

Current State Budget Status

Exploring Economic Development Opportunities for the Virginia First Cities Coalition

Fiscal Analytics, Ltd.

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FY 2018 GF Is Likely to Have a Sizeable Surplus

	<u>% of GF</u>	<u>Est. Growth</u>	<u>Thru March Growth</u>	<u>Apr-June Required to Meet Est.</u>
Withholding*	63.1%	3.5%	4.2%	1.3%
Est Payments/Tax Dues	16.8%	4.3%	16.9%	-7.9%
Refunds	<u>-10.1%</u>	<u>5.8%</u>	<u>3.2%</u>	<u>9.8%</u>
Net Individual Income	69.8%	3.4%	6.4%	-4.2%
Sales Taxes**	18.0%	3.0%	2.9%	3.2%
Corporate Income	4.4%	5.7%	5.8%	5.6%
Recordation	2.1%	3.3%	-1.4%	15.9%
Insurance Premiums	1.9%	6.2%	-13.9%	14.2%
Total GF Revenues	100.0%	3.4%	5.2%	-0.7%

* WH grew 6.5% from Jan-March 2018.

** 19.2% share of GF when including 0.375 cent sales tax transfer to the GF

Upcoming Budget Issues

- Medicaid expansion debate holding up 2018-20 budget.
 - Potential compromise issues: Provider tax; Work requirements; Offsetting tax deductions to help working poor.
 - A sizeable FY 18 GF revenue surplus (\$300-500 mil. likely). The administration and GA have prioritized reserving revenue from any FY 2018 surplus to increase liquidity and preserve state AAA debt rating.
 - However, an upward re-adjustment 2018-20 biennium revenues also likely and provides an opportunity to restore local government funding reductions. Top priorities?
- Virginia tax reform is also likely to offset automatic state income tax increases due to federal tax changes. **New federal tax law SALT caps on itemized deductions will likely shift over 600,000 income tax filers from itemizing deductions to filing a lower amount of standard deduction.**
 - Without offsetting Virginia tax code changes, over \$600 million/year could be generated. An increase in the Virginia standard deduction is likely. VFC has been an advocate for this in the past.
 - It may become harder to raise local property tax rates with the new federal tax law SALT caps on itemized deductions.
 - What other tax reforms would VFC like to advocate?

Previous Tax Changes Annually Reduce State GF Revenues by \$2 Bil.

	<u>Enacted/Amended</u>	<u>FY 2018 \$M est.</u>
Car Tax Reimbursement	1997, 2003	(\$950)
Impose lower 2.5% Sales Tax on Food	2004	(575)
Age Subtraction (net of 2004 means testing)	1994 and 2004	(294)
Low Income Tax Relief, increase filing thresholds, exemptions, etc.	2000, 2004, and 2007	(203)
1/3 Insurance Premiums to Transportation	2007	(162)
Estate Tax Repeal	2009	(140)
100 basis pt Sales Tax Diversion to Transportation		(101)
Land Preservation Tax Credit	2003	(78)
Historic Rehab Tax Credit	1999	(76)
Corp. double weighting sales and single sales factor	1999, 2009	(59)
Sales tax exemption for data centers	2010/2011	(51)
Sales tax exemption for non-prescription drugs	1990	(39)
Subtraction for military wages and unemployment benefits	1999	(37)
Coalfield Employment Tax Credits	2000	(34)
All Other Tax Reductions Since 1999	1990-2017	(121)
State GF Tax Reductions since 1994		(\$2,920)
Add 1/2 percent sales tax on non-food items	2004	\$515
Recordation Tax Increase (net of 3 cents to transp.)	2004/2007	\$150
Tobacco Tax Increase (Va Health Care Fund)	2004	\$146
Close 2 Corp. Tax Loopholes/Eliminate ST Exem for Pub. Svc. Co.	2004	\$143
Sales Tax Presence in Virginia Amazon	2012	\$22
Sales tax on satellite TV equipment	2014	<u>\$10</u>
State Tax Increases since 1994		\$971
Net State Tax Change Since 1994		(\$1,949)

Source: Senate Finance Committee Retreat, Revenue Outlook, Nov. 19 , 2015, Va Dept. of Taxation

Governor's Introduced Budget

	GF Budget Accounting (\$ Mil.)						
	<u>2018 Caboose</u>	<u>FY 2019</u>	<u>Change from FY18</u>		<u>FY 2020</u>	<u>Change from FY19</u>	
			<u>\$</u>	<u>%</u>		<u>\$</u>	<u>%</u>
Legislative and Executive	\$119.4	\$123.7	\$4.3	3.6%	\$123.7	\$0.0	0.0%
Judicial Dept.	485.6	496.0	\$10.4	2.1%	496.0	\$0.0	0.0%
Administration/Comp Board	714.3	736.7	\$22.4	3.1%	739.6	\$2.9	0.4%
Treasury Board Debt Service	739.5	759.1	\$19.6	2.7%	807.6	\$48.5	6.4%
Other Finance/Technology	31.1	191.2	\$160.1	514.8%	189.8	-\$1.4	-0.7%
Rainy Day Fund Deposit	-	-	-	-	-	-	-
Car Tax Reimbursement	950.0	950.0	\$0.0	0.0%	950.0	\$0.0	0.0%
Commerce and Trade	203.5	208.9	\$5.4	2.7%	210.3	\$1.4	0.7%
Agriculture / Nat. Resources	163.7	191.9	\$28.2	17.2%	168.9	-\$23.0	-12.0%
K-12 Education/Central Office	6,031.2	6,297.5	\$266.3	4.4%	6,400.8	\$103.3	1.6%
Higher & Other Education	2,015.2	2,119.8	\$104.6	5.2%	2,148.6	\$28.8	1.4%
DMAS Medicaid *	4,651.7	4,651.2	-\$0.5	0.0%	4,796.3	\$145.1	3.1%
Other Health & Human Services	1,847.1	1,949.5	\$102.4	5.5%	2,029.1	\$79.6	4.1%
Public Safety & Veterans/HS	1,938.0	2,030.8	\$92.8	4.8%	2,041.8	\$11.0	0.5%
Transportation	41.0	43.0	\$2.0	4.9%	43.0	\$0.0	0.0%
Central Appropriations	211.3	71.5	-\$139.8	-66.2%	188.6	\$117.1	163.8%
Cash Reserve	156.4	50.0	-\$106.4	-68.0%	220.7	\$170.7	341.4%
Independent Agencies/Capital	0.3	10.4	\$10.1	NM	5.3	-\$5.1	-49.0%
Total GF Appropriations	\$20,299.3	\$20,881.2	\$581.9	2.9%	\$21,560.1	\$678.9	3.3%
GF Revenues	19,328.2	20,096.5	\$768.3	4.0%	20,892.3	\$795.8	4.0%
Transfers	622.7	615.7	-\$7.0	-1.1%	625.8	\$10.1	1.6%
Rainy Day Fund Withdrawal	272.5	-			-		
Balances for Appropriation	201.6	22.0			(0.5)		
Unappropriated Balance		54.6			12.1		

* Includes Medicaid expansion **savings** of \$421 million

GF State Aid to Localities (\$ Mil.)

	<u>FY 2009</u>	<u>FY 2014</u>	<u>FY 2018 (i)</u>	<u>FY 2019 (i)</u>	<u>FY 2020 (i)</u>
Direct Aid to K-12	\$5,607.6	\$5,240.3	\$5,972.7	\$6,236.5	\$6,339.4
K-12 % of Total GF Appropriations	35.2%	29.6%	29.4%	29.9%	29.4%
Health and Human Services	888.4	791.7	951.0	995.4	1,021.4
<i>CSA</i>	299.7	217.2	279.9	298.6	318.8
<i>Community MH/SA Services</i>	249.4	269.3	350.4	365.2	369.6
<i>Local Social Services Staff</i>	117.4	115.3	122.1	126.8	128.2
<i>Community Health Programs</i>	117.6	107.2	117.9	123.3	123.3
<i>Welfare Services and Programs</i>	104.3	82.7	80.7	81.5	81.5
Public Safety	734.3	687.9	740.0	758.3	768.0
<i>Local Sheriffs Offices</i>	406.1	411.3	453.6	464.4	465.9
<i>Local Police Depts HB 599</i>	197.3	172.4	178.0	184.5	191.7
<i>Local Jail Per diem</i>	80.1	59.4	61.3	61.7	62.7
<i>Assistance for Juvenile Justice</i>	50.8	44.8	47.1	47.7	47.7
Constitutional Officers	155.3	145.8	158.0	161.5	161.5
Dept. of Accounts Transfers	49.3	49.3	49.6	48.9	48.9
Car Tax	950.0	950.0	950.0	950.0	950.0
Aid-to-Locality Reduction	(50.0)	-	-	-	-
Total Local GF Aid	\$8,334.9	\$7,865.0	\$8,821.3	\$9,150.6	\$9,289.2
Total GF Appropriations	\$15,943.0	\$17,705.2	\$20,299.3	\$20,881.2	\$21,560.1
Local Aid % of Total GF	52.0%	44.1%	43.5%	43.8%	43.1%

K-12 Introduced Budget Changes Basically Funded the Status Quo

K-12 Direct Aid GF *biennium* spending increases (above base) primarily included:

- \$487.5 mil. GF for normal Standards of Quality re-benchmarking.
- \$42.7 mil. GF to update sales tax revenues for public education and \$5.2 million for sales tax distributions based on school-age population.
- \$80 mil. GF to offset decreased Literary Fund support for teacher retirement.
- \$51.3 mil. GF for the state share of a 2% salary increase starting December 1, 2019.
- \$11.5 mil. GF in FY 2019 for “no loss” funding in FY 2019 compared to FY 2018. This funding holds localities harmless that otherwise would lose state funding in FY 2019 relative to their FY 2018 allocations.
- \$7.7 mil. GF in FY 2020 for one full-time principal in every elementary school based on the Virginia Board of Education's recommendations to amend the Standards of Quality.
- \$7.1 mil. GF in FY 2020 for additional at-risk student funding based on numbers of free lunch students from a basic aid boost of 1-13% to 1-14% in FY 2020.

K-12 Direct Aid GF *biennium* spending reductions primarily included:

- \$80.4 million GF reduction due to increased Lottery proceeds projections.
- \$47.9 mil. GF reduction from Virginia Pre-school Initiative 25% non-participation
- \$45 million reduction from reduced teacher retirement and OPEB rates - 16.32% to 15.68%
 - VRS funded status for teachers has increased from a low of 62% in FY 2013 to 74% in FY 2019
- \$5.5 mil. GF in savings from revised lower student enrollment projections
- \$1.7 mil. GF in savings from new LCI calculations.

Expect Relatively Minor GA K-12 Budget Changes

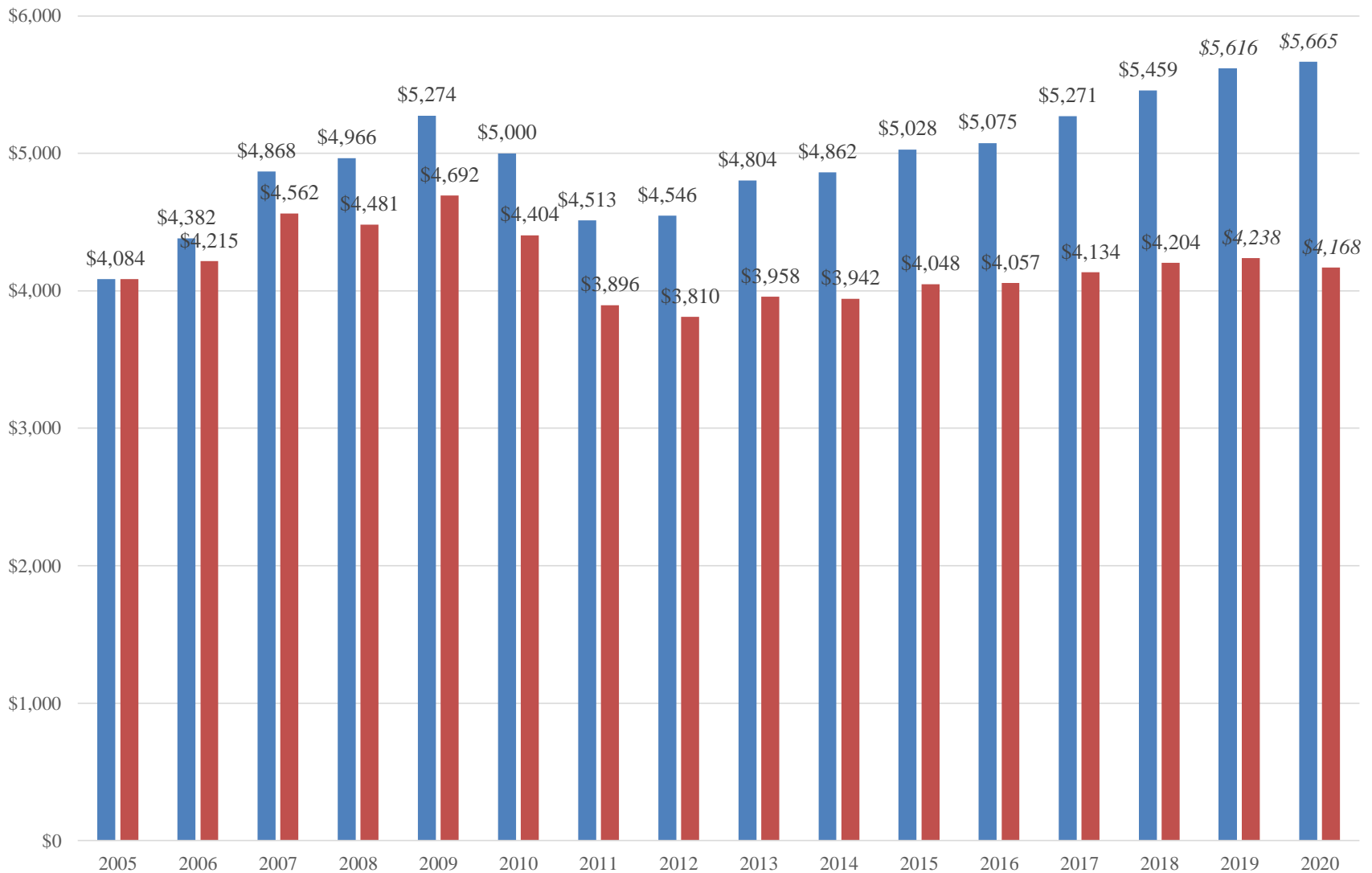
House Budget:

- **Adds** \$62.4 mil. GF and \$17.6 mil. in lottery funds to increase flexible lottery per pupil distributions to 40 percent of total lottery funds.
- **Adds** \$36.3 mil. to advance 2% salary increase from 12/1/19 to 7/1/19.
- Removes \$7.7 mil. introduced budget funding for small school full-time principals.
- **Removes \$7.1 mil. introduced budget funding for the At-risk Add-on.**
- Adds \$6.1 mil. for school division enrollment declines of over 5% over last 5 years and less than 10,000 students.

Senate Budget:

- **Cuts** \$51.3 mil by removing 2% salary increase on 12/1/19.
- Removes \$7.7 mil. introduced budget funding for small school full-time principals.
- **Keeps \$7.1 mil. introduced budget funding for the At-risk Add-on to 14%.**
- **Adds \$9.2 mil by increasing Virginia pre-school Initiative from \$6,125 per pupil to \$6,500.**
- Adds \$5.0 mil. for school division enrollment declines of over 10% over last 10 years and less than 10,000 students.
- **Adds \$1.5 mil. for Master Teacher Residency programs for urban school divisions.**

State Per Pupil K-12 Direct Aid (All Funds, HB 30 Introduced) Nominal and Inflation-Adjusted (CPI \$2005)



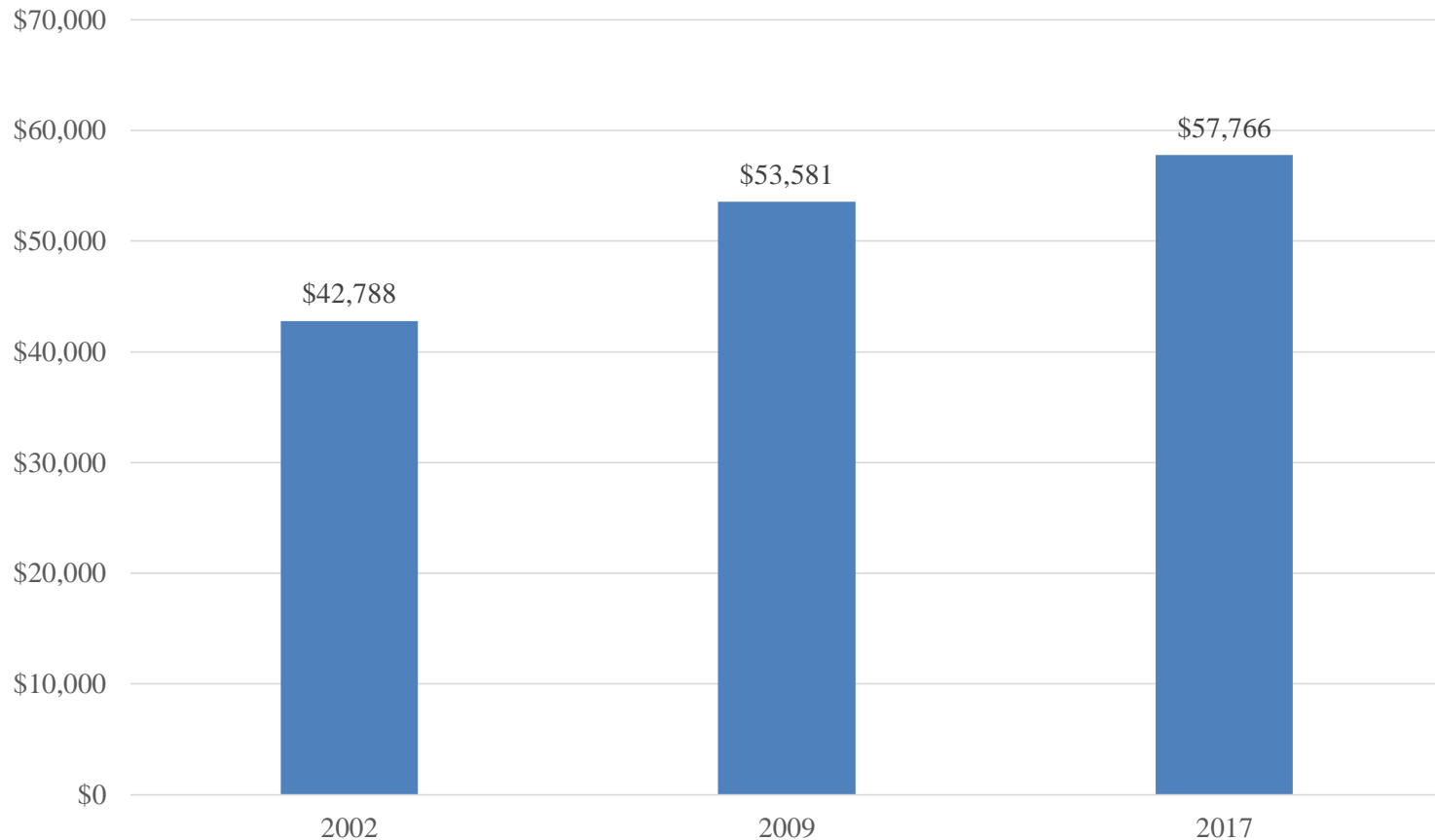
Source: Virginia DOE - http://www.doe.virginia.gov/school_finance/budget/calc_tools/index.shtml

Policymakers Beginning to Recognize Teacher Supply and Demand Issues – But Little Done Yet

- Teachers are central to education – recruiting, retaining, and rewarding effective teachers is at the core of the success of schools.
- Some school divisions face challenges in hiring enough qualified teachers.
 - 1,000 unfilled positions in Fall 2016
 - Declining enrollment in teacher preparation programs
- Teacher supply and demand is a complex equation involving licensure/preparation, compensation, working conditions, and class size.

Instructional Pay Increases Have Slowed Considerably Since FY 2009

Average VA 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 \$62,000 in 2017 if grown at the rate of VA wage inflation since FY2009.

More Funding Needed to Address the Achievement Gap

Major State-Funded At Risk Student Education Programs (Governor's Introduced Budget)	
	<u>FY 2019</u>
K-3 Primary Class Size Reduction	\$130,593,583
SOQ Prevention, Intervention, & Remediation	113,078,853
At Risk Add-on (\$7 mil. increase proposed for FY 20)	100,250,878
Virginia Preschool Initiative	70,234,325
SOQ English as a Second Language	62,210,121
Early Reading Intervention	22,599,681
School Breakfast and Lunch	13,607,703
SOL Algebra Readiness	13,003,937
Targeted Extended School Year Grants	7,763,312
Teacher Recruitment & Retention Grant Programs	1,931,000
Math/Reading Instructional Specialists	1,834,538
Early Reading Specialists Initiative	1,476,790
Communities in Schools	1,244,400
Teacher Residency (Senate budget: \$1 mil. additional)	1,000,000
Mentor Teacher	1,000,000
Major At-Risk Student Funding	\$541,829,121
Total State K-12 Funding	\$7,033,220,624
At-Risk Student % of Total State K-12 Funding	7.7%

Virginia Board of Education Recommends \$600 Mil./Year in Standards of Quality Upgrades

- In 2016, BOE recommended SOQ funding changes - first since the early 2000's. Examined where local practices overwhelmingly exceeded state recognized staffing practices.
 - Localities on average spend 109 percent, or \$4.0 bil. beyond state SOQ requirements to meet SOL and SOA requirements.
 - Only 136,000 out of 200,000 K-12 positions (68 percent) employed by local school divisions are recognized by the SOQ; many support positions and other support costs de-funded after 2009; the “linear weighted average” methodology usually underfunds school district teacher’s salaries; real-time costs not always reflected in re-benchmarking.
- The Board of Education recommended the following changes to the SOQ:
 - Restoring the funding of support positions using prevailing practices rather than the 2009 enacted support position cap of 1 support per 4.27 SOQ funded teachers - \$340 million.
 - Require one school counselor for every 250 students in grades K-12 - \$82.4 million
 - Require one full-time assistant principal for every 400 students in grades K-12 - \$71.4 million
 - Require one full-time social worker for every 1,000 students - \$48.7 million
 - Require one full-time school psychologist for every 1,000 students - \$42.7 million
 - One full-time principal in each elementary school. 12 percent of schools have under 299 students and are only provided funding for a part-time principal - \$7.7 million (*in introduced budget for FY 20*)
 - Require one full-time school nurse for every 550 students - \$1.8 million
- New position standards *would* increase local match requirements for some localities.

Other Budget Issues of Importance to VFC

- **“Community Wealth Building”**: Continues \$7.5 mil./year TANF grants for community employment and training programs. **House adds \$3 mil./yr. and Senate \$2 mil./yr. for second round of grantees to apply.**
- Aid to Police Depts. (HB 599) funded at rate of GF growth in introduced budget, **Senate budget cuts FY 20 introduced budget proposal by \$7.2 mil.**
- Introduced budget established Statewide Grocery Investment Fund at \$3.75 mil. per year to expand access to health foods in underserved communities. **House deletes funding; Senate reduces by \$2.5 mil per year.**
- Continued funding: Brownfields Program (\$2.25 mil/yr.); Housing Trust Fund (\$5.5 mil./yr.); Rapid Re-housing (\$1.1 mil./yr.), or Derelict Structures Fund (\$1.5 mil./yr.).
- **Enterprise Zones** (\$12.8 mil/yr.). **Increased by Senate \$685,533/yr.**
- Go Virginia (\$24.45 mil/yr.) House \$5 mil. increases by FY 19 and \$10 mil. FY 20; Senate decreases by \$637,000 per year.
- CSA program increased 6.9% in FY 19 and 7.3% in FY 20, primarily accounting for Special Ed day placement growth. No change in GA budgets.
- Senate budget doubles telecommunications initiative to \$4 mil. per year.
- Senate eliminates 2% raise for state-supported local employees; House moves funding to 7/1/2019.

VFC Economic Stimulus/Tax Reform Committee

- The Virginia First Cities Coalition is creating a select “Economic Stimulus/Tax Reform Committee” to explore how best practice local programs -- with state help -- can assist economic and business development.
- The Select Committee will look at best practices employed by Virginia localities as well as practices in other states and localities throughout the country. Examples of new/best local economic development practices that build on existing strengths include:
 - The **“Better Block”** uses small, low cost interventions to prototype larger scale projects. Residents and stakeholders are able to co-create change and experience improvements as they go. It's a true alternative to the big project model; a more sophisticated approach with lower risk and higher returns.
 - **Oswego Renaissance Association** provides matching grants and resources to blocks of individuals wanting to invest in improving the look of their street. Addressing the real problem -- a shared lack of confidence in the neighborhood -- has paid huge returns.
 - What do you do when you realize your city is never going to be able to subsidize enough businesses to create the jobs you need? **“Economic Gardening”** for rapidly growing businesses at a fraction of the cost of traditional business handouts - an approach that focuses on growing jobs in existing businesses rather than paying a business to relocate to the community. **Most job creation comes from second stage businesses**, those that are beyond the startup phase but not yet at the size of a Stage 3 corporation. Stage 2 businesses, lead by entrepreneurs, would maybe like a handout, but they don't need it. What they desperately need -- is basic assistance growing their operation. Who are my competitors? What do they charge? What markets can I expand to?
 - **“Small Change”** - a little like crowdfunding, but for real estate - allows the regular investor to use their resources to invest in small scale projects, improvements that often don't neatly fit standard financing models.
- Virginia assists localities through a number of economic development programs administered by various agencies, including the Department of Housing and Community Development, Virginia Economic Development Partnership, VHDA, Virginia Small Business and Supplier Diversity, Virginia Department of Transportation, and Virginia Department of Rail and Public Transit.
 - Virginia First Cities is interested in whether improvements to these existing programs are warranted, or whether there are widespread local needs that currently could use additional state support to help them succeed.

Major State Agency Economic Development Agency Programs

DHCD Grant Programs	FY 19 Introduced
Go Virginia	\$24,450,000
Enterprise Zone Program	\$12,814,467
Housing Trust Fund	\$5,500,000
<i>VA Grocery Investment Fund (new proposal)</i>	<i>\$5,500,000</i>
Telecommunications Initiative	\$2,000,000
Removal of Derelict Structures	\$1,500,000
Rapid Re-Housing	\$1,100,000
Main Street Program	\$500,000
VDEP Grant Programs	
Va Development Opportunity Fund	\$19,750,000
Aerospace Manufacturing Performance Grant	\$6,130,000
Virginia Jobs Investment Program	\$5,669,833
Small Business Jobs Grant Fund Program	\$5,669,833
VA Investment Partnership Grant Fund	\$4,879,210
Economic Development Incentive grants	\$4,400,000
Motion Picture Opportunity Fund	\$3,000,000
Major Eligible Employer Grant	\$1,800,000
Cooperative Marketing Fund	
Brownfields Restoration	\$2,250,000
Other Programs	
Tobacco Revitalization Commission	
Virginia Rural Center	
DSBSD Business One-Stop Program	
VHDA, VA Small Business Financing Authority, Va Community Capital	
VA Tourism Authority	

State Economic Development Incentives

<u>Economic Development Incentive Programs</u>	<u>FY 10-16 Awards</u>	<u>Avg. Annual Awards</u>
Tobacco Region Opportunity Fund	\$142.7	31
Tobacco Commission Megasite Grant	\$102.8	4
Commonwealth Opportunity Fund	\$94.9	24
Virginia Jobs Investment Program	\$76.4	123
Enterprise Zone Real Property Grant	\$72.2	157
Transportation Partnership Opportunity Fund	\$43.7	2
Virginia Investment Partnership Grant	\$35.5	6
Advanced Shipbuilding Training Facility Grant	\$32.8	<1
Va Economic Development Incentive Grant	\$26.0	1
Motion Picture Opportunity Fund	\$22.9	5
Enterprise Zone Job Creation Grant	\$18.6	56
Economic Development Access Program	\$14.5	4
Rail Industrial Access Program	\$9.4	4
Commonwealth Research Commercialization Fund	\$7.6	24
Small Business Job Grant Fund	\$6.6	17
Agriculture and Forestry Industries Devel. Grant	\$2.9	11
VALET Program	\$2.4	24
Port of VA Infrastructure Grant	\$0.8	1
Coalfield Regional Opportunity Fund	\$0.7	<1
Virginia Tourism Growth Fund	\$0.5	4
Small Business Investment Grant Fund	\$0.2	2
<i>Source: Economic Development Incentives, JLARC, November 2017</i>		

Virginia First Cities Commonwealth Opportunity Fund Awards 2013-17

	<u>FY 13</u>	<u>FY 14</u>	<u>FY 15</u>	<u>FY 16</u>	<u>FY 17</u>	<u>Total</u>
Charlottesville						\$0
Danville		\$250,000			\$325,000	\$575,000
Hampton		\$200,000	\$300,000			\$500,000
Hopewell						\$0
Lynchburg	\$300,000	\$350,000		\$500,000		\$1,150,000
Martinsville						\$0
Newport News	\$250,000		\$2,000,000	\$150,000	\$2,000,000	\$4,400,000
Norfolk				\$7,725,000		\$7,725,000
Petersburg						\$0
Portsmouth						\$0
Richmond City			\$5,000,000		\$5,500,000	\$10,500,000
Staunton	\$100,000			\$250,000		\$350,000
Williamsburg						\$0
Winchester						\$0
Total VFC	\$650,000	\$800,000	\$7,300,000	\$8,625,000	\$7,825,000	\$25,200,000
Total COF	\$6,339,500	\$18,270,500	\$20,235,000	\$24,885,000	\$28,352,500	\$98,082,500
VFC % Total	10.3%	4.4%	36.1%	34.7%	27.6%	25.7%

Major Economic Development Tax Preferences

	<u>Cost</u>
Historic Rehabilitation Tax Credits	\$98,100,000
Data Center Equipment Sales Tax Exemption	\$74,500,000
Single Sales Factor Corp. Income Apportionment	\$59,000,000
Research and Development Sales Tax Credit	\$28,900,000
Coalfield Employment Tax Credit	\$25,000,000
Neighborhood Assistance Program Tax Credit for businesses and individuals that make a donation to community services, education, housing assistance, or job training. Tax credit is equal to 65 percent of the value of the donation.	\$17,000,000
Major Business Facility Job Tax Credit	\$4,300,000