



FY 2014 - 2016 State Budget Summary Analysis

Key Links

Locality specific funding can be found at the sites below.

[K-12 Public Education](#)

[Constitutional Officers](#)

[Police Departments \(HB 599\)](#)

[TAX](#) (FY 2015 estimates for the local distributions of the Local Option Sales and Use Tax and the State Recordation and Grantor's taxes are unavailable at this time)

The long drawn out budget impasse of the 2014 session of the Virginia General Assembly ended with passage of a state budget by the General Assembly on June 12, 2014 and signature by the Governor on June 21 with several line item vetoes upheld on June 23. The adopted budget does not include an expansion of Medicaid and it includes an amendment designed to prevent the expansion of Medicaid without approval of the General Assembly. The Governor remains committed to moving forward with expansion of Medicaid and will unveil a plan to do so administratively by September 1.

The enrolled budget is also a placeholder that continues to use the February revenue forecast even though it is now known that general fund revenues are not likely to achieve the previous February forecast targets. The reason the General Assembly continues to use the flawed February revenue forecast is that it is necessary to have an adopted budget in place before July 1, 2014 in order to access the state's Rainy Day Fund. An estimated \$350 million revenue shortfall in FY 2014 will trigger a re-forecast for the biennium. If this re-forecast process determines revenues are at least two percent below the official revenue forecast in the newly adopted budget, the use of Revenue Stabilization Funds (Rainy Day Funds) will be allowed. This will help offset a FY 2014 - 2016 shortfall estimated at \$1.55 billion. While the FY 2014 - 2016 enrolled budget does not technically reduce the revenue forecast, it does anticipate the fall revenue forecast reduction by creating a revenue reserve of \$842 million from a series of spending reductions. The remaining \$707 million in reduced revenues are expected to be covered by the state's Rainy Day Fund.

Revenues

The explanation for the now expected FY 2014 - 2016 revenue reduction of \$1.55 billion begins with an expected shortfall of \$350 million in general fund revenues for FY 2014. This expected shortfall did not become apparent until the first two weeks of May, when it became clear that final payments for Tax Year 2013 were going to be \$350 million below what was collected last year for Tax Year 2012. While some reduction in final payments was expected due to tax policy related timing shifts, no one expected a 45 percent reduction in tax due this year when the stock market achieved a 25 percent gain in calendar year (CY) 2013. Apparently, high income taxpayer behavior changes due to the CY 2013 tax rate increases on capital gains were much larger than anyone expected. As seen below, high income taxpayers shifted capital gains into tax year 2012 to avoid the expected tax rate increases in tax year 2013.

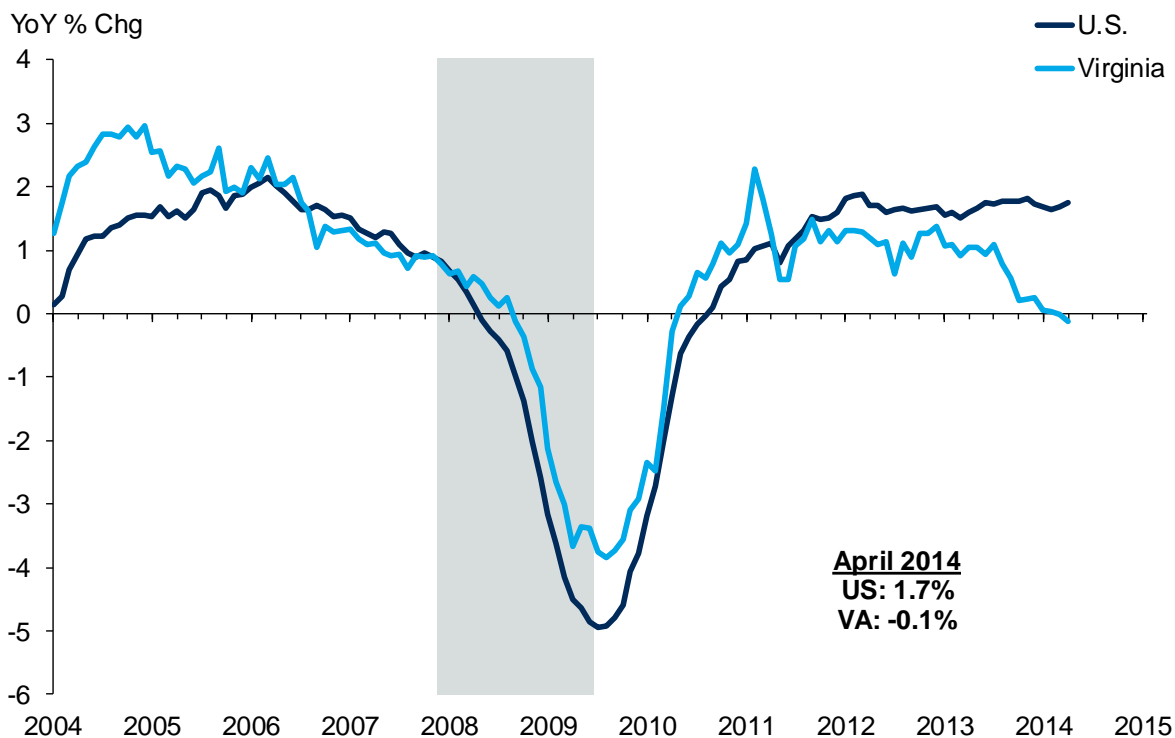
Income Tax Due/Final Payments (\$Millions)

<u>May 2012</u>	<u>May 2013</u>	<u>May 2014</u>
\$444.2	\$776.1	\$433.2

Since the original introduced 2014 - 2016 biennium budget relied on a balance forward of about \$479 million, a FY 2014 revenue shortfall of \$350 million would reduce the balance forward available for the 2014 - 2016 biennium to \$129 million. In addition, if expected growth stays the same for income tax due/final payments, each year of the next biennium would have at least a \$350 million reduction in revenues as well. This accounts for over \$1.1 billion of the expected general fund shortfall.

The second revenue issue for the 2014 - 2016 biennium budget is income tax withholding revenues trends are indicating that FY 2015 and FY 2016 growth of about 4.3 percent growth per year will not be met. Payroll withholding growth is currently running about 2.5 percent and trending down. There is essentially zero year-over-year job growth in Virginia (see chart below), and actually negative growth in high paying business and professional jobs. The job growth that is occurring is in lower paying leisure, hospitality and health care jobs. Virginia payroll trends are the result of Virginia's very high reliance on federal spending – particularly in defense. Virginia ranks #1 among states in federal defense spending per capita; and defense spending in Virginia is falling (CY 2012, \$55 billion and CY 2013, \$41 billion). Therefore, it is likely that the fall revenue re-forecast will lower the growth in the all-important income tax withholding revenues to under 3 percent per year.

Virginia Payroll Employment



Source: Bureau of Labor Statistics/Haver Analytics

5

Major Spending Changes

The table entitled “Pro-Forma 2014-16 GF Budget” on the next page details the actual spending plan adopted by the General Assembly on June 12. The anticipated spending in the FY 2014 - 2016 biennium budget is compared to the actual final appropriations for FY 2014. The table assumes the currently anticipated revenue reductions in all three years (1.55 billion) and the additions of the rainy day fund balances in FY 2015 and FY 2016 (\$707.5 million). The table also removes the temporary revenue reserve contained in central appropriations (\$842.5 million).

Most new spending above the FY 2014 base originally proposed in the introduced budget has been removed except for the following few high-priority categories:

- ✓ funding for K-12 SOQ rebenchmarking
- ✓ funding for Medicaid utilization
- ✓ additional mental health services spending

- ✓ commitment to repayment of VRS short funding from FY 2010-12 budget
- ✓ 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 FY2013 revenue performance)
- ✓ minimized direct impact of cuts on local governments

Changes to the introduced budget to help fill the \$842.5 million revenue reserve also included additional balances and revenue adjustments of about \$177.7 million. This included recapture of \$31 million of GF revenue made to transportation in 2007. Other revenue adjustments included delaying elimination of the accelerated sales tax payment in June 2016 for large retailers (\$29.9 million) in FY 2016 and reinstating early payment for retailers with sales between \$26 and \$48.5 million in FY 2015 (\$20.8 million). Previously approved capital outlay funds were also swept and replaced with debt (\$53 million).

Major general fund spending reductions from the introduced bill included:

- higher education (\$167 million)
- public education (\$104 million)
- health and human services (\$112 million)
- commerce and trade (\$39 million)
- public safety (\$27 million)
- compensation/other (\$168 million)

Pro-Forma 2014-16 Enrolled GF Budget				
		2014 Session Enrolled Budget		
	FY 2014 Adopted Budget (\$ mil.)	FY 2015 (\$ mil.)	FY 2016 (\$ mil.)	FY 15 Change from FY 14
Legislative and Executive Dept's	103.2	109.0	107.2	5.8
Judicial Dept.	425.2	436.4	435.5	11.2
Administration/Comp Board	654.1	675.7	679.1	21.6
Treasury Board GF Debt Service	608.5	682.5	724.0	74.0
Other Finance/Technology	171.9	179.4	181.2	7.5
Rainy Day Fund	339.6	243.2	-	(96.4)
Car Tax Reimbursement	950.0	950.0	950.0	-
Commerce and Trade	183.3	166.5	179.1	(16.8)
Agriculture / Nat. Resources	144.0	182.7	152.4	38.7
K-12 Education/Central Office	5,292.7	5,549.7	5,641.7	257.0
Higher & Other Education	1,782.1	1,858.0	1,858.8	76.0
DMAS Medicaid	3,519.8	3,877.1	4,043.1	357.3
Other Health & Human Services	1,541.5	1,649.2	1,620.9	107.7
Public Safety & Veterans/HS	1,699.0	1,792.0	1,799.8	93.0
Transportation	42.0	13.2	69.1	(28.9)
Central Appropriations*	247.2	112.7	167.5	(134.5)
Independent Agencies/Capital	1.2	1.4	1.2	0.2
Total GF Appropriations	\$ 17,705.3	\$ 18,478.7	\$ 18,610.6	773.4
Available Balance to Spend	\$ 879.7	\$ 276.0	\$ 6.2	
GF Resources**	\$ 16,954.1	\$ 18,484.1	\$ 18,616.4	
Unspent Balance**	\$ 128.6	\$ 5.4	\$ 5.8	
* Net of Reserve		480.0	362.5	842.5
** Anticipated revenue shortfalls	(350.0)	(600.0)	(600.0)	(1,550.0)
** Rainy Day Fund		470.0	237.5	707.5

While there were some significant budget reductions in state aid to localities that will be described in detail later, the state was able to minimize reductions to local government (see following table). The \$104 million in K-12 public education general fund cuts were minimized by replacing \$85 million of the \$104 million in general fund reductions with either additional Lottery revenues (\$35 million), or supplanting teacher retirement general funds with Literary Funds (\$45 million).

However, since spending on items such as Medicaid utilization and debt service continue to outpace growth in general fund revenues, the local relative share of state general fund (and lottery revenues) aid to

localities continues to slide in the 2014-16 biennium from 46.2 percent to 45.7 percent. In pure dollar terms, most areas of state aid for locally-administered programs will be level-funded or see a small increase in the next biennium.

GF/Lottery State Aid to Localities				
	<u>2008-10</u>	<u>2010-12</u>	<u>2012-14</u>	<u>2014-16 (e)</u>
Direct Aid to K-12	\$11,248.0	\$10,550.7	\$11,444.9	\$12,196.0
Health and Human Services	\$1,767.1	\$1,639.5	\$1,610.6	\$1,638.6
Public Safety	\$1,291.1	\$1,356.0	\$1,367.1	\$1,402.0
<i>HB 599 Aid to Police</i>	\$378.1	\$351.1	\$344.8	\$344.8
Constitutional Officers	\$297.5	\$288.0	\$289.3	\$304.9
Car Tax	\$1,900.0	\$1,900.0	\$1,900.0	\$1,900.0
Aid-to-Locality Reduction	(\$100.0)	(\$120.0)	(\$50.0)	\$0.0
Total Local Aid GF + Lottery	\$16,403.7	\$15,614.2	\$16,561.8	\$17,441.5
Total GF + Lottery Appropriations	\$31,600.8	\$32,922.6	\$35,861.4	\$38,124.3
<i>Direct Aid to K-12 % of Total GF/Lottery</i>	35.6%	32.0%	31.9%	32.0%
<i>Total Local Aid % of Total GF/Lottery</i>	51.9%	47.4%	46.2%	45.7%

Budget Items of interest to counties

Compensation and Retirement

The approved budget provided no additional funding for jail per diems, jail overcrowding, salary increases for constitutional officers and their employees. The budget eliminated targeted salary increases for high turnover positions and for career development salary steps. The budget does include a salary adjustment for each assistant Commonwealth's Attorney of \$3,308 effective July 1, 2014.

The budget includes the state share of funding to increase the employer teacher retirement contribution rate to 14.5 percent. This moves the contribution rate from 70 percent to 80 percent of the VRS Board Certified rate and keeps the schedule adopted by the General Assembly in 2012 to phase in full funding of the rates certified by the VRS Board. This rate is scheduled to remain the same over this biennium and then increase to 90 percent of the board certified rate in the FY 2017/18 biennium and 100 percent of the board certified rate in the FY19/20 biennium. Other post-employment benefits (OPEB) funding for teachers were decreased to 90 percent of certified rates. The teacher retiree health credit rate is 1.06 percent, while the group life rate is 1.19 percent (0.71 percent employee; 0.48 percent for employer rate). This will decrease costs for localities this year but increase the unfunded liability of these programs.

The budget restores language that prohibits localities from using Compensation Board funds to supplant local funding required to increase employees' salaries to offset the increase in employee contributions to VRS ("5 for 5").

The budget eliminates any funding increases for state supported local employees pay increases.

Police (HB 599) Funding

The approved budget funds local police departments at the FY 2014 level. All allocations to eligible localities in FY 2015 and FY 2016 match their respective FY 2014 allocations.

Agriculture and Forestry

The budget reduces a proposed increase in funding for agriculture and forestry incentive grants but maintains \$1m a year in grants and \$250,000 a year in planning grants and authorizes an additional \$250,000 in each year from the Governor's Development Opportunity Fund.

Economic and Community Development

The budget provides \$35,000 in FY 2015 to assist the Commission on Local Government in reviewing legislation to determine local fiscal impacts. Additionally, the budget provides \$70,000 each year to restore Planning District Commission (PDC) cuts that were in the introduced budget.

The budget also cuts \$4.0 million each year in the Housing Trust Fund and eliminates \$1.0 million in FY 2016 for developing wind energy.

Education

The budget did not address inflation rates in funding of non-personal support costs (utilities, insurance, etc.). State funding increases in direct aid were approved in the budget (\$752 million) but the cost of competing (COCA) funding for support positions in Northern Virginia localities was eliminated. It should be noted that the budget does not include hold harmless funding due to changes in rebenchmarking.

Funding was eliminated for Opportunity Educational Institution (OEI) in the budget. Also eliminated is the OEI board along with responsibilities that were assigned to OEI by the 2013 General Assembly. The adopted budget has language that prohibits the transfer of schools failing to achieve accreditation to OEI.

The budget provides an additional \$1 million in FY 2015 and \$3.6 million in FY 2016 for the Virginia Preschool Initiative. The FY 2015 funding pays for about 1/3 of the hold harmless slots. The FY 2016 funding is enough to pay for as many slots as were used in FY 2014.

Extended school year funding was increased by \$1 million in FY 2015 and \$2.4 million in FY 2016 to the amount in the introduced budget to provide for start-up grants of up to \$300,000 per school per year and planning grants at \$50,000 per school division.

Finance

The budget eliminates a \$59.9 million deposit in FY 2016 to take into account the downward revisions of the February revenue re-forecast.

The budget does not address nor make any changes to assist localities with the unfunded liability in the teachers retirement plan (VRS), line of duty benefits or the mandated deposits of local fines & fees.

Additionally, the budget cuts \$750,000 each year from the school resource officers program.

The budget provides \$302,151 in FY 2015 and \$212,151 in FY 2016 and 3.0 positions for the state to review local disaster preparedness plans as required by SB 381 and HB 730.

Budget language was adopted from introduced budget bill to not approve or commit additional funds for the state share of the cost of construction, enlargement or renovation of local or regional detention centers, group homes or related facilities. The Department of Juvenile Justice Board may grant exceptions only to address emergency maintenance projects needed to resolve immediate life safety issues.

Health and Human Resources

The budget was not amended to include funding or language that would have increased foster care rates. Funding was reduced \$1.38million in FY 2016 for youth 18-21 years of age who are anticipated to be covered under federal subsidies.

Additionally, funding was reduced by \$347,626 in FY 2015 and \$46,234 in FY 2016 for medical costs related to involuntary mental health commitments. The introduced budget included \$1.4 million the first year and \$1.7 million the second year from a proposed extension of temporary detention orders from 48 to 72 hours. This amendment represents savings from the passage of legislation during the 2014 Regular Session to allow, but not require, a minimum period of detention of up to 24 hours (Chapter 691, 2014 Acts of Assembly). It also reflects the funding required to provide a second two-hour extension of the time during which a person may be held pursuant to an emergency custody order (Chapters 691 and 761, 2014 Acts of Assembly). Language is also added requiring a review of the adequacy of the current rate paid for medical costs associated with involuntary mental health commitments.

The budget reduces funding from the introduced budget in FY 2015 by \$7.8 million (both state and federal funds) for home- and community-based Intellectual Disabilities (ID) and Developmental Disability (DD) waiver slots consistent with the Department of Justice (DOJ) Settlement Agreement. The introduced budget over-funded the number of slots required under the settlement agreement. The settlement agreement dictates that the number of slots created in excess of the "requirement shall be counted towards the slots required to be created in the subsequent fiscal year." In FY 2014, more than 350 ID and 55 DD waivers were created above the settlement agreement's requirement, therefore fewer slots are required in FY 2015.

Other amendments add 15 new DD waivers and funding in FY 2016 to help reduce the waiting list and 50 new ID waivers and funding in FY 2016 to help reduce the waiting list. In both cases, the waivers are above what is required by DOJ.

A floor amendment approved by both the House and Senate but line item vetoed by Governor McAuliffe forbids the appropriation or spending of state or federal funds for expansion of Medicaid to newly-qualified populations under the Affordable Care Act unless those funds are included in an appropriations act enacted after July 1, 2014. The amendment remains in the budget because the Speaker ruled the Governor's veto of this amendment out of order. The Governor objects to the Speaker's ruling and vows to move forward with expansion administratively.

Other actions in the budget include:

- removes \$500,000 each year from Auxiliary Grant payments
- provides \$1.1 million the second year from the general fund and \$1.0 million each year from federal Temporary Assistance to Needy Families (TANF) funds to expand services for victims of domestic violence
- removes language in the introduced budget that required the DSS to prepare a report that was designed to examine the financial, programmatic and policy implications of the state assuming full responsibility for all aspects of the adoption program
- provides \$500,000 in TANF dollars in FY 2015 and \$500,000 in state funds in FY 2016 to expand services provided by Community Action Agencies
- adds \$850,000 from the general fund and \$150,000 in non-general funds in FY 2015 to plan for the eventual replacement of the child welfare and adult services information technology systems

Natural Resources

Language in the budget authorizes DEQ to use available funding to work with Virginia Geographic Information Network to provide better data to support local stormwater programs and activities to manage recurrent coastal flooding.

The budget shifts \$20 million in VPBA bond authority from FY 2016 to FY 2015 for grants to localities for stormwater improvements. Additionally, budget language requires every locality with a stormwater management utility fee to report to DEQ the programs funded by the fees and the expected pollutants removed by each program. The amendment also requires each locality with a stormwater utility fee to certify to the Auditor of Public Accounts in its annual reporting requirements that the funds collected are used in compliance with state law.

The budget provides \$6.5 million (from the Water Quality Improvement Fund) for FY 2015 for grants to local governments to assist with development and management of local stormwater programs.

For the cost-share program for agricultural best management practices (provided through the Water Quality Improvement Fund) the budget reduces funding from \$37.3 million to \$31.3 million in FY 2015. For FY 2016, agricultural cost share funding is reduced from \$19.8 million to \$8.8 million.

Transportation

The budget directs the Secretary of Transportation by December 1, 2014, to recommend methods to provide assistance for local transportation projects.

Courtesy: Jim Regimbal (Fiscal Analytics)

VACo contact:

Dean A. Lynch, CAE dlynch@vaco.org

Deputy Executive Director