



2017 Session Revenue and Budget Outlook

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2017 Session Revenue Forecast and Budget Outlook

- What are Key Economic Indicators Saying?
- Growing Disconnect Between Job Growth and Payroll Withholding
- FY 2016 Performance
- FY 2017 YTD Revenue Performance
- Revised General Fund Revenue Outlook: FY 2016-18 Biennium
- Budget Outlook: FY 2016-18 Biennium
 - FY 2017 Savings Plan
 - Additional Spending Pressures
 - FY 2018 Savings Options



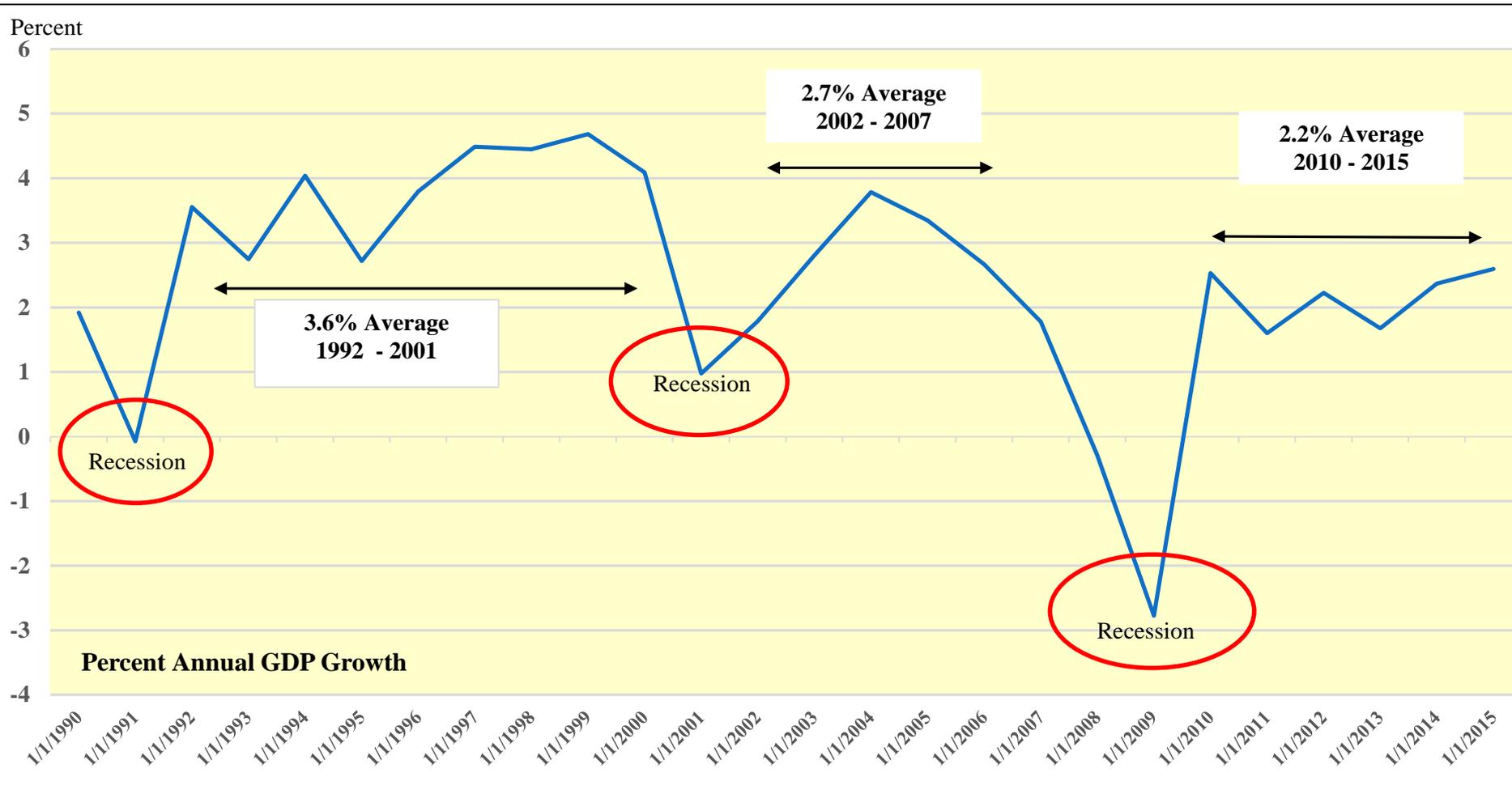
A Look at GDP, ISM Index, and National Employment



Below Trend Growth Continues

- The U.S. economy is growing, but since the end of the recession GDP growth is less than half the rate it was from 1992 to 2001, and 75% of the pace from 2002 through 2007 – a new normal?
 - Third quarter 2016 GDP grew 2.9%
- ISM's Report On Business shows the manufacturing sector growing faster in October, after contracting in August
 - New Orders, Production and Employment are growing
- U.S. Employment grew 161,000 in October, slightly below the 3 month average of 176,000. Nationally, unemployment rose to 5.0%, however, the high U6 employment rate and workforces participation rate mask the real number
- Companies continue to report record solid earnings
- Consumers are spending, but not at the same pace, somewhat unexpectedly in light of far lower gas prices
- While the housing sector continues to improve, year-over-year growth rates have slowed

Since Emerging from the Recession, the US Economy Has Downshifted...2016 Q2 GDP Registered 1.4%, Can 2016 Q3 Shift Upward?



2016 GDP Grew 2.9% in Q3, For the Year GDP Stands At 1.7%

Real GDP: Percent change from preceding quarter

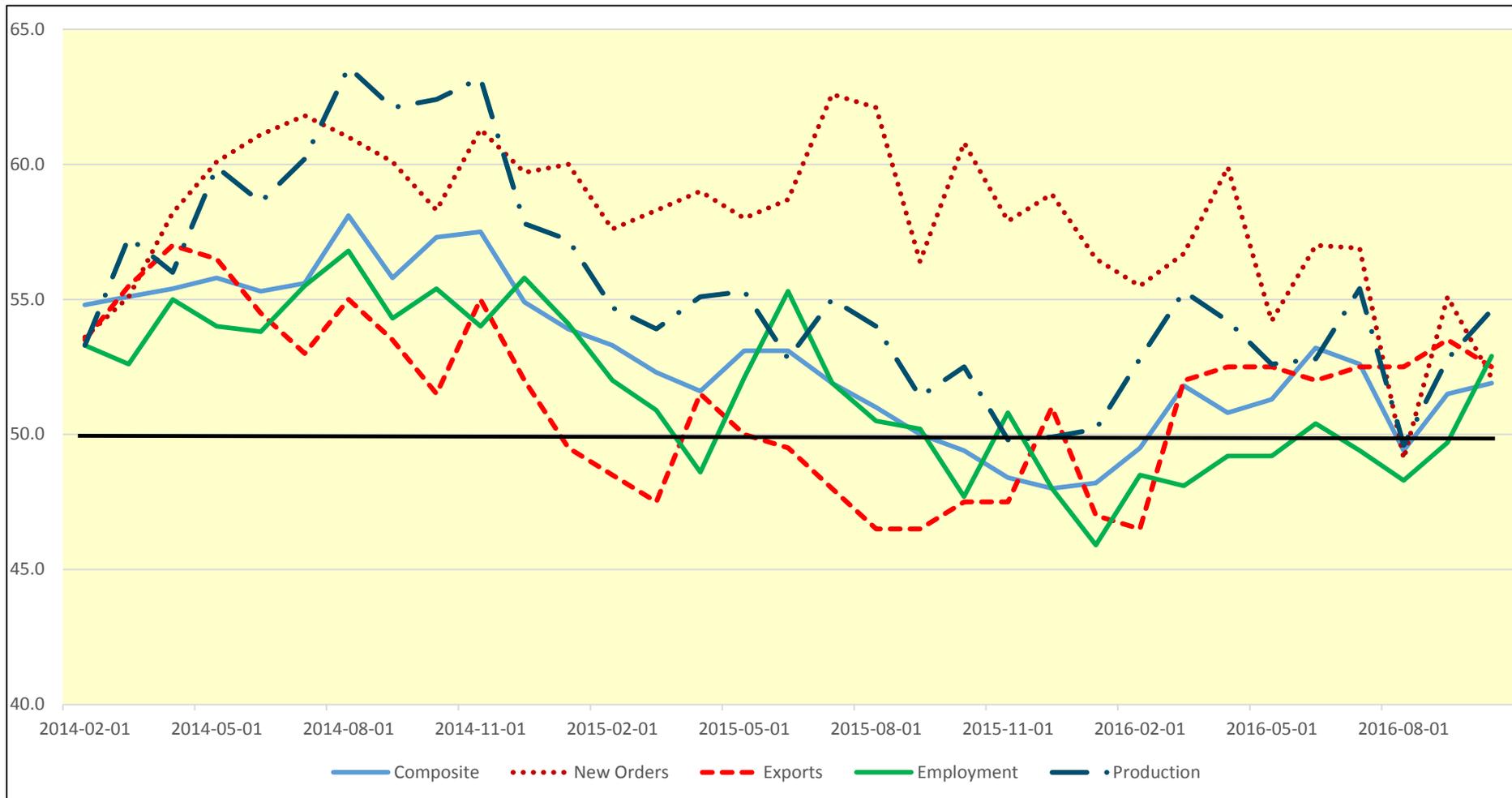


U.S. Bureau of Economic Analysis

Seasonally adjusted annual rates

- The increase in real GDP in the third quarter reflected positive contributions from personal consumption expenditures (PCE), exports, private inventory investment, federal government spending, and nonresidential fixed investment
- Exports surged 10% over the previous quarter (soybeans), while consumer spending, which accounts for two-thirds of U.S. economic activity, increased at a 2.1% rate, down from 4.3% in the second quarter
- Negatives to GDP included residential fixed investment and state and local spending

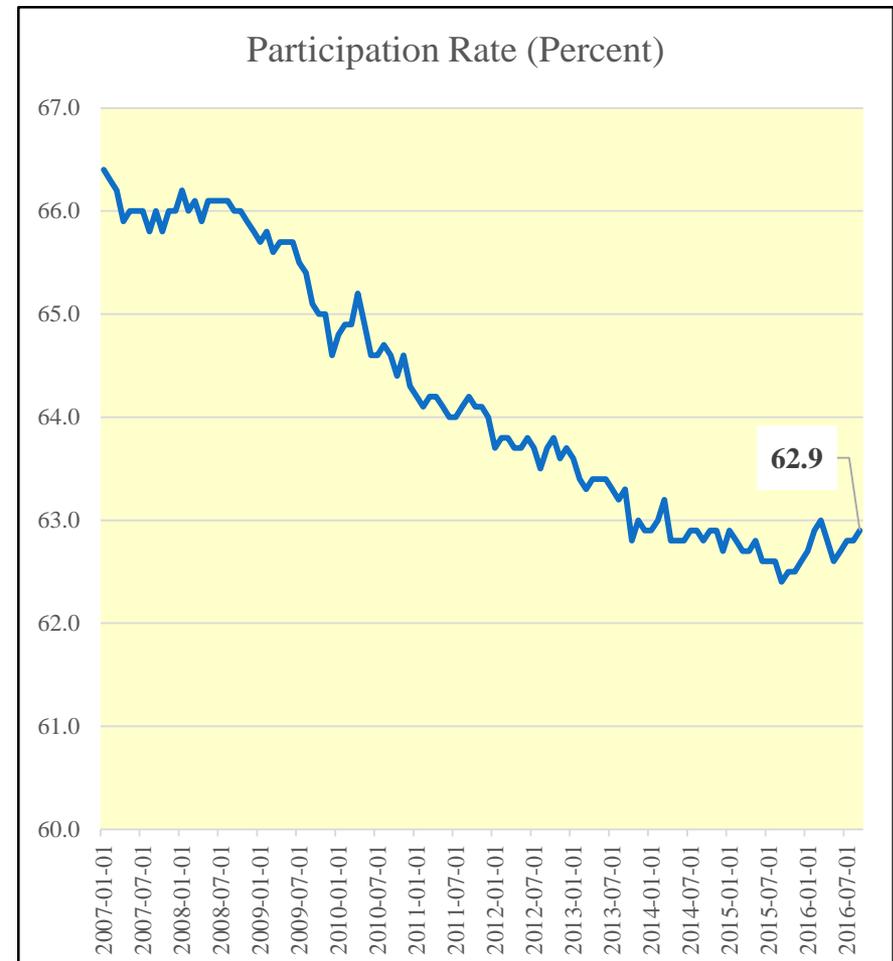
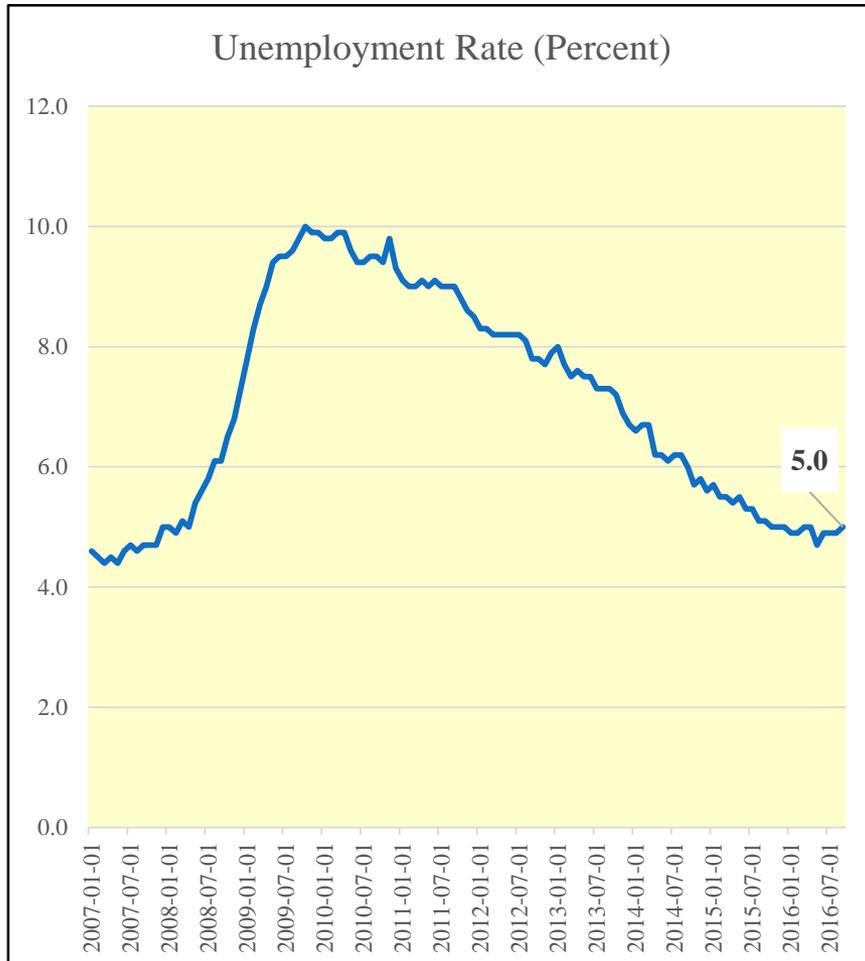
ISM Remains Above 50% with 10 of 18 Industries Reporting Growth – Employment Index Jumped to 52.9%, After Being Below 50% Since June



What Are Key Employment Indicators Showing?

- Private employers have added 15.5 million jobs to their payrolls in the 80 months since February 2010
 - Nonfarm payroll employment was 4.7 percent (6.5 million) higher in October 2016 than it was at the start of the recession
- Job creation has averaged 196,000 a month over the past 12 months, and 176,000 over the past three months. Even October's 161,000 jobs is above what's required to keep up with potential labor force growth
- Manpower's 2016 Q4 survey of 11,000 firms reveals 22% of employers expect to add workers, 6% expect to contract, and 69% of the firms plan no change in hiring
 - All four U.S. regions surveyed report a positive net employment outlook, with the South reporting an employment outlook of +18%

While the U.S. Unemployment Rate Has Dropped, The Workforce Participation Rate is Slow to Recover

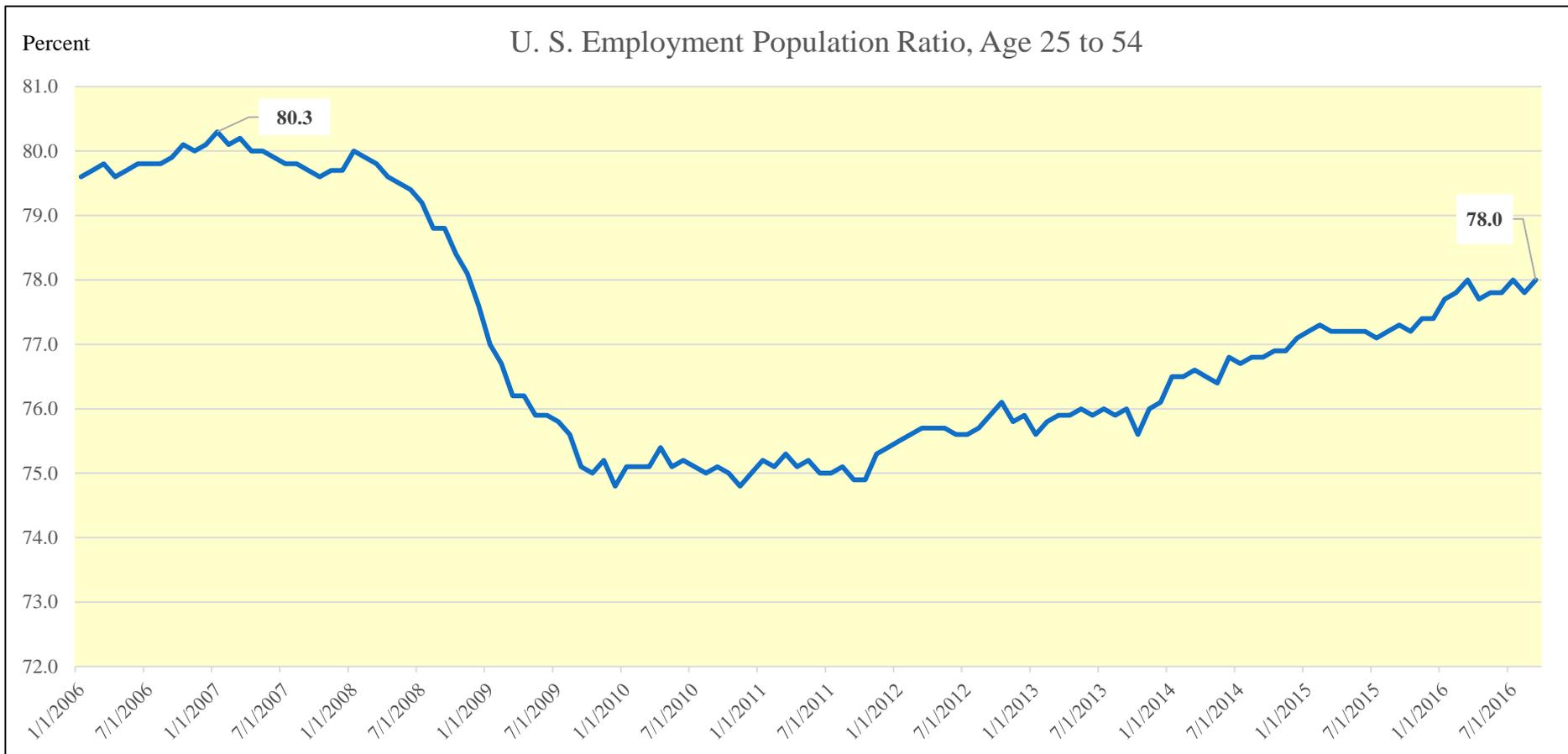


Percent Unemployed, Employed Part-Time for Economic Reasons, & Marginally Attached, All Remain Elevated at the Level of the 2001 Recession – This Dampens Wage Growth



Source: Bureau of Labor Statistics

Share of Prime Working Age Employed is 2.3% Below Pre-Recession Levels. Increase of 2.9 Million Employed Would Be Required To Reach the 2007 Peak



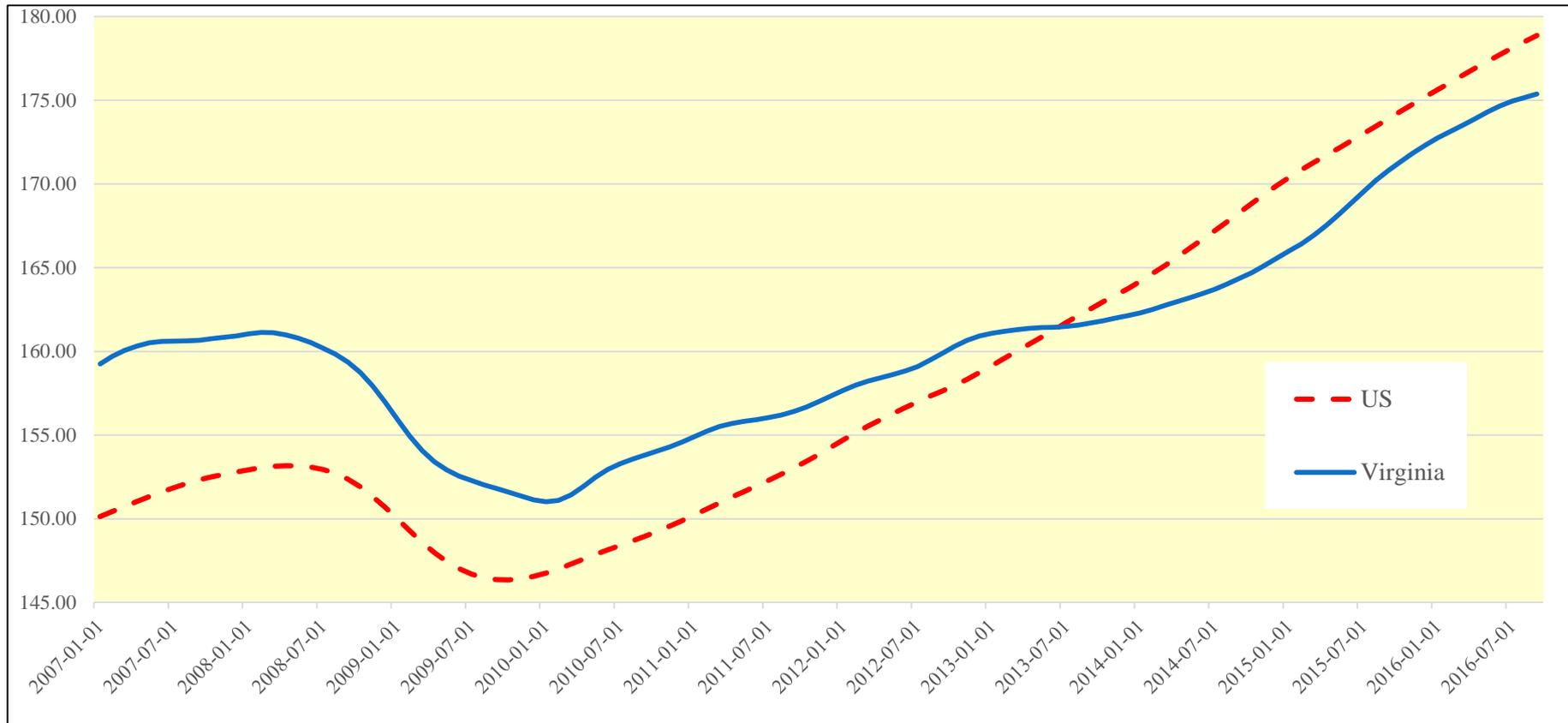
Source: Bureau of Labor Statistics



A Look at Virginia: Are We Underperforming the Nation?



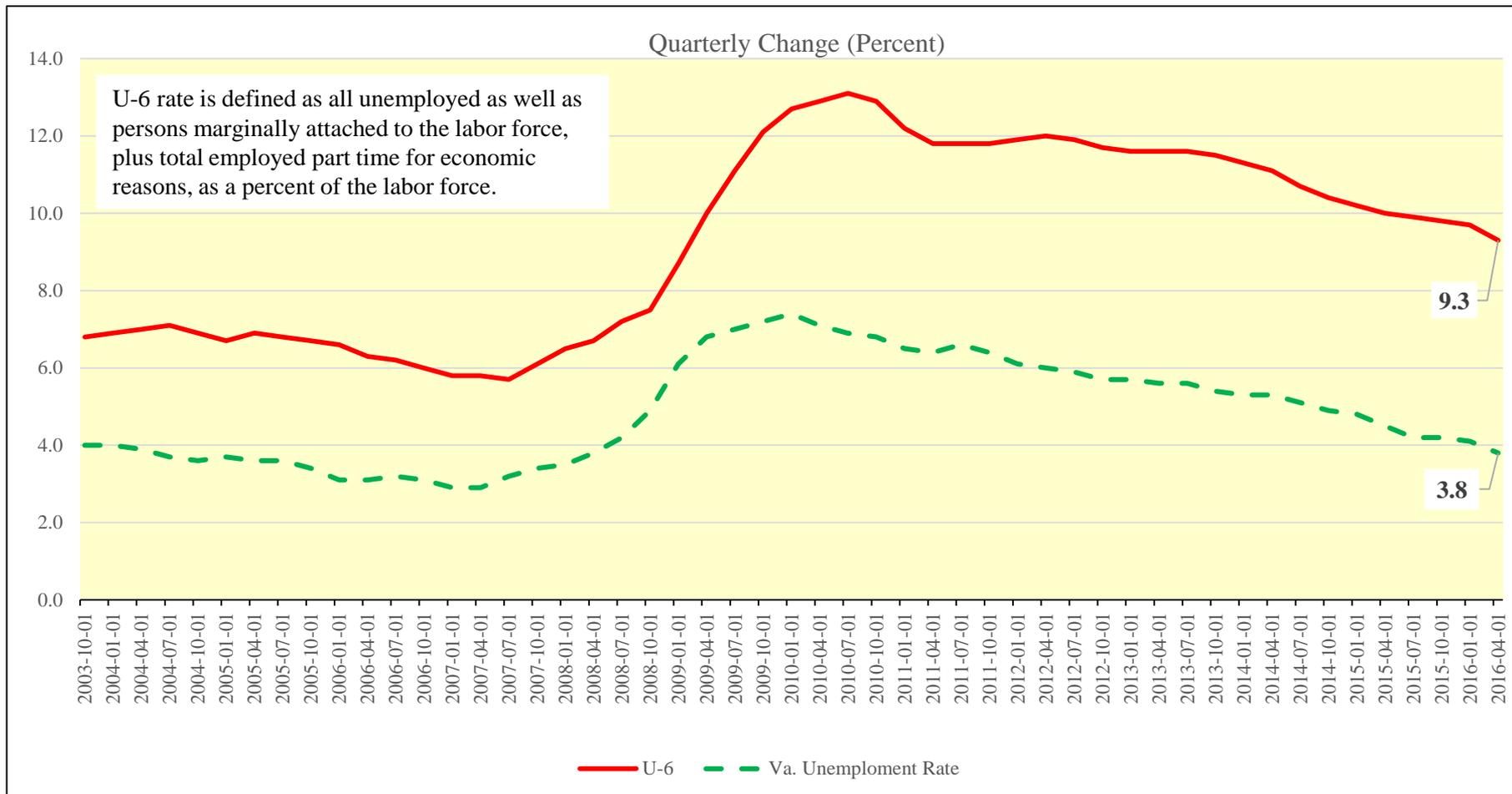
Based on Leading Indicators, Virginia Continues to Underperform the Nation, But is Improving



The Coincident Economic Activity Index includes four indicators: nonfarm payroll employment, the unemployment rate, average hours worked in manufacturing, and wages and salaries.

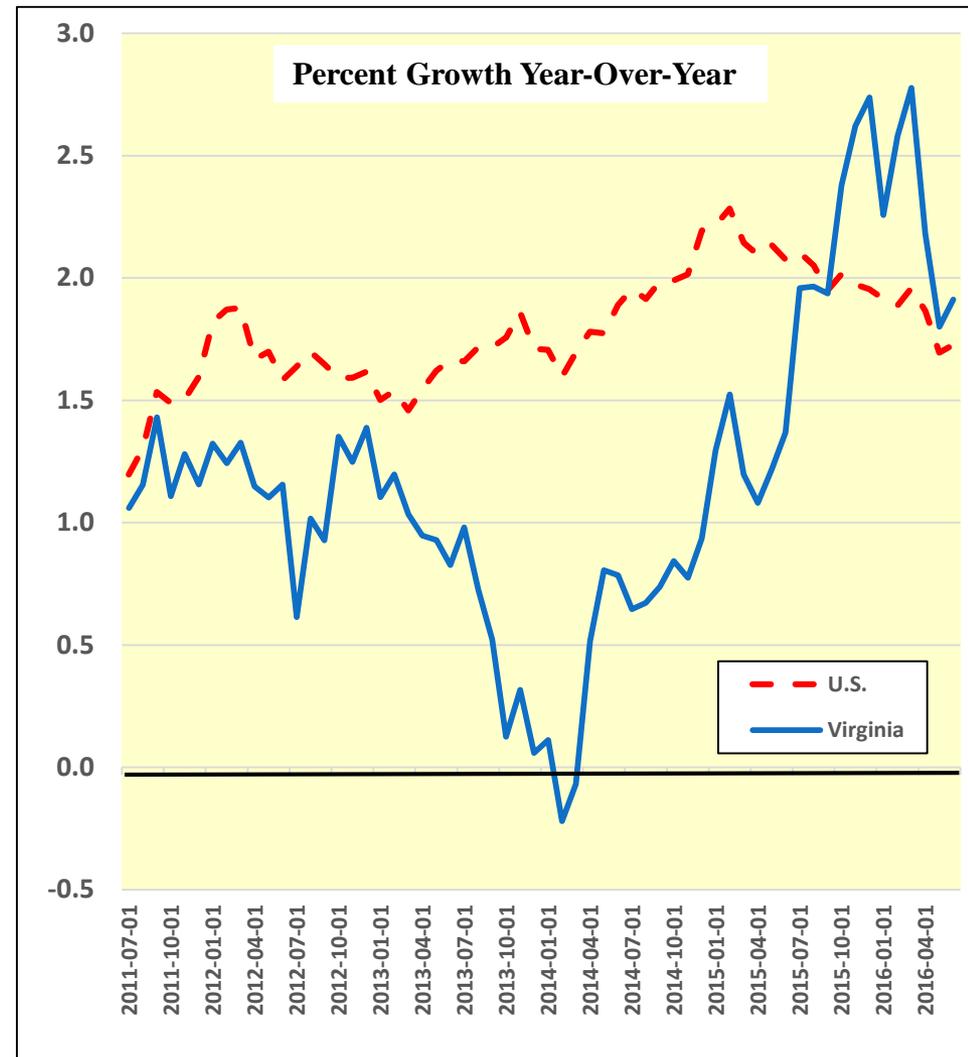
Source: Federal Reserve Bank of St. Louis.

While Virginia's Top Line Unemployment Rate Has Fallen Close to Pre-Recession Levels, the U-6 Rate Remains Elevated



Virginia's Job Growth Had Under Performed the Nation Since May 2011 Before Accelerating In October of 2015

- In the Great Recession, Virginia's job losses were not as severe as the nation's -- Virginia's loss equaled about 5.0% of total employment versus 6.3% nationally
- Initially after the recession, Virginia's economy outperformed the U.S.
- Since May 2011, Virginia's rate of job growth has been below the U.S. by 1.0%
- Virginia's job growth was only 1.0% in FY 2015, and more than doubled to 2.3% in FY 2016, well above the "official" forecast of 1.5%
- Despite Virginia's strong job's growth, payroll withholding grew 2.4% versus the forecast of 4.1% for FY 16
- Since the recession through the end of FY 2016, Virginia's employment has expanded by 259,500 jobs, however, there has been a realignment in the job mix
 - Loss in Manufacturing and Construction and gains in lower paid administrative jobs in Professional and Business Services





The Realignment of Virginia's Jobs

Construction and manufacturing jobs have been replaced by lower paying jobs

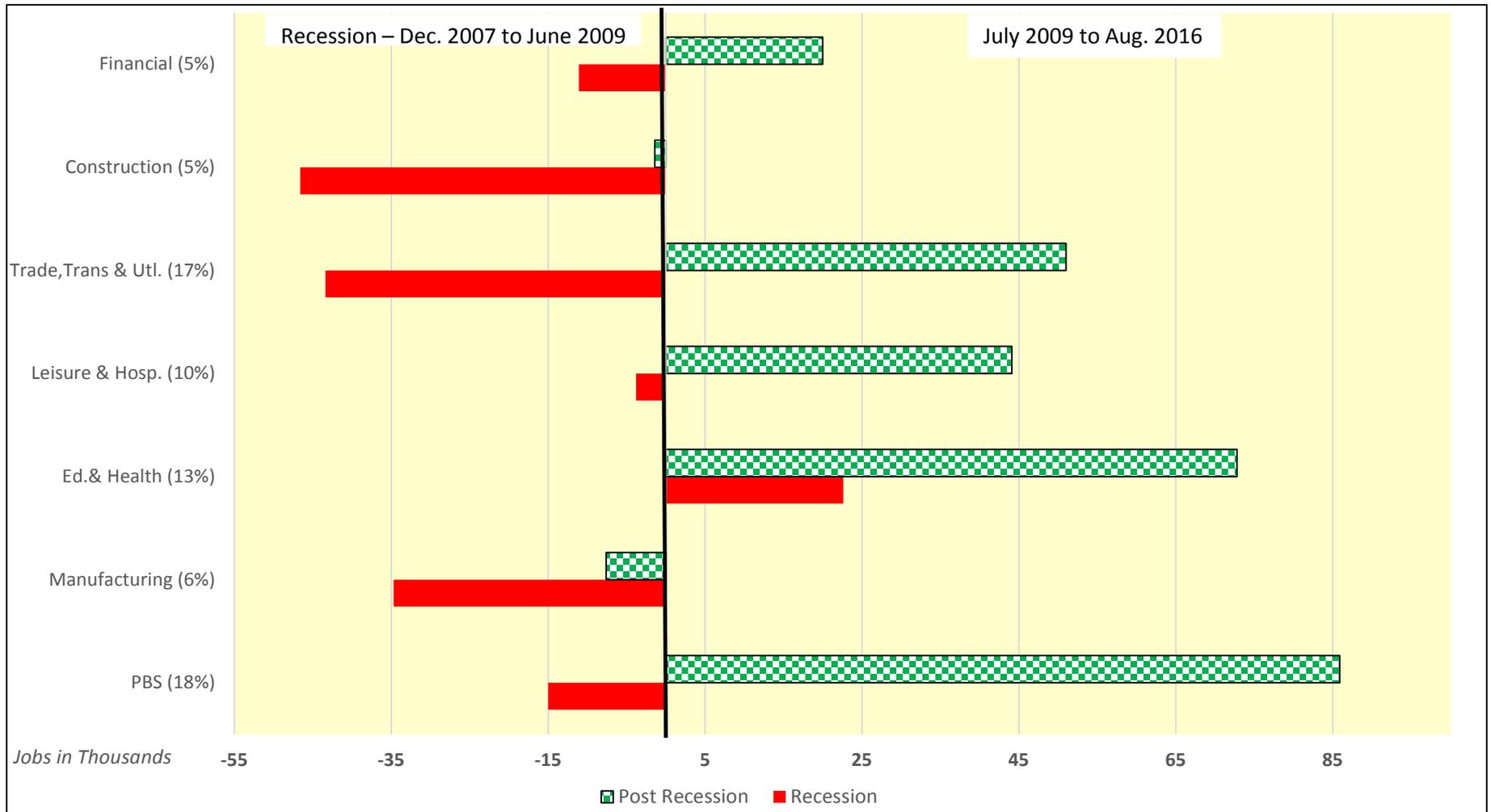


So Why Was There A Disconnect Between Job Growth and Payroll Withholding?

- Withholding taxes represents 63% of total general fund tax collections
 - Job growth and average wages and salaries serve as the proxy for withholding
 - FY 2016 forecast called for job growth of 1.5% and average wage and salaries growth of 2.6%
 - FY 2016 withholding forecasted at 4.1% growth, but grew 2.4%
- It appears several factors are influencing actual collections versus the forecast for payroll withholding:
 - Realignment in the type of jobs created
 - Growth in Professional and Business Services, which have among the highest weekly wages, has been primarily in the lower paying administrative sector
 - Anemic job growth in second half of FY 2016
 - Weakness in wage and salary growth
 - A decrease in the average weekly hours worked
 - Increase in the number of involuntary part-time workers

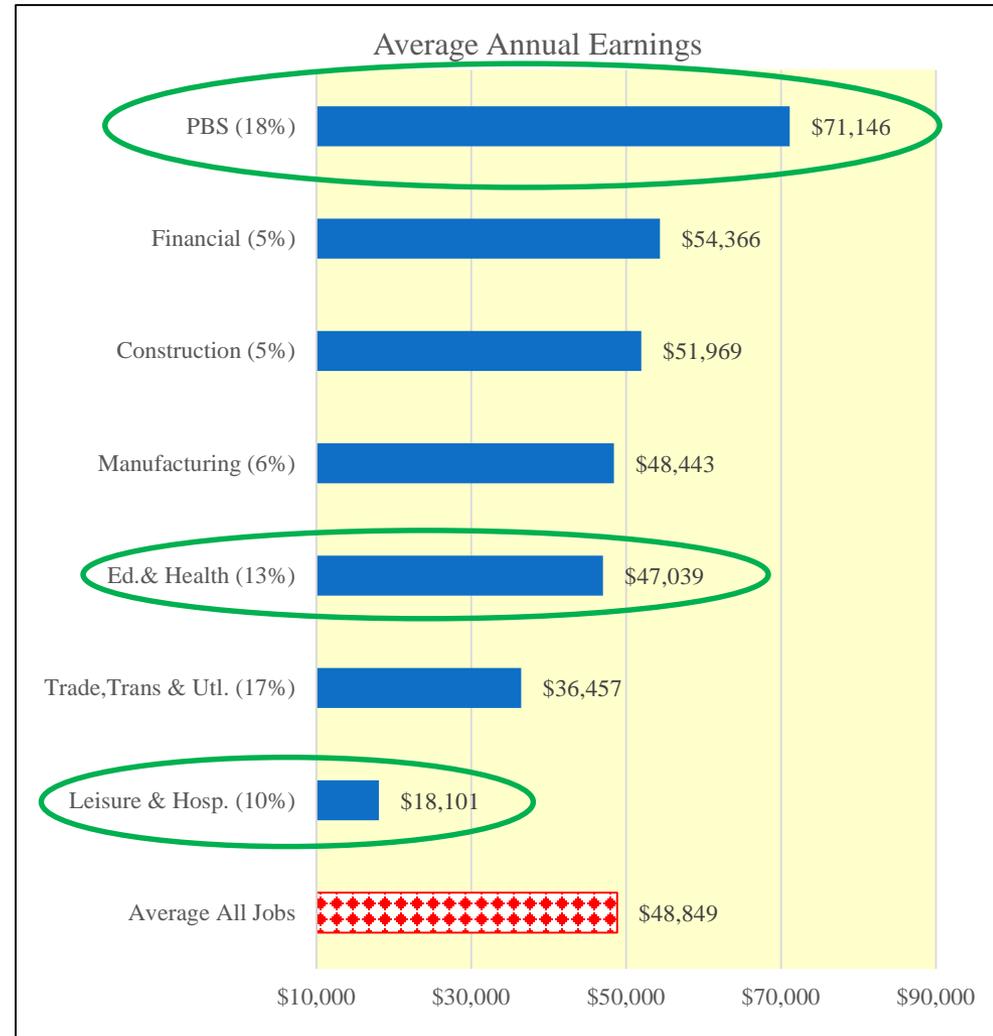
Change In Virginia Jobs

Recession versus Post Recession

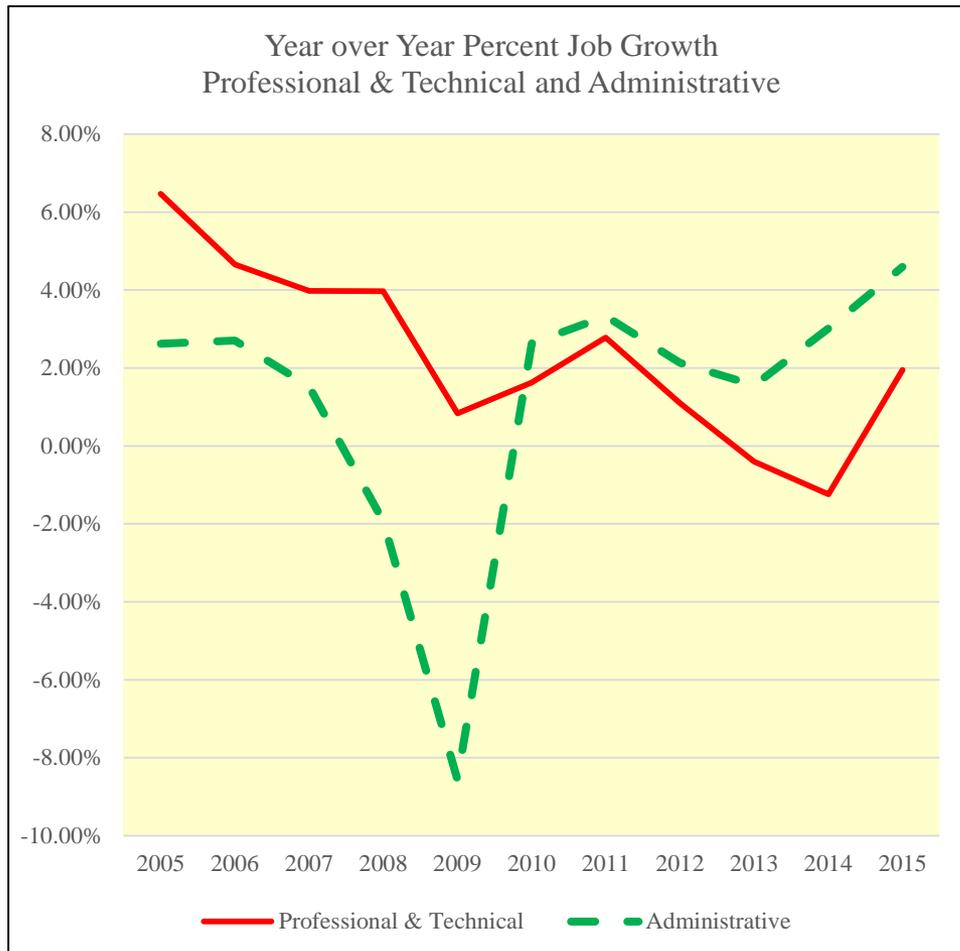


Growth In Post Recession Employment Has Been Focused on Lower Paid Sectors

- Since the recession, Virginia has shed 42,300 manufacturing jobs and 48,000 construction jobs
 - Average value of \$50,000 per year, exclusive of multiplier effect
- Post recession, Virginia has added 85,900 PBS jobs, 72,800 Education & Health, and 44,100 Leisure & Hospitality jobs
 - Growth in PBS has been at the lower Administrative jobs, as opposed to the Professional & Technical jobs that dominated growth prior to 2010
 - Health related jobs represents 83% of Ed. & Health category and accounts for 93% of job growth in that category, again job gains are focused on the lower end health care
 - It takes approximately 3 Leisure & Hospitality jobs to replace each construction and manufacturing job in terms of lost wages

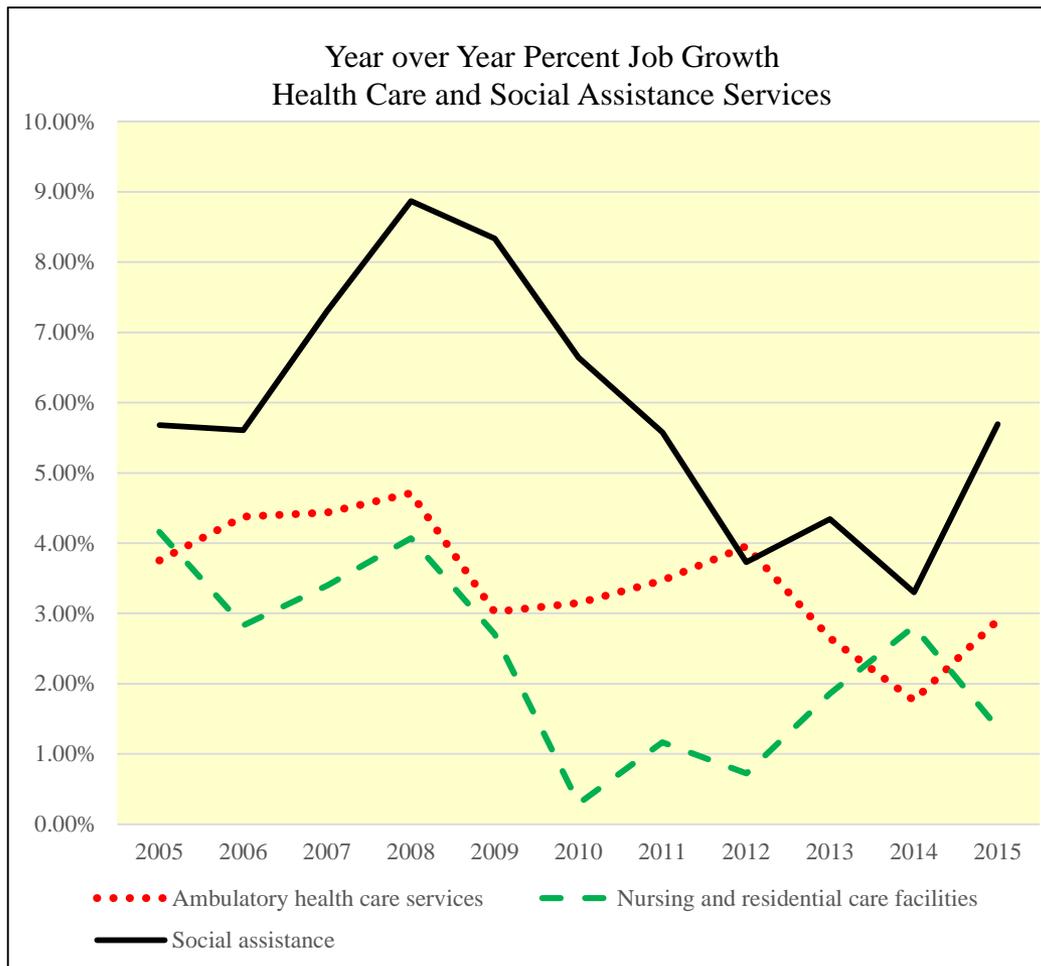


Professional & Business Services Equals 18% of Total Jobs and Accounts For 31% Of Post-Recession Job Growth. Average Earnings Are 146% Of The State Average



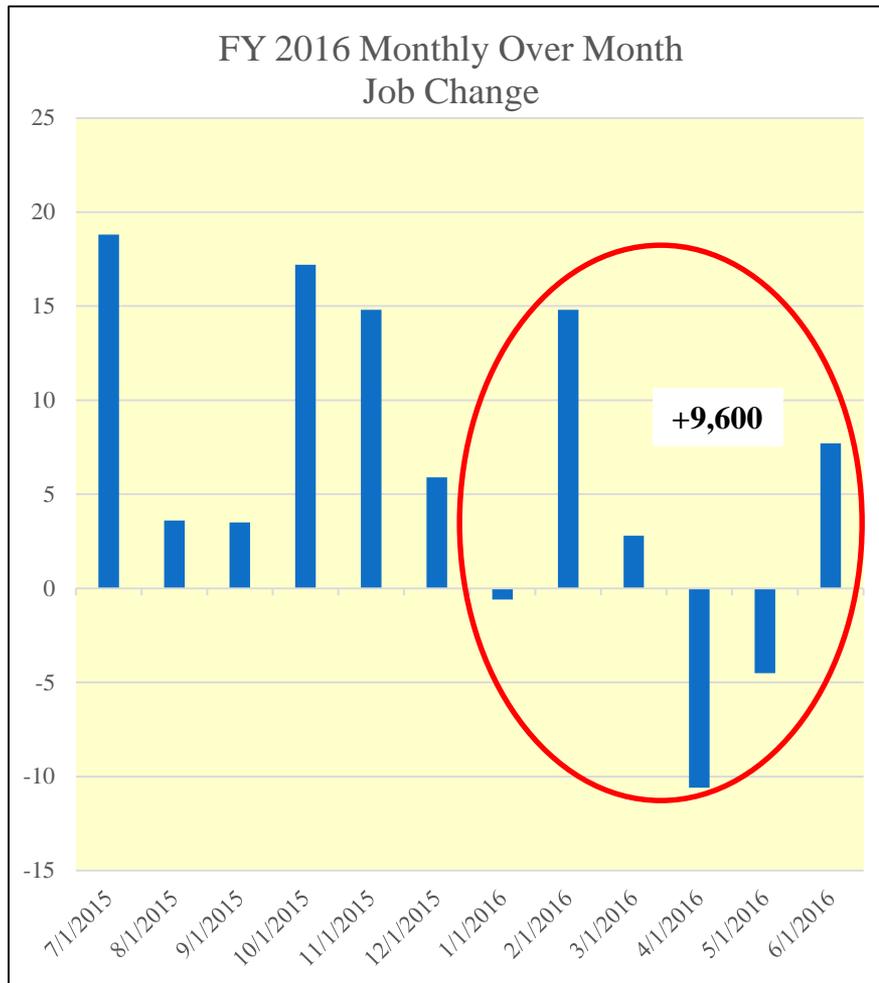
- Professional and Technical Services represents 57% of all PBS jobs with an average salary of approximately \$99,000
- Administration accounts for 32% of PBS employment with an average salary of \$38,740
- During the recession Professional & Tech Services employment fared well, while Administration shed jobs
- Since 2010, most of the growth has been in the lower paid Administrative jobs
 - 52,300 Admin jobs compared to 33,900 Profession & Technical

Education & Health Comprises 13% of Total Jobs and Accounts For 26% Of Post-Recession Job Growth



- Ambulatory Health Care Services total 39.5% of all health care related jobs with an average salary of approximately \$55,484
- Social Assistance accounts for 19% of health care related employment with an average salary of \$25,168
- Nursing and Residential Care jobs account for 18% of health related jobs with an average salary of \$29,536

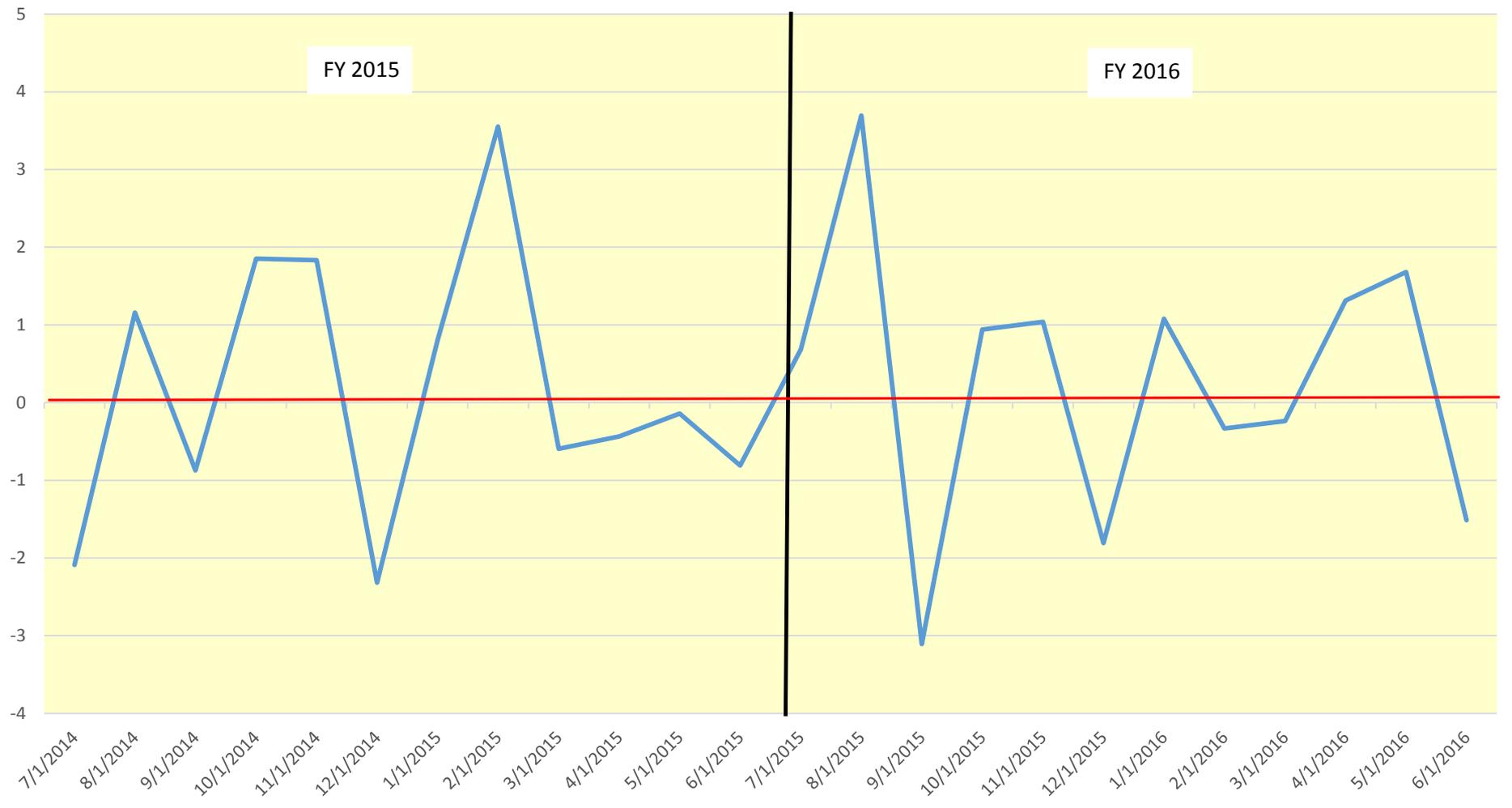
Monthly Job Growth Decelerated The Second Half Of FY 2016



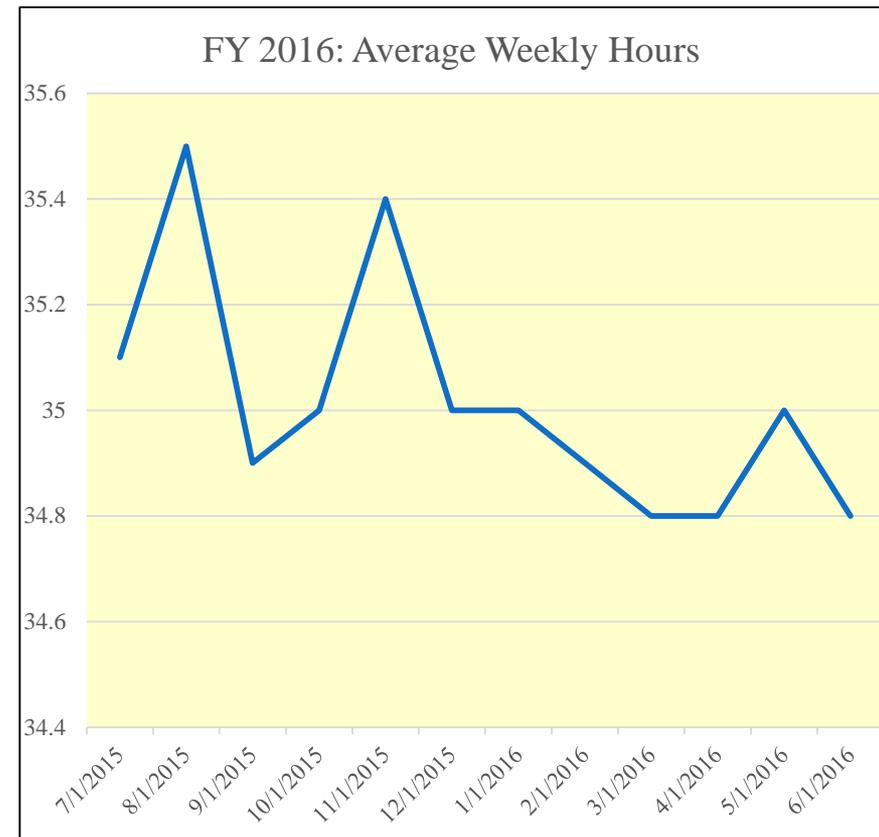
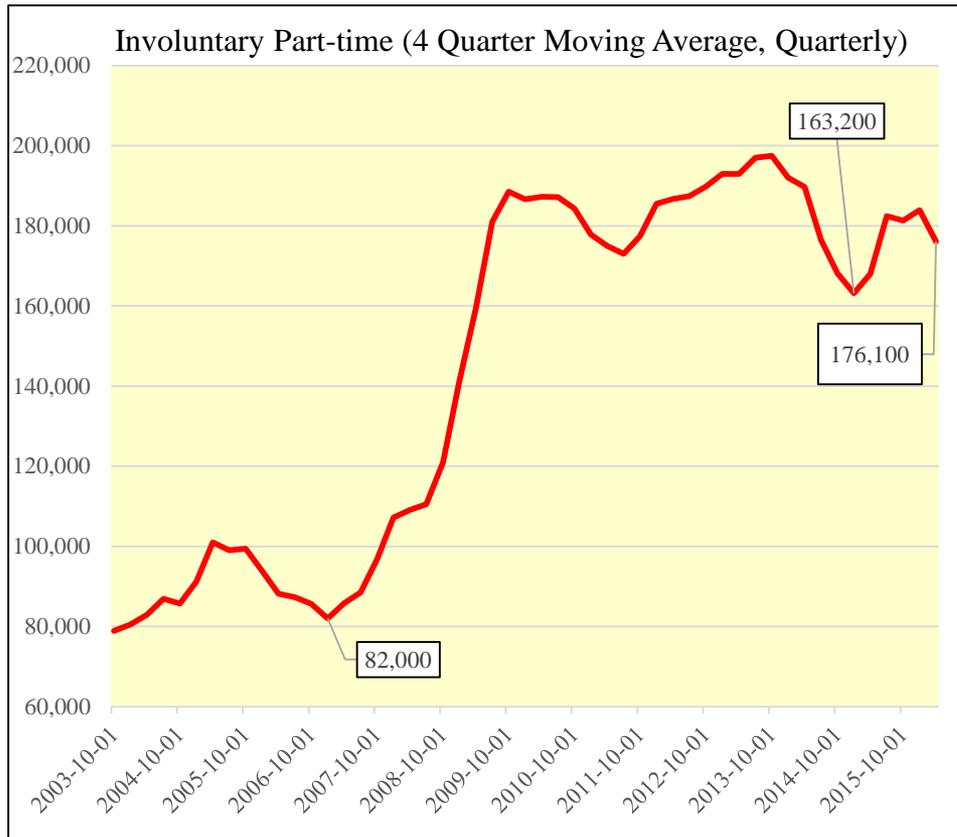
- Year over year job comparisons can give a false impression on how well the job market is performing
- While jobs grew 2.2% year over year, that figure masks the deceleration in monthly job growth
- In total, 73,400 jobs were added in FY 2016, however, 63,800 came in the first half, while in the second half Virginia added only 9,600 jobs
- 3 out of 6 months had negative monthly job growth

FY 2016 Saw Wage Growth Dampen to 2.3% Compared to 3.9% In FY 15

Month Over Month Percent Change In Average Wages

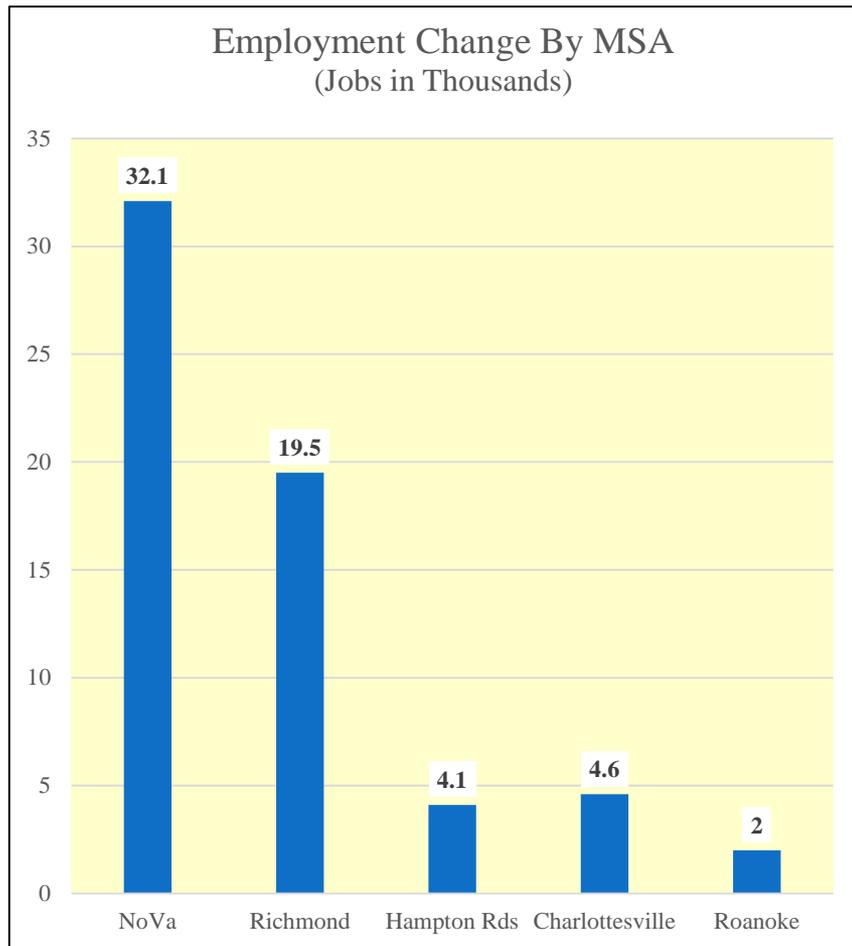


Average Work Week Has Declined, Primarily In Manufacturing and Construction. Involuntary Part-Time Employment Remains Elevated (94,100) Since The Recession, and Is Up Nearly 13,000 Since January 2015



So If FY 2016 Was Part of the
Realignment, Is FY 2017 the Reset
Year?

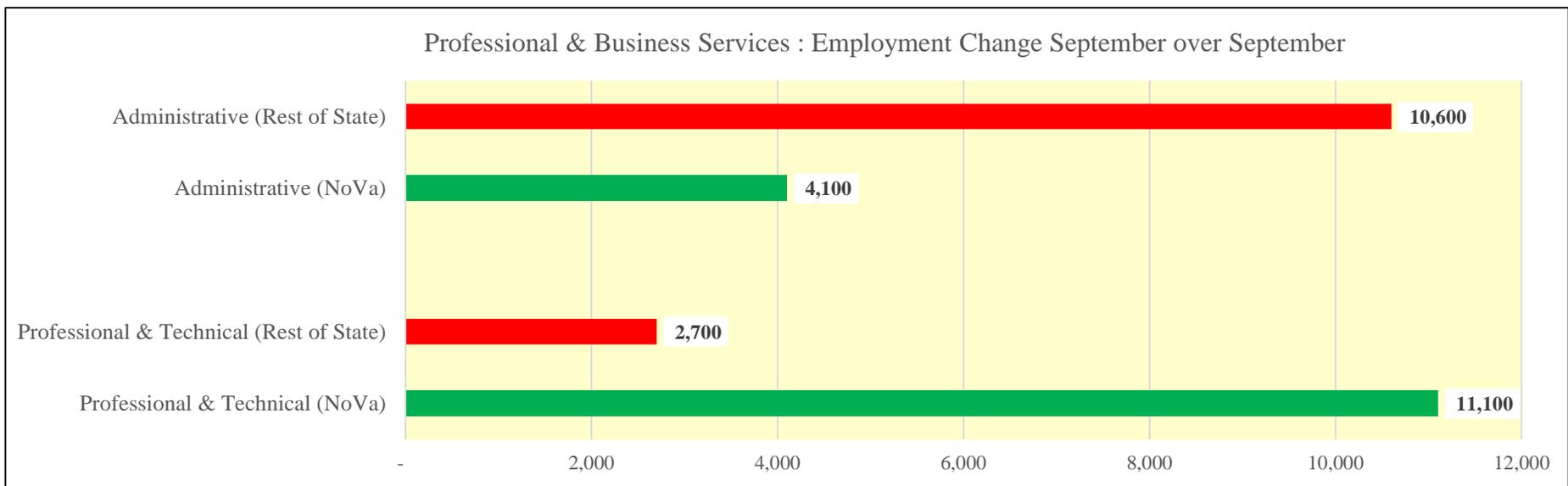
September-Over-September Virginia Added 81,100 More Jobs



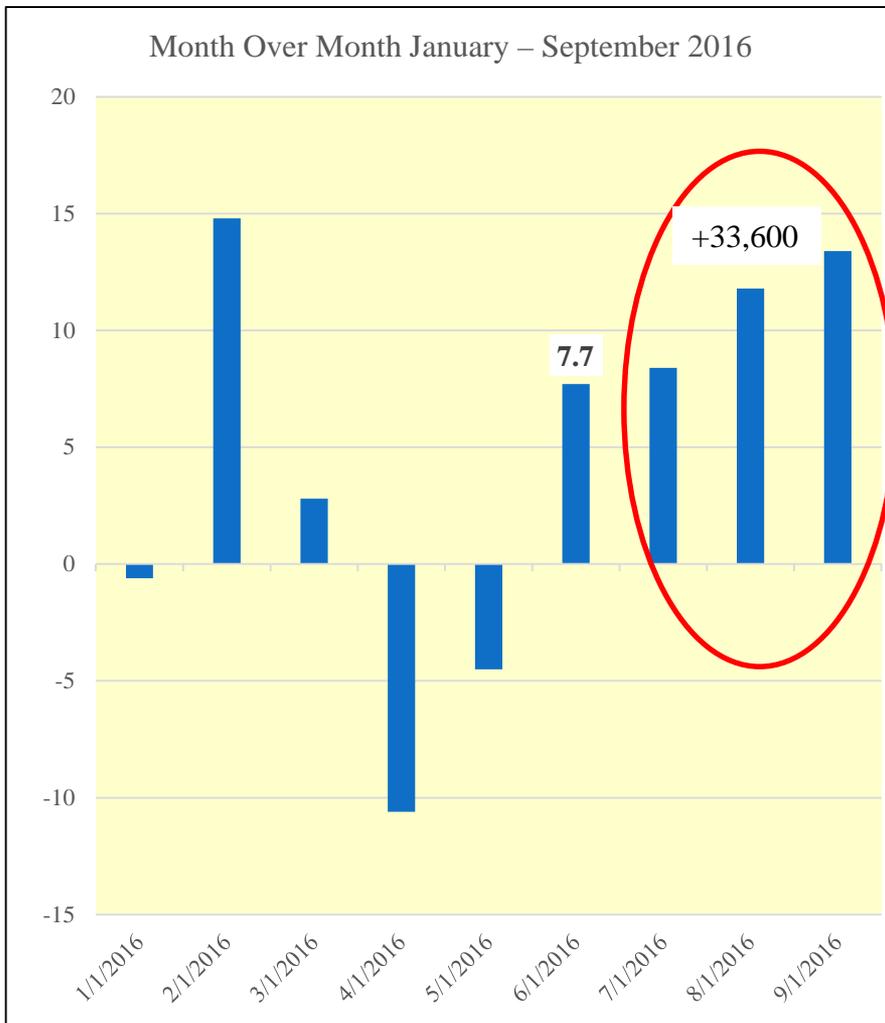
- Professional and Business Services accounted for 36% of Virginia's job growth. Trade, Transportation and Utilities accounted for 23% and Education and Health 21.6%
- Northern Virginia accounts for 36.5% of Virginia's total employment, however they gained 39.6% or 32,100 of the new jobs in the September-over-September period
- 55% of all PBS employment is in NoVa
 - It accounted for 60% of NoVa's job gains

Professional & Business Services

- Professional and Business Services represent 18.5% of Virginia's employment, but accounts for 28% of Northern Virginia's employment
- Two largest categories are Professional and Technical Services and Administration
- The state average annual salary for Professional & Business Services is \$71,146, which is 46% greater than the statewide average salary
 - Professional and Technical Services: \$99,000 statewide average salary
 - Administrative Services: \$38,740 statewide average salary
- Northern Virginia salaries are approximately 30% greater than the statewide average
- Northern Virginia accounts for 67% of all Professional and Technical jobs
 - Accounts for 39% of all Admin jobs

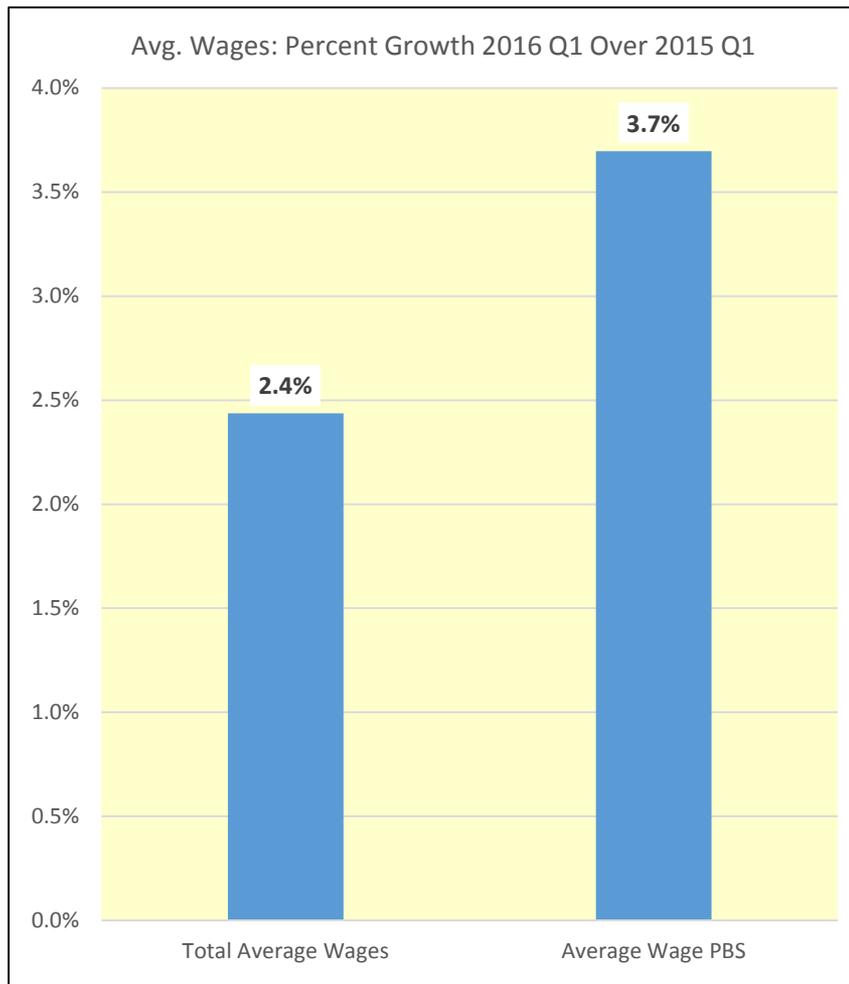


41,300 Jobs Have Been Created Since June



- After a disappointing second half in FY 2016, Virginia has seen 4 months of job gains
- First quarter FY 17 +33,600. Gains included:
 - Construction +3,200
 - Manufacturing +1,500
 - Professional and Business Services +8,700
 - Professional & Technical +6,700
- On a month over month basis, Virginia's rate of growth ranked 9th among states
 - In January Virginia ranked 34th
- The number of persons employed involuntarily part-time has declined to 162,300 for the 4th quarter of FY 2016
 - Below the January 2015 level
- Average weekly hours are up over the last 3 months, standing at 35.0 hours per week versus 34.8 in June

Job Growth Fuels Wage Growth



- First quarter 2016 saw an increase of 2.4% in the average weekly wage
- However, Professional and Business Services saw an increase of 3.7% in average weekly wages
- Professional & Business Services represents 26% of Virginia's wage base

Manpower's 2016 Q4 Survey for Virginia Indicates Continued Hiring

- Employers in Virginia expect to hire at a respectable pace during Quarter 4 2016, according to the Manpower Employment Outlook Survey
 - From October to December, 24% of the companies interviewed plan to hire more employees, while 6% expect to reduce their payrolls. Another 68% expect to maintain their current workforce levels and 2% are not certain of their hiring plans. This yields a Net Employment Outlook of 18%
- For the coming quarter, job prospects appear best in Construction, Durable Goods Manufacturing, Transportation & Utilities, Wholesale & Retail Trade, Professional & Business Services, Leisure & Hospitality, Other Services and Government
- Hiring in Nondurable Goods Manufacturing, Information, Financial Activities and Education & Health Services is expected to remain unchanged

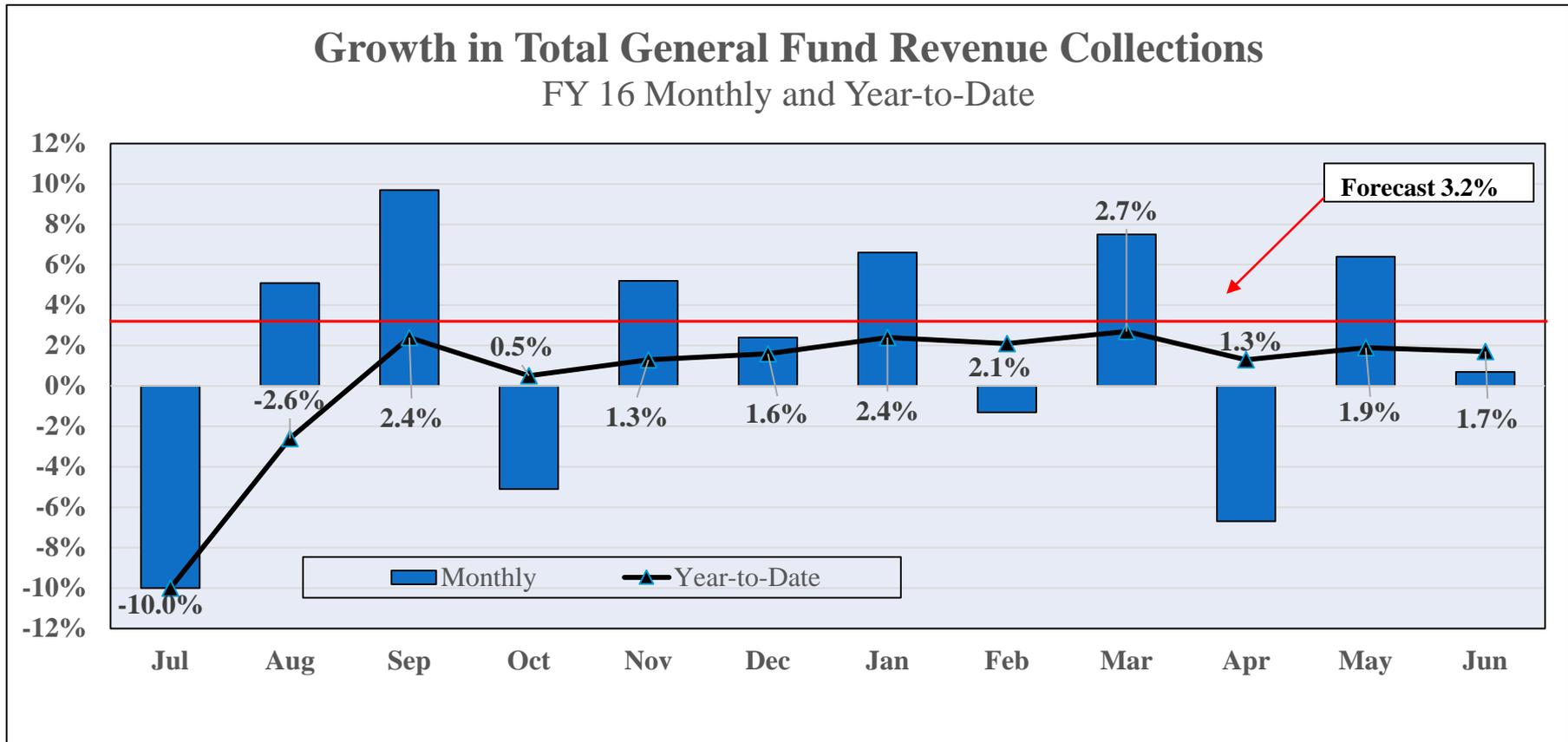


FY 2016 Performance



FY 2016 Revenue Performance

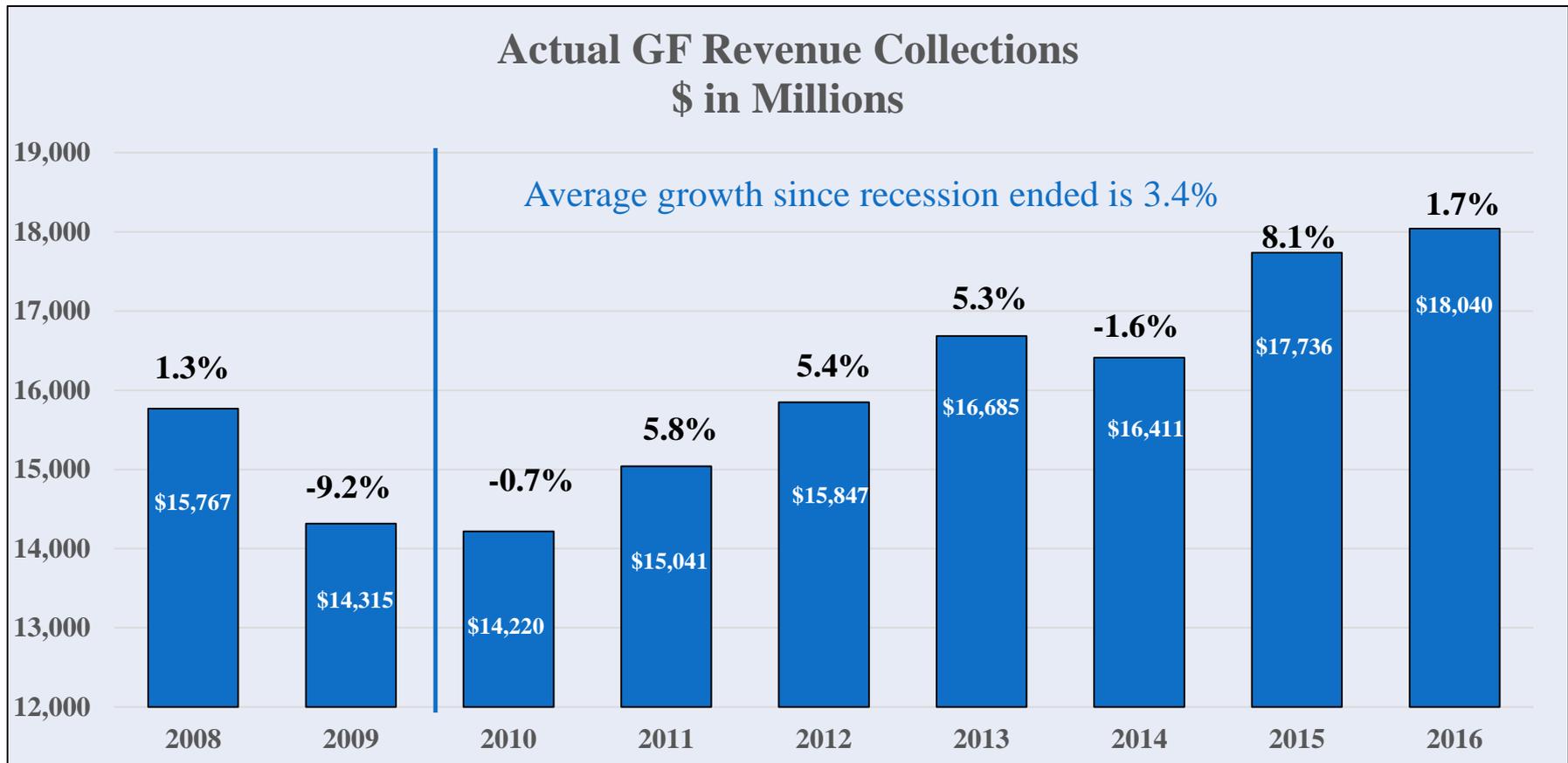
- When the budget was being considered last winter, FY 2016 revenues were running behind the forecast, but coincident economic indicators made estimate seem achievable
- After having reduced the forecast by \$750.0 million during the fall forecasting process, the Governor recommended no further reductions in his Mid-Session review
 - Shifted growth rates for specific sources, but bottom line forecast was unchanged



Source: Virginia Department of Taxation

FY 2016 Revenue Performance

- FY 2016 General Fund revenues rose by only 1.7%, falling short of the official forecast of 3.2% growth by \$268.9 million
- Almost all of the shortfall was due to lower than expected withholding and sales tax collections
 - These are the two largest sources, and also those most closely tied to current economic conditions



Note: Figures include only GF revenues and excludes transfers. Source: Virginia Department of Taxation

Fiscal Year 2016 Revenues Finished \$268.9 Million Below Forecast...

Major Sources	As a % of Total Revenue	Fiscal Year 2016			% Growth Over FY 15	
		Official	Actual	Variance	Official	Actual
Withholding	62.8%	\$11,501.6	\$11,306.3	(\$195.3)	4.1 %	2.4 %
Nonwithholding	16.9	3,099.0	3,070.1	(28.9)	1.9	0.9
Refunds	(9.7)	(1,777.6)	(1,820.7)	(43.1)	1.2	3.6
Net Individual	70.0%	\$12,823.0	\$12,555.6	(\$267.4)	4.0 %	1.8 %
Sales	18.4%	\$3,367.7	\$3,295.9	(\$71.9)	4.1 %	1.9 %
Corporate	4.0	722.8	764.9	42.1	(13.1)	(8.0)
Wills (Recordation)	2.1	383.0	369.1	(13.9)	10.6	6.6
Insurance	1.8	322.7	339.1	16.4	7.3	12.8
All Other Revenue	3.8	689.8	715.5	25.7	(0.4)	3.3
Total Revenue	100.0%	\$18,309.0	\$18,040.1	(\$268.9)	3.2 %	1.7 %
A.B.C. Profits	0.5	\$84.0	\$84.0	\$0.0	0.8 %	0.8 %
Sales Tax (0.375%)	1.9	366.7	366.7	0.0	4.1	4.1
Transfers	1.1	121.3	121.3	0.0	(38.8)	(38.8)
Total Transfers	3.5%	\$572.0	\$572.0	\$0.0	(9.8) %	(9.8) %

FY 2016 Revenue Performance by Source

Withholding Taxes: \$195.3 million below forecast

- Withholding taxes – which made up 63% of total revenues – grew 2.4% compared to a forecast of 4.1%
 - In contrast, growth the prior year was 5.3%, but since 2010, average annual growth has been only 3.1%
- The proxies for this source - job growth and average wages – would have supported the FY 2016 forecast
 - Jobs grew by 2.3% compared to 1.5% forecast
 - Average wages increased 2.3%, in line with the official forecast of 2.4%
- Disconnect appears attributable to the mix of jobs added to the economy
 - Saw fewer higher-wage jobs and expansion coming predominantly in lower wage sectors

Type of Job	Number of Jobs	% of Job Growth	Avg. Weekly Wage
Low Wage	52,303	47.6%	\$367-\$940
Medium Wage	40,972	37.3%	\$941-\$1,513
High Wage	16,605	15.1%	\$1,514-\$2,087

- The failure of the proxies to accurately project withholding growth has led the Department of Taxation to revisit its model, using fewer prior years of historic data, in an attempt to better reflect what appears to be a shift in Virginia's economy

FY 2016 Revenue Performance by Source

Sales Tax: \$71.9 million short of forecast

- Saw an AST-adjusted growth rate of 2.2%; almost 2 percentage points below the economic-based forecast of 4.1% increase
- Contraction was broad-based across the major retail sectors, including department stores, grocery stores, restaurants, leisure and hospitality, and gasoline stations
- The proxy for this source - personal income growth - exceeded the forecast and increased 4.3%, and throughout the year reports of consumer confidence continuously improved
- Virginia and many states have been experiencing a growing disconnect between income growth and consumer spending

FY 2016 Revenue Performance by Source

Remaining Sources:

- Payroll withholding and sales tax respectively accounted for 73% and 27% of the revenue shortfall
- Among all other sources, strengths in certain areas (corporate, insurance premium taxes) offset weakness in other sources (recordation, and refunds)
- The shortfall would have been \$183.0 million larger had the forecast not included a “collar” that capped nonwithholding collections at 16.14% of total revenues



FY 2017: YTD Performance



FY 2017 Performance Through October

- Chapter 780 assumed a GF growth rate of 3.2% in FY 2017
- Subsequent to the FY 2016 revenue shortfall, the mandatory reforecasting process undertaken in August produced an interim forecast of 1.7% growth in the FY 2017
- This lowered the FY 2017 forecast by \$564.4 million, reducing assumed GF revenues from \$18.9 billion to \$18.3 billion
- Through the first third of the fiscal year, revenues have increased 3.5% and are exceeding the revised forecast by 1.8 percentage points
 - Year-to-date strengths are in withholding, corporate and recordation taxes
 - Greatest weakness has been the continued lagging sales tax collections
- Meeting the current forecast for FY 2017 requires growth of only 0.9% in the remaining 8 months of the fiscal year

FY 2017 Year-to-Date Performance

General Fund Revenue Forecast for Fiscal Year 2017

Major Source	Ch. 780 Forecast	Revised August Forecast	Actual Performance Through October	Growth Required Remainder of Year to Meet Forecast
Withholding	4.0%	3.0%	4.3%	2.4%
Nonwithholding	2.1%	(1.2%)	(0.2%)	(1.5%)
Refunds	6.6%	4.0%	(4.0%)	5.1%
Net Individual	3.2%	1.8%	4.1%	0.8%
Sales	4.0%	2.6%	(0.3%)	3.8%
Corporate	5.9%	(3.0%)	14.6%	(7.4%)
Wills (Recordation)	1.7%	5.5%	11.6%	2.3%
Insurance	4.0%	1.3%	--	--
All Other Revenue	(1.2%)	(3.5%)	(4.8%)	(2.1%)
Total GF Revenues	3.2%	1.7%	3.5%	0.9%



Revised GF Revenue Outlook 2016 – 2018 Biennium



Fall Reforecasting Process

- Although the FY 2016 shortfall mandated a revenue reforecast in August, the Code-required Fall reforecasting process is currently underway
- Joint Advisory Board of Economists (JABE) met November 9 to review the latest economic assumptions and revised methodologies
 - Board includes economists from both private sector and academia; input from IHS Markit and Moody's Analytics
 - Department of Taxation and Secretary of Finance develop a revised forecast based on input received
- Governor's Advisory Council on Revenue Estimates (GACRE) will meet November 28
 - Cross section of leaders from Virginia business and industry, General Assembly leadership
 - Members react to forecast developed by Governor's staff and provide input on the proposed forecast and predicted economic climate
- Revisions to the Official forecast will be submitted with the Governor's proposed amendments to Chapter 780
 - Governor will present to Joint Money Committees on December 16

National Economic Outlook: Revisions to the 2016-18 Biennium

- Projections for the national economic picture have degraded since the Interim Forecast was developed based on IHS Markit's May assessment
- Downward adjustments have been incorporated for all the key variables – GDP, total personal income, wage and salaries, and employment for both FY 2017 and FY 2018

Projected National Economic Variables

	Job Growth	GDP	Total Wage/Salary	Income Growth
FY 2017				
IHS May 2016 Standard	1.7%	2.2%	4.8%	4.2%
IHS October 2016 Standard	1.5%	1.7%	4.3%	3.8%
FY 2018				
IHS May 2016 Standard	1.1%	2.8%	5.1%	5.0%
IHS October 2016 Standard	0.9%	2.3%	5.0%	4.7%

Virginia's Economic Outlook: Revisions to the 2016-18 Biennium

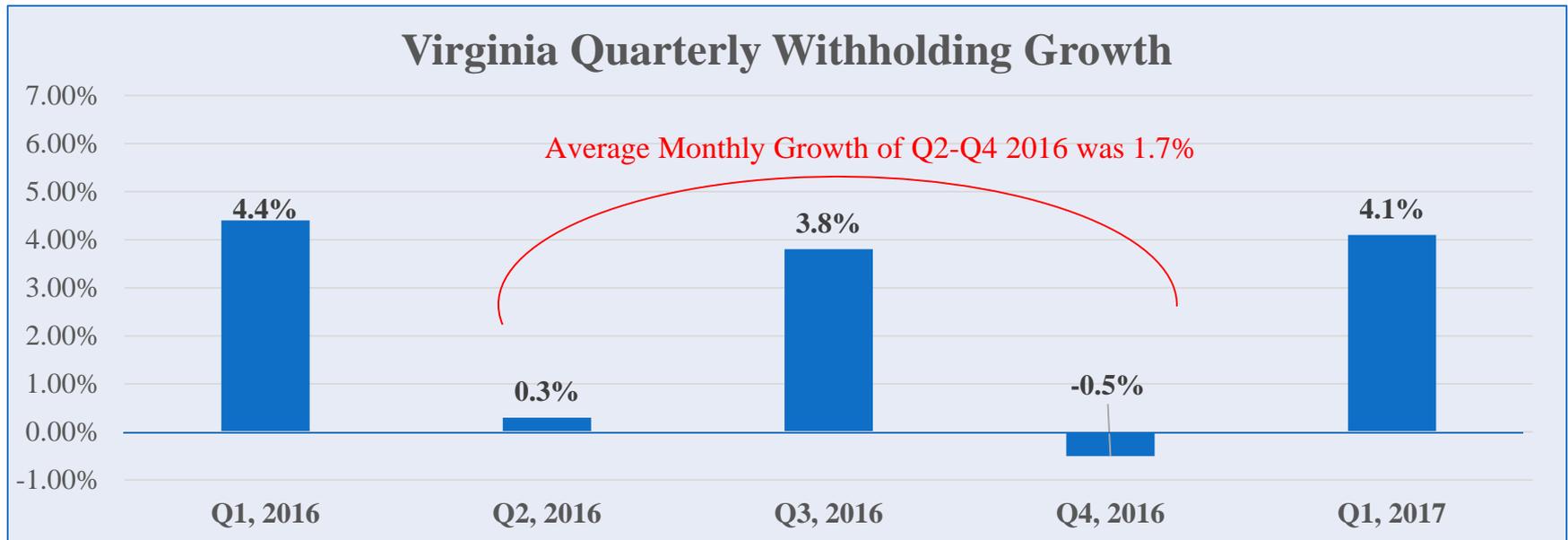
- In contrast, projections on Virginia's economic indicators have remained quite static over the past year
- Slight upward adjustment to the employment forecast is offset by marginally reduced average wage estimates in FY 2017
- FY 2018 assumptions remain virtually unchanged

Projected Economic Variables (National Forecast, adjusted for Virginia specific data)

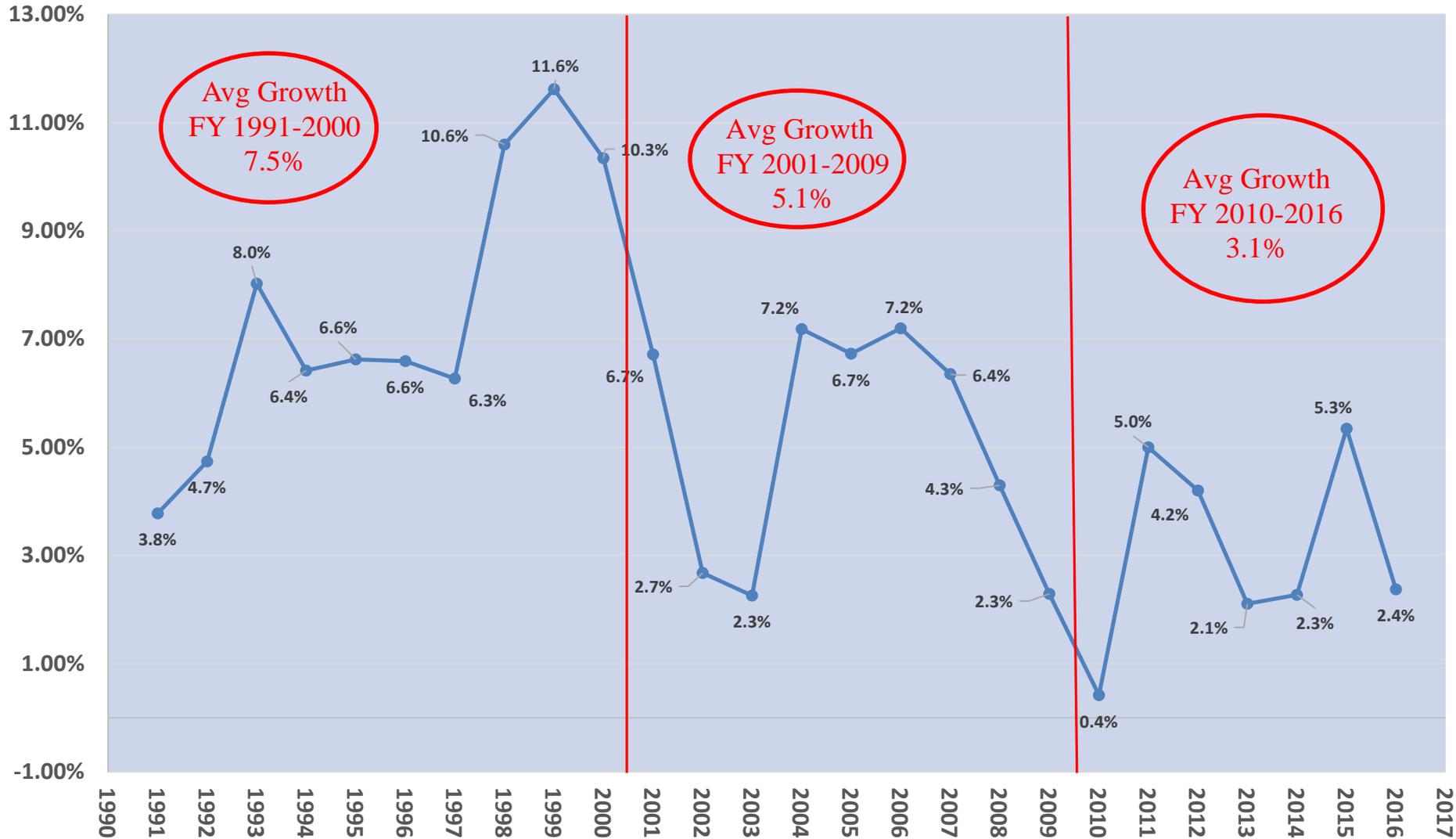
	Job Growth	Avg Wage/Salary	Total Wage/Salary	Income Growth
FY 2017				
Chapter 780/Nov 2015	1.3%	2.9%	4.3%	3.8%
Aug Official/May 2016 Standard	1.5%	2.7%	4.3%	3.8%
IHS October 2016 Standard	1.5%	2.8%	4.4%	3.9%
FY 2018				
Chapter 780/Nov 2015	1.0%	3.0%	4.0%	4.2%
Aug Official/May 2016 Standard	1.0%	3.0%	3.9%	4.2%
IHS October 2016 Standard	1.0%	2.9%	3.9%	4.2%

Withholding Tax Forecast

- Through the first 4 months of FY 2017, withholding tax collections grew 4.3% compared to the current economic forecast of 3.0%
- Withholding tax collections would have to grow 2.4% during the last 8 months of the year to meet the current forecast of 3.0% growth
 - Based on tepid performance during the same quarters last year, this appears quite attainable
 - Strongest quarter in FY 2016 was the first, and in current year we are exceeding the forecast even against that higher bar



Annual Growth in Withholding Tax Collections (FY 1991-2016)



Expected Withholding Forecast Adjustments

- August forecast originally presented to GACRE assumed a withholding tax growth rate of 3.5% in FY 2017
 - This rate was reduced to 3.0% in the Interim Forecast in response to concerns about recent poor performance
- However, FY 2017 will be driven more by “money in the bank” than any short-term economic forecast
 - If withholding tax collections grew 3.0% for the rest of the year, would translate to an annual forecast of nearly 3.5%
- Based on performance through October a growth rate of 3.5% in FY 2017 could be supported
- August forecast for FY 2018 set at 3.4% in FY 2018, about 0.5% below the rate that would be predicted by the proxies
- Erring on the side of caution, recommend reducing the FY 2018 forecast to 3.2% at this point

Expected Sales Tax Forecast Adjustments

- Chapter 780 assumed sales tax growth of 4.0% in FY 2017 and 3.8% in FY 2018
- These were reduced to 2.6% and 2.9% respectively in the interim forecast
- Through October, sales tax collections contracted 0.3%
- Sales tax collections would have to grow 3.8% during the last 8 months of the year to meet the current forecast
 - In light of the low sales tax collections in FY 2016 and poor year-to-date performance, expect there will be substantial further reductions in this source in the final revised forecast
- Recommend lowering the forecast to 1.6% in FY 2017 based on current performance, with no recommended changes to FY 2018 at this point

Why Has Sales Tax Growth Been So Anemic?

- Like withholding tax collections, the proxy for sales tax collections - personal income growth – has been a poor predictor of collections in recent years
- Current economic forecast is for total personal income to increase 3.9% in FY 2017 and 4.2% in FY 2018 but sales tax revenues have grown far more slowly
- Not just a Virginia trend, but seen nationally

What are some of the contributing factors?

- Over half of personal consumption expenditures now are directed to services
 - This includes “new” services like mobile phones, internet access, online media access, etc.
 - Also reflects demographic shifts with baby-boomer generation spending less on goods
 - More likely to be downsizing, not buying more household goods
 - Income directed toward services like medical care and travel/recreation

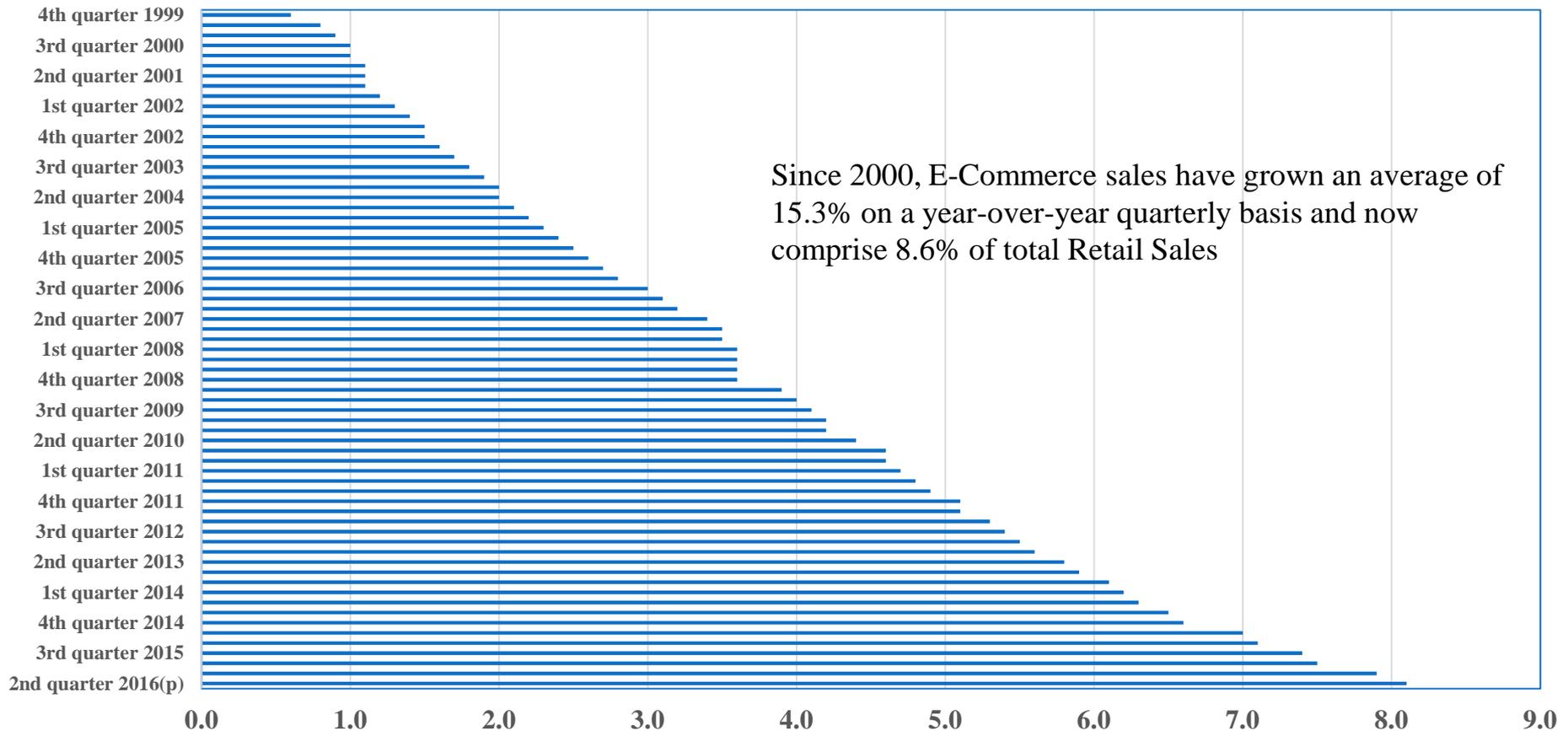
Why Has Sales Tax Growth Been So Anemic?

Contributing factors (continued):

- Even within expenditures for goods, ever increasing share is for non-taxed goods
 - Growth in the TTF portion of sales tax – which still includes food – has grown an average 0.9% faster each year over the last 10 years than the GF portion which excludes food sales
 - Other policy decisions have excluded substantial components of retail sales from taxation – sales tax refunds have totaled \$22.8 million year to date, largely reflecting data center exemptions
- Delayed household formation by the 25-35 year old cohort also depresses sales
 - Attributed to increasing weight of student loan debt on younger consumers, reducing disposable income
 - Lower wages among this large age group
- High growth in untaxed internet sales

Total Sales Have Grown an Annual Average of 3.4% Since 2000...Internet Sales Have Increased an Average of 19.5%

E-Commerce as a Percentage of Total U.S. Retail Sales



Expected Forecast Adjustments

Corporate Income Taxes:

- Most difficult source to predict because collections impacted by complex tax planning decisions made by large firms
- Through October, collections have increased 14.6%, well ahead of the annual forecast of a 3.0% decline
 - Prior to the August reforecast, assumed growth of 5.9% in FY 2017
 - FY 2016 collections impacted by the full implementation of the single-sales factor, with source contracting 8.0%
- Tax reports that the YTD growth in corporate tax collections appear to be broad-based across all sectors, mirroring strong Q3 earnings reports
 - September and October are significant months for corporate taxes, with the first estimated payment being submitted in September for most corporations, and those with February through January fiscal years – largely retailers – filing in October
 - Collections increased 10% for the month in September and 39.2% in October based on reduced refunds
 - Need to wait and see November's collections to complete the refund cycle
- Based on the money in bank through the first 4 months, recommend increasing the forecast for FY 2017 to 5.0%
- Recommend no change in FY 2018, which currently assumes a contraction of 2.4%

Expected Forecast Adjustments

Nonwithholding:

- The current interim forecast projects nonwithholding tax collections to decline 1.2% in FY 2017 and increase 8.2% in FY 2018
 - The rates assumed in Chapter 780 were 2.1% growth in FY 2017 and 7.2% in FY 2018
- Year to date, nonwithholding collections have decreased by 0.2%, marginally ahead of the forecast
- The first estimated payment of the fiscal year was due in September, and monthly collections contracted 3.1% on a year-over-year basis
- Year-to-date S&P growth – which is a major factor in final payments - has been about 7%
 - Final payments make up about 40% of total collections for this source
- Growth in proprietors' income, which drives a portion of estimated payments, is predicted to be less than 4%
- Because an average of 82% of nonwithholding taxes are collected in the last 8 months of the year, with 55% collected in the last quarter, it is too early to make adjustments
 - Better indication will be available after the next estimated payments are received in January and could be addressed as part of the Mid-Session reforecast

Expected Forecast Adjustments

Recordation:

- Through October, collections have increased 11.6%, ahead of the forecast of 5.5% growth
 - About 85% of the collections have stemmed from sales versus re-financings
- National Association of Realtors reports both median and average home prices above pre-collapse levels for first time in 2017
 - Projected price growth of 7% in CY 2016, dropping to 4% in CY 2017 and 2.5% in CY 2018
- Volumes of both new and existing home sales anticipated to continue growing but at modest rates as younger cohorts continue to delay first home purchases
- According to the Virginia Association of Realtors, the third quarter of 2016 saw a 5.7% increase in residential home sales with median sales prices increasing about 2% on a year-over-year basis
- Could expect to see an upward adjustment to this source –
 - Anticipate growth of about 8% in FY 2017
 - Slower growth in the range of 4% in FY 2018

Projected Growth Forecast for FY 2017 and FY 2018

Major Sources	Interim FY 2017	FY 2017 HAC	Interim FY 2018	FY 2018 HAC
Withholding	3.0%	3.5%	3.4%	3.2%
Nonwithholding	-1.2%	-1.2%	8.2%	8.2%
Refunds	4.0%	3.0%	3.9%	3.9%
Sales	2.6%	1.6%	2.9%	2.9%
Corporate	-3.0%	5.0%	-2.4%	-2.4%
Recordation	5.5%	8.0%	0.0%	4.0%
Insurance	1.3%	1.3%	3.2%	3.2%
Total GF Resources*	1.6%	2.2%	3.6%	3.6%

Potential Net Adjustments to Revenue Forecast

- Assumed forecast revisions would increase the total available resources over the biennium by \$226.3 million
- Proposed FY 2017 forecast adjustments would add a total of \$114.4 million above the interim August forecast
 - Upward adjustments in withholding, corporate and recordation taxes as well as reduced refund growth
 - These increases would be offset by proposed reductions to the sales tax forecast
- Forecast adjustments total \$111.8 million in FY 2018 resulting predominantly from the higher FY 2017 base, not from assumed changes in the growth rates
 - Assumes 0.2% reduction in withholding tax forecast
 - Offset by assumed growth in recordation tax collections



Addressing the Biennial Revenue & Budgetary Shortfall



How Does FY 2016 Shortfall Impact FY 2017?

- Chapter 732 – the “Caboose Bill” contained an assumed \$265.3 million unappropriated balance to be carried forward into FY 2017
 - The gap between FY 2016 forecast and actual revenues was almost identical to this amount, meaning that while we had a revenue shortfall in FY 2016, budgeted expenditures for that year did not exceed revenues collected
- This means that the \$265.3 million carry forward balance embedded in Chapter 780 is not available to support budgeted spending in FY 2017
- In addition to budgetary reductions required to offset the revenue reforecast for the FY 2016-18 biennium, FY 2017 expenditures must be reduced further to address spending associated with the assumed balance which is no longer available

Based on the Interim August Reforecast, the Total Projected Budgetary Shortfall Totals \$1.5 Billion

	FY 2016 Actual	FY 2017	FY 2018	Biennial Total
Revenue:				
Revised Interim Forecast – Post-GACRE	\$18,040.1	\$18,338.0	\$19,000.4	\$37,338.4
Official Forecast - CHs 732 & 780	\$18,309.0	\$18,902.4	\$19,633.1	\$38,535.5
Actual/Projected Revenue Shortfall	-\$268.9	-\$564.4	-\$632.7	-\$1,197.1
Change in Transfers	-\$10.4	-\$17.7	-\$21.6	-\$39.3
Total Shortfall	-\$279.3	-\$582.1	-\$654.3	-\$1,236.4
Shortfall Applied by Fiscal Year		-\$861.4	-\$654.3	-\$1,515.7

What is the Process for Addressing the Shortfall?

- The Code of Virginia requires the Governor to prepare a re-estimate of GF revenues if individual income, corporate income, and sales taxes are 1% or more below the budget estimate
 - The preliminary reforecast was issued in August when the Governor presented to the Joint Money Committees
- In the event of a reforecast, “Part 4” of the budget also requires the Governor to withhold general fund spending authority to prevent expenditures in excess of anticipated revenues
- This authority is limited to the current fiscal year, and includes express limitations on total reductions by agency as set out in § 4-1.02 of the Appropriation Act
 - The Governor may not withhold allotments in excess of 15% for any one state or non-state agency or institution
 - State agencies may not apportion a larger cut to a specifically named grantee in excess of the proportional cut received by that agency

How The Governor Has Proposed Addressing the FY 2017 Shortfall

Type of Action	Specific Action	\$ in Millions	Subtotals
Actions based on revenue triggers	Transfer from Revenue Stabilization Fund	\$392.3	\$517.4
	Remove December 1, 2016, pay increase	\$125.1	
Use of FY 2016 Balances	Agency “pledge” balances	\$23.5	\$66.8
	GF Discretionary balances	\$43.3	
Technical Adjustments	Reduce assumed FY 17 carry-forward to FY 18	\$70.0	\$154.1
	Recognize excess FY 16 Lottery proceeds	\$33.2	
	Recognize Lottery reforecast for FY 17	\$5.3	
	Allocate unspent Lottery allocations	\$8.6	
	Recognize sales tax adjustment for Basic Aid	\$12.0	
	Recognize additional Literary Fund revenues	\$25.0	
Policy Changes	Delay Phase-Out of AST	\$35.1	\$63.9
	Recover NGF cost of VRS for Higher Ed	\$24.8	
	Retain Interest & Credit Card Revs. Higher Ed	\$4.0	
Agency Budget Reductions	Across-the-board savings	\$73.0	\$73.0
GRAND TOTAL			\$875.2

Almost Half of FY 2017 Agency Savings are One-Time in Nature to Manage the Problem Short-Term...Longer-Term Solutions Will be Left for FY 2018

Agency Savings by Category	2017 GF Resources	2017 GF Approp. Reduction	2017 Total Impact to the GF
Transfer of NGF operating balances	\$16.7	\$0.0	\$16.7
Supplant GF with NGF	\$0.0	\$10.8	\$10.8
Revert GF Balances	\$0.0	\$2.6	\$2.6
Turnover and Vacancy Savings	\$0.0	\$5.6	\$5.6
Reduce or Delay New Spending	\$0.0	\$15.5	\$15.5
Reduce discretionary expenses	\$0.2	\$11.5	\$11.7
Reduce or eliminate current services	\$0.0	\$6.4	\$6.4
Improved business practices and efficiencies	\$0.0	\$2.0	\$2.0
Reduce personnel costs	\$0.0	\$1.6	\$1.6
New Fees or Change to Existing Fees	\$0.1	\$0.0	\$0.0
Totals	\$17.0	\$56.0	\$73.0

On-going Savings

Next Steps – The Path Ahead . . .

- While the Governor has submitted his reduction plan for FY 2017, a number of items contained within it will require approval of the General Assembly during the 2017 Session
- In addition to the already released savings plans, the Governor must propose options to close the FY 2018 revenue gap currently estimated at \$654.3 million
 - This budgetary gap is increased by an additional \$70.0 million based on the Governor's proposal to reduce the assumed carry-forward from FY 17 into FY 18 as part of the FY 17 reductions
- In addition, the results of the Fall revenue reforecast could result in adjustments to the assumed revenue forecast, and new spending requirements could further exacerbate the budget gap
- The Governor's recommendations to address the FY 2018 shortfall, will be contained in his amendments to the FY 2016-18 budget submitted on December 16, 2016

Agency Budget Requests

- As part of the annual budget development process, agencies are asked to submit “decision packages” outlining their budget requests for the remainder of the biennium
- In October, agencies submitted preliminary general fund budget requests totaling \$77.4 million in FY 2017, and \$273.8 million in FY 2018
- The top 2 items make up more than 50% of total requests in FY 2017
 - \$23.8 million for increased CSA costs and \$15.7 million for increased inmate medical care
- In the second year, the requests are more disbursed, but the top 9 requests still comprise more than half of the total
 - Again, forecast driven expenditures like CSA and inmate medical care are among the largest requests, totaling \$34.9 million and \$14.2 million respectively
 - However, FY 2018 requests also include many discretionary requests in areas like higher education and economic development
- These amounts exclude items like the Medicaid forecast and any adjustments to K-12 based on average daily membership updates, etc.

Agency GF Budget Requests by Secretariat

Amount Requested	GF 2017	GF 2018
Leg/Judicial/Exec	\$300,000	\$722,000
Admin/Finance/Tech	\$2,030,417	\$20,022,044
Commerce & Trade	\$3,250,000	\$8,217,840
K-12	\$0	\$5,632,294
Higher & Other Ed.	\$9,807,979	\$75,748,049
HHR	\$44,263,674	\$124,559,425
Ag & Natural Resources	\$53,477	\$2,527,404
Public Safety, Vets	\$17,649,475	\$36,401,252
TOTAL	\$77,355,022	\$273,830,308

Note: Table excludes the Medicaid forecast and K-12 enrollment and other forecast adjustments

2016-18 Budget Drivers:

HAC Staff Identified Mandatory/Statutory Items

GF \$ in Millions	FY 2017	FY 2018	Total
Medicaid Baseline Forecast	77.0	178.1	255.1
Comprehensive Services Act	23.8	34.9	58.7
DSS - Mandated Reinvestment in Child Welfare Services	-	5.5	5.5
DBHDS-Special Hospitalization Costs at State MH Facilities	1.9	2.0	3.9
Involuntary Civil Commitment	0.3	0.3	0.6
Direct Inmate Health Care	15.7	14.2	29.9
DOC: Impact of FLSA Changes (Overtime Rule)	0.9	1.7	2.6
Backfill HAVA Funds	-	2.8	2.8
Employee Health Insurance Premium Adjustment	-	9.9	9.9
TOTAL - HAC Identified Mandatory/Statutory Drivers	119.6	249.4	369.0

Comparison of Available Resources To Identified Budget Drivers

\$'s in millions	FY 2017	FY 2018	Biennium
Revenue Shortfall Based on August Forecast	\$861.4	\$654.3	\$1,515.7
Governor's FY 2017 Savings Plan	(\$875.2)	\$56.2	(\$819.0)
Mandatory/Statutory Spending Drivers	\$119.6	\$249.4	\$369.0
Net Shortfall (based on current forecast)	\$105.8	\$959.9	\$1,065.7
Additional Revs. From Potential Forecast Adjustments	\$114.4	\$111.8	\$226.2
Net Shortfall	(\$8.6)	\$848.1	\$839.5



2017 Session: Options for Addressing the Remaining Shortfall



Options for Addressing the FY 2018 Shortfall

- In addition to any across-the-board savings requested by the Governor, there are a number of large dollar actions that could be taken to address the FY 2018 shortfall. Some of the major items, which total approximately \$694.0 million, are listed below:
 - Use of Rainy Day Fund in FY 2018
 - Estimated withdrawal of \$392.3 in FY 2017, leaves approximately \$225.0 million available for withdrawal in FY 2018 (Note: final amount dependent on changes to forecast)
 - Funding Reserved for FY 2018 Portion of Planned Salary Increases
 - A total of \$221.3 million was reserved in FY 2018 to fund the full-year component of the salary adjustment planned for December 2016
 - Sweep GF Capital Cash Balances
 - Approximately \$140.0 million in cash balances from previously authorized projects remains; could swap out cash for debt or a portion thereof
 - Accelerated Sales Tax - \$25.0 million in second year could be generated by continuing in FY 2018 the Governor's proposal to retain \$2.5 million threshold

Options for Addressing the FY 2018 Shortfall

- Major Savings Options (continued):
 - Offset GF costs of Medicaid forecast with an estimated \$26.8 million 2016 carry-forward balance in the Virginia Health Care Fund
 - Transfers of \$19.9 million from the OAG Consumer Enforcement Fund
 - Virginia's share from the settlement with Volkswagen and Kia-Hyundai
 - Require Higher Education to cover the NGF portion of the accelerated payback of the VRS deferral
 - DPB estimates this would generate \$16.5 million
 - Capture cash appropriated for maintenance reserve
 - \$10.0 million
 - Continue Governor's proposal to retain higher education interest earnings
 - \$4.0 million
 - Revise Appropriation for HB 599 Allocations
 - Assumed 3.2% growth in 2016, level funded in FY 2018. Could generate savings of \$5.2 million over biennium by level-funding allocations
- Across-the-board reductions
- Revisit New Spending Contained in Chapter 780 for FY 2018

FY 2018 Agency Reduction Plans

- In October the Governor issued 7.5% savings targets for all agencies which, exclusive of higher education, total \$79.1 million
- The total value of exempted programs is \$17.4 billion, leaving only \$1.1 billion for across-the-board reductions. The exemptions include:
 - Aid to localities: Direct Aid for Public Education, SOL support, Compensation Board, aid to local libraries, PPTRA payments, local health department and social services funding, “599” funding
 - HHR Programs: CSA, Medicaid, Children’s Health Insurance, DBHDS, Mental Health Treatment Centers, ID Training Centers, VCBR, TANF, foster care and adoption, auxiliary grants for aged, blind and disabled
 - Economic Development Incentive Payments, Housing Trust Fund, Go Virginia, Higher Education Research Initiative, 2017 WQIF deposit, CRCF
 - Large areas of Public Safety including operation costs for prisons, detention and diversion centers, inmate education, probation and parole offices, DJJ and State Police
 - Debt Service and MELP payments

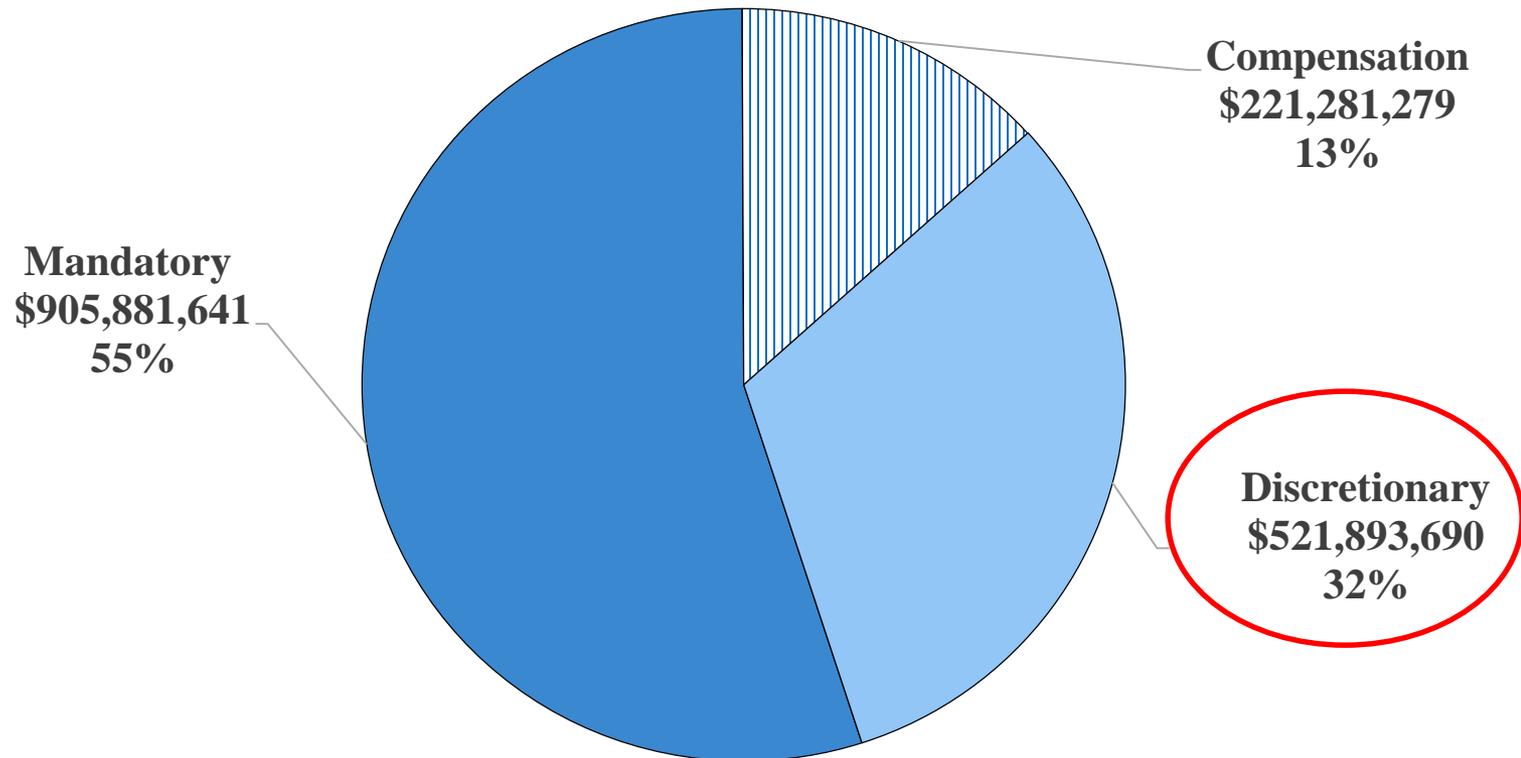
FY 2018 Agency Reduction Plans

- The Governor issued separate 7.5% targets for higher education, which total \$114.1 million
- DPB reports only items excluded from the GF calculation within higher education were:
 - Financial aid,
 - Federal match for Cooperative Extension, and
 - Norfolk State University and Virginia State University
- By way of comparison, a total of about \$77.0 million was provided directly to the colleges and universities in FY 2018 in Chapter 780 (exclusive of the research initiative)

FY 2018 Agency Reduction Plans

- If the full 7.5% cut were applied against the non-exempt agencies/programs and the institutions of higher education, this would generate only \$193.2 million
 - This equates to 20% of the known revenue shortfall in FY 2018 based on the current forecast
 - Does not even backfill requirements for known mandatory increases in budget drivers in FY 2018 (outlined on slide 67)
- Will not be possible to close the gap without instituting targeted cuts against the programs excluded from the across-the-board reductions
 - This means that cuts to local aid, public education, HHR programs and public safety will have to be considered

New FY 2018 Spending Contained in Chapter 780 Totaled \$1.65 billion



Major New/Discretionary Spending in Chapter 780

Spending by Agency	FY 2018
<u>Discretionary Spending</u>	
Public Education	\$211,946,994
Higher Education	\$120,233,163
Health and Human Resources	\$76,395,670
Public Safety	\$47,355,939
Commerce and Trade	\$42,959,347
Ag and Natural Resources	\$22,343,000
General Government	\$659,577
Discretionary Total	\$521,893,690
<u>Mandatory Spending</u>	
Health & Human Resources	\$526,887,751
Public Education	\$280,944,357
State Employee Health Insurance	\$91,731,143
State Employee OPEB	\$6,318,390
Mandatory Total	\$905,881,641
<u>Salary / Compensation Total</u>	\$221,281,279

Challenges of the 2017 Session

- FY 2017 shortfall can be addressed with measures already announced, but solution relies heavily on one-time actions because the fiscal year is already underway
- Heavy lifting will be required to address FY 2018 shortfall
- Big unknown continues to be federal deficit reduction actions and the impact on Virginia
 - Budget agreement that put off reductions expires at close of federal fiscal year 2017
 - How will new President and Congress impact BBA of 2015
 - Devil is in the details – still need to see how spending caps are applied



Appendix



Highlighted New/Discretionary Major Spending by Agency

Agency / Program Expenditure Description	FY 2018
Public Education	
Reinstated Lottery Proceeds Fund Per Pupil Allocations	\$147,165,094
Fund COCA @ 10.60% for SOQ Funded Support Positions	\$17,401,152
Additional General Fund Revenue for Lottery PPA	\$10,000,000
Reduce Literary Fund Support for VRS	\$10,000,000
Expand At-Risk Add-On Range from 1%-12% to 1%-13%	\$7,092,036
New - Increase CTE Credentialing and Equipment Allocations	\$2,499,855
New - Alternative Tchr Compensation Approaches Competitive Grants	\$2,075,000
New - AY Gov's Schls - Incr Tuition 2.5% & Prov \$50/Course/Student Add-on	\$1,680,704
DOE - One-time Funding to Expand Computer Adaptive Testing to 3-5 gr Math & 3-8 Reading	\$1,600,000
New - Provide VECF Funding for Pilot Progr of Public-Private Partnerships for Early Childhood Educ	\$1,500,000
New - VA Preschool Init PPA Incr from \$6000 to \$6125	\$1,449,620
DOE - Add 8 FTEs to Support DOE Programs & School Divisions	\$1,038,076
New - Provide VECF Grant Funding to Comm Colleges for Skills of Early Educ Tuition	\$1,000,000
DOE - eMediaVA - Digital Content Dev & On-line Portal for Virtual Va	\$900,000
Inc Full-time Virtual K12 to 200 Slots & Add New Virtual Math Outreach Progs	\$828,000
New - STEM Progr/Research Study (VA Air & Space Cntr)	\$681,975
New - Computer Science Training to Teachers	\$550,000
Incr After-the-Bell School Breakfast Program Incentive	\$536,703
Incr Initiatives Providing Eff Discip & Alternatives to Suspension	\$500,000
Higher Education	
Higher Ed Operating Support	\$61,700,000
Undergraduate Financial Aid	\$24,098,663
VRIC	\$14,000,000
Workforce Credential	\$8,500,000
Graduate Fin Aid	\$4,425,000
HE Interest Earnings	\$4,000,000
Cyber Security Initiatives (SCHEV, VT, VCCS)	\$2,652,000
SCHEV Initiatives (VLDS, Innovation Fund)	\$857,500

Highlighted New/Discretionary Major Spending by Agency

Agency / Program Expenditure Description	FY 2018
Health and Human Resources	
DBHDS/DMAS - DOJ 355 additional ID/DD Waiver Slots, new positions, Rental Choice VA Subsidy	\$11,527,752
DMAS - comprehensive Medicaid substance use disorder treatment	\$8,376,260
DMAS - Restore 1.3% inflation for hospitals in FY 2017	\$8,262,228
DMAS - Increase personal care rates 2% in FY 17	\$7,972,821
DMAS - Restore 1.8% inflation for nursing facilities in FY 2018	\$6,356,821
DMAS - Recognize 2016 inflation in future nursing facility rebasing	\$5,578,840
DMAS - Expand Eligibility to 80% for Waiver Svcs. for Seriously Mentally Ill, effective FY 17	\$3,782,618
DMAS - 11.5% incr Medicaid private duty nursing rates incr EPSDT, Tech Waiver (equalizes w/ I/DD Waivers)	\$2,757,484
DMAS - Local inpatient geriatric svcs. & discharge asst progr at HGTC & Western State Hospital (WSH)	\$2,500,000
DMAS - Expand permanent supportive housing program	\$2,142,900
DMAS - Expand Prog. of Assertive Community Treatment (PACT) teams	\$2,000,000
DMAS - Expand child psychiatry and children's crisis response services	\$1,750,000
DSS - Expand foster care and adoption payments for youth ages 18-21	\$1,469,698
DBHDS - Expand discharge assistance plan (DAP) funding	\$1,305,000
DMAS - Fund medical residencies through Medicaid	\$1,250,000
DSRS - Guardianship services for mentally ill and vulnerable adults	\$1,011,804
DSS - Increase support for local DSS eligibility workers	\$1,000,000
DMAS - Restore FY 2017 inflation for CHKD	\$726,894
DMAS - Increase payment rate by 15% for nursing Homes with special populations (Virginia Home)	\$619,511
DMAS - Eliminate Vital Records Automation Fund Transfer for Childhood Vaccines	\$518,421
DBHDS - Add direct care staffing to address increased high acuity admissions at WSH	\$515,337
CSA - Increase Funds for CSA Local Administration	\$500,000

Highlighted New/Discretionary Major Spending by Agency

Agency / Program Expenditure Description	FY 2018
Public Safety	
DOC: Open Culpeper Facility	\$21,744,762
HB 599 funding increase	\$5,551,177
DOC: New Security Staffing	\$4,000,000
DCJS: Mental health services in jails	\$2,500,000
State Police: New positions at Driver and Firearms Training Facility	\$2,500,000
State Police: Special operations division position	\$2,400,000
DOC: New mental health specialists at district probation offices	\$2,200,000
DCJS: Establish community corrections and pre-trial release programs in add'l areas	\$2,000,000
State Police: New cyber crime investigators	\$1,400,000
State Police: New information technology positions	\$1,100,000
DOC: Offset revenue loss from lower inmate telephone commission	\$1,000,000
Drug Court Funding	\$960,000
Commerce and Trade	
Go Virginia	\$30,225,000
VEDP Admin Funding	\$5,150,700
Housing Trust Fund	\$1,500,000
Brownsfield Restoration	\$1,500,000
Broadband Initiative	\$1,333,647
Virginia Business Ready Sites	\$1,250,000
Enterprise Zone Program	\$1,000,000
Additional Funding for CCAM	\$1,000,000
DHRM: Learning Management System	\$659,577
Ag and Natural Resources	
Land Conservation Funding (VDACS, DCR, DHR)	\$10,000,000
DGIF – Increase Sales Tax	\$5,000,000
DGIF – Watercraft Sales Tax	\$2,700,000
AFID Increase	\$1,220,000
Reforestation of Timberlands Match Increase	\$773,000
VDACS IT Systems Improvements	\$700,000
DCR Natural Area Preserves	\$500,000