



# Good Government Ventures, LLC

## COMMONWEALTH OF VIRGINIA STATE BUDGET REVIEW FY2020 & FY2021-2022

### EXECUTIVE SUMMARY

This review covers the enrolled FY2021/22 budget prior to re-convened session and final amendments.

1. Budget revenue assumptions made Dec '19 are overly optimistic given self-imposed economic shutdown.
  2. State officials now estimate a \$2 billion budget shortfall that has not been addressed.
  3. A \$2 billion shortfall would empty the total reserves accumulated during the past decade consisting of:
    - a) \$500-700 million beginning cash balance estimate (FY2021),
    - b) \$600 million Revenue Stabilization Fund (aka Rainy-day fund) and
    - c) \$1.0 billion Revenue Reserve Fund.
  4. Budget shortfalls during Great Recession of 2008-10 totaled \$6.7 billion (Goochland Gazette 9/15/16)
  5. Budget deficits and depleted reserves in 2017 led to “negative outlook”/potential downgrade from S&P.
  6. Budget expenses for unemployment compensation and healthcare are rising due to the current crisis.
  7. Duration/severity of pandemic will drive difficult decisions re austerity, deferrals, and tradeoffs.
  8. State code requires a balanced budget, but not a more fiscally responsible “structural balance”.
- Bottom Line: Pre-pandemic/pre-recession budget should be revised to reflect the new reality.

### I. REVENUE FORECAST

Revenue expectations have changed materially since the revenue forecast was done in December, 2019.

- U.S. President has declared a state of emergency given worldwide pandemic.
- VA Governor Northam has closed portions of VA’s economy impacting tax revenue activity.
- Stock market decline has reduced potential for capital gains tax revenue.
- Revenue declines expected in 3Q & 4Q of FY2020 would reduce begin cash balance in FY2021.
- Note: Each 1% decline in general fund revenue would equate to about \$220 million.

REVENUE (\$Billion)	FY2019	FY2020 (R)	FY2021(F)	FY2022(F)	3 Yr
General Fund	20.5	21.9	22.7	23.5	3.0B
<i>Growth Rate</i>		6.8%	3.7%	3.5%	14.6%

R= Revised, F= Budget Forecast.



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## II. VULNERABILITY TO AN ECONOMIC DOWNTURN

1) Emergency Measures: Emergency measures taken during previous downturn still linger.

Example: - Part III Miscellaneous Item 3-506 Accelerated Sales Tax collection.  
Pulls ahead July tax receipts from following year into current year budget.

2) Rainy Day funds: Combined balance of \$1.6 Billion vs combined cap of \$2.8 Billion (57% funded):

a) Revenue Stabilization Fund is about 21% funded.

Example: \$2.8 Billion = Cap at 15% x Average Tax Revenue (FY2019 CAFR, Financial Notes, p.92)  
\$0.6 Billion = Balance Forecast for RSF FY2020 (Approximate, Proposed Budget).  
\$2.2 Billion Shortfall

Note: In 2007 RSF was fully funded at \$1.2 Billion. Cap was 10% x Avg Tax Revenue.

b) Revenue Reserve Fund is 40% funded. Fund created after prior downturn.

Example: \$2.5 Billion = Cap for Revenue Reserve Fund (FY2019 CAFR, Financial Notes, p.92).  
\$1.0 Billion = Balance Forecast for RSF FY2020 (Approximate, Proposed Budget).  
\$1.5 Billion Shortfall

3) Unfunded Benefit Plans Amounts:

Example: Benefit Plans Funding as of 6/30/18 (from most recent VRS Annual Report – FY2019)

### PENSION

78% Pension liability funding level (\$19 billion underfunded)

Note: In 2007, Pension Plan was fully funded.

### OPEB Liability funding level (Plans with over \$2 Million assets)

83% Group Life

15% Retiree Health – State Employees

13% Retiree Health – Teachers

17% Retiree Health – Local

100% Retiree Health – Political Subdivisions

100% Sickness and Disability LT

4) Conservative Budgeting: Function of the underlying assumptions

Highlights of assumptions from November 2019 Senate Finance Com. budget meeting:

- Longest economic expansion on record (125 months so far).
- No recession predicted for next 3 years (2020, 2021, or 2022).
- Continued growth in General Fund Revenue for next three years.
- Medicaid spending to increase 7.2% (2021), 5.9% (2022)
- Budget was developed consistent with the prevailing wisdom at the time.
- Budget assumed the longest economic expansion would continue unabated.



### III. BUDGET IMPLICATIONS FROM ECONOMIC SHUTDOWN

1) Typical impacts:

- a) Lower sales tax revenue.
- b) Lower capital gains tax revenue.
- c) Lower corporate and personal income tax revenue.
- d) Higher unemployment insurance claims.
- e) Higher Social Services and Medicaid healthcare costs (pandemic).
- f) Greater unfunded liabilities from deterioration of VRS pension and OPEB asset portfolios.
- g) Potential pressure on state credit rating depending on duration of pandemic.

### IV. FOCUS ON ESSENTIAL CORE SERVICES

Total Budget FY2021 (General Fund + Non-general Fund) = \$67 Billion

ESSENTIAL SERVICES: Large Categories (\$44 Billion GF + NGF)

Expenditures if not made would endanger public health, safety, welfare and future viability of Virginia.

- 1) \$3.4 Billion. - Office of Public Safety and Homeland Security
  - a) State Police
  - b) National Guard
  - c) Homeland Security
  - d) Office of Veterans and Defense Affairs (\$200M)
- 2) \$21.9 Billion - Office of Health and Human Resources
  - a) Pandemic related expenditures.
  - b) Hospitals
  - c) Medicaid Expansion
- 3) \$21.6 Billion. – Office of Education operating budget
  - a) Pass through payments to Higher Education for tuition.
  - b) Local school subsidy.
  - c) Teacher Salaries
- 4) \$9.7 Billion. – Office of Transportation
  - a) \$1.9 billion VDOT maintenance budget (need to fill potholes).

### NONESSENTIAL: POTENTIAL REDIRECT TO ESSENTIAL SERVICES

Every expense is viewed as essential by its beneficiaries.

Administration is now projecting a \$2 billion budget shortfall.

Certain groups have been hit particularly hard by the pandemic crisis and are in need of targeted relief.

To balance the budget and provide targeted relief to first responders and healthcare professionals that are going above and beyond, discretionary expenditures could be identified and the funds redirected.



The following is one way this could be accomplished:

- 1) Determine magnitude of anticipated budget shortfall and targeted relief desired. This becomes the amount required to balance the budget and provide relief.
- 2) Prioritized expenditures to identify sources to meet the target amount.
- 3) Operating Budget: Prioritize expenses and identify items for potential deferral or elimination.

Examples:

- Discretionary travel and entertainment; conferences, overseas travel (even after ban lifted).
- New studies and new initiatives not in last year's budget.
- Discretionary Leisure and Recreation Services.
- Discretionary items in high growth budget categories growing faster than overall budget.

- 4) Capital Expenditures: Prioritize maintenance and safety related, review expansion related.

Examples:

- \$3.9 Billion VA Dept of Transportation: Expansion construction projects (not safety related).
- \$982 Million Capital projects for Education = Review new expansion construction projects.

## V. IF NO ACTION TAKEN TO REVISE BUDGET

1. Budget will not reflect the new reality, which is disingenuous at best.
2. Reserves will likely be depleted to sub-optimal levels.
3. Opportunity to provide leadership and make tough decisions in time of crisis will be missed.
4. Opportunity to provide targeted relief to first responders and healthcare workers will be missed.
5. Virginia's AAA credit rating will likely be put at risk.
6. Violates guidance on best practices in government from the Government Financial Officers Association.
7. Violates lessons learned from last downturn according to National Association of State Budget Officers.

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*Character is not made in a crisis -- it is only exhibited.*

*by Robert Freeman*