

# Management's Discussion and Analysis

## (Unaudited)

The following is a discussion and analysis of the Commonwealth of Virginia's (the Commonwealth) financial performance, including an overview and analysis of the financial activities of the Commonwealth for the fiscal year ended June 30, 2016. Readers should consider this information in conjunction with the transmittal letter, which is located in the Introductory Section of this report, and the Commonwealth's financial statements, including the notes to the financial statements, which are located after this analysis.

### Financial Highlights

#### Government-wide Highlights

The primary government's assets and deferred outflows of resources exceeded its liabilities and deferred inflows of resources at June 30, 2016, by \$21.7 billion. Net position of governmental activities increased by \$569.0 million and net position of business-type activities increased by \$206.8 million. Component units reported an increase in net position of \$283.5 million from June 30, 2015.

#### Fund Highlights

At the end of the fiscal year, the Commonwealth's governmental funds reported a combined ending fund balance of \$3.7 billion, a decrease of \$744.1 million in comparison with the prior year. Of this total fund balance, \$307.1 million represents nonspendable fund balance, \$1.6 billion represents restricted fund balance, \$2.5 billion represents committed fund balance, and \$29.3 million represents assigned fund balance. These amounts are offset by a negative \$709.3 million unassigned fund balance. The Enterprise Funds reported net position at June 30, 2016, of \$1.6 billion, an increase of \$214.3 million during the year which is primarily attributable to the Unemployment Compensation Fund and the Virginia College Savings Plan. See page 33 for additional information.

The General Fund recognized higher fund revenues and expenditures, as well as lower assets and deferred outflows of resources and liabilities and deferred inflows of resources when compared to fiscal year 2015. See page 34 for additional information.

#### Long-term Debt

The Commonwealth's total debt rose during the fiscal year to \$42.8 billion, an increase of \$873.0 million, or 2.1 percent. During the fiscal year, the Commonwealth issued new debt in the amount of \$409.0 million for the primary government and \$3.8 billion for the component units. These debt issuances, coupled with debt retirements, decreased the debt balances to \$14.5 billion for the primary government and increased the debt balances to \$28.3 billion for component units.

### Overview of the Financial Statements

This discussion and analysis is an introduction to the Commonwealth's basic financial statements, which include three components: 1) government-wide financial statements; 2) fund financial statements; and 3) notes to the financial statements. The report also contains additional required supplementary information and other information.

#### Government-wide Statements

The government-wide financial statements are designed to provide readers with a broad overview of the Commonwealth's finances in a manner similar to a private-sector business. The statements provide both short-term and long-term information about the Commonwealth's financial position which helps readers determine whether the Commonwealth's financial position has improved or deteriorated during the fiscal year. These statements include all non-fiduciary financial activity on the full accrual basis of accounting. This means that all revenue and expenditures are reflected in the financial statements even if the related cash has not been received or paid as of June 30.

The Statement of Net Position (pages 40 and 41) presents information on all of the Commonwealth's assets and deferred outflows of resources, and liabilities and deferred inflows of resources; net position represents the difference between all other elements in a statement of financial position and is displayed in three components – net investment in capital assets; restricted; and unrestricted. Over time, increases or decreases in net position may indicate whether the financial position of the Commonwealth is improving or deteriorating.

The Statement of Activities (pages 42 through 44) presents information showing how the Commonwealth's net position changed during fiscal year 2016. All changes in net position are reported as soon as the underlying event giving rise to the change occurs, regardless of the timing of related cash flows. Thus, revenues and expenses are reported in this statement for some items that will only result in cash flows in future fiscal periods (e.g., uncollected taxes and earned but unused vacation leave).

Both the Statement of Net Position and Statement of Activities report three separate activities. These activities are described as follows:

**Governmental Activities** – account for functions of the Commonwealth that are primarily supported by taxes and intergovernmental revenues. The majority of the Commonwealth’s basic services, such as education, individual and family services, transportation, resources and economic development, administration of justice, and general government, fall within this category.

**Business-type Activities** – account for functions that are intended to recover all or a significant portion of their costs through user fees and charges. The major business-type activities of the Commonwealth include the Virginia Lottery, Virginia College Savings Plan, and Unemployment Compensation Fund.

**Discretely Presented Component Units** – account for functions of legally separate entities for which the Commonwealth is financially accountable. The Commonwealth has 26 non-higher education component units and 22 higher education institutions that are reported as discretely presented component units. Information regarding the individual financial statements of the component units is presented in the notes to the financial statements.

This report includes two schedules (pages 48 and 52) that reconcile the amounts reported on the governmental fund financial statements (modified accrual accounting) with governmental activities on the appropriate government-wide statements (full accrual accounting). The following indicates some of the reporting differences between the government-wide financial statements and the fund financial statements.

- Capital assets used in governmental activities are not reported on governmental fund statements.
- Long-term liabilities, unless due and payable, are not included in the fund financial statements. These liabilities are only included in the government-wide statements.
- Internal service funds are reported as governmental activities in the government-wide statements, but are reported as proprietary funds in the fund financial statements.
- Other long-term assets that are not available to pay for current period expenditures are deferred in the governmental fund statements, but not deferred in the government-wide statements.
- Capital outlay spending in capital assets on the government-wide statements, but is reported as expenditures in the fund financial statements.
- Bond proceeds provide current financial resources on the fund financial statements, but are recorded as long-term liabilities in the government-wide financial statements.

## Fund Financial Statements

A fund is a grouping of related accounts that is used to maintain control over resources that have been segregated for specific activities or objectives. The Commonwealth, like other state and local governments, uses fund accounting to ensure and demonstrate compliance with finance-related legal requirements. All of the Commonwealth’s funds can be divided into three categories: governmental, proprietary, and fiduciary. Each of these categories uses different accounting approaches. Fund financial statements begin on page 46 and provide detailed information about the major individual funds.

- **Governmental funds** – Most of the basic services provided by the Commonwealth are reported in the governmental funds. These statements provide a detailed, short-term view of the functions reported as governmental activities in the government-wide financial statements. The government-wide financial statements are reported using the full accrual basis of accounting, but the governmental fund financial statements are reported using the modified accrual basis of accounting. This allows the reader to focus on assets that can be readily converted to cash and determine whether there are adequate resources to meet the Commonwealth’s current needs.

Because the focus of governmental funds is more limited than that of the government-wide financial statements, it is useful to compare the information presented for governmental funds with similar information presented for governmental activities in the government-wide financial statements. This comparison can help readers better understand the long-term impact of the Commonwealth’s near-term financing decisions. Both the governmental fund balance sheet and the governmental fund statement of revenues, expenditures, and changes in fund balances provide a reconciliation to facilitate this comparison between governmental funds and governmental activities. These reconciliations are presented on the page immediately following each governmental fund financial statement.

The Commonwealth reports 12 individual governmental funds. Information is presented separately in the governmental fund statements for the General, Commonwealth Transportation, Federal Trust, and Literary funds, which are all considered major funds. Data from the other 8 governmental funds are aggregated into a single column on the fund statements. Individual fund data for these nonmajor governmental funds is provided in the combining financial statements immediately following the required supplementary information.

- **Proprietary funds** – The Commonwealth maintains two different types of proprietary funds, enterprise and internal service. These funds report activities that operate more like those of private-sector business and use the full accrual basis of accounting. Enterprise funds report activities that charge fees for supplies or services to the general public like the Virginia Lottery. Enterprise funds are reported as business-type activities on the government-wide financial statements.

The enterprise funds use the full accrual basis of accounting and the only differences between amounts reported on the government-wide statements and the enterprise fund statements are due to internal service fund activity (see reconciliations on pages 54 and 56). Internal service funds report activities that charge fees for supplies and services to other Commonwealth agencies, like Fleet Management. Internal service funds are reported as governmental activities in the government-wide statements because these types of services predominantly benefit governments rather than business-type functions.

The Commonwealth reports 24 individual proprietary funds. Information is presented separately in the proprietary fund statements for the Virginia Lottery, Virginia College Savings Plan, and Unemployment Compensation Funds, all of which are considered major funds. Data from the other enterprise funds are aggregated into a single column on the fund statements. All internal service funds are aggregated into a single column on the fund statements. Individual fund data for all nonmajor proprietary funds is provided in the combining financial statements immediately following the required supplementary information.

- **Fiduciary funds** – These funds are used to account for resources held for the benefit of parties outside the government and use the full accrual basis of accounting. Fiduciary funds are excluded from the government-wide financial statements because the resources of these funds are restricted and cannot be used to finance the Commonwealth's operations. The Commonwealth's fiduciary activities are reported in separate Statements of Fiduciary Net Position and Changes in Fiduciary Net Position beginning on page 64.

The Commonwealth's fiduciary funds are the:

- Private Purpose Trusts, which reports the activities for 7 separate funds and accounts for transactions of trust arrangements in which the principal and income benefit individuals, private organizations, or other governments;
- Pension and Other Employee Benefit Trusts, which reports the activities of 13 separate pension and other employment retirement plans for employees;
- Investment Trust, which accounts for the activities of the external investment pool; and,
- Agency, which accounts for assets held on behalf of others in 20 separate funds.

Individual fund data for all fiduciary funds is provided in the combining financial statements immediately following the required supplementary information.

- **Component Units** – The government-wide financial statements report information for all component units aggregated in a single column. Information is provided separately in the component unit fund statements for the Virginia Housing Development Authority, Virginia Public School Authority, Virginia Resources Authority, and Virginia College Building Authority, all of which are considered major component units. Data from the other component units are aggregated into a single column on the fund statements. Individual fund data for all nonmajor component units is provided in the combining financial statements immediately following the required supplementary information.

## Notes to the Financial Statements

The notes provide additional information that is essential to a full understanding of the data provided in the government-wide and fund financial statements. The notes to the financial statements can be found immediately following the component unit fund financial statements.

## Required Supplementary Information

The basic financial statements are followed by a section of required supplementary information. This section includes budgetary comparison schedules reconciling the statutory and generally accepted accounting principles fund balances at June 30. It also includes information concerning the Commonwealth's funding progress and employer contributions for pension and other postemployment benefits and changes in employers' net pension liability, as well as trend information for Commonwealth-managed risk pools.

## Other Information

The combining statements referred to earlier in connection with nonmajor funds and component units can be found beginning on page 201 of this report. The individual fund information is aggregated into a single total on the combining financial statements, which carries forward to the fund financial statements.

## Government-wide Financial Analysis

The primary government's assets and deferred outflows of resources exceeded its liabilities and deferred inflows of resources by \$21.7 billion during the fiscal year. The net position of the governmental activities increased \$569.0 million, or 2.9 percent, primarily due to increases in capital assets and deferred outflows of resources offset by increases in total liabilities and deferred inflows of resources. Capital assets are discussed further on page 35, the long-term liabilities are discussed further on page 36, and deferred inflows and outflows of resources are discussed in Note 13, "Deferred Outflows and Deferred Inflows of Resources." Business-type activities had an increase of \$206.8 million, or 15.0 percent, primarily due to an increase for the Unemployment Compensation Fund and Virginia College Savings Plan as discussed on page 33. As discussed in Note 2, the government-wide beginning balance was restated predominantly for a change in investment liquidation management strategy for the Literary Fund and the correction of prior year errors to arrive at a restated beginning balance of \$20.9 billion.

**Figure 11**  
**Net Position as of June 30, 2016 and 2015**  
(Dollars in Thousands)

	Governmental Activities		Business-type Activities		Total	
	2016	2015 as restated	2016	2015	2016	2015 as restated
Current and other assets	\$ 8,760,492	\$ 9,394,081	\$ 4,220,594	\$ 4,425,736	\$ 12,981,086	\$ 13,819,817
Capital assets	30,415,387	29,357,553	38,319	40,227	30,453,706	29,397,780
Deferred outflow s of resources	731,279	507,048	17,903	13,438	749,182	520,486
Total assets and deferred outflow s of resources	39,907,158	39,258,682	4,276,816	4,479,401	44,183,974	43,738,083
Long-term liabilities outstanding	12,157,996	11,953,821	2,346,500	2,736,277	14,504,496	14,690,098
Other liabilities	5,059,991	4,841,326	334,095	342,291	5,394,086	5,183,617
Deferred inflow s of resources	2,574,935	2,918,314	9,967	21,371	2,584,902	2,939,685
Total liabilities and deferred inflow s of resources	19,792,922	19,713,461	2,690,562	3,099,939	22,483,484	22,813,400
Net position:						
Net investment in capital						
assets	24,308,954	23,416,290	32,960	34,519	24,341,914	23,450,809
Restricted	1,365,260	1,585,961	1,044,558	845,213	2,409,818	2,431,174
Unrestricted	(5,559,978)	(5,457,030)	508,736	499,730	(5,051,242)	(4,957,300)
Total net position	\$ 20,114,236	\$ 19,545,221	\$ 1,586,254	\$ 1,379,462	\$ 21,700,490	\$ 20,924,683

The largest portion of the primary government's net position reflects its investment in capital assets (e.g., land, buildings, equipment, infrastructure, construction-in-progress, and intangible assets including water rights, easements and software), less any related outstanding debt and deferred inflows of resources used to acquire those assets. These assets are recorded net of depreciation in the financial statements. The primary government uses these capital assets to provide services to citizens; therefore, these assets are not available for future spending. Although the primary government's investment in its capital assets is reported net of related debt, it should be noted that the resources needed to repay this debt must be provided from other sources, since the capital assets themselves cannot be used to liquidate these liabilities (**Figure 11**). The governmental activities net investment in capital assets amount exceeds total net position due to a negative unrestricted net position amount unrelated to capital assets.

An additional portion of the primary government's net position represents restricted net position. These resources are subject to external restrictions or constitutional provisions specifying how they may be used. The remaining balance of negative \$5.1 billion is unrestricted net position (**Figure 11**).

Approximately 55.9 percent of the primary government's total revenue came from taxes. While the primary government's expenses cover many services, the largest expenses are for education and individual and family services. General revenues normally fund governmental activities. For fiscal year 2016, governmental expenses exceeded program and general revenues by \$218.4 million. Program revenues exceeded expenses from business-type activities by \$984.0 million. The following condensed financial information (**Figure 12**) was derived from the Government-wide Statement of Activities and provides detail regarding the change in net position (see page 42).

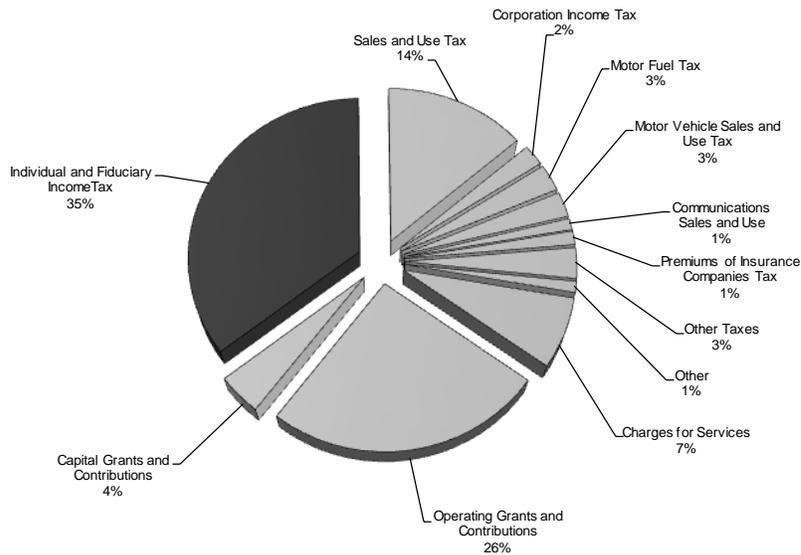
**Figure 12**  
**Changes in Net Position for the Fiscal Years Ended June 30, 2016 and 2015**  
(Dollars in Thousands)

	Governmental Activities		Business-type Activities		Total	
	2016	2015 as restated	2016	2015	2016	2015 as restated
Revenues:						
Program Revenues:						
Charges for Services	\$ 2,567,716	\$ 2,543,208	\$ 4,069,063	\$ 3,953,679	\$ 6,636,779	\$ 6,496,887
Operating Grants and Contributions	9,147,407	9,064,631	430	183	9,147,837	9,064,814
Capital Grants and Contributions	1,466,927	1,618,761	-	-	1,466,927	1,618,761
General Revenues:						
Taxes:						
Individual and Fiduciary Income	12,685,001	12,265,530	-	-	12,685,001	12,265,530
Sales and Use	4,993,762	4,829,677	-	-	4,993,762	4,829,677
Corporation Income	772,639	801,165	-	-	772,639	801,165
Motor Fuel	975,851	888,348	-	-	975,851	888,348
Motor Vehicle Sales and Use	909,617	846,197	-	-	909,617	846,197
Communications Sales and Use	405,576	416,051	-	-	405,576	416,051
Deeds, Contracts, Wills, and Suits	470,644	440,896	-	-	470,644	440,896
Premiums of Insurance Companies	485,018	453,376	-	-	485,018	453,376
Alcoholic Beverage Sales	147,813	139,832	-	-	147,813	139,832
Tobacco Products	176,401	178,954	-	-	176,401	178,954
Estate	175	92	-	-	175	92
Public Service Corporations	108,158	118,849	-	-	108,158	118,849
Beer and Beverage Excise	43,185	42,719	-	-	43,185	42,719
Wine and Spirits/ABC Liter	26,442	26,253	-	-	26,442	26,253
Bank Stock	17,796	19,030	-	-	17,796	19,030
Other Taxes	118,288	112,368	9,141	9,142	127,429	121,510
Unrestricted Grants and Contributions	48,031	48,613	-	-	48,031	48,613
Investment Earnings	63,397	15,970	900	1,603	64,297	17,573
Miscellaneous	281,562	205,625	175	243	281,737	205,868
<b>Total Revenues</b>	<b>35,911,406</b>	<b>35,076,145</b>	<b>4,079,709</b>	<b>3,964,850</b>	<b>39,991,115</b>	<b>39,040,995</b>
Expenses:						
General Government	3,229,507	3,267,158	-	-	3,229,507	3,267,158
Education	10,178,231	9,845,532	-	-	10,178,231	9,845,532
Transportation	4,528,605	4,369,089	-	-	4,528,605	4,369,089
Resources and Economic Development	1,007,607	970,545	-	-	1,007,607	970,545
Individual and Family Services	14,024,213	13,271,422	-	-	14,024,213	13,271,422
Administration of Justice	2,921,635	2,746,146	-	-	2,921,635	2,746,146
Interest and Charges on Long-term Debt	240,007	223,584	-	-	240,007	223,584
Virginia Lottery	-	-	1,415,154	1,299,753	1,415,154	1,299,753
Virginia College Savings Plan	-	-	103,307	155,331	103,307	155,331
Unemployment Compensation	-	-	390,441	431,437	390,441	431,437
Alcoholic Beverage Control	-	-	614,641	579,945	614,641	579,945
Risk Management	-	-	14,281	10,240	14,281	10,240
Local Choice Health Care	-	-	411,656	349,910	411,656	349,910
Route 460 Funding Corporation of Virginia	-	-	1,461	13,024	1,461	13,024
Virginia Industries for the Blind	-	-	41,860	42,722	41,860	42,722
Consolidated Laboratory	-	-	10,016	8,630	10,016	8,630
eVA Procurement System	-	-	22,573	22,563	22,573	22,563
Department of Environmental Quality Title V	-	-	11,135	10,444	11,135	10,444
Wireless E-911	-	-	41,851	36,804	41,851	36,804
Museum and Library Gift Shops	-	-	6,676	6,618	6,676	6,618
Behavioral Health Canteen and Work Activity	-	-	451	466	451	466
<b>Total Expenses</b>	<b>36,129,805</b>	<b>34,693,476</b>	<b>3,085,503</b>	<b>2,967,887</b>	<b>39,215,308</b>	<b>37,661,363</b>
Excess/(Deficiency) before transfers	(218,399)	382,669	994,206	996,963	775,807	1,379,632
Special Item	-	(134,561)	-	34,437	-	(100,124)
Transfers	787,414	728,371	(787,414)	(728,371)	-	-
Increase in net position	569,015	976,479	206,792	303,029	775,807	1,279,508
Net position, July 1, as restated	19,545,221	18,568,742	1,379,462	1,076,433	20,924,683	19,645,175
Net position, June 30	\$ 20,114,236	\$ 19,545,221	\$ 1,586,254	\$ 1,379,462	\$ 21,700,490	\$ 20,924,683

**Governmental Activities Revenues**

**Figure 13** is a graphical representation of the Statement of Activities revenues for governmental activities. Governmental activities revenues increased by \$835.3 million, or 2.4 percent. The net increase is mainly attributable to increases in the General Fund, which are discussed on page 34.

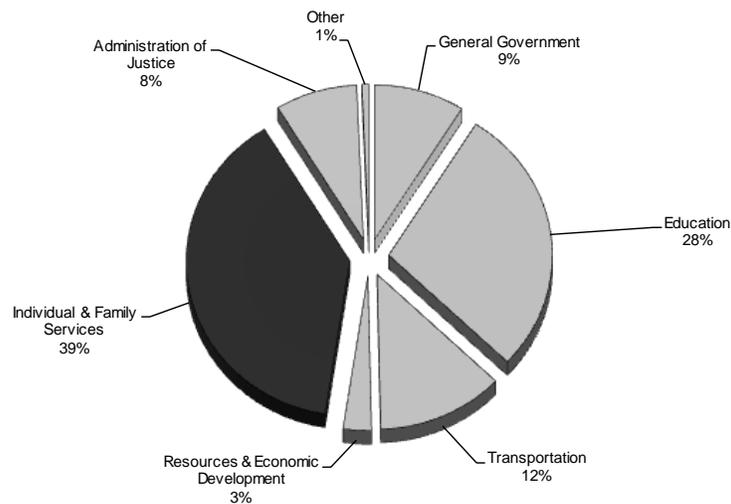
**Figure 13**  
**Revenues by Source – Governmental Activities**  
 Fiscal Year 2016



**Governmental Activities Expenses**

**Figure 14** is a graphical representation of the Statement of Activities expenses for governmental activities. Governmental activities expenses increased by \$1.4 billion, or 4.1 percent. This change is primarily attributable to increases in all expense types with the exception of General Government. See pages 34 and 35 for additional information.

**Figure 14**  
**Expenses by Type – Governmental Activities**  
 Fiscal Year 2016



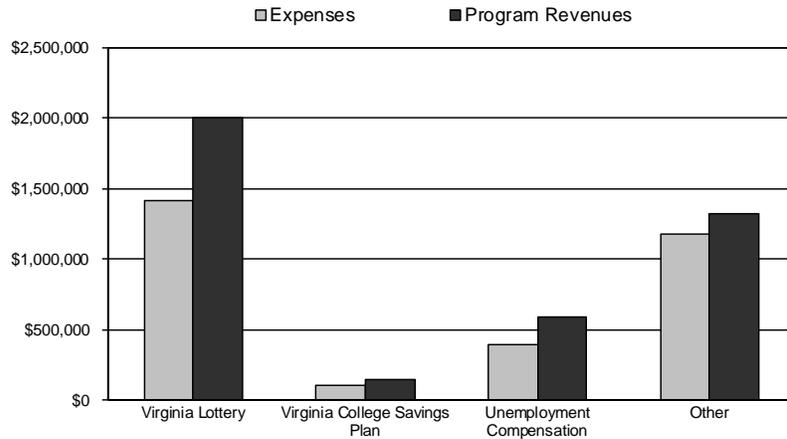
## Net Position of Business-type Activities

Net position of business-type activities increased by \$206.8 million during the fiscal year. As shown in **Figure 15**, highlights of the changes in net position for the major enterprise funds were as follows:

- Lottery sales were \$2.0 billion, an increase of \$163.0 million over the prior year. Net income was \$593.6 million, an increase of \$48.1 million (8.8 percent) from fiscal year 2015. Sales of scratch games increased by \$82.1 million (8.1 percent) and online sales increased by \$80.9 million (9.8 percent). Additionally, there is an increase of \$114.7 million (8.8 percent) in total expenses, primarily attributable to the cost of prizes and claims.
- Virginia College Savings Plan's net position increased by \$43.0 million (7.9 percent) during the fiscal year. Although the investment income decreased from the prior year, total revenues still exceeded expenses incurred during fiscal year 2016.
- Unemployment Compensation Fund net position increased by \$199.3 million during fiscal year 2016, primarily as a result of a decrease in benefit claims. Operating expenses decreased by \$41.0 million. These factors combined give the Trust Fund the large increase.

Over the one year period from July 1, 2015, to June 30, 2016, the unemployment rate declined from 4.9 percent to 4.1 percent. Additionally, there were approximately 16,482 fewer initial unemployment claims filed than in the previous year. These declines were accompanied by a decrease in the average benefit duration from 16.0 weeks to 14.9 weeks in fiscal year 2016. There was an increase in the average weekly benefit amounts from approximately \$289.0 to \$298.1 in fiscal year 2016. These multiple influences led to a decrease in the total benefit payments of \$41.0 million over the prior year.

**Figure 15**  
**Business-type Activities**  
**Program Revenues and Expenses**  
 Fiscal Year 2016  
 (Dollars in Thousands)



## Fund Statements Financial Analysis

As of the end of the fiscal year, the primary government's governmental funds reported combined ending fund balances of \$3.7 billion, including a negative unassigned fund balance of \$709.3 million indicating that restricted and committed amounts exceed the available modified accrual basis fund balance. The remainder of fund balance is nonspendable, restricted or committed to indicate that it is not available for new spending.

### General Fund Highlights

At the end of the fiscal year, the General Fund reported a combined ending fund balance of \$710.3 million, a decrease of \$138.1 million in comparison with the prior year. Of this total fund balance, \$114.4 million represents nonspendable fund balance, \$908.2 million represents restricted fund balance, and \$397.0 million represents committed fund balance. These amounts are offset by a negative \$709.3 million unassigned fund balance.

Fiscal year 2016 General Fund revenues were 3.7 percent, or \$692.8 million, higher than fiscal year 2015 revenues. This revenue change results from increases of \$716.5 million primarily attributable to individual and fiduciary income taxes (\$362.0 million), sales and use taxes (\$122.5 million), other revenue primarily relating to expenditure recoveries from prior years (\$73.6 million), interest, dividends, and rents (\$45.3 million), premiums of insurance companies taxes (\$36.1 million), and deeds, contracts, wills and suits taxes (\$23.4 million), offset by decreases of \$23.7 million primarily attributable to communications sales tax (\$10.8 million), and public service corporations (\$4.9 million).

Fiscal year 2016 expenditures increased by 5.5 percent, or \$1.0 billion, when compared to fiscal year 2015. This was primarily attributable to increases in individual and family services, general government, education, and administration of justice expenditures of \$505.6 million, \$239.7 million, \$159.2 million, and \$114.5 million, respectively. Net other financing sources and uses decreased by \$9.3 million, which is primarily due to lower transfers in from nongeneral funds and lower proceeds from the sale of capital assets offset by a decrease in transfers out to nongeneral funds.

### Budget Highlights

The General Fund began the year with an original revenue budget that was \$547.3 million, or 3.0 percent, higher than the final fiscal year 2015 revenue budget. Additionally, the final revenue budget was slightly higher (\$607.3 million or 3.2 percent) than the original budget. The change between the original and final budget was primarily attributable to increases in the final budget for individual and fiduciary income taxes of \$603.3 million, deeds, contracts, wills and suits of \$61.2 million and sales and use taxes of \$48.4 million. This was offset by decreases in the final budget for corporation income taxes of \$97.9 million and sales of property and commodities of \$31.5 million. Total actual General Fund revenues were lower than final budgeted revenues by \$251.1 million due to weaker actual than anticipated collections.

Total final budget expenditures were higher than original budget expenditures by \$612.2 million, or 3.1 percent. This increase was primarily attributable to budgeted expenditures for individual and family services of \$292.6 million, administration of justice of \$115.7 million, capital outlay of \$82.9 million, and education of \$72.2 million.

The Commonwealth spent less than planned so actual expenditures were \$341.9 million, or 1.7 percent, lower than final budget expenditures.

### Budget Outlook

In order to mitigate the effects of difficult economic conditions over the past several years, the Commonwealth adopted temporary budget solutions such as accelerated sales taxes.

While some of the conditions left by the financial and economic downturn experienced between 2008 and 2010 are still visible in certain sectors, Virginia's economy saw significant improvement. Data regarding the primary economic indicators – jobs and new housing units saw improvement and the state performed better than the nation as a whole. The unemployment rate has continued to decrease from the previous fiscal year and has approached what is considered full-employment while housing indicators continue to improve with home sales accelerating, price appreciation picking up, and building permit issuance growing. During fiscal year 2016, the two General Fund revenue sources most closely tied to current economic activity – individual income taxes and retail sales taxes – experienced increases when compared to the 2015 collections by \$227.0 million (1.8 percent) and \$60.4 million (1.9 percent), respectively. The individual income tax collections and retail sales taxes were less than the estimated revenue by \$267.4 million (2.1 percent) and \$71.9 million (2.1 percent), respectively.

Although the fiscal year 2016 revenue collections exceeded fiscal year 2015, the fiscal year 2016 collections did not meet the estimate. Based on the most recent General Fund revenue estimate, the fiscal year 2017 revenue is projected to increase 1.7 percent over the fiscal year 2016 revenue collections. This planned increase is a result of continued growth in individual income taxes and retail sales taxes. The Governor will release his amendments to the 2017-2018 biennial budget on December 16, 2016.

## Major Special Revenue Fund Highlights

The Commonwealth Transportation Fund ended the fiscal year with a fund balance of \$1.9 billion. Approximately \$3.5 billion is contractually committed for various highways, public transportation, and rail preservation projects (see Note 20). Additionally, revenues and expenditures increased \$111.3 million, or 2.1 percent, and \$463.4 million, or 8.5 percent, respectively. The revenue increase was primarily due to increases in tax collections of \$194.4 million, or 5.9 percent, offset by decreases in federal income of \$87.9 million, or 6.6 percent. Expenditures increased mainly for highway maintenance, acquisition, and construction.

The Federal Trust Fund balance increased by \$8.3 million, or 6.9 percent, primarily due to an increase in expenditure recoveries of \$72.3 million, or 93.7 percent, an increase in Federal Grants and Contracts revenue of approximately \$248.1 million, or 3.0 percent, and offset by a significant increase in expenditures of \$291.3 million. This change in the Federal Grants and Contracts revenue was mainly attributed to an increase in Medicaid funding (\$224.1 million), offset by decreases of American Recovery and Reinvestment Act revenue (\$1.7 million), unemployment insurance (\$7.9 million), food and home energy assistance programs (\$31.0 million), child and family assistance (\$20.2 million), and education grants (\$8.4 million). The remaining difference is distributed over many other federal programs. Net other financing sources and uses experienced a smaller decrease of \$3.0 million, or 12.9 percent, primarily attributable to higher transfers in from other funds.

The Literary Fund ending balance decreased by \$61.7 million, or 54.8 percent. As discussed in Note 2, the beginning balance was restated to reflect a change in investment liquidation management strategy that increased the amounts available to the fund. Additionally, expenditures exceeded net receipts by \$67.6 million. The loans of \$193.9 million owed to the Virginia Public School Authority (major component unit) increased by \$8.0 million or 4.3 percent.

## Capital Asset and Long-term Debt

**Capital Assets.** The primary government's investment in capital assets for its governmental and business-type activities as of June 30, 2016, amounts to \$30.5 billion (net of accumulated depreciation totaling \$17.5 billion). This investment in capital assets includes land, buildings, improvements, equipment, infrastructure, construction-in-progress, and intangible assets including water rights, easements, and software. Infrastructure assets are items that are normally immovable such as roads, bridges, drainage systems, and other similar assets. As noted on page 30, increases in capital assets and deferred outflows of resources offset by increases in total liabilities and deferred inflows of resources resulted in an increase in net position of the governmental activities of \$569.0 million, or 2.9 percent. The increase in the primary government's net investment in capital assets was primarily attributable to increases in infrastructure of \$611.8 million and construction-in-progress of \$365.3 million. These changes are primarily attributable to transportation. The primary government reports equipment with a value of \$50,000 or greater and an expected useful life of two or more years. The primary government capitalizes all land, buildings, infrastructure, and intangible assets that have a cost or value greater than \$100,000 and an expected useful life of two or more years. Additional information on the primary government's capital assets can be found in Note 12, Capital Assets.

**Figure 16**  
**Capital Assets as of June 30, 2016**  
**(Net of Depreciation)**  
(Dollars in Thousands)

	<u>Governmental Activities</u>	<u>Business-type Activities</u>	<u>Total</u>
Land	\$ 3,101,588	\$ 1,977	\$ 3,103,565
Buildings	2,552,870	17,032	2,569,902
Equipment	482,496	11,307	493,803
Water Rights/Easements	75,328	-	75,328
Infrastructure	19,591,501	-	19,591,501
Software	241,433	6,463	247,896
Construction-in-Progress	4,370,171	1,540	4,371,711
Total	<u>\$ 30,415,387</u>	<u>\$ 38,319</u>	<u>\$ 30,453,706</u>

**Long-term Debt.** The Commonwealth is prohibited from issuing general obligation bonds for operating purposes. At the end of the current fiscal year, the Commonwealth had total debt outstanding of \$42.8 billion, including total tax-supported debt of \$20.9 billion and total debt not supported by taxes of \$21.9 billion. Bonds backed by the full faith and credit of the government and tax-supported total \$1.5 billion. Debt is considered tax-supported if Commonwealth tax revenues are used or pledged for debt service payments. An additional \$907.2 million is considered moral obligation debt which is not tax-supported. The Commonwealth has no direct or indirect pledge of tax revenues to fund reserve deficiencies. However, in some cases, the Commonwealth has made a moral obligation pledge to consider funding deficiencies in debt service reserves that may occur. The remainder of the Commonwealth's debt represents bonds secured solely by specified revenue sources (i.e., revenue bonds).

During fiscal year 2016, the Commonwealth issued \$4.2 billion of new debt for various projects. Of this new debt, \$409.0 million was for the primary government and \$3.8 billion for the component units. Additional information on the Commonwealth's outstanding debt can be found in Note 26, "Long-Term Liabilities," as well as in the section entitled "Debt Schedules." The Commonwealth maintains a "triple A" bond rating for general obligation debt from the three rating agencies: Moody's Investors Service; Standard & Poor's Ratings Group, a division of The McGraw Hill Companies, Inc.; and Fitch, Inc.

State statutes limit the amount of general obligation debt the Commonwealth may issue for each specific type of debt. The 9(a) bonds, which may be issued to fund the defense of the Commonwealth; to meet casual deficits in revenue or in anticipation of the collection of revenues; or to redeem previous debt obligations, and are limited to 30.0 percent of 1.15 times the annual tax revenues for fiscal year 2016. The 9(b) bonds, which have been authorized by the citizens of Virginia through bond referenda to finance capital projects, are limited to 1.15 times the average of selected tax revenues for fiscal years 2014, 2015, and 2016. The 9(c) bonds, which have been issued to finance capital projects that will generate revenue upon their completion, are limited to 1.15 times the average of selected tax revenues for fiscal years 2014, 2015, and 2016. The current debt limitation for the Commonwealth is \$5.9 billion, \$18.3 billion, and \$17.9 billion, respectively, for the 9(a), 9(b), and 9(c) general obligation bond issues. These limits significantly exceed the Commonwealth's outstanding general obligation debt. Currently, there is no 9(a) debt outstanding.

**Figure 17**  
**Outstanding Debt as of June 30, 2016**  
**General Obligation Bonds**  
(Dollars in Thousands)

	<b>Primary Government</b>			<b>Component Units</b>
	<b>Governmental Activities</b>	<b>Business-type Activities</b>	<b>Total</b>	
General obligation bonds				
9(b)	\$ 571,915	\$ -	\$ 571,915	\$ -
9(c)	29,717	-	29,717	877,118
<b>Total</b>	<b>\$ 601,632</b>	<b>\$ -</b>	<b>\$ 601,632</b>	<b>\$ 877,118</b>

## **Economic Factors and Review**

During fiscal year 2016, the Commonwealth's economy continued to improve at a faster rate than at the national level. The Commonwealth experienced a higher job growth rate than at the national level (2.3 percent at the state level versus 1.9 percent nationally), closing the gap between the Commonwealth's job growth rate and that of the nation during the last fiscal year. Personal income growth reached 4.1 percent during fiscal year 2016, compared to 4.8 percent in fiscal year 2015. During the fiscal year, the Commonwealth outpaced the nation (3.8 percent) in personal income growth for the first time since 2012. Unemployment in the Commonwealth and at the national level continued to decline during the fiscal year, reaching 4.1 percent and 5.0 percent, respectively. Total taxable sales growth in the Commonwealth experienced a slight decline from 3.9 percent to 3.2 percent compared to fiscal year 2015. Economic indicators show that during fiscal year 2016, the housing market in the Commonwealth improved slightly to 7.6 percent compared to 5.5 percent in fiscal year 2015. Additionally, housing prices in the Commonwealth again showed a positive change for fiscal year 2016, with an increase of approximately 3.6 percent, compared to just over 5.8 percent at the national level. Many major economic indicators show that the Commonwealth outperformed the nation as a whole. Employment growth and higher salaries will continue to support consumer spending, which point toward continued moderate economic growth at both the state and national levels.

## **Requests for Information**

This financial report is designed to provide a general overview of the Commonwealth's finances for all those with an interest in the government's finances. Questions concerning any of the information provided in this report or requests for additional financial information should be addressed to the State Comptroller's Office, Commonwealth of Virginia, P. O. Box 1971, Richmond, Virginia 23218. This report is also available for download at [www.doa.virginia.gov](http://www.doa.virginia.gov).

The Commonwealth's component units issue their own separate financial statements. Contact information regarding each component unit is provided in Note 1.B.

