



# Budget Outlook: 2006 Session

November 15, 2005

House Appropriations Committee  
Retreat



# 2006 Session Budget Outlook

- Understanding the revenue forecast
  - What drives the major revenue sources?
    - Producing a forecast is both an “art” and a “science”
- A look at fiscal year 2005
- How wide is the expansion?
  - Northern Virginia the engine that can?
- Revised economic outlook
  - Nation
  - Virginia
- Revised revenue outlook for fiscal years 2006-2008
  - The same three sources will drive 2006
- 2006 Session, building the 2006-08 budget
  - What are the pressures?
- Budget Issues by Secretarial Area



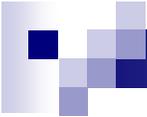
# Revenue Forecast Process

- Section 2.2-1503 of the Code requires the Governor to prepare annually a forecast of the economic activity in the Commonwealth, including an estimate of revenues
- Code established two advisory groups
  - Governor's Advisory Board of Economists (GABE)
    - Consists of 15 private and public sector economists
    - Reviews the economic assumptions and methodology (October)
  - Governor's Advisory Council on Revenue Estimates (GACRE)
    - Business leaders and House and Senate leadership
    - Reviews economic assumptions and economic climate (November)



# Revenue Forecast Process

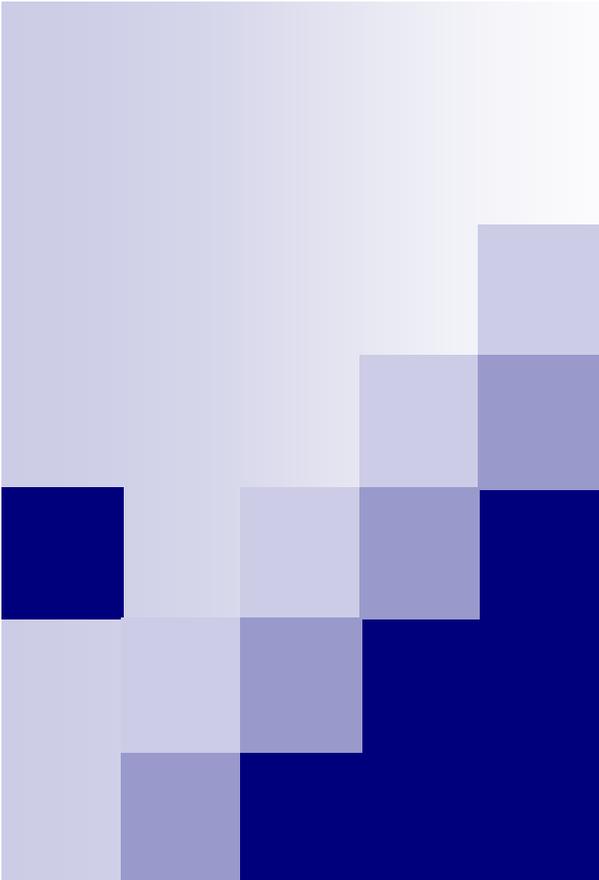
- The forecast is driven primarily by the national economic outlook, adjusted for Virginia
  - Global Insight economic model is used for the national forecast
  - Virginia economic model incorporates Virginia data, including recommendations by GABE and GACRE
  
- Key economic indicators in the Virginia model include:
  - Job growth
    - By industry sector and region
  - Personal income
  - Wages and salary
  - Migration
  - Housing starts



# Revenue Forecast Process

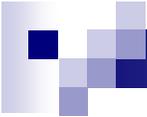
## *Forecasting is an “Art” and a “Science”*

- Several economic indicators serve as proxies to measure growth in the two largest revenue sources
  - Individual Withholding: Jobs and average wages and salaries serve as proxies
  - Sales Tax: Personal income serves as the primary proxy
    - While personal income is a good gauge, it does not capture outside influences that can impact sales tax revenues, such as “cash-out” home refinancing, and natural disasters, i.e., hurricanes
- The remaining revenue sources do not have similar proxies, however, several factors can influence revenue collections:
  - Nonwithholding or estimated payments: This other source of personal income tax revenues falls into two general categories: small businesses/self employed and individuals with substantial investment/dividend income
    - Investment returns (i.e., stock market) have a strong correlation to nonwithholding taxes and business earnings
    - Employment growth does not adequately capture contract or self employed individuals
  - Corporate income taxes: The most volatile of major tax sources and does not lend itself to an easily discernible growth trend. Forecasting is difficult due to safe harbor rules, carry back and forward rules which allow companies to smooth out their income tax liability, and depreciation schedules
    - Corporate taxes can be a leading indicator of the economy
  - Recordation Taxes: Housing starts, interest rates and housing values
  - Public Service Corporation Taxes: Weather conditions influence consumption of power and natural gas
  - Insurance Premium Taxes: Claims experience and interest rates can impact insurance premiums
- While the proxies serve as a gauge in measuring revenue growth, they don’t always pick up the inflection points during an economic slowdown, recovery or expansion



# A Look at Fiscal Year 2005

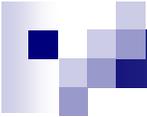
What drove the collections?



# Virginia's Economy: Review of 2005

## *Out-Performed the Forecast*

- FY 2005 tax collections grew 14.8 percent over FY 2004
  - Fiscal year forecast assumed a 10.3 percent growth rate
    - Revised upward from the spring of 2004 growth rate of 4.1 percent
  - Total revenues exceeded forecast by \$544.6 million
    - Income and sales tax within the forecast
      - Represent approximately 78 percent of gross revenues
    - Three sources account for surplus
      - Nonwithholding payments/lower refunds, corporate, and recordation taxes
- Strong job growth in Virginia
  - Virginia out-performed the U.S. in terms of job and income growth
    - Nearly 1 percent greater than U.S. growth rate
      - Virginia job growth was in-line with forecast
    - Virginia wage and salary growth exceeded forecast by 2 percent
  - Northern Virginia continues to be the engine
    - Accounted for over 60 percent of all new jobs created in the state
    - Continued federal spending – homeland security and defense
- Strong consumer purchasing
  - Sales tax collections, adjusted for the tax increase, grew 8.9 percent
    - Performed above the growth in personal income
    - “cash-out” refinancing



# Virginia's Economy: FY 05

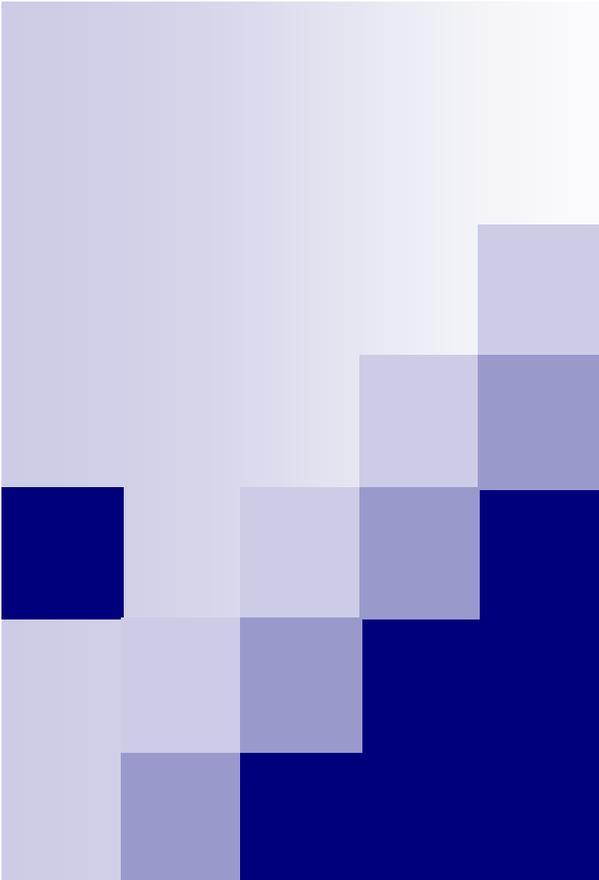
## *What Drove the Collections*

- Nonwithholding or estimated payments: Approximately half (\$264.4 million) of the FY 2005 revenue surplus
  - Strong stock market performance in 2004 – up around 10%
  - Exercise of stock options that were previously “underwater” and coming due benefited from lower federal capital gains tax rate
  - Sizable dividends to shareholders, i.e., Microsoft paid \$32 billion in dividends in December
  - Federal spending and procurement contracts. Many of the companies receiving federal contracts have sub-contracted out work to consultants and other self-employed individuals
- Corporate income taxes: Collections posted their third consecutive double digit year-over-year growth. Strength continues to reflect strong earnings and profits among retailers, defense and oil companies
- Recordation Taxes: Three factors driving collections
  - Strong housing market and new construction
    - In migration, booming economy, low interest rates, purchase of second homes
  - Price appreciation: 20 to 30 percent in golden crescent
  - Refinancing: 25 to 40 percent of mortgage activity is refinancing
    - Three-quarters were “cash-out” refinancing



# FY 2005 Surplus (\$544.6 million)

- Rainy Day Fund
  - Governor reported designation of \$402.2 million in August presentation based on the inclusion of a portion of revenues derived from 2004 tax changes
    - This amount would put the fund almost exactly at the current cap
  - Auditor of Public Accounts has certified constitutionally mandated deposit for FY 2007 (based on FY 2005 revenues) as a minimum of \$354.1 million (based on exclusion of revenues generated by 2004 tax package)
  - No requirement for “super” deposit based on current forecast, but once FY 2006 revenue forecast is updated in December, an additional amount is likely to be required
    - This amount would be constrained by the cap on total deposits to the Fund
- Water Quality Improvement Fund
  - \$54.4 million
    - Plus \$1.9 million representing 10 percent of the un-obligated budget surplus
- Accelerated Sales Tax to TTF
  - \$26.2 million
- Deposit to Nonrecurring Expenditures Fund - HB 1285 of the 2002 Session (Callahan)
  - Governor proposed dedicating \$25.0 million to localities impacted by BRAC process and \$8.9 million to reflect technical corrections to SOQ calculation for FY 2006



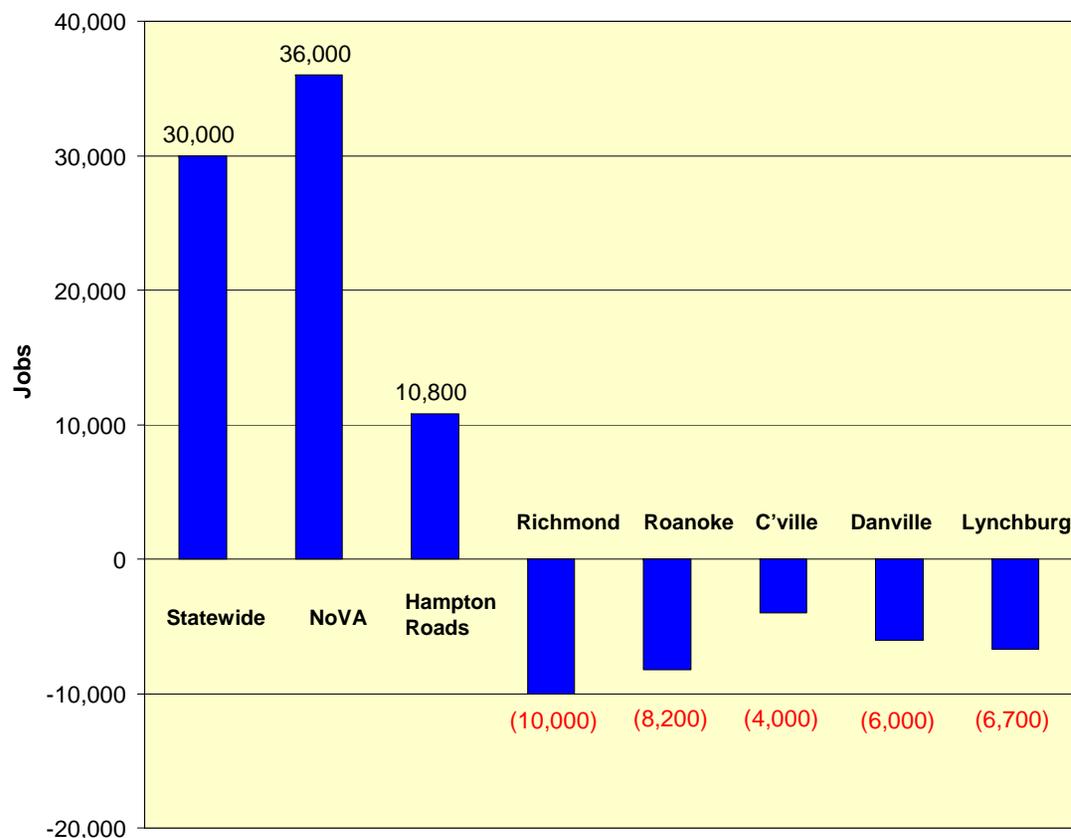
# Fiscal Year 2005: “Has The Expansion Been Widespread?”

Northern Virginia Continues to  
Lead the Recovery

# By the End of Fiscal Year 2004 Virginia Was Well Into a Recovery, but Not in All Regions

- By March 2004, Virginia's economy was expanding, having recovered all of the jobs lost during the recession. As of June 2004, Virginia had gained nearly 30,000 new jobs
- Other than Northern Virginia and Hampton Roads, the remainder of the state had not recovered from their pre-recession peak

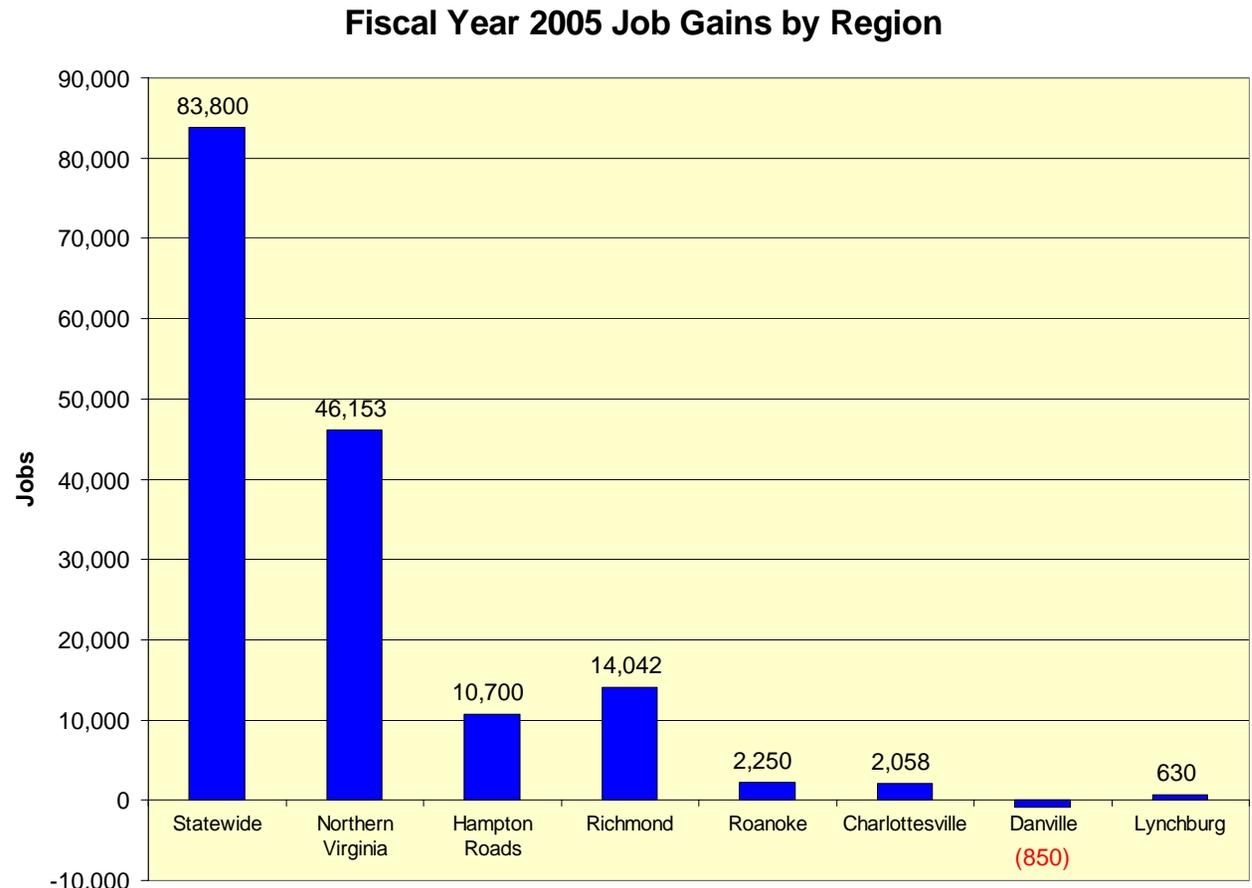
June 30, 2004 Change in Employment from Peak Period



Source: Bureau of Labor Statistics

# There is Gold in That Crescent

- Job growth in Virginia continues to outperform the nation, adding over 80,000 jobs in FY 05
  - Northern Virginia accounted for over half of the job gains, followed by Richmond and Hampton Roads
  - Roanoke, Lynchburg and Danville still have not recovered all of the jobs lost during the 2001 recession
    - Danville continues to lose jobs
    - Charlottesville is slightly above





# What's Driving the Train?

- Over the last two years, Northern Virginia has accounted for over 60 percent of the state's total job growth
  - Northern Virginia ranks sixth in the nation for job growth among MSA's
- Job gains in Northern Virginia have been concentrated in three industries
  - Professional and Business Services
  - Financial Activities
  - Information
- These industries pay the highest salaries
- Federal spending is a major driver of the region's economy



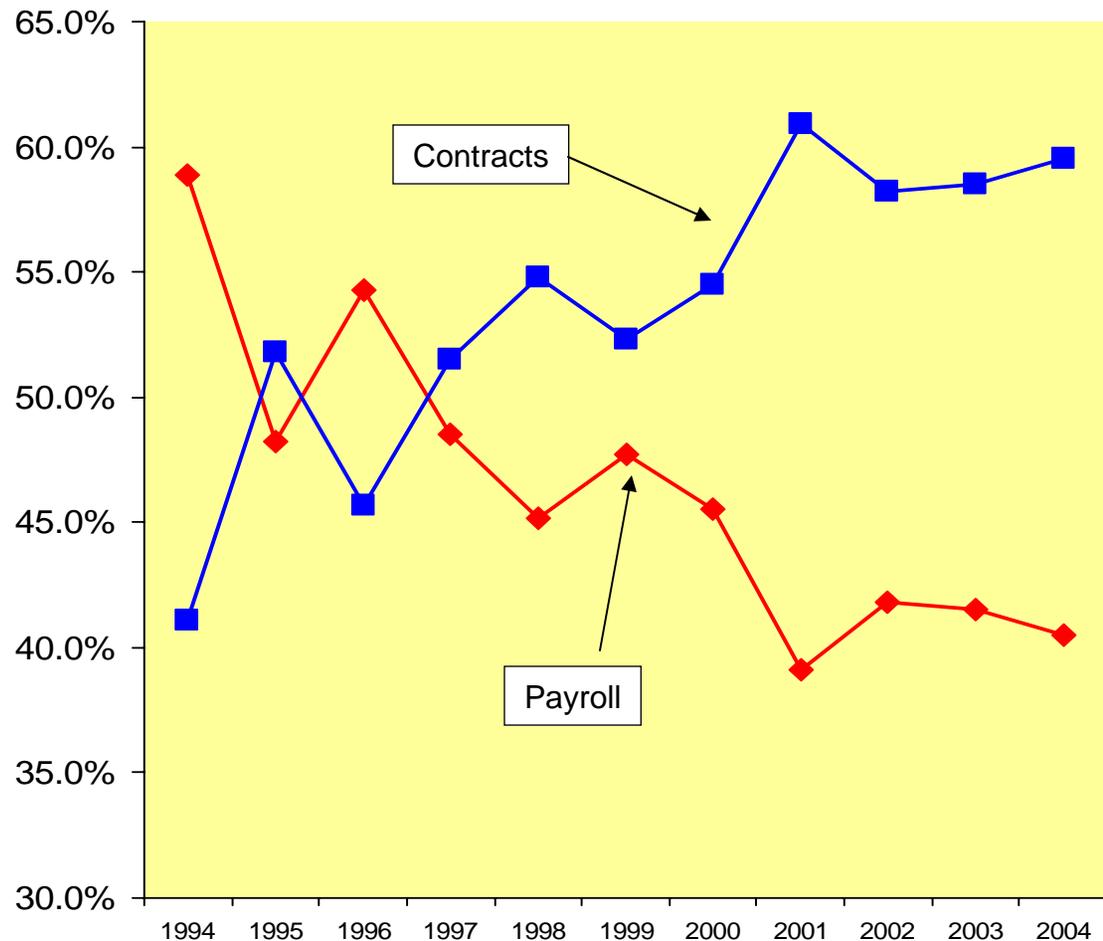
# Northern Virginia and the Federal Government

- Federal spending constitutes 35 percent of the region's economy
  - Payroll and procurement
  - Procurement spending represents over 50 percent of total federal spending
- Nationwide, 16 cents of every federal procurement dollar is spent in the Washington MSA
  - Up from 4 cents in 1983
- Procurement spending in Washington MSA increased 18.4 percent in 2004 versus 10 percent nationwide
  - Over 50 percent of the procurement spending is in Northern Virginia
    - Up 19.1 percent over 2003 level

# DoD Spending in Virginia

Virginia DoD Payroll and Contract Expenditures,  
Percent of Total DoD Expenditures

- In 1994, DoD payroll accounted for 59% of total expenditures
  - In 2004, 40% of DoD expenditures were attributable to payroll
    - Consistent with the nationwide trend
- For the same period, DoD expenditures in Virginia increased by over 100%
  - Nationwide the increase was 63.2%





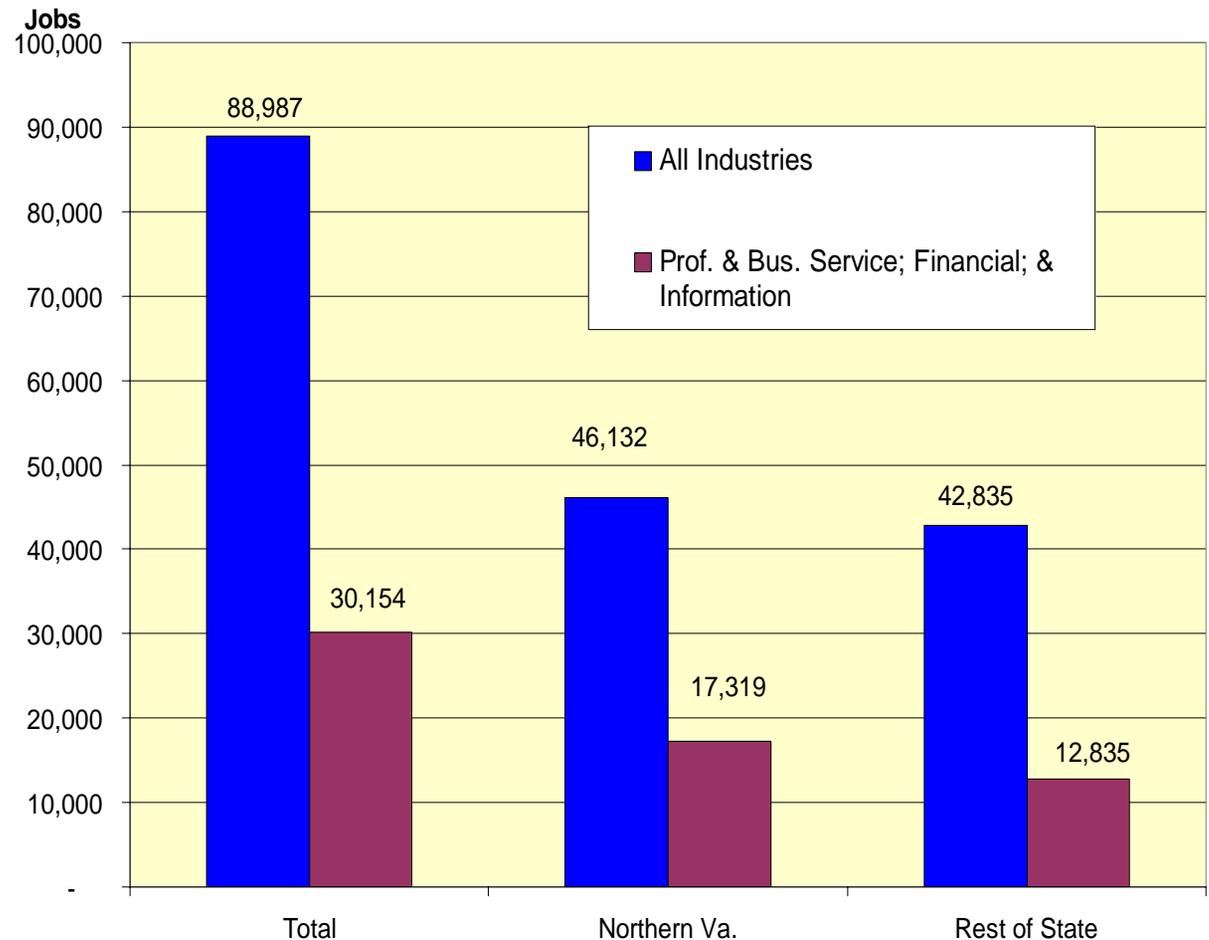
# Procurement Drives the Region's Employment Growth

- Nearly 7,000 jobs created for every \$1.0 billion in federal procurement spending
- Estimated that 65 percent of all new jobs in DC area tied to federal procurement
- 9 federal agencies made contract awards
  - Department of Defense accounts for 70 percent of Northern Virginia contracts
  - 72 percent of the contracts are in the service industry
    - Data processing, telecom services, professional and managerial support
    - Data processing and communication equipment

# 2005 Total Job Growth Compared to Highest Paid Industries

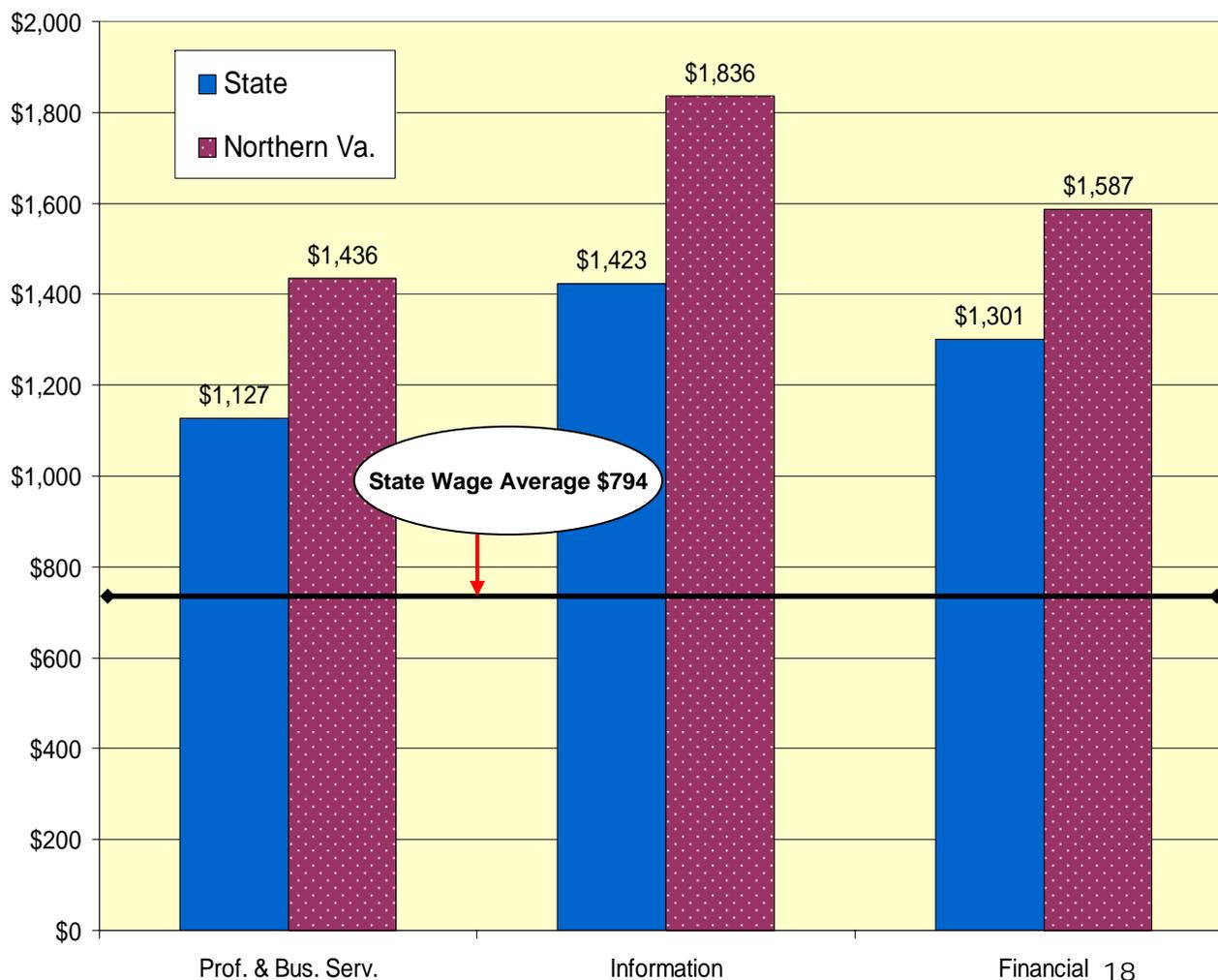
## *A Look at the State Versus Northern Virginia*

- 26% of the state's total jobs are in three industries: professional and business services, financial activities, and information
- In 2005, 1 out of every 3 new jobs created were in these industries
  - 57% of the jobs created were in Northern Virginia
    - Accounted for 38% of region's total employment gains
  - 39% of these jobs were created in Richmond and Hampton Roads



# Average Weekly Wages of the Top Three Industries

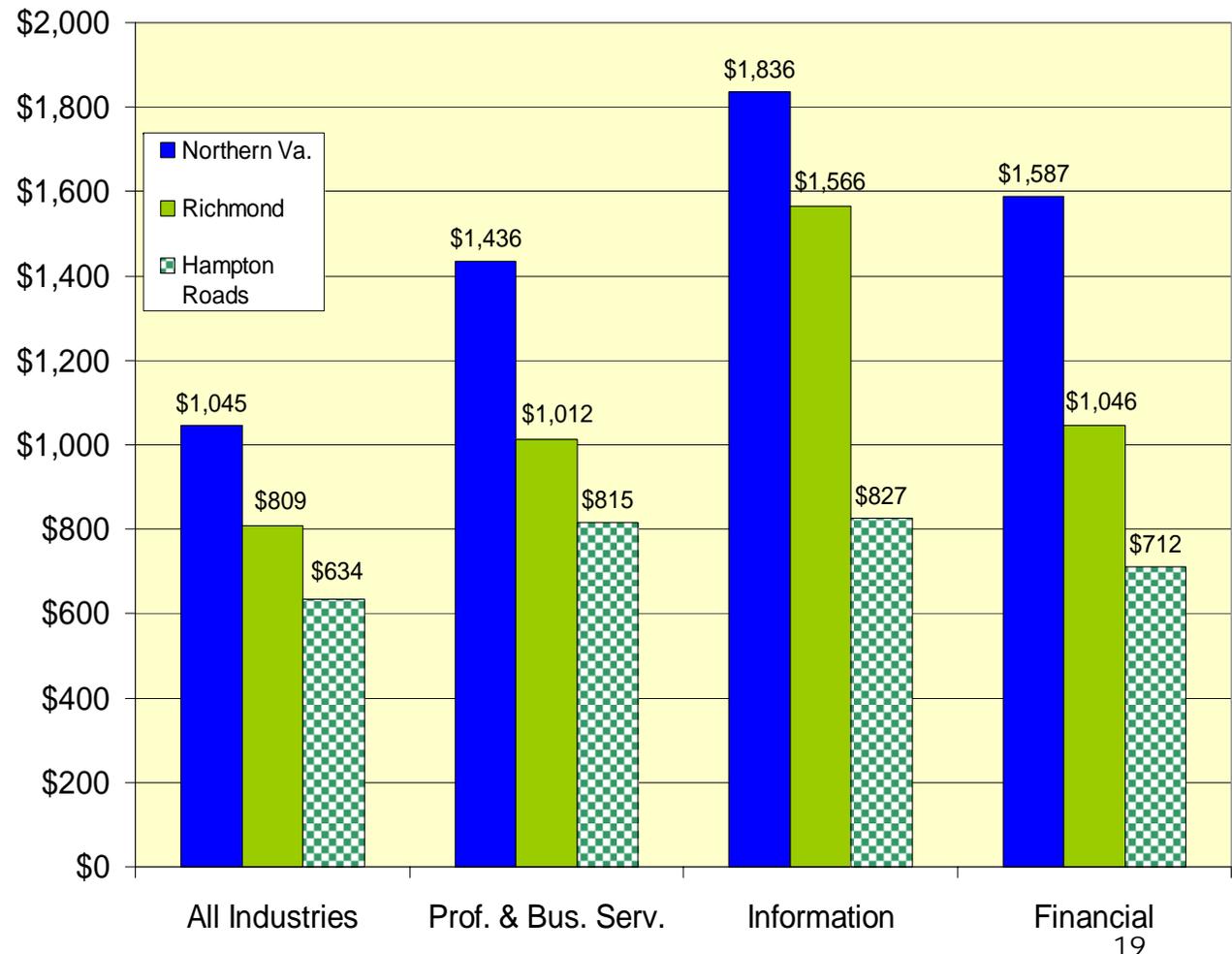
- Highest weekly wages are paid in these industries
- Average weekly wages for these industries in NoVA is twice the state average
- 50% of the total jobs in these industries are located in Northern Virginia
  - Represents 36% of the region's total employment versus 20% for the rest of the state

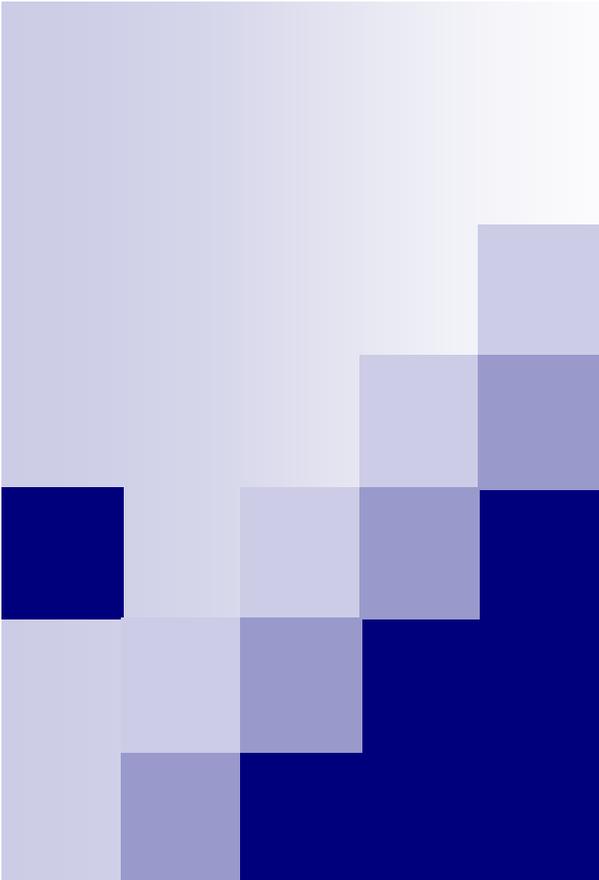


# Comparison of Top Three Industries' Weekly Wages

## *Northern Virginia, Richmond, and Hampton Roads*

- With the exception of the information industry in the Richmond MSA, average wages paid in Northern Virginia are between 140 percent to over 200 percent higher than Richmond and Hampton Roads
  - Year-over-year average wages in these industries increased between 6% and 7% in NoVA
- Disparity in wage rates reflects the higher cost of living in Northern Virginia and the different mix of workers in the industries
  - NoVA and Richmond have more lawyers and banking and finance professionals





# “Record” Recordation Tax Revenue Growth

Can it last and is there a  
housing bubble?



# Housing Market & Recordation Revenues

## *Can it sustain its momentum?*

- Major component of revenue surplus in FY 2004 and FY 2005 was recordation taxes
  - FY 2004 surplus in recordation taxes was \$41.4 million, in FY 2005 recordation taxes exceeded the forecast by \$67.9 million
- Longest growth trend on record – five straight years of double digit growth
  - Base growth rates (excluding tax increase) have been:
    - FY 2002            30.5 percent
    - FY 2003            34.8 percent
    - FY 2004            17.8 percent
    - FY 2005            14.5 percent
  - Through first quarter of FY 2006, recordation continues to substantially exceed the forecast



# Housing Market & Recordation Revenues

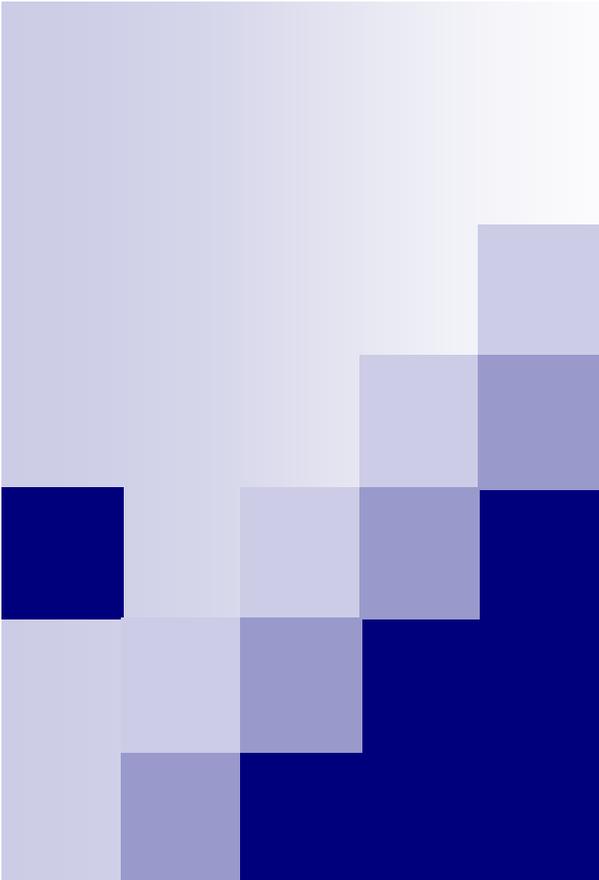
## *Can it sustain its momentum?*

- Recordation taxes are driven by:
  - Home sales
  - Refinancing – 25% to 40% of all recordings
    - Three-quarters are “cash-out” refinancing
  - Price appreciation
  
- While deed recordings have slowed, price appreciation remains extremely strong
  - Median home prices were up in FY 2005:
    - 24% in Northern Virginia
    - 27% in Norfolk
    - 18% in Richmond



# Housing Market & Recordation Revenues – *Can it sustain its momentum?*

- What is the prognosis for recordation tax revenues this fiscal year?
- Experts again calling for a potential slow-down in both housing sales and price appreciation
  - But no expectation that bottom will fall out of the market
  - Growth likely to continue, but at lower rate
  - Housing overvaluation only marginal compared to change in economic fundamentals
- Unknowns include:
  - Potential impact of rising interest rates
  - Mixed opinions on Northern Virginia market
    - Some view it as especially overpriced and think growth is unsustainable
    - Others look to housing shortage in region and believe price appreciation will continue



# Economic Outlook for Fiscal Years 2006-08

The Nation and Virginia



# Economic Outlook

## *A Look at the Nation*

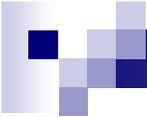
- According to Global Insight, the U.S. economy continues to expand, although the rate of growth has slowed as a result of hurricane disruptions. Payroll employment has grown, albeit at a pace slower than is typical in an expansion
- Several positive and negative factors are in play:
  - Hurricanes will dampen 4<sup>th</sup> quarter growth, but will be offset by stronger growth in the first half of 2006. Overall, 2006 growth is expected to soften as the housing market cools and consumer spending is impacted by higher energy costs
  - Business investment is expected to increase
    - Increased investment spending, replacement of computer equipment and software
    - Manufacturing growth is uneven, Institute of Supply Management Index has fallen
    - Corporate profits continue to be strong, however higher energy and commodity prices could impact profits
      - Impact of higher energy costs on consumers makes it somewhat difficult to pass on costs
  - Consumer spending should be more in line with income growth
    - Home equity withdrawal had fueled consumer spending but is expected to moderate
      - Borrowing costs increasing
    - Higher energy prices and higher interest rates will dampen spending
      - Winter heating will be expensive
    - Could impact the holiday shopping season



# Economic Outlook

## *A Look at the Nation*

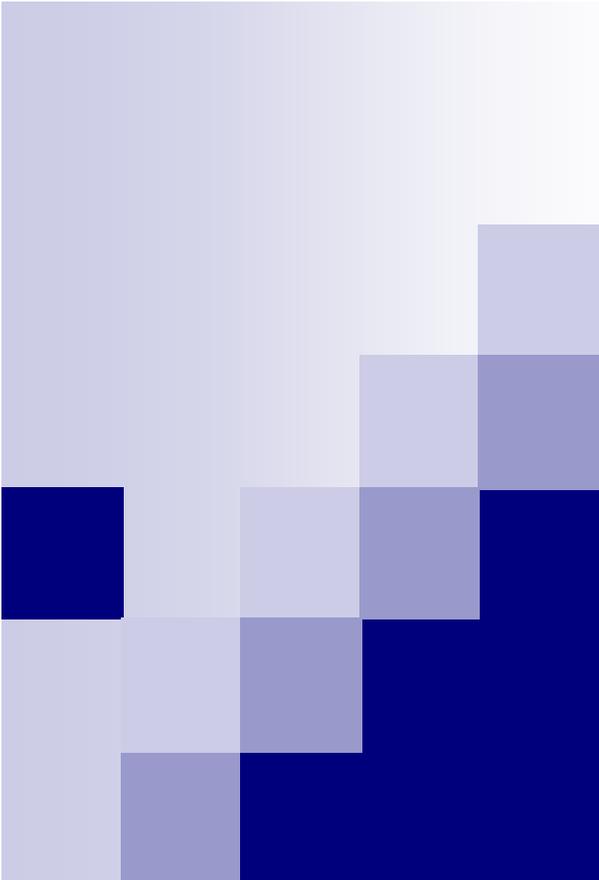
- Energy prices
  - Impact on transportation industry (airlines, auto), manufacturing, chemical
  - Expect the price of oil to drop below \$60 a barrel
  - Natural gas prices expected to be 40% to 50% higher
- Construction
  - Housing prices are strong, but price appreciation is beginning to impact affordability
    - Housing “bubble” is more regional
  - Construction costs have increased due to commodity and energy prices
  - Higher interest rates will impact housing starts
- Federal Reserve monetary policy – continued march to increased rates
  - Balance between keeping inflation in check while not impacting economic growth



# Revised Outlook of U.S. Economic Indicators

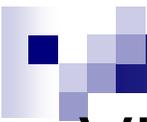
	Employment		Personal Income		Wage and Salary	
	<u>Official</u>	<u>Revised</u>	<u>Official</u>	<u>Revised</u>	<u>Official</u>	<u>Revised</u>
<b>FY 2006</b>	<b>1.5%</b>	<b>1.6%</b>	<b>4.9%</b>	<b>6.0%</b>	<b>5.2%</b>	<b>5.6%</b>
<b>FY 2007</b>	<b>0.9%</b>	<b>1.4%</b>	<b>5.2%</b>	<b>6.2%</b>	<b>5.0%</b>	<b>5.9%</b>
<b>FY 2008</b>	<b>0.9%</b>	<b>1.3%</b>	<b>5.5%</b>	<b>5.7%</b>	<b>5.1%</b>	<b>5.9%</b>

Source: Global Insight, Revised Forecast based on September 2005 Standard U.S. Forecast



# General Fund Revenue Outlook

Fiscal Years 2006 - 2008



# Virginia's Economic Outlook Fiscal Years 2006 through 2008

- Outlook projects that Virginia will continue to out-pace the nation in job, personal income, and wage and salary growth
  - The revised forecast should reflect a modest upward change in personal income and wages and salaries from the official forecast issued in November 2004
    - Wage and salary growth is expected to remain strong due to the concentration of high paid jobs being created in NoVA
- Employment growth has moderated in the second half of 2005. The outlook suggests job growth to be below 2%
  - NoVA job growth is expected to lead the state, albeit at a slower rate
    - Business and professional services jobs continue to lead in the “crescent”
  - Information technology sector is expected to see job gains in 2006 through 2008
  - Manufacturing is expected to see further declines
  - Tourism industry should continue to perform well



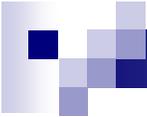
# Virginia's Economic Outlook Fiscal Years 2006 through 2008

- Sales tax collections should fall in line with personal income
  - Cash-out refinancing has slowed down
  - Construction still strong – building materials and supplies
  - Tourism-related sales expected to be strong
  - Will we have another strong holiday for retailers?
    - Energy prices could play a role if weather turns cold



# Fiscal Year 2006

- The FY 2005 surplus has a ripple effect in FY 2006
  - FY 2005 actual collections form the “base” in which the forecasted growth rates apply
  - Collections would have to decline 2.7 % over FY 2005 levels to reflect the current FY 2006 revenue forecast
- December revisions will reflect FY 2005 actual collections, which is approximately \$375 million greater than current FY 2006 forecast
  - Adjustments will be based on changes to the economic forecast for jobs and wage and salary growth
    - Both factors are performing within current forecast
  - Forecast will reflect two tax policy changes which resulted in a reduction of approximately \$350.0 million assumed in forecast
    - Elimination of the sales tax on food and the unwinding of the accelerated sales tax
- Revised growth rate in FY 2006 should be around 6% - \$1.1 billion over current forecast

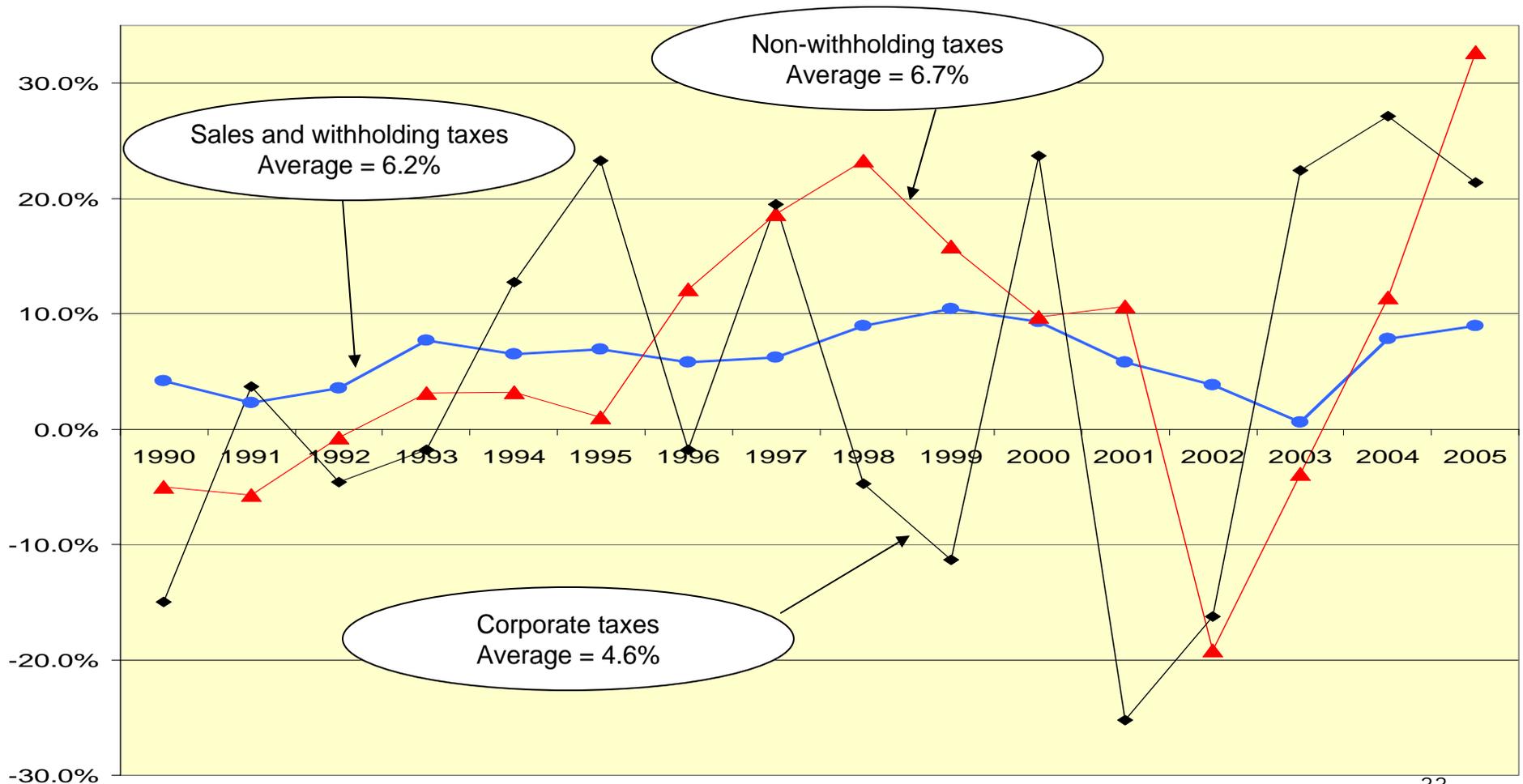


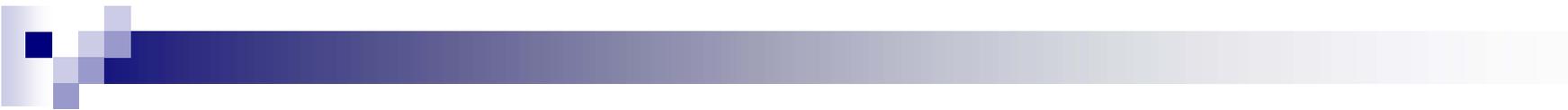
# Revenue Outlook for FY 2006

## *Same Three Sources Account for Strength*

- Most of the excess revenues in fiscal year 2006 will be driven by the same three sources that have been responsible for the fiscal year 2004 and 2005 surpluses
- Nonwithholding or estimated payments: Up 22 percent in the first quarter
  - FY 05 has not been factored into the current FY 06 estimate
    - Grew 33% over 2004
  - Business profits are up
    - Homebuilders, realtors
  - Lower capital gains tax and stock options
    - S&P 500 is flat
    - Stock options that were previously “underwater” and coming due benefited from lower federal capital gains tax rate
    - Continued use of bonuses
- Corporate income taxes: Collections posted their third consecutive double digit year-over-year growth in FY 2005
  - Strength continues to reflect strong earnings and profits among retailers, defense and oil companies
  - September payment largest ever and bigger than final payment in 2005
- Virginia’s housing market remains strong and should continue to fuel recordation tax collections through the end of fiscal year 2006

# Comparison of Sales and Withholding Taxes to Corporate and Non-Withholding Taxes





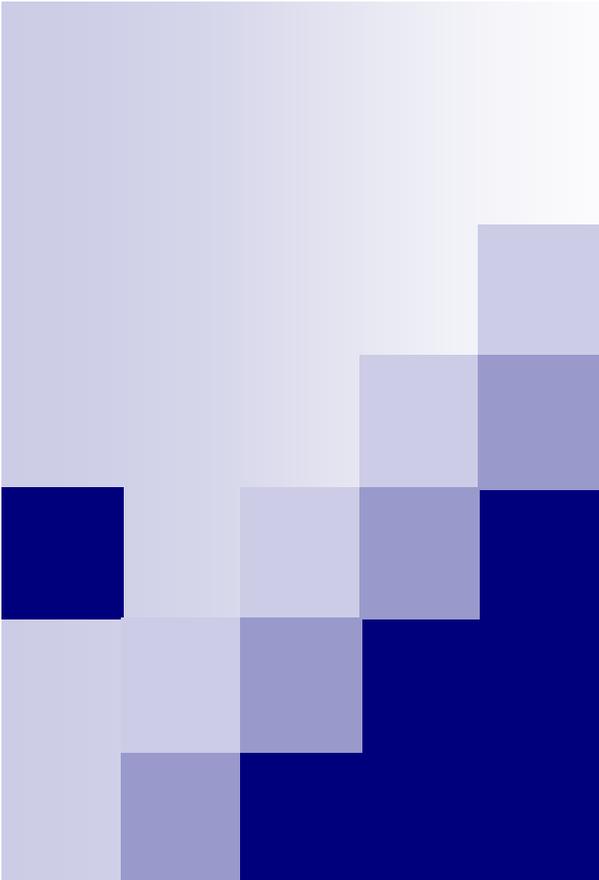
# Revenue Outlook 2006-2008

- Revenue growth should be consistent with long-term trends of around 5.5% to 6.0%
  - The outlook for employment, personal income, and wage and salaries suggest that withholding and sales tax growth should perform in the 6.0% to 6.5% range
    - Represents approximately 80 percent of gross general fund revenues
  - Housing is expected to soften, with price appreciation moderating to a more normal level of 4% to 6%
  - Corporate taxes are expected to flatten due to increased business spending
  - Non-withholding, while volatile, appears to be driven by small businesses and contract employees and resurgence of bonuses in the high wage sectors
- FY 2006-08 has one tax policy changes which resulted in a reduction of approximately \$60.0 million assumed in forecast
  - Earned income tax credit
- Lottery revised forecast reflects the start-up of the North Carolina Lottery
  - Fiscal year 2006 - \$433.5 million
  - Fiscal year 2007 - \$426.1 million
  - Fiscal year 2008 - \$426.1 million

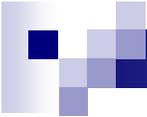


# Revenue Outlook 2006-2008

- Risks to forecast
  - Consumers account for two-thirds of overall economic activity and will be impacted by higher interest rates and fuel costs
  - Federal deficit reduction efforts could impact defense and domestic spending
- Forecast represents a revenue outlook developed in the fall of 2005 for a period that begins in July 2006 and runs for 24 months
  - Updated in February 2006 (Mid-Session forecast)



# **Building the 2006 - 2008 Biennial Budget**



# Budget Outlook for 2006-08 Biennium

- What does it cost to keep doing what we are doing?
  - Base budget equals fiscal year 2006
    - Back out any one-time spending
    - Annualize salary increase
- What are the known budget drivers?
  - Mandatory and statutory
- What are the “discretionary” priorities?
- How does it all fit?



# 2006-08 Base Budget

- DPB develops the base budget, which equals FY 2006 appropriations, adjusted for one-time spending and annualized costs
  - Annualized FY 2006 salary increase, adjust Car Tax Payment to reflect \$950 million cap (FY 2006 equals \$742.4 million), remove one-time equipment and relocation costs, fully fund new positions
- Base budget will not include:
  - Any spending or savings adjustments that may be contained in the “Caboose Bill” - i.e., Medicaid costs
  - Spending increases driven by State or Federal Law
  - Higher priority or discretionary spending



# 2006-2008 Budget Drivers

- Two primary types of budgetary pressures
  - Statutory: Driven by federal or state law i.e., Medicaid, SOQ, “Rainy Day” fund, adult and juvenile corrections, VRS, debt service, “599” funding, economic incentive payments
  - High Priority: Driven by historical commitments or enrollment demands i.e., MR waivers, higher education (in-state students, financial aid), indigent care at teaching hospitals
  
- Other budget pressures
  - Employee compensation, maintenance of facilities
  
- Cost estimates are based on agency information or driven by forecasts (Medicaid, SOQ, Prisons, Higher Education)
  - Subject to further analysis by DPB and Money Committees

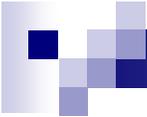


# 2006-08 Base Budget

*(GF Dollars in Millions)*

Chapter 951 (FY 2006 Base)	\$14,632.2
Annualize Partially Funded Costs (FY 2006 Salary Increases, \$950 million Car Tax Cap, Other)	\$276.1
Remove One-Time Savings (Group Life Insurance Holiday, other)	\$15.9
Remove One-Time Spending (FY 2006 Rainy Day Fund Deposit, FRAN debt service, insurance premiums, Water Quality Improvement Fund, etc.)	(\$505.0)
DPB Resource Base Budget Target	\$14,418.9
HAC Adjustments to Reflect True Base Budget*	\$225.3
Base Resource Target	\$14,644.2

\*HAC adjustments reflect inclusion of \$37.4 million FRAN debt service, \$137.9 million insurance premiums deposited to transportation and \$50.0 million Water Quality Improvement Fund deposits each year.



# FY 2006-08 Agency Budget Requests

- Agency operating requests submitted to DPB, Medicaid reforecast and SCHEV higher education recommendations total \$5.9 billion for the next biennium
  - \$2.6 billion in FY 2007 and \$3.3 billion in FY 2008
  
- Operating requests fall into five categories:
  - Statutory/Mandatory: \$2.4 billion over biennium – SOQ rebenchmarking and increases in categorical programs, Virginia Retirement System contributions, Comprehensive Services Act (CSA), foster care and adoption, debt service adjustments
  - High Priority: \$625 million: Operational costs of new prisons coming online, sex offender containment sites, DMHMRSAS pharmacy cost increases, enrollment growth, TAG, undergraduate financial aid, utility cost increases, operations of new facilities
  - Program Expansions: \$1.1 billion: MH/MR system transformation, Water Quality improvement
  - New Initiatives: \$1.1 billion: Provider rate increases, additional Standards of Quality, Medicare Part D, MHMR community services, new university programs, criminal fund rate increase, VA House Partnership Trust fund, land conservation initiative, assisted living incentive plan, additional state troopers
  - Other: \$697 million: Information technology upgrades, vehicle and equipment replacements, fully fund existing positions
  
- Capital requests total more than \$3.2 billion for the FY 06-08 biennium
  - Requests are primarily for new construction and renovation and improvement projects



# 2006-08 General Fund Budget Requests

## *Selected Mandatory / Statutory Spending*

GF \$ in Millions	FY 2007	FY 2008	Total
Medicaid Utilization and Inflation	\$198.7	\$363.1	\$561.8
Medicare Part D Payment	\$38.0	\$42.4	\$80.4
Comprehensive Services Act	\$15.8	\$32.6	\$48.4
Foster Care and Adoption Assistance	\$20.2	\$32.2	\$52.4
Re-benchmarking – SOQ, Incentive and Categorical accounts	\$464.5	\$521.5	\$986.0
Sheriffs: Per Diems, New Deputies @ 1:1500 & Jail	\$3.5	\$12.5	\$16.0
“599” Program Funding	\$10.5	\$11.1	\$21.6
State Employee Health Insurance Rate Adjustment	\$28.2	\$28.2	\$56.4
VRS: State & Teacher System, VaLORS, SPORS, & JRS	\$199.5	\$199.5	\$399.0
VRS: State & Teacher Group Life, Health Credit, & VSDP	\$37.6	\$37.6	\$75.2
Criminal & Involuntary Mental Commitment Fund	\$12.0	\$18.1	\$30.1
Treasury Board Debt Service	\$28.8	\$74.2	\$103.0
<b>Total: Selected Mandatory/Statutory</b>	<b>\$1,057.3</b>	<b>\$1,373.0</b>	<b>\$2,430.3</b>

# 2006-08 General Fund Budget Requests

## *Selected High Priority*

GF \$ in Millions	FY 2007	FY 2008	Total
FAMIS & FAMIS Plus (Children's health insurance) enrollment	\$3.2	\$6.3	\$9.5
MHMR Medication Costs	\$6.4	\$9.0	\$15.4
DSS Child & Family Services Improvements (federal plan)	\$4.1	\$3.6	\$7.7
VIEW (Welfare Reform) Daycare Costs	\$8.0	\$9.7	\$17.7
DSS Mainframe Computer Charges	\$5.5	\$7.2	\$12.7
Capital Project Cost Overruns	\$100.0	\$0.0	\$100.0
Capital Maintenance Reserve – Maintain FY 04-06 Levels	\$40.0	\$40.0	\$80.0
Capital Equipment for New facilities	\$32.5	\$32.5	\$65.0
Capital Outlay Prior Commitments (State Capitol Treasury Loan Repayment / JMU Acquisition / VMI Barracks)	\$61.2	\$8.0	\$69.2
Capital Outlay – MHMR Phase-in Restructuring Plan	\$105.0	\$85.0	\$190.0
Capital Outlay Life, Safety and Federal Mandates	\$25.0	\$25.0	\$50.0
Higher Education Equipment Trust Fund Lease (\$51.7 m / yr)	\$0.0	\$11.3	\$11.3
EVMS Operating Support	\$2.5	\$5.0	\$7.5
Higher Education In-State Enrollment Growth	\$33.0	\$67.0	\$100.0
Higher Education Financial Aid/TAG (\$3,500 award)	\$44.5	\$91.6	\$136.1
Higher Education O & M for New Buildings	\$6.1	\$12.2	\$18.3
Agriculture / Extension Staffing	\$2.3	\$2.3	\$4.6



# 2006-08 General Fund Budget Requests

## *Selected High Priority*

GF \$ in Millions	FY 2007	FY 2008	Total
Costs Associated with Renumbering of Code of Virginia	\$0.0	\$3.7	\$3.7
Wastewater Treatment Plant Grant Funding	\$50.0	\$50.0	\$100.0
National Board Teacher Certification Program increase	\$0.3	\$0.9	\$1.2
Educational Information Management System (EIMS) implementation increase	\$0.6	\$0.7	\$1.3
Utility Increases Statewide	\$15.0	\$15.0	\$30.0
Four New DOC Facilities/Expansions	\$23.6	\$71.0	\$94.6
Education Programs at New DOC Facilities	\$1.6	\$4.3	\$5.9
Inmate Medical/Private Prison Operating Rates	\$10.7	\$15.9	\$26.6
Additional Beds at Juvenile Correctional Centers	\$3.4	\$4.0	\$7.4
Construction/Renovation Local Juvenile Facilities	\$4.1	\$0	\$4.1
Day Reporting Centers/ Offender Containment Programs	\$2.6	\$2.4	\$5.0
Forensic Science – Salaries and Reduction of Case Backlog	\$2.2	\$3.0	\$5.2
<b>Total: Selected High Priority</b>	<b>\$593.4</b>	<b>\$586.6</b>	<b>\$1,180.0</b>

# 2006-08 General Fund Budget Requests

## *Selected Program Expansions*

GF \$ in Millions	FY 2007	FY 2008	Total
VSDB-S: staff increases and pay adjustments	\$0.5	\$0.6	\$1.1
Commerce and Trade – Major Program Expansions	\$19.2	\$17.7	\$36.9
District Court Personnel	\$7.0	\$8.9	\$15.9
Drug Courts – Funding for New Programs	\$1.7	\$1.7	\$3.4
Assistant Attorneys General and Staff	\$1.1	\$1.2	\$2.3
Staff for Constitutional Officers	\$11.8	\$23.6	\$35.4
Funding for Laboratory Equipment Replacement	\$1.5	\$1.5	\$3.0
Positions for Veterans Benefit Services	\$1.0	\$1.0	\$2.0
State Park Operations Funding	\$4.0	\$4.0	\$8.0
Enhance Water Quality Efforts	\$0.7	\$0.7	\$1.4
Higher Education New Program Development	\$15.0	\$15.0	\$30.0
State/Local Community Corrections Capacity	\$4.9	\$6.1	\$11.0
DOC -- Offender Management System Implementation	\$5.6	\$4.8	\$10.4
State Troopers to Meet Workload	\$19.9	\$31.9	\$51.8
<b>Total: Selected Program Expansions</b>	<b>\$93.9</b>	<b>\$118.7</b>	<b>\$212.6</b>

# 2006-08 General Fund Budget Requests

## *Selected New Initiatives*

GF \$ in Millions	FY 2007	FY 2008	Total
BOE Revisions - Additional Asst Principals, Reading Specialists, Elementary Principals and Speech Pathologists	\$95.3	\$96.2	\$191.5
Commerce and Trade – Major New Initiatives	\$35.1	\$29.9	\$65.0
Criminal Fund Rate Increase	\$9.0	\$16.1	\$25.1
Positions to Review Magistrate System	\$1.0	\$1.0	\$2.0
Electronic Case Filing and Imaging Pilot Program	\$1.1	\$0.7	\$1.8
Implement Electronic Polling Books Statewide	\$6.5	\$0.1	\$6.6
Land Preservation Tax Credit Enforcement	\$1.3	\$1.3	\$2.6
Funding for Nonpoint Source Pollution Control	\$4.0	\$4.0	\$8.0
Certifying Dam Safety and Repairs to Faulty Dams	\$0.8	\$0.8	\$1.6
DOC/DJJ Correctional Officer Salary Parity	\$6.0	\$6.0	\$12.0
Higher Education Research Equipment (One-Time)	\$25.0	\$0.0	\$25.0
High Technology Company Innovation Assistance	\$12.0	\$12.0	\$24.0
<b>Total: Selected New Initiatives</b>	<b>\$197.1</b>	<b>\$168.1</b>	<b>\$365.2</b>



# 2006-08 General Fund Budget Requests

## *Selected Discretionary*

GF \$ in Millions	FY 2007	FY 2008	Total
Higher Education Base Operating Support	\$100.0	\$200.0	\$300.0
Graduate student financial aid	\$6.0	\$12.6	\$18.6
Other Education – Public Library Support	\$4.2	\$7.0	\$11.2
Higher Education – Continue Research Initiatives	\$25.0	\$25.0	\$50.0
DSS Eligibility Workers	\$18.1	\$18.1	\$36.2
Funding for Existing Drug Court Programs	\$2.5	\$2.5	\$5.0
Judiciary Technical Assistance Positions	\$1.5	\$1.4	\$2.9
Sheriffs and Commonwealth's Attorneys Technology	\$2.6	\$1.6	\$4.2
Support for DCLS Operational Readiness	\$1.3	\$0.6	\$1.9
Provide general fund support to Land Conservation Fund	\$10.5	\$10.5	\$21.0
Update Base Map and Maintain Address Files	\$3.9	\$0.0	\$3.9
<b>Total: Selected Discretionary</b>	<b>\$175.6</b>	<b>\$279.3</b>	<b>\$454.9</b>

# What Will the 2006-08 Biennium Look Like?

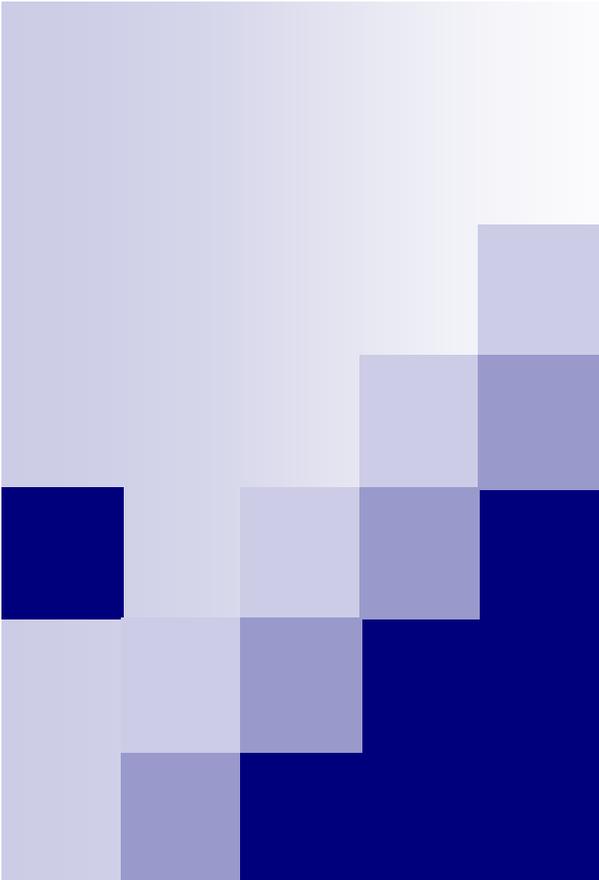
<b>\$'s in millions</b>	<b>FY 2007</b>	<b>FY 2008</b>	<b>Biennium</b>
GF Revenue (forecast) Includes Lottery and Transfers	\$16,100.0	\$16,900.0	\$33,000.0
FY 06 Balance Forward	\$1,100.0		\$1,100.0
Total Resources	\$17,200.0	\$16,900.0	\$34,100.0
Base Budget	\$14,644.2	\$14,644.2	\$29,288.4
Net Resources Available For Budget Drivers*	\$2,555.8*	\$2,255.8	\$4,811.6*
Mandatory/Higher Priority Spending Drivers	\$1,057.3 – 1,287.0	\$1,373.0 - \$1,769.1	\$2,430.3 - \$3,056.1

\*Includes carry forward balance of \$1.1 billion from FY 2006



# 2006 Session

- Bottom Line
  - Considerable “windfall” expected in FY 2006
    - Should be spent on one-time programs
  - Revenues in 2006-08 will be sufficient to cover the “got-to-do’s”
  - Will have some limited flexibility to implement new priorities
- Avoid the “double-up to catch-up” spending
  - FY 2006 revenues in excess of the forecast should not be carried into FY 2007 and spent on on-going programs
    - This would have the effect of doubling up spending that can not be supported within the out-year revenue framework
- FY 2006 revenues not used to address current year issues should be used for one-time costs
  - Eliminate the remaining accelerated sales tax collections
  - Transportation funding
  - Capital projects: A number of capital projects approved by the voters are coming in over bid. Projects could be supplemented using cash instead of increased borrowing
  - Capital repairs and maintenance reserve funding (\$800 million backlog)
- Use constraint in establishing new programs that expand the base
  - Need to match the cost of any spending or tax policy change with future revenue requirements



# Budget Issues by Secretarial Area



# Public Education

- Agency requests total \$561.7 million in FY 2007 and \$620.4 million in FY 2008
- The major budget driver is the mandatory spending related to re-benchmarking process for student enrollment growth, salaries and fringe benefits, composite index, sales tax, lottery, inflation factors and the prevailing expenditures of FY2004 (base year) reported by school divisions



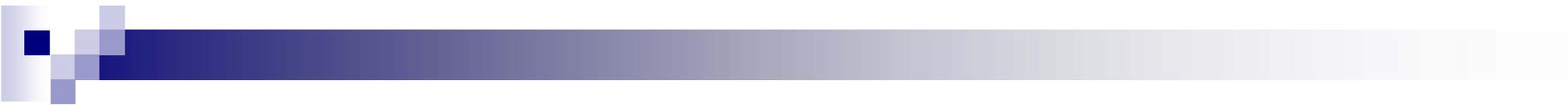
# Health & Human Resources

- Agency requests total \$494.8 million in FY 2007 and \$593.0 million in FY 2008 primarily for mandatory programs, program expansions and new initiatives
- Forecast Changes for 2006-08
  - \$561.8 million for Medicaid utilization, inflation and enrollment growth
    - Growth of 8% in FY 2007 and 7% in FY 2008
    - Growth in the enrollment of low-income aged and disabled as these individuals enroll in the Medicare Part D prescription program and are found eligible for Medicaid
    - Assumes growth in the number of children, pregnant women and low-income adults found eligible for Medicaid through outreach efforts
    - Utilization of services is expected to increase as provider rate increases are fully implemented and access to services is increased
    - Assumes hospital and nursing other services are projected to increase as a result of rebasing rates for these providers
  - \$9.5 million for Medicaid FAMIS and FAMIS Plus utilization, inflation and enrollment growth



# Health & Human Resources

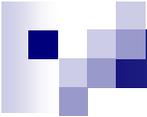
- \$80.4 million in payments to the federal government for Medicare Part D prescription drug benefit for dual eligibles
- \$48.4 million for growth in the cost of caring for at-risk children and youth through the Comprehensive Services Act
- \$52.4 million for foster care maintenance and special needs adoption assistance
- \$17.7 million in child care costs for working parents in the VIEW program (welfare reform)
- 15.4 million for MHMR medications
- \$7.7 million for required improvements in DSS child protective services and foster care systems



# Health & Human Resources

## ■ Service Expansions

- \$307.8 million for MHMRSAS “transformation” to expand community services
- \$36.2 million to expand the number of eligibility workers in local social service agencies
- \$9.0 million for HIV medications
- \$2.2 million for 24 more local health department food inspectors
- \$2.0 million for 20 additional environmental health positions to reengineer programs for onsite soil evaluations and processing applications for onsite sewage systems
- \$1.8 million for booster doses of Tetanus, Diphtheria, Pertussis (Tdap) for adolescents
- \$1.6 million for 12 more medical death investigators



# Health & Human Resources Policy Changes

- **Provider Rate Increases**
  - \$126.1 million for Medicaid and other provider rate increases
    - Assisted living facilities (increase from \$894 to \$1,200 per month)
    - Physician services excluding OB/GYN (increase of 10%)
    - Pediatric services (increase of 30%)
    - Annual rate adjustment for physicians and home- and community-based waiver services
    - Change base year for nursing facility rebasing in FY 2007
    - Medical examiners (increase from \$50 to \$150 per case)
- \$40.2 million to fund care improvements in Assisted Living Facilities
- \$8.5 million to expand FAMIS eligibility for pregnant women from 150% to 200% of the federal poverty level



# Health & Human Resources

## ■ Restorations

- \$2.0 million for aging services through local Area Agencies on Aging

## ■ Technical Changes

- \$12.7 million for DSS mainframe computer costs
- \$12.0 million to replace federal funds for safe drinking water construction projects
- \$1.0 million to relocate Medical Examiner's Northern Virginia regional office



# Capital Outlay

- Agency requests total more than \$3.2 billion for the FY 2006-08 biennium
- Requests are primarily for new construction and renovation and improvement projects
  - These two categories comprise about 90 percent of the total requested
- Other requests include cost overruns on existing projects, equipment for new facilities, equipment replacement at existing facilities, and property acquisitions



# Capital Outlay

- **Debt Service**
  - \$28.8 million in FY 2007 and \$74.2 million in FY 2008 based on last available assumptions used to develop Treasury Board budget request
- **Cost Overruns**
  - \$100 million in FY 2007 for previously authorized projects due to increased costs of construction materials
- **Capital Repairs and Maintenance Reserve**
  - Maintain FY 2006 level funding at \$40 million annually to replace major mechanical systems and repair and replace roofs statewide
- **Equipment for New Facilities**
  - \$65 million for equipment and furnishings for projects coming on-line
- **Prior Capital Outlay Commitments**
  - \$8.0 million annually to continue the JMU purchase of Rockingham Hospital
  - \$13.2 million to repay a Treasury Loan extended for the renovation of the State Capitol
  - \$40 million to complete the renovation and addition to the Old Barracks at VMI for which planning funding was provided in the 2005 Session



# Capital Outlay

- **Life Safety and Federal Mandates**
  - \$25.0 million in each year to address for asbestos removal, fire suppression and ADA compliance
- **Mental Health Restructuring**
  - \$30 million in each year to begin implementing the renovations and construction required to deliver mental health services in accordance with the restructuring plan outlined by the department
  - \$130 million to begin MHMR strategic plan for hospital and training center replacements
- **Renovations and Improvements**
  - Capital requests for renovation and improvements total more than \$800 million for the biennium
- **New Construction**
  - Capital requests for new construction total almost \$1.9 billion for the biennium



# Higher Education

- Agency requests total \$326.0 million in FY 2007 and \$328.0 million in FY 2008 predominantly for program expansions and new initiatives
- System-wide budget drivers:
  - Enrollment Growth
    - \$33.0 million in FY 2007 and \$67.0 million in FY 2008 based on SCHEV approved projected growth of an additional 8,000 in-state FTE in each year of the biennium
  - Student Financial Aid
    - \$34.5 million in FY 2007 and \$69.1 million in FY 2008 to begin a four-year phase-in of fully funding 100 percent of financial aid need for in-state undergraduate students at public institutions
    - \$10.0 million in FY 2007 and \$23.5 million in FY 2008 to increase TAG award to from \$2,500 to \$3,500 for all Virginia students attending private colleges



# Higher Education

- **Base Operating Support**
  - \$100.0 million in FY 2007 and \$200.0 million in FY 2008 to provide additional funding for existing students under higher education guideline assumptions
- **HEETF Lease**
  - \$11.3 million in FY 2008 to provide lease payments for \$51.7 million in new equipment in each year acquired under the equipment trust fund
- **Eastern Virginia Medical School**
  - \$2.5 million in FY 2007 and \$5.0 million in FY 2008 to provide additional operating support for the EVMS in support of continuing accreditation
- **Public Libraries**
  - \$4.2 million in FY 2007 and \$7.0 million in FY 2008 to fund local libraries in accordance with state formula



# Transportation

- VDOT did not request GF support for its activities or for funding removed from base budget by the Executive
  - \$37.4 million annual debt service requirements for the FRANs issued to replace the \$317 million transferred to the GF in FY 2003
    - General Assembly made commitment to repay this debt from GF
    - GF appropriations made each year since FY 2003
  - Insurance Premiums
    - \$138 million in FY 2007 and \$146 million in FY 2008



# Employee Compensation and Benefits

- Employee salary increase: GF cost of every 1% effective December 2007

<i>GF \$\$ in millions</i>	<u>FY 2007</u>	<u>FY 2008</u>
State employees	\$10.2	\$18.7
Higher Education Faculty	\$4.0	\$11.5
State Supported Local Employees	\$4.5	\$7.6

- State Employee Health Insurance Program
  - Premium increase of 9.9% projected in FY 2007 to maintain current benefit levels
    - \$28.2 million GF each year
- VRS conducted an actuarial valuation of all of the system's funds as of June 30, 2005
  - Contribution rates for most VRS administered funds increased

## Employee Compensation and Benefits: 2006-08 Cost of VRS Employer Rate Increases

Fund	Biennial 2006-08 General Fund	Biennial 2006-08 Non General Fund	Biennial 2006-08 Total Funds
<b>State Employees</b>	\$97.4 million	\$114.8 million	\$212.2 million
<b>Teachers</b> (includes prefunded rate for retiree health credit)	\$284.3 million	N/A	\$284.3 million
<b>SPORS</b>	\$5.1 million	\$0.9	\$6.0 million
<b>JRS</b>	\$10.4 million	\$0	\$10.4 million
<b>VaLORS</b>	\$2.2 million	\$0.3 million	\$2.5 million
<b>VSDP</b>	\$8.9 million	\$8.9 million	\$17.8 million
<b>State Retiree Health Credit</b> (prefunded rate)	\$26.2 million	\$28.5 million	\$54.7 million
<b>State/Teacher Group Life</b>	\$39.4 million	\$15.1 million	\$53.7 million
<b>Total:</b>	\$473.9 million	\$168.5 million	\$641.6 million

Note: Teacher estimates do not include the additional cost to the K-3 Class Size Reduction Program, updates to the Non-Professional VRS rate, updated ADM projections, and the 2006-2008 composite index. VRS costs for recognized teacher positions will be included in the SOQ costs in the introduced budget.



# Public Safety

- Agency requests total \$183.0 million in FY 2007 and \$245.8 million in FY 2008
- Major budget drivers are operational costs for new state/local correctional facilities, increased utility costs, and program expansions
- Statutory requirements
  - “599” program (\$10.5 million in FY 2007 and \$11.1 million in FY 2008)
  - Law enforcement positions for 1:1500 (\$1.0 million in FY 2007 and \$2.5 million in FY 2008)
- New or Expanded Correctional Facilities/Inmate Forecast
  - New and expanded correctional facilities (\$23.6 million FY 2007 and \$71.0 million FY 2008)
  - Jail and per diem funding (\$2.5 million in FY 2007 and \$10.0 million in FY 2008)
  - Additional beds at Hanover and Culpeper Juvenile Correctional Centers (\$3.4 million in FY 2007 and \$4.0 million in FY 2008)
  - Detention home/youth home construction (\$4.1 million in FY 2007)
- Utility/Gas Costs Increases
  - Departments of Corrections & Juvenile Justice: \$5.8 million each year
  - State Police: \$1.2 million each year



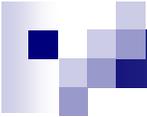
# Public Safety

- **Workload/Caseload/Program Increases**
  - State trooper positions (\$19.9 million in FY 2007 and \$31.9 million in FY 2008)
  - Offender containment / day reporting centers (\$2.6 million in FY 2007 and \$2.4 million in FY 2008)
  - Community corrections staff (\$4.9 million in FY 2007 and \$6.1 million in FY 2008)
  - Forensic science staff (\$1.8 million in FY 2007 and \$2.2 million in FY 2008)
- **Increased Contract or Service Costs**
  - Inmate medical costs (\$9.2 million FY 2007 and \$14.8 million FY 2008)
  - Private prison rate (\$1.6 million in FY 2007 and \$2.2 million in FY 2008)
- **Other**
  - Continue implementation of the Offender Management System (\$5.6 million in FY 2007 and \$4.8 million in FY 2008)
  - DOC & DJJ: Correctional officer salary parity (\$6.0 million each year)
  - Forensic science pay plan (\$0.4 million in FY 2007 and \$0.8 million in FY 2008)



# Commerce and Trade

- Agency requests total \$80.4 million in FY 2007 and \$49.8 million in FY 2008
- FY 2008 request is a 35 percent increase over the FY 2006 base budget level
- Requests predominantly for program expansions and new initiatives
- Department of Housing and Community Development requests total \$32.1 million year, including:
  - Re-capitalize Housing Partnership Trust Fund (\$20.0 million year)
  - New urban revitalization program (\$5.1 million year)
  - Rural housing revitalization initiative (\$4.6 million year)
  - Site redevelopment funding (\$2.0 million year)
- Virginia Economic Development Partnership requests total \$2.9 million in FY 2007 and \$3.3 million in FY 2008, including:
  - Additional advertising funds (\$2.0 million year)
  - Additional marketing funds (\$500,000 in FY 2007 and \$850,000 in FY 2008)
  - Expansion of international markets development (\$200,000 each year)
  - Funding to address dollar devaluation (\$200,000 each year)



# Commerce and Trade

- Virginia Tourism Authority requests total \$3.4 million in FY 2007 and \$3.9 million in FY 2008, including:
  - Jamestown 2007 marketing (\$1.5 million year)
  - Leveraged ad and marketing funds (\$750,000 year)
  - Film incentive fund (\$500,000 year)
  - Welcome Center funding (\$500,000 year)
- Forestry requests total \$7.8 million in FY 2007 and \$5.4 million in FY 2008, including:
  - Support for unfunded FTEs (\$2.8 million in FY 2007 and \$1.9 million in FY 2008)
  - Fire equipment (\$2.7 million in FY 2007 and \$2.2 million in FY 2008)
  - Increased reforestation match (\$467,234 year)
- Department of Business Assistance requests total \$7.8 million in FY 2007 and \$2.8 million in FY 2008, including:
  - Capitalize business financing funds (\$5.2 million in FY 2007)
  - Expand workforce services funding (\$2.0 million year)
  - Small business incubator restoration (\$300,000 year)
- VDACS requests total \$1.4 million each year, including:
  - Additional veterinarian staff (\$450,000 year)
  - Agricultural promotion programs (\$300,000 year)
  - Office of Farmland Preservation (\$220,000 year)



# Natural Resources

- Agency requests for new funding total \$131.7 million in FY 2007 and \$141.7 million in FY 2008
- Four items represent the largest share of these funding requests
  - \$104.1 million in FY 2007 and \$117.6 million in FY 2008 for Chesapeake Bay restoration efforts and TMDL implementation
    - Includes amounts for restoration activities in the “Southern” Rivers – Virginia under no federal time requirement to complete restoration activity in these rivers
    - Includes appropriation of FY 2005 year-end surplus
    - Includes funding for both point source and non-point source pollution control programs
  - \$10.5 million in each year to support the matching grants provided by the Virginia Land Conservation Foundation
    - Represents an alternative to the continuation of the one-dollar vehicle registration charge current divided between Jamestown 2007 and the Virginia Land Conservation Fund
  - \$4.0 million in each year to further address state park operating and staffing needs
  - \$4.0 million in each year to expand the delivery of nonpoint source pollution control programs and increase staffing in Virginia’s Soil and Water Conservation Districts



# General Government / Technology

- Agency requests for new funding total \$101.2 million in FY 2007 and \$123.3 million in FY 2008
- Agency requests were predominantly for program expansions and new initiatives, including:
  - Supreme Court
    - \$7.0 million in FY 2007 and \$8.9 million in FY 2008 for additional district court personnel
    - \$1.9 million each year to expand the number of drug court programs
  - Compensation Board
    - \$11.9 million in FY 2007 and \$23.6 million in FY 2008 to increase staffing for constitutional officers
  - Office of the Attorney General
    - \$1.1 million in FY 2007 and \$1.2 million in FY 2008 for additional assistant attorneys general and support staff
  - Department of Veteran Services:
    - \$1.0 million in each year for additional veteran service representatives and claims examiners



# General Government / Technology

- Agency requests for new initiatives included:
  - Supreme Court
    - \$9.0 million in FY 2007 and \$16.1 million in FY 2008 to increase the rates of pay to court-appointed attorneys for criminal indigent defense services
    - \$1.0 million in each year for review of the magistrate system operations
    - \$1.1 million in FY 2007 and \$0.7 million in FY 2008 to establish a pilot project for electronic case filing and document imaging in the circuit courts
  - State Board of Elections
    - \$6.5 million in FY 2007 and \$60,000 in FY 2008 to distribute electronic polling books statewide
  - Department of Taxation
    - \$1.3 million in FY 2007 and \$1.3 million in FY 2008 to create a conservation easement tax credit enforcement unit
  - Center for Innovative Technology:
    - \$12.0 million each year to support programs designed to close investment and innovation gaps in nanotechnology, SmartBio technology, and accelerate the growth of high technology companies