

Budget Outlook: 2007 Session

November 13, 2006
House Appropriations
Committee Retreat



2007 Session Budget Outlook

- A look at fiscal year 2006
- How wide is the prosperity?
 - It's all about Northern Virginia
- Revised economic outlook
 - The nation
 - Virginia
- Housing's impact on Virginia's revenues
- Impact of federal spending in Virginia
- Revised revenue outlook for 2006-2008
 - 2006 actual collections form the base
- 2007 Session
 - Restraint should be the "rule"
 - What are the pressures?
 - What are the out year obligations?

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Revenue Forecast Process

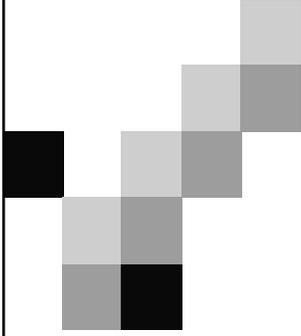
- Section 2.2-1503 of the Code requires the Governor to prepare annually a forecast of the economic activity in the Commonwealth, including an estimate of revenues
- Code established two advisory groups
 - Governor's Advisory Board of Economists (GABE)
 - Consists of 15 private and public sector economists
 - 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)
- Advisory groups meet in the fall

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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

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A Look at Fiscal Year 2006

What drove the collections?



Virginia's Economy: Review of 2006

Out-Performed the Forecast

- FY 2006 tax collections grew 8.4 percent over FY 2005
 - Fiscal year forecast (with mid-Session adjustments) assumed a 7.3 percent growth rate
 - Revised upward from the fall of 2005 forecast growth rate of negative 2.7 percent
 - Total revenues exceeded forecast by \$147.0 million
 - All but \$19.0 million was assumed in Chapter 3
 - Income and sales tax performed slightly better than the forecast
 - Represent approximately 73 percent of gross revenues
 - On a weighted basis, nonwithholding payments and corporate taxes account for the majority of the surplus
- 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. job growth rate
 - Virginia job growth was slightly better than forecast
 - Virginia wage and salary growth was within the forecast
 - Northern Virginia continues to be the engine
 - Accounted for approximately 54 percent of all new jobs created in the state
 - Continued federal spending and a robust construction industry
- Strong consumer purchasing
 - Sales tax collections, adjusted for the tax changes (food tax, AST) grew 6.1 percent
 - Performed in-line with personal income
 - Last quarter began to show weakness

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Summary of FY06 Revenue Collections (millions of dollars)

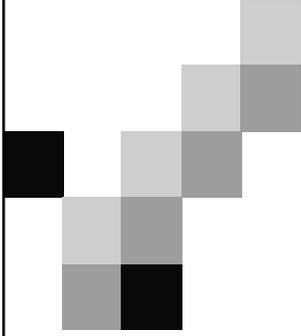
<u>Revenue Source</u>	<u>Forecast</u>	<u>Actual</u>	<u>Variance</u>		<u>Annual Growth</u>
			<u>Dollars</u>	<u>Percent</u>	
Withholding	\$ 7,978.8	\$ 8,061.0	\$ 82.2	1.0 %	7.3 %
Nonwithholding	2,431.3	2,530.2	98.9	4.1	22.0
Refunds	(1,239.7)	(1,282.6)	(42.9)	3.5	3.9
Net Individual	9,170.4	9,308.6	138.2	1.5	11.4
Sales and Use Tax	2,803.8	2,812.7	8.9	0.3	(4.5)
Corporate Income Tax	851.5	871.6	20.1	2.4	41.3
Insurance Premiums	392.5	373.8	(18.7)	(4.8)	0.1
Wills, Suits, and Deeds	723.0	694.7	(28.3)	(3.9)	16.6
All Other	746.1	772.9	26.8	3.6	(3.7)
Total GF Revenue	\$ 14,687.3	\$ 14,834.3	\$ 147.0	1.0 %	8.4 %

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Comparison of Actual FY06 Surplus to Revenues Assumed in FY 2006-08 Budget (millions of dollars)

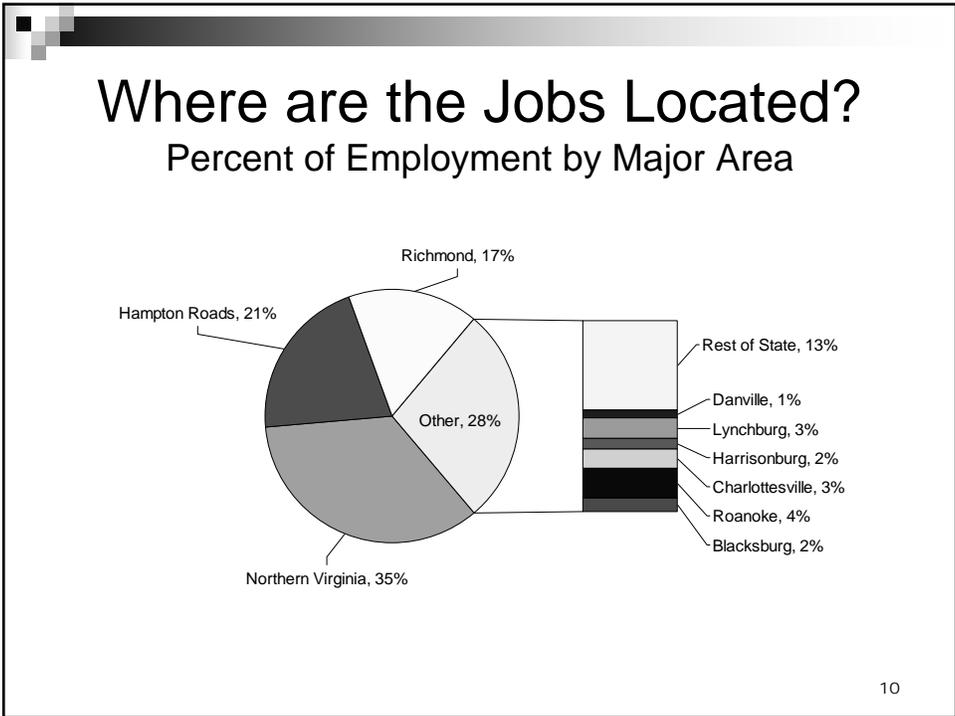
<u>Revenue Source</u>	<u>Actual Surplus</u>	<u>Budget Bill Surplus</u>	<u>Difference</u>
Withholding	\$ 82.2	\$ 30.0	\$ 52.2
Nonwithholding	98.9	107.0	(8.1)
Corporate Income Tax	20.1	35.0	(14.9)
Sales and Use Tax	8.9	20.0	(11.1)
Wills, Suits, and Deeds	(28.3)	(30.0)	1.7
Insurance Premiums	(18.7)	(15.0)	(3.7)
All Other	(16.1)	(19.0)	2.9
Total GF Revenue	\$ 147.0	\$ 128.0	\$ 19.0

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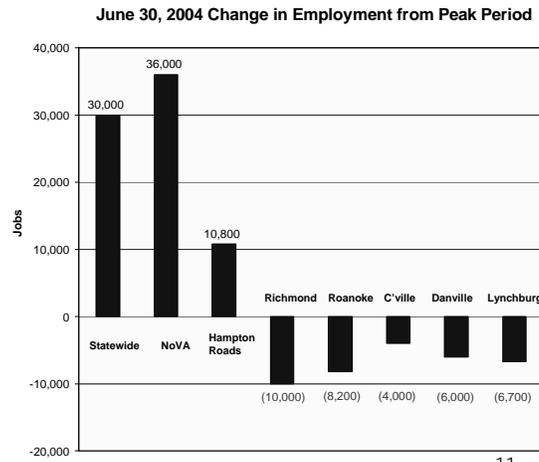
Fiscal Year 2006: Which MSA continues to lead in job growth?

The winner is: Northern Virginia



By the end of Fiscal Year 2004 Virginia was well into a recovery, but not in all regions

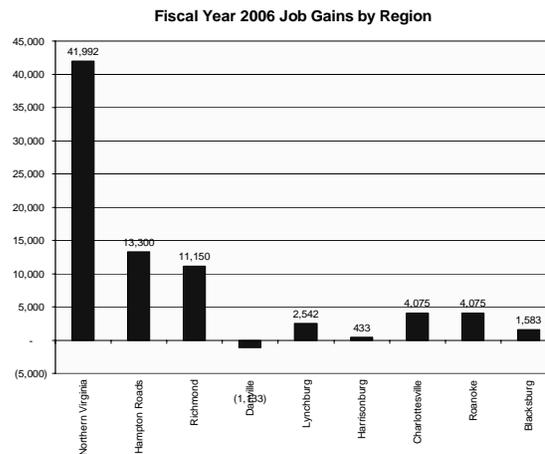
- By March 2004, Virginia economy was expanding, having recovered all of the jobs lost during the recession. As of June 2004, Virginia had gained nearly 30,000 new jobs
- Other than Northern Virginia and Hampton Roads, the remaining areas of the state had not recovered from their pre-recession peak



Source: Bureau of Labor Statistics

Northern Virginia Continues to Lead the State in Total Job Growth

- Job growth in Virginia continues to out perform the nation -- Added over 78,000 jobs in FY 06
 - Northern Virginia accounted for over half of the job gains, followed by Hampton Roads and Richmond
 - Charlottesville had the largest percentage increase in job growth among all MSAs in the state
 - Is approximately 2,200 jobs ahead of pre-recession peak
- Roanoke, Lynchburg and Danville still have not recovered all of the jobs lost during the 2001 recession
 - Danville continues to lose jobs



Source: Virginia Employment Commission

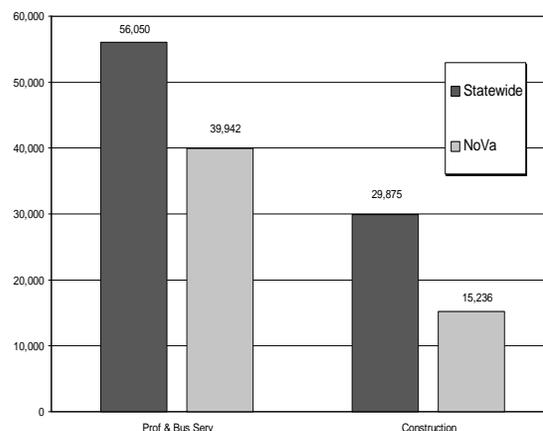
What's Driving the Train?

- Over the last three years, Northern Virginia has accounted for nearly 54 percent of the state's total job growth
 - NoVa employment growth has not fallen below 3 percent since fiscal year 2003
- Nearly 60 percent of the job gains in Northern Virginia have been concentrated in two industries
 - Professional and Business Services
 - Construction
- Employment growth has been driven by federal spending, which accounts for one-third of the region's economy; and the increase in both residential and commercial real estate

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Professional and Business Services and Construction Job Growth Since 2004

- 24% of the state's total jobs are in two industries: professional and business services and construction
- Since the recovery began in 2004, over 50 percent of the jobs created have been in these occupations
 - In NoVa, they account for nearly 60 percent of the total new jobs

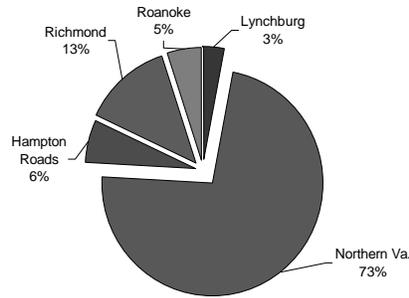


Source: Virginia Employment Commission

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Professional and Business Services Employment - FY 2006 by Region

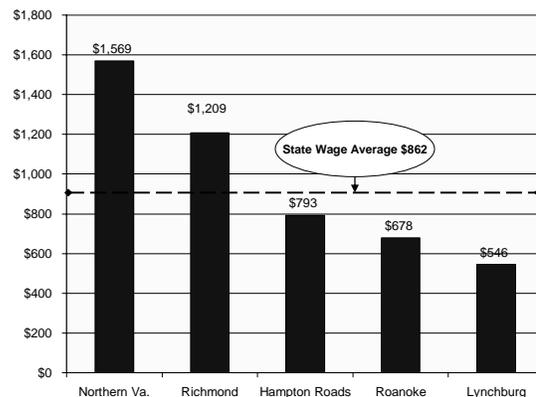
- P&BS accounted for 1 out of every 3 jobs created in FY 2006
 - Three-quarters of these jobs were created in NoVa
- Statewide, 50% of these jobs are located in Northern Virginia
 - Represents 26% of the region's total employment versus 17% for the rest of the state



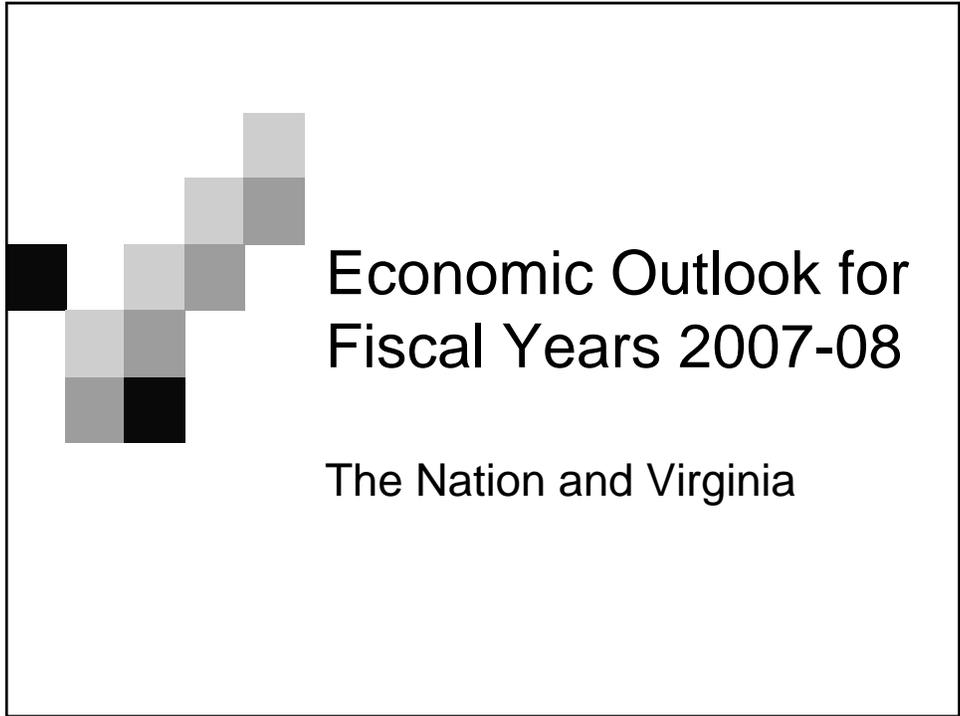
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Comparison of Weekly Wages for Professional and Business Services Industry

- Average weekly wages paid in Northern Virginia are between 130 percent to nearly 300 percent higher than other MSAs
- Disparity in wage rates reflects the higher cost of living in Northern Virginia and the different mix of jobs classified in this industry
 - NoVA and Richmond have more lawyers, architects, engineers, consultants, and management professionals



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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
 - Generally, the revised economic outlook is consistent with the November 2005 forecast
 - Payroll employment has grown, albeit at a below-trend line pace
 - FY 08 downward adjustments reflect the downturn in housing
- Several positive and negative factors are in play:
 - Soft housing market will dampen growth in construction employment and housing related purchases (building materials, furnishings)
 - Business investment is expected to increase
 - Corporate profits continue to be strong –
 - Moderating energy prices will reduce pressure on costs
 - Increased investment spending, replacement of computer equipment and software
 - Manufacturing growth is uneven, Institute of Supply Management Index has fallen
 - Consumer spending should be more in line with income growth
 - Home equity withdrawal had fueled consumer spending
 - Equity withdraw has eased
 - Lower energy prices will ease consumer burden
 - Nationally, every 10 cent reduction in gas price saves consumers \$12 billion annually
 - Should impact the holiday shopping season
 - Federal Reserve monetary policy – holding patterning following 17 rates increases
 - Balance between keeping inflation in check and while not impacting economic growth
 - Global insight's forecast predicts a pause in interest rate hikes with the possibility of a rate cut next spring based on below-trend growth and lower inflation – primarily driven by lower energy prices and slower job growth

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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>
FY 2006	1.5%	1.5%	5.9%	5.8%	5.7%	6.6%
FY 2007	1.4%	1.2%	6.4%	6.4%	6.0%	6.2%
FY 2008	1.3%	1.2%	5.8%	5.2%	5.8%	4.6%

Source: Global Insight, Revised Forecast based on October 2006 Standard U.S. Forecast

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Virginia's Economic Outlook Fiscal Years 2007 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 small changes in wages and salaries from the official forecast issued in November 2005
 - Wage and salary growth is expected to remain strong due to the concentration of high paid jobs being created in NoVA
 - FY 08 downward adjustments reflect the downturn in housing and slower federal procurement spending
- Employment growth has moderated in the second half of 2006. 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"
 - Manufacturing is expected to see further declines
 - Tourism industry should continue to perform well

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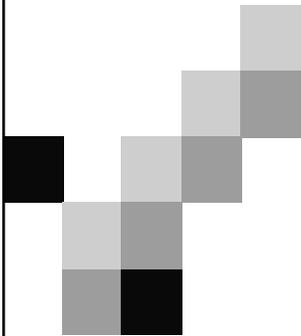
Revised Outlook of Virginia's Economic Indicators

	Employment		Wage and Salary	
	<u>Official</u>	<u>Revised</u>	<u>Official</u>	<u>Revised</u>
FY 2006*	1.8%	2.2%	6.9%	6.8%
FY 2007	1.7%	1.7%	6.4%	6.1%
FY 2008	1.7%	1.5%	6.0%	5.5%

Source: Official Forecast is developed by Dept. of Taxation, based on Global Insight's November 2005 Standard U.S. Forecast; Revised forecast developed by Chmura Economic & Analytics

*Actual

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Impact of the Housing Industry on General Fund Revenues

How Does Housing Impact State Revenues?

- Recent housing boom has affected three core GF revenue sources
 - Recordation
 - Corporate/Nonwithholding
 - Sales Tax
- Direct impacts
 - Recordation revenues
 - Business income: growth in building and real estate industry profits
 - Sales tax: building materials and home furnishings
- Indirect impacts
 - “Wealth effect” of housing

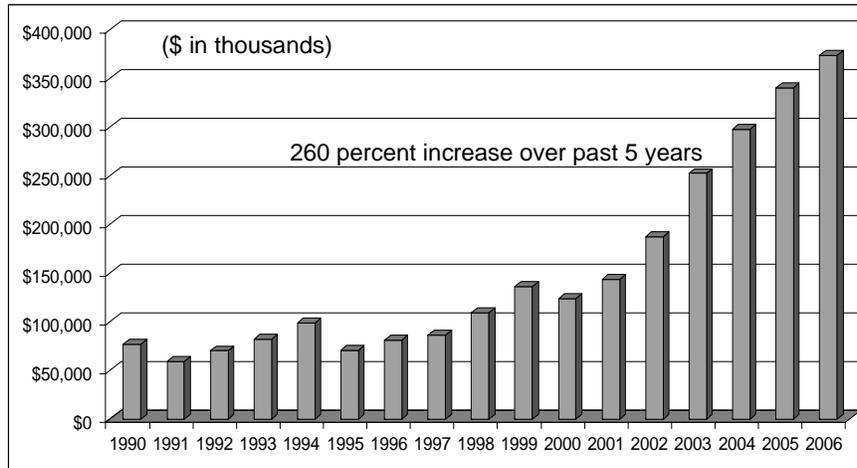
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Recordation Taxes Major Source of Recent Revenue Growth

- Previously, recordation taxes were a minor general fund revenue source
 - In FY 2000, recordation revenues totaled \$123 million and comprised 1.1% of GF revenues collected
- But over the past 5 years, economic-based recordation tax collections (exclusive of tax increase) have grown 260 percent, and comprised 2.7 percent of total GF revenues last year
 - Grew 9.9% in FY 2006 following 5 years of double-digit increases averaging 22.7% per year
 - Exclusive of tax increase, grew to \$373.5 million
- Inclusive of the tax increase, recordation revenues totaled \$622.5 million and comprised almost 5 percent of GF revenues in FY 2006
- Recordation tax revenue increases account for 20 percent of total general fund revenue growth since 2000

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Growth in Recordation Tax Revenues (exclusive of tax increase)

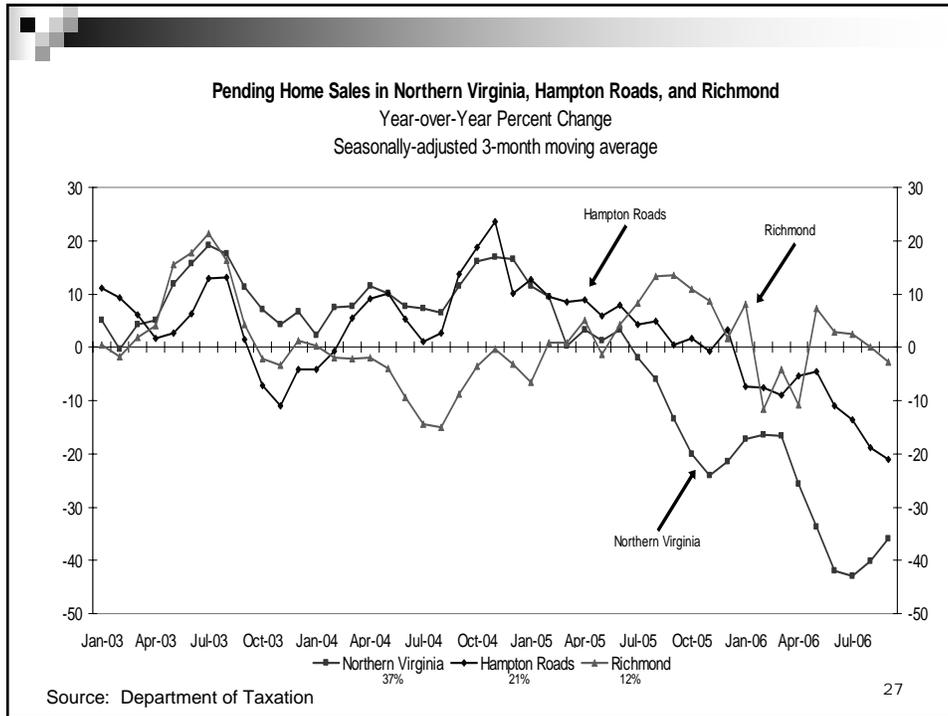


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Recordation Revenues Forecast to Decline

- Official forecast assumes recordation tax revenues will decline 15.4 percent in FY 2007 – a drop of \$71 million
 - Based on first quarter performance and market predictions, FY 07 forecast revenues could decline more than 20-25 percent
- Recordation tax collections are driven by three factors:
 - Homes sales;
 - Price appreciation; and
 - Refinancings
- Recent slump in recordation taxes – and housing market overall – has been driven primarily by declining sales volume to date
- Statewide volume of home sales has declined
 - 8.8% decrease in sales in FY 2006
 - First quarter FY 07 sales are 25% below same quarter last year
- Far steeper decline in Northern Virginia – September 2006 down almost 36 percent compared to September 2005
 - Northern Virginia accounts for 37% of home sales and 50% of recordation revenues

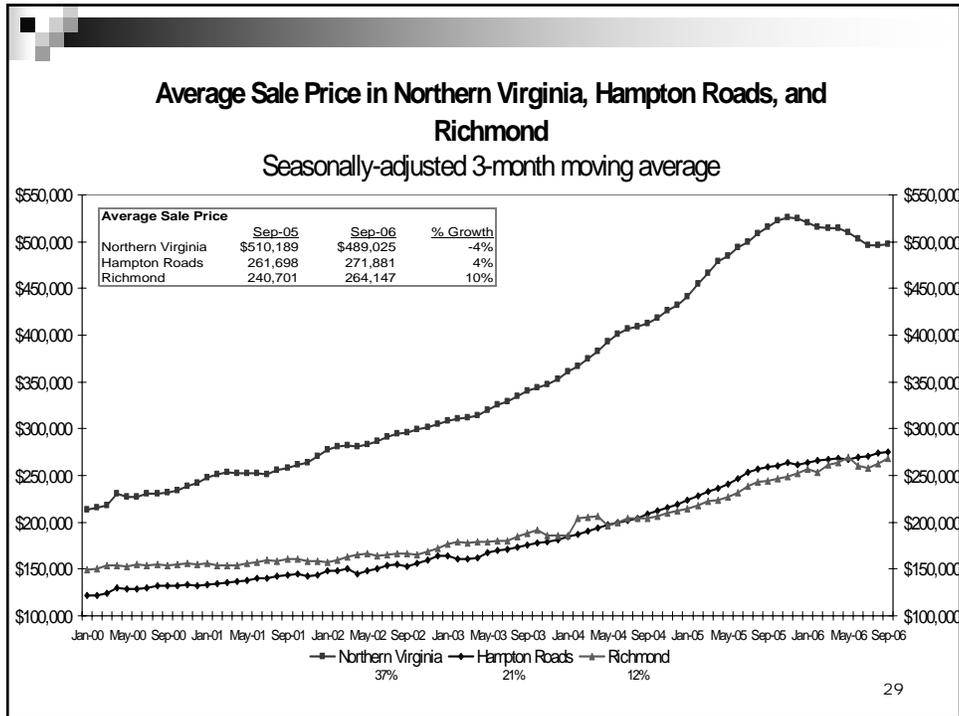
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Housing Market & Recordation Revenues Role of Price Appreciation

- In addition to historically high levels of home sales, record price appreciation drove growth in recordation revenues the past 3 years
- Between January 2003 and Sept 2006, average home prices in the major urban areas increased at following rates:
 - Northern Virginia 58 percent
 - Hampton Roads 73 percent
 - Richmond 56 percent
- Although price appreciation continued after the sales volume began to decline, pricing is flattening and actually declining in some regions as well
 - As of September, Northern Virginia prices have fallen 4 percent year over year from last September
 - Declined 6 percent from high pricing in November 2005
 - Use of builder incentives has staved off price declines to a certain extent
- General rule of thumb is that price depreciation occurs about 18-24 months after the peak in sales volume
 - NoVa pending sales have been declining since 2005
 - Drop off in rest of state has been more recent

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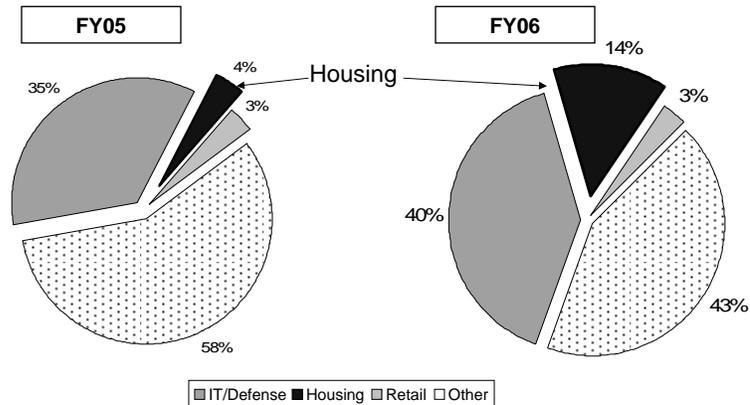


Impact of Housing on Business Taxes

- Recent Trends:
 - Like recordation taxes, both corporate and nonwithholding taxes have been buoyed by the housing industry over past 4 years
 - Along with recordation revenues, corporate and nonwithholding taxes have been major sources of GF revenue growth
 - Corporate income taxes have grown an average over 32 percent each year for past 4 years and account for 15 percent of total GF growth since 2002
 - Nonwithholding tax revenues have increased an average of 22 percent a year for past 3 years and account for 28 percent of total GF growth since 2002
 - Much of this growth has been driven by expansion of home building and real estate industry
 - Share of GDP attributable to residential construction exceeded 6 percent in 2005 – higher than at any time in 35 years

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Large Company Corporate Income Taxes Final & Estimated Payments by Industry



Note: Large companies represent 60 percent of all payments

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Impact of Housing on Business Taxes

■ Forecast:

- Leading home builders have been reporting weaker than anticipated quarterly results
 - Toll Brothers said contracts for new homes fell 57 percent nationally in most recent quarter; Centex, Ryan report similar fall-offs
- Housing permits down almost 40 percent in Virginia
- While corporate income tax receipts lag economic trends, declining corporate profits are projected to impact that source by FY 2008

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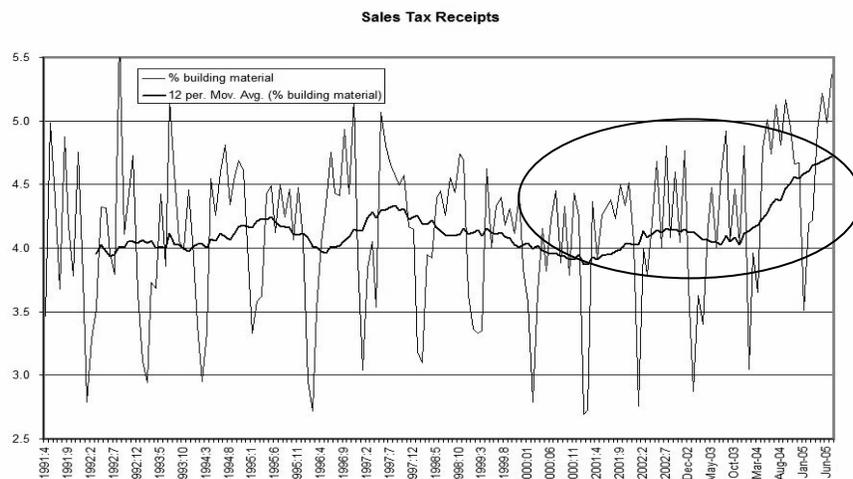
Housing Impact on Sales Taxes

- Housing boom had substantial direct and indirect impacts on sales tax collections
 - Direct impacts on both consumer and business purchases
 - Producer side – building material, lumber etc.
 - Lumber, building materials and supplies were the fastest growing subcategories of sales tax in both FY 2004 and FY 2005, growing 18.3 percent and 16.6 percent in the respective years
 - Consumer side – home furnishings and accessories expenditures which account for about 3.0-3.5 percent of consumer expenditures

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Direct Effects of Housing on Sales Tax Collections – Producer Side

Building Material as Share of Sales Tax Revenues

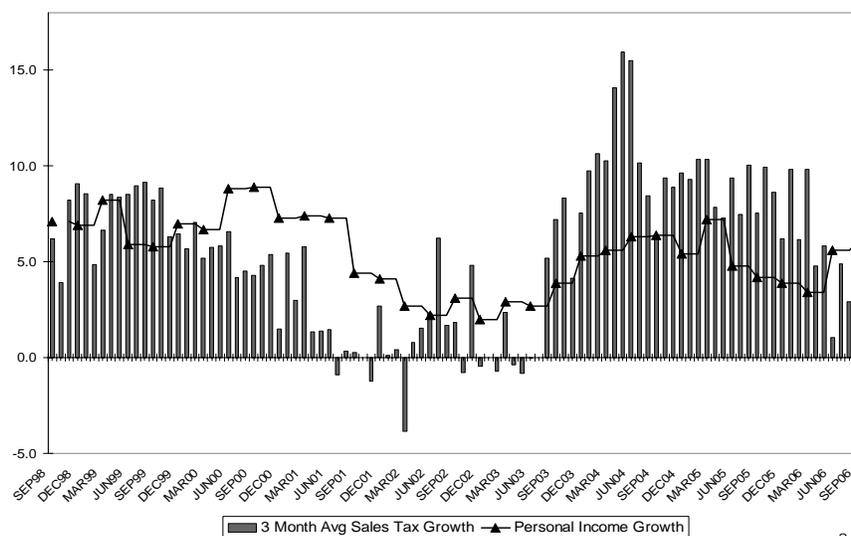


Indirect Impacts of Housing Boom on Sales Tax Collections

- Major indirect impacts of housing boom on sales tax collections were on the consumer side of the equation
- These effects are harder to quantify
 - “Wealth effect” of price appreciation
 - Spending based on general consumer confidence
 - Impact of cash-out refinancings

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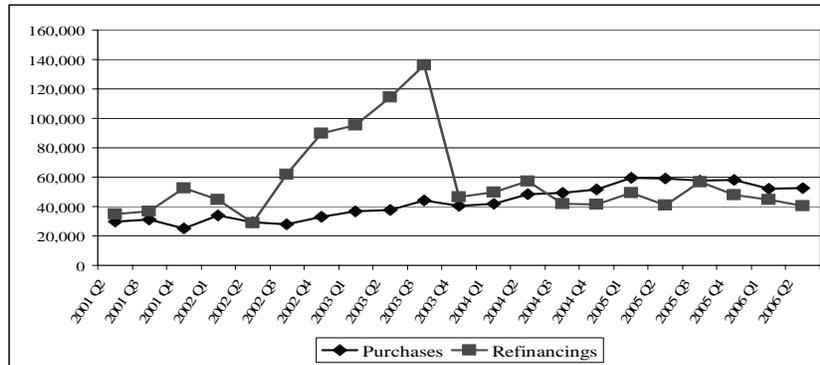
Sales Tax and Personal Income Growth Three-month Moving Average of Year-over-Year Growth



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Consumer Impacts of Indirect Impacts of Housing Boom on GF Revenues

- Growth in refinancings have had substantial impacts of consumer spending
 - Three-quarters refinancings are “cash-out”
- Mortgage withdrawals accounted for close to 8 percent of disposable income and more than 4 percent of consumer spending in 2005



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How Are Funds Used in Cash-Out Refinancings?

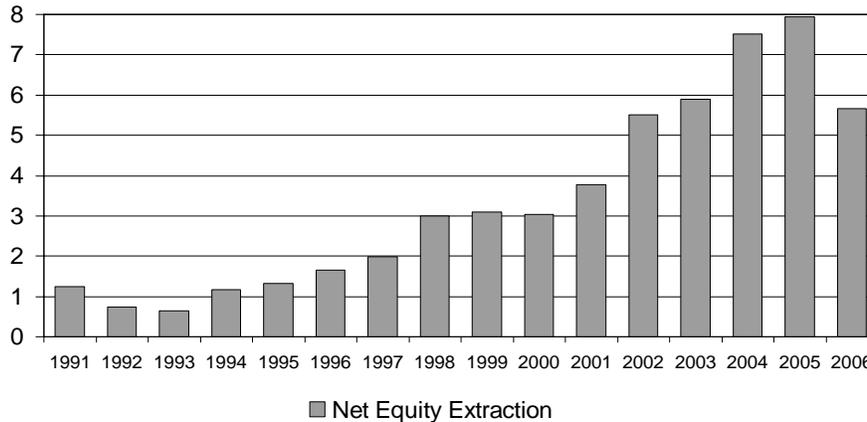
	Share of Dollars
Home Improvements and Other Consumer Expenditures	51%
Repayment of other debts	26%
Stock market/other financial investment	11%
Real estate or business investment	10%
Taxes	2%

Source: Federal Reserve Survey on use of funds from cash out re-financings 2001/2002.

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Mortgage Equity Withdrawal Has Begun To Ease

(Percent of disposable income)



Source: Federal Reserve - Kennedy/Greenspan data updated as of September 2006

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What is the Potential Impact of a Housing Market Decline?

- How substantial and long-lasting will the housing decline be and how will it affect the general fund revenue outlook?
- Negative Pressures:
 - Rapid price increases have placed home prices somewhat out of synch with true values based on underlying economics
 - Market specific – NoVa one of more over-valued regions in nation, rest of state more in line with values
 - Use of alternative financing has sustained activity in recent quarters as interest rates have risen and affordability has declined – reaching its limits
 - ARMs accounted for 35% of loans in 2005, interest-only loans above 25% in same year
 - Not likely to have reached bottom of market – prices could drop in the other areas of the state and market projected to remain flat for the next 12+ months

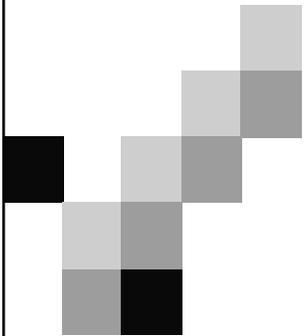
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What is the Potential Impact of a Housing Market Decline?

Stabilizing Forces:

- Unlike previous housing declines, other fundamentals in economy remain strong
 - Interest rates still relatively low, not projected to spike
 - Average rates in current decades have been: 9 percent in 1970s, 13 percent in 1980s, 8 percent in 1990s
 - Even with increases, average rates in 2000s to date has been about 6.5 percent
 - Job and income growth continuing albeit at slower rate on statewide basis
 - Job growth expected to remain in 35-40,000 new jobs per year range in Northern Virginia for next two years, exceeding the 10-year average
- 10 percent decline in house prices not expected to severely dampen consumer spending

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Impact of Federal Spending on Virginia's Economy

Is the Federal Government the Engine in Northern Virginia?

Northern Virginia and the Federal Government

- Federal spending constitutes 35 percent of the region's economy (payroll and procurement)
 - Procurement spending represents nearly 50 percent of total federal spending
 - 78 percent of the contracts are in the service industry – high wage jobs like data processing, telecom services, professional and managerial support
- Federal procurement spending has been the biggest gainer among the major sources of federal spending since 1996
 - Gains have been greatest since 9/11
- According to the Center for Regional Analysis at George Mason University, nearly 7,000 jobs are created for every \$1.0 billion in federal procurement spending
 - Estimated that approximately 50 percent of all new jobs in DC area tied to federal procurement
 - Department of Defense accounts for 56 percent of the contracts

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Federal Spending is Starting to Slow

- From Fiscal year 2002 through 2004, procurement spending increased by approximately \$18.7 billion in the Washington MSA to \$52.6 billion
 - Nationwide, 16 cents of every federal procurement dollar is spent in the Washington MSA
 - Up from 4 cents in 1983
 - Over 50 percent of the procurement spending is in Northern Virginia
- Preliminary data indicates that federal procurement spending increased only about 3.0 percent in 2005
 - Down from the 19 percent gain the previous year
 - Data excludes spending by the Postal Services, FAA, CIA and certain defense intelligent agencies

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What Will be the Impact of Slower Federal Spending?

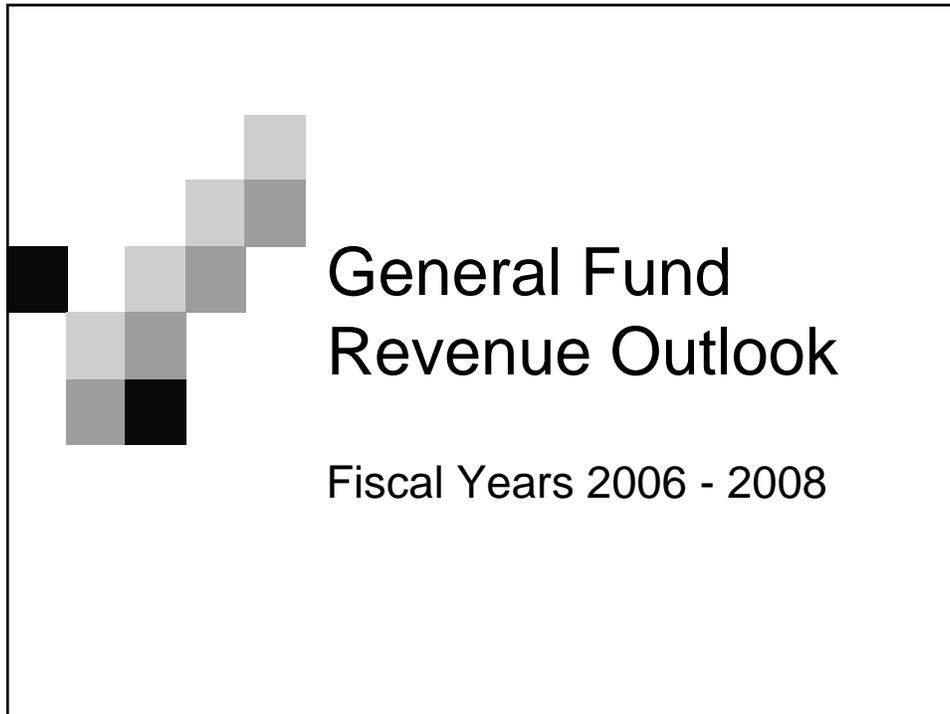
- Impact will not be as significant as the late 1980's – size and diversification
- Not all procurement is the same
 - Services and R&D procurement account for 84 percent of the total spending actually saw an increase of 6.8 percent
- Northern Virginia's share of procurement increased 5.4 percent
 - The District saw a decline of 5.8 percent

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Near Term Outlook

- Continued deceleration in federal spending will dampen employment growth in the region in 2007 and 2008
 - NoVa accounts for nearly 60 percent of the Metro employment growth
- Prior year federal monies are still being spent
 - Pig in the python
- Overall, employment is expected to grow at or slightly less than 3 percent, below the 3.5 - 4.0 percent growth rates seen over the last 3 fiscal years

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Revenue Outlook for Fiscal Years 2007 and 2008

- The FY 2006 surplus has a ripple effect on FY 2007 and FY 2008 revenues
 - FY 2006 actual collections form the “base” in which the forecasted growth rates apply each year
- Revenue adjustments will reflect FY 2006 actual collections, which is approximately \$150 million greater than assumed in the “official” forecast contained in Chapter 3

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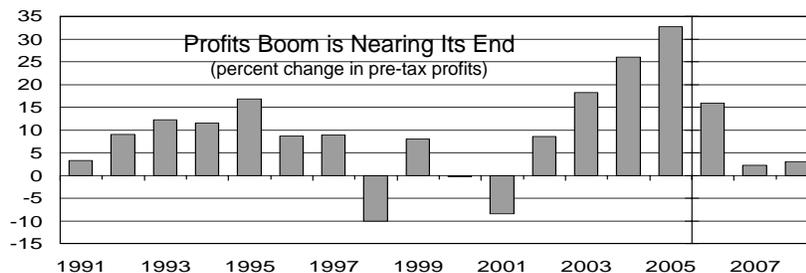
Revenue Outlook for Fiscal Years 2007 and 2008

- The underlining revenue outlook for payroll withholding is for revenue growth to be consistent with historical trends of between 5.5 percent and 6.0 percent
 - Consistent with last year's outlook
- Sales tax is expected to grow below the rate of personal income
 - Adjustments in the sales tax base reflecting a decline in housing related sales tax activity
 - Tourism-related sales expected to be strong in 2007
 - Will we have another strong holiday for retailers?
 - Nationally, sales are expected to increase about 4 – 5 percent over last year's holiday season
 - Lower energy prices could play a role

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Two Sources will Account for Majority of Upward Adjustments

- Corporate income taxes: Collections posted their fourth consecutive double digit year-over-year growth in FY 2006
 - Strength continues in FY 2007, reflecting strong earnings and profits among financials, defense, technology and oil companies
 - According to Thomson Financial, calendar year 2006 growth in 3rd quarter profits among the S&P 500 was running at 17.6%, greater than the 14% estimate
 - 74 percent of the companies have beaten their estimate
 - CY 2007 profits are forecasted to be flat due to housing related companies (home builders, financials, building supply companies) – but impact on tax payments lags



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Two Sources will Account for Majority of Upward Adjustments

- Nonwithholding or estimated payments: June and September estimated payments for tax year 2006 are up 13 percent over last year
 - Final FY 06 collections have not been factored into the current FY 07 estimate
 - Business profits are up
 - Markets are up
 - S&P 500 is up 13 percent year-to-date
 - Continued use of bonuses and stock options as a part of compensation
- These are same two sources that drove FY 2006 revenue growth

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How Much in New Revenue?

- With a higher revenue base from the FY 2006 surplus and year-to-date collections growing within estimate, it is expected that FY 2007 general fund revenues will perform slightly better than the forecast
 - Growth rate in FY 2007 should be around 6%
 - Majority of revenue growth will be driven by corporate and non-withholding
- Growth in FY 2008 should will be weaker due to flattening out in corporate taxes and continued weakness in housing
- These growth rates suggest a revenue revision of between \$475 million and \$550.0 million over the amounts assumed in Chapter 3
 - More than half of this reflects the higher base
- Chapter 3 unappropriated balance of \$113.0 million
- In addition, the Lottery has revised their forecast downward based on North Carolina lottery
 - \$20.7 million in FY 2007 and \$20.7 million in FY 2008
 - Revenues are split 60% for basic aid and 40% to local schools for technology
 - General fund will need to back-fill the basic aid amounts

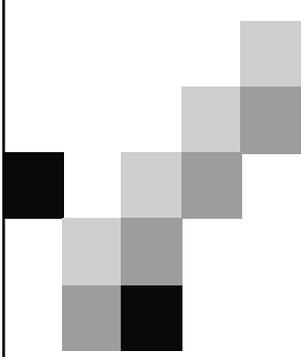
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Risks to Forecast

- Harder landing in the housing sector
- Energy price increase
- Federal deficit reduction efforts could impact defense and overall procurement spending

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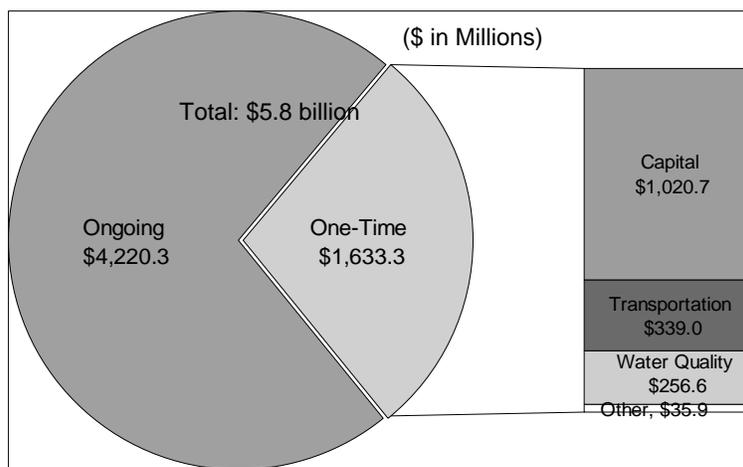
2007 Session
What Are the Issues?

Budget Outlook for Remainder of 2006-08 Biennium

- How were additional revenues appropriated in Chapter 3?
- Structural balance?
 - Annualize FY 08 costs
 - Known out-year costs
- What are required adjustments to the known budget drivers in the 2007 Session?

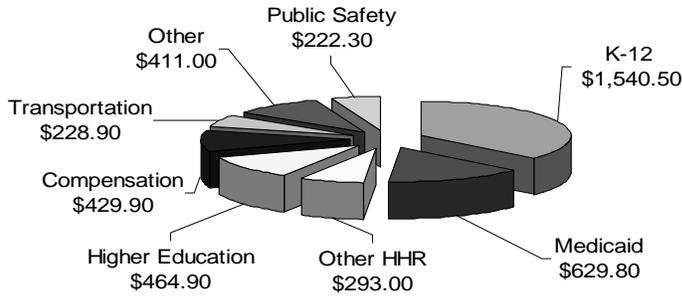
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One-Time Spending as Share of Total New Spending – Chapter 3



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On-Going GF Operating Increases FY 2006-08 Biennium (\$ in millions)



Total On-going Operating Increases: \$4.2 billion

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Chapter 3 – Current Budget GF

\$'s in millions	FY 07	FY 08	Biennium
GF Revenue (forecast) Includes Lottery and Transfers	\$16,260.0	\$17,028.6	\$33,288.6
FY 06 Balance Forward	\$1,410.0		\$1,410.0
Adjustments to Balance	\$134.0		\$134.0
Total Resources	\$17,804.0	\$17,028.6	\$34,832.6
Operating Appropriation	\$16,779.0	\$16,919.7	\$33,698.8
Capital Outlay	\$791.2	\$229.5	\$1,020.7
Total Appropriation	\$17,570.2	\$17,149.3	\$34,719.5
Balances	\$233.8	(\$120.7)	\$113.1

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Adjusted Base Budget for FY 2008

(GF Dollars in Millions)

2008 Total Appropriation	\$17,149.3
Remove Capital Outlays (Except for Maintenance Reserve)	(\$154.5)
Annualize Partially Funded Costs (FY 2008 Salary Increases Including Teacher Pay Raises)	\$87.2
Remove One-Time Spending (FY 2008 Rainy Day Fund)	(\$138.3)
Expected FY 2009 Rainy Day Fund *	\$82.5
HAC Estimated Base Budget	\$17,026.2
FY 2008 Resources Based on Chapter 3	\$17,028.6
Annualize Full Repeal of Estate Tax	(\$105.0)
Adjusted Revenue Base	\$16,923.6
Revised Balance	(\$102.6)

* Based on a revised estimate of FY 07 revenues and FY 09 RDF cap.

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2007 Session – *Why Restraint Should Be the Rule*

- Maintain structural balance -- avoid the “double-up to catch-up” spending
 - FY 2007 revenues in excess of the forecast should not be carried into FY 2008 and spent on on-going programs
 - This would have the effect of doubling up spending that can not be supported within the revenue framework
 - FY 2007 revenues not used to address current year issues should be used for one-time costs
 - Capital projects: During the 2006 Session, six capital projects were given planning money
 - Transportation: The General Assembly still needs to approve the allocation of \$339 million
- FY 2007 and 2008 budget adjustments that need to be addressed include - technical and forecast adjustments in Health and Human Resources and K-12, employee compensation and health insurance, and O&M costs for new facilities

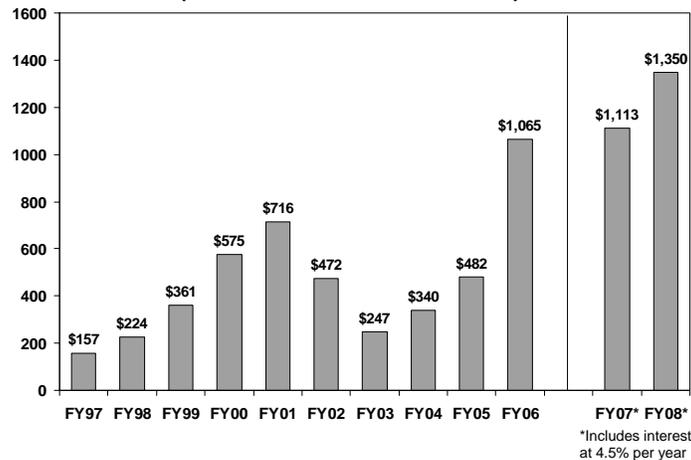
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2007 Session – *Why Restraint Should Be the Rule*

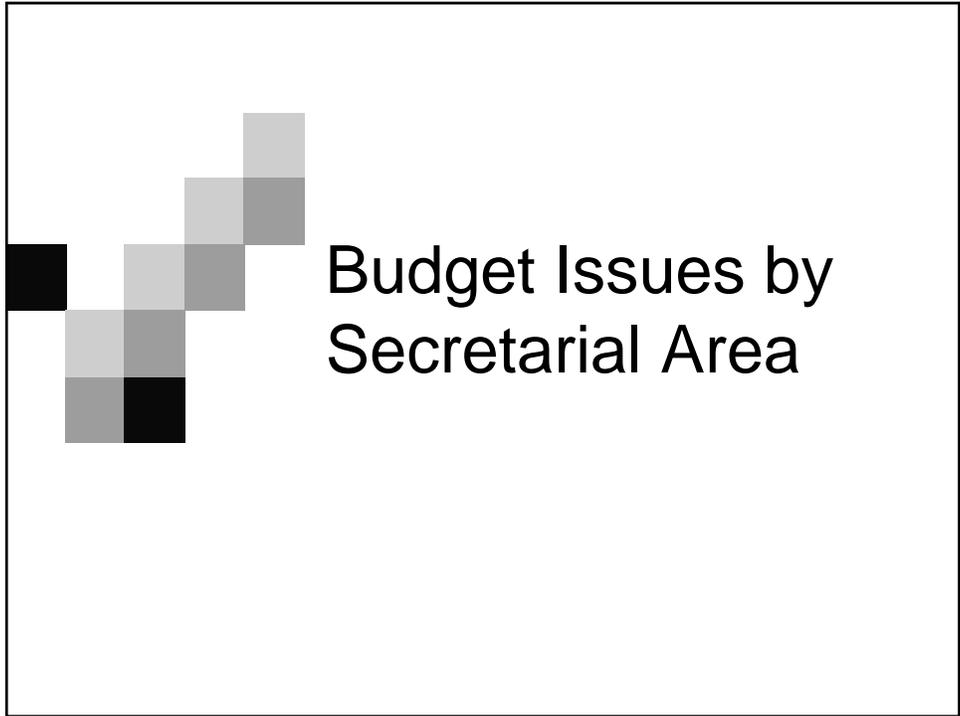
- Avoid new programs that expand the base
- Known 2008 - 2010 budget obligations include:
 - Required Rainy Day Fund deposits based in FY 2009 based on revised revenue outlook for 2007
 - Preliminary estimate is \$82.5 million (based on cap)
 - Estate tax: Due to the effective date of the Estate tax repeal, only \$35 million in revenue loss was recognized. The annual impact is estimated at \$140 million
 - Debt service for General Obligation Bonds
 - Bond issues phased-in
 - Biennial updates for SOQ and Medicaid re-basing
 - Operating and equipment costs of new buildings coming on-line

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Revenue Stabilization Fund, FY97-08 June 30 Balance (millions of dollars)



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FY 2007 Session Agency Budget Requests

- Agency operating requests submitted to DPB total \$1.2 billion for the remainder of the biennium
 - \$334 million in FY 2007 and \$896 million in FY 2008
- Operating requests fall into five categories:
 - Statutory/Mandatory: \$234 million over biennium (Rainy Day Fund, CSA, Health Care Fund shortfall, TANF, MHMR facility Medicaid match, state health insurance cost increase)
 - High Priority: \$222 million (jail per diems, TAG program, higher ed financial aid)
 - Program Expansions: \$300 million (court appointed attorney fees, WQIF, CSO, emergency preparedness, state police staffing, economic development programs)
 - New Initiatives: \$188 million (local PDR grants, nursing career ladder, corrections pay increases, economic development initiatives)
 - Other: \$286 million (VITA rate increases, fuel and utility rate increases, one-time transportation earmarks, social service facility rate increases)
- Part IV budget language limits capital outlay in the short session to project supplements, emergencies, life safety, and prior commitments. Based on that criteria, agency capital requests total about \$390 million for the remainder of the FY 06-08 biennium
 - About half of the amount requested is to fund two projects with prior planning: the replacement of the Western State hospital (\$90 million) and a new correctional facility in Mt. Rogers (\$99 million)

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2006-08 Budget Drivers Selected Mandatory/Statutory Spending

GF \$ in Millions	FY 2007	FY 2008	Total
Medicaid Utilization and Inflation	(\$6.5)	\$2.6	(\$3.9)
Virginia Health Care Fund (Tobacco Tax Shortfall)	\$24.5	\$23.2	\$47.7
Comprehensive Services Act	\$10.2	\$13.6	\$23.8
MHMR Facility Medicaid Match	\$11.7	\$13.9	\$25.6
DMAS National Provider Identifier Initiative	\$0.8	\$0.0	\$0.8
MHMR Adult & Juvenile Competency to Stand Trial Services	\$0.4	\$0.9	\$1.3
DSS TANF Reauthorization	\$9.0	\$29.0	\$38.0
DSS Title IV-E State Adoption Subsidies	\$2.1	\$6.9	\$9.0
Public Education Update Student Membership / Participation	(\$25.1)	(\$28.6)	(\$53.7)
Public Education – Sales Tax Technical Adjustments	TBD	TBD	TBD
Public Education – Net Lottery	\$12.4	\$12.4	\$24.8
Sheriffs – Per Diem Payments, New Deputies - 1:1500 & Jail	\$8.3	\$13.5	\$21.8
Criminal & Involuntary Mental Commitment Fund	\$0.6	\$1.9	\$2.5
State Employee Health Insurance Rate Adjustments	\$0.0	\$30.8	\$30.8

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2006-08 Budget Drivers Selected High Priority

GF \$ in Millions	FY 2007	FY 2008	Total
Higher Education – operating costs for new facilities / campuses	\$0.2	\$4.1	\$4.3
Higher Education Financial Aid/TAG – maintain existing need	\$0.0	\$11.5	\$11.5
Higher Education Undergraduate Aid Phase-in to 50% of Need	\$0.0	\$35.0	\$35.0
Higher Education Enrollment Growth	\$0.0	\$24.0	\$24.0
DEQ Water Quality Improvement Fund	\$0.0	\$75.0	\$75.0
DMA Reenlistment Bonuses	\$0.7	\$2.2	\$2.9
Adult Corrections – Inmate Medical Costs	\$0.4	\$2.9	\$3.3
DSS Child Support Enforcement	\$0.0	\$5.0	\$5.0
DSS Offset Federal Reductions to Child Welfare	\$6.4	\$7.4	\$13.8
Economic Development Attract Research Facility	\$0.0	\$19.0	\$19.0
Transportation Partnership Opportunity Fund	\$35.0	\$0.0	\$35.0
Transportation Revenue Sharing Program Fund	\$35.0	\$0.0	\$35.0
2 nd Year Teacher Pay Raise = 3% Same As Other Employee Groups	\$0.0	\$24.0	\$24.0

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Health & Human Resources

- Agency requests total \$92.4 million in FY 2007 and \$200.6 million in FY 2008 for mandatory programs, program expansions and new initiatives
- Forecast Changes for 2006-08
 - Reduction of \$3.9 million for Medicaid utilization, inflation and enrollment growth
 - Growth of 9.1% in FY 2007 and 7.6% in FY 2008
- \$47.7 million for a shortfall in the Virginia Health Care Fund due to declining tax revenues from tobacco products
 - Revenues running about 7 percent lower than anticipated
- \$25.6 million for MHMR facility Medicaid match requirements

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Health & Human Resources

- \$23.9 million for projected growth in the cost of caring for at-risk children and youth through the Comprehensive Services Act
 - Growth in 2006-08 is estimated at 8.56%, slightly higher than 8% assumed in Chapter 3
 - Prior year expenditures (FY 2006) grew higher than estimate at about 10%
 - Shortfall made up from FY 2007 appropriation
 - Base adjustments made to account for FY 2006 growth
 - Loss in Medicaid reimbursement for treatment foster care totals \$7.8 million due to Federal Deficit Reduction Act of 2005 restrictions on reimbursement for services
- \$38.0 million for TANF reauthorization costs
 - Transitional payments to TANF/VIEW working recipients (up to 1 year)
 - Additional VIEW costs to engage more individuals in work
 - Additional child care costs for TANF/VIEW individuals required to work
 - 1% decline in federal TANF grant

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Health & Human Resources

- \$9.1 million for federal Title IV-E and state special needs adoption assistance
- \$7.4 million to offset federal reductions in federal Title IV-E reimbursement for child welfare services
- \$4.9 million to replace federal funding for child support enforcement operations due to federal Deficit Reduction Act of 2005 changes
- \$1.4 million for mental health services to restore competency to stand trial in adults and juveniles
- \$1.2 million for growth in involuntary mental commitments

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Health & Human Resources

- Service Expansions
 - \$12.7 million for MHMRSAS to expand system “transformation” projects
 - Children’s services, jail diversion & juvenile detention services, regional mental retardation community support centers
 - \$9.6 million for a stockpile of antiviral medications in the event of a flu pandemic
 - \$4.4 million to expand the number of eligibility workers in local social service agencies
 - \$4.0 million to address the waiting list for vocational rehabilitation services
 - \$2.5 million to expand FAMIS eligibility for pregnant women from 166% to 200% of the federal poverty level
 - \$1.4 million for Human Papillomavirus (HPV) vaccinations for girls entering 6th grade
 - \$1.3 million for home-delivered meals for the elderly

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Health & Human Resources Policy Changes

■ Provider Rate Increases

- \$10.5 million to increase the Auxiliary Grant rate from \$1,010 to \$1,100 per month in FY 2008
- \$7.5 million to increase rates for Medicaid pediatric services by an additional 7% in FY 2008 (Chapter 3 provides an 8% rate increase in FY 2008)
- \$4.5 million to increase rates for professional psychiatric services by additional 20% in FY 2008 (Chapter 3 provides a 3% rate increase in FY 2008)
- \$2.7 million to increase Medicaid reimbursement for hospital inpatient psychiatric services from 78% to 90% of allowable costs in FY 2008
- \$1.3 million to increase MHMRSAS funding for private local inpatient mental health services by 10% in FY 2008
- \$926,618 to increase foster care family home rates by 10% in FY 2008

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Health & Human Resources

■ New Initiatives

- \$5.0 million to replace MHMRSAS pharmacy management system
- \$5.0 million to establish 3 residential mental health treatment programs in jails
- \$4.4 million to convert DSS eligibility database system software
- \$2.0 million to implement a child care information system
- \$1.8 million to pilot 20 school-based mental health programs in middle schools
- \$1.2 million to implement a child psychiatry workforce initiative to address the shortage of clinicians who treat children
- \$1.2 million to provide intensive case management to high risk pregnant women and infants in the Medicaid program
- \$1.0 million to include a monetary rewards component in the Medicaid disease management program
- \$537,434 to expand the Programs for All-inclusive Care for the Elderly (PACE) to two additional sites

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Public Education

- Budgetary adjustments to reflect revisions to ADM are needed in K-12
- Actual adjustment in ADM will be based on reported fall 2006 September membership which indicates that there will be 5,100 fewer students
- Building on this lower ADM, basic aid would be reduced by \$53.7 million
 - Updating the average daily membership (ADM) forecast – technical adjustment to reflect continued slower growth trend
 - (\$25.1) million in FY 2007
 - (\$28.6) million in FY 2008
- Preliminary updates in the Sales Tax collection revenues indicate a net decrease to public education. Final estimates will be available in December:
 - For each dollar not collected in sales tax estimates to K-12, the general fund is required to 'back fill' with, on average, \$0.55 cents in SOQ basic aid funding to school divisions
- Lottery forecast has decreased based on 2006 performance and current sales activity by (\$41.4) million for the biennium.
 - Lottery proceeds are split about 60% for SOQ payments and 40% to local schools
 - \$24.8 million is needed in GF revenue for SOQ payments
 - For each dollar not collected in Lottery proceeds, the general fund is required to 'back fill' 100% of the decrease used to fund a portion of the SOQ payments

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Public Education

- Lower student membership growth rate preliminary estimated savings – (\$53.7) million
- Net Sales Tax adjustments - undetermined - new estimates available next month
- Net Lottery adjustments required to SOQ payments - \$24.8 million

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Higher Education

- Undergraduate Student Financial Aid
 - Additional \$8.0 million GF to maintain current level of financial need met of about 35 percent
- Tuition Assistance Grants
 - \$3.5 million increase in FY 2008
 - Provides for enrollment growth to achieve \$3,100 maximum award for Virginia undergraduate students attending private colleges
- Operating Costs for New Facilities
 - \$0.2 million in FY 2007 and \$4.1 million in FY 2008 to fund routine maintenance, utilities and custodial costs for new facilities opening this biennium

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Capital Outlay

- Cost Overruns
 - Budget requests total \$96.7 million in FY 2007 year to address increased cost of construction for previously authorized projects
 - Cost of construction is being impacted by increased demand and cost for construction materials
- Commitments for Projects Previously Approved for Planning
 - Budget requests total approximately \$238.5 million and include
 - \$99.0 million for correctional facility in Mt. Rogers
 - \$90.0 million estimated cost to replace Western State Hospital
 - \$44.0 million to construct new School of Education at William & Mary
 - \$5.5 million to complete architectural work to replace two MHMR training centers
- Equipment for New Facilities
 - Budget requests total \$45.5 million for equipment and furnishings for buildings currently under construction but expected to open during the next two years
 - This allows for necessary lead time to order and receive these items in time for building opening
- Life Safety and Emergency
 - \$7.9 million for asbestos removal, fire systems and health and life safety repairs

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Transportation

- Currently, \$339 million GF is appropriated but not allocated within VDOT based on Chapter 3
 - Transportation agency requests do not include authority to fully expend these amounts
- VDOT GF requests total \$79.5 million and include:
 - Recapitalize Transportation Partnership Opportunity Fund (\$35.0 million in FY 2007)
 - Increase funding for VDOT Revenue Sharing Program (\$35.0 million in FY 2007)
 - Hurricane Evacuation – gates and modeling (\$6.9 million in FY 2007 and \$825,000 in FY 2008)
- Department of Aviation GF requests total \$25.0 million in FY 2007 to recapitalize the Airports Revolving Fund

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Agriculture and Forestry

- Agency requests total \$425,000 in FY 2007 and \$15.6 million in FY 2008
- Requests predominantly for new initiatives and increases in core costs
- Department of Agriculture and Consumer Services requests total \$15.4 million, including:
 - Providing matching funds for local preservation of development rights programs (\$15.0 million in FY 2008)
 - Fund additional veterinarian position (\$111,040 in FY 2008)
 - Grain marketing services (\$92,040 in FY 2008)
- Department of Forestry requests total \$891,000 and reflect increased IT costs

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Commerce and Trade

- Agency requests total \$7.1 million in FY 2007 and \$44.1 million in FY 2008
- Requests predominantly for program expansions and new initiatives
- Department of Housing and Community Development requests total \$12.9 million, including:
 - Increase Enterprise Zone Grants (\$4.0 million each year)
 - Additional funding for Eastern Shore Broadband (\$1.6 million in FY 2008)
 - Additional funding for Indoor Plumbing Program (\$3.0 million in FY 2008)
- Virginia Economic Development Partnership requests total \$5.5 million in FY 2008, including:
 - Grant for VASCIC (\$5.0 million in FY 2008)
 - Expansion of international markets development (\$200,000 in FY 2008)
 - Assess emerging markets (\$300,000 in FY 2008)

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Commerce and Trade

- Department of Business Assistance
 - Request totals \$6.0 million to fund increase of \$3.0 million each year for Workforce Services Jobs Grants
- Virginia Tourism Authority
 - Request totals \$620,000 in FY 2008 to increase funding for State Welcome Centers
- Central Appropriations
 - \$19.0 million of additional funding for the SRI Research Facility incentive
 - \$5.9 million in additional funding for the Governor's Opportunity Fund

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Public Safety

- Agency requests total \$67.6 million in FY 2007 and \$156.2 million in FY 2008
- Major budget drivers include funding for salary increases, emergency preparedness improvements, per diem payments for local and regional jails, increases in utility costs, and program expansions
- Statutory requirements
 - Law enforcement positions for 1:1500 (\$1.3 million in FY 2008)
- High Priority Items
 - Funding for National Guard re-enlistment bonus (\$0.7 million in FY 2007 and \$2.2 million in FY 2008)
 - National Guard state tuition assistance program (\$0.3 million in FY 2007 and \$0.3 million in FY 2008)
- New or Expanded Correctional Facilities/Inmate Forecast
 - Operate new/expanded correctional facilities (\$0.8 million in FY 2008)
 - Positions for overcrowding/new jails (\$5.0 million in FY 08)
 - Jail per diem funding to meet forecast (\$8.3 million in FY 2007 and \$12.2 million in FY 2008)
 - Additional staffing for beds at Hanover and Culpeper Juvenile Correctional Centers (\$1.1 million in FY 2008)
- Utility/Gas Costs Increases
 - Departments of Corrections, State Police, and Forensic Science – fuel, natural gas, and building maintenance (\$6.5 million in FY 2007 and \$6.2 million in FY 2008)
 - VITA and other information technology costs (\$18.4 million in FY 2007 and 18.5 million in FY 2008)

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Public Safety

- Workload/Caseload/Program Increases
 - State trooper positions (\$33.5 million in FY 2008)
 - Pre-trial services programs (\$4.5 million in FY 2008)
- Increased Contract or Service Costs
 - Inmate medical costs (\$0.4 million in FY 2007 and \$2.9 million in FY 2008)
 - Private prison rate (\$0.2 million in FY 2007 and \$0.3 million in FY 2008)
- Other
 - Emergency Preparedness Initiatives (\$14.9 million in FY 2007 and \$3.1 million in FY 2008)
 - Salary increases for DOC, DJJ, Correctional Education, Forensic Science, and Veterans Services (\$3.0 million in FY 2007 and \$24.6 million in FY 2008)

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Natural Resources

- Agency requests total \$4.2 million in FY 2007 and \$144.6 million in FY 2008
- Major budget drivers include funding for water quality improvement, land conservation, and additional operating support for state parks
- High Priority Items
 - Staffing for land conservation tax credit program (\$0.2 million in FY 2008)
 - Funding for Chesapeake Bay clean-up (\$75.0 million in FY 2008)
- Program Expansions
 - Nonpoint source pollution control (\$25.0 million in FY 2008)
 - Land conservation (\$26.6 million in FY 2008)
 - Combined sewer overflow projects (\$3.8 million in FY 2007 and \$10.0 million in FY 2008)
 - State park operating support (\$3.9 million in FY 2008)
 - Support for Soil and Water Conservation Districts (\$1.0 million in FY 2008)
- New Initiatives
 - Virginia Indian Heritage Program (\$0.3 million in FY 2007)
 - Repairs to Soil and Water Conservation District dams (\$0.6 million in FY 2008)

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Employee Compensation and Benefits

- State Employee Health Insurance Program
 - A Premium increase of 7.0% projected in FY 2008 to maintain current benefit levels
 - \$30.8 million GF (FY 2008)
- Current Budget Funds a 3% employee salary increase for state and state supported local employees and includes funding, in reserve, for a 1 and ½ percent raise for SOQ funded school employees
- GF cost of every additional 1% effective December 2007

<u>GF Cost in Millions</u>	<u>FY 2008 Cost</u>	<u>Annualized</u>
State Employees	\$11.6	\$21.4
Local State	\$5.3	\$9.1
Faculty	\$4.3	\$7.9
SOQ Funded School Employees	\$21.5	\$36.9

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Employee Compensation and Benefits: Other Post Employment Benefits

- New standards issued by the Governmental Accounting Board may require increased GF appropriations for Other Post Employment Benefits (OPEB)
 - New standards require these benefits be recognized for financial reporting purposes.
 - Must use an accrual-basis cost of benefits
- Potential cost in FY 2008 to immediately comply with new standards is \$52.5 million GF to fund the accrual-basis cost primarily for the pre-Medicare Retiree Healthcare benefit and the Long Term Disability benefits

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General Government/Technology

- Agency requests for new funding total \$28.1 million in FY 2007 and \$113.4 million in FY 2008
- Agency requests were predominantly for program expansions and new initiatives, including:
 - Supreme Court
 - Requests \$6.5 million to provide a 10% salary increase to judicial personal instead of the 3% increase scheduled for December 2007
 - \$40.2 million in FY 2008 to increase rates paid to court appointed attorneys
 - Compensation Board
 - \$8.8 million in FY 2008 to increase staffing for constitutional officers
 - Office of Administration
 - \$1.0 million each year to fund additional use of public radio and television for emergency preparedness and education
 - Department of General Services
 - \$1.6 million each year to fund agencies for the increased fees charged for eVa

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General Government/Technology

- Agency requests for new initiatives included:
 - Minority Business
 - \$0.4 million in FY 2007 and \$0.4 million in FY 2008 to implement a statewide marketing campaign to promote the SWaM and DBE Certification Programs
 - Office of Attorney General
 - \$0.5 million in FY 2007 and \$0.5 million FY 2008 to provide benefit cost for new legal services positions
 - Department of Accounts
 - \$0.1 million in FY 2007 and \$1.3 million in FY 2008 to fund 14 new positions
 - Taxation
 - \$0.8 million in FY 2008 to fund the cost of relocating employees from West Broad Location
 - \$0.8 million in FY 2008 to fund disaster recovery hot-site

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General Government/Technology

- Agency requests for new initiatives included:
 - Virginia Information Technologies Agency
 - \$3.2 million in FY 2007 and \$1.6 million in FY 2008 to restore GF savings adjustment assumed in budget
 - \$3.4 million in FY 2007 and \$3.4 million in FY 2008 to eliminate part 3 transfer for technology and operational efficiency savings
 - \$16.5 million in FY 2007 and \$21.6 million FY 2008 to fund agencies for increased costs due to VITA rate increases
 - Center for Innovative Technology
 - \$1.5 million in FY 2008 for the expansion of the CIT GAP Fund and the Virginia South Technology
 - \$5.0 million in FY 2008 for the Closing the Innovation Gap by Investing in the Commonwealth Technology Research Fund

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