TO: Executive Branch Agency Heads
CC: Cabinet Secretaries
FROM Clark Mercer, Chief of Staff

SUBJECT: Next steps for your agency’s budget

You will not be surprised to receive this memo: Governor Northam is directing state agencies to begin taking immediate action to reduce spending and find ways to pay for the unbudgeted costs of responding to COVID-19.

BACKGROUND
The virus has brought us challenges that our society has not faced in generations. Events are unfolding quickly and require us to prepare for a new reality that is drastically different from what was certain just a few weeks ago.

Our financial profile was strong at the end of February. Total general fund revenue grew 6.2% year-to-date, well ahead of the annual forecast of 3.2%. This supported a robust revenue forecast for the next two budget years. So the General Assembly used that information to pass a budget that advanced the Governor’s priorities and others, based on work that you accomplished.

New circumstances now require us to revisit those decisions.

One month later, we can expect to enter a recession soon. The fundamental assumptions behind our budget show why. To assemble it last fall, we turned to groups for economic advice: the Joint Advisory Board of Economists and the Governor’s Advisory Council on Revenue Estimates. We presented two economic options to these economists and business leaders: The “basic option,” and the “pessimistic option.” The second option reflected a slower growth during the next two-year budget cycle. This “pessimistic” option forecasted revenues to come in about $1.8 billion LESS than the plan the General Assembly used to write its 2020-2022 budget.

We can now expect to yield significantly less revenue than even our most pessimistic forecast before.
Our intention is not to cut the budget in the short term, but decisions will depend on how much revenue comes in. It’s important to remember that, through careful planning, the Commonwealth was projecting to end the fiscal year with a large surplus cash balance. Because those balances are expected, they are already programmed into the budget for the 2020-2022 biennium that begins July 1. Consequently, any reduction in these anticipated balances will have to be addressed with reductions in FY 2021 general fund spending.

And now, we have to pay for COVID-19 too.

We are taking immediate steps to respond to this public health crisis. We are expanding testing, buying personal protective equipment, investing in needed hospital space, helping vulnerable populations who can least afford the impacts of this virus, and much more. This includes protecting healthcare workers and supporting workers and businesses through economic uncertainty. All of this will cost the Commonwealth extraordinary sums not reflected in the budget passed last month. We are also reviewing recent federal legislation that might help us alleviate some of these emerging budget pressures, but we cannot rely upon temporary federal funding to address our ongoing budget concerns.

NEXT STEPS

The Governor has directed me to begin taking immediate action to reduce spending and to generate savings to help pay for the unbudgeted costs of COVID-19. The following steps will begin immediately. I am directing the Department of Planning and Budget to work with each of you to develop the necessary steps for your agency to comply with the following measures:

- **Eliminate discretionary spending for the remainder of the current fiscal year.** DPB will issue guidance for you to identify the amount of unexpended general fund appropriations that will remain in your agency as a result of doing this. If economic circumstances permit, the Governor’s intent is to allow a portion of the unexpended discretionary general fund balances that you identify from the current fiscal year to be pledged toward general fund budget reductions in FY 2021.

- **Prepare for budget reductions in the next biennium.** The Governor and the General Assembly leadership are discussing the range of actions that must be taken to address this. The total impact is not yet known, and it may not be known for several months. You may be asked to submit budget reduction strategies for the next biennium at some point in the future. You need to consider this possibility before you incur any discretionary expenditures or continue discretionary contracts or commitments in the next biennium.

- **Re-examine funding for new initiatives.** Before reducing current services levels, all new spending will be examined to determine if it has a higher priority than current services. For this reason, you should be cautious when communicating with localities and constituent groups that are scheduled to benefit from the increased spending proposed in the budget passed by the General Assembly. While no decisions have been made, we must be honest with these groups about the challenges we face and the effects they will have on the Commonwealth’s spending capacity. It is better to know the risks now, than to gear-up new programs, learn that there’s no money, and then have to close them down.
• **Avoid new commitments.** This should be obvious. Until the budget has been finalized and signed into law, no agency should sign contracts or obligate itself to commitments that depend on new appropriations. Further, until decisions are made regarding the potential need for budget reductions, agencies should avoid creating new commitments of resources.

• **Hiring and Compensation Actions.** A hiring freeze shall take effect immediately for all classified and wage positions other than those listed in § 4-7.01(e) (Manpower Control Program) of the 2019 Virginia Acts of Assembly, Chapter 854. Hiring of positions exempted in § 4-7.01(e) must be approved in advance by the appropriate Cabinet Secretary. Under extraordinary circumstances, an agency head may request to recruit and fill a position that is absolutely essential to the function and mission of the applicable agency that would otherwise be barred by the hiring freeze. Agency heads must certify that the position meets this test, provide details regarding the impact on the agency if approval to fill the position is denied, and explain how the position will be funded. All hiring requests under these circumstances must be approved in advance by the Cabinet Secretary. This policy affects any offers of employment made after this date. All actions that result in increased personnel cost must be approved in advance by each Cabinet Secretary. This includes promotions, in-band adjustments, voluntary transfers and other pay actions. Exceptional incentive options offered to attract and retain specific positions may be approved in advance along with the guidelines for their intended use by the Cabinet Secretary.

Budget reduction targets will be established only after revenues have been reforecast and the total need is determined. But you should begin preparing for the potential budget reductions that may be required in the next two-year budget cycle. Here is how you can do that:

• **Identify low priority or underperforming activities.** You did this in a special exercise last October, but the strong economy kept us from having to act on those recommendations. So now, you should ask about every activity, “Is this the government’s job?” It is time to consider whether your agency should continue to provide all the services it now provides. You should examine lower priority activities to determine if they can be eliminated, rather than simply reduced.

• **Avoid one-time savings.** The emphasis is to take actions that would provide ongoing long-term reductions, rather than one-time savings. Proposals for one-time actions to balance the budget in FY 2021 will be considered, but you should limit the use of such proposals to the bare minimum and avoid if at all possible for FY 2022.

• **OK to include costs to achieve savings.** It is permissible for an agency to consider individual strategies that include up-front costs to achieve long-time savings. However, agencies must be able to show an overall net savings (from all their strategies) that will meet the required reduction targets for each of the two years.

• **Savings must be against your agency’s general fund appropriation.** Agencies cannot count saving strategies in other agencies against their target. Any such savings ideas, however, are welcome and should be communicated to the appropriate cabinet secretary.
• **Do not transfer costs to another agency.** Agencies should not propose savings that transfer or create additional cost for another agency. This would include proposals to eliminate payments to central agencies for central services such as rent or VITA services.

• **Do not close the “Washington Monument.”** It’s not wise to propose eliminating or curtailing core services, just to try to head off reductions to your agency. (A federal agency once proposed closing the Washington Monument, in hopes that people would protest and protect the agency from budget reductions. The tactic backfired.) The “Washington Monument Syndrome,” is not acceptable. If you propose something like this, you will have to come up with a new plan, resubmit it, and wait.

• **Focus on overall savings to the state.** Do not propose to save money by driving up costs for another agency. This may help you, but it does not result in overall savings to the Commonwealth.

• **Evaluate current budget spending and cash flow.** Agencies with immediate budget concerns are to notify their respective Cabinet Secretary and review financial concerns with staff at the DPB prior to any workforce impacts.

• **Remember that layoffs generate costs.** It may cost more money to lay people off, due to the severance benefits required under the Workforce Transition Act of 1995, as well as payment of any leave balances that employees may be eligible for. The Department of Human Resources can teach you more about:
  
  - Policy 1.30 – Layoffs
  - Policy 1.57 – Severance Benefits
  - Policy 1.65 – Temporary Workforce Reduction

  Here are policies and other information about layoffs: https://www.dhrm.virginia.gov/hrpolicies

As you consider these issues, I encourage you to meet soon with your Cabinet Secretary to begin talking about your agency’s operations and potential budget reduction plans. Please contact your DPB budget analyst if you have questions or need additional information.

These uncertain times will force us all to operate much differently in the future. Everything will change. In time, things will return to a new “normal”—and until then, we must summon all of our patience, creativity, and energy to preserve the most critical functions of government.

The Governor and I know we can count on each of you to do your part. Thank you for your dedication and service to the people of Virginia.