COMMONWEALTH OF VIRGINIA

HOUSE OF DELEGATES

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December 19, 2008

MEMORANDUM

TO: Members, House of Delegates

FROM: Robert P. Vaughn, Staff Director

SUBJECT: Governor Kaine's Revenue Revisions and Budget Proposals in HB 1600

As we do every year, the Appropriations Committee Staff, along with the staff of the Senate Finance Committee, prepare jointly an analysis of the Governor's proposed budget amendments as contained in HB 1600. This analysis will be placed in your GAB mailbox on Tuesday, January 13th.

In an effort to assist you with questions from your constituents, the Appropriations Committee Staff has prepared the attached document that summarizes by Secretarial area the major highlights of the Governor's proposals.

With regard to the general fund revenue revisions, the Governor is recommending an additional downward adjustment of $387.7 million for the remainder of the biennium, for a total downward revision of $2,901.4 billion. These revenue numbers translate into growth rates of negative 4.8 percent in FY 2009 and positive 4.0 percent in FY 2010. It is important to note that despite the assumed revenue growth of 4.0 percent in FY 2010 over FY 2009, the actual amount of revenue assumed to be collected in FY 2010 is still anticipated to be less than the revenue actually collected in FY 2008 by approximately $530 million.

The revenue revisions reflect the recommendation of both the Governor's Advisory Board of Economists (GABE) and the Governor's Advisory Council on Revenue Estimates (GACRE). Specifically, the economic outlook is based on Global Insight's Standard Forecast which assumes a four quarter recession.

A summary of the Governor's budget proposals for fiscal years 2009 and 2010 is outlined in the attached document. For the most part, the fiscal year 2009 budget actions are unchanged from the proposal the Governor outlined in October. In total, these savings strategies generate $278.9 million in FY 2009 and $392.7 million in FY 2010.

Because the anticipated shortfall for FY 2009 was increased by an additional $164.3 million since October, the proposed withdrawal from the Revenue Stabilization Fund was increased from $400 million to $490 million. No additional withdrawal is proposed for FY 2010.

In addition to the October reductions and the Revenue Stabilization Fund, the Governor also captures $350 million by supplanting debt for cash from capital projects; $242.3 million by eliminating all pay raises for all employees groups in the biennium; $79.5 million in savings from lower than budgeted student membership; $64.9 million in technical adjustments due to lower sales tax revenues going to public education; $54.4 million by using Literary Funds to pay for teacher retirement contributions; and, $40.7 million from FY 2008 unexpended agency balances.

With regard to targeted budget savings in public education, the Governor puts forth a series of policy changes resulting in a reduction of $424.2 million in public education, the largest of which is the implementation of a funding cap for support positions outside of the classroom.

General fund reductions in Medicaid total approximately $418.0 million, offset by an increase in spending of $268.4 million, primarily due to increases in utilization and enrollment. The largest GF reduction -- $154.9 million – is the result of a proposed 30 cent per pack increase in cigarettes taxes which are deposited into the Health Care Fund.

In addition to the cigarette tax, several other tax policy changes are also proposed. The largest, $64.3 million, from the elimination of the "dealer discount" paid to retailers for collection of sales taxes. The Governor also proposes modifying the payments to taxpayers under the Land Conservation Tax Credit. Under the proposal, tax credits would be capped at $50,000 per tax year instead of the $100,000 under current law. However, the time in which to claim the total tax credit would increase, thus allowing the taxpayer to claim the total credits.

In closing, the staff will be providing a budget briefing to the Committee on Wednesday, January 14th. We will meet 30 minutes after the House adjourns in the Appropriations Committee room. We will send out a reminder to your office prior to the Session.

If you have any questions, please do not hesitate to call. On behalf of the entire staff, we wish you and your family a safe and Happy Holiday!

cc: The Honorable Lacey E. Putney, Chairman
The Honorable William J. Howell, Speaker of the House

Attachment

HOUSE BILL 1600 AS INTRODUCED

Proposed Tax Policy Changes

Embedded in the Governor's budget recommendations are a series of tax policy changes, each of which will be accompanied by stand-alone legislation. In combination, these changes are anticipated to generate an additional $140.6 million GF and $154.9 million to the Health Care Fund in the second year. The major provisions are listed below:

- ***Tobacco Products Tax Increase.*** Proposes to increase the cigarette tax from 30 cents to 60 cents per pack and increase the other tobacco tax to 25 cents per ounce effective July 1, 2009. generating approximately $155 million in FY 2010 with the revenues being used to offset general fund appropriations for the state's share of Medicaid costs.

- ***Elimination of Dealer Discount on Sales Tax***. The Governor proposes to eliminate the "dealer discount" which allows retailers to retain between 2 and 4 percent of the sales taxes they collect (based on volume of sales) generating $64.3 million each year. North Carolina, Kentucky and Tennessee do not provide a dealer discount and Maryland caps the discount they provide.

- ***Subject Captive REITs to Corporate Income Tax.*** Currently a REIT is subject to income tax but is allowed to deduct dividends it pays its shareholders. Dividends received by shareholders are taxed except that they do not qualify for the corporate dividends received deduction. As a result of differences between federal and Virginia exemption definitions, income attributable to ownership of real estate in Virginia escapes Virginia income tax. The proposed change would generate $10.0 million each year beginning in FY 2010. Similar provisions have been adopted by nine other states including Maryland, Kentucky and North Carolina. Another 20 states require corporate income tax returns to be filed on a unitary combination basis which prevents tax avoidance through captive REITs. Unlike legislation proposed by the Administration last year, bank-held mortgage REITs are excluded from this change.

- ***Land Preservation Tax Credit Annual Cap***. Proposes to reduce the amount of Land Preservation Tax Credit that may be claimed on income tax returns from $100,000 to $50,000 per taxpayer and would extend the period during which a taxpayer can claim the credit. This would generate $50.0 million in FY 2010.

Higher Education

The savings strategies adopted by the Governor for higher education and state museums total $323.5 million for the biennium of which $98.8 million are in FY 2009 and $224.7 million are in FY 2010. Public colleges and universities comprise the majority of the reductions at $86.1 million the first year and $212.1 million in the second year. Affiliated education entities

(SCHEV, VIMS, extension, higher education centers, EVMS and Jefferson Labs) account for reductions of $7.6 million in FY 2009 and $7.2 million in FY 2010. State museums and the Library of Virginia have $5.1 million in reductions in FY 2009 and $5.5 million in FY 2010.

Reductions to colleges and universities were either five percent or seven percent in the first year. Institutions received a five percent reduction if they (1) were either below 93 percent of their funding guideline as of June 2008 or (2) have more than 50 percent of their students applying for financial aid. The remaining institutions were assessed a seven percent reduction. Second year reductions were about 15 percent for all institutions except for Richard Bland and the VCCS which received a ten percent reduction.

The $17.5 million in funding for the Tuition Moderation Incentive Fund (TMIF) was eliminated in the second year after allocating about $5.0 million to the 11 institutions who kept FY 2009 tuition increases moderate and qualified for the continuation funding.

The Governor's budget does propose $25.9 million in increased financial aid funding for 12 of 17 institutions and $13.3 million of restructuring incentive funds related interest earnings and credit card rebates.

Public Education

The Governor's proposed Direct Aid for public education budget includes a total of $10,962.4 million GF for the biennium, a net biennial decrease of $691.9 million GF.

The majority of the GF savings, $583.7 million, occur in the second year of the budget. These adjustments are due to: technical and mandated adjustments attributable to the projected slowing of enrollment growth, a proposed policy change for support positions, elimination of a salary adjustment, and the elimination of construction grants.

The largest proposed amendment changes the current policy for how the state funds education support positions – personnel not in the classroom. This action applies a funding cap of one funded support position to every 4.03 funded instructional positions and saves $340.9 million GF the second year. Along with the cap, the Governor recommends a new funding loss cap allocation of $60.9 million to help mitigate some of the loss of funds for those localities that are most affected by the policy change. The new funding cap ensures that localities will not lose more than $403.9 per student due to the policy change.

The proposed budget also eliminates the use of Lottery funds for school construction grants, adds six programs (Alternative Education, ISEAP, Special Education – Regional Tuition, NCLB, Project Graduation) to the Lottery fund and removes two programs (Enrollment Loss and Remedial Summer School), resulting in total GF savings of $55.8 million the second year. In addition, the Governor's budget reflects reduced estimates for Lottery revenue of $30.5 million in FY 2009 and by $30.8 million in FY 2010. Further, the budget also recommends eliminating the $27.5 million from the school facilities construction grant program in the second year.

Other proposed actions include supplanting a net of $42.6 million NGF in FY 2009 and $11.8 million NGF in FY 2010 from the Literary Fund into the general fund to pay for a portion of teacher retirement payments.

The budget proposes to eliminate the second year 2.0% pay adjustment and makes a slight reduction to the contribution rates for retiree health care credit and group life which saves $71.6 million and $2.7 million the second year respectively.

The Governor's recommended budget also reflects adjustment to the sales tax forecast as follows: 1.) Reflects the revised sales tax forecast which reduces revenue by $30 million in FY 2009 and $44.2 million in FY 2010; 2.) reflects two proposed policy changes related to the elimination of dealer discounts and an increase in cigarette sales tax, adding about $9.2 million to the estimate in the second year; 3.) reflects the 2008 triennial school census data which adds $4.6 million to basic aid payments the second year.

Additional technical adjustments related to updated student membership, student participation and test scores decreases funding to the SOQ, incentive and categorical programs by $35.7 million in FY 2009 and $47.4 million in FY 2010.

Lastly, the proposed budget saves $1.9 million the second year by closing the adolescent unit at Southwest Mental Health Institute and the Commonwealth Center for Children and Adolescents.

Employee Pay Raises

The Governor proposes eliminating all pay raises included in Chapter 879 for all employee groups for a savings of $242.3 million.

Capital Outlay

The savings strategies proposed by the Governor utilize about $360.7 million in general fund savings from capital outlay, including supplanting $350 million GF with VCBA and VPBA bonds for existing projects. The Governor also proposes reverting $10.7 million in capital project balances the majority of which is the reversion of $7 million of planning funds for the Charlotte prison project appropriated as part of the 21st Century Capital Improvement Program.

In addition, the Governor proposes sweeping about $56.0 million in nongeneral fund cash from projects at UVA ($8.9 million from the Alderman Housing Renovation), Radford ($7.1 million from the Heth Hall Renovation) and UVA Medical Center ($40.0 million from the Medical Center Renovation) and supplanting the cash with Virginia College Building Authority bonds.

Public Safety

Amendments proposed for public safety include general fund reductions totaling $38.8 million the first year and $107.3 million the second year. Among these budget reductions was the closure of two prisons, two field units, two detention centers, and eleven day reporting centers within the Department of Corrections. Due to costs associated with the Workforce Transition Act, these closures produced general fund savings totaling $6.1 million the first year; and the second year these reductions produce savings of $31.0 million.

Other significant savings include a reduction in HB 599 payments to localities with police departments of $7.7 million the first year and $14.4 million the second year. The first year reduction reflects the decline in general fund revenue collections, while the second year reduction represents a seven percent reduction. This seven percent reduction is similar to those proposed by the Governor in the second year for the Virginia State Police and sheriffs' offices. While sheriffs and other Constitutional officers' funding was not reduced in the first year, in the second year support for the operations of sheriffs' offices and jail per diems is reduced by $35.3 million.

The Governor's also proposes some additional spending items, including: $6.0 million each year in additional support for sheriffs' office dispatchers, which is transferred from the Virginia Information Technologies Agency's E-9111 fund; $3.4 million in additional funding the second year for local pre-trial services programs and additional probation and parole caseload growth; $1.0 million the first year and $3.5 million the second year to staff new or expanded local jails, and $1.2 million for the costs of utilities at the Northern Virginia forensic laboratory.

Health and Human Resources

The Governor's introduced budget for Health and Human Resources agencies reduced spending by a net total of $287.3 million GF over the biennium. This total reflects new biennial spending of $296.1 million GF offset by reductions of $583.4 million GF. The largest of these reductions come offsetting general fund costs in the Medicaid program through a 30-cent per pack increase in tobacco taxes which generates $154.9 million GF. Other targeted reductions in Medicaid involve delaying provider payments for a one-time savings of $126.5 million in FY 2009, reducing provider payments saving $24.4 million GF, capping enrollment and services in long-term care waivers saving $18.9 million GF, and closing Southeastern Virginia Training Center for a one-time savings of $8.4 million in FY 2010. In addition, Medicaid savings of $7.1 million GF are realized by implementing a provider assessment fee on intermediate care facilities for the mentally retarded (ICF-MRs). Other significant reductions include $7.6 million GF in savings from the closure of the children and adolescent unit at Southwestern Mental Health Institute and the closure of the Commonwealth Center for Children and Adolescents located on the Western State Hospital campus. A savings of $12 million GF is included in the Comprehensive Services Act program from lower utilization of services.

The introduced budget also includes spending items. The budget provides $280.1 million GF over the biennium for Medicaid and children's health insurance program enrollment and utilization increases. An additional $1.8 million is provided for medical services due to increases in temporary detention orders. The budget also includes an additional $1.7 million GF for a 3 percent increase in rates for consumer-directed personal care for individuals enrolled in Medicaid home- and community-based waivers

Natural Resources

Proposed amendments for Natural resources include GF reductions of $11.7 million in the first year and $12.3 million the second year. Among these reductions is $3.0 million in state match for the wastewater revolving loan fund program due to declining federal funds and the elimination of about 59 positions within the Department of Environmental Quality. These position reductions generated GF savings of 808,438 the first year and $4.4 million the second year. Other reductions included $2.2 million each year for state park operations, and $403,697 the first year and $607,394 the second year in reduced support for soil and water conservation districts.

The Governor's proposed amendments also contain some additional spending items, including: $10.0 million from the general fund and $10.0 million in nongeneral fund sources for the Natural Resources Commitment Fund, which supports implementation of agricultural best management practices and an additional $1.5 million from the general fund to provide a statutorily-required deposit into the Water Quality Improvement Fund. $1.1 million of this amount is designated for the Department of Conservation and Recreation for nonpoint source pollution control and $0.4 million is provided to the Department of Environmental Quality for point source pollution control projects.

Agriculture and Forestry

Amendments for the Agriculture and Forestry secretariat include GF reductions of $9.1 million over the biennium. At the Department of Agriculture and Consumer Services GF savings total $4.9 million, or about 7.5% of the agency's GF budget. Targeted reductions include $890,000 GF and elimination of seven FTE positions from the Division of Charitable Gaming and the reduction of $500,000 GF in the state match for local purchase of development rights programs.

General Fund reductions for the Department of Forestry total $4.2 million of 11% of the agency's GF budget. Targeted reductions include $589,000 GF generated by consolidating from six regional offices to three and savings of about $1.0 million from eliminating 23 positions throughout the agency.

Commerce and Trade

Proposed amendments for Commerce and Trade generate a net reduction of $17.6 million GF when compared to Chapter 879, a 6.7 percent GF reduction over the biennium. The largest reduction reflects the elimination of an $8.8 million incentive payment to Qimonda because the company has not met performance targets. Other major reductions include: $1.1 million in the first year and $2.25 million in FY 2010 from the Enterprise Zone Grant program, $1.6 million each year from the indoor plumbing program, $1.0 million in unspecified reductions each year at the Virginia Economic Development Partnership, $800,000 in undesignated reductions each year at the Virginia Tourism Corporation, and approximately $500,000 the second year in combined reductions to water projects in southwest Virginia.

The Governor also has proposed a number of new initiatives and spending increases in Commerce and Trade, including $2.0 million the second year for a new Clean Energy Manufacturing Grant Program, a $5.0 million increase for the Governor's Opportunity Fund, and $1.6 million in the second year for the Fort Monroe Federal Area Development Authority.

Transportation

The Governor's recommended amendments for Transportation agencies result in an appropriation of $82.0 million GF and $9.095 billion NGF for the biennium, a nongeneral fund revenue reduction of $670.1 million compared to Chapter 879. These adjustments reflect reduced growth in a number of transportation revenue sources, in particular motor vehicle titling, gasoline and recordation taxes. With some very minor exceptions, the budget does not include any transfers of transportation funds to the general fund to address the GF budget shortfall. The reductions are contained in a single item in each agency and are not integrated into the specific programs. There is no language specifying how the agencies intend to implement the reductions by program, roadway system or geographic area.

Across the Secretariat, the proposed amendments reduce the agencies' maximum employment level by 1,163 fulltime equivalent positions. All but 13 of the eliminated positions are at VDOT which is reducing its MEL from 9,500 to 8,350 by the end of the biennium.

General Government

Savings amendments proposed in the General Government arena include: a proposal to generate $22.8 million in additional revenues from the hiring of 55 additional Tax staff to enhance its compliance and audit programs; $43.5 million in savings at the Compensation Board through across-the-board reductions in FY 2010 to the offices of constitutional officers. The reductions are 7% for Sheriffs and Commonwealth's Attorney's and 10% for Commissioners of Revenue, Treasurers, Directors of Finance, and the Clerk of Circuit Courts.