Commonwealth of Virginia

Office of Governor Bob McDonnell

FOR IMMEDIATE RELEASE
December 17, 2010

Contact: Stacey Johnson
Phone: (804) 225-4260
E-mail: Stacey.Johnson@Governor.Virginia.Gov

Remarks of Governor Bob McDonnell to the Joint Meeting of the Senate Finance, House Appropriations and House Finance Committees

RICHMOND – This morning at 9:30, Virginia Governor Bob McDonnell will address the joint Senate Finance, House Appropriations and House Finance Committees in Richmond. Below are the Governor's remarks as prepared for delivery.

****

Thank you.

Chairman Colgan, Chairman Putney, Chairman Purkey, members of the General Assembly money committees, ladies and gentlemen: good morning. It's like you never left.

On behalf of a grateful Commonwealth, I want to thank you for your ongoing work to ensure that our state remains a national model of fiscal responsibility. Thanks for working with me the past year to navigate our state through the most turbulent economic times in modern history.

While the federal government racks up record deficits and debt, and can't even pass a budget, and numerous states are raising taxes, placing new mandates upon the private sector, and failing to appropriately address their serious challenges, Virginia has taken a different approach.

We faced a $1.8 billion shortfall last session in the concluding FY 2010 budget.

Through conservative revenue re-forecasting, the implementation of a strict hiring freeze, incentivizing state employees to save taxpayer dollars, holding the line on discretionary spending, and a slight uptick in our tax revenues, we turned that shortfall into a $403 million surplus. More importantly, Virginia was able to close the fiscal year with a positive general fund cash balance, which was a marked improvement over the fiscal year 2009 shortfall.
We then confronted a $4.2 billion shortfall in the current FY 11/12 budget.

We rejected proposals to levy the largest tax increase in history on our citizens, and we made the difficult, but necessary, cuts that reduced state spending to 2006 levels. Our state employees have managed well and provided good service with fewer resources.

As I said in my speech to you in August, this fiscal turnaround and budgetary success was achieved by two Administrations, two houses of the General Assembly, and two political parties. Thank you.

Now it will take both parties working together, to ensure that our citizens can work at good paying and rewarding jobs.

Our budgetary outlook hinges largely upon the ability of the private sector to create good jobs. Government can make it simpler for entrepreneurs and job creators to invest and expand, or more complicated. We choose the former.

I am pleased to say that in our first 11 months together we have made it clear that we are wide open for business, and that Virginia's state government is a friend of the free market, small business owners, entrepreneurs, and job creators.

Since the beginning of this Administration, 55,000 net new jobs have been added in the Commonwealth. This ranks Virginia third nationally, behind only Texas and Pennsylvania and 86% of these new jobs were created in the private sector. By contrast, from February 2006 to January 2010, Virginia only ranked 35th nationally in net jobs created.

Our unemployment rate remains well below the national average of 9.8%, at 6.8%, which is the 10th lowest in the nation. However it is still unacceptably and painfully high, with 280,000 Virginians without work heading into the Christmas holidays.

Last year you approved a broad package of legislation and budget amendments to help us recruit the new projects that would land Virginians new jobs. Those initiatives are working.

Some of the job creators, domestic and international, who have come to, or expanded in, Virginia thanks to our new tools, are here with us today.

From Evatran in Wytheville: Todd Hough, President, and Rebecca Hough, Executive Vice President

From Mercury Paper in Shenandoah County, Phillip Rundle, CEO

From Micron Technology in Manassas, Todd House, Government Affairs Manager

Together, these three companies created 357 direct new jobs for Virginians, and millions of dollars in capital investment. We are working tirelessly to replicate their stories all over the state.

Helping the private sector create good paying jobs remains our top goal. You will see that in the budget amendments we are putting forward today.

From our recommended new investments in higher education, to our new job-creation initiatives, to our plan to put $4 billion into transportation over the next three years, it all focuses on getting our economy back on track and our people back to work.

As we worked on the budget amendments, the consensus opinion heard from the Joint Advisory Board of Economists and the Governor's Advisory Council on Revenue Estimates, was that the economy continues to slowly recover, while major uncertainties linger and job growth remains weak.

Thus, I have adopted the standard minus revenue forecast, and the budget projections reflect that caution in the models from the Department of Taxation.

The revised revenue forecast adds $133.9 million in total net revenue in fiscal year 2011, and $149.1 million in fiscal year 2012, for a total of $283 million over the biennium. These projections are consistent with the range provided by the money committees staff in presentations you received at your fall retreats. The conservative upward projections reflect stronger than planned growth in income tax withholding and sales tax revenues; good indicators of an uptick in economic activity.

However, because revenue forecasts have gone up slightly, that does not mean our need to find savings and make state government more efficient has ended. That is why I have called for $191.6 million in cuts, savings, and reprioritization across state government.

It is also why the ongoing work of our Government Reform and Restructuring Commission is crucially important. Through the work of the Commission, and the agency budget submissions of their 2-4-6 percent reduction plans, we have created this budget savings plan. We realize, in these amendments, savings from many sources, including:

- $24 million in reduced interest on bonds for college buildings
- $1.4 million by reducing consultants in the tax department
- Additional savings from reducing administrative expenses in the offices of the Governor, Lieutenant Governor and Attorney General

We will consolidate or eliminate certain agencies, boards and commissions, and reduce payment of dues to organizations. Richmond does not need a monopoly over selling bourbon and vodka, nor do we need to continue to fund public radio and television programming. Richmond needs to build new roads, run great schools and keep Virginians safe and secure.

And just as we push back against the crushing fiscal impact of unfunded mandates from Washington, we are devising on a plan for removing certain unfunded State mandates on localities.

Government must set priorities, encourage cost-savings and frugality, fund core functions well, set the right climate for job creation and economic growth, and then get out of the way.

Addressing unfunded liabilities and core services are at the heart of the amendments I am sending to you today. Our Administration is focused on four top priorities this session: Government Reform, Economic Development, Transportation, and Higher Education. All these are pivotal towards accomplishing our common goal of job creation and economic recovery.

Economic Development

On Wednesday I joined Lieutenant Governor, Bill Bolling to introduce our "Opportunity at Work" proposals. The $54 million in budget amendments are based upon recommendations made by the Governor's Commission on Economic Development and Job Creation created by an Executive Order I signed on Inauguration Day. The detailed report is available online and reflects the best thinking of legislators and major business leaders.

My amendments request $25 million for a technology and research fund to leverage private and federal research dollars to develop and commercialize products resulting from research. Jobs are created both from the research and the products and services generated by this research. We can become a world leader in technology, biotechnology and nano-technology if we invest now.

We have also requested $3 million to support non-credit courses in the Virginia Community College System that will be used to strengthen workforce development efforts, a key to recruiting new businesses.

Our amendments seek new money to recapitalize our small business financing authority, enhance our tourism development and marketing activities, and revitalize and redevelop rural and urban areas.

We also want to develop a Tourism Development Grant & Clean Energy Manufacturing Incentive Grant and certain other tax incentives.

Having traveled to Europe and other states this year asking for business and promoting our great Commonwealth, I see the competition is fierce. Equip us with the tools and we will get results.

Transportation

Virginians understand that our economy will not grow if they cannot move. For years we have underfunded transportation. I've talked a little about bipartisan successes in economic development and budgeting; well transportation funding is a bipartisan failure.

Nearly 2 million Virginia jobs in multiple industries are very dependent on the state's transportation network. Billions have been cut from the Commonwealth Transportation Board's Six-Year Improvement Program---while our population has continued to grow. As a result, almost a quarter of Virginia's major urban roads are congested. Now is the time that we must begin to address this critical challenge.

As I announced last week in Roanoke, I have proposed a $4 billion transportation package over the next few years.

Of that amount, $1.8 billion would come from accelerating the sale of the $3 billion in bonds that you authorized in 2007 in legislation that was overwhelmingly approved by Democrats and Republicans. These bonds are already built into our existing debt capacity. They don't add a penny to the amount of our authorized tax-supported debt, and you have dedicated a revenue stream with the insurance premium tax. Now, we are simply asking to speed up the issuance of those bonds from $300 million to $600 million per year, to capitalize on the best road construction deals and the lowest interest rates we have seen in modern Virginia history. You will not see a better time to get value for the taxpayer than today and we can put our citizens back to work and reduce congestion now.

I know many issues get political around this Square. But I don't think selling bonds that are already authorized, and are already built into our existing debt capacity models, getting the best deals in modern Virginia history, and putting thousands of Virginians to work while doing it, should be that controversial.

We are also proposing legislation to issue up to $1.1 billion in federal GARVEE bonds. These federal anticipation bonds are not state-supported debt, and do not impact our debt capacity at all. We have issued similar debt instruments in the past, as have many other states. And based on the very successful

VDOT audit, we can use toll credits, not state transportation funds, to draw down the federal money, and leverage our resources to build now.

These two proposals are just a couple of the components of our transportation plan, and will maintain Virginia's total 10-year average debt capacity at the self-imposed 5% revenue limit. Further, VDOT has the funds necessary to make these future debt service payments and it will not take money away from other general fund spending areas.

I have also proposed in the budget funding for a new Virginia Transportation Infrastructure Bank or VTIB. This Bank will be capitalized immediately with $400 million derived from $150 million of last year's budget surplus and $250 million from the audit of VDOT, with a goal of $1 billion by the end of our Administration. The additional funds to reach $1 billion will come from the ongoing government reform savings efforts, future surpluses, and other sources. This Bank will provide loans and loan guarantees to private and governmental entities for the construction and capital maintenance of transportation infrastructure and transit systems, based on local and regional priorities.

Lastly, the amended budget appropriates $50 million from the Transportation Trust Fund to recapitalize the Transportation Partnership Opportunity Fund. The Fund provides grants and loans to encourage the development of design-build transportation projects, projects under the Public-Private Transportation Act, and to provide funds to address the transportation aspects of economic development opportunities.

A better transportation system means better jobs.

Education

The journey towards a good paying, rewarding job starts with a good education.

Not enough young people in Virginia have access to a college education, which in turn provides greater access to achieving the American Dream. I am committed to seeing 100,000 more degrees awarded in the Commonwealth over the next 15 years. That would make Virginia one of the most highly educated states in the country. We are good, but we are being eclipsed slowly by other states and nations, especially in the areas of science, technology, engineering, math and health care.

As I announced at Virginia Commonwealth University two weeks ago, in receiving the excellent work of the Governor's Commission on Higher Education Reform, Innovation and Investment, the proposed budget amendments include $50 million towards the goal of making college more affordable and accessible. I'm recommending $13 million for undergraduate financial assistance, $1 million to enhance the use of technology in the classroom, $3 million to expand cost effective online course offerings, and $30 million to increase student enrollment, graduation and retention rates, and degrees in STEM disciplines. And I expect institutions of higher education to identify significant savings to help leverage the $50 million.

Tuitions for Virginia students have doubled in the past ten years, saddling kids and parents with more expenses and debt. This is unacceptable. In the area of tuition assistance, beyond the $13 million for public institutions, we are providing $3 million to increase the average undergraduate tuition assistance grant (TAG) award to Virginia students attending Virginia's private higher education institutions from $2,600 to $2,700. We are also providing $7.8 million in interest and credit card rebates to honor the state's prior written commitments to reward higher education institutions for achieving performance expectations under the recent restructuring agreements.

K-12

Several amendments have been made to K-12 public education funding.

The rate of student enrollment growth is slowing from what had originally been projected. Since public education is largely funded on the basis of per pupil amounts, these reductions in the enrollment forecast will produce savings in the state's share of public education funding of approximately $49.4 million in FY 2011 and $43.0 million in FY 2012.

At the end of FY 2010, public school divisions received an additional $18.7 million from increased sales tax revenue collections. Going forward, the net increase in sales tax dedicated to public education, after the Basic Aid offset, will be an additional $19.5 million in FY 2011 and $21.0 million in FY 2012. That means Virginia school divisions will have $59.2 million in additional net revenue from above from what we originally anticipated in the budget.

It is important to note that since you departed last March, this new state money of $59.2 million and federal money of $249 million has been added to K-12 over the biennium. With our amendments to the budget that I am introducing today, state funding for K-12 over the biennium will increase by $57 million over final FY 2010.

As a result of injecting that new money, I have recommended a policy change to reprogram discretionary spending in FY 2012 to address a priority need in teacher's retirement. At present, $57.6 million had been appropriated in FY 2012 for the 50% Local Composite Index hold harmless. I recommend those funds be reprogrammed to help finance the state's share of a 2% increase in the teacher's retirement rate at an estimated cost of $53.2 million. This action will make the teacher pension system stronger, offsetting future growth in retirement contribution rates and reducing the level of this unfunded liability, estimated to drop to only 57% funded by 2014.

State Employee Compensation and VRS Benefits

As a triple-A bond rated state and national leader on fiscal responsibility, we have to act now to make our Virginia Retirement System solvent for future generations of retirees. Over the past decade, investment losses have occurred more frequently and more dramatically than before. As a result, the funding status of the state employee and teacher retirement plans have fallen dramatically since 2001 and the decline is projected to continue, with the state system only 61% funded by 2014, and the teacher system only 57% funded. VRS has advised us that contribution rates for local school boards and state agencies are likely to more than double in the next biennium. The recent JLARC report showed our state pension system is underfunded by $17.6 billion, and it would take an impossible 44% market return to just maintain the current contribution rates. I will not pass on a broken retirement system to another governor, and I ask for your help in fixing this problem now. I have 22 years invested in this system myself, so I understand what the changes will mean. I also know that without action now, the solvency and future viability of the entire system is at risk.

In these proposed budget amendments and through proposed legislation, we have taken a number of bold steps to ensure the financial health of our retirement system. It will require shared sacrifice from our valued state employees.

In this proposal, over $300 million in additional contributions will be paid into the VRS Trust Fund in fiscal year 2012, resulting in $4.2 billion in new money over ten years. It has been endorsed by the VRS board yesterday.

We will accomplish this by doing the following:

- Increase the state contribution paid on behalf of state employees and teachers for their defined benefit retirement programs by 2 percentage points effective July 1, 2011. We have put an additional $122 million in the budget for this purpose.
- Require state employees hired prior to July 1, 2010, to pay the 5% employee share of contributions for their defined benefit retirement programs administered by VRS effective July 1, 2011, as we did for new employees last session.
- Provide a 3% salary increase for defined benefit enrolled employees hired prior to July 1, 2010, effective July 1, 2011. This will, in effect, mean a 2% net employee contribution to retirement, and a 2% decrease in employee take home pay, but a larger income for calculation of retirement benefits.
- Afford localities the option to require the same 5% local employee share of contributions, but only if such requirement is offset by a 3% or more salary increase.
- Provide the opportunity in December 2011, for a one-time contingent performance incentive bonus to all state employees of up to 2% to offset the reduction in take home pay, tied to end of year spending reductions and employee performance. This will be modeled on the successful 2010 incentive bonus, which helped generate $175 million in year-end savings.
- Reduce the employer contribution for optional retirement plans from 10.4% to 8.5% for employees hired prior to July 1, 2010.
- Redirect current funding to raise paid employer contributions for teachers by 2%, similar to state employees
- Offer a new optional defined contribution plan for all employees effective July 1, 2011.

I know this proposal to require employees to contribute directly to their retirement is a major change, and alters an understanding the legislature had with employees in 1983. However, Virginia's approach to pensions is behind the times and economically unsustainable. Nearly every public and private pension plan in America requires employees to contribute something toward the cost of their retirement plan.

Beyond our three target issues one of the most significant areas of recommendations comes in one of the biggest growth areas in our budget: healthcare.

Healthcare

One of the more challenging areas in state-provided health care today is the rapid and unsustainable growth in Medicaid. JLARC recently reported that over the 25 years from 1985-2010, Medicaid spending grew an astounding 1600%. In FY 2012, Medicaid general fund expenditures are projected to be 157% higher than FY 2000. Medicaid enrollment has increased by 56% from FY 2000 through FY 2010. We need to find ways to contain the two major cost drivers which are enrollment growth and medical inflation.

Additionally, Secretary Hazel has estimated that federal health care reform will cost Virginia close to $2 billion in unfunded mandates through 2022.

The most effective way that Virginia can prepare for future Medicaid growth is to expand managed care and care coordination models to everyone and every service in the program. Expanding managed care will allow for more cost-effective utilization of services and will ensure that public resources are being used responsibly in the most appropriate manner to best serve Medicaid clients. We will implement some of those ideas to generate $3.5 million in savings in the budget.

The traditional managed care model is not the only method to improve the management of care. The Commonwealth is studying various models to improve care coordination and will implement the most appropriate one for the service or population that is being served. The Virginia Health Reform Initiative headed by Secretary Hazel has bipartisan representatives and will have further reform recommendations during the session.

As you know, the Commonwealth's services provided by the Comprehensive Services Act, or CSA, are also growing at an exceptional rate. Programs in the budget that have "sum sufficient" language create a blank check, with little incentive to control costs. As part of our amendments to the budget, I want to outline with you three actions that will help control costs in this area.

In FY 2009, the State Executive Council reclassified Therapeutic Foster Care from a residential service to a "base" match rate service, thereby exempting it from the incentive match rate change. Expenditures have grown significantly. To control costs the budget amendments will equalize the match rates by returning therapeutic foster care to a "residential" service, encouraging localities to continue to use the least restrictive settings for providing care.

In another action, the State Executive Council classified all special education services at the based match rate with the exception of the "Services in the Public School" category. Classifying this service as an education service will return it to an educational status, keeping all services, directly or indirectly related to their education, at the same match rate. These two actions will save $11.5 million annually.

Additionally, I propose that we eliminate all services not mandated by federal or state law, which will result in savings of $5 million to the CSA. Currently, only 60% of all localities have chosen to access these funds.

Behavioral Health and Developmental Services

We must do better in completing the long term plans set out over a decade ago to transition appropriate mental health consumers from institutional to community based settings to improve quality of life and reduce costs.

We have included amendments to the budget to expand behavioral health services for Tidewater/Eastern State Hospital in the amount of $2.4 million to address years-old problems. We also added 275 intellectual disability waiver slots at a cost of nearly $10 million in general and non-general funds.

This budget invests $11.4 million to address community service deficiencies and crisis intervention programs identified by the Inspector General. We also added $5.2 million in the Hancock Geriatric Center to replace federal funds that were lost when the Center was decertified from the Medicaid program due to issues occurring over recent years. We are working diligently at Hancock Geriatric to resolve longstanding problems necessary for recertification. Lastly, at a cost of $2 million, we will maintain the operation of the Southwestern Virginia Mental Health Institute geriatric unit. These new investments of $30 million will help improve the safety net for the most vulnerable in our society.

VITA

We have also proposed amendments to help address inadequate transfer payments to the Virginia Information Technologies Agency. VITA has lost $56 million between FY2007-FY2010, an average of $14 million per year, due to the long-standing under-recovery of costs caused by an absence of an accurate inventory baseline, and the consequent inability to produce agency bills reflecting customers' total consumption of IT services. In short, for four previous years VITA has been providing services and not billing for and recovering adequate costs to cover its expenses.
As a result of VITA's new information technology rates approved by JLARC and implemented on July 1, 2010, I am requesting the transfer of funds to and from certain impacted agencies to fix this old problem and cover unbudgeted changes in costs resulting from these new rates. Overall, an additional $28.1 million is needed for FY 2011 and up to $30.2 million for FY 2012.
It is important to understand that neither VITA's new rates themselves, nor our recent amendment last spring to the Northrop Grumman contract, are the major source of the significant increase in this area. For years, state agencies have simply failed to adequately pay for their services. Now, we are taking the required steps to cure the historical underfunding of agencies' IT requirements.

Even with these adjusted rates, the Commonwealth's annual expenditure on IT infrastructure services represents less than 2% of total executive branch agency expenditures. Our IT infrastructure costs are well below most other public and private-sector organizations of similar size.
On a positive note, in the past year VITA has reduced its budget and expenses for overhead by $3.75 million or 15% of the total, with additional organizational streamlining and savings underway. As a result, VITA is reducing its position level from 371 to 321 – a net reduction of 50 positions for FY 2012. At the same time, management of service delivery and customer satisfaction is being enhanced. Nonetheless, there is much improvement still to be made, and we will pursue our appropriate contract remedies after the joint Administration/JLARC consultant study of the summer computer outage is completed.

<u>Other Actions</u>

In this tough economy I am pleased to report that we have identified state funding for a number of other, effective organizations and programs as follows:

- $500,000 for The Federation of Virginia Food Banks to bolster the safety net in this tough economy
- $5 million for Eastern Virginia Medical School, the lowest funded medical school in Virginia
- $1 million for The Children's Hospital of The King's Daughters, which has by far the highest hospital Medicaid rate in the state
- $5 million for VCU's Massey Cancer Center to help bring it up to the top tier of America's cancer research centers
- $36.4 million of the FY2010 surplus to be deposited into the Water Quality Improvement Fund, to help fund the Watershed Improvement Plan to significantly reduce pollution in the Bay
- $5.4 million increase to the criminal fund to help pay court costs for indigent defendants in criminal cases.
- $6 million in FY 2012 to funding three new State Trooper Schools and maintain the new Statewide Agencies Radio System (STARS).
- $6.7 million in funding for the repair and renovation of many outdated National Guard armories.
- $1.7 million to fill longstanding priority judicial vacancies

- $24 million for the Sexually Violent Predator program due to a dramatic increase in the number of individuals civilly committed who need bed space

- $1.9 million to support the Fort Monroe Authority's work to receive back this historic Fort from the federal government in FY 12

Conclusion

This is a challenging time for all of us in our great Commonwealth. Such times require tough decisions, and a demonstration to our 8 million citizens that we care about making things better for them.

What Virginians want to know, what they want to see, is that Richmond will not be making their challenges more difficult. In short, that we get it.

The government I'm committed to running with you is one that performs its core functions well, does not reach into areas where it is not useful, and helps facilitate private sector job creation and economic growth. I believe our budget amendments are consistent with these goals, and help facilitate a more prosperous Virginia and move us closer to a true "Commonwealth of Opportunity."

We will attract new job creators and make it easier for existing ones to expand, and that will grow our economy.

We will build roads, and that will grow our economy.

We will expand access to and lower the cost of higher education and that will grow our economy.

We will *not* raise taxes, and that will grow our economy.

I know 2011 is an election and redistricting year, which often creates an environment of intense partisanship. I ask you to evaluate these proposals on their merits, by looking to the next generation, not the next election.

We all know, from our travels, our work, our families and our friends, that many Virginians are still hurting from an uncertain and sluggish economy. This year, more than ever, they want results, not rhetoric, from Richmond.

I thank you for your time today, and look forward to working with all of you in the months ahead to get things done with a sense of urgency and civility.

Thank you, Merry Christmas, and God Bless you and your families.

###