

Virginia's State GF Budget Outlook and Issues



Virginia Association of Counties 2023 Conference



Fiscal Analytics, LTD

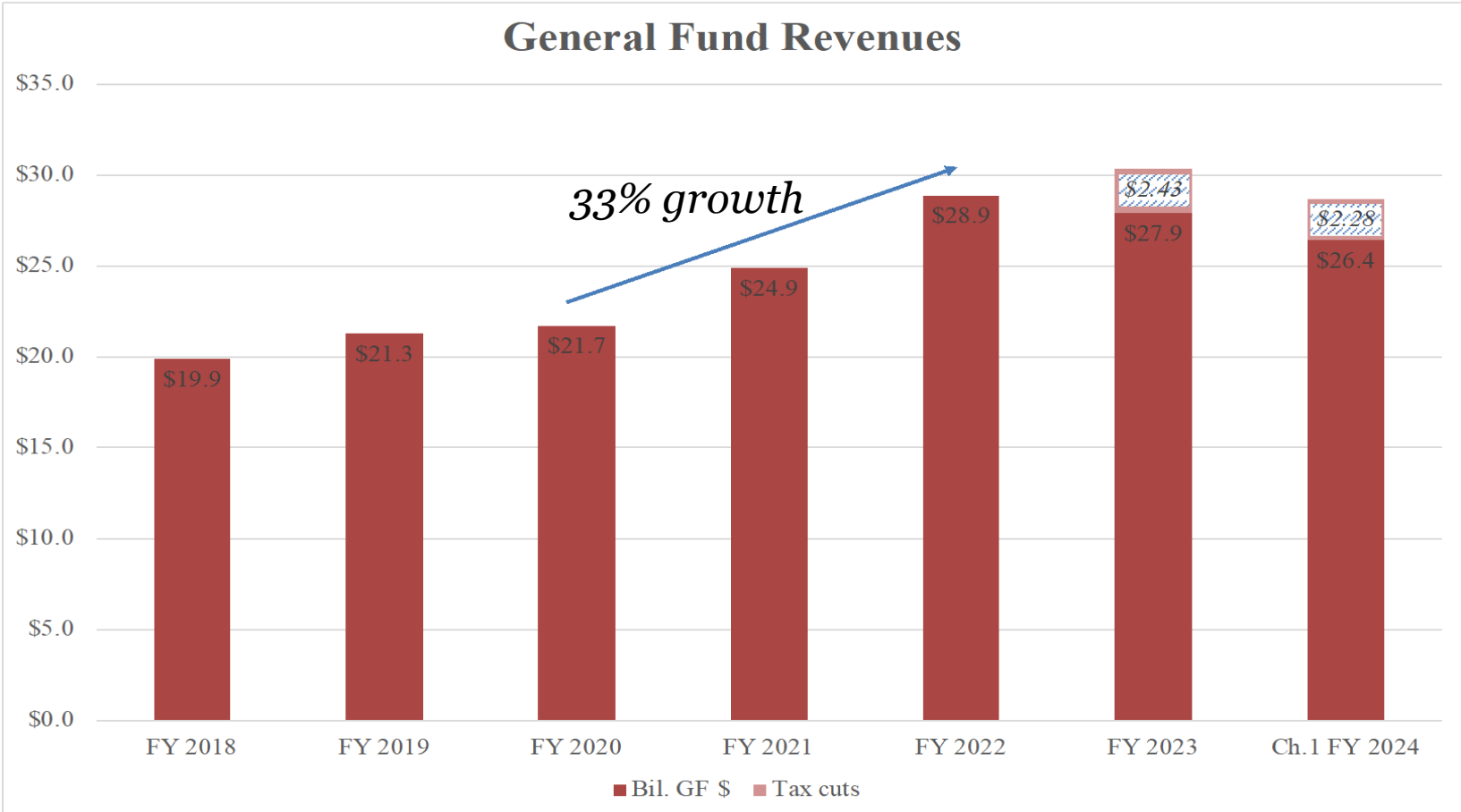
November 13, 2023

Summary of 2022-24 GF Budget



- Much more revenue than initially expected due to better economic performance, generating large balances for spending.
 - Massive federal fiscal stimulus and easing of monetary policy
 - FY 2022 GF revenues and transfers were \$7.8 billion higher than FY 2019.
 - FY 2021, FY 2022 and FY 2023 GF revenue were \$2.5 bil., \$1.9 bil. and \$1.5 bil. above budget forecasts, respectively.
- Adopted 2022-24 budget included large one-time amounts designated for: revenue reserves (\$1.8 bil.); cash for capital (\$2.5 bil.); extra VRS deposit (\$250 mil.); water quality - WQIF (\$651 mil.); economic development (\$200 mil.); transportation (\$260 mil.); and K-12 funding designated for capital improvements and flexible funding (\$1.3 bil.).
- Ongoing funding increases included 5% FY 23 and 7% FY 24 salary increases for state/K-12 employees, partial elimination of the K-12 support cap, and substantial mental health increases.

Massive General Fund Revenue Growth from FY 2020 to FY 2022



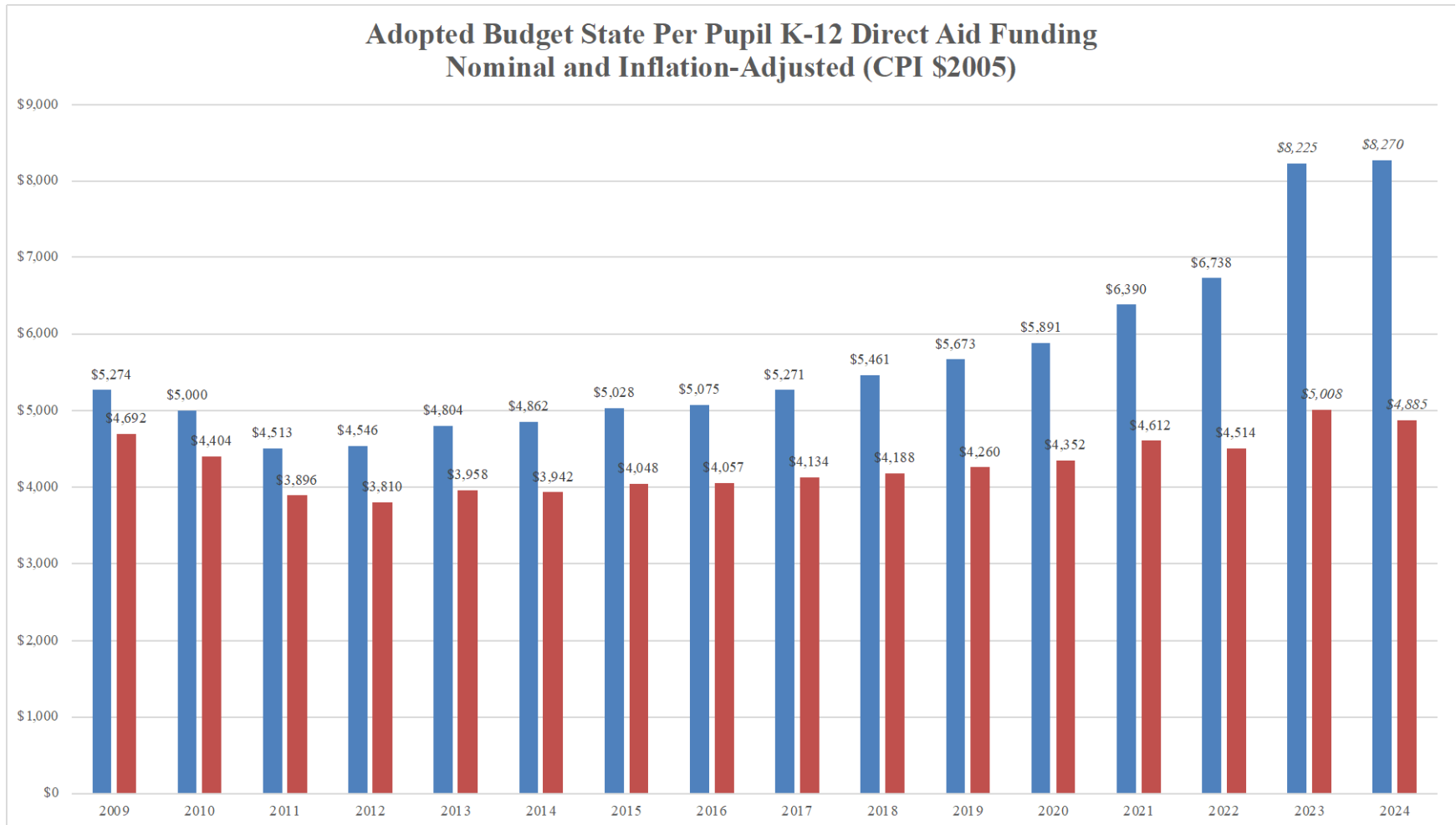
Note: Tax reductions estimated to reduce GF revenues by \$2.4 bil. in FY 23 and \$2.3 bil. in FY 24

Change in FY 2024 GF Appropriations From Recent Budget Compromise



	Final	Ch. 1	Ch. 769	Ch. 1	FY 2024
	<u>FY 2022</u>	<u>FY 2023</u>	<u>FY 2024</u>	<u>FY 2024</u>	<u>\$ Change</u>
Legislative and Executive	\$156.4	\$173.8	\$173.2	\$176.0	\$2.8
Judicial Dept.	\$547.6	\$582.0	\$582.6	\$589.6	\$7.0
Administration/Comp Bd	\$789.2	\$886.3	\$892.3	\$910.5	\$18.2
Treasury Board Debt Service	\$853.5	\$954.2	\$994.6	\$994.6	\$0.0
Other Finance /VRS Deposit	\$918.5	\$430.0	\$170.7	\$173.6	\$2.9
Rainy Day/Revenue Reserve	\$1,148.7	\$1,127.7	\$406.0	\$695.6	\$289.6
Car Tax Reimbursement	\$950.0	\$950.0	\$950.0	\$950.0	\$0.0
Commerce and Trade/Labor	\$488.6	\$590.1	\$549.6	\$818.7	\$269.1
Agriculture / Nat. Resources	\$323.0	\$636.1	\$257.8	\$932.1	\$674.3
K-12 Education/DOE	\$7,252.7	\$9,224.1	\$8,737.5	\$9,296.6	\$559.1
Higher & Other Education	\$2,582.1	\$2,960.3	\$3,082.2	\$3,278.0	\$195.8
DMAS Medicaid	\$4,409.1	\$5,540.8	\$5,948.4	\$5,733.7	(\$214.7)
Other Health & HS	\$2,408.4	\$2,615.4	\$2,716.9	\$2,886.5	\$169.6
Public Safety & Veterans/HS	\$2,292.3	\$2,504.3	\$2,504.3	\$2,553.8	\$49.5
Transportation	\$342.5	\$51.5	\$110.0	\$260.0	\$150.0
Central Appropriations	\$336.2	\$451.1	\$732.5	\$807.2	\$74.7
Independent Agencies/Capital	<u>\$621.1</u>	<u>\$2,064.6</u>	<u>\$218.2</u>	<u>\$429.9</u>	<u>\$211.7</u>
Total GF Appropriations	\$26,419.9	\$31,742.3	\$29,026.8	\$31,486.4	\$2,459.6

K-12 State Per Pupil Funding Saw Significant 2022-24 Funding Increases



2022-24 Major New One-Time K-12 Education GF Spending



- **\$450 mil. School Construction Assistance Program**
 - Grants would cover 10% to 30% of reasonable project costs up to \$100 mil. , depending on a locality’s local composite index and fiscal stress score.
- **\$400 mil. School Construction Grants**
 - Each school division receives \$1 mil. with the remainder distributed by share of ADM modified by their respective LCI.
- Use GF rather than **Literary Fund** for school employee retirement costs (\$166 mil.)
- **Laboratory schools** deposit (\$100 mil.)
- **Hold harmless rebenchmarking** using pre-covid data (\$354 mil.)
- \$146 mil. to **maintain current VRS rates** instead of lowering based on usual methodology. (Higher VRS local match too)
- One-time \$419 million in **FY 2024** to “**support flexible funding** for the implementation of the Virginia Literacy Act, learning loss recovery, and additional operating and infrastructure support.”

2022-24 Major New Ongoing GF K-12 Spending



- **5% salary increase in FY 23 and 7% in FY 24** for state funded SOQ teacher and support positions (\$785 mil.)
- **Offset loss of state sales tax on food** with \$361 mil. in GF
- Partial removal of **support position cap** – increased from 17 to 24 positions per 1000 ADM (\$425 mil.)
- Increase **at-risk add-on** from maximum 26% to 36% basic aid boost per free lunch each year. (\$145 mil.)
- Fund **reading specialists** at 1 per 550 K-3 students (\$63 mil.)
- Fund **principals** in each elementary school (\$20 mil.)
- Increase **VPI per pupil** from \$7,655 to \$8,359 (\$27 mil.)
- Expand **VPI access to three-year-olds** with additional slots: 1,138 FY 2023 and 1,374 FY 2024. (\$19 mil.)

The Spending Increases in the 2024-26 Biennium Budget Likely To Be Much Smaller than Current Biennium



- Smaller carryforward balances available for the 2024-26 biennium since multibillion dollar surpluses are unlikely again.
- *Despite* large one-time funding in FY 2024, ongoing operating spending compared to ongoing revenues appears stretched.
- Medicaid spending increases are forecast to be \$175 million higher in FY 2025 and \$539 mil. In FY 2026. Forecasts are very tenuous due to unwinding of pandemic federal benefits and managed care cost contracts.
- K12 rebenchmarking changes may be higher than recent biennia due to higher inflation adjustments, although lower school population increases may offset to some degree.
- Expect conservative revenue forecasts due to a slowing economy and full implementation of previous adopted tax reductions.
- The Commonwealth does have very healthy reserves and other financial levers it can pull in the event of an unexpected revenue downturn.
 - Rainy day fund and voluntary reserves total \$4.6 bil.
 - 2022-24 budget has \$2.5 billion in GF cash for capital outlay some of which could be delayed or converted to debt in the event of a revenue crisis.
 - \$1.0 bil. recent GF VRS deposit in 2022-24 budget helps provide a pension cushion.

Economic Outlook



Who knows the answer to these questions: Where are inflation and interest rates headed? Will there be a recession and if so, how bad? Will geopolitics or other “black swans” impact our economy? Will there be a government shutdown and what would the impact be in Virginia?

“There are two kinds of forecasters: those who don’t know and those who don’t know they don’t know.” -- John Kenneth Galbraith

- Federal Reserve’s tightening monetary policy will undoubtedly have a lag effect. It’s taken longer than expected...
 - So far, effect on durable goods has been muted. Most people are not moving and keeping their lower rate mortgages. Consumer debt is starting to increase.
- Employment and consumer spending has been better than expected. Will that crack?
 - Virginia employment growth has mainly been in lower paid leisure and hospitality services.
- Economic/revenue forecasts will continue in a ‘**show us the money**’ mode.

Economy Has Performed Better Than Forecast, But Expected to Slow in 2024-26 Biennium



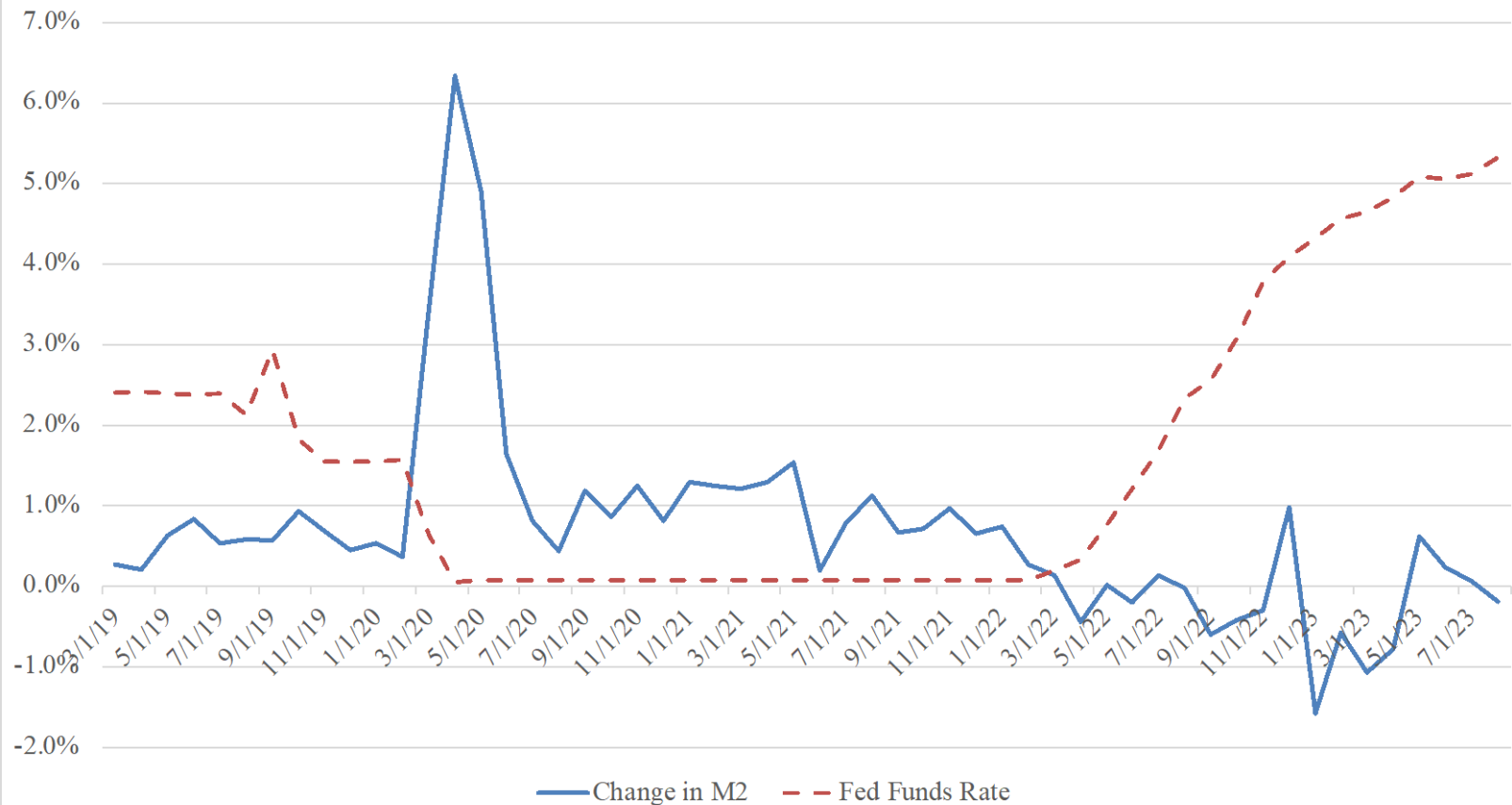
	<u>FY 2022 Actual</u>	<u>FY 2023 Actual</u>
VA Payroll Employment	3.1%	2.7%
VA Wages and Salaries	9.0%	7.6%
CPI	7.1%	6.3%

Note: 2023 3rd Q U.S. GDP grew 4.9%, last year's forecast called for -0.5% growth

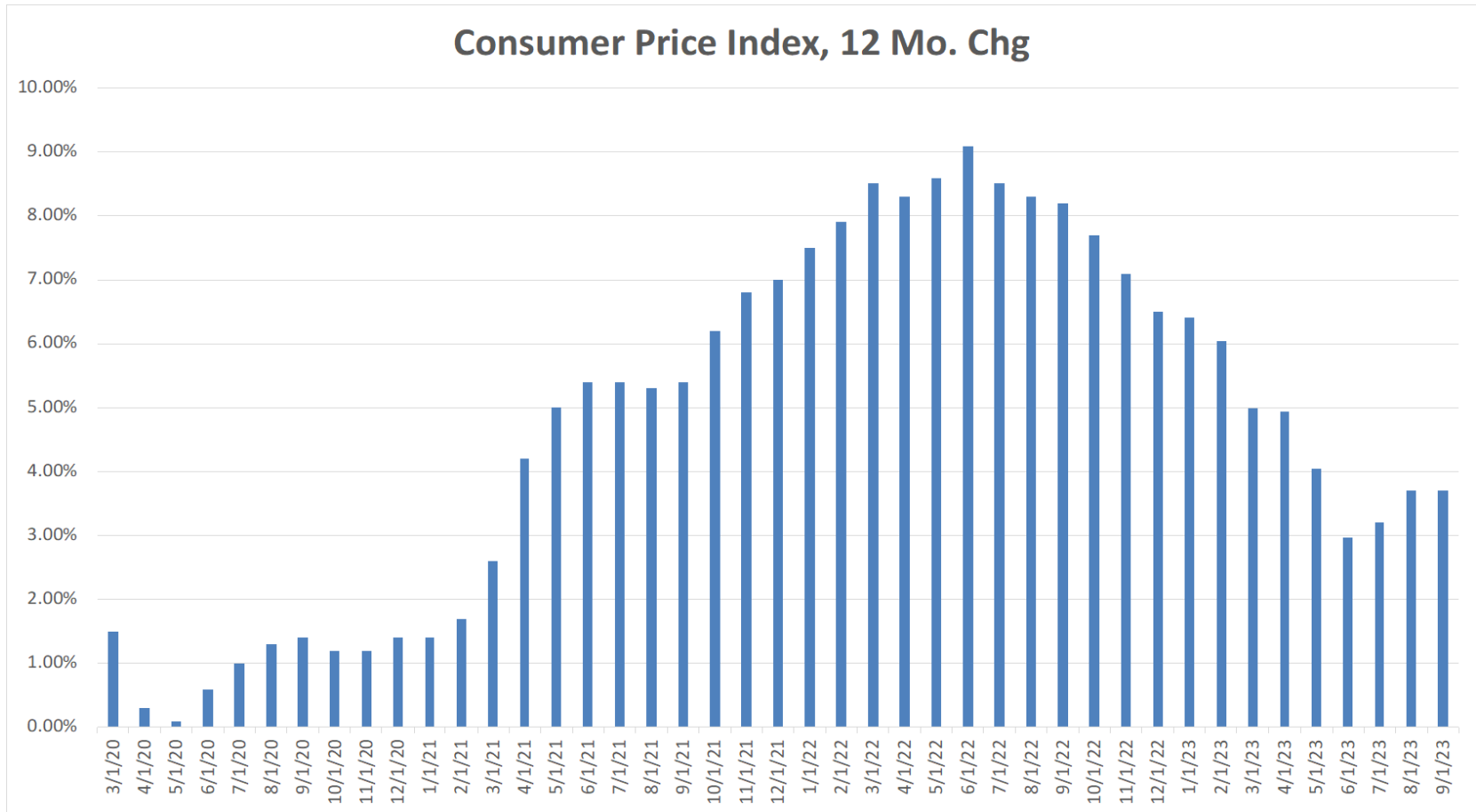
Fed is Working to Reduce Inflation, By Raising Interest Rates and Reducing Money Supply



Change in Interest Rates and Money Supply



...But Consumer Prices Have Not Met Fed Target of 2%, Making Interest Rates Likely Higher for Longer



Source: <https://www.bls.gov/charts/consumer-price-index/consumer-price-index-by-category-line-chart.htm>

Ongoing Tax Policy Changes Reduce Revenues



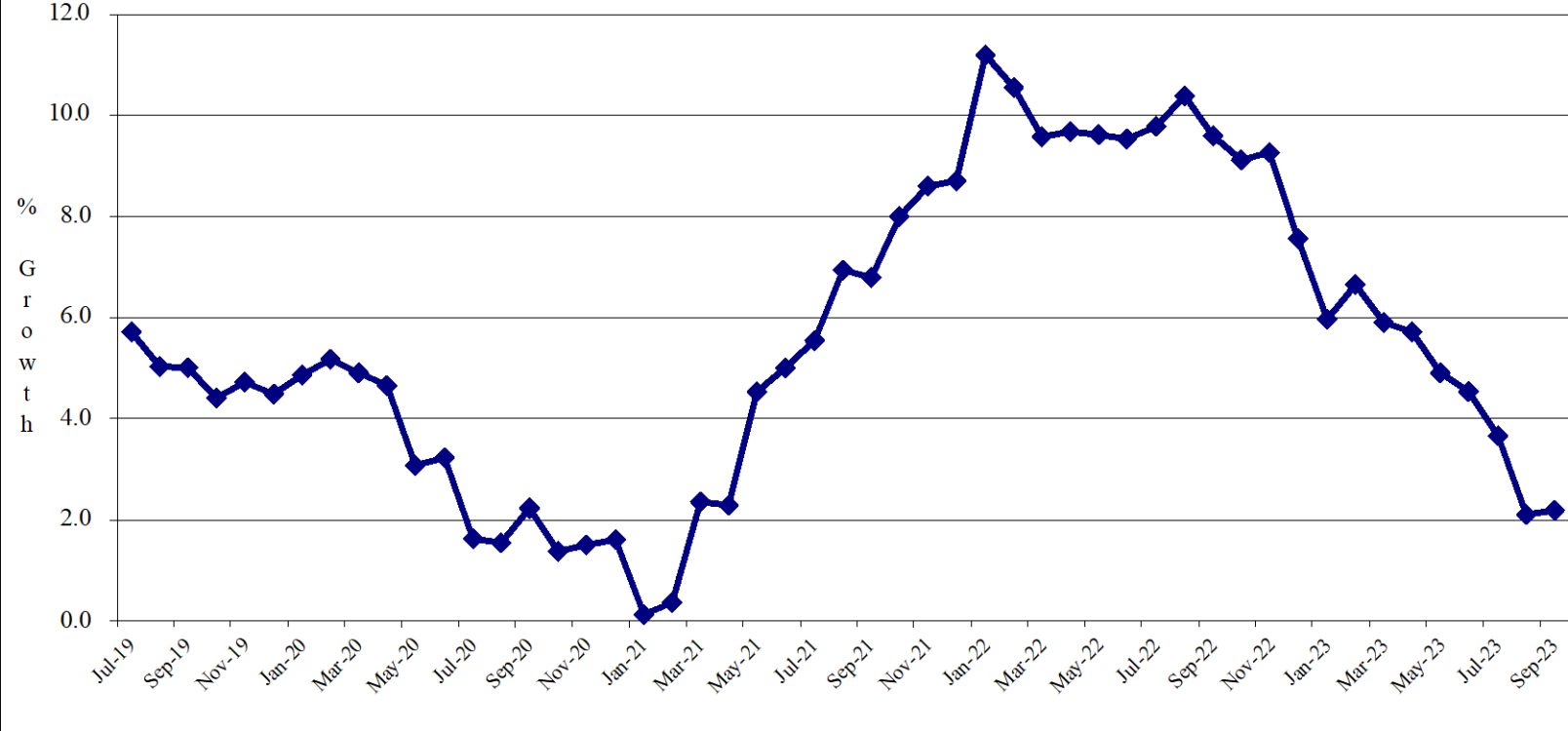
Recent Adopted Tax Policy Changes Impacting Revenue Estimates**				
	<u>FY 2023</u>	<u>FY 2024</u>	<u>FY 2025</u>	<u>FY 2026</u>
Standard Deduction Increases	\$970.4	\$757.6	\$795.5	\$835.3
Refundable Earned Income Tax Credit	\$159.0	\$156.0	\$159.5	\$155.0
Income Tax Subtraction on Military Benefits	\$145.0	\$194.0	\$219.8	\$232.2
Eliminate Sales Tax on Groceries and Personal Hygiene	\$107.3	\$265.1	\$274.4	\$281.5
Tax Rebate	\$1,048.6	\$906.8		
Total	\$2,430.3	\$2,279.5	\$1,449.2	\$1,504.0

** November 2022 GACRE report adjusted for 2023 Special Session tax changes

Income Tax Withholding is Declining Due to Job Growth in Lower Wage Categories and Increased Standard Deduction



12 Mo. Moving Avg Income Tax Withholding



Slowing Revenue Growth Will Likely Constrain 2024-26 Budget



	<u>FY 2023 Actual</u>	<u>FY 2024 Ch. 1 *</u>	<u>FY 2025 FA Forecast</u>	<u>FY 2026 FA Forecast</u>
<i>Withholding</i>	\$15,957.2	\$15,853.0	\$16,328.6	\$16,818.4
<i>Estimated Pay/Tax Dues</i>	\$6,629.2	\$4,687.6	\$5,300.0	\$5,300.0
<i>Refunds</i>	<u>(\$3,602.8)</u>	<u>(\$2,834.8)</u>	<u>(\$2,834.8)</u>	<u>(\$2,834.8)</u>
Net Individual Income	\$18,983.6	\$17,705.8	\$18,793.8	\$19,283.6
Sales Taxes	\$4,734.6	\$4,418.2	\$4,550.7	\$4,687.3
Corporate Income	\$2,031.1	\$1,896.1	\$1,953.0	\$2,011.6
All Other	<u>\$2,160.6</u>	<u>\$2,349.2</u>	<u>\$2,419.7</u>	<u>\$2,492.3</u>
Total GF Revenue	\$27,909.9	\$26,369.3	\$27,717.2	\$28,474.8
GF Transfers	<u>\$815.6</u>	<u>-\$129.8</u>	<u>\$815.6</u>	<u>\$815.6</u>
Total General Funds	\$28,725.5	\$26,239.5	\$28,532.8	\$29,290.4

- FY 2024 GF transfers reflect impact of \$907 mil. in adopted tax rebates, and \$1.0 bil. PTET adjustment for FY 2023 income tax overpayment.

Ongoing Revenues and Spending Seem Mismatched



	Ch. 1	Ch. 1	Base Amount	Base Amount	Biennium
	<u>FY 2023</u>	<u>FY 2024</u>	<u>FY 2025</u>	<u>FY 2026</u>	<u>\$ Change</u>
Legislative and Executive	\$173.8	\$176.0	\$176.0	\$176.0	\$2.2
Judicial Dept.	\$582.0	\$589.6	\$589.6	\$589.6	\$7.6
Administration/Comp Bd	\$886.3	\$910.5	\$910.5	\$910.5	\$24.2
Treasury Board Debt Service	\$954.2	\$994.6	\$1,100.0	\$1,100.0	\$251.2
Other Finance /VRS Deposit	\$430.0	\$173.6	\$173.6	\$173.6	(\$256.4)
Rainy Day/Revenue Reserve	\$1,127.7	\$695.6	\$0.0	\$0.0	(\$1,823.3)
Car Tax Reimbursement	\$950.0	\$950.0	\$950.0	\$950.0	\$0.0
Commerce and Trade/Labor	\$590.1	\$818.7	\$590.1	\$590.1	(\$228.6)
Agriculture / Nat. Resources	\$636.1	\$932.1	\$350.0	\$350.0	(\$868.2)
K-12 Education/DOE	\$9,224.1	\$9,296.6	\$9,296.6	\$9,296.6	\$72.5
Higher & Other Education	\$2,960.3	\$3,278.0	\$3,278.0	\$3,278.0	\$317.7
DMAS Medicaid	\$5,540.8	\$5,733.7	\$5,908.7	\$6,272.7	\$906.9
Other Health & HS	\$2,615.4	\$2,886.5	\$2,886.5	\$2,886.5	\$271.1
Public Safety & Veterans/HS	\$2,504.3	\$2,553.8	\$2,553.8	\$2,553.8	\$49.5
Transportation	\$51.5	\$260.0	\$51.5	\$51.5	(\$208.5)
Central Appropriations	\$451.1	\$807.2	\$100.0	\$100.0	(\$1,058.3)
Independent Agencies/Capital	<u>\$2,064.6</u>	<u>\$429.9</u>	<u>\$0.0</u>	<u>\$0.0</u>	<u>(\$2,494.5)</u>
Total GF Appropriations	\$31,742.3	\$31,486.4	\$28,914.9	\$29,278.9	(\$5,034.9)

Known Mandatory New Spending Items for the 2024-26 Budget



- K-12 rebenchmarking could exceed \$500 million in 2024-26 biennium compared to a low rebenchmarking \$40 mil. amount in the 2022-24 biennium due to pandemic–related impacts
(\$345 mil. more was provided for pandemic hold harmless funding).
- Medicaid cost increases are forecast to cost \$714 billion more over the biennium. Unwinding of pandemic-related federal assistance and eligibility has ended and new managed care contracting is making forecasting difficult.
- Latest 2% salary increases in January 2024 will need to be annualized.
- Additional CSA funding needed due to cost and utilization increases

Other Anticipated Budget Pressures



- Additional state employee and teacher raises to keep up with inflation (\$110 mil per year)
- Continue to fix Virginia's inadequate and overburdened behavioral health care system, including implementation of Governor's Right Help Right Now plan. Several initiatives partially funded in September 2023 budget amendments expected to be revisited, including:
 - Fund new mobile crisis units; increase the number of Crisis Receiving Centers and Crisis Stabilization Units; Expand the elementary, middle, and high school-based mental health program to dozens of new communities; Expand tele-behavioral health services in public schools and on college campuses; partner with hospitals for alternatives to emergency departments for crisis; transportation and in-hospital monitoring by law enforcement and other personnel; serious mental illness housing; additional Medicaid Waiver Priority 1 Waitlist Slots and increased provider rates; opioid abatement initiatives; develop the behavioral health workforce.
- The Department of Social Services has submitted requests to revamp their case management system and improve their foster care system

Other Anticipated Budget Pressures (Cont'd)



- State police staffing issues
- Additional economic development funding, e.g., Virginia Business Ready Sites Program, and workforce development
- Subsidizing child care. The Child Care Subsidy Program using federal COVID-19 relief funding is set to expire in FY24. Fifty percent more children received subsidized child care at the end of FY23 than in FY22, but the entire program is set to expire.
- Stabilizing the finances of the Washington Metropolitan Area Transit Authority and making additional transportation investments, such as I-81
- Funding for reading specialists for grades 4 and 5 as required by 2023 legislation

VACo GF Budget Priorities



K-12:

- Fully eliminate remaining K-12 SOQ support position cap (\$116.7 mil.)
- Additional School Construction and Modernization Assistance Grants
- Implementing JLARC K-12 recommendations

Public Safety:

- Funding for 327 positions for the state to meet the statutory staffing ratio for sheriffs' deputies of one law enforcement deputy per 1500 people in counties where the sheriff bears primary law-enforcement responsibility (\$16.7 mil.).
- Aid to Police (HB 599) funding to meet the state's statutory obligations.
- Additional funding for fire and EMS to recruit and retain sufficient staff.
- Additional support for jail per diems.

Behavioral Health:

- Additional support for crisis stabilization units and crisis receiving centers, mobile crisis teams, and the important near-term funding to reduce pressures on law enforcement (\$39 mil.)
- Stabilize staffing at state hospitals (\$18 mil.)

Constitutional Officers: \$17 million in FY 2025 and \$18.7 million in FY 2026 for the 523 positions currently allocated but unfunded

Election Administration: Estimated \$2.8 million to meet the 100 percent reimbursement levels for general registrars and electoral board members.

Continued investments in transportation needs

Water quality: Wastewater facility improvements (needs of approximately \$200 million per year) and Stormwater Local Assistance Fund (needs of approximately \$25 million-\$28 million per year)

Near-Term JLARC Recommendations



- Consolidate two largest at-risk programs into new SOQ At-Risk Program
 - JLARC found more funds needed to educate at-risk students. The study found that at-risk funding programs do not provide divisions with consistent base amount for each at-risk student. Currently old, inaccurate data used. Also recommends combining the SOQ PIR and the Incentive programs into the SOQ.
- Discontinue Great Recession-era cost reduction measures (increase support positions from 24 to 26.3 positions per 1,000 ADM and \$150 million in other non-personal cost reductions.)
- The prevailing salary cost methodology assumes every school district has equal weighting in the formula, thus skewing SOQ recognized salaries toward lower rural small division salaries rather than much more numerous teacher large division salaries. (\$190 mil./yr.)
- Address technical issues with the formula (\$45 mil.)
- Direct further study of special education staffing needs (\$ undetermined)

Longer-Term JLARC Recommendations



- The state SOQ only recognizes 2/3 of actual staff employed by school divisions, with the single largest unrecognized staff category being teacher aides. (**\$1.86 billion/yr.**)
- The need to cover all higher cost-of-living school divisions with a newer, more accurate cost adjustment. (**\$595 mil./yr.**)
- The need to use a re-benchmarking process that covers real-time school division costs. (**\$490 mil./yr.**)
- Recognize the lack of economies of scale and more support needed in small school divisions. (**\$90 mil./yr.**)

JLARC Recommendations for Improving the Local Composite Index



1. Use 3-year moving average for data to smooth large changes.
2. Weight ADM and population equally in the denominator.
3. Replace the LCI with a Revenue Capacity Index (RCI). JLARC stated, “the best measure of ability-to-pay available currently is revenue capacity.”

JLARC staff calculated the RCI using three main steps.

- a) Calculate statewide average yield rates for real and public service corporation (PSC) property taxes, tangible personal property (TPP) tax, and ‘other’ local taxes;
- b) Calculate the revenue capacity for each of the main sources and aggregate them to calculate total local revenue capacity; and
- c) Calculate the final RCI by comparing local revenue capacity to total statewide average revenue capacity, per pupil and per capita.

The final result of the base revenue capacity calculation is a measure of how much revenue a locality *could* generate if it implemented the statewide average tax rate. For example, if the per pupil local-state revenue capacity ratio equals 1.05, then that locality has a revenue capacity approximately 5 percent greater than the statewide average per pupil. The RCI would find that, in per pupil terms, that locality could raise more revenues than the average locality statewide for education and should receive less state aid for public education.