

Overview of the Governor's Recommendations for the 2012-14 Budget

The Governor's budget for 2012-14 proposes a net increase of \$1,447.5 million GF in the operating budget above the current base budget. Approximately \$1,987.7 million in additional resources over the FY 2012 resource base approved in Chapter 890 of the 2011 Acts of Assembly are available for appropriation, including the carry forward of \$546.0 million from FY 2012 along with upward adjustments to the revenues from projected growth of 3.3 percent and 4.5 percent, respectively, each year over the biennium. Of these available resources, about \$508.8 million is required to cover one-time savings and resources supporting the current base budget.

Major proposed tax policy actions include the re-direct of \$110.7 million GF in sales tax to transportation, as part of a phased approach to bring the 0.5 cent of sales tax dedicated to transportation up to 0.75 cents.

Proposed spending increases of \$2,786.0 million - primarily for retirement rates, Medicaid, and public education - are offset by \$882.4 million in budget reductions from targeted strategies in public education and Medicaid, along with agency-specific savings. Other technical and base adjustment reductions total \$456.0 million. The introduced budget assumes an unappropriated balance of \$31.4 million.

Proposed General Fund Budget for 2012-14			
(\$ in millions)			
	<u>FY 2013</u>	<u>FY 2014</u>	<u>2012-14</u>
Resources Available for Approp.	\$17,191.4	\$17,383.6	\$34,575.0
Ch. 890 Base Budget	\$16,548.0	\$16,548.0	\$33,096.0
Net New Spending	<u>630.4</u>	<u>817.1</u>	<u>1,447.5</u>
Operating Appropriations	\$17,178.4	\$17,365.2	\$34,543.6
Unappropriated Balance	\$13.0	\$18.4	\$ 31.4

Revenues

The Governor's proposed 2012-14 budget includes \$33.2 billion in general fund revenues available for appropriation, based on growth rates of 3.3 percent for FY 2013 and 4.5 percent for FY 2014. The proposed budget also includes \$546.0 million as a projected balance forward at the end of FY 2012 to be carried forward into FY 2013. This balance resulted from the ripple effect of a \$321.7 million revenue surplus in FY 2011, including an upward adjustment to the FY

2012 forecast of \$192.6 million (prior to tax policy adjustments) and net savings of \$157.8 million in FY 2012 spending (for more detail, see the HB/SB 29 Resources Summary).

Other resources include transfers to the general fund totaling \$805.9 million. Of this amount, \$460.0 million represents the 1/4 cent sales tax that is transferred from the Local Real Estate/SOQ Fund for public education. Other customary transfers include ABC profits of \$107.7 million for the biennium, with an additional \$130.7 million in ABC profits and \$18.3 million in wine taxes going to DBHDS for substance abuse programs.

A more detailed discussion of the general fund resources assumed in HB/SB 30, including several proposed tax policy actions, is included in the Resources Section of this document.

General Fund Resources Available for Appropriation (2012-14 biennium, \$ in millions)	
Beginning Balance	\$546.0
Adjustments to the Balance	7.2
Official GF Revenue Estimate	33,215.9
Transfers	<u>805.9</u>
GF Resources Available for Appropriation	\$34,575.0

Proposed Spending Increases

Major spending initiatives include nearly \$390.0 million GF for the biennium to fully fund the contribution rates for the Virginia Retirement System (VRS) for both state employees and the state’s share for teachers. This amount does not include the cost of restoring over \$200.0 million annually that was transferred from agency budgets to the general fund as part of one-time savings from deferring payment of the unfunded liability portion of the contribution rates to VRS in 2010-12.

Other major general fund increases include a net increase of over \$200.0 million in spending for Medicaid; over \$220.0 million for Virginia’s colleges and universities; a net increase of about \$60.0 million in public education, reflecting the cost of rebenchmarking offset by several policy proposals; \$40.0 million to support new and expanded economic development incentives; and \$30.0 million in FY 2013 for an additional deposit to the Behavioral Health and Developmental Services Trust Fund.

Prior to any budgetary adjustments, policy changes, or other savings strategies, major proposed spending items include:

- \$634.1 million GF for the cost of updating the state’s share of the Standards of Quality for public schools, including projected enrollment, prevailing salaries and nonpersonnel

costs, updates to related categorical and incentive programs, and updates to the composite index. In addition, updated retirement contribution rates and other employee benefits total \$342.4 million for the biennium.

- \$650.5 million GF to address the increased cost of Medicaid utilization and inflation;
- \$299.1 million for Constitutionally required deposits to the Revenue Stabilization Fund;
- \$224.0 million GF in higher education funding to support the goals of the “Top Jobs” legislation adopted during the 2011 Session, increased research opportunities, and to increase the Tuition Assistance Grants (TAG) for Virginia students attending private colleges;
- \$100.3 million GF for state employee health insurance premium increases;
- \$115.5 million GF for debt service on previously authorized capital projects; and
- \$50.3 million GF carried forward from FY 2012 for deposit to the Water Quality Improvement Fund (WQIF) in FY 2013. This deposit reflects the WQIF’s portion of FY 2011 revenue in excess of the official forecast and from unexpended agency balances.

Proposed Budget Savings

The Governor’s budget contains about \$880.0 million GF in various savings proposals. The majority of this amount - \$798.8 million - results from targeted savings primarily due to policy changes in Medicaid and Direct Aid to Public Education. The remaining savings of \$83.6 million would be generated through agency specific 2/4/6 percent reduction plans that were submitted as part of the Governor’s budget process. Major savings include:

- \$258.6 million from Medicaid by eliminating the inflation adjustment for hospitals;
- \$75.3 million from Medicaid by eliminating inflation and rebasing of nursing home rates;
- \$109.0 million from removing nonpersonal inflation adjustments from the cost of rebenchmarking public education Standards of Quality (SOQ).
- \$108.0 million from modifying the federal revenue deduction calculation to include a portion of the federal fiscal stimulus funding designated for public education;
- \$81.6 million from the Virginia Preschool Initiative program based on nonparticipation rates and from changing the methodology for calculating the projected four-year-old child count based on projected Fall kindergarten membership rather than census data from the Virginia Employment Commission; and,
- \$65.0 million from removing the Cost of Competing Adjustment (COCA) of 24.61 percent for support salaries in school divisions within the Northern Virginia labor market.

Major Spending and Savings Proposed in HB/SB 30 as Introduced

(GF \$ in millions)

	<u>FY 2012-14</u>
Major Spending Proposed	
Medicaid Utilization and Inflation	\$650.5
Update Costs of K-12 Standards of Quality	377.8
Teacher VRS, Group Life and Retiree Health Care Employer Rates	342.4
Revenue Stabilization Fund Deposits	299.1
Higher Ed. Top Jobs Initiative	204.0
Update Costs of K-12 Incentive and Categorical Programs	142.3
Debt Service for New and Currently Authorized Projects	115.5
State Employee Health Insurance Program (net)	100.3
Update K-12 Composite Index	87.8
VRS Rates and Deferred Contributions for State Employees	86.2
Adjusted Sales Tax for K-12	53.4
Water Quality Improvement Fund	50.3
All Other Spending	<u>256.3</u>
Total Spending:	\$2,765.9
Major Savings Proposed	
Withhold Medicaid Inflation from Hospital Rates	\$(258.6)
Eliminate K-12 Nonpersonal Inflation Update	(109.0)
Modify K-12 Federal Revenue Deduction Calculation	(108.1)
Agency 2/4/6 Percent Reduction Plans	(83.6)
Reduce PreK for Nonparticipation and Four-Year-Old Count	(81.6)
Maintain Nursing Facility Rates	(75.3)
Remove K-12 Cost of Competing Adjustment	(65.0)
DMAS Savings from Federal Bonus Payment	(32.9)
Indigent Care Reductions at Teaching Hospitals	(29.9)
All Other Savings	<u>(38.4)</u>
Total Savings:	\$(882.4)
Net Spending Adjustments	\$1,903.5

A summary of significant general fund spending increases and savings actions proposed in each major area follows:

Public Education. The proposed budget includes a net increase of \$404.4 million (the general fund base budget includes \$107.3 million in one-time spending and is included in the proposed decreases). This amount reflects biennial rebenchmarking of Direct Aid for updated cost and salary data as of FY 2010, updated Composite Index of Local Ability-to-Pay calculations (Tax Year 2009), and a projected additional 13,479 students (a total of 1,229,800 by FY 2014). The proposed budget includes an increase of \$342.4 million GF for the state's share of Virginia Retirement System rates of 11.66 percent, as well as Group Life and Retiree Health Care Credit employer rates. The budget also reflects a net increase \$53.4 million due to project sales tax revenue, and an increase of \$33.2 million in projected Lottery Proceeds.

The proposed budget also reflects several policy changes: 1) continuation of the policy to not fund non-personal inflation costs, which would bring the FY 2010 cost data up to the beginning of the 2012-14 biennium, for a savings of \$109.0 million GF; 2) savings of \$108.1 million GF by including in the federal revenue deduct calculation an additional portion of the federal stimulus dollars from FY 2010; 3) savings of \$65.0 million GF by eliminating the cost of competing adjustment for support costs applied to Planning District 8 and certain adjacent divisions (no change is proposed for the cost of competing adjustment for instructional costs); and 4) savings of \$26.7 million from the Virginia Preschool Initiative by using kindergarten as a proxy for Four-Year-Olds (the budget also reflects savings of \$54.9 million based on estimated school division participation levels).

Proposed new initiatives in K-12 total a net \$5.0 million over the biennium, including \$2.0 million GF for a grant to Communities in Schools, \$1.8 million GF for PSAT testing costs, and \$1.3 million GF for two math and science teacher pilots. Decreases include \$1.7 million GF by eliminating state support for mentor teachers in hard-to-staff schools and \$1.2 million by eliminating the grant to Project Discovery.

Health and Human Resources. Proposed spending increases total more than \$1.0 billion GF driven largely by mandated programs, such as Medicaid, children's health insurance (FAMIS and SCHIP), adoption subsidies, involuntary mental commitments, civil commitments of sexually violent predators, and vocational rehabilitation services. This amount includes a base budget adjustment of \$131.6 million GF and \$131.8 million NGF each year to account for funding that was shifted from FY 2012 into FY 2011 to take advantage of enhanced federal Medicaid funding from the American Recovery and Reinvestment Act of 2009 (ARRA). While the one-time strategy generated savings of \$18.0 million, it also had the effect of reducing the FY 2012 base budget for Medicaid.

About \$678.2 million GF, or 82 percent of the new spending is driven by rising costs and caseload in the Medicaid program, and with costs to comply with federal health care reform legislation which increases Medicaid eligibility beginning January 1, 2014. In addition, the Governor proposes \$30.0 million GF in FY 2013 for the Behavioral Health and Developmental Services Trust fund to expand services to transition individuals from state training centers into the community.

General fund spending reductions within HHR total \$656.4 million over the biennium. More than 70 percent of spending reductions within HHR come from Medicaid by adjusting the expenditure forecast to eliminate inflationary increases for hospitals, nursing homes, home health agencies and outpatient rehabilitation agencies; continuing reductions to indigent care spending at state teaching hospitals; eliminating rebasing of nursing home costs; restricting eligibility for certain long-term care waiver recipients beginning in 2014; savings from expanding managed care to additional populations and services, and other savings items.

Higher Education. Includes over \$100 million GF in new funding in each year for colleges and universities and other higher education entities and centers. The majority of new funding, \$77.3 million is recommended to support the goals of the Virginia Higher Education Opportunity Act of 2011 to promote economic growth in the Commonwealth and prepare Virginians for top job opportunities. The new funding is allocated in six areas: 1) base adequacy (\$25.5 million each year), 2) enrollment growth (\$16.2 million each year), 3) degree production incentives (\$20.4 million each year), 4) institution-specific initiatives (\$5.1 million each year), 5) financial aid (\$6.4 million each year), and 6) research (\$3.8 million each year).

In addition to the new funding, the Governor also proposes a mandatory internal reallocation policy for colleges and universities. Language calls for each institution to redirect a portion of educational and general (E & G) funding to programs and strategies that advance the objectives of the Virginia Higher Education Opportunity Act of 2011. The reallocation amounts are equivalent to approximately three percent of the FY 2012 system-wide E & G general fund base for FY 2013, and five percent of the base for FY 2014. The language further requires the Secretary of Education to approve the institutional plans before the reallocation amounts are released. Reallocations for most institutions are closer to approximately 1 percent of the total E & G funds in FY 2013 and 1.7 percent in FY 2014 reflecting the ability of some institutions to meet the reallocation target through tuition and fees.

Commerce and Trade. Proposes new funding for economic development incentives, including an additional \$20.0 million for the Commonwealth Research and Commercialization Fund created in 2011 and initially capitalized in FY 2012 with \$10.0 million. The proposed budget also includes an increase of \$3.0 million for the Motion Picture Opportunity Fund, and funding for two new programs: \$10.0 million GF for a Life Sciences Initiative and \$4.0 million GF for an Advanced Manufacturing Initiative.

Other new proposed general fund spending includes \$6.2 million in the first year to expand support for the Fort Monroe Authority, \$1.5 million in the first year for new homeless programs intended to provide permanent housing, \$1.0 million the first year for the Virginia Economic Development Partnership to expand international marketing, and \$1.0 million each year for the Virginia Tourism Authority to expand tourism marketing. The budget provides \$4.1 million GF to the Virginia Employment Commission, along with \$4.1 million NGF from a proposed surcharge on the employer tax for calendar year 2013 to provide for an interest payment of \$8.3 million due in the first year to the federal government for unemployment insurance loans.

Central Appropriations. Proposed funding includes \$187.6 million GF for employee compensation and benefit programs (see below), \$20.0 million GF in FY 2014 as a reserve for the impact of potential federal budget reduction (FACT Fund), \$25.0 million to mitigate budgeted reductions for local governments (leaving \$95.0 over the biennium in reductions), \$6.8 million to replace telephone systems at selected agencies, \$3.4 million for the Commonwealth's cost of the Line of Duty Act, and \$2.8 million for the operating costs of the new Performance Budgeting system. Reductions include \$8.6 million for higher education interest and credit card rebates; and \$4.1 million GF from consolidation and elimination of selected agencies, boards, and commissions.

State Employee Compensation and Benefits. Proposed general fund increases for employee benefits include \$100.3 million GF for the employer cost of state employee health insurance, \$50.6 million GF for repayment of employer retirement contributions deferred in the 2010-12 biennium, \$35.6 million GF for increases in employer retirement contribution rates, and \$1.3 million GF for increases in the employer contribution rates for other VRS provided employee benefits. The Governor also proposes a 3 percent bonus for qualifying state employees in December 2012, provided that agencies can generate savings in FY 2011 equal to twice the cost of the bonus.

Public Safety. The proposed budget assumes the closure of Mecklenburg Correctional Center to offset the loss of \$20.4 million NGF each year due to the termination of the contract to house inmates from Pennsylvania. An additional \$15.1 million GF is proposed for the Department of Corrections the first year for increased inmate medical costs, but this is offset in the second year by an assumed savings of \$15.2 million GF from shifting off-site inmate hospitalization costs to Medicaid, based on a provision in the federal health care reform legislation. The proposed budget also includes \$12.1 million GF the first year for deposits into the Corrections Special Reserve Fund, to reflect the projected prison bed space impact for six bills to be introduced, including one bill with an impact of \$11.7 million GF to increase the mandatory minimum sentences for repeat drug dealers. The proposed budget also assumes savings of \$1.5 million GF over two years from consolidating the Department of Correctional Education into the Departments of Corrections and Juvenile Justice.

For State Police, the introduced budget adds \$6.0 million GF over the biennium to fill 40 State Trooper vacancies and \$4.2 million over the biennium to add 43 non-sworn surveillance officers to monitor sex offenders on the registry.

Technology. Includes \$2.8 million GF to offset information technology rate reductions double-counted during budget development, and \$2.3 million for the Innovation and Entrepreneurship Investment Authority to market Virginia's cyber-security and modeling and simulation industries. The proposed budget also includes \$2.5 million in additional federal funds for the Virginia Information Technology Agency (VITA) associated with the Department of Education's Statewide Longitudinal Data Systems project and about \$1.8 million associated with billings for state agencies' use of VITA optional services.

Proposed policy actions include language to increase a working capital advance for VITA's Enterprise Applications Division from \$30.0 million to \$90.0 million. This proposed

working capital advance will address systems planning and development costs for the Cardinal financial accounting system, which will replace the existing Commonwealth Accounting and Reporting System (CARS). While the repayment of the line of credit is to be from agency usage charges, language in the proposed budget authorizes the Governor to expend up to \$2.0 million in FY 2012 balances to begin repayment.

Additional technology-related actions within Central Appropriations include \$13.4 million to both mitigate increases in VITA rates and provide for the implementation of voice-over-internet telecommunications services for several agencies.

Natural Resources. The largest proposed increase is the appropriation of the statutorily required deposit to the Water Quality Improvement Fund of \$50.3 million in FY 2013, due to the FY 2011 revenue surplus. Of this amount \$45.3 million, or 90 percent, is proposed for upgrading wastewater treatment plants through the Department of Environmental Quality. The remaining \$5.0 million, or 10 percent, is proposed for agricultural best management practices through the Department of Conservation and Recreation (DCR). Other general fund increases include \$2.0 million for Civil War battlefield preservation, \$1.9 million for relocation of the DCR offices, and \$1.0 million for oyster restoration.

Proposed general fund reductions include a \$4.0 million cut in soil and water conservation districts' administrative funding, representing a 46 percent reduction. Other general fund reductions include \$1.3 million by eliminating 13 vacant positions in DCR, and a \$900,000 reduction in general fund support for State Parks, which is to be offset with fee increases.

Finance. Includes \$132.7 million in FY 2013 and \$166.4 million in FY 2014 for required deposits to the Revenue Stabilization Fund. The \$132.7 million deposit for FY 2013 is funded from FY 2011 year-end surplus funds set aside for the required deposit. In addition, \$114.0 million of the estimated \$166.4 million FY 2014 appropriation is available from the revenue reserve appropriated in FY 2012 in anticipation of the 2012-14 biennium deposits. The budget for the Treasury Board includes an additional \$40.8 million GF in FY 2013 and \$74.6 million GF in FY 2014 for increased debt service payments.

Transportation. The proposed budget for transportation includes a number of policy adjustments, the most significant of which is a proposal to phase-in the dedication of an additional 0.025% of the existing general sales and use tax for transportation. Currently, one-half cent (0.050%) of the state sales tax is dedicated to transportation. The budget as introduced reflects the appropriation of an additional 0.005% of the sales tax to transportation, estimated at \$54.4 million in FY 2013 and \$56.6 million in FY 2014. Legislation will be introduced to implement this change.

Also proposed are three fee increases at the Department of Motor Vehicles which would help the department cover operating costs by charging a \$10.00 late fee for delinquent vehicle registration renewals, charging \$10.00 for replacement vehicle titles, and charging a \$20.00 minimum for all drivers' licenses. In combination, these fee increases would generate \$9.9 million NGF each year for DMV operations.

Within the Department of Rail and Public Transportation, two proposals would shift existing policies on the distribution and use of funds. First, language would authorize the use of Rail Enhancement Funds to support passenger rail operating costs, which have not been eligible recipients of these funds. The second proposal would allow the Commonwealth Transportation Board to take funding “off-the-top” of the Mass Transit Fund for transportation demand management and park-and-ride projects agreed to as part of the public-private contract for the construction of High Occupancy Toll lanes in the I-95 corridor.

Finally, the budget assumes a transfer from the Department of Environmental Quality to the Department of Transportation’s Highway Maintenance and Operating Fund of \$2.3 million each year from the Waste Tire Trust Fund to support highway maintenance.

Administration. Provides \$7.4 million GF each year in additional funding for sheriffs’ offices and provides \$5.6 million in FY 2013 and \$6.2 million in FY 2014 for additional staffing costs for jails which either recently opened or expanded, or will open or expand during the 2012-14 biennium. Savings actions include the merger of the Department of Employment Dispute Resolution into the Department of Human Resources Management and the merger of the Human Rights Council into the Office of the Attorney General.

Agriculture and Forestry. Includes \$2.0 million GF for a new Governor’s Agriculture and Forestry Industries Development Fund to provide local grants to expand agricultural processing and manufacturing facilities. Other major actions include a proposal to implement a Weights and Measures Fee of up to \$8.00 per device to generate \$2.0 million NGF to support the inspection program. The budget also proposes an increase in food inspection fees from \$40.00 to \$60.00 to generate \$446,840 NGF and an increase for poultry inspection fees to generate about \$100,000 NGF.

Judicial Department. Provides \$2.0 million GF each year for increased costs to the Criminal Fund and \$149,999 GF each year for increased judicial costs paid through the Involuntary Mental Commitment Fund. An additional \$1.0 million GF each year is added to restore five vacant judgeships. The proposed budgets for the General District Courts and the Juvenile and Domestic Relations District Courts each include \$1.5 million GF for 23 new clerk positions, phased in over two years.

Executive Offices. Adds \$3.9 million NGF and 31.5 new positions in the Office of the Attorney General to increase Medicaid fraud investigations. The funding is provided through the state Oxycontin Settlement funds used to match federal Medicaid funds at an enhanced rate (25 percent state/75 percent federal). A companion amendment in the Department of Medical Assistance Services reflects an additional \$20.0 million in revenues from this initiative will be deposited in the Virginia Health Care Fund in FY 2014.

Capital Outlay. The proposed capital outlay program totals \$821.9 million (all funds). Recommendations for projects to be funded from general fund supported bonds issued by the Virginia Public Building Authority and the Virginia College Building Authority include \$200.5 million for maintenance projects and \$39.6 million to provide equipment for buildings scheduled to be completed during the biennium.

The nongeneral fund recommendations include \$61.8 million funded with nongeneral fund cash; \$73.9 million in 9(c) bond authority and \$340.5 million in 9(d) bond authority for auxiliary enterprise and other nongeneral fund revenue-supported projects at the colleges and universities; and \$105.5 million from Virginia Port Authority Bonds for expansion of port terminals.