

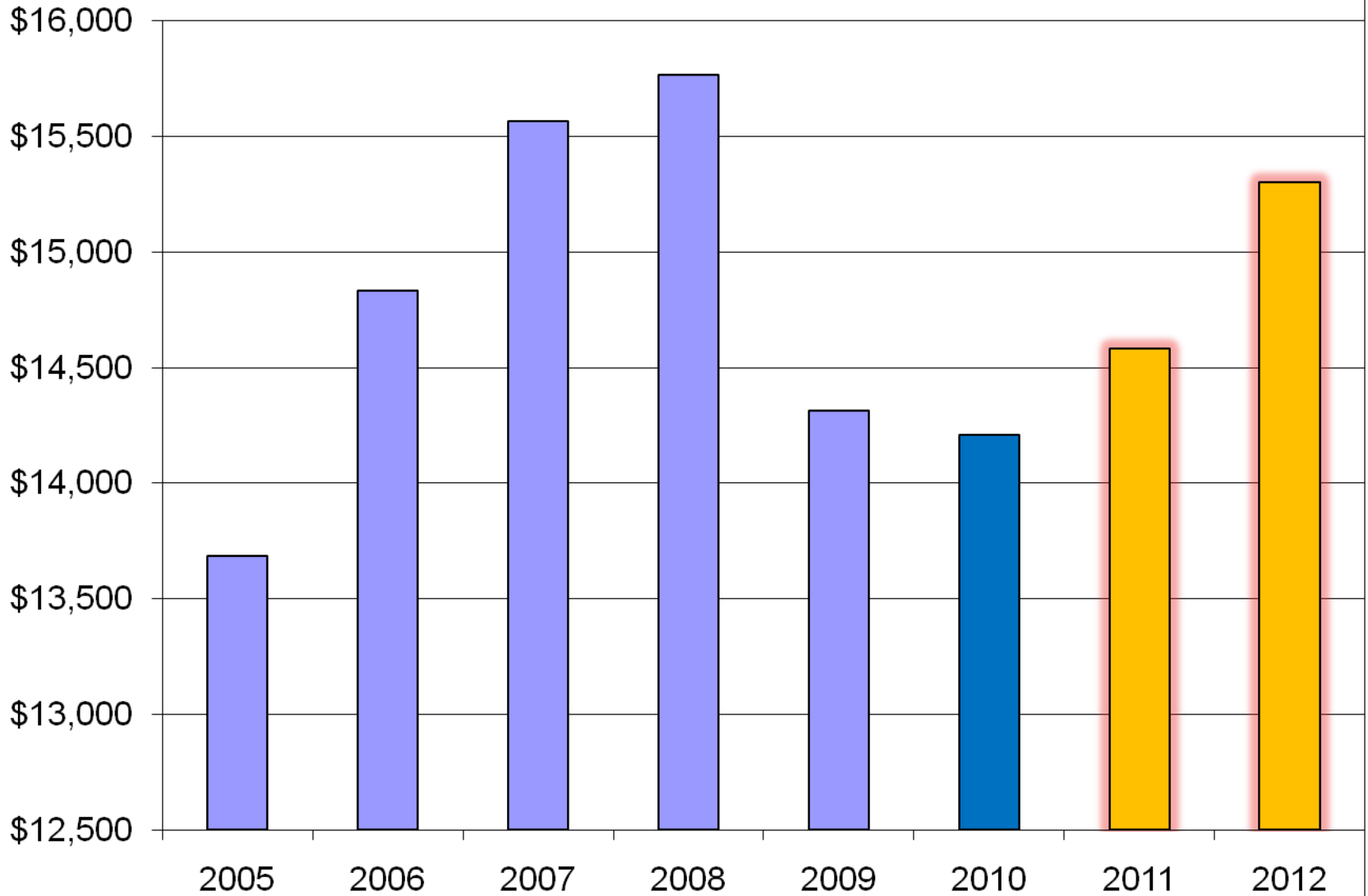
The State Budget “The Train Derailed”

James J. Regimbal Jr.
Virginia Association of Counties
August 6, 2010

Causes for \$4.5 Bil. Budget Gap Go Beyond the Economy

- Dramatic revenue slowdown further compounded by:
 - Dependence on one-time budget actions in 2008-10 biennium;
 - Expiring federal stimulus funding in 2010-12; and
 - Additional spending pressures, particularly for Medicaid program.

2010 Session Adopted General Fund Revenues in FY 2012 Less Than FY 2007



Fiscal Year 2010 Revenue Changes	
Original Ch. 879 Forecast	\$17,190.1
December 2008 Reforecast	(\$1,744.6)
February 2009 Reforecast	(\$418.3)
August 2009 Reforecast	(\$1,182.6)
December 2009 Reforecast	(\$340.0)
February 2010 Reforecast	\$82.5
All Policy Changes	\$621.5
<i>Accelerated sales tax</i>	\$241.8
<i>Tax Amnesty</i>	\$102.1
<i>Reduce LPTC Max Claim</i>	\$50.0
Final Revenue Surplus	<u>\$220.0</u>
Fiscal Year-End Revenues	\$14,208.6

Kaine & General Assembly took different paths to balance the budget

KAINE

- Eliminate the \$1.9 bil. car tax relief program
- Raise \$360 mil. in tax policy and fee increases
- \$2.2 bil. in targeted and across-the-board spending cuts, including additional cuts to K-12 public education beyond 1/3 support position reduction

GENERAL ASSEMBLY

- Increased \$443 million thru revenue re-forecast, fees, transfers, and cash balances
- \$614 million more cuts than in the introduced budget bill
- \$850 million from VRS for employee retirement & benefit contributions (\$504 mil. state employee, \$346 mil. teachers)

General Fund Appropriation Trends

	<u>FY 2009</u>	<u>FY 2010</u>	<u>FY 2011</u>	<u>FY 2012</u>
K-12 Direct Aid	35.2%	32.3%	30.8%	30.7%
Higher & Other ED	12.2%	12.0%	11.6%	9.9%
Other HH&S	9.2%	9.6%	9.0%	8.5%
DMAS (Medicaid)	14.7%	16.3%	18.3%	21.2%
Public Safety/Comp Board	15.3%	14.6%	14.7%	13.8%
Car Tax	6.0%	6.4%	6.2%	5.9%
Debt Service	2.8%	3.2%	3.7%	3.8%
All Other	4.6%	5.6%	5.7%	6.2%

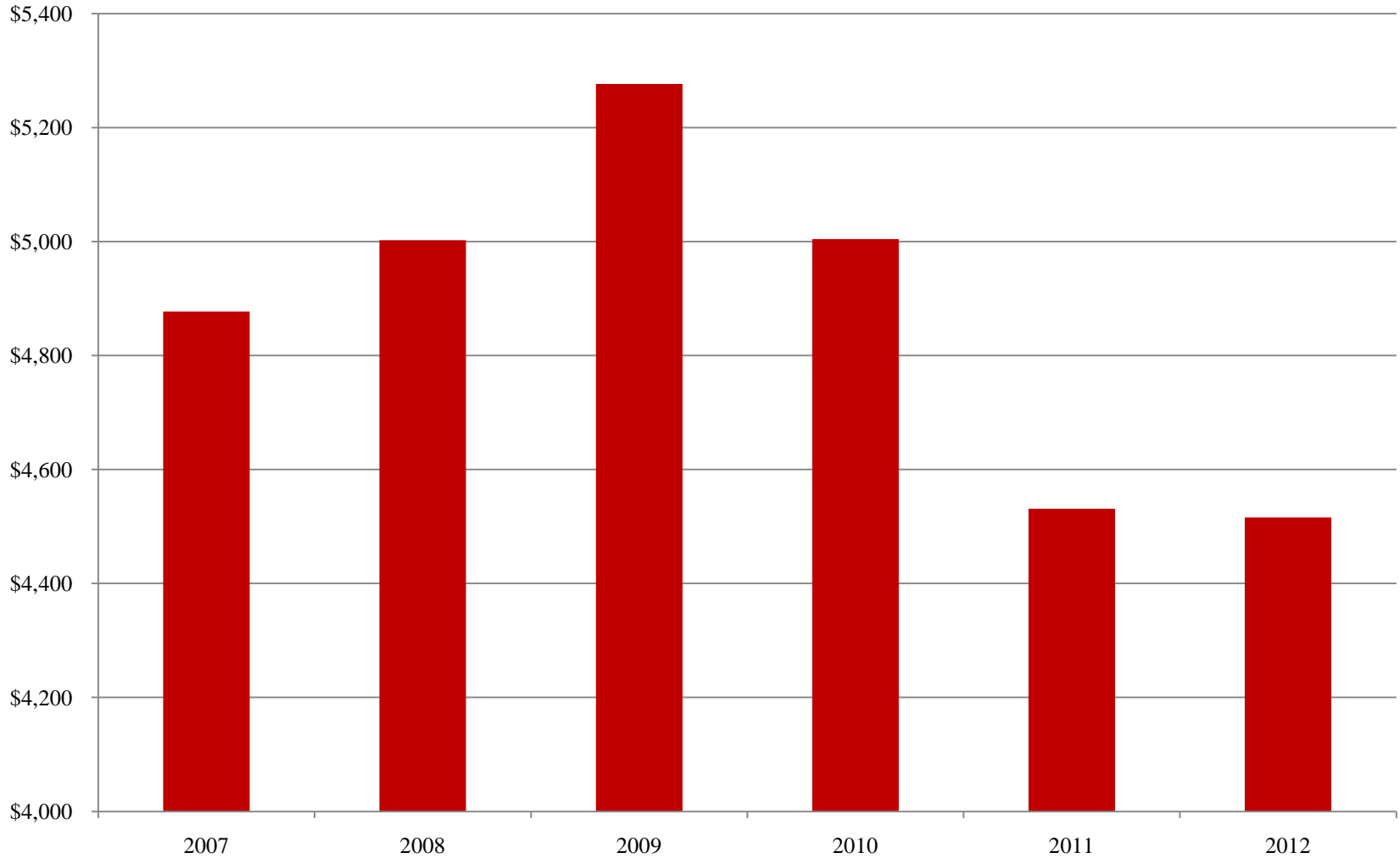
K-12 Funding is Greatest Concern to Localities

- Adopted FY 2010 K-12 state distributions from all funding sources were nearly \$300 million lower than actual FY 2009, even with \$584 mil. in federal stimulus funds.
- Adopted FY 2011 K-12 state distributions from all funding sources (including \$189 million less VRS contributions) are: 1) \$773 million lower than last year's planned FY 2010 distributions and 2) \$512 million lower than this year's adopted FY 2010 distributions.
- Localities are already holding the K-12 education system together to meet SOA and SOL standards by spending **\$3 billion or 82% more per year than required** to match state \$. Local excess is 22 percent of total K-12 spending in state.
- Adopted 2010-12 budget endorsed last year's decision to reduce state support position funding by one-third (\$376 mil. in FY 11) and made numerous further K-12 policy funding reductions.

New Permanent K-12 Changes Adopted in the 2010 Session

- Introduced 2010-12 Budget:
 - Fund health care premium at prevailing participation (\$134 mil./yr.)
 - Eliminate annual/sick leave payments for personnel who terminate employment, capital outlay replacement and a “miscellaneous” category (\$87 mil./yr.)
 - Eliminate non-personnel inflation (\$4.7 mil/yr)
- Additional Support Function Reductions in Adopted Budget (\$100 mil/yr)
 - Include \$0 in division LWA for non-personnel support (\$39 mil/yr)
 - Extend school bus replacement cycle from 12 to 15 years (\$10 mil/yr)
 - Eliminate staff travel, leases/rentals, and facilities from recognized non-personnel support funding (\$35 mil/yr)
 - Increase the federal revenue deduct from 29% to 38% (\$17 mil/yr)
- Lottery Funding Changes Net \$165 mil. (biennial) GF Savings
 - Transfers remedial summer school, ESL, and 2/3 of textbook funding to lottery
 - Eliminates enrollment loss and add'l support for construction and operating costs
 - Limits participation in the K-3 Class Size Reduction Program to schools with free lunch higher than 30 percent

State K-12 Spending per Pupil *



* Includes all state fund sources and appropriated federal stimulus \$

Other State Spending Cuts Will Exert Even More Pressure on Local Budgets

- In Health and Human Resources – CSBs, Comprehensive Services Act, local health services, local social services;
- In General Government – Sheriff’s, Commonwealth Attorney’s, Court Clerks, Treasurers, Commissioners of Revenue, & Finance Directors, Planning District Commissions;
- In Public Safety – Jail inmate policies, per diem support payments, & local police dept. funding;
- In Compensation – VRS retirement/benefit contribution increases;
- In Transportation – Street payments, construction & transit; and
- Increased “Flexible” local reduction.

State Aid to Localities is Falling

Major Categories of State Aid to Localities					
Cumulative Comparison of General Fund Appropriations FY 2008-2012					
Major Direct Aid Categories:	Final FY 08 GF Appropriation	Final FY 09 GF Appropriation	Final FY 10 GF Appropriation	FY 11 GF Appropriation	FY 12 GF Appropriation
K-12 Direct Education Aid	\$5,767,549,297	\$5,607,593,113	\$4,769,832,540	\$4,739,288,334	\$4,903,098,078
Car Tax	\$950,000,000	\$950,000,000	\$950,000,000	\$950,000,000	\$950,000,000
Compensation Board	\$617,869,937	\$648,725,578	\$473,005,983	\$591,640,951	\$581,389,682
Comprehensive Services Act	\$293,606,378	\$299,717,687	\$279,208,772	\$272,234,333	\$274,000,867
Aid to Police Depts (HB 599)	\$215,791,448	\$197,295,927	\$180,824,184	\$178,686,119	\$160,012,837
Flexible State Aid Reduction	\$0	(\$50,000,000)	(\$50,000,000)	(\$60,000,000)	(\$60,000,000)
Major Local Subtotal	\$7,844,817,060	\$7,653,332,305	\$6,602,871,479	\$6,671,849,737	\$6,808,501,464
Total GF Appropriations	\$17,263,027,452	\$15,943,019,335	\$14,787,164,167	\$15,376,985,189	\$16,021,156,894

...And Falling as a Percent of Total GF Appropriations

Major Direct Aid Categories:	FY 08 % of Total GF	FY 09 % of Total GF	FY 10 % of Total GF	FY 11 % of Total GF	FY 12 % of Total GF
K-12 Direct Education Aid	33.4%	35.2%	32.3%	30.8%	30.6%
Car Tax	5.5%	6.0%	6.4%	6.2%	5.9%
Compensation Board	3.6%	4.1%	3.2%	3.8%	3.6%
Comprehensive Services Act	1.7%	1.9%	1.9%	1.8%	1.7%
Aid to Police Depts (HB 599)	1.3%	1.2%	1.2%	1.2%	1.0%
Flexible State Aid Reduction	0.0%	-0.3%	-0.3%	-0.4%	-0.4%
Subtotal	45.4%	48.0%	44.7%	43.4%	42.5%

Existing Spending Pressures

Will Limit New State Aid Spending

- First call on FY 10 \$220 mil. surplus: a) \$82.2 mil. for state employee bonus; b) remaining 10% to WQIF ; c) 2/3 remaining to transportation.
- MOE Medicaid eligibility requirements in new federal health reform voids \$165 mil. in budget savings forcing additional FY 12 budget cuts.
- Continued Medicaid cost & utilization growth, plus new health care bill requirements (additional medicaid eligibility costs state \$100's of millions /yr).
- Constitutional requirement to fill Rainy Day Fund.
 - Requires deposit of half of growth above previous six-year average GF revenue growth.
- VRS contributions for both teachers and state employees will have to be restored. Adopted budget calls for 10 year payback. Employer rates may double.
- Continued growth in debt service requirements.
- Other numerous pent-up demands for additional state funding.
- No appetite for general fund tax increases and additional revenue pressures for transportation.

Significant Additional General Funds Are Necessary to Maintain Current Services When Federal Stimulus Ends

ARRA Stimulus Funding (\$ Mil.)					
	<u>FY 10 ARRA*</u>	<u>FY 11 ARRA*</u>	<u>FY 11 GF Backfill</u>	<u>FY 12 ARRA</u>	<u>FY 12 GF Backfill</u>
Medicaid **	\$746	\$362	\$384	\$0	\$746
K-12 Public Education	\$586	\$126	\$460	\$0	\$586
Higher Education	\$219	\$36	\$183	\$0	\$219
Sheriffs (Bryne Justice)	\$23	\$0	\$23	\$0	\$23
SFSF General	<u>\$109</u>	<u>\$0</u>	<u>\$109</u>	<u>\$0</u>	<u>\$109</u>
Total	\$1,683	\$524	\$1,159	\$0	\$1,683

*Federal ARRA stimulus funds used by Virginia to offset general fund cuts

** DMAS final to Senate Finance Committee 6/14/2010

Note: Does not assume \$417 m FMAP Medicaid extension for last 2 quarters of FY 2011

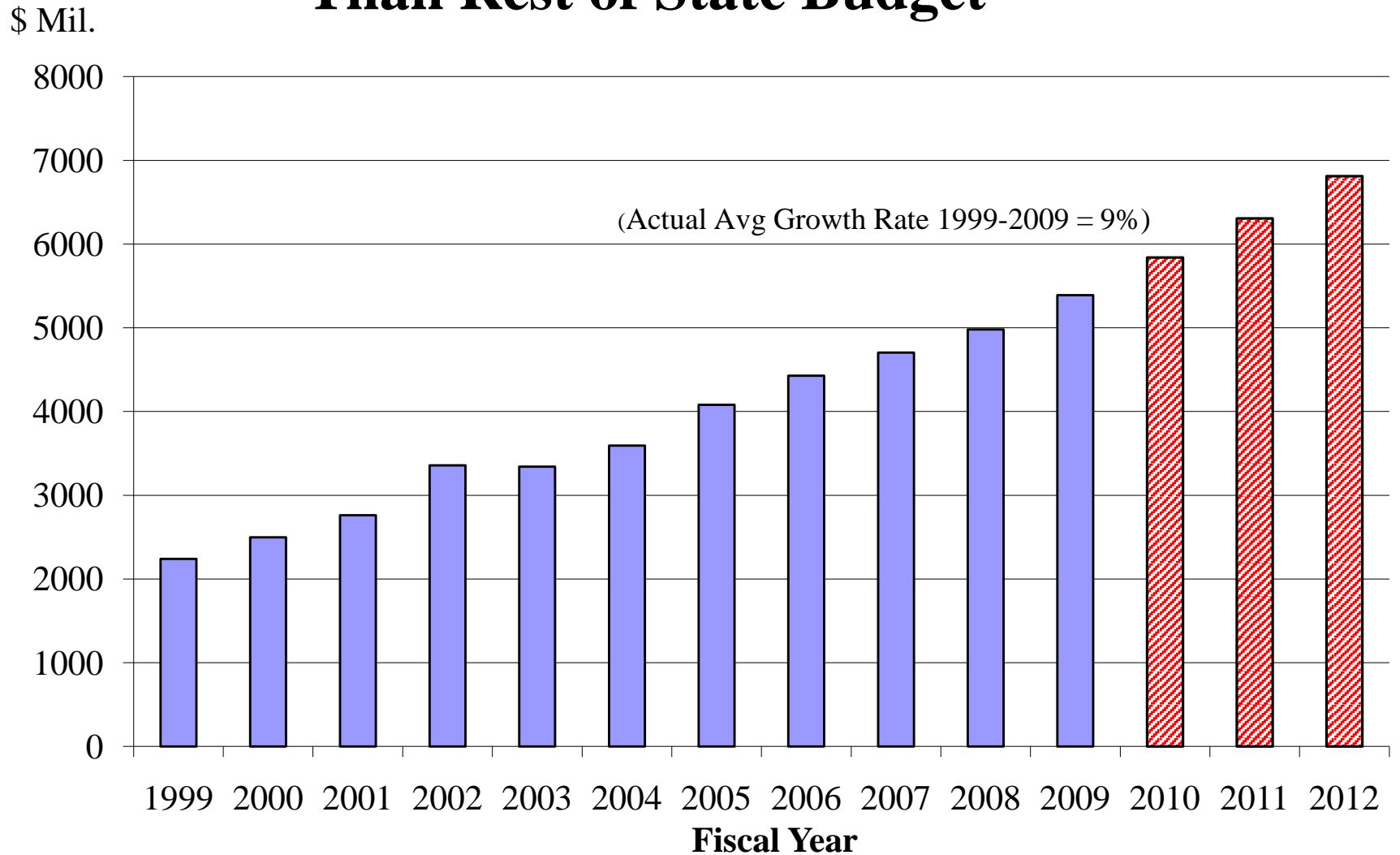
2010-12 VRS Teacher Rates May Triple in Future Biennia

<i>Fall 2009</i>	<i>Spring 2010</i>
<u>VRS Board Certified Employer Rates</u>	<u>VRS Adopted Budget Employer Rates</u>
Retirement* = 12.91%	Retirement* = FY 11: 3.93%; FY 12: 5.16%
Retiree Health Care Credit = 1.08%	Retiree Health Care Credit = 0.60%
Group Life = 1.11%	Group Life = 0.28%
VSDP = 0.66%	VSDP = 0.00%
* Does not include 5% member contribution	

2012-2014:

“In setting the employer retirement contribution rates in subsequent biennia, the Board shall calculate a separate, supplemental employer contribution rate that will amortize the FY 2011 and 2012 contribution shortfalls over a 10-year period using the Board's assumed long-term rate of return. The Governor shall include funds to support payment of such Board-approved, supplemental employer contribution rates in the budget submitted to the General Assembly.”

Medicaid Expenditures Growing Faster Than Rest of State Budget*



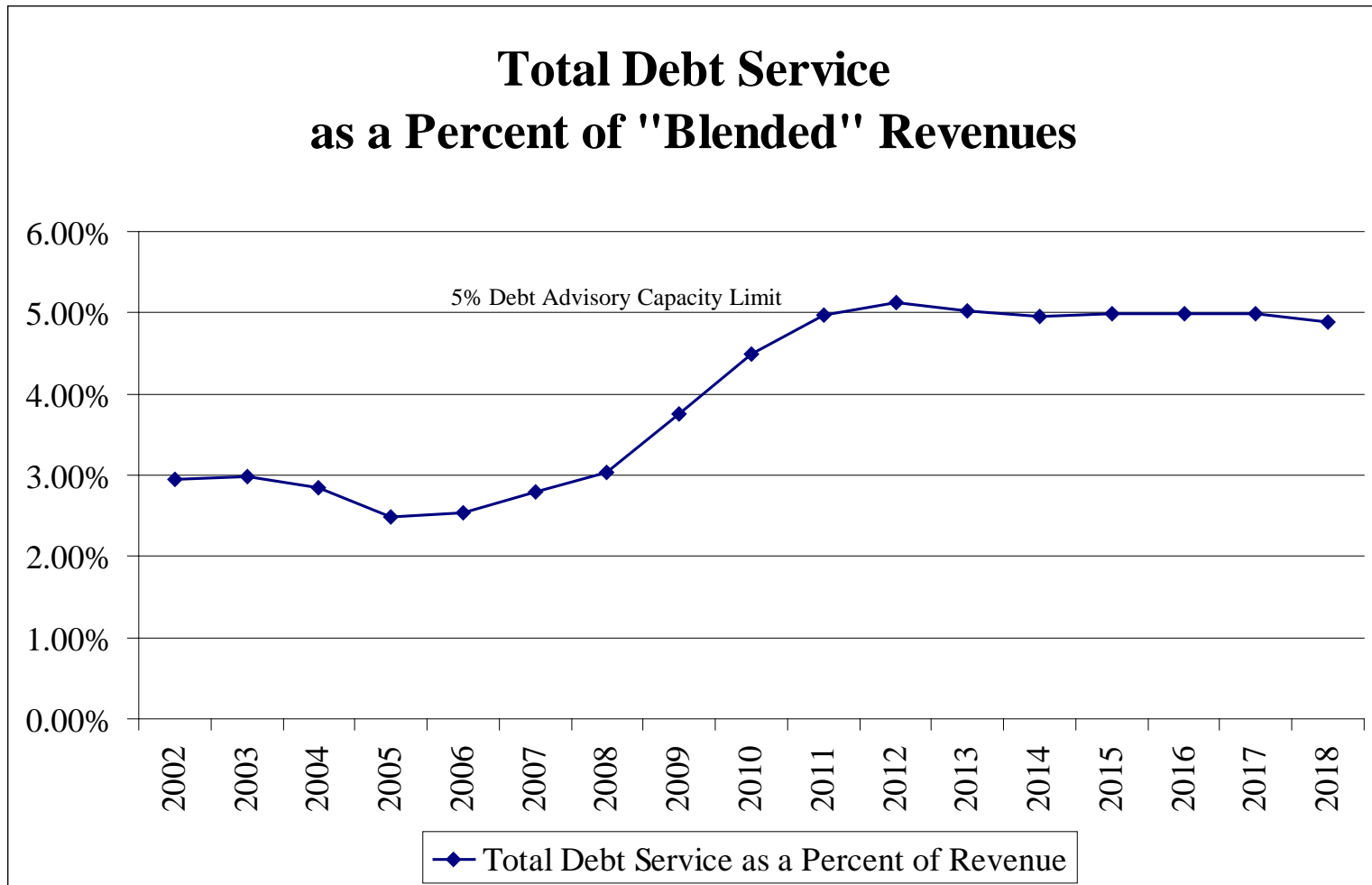
* DMAS forecasted - does not include Medicaid expenditures for MH&MR facilities and CSA = \$361mil. in FY 2008

Estimated State Cost of Federal Health Reform

- DMAS projects state cost of health care reform to be \$2.1-2.8 billion for Medicaid/CHIP between 2014-22.
- Partially offset by est. state savings for primarily pharmacy rebate changes and DSH reductions of \$625 million from 2010-2022.

New Debt Capacity Is Limited...

If Virginia Wants to Keep its AAA Rating



Note: "Blended" revenues include GF and transportation revenues

Source: Debt Capacity Advisory Committee, Dec. 19, 2009 <http://www.trsvirginia.gov/Documents/Debt/DCAC/DCAC2009.pdf>

Recent Major General Fund Tax Changes Have Neutralized 2004 Tax Increase

	<u>FY Implemented</u>	<u>2008-10 (\$ Mil.)</u>
Historic Rehab Tax Credit	1999	(\$92)
Low Income Tax Relief	2000 and 2007	(\$150)
Land Preservation Tax Credit	2003	(\$300)
2004 Tax Reforms	2005	\$1,600
Add'l Reduced Sales Tax on Food	2006	(\$380)
Shift Insurance Premiums and Recordation from GF to Transportation	2009	(\$340)
Estate Tax Repeal	2009	(\$300)
Total		\$38

Local General Fund Revenue Annual Growth Rate*



* Source: APA Comparative Report FY 1990 to FY 2009; VML/VACO survey results for FY 2010

Conclusion

- If economy continues to grow -- plan on level or only slight increases in state K-12 (and other local aid programs) funding over the next several biennia.
- If economy worsens again -- all bets are off.