

Virginia's Economic, Revenue and Budget Outlook



Virginia First Cities Coalition



Fiscal Analytics, LTD

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Virginia Has Strong Cash Balances and Reserves



- GF revenue growth of 14% in FY 21 and 16% in FY 22 driven by massive increases in money supply and federal fiscal stimulus.
- \$1.94 bil. FY 2022 surplus
 - \$900 mil. still available for appropriation -- incl. \$400 mil. for “tax cuts” and \$500 mil. “super deposit”
- On track for \$4.3 bil. in voluntary and Rainy Day Fund reserves.
- \$1 bil. in cash added to VRS Trust funds
- Budget is in structural balance. \$4.7 billion in carryforward balances from the 2020-22 biennium is pared with one-time spending items in the 2022-24 budget:
 - \$2.1 billion in cash for capital projects
 - \$1.13 bil. Rainy Day Fund deposit from FY 2021 revenues
 - \$850 million in school construction grants
 - \$313 million in WQIF
- Medicaid spending forecast for FY 2023 reduced by \$279 mil.

Massive Growth in Non-Withholding and Lower Refunds Generated a Large Surplus in FY 2022

	FY21 Actual Revenue	FY22 Forecast Revenue	FY 22 Forecast Growth	FY22 Actual Revenue	FY22 Actual Growth	
<i>Withholding</i>	\$14,012.9	\$15,267.2	9.0%	\$15,340.3	9.5%	
<i>Estimated Pay/Tax Dues</i>	\$5,217.0	\$5,346.6	2.5%	\$6,810.5	30.5%	
<i>Refunds</i>	<u>-\$1,926.2</u>	<u>-\$2,020.7</u>	<u>4.9%</u>	<u>-\$1,740.5</u>	<u>-9.6%</u>	
Net Individual Income	\$17,303.7	\$18,593.1	7.5%	\$20,410.3	18.0%	
Sales Taxes *	\$4,166.2	\$4,437.6	6.5%	\$4,558.1	9.4%	
Corporate Income	\$1,515.7	\$2,009.6	32.6%	\$1,978.7	30.5%	
Insurance	\$363.1	\$419.3	15.5%	\$426.8	17.5%	
Recordation	\$679.7	\$650.7	-4.3%	\$654.1	-3.8%	
All Other	<u>\$850.1</u>	<u>\$888.0</u>	<u>5.0%</u>	<u>\$907.0</u>	<u>6.7%</u>	
Total GF Revenue	\$24,878.5	\$26,998.3	8.5%	\$28,935.0	16.3%	
Transfers	\$758.6	\$803.9	6.0%	\$814.3	6.0%	
Total General Fund	\$25,637.1	\$27,802.2	8.4%	\$29,749.3	16.0%	
* Removes \$200m AST in June						

Current Economic Conditions Relatively Strong, but Storm Clouds on the Horizon

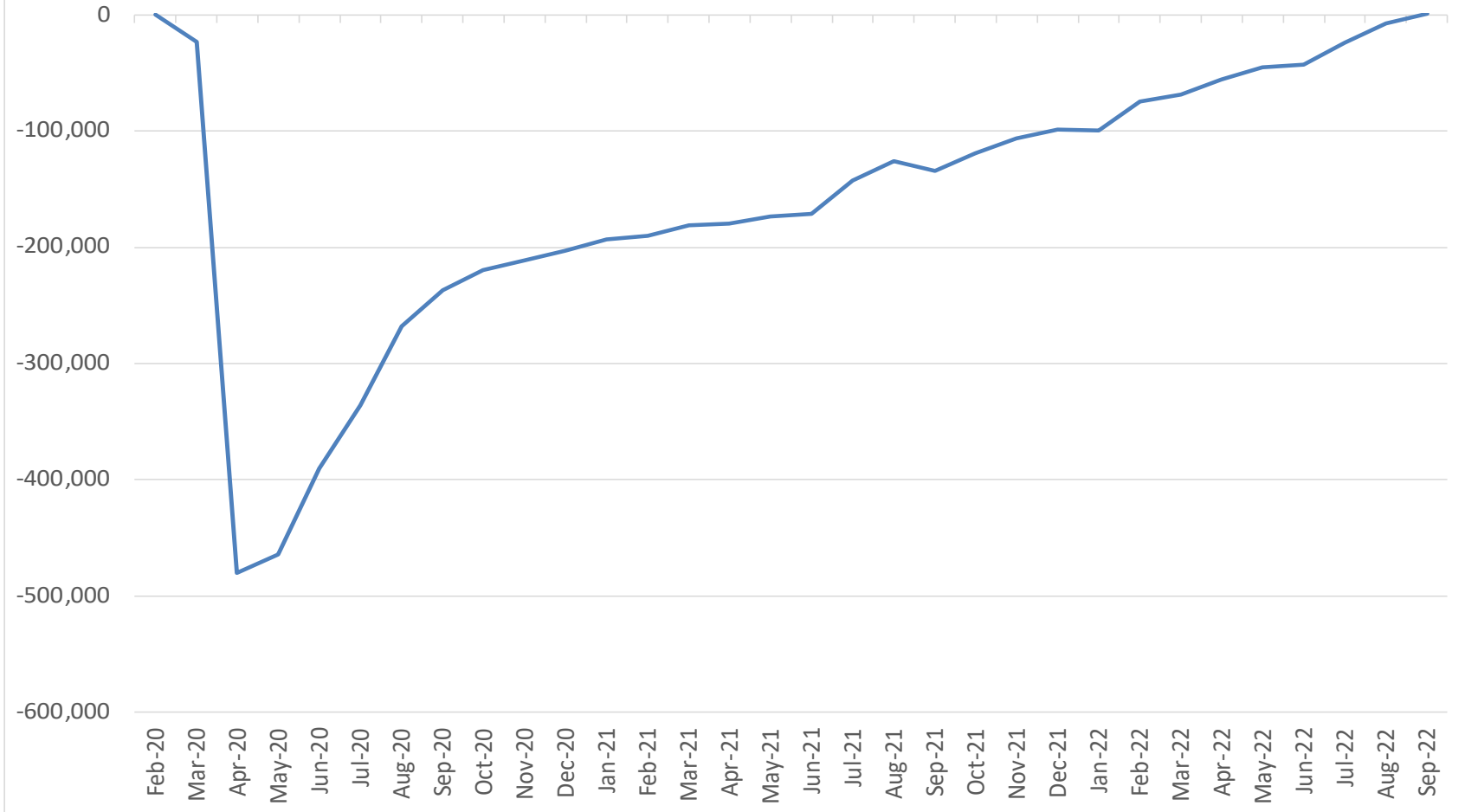


- Virginia unemployment rate was 2.6% in September versus 3.6% a year ago and the current U.S. rate of 3.5%.
- Virginia September non-farm payroll employment was 3.4% higher than a year ago.
- Household balance sheets are still in good shape, albeit historically high savings rates are normalizing and household debt is beginning to increase.
- Virginia new and continuing unemployment claims remain at historic lows (377 - Oct. 20).
- Consumer confidence has generally declined in 2022 as a result of high inflation and rising interest rates, which will remain strong headwinds to near-term growth.
- According to Fifth District Federal Reserve October surveys, both manufacturing and service sector activity weakened in October.

Virginia Is Still Growing Jobs, and Has Finally Recovered All Pandemic Losses



Cumulative Change in VA Nonfarm Employment



Economic Outlook for the 2022-24 Biennium

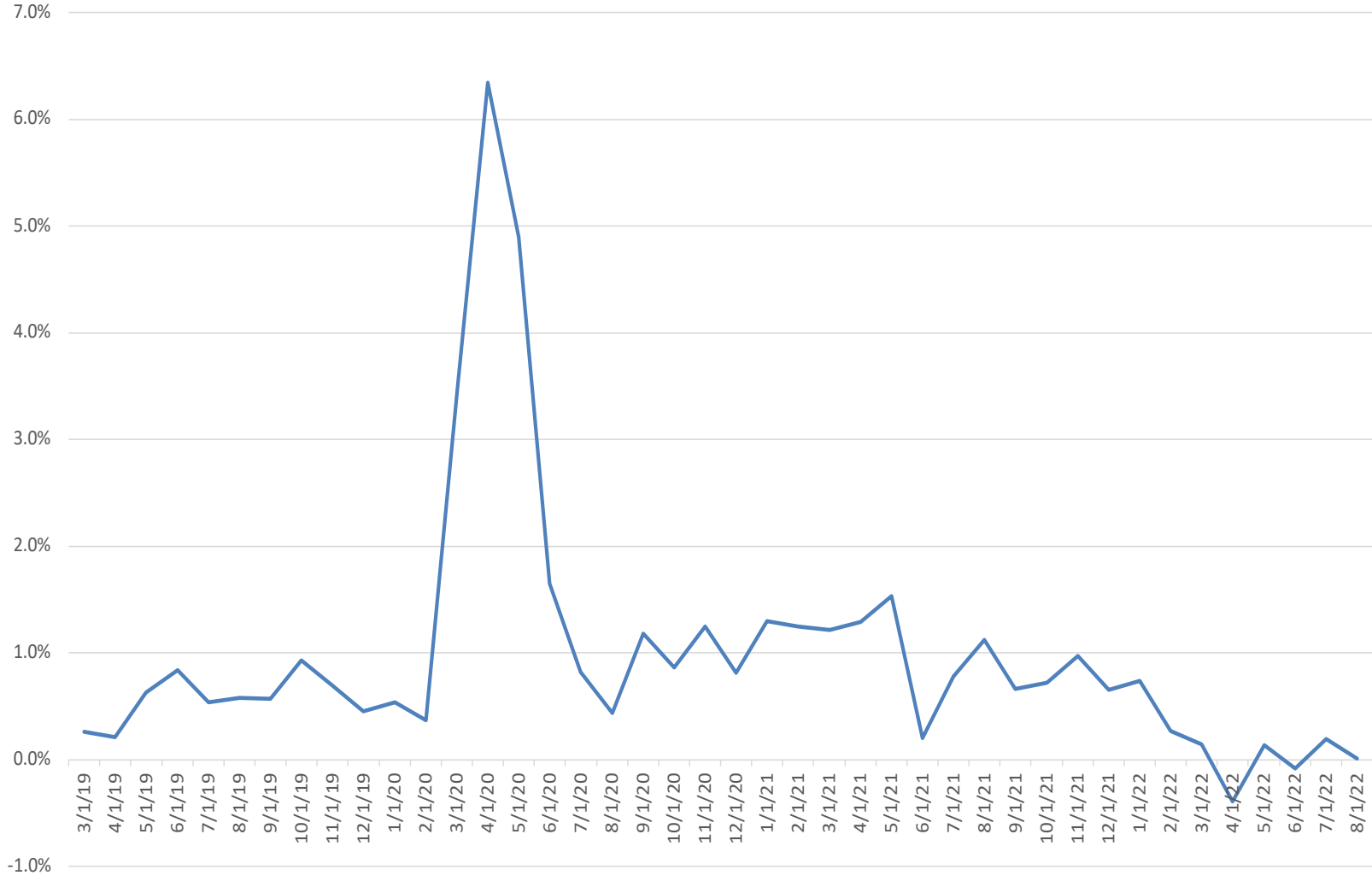


Who knows the answer to these questions: Where is inflation headed? Will there be a recession and if so, how bad? How will the war in Ukraine end? What is going to happen in Taiwan? What is the likely impact from the 2022 and 2024 elections?

“There are two kinds of forecasters: those who don’t know and those who don’t know they don’t know.” -- John Kenneth Galbraith

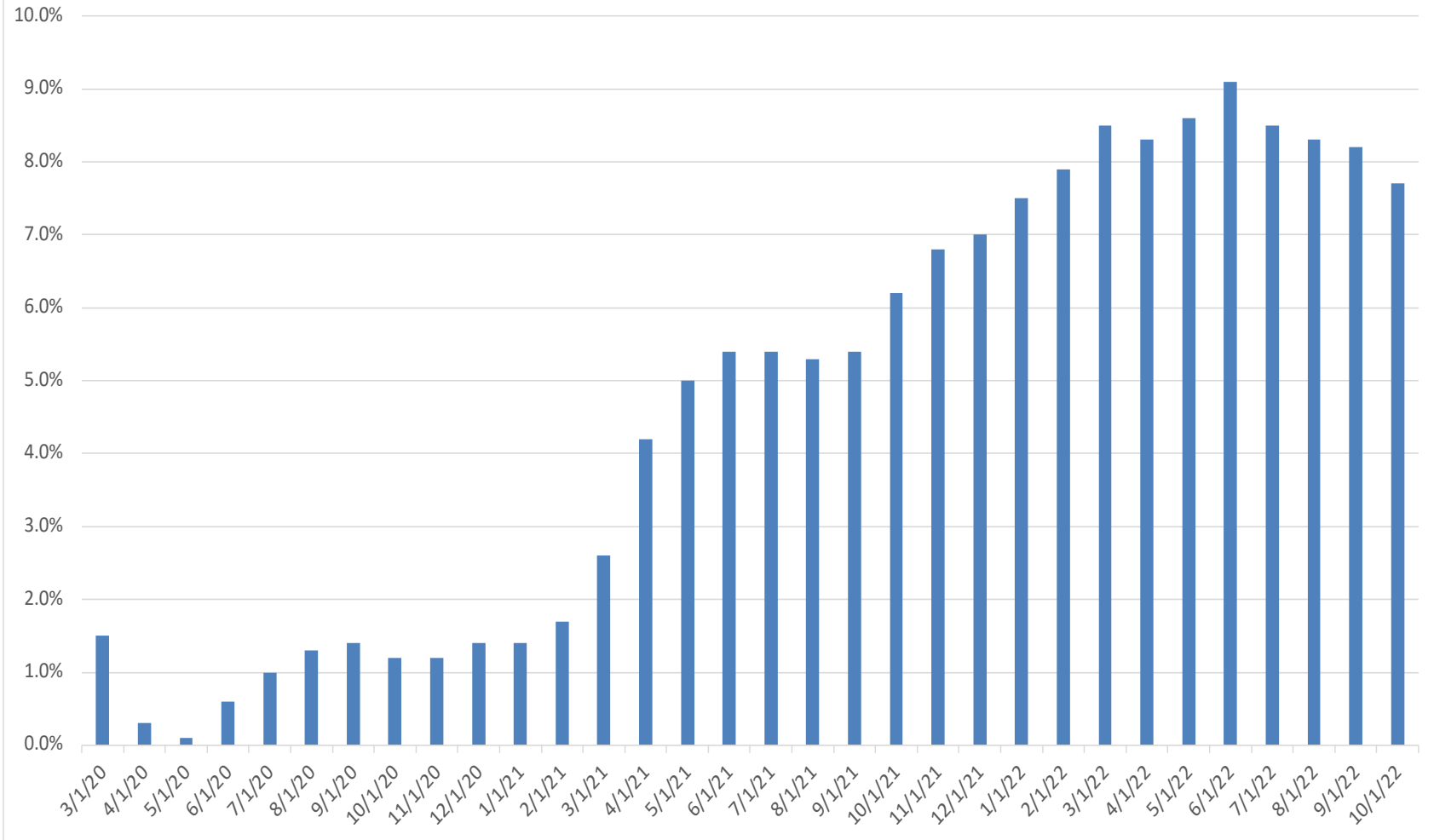
- Federal Reserve is tightening monetary policy and raising the risk of a recession in the 2022-24 biennium. Fed only has the blunt tools of raising interest rates and removing liquidity from the financial system to balance supply and demand. Which will...
 - Reduce aggregate demand for durable goods, such as autos and homes purchases.
 - Lower asset values for stocks, bonds, and homes, and reduce the “wealth effect”.
 - Increase the exchange rate for the dollar, which increases purchasing power to reduce inflation.
- Will Federal Reserve actions to reduce inflation result in a “soft landing” or recession? Soft landings very hard to achieve...interest rate increases are just starting to be felt in the housing and auto markets and renters beginning to see their budgets squeezed.
- Rising interest rates, volatility in stock market, war in Ukraine, etc. will keep economic/revenue forecasts conservative in a **‘show us the money’** mode.
 - Massive deglobalization of ‘just in time’ supply chains is beginning with consequences for economies (e.g. higher prices) around the world.

Change in M2 Money Supply, Seasonally Adj.



Source data: <https://fred.stlouisfed.org/series/M2SL#>

Consumer Price Index, 12 Mo. Chg



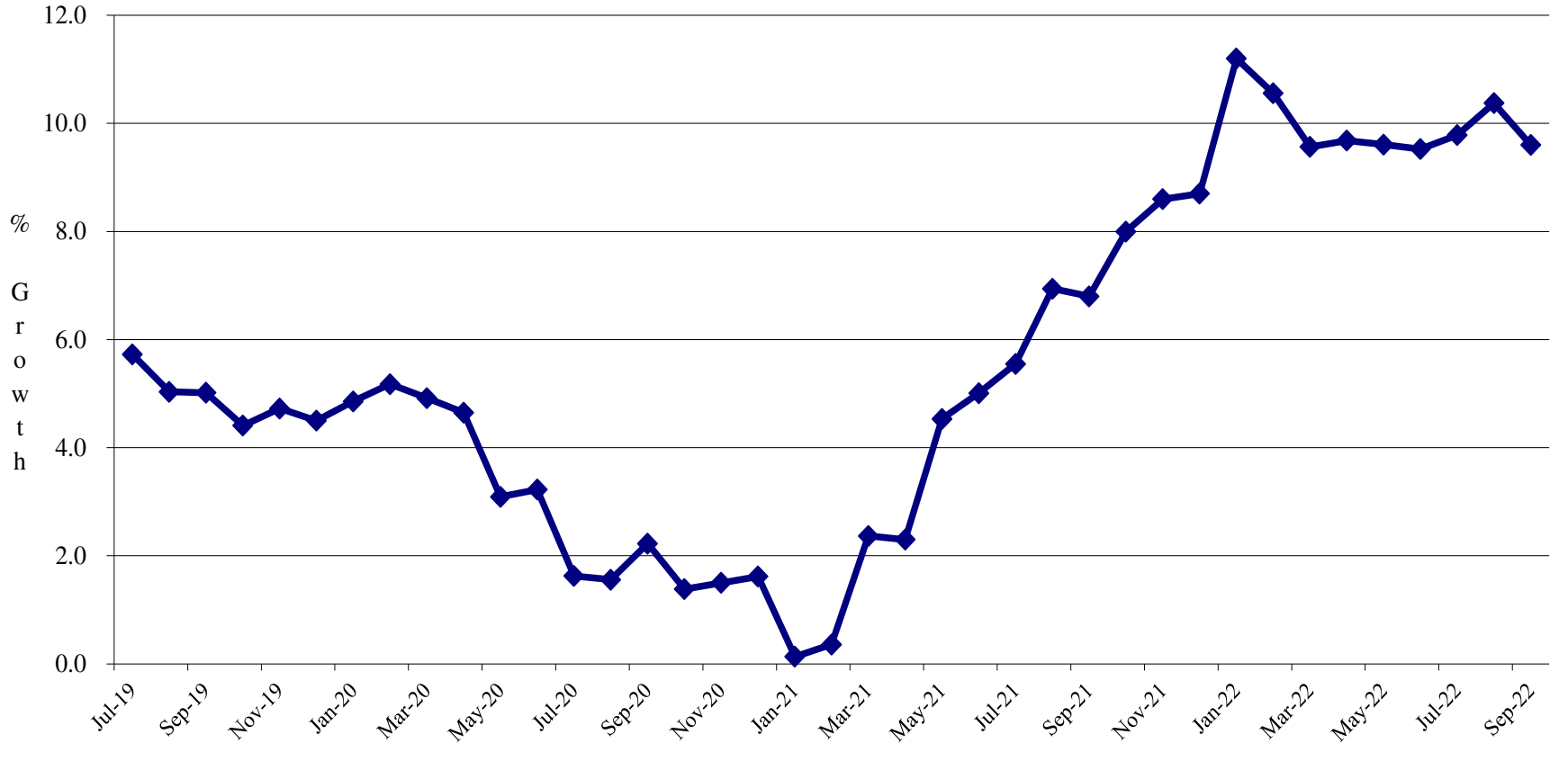
Source: <https://www.bls.gov/charts/consumer-price-index/consumer-price-index-by-category-line-chart.htm>

Expect a Higher 2022-24 Revenue Forecast



- Inflation should keep *nominal* growth in withholding and sales taxes higher than otherwise for the next year or two. For example, higher cost-of-living increases for social security; raises for federal, state and local workers, and higher pay increases in the private sector.
- As usual, Virginia should fare better than the nation in an economic downturn due to its higher federal government and military economic footprint.
- Expect nonwithholding income tax revenues to decline (how much is the question). However, note that official FY 2022 revenue forecast capped FY 2022 nonwithholding collections and did not adjust for lower refunds and thus did not include those revenues in the adopted spending budget.
- FY 2023 GF forecast of \$25.7 bil. would have been \$28.2 bil. without tax cuts, still well below \$29.7 bil. actual FY 2022 GF.

12 Mo. Moving Avg Income Tax Withholding Growth Remains Very Strong



Tax Policy Changes Expected to Reduce 2022-24 GF Revenues by \$3.7 Bil.



Tax Changes Adopted in the 2022 Session (\$ Millions)	<u>FY 2022</u>	<u>FY 2023</u>	<u>FY 2024</u>
Standard Deduction (Increase from \$4,500/\$9,000 to \$8,000/\$16,000)		-\$970.2	-\$665.1
Tax Rebate (\$250/\$500)		-\$1,048.6	
Refundable Earned Income Tax Credit (15.0 percent federal EITC)		-\$159.0	-\$156.0
Income Tax Subtraction on Military Benefits		-\$145.0	-\$156.0
Eliminate State Sales Tax on Groceries and Personal Hygiene Products		-\$107.3	-\$265.1
Eliminate Accelerated Sales Tax	-\$202.8		
Tax Conformity	-\$165.6	-\$35.6	-\$0.6
All Other	<u>\$15.0</u>	<u>-\$23.3</u>	<u>-\$11.2</u>
Total Tax Policy Changes	-\$353.4	-\$2,489.0	-\$1,254.0

Adopted GF Budgets by Secretarial Area

	Adopted	Adopted		Adopted	
	<u>FY 2022</u>	<u>FY 2023</u>	<u>\$ Change</u>	<u>FY 2024</u>	<u>\$ Change</u>
Legislative and Executive	\$156.4	\$173.8	\$17.4	\$173.2	(\$0.6)
Judicial Dept.	\$547.6	\$582.0	\$34.4	\$582.6	\$0.6
Administration/Comp Bd	\$789.2	\$886.3	\$97.1	\$892.3	\$6.0
Treasury Board Debt Service	\$853.5	\$954.2	\$100.7	\$994.6	\$40.4
Other Finance /VRS Deposit	\$918.5	\$180.0	(\$738.5)	\$170.7	(\$9.3)
Rainy Day Fund Deposit	\$498.7	\$1,127.7	\$629.0	\$0.0	(\$1,127.7)
Car Tax Reimbursement	\$950.0	\$950.0	\$0.0	\$950.0	\$0.0
Commerce and Trade/Labor	\$488.6	\$590.1	\$101.5	\$549.6	(\$40.5)
Agriculture / Nat. Resources	\$323.0	\$636.1	\$313.1	\$257.8	(\$378.3)
K-12 Education/DOE	\$7,252.7	\$9,091.4	\$1,838.7	\$8,611.7	(\$479.7)
Higher & Other Education	\$2,582.1	\$2,960.3	\$378.2	\$3,082.1	\$121.8
DMAS Medicaid	\$4,409.1	\$5,540.8	\$1,131.7	\$5,948.4	\$407.6
Other Health & HS	\$2,408.4	\$2,606.2	\$197.8	\$2,710.8	\$104.6
Public Safety & Veterans/HS	\$2,292.3	\$2,504.3	\$212.0	\$2,504.2	(\$0.1)
Transportation	\$342.5	\$51.5	(\$291.0)	\$110.0	\$58.5
Central Appropriations	\$336.2	\$451.1	\$114.9	\$732.5	\$281.4
Cash Reserve	\$650.0	\$0.0	(\$650.0)	\$0.0	\$0.0
Independent Agencies/Capital	<u>\$621.1</u>	<u>\$1,964.6</u>	<u>\$1,343.5</u>	<u>\$218.2</u>	<u>(\$1,746.4)</u>
Total GF Appropriations	\$26,419.9	\$31,250.4	\$4,830.5	\$28,488.7	(\$2,761.7)

Potential Tax Reduction Proposals by the Youngkin Administration



- Eliminate the remaining 1 percent local option on food for home consumption. Would proposal also backfill local loss with state GF (\$270 mil. per year)?
- Reduce the 6% corporate tax rate? Of 44 states, plus D.C. that impose a corporate income tax, 28 have equal or higher rates than VA. NC has a 2.5% rate, MD 8.25%.
- Adjust individual income tax rates- e.g. raise threshold levels.
- BPOL & M&T tax reduction proposals?
- Other?

Still Major Gaps in State K-12 Funding



- **State funding for instructional aides**
 - Out of 21,300 employed, only 2,837 aides were state funded in the SOQ in FY 2022. SOQ: If the average daily membership in any **kindergarten** class exceeds 24 pupils, a full-time teacher's aide shall be assigned.
 - Gap in SOQ funding is over \$400 million for local school divisions.
- **Only 920 assistant principals are funded by the state SOQ out of over 2,800 employed by school divisions.**
- **Resolving the gap in teacher supply**
 - Declining enrollment in teacher preparation programs - remove financial barriers to encourage potential teachers to enroll in teacher preparation programs
 - Find ways to provide teachers with the support they need to minimize burnout
- **\$270 mil. per year for full elimination of the support cost cap**
- **Additional school renovation and construction support**
 - At least \$25 bil. in documented needs.

Even With Large 2020-22 K-12 Funding Increases, K-12 State Per Pupil Funding Not Keeping Pace With Inflation



**2022-24 Adopted Budget State Per Pupil K-12 Direct Aid Funding
Nominal and Inflation-Adjusted (CPI \$2005)**



Appendix of New 2022-24 Spending Items



- For a complete summary of new spending items in the adopted budgets see:

http://sfac.virginia.gov/pdf/committee_meeting_presentations/2022/06012022_SFAC%20Overview%20Conference%20Budget.pdf

Major New One-Time K-12 Education GF Spending



- **\$450 mil. School Construction Assistance Program**
 - Grants would cover 10% to 30% of reasonable project costs up to \$100 mil. , depending on a locality's local composite index and fiscal stress score.
- **\$400 mil. School Construction Grants**
 - Each school division receives \$1 mil. with the remainder distributed by share of ADM modified by their respective LCI.
- Use GF rather than **Literary Fund** for school employee retirement costs (\$166 mil.)
- **Laboratory schools** deposit (\$100 mil.)
- **Hold harmless rebenchmarking** using pre-covid data (\$354 mil.)
- \$146 mil. to **Maintain FY 2022 VRS rates** instead of lowering based on usual methodology. (Higher VRS local match too)
- \$1,000 bonus with \$124.7 mil. in **ARPA** funds distributed based on SOQ funded teacher and support positions with no local match.

Major New Ongoing GF K-12 Education Spending (Biennial Amounts)



- **5% salary increases each year** for state funded SOQ teacher and support positions (\$730 mil.)
- **Offset loss of state sales tax on food** with \$361 mil. in GF
- Partial removal of **support position cap** – increased from 17 to 21 positions per 1000 ADM (\$272 mil.)
- Increase **at-risk add-on** from maximum 26% to 36% basic aid boost per free lunch each year. (\$145 mil.)
- Fund **reading specialists** at 1 per 550 K-3 students (\$63 mil.)
- Fund **principals** in each elementary school (\$20 mil.)
- Increase **VPI per pupil** from \$7,655 to \$8,359 (\$27 mil.)
- Expand **VPI access to three-year-olds** with additional slots: 1,138 FY 2023 and 1,374 FY 2024. (\$19 mil.)

Major New GF Health and Human Services Spending (Biennial Amounts)

- \$911 mil. increase in Medicaid utilization and inflation.
- \$689.4 mil. to increase Medicaid provider rates for developmental disability, personal care, home and community-based, dental, primary care, nursing facility, psychiatric residential treatment, obstetrics and gynecology, vision, and peer and family supports services
- \$248.5 mil. to fully fund the Medicaid and Children's Health Insurance Programs net of additional increases in federal match rates and revenue increases in the Health Care Fund;
- \$119.3 mil. for community behavioral health services, including full funding for STEP-VA, permanent supportive housing, crisis system intervention and other investments;
- \$76.0 mil. for state behavioral health facilities, including direct care staff compensation, expansion of therapeutic intervention and discharge planning, and other related facility costs; Increase Direct Care Staff compensation for behavioral health facilities

Major New Public Safety GF Spending (Biennial Amounts)

- \$113.0 mil. for public safety officer compensation including \$63.6 mil. for employees at the Department of Corrections and \$46.5 mil. for sworn officers at the Virginia State Police
- \$47.0 mil. for the Aid to Local Police Departments (“599”) Program;
- \$15.0 mil. for firearm violence prevention community-based grants;
- \$16.4 mil. for the Cannabis Control Authority operating budget, plus \$3.0 mil. GF for cannabis business loans;
- \$45.0 mil. for the School Resource Officer Incentive Grant Fund; and
- \$75.0 mil. **ARPA** funding for law enforcement equipment and training.

Major New Commerce and Trade GF Spending (Biennial Amounts)

- \$150.0 mil. for the Virginia Housing Trust Fund;
- \$159.0 mil. for the Virginia Business Ready Sites program, including \$50.0 mil. contingent;
- \$85.0 mil. for the Major Headquarters Workforce Grant Fund, including \$35.5 mil. contingent;
- \$66.7 mil. for investments in Virginia's biotechnology, life sciences, and pharmaceutical manufacturing industries (includes \$15.0 mil. for a pharmaceutical manufacturing cluster in Central Virginia, \$36.0 mil. for a statewide biotechnology initiative in partnership with the University of Virginia, and \$15.7 mil. for biotechnology business acceleration in southwestern Virginia);
- \$29.6 mil. in **ARPA** funds for water and wastewater improvements to support a pharmaceutical manufacturing cluster in Petersburg; and
- An additional \$5.1 mil. in **ARPA** funds for deposit to the Industrial Revitalization Fund.

Major New Natural Resources GF Spending (Biennial Amounts)

- \$313.0 mil. from FY 2021 surplus appropriated in FY 23 to support for the Water Quality Improvement Fund;
- \$21.1 mil. to support 19 historic and cultural attractions across the Commonwealth;
- \$17.6 mil. for a deposit to the Clean Water Revolving Loan Fund;
- \$10.0 mil. + \$10.0 mil. ARPA funds for high hazard dams;
- \$10.0 mil. in additional State Park operating support;
- \$12.0 mil. to increase support for the Virginia Land Conservation Fund; and
- \$5.0 mil. to establish a fund for the preservation of archaeological sites associated with Black, Indigenous, and People of Color.

Major New Transportation GF Spending (Biennial Amounts)

- \$110.0 mil. in FY 2024 to support the widening of I-64 to three lanes between Hampton Roads and Richmond, plus \$150.0 mil. from FY 2022 contingent surplus funding.
- \$41.5 mil. the first year to establish a State Trails Office to support the planning, development and construction of multi-use trails projects across the Commonwealth.
- \$5.0 mil. to expedite replacement of the Robert O. Norris Bridge;
- \$5.0 mil. to support long-distance commuter transit services through the Transit Ridership Incentive Fund

Other Major New Spending Items (Biennial Amounts)

- \$2.1 billion in GF cash for capital outlay
- Mandatory FY 23 Rainy Day Fund deposit reserved from FY 2021 surplus (\$1,128 mil.)
- \$750 mil. lump sum VRS deposit, plus \$250 mil. VRS deposit contingent on surplus appropriation.
- 5% salary increase each year for state employees, plus \$1,000 bonus (\$626 mil.)
- 5% salary increase each year for state-supported local employees (\$158 mil.)
- Targeted salary increases: VSP, DOC, DJJ, Sheriffs/RJ, DCP, DLS, DBHDS, Magistrates, et al (\$278 mil.)
- Appropriated FY 2024 Rainy Day Fund deposit based on FY 2022 surplus in (\$499 mil. – *additional amount will be needed*)
- Increase needed debt service funding (\$191 mil.)