

Virginia's Economic and Revenue Outlook



Virginia First Cities Executive Committee



Fiscal Analytics, LTD

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\$1.94 Bil. FY 2022 GF Revenue Surplus

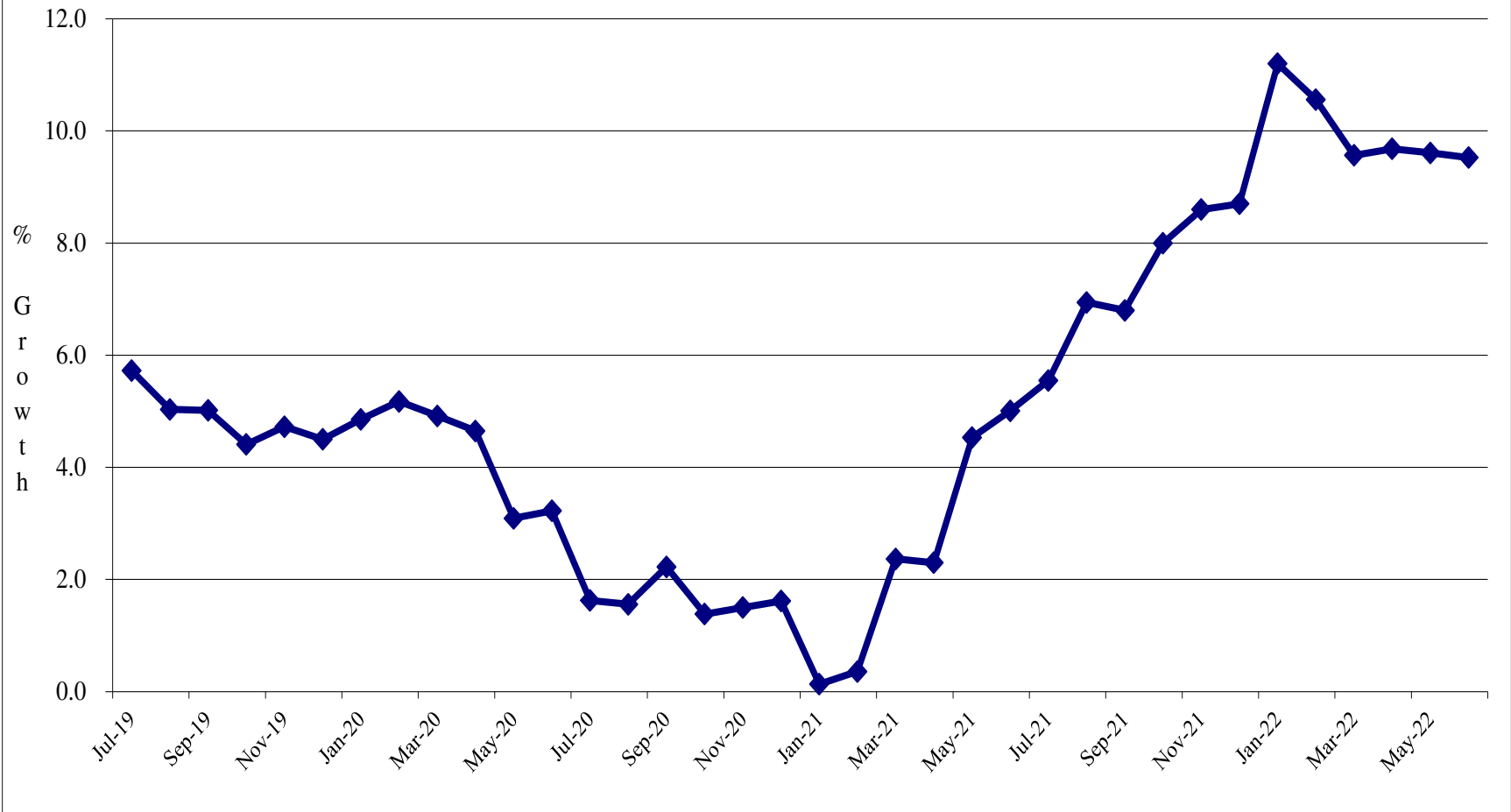


- **\$28.9 billion (16.3% growth) in FY 2022 GF revenue collections, including GF transfers - \$29.7 bil.**
 - Tax policy changes reduced collections by an estimated \$353 mil., including \$203 million in accelerated sales tax payments.
 - Most of the FY 2022 revenue surplus resulted from higher non-withholding income tax collections and lower refunds.
 - Unspent appropriations (balances) added to revenue surplus.
- **Adopted budget includes \$585.5 mil. in contingent appropriations**
 - \$250 mil. for VRS, \$150 mil. for I-64, \$100 mil. for capital supplement pool, \$50 mil. for business ready sites, and \$35.5 mil. for Major Headquarters Grant Fund.
- **Reserved additional \$400 mil. for RDF, plus another \$130 mil. WQIF deposit.**
 - Budget already provided a \$498.7 mil. advance deposit to the Rainy Day Fund for a total \$900 mil. deposit due to FY 22 revenues (\$1 bil. 2022 tax rebate was netted from FY 22 revenues).
- **Governor reserved remaining revenue surplus for a “super” deposit to RDF and future unspecified tax reform.**

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						

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

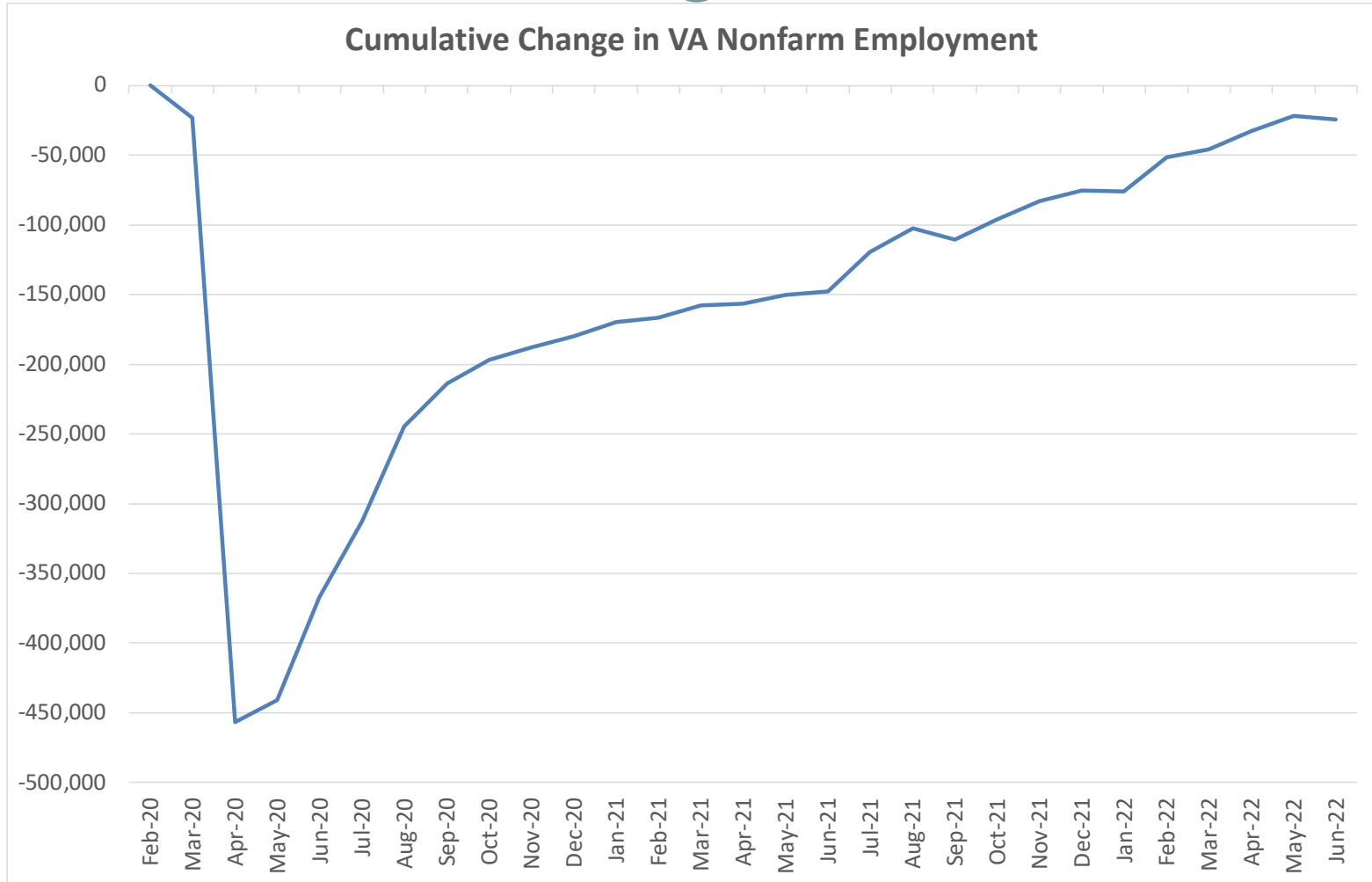


Current Economic Conditions Relatively Strong, but Storm Clouds on the Horizon



- Virginia unemployment rate was 2.8% in June versus 4.0% a year ago and the current U.S. rate of 3.6%.
- Virginia June non-farm payroll employment was 3.1% 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.
- Consumer confidence has declined, primarily as a result of the high inflation rate of 9.1% and rising interest rates.
- U.S. and Virginia new unemployment claims are still historically low, although beginning to rise.

Virginia Is Growing Jobs, But Still Hasn't Recovered All Pandemic Losses



Economic Outlook for the 2022-24 Biennium



- 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...
- 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.

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.
- The Commonwealth also has very healthy reserves and other financial levers it can pull in the event of an unexpected revenue downturn.
 - Rainy day fund and voluntary reserves total well over \$4 bil.
 - 2022-24 budget has \$2.1 billion in GF cash for capital outlay that could be delayed or converted to debt in the event of a revenue crisis.
 - \$1.0 bil. VRS deposit, including \$250 mil. contingent appropriation provides a pension cushion.

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

**FY 2023 GF Forecast Would Have Been \$28.2 Bil. Without Tax Reductions,
Still Well Below \$29.7 Bil. Actual FY 2022 General Funds**

	FY23 Forecast Revenue	Forecast % Growth Over FY 2022	FY24 Forecast Revenue	Forecast % Growth Over FY 2023
<i>Withholding</i>	14,791.1	-3.1%	15,775.5	6.7%
<i>Estimated Pay/Tax Dues</i>	5,213.6	-2.5%	5,573.0	6.9%
<i>Refunds</i>	<u>(3,272.1)</u>	<u>61.9%</u>	<u>(2,289.9)</u>	<u>-30.0%</u>
Net Individual Income	16,732.6	-10.0%	19,058.6	13.9%
Sales Taxes	4,497.8	1.4%	4,472.7	-0.6%
Corporate Income	1,737.0	-13.6%	1,784.9	2.8%
Insurance	406.1	0.0%	425.3	4.7%
Recordation	593.7	-3.1%	593.7	0.0%
All Other	<u>904.1</u>	<u>1.8%</u>	<u>927.8</u>	<u>2.6%</u>
Total GF Revenue	24,871.3	-7.9%	27,263.0	9.6%
ABC Profits	146.7	-17.6%	123.8	2.4%
Sales Tax (0.375%)	534.1	-5.1%	521.5	2.9%
Other Transfers	<u>123.1</u>	<u>-29.4%</u>	<u>87.9</u>	<u>1.2%</u>
Total Transfers to GF	803.9	-11.1%	733.2	2.6%
Total General Funds	25,675.2	-8.0%	27,996.2	9.4%

2022-24 Biennium Budget



- Budget reflects \$4.7 billion in carryforward balances from the 2020-22 biennium.
- Large new one-time spending items in the adopted 2022-24 biennium budget include:
 - \$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
- Significant increases in K-12 funding programs – See Appendix.
- Expect a significant upward GF revenue re-forecast for the 2022-24 biennium due to higher withholding and sales tax revenue than expected in the current adopted budget forecast – primarily due to inflation/cost-of-living-related salary and spending increases.

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)

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 from **ARPA** funds for SOQ funded teacher and support positions

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)

- \$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;
- \$109.0 mil. for the Virginia Business Ready Sites program (\$50.0 mil. contingent);
- \$85.0 mil. for the Major Headquarters Workforce Grant Fund (\$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)

- \$266.0 mil. to modernize and enhance capacity to the Norfolk International Terminal-North
- \$110.0 mil. in FY 2024 to support the widening of I-64 to three lanes between Hampton Roads and Richmond, plus \$210.0 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, plus \$37.5 million from FY 2022 contingent surplus funding;
- \$30.0 mil. from FY 2022 contingent surplus funding for improvements to the Mid-Atlantic Regional Spaceport;
- \$10.0 mil. from FY 2022 contingent surplus funding to support the extension of Nimmo Parkway in the City of Virginia Beach;
- \$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.)