

Virginia's Revenue and Budget Outlook

November 17, 2022

Outline

1. 2022 Session and Special Session I Recap
2. General Fund Revenue Outlook
3. 2022-2024 Budget Pressures and 2023 Session Outlook

2022 Session and Special Session I Recap

2022 Special Session I Recap

- Increased reserve balances by more than $1.6 billion. Combined reserve balances will be nearly $3.8 billion by the end of FY 2023.
- Maintained liquidity and structural balance (included cash for capital, eliminated the AST, one-time spending, voluntary VRS deposit/rates, etc.).
- Large investments in the public workforce. Compensation increases totaled more than $1.8 billion, including:
    - Five percent pay raises in each year for all state and state-supported local employees, including teachers;
    - One-time $1,000 bonus for state employees and a $1,000 bonus from ARPA for SOQ funded teacher and support positions; and
    - Additional increases targeted at mental health and public safety positions.
- Investments in K-12 and higher education, mental health, Medicaid, housing, and natural resources.
- Tax policy actions totaled almost $4.1 billion over FY 2022 and the 2022-24 biennium, including a one-time rebate of $1.0 billion.
- Structural balance and prudent investments helped mitigate concerns by aligning spending with ongoing resources.

2022 Special Session I Recap: Major Spending

- Chapter 2 of the 2022 Acts of Assembly, Special Session I included $59.7 billion in general fund resources available for appropriation.

- New spending totaling approximately $10.7 billion was incorporated and included updates related to K-12 and Medicaid, compensation increases, and prioritized one-time spending.

- **Major spending included:**
  - $1.1 billion for a mandatory Revenue Stabilization Fund deposit in FY 2023;
  - $821.2 million for Medicaid utilization and inflation;
  - $800.0 million in FY 2023 for school construction and modernization;
  - $746.7 million for state share of a 5 percent salary increase in each year for state and state-supported local employees;
  - $729.6 million for a 5 percent salary increase in each year for teachers and support positions;
  - $698.4 million for Medicaid provider rates; and
  - $686.1 million for K-12 rebenchmarking and rebenchmarking impacts from COVID-19.

Chapter 1 & Chapter 2 Tax Policy Changes Assumed in Budget

($ in millions)	FY 2022	FY 2023	FY 2024	2022-24
Housing Tax Credit	$15.0	$0.0	$9.0	$9.0
Worker Misclassification Program		(0.2)	(0.5)	(0.7)
Eliminate Accelerated Sales Tax	(202.8)	0.0	0.0	0.0
Refundable Earned Income Tax Credit (15.0 percent federal EITC)		(159.0)	(156.0)	(315.0)
Veterinarian Sales Tax Exemption		(4.2)	(4.6)	(8.8)
Neighborhood Assistance Program		(3.0)	(3.0)	(6.0)
Tax Rebate ($250/$500)		(1,048.6)	0.0	(1,048.6)
Standard Deduction (Increase from $4,500/$9,000 to $8,000/$16,000)		(970.2)	(665.1)	(1,635.3)
Eliminate State Sales Tax on Groceries and Personal Hygiene Products		(107.3)	(265.1)	(372.4)
Income Tax Subtraction on Military Benefits		(145.0)	(156.0)	(301.0)
Individual/Corporate Income Tax Deduction for Business Interest Disallowed on Fed.		(15.3)	(10.9)	(26.2)
Teacher Deduction		(1.3)	(1.3)	(2.6)
Hardwood Management Tax Credit		(0.3)	(0.3)	(0.6)
Tax Conformity	(165.6)	(35.6)	(0.6)	(36.2)
Total	**($353.4)**	**($2,490.0)**	**($1,254.4)**	**($3,744.4)**

2022 Special Session I Recap: Savings Items

- New spending was offset by spending reductions totaling approximately $1.7 billion. Savings items were largely driven by forecast and enrollment changes.

- **Major savings items included:**
  - $389.2 million from Medicaid Forecast savings due to enhanced federal match rates;
  - $276.9 million from Health Care Fund revenue and Managed Care repayments;
  - $328.7 million from repurposed K-12 2020-2022 No Loss funding;
  - $167.5 million from K-12 Lottery Proceeds;
  - $158.0 million from sales tax adjustment for elimination of the grocery tax; and
  - $117.8 million from K-12 updates for enrollment and incentive programs.

Items Contingent on Additional Revenue

- Reserved $585.5 million GF contingent on revenue in excess of the official forecast in FY 2022 for the following items listed in priority order:

GF Contingent Items ($ in millions)	Amount
Deposit to Virginia Retirement System	$250.0
I-64 Improvements Between Exits 205 and 234	150.0
Virginia Business Ready Sites Program	50.0
Capital Supplements	100.0
Deposit to Major Headquarters Workforce Grant Fund	35.5
Total Contingent Items	**$585.5**

Virginia's ARPA State and Local Relief Funds Total $4.3 Billion with 99.6 Percent Appropriated

Spending Category ($ in millions)	FY 2022 Final Appropriation	FY 2023 & FY 2024 Appropriation	Total Appropriation	% of Virginia SLRF Allocation
Unemployment Assistance	$935.6	$17.6	$953.2	22.2%
CSOs, Wastewater & Drinking Water	355.8	348.4	704.1	16.4%
Broadband	487.5	9.5	497.0	11.6%
Public Health Initiatives	216.0	195.9	411.9	9.6%
Rebuild Virginia	380.0	0.0	380.0	8.9%
Mental Health & Substance Abuse Use Disorder	133.9	115.3	249.2	5.8%
Public Safety & Addressing Community Violence	132.2	100.1	232.3	5.4%
Education – K-12 & Other Education Ventilation	225.7	0.0	225.7	5.3%
Education – K-12	2.0	161.3	163.3	3.8%
Higher Education	161.0	0.0	161.0	3.7%
Utility Assistance	120.0	0.0	120.0	2.8%
Tourism & Other Small Business	83.8	34.6	118.4	2.8%
Other (Food Access, Parks, ARPA Reporting)	46.1	16.1	62.2	1.4%
Total	**$3,279.5**	**$998.8**	**$4,278.3**	**99.6%**
		SLRF Allocation	**$4,293.7**	
		Appropriated	**<u>$4,278.3</u>**	
Note: Totals may not sum due to rounding.		**Remaining Balance**	**$15.4**	**0.4%**

General Fund Revenue Outlook

FY 2022 Collections Exceeded Forecast by $1.9 Billion

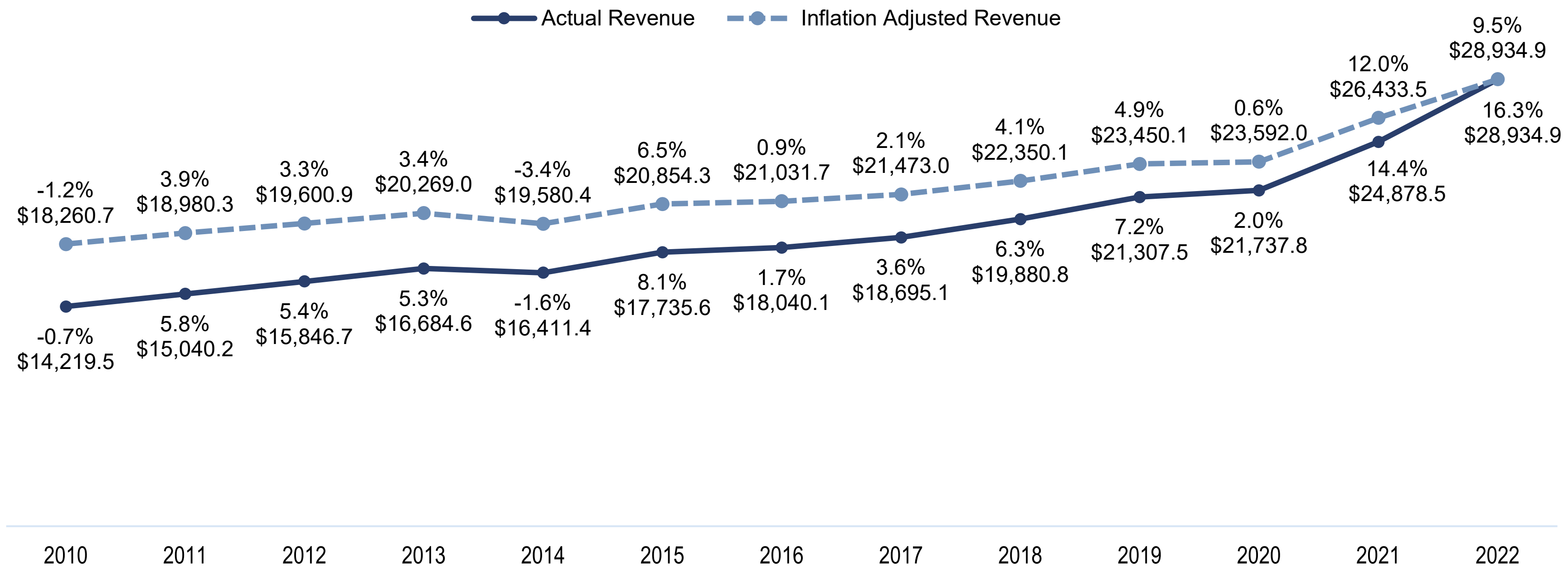
- FY 2022 actual GF revenues exceeded the official Chapter 1 forecast by $1.9 billion and exceeded the December 2021 official forecast by $3.1 billion.
  - Over 93 percent of the excess revenue was from individual income taxes. Nonwithholding made up 75 percent of the total excess revenue.

GF Revenue Sources	Percent of GF	Forecast Growth	Actual Growth	Variance to Official Forecast ($ in millions)
Withholding	53.0%	9.0%	9.5%	$73.1
Nonwithholding	23.5%	2.5%	30.5%	1,463.9
Refunds	(6.0%)	4.9%	(9.6%)	280.2
Net Individual	70.5%	7.5%	18.0%	**$1,817.1**
Sales	15.8%	6.5%	9.4%	120.5
Corporate	6.8%	32.6%	30.5%	(30.9)
Wills/Suits/Deeds	2.3%	(4.3%)	(3.8%)	3.4
Insurance	1.5%	15.5%	17.6%	7.5
All Other	3.1%	4.5%	6.7%	19.0
Total GF Revenue	**100%**	**8.5%**	**16.3%**	**$1,936.6**
Transfers	**2.7%**	**6.0%**	**7.3%**	**$10.4**
Total General Fund	**100%**	**8.4%**	**16.0%**	**$1,947.0**

**Excludes balance adjustments.*

Looking Back: FY 2022 Revenue Performance

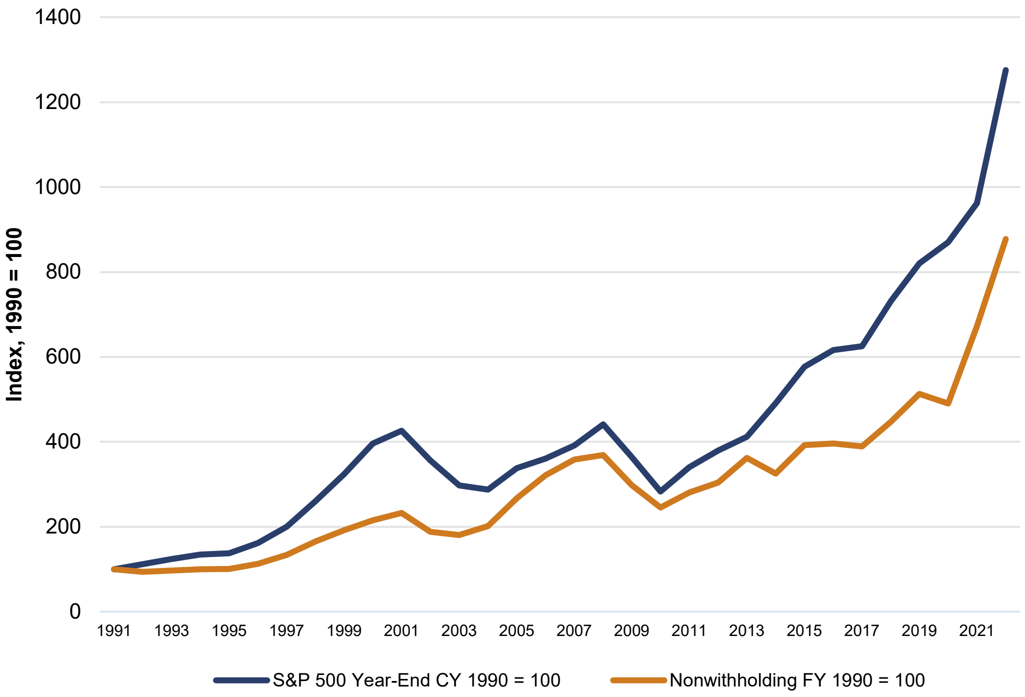
In FY 2022, nominal GF revenue collections grew 16.3 percent; however, inflation adjusted GF revenue collections grew 9.5 percent over FY 2021. ($ in millions and inflation adjusted to FY 2022 dollars)



Source: Staff analysis of the Secretary of Finance's Presentation to the Joint Money Committee on August 19, 2022. Inflation adjusted to FY 2022 dollars using the U.S. Bureau of Economic Analysis Gross Domestic Product Implicit Price Deflator, accessed September 13, 2022. Quarterly averages are used to calculate implicit price deflator by fiscal year.

Nonwithholding Income is Volatile and Largely Driven by Non-Wage Income Sources – Capital Gains

Nonwithholding Revenue and Stock Market Returns



Source: Virginia Department of Tax; Standard & Poor's (S&P).

- Nonwithholding income as a share of total GF revenues increased from 18 percent in FY 2018 to 24 percent in FY 2022.
- Nonwithholding income sources are generally not subject to withholding taxes (capital gains, self-employment income, dividends and interest, and partnership/Sub-S corporate income).
- Nonwithholding payments largely come in the final quarters of the fiscal year, making it difficult to adjust the revenue forecast.
- To conservatively forecast nonwithholding, a collar, the 10-year average of nonwithholding payments as a percent of total revenues, limited to 1 percent of GF revenue is applied.

SFAC Staff General Fund Revenue Outlook

An upward adjustment can be made in FY 2023 with a smaller adjustment in FY 2024.

- FY 2022 surplus created a substantially higher revenue base; however, Chapter 2 assumed downward revenue adjustments of $2.5 billion in FY 2023 and $1.2 billion in FY 2024 for tax policy actions.
- Year-to-date FY 2023 collections are well ahead of forecast with nearly $850 million "in the bank." Revenues, excluding transfers, could contract 18.1 percent from October to June and still meet the FY 2023 forecast.
- Economic outlook is increasingly pointing to the U.S. entering a recession in the next year. Federal Reserve continues to increase the Federal Fund Rates to achieve stable prices, which slows economic growth.
- Staff forecast incorporates the September standard (70 percent) and pessimistic (30 percent) forecast assumptions to mitigate risk with additional downward adjustments in nonwithholding.
- Year-to-date performance in withholding and sales tax supports a $2.2 billion upward adjustment shift in FY 2023; however, there is a risk in the second half of the fiscal year of an economic downturn.
- GF revenue growth is expected to moderate in FY 2024 to 3.4 percent, mainly driven by slower wage and job growth.

FY 2023: Adjusted YTD Revenue Collections are Ahead of the Official Forecast

Major Sources ($ in millions)	FY 2023 Ch 2 Forecast	Jul - Oct FY 2022	Jul – Oct FY 2023	% Change		Req Growth Nov - Jun
				Actual	Req by Est	
Withholding	$15,319.9	$4,704.4	$5,090.6	8.2%	(0.1%)	(3.8%)
Nonwithholding	5,213.6	1,070.4	1,211.8	13.2%	(23.4%)	(30.3%)
Refunds	(3,800.9)	(262.9)	(1,243.6)	373.0%	118.4%	73.1%
Net Individual	$16,732.6	$5,511.9	$5,058.8	(8.2%)	(18.0%)	(21.6%)
Sales & Use Tax	4,497.8	1,352.5	1,585.4	17.2%	(1.3%)	(9.1%)
Corporate	1,737.0	509.0	491.5	(3.4%)	(12.2%)	(15.3%)
Wills/Suits/Deeds	593.7	236.7	171.1	(27.7%)	(9.2%)	1.2%
Insurance	406.1	0.0	0.0		(4.9%)	(4.9%)
All Other	904.1	197.5	260.6	31.9%	(0.3%)	(9.4%)
Total GF Revenue	**$24,871.3**	**$7,807.6**	**$7,567.4**	**(3.1%)**	**(14.0%)**	**(18.1%)**
Adjusted Sales		$1,555.9	$1,658.6	6.6%		
Adjusted Refunds		(262.9)	(259.7)	(1.2%)		
Adjusted Withholding		4,704.4	5,140.6	9.3%		
Total Adjusted GF Revenues		**$8,011.0**	**$8,674.5**	**8.3%**		

- Adjusted year-to-date, GF revenues are $662.6 million, or 8.3 percent ahead of last year.
- Unadjusted GF revenues declined 3.1 percent and are $850.0 million ahead of the official forecast.

Source: SFAC Staff Analysis of Secretary of Finance Presentation to House Appropriations Committee, November 14, 2022.

2022 Special Session I Policy Actions: Adjusted FY 2023 Revenues Downward 14.0 percent

($ in millions)	FY 2023	FY 2024
GACRE Revenue Forecast - December 2021	**$27,339.6**	**$28,496.7**
Revenue Policy Adjustments		
Tax Conformity to ARPA	($30.2)	($0.6)
Eliminate State Sales Tax on Groceries and Personal Hygiene Products	(107.3)	(265.1)
Refundable Earned Income Tax Credit (15.0 percent federal EITC)	(159.0)	(156.0)
Tax Rebate ($250/$500)	(1,048.6)	0.0
Standard Deduction (Increase from $4,500/$9,000 to $8,000/$16,000)	(970.2)	(665.1)
Income Tax Subtraction on Military Retirement Benefits	(145.0)	(156.0)
Eliminate Sales Tax on Prescription Pet Medications	(3.8)	(4.1)
Individual/Corporate Income Tax Deduction for Business Interest Disallowed Federal (20 to 30%)	(15.3)	(10.9)
Sports Betting	16.0	20.0
Misc. - Neighborhood Assistance Program, Hardwood Management Credit, Teacher Deduction, Horse Race Wagering	(4.8)	(4.8)
Housing Opportunity Tax Credit	0.0	9.0
Total Revenue Policy Adjustments	**($2,468.3)**	**($1,233.7)**
FY 2022 Actual $28,934.9		
Total General Fund Revenues, excluding Transfers – Official Forecast (Chapter 2)	**$24,871.3**	**$27,263.0**
Total Revenue Growth over Prior Year	**(14.0%)**	**9.6%**

Economic Forecast Assumes Mild Recession

Projected Economic Variables - September Forecast			
% Change	FY 2022	FY 2023	FY 2024
VA Jobs			
Official (Oct '21)	2.8	1.1	0.8
Sept. Standard	3.2	2.7	0.2
Sept. Standard Minus		**2.5**	**-0.2**
Sept. Pessimistic		1.9	-1.1
VA Wages & Salary			
Official (Oct '21)	6.4	5.3	4.6
Sept. Standard	9.3	7.6	4.0
Sept. Standard Minus		**7.4**	**3.6**
Sept. Pessimistic		6.8	2.5
VA Personal Income			
Official (Oct '21)	4.6	3.9	4.3
Sept. Standard	3.6	5.5	4.3
Sept. Standard Minus		**5.3**	**3.9**
Sept. Pessimistic		4.8	3.1
U.S. Real Consumer Spending			
Official (Oct '21)	5.3	2.7	2.6
Sept. Standard	5.1	1.7	1.3
Sept. Standard Minus		**1.4**	**1.2**
Sept. Pessimistic		0.7	1.1
U.S. Consumer Price Index			
Official (Oct '21)	4.6	2.0	2.1
Sept. Standard	7.2	6.3	2.6
Sept. Standard Minus		**6.5**	**2.8**
Sept. Pessimistic		7.1	3.3

Source: *Virginia Dept. of Taxation; IHS Markit.*

- The September Standard was assigned a 50 percent probability while the pessimistic alternative was assigned a 35 percent likelihood.
  - Based on the discussion at the Joint Advisory Board of Economists meeting in early October, staff opted to use standard minus assumptions (70% standard/ 30% pessimistic).
- Job growth is expected to slow from FY 2022 and wage pressures are anticipated to moderate.
- Consumer spending is expected to soften.
- Economic projections - combined with “cash in the bank” - would call for an increased forecast for withholding and sales tax collections.

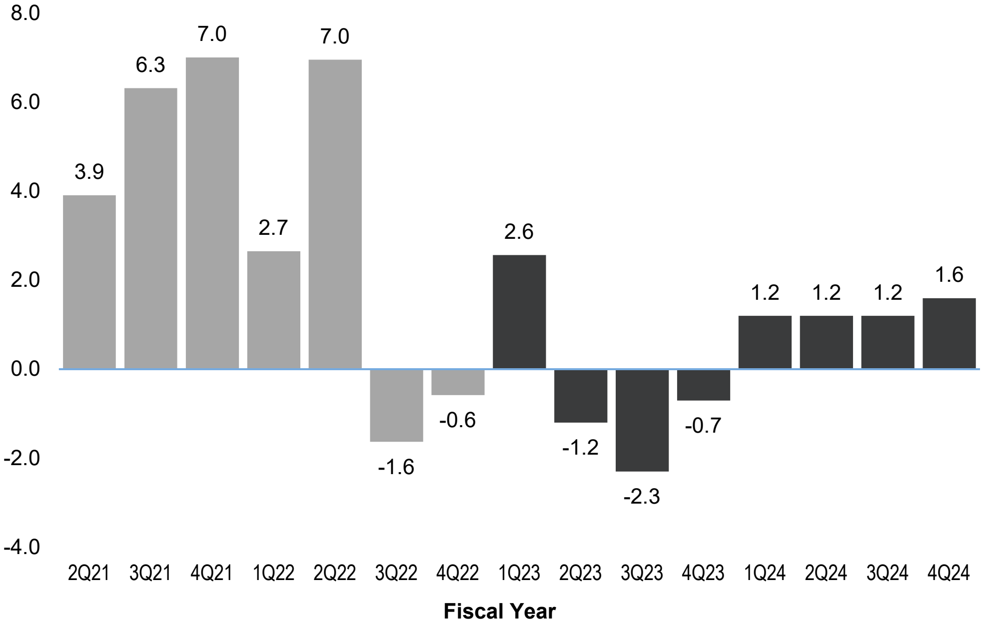
SFAC Staff General Fund Revenue Forecast

GF Revenue Sources	10 Year Average % of Total GF Revenue	Actual Growth	SFAC Staff Estimate	
		FY 2022	FY 2023	FY 2024
Growth by Revenue Source				
Individual Income	70.0%	18.0%	(12.0%)	4.7%
Sales	17.4%	9.4%	6.5%	(0.2%)
Corporate	5.0%	30.5%	(2.0%)	1.2%
Wills/Suits/Deeds	2.2%	(3.8%)	(20.3%)	0.0%
Insurance	1.7%	17.6%	9.2%	3.3%
All Other	3.7%	6.7%	3.5%	3.7%
Total GF Revenue Growth	**100.0%**	**16.3%**	**(6.7%)**	**3.4%**
General Fund Revenues		**$28,934.9**	**$27,007.3**	**$27,912.4**
Transfers		**814.3**	**764.1**	**766.6**
Total General Fund		**$29,749.2**	**$27,771.4**	**$28,679.0**
GF Resources Above Official Forecast		**$1,947.0**	**$2,185.4**	**$682.8**

U.S. GDP Growth is Expected to Decline

U.S. Real GDP growth is forecasted to decrease in the fourth quarter of 2022 and increase beginning in the third quarter of 2023.

Percentage Change, Annual Rate, Seasonally Adjusted



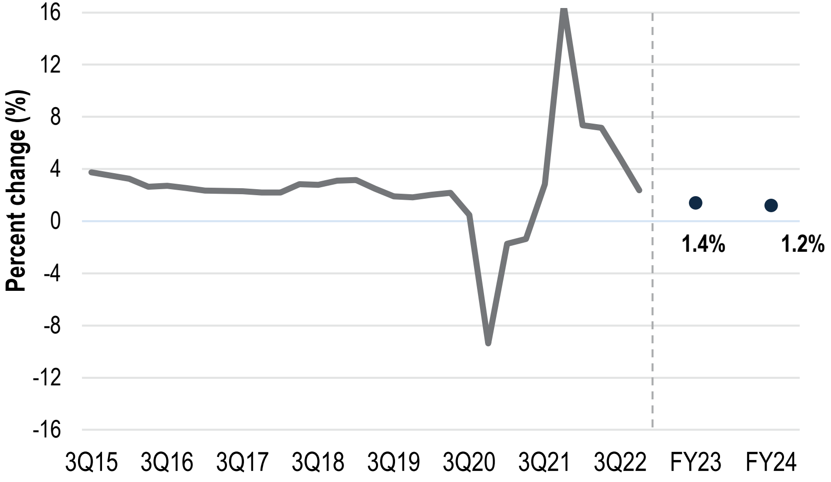
Source: Federal Reserve Bank of St. Louis. IHS Markit, October Standard Forecast.

- October Standard Forecast projected U.S. GDP to decline in the 4th quarter of CY 2022.
- Trade contributed 2.8 percentage points to 3rd quarter GDP growth in CY 2022, while fixed residential investments and inventories dragged growth.
  - Trade will become a drag on growth since a strong U.S. dollar will drive up trade deficit as exports become more costly.
- Consumer spending remained a source of growth in the 3rd quarter of CY 2022, a 1.0 percentage point increase, but has been contributing only modestly because of weak real incomes.
  - Services accounted for most of the contributions as spending for goods fell. Individuals also reduced spending on nondurable goods.

Continued Growth in Sales Tax Collections - Driven by Price Increases

Consumer spending expected to be flat, limited by growth in real income.

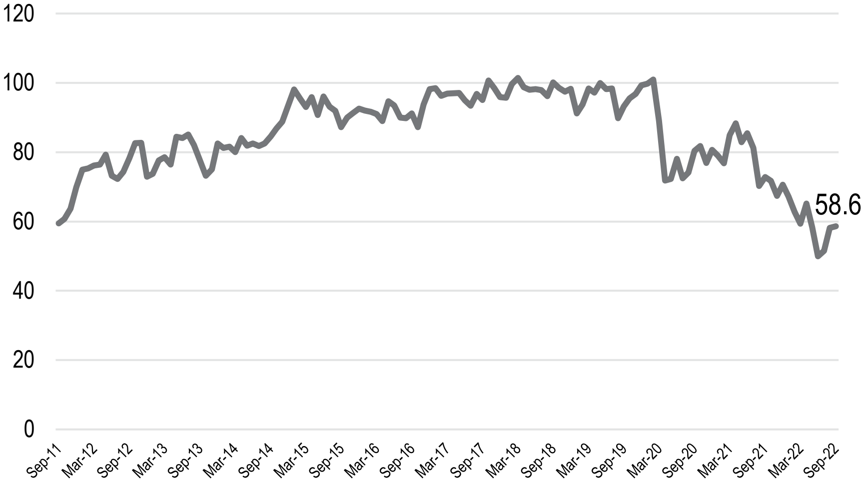
Growth in real US personal consumption expenditures, SAAR



Source: Federal Reserve Bank of St. Louis; Virginia Dept. of Taxation; IHS Markit.

Consumer sentiment remained strikingly low in September.

Index, 1966:Q1=100



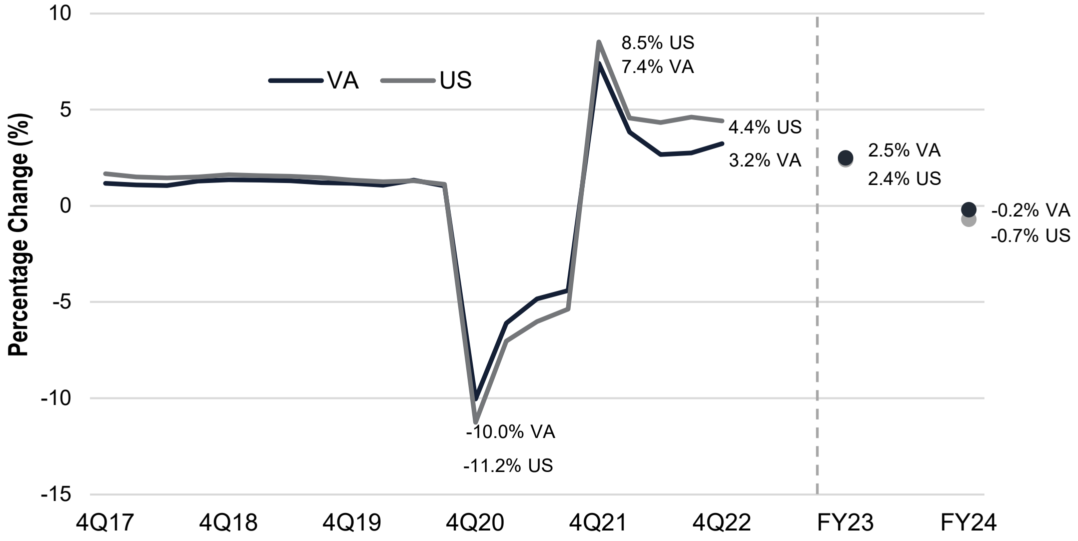
Source: Federal Reserve Bank of St. Louis; University of Michigan Consumer Sentiment.
** Board of Governors of the Federal Reserve System, Z.1 Financial Accounts of the United States.*

- Growth in real consumer spending is slowing from high prices; however, higher prices increase sales tax collections.
- Consumer confidence remains low and a potential risk if consumers pull back on spending. However, household liquidity is still high at $5.0 trillion.*
- Staff estimate sales tax, adjusted for AST repeal, to increase 6.5 percent in FY 2023 and decline 0.2 percent in FY 2024.

Virginia's Job Growth Lags the U.S., but Declines Are Not As Severe

Jobs are expected to grow slightly in FY 2023, but contract in FY 2024 **(Standard minus).**

Year-over-year growth in nonfarm employment.



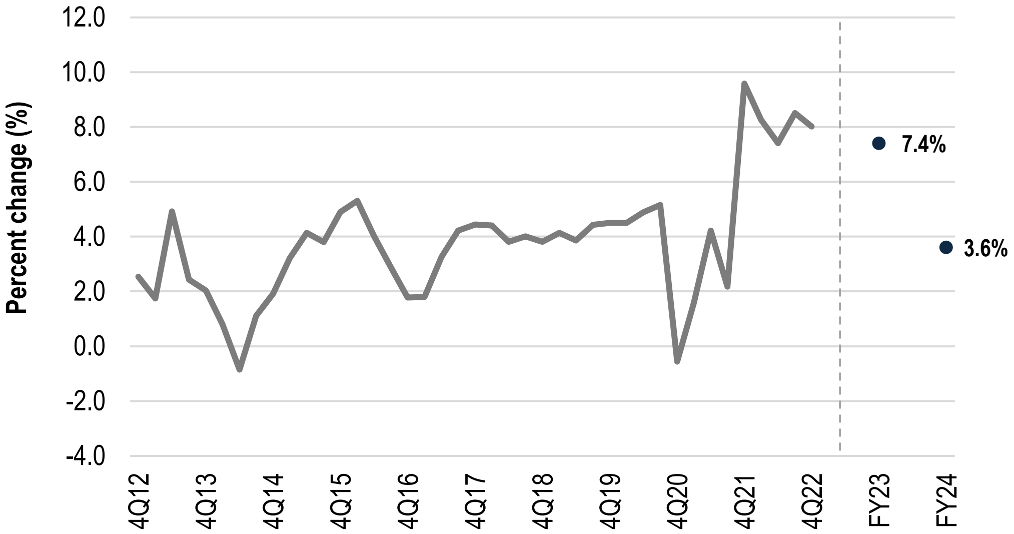
Source: U.S. Bureau of Labor Statistics; Virginia Dept. of Taxation; IHS Markit. Seasonally adjusted total nonfarm employees.

- As of September, Virginia has recovered 100.0 percent of non-farm jobs lost since February 2020 while the U.S. recovered 100.3 percent.
- Labor market remains very tight with U.S. openings increasing and fewer employers laying off employees in September. Quits have modestly been trending downwards.
- Virginia's unemployment rate was 2.6 percent in September with the U.S. rate at 3.5 percent.
  - Virginia's unemployment rate is down one percentage point on a year-over-year basis.
  - Virginia's lower rate is a product of weaker growth in our labor force participation.
- Both the standard and pessimistic forecasts predict that Virginia will outperform the nation in employment, especially if the U.S. economy enters a recession.

Wage Growth Supports Continued Growth in Withholding Collections

Wages & Salaries are expected to grow, but at a slower rate in FY 2024.

Year-over-year growth in VA Wages & Salaries

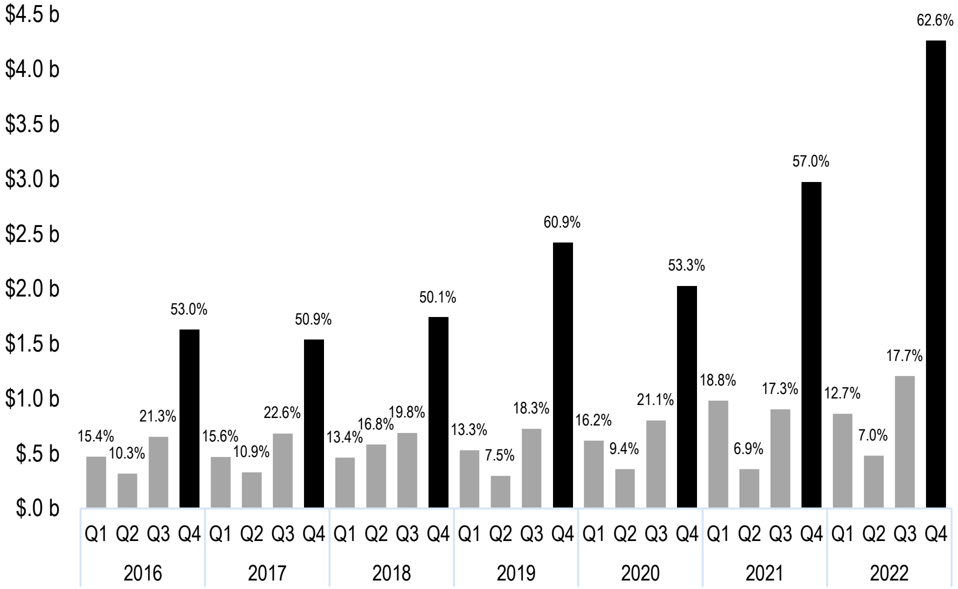


Source: Federal Reserve Bank of St. Louis; Virginia Dept. of Taxation; HIS Markit.

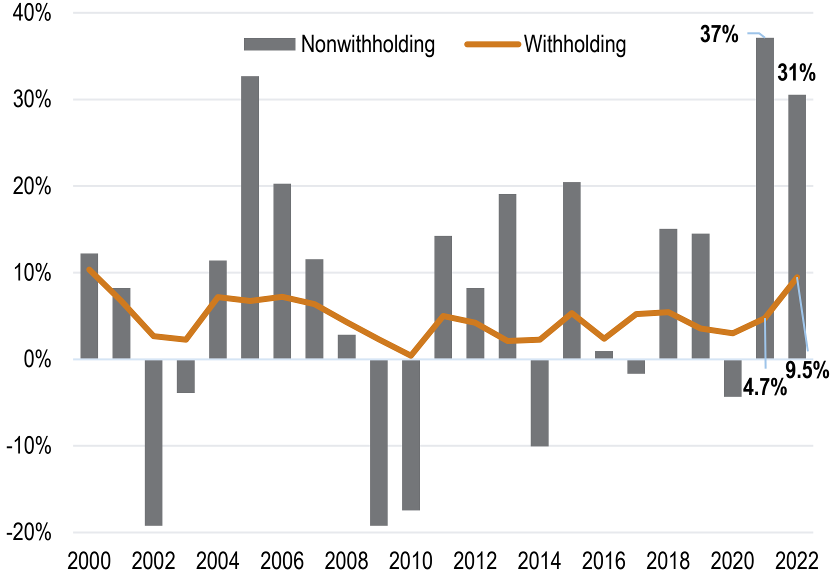
- Job market remains stable in Virginia.
- Job growth may contract with a recession but increases in average wages support continued growth in payroll withholding.
- Staff anticipates withholding collections, after adjusting for the standard deduction increase, to increase 1.9 percent in FY 2023 and 1.3 percent in FY 2024.

Nonwithholding Remains the Greatest Risk to Forecast

Nonwithholding income tax payments are heavily backloaded to the 3rd and 4th quarters of the fiscal year.



Nonwithholding income tax collections year over year revenue growth varies compared to withholding.

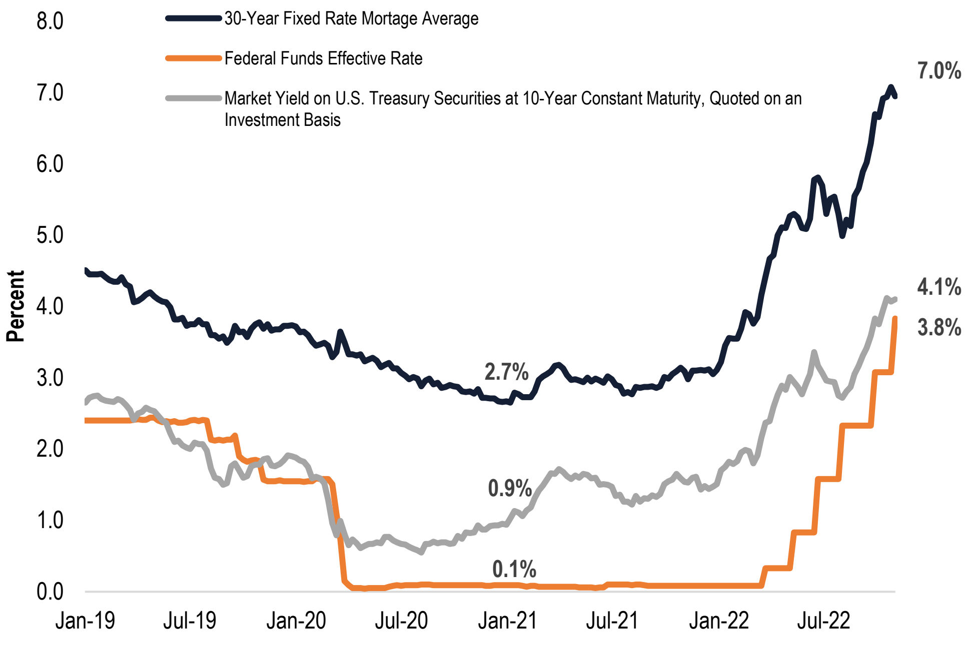


Source: SFAC Staff Analysis of Virginia Department of Tax Revenue Data.

- Staff forecasted nonwithholding conservatively, using the collar with an additional downward adjustment to account for larger FY 2022 base.

Recordation Revenue Expected to Decline as Home Sales Slowdown due to High Mortgage Rates

The Federal Reserve increasing the federal funds rates has increased mortgage rates to 7.0 percent and the 10-YR yield on Treasury Securities to 4.1 percent.



Source: Federal Reserve Bank of St. Louis. Rates as of week ending November 4, 2022.

- Mortgage rates have doubled just in the past year and are currently at levels not seen since 2000.
  - Higher rates, induced by the Federal Reserve rate hikes, have slowed refinancing activity and homes sales.
- Virginia REALTORS Association reported September's home sales decreased 23.1 percent compared to last year with $4.5 billion sold, a 20.3 percent or $1.1 billion decline from last year.
- Staff anticipates substantial reduction in recordation revenues in FY 2023 and limited growth in FY 2024.

Potential Risks to the Revenue Outlook

- Recessions ultimately are a loss of faith: consumers lose faith that they will have a job and pull back on spending; businesses lose faith that there will be demand for the goods or services they provide, and they lay off workers.
- There are both upside and downside risks to the forecast; however, downside risks are the predominant ones:
  - Labor demand drops and layoffs increase;
  - Stock market continues to decline and timing of (reduced) profit taking from investment markets;
  - Corporate debt meltdown;
  - Inflation remains high;
  - War in Ukraine;
  - Supply chain disruptions; and
  - Consumers pull back on spending.

2022 Revenue Forecasting Schedule

- **August 5:** Governor's Advisory Council on Revenue Estimates (GACRE) met to discuss labor and economic conditions with Virginia business leaders and General Assembly leadership.
- **October 12**: Joint Advisory Board of Economists (JABE) reviewed economic projections for the current biennium.
- **November 21:** GACRE will review the Administration's revenue forecast for the 2022-2024 biennium.
- **December 15:** Governor submits revised forecast and proposed amendments to Chapter 2, 2022-2024 biennial budget.

Tax Policy Outlook

Tax Conformity

- Conforming to tax provisions in the Inflation Reduction Act of 2022 would result in GF revenue reductions of $210,000 in FY 2023 and $300,000 in FY 2024 (Virginia Dept. of Tax, October 18, 2022).
    - Virginia also conformed to provisions of the American Rescue Plan Act excluding student loan forgiveness from gross income for Taxable Year 2021 through 2025. The one-time student loan debt forgiveness program, announced by President Biden on August 4, 2022, would be exempt on the Virginia income tax return.

Tax Preferences Outlook

- In October, JLARC presented 11 options to increase progressivity in Virginia's individual income tax.
- Joint Subcommittee on Tax Policy will meet on December 12th to discuss JLARC options and tax preferences.
- General Assembly members have expressed interest in increasing Virginia's standard deduction from $8,000/16,0000 to $12,500/25,000 ($1.3 billion FY 2024) and eliminating the local one percent sales tax on food for human consumption and personal hygiene products ($267.8 million FY 2024).

2022-2024
Budget Pressures and 2023 Session Outlook

2023 Session: *Amending the Adopted Budget*

- In odd-numbered sessions, action is taken to amend the previously adopted biennial budget for the current and next fiscal year.
  - Current budget (Chapter 2, 2022 Special Session I) covers July 1, 2022 through June 30, 2024 (i.e. FY 2023 and FY 2024).
  - FY 2024 will be the base year for developing the 2024-26 biennial budget.
  - On December 15th, the Governor will present the introduced budget for the 2023 Session to the General Assembly.

Agency GF Requests Total Over a Billion Dollars for the Biennium

Secretarial Area ($ in millions)	**FY 2023**	**FY 2024**
Administration	$1.6	$30.0
Agriculture & Forestry	0.0	7.0
Commerce & Trade	9.4	37.6
Education	19.9	158.8
Executive Offices	0.7	6.0
Finance	1.1	3.0
Health & Human Resources	3.6	201.8
Independent Agencies	0.0	0.0
Judicial	0.03	13.5
Labor	5.6	7.4
Natural Resources	21.7	154.1
Public Safety & Homeland Security	2.0	144.3
Transportation	160.6	10.6
Veterans & Defense Affairs	0.6	13.4
Grand Total	**$226.8**	**$787.5**

- GF position increase requests total over 1,300 (mainly Public Safety, Higher Education, Natural Resources and HHR).
- Request categories included the following (GF amounts):
  - Workload changes ($108.8 million);
  - Emergencies ($10.7 million);
  - IT ($46.2 million);
  - Mandates ($19.6 million);
  - New spending ($605.9 million);
  - Efficiencies or service reductions ($3.0 million);
  - Reorganizations ($4.3 million);
  - Salary increases or regrades ($49.7 million);
  - Other spending ($137.0 million); and
  - Unavoidable cost adjustments ($28.9 million).

Outstanding Debt and Capital Outlay Requests

GF/Tax Supported Debt Capital Project Requests 2022-24 Biennium		
($ in millions)	**Total**	**GF/Tax Supported Portion**
Equipment Projects Nearing Completion	$22.5	$22.5
Acquisition/Demolition/Planning	16.0	15.4
Improvements/Renovations	995.3	863.4
New Construction	4,561.9	3,784.2
Supplements – Cost Escalations/Overruns	103.1	97.3
Maintenance Reserve/Deferred Maintenance	94.1	74.1
Grand Total	**$5,792.9**	**$4,856.9**

Source: Staff analysis of Department of Planning and Budget, Agency Capital Requests accessed November 14, 2022.
** Department of Treasury, as of June 30, 2022.*

- Outstanding Tax-Supported Debt – 9(b), 9(c), and 9(d) – totals $13.0 billion.*
  - $1.1 billion is General Obligation Debt.
  - $11.9 billion is revenue/appropriation backed 9(d).
- Authorized but unissued tax-supported debt totals $4.7 billion.*
  - Debt service appropriations will need to be adjusted as interest rates rise.
- During the 2022 session, the General Assembly prudently only authorized an additional $363.8 million in debt even though debt capacity would allow almost $1.1 billion to be issued in each fiscal year.
  - Debt capacity model will be updated in December, but capacity is sensitive to actual forecasted revenues and interest rates.

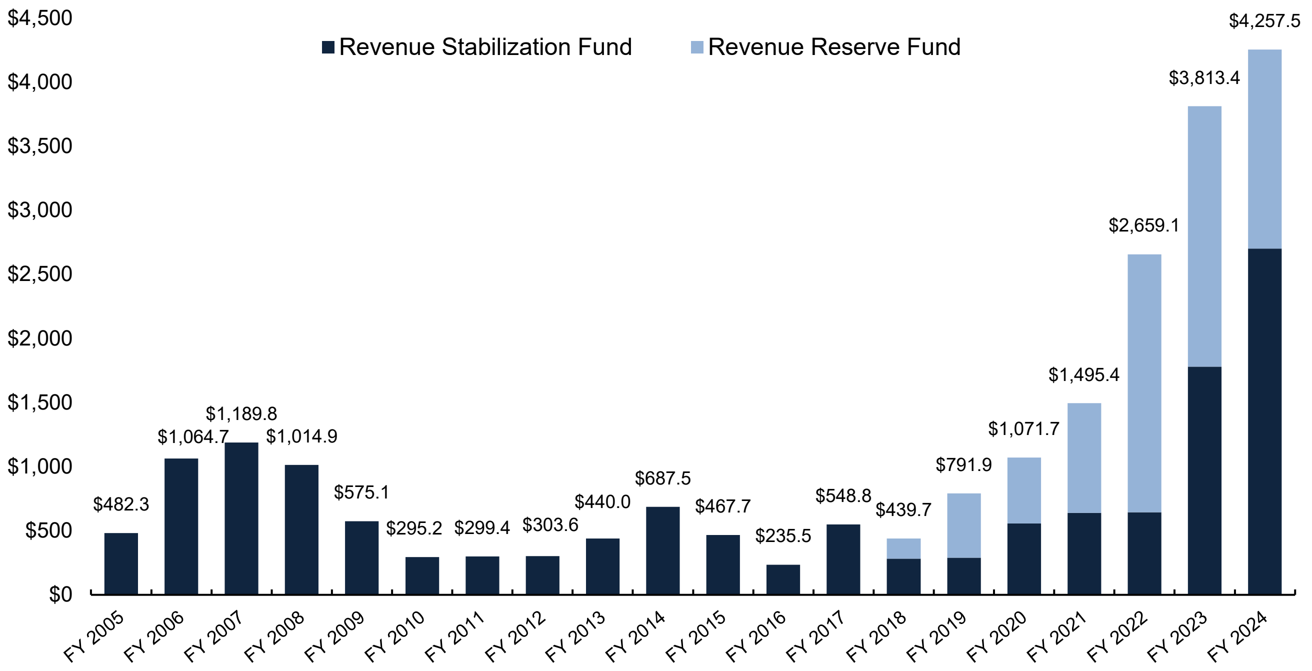
FY 2022 Cash Year-End Balances are Restricted, Committed, or Assigned on the Preliminary Balance Sheet

General Fund Preliminary Balance Sheet Assignments ($ in millions)	
Balance Sheet – Restricted, Committed, or Assigned	
Balance of Rainy Day Deposit (Chapter 1 deposited $498.7 million to the Revenue Reserve Fund in FY 2022 as an advance reservation for the required 2024 deposit to the Revenue Stabilization Fund. The Auditor of Public Accounts certified a required Revenue Stabilization Fund deposit of $904.7 million in FY 2024.)	$406.0
Potential "Super Deposit" to the Rainy Day Fund	452.3
VRS Payment	*250.0*
I-64 Project	*150.0*
Virginia Business Ready Sites — Reserved pursuant to Chapter 2, Item 485. L	*50.0*
2022 Capital Supplement Pool	*100.0*
Major Headquarters Workforce Grant	*35.5*
Mandatory Reappropriations	807.7
Discretionary Reappropriations	380.1
Water Quality Improvement Fund Deposit (Part A - $88.8 million; Part B - $42.2 million)	131.0
Amount for Additional Taxpayer Relief	396.9
Total	**$3,159.5**

- **However, except for Constitutionally-mandated deposits to the Revenue Stabilization Fund ("Rainy Day Fund"), the General Assembly has the authority to decide if and how to appropriate these set-asides.**

Reserve Balances Projected to Total $4.2 Billion by FY 2024

Combined Balances of Revenue Stabilization Fund and Revenue Reserve Fund
($ in millions)



- To calculate the mandatory deposit for FY 2024, the Department of Accounts reduced FY 2022 certified tax revenues by the total 2022 Tax Rebate amount, $1,048.6 million.
  - In 2019, Item 3-5.21 of Chapter 854 of the 2019 Acts of Assembly explicitly directed the total amount of the 2019 Tax Rebate to be excluded from FY 2019 certified revenues; however, similar language was not included in either Chapter 1 or Chapter 2 for the 2022 Tax Rebate.
- Excluding the 2022 Tax Rebate amount, the Auditor of Public Accounts (APA) calculated a deposit of $904.6 million, the amount restricted on the Preliminary Balance Sheet.
- Without excluding the 2022 Tax Rebate amount, APA calculated the mandatory FY 2024 deposit to be $1,554.9 million, which is $650.2 million more than the amount restricted on the Preliminary Balance Sheet.

Source: SFAC Staff Analysis of Secretary of Finance Joint Money Committee Presentation, August 19, 2022. Pursuant to Item 274 C.1 of Chapter 1, of the 2022 Acts of Assembly, Special Session I, the Comptroller deposited $498.7 million to the Revenue Reserve Fund as an advance reservation for the required 2024 deposit to the Revenue Stabilization Fund, which is displayed. Excludes the $452.3 million potential FY 2023 "Super Deposit" to the Revenue Stabilization Fund reserved on the 2022 Preliminary Annual Report.

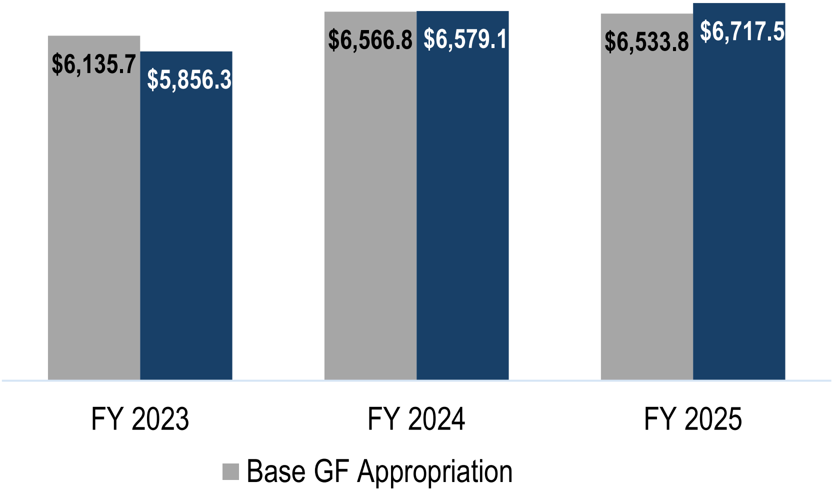
Major Budget Pressures/Commitments

2022-2024 Funding Commitments/Budget Pressures ($ in millions)	**FY 2023**	**FY 2024**
Capital Outlay Additional Project Supplements (materials and wage inflation)	$0.0	$250.0
High Priority Economic Development Projects & Investments	165.0	11.5
Salary Compression/Adjustments (does not include additional targeted increases)	1.5	48.2
DMAS Backfill Health Care Fund Estimate	0.0	44.1
VSP VCIN Solution, Helicopter Replacements, VITA Transformation	0.0	42.4
K-12 SOQ Enrollment & Technical Updates	40.3	42.1
DBHDS Crisis System Investments	0.0	39.8
Unavoidable Cost Adjustments	6.1	20.9
DMAS Contract Cost Escalations, Transportation, Correct Early Interv. Serv. Rate	0.0	7.4
VDH State Match for Drinking Water Infrast. Projects & Backfill Trauma Fund	0.0	8.4
Higher Education Operations/Maintenance & Capital Outlay Equipment	0.0	29.1
DOC Inmate Medical Cost Increases	0.0	13.2
Other High-Priority IT Projects	0.0	7.1
Higher Education Mental Health Requests	3.0	6.4
Target Comp & Salary Increase at 1% for State/State Support. Local & Teachers	0.0	127.3
TOTAL	**$215.9**	**$697.9**

Medicaid Forecast Reflects Additional Savings from Federal Matching Funds and Lower Managed Care Rates

Forecast projects a net $267.0 million in GF savings for the 2022-24 Biennium. A need of $150.7 million GF is estimated in FY 2025, which falls outside this biennium.

(Dollars are in millions.)



- The Medicaid Forecast projects a **net savings of $279.3 million GF in FY 2023** and an additional **need of $12.3 million GF in FY 2024**. This is due to:
  - One-time savings from the higher federal match rate for two additional quarters in FY 2023 due to the extension of the federal public health emergency, which continues the 6.2 percentage point increase in the federal match rate.
  - Lower than projected managed care rates in FY 2023.
  - Reflects unwinding of higher enrollment resulting from the federal requirement to continue health care coverage, beginning in the second half of FY 2023.
- Forecast anticipates overall Medicaid spending will increase:

	FY 2023	FY 2024	FY 2025
Current Forecast	**13.1%**	**3.2%**	**2.9%**
Last Year's Forecast	1.0%	5.4%	N/A

Budget Outlook 2023 Session

Comparing projected resources to spending needs

- Available resources from the SFAC forecast are sufficient to cover major budget pressures. However, there are many other items that would typically be considered.

2022-2024 Budget Outlook

($ in millions)	FY 2023	FY 2024	2022-24
SFAC Staff Projected GF Resources	$27,771.4	$28,679.0	$56,450.4
Official Forecast Chapter 2 (Revenue +Transfers)	(25,586.0)	(27,996.2)	(53,582.2)
Resources Above Base	$2,185.4	$682.8	$2,868.2
Less: Medicaid Forecast	279.3	(12.3)	267.1
Less: K-12 Sales Tax	(84.8)	(84.2)	(169.0)
Less: Major Budget Pressures/Commitments/High Priorities	(215.9)	(697.9)	(913.8)
Net Available Resources*	**$2,164.0**	**($111.6)**	**$2,052.5**

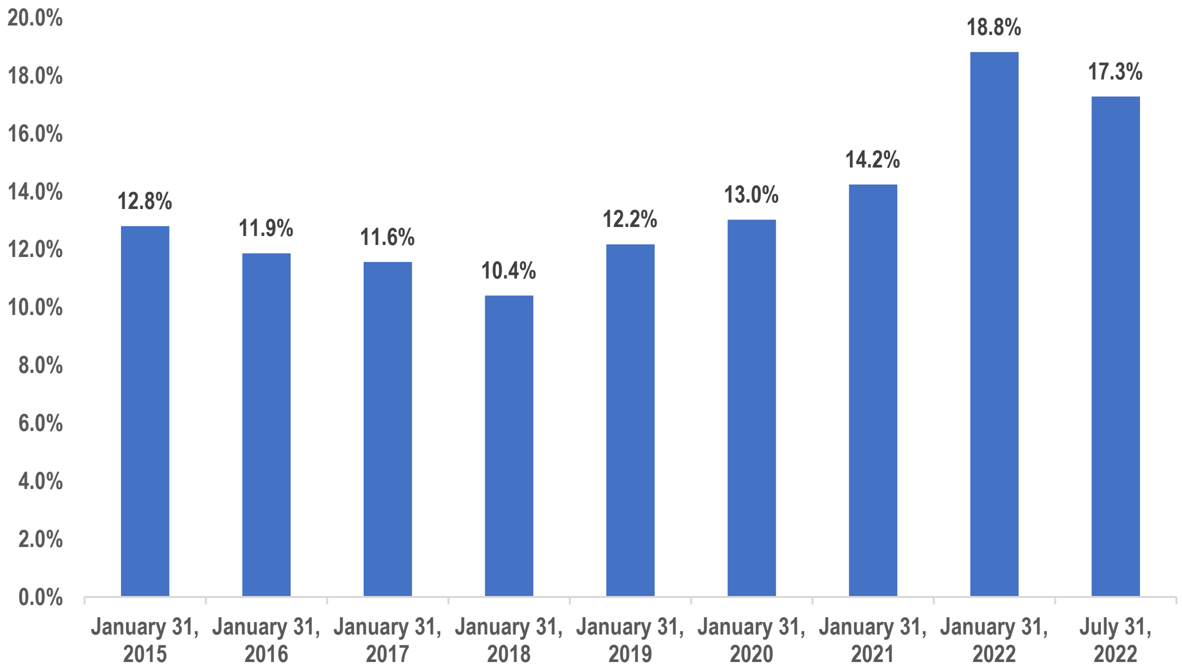
*Does not include any potential carryforward balances from FY 2022.

Other Possible Funding Commitments/Member Priorities

- **Unfunded Liabilities** – Virginia Retirement System plans and Other Post Employment Benefits.
- **Salary Increases** – A one percent increase for all groups (classified state employees/state-supported local employees, teachers, and faculty) = approximately $110.0 million for FY 2024 before additional adjustments to specific groups (with inflation, investments may need to be higher).
- **HHR Pressures** – Medicaid: additional adjustments and provider rates; other initiatives to relieve stress on mental health beds in state hospital, etc.
- **Education Initiatives** – Supports for students and teachers, targeted investments/study related to fiscal implications around enrollment and demographics.
- **Public Safety** – Review of inmate healthcare needs, staffing in facilities, and facility usage.
- **Capital Outlay** – Additional supplements for existing projects, deferred maintenance, and additional one-time cash for capital.
- **Natural Resources** – Dam safety and state park maintenance and operations.
- **Tax Policy** – Joint Subcommittee on Tax Policy will evaluate tax preferences (rebates, standard deduction, etc.).

State Employee Vacancies Provide Temporary Savings to Cover Higher Costs, but as Agencies Fill Positions Those Additional Costs Will Need to be Evaluated

Vacancy rate for State non-education salaried employees is typically around 12.0 percent, but increased starting in 2020.

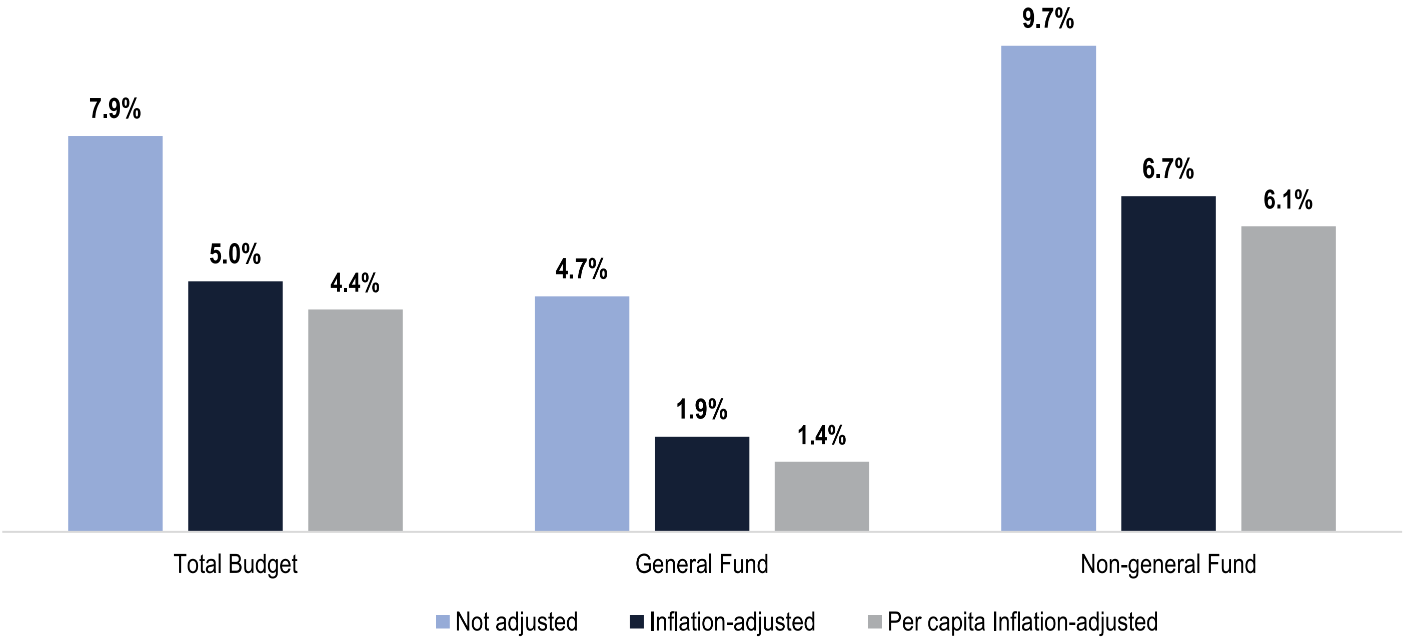


Source: Staff analysis of Department of Human Resources Management Full-Time Equivalent Reports.

- State agencies normally have savings from vacant positions, vacancies increased during the pandemic and have further accelerated in 2022.
- An 18.8 percent rate equals 11,539 vacant positions and 17.3 percent equals 10,599 vacant positions.
  - Total non-education salaried positions equal 61,347 for 2022.
  - An average vacancy rate of 12.0 percent equals around 7,400 positions.
- These savings allow agencies to cover other increased costs (i.e. gasoline, supplies, etc.).
- As agencies reduce their vacancy rates going forward, funding may be needed to cover increased costs due to inflation.

Operating Budget Growth – Previous 10 Years

From FY 2013 to FY 2022, general fund appropriations grew, on average, 4.7 percent per year. Adjusted for inflation, general fund appropriations grew 1.9 percent annually.



Source: JLARC, State Spending: 2022 Update.

Outlook and Considerations – 2023 Session

- Additional GF resources of $2.9 billion forecasted to be available above what was assumed in Chapter 2 (2022 Special Session I).
- Structural balance continues to be a concern and must be considered before making on-going commitments.
- Operating budget requests for agencies total almost $1.0 billion for the biennium.
  - Staff analysis of major budget drivers anticipates needs of over $900 million for must-do or high-priority items.
- Economic outlook is increasingly pointing to the U.S. entering a recession in the next year but may continue to be unclear through the start of session. Federal Reserve continues to increase rates to achieve stable prices/counter inflation.
  - Current job recovery has been uneven (i.e. hospitality/tourism and government sectors still show overall declines in job numbers from pre-pandemic levels).
- May want to consider additional funding for one-time items including cash for capital outlay or unfunded liabilities.

Appendix

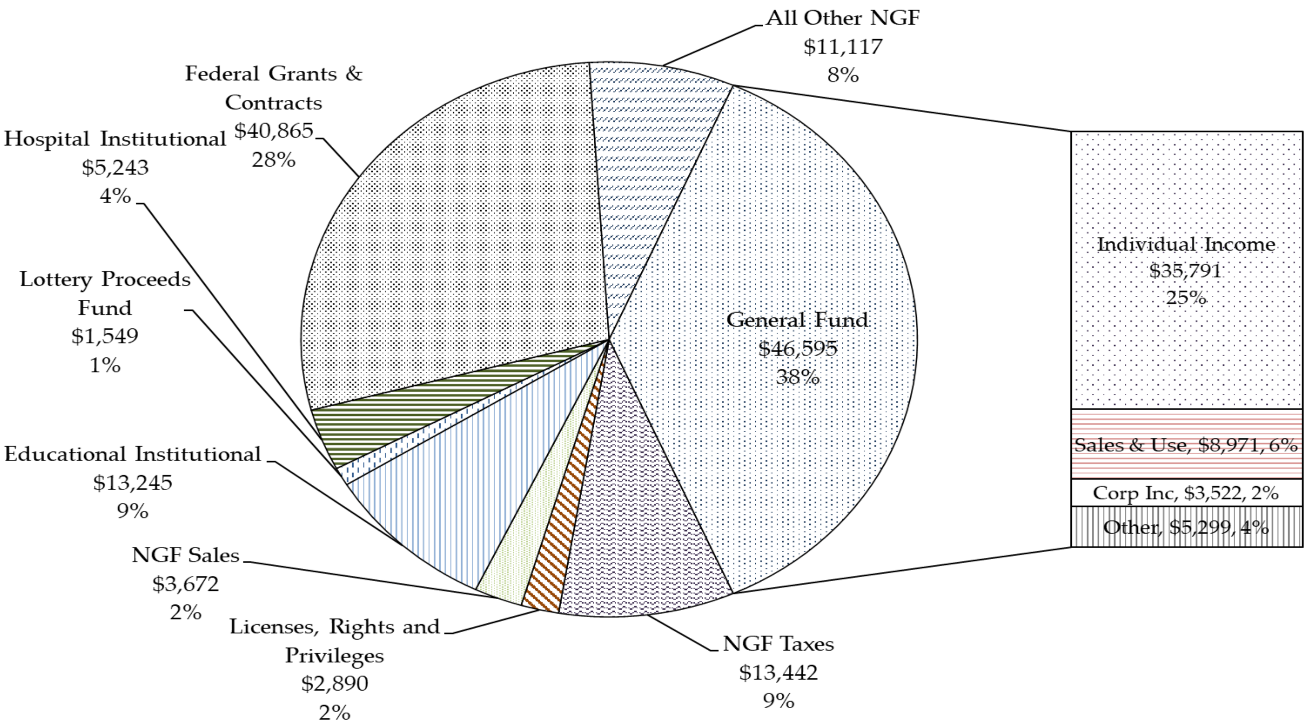
Virginia's Budget

Revenue Sources:

2022-24 Total Revenues = $145.3 Billion

Chapter 2 (HB 30, as Adopted)

($ in millions)



Virginia's Budget

How GF Resources are Used: