

Overview of Local Fiscal Stress in Virginia

Senate Finance Committee
Annual Meeting

November 16, 2017

Topics:



Overview of Local Fiscal Stress

Demographic and Statistical Information

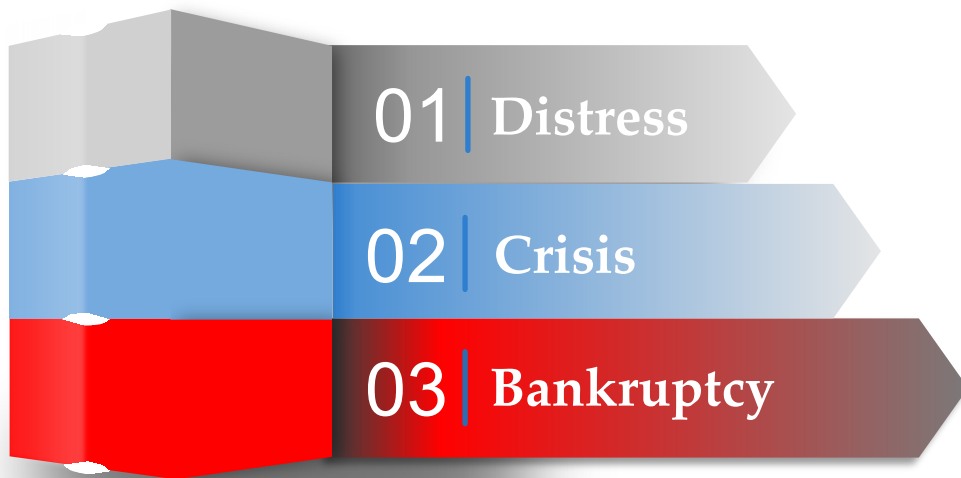
Policy Options for Consideration

Stages of Local Fiscal Difficulty

1) Distress – Sustained period of budgetary imbalance, cutbacks to essential services, and inability to pay bills.

2) Crisis – Mechanisms to address budgetary issues, such as expense reductions, tax/fee increases and short term borrowing fail to stabilize problem(s) resulting in financial emergency.

3) Bankruptcy – Rarely, localities may file for Chapter 9 bankruptcy (not authorized in Virginia).



Source: The Pew Charitable Trusts

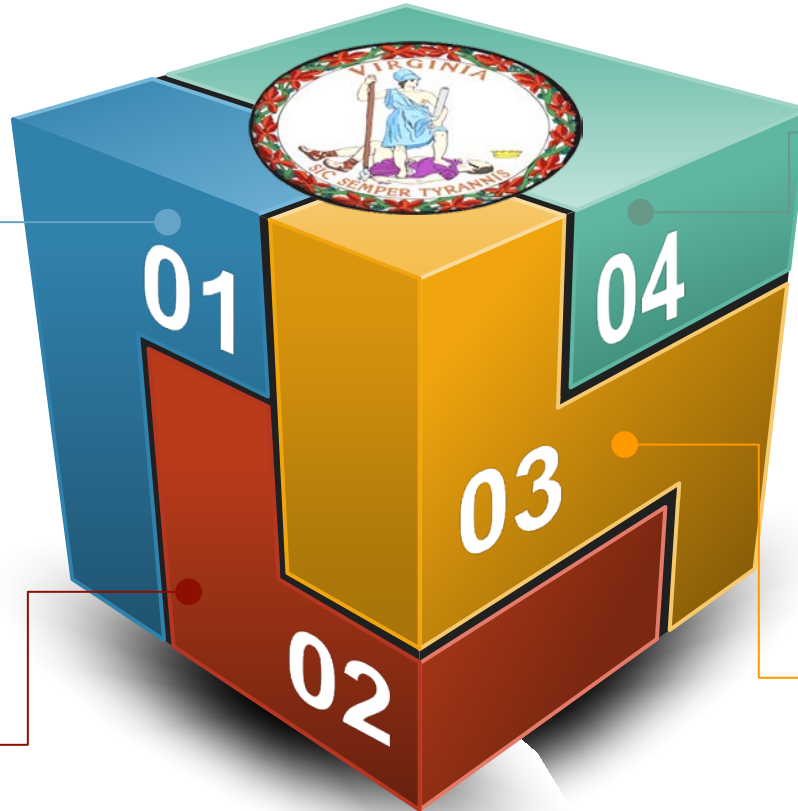
Why Should the State Help Prevent and/or Remedy Local Fiscal Stress?

Ensure public health and safety

- Need to maintain essential services

Preserve credit worthiness and reputation

- Rating agencies value local support



Promote economic growth and stability

- State is stronger when localities are strong

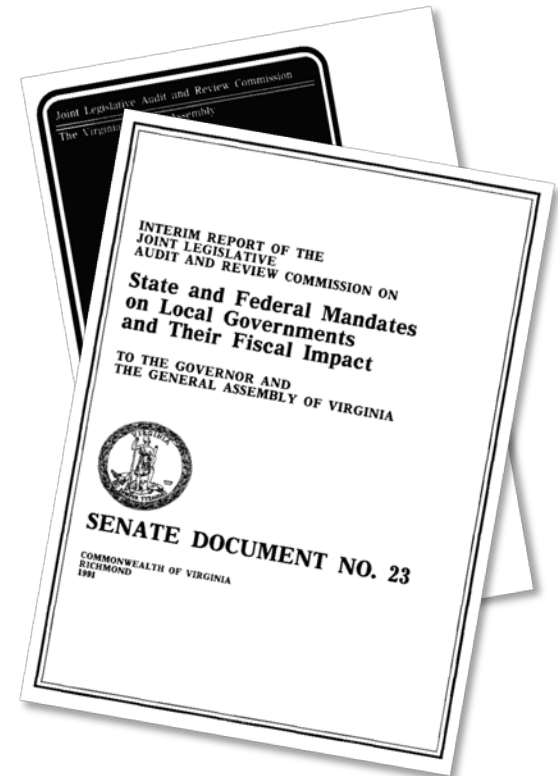
Attract and retain businesses

- Stable economies promote business and job growth

Source: The Pew Charitable Trusts

What Has the State Done Historically, Regarding Local Fiscal Stress?

- JLARC report on “State Mandates on Local Governments and Local Financial Resources” (1984), was followed by:
- A comprehensive study of “Local Fiscal Stress and State Aid”(1986)
- Recommendations included:
 - Periodically reassessing state funding formulas – include measures of fiscal capacity, local fiscal stress, and need;
 - Abandon formula for local public health distributions;
 - Provide funding to localities based on level of state control and historical commitment;
 - Appropriating funds to localities based on stress formula, after mandated commitments are met;
 - Equalizing the taxing authority of localities; and,
 - Conduct ongoing fiscal assessment based on fiscal capacity, tax effort, and fiscal stress.
 - Assessment is performed by the Commission on Local Government.



Source: Joint Legislative Audit and Review Commission

Several Subcommittees/Commissions Have Been Convened

Subcommittee/Commission	Year, Enabling Authority, Chair(s), Reporting Document	Recommendations*
Joint Subcommittee Studying the Business, Professional and Occupational License Tax	1994 HJR 110, Brickley/Holland, 1995 House Document 59	Retain BPOL - no alternative revenue source identified; enact legislation to provide uniformity to the tax.
Commission on State and Local Government Responsibility and Taxing Authority	1997 HJR 532, Teig, 1998 House Document 88	Exempt motor vehicles of a certain value, maintain revenue neutrality; equalize taxing authority of cities, counties, and towns; fully fund obligations to localities.
Commission on Virginia's State and Local Tax Structure for the 21st Century	1998 HJR 578, Morris, 2001 House Document 22	Increase support for local school divisions; assume full cost of mandated services through CSA; dedicate minimum of 6% of individual income tax collections to localities; equalize taxing authority of cities and counties.
Joint Subcommittee to Study and Revise Virginia's Tax Code	2001 HJR 685/SJR 387, 2002 HJR 60, McDonnell/Hanger, 2003 House Document 26	Impose no new unfunded mandates, and eliminate existing ones when possible; impose moratorium on sales tax exemptions.
Commission on Government Finance Reform for the 21st Century	Executive Order 75 (Gilmore)	Replace car tax revenue with 20% dedication of income tax revenues to localities; equalize taxing authority of counties and cities; no unfunded state mandates.

*Recommendations not all-inclusive

Source: Department of Taxation

Timeline of Recent State Involvement in Local Government Fiscal Stress

Petersburg

- City requests assistance May 2016.
- Finance team assembled, deployed in June 2016.
- SFC and HAC briefings in Sept. and Nov. 2016 raise issue of Early Warning System.



Workgroup

- Situation in Petersburg, legislative briefings raise general awareness of potential for local fiscal distress.
- Workgroup begins examining issue in January 2017.

Budget Language

- Workgroup discussions, analysis facilitate development of budget language (Chapter 836) for Jt. Subcommittee on Local Government Fiscal Stress, APA workgroup, local auditor requirements, funding.

Early Warning System – Financial Assessment Model

- The Auditor of Public Accounts was directed via budget language (§ 4-8.03, Chapter 836, 2017 Acts of Assembly) to develop a prioritized early warning system.
 - To be used to assist in making a preliminary determination of potential local fiscal distress, based on objective, subjective, quantitative and qualitative information.
- Uses 10 ratios from financial information already contained within localities' Comprehensive Annual Financial Report (CAFR).
- Average of percentile rankings used to assign Financial Assessment Model (FAM) score.
- Locality's FAM score is used to determine need for follow-up.
 - Score of **16% or below** qualifies for follow-up.
 - Subsequent, subjective analysis used to make preliminary determination of local fiscal distress.
- Determination for follow-up can also be based on qualitative analysis and other information.
 - (e.g. multi-year downward trend that doesn't fall below 16% threshold)

Financial Assessment Model (FAM) Ratios

Example: Ratios calculated using localities' Government Wide Statement of Net Position and Statement of Net Activities (all funds) – 6 of 10 Ratios.

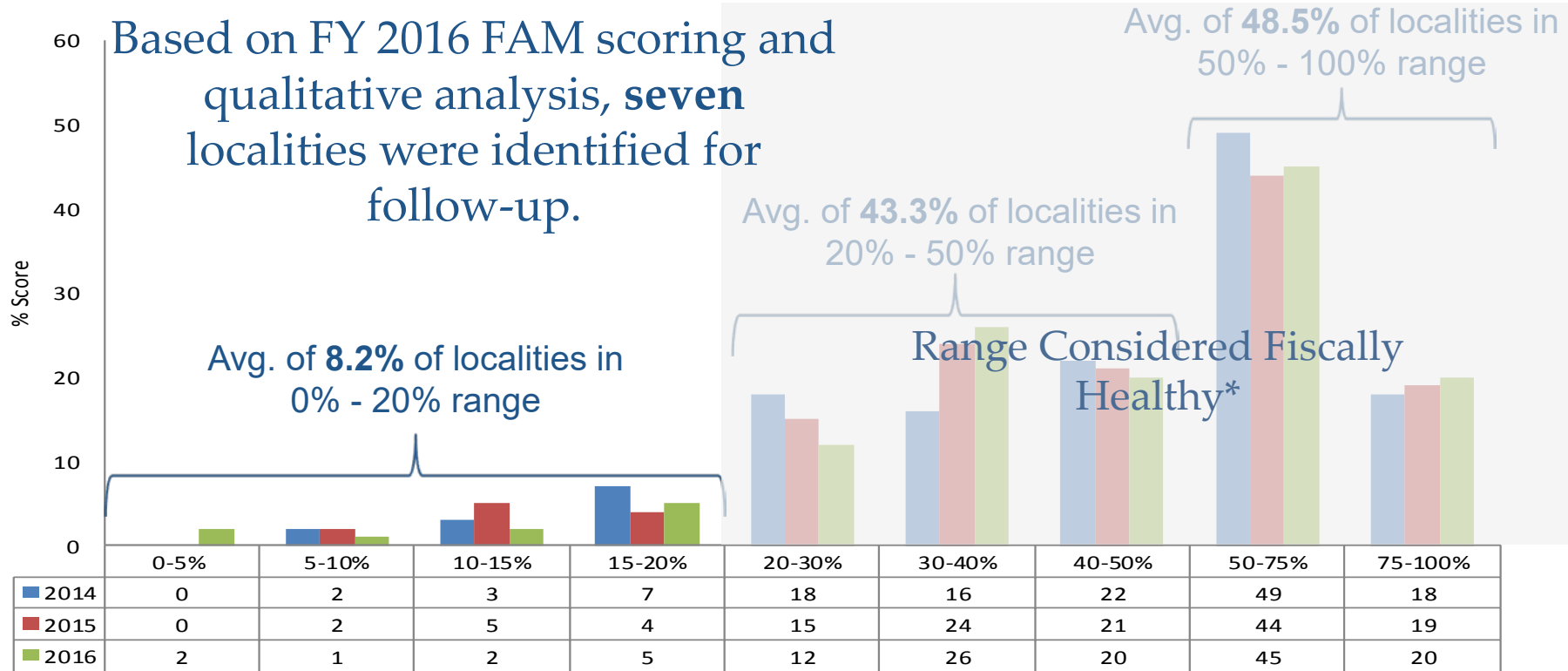
Financial Indicator Ratio	Description/Interpretation
Cash and Cash Equivalents + Investments - Current Liabilities (incl. any applicable cash overdraft) / Charges for Services + General Revenues	Measures the sufficiency of unrestricted reserves relative to the locality's normal (non-grant) revenue
Cash and Cash Equivalents + Investments / Current Liabilities (incl. any applicable cash overdraft)	Measures the sufficiency of unrestricted reserves relative to the locality's current liabilities
Cash and Cash Equivalents + Investments / Total (current and long-term) liabilities	Measures the sufficiency of unrestricted reserves relative to the locality's total liabilities

Example: Ratios calculated using GF activity from the Balance Sheet, Statement of Revenues, Expenditures and Changes in Fund Balance – 4 of 10 Ratios.

Financial Indicator Ratio	Description/Interpretation
Cash and Cash Equivalents + Investments (incl. unrestricted and restricted) / Total current and long-term liabilities	Measures the sufficiency of reserves relative to the locality's general fund liabilities

Source : "Financial Indicator Ratios" and "Description/Interpretation" – Auditor of Public Accounts

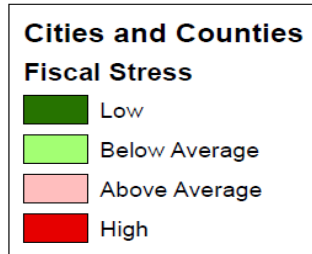
Distribution of FAM Scoring



*For purposes of APA objective FAM scoring

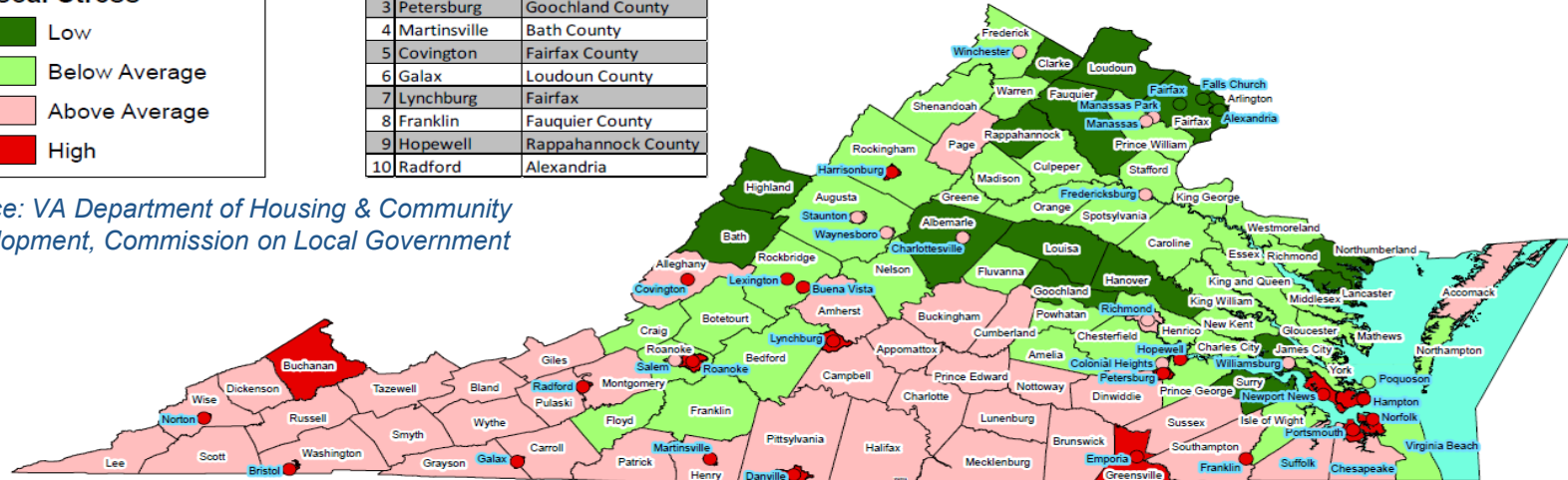
Source: Auditor of Public Accounts data

Commission on Local Government – Fiscal Stress Index



	Greatest Stress	Least Stress
1	Emporia	Falls Church
2	Buena Vista	Arlington County
3	Petersburg	Goochland County
4	Martinsville	Bath County
5	Covington	Fairfax County
6	Galax	Loudoun County
7	Lynchburg	Fairfax
8	Franklin	Fauquier County
9	Hopewell	Rappahannock County
10	Radford	Alexandria

Source: VA Department of Housing & Community Development, Commission on Local Government



- The Fiscal Stress Index is comprised of the aggregate of three separately computed indices.
 - Revenue Capacity; Revenue Effort; and Median Household Income.
- Origin of the Fiscal Stress Index contained within 1984 JLARC report.
- While useful in several capacities, the CLG has no statutory authority for local intervention in cases of suspected fiscal distress, and the index alone is not sufficient as a fiscal monitoring tool.

FAM vs. CLG Fiscal Stress Indices – Different Measurements

	Fiscal Stress Rank (CLG) ⁽¹⁾	FAM Score (2014)	Score Indicates APA Follow-up (2014) ⁽²⁾
1	Emporia	66.9%	No
2	Buena Vista	19.9%	No
3	Petersburg	13.9%	Yes
4	Martinsville	52.4%	No
5	Covington	12.8%	Yes
6	Galax	11.6%	Yes
7	Lynchburg	38.1%	No
8	Franklin City	41.1%	No
9	Hopewell	57.6%	No
10	Radford	45.5%	No

(1) Commission on Local Government Fiscal Stress Rank reflects FY2014 data.

(2) Follow-up by APA based only on FAM quantitative score, objective criteria.

The CLG Fiscal Stress Index is a relative score of a locality's revenue generating capacity, and effort and ability to meet that capacity, while the FAM scoring largely reflects assets, liabilities and liquidity as indicated through financial metrics.

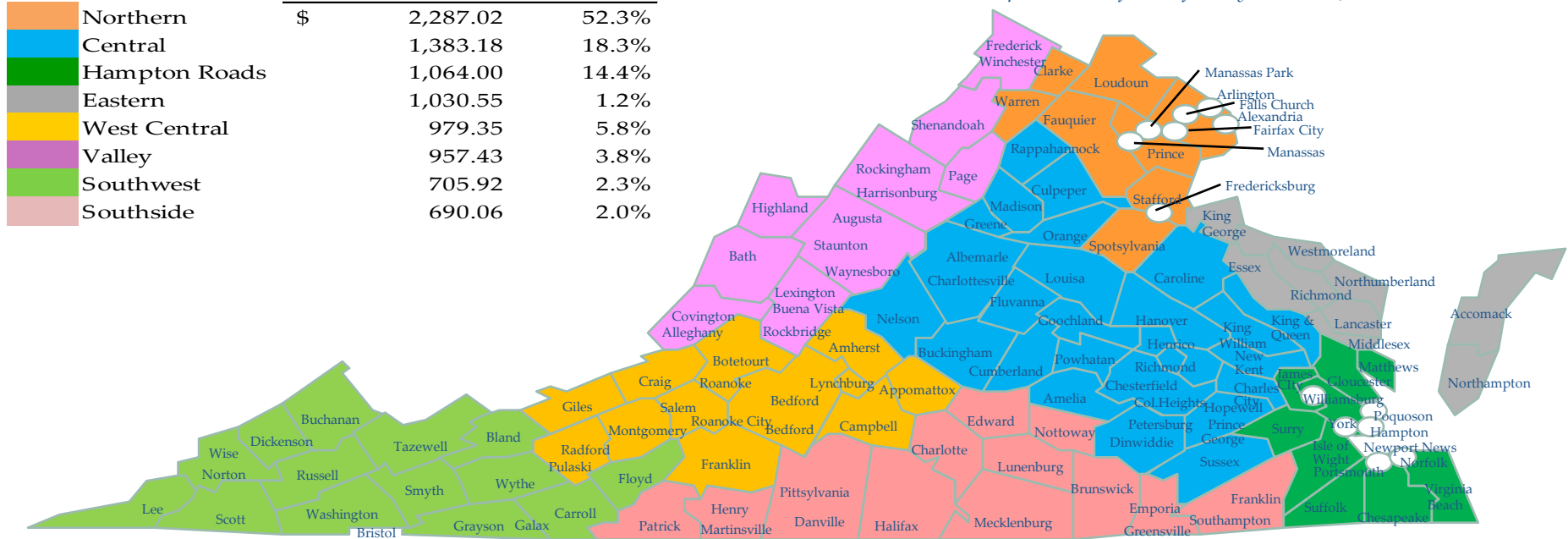
Of the top 10 in the CLG ranking, only 3 localities would have qualified for APA follow-up in FY 2014.

Demographic and Statistical Information

Per Capita Distribution of Income Tax Collections

	Per Capita Income Tax Distribution	% Share of Total
Northern	\$ 2,287.02	52.3%
Central	1,383.18	18.3%
Hampton Roads	1,064.00	14.4%
Eastern	1,030.55	1.2%
West Central	979.35	5.8%
Valley	957.43	3.8%
Southwest	705.92	2.3%
Southside	690.06	2.0%

Source: Auditor of Public Accounts, "Comparative Report of Local Government Revenues and Expenditures" for the fiscal year ended June 30, 2016.



Greater than half the wealth in the state, as measured by share of total income tax collections, is concentrated in the Northern Virginia area.

Measure of Economic Activity Throughout the State

	Per Capita Local Option Sales & Use Tax	% of Total Local Sales Tax	% Population in Poverty	Avg. % Unemployment
Northern	\$ 162.19	39.2%	8.0%	3.3%
Central	145.24	20.3%	12.6%	4.1%
Valley	142.58	5.9%	13.9%	4.2%
Hampton Roads	130.02	18.6%	12.3%	4.4%
West Central	128.46	8.0%	14.8%	4.4%
Eastern	105.71	1.3%	14.7%	4.2%
Southside	103.98	3.2%	19.4%	5.1%
Southwest	103.47	3.5%	18.4%	5.2%

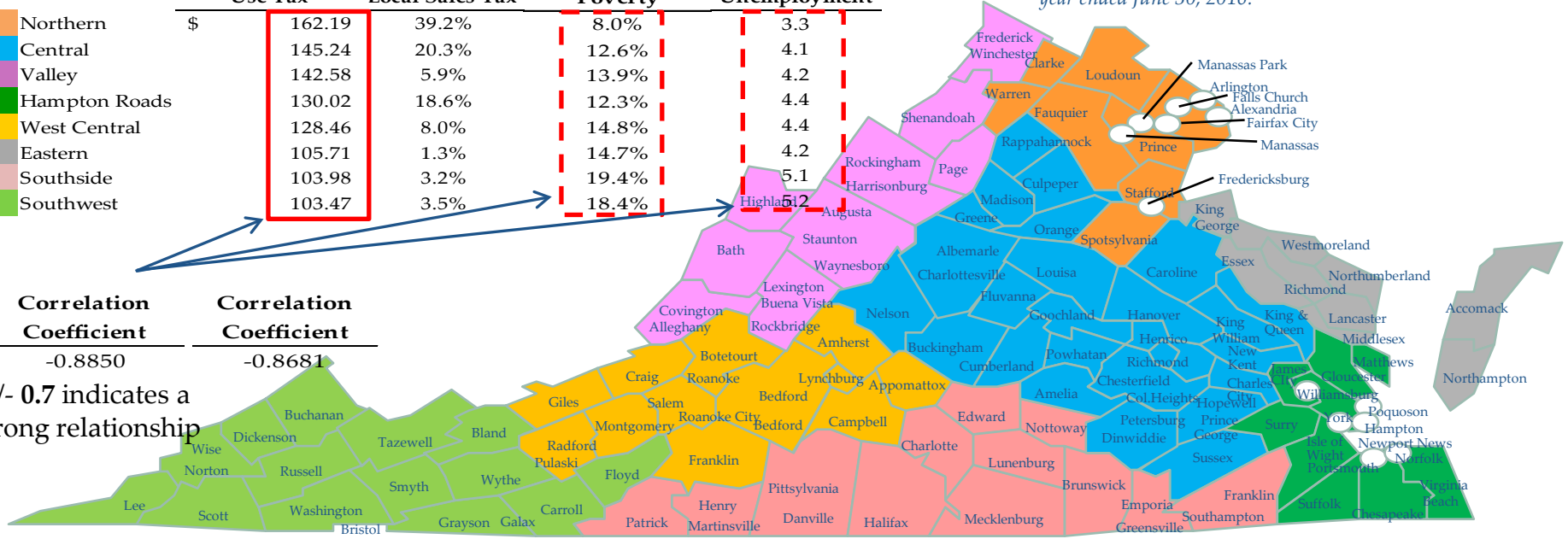
Source: Auditor of Public Accounts, "Comparative Report of Local Government Revenues and Expenditures" for the fiscal year ended June 30, 2016.

- Northern
- Central
- Valley
- Hampton Roads
- West Central
- Eastern
- Southside
- Southwest

Correlation Coefficient
-0.8850

Correlation Coefficient
-0.8681

+/- 0.7 indicates a strong relationship



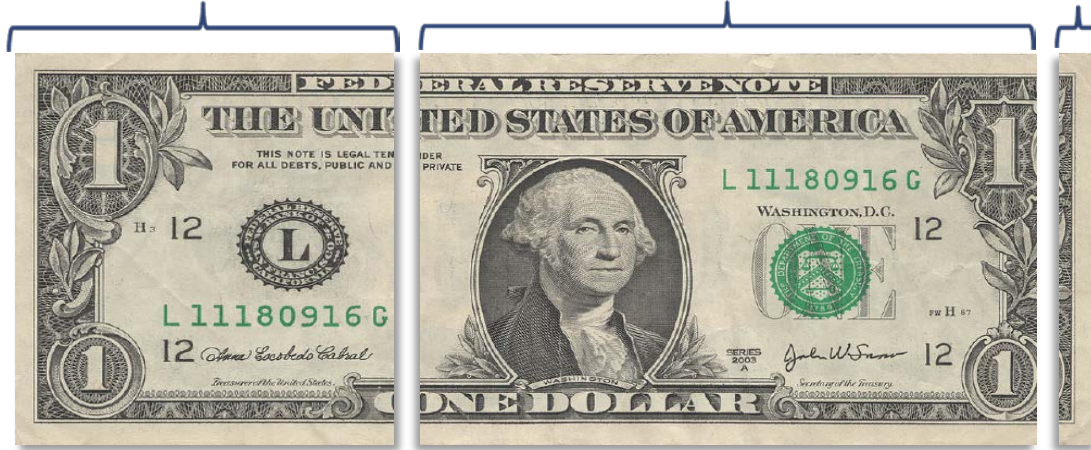
Northern Virginia accounts for the highest per capita taxable sales – as a % of total local sales tax collected is roughly the same as all other localities combined, less the Central Virginia area.

Shares of Local Revenue

31.4% = State

62.7% = Local

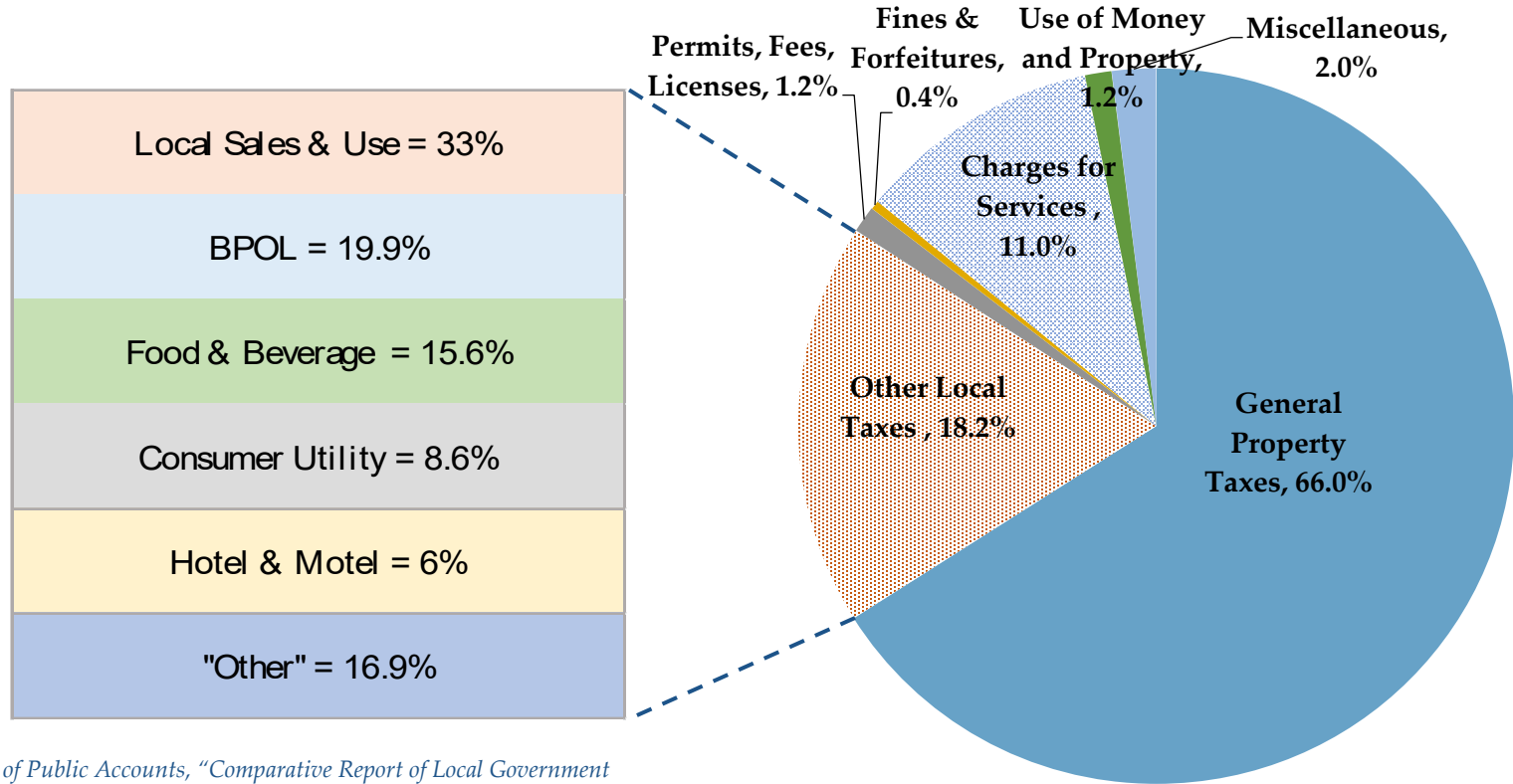
6% = Federal



- Just under 1/3 comes from state aid to localities, excluding federal pass-through dollars.
- Just under 2/3 of total revenue for localities is generated at the local level.
- Federal aid accounts for about 6%, of which, only about one percentage point is attributable to direct federal aid to localities.

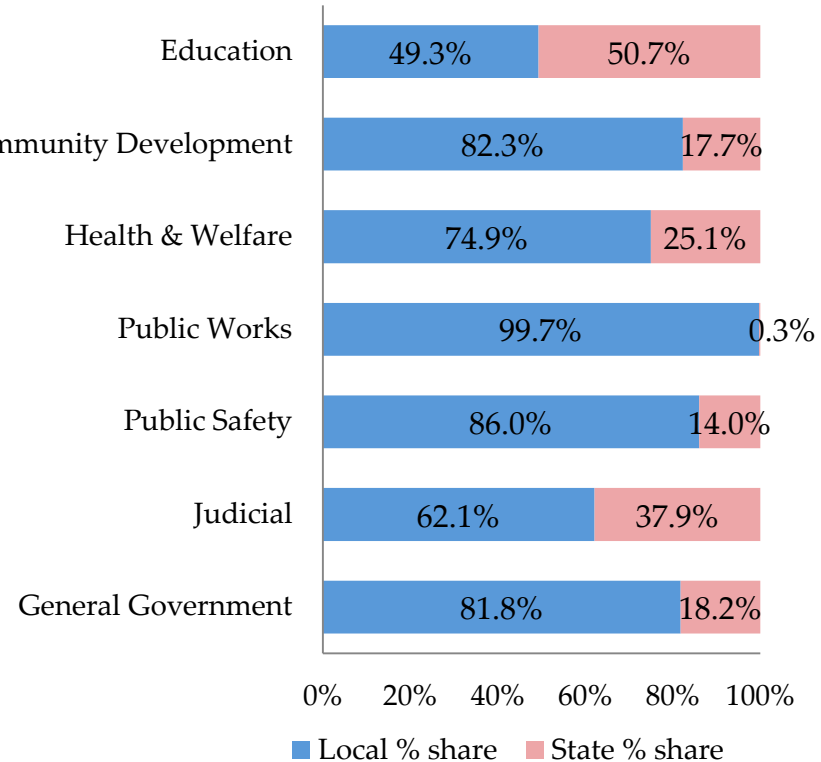
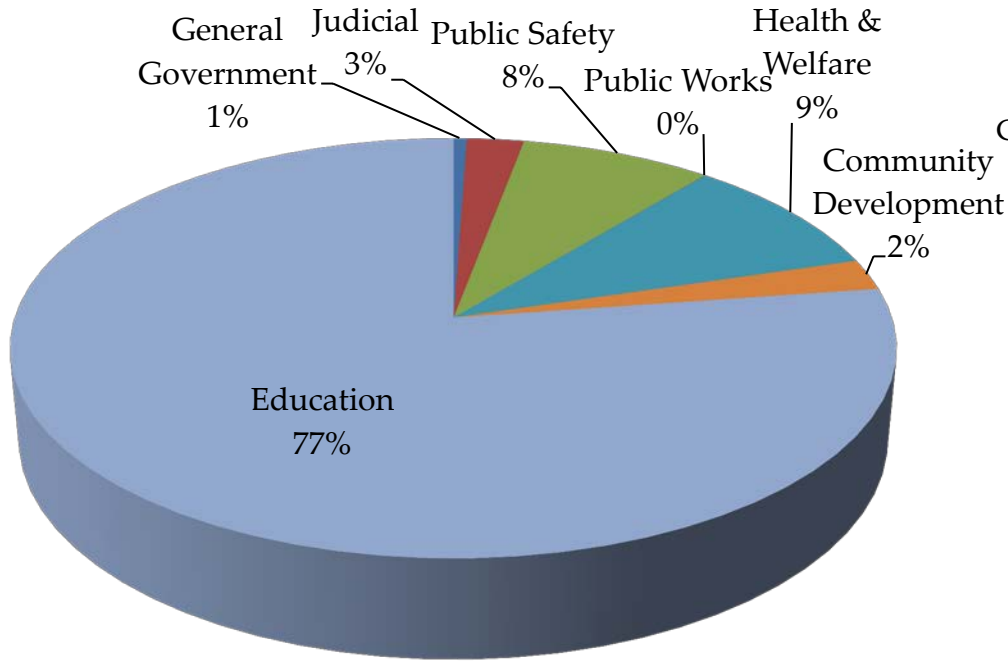
Source: Auditor of Public Accounts, "Comparative Report of Local Government Revenues and Expenditures" for the fiscal year ended June 30, 2016.

Composition of Local Revenue Sources



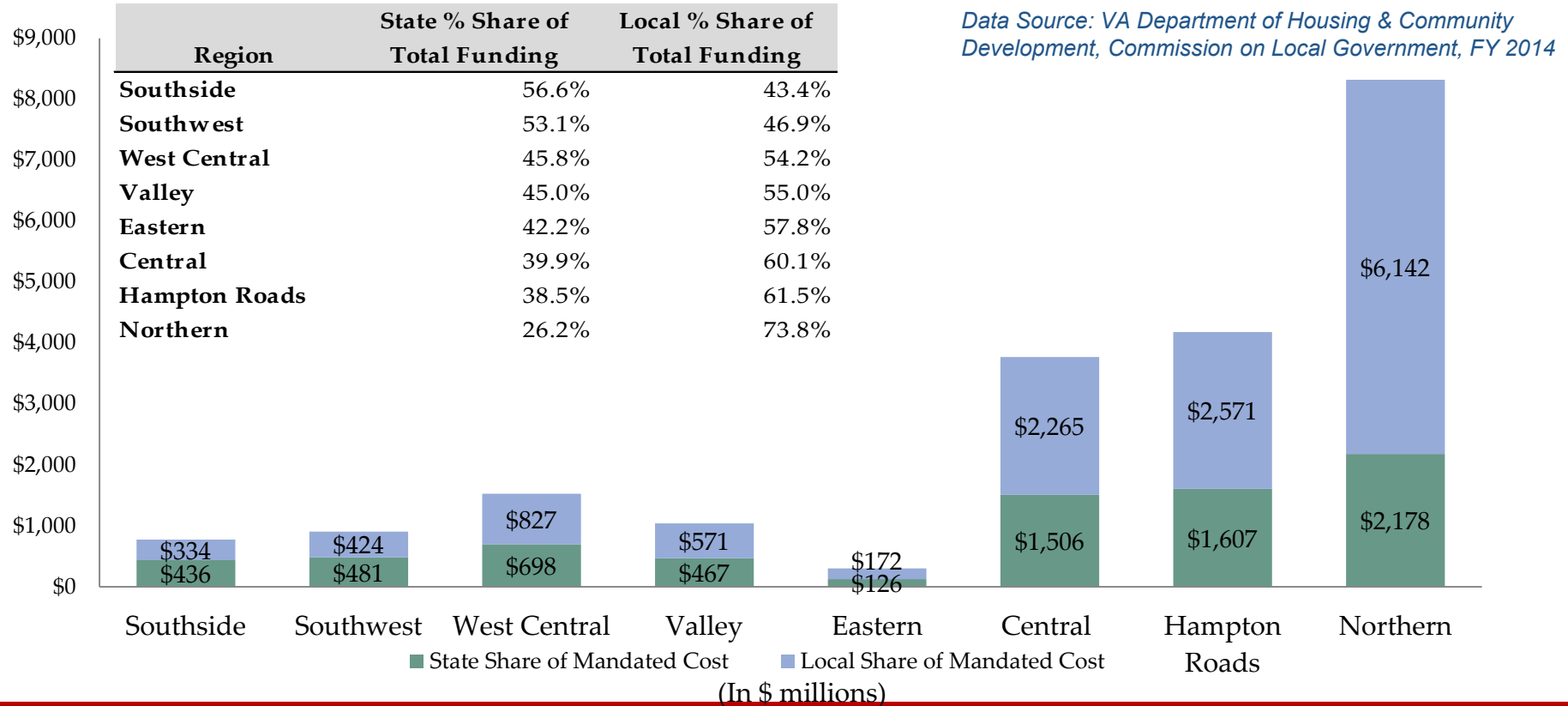
Source: Auditor of Public Accounts, "Comparative Report of Local Government Revenues and Expenditures" for the fiscal year ended June 30, 2016.

Over ¾ of State Funding for Mandated Services Goes to Education



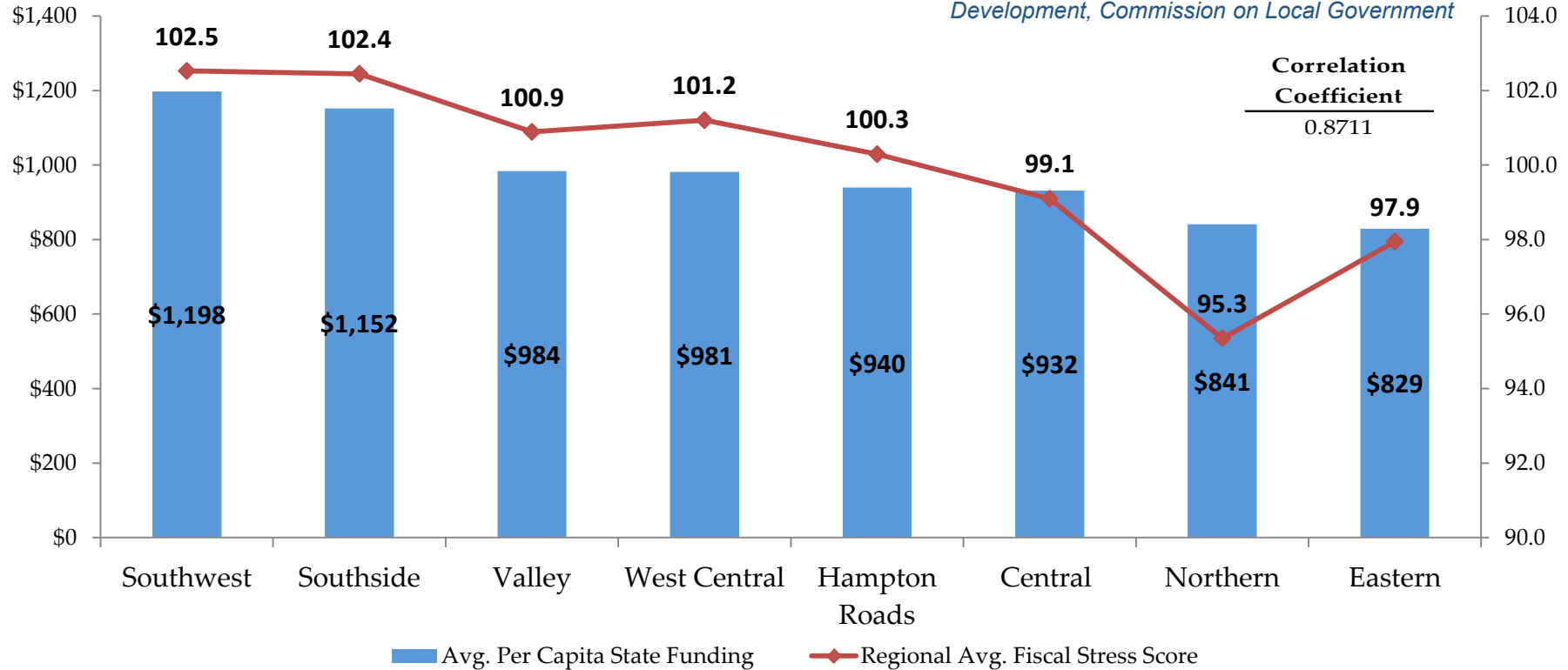
Data Source: VA Department of Housing & Community Development, Commission on Local Government, FY 2014 data

The South and Southwest Regions Receive the Highest Proportional Share of State Funding

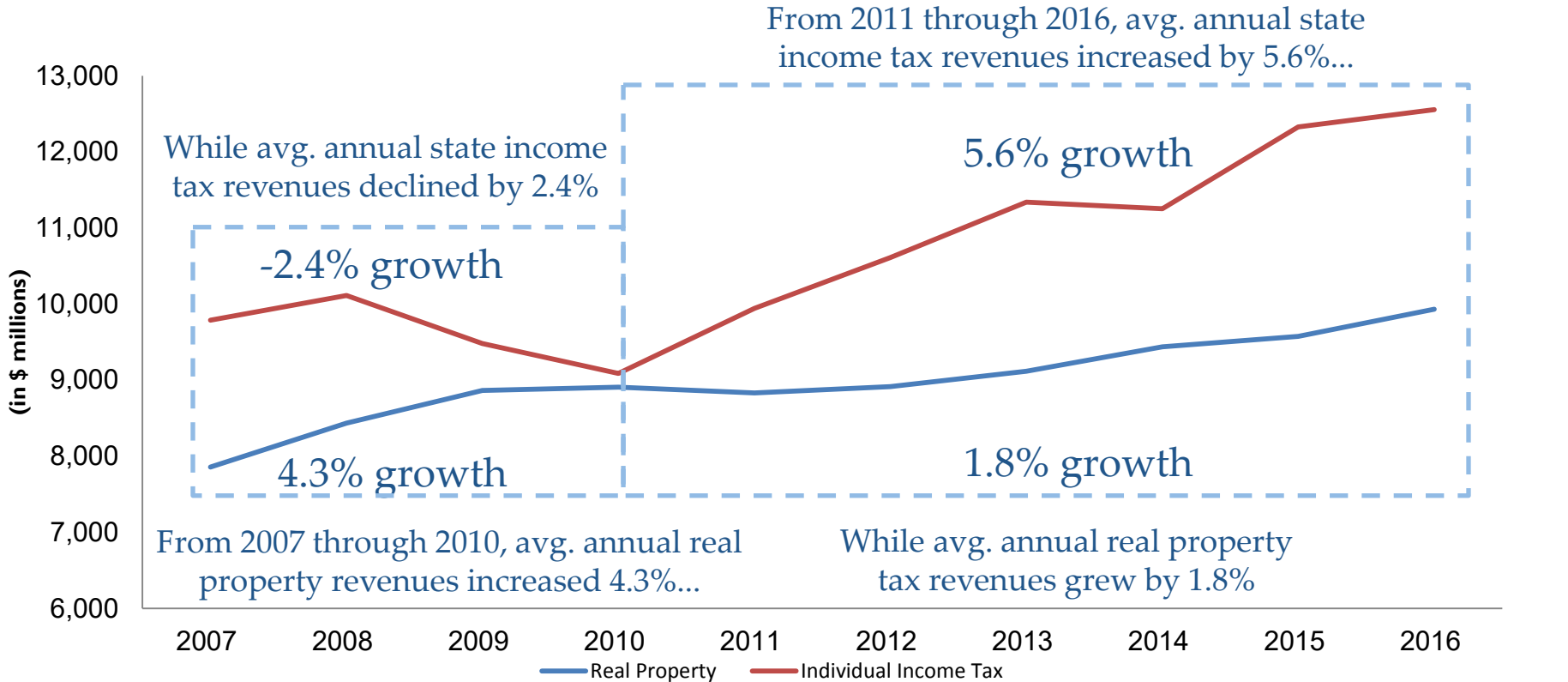


There Is a Strong Correlation Between State Funding Levels and Regional Need

Data Source: VA Department of Housing & Community Development, Commission on Local Government



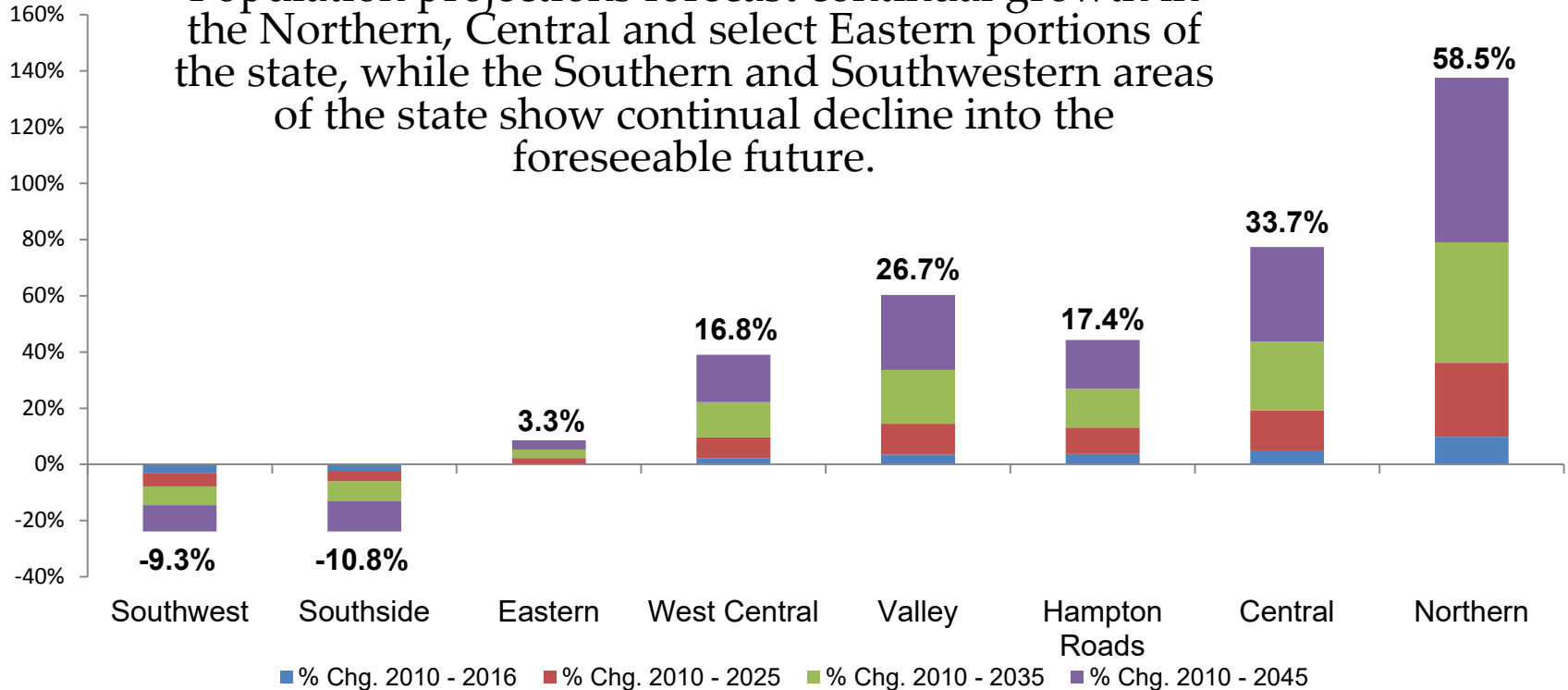
Growth in Real Property Lags Behind an Economic Recovery



Data source: Department of Taxation Annual Reports (FY 2007 – FY 2016)

Population Dispersion Compounds Regional Economic Challenges

Population projections forecast continual growth in the Northern, Central and select Eastern portions of the state, while the Southern and Southwestern areas of the state show continual decline into the foreseeable future.



Policy Options for Consideration

Fiscal Monitoring and Early Detection - Policy Options for Consideration

- Refine processes for prevention, identification and remediation (including intervention, if required).
 - To include early warning system, ongoing fiscal monitoring.
 - Clearly define state role in local financial matters in cases of fiscal distress/crisis.
 - Determine if state intervention laws are required, and the mechanics of state intervention.
- Determine extent of state technical and financial assistance.
 - Technical – State assistance to include review of accounting, operational procedures and causes of distress, identification of structural problems and mechanisms to remedy them.
 - Financial – Funding for outside consultancy (similar to Petersburg), if necessary.
 - Other?

Ways To Address Local Fiscal Stress – Policy Considerations

- Revenue diversification – diversify sources, move away from dependence on real estate tax revenues.
- Address differences in local taxing authority.
- Economic development efforts – What makes a locality attractive to a current or prospective business (tax structure, educated/trained workforce, good schools, etc.) and how to improve the local infrastructure, given economic and demographic challenges in certain regions?
- Ways to encourage local/regional collaboration, consolidation, and reversion when necessary.

Issues to be Addressed by the Joint Subcommittee on Local Government Fiscal Stress

- The Joint Subcommittee on Local Government Fiscal Stress continues to examine the issue (authority specified in Item 1, paragraph U., Chapter 836).
- Has met twice during 2017 interim – June and August.
- The stated goals and objectives of the Subcommittee include the review of several issues that contribute to, and could potentially alleviate local fiscal stress, including:
 - **Savings opportunities from increased regional cooperation and consolidation of services;**
 - **Local responsibility for service delivery of state mandated or high-priority items;**
 - **Causes of fiscal stress among local governments;**
 - **Potential financial incentives and other governmental reforms to encourage increased regional cooperation; and,**
 - **Different taxing authorities of cities and counties.**

Virginia's Efforts Acknowledged Among States

Virginia's effort to address the situation in Petersburg and other potentially fiscally distressed localities has been acknowledged among states looking to address issues of local fiscal stress.

