



2019 Session Revenue and Budget Outlook

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House Appropriations Committee

November 13, 2018

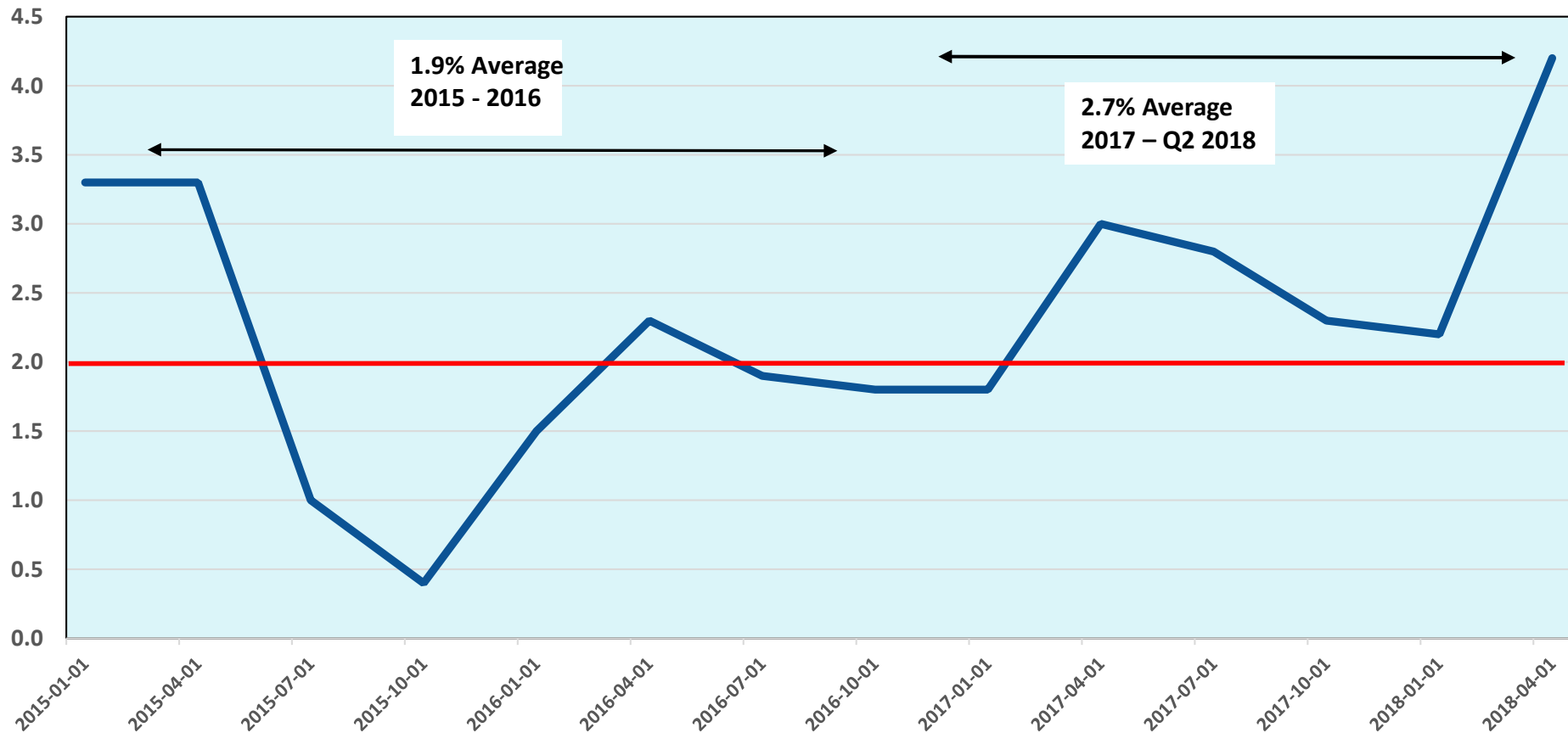


Snapshot of U.S. Economy

- The U.S. economy is growing, with GDP growth of 4.2% in the second quarter of 2018 and the first estimate of Q3 2018 posting a gain of 3.5%
 - National forecast expects GDP to grow 2.4% over CY 2019
- The U.S. economy added 250,000 jobs in October. The 12-month average payroll gain of 211,000 indicates that job growth remains solid
 - The current unemployment rate is 3.7%
- Economic activity in the manufacturing sector expanded in September, and the overall economy grew for the 113th consecutive month
 - Employment in manufacturing continued to trend up in September (+18,000), reflecting a gain in durable goods industries. Over the year, manufacturing has added 278,000 jobs, with about four-fifths of the gain in the durable goods component
- Strong growth of hours worked and an acceleration in hourly compensation are driving robust gains in wage and salary income, aided further by personal income tax cuts. As a result, economists expect real Disposable Personal Income (DPI) growth to remain strong, registering 2.6% growth in 2018 (Q4/Q4), 2.9% over 2019, and 2.3% over 2020
 - Retail sales are expected to grow between 5 and 5.6% from a year ago, according to Deloitte's annual forecast for the holiday season
- Existing home sales were flat in August, remaining at their lowest level in 29 months. Higher borrowing rates and a shortage of houses at particular price points are suppressing home sales. The National Association of Realtors' short-term forecasting index, the Pending Home Sales Index, fell 1.8% in August, sinking to a 46-month low and pointing toward lower existing home sales in September and October
 - Higher interest rates, higher construction costs, and shortages of buildable lots are holding housing starts down

After Several Quarters of Below 2% Growth, GDP Surged to 4.2% in 2018

Percent



Source: U.S. Bureau of Economic Analysis, Real Gross Domestic Production
Percent Change from Proceeding Period, Seasonally Adjusted Annual Rate



ISM, Consumer Sentiment, and a Look at National Employment

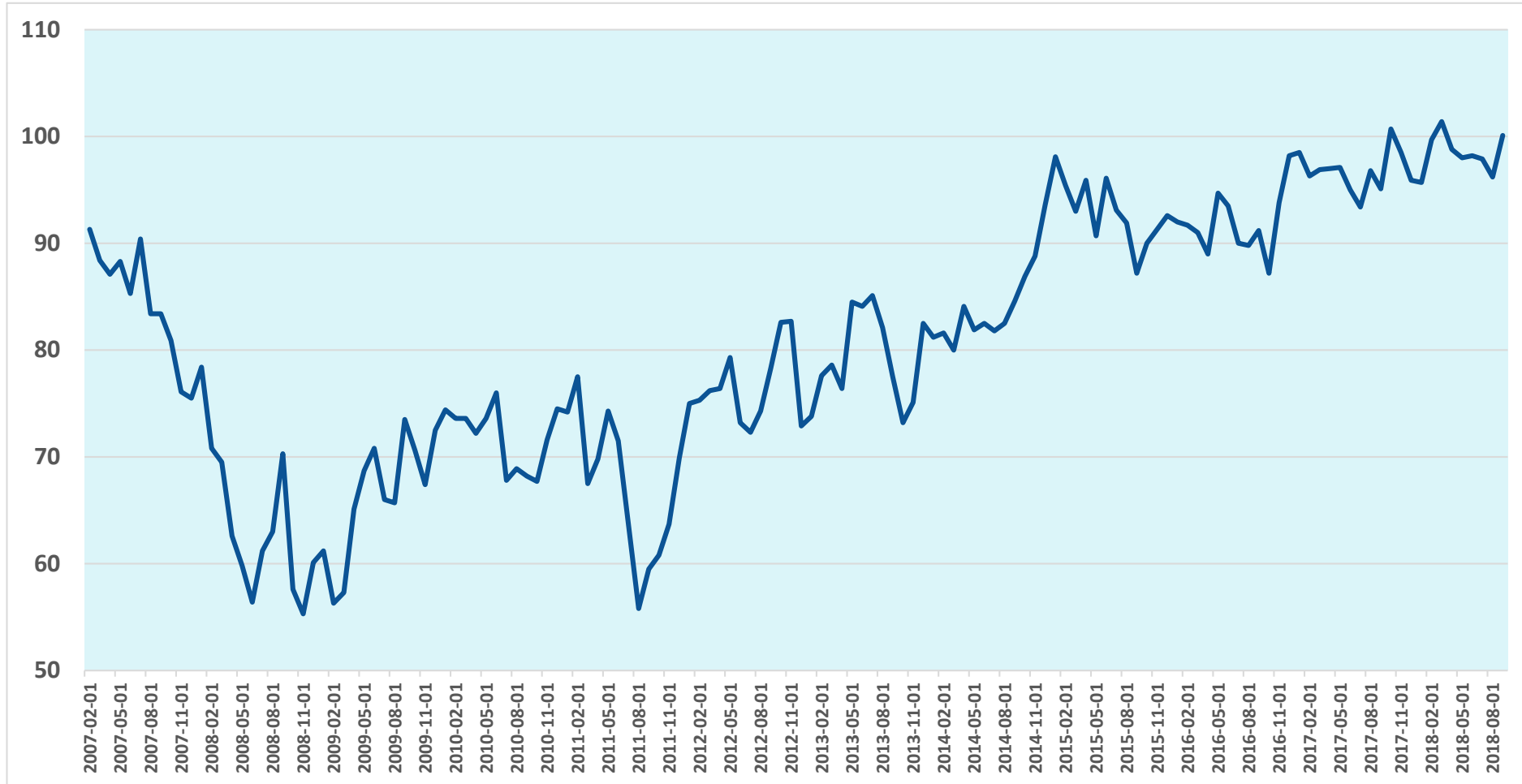


ISM Manufacturing Report

Of the 18 manufacturing industries, 15 reported growth in September

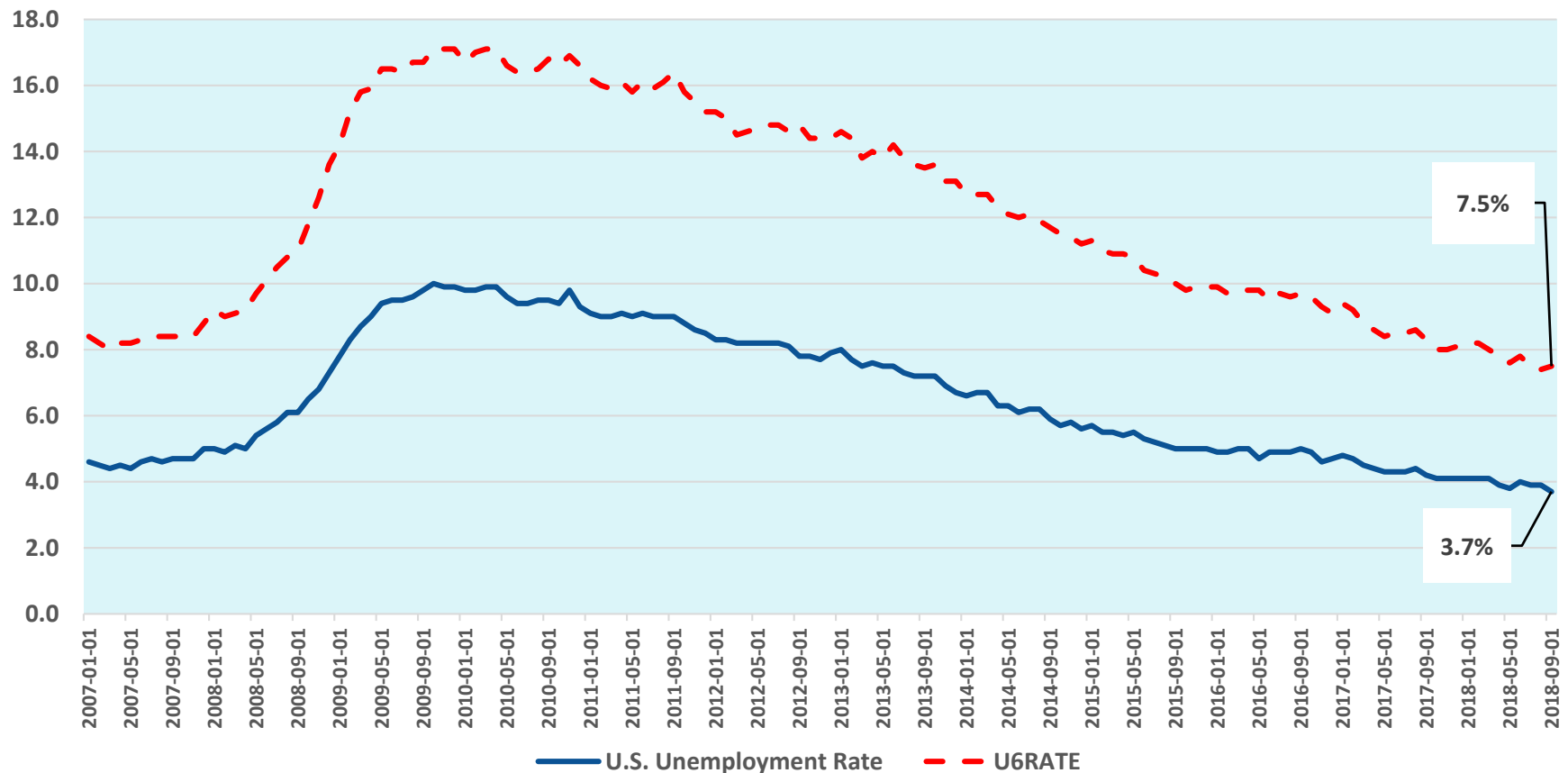
Index	Series Index Sep	Series Index Aug	Percentage Point Change	Direction	Rate of Change	Trend* (Months)
PMI [®]	59.8	61.3	-1.5	Growing	Slower	25
New Orders	61.8	65.1	-3.3	Growing	Slower	33
Production	63.9	63.3	+0.6	Growing	Faster	25
Employment	58.8	58.5	+0.3	Growing	Faster	24
Supplier Deliveries	61.1	64.5	-3.4	Slowing	Slower	24
Inventories	53.3	55.4	-2.1	Growing	Slower	9
Customers' Inventories	40.5	41.0	-0.5	Too Low	Faster	24
Prices	66.9	72.1	-5.2	Increasing	Slower	31
Backlog of Orders	55.7	57.5	-1.8	Growing	Slower	20
New Export Orders	56.0	55.2	+0.8	Growing	Faster	31
Imports	54.5	53.9	+0.6	Growing	Faster	20
OVERALL ECONOMY				Growing	Slower	113
Manufacturing Sector				Growing	Slower	25

Consumer Sentiment is Up, Buoyed By a Strong Job Market



Source: University of Michigan: Consumer Sentiment, Index; Federal Reserve of St. Louis

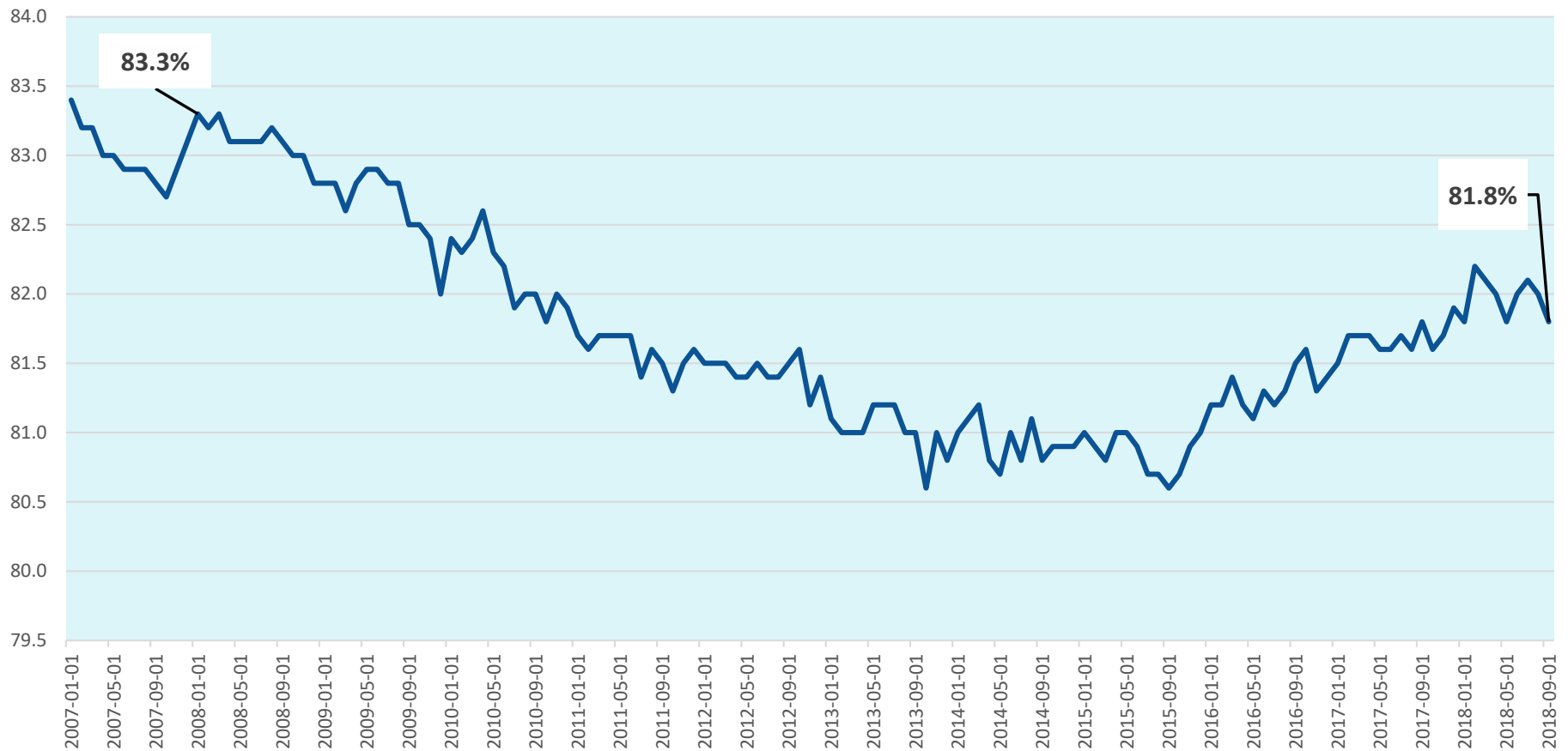
At 3.7%, the U.S. Unemployment Rate Is at a 49-Year Low and the U6 Rate Is At a 17-Year Low



Note: U6 Rate represents total unemployed, plus all marginally attached workers plus total employed part time for economic reasons. Source: Federal Reserve Bank of St. Louis

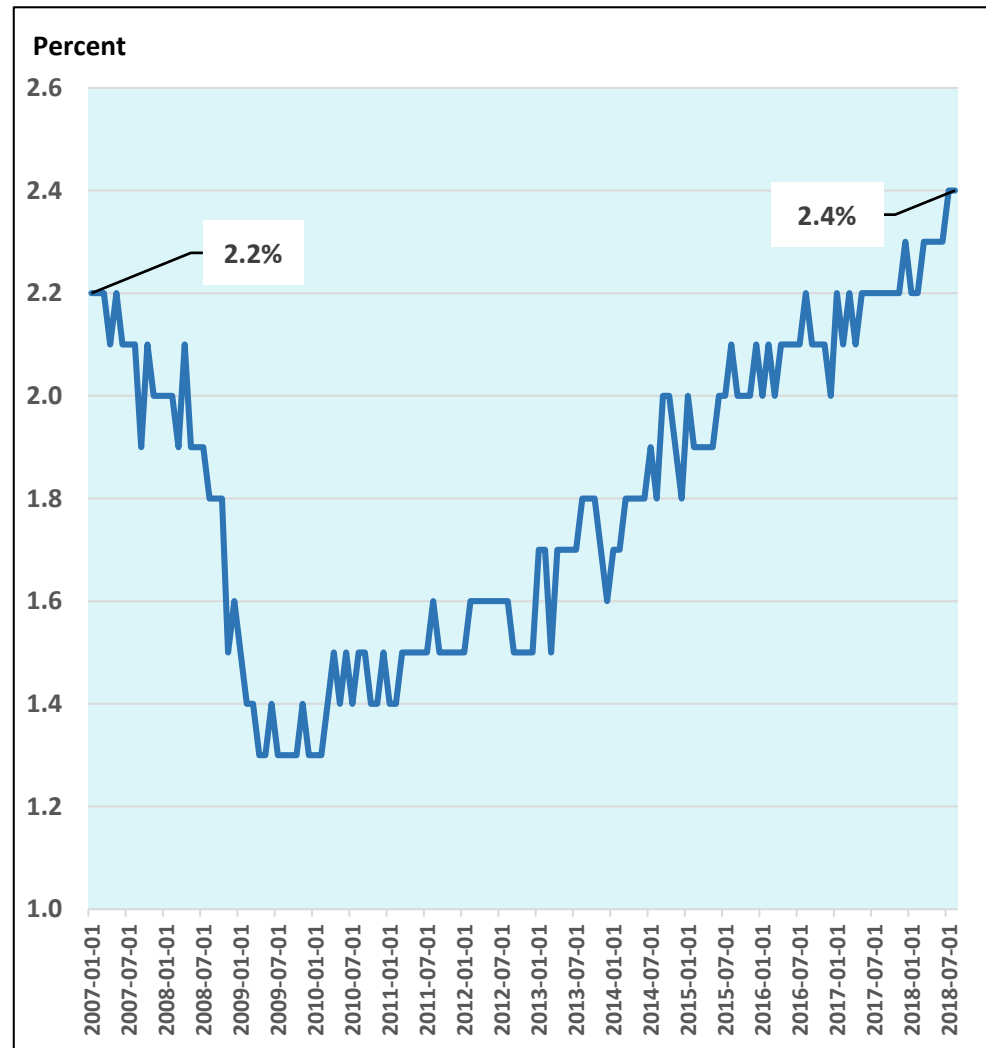
Employment – Share of Prime Working Age (25-54)

Employed is Still 1.5% Below Pre-Recession Levels, But Has Been Improving

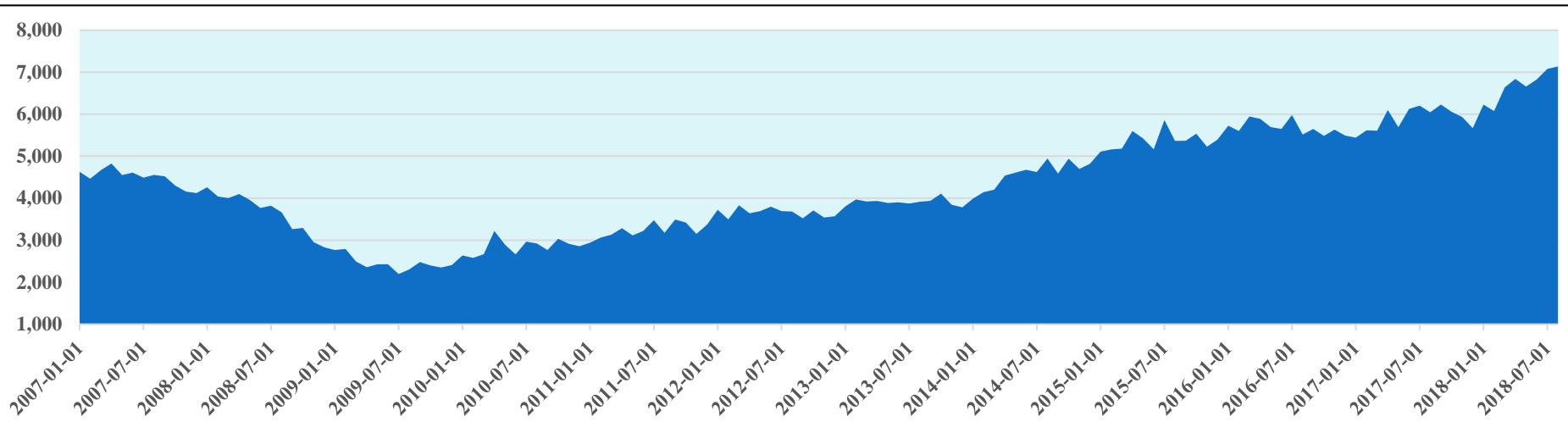


Quit Rates Are The Highest Since 2001

- The quit rate is a useful measure of how much confidence workers feel and how many opportunities they have to switch to a more attractive job
- The percentage of working-age Americans who voluntarily left their job stood at 2.4% in August, above 2007 pre-recession levels
 - South region quit rates are the highest, at 2.7%, up from 2.3% a year ago
- The rise in the quit rates also bolsters expectations that wage gains will accelerate
- Leisure and Hospitality; Retail; and, Professional and Business Services have the highest quit rates



Job Openings Are At an All Time High



Source: Federal Reserve Bank of St. Louis

- A high number of job openings is a mix of good and bad news
 - The good: Employers are hiring. When the Great Recession was at its worst in 2009, job openings fell to 2.2 million, an all-time low
 - The bad: The gain in job openings underscores the need for workers in an economy that's continuing to expand. At the same time, the pool of qualified Americans is shrinking and making some positions tougher to fill
 - Will spur employers to pay more to attract workers
- 52% of all job openings are in: Professional and Business Services; Trade, Transportation and Utilities; and Health Care
- South region of the country accounts for 37.7% of all openings



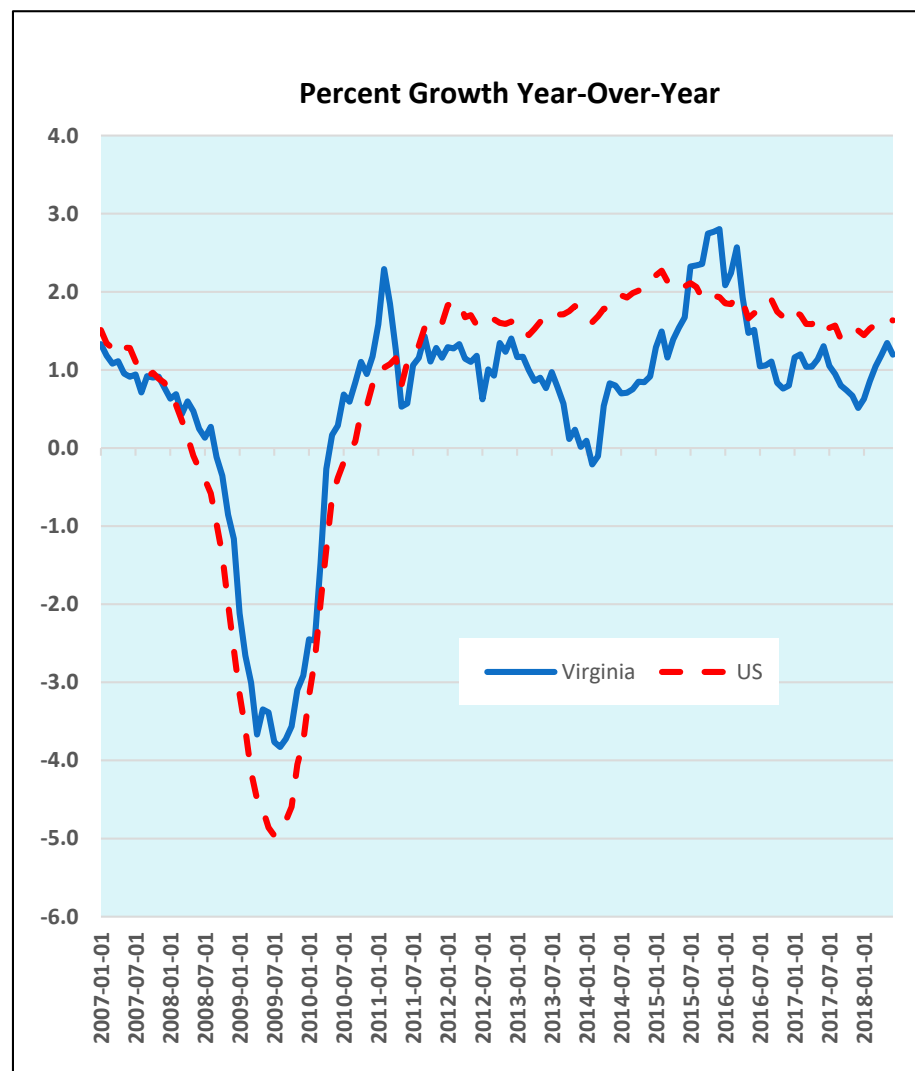
Virginia's FY 2018 Performance

Is There a Disconnect Between Withholding
and Job and Wage Growth?



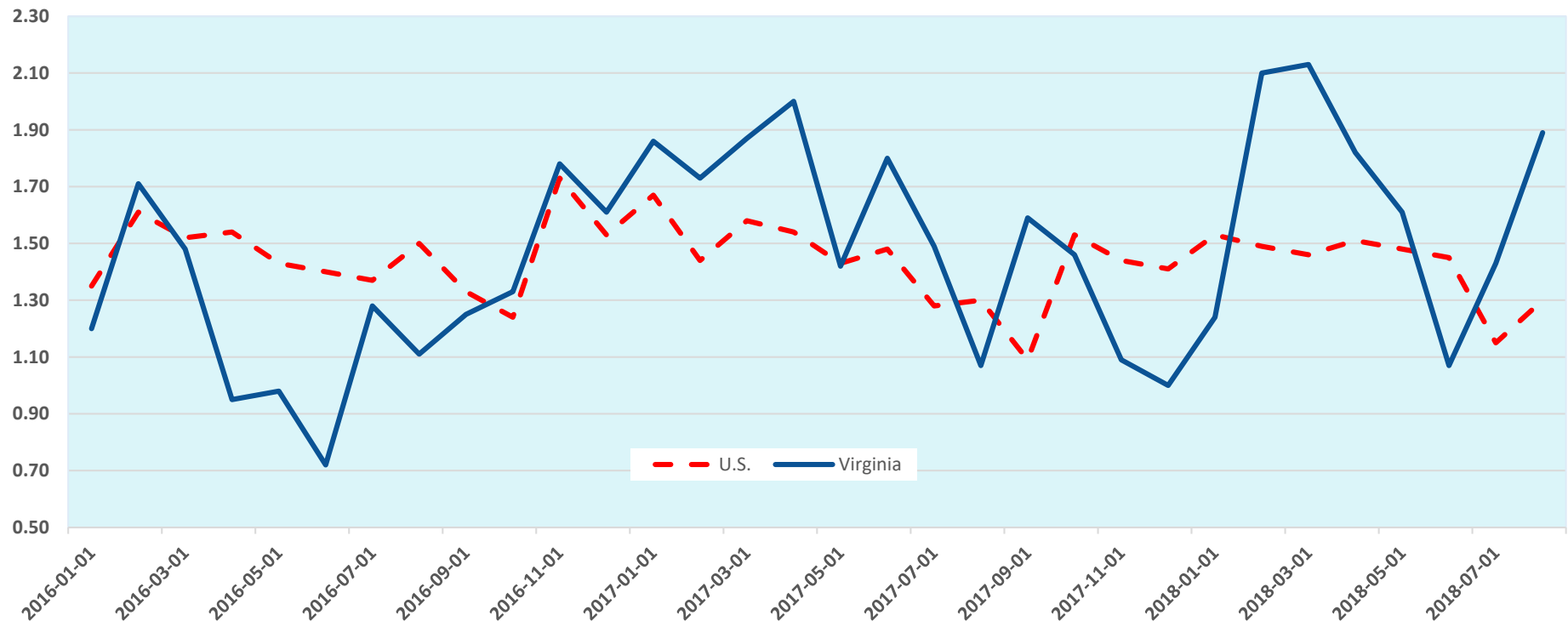
Since The Recession Several Factors Have Impacted Virginia's Job Growth

- 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
- During the recession and shortly thereafter, Virginia out-performed the nation
- Budget sequestration and continued federal budget uncertainty impacted growth in 2013, 2014, and 2015
- Other factors that may impact job growth is Virginia's low unemployment rate and the lack of skilled workers for high demand jobs



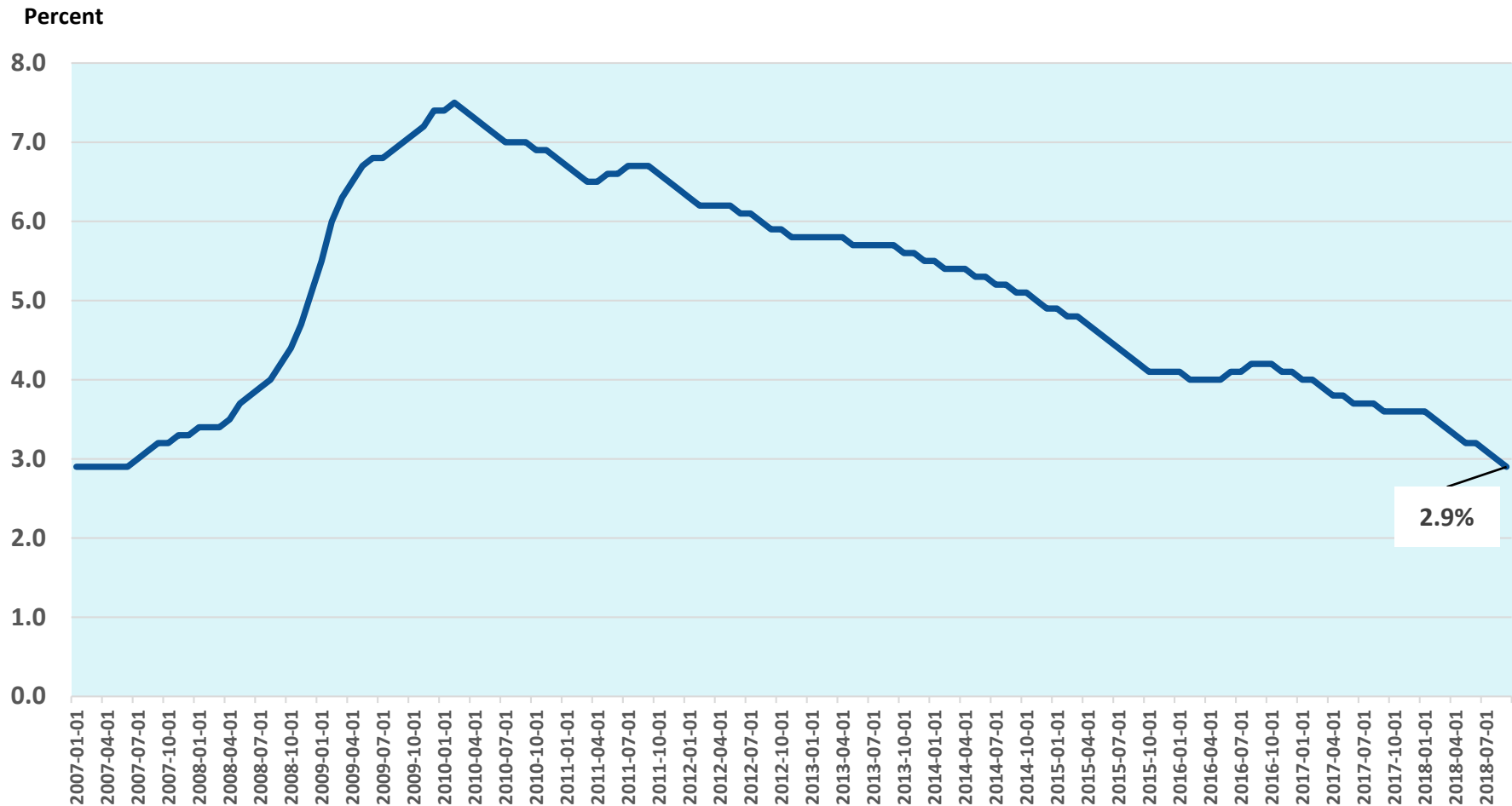
Virginia Is Out-Performing The Nation

Leading Coincident Index



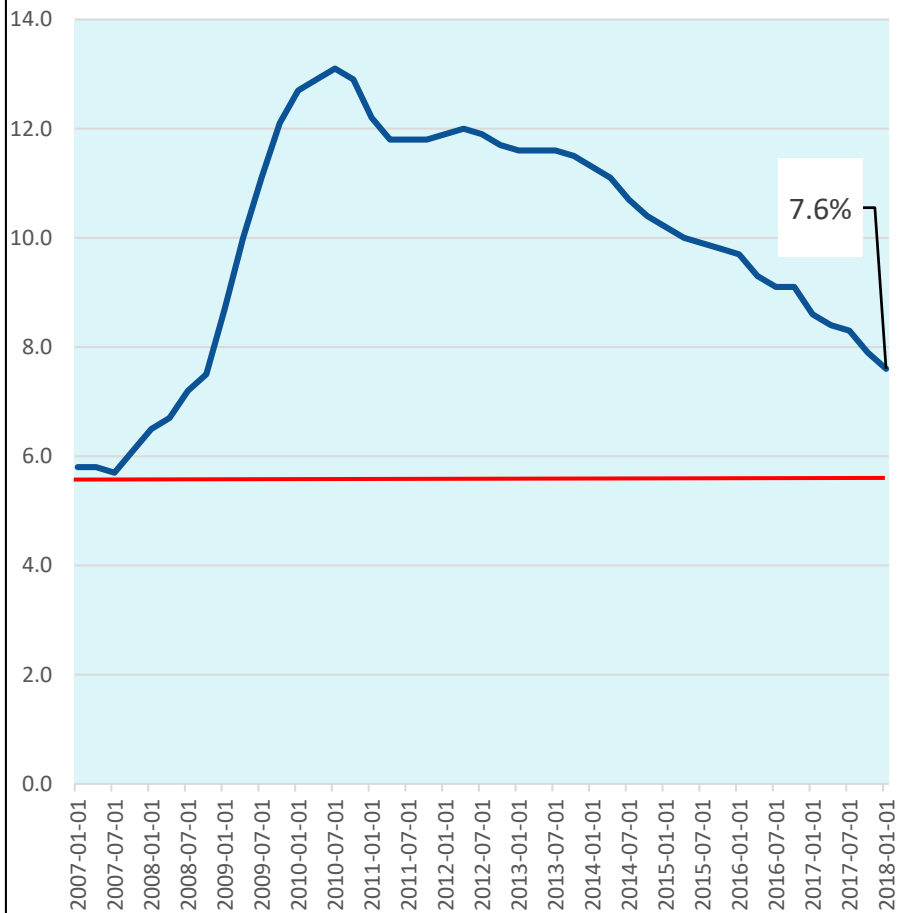
The leading index for each state predicts the six-month growth rate of the state's coincident index. In addition to the coincident index, the models include other variables that lead the economy: state-level housing permits (1 to 4 units), state initial unemployment insurance claims, delivery times from the Institute for Supply Management (ISM) manufacturing survey, and the interest rate spread between the 10-year Treasury bond and the 3-month Treasury bill

Virginia's Unemployment Rate Is Back At Prerecession Levels, Ranks in the Lowest 8 Among States

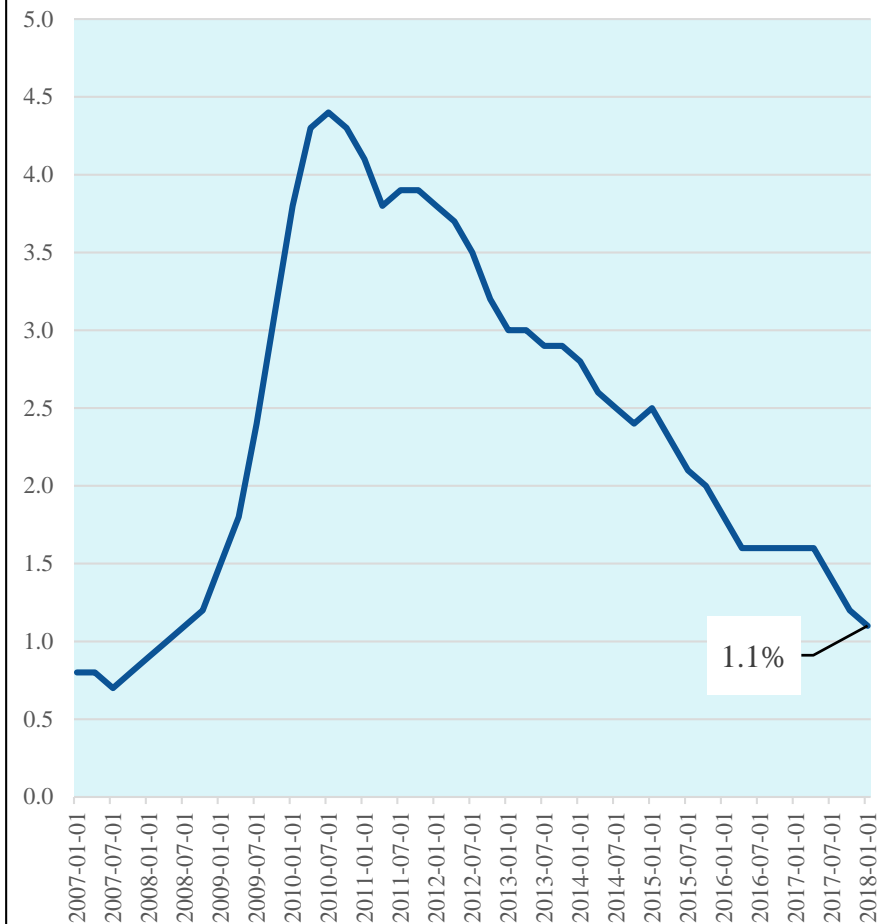


Employment Situation Has Been Improving, Moving Closer To Pre-Recession Levels

Percent: Total Unemployed, Plus Marginally Attached, Plus Part-time



Percent: Unemployed 15 Weeks or Longer

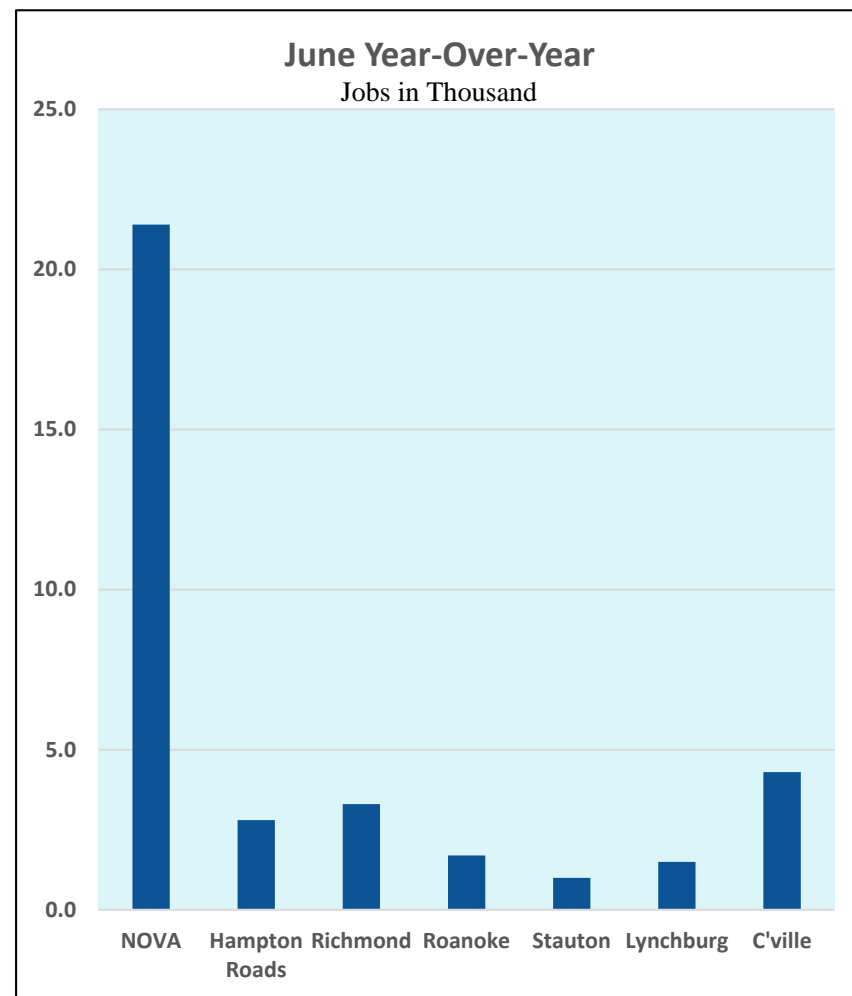


June 2017-18, Virginia Employment Grew 1.2%, Adding 47,300 Jobs. Was Performance Consistent With The Economic Forecast?

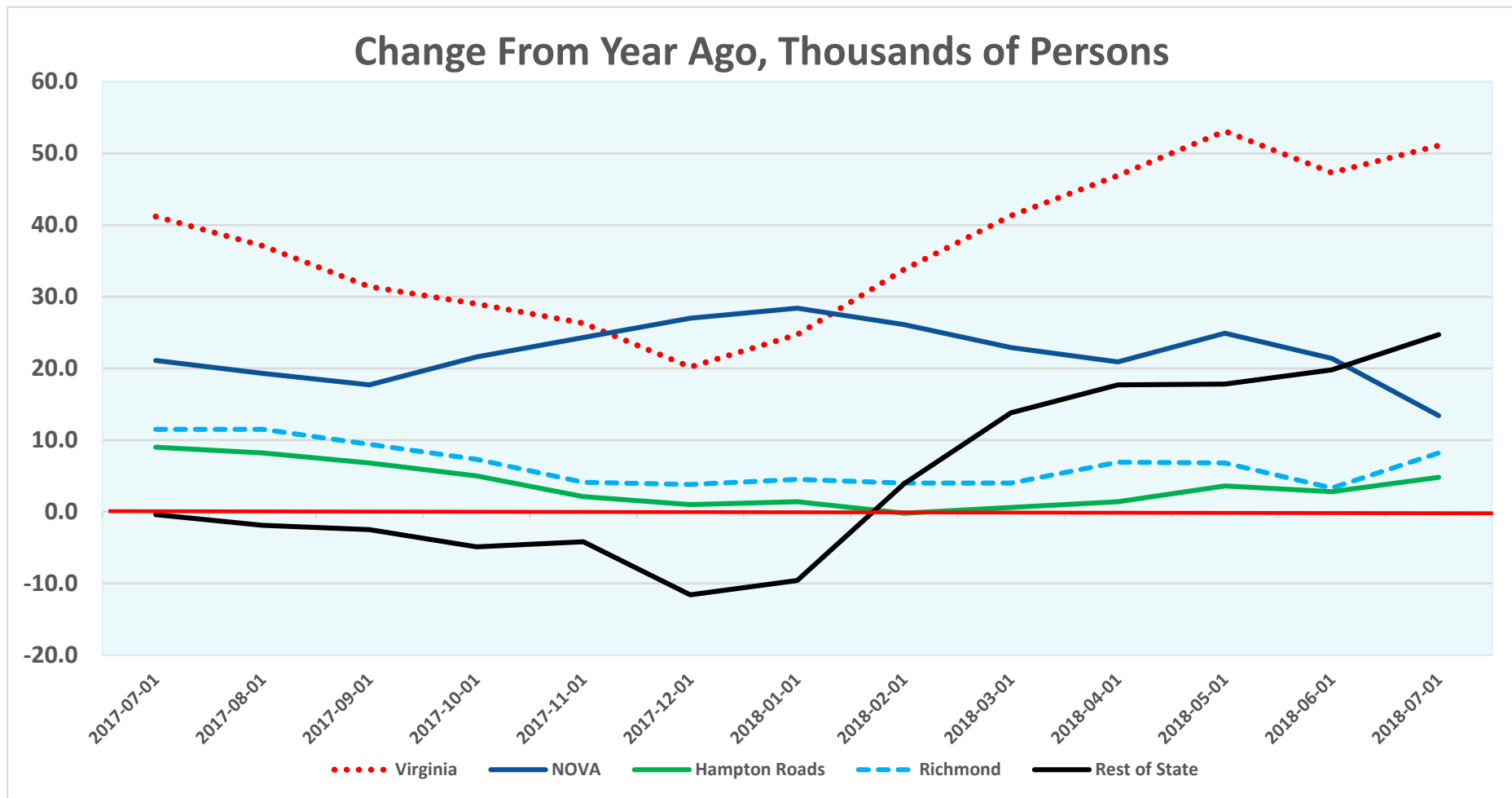
- Withholding taxes represents 63% of total general fund tax collections
 - Job growth and average wages and salaries serve as the proxy for withholding
- Virginia payroll withholding grew 5.4% or \$227.2 million above forecast. When adjusted for approximately \$120 million in collections that should have occurred in July, payroll withholding grew 4.4%, exceeding the forecast of 3.5%
- Preliminary economic data suggests Virginia's job and salary growth was consistent with the forecast assumptions
- So why is there a disconnect between economic inputs and actual payroll withholding?
- Is payroll tax collections driven more by where job growth occurs, the industry mix, and wages paid?

Northern Virginia Captured 45.3% of New Jobs in June 2018, Year Over Year

- NoVa accounted for over half the total jobs, with a year-over-year rate of growth of 1.7%, ranking 23 out of 36 in job growth for MSAs over 1 million people
- Charlottesville had the highest rate of growth at 3.7%, ranking 30 out of 363 in growth for MSAs under 1 million people
- Richmond and Hampton Roads had job growth less than half a percent, ranking 243 and 246 in growth for MSAs under 1 million people
 - These regions account for 36.5% of Virginia total jobs, and is why Virginia's overall growth rate was subpar

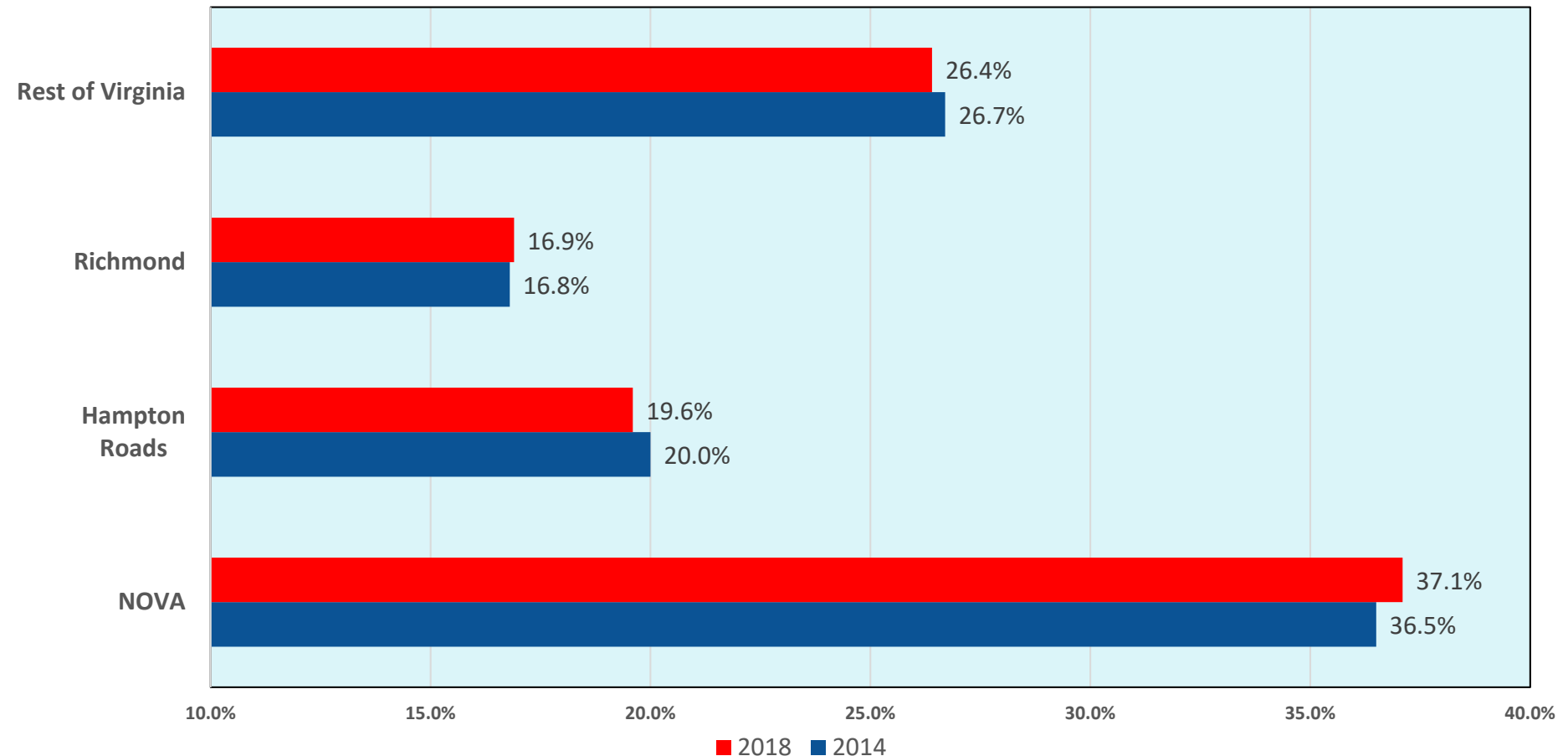


Northern Virginia Dominated Overall Job Growth, But Employment Picked Up Considerably Around March For the Rest of The State



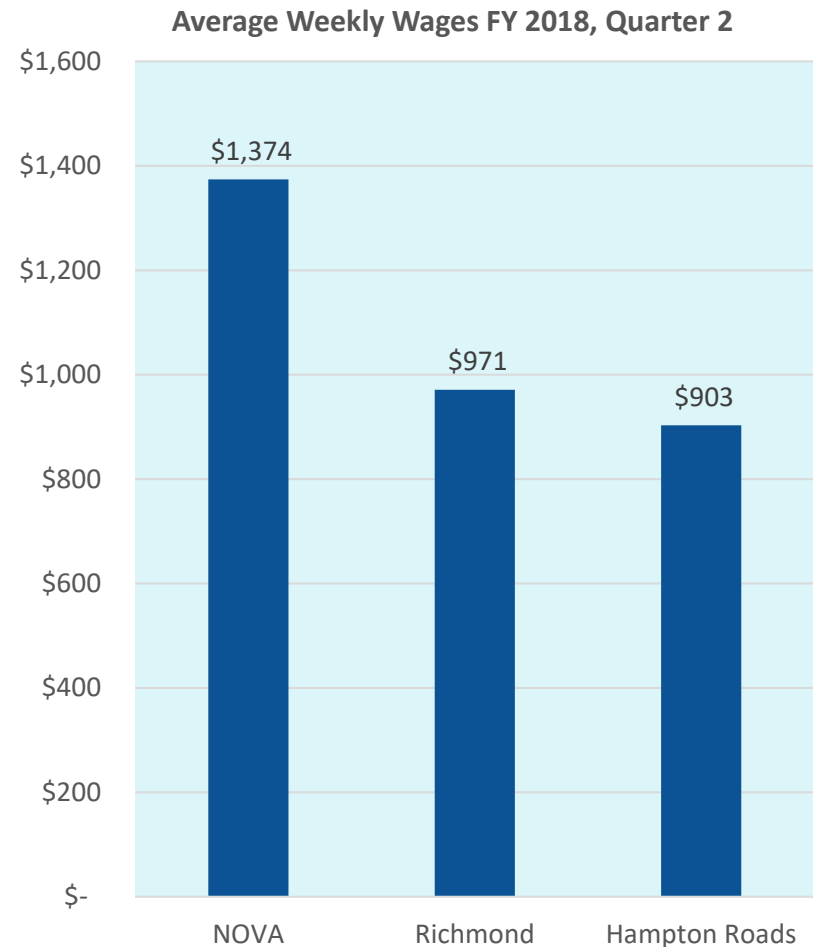
Northern Virginia Now Accounts for 37.1% of Virginia's Total Jobs, Up From 36.5% 4 Years Ago

Employment By Region

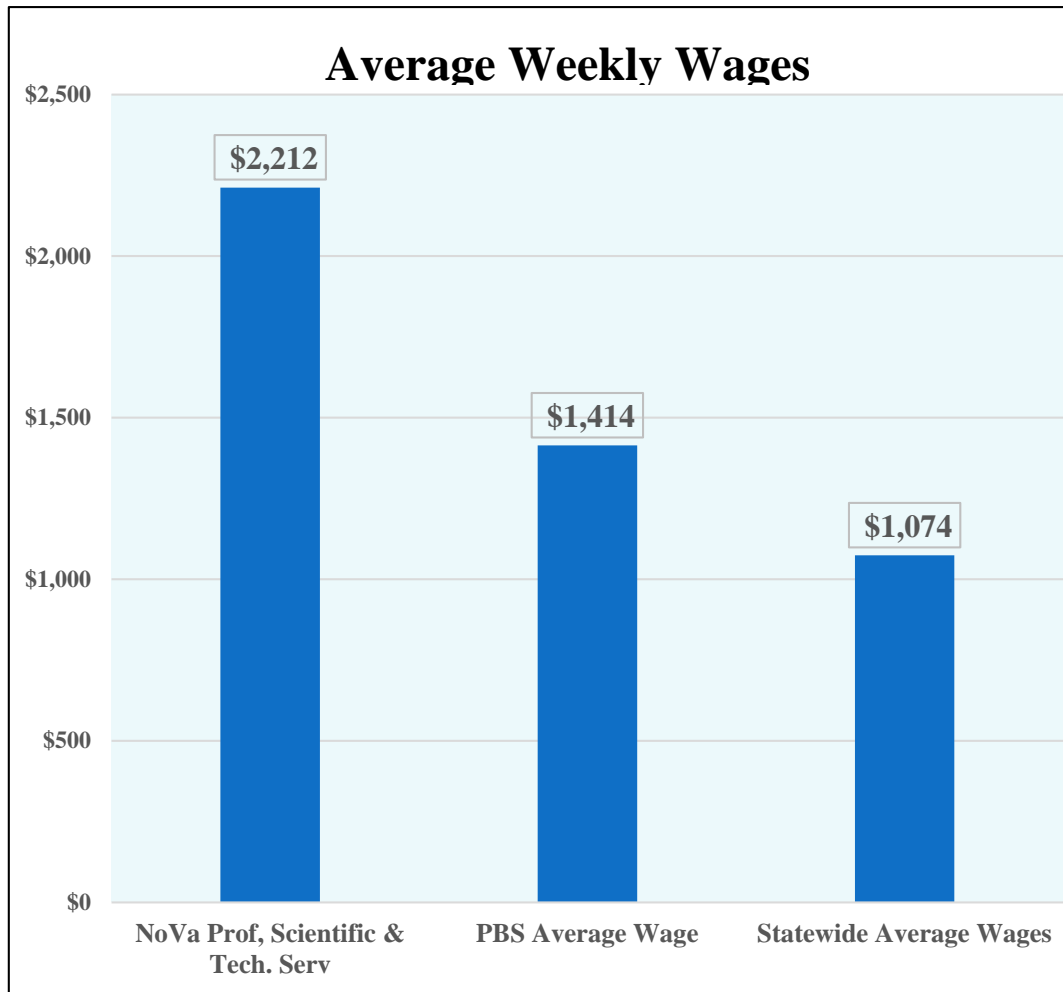


NOVA Average Weekly Wages Are 28% Higher Than State Average, But They Are Included In The Average

- Northern Virginia accounted for 53% of the job growth in FY 18 and have average wages 41.5% and 52.1% greater than Richmond, and Hampton Roads respectively
- Professional and Business Services, which have among the highest weekly wages, accounts for 28% of Northern Virginia's total employment
 - 55% of all PBS jobs are in Northern Virginia
 - Richmond and Hampton Roads account for 30%



Professional, Scientific, and Technical Services Represents 65% of PBS Employment in NOVA

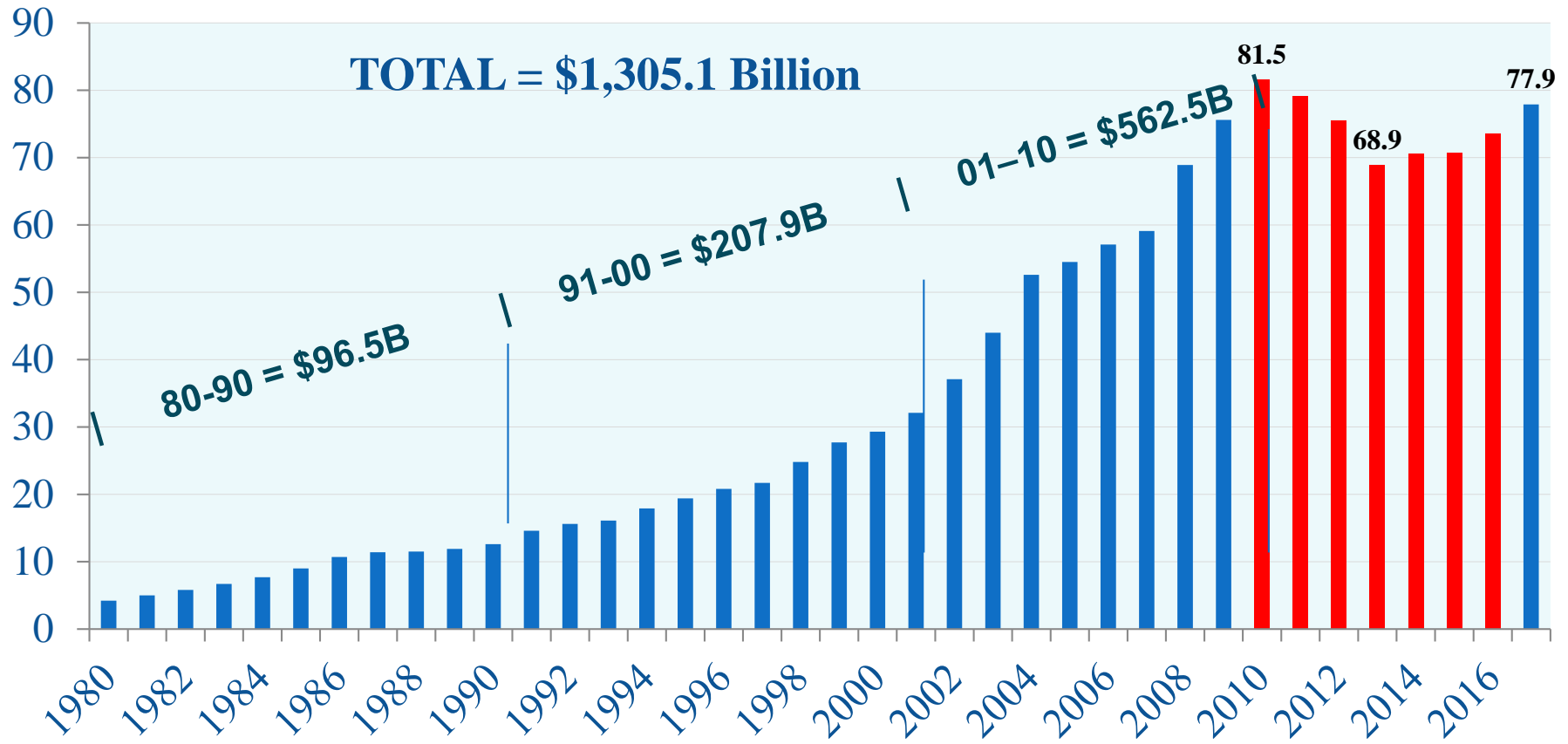


- Professional, Scientific and Technical Services Sector accounts for 20% of NOVA's total employment
- Average weekly wages are over 200% higher than the statewide average and over 56% greater than the average wages for Professional and Business Services
- Contributing to the increase in jobs has been an increase in federal procurement in the Washington region

Federal Procurement in the Washington Region, 1980-2016

After Peaking in 2010, Procurement Spending Dropped For 3 Years, Before Increasing Again Since 2014

(\$s Billions)



Source: US Census, Consolidated Federal Funds Report and USAspending.gov, The Stephen S. Fuller Institute at the Schar School, GMU



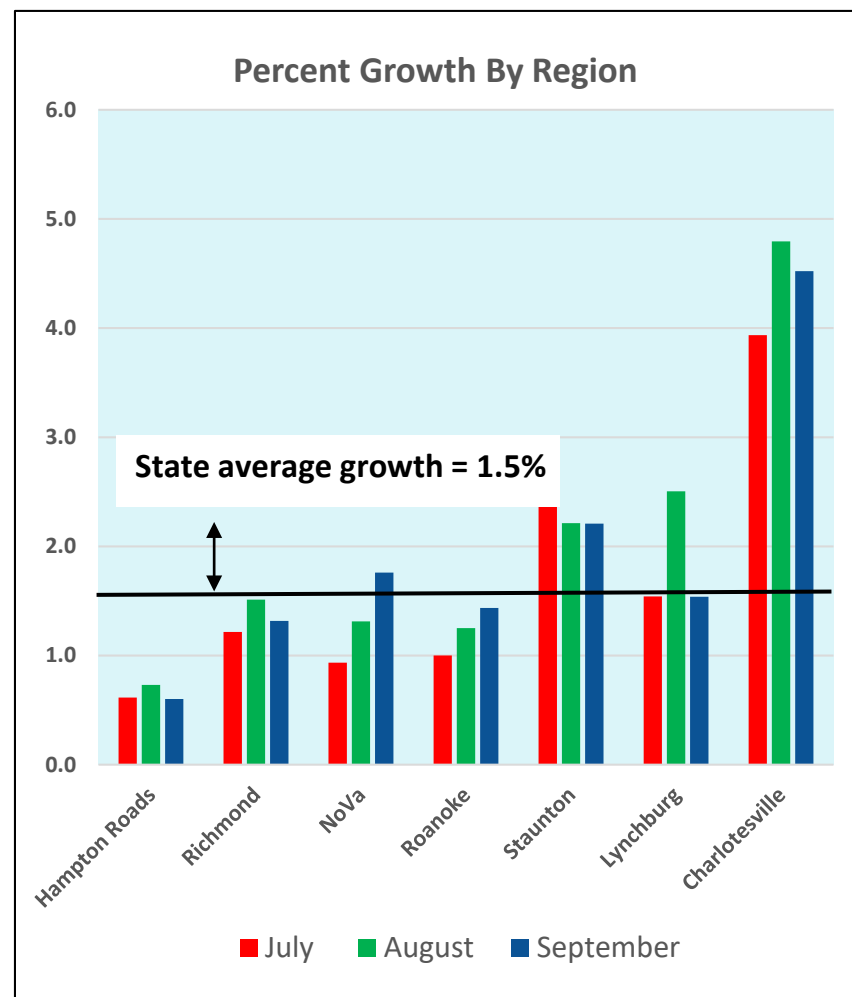
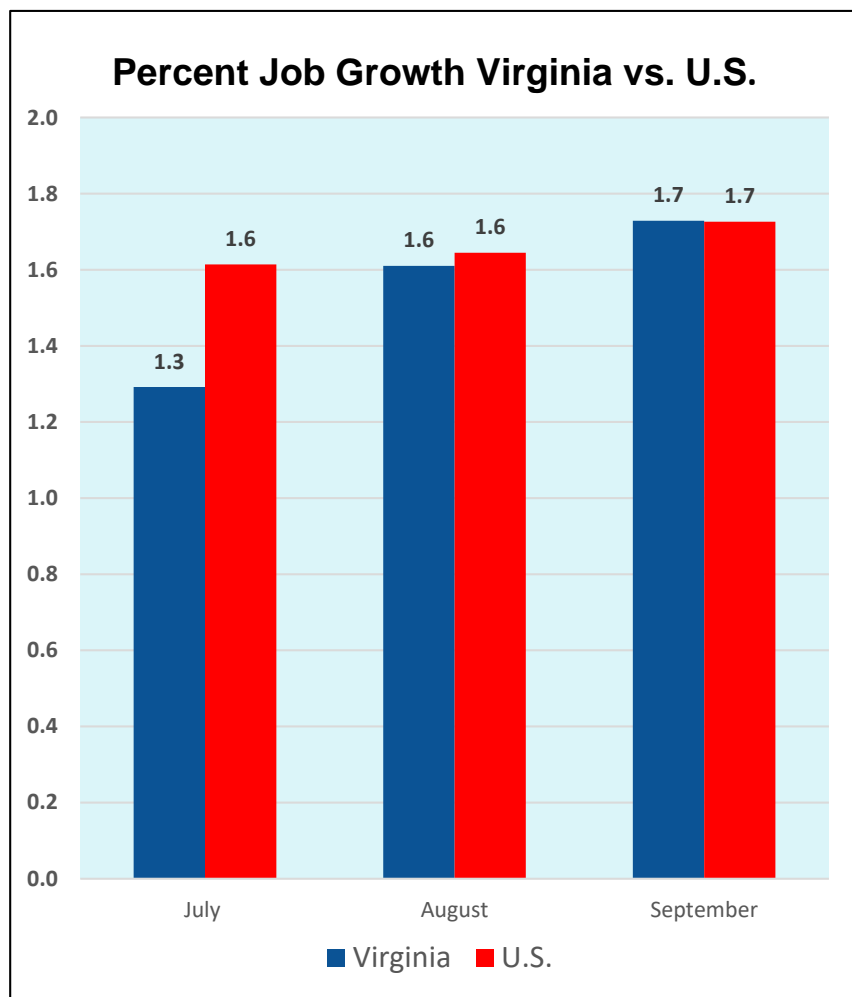
Fiscal Year 2019

First Quarter Employment



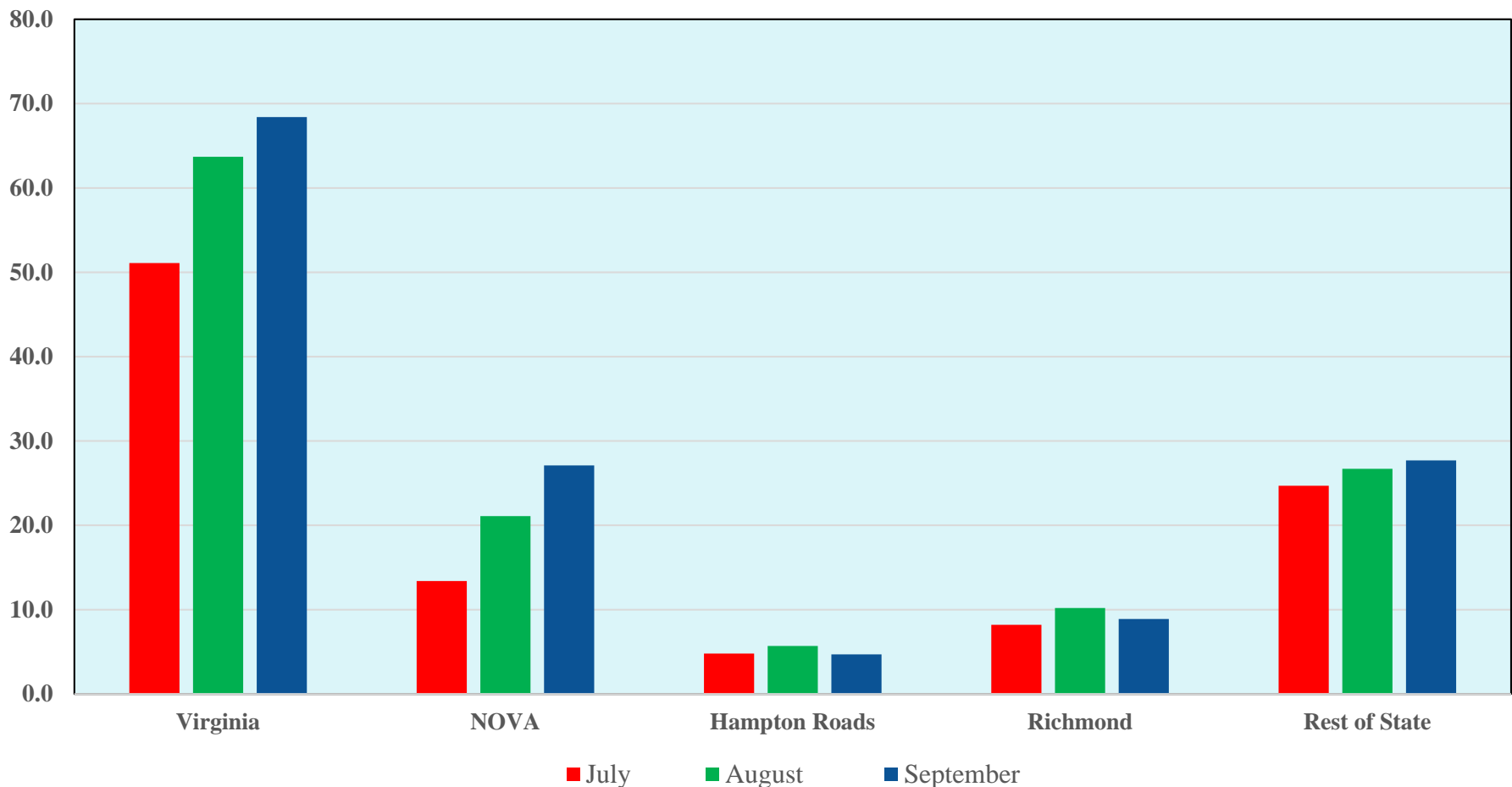
Virginia's Employment Growth is On Par With The Nation...But Job Growth By Region Varied

Percent Year over Year July – September 2018



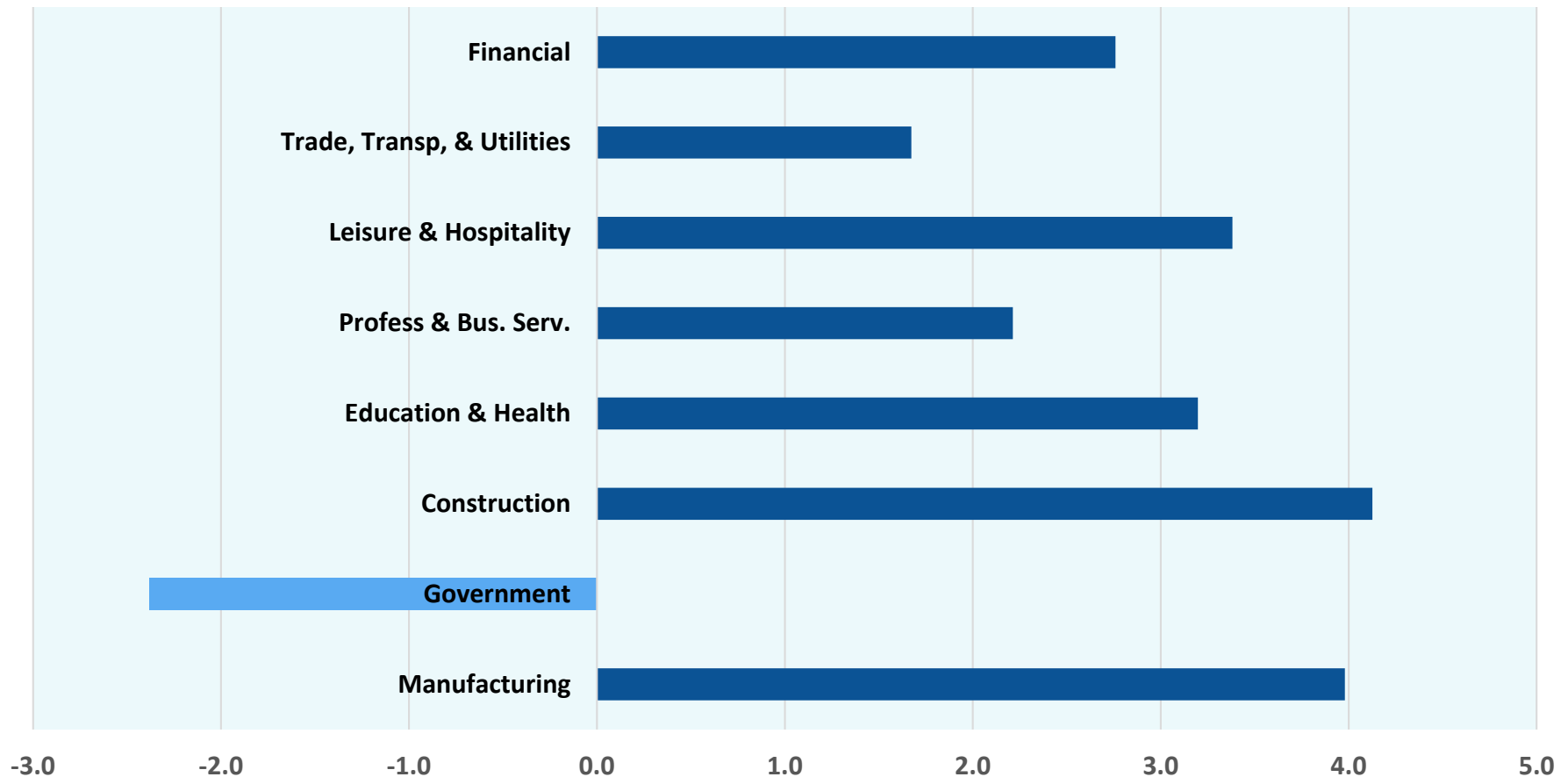
First 3 Months Saw Strength in All Regions Except Hampton Roads

Change From Year Ago, Thousand of Persons



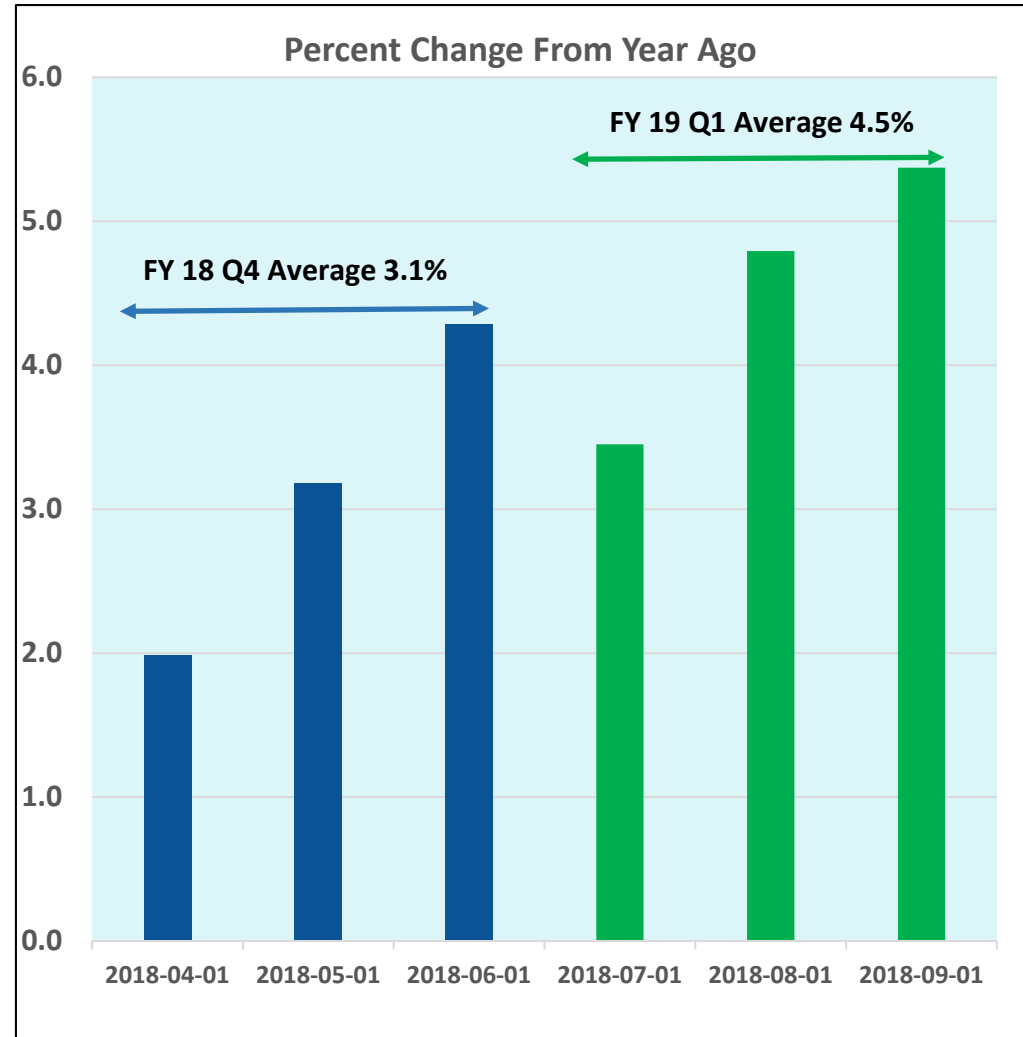
Growth in Virginia's Employment Was Led by Construction and Manufacturing Sectors

Percent Growth, Year-over-Year September 2017-2018

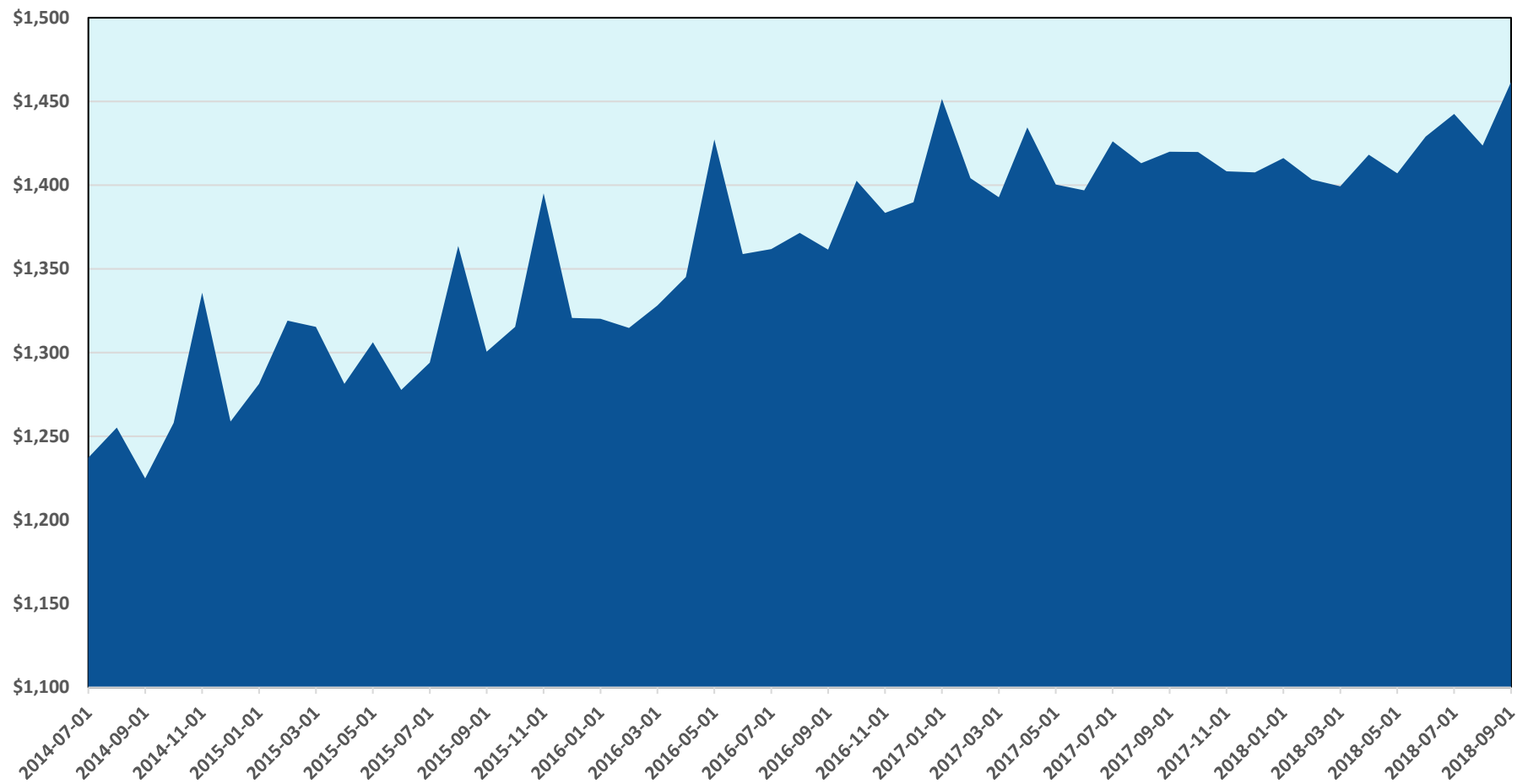


Average Weekly Wages For Private Employers Have Been Rising

- Average weekly wages for private industry have increased 7.1% from fiscal year 2016 through FY 2018
 - Average about 2.4% per year
- Average weekly wages in the first quarter of 2019 are up 4.5% over first quarter of 2018
 - September over September average weekly wages is up 5.4% overall, and 5.6% in NOVA
- The strongest average wage growth has been in Professional and Business Services



Average Weekly Wages For Professional and Business Services (PBS) has Risen 12.8% Fiscal Year 2015 Through FY 2019 Q1





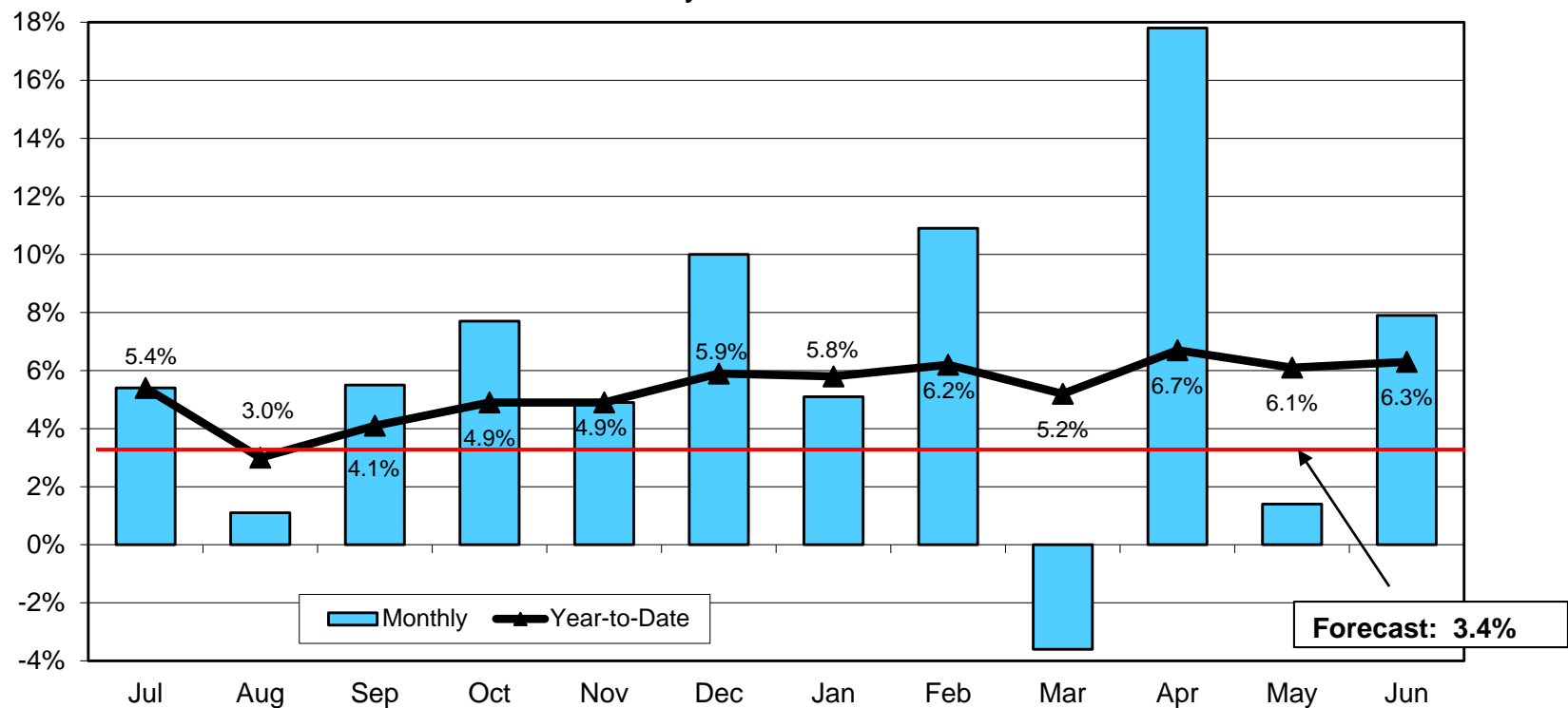
FY 2018 Performance



Looking Back: FY 2018 Revenue Performance

- FY 2018 GF collections rose 6.3%, ahead of the annual forecast of 3.4% growth. Annual growth remained above forecast levels 11 months of the year
- Excluding transfers, revenue collections exceeded the forecast by \$552.6 million, a variance of 2.9%

Growth in Total General Fund Revenue Collections
FY18 Monthly and Year-to-Date



With Transfers, FY 2018 Revenues Finished \$555.5 Million Above Forecast...

Summary of Fiscal Year 2018 Revenue Collections (millions of dollars)

Major Sources	As a % of Total General Fund				% Growth Over FY 17	
		Official	Actual	Change	Official	Actual
Withholding	61.5%	\$12,313.3	\$12,540.5	\$227.2	3.5 %	5.4 %
Nonwithholding	15.6	3,147.3	3,472.9	325.6	4.3	15.1
Refunds	(9.6)	(1,968.7)	(1,907.6)	61.1	5.8	2.5
Net Individual	67.5%	\$13,491.9	\$14,105.8	\$613.9	3.4 %	8.1 %
Sales	17.4%	\$3,458.2	\$3,461.8	\$3.6	3.0 %	3.1 %
Corporate	4.3	874.0	861.9	(12.1)	5.7	4.2
Wills (Recordation)	2.0	407.2	394.9	(12.3)	3.3	0.1
Insurance	1.8	362.1	337.9	(24.2)	6.2	(0.9)
All Other Revenue	3.7	734.8	718.5	(16.3)	1.6	(0.6)
Total Revenue	96.6%	\$19,328.2	\$19,880.8	\$552.6	3.4 %	6.3 %
A.B.C. Profits	0.6	\$104.1	\$109.5	\$5.4	(5.8) %	(0.9) %
Sales Tax (0.375%)	1.9	379.1	376.6	(2.5)	3.6	2.9
Transfers	0.9	142.1	142.2	0.1	(19.7)	(19.6)
Total Transfers	3.4%	\$625.3	\$628.3	\$3.0	(4.3) %	(3.8) %
TOTAL GENERAL FUND	100.0%	\$19,953.5	\$20,509.0	\$555.5	3.1 %	6.0 %

FY 2018 Revenue Surplus Fully Obligated

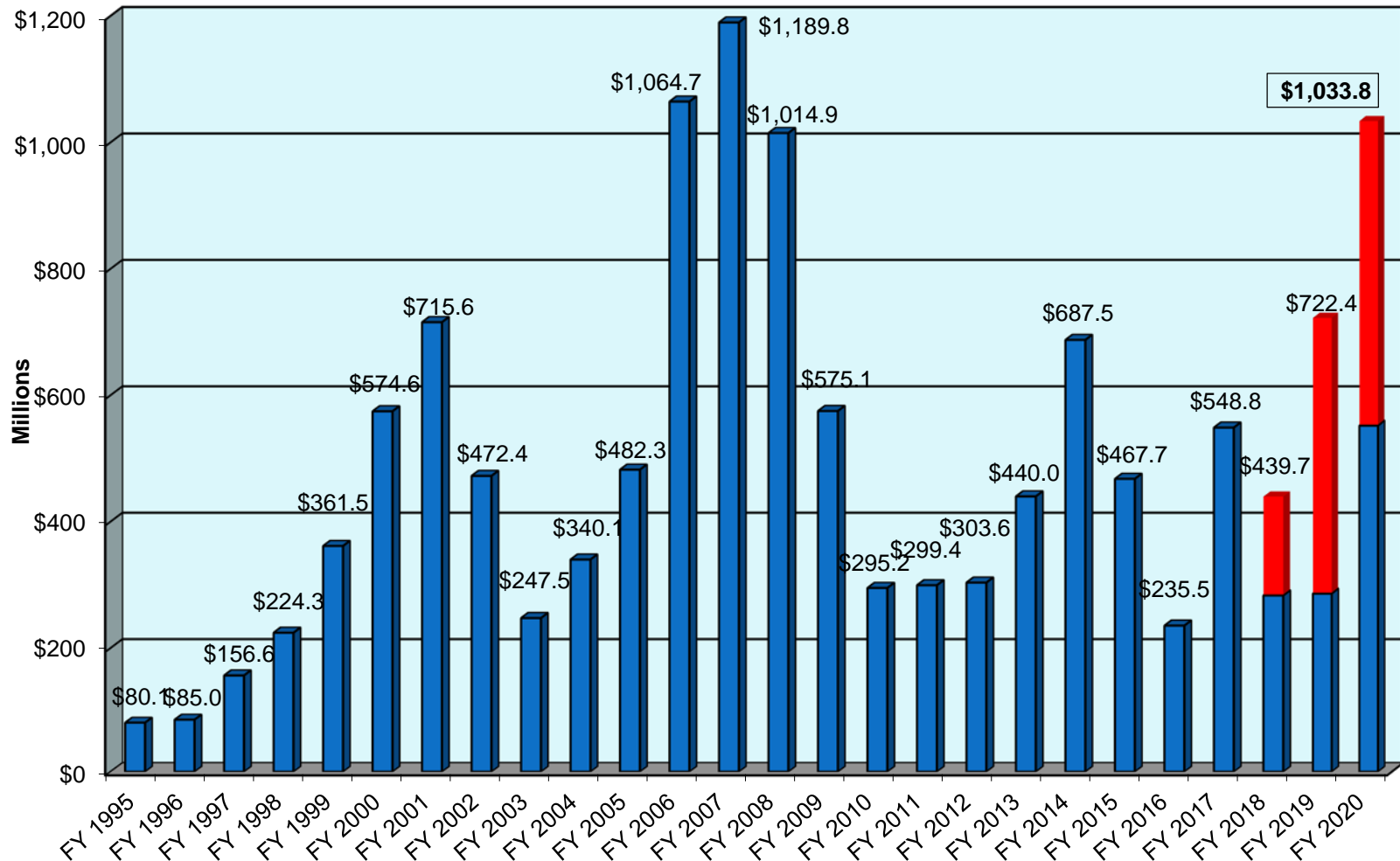
- Mandatory activities consumed the revenue surplus
 - Vast majority of the \$552.6 million surplus is required to meet Revenue Stabilization Fund and Revenue Cash Reserve Fund requirements
 - \$262.9 million will be deposited to the Rainy Day Fund to meet the FY 2020 mandatory deposit requirement based on FY 2018 performance
 - \$234.4 million from surplus went to the Revenue Cash Reserve Fund established pursuant to House Bill 763, 2018 General Assembly
 - Chapter 2 included \$90.0 million for the Revenue Cash Reserve
 - \$156.4 million had been appropriated to the Revenue Cash Reserve Fund in FY 2018
 - Water Quality Improvement Fund deposit based on surplus revenues totals \$55.3 million, using remainder of revenues
 - An additional \$18.5 million goes to the WQIF based on unencumbered agency balances
 - Results in a total appropriation of \$73.8 million in FY 2020

In FY 2020, Total Reserves Are Estimated Will Exceed \$1.0 Billion

Total of All Reserves

■ Revenue Stabilization Fund

■ Revenue Cash Reserve



Revenue Stabilization Fund totals \$551.9 million, Revenue Cash Reserve will total \$481.9 million by FY 2020.

Biennial Adjustments Resulting from Higher than Anticipated FY 2018 Base

- Although the FY 2018 surplus exceeded \$555 million, the full amount of that surplus does not flow through to the FY 2019 base
- Two major adjustments have to be made:
 - Exclude \$120 million in withholding collections accruing in FY 2018 that otherwise would have been in FY 2019 except for the timing of the July 4 holiday
 - Discount non-withholding to reflect the continued use of the “collar” and the exceptionally high collections in FY 2018 – that requires removing \$193.0 million from assumed base to continue “collaring” non-withholding
 - The collar is calculated by capping non-withholding at the 10-year average share of total revenues generated by that source. Currently that is 15.89%
 - Actual collections in FY 2018 were 17.47% of GF revenues
- After making these adjustments, the base increases only \$242.0 million above the FY 2018 forecast when calculating new forecast for FY 2019 and FY 2020



Revised GF Revenue Outlook 2018 – 2020 Biennium



Fall Reforecasting Process

- The *Code*-required Fall reforecasting process is currently underway
- Joint Advisory Board of Economists (JABE) met on October 11th to review the latest economic assumptions and revised methodologies
 - Board includes economists from both private sector and academia, as well as input from IHS Markit and Moody's Analytics
 - Department of Taxation and Secretary of Finance will develop a revised forecast based on input received
- Governor's Advisory Council on Revenue Estimates (GACRE) will meet November 19th
 - Cross-section of leaders from Virginia business and industry, and General Assembly leadership
 - Members review the 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 2
 - Governor will present to Joint Money Committees on December 18th

National Economic Outlook: Revisions to the 2018-20 Biennium

- Overall projections for the national economic picture have been upgraded slightly since the Official Forecast was developed based on IHS Markit's October 2017 assessment
- Upward adjustments have been incorporated for employment and GDP; total income growth remains largely unchanged; and wage growth has been reduced marginally for both FY 2019 and FY 2020

Projected National Economic Variables

	Job Growth	GDP	Total Wage/Salary	Income Growth
FY 2019				
IHS October 2017 Standard	1.2%	2.3%	4.9%	4.5%
IHS October 2018 Standard	1.6%	3.0%	4.6%	4.4%
FY 2020				
IHS October 2017 Standard	1.0%	2.2%	4.9%	5.0%
IHS October 2018 Standard	1.3%	2.4%	4.8%	4.9%

Virginia's Economic Outlook: Revisions to the 2018-20 Biennium

- Sizeable improvements in Virginia's jobs outlook are projected compared to last year's forecast for the biennium
- These are offset by marginally reduced average wage estimates
- Slight improvements assumed for personal income and total wages and salaries in both years

Projected Economic Variables

(National Forecast, adjusted for Virginia specific data)

	Job Growth	Avg Wage/Salary	Total Wage/Salary	Income Growth
FY 2019				
Official Forecast (October 2017)	1.0%	3.4%	4.4%	4.3%
September 2018 Standard	1.7%	2.9%	4.6%	4.4%
FY 2020				
Official Forecast (October 2017)	0.8%	3.1%	4.0%	4.6%
September 2018 Standard	1.2%	3.0%	4.2%	4.7%

FY 2019 Performance Through October

- The budget forecast in Chapter 2 was predicated on revenue growth of 4.4% in FY 2019
- Because FY 2018 actual collections exceeded the revenue forecast substantially, we now can meet the budget forecast – the actual revenue numbers – with a growth rate of 1.5%
 - The increase in the base against which FY 2019 growth is measured means we will generate more revenue than assumed in Chapter 2 even absent any changes to the underlying economic forecast
- Through the first third of the fiscal year, revenues have increased 4.5% and are exceeding the official forecast by 3 percentage points
 - Year-to-date strengths are seen in our 3 largest sources: withholding, nonwithholding, and sales taxes
 - Weaknesses apparent in corporate and recordation taxes
- Meeting the current forecast for FY 2019 requires growth of only 0.2% in the remaining 8 months of the fiscal year

FY 2019 Year-to-Date Performance

General Fund Revenue Forecast for Fiscal Year 2019

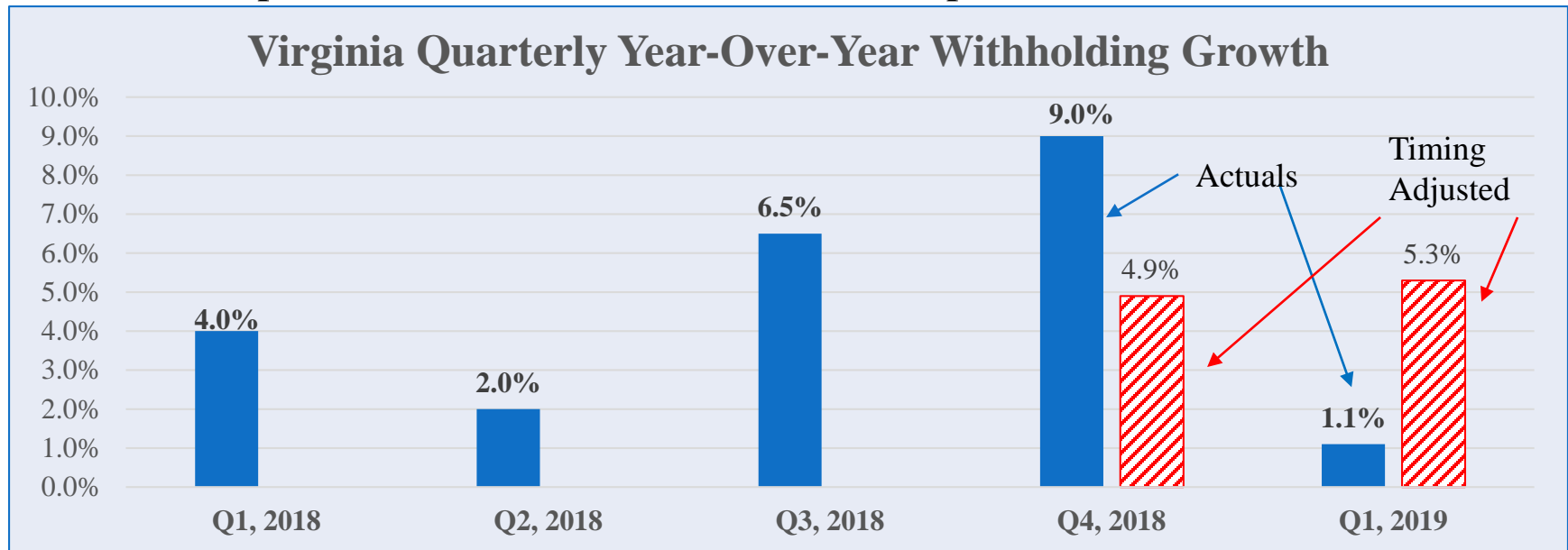
Source	<u>Growth Rates</u> Assumed in Ch. 2 Forecast	Growth Required to Meet Ch. 2 <u>Revenue</u> Forecast	Actual Performance Through October	Nov-June Required to Meet Forecast
Withholding	4.5%	2.6%	4.1%*	2.0%*
Nonwithholding	6.8%	(3.0%)	15.5%	(6.7%)
Refunds	4.7%	7.7%	6.6%	7.8%
Net Individual	5.1%	0.6%	5.5%	(3.1%)
Sales	2.6%	2.5%	4.7%	1.6%
Corporate	4.3%	5.8%	(10.9%)	13.4%
Wills (Recordation)	0.0%	3.1%	(7.4%)	9.0%
Insurance	4.0%	11.4%	--	11.4%
Total GF Revenues	4.4%	1.5%	4.5%	0.2%

Source: Virginia Department of Taxation

*Note: Withholding figures do not reflect \$120.0 million deposit made in June that should have been made in July. Adjusting for that timing anomaly, YTD withholding growth rate would be 7.2% and withholding would have to increase only 0.6% for the remainder of the year

Withholding Tax Forecast

- Withholding tax collections grew 4.1% through October, with year-to-date growth diminished by July collections which fell 5.5%
- Current economics support an underlying growth rate of 4.6% in FY 2019 and 4.2% in FY 2020 for withholding taxes
 - Assume actual growth of 4.0% for FY 2019 - lower than the economic growth because of a timing anomaly, and 4.1% growth in FY 2020
- This translates into an increase of \$174.2 million in FY 2019 and \$210.7 million in FY 2020 compared to the revenues assumed in Chapter 2



Note: Actual collections in Q4 FY 2018 and Q1 FY 2019 were distorted because of timing of the year-end close/July 4 holiday. \$120.0 million that typically would have accrued to FY 2019 was booked in FY 2018.

Sales Tax Forecast

- Sales tax collections grew 3.1% in FY 2018 following two tepid years of sub-2% growth
 - Chapter 2 assumed sales tax growth of 2.6% in FY 2019 and 2.2% in FY 2020
- The pace of personal income growth is projected to increase in both FY 2019 and FY 2020 and consumer confidence remains high
- Through October, sales tax collections have grown 4.7%
- Sales tax collections would have to grow only 1.6% during the last 8 months of the year to meet the current forecast
- Recommend raising the forecast to 4.0% in FY 2019 and assume smaller changes in the growth rate for FY 2020 at this point – 3.2% growth
 - Results in additional revenues of \$52.9 in FY 2019 and \$90.3 in FY 2020 compared to Ch. 2
- These projections make no explicit assumptions about revenue that would be generated from expanded taxation of internet sales
 - However, an increasing number of online retailers have begun voluntarily remitting sales tax further supporting assumptions of higher growth as collections come more aligned with rates of total retail sales

Non-Withholding Forecast

- Chapter 2 assumes non-withholding growth of 7.0% in FY 2019 and 7.9% in FY 2020
- FY 2018 actuals were far better than anticipated –growth of 15.1% compared to a forecast of 4.3%
 - As a result, FY 2019 collections could decline by 3.0% and still meet the revenue figure assumed in Chapter 2
- Year to date, non-withholding collections have increased by 15.5%, well ahead of the forecast
 - The first estimated payment of the fiscal year was due in September, and monthly collections grew 15.4% on a year-over-year basis
- But an average of 82% of non-withholding taxes are collected in the last 8 months of the year, and fully 55% are remitted in the last quarter
 - Year-to-date S&P gains have been largely lost in the recent correction and market performance is a major factor in final payments
- Can't assume FY 2019 growth will continue at this pace when you consider that FY 2018 collections made up 17.5% of total GF revenues – a share that has been exceeded only twice over past 20 years
- Policy of collaring non-withholding continues to be used to hedge against revenue shortfalls
- Assume collared growth in the range of 2.1% in FY 2019 and 4.8% in FY 2020, increasing the forecast by \$176.4 million in FY 2019 and \$88.2 million in FY 2020
- Will have better idea of performance after January payment – could be readdressed in Mid-Session reforecast

Corporate Income Forecast

- Most difficult revenue source to predict because collections affected by complex tax planning decisions made by large firms, and those decisions are largely driven by minimizing federal tax liabilities
- Through the first four months of FY 2019, collections from this source have decreased 10.9%, behind the annual estimate of 5.8% growth
 - Tax reports that the YTD contraction in corporate tax collections appear to be broad-based across all sectors
- Based on the collections through the first third of the fiscal year, recommend reducing the forecast for FY 2019 to -6.0%
- Assume slight improvement in collections in FY 2020 with growth in the 4% range
- Result is a forecast reduction of \$101.8 million in FY 2019 and \$83.8 million in FY 2020

Other Expected Forecast Adjustments

Recordation:

- Through October, collections have fallen 7.4%, compared to a forecast of 3.1% growth adjusted for the FY 2018 shortfall in this source
 - Chapter 2 forecasts flat collections in both FY 2019 and FY 2020
- While YTD Virginia price increases have been in the 4-5% range, sales volumes have declined by a similar percentage
- Rising interest rates are suppressing refinancing collections
- Expect a reduced forecast for this source –
 - Expect contraction of about 6% in FY 2019 and flat collections in FY 2020
 - Results in a downward revenue adjustment of about \$36 million each year

Insurance Premium Tax:

- Expect growth of 13.0% in FY 2019 and 2.5% in FY 2020 compared to Ch. 2 forecast of 11.4% and 7.8% respectively
- Produces revenue increase of \$5.3 million in FY 2019 and a reduction of \$14.6 million in FY 2020
- Impacted by the cap on historic rehabilitation tax credits as well as lag in calculated amounts transferred to transportation

Anticipate Revenues of \$602.1 Million Above Chapter 2 Forecast

(\$ in Millions)	HAC FY 2019	FY 2019 Growth	FY 2019 Add'l \$	HAC FY 2020	FY 2020 Growth	FY 2020 Add'l \$
Withholding	\$13,044.4	4.0%	\$174.2	\$13,579.2	4.1%	\$210.7
Nonwithholding	\$3,544.7	2.1%	\$176.4	\$3,713.4	4.8%	\$88.2
Refunds	(\$2,054.7)	5.0%	\$51.7	(\$2,147.3)	5.2%	\$40.2
Net Individual	\$14,534.4	3.0%	\$402.3	\$15,145.3	4.2%	\$339.1
.						
Sales	\$3,600.2	4.0%	\$52.9	\$3,715.5	3.2%	\$90.3
Corporate	\$810.2	(6.0%)	(\$101.8)	\$842.6	4.0%	(\$83.8)
Recordation	\$371.2	(6.0%)	(36.0)	\$371.2	0.0%	(36.0)
Insurance	\$381.8	13.0%	\$5.3	\$391.4	2.5%	(\$14.6)
Total Major Sources	\$19,697.8	2.8%	\$322.7	\$ 20,466.0	3.9%	\$295.0
Other Revenue	\$743.3	3.5%	(\$3.5)	\$755.0	1.6%	(\$12.1)
Total GF Revenues	\$20,441.1	2.8%	\$319.2	\$21,221.0	3.8%	\$282.9



Anticipated Budgetary Pressures in the 2019 Session



2019 Session: Amending the Adopted Budget

- In odd-numbered sessions, action is taken to amend the previously adopted biennial budget for the current and next fiscal year
- 2018 General Assembly focused on fully-funding needs in both years of the biennium, so adjustments to spending should be far more minor than in “big budget” years
- Chapter 2 already includes:
 - Full-year pay raises in FY 2020 for teachers and state and state-supported local employees as well as fully-funding increases in health care and other fringe benefits
 - Funding for Reserves – both Rainy Day Fund and Cash Revenue Reserve – which bring total reserves to \$1.0 billion by end of FY 2020
 - Full funding of K-12 re-benchmarking for the biennium
 - Additional funding in the second year for higher education totaling \$130 million
 - FY 2018 surplus provides additional \$73.8 million for WQIF in FY 2020

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 \$201.4 million in FY 2019, and \$1.1 billion in FY 2020
 - This includes caseload adjustments, unavoidable cost increases, technical adjustments, information technology requests and other spending for new or expanded initiatives
 - Not limited to mandatory spending – includes agency wishes
- These amounts exclude items like the Medicaid forecast and any adjustments to K-12 based on average daily membership updates, etc.
 - Medicaid forecast has subsequently been released and will be discussed later in this presentation

Agency GF Budget Requests by Secretariat

Amount Requested	GF 2019	GF 2020
Administration	\$4,016,481	\$25,776,351
Agriculture and Forestry	-	\$2,586,866
Commerce and Trade	\$10,413,819	\$128,164,604
Education (K-12 & Higher Ed)	\$10,898,357	\$436,319,871
Finance	-	\$1,872,619
HHR	\$16,334,889	\$136,979,983
Judicial	\$425,202	\$6,650,451
Natural Resources	\$720,473	\$94,483,071
Public Safety	\$158,610,225	\$229,518,557
Veterans/Defense Affairs	-	\$3,519,286
Grand Total	\$201,419,446	\$1,065,871,659

Note: Table excludes the cost drivers like Medicaid forecast adjustments

Mandatory Spending Estimate Totals \$598.1 million

General Fund \$ in millions	FY 2019	FY 2020
Health and Human Resources		
DMAS – Medicaid Forecast of Utilization and Inflation*	\$202.2	\$260.3
DMAS – Continue Funding for MMIS in FY 2020 until new system is federally certified	\$0.0	\$12.4
DBHDS – Backfill Loss of Federal Funds for Catawba and Piedmont Geriatric Hospitals	\$0.0	\$27.3
VDH/DARS/DSS – VITA Rate Increases	\$3.0	\$2.7
DSS – Child Welfare Forecast	\$0.0	\$3.4
DSS – Federally Required SNAP Eligibility Improvements	\$0.0	\$2.0
DSS –Required COLA Rate Increase for Foster Care and Adoptions	\$0.3	\$1.3
Public Safety		
DOC: Increases in offender medical costs	\$4.6	\$19.1
Forensic Science: Backfill 2 nd yr funding for positions – controlled substances section	\$0.0	\$3.3
Commerce and Trade		
Econ. Development Incentive Payment – Micron	\$0.0	\$50.0
Finance		
Hurricane Florence (state share)	\$10.8	\$0.0
GRAND TOTAL:	\$216.3	\$381.8

*Medicaid forecast includes \$57.9 m. in FY 2019 to backfill federal Medicaid payments to Catawba and Piedmont Geriatric Hospitals based on an Inspector General audit for the period of 2006-2010. It does not include amounts paid for the post audit period of Jan. 1, 2011 to March 31, 2019, estimated at \$117.4 million.

Major High Priority Spending Estimates Total \$224.9 m.

General Fund \$ in millions	FY 2019	FY 2020
Health and Human Resources		
DBHDS - Accelerate STEP-VA Crisis Response Services	\$0.0	\$19.8
DMAS – Increase primary care provider rates to 80% of Medicare	\$0.0	\$19.1
DBHDS – Add direct care nursing staff and psychiatrists at state facilities	\$0.0	\$15.7
DMAS – Increase nursing services rates to 75% of benchmark rates	\$0.0	\$8.1
DSS – Address local DSS compensation	\$0.0	\$6.1
DBHDS – Add community transition support to address census at state MH hospitals	\$0.0	\$6.0
DBHDS – Support crucial data quality enhancements for data warehouse, data analytics & cloud capabilities	\$2.3	\$5.0
DMAS – Cover preventive services and vaccines for current FFS adult population	\$0.0	\$3.5
DMAS – Increase rates licensed mental health professional rates	\$0.0	\$3.3
DMAS – Fund increased costs for Cover VA Call Center, Eligibility and Medicaid Enrollment Broker for Medallion 4.0 and CCC Plus enrollees	\$0.0	\$2.2
DSS – Update child support information technology structure	\$0.0	\$2.1
DMAS – Backfill federal funds for administration of CHIP program	\$0.0	\$1.9
DBVI – Fund GF match for federal vocational rehabilitation grant	\$1.9	\$1.9
DBHDS – Increase rates for psychiatrists to improve recruitment & retention	\$0.0	\$1.6
DSS – Fund mobile device management software services	\$1.2	\$1.2
DBHDS – Growth in the Early Intervention Program - Part C	\$0.7	\$0.7
Public Education	\$0.0	
DA – Reduce School Counselor Ratio – Phase-in over 3 years	\$0.0	\$36.2
DA – Increase Teacher Mentor Program from \$1M to \$5M	\$0.0	\$4.0
DOE – Implementation of Restraint & Seclusion Regulations	\$0.0	\$4.7
DOE – Virginia Learner Equitable Access Platform & 11 Positions	\$0.0	\$7.1
DOE – Convert Algebra I test to CAT, add Gr 3-8 Math CAT, update VA & US History & Econ tests, Audits for Writing Scores	\$0.0	\$4.5

Major High Priority Spending Estimates Total \$224.9 m.

General Fund \$ in millions	FY 2019	FY 2020
Higher Education		
TAG: Maintain per student award of \$3,350	\$0.0	\$4.8
UVA Wise Academic Programs (restore year 2)	\$0.0	\$2.0
Administration		
DOA/DHRM – human resources system replacement	\$6.2	\$2.7
VRS: Increase funding to address unfunded liability	TBD	TBD
Comp Board: 1:1,500 for law enforcement deputies	\$0.0	\$8.1
Comp Board: Fill 25% of staffing standards unfunded positions	\$0.0	\$6.7
DGS: Funding for DCLS to perform mandated testing	\$0.0	\$0.5
Elections: Funding for presidential primary	\$0.0	\$5.9
Finance		
Enhance security at tax locations	\$0.0	\$0.5
Tax: Response to federal tax reform	TBD	TBD
Enhance Cash Revenue Reserve	TBD	TBD
Public Safety		
DOC: Increased heal costs at Fluvanna correctional center	\$6.5	\$6.4
DOC: Expand probationer opioid treatment diversion	\$0.0	\$1.1
DCJS: Continue 2 nd yr funding for SRO grant program	\$0.0	\$1.3
Commerce and Trade		
VATI Broadband Initiative	\$0.0	TBD
Ag and Natural Resources		
Land preservation funding	\$0.0	\$5.5
Continue funding newly opened/partially opened state parks	\$0.0	\$1.0
DEQ Funding for air and water monitoring and compliance	\$0.0	\$4.9
GRAND TOTAL:	\$18.8	\$206.1

Comparison of Available Resources To Identified Budget Drivers

\$'s in millions	FY 2019	FY 2020	Biennium
Additional Revenues	319.20	282.90	602.10
Budgetary Savings	3.00	54.50	57.50
Total Additional Resources	322.20	337.40	659.60
Mandatory/Statutory Spending Drivers	216.30	381.80	598.10
High Priority Drivers	18.80	206.10	224.90
Total – HAC Identified Drivers	235.10	587.90	823.00
Available Resources After Budget Drivers Funded	84.10	(305.00)	(220.90)

- Additional revenues reflects continued use of the “collar” which reduces available revenues by \$418 million over biennium.
- Estimation of resources available to address budget drivers includes no assumptions regarding state revenues generated pursuant to federal tax reform



2019 Session: Balancing Priorities to Ensure Structural Integrity



Challenges of the 2019 Session

- As usual, structural balance in the second year will be important to setting the stage for the 2020-22 biennium
- Meeting commitment to fund core programs
 - High cost of base Medicaid utilization and inflation reforecast
- Continuing to strengthen our cash position in the face of concerns raised by rating agencies
 - Additional deposits to the Revenue Cash Reserve
 - Override or amend Code provisions – consider amending language to apply the 15% Rainy Day Fund cap to combined amounts in RDF and Revenue Cash Reserve
 - Revenue Cash Reserve currently capped at 2%



Medicaid Expenditure Growth

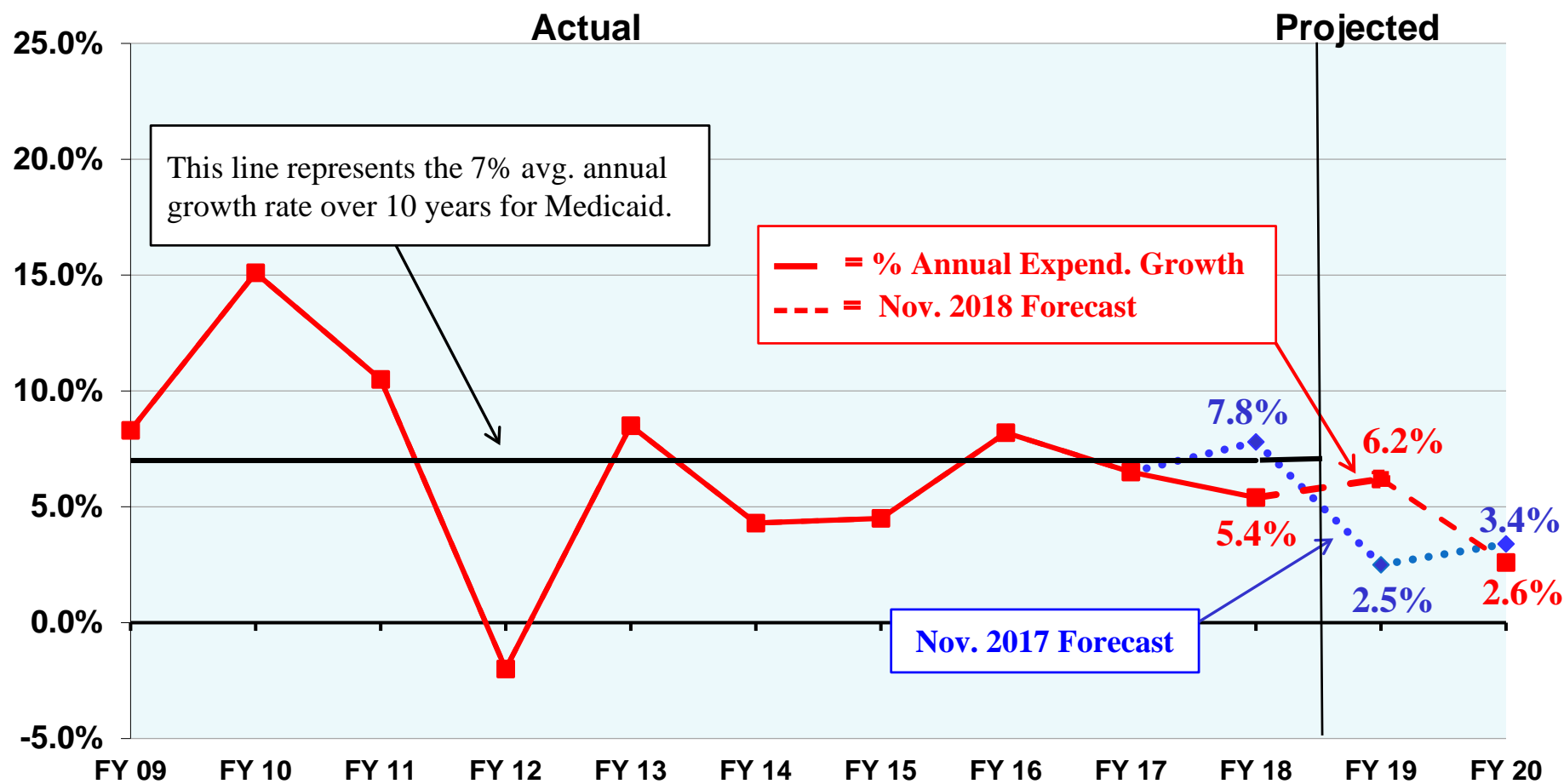
Susan E. Massart



Medicaid Forecast

- Official Medicaid forecast updated every November
- 2018 Official Medicaid forecast updates projected spending for FY 2019 and FY 2020 for the current Medicaid program
- Virginia Health Care Fund (VHCF) revenues will influence how much general fund dollars are required to meet the forecast costs of the Medicaid program
 - Revenues in the fund are used as a portion of the state's match for the Medicaid program
 - Comprised of tobacco taxes, Medicaid recoveries and a portion of the Master Tobacco Settlement Agreement (41.5%)
 - Revenue changes in the VHCF are not included in Official Medicaid forecast
 - The VHCF ended FY 2018 with a \$30.2 million balance

November 2018 Medicaid Forecast: Annual % Change

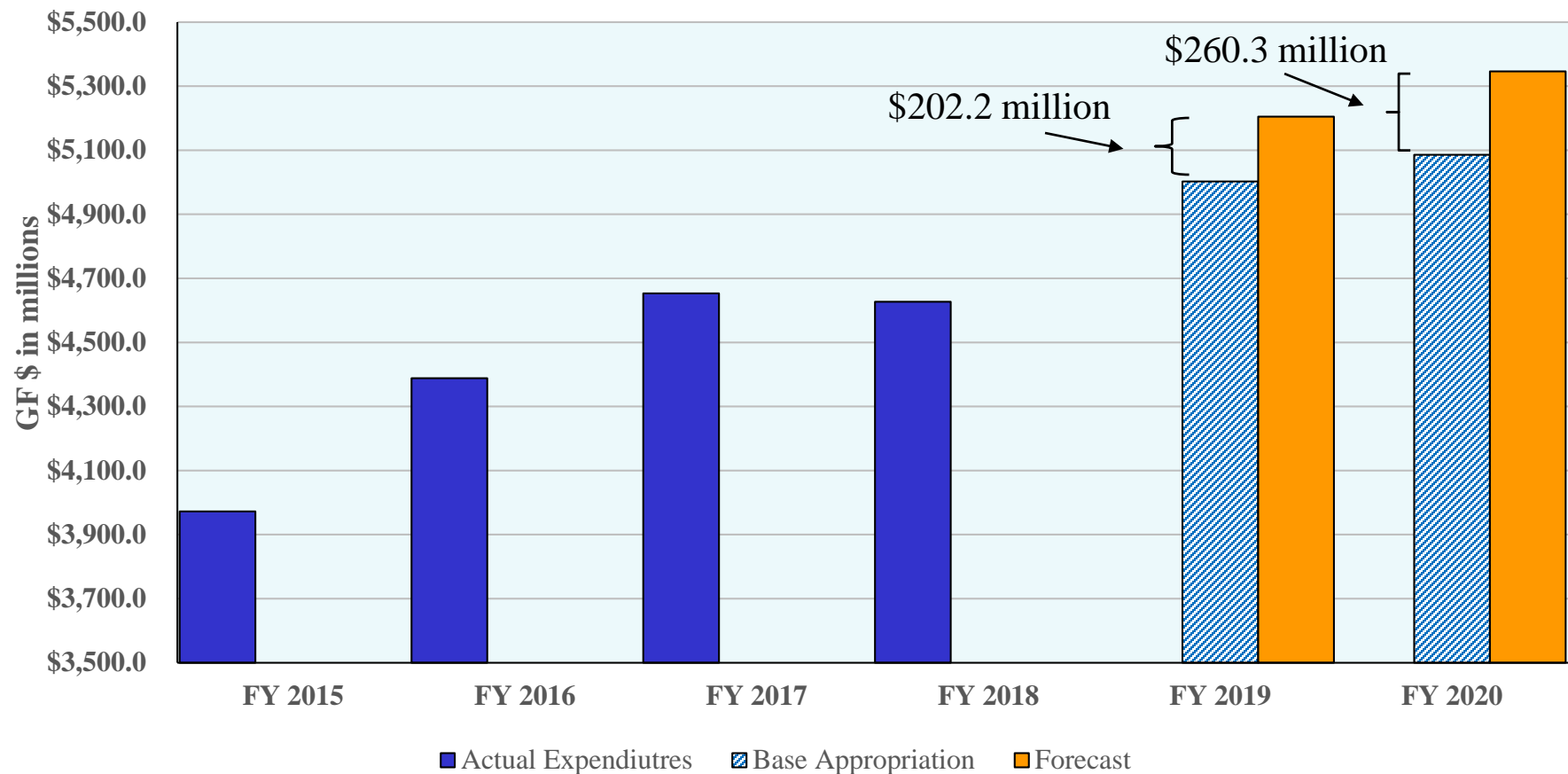


Note: Represents percentage change in all funds, state and federal, adjusted for payment timing changes, cash management, FMAP maximization.

Source: 2017 and 2018 DPB and DMAS consensus forecast reports.

Medicaid Forecast: FY 2019 and FY 2020

- Projected needed funding is \$462.5 million GF over the 2018-20 year period
 - Amount is in addition to \$575.8 million GF added for the biennial forecast in Chapter 2



Source: November 1, 2018 DPB and DMAS Consensus Forecast Report.

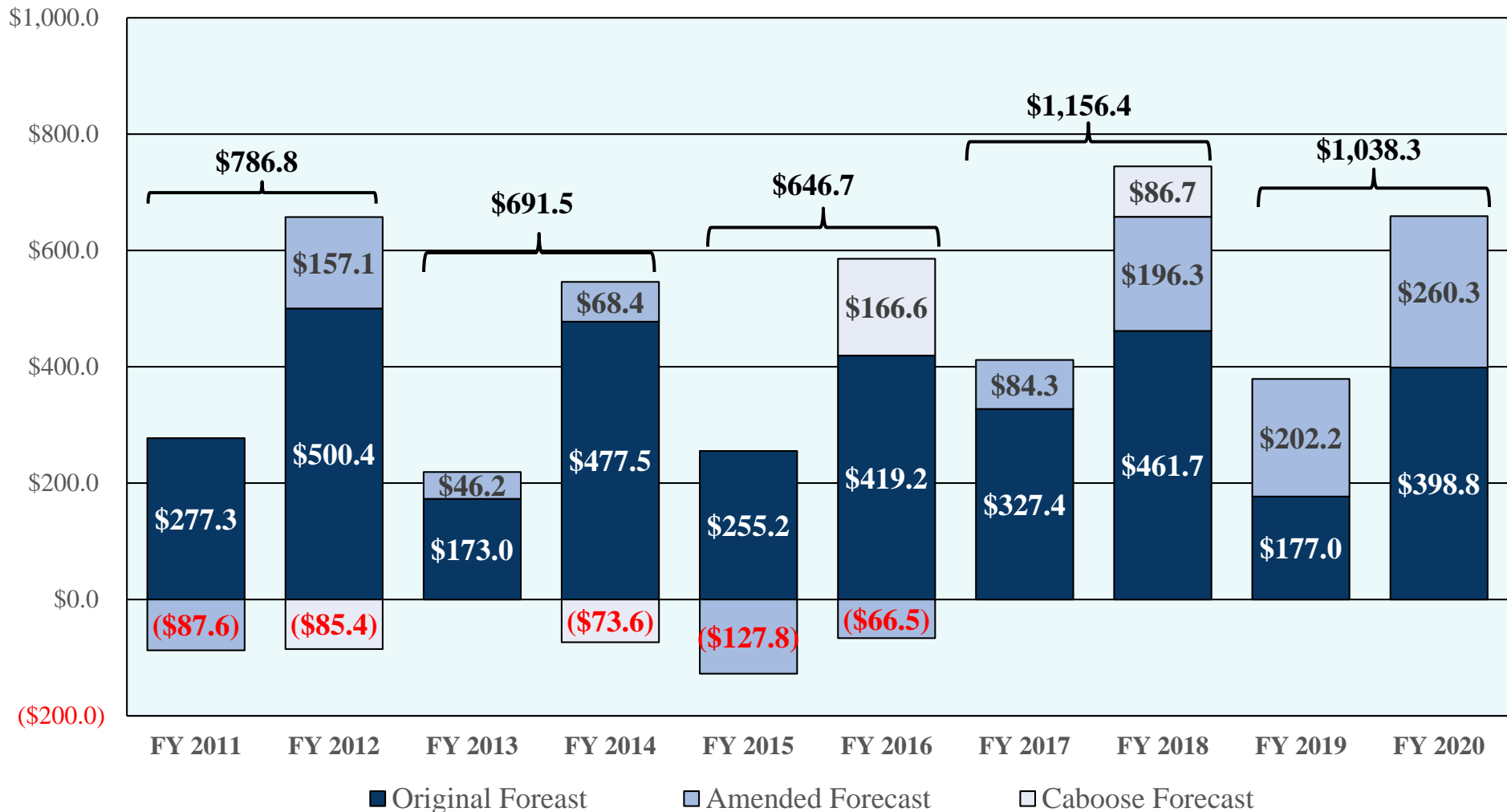
Preliminary Medicaid Forecast

(\$ in millions)

Base Medicaid Forecast	FY 2019		FY 2020	
	GF	NGF	GF	NGF
November 2018 Forecast	\$5,204.8	\$5,022.4	\$5,346.2	\$5,148.6
Chapter 2 Funding (Base)	\$5,002.6	\$4,896.9	\$5,085.9	\$5,000.5
Additional Funds Needed	\$202.2	\$125.5	\$260.3	\$148.1

- Represents the largest biennial increase in an amended budget in recent years

Historical Medicaid Annual Forecast Changes (GF \$ in millions)



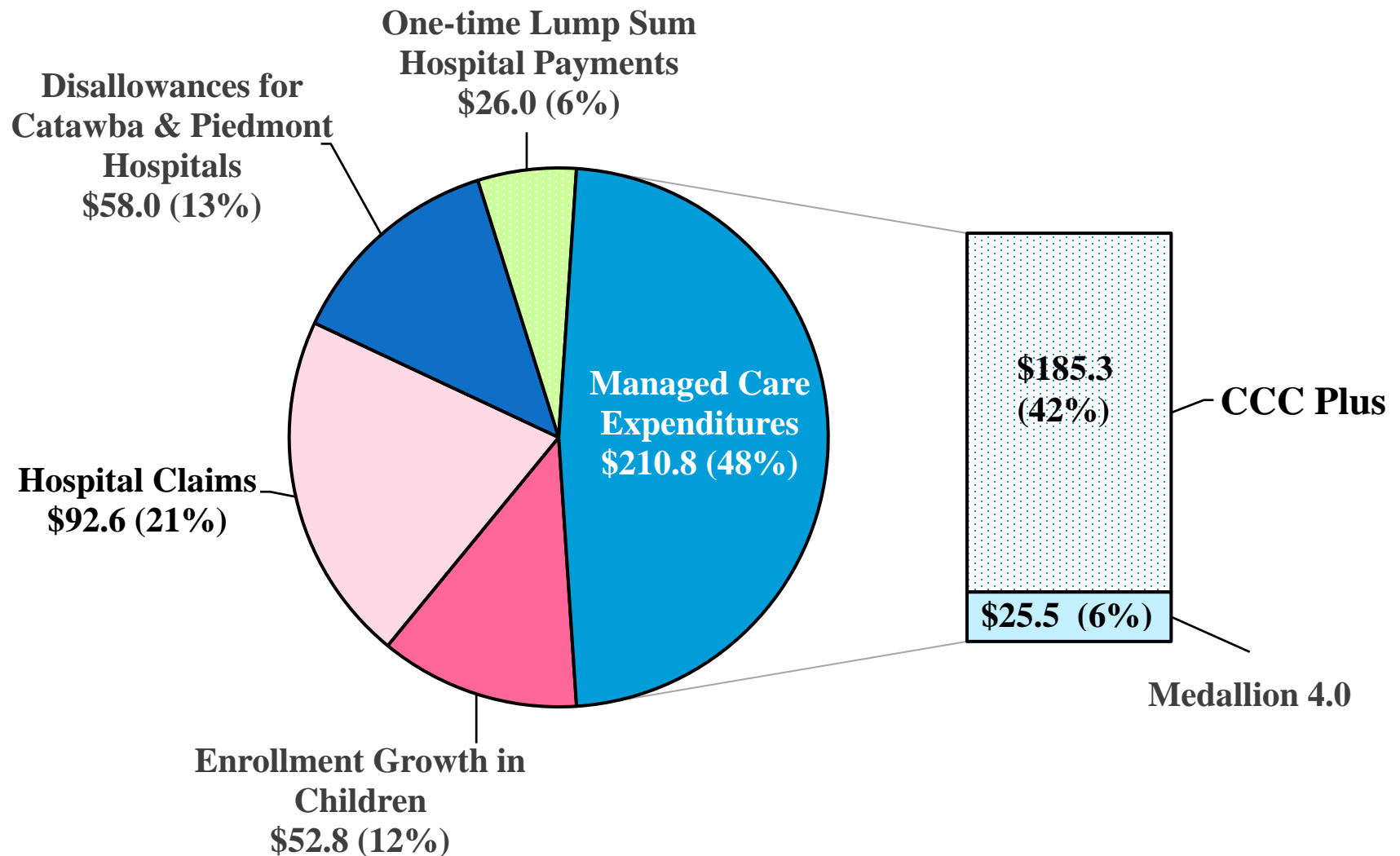
Note: Nov. 2017 forecast for the 2018-20 biennium was adjusted downwards to account for an adjustment for CSA transfers and Congressional action to suspend the ACA insurance tax for one additional year.

Major Factors Affecting Medicaid Spending Growth

- Enrollment and Utilization
 - Enrollment of low-income children is growing faster than anticipated
 - Aggressive utilization savings in Medicaid's fee-for-service program have not materialized (particularly long-term care savings)
 - Growth in hospital claims and expenditures
- Managed Care Changes
 - Rate increases above last year's forecast
 - Savings assumptions have not materialized
 - Hospital and nursing home reimbursement increases (also has effect on fee-for-service program)
- Federal disallowances (FY 2019)
 - Payments Catawba and Piedmont Geriatric Hospitals
 - Cost allocation payments

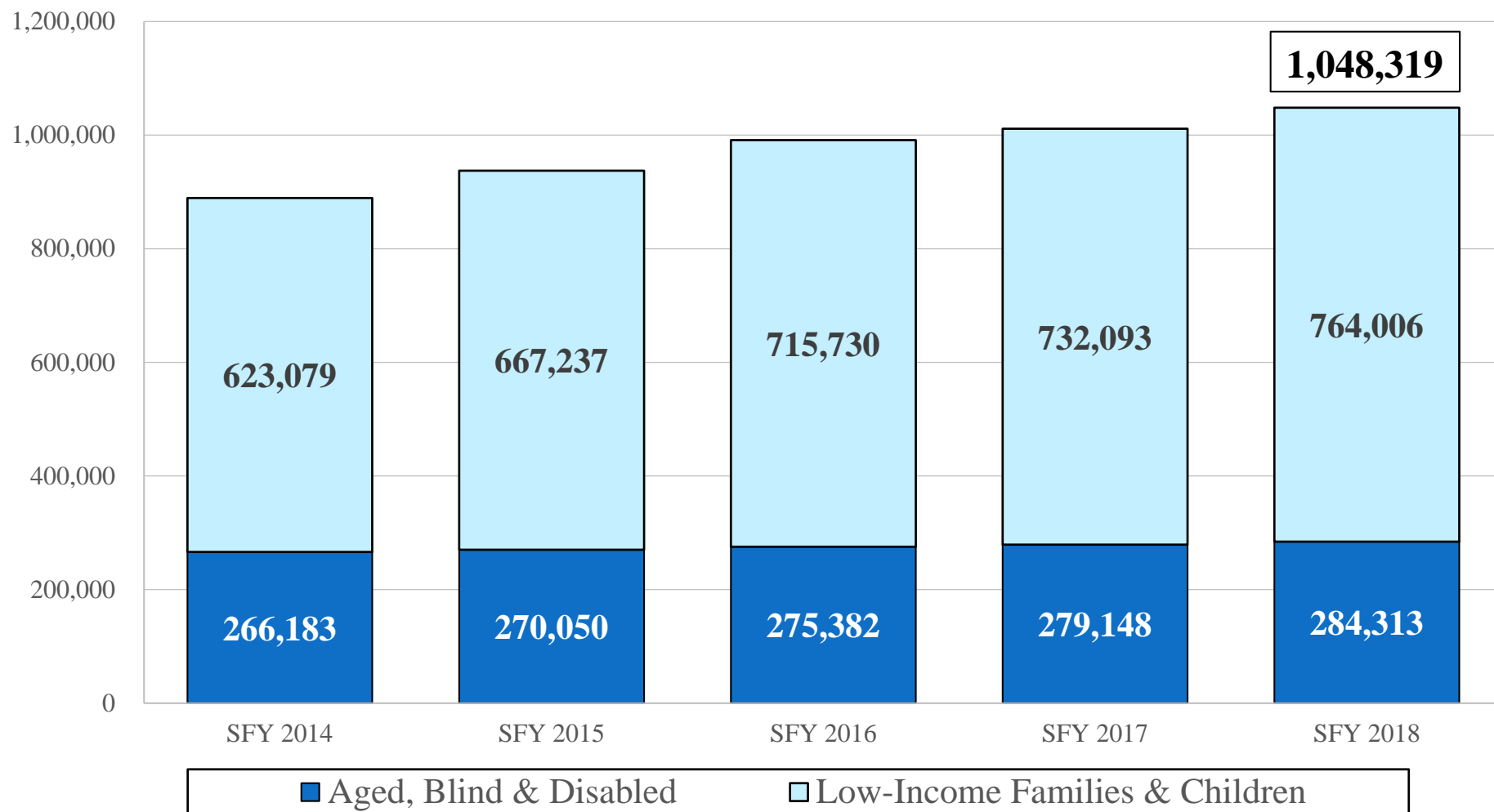
Major Factors in Medicaid Expenditure Growth

(\$ in millions)



Enrollment Trends in Medicaid

- Enrollment has grown by almost 18% since FY 2014
- Average annualized growth rate is 3.3% over 5-year period
- Enrollment of children grew by about 3.1% in FY 18, compared to anticipated growth of 1%



Factors Driving Managed Care Expenditure Growth

- Rates for two Medicaid managed care programs are projected to increase
- DMAS contracts with an actuary to analyze MCO expenditures and set rates
 - New actuary hired in January 2018 with more experience in Medicaid managed care
 - Managed care rates are required to be actuarially sound by federal government
- CCC Plus rates are projected to increase by 5.4% in CY 19 and 4.8% in CY 20
 - 2017 Medicaid forecast assumed rate increases of 2.4% in CY 19 and 3.5% in CY 20
 - The rate increase could be actuarially sound within the range of 3.9% to 6.7%
- Medallion 4.0 rates are projected to increase by 4.1% in FY 20
 - 2017 Medicaid forecast assumed rate increase of 3.8%

MCO Rate Increases (\$ in millions)	FY 2019		FY 2020	
	GF	NGF	GF	NGF
CCC Plus	\$77.0	\$77.0	\$165.0	\$165.0
Medallion 4.0	0.0	0.0	\$44.0	\$44.0
Total	\$77.0	\$77.0	\$209.0	\$209.0

Factors Driving Managed Care Expenditure Growth

- Enrollment growth and complexity of care
 - Even small enrollment changes can have big impacts if the care is more complex
 - Aged, blind and disabled population grew by 1.8% in FY 2018 over FY 2017
 - Rate adjustments were based on the expected case mix of nursing home and community-based long-term care recipients
- Savings assumptions have not materialized
 - 2017 forecast assumed CCC Plus program would realize \$82 million in savings
 - Forecast of savings assumptions in FY 2020 have not been adjusted downwards
- Inflation adjustments for hospitals and nursing homes are higher than prior forecast
 - 2.9% in FY 2019 for hospital inpatient expenditures, compared to 2.8% currently funded
 - 3.6% in FY 2019 for nursing homes, compared to 2.9% currently funded
- Hospital rebasing in FY 2020 was unknown when 2017 forecast was completed
 - \$6.6 million GF impact for CCC Plus, Medallion 4.0 and the fee-for-service programs

Federal Disallowances

Catawba & Piedmont Geriatric Hospitals

- 2014 federal Office of the Inspector General (OIG) report found that two mental health hospitals were not eligible to receive Medicaid payments
- Centers for Medicare and Medicaid (CMS) issued a disallowance letter on June 26, 2018
 - Amount of disallowance was \$57.9 million
 - Covered audit period of January 1, 2006 to December 31, 2010
 - Did not address payments made since the audit period
 - DMAS continues to pay facilities
- If payments since 2010 are disallowed including Medicaid disproportionate share hospital payments, the potential additional liability is estimated to be \$117.3 million

Potential Disallowance Related to Cost Allocation

- CMS is likely to issue a disallowance letter for approximately \$39.5 million related to Virginia's Medicaid cost allocation plan which it contends did not properly allocate administrative costs across agencies
 - Technical dispute regarding language in cost allocation plan related to OIG & CMS audits
 - DMAS is planning to appeal when disallowance letter is received
 - Forecast does not address this since disallowance letter has not been issued

Unresolved Issues on Medicaid Expenditure Forecast

- FY 2017 forecast assumed aggressive savings in the Medicaid fee-for-service program that have not been realized
 - Hospital and nursing facility expenditures
 - Behavioral health expenditures
 - Physician services
- Data analysis is incomplete on why cost savings have not been realized
 - Was this simply a forecasting error or did other factors play a role?
 - Substantive analysis on what is driving costs for certain expenditures in the fee-for-service program is lacking
 - Data on characteristics of fee-for-service population and utilization trends are lacking
- Better integration of Medicaid forecasting, actuarial analysis of managed care expenditures and rate development, and budget development is needed
- Ongoing robust analysis is needed to examine utilization trends, identify potential cost impacts early and propose solutions to ensure Medicaid dollars are spent wisely

Benefits of Managed Care Changes Not Yet Realized

- Expected benefits of managed care changes are in nascent stages
 - CCC Plus program experience is limited – 10 months into the first full year of implementation with new populations and services
 - While experience in Medallion is extensive, care management of new services such as behavioral health services is limited
- Replacement of Medicaid Management Information System is not fully complete, but should enhance analytic capability as components are completed
 - New managed care encounter data system has recently been implemented to improve oversight
- Managed care programs are beginning to achieve some goals
 - Goal: Improve quality of care and health outcomes
 - Each CCC Plus member has a care coordinator who follows up with member at least quarterly
 - Care coordinator performs an in-person Health Risk Assessment and an interdisciplinary care plan
 - Goal: Bend the cost curve of Medicaid expenditure growth
 - Implementing performance measures to monitor hospitalizations, ER utilization, behavioral health, opioid prescribing patterns and transitions of care
 - Goal: Provide better budget predictability
 - Goal: Employ stronger MCO contracts and DMAS contract management
 - Implemented process to remove members not receiving services in CCC Plus or who did not need waiver services from MCO capitation payments, saving \$4.3 million per month (all funds)
 - Implemented profits caps
 - New actuary is implementing rate adjustment to ensure they do not cover excessively high spending, account for savings from required initiatives and account for negative historical trends in medical spending to be included in setting rates
 - Required the provision of additional MCO financial and utilization data and to better monitor spending and service utilization trends
 - Implementing incentives for MCOs to improve performance

Stronger Program Oversight

- 2018 General Assembly adopted language to reign in cost increases in the Medicaid program in future biennia
 - Development of 2020-22 biennial budget will require a spending target for each year, established by the Joint Subcommittee for Health and Human Resources Oversight by September 15
 - Target shall take into account:
 - 10-year rolling average by eligibility category and utilization of services
 - 20-year rolling average of general fund revenue growth
 - Policy decisions by the General Assembly in the previous Session which impact Medicaid spending
- 2018 General Assembly created a new JLARC unit to focus on oversight of Health and Human Resources agencies and programs, including responsibility for
 - Targeted analysis of spending trends and other issues
 - Assessment of the soundness and accuracy of population and spending forecasts
 - Will be monitoring components of the Medicaid program as directed by JLARC members in consultation with the Joint Committee for Health and Human Resources Oversight