

Overview of the 2014-16 Biennial Budget Chapter 2, 2014 Special Session I

The adopted budget for 2014-16 provides a net increase of \$1,958.4 million GF over the operating budget for the 2012-14 base budget. Approximately \$1,961.0 million in additional general fund resources are available for appropriation, including a projected FY 2014 balance of \$478.6 million. However, this amount will likely be significantly lower due to an anticipated revenue shortfall in FY 2014 (see discussion below).

2014 Regular Session

During the 2014 Regular Session, the mid-session reforecast signaled slower than forecast growth in payroll withholding and nonwithholding. Downward adjustments of \$125.0 million in FY 2014 (reflected in Chapter 1 of the 2014 Special Session I Acts of Assembly (HB 5001), the final amended 2012-14 biennial budget, or “Caboose Bill”), and \$15.0 million in FY 2015 were made against the general fund resources in the budgets as introduced. No change was recommended for FY 2016.

2014 Special Session I

In the 2014 Special Session I, HB 5002 was adopted by the House and SB 5003 was adopted by the Senate. The final 2014-16 biennial budget adopted during the Special Session I was HB 5002 as amended by the Senate (the bill was not a “conference” report, but reflects HB 5002 as introduced with agreed-upon Senate amendments).

In early June 2014, the Secretary of Finance cautioned that FY 2014 revenues might not meet the revised forecast. Based on lower nonwithholding/estimated payments collections, it appeared that FY 2014 revenues would fall short of the forecast by about \$350.0 million GF. As a result of the lower FY 2014 base and assumed reductions in growth rates for FY 2015 and FY 2016, revenue projections would likely need to be lowered by approximately \$600.0 million in each year of the new biennium.

However, the official forecast adopted in Chapter 2 of the 2014 Special Session I Acts of Assembly (HB 5002) on June 12, 2014, did not reflect an explicit adjustment to the revenues, pending an official revenue re-forecast post-June 30th, 2014. Instead, a Central Account reserve was created to reflect anticipated spending cuts of \$480.0 million GF in FY 2015 and \$362.5 million GF in FY 2016. These amounts, in combination with potential withdrawals from the Rainy Day Fund, would help cover most of the expected revenue shortfall in the next biennium.

General Fund Budget for 2014-16
Chapter 2, 2014 Special Session I
(\$ in millions)

	<u>FY 2015</u>	<u>FY 2016</u>	<u>2014-16</u>
Resources Available for Appropriation	\$18,959.6*	\$18,973.5	\$37,933.1
Ch. 806 Base Budget	\$17,986.1	\$17,986.1	\$35,972.2
Net Budget Actions	492.2	623.5	1,115.7
Reserve Fund	<u>480.0</u>	<u>362.5</u>	<u>842.5</u>
Total Operating Appropriations	\$18,958.3	\$18,972.1	\$37,930.4
Capital Outlay	\$0.2	\$0.0	\$0.2
Unappropriated Balance	\$1.2	\$1.4	\$2.6

**Reflects Governor's veto of FACT Fund balance reversion*

Revenues

Chapter 2 assumes \$37,933.1 million in general fund resources available for appropriation. The budget includes \$478.6 million GF as a projected unspent balance at the end of the 2012-14 biennium, resulting primarily from the FY 2013 revenue surplus of \$264.3 million GF and combined with spending reductions included in Chapter 1. The balance contains \$243.2 million GF which was reserved for the FY 2015 required deposit to the Rainy Day Fund. A balance adjustment of \$95.0 million GF carries forward the amount appropriated in Chapter 806 of the 2013 Acts of Assembly (HB 1500) as a Rainy Day Fund reserve to be used to offset the required deposit in FY 2015.

The 2014-16 general fund revenue forecast reflected in Chapter 2 assumes growth rates of 5.2 percent in FY 2015 and 4.1 percent in FY 2016, including a net \$94.0 million GF from tax policy changes and technical adjustments, resulting in projected collections of \$36,170.5 million GF. The forecast assumes that growth will remain sluggish and Virginia will underperform the nation as the impact of federal budget actions dampens the Virginia economy due to a large military presence and a heavy reliance on federal procurement spending.

General Fund Resources Available for Appropriation
Chapter 2, 2014 Special Session I
(2014-16 biennium, \$ in millions)

Beginning Balance	\$478.6
Additions to the Balance	143.8
Official GF Revenue Estimate	36,170.5
Transfers	<u>1,140.2</u>
GF Resources Available for Appropriation	\$37,933.1

Spending Increases

Major spending increases adopted in the 2014-16 biennial budget include:

- \$674.4 million GF to address the increased cost of Medicaid utilization and inflation;
- \$589.6 million GF for the cost of updating the state’s share of rebenchmarking the Standards of Quality for public schools. Included in this total is \$163.5 million GF reflecting changes in the retirement contribution rates, retiree health care credit and group life, and \$53.4 million GF for health care coverage.
- \$243.2 million for a Constitutionally required deposit to the Revenue Stabilization Fund in FY 2015;
- \$179.2 million GF to provide debt service for capital projects and equipment;
- \$144.4 million GF for increases in the cost of state employee retirement, and the repayment of deferred state employee retirement contributions; and
- \$83.9 million GF for state employee health insurance premium increases.

Budget Savings

Major savings actions include:

- \$76.4 million GF from removing non-personal inflation adjustments from the cost of rebenchmarking public education Standards of Quality (SOQ);

- \$48.5 million GF from the Virginia Preschool Initiative program based on historic nonparticipation rates of 25.4 percent;
- \$49.4 million GF from Medicaid by withholding the inflation adjustment for hospitals in FY 2015; and
- \$20.7 million GF from removing the remaining Cost of Competing Adjustment (COCA) of 6.98 percent for support salaries in school divisions within the Northern Virginia labor market.

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

Major Spending and Savings in Chapter 2	
(GF \$ in millions)	
	<u>FY 2014-16</u>
Major Spending	
Appropriated Revenue Reserve	\$842.5
Medicaid Utilization and Inflation	674.4
Rebenchmarking Costs for K-12 Standards of Quality	589.6
Appropriate Deposits to Revenue Stabilization Fund	243.2
Debt Service for Currently Authorized Projects and Equipment	179.2
Fund Updated Costs for State Employee Retirement Rates	97.6
Fund State Employee Health Insurance Program	83.9
Fund K-12 Retirement to Supplant Literary Fund Payments	32.9
Fund Payback of Deferred Retirement Contributions	46.8
DMAS: Funding for Mandatory Waiver Slots	37.5
Major Savings	
DOJ: Reduce Funding for State ID Training Centers	(\$84.7)
Eliminate K-12 Non-Personal Inflation Update	(76.4)
DMAS: Adjust Appropriation for FAMIS and Children’s Health Insurance	(54.1)
DMAS: Withhold Hospital Inflation in FY 2015 and FY 2016	(51.4)
Reduce PreK for Nonparticipation	(48.5)
DMAS: Teaching Hospital Indigent Care Savings	(29.9)
Eliminate K-12 COCA for Support Positions	(20.7)
DMAS: Remove Funding for Nursing Home Rebasing, FY 2015 Inflation and Reduce Capital Rates	(20.6)
DMAS: Withhold Teaching Hospital Inflation in FY 2015 and FY 2016	(19.0)
Eliminate K-12 Strategic Compensation Initiative Grants	(15.0)

Major Spending and Savings in Chapter 2

(GF \$ in millions)

	<u>FY 2014-16</u>
Repurpose Culpeper Juvenile Correctional Center	(14.9)
Smooth K-3 Class Size Reduction, Using Three-Year Average	(10.2)
DJJ: Turnover and Vacancy Savings	(8.9)
Technical and Base Adjustments	\$(688.9)
Net Spending Adjustments	\$1,959.4

Judicial Department. The adopted FY 2014-16 budget for the Judicial Department includes sufficient funding to support a total of 396 elected judges. This allows for the election of up to 36 judges, as the number of sitting judges as of July 1, 2014, will be 360. The 2014 General Assembly adopted legislation, Chapter 812 (HB 606) and Chapter 822 (SB 443) of the 2014 Acts of Assembly which increased the number of authorized judgeships from 402 to 429. The adopted budget transfers \$8.9 million GF the first year and \$10.1 million GF the second year from the Judicial Department to Central Appropriations, where a companion amendment provides these amounts to support the filling of the 36 vacancies. Language in that item freezes all judicial vacancies unless the individual judgeship is specifically authorized in the language or is elected in a special session of the 2014 General Assembly. The language directs the Comptroller to revert savings of \$1.0 million each year to the general fund, based on the assumption that fewer than the 402 funded judgeships will actually be filled.

Administration. The adopted budget for Administration results in a net increase of \$31.0 million GF for FY 2015 and \$34.4 million GF for FY 2016 compared to the FY 2014 budget approved in Chapter 806 due to the distribution of funding for prior salary actions to agency base budgets. The NGF appropriations to the agencies in the Secretariat of Administration are increased by over \$1.2 billion in each year, reflecting a significant policy change toward traditionally “sum sufficient” appropriations. Of this amount, approximately \$1.0 billion in each year is to accurately account for annual expenditures on employee health insurance and remaining amounts account for charges for rent and lease space, procurement, and fleet management charges.

New GF spending under Administration is primarily limited to funding of planned openings of local jails, including the Richmond Justice Center, and the planned replacement of mission-critical administrative information systems.

Agriculture and Forestry. The adopted general fund budget actions for the Agriculture and Forestry Secretariat include increases totaling \$6.9 million GF for the biennium. Increases include \$0.9 million GF to meet computer security standards at the Department of Agriculture and Community Services and \$0.4 million GF for the Reforestation of Timberlands program in the second year. Other actions include the transfer of the Virginia Racing Commission from the Commerce & Trade Secretariat to the Agriculture and Forestry Secretariat.

Commerce and Trade. The adopted FY 2014-16 general fund budget includes a net decrease of \$19.8 million GF for economic development incentives. The majority of these savings is based on adjustments to performance-based grant funding from previously committed obligations and related to the Governor's Opportunity Fund and the Commonwealth Research and Commercialization Fund. Programs with significant increases include Aerospace Engine Facility Incentive Payments, the Advanced Shipbuilding Training Facility Grant, and the Major Eligible Employer Grant Fund. Additionally, the adopted budget recognizes several legislative actions that were enacted during the 2014 Regular Session including a reduction in the Motion Picture Opportunity Fund to offset increases in tax credits; \$3.0 million GF in initial capitalization for the Biofuels Production Fund and the merger of the former Departments of Business Assistance and Minority Business Enterprise into the new Department of Small Business and Supplier Diversity, which results in a small net savings. The adopted budget also includes the creation of the Fort Monroe Authority as a stand-alone agency, and provides \$12.2 million GF for operations of the authority and \$22.5 million in bond funds for maintenance needs of the former U. S. Army installation.

Public Education. The adopted FY 2014-16 general fund budget for Direct Aid to Public Education totals \$11.1 billion, a net increase of \$403.6 million when compared to Chapter 806 the base budget. The general fund base budget includes \$111.3 million in one-time spending, which is removed in rebenchmarking decreases. The budget reflects biennial re-benchmarking of Direct Aid for updated cost and salary data as of FY 2012; updated Composite Index of Local Ability-to-Pay calculations (Tax Year 2011); and a projected additional 17,918 students to a total of 1,246,428 students by FY 2016, which represents an enrollment increase of 1.5 percent over two years.

The budget includes an increase of \$163.5 million GF for the state's share of the employer's portion of the Virginia Retirement System (VRS) rates of 14.50 percent for teacher retirement, as well as Group Life and Retiree Health Care Credit rates of 0.48 percent and 1.06 percent, respectively.

The budget also adds \$32.8 million GF to backfill the Literary Fund for teacher retirement costs due to the decline in loan repayments and the additional amounts needed for school security grants. The budget also reflects an additional estimated \$25.0 million in Literary Fund proceeds from the sale of unclaimed property. A projected increase in Sales Tax revenue and Lottery Proceeds provides \$2.6 billion and \$1.0 billion, respectively, over the biennium.

The adopted budget reflects several policy changes including: 1) continuation of not funding non-personal inflation costs for a state savings of \$76.4 million GF; and 2) savings of \$20.7 million GF by eliminating the remaining cost of competing adjustment for support costs applied to Planning District 8 and certain adjacent divisions (no change for the cost of competing adjustment for instructional costs).

New initiatives in K-12 include \$3.4 million GF for year-round schooling grants; \$3.6 million GF for Math and Reading Specialists in unaccredited schools; and \$1.0 million GF for Teach for America. Other net increases include: \$4.6 million GF to extend and prorate hold harmless slots for the Virginia Preschool Initiative for at-risk four-year-olds; \$1.2 million GF for awards for teachers with national board certification; \$538,000 GF to Communities in Schools; \$513,920 GF for Positive Behavioral Interventions; and \$500,000 GF for the Achievable Dream program.

Higher Education. The introduced budget for higher education proposed \$184.5 million GF of new funding for the biennium for colleges and universities and other higher education entities and centers. The majority of the new funding, about \$75.0 million GF per year, was directed to support the goals of the Virginia Higher Education Opportunity Act of 2011. Of this amount, \$183.9 million GF was removed during Special Session I due to an anticipated decline in revenue for the biennium. Therefore, the amount remaining is less than \$0.7 million GF net under the higher education section of the budget.

Under Central Appropriations, \$20.0 million GF is provided in the second year for an undistributed Higher Education Reserve Fund. Additionally, \$5.1 million GF is provided in each year of the biennium for additional in-state undergraduate seats, along with operation and maintenance funding at several higher education centers and for a new facility operated by Virginia Tech Extension. Lastly, funding of \$5.5 million GF and \$1.2 million NGF (Higher Education Operating) per year is eliminated that went to higher education institutions for interest on earnings for Educational and General Revenues and credit card rebates from purchasing.

Finance. Adopted amendments for the Finance Secretariat result in a net decrease of \$19.7 million GF for FY 2015 and \$219.7 million GF for FY 2016 compared to the FY 2014 budget approved in Chapter 806. Significant general fund expenditures for the 2014-16 biennium focus on making the mandatory revenue stabilization deposit of \$243.2 million in FY 2015 and increasing funding for mandatory debt service requirements at the Treasury Board. The \$243.2 million FY 2015 deposit includes \$95.0 million which was held in reserve for FY 2014 in anticipation of the 2014-16 biennium deposits. The budget also includes an additional \$68.9 million GF in FY 2015 and \$110.3 million GF in FY 2016 for increased debt service payments. Finally, a significant policy action regarding “sum sufficient” appropriations is included in the Department of Accounts resulting in net NGF increases of \$24.1 million the first year and \$24.5

million the second year for the Cardinal, Performance Budgeting, and Payroll Services chargeback items.

Health and Human Resources (HHR). The approved budget includes a net increase of \$711.6 million GF and \$625.2 million NGF for the 2014-16 biennial budget. Additional spending of \$1.1 billion GF is offset by \$361.5 million GF in budget reductions.

Mandatory spending in HHR is primarily related to funding for Medicaid acute health and long-term care services, continued implementation of the Department of Justice (DOJ) Settlement Agreement -- which is contributing to rising costs in Medicaid -- and other mandatory HHR spending items. The introduced budget included \$674.4 million in new general fund spending for increased utilization and inflationary costs of Medicaid services. The approved budget removes nearly 13 percent of the new spending on Medicaid for inflation for hospitals and nursing homes. Overall growth rates in Medicaid are expected to continue to fall during the biennium from the double-digit levels experienced during the height of the recent recession.

Mandatory spending related to the continued implementation of the DOJ Settlement Agreement accounts for \$85.9 million in new general fund spending over the biennium, including \$37.5 million for 475 new intellectual disability waiver slots and 40 new developmental disability waiver slots and \$30.7 million to maintain support operations at state mental health hospitals and training centers after the closure of Southside Virginia Training Center and other training center beds. An additional \$12.2 million is provided for child welfare services and child support operations. Unlike prior years, technical budget actions account for 18 percent of "new" general fund spending in HHR. The unusually high funding allocation for technical budget issues is primarily related to establishing the general fund base for the DOJ Settlement Agreement, which had been funded with one-time appropriations in FY 2013 carried forward to FY 2014, therefore no base funding existed in FY 2015. Further, agency budgets include increases to account for the distribution of costs from last year's budget actions, such as state employee salary increases as well as other administrative costs.

Discretionary spending in HHR was limited this year with the exception of funding to expand and enhance community and facility-based care for individuals with mental illness. The approved budget includes \$63.2 million in new general fund spending including funding to support community-based services such as PACT teams, crisis intervention or "drop off" centers, and children's mental health services as well as building inpatient bed capacity at community hospitals and state facilities.

New spending in HHR is offset by general fund budget reductions of \$343.7 million. Twenty-nine percent of the reductions, or \$100.3 million, result from withholding inflation adjustments to Virginia's hospitals, including UVA and VCU, as well as indigent care subsidies to the teaching hospitals. An additional 25 percent of the reductions are related to savings generated by closing units at the state's Intellectual Disability Training Centers as a result of

discharging individuals pursuant to the U.S. Department of Justice Settlement Agreement. Finally, \$55.7 million in general fund savings are generated through a provision in the Patient Protection and Affordable Care Act that allows Virginia to receive enhanced federal matching funds (88 percent) for health care services provided to children in FY 2016.

Natural Resources. The largest general fund increase in Natural Resources is the appropriation of the statutorily required deposit to the Water Quality Improvement Fund of \$31.5 million in FY 2015. Of this deposit, \$23.9 million, or 75 percent, is proposed for agricultural best management practices through the Department of Conservation and Recreation (DCR), and the remaining \$7.6 million, or 25 percent, is proposed for stormwater management and other nonpoint pollution control projects managed by the Department of Environmental Quality.

Public Safety and Homeland Security. Legislation adopted by the 2014 General Assembly, Chapter 115 (HB 730) and Chapter 490 (SB 381) of the 2014 Acts of Assembly, changes the name of this secretariat to the Office of Public Safety and Homeland Security, based on recommendations of the 2013 JLARC report on disaster preparedness. The FY 2014-16 budget, as adopted, includes the closure of Culpeper Juvenile Correctional Center as a juvenile facility and the reopening of the same facility as a women's prison. The new cost to operate this facility as a women's prison is \$12.4 million GF the first year and \$12.7 million GF the second year. This cost is offset by a net savings of \$7.6 million GF the first year and \$7.3 million GF the second year, which will be achieved by closing Culpeper as a juvenile facility, closing two underutilized halfway houses, and restructuring juvenile services to include 40 placements in local and regional juvenile detention centers, an independent living program, and continuing mental health services for juveniles released from state facilities. Also included is \$2.0 million GF the first year and \$6.8 million GF the second year for increased inmate medical costs in the Department of Corrections.

Veterans and Defense Affairs. Legislation adopted by the 2014 General Assembly, Chapter 115 (HB 730) and Chapter 490 (SB 381) of the 2014 Acts of Assembly, changes the name of this secretariat to the Office of Veterans and Defense Affairs, based on recommendations by the 2013 JLARC report on disaster preparedness. The adopted budget includes \$3.1 million the first year as the NGF portion of the \$7.5 million state contribution to address encroachment at Oceana and Fentress Auxiliary Landing Field in FY 2015. The nongeneral funds are derived from the state share of the revenue from the sale of property that was previously purchased using state funding to address encroachment.

Technology. Actions in this area include about \$400,000 GF the first year, \$5.0 million GF the second year, and nongeneral funds to assist 109 state agencies with VITA information technology charges. Other nongeneral fund initiatives include funding to deal with expiration of VITA's contract with Northrup Grumman, funding associated with the web-hosting services

VITA is providing other state agencies, and additional funding to implement a new telecommunications management and billing system.

The most significant policy action in Technology is the elimination of sum sufficient appropriations for VITA's internal service fund. Instead, line item budgets have been provided for the payment of vendors, optional services to state agencies, and VITA's administrative overhead costs. This action increases nongeneral fund spending in the Technology Secretariat by \$341.8 million. In addition, \$3.4 million NGF the first year and \$18.2 million NGF the second year is added to these internal service fund line item appropriations to reflect growth in the level of information technology services provided to state agencies.

Transportation. The adopted 2014-16 budget for transportation includes a series of actions to address an anticipated reduction in FY 2015 general fund revenues as well as a number of policy adjustments, the most significant of which is establishing the Virginia Commercial Spaceflight Authority as an agency within the Appropriation Act. Actions taken to address the anticipated reduction in general funds include: 1) the one-time sweep of \$31.1 million in balances from the Transportation Partnership Opportunity Fund, 2) a \$28.0 million reduction in general debt service on Route 58 bonds in FY 2015 that is repaid in FY 2016, and 3) a temporary diversion of \$30.0 million in Highway Maintenance and Operating Funds that is returned in FY 2016. Additionally, funding and authorization is provided to the Virginia Port Authority for the dredging of the Norfolk Harbor and Elizabeth River Channels and equipment and facility improvements to the APM-Portsmouth container yard facilities.

Capital Outlay. The capital outlay budget for FY 2014-16 totals \$951.3 million from all fund sources. Of this amount, \$0.2 million is general fund cash, and \$355.3 million is Virginia Public Building Authority or Virginia College Building Authority tax-supported bonds. The budget also includes \$245.0 million in 9(C) revenue bonds and \$136.8 million in 9(D) revenue bonds. The balance of \$213.9 million is nongeneral fund cash from a variety of agency fund sources.

The tax-supported bonds include \$75.0 million each year for the Central Maintenance Reserve. However, the budget includes a substantial change in the allocation of these funds. Rather than budgeting for specific projects in the agencies and institutions, the allocation is based on the ratio of square footage of buildings maintained by the agency or institution. The adopted budget includes a hold-harmless for agencies, a minimum of \$100,000 per year, and a 35 percent increase for higher education institutions over FY 2014 levels. The tax-supported bonds also include \$21.1 million in equipment supplements for capital projects expected to be completed in FY 2015.