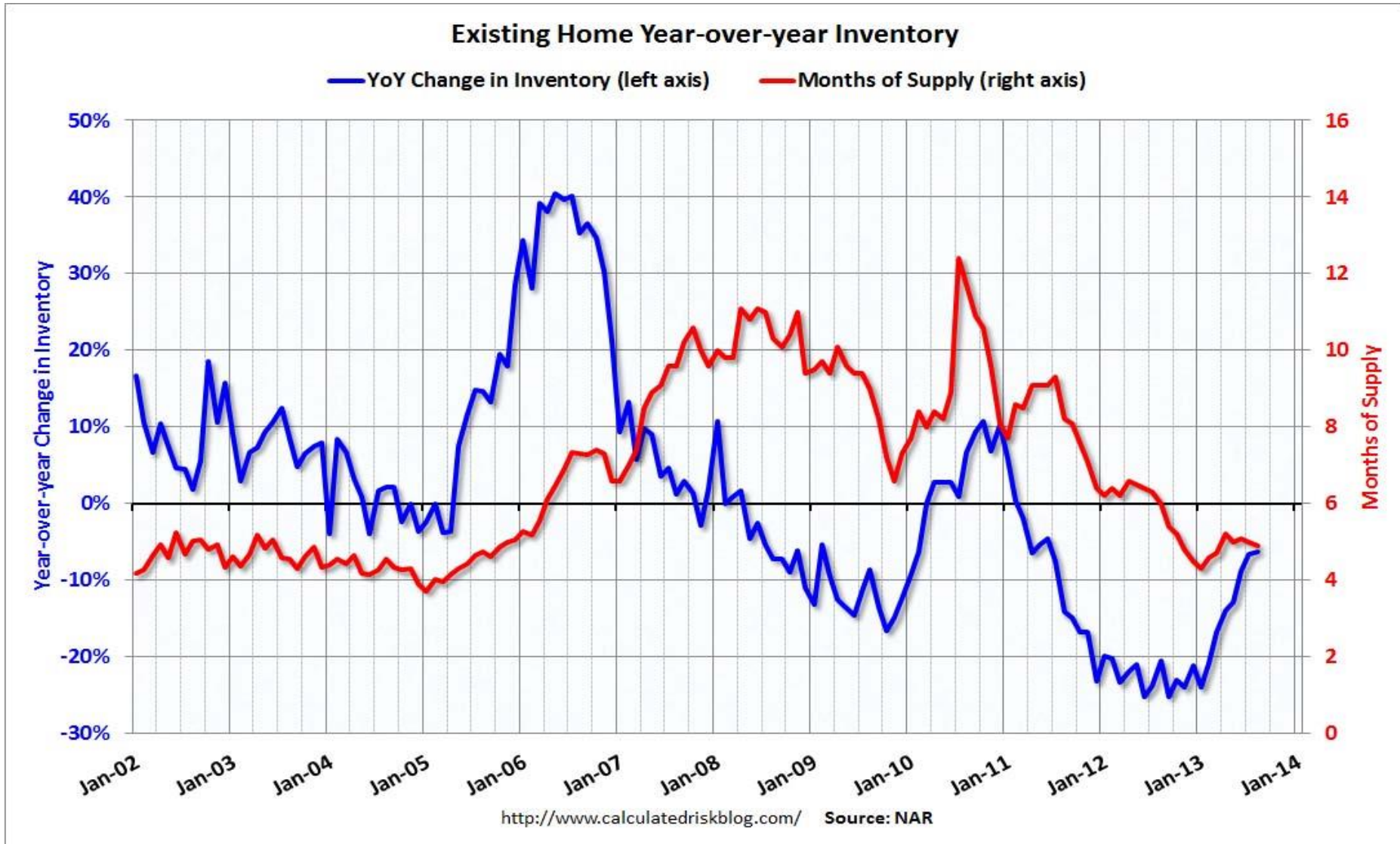
Housing Starts
Thousands of Units



- US Bureau of Census data on housing starts show they reached a bottom in 2009 at 554,000
- Growth remained very modest in 2010 and 2011 despite repeated predictions that improvement was just around the corner
- While growth accelerated in 2012, the rate of increase in 2013 has been much slower. Housing starts in August 2013 were growing at a seasonally adjusted annual rate of 891,000 – 13% above the July rate and 19% above the August 2012 rate

Source: U.S. Department of Commerce, August 2013

Housing Inventory at Healthy Levels



Source: National Association of Realtors

Home Prices Continue to Increase

Figure 1 - Home Price Index

Percentage Change Year Over Year

Home prices at highest level since 2009



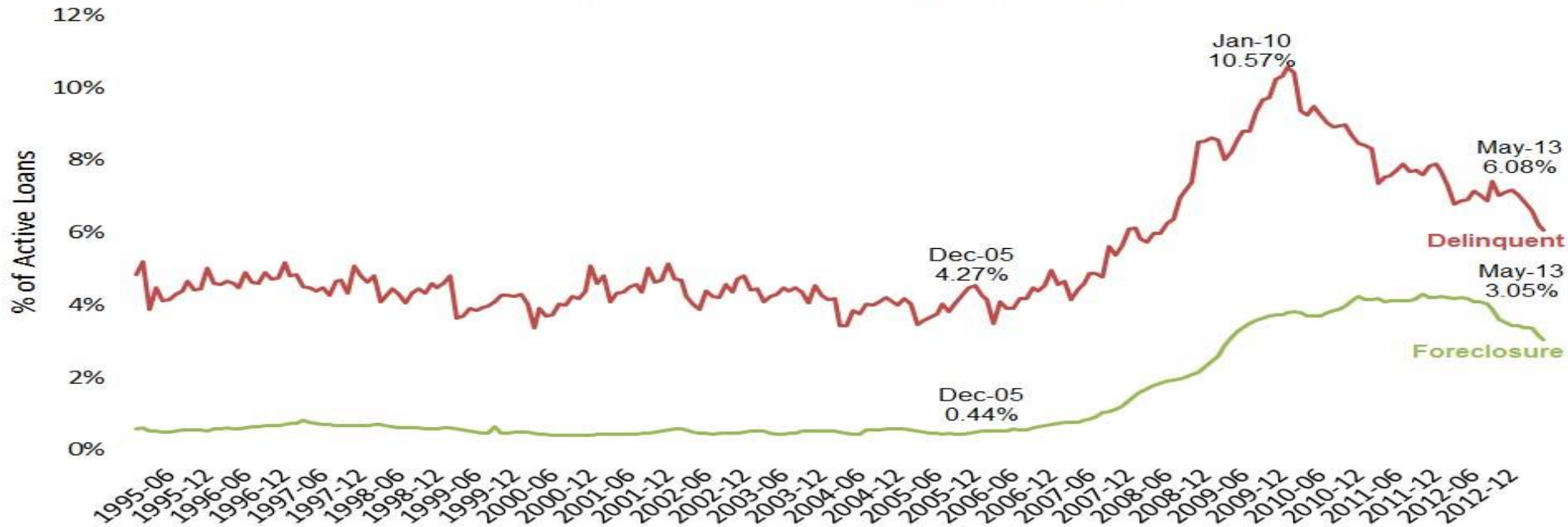
Source: CoreLogic August 2013

Continued Constraints on Housing Market

- Pending home sales declined for the 4th consecutive month in September as higher mortgage rates and home prices curbed buying power
 - First time in 29 months home sales were below year-ago levels
 - National Association of Realtors predicting lower home sales for the 4th quarter and a flat trend going into 2014
 - Total existing home sales this year will be 10% higher than 2012, but are likely to just hold even in 2014
- Although foreclosure rates are dropping, they are still 50% above normal levels – Freddie Mac reported the serious delinquency rate declined to the lowest level since early 2009 in September, indicated continued declines in foreclosure going forward
 - But at current rate, you can expect an above normal level of distressed sales for 2 or 3 more years, especially in judicial states
- Negative equity and near-negative equity mortgages still account for 21% of all residential properties with mortgages (compared to 27% a year ago)
- Continued tight lending standards but relaxed compared to prior years
 - The average credit score for mortgages has fallen from high of 750 last year to 732 and 30% of all loans have score below 700
 - But average score for those denied mortgage was 696. Before the crash, was common to get mortgage with scores of 600 or lower

Foreclosures Declining

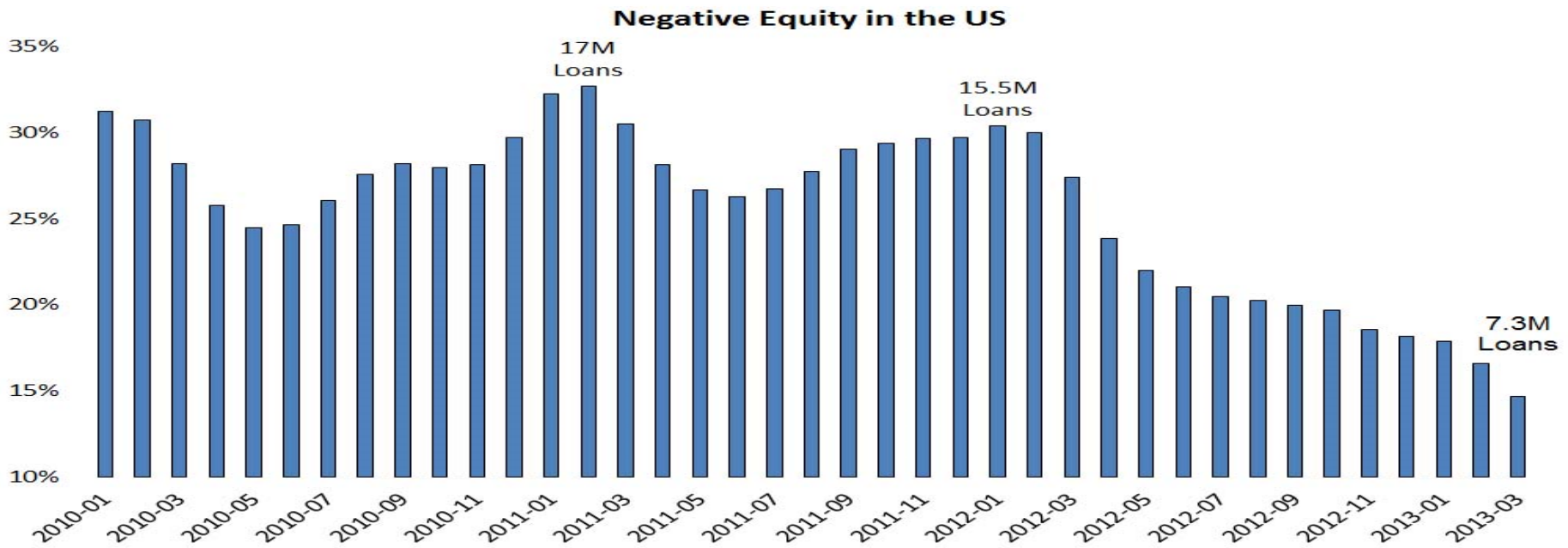
Total Delinquent and Foreclosure Percent by Month



- Foreclosure listings are down 47% from their October 2009 peak, and are down 23% from one year ago - Banks selling more homes to investors at trustee sales and approving more short sales
- According to Lender Processing Services, the number of seriously delinquent mortgages is down 26% compared to a year ago, foreclosures are down 34% from a year ago, and foreclosure starts are down 46.5%
- Virginia has the 5th lowest percentage of homes in foreclosure in the nation

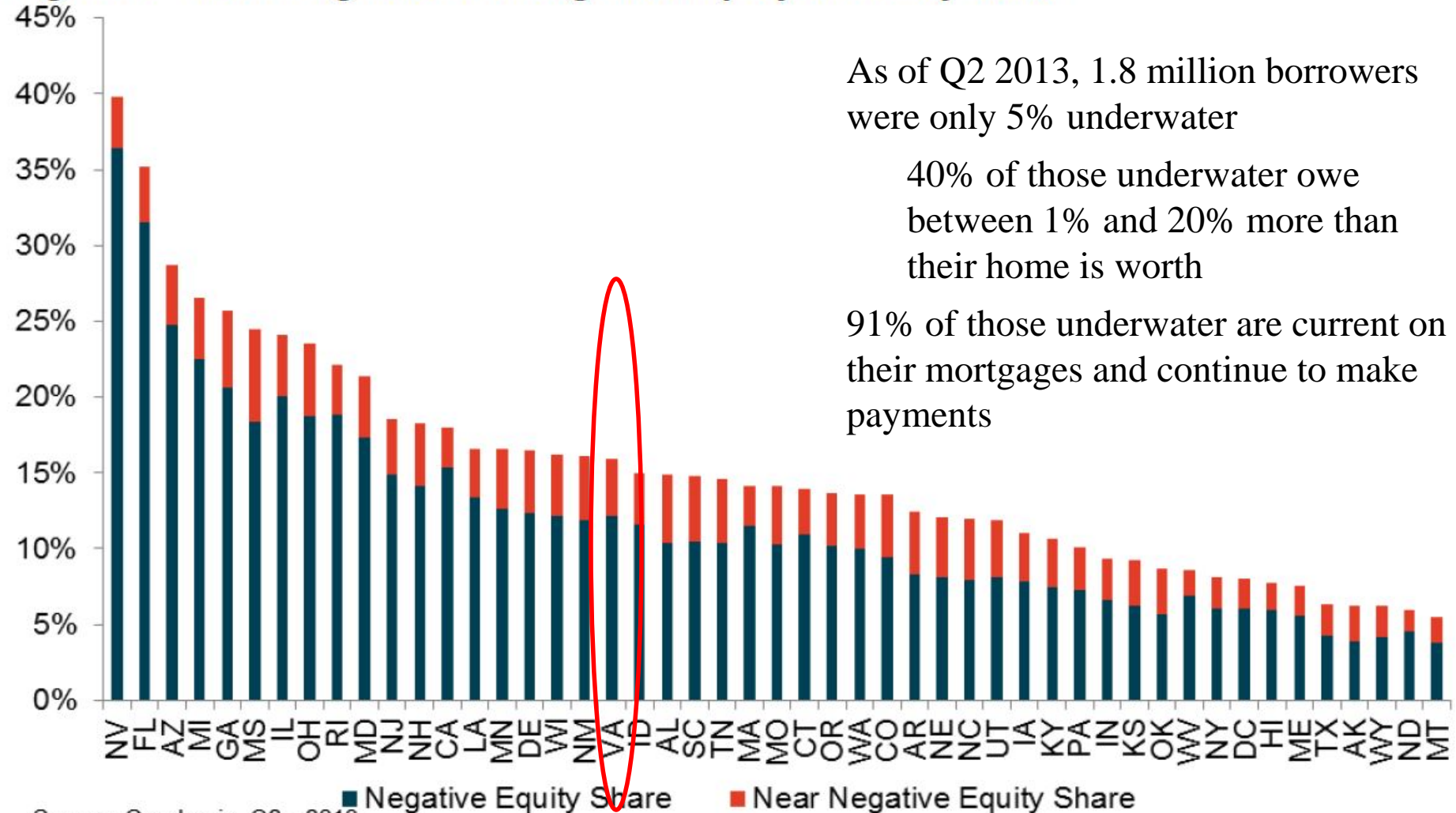
The Water Has Receded

- Lendor Processing Services reported just over 14.5%, or 7.3 million, of properties with a mortgage were underwater in the Q2 2013
 - In the first half of 2013 alone almost 3.5 million homeowners have returned to positive equity
 - Again, 5 states account for more than 35% of all negative equity in the U.S. (NV, FL, AZ, MI, GA)



Distribution of Negative Equity

Figure 3 – Near-Negative and Negative Equity Share by State



Source: CoreLogic, Q2 - 2013

FY 2013 Year-End Close

FY 2013 Year-End Revenue Surplus and Agency Balances

- On August 19th, Governor McDonnell presented the final FY 2013 year-end revenue and agency balance figures to the Joint Money Committees of the General Assembly
- He reported that FY 2013 general fund revenues and transfers collections totaled \$16.68 billion in FY 2013, finishing \$264.3 million above the forecast
- Total general fund revenue collections (excluding transfers) rose 5.3%, compared to an annual forecast of 3.6% growth
 - Adjusting for the Accelerated Sales Tax (AST) program, revenues grew 5.1%, ahead of the economic-based forecast of 3.4%
- In addition, year-end unexpended balances totaled \$320.7 million, bringing total unexpended resources to \$585.0 million

FY 2013 Performance by Source

Majority of surplus was generated by 3 of Virginia's smaller revenue sources

- Nonwithholding: \$290.1 million of surplus
 - Nonwithholding makes up 16% of total revenues and grew 19% percent in FY 2013
 - Historically tied to capital gains and other non-wage income, thus very volatile. Despite very robust year, remain below FY 2008's peak
- Tax Refunds: \$72.2 million of surplus
 - Refunds were down 3.7%, below the estimate of 0.7% growth
 - But doesn't reflect smaller or fewer refunds, excess came from lower than anticipated usage of land preservation tax credit
- Recordation Taxes: \$41.0 million ahead of forecast
 - Grew 17.2% in FY 2013, 12.2% ahead of annual forecast of 4.5%
- Insurance Premium Revenues: \$6.6 million of surplus
 - 2% of GF revenues, exceeded forecast of 1.1% growth by 2.6%
- All other revenues were \$20.3 million above expectations

FY 2013 Performance by Source

Our 2 “bread and butter” sources fell short of the forecast by a combined \$144.0 million - a forecast variance of 1.1%

- Payroll Withholding: (\$115.0 million) below forecast
 - Collections of payroll withholding taxes make up 64% of GF revenue; grew only 2.1% compared to a forecast of 3.3% growth
 - Slower than expected employment growth – attributable to weakness in federal contractors and small businesses – dampened collections of this source
- Sales Tax: (20% of revenues) fell \$29.0 million below forecast
 - Adjusting for AST, sales tax grew 2.1%, trailing the economic-based forecast of 3.2%
- These two sources are the best indicators of current economic activity and are directly tied to the economic outlook for jobs and wage income
- Slowdown in withholding and sales tax collections over the last 5 months of FY 2013 suggests federal sequestration is having an impact in Virginia
- Also declining were Corporate income tax collections, which were \$23.8 million behind forecast
 - Make up 5% of revenues – one of most volatile sources
 - Declined 7.3% compared to forecast of 4.5% decline

Uses of FY 2013 Year-End Revenue Surplus and Agency Balances

- Mandatory activities consume the entire revenue surplus
 - Vast majority of revenue surplus is required to meet the Constitutional Rainy Day Fund requirements for the biennium
 - Rainy Day Fund requirements for FY 2015 and FY 2016 total \$313.9 million (based on the current forecast for FY 2014). These amounts are offset by a \$95.0 million pre-deposit made by the General Assembly this past Session, making the Governor's proposed biennial deposit \$218.9 million from the surplus
 - A mandatory deposit to the Water Quality Improvement Fund utilizes \$26.4 million of the revenue surplus (and additional \$5.1 million of balances)
 - Finally, transportation received its share of the accelerated sales tax collections (\$21.7 million)

FY 2013 Year-End Revenue Surplus and Agency Balances

- The vast majority of the \$320.7 million in agency balances are already accounted for. The table below outlines the uses, after which discretionary reappropriations are limited to \$46.1 million
 - The Governor will determine whether to reappropriate the discretionary amounts or revert them to the GF for other purposes when he submits his caboose budget in December

Uses of Balances	Amount
Mandatory reappropriations – incl. higher ed	\$134.7
NGF historically reported in GF	69.8
Restore capital outlay projects	0.5
Natural Disaster Sum Sufficient	34.5
Water Quality Improvement Fund Part B	5.1
Reappropriate FACT Fund balance	22.5
Federal Refunds	4.9
Discretionary reappropriations	\$ 46.1

Virginia's Performance Reflects National Trends

- Virginia's FY 2013 revenue growth mirrored that of the nation
- The National Conference of State Legislatures reports that all state general fund revenues grew by 5.3% - same growth rate experienced in Virginia
 - This rate was notably strong and outpaced projections in most states
 - Most states attributed the growth to taxpayers pushing income tax into TY 2012 to avoid anticipated increases in federal tax rates
- But a slowdown is anticipated in FY 2014 with projected average state revenue growth at 1.3% nationally
- At the same time, major programs are projected to push expenditures in those categories higher, averaging 5.9% for Medicaid, 5.1% for higher education, 2.5% for corrections and 2.4% for K-12 education

General Fund Revenue Outlook Fiscal Years 2014 - 2016

Virginia's Revenue Forecasting Process

- § 2.2-1503 of the Code requires the Governor to prepare annually a forecast of the economic activity in the Commonwealth, including an estimate of revenues
- Code establishes two advisory groups: Joint Advisory Board of Economists (JABE) and Governor's Advisory Council on Revenue Estimates (GACRE)
 - Joint Advisory Board of Economists (JABE), which met in October, is chaired by the Secretary of Finance and consists of 12 private and public sector economists appointed by the Governor and 3 appointed by the Joint Rules Committee and the directors of the House Appropriations and Senate Finance Committees
 - Reviews the economic assumptions and methodology
 - Governor's Advisory Council on Revenue Estimates (GACRE) is comprised of business leaders and House and Senate leadership and will meet next Monday
 - Tasked with reviewing the economic assumptions and economic climate
- Governor will present budget proposals (Caboose and FY 2014-16 biennium) on December 16

Virginia's Revenue Forecasting Process

- Virginia's general fund revenue forecast is driven primarily by the national economic outlook, adjusted to reflect Virginia-specific variables
 - Global Insight is Virginia's primary economic advisory firm and its economic model is used for the national forecast
 - Tax modifies the national economic model to incorporate Virginia-specific data and to reflect recommendations made by GABE and GACRE
- Key economic indicators in the Virginia model include:
 - Job growth by industry sector and region
 - Personal income
 - Wages and salary
 - Migration
 - Housing starts
- Jobs and average wages and salaries serve as proxies for our largest source, individual income tax withholding
- Personal income serves as the primary proxy for sales tax collections
 - While income growth is a good gauge, it does not capture outside influences that can impact sales tax revenues such as low consumer confidence or the impact of things such as consumer debt pay-down

U.S. Economic Forecast

Percentage Change	FY 2014
National Forecast	
Real GDP	
Chap 806/Official	2.3
Sept 2013 Standard	2.0
Average Wage	
Chap 806/Official	2.6
Sept 2013 Standard	1.3
Consumer Spending	
Chap 806/Official	2.6
Sept 2013 Standard	2.1
Employment	
Chap 806/Official	1.7
Sept 2013 Standard	1.7

Virginia Economic Forecast

Percentage Change	FY 2014
Virginia Forecast	
Total Personal Income	
Chap 806/Official	4.1
Sept 2013 Standard	3.0
Average Wage	
Chap 806/Official	2.5
Sept 2013 Standard	1.5
Wages and Salaries	
Chap 806/Official	3.9
Sept 2013 Standard	2.8
Employment	
Chap 806/Official	1.4
Sept 2013 Standard	1.2

FY 2014 Year to Date Performance July through October

General Fund Revenue Forecast for Fiscal Year 2014			
<u>Major Source</u>	Source as a % of Total <u>Revenues</u>	<u>Ch. 806 Official Forecast</u>	<u>Y-T-D Performance Through October</u>
Withholding	63.8%	5.4%	3.6%
Nonwithholding	15.6%	(5.9%)	7.1%
Refunds	(10.8%)	6.3%	34.7%
Net Individual	68.6%	2.5%	2.7%
Sales	18.8%	(1.0%)	(3.7%)
Corporate	5.0%	5.4%	(12.9%)
Wills (Recordation)	2.0%	(10.9%)	(0.3%)
Insurance	1.7%	7.0%	--
All Other Revenue	4.0%	(2.3%)	5.6%
Total GF Revenues		1.5%	0.6%

Source: Secretary Brown's October 2013 monthly revenue report.

Year-to-Date Performance: Individual Income Taxes

- Year-to-date, net individual income tax collections have grown 2.7%, close to the annual forecast of 2.5% growth
 - Only strength has come from higher than anticipated non-withholding tax revenues

Payroll Withholding:

- FY 2014 forecast projects growth of 5.4%; actual collections through October grew 3.6% and collections for the month rose only 0.5%
 - YTD collections are below 3.0% when adjusted to reflect an extra deposit day in the first quarter, and the loss of an additional deposit day at year-end
 - We did not meet last year's forecast for withholding tax collections and have been seeing average growth in the 3% range since the last half of FY 2013, with an average of 2.7% over the past 6 months
 - In light of low employment job growth and continued uncertainty in federal spending, expect a downward adjustment for this source
 - If growth is assumed to be in the 3% range, would see a forecast reduction of about \$250 million (in part because of last year's lower than anticipated performance)

Year-to-Date Performance: Individual Income Taxes

Nonwithholding: Forecast for year is -5.9%, actual collections through October grew 7.1%

- September growth was 2.1%. This represents the first estimated payment for FY 2014 - Need to look at January's estimated payments to get a better picture
- Final payments – which have accounted for 40% of the revenue from this source in recent years – tend to track the S & P which is 24% for the year through early November
 - Last year's forecast assumed CY 2013 S&P growth of 3.9%, revised estimate of proxy assumes 17.3%
 - If the forecast is adjusted to reflect the model for this source, could see up to \$300 million in additional revenues

Refunds: Forecast for the year is increase of 6.3%, actual refunds grew by 34.7% through October

- Through September, the high level of refunds has been driven by the land preservation tax credit
- October's bump in refunds reflected extension filers, with a sharp increase in both the number of checks and check sizes

Year-to-Date Performance: Sales Tax

Sales Tax:

- Through October, sales tax collections declined 3.7% compared to the annual estimate of a 1.0% decline
 - Adjusting for AST and HB 2313, the rate is 1.5% - well behind the economic-based forecast of 5.2% growth
- Sales tax revenues have consistently trailed the forecast and we are likely to see a substantial downward adjustment to the assumed growth rate as sales tax revenues have been falling off since last April
- Could be further exacerbated by the federal shut-down, which won't be seen until November's sales tax remittance because of the lag in payment by retailers
- If the economic-based forecast was reduced to reflect of 2% collections, the forecast would be reduced by about \$100 million

Year-To-Date Performance: Other Major Sources

Corporate Income:

- Corporate collections through October fell 12.9% compared with the forecast of 5.4% growth
 - October's low collections reflected both strong refund activity as well as low estimated payments from companies with February through January fiscal years, primarily retailers
 - The mixed signals suggest potentially lower performance for this source, but need to see November and December payments should provide a clearer picture the non-retail sectors
 - Assume flat performance for this source – but could require adjustment Mid-Session

Recordation Taxes:

- Forecast for year is -10.9%, actual collections through October fell 0.3%
 - Last year we experienced 17.8% growth in this source and growth in the second half of the year was 20% - likely to end year closer to forecast than we currently are
 - While housing is anticipated to remain a positive to the economy overall, don't expect growth at the same levels – either in terms of home sales or refinancing activity
 - Official forecast reflects the higher than anticipated performance in FY 2013 – if you assume the core economics relating to housing remain the same as assumed a year ago you see a positive revenue adjustment of about \$50 million

FY 2014 Forecast Revisions?

- When adjusted to reflect the FY 2013 surplus, FY 2014 will have to grow only 1.5% to meet the appropriated expenditures in Chapter 806
 - Forecast was 3.9% prior to accounting for FY 2013 actuals
- This low rate makes the forecast achievable even in light of the weakened growth outlook
- There are likely to be some major adjustments to individual sources (as outlined on previous pages) which impact the base going into the next biennium
- Expect little to no net GF revenue adjustment resulting from the larger than expected base, weaker growth in withholding and sales taxes offset by strength in nonwithholding
 - You will see a Lottery forecast adjustment of \$33.0 million in FY 2014
- Governor will have one additional month of data before finalizing his budget recommendations

Revenue Growth: FY 2014-2016 Biennium

- The September 2013 Standard Outlook presented to the Joint Advisory Board of Economists (JABE) slightly tempers the outlook for the next biennium but continues to reflect slightly more softening of growth
 - Assumes Virginia will grow slower than the nation both in terms of jobs and income
 - Largest downward adjustment relates to slower job growth
- Forecast will reflect revised Outlook and input from members of GACRE at its meeting next week

Percentage Change	Job Growth	Avg. Wage/ Salary Growth	Total Wage/ Salary Growth	Income Growth
FY 2015				
Official (November 2012)	2.0%	2.3%	4.4%	4.6%
Global Insight September	1.5%	2.5%	4.1%	4.5%
Global Insight Pessimistic	0.1%	2.3%	2.3%	2.8%
Moody's Economy.com	1.9%	4.9%	6.8%	6.2%
FY 2016				
Official (November 2012)	2.0%	2.2%	4.2%	4.7%
Global Insight September	1.6%	2.5%	4.1%	4.4%
Global Insight Pessimistic	0.6%	2.5%	3.1%	3.4%
Moody's Economy.com	2.2%	4.7%	7.0%	6.6%

Revenue Growth: FY 2014-2016 Biennium

- Withholding:

- Job growth will likely to reflect the Global Insight Standard; however, average wage/salary growth rates will be applied to lower base assuming reduction in FY 2014
 - Withholding growth should be slightly above 4% each year based on the proxies – job growth in the 2% range mixed with modest increases in average wages (2.5% range)

- Sales Tax:

- Personal income growth is the proxy used to project sales tax
 - Sales tax growth has been below model in last couple of years
 - Expect lackluster consumption until confidence improves
 - Reasonable to project growth slightly below the Standard, or about 4% on an economic basis
 - But remember – the GF portion reflects the phased-transfer to transportation. Is equivalent to about 1.5% growth

Revenue Growth: FY 2014-2016 Biennium

- Corporate and Nonwithholding:

- These are the two most volatile sources
- Expect flat performance for corporate after higher growth for last few years
- Assume average growth in nonwithholding – 6% range
 - Based on continued growth in stock market, albeit at lower pace and typical increases in proprietors and other non-wage income

- Recordation Tax:

- Moderating sales volumes and price appreciation will reduce growth rates compared to the past 2 years
- Assumed increases in record-low interest rates will hold down refinancing market as well
- In combination, expect general flat performance of this source

Tax Policy Changes Impacting the FY 2014-2016

- A number of policy adjustments related to the resource side of the equation will further constrain the upcoming biennium
- First, the upcoming budget will reflect costs of tax policy changes adopted in prior years which had a delayed enactment or were phased-in
- Known costs total \$101.9 million in FY 2015 and \$167.2 million in FY 2016 – equivalent to almost 1% revenue growth in the second year

Tax Policy Adjustments Reducing Resources:

- HB 2313 includes a phased shift of an additional 0.05% of the general sales tax revenues to transportation each year (beyond the 0.05% was transferred in FY 2014)
 - Based on the current forecast, that would cost \$52.7 million in FY 2015 and \$109.4 million compared to FY 2014

Tax Policy Changes Impacting the FY 2014-2016

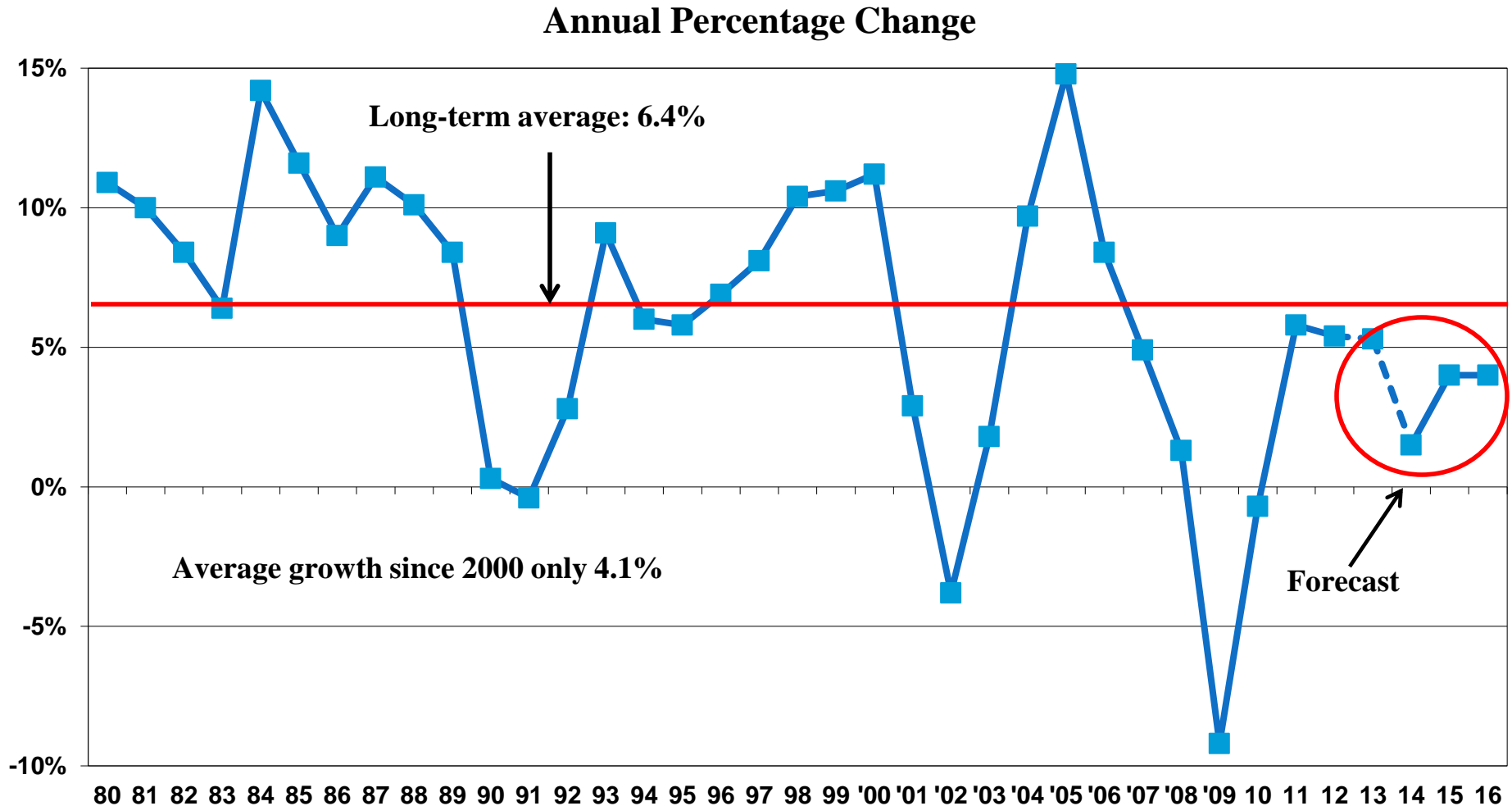
Tax Policy Adjustments Reducing Resources (continued):

- Continued phase-in of single-sales factor (Byron, HB 2437, 2009): total of \$58.9 million in FY 2015 and \$58.6 million in FY 2016 (increase of \$40 million/year compared to current year)
- Education Improvements Scholarship Tax Credit (Massie, HB 1996, 2013): \$25.0 million annual credit cap beginning in TY 2013 (assume \$10.0 million each year)
- Increased cap of Qualified Equity and Subordinated Debt (Ch. 806): \$500,000/year (cap brought back up to \$5.0 million in TY 2014)
- “Amazon tax” went into effect in September. Yet to see the impact on sales tax collections compared to the assumptions when SB 597 was passed by 2012 General Assembly
- Budget also will reflect decisions made to phase-out policies like retention of interest earnings – cost of \$11.6 million over the biennium per language in Ch. 806

Summary - FY 2014-16 Revenue Forecast

- Based on an analysis of projected revenues and economic variables, HAC staff estimates continued modest revenue growth of between 3.8% and 4.2% each year of the upcoming biennium
- Would result in revenue adjustments of about \$610 - 700 million in FY 2015 and \$1.1 - \$1.3 billion in FY 2016
 - Average annual growth has been 4.1% since FY 2000
- Continued uncertainty as to the impact of federal cut-backs means we must retain conservative bent to the forecast to retain flexibility to respond to potential revenue reductions
- Low forecast provides potential for continuing pattern of year-end surpluses
 - Provides some cushion to respond to impact of federal spending reductions, both direct and indirect

General Fund Revenue Growth FY 1980-2016



*Actual Collections FY 1980-2013, FY 2014-16 HAC Estimate. (All exclude transfers.)

Budget Outlook: Caboose Bill and FY 2014-16 Biennium

Budget Outlook for the FY 2014-2016 Biennium

- FY 2014 Adjustments - Caboose Bill
- What is our base budget?
- What are known budget drivers?
- Does our projected revenue growth fully support these drivers?
- What can we do to position ourselves to respond to the potential impact of federal budget reductions on Virginia's revenues and budget?

2014 Caboose Bill

Selected Spending and Savings Items

	GF \$ in Millions	FY 2014
Caboose Bill Resources		
	DMAS and Health Care Fund FY 2013 Year-End Balance	\$68.4
	Health Care Fund – GF Offset for Drug Settlement	\$30.0
	DMAS FY 2014 Forecast Adjustment	\$73.6
	FY 2013 Excess Lottery Revenues	\$22.2
	Total Savings:	\$194.2
Caboose Bill Spending		
	Criminal Fund Forecast	-\$ 1.7
	Compensation Board – Jail Per Diems	-\$ 9.3
	Direct Aid – Backfill FY 2014 for ADM Adjustment in FY 2013	-\$ 4.3
	Direct Aid – Backfill for Sales Tax Forecast Reduction	-\$20.9
	Department Social Services – Backfill Child Support Enforcement	-\$ 3.9
	Fort Monroe	-\$ 4.0
	Total Spending:	- \$44.1

FY 2014 - 2016 Base Budget

- The “base budget” equals FY 2014 appropriations, adjusted for one-time spending and savings, as well as the annualization of any partial year costs
 - Base budget does not include spending increases driven by state or federal law, or high priority or discretionary spending
- Major base adjustments base for the FY 2014-16 biennium include annualizing the costs of: the FY 2014 salary increase, the opening of the River North correctional facility, new local jails, as well as annualized savings from closing juvenile correctional facilities
- The largest “one-time” item removed from the base is the FY 2014 Rainy Day Fund payment. Other one-time items removed include IT and other equipment funding, claims payments and one-time grants to localities
- Added to base costs are the DOJ settlement and the community waivers phased-in in the current biennium

Adjusted Base Budget for FY 2014-2016

(GF Dollars in Millions)

	FY 2015	FY 2016
Chapter 806 (FY 2014 Operating Base)	\$17,986.1	\$17,986.1
DPB Base Budget Adjustments (Rainy Day Fund payment, technical adjustments and one-time savings)	(\$243.6)	(\$243.8)
DPB Base Budget	\$17,742.5	\$17,742.3
HAC Identified Adjustments* (Prior commitments, on-going costs)	(\$43.7)	(\$43.7)
HAC Estimated Base Budget	\$17,698.8	\$17,698.6

*Note: HAC Adjustments include addition of base funding for DOJ settlement, Fort Monroe, annualization of higher education portion of FY 2014 salary increases and River North correctional center.

Range of Resources Available for Budget Drivers

\$'s in millions	FY 2015	FY 2016	Biennium
FY 2014 Carry-forward (based on CH. 806)	\$ 11.6	\$ 0.0	\$ 11.6
Additional FY 2014 Balances	\$ 150.1	\$ 0.0	\$ 150.1
Low Revenue Forecast - FY 15 at 3.8%, FY 16 at 3.8% (incl. transfers)	\$18,134.5	\$18,823.6	\$36,958.1
Higher Revenue Forecast - FY 15 at 4.2%, FY 16 at 4.2% (incl. transfers)	\$18,204.4	\$18,968.9	\$37,173.3
HAC Base Budget	\$17,698.8	\$17,698.6	\$35,397.4
Net Resources Above Base Budget (includes carryforward/balances)	\$597.4 – 667.3	\$1,125.0 – 1,270.3	\$1,722.4 – 1,937.6

Developing the FY 2014-2016 Biennial Budget

- Each year agencies submit decision packages requesting funding to address increased costs, maintain and/or expand programs and address new initiatives
- First steps are addressing two types of budgetary pressures
 - Mandatory/Statutory: Driven by federal or state law, i.e. Medicaid forecast adjustments, SOQ re-benchmarking, “Rainy Day” fund deposits, VRS payments, debt service
 - High Priority: Driven by historical commitments or enrollment demands i.e., higher education (in-state students, financial aid), indigent care at teaching hospitals, corrections
- Tables on the next pages include only those considered mandatory or high priority as identified by HAC Staff
 - The table excludes many “nice to do’s” included in the pool of requests and is intended only to reflect the major items

2014-16 Budget Drivers:

HAC Staff Selected Mandatory/Statutory Items

GF \$ in Millions	FY 2015	FY 2016	Total
Medicaid Baseline Forecast (includes hospital and nursing home rebasing)	\$255.2	\$419.2	\$674.4
Medicaid DOJ Required Waiver Slots	14.9	30.4	45.3
DOJ – Other Requirements	12.2	0.0	12.2
K-12 Rebenchmarking Estimate (includes composite index, and Lottery accounts excludes VRS, and ADM adjustments)	213.0	240.5	453.5
State Employee Retirement and OPEB Rates	88.0	88.0	176.0
Teacher Retirement Rate and OPEB Rates	85.5	85.5	171.0
State Employee Health Insurance Rate Adjustment	25.0	52.0	77.0
Debt Service	64.7	99.5	164.2
DSS – Offset decreased child support enforcement revenue	5.3	5.3	10.6
Adjustments to Economic Development Incentives	-3.8	10.5	6.7
1:1,500 Ratio	5.4	6.4	11.8
Direct Inmate Health Care	1.5	6.5	8.0
New and Expanded Jail Capacity	6.4	8.8	15.2
Total – Known Mandatory/Statutory Budget Drivers	\$773.3	\$1,052.6	\$1,825.9

2014-16 Budget Drivers:

HAC Staff Selected High Priority Items

GF \$ in Millions	FY 2015	FY 2016	Total
Higher Education – O & M for New Facilities	\$8.5	\$12.2	\$20.7
New In-state Seats at CWM, JMU, UVA & VT	3.1	3.1	6.2
Asst. Commonwealth Atty Salary Adjustment	2.1	2.1	4.2
DOA – Positions for Cardinal System	0.5	1.1	1.6
Fort Monroe Authority (above base)	9.2	8.2	17.4
Phase-Out Retention of NGF Interest Earnings	3.8	7.6	11.4
DBHDS – IT Costs of e-Health Records	2.5	3.3	5.8
DMAS – Dual Eligible Demonstration Program	1.3	1.3	2.6
Lawrenceville Rate Adjustment	1.4	1.4	2.8
State Police Gasoline Costs	2.9	2.9	5.8
Increase Sex Offender Probation Positions	1.1	1.1	2.2
TOTAL – Known High Priority Budget Drivers	\$36.4	\$44.3	\$80.7

Developing the FY 2014-2016 Biennial Budget

- Agency budget requests received as of November 1 totaled \$480.7 million GF in FY 2015 and \$607.5 million GF in FY 2016
 - Largest component is requests from higher education at \$206.0 million in FY 2015 and \$300.1 million in FY 2016
 - Other large areas are health and human resources at \$78.3 million in FY 2015 and \$96.3 million in FY 2016 and public safety, with requests totaling \$64.4 million in FY 2015 and \$68.3 million in FY 2016
- Agency budget submissions are not all inclusive either
 - Many formula and forecast driven items have not finalized when the requests are submitted – this includes items like foster care and adoption, FAMIS etc.
- A substantial number of the requests relate to back-filling reductions to federal programs (non-mandatory)

Potential Budget Gap/Available Resources Based on Identified Drivers

\$'s in millions	FY 2015	FY 2016	Biennium
Net Resources for Budget Drivers	\$597.4 – 667.3	\$1,125.0 – 1,270.3	\$1,722.4 – 1,937.6
Mandatory/Statutory Spending Drivers	\$773.3	\$1,052.6	\$1,825.9
High Priority Drivers	\$36.4	\$44.3	\$80.7
Total Drivers	\$809.7	\$1,096.9	\$1,906.6
Potential Budget Gap/Available Resources	(\$212.3 - \$142.4)	\$28.1 - \$173.4	(\$184.2) - \$31.0

2014 Session – Planning for Uncertainty

- This fall the Governor again asked all agencies to submit 2% budget reduction plans for the current year, and 4% budget reduction plans for each year of the upcoming biennium
 - This marks the 6th consecutive year that agencies have been asked to produce such plans
 - Targeted strategies – outside of the across-the-board plans – are to be developed for higher education, K-12, Medicaid and behavioral health, which total about 75% of the GF budget
- The savings plans are intended to provide some contingency options given the uncertainty in the economy, especially in light of continued uncertainties associated with the federal budget
 - Agency savings may not be required to meet current budgetary obligations, but could provide a roadmap of options if reductions become necessary
 - The identified strategies totaled about \$120 million each year through a combination of GF reductions, additional resources and supplanting with nongeneral funds
 - If implemented in total, the plans could result in 227 layoffs in the first year and 85 layoffs in the second year

Agency 2%/4% Reduction Plans

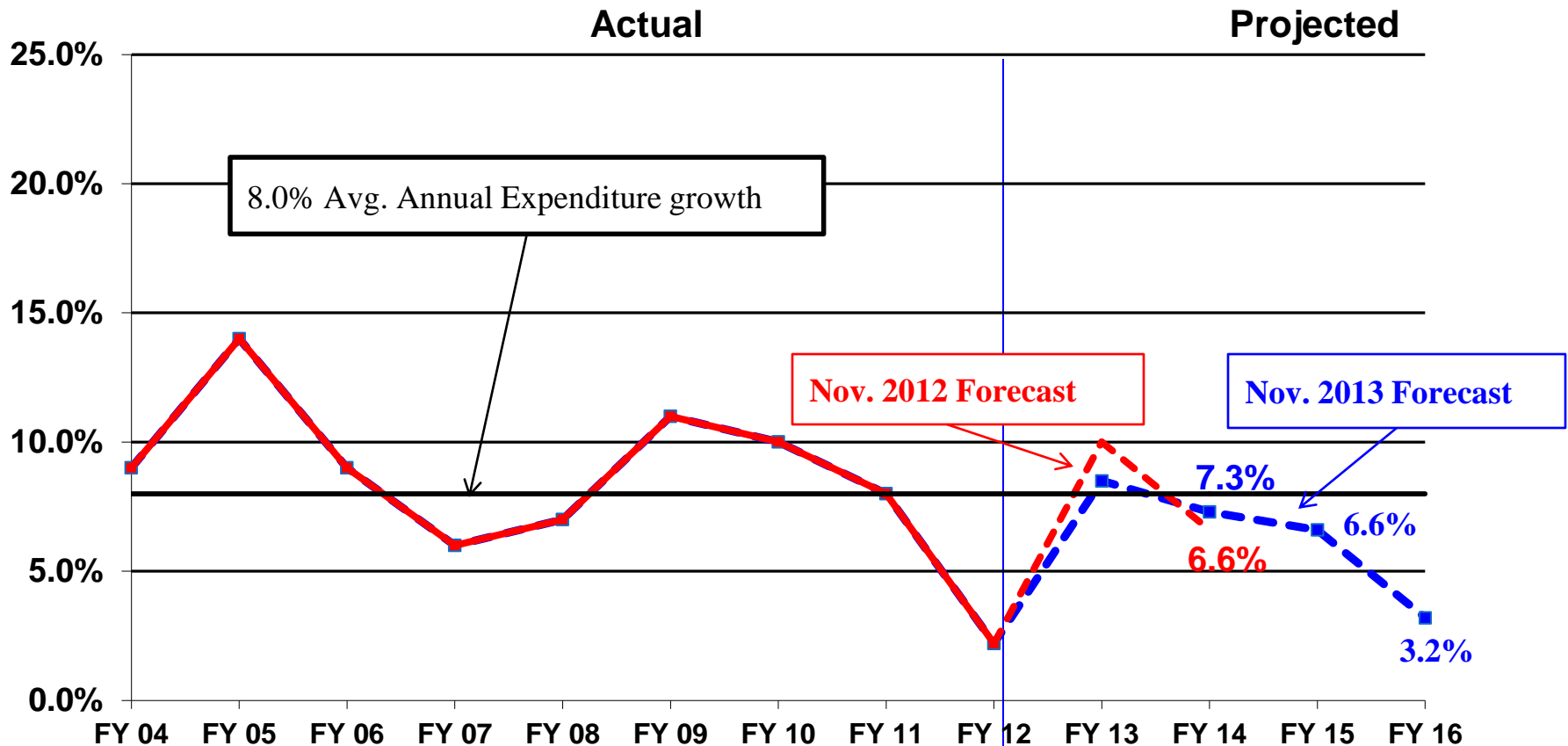
- The savings strategies proposed vary across agencies and Secretariats but are similar to strategies we have seen in previous years
 - In the current fiscal year savings are more limited because of the timing of Caboose bill
- Some of the major categories of strategies for the next biennium include:
 1. Elimination of funds supporting new initiatives or recently provided restorations
 2. Closure of facilities and/or elimination of positions
 3. Reduction in pass-through grants
 4. Reduction in reimbursements
 5. Supplant GF support with nongeneral fund resources
 6. Use of fees
 7. Reduction or elimination of services

Major Budget Drivers

Medicaid Forecast

- Official Medicaid forecast updated every November
 - Governor's introduced budget may include updated data elements
- 2013 Official Medicaid forecast updates projected spending for FY 2014 and the 2014-16 biennium
- Virginia Health Care Fund revenues will influence how much general fund dollars are required to meet the forecast costs of the Medicaid program
 - Revenues in the fund are used as a portion of the state's match for the Medicaid program
 - Comprised of tobacco taxes, Medicaid recoveries and a portion of the Master Tobacco Settlement Agreement (41.5 percent)
 - Last Session revenues to the fund increased by about \$65 million each year from prior year pharmacy rebates
 - Primarily due to rebates on behalf of managed care recipients required under the federal health care reform legislation
 - Revenue changes in the Virginia Health Care Fund are not included in Official Medicaid forecast

Annual % Change in Medicaid Expenditures



Note: Represents percentage change in all funds, state and federal, adjusted for payment timing changes, cash management, FMAP maximization.
Source: 2013 final DPB and DMAS consensus forecast

Preliminary Medicaid Forecast: GF Need

(GF \$ in millions)

Medicaid Forecast	FY 2014	FY 2015	FY 2016
Medicaid Expenditures Baseline Forecast	(\$73.6)	\$218.2	\$355.2
Inflation Adjustment for Hospital Costs		12.5	27.2
Inflation Adjustment for Nursing Facility Costs		7.5	18.1
Rebasing of Nursing Facility Costs		14.3	15.7
Nursing Facility Capital Rate Increase <i>(current rate as specified in Chapt. 806 will sunset June 30, 2014)</i>		2.7	3.0
Offset from Virginia Health Care Fund Balance	(\$68.4)		
Total Change in GF Need	(\$142.0)	\$255.2	\$419.2

Note: Reflects November 15, 2013 Medicaid consensus expenditure forecast. Projected revenues for the Virginia Health Care Fund are preliminary and may change when finalized.

Factors Affecting FY 2014 Medicaid Spending

- Forecast projects \$73.6 million in general fund savings in FY 2014
 - \$63.6 million GF savings due to a slight decreases in projected expenditures
 - Projected expenditures for fee-for-service medical expenditures is expected to be lower due to the expansion of managed/coordinated care
 - Woodwork effect on enrollment is projected to be slightly less than last year's estimate
 - Managed care rates were in line with budget projections (6%)
 - \$10.3 million GF in savings due to changes to behavioral health care regulations for adults
- FY 2013 cash balance in the Virginia Health Care Fund of \$68.4 million will roll over to FY 2014 and offset Medicaid general fund expenditures
 - Revenues were higher than originally projected due to pharmacy rebates and additional Medicaid recoveries

Factors Affecting Medicaid Spending Growth in 2014-16 Biennium

- Enrollment growth
 - Growth projected at about 2.0%-2.5% annually
 - Lower than the 5.8% average annual growth rate from FY 2009 to FY 2013
 - Substantially lower than recessionary high of 10% in FY 2010
 - Enrollment growth historically accounts for almost one-quarter of the overall growth in Medicaid expenditures
- Inflation in health care costs and intensity of services
 - Accounts for about 23% of the increase in Medicaid expenditures for children, caretaker adults and pregnant women
 - Accounts for about 43% of the increase in Medicaid expenditures for aged and disabled recipients

Factors Affecting Medicaid Spending Growth in 2014-16 Biennium

- Rate increases
 - Managed care organization (MCO) capitation rates
 - Forecast includes a 4% rate increase in FY 2015 and FY 2016
 - Rates required to be actuarially sound by federal government
 - Rates recommended by actuary
 - Represents \$88.6 million (all funds) in FY 2015 and \$193.4 million (all funds) in FY 2016
 - Nursing Facility Capital Rates
 - Forecast assumes a sunset in the rental rate floor of 8.5% for nursing facility capital improvements
 - Rate would revert to 9% in FY 2015
 - Rate was reduced from 9% to 8.0% in FY 2012 and partially restored to 8.5% in FY 2013
 - Represents \$11.4 million (all funds) over the 2014-16 biennium

Factors Affecting Medicaid Spending in 2014-16

- Rate increases (continued)
 - Medicaid forecast includes hospital and nursing home inflationary adjustments and nursing home rebasing as required by regulations
 - 2.5% inflation adjustment each year assumed for inpatient hospital expenditures
 - 1.7% in FY 2015 and 2.1% in FY 2016 inflation adjustment assumed for nursing facility services
 - Nursing home rebasing would take effect in FY 2015

Impact of Hospital & Nursing Home Inflation and Rebasing		
\$ in millions	FY 2015	FY 2016
Hospital inflation	\$22.9	\$49.8
Nursing home inflation	15.1	36.2
Nursing home rebasing	28.6	31.4
All funds (state and federal)	\$66.6	\$117.4
GF Total	\$37.0	\$61.0

Factors Affecting Medicaid Spending Growth in 2012-14 Biennium

- Growth in Medicaid services
 - Behavioral health services
 - Continued growth expected in mental health skill building services (formerly mental health support services): 4% in FY 2015 and 15% in FY 2016
 - Offset partially by savings from recent regulatory changes to ensure appropriate type and levels of services are provided
 - Cost of new Behavioral Health Services Administrator incorporated into forecast
 - Savings of \$20.0 million taken in the Medicaid administrative budget in FY 2013 from implementing managed behavioral health care services
 - Intellectual and developmental disability waiver services
 - Growth of about 8% in FY 2015 and 2% in FY 2016

Overview of the K-12 Rebenchmarking Process

- Rebenchmarking is the process of updating the state's costs of the Direct Aid programs into the new biennium and is based on a look back of local expenses
- The updates are technical in nature and do not involve changes in any existing policies or current funding methodologies, other than those previously approved by General Assembly action
- The input data used to calculate the cost of the Direct Aid accounts is updated every two years to recognize changes in costs that have occurred over the previous biennium
- Since SOQ accounts represent approximately 90% of state Direct Aid funding, most of the rebenchmarking impact is in the SOQ, but the Lottery, Incentive and Categorical funding is also impacted
- Because rebenchmarking changes the total costs generated from the SOQ funding formula, both state and local costs are effected

The Process

- SOQ funding is driven primarily by the instructional staffing standards in the Code of Virginia and the salary and fringe benefit costs for the required instructional positions.
- Basic Aid also includes funding for support positions and non-personal support costs on a “prevailing cost” basis
- Major components of the SOQ funding formula include:
 - 1) Student data for September membership and March 31st ADM
 - 2) Staffing standards for instructional positions
 - 3) Salaries of instructional positions
 - 4) Fringe benefit rates
 - 5) Support costs (salary and non-salary)
 - 6) Inflation factors
 - 7) Federal revenues deducted from support costs
 - 8) Sales tax revenue forecast
 - 9) Local composite index (LCI)

Starting Rebenchmarking

- The adopted FY 2014 Direct Aid budget serves as the starting point for rebenchmarking FY 2015 & FY 2016
 - FY 2014 total budget equaled \$6.8 billion:
 - \$5,943.9 million - GF, Lottery, Literary, & Commonwealth Transportation
 - \$870.9 million - Federal funds
- In September, DOE reported the preliminary state's share of the rebenchmarking costs for the Direct Aid program accounts at a total of \$350.6 million
- In addition, last week, DOE indicated that the cost of updating the local composite index (LCI) is estimated at \$37.1 million, the Lottery-funded program accounts at \$66.4 million, and the Incentive & Categorical accounts at (\$0.6) million over the biennium
- The table reflects rebenchmarking totals, including the LCI, Lottery and Incentive & Categorical costs

Estimated Rebenchmarking	FY 2015 (\$ in millions)	FY 2016 (\$ in millions)	Biennium (\$ in millions)
Adjusted Net Increases	\$360.7	\$388.1	\$748.8
Total Net Decreases	(\$147.6)	(\$147.5)	(\$295.1)
REVISED Total	\$213.1	\$240.6	\$453.7

FY 2014 - 2016 Rebenchmarking Estimates

Preliminary Net Cost <u>Increases</u> (\$ in millions)	FY 2015	FY 2016	Biennium
Reflect 2% Salary Incentive on Funded Instructional & Support	\$68.8	\$68.8	\$137.6
Federal Revenue Deduct	51.9	52.0	103.9
Non-personal Support Cost Inflation Factors	47.0	47.1	94.1
Base-Year Expend. from ASR to FY12 for Non-personal Support Costs	34.9	35.4	70.3
Lottery-funded Program Accounts	29.6	36.8	66.4
Health Care Premium from \$3,778 to \$4,340	26.7	26.7	53.4
Remove Non-participation Savings Estimate for PreK (25%)	23.4	23.4	46.8
Local Composite Index	18.4	18.7	37.1
Pupil Transportation Costs	18.2	18.8	37.0
FY12 SOL Failure Rates and FY13 Free Lunch Percentages	16.8	16.9	33.7
Fall Membership and ADM	9.1	24.5	33.6
Base-Year Expenditures from ASR to FY12 for Personal Support Costs	5.9	5.9	11.8
Textbooks Per Pupil Amount from \$89.73 to \$99.42	4.5	4.5	9.0
Remedial Summer School Per Pupil Amount & Enrollment Proj.	1.7	3.3	5.0
SOQ Gifted, Support Technology & Instruc. Technology Positions	2.2	2.4	4.6
ESL Enrollment Projections	1.3	2.5	3.8
Costs for Superintendents, School Boards & School Nurses	0.3	0.4	0.7
TOTAL INCREASES	\$360.7	\$388.1	\$748.8

FY 2014 - 2016 Rebenchmarking Estimates

Preliminary Net Cost <u>Decreases</u> (\$ in millions)	FY 2015	FY 2015	Biennium
Reset Personal Support Inflation Factors to 0% (not funded in FY14) & Remove 2% Salary Incentive Supplement Funding	(\$70.4)	(\$70.4)	(\$140.8)
Remove One-Time Spending from FY14 Base Budget	(55.6)	(55.6)	(111.3)
Special Education Child Count as of Dec 1, 2012	(8.3)	(8.1)	(16.4)
Career & Technical Educ. Enrollment to 2012-13 School Year	(5.4)	(5.4)	(10.8)
SOQ Base for Funded Instructional Salaries	(4.6)	(4.6)	(9.2)
Ratio of Instructional to Support Positions (4.06 to 4.09)	(2.9)	(3.2)	(6.1)
Incentive & Categorical Program Accounts	(0.4)	(0.2)	(0.6)
TOTAL DECREASES	(\$147.6)	(\$147.5)	(\$295.1)

Remaining Data & Cost Updates for Rebenchmarking

- In addition to those steps and associated costs reported to date, there are other updates still pending due to the timing of when the input data are available -- they will be incorporated into the Governor's 2014-16 budget plan that will be presented in December
 - Final update to enrollment projections (to reflect September 30, 2013 membership)
 - Revised Sales Tax forecast
 - Revised Lottery Proceeds forecast
- Along with the three data points just mentioned, the last cost deal deals with teacher retirement, group life, and retiree health care credit (RHCC) and these updates probably will have a significant impact on rebenchmarking but will be addressed along with other policy considerations

Teacher Retirement, RHCC, & Group Life Rates

- The table shows the current rates in Chapter 806, the most recent VRS Board approved actuary rates plus DOE estimated state costs, and the phased-in rates plus costs for the proposed FY2014-16 biennium
 - Because school divisions choose to hire more, or aspirational, positions than the number calculated by the funding model, the total local costs are higher than the state's costs

Teacher Group	Current Employer Rate	<u>PHASED-IN RATES</u>	Percent Change in Rates	DOE Estimated Additional Biennial Cost
		@ 79.69%		
Retirement*	11.66%	14.50%	2.84%	\$162.7 million
RHCC	1.11%	1.18%	0.07%	\$3.9 million
Group Life	0.48%	0.53%	0.05%	\$1.4 million
TOTAL	13.25%	16.21%	2.96%	\$169.4 million

* Teacher retirement rates exclude the 5% employee rate

Higher Education Six-Year Plans

- College & university six-year plans total \$157.9 million in FY 15 and \$308.8 million in FY 16
 - More than 25 percent of the plan (\$42.4 million in FY 15 & \$91.1 million in FY 16) is related to faculty & staff compensation – this is the single largest request across the system
 - Additional faculty & staff comprise \$25.2 million in FY 15 & \$55.2 million in FY 16 or about 18%
- Other major items in the plan include:
 - Enrollment & retention funding: \$11.8 million in FY 15 & \$20.1 million in FY 16
 - TJ 21 items: \$10.8 million in FY 15 & \$17.5 million in FY 16
 - O & M and Utility costs: \$12.6 million in FY 15 & \$22.4 million in FY 16
- Undergraduate in-state tuition could increase an average of 7 to 8 percent in FY 15 assuming no new GF were available and institutions were authorized to proceed with the full array of initiatives contained in their plans
 - Increases range from 3% to nearly 20% depending on the institution
 - Proposed compensation actions account for 2 to 3 percentage points alone

2012 Pension Reform Phases in Full Funding of VRS Board Certified Rates

Required Percentage of VRS Board Certified Rates

	FY 13 & 14	FY 15 & 16	FY 17 & 18	FY 19 & 20
State Employees	67.02%	78.02%	89.01%	100.00%
Teachers	69.53%	79.69%	89.84%	100.00%
SPORS	75.84%	83.90%	91.95%	100.00%
VALORS	75.82%	83.88%	91.94%	100.00%
JRS	83.98%	89.32%	94.66%	100.00%

- Required percentage of VRS board certified rates pursuant to Chapter 823, 2012 Acts of Assembly. Retirement rates will also reflect the cost of the 10-year repayment of the contributions which were deferred during the 2010-12 biennium (through FY 2022)

Phase-In of VRS Rates

Retirement System	Chapter 806 Rates (FY 13/14)	Phase-In FY15/16	Board Certified
State Employees	8.76%	12.33%	15.80%
Teachers	11.66%	14.50%	18.20%
SPORS	24.74%	27.63%	32.93%
VALORS	14.80%	18.24%	21.74%
JRS	45.44%	51.66%	57.84%

Policy Assumptions for Board Certified Rates:

- 7.0% Rate of Return
- 2.5% Cost of Living Adjustment
- 30 year closed amortization period for actuarial accrued liability as of 2013 (new funding policy will treat future unfunded liabilities differently)

Estimated Fiscal Impact of New Rates

(Annual GF Impact, \$\$ in Millions)

State GF Share by Retirement System	FY 15/16 Phased-in Rates	FY 15/16 Full Board Certified Rates
State Employees	\$60.0	\$118.0
Teachers	\$82.0	\$188.0
SPORS	\$3.0	\$8.0
VALORS	\$11.0	\$22.0
JRS	<u>\$4.0</u>	<u>\$7.0</u>
Total	\$160.0	\$343.0

Estimated Impact on School Divisions - Annual Impact Per Year in Millions

Teachers' Retirement System	FY 15/16 Phased-in Rates	FY 15/16 Full Board Certified Rates
School Divisions' Share	\$122.0	\$282.0

Final Thoughts: 2014 Session Challenges

- Uncertainty clouds Virginia's economic forecast for the remainder of FY 2014 and the next two fiscal years
- The revenue outlook for FY 2015 and 2016 will mark 6 years of below-trend growth after two consecutive years of decline
- Impact of cuts to federal spending – especially defense spending – continue to be the greatest unknown facing Virginia as Congress delays conclusive action and relies on stop-gap measures
 - Has reduced Virginia's revenue growth so that we no longer out-perform the nation
- Projected revenue growth barely covers the existing base budget and standard adjustments to most mandated budgetary pressures
 - Between \$1.7 and \$2.0 billion in additional funding will be available over the biennium
 - \$600 – \$700 million in FY 2015
 - \$1.1 – \$1.3 billion in FY 2016

Final Thoughts: 2014 Session Challenges

- After funding the base budget and known mandatory budget items, little remains for high priority yet discretionary budget pressures
- FY 2015 will be most difficult year to address
 - Major drivers like VRS and re-benchmarking are static from year one to year two, thus requiring a larger share of the revenue growth in the first year
 - FY 2014 spending propped up by large balance carried forward from FY 2013
- Remember – the known mandatory and high priority budget budgetary drivers are not finalized and do not address other legislative priorities
 - Does not fully address VRS funding beyond the requirements of the reform legislation
 - Does not expand phase-out of accelerated sales tax collections