



# Virginia's Revenue and Budget Outlook

November 16, 2023

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# **2023 Session & 2023 Special Session I Recap**

# Budget Tale: 2023 Session and Special Session I

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## 2023 Session

- The General Assembly passed Chapter 769, “skinny budget.”
- Chapter 769 included seven spending amendments totaling \$1.0 billion and maintained an unappropriated balance of \$847.9 million.
- Official revenue forecast was not adjusted for economic projections and relied on assumptions from Fall 2021.

## FY 2023 Year-End

- Without revising the official forecast, a \$3.0 billion surplus resulted and required the following deposits:
  - Revenue Reserve Fund at \$289.6 million;
  - WQIF A at \$408.7 million; and
  - WQIF B at \$104.7 million.
- Surplus and unspent GF cash balances were reserved on the year-end balance sheet.

## 2023 Special Session I

- The General Assembly passed a revised budget for FY 2024, Chapter 1.
- FY 2024 official forecast assumes more downside risks and provided less revenue when compared to the December 2022 forecast.
- Available resources totaled \$4.5 billion; however, tax policy reduced resources by \$2.0 billion. Chapter 1 has an unappropriated balance of \$7.3 million.

# 2023 Session: Chapter 769 (Skinny Budget)

\$ in millions	FY 2023	FY 2024	Biennium
<b>Unappropriated Balance, Chapter 2, 2022 Special Session I</b>	<b>\$509.1</b>	<b>(\$493.1)</b>	<b>\$16.0</b>
Additions to Balance	1,432.6	405.9	1,838.5
Tax Conformity (SB 882/HB 1595)	<u>(0.2)</u>	<u>23.4</u>	<u>23.2</u>
<b>Total GF Resources Available</b>	<b>\$1,941.5</b>	<b>(\$63.7)</b>	<b>\$1,877.7</b>
<b>GF Spending</b>			
Direct Aid Technical Changes & Hold Harmless	\$132.7	\$125.8	\$258.5
Mandatory Revenue Stabilization Fund Deposit	0.0	406.0	406.0
VRS Lump Sum Deposit	250.0	0.0	250.0
TANF-UP GF Increase	9.2	6.1	15.3
2022 Capital Supplement Pool	<u>100.0</u>	<u>0.0</u>	<u>100.0</u>
<b>Total Spending (subtraction)</b>	<b>\$491.9</b>	<b>\$537.9</b>	<b>\$1,029.8</b>
<b>Chapter 769 GF Ending Balance/Unappropriated Balance</b>	<b>\$1,449.6</b>	<b>(\$601.6)</b>	<b>\$847.9</b>



Starting Point  
for Chapter 1.

# 2023 Special Session I: Chapter 1 Includes \$2.0 billion in Tax Policy

Provides ongoing tax relief of \$200.0 million annually in the next biennium in addition to the ongoing \$1.2 billion that was adopted last year.

Chapter 1, 2023 Special Session I, Tax Policy Actions (\$ in millions)	FY 2024	FY 2025	FY 2026
Increase Standard Deduction to \$8,500 & \$17,000 TY24	(\$48.1)	(\$101.7)	(\$102.6)
Eliminate Age Limitation for Military Retirement Subtraction TY24	(37.8)	(33.4)	(34.7)
Increase Business Interest Deduction 163(j) from 30 to 50 percent TY24	(10.3)	(22.6)	(23.5)
Tax Rebate \$200 & \$400 (Transfer to Special Fund)	(906.8)	0.0	0.0
Pass-Through Entity Tax Refund Estimate	(1,000.0)	0.0	0.0
Continuation of 2022 Tax Policy Legislation Costs	(44.4)	(47.0)	(49.4)
<b>Total Tax Policy Actions</b>	<b>(\$2,047.4)</b>	<b>(\$204.7)</b>	<b>(\$210.2)</b>

**Standard Deduction Trigger Language:** Requires withholding collections to equal or exceed the growth rate adopted in the official revenue estimate in this Act for the six-month period from July to December 2023. If condition not met, standard deduction remains at \$8,000 and \$16,000.

**Sales Tax Holiday:** Reinstates the sales and use tax holidays for school supplies, clothing and footwear, energy and water savings products, and hurricane preparedness equipment until July 1, 2025, and sets the calendar year 2023 sales tax holiday for October 20-22, 2023.

# Chapter 1, Net Available GF Resources Total \$2.5 billion; Unappropriated Balance is \$7.3 million

(\$ in millions)	FY 2024
<b>Ending Balance/Unappropriated Balance, Chapter 769, 2023 Session</b>	<b>\$847.9</b>
Revert Amount Reserved for Taxpayer Relief on FY 2023 Preliminary Balance Sheet	2,128.1
Revert FY 2022 Surplus Contingents & WQIF A & B	366.5
Revert WQIF Part A & B FY 2023	513.5
Revert Revenue Reserve Fund Deposit FY 2023	289.6
August Revenue Reforecast	223.5
Tax Policy Actions	(2,047.4)
Revert Agency Balances	101.4
Transfers to GF	43.8
<b>Total GF Resources</b>	<b>\$2,466.9</b>
Operating Spending Actions	\$2,248.4
Capital Spending Actions	211.2
<b>Total Spending, Chapter 1, 2023 Special Session I (subtraction)</b>	<b>\$2,459.6</b>
<b>Chapter 1, Revised Ending/Unappropriated Balance</b>	<b>\$7.3</b>

# 68 Percent of Net Spending in Chapter 1 is One-Time

Major Operating and Capital Spending Items (\$ in millions)	FY 2024	One-Time
<b>Water Quality Improvement Fund: FY 2023 Deposit</b>	\$513.4	Yes
<b>K-12: Student Learning &amp; Flexible Operating Support Per Pupil Add-On</b>	418.3	Yes
<b>Revenue Reserve: FY 2023 Deposit</b>	289.6	Yes
<b>Capital Outlay Projects</b>	211.2	Yes
K-12: Increase Support Position Funding	152.3	
<b>VDOT: I-64 Improvements (FY 2022)</b>	150.0	Yes
<b>Water Quality Improvement Fund: FY 2022 Deposit</b>	131.0	Yes
<b>EDIP: Business Ready Sites Program Fund</b>	125.0	Yes
Higher Education: Maintain Affordable Access Operations	75.0	
<b>EDIP: Virginia Business Ready Sites Acquisition Fund and Program</b>	75.0	Yes
Higher Education: Maintain Affordable Access Financial Aid	62.5	
Central Appropriations: Two Percent Salary Increase State Employees and State Supported Locals	60.6	
DBHDS: Increase Funding for Comprehensive Crisis Services System	58.0	
K-12: Two Percent Salary Increase SOQ Positions	54.6	
<b>EDIP: Major Headquarters Workforce Grant Fund (FY 2022)</b>	35.5	Yes



# In the 2022-2024 Biennium, On-Going Tax Policy Reduced Revenue by \$2.8 billion with Additional One-Time Rebates of \$1.9 billion

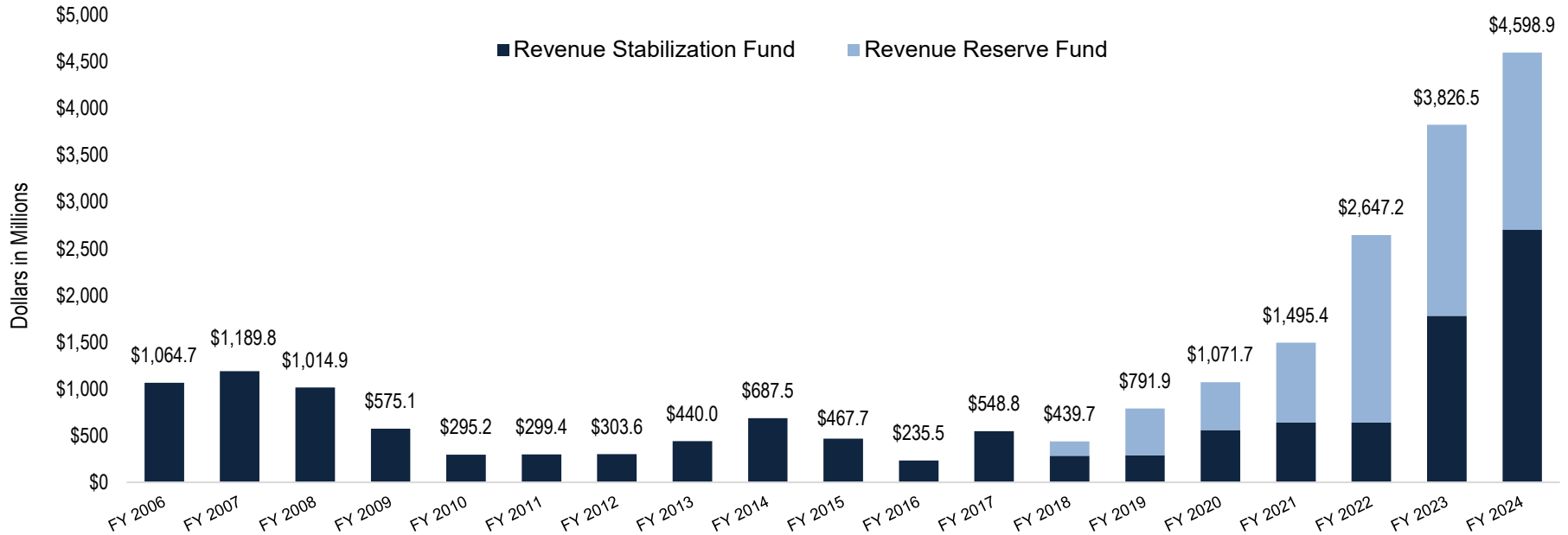
Tax Action (\$ in millions)	FY 2023	FY 2024	FY 2025	FY 2026
Individual: Increase Standard Deduction \$8,000/\$16,000 *	(\$1,015.8)	(\$707.4)	(\$719.4)	(\$730.8)
Individual: Increase Standard Deduction \$8,500/\$17,000 (TY24)	0.0	(48.1)	(101.7)	(102.6)
Sales and Use: Eliminate State Portion on Groceries (1.5 percent) *	(115.0)	(267.2)	(272.5)	(273.6)
Individual: Refundable Earned Income Tax Credit to 15.0 percent of Federal Credit	(159.0)	(156.0)	(159.6)	(155.0)
Individual: Military Retirement Subtraction for Age 55 or Older	(145.0)	(156.0)	(182.0)	(194.4)
Individual: Military Retirement Subtraction Eliminate Age Limitation (TY24)	0.0	(37.8)	(33.4)	(34.7)
Individual/Corporate: Increase Business Interest Deduction Disallowed from 20% to 30%	(15.3)	(10.9)	(11.3)	(11.8)
Individual/Corporate: Increase Business Interest Deduction Disallowed from 30% to 50% (TY24)	<u>0.0</u>	<u>(10.3)</u>	<u>(22.6)</u>	<u>(23.5)</u>
<b>Total On-Going Tax Cuts</b>	<b>(\$1,450.1)</b>	<b>(\$1,393.7)</b>	<b>(\$1,502.5)</b>	<b>(\$1,526.4)</b>
Individual: 2022 Tax Rebate (\$250/\$500)	(\$1,048.6)	0.0	0.0	0.0
Individual: 2023 Tax Rebate (\$200/\$400) (Paid from Special Fund)	<u>0.0</u>	<u>(906.8)</u>	<u>0.0</u>	<u>0.0</u>
<b>Total On-Going + One-Time</b>	<b>(\$2,498.7)</b>	<b>(\$2,300.5)</b>	<b>(\$1,502.5)</b>	<b>(\$1,526.4)</b>

Source: Virginia Department of Tax, Revenue Impacts. \* Estimates updated in July 2023 to reflect wage and inflation growth since fall 2021 estimates.

# 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.



# **FY 2023 Revenue Performance**

# FY 2023 Year-End Revenue Exceeded the Forecast by \$3.04 billion

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- FY 2023 GF revenue exceeded the official forecast in Chapter 769 (“skinny budget”) by \$3.04 billion; however, the official forecast was largely unchanged since the fall 2021 forecast.
- Overall, GF revenue declined 3.5 percent, \$1.0 billion, compared to FY 2022 while the official forecast assumed a 14.0 percent decline (as largely adopted in Chapter 2, 2022 Special Session I).
  - Tax policy reduced revenues by \$2.5 billion in FY 2024.
- Withholding, sales and use, and corporate income taxes outperformed the official forecast since the forecast was last updated for economic adjustments in fall 2021.
- Nonwithholding collections drove the excess revenue, and this is largely due to timing issues related to the new Pass-Through Entity Tax (PTET). Taxpayers will receive refunds in FY 2024, and this will reduce revenues by \$1.0 billion in November 2023.
- FY 2023 revenue outperformed the December 2022 GACRE forecast by \$1.45 billion. PTET resulted in \$1.0 billion in overpayments, so revenue increased by \$450.3 million, largely from sources like interest income outperforming the forecast.

# FY 2023 GF Revenues Exceeded the Official Forecast by \$3.0 billion

FY 2023 official forecast was not adjusted for any economic adjustments during the 2023 Session, except tax conformity, and remained largely unchanged from the fall 2021 forecasting process (as adopted in Chapter 2, 2022 Special Session I).

Source, \$ in millions	Actuals				Variance to Forecasts	
	FY 2022	FY 2023	Change	% Change	Chp 769, 2021 Special Session I	December 2022
Withholding	\$15,340.3	\$15,957.2	\$616.9	4.0	\$637.5	(\$121.1)
Nonwithholding	6,810.5	6,629.2	(181.3)	(2.7)	1,415.6	1,540.6
Refunds	<u>(1,740.5)</u>	<u>(3,602.8)</u>	<u>(1,862.3)</u>	<u>107.0</u>	<u>198.1</u>	<u>(67.6)</u>
Net Individual Income Tax	\$20,410.3	\$18,983.6	(\$1,426.7)	(7.0)	\$2,251.2	\$1,351.9
Sales and Use	4,558.1	4,734.6	176.5	3.9	236.7	(191.8)
Corporate	1,978.7	2,031.1	52.4	2.6	294.1	150.1
Insurance Premiums	426.6	450.9	24.3	5.7	44.8	25.9
Will, Suits, and Deeds	654.1	430.6	(223.5)	(34.2)	(163.1)	(83.4)
All other	<u>907.0</u>	<u>1,279.2</u>	<u>372.2</u>	<u>41.0</u>	<u>375.1</u>	<u>197.6</u>
<b>Total GF Revenues</b>	<b>\$28,934.8</b>	<b>\$27,909.9</b>	<b>(\$1,024.9)</b>	<b>(3.5)</b>	<b>\$3,038.8</b>	<b>\$1,450.3</b>

# Adjusting for Tax Policy Actions, FY 2023 Revenues Increased 5.1 percent over FY 2022

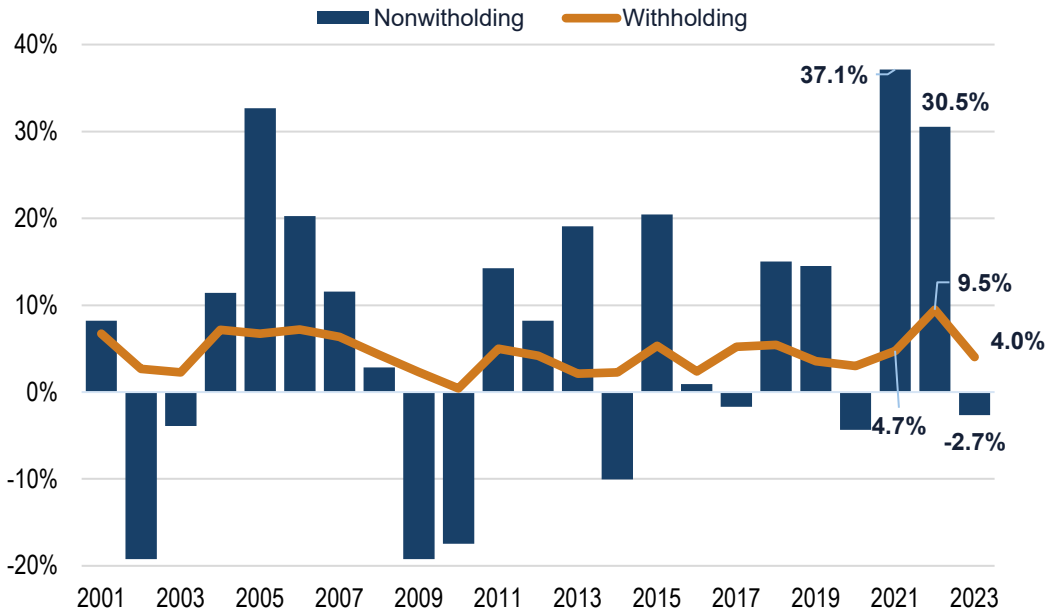
Tax policy actions subtracted \$2.5 billion from revenues, including a one-time tax rebate (\$1.06 billion) and an increased standard deduction (\$1.01 billion).

Source, \$ in millions	FY 2022	FY 2023			
	Adjusted	Unadjusted	Policy Adjustments	Adjusted	Adjusted Growth
Withholding	\$15,340.3	\$15,957.2	\$575.9	\$16,533.1	7.8%
Nonwithholding	6,810.5	6,629.2	345.2	6,974.4	2.4%
Refunds	<u>(1,740.5)</u>	<u>(3,602.8)</u>	<u>1,519.9</u>	<u>(2,082.9)</u>	<u>19.7%</u>
Net Individual Income Tax	\$20,410.3	\$18,983.6	\$2,441.0	\$21,424.6	5.0%
Sales and Use	4,558.1	4,734.6	61.9	4,796.5	5.2%
All other	<u>3,966.6</u>	<u>4,191.8</u>	<u>0.0</u>	<u>4,191.8</u>	<u>5.7%</u>
<b>Total GF Revenues</b>	<b>\$28,934.8</b>	<b>\$27,909.9</b>	<b>\$2,502.9</b>	<b>\$30,412.8</b>	<b>5.1%</b>

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

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

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

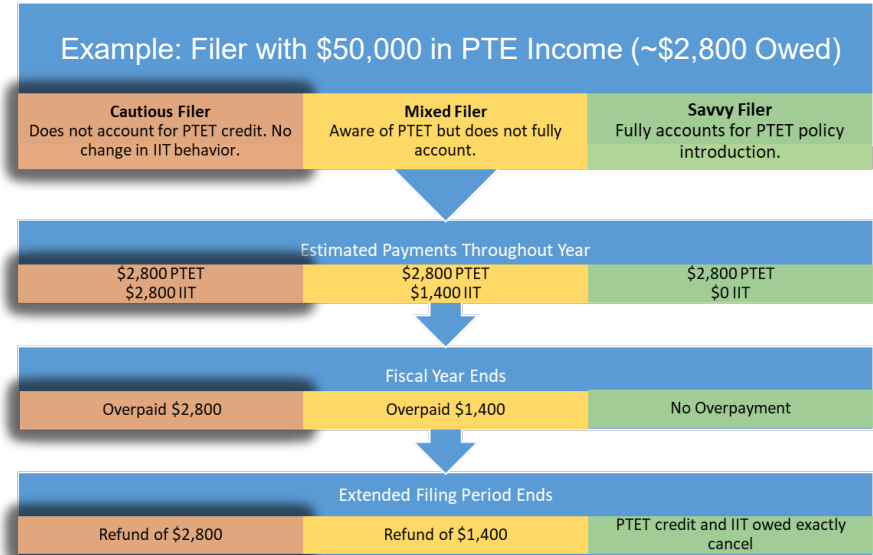


Source: Virginia Department of Taxation.

- Nonwithholding income as a share of total GF revenues increased from 18 percent in FY 2018 to 24 percent in FY 2023.
- 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 for in-year payments.
- To conservatively forecast nonwithholding, SFAC staff applied a “collar”, the 10-year average of nonwithholding payments as a percent of total revenues, to reduce the nonwithholding revenue estimate by one percent of GF revenue.

# Taxpayer Behavior Increased Nonwithholding Collections in FY 2023 Significantly as Taxpayers Overpaid Tax Liability to Work Around the Federal SALT Cap

- The 2017 Tax Cuts and Jobs Acts limited the state and local tax (SALT) deduction to \$10,000. **The SALT cap applies only to individuals and not to business entities.**
- Virginia adopted a pass-through entity (PTE) tax that allows taxpayers to pay a 5.75 percent tax at the entity level rather than the individual level on pass-through entity income.
- Shifting the tax burden to the entity-level allows the entity's owners to deduct the state PTE tax as a business expense on their federal returns while still deducting up to the \$10,000 state and local tax deduction cap.
- Individuals receive offsetting credits at the state level for the individual income tax liability and **overtime should account for the offsetting PTET credits, reducing or eliminating overpayments.**



Source: Virginia Department of Taxation, Update on Pass-Through Entity Tax, presented to Senate Finance and Appropriations Committee on October 17, 2023.





# Revenue Outlook

# September Forecast Points to a Slowdown

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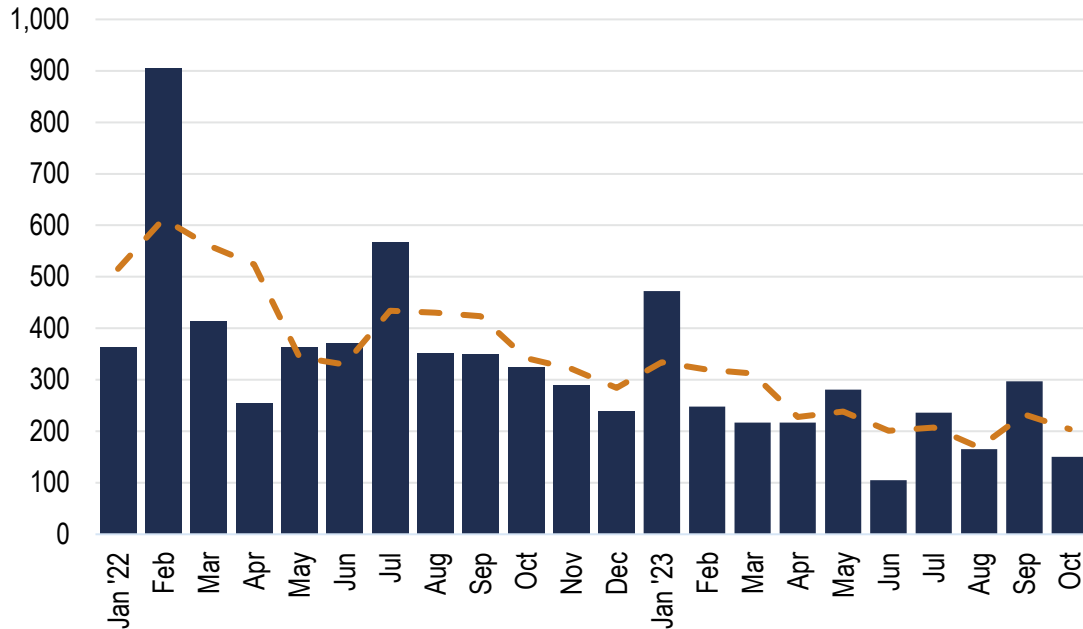
- **Soft Landing (50 percent probability of performing better)**
  - Assumes inflation is beginning to ease and economy has cooled from the Federal Reserve rate hikes.
  - Federal Reserve completes tightening.
  - Real GDP increases 1.8 percent in FY 2024, 1.4 percent in FY 2025 and 2.4 percent in FY 2026.
- **Mild Recession (75 percent probability of performing better)**
  - Assumes higher interest rates, higher inflation, prolonged government shutdown, tighter credit, and rising geopolitical pressures tip the U.S. into a recession.
  - Real GDP falls in CY 2023 4<sup>th</sup> quarter and the downturn lasts until the CY 2024 2<sup>nd</sup> quarter. Real GDP increases 1.0 percent in FY 2024, 0.7 percent in FY 2025, and 3.2 percent in FY 2026.
  - Unemployment rate rises to 6.5 percent in the 3<sup>rd</sup> quarter of 2024.
- **The Joint Advisory Board of Economists' consensus was to assume a mild recession.**

*Source: U.S. Bureau of Economic Analysis (BEA); Moody's Analytics Estimated and Forecasted September 2023.*

# U.S. Labor Market Shows Sign of Cooling

## U.S. Monthly Job Creation and 3-Month Moving Average

In Thousands



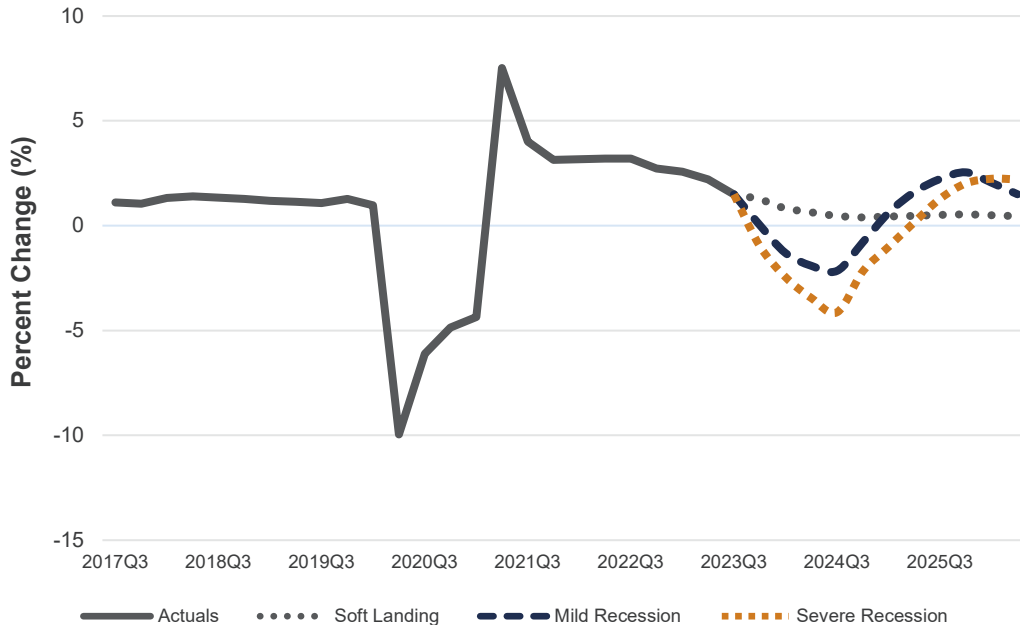
Source: Federal Reserve Bank of St. Louis.

- The U.S. added 150,000 jobs in October. The 3-month average for new jobs is 204,000 compared to 266,000 average in September (pre-revised September).
- The U.S. September quits rate remained at 2.3 percent, the lowest since before the pandemic.
- U.S. Real GDP increased at an annual rate of 4.9 percent in 2023 Q3.
- U.S. labor productivity increased 4.7 percent annually. Stronger productivity means fewer wage increases are passed on to consumers through higher prices.
- Federal Reserve kept rates steady for the third consecutive meeting and higher interest rates are slowly working through the economy.

# Virginia's Job Growth is Expected to Slow

Jobs are expected to decline after 2.7 percent growth in FY 2023.

Year-over-year growth in nonfarm employment.



- Under the mild recession scenario, total nonfarm employment is estimated to have negative growth of 0.5 percent in FY 2024 and 0.2 percent in FY 2025 but increase 2.1 percent in FY 2026.
- Under the soft landing, employment growth is estimated to grow 1.0 percent in FY 2024, 0.4 percent in FY 2025, and 0.5 percent in FY 2025.
- Labor demand continues to exceed labor supply, but the gap is narrowing.
- Virginia's quit rate remained at 2.7 percent in August, compared to the 2019 average of 2.3 percent.
- Virginia's unemployment rate was 2.5 percent in September with the U.S. rate at 3.8 percent.
  - Virginia's unemployment rate is down 0.3 percentage point on a year-over-year basis.
  - Virginia's lower rate is a product of weaker growth in our labor force participation.

Source: U.S. Bureau of Labor Statistics (BLS); Moody's Analytics Estimated and Forecasted October 2023. Seasonally adjusted total nonfarm employees.

# Virginia's Low-Wage Jobs are Growing Faster Than Higher-Wage Jobs

## Year-Over-Year Job Growth By Sector

<i>(Sector Share of Overall VA Employment)</i>	<b>Avg. VA Salary*</b>	<b>Forecast</b>	<b>FY 2023</b>	<b>FY 2024</b>	<b>FY 2025</b>	<b>FY 2026</b>
<b>Total Nonagricultural</b>	<b>\$67,990</b>	<b>Standard</b>	<b>2.7%</b>	<b>1.0%</b>	<b>0.4%</b>	<b>0.5%</b>
		<b>Mild</b>		<b>(0.4%)</b>	<b>(0.2%)</b>	<b>2.1%</b>
Trade; Transportation & Utilities (16%)	\$51,166	Standard	1.0%	0.1%	0.6%	0.4%
		Mild		(1.3%)	0.1%	1.9%
<b>Financial Activities (5%)</b>	<b>\$102,495</b>	Standard	1.0%	0.5%	0.3%	0.1%
		Mild		(1.3%)	(0.7%)	1.7%
<b>Professional &amp; Business Services (13%)</b>	<b>\$122,110</b>	Standard	2.5%	0.4%	0.5%	1.2%
		Mild		(1.4%)	(0.4%)	3.0%
<b>Education &amp; Health Services (14%)</b>	<b>\$57,089</b>	Standard	4.3%	2.4%	0.8%	0.5%
		Mild		0.6%	0.3%	2.5%
<b>Leisure &amp; Hospitality (10%)</b>	<b>\$24,869</b>	Standard	6.7%	1.4%	0.7%	0.3%
		Mild		(0.3%)	(0.3%)	2.0%
Government (18%)	\$67,279	Standard	1.6%	2.3%	0.2%	0.2%
		Mild		2.1%	0.3%	0.9%

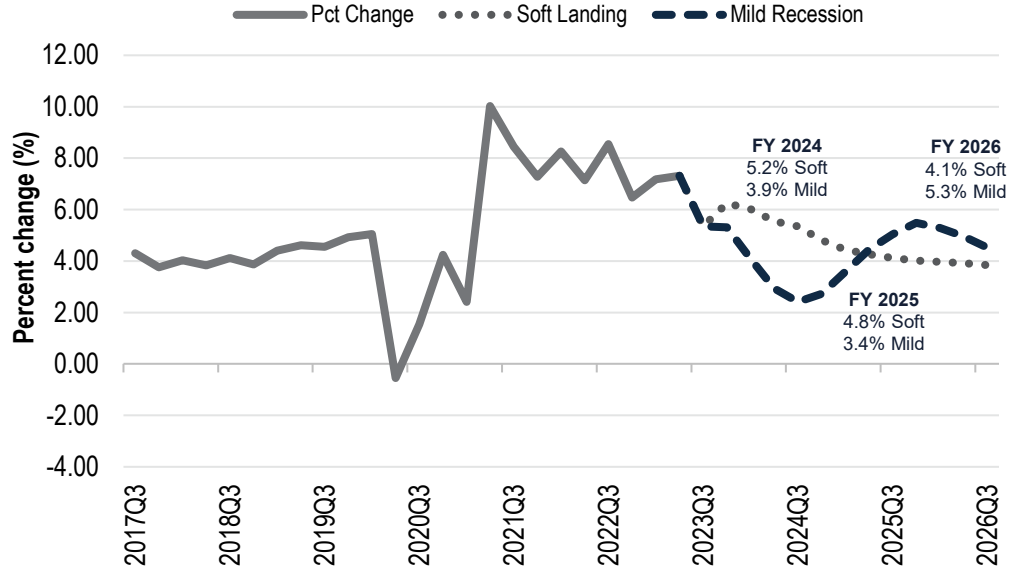
Source: U.S. Bureau of Labor Statistics (BLS); Moody's Analytics Estimated and Forecasted October 2023; Virginia Department of Taxation, March 2023 Virginia Economic and Revenue Brief.

\* Average Salary data is based on the latest 2021 full year data from the Quarterly Census of Employment and Wages (QCEW)

# Virginia's Wage Growth is Estimated to Moderate

Wages & Salaries are expected to moderate significantly from 7.6 percent growth in FY 2023.

Quarter over Quarter growth in VA Wages & Salaries



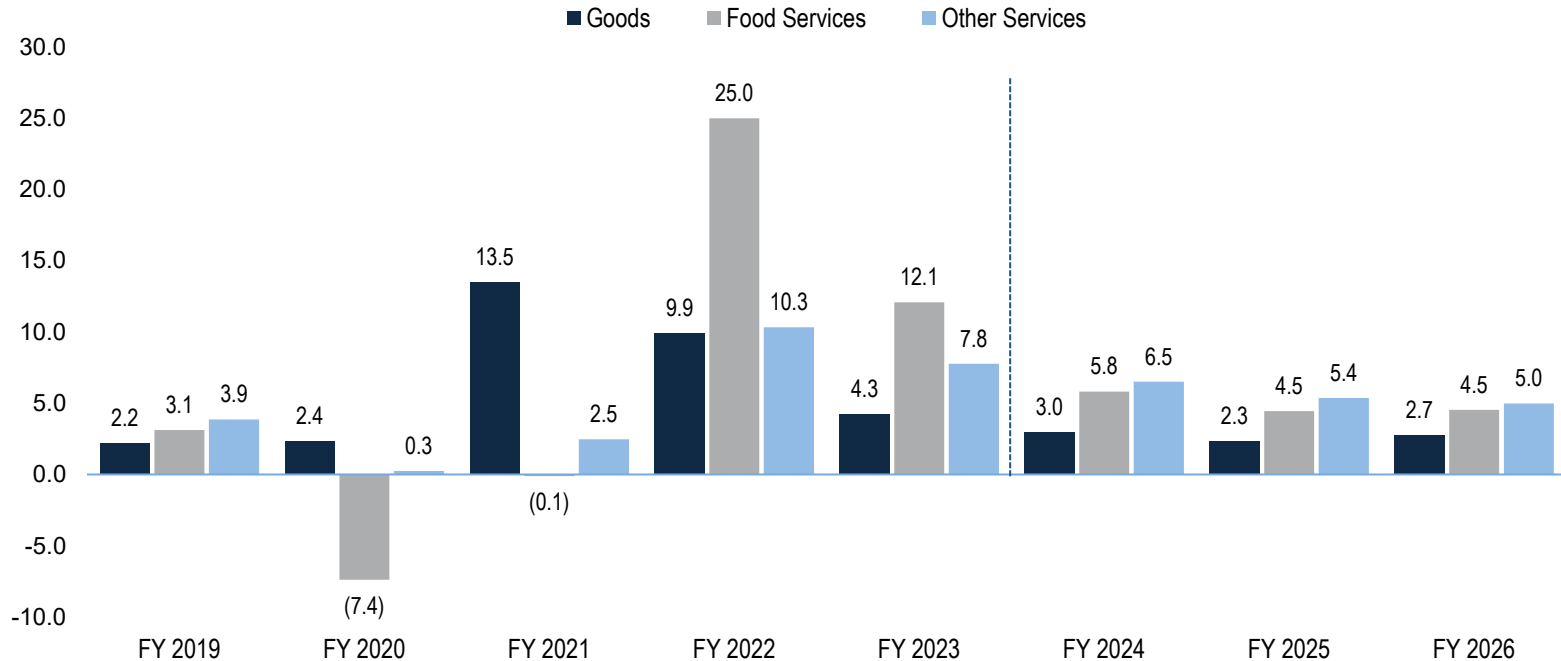
- Wages and salaries are estimated to moderate to pre-pandemic trends under the soft landing and moderate further under a mild recession.
- Job growth slowing in higher-paying sectors will likely dampen withholding growth collections.

Source: U.S. Bureau of Labor Statistics (BLS); Moody's Analytics Estimated and Forecasted October 2023.

# Virginia's Spending Consumption is Expected to Moderate

Consumer consumption patterns were distorted by the pandemic. Goods and food services consumption is expected to slow in the next biennium.

Year over year % growth.



Source: U.S. Bureau of Labor Statistics (BLS); Moody's Analytics Estimated and Forecasted October 2023 Baseline Virginia Forecast.

# FY 2024: Year-to-Date Revenue Collections

Major Sources (\$ in millions)	FY 2024 Ch. 2 Forecast	Jul - Oct FY 2024	Jul - Oct FY 2023	% Change		% Req. Growth Nov - Jun
				Actual	Req. by Est	
Withholding	\$15,852.9	\$5,140.6	\$5,090.6	1.0	(0.7)	(1.4)
Nonwithholding	4,687.6	1,000.0	1,211.8	(17.5)	(29.3)	(31.9)
Refunds	<u>(2,834.8)</u>	<u>(738.8)</u>	<u>(1,243.6)</u>	<u>(40.6)</u>	<u>(21.3)</u>	<u>(11.2)</u>
Net Individual	\$17,705.7	\$5,401.8	\$5,058.8	6.8	(6.7)	(11.6)
Sales & Use Tax	4,418.2	1,589.4	1,585.4	0.3	(6.7)	(10.2)
Corporate	1,896.1	611.6	491.5	24.4	(6.6)	(16.6)
Wills/Suits/Deeds	374.9	136.1	171.0	(20.5)	(12.9)	(8.0)
Insurance	429.7	-	-	-	(4.7)	(4.7)
All Other	<u>1,544.7</u>	<u>746.0</u>	<u>260.7</u>	<u>186.2</u>	<u>20.7</u>	<u>(21.6)</u>
<b>Total GF Revenue</b>	<b>\$26,369.3</b>	<b>\$8,484.9</b>	<b>\$7,567.4</b>	<b>12.1</b>	<b>(5.5)</b>	<b>(12.1)</b>
<b>Adjusted Withholding</b>		\$5,318.4	\$5,090.6	4.5		
<b>Adjusted Nonwithholding</b>		1,292.8	1,211.8	6.7		
<b>Adjusted Refunds</b>		(419.4)	(274.1)	53.0		
<b>Adjusted Sales</b>		<u>1,619.0</u>	<u>1,585.4</u>	<u>2.1</u>		
<b>Total Adjusted GF Revenues</b>		<b>\$9,013.6</b>	<b>\$8,536.9</b>	<b>5.6</b>		

- Unadjusted GF revenues increased 12.1 percent and are \$917.5 million ahead compared to FY 2023.
- GF revenues are \$1.3 billion ahead of the official forecast decline assumed in the Chapter 1 forecast.
- FY 2024 forecast can now be met even if revenues contract 12.1 percent over the next 8 months.

Source: SFAC Staff Analysis of Secretary of Finance Presentation to House Appropriations Committee, November 14, 2023.



# Adjustments to the FY 2024 Economic Outlook

- FY 2023 actual economic performance in job and wage growth exceeded the forecast as a projected recession beginning in CY 2022 Q4 did not occur.
- The official forecast in Chapter 1 assumes more downside risks from a potential recession and appears too pessimistic based on economic performance and year-to-date collections.

% change	VA Job Growth	VA Avg. Wage/Salary Growth	VA Jobs + Avg. Wage Salary	U.S. Real Consumer Spending	VA Personal Income Growth
FY 2023 Forecast (Oct. 2022)	2.5%	5.5%	8.0%	0.9%	5.5%
FY 2023 Actuals	2.7%	7.6%	10.3%	2.1%	6.1%
FY 2024 Soft Landing	1.0%	5.2%	6.2%	2.1%	4.7%
<b>FY 2024 Mild Recession</b>	<b>(0.5%)</b>	<b>3.9%</b>	<b>3.4%</b>	<b>1.3%</b>	<b>3.9%</b>

Source: Virginia Dept. of Taxation; FY 2023 Forecast Oct. Standard IHS Markit; FY 2024 Moody's Analytics Estimated and Forecasted September 2023.

# SFAC Outlook Assumes a Mild Recession

- In October, the Joint Advisory Board of Economists' consensus was a mild recession scenario based on sectoral performance of jobs, potential government shutdown, global tension, and tightening money supply.
- Mild recession scenario expects job growth to contract 0.2 percent in FY 2025 and grow 2.1 percent in FY 2026. Wage and personal income growth moderates from recent increases.

% change	VA Job Growth	VA Avg. Wage/Salary Growth	VA Jobs + Avg. Wage Salary	U.S. Real Consumer Spending	VA Personal Income Growth
FY 2025 Soft Landing	0.5%	4.8%	5.3%	1.6%	4.5%
<b>FY 2025 Mild Recession</b>	<b>(0.2%)</b>	<b>3.4%</b>	<b>3.2%</b>	<b>1.0%</b>	<b>3.3%</b>
FY 2026 Soft Landing	0.5%	4.1%	4.6%	2.1%	4.4%
<b>FY 2026 Mild Recession</b>	<b>2.1%</b>	<b>5.3%</b>	<b>7.4%</b>	<b>2.8%</b>	<b>4.2%</b>

Source: Virginia Dept. of Taxation; Moody's Analytics Estimated and Forecasted September 2023.

# SFAC Staff General Fund Revenue Outlook

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Upward adjustment can be made in FY 2024 with growth slowing to pre-pandemic trends in 2024-2026 biennium.

- FY 2023 base includes one-time rebates increasing refunds by \$1.0 billion and an estimated \$1.0 billion overpayment of individual income tax related to the Pass-Through Entity Tax.
- FY 2024 official forecast, adopted in September, assumed more downside risks, but these have not materialized in the 1<sup>st</sup> quarter of FY 2024. Official forecast assumes a 5.5 percent decline in revenue.
- Year-to-date FY 2024 collections are well ahead of forecast with nearly \$1.3 billion “in the bank.” Revenues, excluding transfers, could contract 12.1 percent from November to June and still meet the FY 2024 forecast.
- Economic outlook is increasingly pointing to the U.S. entering a slowdown or mild recession in the next year. Soft landings have been hard to achieve in the past and interest rate hikes are slowly working through the economy.
- Staff forecast utilizes the September mild recession forecast assumptions to mitigate risk with additional downward adjustments in nonwithholding due to volatility and unknown taxpayer behavior related to Pass-Through Entity Tax.
- Year to date performance in corporate income, interest income, and stronger than expected growth in withholding and sales tax supports a \$1.4 billion upward adjustment to FY 2024, 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 2025 to 3.0 percent and grow 3.8 percent in FY 2026.

# SFAC Staff General Fund Revenue Forecast

GF Revenue Sources	Actual	SFAC Staff Estimate		
	FY 2023	FY 2024	FY 2025	FY 2026
<b>Growth by Revenue Source</b> (% of total revenue)				
Individual Income (70.0%)	\$18,983.6	\$18,579.1	\$19,212.6	\$20,047.2
Sales (17.4%)	4,734.6	4,767.0	4,906.6	5,050.9
Corporate (5.0%)	2,031.1	2,050.4	2,064.1	2,118.6
Wills/Suits/Deeds (2.2%)	430.6	375.0	379.5	384.9
All Other (3.7%)	<u>1,730.2</u>	<u>2,000.7</u>	<u>2,041.6</u>	<u>2,081.9</u>
<b>Total GF Revenue</b>	<b>\$27,909.9</b>	<b>\$27,772.2</b>	<b>\$28,604.4</b>	<b>\$29,683.5</b>
	<b>(3.5%)</b>	<b>(0.5%)</b>	<b>3.0%</b>	<b>3.8%</b>
<b>General Fund Revenues</b>	<b>\$27,909.9</b>	<b>\$27,772.2</b>	<b>\$28,604.4</b>	<b>\$29,683.5</b>
<b>Transfers (excludes 2023 Tax Rebate)</b>	<b><u>815.6</u></b>	<b><u>821.5 *</u></b>	<b><u>839.9</u></b>	<b><u>864.0</u></b>
<b>Total General Fund</b>	<b>\$28,725.5</b>	<b>\$28,380.1</b>	<b>\$29,444.4</b>	<b>\$30,547.6</b>
<b>GF Resources Above Official Forecast</b>	<b>\$3,139.7</b>	<b>\$1,447.5</b>		

# Risks are Skewed to the Downside and Require a Conservative Outlook

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- “Soft Landing” may be possible. Recent economic performance continues to push potential slowdown further out.
- Recent increases to the standard deduction have reduced individual income tax revenue, the primary GF source, and staff would caution against further changes without adjusting spending or increasing other revenue sources.
- Risks that could tip this to a downturn:
  - Further Fed rate hikes/overstep.
  - Extended federal government shutdown.
  - Oil prices spike.
  - Geopolitical tensions increase.
  - Tightening credit.
  - Housing supply and prices.
  - Weaker consumer spending as savings are depleted.

# 2023 Revenue Forecasting Schedule

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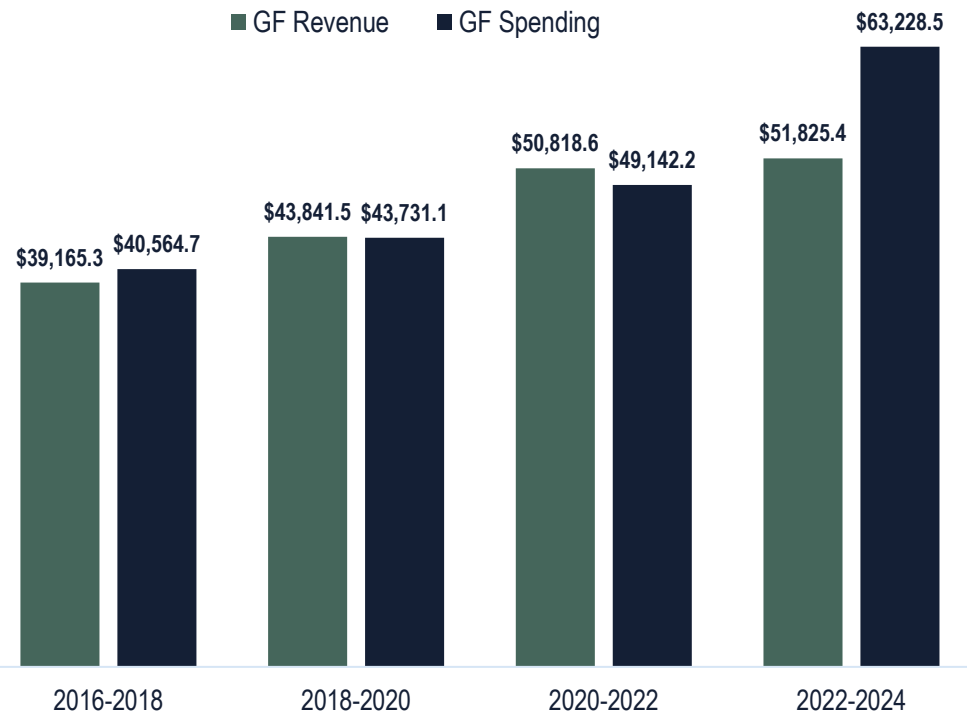
- **August 7:** Governor's Advisory Council on Revenue Estimates (GACRE) met to discuss labor and economic conditions with Virginia business leaders and General Assembly leadership.
- **October 11:** Joint Advisory Board of Economists (JABE) reviewed economic projections for current biennium.
- **November 20:** GACRE will review Administration developed revenue forecast for FY 2024 and the 2024-2026 biennium.
- **December 20:** Governor submits revised forecast and proposed amendments for FY 2024 and introduces the 2024-2026 biennial budget.



# 2024 Session Outlook

# 2022-2024 Biennial Spending Relies on Balances, but Spending Focused on One-Time Items

During the 2022-2024 biennium, GF spending exceeded GF revenue by \$11.4 billion with cash balances allowing the level of operating and capital spending.



2022-2024 Major One-Time GF Spending (\$ in millions)	
Capital Outlay GF Cash	\$2,460.5
Revenue Stabilization and Revenue Reserve Funds	\$1,533.7
Water Quality Improvement Fund Deposits	\$957.5
2023 Tax Rebate (\$200/\$400)	\$906.8
School Construction Grants	\$800.0
Transportation GF Cash	\$311.6
Business Sites	\$309.0
Revenue Reserve Fund	\$289.6
VRS Deposit	\$250.0
Major Headquarters Workforce Grant	\$120.5
Economic Development Projects	\$43.5

Source: The Appropriation Act. Reflect GF revenue, including transfers, and spending contained within the Caboose Budget each biennium.



# 2024 Session has Two Budget Bills

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In even-numbered sessions, action is taken to amend the current year budget (FY 2024) and to adopt a budget for the biennium that starts July 1, 2024.

- **SB 29 (“Caboose Bill”)** – Amends the CURRENT budget (Chapter 1) to reflect the revised revenue estimate, required spending, and any savings in FY 2024.
  - Effective when signed by the Governor.
- **SB 30** – The proposed biennial budget for the next two fiscal years, **FY 2025 and FY 2026**.
  - Effective July 1, 2024.

# Caboose Bill Adjustments

FY 2024 GF Caboose Adjustments (\$ in millions)	
Chapter 1, Unappropriated Balance	\$7.3
Additional Revenue (SFAC staff estimate)	1,447.5
Medicaid Forecast Update	125.9
Increased Lottery Profits (offsets K-12 GF)	89.5
K-12 Adjustments (Sales Tax and Enrollment)	<b>TBD</b>
Revert Discretionary Reappropriations (2/3 of reserved amount)	628.3
Additional Capital Project Supplements	<u>(300.0)</u>
<b>Net Available Resources/Unappropriated Balance</b>	<b>\$1,998.5</b>

- Agency requests for FY 2024 total \$88.9 million.

# Calculating the Base Budget

- **Base budget** = cost of maintaining **current** services and caseloads (FY 2024 appropriation).
- **One-time** spending items are **deducted** from the base year budget (e.g. cash reserve deposits).
- On-going items that are **not fully funded** in FY 2024 are **added** to the base (e.g. new position costs, partial-year items).

2024-2026 GF Base Budget Calculation (\$ in millions)	
Ch. 1, FY 2024 GF Approp. x 2	\$62,647.3
Minus: One-time Spending/Savings	(3,791.3)
Plus: Annualization of Costs	457.2
<b>Total, Adjustments to Base</b>	<b><u>(3,334.1)</u></b>
<b>Biennial (Two-Year) GF Base</b>	<b>\$59,313.2</b>

# Agency Operating Requests Total \$3.7 billion for 2024-2026 Biennium

Secretarial Area (\$ in millions)	FY 2025	FY 2026
Administration	\$26.3	\$35.8
Agriculture & Forestry	11.1	9.7
Commerce & Trade	280.3	274.7
Education	863.2	696.4
Executive Offices	3.4	3.4
Finance	0.03	0.03
Health & Human Resources	312.0	356.7
Independent Agencies	5.0	47.0
Judicial	3.2	5.4
Labor	14.3	14.3
Natural Resources	344.3	87.5
Public Safety & Homeland Security	119.4	128.7
Transportation	6.8	6.8
Veterans & Defense Affairs	<u>41.5</u>	<u>14.7</u>
<b>Grand Total</b>	<b>\$2,030.8</b>	<b>\$1,681.0</b>

- Agency requests total more than \$3.7 billion for the biennium.
- This does not include:
  - Medicaid Forecast;
  - K-12 Rebenchmarking; or
  - Costs for an across-the-board salary increase for state and state-supported local employees.

Source: Department of Planning and Budget, accessed November 14, 2023, Agency Operating Requests.

# Capital Outlay Requests Total \$7.1 billion GF

## GF/Tax Supported Debt Capital Project Requests 2024-2026 Biennium

(\$ in millions)	Total Project Requests	GF Portion
Acquisition/Demolition/Planning	\$47.1	\$40.8
Improvements/Renovations	2,069.3	2,001.6
Maintenance Reserve/Deferred Maintenance	306.8	306.1
New Construction	5,437.8	4,705.8
Supplements – Cost Escalations/Overruns	<u>2.5</u>	<u>2.5</u>
<b>Total</b>	<b>\$7,863.4</b>	<b>\$7,056.7</b>

- Higher Education Institutions requests for GF supported capital total \$5.0 billion.
- SFAC staff analysis suggests \$950.0 million of these requests represent previously authorized commitments (detailed planning complete), or high priority projects, including maintenance reserve, infrastructure, or life-safety project.
- Other needs are expected to include (SFAC budget outlook assumes):
  - Additional project supplements (\$300.0 million in FY 2024);
  - Continuing the maintenance reserve program (\$400.0 million); and,
  - Equipment needs for projects nearing completion (\$80.0 million).
- During the 2022-2024 biennium, the General Assembly funded most capital projects with cash and limited debt authorizations even though debt capacity was available in each year.
  - Debt capacity model will be updated in December, but capacity is sensitive to actual forecasted revenues and interest rates.

Source: SFAC Analysis of Capital Agency Requests, Department of Planning and Budget.

# Developing the 2024-2026 Budget

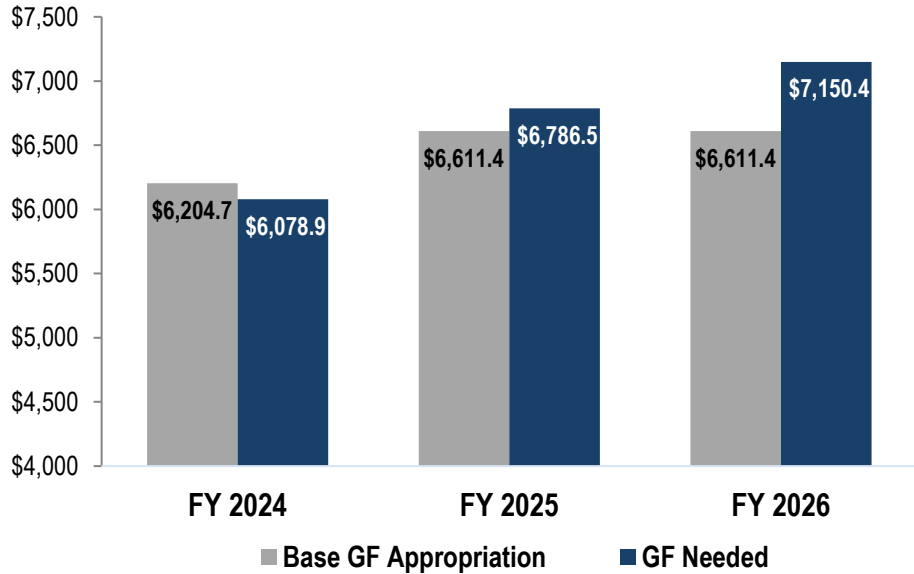
## Projected Resources Compared to the Base Budget

(\$ in millions)	FY 2025	FY 2026	2024-2026
SFAC Projected GF Resources	\$29,444.4	\$30,547.6	\$59,992.0
GF Adjusted Base Budget	<u>(29,656.6)</u>	<u>(29,656.6)</u>	<u>(59,313.2)</u>
<b>Resources Above Base</b>	<b>(\$212.2)</b>	<b>\$891.0</b>	<b>\$678.8</b>

# Medicaid Forecast Reflects Significant GF Need as Federal Pandemic Funding Expires

Forecast projects net savings in FY 2024 and a GF need during the 2024-2026 Biennium.

(\$ in millions)



- Medicaid Forecast projects **net savings of \$125.9 million GF in FY 2024** and an additional need of **\$714.0 million GF over the 2024-2026 Biennium.**
- FY 2024 GF savings is due to lower-than-expected managed care rates and utilization.
- 2024-2026 biennial GF need is due to higher managed care rates, inflationary increases for providers, the annualized costs of recent budget actions, lower pharmacy rebates, and a lower federal match rate.
- Forecast anticipates overall Medicaid spending will increase:

	<u>FY 2024</u>	<u>FY 2025</u>	<u>FY 2026</u>
<b>Current Forecast</b>	<b>(4.0%)</b>	<b>8.3%</b>	<b>6.2%</b>
Last Year's Forecast	3.2%	2.9%	N/A

# Budget Outlook 2024 Session

## Comparing projected resources to spending needs

- Available resources from the economic forecast are **not** sufficient to cover major budget pressures. However, there are many other spending items that would typically be considered.

### 2024-2026 Budget Outlook

(\$ in millions)	FY 2025	FY 2026	2024-2026
SFAC Staff Projected GF Resources	\$29,444.4	\$30,547.6	\$59,992.0
GF Base Budget	<u>(29,656.6)</u>	<u>(29,656.6)</u>	<u>(59,313.2)</u>
<b>Resources Above/Below Base</b>	<b>(212.2)</b>	<b>\$891.0</b>	<b>\$678.8</b>
Less: Medicaid Forecast	(175.1)	(538.9)	(714.0)
Less: Shortfall in Health Care Fund	(235.2)	(239.8)	(475.0)
Less: CSA/Children's Health Insurance & Child Welfare Forecast	(44.5)	(78.9)	(123.4)
Less: K-12 Rebenchmarking (other updates to come, could increase or decrease)	(171.8)	(244.5)	(416.3)
Less: SFAC Identified Other Mandatory Pressures or Commitments	<u>(4.6)</u>	<u>(39.4)</u>	<u>(44.0)</u>
<b>Net Available Resources*</b>	<b>(\$843.4)</b>	<b>(\$250.5)</b>	<b>(\$1,093.9)</b>



# Budget Outlook 2024 Session

One-time balances from FY 2024 will be carried forward and available for one-time uses

(\$ in millions)	FY 2025	FY 2026	2024-2026
Unreserved Beginning Balance (FY 2024 Unappropriated Balance)	\$1,998.5	-	\$1,998.5
<b>Net Available Resources</b>	<u>(843.4)</u>	<u>(250.5)</u>	<u>(1,093.9)</u>
<b>Unappropriated Balance</b>	<b>\$1,155.1</b>	<b>(\$250.5)</b>	<b>\$904.6</b>
<b>Other Potential Commitments:</b>			
Less: Increased Debt Service Costs	(\$24.4)	(\$59.3)	(\$83.7)
Less: Fund Reading Specialists (2023 Session Legislation)	(30.8)	(30.8)	(61.6)
Less: Lower K-12 Enrollment (subject to final DOE/DPB estimates)	<u>96.5</u>	<u>153.8</u>	<u>250.3</u>
<b>Adjusted Unappropriated Balance (with additional options)</b>	<b>\$1,196.4</b>	<b>(\$186.8)</b>	<b>\$1,009.6</b>

# 2022-2024 Categorized Agency Requests, Other Than Mandatory Pressures or Commitments, Total \$3.7 billion

## 2022-2024 Agency Budget Requests – Excludes Mandatory Pressures Categorized by SFAC Staff

(\$ in millions)	FY 2025	FY 2026
Governor's Priority	\$428.9	\$391.2
High Priority	189.7	216.7
Discretionary Spending	1,175.2	1,047.3
One-time Spending	<u>246.7</u>	<u>0.8</u>
<b>Total</b>	<b>\$2,040.6</b>	<b>\$1,655.9</b>

Source: Department of Planning and Budget, accessed November 6, 2023, Agency Operating Requests.

# Outlook and Considerations – 2024 Session

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- Additional GF resources of \$1.4 billion in FY 2024 forecasted to be available above the revenue assumption in Chapter 1, 2023 Special Session I.
- Economic outlook is pointing to the U.S. slowing down from the post-pandemic growth. Federal Reserve continues to pursue stable prices, which may result in a recession.
  - Virginia's job growth has been in low-wage job sectors and are expected to keep our job growth from drastically decreasing in a mild recession.
- Large year-end balances over the past two biennia allowed for additional one-time spending.
- Mandatory budget pressures will consume most or all ongoing revenue in this biennium; however, carry-forward balances from FY 2024 will be available for some one-time spending.
- Going forward, to achieve structural balance, revenue and spending will need to be closer aligned as economic uncertainty makes forecasting revenues difficult (rolling conformity, PTET, shifting consumer spending, and growing revenue loss from adopted tax policy actions).