

Summary of 2018-20 Budget Issues of Importance to Local Government

Fiscal Analytics, Ltd

December 1, 2017

Presentation Outline

- State Revenue/Budget Outlook and Issues
- Teacher Supply and Demand Issues
- Local Fiscal Stress Policies and Issues

General Assembly Money Committees’ Economic Outlook

The Good

- U.S. economy is growing slowly but steadily.
- Expectations remain upbeat.
- Stock market is near an all-time high.

The Bad

- Supply constraints (mostly labor) are holding back growth.
- Employment growth is slowing.
- State sales tax growth is among the worst in the nation. Adjusted for inflation and rate changes, Virginia sales tax collections fell 25% between 2000 and 2016. Virginia taxes fewer services than other states.

The Unknown

- What impact will U.S. fiscal policy have on state tax collections? Sequestration – Automatic spending cuts are likely if Congress passes a Continuing Resolution to fund the government at same levels for full-year Federal FY 2018. Would disproportionately impact Northern Virginia and Hampton Roads regions with high reliance on Department of Defense spending.
- How long can the economy continue on the current path? Current economic expansion is more than eight years old.

General Assembly Money Committees’ Revenue Outlook

Money Committee staff believe a conservative revenue forecast is appropriate:

- Employment will continue to expand slowly, but the rate of job growth will decelerate in fiscal years 2019 and 2020.
- Tightening labor markets, particularly in high-demand fields (information technology, healthcare, etc.) will lead to improved average wage growth.
- Payroll withholding collections will benefit from increasing wages.
- Sharp increase in corporate income tax collections will moderate, but growth continues.
- Sales tax collections have improved over last year, but growth will remain relatively weak over the biennium.
- Expectations around U.S. tax reform will continue to depress non-withholding collections temporarily, but if passed it will likely be a net positive in FY 2019 and 2020. However, the exact timing and magnitude of the impact is difficult to estimate.
- Federal spending could have a significant impact on state income tax collections.

Money Committees' Budget Outlook

	<u>FY 2018 Forecast</u>	<u>FY 2019 Forecast</u>	<u>FY 2020 Forecast</u>
Total GF Revenue Growth (FY 18 YTD Growth = 4.9%)	3.8%	3.6%	3.7%
SFC GF Revenue Forecast	\$19,399.0	\$20,106.9	\$20,840.9
SFC Transfer Estimate	<u>\$645.1</u>	<u>\$603.1</u>	<u>\$618.1</u>
SFC Total GF Resources Estimate	\$20,044.1	\$20,710.0	\$21,459.0
Net Resources Above Base Budget		\$546.2	\$1,136.2

- Resources for the 2018-20 biennium are projected to be adequate to cover growth in major budget drivers (Medicaid, K12 rebenchmarking, CSA growth, debt service).
 - *Lower Medicaid growth assumed due to massive move to managed care.*
- Next in priority: building a back-up cash reserve.
- Little will remain for other spending priorities.

Senate Finance Committee (SFC)

Other Identified Potential 2018-20 Funding Items

- Salary Increase – 1 percent increase for classified state employees/state-supported locals = \$34.1 million per year.
- Teacher Salary Increase – 1 percent increase = approximately \$40 million per year.
- Faculty Salary Increase – 1 percent increase = \$9.6 million GF per year.
- Public Safety – High turnover DOC positions; Culpeper opening; State Police tactical team; IT security.
- Higher Education – SCHEV recommendations = \$241.1 million GF over the biennium.
- Capital Outlay – \$800 million in projects in the planning stage; additional needs.
- Economic Development – GO Virginia and Economic Development Incentives funding requests.
- Education Initiatives – State Board SOQ revisions for counselors, social workers, nurses.

General Fund Operating Appropriation Growth (\$ Mil.)

	<u>2001</u>	<u>2018</u>	<u>Growth</u>	<u>Annualized Compound Growth</u>
Medicaid (DMAS)	\$1,384.2	\$4,605.7	232.7%	7.3%
GF Debt Service	\$243.1	\$763.7	214.2%	7.0%
Behavioral Health	\$430.2	\$772.6	79.6%	3.5%
Other H&HS	\$648.9	\$1,059.0	63.2%	2.9%
K-12 Public Education	\$3,942.4	\$6,030.0	53.0%	2.5%
Public Safety/Comp Board	\$1,949.1	\$2,588.3	32.8%	1.7%
Higher Education	\$1,634.2	\$2,014.5	23.3%	1.2%
Natural Resources	\$152.1	\$128.5	-15.5%	-1.0%
All Other	<u>\$1,899.4</u>	<u>\$2,392.3</u>	<u>25.9%</u>	<u>1.4%</u>
Total GF Operating	\$12,283.6	\$20,354.6	65.7%	3.0%

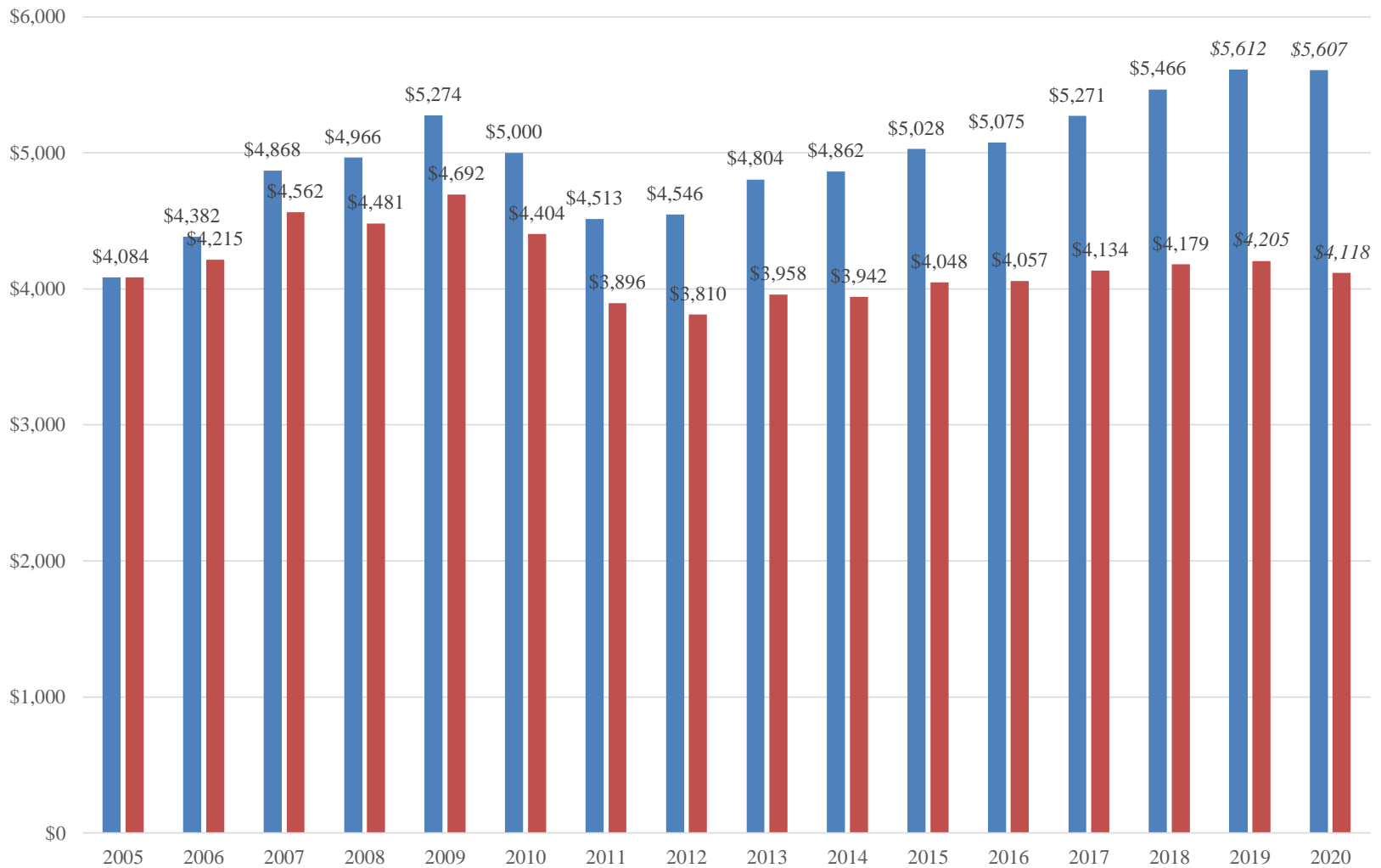
Note: Since 2001, the Consumer Price Index has averaged 2.0%.

Initial 2018-20 Biennium K-12 Rebenchmarking Increases State Funding by About 3 Percent

- FY 2019 = \$210.8 m; FY 2020 = \$232.6 m; Total = \$443.4 m
(Net 25.4% non-participation for VA Pre-School Initiative, Not including VRS rate reduction from 16.32% to 15.68%)

Major Cost Increases:	<u>Biennial Cost</u> (\$ Mil)	Major Cost Decreases:	<u>Biennial Cost</u> (\$ Mil)
Recognize Full Year Cost of 2.0% State Salary Increase and Instructional/Support Prevailing Costs	\$169.5	Pupil Transportation Costs	(\$24.1)
Non-personal Support Prevailing and Inflation Costs (largest factor: substitute teachers up 9.3%)	\$161.3	3-Year Avg. FL Rates for CEP Schools	(\$21.0)
Health Care Premium (up 10%)	\$58.0	Support Position Cap Ratio (4.27-1)	(\$18.9)
Update Lottery Accounts	\$43.7	Textbook Costs	(\$14.4)
Projected Enrollment Counts	\$38.4	Federal Revenue Deduct	(\$2.3)
ESL, CTE, Remedial Summer School, Categorical, Superintendents, School Board, Nurse Costs	\$22.7	Other	(\$1.7)
SOL Test Failure Rate Data	\$17.5	Total Decreases	(\$82.4)
Special Ed Child Counts	\$14.6		
Total Increases	\$525.7		

Real State Per Pupil K-12 FY 18 Funding \$513 Below FY 09* Nominal and Inflation-Adjusted Direct Aid (CPI \$2005)



* 2018-20 funding levels assume initial \$211m and \$233m rebenchmarking amounts only and 2.0% inflation each year.

Will Massive Move to Managed Care Provide Assumed Medicaid Savings?

<u>Fiscal Years</u>	<u>Avg. GF Annual Growth</u>
2000-2009	8.8%
2010-2015	6.2%
2016	9.3%
2017	7.2%
<i>2018 Forecast*</i>	<i>6.5%</i>
<i>2019 Forecast*</i>	<i>2.3%</i>
<i>2020 Forecast*</i>	<i>3.4%</i>

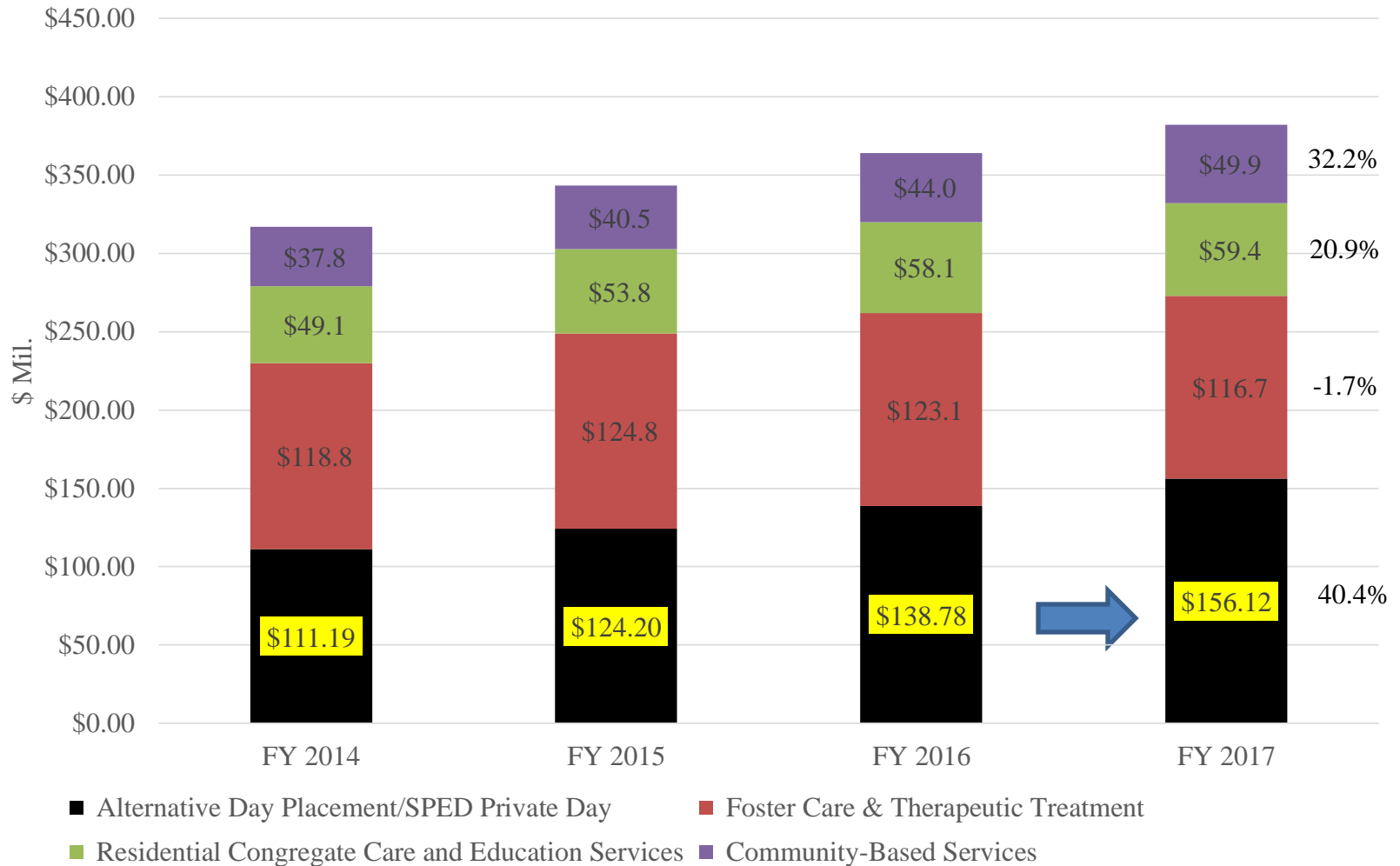
* Reflects expansion of managed care from 30% to 70% of all enrollees beginning 1/1/18, mostly in long-term care and behavioral health with *assumed* lower rates and lower 2% growth in new eligibility (better economy) versus avg. growth of 4.5% since 2008.

Biennial Changes in Medicaid Funding

<u>Biennium</u>	<u>GF \$ Millions</u>
2010-12	\$786.8
2012-14	\$691.5
2014-16	\$646.7
2016-18 est.	\$1,156.4
<i>2018-20 est.</i>	\$583.9

CSA Special Education Day Placement Costs Are Growing

CSA EXPENDITURE GROWTH



Special Education Day Placement Cost Containment Proposals

- Continue current funding methods and improve the system.
 - For example, use outcome measures to track the progress of children in private day placements; and enhance local school divisions' abilities to serve kids in their local schools such as better use of CSA wrap-around funds for behavioral aides.
- State management of costs and rates.
- State proposal: Place appropriations with VDOE and more directly linked to local IEP team placements.
 - Change current local match rates to the local composite index rate?

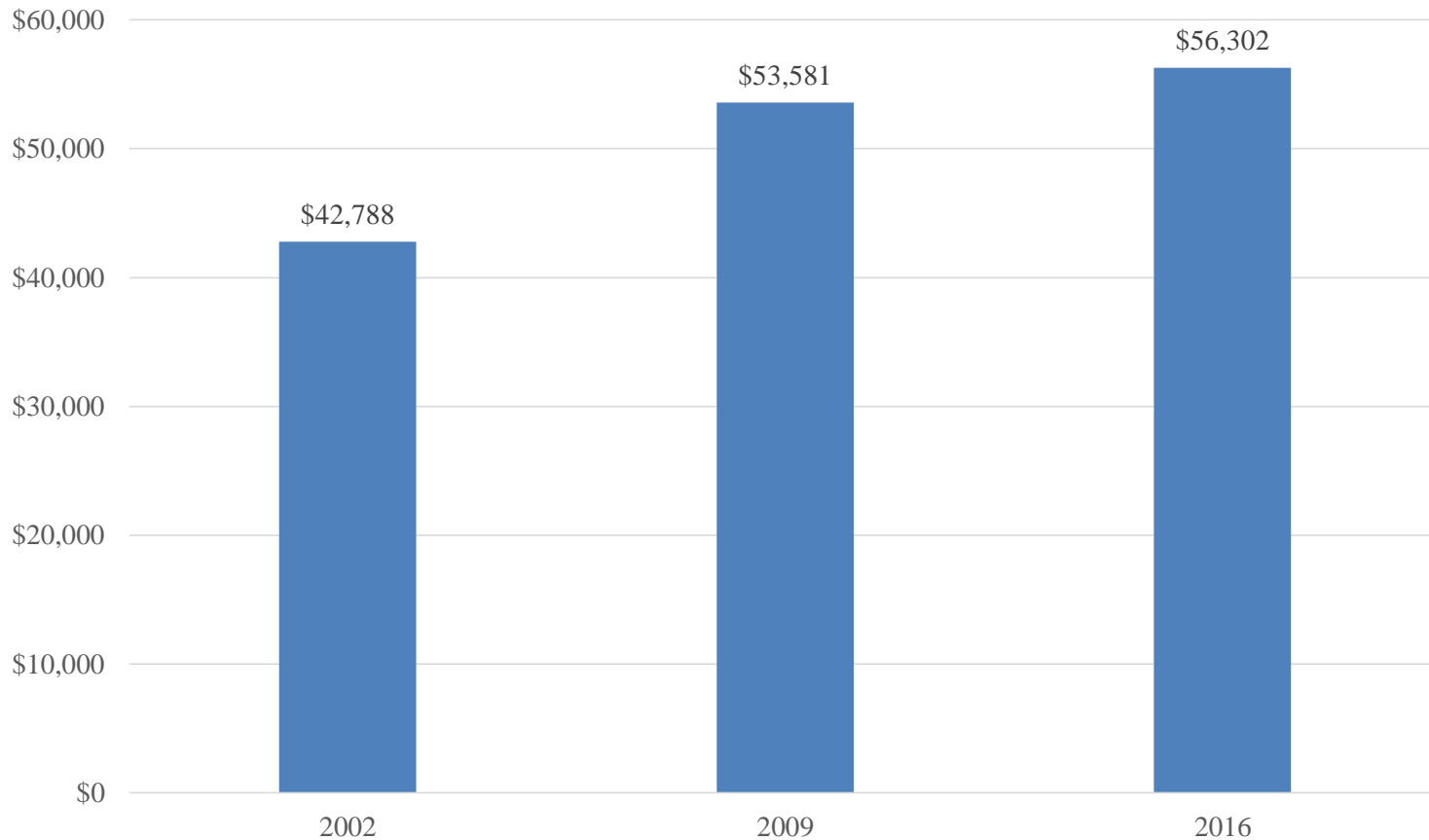
Senate Finance Committee Retreat

Teacher Supply and Demand Issues

- Some localities face challenges in hiring enough qualified teachers.
 - In Central Virginia, Petersburg and Richmond each had more than 50 unfilled teaching positions as the current school year opened.
 - More than 1,000 positions were unfilled at the start of the 2016-17 school year.
- Since teachers are central to education -- recruiting, retaining, and rewarding effective teachers is at the core of the success of the enterprise.
- Teacher supply and demand is a complex equation involving licensure/preparation, compensation, working conditions, and class size.
- Virginia average teacher salary ranks 29th among the states.

Instructional Pay Increases Have Slowed Considerably Since 2009

Average Salary - All Instructional Positions*



Source: Superintendent's Annual Report.

* All instructional positions include classroom teachers, guidance counselors, librarians, principals, and assistant principals.

Note: Average instructional pay would have been \$59,872 in 2016 if grown at the rate of the CPI from 2009.

SFC Retreat

Addressing Teacher Shortages/Quality

- Gain better understanding of the multiple causes and the extent of the shortage/quality issue. There is concern about declining enrollment in teacher education programs.
 - Are vacancies “just the beginning” of more widespread shortages of effective teachers, or are they mostly a symptom of challenged, low-performing school divisions?
- In the meantime, build on, refine and re-evaluate the effectiveness of things Virginia has already done. Options include:
 - Evaluate impact of different approaches to compensation.
 - Revamp the Virginia Teaching Scholarship Loan Program.
 - Continue to support Teacher Residency Programs that prepare committed students and other alternative programs like Career Switchers, Teach for America, and the Virginia Reading Corps in attracting graduates to the profession.
 - Re-institute the Great Virginia Teach-In recruitment fair or similar regional fairs.
 - Use distance learning where possible to link available, qualified teachers with classroom needs.
- As Virginia continues to explore new approaches for the future of elementary and secondary education, develop longer-term strategies for elevating the teaching profession, including maximizing the impact of the very best teachers and providing schools and districts with results-based flexibility.

How is Local Fiscal Stress Currently Identified in Virginia?

- Commission on Local Government (COLG) Fiscal Stress Index.
 - COLG index is a measure of relative tax effort and relative tax capacity against a benchmark of the state average. The assumption is that departure from the average for either high relative effort or low relative capacity, or both, is an indication of high fiscal stress.
- New “Financial Assessment Model” (FAM) being developed per state budget language by the Auditor of Public Accounts.
 - Monitored by GA Joint Subcommittee on Local Government Fiscal Stress
 - Still receiving input on model development by workgroup.
 - Current design really measures “financial stewardship” with high reliance on measures of debt and liquidity – not necessarily fiscal stress.
- A good fiscal stress measure must be able to provide early identification of troubled locations, an accurate assessment of the degree of deterioration, and an indication of the fiscal policy solutions needed.

Improving the APA Assessment of Locality Financial Conditions

- Collect more information on the front-end and change FAM label to “Fiscal Conditions Model”. For example, incorporate the COLG Index or some similar elements, such as per capita personal income, into a Fiscal Conditions Model.
- Assign weights to some of ratios so as to address the FAM score over-reliance on measures of debt and liquidity.
- Group and compare scoring by peer locality.
- Create a “Dashboard” that reveals only Green (ok) and Orange (caution) to avoid yearly score comparisons.

Fiscal Stress (COLG) versus Fiscal Stewardship (FAM)

CLG Fiscal Stress Rank	2016 FAM Score	2009 RE Tax Revenues	2016 RE Tax Revenues	Growth FY09-16	VA GF Exceeds Local RE Growth?
<i>Virginia (Total GF)</i>		<i>\$14,315,100,000</i>	<i>\$18,040,100,000</i>	<i>26.0%</i>	
1 Emporia	75.3%	\$2,704,096	\$3,231,115	19.5%	Yes
2 Buena Vista	18.1%	\$3,337,299	\$3,982,630	19.3%	Yes
3 Petersburg	4.5%	\$23,651,270	\$25,523,837	7.9%	Yes
4 Martinsville	41.1%	\$6,887,656	\$6,609,824	-4.0%	Yes
5 Covington	35.6%	\$1,845,129	\$2,114,507	14.6	Yes
6 Galax	20.7%	\$2,306,898	\$3,413,186	48.0%	No
7 Lynchburg	35.2%	\$48,391,257	\$56,475,151	16.7%	Yes
8 Franklin City	34.9%	\$4,922,643	\$5,558,277	12.9%	Yes
9 Hopewell	N/A	\$12,829,945	N/A	-	N/A
10 Radford	35.2%	\$5,335,962	\$6,105,625	14.4%	Yes
11 Bristol	4.2%	\$9,593,966	\$12,246,361	27.6%	No
12 Portsmouth	49.0%	\$90,174,449	\$90,944,523	0.9%	Yes
13 Norfolk	20.7%	\$206,319,083	\$217,125,915	5.2%	Yes
14 Hampton	42.8%	\$121,510,087	\$135,302,923	11.4%	Yes
15 Norton	17.9%	\$1,601,572	\$2,062,943	28.8%	No
16 Newport News	25.6%	\$167,606,717	\$174,097,563	3.9%	Yes
17 Danville	76.8%	\$16,134,891	\$16,364,473	1.4%	Yes
18 Harisonburg	43.6%	\$20,253,878	\$28,256,206	39.5%	No
19 Roanoke City	21.4%	\$78,417,254	\$81,997,230	4.6%	Yes
20 Greensville County	51.7%	\$3,014,889	\$4,147,984	37.6%	No
21 Buchanan County	66.8%	\$7,624,465	\$9,260,576	21.5%	Yes
22 Lexington	72.4%	\$3,651,580	\$5,560,264	52.3%	No
23 Staunton	63.1%	\$16,500,114	\$16,974,204	2.9%	Yes
24 Smyth County	38.5%	\$7,422,198	\$10,624,941	43.2%	No
25 Sussex County	61.0%	\$4,221,374	\$4,633,591	9.8%	Yes
26 Richmond City	13.7%	\$222,174,092	\$244,148,174	9.9%	Yes
27 Dickenson County	36.4%	\$5,658,058	\$7,709,242	36.3%	No
28 Waynesboro	51.9%	\$12,190,852	\$13,523,760	10.9%	Yes
29 Salem	45.3%	\$22,701,024	\$24,430,486	7.6%	Yes
30 Scott County	30.1%	\$7,057,811	\$8,094,350	14.7%	Yes

SFC Retreat

Policy Options for Local Fiscal Stress

- **Fiscal Monitoring and Early Detection**
 - Refine processes for prevention, identification and remediation (including intervention, if required).
 - Determine extent of state technical and financial assistance.
- **Ways To Address Local Fiscal Stress**
 - Revenue diversification – diversify sources, move away from dependence on real estate tax revenues.
 - Address differences in local taxing authority.
 - Economic development efforts –What makes a locality attractive to a current or prospective business (tax structure, educated/trained workforce, good schools, etc.) and how to improve the local infrastructure, given economic and demographic challenges in certain regions?
 - Ways to encourage local/regional collaboration, consolidation, and reversion when necessary.
- **Issues before the Joint Subcommittee on Local Government Fiscal Stress**
 - Savings opportunities from increased regional cooperation and consolidation of services;
 - Local responsibility for service delivery of state mandated or high-priority items;
 - Causes of fiscal stress among local governments;
 - Potential financial incentives and other governmental reforms to encourage increased regional cooperation; and,
 - Different taxing authorities of cities and counties.

Local Composite Index (LCI)

State Measure of Ability-to-Pay for K-12

- The Local Composite Index (LCI) dates to the 1970's. The LCI measures a locality's ability-to-pay for its share of the Standards of Quality (SOQ) K-12 education costs.

The Local Composite Index Formula:

$$\frac{0.5 (TVRE) + 0.4 (VAGI) + 0.1 (Sales)}{0.667 (ADM) + 0.333 (Population)}$$

TRVE = True Value of Real Estate

VAGI = Virginia Adjusted Gross Income

Sales = Taxable Sales

ADM = Average Daily Membership

- The result is the LCI applied to the locality SOQ costs.
(Note: the lower the numerator value the lower the LCI, and the higher the denominator value the lower the LCI.)

2018-20 K-12 Local Ability-to-Pay (LCI)

				Numerator	Denominator	
			LCI	Weighted Average	Weighted Average	Num/Denom
	<u>2016-18 LCI</u>	<u>2018-20 LCI</u>	<u>Change</u>	<u>% of State</u>	<u>% of State</u>	<u>Ratio</u>
Statewide Average	0.4500	0.4500	0.0000	100.0%	100.0%	1.00000
CHARLOTTESVILLE	0.6590	0.6772	0.0182	0.5760%	0.4103%	1.40375
DANVILLE	0.2629	0.2546	-0.0083	0.2893%	0.4883%	0.59240
HAMPTON	0.2773	0.2741	-0.0032	0.9822%	1.6132%	0.60888
HOPEWELL	0.2108	0.2032	-0.0076	0.1377%	0.3069%	0.44887
LYNCHBURG	0.3630	0.3700	0.0070	0.5928%	0.7435%	0.79734
MARTINSVILLE	0.2111	0.2135	0.0024	0.0804%	0.1642%	0.48991
NEWPORT NEWS	0.2821	0.2781	-0.0040	1.3679%	2.1949%	0.62321
NORFOLK	0.2988	0.2958	-0.0030	1.6973%	2.5749%	0.65916
PETERSBURG	0.2365	0.2430	0.0065	0.1813%	0.3356%	0.54006
PORTSMOUTH	0.2506	0.2462	-0.0044	0.6298%	1.1382%	0.55330
RICHMOND CITY	0.4758	0.4925	0.0167	2.1848%	2.0350%	1.07359
STAUNTON	0.3827	0.3867	0.0040	0.1954%	0.2339%	0.83522
WILLIAMSBURG	0.7747	0.7703	-0.0044	0.1690%	0.1121%	1.50806
WINCHESTER	0.4326	0.4244	-0.0082	0.3174%	0.3367%	0.94272
FREDERICKSBURG	0.6071	0.6210	0.0139	0.3937%	0.2847%	1.38281
WAYNESBORO	0.3556	0.3578	0.0022	0.1987%	0.2502%	0.79437