



## Panel: Fiscally Well-Managed States

November 16, 2023

# Outline

- 1 Overview and Panelist Introductions
- 2 Moody's State Credit Rating Criteria
- 3 Pew: Sustainable State Budgeting – Key Trends and Tools

# Virginia is Focused on Fiscal Management and Structural Balance

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- Virginia has a long-standing history of conservative fiscal management and adopting oversight practices to minimize liabilities. Some examples include:
  - Consensus revenue forecasting process.
  - Sophisticated debt capacity model and additional pension oversight.
  - Six-year capital outlay planning.
- Recent surpluses and above trend revenue growth have been used to fund one-time spending priorities and strengthen reserves.
  - Additional deposits to the Virginia Retirement System and higher contribution rates.
  - Funding capital outlay with cash and supplementing projects for cost increases.
  - Tax rebates.
  - Transportation priorities.
- The “Money Committees” play an active role in managing the state’s resources.

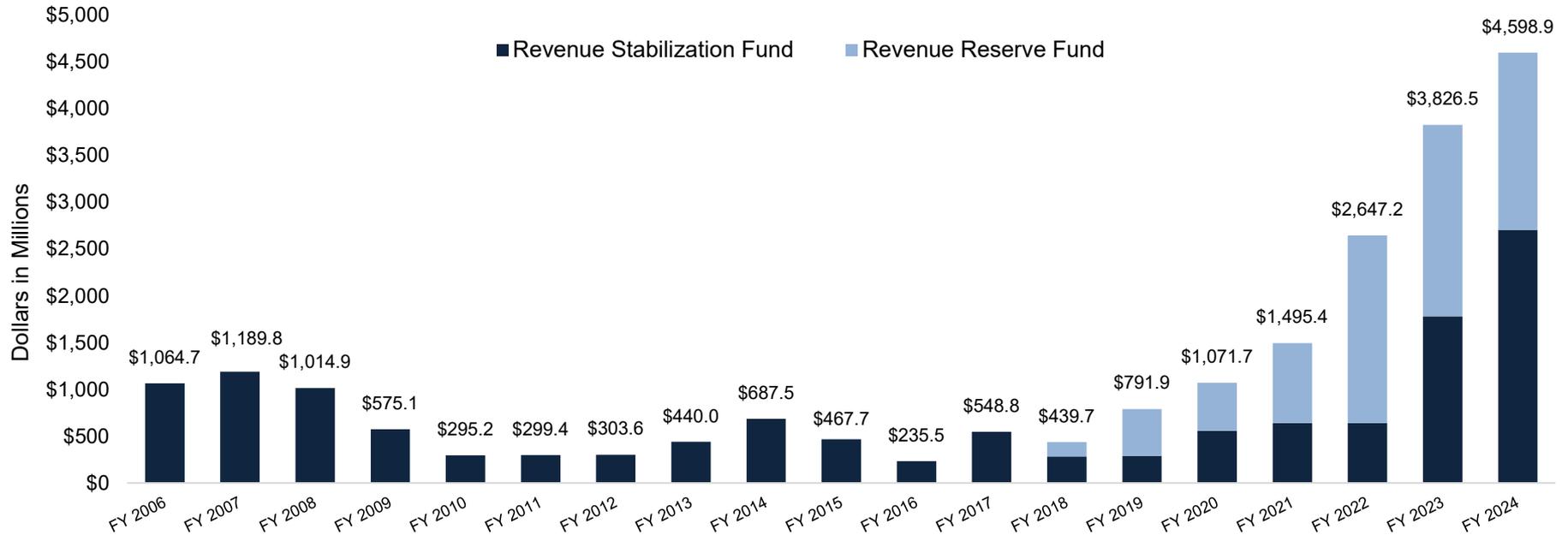
# Fiscal Management - General Fund Revenue Surplus Set-Asides

- A general fund revenue surplus becomes part of the year end balances and is subject to specific adjustments provided in the Constitution and state law, as well as other accounting requirements.
- A surplus in “certified tax revenues” (income and sales tax) may trigger requirements for deposits into the Revenue Stabilization Fund or the Revenue Reserve Fund.
- The Constitution and Code set out the conditions when withdrawals can be made from the Revenue Stabilization and Revenue Reserve Funds.
- Article X, Section 8, Constitution of Virginia  
Limit of tax or revenue; **Revenue Stabilization Fund.**
- § 2.2-1829, Code of Virginia;  
Reports of Auditor of Public Accounts; **Fund deposits and withdrawals.**
- § 2.2-1831.3, Code of Virginia;  
Commitment of funds for **Revenue Reserve Fund.**
- § 10.1-2128, Code of Virginia;  
**Virginia Water Quality Improvement Fund** established; purposes.
- § 2.2-1514, Code of Virginia;  
Commitment of general fund for **nonrecurring expenditures.**
- There are other situation-based adjustments that are part of the balance sheet calculations that may claim portions of the surplus such as authorized deficits or sum sufficient liabilities for natural disasters.

# Reserve Balances Projected to Total \$4.6 Billion by FY 2024

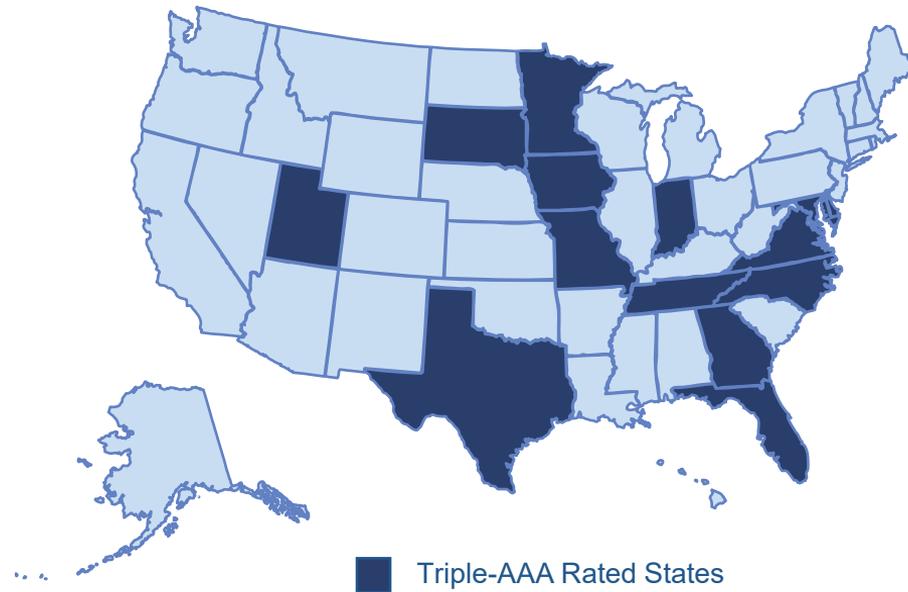
Reserves represent 19 percent of certified GF revenues and exceed the 15 percent cap provided in Code. However, the Appropriation Act extends the cap to 20 percent for this biennium.

## Total of Reserve Funds



Source: Secretary of Finance Joint Money Committee Presentation, August 23, 2023.

# Virginia's Well-Managed Status Affords the Commonwealth a Higher Credit Rating



- Credit ratings are an assessment of a governmental entity's ability and willingness to repay debt on a timely basis. These ratings are an important factor in the public debt markets and influence the interest rates a borrower must pay.
  - The global credit rating industry is concentrated in three leading agencies: Moody's, Standard & Poor's, and Fitch.
  - The Commonwealth is rated Aaa/Stable (Moody's), AAA/Stable (S&P), and AAA/Stable (Fitch).
  - Virginia has held the triple-A bond rating since 1938 and this allows the state to have the lowest borrowing costs.

Source: *Virginia Debt Capacity Advisory Committee Report to the Governor and the General Assembly*, December 16, 2022.

# Meet the Panelists

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# Moody's State Credit Rating Criteria

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## Expertise

A comprehensive view of the global markets through our ratings and research

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## Credibility

Over 100 years of experience delivering forward-looking, independent, stable and transparent opinions

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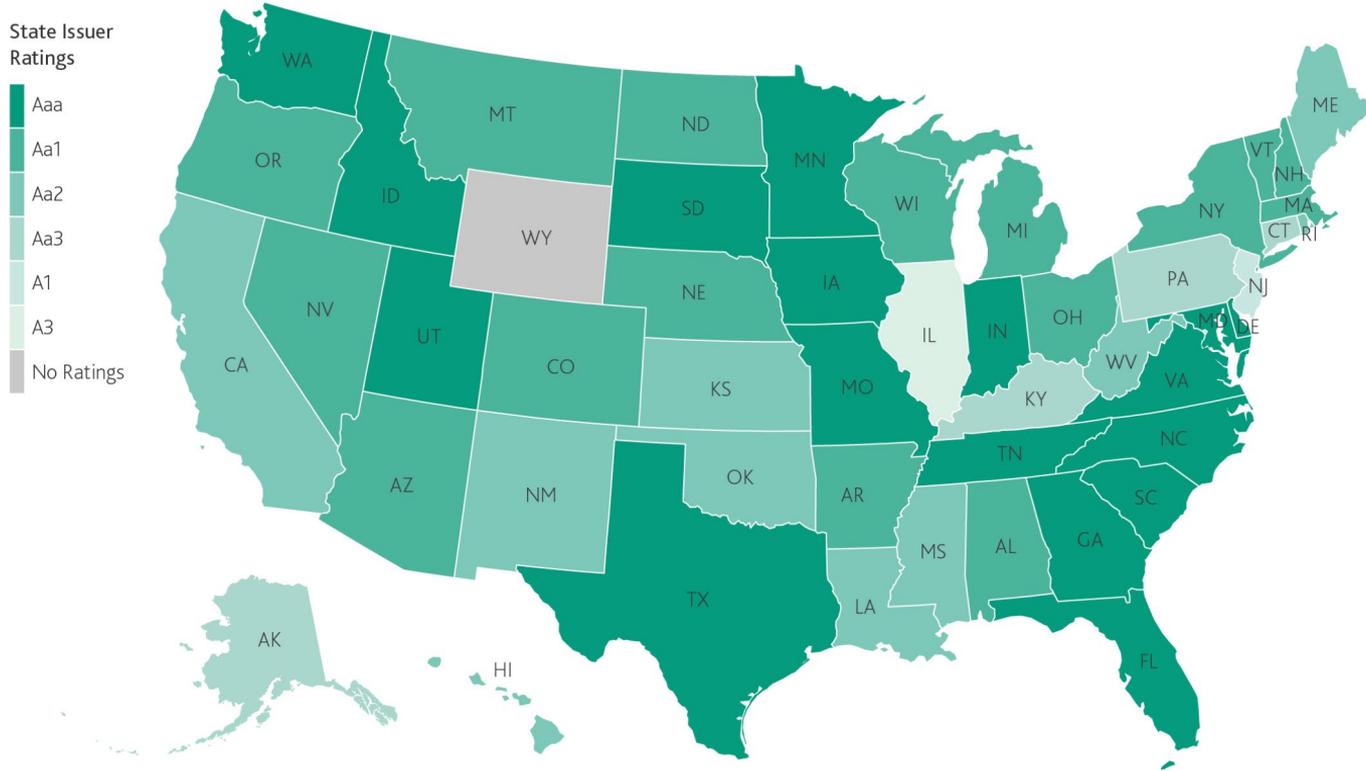
## Engagement

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# US states are highly rated



Source: Moody's Investors Service

# Moody's state rating scorecard

## Commonwealth of Virginia

US states and territories rating methodology scorecard			
Virginia (Commonwealth of)			
	Measure	Weight	Score
<b>Economy</b>			
Resident Income (PCI Adjusted for RPP / US PCI)	103.0%	15%	Aaa
Economic Growth (5-year CAGR real GDP - 5-year CAGR US real GDP)	0.1%	15%	Aaa
<b>Financial performance</b>			
Financial performance	Aaa	20%	Aaa
<b>Governance/Institutional Framework</b>			
Governance/Institutional Framework	Aaa	20%	Aaa
<b>Leverage</b>			
Long-term liabilities ratio (adjusted long-term liabilities / own-source revenue)	80.5%	20%	Aaa
Fixed-costs ratio (adjusted fixed costs / own-source revenue)	3.9%	10%	Aaa
<b>Notching factors</b>			
Very limited and concentrated economy	0		
Scorecard-Indicated Outcome			Aaa
<b>Assigned rating</b>			Aaa
Economy measures are based on data from the most recent year available. Source: Moody's Investors Service			

# Key indicators

## Commonwealth of Virginia

	2020	2021	2022	State Medians (2022)
<b>Economy</b>				
Nominal GDP (\$billions)	565.1	613.9	663.1	288.7
Real GDP, annual growth	-1.3%	5.4%	2.5%	1.7%
RPP-adjusted per capita income as % of US*	103%	101.4%	103.0%	96.6%
Nonfarm employment, annual growth	-5%	2.4%	3.1%	4.3%
<b>Financial performance</b>				
Available balance as % of own-source revenue	24.0%	32.5%	43.1%	38.6%
Net unrestricted cash as % of own-source revenue	48.4%	66.2%	77.1%	73.4%
<b>Leverage</b>				
Total long-term liabilities as % of own-source revenue	87%	90.1%	80.5%	127.0%
Adjusted fixed costs as % of own-source revenue	5.0%	4.5%	3.9%	4.7%

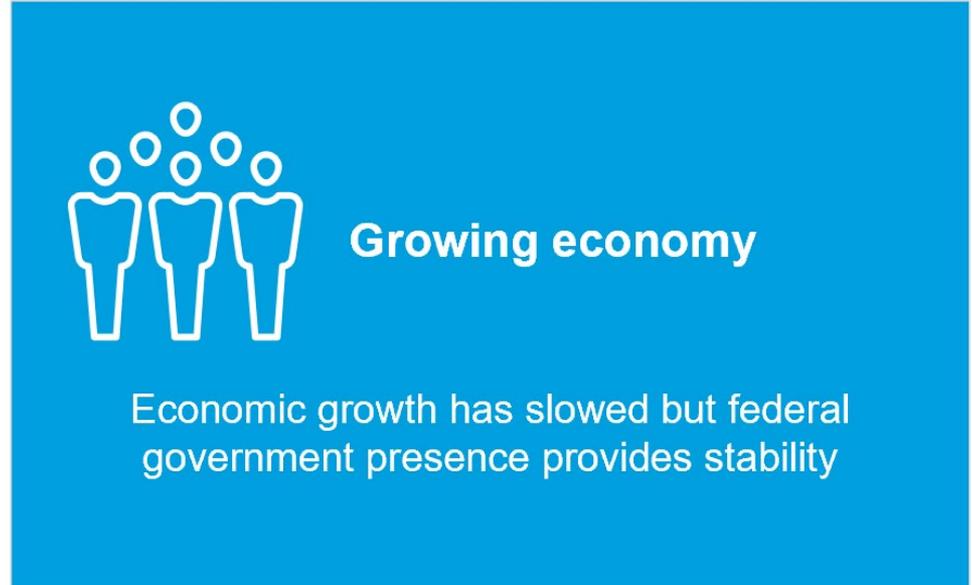
\*2022 adjusted per capita income uses RPP for 2021.

Sources: Commonwealth of Virginia annual comprehensive financial reports, US Bureau of Economic Analysis, US Bureau of Labor Statistics and Moody's Investors Service

# Economy

## Scorecard metrics – resident income and economic growth

- » Other considerations:
  - Federal government presence
  - Low unemployment rates
  - Employment growth typically lags nation, but declines not as steep
  - Thriving technology sector
  - Personal income growth benefits from highly educated workforce
  - Population loss in rural areas offset by population gains in Northern Virginia



# Financial performance

## Scorecard metric – qualitative assessment

- » Quantitative analysis:
  - Fund balance (GAAP-basis)
  - Liquidity (GAAP-basis)
  - Rainy day fund levels
  - Budgetary balance
  - Revenue concentration and performance
  - Expenditure controls



**Strong finances**

Available fund balance over 40% of revenue

# Governance/Institutional Framework

## Scorecard metric – qualitative assessment

### » Considerations:

- Fiscal planning and operational management
- Conservative financial projections
- Consistent long-term planning and in-year monitoring
- Conservative debt and liability management
- Strong revenue-generating and expenditure flexibility



### **Strong governance**

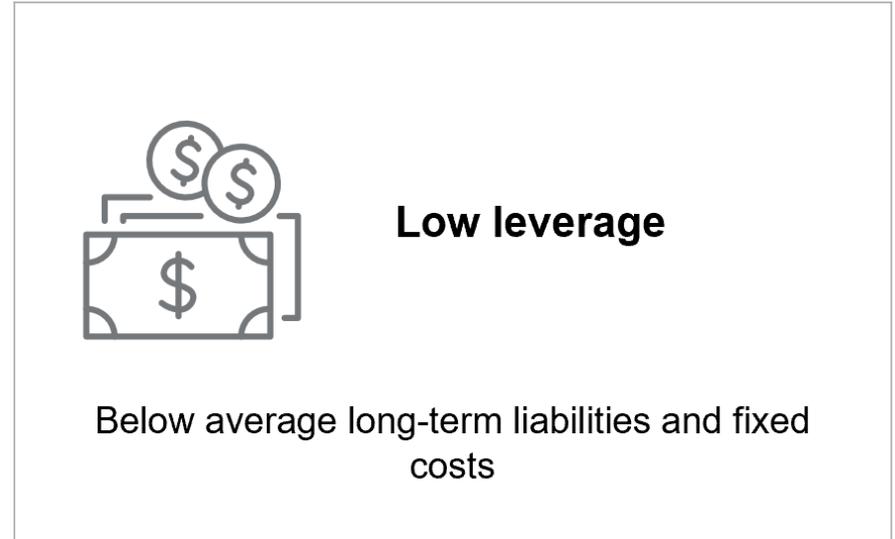
Commonwealth manages budget well, has built significant reserves

# Leverage

## Scorecard metrics – long-term liabilities and fixed costs

### » Considerations:

- Total long-term liabilities include debt, pensions, OPEB and other long-term liabilities
- Fixed costs include debt service, other long-term liabilities carrying cost, pensions and OPEB contributions
- Debt management practices
- Exposure to variable rate debt
- Overlapping liabilities (teacher pension liabilities)



# ESG tightly woven into states' credit analysis

ESG stands for environmental, social and governance

- » Environmental factors, especially physical climate exposures, can impact economic growth metrics.
- » Investment in adaptation impacts leverage metrics.
- » Social factors such as demographics, income levels and ageing influence the economy, can impact financial performance and sway leverage metrics relative to revenue trends
- » Governance heavily influences how governments operate, especially their finances and approaches to debt, pensions and other leverage metrics.

US States & Territories Scorecard

Rating Factor	Rating Subfactor	Environmental	Social	Governance
Economy	Resident Income			
	Economic Growth			
Financial Performance				
Institutional Framework/ Governance				
Leverage	Long-term Liabilities			
	Fixed Costs			

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# Sustainable State Budgeting

Key trends and tools

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## Current fiscal landscape

- The budget conditions and surpluses that states have seen in recent years reflect **temporary factors** that are dissipating
- States used their surpluses for a mix of **one-time investments, ongoing commitments, and savings**
- Key question is whether states are on a **sustainable path**

# Rainy day fund trends

## Days Virginia could run on its rainy day fund alone

The number of days Virginia could run solely on its rainy day fund **more than quadrupled** from 7.8 days at the end of FY 2018 to 36.6 days at the end of FY 2022.



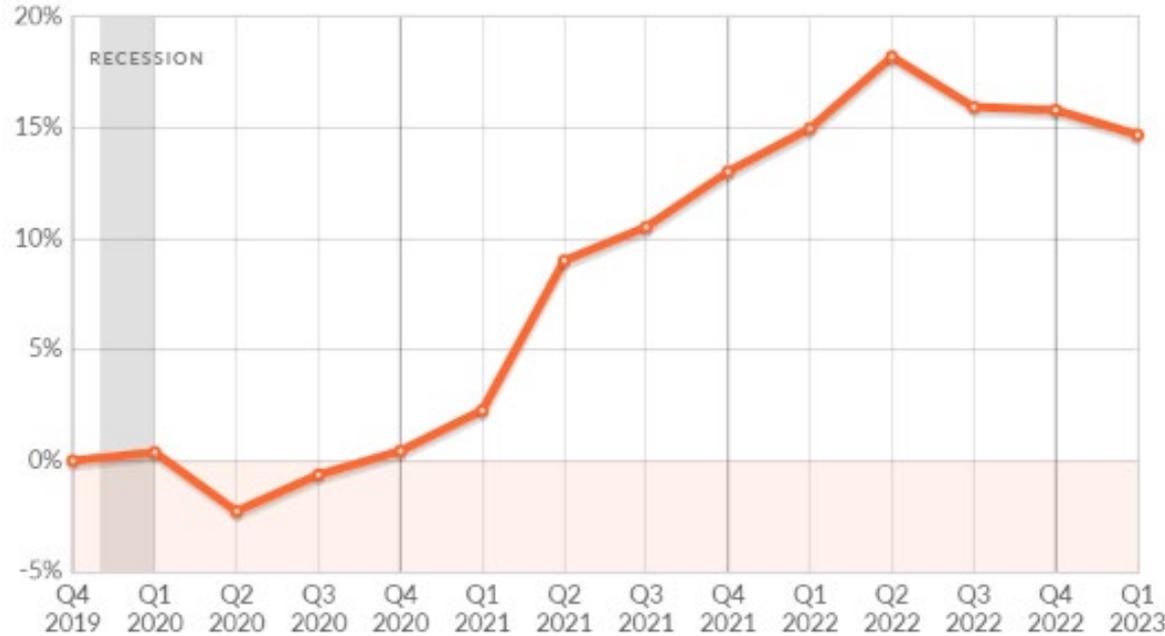
Source: The Pew Charitable Trusts, [Fiscal 50](#)

# Tax revenue trends

## Change in Virginia's tax revenue from pre-pandemic level

As of the end of the first quarter of 2023, Virginia's cumulative tax collections were 14.7% above their pre-pandemic level (adjusted for inflation).

Despite relatively high collections, receipts have appeared to be on a downward trend nationwide and in most states, including Virginia.



Source: The Pew Charitable Trusts, [Fiscal 50](#)

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## Analytical tools for sustainable budgeting

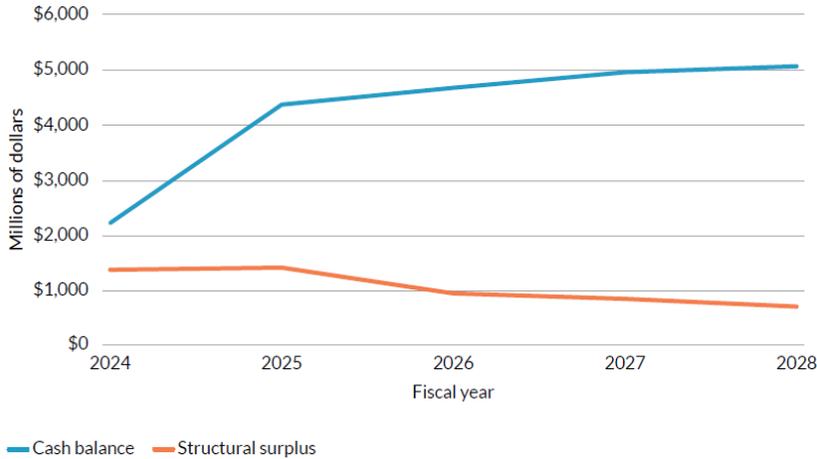
**Long-term budget assessments:** Analyze several years of projected revenue and spending to determine whether states face **chronic budget deficits** and, if so, **why**.

**Budget stress tests:** Estimate the size of **temporary budget shortfalls** that would result from recessions or other economic events and **assess** whether states are **prepared** for these events.

# How these tools are making a difference

## A Focus on Ongoing Spending and Revenue Revealed MD's Shrinking Structural Surplus

General fund cash balance and structural surplus projections, FY 2024-28



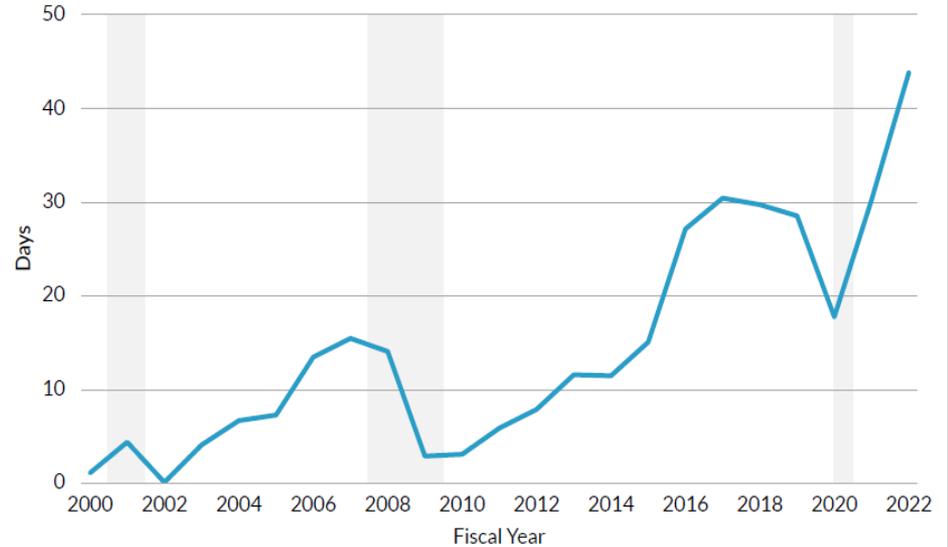
Note: Cash balances are the unspent dollars at the end of the fiscal year, while the structural surplus is ongoing revenue minus ongoing spending.

Source: Maryland Department of Legislative Services, "Spending Affordability Committee 2022 Interim Report" (2022), [https://dls.maryland.gov/pubs/prod/RecurRpt/Spending\\_Affordability\\_Committee\\_2022\\_Interim\\_Report.pdf](https://dls.maryland.gov/pubs/prod/RecurRpt/Spending_Affordability_Committee_2022_Interim_Report.pdf)

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## Stress Tests Have Helped NC Increase Its Savings

Number of days the state could run on its rainy day fund alone, FY 2000-22



Note: Shaded columns indicate recessions.

Source: Pew analysis of National Association of State Budget Officers data

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## Virginia: One of 30 states with no published budget stress test or long-term budget assessment

### Questions to get started include:

- Who could produce long-term budget assessments and budget stress tests?
- What existing analyses could serve as building blocks?
- How could the results be connected to the policymaking process?

# Pension Sustainability

A snapshot of key indicators

# Pension sustainability trends

## Indicators of VRS fiscal health and sustainability from Pew's 50-state matrix

### Actuarial metrics:

- Funded ratio, 2021: 88% (50-state aggregate: 82%)
- Change in funded ratio, 2008 to 2021: 4%
- Employer cost of payroll, 2020: 15% (50-state average: 20%)

### Plan financial metrics:

- Operating cash flow ratio (OCF), 2021: -2.5%
- Change in OCF, 2014-2021: -.2%
- Net amortization, 2021: Stable (50-state: 24 positive, 21 negative, 5 stable)

### Budget risk indicators:

- Historic contribution volatility: 9.7% (50-state average: 11.4%)
- Stress testing: Yes (25 states)

# Managing Emerging Fiscal Risks

Focus on budgeting for natural disasters

# Background on disasters and state budgets

## Disasters are more frequent, severe, and costly:

- Cumulative disaster costs **more than tripled** in the last 20 years when compared to the preceding 2 decades.

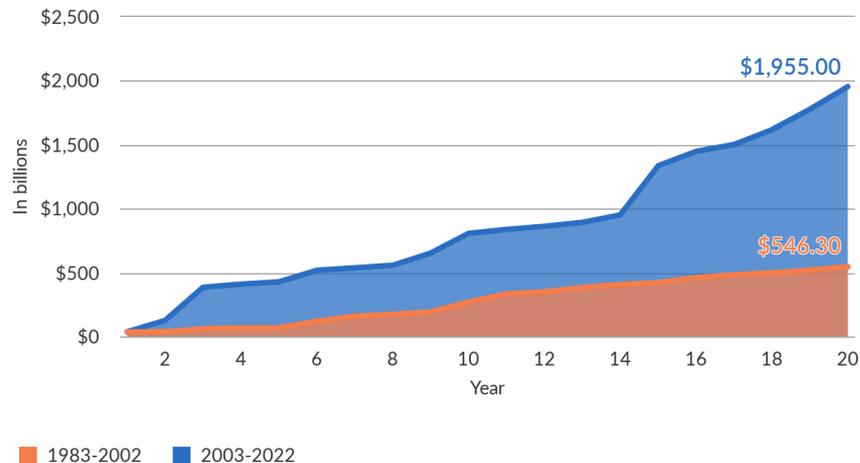
## States play a key role in paying for disasters

- States fund smaller disasters, cost-shares for federal grants, and statewide resilience efforts

## Growing risk demands a closer look

- State disaster spending not consistently tracked
- Budgets are built for “if” not for “when”
- Risk reduction is critical, but often underinvested

Cumulative Cost of Billion-Dollar Disasters



Source: National Oceanic and Atmospheric Administration (<https://www.noaa.gov/access/billions/events.pdf>)

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## What can states do?



### Measure

Improve comprehensive disaster spending data



### Manage

Assess and improve budgeting practices



### Mitigate

Prioritize and implement mitigation

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# Measure disaster spending

## Tracking and reporting spending data

### Most states currently don't comprehensively track spending:

- Tracking is hard, but...
- Better data could drive budget planning and stability
- Necessary to inform investments in mitigation

### Virginia's approach

- Legislatively mandated reporting reflects Pew recommendations
- Areas exist for expansion, application of data

# Manage the budget

## How do states budget for disasters?

### Preemptive

- Statewide disaster accounts
- Rainy day funds

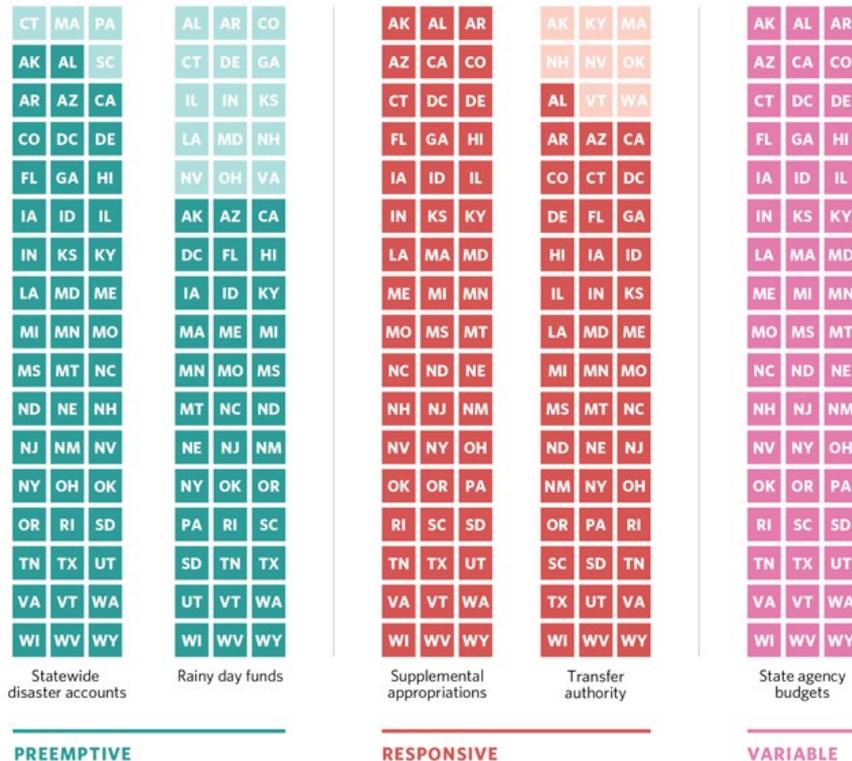
### Responsive

- Supplemental appropriations
- Transfer authority

### Variable

- State agency budgets

Use of each mechanism, by state



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## Manage the budget

Evaluating current processes and practices

### Assessing if current budgeting processes are up to the challenge

- Looking at totality of spending
- Evaluating frequency of supplemental appropriations/emergency mechanisms
- Thinking about purpose of different funding mechanisms and funding them accordingly
- Integrate risk information (e.g. Virginia Coastal Resilience [Mapping Tool](#))

### Virginia's approach

- The Virginia Disaster Recovery Fund uses a governor authorized “sum sufficient appropriation” as opposed to an annual appropriation
- Disaster costs are not a direct use for the Revenue Stabilization and Reserve Funds

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## Mitigate disaster risk

Essential to managing long term costs

### Funding is growing, but challenges persist

- Federal (and some state) investments are at an all time high, but...
- Response, recovery still take precedence
- The scale of needed investment outpaces current funding
- Implementing federal funds a major hurdle

### Virginia's approach

- Over \$480 million committed since 2021
- Community Flood Preparedness Fund
- Resilient Virginia Revolving Loan Fund

## Recap



### Measure

Improve comprehensive disaster spending data



### Manage

Assess and improve budgeting practices



### Mitigate

Prioritize and implement mitigation

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## Considering other emerging risks

Long term budget concerns (beyond disasters)

### How does the state look at long term risks to budget stability?

- E.g. changes in demographics and technology
- What venues exist for analyzing these risks?
- What expertise on these risks already exists in state government?

### How does the state manage uncertainty in federal funding?

- What are the best approaches for using one-time federal funds?
- Given that federal funds make up nearly a third of Virginia's budget, how are changes in that funding managed?

