2016 Session Revenue and Budget Outlook

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House Appropriations Committee

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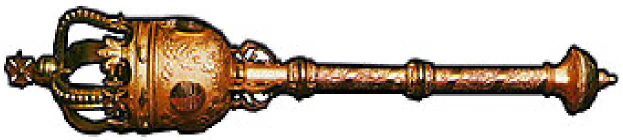


2016 Session Economic and Budget Outlook

- Snapshot of Current Conditions
- How Does the Current Recovery Compare?
- What Are the Key Indicators Saying?
- FY 2015 Performance
- FY 2016 YTD Performance, Expected Forecast Adjustment and Caboose Spending Requests
- GF Revenue Outlook: FY 2016-2018 Biennium
- Budget Outlook: FY 2016-18 Biennium

The Economy at a Glimpse

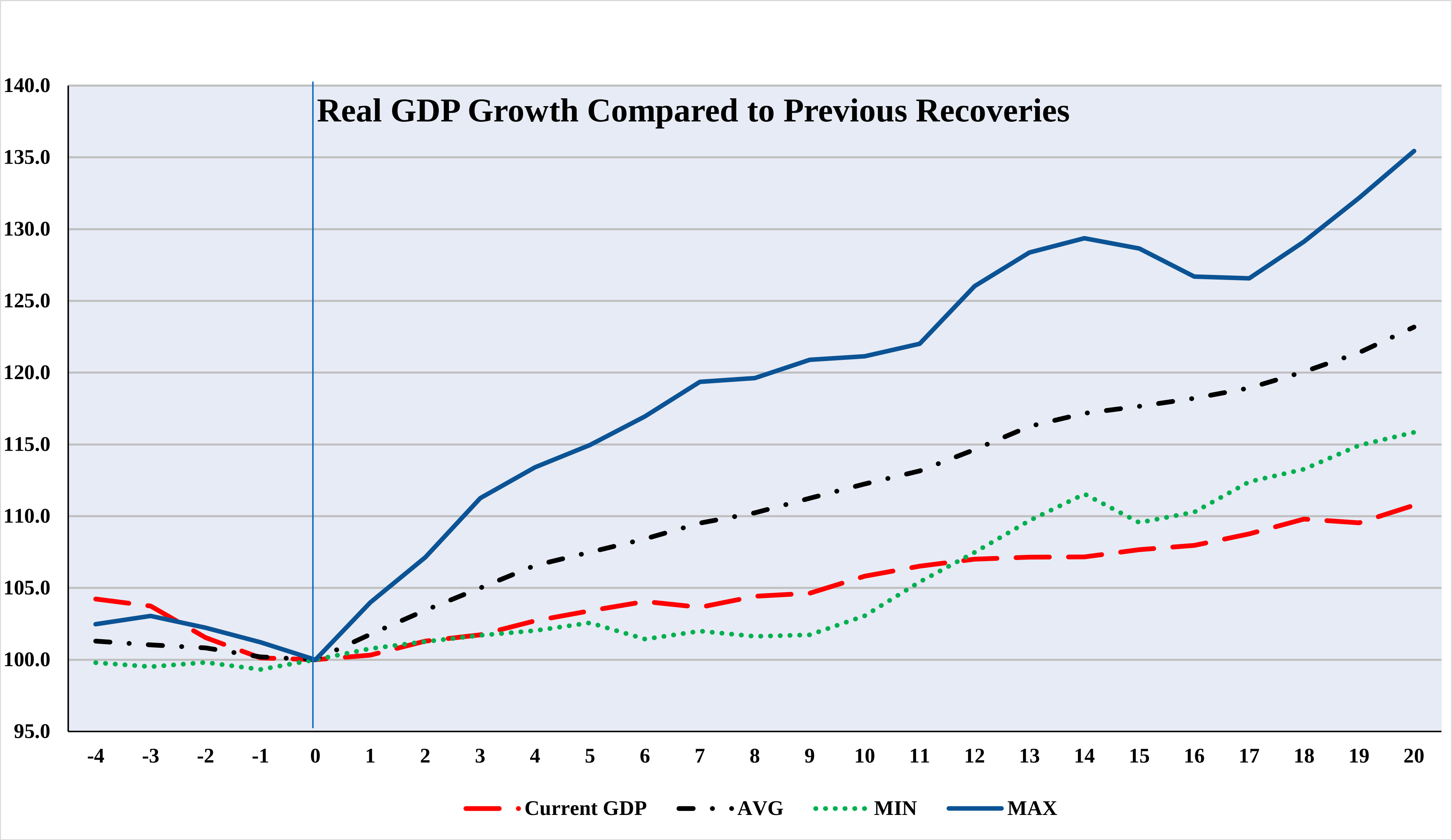
Overall Outlook	U.S. growth remains solid but unspectacular. Employment conditions have improved in recent years, but gains have moderated more recently.
Monetary Policy	The Fed has talked as if it is poised to raise interest rates but is understandably reluctant to move given the fragile state of the global economy, weakening manufacturing sector and lack of inflationary pressures; however the October jobs report may be the turning point.
Fiscal Policy	Continued battles over the budget process and debt ceiling remain a negative influence on the economy.
Global Economy	Slower growth in China is weighing on other economies, pushing up the value of the dollar and presenting a threat to U.S. exports and corporate earnings.
Virginia	Sequestration has hit Virginia particularly hard, reducing federal employees, government contractors and the military. The recent budget deal may give short-term relief. Education, healthcare and technology remain bright spots. Homebuilding is slowly gaining strength.

Source: Wells Fargo Securities

How Does the Current Recovery Compare to Prior Ones?

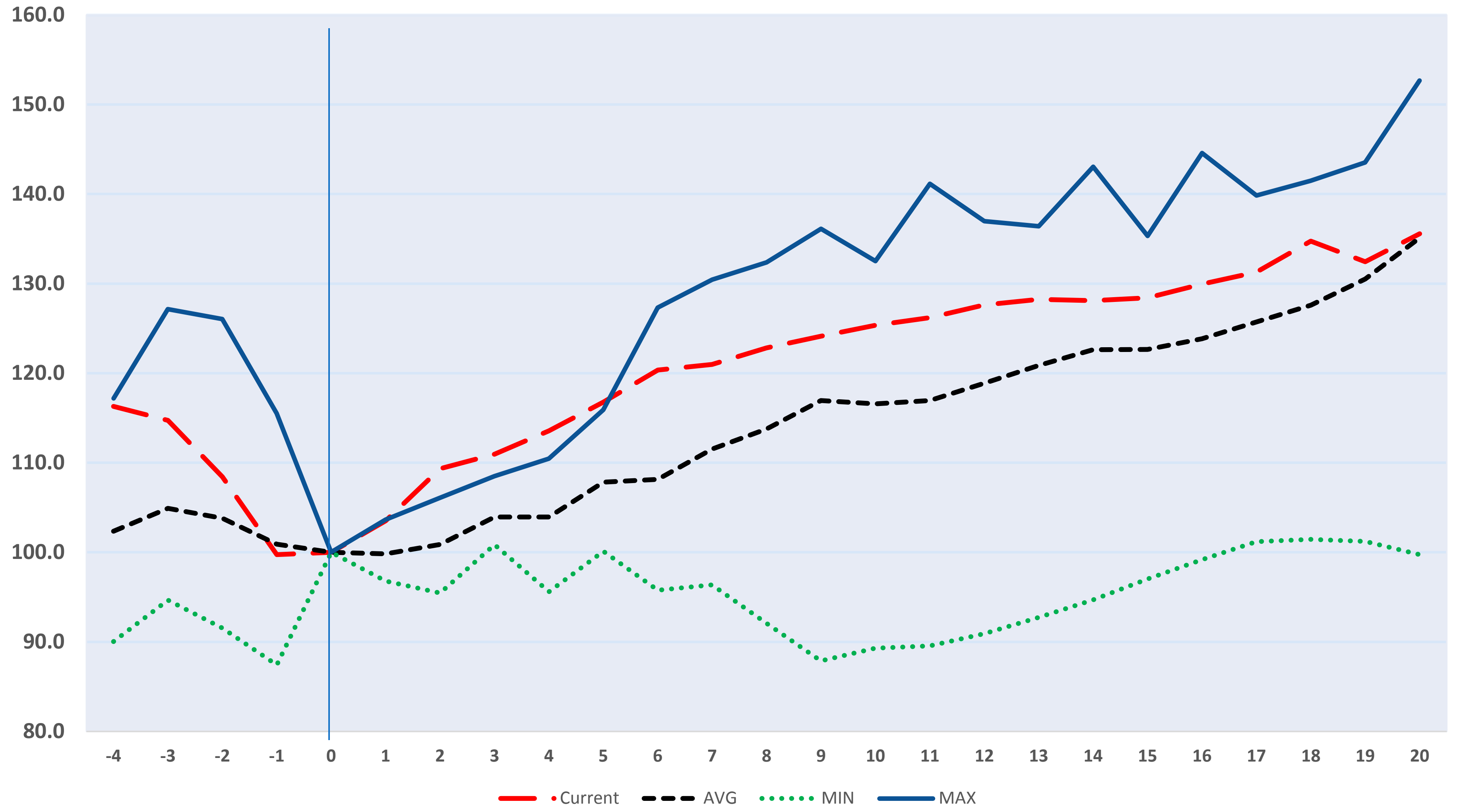
- The St. Louis Federal Reserve has tracked economic recoveries from 1949 through the present
- They measure key economic indicators and compare the current recovery to average, best and slowest economic recoveries
- Since the "Great Recession" real GDP growth has been subpar overall
  - Real personal consumption (durable and non-durable goods and services) has performed amongst the worst compared to previous recoveries
  - Exports have been the one bright light for GDP
- Growth has remained slow because both employment and personal income growth have lagged typical recoveries

Real GDP Below Worst Economic Recovery



Source: Federal Reserve Bank of St. Louis

Real Exports Have Fueled GDP

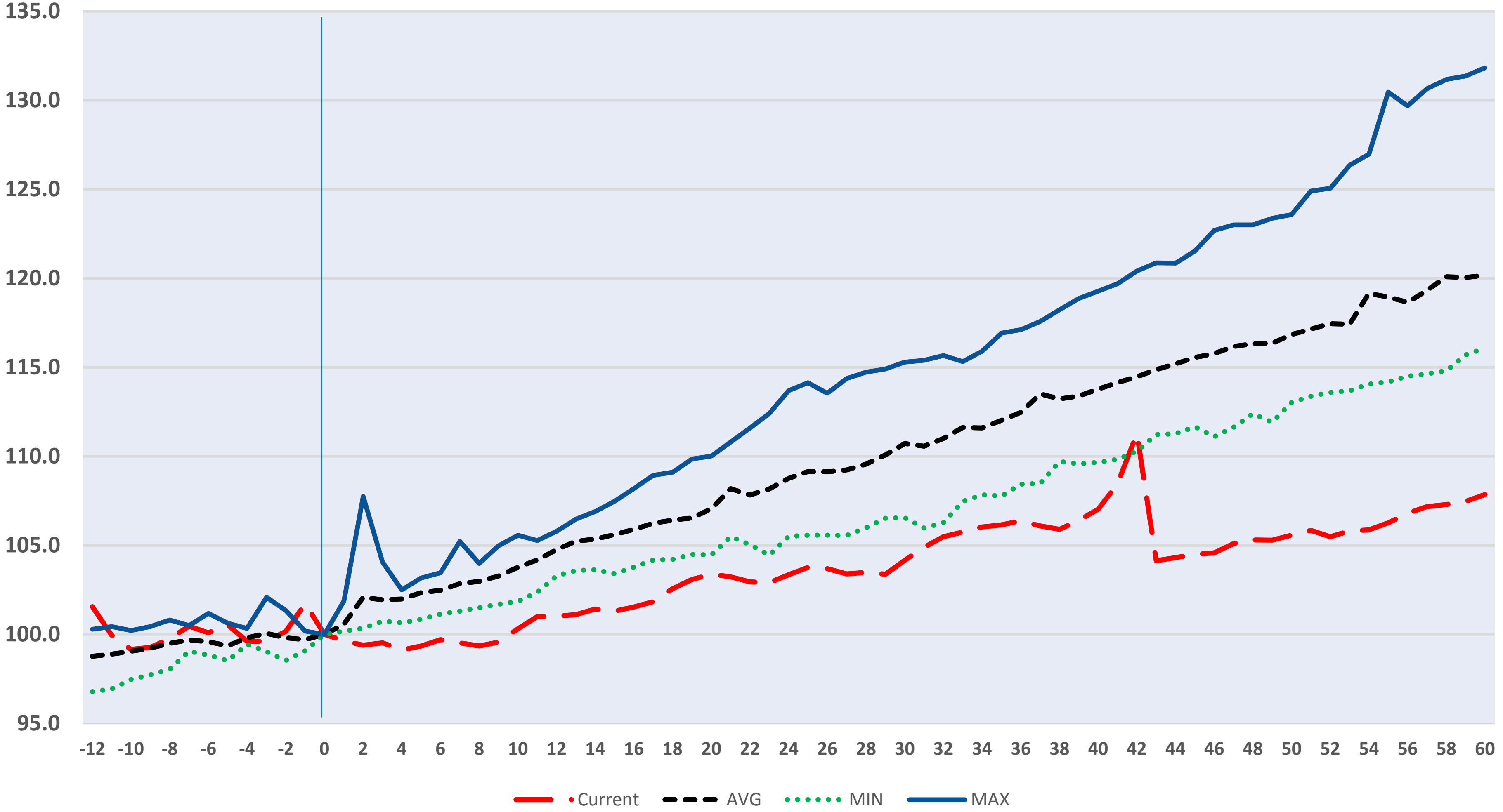


Source: Federal Reserve Bank of St. Louis

Real Personal Consumption Has Been a Drag on GDP

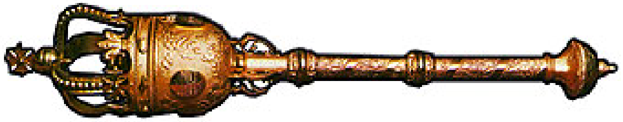
Source: Federal Reserve Bank of St. Louis

Real Personal Disposal Income is Performing Below All Previous Recoveries



Source: Federal Reserve Bank of St. Louis

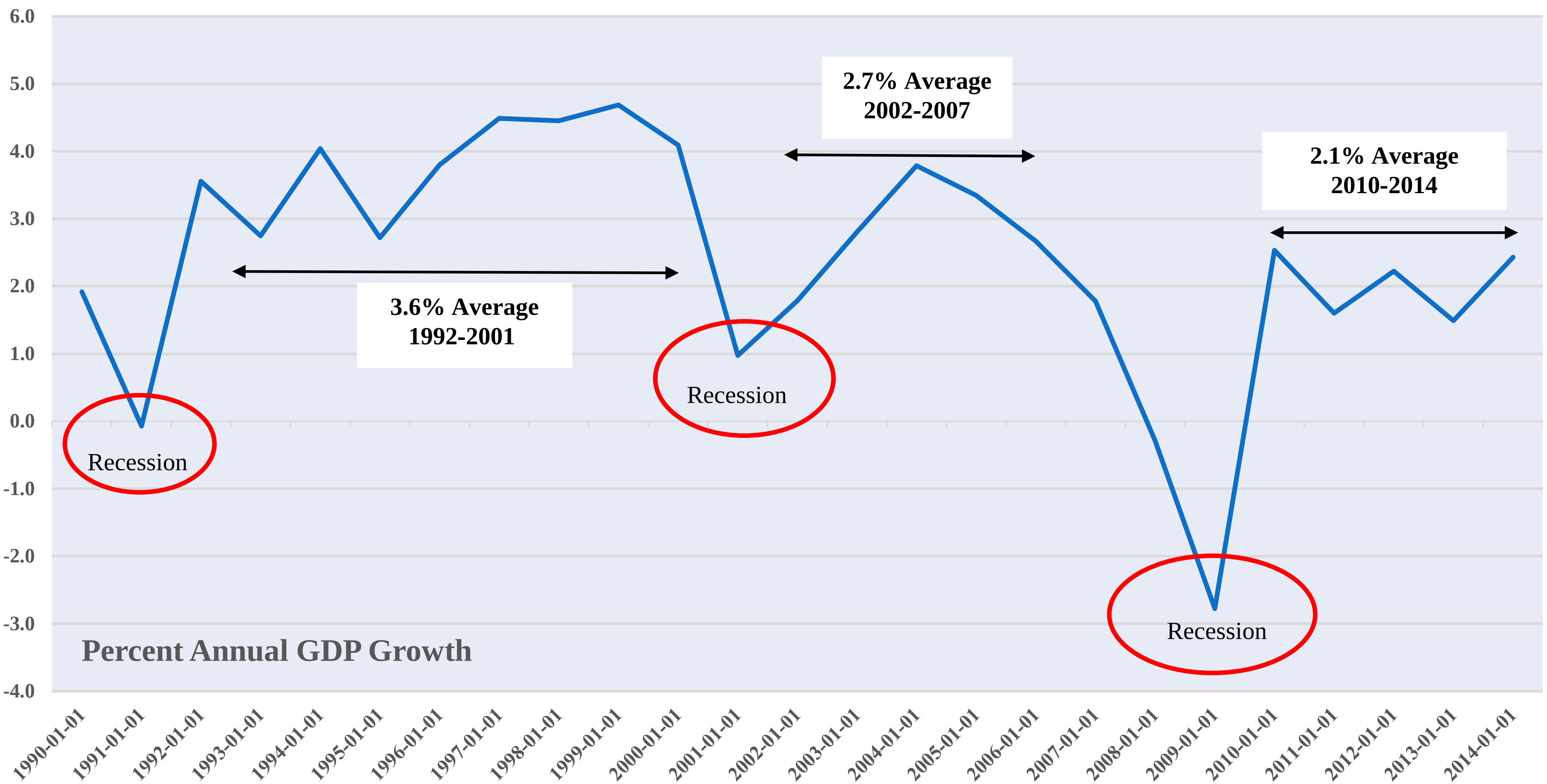
GDP and ISM
A Look at National Employment, and
Why Virginia Is Underperforming The Nation



Below Trend Growth Continues

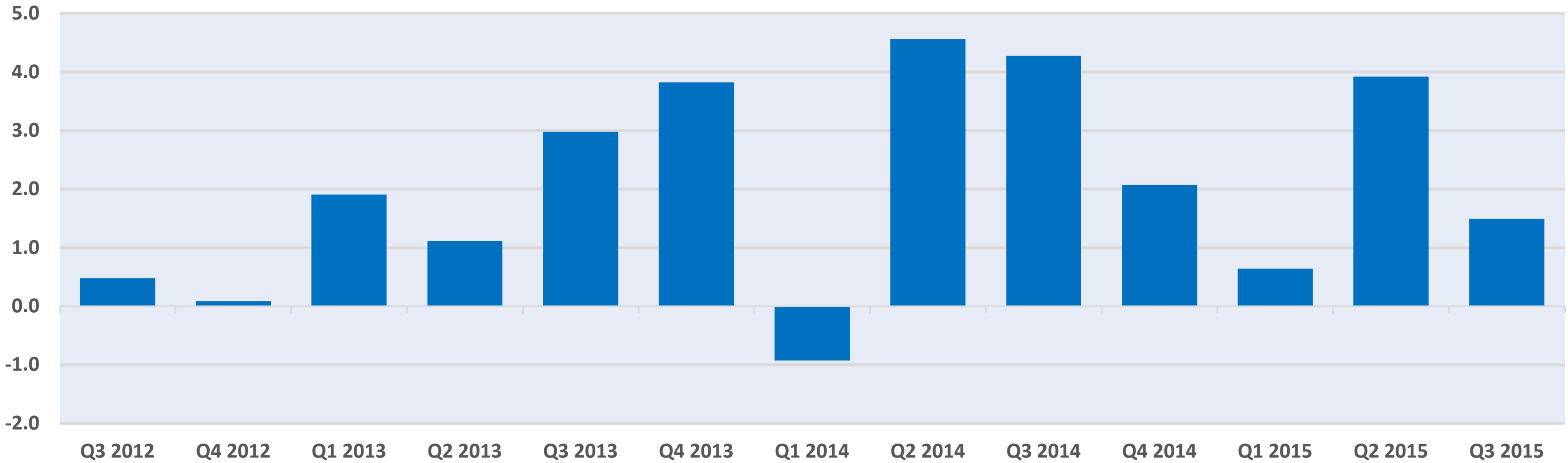
- The U.S. economy is growing, but GDP growth is less than half the rate it was from 1992 to 2001, and 75% of the pace from 2002 through 2007 – a new normal?
- Manufacturing output remains above 50 – the benchmark for growth – but has weakened, as exports orders have slowed
- Employment continues to struggle with slow job growth and weak wage growth. Nationally, unemployment has dropped to 5.1%, but the U6 employment rate and the workforce participation rate mask the real number
- Companies continue to report record solid earnings. Has come at the expense of jobs and wage increases
- Consumers are spending, but not at the same pace, especially in light of lower gas prices
- While the housing sector continues to improve, year-over-year growth rates have slowed

Since Emerging from the Recession, the US Economy Has Downshifted…But Q2 GDP Shifted Upward, Can Q3 Stay in Gear?



Source: Bureau of Economic Analysis

Advance Estimate Third Quarter 2015 GDP Weaker than Anticipated, Driven by Cut Back in Private Inventory Investment



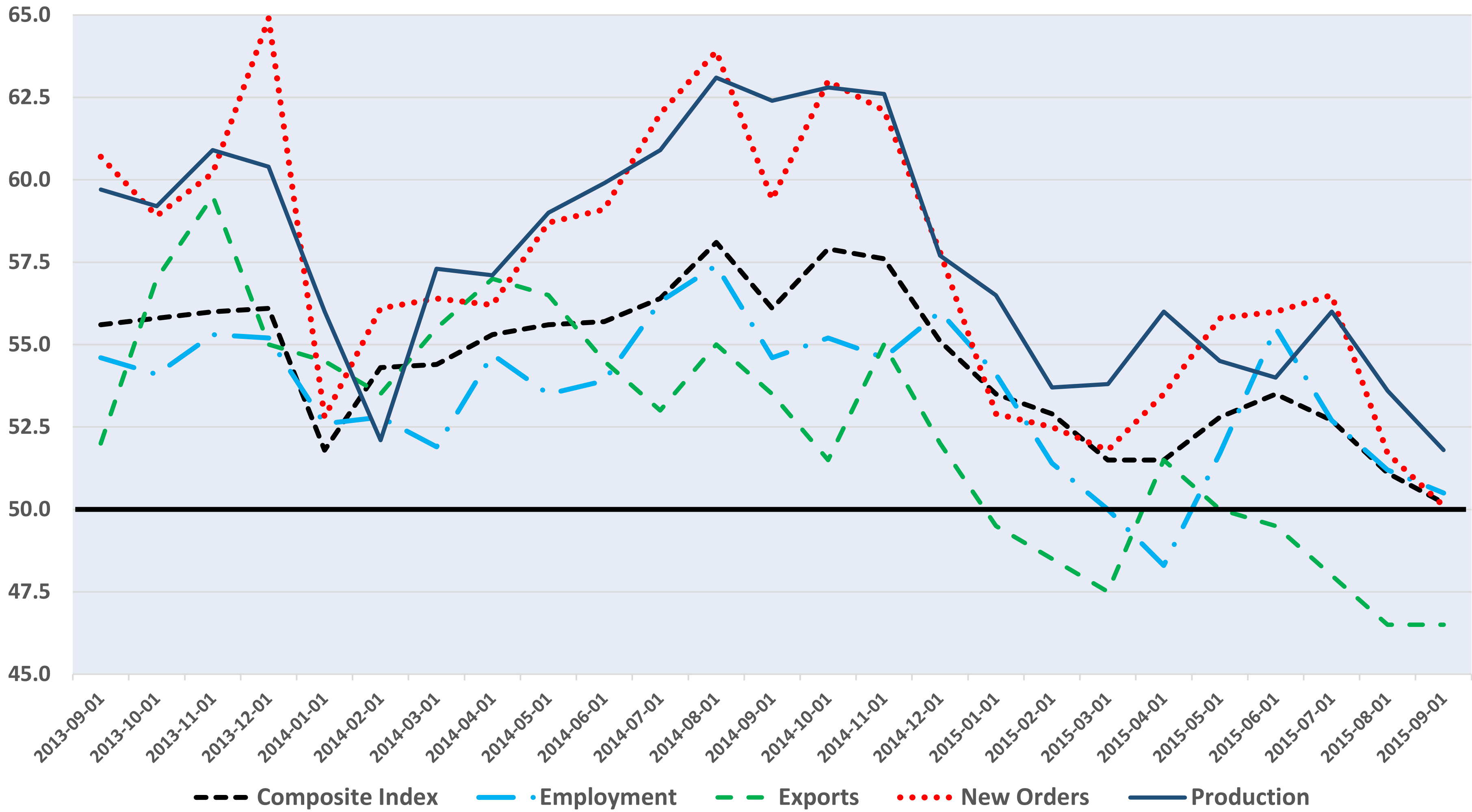
- The level of activity in the Advance Estimate of Q3, was weaker than anticipated and shows an economy growing at a painfully slow clip compared to prior recoveries
- The inventory drag, which shaved 1.44% off of GDP is likely to be temporary as economists expect growth to pick up in the fourth quarter given strong domestic fundamentals
- Positive contributions from personal consumption expenditures (PCE), which grew 3.2%, down from 3.6% in the second quarter. Consumers are being aided by lower gas prices
- Exports slowed to 1.9% in the Q3, compared to 5.1% in Q2. However, goods decelerated to 0.7% down from 6.5% in Q2
- State and local government spending grew 2.6%, while federal spending grew 0.2%, and defense spending declined 1.4%

Source: Bureau of Economic Analysis

What Are Other Key Indicators Showing?

- ISM's *Report On Business* shows the manufacturing sector expanded in September, but the index has been slowing down since July
  - New Orders Index at 50%, driven by contraction in exports
- Manpower's 2015 Q4 survey of 11,000 firms reveals 21% of employers expect to add workers, 6% expect to contract, and 71% of the firms plan no change in hiring
  - All four U.S. regions surveyed report a positive net employment outlook, with the South reporting an employment outlook of +17%
  - In the South, 22% of employers surveyed expect to increase staff levels and 6% plan to decrease their employee headcounts, resulting in a net employment outlook of +16%. When seasonal variations are removed from the data, hiring plans are relatively stable compared to last quarter and improve slightly compared to Q4, 2014. Quarter over quarter, durable goods manufacturers report a considerable increase in hiring plans. A slight improvement in job prospects is expected in Construction, Financial Activities, Information and Transportation & Utilities. Employers in the Government and Other Services industry sectors report relatively stable hiring expectations.
  - **Employers in the Education & Health Services, Nondurable Goods Manufacturing, Professional & Business Services and Wholesale & Retail Trade industry sectors anticipate a <u>slight weakening of the hiring pace</u>, while Leisure & Hospitality employers expect a moderate decline.**

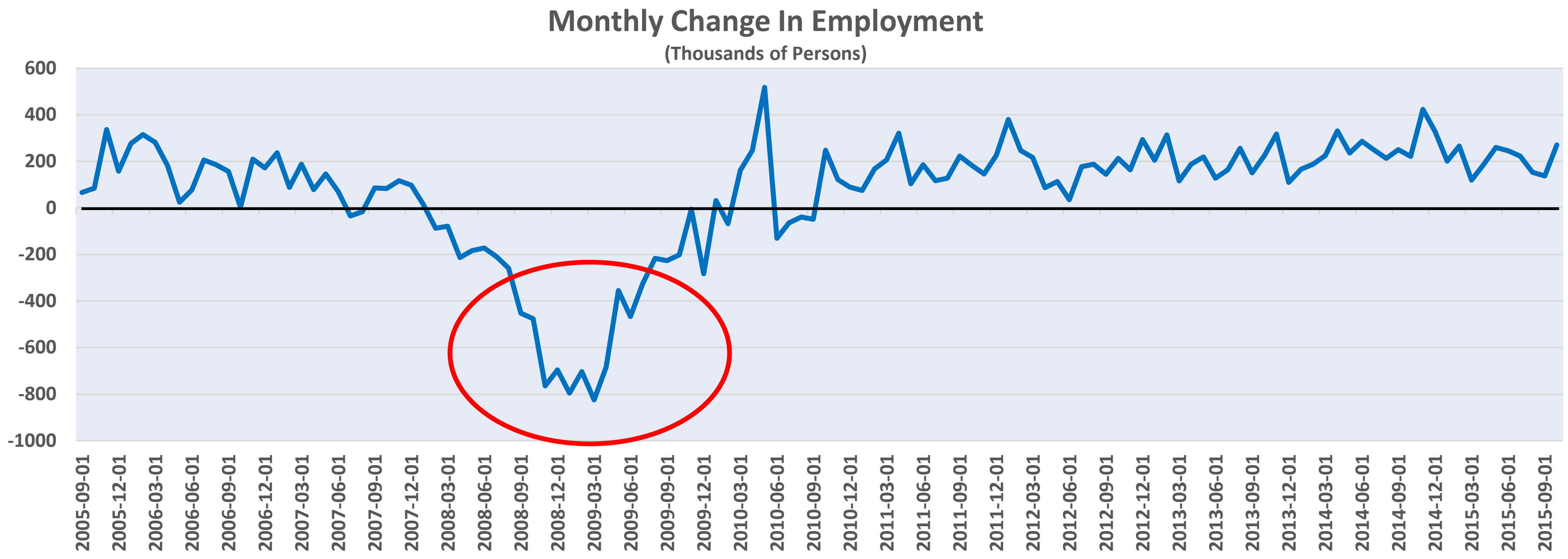
ISM Index Remains Above 50%, But Overall Manufacturing Has Slowed Down the Last 3 Months, With Exports Contracting the Most



Source: ISM Report on Business

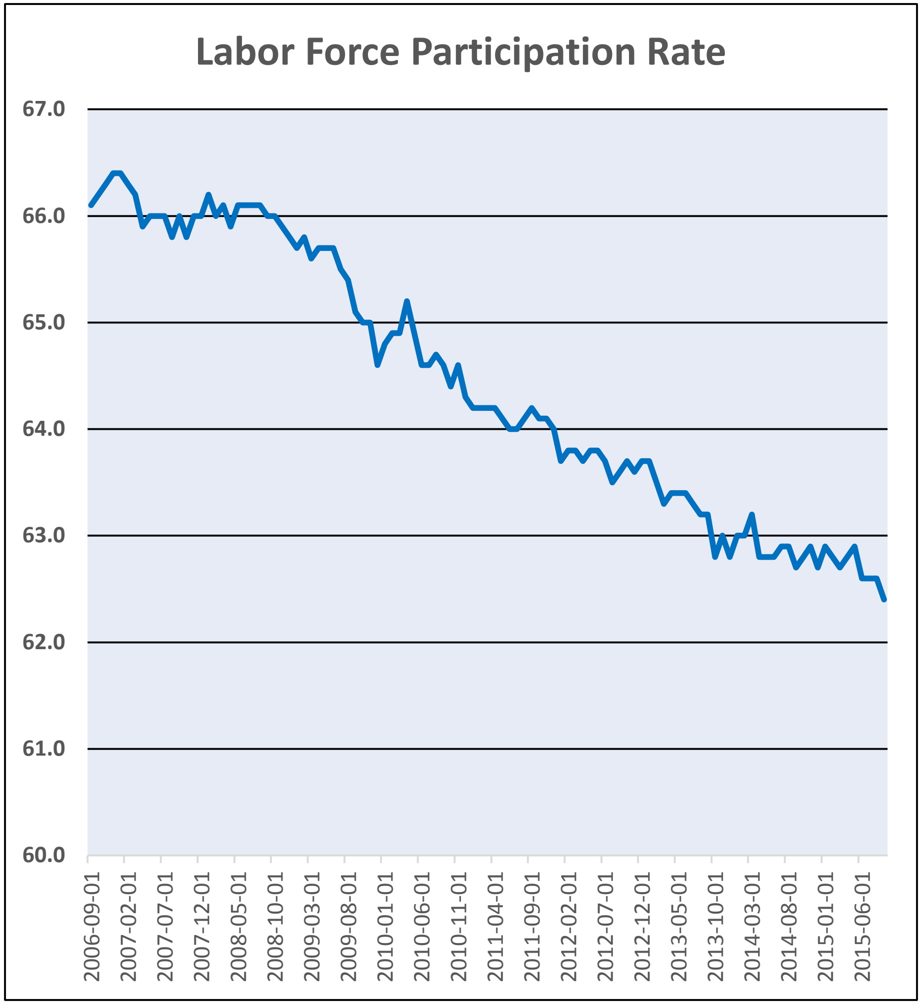
U.S. Employment Has Fully Recovered from The Recession

- A total of 8.7 million jobs were lost during the recession. US employment now stands nearly 4.3 million over the pre-recession peak
  - Average of 187,000 new jobs per month since trough
- Over the last 12 months average job growth has been 235,000, but has slowed over the last 6 months to about 215,000 per month
- While the economy is adding jobs, the percent of prime working age individuals (25 to 54) remains below the pre-recession peak, as does the workforce participation rate



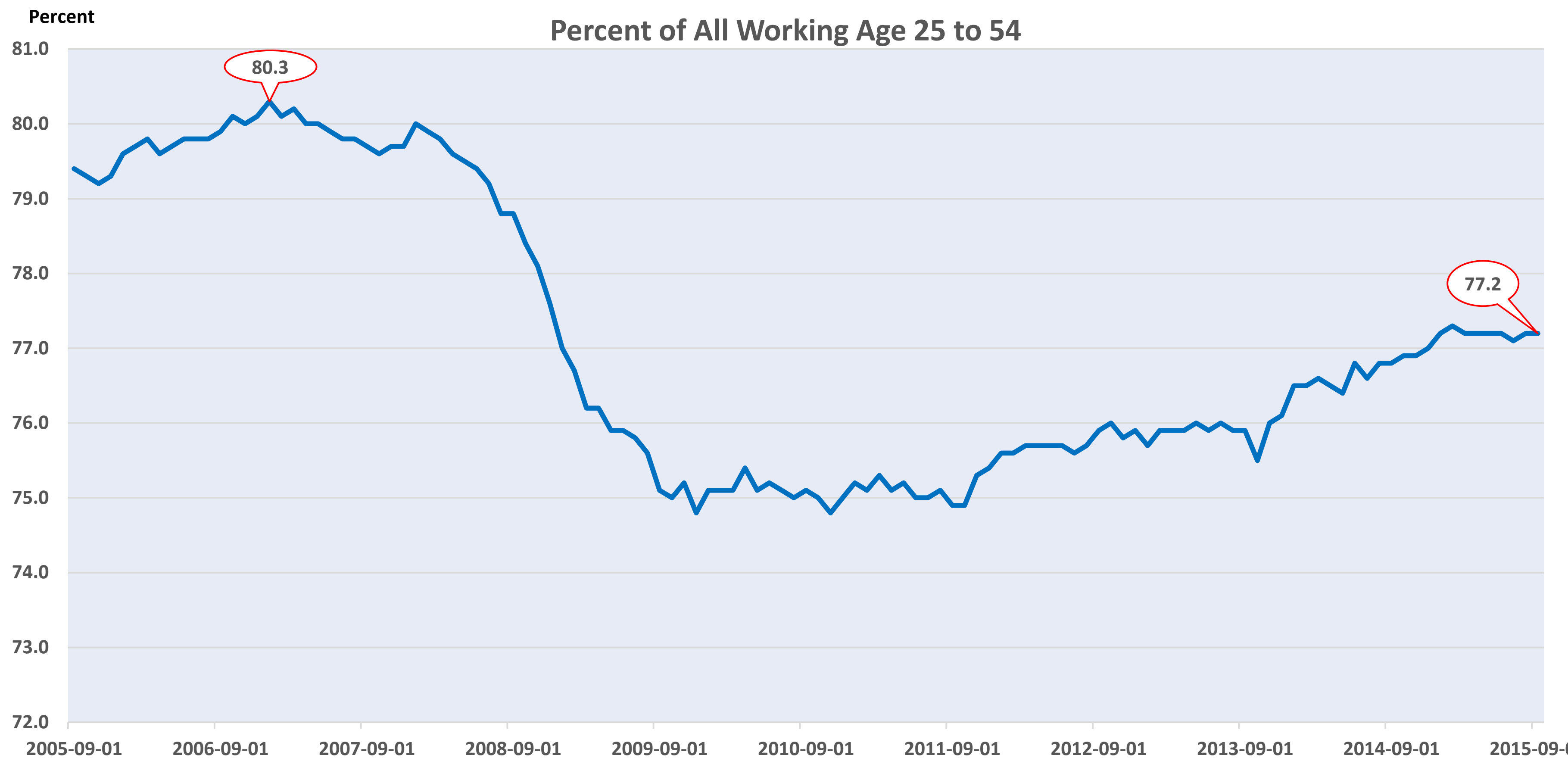
Source: Bureau of Labor Statistics

While the U.S. Unemployment Rate Has Dropped, So Has the Workforce Participation Rate



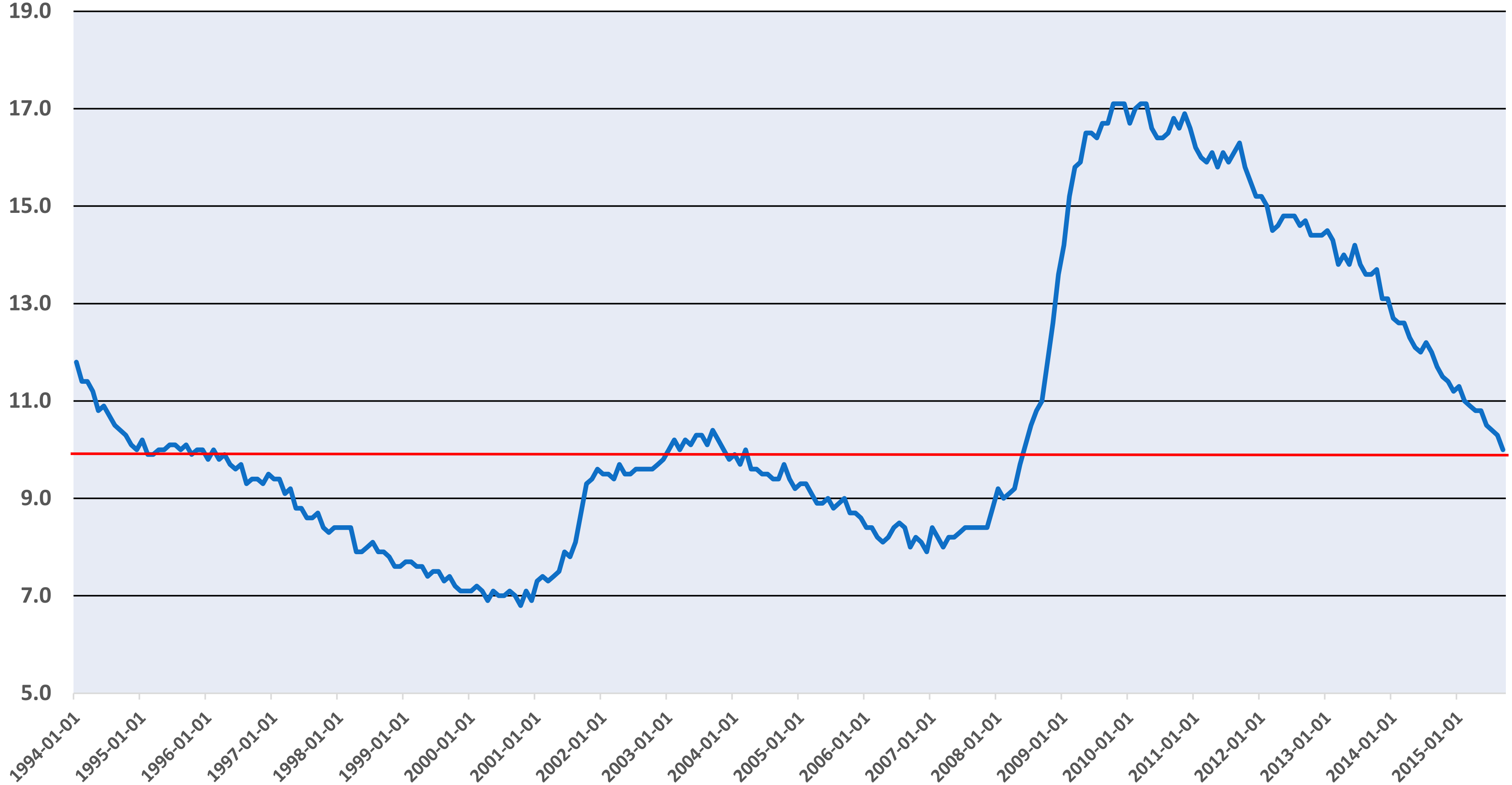
Source: Bureau of Labor Statistics

Employment – Population Ratio of Prime Working Age is 3% Below Pre-recession Levels. An Additional 3.6 Million Employed Would Be Required To Reach the 2007 Peak



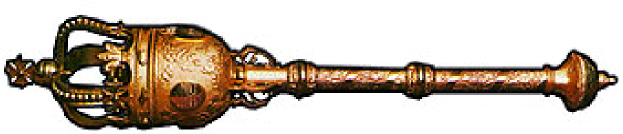
Source: Bureau of Labor Statistics

Percent Employed Part-Time for Economic Reasons Remains Elevated at the Level of the 2001 Recession -- Dampens Wage Growth

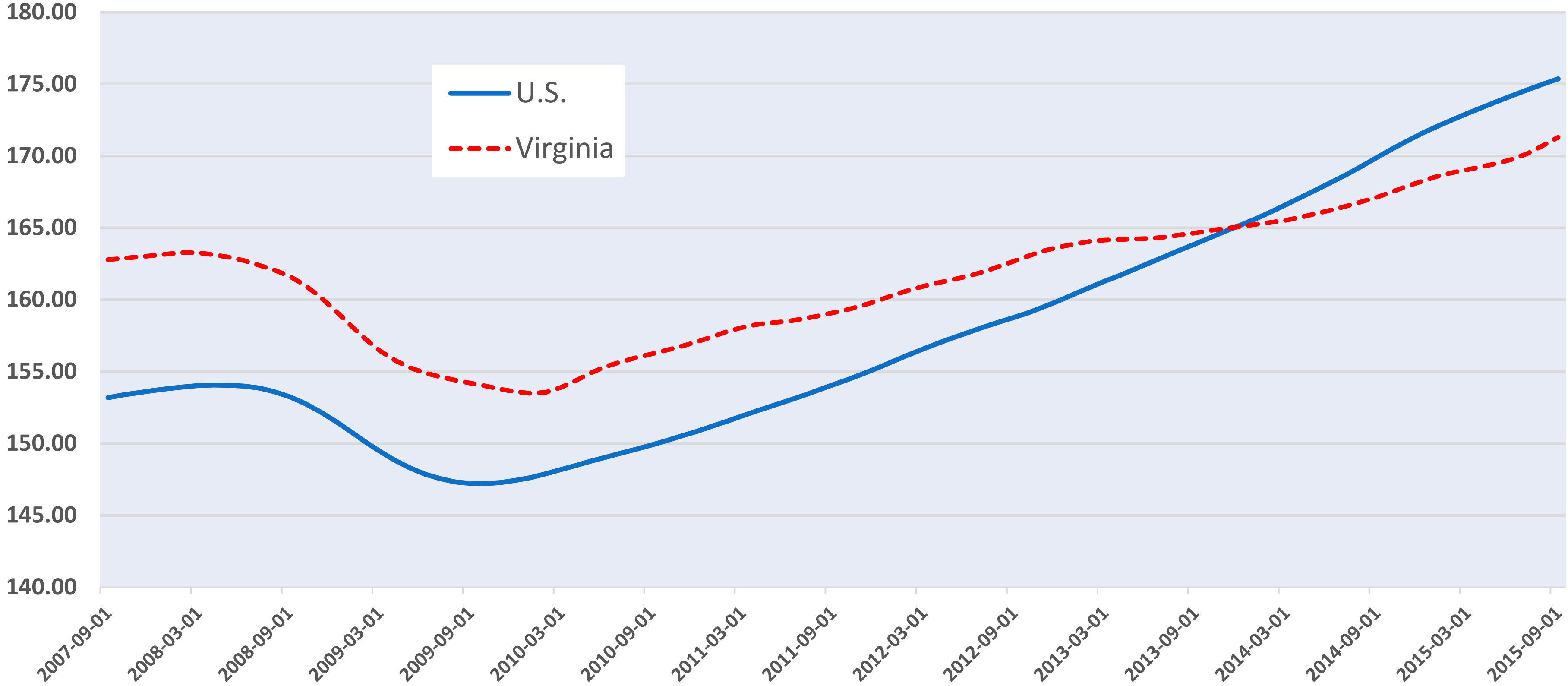


Source: Bureau of Labor Statistics

Key Indicators Reflect Virginia Continues to Grow Slower Than Nation



Based on Leading Indicators, Virginia Continues to Underperform the Nation

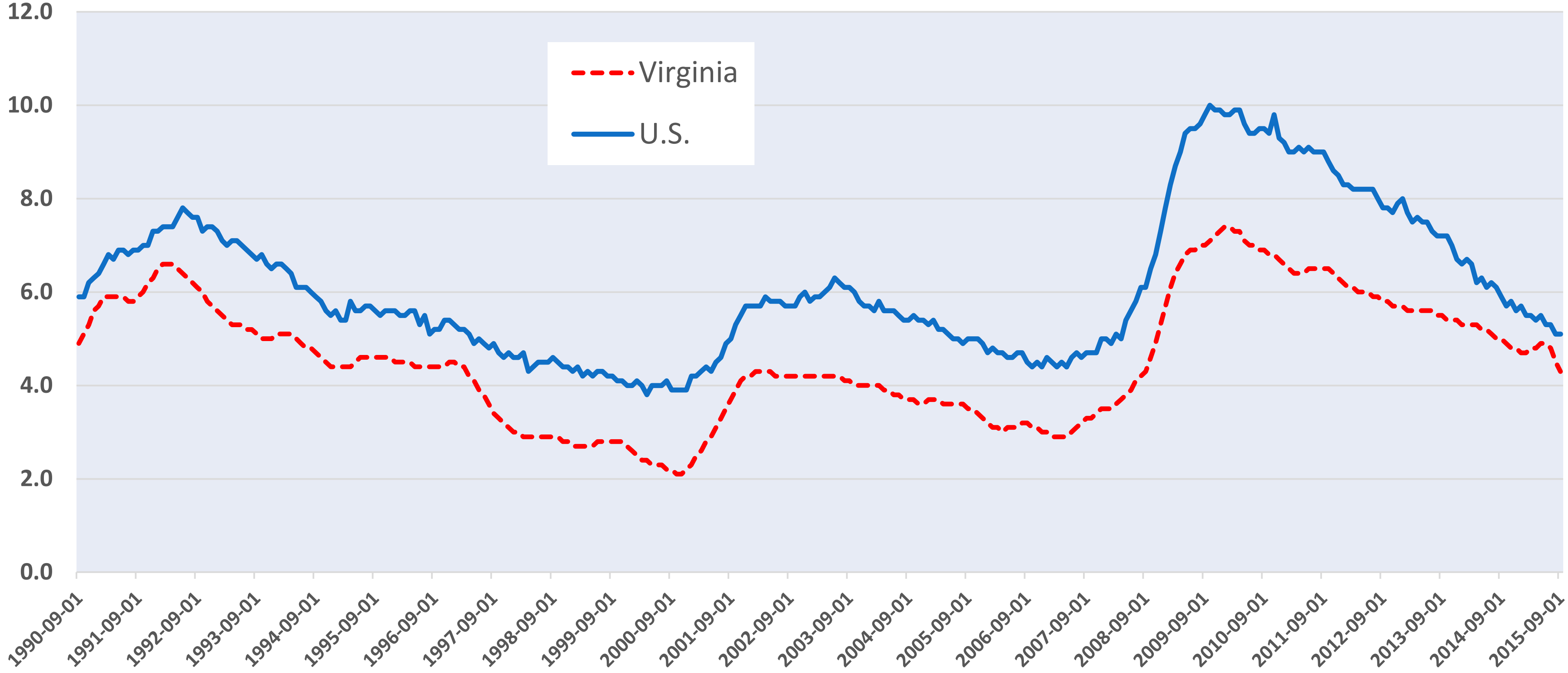


The Coincident Economic Activity Index includes four indicators: nonfarm payroll employment, the unemployment rate, average hours worked in manufacturing, and wages and salaries.

Source: Federal Reserve Bank of Philadelphia.

Virginia's Unemployment Rate in Perspective

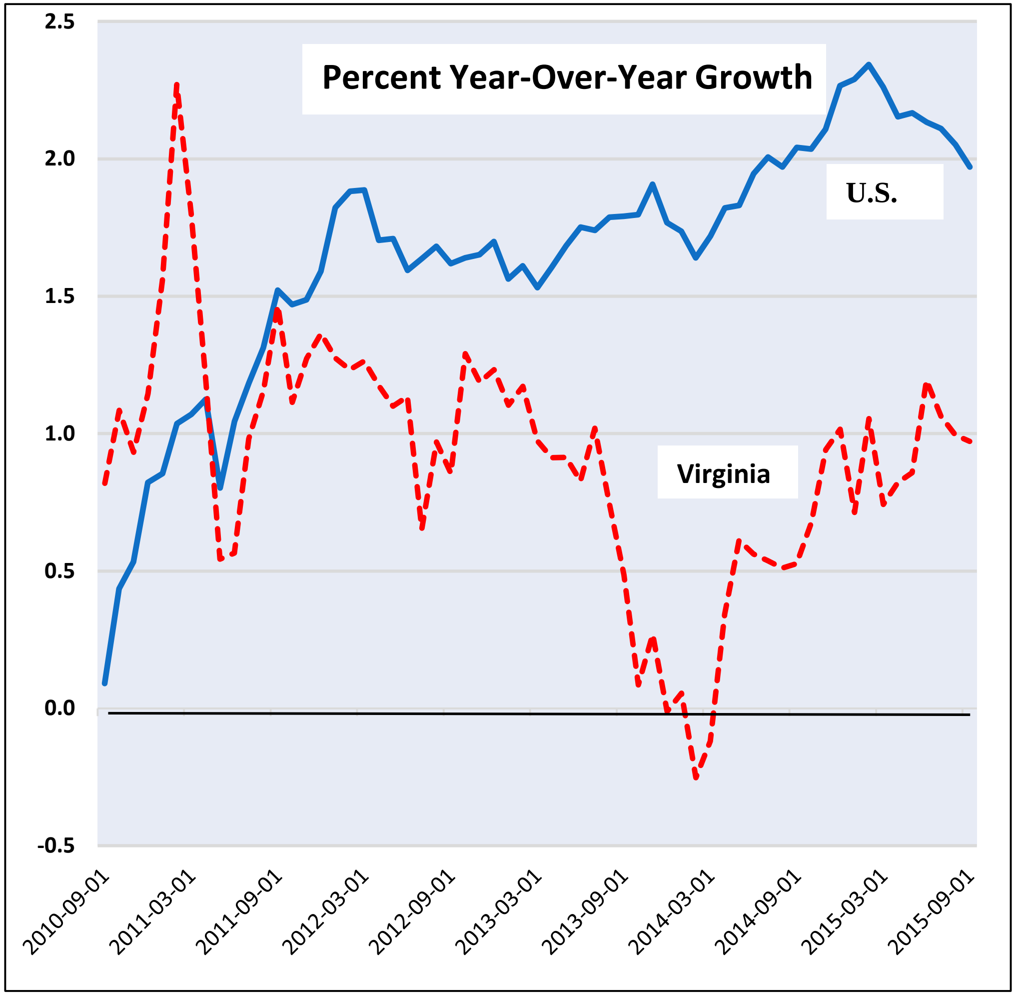
- At 4.3 %, Virginia's unemployment rate is 15% lower than the national unemployment rate of 5.1%
- While the nation's rate has fallen 4.9% from its peak of 10% in October 2009, Virginia's rate has fallen 3.1% from its peak of 7.4% in January 2010



Source: Bureau of Labor Statistics

Virginia's Job Growth Has Under Performed the Nation Since May 2011 – Why?

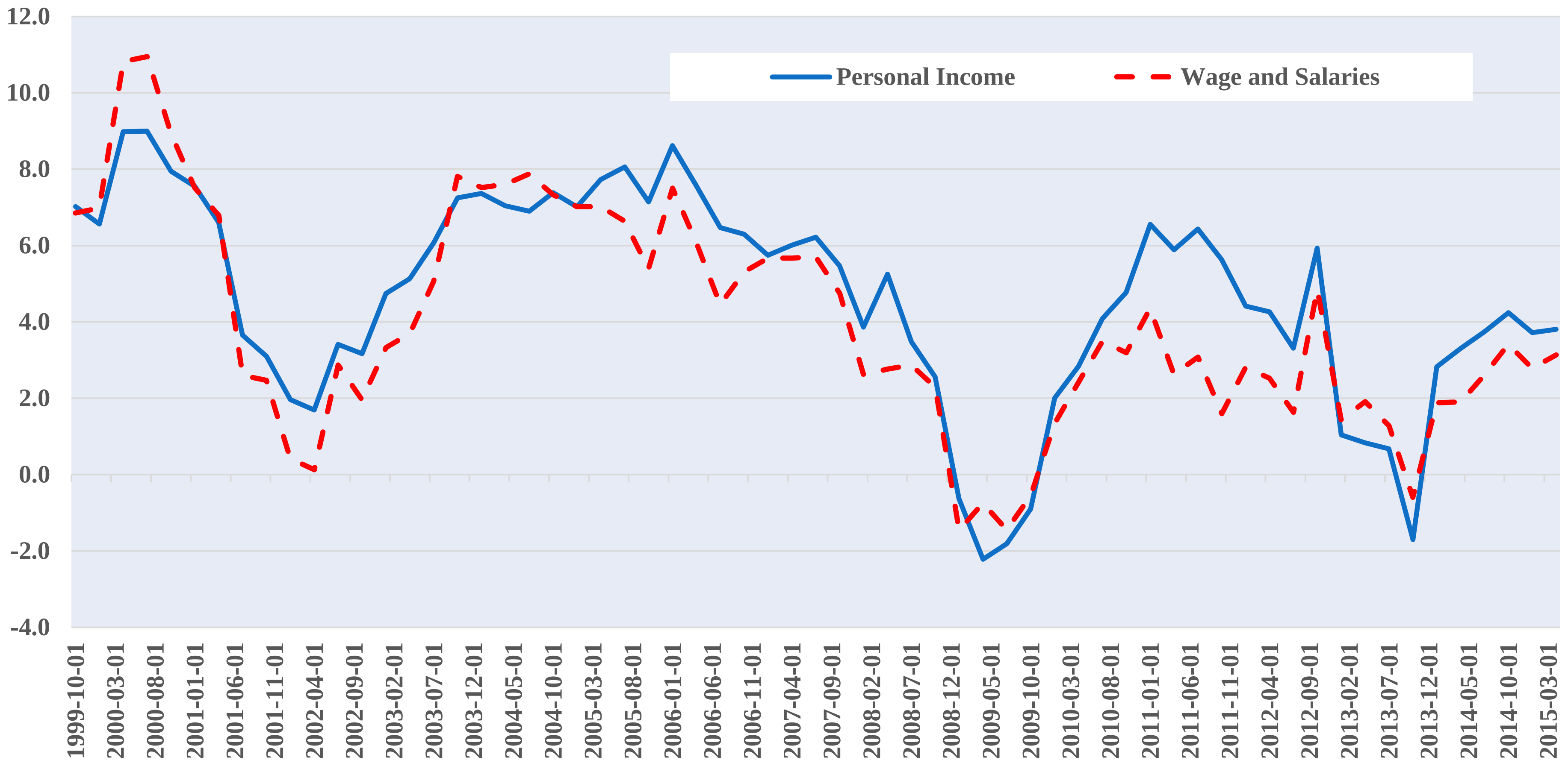
- Virginia's job losses were not as severe as the nation's -- Virginia's job loss equaled about 5.0% of total employment versus 6.3% nationally
- Initially after the recession, Virginia's economy out-performed the U.S.
- However, since May 2011, Virginia's rate of job growth has been below the U.S. by 1.0%
- Virginia's job growth was 0.8% for FY 2015 -- below the "official" forecast of 0.9%
- For the first 3 months of FY 2015, jobs grew 1.0% -- 0.4% below the current "official" forecast of 1.4%



Source: Bureau of Labor Statistics

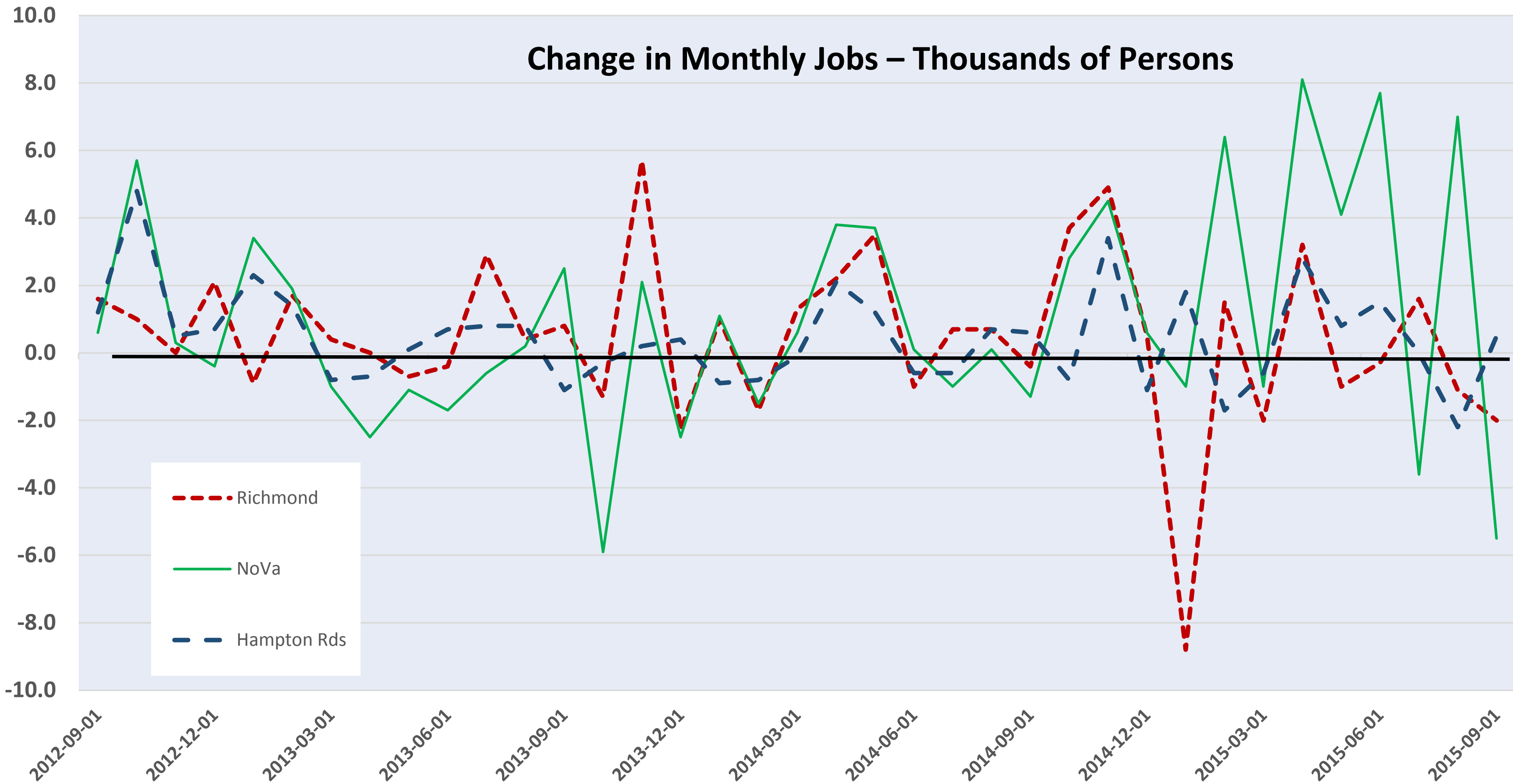
If Virginia's Job Growth Is Anemic, What Drove Payroll Withholding Growth In FY 2015?

Virginia Personal Income and Wages and Salaries Grew 3 Times Faster in FY 2015 than FY 2014, Which Helped Drive Payroll Withholding and Sales Tax Collections…But Still Below Long-term Trend Growth



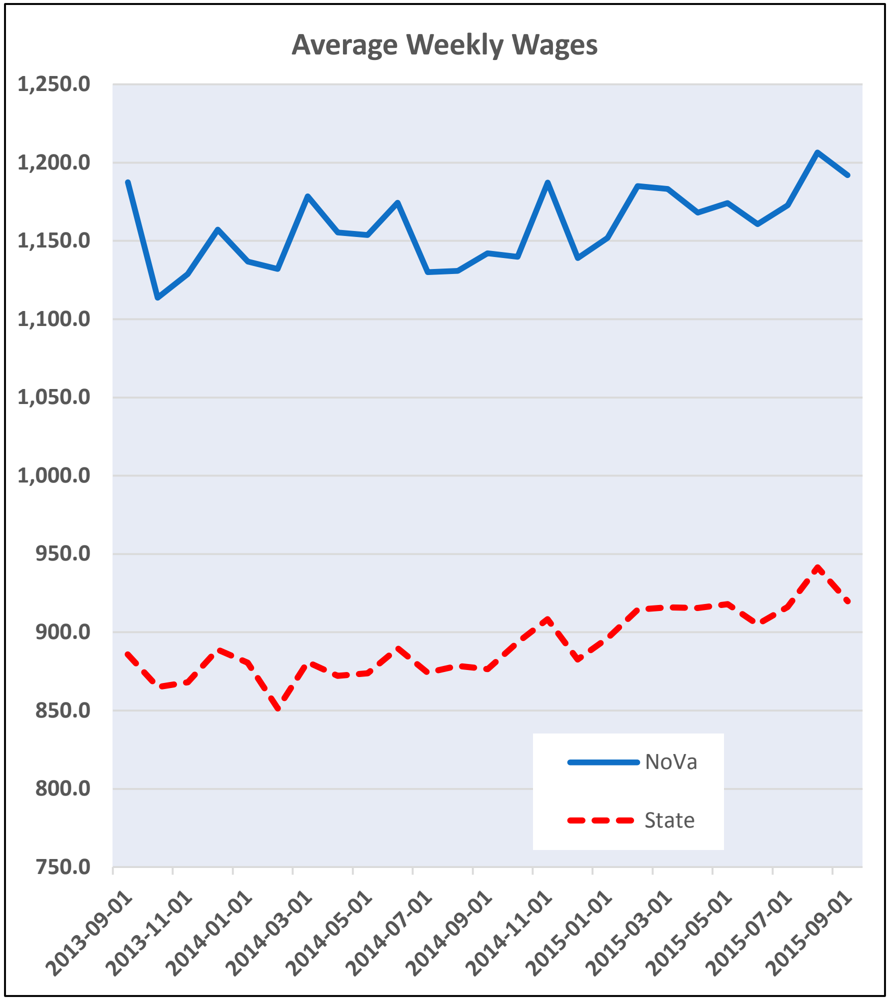
Source: Bureau of Economic Analysis

After Negative Job Growth in FY 2014, NoVa Bounced Back in The Second Half of FY 2015, With Year-Over Year Growth of 1.8% Since February … But, Since July, Month Over Month Has Slowed



Source: Bureau of Economic Analysis

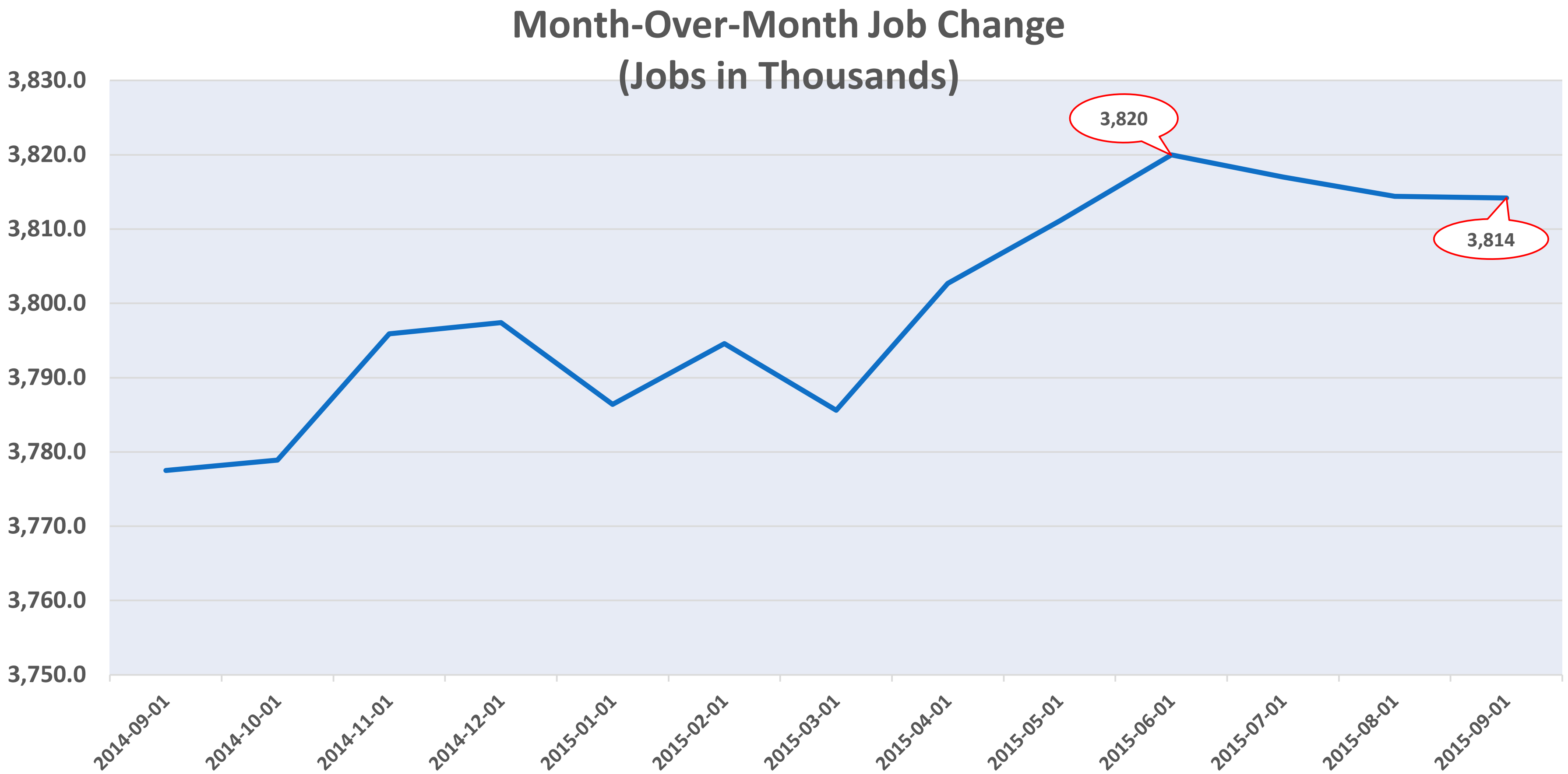
Northern Virginia's Accelerated Job Growth and Higher Average Weekly Wages Helped Drive Payroll Withholding in FY 2015



- During the second half of FY 2015, NoVa job growth accelerated from 0.5% to 1.5%, about 67% greater than the statewide job growth rate
- Average weekly wages in NoVa are about 30% higher than the statewide rate
  - Average weekly wage rates grew 2.5% in the second half for FY 2015 – from $1,145 to $1,171

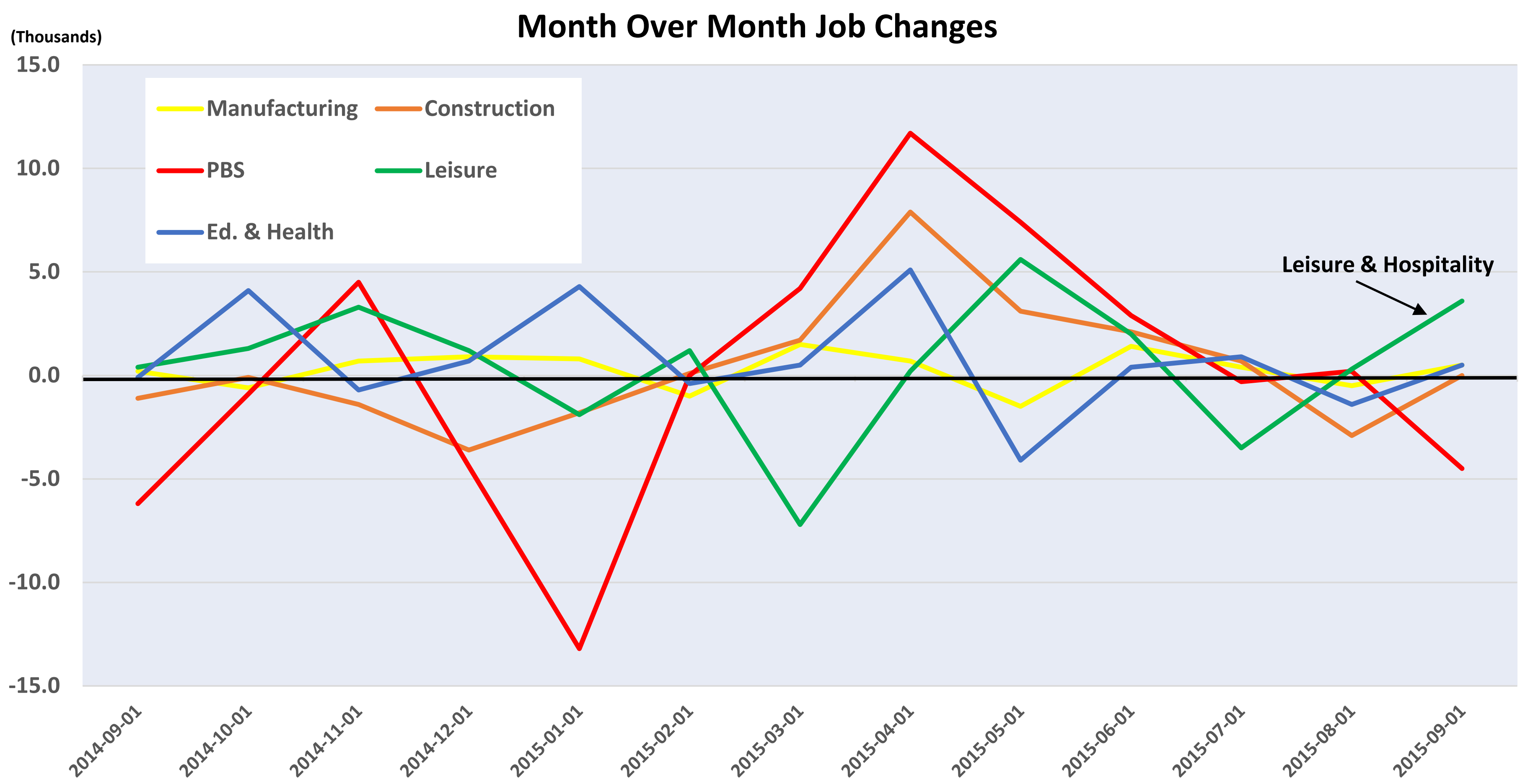
Source: Bureau of Economic Analysis

On a Year-Over-Year Basis, Virginia Has Seen Job Growth. However, Employment Peaked In June and Has Since Declined 6,000 Jobs



Source: Bureau of Labor Statistics

Since Summer, Construction and Professional and Business Services Have Seen Month-Over-Month Job Losses, Manufacturing and Education and Health Have Been Flat, While Leisure Jobs Have Grown



Source: Bureau of Labor Statistics

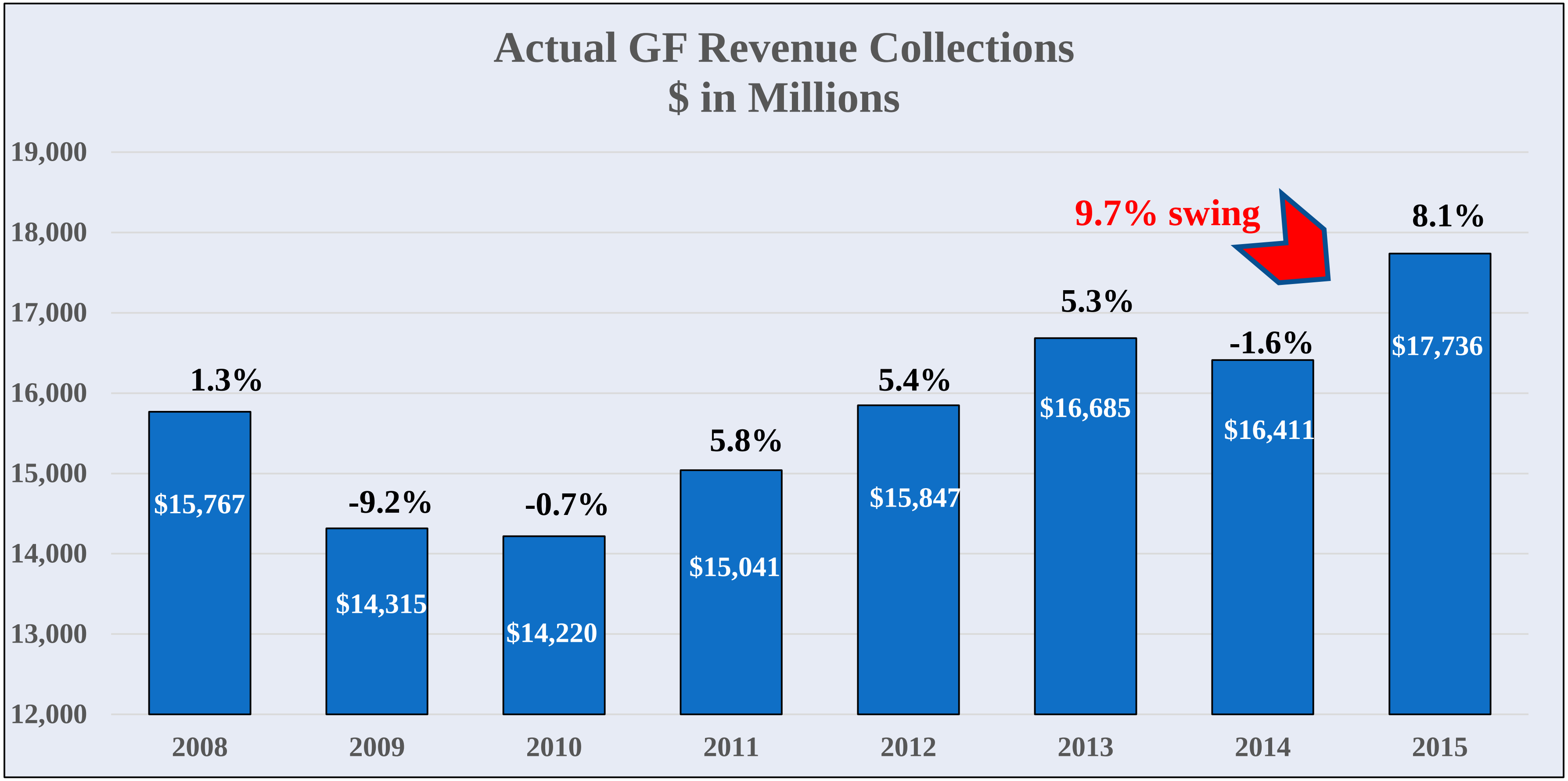
Short-Term Outlook Improved, but Won't Necessarily Be Sustainable

- After 2 years of tepid job and wage and salary growth, Virginia's economy rebounded somewhat in FY 2015
  - After negative job growth in FY 2014, NoVa saw positive job growth, and out performing the state job growth rate by 67%
  - This growth, along with average wages 30% above the state average in that region, resulted in payroll withholding growing at about 4.6%
- The recently passed federal budget deal suspends the budget caps for 2 years, expiring in October 2017
  - The details of the additional budget spending still needs to be worked out by December 11th
  - The additional spending authority expires in FFY 2018 and absent a long term fix, sequestration will be back in play
- From a economic point of view FY 2016 should be a good year; however, it is hard to change business behavior given that sequestration is still in the picture during the 2016-18 biennium

FY 2015 Performance

FY 2015 Revenue Performance

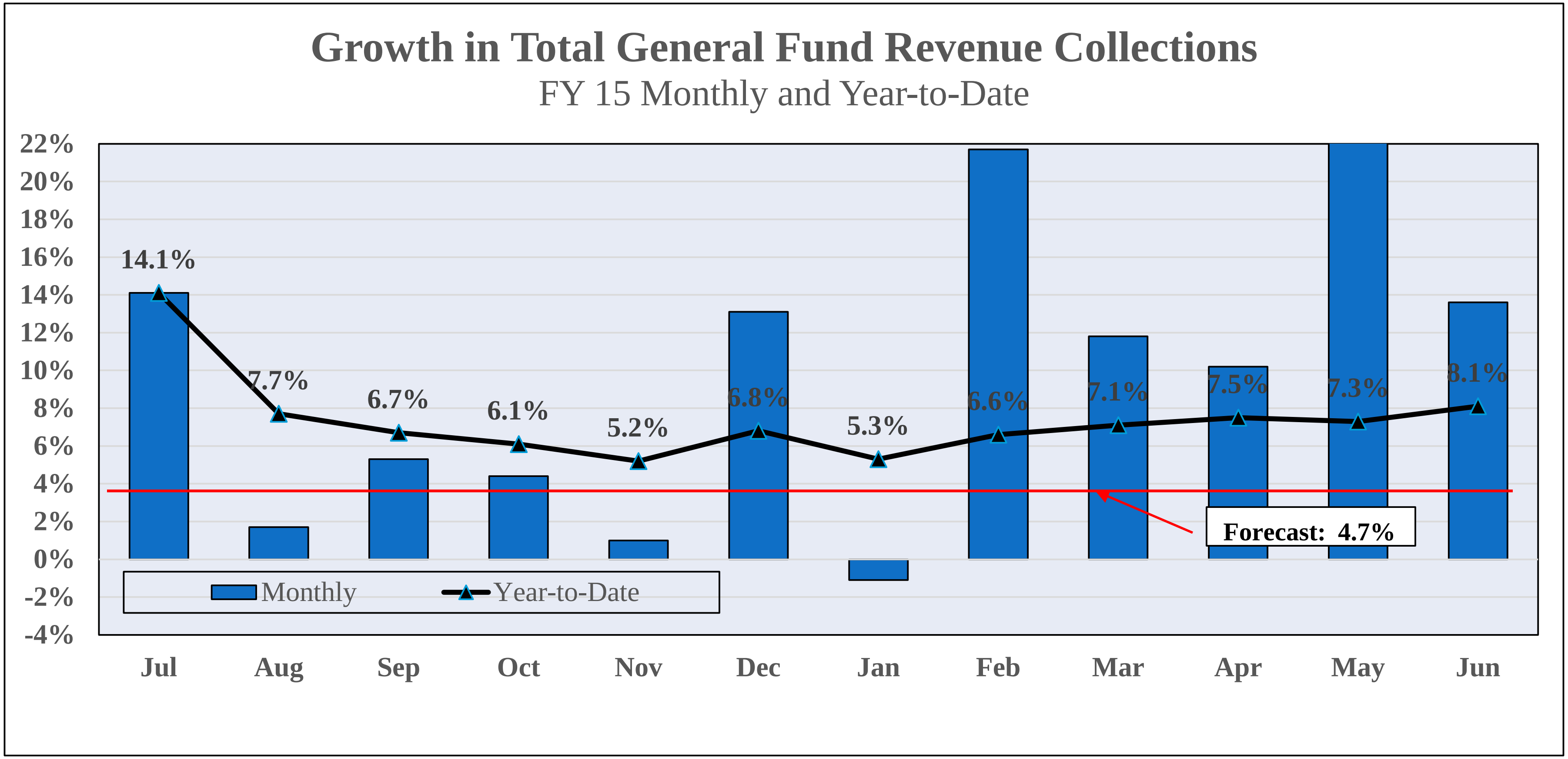
- FY 2015 General Fund revenues grew 8.1%, well ahead of the forecast of 4.7% growth
- Revenues exceeded the forecast by $549.6 million, or 3.2%
  - Collections showed highest growth since FY 2006



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

FY 2015 Revenue Performance

- When budget was being considered last winter, FY 2015 still appeared to be somewhat tepid, and we had experienced a revenue decline in FY 2014
- Forecast was revised upward by House and Senate Mid-Session
- Second half of fiscal year 2015 was markedly stronger than the first half



Source: Virginia Department of Taxation

FY 2015 Revenue Performance by Source

<u>Nonwithholding: $316.4 million above forecast</u>

- Grew 20.5% compared to estimate of 7.9% growth
  - Majority of surplus generated by final payments, which increased 25.1% compared to a forecast of 6.5% growth
  - 55% of total the nonwithholding tax collections were remitted in the last quarter of FY 2015
- Decision made to “collar” forecast of this very volatile source at the 10-year prior average percentage of total general fund revenues
  - FY 2015 collar was 15.34% of total revenues
  - Actual nonwithholding collections accounted for 17.15% of GF
- Decision to employ a “collar” was intended to maintain structural balance in the budget by avoiding increasing the spending base beyond sustainable levels
- Understood source could likely exceed forecast, but knew any surplus would be required to help meet the mandatory Rainy Day Fund deposit

FY 2015 Revenue Performance by Source

<u>Withholding Taxes: $140.4 million above forecast</u>

- Withholding taxes – which made up 63% of total revenues – grew 5.3% compared to a forecast of 4.0%
  - In contrast, growth the 2 prior years was 2.1% and 2.3% respectively
- The proxies for this source - job growth and average wages – slightly underperformed the forecast
  - Jobs grew by 0.8% compared to 0.9% forecast
  - Average wages increased 3.3% compared to 3.4% forecast growth
- Revenue surplus attributable to timing differences as well as the regional distribution of new jobs
  - Prior to June, YTD growth was 4.6%. An extra payroll deposit day in June bolstered monthly performance to 13.5% growth increasing the annual growth
  - When extra June payroll day accounted for, performance in 4.5% range
  - Northern Virginia performed better than expected, other areas lagged

<u>Tax Refunds: Paid out $55.5 less than forecast</u>

- Refunds grew 0.1%, slower than estimate of 3.2% growth

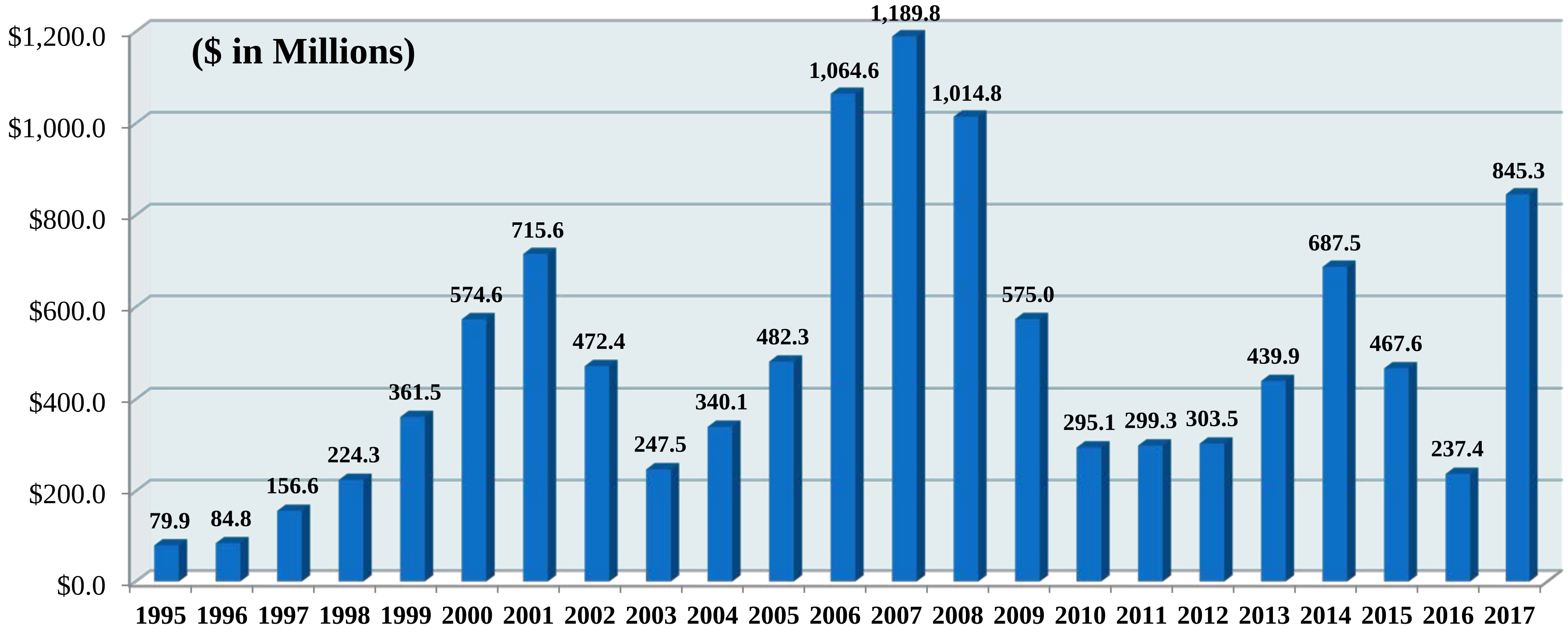
FY 2015 Revenue Performance by Source

- Sales Tax: $17.6 million above forecast
  - Adjusted growth rate of 4.9%; 1% above the economic-based forecast of 3.9% increase
  - Increased growth mirrors upward revisions to estimates of personal consumption released in September by the BEA
  - Housing, supercenters, leisure and hospitality sectors grew most rapidly
- Recordation Tax: $28.0 million above forecast
  - Housing market continues to rebuild, albeit at a slower pace
  - Grew 11.4% compared to 2.4% forecast
- Other Sources: Offsetting gains were shortfalls in two sources
  - Corporate income taxes fell $9.0 million below estimate, growing 9.8%
  - Insurance premium taxes were $19.9 million off the forecast, contracting 6.2% compared to a flat forecast (0.0% growth)

FY 2015 Revenue Surplus Fully Obligated

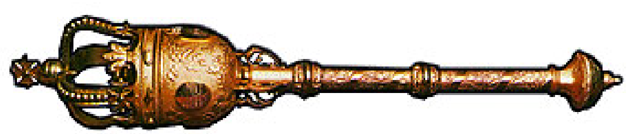
- Mandatory activities consumed the revenue surplus
  - Vast majority required to meet Revenue Stabilization Fund requirement
    - FY 2017 mandatory deposit of $605.6 million based on FY 2015 performance
    - $476.1 million from surplus was added to the $129.5 million reserve in the budget to fully meet the commitment
  - Water Quality Improvement Fund deposit based on revenues totals $55.0 million, using remainder of revenues
    - An additional $6.7 million goes to the WQIF based on unencumbered agency balances

Revenue Stabilization Fund Status



- FY 2017 balance reflects mandatory deposit of $605.6 million in FY 2017 based on FY 2015 revenue collections
- Based on the current forecast, no deposit will be required based on FY 2016 revenues (2018 deposit). ***However, if FY 2016 revenue growth exceeds 4.05%, that will trigger a mandatory deposit (FY 2018)***

FY 2016: YTD Performance, Expected Forecast Adjustments, and Caboose Spending



FY 2016 Performance Through First Quarter

- Chapter 665 assumed a growth rate of 3.1% in FY 2016
- But because the FY 2015 actual collections exceeded the revenue forecast by approximately $550 million, we can meet the budget forecast – the actual revenue numbers – with a 0.1% decline in revenues
- The large increase in the base upon which FY 2016 growth is measured means we will have a forecast adjustment far larger than usually seen in a Caboose Bill

FY 2016 Year-to-Date Performance

General Fund Revenue Forecast for Fiscal Year 2016			
Major Source	**Growth Required to Meet Ch. 665 Revenue Forecast**	**Growth Rates Assumed in Ch. 665 Forecast**	**Actual Q-1 Performance**
Withholding	2.1%	3.4%	4.4%
Nonwithholding	(8.4%)	2.2%	10.3%
Refunds	4.7%	1.5%	(0.5%)
Net Individual	**(0.9%)**	**3.4%**	**5.5%**
Sales	2.7%	3.3%	(5.1%)*
Corporate	(1.3%)	(2.4%)	(17.0%)
Wills (Recordation)	(8.1%)	2.0%	9.7%
Insurance	8.7%	0.0%	--
All Other Revenue	2.8%	5.9%	1.6%
Total GF Revenues	**(0.1%)**	**3.1%**	**2.4%**
Adjusted for AST	**0.0%**	**3.1%**	**4.0%**

Source: Virginia Department of Taxation.
Note: Sales tax collections increased 4.5% through the first quarter once adjusted for AST.

Economic Assumptions for FY 2016 Largely Unchanged

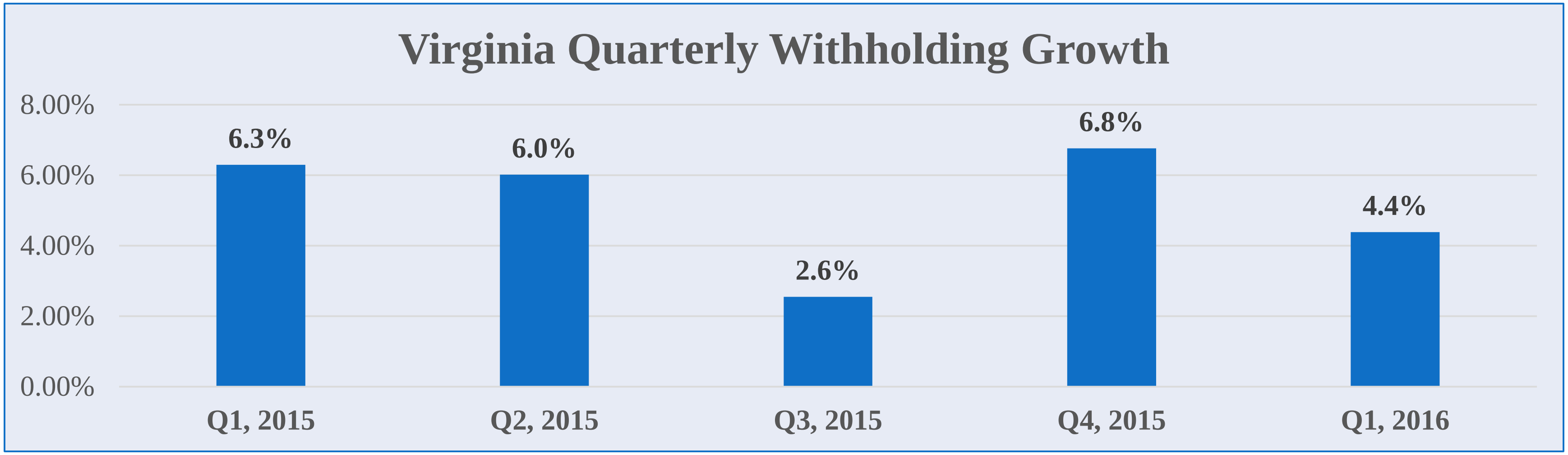
- Outlook for FY 2016 shows slightly improved growth compared to last year's assumptions
  - Although revisions to the forecast variables are somewhat minimal, adjustments all positive in nature
  - While Virginia still lags the nation in terms of growth, the gap is narrowing
  - NOVA's drag on growth anticipated to subside as federal budget outlook stabilizes, seen in wage growth
  - One caution is YTD job growth below forecast
    - Uptick compared to last year's employment figures not supported to date, although October national jobs report far stronger than anticipated

Percentage Change	FY 2016
Virginia Forecast	
Total Personal Income	
Chap 665/Official	3.8%
Sept 2015 Standard	3.8%
Average Wage	
Chap 665/Official	2.0%
Sept 2015 Standard	2.6%
Wages and Salaries	
Chap 665/Official	3.5%
Sept 2015 Standard	4.1%
Employment	
Chap 665/Official	1.4%
Sept 2015 Standard	1.5%

Source: Virginia Department of Taxation.

YTD Performance and Adjustments to Withholding Tax Forecast

- Through the first quarter, withholding tax collections grew 4.4% compared to the current economic forecast of 3.4%
- Strong withholding collections in FY 2015 and above forecast growth through the first quarter support a modest upward adjustment to the forecast
- Revised model predicts average wage growth of 2.6% and employment growth of 1.5%, resulting in a withholding growth rate of 4.1%
  - To date, the anticipated job growth appears slightly optimistic
- Expect FY 2016 withholding tax collection growth of 3.9%



FY 2016: Expected Forecast Adjustments

Sales Tax:

- Official economic-based growth rate is 3.3%
  - Adjusted YTD growth of 4.5% through first quarter
- National Retail Federation forecast anticipates growth in holiday sales of 4.1%, consumer expectations remain largely positive
- These factors suggest a growth estimate of 4.4%

Corporate:

- Most difficult source to predict because collections impacted by complex tax planning decisions made by large firms
- Through first quarter, collections have fallen 17%
  - Affected by a few large refunds
- Recommend revising the forecast to negative -12%

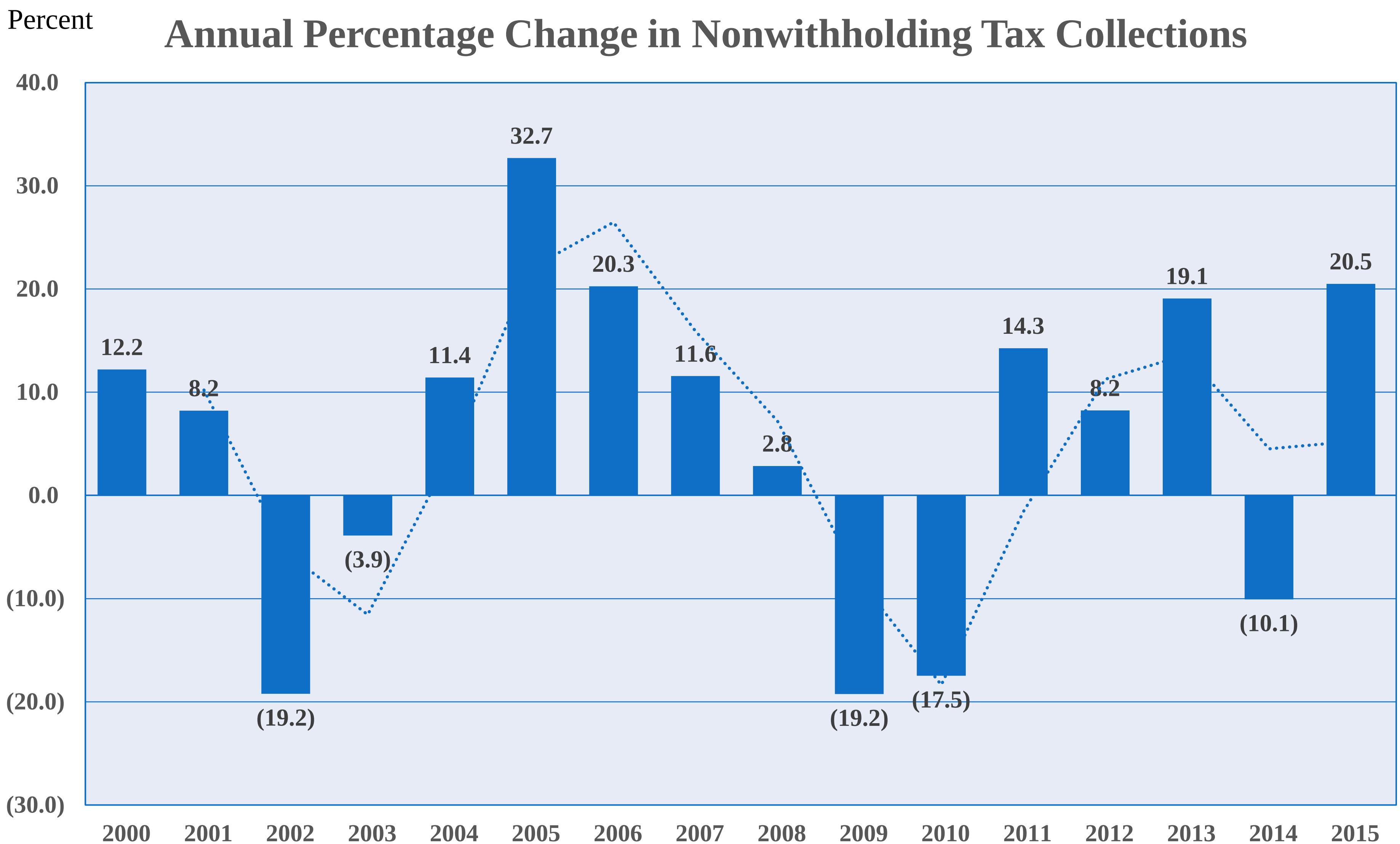
Recordation:

- Through first quarter, collections have increased 9.7%
- Potential impact of rising mortgage rates should hamper refinance market
- Anticipate growth of about 5%

YTD Performance and Adjustments to Nonwithholding Tax Forecast

- Due to the large surplus of nonwithholding collections in FY 2015, FY 2016 actual collections could be 8.4% below FY 2015 levels and still meet the revenue assumption in Chapter 665
- Nonwithholding collections grew 10.1% through the first quarter, compared to a projected growth rate of 2.2%
- Year-to-date S&P growth – which is a major factor in final payments - has been below 4% so growth could be far less robust than last year
  - Potential offsetting impact of capital gains generated by sell-offs after last market rally
- Growth in proprietors' income, which drives a portion of estimated payments, is predicted to be less than 4%
- Based on these factors, and a ratio analysis of first quarter collections, an "uncollared" growth rate in the 6% range would be supported
- If you continue to employ a "collar" in FY 2016 the forecast growth rate would be capped at -1.8% growth

Volatility of Nonwithholding



HAC Estimate FY 2016 Revenue Forecast

- Based on "money in the bank" and updated economic variables, adjustments to the current year forecast expected to total $453.2 million, a growth rate of 2.4% after the "collar" has been applied
  - "Collar" reduces revenues by about $251.9 million. Exclusive of "collar," growth rate would be 3.8% and additional available resources would increase to about $705.1 million

Source	Ch. 665	HAC Forecast	Change
Withholding	11,275.1	11,475.0	199.9
Nonwithholding	2,785.2	2,972.2	187.0
Refunds	(1,840.6)	(1,801.2)	39.4
Net Individual	**$ 12,219.7**	**$ 12,646.0**	**$ 426.3**
Sales	3,323.1	3,377.8	54.7
Corporate	820.7	732.1	(88.6)
Recordation	318.3	363.6	45.3
Insurance	326.8	309.6	(17.2)
Other Revenue	712.1	733.6	21.5
Total Revenue	**$ 17,720.7**	**$ 18,162.6**	**$ 441.9**
Total Transfers	564.5	575.8	11.3
Total GF Res.	**$ 18,285.2**	**$ 18,738.4**	**$ 453.2**

Note: Change in revenues reflects combined effects of base adjustments and changes in growth rates and assumes policy of "collaring" nonwithholding remains in effect.

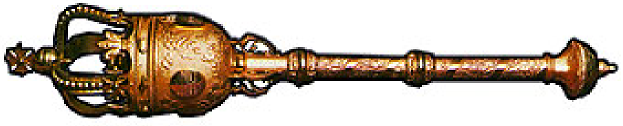
Caboose Bill Requests

- As part of the typical fall budget development process, agencies were asked to identify additional spending needs beyond those provided for in Chapter 665
  - Agency decision packages for the caboose bill focuses on items that are “mandatory” in nature – i.e. forecast changes or Code requirements – and include few “nice to do’s” that agencies view as priorities
- FY 2016 agency budget requests received as of October 1 totaled $77.5 million GF. The largest requests are as follows:
    - $16.4 million for CSA
    - $11.3 million increase in jail per diems
    - $8.5 million for shortfalls at Hancock Geriatric Treatment Center
    - $8.7 million for DEQ wastewater treatment plant commitments
- In addition, the recently updated Medicaid forecast anticipates a gap of $166.8 million GF in FY 2016, for a total of $244.3 million in identified needs

Use of Additional FY 2016 Revenues

- Based on assumed forecast adjustments for FY 2016 you can expect about $453 million in additional revenue for the current fiscal year
- This leaves about $209 million in revenue available even if one fills <u>all</u> the agency requests
- Instead of allowing these funds to be used for items that would build up the base budget for the upcoming biennium, they should be used first to address remaining structural imbalances and one-time needs
- One option would be unravel the accelerated sales tax collection
  - Currently all dealers with sales above $2.5 million annually are impacted
  - Entirely eliminating AST in FY 2016 would cost $198.2 million
  - Raising threshold to $50.0 million would cost $84.7 million
- Another option is addressing a portion of the capital outlay requests

GF Revenue Outlook
2016 – 2018 Biennium



Virginia's Revenue Forecasting Process

- Joint Advisory Board of Economists (JABE) meets in October and reviews the economic assumptions and methodology
  - Economists from private sector and academia; input from IHS Economics and Moody's Economy.com
  - Department of Taxation and Secretary of Finance develop forecast based on input received
- Governor's Advisory Council on Revenue Estimates (GACRE) will meet November 30
  - Cross section of leaders from Virginia business and industry, General Assembly leadership
  - Members react to forecast developed by Governor's staff and provide input on the proposed forecast and economic climate
- Official forecast proposed in Governor's budget as introduced
  - Governor will present Caboose and FY 2016-18 biennium forecasts December 17

Virginia's Revenue Outlook: Turning to the 2016-18 Biennium

- Although the factors underlying the FY 2016 forecast show some improvement compared to last year's forecast, little change is seen in estimates of growth in the next biennium
  - Economic growth is expected to slow slightly

Projected Economic Variables

(National Forecast, adjusted for Virginia specific data)

	Job Growth	Avg Wage/Salary	Total Wage/Salary	Income Growth
FY 2017				
Official/Nov 2014 Standard	1.8%	2.8%	4.6%	4.8%
IHS September 2015 Standard	1.4%	3.1%	4.5%	4.3%
FY 2018				
Official/Nov 2014 Standard	1.2%	3.0%	4.2%	5.0%
IHS September 2015 Standard	1.1%	3.1%	4.2%	4.5%

Source: Virginia Department of Taxation

Little Has Changed in Forecast of Major Sources for FY 2017 and FY 2018

Major Sources	FY 2017 12/15 Standard	FY 2017 12/15 Pess. +	FY 2017 HAC	FY 2018 12/15 Standard	FY 2018 12/15 Pess. +	FY 2018 HAC
Withholding	4.7%	4.3%	**4.0%**	4.5%	4.2%	**3.6%**
Nonwithholding	3.8%	3.3%	**3.8%**	3.9%	3.6%	**3.9%**
Refunds	3.8%	3.8%	**4.5%**	4.2%	4.2%	**4.0%**
Net Individual	4.6%	4.2%	**3.9%**	4.4%	4.1%	**3.6%**
Sales	3.1%	2.4%	**3.1%**	4.3%	4.0%	**4.0%**
Corporate	1.5%	1.1%	**1.5%**	-1.6%	-1.7%	**-1.6%**
Recordation	0.0%	0.0%	**2.0%**	0.0%	0.0%	**2.0%**
Insurance	6.9%	6.9%	**5.0%**	5.2%	5.2%	**5.0%**
Major Tax Sources	**4.2%**	**3.7%**	**3.6%**	**4.1%**	**3.8%**	**3.4%**

Forecast of Major Sources: FY 2017-2018

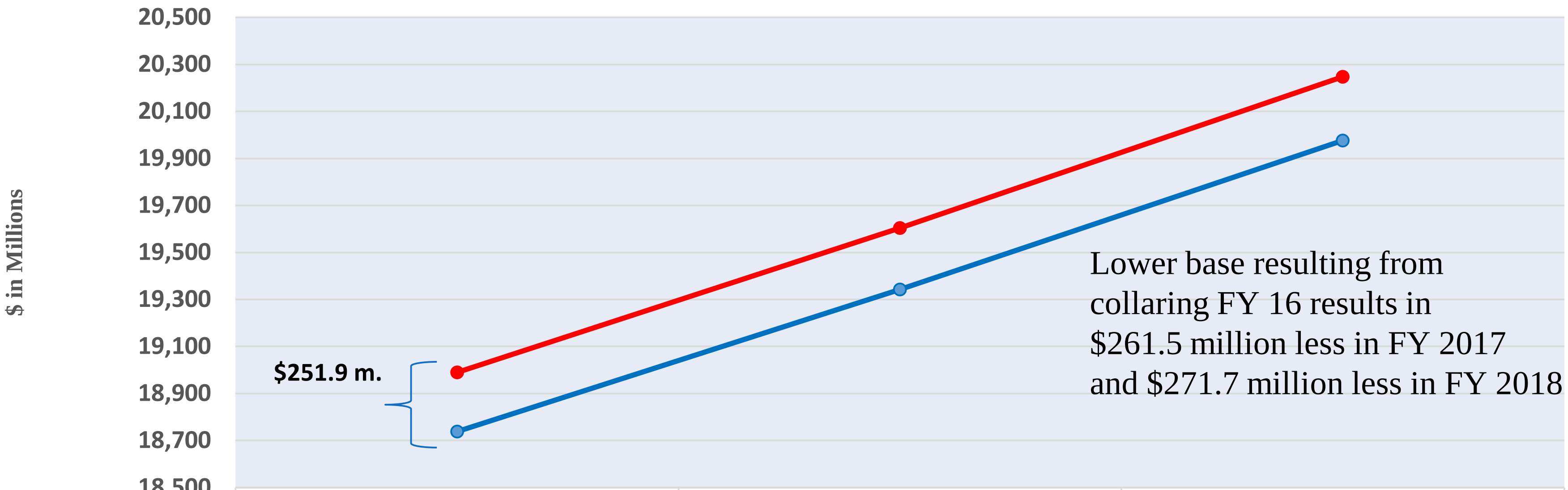
($ in Millions)	HAC FY 2017	FY 2017 Growth	HAC FY 2018	FY 2018 Growth
Withholding	11,934.0	4.0%	12,363.6	3.6%
Nonwithholding	3,085.1	3.8%	3,205.5	3.9%
Refunds	(1,882.3)	4.5%	(1,957.6)	4.0%
Net Individual	**$13,13**	**3.9%**	**$13,611.5**	**3.6%**
.				
Sales	3,482.5	3.1%	3,614.8	3.8%
Corporate	743.1	1.5%	731.2	-1.6%
Recordation	370.9	2.0%	378.3	2.0%
Insurance	325.1	5.0%	341.4	5.0%
Total Major Sources	**$18,058.4**	**3.6%**	**$18,677.2**	**3.4%**
Transfers & Other Revenue	1,284.2	-1.9%	1,298.6	1.1%
Total GF Resources	**$19,342.9**	**3.2%**	**$19,975.8**	**3.3%**

Note: Forecast assumes a “collar” is applied in FY 16, which reduces available revenues by $533.2 million over the biennium

Impact of Collar in FY 2016 on Next Biennium

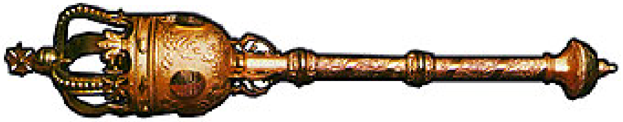
- The forecast slide on the previous page assumes nonwithholding is “collared” in FY 2016
- Although no “collar” is applied to the out-years, because the base year (FY 2016) is reduced, the next biennium generates less revenue while applying the same growth rates
- If no “collar” was applied in FY 2016, nonwithholding collections as a share of total revenues would increase above 17.5% in FY 2017 and FY 2018, a share experienced only twice since 1990
- The three year impact on the revenue forecast of collaring in FY 2016 is $785 million that could be added to the forecast if the collar were not applied in the current fiscal year

Impact of FY16 Collar on Revenue Estimates for FY17-18 Biennium



	FY 2016	FY 2017	FY 2018
Collared FY 16	18,738.4	19,342.6	19,975.8
Uncollared 16	18,990.3	19,604.0	20,247.5

Budget Outlook:
FY 2016-18 Biennium



Budget Outlook:
FY 2016-18 Biennium

- What is our base budget?
- What are known budget drivers?
- Does our projected revenue growth fully support these drivers?

FY 2016 - 2018 Base Budget

- The "base budget" equals the FY 2016 GF operating appropriations, adjusted to remove one-time spending and savings, and annualizing partial year costs
  - Base budget does not include spending increases driven by state or federal law, or high priority or discretionary spending
- Major base adjustments base for the FY 2016-18 biennium include annualizing the costs of:
  - The FY 2016 base and compression salary adjustments and health insurance costs
  - Accelerated payments to the VRS
  - Changes in adopted VITA and other internal service fund rates
- The largest "one-time" item removed from the base is the FY 2016 use of $141.2 million GF to support capital projects

Adjusted Base Budget for FY 2016-2018

(GF Dollars in Millions)

	FY 2017	FY 2018
Chapter 665 (FY 2016 GF Appropriation)	$18,764.2	$18,764.2
DPB Base Budget Adjustments	$10.9	$10.1
Removal of GF for Capital Outlay	($141.4)	($141.4)
DPB Base Budget	$18,633.6	$18,632.9
HAC Identified Adjustments (removal of additional one-time spending and technical adjustments)	($69.0)	($78.5)
HAC Estimated Base Budget*	$18,564.6	$18,554.4

*Excludes impact of any additional on-going spending included in the Caboose Bill.

Range of Resources Available for Budget Drivers

$'s in millions	FY 2017	FY 2018	Biennium
Estimated Transfers	$587.3	$601.8	$1,189.0
HAC Revenue Forecast – *Including a "collar" in FY 2016*	$18,755.3	$19,374.1	$38,129.3
HAC Revenue Forecast – *No collar in FY 2016*	$19,016.8	$19,645.7	$38,662.5
HAC Base Budget	$18,567.6	$18,557.4	$37,125.0
Net Resources Above Base Budget (including transfers)	**$775.0 - 1,036.4**	**$1,418.4 - 1,690.0**	**$2,193.4 - 2,726.5**

Agency Budget Requests

- As part of the annual budget development process, agencies are asked to submit "decision packages" outlining their budget requests for the upcoming biennium each fall
- In October, agencies submitted preliminary general fund budget requests totaling \$1.0 billion in FY 2017, and \$1.1 billion in FY 2018
  - In contrast, last year's biennial requests totaled only \$420 million GF for the two-year period
  - This is the first time that agencies have not been requested to submit savings plans after 7 years of budget reduction plans
- Although submitted GF requests totaled \$2.1 billion, they were incomplete and preliminary in nature
  - A number of forecast-driven submissions were, and are still, being developed
  - ***Many of the high-cost drivers such as the Medicaid, CHIP, adoption and foster care, as well as some components of K-12 re-benchmarking (changes based on enrollment, LCI, and lottery and sales tax forecast adjustments) were not yet available and are not included in that initial figure***

Agency Budget Requests by Secretariat

Amount Requested	GF 2017	GF 2018	NGF 2017	NGF 2018
Leg/Judic/Exec	$14,194,132	$17,391,006	-$3,466,982	-$3,470,621
Admin/Finance/Tech	64,948,696	80,661,821	53,910,616	48,024,717
Ag and Commerce	95,082,735	89,933,450	19,439,494	15,041,310
K-12	197,838,089	225,010,574	0	0
Higher Ed	230,110,402	306,565,924	261,221,082	384,046,877
Other Ed	8,657,280	10,688,988	60,000	14,000
HHR	217,388,185	252,677,819	149,176,071	176,760,683
Natural Resources	100,813,964	33,730,486	31,590,521	8,893,387
Public Safety, Vets	103,846,933	102,377,679	43,227,987	44,022,987
Independent	200,000	200,000	56,328,700	87,155,745
TOTAL	**$1,033,080,416**	**$1,119,237,747**	**$617,500,523**	**$782,403,916**

Note: Table excludes the Medicaid forecast and includes only a preliminary portion of the K-12 rebenchmarking

2016-18 Budget Drivers:

HAC Staff Selected Mandatory/Statutory Items

GF $ in Millions	FY 2017	FY 2018	Total
Medicaid Baseline Forecast (offset by reductions of $22.9 in FY 17 and $22.1 in FY 2018 in SCHIP & FAMIS)	327.4	461.7	789.1
Medicaid DOJ Required Waiver Slots	13.5	30.1	43.6
DOJ – Other Requirements	8.3	6.8	15.1
Waiver Redesign	14.4	24.3	38.7
Hancock Geriatric - Maintain Services and Discharge	8.3	8.3	16.6
Foster Care and Adoption Subsidies	5.9	5.9	11.8
Comprehensive Services Act	16.4	16.4	32.8
Preliminary K-12 Rebenchmarking Costs	204.0	234.5	438.5
Add'l Potential Cost of Rebenchmarking (Final ADM, sales tax lottery)	25.0	50.0	75.0
Teacher Retirement Rates (@ 90%)	18.9	19.0	37.9
State Employee Retirement at 100% VRS Rate	12.5	12.5	25.0
State Employee OPEB Rates	6.6	6.6	13.2
State Employee Health Insurance Rate Adjustment	43.0	89.4	132.4
Debt Service	51.4	56.8	108.2
DEQ - Wastewater Treatment Plants	38.3	11.2	49.5
VITA Internal Service Fund Rate Increases and Cardinal Rates	17.7	18.3	36.0
Criminal Fund/Involuntary Civil Commitment	0.7	4.1	4.8
Direct Inmate Health Care	6.2	11.2	17.4
Compensation Board - Jail Per Diems & 1:1,500 Ratio	17.3	18.7	36.0
State Police - VITA Separation Costs	9.9	4.4	14.3
Economic Development - Tranlin Incentive	2.0	3.0	5.0
TOTAL - HAC Identified Mandatory/Statutory Drivers	**847.7**	**1,093.2**	**1,940.9**

2016-18 Budget Drivers:

HAC Staff Selected High Priority Items

GF $ in Millions	FY 2017	FY 2018	Total
State Employee and State Supported 2% COLA	55.0	66.0	121.0
Faculty 2% COLA	15.0	18.0	33.0
Higher Education - Enrollment	30.0	50.0	80.0
DOC - Open Culpeper Center for Women	18.4	22.5	40.9
DOC - Eliminate Turnover and Vacancy Savings	32.0	32.0	64.0
State Police - IT Modernization	3.2	1.1	4.3
DCR - Fulfill Prior Commitment for Stream Exclusion Projects	10.0	10.0	20.0
Land Preservation (HB 1828, 2015)	20.0	20.0	40.0
DBHDS - Housing Supports for Waiver Redesign	2.7	6.7	9.4
DBHDS - Replace MMIS	4.6	5.8	10.4
Comp Bd - Positions to Address Jail Overcrowding	5.1	5.3	10.4
Comp Bd - VARISK Premium Increase	4.5	4.5	9.0
Dept of Education - Computer Adaptive Testing	4.3	4.7	9.0
Dept of Elections - Backfill Federal HAVA Funds	-	7.1	7.1
DSS - Child Support IT Infrastructure	1.8	0.8	2.6
TOTAL – HAC Identified High Priority Drivers	**206.6**	**254.5**	**461.1**

Comparison of Available Resources To Identified Budget Drivers

$’s in millions	FY 2017	FY 2018	Biennium
Net Resources for Budget Drivers	$775.0 - 1,036.4	$1,418.4 - 1,690.0	$2,193.4 - 2,726.5
Mandatory/Statutory Spending Drivers	$847.7	$1,093.2	$1,940.9
High Priority Drivers	$206.6	$254.5	$461.1
Total – HAC Identified Drivers	$1,054.3	$1,347.7	$2,402.0
Add’l Available Resources	**($297.3) - ($17.9)**	**$70.7 - $342.3**	**($208.6) - $324.4**

What Isn't Included in Budget Drivers?

- The budget drivers summarized on the prior pages focuses solely on those items mandated by state or federal law, increases driven by forecast adjustments, and some traditionally addressed high priority items
- What is not included, and would have to compete for any other dollars that may become available, is:
  - Additional funding for K-12 beyond the amounts for re-benchmarking
  - Research initiatives – higher education generally or bio sciences related
  - Economic development incentives beyond base funding and commitments previously made based on company performance
  - Higher Education initiatives

Challenges of the 2016 Session

- Uncertainty continues to color the national economic outlook and the revenue forecast for Virginia
- Structurally, budget is in fairly good shape and actions can be taken in the current fiscal year to improve the balance even further
- Revenue growth is expected to be in the 4% range over the 3-year period – still below long term trends
- Leaves little budget flexibility beyond funding the mandated and high priority spending pressures
- Biggest unknown continues to be federal deficit reduction actions
  - Devil is in the details – still need to see how spending caps are applied
  - Recent budget agreement again puts off reductions but expires before the 2017-18 biennium ends

Appendix: Agency Budget Requests

Judicial and Executive Offices

- Supreme Court requests include:
  - $0.7 million GF in FY 2017 and $4.1 million GF in FY 2018 for increased Criminal Fund and Involuntary Mental Commitment costs
  - $2.0 million GF in each year for legal aid
- Office of State Inspector General requests $2.0 million GF each year to offset NGF transfers received from VDOT and DBHDS

Administration, Finance and Technology

- Administration, Finance, and Technology agencies requested increases of $65.0 million GF in FY 2017 and $80.7 million GF in FY 2018
- Compensation Board requests include:
  - $10.4 million GF in FY 2017 and $11.1 million GF in FY 2018 for growth in jail per diem payments
  - $6.9 million GF in FY 2017 and $7.6 million GF in FY 2018 for 1:1500 funding
  - $5.1 million GF in FY 2017 and $5.3 million GF in FY 2018 for jail overcrowding positions
  - $4.5 million GF in each year for VARISK premium increase for constitutional officers
- Department of Elections requested $7.1 million GF in FY 2018 to backfill exhaustion of federal HAVA fund balance
- VITA requested ISF increases of $18.1 million in FY 2017 and $19.7 million in FY 2018 for increases in forecast IT infrastructure services costs (all funds)

Agriculture and Forestry

- Agriculture and Forestry agencies requested increases of $8.2 million in FY 2017 and $8.8 million in FY 2018 compared to a base budget of $51.7 million GF
- VDACS biennial requests include:
  - $2.9 million for information technologies improvements,
  - $2.4 million to increase support for the Agriculture and Forestry Industries Development Fund,
  - $1.8 million for enhanced agriculture marketing activities both domestically and internationally, and
  - $1.3 million to enhance the food safety inspection and weights and measures programs
  - $1.2 million over biennium to shift wineries tax credit to a grant program
- Forestry requests include:
  - $3.0 million over biennium for replacement of fire suppression vehicles
  - $2.6 million to support reforestation initiatives

Commerce and Trade

- Commerce and Trade requested increases of $87.6 million in FY 2017 and $82.7 million in FY 2018 compared to a base budget of $196.7 million GF
  - If base is adjusted to reflect elimination of what traditionally have been considered one-time spending, base is reduced to $167.8 in FY 17 and $158.0 in FY 2018
- Economic Development Incentives Payments requests include approximately $23 million each year for the COF, $8.4 million annually for the Motion Picture Opportunity Fund and $5.0 million to meet commitment to Tranlin
- VEDP requests total about $22.8 million each year to expand domestic and international marketing
- The Tourism Authority has requested $13.8 million over biennium largely to implement its strategic vision strategy
- DHCD includes GF requests totaling $34.8 million in FY 2017 and $29.5 million in FY 2018
  - Largest request is $16.0 million each year for the Housing Trust Fund
  - $2.0 million each year for removal of derelict structures
  - $2.0 million annual increase in Enterprise Zone Grant program
  - $3.1 million each year to expand entrepreneurship and small business development through new initiatives

Public Education

- Department of Education requested increases of $197.8 million GF in FY 2017 and $225.0 million GF in FY 2018
  - Direct Aid to Public Education requests include:
    - $178.7 million in FY 2017 and $209.1 million in FY 2018 for the preliminary update for rebenchmarking
    - $3.6 million each year to change the Governor's Schools funding formula
    - $2.2 million each year to expand the initiatives for extended and year-round school programs
    - $1.0 million in FY 2017 and $0.6 million in FY 2018 to expand the Positive Behavioral Invention Support initiative
    - $0.9 million each year to expand Virtual Learning programs into middle schools
  - Department of Education – Central Office request include:
    - $5.0 million in FY 2017 and $2.0 million in FY 2018 to provide one-time funding to expand Computer Adaptive Testing into other grades and for SOL Algebra Readiness Testing contract costs
    - $3.2 million each year to expand the Instructional Improvement System and the Virginia Longitudinal Data System
    - $1.0 million each year for 4 additional staff

Higher Education

- Higher Education institutions and agencies requested operating increases of $230.1 million GF in FY 2017 and $306.6 million GF in FY 2018
- The spending is intended to address the following priorities:
  - Salary increases and compensation for faculty and other staff
  - Financial Aid
  - Enrollment, O & M, Base Adequacy Funding, additional faculty and staff
  - Specific initiatives such as student success, retention, research, workforce, online offerings and STEM

Health & Human Resources

- Health and Human Resources agencies requested increases of $217.4 million in FY 2017 and $252.7 million in FY 2018, not including the Medicaid forecast
- Two agencies account for the over 80% of the funding requested: DMAS and DBHDS
- DMAS funding requests total $112.9 million in FY 2017 and $155.0 GF in FY 2018
  - $38.9 million GF in FY 2017 and $47.0 million GF in FY 2018 to remove the local match rate for CSA children placed in Medicaid residential treatment foster care case management services
  - $17.2 million GF in FY 2017 and $28.7 million GF in FY 2018 to increase personal care rates by 5% in the first year and 2.5% in the second year
  - $13.5 million GF in FY 2017 and $30.1 million GF for additional ID/DD waiver slots required by the DOJ Settlement Agreement
  - $14.4 million GF in FY 2017 and $24.3 million GF in FY 2018 to redesign the ID/DD/DS waiver programs
  - $11.3 million GF in FY 2017 and $13.1 million GF to increase private duty nursing rates by 40% in the Technology Assisted waiver and EPSDT services

Health & Human Resources

- DBHDS funding requests total $61.8 million GF in FY 2017 and $60.8 million GF in FY 2018
  - $10.8 million GF in FY 2017 and $7.4 million GF in FY 2018 to continue funding for the Electronic Health Records system and support other critical IT projects
  - $10.4 million GF in FY 2017 and $4.3 million GF to support the implementation of a new federal demonstration grant – Certified Community Behavioral Health Clinics with 8 CSBs to promote behavioral and physical health integration for seriously mentally ill individuals, and establish a prospective payment system providing bonuses for quality outcomes
  - $8.3 million GF in FY 2017 and $6.8 million GF for additional activities to address the DOJ Settlement Agreement, including facility closure savings
  - $5.7 million GF each year of the biennium to maintain services at Hancock Geriatric Treatment Center
  - $2.5 million GF each year for community inpatient and discharge assistance funds to divert admissions to Hancock and support transitions to the community
  - $1.8 million GF in FY 2017 and $2.6 million GF in FY 2018 for Part C early intervention program for infants and toddlers caseload growth

Health & Human Resources

- DSS funding requests total $12.1 million GF in FY 2017 and $7.3 million GF in FY 2018
  - $5.9 million GF each year to fund foster care, adoption subsidies and special needs adoptions
  - $3.4 million GF in FY 2017 and a reduction of $4.0 million GF to align funding needed for eligibility system operating costs
  - $2.2 million GF in FY 2017 and $4.2 million GF for Child Protective Services investigations and ongoing services required by federal law
  - $1.4 million GF in FY 2017 and $2.1 million GF in FY 2018 to reinvest adoption savings to meet federal requirements
  - $1.8 million GF in FY 2017 and $752,750 in FY 2018 to modernize the Child Support Information Technology Infrastructure
  - $826,419 GF each year to provide a foster care and adoption rate increase required by budget language in years following a state employee pay increase

Natural Resources

- Natural Resources agencies requested increases of $100.8 million in FY 2017 and $33.7 million in FY 2018 compared to a base budget of $110.4 million GF
- The vast majority of the requests come from DCR, with decision packages totaling $98.9 million in FY 2017 and $38.2 million in FY 2018, including:
  - $61.7 million based on appropriation of 100% of the WQIF deposit based on FY 2015 surplus/balances to DCR for use in FY 2017
  - $10.0 million each year to fund the backlog of cattle stream exclusion projects
  - $14.1 million in FY 2017 and $10.6 million in FY 2018 for state park related requests, including operating and staffing increases and the limited opening of 4 state parks
  - $20 million over the biennium for soil and water conservation district technical and engineering funding and dam safety activities
- DEQ's GF requests total $400,000 each year, but the agency also has requested NGF support from the WQIF of $38.3 million in FY 2017 and $11.2 million in FY 2018 to meet outstanding commitments for sewage treatment plant upgrades
  - If WQIF funding/bonds are not available for this purpose, these amounts will be requested as GF
- At the other Natural Resources agencies, DGIF requested the restoration of the HB 38 funding of $4.3 million each year, and VMRC requests $2.6 million over the biennium for habitat management and to fill a number of vacant positions

Public Safety and Veterans Affairs

- Public Safety and Veterans Affairs agencies requested increases of $103.8 million in FY 2017 and $102.4 million in FY 2018
- Majority of requests came from DOC, totaling $66.8 million in FY 2017 and $73.4 million in FY 2018, including:
  - $32.0 million GF each fiscal year to reduce assumed turnover and vacancy savings
  - $18.4 million GF in FY 2017 and $22.5 million GF in FY 2018 to fully open and operate Culpeper Correctional Center for Women
  - $6.2 million GF in FY 2017 and $11.2 million GF in FY 2018 for increases in offender medical costs
- State Police requests include:
  - $9.9 million GF in FY 2017 and $4.4 million GF in FY 2018 to provide adequate funding for separation from VITA services
  - $3.2 million GF in FY 2017 and $1.1 million GF in FY 2018 for additional IT resources and staff

Public Safety and Veterans Affairs (cont'd)

- Emergency Management requests include:
  - $4.7 million GF each year to rebalance state and federal revenue streams
- Veterans Services requests include:
  - $3.1 million GF in FY 2017 and $4.1 million GF in FY 2018 to re-launch the Virginia Veteran and Family Support program, and expand Benefit Services Division
  - $1.4 million GF each year to hire additional staff in support of V3 and VTAP programs, and other workforce-related activities
  - $510,000 GF in FY 2017 and $800,000 GF in FY 2018 to staff and operate expansion of Virginia War Memorial