The Economy, the Revised Revenue Forecast, and FY 2009 Budget Reductions Strategies

House Appropriations Committee Retreat

November 18, 2008

Condition of the National Economy

- The credit crunch, growing unemployment, the housing crash, and low consumer confidence are undermining U.S. economic growth
- Housing sales and prices have plummeted for almost 3 years
  - National housing market shows some signs of reaching bottom
  - Prices will continue to decline
  - Sales volume could begin to increase as affordability is addressed
- Auto industry experiencing worst sales in 25 years
  - Tight credit, high energy prices, drop in car values – consumers are "upside down" on trucks and SUV's
- Consumers spending is negative
  - Impact of high food and energy prices reduced discretionary purchases
  - Support from federal fiscal stimuli (rebates) has faded
  - Grim Christmas sales outlook – 1982 levels

Condition of the National Economy

- Monetary policy (fed funds rate) doesn’t appear likely to stimulate economy due to tight credit markets
  - Funds rate already at historically low levels
- Businesses are spending cautiously
  - Exports had propped up growth, however global slowdown is beginning
- Price of oil has dropped below $60 a barrel
  - More than 50% below July’s record high
- Inflation has moderated over last two months
  - Had been growing in 5% rate – highest rate in years
  - Now expected to be into negative territory by mid-2009
- Leading economists believe that the downturn began in December 2007
  - Can be seen in consecutive monthly declines in four key economic indicators

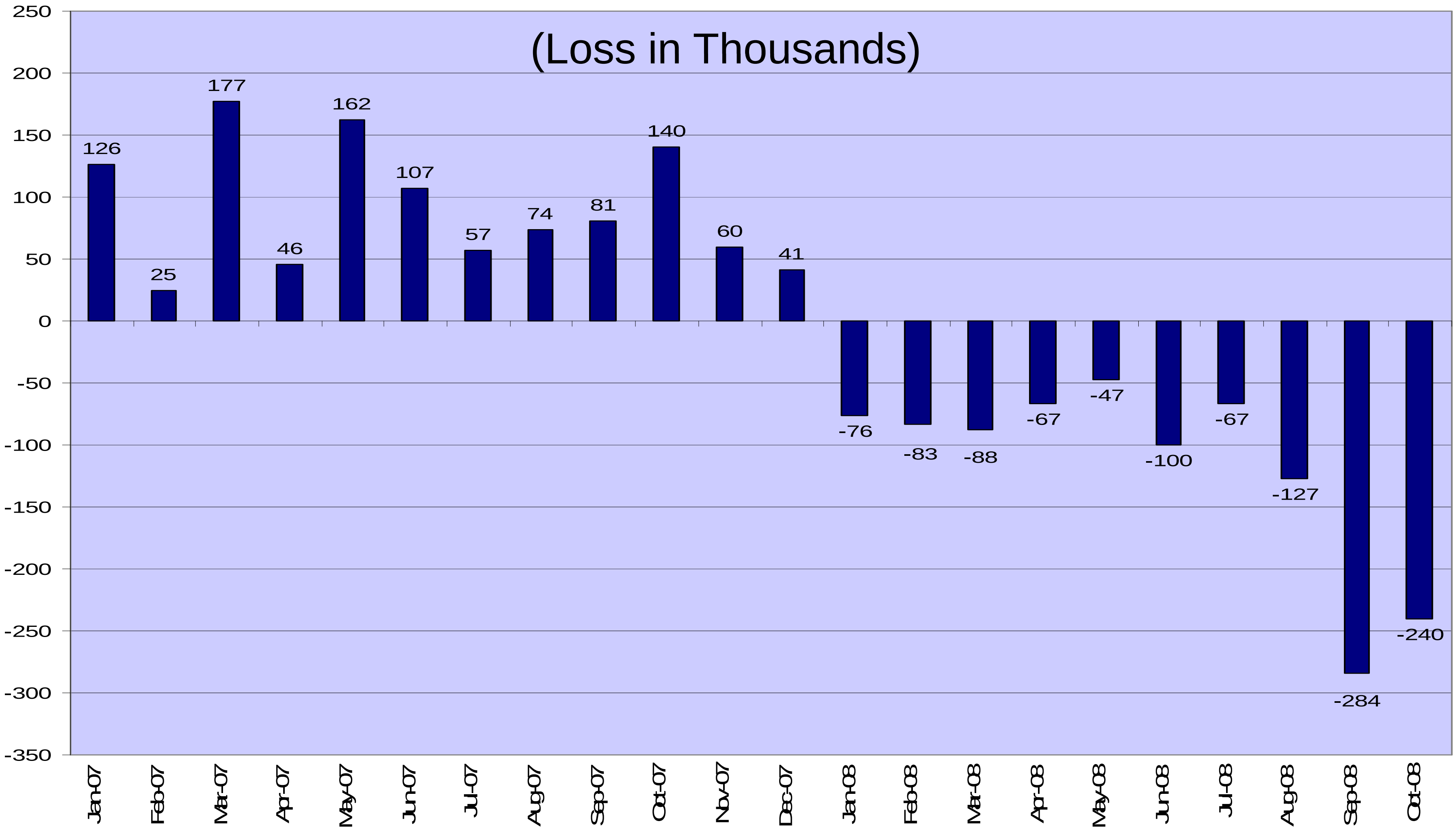
U.S. Recession is Here

- Conventional definition of a recession is:
  2 quarters of negative gross domestic product (GDP)
- New definition is:
  "a significant decline in economic activity spread across the economy, lasting more than a few months, as seen in GDP, employment, real income, industrial production and wholesale-retail sales"

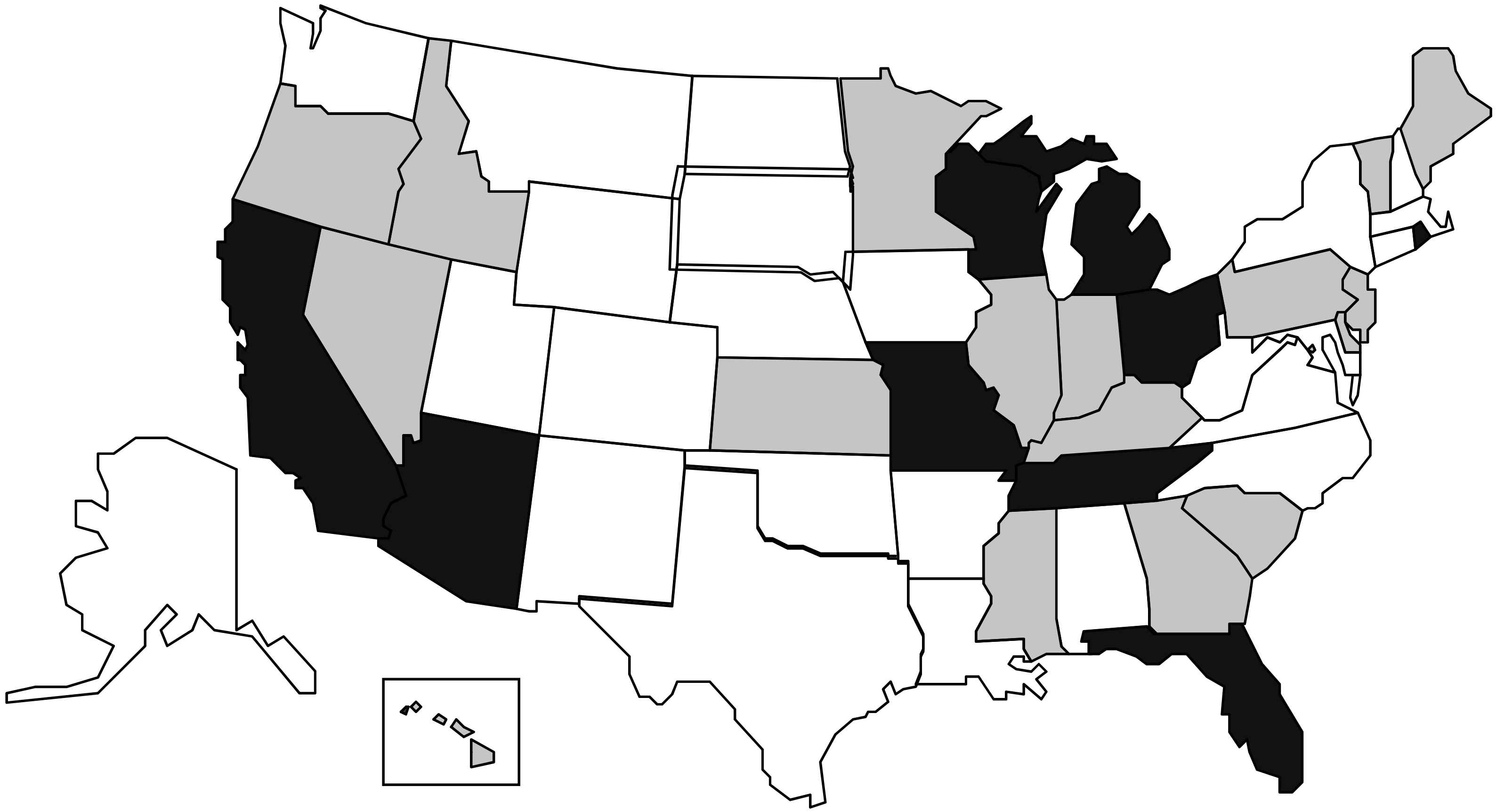
What are the National Indicators Showing?

- GDP showed first decline in the third quarter of 2008 and contracted 0.3%
  - Result was better than economists had expected, but following recent employment reports many believe 3rd Q GDP will be revised downward
  - Buoyed by exports (up 5.9%) and government spending (defense spending increased 18.1%)
  - Consumer spending contracted 3.1%
- Employment is the most important signal
  - Nationally we have had 10 months of job losses, with unemployment now at 6.5%
  - 1.2 million jobs have been lost so far this year – less than 1% job loss
    - Heavily concentrated in manufacturing, construction, financial services and retail
  - From December 2007 through August 2008, 24 states have reported job loss, with 13 states experiencing 4 or more months of decline
  - Layoff announcements in October totaled 112,884, up 19% from September

Month-Over-Month Change in National Employment 2007-08



States Experiencing Monthly Job Loss, Dec 2007-August 2008

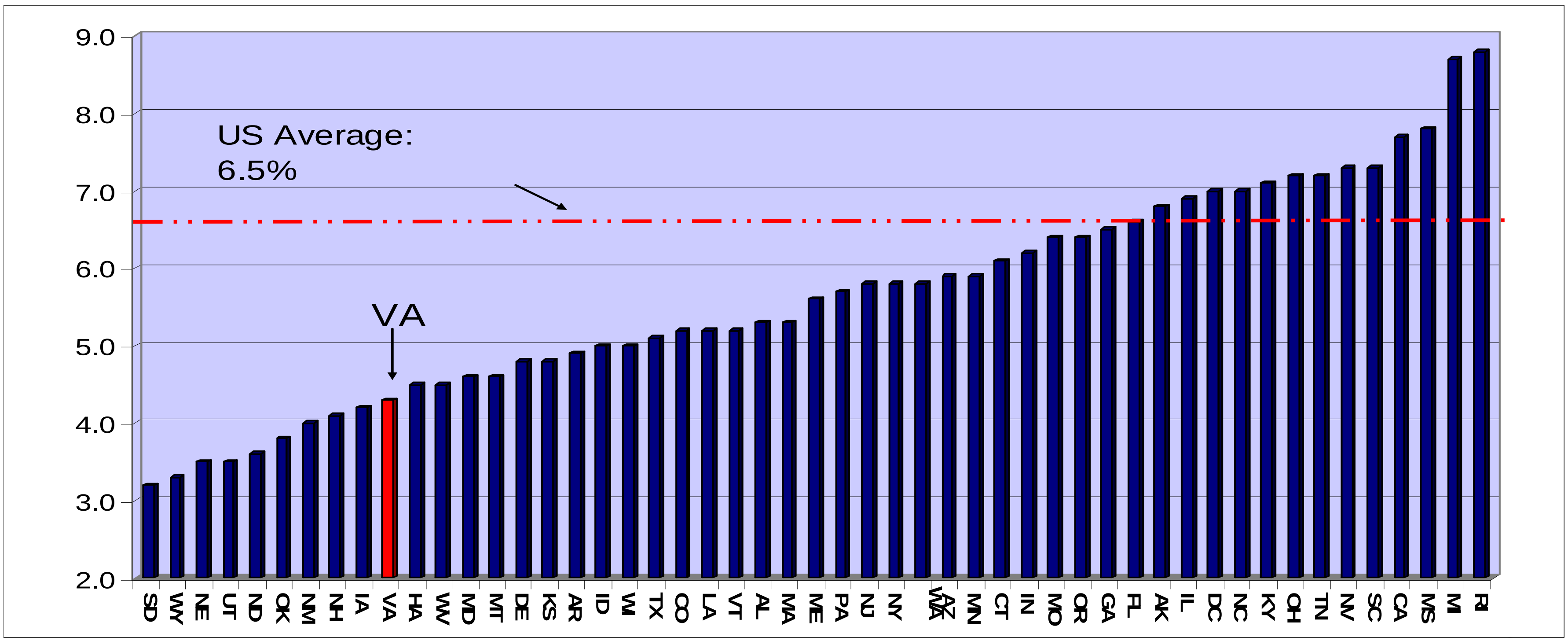


■ 5 or more months of job loss ■ Job loss in 1-4 months

Source: Arizona State University, "Blue Chip Job Growth Report"

Unemployment Rates by State

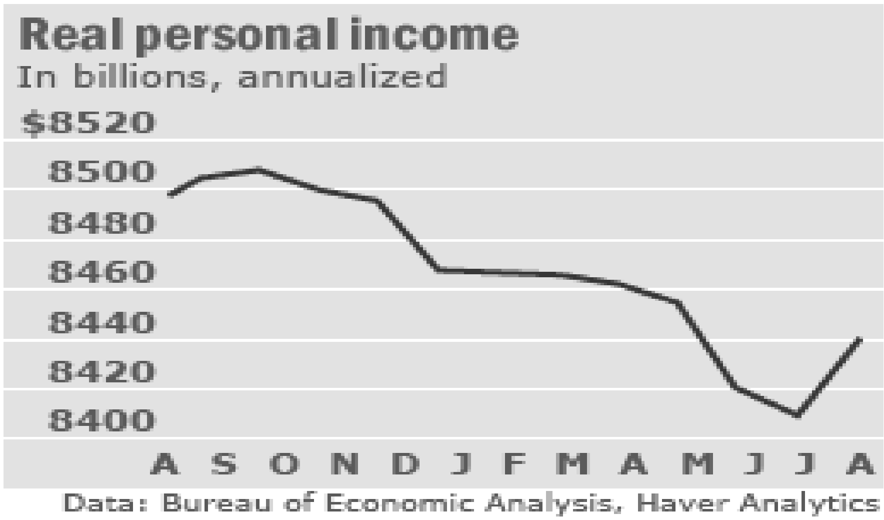
- In September, Virginia had the 10th lowest unemployment rate in the nation, at 4.3%
  - 35 states have unemployment rate below the 6.5% national average
  - States with unemployment lower than Virginia are largely low population Western states
- States with higher job losses are those focused on auto industry, real estate, tourism and financial industries

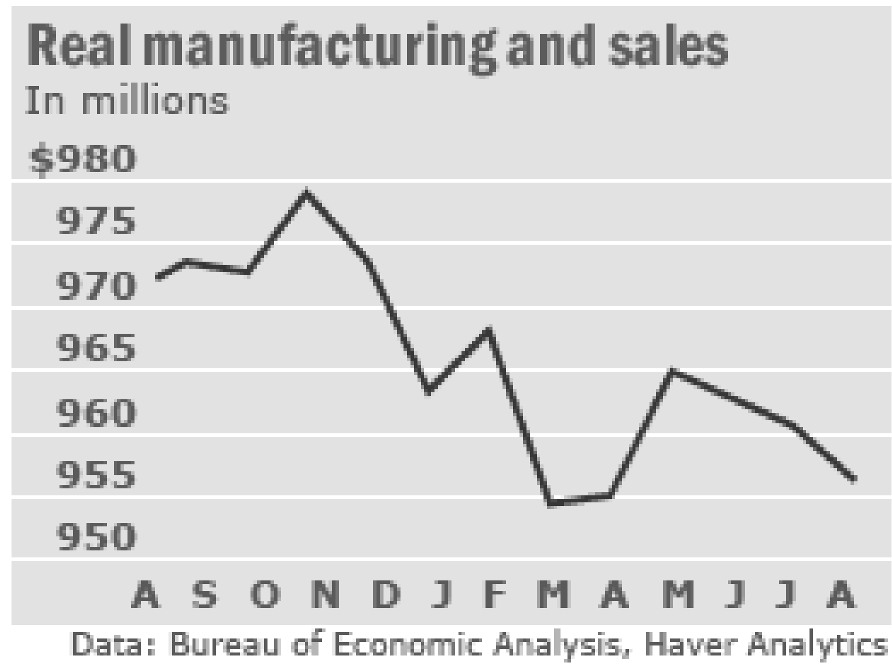


What Are the Other Indicators Showing?

- Real income has fallen 1% nationally
  - Inflation - led by higher fuel and food – have wiped out income gains
- Industrial output, a key indicator on the supply side of the economy, is down 2.8%
  - Led by weakness in auto (vehicles and parts) and housing industries
  - October ISM Index at 38.9 - lowest level since 1982
  - Inventory levels falling
- Manufacturing and wholesale-retail sales, which are a good indicator of domestic demand, is down 1.3%
  - Retail sales got a brief boast in the Spring from federal rebates
    - Have declined each month since June
    - Consumers hit hard with rising energy and food costs are retrenching, resulting in the worst quarterly contract in consumer spending

What Are the National Indicators Showing?





Revised National Economic Outlook

- Based on Global Insight's November outlook, the economy will experience a four-quarter recession (60% probability)
  - GDP is expected to contract 3.3% in fourth quarter of 2008 and 2.1% and 0.5% respectively in the first two quarter of 2009 following first contraction this past quarter
  - Alternative outlook is a six-quarter recession worse than those in 1973-75 and 1981-82 (25% probability)
- Global Insight's standard forecast is more pessimistic than the consensus among the 50 economists surveyed each month by Blue Chip Economic Indicators
- Model assumes the severity of the recession will be at least as severe as the 1991 recession
  - Unemployment expected to rise to 8.3%, up from current 6.5%
    - 1991 unemployment rates reached 7.5% nationally
    - 2001 unemployment rates reached 6.0% nationally
- Total job loss expected to be around 3.0 million peak-to-trough decline
  - Pace of job loss is accelerating, with continued monthly job losses of between 150,000 to 200,000 expected over the next 12 months
  - Start of job recovery not expected to occur until the first quarter of 2011

Revised National Economic Outlook
(continued)

- Assumes oil to range from $50-60/barrel through forecast period
  - Down from $120 in August forecast
- Consumer spending is expected to be anemic, growing 0.4% in 2008 and 0.2% in 2009
  - Consumers are getting relief from lower oil prices, but that does not outweigh their concerns about a deteriorating labor market, tight credit and lower stock-market value
- Fed Funds Rate is expected to drop to 0.50% and hold throughout 2009
  - Lowest rate ever
- Forecast assumes economic conditions begin to improve in late CY 2009, with a modest recovery in 2010, and a more robust recovery in 2011
  - Economic expansion does not begin until employment reaches its previous peak-employment level

Federal Policy Actions Designed To Mute The Severity Of The Problem

- The Spring, Congress approved the Residential Housing Act
  - Foreclosure relief for 400,000 homeowners
  - Substantially higher FHA loan limits – helps higher cost markets
  - Down payment support – 10% or $7,500
- Last month, Congress approved the $700 billion rescue of financial institutions (TARP)
- To deal with the financial crisis, central banks around the globe have lowered interest rates
- The Federal Reserve lowered the federal funds rate by another 50 basis points to 1.00% on October 29
- Another federal stimulus package is anticipated
  - Global Insight expects package to be around $200 million
  - Intended to focus on longer lasting stimuli, including:
    - Extended unemployment benefits
    - Enhanced Medicaid payments to help states address their budget shortfalls (similar to actions taken in 2003)
    - Investments in infrastructure
    - Tax policy

Impact of Consumer Spending and Housing Crash on the Economy

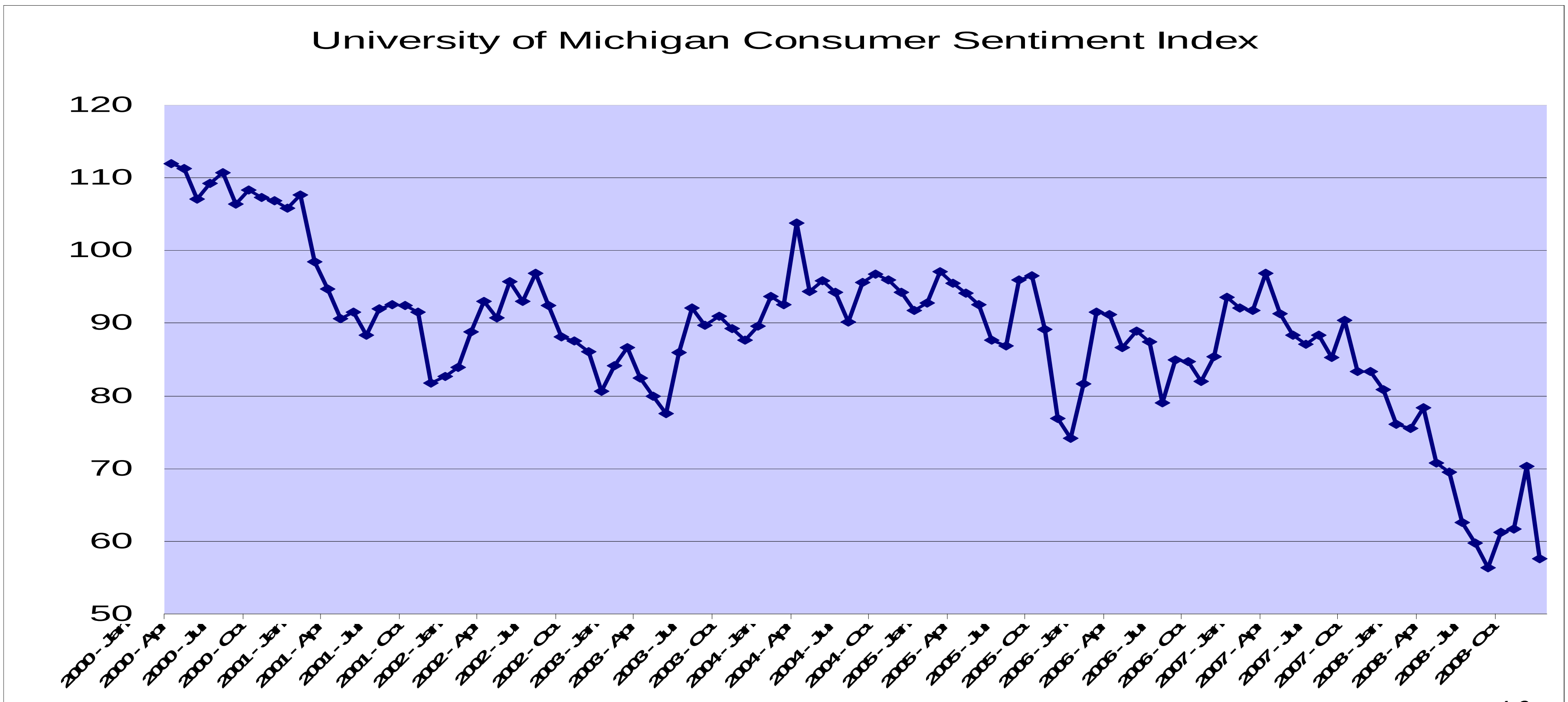
Consumer Spending

What is Driving the Economic Slowdown?

- Consumer spending accounts for two-thirds of economic activity
- In other recent economic downturns consumer spending remained, if not robust, at least on the rise
  - During the recession in 2001, spending simmered at a 1 to 2% growth rate
- But today's economic slowdown is proving to be toxic for consumers
  - Consumer spending has not grown since June
  - Consumer spending contracted 3.1% in the third quarter
    - The first quarterly decline in nearly two decades and largest decline in 28 years
  - In October, spending fell 2.8 percent – the biggest monthly drop on record
- Many forecasters predicting spending to decline at a 1 to 2% annual rate for multiple quarters
  - Global insight now projecting anemic consumer spending growth of 0.4% in 2008 and 0.2% in 2009 after a gain of 2.8% last year

What Are Consumers Saying?

- October consumer confidence report pegged confidence at 57.6 –
  an all-time low. At the low point during that 1990s recession, consumer confidence was 64
- Central concerns: Potential job losses, low income gains, high energy and food prices
- About 60 percent of consumers are putting off major purchases because of fear of job losses/lowered incomes

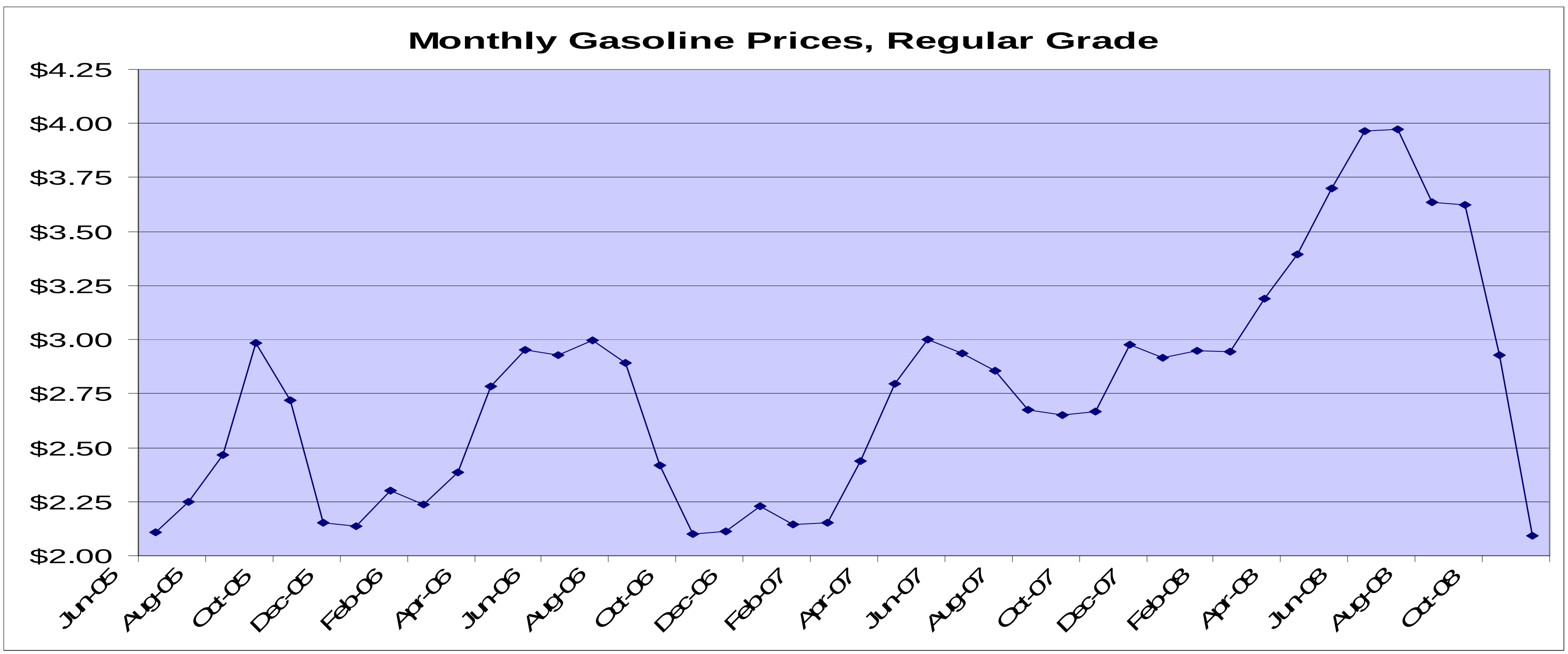


Consumer Spending

- Consumer slowdown is across almost all product categories
- Practically only retailer showing growth is Walmart
  - All spending focused on essentials
  - High-end retailers largely down double-digits in October
  - Restaurant index has contracted for 13 straight months
  - Travel industry suffering as well with declining hotel occupancy rates
- What is holding down consumer spending? It has been hampered by a number of factors:
  - Consumer already had been anxious before we entered the recession because of high gas, energy and food costs over the past year
  - Declining home values
    - Home equity helped drive consumer spending up through 2006
  - Tight credit markets
  - Massive stock market declines
    - People feeling poor, concern about retirement accounts
  - Growing unemployment

Impact of Energy Costs On The Consumer

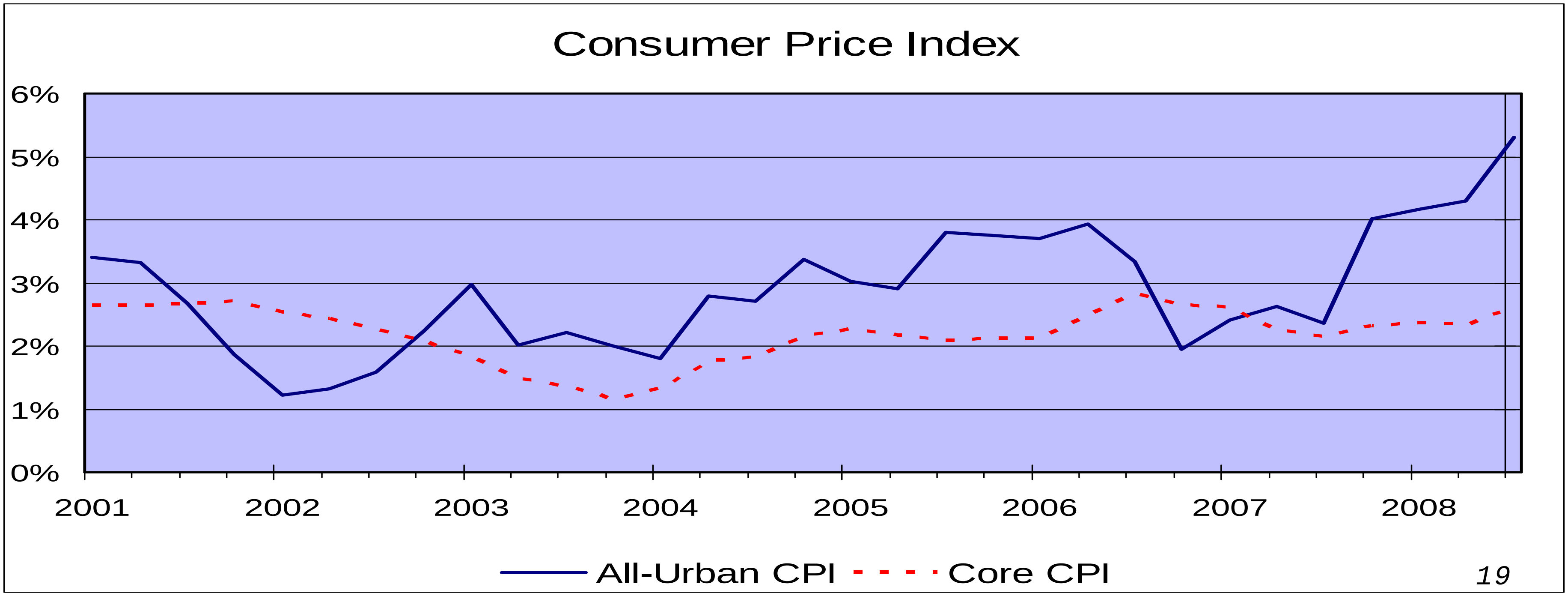
- In July 2008, the price per barrel of oil had reached its all time inflation-adjusted high
  - Previous high was in 1981
- In July 2008, gas prices consumed $185 billion or more than 1% of GDP
  - Nationally every 10 cent increase in gas costs consumers $12 billion annually and a $1.50 increase in gas prices will cost the average auto owner $900 a year (per car)
- While oil price are down over 50 percent from the high point in July, consumers have long memories
  - Prices need to stabilize longer term for anxiety to decline and the retrenchment to abate



Source: Energy Information Agency

Impact of Inflation Costs On The Consumer

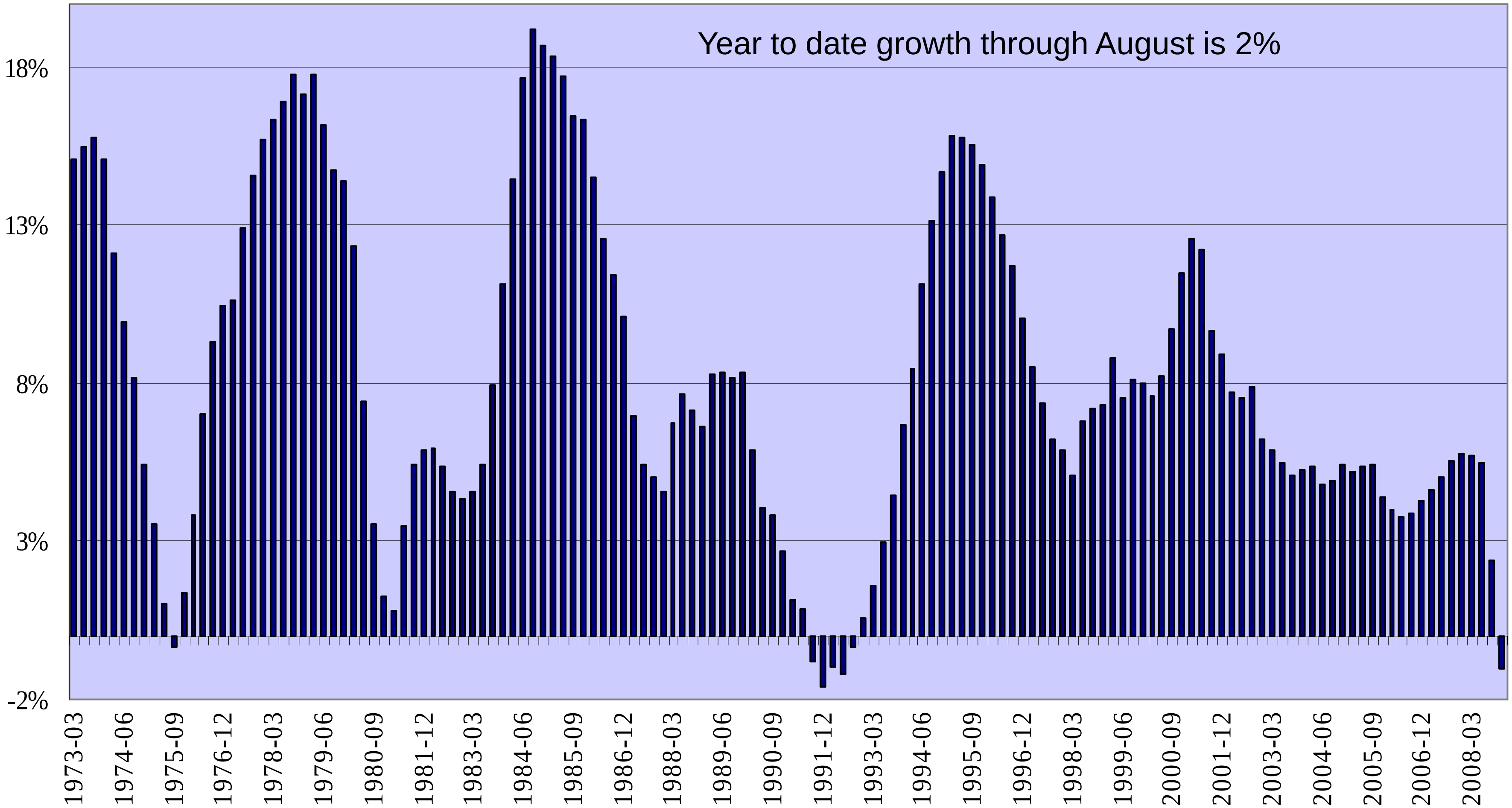
- Energy costs flowed through to other areas of the economy
- In particular, high energy prices resulted in higher food costs
  - While stabilizing, food prices are up over 6 percent from a year ago
- When energy and food is removed from CPI, “core” inflation has been in the 2-3% range over past year
  - But few consumers budget exclusive of food and energy. Total inflation was above 5%
  - Core inflation expected drop to the 1-2% range through 2009



Impact of Credit Markets on Consumer Spending

- Reliance on home equity extraction to support spending during housing boom
  - Mortgage equity withdrawal has fallen from in excess of 8% of total disposable income in the 2004-2006 time frame to almost zero in most recent quarter
- Data from the Consumer Sentiment Surveys indicate that 1 in 10 consumers report recent difficulties obtaining consumer credit
  - Tighter consumer credit standards resulting from concern about growing charge-offs in credit card debt as “the next shoe to fall” in the finance industry
  - “Americans don’t stop spending when they run out of cash, they stop spending when they run out of credit”
- Since 1968, the average annual growth in total outstanding consumer credit has been 8%
  - This includes both revolving (credit card) and non-revolving credit (e.g. car loans) – in essence, all debt exclusive of home loans
- Annual growth in outstanding credit has fallen below 5% only 3 times:
  - During the recession of the mid-1970s
  - During the recession of the early 1980s
  - Since 2005 (4% in 2005 and 2006, up to 5% in 2007, down this year)

Percent Change in Outstanding Consumer Credit
(Year over Year, 3-Month Average)



Source: Federal Reserve. Consumer credit includes all revolving and non-revolving credit exclusive of home loans.

Impact of Consumer Spending and Housing Crash on the Economy

Housing

Housing Market Collapse

- Housing sales are down 25 percent from 2005 peak nationally and are now at 1998 levels
- Pricing continues to decline, housing starts are at all time lows, and foreclosures are higher than in decades
- What will it take to turn the market around, and what trends can we see in key housing indicators?
  - Sales volumes
  - Housing starts
  - Foreclosures
  - Inventory levels
- Negative pressures hampering stabilization
  - Proportion of mortgage holders facing negative amortization
  - Continued credit crunch
  - High unemployment

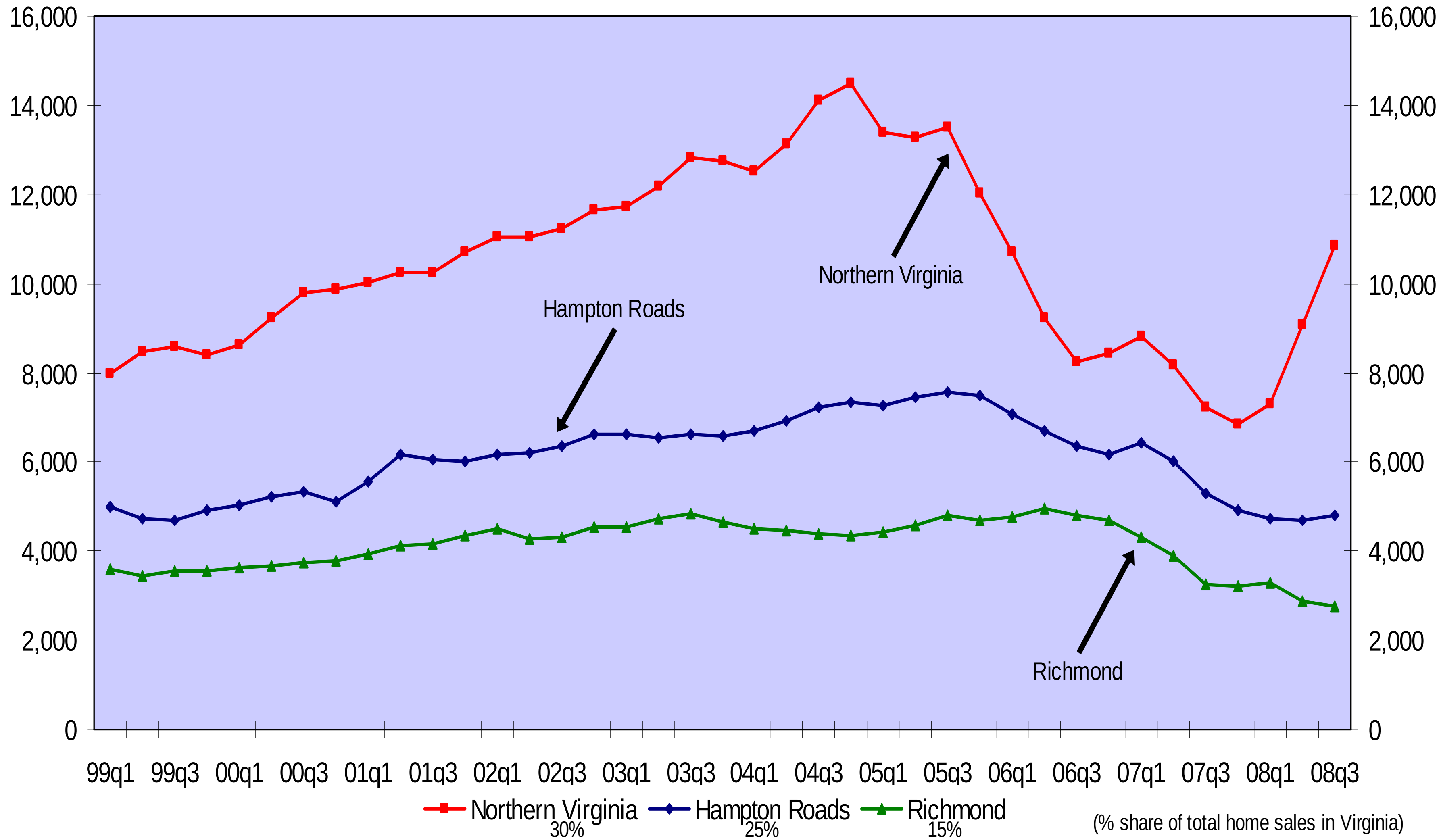
Existing Home Sales

- Nationally, existing home sales have begun to stabilize in terms of sales volumes
  - In September, existing home sales increased 5.1 percent over the prior month and were 1.4 percent ahead in terms of year-over-year comparisons
  - While these increases are compared to against multi-year lows, it does indicate the free-fall may be ending
- Virginia trends are mixed – statewide decline of 7.9% masks vast regional variations
  - Those regions that led into the decline appear to be coming out first
  - In Northern Virginia, sales volumes increased 50% compared to the 3rd quarter 2007
  - In Richmond, seasonally adjusted sales are down 15% compared to last year, and in Hampton Roads, sales are down 9% year-over-year, while slightly above the 2 prior quarters
- Even at the regional level, all real estate is local
  - Increases in Northern Virginia caused in large part by sales in Prince William which have tripled over the same quarter last year
    - Pricing has fallen so dramatically in Prince William – 40-50% in many areas – that interest is strong
    - Dulles area sales growth up 50%
    - Every jurisdiction in NoVa now showing year-over-year growth

Pending Home Sales in Northern Virginia, Hampton Roads, and Richmond

Levels

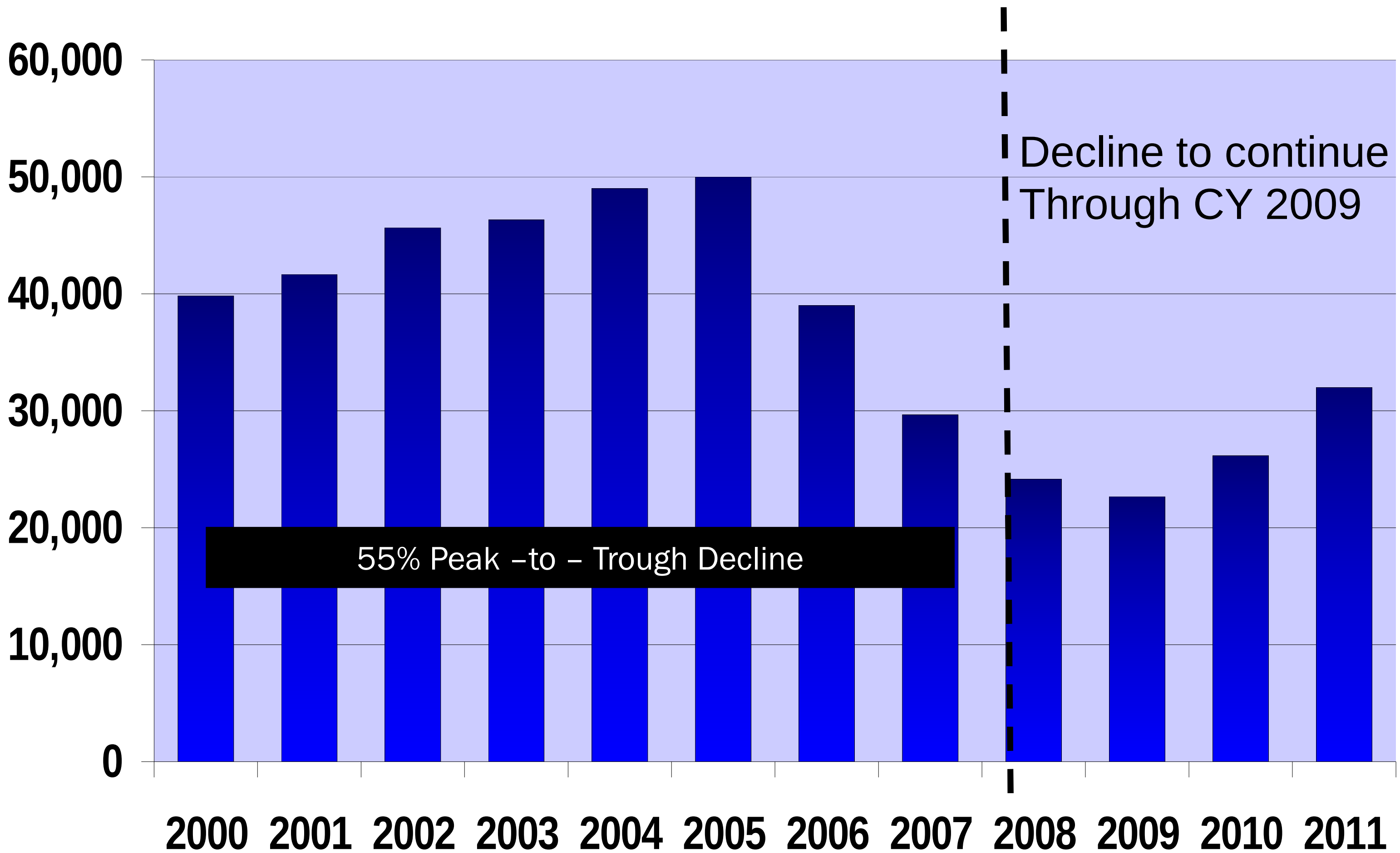
Seasonally-adjusted 2-quarter moving average



Housing Starts

- Nationally, new housing construction expected to continue to decline throughout 2009
- 2008 is the first year since World War II that new housing starts have fallen below 1.0 million
  - New home starts exceeded 2.1 million in 2005
  - Fell to 1.3 million in 2007
  - Expected to drop to 927,000 in current year and fall further to 715,000 in 2009
  - New home starts expected to increase to 1.1 million in 2010 -- still about half of the level seen between 2001-2006
- Trends similar in Virginia with peak to trough decline of 55% anticipated by close of 2009
- "Good news" is that the drastically reduced supply of new homes will help reduce inventories, a necessary precursor to market stabilization

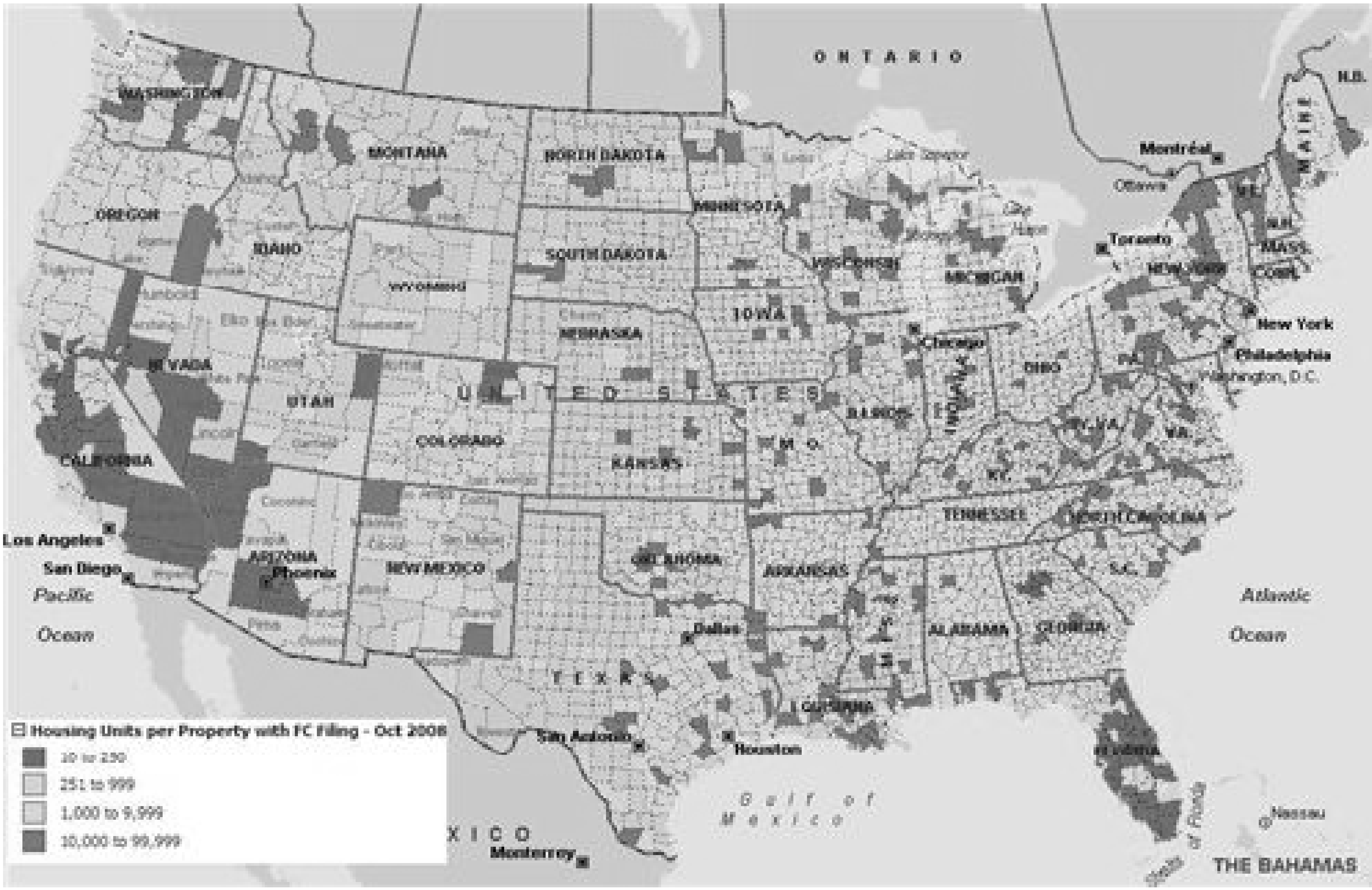
New Home Market: Single Family Permits - Virginia



Foreclosures Nationally

- The overall foreclosure rate has tripled since 2006
  - The Mortgage Banker's Association reported that the monthly rate of new foreclosures increased to above 1% for the first time in the survey's 29 years in the second quarter 2008
  - Foreclosures in the third quarter of 2008 increased 70% over the prior year
- 9% of all homes with mortgages were delinquent or in foreclosure in the most recent quarter
- According to Realtytrac, banks now own a record 820,000 homes and by the end of this year, that figure could be 1.2 million
  - This would constitute 1/3 of all homes for sale in the nation
- Foreclosures are concentrated in certain states/regions
  - Nevada – 1 in 74 households, Arizona – 1 in 149 households, Florida – 1 in 157 households received foreclosure filings in October
  - These 3 states, along with California, Michigan and Ohio, made up 60 percent of all foreclosures in the most recent quarter
- It is expected that foreclosures will abate somewhat at the end of 2008 as sub-prime mortgage resets begin to fall
  - Some of the states with highest foreclosure rates are seeing the rate of increase decline
  - However, some of the anticipated decline is artificial in that it reflects state action to delay the initiation of foreclosures

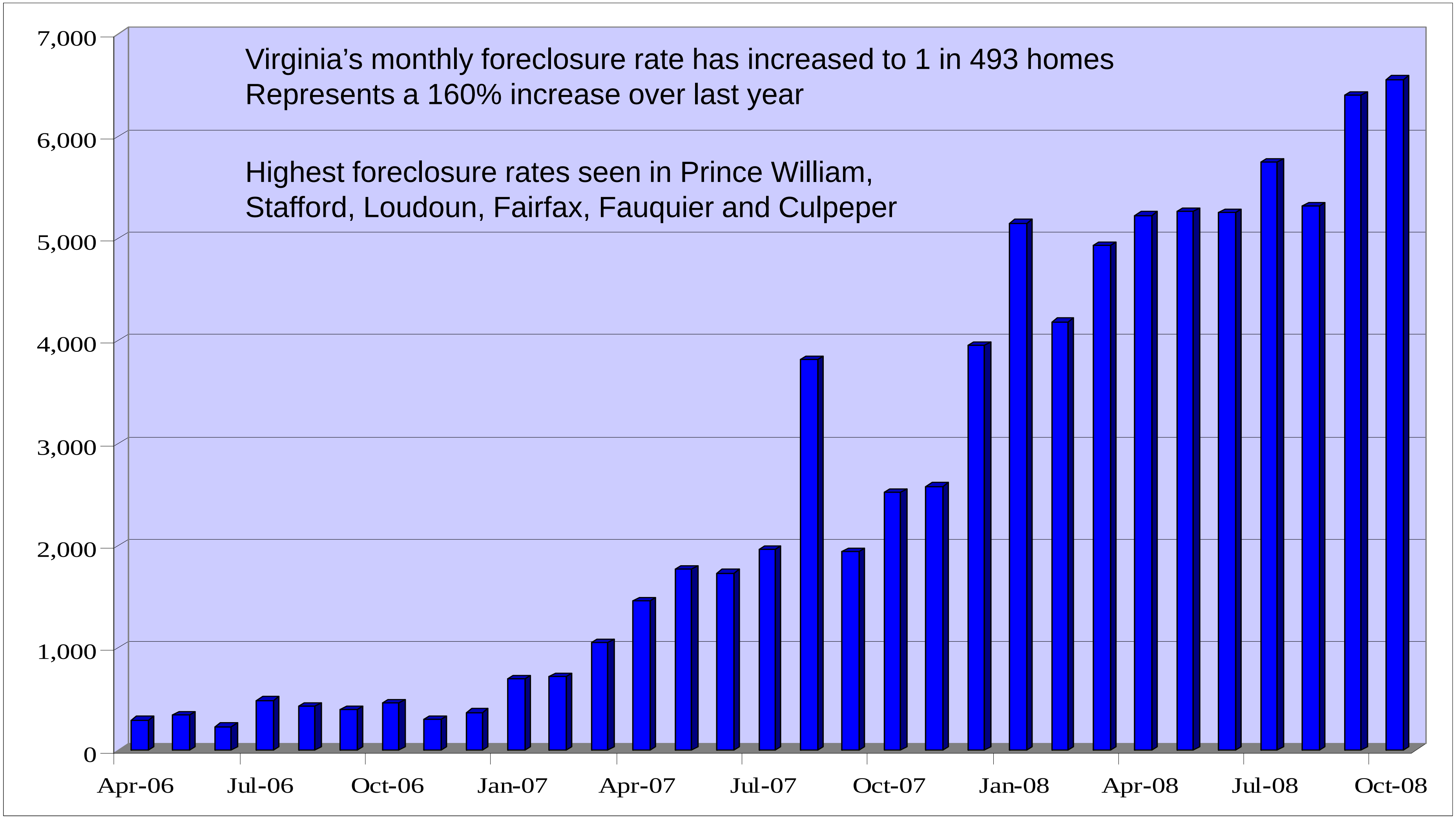
National Foreclosure Activity

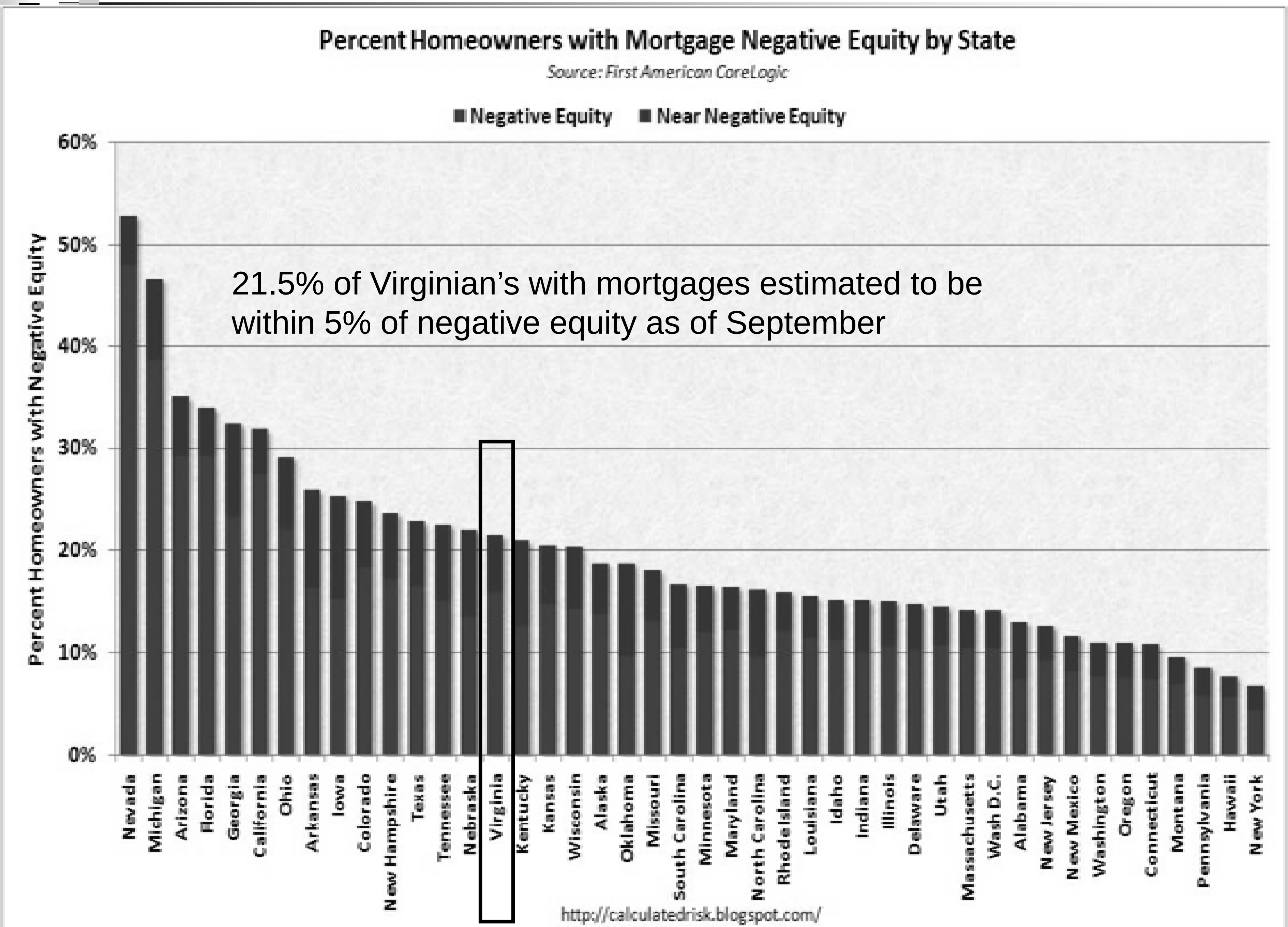


Virginia Foreclosures

- Nationally, 1 in 452 homes received a foreclosure filling in October, while in Virginia the rate was 1 in 493
  - Throughout 2006 Virginia had one of the lowest foreclosure rates in nation
  - Virginia moved into the “top” group in July, and has maintained a position of 10-15th highest since then
- New VA foreclosure filings totaled 6,555 in October, up more than ten fold since 2004
  - In October, Virginia’s foreclosure rate was 160% above October 2007
  - Through July, there were a total of 56,681 new foreclosure filings in Virginia
- As of October, 80% of all Virginia foreclosures were in Northern Virginia
  - Highest rate is Prince William County where one in every 95 homes entered foreclosure this past month, followed by Stafford and Loudoun Counties
  - Virginia’s worst markets come close to the depth of issues in CA/FL/AZ/NV however, in those states foreclosures are more dispersed across a much larger portion of the state

Virginia Foreclosure Filings By Month




Percent Homeowners with Mortgage Negative Equity by State
Source: First American CoreLogic
Negative Equity
Near Negative Equity
21.5% of Virginian's with mortgages estimated to be within 5% of negative equity as of September
Percent Homeowners with Negative Equity
60%
50%
40%
30%
20%
10%
0%
Nevada
Michigan
Arizona
Florida
Georgia
California
Ohio
Arkansas
Iowa
Colorado
New Hampshire
Texas
Tennessee
Nebraska
Virginia
Kentucky
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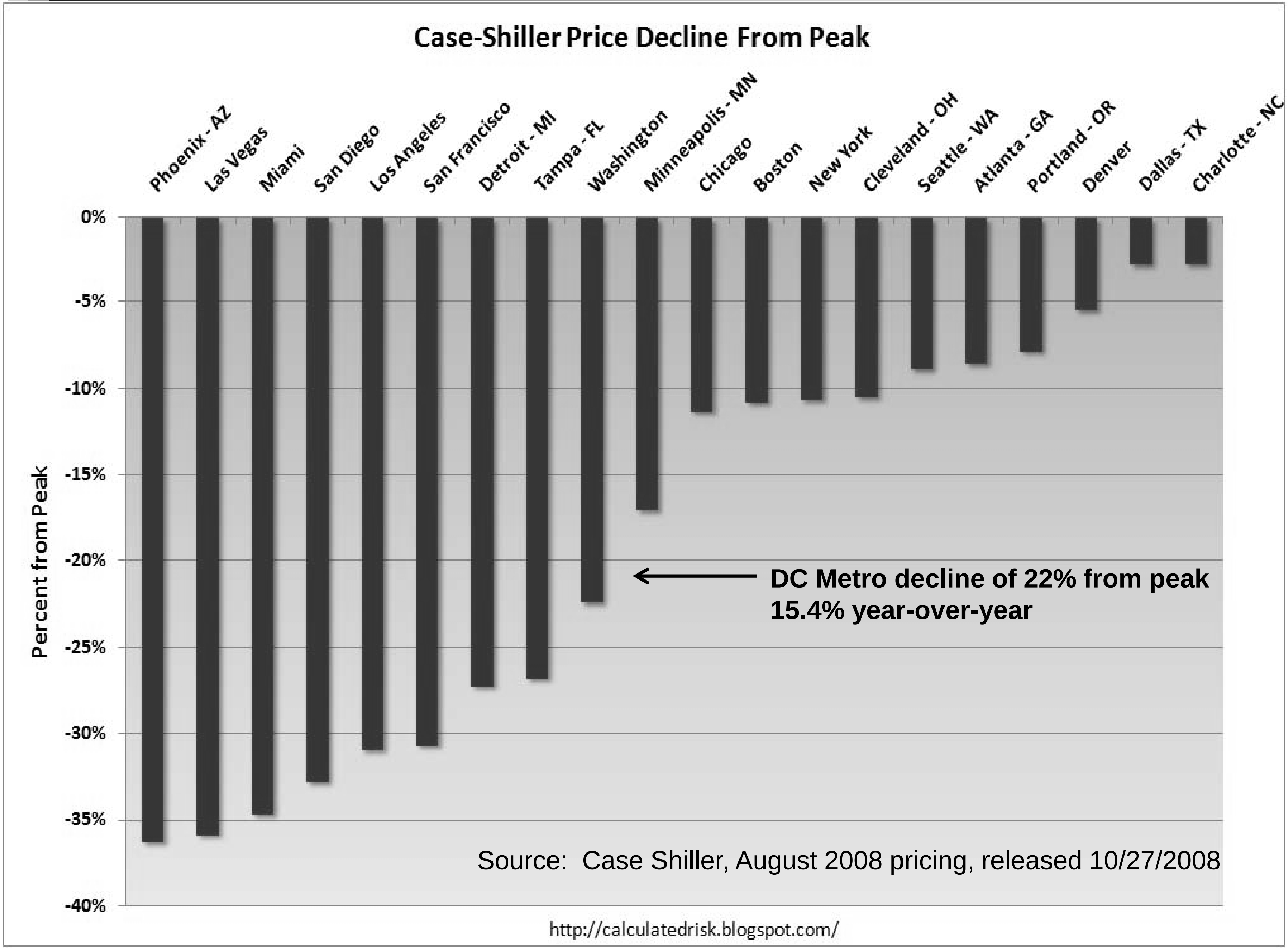
Indiana
Illinois
Delaware
Utah
Massachusetts
Wash D.C.
Alabama
New Jersey
New Mexico
Washington
Oregon
Connecticut
Montana
Pennsylvania
Hawaii
New York
http://calculatedrisk.blogspot.com/

Home Prices

- Nationally, it is estimated that nominal home prices have declined 19.5 percent from their peak two years ago
  - This translates to a real decline of approximately 27 percent
  - The bubble is approximately 60 percent deflated
- S&P Case Shiller index has shown new record annual declines for its 10 and 20-city indexes
  - But, while the annual returns of the two indices continue to reach record lows, the pace of the decline has slowed
  - There are signs of a slowdown in the rate of decline, but no solid evidence we have reached a bottom
- Pricing down substantially even in markets that didn't have substantial ramp-ups in pricing
  - Nationwide, pricing is down 9.1% as of October
- Since the peak in late 2005, nominal prices have fallen by 22 percent in Washington, DC metro area
  - Average sales prices in Northern Virginia have fallen from 99-100% of list price to 92-93% in the past two years
  - Days on market remains in the 90-100 day range, up from less than 30 days during the boom

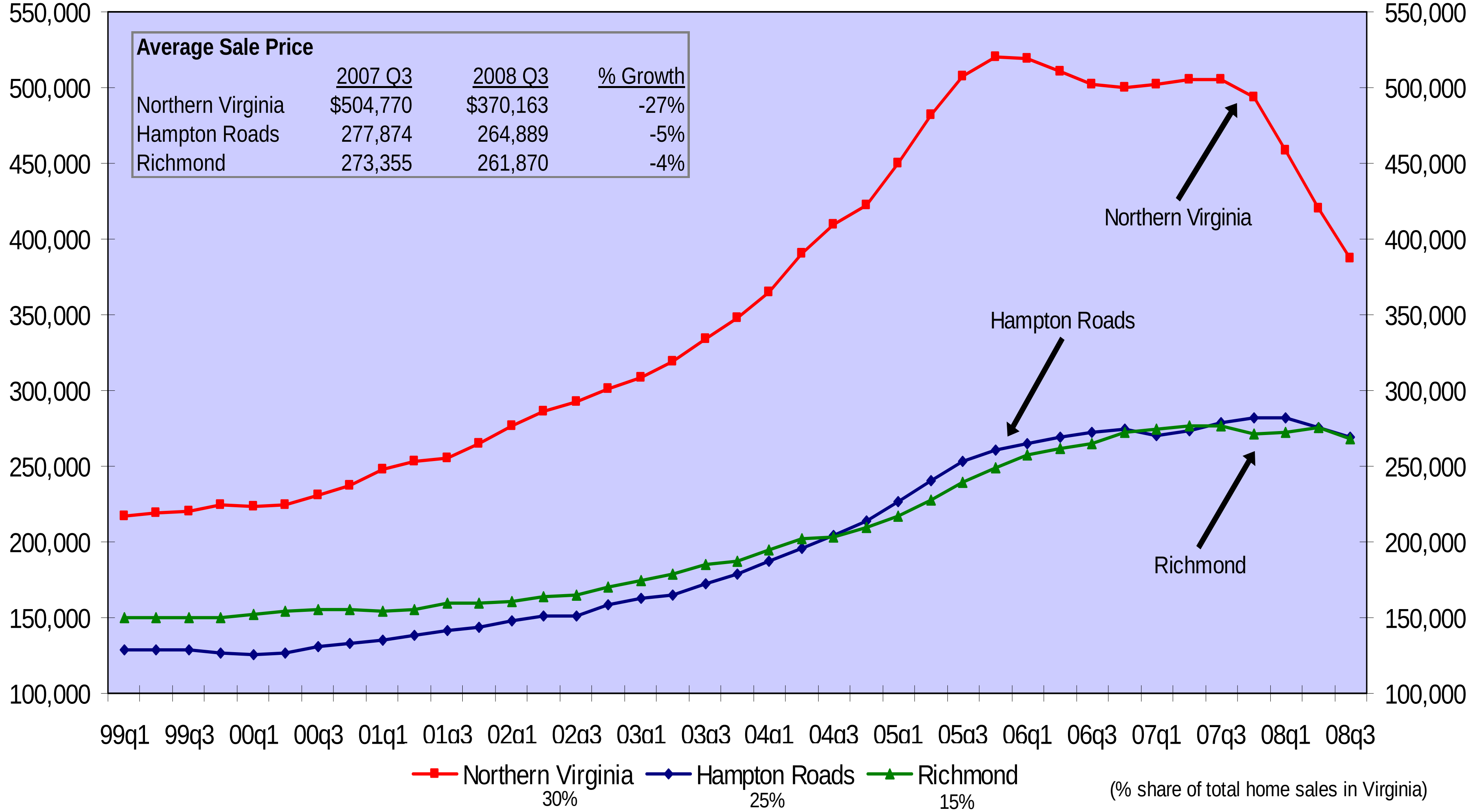


Case-Shiller Price Decline From Peak
Phoenix - AZ
Las Vegas
Miami
San Diego
Los Angeles
San Francisco
Detroit - MI
Tampa - FL
Washington
Minneapolis - MN
Chicago
Boston
New York
Cleveland - OH
Seattle - WA
Atlanta - GA
Portland - OR
Denver
Dallas - TX
Charlotte - NC
0%
-5%
-10%
-15%
-20%
-25%
-30%
-35%
-40%
Percent from Peak
DC Metro decline of 22% from peak
15.4% year-over-year
Source: Case Shiller, August 2008 pricing, released 10/27/2008
http://calculatedrisk.blogspot.com/

Average Sale Price in Northern Virginia, Hampton Roads, and Richmond

Levels

Seasonally-adjusted 2-quarter moving average



Housing Inventories Still High

- Nationally, inventories of new home are at highest levels since 1981 and total Inventories – new and existing homes – hovers in the 10-11 month range on average, but varies dramatically by market
- Supply and demand in the housing market is considered balanced when the inventory settles at about six months
- First inventory reductions were seen in August and September, but these were modest and we are entered slowest sales period of the year
  - Data on pending home sales also indicates much of progress may have been wiped away as a result of credit crisis in October – pending sales and cancellations increased dramatically again
- Virginia has mirrored to nation to a large degree and while we don't have inventories in the multi-year range like some areas in south Florida, many Virginia markets have been in the 10-14 month range
  - Seeing greatest improvements in Northern Virginia, coincident with the greater increase in sales
- Outstanding concern is that there is a substantial "shadow inventory" – homeowners wanting to sell, but waiting for a better market
  - This could keep inventories elevated above normal levels as these homes enter the market

Factors Impacting the National Housing Recovery

Constraints:

- Tight Credit:
  - Until recently, about 90 percent of customers with good credit were approved for a loan; that rate has fallen to about 60 percent
  - For customers with a poor credit record, the approvals rate has fallen from 50 percent to about 10 percent
- Homeowners “underwater” - negative amortization
- Consumers waiting to “find bottom”
- Overall economic stagnation and growing unemployment

Positive Forces:

- Affordability has improved dramatically in major markets – OFHEO measure of home affordability at lowest rate in 3 years
- “Fire sales” – number of homes in foreclosure presses pricing even lower
- Low level of housing starts points to long-term stabilization of supply

Virginia’s Economy

Virginia Revised Economic Outlook

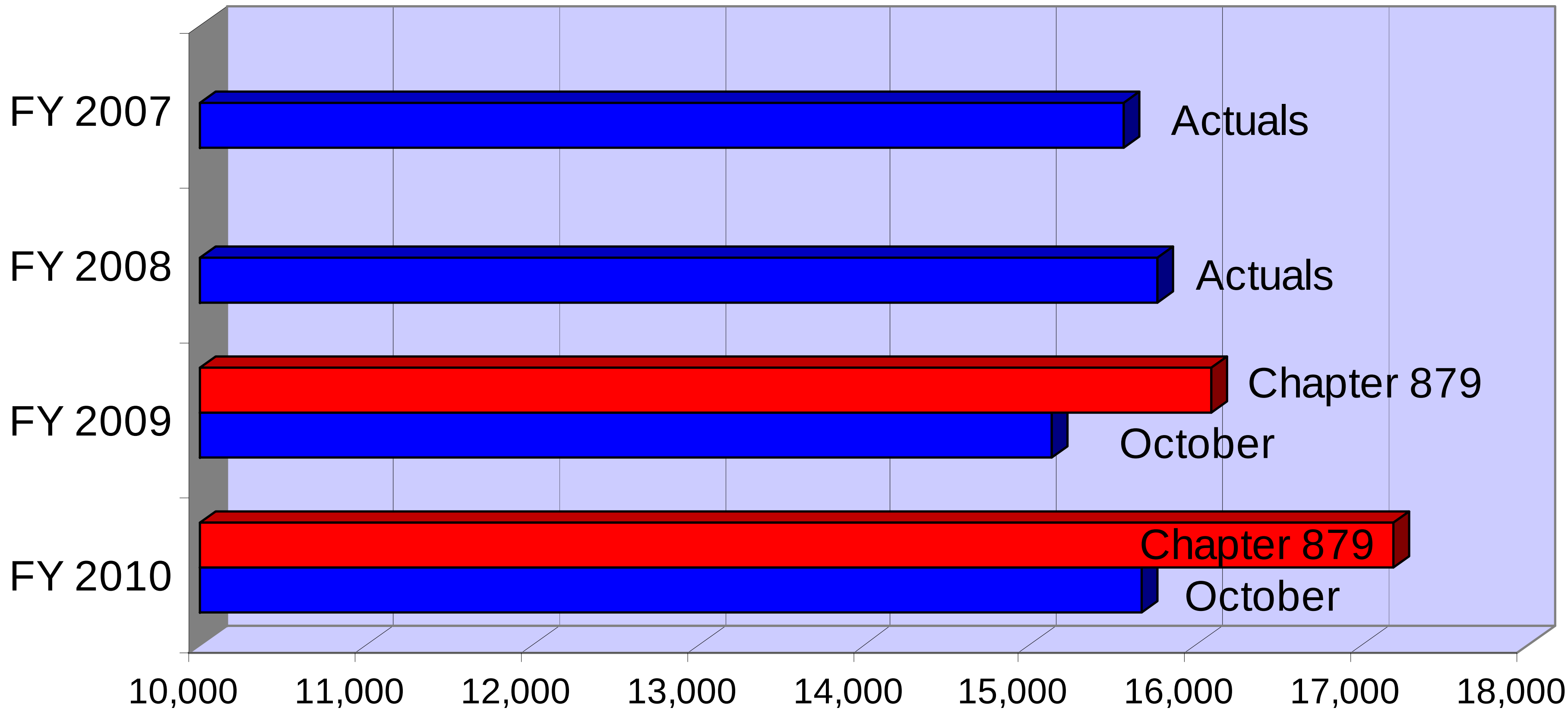
- The October revisions to the Official forecast reflect the recommendations of the Governor's Advisory Board of Economists (GABE) and the Governor's Advisory Council on Revenue Estimates (GACRE)
  - Forecast based on three-quarter recession
- Assumes Virginia will have three quarters of declining employment, starting in 2008Q4 and lasting through 2009Q2
  - Employment growth in Virginia has remained positive, growing 0.5% in September
  - Fiscal Year 2009 forecast assumes total job loss of 0.6%
  - Total job loss expected to be around 38,000, peak-to-trough decline
- Unemployment in Virginia peaking at 4.9% -- 2% higher than low point
  - 1991 unemployment rates -- 6.2%
  - 2001 unemployment rates -- 4.2%
- Assumes a very modest recovery beginning in FY 10
  - Job growth is anticipated to be flat
  - Wage and salary growth around 3.6% and personal income growth around 3.3%

Revised 2009/2010 Economic Forecast

October Revisions

- The October revenue forecast reflects a combination of the Standard and Alternative Low Growth Scenarios as well as actual first quarter payroll withholding collections for FY 2009
- Revenues now expected to decline 4.0% in FY 2009
  - The projected decline for FY 2009 represents the second worst performance on record (after FY 2002)
  - Major revision from the +2.0% growth projected in the official forecast
- Total GF revenues are projected to increase a sluggish 3.6% in FY 2010
  - However, the dollar amount of the projected revenue collections for FY 2010 will remain below actual revenue collections for FY 2008
- The resulting October revenue forecast reduces total general fund revenues by slightly over $2.51 billion
  - FY 2009: -$973.6 million
  - FY 2010: -$1,540.1 million
- Revenue shortfall does not reflect costs of any potential budgetary pressures: (Medicaid, second year premium increase for employee healthcare, and rising energy costs)

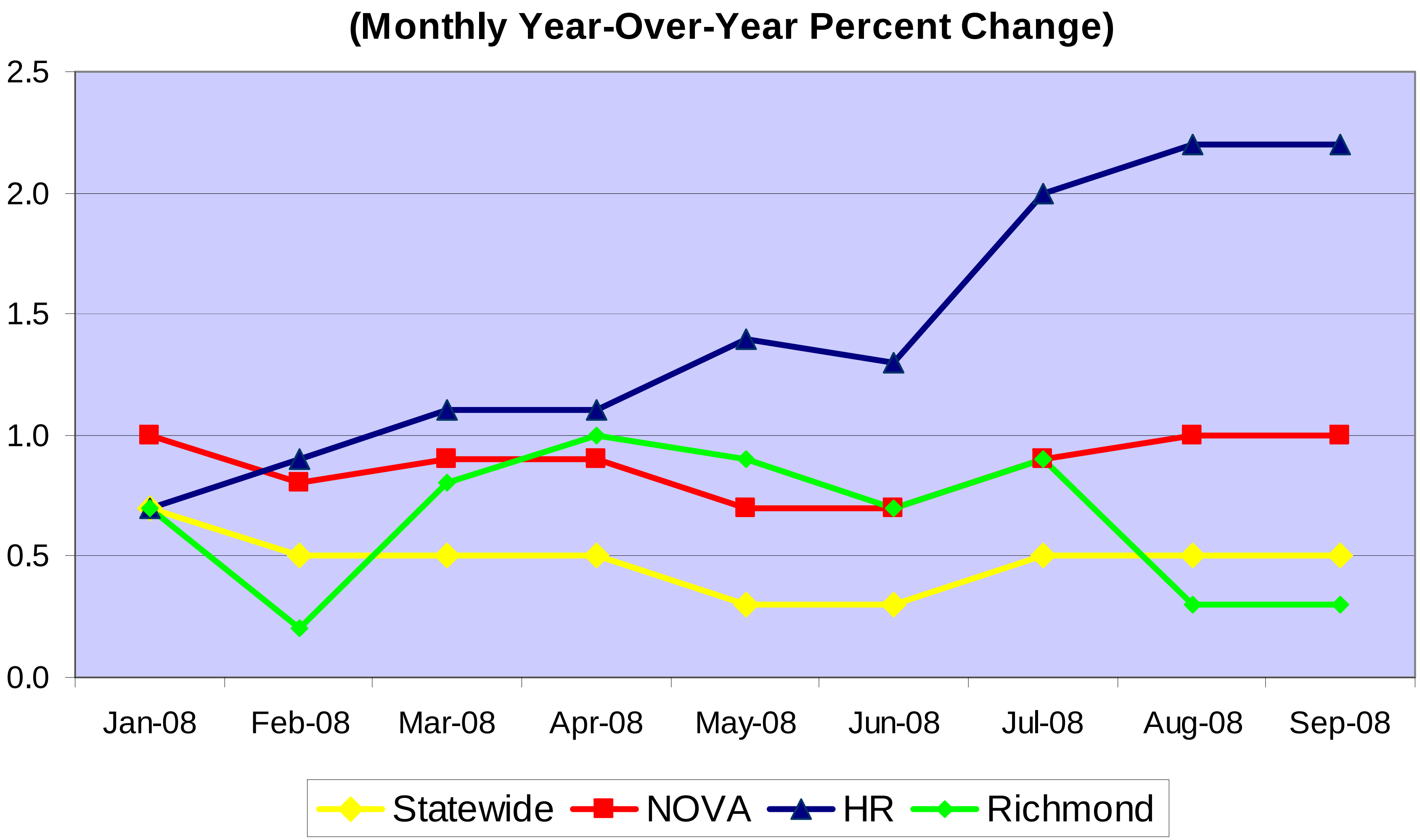
General Fund Revenues
($ in millions)



Year-To-Date Collections Slightly Better Than Forecast

- September completed the first quarter of the fiscal year and is a significant month for revenue collections. Estimated payments from individuals and corporations were due
  - Corporate is performing within forecast
  - Despite YTD performance, nonwithholding forecast anticipates the May final payment will decline 20%
    - This revenue source has a strong correlation with the S&P
    - January estimated payments will provide greater insight on how May payments will perform
- Payroll withholding is out-performing the revised forecast, with year-to-date growth at 5.5% versus 3.3% in revised forecast
  - Growth rate might be slightly overstated due to extra deposit days
  - November collections will account for that and provide a clean comparison
  - Payroll would have to fall to 2.3% for the remainder of the year to meet current forecast levels

Change in Virginia Employment by Region



Year-To-Date Collections Slightly Better Than Forecast

- Sales tax is negative, with year-to-date collection negative 2.6%, well below the revised forecast
- If the odd timing factor of insurance premiums is excluded from the equation, YTD revenue growth has fallen only –2.3% not –3.5%
- The revised forecast assumes Virginia's economy will begin to see a loss of jobs over the next 6 to 9 months and payroll revenue will decline

General Fund Revenue Forecast for Fiscal Year 2009

Major Source	Source as a % of Total Revenues	Chapter 879 Official Forecast	Dollar Reduction	October Forecast Revision	Y-T-D Performance
Withholding	59.1	6.4%	($274.6)	3.3%	5.5%
Nonwithholding	19.0	6.9%	($422.1)	-7.9%	0.2%
Refunds	(11.1)	6.4%	$8.1	6.8%	17.9%
Net Individual	67.0	6.5%	($704.8)	0.4%	4.1%
Sales	20.0	4.9%	($150.2)	0.0%	-2.6%
Corporate	4.4	-12.6%	($21.1)	-15.2%	-14.8%
Wills (Recordation)	2.4	-16.6%	($33.5)	-23.9%	-32.6%
Insurance	1.8	-25.7%	($37.3)	-35.1%	-100.0%
All Other Revenue	4.4	-22.9%	($9.5)	-24.0%	-29.3%
Total GF Revenues	**100.0**	**2.0%**	**($956.4)**	**-4.0%**	**-3.5%**

Note: YTD revenues are -2.3% when adjusted for insurance premiums

What's Next? Fall Reforecast Process Ongoing

- GABE met November 14th to review the latest economic data, including updates from Global Insight
  - Global Insight's November Executive Summary has been revised downward to reflect a 4-quarter recession
  - They have assigned a 60% probability to the standard forecast
  - October reforecast had been revised downward to assume a 3-quarter recession
  - GABE members felt November revision more closely reflected the nation than the August low forecast
- GACRE is scheduled to meet on December 2nd
  - Payroll withholding and sales tax collections through November will be incorporated
- New forecast will be submitted by the Governor as part of his amendments to the 2008-10 budget in December

Economists' Thoughts on VA Economy

- Since last meeting in September, the economists, like Global Insight, have become more pessimistic on consumer spending (sales tax) in particular
- In terms of housing (recordation), opinions were mixed based on regional differences
  - Northern Virginia all jurisdictions now showing increases in sales and declining inventories
  - Hampton Roads and Richmond sales volumes relatively flat
- Employment (withholding) picture also mixed by region
  - Northern Virginia and Hampton Roads showing the greatest gains – also have incomes higher than state average
  - Richmond starting to show weakness in job growth, reflecting layoff announcements (Qimonda, Circuit City, Land America, Carmax, Reynolds)
    - Genworth Financial could be the next large employer
- Northern Virginia tends to see up-tick in employment during change of Administrations and crisis – TARP hiring already being seen

Anticipated Changes to the December Forecast

- Depending on YTD collections through November, payroll withholding could be revised slightly upward for FY 2009
- Based on YTD sales tax collections and deteriorating consumer spending, the forecast for FY 2009 sales tax collections will be revised downward, offsetting any gain from withholding
- Estimated payments may be updated to reflect continued weakness in the stock market
  - The S & P down over 35% year-to-date
  - However, dismal market may have led to sales/capital gains
  - Will need to see January estimated payments to test the accuracy of the revised forecast
- In combination, these three sources make up more than 85% of GF revenues
- Virginia, which typically lags going into a recession, could experience a "slow growth" recession that drags revenues down deeper than anticipated in FY 2010
  - This sentiment was echoed by several members of GABE

Final Thoughts

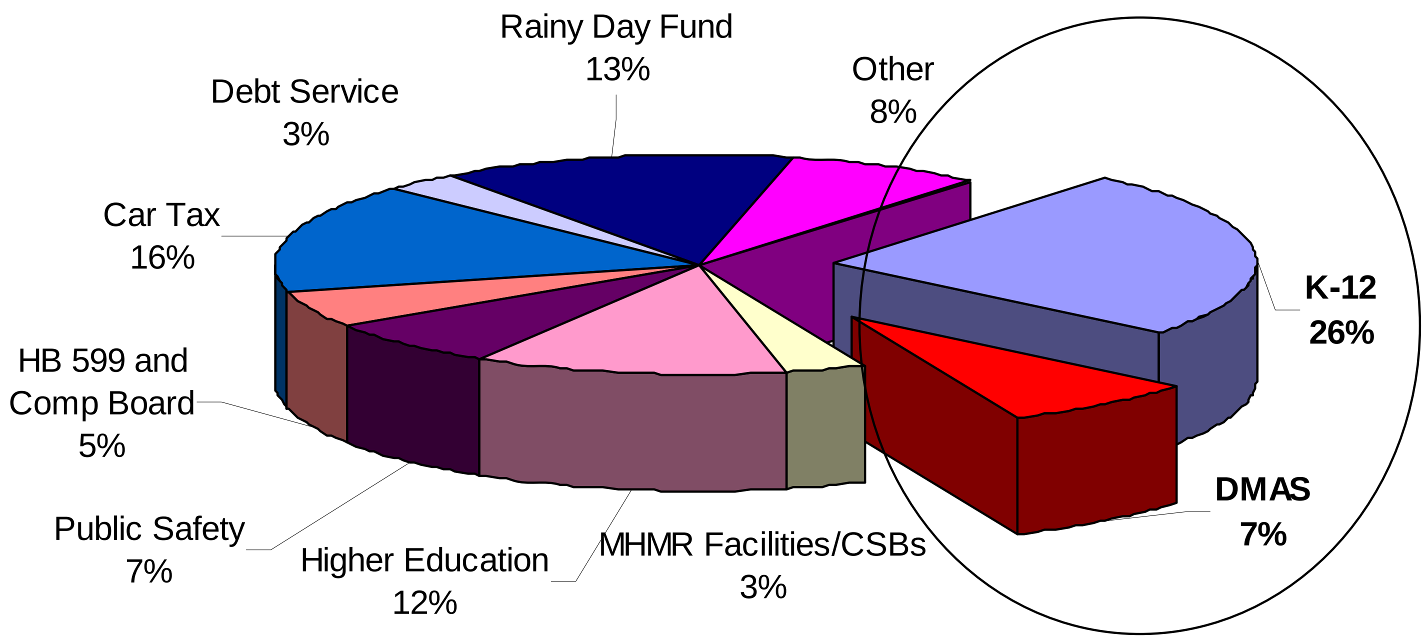
- Potential Downside Risks:
  - Extended job losses will exacerbate the decline in home prices, construction, and foreclosures, pushing back the housing recovery
  - Higher oil prices and a weaker dollar could reignite inflation, forcing the Fed to raise interest rates in 2009-10
  - Consumer confidence remains weak, further depressing discretionary spending
    - Dampens large purchases, i.e., homes and autos
  - Federal policy shifts could impact defense and domestic spending
    - Federal spending constitutes 35% of NoVa's economy
      - Procurement spending has doubled since 2001
    - More than 60% of federal spending in NoVa has been defense/homeland security-related
- Error on the side of caution in FY 2010
  - Easier to restore than it is to take

Balancing Virginia's Budget

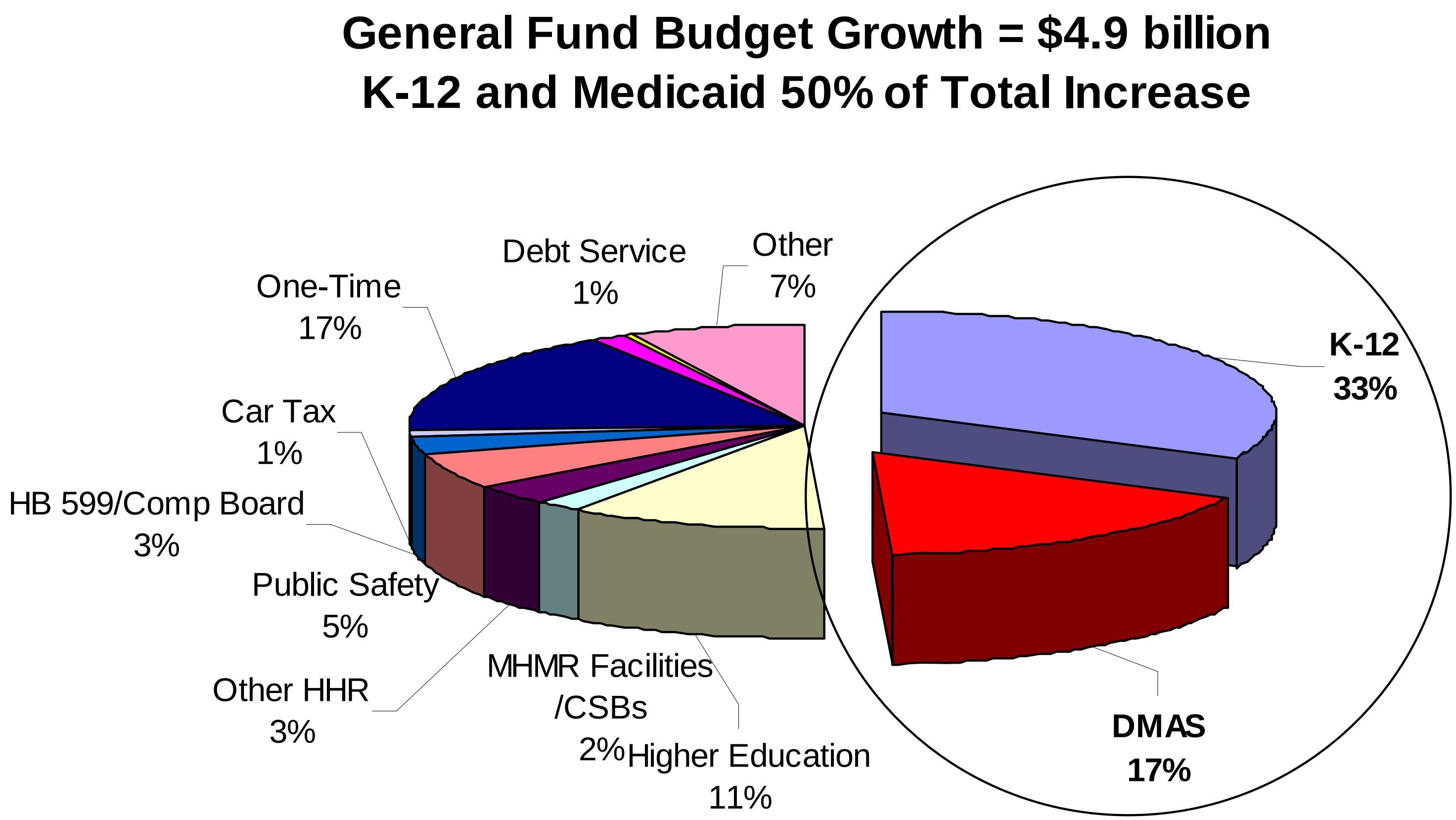
- Comparison of GF Budget Drivers
  - 1998-2001
  - 2004-2007
  - Current biennium
- Actions to Balance Virginia’s Budget 2008-2010
  - Impact on local aid
- Governor’s Strategies to Address October FY 2009 Shortfall
- 2009 Session Objective
- Other States’ Responses to Revenue Shortfall

General Fund Budget Growth FY 1998 to FY 2001

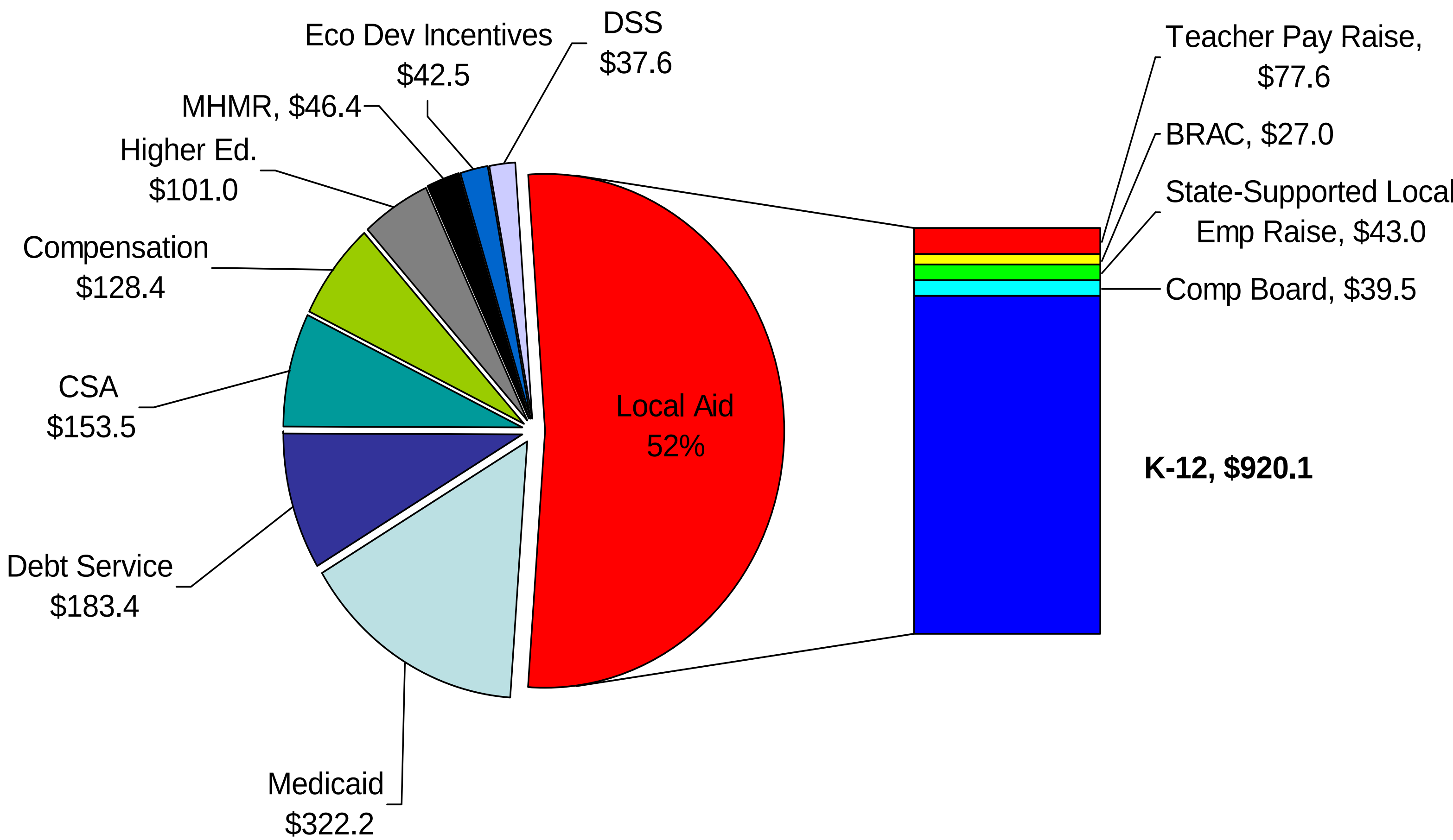
General Fund Budget Growth = $3.6 billion
K-12 and Medicaid 33% of Total Increase



General Fund Budget Growth FY 2004 to FY 2007



General Fund Budget Increases FY 2009-2010



K-12 and Medicaid made up 54% of new spending

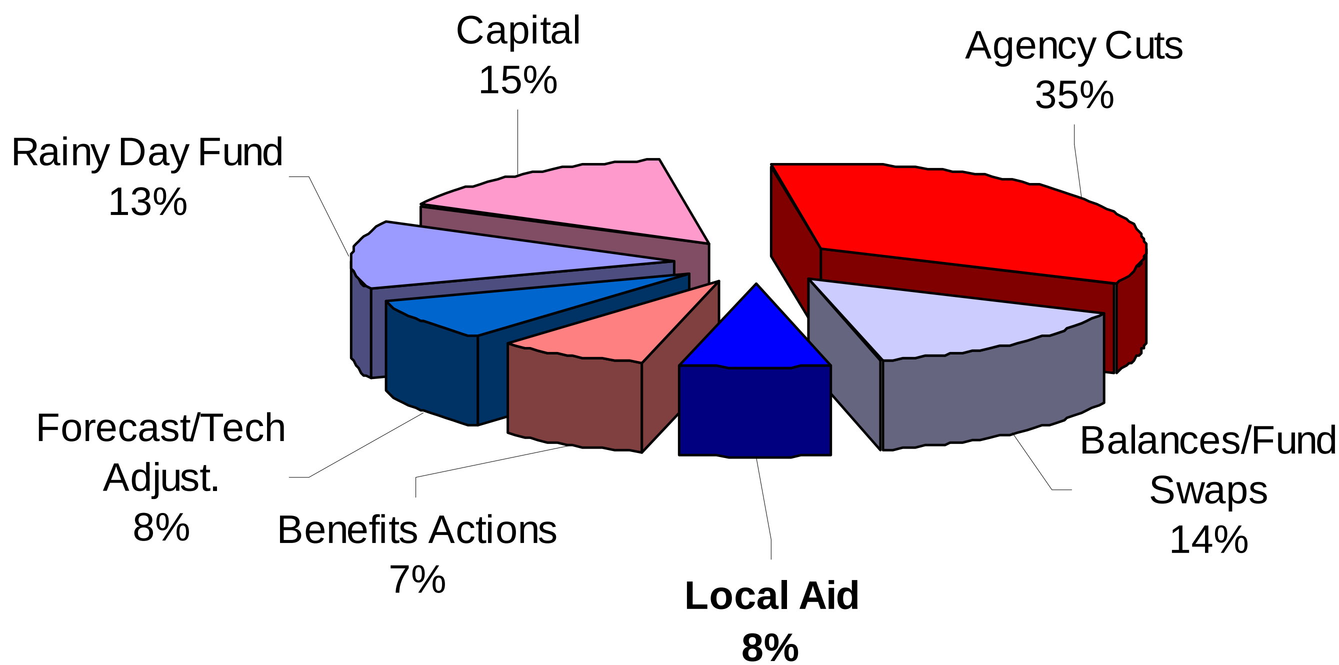
Budget Actions through 2008 Session

- Since August 2007, the state has had 3 rounds of reductions to state spending
  - In August 2007, the Governor reduced the '08 forecast by $641 million (in part reflecting a FY 2007 shortfall of $234 million which had been assumed to be available for carry-forward to FY 2008)
    - As part of this interim reforecast, Governor also reduced the forecast for the FY 2009/2010 biennium by just over $800 million
  - In February 2008, he reduced the '08 forecast an additional $323 million (total $1.0 billion for FY 2008) and also reduced the 09-10 forecast by approximately $1.0 billion
  - 3-year cumulative shortfall was $2.6 billion (exclusive of October 2008 revenue revision)
- For the most part, the General Assembly has insulated local governments from the impact of declining state revenues in the current biennial budget

Summary of 3-Year Reduction Strategies (FY 2008-10)

How Was the Budget Gap Been Closed?

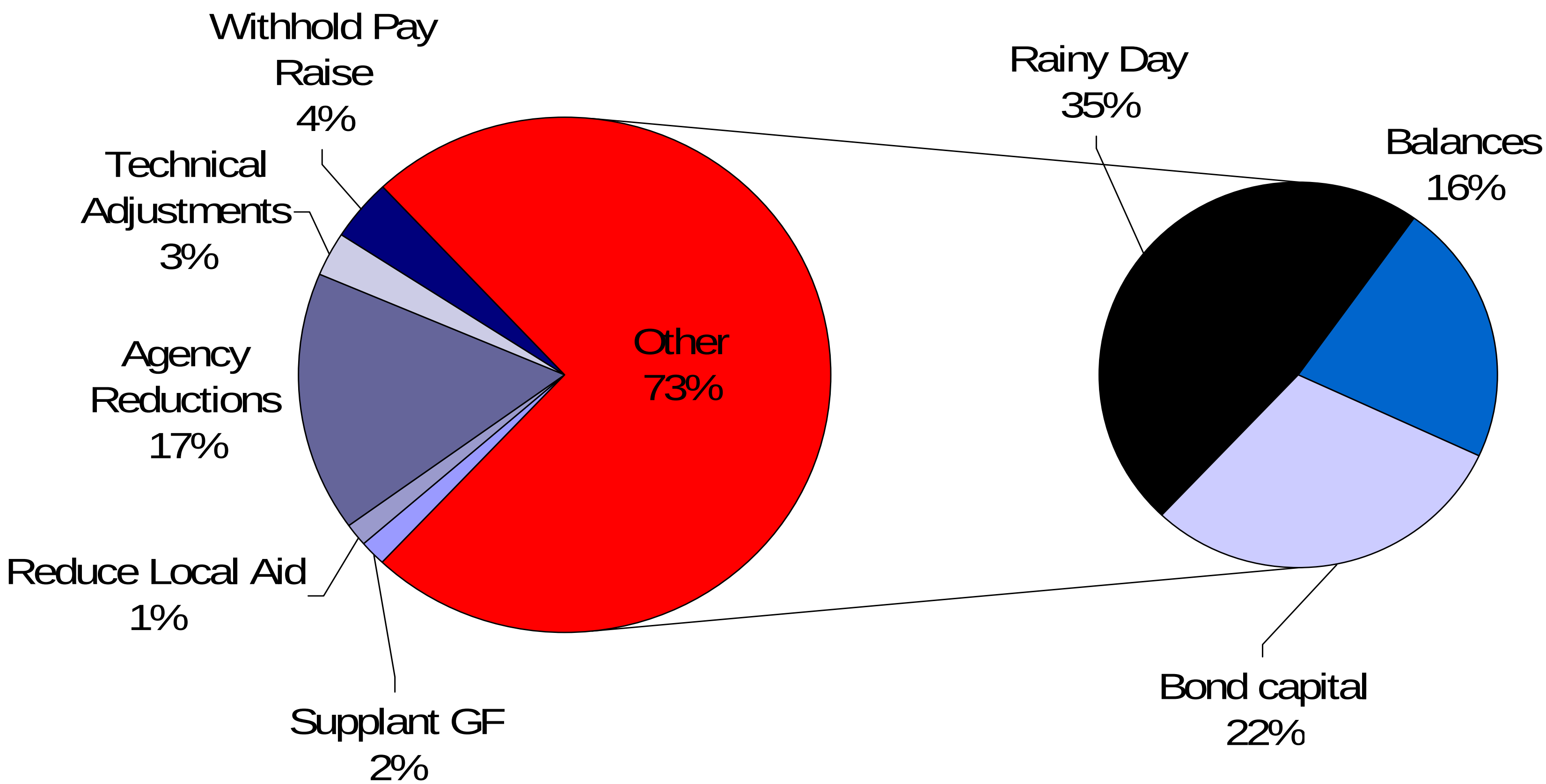
Cumulative Cut of $2.6 billion FY 2008-2010



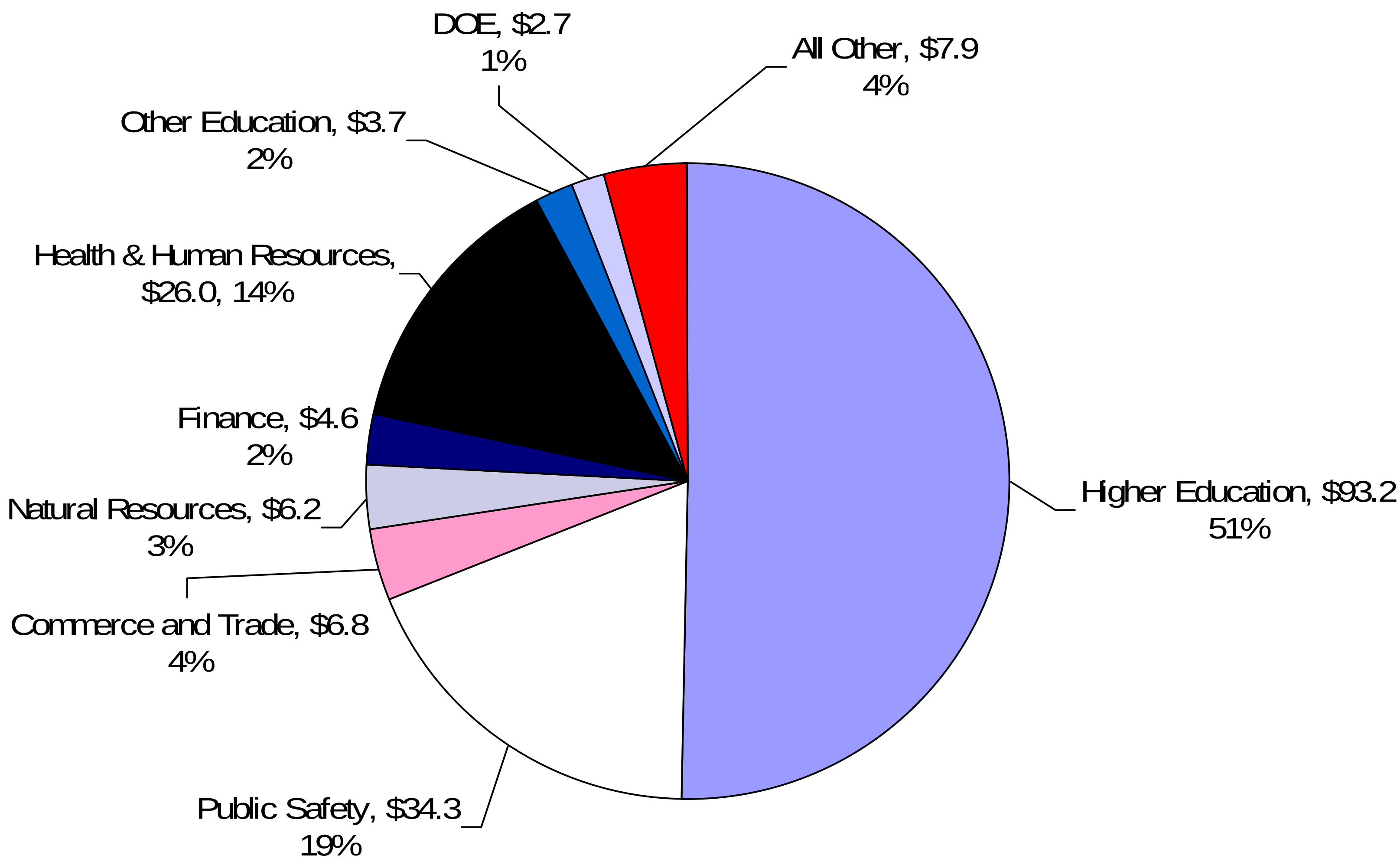
Governor's October FY 2009 Budget Reductions

- The majority of strategies are one-time savings actions, designed to manage the FY 2009 shortfall, rather than to address FY 2010 shortfall
  - Approximately 75% of actions are one-time, including Rainy Day Fund, balances and using bonds for GF cash
  - Approximately $151.1 million will carry forward to FY 2010
- K-12 and most of Health and Human Resources were exempt from across-the-board cuts
  - Governor has indicated they will be reviewed for targeted reductions in FY 2010
- Agency reductions amount to approximately $202.0 million
- First year 2% pay raise is being rolled back, generating $44.7 million
  - Additional savings of $77.0 million will be recognized an FY 2010
- Governor has not proposed any action regarding second year pay raise or the teacher pay raise -- $123.0 million in budget
- FY 2010 reductions proposals will be addressed through amendments to the budget

Governor's October FY 2009 Savings Strategies



Governor's October FY 2009 Agency Budget Reductions: $202 million



Budget Actions Through the 2008 Session

Impact On Local Aid

- In the first round of cuts (August 2007) reductions to local aid totaled only $19 million, or about 6% of the total, the largest of which was level-funding of “HB 599” funding to localities with police departments
  - Other strategies included the use of managing turnover and vacancy savings in Constitutional offices and reverting unused year-end balances
- During the 2008 Session, the General Assembly further mitigated the reductions for the new biennium proposed by the Governor
  - Reduced across-the-board from $65 million to $50 million each year
  - Continued level-funding HB 599 and managing turnover and vacancy in Constitutional offices
  - Limited inflation adjustments for non-personal services in K-12 to no more than 5%
  - Other actions included capturing all ABC profits and wine taxes ($9.0 million/year) that otherwise would have been returned to localities
  - Other actions – used Literary Fund for teacher retirement contributions – resulted in no loss of funding for local school divisions yet saved the GF $65 million over the biennium
  - Similarly, by adjusting actuarial assumptions used for the VRS contributions, both the state and localities saw budgetary savings
- In total, about 10% of the savings strategies for the 3 fiscal years (FY 2008-2010) came from local aid, although local aid makes up 52% of the GF budget

Local Aid Savings October FY 2009

- K-12 was exempt from Governor's reduction plan
- For local aid, adjustments totaled $44.7 million, or less than 4% of the total reduction actions
  - $28.4 million (64%) represent automatic technical adjustments to K-12 sales tax and HB 599 payments which are formula driven based on revenue growth
  - $12.8 million reduction in administrative costs at Community Services Boards
- In order to meet the $1.54 billion shortfall in FY 2010, many of the once-exempt local aid programs will be reviewed for targeted reductions

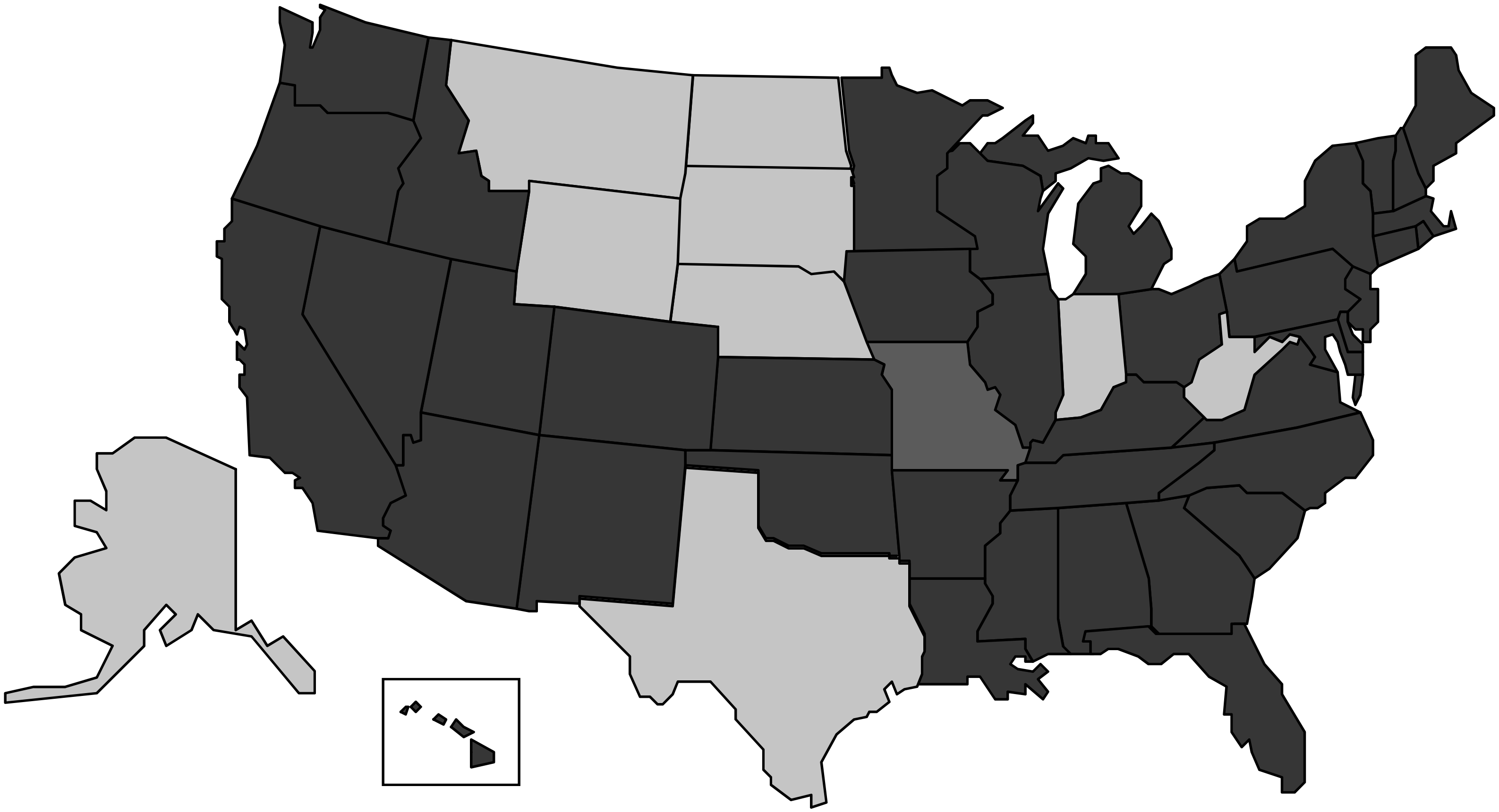
The Objective For Fiscal Year 2010 Should Be To Structurally Balance The Budget

- Because 75% of the savings strategies adopted by the Governor in FY 2009 were one-time actions, only about $332.0 million in on-going savings carries into FY 2010 to meet the $1.54 billion shortfall
  - Additional $151.1 million in one-time dollars is also available
- Reliance on one-time actions creates a structural imbalance in the 2010-12 budget
  - Out-year forecast assumes revenue growth of about 5% each year
  - Every $150.0 million in one-time actions in FY 2010 requires 1 percent of revenue growth in FY 2011
- In managing the 1991 recession, one-time actions were used for several years, which prolonged achieving a structurally balanced budget until 1996

Most States Are In The Same Boat

Economic Slowdown Impacting Most States

41 States Project FY 2009-10 Revenue Shortfall



States' Budgets -- What A Difference A Year Makes

- In FY 2007, states held an combined year-end balance nearing 10% of general fund spending
- In FY 2008, nearly half the states reported budget gaps, even after assuming forecasts with declining revenues
  - According to NCSL, the cumulative shortfall was nearly $13.0 billion
- No single tax source is the culprit, however, declining sales tax collections seems to have been a unifying theme
- FY 2009, revenues have fallen, the size and gap of the shortfalls are projected to more than triple those in FY 2008
  - Global Insight projects operating deficits for state and local governments of $92 billion
- The exceptions are states that have significant portions of their tax bases tied to natural resources
  - However, even in these states, strength in particular collections simply is helping to compensate for weaknesses in other taxes

State Actions to Balance the 2008 Budget Spending Actions

- Across-the-board budget cuts (10 states)
- Targeted program cuts
  - Higher education (12 states)
  - K-12 education (11 states)
  - Medicaid (10 states)
  - Corrections (9 states)
  - Aid to local government (8 states)
  - TANF (3 states)

State Actions to Balance the 2008 Budget Employee Actions

- Layoffs (4 states)
- Hiring freezes (9 states)
- Salary freezes (3 states)
- Reduced benefits (6 states)
- Less-than-full contributions to retirement funds (4 states)
- Early retirement program (1 state)

State Actions to Balance the 2008 Budget Miscellaneous

- Use of “Rainy Day” Funds (6 states)
- Shifted Pay-as-You-Go to Debt (6 states)
- Delayed capital projects (7 states)
- Expanded gambling (4 states)
- Tax amnesty (2 states)
- Borrowed from Special Funds (3 states)
- Tapped Tobacco Funds (9 states)

Medicaid Program: States’ Actions During Economic Declines

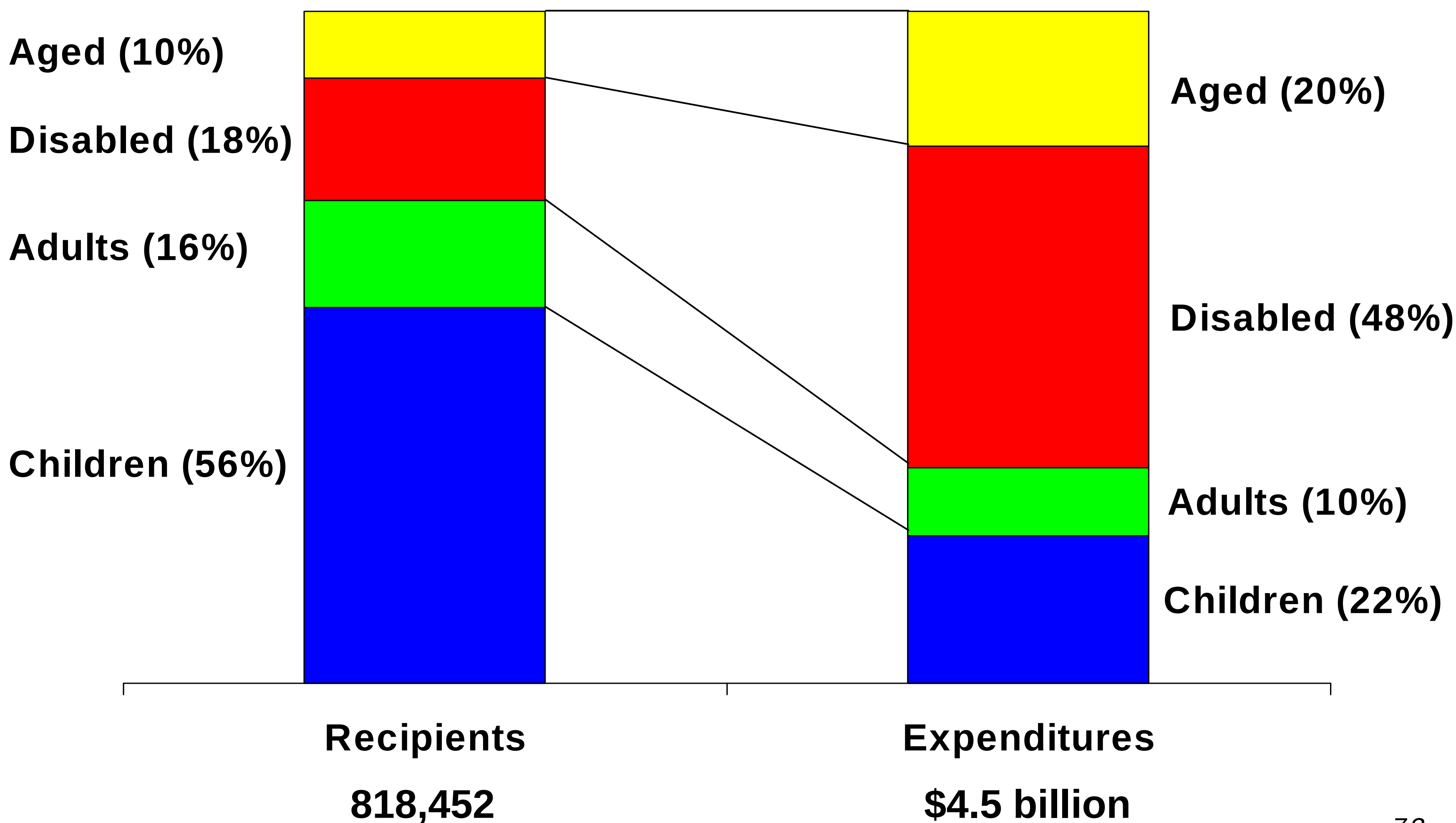
Medicaid Program: States' Actions During Economic Declines

- Overview of Virginia Medicaid Program
- How have states dealt with growing Medicaid expenditures during periods of revenue decline?
- What Medicaid cost containment actions are states considering as they balance budgets in the current fiscal climate?

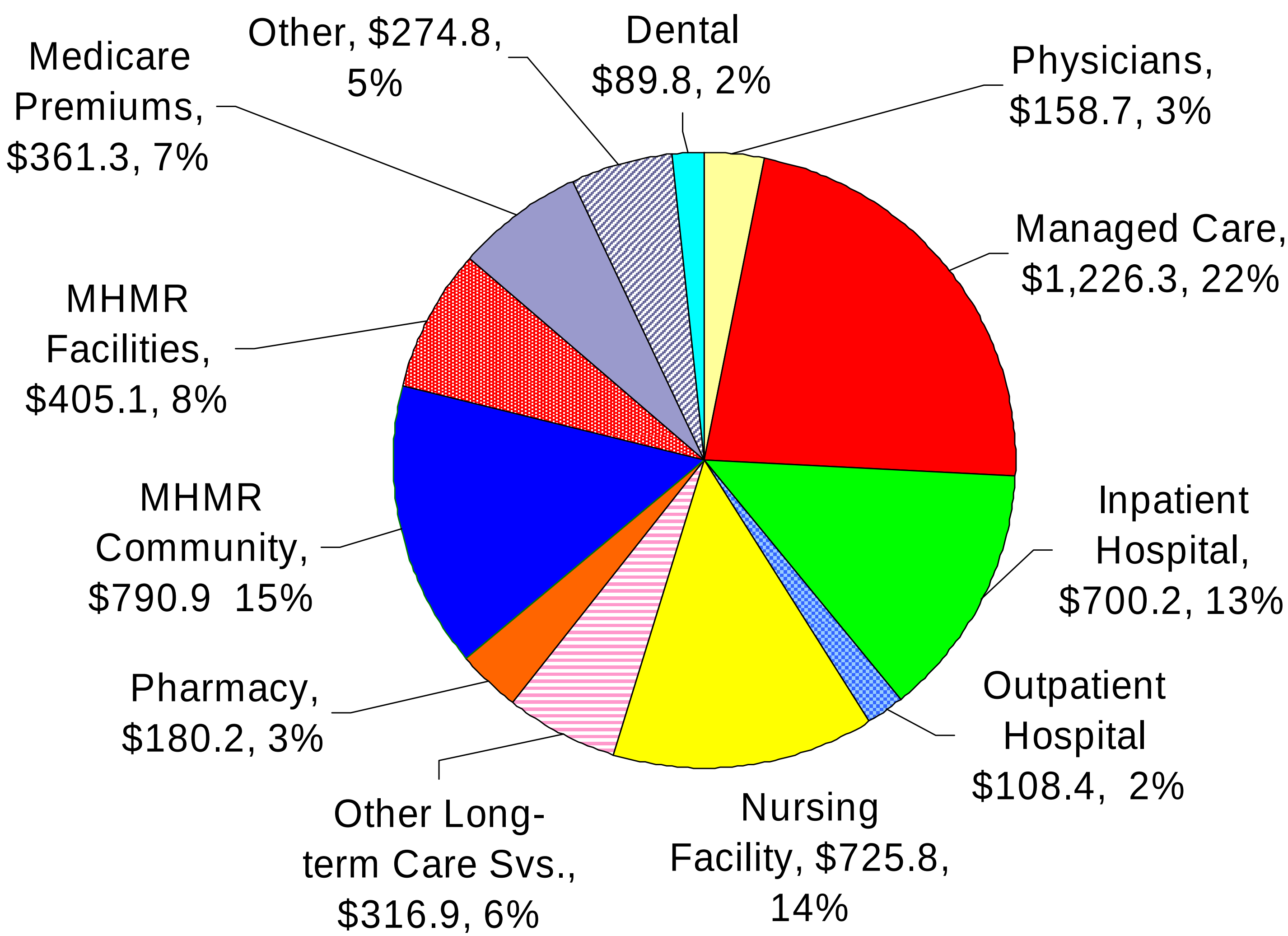
Virginia Medicaid Program

- Largest health care financing program for indigent persons in Virginia
- In FY 2008, Medicaid provided reimbursement for 818,452 recipients at a cost of $4.5 billion
  - Excludes lump sum payments and cost settlements
- Program costs are shared by the state and federal government
- Virginia’s share is 50 percent or $2.2 billion in FY 2008

Comparison of Recipient Groups as a Percent of All Recipients and Expenditures (FY 2008)

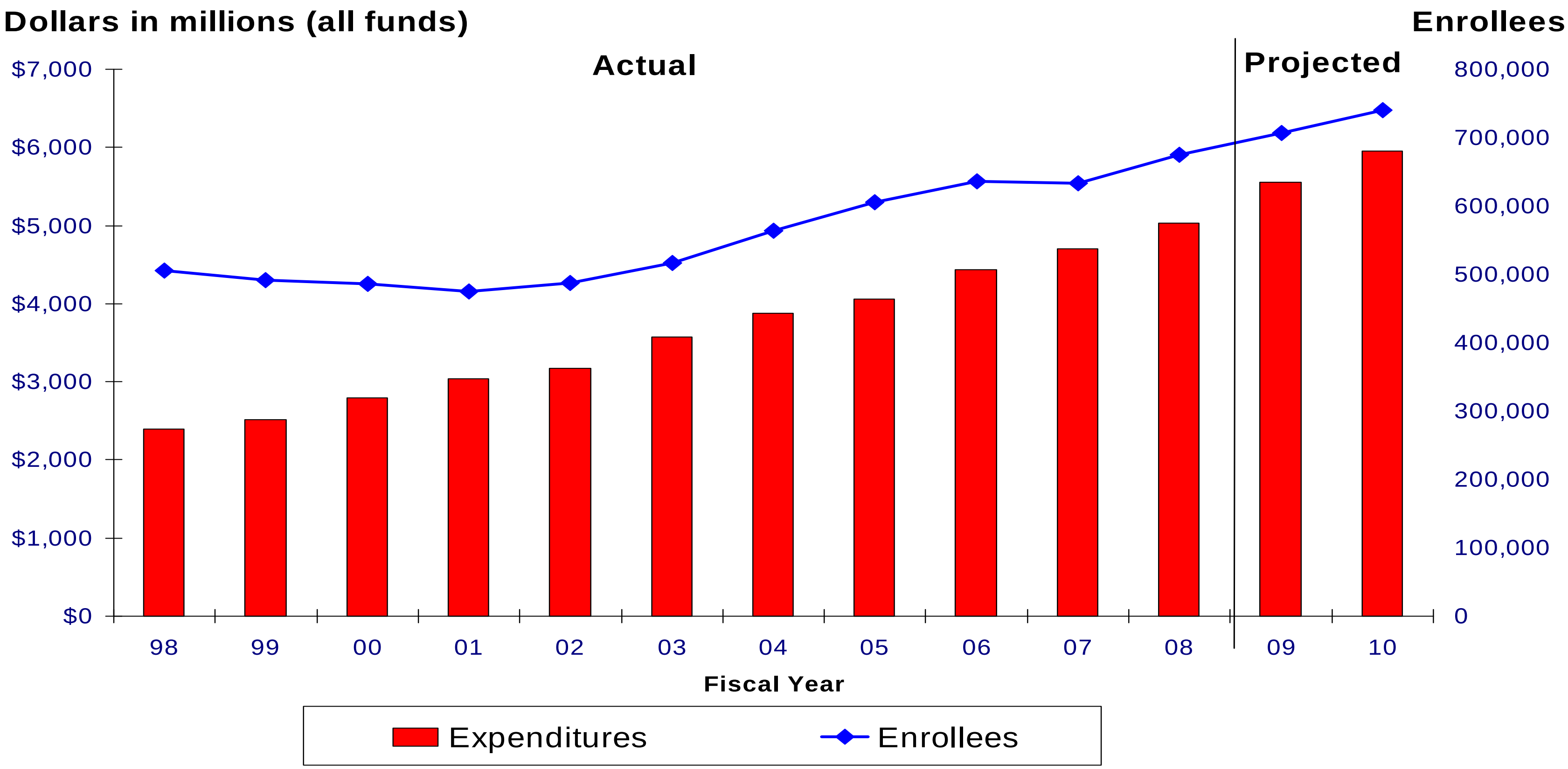


Expenditures by Medical Service
FY 2008 = $5.3 billion



Growth in Medicaid Medical Expenditures & Enrollees

- 7.7% historical avg. annual expenditure growth
- 8.9% projected avg. annual expenditure growth*



*FY 09 expenditure growth is artificially high because $73 million in FY 08 expenses were carried forward into FY 09.

Factors Affecting Historical Medicaid Spending Growth

- Inflation in health care costs greater than other goods and services, particularly prescription drugs
- Good economies in late 90s led Virginia, along with many states, to begin providing “catch up” increases in provider payment rates
- Expanded services
  - Added mental retardation waiver slots
  - Added substance abuse services
- Expanded coverage of organ transplants
  - Expanded coverage for screening and treatment of certain cancers
- Expanded eligibility
  - Increased eligibility threshold for elderly and disabled from 74 to 80 percent of the federal poverty level
- Increased enrollment for mandated groups
  - Added back TANF recipients who were inadvertently dropped from rolls with advent of welfare reform
  - Children’s health insurance - federal requirements to screen for Medicaid eligibility first increased rolls

States' Actions to Contain Medicaid Costs during Economic Declines

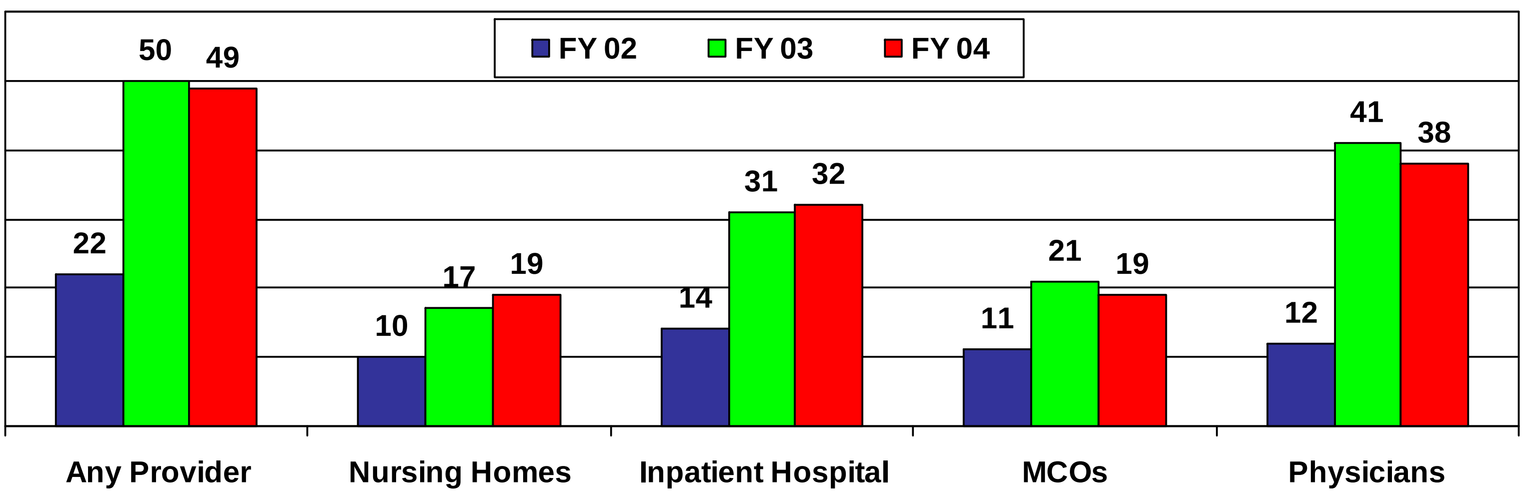
State Budget Actions on Medicaid Focus on Cost Containment

- Medicaid spending growth is nearly constant regardless of economic growth or decline
- In good times, the program often grows to cover more people, expand services and “catch up” provider rates
- In bad times, the program grows when more families qualify for Medicaid as they lose jobs and their family income drops
- Consequently, states are always looking for ways to contain Medicaid costs, typically by:
  - Reducing reimbursement to providers
  - Reducing coverage or cost of services
  - Reducing number of people receiving Medicaid or higher cost Medicaid services
  - Maximizing federal payments
  - Improving administrative efficiencies

State Actions to Contain Medicaid Costs: Provider Reimbursement

- Early 2000s, states either froze or reduced provider payments to large provider groups
  - Hospitals
  - Nursing homes
  - Managed care organizations (MCOs)
  - Physicians
- Virginia reduced payments for hospitals, nursing homes, managed care organizations, and durable medical equipment providers in FY 2003 and FY 2004

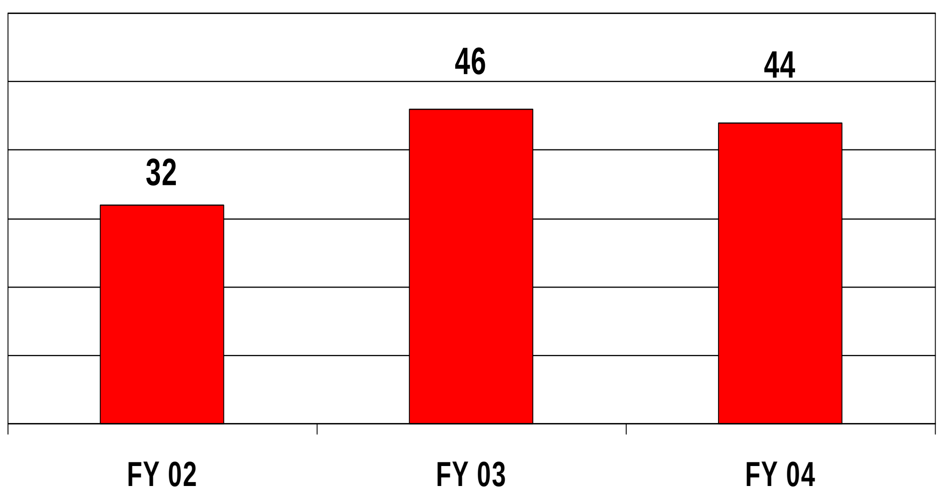
Number of States Freezing or Reducing Provider Payments
FY 2002, FY 2003 and FY 2004



State Actions to Contain Medicaid: Pharmacy Cost Controls

- In early 2000s, states took more aggressive actions to control pharmacy costs, as prescription drug cost increases became one of the top drivers of Medicaid growth
- Actions focused on all aspects of pharmacy costs and continued throughout this decade
  - Pricing
  - Reimbursement
  - Prescribing patterns
  - Utilization

Number of States Implementing Pharmacy Cost Controls



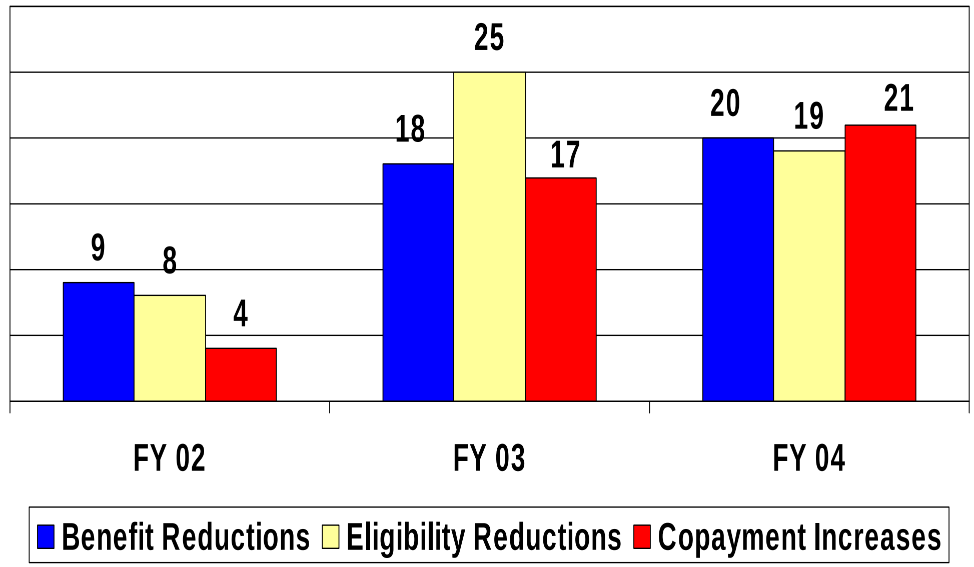
Types of Pharmacy Cost Controls

- Pricing / Reimbursement
  - Multi-state purchasing agreements
  - Supplemental rebates for selected therapeutic classes
  - Greater discounts on average wholesale prices (AWP) for drugs
  - State maximum allowable cost ceilings for multiple source drugs
  - Reductions in dispensing fees
  - Pharmacy Benefit Managers to manage costs
- Prescribing
  - Preferred drug lists
  - Required formulary
  - Requirements to dispense generic drugs
  - Prior authorization
- Utilization
  - Increased drug utilization review
  - Limits on number of prescriptions
  - Increased co-payments
  - Mail order options
- In Virginia
  - Increased drug utilization review and prior authorization of prescription drugs
  - Reduced pharmacy reimbursements (↑ discount on AWP) in FY 03 and dispensing fees in FY 04
  - Implemented Preferred Drug List in FY 2004, some drug classes excluded

Other State Cost Containment Actions

- Benefit Changes
  - Eliminate optional services
  - Limits on services or visits
  - Prior authorization of services
- Eligibility Cuts
  - Changing eligibility standards
  - Increasing waiting periods from 6 to 9 months for eligibility
  - Freezing enrollment
  - Increasing asset transfer look-back period from 3 to 5 years
  - Limiting countable prior medical bills to those incurred within 3 months of Medicaid application
- Co-payments
  - Must be nominal per Federal law, some groups exempted
  - Typically up to $3.00 per service
  - Less used, up to 5% of the service payment

No. of States Reducing Benefits and Eligibility or Increasing Copayments



- In Virginia
  - Eliminated substance abuse benefit
  - Prior authorization for certain services
  - Targeted eligibility changes to reduce enrollees
  - Increased patient payments for LTC

Other Actions to Contain Costs

- Adopted by States and Virginia
  - Managed care expansions
  - Disease management
  - Increased fraud and abuse activities
  - Administrative cost reductions
  - Use of new technology to better manage program
- Adopted by Other States
  - Use of competitive bidding for medical equipment, supplies or other services
  - Premium subsidies for certain populations

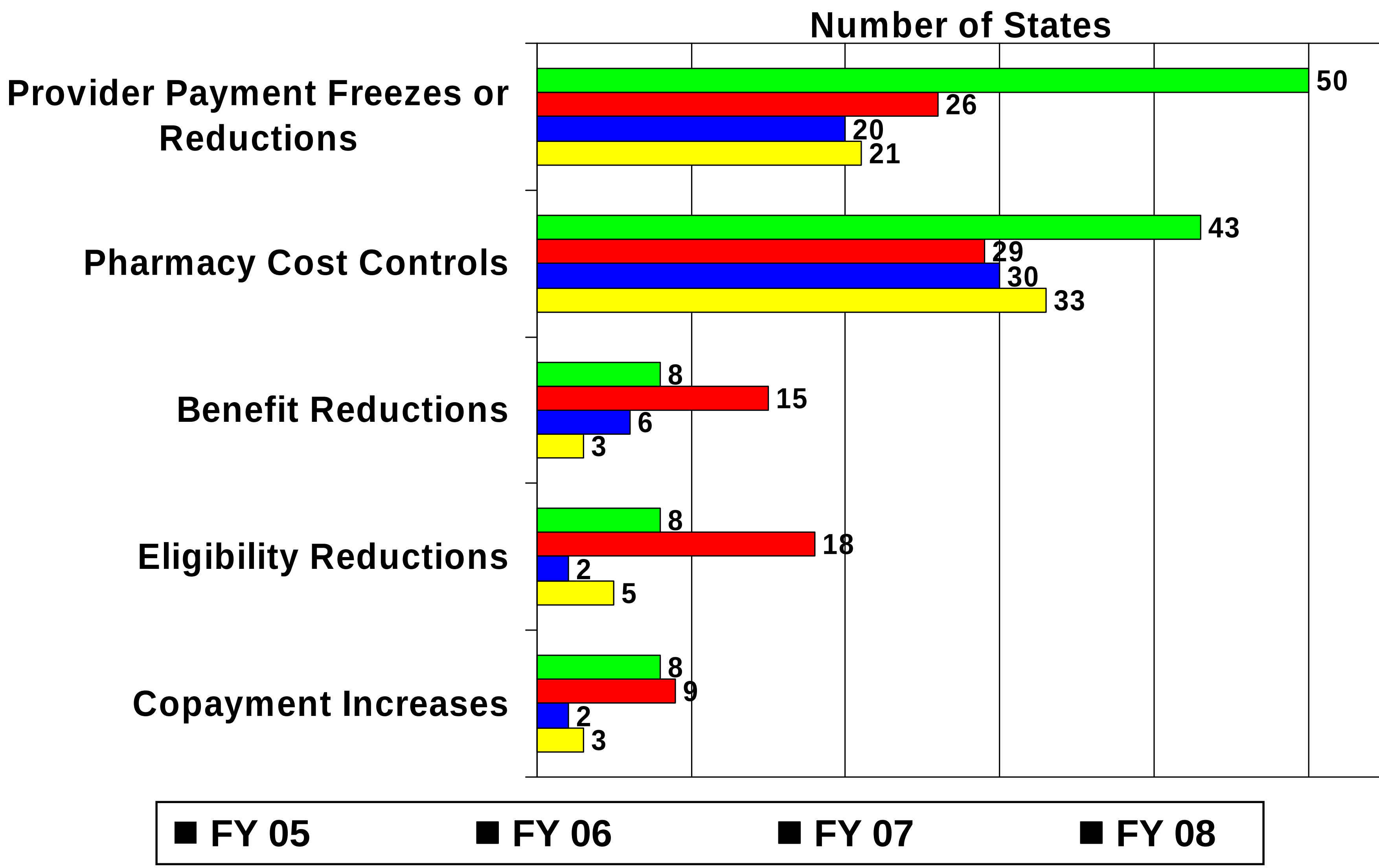
State Actions to Maximize Federal Medicaid Funds

- Increase federal funding by imposing provider taxes
- Use of Medicaid upper payment limits for public facilities
- Intergovernmental transfers for public facilities
- Obtain federal match for school based services
- Virginia has taken all the above actions except imposing provider taxes

Federal Assistance Helped States Address Medicaid Shortfalls and Balance Budgets

- Despite more aggressive cost containment actions, states struggled with Medicaid shortfalls in early 2000s with economic downturn
- Federal Jobs and Growth Tax Relief Reconciliation Act of 2003 provided $20 billion in temporary federal fiscal relief to states
  - $10 billion in relief was used to increase federal matching rates (FMAP) paid to states for Medicaid expenditures for 15-months
  - States were required to maintain existing eligibility levels

Despite Economic Recovery States Continued Cost Containment Actions FY 2005 – FY 2008



State Containment Actions Under Consideration Today

How are states responding to Medicaid growth demands?

- **Maryland:**
  - Partial roll back of rate increases to nursing homes, community providers, residential treatment centers and physicians
  - Revision in rules for outpatient hospital payments, rate cuts to managed care organizations in 2 counties
- **North Carolina:**
  - Pharmacy - prior authorization of additional prescription drugs, increased discount on Average Wholesale Price of drugs
  - May revisit provider rates
- **South Carolina:**
  - 3% across-the-board base cut in all state agency budgets, including Medicaid agency
  - Rates for physicians and dentists, and other ambulatory care service providers were reduced as of October 1, while rates for nursing homes will be reduced later
  - Transitional Medicaid benefits for TANF clients reduced from 2 to 1 year
  - Additional 8.1% budget reduction for Medicaid agency passed by Legislature in September; agency has flexibility to use SCHIP balances to offset cuts
- **Georgia:**
  - Delaying some Medicaid rate increases
  - Quality assessment fee on managed care organizations

How are states responding to Medicaid growth demands?

- **Florida:** Rates cut for HMOs, primary care case management fee, inpatient and outpatient hospital services, nursing homes and other provider categories
- **Indiana:** Limits on Medicaid coverage for nursing home care if individual used their money to contribute to a charity or paid a family member who is caring for them without a formal contract with a 5-year look-back period
- **Nevada:** Mid-year rate cuts to hospitals; restriction on allowable personal care hours; elimination of adult eyeglass coverage
- **Utah:** 3% to 5% reduction in program, optional benefit reductions (eyeglasses, dental care and physical therapy), possible provider payment reductions
- **California:**
  - 10% rate cuts for most providers effective July 1, 2008 to February 2, 2009, with partial restoration beginning March 1; partial rollback of rate increase for family planning services
  - Reducing certain dental benefits; discontinuing of payments for over-the-counter drugs
  - Eligibility: dis-enrolling beneficiaries who have left state, reducing benefits for undocumented immigrants; eliminating of continuous eligibility for children
  - Use of law enforcement asset forfeiture funds for substance abuse treatment services
  - Expanding family cost participation for developmental services
  - Suspension of COLA for county administration
- **New York:**
  - As of August, mid-year rate cuts for hospitals, nursing homes and MCOs
  - Recent press reports indicate Governor will impose 8% across-the-board reductions to hospital and clinic payments this year and another 2% next year

Other Ideas States Are Considering

- Implementation of options allowed under federal Deficit Reduction Act of 2005
  - Increased cost sharing for certain populations and benefits (e.g., use of non-preferred drugs, use of non-emergency services in emergency room, services for higher income beneficiaries, use of premiums for specific groups)
  - More specific definitions of “medically necessary” services
  - Benefit flexibility
    - Replacement of existing Medicaid benefits package for children and certain other groups with “benchmark” coverage (excludes many higher cost groups)
    - Targeted variation in benefits across beneficiary groups and geographic areas
    - Virginia received approval to require Medicaid enrollees to participate in disease management program unless they “opt out”
  - Health Opportunity Accounts demonstration program
    - Similar in concept to Health Savings Accounts
    - Up to 10 states can participate during first 5 years
    - States may set up to $2,500 in account and Medicaid beneficiaries must share in the cost to meet a deductible amount before having access to full Medicaid benefits
    - Medicaid benefits can be limited
    - Additional cost sharing can be imposed up to new federal limits
  - Demonstration program to move persons from nursing homes to community settings (“Money Follows the Person”)
    - Virginia is implementing a demonstration program
  - Long Term Care flexibility
    - Promotes purchasing of long-term care insurance by allowing purchasers to shelter some or all of their assets when they apply for Medicaid after exhausting their policy benefits

Other Ideas States Are Considering

- Pharmacy cost containment
  - Adding more drugs to existing Preferred Drug Lists or expanding prior authorization programs (e.g., behavioral health drugs)
  - Scrutinizing drugs prescribed for off-label uses (e.g., psychotropic drugs for aged recipients with dementia)
  - Bulk purchasing for drugs
  - Carving out prescription drug benefits from managed care services to obtain additional manufacturer rebates
- Expand managed care for elderly and disabled population
  - Virginia has begun four pilot programs (called PACE) and a regional project to integrate acute and long-term services for aged, blind and disabled Medicaid beneficiaries, currently serving about 1,000 clients
  - Program to be expanded to Medicaid and Medicare “dual eligibles” in FY 2010
- Quality improvement and use of new technology
  - Electronic prescribing / electronic health records
  - Behavioral health care reviews
  - Pay for performance for MCOs, hospitals, nursing homes and physicians
  - Accrediting and credentialing providers to meet Medicaid standards
  - In FY 2007, Virginia began reviews of mental health and inpatient hospital diagnostic claims and in FY 2008 began additional prior authorization and utilization review for community mental health services
  - Virginia is in very initial stages of exploring the development and use of electronic health records

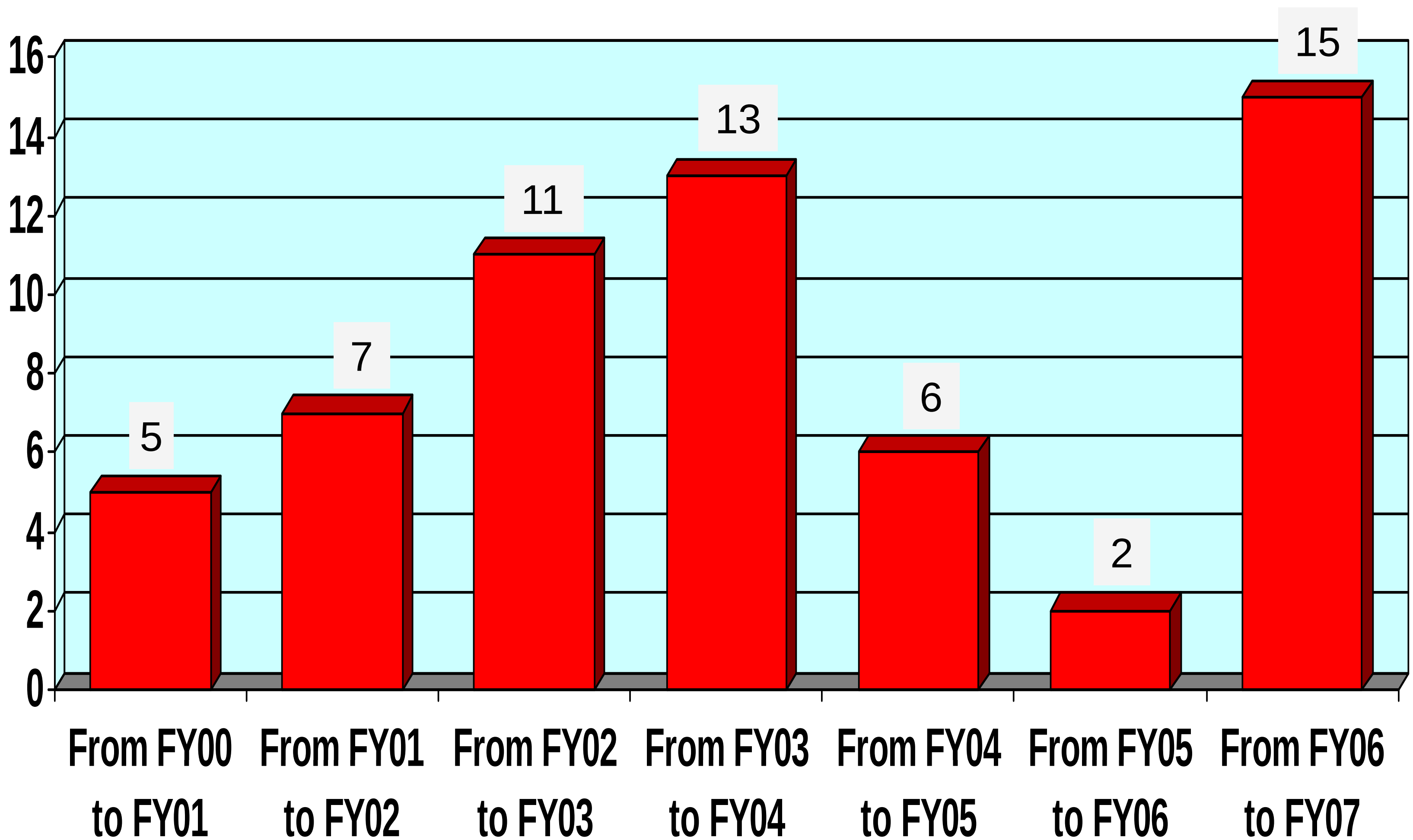
Public Education – States' Actions During Tough Times

Overview

- In times of economic downturn, many states struggle with ways to balance their budgets
- How did those states deal with declining revenue growth relative to their public education budget?
- What decisions did those states make that resulted in changes in the way school divisions conduct business in the future?

Closer Look at the States' Budgetary Actions to K-12

Since Last Recession - Number of States That Reduced Funding, by Year, to Public Education



Note: Some states are counted in more than one year

Data source: National Center for Education Statistics

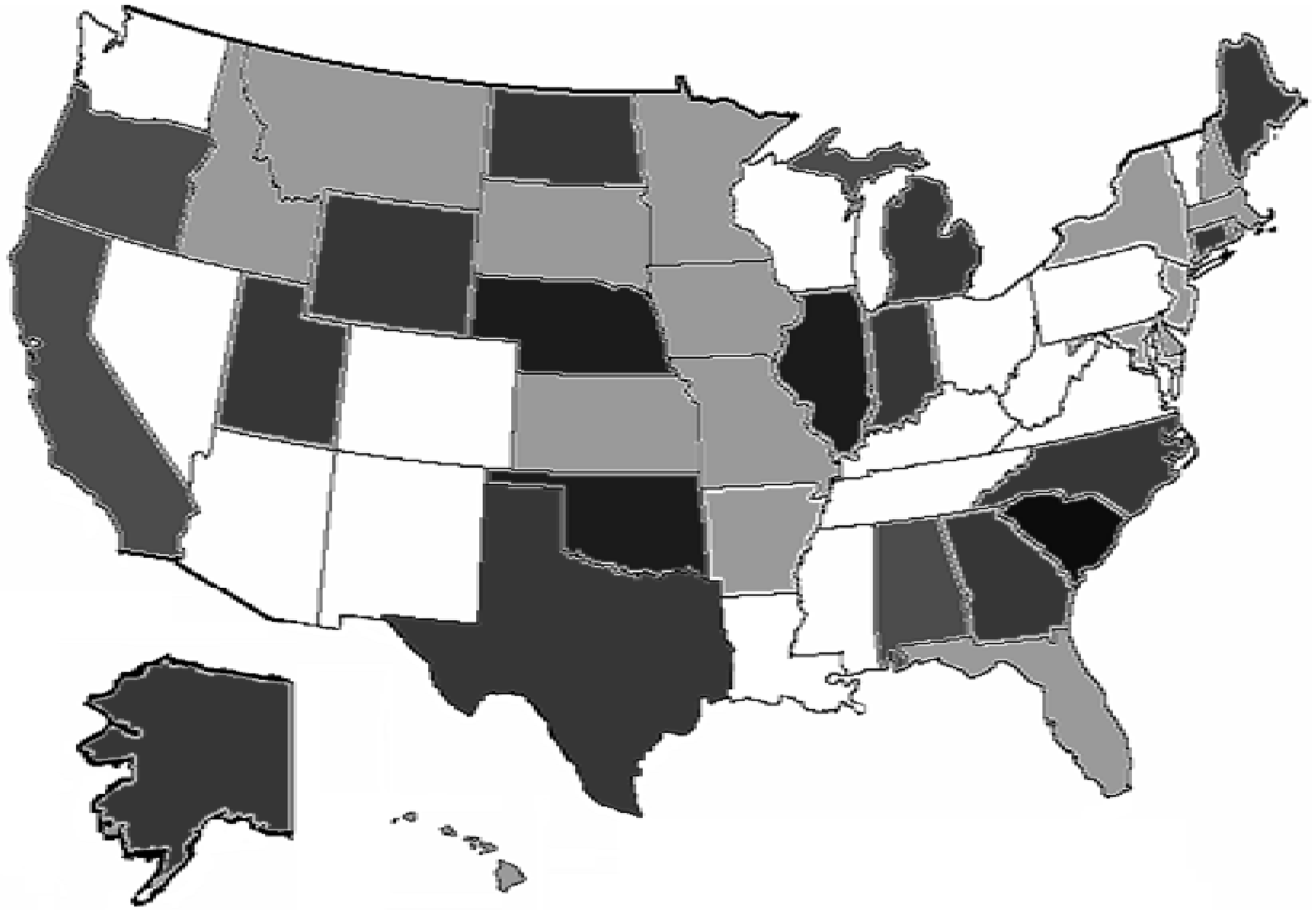
States’ Historical K-12 Funding

- During the period between FY 2000 and FY 2007, 35 states reduced funding for public education in at least one or more of those years
  - One Year: 16 states had a net decrease year over year
    - AR, DE, FL, HI, ID, IA, KS, MA, MD, MN, MO, MT, NH, NJ, NY, SD
    - Ranged from :
      - -0.2% to -0.8% = six states
      - -1.0% to -3.4% = seven states
      - -6.4% to -19.7% = three states
  - Two Years: 15 states had decreased funding in two of the seven years
    - AL, AK, CA, CO, GA, IN, MA, MI, NC, ND, OR, RI, TX, WY, UT
    - Two years’ average ranged from:
      - -1.4% to -2.9% = six states
      - -3.1% to -6.1% = five states
      - -7.4% to -17.5% = four states

States' Historical K-12 Funding

- Three Years: three states had decreased funding in three of the seven years
  - Nebraska averaged -0.5% reduction
  - Oklahoma averaged -2.4% reduction
  - Illinois averaged -4.3% reduction
- 1 state, South Carolina, had decreased funding in four of the seven year-to-year comparisons
  - Annual reductions ranged from -0.1% to -3.9%
- Additional details of some individual state reductions are included in the appendix

States with an Annual Decrease, for Year-to-Year Comparisons, in Funding to Public Education



FY 2000 to FY 2007

- 16 States: decreased funding in 1 of the year-to-year comparison
- 15 States: decreased funding in 2 of the year-to-year comparisons
- 3 States: decreased funding in 3 of the year-to-year comparisons
- 1 State: decreased funding in 4 of the year-to-year comparisons

Data Source: National Center for Educational Statistics

Funding Reductions Take Two Pathways

K-12 funding reductions are either:

- Temporary, with the assumption that as the economy improves, increased revenues will allow things to return to normal; or
- The changes are designed to structurally change funding allocations, improve efficiency, and reduce waste to meet long term budgetary constraints

Summary of One-time Reductions Actions Taken

One-time Actions:	Alabama	Alaska	Connecticut	Florida	Georgia	Illinois	Indiana	Massachusetts	Michigan	Minnesota	Nebraska	North Carolina	Oklahoma	Oregon	Rhode Island	South Carolina	Texas
Reduced state's basic aid funding formula - per pupil amount	✔	✔	✔	✔	✔	✔		✔	✔	✔	✔	✔		✔	✔		✔
Reduced non-mandatory programs: PreK or early childhood	✔	✔	✔	✔	✔			✔		✔	✔					✔	✔
Implemented personnel or hiring freeze			✔	✔	✔							✔	✔	✔	✔		
Eased mandatory or prescriptive polices (allowed more flexibility)				✔	✔			✔		✔	✔			✔		✔	
Used School Divisions' Year End Balances		✔	✔				✔		✔		✔		✔				✔
Across-the-board cuts to non-mandatory discretionary spending	✔				✔	✔			✔			✔					✔
Reduced administrative non-instructional costs	✔			✔								✔		✔			✔
Delayed capital projects	✔		✔			✔						✔					
Transportation costs: consolidated routes, reduced fleet, reduced maintenance supply inventory	✔							✔			✔	✔					
Used Public Education Rainy Day Fund	✔					✔											✔
Held payments to localities until next fiscal year							✔			✔							✔
Lowered inflation rates used in funding formulas										✔		✔					
No salary increases / adjustments					✔											✔	
Reduced technology / equipment initiatives						✔										✔	
Eliminated incentive pay, mentoring, overtime, unused vacation/ sick time												✔					

Summary of Ongoing Structural Changes

- Several states continued funding methodology changes that resulted in on-going budget reductions – HI, NH, AR, MD, NJ, ME
  - Changes to the state's basic aid funding formula was most common
  - Caps on locality's millage tax rate - which limited potential revenue growth and consequently limited expenditure growth

FY 2009 States' Budget Actions

- The Center on Budget and Policy Priorities reported earlier this year that at least 15 states are cutting K-12 funding in FY 2009
  - **Maryland** - cutting funding for its school breakfast pilot program, professional development for administrative staff, health clinics in schools, gifted and talented summer centers, and math and science initiatives
  - **Georgia** - cutting the state's education aid by $99 per pupil
  - **Florida** - cutting the state's basic aid amount by an estimated $130 per student
  - **Rhode Island** - level funding state aid at last year's amounts, and limited the number of student slots in Pre-K programs (eliminating early childhood funding for 550 four-year-olds)
  - **California** – reducing basic K-12 education aid, and a variety of other programs such as adult literacy instruction

FY 2009 States' Budget Actions

- **Massachusetts** - reducing funding for a number of early care programs such as Head Start, universal Pre-K, early intervention services for special education
- **Nevada** - across-the-board cuts, delaying implementation of a full-day kindergarten program expansion; eliminated funding for gifted and talented programs and for a magnet program for special needs students
- State funding also has been cut in **Alabama, Delaware, Connecticut, Kentucky, Maine, Ohio, South Carolina, and Utah**

Economic Slowdown is Impacting Most States
Which Pathway Will Virginia Take?

- Despite Virginia's revenue shortfall in FY 2009, funding for public education has been spared so far this year
- However, in FY 2010, all areas of the state's budget are being reviewed and targeted for reductions – including public education
- With that in mind: will Virginia's budgetary actions be:
  - Only temporary and one-time in nature, which may potentially lead the state back to similar situation during the next recessionary period, or:
  - Will the actions be systemic, with structural changes that will be designed as long-term

Appendix of Selected States' Actions in K-12

Summary Table of States with Year-to-Year Net Funding Reductions for Public Education

	Alabama	Alaska	Arkansas	California	Connecticut	Delaware	Florida	Georgia	Hawaii	Idaho	Illinois	Indiana	Iowa	Kansas	Maine	Maryland	Massachusetts	Michigan	Minnesota	Missouri	Montana	Nebraska	New Hampshire	New Jersey	New York	North Carolina	North Dakota	Oklahoma	Oregon	Rhode Island	South Carolina	South Dakota	Texas	Utah	Wyoming	Total
FY00 to FY01	✔	✔																				✔					✔								✔	**5**
FY01 to FY02				✔		✔	✔					✔														✔		✔			✔					**7**
FY02 to FY03	✔				✔					✔											✔	✔				✔		✔	✔		✔	✔		✔		**11**
FY03 to FY04				✔				✔	✔				✔	✔	✔		✔	✔	✔	✔		✔									✔		✔			**13**
FY04 to FY05											✔							✔					✔						✔	✔			✔			**6**
FY05 to FY06											✔																								✔	**2**
FY06 to FY07		✔	✔		✔			✔			✔	✔			✔	✔								✔	✔		✔	✔		✔	✔			✔		**15**

Highlights of State Budget Reductions

- North Carolina: two consecutive years of reductions
  - ($139.0) million, or 2.3% reduction from FY 2001 to FY 2002
  - ($29.4) million, or 0.5% reduction from FY 2002 to FY 2003
    - Reduced non-instructional support personnel by 3.3%
    - Decreased number of assistant principal positions
    - Level funded administrative costs in funding formula
    - Decreased inflation rate applied to classroom materials, supplies and equipment to be in line with Consumer Price Index rather than estimated growth factor
    - Reallocated corporate tax revenues from Public School Building Capital Fund into Public School Fund to offset operational costs
    - Implemented a lease/purchase process for payment of school buses
    - Reduced transportation supply inventory
    - Local education agency discretionary reduction (across the board)
    - Reduced additional pay incentives – restricted mentor teachers for only first & second year new instructional personnel
    - Eliminated pay for unused vacation time in excess of 30 days for teachers

Highlights of State Budget Reductions

- South Carolina: four years of reductions, of which three years were concurrent
  - ($72.1) million, or 2.5% reduction from FY01 to FY02
  - ($111.0) million, or 3.9% reduction from FY02 to FY03
  - ($4.1) million, or 0.1% reduction from FY03 to FY04
  - ($71.8) million, or 2.4% reduction from FY06 to FY07
    - Decreased the basic student cost amount funded in formula
    - Decreased K-12 technology initiative
    - Decreased transfer for Continuum of Care program
    - Developed flexibility guideline procedures for localities

Highlights of State Budget Reductions

- Georgia:
  - ($139.1) million, or 2.1% reduction from FY 2003 to FY 2004
  - ($53.2) million, or 0.7% reduction from FY 2006 to FY 2007
    - Quality Basic Education (QBE) funding formula component amounts were reduced for media materials, equipment, and operating costs
    - No pay increases funded
    - Froze changes to class-size reduction initiative for K-8 grades
    - ‘Austerity’ reductions (across-the-board)
      - Based percentage of reduction to ‘mil’ rate charged by locality
        - If locality charged 5 mils - the minimum rate required – then state maximized the reduction percentage
        - If locality charged 20 mils – the maximum rate allowed – then state made minimum reductions

Highlights of State Budget Reductions

- Florida:
  - ($588.2) million, or 6.4% reduction from FY 2001 to FY 2002
    - Reduced the per pupil amount calculated in the state's funding formula: Florida Education Funding Program
    - Reduced allocations from other state agencies, such as health care services

Highlights of State Budget Reductions

- Texas: two consecutive years of decreases
  - Budget crisis in FY 2003 – projected a $1.0 billion revenue shortfall for K-12 over the next biennial budget
  - ($468.5) million, or 3.3% reduction from FY 2003 to FY 2004
  - ($463.4) million, or 3.4% reduction from FY 2004 to FY 2005
    - Accounting entry change: held final state aid payment to localities until the next fiscal year
    - Level funded basic aid per pupil amounts
    - Made across-the-board reductions to some programs
    - Captured year-end fund balances from wealthy localities and redistributed to poorer localities
    - Utilized a portion of the Public Education Rainy Day Fund (NGF) to help close revenue shortfall

Highlights of State Budget Reductions

- Oklahoma: three years of reductions, of which two years were concurrent
  - ($43.8) million, or 1.8% reduction from FY 2001 to FY 2002
  - ($65.1) million, or 2.8% reduction from FY 2002 to FY 2003
  - ($68.2) million, or 2.6% reduction from FY 2006 to FY 2007
    - 7 months into the FY 2002– revenue shortfalls necessitated the need to prorate K-12 funding
      - Many localities used fund balances
      - Were not allowed to borrow money – (precluded by law)
      - Many localities ended the year in a deficit
        - State law allows localities to spend up to appropriation amounts regardless of revenues received
        - Those that did end year with deficits filed judgments against the state to collect the revenue balance
    - Reduction of force
      - Combined job responsibilities
    - County excise community
      - Revenues from 35 mils 1/10 of a penny are deposited into the schools' general operating fund
      - Revenues from an additional 5 mils are used for school related capital projects
        - Voters can opt to pass a bond note for additional revenue
      - 90% of prior year collections as a guide with a mid-year adjustment
    - Growth production in Oil & Gas - optional local taxes dedicated to schools
      - Get less state money when additional revenues are generated from natural resources

Highlights of State Budget Reductions

- Nebraska: three years of reductions, of which two years were concurrent
  - ($7.0) million, or 1.0% reduction from FY 2000 to FY 2001
  - ($1.3) million, or 0.2% reduction from FY 2002 to FY 2003
  - ($4.0) million, or 0.5% reduction from FY 2003 to FY 2004
    - Level funded localities that would have received additional funding over prior year
    - Decreased base of state’s K-12 funding formula by (1.25%)
      - Tied to reduction in income tax rate by same percentage
    - Locality realized additional state reductions if it didn’t maximize its’ millage rate
    - Provided incentives for small divisions to consolidate
      - Would save operational costs in out years
    - Provided localities with more flexibilities within funding categories impacted by reductions

Highlights of State Budget Reductions

- Oregon:
  - ($339.9) million, or 12.0% reduction from FY 2002 to FY 2003
  - ($218.3) million, or 8.2% reduction from FY 2004 to FY 2005
    - Reduced state’s basic aid equalization funding formula’s per student allocation
    - Reduced central office and school level administrative costs by 15%
    - Increased average class sizes by two students in middle schools and by three students in high schools

Highlights of State Budget Reductions

- Indiana:
  - ($289.4) million, or 6.0% reduction from FY 2001 to FY 2002
  - ($67.5) million, or 1.2% reduction from FY 2006 to FY 2007
    - One-time accounting entry change – typically, state provides equal monthly allocations to localities
    - Held June allocation payment until July
    - Made up the June payment to divisions by the end of the calendar year, so divisions realized no revenue impact to their budgets
      - School divisions' fiscal year - January to December
      - State's fiscal year - July to June

Highlights of State Budget Reductions

- Michigan: two concurrent years of decreases
  - ($211.8) million, or 1.9% reduction from FY 2003 to FY 2004
  - ($103.0) million, or 1.0% reduction from FY 2004 to FY 2005
    - Prorated the per pupil allocations based on equal amount not collected from the main revenue sources dedicated to K-12 :
      - Sales Tax: 4.4 cents of the state's 6 cents
        - Bottom dropped out of car market due to recession and caused severe revenue shortfall in sales tax collections
      - Property Tax: 100% of 6 millage rate
      - Lottery Profits: 100%
    - Proration occurred mid-year based on January reforecast of revenue estimates
      - Majority of localities used fund balances to make up state's prorated revenues

Highlights of State Budget Reductions

- Minnesota:
  - ($209.5) million, or 3.4% reduction from FY 2003 to FY 2004
    - Accounting entry change – typically, state provided 90% of basic education allocations to localities by end of fiscal year and then adjusted the final 10% of payments based on student changes prior to closing accounting ledger
    - In FY 2004, state decreased the 90% allocation to 77%; held the balance of state aid payments until the next fiscal year
      - Localities on accrual basis – didn't realize state reduction
        - However did lose interest on cash accounts that would have held funds received from state
        - Localities had authority to borrow short-term bank 'Aid Anticipation' notes at very low interest rates to cover any cash flow problems
    - Capped special education growth factor in funding formula
    - Cut after-school, early childhood education and community-based education programs

Highlights of State Budget Reductions

- Connecticut:
  - ($233.7) million, or 8.1% reduction from FY 2002 to FY 2003
  - ($135.1) million, or 4.0% reduction from FY 2006 to FY 2007
    - Due to its geographical proximity to New York - economy was heavily impacted by 9/11 tragedy
      - Largest hedge fund capitol of the world and experienced heavy revenue losses due to the resulting downturn in Wall Street & stock market
    - Changed the Education Cost Sharing Funding Formula – capped per pupil amounts
    - Level funded allocations at the prior year's amount for school divisions
    - General Assembly passed a mid-year income tax increase and cut funding to school divisions at the same time
      - School divisions issued short-term five year notes to offset reductions from state

Highlights of State Budget Reductions

- Illinois: three concurrent years of decreases
  - ($156.9) million, or 2.3% reduction from FY 2004 to FY 2005
  - ($138.8) million, or 2.1% reduction from FY 2005 to FY 2006
  - ($693.3) million, or 10.5% reduction from FY 2006 to FY 2007
    - Teacher Retirement Pension funding
    - Hold Harmless basic aid allocations
    - School Infrastructure funding
    - Driver Education initiative
    - Fast Growth District supplements
    - School Technology Revolving Loan program
    - Emergency Financial Assistance Fund
- Rhode Island:
  - ($41.5) million, or 5.4% reduction from FY 2004 to FY 2005
  - ($248.2) million, or 29.5% reduction from FY 2006 to FY 2007
    - Froze state's funding basic aid formula from FY 2005 through current year
- Alabama:
  - ($122.6) million, or 4.1% reduction from FY 2000 to FY 2001
  - ($44.0) million, or 1.5% reduction from FY 2002 to FY 2003

Highlights of State Budget Reductions

- California:
  - ($354.2) million, or 1.1% reduction from FY 2001 to FY 2002
  - ($1,539.6) million, or 4.6% reduction from FY 2003 to FY 2004
- Alaska:
  - ($18.8) million, or 2.3% reduction from FY 2000 to FY 2001
  - ($149.9) million, or 14.9% reduction from FY 2006 to FY 2007
- Utah:
  - ($67.5) million, or 3.9% reduction from FY 2002 to FY 2003
  - ($40.8) million, or 2.2% reduction from FY 2006 to FY 2007
- Wyoming:
  - ($5.3) million, or 1.3% reduction from FY 2000 to FY 2001
  - ($78.6) million, or 13.4% reduction from FY 2005 to FY 2006
- Maine:
  - ($6.2) million, or 0.7% reduction from FY 2003 to FY 2004
  - ($37.6) million, or 3.7% reduction from FY 2006 to FY 2007
- North Dakota:
  - ($2.2) million, or 0.7% reduction from FY 2000 to FY 2001
  - ($22.9) million, or 6.6% reduction from FY 2006 to FY 2007

Highlights of State Budget Reductions

- New Jersey: ($1,895.4) million, or 19.7% reduction from FY06 to FY07
- New York: ($213.9) million, or 1.1% reduction from FY06 to FY07
- New Hampshire: ($89.3) million, or 9.2% reduction from FY04 to FY05
- Massachusetts: ($88.9) million, or 1.8% reduction from FY03 to FY04
- Maryland: ($87.2) million, or 2.1% reduction from FY06 to FY07
- Missouri: ($22.9) million, or 0.8% reduction from FY03 to FY04
- Iowa: ($21.3) million, or 1.1% reduction from FY03 to FY04
- Hawaii: ($18.8) million, or 1.0% reduction from FY03 to FY04
- Arkansas: ($11.3) million, or 0.5% reduction from FY06 to FY07
- South Dakota: ($10.5) million, or 3.1% reduction from FY02 to FY03
- Kansas: ($4.3) million, 0.2% reduction from FY03 to FY04
- Idaho: ($3.0) million, or 0.3% reduction from FY02 to FY03
- Montana: ($1.3) million, or 0.2% reduction from FY02 to FY03
- Delaware: ($1.2) million, or 0.2% reduction from FY01 to FY02