



# Part A Overview and Reader's guide



# Reader's Guide to the Budget Document

## **Part A Overview and Reader's Guide**

Part A includes the Reader's Guide, which is a citizens reference tool to explain the terminology and processes used in the state budgeting process. The economic and revenue forecast as well as the Director of Planning and Budget's and the Governor's overview of the budget are included. The Commonwealth of Virginia operates on a biennial budget cycle, with this publication presenting 2006-2008. State fiscal years begin on July 1 and end on June 30.

## **Governor Warner's Presentation**

Governor Warner presents the 2006-2008 biennial budget to the joint meeting of the House Appropriation, House Finance and Senate Finance Committees on December 16, 2005. The presentation will be displayed on the Department of Planning and Budget web site immediately following the presentation.

## **Overview**

A summary of the key issues of the budget are also presented on December 16, 2005 by the Department of Planning and Budget.

## **Reader's Guide to the Budget Document**

Each chapter in this section describes the components of the Executive Budget Document for the benefit of the reader.

## **Economic Forecast**

In November of each year, the Governor's Advisory Board of Economists reviews the 6-year revenue plans including each plan's economic assumptions and technical econometric methodology. The economic status report, or forecast, is prepared after the meeting by the Department of Taxation and the Secretary of Finance. The Council on Revenue Estimates also examines the economic assumptions with respect to the general economic climate of the Commonwealth.

## Revenue Forecast

The Governor's Advisory Council on Revenue Estimates meets in November, and the conclusive review leads to the revenue forecast on which the Executive Budget will be based. The report presents the state's fiscal outlook, including the projected revenues supporting the Governor's recommended 2006-2008 biennial budget. The revenue forecast is prepared by the Department of Taxation and the Secretary of Finance.

## Part B Executive Budget for the 2006-2008 Biennium

The operating and capital addenda are represented in section B for the Governor's Executive Budget for the 2006-2008 biennium. Extracts from each agency's strategic plan and service area plans are listed, with the budget proposals under each service area. The information is sorted by secretarial area, under which the appropriate agencies appear. Each agency lists the service areas and budget proposals in budget bill order.

### Secretarial Area Description

The secretarial area description and budget summary tables appear near the beginning of each secretarial area. The description gives a brief overview of the purpose of the secretarial area. The tables provide a summary of the total recommended funding for each area.

### Secretarial Area Budget Summary

The table provides a summary of the operating and capital budget for the area. The summary includes a historical representation of secretarial funding, funding for the present biennium, and the proposed funding. General fund, nongeneral funds, personnel costs, other costs (non-personnel costs), and positions are included.

#### General Fund

This fund shows unrestricted revenues derived primarily from broad-based taxes such as individual, corporate and sales taxes. General Fund revenues may be expended for a variety of state government services.

#### Nongeneral Funds

Nongeneral funds are earmarked by law for special purposes. Examples would be federal grants for mandated programs, the motor fuel taxes for transportation needs, and tuition and fees for educational programs at state colleges and universities. The funds are normally received from outside sources, such as federal funds or grant programs.

#### Personnel Costs

Personnel costs include employee compensation and benefits for the number of allowed positions.

#### Other Costs

Other costs are the agency non-personnel budgeted expenses totaled by secretarial area. The figure is derived from the calculation of personnel costs, subtracted from the total budget figure. Non-personnel historical costs from fiscal years 2003-2006 is shown with the 2006-2008 biennial costs.

#### Positions

Positions displays the maximum allowed staffing positions of the agency. Positions are expressed as full-time equivalents.

#### Operating Budget History

Operating budget history includes budget for the agencies under the specific secretarial area for the fiscal years 2003, 2004, 2005, and 2006.

**New Operating Budget Summary** The new operating budget presents the proposed budgetary figures for 2007 and 2008 for all the agencies under each area.

**Capital Outlay Budget Summary** The capital outlay budget summary totals the building projects for the area.

**Mission Statement**

Strategic plan component: the agency mission statement describes the organization's purpose. The statement provides organization-wide strategic direction, and communicates the organization's purpose.

**Agency Goals**

Strategic plan component: agency goals are broad, general statements of the long-term results needed to achieve the mission and vision. A goal is clarified by the objectives associated with it.

**Customers Served**

Strategic plan component: customers are the primary persons, groups, or organizations impacted by the products and services of the agency.

**Agency Budget Summary**

Table represents the Governor's operating budget amendments for the 2006-2008 biennium. The sections are organized by branch of government and, within the Executive Department, by secretarial area. Agencies appear in this document in the same order as in the Budget Bill. The funding categories are general fund, nongeneral fund, personnel costs, other costs and maximum allowed positions.

**Agency Summary of Recommended Budget Addenda**

Descriptions of the proposed budget items are listed for each agency. The sentence that is in bold is the title of the proposed amendment. The order of the amendments is dependant upon the type of budget request. Technical adjustments, emergency funding and legislatively mandated requests will appear first in the list. Technical adjustments change the previous budget so that a base line budget can be used in new budget construction. Next in the listing will be unanticipated and unavoidable cost adjustments, caseload adjustments, reorganizations, operational efficiencies and service reductions, information technology requests, other spending or initiatives, position level changes and Appropriation Act language changes. Language changes do not involve funding of any sort. The last descriptions include capital projects. Dollars and positions are listed for each year. The detail table at the back of the secretarial area section lists each proposal by the bolded title at the beginning of the descriptions.

**Agency Summary of Recommended Capital Budget Addenda**

Descriptions of the proposed capital budget items are listed for each agency. Dollar amounts are listed for the total biennium, and the funding is general fund (GF) or nongeneral funds (NGF).

**Agency Service Areas**

Strategic plan component: the specific level of performance the agency is striving to achieve. The desired level of performance of an objective which can be measured within a specific point in time, usually expressed as a number or percentage.

<b>Objective</b>	Service area plan component: the objective describes an intended outcome for the agency. The agency goals are supported by the objectives and explain the results, outcomes or effects of the organizations activities on its customers. The Executive Budget contains "key" or critical objectives for each agency. The agency website contains all of the pieces of the strategic plan.
<b>Performance Measure</b>	Service area plan component: the measure is a quantitative measure that describes the magnitude or degree of an aspect of a product, service, or activity performance characteristic over time. The Executive Budget contains "key" or critical performance measures for each agency. The agency website contains all of the pieces of the strategic plan.
<b>Measure Baseline</b>	Service area plan component: the baseline is a description or measure of the present condition of the objective described. It is the starting point from which the agency can measure changes over a progressive period of time.
<b>Measure Targets</b>	Service area plan component: the specific level of performance the agency is striving to achieve. The desired level of performance of an objective which can be measured within a specific point in time, usually expressed as a number or percentage. The target is tied to the baseline funding.
<b>Service Area Budgets</b>	Table shows funding by service area, with the bolded title of the proposal under the amendment section in italics. The information in the table duplicates the funding and position requests in the previous description.

## **Part C Other Reports**

The Governor's Executive Budget Document includes various reports that are required by the Code of Virginia. These reports are included in this section.

## **Studies and Evaluations**

List of the various studies, evaluations, and assessments of agencies or agency programs or projects that have been conducted in the two most recent fiscal years and where they can be obtained.

## **Aid to Localities**

Describes the Governor's recommendations for state aid to localities. The funds go directly to localities for locally operated programs or are spent by the state on behalf of localities for specific programs.

## **Supplemental Information**

Presents information about tax supported debt capacity and per capital appropriations.

## **Miscellaneous Transfers**

Reviews actions affecting state debt, revenue transactions, interfund transfers, working capital advances and loans, and required deposits to the general fund.

## **Amendments to the 2005 Virginia Acts of Assembly**

Presents the Governor's changes to the current budget, Chapter 951. It is called the Caboose Bill.



# Governor Warner's Presentation

After Governor Warner presents his budget for the 2006-2008 biennium to the joint meeting of the House Appropriation, House Finance, and Senate Finance Committees on December 16, 2005, this portion of the overview will be posted on the Department of Planning and Budget web site at: [dpb.virginia.gov](http://dpb.virginia.gov)





# Economic Forecast

## Review of fiscal year 2005

The performance of the national economy in fiscal year 2005 was in line with expectations. Consumers continued to experience solid purchasing power from strength in the housing market and healthy income growth. Strength in consumer demand encouraged businesses to expand both capital investment and payrolls, leading to solid growth in the labor market. Despite these positives, global uncertainty, including ongoing military operations and their impact on federal budget deficits, as well as escalating energy costs, continued to be a source of caution for investors.

The Virginia economy continued to outperform the nation in fiscal year 2005, following its healthy performance in fiscal year 2004. Growth in total nonagricultural employment averaged 2.9 percent for the first nine months of the fiscal year, with some moderation occurring in the spring. Growth was strongest in Northern Virginia, driven by the continued strength in federal government spending on national defense programs and homeland security.

## The national economy picked up momentum in fiscal year 2005

The U.S. economy continued to expand at a healthy pace in fiscal year 2005 although the labor market continued on an uneven expansionary path.

**Growth in U.S. Gross Domestic Product moderated to a sustainable rate in fiscal year 2005.** The value of all goods and services produced within the U.S., adjusted for inflation, grew at 3.7 percent in fiscal year 2005. Growth in total personal income was 6.4 percent, while wages and salaries increased by 6.8 percent.

**Stronger wage growth and continued low interest rates drove consumer spending.** Consumer spending grew by 3.7 percent in fiscal year 2005.

**The labor market continued on an uneven expansionary path.** Total nonagricultural employment in the U.S. increased by 1.6 percent during fiscal year 2005. Employment gains averaged 176,000 new jobs per month, up from fiscal year 2004 levels of 135,000 per month. Seven out of ten major employment sectors experienced growth equal to, or better than, anticipated in fiscal year 2005.

**The federal funds rate was increased gradually throughout fiscal year 2005.** The Federal Reserve raised the federal funds rate at each of its eight meetings in fiscal year 2005 by a total of 200 basis points. The Federal Reserve retained the view that tightening could continue at a measured pace. The federal funds rate was increased by 25 basis points in June to 3.25 percent.

## US Economic expansion continues

	Actual		Forecast		
	2004	2005	2006	2007	2008
Real GDP	4.1%	3.7%	3.4%	3.1%	3.4%
Total Employment*	0.3%	1.6%	1.5%	1.4%	1.3%
Unemployment	5.8%	5.3%	5.0%	4.9%	4.9%
CPI	2.2%	3.0%	3.8%	1.5%	1.6%

\* Total nonagricultural employment. Figures represent percent change over previous year, except unemployment rate, which is a percentage. Data based on the October 2005 Global Insight standard forecast. Source: Department of Taxation

## In Virginia, the economic expansion continued at a solid pace.

The Commonwealth's labor market grew at well-above trend rates through the first nine months of the fiscal year with some moderation occurring in the spring. Employment growth averaged 2.9 percent through March but slowing in the spring brought the fiscal year 2005 rate down to 2.5 percent.

Total nonagricultural employment increased by 89,600 jobs in fiscal year 2005 after increasing by 45,700 jobs in fiscal year 2004. Nonagricultural employment grew by 2.5 percent in fiscal year 2005, slightly outpacing the official forecast of a 2.4 percent increase. The service sector was the major driver of growth, along with construction. The manufacturing and information sectors continued to lose jobs, although the pace of decline did slow.

Here is a look at regional employment in Virginia during fiscal year 2005:

### ***Northern Virginia***

In Northern Virginia, which represents about a third of all jobs in the state, total employment increased by 4.6 percent -- a gain of 54,700 jobs, well over half of total state gains for the year. The services sector as a whole added 31,700 jobs, approximately 60 percent of total gains, including 18,500 in professional and business services, most of which are defense-related. Construction employment was also a bright spot, with growth of 6.7 percent, adding 5,500 jobs. These gains were partially offset by a decline of 1,700 jobs in the information sector.

### ***Richmond/Petersburg***

Employment in the Richmond-Petersburg MSA increased by 2.2 percent in fiscal year 2005, an addition of 13,200 jobs. Gains were broad-based across industries, with notable contributions from construction, education and health services, and leisure and hospitality.

### ***Norfolk/ Virginia Beach/ Newport News***

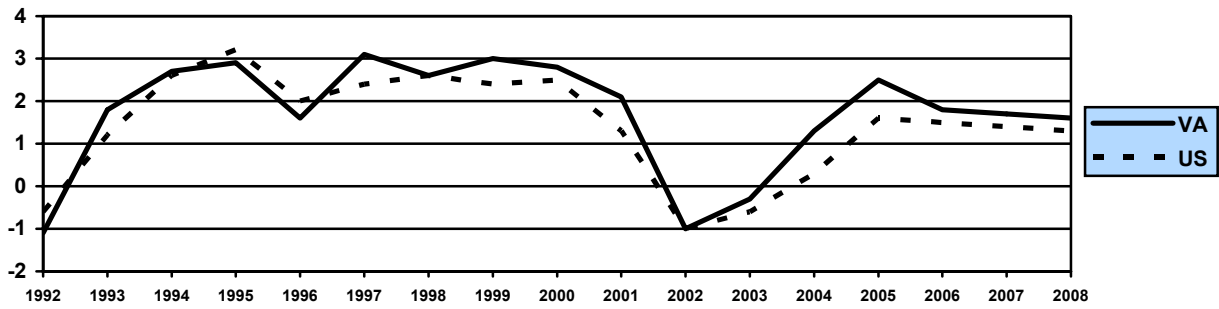
The Norfolk-Virginia Beach-Newport News MSA experienced employment growth of 2.3 percent in fiscal year 2005. The region had a gain of 17,000 jobs, the largest gain since fiscal year 1999. The continued deployment of many of the military personnel situated in the area has remained a drag on growth. The manufacturing sector increased 2.5 percent from fiscal year 2004, supported by solid growth in ship and boat building. The tourism industry, long a staple of the area economy, added 1,100 jobs.

### ***Balance of the state***

Employment in the balance of the state increased by 4,800 jobs, growth of 0.5 percent. Growth in services employment was offset by declines in manufacturing, construction and mining, trade, transportation, utilities, and financial activities. The manufacturing sector has lost 57,600 jobs, or 25 percent of its employment base, since annual declines began in fiscal year 1999. Many rural areas of the state, particularly Southside and Southwest Virginia, are still dependent on manufacturing activity and international trade. Weakness in those sectors continues to be a drag on overall growth.



**Virginia employment growth to moderate to long-term trend  
Percentage growth in nonagricultural employment**



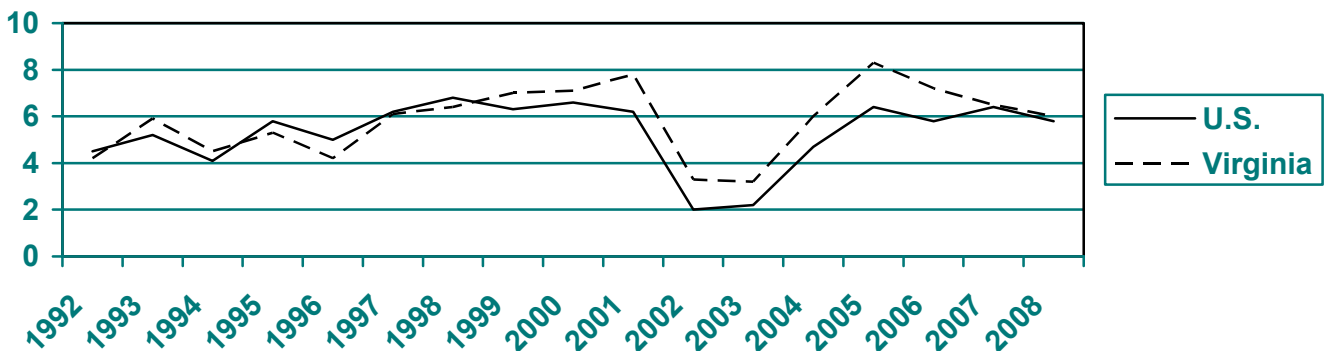
Data for 2006 through 2008 are forecasts. Source: Department of Taxation

**U.S. economic outlook expects moderation in economic growth**

The economic expansion is expected to continue over the forecast horizon although Hurricanes Katrina and Rita disrupted growth in 2005. The underlying trend is for slower economic growth in fiscal years 2006 and 2007 due to softness in consumer spending and a slowdown in the housing market. At the November meeting of the Governor’s Advisory Council on Revenue Estimates, the consensus economic forecast was for a steady expansion. Highlights of the economic outlook for the next three years include:

- Real GDP is anticipated to grow by 3.4 percent in fiscal year 2006, 3.1 percent in fiscal year 2007, and 3.4 percent in fiscal year 2008.
- Job growth in fiscal year 2006 is expected to be close to fiscal year 2005, with a 1.5 percent increase in nonagricultural employment. Growth is expected to fall to 1.4 percent in fiscal year 2007, and 1.3 percent in fiscal year 2008.
- With the effects of higher energy prices and larger debt burdens intensifying, real consumer spending will slow from fiscal year 2005, increasing by 2.8 percent in fiscal year 2006, 3.4 percent in fiscal year 2007, and 3.2 percent in fiscal year 2008.
- Business investment has become the main driver of growth for the national economy. Healthy corporate balance sheets are expected to fuel double-digit increases in business equipment spending through next year. Growth will be centered in information processing equipment, specifically computers and peripherals, as companies work to replace dated technologies.
- Surging energy prices are expected to push the CPI to 3.8 percent in fiscal year 2006. Although gasoline prices have come down, natural gas prices are likely to stay high, increasing home heating bills this winter by forty to fifty percent.
- The Federal Reserve Bank is expected to raise the federal fund rate to 4.5 percent by the end of January 2006 before taking an extended pause.

**Personal income growth to exceed the nation's over the forecast horizon**



Data for 2006 through 2008 are forecasts. Source: Department of Taxation

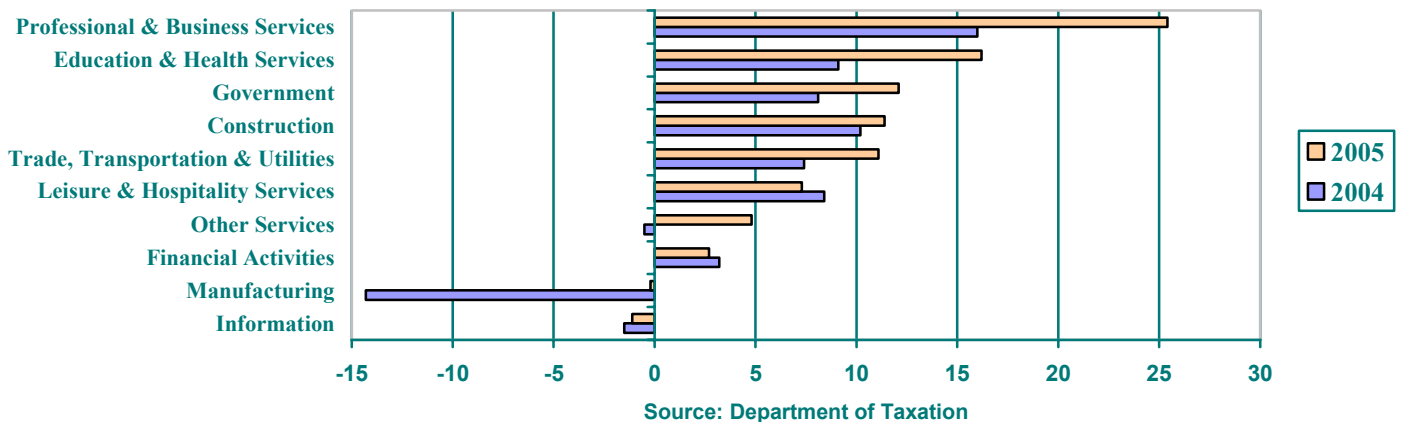
## Fiscal year 2006 expected to be a year of continued expansion

The Virginia economy is well-situated for a period of solid economic growth. The service sector will continue to drive growth, while the information technology sector should pull out of its four-year malaise. Continued defense-related spending, as well as low business costs and strong population growth, are expected to drive Virginia's economic performance over the forecast horizon.

Here is a look at what economists are predicting for Virginia:

- Personal income is expected to grow 7.2 percent in fiscal year 2006, 6.5 percent in fiscal year 2007, and 6.0 percent in fiscal year 2008. Wages and salaries are expected to grow 6.9 percent in fiscal year 2006, 6.4 percent in fiscal year 2007, and 6.0 percent in fiscal year 2008.
- Employment growth of 1.8 percent, 1.7 percent, and 1.6 percent is expected in fiscal years 2006 through 2008, respectively.
- Employment in the professional and business services sector is forecast to grow at 3.1 percent in both fiscal years 2006 and 2007.
- Construction employment is expected to slow as the hot housing market cools, growing at 3.2 percent in fiscal year 2006 with further slowing to 1.3 percent and 2.2 percent in fiscal years 2007 and 2008, respectively.
- Employment in trade, transportation and utilities is expected to grow 1.3 percent and 1.7 percent in fiscal years 2006 and 2007.
- The forecast expects Virginia's manufacturing sector to continue to lose jobs over the forecast horizon.

### High paying professional and business services dominant job producer





## Revenue Forecast

The Commonwealth's total revenue consists of two types of resources: the general fund and nongeneral funds. About half of state revenues are "nongeneral funds," or funds earmarked by law for specific purposes. For example, motor vehicle and gasoline taxes are earmarked by law for transportation programs, student tuition and fees support higher education, and federal grants are designated for specific activities.

General fund revenues are derived from general taxes paid by citizens and businesses in Virginia. Since general fund revenue is not dedicated to any particular purpose and can be used for a variety of government programs, these are the funds that the Governor and the General Assembly have the most discretion to spend.

General fund revenues are derived primarily from five major revenue sources. The two largest sources are the individual income tax and the sales and use tax. Other major revenue sources are public service gross receipts/consumption taxes, corporate income taxes, and taxes on insurance company premiums. Miscellaneous taxes and other revenues also contribute to the general fund.

### **Fiscal year 2005 collections driven by stock market and housing gains, and corporate profits**

In fiscal year 2005, total general fund revenues rose by 14.8 percent to \$13,687.3 million, exceeding last year's official forecast by \$544.6 million. Although the strength in revenue collections was broad-based, more than three-fourths of the surplus occurred in three revenue sources -- individual nonwithholding, corporate, and recordation taxes. Lower refunds also contributed significantly to the surplus. The two largest revenue sources -- individual withholding and sales and use taxes, which account for 76 percent of general fund revenues, were within 0.3 percent of their respective forecasts.

Collections of miscellaneous taxes and other revenues were \$125.6 million above last year's estimate in fiscal year 2005. The bulk of the surplus was due to higher than expected collections of wills, suits, deeds, and contract fees, which are primarily recordation taxes.

### **General fund revenue forecast reflects maturing expansion and continuing strength in corporate profits, the housing market, and non-wage income**

The general fund revenue forecast for fiscal years 2006 through 2008 reflects the strong growth in fiscal year 2005, the continuing economic expansion, and the impact of tax policy changes enacted during the 2004 and 2004 legislative sessions.

Throughout the explanation of the general fund revenue forecast, monetary changes and growth rates are presented as both pre- and post-tax policy changes. As such, the revenue forecast can be examined on the basis of changes strictly to the baseline (mainly economic-based) and the separate impact of tax policy changes.

Baseline general fund revenue growth in fiscal year 2006 was revised up from the 4.3 percent growth projected in last year's official forecast to 6.1 percent growth in the December forecast. Growth in fiscal year 2007 is expected to be lower than last year's official forecast, falling from 6.8 percent to 6.0 percent. Growth in fiscal year 2008 is projected at 5.3 percent, slightly below last year's official forecast of 5.8 percent growth. Adjusting for 2004 and 2005 tax policy changes, general fund revenues are expected to increase by 8.4 percent in fiscal year 2006, 5.1 percent in fiscal year 2007, and 5.3 percent in fiscal year 2008.

## The general fund forecast for fiscal year 2006 and the 2007-2008 biennium

	Fiscal year 2005	2004-2006 biennium		
	<i>Actual</i> 2005	<i>Forecast</i> 2006	<i>Forecast</i> 2007	<i>Forecast</i> 2008
<b>Major tax sources</b>				
Corporate income	\$616.7	\$722.4	\$746.5	\$795.9
Individual income	\$8,352.4	\$9,074.6	\$9,610.4	\$10,159.8
Insurance Premiums	\$373.6	\$392.5	\$416.4	\$440.2
Public utility	\$88.3	\$90.6	\$92.8	\$95.1
State sales & uses	\$2,946.1	\$2,811.8	\$3,150.3	\$3,310.1
<b>Miscellaneous</b>	\$1,310.2	\$1,435.9	\$1,384.9	\$1,413.3
<b>Total revenues</b>	\$13,687.3	\$14,527.8	\$15,401.3	\$16,214.4
<b>Transfers</b>				
ABC Profits	\$24.9	\$21.1	\$22.8	\$24.6
Lottery Profits	\$423.5	\$433.5	\$426.1	\$426.1
Transfers per the Appropriation Act	\$291.1	\$372.5	\$331.1	\$331.4
<b>Total transfers</b>	\$739.5	\$827.1	\$780.0	\$782.1
<b>Total general fund</b>	\$14,426.8	\$15,354.9	\$16,181.3	\$16,996.5

\*Dollars in millions. Excludes balances available for appropriation. Figures may not add due to rounding. Source: Department of Taxation

## Forecast for the major general fund revenue sources

For each of the major categories of general fund revenue, the following describes the actual performance in fiscal year 2005 and the forecast for the next three fiscal years:

### Individual income taxes

In fiscal year 2005, collections of net individual income taxes grew 13.1 percent. Receipts of \$8,352.4 million exceeded last year's official estimate by \$349.7 million. Most of the surplus resulted from a surge in collections of nonwithholding payments, which was accompanied by lower-than-expected refunds.

The forecast for net individual income taxes was revised upward substantially over the forecast horizon. The bulk of the increase is attributable to the nonwithholding component, while withholding and refunds also make a positive contribution. Tax policy changes are expected to reduce net individual income tax revenues by a small amount over the forecast horizon.

Baseline growth in individual taxes is expected to be 8.6 percent in fiscal year 2006, 5.9 in fiscal year 2007, and 5.7 percent in fiscal year 2008. Adjusting for tax policy changes, growth is projected to be 9.6 percent, 6.1 percent, and 5.6 percent in fiscal years 2006 through 2008 respectively.

## General fund revenues show typical recovery percent change over previous year



### Sales and use taxes

Collections of sales and use taxes grew 15.0 percent in fiscal year 2005; \$8.1 million ahead of last year's forecast of 14.7 percent growth. Growth was distorted by tax policy changes enacted during the 2004 General Assembly, which increased the tax rate on non-food items effective September 1, 2004.

The estimates for sales tax collections are affected by several changes enacted in the 2004 and 2005 legislative sessions. The increase in the sales tax on non-food items effective September of last fiscal year is projected to increase general fund revenues by over \$200 million per year over the forecast horizon. In addition, the elimination of the exemption for public service corporations is expected to increase revenues by \$50 million per year. These increases will be offset by the 1.5 percent reduction in the sales tax on food that was effective this past July. Collectively, tax policy changes are expected to increase sales tax collections by about \$100 million per fiscal year. In addition, the repeal of most of the accelerated sales tax collections will lower sales tax collections in fiscal year 2006 by \$200.1 million. Adjusted for these changes, collections of sales and use taxes are expected to increase by 5.3 percent in fiscal year 2006, 4.6 percent in fiscal year 2007, and 5.2 percent in fiscal year 2008.

### Corporate income taxes

Corporate income tax collections surged in fiscal year 2005 to the largest amount on record. It was also the third consecutive year of double-digit growth in this source.

Corporate income tax collections contributed \$67.7 million to the surplus in fiscal year 2005. Growth of 44.9 percent was 15.9 percentage points above last year's official estimate of 29.0 percent. Gross payments increased 25.2 percent in fiscal year 2005, while refunds fell 23.9 percent from last year. Retail, housing, and defense-related industries drove the surplus.

Corporate income taxes represent the most volatile revenue source in Virginia. Collections over the last three fiscal years have increased at a double-digit pace. This follows two years of double-digit declines. Receipts for fiscal year 2005 far exceeded expectations. A combination of strong productivity growth and low unit labor costs has allowed firms to build cash holdings, leading to high taxable corporate profits.

The November forecast increases baseline growth in corporate receipts to 17.1 growth in fiscal year 2006 -- \$214.2 million above last year's official estimate. The pace of growth is projected to slow in fiscal year 2007, with a gain of 3.3 percent. Growth in fiscal year 2008 is expected to be 6.6 percent.

Tax policy changes are expected to increase corporate income tax collections by more than \$20 million per year over the forecast horizon. Adjusting for these changes, growth in corporate income tax collections is expected to be 19.8 percent in fiscal year 2006, 3.3 percent in fiscal year 2007, and 6.7 percent in fiscal year 2008.

### Insurance company premiums taxes

Tax collections on insurance company premiums were \$7.4 million below forecast in fiscal year 2005. Collections of insurance premiums taxes are anticipated to increase 5.1 percent in fiscal year 2006, 6.1 percent in fiscal year 2007, and 5.7 percent in fiscal year 2008.

### Wills, Suits, Deeds & Contract Fees

Revenue from wills, suits, deeds, and contract fees exceeded its forecast by \$83.3 million to finish the year at \$596.1 million, a 75.0 percent increase from fiscal year 2004. Most of the revenue in this source is derived from taxes levied on the recordation of real estate transactions. Low interest rates have kept activity in the housing market at record levels. In addition to transaction activity, median home prices have continued to increase at a double-digit pace.

#### Revenue Forecast

Growth in this source has been revised to 29.5 percent for fiscal year 2006. A decline of 14.6 percent is projected for fiscal year 2007 as long-term interest rates move higher. Growth below one percent is expected for fiscal year 2008.

Adjusting for tax policy changes, collections are expected to grow 20.6 percent in fiscal year 2006, decline 13.7 percent in fiscal year 2007, and grow 0.8 percent in fiscal year 2008.

## **Over half (52%) of state revenue is nongeneral fund revenue**

Although most public attention is focused on general fund revenue, over one-half of all revenue in the state budget is nongeneral funds that are earmarked by law for specific purposes.

Nongeneral fund revenue is expected to increase by 11.0 percent in 2006, by 6.5 percent in 2007, and by 2.6 percent in 2008. Nongeneral funds will comprise about 52.3 percent of total state revenue during the 2006-2008 biennium.

### **Federal grants and other contracts**

Federal grants are the largest source of nongeneral fund revenue, more than 38 percent of the total. Frequently these grants do not come to the state as simple cash transfers. The federal government mandates many program requirements as conditions of the grants and, often, states must provide matching funds. The Medicaid program for indigent health care is an example of a federal entitlement program that requires a state contribution.

In 2005, federal grants and other contracts totaled \$6.0 billion. This source is projected to increase by 19.0 percent to \$7.1 billion in 2006, by 7.1 percent in 2007 to \$7.6 billion, and by 1.0 percent in 2008 to \$7.7 billion. This pattern is caused by the uncertainty surrounding the federal budget and federal domestic spending in the future.

### **Institutional revenue**

The second largest class of nongeneral fund revenue is institutional revenue. The principle sources of this revenue are patient fees at teaching hospitals and mental health institutions as well as tuition and fees paid by students at institutions of higher education. In 2005, institutional revenue collections were \$3.6 billion, about 23 percent of all nongeneral fund revenue. Institutional revenues are projected to grow by 7.0 percent to \$3.8 billion in 2006 and by 8.4 percent in 2007 and by 6.5 percent in 2008. These growth rates are affected by two offsetting trends. An increase in tuition is assumed for institutions of higher education for the next biennium, but the collection of additional revenues at correctional institutions for out-of-state prisoners continues to decline in the out years.

### **Transportation Fund**

State transportation revenue comes from several sources including the motor vehicle fuels tax, the motor vehicle sales and use tax, road taxes, vehicle license fees, state sales tax, interest earnings, and other miscellaneous taxes and fees. Money in this fund is used to support highway construction and maintenance and operating costs. Federal, local, and toll revenues are also used to finance transportation programs.

Fiscal year 2005 growth of 3.3 percent in Commonwealth Transportation Fund (CTF) revenues was slightly below the long-run growth rate of 3.5 percent. The CTF revenue estimates were based on an economic scenario of a continuing expansion. The fiscal year 2005 revenue surplus can be attributed to stronger than expected growth in the transportation fund portion of the state sales and use tax. Most of the other major revenue sources performed close to expectations.

For fiscal years 2006 through 2008, total fund revenues from state sources are expected to be about \$2.3 billion per year in the first two fiscal years and over \$2.4 billion in fiscal year 2008. These amounts are equal to annual growth of 2.2 percent, 3.8 percent, and 3.2 percent respectively.

### **Unemployment insurance fund**

Unemployment insurance tax collections rise and fall with trends in the economy. Projected collections are expected to be lower each year of the biennium, reflecting an improved economy and an increase in the fund balance factor (solvency level) that governs the tax schedules or formula used to make collections for the Unemployment Insurance Trust Fund. For 2006, unemployment tax collections are expected to increase to \$581.8 million from actual collections of \$510.7 million in 2005. For 2007 and 2008, revenues are anticipated to decline to \$538.2 million and \$425.7 million, respectively.

### **Master Tobacco Settlement Agreement Funds**

The Master Settlement Agreement (MSA) was signed between the major participating cigarette manufacturers and 46 states, the District of Columbia, and five United States' territories on November 23, 1998. The settlement agreement releases participating manufacturers from past, present, and future smoking-related claims of the states in return for an annual cash payment to the states in perpetuity. These payments are to be adjusted over time for several factors, including inflation and changes in volume of domestic cigarette shipments.

The Commonwealth's plan for the use of MSA funds has three elements. First, legislation passed by the 1999 General Assembly (Chapter 880, 1999 Acts of Assembly) earmarked 60 percent of the allocation in two separate trust funds. The Tobacco Indemnification and Community Revitalization Fund receives 50 percent of the MSA allocation. This share is used to compensate tobacco growers and tobacco quota holders for the economic loss resulting from quota loss or elimination and to promote economic growth and development in tobacco-dependent communities in the Southside and Southwest regions of the state. Recently, one-half of the annual amount received by this Fund was securitized and turned into an endowment. Thus, the Fund now receives 25 percent of the MSA allocation annually as a recurring revenue source.

The Virginia Tobacco Settlement Fund receives the next 10 percent of the MSA allocation for the purposes of discouraging, eliminating, or preventing the use of tobacco products by minors and for health care. Programs targeted at minors include but are not limited to educational and awareness programs on the health effects of tobacco and on laws restricting the distribution of tobacco products to minors.

The final portion of the allocation (40 percent) goes to the Virginia Health Care Fund. This Fund can be used to pay for various health care costs faced by the Commonwealth, including the Medicaid program for indigent health care.

For fiscal years 2006, 2007, and 2008, it is anticipated that the Tobacco Indemnification and Community Revitalization Fund will receive \$33.1 million, \$33.6 million, and \$36.2 million, respectively. The Virginia Tobacco Settlement Fund will take in \$13.2 million, \$13.4 million, and \$14.5 million over the same period. The Virginia Health Care Fund will receive \$53.0 million, \$53.7 million and \$58.7 million during this three year period.

**The nongeneral fund forecast for the 2006-2008 biennium**

	<b>Actual 2005</b>	<b>Forecast 2006</b>	<b>Forecast 2007</b>	<b>Forecast 2008</b>
Motor vehicle fuel tax	\$911.1	\$926.8	\$953.5	\$989.7
Unemployment compensation payroll tax	\$510.7	\$581.8	\$538.2	\$425.7
Special highway tax from sales tax	\$449.9	\$479.8	\$521.9	\$547.2
Motor vehicle sales and use tax	\$608.2	\$610.5	\$624.0	\$634.7
Other taxes	\$344.5	\$326.2	\$334.4	\$336.5
Rights and privileges	\$710.6	\$837.7	\$892.7	\$909.3
Sales of property and commodities	\$478.4	\$503.5	\$526.0	\$543.8
Institutional revenue	\$3,562.3	\$3,812.8	\$4,134.4	\$4,402.2
Interest dividends and rents	\$81.6	\$87.2	\$98.2	\$107.9
Federal grants and contracts	\$5,982.6	\$7,121.5	\$7,625.2	\$7,698.0
Master Tobacco Settlement Agreement Funds	\$129.7	\$99.3	\$100.7	\$109.4
Other revenue	\$1,397.7	\$1,454.8	\$1,579.7	\$1,691.7
<b>Total</b>	<b>\$15,167.3</b>	<b>\$16,841.9</b>	<b>\$17,928.9</b>	<b>\$18,396.1</b>

Dollars in millions. Figures may not add due to rounding. Total excludes balances and bond proceeds available for appropriation, as well as Lottery, operations, unappropriated Literary Fund transactions, and internal service funds.

Source: Department of Planning and Budget, based on data submitted by agencies.



## Overview

Virginia's economy has continued to grow resulting in increased revenue to the Commonwealth. A large portion of the revenue, however, is derived from the three most volatile revenue sources: individual non-withholding (taxes from non-wage sources); corporate income, and recordation taxes. The question is not if growth in these sources will decline but when this will occur. Governor Warner's 2006-2008 budget was developed with the following objectives in mind:

1. Maintain the Commonwealth's financial stability for the long term;
2. Make targeted investments that will pay measurable returns in the future; and
3. Meet the Commonwealth's ongoing commitment to fund core services.

Given the volatile nature of much of the revenue growth, the 2006-2008 biennial budget targets as much funding as possible for one-time expenses. The Governor has proposed to make an additional deposit to the Revenue Stabilization Fund, more commonly called the Rainy Day Fund, of \$402.2 million. This deposit will take the Fund to its Constitutional maximum (\$1.065 billion) for the first time. The introduced budget uses cash rather than tax-supported debt for capital outlay on new projects, cost over-runs, and equipment for buildings coming on-line, while significantly increasing support for deferred facility maintenance.

Major investments in Virginia's future are provided for transportation, restoring the quality of the Chesapeake Bay and rivers statewide, and higher education research. These represent significant one-time spending commitments which will yield results well into the future.

The proposed budget funds the transformation of the mental retardation and mental health system, as well as improving the health outcomes of all Virginians. The budget fully funds the Standards of Quality for public schools and reinforces the safety net for Virginia's most vulnerable citizens by funding increased caseloads, rising costs, and other priority needs in health and human resources programs. In response to rising energy prices, investments to reduce the consumption of

energy resources and encourage individuals to become part of a conservation effort have been provided.

A major objective reflected in the introduced 2006-2008 biennial budget is to make focused investments, which will provide measurable benefits and returns in the future. Central among these is the provision of targeted funding provided which will bolster Virginia's research facilities, as well as allow for the hiring of top researchers in the fields of biomedical science, biomaterials engineering, nanotechnology, and modeling and simulation. Through these efforts, Virginia can make progress in the search for cures for cancer, diabetes, tuberculosis, Alzheimer's and Parkinson's diseases, and avian flu.

### ***Long-Term Financial Stability: The Revenue Stabilization Fund***

A principle priority reflected in the 2006-2008 budget is the commitment to ensuring Virginia's financial stability for the long-term. To that end, Governor Warner has proposed an additional deposit to the Revenue Stabilization Fund for 2006 that will, for the first time, take the Fund to its Constitutional maximum (\$1.065 billion).

The Governor's amendments for 2006 include a mandatory deposit to the Fund of \$402.2 million. This amount will be more than enough to reach the Constitutional maximum for the first time and any excess deposit will be transferred back to the general fund. The \$402.2 million deposit excludes the effects of tax reform for sales and use taxes.

The required mandatory deposit to the Fund based on 2005 revenue collections ranges from \$354.1 million to \$600.6 million, depending on which, if any, of the effects of tax reform are included. The Constitution of Virginia provides that the growth in tax revenues that is the result of either increases in tax rates on income or retail sales or the repeal of exemptions may be excluded, in whole or in part, from the computations of Revenue Stabilization Fund mandatory



deposits for a period of up to six years from the year in which the tax rate increase or exemption repeal was effective.

## **Targeted Investments: Cleaning the Chesapeake Bay and Rivers Statewide**

In recognition of the costs associated with improving the water quality of the Bay and rivers statewide the Governor has funded a three-fold strategy to meet the state's obligation to reduce nutrients, restore water quality, and to hold down costs on sewer rates for the families and businesses of Virginia served by facilities now required to make upgrades.

Investments include:

1. \$200 million in a cost-sharing program with local, publicly owned treatment plants for point source nutrient reduction projects (92 eligible municipal wastewater treatment plants) in all five river basins within Virginia's portion of the Chesapeake Bay watershed. This funding level will support installation of treatment technologies which will reduce the amount of nitrogen emptied into Virginia's river basins by an estimated 2.6 million pounds per year, or almost two-thirds of the state's 2010 point source goal included in the Chesapeake Bay Agreement of 2000, and as required by regulations adopted by the Virginia State Water Control Board in 2005;
2. \$25 million for grants to local governments located outside the Chesapeake Bay watershed for point source projects (publicly owned treatment works and on-site systems) and the development of comprehensive local and regional wastewater treatment plans, preliminary engineering, and environmental reviews. The area outside the Chesapeake Bay watershed includes all or part of the Planning District Commissions (PDC's 1, 2, 3, 4, 5, 11, 12, 13, 14, and 23) that are mainly south and west of Roanoke as well as large portions of Southside Virginia. Only facilities within the listed PDCs that discharge to water bodies outside the Chesapeake Bay watershed would be eligible for this source of funds; and,
3. \$7.5 million for the combined sewer overflow projects in Richmond and Lynchburg (\$3.75 million each).

This \$232.5 million is in addition to the Virginia Water Quality Improvement Fund mandatory deposits proposed for 2006 and are based on 2005 excess general fund revenues and discretionary year-end general fund balances. The mandatory deposit is \$56.6 million, of which 70 percent (\$39.6 million) will be provided to the Department of Conservation and Recreation for nonpoint source nutrient and sediment reduction grants primarily to farmers and 30 percent (\$17 million) to the Department of Environmental Quality for state of the art point source nutrient reduction projects and point

source projects developed under the public/private partnership act.

## **Targeted Investments: Raising the Bar for Higher Education in Virginia**

Through the recommendation of \$518.9 million in additional general funds for higher education for the biennium, the proposed budget continues progress to expand educational opportunity, provide affordable higher education, meet the needs of a changing economy, and promote quality, with the backdrop of performance accountability for Virginia's higher education institutions.

During the 2005 General Assembly Session, the Governor and the General Assembly crafted groundbreaking legislation giving greater autonomy to higher education institutions, while holding the institutions accountable for providing greater access to higher education for Virginians as well as a quality education that is affordable. The budget provides the necessary investment to allow Virginia's higher education institutions to meet these challenges.

Many colleges and universities are stepping up to the plate to help accommodate an estimated 56,500 additional students seeking places in our public colleges and universities through 2012. The proposed budget provides funding to recognize the enrollment growth these institutions have absorbed, and offers additional support to institutions that are increasing the number of degrees awarded each year. By ensuring that students not only enroll in but also successfully complete their degree programs, these institutions are helping to meet the Governor's goal to yield an additional 10,000 degrees by the end of the decade.

The proposed budget ensures broad access to affordable higher education through student financial aid, including increases in need-based aid to offset tuition hikes at public colleges and universities, increases in Tuition Assistant Grants to help students attending Virginia's independent colleges and universities, and a two-year waiver of out-of-state tuition for military personnel stationed in Virginia and their dependents. Building on funding provided in 2006 for the first time in nearly ten years, new funding is also recommended for graduate student financial aid. In addition to meeting students' financial needs, the funding will help Virginia keep the best and brightest graduate students in the Commonwealth, contributing to our success in research and economic development.

The proposed budget also makes targeted investments in the future of Virginia through funding to enhance Virginia's strengths in research. Funding is provided to bolster Virginia's research facilities, as well as allow for the hiring of top researchers in the fields of biomedical science, biomaterials engineering, nanotechnology, and modeling and simulation. Through these efforts, Virginia can make progress in the search for cures for cancer, diabetes, tuberculosis, Alzheimer's and Parkinson's diseases, and avian flu. Investing in programs that simulate complex human activities, such as the response to a natural disaster or fighting a battle, through computer models will allow both military and civilian

organizations to better plan and prepare for those situations. Besides helping our country, this investment will help stimulate economic development throughout Virginia and allow Virginia to stay economically competitive in an increasingly challenging international economy.

The higher education budget also includes funding for innovative collaborations between local school divisions, community colleges, and universities to help individuals who did not complete high school. The Virginia Community College's successful Middle College is a proven model of providing avenues for individuals ages 18 through 24 to receive the necessary education to complete a high school equivalency degree, thus enhancing their ability to compete for better paying jobs. In addition, funding is included to provide enhanced counseling through on-site Community College advisors in high schools in order to help students recognize their options and the benefits of pursuing higher education.

Additional funding is proposed for faculty salaries, cutting-edge research and resources for engineers and scientists which will help Virginia attract and retain top faculty and continue to excel in the knowledge economy. These investments in higher education will help to make Virginia a Commonwealth of Opportunity – a more prosperous state, with better jobs and a better quality of life for Virginians.

### ***Targeted Investments: Continuing the Progress of Transportation***

Governor Warner's proposed budget provides nearly \$625 million in general fund support for transportation projects and programs in the next biennium. Approximately 46 percent or \$285.5 million of this amount is for ongoing, permanent funding through the dedication of the insurance tax proceeds as called for by the 2000 General Assembly and Governor Warner's 2004 introduced budget. The remaining 54 percent or \$339 million is for one-time, general fund appropriations to support specific transportation investments.

These commitments will continue the financial rehabilitation of Virginia's transportation programs and add key investments in regional mobility and statewide economic development.

The deposit of one-third of the insurance tax proceeds is intended to meet two long-term obligations of the Commonwealth. The amount of insurance tax proceeds attributable to automobile insurance premiums is deposited into the Priority Transportation Fund, where it will effectively relieve the annual debt service burden on the Transportation Trust Fund and allow for new highway, rail, and transit projects across the Commonwealth. The remainder of the insurance tax proceeds is dedicated to the support of mass transit capital. This dedication is the most significant, long-term contribution to transit capital needs in two decades and will allow the Commonwealth to pay approximately half of all eligible transit capital costs for the foreseeable future.

The one-time, general fund investments achieve four goals:

1. Provide the 20 percent match for all earmarked projects in the recently passed federal transportation

bill. Without this funding, these federal earmarks would take funding away from the current six year program, rearrange Virginia's current six year program priorities, and potentially upset the on-time, on-budget commitments of our transportation agencies.

2. Substantially advance or complete major mobility projects that were identified by Congress as national priorities. These include additional Metrorail railcar storage, VRE rolling stock, the I-66 westbound widening inside the Capital Beltway, the I-64/264 interchange, the Rt. 164 rail relocation, a statewide bus purchase, and the Rt. 460 Coalfields Connector project. These projects represent an important convergence of state and federal priorities.

3. Provide a means to bring the economic benefits of the port expansions in Hampton Roads to the Rt. 460 corridor near Prince George and Petersburg, as well as to the Rt. 58 corridor in southside Virginia.

4. Encourage teleworking initiatives by employers to help address congestion problems.

Taken as a whole, these very significant general fund investments complete Governor Warner's commitment to restore financial health and accountability to Virginia's transportation programs, and to begin making smarter, better transportation investments in Virginia's transportation future.

### ***Targeted Investments: Health and Human Resources***

The Governor's budget includes investments aimed at transforming the mental retardation and mental health system, as well as boosting efforts to promote early childhood development, improving the health outcomes of all citizens through Healthy Virginians initiatives, and modernizing health record keeping by encouraging the adoption of electronic health records.

Core funding in this area is provided for increasing caseloads, rising costs, and other priority needs in health and human resources programs. The transformation of the mental health, mental retardation, and substance abuse services system to an integrated community-based system builds on investments made by the Governor and General Assembly during the 2002-2004 biennium.

In this budget, the Governor continues to recognize the need for additional community-based services, while addressing the pressing need to restructure Virginia's facility-based system of care. Existing facilities are poorly designed for those presently served and pose serious health and safety risks to both residents and staff. As part of the restructuring, the Governor will propose separate legislation to fund the capital costs of replacing one mental health facility, Eastern State, and two mental retardation training centers, Central Virginia and Southeastern Virginia. Financing for another mental health facility, Western State Hospital, is authorized in amendments to the 2004-2006 appropriations act. The estimated replacement cost of the four facilities is \$290 million.

The newly constructed facilities will be smaller and will support the Commonwealth's efforts to provide care in the most appropriate setting. The new facilities will better accommodate current residents that tend to have multiple and severe disabilities, which require more specialized facility design and staffing. The transformation initiative also includes \$170 million in targeted funding to allow hundreds of current facility residents and thousands of individuals presently without services to receive care in community-based settings.

Proposed funding for early childhood recognizes the importance of focusing resources on children at a young age to provide the best possible start in life. The Governor has included nearly \$57 million for this purpose. The funding is provided to create an early childhood foundation to address issues facing young children, address the childcare service needs of citizens enrolled in Virginia's Initiative for Employment Welfare activities, eliminate the waiting list for children under six in urgent need of mental retardation waiver services, and increase funding for early intervention services for infants and toddlers.

Improving the health outcomes of all Virginians is also clearly reflected in the Governor's recommendations. The "Healthy Virginians" initiative provides over \$17 million in resources to assist people in improving their health over the long-term. Funding is provided to enhance preventive coverage under the state health insurance program, increase breast, and cervical cancer screenings for women between the ages of 40 through 49, and expand the Comprehensive Health Investment Program which provides home visits to families for medical case management, developmental screenings, and other services to help families improve their overall health. This initiative also includes diagnostic and preventative service incentives for state employees.

The proposed budget recognizes the rising cost of providing health care. Additional funding is recommended to meet enrollment growth and inflation Medicaid. Increased reimbursements rates for physicians, hospitals, and nursing homes are proposed to help those providers better serve Medicaid clients. To improve the quality of health care, the Governor recommends more than \$6 million to initiate an electronic records project.

### ***Targeted Investments: Conserving Energy***

Through executive action in 2006, the Department of Social Services and the Department of Housing and Community Development will utilize over \$17 million general fund dollars to expand both heating assistance and weatherization projects to aid the poor, elderly and disabled. General fund dollars are included now because of the dramatic cost increases in home heating and lack of a federal response to the crisis.

State agencies will do their part in the conservation effort by absorbing approximately ten percent of the increased gasoline costs and thereby reduce discretionary travel. Economic contingency dollars will be used to reduce the number of vehicles on the road carrying state employees to and from

work through incentives for the use of mass transit and car-pooling.

The Department of General Services will replace 150 fleet vehicles with more fuel-efficient vehicles. The cost of the new vehicles is met through fuel savings and reduced travel. However, essential public safety and human services travel will not be affected.

Capital investments totaling \$50 million dollars have been proposed to replace aged and failing infrastructure such as heating, ventilation and air conditioning (HVAC), heating plants, and power plants at state facilities throughout Virginia.

The Department of Mines, Minerals, and Energy will add a technical expert to further facilitate all state agencies use of energy savings performance contracting to reduce energy consumption in state buildings.

Promotion of alternative energy is also a focus, through use of E-85 in state vehicles. Up to \$2 million in manufacturing incentives for a broad range of alternative fuels is recommended.

### ***Targeted Investments: Preserving Natural Areas***

More than \$11 million has been recommended for the preservation of forestlands in Virginia. This funding will allow the Commonwealth to purchase almost 10,000 acres of forest property. The purchase of the Bromley Mountain tract for \$3.6 million will add land in Washington County. This property is a key, intact forest on the crest of Clinch Mountain, and lies between two parcels of land already owned by the Commonwealth. Another tract of land will be purchased for \$7.4 million in Sussex County which will help protect one of the largest pristine forests still existing in Virginia. The Departments of Forestry, Game & Inland Fisheries, and Conservation and Recreation will jointly manage this property.

### ***Meeting Core Commitments: K-12 Education***

The Governor's introduced budget provides over \$1.5 billion in additional state funding for the Commonwealth's elementary and secondary schools. The proposed budget includes \$941.9 million in additional funding for the estimated state cost of the technical rebenchmarking of the Standards of Quality based on approved funding methodologies and increased enrollment. A total of \$167.6 million is recommended for the state share of funding for a three percent salary increase for teachers and other public school employees, effective December 1, 2006, and \$165.9 million is provided for the increased costs of fringe benefits, including teacher retirement.

The budget also distributes \$185.0 million in additional sales tax revenues. Proposed funding contains revised estimates for Lottery proceeds that have been adjusted downward by \$31.4 million for the biennium based on the assumption that the

North Carolina Lottery will be fully operational by 2007. Also included is the biennial recalculation of the composite index that resulted in an increase of \$41.3 million for the biennium.

The budget incorporates an update of student enrollment; based on September 30, 2005, fall membership which results in an increase of \$115.1 million for the biennium. For 2007, the forecast increase in enrollment is 10,786 and for FY 2008, the forecast of students increases by 11,235. The proposed budget includes \$7.8 million for the update for the 2005 Triennial Census Count which reflects an increase of 34,655 school-age children over the 2002 count of school-age population.

Funding is provided to specific categorical and incentive accounts, as well as a number of technical amendments to update enrollment and participation rates in various programs. An additional \$278.7 million in nongeneral fund appropriation is provided primarily to address increased federal grants for No Child Left Behind and school nutrition programs.

### **Meeting Core Commitments: Capital Outlay**

Due to strong fiscal performance and management in the previous biennium, the Governor proposes a return to the conservative Virginia tradition of addressing capital outlay projects primarily on a “pay-as-you-go” basis from current revenues. The proposed capital budget includes \$930.6 million from the general fund to construct, repair, renovate, or maintain state-owned buildings.

The first priority for this funding is to address projected cost overruns in existing funded projects. These overruns are due primarily from price increases in raw materials and outdated cost estimates which were the basis of the original project appropriation. The proposed budget includes \$139.8 million to address these cost overruns.

The next priority is to address previously unfunded equipment and furnishing needs in existing projects that will be completed during the biennium. The proposed budget includes \$38.8 million from the general fund to acquire the needed equipment. Targeted funding has been provided to meet the highest identified priorities for state agencies and institutions of higher education for new construction and renovation.

The remaining funding will address and repair critical infrastructure needs that cannot meet code requirements, cannot be deferred, or are part of an unfunded maintenance reserve backlog. Recently, agencies conducted an assessment of state-owned facilities across the Commonwealth and identified over \$2.0 billion in unfunded maintenance needs of which \$1.6 billion was categorized as critical. This assessment was part of the implementation of the Facility Inventory Condition and Assessment (FICA) system that will be used to track the condition and maintenance needs of all state-owned facilities. A total of \$151.1 million from the general fund is earmarked for unfunded maintenance reserve projects throughout the Commonwealth. This funding, along

with significant specific project funding for repairs and replacements will help address the maintenance needs identified in the assessment.

### **Meeting Core Commitments: Public Employee Compensation**

The Governor’s budget includes an additional \$365 million to increase the salaries of Virginia’s state supported public employees. State employees will receive a three percent increase effective November 25, 2006. In addition, the Governor’s budget authorizes state agencies to utilize an amount equivalent to one-half of one percent of salaries to address retention, recruitment, and reward issues in state agencies.

The Governor has recommended funding for a three percent salary increase effective December 1, 2006, for teachers and other public school employees funded through the Standards of Quality and state supported local employees such as constitutional officers, local social services employees, local election board employees, local health employees, local juvenile justice workers, and Community Services Board employees.

The Governor is recommending \$43.6 million in additional general funds (or \$80.3 million including nongeneral funds) for faculty salary increases for teaching and research faculty. The increases average 3.65 percent across the system, ranging from 2.0 percent to 4.0 percent. This funding will allow institutions to make progress toward meeting the 60th percentile of their peer institutions. This also includes funds for a three percent increase for administrative faculty, graduate teaching assistants, and part-time faculty.

In addition to the salary increase, the introduced budget provides \$71.4 million to cover the general fund share of employee health insurance premiums increases for state employees.

### **Budget Transparency**

The new form and structure of this budget meets a basic commitment to make the budget more understandable. Tremendous effort established a structure to link state spending to specific performance and more clearly demonstrate the results achieved through government spending. Over the past two years, a more refined performance budgeting system has been introduced to accomplish this. This system brings many benefits:

“Service areas” have been constructed as the basic unit of the budget to better describe the activities of government. Obsolete and vague descriptions of agency programs have been replaced with more straightforward language. Likewise, similar activities (for example Administrative Support) in separate agencies now describe these activities in the same language for ease of tracking. Strategic plans have been developed by each agency to clearly identify the goals of the organization – and to explain how these goals align with the overall objectives of the Commonwealth. The Council on

Virginia's Future, created by legislative action in 2003, and has articulated eight overarching principles for state government. These include:

1. Be recognized as the best-managed state in the nation.
2. Be a national leader in the preservation and enhancement of our economy.
3. Engage and inform citizens to ensure we serve their interests.
4. Elevate the levels of educational preparedness and attainment of our citizens.
5. Inspire and support Virginians toward healthy lives and strong and resilient families.
6. Protect, conserve, and wisely develop our natural, historical, and cultural resources.
7. Protect the public's safety and security, ensuring a fair and effective system of justice and providing a prepared response to emergencies and disasters of all kinds.
8. Ensure that Virginia has a transportation system that is safe, enables easy movement of people and goods, enhances the economy, and improves our quality of life.

As each agency crafted its strategic plan, linkages between the agency's mission and goals and the state's objectives had to be demonstrated. Taken as a whole, it is now possible to understand all of state government's efforts that support each statewide objective and to identify those areas that may need additional emphasis or support.

Plans have also been created for each service area, detailing the activities of the agency, identifying who is served by these activities and how much is budgeted to deliver these services. Since agency budgets are now determined at the service area level, it is appropriate that the agency fully describe how that service area supports the overall agency strategic plan. This increased focus allows decision makers and the public to see what activities the agency performs and how much funding it receives in each area.

Quantified measures have been put in place to specify the agency's current and targeted performance levels in each service area. For the first time, Virginians can see not only how much is budgeted for state agencies but also what results the agency plans to achieve in each area.

The quest for transparency is continuing. Each agency's strategic plan and service area plans will soon be published on its website so that all Virginians may readily understand what functions each agency performs, what that performance costs, and how that performance is measured. Additionally, each agency will soon begin providing updates on their progress toward performance target