North Carolina Association of County Commissioners

COVID-19 Revenue and Budget Updates

April 2020

Introduction

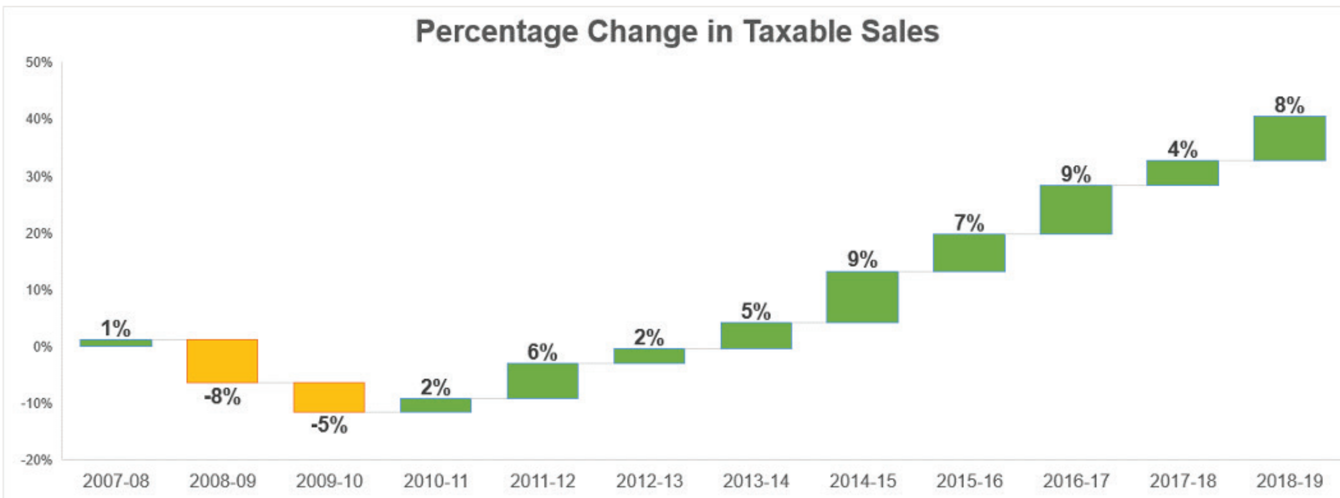
It is an understatement to write that the economic and revenue impact of the COVID-19 pandemic is both severe and uncertain. To respond to the virus that has, as of April 12, caused more than 20,000 deaths in the United States and more than 100,000 deaths worldwide, countries, states, and local governments are working to slow the rate of transmission. These mitigation efforts, put in place to fight a quickly spreading and dangerous novel coronavirus, are having a sharp and widespread effect on the economy, which economists confirm is entering a recession.

The purpose of this update is to set out many of the primary county revenue sources that will be impacted as a result of extremely reduced consumer activity, mandates put in place to combat COVID-19, and the corresponding economic downturn. It is almost impossible to make solid predictions because there are so many unknown factors, including how long mitigation efforts will be necessary, what types of fiscal support the state and federal government and the Federal Reserve will provide, how long and what shape an economic recovery will take, and a near complete lack of data and comparable events to inform the current public health crisis. Additionally, the variation among North Carolina counties will contribute to differing impacts and rebound trajectories; it will be important to modify any guidance to meet local dynamics.

This update will offer context and a range of possible scenarios where applicable based on analyses from established economists, guidance from counties working through these issues, and data where available. Wrapping up FY 2020 budgets and crafting FY 2021 plans under this new and uncertain dynamic will be an extremely challenging task for counties, and NCACC will continue to provide Revenue & Budget Updates to assist going forward.

Economic Impact Uncertain

Because this historic and sudden decline is unlike previous downturns, it is challenging to use previous data and experience as a guide, as there are not useful comparisons. For example, during the Great Recession, which stretched for 18 months from December 2007 to June 2009, taxable sales in North Carolina declined by -8% between 2007-08 and 2008-09, and by -5% between 2008-09 and 2009-10, before beginning to slowly increase.



In contrast, the economy in 2020, generally perceived as strong before COVID-19, is intentionally slowing certain sectors of production and activity to reduce the spread of a deadly virus. Economic analyses forecast a sharp economic contraction in the second quarter of 2020, with some projecting a second quarter GDP drop of -18% to -20% at an annualized rate (Moody's Analytics); a two-quarter GDP contraction (J.P. Morgan) between -10% and -25%; and an overall full 2020 decline of -3% (Morgan Stanley). And some economists caution against applying traditional policies and using standard economic indicators during this engineered "controlled, partial, and temporary shutdown of certain sectors of the U.S. economy" (Bullard, Federal Reserve Bank of St. Louis).

Analyses performed on early personal consumption expenditures show a 28% annualized pace of decline in the second quarter of 2020 (Wells Fargo). Unemployment claims are at historic levels, with more than 500,000 people filing for unemployment in North Carolina in the last three weeks, which represents 10% of the state's workforce. The Congressional Budget Office expects the country's unemployment rate will exceed 10% in the second quarter.

And while most economists originally believed the economy would rebound in the second-half of the year, there is growing uncertainty around what the recovery will look like and whether it will be "V-shaped," what type of COVID-19 testing protocols and vaccines will be available and when, and how a phased lifting of mitigation efforts and restrictions may influence consumer behavior. In developing and modifying budgets, counties will likely take a quarter-by-quarter, or even month-by-month, approach to determine how to apply possible recovery estimates and timelines.

County Budgets

Counties are developing or have largely completed their budget preparation for fiscal year 2020-21, which must be adopted by July 1. Two challenges, among many, going forward will be cash flow and balancing the budget as required amid much uncertainty.

The N.C. Dept. of Revenue has extended from April 15 to July 15 the due date to file state income tax returns, mirroring the federal extension, and has also waived late action penalties for late filing and late payment of sales taxes and other trust taxes the Department holds for local governments until July 15, 2020. The Dept. of Revenue specifically does not change or extend the tax due dates, and is unable to waive interest payments without a statutory change.

We do not currently know if the legislature will postpone or modify the sales tax collection and distribution process, or waive interest payments when it returns for the legislative session. Draft legislation to waive interest on late income tax payments has been discussed. Any modifications to counties' expected and budgeted sales tax revenue stream, compounded by the severe drop in economic activity, will cause the greatest decline to cash flow and FY 2021 budgets. NCACC continues to emphasize the importance of anticipated and expected revenue streams for counties to fulfill budgetary needs and particularly when the impact will begin to be most felt.

NCACC recently sent a letter to the Office of the State Treasurer, highlighting an understanding of the importance of financial stability, and also requesting flexibility with operational guidelines and statutory deadlines during these times. The State and Local Government Finance Division recently posted a blog outlining considerations on adopting an interim budget, assuring local governments that doing so does not raise concerns with the LGC under the current circumstances.

Local Sales and Use Taxes

Revenue from local sales and use tax distributions makes up 14-20% of a county's budget. Last year, of the $3.5 billion in local sales tax revenue distributed to local governments, $2.3 billion was distributed to counties. Because the timeline for the local sales tax collection and distribution process includes multiple steps, local governments receive their distribution three months after the applicable sale.

The graphic below illustrates why the N.C. Dept. of Revenue and local governments will not immediately see the sales tax implications of the COVID-19 economic downturn in the distributions. The Governor declared a state of emergency in North Carolina on March 10, and March sales (April collections) will be distributed in June, so it will be several months before local governments see an early picture of the impact. And April and May sales, which will be distributed in July and August will almost certainly take a larger hit. In past years, March through June taxable sales (June through September distributions) have trended high relative to other months, totaling $807 million for all counties in those months last year.

The N.C. Dept. of Revenue has promised to share any information on preliminary sales tax returns as soon as they are able to, though that will likely not be until May.

Current Guidance - Monitor timeline of mitigation efforts and a likely phased recovery and apply quarterly or monthly projections

For example:

- April – June 2020*: -10% to -50% reduction in sales tax revenue compared to the previous year
- July – September 2020*: -5% to -40% reduction compared to the previous year
- October – December 2020*: 0% to -20% reduction compared to previous year
- January 2021 and after: Multiple scenarios possible, depending on whether economy is in strong recovery mode and whether there is a second wave of the pandemic in the fall/winter

Note: These are wide ranges, spanning from serious to severe, based on the uncertainty of the timeline and recovery, as well as local and regional distinctions. County-specific variations will apply to both timeline and revenue loss.

Fiscal Impact: A decline of local sales tax revenue of -20% in March, and -40% in April through June 2020 totals an almost $300 million loss statewide for all counties compared to the previous year. Under this example scenario, sales tax revenues statewide could potentially drop -8% to -10% for FY 2020 from the previous fiscal year.

North Carolina Association of County Commissioners

Property Taxes

While counties report that most of the property tax levy has been collected for FY 2020, some counties are slightly lowering their expected collection rate for the current year, which will directly influence the estimated rate included in the FY 2021 budget. Some counties have relaxed enforced collection actions in response to the crisis, and several counties are estimating a -0.5% to -1% decrease in the collection rate for FY 2020.

Forecasting changes to property tax revenues in the upcoming budget year also proves challenging, and is dependent on the same timeline and path of recovery factors. Counties may see an increase in the number of appeals from taxpayers, some taxpayers may face increased economic hardship on their ability to pay, and closed businesses will reduce the tax base.

Tag & Tax

Counties received $630 million last fiscal year from registered motor vehicle tax revenue. Preliminary tag & tax figures show a -10% reduction for March collections (approximately $8 million across all local governments). Because taxpayers are not getting their cars inspected and registrations renewed, this reduction, likely increased, will continue into April and May and perhaps beyond. It is possible the decline in April and May will be -10% to -30%.

Legislative leadership has expressed support to retroactively extend vehicle registration deadlines when the legislature returns to session, however no specific details have been released.

Current Guidance - Estimate conservatively for end of FY 2020 and for FY 2021. Many factors will influence taxpayers' ability to pay in the upcoming year, including the economic recovery and possible changes made or recommended by the legislature and state agencies.

Fiscal Impact: A decline in property tax revenues of -1% statewide would equal a loss statewide of $74 million over the previous year. A -2% decline equals a $149 million loss and a -5% drop is a $372 million loss. Property tax revenues make up the majority of a county's budget, funding the largest share of mandated services.

Occupancy Taxes

Counties received $125 million in occupancy tax revenue on rental accommodations last year, which help fund local tourism. These revenues may experience a steeper decline than other revenues based on the reduction in tourism and the hospitality industry during the public health crisis. The annual impact is also unknown due to uncertainties about timing and economic recovery.

Fiscal Impact: Counties received $125 million statewide last fiscal year in occupancy taxes on rental accommodations. It is currently unknown and difficult to estimate how the COVID-19 pandemic and associated public health response measures will impact this revenue.

Utilities

Executive Order 124, issued March 31, 2020, prohibits all utility service providers from terminating service for residential customers for nonpayment for at least 60 days. Many counties had already suspended disconnections for nonpayment before the Executive Order was issued, and will continue to absorb these costs while the mandate is in place. While EO 124 allows utility service providers to set up payment plans with customers, there will be lost revenue and administrative costs associated with this requirement, as late fee penalties are also prohibited and customers' ability to meet payment plans will vary.

Fiscal Impact: Counties received $350 million statewide last fiscal year in utility revenues including water, sewer, electric, gas, and stormwater fees. It is currently unknown how the COVID-19 pandemic and associated public health response measures will impact this revenue.

Building Inspections and Permits

Counties received $169 million in permitting and inspection fees last fiscal year to fund statutory enforcement functions. To protect county staff and the public, counties are modifying and limiting inspection activities.

Fiscal Impact: Counties received $169 million statewide last fiscal year in permitting and inspection fees. It is currently unknown how the COVID-19 pandemic and associated public health response measures will impact this revenue.

Medicaid Hold Harmless

Under GS 105-523, as part of changes in 2007, eligible counties receive 90% of the estimated Medicaid Hold Harmless (MHH) payment they are entitled to in March of each year. This hold harmless payment is distributed because counties exchanged a portion of their local sales and use tax revenue for the state's agreement to assume responsibility for certain non-administrative Medicaid costs. Since sales tax revenues are increasing as a general trend, more counties are seeing a Medicaid Hold Harmless payment. See the March 2020 payment amounts here. The NC Dept. of Revenue is then required to send the reconciled MHH payment to counties by August.

The concern this year and 2020-21: Due to the impact of COVID-19 on sales tax revenues, sales tax collection in the coming months may not exceed Medicaid costs, making the MHH reconciliation a negative number. In this case, counties would potentially refund the applicable portion of the MHH payment they received in March 2020. While it is not possible to estimate whether there will be a payback and what a county's payback may be, it is recommended that counties earmark or in some way designate and not expend this MHH payment in case there is a payback situation. Based on reduced sales tax revenues in 2020-21, counties may receive a reduced or no MHH payment next year.

Current Guidance - Earmark or in some way designate and not expend the Medicaid Hold Harmless payment in case there is a payback requirement in 2020. Budget a reduced amount for the 2020-21 budget year based on a reduction in expected sales tax revenues.

Other Issues Impacting Revenue

Counties received approximately $148 million in state-shared revenues including video programming taxes, beer and wine excise taxes, and solid waste disposal taxes. These revenues will likely be impacted by the economic downturn.

The base employer contribution rate for the Local Government Employees Retirement System (LGERS) increases from 8.95% 10.15% for non-LEO members and from 9.70% 10.90% for LEOs for FY 2020-21, a cost of $80 million to local governments.

Variations in county fund balances will also play a critical role in cash flow and budgeting challenges.

North Carolina Association of County Commissioners

Local governments are required to amend and update their development ordinances by January 1, 2021, to comply with the adoption of new GS Chapter 160D. Additional conforming legislative changes were also anticipated during the 2020 short session. The expense and time required to comply with new GS Chapter 160D may necessitate an extension of the deadline.

Going Forward

NCACC will continue to provide Budget & Revenue updates as information and data becomes available to shed light on the economic impact of COVID-19. Please note that this is preliminary guidance and the forecasts are constantly changing. The state legislative House Select Committee on COVID-19 working groups continue to meet to hear presentations related to health care, education, continuity of operations, and economic support. At the federal level, Congress is discussing a fourth fiscal relief package and members are not expected to return until April 20th at the earliest.

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