

**2016-18 Adopted State GF Budget Highlights
for the Virginia First Cities Coalition
By: Fiscal Analytics, Ltd., April 2016**

The FY 2016 Caboose bill forecasts a 3.2 percent GF revenue increase for FY 2016. The major revision to the FY 2016 budget was a \$172.7 mil. GF lump sum payment to the Virginia Retirement System (plus \$16.8 mil. in NGF) to expedite the repayment for deferred contributions during the last recession for state employee retirement programs. This will have the effect of reducing future state contribution rates by about one percent. Unlike last year's \$193 mil. lump sum payment, this year's lump sum payment will have no impact on the teacher retirement plan rates. This payment was also the primary reason the FY 2016 unspent revenue balance forward to the 2016-18 biennium budget was reduced from \$426 mil. to \$265 mil.

2016-18 budget assumes modest general fund revenue growth forecasts of 3.2 percent in FY 2017 and 3.9 percent in FY 2018. The primary driver of the revenue forecast increases is individual income tax growth of 3.0 percent FY 2017 and 4.5 percent FY 2018. The adopted budget increased available revenues above the introduced budget by \$65 million in FY 2017 and \$95 million in FY 2018 mainly by eliminating the tax reductions proposed by the Governor, including the reduction in the corporate income tax rate and the increase in the personal exemption amount. Including carryforward balances from FY 2016 and transfers, \$40,658 million in general funds are estimated to be available for appropriation in the 2016-18 biennium budget. The 2016-18 budget appropriates about \$2.43 billion above FY 2016 spending levels and leaves a \$21.2 million unappropriated balance.

Highlights in the budget included additional funding championed by the Virginia First Cities Coalition (VFC) for at-risk student K-12 programs and economic development programs. Specifically, in K-12 programs VFC was successful in increasing the formula for at-risk add-on program funding; increasing the Virginia Pre-school Initiative per pupil grant amount for the first time since 2008; instituting a new "Teacher Improvement Program" designed to encourage teaching in hard-to-staff schools and subjects; and continuing the expanded funding for extended year schools and the urban master teacher residency program.

For economic development, VFC successfully promoted increasing funding for the Virginia Enterprise Zone program by \$1 million per year. This will lessen the need for prorating and diluting the impact of the real property improvement grant. For the Brownfield Restoration program, VFC efforts succeeded in significantly increasing the program funding to \$2.25 million per year. For the first time, this will allow for site remediation grants of up to \$500,000. The Housing Trust Fund, also a VFC priority, was increased by \$1.5 million per year to a total of \$5.5 million per year.

K-12 Education

The largest increase in appropriation above the FY 2016 budget was for an additional \$939 million in GF direct aid to K-12 public education. This represents about 39 percent of the new money available for appropriation. In addition, the new K-12 funding provides a 5.8% increase in state K-12 direct aid general funds in FY 2017 over FY 2016. About \$400 million of the new spending was due to re-benchmarking the Standards of Quality, as well as other K-12 incentive and categorical funds.

While the General Assembly re-worked how K-12 funding in the Governor's introduced budget was allocated, they did not increase total K-12 funding above the introduced budget. The Governor had primarily proposed new spending of: \$139 million for 2,500 additional teachers, \$83 million for a 2017 teacher salary increase, \$57 million to advance 100% VRS payment "normal" rates to FY 2018, \$50 in additional at-risk add-on funding for free lunch qualified students, \$41 mil. to restore cost of competing funding in Northern Virginia, and \$30 mil. to reduce the diversion of Literary funds to teacher retirement.

The General Assembly altered the Governor's proposed K-12 funding initiatives by eliminating the \$139 mil. new teacher funding, cutting \$20 million in Literary funds and reducing \$35 mil. in proposed new at-risk add-on funding. The General Assembly did ultimately increase funding for the state's at-risk add-on program by about \$7 million per year by changing the current 1-12% boost in basic aid funding per free lunch student (depending on a school divisions' free lunch concentration) to a 1-13% boost. This funding policy change mostly helps the school divisions with high concentration of free lunch students.

The General Assembly also made \$20 mil. in "technical" reductions to K-12 funding, as well as \$7 mil. in reductions to the Northern Virginia cost-of-competing increases and other minor changes. The General Assembly primarily spent these savings to provide a flexible \$173 million lottery fund per pupil distribution that equates to \$52.42 in FY 2017 and \$224.43 in FY 2018 (50% must be used for non-recurring expenses). The General Assembly also advanced a 2 percent teacher salary increase at a cost of \$51 million from July 2017 to December 2016.

Other notable new K-12 policy initiatives adopted included:

- \$4.6 million GF over the biennium for the Virginia Early Childhood Foundation to provide grants to incentivize additional public-private partnerships in preschool services and to develop and operate a new scholarship grant program at community colleges to increase skills of the early education workforce;
- \$2.9 million over the biennium to increase the Preschool Initiative per pupil amount from \$6,000 to \$6,125;
- \$2.1 million GF for new competitive grants for school divisions with high numbers of at risk students needing qualified teachers that develop and implement a performance-based

teacher compensation system and provide teachers with incentives to take on additional training and responsibilities.

- \$2 million over the biennium for 8 new central office positions to support school divisions.

VRS teacher payment rates are scheduled to increase from 14.06% in FY 2016 to 14.66% in FY 2017 to 16.32% in FY 2018. In addition, while the state and localities will be funding 100% of the “normal” VRS rate by FY 2018, the Teacher Plan will still have a balance of \$269 million in the 10 year deferred contribution account balance as of 6/30/16. Last year, the General Assembly reduced the outstanding Teachers Plan balance with a lump sum payment of \$193 million on 6/30/15. While last year’s action reduced the Teacher Plan contributions by approximately 0.50% of payroll for the remainder of the payment schedule, the remaining \$269 million deferred contribution account balance continues to increase the annual payment rates by about 0.8%.

Other Budget Issues of Interest to Local Government

There were a number of other budget items of interest to local governments.

Compensation

Compensation supplements include \$6.9 million GF in FY 2017 and \$14.7 million GF in FY 2018 for a 2% raise for state-supported local employees effective December 1, 2016, including employees in sheriffs’ offices and regional jails, career development programs for constitutional offices, and district court clerks.

Commerce and Trade

Economic development initiatives were a major theme of this year’s General Assembly. The Governor’s introduced budget proposed \$118 million in new economic development spending over the 2016-18 biennium. Ultimately, the General Assembly only adopted a net new \$30 million in spending for the biennium above FY 2016 levels for all Commerce and trade agency programs.

The largest new economic development initiative is for the Virginia Initiative for Growth and Opportunity in Each Region (GO Virginia). Go Virginia received \$5.7 million GF the first year and \$30.2 million GF the second year. This funding will initially be used to set up regional councils. The regional councils will vet and propose projects to a state board for funding.

Over the biennium, the adopted budget also added \$2 million to the state’s Enterprise Zone program, \$1.5 million per year to the Housing Trust Fund (for a total of \$5.5 mil./year), and \$3

million (for a total of \$2.25 mil./yr.) to the Brownfield Restoration Program. The brownfield program will now have enough funding to go beyond assessing environmental issues, to helping fund remediation efforts.

Health and Human Services

The adopted budget removed all savings or expenditures related to expanding Medicaid as contained in the introduced budget. The General Assembly did add inflation adjustments for hospitals and nursing facilities. Significant additional funding was also provided for mental health services to help comply with the U.S. Department of Justice settlement agreement. In total, the adopted budget increased funding by \$105 million over the biennium for increased DD/ID waiver slots and other mental health services.

Local governments that administer the Children's Services Act (CSA) on behalf of the state will see the first increase in administrative funding since FY2000 (an additional \$500,000 per year). Also in CSA, the General Assembly created a new language amendment requesting the State Executive Council to develop options for two issues studied last year: tracking the progress of, and looking for ways to re-integrate children in private day special education placements back into their community school; and developing options for paying the education costs of children whose parent/guardian makes a direct placement into private residential treatment facility and whose treatment costs are covered by Medicaid.

Local social services departments also received additional administrative funding (\$4.3 million each year) to help them with the increased volume of work with Medicaid eligibility determinations and redeterminations. The adopted budget also included language clarifying additional authority for Virginia Social Services to administer a new Fostering Futures Program. It authorizes the state to offer some assistance to youth from 18 to 21 years of age who were in foster care when they reached the age of 18 – assistance to keep them in stable living situations, including health care benefits. This will help alleviate some local CSA costs as well as public safety or other public assistance costs.

Public Safety

There were modest funding increases and policy changes adopted for public safety that directly impact localities, including:

- \$21.5 million to fully fund local jail per diems;
- \$11.1 million to increase Aid to Police Department funding to \$178 mil. per year. This was the first increase in HB 599 funding since FY 2008 when funding reached \$205 million.
- \$4.2 million to support the state costs of operating completed jail expansion projects at the Central Virginia and Pamunkey Regional Jails and \$766,483 for the state share of three local construction or renovation projects;

- \$3.5 million to establish pilot programs to provide services to mentally ill inmates, or to provide pre-incarceration crisis intervention services to prevent mentally ill offenders from entering jails.
- Created an Inter-Agency Task Force to consider the future capital and operational requirements for Virginia's juvenile correctional centers, including the construction of a new facility in the City of Chesapeake. Funding was provided for this new facility effective 30 days after November 1, 2016 interim task force report. Planning money for a second facility was also provided, but is contingent on the final task force report in the following year.

Natural Resources

The adopted budget provides \$59.0 million in bond proceeds to meet commitments to point source protection by improving municipal water treatment. Water Quality Improvement Funds total \$61.7 million GF the first year for nonpoint source programs:

- \$8.2 million (15%) set aside for the WQIF Reserve Fund
- \$26.0 million for agricultural best management practices
- \$19.6 million for previously approved livestock exclusion projects
- \$6.2 for Soil and Water Conservation Districts technical assistance programs

Bottom Line

The Governor and General Assembly have adopted a fairly structurally balanced general fund budget for the 2016-18 biennium. Assumed annual revenue growth is modestly forecast to average about 3.5 percent, VRS pension contribution rates are 100 percent funded by FY 2018, and the Rainy Day Fund has been restored to a balance of \$845 million. State employee (and state supported local employees) and teacher salary increases have been funded in the first year. Significant progress has been made in complying with the U.S. Department of Justice settlement agreement for mental health services. For local governments, the budget fully funds K-12 education re-benchmarking, plus some modest restoration of recent past state K-12 funding reductions. The budget also increases Aid to Police (HB 599) funding for the first time since FY 2007, and fully funds jail per diems in both years of the biennium.

The caveats to full funding of a structurally balanced budget that should be noted include a historically low growth rate assumption for Medicaid funding that may ultimately require additional funds, and a continued reliance on debt for all of our capital outlay needs. In addition, as previously discussed, there is still a \$269 million VRS Teacher Plan contribution balance outstanding that is still annually raising state/local VRS teacher rates by about 0.8 percent.

2016 Session Adopted GF Budget

	FY 16 Budget	FY 17 Budget	FY 18 Budget	Above FY 16 Budget X 2
Legislative and Executive	107.7	115.5	115.5	15.5
Judicial Dept.	456.0	484.5	485.2	57.7
Administration/Comp Board	691.7	711.8	718.6	47.0
Treasury Board Debt Service	675.0	734.9	766.3	151.2
Other Finance/Technology	181.6	191.6	188.6	16.9
Rainy Day Fund	-	605.6	0.0	605.6
Car Tax Reimbursement	950.0	950.0	950.0	-
Commerce and Trade	197.0	203.9	217.3	27.1
Agriculture / Nat. Resources	174.7	237.7	172.2	60.5
K-12 Education/Central Office	5,576.0	5,900.0	6,190.6	938.6
Higher & Other Education	1,865.5	2,046.7	2,081.1	396.8
DMAS Medicaid	4,159.5	4,280.4	4,405.1	366.5
Other Health & Human Services	1,682.6	1,772.7	1,780.7	188.2
Public Safety & Veterans/HS	1,837.5	1,921.8	1,949.4	196.2
Transportation	69.1	41.0	41.0	(56.2)
Central Appropriations	334.8	139.6	223.0	(307.0)
Independent Agencies/Capital	<u>143.2</u>	<u>12.0</u>	<u>0.3</u>	<u>(274.1)</u>
Total GF Appropriations	\$19,102.0	\$20,349.7	\$20,284.9	2,430.6
GF Resources	\$19,119.3	\$19,481.2	\$20,228.8	
Balances	\$932.1	\$946.2	-\$0.5	
Unreserved Balance	\$265.3	\$77.7	\$21.2	