



Virginia's Economic and Fiscal Climate

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Virginia Secretary of Finance

July 15, 2009

Virginia's Economic Climate Topics for Discussion

Economy

- Deteriorating Economy
- Affect on Virginia State Government
- Impact on Local Governments

Other Issues

- Federal Stimulus Package
- Revenue Stabilization Fund
- Tax Amnesty Program
- Debt Financing
- Revenue Volatility
- Sales Tax Improvements

Uncertainty . . .

- **In the fall of 2007, national economists acknowledged slowed growth but argued that a recession could be avoided**
 - Personal income, employment and consumption were more resilient than expected in fragile economy
 - Housing unwinding for two years
 - Commodity prices rising
 - Crisis unfolding in financial markets
 - Stock market a roller coaster
- **Typical “turning point scenario”**
 - Storm clouds gathering
 - Disagreement among experts
 - No hard data to prove or disprove anything (lag in key economic data)
- **Caution, caution and more caution**
 - Rely on instinct;
 - At the point you **know** you’re in trouble, you’re in trouble;
 - Budget funds in way they can be easily extracted, if necessary.

Rapid Deterioration . . .

- **Early January 2008: a few noted economists started to use the “r” word.**
 - Virginia sales tax in January (2007 Christmas sales) dropped 12 percent;
 - Small business owners signaled reduced tax liability in final quarterly payments made by mid-January.
- **Based on this data, General Assembly pulled \$1.0 billion out of projected 2008-10 revenue stream (on top of \$849 million extracted in the August 2007 reforecast).**
- **Growth rates assumed in budgets adopted by 2008 General Assembly**
 - FY2008: 1.2 percent
 - FY 2009: 2.2 percent
 - FY 2010: 6.8 percent (assumes recovery underway)

FY 2008 Year End Close

- **In August 2008, the Governor determined that the economic and revenue trends did not support the official forecast approved by the 2008 General Assembly**
 - The three-month moving average growth rate for withholding through July 2008 was 1.6 percent, well below the 6.4 percent growth rate required to meet the annual estimate for FY09;
- **Sales tax collections fell 3.1 percent during the second half of FY 2008, the worst 6-month performance since the 6.4 percent decline in the second half of FY 1991**
- **Pending home sales, a leading indicator of future closings, pointed to a continued slump in housing**

View of National Experts in Summer 2008

- **Question no longer “if” recession, but how deep and how long?**
 - Consensus view is a shallow recession but a protracted recovery.
- **Why shallow?**
 - Businesses appeared to be in good financial shape;
 - Feds have demonstrated willingness to do whatever is necessary.
- **Why protracted recovery?**
 - Housing is at root of problem; takes long time for housing to correct.
 - Unsold inventory at record high and still increasing.
 - Consumer confidence/spending will suffer.

View of National Experts at End of 2008

- **Longer and deeper recession than originally anticipated**
 - Financial and banking crisis continue to grow
 - Credit crunch (lack of liquidity)
 - Loss of wealth and uncertainty reduce consumer confidence/spending
 - Lack of demand and credit hurt employers
 - Unemployment could reach 10%
- **When will it end?**
 - 6 to 8 quarters from January 2008 (longest past WWII recession)
 - Labor markets weak until 2010
 - Unsold housing inventory gradually recedes (must stabilize to recover)
 - Consumer confidence takes time to restore
 - Federal stimulus acting more like safety net, not economic ladder
- **Slower growth for some time to come**
 - No artificial “bubble” stimulus (dot.com or housing)
 - Growth will settle in at more sustainable long-term trend

Impact on State Government

- **A series of revenue reductions for the 2008-2010 biennium, totaling more than \$5.6 billion.**

<u>Date</u>	<u>Reductions in Millions</u>
August 2007	-\$ 849.1
February 2008	- 1,064.5
October 2008	- 2,513.7
December 2008	- 373.6
February 2009	<u>- 821.5</u>
Total	-\$5,622.4

- **Growth rates assumed in adopted budget**
 - FY2009 -7.3 percent
 - FY2010 +4.4 percent (recovery reached by 2011)
- **Percentage loss in general fund revenue for FY2009 is almost twice as bad as FY2002 recession.**

Growth in Total General Fund Revenues
Fiscal Year 1961 - Fiscal Year 2010
(Nominal - Actual Dollars)

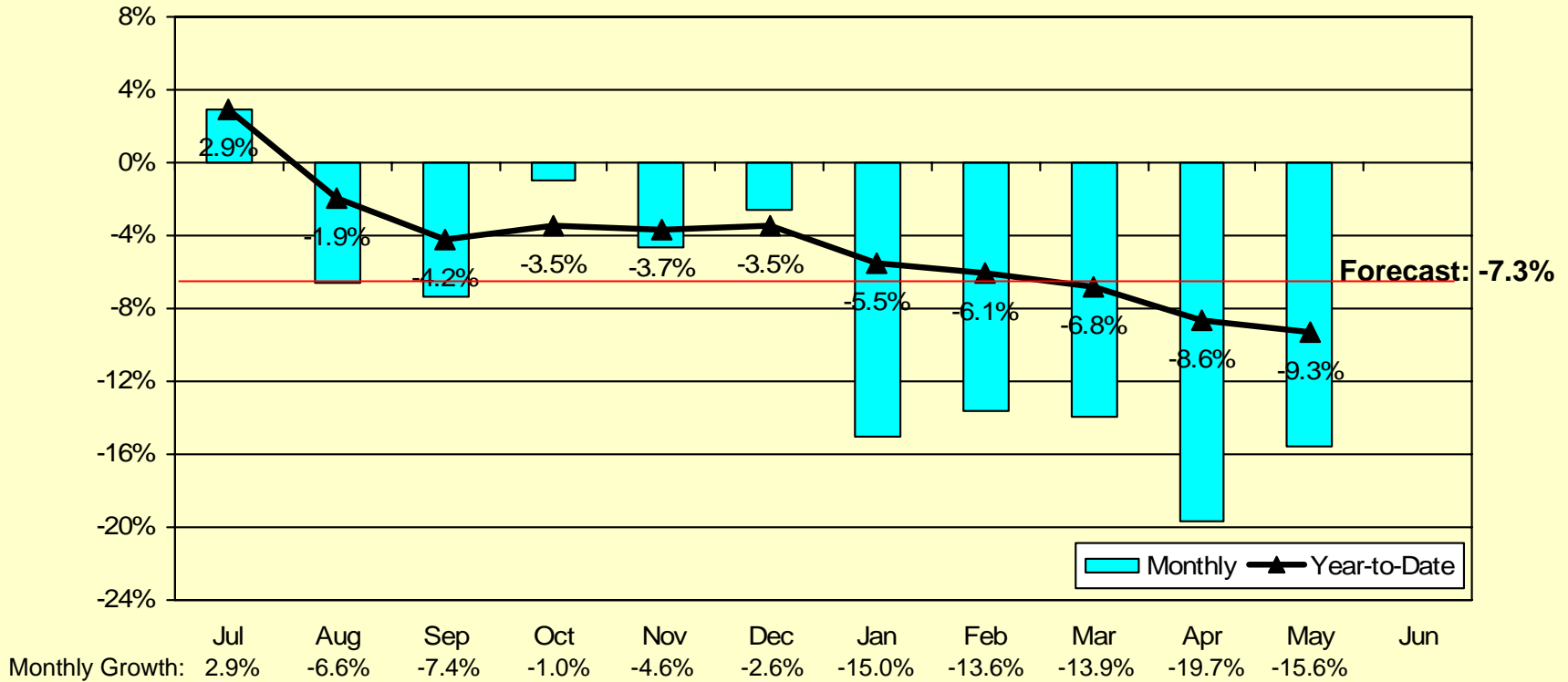
<u>FY</u>	<u>Total Revenues</u>	<u>Growth</u>	<u>FY</u>	<u>Total Revenues</u>	<u>Growth</u>
61	230,998,887	-	86	4,131,778,000	9.0%
62	242,144,567	4.8%	87	4,590,434,000	11.1%
63	286,304,265	18.2%	88	5,054,382,000	10.1%
64	298,033,919	4.1%	89	5,478,912,000	8.4%
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68	533,597,744	28.7%	93	6,133,637,000	9.1%
69	706,254,374	32.4%	94	6,503,368,000	6.0%
70	743,721,322	5.3%	95	6,881,145,000	5.8%
71	807,954,651	8.6%	96	7,356,110,000	6.9%
72	922,653,686	14.2%	97	7,949,327,000	8.1%
73	1,054,469,443	14.3%	98	8,773,520,000	10.4%
74	1,168,562,871	10.8%	99	9,702,747,000	10.6%
75	1,303,178,893	11.5%	00	10,788,482,000	11.2%
76	1,428,421,157	9.6%	01	11,105,275,000	2.9%
77	1,636,301,819	14.6%	02	10,678,954,000	-3.8%
78	1,923,085,084	17.5%	03	10,867,149,000	1.8%
79	2,115,211,522	10.0%	04	11,917,867,000	9.7%
80	2,344,928,934	10.9%	05	13,687,252,000	14.8%
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84	3,397,710,261	14.2%	09*	14,617,600,000	-7.3%
85	3,790,816,000	11.6%	10*	15,265,700,000	4.4%

* March Post-GA Forecast (Excludes Transfers)

Closing Out FY2009

Growth in Total General Fund Revenue Collections

FY09 Monthly and Year-to-Date



- **Through May, total general fund revenues have declined 9.3 percent, below the projected annual decline of 7.3 percent.**
- **Total revenues must increase 10.2 percent in June in order to attain the annual estimate.**

Bracing for Another Downward Adjustment

- Preliminary data on June general fund revenue collections indicates that the state is on track for a \$300 million revenue shortfall for FY2009.
- Department of Planning and Budget has released budget reductions instructions to agencies. Agency budget reduction plans are to be submitted July 22.
- Governor has ordered a reforecast of revenues to be presented on August 19th.

Current National and State Economic Indicators

- The economy remains in a deep recession; however, most national indicators suggest the rate of decline is slowing.
- First-quarter real GDP was revised up from a 5.7 percent decline in the preliminary estimate to a 5.5 percent annualized decline in the final report. Real GDP declined 6.3 percent in the fourth quarter of 2008.
- The labor market continued to contract in June; however. Payroll employment fell by 467,000 jobs in June, following losses of 322,000 in May and 519,000 in April.
- The national unemployment rate rose to 9.5 percent in June from 9.4 percent, +5.1 percentage points from the pre-recession low.
- In Virginia, payroll employment fell by 2.6 percent in May, following a 2.7 percent drop in April, the largest monthly drop since August 1991. Northern Virginia posted a decline of 1.5 percent, Hampton Roads fell 0.9 percent, and employment in the Richmond-Petersburg area fell 3.3 percent in May.
- The unemployment rate in Virginia rose from 6.6 percent to 7.0 percent in May. The unemployment rate was 3.6 percent in May 2008, and has not reached the 7 percent range since February 1992.

Current National and State Economic Indicators

- The rate of contraction in the manufacturing sector continues to slow. The Institute of Supply Management index increased by 2.0 points in June, rising from 42.8 to 44.8. Although the index remains at recessionary levels, the gradual improvement over the last several months suggests the manufacturing sector has hit bottom.
- The Conference Board's index of leading indicators rose 1.2 percent to 100.2 in May, the second consecutive increase. Seven of the ten components contributed to the increase. The rise in the index suggests the economy is stabilizing.
- Following significant improvement in April and May, consumer confidence slipped in June. The Conference Board index of consumer confidence fell from 54.8 to 49.3 in June. The present conditions component more than reversed the prior month's gain. After surging in May, the expectations component also dropped in June.
- The Virginia Leading Index fell 0.3 percent in April, its eighth consecutive decline. Two of the three components – auto registrations and initial unemployment claims – contributed to the decline. Building permits, the third component, increased in April. The leading index declined in eight of the eleven metro areas in the Commonwealth in April. The index remained flat in Richmond and Winchester, and increased modestly in Hampton Roads.

Looking Ahead to the Next Biennium

Slower Growth

- How have general fund revenues grown?

	<u>Average Annual Growth</u>
Last 5 years (FY03 to FY08)	+7.6%
Last 10 years (FY98 to FY08)	+6.0%
Last 15 years (FY93 to FY08)	+6.5%
Last 20 years (FY88 to FY08)	+5.9%
Last 25 years (FY83 to FY08)	+6.9%
Last 30 years (FY78 to FY08)	+7.3%
Last 35 years (FY73 to FY08)	+8.0%
Last 40 years (FY68 to FY08)	+7.8%

- There is no revised general fund revenue forecast for the 2010-12 biennium at this point.
- However, the last official long-term forecast of general fund revenues (released December 2008) called for much slower growth in the future.

	<u>Average Annual Growth</u>
FY2011	+4.7%
FY2012	+4.7%
FY2013	+4.8%
FY2014	+4.6%

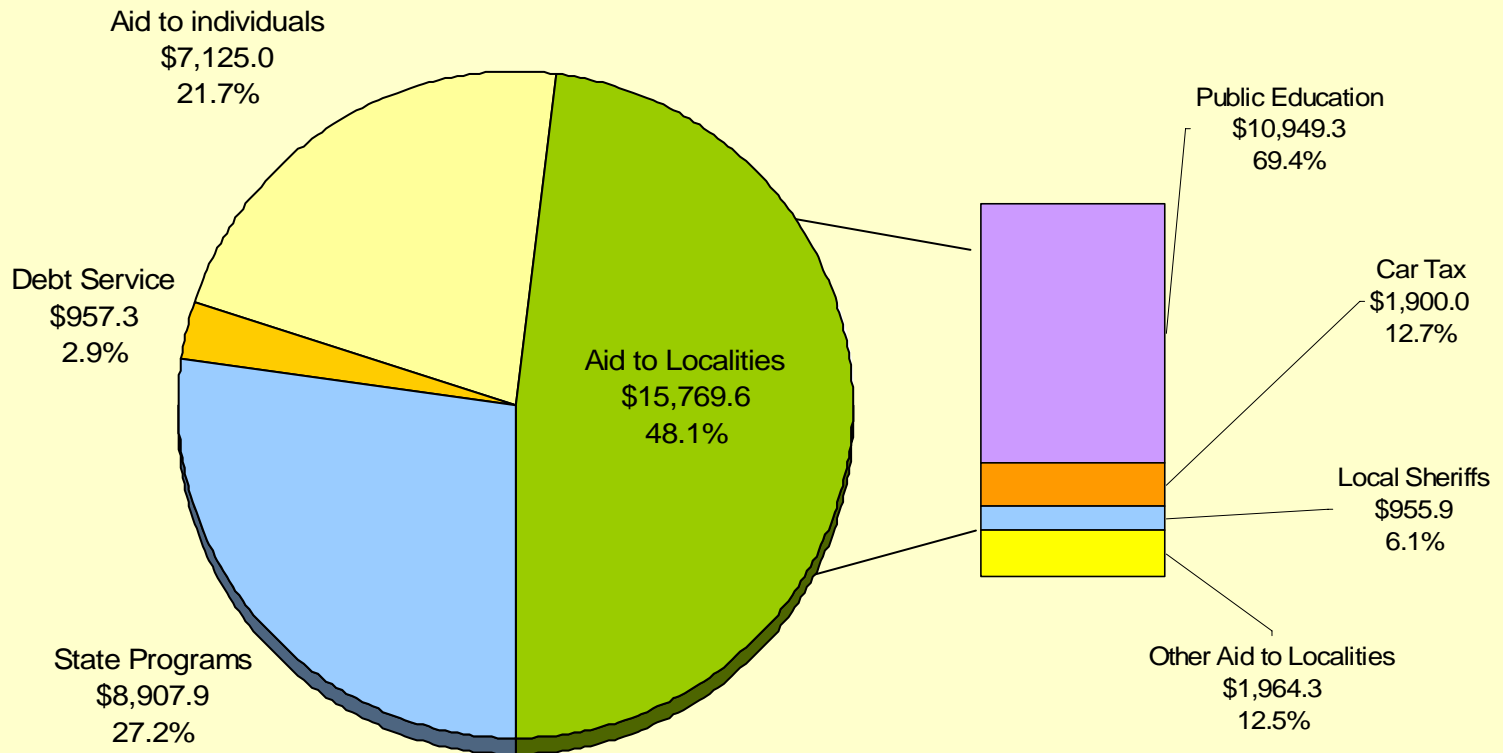
Looking Ahead to the Next Biennium

- **The fact is that:**
 - Slower revenue growth in the future
 - Growing spending needs as the result of recessionary pressures, rising costs, and unmet needs, as well as
 - The end of enhanced federal aid as the stimulus package begins to terminate in the future
- **Means that:**
 - Significant budget pressures will continue in the next biennium, and
 - Budget reductions to current spending levels in many areas will be needed to maintain fiscal balance.

Impact on Local Governments

- **Unlike last recession, local governments are more likely to feel the impact of this recession.**
 - Local government finances are squeezed between low-growth rates in both local and state revenues and increasing program costs.
 - Double-digit assessment increases are over -- real estate taxes may not raise enough money to cover current budgets.
 - Fuel and other personal and non-personal costs continue to rise.
 - Fiscal strains at state level are resulting in cuts to local governments going forward.

Almost Half of the General Fund Operating Budget Goes to Localities



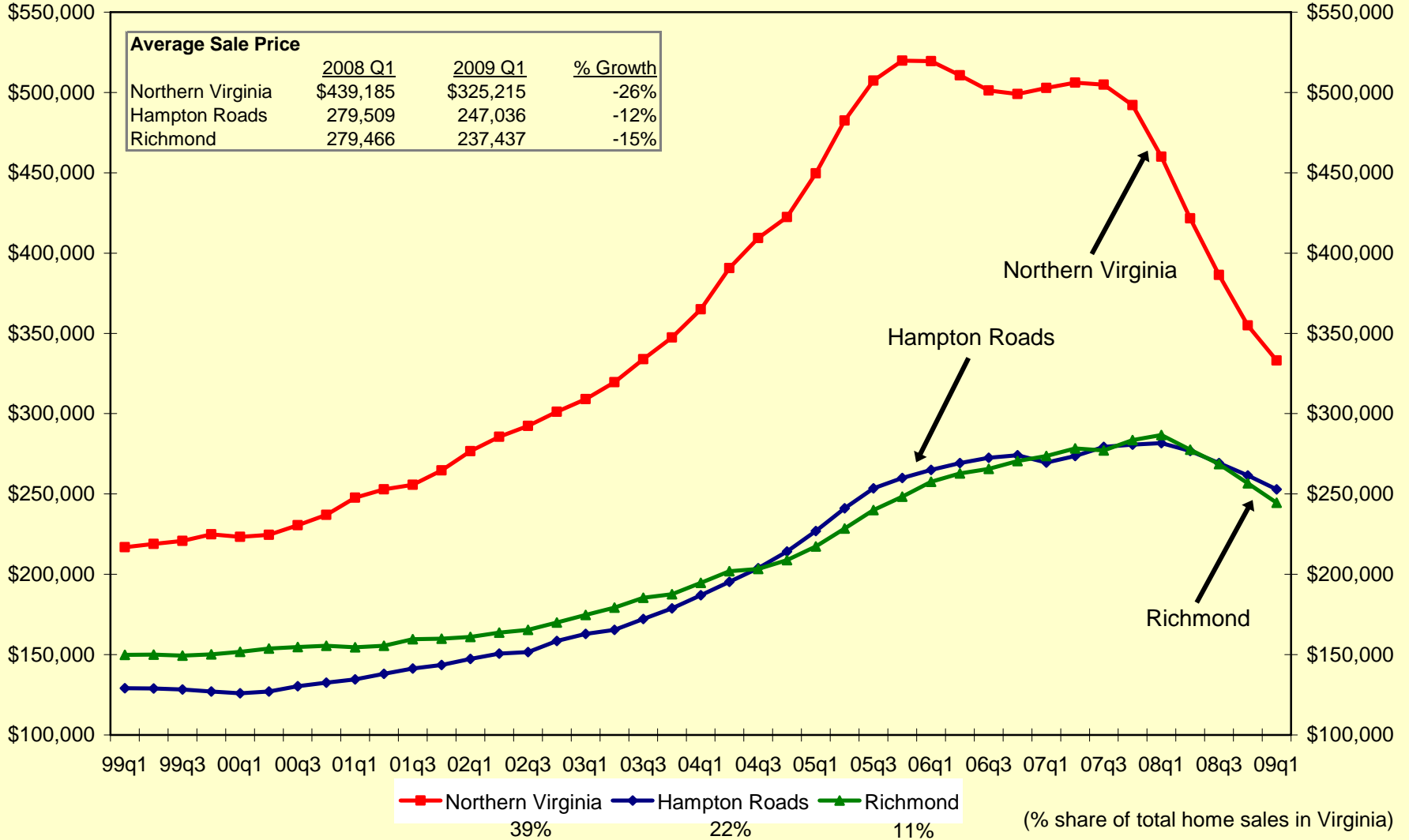
*Total GF Operating \$32,759.7 million; HB1600 Introduced.

The Depression in Housing Continues

- Since peaking in the third quarter of 2005, home sales and average sale prices in Virginia have fallen to levels not seen since early-2002.
- Statewide volumes are suggesting a bottom; however, this is a phenomenon driven only by Northern Virginia, and more specifically Prince William County, where drastic price declines have fueled a surge in sales activity.
 - Sales volume in Hampton Roads and Richmond continues to deteriorate.
- On a statewide basis, quarterly sales volume is below 20,000 units, similar to year-ago levels but still 44 percent below peak levels.
- For the state as a whole, the average sale price has declined for five consecutive quarters, with all three major regions declining at a double digit rate during the first quarter of 2009.
 - Northern Virginia -26%, Hampton Roads -12%, Richmond -15%

Average Sale Price in Northern Virginia, Hampton Roads, and Richmond Levels

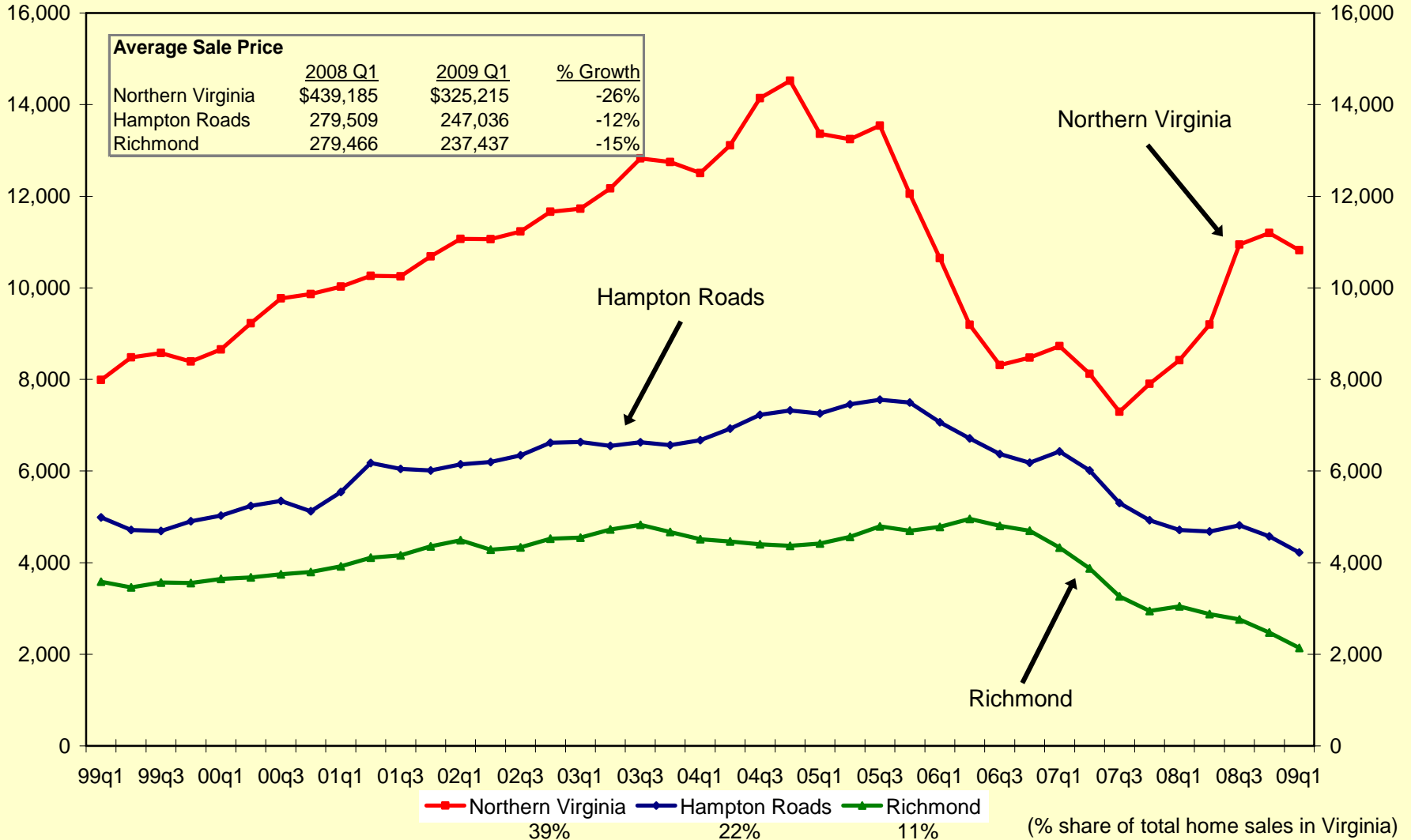
Seasonally-adjusted 2-quarter moving average



Pending Home Sales in Northern Virginia, Hampton Roads, and Richmond

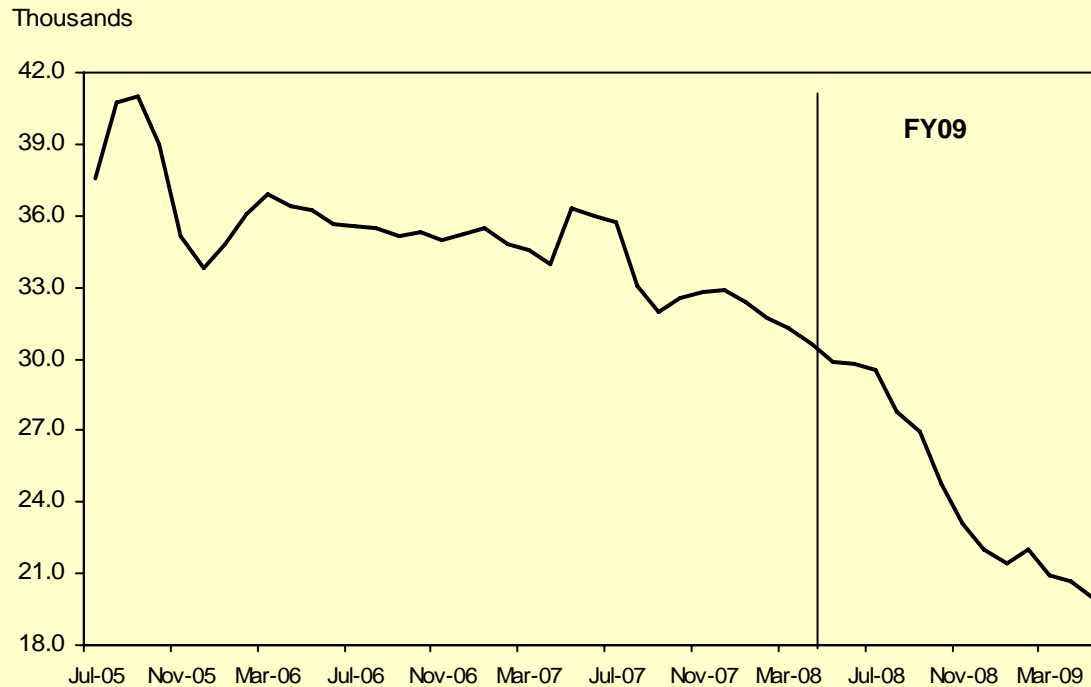
Levels

Seasonally-adjusted 2-quarter moving average



Demand for New Vehicles is Declining

New Taxable Titles
Year-over-Year Percent Change
Seasonally-adjusted 3-month moving average



- The seasonally-adjusted 3-month moving average has fallen to 20,038 titles, the lowest level on record back to the mid-1980s.

Major Issues With ARRA

(American Recovery and Reinvestment Act)

- **Stimulus or Maintenance**
 - When are funds being budgeted?
 - States have flexibility in amount spent
 - Covers three fiscal years (2009, 2010, 2011)
 - How are funds being used?
 - Flexible grants
 - Infrastructure and competitive grants
- **Reporting Requirements**
 - Transparency
 - Economic impacts

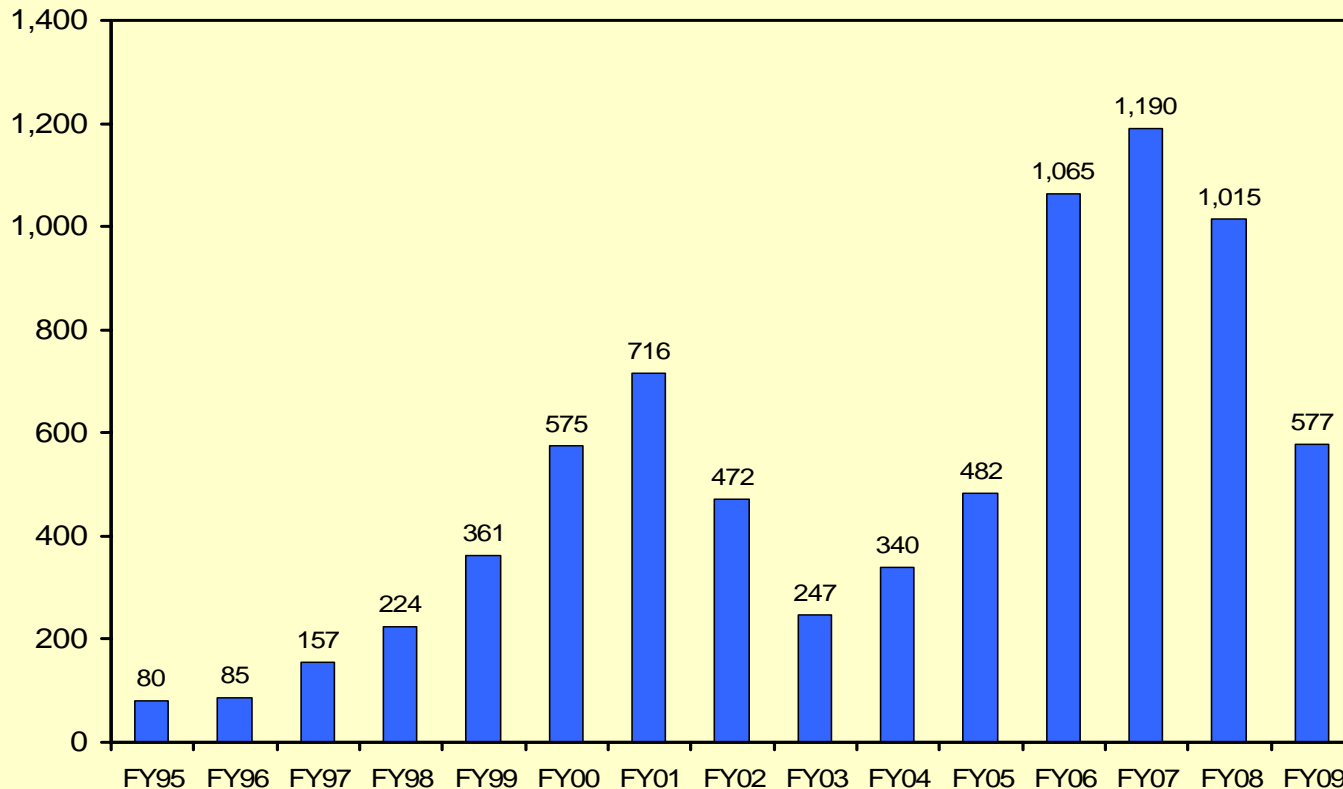
A Withdrawal of \$490 Million from the Revenue Stabilization Fund Was Used to Address the FY 2009 General Fund Shortfall

- **The revenue stabilization fund balance on June 30, 2008 was \$1,014.9 million.**
 - A \$21.3 million deposit required by Chapter 879 on or before June 30, 2009.
 - Interest credited to the fund quarterly.
- **Proceeds from the Revenue Stabilization Fund are available to meet a revenue shortfall in the currently enacted budget under proscribed conditions.**
 - General Assembly may appropriate a withdrawal from the Fund if there is a revenue shortfall of 2 percent or greater in certified tax revenue (\$284.5 million) for FY 2008.
 - The withdrawal cannot exceed one-half of the revenue shortfall (\$493.3 million).
- **The balance in the Revenue Stabilization Fund after withdrawing the \$490 million will be in excess of \$575 million after the required FY 2009 deposit and accrual of interest through June 30, 2009.**

The Balance in the Revenue Stabilization Fund

Will Exceed \$575 Million After the Proposed Withdrawal of \$490 Million

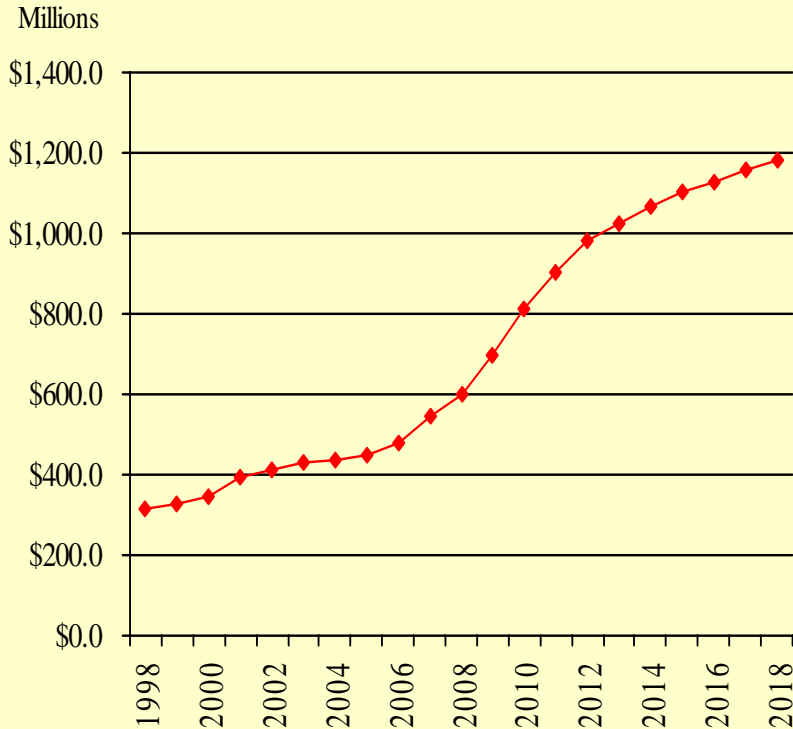
Revenue Stabilization Fund - June 30 Balance
FY 1995-08 Actual and FY 2009 Forecast
(millions of dollars)



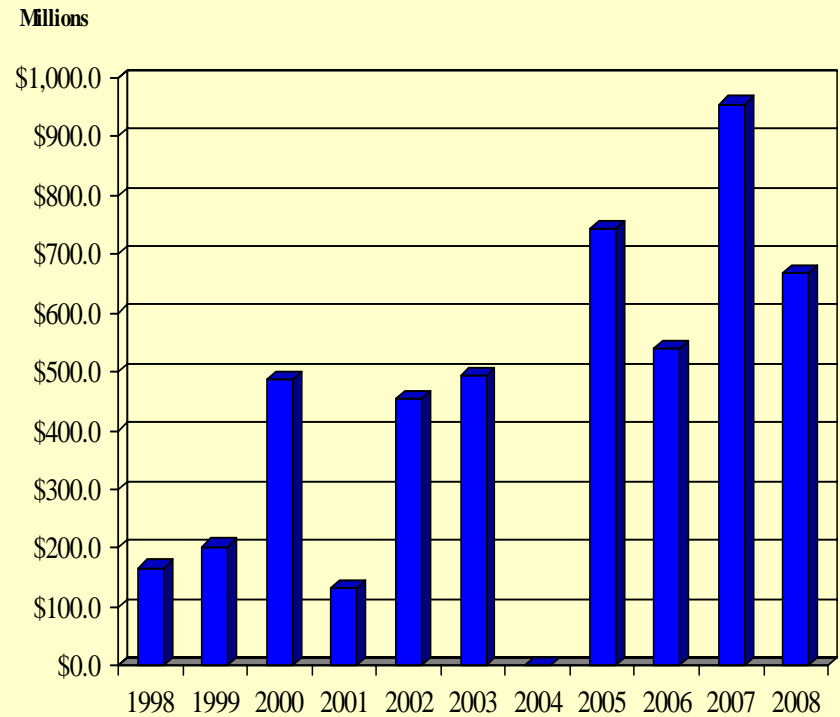
Amnesty 2009 Status

- There will be a Tax Amnesty in FY10, as authorized by the General Assembly.
- The program will run between 60-75 calendar days.
- Any eligible amount owed that is satisfied during the amnesty period will receive Amnesty benefit.
 - The Amnesty benefit eliminates all penalties and 50% of the interest due.
- Unsatisfied Amnesty eligible liabilities are subject to a 20% amnesty penalty.
- Amnesty Eligibility:
 - Outstanding liabilities must be at least 90 days old at the start of Amnesty.
 - 2008 Individual, Corporate, Fiduciary, and Pass Through Entity returns are NOT eligible for Amnesty relief.
 - Taxpayer's must satisfy 100% of the Amnesty balance to receive amnesty benefits.
- An advertising agency and a call center have been selected.
- “Online chat” will be added as a feature to assist with customer service.
- Project is on schedule.

Tax-Supported Debt Service Actual and Projected Fiscal Years 1998 – 2018



Trend in Tax-Supported Debt Issuance Fiscal Years 1998 - 2008



AAA / Aaa / AAA State Debt Burdens 2001 – 2008

AAA/Aaa/AAA STATE DEBT BURDENS FROM 2000-2007 PROVIDED BY MOODY'S INVESTORS SERVICE

Net Tax-Supported Debt per Capita (1)

	<u>2008</u>	<u>2007</u>	<u>2006</u>	<u>2005</u>	<u>2004</u>	<u>2003</u>	<u>2002</u>	<u>2001</u>
Delaware	2002	1998	1845	1,865	1,800	1,599	1,650	1,616
Maryland	1297	1171	1169	1,064	1,077	977	879	819
Georgia	954	916	784	803	827	802	804	679
North Carolina	898	728	-	-	-	-	375	340
VIRGINIA	764	692	601	589	546	546	566	537
Missouri	675	613	496	449	461	368	347	288
Utah	542	621	707	792	846	682	708	634
Minnesota	-	-	-	-	-	-	576	546
South Carolina	-	-	-	-	599	587	615	398
AAA Median	898	728	746	798	827	682	615	546
AAA Average	1019	963	934	927	879	794	724	651

(1) Population is based on Census data from one year prior to each respective year's debt analyzed.

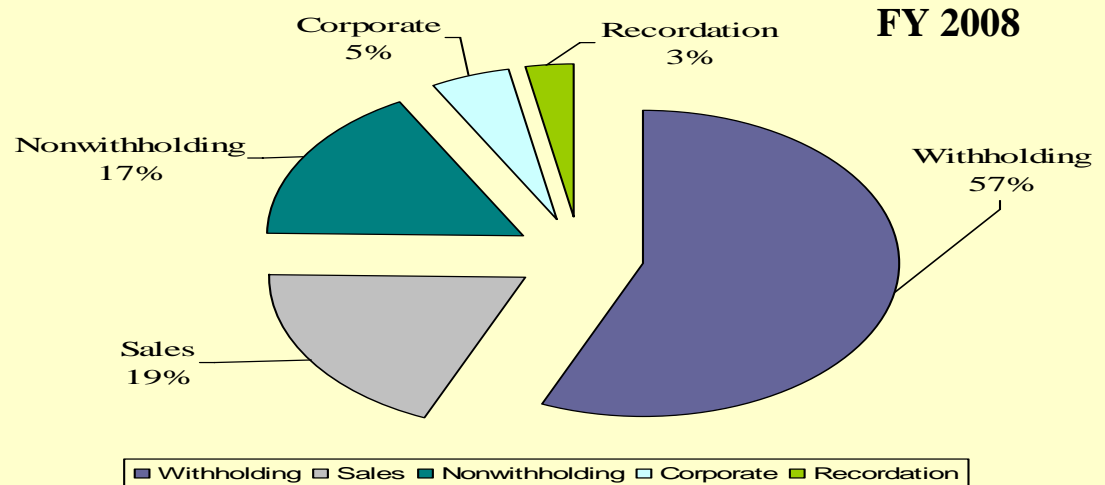
Net Tax-Supported Debt as Percent of Personal Income (2)

	<u>2008</u>	<u>2007</u>	<u>2006</u>	<u>2005</u>	<u>2004</u>	<u>2003</u>	<u>2002</u>	<u>2001</u>
Delaware	5.2	5.5	5.3	5.5	5.6	4.9	5.3	5.5
Georgia	3.0	3.0	2.7	2.8	2.9	2.8	2.9	2.6
Maryland	3.0	2.8	3.0	2.9	3.0	2.7	2.6	2.6
North Carolina	2.8	2.4	-	-	-	-	1.4	1.4
Missouri	2.1	1.9	1.6	1.5	1.6	1.3	1.3	1.1
VIRGINIA	1.9	1.8	1.7	1.8	1.7	1.7	1.8	1.9
Utah	1.9	2.3	2.7	3.2	3.5	2.8	3.0	2.8
South Carolina	-	-	-	-	2.4	2.3	2.5	1.8
Minnesota	-	-	-	-	-	-	1.8	1.8
AAA Median	2.4	2.4	2.7	2.9	2.9	2.7	2.5	1.9
AAA Average	3.2	3.2	2.8	3.0	3.0	2.6	2.5	2.4

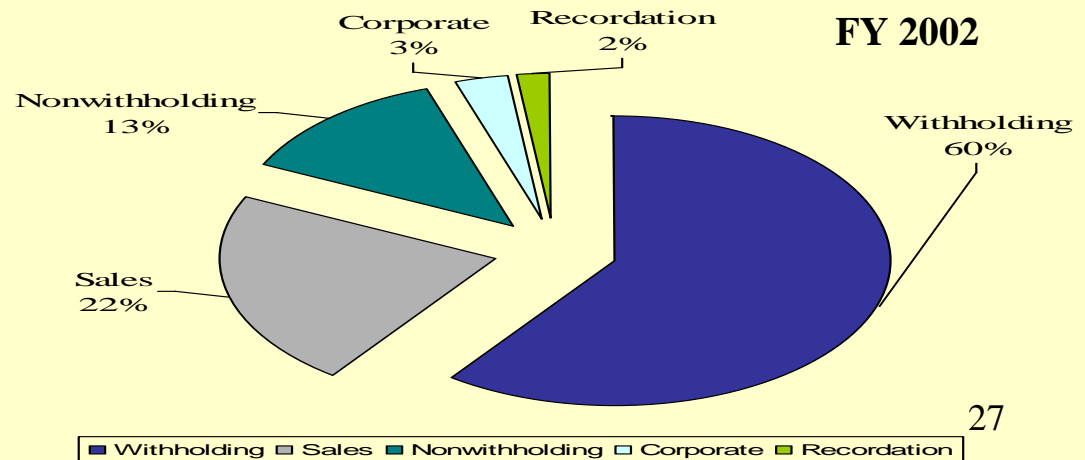
(2) Personal income is based on Census data from two years prior to each respective year's debt analyzed.

Components of General Fund Revenues

■ In FY08, individual nonwithholding, corporate income, and recordation tax payments accounted for \$4.0 billion of GF Revenues. Up significantly from FY02's \$2.0 billion.

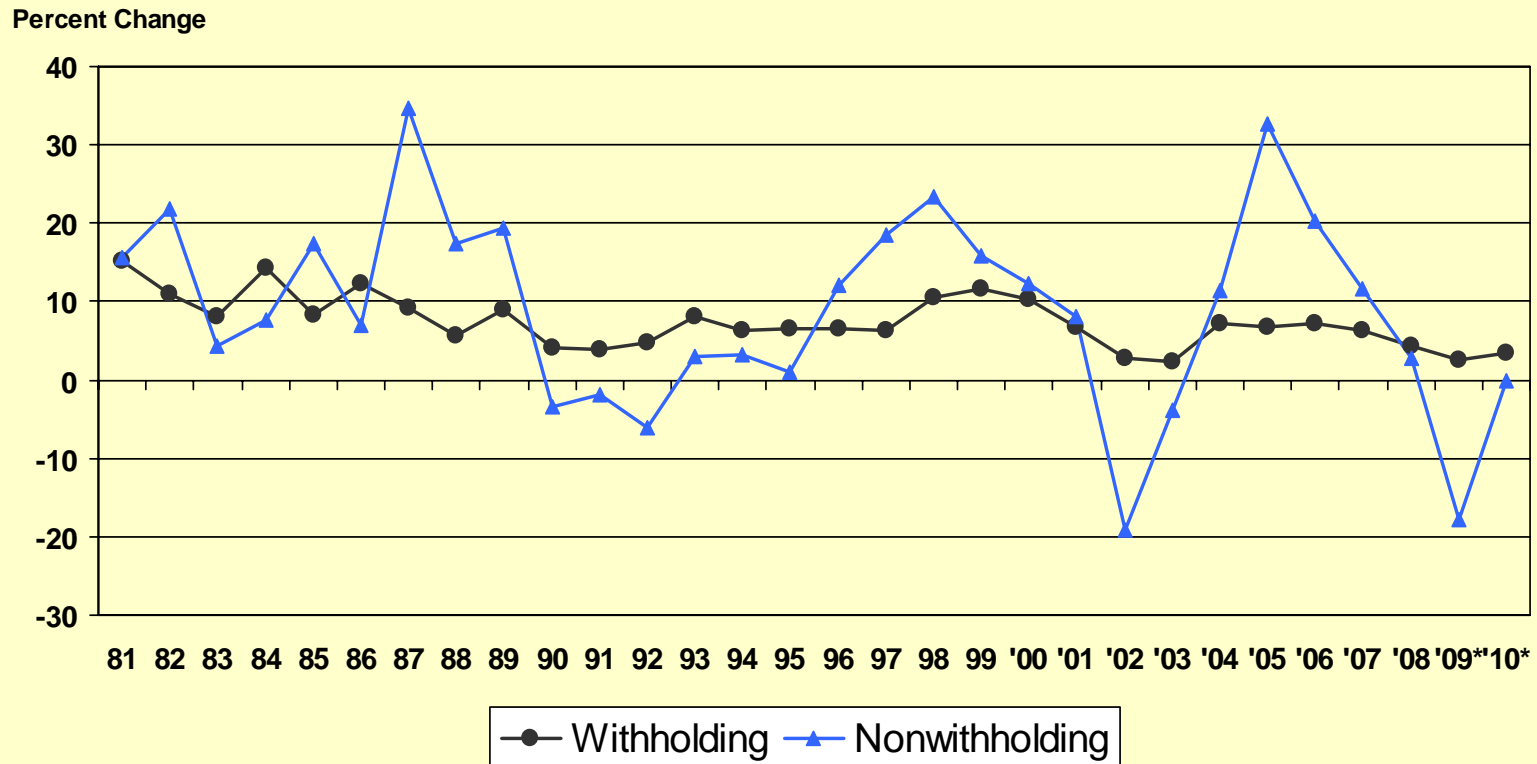


■ In FY02, 82% of GF Revenues were from ongoing economic activity via withholding and sales tax collections. FY08 these sources made up only 76%.



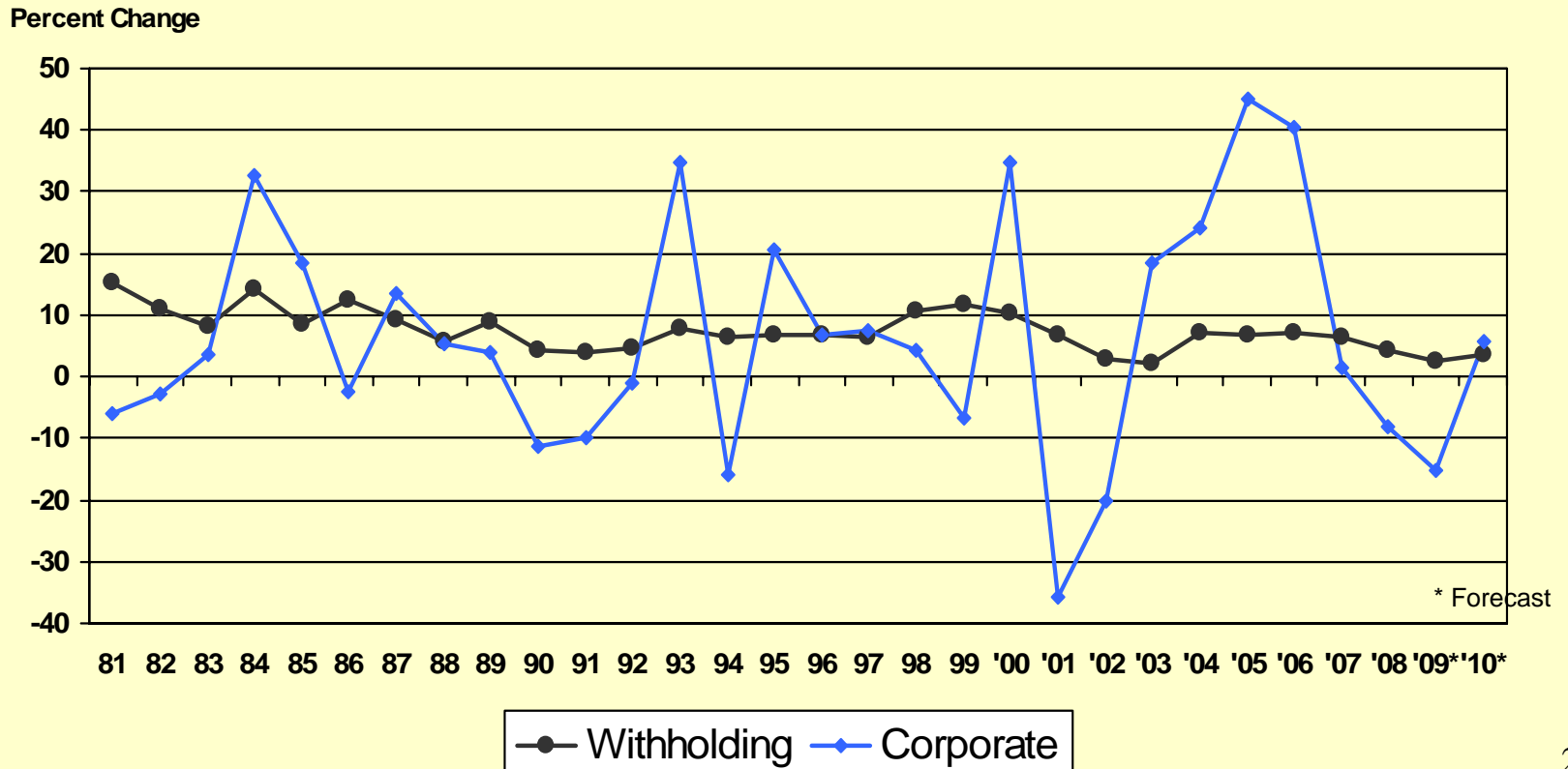
Trends in Withholding Compared to Nonwithholding

Percent Growth Over the Prior Year



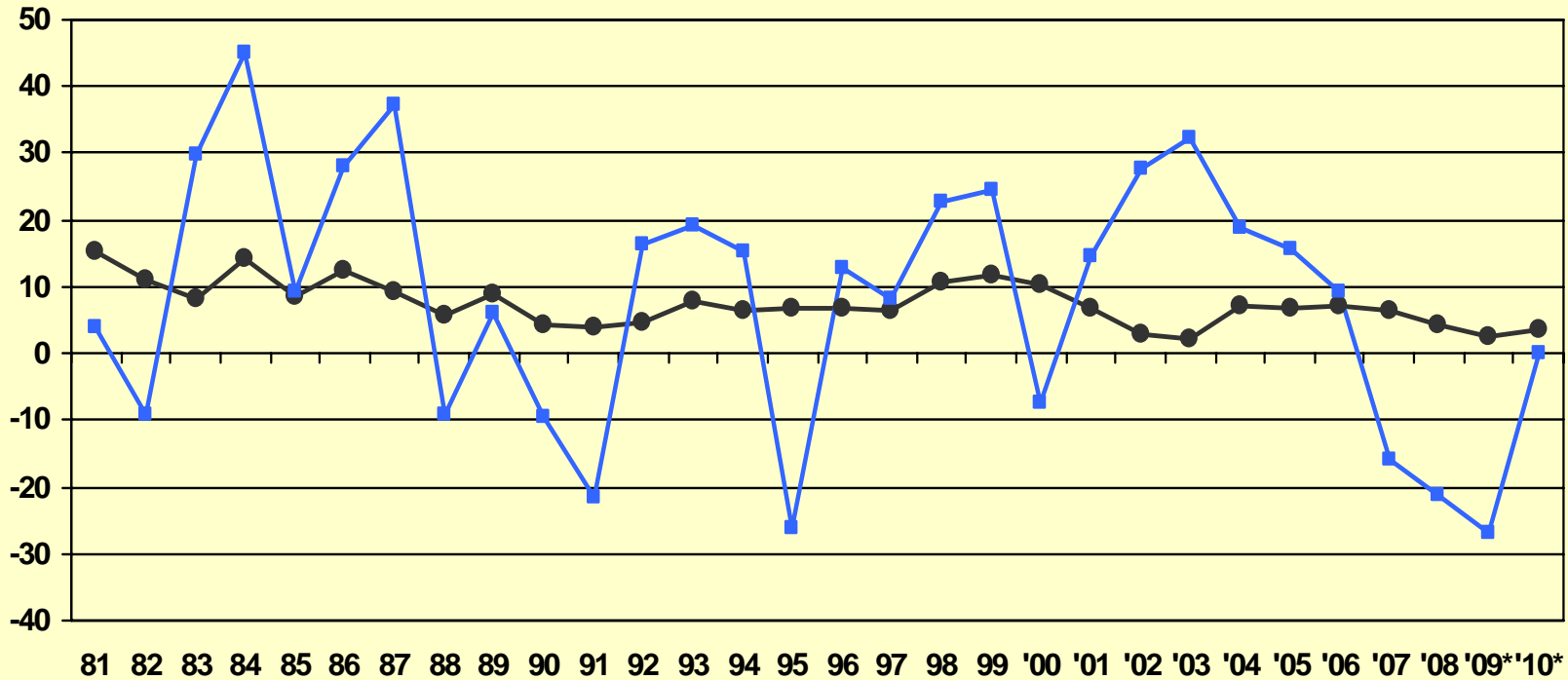
Trends in Withholding Compared to Corporate Income Tax

Percent Growth Over the Prior Year



Trends In Withholding Compared To Recordation Percent Growth Over the Prior Year

Percent Change



● Withholding ■ Wills (Recordation)

* Forecast

Note: Recordation growth rate is adjusted to remove the rate increase and for transfers per HB 3202.

Growth in Total General Fund Revenues Fiscal Year 1961 - Fiscal Year 2010 (Nominal - Actual Dollars)

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Sales Tax Updates

- On July 1, 2009, the Department of Taxation (TAX) enhanced the software it uses to assign FIPS codes to business locations.
 - The enhancement adds Global Positioning Software (GPS) to TAX's suite of applications used for address validation.
 - GPS will help reduce errors when assigning FIPS codes to business locations.
- Effective July 2009, businesses that file a consolidated Retail Sales and Use tax return will be required to provide the count of business locations in each locality on the sales schedule.
 - TAX will conduct reviews whenever the count reported on the tax return does not match its registration system.
 - This change should help reduce locality reporting errors made by businesses with locations in multiple localities.

**For more information on Virginia's
budget, visit these websites at:**

www.Finance.Virginia.gov

or

www.DPB.Virginia.gov

Thank You