

2018 Session Revenue and Budget Outlook

Presentation to the 2018 VML and VACO Finance Forum

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Topics:

- GF Growth Trends and Recap of 2016-18 Biennium
- Highlights of the Governor's Proposed 2018-20 Budget
- Issues/Opportunities/Challenges for the 2018 Session
- K-12 Education Issues

FY 2017 Recap: GF Revenues Beat Forecast By \$134.1 Million

- Gains in withholding and corporate income tax were partially offset by shortfalls in nonwithholding and sales tax.
- Including transfers, the surplus totaled \$136.6 million.

Fiscal Year 2017 General Fund Revenues (\$ in millions)

Major Sources	Actual	Forecast	Variance	Change (%)	
				Actual	Forecast
Withholding	\$11,895.4	\$11,713.3	\$182.1	5.2	3.6
Nonwithholding	3,018.5	3,048.5	(30.0)	(1.7)	(0.7)
Refunds	<u>(1,861.0)</u>	<u>(1,848.0)</u>	<u>(13.0)</u>	<u>2.2</u>	<u>1.5</u>
Net Individual	<u>\$13,052.9</u>	<u>\$12,913.8</u>	<u>\$139.1</u>	<u>4.0</u>	<u>2.9</u>
Sales	\$3,357.1	\$3,386.8	(\$29.7)	1.9	2.8
Corporate	827.0	794.2	32.8	8.1	3.8
Recordation	394.4	398.6	(4.2)	6.9	8.0
Insurance	340.9	344.1	(3.2)	0.5	1.5
All Other	<u>722.9</u>	<u>723.5</u>	<u>(0.6)</u>	<u>1.0</u>	<u>1.1</u>
Total GF Revenue	\$18,695.1	\$18,561.0	\$134.1	3.6	2.9

General Fund Revenue Forecast: 3.7% for FY19, 3.9% for FY20

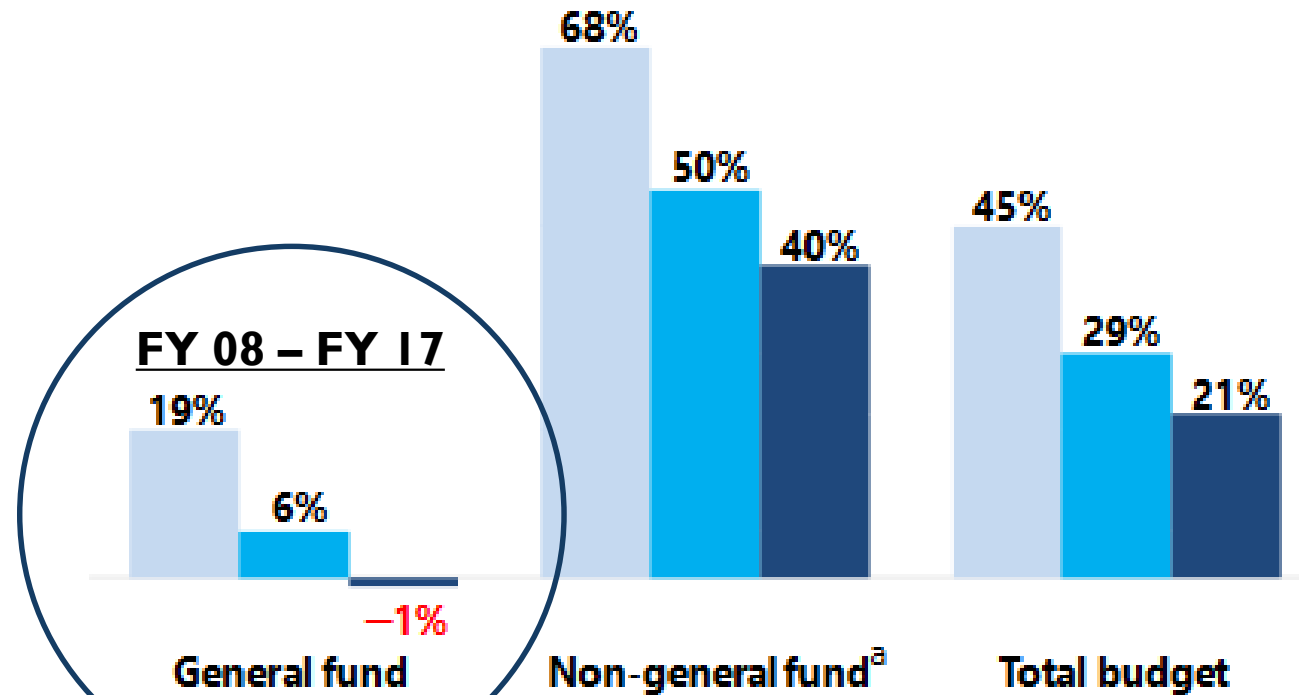
- Employment will continue to expand slowly, but the rate of job growth will decelerate in Fiscal Years 2019 and 2020.
- Tightening labor markets, particularly in high-demand fields (information technology, healthcare, etc.) will lead to improved average wage growth.
- Payroll withholding collections will benefit from increasing wages.
- Sharp increase in corporate income tax collections will moderate, but growth continues.
- Sales tax collections have improved over last year, but growth will remain relatively weak over the biennium.
- Expectations around U.S. tax reform will continue to depress nonwithholding collections temporarily, but will likely be a net positive in FY 2019 and 2020. However, the exact timing and magnitude of the impact is difficult to estimate.
- Federal spending could have a significant impact on state income tax collections. A conservative forecast is appropriate.

After a Decade of Modest GF Growth

GF Average Annual Growth of 2%; Negative if Adjust for Inflation and Population Growth

Change in appropriations adjusted for inflation and population growth, FY08–FY17

Not adjusted Inflation-adjusted Per capita inflation-adjusted



SOURCE: Appropriation Acts; U.S. Census Bureau; U.S. Bureau of Labor Statistics.

^a Increases in non-general funds reflect the budget including a specific appropriation amount for ISFs starting in FY15.

Source: JLARC, 2017 State Spending Report

Recap of the Current Biennium (2016-18 Biennium)

Tale of Two Sessions

Sound 2016 Budget Actions Mitigated Impact of FY 16 Shortfall

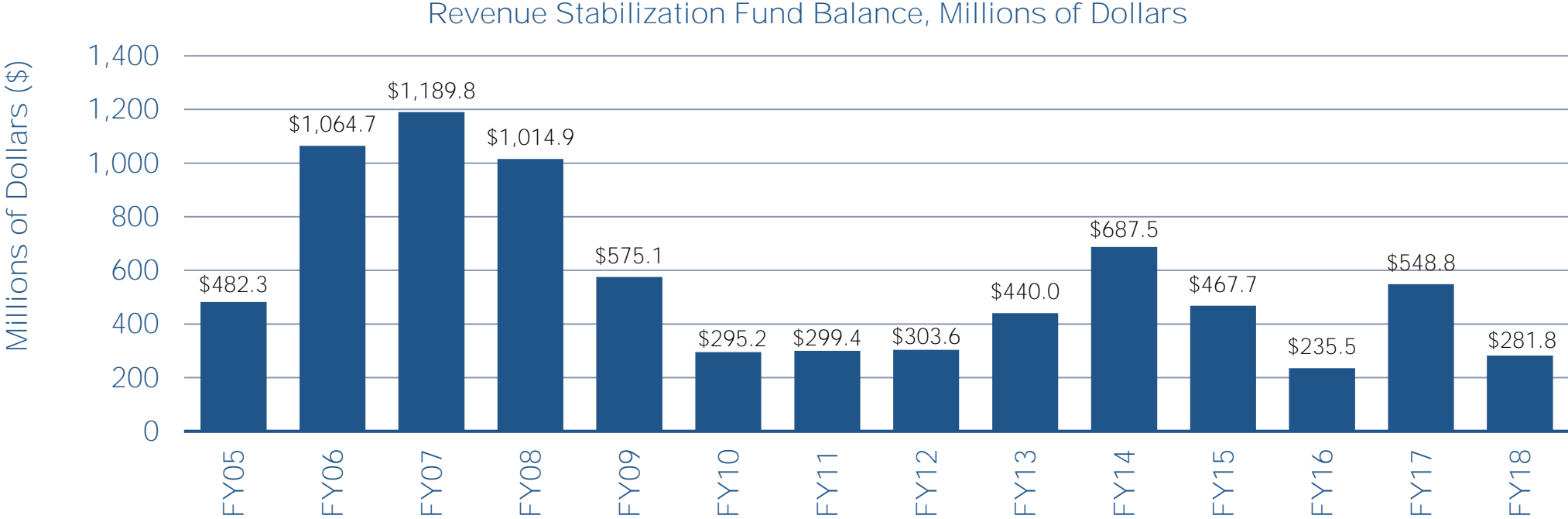
- **2016 Session.** *Adjourned in March 2016 with an adopted Conference Report for HB 30 that provided \$3.4 billion above the base budget – to cover growth in major budget drivers and allow for new investments in economic development and research, along with a renewed emphasis on structural balance (VRS obligations).*
- **2017 Session.** *Opened in January 2017 with introduced budget nearly \$1 billion less in forecast revenue.*
 - Revenue growth did not improve in the final quarter of FY 2016, resulting in \$279.3 million shortfall that led to the ripple effect in FY 2017 and FY 2018.

Strategies to Close the 2016-18 Budget Gap

- *Many actions were included in October 2016 budget reduction plans for FY 2017 and then extended into FY 2018 in the amended budget:*
 - ***\$567.2 million withdrawal from the Revenue Stabilization Fund.***
 - ***\$347.2 million by eliminating Dec. 2016 contingent salary actions (in effect they were delayed until FY 2018).***
 - ***\$175.5 million in across-the-board reductions to state agencies and institutions of higher education.***
 - ***\$89.5 million from a Tax Amnesty program.***
 - *\$58.0 million Literary Fund/GF Offset to Teacher Retirement.*
 - *\$52.3 million in additional Lottery revenue.*
 - *\$47.9 million by slowing the elimination of the Accelerated Sales Tax (AST).*
 - *\$43.5 million to recover Higher Education NGF share of VRS savings.*

Use of Rainy Day Fund to Help Close the Budget Gap

- There was a required deposit of \$605.6 million in FY 2017, based on FY 2015 revenue growth.
- **Budgeted withdrawals of \$294.7 million in FY 2017 and \$272.5 million in FY 2018.**
- APA certifies no mandatory deposit in FY 2019, but FY 2018 balance is well short of the \$1 billion withdrawals that were utilized in the 2002, 2008, and 2015-2017 rounds of withdrawals.



- In April 2017, S&P issued a “negative” outlook (from “stable”) for Virginia’s AAA rating, citing concerns about the budgeted withdrawals from the Revenue Stabilization Fund.

Other Budget Actions in 2017 Session

- *In addition to eliminating the shortfall, the General Assembly:*
 - *Restored in the second year of the budget, the delayed across-the-board compensation increase as well as targeted initiatives.*
 - *Maintained commitment to annual full funding of VRS contributions.*
 - *Advanced the GO Virginia initiative to enhance regional cooperation in economic development.*
 - *Initiated an early warning system to identify localities that may be experiencing financial distress and established a Joint Subcommittee on Local Fiscal Stress.*
 - ***Created a Revenue Cash Reserve of \$35 million, and directed that half of any FY 2017 revenue surplus be set aside to increase the cash reserve.***

FY 2017 Ended with \$134.1 million Revenue Surplus

- Chapter 836 called for at least 50 percent of any FY 2017 revenue surplus, not required for the Rainy Day Fund or the Water Quality Improvement Fund (\$13.4 million), to be placed in a Cash Reserve to help address revenue shortfalls or federal budget actions = **\$60.4 million.**
 - Continued use of the “collar” on the nonwithholding forecast mitigates volatility risk and contributed to the surplus.
- Remaining surplus is reserved by the Comptroller for a Capital Projects Reserve (one-time spending) = **\$60.4 million.**

FY 2018 Increases From Ripple Effect of FY 2017 Surplus

- In addition to the unappropriated balance of \$8.4 million from Chapter 836 (2017 Appropriation Act), the introduced budget includes additional FY 2018 resources of \$294.4 million.
- After addressing budget pressures in FY 2018 of \$101.2 million, a net balance of \$201.6 million is proposed as the starting point for 2018-20 biennium.

Two Budget Bills

- In even-numbered sessions, action is taken to amend the current year budget (FY 2018) and to adopt a budget for the biennium that starts July 1, 2018.
- **HB/SB 29 (“Caboose Bill”)** – Amends the CURRENT budget (Ch. 836) to reflect revised revenue estimate, required spending, and any savings in FY 2018.
 - Goes into effect when signed by the Governor.
- **HB/SB 30** – the proposed biennial budget for the next two fiscal years, FY 2019 and FY 2020.
 - Goes into effect on July 1, 2018.

Proposed Amendments to FY 2018

Major Spending and Savings Proposed	(GF, \$ in Millions)
Revenue Cash Reserve	\$121.4
Medicaid Utilization and Inflation	86.7
Inmate Medical	5.0
Others Spending Adjustments	<u>25.0</u>
Total Spending	\$238.1
K-12 Direct Aid: Additional NGF Lottery Proceeds	(52.0)
Health Care Fund Revenues	(40.5)
Debt Service Refunding	(24.3)
Other Savings Adjustments	<u>(20.1)</u>
Total Savings	(\$136.9)
Net Adjustments	\$101.2

Turning to the Next Biennium
2018-20 Biennial Budget

Highlights of Governor's Budget

- Uses Chapter 836, enacted in April 2017, as the starting point.
- **Resources:** Proposed 2018-20 budget includes \$42.5 billion GF resources available for appropriation.
 - Includes a few tax policy actions totaling \$19.1 million (federal conformity, expanding audits, and payroll breach notification).
- **Spending:** Includes a **net** increase of \$1.8 billion:
 - \$2.5 billion in spending offset by \$700 million in savings.

Major Spending Proposed

Major Spending Proposed	(GF, \$ in Millions)
Medicaid Utilization and Inflation	\$575.8
Update Costs of K-12 Standards of Quality	481.0
Revenue Cash Reserve	270.7
State Employer Health Insurance	118.2
2.0% FY20 Salary Increase (State, State-Supported, Teachers)	100.7
Children's Services Act	54.2
Higher Education Need-Based Financial Aid	45.5
Additional Waiver Slots Required by DOJ Settlement	45.0
Net Additional Debt Costs	39.2
Inmate Medical	38.3

Major Savings Proposed

Major Savings Proposed	(GF, \$ in Millions)
Medicaid Expansion	(\$427.5)
Capture PreK Nonparticipation (Ch. 836 Rate)	(47.9)
Training Center Closures	(27.6)
Health Care Fund	(18.7)
VRS Employer Rates	(13.4)

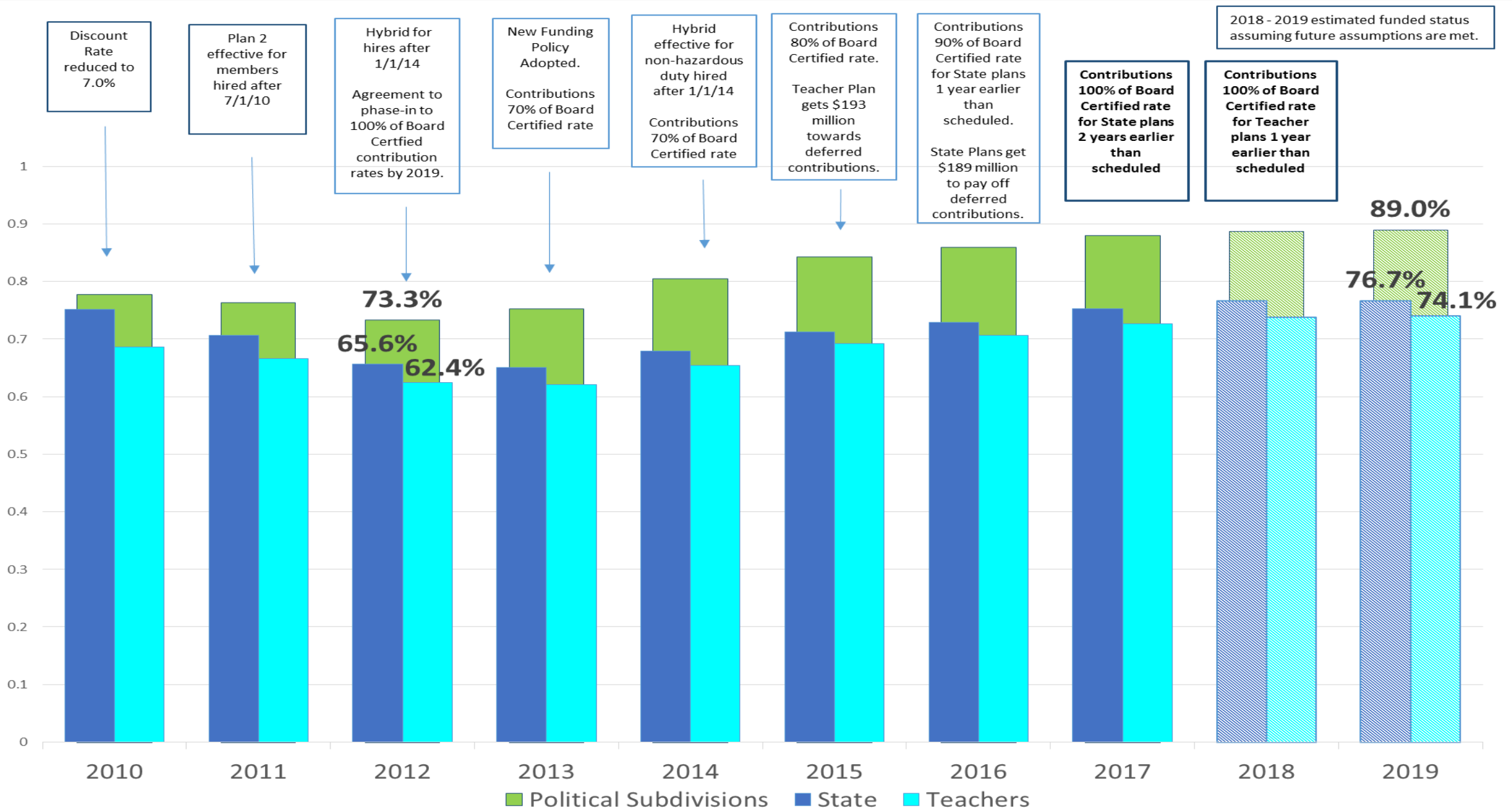
Some Relief on Retirement (VRS) Contribution Rates

- Three factors – strong investment returns of 11.7 percent for FY 2017, full payment of annual employer contributions, and reduced plan costs from pension reform – have contributed to significant improvement in the retirement plans' funded status and budgetary relief on rate changes.

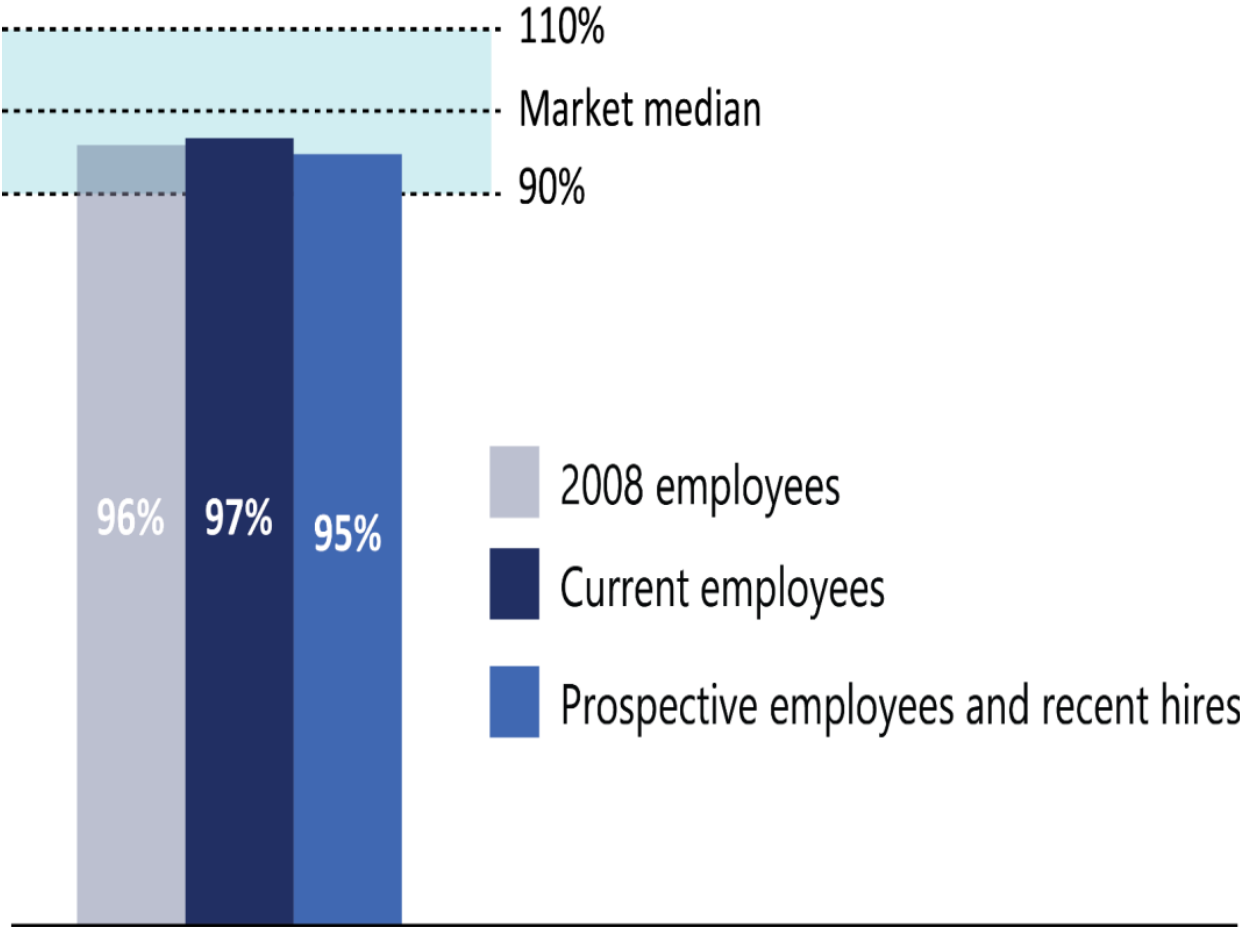
	General Assembly Approved Rate (FY 2018)	VRS Board Approved Rates (2018-20 Biennium)	Change
Teachers	16.32%	15.68%	(0.64%)
State	13.49%	13.52%	0.03%
VaLORS	21.05%	21.61%	0.56%
SPORS	28.54%	24.88%	(3.66%)
Judicial	41.97%	34.39%	(7.58%)

* Approximately 2/3 of the employer rates are due to amortizing the unfunded liability.

VRS Funded Status Steadily Moving Up



Total Compensation Should Continue to Be Addressed Strategically



Source: Joint Legislative Audit & Review Commission (JLARC)

2017 JLARC Report Key Findings:

- Combination of salary and benefits is comparable to other Virginia employers on average.
- Salaries are slightly below market median, while benefits are above market median.
- Competitive starting salaries are key for recruitment, and regular salary growth improves retention.
- State could strategically spend funds on targeted salary increases for jobs with greatest recruitment and retention challenges.

Budget Challenges of the 2018 Session

- Proposed Medicaid expansion and the hospital provider assessment account for \$427.5 million of savings in the proposed budget.
- Proposed allocations to the Cash Reserve of \$392.1 million total.
- Proposes \$729.8 million in debt to be authorized for Capital Outlay.
- Agencies submitted \$2.6 billion in budget requests, many of which are not included in the proposed budget.
- Next proposed salary actions (\$100.7 million) would be effective in Nov. or Dec. 2019 – more than 18 months after the Session concludes.
- Many other issues with smaller dollars and/or complicated issues.

Next Steps

- General Assembly convenes: Wednesday, January 10
 - Revenues will be monitored throughout the session, with a potential mid-session re-forecast in mid-February.
- Senate and House report their budgets on Sunday, February 18.
- Sine Die (last day of session): Saturday, March 10
- Reconvened Session: Wednesday, April 18

K-12 Re-benchmarking and Overview of Teacher Supply & Demand Issues

Recent K-12 Budget Issues

2016 Session

- Re-benchmarking,
- Phase-in of VRS rates,
- Additional Positions (proposed),
- At-risk add-on,
- Cost of competing adjustment,
- Governor's Schools formula,
- CTE equipment,
- Early childhood, and
- **Alternative teacher compensation.**

2017 Session

- Enrollment Loss,
- **2% salary increase,**
- Lottery per pupil amount, and
- **Teacher residency programs.**

2018 Session Proposed Direct Aid Budget, As Introduced

Major Proposed Spending (GF \$ in Millions)	FY 2019	FY 2020	Total
Re-benchmarking	\$216.5	\$264.5	\$481.0
State's Share of 2% Compensation Increase	0.0	51.3	51.3
FY 2019 "No Loss" Funding	11.5	0.0	11.5
Funding a Full-Time Principal in Small Elementary Schools	0.0	7.7	7.7
Expand At-Risk Add-On Range to 14.0%	0.0	7.1	7.1
Extend FY 2018 Governor's School Funding Policy	1.3	1.3	2.6
Increase Positive Behavior Intervention and Support (PBIS)	0.5	0.5	1.0
Establish a New Fund for Principal Recruitment & Retention	0.5	0.5	1.0
New Cyber Security "Camps"	0.5	0.5	1.0
Other Actions	(0.4)	(0.1)	(0.5)
Apply PreK Nonparticipation Rate (25.4%, same as Ch. 836)	<u>(23.9)</u>	<u>(24.0)</u>	<u>(47.9)</u>
Total	\$206.5	\$309.4	\$515.9

K-12 Re-benchmarking

- Re-benchmarking is the formula-driven (“technical”) cost adjustment to meet the SOQ minimum staffing requirements and related support services (updates from FY 2014 to FY 2016 base year actual data).

(\$ in millions)		Preliminary Estimate (September)	Revised Total	Percent Change Over Prior Year
FY 2018 Base Budget	\$6,761.5			
FY 2019		235.0	216.5	3.2%
FY 2020		<u>256.8</u>	<u>264.5</u>	0.7%
Biennial		\$491.8	\$481.0	

Local Average Annual Growth Has Exceeded State, FY 07 – FY 16

(\$ in Millions)	FY 2007	FY 2016	% Change	Avg. Ann. % Change
State	\$5,616.2	\$6,202.2	10.4%	1.1%
Local	6,114.8	7,782.6	27.3%	2.7%
Federal	<u>848.3</u>	<u>1,038.1</u>	<u>22.4%</u>	<u>2.3%</u>
All Sources	\$12,579.2	\$15,022.9	19.4%	2.0%
Source: VDOE, Superintendent’s Annual Reports				

Re-benchmarking Updates

(\$ in Millions)	FY 2019	FY 2020	Total
Prevailing Salaries & Other Personnel Related	\$95.6	\$95.6	\$191.4
Non-personal (Textbooks, Transp., Inflation)	73.0	\$75.6	148.6
Student Enrollment Projections	27.6	37.8	65.4
Health Care Premium	29.0	29.0	58.0
All Other Updates	<u>9.8</u>	<u>18.5</u>	<u>28.3</u>
As of September	\$235.0	\$256.8	\$491.8
Projected Sales Tax and School Aged Population	17.1	30.8	47.9
Local Composite Index	(0.8)	(0.9)	(1.7)
Proj. ADM Based on Fall Membership, Other Updates	(7.1)	(4.4)	(11.5)
VRS, RHCC, GL Rates	(22.5)	(22.6)	(45.1)
Lottery Revenue Forecast	(40.2)	(40.2)	(80.4)
Literary Fund Forecast and Backfill with GF	<u>35.0</u>	<u>45.0</u>	<u>80.0</u>
Revised Total	\$216.5	\$264.5	\$481.0

2018 Outlook

- Board of Education Proposed Revisions,
 - Including counselors, psychologists, social workers, and nurses.
- Special Education Regional Tuition,
- H.S. Redesign and Dual Enrollment,
- Virtual Education and Charter Schools,
- Joint Committee on the Future of Elementary & Secondary Education, and
- **Early Childhood (Dec. 2017 JLARC),**
- **Teacher Supply and Demand Issues.**

Joint Legislative Audit and Review Commission (JLARC)

Study on Early Childhood (Dec. 11, 2017)

Findings

- One-third of entering kindergarteners may not be fully ready, but no statewide data
- Voluntary home visiting is generally effective, but hindered by unstable funding
- VPI improves literacy, but needs stronger quality assurances
- Child Care Subsidy program includes few features to promote quality

Recommendations

- Require more comprehensive kindergarten readiness assessments and more useful data
- Improve data to ensure effective use of funds
- Increase VDOE role in ensuring quality

Options

- Pilot tiered child care reimbursement rates based on quality
- Eliminate state tax deduction (\$28.9 million total, average family benefit is \$141 per year) to fund improvements in early childhood development programs

Teacher Supply & Demand

What's the Issue?

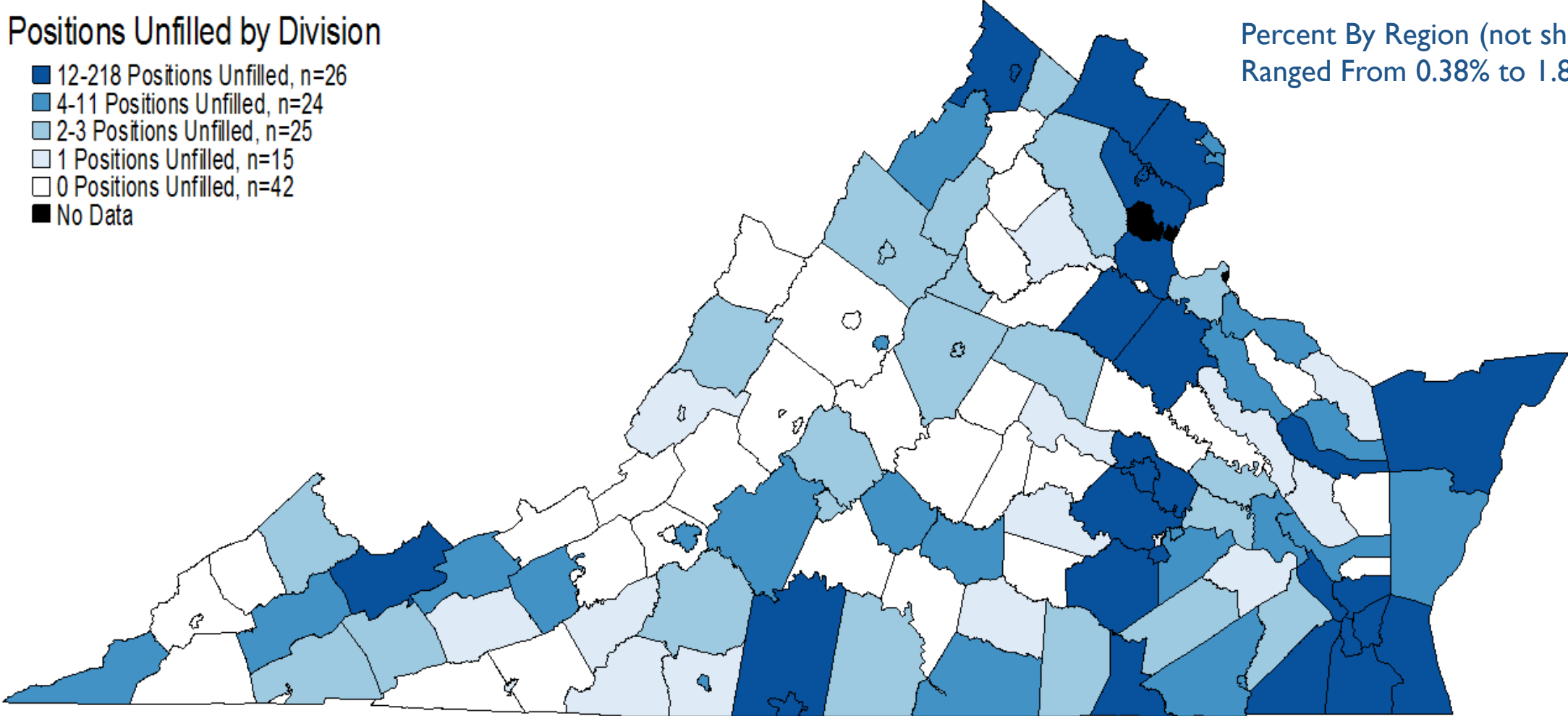
- Some localities face challenges in hiring enough qualified teachers.
 - Example: In Central Virginia, Petersburg and Richmond each had more than 50 unfilled teaching positions as the school year opened.
- Since teachers are central to education -- recruiting, retaining, and rewarding effective teachers is at the core of the success of the enterprise.
- Teacher supply and demand is a complex equation involving licensure/preparation, compensation, working conditions, and class size.

Over 1,000 Unfilled Positions

Positions Unfilled by Division

- 12-218 Positions Unfilled, n=26
- 4-11 Positions Unfilled, n=24
- 2-3 Positions Unfilled, n=25
- 1 Positions Unfilled, n=15
- 0 Positions Unfilled, n=42
- No Data

Percent By Region (not shown)
Ranged From 0.38% to 1.82%



Source: Virginia Department of Education, September 2017 Presentation (Fall 2016 Data)

Some School Divisions Have Over 5 Percent Unfilled Positions

Divisions with Largest Teacher Shortages

Top 10 Divisions with Highest Percent of Unfilled Positions vs. Highest Number of Unfilled Positions
2016-2017

Top 10 Divisions with Highest % Unfilled Positions	2016	
	Shortage %	# Unfilled Positions
Middlesex Co Pblc Schs	20.3%	20
Petersburg City Pblc Schs	13.9%	47
Danville City Pblc Schs	10.1%	47
Bland Co Pblc Schs	8.6%	6
Greensville Co Pblc Schs	6.7%	13
Caroline Co Pblc Schs	5.4%	13
Martinsville City Pblc Schs	4.9%	9
Appomattox Co Pblc Schs	4.5%	8
Bath Co Pblc Schs	4.4%	3
Dinwiddie Co Pblc Schs	4.4%	15

Top 10 Highest Divisions with Highest # of Unfilled Positions	2016	
	# Unfilled Positions	Shortage %
Fairfax Co Pblc Schs	218	1.4%
Prince Wm Co Pblc Schs	61	1.0%
Richmond City Pblc Schs	53	3.2%
Norfolk City Pblc Schs	53	2.2%
Petersburg City Pblc Schs	47	13.9%
Danville City Pblc Schs	47	10.1%
Suffolk City Pblc Schs	44	4.0%
Loudoun Co Pblc Schs	34	0.6%
Chesapeake City Pblc Schs	24	0.9%
Portsmouth City Pblc Schs	23	2.2%

Source: Preliminary Report from the Advisory Committee on Teacher Shortages, October 2017

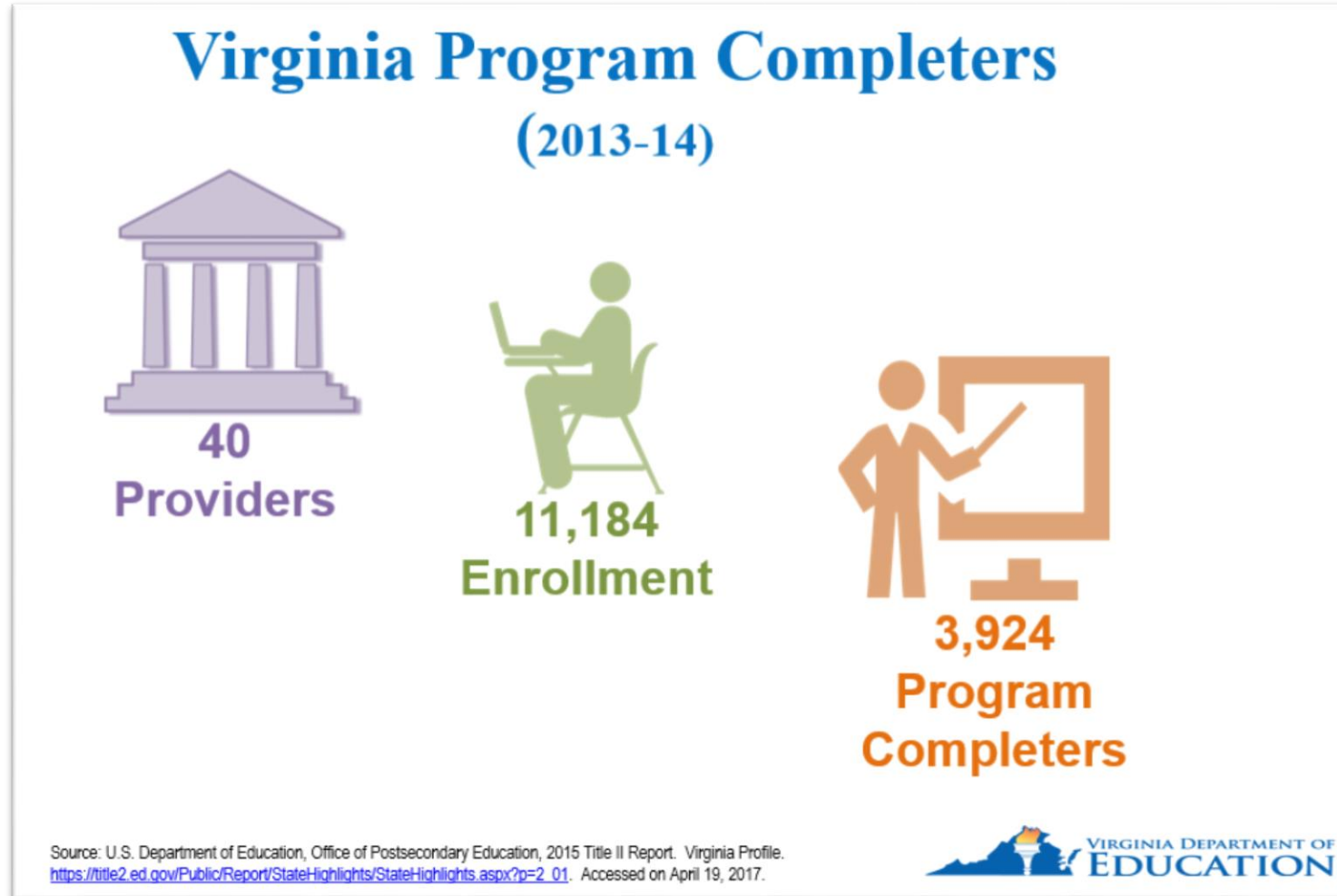
Areas of Concern Related to Recruitment and Retention

- 2015 legislatively-requested study of shortages of qualified teachers, generally and in certain endorsement areas by VDOE/SCHEV.
 - Impact of teacher turnover.
 - Recommended local “Grow Your Own” and “Teach for Tomorrow” programs targeting high school students.
- Spring 2017, VDOE/SCHEV (Cannaday-Minor) working group on Teacher Shortages.

Area of Concern	Reason for Concern
Pathways	The current pathways are cumbersome and impractical for the modern needs of our schools.
Transition/ Induction	New teachers need help with management strategies, curriculum development and navigating the administrative side of teaching as they transition from the classroom to teaching.
Compensation	There are few financial incentives attracting candidates to the teaching profession and inadequate incentives enticing teachers to remain in the field. Student loan debt is also a major factor for graduates looking to enter the workforce.
School Climate	Working conditions play a significant role in attrition, transferring to other schools, or leaving the profession entirely.
Retention	While teacher retention is challenging in many of Virginia’s school divisions, teacher attrition is particularly acute in some schools and subject areas.

Source: Preliminary Report from the Advisory Committee on Teacher Shortages, October 2017

There is Concern about Declining Enrollment in Teacher Education Nationally and Potentially in Virginia



Source: October 24, 2017 VDOE Presentation

Pathways

Issue of Undergraduate Programs with Education Majors (vs. Arts & Sciences Majors)

Public Colleges	PreK-6	Private Colleges	PreK-6	Private (continued)	PreK-6
CNU	G	Sweet Briar	G	Lynchburg	U
GMU	G	Emory & Henry	U,G	Randolph	U
JMU	G	Hampton	U,G	Randolph Macon	U
ODU	G	Hollins	U,G	Roanoke	U
UMW	G	Liberty	U,G	Univ. of Richmond	U
UVA	G	Mary Baldwin	U,G	Virginia Union	U
VCU	G	Marymount	U,G	Virginia Wesleyan	U
VT	G	Regent	U,G	Washington & Lee	U
CWM	U,G	Shenandoah	U,G	G = Graduate Program U = Undergraduate Program Source: SFC Staff Analysis of VDOE, October 27, 2017 Report	
LU	U,G	Averett	U		
NSU	U,G	Bluefield	U		
RU	U,G	Bridgewater	U		
VSU	U,G	Eastern Mennonite	U		
UVA-W	U	Ferrum	U		

Virginia Needs to Examine the Multiple Factors That Influence a State's Teacher Supply & Demand

Selected Indicators, Selected States	Compensation		Teacher Turnover	Working Conditions			Teacher Qualifications	Index of Key Factors	
	Average Starting Salary (2013)	Wage Competitiveness Ratio (Teachers to Non-Teachers) (2012)	% Planning to Leave As Soon As Possible (2012)	% Who Feel Supported by Admin. (2012)	% Worried About Job Security Because of Testing (2012)	% Who Feel Autonomy in Their Classroom (2012)	Pupil-Teacher Ratio (2014)	% of Teachers Not Certified (2014)	Teaching Attractiveness Rating
PA	\$41,901	80	4.4	45	13	76	14.5	0.5	3.9
Mass.	\$40,600	69	3.5	45	7	78	13.6	2.4	3.2
NC	\$30,778	67	9.2	53	9	69	15.4	0.3	2.7
VA	\$37,848	63	10.2	48	8	65	14.1	3.5	2.6
FL	\$35,166	73	9.3	52	25	58	15.3	4.2	2.3
MD	\$43,235	75	10.9	41	15	59	14.8	3.2	2.2
US	\$36,141	74	6.6	48	12	77	16.1	1.9	-

SFC Staff Analysis of Appendix B: State Indicators Influencing Supply and Demand, Learning Policy Institute, September 2016.

Advisory Committee on the Teacher Shortage (ACTS)

- October 2017 report: “An array of initiatives is needed to address the multifaceted root causes of teacher shortages.”
- 5 priority recommendations from among the 31 listed:
 - 1) Stackable pathways from middle school into the profession (including dual enrollment),
 - 2) Four-year undergrad major in teaching,
 - 3) Awareness of federal loan forgiveness and income-driven repayment (IDR) programs,
 - 4) Establish a Commonwealth Teaching Fellows Program (competitive scholarship, serve in high need areas), and
 - 5) State funding for differential compensation or retention bonuses.
- Areas for further study next year
 - Mentorship and principal training programs.

What Can/Should the State Do?

- **Gain better understanding of the multiple causes and the extent of the issue.**
 - Are vacancies “just the beginning” of more widespread shortages of effective teachers, or are they mostly a symptom of challenged, low-performing school divisions?
- **In the meantime, build on, refine and re-evaluate the effectiveness of things Virginia has already done. Options include:**
 - Revamp the Virginia Teaching Scholarship Loan Program.
 - Continue to support Teacher Residency Programs that prepare committed students and other alternative programs like Career Switchers, Teach for America, and the Virginia Reading Corps in attracting graduates to the profession.
 - Re-institute the Great Virginia Teach-In recruitment fair or similar regional fairs.
 - Evaluate impact of different approaches to Compensation.
 - Use distance learning where possible to link available, qualified teachers with classroom needs.
- **As Virginia continues to explore new approaches for the future of elementary and secondary education, develop longer-term strategies for elevating the teaching profession, including maximizing the impact of the very best teachers and providing schools and districts with results-based flexibility.**