GOVERNOR'S TASK FORCE

FOR LOCAL GOVERNMENT MANDATE REVIEW

INTERIM REPORT TO THE GOVERNOR

December 10, 2014

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Dear Governor McAuliffe:

I am pleased to submit for your review this interim report of the Governor's Task Force for Local Government Mandate Review. We held our first meeting on October 23rd and determined our most urgent task was to highlight key recommendations for your consideration as legislative priorities during the 2015 General Assembly Session. These priorities were compiled with input from the Virginia Municipal League, the Virginia Association of Counties, the Virginia Association of School Superintendents, and by reviewing earlier recommendations from the prior membership of the Task Force.

During the upcoming year, we intend to develop a strategy to focus on critical areas affecting the state-local government relationship and ways to reduce the regulatory burdens that localities face. We also look forward to building upon a successful practice developed by our predecessors on the Task Force – specifically, we intend to continue focusing on agencies and subject areas for roundtable discussions with local officials.

Thank you for providing us the opportunity to improve the relationship between the Commonwealth and its local governments. We look forward to developing additional recommendations, and will provide you with periodic progress updates.

Sincerely,

Wyatt Shields

Chairman

MEMBERS OF THE

TASK FORCE FOR LOCAL GOVERNMENT MANDATE REVIEW

Wyatt Shields, Chair
City Manager, City of Falls Church

The Honorable Mimi Elrod, PhD, Vice-Chair
Mayor, City of Lexington

The Honorable George Wallace
Mayor, City of Hampton

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Superintendent, Chesterfield County Public Schools

INTERIM REPORT OF THE TASK FORCE FOR LOCAL GOVERNMENT MANDATE REVIEW

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INTRODUCTION

For the 2015 Virginia General Assembly session, the Governor's Task Force for Local Mandate Review has identified several priorities for the Governor and legislature to consider. These recommendations generally fall into three themes: (1) protecting local government revenue sources; (2) discouraging the practice of shifting State financial responsibilities onto local governments; and (3) implementing legislative process improvements to better inform the legislature and administration of the impacts of proposals on localities. With respect to specific programs and financial practices, we have identified actions that have over time shifted funding responsibilities from the state to localities that currently cost at least $100,000,000 annually.

We respectfully request consideration of the following priorities:

1. Protect local government authority to raise revenue

Over the past several years, many proposals have been advanced to the legislature to overhaul certain local taxes or to exempt certain classes of real estate from taxation. These measures generally do not have any impact to the Commonwealth's finances, but can have a significant impact on local government revenues.

The intent of these measures varied, as some were intended to create statewide uniformity among local taxes, while some provided general tax relief, and some provided tax relief to a specified class of entities or individuals. Examples of these measures include:

Real Property Tax Exemptions. For many years, local governments have had the option to provide real estate tax exemptions for the primary residence of elderly and disabled persons, although recipients of the exemption must meet income and net worth restrictions. Following a constitutional amendment passed in 2010, localities were required to exempt primary residences owned by disabled veterans (and their spouses) from real estate taxation, and again in 2014, the Constitution was amended to extend such an exemption to the primary residence of individuals whose spouses were killed in action. These exemptions that began in 2010 and 2014 have no limitation on the beneficiary's income or net worth. Because Virginia's military presence is concentrated in Hampton Roads and Northern Virginia, these tax exemptions will impact localities in these regions more than in other parts of the State.

Business Taxes. The Business Professional and Occupational License (BPOL) Tax has been subject to criticism from certain business sectors in recent years. The business community contends that the tax is unfair because it is assessed on gross receipts instead of net income (profits), penalizing businesses that

generate little or no profit in a given year. A Joint Legislative Audit and Review Commission (JLARC) report in 2013 revealed that if the tax were based upon profits instead of total receipts, localities would have to raise the tax rate by 40% in order to remain revenue neutral, essentially shifting all of the tax burden to profitable businesses. JLARC's report also found that administering the tax if it were based on net income would be expensive, and most beneficial for larger businesses, retailers, and those with little to no profit. Two other taxes, the Machinery and Tools Tax (M&T) and the Merchant's Capital Tax are property taxes that are also frequently cited as a hindrance for business expansion.

Altogether in FY 2013, BPOL, M&T and Merchant's Capital taxes generated $930,156,159 for cities and counties, or 5.14% of total local source revenues to cities and counties. Only one locality – Rappahannock County – reported no FY 2013 revenues from any of these sources.[1]

Religious Institutions. In recent years, proposals have been advanced to limit a locality's ability to charge fees to religious institutions. While religious institutions have long been protected from local property taxes, they are subject to fees assessed by local governments for services provided. Unlike taxes, fees are charged to cover the cost of a specific service rendered, such as water service, or for the review of a building permit application. More recently, localities have begun to create stormwater utilities, which charge an annual fee based upon the area of impervious surface on a property, to help the locality address drainage and water quality issues. Limiting a locality's ability to assess fees for a specific service requires a locality to recoup the cost of the service provided elsewhere, through higher fees for other users, service reductions or using tax revenues.

RECOMMENDATION: No further legislation should be passed that erodes the revenue generating potential of localities in Virginia and the General Assembly should consider repealing prior actions that have impacted the revenue generating potential of localities. If the Commonwealth wishes to extend tax incentives to certain classes of individuals or entities, it should first consider doing so using its own revenue streams. If that is not possible, all efforts should be made so that the impact is revenue-neutral to local governments. The fiscal impact of any additional restriction of local government taxation authority should be studied when considering such actions.

2. Eliminate the State capture of local fines and fees

The 2012 General Assembly altered how fines and fees assessed on local ordinances were transferred from local courthouses to the locality's coffers. In the past, when a fine or fee was paid at the courthouse for a violation of a local ordinance, those funds were deposited with the locality. Beginning in FY 2013, all fines and fees collected by local courts would be deposited to the state's General Fund, and the state would then distribute the local fines and fees monthly to each locality. The state also would begin keeping one-half of local fines and fees that are in excess of 50% of the total state and local collections within a city or county. The justification for this practice is that some localities were writing citations on local ordinances rather than state laws, in effect siphoning money that otherwise would have gone to the state's Literary Fund, although the origins of this practice appear to also be intended to discourage localities from setting up speed traps on highways. All localities are affected by this practice

[1] Auditor of Public Accounts. Comparative Report of Local Government Revenues and Expenditures for the Fiscal Year Ended June 30, 2013.

because funds must make a circuitous route through State coffers before the locality receives it. It is noteworthy that all of the localities that have had funds retained by the State have populations under 30,000. Some of these localities have been impacted only because they do not have regular State Police patrols, which causes the number of citations written on local ordinances to be greater than in other localities. This practice unfairly burdens smaller localities, and can discourage localities from enforcing highway safety laws.

A report by the State's Inspector General found no justification for this new procedure, but rather found that the Literary Fund balance had been negatively impacted by increased expenditures, not decreased fine and fee revenue. The Attorney General also has opined that fines and fees are local revenues, and as such are not constitutionally required to be deposited into the Literary Fund.

RECOMMENDATION: Eliminate the current system of sweeping local fine and fee revenue into State coffers, and eliminate the capture of "excessive" fines and fees. At a minimum, the threshold for withholding revenues should be raised so that no localities would have funds retained by the State.

Local Fine and Fee Revenue Retained by the Commonwealth

FY 2013	**$261,972**
FY 2014	**$275,997**
FY 2015	**$200,512**

Locality Impacted	Population (2010)
Emporia	**5,927**
Falls Church	**12,332**
Fairfax	**22,565**
Hopewell	**22,591**
Dinwiddie Co.**	**28,001**
Greensville Co*	**12,243**
Sussex Co.**	**12,087**

* impacted only in FY 14 & FY 15
** impacted only in FY 11
Source: US Census and Auditor of Public Accounts

3. Eliminate the return of local aid to the state

Beginning in FY 2009 and through FY 2013, cities and counties were required to return $270,000,000 in state aid to the Commonwealth as a measure to close budget shortfalls. As part of spending reductions for the current biennium, an additional $60,000,000 must be returned during FY 2015 and FY 2016.

When this practice was implemented, it was intended to provide localities flexibility to choose which state-assisted programs would be impacted by cuts, rather than having the legislature cut support for specific programs. Unfortunately, no corresponding relaxation of regulations or standards for the locally-delivered state programs was provided, and the localities must make up for the loss in funding either through service reductions or using local revenue.

RECOMMENDATION: Eliminate the requirement for localities to return a portion of their state aid each year in order to balance the State's budget. When a budget shortfall is encountered, ineffective tax preferences should also be considered as expenditures that could be cut to balance the budget.

Local Aid Returned to the Commonwealth

FY09	**$50 million**
FY10	**$50 million**
FY11	**$60 million**
FY12	**$60 million**
FY13	**$50 million**
FY14	**$0**
FY15	**$30 million***
FY16	**$30 million***

* planned
Source: Appropriation Acts

4. Fully fund the Line of Duty Act Program

The Line of Duty Act provides benefits to public safety employees, or their survivors, should they die or become disabled in the line of duty. The primary benefit until 2000 was a cash payment; however at that time benefits were expanded to include health insurance benefits for disabled persons, their spouses and dependents, and the spouses and dependents of the deceased. This additional benefit increased the cost of the program significantly. All of the benefits for this state-created program were paid for with state funds until FY 2012.

Estimated FY13 Cost to Localities: $9,727,000

Projected Statewide Cost (state & localities):

FY15	**$15.7 million**
FY24	**$34.1 million**

Source: JLARC

After FY 2012, the state no longer provided funding to insure local public safety employees, so local governments were then required to pay the premium for this coverage to the State, or opt out and seek similar coverage on their own. As of FY 2013, the statewide cost to localities to provide these benefits is estimated to be $9,727,000 annually.[2] The state instituted these benefits, and expanded the benefits over time, making the program more costly. Now that the cost has become too great for the State, the cost, as well as the associated liability to payout claims, has been shifted to local governments.

Benefit eligibility for this program is administered by the State Comptroller, and it has been suggested that the Virginia Retirement System may be better suited to provide this service. A two-year JLARC study, the first part of which is to be released on December 8, 2014, should provide direction on how to more efficiently manage this program.

RECOMMENDATION: Return the funding responsibility of this program to the State and closely review JLARC's December 8, 2014 report for potential efficiencies and implement as appropriate.

5. Fully fund the Health Insurance Credit for Retired Teachers

In 1998, the Commonwealth began offering a health insurance credit to teachers as part of their retirement package, and this benefit was 100% funded by the Commonwealth. In 2002, the state could no longer fully fund this benefit, and today localities pay about 64% of the cost, with the state paying the remainder. This translates to an approximately $73 million cost for localities, and is even higher when considering that any 100% locally funded positions are not included in this estimate. Also an estimated $1.2 billion of liabilities are associated with this credit, which will appear on the balance sheets of Virginia's local governments and could potentially affect borrowing power.[3]

Estimated Annual Cost to Localities: $73 Million +

RECOMMENDATION: For the 2016-2018 biennium, return the funding responsibility for this employment benefit to the State, as it was a State initiative until the cost was shifted to local governments.

[2] JLARC Study.
[3] Virginia Municipal League staff estimate.

6. Reinstate the First-Day Introduction requirement for local fiscal impact legislation

One of the consequences of Virginia's relatively short General Assembly sessions is the fast pace at which legislation makes its way through the legislature once it is introduced. This can make it difficult for stakeholders such as local governments, as well as the public at-large, to stay on top of legislation that can have serious impacts. When the legislature approves bills that increase a locality's expenditures, or reduce their revenues, localities are forced to respond by increasing taxes and fees, or by reducing services.

From 1995 through 2010, any proposed legislation that would potentially impact localities by causing a net additional expenditure or a net reduction in revenues was required to be introduced no later than the first day of the General Assembly session. This provided sufficient time for localities and affected interest groups to analyze the legislation for any fiscal impact before the bills were heard in committee. In addition, the Commission on Local Government drafts fiscal impact statements on these bills, which requires several days for localities to provide fiscal data to the commission. These fiscal impact statements are prepared so that legislators can make informed decisions when the bill is in committee. In 2010, the legislature eliminated the requirement for these bills to be filed early, along with the same requirement for bills proposing sales tax exemptions, claims against the state, and increased terms of imprisonment. Only bills affecting the Virginia Retirement System are still required to be filed early.

Under the current procedure, a bill with a local fiscal impact can be filed until the tenth day of session. During a short session, the house of introduction must have completed action on bills for crossover by the 28th day of session. This constrained timeframe leaves little time for the referral of the bill to the commission, to engage its volunteer localities for data, and to compile the responses. During short sessions, it is not uncommon for the fiscal impact statement to be completed the day before it goes to committee.

RECOMMENDATION: Amend Section 30-19.03 of the *Code of Virginia* to require proposed legislation that may have a fiscal impact on localities to be introduced no later than the first day of session.