

Virginia's Budget Choices

VACo Conference

Fiscal Analytics, Ltd.

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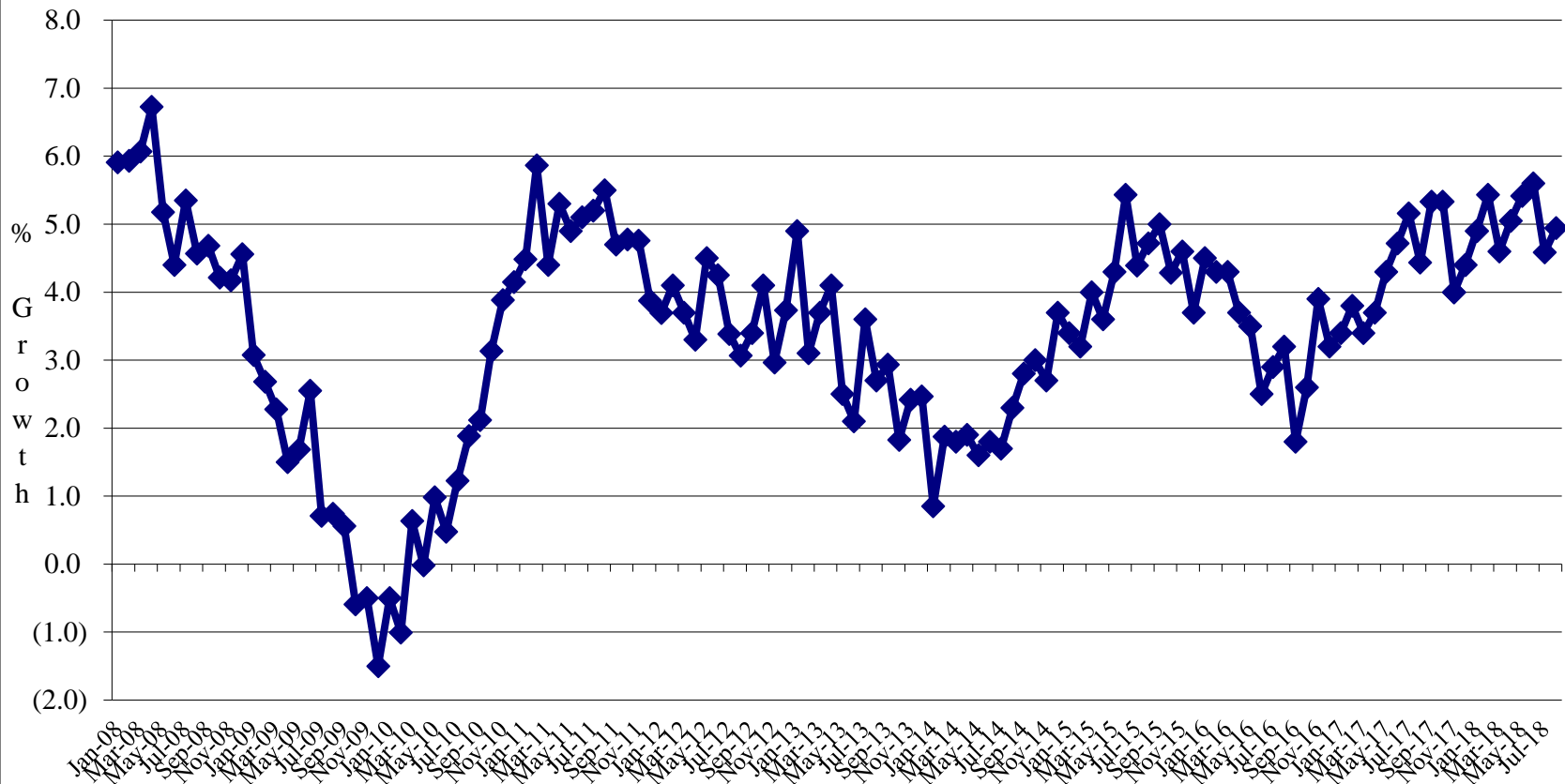
2018-20 GF Revenues Healthy, But There are Budget Holes to Fill

- **Unfunded 2018-20 state budget needs are in the \$900 mil. range.**
 - Last years' budget expected estimated \$371 mil. in Medicaid expansion savings, but expected managed care savings have not materialized. **New Medicaid forecast raised by \$462.5 mil.**
 - Additional Medicaid disallowances and deferrals could cost over \$100 m; VITA Northrup Grumman settlement - \$100 m; Micron expansion tax incentives - \$70 m; Hurricane Florence costs; other agency obligations and capital needs.
- The administration and GA prioritized **reserving most of the \$555 million FY 18 surplus** to increase liquidity and preserve state AAA debt rating. By FY 2020, over \$1 bil. in state reserves are budgeted, or about 5% of GF revenues.
 - Some policymakers would like to increase reserves to 8-10% of GF revenues.
- **FY 2019 budget only needs 1.4% GF revenue growth. Current growth trends are in the 4 percent range. \$1 bil. in additional 2018-20 revenue is possible.**
 - Virginia economy improving with increased federal spending - particularly in defense.
 - “Collar” on non-withholding revenue growth could reduce *appropriated* revenues.
- **Federal tax changes could yield significant new state revenues – if not returned to the taxpayer.** Without Virginia tax changes, Federal income tax changes will yield estimated \$600 million in additional state revenue in FY 2019 – growing to over \$900 million in FY 2024.
 - Federal tax reform for individuals expires after FY 2024.
 - Additional sales tax revenue likely from *Wayfair* decision on internet sales, but many large dealers already collecting. One issue - Virginia has to determine how to minimize “undue burden”.

Virginia Income Tax Withholding Has Accelerated

(Even Though Withholding Tables Have Yet to Be Adjusted)

12 Mo. Moving Avg Income Tax Withholding Growth Now about 5 Percent



Chances for a Substantial 2018-20 Upward Revenue Re-forecast Are Good

	<u>% of GF</u>	<u>Actual FY 2018</u>	<u>Budget FY 2019</u>	<u>% Change Needed</u>	<u>Budget Forecast</u>
Withholding	63.1%	\$12,540.5	\$12,870.2	2.6%	4.5%
Est Payments/Tax Dues	16.8%	\$3,472.9	\$3,368.3	-3.0%	7.0%
Refunds	-10.1%	-\$1,907.6	-\$2,054.7	7.7%	4.4%
Net Individual Income	69.8%	\$14,105.8	\$14,183.8	0.6%	5.1%
Sales Taxes*	18.0%	\$3,838.4	\$3,934.0	2.5%	2.6%
Corporate Income	4.4%	\$861.9	\$912.0	5.8%	4.3%
Recordation	2.1%	\$394.9	\$407.2	3.1%	0.0%
Insurance Premiums	1.9%	\$337.9	\$376.6	11.5%	4.0%
Total GF Revenues*	100.0%	\$20,509.0	\$20,794.7	1.4%	4.2%

* Includes GF transfers

Medicaid Preventing Other Priority Spending Growth in GF Appropriations Since FY 2001 (\$ Mil.)

	<u>2001</u>	<u>2019</u>	<u>Growth</u>	<u>Annualized Compound Growth</u>
Medicaid (DMAS)	\$1,384.2	\$4,693.0	239.0%	7.0%
GF Debt Service	\$243.1	\$759.1	212.3%	6.5%
Behavioral Health	\$430.2	\$822.8	91.3%	3.7%
Other H&HS	\$648.9	\$1,131.9	74.4%	3.1%
Direct Aid to K-12 Education	\$3,942.4	\$6,273.1	59.1%	2.6%
Public Safety/Comp Board	\$1,949.1	\$2,705.5	38.8%	1.8%
Higher Education	\$1,634.2	\$2,108.6	29.0%	1.4%
Natural Resources/Forest M	\$152.1	\$175.8	15.6%	0.8%
All Other	<u>\$1,899.4</u>	<u>\$2,320.5</u>	<u>22.2%</u>	<u>1.1%</u>
Total GF Operating	\$12,283.6	\$20,990.3	70.9%	3.0%

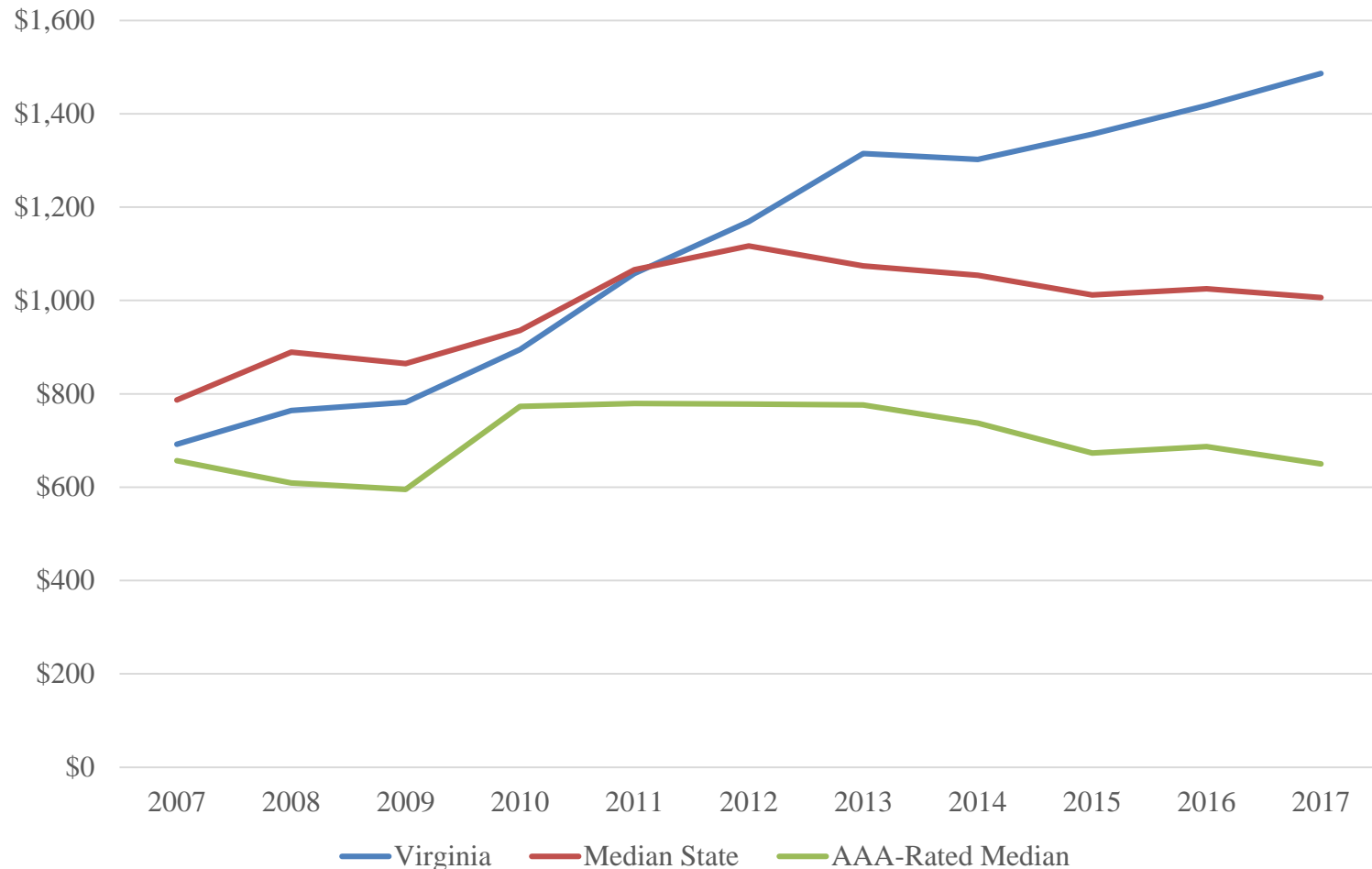
Note: Since 2001, the Consumer Price Index has averaged 2.0%.

Managed Care Didn't Provide Savings As Expected

<u>Fiscal Years</u>	<u>Avg. GF Annual Growth</u>
2000-2009	8.8%
2010-2015	6.2%
2016	9.3%
2017	7.2%
2018	5.5%
2019 Forecast	-2.3% 6.2% (7.6% w/o expansion)
2020 Forecast	-3.4% 2.6% (5.6% w/o expansion)

Virginia Has Limited Capacity for New Debt Authorizations

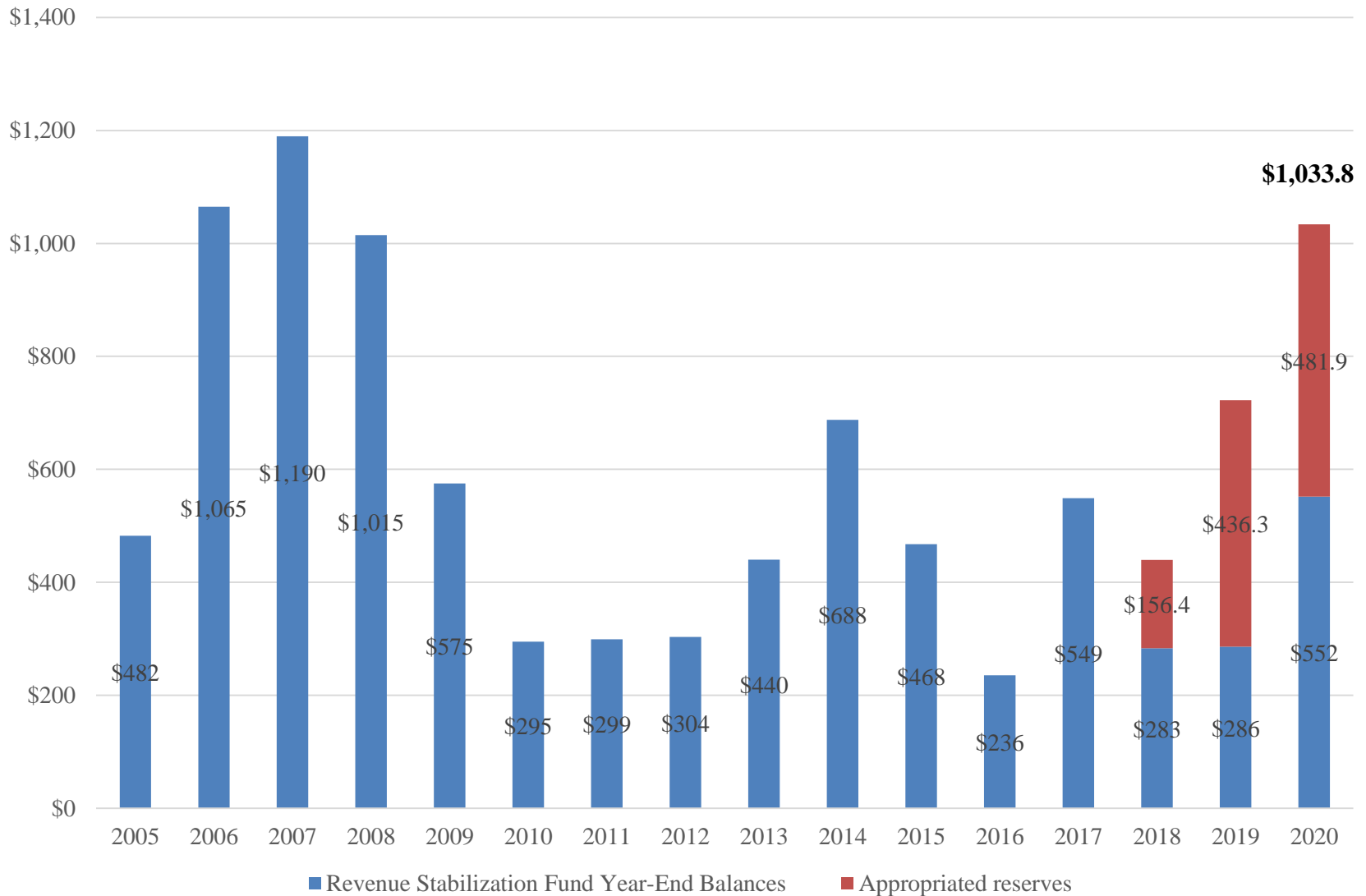
Virginia Debt per Capita Compared to Other States



** Additional debt capacity based on self-imposed cap of 5% of GF + transportation revenues. 2017 DCAC model assumed an average of \$580 mil. per year over next 10 years can be issued. **About \$5 bil. in authorized but unissued debt already exists.***

Source: Virginia Debt Capacity Advisory Committee, Dec. 2017

By FY 2020 State Reserves Will Total Over \$1 Billion Helping Shore Up our AAA Credit Rating



Review of Budget Pressures/Options for 2019 Session

- Fund mandatory spending items.
- Increase reserves and liquidity?
- Budget one-time spending (such as capital/VRS) to maintain future flexibility?
- Modify Virginia's tax code and return revenue in response to federal changes?
- Respond to budget pressures by keeping additional revenue— particularly for K12 and mental health?

2018 Session Adopted State GF Budget (\$ Mil.)

	GF Budget Accounting (\$ Mil.)						
	<u>2018 Caboose</u>	<u>FY 2019</u>	<u>Change from FY18</u>		<u>FY 2020</u>	<u>Change from FY19</u>	
			<u>\$</u>	<u>%</u>		<u>\$</u>	<u>%</u>
Legislative and Executive	\$119.4	\$129.5	\$10.1	8.5%	\$129.4	-\$0.1	-0.1%
Judicial Dept.	485.6	495.7	\$10.1	2.1%	505.1	\$9.4	1.9%
Administration/Comp Board	714.3	738.0	\$23.7	3.3%	740.2	\$2.2	0.3%
Treasury Board Debt Service	739.5	759.1	\$19.6	2.7%	807.6	\$48.5	6.4%
Other Finance	187.5	184.2	-\$3.3	-1.8%	179.4	-\$4.8	-2.6%
Rainy Day Fund Deposit	-	-	-	-	-	-	-
Car Tax Reimbursement	950.0	950.0	\$0.0	0.0%	950.0	\$0.0	0.0%
Commerce and Trade	203.5	225.7	\$22.2	10.9%	230.1	\$4.4	1.9%
Agriculture / Nat. Resources	163.7	213.4	\$49.7	30.4%	173.8	-\$39.6	-18.6%
K-12 Education/Central Office	6,021.5	6,334.4	\$312.9	5.2%	6,512.6	\$178.2	2.8%
Higher & Other Education	2,015.2	2,109.2	\$94.0	4.7%	2,176.8	\$67.6	3.2%
DMAS Medicaid	4,651.4	4,693.0	\$41.6	0.9%	4,775.5	\$82.5	1.8%
Other Health & Human Services	1,850.6	1,954.7	\$104.1	5.6%	2,046.0	\$91.3	4.7%
Public Safety & Veterans/HS	1,938.0	2,035.8	\$97.8	5.0%	2,041.0	\$5.2	0.3%
Transportation	41.0	41.0	\$0.0	0.0%	41.0	\$0.0	0.0%
Central Appropriations	212.0	81.3	-\$130.7	-61.7%	288.8	\$207.5	255.2%
Cash Reserve	156.4	45.0	-\$111.4	-71.2%	45.0	\$0.0	0.0%
Independent Agencies/Capital	0.3	0.3	\$0.0	NM	0.2	-\$0.1	-33.3%
Total GF Appropriations	\$20,449.9	\$20,990.3	\$540.4	2.6%	\$21,642.5	\$652.2	3.1%
GF Revenues	19,328.2	20,173.7	\$845.5	4.4%	20,976.2	\$802.5	4.0%
Transfers	625.3	621.0	-\$4.3	-0.7%	631.0	\$10.0	1.6%
Rainy Day Fund Withdrawal	272.5	-			-		
Balances for Appropriation	212.2	22.0			(0.5)		
Unappropriated Balance		38.6			2.8		

Note: Includes Medicaid expansion *savings* of \$371 million

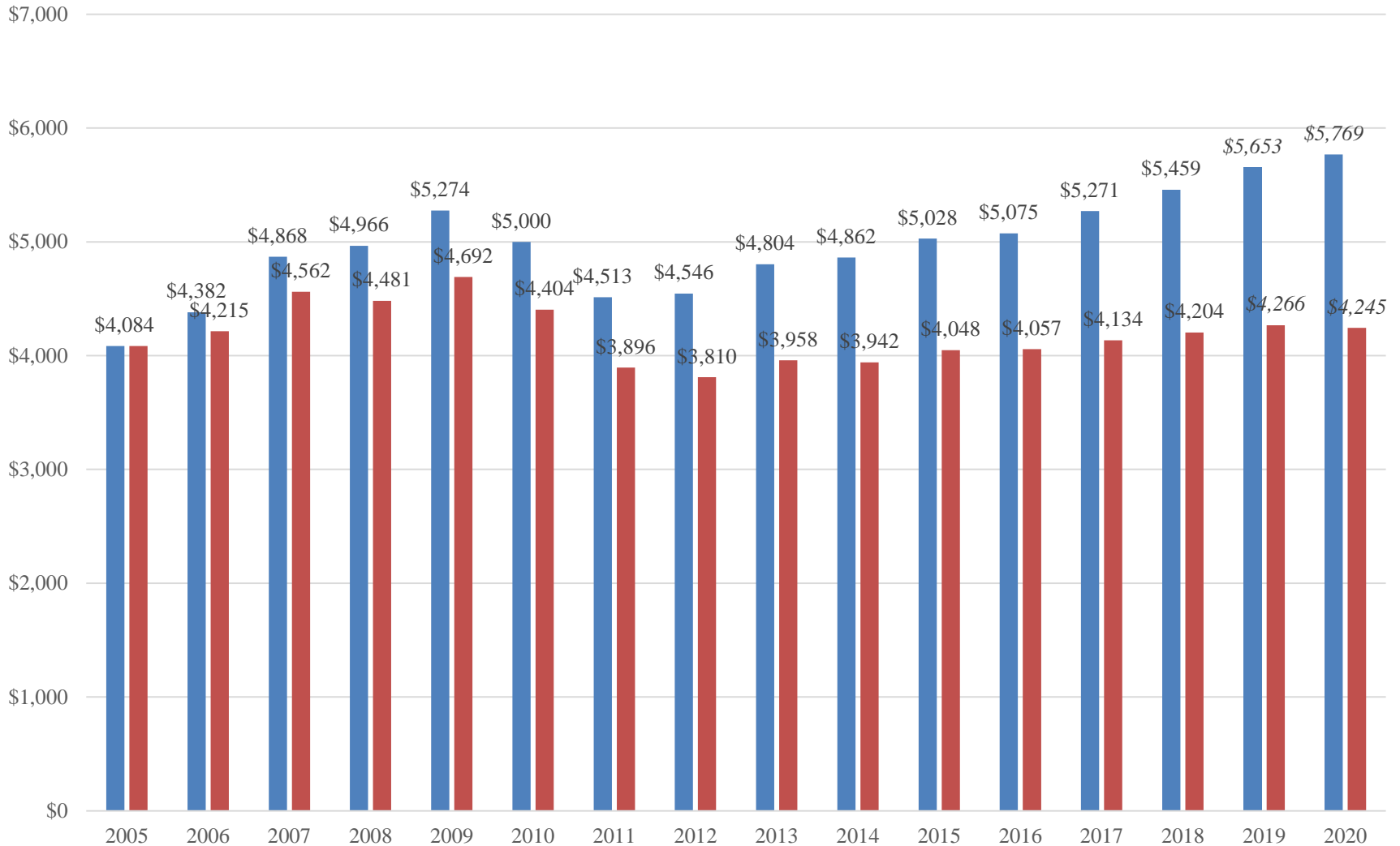
GF State Aid to Localities (\$ Mil.)

	<u>FY 2009</u>	<u>FY 2014</u>	<u>FY 2018</u>	<u>FY 2019</u>	<u>FY 2020</u>
Direct Aid to K-12	\$5,607.6	\$5,240.3	\$5,963.0	\$6,273.1	\$6,451.3
K-12 % of Total GF Appropriations	35.2%	29.6%	29.2%	29.9%	29.8%
Health and Human Services	888.4	791.7	951.0	1,003.4	1,034.4
CSA	299.7	217.2	279.9	298.6	308.5
Community MH/SA Services	249.4	269.3	350.4	371.0	392.7
Local Social Services Staff	117.4	115.3	122.1	126.8	128.2
Community Health Programs	117.6	107.2	117.9	125.5	123.5
Welfare Services and Programs	104.3	82.7	80.7	81.5	81.5
Public Safety	734.3	687.9	738.8	758.4	768.2
Local Sheriffs Offices	406.1	411.3	452.4	464.5	466.1
Local Police Depts HB 599	197.3	172.4	178.0	184.5	191.7
Local Jail Per diem	80.1	59.4	61.3	61.7	62.7
Assistance for Juvenile Justice	50.8	44.8	47.1	47.7	47.7
Constitutional Officers	155.3	145.8	158.0	161.5	161.5
Dept. of Accounts Transfers	49.3	49.3	49.6	48.9	48.9
Car Tax	950.0	950.0	950.0	950.0	950.0
Aid-to-Locality Reduction	(50.0)	-	-	-	-
Total Local GF Aid	\$8,334.9	\$7,865.0	\$8,810.4	\$9,195.3	\$9,414.3
Total GF Appropriations	\$15,943.0	\$17,705.2	\$20,449.9	\$20,990.3	\$21,642.5
Local Aid % of Total GF	52.0%	44.1%	43.1%	43.8%	43.5%

2018-20 K-12 Budget Changes Were Minor

- Standards of Quality re-benchmarking basically funded inflation.
- \$131.3 mil. GF for the state share of a 3% salary increase starting July 1, 2019.
Localities will need to provide about 60% of total cost.
- \$80 mil. GF to offset decreased Literary Fund support for teacher retirement.
- \$62.4 mil. GF and \$17.6 mil. in lottery funds to increase flexible lottery per pupil distributions to 40 percent of total lottery funds.
- \$9.9 mil. GF to the Virginia Pre-School Initiative enhancements, including increasing per pupil payments from \$6,125 to \$6,326 and helping with professional development and finding teachers in hard-to-staff schools.
- \$7.1 mil. GF in FY 2020 for additional at-risk student funding based on numbers of free lunch students from a basic aid boost of 1-13% to 1-14% in FY 2020.
- \$6.1 mil. GF for school division enrollment declines of over 5% over last 5 years and less than 10,000 students
- \$1.5 mil. for Master Teacher Residency programs for urban school divisions.
- \$45 million *reduction* from reduced teacher retirement and OPEB rates -
16.32% to 15.68%
 - VRS funded status for teachers has increased from a low of 62% in FY 2013 to 74% in FY 2019

Real \$ State K-12 Funding Over \$400 per Pupil Less than FY 09
2018 Session State Per Pupil K-12 Direct Aid - All Funds
Nominal and Inflation-Adjusted (CPI \$2005)



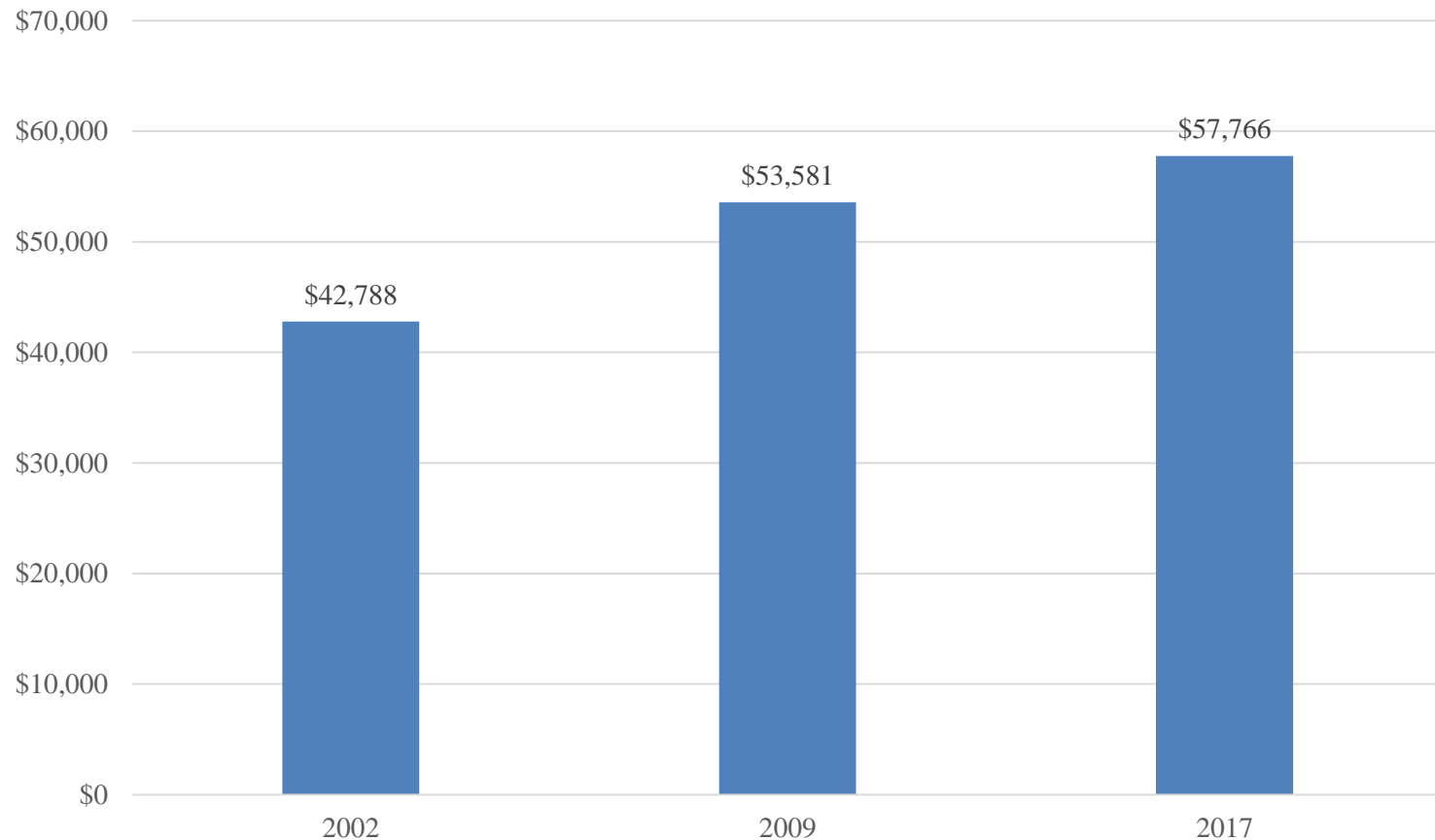
State Standards of Quality Do Not Reflect True Costs for Local K-12 Divisions

- Only 136,000 out of 200,000 K-12 positions (68 percent) employed by local school divisions are recognized by the SOQ; **support positions capped and costs de-funded in 2010**; the “linear weighted average” methodology underfunds teachers’ salaries; real-time costs not reflected in re-benchmarking.
- State Board of Ed recommended \$600 mil./yr. in SOQ changes. Raising teacher salaries from 29th (*JLARC 2018*) to the national average and funding prevailing support costs would require an additional \$750 million/year.
- Localities on average spent more than double, or \$4.0 bil. beyond state requirements to meet SOL and SOA requirement in FY 17. All 134 local school divisions exceeded Required Local Effort (RLE) in FY 17.

Divisions up to 25% Above RLE	16
Divisions Exceeding 25% to 75%	45
Divisions Exceeding 76% to 100%	30
Divisions Exceeding 100% RLE	43

Instructional Pay Increases Have Slowed Considerably Since FY 2009

Average VA Salary - All Instructional Positions*



Source: Superintendent's Annual Report.

* All instructional positions include classroom teachers, guidance counselors, librarians, principals, and assistant principals.

Note: Average instructional pay would have been \$62,000 in 2017 if grown at the rate of VA wage inflation since FY2009.

NEA Average Teacher Salaries by State vs Zillow Median Home Value Index

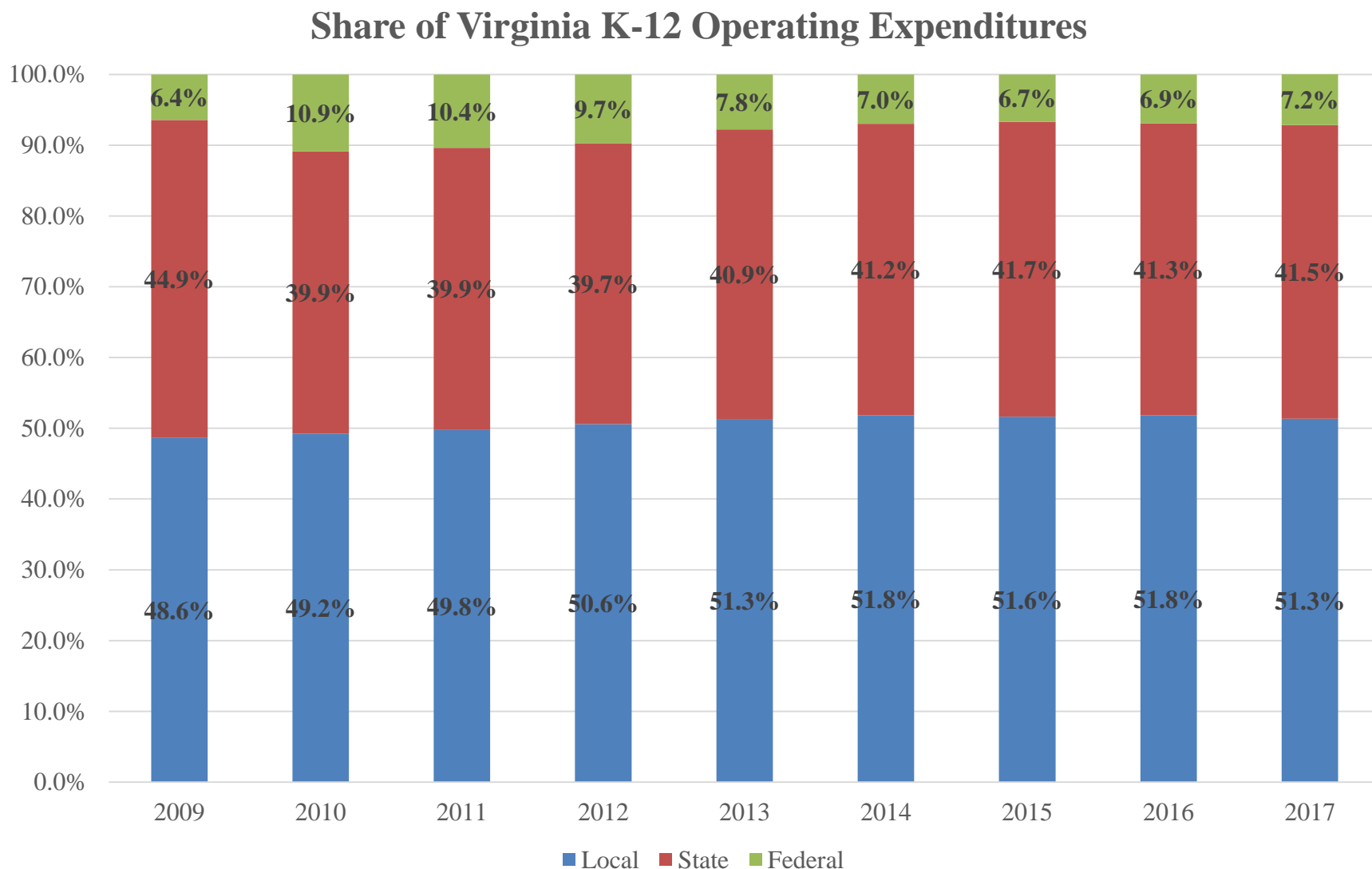
Rank		NEA AVG Teacher Salary - 2016		Rank		Zillow Home Value Index
	United States	\$60,205			United States	\$216,700
1	New York	\$79,767		1	Hawaii	\$615,000
2	Washington D.C.	\$77,623		2	Washington D.C.	\$567,400
3	California	\$77,179		3	California	\$539,400
4	Massachusetts	\$76,981		4	Massachusetts	\$395,300
5	Rhode Island	\$73,631		5	Washington	\$370,700
6	New Jersey	\$73,044		6	Colorado	\$364,600
7	Connecticut	\$72,013		7	Oregon	\$334,100
8	Maryland	\$70,279		8	New Jersey	\$316,500
9	Alaska	\$67,590		9	Utah	\$310,800
10	Pennsylvania	\$67,012		10	Alaska	\$307,600
11	Minnesota	\$66,157		11	Maryland	\$282,500
12	Delaware	\$64,193		12	New York	\$280,000
13	Oregon	\$63,551		13	Nevada	\$275,200
14	Michigan	\$62,028		14	Rhode Island	\$273,500
15	Illinois	\$61,342		15	New Hampshire	\$264,400
16	Nevada	\$60,883		16	Virginia	\$250,700
17	Wyoming	\$60,328		17	Arizona	\$240,300
18	Hawaii	\$59,855		18	Connecticut	\$238,600
19	Vermont	\$58,901		19	Idaho	\$232,400
20	Louisiana	\$58,729		20	Delaware	\$231,200
21	Wisconsin	\$58,485		21	Minnesota	\$225,100
22	Iowa	\$56,995		22	Montana	\$225,100
23	Georgia	\$56,814		23	Florida	\$224,600

24	New Hampshire	\$56,616	24	Maine	\$222,000
25	Washington	\$56,089	25	Wyoming	\$219,800
26	Ohio	\$55,749	26	North Dakota	\$202,100
27	Utah	\$55,316	27	Vermont	\$195,400
28	Texas	\$55,126	28	New Mexico	\$186,600
29	Kentucky	\$54,663	29	Texas	\$185,800
30	Montana	\$54,385	30	South Dakota	\$181,800
31	North Dakota	\$53,678	31	Wisconsin	\$177,700
32	Virginia	\$52,995	32	Georgia	\$175,500
33	Maine	\$52,394	33	Illinois	\$174,300
34	Arkansas	\$51,515	34	North Carolina	\$173,500
35	Nebraska	\$51,514	35	Pennsylvania	\$168,500
36	South Carolina	\$51,508	36	South Carolina	\$158,800
37	Indiana	\$50,715	37	Tennessee	\$158,400
38	Florida	\$50,690	38	Nebraska	\$157,800
39	Alabama	\$50,513	39	Missouri	\$153,000
40	Tennessee	\$50,462	40	Louisiana	\$145,300
41	Missouri	\$50,232	41	Michigan	\$143,100
42	New Mexico	\$49,030	42	Kentucky	\$138,800
43	Idaho	\$48,882	43	Iowa	\$138,500
44	Kansas	\$48,837	44	Kansas	\$134,200
45	West Virginia	\$48,173	45	Indiana	\$133,700
46	North Carolina	\$47,941	46	Ohio	\$132,900
47	Oklahoma	\$47,326	47	Alabama	\$126,600
48	Arizona	\$47,218	48	Mississippi	\$122,500
49	Colorado	\$46,155	49	Arkansas	\$121,800
50	Mississippi	\$44,196	50	Oklahoma	\$119,300
51	South Dakota	\$43,765	51	West Virginia	\$95,300

Hanover County Median Zillow Home Price Index is \$271,900 (rank 15)

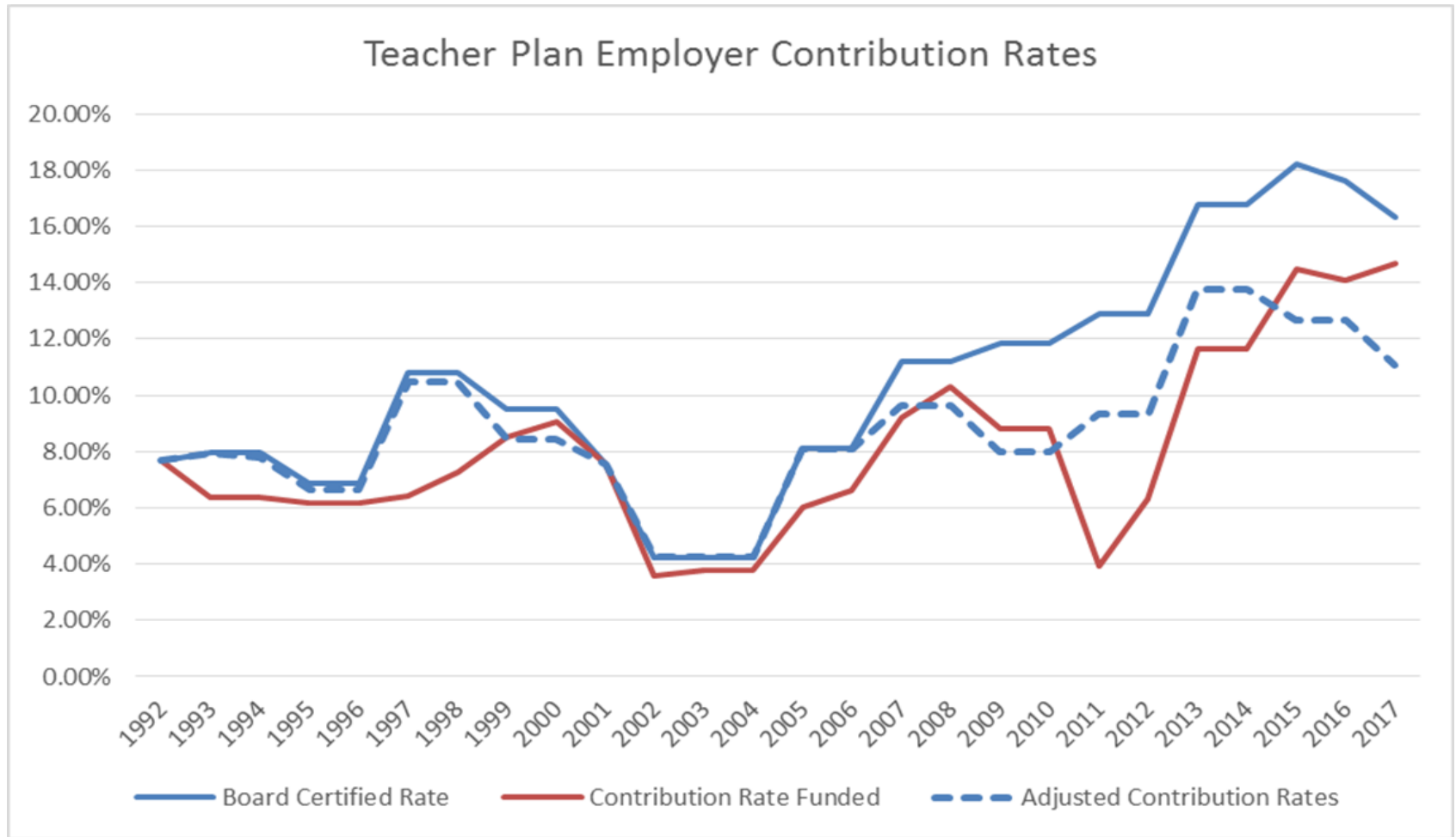
Hanover FY 2016 teaching position average salary \$51,720 (rank 34)

Localities Have Increased Their Share of K-12 Expenditures



Source: Superintendent's Annual Report, Table 15

Impact of VRS Underfunding – Teacher Plan



- If the Teacher plan had received 100% of the required contributions since 1993, the employer rates today would be approximately 11.90% versus the actual 16.32%.
- The funded status as of June 30, 2016 was 70.6%. With full funding of rates the funded status would be approximately 86.1%.
- Teacher contribution rates were funded at VRS Board certified actuarial determined rate in fiscal year 2018.

Virginia Public School Construction and Renovation Costs From FY 2013-17					
	<u>Number</u>	<u>Cost</u>	<u>Avg. Cost/School</u>	<u>Sq. Feet</u>	<u>Cost/Sq Ft.</u>
New Elementary Schools	22	\$450,158,034	\$20,461,729	2,094,665	\$215
New Middle Schools	8	\$273,672,113	\$34,209,014	1,192,914	\$229
New High Schools	8	\$473,784,482	\$59,223,060	1,515,484	\$313
New Combined or Other	6	\$235,566,159	\$39,261,027	992,977	\$237
Additions/Renovations	<u>219</u>	<u>\$1,197,693,347</u>	<u>\$5,468,919</u>	<u>8,494,960</u>	<u>\$141</u>
Total	263	\$2,630,874,135	\$10,003,324	14,291,000	\$184

Source: http://www.doe.virginia.gov/support/facility_construction/school_construction/costs/

K-12 Education Funding Summary and Needs

State Actions:

From FY 2001 thru FY 2019 state general fund appropriations for K-12 education have grown at a compound annual rate of 2.6% versus 3.0% growth in total general funds.

- Since FY 2009, the K-12 *appropriation* has dropped from 35.2% of total GF appropriations to 29.9% in FY 2019. In addition, *inflation-adjusted* (2005\$) average per pupil state funding has dropped nine percent from \$4,692 in FY 2009 to \$4,266 in FY 2019.
- From FY 2009 to FY 2017, average instructional pay in Virginia has grown less than the rate of inflation – from \$53,581 to \$57,766. If instructional pay had grown at the rate of the consumer price index (CPI), average pay would have been \$62,000 in FY 2017. According to the latest National Education Association salary survey, Virginia ranks 32nd in teacher pay, or \$7,210 below the national average. **However, if Northern Virginia (PD8) localities are removed from the state average, Virginia would rank among the bottom five states.**
- Roughly two-thirds of school division employees (136,000 out of 200,000) are recognized and funded by the state's Standards of Quality (SOQ). Adopting the 2016 state Board of Education SOQ revisions would require about \$600 million per year in additional state appropriations, eliminating the arbitrary support position funding cap set by the state (\$350 mil./yr.), and revising various professional staffing ratios.
- Increasing the state-determined 55 percent share of funding for the current SOQ standards would annually cost the state an additional \$93 mil. per increased percentage point.

Local Reactions:

- Most locality revenue sources have not kept pace with inflation and population growth, despite median real property tax rates increasing 17 cents for cities and 12 cents for counties since FY 2009.
- As a result of the slower growth in state K-12 funding, local funding for K-12 operations has increased from 52.0% (FY 2009) to 55.3% (FY 2017) of total state-local expenditures (DOE Superintendent's Annual Report).
- Localities also borrowed \$2.6 billion for school construction, additions, and renovations from 2013-17. Direct state grants for capital improvements have not been available since FY 2010. Literary fund loans to school divisions have also been minimal since the recession.

Other 2018-20 Budget Changes Important to Localities

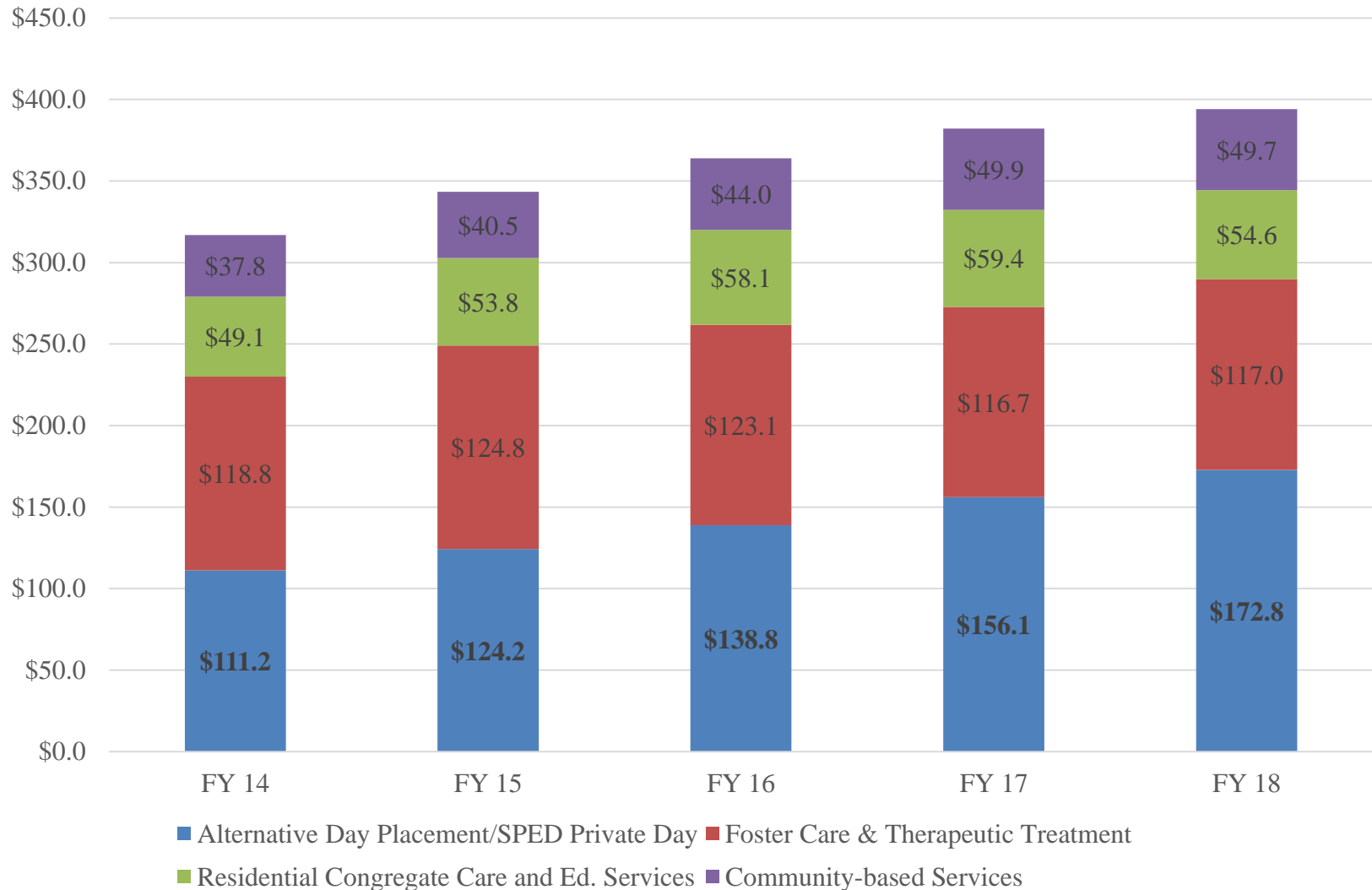
- Increases Go Virginia by \$5,000,000 in FY 19 (to \$29.5 mil. GF) and \$10,000,000 in FY 20 (\$34.5 mil. GF) in FY 20.
- Increases Aid to Police Departments from \$178.0 mil. to \$184.5 mil. in FY 19 and \$191.7 mil. in FY 20.
- Saves \$10.3 million from CSA in FY 20 to reflect a two percent rate increase cap on private day special education rates. Also directs the Office of Children's Services along with the Department of Education to facilitate a workgroup with stakeholders to develop outcome measures to assess students' progress in private day placements.
- Increases funding for STEP-VA same day access and CSB primary care screening and begins phasing in an expansion outpatient mental health and substance abuse services and funds an expansion of detoxification services in FY 20 at Community Services Boards and Behavioral Health
- Provides \$3,000,000 each year from TANF funds for a second round of grants for community employment and training programs designed to move low-income individuals out of poverty
- Adds \$2.0 million from the general fund each year (\$4 mil./year total) to the Virginia Telecommunication Initiative to support the extension of broadband networks by the private sector in unserved areas.
- Adds \$20.0 million GF in the first year for the Stormwater Local Assistance Fund.
- Provides a two percent salary increase for state-supported local officials on July 1, 2019.
- Increases the Enterprise Zone Grant program by \$685,533 each year to \$13.5 million to reduce RPIG proration.
- Directs a working group to investigate how body worn cameras impact the workloads experienced by Commonwealth's Attorneys offices.
- Transfers \$2.0 mil. each year from the Communications Sales and Use Tax to the state general fund.

Other Budget Needs For Localities

- 2018-20 budget increased funding for STEP-VA same day access and CSB primary care screening and began phasing in an expansion of outpatient mental health and substance abuse services and funded an expansion of detoxification services in FY 20 at Community Services Boards and Behavioral Health. **However, additional CSB funding is still needed for:**
 - Full implementation of STEP-VA
 - Mental health needs/jails
 - Same day access and alternative transportation
 - Primary care coverage
 - Potential backfilling of GF reductions assumed in biennial budget associated with Medicaid expansion
- Rising costs for private day placements in CSA
 - FY 20 budget reflects a two percent rate increase cap on private day special education rates.
- Uncovered Medicaid expansion costs for local social service departments
- Implementation costs for the Family First Prevention Services Act
- Stormwater Local Assistance Funds
- Inadequate highway and public transportation funding

Special Education Day Placement Costs Continue to Grow

STATE CSA EXPENDITURE GROWTH



Special Education Day Placement Costs

	<u>FY 2014</u>	<u>FY 2018</u>	<u>% Growth</u>
Number Served	3,158	4,101	29.9%
Avg. Annual Cost per Child	\$34,437	\$45,118	31.0%

VDOT Construction Allocations Have Grown Slowly Since HB 2313

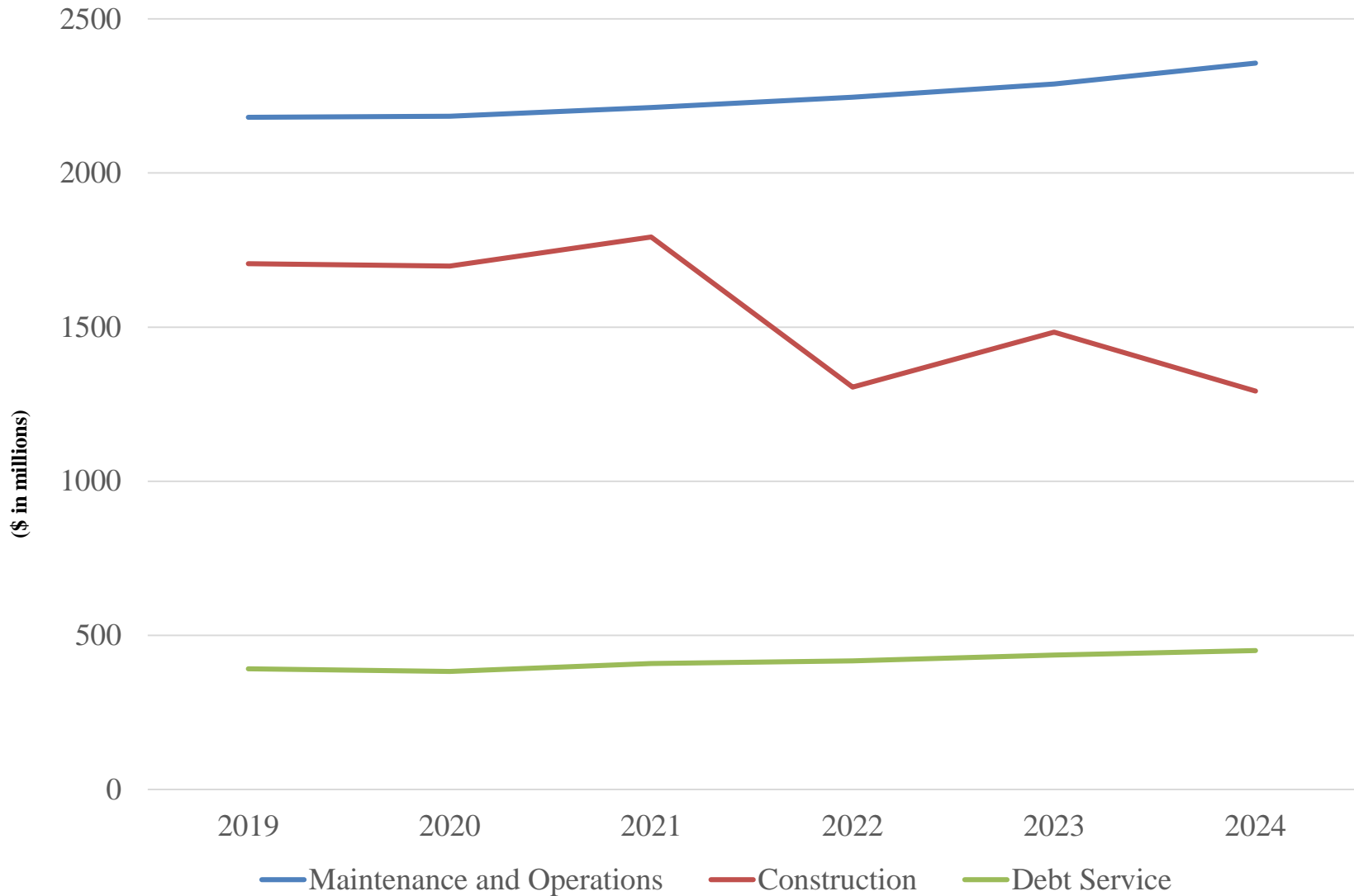
	<u>FY 2013</u>	<u>FY 2019</u>	<u>% of Budget</u>	<u>% Increase</u>
Evaluation, Planning, Research	\$77.5	\$99.4	1.9%	28.3%
Highway Construction	\$1,614.3	\$1,730.6	32.3%	7.2%
Highway Maintenance	\$1,452.2	\$1,724.2	32.2%	18.7%
Toll Facilities	\$43.3	\$80.9	1.5%	86.8%
Assistance to Localities	\$390.9	\$472.4	8.8%	20.8%
Regional Programs	\$0.0	\$471.5	8.8%	NM
Non-Toll Debt Service	\$292.8	\$390.5	7.3%	33.4%
Admin, Support, Capital Outlay	\$242.9	\$289.8	5.4%	19.3%
Support to DRPT and Other Agencies	<u>\$70.0</u>	<u>\$99.4</u>	<u>1.9%</u>	<u>42.0%</u>
Total VDOT Programs	\$4,183.9	\$5,358.7	100.0%	28.1%

Future Transportation Revenue Growth Expected to Be Flat

	<u>State*</u>	<u>Federal</u>	<u>Regional</u>	<u>WMATA</u> <u>Pass-Thru</u>	<u>Bonds</u>	<u>Total</u>
2019	\$4,251	\$1,143	\$472	\$135	\$147	\$6,147
2020	\$4,191	\$1,087	\$467	\$135	\$302	\$6,182
2021	\$4,288	\$1,104	\$477	\$136	\$397	\$6,403
2022	\$4,124	\$1,122	\$486	\$137	\$76	\$5,946
2023	\$4,108	\$1,141	\$495	\$137	\$296	\$6,177
2024	\$4,172	\$1,159	\$505	\$138	\$125	\$6,099
	* Includes local participation and toll revenue					

Source: June 2018 VDOT budget presentations to the CTB

Declining Construction Allocations Planned for VDOT



Source: June 2018 VDOT budget presentation to the CTB

SmartScale Allocations Indicate Far Greater Need

<u>FY 2018 Round</u>	<u>Statewide</u>
Requested Project Costs	\$10,886,155,180
Total Smartscale Funding Requested	\$8,566,240,501
Accepted Project Costs	\$2,350,395,696
Smartscale Funds Allocated	\$1,026,812,430
% Smartscale Request Funded	12.0%

Thru FY 2017, County Revenues Have Done Better Than Cities in Relation to Inflation/Population

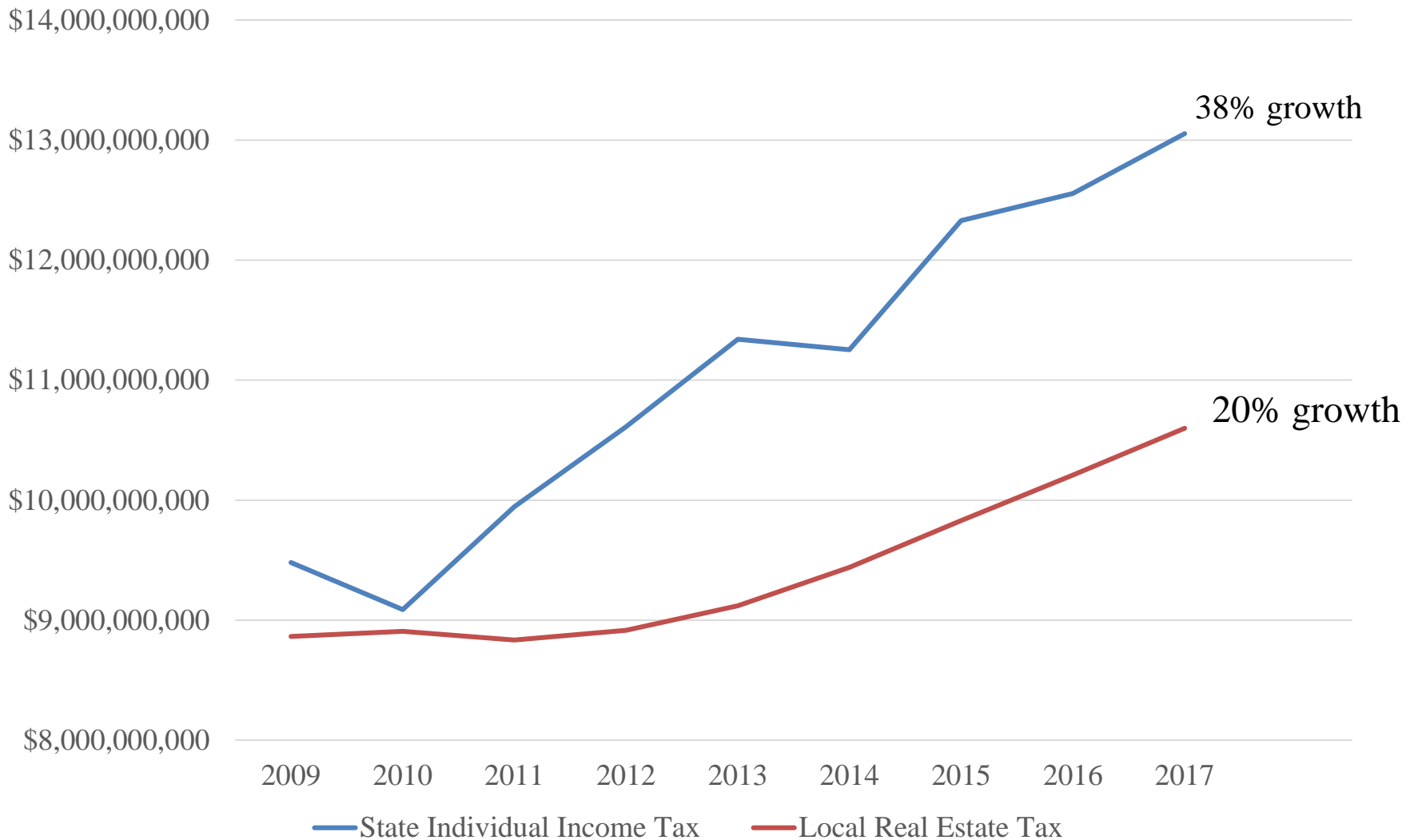
FY 2009 - FY 2017 Growth Comparison					
	Locally-Generated Revenue	State/Federal Revenue for Localities	All Revenue for Localities	Population	Population +Inflation
VA Cities*	15.0%	6.3%	11.3%	3.5%	17.1%
VA Counties	24.6%	16.2%	21.4%	7.3%	20.9%

** Net of Emporia, Hopewell, and Manassas Park City - missing FY 2017 APA data*

Note: Growth in consumer price index (CPI) from fiscal years 2009-17 = 13.6%

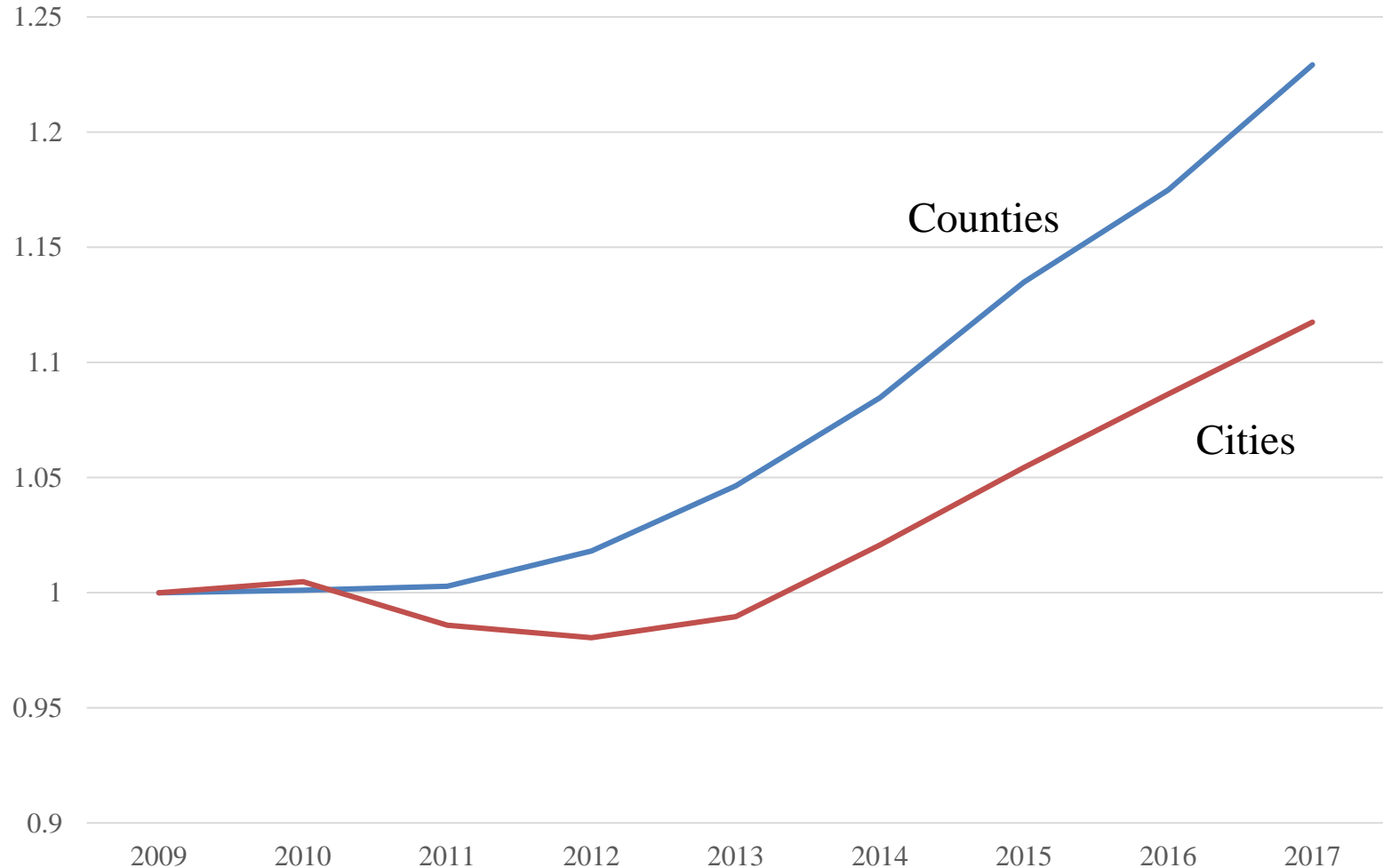
Sources: Virginia Auditor of Public Accounts Comparative Revenue and Expenditure Reports, U.S. Bureau of Labor Statistics, CPI Detailed Report

State Income Tax Growth Has Significantly Exceeded Local Real Estate Tax Growth Since Recession



Note: FY 2018 state income tax grew 8.1%; local property tax growth not yet available.

Real Property Tax Growth in Counties Exceeded Cities Since Recession



Real Property Revenue Growth Has Required Sharply Rising Rates

Median Real Property Tax Rates in Virginia Localities

	<u>CY 2009</u>	<u>CY 2017</u>	<u>Change</u>
Cities	0.90	1.07	0.17
Counties	0.55	0.67	0.12
Towns	0.18	0.18	-

Note: From FY 2009-17 real property taxes grew 13.3% in cities and 22.8% for counties

Source: Weldon Cooper Center, “Virginia Local Tax Rates”, 2009 and 2017

Despite Local Fiscal Issues, the Burden of the State-Local Fiscal Partnership is on Localities

	<u>2012 JLARC Ranking</u>	<u>2018 JLARC Ranking</u>
Per capita personal income	8	12
Per capita state taxes	34	33
Per capita local taxes	13	16
State Per Pupil Funding	35	40
State and Local Per Pupil Funding	17	24
Average Salary of Public School Teachers	28	29

Source: Virginia Compared to Other States, JLARC, 2012, 2018 Editions

Federal Income Tax Policy Changes Offer Chance for Additional Virginia Revenues

- The Tax Cuts and Jobs Act is the most substantial federal tax legislation since 1986.
- Certain provisions, such as rate and bracket changes, have no Virginia impact.
- Many provisions do have a Virginia revenue impact. Individual income tax changes are temporary – lasting thru tax year 2024. Business provision changes are permanent. With no changes, Virginia could expect \$600-950 mil. additional revenue per year thru 2024.
- Do not expect a Virginia tax reform special session in 2018. Therefore, tax year 2018 revenue impacts of nearly \$600 mil. will flow to Virginia coffers – without ex-post refunds.
- Expect Virginia tax reform to be debated in the 2019 Session.
- Localities may find it harder to raise local property tax rates with the new federal tax law SALT caps on itemized deductions and reduced allowable mortgage interest deduction.

Federal Tax Cuts and Jobs Act of 2017

Individual Provisions Increasing Revenues:	Business Provisions Increasing Revenues:
Increase in Federal Standard Deduction	Interest Deduction Limitation to 30% of AGI
State and Local Tax Itemized Deduction Cap	NOL Limited to 80% of Taxable Income
Decrease in Mortgage Interest Deduction	New Amortization of Research Expenses in 2022
Limitation on Losses for Noncorporate Taxpayers	Repeals Domestic Production Activities Deduction
	Some Employer Fringe Benefit Deductions Disallowed
	Repeal of Certain Like-Kind Exchanges
Individual Provisions Decreasing Revenues:	Business Provisions Decreasing Revenues:
Medical Expenses Deduction	Increases IRC 179 Expensing to \$1 mil.
Repeal High Income Limit on Itemized Deductions	Simplified accounting rules for small businesses

Significant Revenues Accrue to Virginia Without Tax Policy Changes (\$Mil.)

By Source:	<u>FY2019</u>	<u>FY2020</u>	<u>FY2021</u>	<u>FY2022</u>	<u>FY2023</u>	<u>FY2024</u>
Individual Provisions*	\$532.1	\$443.8	\$466.7	\$492.5	\$520.0	\$546.1
Business Provisions	\$29.4	\$114.6	\$181.5	\$300.3	\$417.2	\$398.2
International Provisions	<u>\$32.6</u>	<u>\$62.7</u>	<u>\$5.5</u>	<u>\$5.8</u>	<u>\$6.0</u>	<u>\$6.3</u>
Total	\$594.2	\$611.1	\$653.7	\$798.6	\$943.2	\$950.6
By Expiration Date:						
Temporary*	\$517.3	\$433.6	\$455.7	\$480.4	\$506.8	\$532.5
Permanent	\$76.9	\$177.5	\$198.0	\$318.3	\$436.4	\$418.1
* Most individual provisions are temporary and expire in 2025. FY 2019 includes tax year 2018 revenues						

Relative Share of Federal Tax Liability Decreases for Low/Middle Income from Federal Tax Reform

Change in Federal Income Tax Liability, Virginia Residents (\$ mil.)

	Baseline	% of Total Tax Liability	New Law	% of Total Tax Liability	\$ Change
Under \$25,000	\$ 240.0	0.56%	\$ 211.1	0.54%	(\$28.9)
\$25,000-50,000	\$ 1,510.5	3.52%	\$ 1,259.1	3.23%	(\$251.4)
\$50,000-150,000	\$ 11,943.4	27.81%	\$ 10,013.7	25.70%	(\$1,929.7)
\$150,000-500,000	\$ 16,533.5	38.50%	\$ 15,521.8	39.83%	(\$1,011.7)
Over \$500,000	\$ 12,718.7	29.62%	\$ 11,960.2	30.69%	(\$758.5)
Totals	\$ 42,946.1	100.00%	\$ 38,965.9	100.00%	(\$3,980.2)

Relative Share of Virginia Tax Liability Increases for Low/Middle Income Taxpayers

Change in Virginia Income Tax Liability, Virginia Residents (\$ mil.)

	Baseline	% of Total Tax Liability	New Law	% of Total Tax Liability	\$ Change
Under \$25,000	\$ 165.5	1.36%	\$ 178.6	1.43%	\$13.1
\$25,000-50,000	\$ 866.9	7.12%	\$ 899.9	7.19%	\$33.0
\$50,000-150,000	\$ 4,453.4	36.55%	\$ 4,602.0	36.76%	\$148.6
\$150,000-500,000	\$ 4,504.8	36.97%	\$ 4,594.9	36.71%	\$90.1
Over \$500,000	\$ 2,193.5	18.00%	\$ 2,242.4	17.91%	\$48.9
Totals	\$ 12,184.1	100.00%	\$ 12,517.8	100.00%	\$333.7

Relative Share of Combined Tax Liability Decreases for Middle Income Taxpayers

Combined Change in Virginia and Federal Income Tax Liability (\$ mil.)

VA Adjusted Gross Income	Baseline	% of Total Tax Liability	New Law	% of Total Tax Liability	\$ Change
Under \$25,000	\$ 405.5	0.74%	\$ 389.7	0.76%	(\$15.8)
\$25,000-50,000	\$ 2,377.4	4.31%	\$ 2,159.1	4.19%	(\$218.3)
\$50,000-150,000	\$ 16,396.9	29.74%	\$ 14,615.7	28.39%	(\$1,781.2)
\$150,000-500,000	\$ 21,038.4	38.16%	\$ 20,116.6	39.07%	(\$921.8)
Over \$500,000	\$ 14,912.0	27.05%	\$ 14,202.7	27.59%	(\$709.3)
Totals	\$ 55,130.2	100.00%	\$ 51,483.8	100.00%	(\$3,646.4)

*Note: Derived from Chainbridge Software analysis of combined federal/state impact
Secretary Lane presentation to Joint Money Committees, August 19, 2018.*

U.S. Supreme Court Decision Could Provide *Limited* New Internet Sales Tax Revenue

- On June 21, 2018 the U.S. Supreme Court in *South Dakota v. Wayfair* held that states may require out-of-state sellers to collect sales tax, even if the seller does not have a physical presence in the taxing state.
- Did not rule on undue burden aspect of 1992 *Quill* decision.
 - South Dakota law exempts companies under \$100,000 revenue and less than 200 transactions from collection requirements.
 - Virginia not a member of “Streamlined Sales Tax” project” that requires numerous simplification and uniformity requirements states must adopt to remove or reduce the undue burdens on all sellers.
- In 2017, GAO estimated that in 2017 states lost over \$13 billion in uncollected sales taxes. Basis for \$250 million Virginia estimate.
 - **Amount probably smaller now** since Amazon and other large internet sellers already collect Virginia sales taxes.
- Existing sales tax distribution already favors K-12 and transportation funding.

Analysis of <i>Possible</i> VA Additional Internet Sales Tax Revenue		
<i>Est. Additional Taxable Sales Subject to Tax*</i>	<i>\$5,000,000,000</i>	
	<u>Rate</u>	<u>% of Total Va Taxable Sales</u>
General Fund Unrestricted (2.025%)	2.025%	\$101,250,000
Direct Public Education (1.375%)		
<i>By School-Age Population (1.125%)</i>	1.125%	\$56,250,000
<i>By SOQ Composite Index (0.25%)</i>	0.250%	\$12,500,000
Transportation (0.9%)		
<i>Highway Maintenance and Operating</i>	0.669%	\$33,425,000
<i>Airports</i>	0.012%	\$600,000
<i>Ports</i>	0.021%	\$1,050,000
<i>Intercity Rail</i>	0.050%	\$2,500,000
<i>Public Transit</i>	0.149%	\$7,425,000
Total <u>State</u> Add'l Annual Sales Tax at 4.3%	4.300%	\$215,000,000
Local Government Add'l Unrestricted	1.000%	\$50,000,000
Regional Transportation 0.7% Sales Tax	0.700%	\$18,157,287
<i>Northern VA (32.4% of state)</i>		<i>\$11,325,874</i>
<i>Hampton Roads (19.5% of state)</i>		<i>\$6,831,413</i>
<i>* Equals 4.7% of \$107 billion in 2017 total VA taxable sales</i>		

Summary

- Additional GF revenues are likely for the 2018-20 biennium due to a higher revenue base from the FY 2018 surplus, along with likely continued good economic growth and additional federal defense and other spending.
- Additional unbudgeted expenditures will eat up most if not all of this new revenue.
 - Move to managed care did not deliver the expected savings. Will Medicaid expansion produce the estimated budget savings? Will expansion increase out-year expenditures?
- Federal income tax reform and the U.S. Supreme Court decision in *Wayfair v. South Dakota* will force a debate by policymakers on how much additional revenue should be retained and how much returned to taxpayers.
- The 2009-10 recession took a big bite out of state funding for localities, particularly K-12 funding that has yet to be restored. Other funding needs include CSB, mental health, Medicaid expansion administration, transportation, and stormwater management.
- The state should shoulder more funding responsibility, provide localities with greater revenue generating capacity, and better target stressed localities with state assistance.

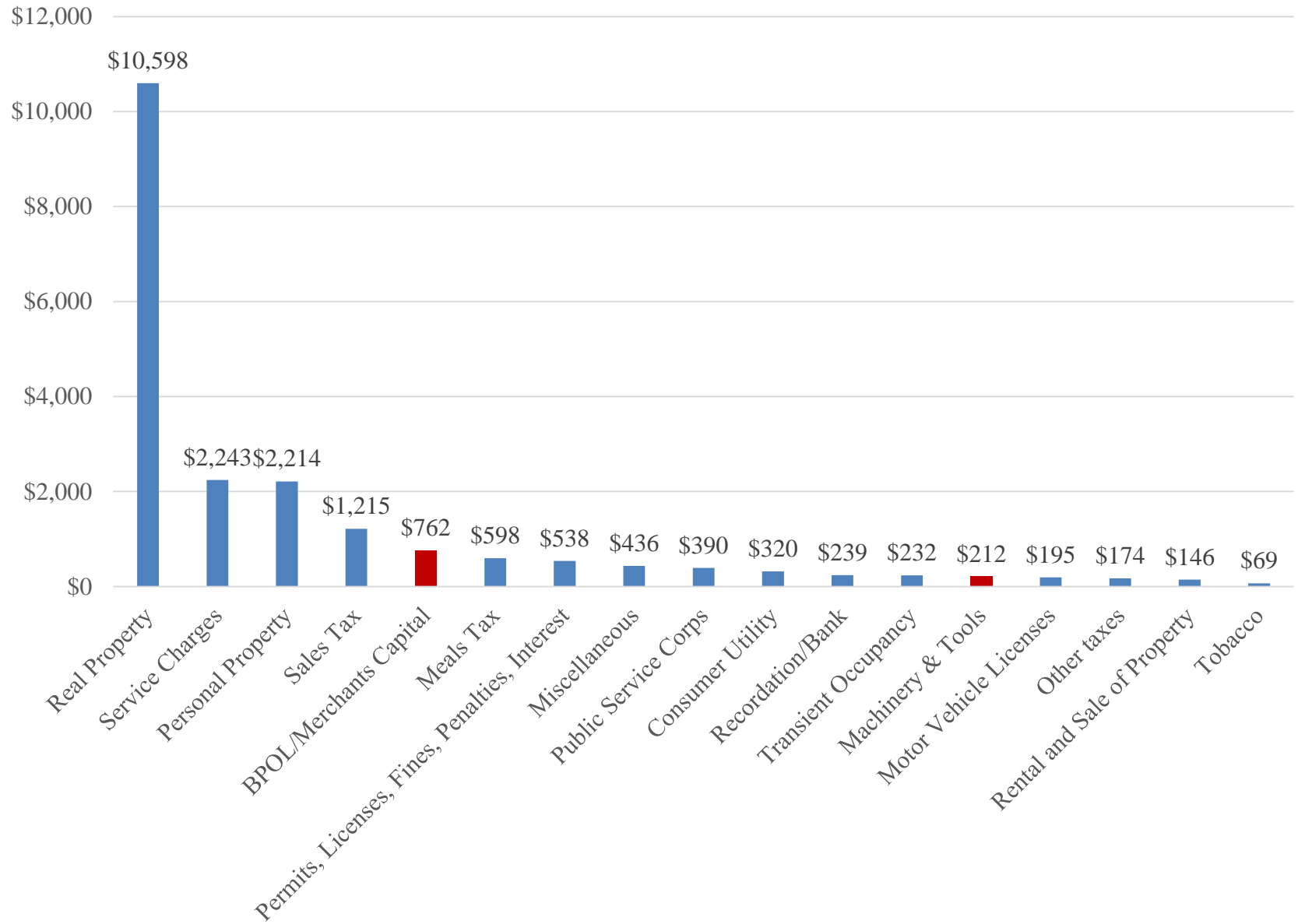
Appendices

General Assembly Usually Cuts Taxes When Times Are Good

	<u>Enacted/Amended</u>	<u>FY 2018 \$M est.</u>
Car Tax Reimbursement	1997, 2003	(\$950)
Impose lower 2.5% Sales Tax on Food	2004	(575)
Age Subtraction (net of 2004 means testing)	1994 and 2004	(294)
Low Income Tax Relief, increase filing thresholds, exemptions, etc.	2000, 2004, and 2007	(203)
1/3 Insurance Premiums to Transportation	2007	(162)
Estate Tax Repeal	2009	(140)
100 basis pt Sales Tax Diversion to Transportation	2013	(101)
Land Preservation Tax Credit	2003	(78)
Historic Rehab Tax Credit	1999	(76)
Corp. double weighting sales and single sales factor	1999, 2009	(59)
Sales tax exemption for data centers	2010/2011	(51)
Sales tax exemption for non-prescription drugs	1990	(39)
Subtraction for military wages and unemployment benefits	1999	(37)
Coalfield Employment Tax Credits	2000	(34)
All Other Tax Reductions Since 1999	1990-2017	(121)
State GF Tax Reductions since 1994		(\$2,920)
Add 1/2 percent sales tax on non-food items	2004	\$515
Recordation Tax Increase (net of 3 cents to transp.)	2004/2007	\$150
Tobacco Tax Increase (Va Health Care Fund)	2004	\$146
Close 2 Corp. Tax Loopholes/Eliminate ST Exem for Pub. Svc. Co.	2004	\$143
Sales Tax Presence in Virginia Amazon	2012	\$22
Sales tax on satellite TV equipment	2014	<u>\$10</u>
State Tax Increases since 1994		\$971
Net State Tax Change Since 1994		(\$1,949)

Source: Senate Finance Committee Retreat, Revenue Outlook, Nov. 19 , 2015; Va Dept. of Taxation

Major Local Revenue Sources (\$ Mil. - FY 2017)



60 Percent of Business Licenses Pay Under \$100 per Year*

<u>Gross Receipts Level</u>	<u># of Licenses</u>	<u>Percent</u>	<u>\$ Amount</u>	<u>Percent</u>	<u>Avg per License</u>
Flat Fee only	74,888	23.6%	\$4,134,673	0.7%	\$55
\$0-\$100,000	117,469	37.0%	\$4,841,153	0.8%	\$41
\$100,001-200,000	29,165	9.2%	\$9,273,349	1.6%	\$318
\$200,001-500,000	35,989	11.3%	\$27,652,331	4.8%	\$768
\$500,001-5,000,000	50,616	16.0%	\$177,978,987	30.8%	\$3,516
\$5,000,001-25,000,000	7,622	2.4%	\$174,518,999	30.2%	\$22,897
Over \$25,000,000	<u>1,456</u>	<u>0.5%</u>	<u>\$178,979,953</u>	<u>31.0%</u>	<u>\$122,926</u>
Survey Totals	317,205	100.0%	\$577,379,446	100.0%	\$1,280

* Survey responses covered about 85% of total BPOL levies collected in FY 12.

Note: Mid-size low margin retail businesses (\$500k-\$5 mil.) pay about \$50 mil. in BPOL levies averaging \$2,800/yr.

M&T Taxes Are Concentrated in Localities

		Total FY 2016 M&T \$	Effective 1st Yr Tax Rate/\$100			M&T as % of Total Local Revenue	Effective 1st Yr Tax Rate/\$100
1	Newport News	\$20,312,830	\$1.25	1	Alleghany	23.20%	\$0.89
2	Richmond City*	12,838,347	\$2.07	2	Covington	19.10%	\$0.83
3	Rockingham	8,693,745	\$2.30	3	Giles	17.70%	\$1.06
4	Frederick	6,895,312	\$1.20	4	Buchanan	15.90%	\$1.56
5	Norfolk	6,063,521	\$1.70	5	Hopewell**	12.10%	\$0.76
6	Alleghany	5,876,975	\$0.89	6	Henry	9.10%	\$1.44
7	James City	5,792,203	\$1.00	7	Campbell	8.60%	\$0.81
8	Buchanan	5,697,213	\$1.56	8	Southampton	8.00%	\$1.92
9	Campbell	5,618,130	\$0.81	9	Rockingham	7.80%	\$2.30
10	Hopewell**	5,066,978	\$0.76	10	Botetourt	7.30%	\$0.90
11	Manassas	4,909,651	\$1.68	11	Sussex	7.00%	\$2.43
12	Lynchburg	4,731,874	\$0.90	12	Greensville	6.80%	\$0.80
13	Chesterfield	4,564,090	\$0.25	13	Pulaski	6.50%	\$0.72
14	Henry	4,468,853	\$1.44	14	Isle of Wight	5.90%	\$0.70
15	Isle of Wight	4,121,487	\$0.70	15	King William	5.60%	\$0.56
16	Giles	3,812,525	\$1.06	16	Amherst	5.50%	\$0.50
17	Augusta	3,649,048	\$0.40	17	Galax	4.90%	\$0.75
18	Botetourt	3,438,291	\$0.90	18	Newport News	4.80%	\$1.25
19	Pulaski	3,372,366	\$0.72	19	Frederick	4.70%	\$1.20
20	Bedford	3,114,881	\$1.20	20	Accomack	4.60%	\$1.67
21	Roanoke City	3,028,795	\$2.07	21	Manassas	4.50%	\$1.68
22	Salem	2,931,060	\$2.24	22	Augusta	4.20%	\$0.40
23	Covington	2,874,828	\$0.83	23	Washington	4.20%	\$1.55
24	Washington	2,821,283	\$1.55	24	Salem	4.20%	\$2.24
25	Chesapeake	2,803,960	\$0.63	25	Shenandoah	4.10%	\$1.73

* FY 2015, ** FY 2014

Understanding State Operating *Non*-General Funds

Non-General Fund Category	Major Examples	<u>FY 2007</u>	<u>FY 2018</u>	<u>% Growth</u>
Higher Ed Operating	Tuition and fees, university hospital revenue, federal funds for Hi ED	\$4,852.8	\$8,249.0	70%
Federal Trust	All federal funds received (e.g. medicaid), except those received by VDOT, VEC, and Hi Ed	\$4,871.6	\$8,395.9	72%
Commonwealth Transportation	Transportation taxes incl. federal \$, excluding tolls	\$3,928.5	\$5,591.8	42%
Trust and Agency	Unemployment insurance, tobacco settlement, lottery and literary funds earmarked to K-12	\$1,083.3	\$2,235.1	106%
Internal Service	DGS leasing office space, VITA providing IT services to other agencies, and DHRM administering state and local government employees' health plans	n/a	\$1,975.2	n/a
Dedicated Special Revenue	VA Health Care Fund, Safe Drinking Water Fund, Game Protection Fund, highway tolls, DMV fees, state park fees, solid waste fees, etc	\$638.2	\$1,900.2	198%
Special revenue	Revenues derived from restricted taxes and other special revenue sources, e.g. state ID health services	\$1,602.6	\$1,781.5	11%
Enterprise	ABC and lottery sales, prepaid tuition 529 plans	\$850.1	\$1,684.2	98%
Other Debt Service	Primarily Hi Ed student fees for dining, housing, athletics	\$234.4	\$337.5	44%
Total Non-General Funds		\$18,061.5	\$32,150.4	78%
General Fund		\$17,033.1	\$20,455.8	20%
Total		\$35,094.6	\$52,606.2	50%