

Governor Northam's Proposed Amendments to the 2018-20 Budget

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Outline

- Background Information, Fall Budget Development, and Goals of Governor's Budget
- Overview of revenue picture
- Highlights of Governor's spending proposals
- Future Budget Process and Concluding Thoughts

Orientation to the 2019 Session

2018 Session (Looking Back)

- New Governor and Nearly Equally Divided Chambers
- Many accomplishments
 - Expanded Medicaid for low-income adults
 - Added significant resources to K-12 and Behavioral Health Services
 - Increased salaries for state employees, state-supported locals, and teachers
 - Boosted general fund revenue reserves
- Budget resolution was “unusual”
- Lingering tensions in the General Assembly

2019 Session (Peering Ahead)

- Tax policy and budget issues will be focus
- Additional resources on the table but many are one-time
- Other issues will add to friction in this short, 46-day session
- And, of course, it's an election year!

Fall Budget Development

- **Process began a few months after new biennial budget enacted**
 - Agencies implementing new budget in the fall
- **DPB guidance to agencies consistent with off-year budget. Agencies should consider:**
 - Governor's priorities
 - Emergency and life-safety issues
 - Unavoidable cost increases
 - What about Medicaid and K-12 enrollment?
- **Revenue growth appeared to be strong but most revenues from federal Tax Cuts and Jobs Act (TCJA) were temporary**

Fall Budget Development (My perspective)

- **My frame of reference in budgeting has always been reactive**
 - “Governor proposes and legislature disposes”
 - But legislature typically tinkers at the margins
- **Executive budget process is similar to General Assembly but more comprehensive and time-consuming**
 - How much revenue do we have?
 - What are our spending priorities?
 - Must do items (What has to be done?)
 - Governor’s priorities and strategic investments (What should be done?)
 - Nice to do proposals (Can they wait until next year?)
 - How much tax relief should be provided with additional revenues from federal TCJA?
- **Balance new spending and tax relief but shore up the Commonwealth’s finances**

Goals of the Governor's budget

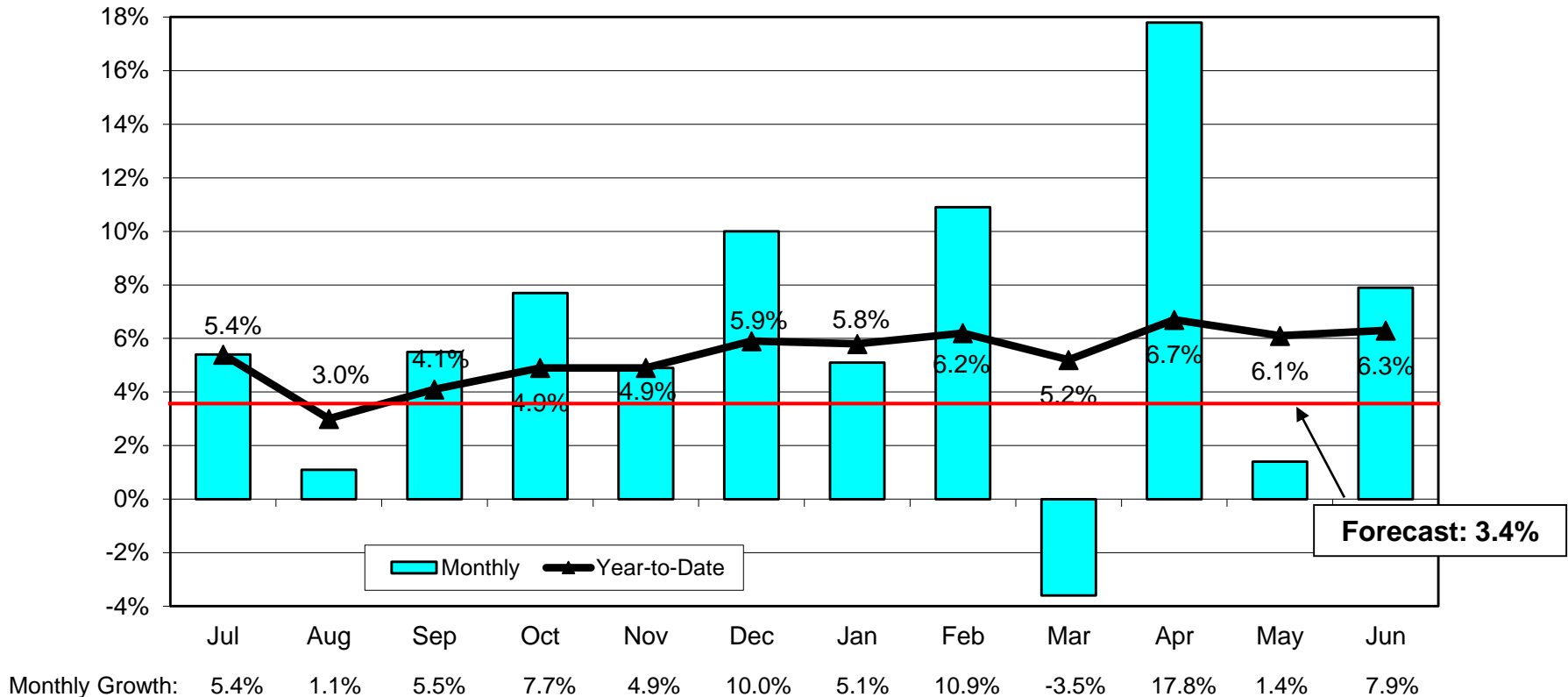
- Build up savings account and prepare for a rainy day
- Address current obligations
 - Fully fund health and long-term care services for Medicaid enrollees
- Make strategic investments to grow Virginia's economy
 - Strengthen Virginia's educational system
 - Invest in broadband and workforce development
 - Maintaining our commitment to economic development
- Improve citizen quality of life
 - Expand access to healthcare, mental health services, addiction treatment and prevention, and housing assistance
 - Improve infrastructure with investments in transportation, water quality, and clean energy
 - Enhance school safety, public safety, election security, and emergency preparedness
 - Increase employee compensation and benefits

Revenue Picture

Fiscal Year 2018 General Fund Revenue Grew at an Average Pace of 6.3 Percent

Growth in Total General Fund Revenue Collections

FY18 Monthly and Year-to-Date



- Total general fund revenue collections exceeded the forecast by \$552.6 million, excluding transfers in fiscal year 2018, a forecast variance of 2.9 percent.
- Total general fund revenues rose 6.3 percent, ahead of the annual forecast of 3.4 percent.

Including Transfers, Fiscal Year 2018 General Fund Resources Grew 6.0 Percent and Finished \$555.5 Million (2.8 Percent) Above Forecast

Summary of Fiscal Year 2018 Revenue Collections (millions of dollars)

Major Sources	As a % of Total General Fund				% Growth Over FY 17	
		Official	Actual	Change	Official	Actual
Withholding	61.5%	\$12,313.3	\$12,540.5	\$227.2	3.5 %	5.4 %
Nonwithholding	15.6	3,147.3	3,472.9	325.6	4.3	15.1
Refunds	(9.6)	(1,968.7)	(1,907.6)	61.1	5.8	2.5
Net Individual	67.5%	\$13,491.9	\$14,105.8	\$613.9	3.4 %	8.1 %
Sales	17.4%	\$3,458.2	\$3,461.8	\$3.6	3.0 %	3.1 %
Corporate	4.3	874.0	861.9	(12.1)	5.7	4.2
Wills (Recordation)	2.0	407.2	394.9	(12.3)	3.3	0.1
Insurance	1.8	362.1	337.9	(24.2)	6.2	(0.9)
All Other Revenue	3.7	734.8	718.5	(16.3)	1.6	(0.6)
Total Revenue	96.6%	\$19,328.2	\$19,880.8	\$552.6	3.4 %	6.3 %
A.B.C. Profits	0.6	\$104.1	\$109.5	\$5.4	(5.8) %	(0.9) %
Sales Tax (0.375%)	1.9	379.1	376.6	(2.5)	3.6	2.9
Transfers	0.9	142.1	142.2	0.1	(19.7)	(19.6)
Total Transfers	3.4%	\$625.3	\$628.3	\$3.0	(4.3) %	(3.8) %
TOTAL GENERAL FUND	100.0%	\$19,953.5	\$20,509.0	\$555.5	3.1 %	6.0 %

- The gain in net individual income tax and sales tax, about \$618 million, was somewhat offset by shortfalls in all other revenue sources.

Recent National and State Economic Indicators Suggest Continued Expansion

- According to the second estimate, real GDP grew at an annualized rate of 3.5 percent in the third quarter of 2018, down from 4.2 percent in the second quarter.
- Payroll employment growth slowed in November, rising by 155,000 jobs after adding 237,000 in October.
 - *December jobs growth accelerated to 312,000.*
- The national unemployment rate remained at 3.7 percent in November.
- Initial claims for unemployment fell by 4,000 to 231,000 during the week ending December 1.
 - The four-week moving average rose by 4,250 to 228,000. Claims are volatile this time of year and the reporting period included the Thanksgiving holiday.
- The Conference Board's index of consumer confidence remains strong but fell 2.2 points in November and an additional 8.3 points to 128.1 in December.
- The Conference Board's index of leading indicators rose 0.1 percent in October, suggesting the expansion should continue.
- Conditions in the manufacturing sector improved in November. The Institute of Supply Management index rose from 57.7 to 59.3.
 - *But the index fell sharply in December to 54.1.*

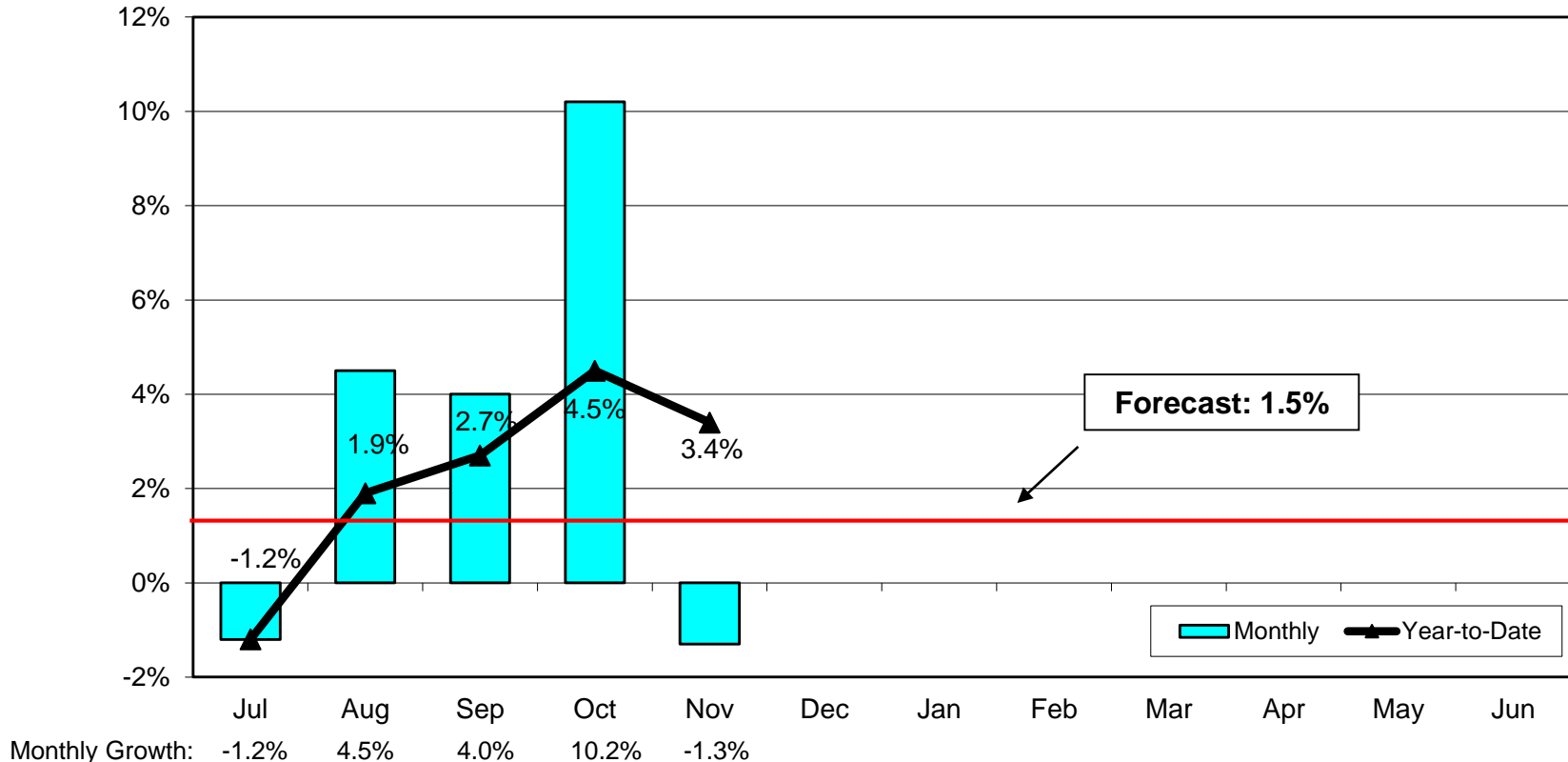
Recent National and State Economic Indicators Suggest Continued Expansion (*continued*)

- The CPI rose 0.3 percent in October after a 0.1 percent gain in September and stands 2.5 percent above October 2017.
 - Core inflation (excluding food and energy prices) rose 0.2 percent, and has increased 2.2 percent from last year.
- In December, the Federal Reserve increased the federal funds rate target range to 2.25 to 2.50 percent, the fourth rate increase in 2018.
- In Virginia, employment growth remains solid. Payroll employment rose 2.6 percent in October from a year ago.
 - Northern Virginia posted growth of 2.7 percent, Hampton Roads grew 1.9 percent, and Richmond-Petersburg rose 2.5 percent.
 - The seasonally adjusted unemployment rate held steady at 2.9 percent and stands 0.7 percentage point below October 2017.
- The net impact of federal and state tax relief to Virginians from the *Tax Cuts and Jobs Act* (TCJA) is projected to be about \$4 billion per year.
- But uncertainty appears to be creeping back onto the scene
 - International trade disputes
 - Federal government shutdown
 - Divided Congress

Fiscal Year 2019 Year-to-Date Revenue Collections Through November

Growth in Total General Fund Revenue Collections

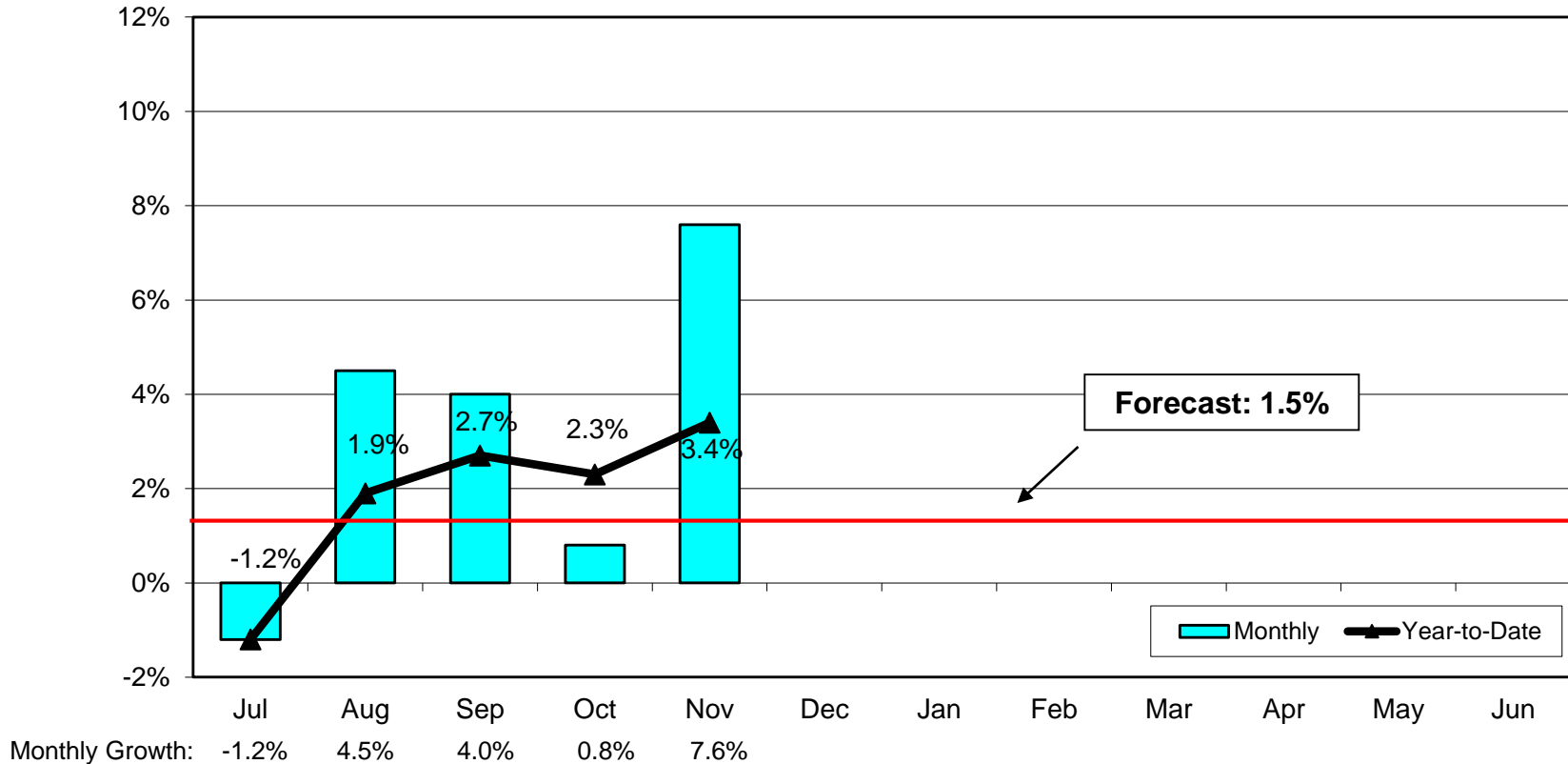
FY19 Monthly and Year-to-Date



- Total general fund revenues decreased 1.3 percent in November.
 - Payroll withholding in November had one less deposit day.
- On a year-to-date basis, total revenues increased 3.4 percent, ahead of the annual forecast of a 1.5 percent increase.

Fiscal Year 2019 Year-to-Date Smoothed Revenue Collections Through November

Growth in Total General Fund Revenue Collections FY19 Monthly and Year-to-Date



- Total general fund revenues are adjusted for the extra October deposit day being counted as November revenue.
 - Each month now has the same number of deposit days.
- For illustrative purposes only.

Fall 2018 Consensus Forecasting Process

- **Joint Advisory Board of Economists (JABE)** met October 11th.
 - The September standard forecast was a bit stronger than the standard outlook adopted last year; 10 members voted for the standard, 4 members thought that Virginia would do better than the standard in the short-term, no members voted for the pessimistic, and no members supported the Moody's Analytics forecast.
- **Governor's Advisory Council on Revenue Estimates (GACRE)** met November 19th.
 - Members evaluated JABE recommendations, revenue collections through October, and the associated revenue forecasts for the FY18-20 biennium.
 - At the GACRE meeting, 11 business members voted for the standard. 1 member voted for a standard plus forecast and 1 for a standard minus forecast for the FY18-20 biennium.
 - No members were expecting a recession to start in this biennium.

December Revenue Forecast (*Introduced Budget*) Includes Policy Adjustments

- Improved revenue collections through November suggested that the GACRE forecast was conservative and in line with the advice of the GACRE members.
 - General fund revenue expected to be \$408.2 million more than Chapter 2 Official Forecast.
- The main post-GACRE revenue adjustment was to increase the payroll withholding forecast by \$70 million per year based on collection trends.
 - Many GACRE members believed payroll growth would be stronger given the recent rise in average wages and tight labor market.
- This forecast remains more conservative than the money committees' forecasts presented at the General Assembly retreats last month.
- Some tax policy changes (federal tax conformity and Wayfair estimates) are proposed by the Governor.
- Virginia currently conforms to the federal tax code as of December 1, 2017. A bill will be introduced to set fixed state conformity as of December 31, 2018.
 - The Governor's introduced budget includes fully conforming to the IRS Code.

Fiscal Year Cash Flow of Almost \$600 Million per Year But Most New Revenue is Temporary

Estimated Virginia Revenue Impact of the TCJA Fiscal Years 2019 to 2024 (Includes Residents and Nonresidents)

	(\$Millions)					
By Source	2019	2020	2021	2022	2023	2024
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	32.6	52.7	5.5	5.8	6.0	6.3
Total, All Provisions	594.2	611.1	653.7	798.7	943.2	950.6

	(\$Millions)						
By Provisions	2019	2020	2021	2022	2023	2024	
Temporary Provisions (Expiring after 2025)	517.3	433.6	455.7	480.4	506.8	532.5	← One-time
Permanent Provisions	76.9	177.5	198.0	318.3	436.4	418.1	← Ongoing
Total, All Provisions	594.2	611.1	653.7	798.7	943.2	950.6	

- Most of the individual provisions are temporary and expire after 2025; the only substantial individual provision that is permanent is related to alternative inflation measures.
- Due to the likely timing of Virginia's conformity to the federal provisions, the full impact for Taxable Year 2018 is recognized in fiscal year 2019.
- Nonresidents account for approximately 11% of revenues.

Internet Sales (*Wayfair*)

Estimated Revenue Impact by Fund (millions of dollars)

State Sales and Use Tax (5.3% net of Dealer Discount)	5.280%	\$ 144.9
GF - Unrestricted ⁽¹⁾	2.015%	\$ 55.3
GF - Restricted 1% Education ⁽²⁾	0.990%	\$ 27.2
Education School Age 1/8% (GF transfer from Restricted)	0.125%	\$ 3.4
Education SOQ 1/4% (GF transfer from Unrestricted)	0.250%	\$ 6.9
Transportation ⁽³⁾	0.800%	\$ 22.0
HMOF (GF transfer)	0.100%	\$ 2.7
Local Option	1.000%	\$ 27.4
Regional Trans. Funds (0.7%) ⁽⁴⁾	0.367%	\$ 10.1
Hampton Roads (TPO)	0.127%	\$ 3.5
Northern Virginia (NVTA)	0.240%	\$ 6.6
Total Sales and Use Tax ⁽⁴⁾	5.647%	\$ 155.0



Notes:

- 1) Includes: 2.025% General Fund Unrestricted, -0.01% Dealer Discount.
- 2) Includes: 1% Education based on school age population, -0.01% Dealer Discount.
- 3) Includes 0.5% TTF, 0.175% HMOF, 0.050% IPROCF, and 0.075% Mass Transit Fund.
- 4) The assumed state, local and regional sales and use blended tax rate is 5.65%, after dealer discount.

December General Fund Revenue Forecast

Composition of the December Revenue Forecast Fiscal Years 2019 and 2020 (millions of dollars)

	FY19	FY20	2019-20 Biennium
<u>GACRE Revenue Forecast</u>	\$20,400.1	\$21,158.0	\$41,558.1
Total Revenue Growth: GACRE	2.6%	3.7%	
<u>Revenue Adjustments</u>			
Payroll Withholding Forecast	70.0	70.0	140.0
<u>Revenue Policy Adjustments</u>			
Wayfair internet sales (unrestricted amount)		55.3	55.3
Wayfair internet sales (restricted K-12 amount)		27.2	27.2
Federal tax conformity - permanent	76.9	177.5	254.4
Federal tax conformity - expires after 2025	517.3	433.6	950.9
Refundable Earned Income Tax Credit	(10.3)	(206.0)	(216.3)
Accelerated Sales Tax -- increase threshold to \$10 million		(27.2)	(27.2)
Miscellaneous minor actions	(3.4)	0.6	(2.8)
Total	650.5	531.0	1,181.5
Total General Fund Revenues	\$ 21,050.6	\$ 21,689.0	\$42,739.6
Total Revenue Growth	5.9%	3.0%	

Note: numbers may not add due to rounding.

Total changes to resources provide a net increase of \$2.2 billion in new funds available for spending . . .

	FY 2019	FY 2020	Biennium
<u>BASE RESOURCES - CH 2</u>			
Prior Year Balance	\$212.2		\$212.2
Additions to Balance	22.0	(0.5)	21.5
Revenue Forecast	20,173.7	20,976.2	41,149.8
Revenue Stabilization Fund	0.0	0.0	0.0
Transfers	621.0	631.0	1,252.0
Total GF Resources	<u>\$21,028.8</u>	<u>\$21,606.7</u>	42,635.5 <u>\$42,635.5</u>
Revisions			
Prior Year Balance	\$1,017.8	\$0.0	\$1,017.8
Additions to Balance	(777.1)	336.7	(440.4)
Revenue Forecast	876.9	712.8	1,589.7
Revenue Stabilization Fund	0.0	0.0	0.0
Transfers	1.1	(0.7)	0.4
Total Revisions	<u>\$1,118.7</u>	<u>\$1,048.9</u>	2,167.6 <u>\$2,167.6</u>
<u>Revised Resource Forecast</u>			
Prior Year Balance	\$1,229.9	\$0.0	\$1,229.9
Additions to Balance	(755.0)	336.2	(418.8)
Revenue Forecast	21,050.6	21,689.0	42,739.6
Revenue Stabilization Fund	0.0	0.0	0.0
Transfers	622.1	630.3	1,252.4
Total GF Resources	<u>\$22,147.6</u>	<u>\$22,655.6</u>	<u>\$44,803.1</u>

*Amounts shown in millions

Spending and Savings

20 Changes in operating costs are driven by issues that both increase and decrease spending . . .

- 209 amendments totaling \$2.4 billion increase spending
 - Examples include:
 - Deposits to the Revenue Reserve and Revenue Stabilization Fund from the FY 2018 surplus
 - Updates to mandated programs like Medicaid
 - Revisions in other expenditure forecasts
 - Compensation for teachers, state employees, and state-supported locals
 - Funding for core services and priority needs in education, health and human resources, public safety, and veteran's services
 - Investments in water quality, broadband, public schools, transportation, and other infrastructure
- 22 amendments totaling \$313.6 million decrease spending
 - Examples include:
 - Savings from revised forecasts of employee health insurance and debt service
 - Use of nongeneral fund revenue to supplant the general fund
 - Updates in public school enrollment

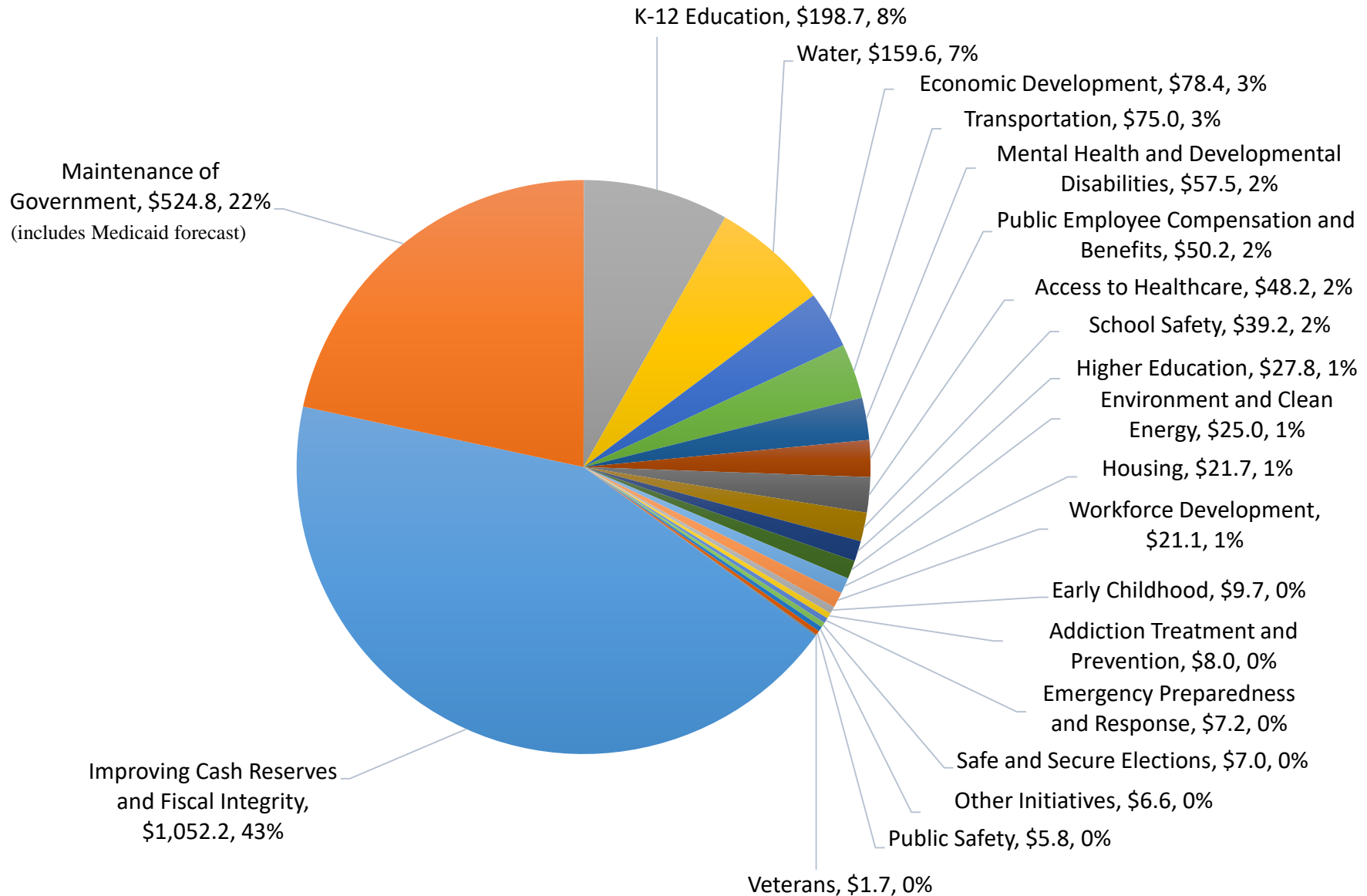
The combined impact is an overall net increase in operating spending of \$2.1 billion for the biennium

To achieve these goals, the proposed budget reflects net new general fund spending of \$2.1 billion over the biennium summarized across 21 categories . . .

Category	FY 2019	FY 2020	Biennial Total	% of Total
Improving Cash Reserves and Fiscal Integrity	\$739.3	\$312.9	\$1,052.2	43.38%
Maintenance of Government	\$238.3	\$286.5	\$524.8	21.64%
K-12 Education	\$86.8	\$111.9	\$198.7	8.19%
Water	\$20.0	\$139.6	\$159.6	6.58%
Economic Development	\$20.6	\$57.8	\$78.4	3.23%
Transportation	\$75.0	\$0.0	\$75.0	3.09%
Mental Health and Developmental Disabilities	\$0.5	\$57.1	\$57.5	2.37%
Public Employee Compensation and Benefits	\$0.9	\$49.3	\$50.2	2.07%
Access to Healthcare	\$15.7	\$32.5	\$48.2	1.99%
School Safety	\$0.0	\$39.2	\$39.2	1.62%
Higher Education	\$0.7	\$27.2	\$27.8	1.15%
Environment and Clean Energy	\$15.7	\$9.4	\$25.0	1.03%
Housing	\$14.5	\$7.2	\$21.7	0.90%
Workforce Development	\$8.1	\$13.0	\$21.1	0.87%
Early Childhood	\$0.0	\$9.7	\$9.7	0.40%
Addiction Treatment and Prevention	\$1.6	\$6.4	\$8.0	0.33%
Emergency Preparedness and Response	\$0.0	\$7.2	\$7.2	0.30%
Safe and Secure Elections	\$0.0	\$7.0	\$7.0	0.29%
Other Initiatives	\$2.5	\$4.1	\$6.6	0.27%
Public Safety	\$0.1	\$5.7	\$5.8	0.24%
Veterans	\$0.0	\$1.7	\$1.7	0.07%
Subtotal Spending	\$1,240.1	\$1,185.4	\$2,425.5	100.00%
Less Savings	(\$135.9)	(\$177.7)	(\$313.6)	
Grand Total	\$1,104.2	\$1,007.7	\$2,111.9	

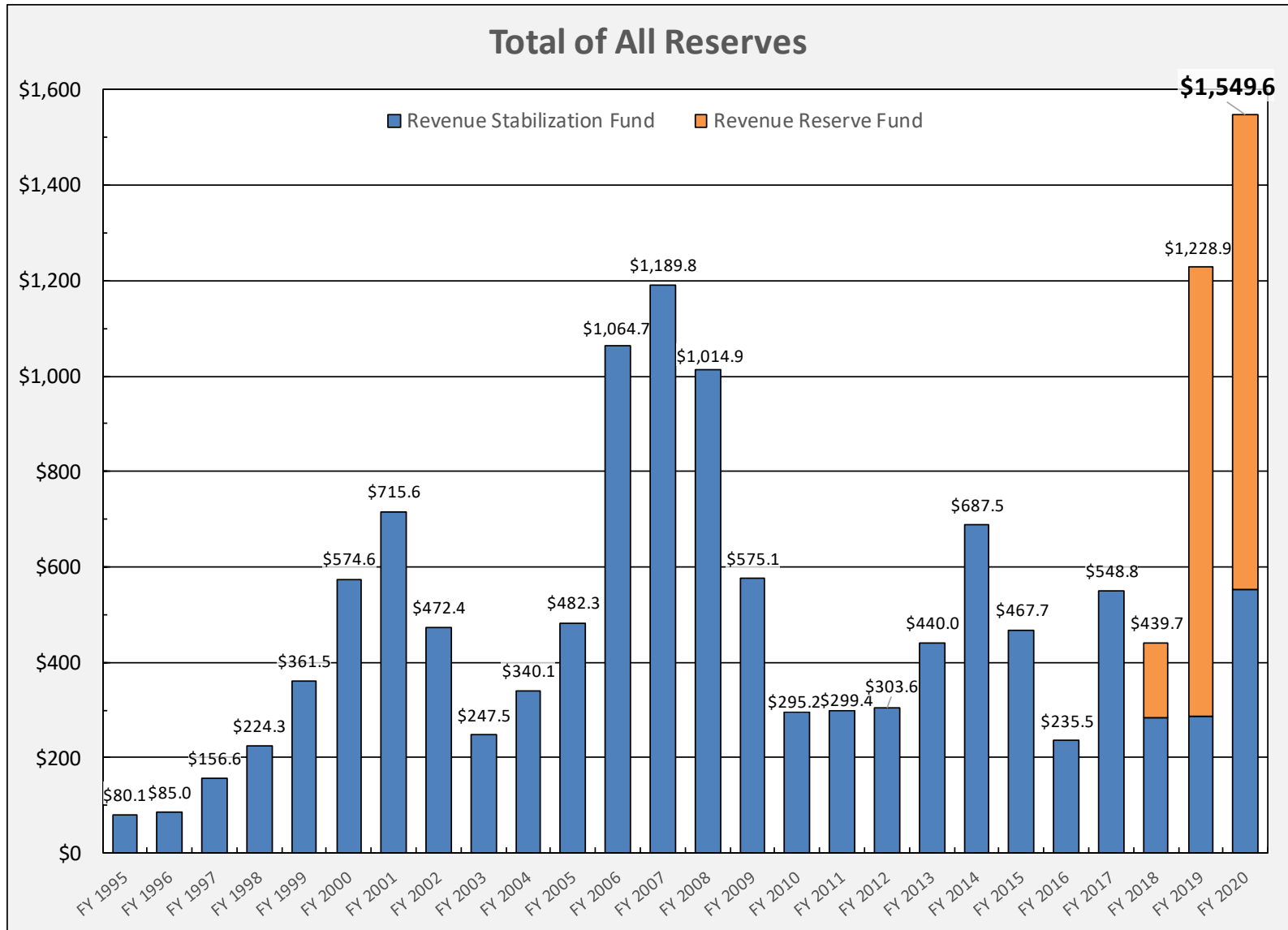
*Amounts shown in millions

Reserves and Medicaid related expenses dominate new spending . . .



*Amounts shown in millions

By the Close of FY 2020, Total Reserves Are Estimated to Exceed **\$1.5 Billion**, the Largest Total in History



The top 10 spending amendments account for 79.5 percent of the total increased cost . . .

Secretarial Area	Agency	Title	FY 2019	FY 2020	Biennial Total	% of Total
Finance	162: Department of Accounts Transfer Payments	Provide additional funding for the Revenue Reserve Fund	\$504,070,000	\$50,000,000	\$554,070,000	22.8%
Health and Human Resources	602: Department of Medical Assistance Services	Fund Medicaid utilization and inflation	\$202,221,659	\$260,327,089	\$462,548,748	19.1%
Finance	162: Department of Accounts Transfer Payments	Appropriate mandatory Revenue Stabilization Fund deposit	\$0	\$262,941,731	\$262,941,731	10.8%
Finance	162: Department of Accounts Transfer Payments	Appropriate mandatory balances to the Revenue Reserve Fund	\$235,227,895	\$0	\$235,227,895	9.7%
Education	197: Direct Aid to Public Education	Increase salaries for funded Standards of Quality instructional and support positions	\$0	\$87,569,974	\$87,569,974	3.6%
Education	197: Direct Aid to Public Education	Increase general fund support for school employee retirement contributions to make Literary Fund available for school construction loans	\$80,000,000	\$0	\$80,000,000	3.3%
Transportation	501: Department of Transportation	Supplement the Virginia Transportation Infrastructure Bank	\$75,000,000	\$0	\$75,000,000	3.1%
Natural Resources	199: Department of Conservation and Recreation	Appropriate the required deposit to the Water Quality Improvement Fund from the FY 2018 surplus	\$0	\$73,757,699	\$73,757,699	3.0%
Natural Resources	440: Department of Environmental Quality	Provide funding for stormwater local assistance	\$0	\$50,000,000	\$50,000,000	2.1%
Commerce and Trade	165: Department of Housing and Community Development	Expand the Virginia Telecommunication Initiative	\$0	\$46,000,000	\$46,000,000	1.9%

Top 10 Items	\$1,096,519,554	\$830,596,493	\$1,927,116,047	79.5%
Remaining Items (199)	\$143,554,445	\$354,809,736	\$498,364,181	20.5%
Grand Total Spending	\$1,240,073,999	\$1,185,406,229	\$2,425,480,228	100.0%

NOTE: These amendments reflect discrete changes and may need to be read with other amendments to obtain a comprehensive result.

Employee compensation, guidance counselors, and water quality top the list of other recommendations greater than \$30 million . . .

- \$40.2 million to provide a one percent bonus to state employees and state-supported local employees, effective December 1, 2019.
- \$36.0 million to increase school counselors in public elementary, middle, and high schools.
- \$35.0 million to supplement the FY 2018 surplus deposit to the Water Quality Improvement Fund in support of agricultural best management practices and other nonpoint source reduction efforts.
- \$28.1 million to fund changes in the general fund share of costs for information technology and telecommunications usage by state agencies.
- \$27.3 million for the continued operations of Piedmont Geriatric and Catawba Hospitals after the loss of Medicaid certification.
- \$20.0 million to enhance the Virginia Business Ready Sites Program.
- \$19.0 million to support the Virginia Housing Trust Fund.

Highlights of other proposed new spending include . . .

- \$14.4 million to reflect additional education sales tax revenues from internet sales.
- \$13.0 million to cover the estimated cost of administering the Medicaid expansion related 1115 demonstration waiver.
- \$12.9 million and 123 positions to transition medical care at Fluvanna Correctional Center from a third-party contract to the Department of Corrections.
- \$12.8 million to fund the revised forecast of utilization and inflation in the Commonwealth's Children's Health Insurance programs.
- \$11.0 million to address workforce needs by strategically investing in bolstering computer science-related education at both the K-12 and higher education levels.
- \$11.0 million to support land conservation through the Virginia Land Conservation Fund.
- \$10.9 million to update sales tax revenues for public education based on the Department of Taxation's November 2018 education sales tax forecast.
- \$10.0 million to support the development of a public/private partnership program to finance energy efficiency and renewable energy loans for both private and local government properties and entities within the Commonwealth of Virginia.

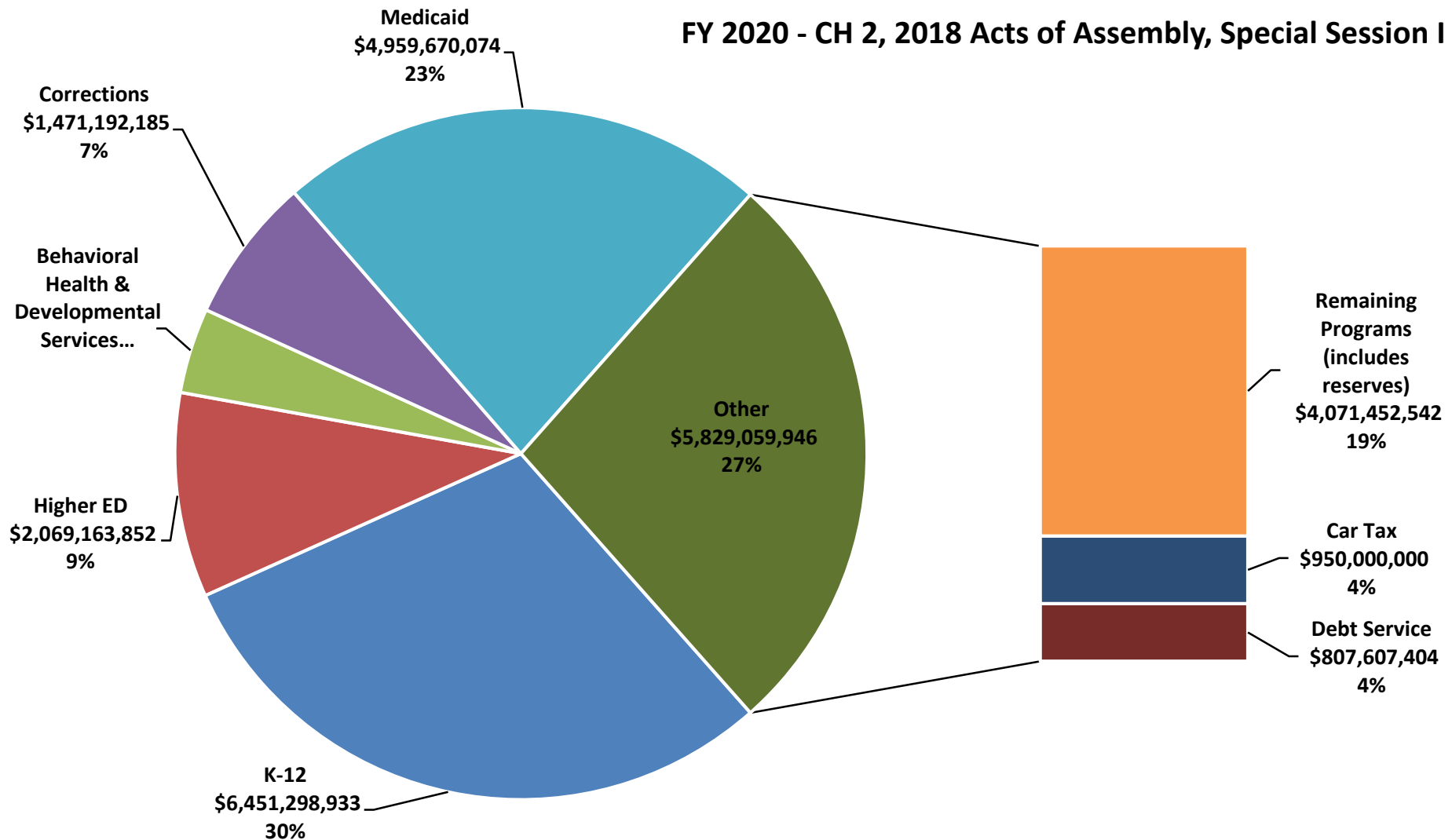
27 ***One-time revenues from conformity will be dedicated to five purposes through FY 2024 . . .***

One-Time Spending Plan From One-Time Conformity Revenue

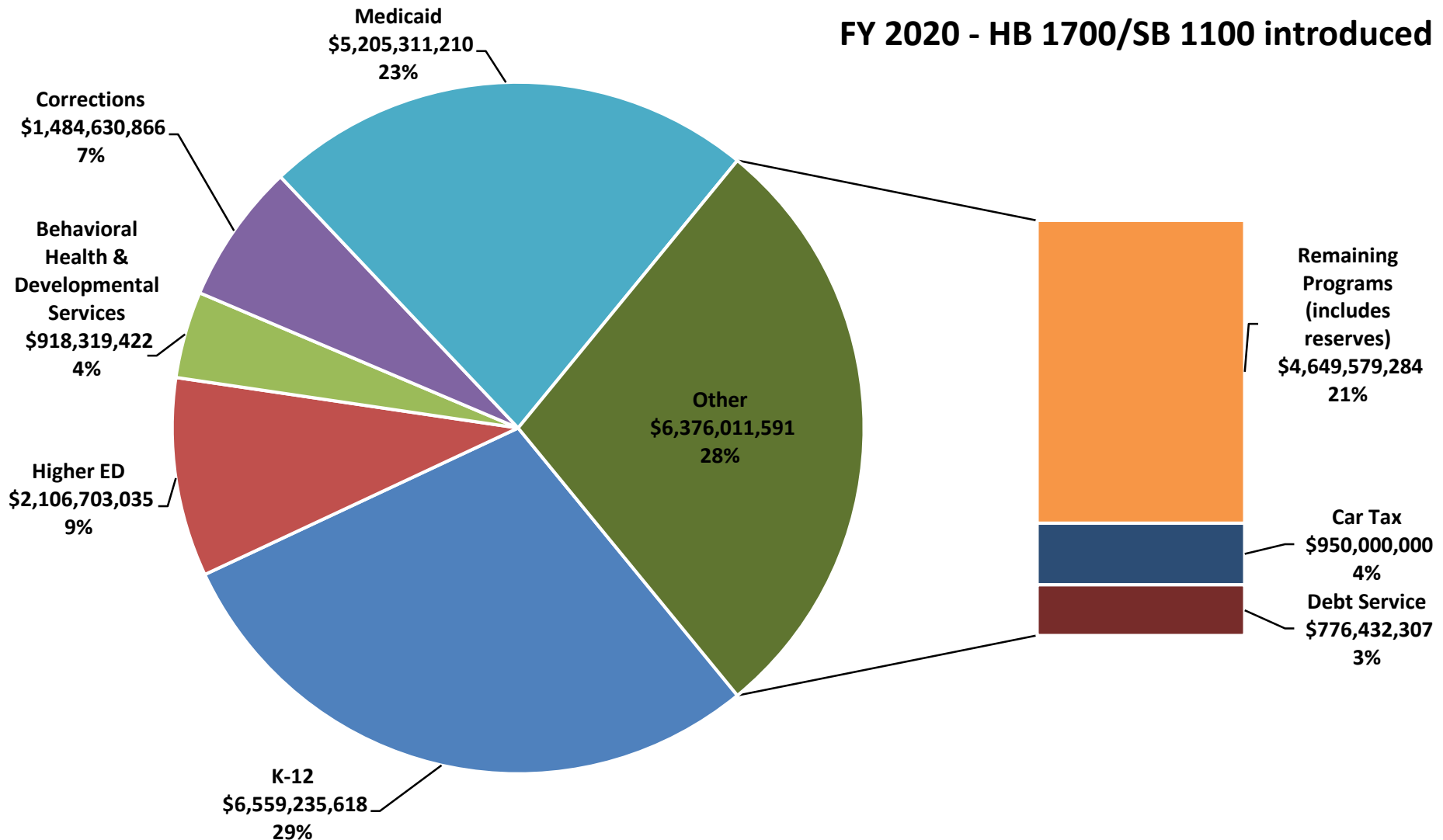
	FY 2019	FY 2020	FY 2021	FY 2022	FY 2023	FY 2024	TOTAL	
One-Time Revenue	517.30	433.60	455.70	480.40	506.80	532.50	2,926.30	
Less Uses:								Notes:
Refundable Earned Income Tax Credit	10.30	206.00	212.90	220.00	226.60	233.80	1,109.60	
Water Quality - Storm Water Local Assistance	-	50.00	50.00	50.00	50.00	50.00	250.00	\$50 million/year for five years starting in FY 2020
Water Quality - NRCF/Agricultural Best Management Practices/special projects	20.00	15.03	80.50	80.50	80.50	80.50	357.03	\$90.5 million/year for five years starting in FY 2020 - \$10 million in base each year + \$65.5 million from FY 2018 surplus appropriated in FY 2020
Broadband	-	46.00	46.00	46.00	46.00	46.00	230.00	\$50 million/year for five years starting in FY 2020 - \$4 million in base
Land Conservation	5.50	5.50					11.00	Land Conservation Fund
Accelerated Sales Tax - move threshold to \$10.0 million or greater	-	27.20					27.20	Current threshold is \$4.0 million. Removes ~1,800+ dealers. ~1,300 dealers would continue to file.
Revenue Reserve	479.07	50.00	64.50	74.50	74.50	74.50	817.07	Amounts are in addition to \$45.5 million appropriated in base in CH 2.
Subtotal Uses	514.87	399.73	453.90	471.00	477.60	484.80	2,801.90	
Balance/(Shortfall)	2.43	33.87	1.80	9.40	29.20	47.70	124.40	

*Amounts shown in millions

28 *Five budget drivers make up 73 percent of the FY 2020 general fund budget in Chapter 2 . . .*



29 In FY 2020, the five budget drivers drop to 72 percent of the general fund in the introduced budget . . .



Future Budget Process

- **The Secretary of Finance intends to take a new approach to budget development.**
- **The base budgets of state agencies will be scrutinized more closely to ensure funding is consistent with mission of agency.**
 - Policymakers tend to budget at the margin.
 - It's time for a systematic review of agencies' base funding.
- **If we can “repurpose” 1% of current general fund spending, that is more than \$400 million that could be considered for other priorities.**
- **This process will be a multi-year effort.**
 - It's a commitment to taxpayers that we are willing to do the hard work to scrutinize the efficacy of state spending.
 - And nongeneral fund spending too!

Concluding Thoughts

- The Governor's proposed amendments to the current biennial budget are the first act of a multi-act play.
- The Governor has demonstrated a willingness to discuss alternatives with members of the General Assembly and maintains an open door policy to hear their concerns.
- Tax policy discussions, and implications on budget priorities, will clearly be a point of contention.
- It's an election year!

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