

Remarks of Governor Bob McDonnell
Speech to the Joint Money Committees
Richmond
August 19, 2013
For Public Release

Thank you.

Chairman Stosch, Chairman Putney, Chairman Purkey, Members of the General Assembly and money committees, ladies and gentlemen: Good morning and welcome back.

This is the time of the year I am called on to report to you on the finances of the Commonwealth, as well as to discuss matters of importance as we begin to develop the next biennial budget. Each of our past three reports has noted our mutual accomplishments and challenges. All have indicated good progress. Ladies and gentlemen, I'm pleased to report today, that excellent progress continues.

I spent much of last week on the road, traveling the Commonwealth from the Kentucky border in Buchanan County to the Eastern Shore; from Martinsville to Leesburg. At every stop I saw our "Commonwealth of Opportunity" on vivid display. I saw how the policies we have passed here in Richmond, with bipartisan support, are helping our fellow Virginians achieve their dreams, and make this a better Virginia.

- At Chatham Vineyards and Winery in Machipongo, we announced that sales of Virginia wine have reached an all-time high. Jefferson would be pleased!
- At Kellum Seafood in Weems, we put out the good news that the state oyster harvest is at a 25-year high.
- In Bristol, we saw the entrepreneurs and employees of WireTough utilizing grants from our CIT GAP Funds' Commonwealth Energy Fund to develop their natural gas fuel technology, which can help our state fleet conversion to natural gas. We were the first state in the Union to order such a transition.
- In Leesburg, we announced that through our Civil War Site Preservation Fund we have conserved another 1,265 acres of land on 13 battlefields around the state.
- In Chesapeake, we joined with Perdue to announce a major, new soybean agreement approaching a market-value of \$100 million that was facilitated during our recent trade mission to China. In 2012, agricultural exports from the Commonwealth reached a record high of \$2.6 billion.
- In Hampton, I visited with the great men and women of the Virginia Air National Guard 192nd Fighter Wing, the best F-22 Raptor unit in the country.

These are a few of the accomplishments of the entrepreneurial and industrious people of Virginia. Working together, we have created a government that has helped make their accomplishments possible. We've been a partner; not an obstruction. From the Commonwealth's

healthy balance sheet to our low employment rate, the empirical evidence conclusively demonstrates that our approach is working. This IS a Commonwealth of Opportunity... and results.

And today I'm pleased to announce another positive result: For the fourth straight year, we have generated a significant surplus in state government finances. The Commonwealth finished fiscal year 2013 with a total budget surplus of \$585 million, the largest since 2005. This is made up of an additional \$264.3 million in general fund revenue collections and transfers above the official budget estimate, up slightly from the initial \$261.9 million estimate I announced last month. Additionally, we finished the year with a substantial \$320.7 million in balances, savings and recoveries from unexpended general fund appropriations and other unexpended nongeneral funds that must be reported on the general fund balance sheet as liquid assets. Taken together with the budget surpluses that I have previously announced over the last three years, the cumulative surplus for the last four years now stands at nearly \$2 billion.

This joint achievement is remarkable when one considers the difficult economic conditions we worked through together. The total surplus on the revenue side alone constitutes the first time since the Allen administration that an administration has attained a revenue surplus at the end of all four of its fiscal years in office.

Also, from what Secretary Brown has been able to determine, it appears that the total cumulative surplus of nearly \$2 billion is the largest surplus ever compiled by one administration. We have been blessed by the good judgment and the sound advice of all those involved in the budget development and financial decision making process. Accordingly, I thank you leaders on the committees for your excellent work in budgeting conservatively and controlling spending. The people of Virginia are the beneficiaries of these solid financial results.

As for the comparative details of our financial performance during fiscal year 2013, general fund revenues rose 5.3 percent compared with the budget forecast of 3.6 percent. This marks the third straight year that revenue growth has exceeded 5 percent. The main drivers of the revenue surplus were growth in individual income tax receipts from nonwithholding payments, lower individual income tax refunds, and higher than expected recordation tax collections.

Our good performance on the revenue front is concrete evidence of the Commonwealth's improving jobs picture, real estate market, and overall economic conditions. Virginia has created 172,600 net new jobs since February 2010. Over 90% of those jobs are in the private sector. Virginia's seasonally adjusted unemployment rate has declined from 7.4% in February 2010 to 5.5% today. Our unemployment rate is the lowest rate in the Southeast, and well below the rates of our neighboring states. It is the third lowest state unemployment rate east of the Mississippi.

As I indicated earlier, the fiscal year 2013 surplus also results from reliable fiscal advice, which drove Virginia's consensus revenue forecast process. In the fall of 2012, based on candid analysis from economists, Virginia business leaders, and many of you, received through GACRE and JABE, we adopted a "standard minus" economic outlook for the fiscal year. The resulting conservative revenue forecast was crucial to our ability to budget responsibly in the midst of a

complicated global economic environment and great uncertainty in Washington. And, given that year-to-date trends did not support a change to the forecast, we did not revise that forecast during the 2013 legislative session. Prudent fiscal restraint enhanced our ability to realize a sizeable surplus for fiscal year 2013.

Of the \$320.7 million in balances, savings, and recoveries, \$69.8 million represents balances in certain nongeneral fund accounts that have traditionally been required to be reported on the general fund balance sheet at the end of the fiscal year. Another \$55.6 million of the savings constitute higher education operating balances that are customarily brought forward pursuant to language in the Appropriation Act. The remaining \$195.3 million comes from unspent general fund appropriations and recoveries. All of these amounts will be carefully reviewed during the budget development process to ascertain what amounts actually should revert, and what resources can be reprogrammed to higher priority uses. Suffice it to say: we begin budget development in good shape.

The fact that we have a significant unspent balance is reflective of our efforts to streamline state government operations and change the long-time prevailing culture that held “the only way to go was to spend every appropriated dollar.” Over the course of these last four years, our administration instituted two performance incentive bonuses of 3% for state employees in 2010 and 2012 that were contingent upon sufficient savings being realized at year end. Both of these incentive bonuses succeeded, and employees were rewarded for their actions to save taxpayers money. Similarly, we provided individual cash rewards through our “30-Day Sprint Program” to state employees who could identify ways to save money in state government operations. Even our approach to this month’s 2 percent pay increase for state employees, received for the first time last Friday, the first base pay increase since December 2007, was predicated on realizing collections equal to the budget revenue forecast.

We have also challenged state agencies to set priorities and continually look for efficiencies, and to submit them in savings plans every year during budget development. Last year alone, we identified over \$92 million in savings which we included in the introduced budget bill. In total, we have provided over \$1.0 billion in savings strategies for consideration in budget development since the beginning of our administration.

We have also tried to better our performance and customer service through reorganization and operational changes. Specifically, I proposed and you agreed to numerous strategies to streamline state government and reduce unnecessary spending. An example of this is the elimination of dues paid to various organizations agreed to during the 2012 session. This effort resulted in the elimination of 22 low-priority organizational memberships which has saved over \$301,000 annually.

Since coming into office in 2010, we have also overseen important reforms of state government designed to reorganize operations, reduce bureaucracy, and improve services for the citizens. This effort has resulted in seven agencies being eliminated or merged into other agencies, producing over \$2 million in annual general fund savings. Additionally, thirty-six boards and commissions have either been eliminated or merged into other boards. We created the Office of the State Inspector General from five agencies with separate inspector general

functions, deregulated several industries, and moved several major functions between agencies to better align services for the customers of state government. We are now in the midst of a major effort to revise or eliminate over burdensome government regulations to serve people and businesses better. Our great state workforce is leaner and more productive. Today, there are over 2000 fewer filled positions within those agencies under the control of the Governor, excluding higher education, than at the beginning of our administration.

We continue to examine operations in key state agencies through the use of external audits. You recall that our Department of Transportation audit in 2010 yielded \$1.4 billion in unallocated funds that have since been invested in new transportation projects. Since we have made it clear that good performance and efficiencies are welcome and rewarded, we have set the stage for the good results we now see at year end. Performance incentives work, and our state employees are both hard-working and innovative.

While we are on the subject of state spending, I want to call your attention to a little known fact. If you examine the growth of general fund operating appropriations from 2007 to 2013, and subtract the required Constitutional deposits to the Revenue Stabilization Fund in those years, since those deposits are actually savings rather than spending, what you find is that the net general fund operating appropriations increased by only \$56.9 million over that six-year period. This represents a total increase of 0.3% percent, which equates to an annual average growth rate in general fund spending of one-tenth of one percent per year, well below the growth rate of inflation and population growth over the same period.

The bottom line is that, during this administration, we have worked closely with you to firmly hold the line on state spending and focus on economic growth. I am especially pleased with our bipartisan accomplishments and new targeted investments in K-12 and higher education, public safety, economic development, health and human services, natural resources, and transportation.

Through the budget process we have:

- Put close to \$400 million more into higher education, producing over the last two years the lowest average yearly tuition increases at our colleges in a decade, and generating 14,000 new slots at our schools for in-state students, thus keeping us on the path to award 100,000 additional degrees by 2025 as outlined in the 2011 Top Jobs legislation.
- Provided our National Guard with additional resources and support that have helped them to earn several national awards over the past few years.
- Increased teacher pay by 2%, implemented strategic compensation so our best teachers are properly rewarded, created incentives for STEM teachers, and ended social promotion through intense third grade reading resources.
- Ensured the opening of the River North Prison in Grayson County this September, restored prior cuts and made new commitments to our sheriffs, State Police and Commonwealth's Attorneys, and supported successful prisoner re-entry programs.
- Invested in proven programs that have helped reduce Virginia's homeless population by 16%.

- Returned \$45 million to localities by ending a budget gimmick that was taking cash away from cities and counties.
- Fueled private-sector job creation by investing \$120 million in new incentives and foreign trade offices and programs that work.
- Helped our agricultural and forestry industries grow through creating unique grant programs like the Governor's Agricultural and Forestry Industries Development Fund –the AFID- which spurs increased investment here at home and growth in Virginia exports.
- Created new grants to support the Port of Virginia, the Commonwealth's worldwide storefront, to prepare for the 2015 widening of the Panama Canal.
- Funded new infrastructure at Wallops Island to give our Spaceport the opportunity to be a national leader.

We have been able to accomplish all that we have within the context of extremely limited growth in overall state general fund spending. That is, perhaps, our greatest accomplishment together because it goes right to the heart of being good stewards of Virginians tax dollars.

Now, I know that each of you, and all of your constituents, have definite ideas on how best to spend our new surplus. Good ideas always outpace available resources. Yet, the State Constitution and the Appropriation Act already contain a number of provisions that specify how most of this money shall be used. Principally, the Constitution prescribes that an additional \$313.9 million shall be deposited to the Rainy Day Fund in fiscal years 2015 and 2016 based on actual collections of general fund revenues in fiscal year 2013, and the official budget estimate for general fund revenues in fiscal year 2014. Net of the \$95 million advance deposit to the Fund you wisely included in the current Appropriations Act, this means that an additional \$218.9 million must be reserved for the fund in 2015 and 2016, which I will do.

With these additional deposits, the Fund's balance is projected to be just over \$1 billion at the end of fiscal year 2016. Essentially, the Fund's balance will have grown by almost 350 percent, from the \$295 million at the end of FY 2010. The Rainy Day Fund balance at the end of fiscal year 2016 will be the third highest in history, and the largest balance since the end of fiscal year 2007. I can think of no better safeguard to offset the uncertainty of federal fiscal policy or prepare for potential future shortfalls in budgeted revenues than to build up liquidity in our Revenue Stabilization Fund. This critical action will be well received by both Wall Street and Main Street, and it is an accomplishment that will have a long term payoff, well beyond my term of office.... I think the applause you hear in the background is from the candidates running for Governor.

Another major beneficiary of the surplus will be the Virginia Water Quality Improvement Fund. By statute, the Fund gets 10 percent of any revenue surplus and 10 percent of unspent discretionary balances in general fund appropriations at the end of each fiscal year. Such deposits help meet our obligations under the Watershed Improvement Plan to accelerate our efforts to clean up the Chesapeake Bay. Given their rebounding numbers, the oysters and crabs appear to be very happy.

The additional amount reserved for the Water Quality Improvement Fund from the fiscal year 2013 surplus is approximately \$31.5 million. This is the fourth straight year in which the Fund has received a portion of the surplus. The total amount deposited to the Fund during our administration is more than \$218 million, with a cumulative investment in all water quality programs reaching over \$430 million, including the additional bond financing I proposed and you approved this past session to address critical storm water and wastewater infrastructure projects.

The third allocation of the surplus will be the repayment of \$21.7 million to the Transportation Trust Fund for transportation's share of the accelerated sales tax collections received in June. I am grateful that we worked together to continue to phase out the accelerated sales tax provision for both the general fund and the transportation trust fund. This fiscal year we have made another \$20.8 million appropriation to further phase it out, which will end it for 98 percent of the affected dealers. I would like to continue this progress in the next biennial budget.

Finally, we will set aside \$34.5 million to cover the state's obligations resulting from several natural disasters, and \$22.5 million to bring forward balances in our newly created FACT Fund which we established to mitigate the consequences of potentially adverse federal budget actions.

The remaining portion of the surplus, about \$255.9 million will be directed as follows: 69.8 million will initially be reserved for reappropriation actions involving certain nongeneral fund accounts; \$134.7 million for mandatory carry forward items; \$5.4 million for contractual and federal requirements; and \$46.1 million for discretionary program balances. All of these items will be reviewed during the budget development process, and final actions will be reported to you in December when I introduce the budget bill.

Before we get complacent about our improving fiscal situation, we must acknowledge that the way ahead remains uncertain. Policies and indecision coming from Washington will potentially have a tremendous adverse impact on all states, especially Virginia. The biggest immediate factor for us is the potential for devastating cuts to our military and defense industry from sequestration. The belief was that the automatic across-the-board cuts imposed by sequestration would force the federal government to wisely fashion a prudent approach to addressing our nation's spending and debt crisis. That did not happen, and sequestration went into effect this March.

Some of the negative projections on the front end of what would occur with sequestration have not yet materialized. For example, the Department of Defense said early on that civilian employees would be furloughed for 22 days under sequestration. This projection was revised downward to 11 days by June, and more recently adjusted back to 6 days. As long as sequestration stays in place, Defense will be in the crosshairs and that is a real threat both to national security and to Virginia's long term economic well being, with our 19 military bases, the Pentagon, 837,000 veterans, and our position as the top defense procurement state in the country.

Congress has recessed without passing the necessary appropriation bills to run the federal government past September 30th, and there is little expectation now that an actual budget will be enacted for fiscal year 2014. Far more likely is that Congress will do another temporary fix at the eleventh hour to avoid an immediate government shutdown. That will do nothing to curtail the longer term negative effects on the national and state economies resulting from the continued inability of the federal government to pass a comprehensive budget and deal with the mushrooming debt.

This makes our job in the future more difficult. We have done well together navigating the unprecedented economic uncertainty. We have been prudent and conservative by assuming slower revenue growth and recovery. How we deal with this federal uncertainty becomes the number one issue directing the course of budget development. We must also anticipate the impact of changing global security and economic situations, and how specific Virginia economic sectors might be affected. In any event, a future laser focus on job creation, education, infrastructure, and comprehensive STEM and workforce development efforts, will be key in this upcoming budget to ensuring Virginia's future success.

We will also have to meet our new obligations for funding for the Virginia Retirement System. The underfunding of public employee pension plans has become nothing short of a national crisis. I am pleased that Virginia was in the forefront of addressing this issue with our successful bipartisan effort last year to stabilize and strengthen VRS for the hundreds of thousands of Virginians who depend on it.

In the new budget, we must begin our agreed upon phase-in from an 8% to a 7% rate of return, which will mean hundreds of millions of dollars of additional employer contributions. We have collectively made this a priority for the retirement system to remain strong and solvent. Shortly after we enacted our measures for pension reform in 2012, Moody's Investors Service issued a notice citing our reforms as "credit positive." We must continue this progress.

We must also remain committed to ensuring that intellectually and developmentally disabled Virginians be enabled to live fulfilling lives in the least restrictive settings appropriate to their care needs. Just last week I visited the Sugar Plum Bakery in Virginia Beach, where Virginians with intellectual and developmental disabilities are working in rewarding jobs providing the community with...I must say... incredible sweets! That's the outcome we should be striving for. Consistent with Virginia's long-standing commitment to a community-based system for those with disabilities, over the next 8 months, 240 individuals will use Medicaid waivers to move out of training centers to new homes, closer to family and natural support networks. Since 2010 the census of our training centers has decreased from 1,198 to 775 individuals. Southside Virginia Training Center will close by the end of this fiscal year. Three of the four remaining training centers are on track to close by FY 2020. The funds from the sale of closed properties will be placed in the Mental Health Trust Fund and redirected to community-based requirements of the Settlement Agreement with the Department of Justice. Beginning in FY 2015, an additional 2,190 waiver slots for the intellectually disabled (ID) and 250 waiver slots for the developmentally disabled (DD) will need to be created under the terms of the agreement. The Department of Behavioral Health and Developmental Services also must

continue to increase access to crisis services and strengthen both their licensing and quality management systems to provide a more integrated setting for these vulnerable Virginians.

Healthcare reform remains an area of concern. The federal Affordable Health Care Act is a complicated system that does not necessarily ensure better outcomes. Our current budget requires sweeping reform of the Medicaid system before considering expansion. Medicaid spending and expansion have the potential to dramatically impact the budget. Our state spending on Medicaid has increased by 1600% in the last 30 years alone.

Our reform initiatives are underway and are being evaluated by the Medicaid Innovation and Reform Commission.

We are working to enhance our fraud prevention efforts and to ensure program integrity. This includes implementing a three-year Medicare and Medicaid Enrollee (dual eligible) Financial Alignment Demonstration. A major success has been the creation of a behavioral health organization which will ensure that individuals who need non-traditional mental health services receive them in a coordinated manner. We are also working to transition all children in Foster Care into managed care, and to implement a new eligibility and enrollment information system for Medicaid and other social services.

DMAS has just implemented a revised Medicaid managed care contract. A new quality incentive program is created which will withhold payments to be used to pay plans after quality measures are met. Also each plan will be required to test innovations in delivery and payment in at least two pilot programs.

We are seeking flexibility from the Center for Medicaid Services to facilitate these innovations in service delivery, administration, and beneficiary engagement. By developing a commercial-like benefits package for Medicaid populations, we will improve the system and reduce barriers to transitioning off Medicaid. Secretary Hazel and his team continue to work with Center for Medicaid Services and Medicaid Managed Care contractors to drive cost savings and patient accountability while improving service delivery.

Finally, we will move forward with coordination of long-term services and supports. In doing so, we will build on Virginia's long standing and successful Medicaid Managed Care program and expand the benefit of coordinated care to all remaining services, including long-term care waivers.

For the next biennium, we also will have to address the regular rebasing of K-12 education and fund the new reforms to ensure their maximum effectiveness. I also plan to continue our commitment to increasing access and affordability in higher education with targeted new resources as our financial situation permits.

While I have spoken mostly about the financial condition of the general fund, I want to thank you again for supporting the Speaker's game-changing transportation funding bill. Let me explain in concrete terms why this new funding bill for transportation was necessary. In FY 2013 transportation revenue missed its official forecast by 0.5%. The motor fuels tax in fiscal year

2013 fell by 1.0% compared to fiscal year 2012. In contrast, our broader retail sales and use tax grew by 2.1%. Given the long-term transportation funding shortfalls we already faced, it was critical that we change the paradigm for funding our transportation needs.

As a result of the passage of the transportation bill, the Commonwealth Transportation Board's FY2014-2019 Six-Year Improvement Program has grown statewide by \$3 billion, from \$11.4 billion last year to \$14.4 billion this year. Once the additional \$1.3 billion in Hampton Roads transportation funding and the additional \$1.9 billion in funding for Northern Virginia are factored in, the total investment in transportation over the next six years will increase to \$17.6 billion, an increase of 54%. This will provide much needed congestion relief as well as aid future economic development. I was pleased to see the fruits of that bill already with stops last week at the 460 extension and bridge construction at the Kentucky border in Buchanan, the Odd Fellows interchange in Lynchburg, and the soon-to-be Amtrak train stop in Roanoke. The 2013 transportation bill is working, right now. A recent study of the legislation by Chmura Economics found the bill will annually sustain 13,058 jobs and have a \$9.5 billion economic impact.

Our budget work together has produced good results. We have now achieved surpluses at the end of all four fiscal years of this administration with a cumulative record total of nearly \$2 billion. This was achieved by improved economic activity in the private sector, as well as prudent actions by state government to manage resources well and solve problems Virginians care about. Working across party lines, we seek the practical, focus on the doable, look to improve government, and demand results. That is how we operate because that is the Virginia way. Unemployment is down; the Rainy Day Fund is up; the core functions of government are being funded well; general fund spending is flat and Virginia's economy is growing.

Messrs. Chairmen and members of the General Assembly, as we enter the last months of our administration, I am very thankful for your ongoing support and leadership to help Virginia achieve this progress during uncertain times. I'm certain that we will continue that teamwork as I put together the last budget. The fiscal path we have charted has proven successful. We must stick to it. We will continue building this Commonwealth of Opportunity and getting real results for our people.

Let me also say, having not been a member of the money committees during my fourteen-years in the House, I have learned a great deal from my Cabinet, my staff and from all of you. Much credit for Virginia's fiscal success goes to Secretary Ric Brown, Budget Director Dan Timberlake, and your directors Robert Vaughan and Betsey Daley. I also want to thank Chairman Lacey Putney and Chairman Bob Purkey, and Delegates Jim Scott, Beverly Sherwood, Bob Tata, Joe Johnson and Joe May, as they retire after long and remarkable careers, for your hard work and your love for the people of Virginia.

It's an honor to serve you, and with you, as governor. As I bring my 37 years of consecutive military and state service to a close, I am inspired to see Virginia continue to be a national leader, as she has been over the course of the 237 years of the American Republic. A Republic born right here, in our beloved Commonwealth.

Thank you, God bless the people of Virginia, and please enjoy the remainder of the summer – you've earned it.