



Summary of

**The Governor's Proposed
Amendments to the
2004-2006 Budget**

Introduced as House Bill 1500 / Senate Bill 700

January 10, 2005

Prepared jointly by the staffs of the:

**SENATE FINANCE COMMITTEE
and
HOUSE APPROPRIATIONS COMMITTEE**

INTRODUCTION

This document was prepared by the staffs of the Senate Finance and House Appropriations Committees as a preliminary report on the Governor's Proposed Amendments to the budget for the 2004-2006 biennium. Additional information will be made available during the 2005 General Assembly Session.

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Table of Contents

OVERVIEW.....	O-1
RESOURCES	1
LEGISLATIVE.....	6
JUDICIAL.....	7
EXECUTIVE OFFICES	10
ADMINISTRATION.....	12
AGRICULTURE & FORESTRY	16
COMMERCE AND TRADE.....	17
PUBLIC EDUCATION.....	22
HIGHER EDUCATION	31
OTHER EDUCATION	38
FINANCE.....	39
HEALTH & HUMAN RESOURCES	45
NATURAL RESOURCES	61
PUBLIC SAFETY.....	66
TECHNOLOGY.....	75
TRANSPORTATION.....	77
CENTRAL APPROPRIATIONS	83
INDEPENDENT AGENCIES.....	87
NONSTATE AGENCIES.....	88
CAPITAL OUTLAY.....	89

Appendices:

Aid for Public Education 2004-2005	A
Aid for Public Education 2005-2006	B
Summary of Detailed Actions in Budget	C
Capital Outlay	D
Detailed Employment Summary	E

Overview of Proposed Amendments to the Budget for 2004-2006

The proposed amendments to the 2004-06 budget (Chapter 4, 2004 Special Session I) include actions to enhance budget and fiscal stability; expand tax relief; and provide funding for basic budget commitments, primarily in the areas of transportation, health care, and education. General fund operating budget amendments totaling a net \$1.0 billion are proposed, along with \$166.5 million GF for capital projects.

Many of the proposed spending items are one-time in nature, such as capital outlay projects, specific transportation initiatives, and deposits to the Revenue Stabilization Fund. The use of the additional revenue for one-time items minimizes the creation of out-year obligations.

The budget includes about \$1.2 billion in net additional general fund resources, comprised largely of a revision to the general fund revenue forecast of \$918.7 million for the biennium, which is then reduced by \$99.1 million to reflect the phase-out of the food tax effective July 1, 2005; the transfer of \$23.2 million (3 percent car rental tax) to transportation for rail services; and, \$6.9 million to reflect conformity to recent federal tax law changes.

Other resource changes reflect the net budget surplus and agency reverted balances at the end of FY 2004. These result in an additional \$306.3 million carried forward into the 2004-06 biennium. This carry-forward balance is largely offset by commitments to the Revenue Stabilization Fund and the Water Quality Improvement Fund. Finally, general fund transfers are increased by \$108.2 million, including an upward revision in the Lottery forecast of \$68.3 million and ABC profits of \$10.0 million.

Revenues

The economic outlook for the remainder of this biennium is slightly stronger than it was at this time last year. When the economics are applied to the strong fiscal year 2004 performance, the result is an upward revision of \$917.0 million in general fund tax revenues (increased to \$918.7 million from minor adjustment in rental income and prisoner revenue). When added to the balances carried forward from fiscal year 2004, and combined with stronger than projected Lottery and ABC profits, resources available for appropriations during the 2005 session total \$1.2 billion.

This net increase in resources results primarily from four factors: (1) stronger than anticipated revenue growth in fiscal year 2004, which resulted in revenue collections of \$323.8 million above the forecast; (2) a corresponding increase in the revenue base for the 2004-06 biennium; (3) continued economic expansion with moderate growth in the 5 to 6 percent range; and (4) a sizeable increase in the Lottery forecast.

General Fund Resources Available for Appropriation (2004-06 biennium, \$ in millions)			
	<u>Chapter 4</u>	<u>HB 1500/SB 700</u>	<u>Change</u>
Available Balances	\$272.9	\$579.2	\$306.3
Revenue Estimate	25,545.3	26,335.0	789.7
Transfers/Deposits:			
Lottery Proceeds Fund	797.0	865.3	68.3
Other Transfers	670.9	710.8	<u>39.9</u>
			108.2
Total GF Resources Available	\$27,286.1	\$28,490.4	\$1,204.2

Available Balances

The balance adjustment reflects funds that are available from fiscal year 2004 revenues collected above the forecast and unexpended agency balances that have been reverted. After setting aside funds for natural disaster awards, the Transportation Trust Fund portion of accelerated sales tax revenues, and non-general fund interest earnings returned to NGF accounts, a balance of \$306.3 million has been carried forward and is available for required Rainy Day Fund and Water Quality Improvement Fund deposits and other budget needs.

Revenue Estimate

The introduced budget includes an upward revision of \$917.0 million in the general fund revenue forecast to recognize the higher revenue base from fiscal year 2004 activity and the expectation that Virginia's economy will continue to outpace the nation. Minor changes in projected rental income and prisoner revenue add \$1.7 million, to produce a total projected increase in GF revenue of \$918.7 million.

The revised growth rate based on pure economics (omitting tax policy changes and funds moved to the Virginia Health Care Fund), is 6.1 percent in fiscal year 2005 and 5.4 percent in fiscal year 2006. (Revenue increased by 9.7 percent in fiscal year 2004.)

Three tax policy changes are proposed that reduce GF revenue by \$129.0 million, resulting in a net revenue change of \$789.7 million.

Proposed tax policy changes include:

- ***Sales Tax on Food.*** The 2004 General Assembly approved a phased reduction in the state portion of the sales tax on food, beginning in July 2005. The reduction was to occur in three ½ percent increments, at a cost of roughly \$50 million per ½ percent reduction. The introduced budget assumes that legislation to be proposed during the 2005 session to advance the entire 1 ½ percent reduction to July 2005, will be approved. *Revenue impact: (\$99.1 million).*
- ***Selective Deconformity.*** Since 2001, Virginia has selectively conformed to federal tax law by advancing the date of conformity one year at a time. The introduced budget assumes that legislation proposed during the 2005 session to advance the date of conformity to December 31, 2004, will be approved, thereby passing federal tax benefits to small businesses and individuals through increased business expensing allowances; teacher deductions up to \$250 for classroom expenses; and, simplified tax filing measures. *Revenue impact: (\$6.7 million).*
- ***Car Rental Tax.*** The 2002 General Assembly redirected to the general fund the 3 percent car rental tax used to support DMV operations. This action was taken in order to balance the general fund budget. The introduced budget proposes redirecting the 3 percent rental tax to transportation as a dedicated fund source for rail improvement. *Revenue Impact: (\$23.3 million).*

Transfers/Deposits to General Fund

The primary transfer change in the introduced budget is an increase in expected Lottery profits available to public education of \$68.3 million over the biennium (plus an additional \$22.7 million included in the balance forward resulting from fiscal year 2004 activity).

Recommended Budget Savings

General fund savings within the biennial budget adopted last session add to the resources which are available for use. In total, HB 1500/SB 700 recommends \$213.5 million in funding reductions; most of which come from reduced projected enrollment for public education and lower-than-projected reimbursements for Car Tax relief. Other savings include the receipt of additional Medicaid disproportionate share hospital funding for the Virginia Commonwealth University Health System. Reductions in the Department of Mental Health, Mental Retardation and Substance Abuse Services (DMHMRSAS) are the result of supplanting general fund monies for Community Services Boards with fee revenue from a Medicaid case management rate increase.

Major savings items in the budget as introduced include:

Major Savings Proposed in HB 1500/SB 700, as Introduced (Biennial GF, \$ in millions)	
Public Education	
Direct Aid	
Technical - Revised ADM forecast	(\$61.3)
Technical - Updates based on participation, test scores, special enrollments	(18.2)
Defer middle school math teacher initiative, mentor teacher program savings	(2.0)
Human Resources	
Department of Medical Assistance	
Disproportionate share teaching hospital savings	(\$20.0)
Department of Mental Health, Mental Retardation and Sub. Abuse Svs.	
Supplant GF in CSBs with Medicaid case management fee increase	(\$16.9)
General Government	
Central Accounts	
Adjust car tax to reflect revised forecast for TY 2005 at 70 percent	(\$59.3)
Treasury Board	
Debt service savings	(\$32.8)
Judicial Department	
Capture savings from public defender offices	(\$3.0)
GRAND TOTAL	(\$213.5)

Proposed Spending Increases

The Governor's budget recommendations provide approximately \$1.4 billion in general fund spending adjustments. Of this total, five commitments account for approximately \$1.1 billion of the spending adjustments:

- 1) Depositing \$229.4 million to the Revenue Stabilization Fund representing both the constitutionally required deposit and the "super" deposit required by the Code of Virginia;
- 2) Providing \$209.6 million to meet the projected cost of Medicaid services for mandated clients;
- 3) Providing \$166.5 million for capital project cost overruns, maintenance and repair of state owned facilities, and equipment for previously approved projects;
- 4) Allocating \$373.6 million for a variety of new transportation initiatives; and
- 5) Providing \$81.0 million for a 3 percent salary increase for state employees, college faculty, teachers, and state-supported local employees, and \$31.2 million representing the employer's share of the state employee health insurance premium increase.

Major spending items in the budget as introduced include:

Major Spending Increases Proposed in HB 1500/SB 700, as Introduced (Biennial GF, \$ in millions)	
Public Education	
Direct Aid	
3.0% teacher salary increase, Dec. 1, 2005	\$54.8
Technical – Distribute increased Lottery proceeds	35.2
Technical – Unfunded corrections	19.7
Technical – Distribute increased sales tax revenue	13.0
Increase funding for "Race for the GED"	2.4
Begin state support for school breakfasts	1.6
Technical – Fund composite index for Board-approved consolidation of Alleghany with Clifton Forge	0.7

Dept. of Education	
Education for a Lifetime (NCLB) - Fund remainder of UVA contract for turnaround specialists program	\$0.7
Education for a Lifetime - Radio advertising of "Race for the GED"	0.6
Education for a Lifetime (NCLB) - Career planning software	0.5
Human Resources	
Dept. of Medical Assistance Services	
Medicaid utilization and inflation (excluding Virginia Health Care Fund)	\$182.7
Virginia Health Care Fund shortfall	26.9
Increase reimbursement rates for OB/GYN services	16.6
Fee increase for Medicaid supplemental clinic payments and mental health case management	9.3
Low-income children (Medicaid SCHIP) caseload growth	7.1
Increase inpatient hospital reimbursement	3.6
Special education medical services for school districts	3.3
Expand prenatal care and pregnancy-related services to pregnant women in FAMIS	3.3
Increase Medicaid reimbursement for dental services	2.8
Involuntary mental health commitments (also see Judicial)	2.7
FAMIS caseload growth	2.1
Medicaid effect of Auxiliary Grant payment increase	1.7
Dept. of Mental Health, Mental Retardation and Substance Abuse Services	
Fund shortfall in community aftercare pharmacy	\$5.5
Part C early intervention services	4.5
Community crisis services	2.9
Fund shortfall in facility medications	1.4
Mental retardation waiver start-up costs	1.3
Adjust nurse salaries to improve retention	1.0
Increase funding for the Office of the Inspector General	0.5
Increase community mental health services for children and adolescents	0.5
Dept. of Social Services	
Supplant TANF with GF for child day care subsidies for at-risk, low-income families	\$6.8
Improve child welfare services	2.7
Supplant TANF with GF for child day care licensing	2.6
Increase assisted living facility Auxiliary Grant payments	2.3
Increase oversight of assisted living facilities	0.5
Department of Health	
Increase access to dental services	\$0.9
Transportation	
Va. Dept. of Transportation	
Public-Private Transportation Act (PPTA) leverage fund	\$140.0
Project deficit funding	90.0
Transit capital project funding	80.0
	40.0
Local partnership incentive funding	

Supplant transportation funds to support other agencies	23.6
Capital Outlay	
Project cost overruns	\$69.3
Maintenance Reserve for state agency facilities	40.1
Equipment for previously approved projects	31.6
Miscellaneous construction, renovation, and planning projects	12.6
Old City Hall buy-out leasehold interest	7.6
NSU Maintenance Reserve	2.9
VSU Maintenance Reserve	2.4
General Government	
Employee Compensation	
Fund increased health benefit premiums for state employees	\$31.2
Fund Dec. 1, 2005 salary increase for state-supported local employees	12.7
Additional funding for Nov. 25, 2005 salary increase for state employees	1.9
Car Tax	
Provide supplement for reimbursement of delinquent car tax payments	\$24.0
Innovative Technology Authority (CIT)	
Additional baseline funding and VECTEC support	\$2.2
Virginia Information Technologies Agency (VITA)	
Fund GIS aerial photography update	\$1.5
Fund data center operations	1.1
Constitutional Officers	
Commonwealth's Attorneys staffing	\$1.3
Law enforcement deputies at 1:1,500	0.8
Department of Veterans Affairs	
Additional staff	\$0.6
Finance	
Department of Accounts	
Additional staff	\$0.3
Payroll Service Bureau	0.1
Rainy Day Fund payments (Constitutional and Super Deposit)	\$229.4
Planning and Budget	
School efficiency reviews	\$1.4
Staff increase	0.2
Taxation	
Tax reform systems costs	\$1.3
Administration of tobacco and corporate tax changes	1.0
Higher Education/Other Education	
SCHEV	
Complete GEAR-UP state match	\$2.1
Continue tuition waivers for military dependents	2.0
Increase Tuition Assistance Grants (TAG)	1.8
	0.4
Expand the Virtual Library of Virginia (VIVA)	

Colleges & Universities	
Provide base adequacy funding	\$12.2
3% faculty salary increase for FY 2006	11.7
Provide additional undergraduate and graduate student financial aid	9.1
One-time research supplement	2.5
Fund operation & maintenance of new E&G facilities coming on-line	2.5
UVA health insurance premiums	1.4
Fund operations of Northern Va. CC-Medical Education Campus	1.2
VCCS Workforce Certification Program	1.1
Dual enrollment pilot programs	0.6
Other Education	
Library of Virginia - State Aid to Local Libraries	\$0.3
Commission for the Arts - Increase grants	0.3
Economic Development	
Department of Housing and Community Development	
Virginia Works – Artisan industry support and promotion	\$5.0
Virginia Works – Regional workforce consortia grants	4.0
Virginia Works – Brownfields fund and industrial site redevelopment	4.0
Virginia Works – Trails programs and tourism support	3.8
Virginia Works – Small manufacturing and specialty agriculture support	1.4
Virginia Works – Community development bank and market tax credits	0.7
Support for housing for persons with disabilities	1.5
Central Appropriations	
Increase Governor’s Opportunity Fund	\$2.0
Semiconductor education grant	2.0
Biotechnology commercialization support fund	1.6
PPEA evaluation costs	1.1
Public Safety	
Corrections	
Expand day reporting centers	\$0.8
Establish return to custody program/electronic monitoring	0.4
Expand system bed capacity	0.2
Criminal Justice Services	
Increase funding for H.B. 599 program	\$4.2
Increase forensic science staff	1.1
Establish mitochondrial DNA laboratory program	0.4
Emergency Management	
Fund staff for Fusion and Emergency Operations Center	\$0.5
Juvenile Justice	
Increase funding to support system utilization plan	\$1.2
State Police	
Increase funding for higher fuel and insurance premium costs	\$1.0
Fund gang law enforcement and investigation activities	1.0
	0.
Fund staff for Fusion Center	3

Judicial Department	
Increase funding for Criminal Fund	\$5.4
Fund additional law clerks	1.5
Increase funding for Involuntary Mental Commitment Fund	1.4
Transfer general fund support for drug courts	0.6
Natural Resources	
Department of Conservation and Recreation	
Water Quality Improvement Fund deposit allocation	\$16.2
Address state park operations and staffing needs	2.0
Repair dams in state parks	0.7
Department of Environmental Quality	
Water Quality Improvement Fund deposit allocation	\$16.2
Repayment of Litter Control and Recycling Fund treasury loan	1.3
Funding for water supply planning	0.7
Marine Resources Commission	
Funding for five marine police officers	\$0.3
Virginia Museum of Natural History	
Provide additional funding for new museum's operating expenses	\$0.5
Executive Offices	
Office of the Governor	
Fully budget operating expenses	\$1.8
Secretary of the Commonwealth	
Fully budget operating expenses	\$0.5
GRAND TOTAL	\$1,412.3

A summary of significant general fund spending increases and savings actions proposed in each major area follows.

Public Education. The Governor's proposed amendments result in a net increase of \$45.5 million GF and \$53.3 million NGF for the Direct Aid budget compared to the original biennial budget. This total reflects new spending of \$127.6 million GF offset by \$82.1 million in GF savings. In addition, Literary Fund revenue estimates are increased by \$20 million and are allocated for additional interest rate subsidies for school construction projects.

The proposed increases include: \$54.8 million GF for a 3 percent salary increase for teachers effective December 1, 2005; \$35.2 million to distribute projected increased lottery proceeds; \$19.7 million for unfunded technical corrections; \$13.0 million to distribute increased sales tax revenues for public education; \$0.7 million to fund the Board-approved lower composite index for Allegheny County school divisions due to the consolidation with Clifton Forge;

and \$4.3 million for several initiatives, including “Race to GED” and support for school breakfast programs.

Proposed decreases include \$79.5 million GF in Standards of Quality, Incentive-based and Categorical accounts reflecting the revised Average Daily Membership (ADM) forecast and other technical updates in participation levels, test scores, and special enrollments. Projected ADM declined by 7,859 for FY 2005 and by 10,738 for FY 2006. In addition, savings of \$2.0 million GF are captured in the middle school math teacher initiative and mentor teacher program.

The proposed amendments include a net increase of \$2.9 million for the Department of Education, including funds for the turnaround specialists program, GED advertising, career planning software, training for school board members as part of the Partnership for Achieving Successful Schools (PASS), and academic reviews.

Higher Education. The Governor’s proposed amendments for higher education result in a net increase of \$50.9 million GF or 1.8 percent when compared to the original biennial budget. This reflects an increase of \$51.6 million GF offset by a \$0.8 million GF decrease. In addition, the Governor proposes \$1.5 million GF in Central Accounts to plan for a new university in Southside Virginia. When combined with the legislative actions in the 2004 Session, the biennial increase for higher education is about 12 percent.

Of the \$51.6 million proposed general fund increase, \$33.0 million, or almost two-thirds, is recommended in three areas: base adequacy (\$12.2 million), a 3 percent increase in faculty salaries for FY 2006 (\$11.7 million), and undergraduate and graduate student financial aid (\$9.1 million).

Other Education. The Governor’s proposed amendments to the 2004-06 biennial budget provide a net increase of \$0.8 million GF for state museums and other educational entities. These actions reflect a proposed \$860,000 GF increase for operating costs offset by a reduction of \$33,000 GF to transfer funding for the Council on Indian Affairs from the Jamestown-Yorktown Foundation to the Office of Natural Resources.

Health and Human Resources. The Governor’s proposed amendments for Health and Human Resources agencies provide a net increase of \$259.0 million GF and \$363.0 million NGF compared to the original biennial budget. More than three-quarters of new spending in Health and Human Resources is required to meet projected cost and enrollment increases in Medicaid (\$209.6 million GF); Medicaid SCHIP and FAMIS, the state health insurance programs for low-income children (\$9.3 million GF); Temporary Assistance to Needy Families

(TANF) (\$9.4 million GF); and involuntary mental commitments (\$2.7 million GF).

The budget also includes \$16.6 million GF to fund a 34 percent increase in Medicaid rates for OB-GYN services that went into effect September 1, 2004; \$6.9 million GF to meet cost increases in medications for mentally disabled individuals in communities and state facilities; \$4.5 million GF to meet the increasing cost to provide federally-required early intervention services to children from birth to age three who are developmentally delayed; and \$2.7 million GF to make federally-required improvements to Virginia's foster care and child welfare systems.

Proposed initiatives of \$19.2 million GF would provide selected health care provider rate increases and service expansions. These include \$10.4 million GF for rate increases for Medicaid-funded dental and inpatient hospital services, and assisted living facilities; \$3.3 million GF to expand FAMIS eligibility for pregnant women from 133 percent to 175 percent of the federal poverty level; \$2.9 million GF to expand community crisis services for mentally disabled persons; \$1.3 million GF to expand access to dental services and medication in medically underserved areas; \$0.8 million GF for Olmstead initiatives to expand community services for disabled individuals; and \$0.5 million GF to increase community mental health services for children. In addition, funding is proposed to adjust nurse salaries to improve retention in state mental health and mental retardation facilities (\$1.0 million GF); increase oversight of assisted living facilities (\$0.5 million GF); and provide funding for the Office of the Inspector General in the Department of Mental Health, Mental Retardation and Substance Abuse Services (\$0.5 million GF).

General fund spending reductions are concentrated in two areas: Medicaid (\$20.0 million GF) and mental health, mental retardation and substance abuse services (\$16.9 million GF). Medicaid savings result from the receipt of additional disproportionate share hospital funding for the Virginia Commonwealth University Health System. Reductions in the Department of Mental Health, Mental Retardation and Substance Abuse Services (DMHMRSAS) are the result of supplanting general fund monies for Community Services Boards with fee revenue from a Medicaid case management rate increase.

Transportation. The Governor's recommended amendments for Transportation agencies reflect his transportation initiative, "The Transportation Partnership Act of 2005" which totals \$824.0 million. The initiative includes \$373.6 million GF, as well as \$450.4 million from state and federal transportation funds.

The major components of the Governor's transportation initiative include: \$140.0 million GF for the creation of a Public-Private Partnership Revolving

Fund; \$80.0 million GF for mass transit capital improvements; \$23.3 million NGF to establish a Rail Partnership Fund; \$40.0 million GF and \$40.0 million NGF to develop a Local Partnership Fund to encourage increased local management of construction projects; \$90.0 million GF and \$166.4 million NGF to pay off costs of construction projects already completed; \$97.0 million in federal funds to be transferred to maintenance activities; and \$147.0 million NGF reflecting revised estimates of revenues to be deposited into the Transportation Trust Fund.

The state nongeneral fund revenues reflect the carry-forward of revenues in excess of the FY 2004 forecast, as well as anticipated adjustments to the FY 2005 and FY 2006 transportation trust fund forecast. The federal funds represent adjusted apportionments received from the Federal Highway Administration. Also included is language eliminating the requirement in the Virginia Transportation Act of 2000 directing one-third of the insurance premium tax revenues to transportation.

Commerce and Trade. The Governor's recommended amendments for Commerce and Trade agencies result in a net increase of \$23.0 million GF (9.8 percent) and \$1.9 million NGF for the biennium. The majority of the proposed amendments support the Governor's economic development initiative, "Virginia Works." A total of \$18.9 million from the general fund is provided for a series of new initiatives intended to encourage economic expansion in the distressed rural areas of the Commonwealth.

The largest components of the Virginia Works program include: \$5.0 million to support Virginia's artisan and crafts industries; \$4.0 million for grants to regional workforce training consortia; \$4.0 million to the Department of Environmental Quality for the Brownfields program and industrial site redevelopment; \$3.0 million to support expansion of the "Rails to Trails" program at the Department of Conservation and Recreation; \$1.4 million to support small manufacturing and specialty agriculture development; \$0.8 million to support tourism efforts, including new trails programs and support for local tourism efforts; and \$0.7 million to finance the establishment of a community development bank and access federal new market tax credits.

Two other proposed economic development expenditures include \$2.0 million GF to support the Governor's Economic Development Opportunity Fund (located in the Central Appropriations) bringing total funding for FY 2005 to \$15.9 million; and \$2.0 million from the general fund is proposed in the second year for Virginia Commonwealth University's School of Engineering for programs that support the semi-conductor industry.

Natural Resources. The Governor's recommended amendments for the Natural Resources agencies result in a net increase of \$38.6 million from the

general fund and \$0.6 million from nongeneral funds when compared to the 2004-06 biennial budget (Chapter 4, Special Session I). Amendments include a deposit of \$32.4 million GF to the Water Quality Improvement Fund, based on a statutory requirement that 10 percent of the FY 2004 year-end balance be deposited to the fund. Of this amount, \$16.2 million GF is designated for Department of Conservation and Recreation programs to reduce nonpoint source pollution in Virginia's waters. The remaining \$16.2 million GF for the Department of Environmental Quality (DEQ) would be used for providing technical assistance grants to publicly-owned wastewater treatment works.

Other general fund amendments include funding for the state parks system (\$2.0 million); DEQ's Litter Control and Recycling Fund (\$1.3 million); and water supply planning activities (\$701,510).

Central Appropriations. Proposed general fund increases include \$24.0 million for the Personal Property Tax Relief program to cover any outstanding delinquent payments as the program transitions to a capped tax relief program; \$31.2 million GF for the employer share of employee health insurance premium increases for FY 2006; \$2.0 million GF to provide additional funding for Semiconductor Education Grants; \$2.0 million GF for the Governor's Economic Development Opportunity Fund; \$1.6 million GF for the Biotechnology Commercialization Loan Fund; \$1.5 million GF for enhancement of post-secondary education opportunities in Southside Virginia; \$1.1 million GF for evaluation of information technology proposals under the Public-Private Education Facilities and Infrastructure Act (PPEA); \$0.6 million GF for transition support for the state-wide elected officers elected in November 2005; and \$0.6 million GF for telecommunications rate increases for state agencies. A proposed decrease in Central Appropriations of \$59.3 million GF reflects a revision in anticipated reimbursement to localities at the 70 percent level for tax year 2004 and 2005.

Employee Compensation and Benefits. A total of \$107.8 million GF is proposed for a 3 percent salary increase in the second year for state classified employees, faculty, state-supported local employees, and local teachers. This is an increase of \$81.2 million GF above the \$26.6 million GF compensation reserves set aside by the General Assembly at the 2004 session.

- **Classified Employees.** Proposes an additional \$1.9 million GF (current budget contains \$26.6 million GF) for a 3 percent salary increase on November 25, 2005 for state classified employees. These funds are budgeted to the Central Appropriations.
- **State-supported Local Employees.** Recommends \$12.8 million GF for a 3 percent salary increase on December 1, 2005 for state-

supported local employees. These funds are budgeted to the Central Appropriations.

- **Faculty.** Recommends \$11.7 million GF for an average 3 percent salary increase on November 25, 2005 for faculty. These funds are budgeted to the various institutions of higher education.
- **Local Teachers.** Proposes \$54.8 million GF for a 3 percent salary increase on December 1, 2005 for local teachers. These funds are budgeted to Direct Aid for Public Education.

Public Safety. The Governor’s recommended amendments to the 2004-06 budget result in a net increase of \$12.7 million GF and \$95.7 million NGF compared to the adopted budget. Proposed actions include \$1.7 million GF for the Department of Corrections for intermediate sanctions for technical probation violators, including return-to-custody centers, day reporting centers, and home electronic monitoring; staffing for the new Emergency Operations Center and the Fusion Center located in the State Police Headquarters facility; and funding for 17 new forensic scientists, a new mitochondrial DNA testing program, and expansion of the Eastern forensic laboratory in Norfolk.

Funds are proposed for the expanded utilization of Culpeper Juvenile Correctional Center, in tandem with the “mothballing,” or temporary closure of the Barrett Juvenile Correctional Center in Hanover County. Also, funding is proposed for a new gang law enforcement initiative with training for Commonwealth’s Attorneys and juvenile correctional center staff, and 12 State Police Special Agents.

Nongeneral fund amendments include \$65.4 million NGF for the Department of Alcoholic Beverage Control for purchase of additional product for sale and additional store staffing costs, as well as an increase of \$8.0 million NGF in Virginia Correctional Enterprises which reflects increased sales of prison-made goods or services. Projected revenues for the Fire Programs Fund are increased by \$4.0 million NGF and increased federal revenues for the Department of Military Affairs total \$8.8 million NGF.

Capital Outlay. The Governor’s proposed capital outlay amendments include a net increase of \$561.6 million in project related funding. Specific actions include an increase of \$166.5 million GF, of which \$69.3 million would address cost overruns on previously approved projects, \$45.4 million GF for capital maintenance reserve projects, and \$31.6 million GF for equipment and furnishings for projects scheduled to open this biennium. In addition, the Governor proposes \$10.6 million in 9(c) bond authority for college dormitories; \$159.4 million in 9(d) bond authority for auxiliary enterprise and other

nongeneral fund revenue-supported projects at the colleges and universities; and \$225.1 million in nongeneral fund cash projects.

Administration. The Governor's proposed general fund amendments for Administration include \$0.8 million for 28 additional law enforcement deputies to fund the 1:1500 staffing ratio; \$0.7 million for the Master Deputy Program and the Sheriff Career Development Program; \$1.3 million for 36 new Commonwealth's Attorneys' positions; and \$0.2 million to convert three Commonwealth's Attorneys' offices to full-time status. Other proposed general fund amendments include \$0.5 million to improve veterans' services and \$0.4 million for auditors, inspectors, and enforcement positions at the Department of Charitable Gaming.

Finance. Among the recommended amendments for the Finance Secretariat, \$229.4 million GF is for deposit to the Revenue Stabilization Fund to cover the mandatory deposit required by the Constitution and a "super-deposit" required when revenue growth exceeds certain statutory benchmarks. Other general fund spending items include: \$2.3 million to modify the Department of Taxation's computer systems to account for the additional revenues in HB 5018; \$1.4 million in additional funding for school efficiency reviews; \$0.4 million for additional financial control positions within the Departments of Accounts and Treasury; \$0.2 million for additional staff for the Department of Planning and Budget; and \$0.2 million in additional funding for the Office of the Secretary of Finance. A reduction of \$32.8 million GF in the Treasury Board results from adjusted bond issuance schedules and debt refinancings.

Technology. The Governor's proposed amendments for Technology include: \$1.9 million GF for support of current programs at the Innovative Technology Authority; \$1.1 million GF to prepare for relocation of the state data center in Richmond; \$0.5 million GF and \$1.0 million NGF to update Virginia's aerial photography database; and, \$0.6 million GF for miscellaneous smaller items. Continued implementation of the Virginia Information Technologies Agency (VITA) is reflected in the recommended transfer of 706 FTE positions to VITA from various state agencies.

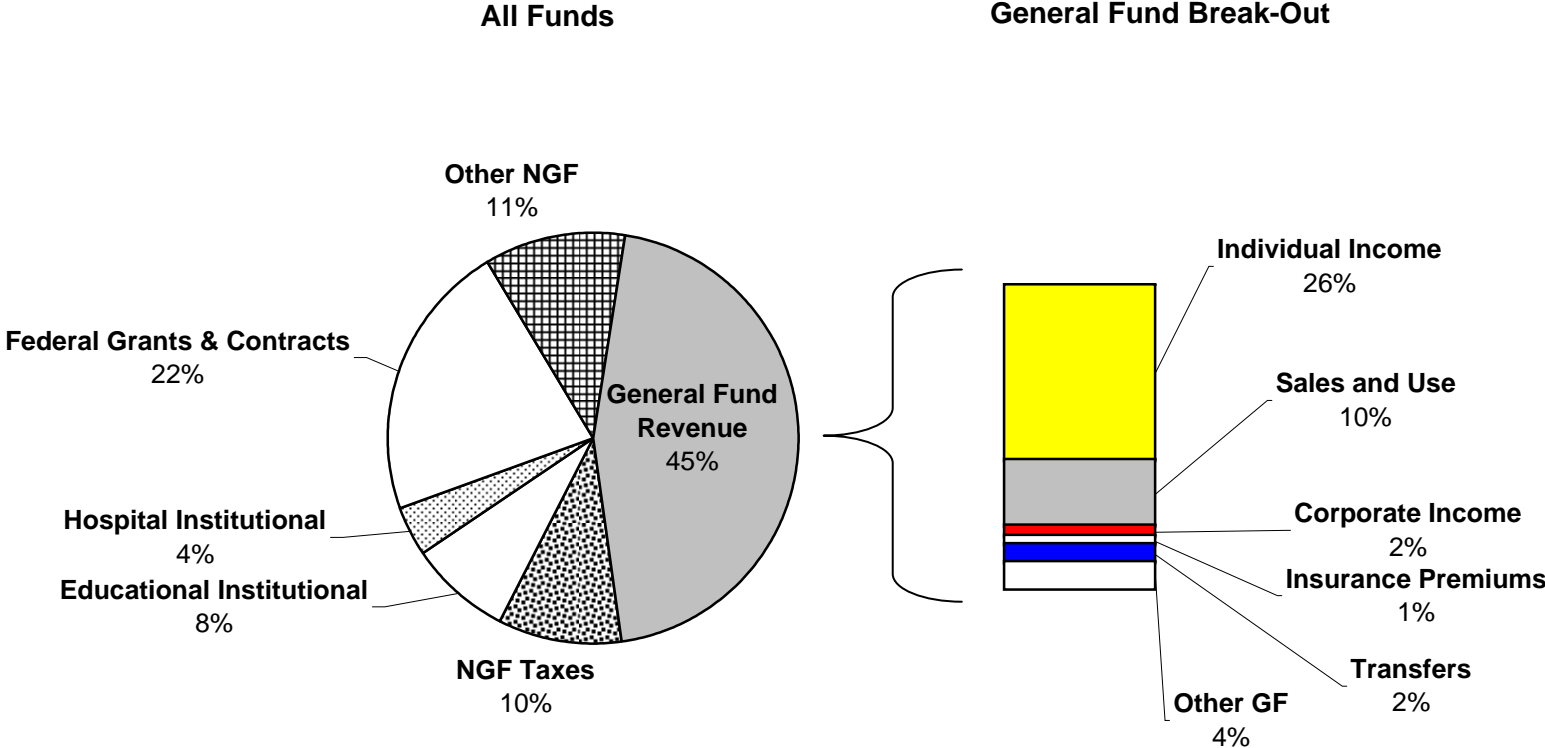
Judicial Department. The Governor's recommended amendments provide a total of \$630,000 GF, \$1.0 million NGF, and two positions in the second year to enable the Supreme Court of Virginia to assume the administration of drug courts. Additional funding of \$5.4 million GF is proposed for the Criminal Fund, of which \$3.0 million represents a savings captured in the Indigent Defense Commission from the slower-than-expected start-up of four new public defender offices. Additional funding for the Involuntary Mental Commitment Fund totals \$0.7 million GF each year. A companion amendment in the Department of Medical Assistance Services provides an additional \$2.7 million

GF the first year for reimbursement for medical services provided through the fund.

Independent Agencies. The Governor's recommended amendments include an increase of \$185,000 NGF in the second year to support the costs of additional leased office space for the Virginia Retirement System.

2004-2006 Total Revenues = \$61,459.5

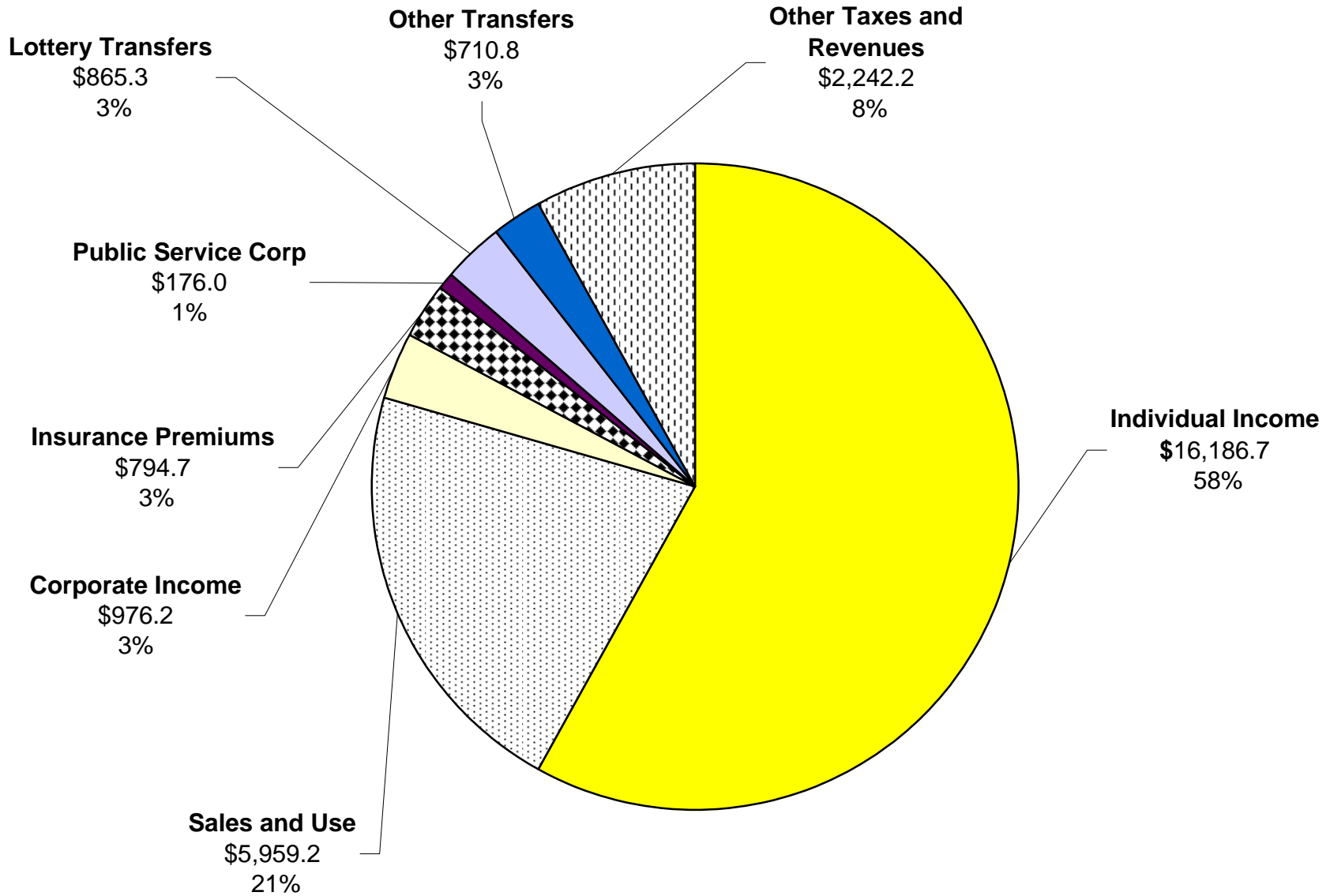
HB1500/SB700, as Introduced
(\$ in millions)



2004-2006 General Fund Revenues = \$27,911.1

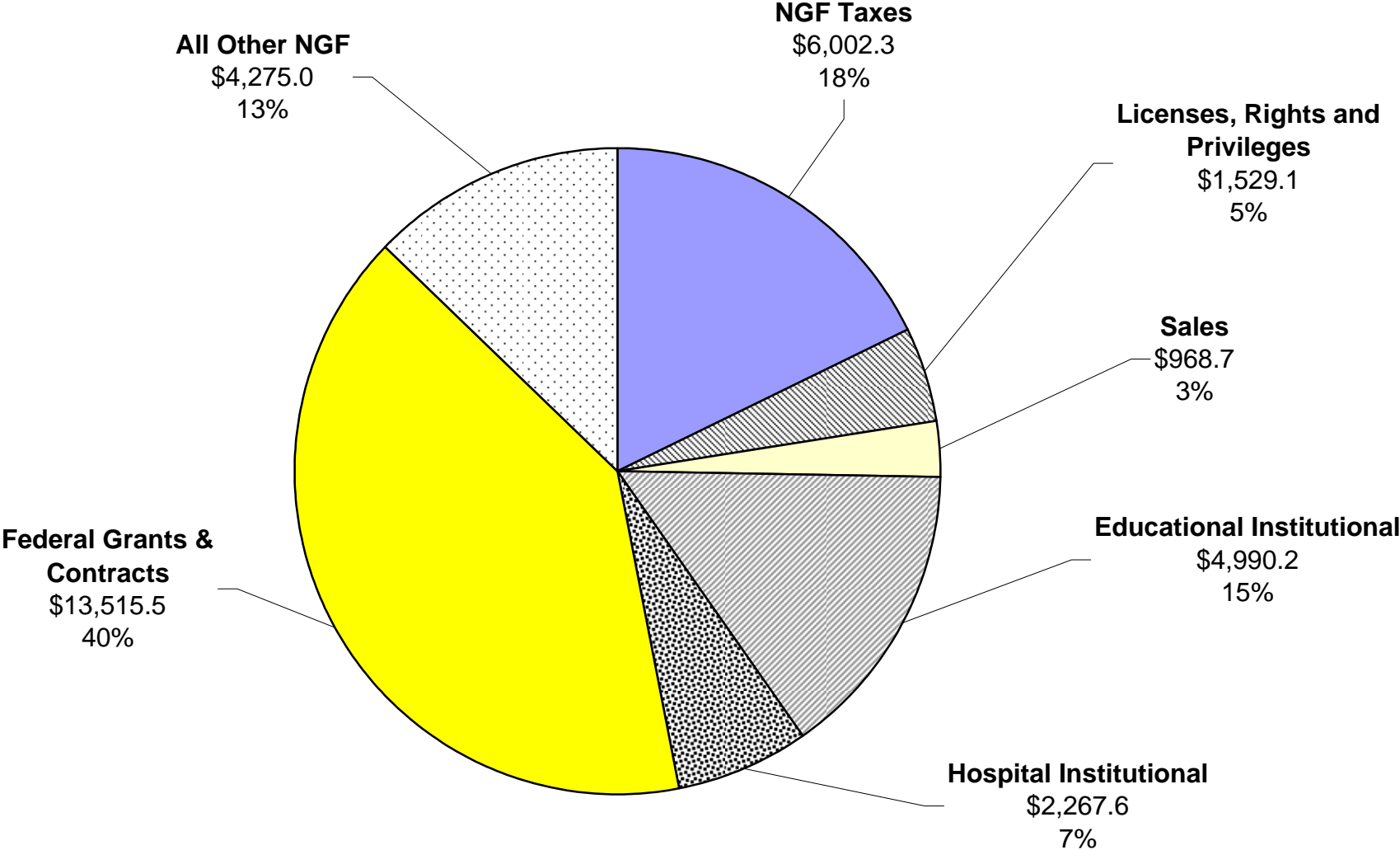
HB1500/SB700, as Introduced

(\$ in millions)



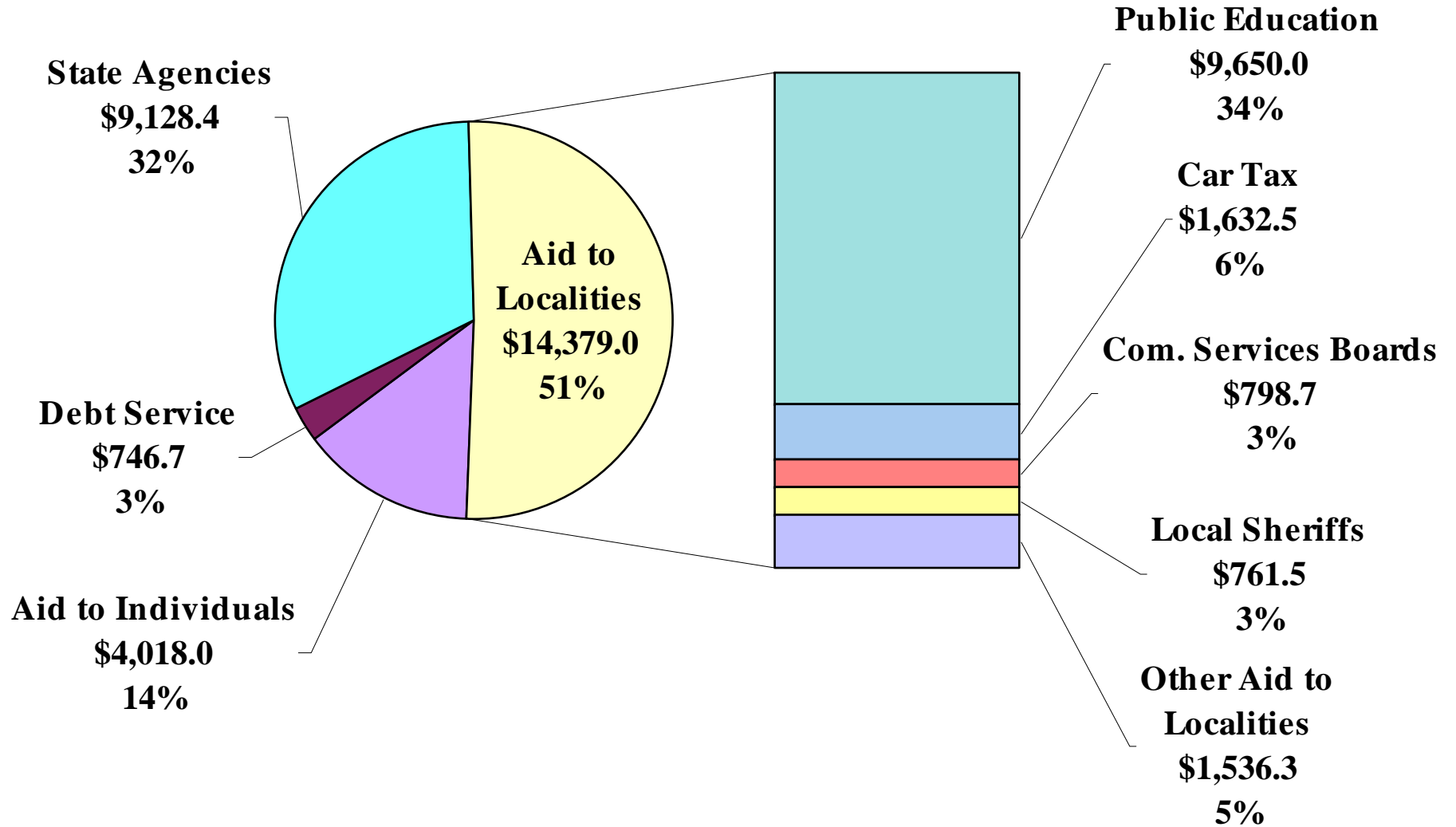
2004-2006 Nongeneral Fund Revenues = \$33,548.4

HB1500/SB700, as Introduced
(\$ in millions)



2004-2006 GF Operating Budget

\$28,272.1 million



Resources

The budget, as introduced, includes a net increase of \$1,204.2 million in general fund resources available for appropriation during the 2004-06 biennium.

This net increase results primarily from four factors: (1) stronger than anticipated revenue growth in fiscal year 2004, which resulted in revenue collections of \$323.8 million above the forecast; (2) a corresponding increase in the revenue base for the 2004-06 biennium; (3) continued economic expansion with moderate growth in the 5 percent to 6 percent range; and (4) a sizeable increase in the Lottery forecast.

General Fund Resources Available for Appropriation (2004-06 biennium, \$ in millions)			
	<u>Chapter 4</u>	<u>HB 1500/SB 700</u>	<u>Change</u>
Available Balances	\$272.9	\$579.2	\$306.3
Revenue Estimate	25,545.3	26,335.0	789.7
Transfers/Deposits:			
Lottery Proceeds Fund	797.0	865.3	68.3
Other Transfers	670.9	710.8	<u>39.9</u>
			108.2
Total GF Resources Available	\$27,286.1	\$28,490.4	\$1,204.2

Available Balances

Balance adjustments include accounting for the \$323.8 million in fiscal year 2004 revenue that was collected above the estimate, with set-asides for natural disaster awards approved prior to June 30; the Transportation Trust Fund portion of accelerated sales tax; and non-general fund interest earnings returned to NGF accounts. Balance adjustments also include technical entries related to mandatory reserves established for accrued payroll at the end of fiscal year 2004 and \$22.7 million in Lottery profits above the estimate.

Finally, capital balances unspent at the end of fiscal year 2004 are re-appropriated, and \$92.4 million of operating balances are returned to agencies, with the remaining \$27.2 million reverted for use in the 2004-06 biennium.

Additional obligations proposed against the balance include \$10.2 million for natural disaster costs incurred since July 1, deficit loan authorizations for

start-up costs of the Virginia Information Technologies Agency (VITA), and to offset a change in fund source for staff salaries in the Governor's and Cabinet Secretaries' offices, until proposed 2005 session amendments can be considered.

The remaining \$306.3 million balance is applied toward required Rainy Day Fund and Water Quality Improvement Fund deposits and other budget items.

Proposed Adjustments to Balances (\$ in millions)	
FY 2004 Revenue Above Forecast/Agency Balances	\$403.2
Technical adj. for year-end payroll/Lottery reserves	92.4
Set-asides from FY 2004 balance:	
Natural Disaster match authorized through June 04	(26.0)
TTF share of accelerated sales tax	(23.8)
Interest earnings returned to NGF agencies	(7.6)
Re-appropriation of capital and operating balances	(113.5)
Additional Natural Disaster Allocations	(10.2)
Deficit authorization for VITA start-up	(6.1)
Deficit authorization for Gov/Cabinet staff salaries	(2.3)
Federal Audit of Internal Service Funds	(0.3)
Miscellaneous other	<u>0.5</u>
Total Balance Adjustments	\$306.3

Estimated Revenues

The introduced budget includes an upward revision of \$917.0 million in the GF revenue forecast to recognize the higher revenue base from fiscal year 2004 activity and the expectation that Virginia's economy will continue to outpace the nation. The revised growth rate based on pure economics (omitting tax policy changes and funds moved to the Virginia Health Care Fund), is 6.1 percent in fiscal year 2005 and 5.4 percent in fiscal year 2006. (Revenue increased by 9.7 percent in fiscal year 2004).

Minor changes in projected rental income and prisoner revenue add \$1.7 million, to produce a total projected increase in GF revenue of \$918.7 million.

When tax policy changes approved in the 2004 session are taken into account, the revised GF growth rate is 8.3 percent in fiscal year 2005 and 5.1 percent in fiscal year 2006.

Changes in Major Tax Sources (November Forecast) (\$ in millions)		
	<u>FY 2005</u>	<u>FY 2006</u>
Income Tax Withholding	\$124.4	\$166.3
Income Tax Non-withholding	2.9	(25.4)
Tax Refunds	(33.5)	(26.4)
Corporate	80.7	83.1
Sales Tax	85.7	136.2
Wills, Suits, & Deeds	143.7	104.1
Other Revenue	<u>46.9</u>	<u>30.0</u>
Total Economic-Driven Changes	\$450.8	\$467.9

Key assumptions underlying the revised forecast are (1) job growth of 2.4 percent each year, compared to 1.9 percent estimated growth in fiscal year 2004, and (2) wage and salary growth of 5.9 percent in fiscal year 2005 and 5.7 percent in fiscal year 2006, compared to an estimated 5.8 percent growth in fiscal year 2004.

Economic Variables Assumed in Forecast (November Forecast) (Percent Growth Over Prior Year)			
	<u>Actual</u> <u>FY 04</u>	<u>Forecast</u>	
		<u>FY 05</u>	<u>FY 06</u>
Virginia Employment	1.9%	2.4%	2.4%
Virginia Wages & Salaries	5.8	5.9	5.7
Virginia Personal Income	5.4	6.0	5.4

Tax Policy Changes. Beyond the economics, the introduced budget includes three proposed tax policy changes that would reduce GF revenue by \$129.0 million, resulting in revised GF growth rates of 8.2 percent in fiscal year

2005 and 4.3 percent in fiscal year 2006. After incorporating tax policy changes, the net GF revenue change included in the introduced budget is \$789.7 million.

Proposed tax policy changes are explained in greater detail below.

Proposed Tax Policy Changes (\$ in millions)	
Reduce the sales tax on food by 1.5% on July 1, 2005, rather than phasing the cut over three years.	(\$99.1)
Move fixed date conformity with federal tax law to December 31, 2004.	(6.7)
Return 3% of the 5% car rental tax to Transportation rather than the GF, beginning in FY 2006.	<u>(23.2)</u>
Total Proposed Adjustments	(\$129.0)

- *Sales Tax on Food.* The 2004 General Assembly approved a phased reduction in the state portion of the sales tax on food, beginning in July 2005. The reduction was to occur in three ½ percent increments, at a cost of roughly \$50 million per ½ percent reduction. The introduced budget assumes that legislation proposed during the 2005 session to advance the entire 1 ½ percent reduction to July 2005, will be approved.
- *Selective Deconformity.* Since 2001, Virginia has operated under moving fixed date conformity with federal tax law to allow for selective conformity with tax law changes passed by Congress. The introduced budget assumes that legislation proposed during the 2005 session to advance the date of conformity to December 31, 2004, will be approved, thereby passing federal tax benefits to small businesses and individuals through increased business expensing allowances, teacher deductions up to \$250 for classroom expenses; and simplified tax filing measures.
- *Car Rental Tax.* The introduced budget proposes redirecting the three percent share of the vehicle rental tax that has been dedicated to the general fund since FY 2003 to transportation as a dedicated fund source for rail improvement. Prior to FY 2003, these revenues went to the DMV Special Fund. An additional one percent of the

existing rental tax remains dedicated to the highway maintenance and operating fund.

Transfers/Deposits to General Fund

The introduced budget increases proposed transfers/deposits to the general fund (including Lottery profits) by \$108.2 million. Lottery profits available to public education would increase by \$68.3 million over the biennium (plus an additional \$22.7 million included in the balance forward resulting from fiscal year 2004 activity). Additional funds of \$10.0 million from ABC operations are included as a result of operating cost efficiencies.

The following table details transfer/deposit additions proposed in the introduced budget.

Additional Transfers/Deposits (\$ in millions)	
Lottery profits	\$68.3
ABC profits increase from operating efficiencies	10.0
Increased Court debt collections	3.3
Increased proceeds from sale of ABC regional office	4.5
Correction of amount related to prior year action on VRS amortization period	6.9
Special Education Recovery Fund	3.3
Unobligated balance in Tax Public/Private Technology Partnership Fund	10.8
Miscellaneous other	<u>1.1</u>
Total	\$108.2

- *Special Education Recovery Fund.* In order for local school divisions to continue receiving federal Medicaid reimbursement for medical services provided to special education students, the Department of Education must become the fiscal agent for the school divisions. This is a pass-through amount that is offset by an increased appropriation of \$3.3 million in the Department of Medical Assistance Services.

