Updates to the 2014-16 Biennial Revenue & Budget Outlook

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House Appropriations Committee

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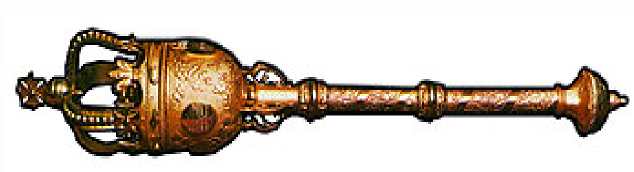
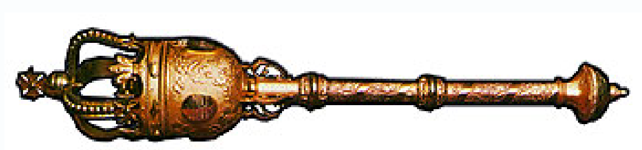


2015 Session Economic and Budget Outlook

- FY 2014 Revenue Performance
- Fall Revenue Reforecasting Process
- Recovery Compared to Prior Recessions
- Current Performance of Key Economic and Employment Indicators on a National Level
- Virginia's Economic Performance Lags the Nation's
- Year to Date Revenue Growth
- 2015 Session: Addressing the Budgetary Shortfall for Remainder of the FY 2014-16 Biennium Budget

FY 2014 Revenue Performance



Chapter 2 Revenue Assumptions

- Chapter 2 (FY 2014-16 biennial budget adopted in June) attempted to address the budget shortfall *known at that time*
- It was predicated on a three-year shortfall of $1.55 billion, compared to the Official Mid-Session reforecast
  - FY 2014 - $350.0 million
  - FY 2015 - $600.0 million
  - FY 2016 - $600.0 million
- Because the Caboose Budget (Chapter 1) had already been adopted, the entire 3-year estimated shortfall was programmed into Chapter 2
- Most of the assumed shortfall was based on lower estimated/final payments in FY 2014. The lower revenue base was carried through to FY 2015 and FY 2016, resulting in an anticipated shortfall of $500.0 million each fiscal year
- An additional negative annual adjustment of $100.0 million was included to reflect softness in payroll withholding
- Chapter 2 included a reserve of $842.5 million and anticipated withdrawal of $707.5 million from the Rainy Day Fund to close the $1.55 billion gap

FY 2014 Year-End Close Revealed Revenues Declined More Than Anticipated

- In August, the Governor reported that FY 2014 revenues and transfers finished $437.8 million below the forecast
  - All major tax sources - Corporate, Withholding, Nonwithholding, Sales and Recordation Taxes – were down $559.1 million
  - This was offset by $120.6 million in better than anticipated performance of refunds, insurance premium taxes, interest earnings, and other minor sources (ABC/Beer)
- While the largest deficit was in nonwithholding, the widespread nature of the shortfall reflects that the Virginia economy was weaker than the national economy. Both Virginia's employment and personal income growth were more anemic than expected
- Payroll employment rose by 22,800 jobs in FY 2014, an increase of only 0.6% compared to the official forecast of a 1.0% increase
  - 8,200 job losses were seen in the high-paying professional and business services sector. Lower-paying education and health services sector gained 11,800 jobs and leisure and hospitality gained 5,200 jobs
- Personal income growth also fell short of the forecast, increasing 1.6% in FY 2014 compared to a forecast of 2.9% growth

FY 2014 Year-End Close Revealed Revenues Declined More Than Anticipated

- The FY 2014 shortfall – which was $88 million more than anticipated in Chapter 2 – triggered the requirement for an immediate revenue reforecast
- JABE met in July, and while members generally supported the national forecast presented, they questioned whether Virginia's growth would be as robust, or fall below the Global Insight forecast
  - Board of Economists' concerns were driven by anticipated continued weak job and income growth in Northern Virginia and Hampton Roads, both of which are heavily dependent on federal spending
- Similar concerns were expressed at GACRE by the legislative members and business industry representatives
- This led to modifications to the model-driven forecast, including reductions to the estimates of job and wage growth in Virginia

August Interim Forecast

- Governor McAuliffe presented the revised revenue forecast to the Joint Money Committees on August 15th
- The August interim general fund revenue reforecast for FY 2014-16, which was based on the May Global Insight economic outlook with adjustments made based on the recommendations of JABE and GACRE
- The forecast is significantly lower than was anticipated in Chapter 2 and reflects the following:
  - The impact of the FY 2014 shortfall on the FY 2015 revenue base
  - The expectation that Virginia will continue to underperform the Nation
  - Continued sluggish job and wage and salary growth, particularly in Northern Virginia, which typically accounts for half of the state's job growth and pays amongst the highest salaries

August Interim Forecast

- What model changes drove the adjustments in the Interim forecast?
- The employment outlook for Virginia in the interim forecast for 2015 is 0.7%, half the expected growth rate assumed in the November 2013 forecast that formed the basis of Chapter 2 revenues
  - The revised job outlook for Northern Virginia is 0.6%, a drop of 1%
  - The revised job outlook for Hampton Roads is 0.9%, a drop of 1.2%
  - The revised job outlook for Richmond is 1.4%, a drop of 0.5%
- Total personal income and average wage and salary growth also were reduced a full percent in FY 2015 and about half a percent in FY 2016
- Based on this outlook, total general fund revenue growth of 2.7% each year (reduced from 5.2% in FY 2015 and 4.1% in FY 2016 in Chapter 2) is assumed in the Interim forecast

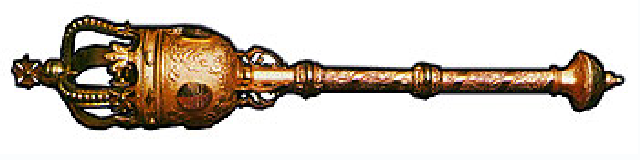
Interim General Fund Revenue Forecast for FY 2014-16 Biennium

($ in Millions)

Source	FY 2015 % Growth Ch. 2 Forecast	FY 2015 % Growth Interim Forecast	FY 2015 Forecast Chapter 2 Forecast	FY 2015 Forecast August Interim Forecast	FY 2016 % Growth Ch. 2 Forecast	FY 2016 % Growth Interim Forecast	FY 2016 Forecast Chapter 2 Forecast	FY 2016 Forecast August Interim Forecast
Withholding	4.5%	2.7%	$11,025.6	$10,770.3	4.3%	3.1%	$11,504.6	$11,100.5
Nonwithholding	9.7%	6.3%	3,209.3	2,685.2	6.0%	2.3%	3,401.6	2,747.3
Refunds	4.3%	3.6%	(1,885.0)	(1,819.0)	4.2%	3.6%	(1,965.0)	(1,884.5)
Sales	4.3%	2.8%	3,211.4	3,152.5	2.9%	3.6%	3,303.5	3,265.5
Corporate	6.1%	-2.5%	816.6	738.9	1.4%	0.7%	827.7	744.2
Recordation	0.0%	1.2%	377.5	314.5	0.0%	0.0%	377.5	314.5
Insurance	0.5%	7.5%	290.9	344.4	4.2%	-4.1%	303.1	330.2
All Other	1.7%	-3.9%	675.6	675.6	3.0%	3.0%	695.6	695.6
Total GF Revenue	5.2%	2.7%	**$17,721.9**	**$16,862.4**	4.1%	2.7%	**$18,448.6**	**$17,313.3**

Note: Chapter 2 addressed $600.0 million each year in anticipation of the reforecast. The net additional shortfall (including FY 2014 shortfall) totals $881.5 million

Fall Revenue Reforecasting Process



Fall Revenue Forecasting Process

- Although the FY 2014 shortfall triggered the revenue reforecast in August, § 2.2-1503 of the Code requires the Governor to prepare a forecast of the economic activity in the Commonwealth each fall
- As such, the process is being repeated prior to the introduction of the Governor's proposed amendments to the budget in December
- The Joint Advisory Board of Economists (JABE) met again in October to review the latest economic assumptions
- Governor's Advisory Council on Revenue Estimates (GACRE) – comprised of business leaders and House and Senate leadership – will meet next Monday to provide its input on likely economic activity levels
- Governor will present his proposed amendments to the budget on December 17

What Has Changed Since the May Forecast?

- Nationally, Global Insight's September standard forecast projects little to no change in GDP growth, consumer spending, average wages or employment growth in FY 2015 compared to its May forecast (which was the basis of the Interim forecast)
- In FY 2016 the projected growth rates have fallen slightly on all factors, driven by a drop-off in GDP growth
- The JABE members concurred with the national forecast, believing little had changed in recent months, but again questioned the model results for Virginia
- JABE consensus was that the August interim forecast – which contained explicit reductions in Virginia's job and income growth rates – was the most likely scenario

U.S. Economic Forecast

Percentage Change	FY 2015	FY 2016
National Forecast		
Real GDP		
May Standard	2.7	3.4
Sept Standard	2.7	2.8
Average Wage		
May Standard	2.7	3.2
Sept Standard	3.1	3.1
Consumer Spending		
May Standard	2.8	3.3
Sept Standard	2.4	3.0
Employment		
May Standard	1.9	2.0
Sept Standard	1.9	1.7

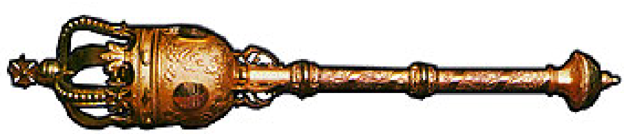
Virginia Economic Forecast

Percentage Change	FY 2015	FY 2016
Virginia Forecast		
Total Personal Income		
May Standard	4.8	4.4
Interim (May 2014)	**3.7**	**3.8**
Sept Standard	3.6	4.2
Average Wage		
May Standard	2.9	2.5
Interim (May 2014)	**2.5**	**2.1**
Sept Standard	2.7	2.6
Wages and Salaries		
May Standard	4.2	4.2
Interim (May 2014)	**3.2**	**3.6**
Sept Standard	4.2	4.3
Employment		
May Standard	1.3	1.7
Interim (May 2014)	**0.7**	**1.4**
Sept Standard	1.5	1.6

Source: Virginia Department of Taxation.

JABE economic scenario sees no change from the Interim (May 2014) forecast

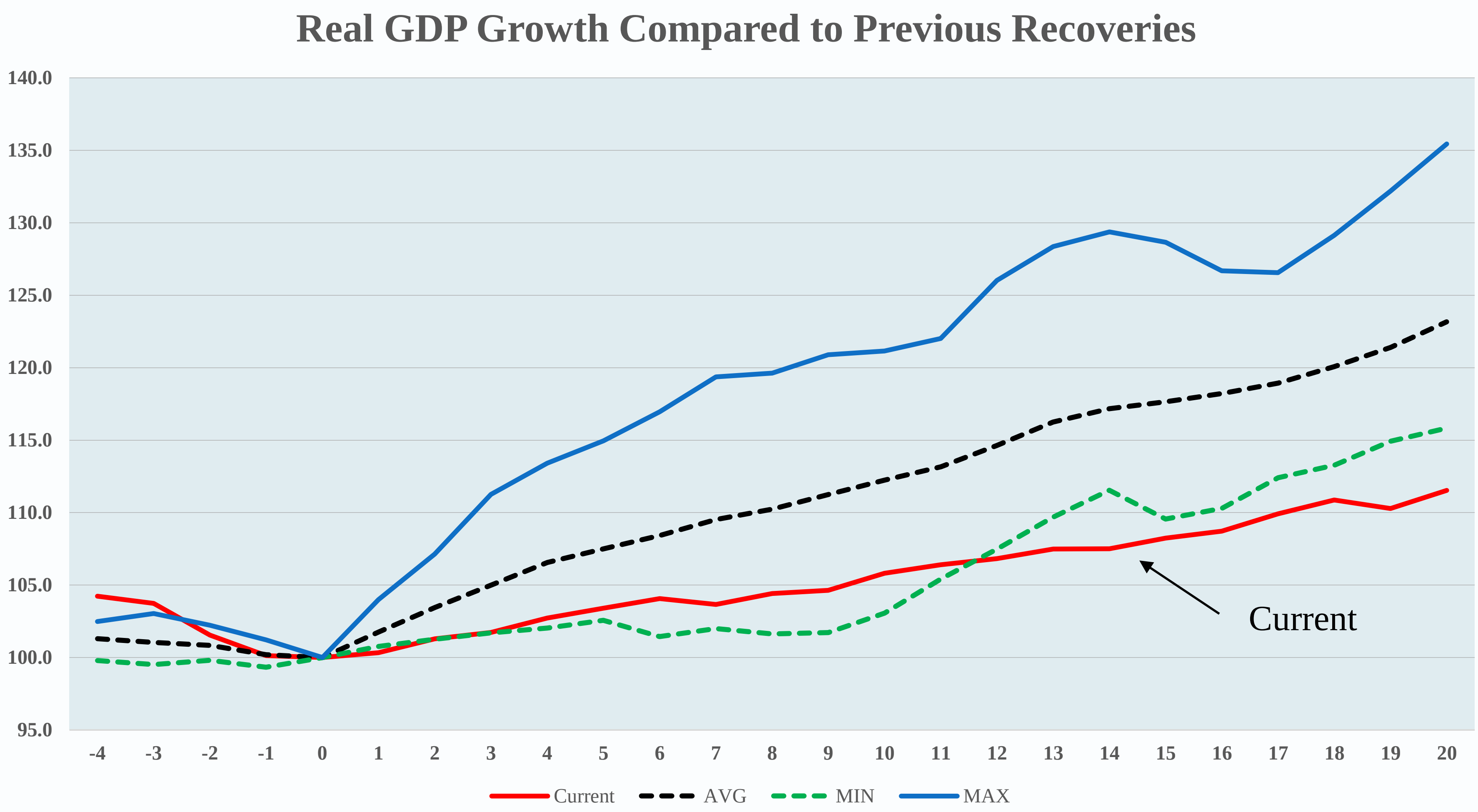
Recovery Compared to Prior Recessions



How Has the Economy Performed Since the "Official" End of the Recession?

- The St. Louis Federal Reserve has tracked economic recoveries since 1949 and has calculated comparisons of how strongly key economic measures have recovered compared to average, quickest and slowest post-recession recoveries
- Since the "Great Recession" real GDP growth has been amongst the least robust we have ever seen
- Growth has remained slow because employment, personal income growth and consumption all have lagged typical recoveries, generally performing worse than during all prior recoveries
- Equally troubling is the fact that instead of improving as we move further from the recession, the economy has shown even slower expansion

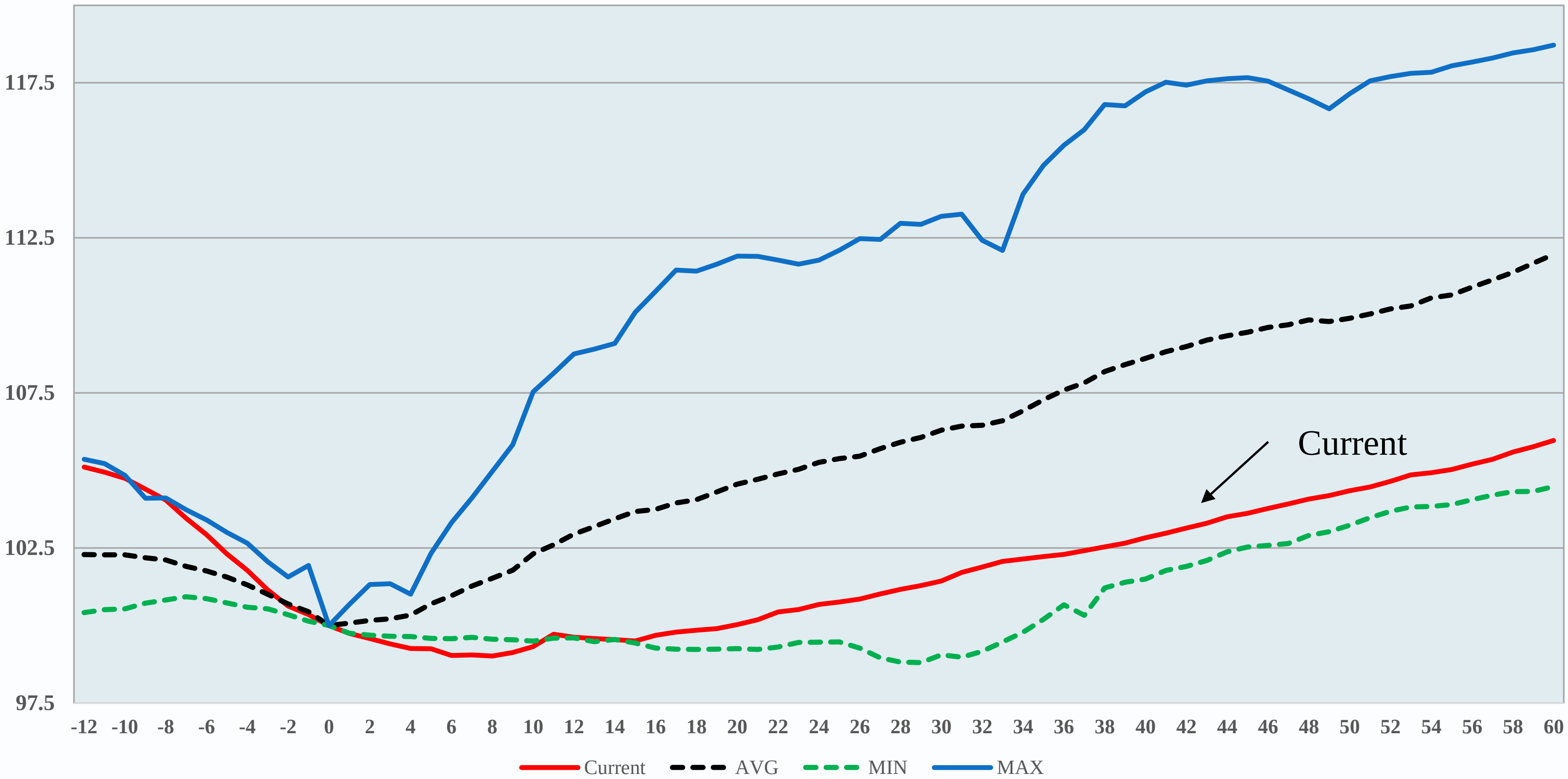
Real GDP On Par With The Worst Economic Recovery



Source: Federal Reserve Bank of St. Louis

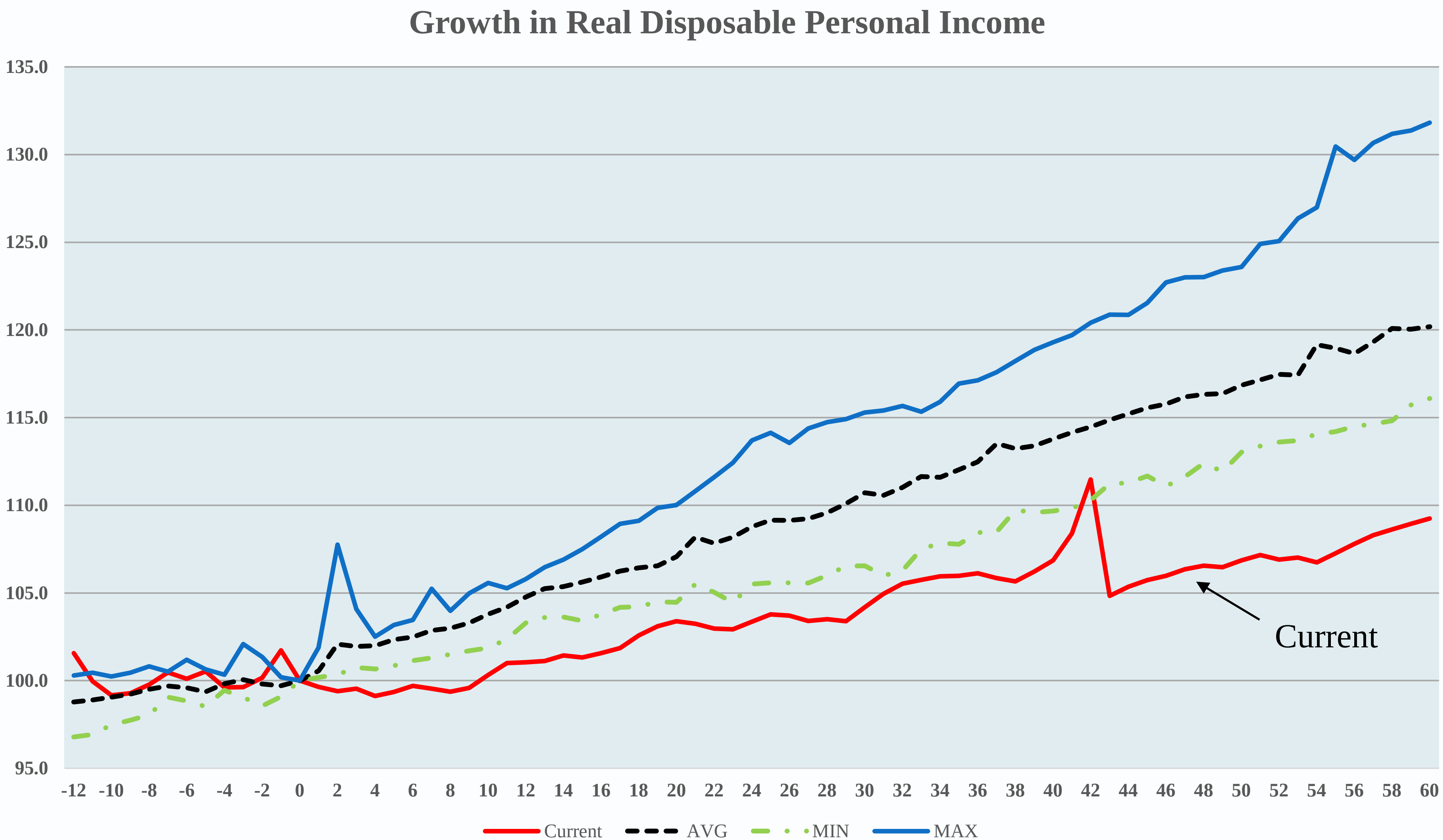
Post-Recession Job Growth Remains Well Below Average Recoveries

Job Growth Compared to Prior Recoveries



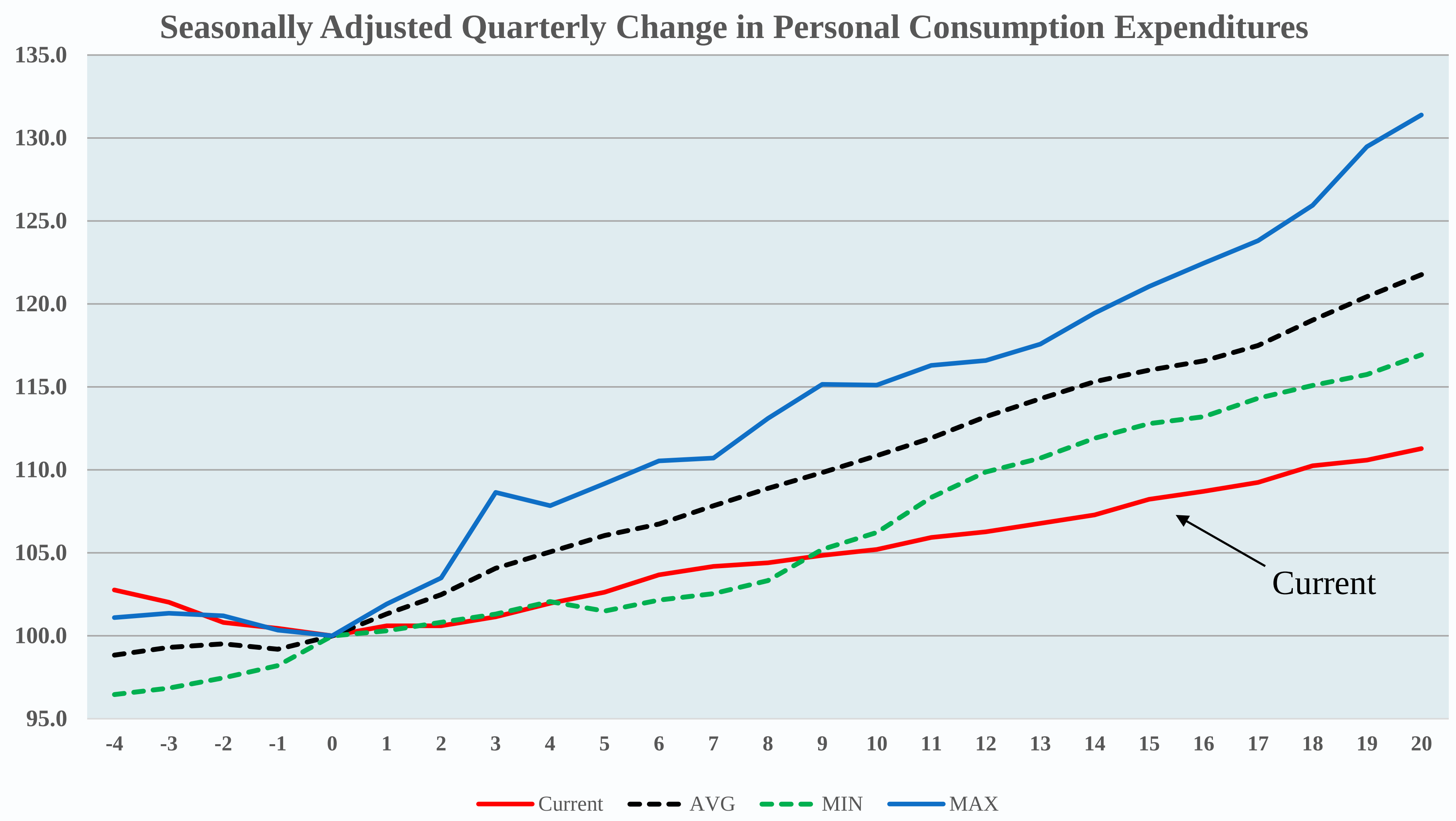
Source: Federal Reserve Bank of St. Louis

Growth in Disposable Income Continues to Perform Below All Previous Recoveries



Source: Federal Reserve Bank of St. Louis

Personal Consumption Expenditures



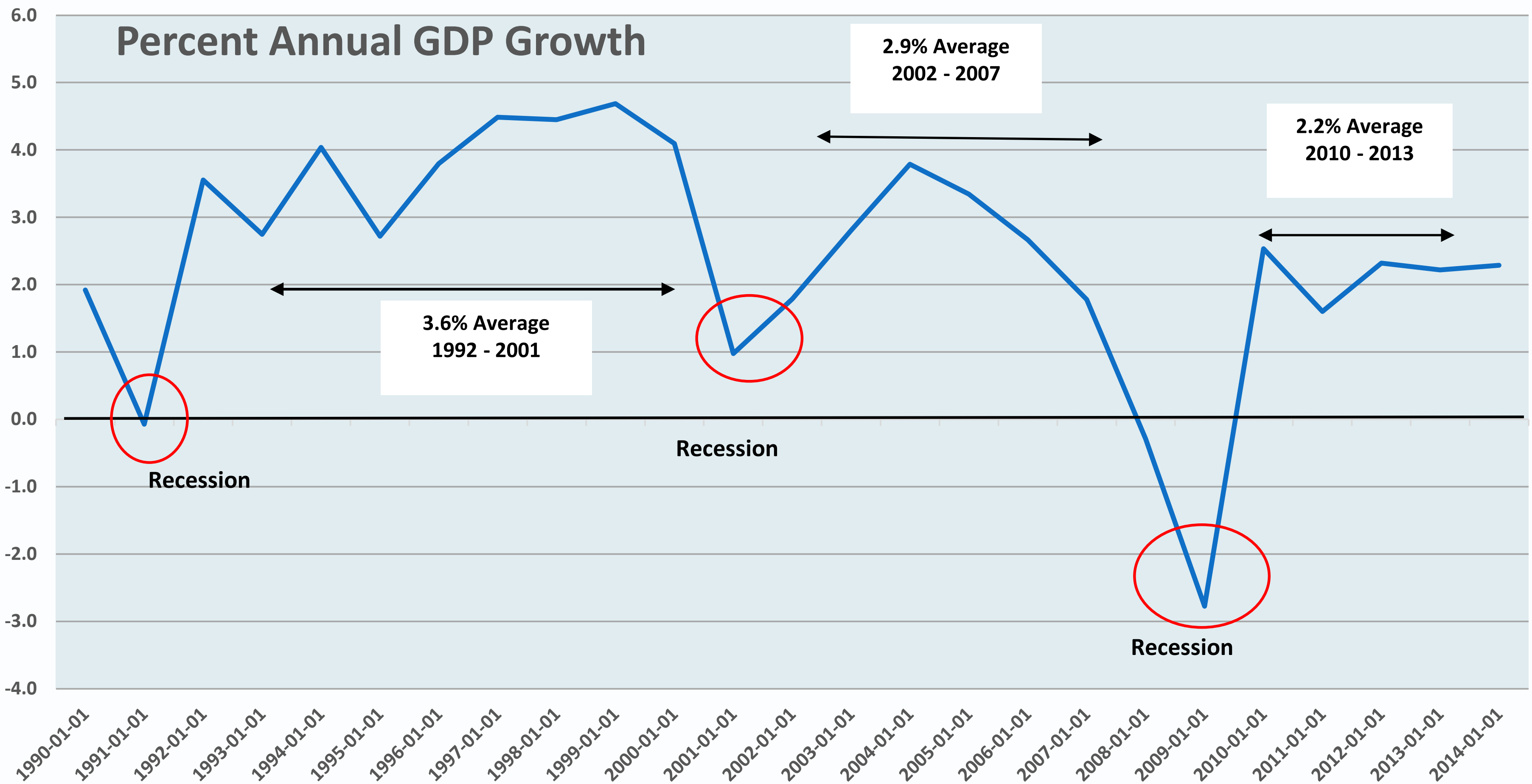
Source: Federal Reserve Bank of St. Louis

Current Performance of Key Economic and Employment Indicators on a National Level

National Economy Growth Continues

- The U.S. economy is growing and we saw solid GDP performance in the second and third quarters of 2014
- Nationally, job creation has averaged 227,000 per month since the start of the year
- The unemployment rate stands at 5.9% in September, down 1.3% from a year ago
- Companies continue to report record profits and stock prices
- Manufacturing output remains above 50
- Fuel prices are down, with gas well under $3.00 per gallon, its lowest price in 4 years
- Consumers spending dropped in September, but with lower gas prices, steady job growth, stock market gains, and consumer confidence at a 7-year high, the holiday shopping season is looking good
- While the housing sector may celebrate small victories such as rising sales and an increase in housing starts, the current figures don't come anywhere close to the recent highs. Existing-home sales are still about 27% below mid-2005 and building permits are just one-third of 2005 levels

Since Emerging from the Recession, the US Economy Downshifted…but Did Q3 GDP Shift to the Next Gear?



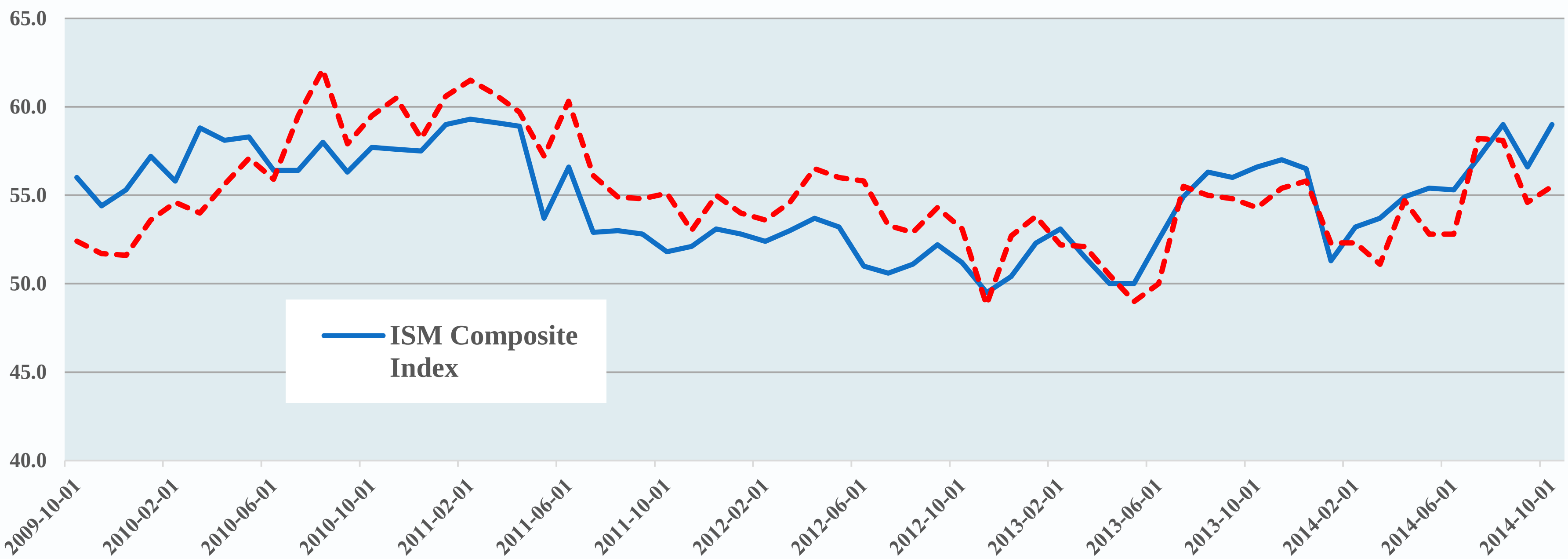
Source: Federal Reserve Bank of St. Louis

Q3 GDP Grew at a 3.5% Pace, Down from 4.6% in Q2, but Well Ahead of the 3.0% Forecast

- The most recent GDP report affirmed what was broadly believed to be the case: the economy grew at an above trend rate in recent months, extending its strong advance since early spring
- However growth was driven by what are likely unsustainable gains in government spending, led by a 16% increase in defense spending
  - Government spending was responsible for 0.83% of overall growth
- Exports, contributed 1% to the 3.5% growth, however an examination of the September data indicates September exports were weaker than initial estimates, thus the new data will likely drive down Q3 GDP growth in next month's revision
- Consumer spending, which accounts for 70% of GDP, grew only 1.8%, down from the 2.5% Q2 growth rate
  - With falling gas prices, the expectation was for higher growth
- Housing reflected a gain of 1.8%, down from an 8.8% Q2 increase

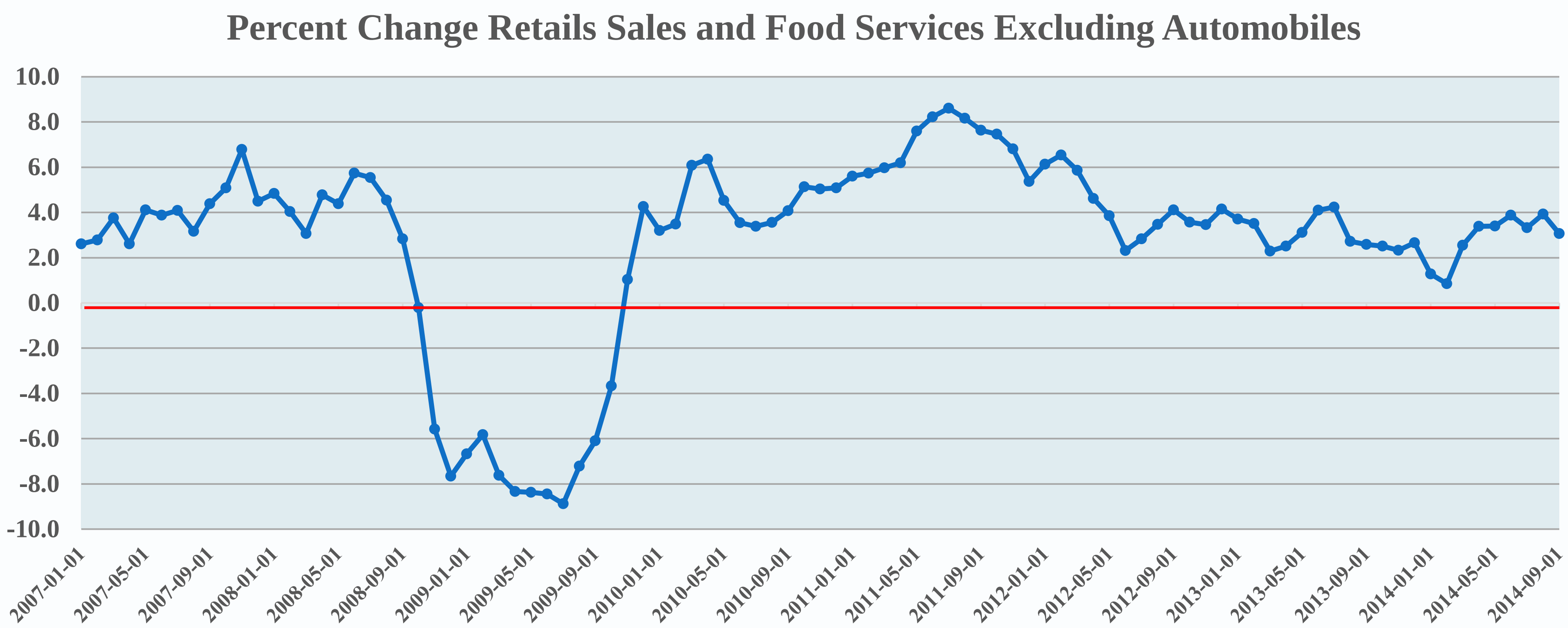
16 of the 18 Manufacturing Industries Reported Growth in October, With Holiday Orders Exceeding Forecasts

- ISM's *Report On Business* shows the manufacturing sector expanded in October for the 17th consecutive month, and the overall economy grew for the 65th consecutive month
  - Export Orders Index while growing has slowed



Retail Sales Improving But Still Slow

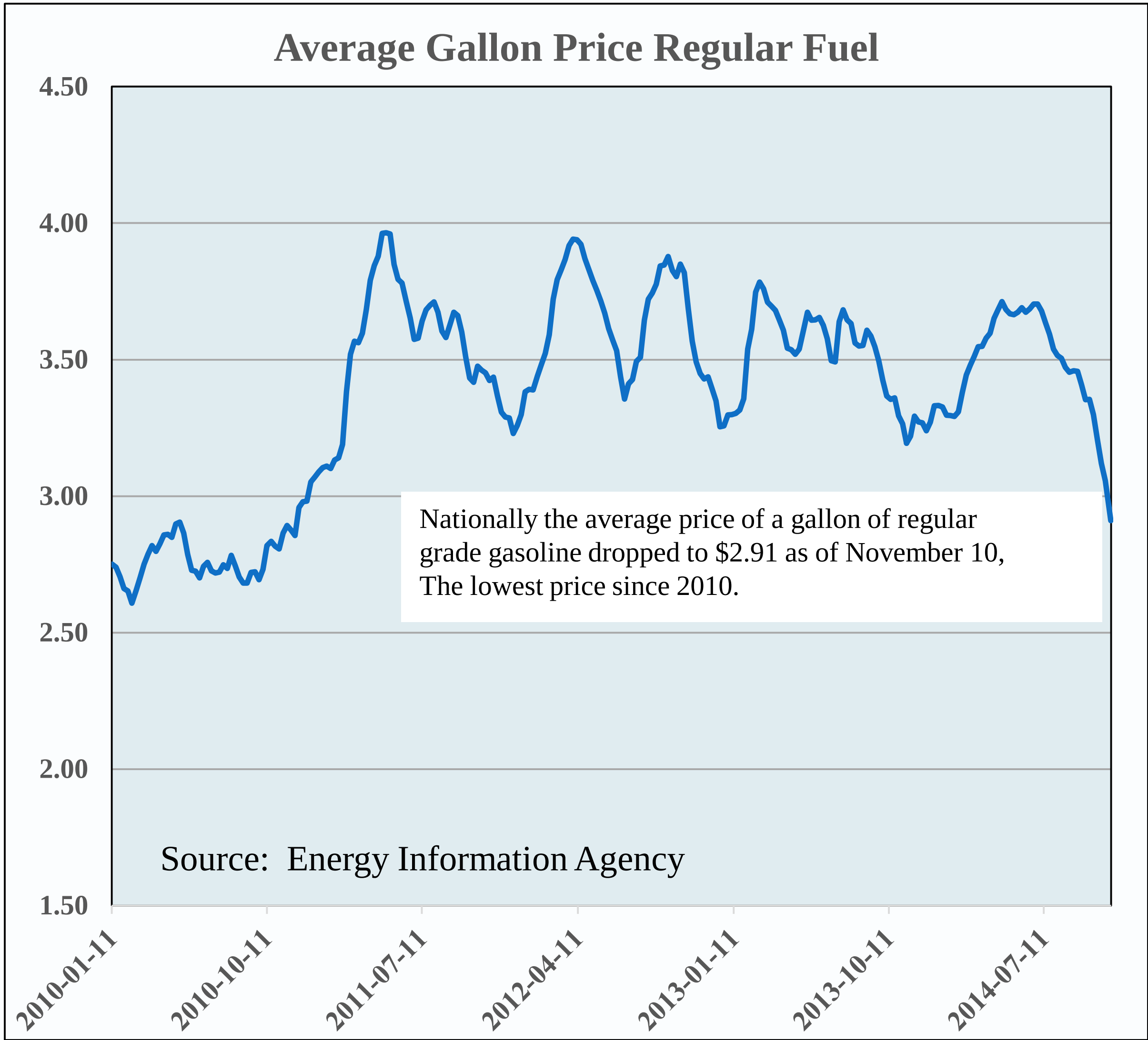
- After rebounding strongly in 2010-11, year-over-year retail sales growth diminished in 2012 and 2013, but has shown modest improvement this year
  - In particular discretionary expenditures are increasing nationally. Automobile sales were up 10.4% and food services were up 7.1% from last year
- In September retail sales were up 4.3% on a year-over-year basis from September 2013



Source: Federal Reserve Bank of St. Louis

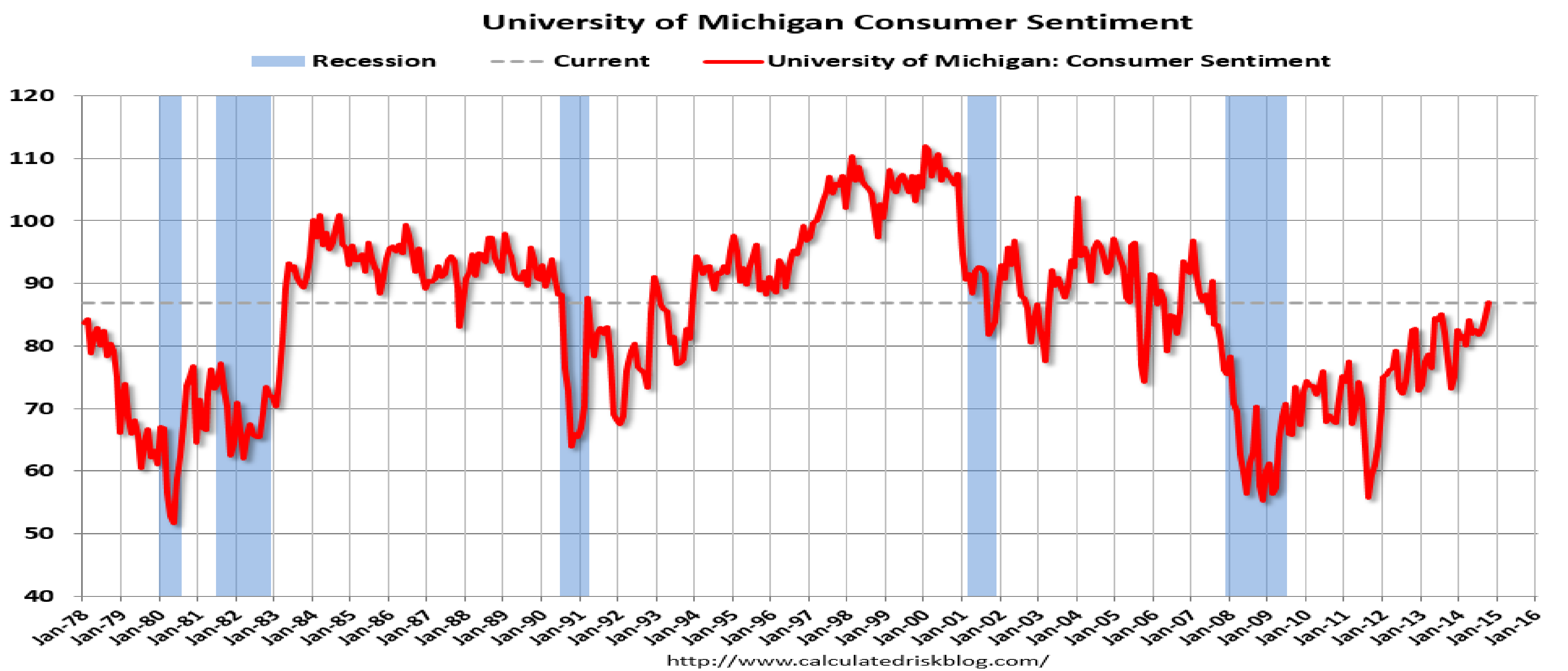
Gas Price Decline Increases Discretionary Income

- In March 2012, average price per gallon was $3.92, just below the 2008 high of $4.10 per gallon
- Gas prices are now down 60 cents since last Spring
- U.S. Energy Department issued its forecast for 2015 this week, indicating gas prices should stay below $3.00 per gallon throughout 2015
- This translates into a savings of $61.0 billion in energy expenditures compared to 2014



Consumer Confidence Continues Slow Improvement

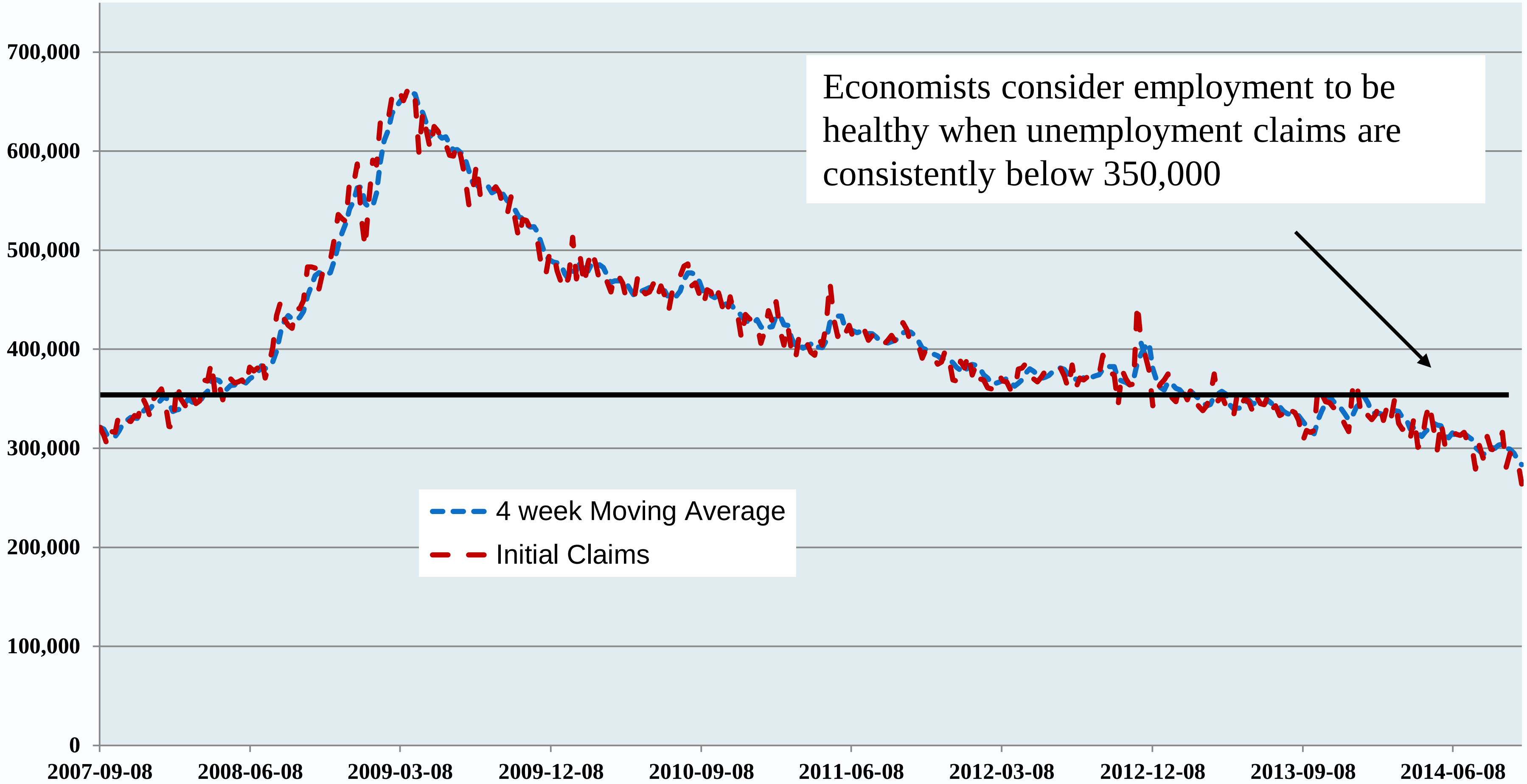
- The final Reuters / University of Michigan consumer sentiment index for October was at 86.9, up to its highest level since 2007
- Generally little change in sentiment over the past year but the trajectory is positive
- Sentiment has generally been improving following the recession - with plenty of ups and downs
- Need a reading of at least 90 for consumers to be considered in “comfort zone”



What Are Other Key Indicators Showing?

- Manpower's 2014 Q4 survey of 18,000 firms reveals 19% of employers expect to add workers, 7% expect to contract, and 72% of the firms plan no change in hiring
  - Employers have a positive outlook in all 13 industry sectors, with Leisure & Hospitality, Mining, and Wholesale & Retail Trade employers reporting the greatest hiring intentions
- The number of individuals in part-time employment due to economic reasons remains extremely high for this period of the recovery
- Initial unemployment claims have fallen below 300,000

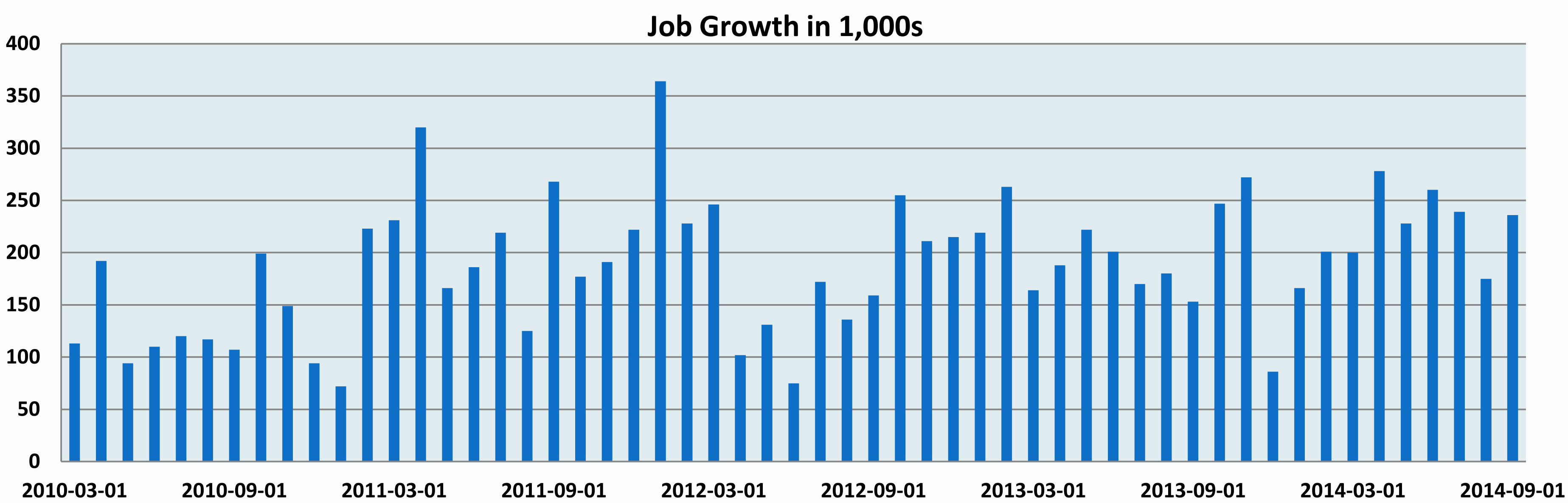
Initial Unemployment Claims Continue to Decrease, Dropping Below 300,000



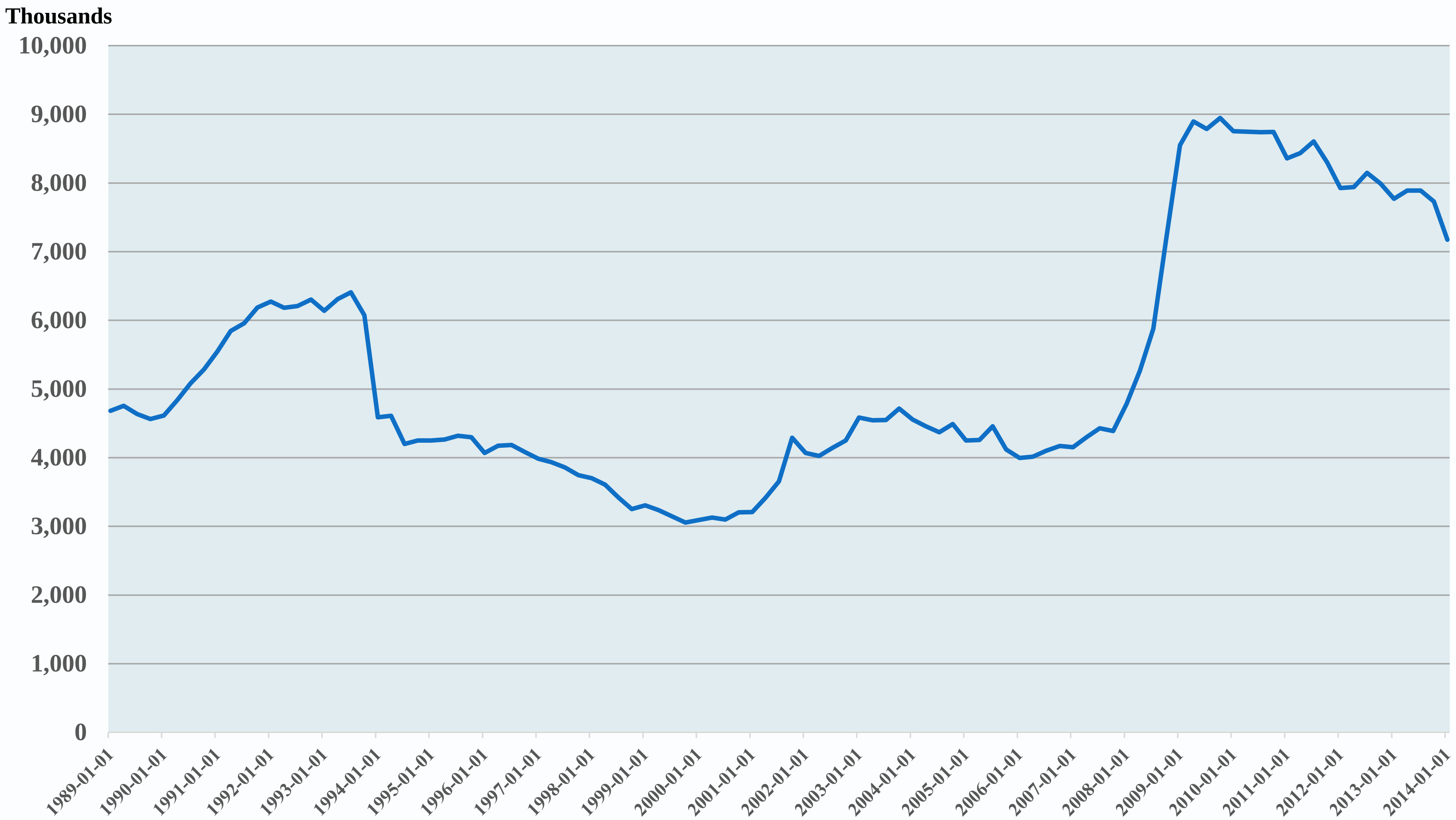
Private Sector Employment -- The Silver Lining

Monthly Job Growth (in thousands)

- Nationally, 8.7 million jobs were lost during the recession. Total private sector employment has since increased by 10.3 million, an average of 188,000 jobs per month since trough
- U.S. private sector employment gains have occurred for 55 consecutive months and job growth has stayed strong in 2013 and 2014 with average monthly job growth of 207,000. Average job growth has been 220,000 per month over the last 6 months
    - Total employment now exceeds the pre-recession high, however the unemployment rate has yet to recover reflecting the new entrants into the labor market
    - Total employment also includes a large number of part-time employees who want to work full-time

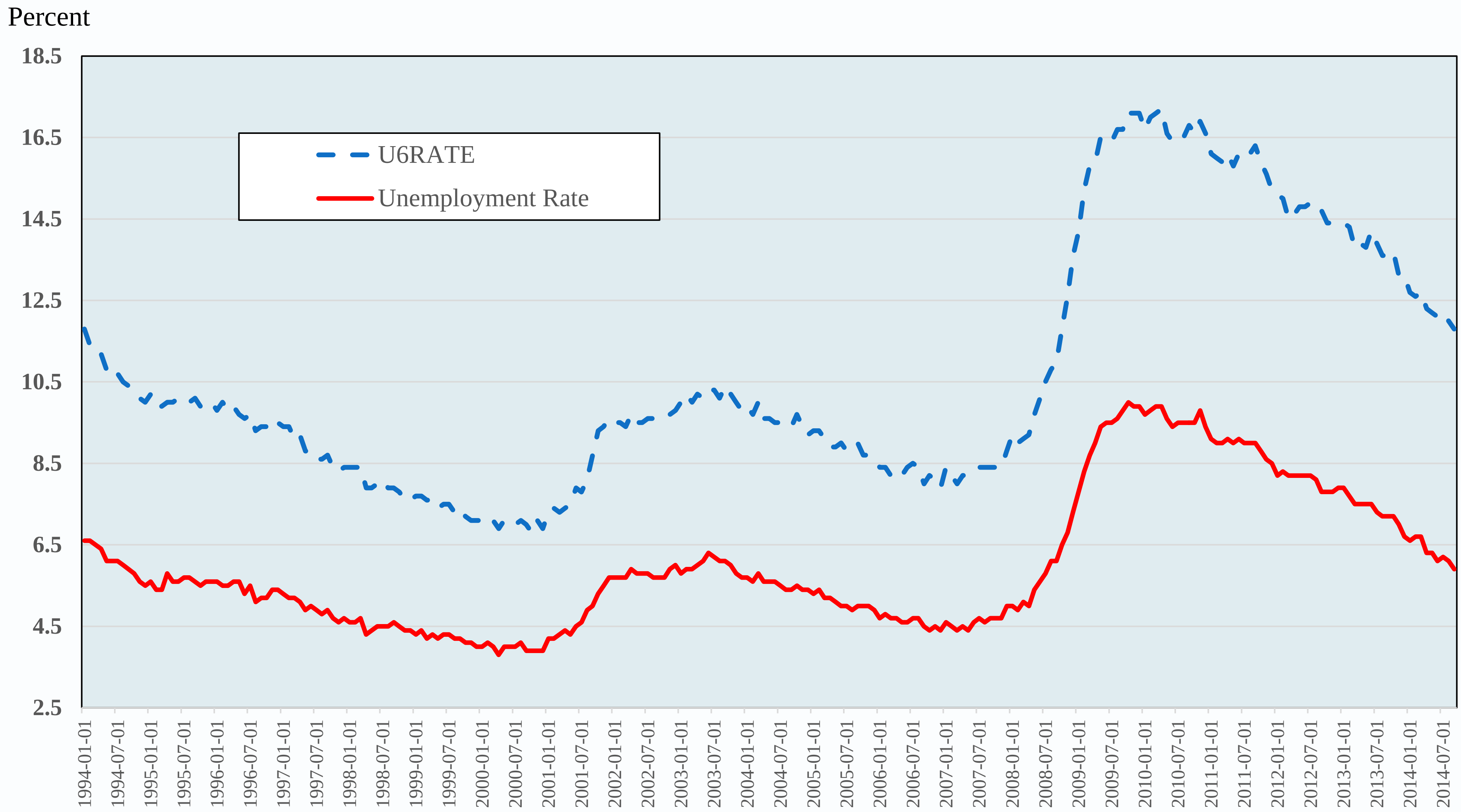


Part-Time Employment Due to Economic Reasons Remains Elevated And Has A Dampening Effect On Wage Growth



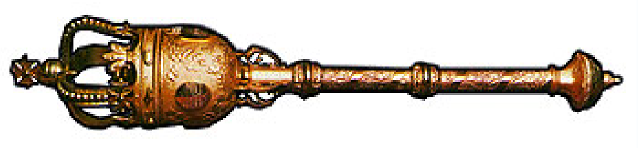
Source: Bureau of Labor Statistics

What Is The Real Unemployment Rate?

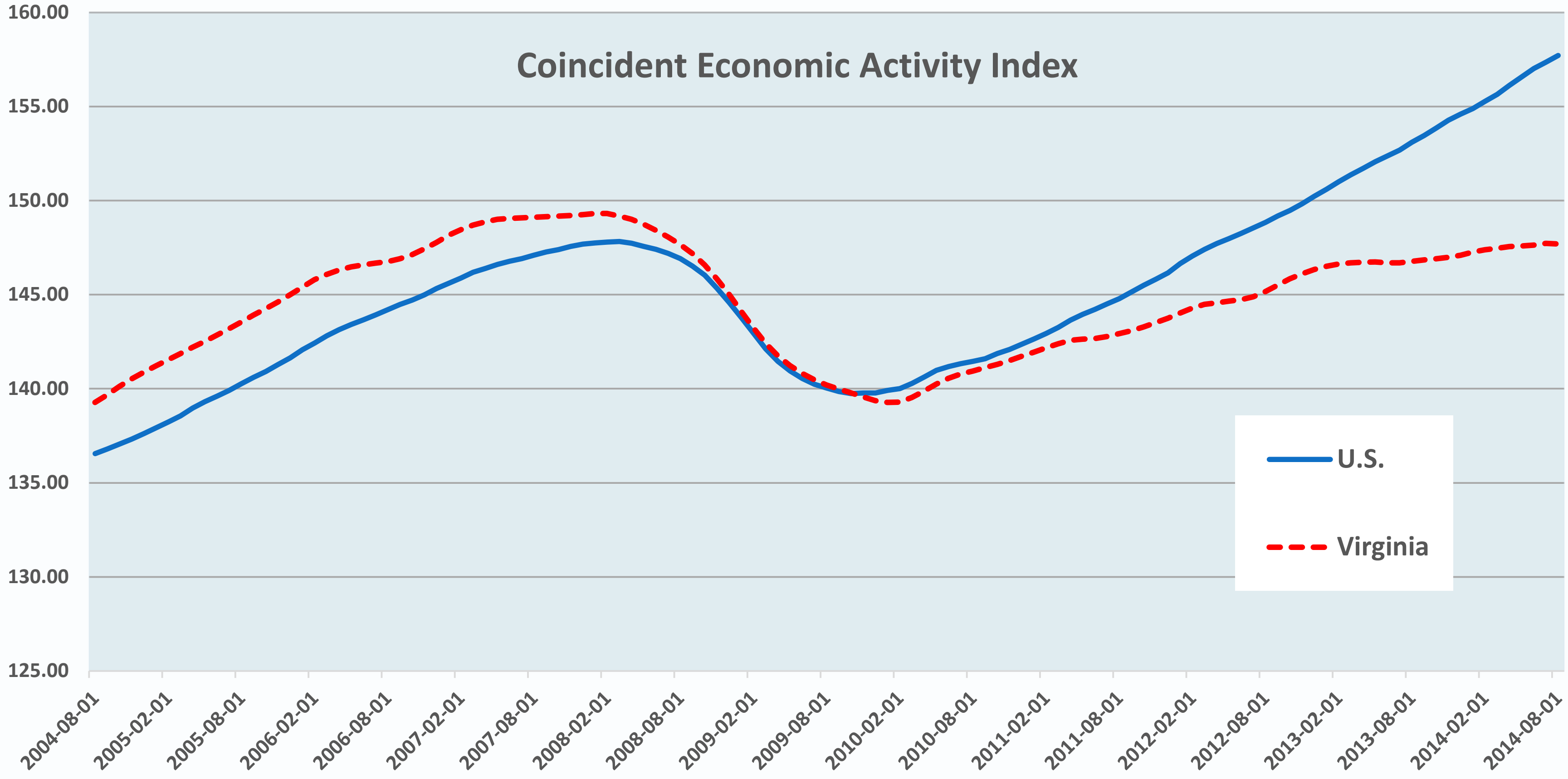


U6 Rate = Total unemployed, plus all marginally attached workers, plus employed part time for economic reasons

Virginia’s Economic Performance Lags the Nation’s



Based on Leading indicators, Virginia Continues to Underperform the Nation

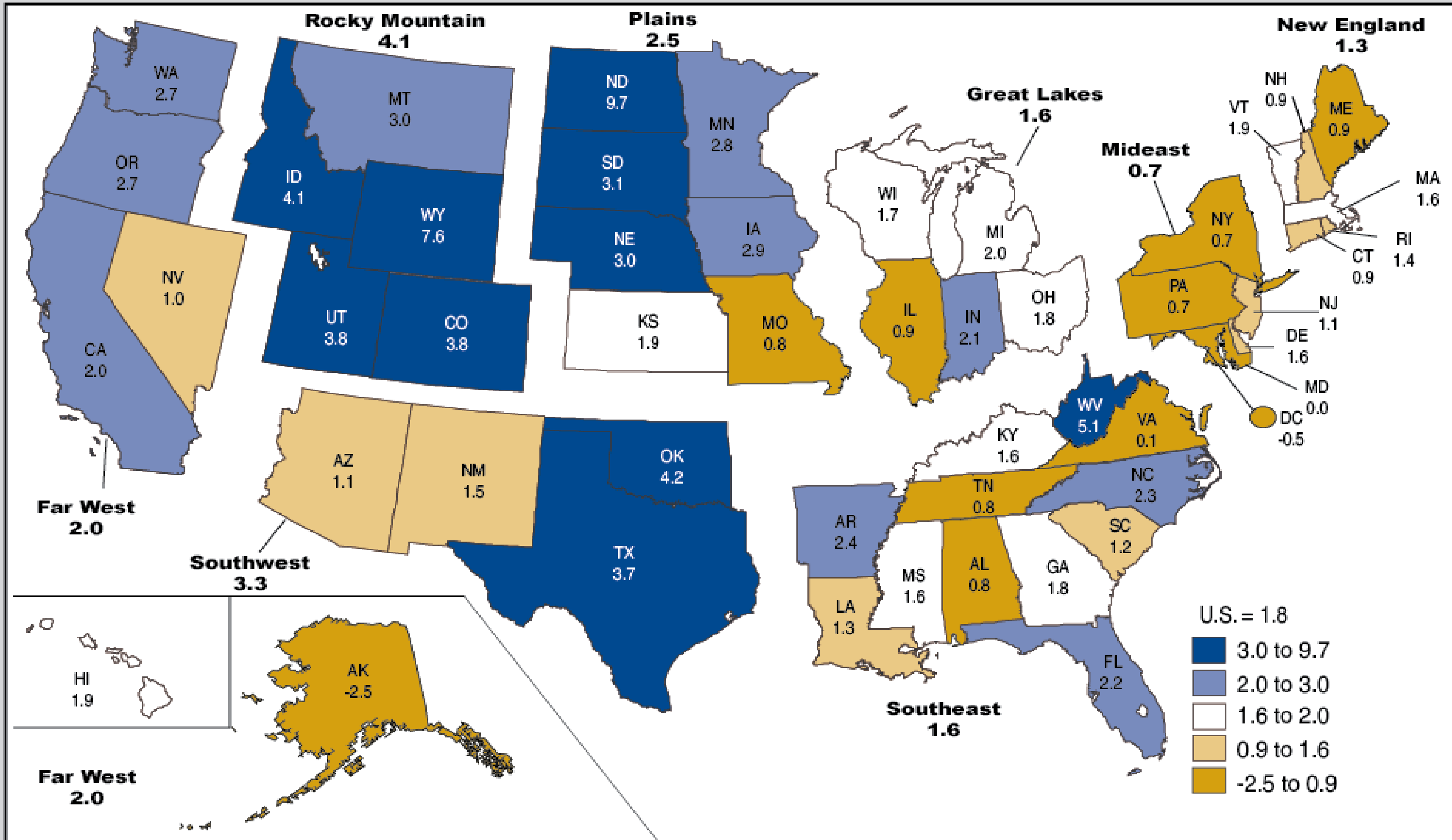


The Coincident Economic Activity Index includes four indicators: nonfarm payroll employment, the unemployment rate, average hours worked in manufacturing, and wages and salaries.

Source: Federal Reserve Bank of Philadelphia.

Virginia's Economic Growth Among Lowest in Nation

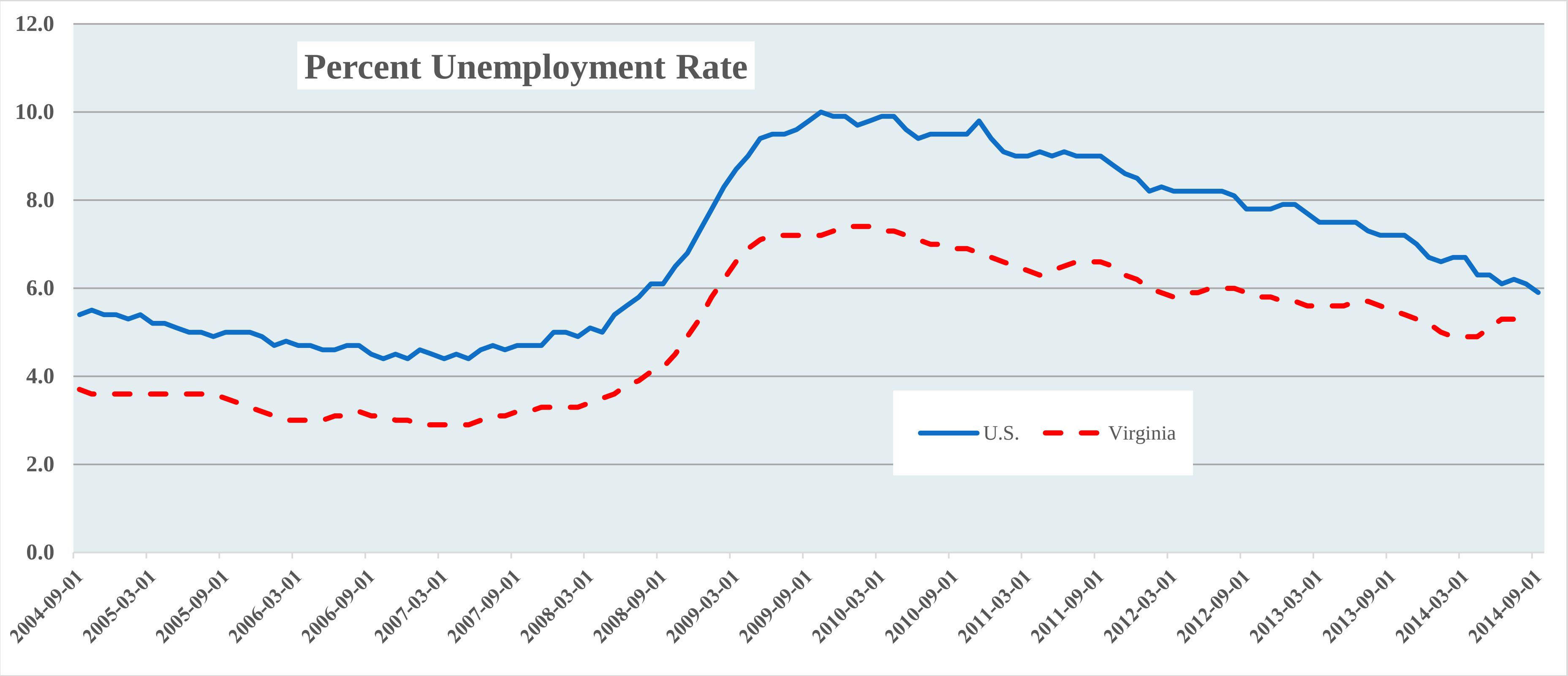
Percent Change in Real GDP by State, 2013



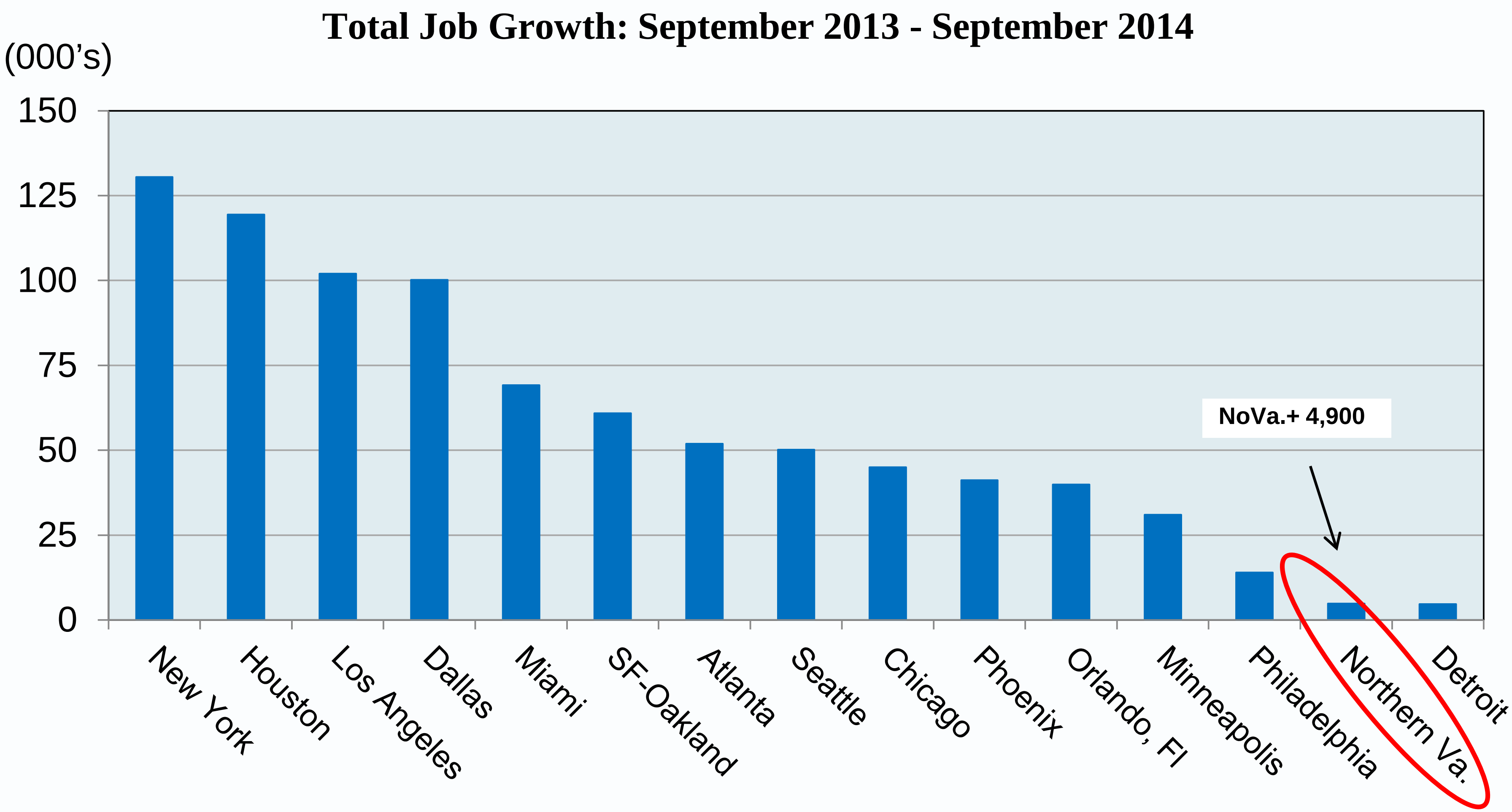
U.S. Bureau of Economic Analysis

Virginia's Unemployment Rate in Perspective

- Prior to the recession, Virginia's unemployment rate was 3.3% versus 5.0% for the US
- After peaking at 10%, the US unemployment rates has dropped to 5.9%, while Virginia's rate stands at 5.6%, down from it's peak of 7.4%
- Virginia's unemployment rate reflects the anemic rate of job growth in the state as compared to the nation, which has grown nearly 3 times faster

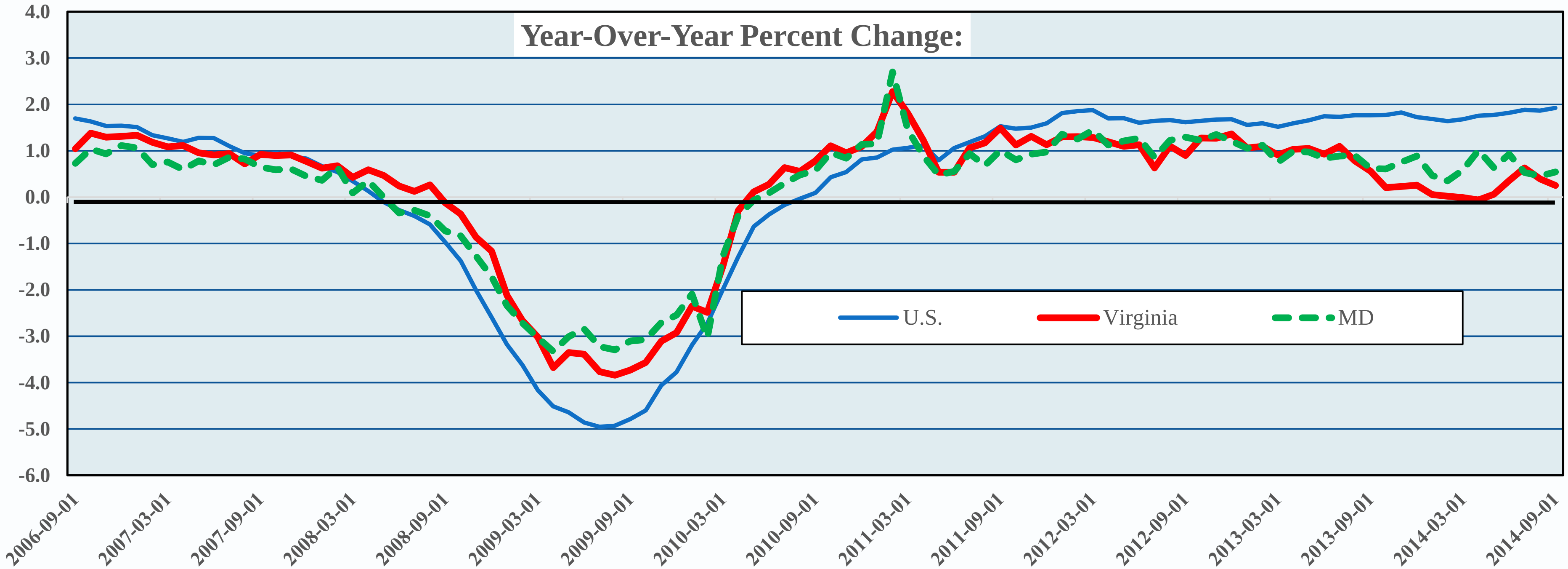


Northern Virginia Ranked 26 Out of the 27 Largest Metro Areas in Percentage Job Gains



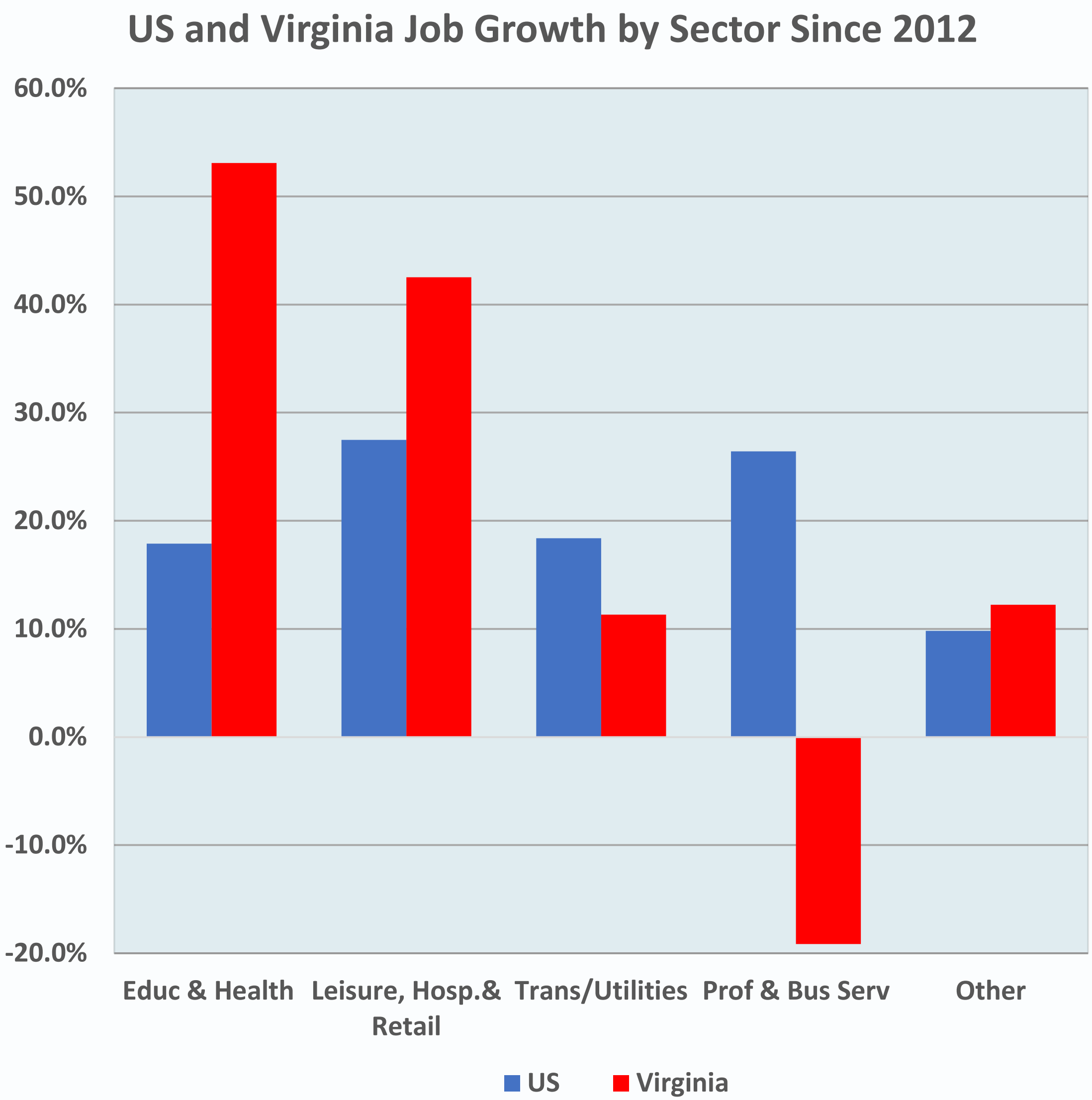
Source: BLS data, Seidman Research Institute, W.P. Carey School of Business, Arizona State University

Virginia's Job Growth Has Underperformed the Nation Since May 2011, But So has Maryland's -- Why?



- Virginia's job loss was less than the Nation and it's recovery initially greater. However, unlike the nation, Virginia still has not recovered all of the jobs lost during the recession
- Beginning in 2011 – at the same time Congress began debating the Budget Control Act – Virginia's and Maryland's rate of job growth dropped dramatically and instead of leading the nation they now lag it
- Virginia and Maryland are heavily dependent on direct and indirect federal employment
  - Over the last 20 months Northern Virginia has lost 20,000 jobs in the Professional and Business Services, IT, and Federal Government sectors

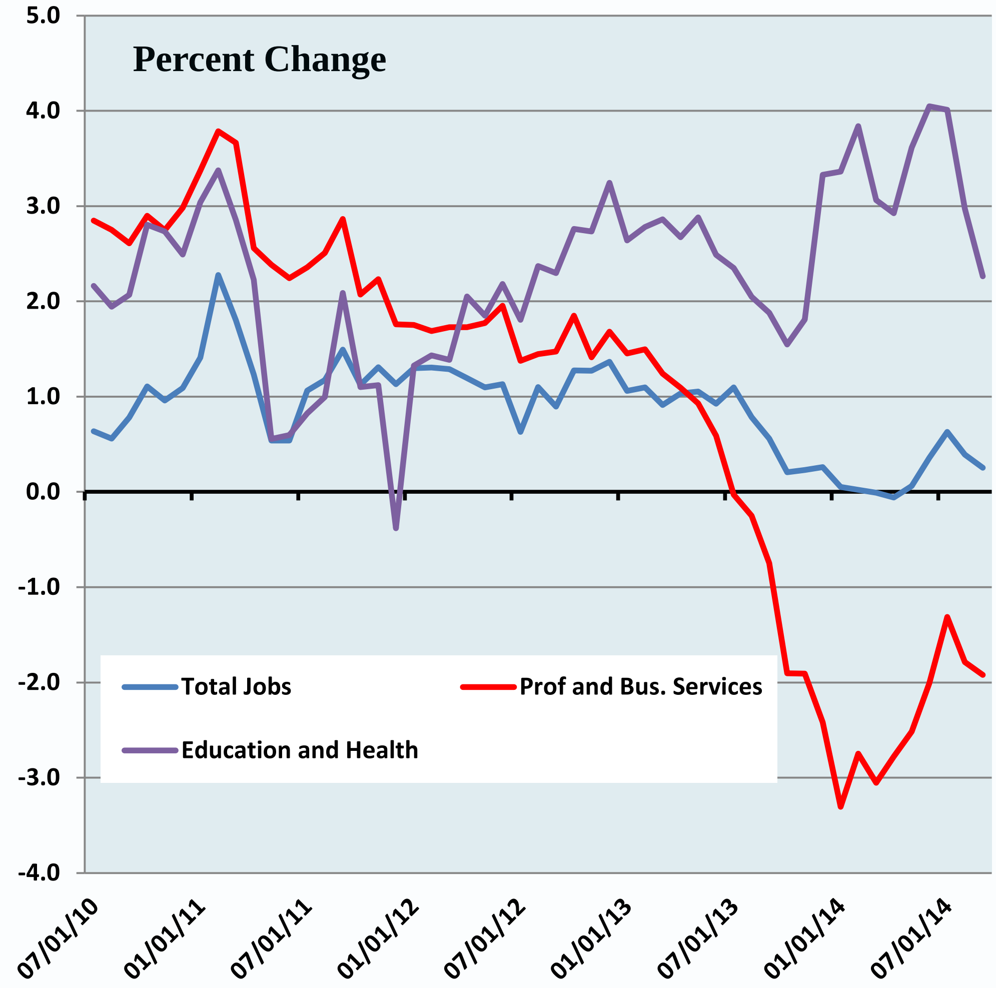
Comparing Virginia's Job Mix with the Nation



- Since 2012, the professional and business services sector has been an actual drag on Virginia's overall employment levels
- Instead, Virginia's job growth has been in lower-paying leisure, hospitality and retail sector and education and health
  - These two sectors account for 80% of Va's job growth over the past 2 years

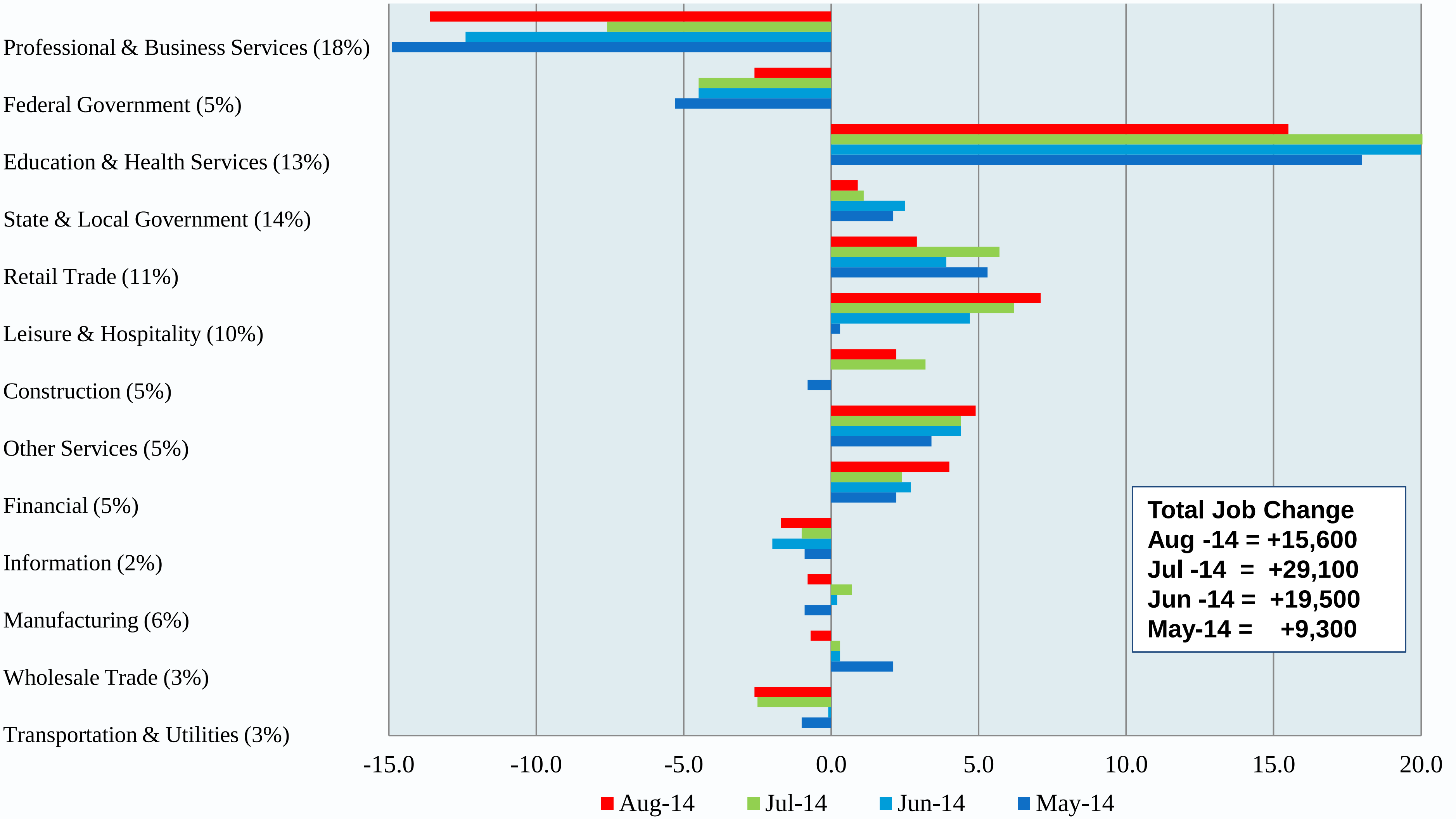
Total Virginia Jobs Have Grown at Less Than 1% Over the Last Year

- Professional and Business Services makes up 18% of Virginia's workforce
- Virginia has lost 21,300 jobs in this sector since February of 2013 (a decrease of 3.1%)
  - P&BS accounted for 68% of Virginia's total job gains in FY 2011 and 31% in FY 2012
- Overall, job growth in Virginia has fallen to 1% or lower for the last few years
- Through September, Virginia's job growth lags the forecast, and has averaged 0.4%, compared to a fiscal year forecast of 0.7%



Virginia Job Change by Sector

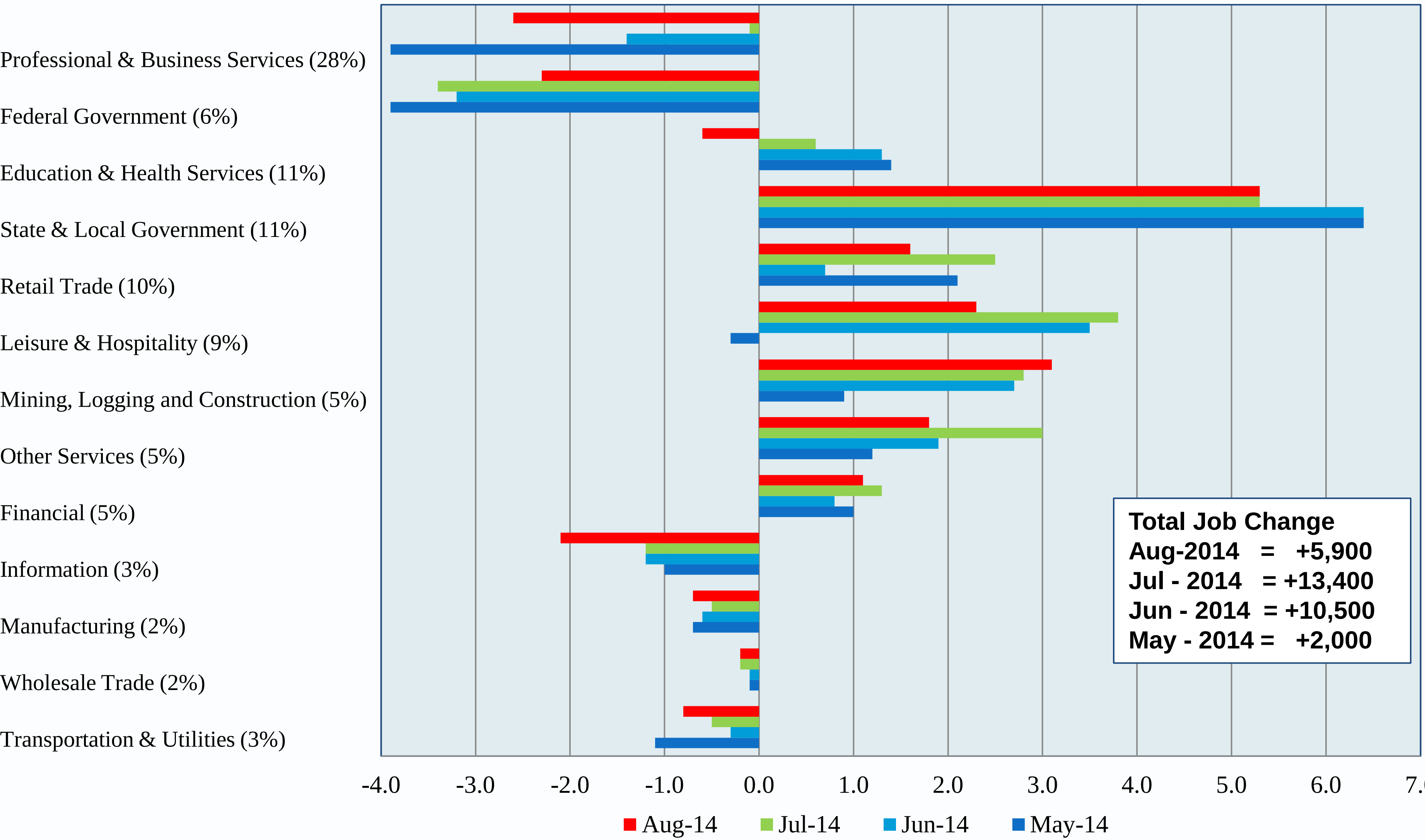
Year-Over-Year, Thousands of Jobs



Source: Virginia Department of Taxation

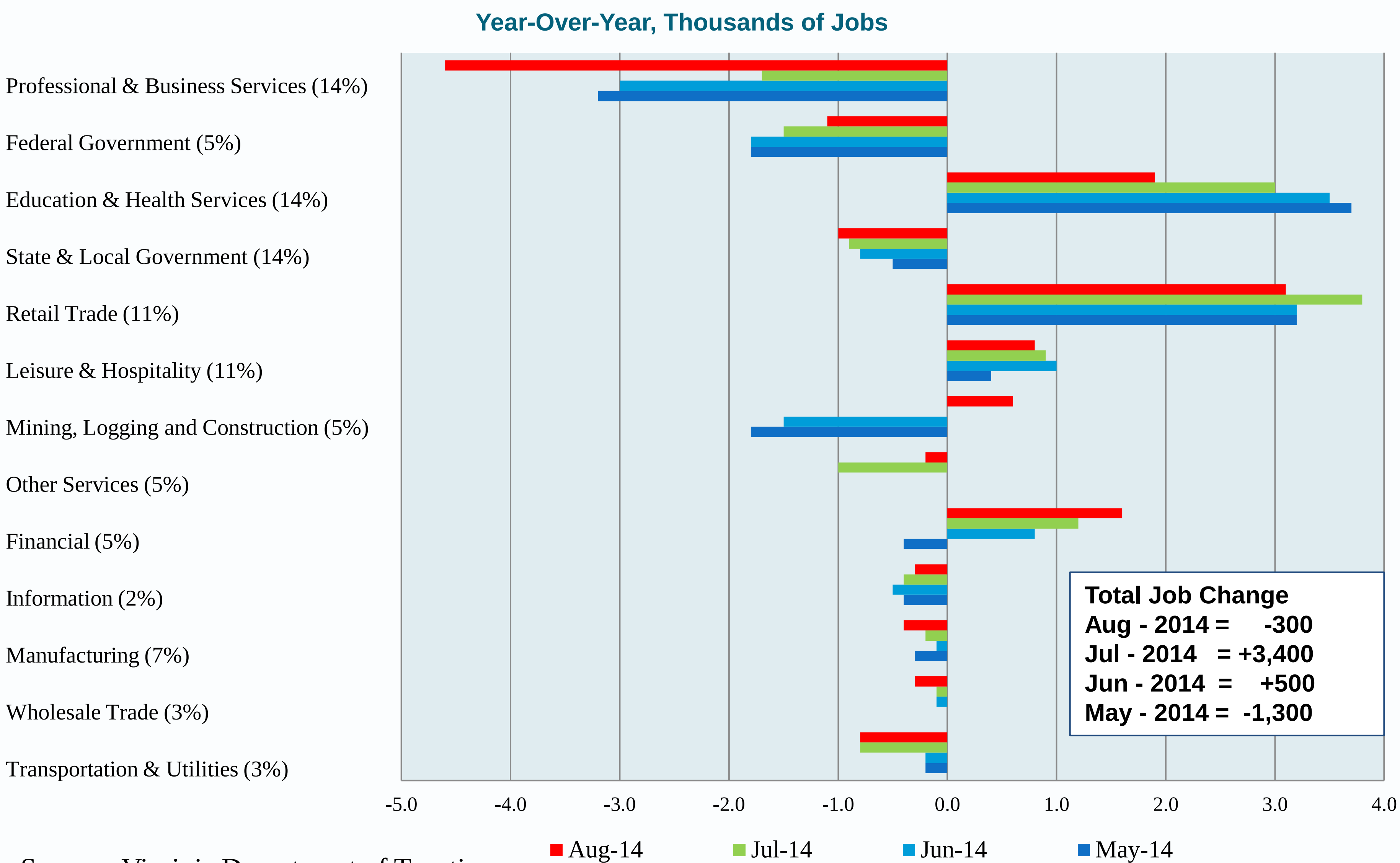
NoVa Job Change by Sector

Year-Over-Year, Thousands of Jobs



Source: Virginia Department of Taxation

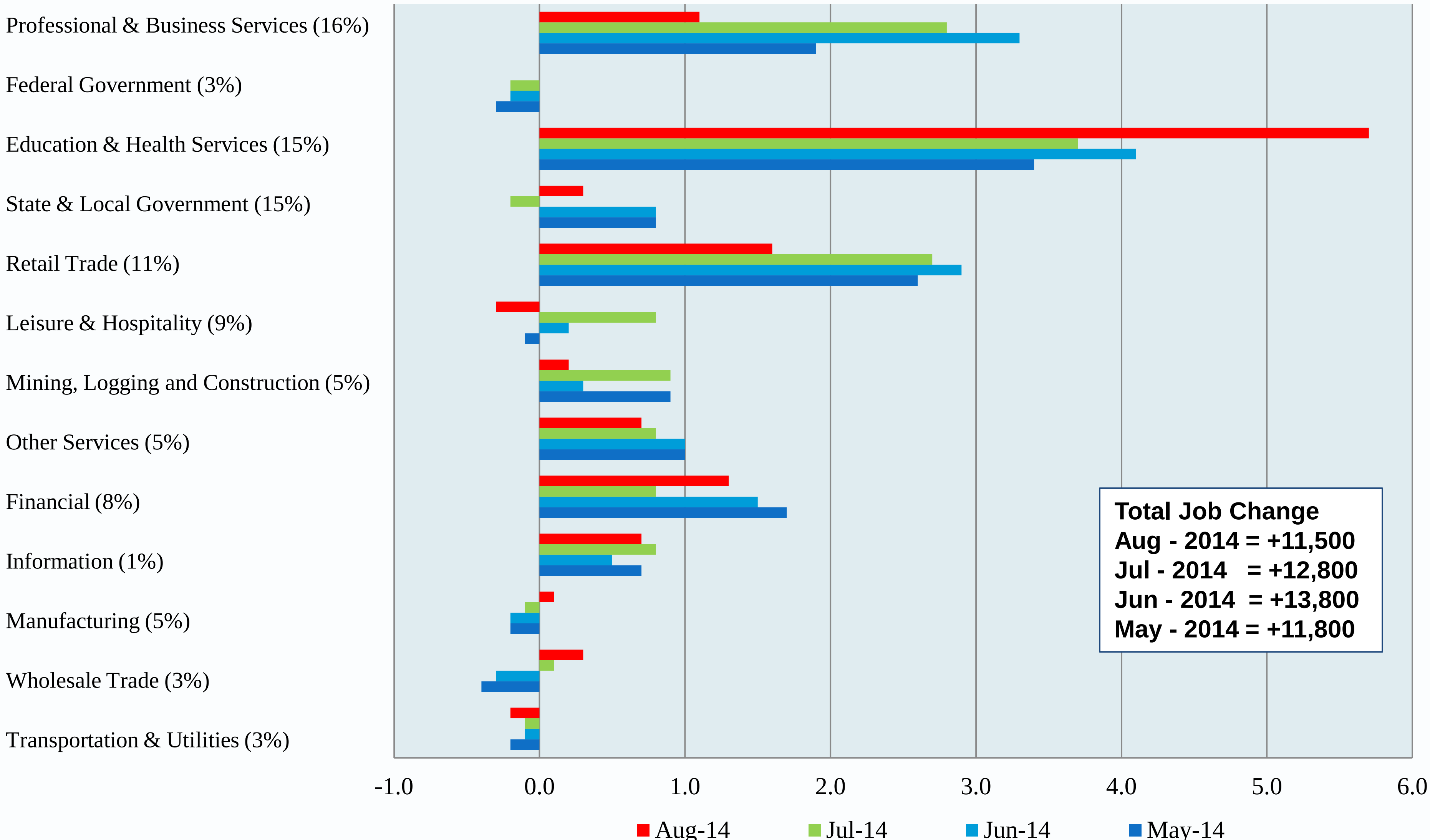
Hampton Roads Job Change by Sector



Source: Virginia Department of Taxation

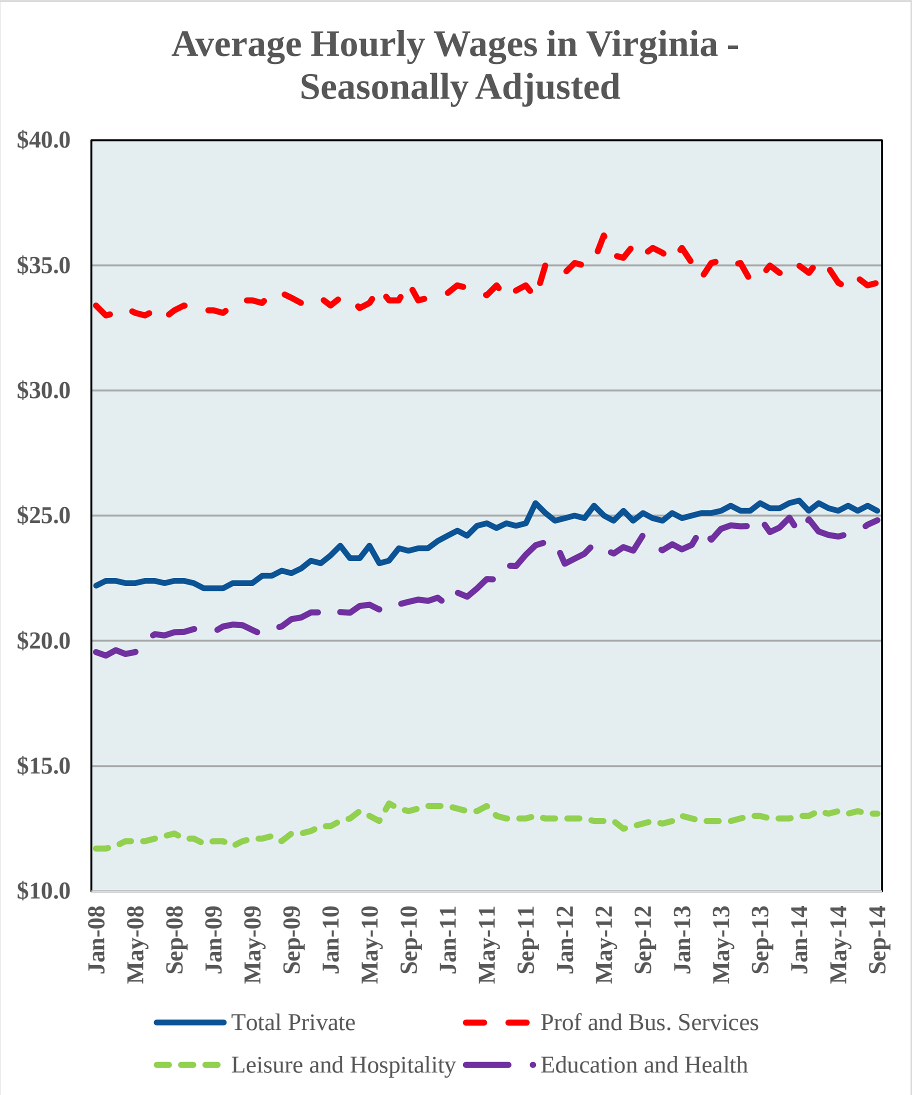
Richmond Job Change by Sector

Year-Over-Year, Thousands of Jobs



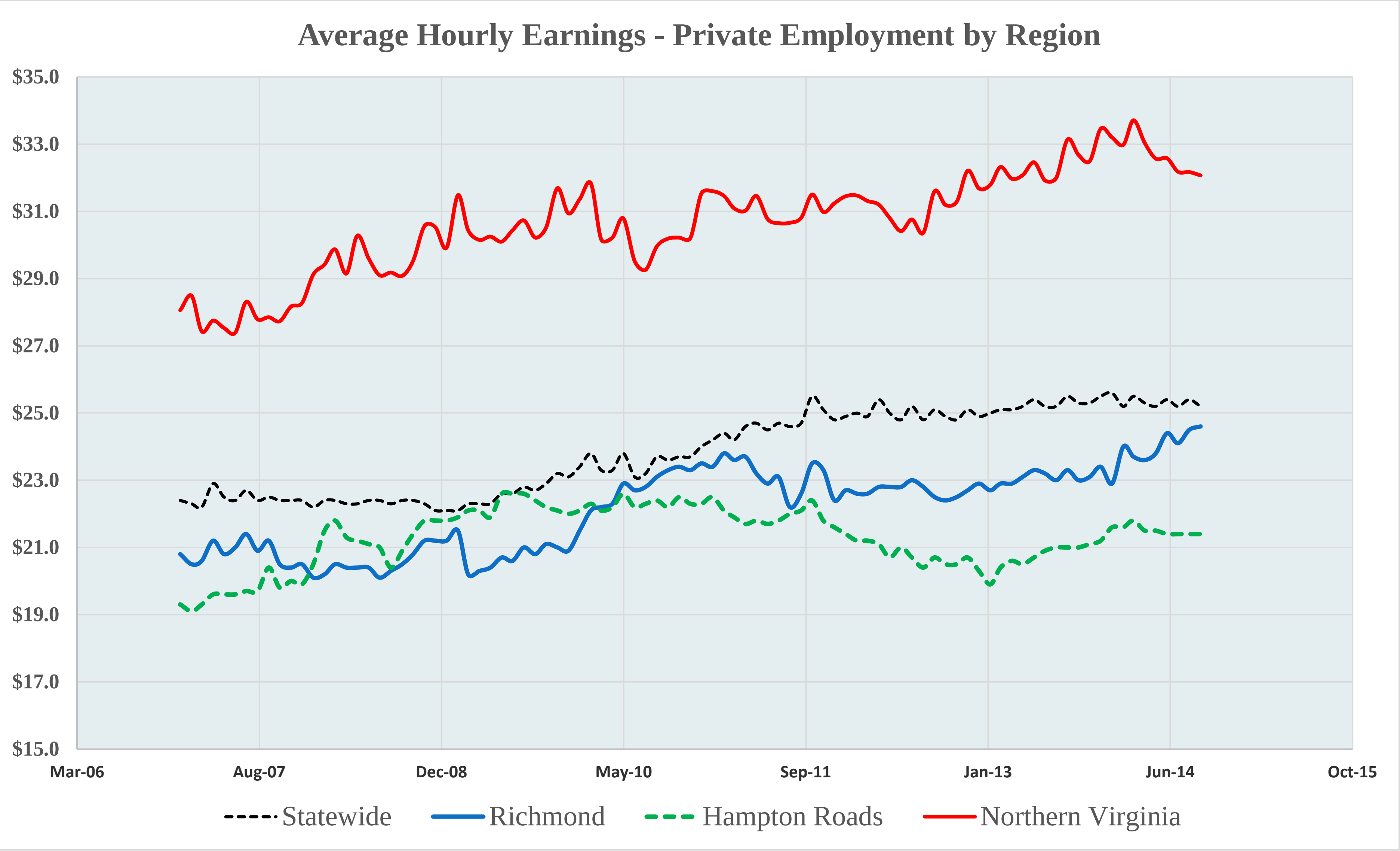
Source: Virginia Department of Taxation

Virginia's Overall Job Growth Masks Shift into Lower Paying Sectors



- While the overall number of jobs in Virginia has increased slowly, we have seen a reduction in the number of jobs in the higher paying sectors
- Instead, job growth is centered in the lower paying fields – leisure and hospitality, and education and health
- To generate the same level of income – and withholding tax receipts – generated by one average job in the professional and business services sector, you need almost 3 jobs in leisure and hospitality because of the salary differential
- While the salary gap is not as extreme between P&BS jobs and education and health positions, the average hourly wage is still 30% lower in education and health

Average Wages in NoVa Are 30-50% Higher than Other Metro Areas in State



Withholding Tax Collections by Sector

($ in millions)

Industry (% of Total in FY 14)	# of Firms	$ FY 12	$ FY 13	$ FY 14	% Chg. FY 12	% Chg. FY 13	% Chg. FY 14
Fed'l Contractors (9%)	192	$495.60	$482.80	$451.70	-1.7%	-2.6%	-6.4%
Other (9%)	720	$468.00	$468.80	$464.10	-1.8%	0.2%	-1.0%
Public Sector (40%)	93	$1,831.50	$1,874.90	$1,888.60	2.7%	2.4%	0.7%
Prof. & Bus. Srv. (7%)	538	$260.50	$285.50	$288.10	8.1%	9.6%	0.9%
Educ. & Health (16%)	244	$750.40	$757.40	$772.90	-1.2%	0.9%	2.0%
Energy (2%)	47	$96.20	$84.40	$86.20	-2.8%	-12.3%	2.2%
Finance (7%)	134	$270.30	$294.70	$306.60	7.0%	9.0%	4.0%
Transportation (2%)	41	$103.10	$108.90	$113.90	0.4%	5.7%	4.6%
Manufacturing (4%)	174	$135.80	$141.00	$157.30	7.2%	3.8%	11.6%
Investment (4%)	148	$134.80	$159.60	$179.00	3.1%	18.4%	12.2%
Total Large Payers	2,331	$4,546.1	$4,658.0	$4,708.6	1.6%	2.5%	1.1%
Total Small Payers (55%)	242,267	$5,493.5	$5,593.3	$5,775.6	6.5%	1.8%	3.3%
Total All	**244,598**	**$10,039.7**	**$10,251.3**	**$10,484.2**	**4.2%**	**2.1%**	**2.3%**

Source: Virginia Department of Taxation

Year-to-Date Revenue Growth

FY 2015 Year to Date Performance through October

General Fund Revenue Forecast for Fiscal Year 2015			
Major Source	**Source as a % of Total Revenues**	**Ch. 3 Official Forecast**	**Y-T-D Performance Through October**
Withholding	63.8%	2.7%	5.5%
Nonwithholding	15.9%	6.3%	14.2%
Refunds	(10.8%)	3.6%	5.5%
Net Individual	**68.9%**	**3.4%**	**6.7%**
Sales	19.0%	4.4%	3.8%
Corporate	4.4%	(0.9%)	16.6%
Wills (Recordation)	1.9%	1.2%	(2.7%)
Insurance	2.0%	7.5%	--
All Other Revenue	3.8%	(10.0%)	4.7
Total GF Revenues	**100%**	**2.9%**	**6.1%**

Source: Secretary Brown’s October 2014 monthly revenue report

Noise in July-October Collections

- While revenue collections through October were stronger than anticipated, 3 adjustments have to be taken into consideration:
  - July collections included approximately $37.0 million in nonwithholding tax receipts that should have been deposited in FY 2014 if not for a mail delivery problem
  - July collections also included $21.0 million from a portion of the accelerated sales tax (AST) phase-out. This is one-time revenue that does not reflect increased growth in underlying sales and will be “erased” next June
  - November 1 is the due date for individual extension filer payments. Recent mail delivery issues make it likely that some of these refunds won’t be booked until November
  - If you adjust for the combined impact of these differences, year-to-date collections are not as robust as it appears at first glance
  - While the reported growth rates may be a bit overstated, money in the bank is a real measure, and we are about $300 million above forecast on a cash basis

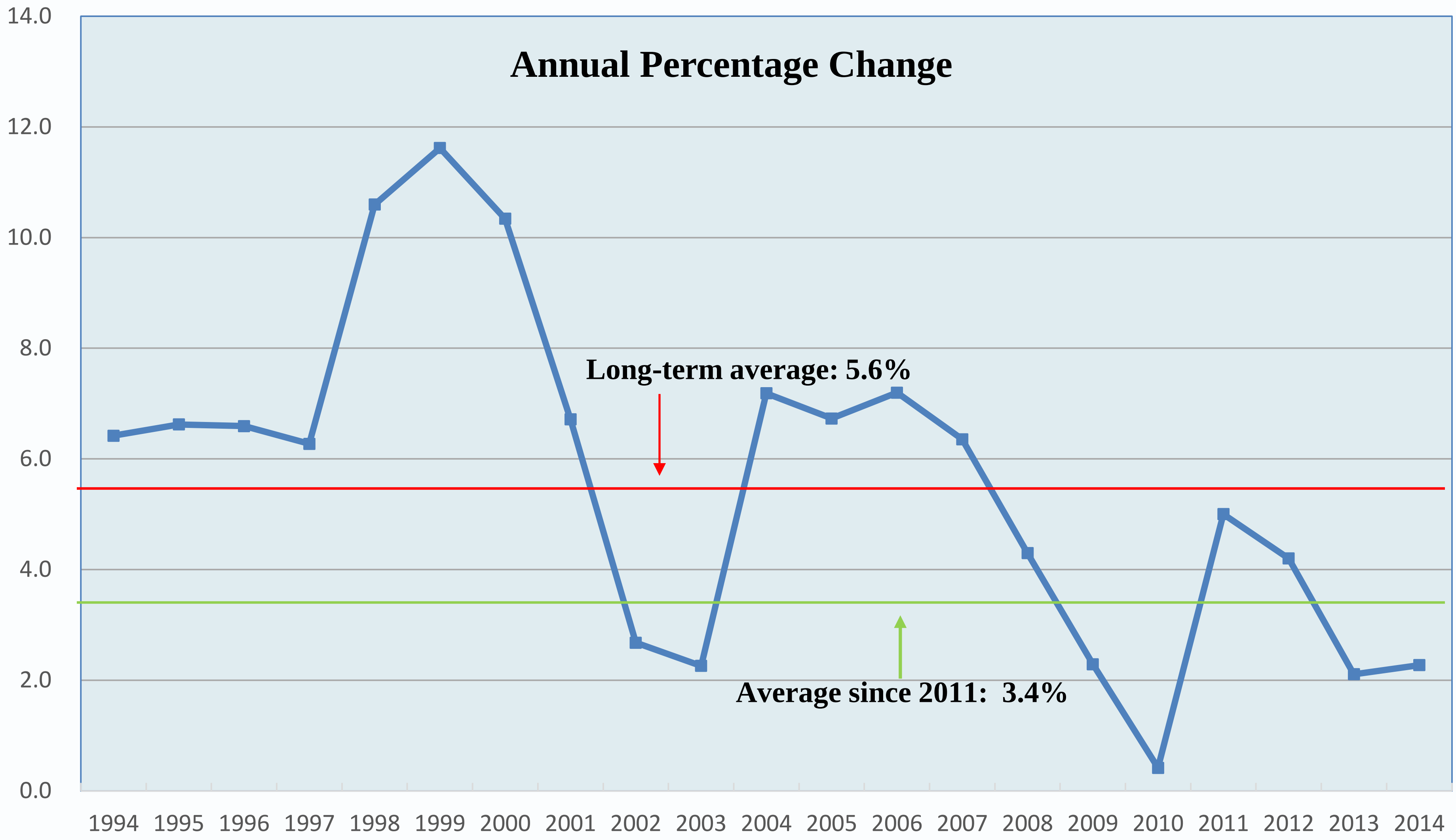
Year-to-Date Performance: Individual Income Taxes

- Year-to-date, net individual income tax collections have grown 6.7%, 3.3% ahead of the annual forecast of 3.4% growth on an unadjusted basis
  - Strength has come both from payroll withholding and from higher than anticipated non-withholding tax revenues

Payroll Withholding:

- FY 2015 forecast projects growth of 2.7%; actual collections through October grew 5.5%
  - October withholding collections were 3.4% above October 2013, with one less deposit day
  - But year-over-year employment growth was only 0.2% in most recent report. Even more troubling is the low level of growth in the two largest metro areas. Northern Virginia employment has grown just 0.4% and growth was 0.5% in Hampton Roads
    - Richmond has been the bright spot, with growth of 1.3%
  - We did not meet last year's forecast of 2.9% for withholding tax collections, seeing only 2.3% growth even after an equally slow FY 2013 with 2.1% growth

Percent Annual Growth in Withholding Tax Revenues



Year-to-Date Performance: Individual Income Taxes

Refunds: Forecast for the year is increase of 3.6%, actual refunds grew by 5.5% through October

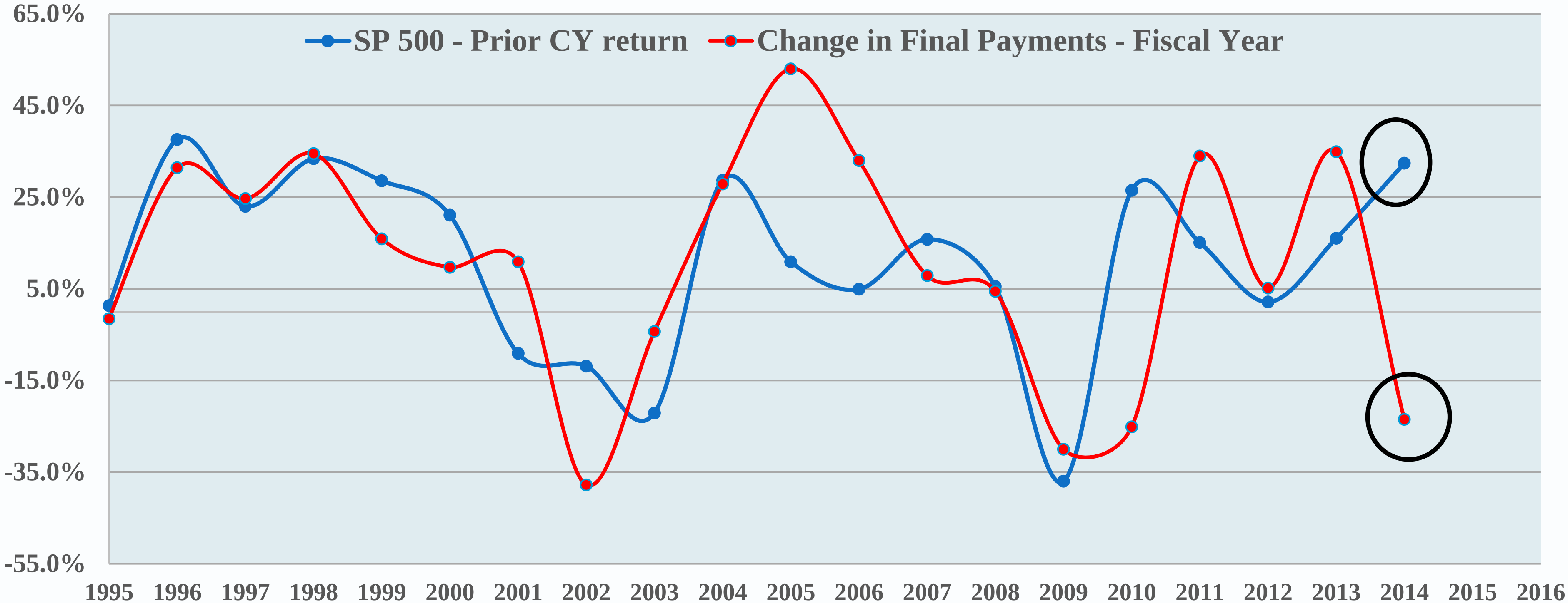
- Through October, Tax has issued $216.2 million in refunds compared with $205.0 million last year, close to the forecast of 3.6% growth
- Refund activity is weighted toward the later portion of the year - over the last 20 years on average only about 10% of all refunds are issued in first 4 months of the year

Nonwithholding: Forecast for year is 6.3%, actual collections through October grew 14.2%

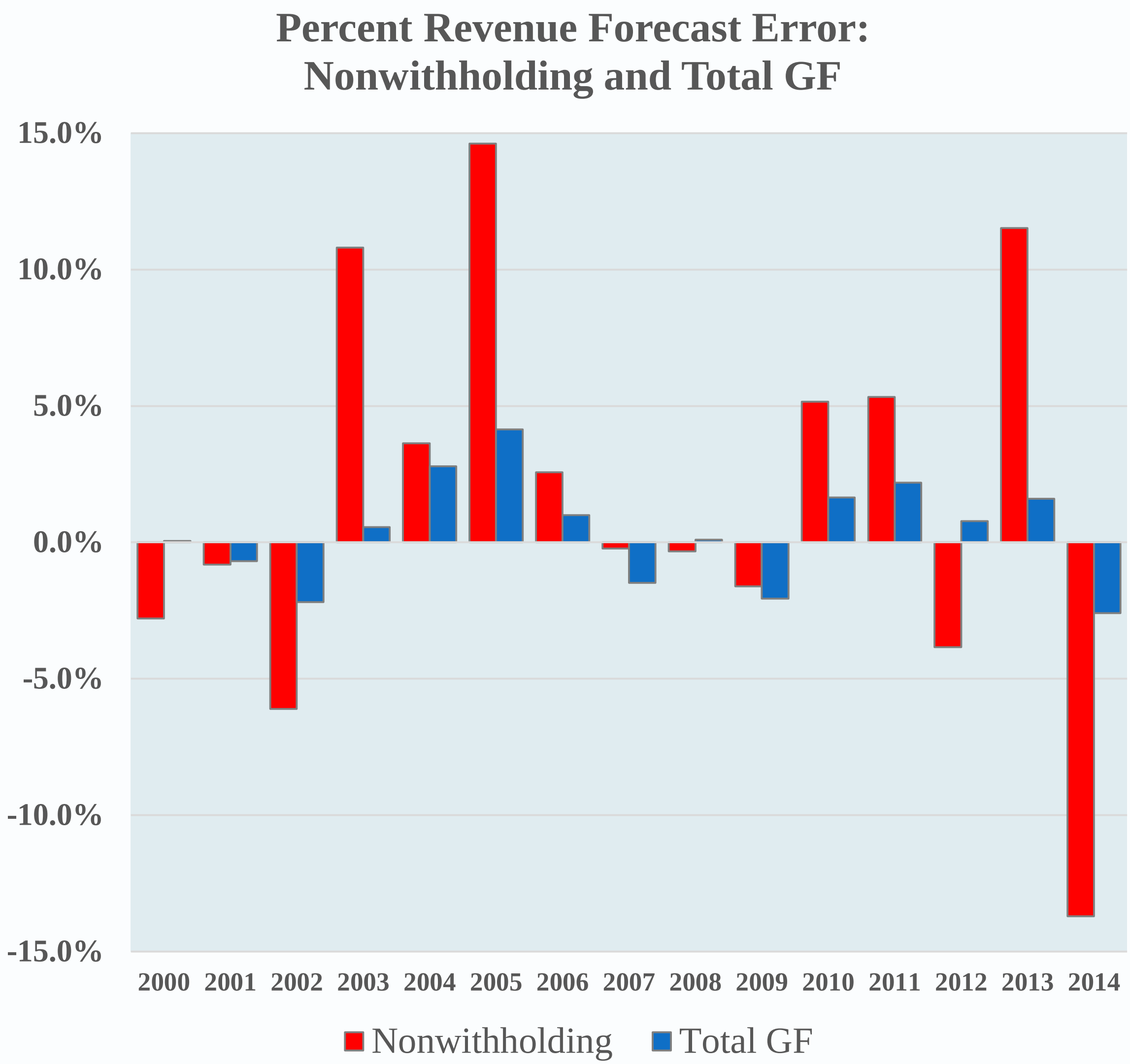
- The first estimated payment for FY 2015 was due in September. Total monthly collections increased 2.8% -- Need to look at January's estimated payments to get a better picture
- Final payments – which have accounted for 40% of the revenue from this source in recent years – tend to track the S & P which is up 11% for the year
- Through October last year, Nonwithholding was up 7.1% yet finished the year at -10.1%, accounting for $401.1 million of the shortfall in FY 2014

"Final Payments" Normally Tied to Prior Year's Stock Market Performance

- FY 2014's final nonwithholding payments broke from the model – typically the S & P performance for a given year drive's the next fiscal year's final payments
- While the S & P ended CY 2013 up 32%, final payments in FY 2014 fell 23%



Forecast Uncertainty Driven by Nonwithholding Volatility



- Virginia's revenue forecasting process produces generally accurate estimates, with overall annual error averaging about 1.5% since 2000
- Forecast error tends to center around two very volatile sources, nonwithholding and corporate income tax collections
- Error in nonwithholding estimates has average 5.5% since 2000
  - This source includes many different types of income and is hard to model
  - Also impacted by tax planning
- Nonwithholding has made up the vast majority of both our shortfalls and surpluses

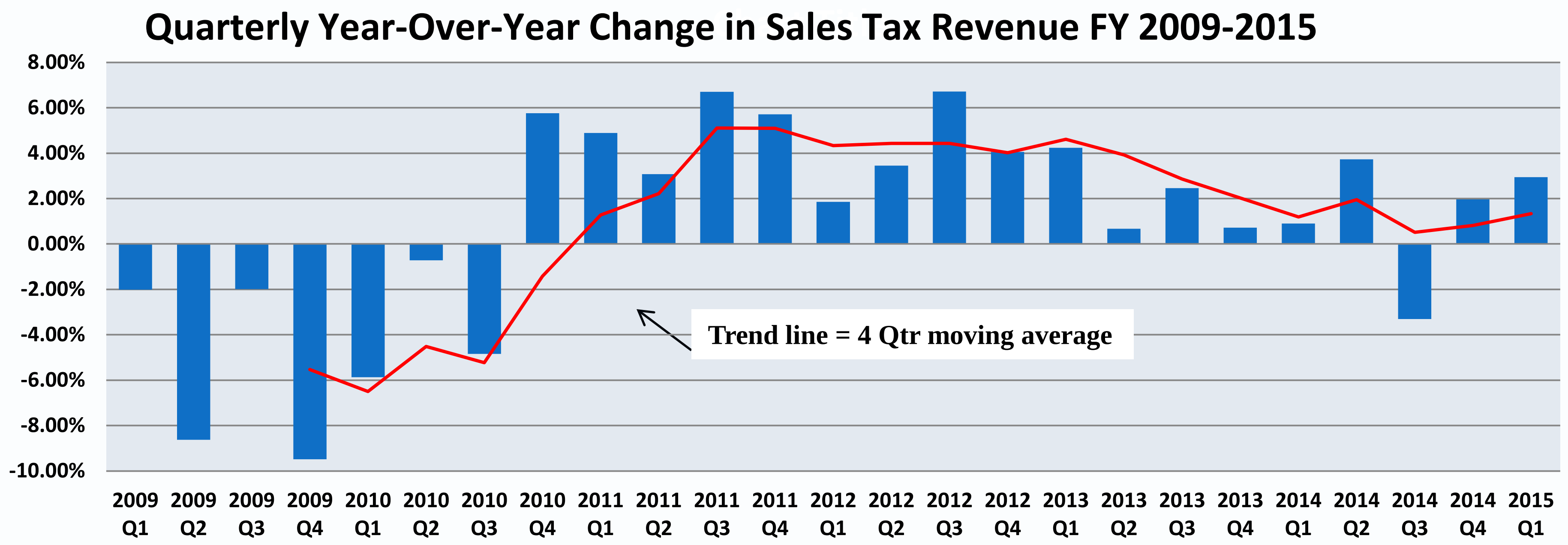
Year-to-Date Performance: Sales Tax

Sales Tax:

- Through October, sales tax collections have grown 4.0% - slightly ahead of the economic-based forecast of 3.4% growth – when adjusted for the impact of accelerated sales tax and HB 2313
  - The unadjusted collections increased 3.8%, compared to a forecast of 4.4%
- Current projections of personal income – the model driver of sales – has not changed substantially since the forecast was adopted, making it unlikely we will see much change in the forecast
- While the upcoming holiday season is expected to be a bit more robust than in recent years with 4.1% growth, sales tax growth levels are in line with these revised holiday sales expectations
- Virginia's consumer spending saw a short-term bump up at the start of the recovery, but slow job and income growth make it unlikely the figures will return to those more robust levels in the near term
  - Sales are driven in part by sentiment, and Virginia's proximity to Washington has resulted in slower growth than seen elsewhere in the nation

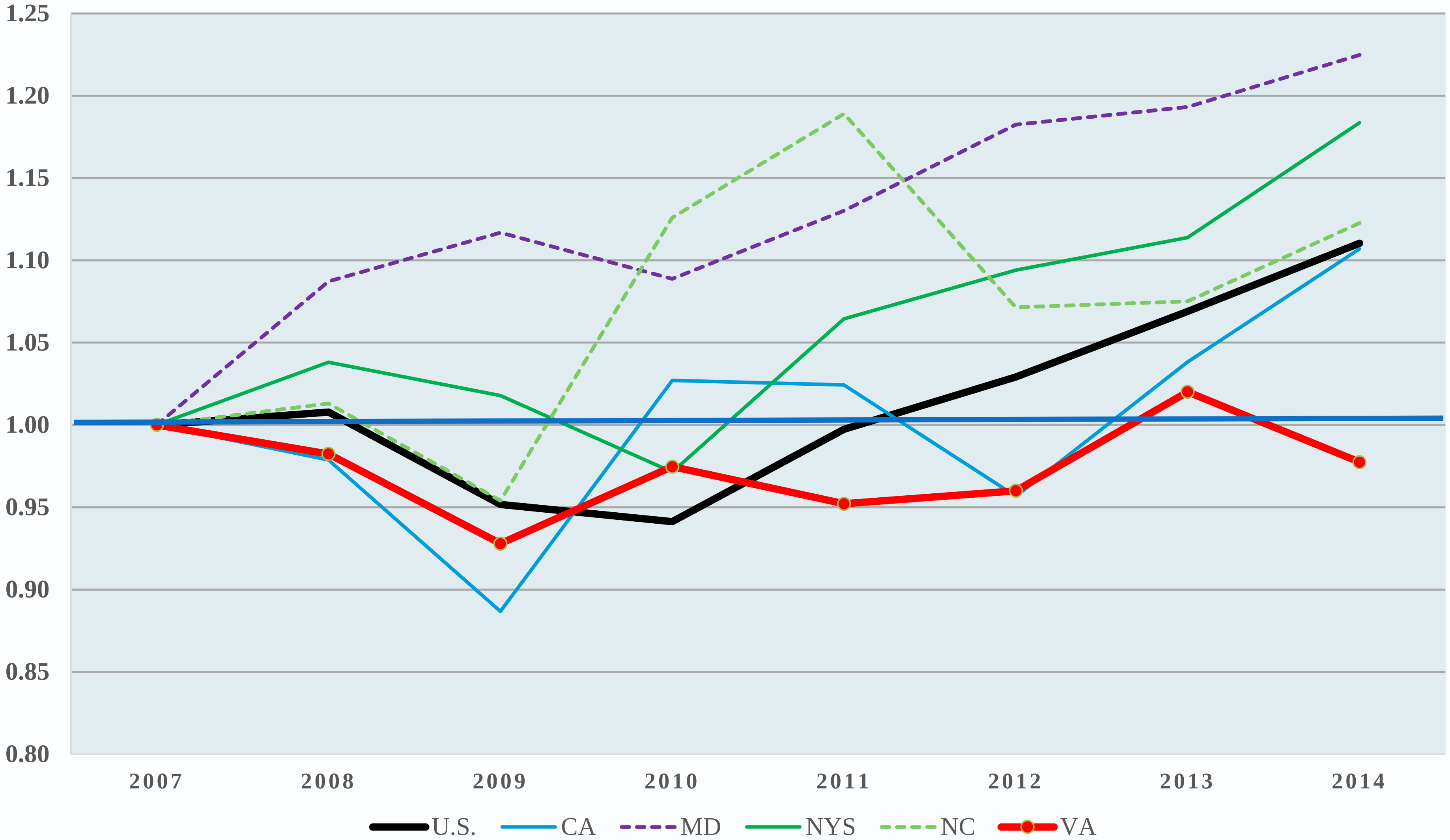
Virginia's Consumers More Cautious

- In Virginia, sales tax growth was 5.1% in FY 2011, and 4.0% in FY 2012, 2.0% in FY 2013, and only 0.8% in FY 2014
- Virginia consumers have shown restraint in the face of sequestration and government shutdowns
  - Unresolved nature of federal stand-off limits purchases to replacement items
- There has been some improvement in FY 2015



Sales/Use Tax Receipts

(2007 = 1.00)



Source: Bureau of the Census

Year-To-Date Performance: Other Major Sources

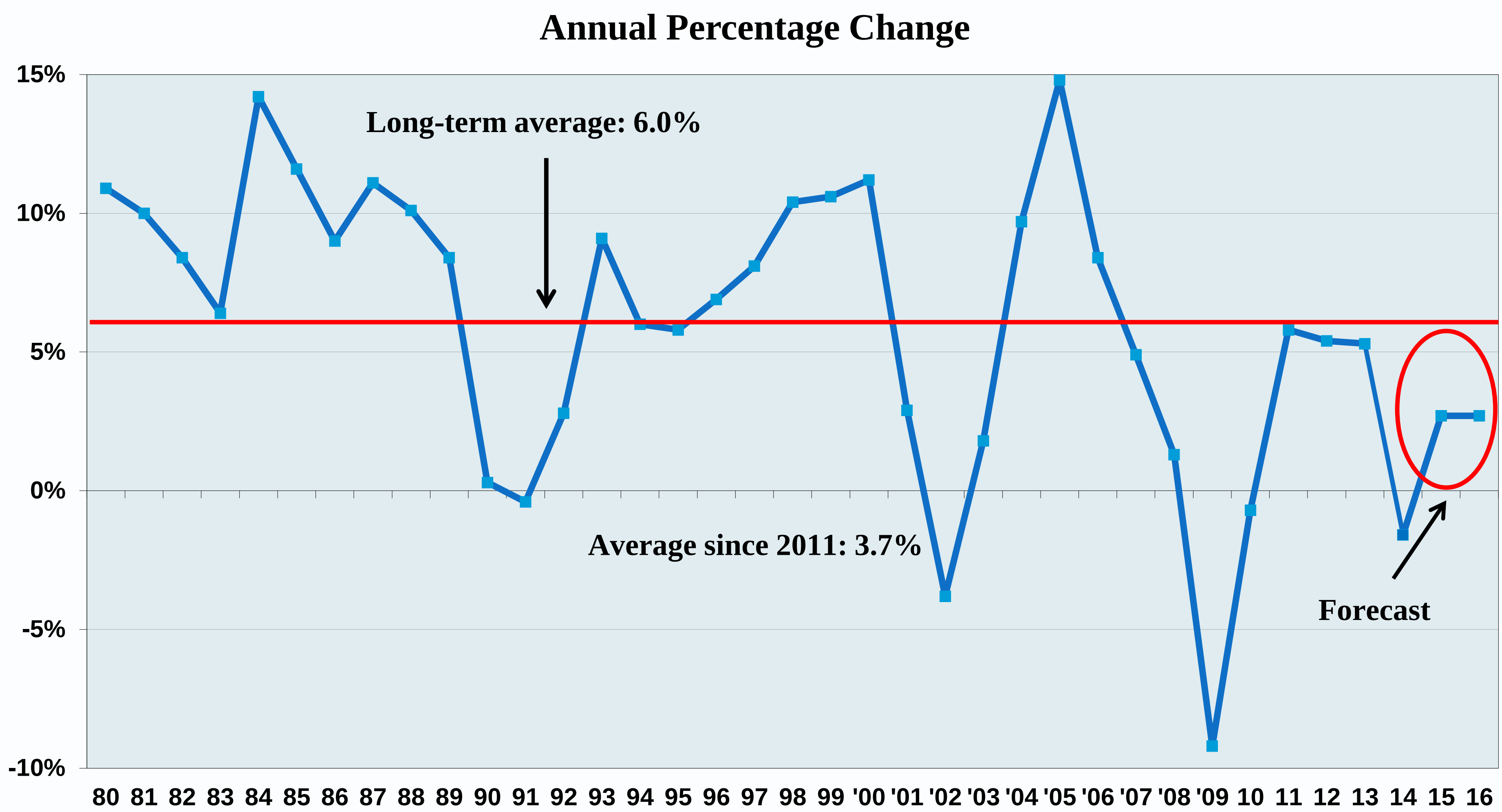
Corporate Income:

- Corporate collections through October increased 16.6% compared with the forecast of a 0.9% decline
  - September was the first significant month in corporation income tax collection because that is when the first estimated payment is due and the first quarter increase was reported to reflect widespread strength in payments from many large corporations
  - October's payments reflected refund activity as well as estimated payments from companies with February through January fiscal years, primarily retailers
  - Could see an upward adjustment to this source based on "cash in the bank" but because this source is small, even a 10% swing would produce only $75 million in additional revenues

Recordation Taxes:

- Forecast for year is 1.2% growth, actual collections through October fell 2.7%
  - September and October were positive months are 13 months of decline for this source
  - While the real estate market has improved, initial jump has fallen off and price appreciation is modest

General Fund Revenue Growth FY 1980-2016



***Actual Collections FY 1980-2014, FY 2015-16 Official Forecast. (All exclude transfers.)**

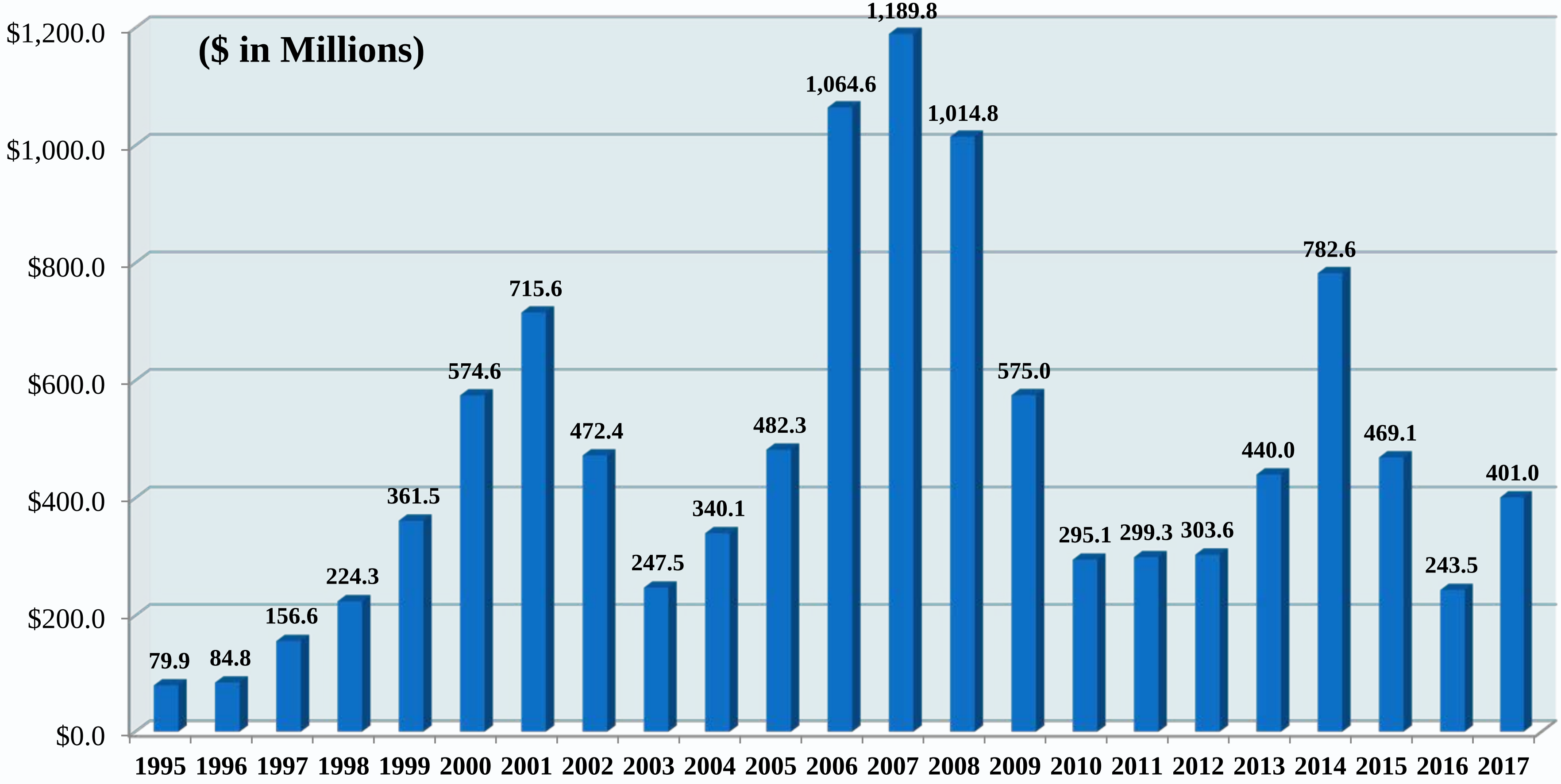
What Revenue Adjustments Can Be Expected and What Happens If We Exceed the FY 2015 Forecast ?

- While GACRE has not yet met, consensus among the members of the Joint Advisory Board of Economists was that current economic conditions did not merit any changes to the fundamentals - job growth or wage and salaries
  - These factors drive 80% of our forecast model (sales and payroll withholding)
- Assuming that we grow at forecast levels for the remaining 8 months of the year, FY 2015 would finish about 1% ahead of the official forecast
  - This translates to about $170 million
- But…it's still early in year
  - Last year revenue grew 2.8% through the first quarter and FY 2014 ended at -1.6%, a drop of 4.4%
  - Have to get through the holiday season and January estimated payments
  - Mid-Session reforecast will have greater importance
- Keep in mind that usage of surplus revenues is prescribed by the Code – payments to the Revenue Stabilization Fund and Water Quality Improvement Fund take precedence, followed by requirements that the remainder be used for transportation and other non-recurring activities

What Happens in FY 2015 Revenues Exceed the Forecast

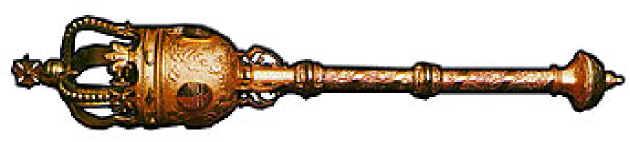
- While the FY 2015 GF forecast projects growth of only 2.9%, even this growth substantially exceeds the preceding six-year annual average because of the years of revenue contraction
- Because of that, the current FY 2015 forecast will result in a mandatory deposit to the Rainy Day Fund in FY 2017 of $157.5 million according to the Auditor of Public Accounts' annual certification
- As a rule of thumb, 50% of any growth above that level must also be deposited into the Rainy Day Fund
  - This applies only to growth in personal and corporate income and sales taxes, the 3 sources used in the revenue stabilization fund formula
- At year-end close, the Comptroller will reserve any revenue above the forecast to meet the FY 2017 deposit requirement as a first call on those funds

Revenue Stabilization Fund Status



- Note: FY 2017 balance based on the interim forecast for FY 2015, which results in a FY 2017 deposit of $157.5 million. Any surpluses or shortfalls in the current year would increase or reduce that required deposit

Remaining Budgetary Gap:
FY 2014-16 Biennium



What Issues Must be Addressed in the 2015 Session?

- Undesignated Spending Reductions Included in HB 5010
- Agencies Submitted Budget Drivers
- Forecast Changes
- Options to Close the Remaining Gap?
- Positioning Ourselves for the Upside Potential

Undesignated Spending Reductions in HB 5010

- Last week, the General Assembly adopted HB 5010 (Chapter 3) to address the additional revenue shortfall resulting from the August revenue reforecast
- While the legislation details the vast majority of the required savings actions, two items are left to be addressed:
  - Item 471.40 of HB 5010 directs the Governor to develop specific strategies for submission to the 2015 General Assembly to address the remaining $272.0 million in FY 2016 savings not detailed in HB 5010
    - Because this was a second year issue, seemed prudent to provide additional time to develop targeted reductions to help close the gap
  - The HB 5010 substitute also increased the assumed year-end balances in FY 2015 by $49.8 million to allow for the continued transfer of sales tax to transportation as set out in HB 2313 (2013 Session)
    - Savings strategies still have to be identified to close that gap

2015 Session Budgetary Pressures

- As part of the standard fall budget development process, agencies were asked to identify additional spending needs beyond those provided for in Chapter 3
  - Each year agencies submit decision packages requesting funding for both items that are "mandatory" in nature – i.e. forecast changes or Code requirements, and "nice to do's" that agencies view as priorities
- Agency budget requests received as of November 1 totaled $93.6 million GF in FY 2015 and $360.4 million GF in FY 2016
  - Largest component is requests from health and human resources agencies totaling $36.8 million in FY 2015 and $111.6 million in FY 2016
  - Other large areas are higher education at $3.4 million in FY 2015 and $82.9 million in FY 2016 and Commerce and Trade, with requests totaling $10.5 million in FY 2015 and $76.5 million in FY 2016

2014-16 Budget Drivers:

Mandatory/Statutory Items

GF $ in Millions	FY 2015	FY 2016	Total
Offset Reduced Tobacco Tax Collection	$20.0	$20.0	$40.0
Add Licensing Staff for DOJ	$0.1	$1.0	$1.1
Backfill Federal Funds for DBHDS Geriatric Facilities*	$11.1	$26.6	$37.7
Backfill Federal Electronic Health Records Payments	$3.0	$0.8	$3.8
Fund Revised Estimate Foster Care to 21	$0.0	$5.8	$5.8
Criminal Fund Forecast Updates	$5.1	$8.1	$13.2
Jail Per Diems	$13.0	$15.9	$28.9
1:1,500 Ratio	$0.0	$6.6	$6.6
Direct Inmate Health Care	$14.4	$30.2	$44.6
State Board Elections Redistricting Costs	$3.6	$0.0	$3.6
Total – Known Mandatory/Statutory Budget Drivers	**$70.3**	**$115.0**	**$185.3**

2014-16 Budget Drivers:

Other High Dollar Budget Request Items

GF $ in Millions	FY 2015	FY 2016	Total
Higher Education Requests – All Institutions	$3.4	$82.9	$86.3
Increase Governor's Opportunity Fund	$10.5	$18.0	$28.5
Fund Mega Site Development	$0.0	$10.0	$10.0
Increase Motion Picture Opportunity Fund	$0.0	$3.6	$3.6
Finance Tourism Growth Incentive Fund	$0.0	$25.0	$25.0
Virginia Branding and Marketing Strategy	$0.0	$5.0	$5.0
Expand Tourism Advertising and Marketing	$0.0	$8.7	$8.7
Career Dev. Programs for Const. Officers	$0.0	$2.7	$2.7
Constitutional Officers Staffing Standards	$0.0	$6.4	$6.4
Soil and Water Conservation Dist. Staffing	$2.3	$2.3	$4.6
Veteran's Services: Disability Claims Staffing	$0.0	$1.8	$1.8
Subtotal – Other Budget Requests (current page)	**$16.2**	**$166.4**	**$182.6**

2014-16 Budget Drivers:

Other High Dollar Budget Request Items

GF $ in Millions	FY 2015	FY 2016	Total
VA Center For Behavioral Health	$0.2	$2.3	$2.5
Local Foster Care Staffing	$5.7	$5.4	$11.1
Medicaid Data Warehouse and MMIS Procure.	$0.1	$9.6	$9.7
Foster Care Prevention Staffing	$5.7	$5.3	$11.0
DMAS ID/DD Waiver Redesign	$3.5	$12.3	$15.8
DSS Eligibility Workers	$2.1	$1.9	$4.0
Backfill Loss of Child Support Revenues	$2.3	$2.3	$4.6
TOTAL – Other Budget Requests (both pages)	**$35.8**	**$205.5**	**$241.3**

Potential Budget Gap
Based on Identified Drivers

$'s in millions	FY 2015	FY 2016	Biennium
Ch. 3 Unappropriated Balance	$15.3	($12.4)	$2.9
Undesignated Savings Required in HB 5010	($49.8)	($272.0)	($321.8)
Mandatory/Statutory Spending Drivers	($70.3)	($115.0)	($185.3)
Medicaid Forecast Savings*	$127.8	$66.5	$194.3
Potential Budget Gap	**$23.0**	**($332.9)**	**($309.9)**

The Medicaid Forecast figure assumes the Governor's Healthy Virginia Initiative

Options to Close the Remaining Gap

- Agency Reduction Plans
  - Following the announcement of the FY 2014 shortfall in August, the Governor again asked all agencies to submit 5% budget reduction plans for FY 2015 and 7% budget reduction plans for FY 2016
  - The identified strategies equal about $23.0 million for each one percent
  - The 5% plans, which totaled $114.7 million, served as the base for meeting the FY 2015 state agency reductions
  - The 7% plans provide options totaling $161.2 million in FY 2016 through a combination of GF reductions and NGF supplants
    - While $100 million is required to meet the agency reduction cuts contained in HB 5010, the remaining $61.2 million is available to help address a portion of the $272.0 million in unspecified savings
- Higher Education Reduction Plans
  - Like state agencies, higher education institutions were asked to develop savings plans at the 7% level in FY 2016. These total $95.5 million
  - HB 5010 requires savings of $45.0 million each year from higher education, or about 3.3%; this means there are $50.0 million in additional identified higher education savings potentially available to help close the remaining gap

Options to Close the Remaining Gap

- Adjustments to Fees and Tax Preferences
  - The Governor has indicated that he intends to review fees and tax preferences as part of the development of his budget proposals to close the gap in FY 2016
  - He has indicated his focus will be on ensuring fees cover the costs of services, and eliminating tax preferences that no longer meet their intended purpose
- Literary Fund Proposal
  - Review of exemptions to the unclaimed property laws could have a potential positive impact on the Literary Fund and be used to offset portion of Public Education costs

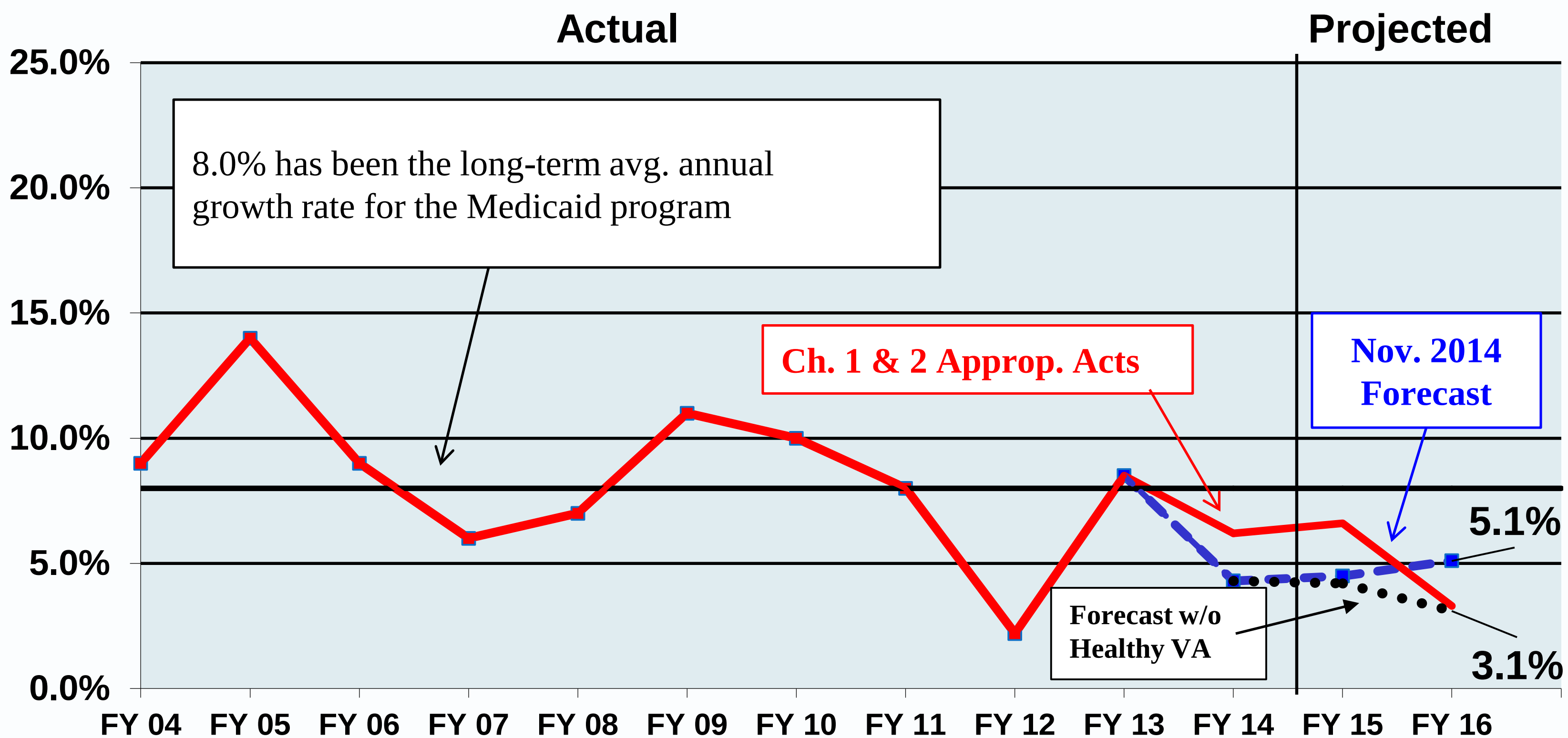
Options to Close the Remaining Gap

- Savings from Programs Exempted from Across-the-Board Savings Plans
  - K-12 and Medicaid, which comprise about 55% of the GF budget, were excluded from across-the-board cuts with an understanding that they would be looked at for targeted savings in FY 2016
- Public Education
  - While ADM declined 1,500 students and will have an impact on basic-aid and other categorical programs, it is anticipated to produce only small savings
  - One option to generate additional savings in K-12 is to review funding methodologies for programs that exceed the Code-required standard such as school nurses and resource teachers
  - Another option would be to apply the same eligibility methodology to the At-Risk Add-On as is used for the K-3 class-size funding
- Medicaid
  - The annual update to the Medicaid forecast reduces GF expenditures of $127.8 million in FY 2015 and $66.5 million in FY 2016, primarily due to lower than anticipated enrollments into Medicaid under current eligibility (woodworking effect), lower than projected managed care rate increases, and lower payments to the state teaching hospitals

Medicaid Forecast

- Official Medicaid forecast updated every November
  - Governor's introduced budget may include updated data elements
- 2014 Official Medicaid forecast updates projected spending for the 2014-16 biennium and provides initial projection for FY 2017
- In addition, Virginia Health Care Fund revenues will influence how much general fund dollars are required to meet the forecast costs of the Medicaid program
  - Revenues in the fund are used as a portion of the state's match for the Medicaid program
  - Comprised of tobacco taxes, Medicaid recoveries and a portion of the Master Tobacco Settlement Agreement (41.5%)
  - Revenue changes in the Virginia Health Care Fund are not included in Official Medicaid forecast
  - The fund ended FY 2014 with a $74.2 balance which will be carried forward into the 2014-16 biennium

November 2014 Medicaid Forecast



Note: Represents percentage change in all funds, state and federal, adjusted for payment timing changes, cash management, FMAP maximization.
Source: 2014 preliminary DPB and DMAS consensus forecast

- Medicaid expenditures grew by 4.3% in FY 2014, 1.9% less than the 6.2% assumed, resulting in a lower expenditure base heading into the 2014-16 biennium
- The Nov 2014 forecast projects an increase of 4.5% in FY 2015, compared to 6.6% in Chapter 2. FY 2016 growth increases to 5.1%, in part because it assumes implementation of the Governor's Healthy Virginia Initiative, costing $98.6 million in FY 2016 alone
    - Growth rate in FY 2016 would be about 3.1% without Governor's initiative

Preliminary Medicaid Forecast

($ in millions)

Medicaid Forecast	FY 2015 Total Funds	FY 2015 GF	FY 2016 Total Funds	FY 2016 GF
Chapter 2 Funding	$8,239.0	$4,155.5	$8,510.1	$4,333.6
November 2014 Forecast	$7,942.2	$4,027.7	$8,360.0	$4,267.1
Additional Need (Savings)	($296.8)	($127.8)	($150.1)	($66.5)

Factors Resulting in Reduction in Projections
(GF $ in millions)

	FY 2015	FY 2016	Total
Reduction in supplemental payments to state teaching hospitals (DSH, IME, GME, supplemental physician payments)	($60.0)	($57.0)	($117.0)
Increased savings from behavioral health services reforms	($40.0)	($58.5)	($98.5)
Lower estimates related to “woodwork effect” from federal health care exchange	($49.5)	($37.5)	($87.0)
Lower than projected managed care rate increases, effective July 1, 2014	($33.5)	($37.5)	($71.0)

Factors Increasing Medicaid Projections in 2014-16 Biennium

(GF $ in millions)

	FY 2015	FY 2016	Total
Lower than projected savings from Commonwealth Coordinated Care program (dual-eligible demonstration program)	$11.7	($1.7)	$10.0
Funding for Healthy Virginia Initiatives			
GAP Program	$13.0	$77.0	$90.0
Medicaid Impact of CHIP Outreach	$1.0	$11.4	$12.4
Dental Coverage for Pregnant Women	$0.3	$1.6	$1.9
Behavioral Health Homes	$0	$8.6	$8.6
Total for Healthy Virginia	**$14.3**	**$98.6**	**$112.9**

Final Thoughts: 2015 Session Challenges

- While the national economy has shown some improvement, Virginia continues to underperform the nation, making the standard economic models less accurate
  - Virginia's revenue outlook has fallen from its long-term average growth of 6.0%, to only 3.7% annual growth since FY 2011
  - Impact of cuts to federal spending – especially defense spending – have held down our employment and income growth, and thus our tax revenues
- Because of the actions taken in HB 5010, FY 2015 has been addressed to a large extent
  - However, because we already have utilized reduction plans and capturing of year-end resources, additional savings will be more difficult to identify half-way through the fiscal year
- FY 2016 will be the major challenge for the 2015 Session
  - Shortfall of $300-350 million in FY 2016 when undesignated cuts and growth in budgetary drivers are taken into consideration

Final Thoughts: 2015 Session Challenges

- Through the first four months of the fiscal year, we are exceeding the forecast by about $300 million
  - Strength has been centered in corporate and non-withholding, our 2 most volatile sources
  - Withholding tax collections grew 5.5% through October, but last year at this point withholding was 1.3% above forecast through October yet ended the year below forecast
- Year-to-date "money in the bank" indicates revenues could exceed the current forecast, but it is too early to tell
  - Virginia's revenues – especially the volatile sources – are back-loaded into the Spring
  - January and February are key deposit months
    - Includes holiday season sales tax collections
    - The second nonwithholding and corporate income tax payments
- The Mid-Session forecast likely to be especially important this year – remember: the current forecast was just finalized in August and little time has elapsed since
- If FY 2015 revenues exceed the forecast, about 50% of any excess will be deposited into the Rainy Day Fund
  - Mandatory deposit of $157.8 million already required in FY 2017
  - FY 2017 spending also will have to be adjusted to backfill the use of $235.0 million in withdrawals from the Rainy Day Fund in FY 2016