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Budgeting Strategies Being Employed by County and Municipal Governments for Fiscal Year 2021 During the COVID-19 Pandemic

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Introduction

The COVID-19 pandemic has thrown all businesses, households, nonprofits, and governments into unchartered territory. At this point, the question is not whether the pandemic will cause a recession but when the recession will start and how bad it will be. In fact, some economists have said that the likelihood of a recession is 100 percent and that this economic downturn will be the worst in generations.[1] Like other states, North Carolina is feeling the effects of the pandemic. Unemployment is at an all-time high, the governor has issued a stay-at-home order, schools are closed, and, of course, we are in the midst of a public health crisis. While the situation is dire, we are also confronted with a somewhat unique opportunity: the ability to budget for a recession before it begins.

This analysis presents the results of a survey conducted in April 2020 of county and municipal governments in North Carolina. The survey was conducted by the North Carolina Local Government Budget Association (NCLGBA) and the North Carolina League of Municipalities (NCLM). The survey reflects the local governments' working assumptions regarding preparing budgets and employing budget balancing strategies for Fiscal Year 2021 (FY21), which is when a revenue shortfall is anticipated. The survey reveals that local governments are preparing for a recession and anticipating revenue shortfalls, especially for sales taxes, occupancy taxes, and utilities. The governments are coping with these shortfalls using multiple mechanisms, but the most commonly used strategies include appropriating fund balances, closing facilities, making staffing adjustments, and increasing fees.

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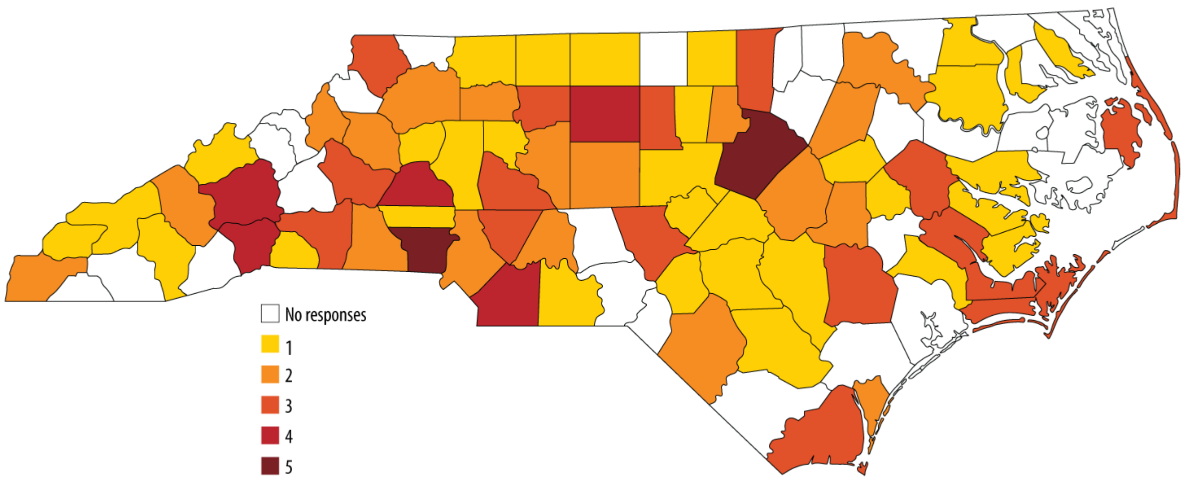
1. Reade Pickert, Yue Qiu, and Alexander McIntyre, "U.S. Recession Model at 100% Confirms Downturn Is Already Here," *Bloomberg*, October 14, 2019 (updated April 8, 2020), https://www.bloomberg.com/graphics/us-economic-recession-tracker/.

Survey Tool and Responses

In April 2020, the NCLGBA and the NCLM sent out a survey on budget strategies to all local governments in the state of North Carolina. Jurisdictions were instructed to have only one local government official complete the survey, and there were approximately 142 usable responses, with 29 from counties and 113 from municipalities. Clustering the responses into county areas, 71 counties are represented. Figure 1 shows the number of responses from each county area across the state.

Figure 1. Number of Survey Responses by County Area



In addition to geographic diversity, there is a great deal of diversity in the size of the county and municipal governments that responded, particularly in regard to General Fund and staffing characteristics. For example, the Town of Lattimore in Cleveland County has a reported General Fund budget of $89,000, with no full-time staff and only two part-time staff. This is in contrast to Wake County, which reported its General Fund budget as almost $1.5 billion, with a full-time staff of 4,361 and a part-time staff of 117. See Table 1 for more information about the size distribution of these characteristics in the reporting jurisdictions.

Table 1. Survey Respondent Jurisdictions: Size of General Funds and Staffs

	Mean	Minimum	Maximum	First Quartile	Second Quartile	Third Quartile
General Fund ($)	59,800,000	89,000	1,470,000,000	3,548,235	9,362,322	450,000,000
Full-Time Positions	412.640	0	8,232.000	31.000	76.500	2,651.000
Part-Time Positions	39.450	0	500.000	4.000	11.500	245.000
Seasonal Positions	20.389	0	355.000	0	2.500	100.000

Despite their diversity in geography and size, most of the local governments demonstrated similar perceptions of their local economic conditions. Figures 2 and 3 present the counties' and municipalities' assessments of their local economic conditions by industry, respectively. The majority of the respondents reported that many industries (real estate, building and construction, and manufacturing) are stable and in some instances enjoying a period of growth, while other industries (tourism, restaurants, and retail) are declining.

Figure 2. Reported Local Economic Conditions by Industry: County

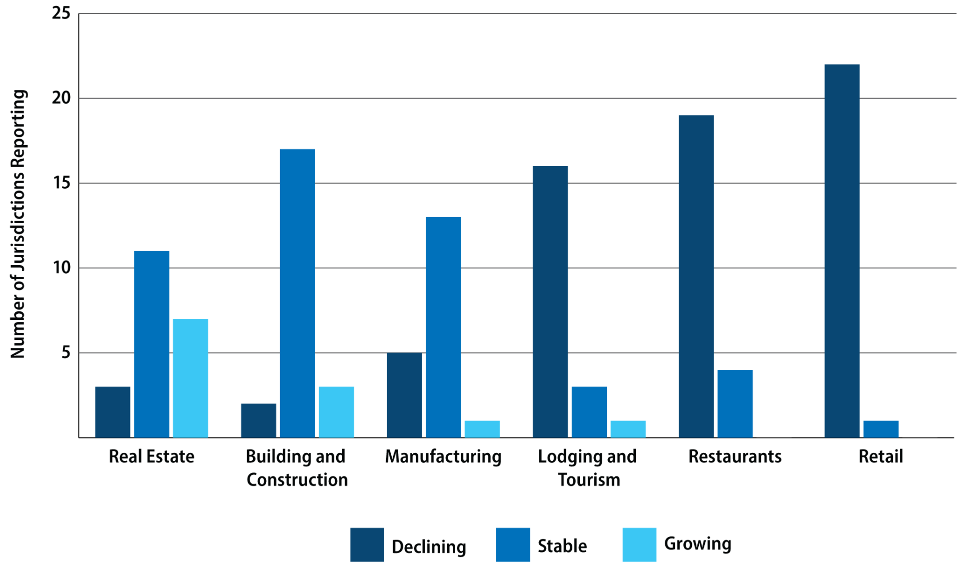
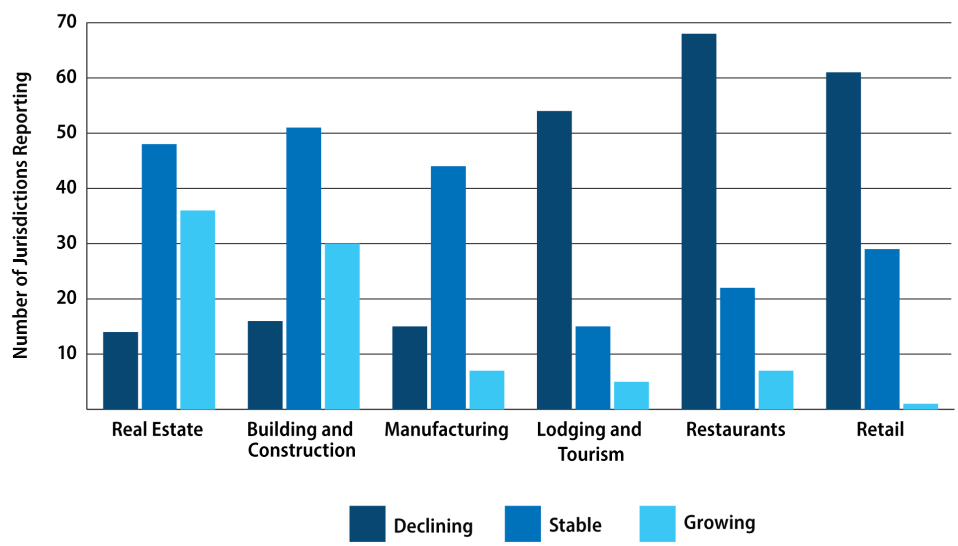


Figure 3. Reported Local Economic Conditions by Industry: Municipal



Anticipated Revenue Shortfalls

With businesses closing their doors, Spring Break travel being cancelled, schools closing, and the economy screeching to a halt, it is clear that local revenues are going to be impacted. While social distancing and formal stay-at-home orders have been in place for several months, it is still unclear how much current revenues have been impacted by the pandemic because of the lag between time of purchase (for sales taxes) and the distribution of revenues from the state—typically a three-to-four-month turnaround. While sales taxes are expected to be one of, if not the, most impacted revenue instruments, there are similar anticipated lags for occupancy taxes, and it is still unclear how property taxes are going to be affected. Overall, leading scholars predict that jurisdictions that rely heavily on sales taxes are going to immediately feel the economic impact of the pandemic when residents begin to experience unemployment and consume less (whether that consumption is related to tourism, shopping, recreation and entertainment, or another industry). Scholars also predict that property taxes will likely experience a lagged effect, demand for property will decrease, and property tax revenues may be negatively affected in the short term.[2]

The results of the survey show that the majority of local governments are anticipating budget shortfalls and are budgeting accordingly. Ninety-two percent of the respondents reported anticipating a General Fund shortfall for FY21, and more than 20 percent reported expecting a shortfall of greater than 10 percent. Figure 4 shows the percentage of reporting jurisdictions (county and municipal governments) within the county areas that are anticipating a revenue shortfall in FY21. The responses of "No" and "Unsure" to whether a revenue shortfall is anticipated were both treated as "No." Only five of the responding jurisdictions answered "No." When the respondents stated that they were anticipating a revenue shortfall, their responses were coded as "Yes."

While most of the responding jurisdictions are anticipating shortfalls, there is diversity in the anticipated size of those shortfalls. Figure 5 presents the average anticipated reduction in revenues by county area. The survey question was, "What percentage range of your General Fund budget do you expect the shortfall to be?", and the options were "0%–5%", "6%–10%", "11%–20%", and "21%–50%". If the response to the previous question was "No" or "Unsure," then a zero was the assigned value for calculating the average. The upper bound of each range was used as the respondents' answer.

The county areas expecting the greatest impact are primarily rural and have small populations, including Johnston, Dare, Rutherford, and Jones. The one exception is Forsyth. Otherwise, the anticipated effects of the pandemic on revenues are distributed across the state relatively evenly with little regional trends. This is surprising given the impact of tourism on occupancy taxes and sales taxes.

2. Michael A. Pagano and Christiana K. McFarland, "When Will Your City Feel the Fiscal Impact of COVID-19?" *Brookings*, March 31, 2020, https://www.brookings.edu/blog/the-avenue/2020/03/31/when-will-your-city-feel-the-fiscal-impact-of-covid-19/?utm_source=newsletter&utm_medium=email&utm_campaign=newsletter_axiosam&stream=top.

Figure 4. Percentage of Jurisdictions in the County Areas That Report Anticipating General Fund Shortfalls for Fiscal Year 2021

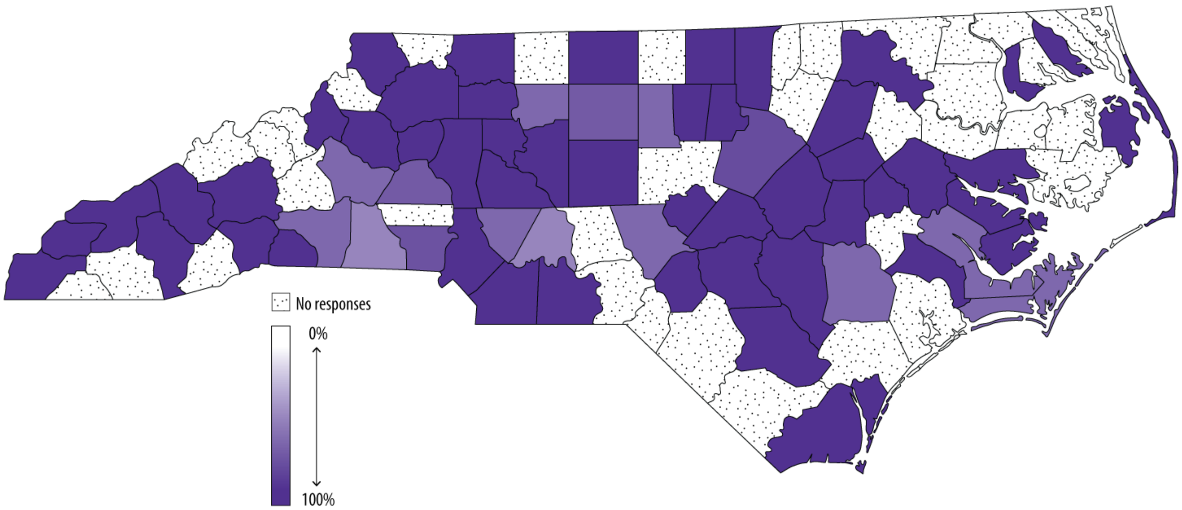
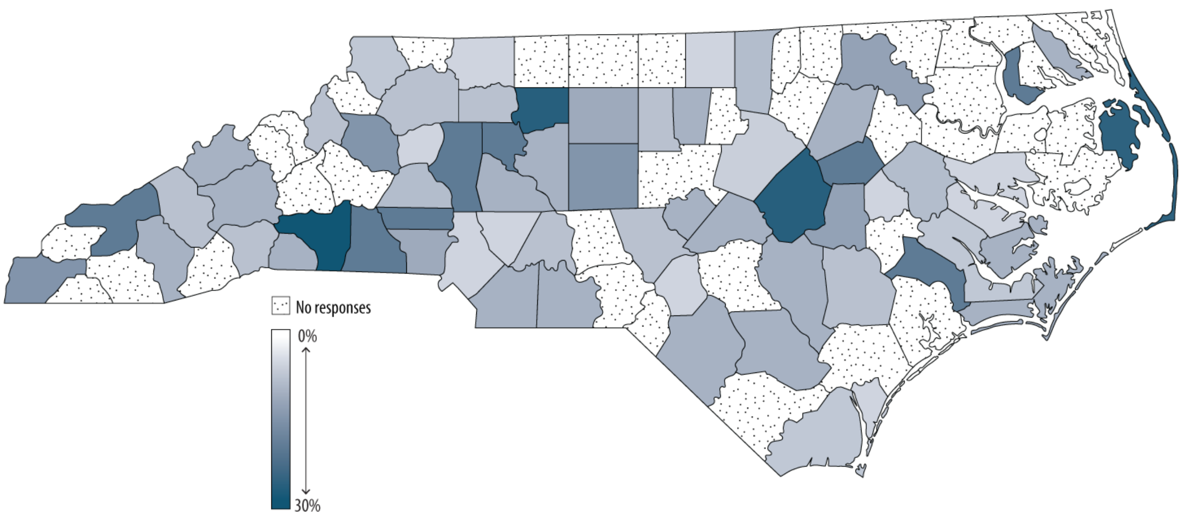


Figure 5. Fiscal Year 2021 Anticipated Shortfalls (Expressed as Percentage Range of General Fund Budget) by County Area



Not surprisingly, most of the reporting jurisdictions are anticipating reductions in local sales tax revenues. Figures 6 and 7 reflect the assumed impact of COVID-19 on counties' and municipalities' local sales tax revenues, respectively, by quarter from Fiscal Year 2020 (FY20) Quarter 4 (Q4) to FY21 Q4. Most of the responding jurisdictions are anticipating a substantial impact starting in FY20 Q4, but most are also optimistic that by FY21 Quarter 2 (Q2) the impact on local sales taxes will be minor, with many projecting growth in local sales tax revenues by the end of the next fiscal year. For counties, 96 percent are anticipating declines in sales tax revenues for FY20 Q4, and 70 percent are anticipating the decrease to be greater than 10 percent. This trend is stronger in FY21 Quarter 1 (Q1), for which all counties anticipate reduced sales tax revenues and 84 percent anticipate reductions of greater than 10 percent. The anticipated impacts quickly reduce beginning in FY21 Q2, with only 21 percent of counties anticipating sales tax reductions of greater than 10 percent and none anticipating reductions of greater than 20 percent. For FY21 Q4, only 15 percent of counties anticipate sales tax reductions of more than 6 percent. Municipalities follow similar trends. Sixty-two percent of the respondents report expecting sales taxes to decline by more than 10 percent in FY20 Q4, though by FY21 Q1 that number reduces to 47 percent. For FY21 Q4, only 11 percent anticipate shortfalls of over 6 percent, though 3 percent of municipal respondents still anticipate shortfalls of greater than 20 percent.

Figure 6. Expected Reduction in Sales Tax Revenue by Quarter: County

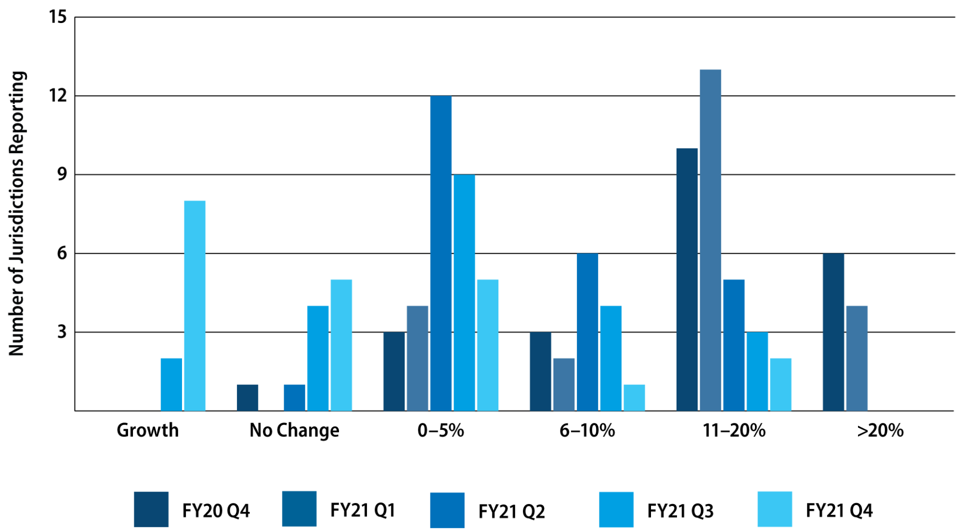
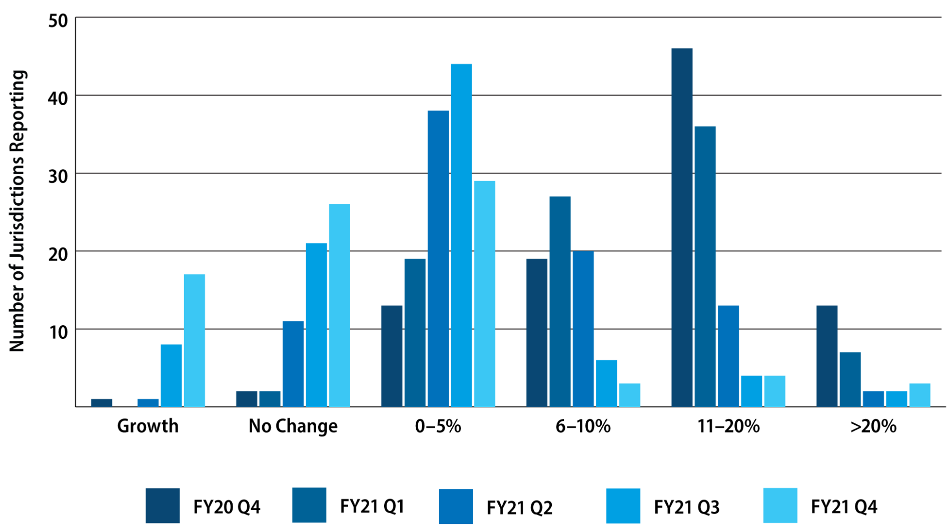


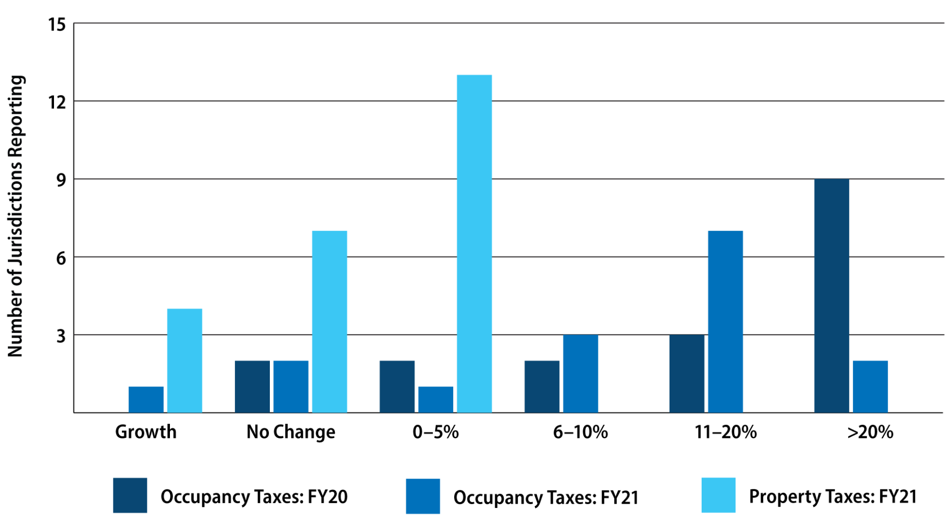
Figure 7. Expected Reduction in Sales Tax Revenue by Quarter: Municipal



Occupancy taxes (both for FY20 and FY21) and, in some cases, property taxes are also expected to be negatively affected by the COVID-19 pandemic. Figures 8 and 9 present the anticipated impact of the pandemic on both of these revenue instruments for counties and municipalities, respectively. Most municipalities and counties with occupancy taxes are anticipating reductions in revenue for the remainder of FY20, with slightly less dramatic reductions expected in FY21. However, property tax expectations are less consistent. Numerous jurisdictions are still expecting growth in property tax revenues in FY21, whereas many are anticipating declines (though generally small declines). The most likely reason for this is reduced collections. For example, Durham County is expecting a reduction in property tax revenue between 0 and 5 percent and commented that the county is "[e]xpecting [the] property tax collection rate to suffer. We are currently at 99.6%, planning 99.1% for FY 20–21."

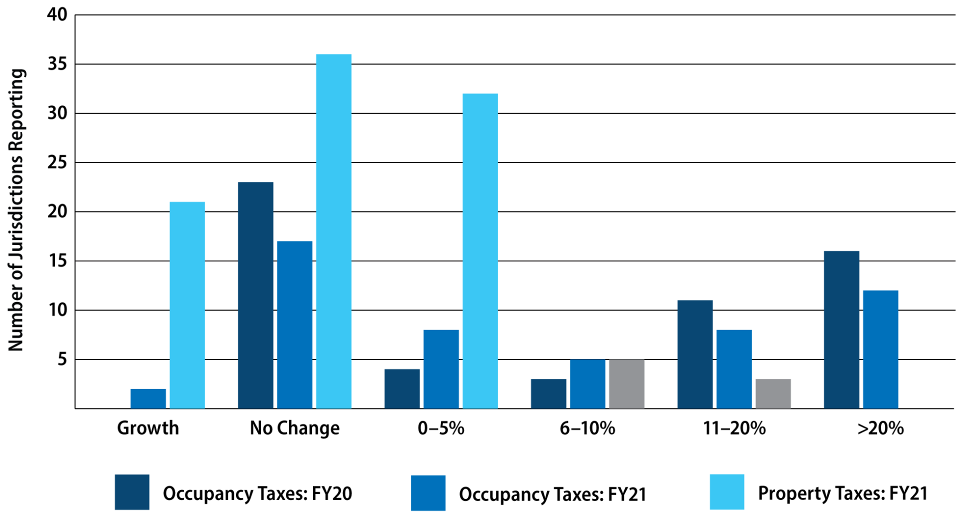
Regarding other revenues, utilities were most often cited to be expecting shortfalls, with many reporting jurisdictions noting that they have policies in place that now prohibit disconnects and that many residents are currently unable to pay their utility bills. For example, the Town of Granite Falls reports that the anticipated revenue from the electric utility will be down by 15 percent in FY20 Q4, and water and sewer utilities are expected to be down by 8 percent. However, two jurisdictions believe that utility revenues will be higher than the current fiscal year. The other type of revenue most cited as expecting to decrease is investments and/or interest earnings, with sixteen jurisdictions reporting that they are budgeting for dramatic decreases. The Town of Montreat is representative of many of the jurisdictions and reports expecting a decrease in interest earnings of 75 percent and a decrease in water and sewer revenues of 10 percent due to residents' inability to pay. Additionally, the respondents highlight rental car taxes (2), real estate excise taxes (1), vehicle taxes (2), user fees (2), landfill hosting fees (1), building permits (3), and recreation revenues (12) as other revenue sources that are expected to decline.[3]

Figure 8. Expected Reductions in Other Tax Revenues: County



3. The numbers in parentheses note the number of jurisdictions that wrote that particular response to an open-ended question.

Figure 9. Expected Reductions in Other Tax Revenues: Municipal



The last revenues reported on were intergovernmental transfers (IGTs) from the state and federal government. This is the area in which the respondents reported the least confidence, with the most responses of "Unknown" of any of the revenue categories. Thirty jurisdictions reported "Unknown" for anticipated change in state IGTs, and thirty-eight responded "Unknown" for anticipated change in federal IGTs. However, of those comfortable in their projections of IGTs, the counties appeared more optimistic than the municipalities that the IGTs would remain stable and that IGT revenues from both the state and federal government would increase. Municipalities largely reported that no change is expected, but a higher percentage of municipalities reported anticipated decreases in both state and federal IGTs than counties. Figures 10 and 11 show the number of reporting jurisdictions that are expecting IGTs to change, or not, in FY21.

Figure 10. Expected Reductions in Intergovernmental Transfers for FY21: County

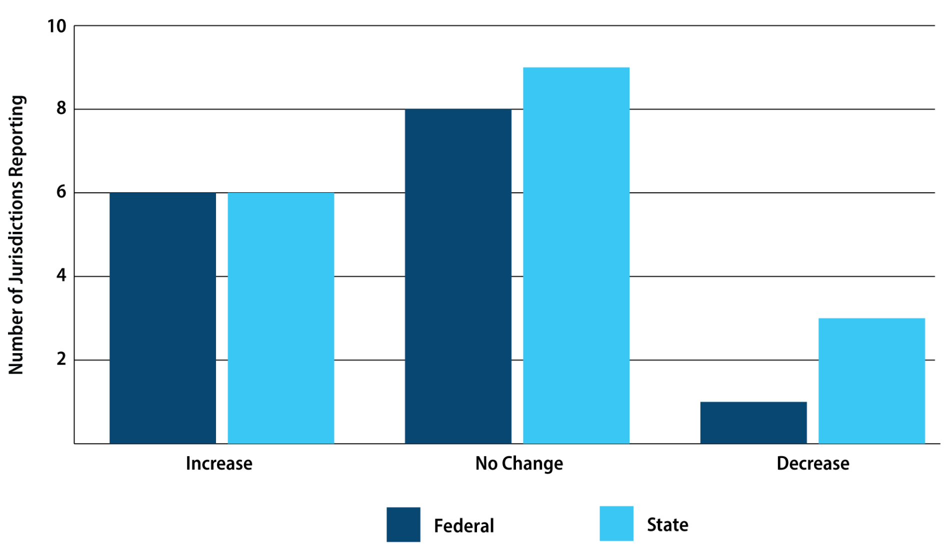
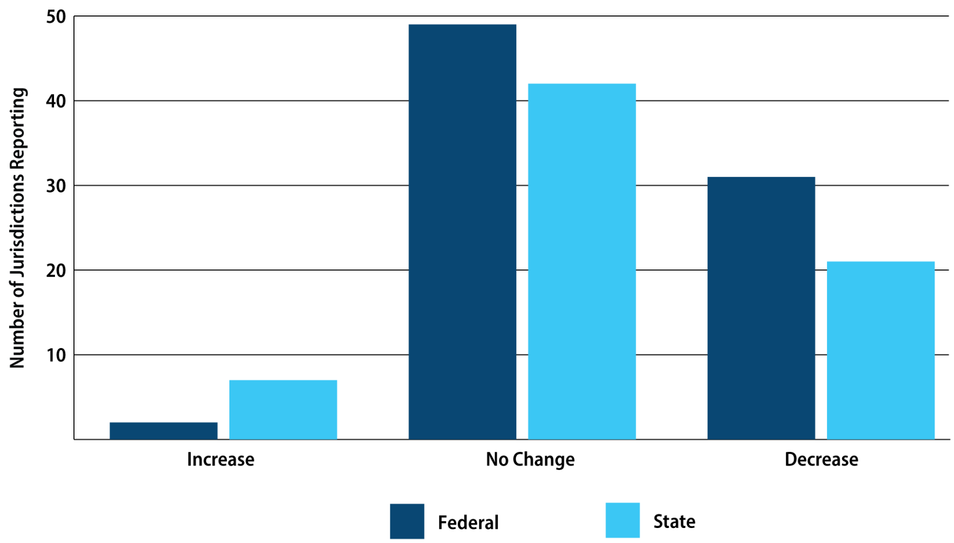


Figure 11. Expected Reductions in Intergovernmental Transfers for FY21: Municipal



Budget Balancing Strategies

Given that both county and municipal governments are anticipating revenue shortfalls, it is critical to understand how these governments are crafting a balanced budget. We know, from previous recessions, what some of the best practices are. For example, a previous survey of county commissioners in Georgia and California during the Great Recession found that county commissioners believed that the most effective way to minimize the negative impact of an economic downturn was to be "proactive in planning ahead, through mechanisms like fund balances and monitoring your local economy."[4] Additionally, scholars have identified the three best practices for local governments: maintaining spending levels, increasing infrastructure spending, and avoiding tax increases if possible.[5] These can be accomplished through reliance on increased IGTs and the use of fund balance. Figures 12 and 13 show the budget balancing strategies reported by the responding jurisdictions. For counties, the use of fund balance is the most common strategy for FY21, and for municipalities it is the second most common. It is important to note that the respondents were able to report multiple strategies, and, on average, counties reported 2 strategies and municipalities reported 1.88 strategies.

4. Whitney B. Afonso, "Coping with the Great Recession: Theory and Practice for County Governments," *International Journal of Public Administration* 36, no. 11 (2013): 768–79.

5. Gerald G. Miller and James H. Svara, eds., "Navigating the Fiscal Crisis: Tested Strategies for Local Leaders" (white paper prepared for the International City/County Management Association, 2009); Justin Marlowe, "Can Local Government Leaders Formulate Strategies That Will Actually—Rather Than Hopefully—Stimulate Their Local Economies? Has History Any Record of Such Successes?" in Miller and Svara, "Navigating the Fiscal Crisis"; Afonso, "Coping," 768–79.

Figure 12. Strategies to Balance the Budget in Response to Projected Revenue Shortfalls: County

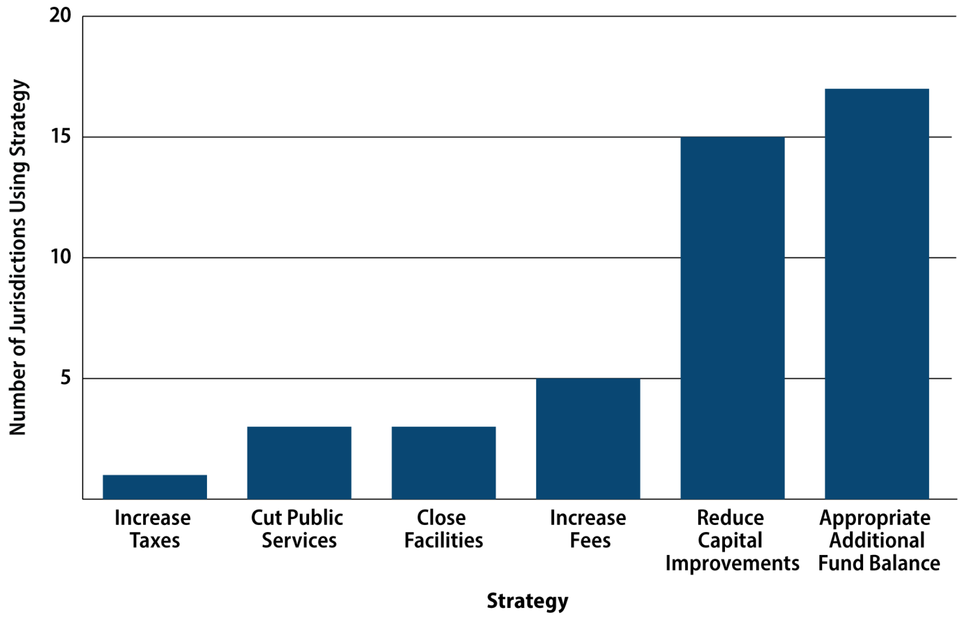
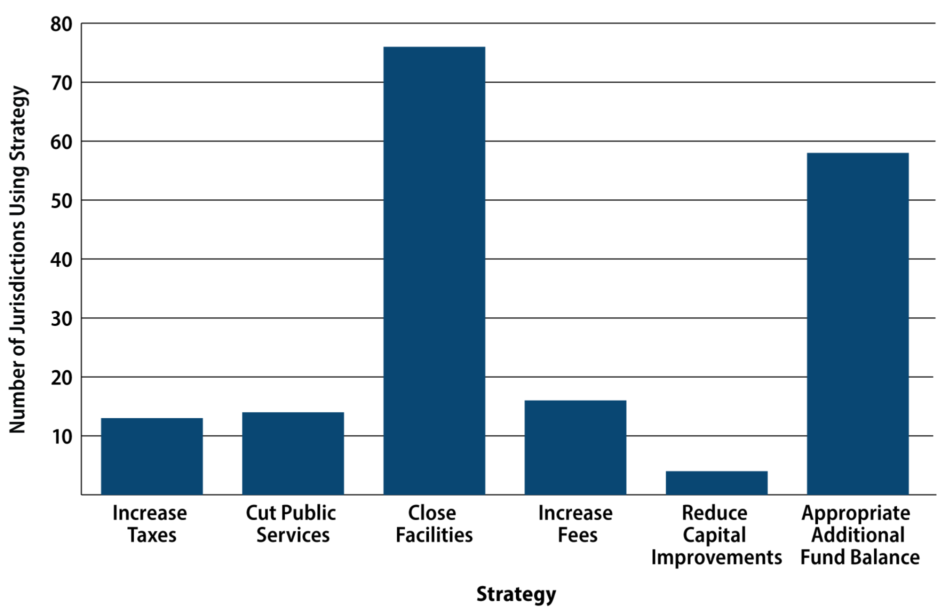


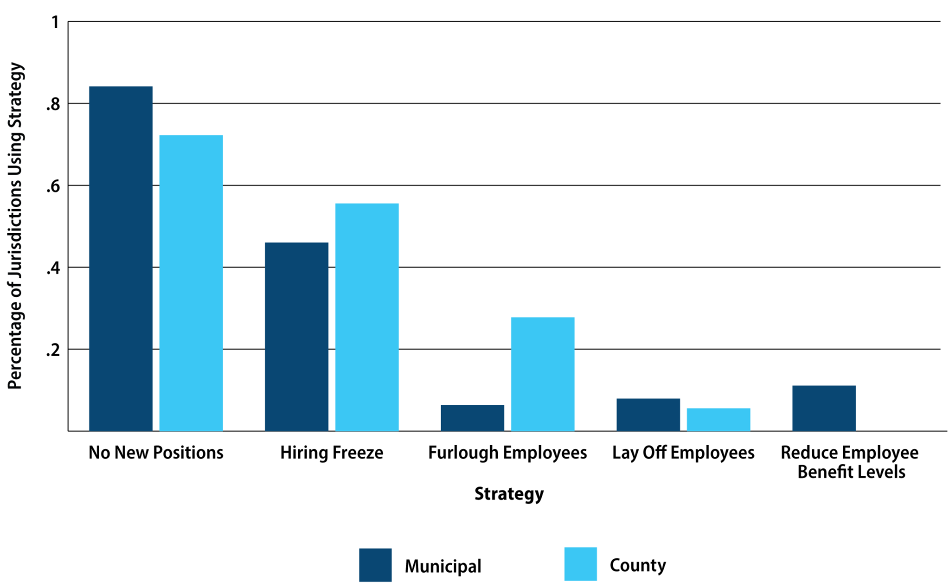
Figure 13. Strategies to Balance the Budget in Response to Projected Revenue Shortfalls: Municipal



For counties, the second and third most common strategies are reducing capital expenditures and increasing fees, with only one jurisdiction reporting the intention of increasing taxes. Reducing capital expenditures is a common strategy implemented to balance budgets during economic downturns.[6] Municipalities, however, are relying most heavily on closing public facilities and increasing fees. Their least common strategy is reducing capital expenditures, and thirteen report that they plan to increase taxes. It is surprising that so few municipalities intend to reduce capital expenditures; given the literature, there is evidence that North Carolina municipalities did not reduce their capital expenditures by much during the Great Recession either.[7] Therefore, this may be in keeping with prior municipal tactics to balance their budgets.

The literature on budgeting during recessions has identified that one of the most common strategies used by local governments to balance their budgets is to make adjustments and reductions to their staffing and personnel costs.[8] Figure 14 presents the staffing policies being implemented by municipal and county governments for FY21. The most common policy is to not add any new positions. Half of the responding jurisdictions are also putting hiring freezes in place. Neither counties nor municipalities are widely reducing employee benefits or laying off staff. The average number of strategies being used by counties is 1.6, while the average being used by municipalities is 1.7.

Figure 14. Percentage of Jurisdictions Utilizing Staffing Strategies in Response to Projected Revenue Shortfalls



6. Whitney B. Afonso, “Local Government Capital Spending During and After Recessions: A Cause for Concern?” *International Journal of Public Administration* 37, no. 8 (2014): 494–505; David Ammons and Trevor Fleck, *Budget Balancing Tactics in Local Government*, (Chapel Hill, NC: University of North Carolina School of Government, 2010), https://www.sog.unc.edu/publications/reports/budget-balancing-tactics-local-government

7. William C. Rivenbark, Whitney Afonso, and Dale J. Roenigk, “Capital Spending in Local Government,” *Journal of Public Budgeting, Accounting & Financial Management* 30, no. 4 (2018): 402–14.

8. Ammons and Fleck, *Budget Balancing*; Afonso, “Coping,” 768–79.

One final consideration for how local governments are coping with the impacts of the expected revenue shortfalls is how these governments are allocating any reductions in expenditures across different departments. Figures 15 and 16 present the impact of proposed budget reductions on county and municipal governments in North Carolina by department. Law enforcement is the least impacted for both counties and municipalities. For counties, law enforcement is followed by fire and EMS and social services, with the majority of counties reporting that reductions will have either no effect or only a minor effect on the budgets of these departments. The most negatively impacted departments are parks and recreation, general government, libraries, and education. Municipalities report that in addition to law enforcement infrequently bearing the brunt of budget reductions, sanitation, fire and EMS, and public works are also either not being affected or only experiencing minor reductions in budget allocations for FY21. Therefore, general government and parks and recreation are left to bear the largest burdens of any reductions.

Figure 15. Impact of Projected Revenue Shortfalls on Public Expenditures by Department: County

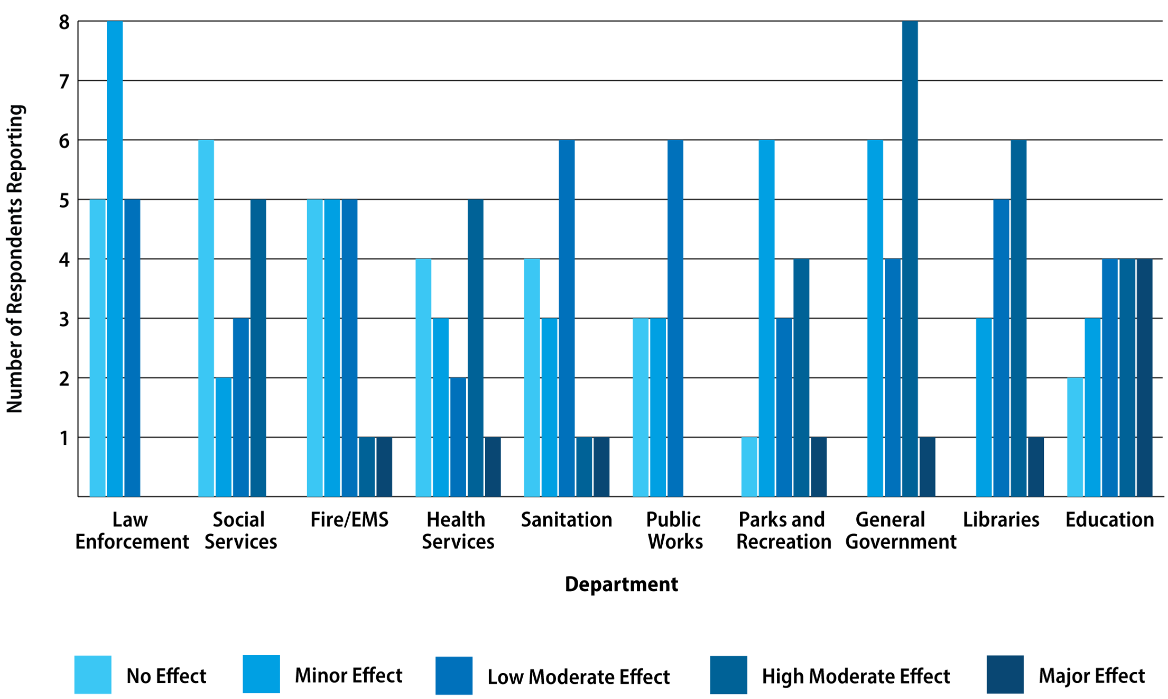
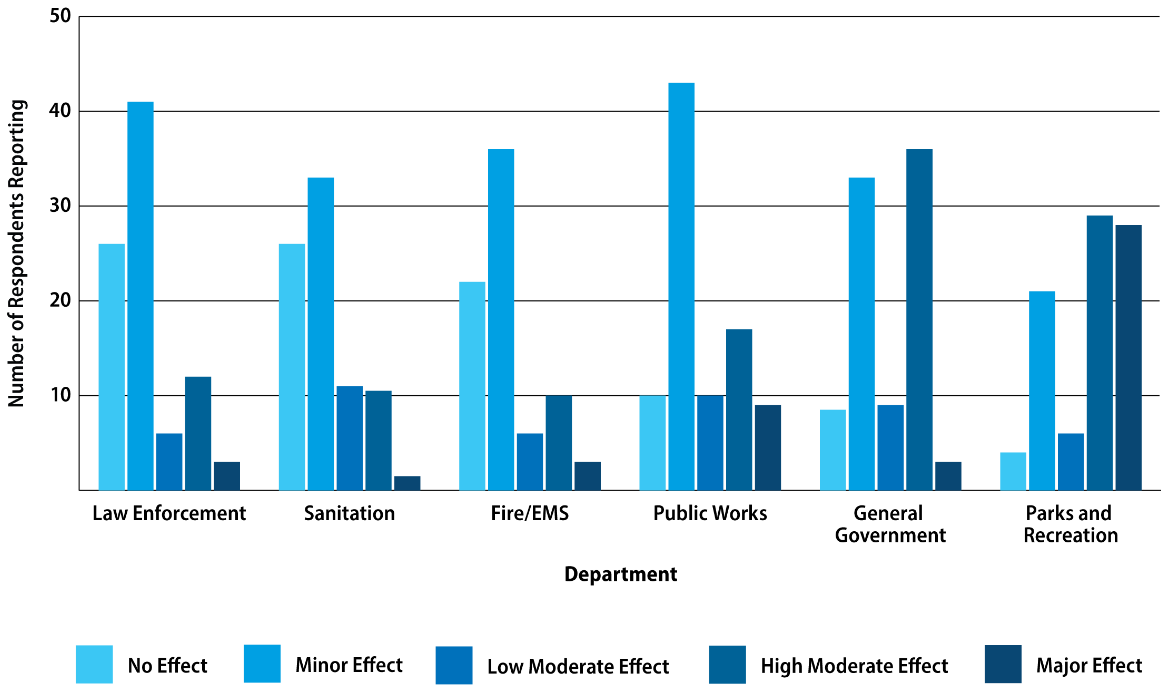


Figure 16. Impact of Projected Revenue Shortfalls on Public Expenditures by Department: Municipal



Concluding Thoughts

It is unclear how long the crisis created by COVID-19 will last. We don't know how many jobs will be lost, how many businesses will close, or how long it will take our communities to recover. However, local governments do not have the gift of patience to wait for more information or put their processes on hold. They must allocate dollars, collect taxes, and provide the vital services that their communities depend on. Of course, they must also do this with a balanced budget. The present analysis suggests that local governments are looking to minimize the negative impacts of revenue shortfalls on their citizens by delaying and reducing capital expenditures, making reductions in staffing, and spending down their reserves. This research also shows that local governments are somewhat optimistic about how long the pandemic is likely to impact their communities, as evidenced by their sales tax projections.